Frontier Global Watch -
Why the economies of South East Asia matter now

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Key Takeaways

- South East Asia's economies are largely driven by production-export dynamics compared to the consumer-heavy economies of South Asia. Significantly, there is a large import component from China and a large export component to the US. This makes them highly exposed to global trade shocks, both for their own economic trajectories but also in terms of how it affects global trade and capital allocation decisions.

- So far, South East Asian economies seem to have front-loaded exports to the US during the ongoing trade conflict – which has helped keep their currencies afloat. If this means there is a corresponding fall in exports in the upcoming period, that is likely to mean domestic economic pressures can materialize. There is currently some amount of capital repatriation ongoing in the South East Asian economies in response to this, which is keeping their currencies roughly stable.

- Individual economies in South East Asia also have specific fiscal and external dynamics outside of the overall trade story that can add onto this. Depending on whether any South East Asian economies will appreciate or depreciate their currencies, there can be big differences to the costs across the supply chain. This matters to the South Asian region, since almost all of South Asia's trade has input components coming in from supply chains in South East Asia.

South East Asia functions primarily as an export-manufacturing hub between the US and China

The economies of South East Asia are largely driven by their strong export manufacturing sectors. Their economies tend to import inputs from China, perform some value addition, and then sell across to the US economy. GDP growth is driven by this, employment is driven by this, and most capital inflows are also driven by this overall story.

The export-manufacturing dominance of the region is visible when taking both the share of manufacturing GDP and the share of export GDP (See Pages 09 and 10). Most countries in South East Asia have industrial GDP north of 30% while exports tend to be higher than 50% of GDP. Even those with lower export numbers still do significantly higher exports than South Asian economies. Sometimes, these GDP numbers are distorted by how different sectors are measured. For example, larger amounts of gross capital formation (which measures investment in the economy) can make the export sector look comparatively smaller than it is, in cases like Indonesia.

This export-story ties into their place as a supply chain hub between China and the US, which also ends up going across other intermediary countries as well (See Pages 11 and 12). This ends up being a story of both importing inputs for value addition from China, but also where Chinese capital sets up investment within South East Asia in order to take advantage of labour conditions. Overall, the economies of South East Asia directly import 25% of their imports from China, and this is up significantly from less than 10% in the early 2000s. While only 16% is directly sold to the US by the whole of South East Asia, specific countries do significantly more.

Export-manufacturing has meant a weak consumer economy in South East Asia

The presence of an economy that is largely geared towards export-manufacturing means that the structure of South East Asian economies is geared away from domestic consumption. Consumption itself is weak, but more critically, the economy itself is structured in a way that supports manufacturing and disincentivizes consumption. As a result, even the political economy of these countries can be geared towards policies that maintain the current economic balance as opposed to being particularly ready for moments of transition.

Household consumption as a share of GDP is one way to look at this. Household consumption in South East Asia is moderate, and a few examples are actually significantly low – Singapore is a specific example here. Even in contexts where overall consumption is more moderate, we see most household consumption levels being lower and in particularly, falling over time (See Page 13). For example, World Bank data shows that in Thailand final consumption is as high as 75% of GDP, but this used to be around 60-65% of GDP in the 1990s. In contrast, household consumption is lower, below 60% of GDP, but this used to be above 60% in the past – especially before the 1990s.

The factors that support manufacturing are critical here to understand. The currency is generally kept at a depreciated level to help exports, and there are even criticisms that currencies are kept artificially undervalued. Wages are generally considered to be on the lower end, especially in the availability of low-cost labour for labour-intensive manufacturing. Fiscal support is largely at the corporate level – lower tax regimes being the most visible aspect - rather than at the individual subsidy level. Spending on public services in particular, is quite weak, with public expenditure on healthcare and education generally underspending the South Asian region.

The global trade war is likely to be more negative to South East Asia soon

So far, South East Asia hasn't shown dramatic negative outcomes despite their exposure to global trade, largely due to frontloading of exports. As this context fades, we could start to see clearer impacts on their economies in the upcoming period. Given the large export-manufacturing bias of their economies, this would be quite impactful to the overall story and how they respond to those outcomes will be critical.

