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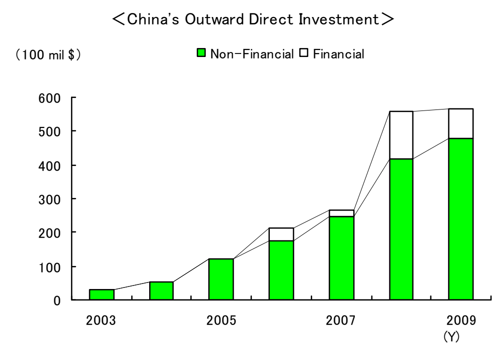
Topics China's outward direct investment continues to expand

China's outward investment has continued to grow since 2003, and the scale of investment now exceeds $50 billion. Given enterprises' drive for overseas investment amidst the rush to secure resources, and government incentive measures, it is likely that investments will continue to expand going forward.

■ Growth in outward direct investment maintained in 2009

On September 13, the Ministry of Commerce, National Bureau of Statistics, and State Administration of Foreign Exchange jointly issued the "2009 Statistical Bulletin of China's Outward Foreign Direct Investment" (hereafter Bulletin). The Bulletin makes it clear that China's enterprises have become more active in developing their business interests overseas.



Source: Ministry of Commerce, *2009 Statistical Bulletin of China's Outward Foreign Direct Investment*

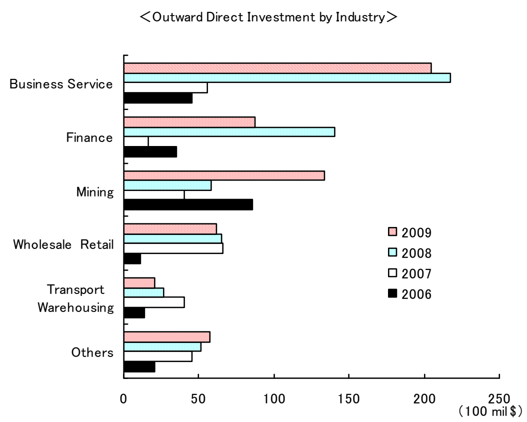
China's outward direct investment in 2009 was 1.1% up on the previous year, at $56.53 billion. While the global foreign direct investment total continues to contract, shrinking 42.9% in the same period, China's outward investment has been able to maintain growth, albeit very slight. The fall in the number of large scale investments caused investments in the financial sector to contract by 37.8% in the previous year, in terms of money amount, while investments in non-financial sectors grew 14.2%, similarly. Considering the fact that, in the first half of the year 2009, investments in the non-financial sector also fell drastically (down 51.7% on the same period in the previous year), it could be concluded that the impact of economic deterioration has been limited, and that Chinese enterprises' foreign investments are once again picking up the pace.

An examination of recent developments shows that, whereas the scale of outward direct investments was no more than 5% of that of inward direct investments in 2003, it had grown to around 60% by 2009. China is not only a recipient nation of direct investment, but has become one of the leading investor nations in the world (fifth place in 2009).

By country and region, investments in Hong Kong account for 63.0% of the total, number one for three consecutive years, followed by the Cayman Islands, Australia, Luxembourg, and the British Virgin Islands. In terms of the cumulative total also, the top spot is held by Hong Kong at 66.9% of the total, followed by the Virgin Islands, then the Cayman Islands, Australia and Singapore. Although a noticeable amount of these investments have been directed at Hong Kong and tax havens, it is significant that Australia has been able to fill a place as a major investment destination.

■ Powerful Chinese firms focus on securing foreign resources and technology

In terms of industry, despite a slight contraction from the previous year, business services maintained their lead with $20.47 billion (36.2% of 2009's total investments). With regard to business services, the Bulletin explains that these were principally investments for the purposes of obtaining shares.



Source: Ministry of Commerce, *2009 Statistical Bulletin of China's Outward Foreign Direct Investment*

Other points attracting attention include the fact that mining, at $13.34 billion, has risen to the number two spot in terms of investment amount, beating finance, and wholesale and retail (including trade enterprises). 2009's investment amount was the highest ever for mining, and the industry has attracted attention by being able to maintain a high level of investment of over $4 billion annually since 2006. These data suggest that the expansion in resources related investments is no transitory phenomenon. In addition, the Bulletin gives only percentages of cumulative totals, but 85.9% of outward direct investment in Australia was in mining. Investments in other major destinations, in contrast, have tended to focus on business services and finance.

