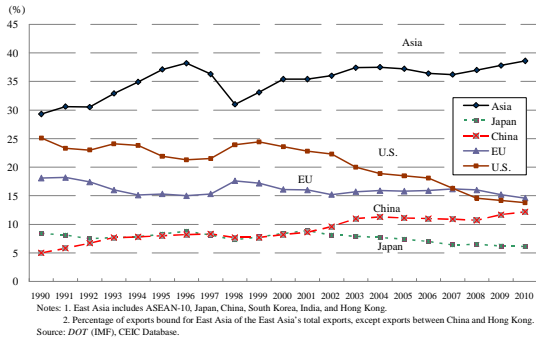


**Section 5 Other Asian economies**

**1. Overview**

This section examines the overview of the economy and risk factors featuring other Asian economies, especially South Korea. Asian economies are developing deeper relations between Asian economies as well as with Europe and the U.S. advanced economies through trade and investment. From a long-term perspective, as major export counterparts in Asia, the share of the USA has been declining, while the share of Asian economies has been increasing (see Figure 1-5-1-1). In recent cases, we can see the influence through supply chain in the Great East Japan Earthquake in Japan and floods in Thailand. The background to this is the progress of the division of production and the growth of intermediary goods trade resulting from such progress thereof, which should be discussed in the next chapter. Such relationships in trade and investment also lead to a strong relationship in economic trends.

Figure 1-5-1-1  
Export counterparts in East Asia

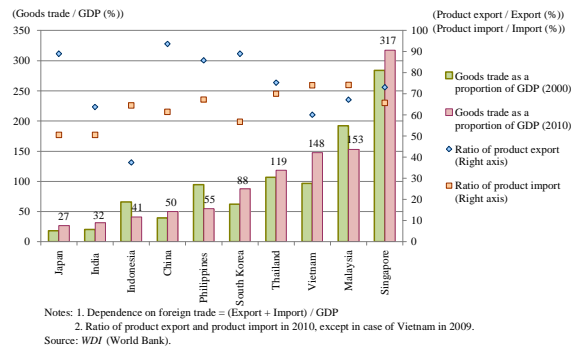


Asian economies, as a whole, made a relatively early recovery from the failure of Lehman Brothers and continued moderately recovering also in 2011. However, as examined in Section 1 of this chapter, the pace of recovery became moderate from around the middle of 2011 primarily due to worldwide excessive liquidity, surging resources prices, rising domestic prices and a tight monetary policy adopted in response to such price movements, as well as a slowdown in exports reflecting the deepening European debt crisis.

Many Asian economies have high dependence on foreign trade (export-to- and import-to- GDP ratio), but there is great variability among such degree and the composition of exports is also diversified (see Figure 1-5-1-2).

Figure 1-5-1-2

Dependence on foreign trade and ratio of product trade of Asian major countries



According to the transition of real GDP growth rate of each country, though some countries with high dependence on foreign trade and with a great percentage of export of products, such as South Korea, experienced rapid decline and recovery in real GDP growth rate following the failure of Lehman Brothers, such economies continued stable growth afterwards (see Figure 1-5-1-3 (a)). However, as to last year, there are signs of gradual economic slowdown due to deceleration in exports bound for Europe and other reasons. Furthermore, even some countries with relatively low dependence on foreign trade and with a relatively small percentage of export of products, such as China and India, continued relatively stable and high growth, but there are also signs of gradual economic slowdown (see Figure 1-5-1-3 (b)). As for Thailand, it is remarkable that the real GDP growth rate sharply declined in the fourth quarter of last year due to floods.

As just described, Asian economies, as a whole, show similar movement in 2011. However, each country has a different situation and problem from a detailed viewpoint. This section examines the current situations and problems of economy featuring Asian economies, especially South Korea. As for Thailand, Chapter 2 makes an analysis focused on the influence of floods.

Figure 1-5-1-3(a)

Real GDP growth rate of Asian major countries (ratio to the same quarter of the previous year)