The frontloading that South East Asian economies have undertaken is clear when looking at how their exports have grown this year compared to the past. There is a clear overperformance in South East Asian YoY export growth compared to South Asia. The overall economic story also shows this – with GDP growth doing quite well across the first half despite the global trade shocks that are at play. US inventories have risen in response, supporting the idea that the US is buying more of the exports ahead of time.

If the requirement for the US to buy more exports from the rest of the world reduces given their inventory buffers, it would imply that the South East Asian economies that actually have frontloaded to build these inventories are likely to see their exports fall over the coming quarters – simply because their buyers have already bought what is needed from them. This is in contrast again to countries that haven't seen large export increases in 2025, and therefore haven't seen inventories built up for those products. For economies in South East Asia that are largely export driven, a fall in exports likely means weaker GDP numbers, weaker employment numbers, and even shifts in how capital moves. The question then is how these countries react to these outcomes.

Capital movement and currency shifts are a big point to watch out for

As the global trade conflict continues in this new mode – what we have called a world in transition – South East Asian economies can move in one of two ways. Either, they can end up strengthening their position as export production economies or they can start losing that edge dramatically. We see two main levers through which this can happen, capital movement and currency shifts.

The context in which capital movement occurs depends both on existing firms in the region as well as expansions of new firms. Existing firms might either consider moving out of the region, taking money out, or if they want to double down they can bring down the surplus FX that they would have kept over time. Here, this also ties into the specific fiscal and external support that individual countries can give. Some countries which have already used substantial fiscal levers such as tax support to attract investment and are now at relatively constrained fiscal levels – Vietnam might be an example here – might have different policy options open compared to those with such fiscal space.

Capital movements directly engage with the willingness and the ability of governments in individual South East Asian economies to take varied currency policies, especially alongside their fiscal space. If countries choose to depreciate their currencies, that keeps their export sectors afloat but makes their economies even more export reliant in the future and exposed to trade shocks. This ties into their existing political economy, but sacrifices their ability to make changes against the current global moment of trade transition. If they appreciate their currency instead, then you start to see the need for existing players to look again at whether the same export production incentive exists in South East Asia – which is part of what pushes against the existing political economy of the region.

What does all of this mean for Sri Lanka and for South Asia?