From various recent press reports, trends in Chinese firms' takeovers of foreign firms could be grouped according to the following two characterizations. First, there are positive initiatives geared towards the securing of important resources. By increasing the number of corporate takeovers and investment ratios in Australia, North America, and Europe, China's stance appears to be one of attempting to secure the procurement of resources from around the world. In addition to energy resources such as petroleum and natural gas, there have been positive efforts to secure iron ore and other mineral resources.

＜Major Overseas Investment Trends among Chinese Enterprises ＞

(since 2009)

Company	Outline
Shandong Ruyi Science & Technology Group Co., Ltd. (apparel)	Recipient of Renown's allocation of new shares to a third party, making them the largest shareholder. In addition to a capital tie-up, Renown has also concluded a business tie-up.
Zhejiang Geely Holding Group (automobiles)	Bought Drivetrain Systems International Pty Ltd (Australian manufacturer of transmission systems)
	Bought Volvo Cars from Ford.
BYD Company Limited (automobiles, batteries, etc.)	Bought Ogihara Corporation's Tatebayashi plant.
Petro China Company Limited (petroleum)	Bought Arrow Energy (Australian natural resources company), jointly with Royal Dutch Shell
China Petrochemical Corporation (Sinopec) (petroleum)	Purchased shares in Brazilian subsidiary of Repsol (Spanish petroleum company)

Source: JETRO, *2010 Global Trade and Investment Report*

Second, there is the acquisition of foreign firms' high levels of technological capability and brand strength. The Zhejiang Geely Holding Group has bought out an Australian manufacturer of transmission systems, as well as Volvo Cars from Ford. Similar trends may be seen with other powerful companies. Part of the background to this may be said to have been the attempt to consolidate competitiveness in an early stage. The World Economic Forum's latest Global Competitiveness Report puts China in 27th place overall, but in terms of the level of sophistication of its production processes, and the number of utility patents per million population, it ranks over 50th. It would appear that, in order to advance China's levels in these areas, Chinese firms may be said to be pushing ahead with takeovers of foreign firms.

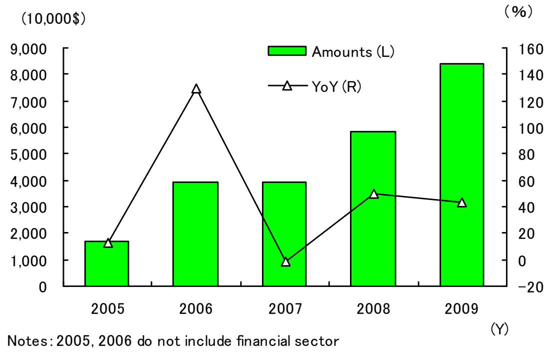
In addition, the government is working to encourage Chinese enterprises' overseas investments, and has developed related measures to accomplish this. The promulgation of the procedure for investment abroad (May, 2009), based principally on the shortening and simplification of the expansion period, may be said to be symbolic of this development. The official announcement (August, 2010) of new regulations calling for thorough risk training of staff before they are sent overseas, and for staff posted overseas to show respect for local laws and customs, are part of the response to increased trouble in countries and regions where Chinese staff are posted, and indicate the government's desire to boost the smooth development of business overseas.

■ Expected continued expansion of China's outward direct investment

Looking forward, there appear to be no signs of impending change in the trend of powerful local companies working to secure overseas resources, or in the government's drive to implement stimulus measures. It is envisaged that China's outward direct investment will continue to increase.

Under these circumstances, Japanese enterprises, with their advanced technological skills and brand strength, will be among the main targets for Chinese investments and takeovers. Current direct investment in Japan is less than $100 million annually ($84.1 million in 2009), but is expected to expand further in the near future.

