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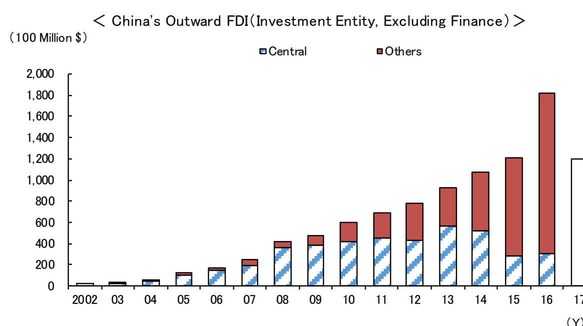
Topics *China's direct outward investment coming to a turning point*

Given the unrestrained outward investment that is being carried out in some sectors, the Chinese government has begun to tighten up its investment controls, such as restricting investments by companies in some countries and industries, and requiring certain types of reporting. China's direct outward investment is coming to a turning point.

■ Direct outward investment fell year on year in 2017 for the first time in 15 years

The Chinese Ministry of Commerce has announced that direct outward investment in 2017, with the exception of finance market investments, fell by 29.4%, year on year, to $120 billion. Even factoring in the financial market investments to be announced later, the probability is high that the direct outward investment total for 2017 will turn out to have been lower than that of the previous year for the first time in 15 years.



Source: Ministry of Commerce "Statistical Bulletin of China's Outward Foreign Direct Investment"
Note1: Central means State-owned enterprises under the jurisdiction of the State-owned Assets Supervision and Administration Commission
Note2: Data of the Year 2002 is UNCTAD, that of the Year is Ministry of Commmerce. Neither of these data are classified.

The tightening of regulations by the authorities is part of the background to this decline in investment growth. In August of 2017, the National Development and Reform Commission, speaking about the recent situation in direct outward investment, cited 1) losses incurred in overseas business projects due to reckless management decisions among some companies, 2) the outflow of capital overseas due to excessive investment by these companies in non-real economy sectors (real estate, etc.) and the impact on domestic finance, and 3) problems faced by these companies when their business activities run afoul of environmental protection, energy conservation, and safety standards in the countries in which they have invested.

In addition, the Commission has divided outward investment projects into sectors to be encouraged and those to be restricted or prohibited, and with respect to the latter category in particular, has published a "Circular on the Guiding Opinions on Further Guiding and Regulating the Direction of Overseas Direct Investment" jointly with the Ministry of Commerce, detailing their intention to tighten controls.

Therefore, it would appear that the Ministry of Commerce and other departments of the Chinese government are responding positively to this latest decline in investment growth.

■ Government to strengthen countermeasures against overseas investment risk

Looking forward to future developments, the Chinese government appears to be gearing up to strengthen efforts to do as much as possible to lessen the risk of loss and trouble on the part of Chinese companies in the course of developing their overseas businesses by placing restrictions on outward investment projects likely to pose an economic management risk. The Xi Jinping administration, at the 19th National Congress of the Communist Party of China in October of 2017, while continuing to promote overseas investment by Chinese companies, also proposed policies that hinted at a review of control methods. In response to this, government agencies responsible for direct outward investment have been announcing new regulations aimed at lessening investment risk, one after another. Among these, the most attention has been attracted by the Administrative Measures for Enterprise Outbound Investment (hereinafter referred to as "Administrative Measures") to be enacted from March 1, 2018.

<Administrative Measures for the Outbound Investment of Enterprises >

Featured Area	Main Points
Dividing Outward Investment Projects	・For some countries, regions, and industries, as a sensitive project, review and approval by the National Development and Reform Commission are required
	・All investment projects that were not classified as sensitive were made nonsensitive projects with simplified procedures
Condition of Approval	・Not against the national developing plans, macro-control policies, industrial policies, policy of opening the country to foreign business
Reporting Requirements	・Companies will be required to report major incidents such as the death or injury of dispatched staff, major losses of overseas assets, or damage to diplomatic relations within five working days of the occurrence of the incident, via a network reporting system

Source: National Development and Reform Commission
Note: Reporting Requirements also apply to non-sensitive projects.

