ONYX
STRATEGIC INSIGHTS

Southeast Asia-5's Future Capacity and Industry Specialization

Key Insights

June 2024

Executive summary

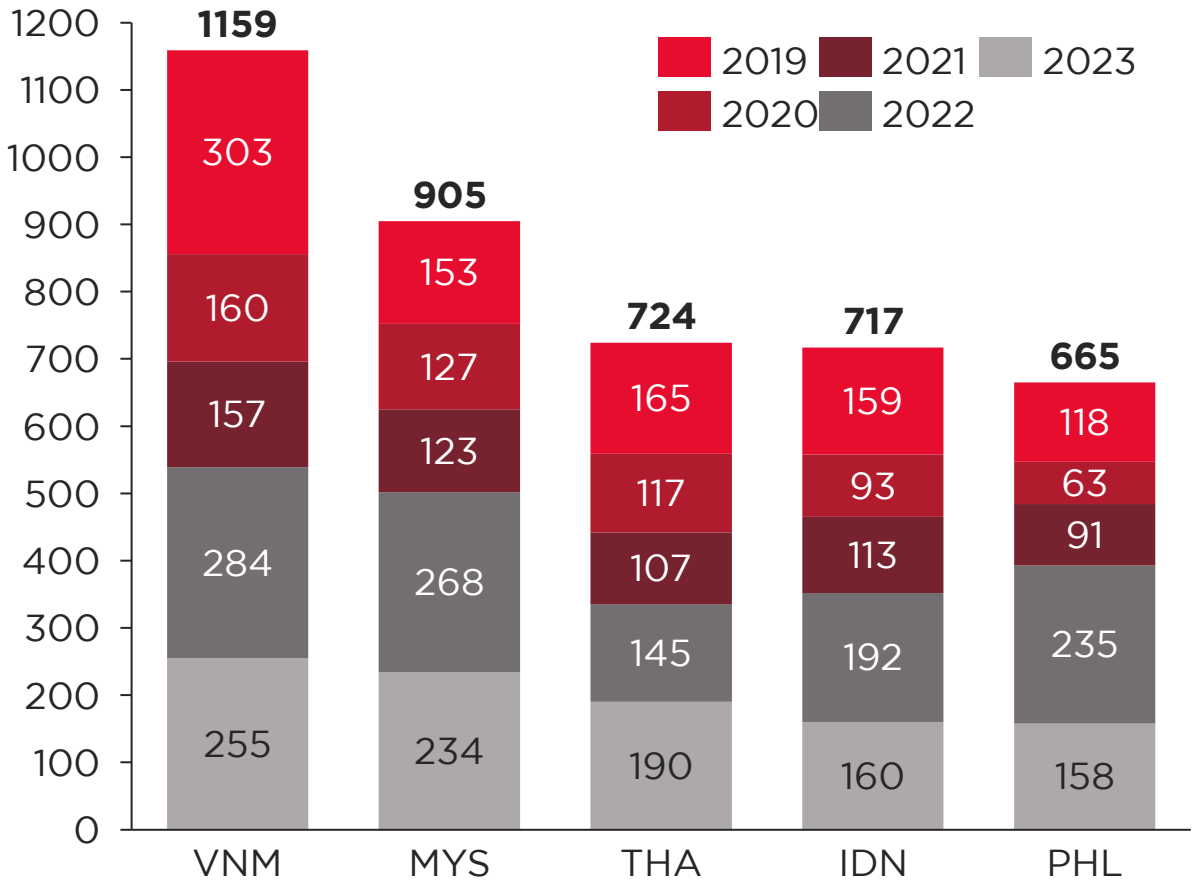
Supply chain diversification to Southeast Asia-5 (SEA-5)* prompts capacity concerns	▪ Investment influx in SEA-5 tightens labor markets, with job openings surpassing available workers ▪ Past labor cost advantage over China may diminish in SEA-5 due to tight labor markets, potentially raising wages and inflation in Malaysia, Thailand, and Vietnam
Boosting labor productivity and labor transition lift the ceiling on labor capacity constraint	▪ Boosting labor productivity is crucial for capacity growth in the SEA-5 ▪ Elevating human capital quality, including upskilling, is a key productivity strategy across SEA-5 ▪ Indonesia, Malaysia, Philippines, and Thailand can diversify their manufacturing workforce, whereas Vietnam faces labor reallocation constraints, limiting government influence on capacity
Industry specialization is another key strategy to address capacity constraint	▪ SEA-5 tackles capacity constraint through industry specialization ▪ Key industrial clusters in SEA-5 include electronics, machinery, automotive, and metals ▪ Future policies in SEA-5 will focus on enhancing industry specialization

