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Topics South Korean corporate investment in Indonesia gaining momentum

Recent years have seen the invigoration of South Korean corporate investment in Indonesia. Some of the reasons for this are, besides a more settled political situation, an expanded middle class as the result of sustained economic growth, and the growing allure of Indonesian markets

■ Investment in Indonesia growing

Korean businesses have accelerated the pace of their global business expansion since the start of the 2000s, through export and local production. They have paid particular attention to the emerging markets with their growing demand. In terms of export destinations, from the 1990s onwards, the portion of exports destined for the industrialized nations has declined, while that destined for China and other Asian markets has climbed, with substantial growth reported in recent years in exports to newly emerging economies other than Asia. Still, in terms of direct outward investment, China and the US are the main investment targets, but emerging markets such as former east European bloc countries, Brazil, Vietnam and Indonesia are already appearing among the top ranks.

Korea's domestic market is small (GDP is approx. 1/5 of Japan's), and is expected to contract further in the years ahead as the population ages rapidly. For these reasons, it is essential that corporations open up new markets if they are to grow. This has been the major reason that Korea has pushed ahead of Japan with its own globalization.

As Korean businesses work aggressively to open up markets in the newly emerging economies, investments in Indonesia have increased steadily in recent years. According to statistics provided by The Export-Import Bank of Korea, Korean enterprises' direct investment in Indonesia grew from $330 million in 2009 to $870 million in 2010, with Indonesia becoming Korea's 8th largest investment destination, ahead of Vietnam. Also, statistics released by Indonesia's Investment Coordination Bureau show that in 2010 Korea became Indonesia's 9th largest investor nation, rising to 5th place in the period January to June, 2011.

＜South Korea's Investment Destination＞

(million $)

2008		2009		2010	
Country	Value	Country	Value	Country	Value
US	5,134	US	3,560	US	3,290
China	3,816	Canada	2,420	UK	3,280
Hong Kong	2,543	China	2,084	China	3,167
Vietnam	1,363	UK	1,680	Malaysia	1,555
Kazakstan	822	Hong Kong	1,565	Hong Kong	1,262
Netherlands	673	Netherlands	1,023	Canada	1,210
Australia	580	Vietnam	590	Brazil	1,054
Singapore	553	Ireland	518	Indonesia	874
Bermuda	535	Russia	426	Vietnam	832
Indonesia	529	Cayman Islands	406	Germany	757

Source: Korea Eximbank, Foreign Investment Statistics

What is noteworthy is that interest in Indonesia is growing among Japanese businesses also. The Survey Report on Overseas Business Operations by Japanese Manufacturing Companies, issued annually by the Japan Bank for International Cooperation, reports that Indonesia's ranking as a mid term (over the next three years or so) promising country for overseas business development rose from 8th in 2009 (10.8% of votes) to 6th (20.7%) in 2010.

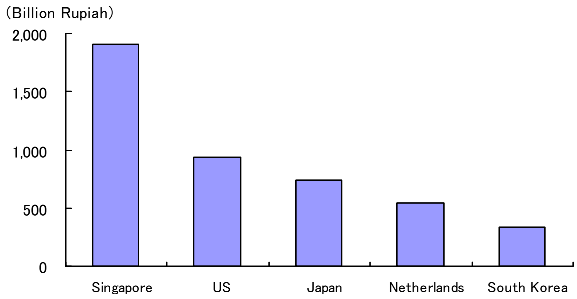
■ Market allure increases as economy posts stable growth

Besides the fact that the feared political instability in the wake of the collapse of the Suharto administration failed to materialize, the three main factors behind the growing interest in Indonesia are as follows.