The Administrative Measures classify investment projects as either sensitive or non-sensitive, depending on whether they will need to be examined and approved by the National Development and

Reform Commission. Non-sensitive projects will enjoy the benefits of simplified procedures. On the other hand, projects classified as sensitive will be verified according to two sets of criteria: 1) sensitive countries and regions, and 2) sensitive industries (Article 13). While it is a natural step to restrict investments in countries and regions that have no diplomatic relations with China, or which are experiencing war or internal strife, the Administrative Measures also make reference to “other sensitive countries and regions”. There are no specific criteria mentioned with regard to this item, and it is possible that the granting of permits will depend on case by case decisions of the National Development and Reform Commission.

What is noteworthy about the sensitive industries is that, in addition to “cross-border water resources development and utilization” and two other categories, there are also “industries to be restricted from outbound investments according to relevant policies”. Given that it is also a condition of approval that, when sensitive projects are being verified, they are not contrary to national development plans or industrial policies (Article 26), it can be read that the policy is to examine projects against economic management policies and other individual policies and reject those projects that do not conform.

The Administrative Measures also indicate measures to counter the risks involved in projects currently underway that are outside of its classifications. Companies will be required to report major incidents such as the death or injury of dispatched staff, major losses of overseas assets, or damage to diplomatic relations, within five working days of the occurrence of the incident, via a network reporting system (Article 43). This duty of reporting applies not only to sensitive projects but also to non-sensitive ones.

In addition to the Administrative Measures, a code of conduct for private sector companies investing overseas, which was released jointly by the National Development and Reform Commission, the Ministry of Commerce and three other government agencies and organizations in December of 2017, is attracting attention. The code of conduct urges private sector companies to 1) exercise caution when borrowing capital to make overseas investments, 2) be aware of local environmental protection and job creation in the countries where they plan to do business, and 3) consider the use of expert advice and the development of measures for obtaining risk information, etc., in order to avoid possible trouble.

One reason behind the issue of this code of conduct for private enterprises only is the structural change that has taken place in the nature of the investors themselves. In the early 2000s, the big expansion in China’s direct overseas investment growth was driven by large state owned enterprises, known as central enterprises. However, after peaking in 2013, the total amount of investments by central enterprises has been in decline. On the other hand, while no breakdown figures are available, the total amount of investments by investors other than central enterprises is on the rise. It may be assumed that private sector enterprises are at the heart of this investment growth, but the fact that these are more difficult for central government to control than central enterprises or local government state-owned enterprises has meant that the implementation of suitable policies has been put off. However, it would seem that the government has viewed that, in the light of the changes in recent years, it could no longer put matters off and has decided that, in addition to policies covering all companies, it needed to implement policies aimed at reducing overseas investment risk, targeting private sector enterprises specifically.

■ China’s direct outward investment approaching a turning point

From this series of initiatives, it can be judged that the Chinese government has switched its priority from the full-hearted promotion of direct outward investment to the curbing of high risk projects and the appropriate control of investment risk. Companies too are tending to prefer to avoid risk and trouble before they happen, and are expected to beef up their own countermeasures in line with the government’s policies, as well as being more careful not to run afoul of any trouble in the countries in which they do business. For this reason, it seems that China’s direct outward investment is approaching a turning point and that the high pace of growth that was seen until 2016 can no longer be expected.

In the future, the Chinese government will shift its focus to those fields in which it is encouraging investment, towards countries along the Belt and Road initiative, and toward industries such as the development of natural resources. If companies become more risk averse, there is a danger that this will strongly impede the progress of the Belt and Road initiative and the securing of natural resources. Given that investment in the Belt and Road countries has slumped recently (decreasing by 1.2% in 2017, compared to the previous year), as well as in the mining industry, such concerns cannot help but be intensified. The ability of the Xi Jinping administration will be tested in terms of what kinds of policy measures it can implement to restrain direct outward investment in some fields on the one hand, while restoring investments to health in priority fields on the other.

(Junya Sano)

Korea Economy grows negatively, but maintains recovery keynote

■ Economy has slowed down temporarily in Q4, 2017

Korea's real GDP growth rate in the October to December quarter of 2017 was down -0.2% compared to the previous quarter (hereinafter the same), slowing from the July to September quarter (1.5%), and the first negative growth since the October to December quarter of 2008.

