
Mizuho Economic Outlook & Analysis

December 17, 2013

Japanese investments in China and ASEAN countries since the second half of 2012

More Japanese companies opting for the China-Plus-One strategy

< Summary >

- ◆ Japanese companies have started to increase their investments in ASEAN countries instead of China due to rising labor costs in China and Japan-China tensions since the second half of 2012, and this trend is more prominent among small and medium enterprises than large companies
- ◆ By business type, investments in precision instruments are increasing in Thailand and Vietnam, in electrical machinery in the Philippines, Thailand and Vietnam, and in transportation equipment in Indonesia as well as Thailand.
- ◆ Several points of focus for the future include i) whether or not China-based subsidiaries can get back on track, ii) the use of M&A strategies to gain a foothold in the ASEAN market, and iii) how to address ASEAN labor costs, which are on the rise following the trend in China.

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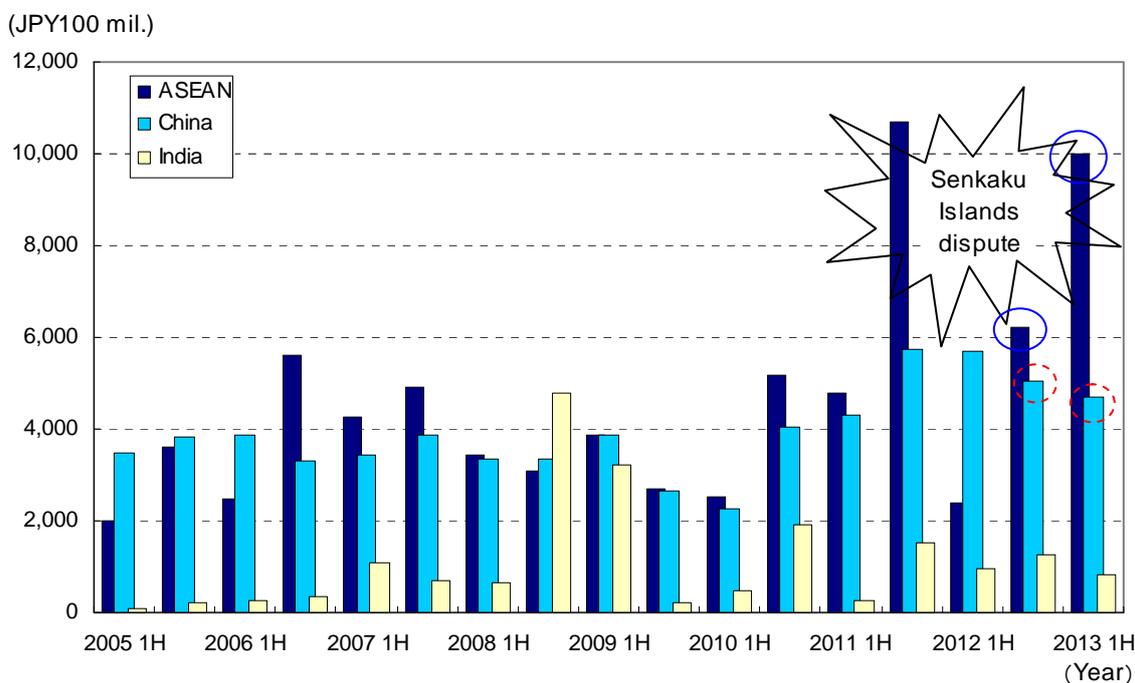
1. Introduction

With growing Chinese labor costs and rising tensions between Japan and China in the second half of 2012, Japanese companies for the last year have been shifting their investments away from China and towards ASEAN countries instead. According to Japanese Ministry of Finance statistics, direct investment has been decreasing in China and increasing in ASEAN countries since the second half of 2012 (**Chart 1**), particularly in Thailand, Indonesia, and Vietnam (**Chart 2**). There has always been a certain amount of Japanese investments in Thailand, but the recent trend shows that investments are now also spreading to ASEAN countries besides Thailand.

On the other hand, many Japanese companies continue to focus on China as an economic giant with the world's second-largest GDP and industrial complexes already on the ground. The fact that the anti-Japan protests that erupted across China have calmed down in 2013 has also been a comforting sign for Japanese companies.

This paper summarizes the trends of Japanese investments in China and ASEAN countries over the last year and provides points to consider for investments in the future.

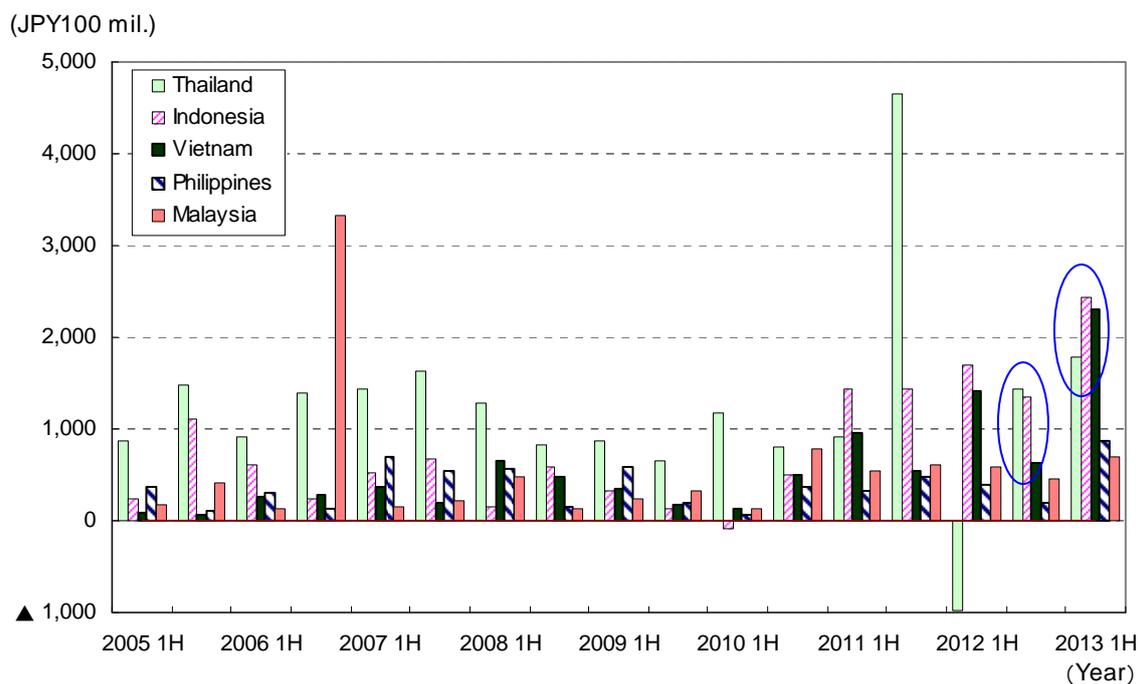
Chart 1: Japanese investments in Asia



Note: Data of 10 ASEAN countries, China, and India selected from data on Asia.