First, sustained economic growth has increased Indonesia's attractiveness as a market with a 230 million strong population. Even in 2009, while many Asian economies were experiencing slowdowns as a result of the effects of the global financial crisis, Indonesia's GDP grew 4.5%. In comparison with Malaysia and Thailand, Indonesia's export dependence (export value/ GDP) is low and domestic demand is growing at a steady pace, making the economy much less vulnerable to the effects of global economic fluctuation. Since Q1, January to March, 2010, the economy has continued to grow in the 5 to 6% range, and in 2010 Indonesia's per capita nominal GDP exceeded $3,000. In addition to the expanding middle class, consumption has grown as a result of the development of consumer financing and falling interest rates due to inflationary controls (in comparison with the rampant inflation of 2008).

Second, Indonesia is being reconsidered as a production base. In recent years, due to increased wage costs and insufficient manpower along China's coastal regions and in Vietnam, there has been a shift of production to Indonesia in labor intensive industries such as footwear and clothing.

＜Foreign Direct Investment Realization(2011 1st Half)＞



Source: Indonenesia Investment Coordination Board

Third, rises in the prices of primary products have led to increased incomes in agricultural communities. Indonesia is becoming a net importer of crude oil, but rises in the prices of other major export items, such as natural gas, natural rubber, coal, and palm oil, have contributed to increased incomes. This in turn has raised the purchasing power of agricultural communities. Increased purchasing power in the agricultural communities, in addition to the urban section, has resulted in a swift expansion in sales of automobiles and mobile telephones, for example. In fact, the sales of automobiles in 2010 grew 57%, compared to the previous year, to 764,000 vehicles. Additionally, many new foreign owned and domestic convenience stores have opened up.

Recent trends among Korean businesses show a conspicuous increase in business developments in response to growing local demand. While Korea's presence in the automobile market is relatively weak, LG Electronics and Samsung have cornered the lion's share of the household electrical appliances market, thanks to reasonable pricing, a rich product lineup that meets local needs, and brand growth through aggressive advertising.

The Lotte Group has undertaken some very pro-active business development of late. With stakes in Indonesia's supermarket (buying out the Dutch Makro chain) and membership system wholesale businesses, the Lotte Group plans to open its Indonesia 1st Store in 2012. In addition, group company Honam Petrochemical is planning to move into the petrochemical field.

Responding to the growth in the household appliance and automobile markets, POSCO has embarked upon the construction of an integrated steel mill with Indonesia`s national steel company, Krakatau Steel. POSCO is also planning the construction of another integrated steel mill in India, and is taking the initiative in the field in Asia. In addition, there are reports of banks and securities companies considering venturing into Indonesia.

■ Korean government also positive on economic cooperation

One of the biggest hindrances to Indonesia's achievement of sustainable growth is the poor development of its infrastructure. The government plans to utilize private sector capital to advance the development of rail and road transportation networks and electrical power and other forms of energy, as well as developing its land expropriation system.

In addition, the Korean government is working to strengthen ties with the Indonesian government. When South Korean President Lee Myung-bak visited Indonesia in December, 2010, President Yudhoyono requested that South Korea participate in Indonesia's economic development plan as a main partner. Also, discussions have recently begun on the completion of a comprehensive economic collaboration agreement. In addition to supporting Indonesia's economic development through economic cooperation, the Korean government's policy is to strengthen government and private sector cooperation in order to win orders for business.

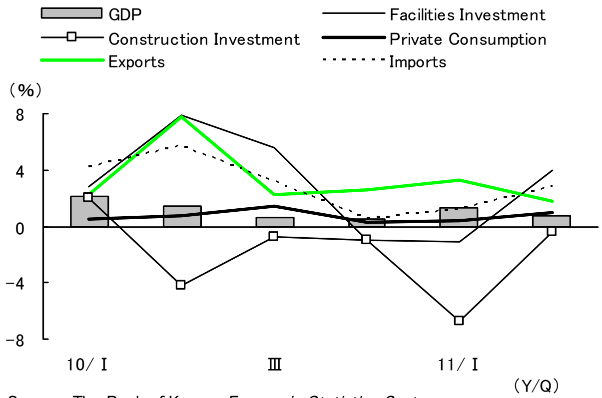
As Japanese businesses set their sights on growing demand in the emerging markets, they would do well to keep careful watch on the activities of their Korean counterparts. **(Hidehiko Mukoyama)**

