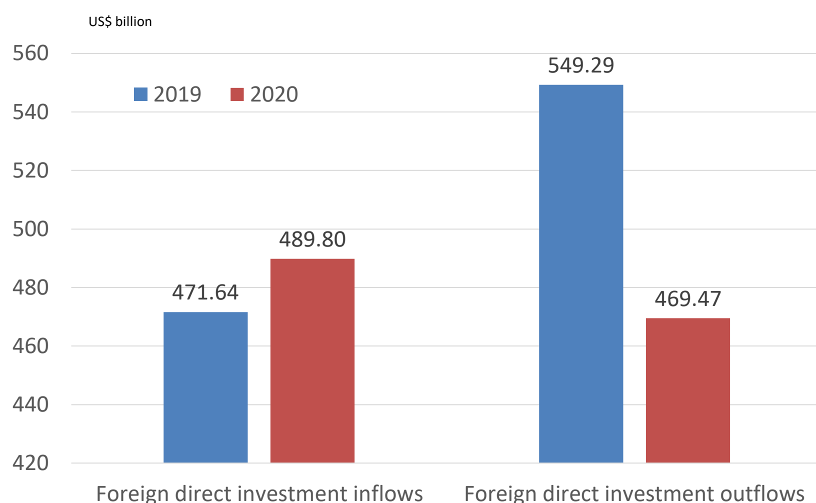
ASIAN INTELLIGENCE

An Independent Fortnightly Report on Asian Business and Politics

No. 1,071 **Wednesday June 30, 2021**

Direct Investment Flows Into and Out of *Asian Intelligence* Economies



Source: UNCTAD

REGIONAL OVERVIEW 2
CHINA 4
HONG KONG 5
INDIA 6
INDONESIA 7
JAPAN 8
MALAYSIA 9
PHILIPPINES 10
SINGAPORE 11
SOUTH KOREA 12
TAIWAN 13
THAILAND 14
VIETNAM 16
EXCHANGE RATES 18

POLITICAL & ECONOMIC RISK CONSULTANCY LTD.

REGIONAL OVERVIEW

Major shifts in foreign direct investment flows

Foreign direct investment (FDI) flows fell sharply in 2020 due to the COVID-19 crisis. There could be a modest upturn in some countries in 2021, but flows are unlikely to return to pre-COVID levels until restrictions on international travel are removed, vaccination rates in both source and target countries are high enough to give business executives confidence, and the pandemic stops intensifying in some key target countries like India and Indonesia.

Earlier this year, the United Nations Conference on Trade and Development (UNCTAD) published its *World Investment Report for 2021.* The report estimated that global direct investment flows fell 34.7% in 2020 to just under US$1 trillion. This was the lowest level since 2005. Unlike many government figures, which calculate FDI based on the value of projects approved or by what the total value of a new project is expected to cost, the UNCTAD numbers are based on actual fund flows into and out of a country on a balance of payments basis. The net inflows represent the net value of direct investments into a country by foreign entities, while the net outflows equal the net value of foreign direct investments by entities of an individual country.

Projections point to an increase of 10%-15% in global foreign direct investment flows this year, which would leave FDI about 25% below its 2019 level. While some existing investors might decide to expand certain facilities and merger and acquisition activity could increase due to an increase in the number of distressed sales in some industries, foreign direct investment in greenfield projects will probably stay relatively low. This is likely to be especially the case in developing countries, which so far have had to carry the brunt of the FDI downturn.

The country entries that follow look at direct investment trends in individual countries. Collectively, these 12 economies did much better than the rest of the world. For example, they saw their direct investment inflows actually rise by 3.9% in 2020, which raised their share of global investment inflows to 49.0% from 30.8% in 2019.

Their share of direct investment outflows was even more impressive. Although the collective value of such outflows declined 14.5% to US$469.5 billion, because outflows from other parts of the world fell even more sharply, the 12 economies covered by this newsletter saw their share of global direct investment outflows jump to 63.5% in 2020 from 45.0% in 2019.

