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# urrent and Future Investment Outlook in Asia

## Asian economic trends and Japanese direct investment

The Asian economy has shown continued strong growth since 1993. Real-term growth rate for 11 Asian countries, including NIEs, ASEAN, China, India and Vietnam, has been high, rising from 5.8% in 1991 to 7.6% in 1992; to 7.9% in 1993; and to 7.8% in 1994. For 1995, we expect another year of high growth (approximately 7.4%), led mainly by strong exports, although moderately lower than the previous year due to stagnating growth in China.

Having sought export-led industrialization, due to the entry of Japanese companies reflecting a stronger yen against the dollar following the Plaza Agreement in 1985 and a sharp rise in exports to Japan and the U.S., NIEs have entered an era of unprecedentedly high growth. NIE real economic growth reached 11.2% in 1986, and 12.1% in 1987. Having achieved industrialization through direct investment of Japan and the U.S., NIEs joined the investors club after 1988 and, together with Japan, boosted direct investments to ASEAN countries.

As a result, ASEAN countries have achieved high economic growth, record-

ing a stronger growth than NIEs from 1989 to 1994, with the exception of 1991. The Chinese economy, on the other hand, became stagnant after the Tiananmen Square incident in 1989, but showed signs of recovery in 1991. The previous high growth trend resumed following the proposal issued by Deng Xiaoping in the spring of 1992 for the further acceleration of China's economic development. Investments in China rose sharply, mainly by overseas Chinese and Chinese-owned corporations, generating a new stream in the Asian economy.

From 1986 to 1993, the Asian economy grew by an annual average of 8.5%. Described as a flying pattern of geese,

the lead has changed hands, starting with the NIEs, which achieved an average annual growth of 10.9% from 1986 to 1988, followed by ASEAN countries recording an average 8.4% growth from 1988 to 1990, and then by China with an average 11.6% from 1991 to 1993. Through these changes, the Asian economy as a whole firmly established itself as the "growth center of the world" (Chart 1).

Japan's direct overseas investment, since peaking at \$67.54 billion in fiscal 1989, has fallen continually to \$34.14 billion in fiscal 1992 (through March 1993). These declines were due to both a deteriorated corporate earnings envi-



Photo: Kyodo News Service



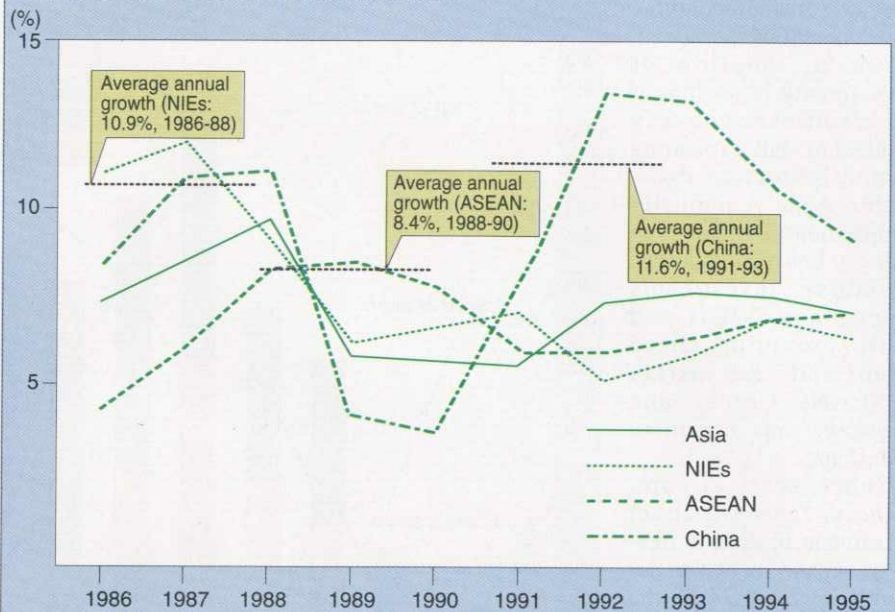
ronment and depressed sentiment for investments since the bursting of the bubble, and a virtual completion of the first-round of establishing overseas production bases which began in 1986 following the high appreciation of the yen. Japanese overseas investments finally picked up 5.5% year-on-year to \$36.03 billion in fiscal 1993, but this figure still only represents 53% of the fiscal 1989 peak (Chart 2).