Source: Ministry of Finance "Balance of Payments"

Chart 2: Japanese investments in five ASEAN countries



- Notes: 1. The five ASEAN countries are Thailand, Malaysia, Indonesia, Philippines, and Vietnam.
 2. The rapid increase in Thailand in the first half of 2011 is due to the demand for reconstruction after the severe floods.

Source: Ministry of Finance "Balance of Payments"

2. Investments in China on the decline

(1) Overall decrease in manufacturing investments

First, examining recent Japanese investments in China (every six months from the first half of 2011 to the first half of 2013) and dividing the data into manufacturing and non-manufacturing, the figures indicate that many manufacturing businesses have seen a decline after peaking in the second half of 2011 (**Chart 3**). This trend is particularly prominent with textile products, electrical machinery, and precision instruments.

With textile products businesses having many sewing plants in China, electrical machinery businesses operating plants for printers/combined machines and other office equipment or semiconductors (post-processes), and precision instrument businesses running assembly plants for digital cameras, medical equipment, and other products, labor costs necessarily account for a relatively high percentage of the production cost in their processes. Furthermore, since a large portion of these products are exported to Japan, North America, and Europe, there is a limit to how much increased production costs can be absorbed by sales in China. Thus it appears that rising labor costs in China

have prompted Japanese companies to gradually shift their production bases from China to ASEAN countries, and heightened tensions between Japan and China have pushed this trend further, causing investments in China to see a major drop.

On the other hand, food-related businesses are increasing their investments in China as the world's largest population and promising market for foodstuffs. Rising income levels have also increased Chinese public awareness regarding food safety, and this may have helped Japanese manufacturers in particular.

Chart 3: Japanese investments in China by industry

(Unit: JPY100 mil.)

Type of business/year	2011 1H	2011 2H	2012 1H	2012 2H	2013 1H
Manufacturing	2,856	4,092	3,822	3,512	3,165
Foodstuffs	76	97	64	146	144
Textile products	68	362	104	41	60
Lumber and pulp	152	125	217	122	86
Chemicals and health	404	419	410	279	368
Petroleum	0	0	9	-4	-4
Rubber and leather	79	100	162	57	67
Glass, stone, and clay	160	81	54	54	161
Iron, nonferrous metals, and metals	369	643	385	345	392
General machinery	724	702	796	578	568
Electrical machinery	257	539	564	471	374
Transportation equipment	309	852	986	1,271	843
Precision instruments	134	83	-12	13	3
Non-manufacturing	1,433	1,665	1,892	1,534	1,667
Agriculture and forestry	2	0	0	1	0
Fishery	0	0	0	0	0
Mining	0	0	0	0	0
Construction	8	2	11	0	3
Transportation	31	22	57	68	47
Communications	223	22	71	40	17
Wholesale and retail	764	742	823	750	559
Finance and insurance	209	380	264	231	220
Real estate	108	404	501	302	690
Services	87	92	154	149	121
Total	4,289	5,757	5,714	5,046	4,832

Notes: 1. The shaded areas indicate investment amounts of more than 50 billion yen.

2. The negative readings (-) indicate the backflow of funds due to closures or dissolution of mergers. (The same with Chart 7 and 9 to 12.)

3. The business-type sum and total do not match because of "Other manufacturing businesses" and "Other non-manufacturing businesses." (The same with Chart 7 and 9 to 12.)

4. The solid-line circles show increases, and the dotted-line circles represent decreases. (The same with Chart 7 and 9 to 12.)

Source: Bank of Japan "Balance of Payments"

(2) Real estate businesses driving non-manufacturing investments

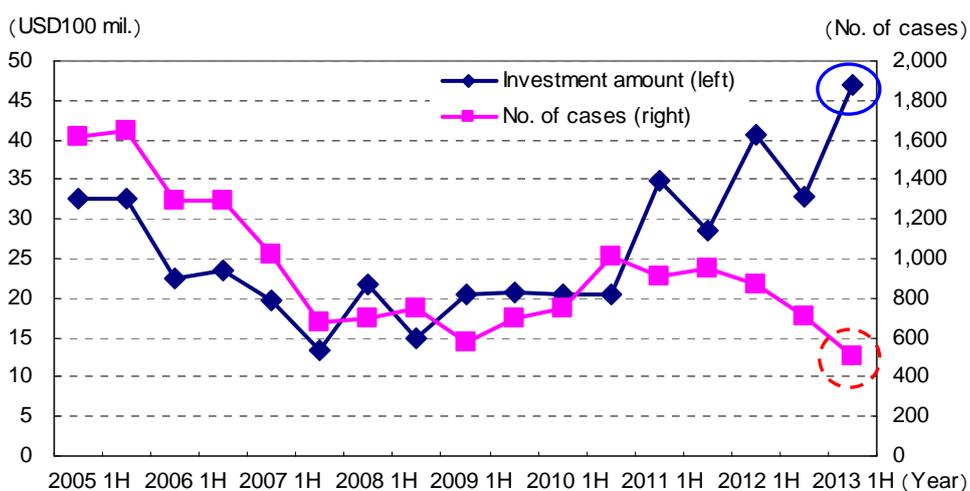
The non-manufacturing industry continues to see steady investments compared with manufacturing. Nevertheless, investments are on the decline for many non-manufacturing businesses, with the exception being real estate, for which investment increased in the first half of 2013. This is due to Japanese developers opening shopping malls and condominiums, with for example, Mitsubishi Estate opening the Shenyang Park Outlet in October 2012, and Mitsui Fudosan to open the LaLaport Shanghai Jinqiao shopping mall in 2017.

Chinese real estate prices have soared in recent years, and though it should be noted that the government is implementing policies to suppress rising prices, consumer purchasing power is on the rise, and the strong demand for residential housing and associated commercial facilities in major cities with populations of more than five million people appears set to continue.

(3) Large companies continue to invest in China as SMEs tone down

While Japanese statistics show that investments are decreasing in China, Chinese statistics indicate that Japanese investments are basically continuing to increase (**Chart 4**). Chinese company law stipulates that when a company is approved to operate in China, 20% of the capital should be transferred within three months of the date of certification and the rest can be paid in installments over two years. Chinese statistics may possibly reflect the remaining installments for projects launched in 2011 and 2012.

