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Topics *Startup Winter in ASEAN*······································1
Topics *A sharp decline in long-term interest rates in China*······························3

株式会社 日本総合研究所

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Topics *Startup Winter in ASEAN*

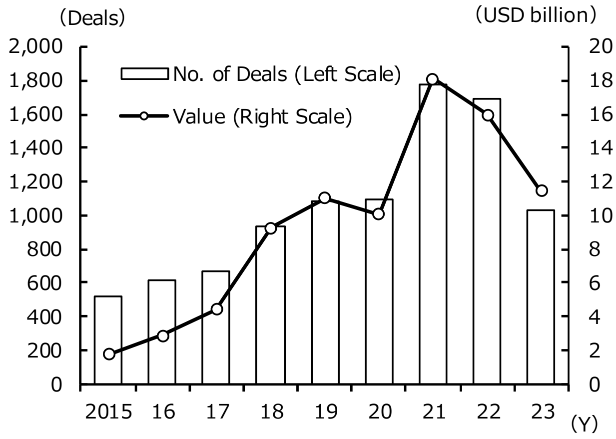
The ASEAN region is in the midst of a difficult phase due to a global correction in startup investment, but companies there are trying to push through it by getting themselves on a stronger footing. Meanwhile, Japanese firms are also resuming collaboration with startups in the region.

■ A decade-long startup boom

In the ASEAN region, startup launches went from close to zero at the beginning of the 2010s to eye-popping levels in just a little over 10 years. Venture capital (VC) investment, a gauge of the level of startup activity, reached USD 18.1 billion at its peak in 2021. Given that the figure was only USD 100 million in 2010, the growth has been staggering.

By country, Singapore and Indonesia have been leading the pack, the former thanks to its excellent business infrastructure and the latter on the back of its huge population of 280 million people. Startup activity in other ASEAN nations has also seen steady expansion, albeit not to the extent witnessed in the aforementioned two countries. Quite a few startups have been attracted to Singapore to establish their headquarters there even though their actual businesses are in other countries in the region.

<Venture Capital Investment in The ASEAN Region>



	2019 to 2021	2021 to 2023
No. of Deals	+64.1%	-41.5%
Value	+64.4%	-36.6%

Source: Prepared by JRI based on Pitchbook, "The 2024 Southeast Asia Private Capital Breakdown," 2024

■ End of euphoria

Startup investment in the ASEAN region has been supported by money from outside the region. In the few years leading up to 2021, there was a mood verging on euphoria surrounding startup investment in the ASEAN region. First, the region's huge market of 680 million people and continuing economic development led to rising expectations that startups there have great potential for growth. The emergence of success stories also boosted investment. Grab Holdings (founded in 2012, headquartered in Singapore), whose main business is ride-hailing services, and Gojek (currently GoTo Group, founded in 2010, headquartered in Indonesia), which also operates a ride-hailing service, joined the ranks of unicorns (unlisted companies with an estimated valuation of more than USD 1 billion) in just a few years following their establishment; in the blink of an eye, they rose to become two of the leading companies in the ASEAN region. Witnessing this, more and more investors began searching for the next Grab or Gojek. And in 2020, as they battled the COVID pandemic, countries around the world pursued large-scale monetary easing policies, leading to global excess liquidity. Risk tolerance increased as a result, triggering a worldwide surge in startup investment, and this has also spurred investment in the ASEAN region.

However, as the pandemic subsided, inflation accelerated globally and countries began to tighten their monetary policy, pushing startup investment into a phase of recalibration commonly referred to as a "funding winter." The ASEAN region was also not immune, with investors coming down from their euphoric high and regaining their composure. This brought a reminder that ASEAN is not a single market of 680 million people, but rather a patchwork of countries that differ from each other in myriad ways, from the legal and regulatory landscape to business practices and culture. It came to be widely recognized that unless startups have plenty of cash for investment and strong managerial talent, it will take them a considerable amount of time to expand into other countries in the region, which will inevitably slow their growth. The fact that Grab and Gojek were still unable to turn a profit even after their IPOs, causing their stock prices to slump and then remain weak for an extended period, also threw cold water on the startup investment fever in the ASEAN region. The number and value of VC investments increased by about 60% between 2019 and 2021, but then dropped by around 40% between 2021 and 2023.