＜China's Outward Direct Investment to Japan＞



Notes: 2005, 2006 do not include financial sector
Source: Ministry of Commerce, *2009 Statistical Bulletin of China's Outward Foreign Direct Investment*

For the Japanese government and Japanese enterprises, based on the premise of expanding overseas investment by Chinese companies, it will be essential to work out a China strategy that takes the merits and demerits of the situation into full consideration.

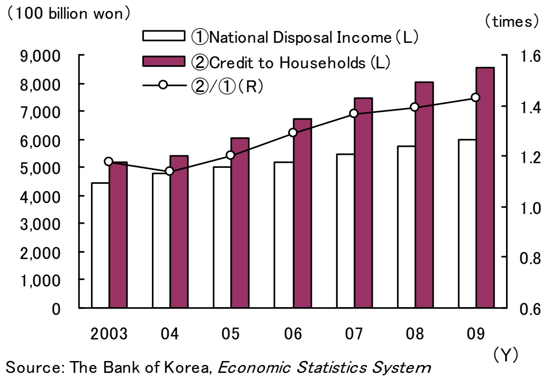
(Junya Sano)

Korea Koreans concerned over impact of interest rate hikes

■ Issues surrounding interest rate hikes

On July 9, Korea raised the Base Rate for the first time in about two years, due to the advance of the economic recovery and expectations of stronger inflationary pressure in the second half of the year. Many in the market were of the opinion that additional hikes would come sooner rather than later, but the Monetary Policy Committee in August and September decided to maintain the Base Rate. In fact, within the government, there are some who voice opposition to any hasty interest rate hikes. Part of the reason for this is the growing impact of the real estate market depression, and particularly the increase in the debt burden on household budgets.

＜Credit to Households＞



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

The prices of apartments in the Seoul Metropolitan area fell rapidly in the latter half of 2008, and then began to rise again in the wake of the economic recovery, but have recently begun to trend downwards again. In Gangnam District, some properties have fallen by double digits from their peak prices. The main factors behind the depression in the real estate market are that 1) real estate developers pushed ahead with construction based on expectations of aggressive demand after apartment prices soared in 2006 and 2007, 2) the government increased the housing supply by constructing 'new cities', 3) there was rapid economic deceleration in the wake of the Lehman collapse, and 4) housing price restraints were implemented(partly relaxed when the economy began to decelerate). In recent times, increased inventory and shrunken demand have given rise to a drop in housing prices.

Many construction companies have gone under due to the stagnating real estate market, causing financial institutions' non-performing loan totals to grow, and resulting in an increased deficit for the Korea Land and Housing Corporation after the Corporation bought up some leftover housing as part of measures to support the construction industry. In addition, the impact has begun to show in household budgets. Due to the growth in real estate secured loans in recent years, the debt to disposable income (DTI) ratio of the average household budget increased from 1.39 in 2008 to 1.43 in 2009. There have been many cases where people have used bank loans to purchase newly built apartments, but cannot sell the apartment where they are currently living, and so have had to sell off the new apartment at below the condominium price.

Given these circumstances, many have voiced concern over the effects on debt and consumption in the average household budget domestically, but the Bank of Korea, in its Financial Stability Report April, 2010, presents analysis to the effect that, in macro-economic terms, though the household budget DTI ratio is high (higher than those of U.S. and Japan), debt tends to be concentrated among the higher income brackets, and since their DTI ratio is low there is no danger that this will destabilize the financial system. On the other hand, attention is leaning towards the fact that the DTI ratio among the lower income brackets is also high.

■ All eyes on future monetary policy

In consideration of the fact that the dramatic rise of apartment prices in 2006 and 2007 was due in part to excess liquidity accompanying a prolonged spell of low interest rates, and that September's consumer price index increase rate (compared to the same month in the previous year) was 3.6%, up from 2.6% in August (due to the rise in food prices), it is to be hoped that interest rates could be raised in gradual steps towards an appropriate level, but given the spreading stagnation in the real estate market and the partial relaxation on real estate financing restrictions, the likelihood is high that the Base Rate will only be raised once within the year.

