Mizuho Economic Outlook & Analysis

December 7, 2015

Will Japan's investment in Asia stay firm?

ASEAN continues to be the top key destination while China bottoms out, but the outlook remains uncertain.

< **Summary** >

◆ Japanese companies continue to view ASEAN as the top key destination for investment. The concentration of specific industries in specific countries continues, such as transportation machinery in Thailand and Indonesia, and electric machinery in the Philippines and Vietnam, and the investment value remains high.

◆ Concerning investment bound for China, investment in the manufacturing sector is driven by Japan' s machine tool makers trying to meet the needs of Chinese companies to mechanize their production facilities, while investment in the non-manufacturing sector is fueled by the wholesale and retail industries. The investment value started to recover from the latter half of 2014.

◆ With the slowdown of Asia's economic growth, sales of local subsidiaries have slumped to a lower than expected level, and Japanese firms will likely restrain their investment in the short term. In the middle to long term, however, investment is expected to remain firm to fulfill the demand of middle income bracket of consumers, and the establishment of the ASEAN Economic Community and the enforcement of the TPP broad agreement are expected to provide a critical boost to investment.

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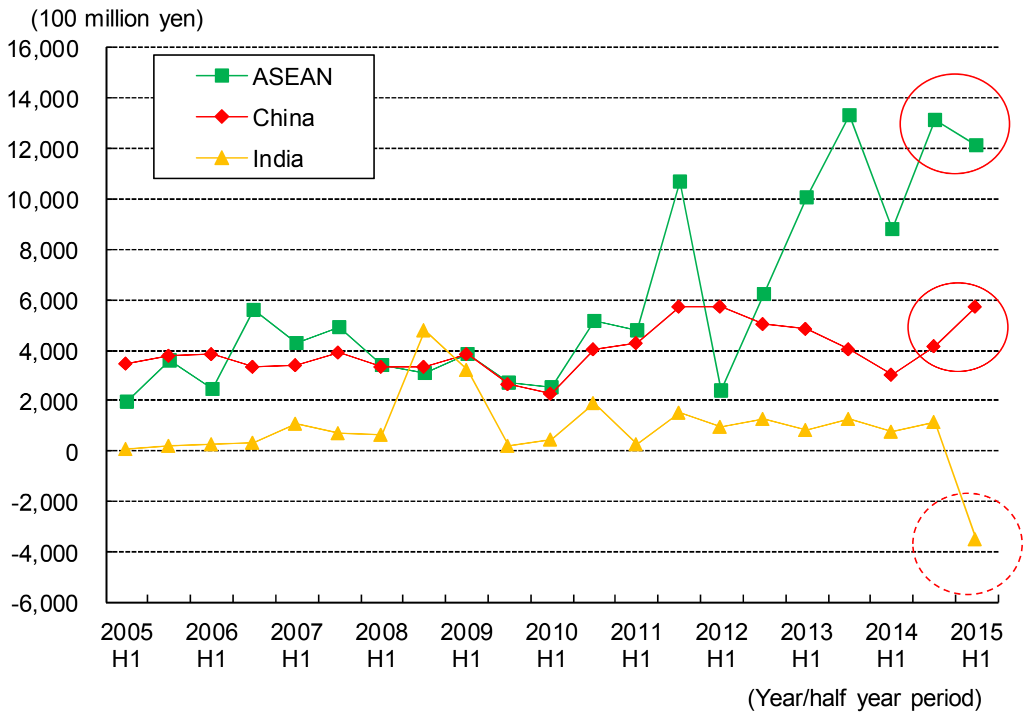
1. Introduction

Japanese companies' direct investment in Asia (hereinafter "investment") has continued at a high level since the latter half of 2014, while investment in China, which had been declining since the latter half of 2012 due to growing tensions in the Japan-China relationship, also turned to a recovery trend during the same period. Meanwhile, investment bound for India continues to hover at an unchanged level, and with the withdrawal of a Japanese company[1] involved in a large-scale acquisition in the first half of 2015, the financial outflow has exceeded the inflow (**Chart 1**).

In this report, we analyzed the background and development of Japan's investment in China and ASEAN from the second half of 2014 to the first half of 2015 in an attempt to uncover what we need to focus on in the future.

Chart 1： Japan's investment in Asia



Note: We extracted 10 ASEAN countries, China and India from Asia.
Source: Bank of Japan, *Balance of Payments Statistics*.

[1] Due to the sale of an Indian pharmaceutical company's shares owned by a Japanese pharmaceutical company.

2. Investment in China once bottomed out

(1) Investment in the manufacturing sector led by "general machinery"

Dividing Japan's investment in China on a semiannual basis by manufacturing and non-manufacturing industries (**Chart 2**, **Chart 3**), the investment amount started to recover from the second half of 2014 in both industries. The resumption of investment was probably triggered by positive developments in Japan-China relations after the first Japan-China summit meeting in about three years in November 2014.