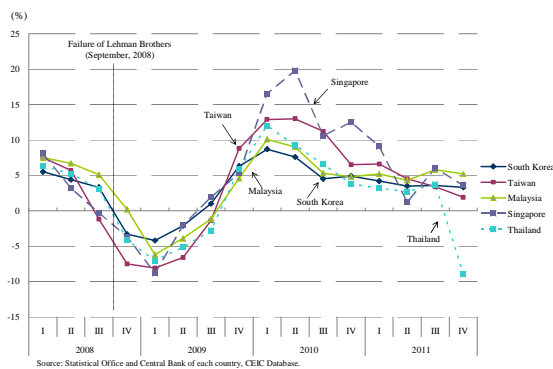
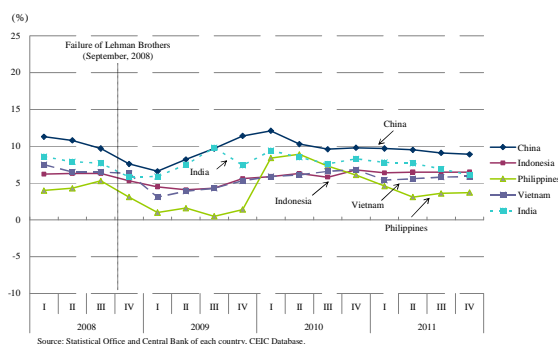


Figure 1-5-1-3(b)

Real GDP growth rate of Asian major countries (ratio to the same quarter of the previous year)



## 2. South Korean economy

### (1) Overview of the South Korean economy

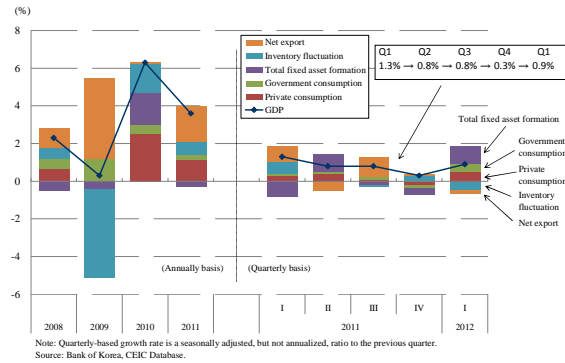
Though the South Korean economy continued moderately recovering in the first half of 2011, exports mainly bound for Europe started to decelerate from around the middle of 2011 due to refueling European debt crisis. Around autumn, overseas investors such as European financial institutions increased a tendency to avoid risk and withdrew capital from South Korea and other Asian economies, resulting in a sharp decline in the South Korean won and a decrease in foreign currency reserves, etc. Under these circumstances, economic slowdown became evident. Recently, there are signs of some recovery but the economy remains at a standstill. Below, we examine trends of key economic indicators including GDP.

#### (GDP)

According to the transition of real GDP growth rate (ratio to the previous quarter, seasonally adjusted), the real GDP growth of 2010 marked a third consecutive quarter of slowdown (see Figure 1-5-2-1). By category of demand, deceleration in exports puts downward pressure on the economy, however, reduction in imports of intermediary goods resulting from production decrease and deceleration in domestic demand led to a slowdown in import, and net exports continued positive contribution. Furthermore, companies reduced equipment investments due to concern about the future of export and, as a result of that, fixed capital formation also marked gradual decrease. Under such circumstances, private consumption slowed down, government consumption which had supported the economy ran out of steam, and, in the fourth quarter of 2011, all of the fixed capital formation, private consumption and government consumption fell into the negative from the previous quarter. In earlier 2012, the preliminary data for GDP growth in the first quarter showed a slight increase as a whole due to factors such as positive growth of each item of domestic demand. However, such increase could be seen as a reaction to the fourth quarter and remains on low growth rate, and we cannot still afford to become optimistic about such a situation.

Figure 1-5-2-1

South Korea's real GDP growth rate (ratio to the previous quarter)

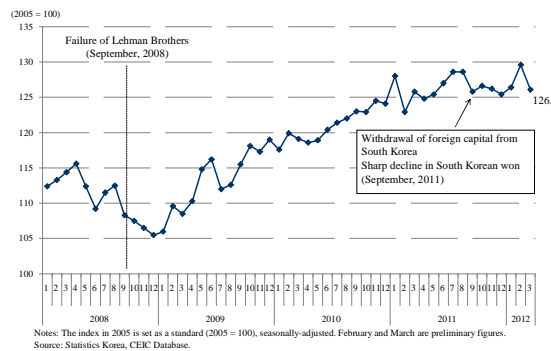


**(Consumption)**

According to the transition of South Korea's retail sales index, consumption was on a rising trend in the first half of 2011, but significantly declined in September when the events, such as withdrawal of foreign capital from South Korea and a sharp decline in the South Korean won, occurred. Afterwards, consumption has been alternating between growth and decline (see Figure 1-5-2-2).<sup>169</sup>