Chart 4: Japanese direct investments in China (amounts and number of cases)



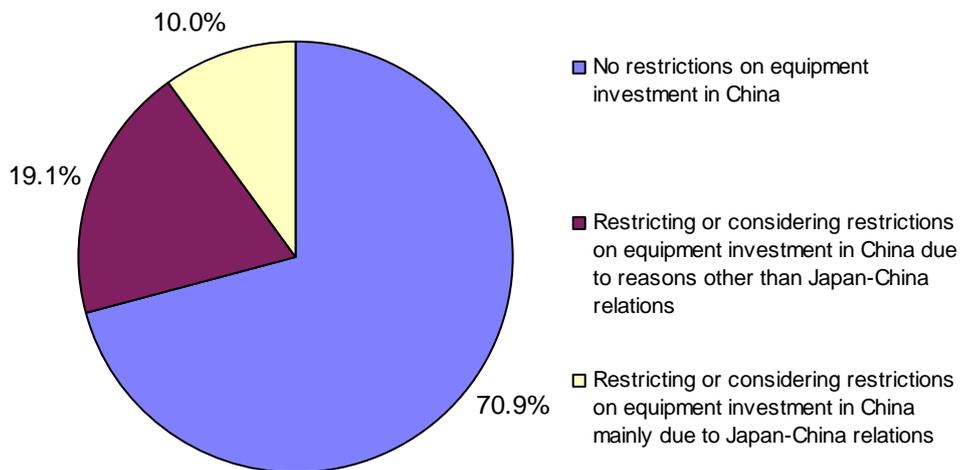
Note: Based on actual executed cases.

Source: Chinese Ministry of Commerce

On the other hand, Chinese statistics also indicate a drop in the number of investments (**Chart 4**). This means that the amount per investment has grown larger, suggesting that while there is a steady flow of large companies making large investments in China, there is also a significant decrease in the number of investments by small and medium enterprises (SMEs).

In fact, according to an equipment investment survey of large companies conducted by the Development Bank of Japan in August 2013, 70% of the companies replied they were not holding back on investment in China (**Chart 5**). This suggests that the importance of the Chinese market, the world’s second-largest GDP, remains high for large companies that hope to expand their businesses overseas. Furthermore, of the companies that replied they had curbed investment, the number stating reasons other than Japan-China relations was twice that of companies citing Japan-China relations as the main cause. Thus it appears that the factors directly responsible for corporate decisions to refrain from investing in China are recent changes in the business environment, for example, rising labor costs, decreasing Chinese growth rate, and intensifying competition.

Chart 5: Chart 5. Mid- and long-term policies regarding equipment investment in China (large companies)



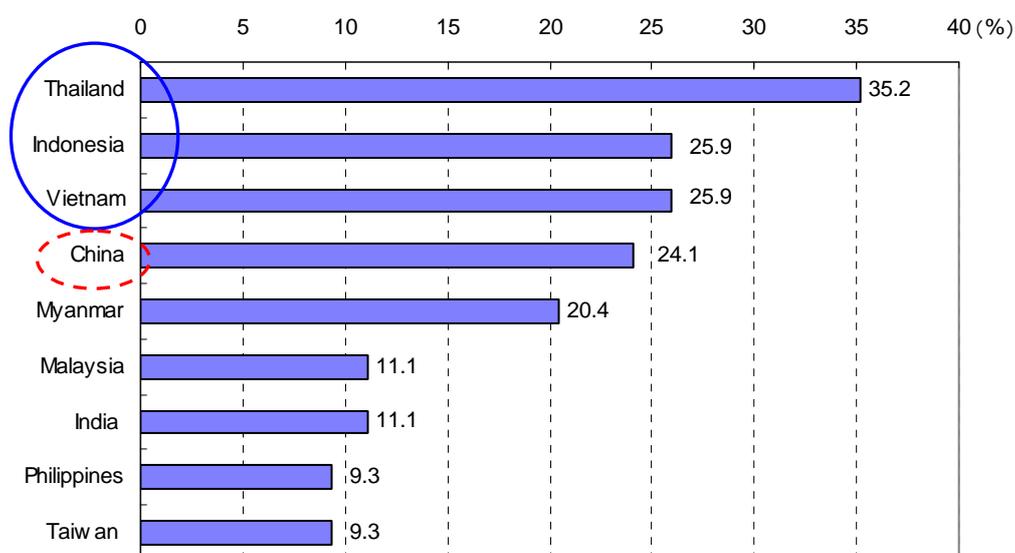
Note: Respondents were 491 large manufacturing companies with capital of more than 1 billion yen.

Source: Development Bank of Japan “Equipment investment plan survey” (August 2013)

Meanwhile, a survey regarding overseas development (conducted from November 2012 to January 2013 by Kanagawa Prefecture) asked SMEs where they hoped to expand

their business, and Thailand was the number one destination, with Vietnam and Indonesia both coming in at number two, and China at number four (**Chart 6**). Compared with large companies, SMEs seem hesitant about investing in China since they have a limited risk tolerance regarding overseas investment and are subsequently more sensitive to China risks mainly caused by Japan-China tensions.

Chart 6: Preferred countries & region with industrial complexes for expansion overseas (SMEs)



Note: Respondents were 434 SMEs in Kanagawa Prefecture.

Source: Kanagawa Prefecture “Kanagawa companies overseas development survey” (March 2013)

3. Japanese investments surge in ASEAN countries

This segment will examine Japanese investments in the ASEAN region by country – specifically, Thailand, Indonesia, Vietnam, Philippines, and Malaysia (collectively referred to as “ASEAN5” hereinafter).

(1) Thailand: Steady flow of investments in wide-ranging manufacturing businesses and increasing SME investments

Thailand is said to have 7,000 to 8,000 Japanese companies, or the highest concentration of Japanese companies in the ASEAN region, and after the severe flooding in 2011, the demand for reconstruction spurred an influx of Japanese investments from the second half of 2011 to the first half of 2012. Figures indicate that a wide range of

manufacturing businesses, including transportation equipment, iron/nonferrous metals/metals, electrical machinery, chemicals and health, and precision instruments, have maintained a high level of investment since the second half of 2012 (**Chart 7**).

Another point of interest is the increase in wholesale and retail investments. The nominal GDP per capita in Thailand is on par with China's (USD6,072 in China and USD5,678 in Thailand; similar for 2012 onwards), and it may be said that Thailand's major cities such as Bangkok are starting to attract renewed attention as consumer markets.

Chart 7: Japanese investments in Thailand (by business type)

(Unit: JPY100 mil.)

Type of business/year	2011 1H	2011 2H	2012 1H	2012 2H	2013 1H
Manufacturing	730	1,481	1,697	1,290	1,555
Foodstuffs	55	-14	42	32	17
Textile products	11	19	15	11	11
Lumber and pulp	39	38	36	81	59
Chemicals and health	85	114	146	143	204
Petroleum	0	0	0	0	9
Rubber and leather	37	55	146	85	81
Glass, stone, and clay	-3	60	5	37	38
Iron, nonferrous metals, and metals	132	220	295	201	220
General machinery	67	140	127	47	79
Electrical machinery	92	193	201	240	204
Transportation equipment	142	586	550	189	442
Precision instruments	51	32	14	228	116
Non-manufacturing	184	3,181	-2,677	154	224
Agriculture and forestry	0	0	0	0	0
Fishery	0	0	4	1	0
Mining	0	-0	3	-4	0
Construction	3	-2	-1	4	7
Transportation	32	86	26	4	47
Communications	0	0	0	0	1
Wholesale and retail	122	25	35	-33	131
Finance and insurance	55	3,044	-2,759	146	9
Real estate	0	0	0	8	3
Services	28	19	8	14	32
Total	914	4,662	-980	1,444	1,779

Notes: 1. The shaded areas indicate investment amounts of more than 10 billion yen.