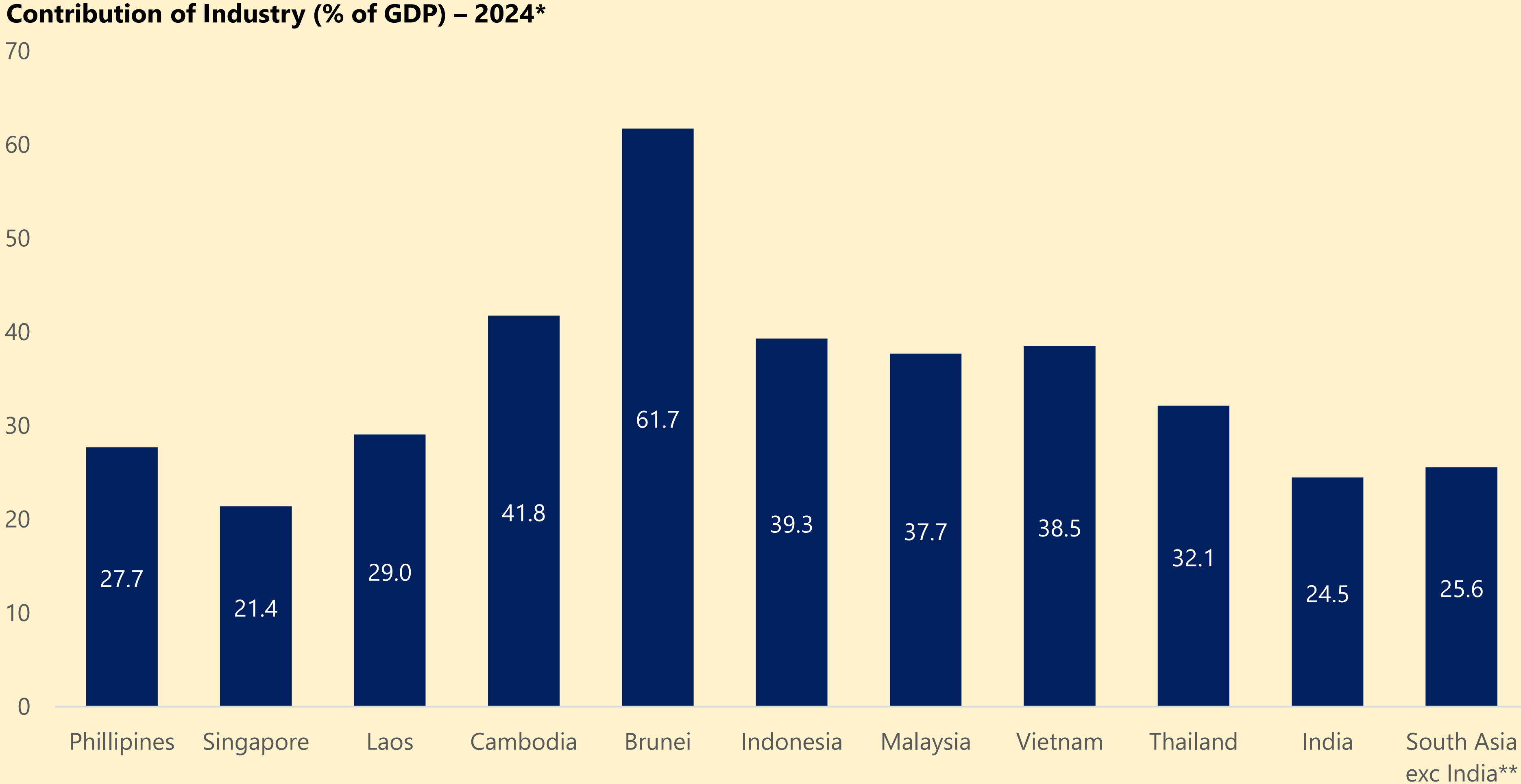
Individual movements in South East Asian economies will immediately matter for both consumers and producers in South Asia, given that a large volume of inputs come from South East Asia. Import prices can change dramatically if there IS a shift in their currencies. For us, this is the biggest factor to watch out for. On the more clearly positive angle, however, if capital flows look to exit South East Asia, there might be SOME ability for South Asia to benefit from this.

However, what we see primarily is that any shifts in South East Asia are likely to be across the next few years, but with more immediate consequences in the upcoming quarters. In the next few quarters, the ability for hot money to move out increases if risks materialising. Beyond that, what we see is individual firms making decisions to derisk away from that region over time, and small amounts of investment flowing to other parts of the world. Given China's large role as a producer, we don't think anything dramatic happens within South East Asia just yet, but slow and gradual shifts is possible.

There can be specific opportunities and challenges even in the short-term. The rising Indian domestic market as well as the current tariff structure in India might be the kind of situation that make some producers look at other entry points within South Asia – Sri Lanka and to some extent Pakistan and Bangladesh being the natural beneficiaries of such a strategy. The same story can apply to risks – with specific products facing challenges if inputs become dramatically more expensive or if competitive products suddenly rush into demand markets.

For Sri Lanka in particular, we think the overall benefits of this story outweigh the costs, especially on a short-term capital flow perspective. However, the context in which large investment comes into Sri Lanka still likely requires significant changes in South East Asia. Such shifts probably make business very volatile for firms whose base is in South Asia anyway, which might make it harder for existing players to take advantage of any opportunities – especially if they have balance sheet constraints. Even large-scale export diversions might require multiple years, and in the current global situation, such diversions might face challenges due to volatility.