Figure 1-5-2-2

South Korea's retail sales index



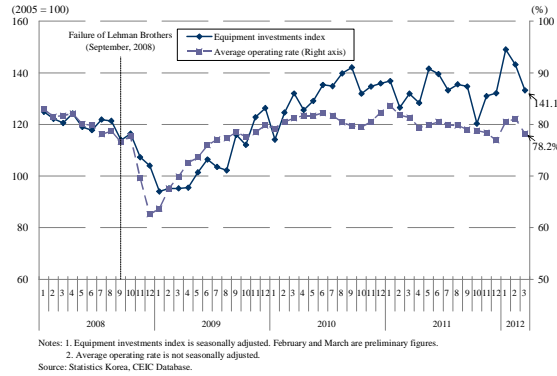
**(Investment)**

The equipment investments index also significantly declined immediately after September 2011 when the events, such as withdrawal of foreign capital from South Korea and a sharp decline in the South Korean won, occurred (see Figure 1-5-2-3). Afterwards, the index remained low though the level slightly recovered. In earlier 2012, though the index rose in January and February, it returned to the low level again in March. In addition, the average operating rate of manufacturing industries

169 The index rose temporarily in February 2012, but returned to the former level in March. Such movement may be affected by seasonal factors. In South Korea, as the New Year's holidays are determined according to the lunar calendar, they vary from year to year. The New Year's holidays were in February in 2011 and in January in 2012. Therefore, in 2012, the number of business days decreased in January and increased in February compared with last year.

gradually declined in the latter half of 2011, rose temporarily in early 2012, and declined in March. Under such circumstances, it remains hard to make equipment investments aggressively.

Figure 1-5-2-3  
South Korea's equipment investments index



**(External demand)**

Though both import and export recovered in terms of monetary amounts from a drop after the failure of Lehman Brothers, there has been little change after the middle of 2011 (see Figure 1-5-2-4). In comparison to the same quarter of the previous year, exports bound for the EU, in particular, remarkably slow down and have fallen from the previous year since the middle of 2011 (see Figure 1-5-2-5).

Figure 1-5-2-4  
South Korea's trade amount

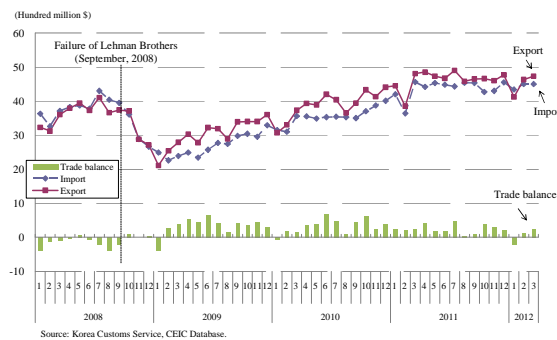
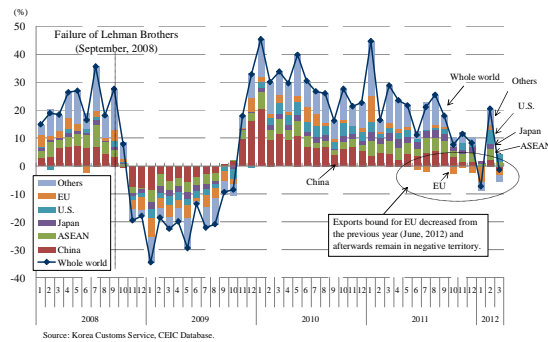


Figure 1-5-2-5

South Korea's export growth rate (ratio to the same month of the previous year)

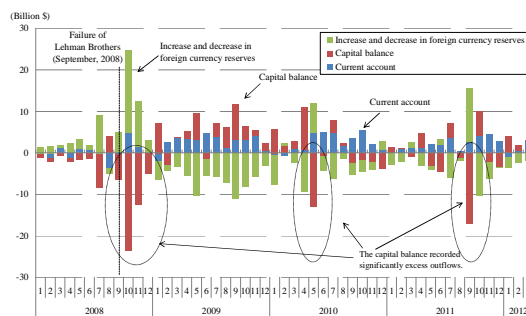


**(Balance of payments)**

In 2011, the current account was maintained positively reflecting the trade surplus (see Figure 1-5-2-6). In September 2011, the capital balance recorded significantly excess outflow mainly in “other investments” (bank finance, etc.) due to an increased tendency to avoid risk by overseas investors such as European financial institutions resulting from the European debt crisis. This led to a sharp decline in the South Korean won, and it is believed that Bank of Korea carried out foreign exchange intervention to stabilize the won exchange rate. The foreign capital outflow and foreign exchange intervention resulted in a substantial decrease in South Korea's foreign currency reserves in September, and South Korea raised the swap line of the currency swap agreement with Japan and China. Afterwards, though the capital balance has varied between excess outflow and excess inflow, substantial capital outflow could be stopped. Foreign currency reserves are recovering with the help of the current account surplus.