* Indonesia, Malaysia, Philippines, Thailand, and Vietnam

SEA-5 countries are experiencing an influx of investments

However, labor shortages are a concern, especially in Vietnam, Malaysia, & Thailand

NUMBER OF FDI PROJECTS TO EACH SEA-5 COUNTRY BY ORIGIN
TOTAL FIGURE FOR 2019-2023



Source: GlobalData, Onyx

Factors boosting FDI to SEA-5

- US-China tensions
- Economic environment improvements and labor cost competitiveness
- Government policy for tech and manufacturing industries
- Infrastructure investment and industrial development plan

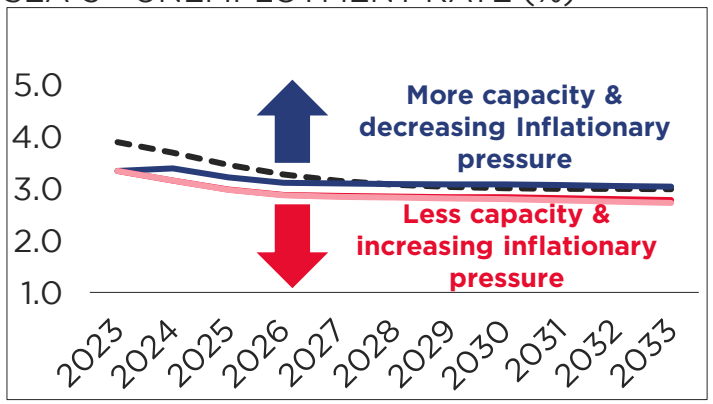
WHAT TO WATCH FOR

- Labor shortages
- Input cost pressure
- Logistics performance
- ESG – in particular, environmental concerns

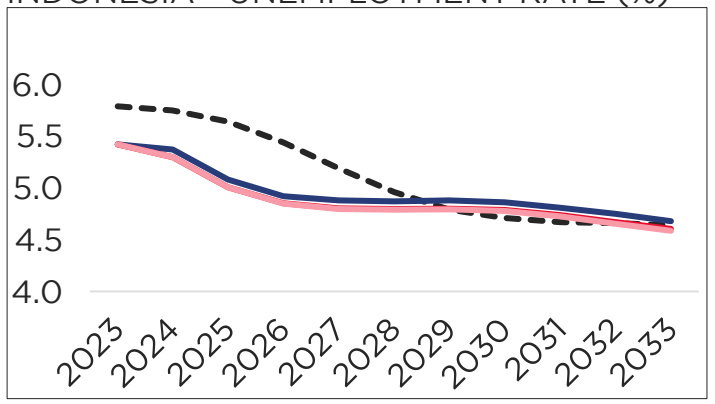
Tight labor markets may lead to capacity constraints

And further investment could stoke inflation in Malaysia, Thailand, & Vietnam

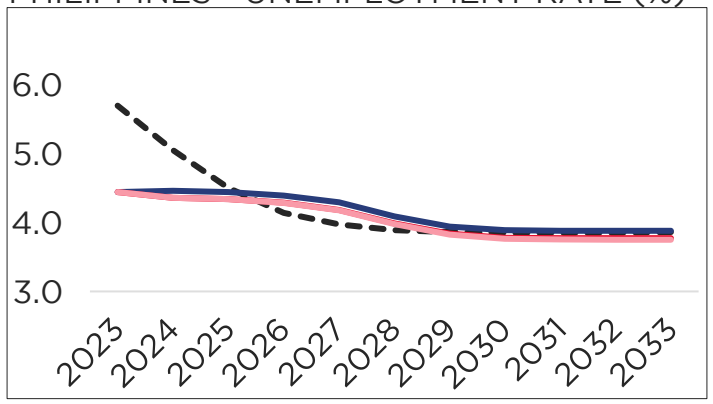
SEA-5 - UNEMPLOYMENT RATE (%)



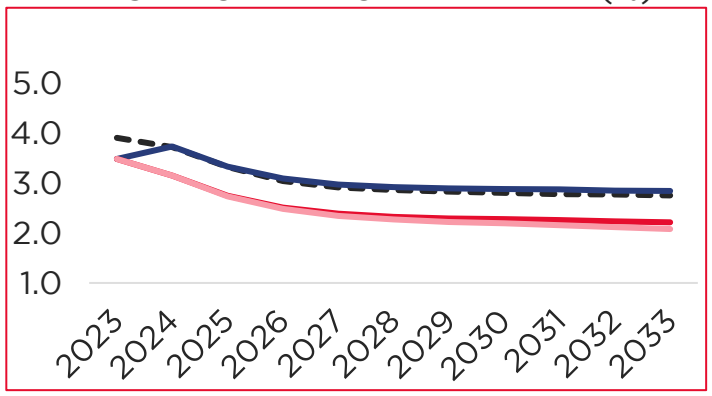
INDONESIA - UNEMPLOYMENT RATE (%)