It is even more revealing if the 12 economies covered by *Asian Intelligence* are divided into two distinct groups and one critical subgroup. The two distinct groups are Asia's developed economies, including the four Tigers, Japan and China, which are the biggest sources of direct investment outflows from the region, and Asia's developing economies, all of which export some direct investment but which are much more dependent on foreign direct investment inflows for their overall growth and economic development than are the region's developed economies, all of which have a greater capacity to self finance their investments.

Last year saw Asia's developed economies jump in importance as direct investors not only elsewhere in Asia but also in the rest of the world, including in developed areas like the US and the EU. To be sure, the collective value of direct investment outflows by China, Japan, South Korea, Taiwan, Hong Kong and Singapore declined 16.4% to US$430 billion. However, because outflows from other traditionally big sources like the US and the EU fell even more, the developed countries covered by *Asian Intelligence* saw their global share as providers of direct investment increase to 58.1% in 2020 from 42.1% in 2019. Moreover, since the total inflow of foreign direct investment into developing Asia last year was only US$102.4 billion (down 7.0% from 2019), the implication is that Asia's more developed economies and exporters of direct investment are investing a lot more within each other as well as with countries outside of Asia than they are with the developing ASEAN countries and India.

The subgroup of economies that warrants special mention is Mainland China and Hong Kong – which are really one country but two separate places

in terms of how foreign direct invest flows are broken down. Such a large amount of the direct investment flows takes place between these two economies that it distorts the overall investment figures for the Asian region. However, what the Hong Kong and China direct investment numbers do show quite clearly are, first, how China has really taken the lead as a driver of direct investment outside its borders and, second, how China's use of Hong Kong is supporting the SAR's development as an international hub for business relating to the Mainland. Hong Kong's recent political developments might be very disturbing for many, but China has the ability to sustain Hong Kong's role as a business hub as long as Beijing can keep the Mainland's economy on track.

A careful look at the investment inflow figures of individual countries also leads to other conclusions. The pattern of flows in most developing countries is the same except for two standouts, namely, Malaysia and Thailand, both of which suffered much steeper falls in direct investment inflows last year than other countries in the region. This indicates that there is more at play in these two countries than just the pandemic. It could be that these two countries are having more negative fallout from their volatile political situations than are other countries.

Vietnam stands out as the developing ASEAN country that has been able to maintain direct investment inflows better than other members. At the same time, its exports held up better last year than did those of other countries, and its GDP grew more rapidly that other economies in ASEAN. The implication is that Vietnam is one country that is really capturing investment that is being diverted away from China due to rising labor and other costs there, as well as fears arising from China's poor relations with the US. For foreign companies looking at a "China-plus-one" strategy, Vietnam seems to be the place where most are deciding is the "plus one."

It is also worthy of note that Vietnam has never supported or participated in China's Belt and Road Initiative (BRI), in large part because it does not want to become too dependent on China economically. However, the governments of other ASEAN countries like the Philippines, Thailand, Malaysia and Indonesia have been much more vocal supporters of BRI, hoping to benefit from China's largesse. Yet these countries all suffered big falls in FDI inflows last year, and it is well known that many major projects proposed in the BRI umbrella have never really gotten off the ground. The implication is that the BRI is falling far short of expectations and that the negative fallout from COVID-19 is highlighting these deficiencies.

Similarly, the falling levels of direct investments in these ASEAN countries while China's own direct investment inflows actually increased 5.7% to a new record high last year indicates that foreign companies and brands are not rushing to diversify out of China nearly as fast as many observers thought would happen when the US and China were at the height of their trade war. Many foreign companies are keeping China a critical part of their global supply chains, while many others are investing more in China to position for the domestic market there. The Biden Government, along with the EU, might be trying to reduce their economies' dependence on China, but a significant number of major companies and banks from these same countries remain enthusiastic about China's prospects and are not really supporting their government's more confrontational lines toward China.