Figure 1-5-2-6

South Korea's balance of payments



**(Employment situation)**

Though the unemployment rate in 2011 becomes lower than that in 2010, the unemployment rate for young people remains high (see Figure 1-5-2-7). The number of workers increases compared to the same month of the previous year, but such increase is supported by the tertiary industry including

“business/personal/public service”, and the number of workers in mining and manufacturing industries continues to decrease from August 2011 (see Figure 1-5-2-8).

Figure 1-5-2-7

South Korea’s unemployment rate

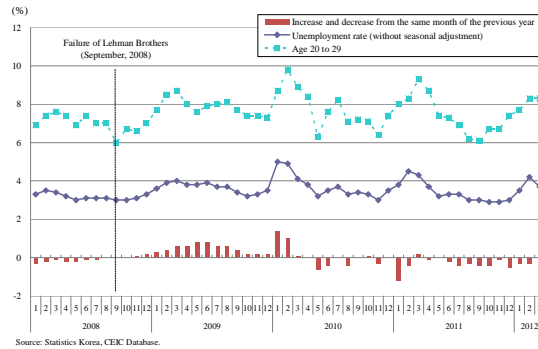
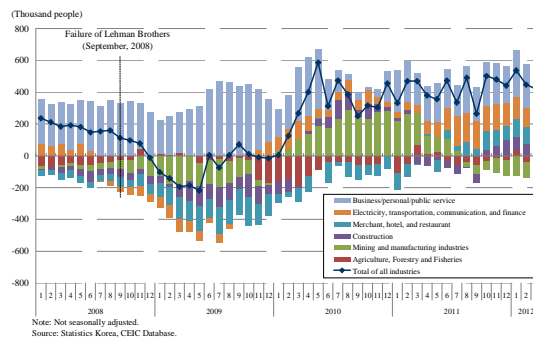


Figure 1-5-2-8

South Korea’s workers by industry (compared to the same month of the previous year)



**(Consumer price and monetary policy)**

The growth rate of consumer price has accelerated from the beginning of 2011 and, in August, rose to 4.7% exceeding 4% which was the upper limit of an inflation target of the Bank of Korea (see Figure 1-5-2-9). In response to that, the Bank of Korea raised the policy interest rate on five occasions for the period from July 2010 to June 2011 (see Figure 1-5-2-10). In the latter half of 2011, the growth rate of consumer price started to decline, and there has been increased demand for the interest-rate cut arising from a concern over the economy due to a slowdown in exports. However, the interest-rate cut contributes to economic stimulus, while it may result in a foreign capital outflow, depreciation of the South Korean won, and inflation of import prices. Therefore, it is tough to make a decision.

Figure 1-5-2-9

Growth rate of South Korea's consumer price index (ratio to the same month of the previous year)

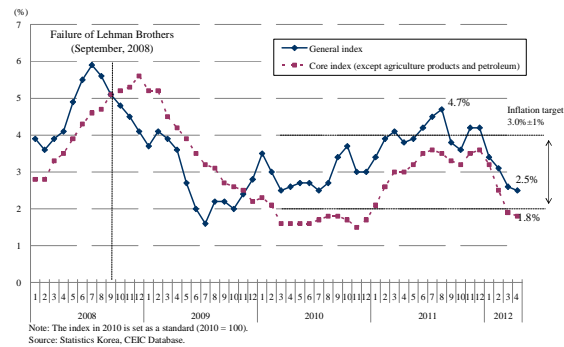
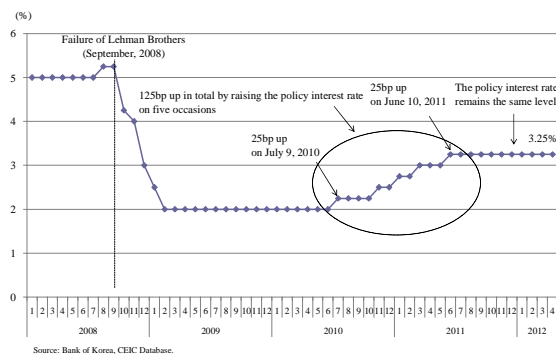