Korea *Economy slows gradually, while inflation picks up the pace*

■ Korea's economic growth for Q2 falls below Q1 at 0.8%

Korea's real GDP growth rate for the period April to June (flash report) was 0.8% compared to the previous period, down from 1.3% for the first quarter, January to March (with similar figures in the previous year falling from 4.2% to 3.4%). Facilities investment grew 4.0%, exports 1.8% and private consumption 1.0%, while construction investment growth was minus 0.4%. Construction investment has grown negatively for five consecutive quarters, indicating that the real estate market is still in the doldrums. Industry by industry, construction could only manage a wafer thin 0.3% growth, while real estate and leasing grew minus 0.3%. This was because the number of real estate transactions decreased again, following the end of the partial relaxation of real estate financing restrictions at the end of March.

＜Growth Rates of Korea's GDP（QoQ)＞



Source: The Bank of Korea, *Economic Statistics System*

Also, gross domestic income was down 0.1%, due to the deterioration in income terms of trade following the increase in prices of primary commodities, posting negative growth for the second consecutive quarter (with similar figures in the previous year falling from 1.9% to 0.4%), and the possibility is that consumption will be restrained in the months ahead.

Additionally, the consumer price index increase rate (compared to the same period in the previous year) for July rose to 4.7% from 4.4% in June. Besides a 10% increase in commodity prices for food and drink, heat, and lighting costs went up 5.2%, and transportation 7.3%, against the backdrop of swiftly rising crude oil prices and increased public utility charges.

■ Increasing delinquency rate on housing loans

The effects of the worsening real estate market had already made themselves apparent in the collapse of construction companies and savings banks distress, and are now affecting household budgets. With the recent increase in housing loans, Korea's household debt levels are high by international standards. However, in Korea many loans are short term variable interest types, repaid in a lump-sum at the end of term, so there is a growing concern that the cumulative effects of 1) falling house prices, 2) falling incomes and 3) rising interest rates, such as is the situation today, may result in more delinquencies. The banks' ratios (as of the end of June), show that the delinquency rate on corporate loans was lower than in the previous month, as loans were sold off to bad banks, but that the lump-sum repayment type housing loan delinquency rate rose rapidly from 1.15% in April to 1.88% in June.

The Financial Services Commission announced its Comprehensive Measures on Household Debt on June 29. The initiative is comprised of 1) measures to keep household debt growth at a manageable pace, 2) measures to enhance the soundness of household debt, 3) measures to strengthen consumer protection, and 4) measures to ensure low-income households' access to loans. With regard to the measures to enhance the soundness of household debt, there will be increased tax deductions for interest repayments on a fixed rate with no delay in repayment of principal, and greater income deductions to promote the use of debit cards over credit cards.

Since the inflation rate is above target (3±1%) and it will be necessary to curb expected inflation, there is every possibility that there will be further interest rate hikes ahead. As the situation surrounding household debt is already very severe, attention will need to be paid to future developments in this field.

(Hidehiko Mukoyama)

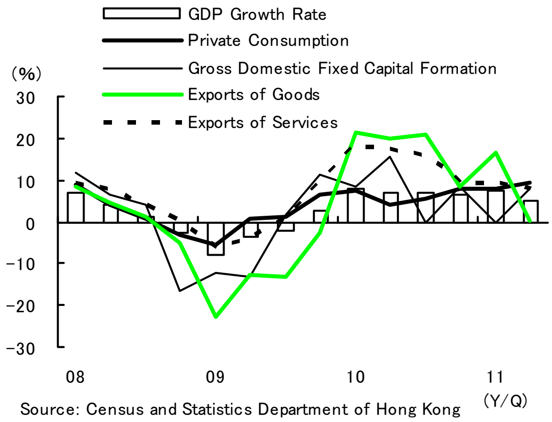
Hong Kong *External demand slows while domestic demand grows*

■ Domestic demand continues to expand

Hong Kong's real GDP for the second quarter, April to June, 2011, was 5.1% compared to the same period in the previous year, down from 7.5%, in the first quarter, January to March (minus 0.5% on previous quarter).