2. The sudden increase and decrease in finance and insurance investments in the second half of 2011 and first half of 2012 are probably flood-related.

Source: Bank of Japan "Balance of Payments"

As such, Japanese statistics indicate how manufacturers are choosing to invest in Thailand since the recovery efforts after the 2011 floods, as Thailand has a relatively

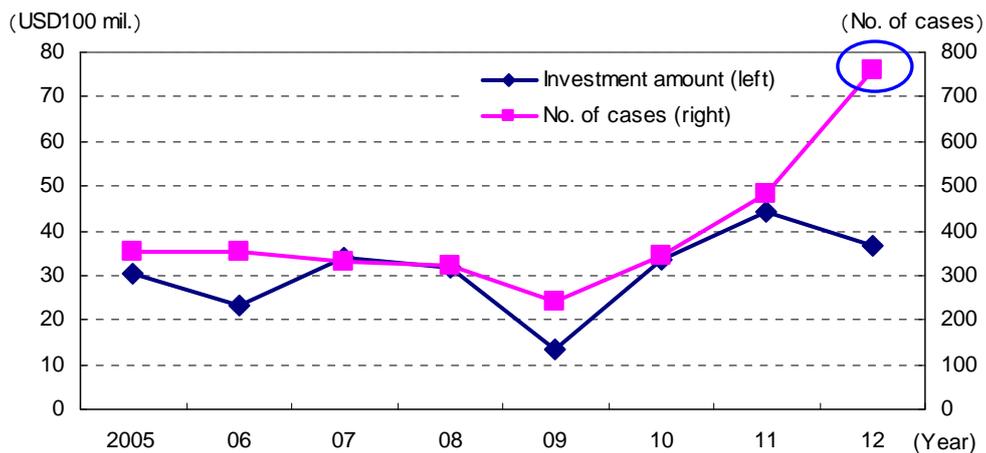
good infrastructure among ASEAN countries, besides already having industrial complexes in a wide range of fields, making it convenient to procure parts. Thai statistics also show there has been a steady flow of Japanese investments, with a surge in the number of investments in 2012 in particular (**Chart 8**), suggesting how Japanese SMEs, sensitive to China risks, have started to invest in Thailand rather than China.

(2) Indonesia: Investments led by transportation equipment spreading to parts and materials

In Indonesia, there has been a steady flow of investments in transportation equipment with the rapid increase of car sales in 2012, selling more than a million new cars for the first time (**Chart 9**)¹. Statistics show that these investments have also prompted companies to invest in iron/nonferrous/metals and other such materials and raw materials, as well as general machinery and other peripheral businesses of equipment and parts.

Non-manufacturing investments have also increased due to wholesale and retail businesses expanding their investments aimed at domestic demand generated by Indonesia’s large population of approximately 250 million people, and finance and insurance businesses conducting M&As with local finance and insurance businesses. Real estate investments have also increased, with Japanese developers engaged in condominium and other projects in residential markets, in anticipation of rising income levels and growing domestic demand.

Chart 8: Japanese direct investments in Thailand (amounts and number of cases)



Note: Investment amounts are based on actual executed cases, and the number of cases is based on approvals.

Source: Bank of Thailand and Thailand Board of Investment

¹ The nominal GDP per capita in Indonesia for 2012 is USD3,552, the first time to exceed the USD3,000 mark, which had been a milestone indicating the arrival of the age of motorization.

Chart 9: Japanese investments in Indonesia (by business type)

(Unit: JPY100 mil.)

Type of business/year	2011 1H	2011 2H	2012 1H	2012 2H	2013 1H
Manufacturing	456	1,031	1,277	964	913
Foodstuffs	8	56	15	63	48
Textile products	8	14	12	35	32
Lumber and pulp	53	34	61	16	43
Chemicals and health	42	84	197	70	-21
Petroleum	0	1	1	0	-10
Rubber and leather	49	41	39	40	64
Glass, stone, and clay	2	3	9	30	32
Iron, nonferrous metals, and metals	-26	89	145	122	127
General machinery	61	35	58	100	62
Electrical machinery	-1	72	47	61	34
Transportation equipment	147	547	598	371	467
Precision instruments	0	0	0	0	0
Non-manufacturing	986	404	417	382	1,517
Agriculture and forestry	8	11	15	6	16
Fishery	-6	-1	0	-1	1
Mining	96	0	0	0	0
Construction	-1	15	-5	1	-15
Transportation	0	0	34	6	22
Communications	0	0	0	0	0
Wholesale and retail	15	156	47	121	49
Finance and insurance	844	198	241	162	1,371
Real estate	4	0	11	74	57
Services	3	16	2	3	5
Total	1,442	1,435	1,694	1,346	2,430

Note: The shaded areas indicate investment amounts of more than 10 billion yen.

Source: Bank of Japan "Balance of Payments"

(3) Vietnam: Investments led by electrical machinery and growth in precision instruments

Electrical machinery investments have slowed in China but have led the drive in Vietnam, and investments in precision instruments have also increased (**Chart 10**) due to Vietnam's close proximity to China, Thailand, and Japan, making it convenient for procuring parts and materials, and relatively low labor costs among ASEAN countries.

Investments in transportation equipment appear to be growing due to the expanding number of motorcycle parts manufacturers in Vietnam. Though the four-wheel market in Vietnam is small among ASEAN countries at 100,000 units or so, the two-wheel market at around four million units is the world's fourth largest after China, India, and Indonesia.

Chart 10: Japanese investments in Vietnam (by business type)

(Unit: JPY100 mil.)

Type of business/year	2011 1H	2011 2H	2012 1H	2012 2H	2013 1H
Manufacturing	410	444	705	507	1,162
Foodstuffs	76	35	33	24	9
Textile products	2	16	5	4	10
Lumber and pulp	13	54	24	22	14
Chemicals and health	21	28	49	50	97
Petroleum	0	0	0	18	215
Rubber and leather	4	5	29	34	210
Glass, stone, and clay	8	-13	2	1	58
Iron, nonferrous metals, and metals	86	68	145	51	62
General machinery	39	38	72	53	64
Electrical machinery	97	119	188	114	203
Transportation equipment	58	78	86	73	110
Precision instruments	-2	1	35	37	70
Non-manufacturing	552	90	716	123	1,150
Agriculture and forestry	0	0	0	0	0
Fishery	0	0	0	0	0
Mining	12	0	0	9	0
Construction	-4	0	-5	2	16
Transportation	0	0	3	0	14
Communications	0	17	0	1	0
Wholesale and retail	19	25	10	30	8
Finance and insurance	495	4	446	8	1,081
Real estate	0	0	249	2	5
Services	13	8	10	7	5
Total	962	534	1,421	630	2,312

Note: The shaded areas indicate investment amounts of more than 10 billion yen.