South East Asian economies tend to have large industrial sectors



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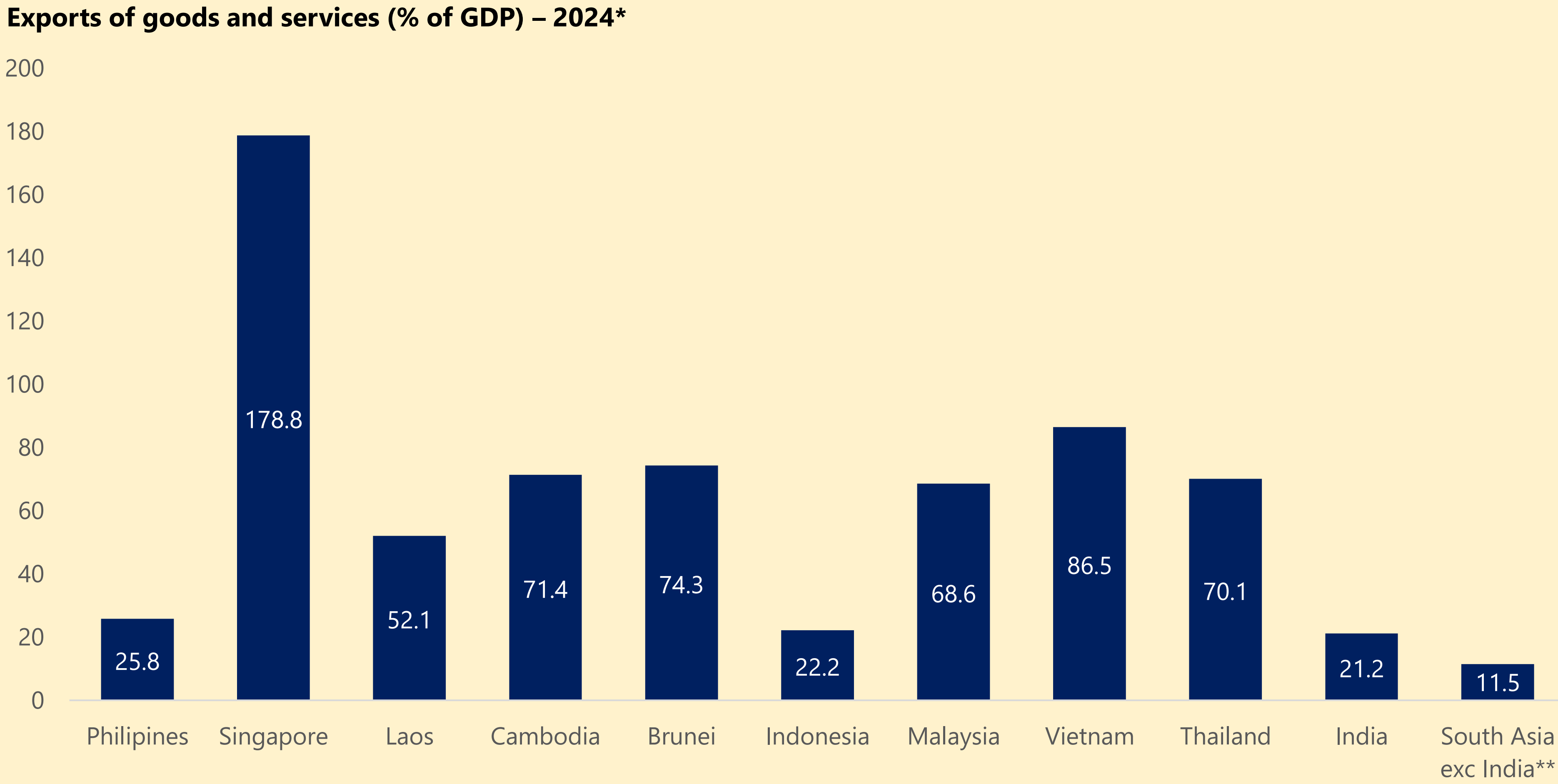
* Data for Maldives and Bhutan is 2023