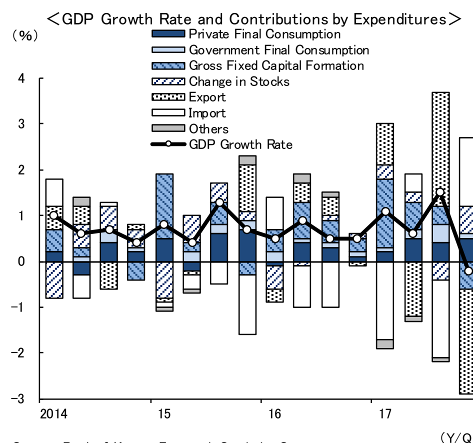
In terms of the contribution level of individual items, exports fell significantly, slowing by -2.3% points. However, this slump was due to special factors such as 1) the bringing forward of exports to September due to the long Chuseok holiday in October, and 2) the slump in services exports caused by the decline in the numbers of Chinese tourists as a result of the THAAD issue, and there is no need to be especially pessimistic.

In fact, examination of recent trends confirms that the keynote of export driven economic recovery is continuing.

January's export growth (US dollar denominated) accelerated by a massive 22.2%, compared to the same period in the previous year. In terms of individual export items, though telecommunications equipment and liquid crystal display exports fell below the previous year's levels, automobile exports recovered strongly from their slump and grew 13.3%, while semiconductor exports continued their strong pace and grew 53.4%. In terms of countries and regions, exports to China, Europe, and the US continue to lead the trend of expansion. Against the backdrop of the global economic recovery, exports look set to continue to grow strongly in the foreseeable future.

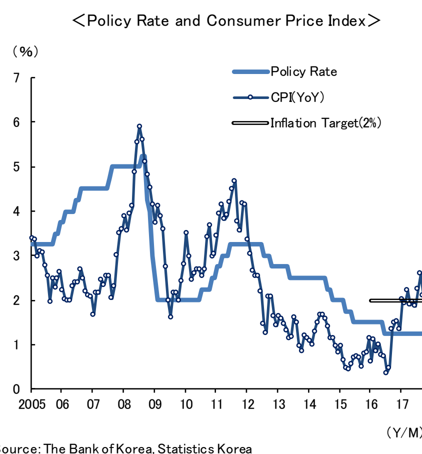
Meanwhile, the contribution level of private sector consumption in the October to December quarter stayed solid at 0.5%. Examination of recent trends shows no evidence of any major deterioration in consumer sentiment, which sways private sector consumption.

<GDP Growth Rate and Contributions by Expenditures>



Source: Bank of Korea, Economic Statistics System

<Policy Rate and Consumer Price Index>



Source: The Bank of Korea, Statistics Korea

The consumer confidence index has stayed steady since passing the benchmark 100 points in April of 2017. Although the 109.9 points posted in January of 2018 was slightly below the previous month's level, the index has nevertheless maintained a high level.

Incidentally, the real GDP growth rate for the whole year 2017 was 3.1%, year on year, recovering to the 3% range for the first time in three years. Private sector consumption growth was solid at 2.6%, while gross fixed capital formation grew an impressive 8.6%, boosted by accelerated growth in semiconductor related plant and equipment investments. Although export growth is thought likely to contract slightly in 2018, both domestic and foreign demand are expected to continue strongly, with a prediction for growth in the upper 2% range.

■ Consumer price index falls below central bank target

Bank of Korea raised its policy interest rate by 0.25% points in November of 2017, and has kept the rate at the 1.5% level since then. With regard to further interest rate hikes, Bank of Korea Governor Lee Ju-yeol has adopted the cautious stance of waiting to see what the effects of the November increase will be. The latest consumer price index is in the low 1% range, which is lower than Bank of Korea's inflation target, so any future interest rate hikes are expected to be modestly paced.