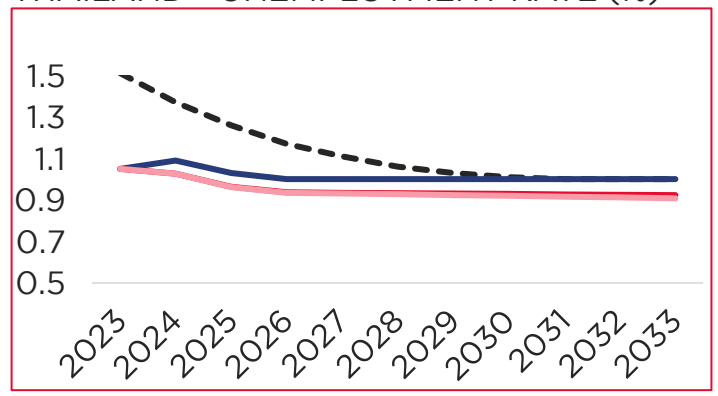
PHILIPPINES - UNEMPLOYMENT RATE (%)



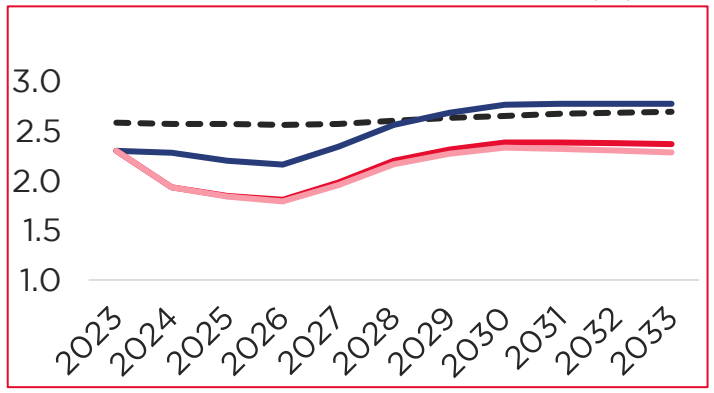
MALAYSIA - UNEMPLOYMENT RATE (%)



THAILAND - UNEMPLOYMENT RATE (%)



VIETNAM - UNEMPLOYMENT RATE (%)



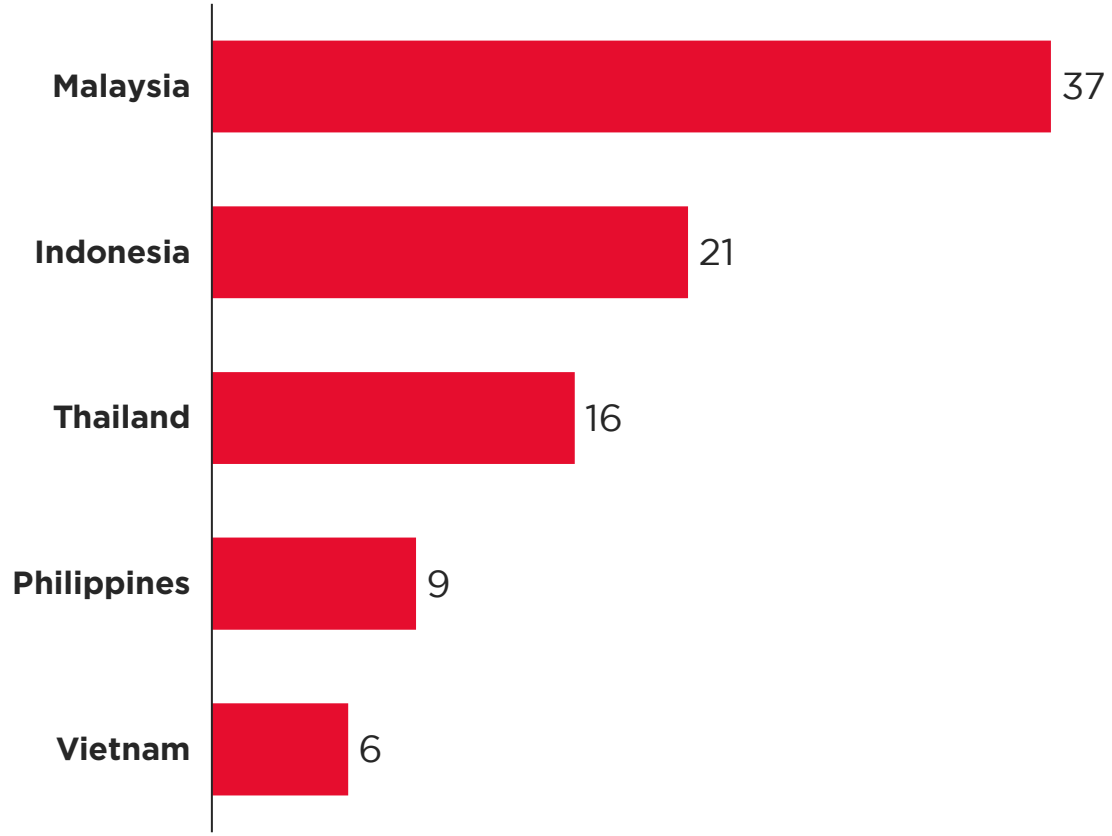
Neutral rate
Baseline unemployment
Unemployment with status quo investment
Unemployment with high investment