Foreign Direct Investment Flows By Economy

FDI inflows (US$ mil)				FDI outflows (US$ mil)			
Destination	*2019*	*2020*	*% change y-o-y*	**Source**	*2019*	*2020*	*% change y-o-y*
China	141,225	149,342	5.7%	**China**	136,905	132,940	-2.9%
Hong Kong	73,714	119,229	61.7%	**Hong Kong**	53,202	102,224	92.1%
India	50,558	64,082	26.7%	**India**	13,144	11,560	-12.1%
Indonesia	23,883	18,581	-22.2%	**Indonesia**	3,352	4,467	33.3%

Japan	14,552	10,254	-29.5%	**Japan**	226,648	115,703	-49.0%
Malaysia	7,813	3,483	-55.4%	**Malaysia**	6,231	2,827	-54.6%
Philippines	8,671	6,542	-24.6%	**Philippines**	3,351	3,525	5.2%
Singapore	114,162	90,562	-20.7%	**Singapore**	50,578	32,375	-36.0%
South Korea	9,634	9,224	-4.3%	**South Korea**	35,239	32,480	-7.8%
Taiwan	8,240	8,802	6.8%	**Taiwan**	11,787	14,268	21.0%
Thailand	3,063	-6,100	-299.2%	**Thailand**	8,391	16,716	99.2%
Vietnam	16,120	15,800	-2.0%	**Vietnam**	465	380	-18.3%
World	1,530,228	998,891	-34.7%	**World**	1,220,432	739,872	-39.4%

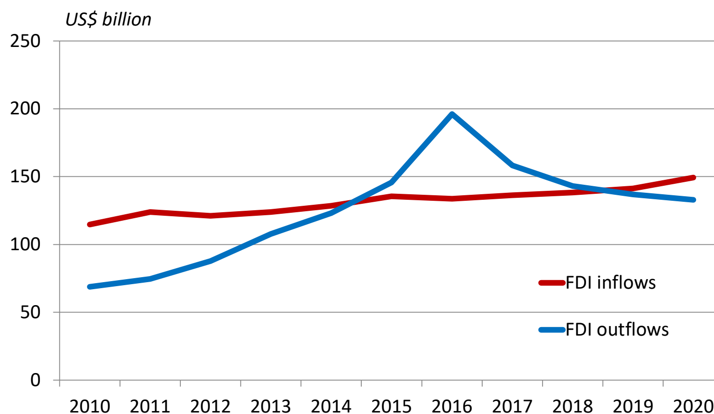
Source: UNCTAD

CHINA

Comments

It is nothing short of amazing that the COVID-19 pandemic and shutdown in international travel did not hammer direct investment flows into and out of China last year. However, instead of falling sharply, foreign direct investment inflows increased 5.7% to US$149.34 billion, while direct investment outflows by Chinese entities eased only 2.9% to US$132.94 billion. This means that China overtook the US as the world's top destination for new foreign direct investment last year, while China remained the largest investor in the world.

China's government keeps pointing to the large FDI outflow figures as evidence of the success of its Belt & Road Initiative (BRI). However, this is misleading. Many of China's outward investments would have gone ahead in any event, but because they were in countries that were theoretically covered by the BRI, they were classified as being part of this program.



While there is a good deal of coverage of China's foreign direct investments, including mergers and acquisitions that do take place, it is much harder to quantify how much business is not going ahead because of political opposition by the governments of the countries in which these investments are targeted. Both the US and the EU have been screening Chinese direct investments more carefully. In May, the European Parliament voted to freeze discussion on the Comprehensive Agreement on Investment with China until Beijing removes the retaliatory sanctions it imposed on EU officials, diplomats, academics and researchers in March. Some European countries have also moved to block several acquisitions by Chinese firms. The US is screening direct investments from China more tightly too, while the US Senate Committee on Foreign Relations has introduced a bill called "the Strategic Competition Act of 2021," which lays

out a program to help US companies exit the Chinese market, diversify their supply chains, and identify alternative markets.