In terms of external demand, exports of capital goods in the April to June time frame felt the effects of economic deceleration in Europe, the US and China, and year on year growth was a mere 0.3%, well down on 16.8% growth in the first quarter (minus 11.1% on the previous quarter). The failure of trade related services to grow meant that service exports also lost some momentum, posting 7.8% growth (up 1.0% on the previous period).

＜Real GDP Growth Rate (YoY)＞



Source: Census and Statistics Department of Hong Kong

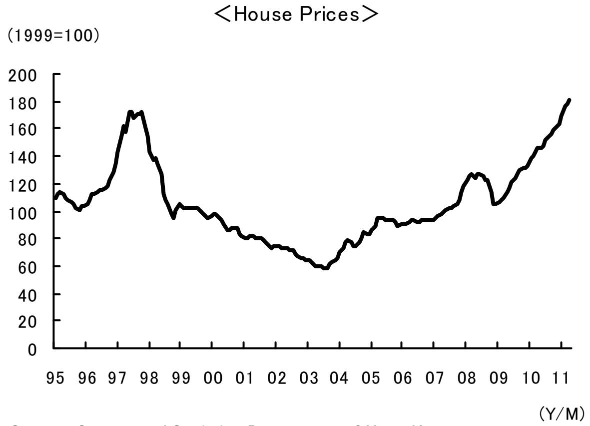
As for domestic demand, private consumption grew 9.2% in the second quarter, compared to the same period in the previous year, continuing to grow strongly from 8.0% year on year growth in the first quarter (up 2.3% on the previous period). Exceeding by high house prices and rising wages pushed private consumption up. Housing prices have exceeded even 1997 levels (figure lower right). Total fixed capital formation, encouraged by lower interest rates, grew 8.1%, moving to positive growth from minus 0.3% year on year growth in the first quarter.

The unemployment rate reflected the slowdown in external demand and rose to 3.5 in the April to June time frame, up 0.1 point from January to March.

■ Stability needed in housing prices

Rising housing prices have the positive side of pushing domestic demand up. But they also have a negative side. That is the increased burden placed on those who are planning to purchase homes. Moreover, there is the increased risk of a sudden drop in real estate prices.

＜House Prices＞



Source: Census and Statistics Department of Hong Kong

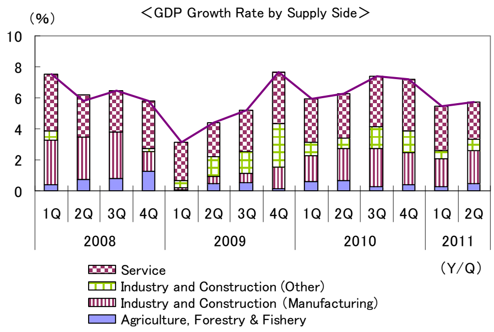
The Hong Kong government is working to stabilize housing prices. In November, 2010, the stamp duty levied on house purchases and sales was increased. Also, the government is promoting the sale of government owned land. According to the budget proposal for 2011 to 2012, the government planned to put four housing sites from its land planning schedule up for public sale within 2011. At the same time, in order to enable the construction of some 3,000 new small and medium sized homes, five housing sites outside of the land planning schedule will be put up for auction. The available supply of government owned land for housing has increased by 18 sites, from the original 34 sites to 52 sites in 2011. These housing sites will allow the construction of 16,000 homes, 1.7 times the amount in fiscal 2010 to 2011.