In the manufacturing industry, the investment value grew consecutively in the second half of 2014 and the first half of 2015. The increase was particularly strong in "general machinery," primarily due to Japan's machine tool makers' move to establish production sites of industrial robots in response to Chinese companies' heightening needs to mechanize their production facilities.

According to the International Federation of Robotics (IFR), sales of industrial robots in China in 2014 grew 56% year on year to 57,000 units, accounting for about a quarter of the 229,000 units sold globally. Since China is facing the problem of rising production costs due to the surge in labor costs and the shortage of a young workforce, Japanese firms seem to hold that demand for industrial robots will continue expanding in the future.

(2) Investment in the non-manufacturing sector fueled by "wholesale and retail"

In the non-manufacturing sector, robust investment in "wholesale and retail" industries stands out from others. The main factor behind this development is the growing purchasing power of Chinese consumers that has accelerated store opening activities of Japanese companies in the Chinese market.

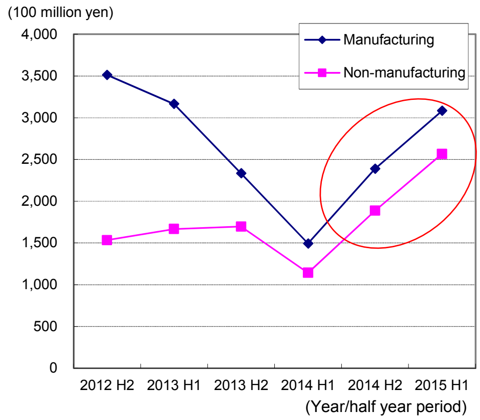
While many Asian countries try to protect domestic companies by imposing regulations on foreign capital entry in their wholesale and retail industries, the Chinese market is basically open to foreign companies. In addition, from an environmental load point of view, regulators place emphasis on the non-manufacturing sector when inviting investment, and this is another factor that has led to an expansion of investment in this sector.

Chart 2: Japan's investment in China (by industry)

(100 million yen)

Industry/year	2012 H2	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1
Manufacturing	3,512	3,165	2,333	1,492	2,387	3,083
Food	146	144	183	175	96	113
Textile	41	60	25	-12	12	22
Lumber and pulp	122	86	122	106	7	70
Chemicals and pharmaceuticals	279	368	155	224	283	218
Petroleum	-4	-4	2	2	5	8
Rubber and leather	57	67	85	51	13	188
Glass and ceramics	54	161	6	142	117	49
Iron, non-ferrous, and metals	345	392	258	278	163	204
General machinery	578	568	486	72	657	777
Electric machinery	471	374	223	-102	217	612
Transportation equipment	1,271	843	717	491	703	695
Precision machinery	13	3	9	31	-4	16
Non-manufacturing	1,534	1,667	1,696	1,143	1,886	2,567
Farming and forestry	1	0	28	0	0	3
Fishery and marine products	0	0	0	0	0	0
Mining	0	0	0	0	0	0
Construction	0	3	9	21	10	11
Transportation	68	47	21	22	18	22
Communications	40	17	14	14	2	25
Wholesale and retail	750	559	526	234	910	1,046
Finance and insurance	231	220	757	652	661	987
Real estate	302	690	195	105	174	371
Services	149	121	134	81	48	71
Total	5,046	4,832	4,029	2,635	4,274	5,650

Chart 3 Japan's investment in China (by manufacturing/non-manufacturing industries)



Source: Bank of Japan, *Balance of Payments Statistics*.

Notes: 1. Highlighted figures are investment values exceeding 50 billion yen.
2. A negative reading means financial outflow due to withdrawal and dissolving joint ventures (the same applies to Charts 4 to 8).
3. Due to the existence of "other manufacturing" and "other non-manufacturing," total values are not necessarily equal to the sum of the figures in the table (the same applies to Charts 4 to 8).
4. Data items with less than three reports are indicated as 0 (the same applies to Charts 4 to 8).
5. ○ indicates an increasing trend and ○ in dotted lines indicates a decreasing trend (the same applies to Charts 4 to 8).

Source: Bank of Japan, *Balance of Payments Statistics*.

3. Investment in ASEAN remains at a high level

(1) Thailand: Investment remains firm even under the military government

Next, we look at Japan's investment in ASEAN by country (mainly Thailand, Indonesia, Malaysia, Philippines and Vietnam [ASEAN5], and Cambodia, Laos, and Myanmar [CLM]).