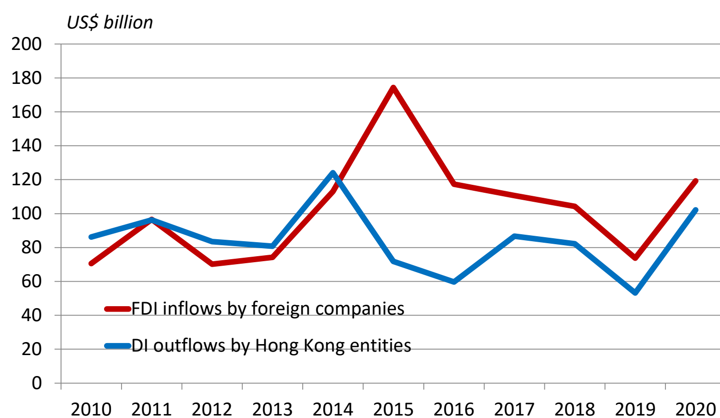
However, the Senate's initiative reveals the disconnect that currently exists between US political policy toward China and the views of a major segment of the US business community. To be sure, some US companies put their China expansion plans on hold and in some cases began withdrawing their investments in the initial months of 2020. However, as China's economy started gaining momentum while the rest of the world began to look increasingly rocky, foreign companies moved to pour more money into China, viewing the country as a production base and as a critical growth market for their products irrespective of what their governments were warning about the national security and other threats posed by the Mainland's emergence. Multinational enterprises and banks consider China to be an indispensable strategic market. They are encouraged by its rising purchasing power, well-developed infrastructure and generally favorable investment climate. Some major foreign brands may reshore or diversify away from China because of rising labor costs and the need to improve supply-chain resilience. However, the substantial flow of market-seeking FDI, particularly by foreign-owned technology and services industries, is cushioning any negative trend in efficiency-seeking FDI.

The inflow of FDI has picked up more steam this year. According to China's Ministry of Commerce, in the first five months of this year, 18,497 foreign-invested enterprises were established in China, up by 48.6% year-on-year and up by 12.4% from the same period in 2019. Paid-in foreign investment reached RMB481 billion (US$75.2 billion), up by 35.4% year-on-year and up by 30.3% from the same period in 2019. By sectors, paid-in FDI to the service sector reached RMB381.9 billion, up by 41.6%. Paid-in FDI to high-tech industries grew by 34.6%, among which high-tech service industries grew by 37.6%, and high-tech manufacturing industries grew by 25%.

HONG KONG

Comments

There were two economies in East Asia last year that registered big increases in foreign direct investment flows despite the pandemic: Mainland China and Hong Kong. Not surprisingly, there is a close relationship between the results for both. Hong Kong's direct investment inflows and outflows were closely tied to conduit flows to and from China.



FDI inflows into Hong Kong surged by 61.7% (to US$119 billion), after a 29.3% fall of FDI in 2019, when activity was severely disrupted by social unrest. Last year's surge was driven mainly by an increase in intracompany loans and reinvested earnings – dominant components of FDI for the economy. Although accounting for a small share of FDI, the rebound in cross-border M&A sales to US$11 billion (from -US$1 billion in 2019) also contributed to this rise, due to many instances of Mainland companies consolidating

affiliates in Hong Kong.

Considering the economy's substantial intrafirm flows and its close ties with China, growth in FDI in Hong Kong reflects corporate restructuring, particularly by Mainland companies. Moreover, since much of the capital that is attracted into Hong Kong through new IPOs and other restructuring activities are by companies based on the Mainland, many of these funds also leave Hong Kong (mostly to Mainland China) in the form of direct investment capital outflow. Such outflows surged 92.1% last year to US$102 billion from US$53.2 billion in 2019. This was the biggest outflow number since 2014.