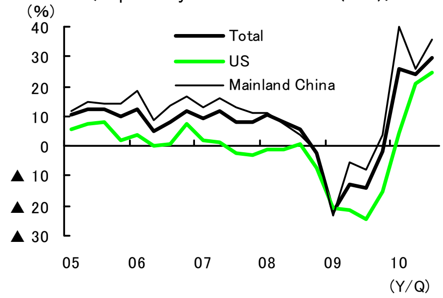
(Hidehiko Mukoyama)

Hong Kong *Economy growing smoothly, real estate price stability a concern*

■ Domestic and foreign demand maintain high rate of growth

Hong Kong's economy is continuing to grow, thanks to robust domestic and foreign demand. In terms of foreign demand, exports in July and August maintained a high growth level at 29.7% up compared to the same period in the previous year. Exports to the US grew 24.6% (YoY) in July and August, an increase from the 20.9% growth in the period April to June. Exports to China were 35.5% (YoY) in July and August, a 9.6 point increase on the pace of growth in April to June. Strong growth in China's domestic demand has been a major contributory factor. The majority of Hong Kong's exports are transit trade, so the ability of China's exports to the US and Europe to maintain high levels of growth also translates into healthy exports from Hong Kong to China. The number of travelers has increased strongly. In particular the number of visitors from mainland China grew 33.2% (YoY) in July to August.

＜Exports by Main Destination (YoY)＞



Note: The figures in 2010Q3 are for July-August.
Source: Census and Statistics Department of Hong Kong

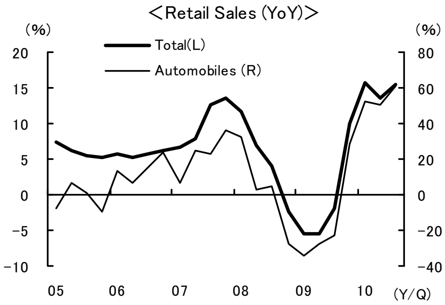
In terms of domestic demand also, total retail sales (volume basis) for July to August 2010, rallied to 15.6%, compared to the same period in the previous year. In particular, the volume of sales of automobiles (including parts and components) grew by an impressive 60.8%. This has been due to improved consumer sentiment against a backdrop of increased asset prices and improvements in the employment environment. Housing prices in August rose 15.6%, compared to what they were in December 2009.

The seasonally adjusted unemployment rate in the June to August timeframe was 4.2%, down 0.4 points from the period April to June. There were signs of improvement in trade related industries, as well as in finance and domestic demand related industries.

■ Real estate price stability most important issue

Housing prices have risen sharply from the end of 2008. They rose 26.9% in 2009, and 15.6% in the period January to August 2010. Once an adjustment begins, it is possible that prices will drop significantly.

＜Retail Sales (YoY)＞



Note: Volume basis.The figures in 2010Q3 are for July-August.
Source: Census and Statistics Department of Hong Kong

The Hong Kong government is working on the following four initiatives in an attempt to secure stable development in the real estate market. The first step is to increase the housing stock supply. The private sector completed 7,160 units of new houses in 2009. The Hong Kong government is pushing ahead with the sales of government owned land in order to increase the number of new house completions to 14,260 in 2010. In new housing construction, preference is given to small and medium sized units. And, in addition to new construction, the increase of the supply of houses for resale is also moving ahead. Second, the government has toughened taxation on real estate transactions. On April 1, 2010, the stamp duty on real estate transactions of over HK$20 million was increased from 3.75% to 4.25%. At the same time, tougher measures were introduced to follow up on tax arrears. Additionally, the real estate transaction situation is to be monitored carefully, and if evidence of excessive speculative investment is discovered, the applicable scope of related measures will be widened. Third, the government strengthened the control of sales of houses in order to ensure transparency in transactions and price formation. Fourth, the Hong Kong Monetary Authority has asked banks to reduce the number of housing loans for properties of over HK$20 million in order to prevent the rapid increase in housing loans. The Authority also has required stricter handling of housing loan applications.

In recent months, housing prices have reached their highest levels since 1997, when the highest levels were recorded. In the future, if housing prices continue to rise, the Hong Kong government will introduce further price restraint measures.