First of all, looking at Thailand which has the highest concentration of Japanese companies, the military government[2] continues to control the country since the military coup in May 2014. The transition from military rule to democratic government, which was originally scheduled in 2015, is expected to be delayed a few years due to the time consuming process of drafting a new constitution. However, the country has regained political stability under military control, and for this reason Japanese firms' investment continued to rise steadily after the second half of 2014 (**Chart 4**). In addition to the expansion of investment in the overall manufacturing sector, driven particularly by the

[2] Both upper house and lower house continue to be dissolved.

high concentration of "transportation equipment" in the country, investment in the "wholesale and retail" sectors was also firm centered on the Bangkok metropolitan area thanks to its relatively advanced urban infrastructure.

Nonetheless, the Board of Investment (BOI) of Thailand, which resumed investment approval under the military government, tightened the regulations on businesses eligible for investment (with tax incentives) in the manufacturing sector at the beginning of 2015. Thus, it should be noted that the last-minute rush in investment applications based on the old 2014 investment criteria may have served to inflate the amount of investment.

(2) Indonesia: "Transportation equipment" stays robust and "real estate" is growing in the non-manufacturing sector

Investment in Indonesia has shown a steady trend since the latter half of 2014 driven by the "transportation equipment" sector (**Chart 5**). As the country surpassed Thailand to become the largest automobile market in ASEAN in 2014, peripheral industries such as "iron, non-ferrous, and metals" are also increasing their presence, and the country has become the second largest automobile production site after Thailand. Likewise, the "chemicals and pharmaceuticals" sector has also seen investment rise by virtue of Japanese cosmetics companies working to grow their local market share by expanding their production facilities in Indonesia.

In addition, investment in the non-manufacturing sector is also growing. In anticipation of increasing financial needs following the rise of consumers in the middle income bracket, the trend to acquire local banks and insurance companies continues, and investment in the "real estate" sector is also increasing. This may be explained by the ongoing market entries into the housing industry by companies expecting to see an increase in demand.

Chart 4 Japan's investment in Thailand (by industry)

(100 million yen)

Industry/year	2012 H2	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1
Manufacturing	1,290	1,555	1,915	2,121	1,645	1,813
Food	32	17	-38	100	-89	-68
Textile	11	11	18	26	43	42
Lumber and pulp	81	59	44	149	51	66
Chemicals and pharmaceuticals	143	204	102	-12	90	77
Petroleum	0	9	0	0	0	0
Rubber and leather	85	81	134	138	45	66
Glass and ceramics	37	38	-48	33	40	62
Iron, non-ferrous, and metals	201	220	263	177	304	359
General machinery	47	79	125	107	188	115
Electric machinery	240	204	184	236	123	218
Transportation equipment	189	442	987	993	765	762
Precision machinery	228	116	78	35	38	52
Non-manufacturing	154	224	6,438	530	1,066	374
Farming and forestry	0	0	0	0	0	0
Fishery and marine products	1	0	0	0	0	0
Mining	-4	0	0	-9	0	-1
Construction	4	7	-3	-15	6	11
Transportation	4	47	21	34	33	49
Communications	0	1	5	13	11	-10
Wholesale and retail	-33	131	203	222	229	128
Finance and insurance	146	9	6,191	230	672	130
Real estate	8	3	1	3	9	15
Services	14	32	20	49	19	29
Total	1,444	1,779	8,353	2,651	2,711	2,188

Note: Highlighted figures are investment values exceeding 10 billion yen.
Source: Bank of Japan, *Balance of Payments Statistics*.

Chart 5 Japan's investment in Indonesia (by industry)

(100 million yen)

Industry/year	2012 H2	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1
Manufacturing	964	913	683	741	1,017	1,290
Food	63	48	96	-20	50	23
Textile	35	32	23	32	-2	39
Lumber and pulp	16	43	26	25	51	84
Chemicals and pharmaceuticals	70	-21	-48	-55	6	117
Petroleum	0	-10	0	0	0	0
Rubber and leather	40	64	25	104	9	38
Glass and ceramics	30	32	18	16	13	19
Iron, non-ferrous, and metals	122	127	-328	67	144	240
General machinery	100	62	36	15	30	23
Electric machinery	61	34	102	39	24	2
Transportation equipment	371	467	659	485	592	662
Precision machinery	0	0	10	6	3	6
Non-manufacturing	382	1,517	709	1,576	1,511	679
Farming and forestry	6	16	12	140	30	24
Fishery and marine products	-1	1	0	1	1	0
Mining	0	0	-9	0	-5	-4
Construction	1	-15	66	19	63	18
Transportation	6	22	14	4	65	69
Communications	0	0	0	0	4	0
Wholesale and retail	121	49	64	44	37	64
Finance and insurance	162	1,371	419	1,219	1,093	295
Real estate	74	57	80	93	61	134
Services	3	5	12	17	31	16
Total	1,346	2,430	1,392	2,317	2,528	1,968

Note: Highlighted figures are investment values exceeding 10 billion yen.
Source: Bank of Japan, *Balance of Payments Statistics*.