The success rate for startups had always been low and shutting down their businesses was commonplace, but as the funding environment deteriorated, the prospects for startups became even bleaker. Numerous startups in the ASEAN region, including ones that were considered promising until recently, have been having to wind up their operations. And the survivors among them are moving to radically revamp their businesses and cut out inefficiencies. Back when it was easy to obtain funding, profligacy was widespread. Though the degree of wastefulness varied from firm to firm, startups often exhibited practices such as hiring people as employees for operations that they could easily have outsourced, ramping up their marketing budgets, and relocating to plush offices that were beyond their means. One after another, startups have pulled out of businesses or countries where they failed to produce the results expected.

However, those startups that have managed to survive through aggressive restructuring are gradually becoming healthier, and the expectation is that they will go on the offensive again once the current correction phase has passed. This view is supported by the fact that, over the past decade or so, startups have become part of the ASEAN landscape, and they continue to draw in first-class talent. Added to that, the strengths of ASEAN region startups, which were what caused them to attract attention in the first place, have not changed significantly. Although viewing the entire region as a single market has come to be recognized as short-sighted, the long-term outlook for the ASEAN region remains unchanged: the population of the region continues to grow and this will help steady economic expansion to be maintained.

■ Japanese companies resuming collaboration

The rise of startups in the ASEAN region led to collaboration between them and companies from various other countries such as China, South Korea, and the U.S. This development reflected an eagerness among firms from outside the region to gain a foothold for unlocking new markets and strengthening their existing operations in the region, and Japanese companies also moved to grab a piece of the action. Japanese companies began investing in startups and forging business alliances in the ASEAN region in the mid-2010s. Initially, the main players were IT startups, but the trend soon expanded to encompass traditional large corporations.

The collaboration trend temporarily subsided during the COVID pandemic, but has begun to see a resurgence of late. One Japanese company that had run an annual pitch contest for startups in the region, but had then suspended it, has brought it back recently. Through this event, it aims to re-engage with the ASEAN startup community in order to discover promising startups and ultimately collaborate with them in some way.

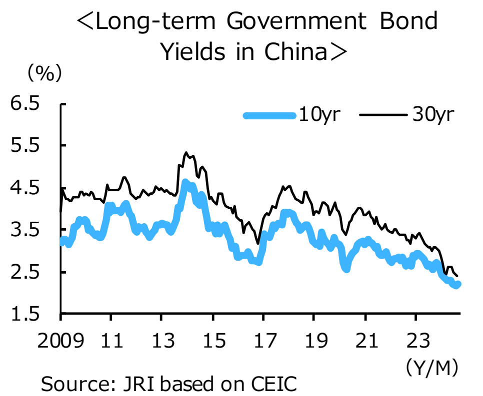
Collaboration with companies from Japan also benefits the region's startups. Japanese firms possess various technologies, impressive know-how, and extensive networks, and ASEAN's startups can leverage those assets to accelerate their growth. For example, they could utilize the networks of Japanese companies that operate globally to expand beyond the ASEAN region. And from the opposite perspective, for Japanese firms to triumph in the competition among companies from different countries to tie up with promising startups in the region, it will be critical for them to find ways of conveying how those aforementioned strengths can help startups so that they can achieve growth.

(Iwasaki Kaori)

Topics A sharp decline in long-term interest rates in China

In China, a sharp decline in long-term interest rates is being viewed as a problem. One reason is that China's monetary policy is in the process of being reformed, making it difficult to influence the movement of long-term interest rates.