Nevertheless, judging from the details of the 2010 to 2011 budget proposal, the measures described above may be considered insufficient in terms of curbing the rise of housing prices. The 2010 to 2011 budget proposal called for increasing the 2010 housing supply to 14,260 units, twice that of 2009. Thus, although the total area of government owned land put up for sale was twice that of the previous year, it failed to brake the rise in housing prices. From the perspective of sustainable growth in domestic expansion also, further restraint measures are expected. **(Shinichi Seki)**

Vietnam *High commodity prices and weak dong*

■ Domestic demand stagnates as commodity prices rise

According to the Vietnam General Statistical Office, the real GDP growth rate for the period April to June was 5.7%, compared to the same period in the previous year, a slight improvement on the 5.4% growth posted for January to March. In terms of supply item contribution, though the service industry slipped from 2.8% points to 2.4% points, agriculture, forestry and fisheries increased from 0.3% points to 0.5% points, industrial and construction (manufacturing) from 1.8% points to 2.1% points and industrial and construction (non-manufacturing) from 0.5% points to 0.7% points.



Source: CEIC

The mining and manufacturing production index for the period January to July was up 8.8% compared to the same period in the previous year. While mining could only manage a wafer thin 1.7% growth, manufacturing delivered a very robust performance, posting 11.9% growth in the same period. In terms of individual product items, electronic cables and automobiles both fell, to minus 20.4% and minus 3.7%, respectively, as a result of the effects of Japan's Tohoku earthquake and tsunami, but major items such as textiles (+18.2%), footwear (+13.5%), marine produce (+8.5%), and other export related items, all performed strongly.

Meanwhile, commodity prices have continued to rise since the end of last year, and private consumption is in a clear slump. The consumer price index increase rate for July was 1.2% up on the previous month, up 22.2% compared to the same period in the previous year. In addition to rice, the nation's staple, prices have been rising across a wide range of commodities. This is having a sever impact on the lives of low income families. The total retail value of consumer goods and services in the period January to July was up 22.5%, compared to the same period in the previous year, on a nominal basis, but when the value of commodity price increases is subtracted, this figure is 4.6% on an actual basis. This is an unheard of low, since the actual total retail value of consumer goods and services did not fall below 5% even in the days of the currency crisis of 1997.

■ Wavering faith in dong

The new government and parliamentary leadership were consolidated after obtaining national assembly approval in late July. Trương Tấn Sang elected to the position of president, having previously served as a senior member of the politburo. Nguyễn Sinh Hùng, formerly deputy prime minister, is the new chairman of the national assembly. Nguyễn Tấn Dũng stays on as prime minister.

The most pressing matter facing the new team is the question of restraining commodity prices. Although Central Bank has adopted the stance of reinforcing its tight financial policy, some in government are already voicing the opinion that it will be difficult to restrain price rises to within the target 17%. If commodity prices continue to rise, the possibility is high that the dong will weaken at a more rapid pace. Though July's balance of trade was a $1.03 billion surplus, this was a temporary phenomenon occasioned by increased gold exports, and it is expected that the latter half of the year will see the trade deficit expand once more, along with greater dollar demand. In August, Central Bank announced that it was reducing the dong – dollar exchange rate fluctuation range from the earlier ±3% to ±1%. Dong interest rates are at high levels as a result of Vietnam's tight monetary policy, leading more and more businesses to take out dollar-based loans at lower interest rates. The aim of reducing the exchange rate fluctuation range appears to be to try to put the brakes on dollar-based financing, but the move seems to be having the effect of increasing the demand for gold.

As long as commodity prices continue to rise, faith in the dong will fall and the demand for dollars and gold will rise. This will very likely cause financial policy to fail to function and lead to a contraction in individual consumption and investment, which have previously been drivers of the economy. If the new cabinet is to dispel these concerns, commodity price increase restraint measures will need to be fully mobilized.