(3) Malaysia: "Electric machinery" continues to weaken, but "chemicals and pharmaceuticals" and others shore up investment

In Malaysia, the slowdown of "electric machinery" investment has been compensated by increases in other sectors, such as "chemicals and pharmaceuticals," "glass and ceramics" and "general machinery," resulting in strong overall investment (**Chart 6**). While companies continue to either withdraw from or scale down unprofitable businesses, including TVs and liquid crystals in the "electric machinery" industry, Malaysia has started attracting investment in capital intensive industries thanks to its relatively well-developed infrastructure.

Among non-manufacturers, investment in the "finance and insurance" sector is growing, excluding a large investment made by a Japanese energy company to acquire resource interests in the field of natural gas and oil in East Malaysia. With significantly higher purchasing power in the ASEAN, as shown by nominal per capita GDP exceeding 10,000 USD, and a relatively higher urbanization rate[3] in the 70% range compared with under 50% in the surrounding countries, various fields including retail finance are attracting attention.

(4) Philippines: "Electric machinery" recovers and investment targeted at domestic demand continues

Investment bound for the Philippines recovered in the second half of 2014, triggered

[3] Urban population/total population.

by a bounce back in the “electric machinery” sector, which was apparently slowing down up until the first half of 2014 (**Chart 7**). Since the “electric machinery” industry in the Philippines mainly comprises business machines and the after-process of semiconductor devices, it showed contrasting development compared with the same sector in Malaysia where consumer products are the major area.

Meanwhile, it is worth noting that investment in “transportation equipment” is gradually increasing. While sales of new cars in the Philippines reached the 234,000-level in 2014, which was about a quarter or fifth of the scale of Indonesia or Thailand, the figure has continued to grow at a double-digit rate in recent years, presumably reflecting potential market expansion in the future.

With a population of approximately 100 million, the Philippines has started to draw attention as an attractive consumer market. In addition to “transportation equipment,” such sectors as “food” and “wholesale and retail” are also inviting growing investment, demonstrating an increase in investment in anticipation of expanding domestic demand.

Chart 6: Japan’s investment in Malaysia (by industry)

(100 million yen)

Industry/year	2012 H2	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1
Manufacturing	105	410	363	170	404	574
Food	21	8	0	-1	8	13
Textile	11	0	7	26	29	4
Lumber and pulp	-9	15	6	1	11	22
Chemicals and pharmaceuticals	114	182	150	125	389	133
Petroleum	0	0	0	0	0	0
Rubber and leather	11	33	9	2	13	22
Glass and ceramics	-14	-17	101	-36	-32	168
Iron, non-ferrous, and metals	3	57	72	67	35	18
General machinery	14	17	42	34	-38	121
Electric machinery	-102	53	-48	-60	-100	-84
Transportation equipment	25	56	36	48	36	30
Precision machinery	3	1	-1	-5	-6	7
Non-manufacturing	455	298	163	-61	462	2110
Farming and forestry	0	0	0	0	0	2
Fishery and marine products	0	0	0	0	0	0
Mining	0	22	19	22	12	1630
Construction	14	4	-5	36	1	1
Transportation	13	-1	-1	-1	6	81
Communications	2	59	11	37	304	68
Wholesale and retail	298	58	-2	32	45	-27
Finance and insurance	88	40	68	149	87	348
Real estate	16	0	0	-19	1	-17
Services	5	7	60	7	6	36
Total	560	708	526	109	866	2684

Notes: Highlighted figures are investment values exceeding 10 billion yen.
Source: Bank of Japan, *Balance of Payments Statistics*.

Chart 7: Japan’s investment in the Philippines (by industry)

(100 million yen)

Industry/year	2012 H2	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1
Manufacturing	133	366	258	76	159	459
Food	2	18	21	30	34	40
Textile	0	0	0	0	0	0
Lumber and pulp	0	0	0	0	0	0
Chemicals and pharmaceuticals	13	10	6	12	12	9
Petroleum	0	0	0	0	0	0
Rubber and leather	8	5	4	4	-2	11
Glass and ceramics	-8	-2	2	0	2	0
Iron, non-ferrous, and metals	25	98	75	-58	-67	-7
General machinery	3	-1	4	0	3	4
Electric machinery	58	220	95	32	109	318
Transportation equipment	22	-5	28	36	30	30
Precision machinery	0	0	11	15	19	28
Non-manufacturing	52	562	16	128	182	153
Farming and forestry	0	0	0	0	0	0
Fishery and marine products	0	0	0	0	0	0
Mining	6	0	2	0	0	0
Construction	4	10	0	0	2	12
Transportation	0	1	-3	2	1	1
Communications	0	0	-4	3	0	0
Wholesale and retail	13	-3	14	24	24	40
Finance and insurance	16	0	0	92	61	5
Real estate	-3	11	-20	-12	22	18
Services	2	3	0	3	0	15
Total	185	928	274	204	339	612

Note: Highlighted figures are investment values exceeding 10 billion yen.
Source: Bank of Japan, *Balance of Payments Statistics*.