Accordingly, Japan's direct investments in Asia also fell two years in a row from a peak of \$8.24 billion in fiscal 1989. Fiscal 1992 saw an upturn, with \$6.64 billion being reached in fiscal 1993. The Asian share of Japan's total direct overseas investments rose from 12.2% in fiscal 1989 to 18.4% in fiscal 1993. In the first half of fiscal 1994, the figure rose further to 21.5% (Chart 3).

The main characteristic of Japanese investments in Asia lies in a considerably high proportion of manufacturing industries compared to other regions, with the tendency intensifying in recent years. In fiscal 1993, investments by manufacturers accounted for 55.1%, or \$3.7 billion, of the total direct overseas investments. Compared to North America and Europe, Asia exceeded Europe in value in fiscal 1991, although still falling \$4.15 billion behind North America in value.

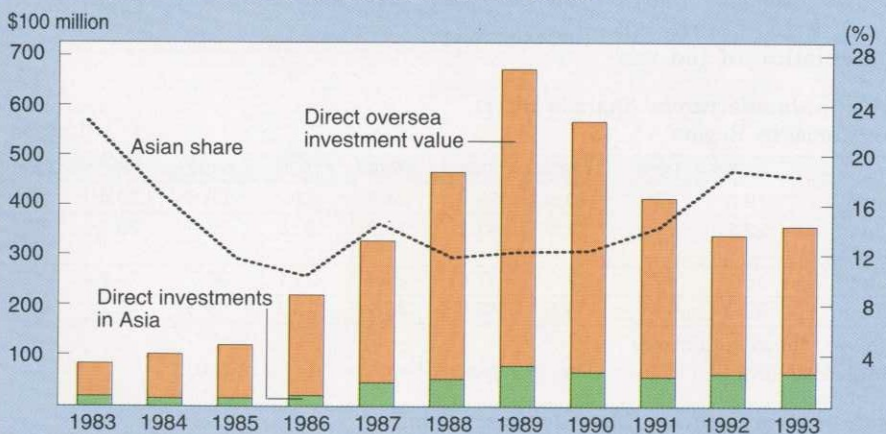
Manufacturers accounted for only 27.1% and 25.7% respectively in Japanese direct investment in North America and Europe in fiscal 1993, suggesting strong inclinations toward Asia among Japanese manufactures (Table 1). Manufacturers' motivations for direct investment can be classified into several categories: avoidance of trade friction or trade policy pressures, such as dumping charges, by starting local production; having products reflect local needs by producing in direct access to local markets; and reduction of labor costs to reduce overall production costs. As the continual appreciation of the yen has made Japanese wages extremely high compared to international standards, Japanese manufacturers, especially those in labor intensive industries, have

Chart 1: Asian Economic Growth Rates



Source: World Tables, IFS, statistics in each country. Estimates for 1994 and 1995 from Sakura Sogo Kenkyusho (Sakura Institute of Research).

Chart 2: Japanese Direct Overseas Investment Trends



Source: Ministry of Finance

turned to cheaper labor and begun producing in developing Asian nations.

Looking at investment value by destination since fiscal 1985, NIEs held the highest share until fiscal 1988, when ASEAN nations took over, later to be surpassed by China in fiscal 1992. In fiscal 1993 China and ASEAN nations came in neck-and-neck, with the former receiving \$1.38 billion and the latter \$1.47 billion. These shifts have closely

coincided with the high growth period of each region, providing evidence of the fact that in the developing Asian economy, Japanese manufactures have expanded to those countries in their search for cheap labor (Table 2).