■ Government bond prices have soared, and the People's Bank of China has started to intervene by selling government bonds



Source: JRI based on CEIC

Long-term interest rates in China have been declining rapidly. On September 24, the yield on 10-year government bonds dropped to 2%, a record low. In addition to growing concerns about economic deterioration due to the slump in the real-estate market, banks, which have been curbing lending to the private sector, are plowing their surplus funds into government bond investment. The National People's Congress in March saw the announcement of a plan to issue one trillion yuan of ultra-long-term special government bonds to support the economy, with some of the money to be allocated to disaster-prevention infrastructure development. Upward pressure on long-term interest rates was expected to build in May-November this year, the time frame for the issuance of the bonds, but that upward pressure has been offset by increasing demand for government bonds from financial institutions. When ultra-long-term special government bonds with a term of 30 years were listed on the Shanghai and Shenzhen stock exchanges in May this year, there was a rush to buy on the first day, with trading suspended twice on both exchanges.

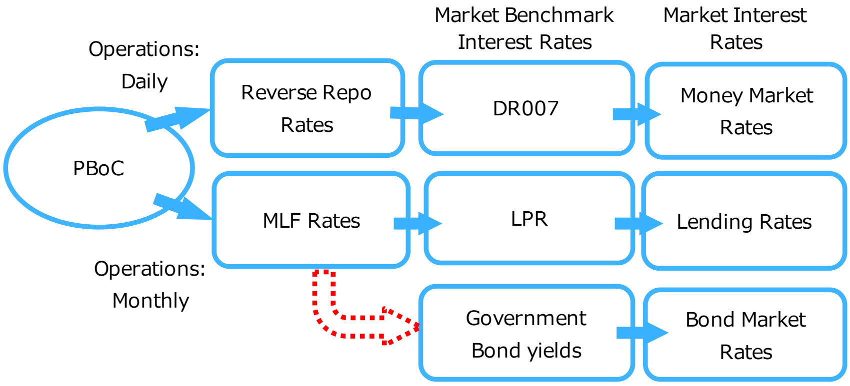
The People's Bank of China (PBOC) is increasingly on guard, contending that prices in the government bond market have gone too high. If government bond prices were to fall sharply, financial institutions and other investors would suffer huge losses, and the sudden rise in interest rates could adversely affect the economy as a whole. On July 1, having issued a series of verbal warnings, the PBOC finally announced that it would be borrowing government bonds through open market operations (OMO), indicating its intention to correct the supply-and-demand balance by offloading those borrowed government bonds in the market. The move represents a direct intervention in the government bond market by the central bank, something that has only occurred twice before: in 1997 (test operation) and 2007 (purchase of government bonds issued for the establishment of the China Investment Corporation (CIC)). On September 10, it was reported in the media that trading in Chinese government bonds was surging and that the PBOC may be expanding its intervention involving the sale of government bonds.

■ Monetary policy reform is only halfway complete, and controlling moves in long-term interest rates remains difficult

In China's government bond market, market participants are actively buying and selling, but it would be hard to argue that the market's price discovery function is working properly. In theory, the nominal interest rate is the sum of the real long-term interest rate (≈ the real expected growth rate), the expected inflation rate, and the risk premium, and so when the risk premium is small, the nominal interest rate should be close to the nominal GDP growth rate. However, unlike in most developed countries, in China there is a large gap between long-term interest rates and growth rates. Since 2006, long-term interest rates have tended to be lower than the nominal GDP growth rate, and the range of fluctuation in long-term interest rates has been relatively small. For example, the annual nominal GDP growth rate has been volatile, recording figures in the range of 2.7% to 23.1%, while the yield on 10-year government bonds has hovered in the narrow range of 2.1 to 4.8% (daily basis).

This trend may be partly attributable to the fact that the PBOC's monetary policy approach has centered on "window guidance," a method of leaning on banks to influence their lending practices. In most other countries, and especially developed ones, a mechanism is in operation that sees short-term interest rates manipulated as "policy interest rates," with the adjustments automatically spreading to affect long-term interest rates. However, in the case of China, the main tools of monetary policy are OMO via seven-day reverse repos and a one-year medium-term lending facility (MLF), and while the interest rate for the former is linked to short-term interest rates, the rate for the latter is determined via a complex mechanism. Specifically, the actual lending rate is altered by adjusting the loan prime rate (LPR), which is positioned as a "de facto policy rate," and this impacts long-term rates indirectly. Under this current mechanism, short-term and long-term interest rates are separated, making it difficult for the market to establish a natural yield curve. Monetary policy in China is still underdeveloped, and this can be said to be undermining the efficiency of the government bond market.