** South Asia exc India includes Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan, Maldives

Source: IMF, World Bank

Exports drive a significant component of South East Asian economies



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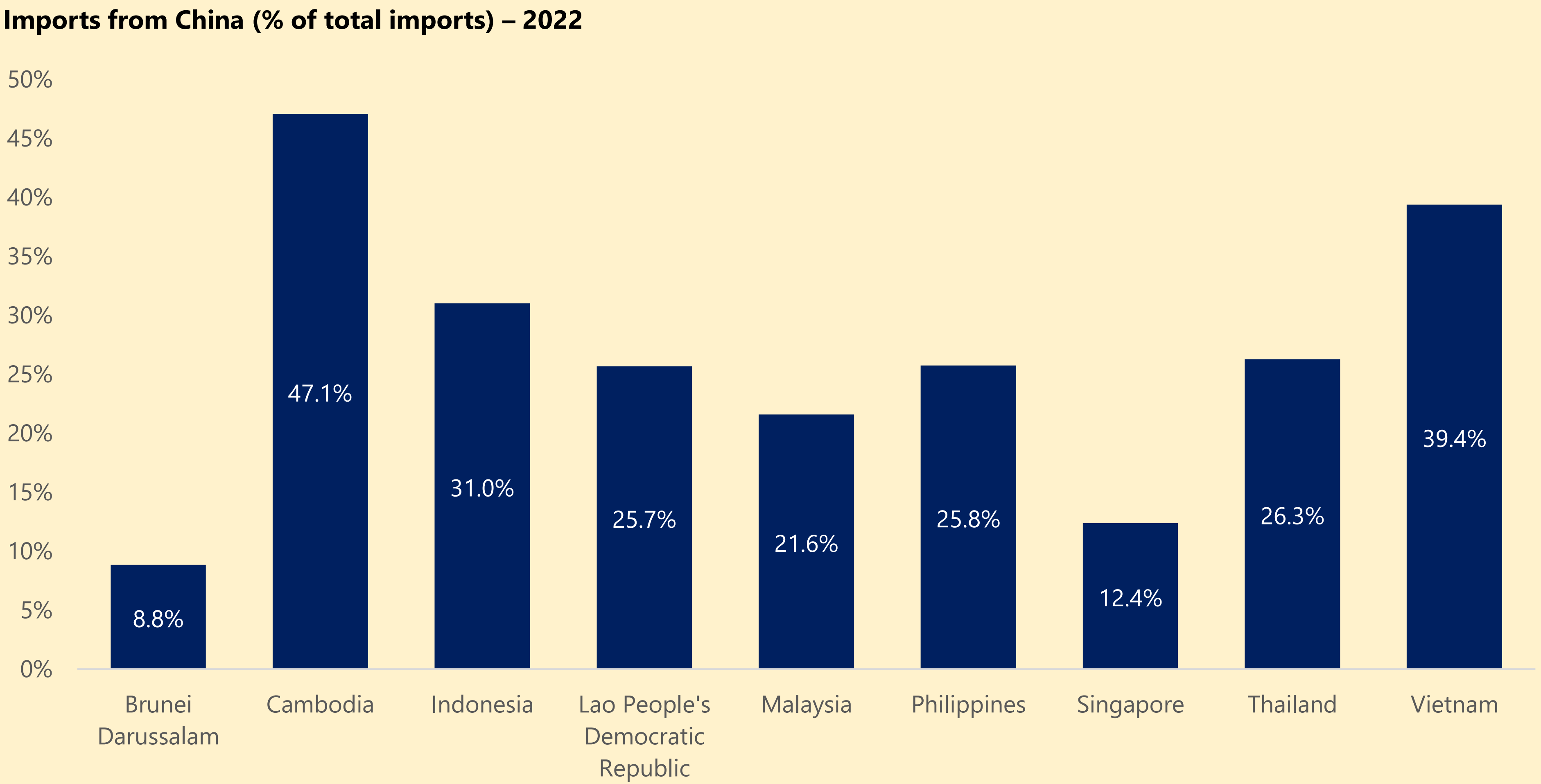
* Data for Malaysia, Vietnam, Laos, Maldives, and Bhutan is 2023
** South Asia exc India includes Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan, Maldives