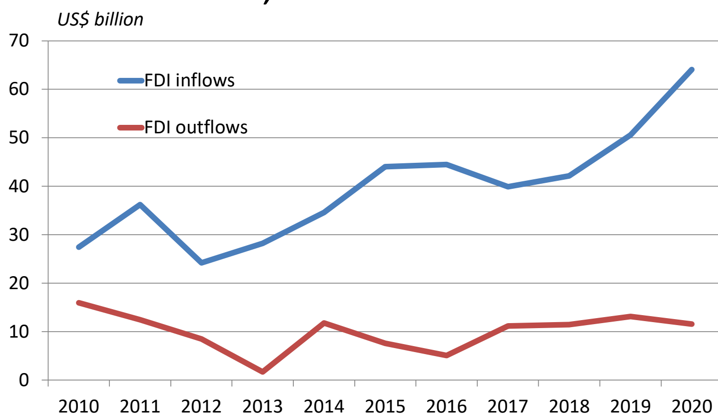
Considering how disruptive the pandemic was for capital flows almost every place else in Asia, Hong Kong's ability to buck the trend is a good indication of just how much China is the driving force behind Hong Kong's success or failure as an international business center. Some observers are pessimistic and warning that the political crackdown and decline of personal freedoms will seriously hurt its ability to act as a business hub, but facts so far tell a different story. First, Chinese companies are using Hong Kong more, not less. Secondly, major foreign companies and banks are still investing heavily in Mainland China as a market and are using Hong Kong as a base to coordinate and oversee much of this business. The increase in new foreign direct investment into China last year also implies that foreign companies and institutional investors are pushing more business through Hong Kong, raising its international status despite the controversial change in the local political environment.

INDIA

Comments

COVID-19 has had a delayed impact on direct investment flows to and from India. Instead of falling sharply like most other countries, direct investments in India by foreign companies rose 26.7% last year to a record US$64.1 billion. However, as the pandemic has deepened this year, it is very likely that FDI inflows will be weaker in 2021.

There are several reasons for pessimism. First, last year's inflow figure was distorted by a single, large investment: more than US$10 billion in direct investment (mostly from Silicon Valley companies like Facebook and Google) went into Jio Platforms, the telecom-and-digital services arm of Mukesh Ambani's Reliance Industries. Without this one investment, last year's total figure looks much less impressive. A closer look at the capital flows points to the disparity in the sectors that have received capital investments from global investors. Over 47% of the FDI has flown into the computer software and hardware sector, while construction (including infrastructure) accounted for 13.9%. The share of the inflow into other sectors has been fairly small.



Source: UNCTAD

Second, while many foreign

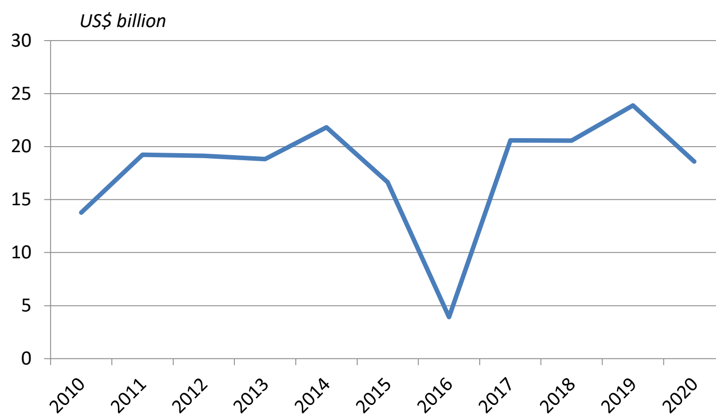
companies and banks might want to invest more in India to expand their backroom operations, the intensification of the pandemic has hit this type of business so hard that many existing investors, as well as Indian companies selling backroom services to foreign companies, have had to pull capacity out of India to relieve pressure on local staff. This will hit direct investment inflows to these industries in 2021 very hard.