Source: Bank of Japan "Balance of Payments"

Investment growth in rubber/leather and petroleum businesses is mainly due to the Bridgestone tire plant, the joint refinery project led by Japanese companies², and other major projects, anticipating both exports and domestic demand. In the non-manufacturing industry, as in Indonesia, Japanese finance and insurance businesses are involved in M&As with local finance and insurance businesses.

(4) Philippines: Investments led by electrical machinery

In the Philippines, there is a significant rise in electrical machinery investments (**Chart 11**) due to the rapid increase in assembly plants for printers and other office equipment or semiconductor-related parts and products.

² Bridgestone's tire plant in northern Haiphong is due to start operations in March 2014. The petrochemical complex funded by Idemitsu Kosan, Mitsui Chemicals, Kuwait Petroleum International, and PetroVietnam in northern Nghi Son is due to start operations in 2017.

Chart 11: Japanese investments in the Philippines (by business type)

(Unit: JPY100 mil.)

Type of business/year	2011 1H	2011 2H	2012 1H	2012 2H	2013 1H
Manufacturing	294	137	319	133	366
Foodstuffs	5	14	11	2	18
Textile products	0	0	0	0	0
Lumber and pulp	0	0	0	0	0
Chemicals and health	16	25	37	13	10
Petroleum	0	0	0	0	0
Rubber and leather	3	7	11	8	5
Glass, stone, and clay	2	-3	6	-8	-2
Iron, nonferrous metals, and metals	175	-17	52	25	98
General machinery	1	2	25	3	-1
Electrical machinery	79	64	108	58	220
Transportation equipment	19	25	22	22	-5
Precision instruments	0	0	0	0	0
Non-manufacturing	40	336	80	52	562
Agriculture and forestry	0	0	0	0	0
Fishery	0	0	0	0	0
Mining	28	26	15	6	0
Construction	1	5	2	4	10
Transportation	0	1	2	0	1
Communications	0	0	0	0	0
Wholesale and retail	16	8	18	13	-3
Finance and insurance	0	10	0	16	0
Real estate	20	44	34	-3	11
Services	4	15	5	2	3
Total	334	473	399	185	928

Notes: 1. The shaded areas indicate investment amounts of more than 10 billion yen.

2. The business-type sum and total do not match because of "Other manufacturing businesses" and "Other non-manufacturing businesses."

Source: Bank of Japan "Balance of Payments"

The Philippines had initially lagged behind other ASEAN countries as a viable option because of the negative image of political instability and security issues. Some of the reasons why Japanese companies have changed their minds are i) the political stability and improved security brought about by Benigno Aquino III, who became president in 2010 after vowing to fight corruption during the election campaign; ii) the slow pace of industrial development in the Philippines with its 7% unemployment rate (higher than the surrounding countries), which has made it easier to recruit workers, while keeping the increase in wage levels slower compared with the surrounding countries; and iii) the Philippines' relatively close proximity to Japan and China, which makes it convenient in terms of logistics. Such circumstances appear to be helping the Philippines gain popularity as a new option.

(5) Malaysia: Investments led by chemicals and health

In Malaysia, there is a steady flow of investments by chemicals and health businesses (**Chart 12**). While the population stands at approximately 30 million and is smaller than the surrounding ASEAN countries, Malaysia has relatively good infrastructure and is an attractive destination for capital-intensive industries.

Meanwhile, electrical machinery investments are seeing a decline, plunging into negative figures in the second half of 2012. Malaysia is known for its concentration of Japanese home appliance manufacturers, and the recent figures reflect how Japanese manufacturers are being forced to review unprofitable areas of their businesses and subsequently close liquid crystal and solar energy panel plants in Malaysia.

Wholesale and retail investments are increasing. In 2012, Aeon purchased French Carrefour's Malaysia store and established its ASEAN head office in Malaysia, anticipating the nation's exceptionally high purchasing power among ASEAN countries, with its nominal GDP per capita at more than 10,000 dollars. This is an indication of how the country is attracting attention as a consumer market.

Chart 12: Japanese investments in Malaysia (by business type)

(Unit: JPY100 mil.)

Type of business/year	2011 1H	2011 2H	2012 1H	2012 2H	2013 1H
Manufacturing	311	395	461	105	410
Foodstuffs	43	8	75	21	8
Textile products	0	0	0	11	0
Lumber and pulp	71	-31	1	-9	15
Chemicals and health	40	154	178	114	182
Petroleum	0	0	0	0	0
Rubber and leather	13	15	43	11	33
Glass, stone, and clay	13	43	22	-14	-17
Iron, nonferrous metals, and metals	43	46	12	3	57
General machinery	14	18	30	14	17
Electrical machinery	67	106	42	-102	53
Transportation equipment	2	15	44	25	56
Precision instruments	1	-13	-27	3	1
Non-manufacturing	230	213	133	455	298
Agriculture and forestry	0	0	0	0	0
Fishery	0	0	0	0	0
Mining	-3	0	0	0	22
Construction	-3	4	-2	14	4
Transportation	0	1	0	13	-1
Communications	0	0	49	2	59
Wholesale and retail	-4	14	23	298	58
Finance and insurance	225	123	87	88	40
Real estate	0	0	14	16	0
Services	13	4	6	5	7
Total	541	608	594	560	708

Notes: 1. The shaded areas indicate investment amounts of more than 10 billion yen.

2. The business-type sum and total do not match because of “Other manufacturing businesses” and “Other non-manufacturing businesses.”