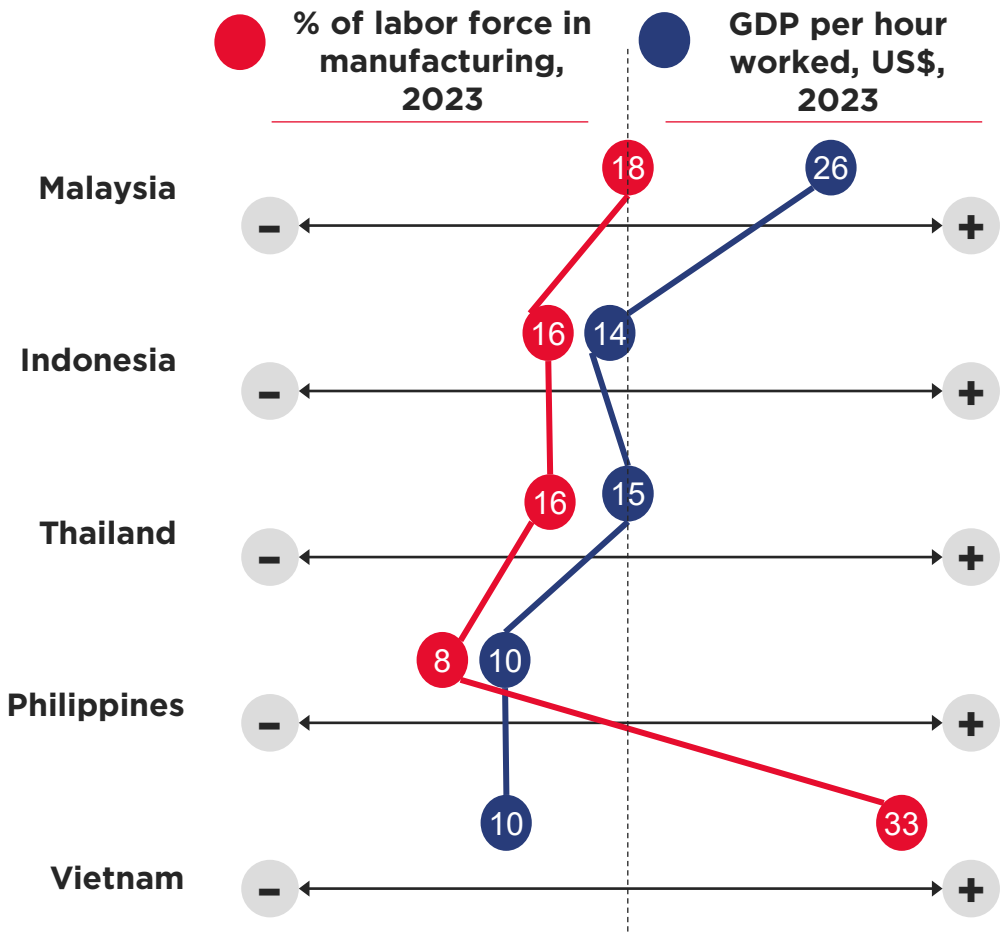
Source: Oxford Economics, Penn World Table, Onyx

Labor transition to manufacturing sector and improved productivity may help drive capacity growth

Malaysia has significant untapped potential, while Vietnam's upside is limited

ESTIMATED INCREASE IN INDUSTRIAL OUTPUT IN MAX LABOR SHIFT AND PRODUCTIVITY GAIN SCENARIO
% DIFFERENCE COMPARED TO THE BASE CASE, 2035