(5) Vietnam: “Electric machinery” recovers while “iron, non-ferrous, and metals” begins to increase

Investment in Vietnam stayed firm (**Chart 8**) supported by a large-scale investment refinery project by a Japanese consortium in the manufacturing sector, and also by virtue of the recovery in investment in the “electric machinery” sector in the first half of 2015, as in the Philippines. As Vietnam has become a major unit of assembling and handling global exports of office machinery and communication equipment, the concentration of electronic parts firms is gradually taking root.

Also in the non-manufacturing sector, investment in the "real estate" and "services" industries is solid, and it is noteworthy that investment[4] targeted at capturing the domestic demand is growing in Vietnam, a country with a population of approximately 90 million.

(6) Cambodia, Laos and Myanmar (CLM): Myanmar shows remarkable growth

The three CLM countries are attracting attention in ASEAN as new promising investment destinations. Their locations adjacent to Thailand and Vietnam, where Japanese firms have concentrated, make it easier to establish supply chains, and labor costs are relatively cheap in these nations. While investment in the three nations remained limited until the latter half of 2014, it should be noted that investment in Myanmar grew sharply, reaching 6.6 billion yen in the first half of 2015 (**Chart 9**).

The scale of investment in Myanmar is still under one-tenth of that made in the manufacturing industry in Thailand, amounting to roughly 150 to 200 billion yen semiannually, and the same industry in Vietnam amounting to about 50 to 100 billion yen. Even so, given the united efforts of Japan's public and private sectors in opening of an industrial park in Myanmar's Thilawa special economic zone near Yangon in September 2015, investment in Myanmar will likely expand on a full-fledged scale in the near future.

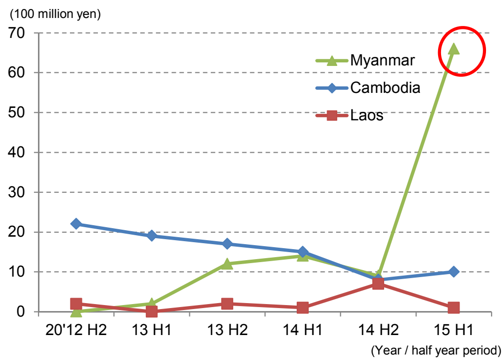
Chart 8: Japan's investment in Vietnam (by industry)

(100 million yen)

Industry/year	2012 H2	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1
Manufacturing	507	1,162	656	675	474	819
Food	24	9	30	-36	55	58
Textile	4	10	7	10	3	3
Lumber and pulp	22	14	37	0	14	11
Chemicals and pharmaceuticals	50	97	77	74	71	45
Petroleum	18	215	107	146	11	238
Rubber and leather	34	210	14	150	-4	38
Glass and ceramics	1	58	49	21	30	-16
Iron, non-ferrous, and metals	51	62	106	114	30	45
General machinery	53	64	25	58	87	68
Electric machinery	114	203	14	15	36	146
Transportation equipment	73	110	114	39	70	87
Precision machinery	37	70	54	37	16	43
Non-manufacturing	123	1,150	209	123	136	130
Farming and forestry	0	0	1	3	2	0
Fishery and marine products	0	0	0	0	0	0
Mining	9	0	0	0	0	-6
Construction	2	16	17	19	-40	-31
Transportation	0	14	0	23	0	16
Communications	1	0	0	12	0	10
Wholesale and retail	30	8	26	31	-22	-75
Finance and insurance	8	1,081	138	2	107	104
Real estate	2	5	22	20	51	57
Services	7	5	5	10	37	47
Total	630	2,312	865	798	610	949

Note: Highlighted figures are investment values exceeding 10 billion yen.
Source: Bank of Japan, *Balance of Payments Statistics*.

Chart 9: Japan's investment in CLM (manufacturing sector)



Source: Bank of Japan, *Balance of Payments Statistics*.

[4] Although the fund outflow exceeded the inflow in the "wholesale/retail" sectors, this can be attributable to an one-off factor of Japan's leading retail company selling its shares to a partner company for the purpose of business restructuring.

4. Focal points in forecasting future investment trends to China and the ASEAN

As described in the previous sections, Japan's investment in China regained momentum from the second half of 2014 to the first half of 2015, and investment in the ASEAN has also remained strong. Nonetheless, the recent slowdown of the Asian economies has cast a shadow over the outlook on investment.

Meanwhile, there have been new developments in international trade policy in Asia, such as the scheduled establishment of the ASEAN Economic Community at the end of 2015 and the conclusion of the broad agreement of the Trans-Pacific Partnership negotiations in October 2015.

In light of these situations, we will conclude this report by describing the focal points when projecting the future development of Japan's investment.