Figure 1-5-2-10

South Korea's policy interest rate

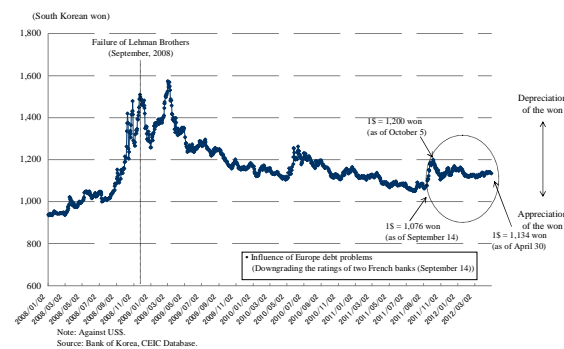


**(Exchange rate)**

As already examined, refueling European debt crisis and an increased tendency to avoid risk by overseas investors such as European financial institutions around the middle of 2011 resulted in a substantial outflow of foreign capital and a sharp decline in the South Korea won in September 2011 (see Figure 1-5-2-11). The exchange rate slightly recovered to the former level after the next month, and has been hovering with a small fluctuation afterwards.

Figure 1-5-2-11

South Korean won exchange rate





## (2) Risk of South Korean economy

With respect to South Korea, high attention is focused on South Korean companies' considerable success, while some are concerned about the future of the South Korean economy as a nation. The current factor of depressed South Korean economy is a trend of exports mainly bound for Europe, and, in addition to that, there are many risks faced by the South Korean economy in the medium- and long-term. Below, we consider the potential risks of the South Korean economy.

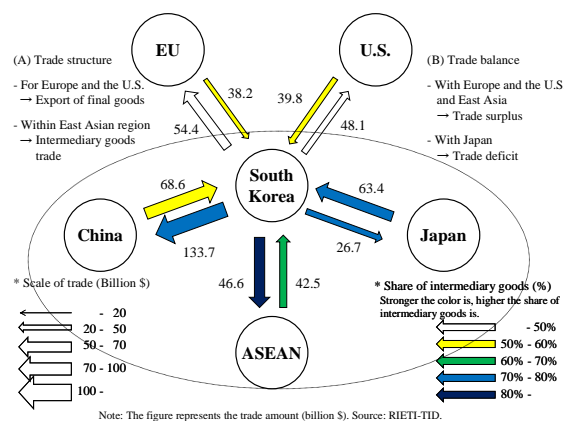
### (A) South Korea's trade structure

At first, we review South Korea's trade structure in advance of considering the risks. Figure 1-5-2-12 shows the trade structure surrounding South Korea of 2010. With regard to an arrow of trade, the width shows the scale of trade and the color shows the share of intermediary goods. The wider the arrow is, larger the trade amount is; the stronger the color is, higher the share of intermediary goods is. This reveals two distinctive characteristics of South Korea's trade structure. One characteristic is that the share of intermediary goods is high in export bound for China and ASEAN, and export and import with Japan, and, on the other hand, the share of final goods is high in export bound for the U.S. and the EU.

Such trade structure shows that South Korea as well as Japan is in a position to supply intermediary goods for China and ASEAN, which are in charge of an assembly process, in the international division of production in East Asia, as examined in Section 2 of the next chapter.

Figure 1-5-2-12

South Korea's trade structure (2010)



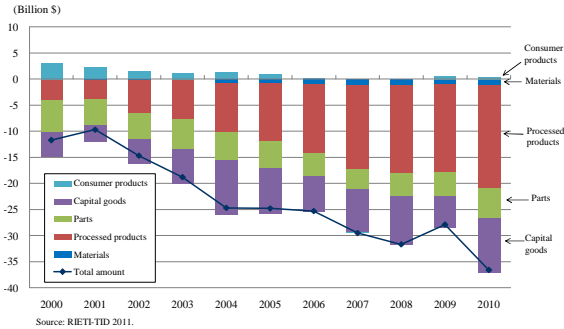
### (Intermediary goods are dependent on import)

Another characteristic is that South Korea runs a trade surplus with Europe and the U.S. and East Asia, and, on the other hand, runs a trade deficit with Japan. The share of intermediary goods is high in imports from Japan, and it may be greatly affected by import of key parts and materials.

Trade deficit with Japan includes processed products, parts and capital goods. This suggests that production facilities, such as key parts, advanced materials and machine tools, are imported from

Japan (see Figure 1-5-2-13). Some sources point out that this is because, in South Korea, though large companies are supported generously, small and medium-sized companies are not supported sufficiently, and the fact makes it difficult for blue-chip small and medium-sized suppliers to develop unlike Japan.