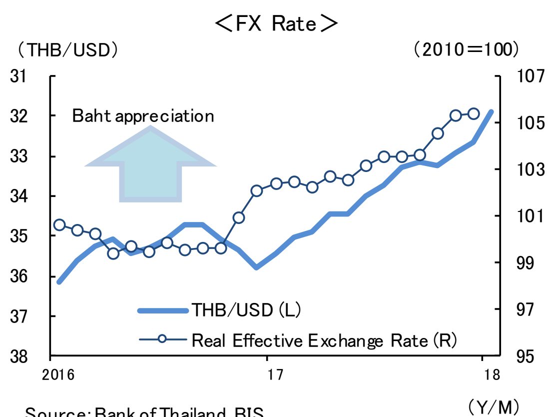
While there are concerns that higher US interest rates may prompt an outflow of funds from Korea, there is also the concern that additional interest rate hikes carry the risk of stalling the economic recovery due to a cooling of the housing market and an increased burden of interest payments on household debt. Central bank will need to work out monetary policies that balance these two risk factors.

(Kentaro Matsuda)

Thailand Baht grows stronger

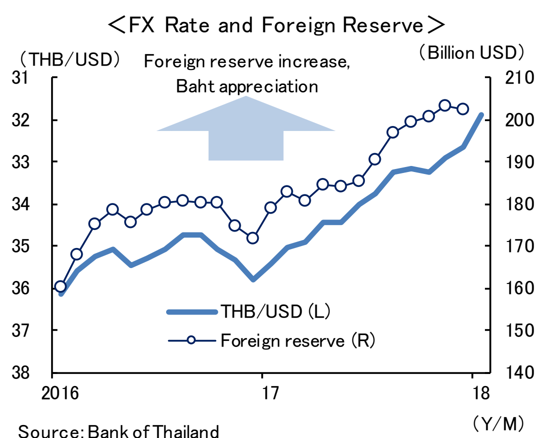
■ Baht appreciation picks up pace

In Thailand, while import growth has been restrained by the cooling of raw materials prices, the recovery in the global economy has helped boost export growth, resulting in continued upward pressure on the baht as trade and current account balances improve. In addition, as the Thai economy's recovery becomes ever more certain, upward pressure on the baht has also in increased in terms of the balance of capital account, and baht appreciation has been gathering momentum since the latter half of 2016. In January of this year, the dollar-baht exchange rate went to \$1 = Bt31 as dollar depreciation strengthened globally in response to the Secretary of the US Treasury's hints about accepting a weaker dollar.



■ Central Bank responding to strong baht other than by lowering interest rates

Regarding measures in response to the baht's appreciation, from the point of view of concerns over declining export competitiveness, there had already been calls from industry and the Ministry of Finance for Central Bank to lower interest rates. However, concerned over expectations that the inflation rate would gradually rise in the wake of economic recovery, and over the possible adverse effect that higher interest rates would have on household debt, Central Bank has kept the policy interest rate (repo rate) at 1.5% since it was lowered to that rate in April of 2015. In the meantime, Central Bank is working on correcting excessive baht appreciation by relaxing capital regulations on overseas investments and through currency intervention.



As a result of dollar buying – baht selling intervention, foreign currency reserves that were at around \$160 billion at the start of 2016 have grown recently to around \$200 billion which is the equivalent of just over 40% of nominal GDP. This is the equivalent of about nine months' worth of goods and services imports, and about three years' worth of short term external debt, in each case about three times the level that is considered sound. Although, to date, there has been nothing to brake the baht's appreciation, if there had been no exchange intervention, it is highly possible that the baht may have strengthened to a much higher level than at present.