Source: IMF, World Bank

Like most of the world, South East Asia imports a lot of inputs from China



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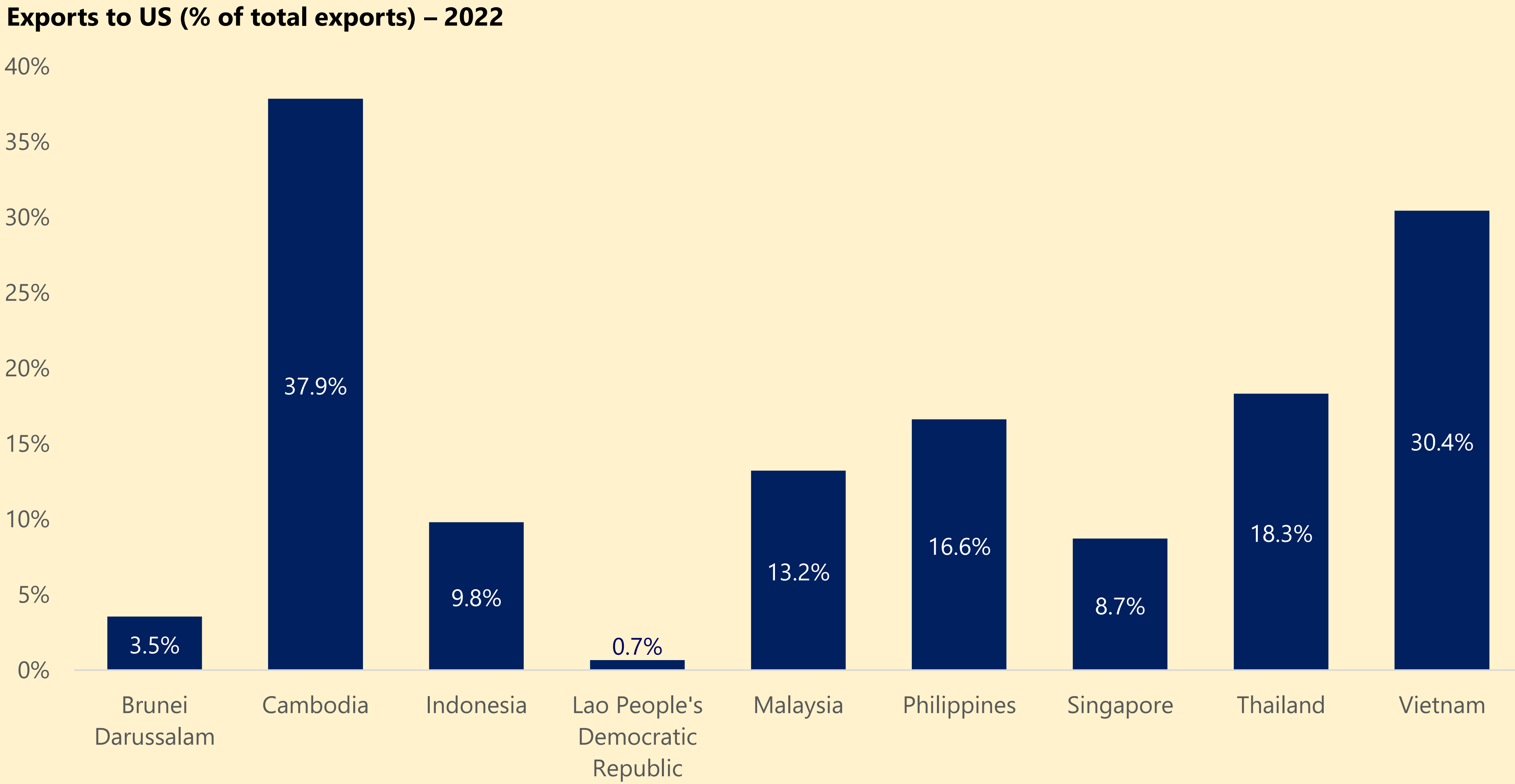
Source: IMF, World Bank