Figure 1-5-2-13  
South Korea's trade balance with Japan



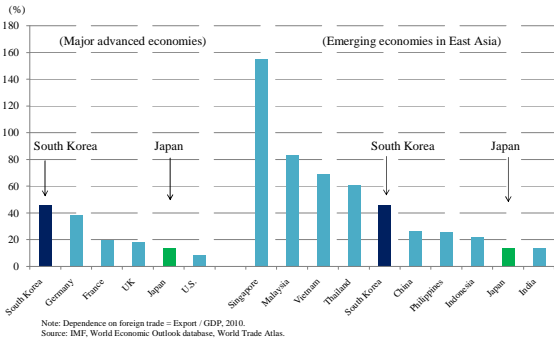
**(B) Risk of South Korean economy**

South Korea has been highly competitive in the international market: it develops the international division of production as a supplier of intermediary goods in East Asia and runs trade surpluses with many countries. Below, we consider potential problems of South Korea.

**(High dependence on export)**

The population size of South Korea is less than half that of Japan, about 49 million people. Therefore, the domestic market is relatively limited and its dependence on export is high. The share of export in GDP of South Korea is not remarkably high compared to that of emerging economies in East Asia, but is evidently high compared to that of advanced economies (see Figure 1-5-2-14). High dependence on export suggests that South Korea is easily influenced by a trend of the world economy and is vulnerable to an international demand shock such as the failure of Lehman Brothers.

Figure 1-5-2-14  
Dependence on exports of major countries



### **(Dependence on foreign capital)**

In comparison of South Korea's external asset balance /debt balance (at the end of 2010) with those of other major economies of East Asia, the gross amount of debt of South Korea is larger than those of Thailand and Malaysia (see Figure 1-5-2-15). In the composition of debts, "securities investment" and "other investments" (loan, etc.) which are easy to be withdrawn account for larger proportion than "direct investment" which is difficult to be withdrawn easily. It is considered that a short-term loan accounts for a large proportion in the loan, and this creates a volatile structure.

High dependence on foreign capital could lead to the contraction of fund supply within South Korea by withdrawing of foreign capital and the shrinking of smooth economy activities. The transition of external net debt balance remarkably shows an outflow of foreign capital and a decline in debt balance before and after the failure of Lehman Brothers (see Figure 1-5-2-16). In the third quarter of 2011, similarly but differently in degree, an outflow of foreign capital and a sharp decline in the South Korean won caused anxiety about the future of the South Korean economy.

According to external net debt balance, South Korea is a net debtor nation and it is quite unlikely to produce a massive surplus in income balance. Therefore, for example, a decline in exports and a deficit in trade balance caused by an external shock will easily lead to a deficit in the current account.

We have examined the characteristics of the South Korean economy and its main risks. South Korea has high dependence not only on export but also on foreign capital and import of intermediary goods, because the domestic market is limited. That has become the source of growth as well as a factor of volatility. In other words, South Korea has been "leveraged" effectively by export as well as import and foreign capital. When the economy mainly in Europe and the U.S. is strong, a virtuous cycle is created; on the other hand, when the world economy becomes weak, such factors as slowdown in exports, outflow of foreign capital and a sharp decline in the South Korean won are likely to cause a risk falling into a vicious cycle. In addition to those, some sources point out various problems including the significantly fluctuating South Korean won, worsening of terms of trade, employment, disparity, declining birthrate and aging population, and revamping of financial conglomerates (chaebol).

With a presidential election scheduled in December 2012, such problems as disparity, employment or social welfare are becoming a point of issue. South Korea's future political direction attracts attention.

Figure 1-5-2-15

External asset balance /debt balance of Asian major emerging economies (end of 2010)

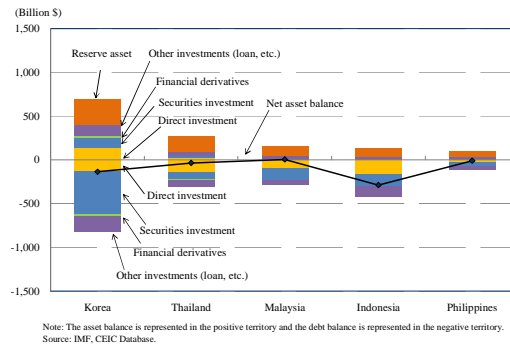
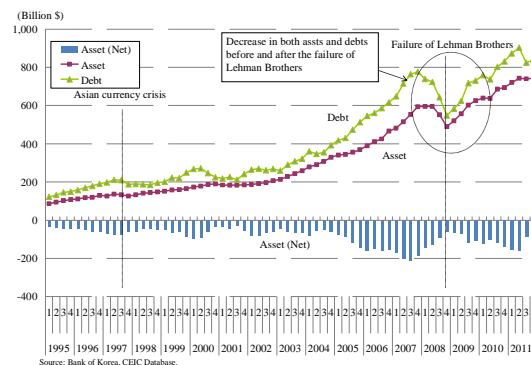