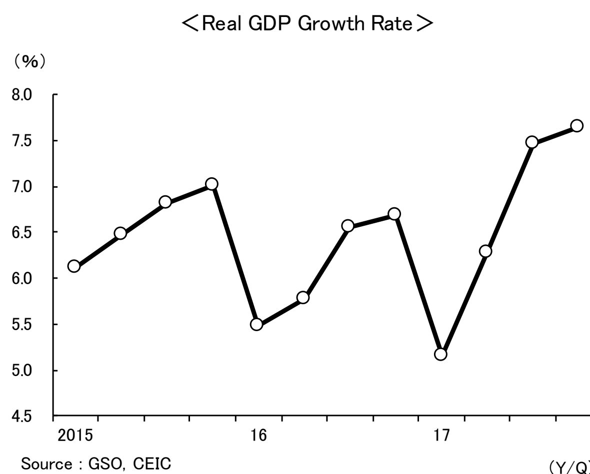
Central Bank is attempting to curb baht appreciation by introducing a range of measures other than lowering interest rates, such as aiming to alleviate upward pressure on the baht by encouraging investments that lead to more capital goods imports and expanding domestic demand, as well as encouraging companies to take advantage of currency hedging and to select new currencies of settlement. In addition, with regard to the appreciation of the baht in January, there has been talk that non-resident accounts may very well have been used for huge sums of speculative investment, and Central Bank will make decisions about how to handle such situations in the future, after having verified the details of these transactions. In the event that the conclusion should be that speculative investment did indeed influence recent baht appreciation to a significant degree, there is every possibility that Central Bank will take it upon itself to implement measures to restrict the inflow of capital, with the aim of curbing speculative investment, all the while taking into consideration the possible impact on share prices, etc.

(Shotaro Kumagai)

Vietnam *Non-tariff barriers expected to be lifted soon*

■ Economic recovery continues

Vietnam's real GDP growth in the October to December quarter of 2017 was 7.7%, compared to the same period in the previous year, picking up the pace a bit from the July to September quarter (7.5%, similarly). As a result, Vietnam's real GDP growth rate for the whole year 2017 was 6.8%, year on year, accelerating from 2016 (6.2%, similarly), and coming in ahead of the government's target (6.7%, similarly).



Source : GSO, CEIC

Viewing Vietnam's 2017 growth rate in terms of demand items, both domestic and foreign demand performed strongly. First, it was consumption that powered economic growth. Private consumption contributed 5.0 percentage points to economic growth. In addition to the fact that a persistently comparatively low inflation rate has helped to maintain consumer purchasing power, the expansion in export growth brought about an improvement in incomes, which significantly boosted the growth in consumption. Second, investments have performed solidly. The contribution level of gross capital formation in 2017 was 3.3%, growing from the previous year (2.9 percentage points). In addition to the progress of infrastructure development projects, and new and expanded investment projects by foreign capitalized firms, the effects of lower interest rates in July of 2017 are believed to have permeated through the latter half of the year. Furthermore, the increase in export growth has provided a boost to economic growth. Dollar denominated exports in 2017 were able to take advantage of global economic expansion and the rapid growth in semiconductor demand, and grew an impressive 21.4%, compared to the previous year.

With regard to the outlook for the near future, given the progress in infrastructure projects and expansion in direct inward investment, it is expected that domestic demand will continue to perform strongly. In terms of foreign demand, however, in spite of the tailwind provided by the economic recovery in the US, Vietnam's biggest export partner, and other industrialized countries and regions, such as the EU and Japan, the forecast is that growth will shrink in rebound from the rapid growth enjoyed in 2017. Given the above, for the time being, though Vietnam's economy will slow somewhat, it is expected to continue to maintain a steady pace of expansion.

■ Non-tariff barriers against finished automobile imports

Nevertheless, attention needs to be paid the fact that, recently, there are still elements of uncertainty with regard to the future of the economy. Within ASEAN, tariff barriers were completely abolished from January of 2018. This meant that Vietnam had to abolish tariffs on imports of finished automobiles produced in Thailand and Indonesia. It was expected that this would mean that Vietnamese consumers could purchase automobiles more cheaply, and that there would be a sudden growth in automobile sales from the start of 2018. However, in order to protect the domestic automobile industry, the Vietnamese government has put de facto non-tariff barriers in place for finished automobile imports, for example, by requiring importers to submit the certificates issued by foreign governments at the time of inspection, and requiring safety and other inspections by the Ministry of Transport for each shipment and vehicle specification. This has resulted in significant costs for importers. If this situation continues, automobile sales in 2018 are thought likely to slump. In addition, this kind of protectionist policy management may very well become a factor in a significant deterioration in foreign firms' appetite for investment in Vietnam.

In recent years, Vietnam has relaxed restrictions on the electronic parts and components industry and has enjoyed continued high levels of growth by succeeding in attracting foreign firms. To that extent, the hope is that, in the finished automobile sector also, non-tariff barriers can be removed as quickly as possible, and improvements made to the investment environment.

(Yuta Tsukada)