Many of India's largest companies have been registering good profits both last year and this year. Banks are protected from a surge in bad loans by emergency government relief measures to some of the companies to which they are exposed. This is helping banks' profits. Large IT service providers like Infosys are benefitting from a surge in demand from foreign clients who have been wrestling with their own COVID-19 problems and trying to shift to remote, cloud-based working. Work forces of these major Indian companies are under a heavy strain, but the firms' profits are holding up well. Finally, industrial groups like steelmakers are profiting from high global commodity prices. These factors are generating a lot of foreign capital – but in the form of portfolio investments, not direct investments.

While direct investments abroad by Indian companies declined 12.1% last year to US$11.6 billion, big profits being earned by India's family-owned companies like Reliance Industries could result in a jump in direct investment outflows this year. The major obstacle these investors will face is being able to travel abroad to inspect prospective investments and undertake negotiations. This could be more difficult in developing Asian than in the US and the EU, which are further ahead in terms of getting the pandemic under control and restarting their economies.

INDONESIA

Comments



The pandemic interfered with FDI inflows into Indonesia in 2020, but there should be a modest recovery this year. Figures published by the government's Investment Coordinating Board (BKPM), which exclude foreign investments in banking and the oil and gas industry, paint a much brighter picture than UNCTAD's estimates, but we would lend more credence to the UNCTAD figures, which are based on the balance of payments and therefore include investments in the banking and energy industries. Moreover, while the BKPM says its figures represent "investment realization," they are too large relative to UNCTAD's figures to be believable, especially since they exclude two of the biggest sectors. More likely, the BKPM is referring to projects that it has approved or, perhaps, to the ultimate value of investments that have started but not yet been fully implemented. This is the only way to explain such large differences.

According to the BKPM, realized foreign direct investment in 2020 actually rose 1.6% from 2019 to US$28.67 billion. In contrast, UNCTAD – whose figures are in line with those published by Indonesia's Central

Bank – estimates that foreign direct investment flows into Indonesia fell 22.2% in 2020 to US$18.58 billion. Most foreign investment into Indonesia was channeled through Singapore. Last year, it accounted for a little more than one third of the total. It was followed by China, Hong Kong, Japan, and South Korea.

There could be a recovery in foreign direct investment in Indonesia this year. High metal prices should stimulate investment in mining activities. For the same reason, more investment could also go into food and food products and the oil and gas industries. However, some key industries like hotels will remain seriously depressed by the lack of tourists, and investment that does flow into the industry could be in the form of bargain basement purchases of facilities that have been brought to their knees by the pandemic.

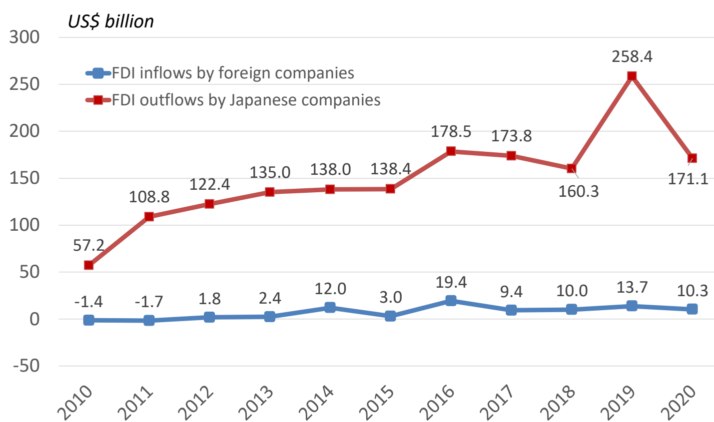
However, overall foreign investor interest should be stimulated by the new law that came into effect in March of this year. The reform is an attempt to reduce the number of sectors that are subject to foreign ownership restrictions. The technology, media, and telecommunication sector is one of the sectors that is now open to foreign investment. All telecommunication network and service activities, which include telecommunication activities with or without cable, satellite telecommunication activities, premium call services, premium SMS content services and other multimedia services were subject to a 67% foreign investment restriction, but now are open for 100% foreign investment.