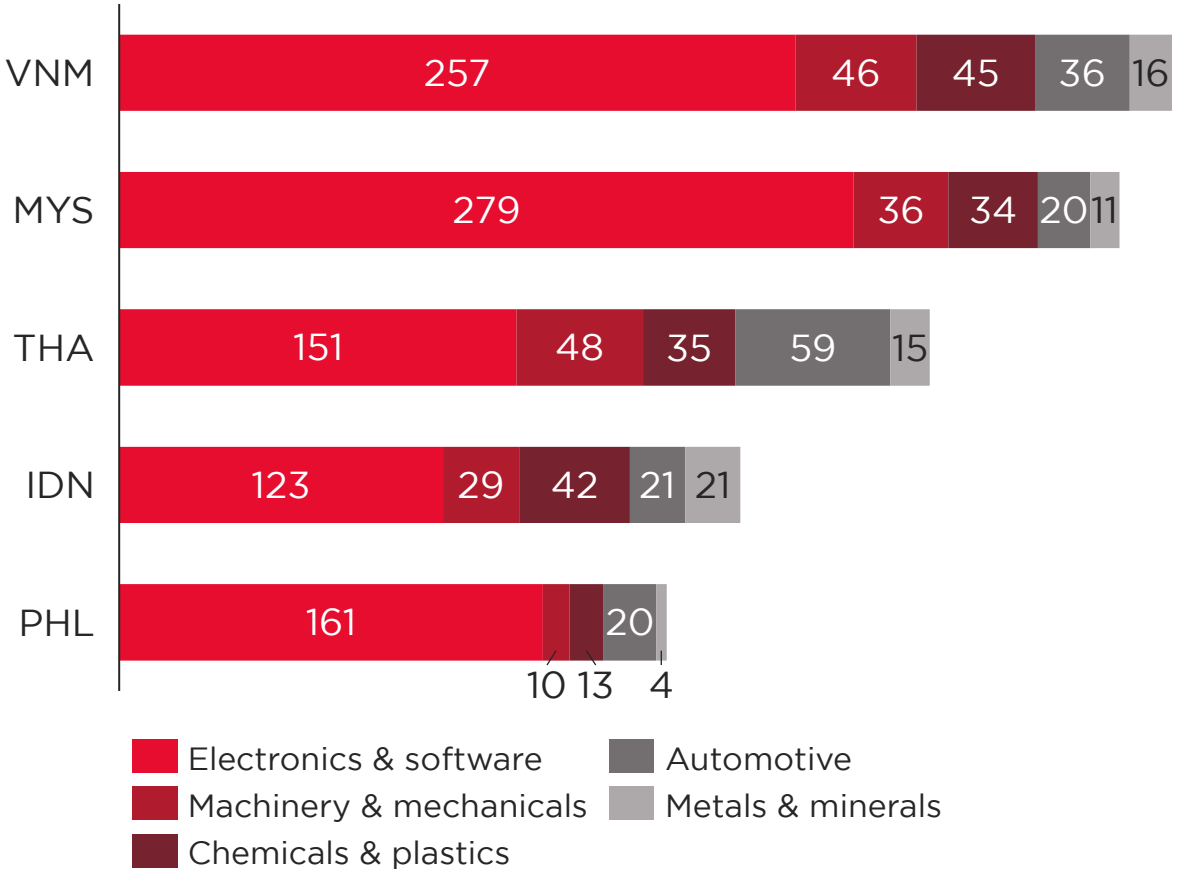


Source: Oxford Economics, Onyx

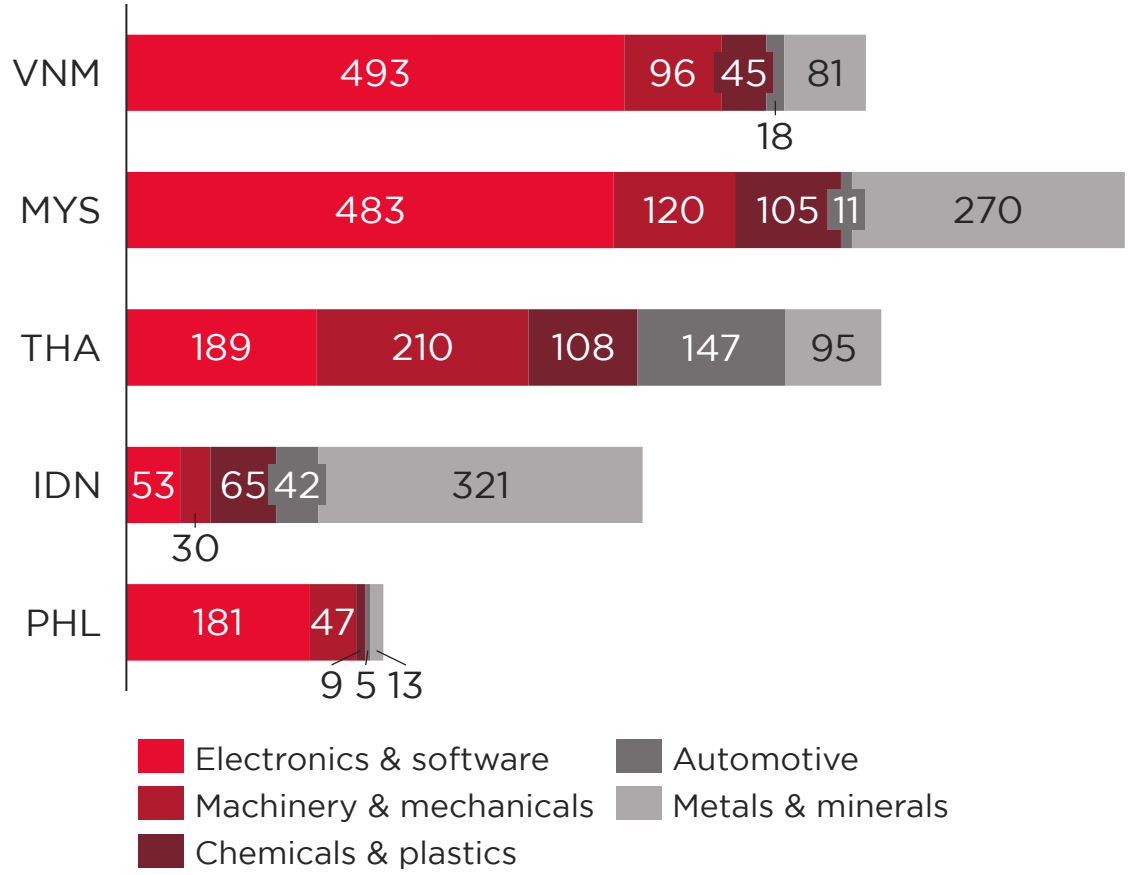
Each SEA-5 country is pursuing industry specialization

Three big clusters: electronics & software, machinery & auto, and metals & minerals

NUMBER OF FDI PROJECTS TO EACH COUNTRY BY SECTOR
TOTAL FIGURE FOR 2019-2023



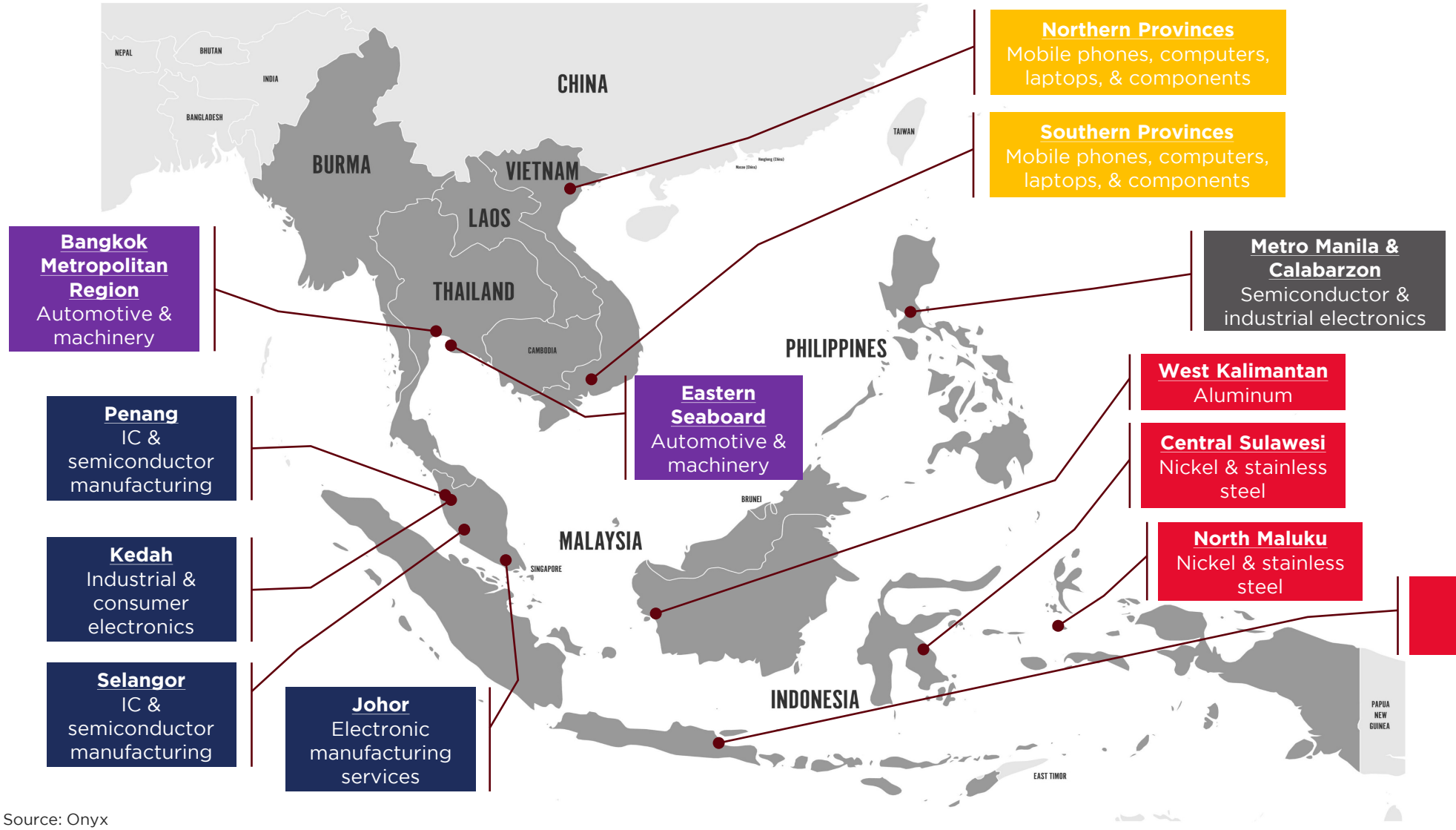
SEA-5'S EXPORT BY SECTOR
TOTAL FIGURE FOR 2019-2023 (US$ BILLION)



