

Trends in Japan's Foreign Direct Investment (FDI) toward Asia since the first half of 2015

FDI toward China declines again while FDI to the ASEAN remains steady

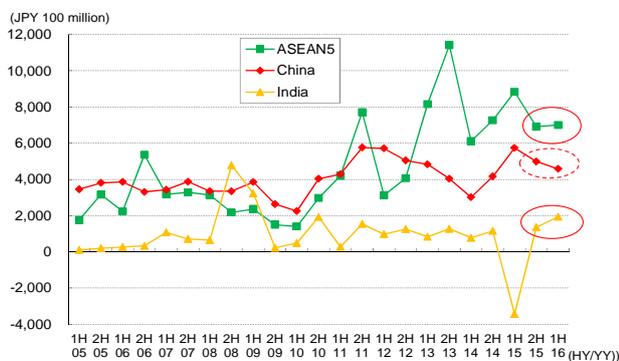
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Japan's FDI toward China remains strong in manufacturing sectors but declines in non-manufacturing sectors

Looking at Japan's FDI toward Asia from the second half of 2015 to the first half of 2016, investment in China has declined once again after the recovery that began in the second half of 2014. Meanwhile, Japan's FDI toward ASEAN has been steady. Investment toward India continues to expand where the economy is continuing to grow at a fast pace exceeding +7% (**Chart 1**). This report focuses on FDI toward China and the major ASEAN member states where Japan invests large sums, and examines the investment trends by industry.

FDI toward China took a downturn in non-manufacturing sectors in the second half of 2015 and in manufacturing sectors in the first half of 2016 (**Chart 2**). In manufacturing, investment in "electric machinery" contracted in the second half of 2015, and "general machinery" and "transportation equipment" contracted in the first half of 2016. But these sectors have nonetheless remained relatively strong. The need for mechanization in production due to rising labor costs, the government's drive to develop high-tech industries, such as

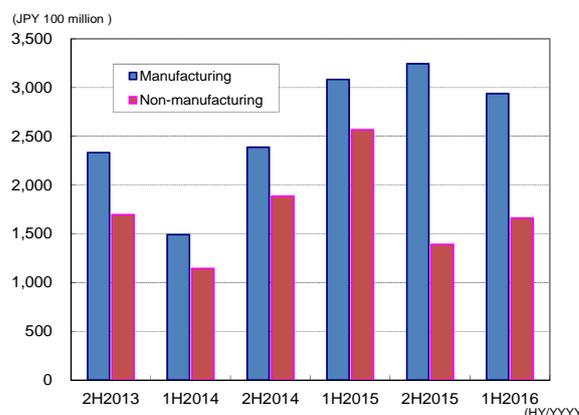
[Chart 1: Japan's FDI toward Asia]



Note: Data for ASEAN5 (Thailand, Malaysia, Indonesia, Philippines, Vietnam), China, and India have been extracted from Asia.

Source: Made by MHRI based on the Bank of Japan, *Balance of Payments*.

[Chart 2: Japan's FDI toward China (Manufacturing and Non-Manufacturing Sectors)]



Source: Made by MHRI based on the Bank of Japan, *Balance of Payments*.

semiconductors and organic EL, and strong automobile sales have all contributed to bolstering investment in China by Japanese manufacturers. However, investment continues to flow out of the “textile” industry as companies pull out of China amid rising labor costs. In non-manufacturing sectors, investment in “wholesale & retail” sectors remains strong, but investment in “finance & insurance” dropped in the second half of 2015, and the “real estate” sector saw a net outflow in the first half of 2016. In 2015, the Chinese government eased restrictions on home purchases by relaxing down-payment requirements and lowering mortgage rates, measures that caused a sharp rise in housing prices, raising concerns of a housing bubble, and dampened investment in real estate and other non-manufacturing sectors. Since the end of September 2016, the Chinese government has tightened down-payment requirements and restrictions on the number of home purchases to curb rising prices, but uncertainty remains.