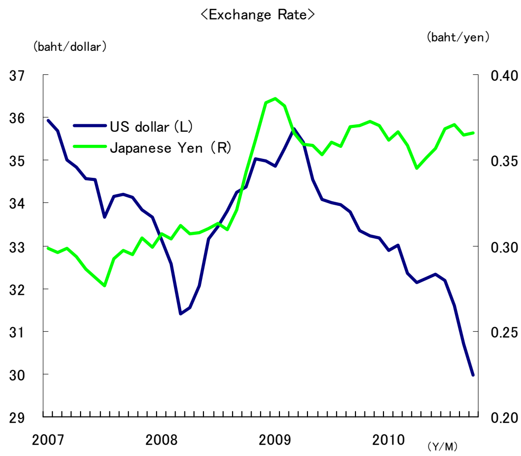
(Shinichi Seki)

Thailand Baht appreciation and growing upward pressure on wages

■ Baht reaches 13 year high against the dollar

Thailand's economic recovery is continuing to push forward, but new problems are appearing, such as the impact on exports of the baht's appreciation, and the growing upward pressure on wages due to the raising of the minimum wage level.

August's exports were up 23.9% compared to the same period in the previous year, and the manufacturers' production index followed suit, maintaining a robust 8.7% growth, year on year. Furthermore, the private consumption index was up 6.7%, similarly, and the private investment index up 22.0%, both figures good news for domestic consumption.



Source: Bank of Thailand

On the other hand, the baht has strengthened at an ever faster pace since June, and there are growing fears as to the potential impact on exports. The baht recorded its highest level in 13 years in September, and in October passed the $1 - Bt29 mark. On September 23, the Thai Ministry of Finance announced a series of relaxations on restrictions, such as raising the upper limit amount on overseas real estate purchases, and abolishing the upper limit on corporations' foreign currency investments and lending to subsidiaries. October saw a continuation of the baht's sharp appreciation, and there were growing calls from industry for additional measures. On October 12, the Cabinet approved the ending of the tax exemption on state bonds held by foreign investors, measures to accelerate government and state run enterprises' capital goods imports related investments, and low interest financing for export oriented small and medium sized enterprises. Bank of Thailand pointed out that the baht's appreciation was similar to that of the yen, and Malaysia's ringgit, and was not particularly a Thai issue. Therefore, BOT is holding off on market intervention, but Thai export products face no shortage of competition from Vietnam and China, and it will be impossible for small and medium sized exporters to avoid being affected, particularly those involved in the export of labor intensive products.

■ Labor shortages and minimum wage hikes increase upward pressure on wages

In addition, there is an increasingly conspicuous labor shortage. July's unemployment rate was 0.9%. Even given the fact that it was the peak agricultural season, it was the lowest rate in recent years. Some estimates put the current labor shortage at between 300,000 to 400,000 people. The number of foreigners working in Thailand as simple laborers is over two million. In August, BOI (Board of Investment) decided to permit foreign companies to hire foreigners for simple labor in BOI-approved projects, with certain conditions, such as scale of investment. However, there are problems in whether companies can find the staff they are looking for, and how workers with different languages and cultural backgrounds can be instructed.

In addition to the labor shortage, the government is now mulling a minimum wage hike, giving rise to the possibility of future upward pressure on wages. The latest rise in the minimum wage level has been advocated by Prime Minister Abhisit since the period of political turmoil as a measure aimed at correcting income disparity, and is characterized by being a significant raise applied uniformly to minimum wages across the country. If the rate of Bt250 (9.5 dollar) per day currently being considered is eventually applied, this will mean an increase of over 20% in Bangkok, where the minimum wage is comparatively high, and over 64% in the provinces where it is lowest. Industry is reacting strongly to the government-led wage hike, due to the amount of the raise, and the fact that the decision was made by the Central Wages Committee. Measures to counter baht appreciation, secure adequate labor and adjust minimum wage levels are all related to Thailand's export competitiveness, and require swift and appropriate action by the government.

