Last June, the United Kingdom became the first country in history to exit the European Union (EU), sending markets not only in Europe but around the globe into frenzy. While experts agree that the UK will be the party taking the brunt of the heat, with the EU being ASEAN´s second biggest trading partner, invariably, the Southeast Asian economies are set to be affected – both negatively and positively – by any change shaking the western trading hubs.

Effects on ASEAN economies vary strongly across countries

Currency markets, especially, were swift to react. All ASEAN currencies have appreciated significantly against both the British Pound and the Euro, as Brexit raises concerns about the EU´s economic and monetary stability. With investors pulling assets from the Eurozone and heading to lower-risk destinations, namely the US and Japan, the US Dollar saw a substantial rise in its value against ASEAN markets. In Indonesia and Malaysia, in particular, the fear of a broader flight of quality assets in a risk-off movement is big due to both countries´ dependence on external financing. Bank of Indonesia´s governor Agus Martowardojo did attribute the plummeting of the Rupiah to investors' move away from riskier developing country assets.

However, considering ASEAN´s low trade exposure to Britain, some argue, the financial market panic is hardly justified and not in line with the actual risk level. According to a worst-case scenario estimated by London´s National Institute of Economic and Social Research, even a 25 percent decline in British imports worldwide within two years would only cause a GDP drop of 0.2 percent across all of Asia. However, should the EU economy face a significant economic downturn, effects on Asian economies´ GDP are likely to be up. In any case, considering the extremely heterogeneous nature of Asian economies, a more accurate assessment may be that the effects are multi-fold, varying strongly across countries, sectors and time span.

Consumers could benefit in the near term, but lower export demand poses threat

In the near term, ASEAN consumers are bound to benefit from discounted import goods as products sourced in the UK as well as the remaining EU-27 will become cheaper thanks to the stronger standing of ASEAN currencies. Countries nurturing tight trade relations with the US, too, will find themselves on the winning side, with Indonesia and Malaysia most clearly set to benefit. Nevertheless, anticipation should be cautious. Both companies and consumers across ASEAN will face higher costs for products sourced in the USA and Japan, very likely annihilating the benefit of cheaper European products.

Moreover, economic decline in Britain and possibly Europe will cause ASEAN exports to these destinations to see reduced demand, in particular as export prices spike due to rising currencies, by consequence slowing local export industries and squeezing wages. With the EU being ASEAN´s largest foreign direct investor, moreover, spending cuts by European companies in the wake of growing uncertainty in their home market are likely to translate to the ASEAN markets. Amongst the ASEAN economies, Singapore and Vietnam certainly stand out as the member states most exposed to developments both in the UK and EU markets.

Singapore and Vietnam are most affected

In the case of Singapore, the EU is the city state´s primary trading partner for services exports, with the UK being Singapore's top country market in the EU. More than 41 percent of Singapore's total services exports to the EU were destined to the UK in 2014. Moreover, Singapore's exposure in terms of FDI stock in the UK is much higher compared to that of other ASEAN members, possibly leading to an at least interim period of lower spending as exposed Singaporean companies navigate the uncertain situation and prepare for potential restructuring. Main branches to suffer from a likely economic downturn in the UK include business process outsourcing, IT services and professional service exports. However, Singapore, known for its outstanding financial services industry, could also benefit as London's finance businesses and investors look for a steadier environment amidst the turmoil.

Vietnam could benefit from midterm effects

For Vietnam, the UK constitutes its second biggest export market in the EU after Germany, importing primarily Vietnamese agricultural and processed food as well as mining products. While Vietnam might initially suffer negative push-back from a slowing UK market, the long-term picture is a much different one. As of now Vietnam is the only ASEAN country, besides Singapore, to have signed a Free Trade Agreement with the European Union. The implementation of the agreement has the potential to outweigh European investors' cost disadvantages caused by a weaker Euro thanks to lower processing costs and higher export efficiency. Especially as Brexit is sure to detract the EU officials' attention away from ongoing negotiations with Thailand, Malaysia and the Philippines, the land of the ascending dragon will offer European low cost investment unrivalled opportunities. As European and UK consumers are challenged by lower purchasing power, producers will increasingly look for both cheaper sourcing and production locations. With its abundant labor force, good investment climate and strategic location, Vietnam is the number one contender. The longer the other ASEAN states´ negotiations with the EU are drawn out, the larger Vietnam´s strategic advantage will grow. Vietnam´s favorable position would further solidify should the Trans-Pacific Partnership come into effect, allowing Vietnam based producers to serve both the EU and the USA market at reduced tariffs and enabling the country to equalize possible losses due to lesser European demand.

Growing intra-ASEAN trade increases economic resilience

All ASEAN states are in addition party to the upcoming Regional Comprehensive Economic Partnership agreement, aiming to cut through the noodle bowl of the region's many trade agreements, by bringing together existing commitments between ASEAN and major economies such as India and Japan. Furthermore, despite the Brexit debacle possibly slowing ASEAN's political and thus economic integration as member states become even more wary of avoiding the EU's mistakes in their own integration process, intra-ASEAN trade has been growing solidly over the past years and is expected to intensify under the ASEAN Economic Community, established in January of this year. It is this growing intra-Asia focus and the strengthening of ties in the Asia-Pacific, which has and will continue to make ASEAN ever more resilient to volatilities in the European market. Thus, despite countries like Vietnam and Singapore possibly experiencing short-term economic repercussions, overall growth as well as consumer demand should be expected to remain solid.

BDG insights

With European markets in crisis once again, the strengthening of ASEAN currencies against the Euro offers European exporting companies a unique opportunity to position themselves competitively in ASEAN's consumer market, especially as the strong greenback drives prices for US sourced products. In the long-term the upcoming trade agreements and growing stability of ASEAN markets, due to a stronger regional focus, will offer producers in the region a host of opportunities, including access to major markets such as India and the USA. As many investors might be reluctant to invest in the current situation of heightened uncertainty in the EU market, liquid companies should seize the chance to enter the market at a point of low demand, ensuring not only cost-competitive investment but also first mover advantage. Both the strong USD and the upcoming trade agreements attribute US and Asian companies significant market power, European investors should be wary of how to maintain their standing in ASEAN´s (nominal GDP).

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