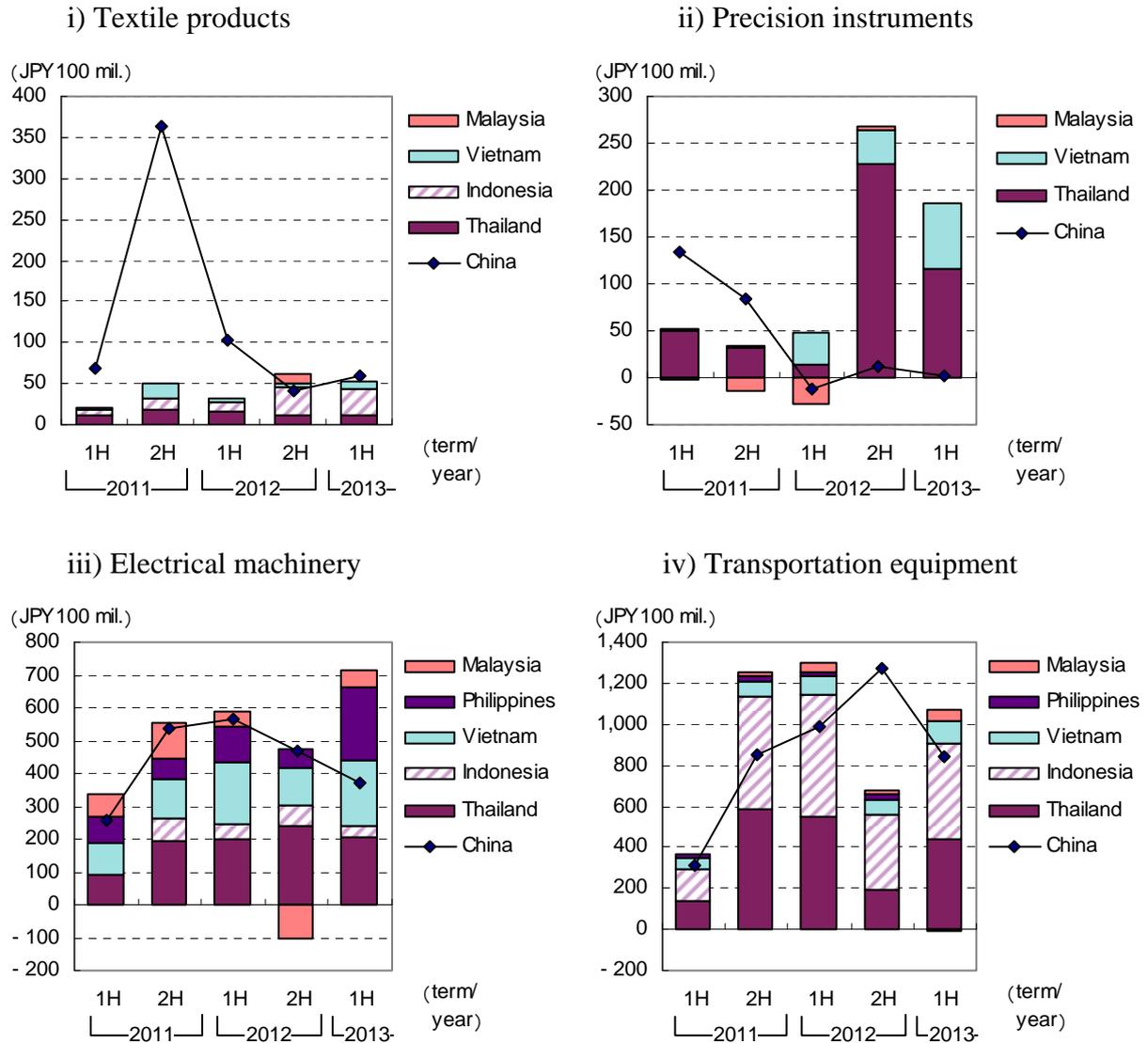
Source: Bank of Japan “Balance of Payments”

(6) Japanese investments in China and ASEAN countries by business type

As seen so far for Japanese investments in China and ASEAN countries, the situation can differ greatly depending on the type of business. Therefore, this segment will assess Japanese investments in China and ASEAN countries by business type.

First of all, let us examine the manufacturing businesses with declining investments in China: i) textile products, ii) precision instruments, iii) electrical machinery, and iv) transportation equipment (**Chart 13**).

**Chart 13: Japanese investments in China and ASEAN by business type
(manufacturing industry)**



Note: Textile products: Philippines N.A.
 Precision instruments: Indonesia, Philippines N.A.
 Source: Bank of Japan "Balance of Payments"

i) Textile products: Partial shift from China to Indonesia and Vietnam

In textile products, though investments in ASEAN countries are not large enough to make up for the decrease in China, there is an increase in Indonesia, which has a relatively abundant work force, and in Vietnam, which has low labor costs. Japanese companies may also be choosing Cambodia and Myanmar, where wage levels are lower than wages in the ASEAN5.

ii) Precision instruments: Significant shift from China to Thailand and Vietnam

There are hardly any new precision instruments investments in China, though significant growth is seen in Thailand and Vietnam. This business type represents the largest shift of investments from China to ASEAN countries.

iii) Electrical machinery: Significant shift from China to the Philippines as well as Thailand and Vietnam

In electrical machinery, it is clear that ASEAN countries are making up for the decline in China. The countries driving this trend are Thailand and Vietnam, but investments in the Philippines have also been growing since the beginning of 2013. As mentioned before, political stability may also have contributed to the Philippines emerging as a China-Plus-One country.

iv) Transportation equipment: Concentration in Indonesia as well as Thailand

In transportation equipment (Chart 13), there have been more Japanese investments in ASEAN countries than in China since 2011, with the exception of the second half of 2012. The leading ASEAN countries are Thailand and Indonesia, and it should be noted that there are now more investments in Indonesia than in Thailand. This is an indication of how the Japanese automotive industry has started to amass its business in Indonesia, in addition to Thailand, which, with its intensive automotive industry, is already described as Asia's Detroit.

Next, let us examine the trends in the non-manufacturing businesses of v) wholesale and retail and vi) finance and insurance (**Chart 14**).

v) Wholesale and retail: Investors continue to prefer China

In wholesale and retail, though investments in China have seen a significant slowdown, the amounts are still twice as large as those in ASEAN countries. Nevertheless, there have been major investments mainly in Malaysia, which has the highest income level, followed by Thailand, and then Indonesia, which has an overwhelmingly large population, showing how businesses are focusing on these three countries as consumer markets after China.

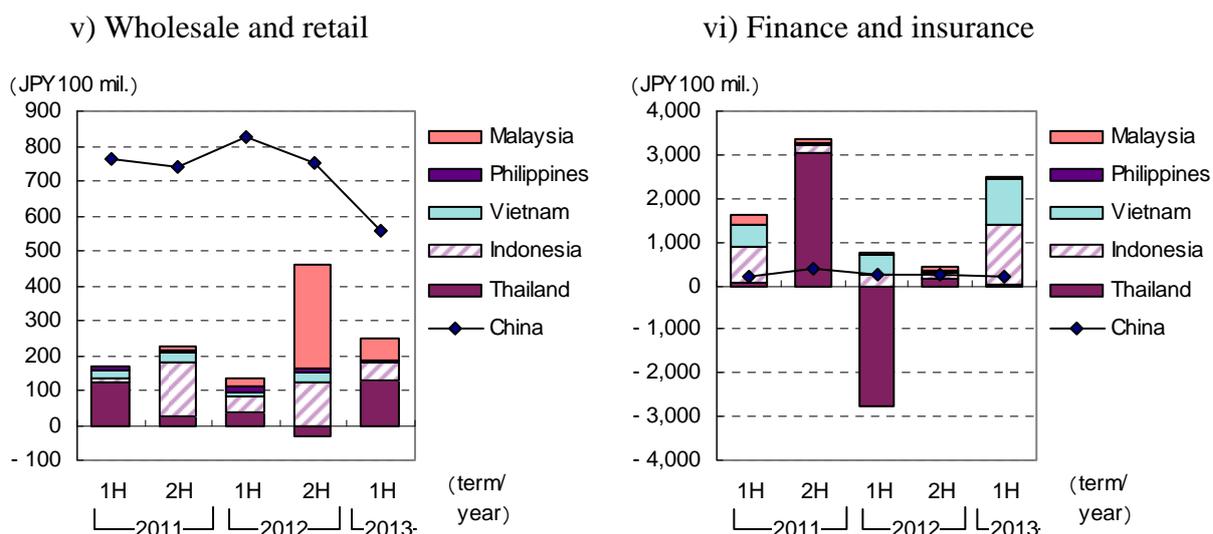
vi) Finance and insurance: More M&As in Indonesia and Vietnam