(1) In the short term, investment will be restraint due to the economic slowdown in China and the ASEAN

While overall investment in Asia continued to perform strongly after the second half of 2014, actual sales generated by local subsidiaries started to decline from the latter half of 2014 compared with the same period in the previous year in both China and the ASEAN countries (**Chart 10**).

This reflects the real GDP growth rate in China falling to 7.3% (2014) from 7.7% (2013) and that of the ASEAN5 countries declining to 4.6% (2014) from 5.1% (2013). In October 2015, MHRI forecasts that the economic growth rate would continue to decelerate in China to 6.6% (2016) from 6.9% (2015) and that of the ASEAN5 countries declining to 4.3% (2016) from 4.4% (2015).[5]

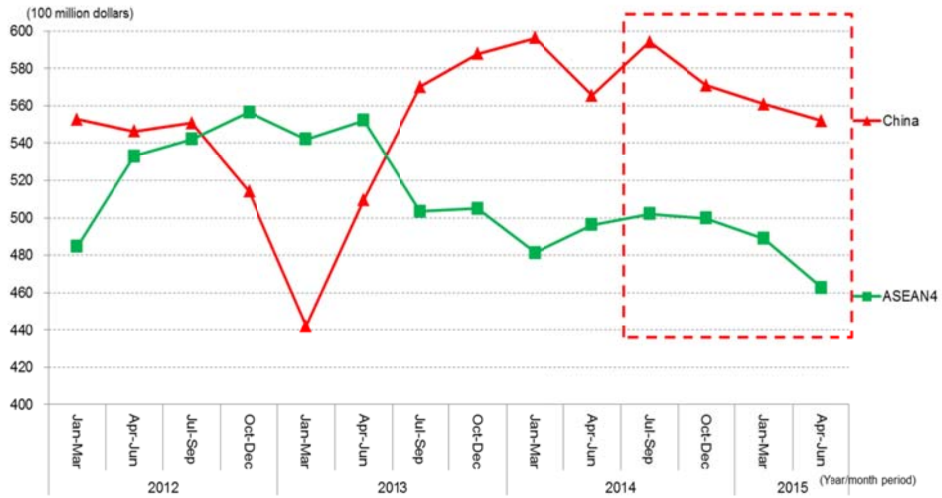
Concerns over the potential negative impact on investment are particularly strong in the "transportation equipment" sector. This is because the sector is not only a driving force behind ASEAN investment but is also considered to be the ultimate user of the "general machinery" sector in China, a leading investment area in the country.[6] In addition to the stagnant rise of new car sales in both China and the ASEAN nations (year-on-year growth rate in the January to September period in 2015 was +0.3% in China, -18.0% in Indonesia and -14.6% in Thailand), the markets in Asia and Oceania, which are the main export destinations of automobiles (Thailand exports most of the cars manufactured in the country), are also slowing down. Hence it is highly likely that investment in the manufacturing sector, which had been fueled by the "transportation

[5] For details, refer to MHRI (2015).
[6] For details, refer to Ueda (2014).

equipment” sector, will be subdued from the second half of 2015.

Moreover, Japanese companies are subject to other negative factors which may lead to a reduction in investment. For instance, in China, the ongoing issue of excessive production facilities in the areas of iron, cement, glass and chemicals by domestic firms has intensified price competition. In the ASEAN also, production costs are increasing due to the surge in import material prices following the weakening of local currencies in countries such as Indonesia and Malaysia