Figure 1-5-2-16

South Korea's external asset balance /debt balance



#### Column 4 China and India

China and India are in the spotlight as BRICs in Asia. Both have achieved higher economic growth rates than those of advanced economies, and have the world's largest scale of the economy and population. Here, we try the comparison between both economies.

According to the questionnaire survey on companies conducted by Japan Bank for International Cooperation in 2011, as a promising candidate for expanding business from a medium-range viewpoint, China is ranked No.1 (72.8% of answers), followed by India (58.6% thereof) and Thailand (32.5% thereof), which achieves far higher point than other two answers. However, according to "Basic survey of overseas business activities" by the Ministry of Economy, Trade and Industry, the number of Japanese enterprises holding overseas subsidiaries was actually 5,565 companies in China and 267 companies in India at the end of fiscal 2010.

The reasons for major expansion into China are that China is an economical precedent and that China is superior to India in GDP, per capita GDP and the total trade amount (see Column Table 4-1).

Column Table 4-1

Major economic indicators of China and India

	China	India
Area	9.6 million km <sup>2</sup>	3.29 million km <sup>2</sup>
Population	1,341 million people	1,191 million people
GDP	5,930 billion dollar (Second in the world)	1,600 billion dollar (Ninth in the world)
GDP growth rate (Average between 2010 and 2011)	10.5%	7.5%
Per capita GDP	4,421 dollar	1,342 dollar
Total trade amount	2,970 billion dollar	470 billion dollar
Foreign direct investments	105.7 billion dollar	24.6 billion dollar

Note: All is statistic value in 2010.

Source: Statistical Office of each country, IMF “WEO database”, UNCTAD “World Investment Report”, and CEIC Database.

It is also considered one of the reasons that China has invited the establishment of foreign affiliated companies through aggressively preferential treatment to foreign companies and has realized economic growth driven by export, taking advantage of an abundant labor force. However, recently, the preferential treatment to foreign companies has been abolished and shifted to that focused on a particular industry and region encouraged by the government.<sup>170</sup> Furthermore, as described in Section 4 of Chapter 1, wages are increasing in China and it has become difficult to depend on cheap and simple labor. Potential reason and problems are also examined in the abovementioned questionnaire survey by Japan Bank for International Cooperation. “Labor cost increase” is ranked No.1 (74.0% of answers) as a problem in China (see Column Table 4-2) .

Instead, recently, there is great interest in China as a potential market. In the abovementioned questionnaire survey, “growth potential of local markets” (82.3% of answers) is the top answer, which vastly exceeds “cheap labor” (32.8% thereof), as a potential reason. Also for India, “growth potential of local markets” (90.5% of answers) is the overwhelming majority as a potential reason.

So, we examine a future increase in the number of buyers in China and India. Based on the estimate in the private sector<sup>171</sup>, household budgets are classified by annual disposal income into the following classes: wealthy class (over 35 thousand dollars), upper middle class (15 to 35 thousand dollars), lower middle class (5 to 15 thousand dollars), and low-income class (5 thousand dollars or less). According to their transition, the low-income class has been decreasing in the share and shifting to the wealthy class and middle class in both China and India (see Column Figure 4-3). In the case of China, for example, the wealthy class counted about 40 million people equivalent to 2.7% of the population in 2010 but is estimated to count about 170 million people equivalent to 12.6% of the population in 2020. If changing as estimated, the wealthy class equivalent to Japan’s total population will newly emerge. In the case of India, the wealthy class is also expected to increase from about 20 million people

170 For example, “Corporate Income Tax Law” (2008) stipulates that the tax rate is set at 25% without exemption and the favorable tax rate for foreign companies is abolished after a transitional period.

171 We used the future share of household budgets by income class estimated by Euromonitor International.

equivalent to 1.5% of the population in 2010 to about 90 million people equivalent to 6.8% of the population in 2020. Similarly, when making estimation for the upper middle class just behind the wealthy class, it is expected to count 400 million and 370 million people respectively in China and India in 2020. Though this is only estimation, a substantial increase in the number of buyers will be certainly expected.