JAPAN

Comments

One of the main reasons foreign direct investment collapsed last year was because Japanese companies were forced by the pandemic to stay at home. Japan is normally one of the largest sources of direct investment in the world, but in 2020 direct investment outflows in balance of payments terms plunged 48.9% to US$115.7 billion.

ASEAN and the EU suffered some of the steepest declines. Japanese direct investments in the ASEAN region fell 34.4% to US$21.55 billion, while its direct investments to the EU plunged 74.2% to US$20.55 billion. In contrast, Japanese direct investments in its two biggest markets, China and the US, held up relatively well. Japanese investments to the Mainland declined only 7.5% to US$11.3 billion, while direct investments in the US were down 4.3% to US$48.94 billion.



Japan has long been very suspicious of China's Belt and Road Initiative, viewing it as an attempt by China to expand soft power and increase hegemony through infrastructure spending. Such as increase would jeopardize Japan's own national security and reduce its influence in the region. Consequently, Tokyo has all along been trying to present itself as an alternative to China in many key infrastructure projects, offering greater transparency and quality while having none of China's ulterior motives. Japan has reformed its own

lending practices to make it more desirable in the face of competitive Chinese tenders, increasing official development assistance, and by focusing on quality rather than cost.

The Japanese Government will wholeheartedly support US President Biden's latest call for cooperating on an alternative global support program to Chia's BRI, but it is difficult to see how this will translate into anything different from what Japan has been doing all along. It was the main backer of the Asian Development Bank long before China set up its Asian Infrastructure Investment Bank, and its companies have been bidding against Chinese state-owned companies in many of the biggest infrastructure projects in the region. China seems to win a lot more of these contracts, but its track record in actually implementing them is poor and getting worse. This is helping to raise Japan's own credibility and desirability as an investor in the eyes of many Asian countries. This is especially true in places like India and Vietnam, but it is also increasingly true in countries where the competition against Mainland companies remains intense – such as the Philippines, Indonesia, Thailand, and Malaysia.

In many ways, Japan picked up the ball in Asia when the Trump Administration dropped it shortly after taking office by pulling out of the Trans-Pacific Partnership Pact. Mr. Biden is trying to re-engage with the region, but most of his initial efforts will be on repairing damage done to US relations with traditional allies like Japan and South Korea. This will leave Japan to keep taking the lead in countries that China's has been wooing more aggressively. In addition to the four ASEAN countries mentioned above, other such countries include Cambodia and Myanmar, places where China remains quite aggressive in carrying out projects under the BRI banner.

FDI flows to Japan remain low compared to most other developed nations across the world, as well as to direct investment outflows by Japanese companies. The value of FDI inflows last year slumped 29.5% to US$10.25 billion. Most of the FDI inflow went into finance and insurance, followed by transportation equipment production. "Other services" were the third leading target of foreign investors. On the other hand, foreign companies pulled out of some industries, including wholesale and retail trade, chemical and pharmaceutical production, communications, food, and real estate.

MALAYSIA

Comments

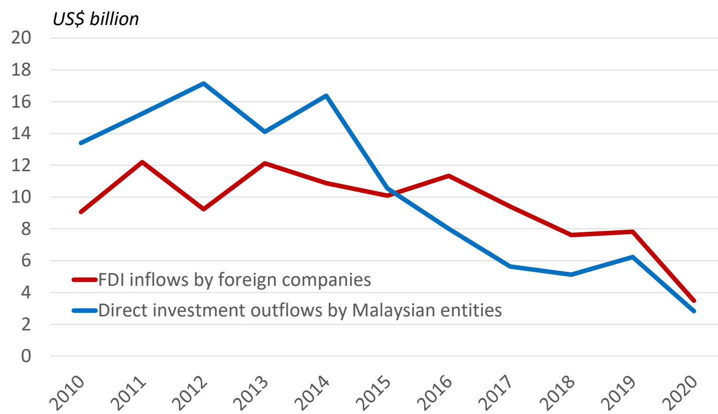
Malaysia stands out as the country covered by this report that received the smallest amount of foreign direct investment last year. It was also the country where the decline in direct investment inflows was the sharpest. According to UNCTAD figures, total FDI inflow in 2020 plunged 55.4% to only US$3.5 billion. The last time annual FDI inflows to Malaysia were this low was back in 2003.