(Yuji Miura)

India Concern over economic deceleration as inflation stays high

■ Inflation stuck at a high level

India's wholesale price index (WPI), after reaching 8.7% in January, 2010, compared to the same month in the previous year, has continued at over 8% since then, and has been in the 9% range since December, 2010, until July of this year. The causes include rises in international commodity prices and a strengthening domestic demand, with the overall growth rate being heightened by the rising prices of primary products and fuels.

Among primary products, prices of food products are considerably lower in comparison with the high level during the early part of 2010, which reflected the poor agricultural production at that time. Nevertheless, they are still high. The proportion of personal consumption accounted for by food products has fallen as the economy has developed. However, if high protein foods are considered in isolation, the proportion is rising, and the prices remain high due to their limited supply. The increased consumption of high protein food products is a trend that can be witnessed both in urban and rural communities.

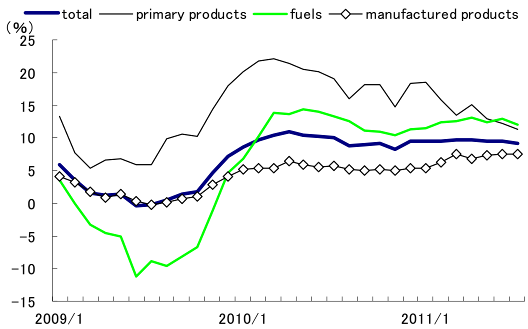
Also, the administered prices of domestic petroleum related products were raised in May and June, in response to crude oil price hikes, and this has affected increases in fuel prices. However, the raising of the administered prices in reflection of international prices may be judged to have been the right thing to do, since failure to do so could well have led to inflation in the form of increased government subsidies.

Further, reflecting increased domestic demand, increases in manufactured product prices have risen to the 7% level. This is a clear indication that companies are passing on soaring production costs to product prices.

With inflation high and refusing to come down, Reserve Bank of India decided in its July meeting to raise the repo rate by 0.5%. The repo rate was 9.0% just immediately prior to the Lehman Brothers shock, and was lowered after the shock to 4.75%. Since March, 2010, it has been rising step by step reaching 8.0% with this latest increase.

■ Outlooks for inflation and the economy

<Wholesale Price Index (YoY)>



Source: CEIC Database

Because inflation tends to discourage investment, thereby hindering mid-term economic growth, Reserve Bank has set inflation control as a priority issue, and as long as the inflation rate or the economic growth rate does not fall considerably, intends to continue with a tight monetary policy. With this latest interest rate hike, while the economic growth forecast for fiscal 2011 was kept unchanged at 8%, the inflation forecast for March, 2012, was raised from 6% to 7%.

Despite repeated interest rate hikes, the inflation rate refuses to come down and looks likely to stay at its current level for the foreseeable future, as there are many areas of concern. While the increases in the administered prices of petroleum related products may be insufficient, the crude oil prices may possibly rise. Also, the minimum reference prices of rice and other agricultural products have been raised sharply. Examination of the situation as it stands at the moment would suggest that it is going to be difficult to address inflation by means of monetary policy alone. The reduction of the fiscal deficit, which stands at roughly 5% of GDP, and the implementation of measures to relieve the supply bottleneck, such as agricultural reform and infrastructure development, will be essential.

As regards the domestic economy, given that real wages are rising and personal consumption is robust, that exports are growing strongly and that rainfall has been normal, there is not likely to be any major deceleration. However, as interest rates continue their upward drift, corporate business confidence continues to deteriorate, and manufacturing growth will very likely decelerate in the short term. Also, the increasing uncertainty with regard to the global economic and financial situation may very well exert a negative influence on India's economy. Reserve Bank's tight monetary stance will also need to take the economic climate into account. If export growth falls and the balance of current account deteriorates, the maintenance of capital inflows will also need to be considered.

(Satoshi Shimizu)