Chart 10: Sales of Japanese subsidiaries in China and the ASEAN

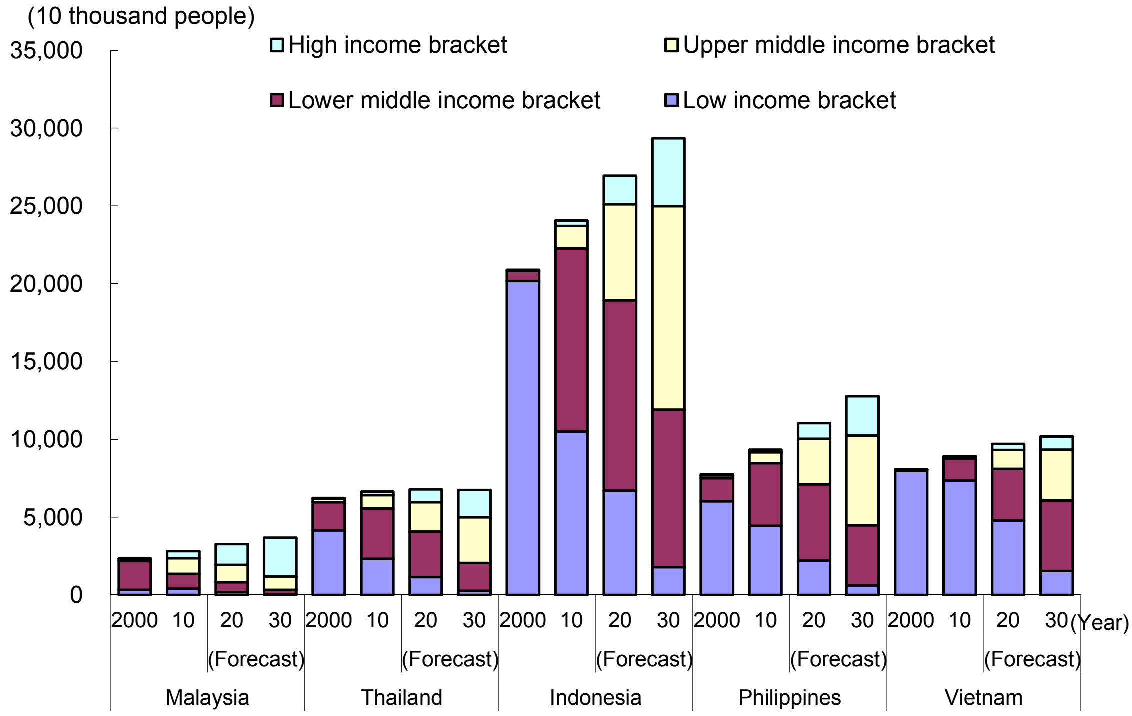


Note: China includes Hong Kong. ASEAN comprises Thailand, Indonesia, Malaysia and the Philippines.
Source: Ministry of Economy, Trade and Industry, *Quarterly Survey of Overseas Subsidiaries*.

On the other hand, in the middle to long term, the number of people in the “high income bracket” and “middle income bracket” is expected to increase in urban areas of the ASEAN countries, following a similar pattern of increase in the coastal areas of China, and according to the survey conducted by Euromonitor, a London-based market research firm, the population in the high and middle income brackets is expected to reach 600 million in the ASEAN nations by 2030 (**Chart 11**). In line with this trend, the content of consumer spending is projected to gradually shift from daily necessities to expenditures targeting services.

As a result, investment in the non-manufacturing sector, in an attempt to cover the needs of the high and middle income bracket, is expected to remain firm in both China and the ASEAN countries, even if their economies slide into recession. But in the case where their economic and financial markets become unstable, the timing of investment may be reexamined.

Chart 11: Population by income bracket in the ASEAN5



Note: Low income bracket is under USD 5,000, lower middle bracket is over USD 5,000 and under USD 15,000, upper middle bracket is over USD 15,000 and under USD 35,000, and high bracket is USD 35,000 or over. USD amount is the nominal value.
Source: Made by MHRI based upon Euromonitor and the United Nations.

(2) In the middle to long term, the concentration of specific industries will progress in the ASEAN due to the establishment of the AEC

In addition to the elimination of customs tariffs at the end of 2015, the AEC is scheduled to be established aimed at liberalizing the services sector and part of the transfer of human resources, but the elimination of customs tariffs was mostly completed among ASEAN's early member nations (Singapore, Brunei, Thailand, Indonesia, Malaysia and Philippines) in 2010. At the beginning of 2015, the late ASEAN members (Cambodia, Laos, Myanmar and Vietnam) also eliminated customs tariffs on over 90% of the items (**Chart 12**), and the rest of the items are basically scheduled for customs tariff elimination by 2018.

As customs tariff elimination within the ASEAN region proceeds, logistics costs are also expected to decline [7] due to infrastructure development in the area and implementation of electronic customs systems, and it is highly likely that production sites targeting the ASEAN region will head toward concentration in the middle to long term.

Looking at outstanding investment in the ASEAN by Japanese companies, the

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[7] For details, refer to Sako (2015).

concentration in Thailand is the most notable. But looking at investment by sector, each country appears to attract investment in specific sectors by taking advantage of their respective characteristics (**Chart 13**). For example, investment in "transportation equipment" is the largest in Indonesia, characterized by strong domestic demand; "chemical and pharmaceuticals" is the largest in Malaysia, where infrastructure is relatively well-developed; and "electric machinery" is the largest in the Philippines and Vietnam due to their close proximity to South China, a region with a concentration of high-tech industries, making it easier to procure materials. They are also known for their abundant workforce available at a relatively low cost.

Therefore, after the establishment of the AEC, Thailand is expected to increase its presence as a core factory in the ASEAN in the middle to long term. At the same time, investment in other countries is also forecast to expand further, mainly in areas where the concentration of specific industries has already started.