Source: Trade Map, Oxford Economics, GlobalData, Onyx

Each country is developing tightly integrated industrial clusters

Except in Indonesia, these clusters are in one or two key locations



Source: Onyx

Industry specialization will become the key focus

Future policies in SEA-5 countries will focus on this angle

POLICIES FOCUSING ON INDUSTRY SPECIALIZATION

INDONESIA	MALAYSIA	PHILIPPINES	THAILAND	VIETNAM
Mining Industrial Downstreaming ▪ Focusing on bauxite, copper, and tin ▪ Replicating the approach for nickel downstreaming and starts with commodity export bans ▪ The end goal will be to build national supply chain	**New Industrial Masterplan** ▪ Attract investments for semiconductor wafer fabrication in Malaysia ▪ Developing semiconductor supply chain ▪ Strengthening domestic linkages and existing industrial clusters as well as skilled workforce	**Comprehensive National Industrial Strategy** ▪ Broad sectoral focus ▪ Promote green industry and use of clean technologies in industrial production ▪ Addressing the high cost of power and domestic shipping	**Thailand 4.0** ▪ Increasing the productivity of automotive and machinery sectors ▪ Strengthening the following key sectors: EV, electronics, medical devices, and smart farming and precision agriculture ▪ Developing the Eastern Economic Corridor (EEC)	**Industrial Development Strategy** ▪ Elevating the electronics industry to a pivotal role ▪ Cultivating supporting industries in electronics and automotive sectors ▪ Implementing programs to train workers and bolster local firms in supporting industries

Source: Onyx

Scenario: Vietnam Industrial Development Strategy

In this analysis, we delve into the potential ramifications of Vietnam's Industrial Development Strategy, with a particular focus on three pivotal factors: productivity, economic growth, and job competitiveness.

Notably, the electronics sector stands out as a priority area due to its substantial competitive edge. A crucial facet of this strategy involves fortifying the skills of the workers within the electronics sector to bolster their productivity, thereby enhancing its competitiveness.

Our modeling endeavors concentrate on evaluating the effects of the specific action plan to upskill workers in the electronic manufacturing sector.