In finance and insurance, investments in ASEAN countries are increasing rapidly in the form of Japanese subsidiaries conducting mergers and acquisitions with local companies. There have been significant investments in Indonesia, which has the largest

population and economy among ASEAN countries, and in Vietnam, which now welcomes foreign finance and insurance investors based on the government's policy of strengthening capital in the country's finance and insurance sector.

In summary, in the manufacturing industry, precision instruments and electrical machinery have seen a significant shift from China to ASEAN countries – Thailand and Vietnam in particular. In the case of electrical machinery, investments are also heading towards the Philippines. With transportation equipment, Indonesia has also become an emerging presence in addition to China, which is an auto market on par with the United States, and Thailand, where the Japanese automotive industry has already concentrated its business.

Chart 14: Japanese investments in China and ASEAN by business type (nonmanufacturing industry)



Note: The sudden increase and decrease in Thailand in the second half of 2011 and first half of 2012 are probably due to flood-related transactions.

Source: Bank of Japan "Balance of Payments"

In the non-manufacturing industry, wholesale and retail businesses are eyeing Malaysia, Thailand, and Indonesia as promising consumer markets, though investments are no way near the size of those in China. With finance and insurance, while investments in China remain at low levels, they have been increasing significantly in Indonesia and Vietnam.

4. Points of focus for future investments in China and ASEAN countries

As seen so far, Japanese companies have been shifting their investments in Asia from China to ASEAN countries since the second half of 2012, and this trend seems to be particularly prominent with SMEs. But as seen in the survey results that 70% of large companies are willing to continue investments in China, the importance of China as a market has certainly not been lost. Therefore, this final segment will assess the points of focus for investment trends in the future.

(1) Will sales recover for China-based subsidiaries?

When trying to decide whether or not to increase investments in the future, the first thing to note is the performance of local subsidiaries. Obviously, investments will tend to increase if sales are looking up, and decrease if sales are declining. The Japanese Ministry of Economy, Trade, and Industry's "Quarterly survey of overseas subsidiaries (of Japanese manufacturers)" showed that subsidiaries in China faced a sharp decrease in sales for the second half of 2012, and sales continued to decline in the first quarter (January to March) of 2013 due to the slowdown in China's growth rate and consumers boycotting Japanese products after anti-Japan protests. Though the decline bottomed out in the second quarter (April to June) of 2013, sales have not returned to the levels of the first half of 2012 (**Chart 15**).

By business type, transportation equipment (mainly the automotive industry) accounts for the largest share, or roughly 50% of the total sales of China-based subsidiaries. Since tens of thousands of parts go into just one car, the automotive industry has a broad base of supporting industries, and the sector has a major impact on the total sales for China. The increase in car sales at the beginning of 2013 appears to have contributed to the improvement in total sales in China, as Japanese car manufacturers expand their lineup with models specifically designed by local subsidiaries in an effort to recover their business in China. However, sales have not yet reached the 20% mark³, the Japanese market share before the anti-Japan protests, and whether or not this share will be regained is a point of focus.

Meanwhile, the ASEAN-based subsidiaries have been increasing their sales since the second half of 2011, exceeding the sales of China-based subsidiaries by the second half of 2012, showing that ASEAN countries are making up for the drop in China. With the ASEAN-based subsidiaries, transportation equipment accounts for roughly 70% of total

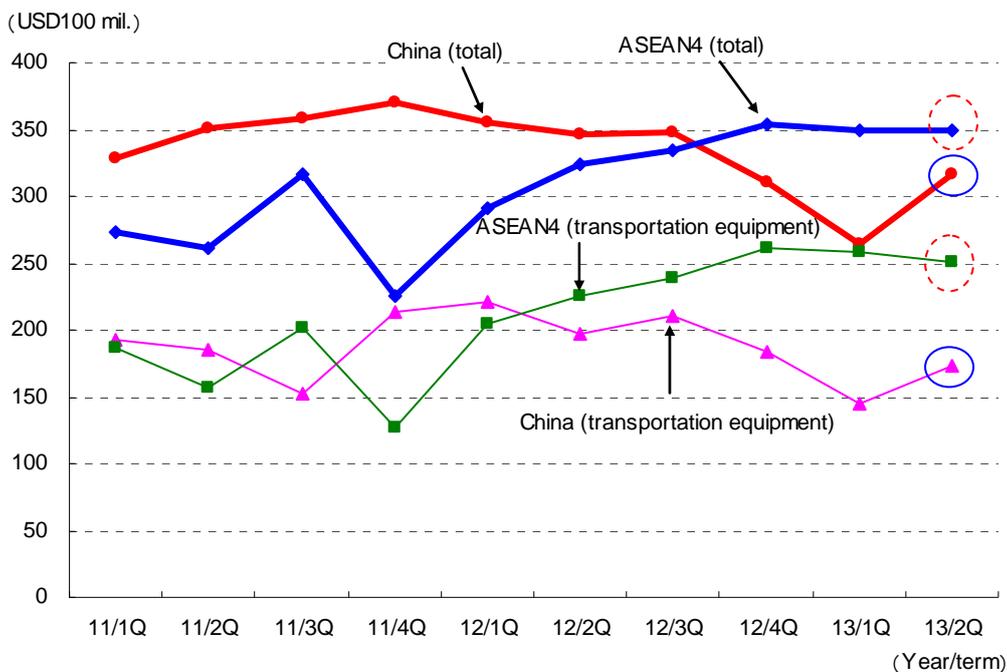
³ According to the China Association of Automobile Manufacturers, the Japanese market share of car sales recovered to 17.5% in September 2013 from 7.6% of October 2012.

sales, showing that they have a higher dependence on the automotive industry than the China-based subsidiaries. Strong car sales in Thailand and Indonesia appear to have helped increase the total sales in 2012.

Then again, it should also be noted that sluggish car sales in 2013 – in Thailand because the government’s sales incentive ended in 2012, and in Indonesia because inflation rates have prompted car loan rates to rise – have led to stagnating sales for local subsidiaries.

Nevertheless, Japanese cars continue to occupy an extremely high market share of roughly 80% in ASEAN countries, and since Japanese manufacturers lead in the introduction of fuel-efficient, low-price cars, they will very likely continue to retain their superior position in the business.