Column Table 4-2

Potential reasons/problems for expansion into China and India

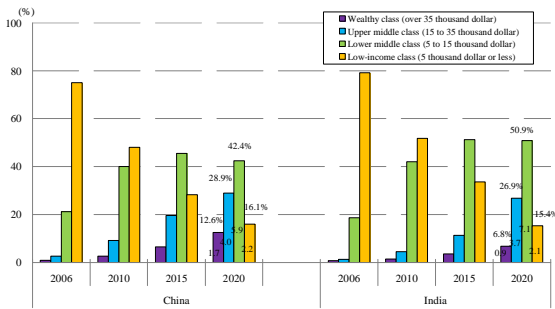
	China			India		
	Ranking	Reasons/Problems	Share	Ranking	Reasons/Problems	Share
Potential reasons	1	Growth potential of local markets	82.3%	1	Growth potential of local markets	90.5%
	2	Current size of local markets	46.4%	2	Cheap labor	39.6%
	3	Cheap labor	32.8%	3	Current size of local markets	24.4%
Problems	1	Labor cost increase	74.0%	1	Infrastructure not improved	47.8%
	2	Unclear management of legislation (Frequent modification and others)	59.9%	2	Fierce competition with other companies	38.0%
	3	Fierce competition with other companies	55.5%	3	Unclear management of legislation (Frequent modification and others)	31.0%

Note: The effective answers: China (Potential reasons: 351 companies, Problems: 339 companies)  
 India (Potential reasons: 283 companies, Problems: 255 companies)

Source: Japan Bank for International Cooperation “Survey Report concerning the Overseas Expansion of Japanese Manufacturing Businesses – Results of the JBIC FY2011 Questionnaire Survey of Japanese Foreign Direct Investment (23rd annual survey)”.

Column Figure 4-3

Income classes in China and India

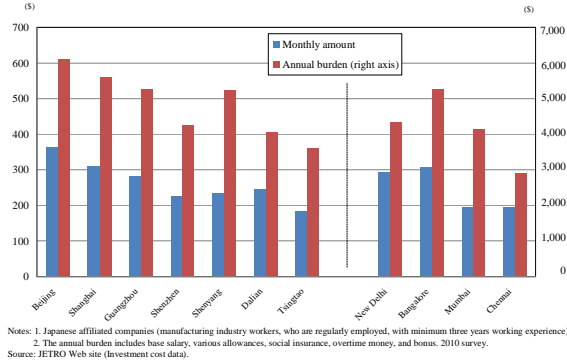


Notes: 1. Proportion of household budgets by annual disposal income per household estimated by Euromonitor International.  
 2. The figures on bar charts of 2020 represent the number of people calculated provisionally (100 million people), which are provisionally calculated by multiplying total population by the proportion of household budgets by income class estimated by Euromonitor International.  
 For total population, using the moderate-range projection of World Population Prospects: the 2011 Revision (United Nations).  
 Source: Statistical Office of each country, World Population Prospects (United Nations), and Euromonitor International database.

As examined above, both China and India are potential markets, but it is important to make advance investigations before expansion. In India, for example, language and culture vary by region. In addition, some sources point out that, as examined in Chapter 3, the distribution system is complicated and with high cost, and the market is divided though the overall market size is large. Therefore, it is desirable to take careful measures, including allying with local partners.

We considered the possibilities as a market. When considering as a production base, it appears that China is losing its superiority due to abolition of preferential treatment to foreign companies and increase in wages. In the case of India, on the other hand, many point out “infrastructure not improved”. In India, an industrial complex has no refurbished infrastructure and, at first, it is needed to determine the terms and conditions for building infrastructure and others upon negotiation with local government. Furthermore, the wage level, which is often referred to as one factor of investment costs, of China is higher than that of India, but that of India is surprisingly high considering the difference in per capita GDP (see Column Figure 4-4). There are many migrant workers from rural areas in China, but, regional labor movements are limited in India due to the differences in language, religion and culture. In addition, it seems that service industries secure human resources even in the government sector as well as the private sector, and manufacturing industries have a shortage of human resources. Some sources also point out that as a small number of Japanese enterprises have expanded into India, there is a limited number of component supply business among Japanese enterprises as found in East Asia. It may be required to be ready to compete against local companies in the local market before expansion.

Column Figure 4-4  
Wage level of Japanese enterprises in China and India



In any case, China and India attract a lot of attention as a candidate for overseas expansion of business, but it is important to give consideration in combination with each economy’s characteristic and enterprise characteristics in making a decision.