Chart 12: Status of eliminating customs tariffs in the ASEAN

(Unit of share: %)

Country/number of items	Total number of items	Number of non-tariff items	Share to total number of items	Number of items with tariff rates over 0% and up to 5%	Share to total number of items	Number of items with tariff rates over 5%	Number of other items
ASEAN6	61,202	60,712	99.2	148	0.2	65	277
Singapore	9,558	9,558	100.0	0	0.0	0	0
Brunei	9,916	9,844	99.3	0	0.0	0	72
Thailand	9,558	9,544	99.9	14	0.1	0	0
Malaysia	12,337	12,182	98.7	60	0.5	13	82
Indonesia	10,012	9,899	98.9	0	0.0	17	96
Philippines	9,821	9,685	98.6	74	0.8	35	27
CLMV	38,232	34,732	90.8	2,917	7.6	247	336
Cambodia	9,558	8,744	91.5	662	6.9	152	0
Laos	9,558	8,537	89.3	934	9.8	0	87
Myanmar	9,558	8,847	92.6	660	6.9	0	51
Vietnam	9,558	8,604	90.0	661	6.9	95	198

Notes: 1. Data is as of January 2015.
2. Others include items whose customs tariff rates are unknown.
Source: ASEAN Secretariat

Chart 13: Outstanding amount of Japan's investment in the ASEAN

(Unit: 100 million yen)

Country	/year	Food	Chemicals and pharmaceuticals	Rubber and leather	Iron, non-ferrous, and metals	General machinery	Electric machinery	Transportation equipment	Precision machinery
Thailand	13	939	2,551	1,842	4,560	2,484	5,758	10,942	1,277
	14	1,074	2,986	2,243	5,504	2,933	6,908	13,046	1,360
Indonesia	13	447	1,745	722	479	885	863	5,745	87
	14	563	1,994	845	1,474	1,011	860	7,300	155
Malaysia	13	345	2,876	232	764	1,233	1,806	847	313
	14	351	4,118	261	912	1,085	2,282	987	304
Philippines	13	1,855	256	204	1,558	- 15	2,175	873	172
	14	2,158	258	200	1,699	49	2,731	1,013	249
Vietnam	13	319	507	361	928	741	1,081	1,278	488
	14	439	685	604	1,122	956	1,188	1,655	536

Note: Highlighted figures are investment values exceeding 100 billion yen.
Source: Bank of Japan, *Balance of Payments Statistics*.

(3) New developments related to TPP enforcement

After overcoming many hurdles, the TPP negotiations finally came to an end in October 2015 with the conclusion of a broad agreement. Since the actual enforcement of the agreement awaits the completion of the ratification process in each country's legislature, the exact timing of the enactment is yet unknown. That said, we are already witnessing new developments in anticipation of the TPP enforcement in the area of investment.

Asian countries participating in the TPP negotiations comprise Singapore, Brunei, Malaysia and Vietnam. Among the four nations, Vietnam will likely attract the greatest attention as an export destination within the TPP region because its labor cost is the lowest among the twelve TPP participating countries. Since Vietnam needs to lift the local procurement ratio (increase the added value in Vietnam) in order to clear the rule of origin, investment in supporting industries of the manufacturing sector is projected to increase.

In addition, according to the Government Headquarters for the TPP of the Cabinet Secretariat, Vietnam and Malaysia will relax their regulations in the non-manufacturing sector in line with the other TPP nations (**Chart 14**), and this is raising the expectations of Japan's non-manufacturing companies on new developments related to potential deregulation.

As a matter of fact, the AEC has also targeted liberalization of the services sector by raising the foreign ownership ratio to 70% for companies within the ASEAN region. However, implementation of this rule did not proceed as expected, and it was implemented only in Singapore and Cambodia. In addition, as it remains uncertain whether foreign companies' local subsidiaries are eligible as companies within the ASEAN region, the AEC framework has failed to implement deregulation speedily and in a transparent manner. For this reason, there is a high possibility that investment by Japanese firms in the non-manufacturing sector will head straight to Vietnam and Malaysia out of expectations that deregulation will proceed and transparent investment rules will be implemented consistently under the TPP rules.

Chart 14: Market access of items other than goods following the TPP enforcement

Industry/country	Vietnam	Malaysia
Retail	• Abolish the Economic Needs test (store opening screening test based on the number of existing stores and the size of the market) across Vietnam when opening new convenience stores and supermarkets, after a grace period of 5 years after enforcement.	• Relax the foreign investment rate restriction on convenience stores (no foreign investment allowed → maximum foreign investment rate set at 30%).
Telecommunications	• Relax the foreign investment rate restriction on telecommunications companies (65% → 75%).	
Finance and insurance	• Relax the foreign investment rate restriction on local banks (15% → 20%).	• Increase the maximum number of foreign bank branches (8 → 16). • Eliminate, in principle, the restrictions on foreign banks installing ATM outside branches. • Relax the obligation to purchase reinsurance from state-run reinsurance companies (purchase ratio fixed at 30% → 2.5%).

Source: The Government Headquarters for the TPP, Cabinet Secretariat, "*Summary of the Trans-Pacific Strategic Economic Partnership Agreement (TPP)*," (October 5, 2015).

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