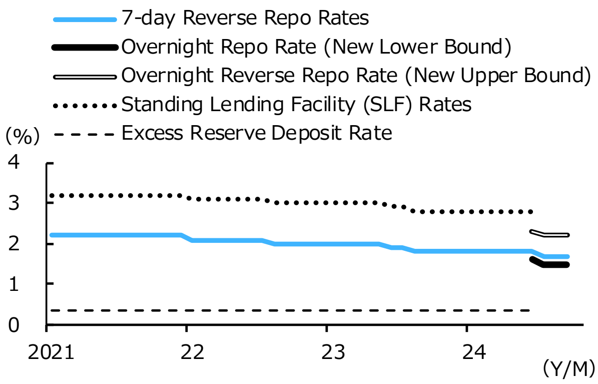
<China's Monetary Policy Framework>



Source: JRI based on the website of the People's Bank of China

Against this backdrop, the PBOC has been taking steps to adopt a more modern approach to monetary policy management. On July 8, it announced that it would introduce overnight repos and overnight reverse repos as temporary OMO tools for adjusting liquidity. The interest rates on overnight repos and overnight reverse repos (-0.2% and +0.5%, respectively, compared to the seven-day reverse repo rate) will be used to establish an interest-rate corridor. The move is seen as an indication of the PBOC's intention to stabilize money market interest rates, shift its policy orientation away from the MLF interest rate and LPR in favor of the seven-day reverse repo rate, and place greater emphasis on interest rate control as a mechanism of transmission to the term structure of interest rates. With this alone, however, monetary policy reform is still only halfway complete. The current policy framework, which has emphasized lending rates, remains unchanged, so it will likely be difficult to influence the movement of long-term interest rates.

<New Framework of China's Monetary Policy>

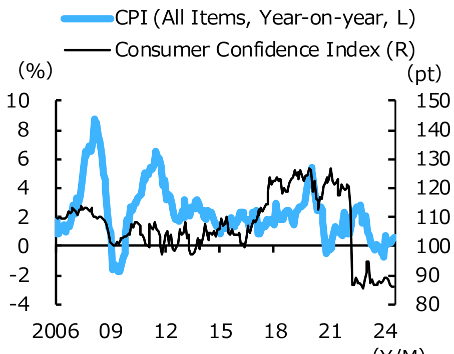


Source: JRI based on CEIC

■ How should deflation concerns and expectations for quantitative easing be viewed?

In China, market expectations of a commencement of quantitative easing are rising due to growing worries that the economy will fall into deflation. In March 2024, it was reported that President Xi Jinping, at a meeting on monetary matters held in October of last year, had said that the PBOC must gradually expand government bond transactions through OMO. However, the current PBOC leadership views the excessive decline in long-term interest rates as a

<Inflation and Consumer Sentiment in China>



Source: JRI based on CEIC

problem, and there is no sign of it implementing quantitative easing. Because the price discovery function is weak in the Chinese market, even if the PBOC were to make large-scale purchases of government bonds, factors such as sudden fluctuations in long-term interest rates when it exits those positions could pose a risk to the economy.

The U.S. cut interest rates by 0.5% on September 18, giving China more room for monetary easing, and on September 24, the PBOC announced cuts in key interest rates and banks' reserve requirement ratio. Yet the PBOC will find it difficult to further strengthen its accommodative stance as there are growing concerns that rate cuts could cause the government bond market to become even more overheated. If expectations remain that monetary policy cannot be counted on to stimulate the economy, further difficulties for the domestic economy could be on the horizon.

(Minoru Nogimori)