Most of South East Asia also exports a significant component to the US



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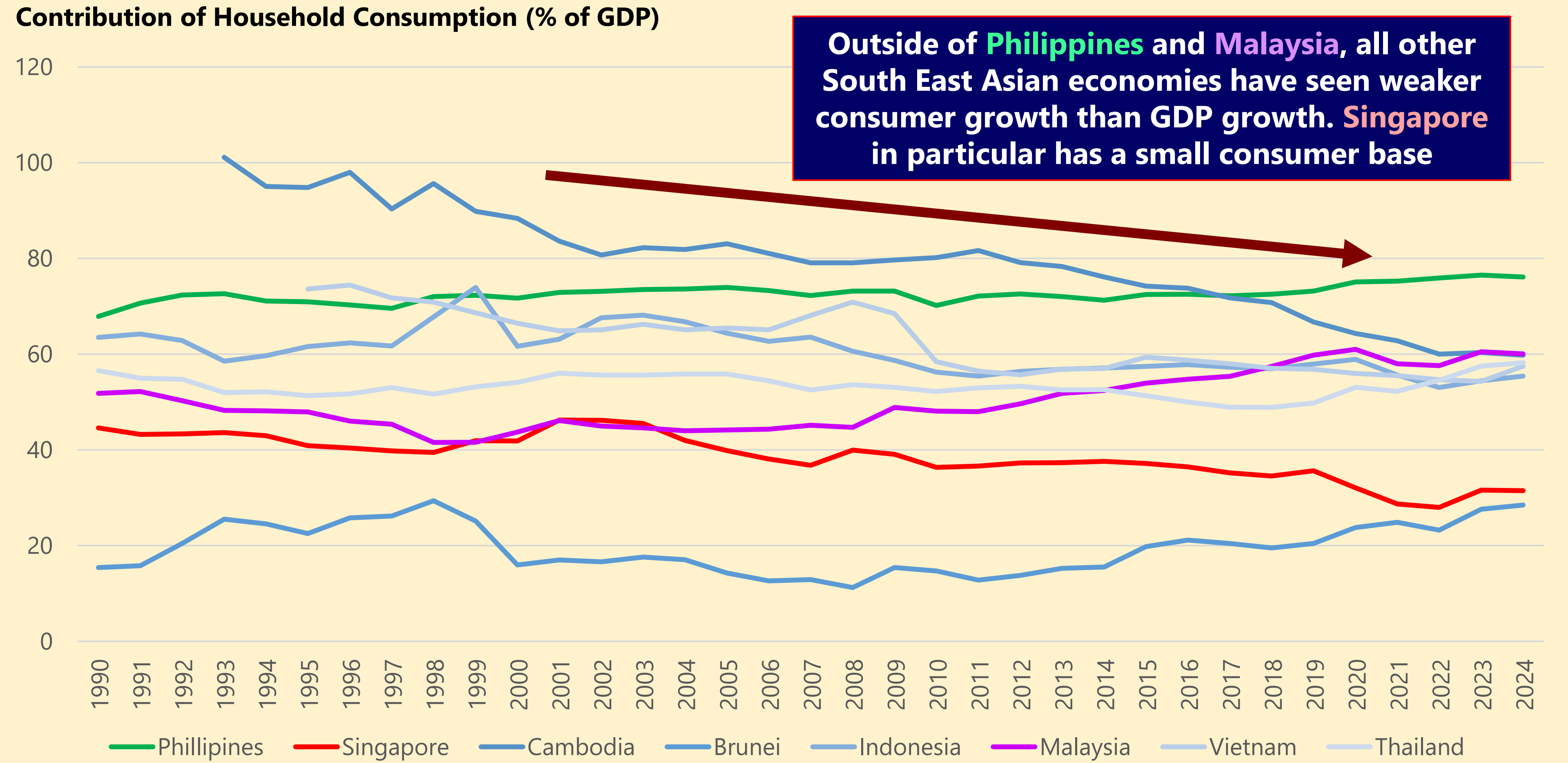
Source: IMF, World Bank

South East Asian economies don't generally have particularly strong and rising consumers



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Source: IMF, World Bank

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