Chart 15: Sales of local subsidiaries (sales in the country of residence)



Note: ASEAN4 refers to Thailand, Indonesia, Philippines, and Malaysia.

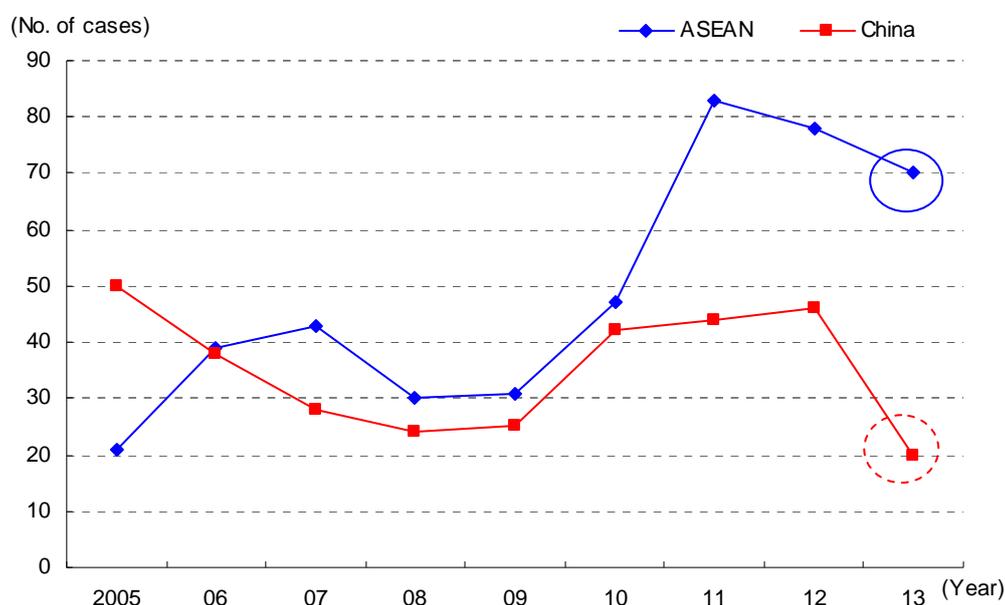
Source: Ministry of Economy, Trade and Industry “Quarterly survey of overseas subsidiaries”

(2) Use of M&A strategies to help gain a foothold in the ASEAN market

The use of M&A strategies could be an effective method for Japanese companies to accelerate their businesses in China and ASEAN countries. Recent trends show that while the number of M&A deals in China is dropping, the number of deals in ASEAN countries remains high (Chart 16), particularly in food/daily commodities and finance/insurance projects, anticipating greater domestic demand accompanying rising

income levels. At the moment, ASEAN countries are highly dependent on the automotive industry, but M&As in a wide range of businesses could boost the sales of local subsidiaries further. Meanwhile, it is said that during the 2000s foreign investors in China used to prefer full ownership to secure their control over management, but in the 2010s they have started to partner with Chinese companies to gain a foothold in the Chinese domestic market. Considering the tensions between Japan and China, the choice to have Chinese partners may also have gained importance in terms of hedging risks. Thus, M&As could be an effective strategic tool to strengthen partnerships.

Chart 16: Number of Japanese M&As in China and ASEAN



Notes: 1. ASEAN refers to 10 countries.
 2. The figures for 2013 are up to October 2013.
 Source: RECOF "M&A database"

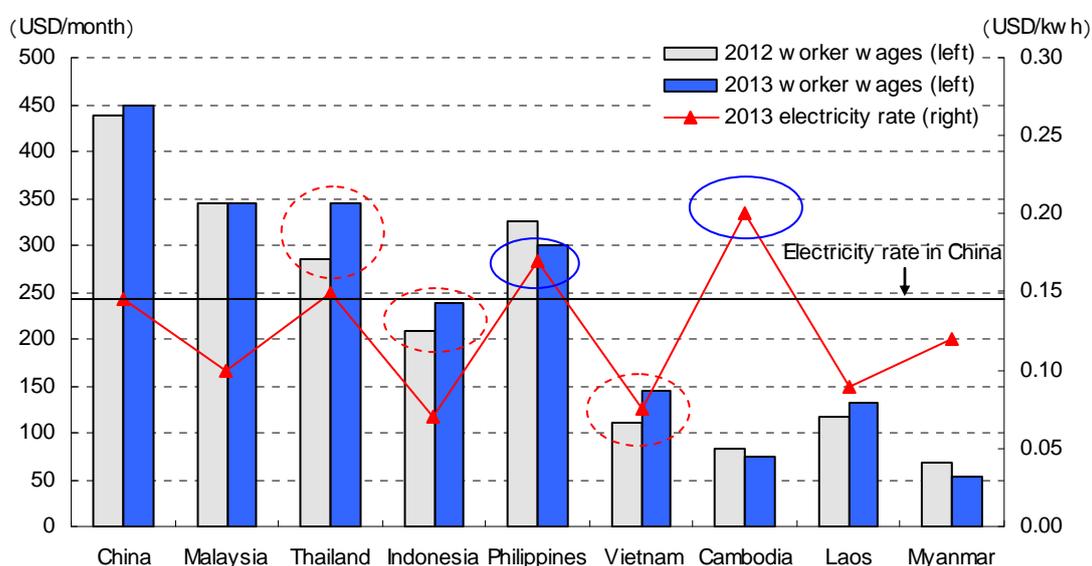
(3) Will ASEAN countries be able to absorb rising labor costs?

One of the circumstances that have prompted the shift from China to ASEAN countries is the continuing double-digit increase in labor costs in China. However, though worker wages in China are certainly higher than in the ASEAN economies (**Chart 17**), they are also on the rise in Thailand, Indonesia, and Vietnam. It should be noted that labor costs in all ASEAN countries are increasing, as they are in China.

An effective way to absorb rising labor costs with increased productivity would be to bring in machinery and equipment as well as advanced products. A key element here

would be the ability to secure a stable source of low-priced electricity. According to the Global Competitiveness Report (published each year by World Economic Forum⁴) of 2013, only Malaysia and Thailand among the ASEAN5 are better than China in terms of providing electricity. Electricity costs in the Philippines (and Cambodia) are higher than in China, while in Indonesia and Vietnam (and Myanmar), government support that had kept electricity costs down has been cut to improve state finances, and electricity costs are subsequently beginning to rise. In ASEAN countries, it is necessary to consider electricity and other infrastructure conditions as well as wage levels to assess the feasibility of increasing productivity and decide whether or not to make investments.

Chart 17: Worker wages and industrial electricity rates in China and ASEAN



Note: Figures are for Shanghai in China and the capital cities for the other countries for 2012 and the beginning of 2013.

Source: JETRO “Comparison of major cities in Asia and investment-related costs”

⁴ The World Economic Forum holds the Davos meeting every year in Switzerland.