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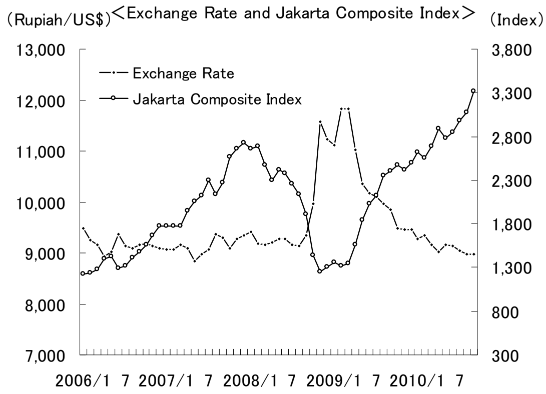
(keiichiro Oizumi)

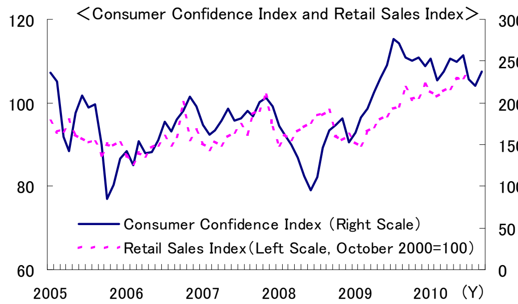
Indonesia *Central Bank required to steer a difficult course*

■ Share prices and currency continue to strengthen

The Jakarta Composite Index stood at 3,313 (mid month average) in September, 2010, continuing to record new highs. The rate of increase since the beginning of the year is 26.6%, lower than that of the Philippines (29.6%) and Thailand (28.6%), but nevertheless 151.2% up on February, 2009, when the lowest rate in recent times was recorded, and still one of the highest rates of growth among the major ASEAN nations. Robust domestic demand has meant that retail, manufacturing and finance related brands have been the drivers of economic growth. The rupiah has strengthened, keeping pace with share prices. The rupiah's exchange rate against the dollar in September, 2010, was 8,981 (monthly average). Though the rate has only grown 3.2% since the beginning of the year, it is up 24.0% compared with February, 2009, and is still one of the highest among the major ASEAN countries.



Note: Monthly Average
Source: CEIC



Note: Balance Score Method (net balance+100) has been adopted to construct the Consumer Confidence Index, where an index above 100 points indicates optimism.
Source: CEIC

This may be considered the result of the high praise given to Indonesia's economic performance, supported as it is by growing domestic demand. Consumer confidence and retail indices are all growing at high levels, and sales of automobiles and motorbikes are growing at unprecedented levels. Indonesia's steady economic management, with its priority on financial discipline, has been another influential factor in winning praise for the country's economic performance. According to the Asian Development Bank, Indonesia's fiscal deficit is 2.3% against GDP, which is low in comparison with Vietnam (7.7%), Malaysia (7.0%), Thailand (4.1%) and the Philippines (3.9%). All of the major ASEAN economies experienced rapid expansion of their fiscal deficits due to the implementation of economic stimulus measures in the wake of the financial crisis, but Indonesia's has grown by only 2.2 points since 2008.

■ Difficult timing of interest rate hikes

One factor pushing up share prices and the exchange rate is the inflow of foreign capital. Portfolio investments between January and June, 2010, were up 133.2% compared to the same period in the previous year, due to $7.8 billion worth of excess capital inflow. Greater interest in Indonesia from abroad is to be welcomed, but if the inflow of short term capital continues, Central Bank will be forced to make difficult course choices in the near future. One problem is the rupiah's rapid appreciation. A stronger rupiah may well become a hindrance to healthy exports. Central Bank is intervening to restrain the rupiah, but too much intervention may well lead to excess liquidity. The timing of policy interest rate hikes is very difficult. As can be understood from the fact that October's policy interest rate (BI rate) was held unchanged at 6.5%, upward pressure on commodity prices is currently very weak. However, many think that, in order to avoid rapid fluctuations in economic performance, the government will need to find the best timing with which to implement raises in the policy interest rate. The problem is that preventative interest rate hikes run the risk of accelerating capital inflow, while hesitancy is very likely to invite an outflow of short term capital. President Yudhoyono gave his annual address in August and expressed the view that the economic growth rate could well reach 7.7% by 2014. If this is to be achieved, it will be essential to stabilize commodity prices and the exchange rate, and all eyes will be on Central Bank to see how well they chart their course.

(Yuji Miura)