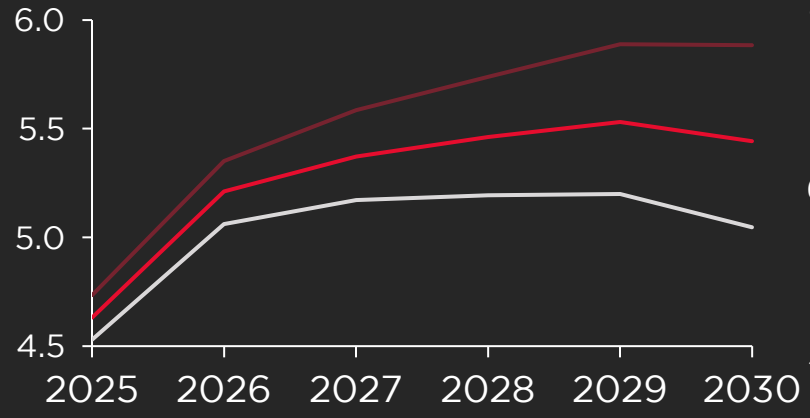
Key Assumptions

- Total labor force in the manufacturing sector will increase by 9% in 2030
- Share of workers in the electronics sector is 4.5% of the total labor force
- By 2030, upskilling workers is projected to boost productivity in the electronics sector by 20-30%

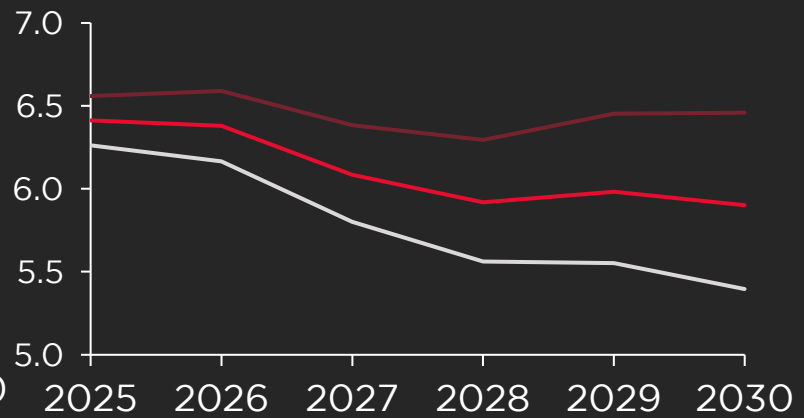
Upskilling workers enhances economic productivity

Increased productivity cuts unit costs and reduces inflation

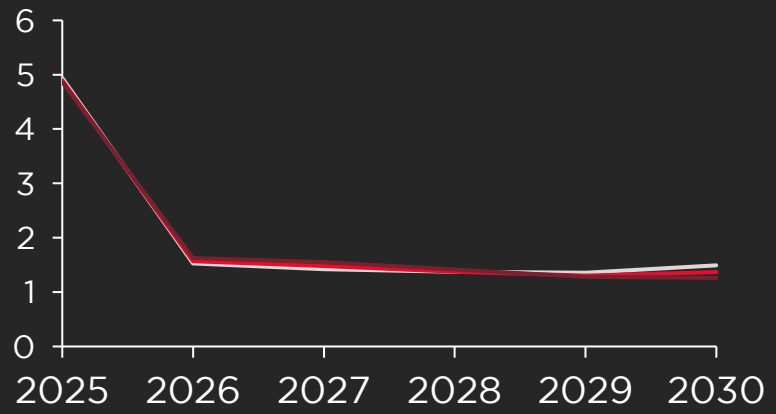
PRODUCTIVITY, YOY % CHANGE



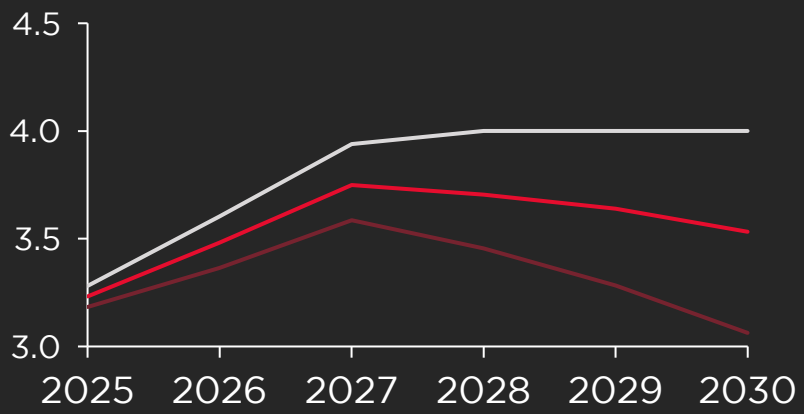
GROSS DOMESTIC PRODUCT, YOY % CHANGE



UNIT LABOR COSTS, YOY % CHANGE



INFLATION, YOY % CHANGE



Source: Oxford Economics, Onyx

Base Case
Moderate Impact
High Impact

KEY INSIGHTS

- Overall economic productivity improves quite significantly due to positive effects of the upskilling programs
- Improved productivity sustains long-term economic growth better
- Productive workers produce more goods at a lower cost per unit and puts downward pressure on prices, which leads to lower inflation

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