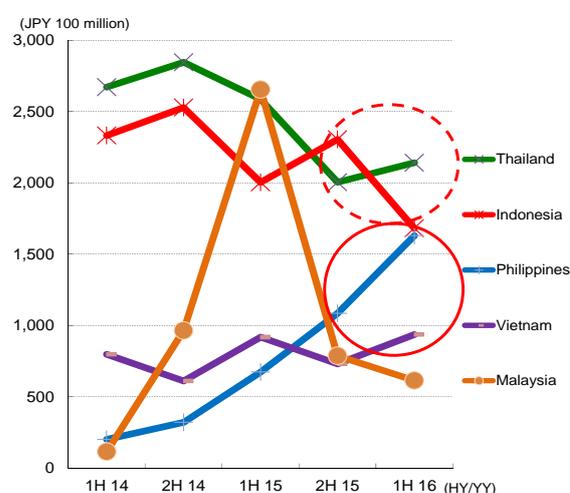
FDI toward ASEAN is generally strong

Turning to investment in the ASEAN (major 5 countries), FDI declined in Thailand in the first half of 2015 and in Indonesia in the first half of 2016 (**Chart 3**) due to the contraction in the “transportation equipment” sector, which had driven investment in both countries. In Thailand, Phase 2 of the government-led eco car program (measures to stimulate investment in small, fuel-efficient cars; Phase 1 began in 2009) boosted investment when it began in 2014, but appears to have come full circle. The slowdown in car sales in Thailand (882 thousand units in 2014, 800 thousand units in 2015, and 557 thousand units in Jan-Sep 2016) is also attributed to the decline. Slowing car sales appear to have affected investment in Indonesia as well (1,208 thousand units in 2014, 1,013 thousand units in 2015, and 783 thousand units in Jan-Sep 2016).

Meanwhile, FDI toward the Philippines continued to expand, and Vietnam grew in the first half of 2016. In the Philippines, investment is continuing to grow in the “electric machinery” sector, one of the country’s main export-oriented industries. Investment also grew in the “food”, “transportation equipment”, and “wholesale & retail” sectors, reflecting expectations toward expanding domestic demand. In Vietnam, investment in “transportation equipment” increased, mainly with respect to motorcycles. Investment in “wholesale & retail” sectors also increased.

FDI toward Malaysia declined due to a backlash to the large-scale investment in the energy sector in the first half of 2015. Investment in “electric machinery”, one of the major industries of Malaysia has also been sluggish, reflecting Japanese manufacturers’ reexamination of their global production systems. Meanwhile, investment in “chemicals & pharmaceuticals” has been stable. Boosted by the nation’s relatively strong infrastructure, there seems to be a renewed interest in Malaysia as a destination of investment by capital-intensive industries. Investment in “wholesale & retail” sectors is also growing, as investors focus on Malaysia’s purchasing power, which stands out among ASEAN members.

[Chart 3: Japan’s FDI toward the ASEAN]



Source: Made by MHRI based on the Bank of Japan, *Balance of Payments*.

Future focus on China's automotive industry

As mentioned earlier, “transportation equipment” is one of the industries driving direct investment in China. Car sales in China have remained strong since the second half of 2015, helped by the measure to boost small car purchases. The acquisition tax for cars with engines 1.6 liter or smaller was lowered from 10% to 5% during the period between October 2015 and December 2016. The automotive market was sluggish until the first half of 2015 but recovered rapidly after the tax cut was implemented. The support measure to buoy vehicle sales has been extended for another year until the end of 2017 with the acquisition tax set at 7.5%. Meanwhile, the excessive production capacity of manufacturers has become a structural problem in China, and the automotive industry is no exception. In May 2015, before the tax-cut program was introduced, the government-affiliated China Association of Automobile Manufacturers warned of over-investment in the automotive industry. Japanese manufacturers should also remember to exercise caution in their active efforts to make new investments.

Focus on large-scale FTAs to replace the TPP

Asia held high expectations toward the Trans-Pacific Partnership (TPP), essentially a free trade agreement (FTA) with the United States. But now that President-elect Donald Trump has announced the US will pull out of the economic partnership agreement, it is unclear whether the TPP will actually come into effect. Investors are now focusing on mega-FTAs to serve as alternatives to the TPP, such as FTAs between the Asian economies and the EU, and the Regional Comprehensive Economic Partnership (RCEP) among the 16 participating countries including the ASEAN10, Japan, China, South Korea, Australia, New Zealand, and India. Japan's investment toward Asia previously eyed the TPP, but going forward, investors will be focusing on FTAs with the Asian economies and the EU as well as the RCEP. The participants of RCEP aimed at reaching an agreement by the end of 2015, but a conclusion is yet to be achieved. However, with growing uncertainty surrounding the TPP, the significance of RCEP is increasing in terms of promoting trade across broader Asia and establishing investment rules. Investors should keep a sharp eye on developments in the two wide-area FTAs.

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