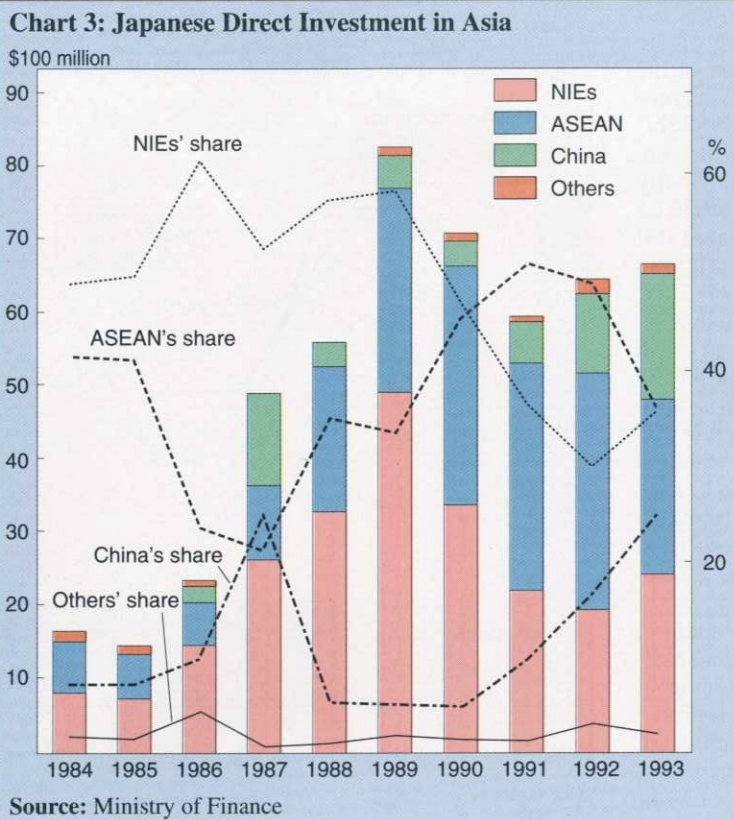
## Outlook for direct investment in Asia

Japan is the largest investor in Asia



and has played a significant role in the economic development of the region. However, the flow of investments is no longer the traditional one-way southward, but expanding to multi-direction flows within Asia. A mutually supplemental relation in industry between countries providing investments (Japan and NIEs) and those providing cheap labor and the market (ASEAN, China, and Vietnam) has begun to take shape.

Under such circumstances, Japanese direct investment in Asia is likely to expand in two major trends. One would be the setting up of local production sites in Asia, shifting away from ASEAN nations to China and Vietnam. Although it takes some time before an appreciation of the yen



actually results in higher direct investment, given the continuing strength of the yen since 1993 direct investments in Asia are almost certain to grow. While total Japanese direct overseas investment in the first half of fiscal 1994 rose 8.3% from the previous year to \$17 billion, those directed to Asia rose 24.3%, showing a sign of surge.

The other trend is a likely intensification in existing facility expansion in NIEs and ASEAN countries, in parallel to continued investments in China and Vietnam. Although the local content ratio of Japanese companies is already relatively high, due to the recent strength of the yen, making imports from Japan more expensive, local content ratios are likely to rise. Although facility

expansion financed by either internal capital or bank loans are not included in direct overseas investment statistics, production in NIEs and ASEAN countries by Japanese companies is likely to continue vigorously.

Currently the main motivation behind Japanese companies expansion into Asia is shifting from securing labor and avoiding currency risks to one of securing and expanding local and neighboring markets of the country they have invested in, as well as responding to customer expansion in those areas. Thus, the development of the local economy must become the main factor for Japanese companies to expand their market and direct investments in Asia.

(Moriguchi Shigeru, senior economist)

**Table 1: Manufacturers' Share in Direct Investment by Region**

	1985	1986	1987	1988	1989	1990	1991	1992	1993
World	19.2	17.1	23.5	29.4	24.1	27.2	29.6	29.4	30.1
North America	22.2	21.1	31.5	41.1	28.3	25.0	31.2	28.7	27.1
Europe	16.7	10.7	12.9	17.0	20.9	32.1	28.7	29.8	25.7
Asia	32.0	34.6	34.5	42.6	39.1	43.5	49.3	48.3	55.1

Source: Ministry of Finance

Notes: Manufacturing industry share of Japanese direct overseas investment.

**Table 2: Manufacturers' Direct Investment and Share in Asia by Region**

	1985	1986	1987	1988	1989	1990	1991	1992	1993
NIEs	257	498	887	775	1,343	821	641	474	736
	55.9	62.0	52.8	32.7	41.7	26.8	21.9	15.3	20.1
ASEAN	166	193	704	1,360	1,553	2,028	1,945	1,808	1,474
	36.2	24.0	41.9	57.4	48.2	66.1	66.4	58.2	40.3
China	22	23	70	203	206	161	309	650	1,377
	4.8	2.8	4.2	8.5	6.4	5.2	10.5	20.9	37.6
Asia	459	804	1,679	2,370	3,220	3,068	2,928	3,104	3,659
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: Upper scale: Amount of direct investment; Lower scale: Share

Source: Ministry of Finance

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