This implies that there was far more at play than just the pandemic. Domestic politics was hurting the confidence of potential new foreign investors long before COVID-19 materialized. Prior to UMNO's being voted out of office in May 2018, the 1MDB scandal was shaking confidence in the way the country's economy was being managed. This resulted in the value of new FDI declining and in Malaysia's missing the boat at a time when foreign companies were trying to decide where else in the region to establish production facilities as conditions in Mainland China became more difficult and foreign buyers were reviewing their supply chains.

At the same time, the government's fiscal situation was becoming much more difficult. The former UMNO government, in its attempt to hide the seriousness of the 1MDB crisis, understated the public debt and put pressure on state-owned companies and investment agencies like Petronas and Khazanah Nasional Berhad to shore up the fiscal accounts. Consequently, these public bodies had less funds to invest on their own behalf

inside and outside Malaysia. This resulted in protracted slowdown in direct investment outflows by Malaysian entities. Such outflows fell 54.6% last year alone to US$2.8 billion. This was the smallest outflow since 2004.

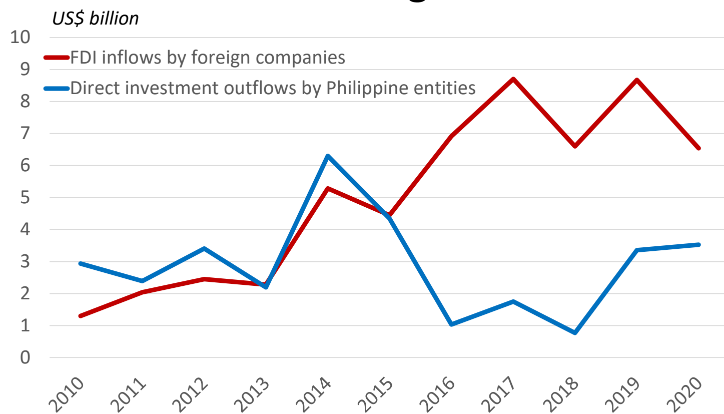
A major question now is when direct investment inflows and outflows will turn upwards again. In other countries in the region, the main variable is how long it takes to get COVID-19 under control and international travel can resume on a normal scale. However, in the case of Malaysia, the domestic political situation remains very unstable. The current government's hold on power is too tenuous to instill confidence, and the government's fiscal situation remains weak. If elections are held and a new government is formed, investors will want to see what kind of government it is. If it is seen as the same kind of kleptocracy as the regime of Najib Razak – which is a possibility – foreign companies will continue to take a cautious approach when considering investing in Malaysia. However, if the new government has more credibility, Malaysia could become a very attractive investment proposition thanks to its wealth of natural resources and well-trained labor force.



PHILIPPINES

Comments

Foreign direct investment in the Philippines has long trailed most other countries in the region. The entry barriers have been too high and designed more to protect the domestic market for local companies than to encourage foreign companies to set up export-oriented factories. Bureaucracy and other deterrents have made it difficult for many existing foreign investors, so rather than expand facilities in the Philippines, many have chosen to invest elsewhere, including in relative newcomers countries like Vietnam and Cambodia.



There have been some attempts by recent governments to improve the environment for foreign investors, and the trend of FDI has generally increased

over the past decade. Much of the new investment had been flowing into backroom business process outsourcing and, more recently, into online casinos that have been owned by Mainland Chinese and focused on the China market. However, total annual FDI inflows were still running at a lower level than in most other developing Asian countries in the years leading up to the pandemic, and, like the rest of Asia, FDI declined last year by 24.6% to only US$6.54 billion. The main sectors for investments were information and communication, M&A deals in agriculture and energy, and administrative and support service activities.

The inflow of Chinese investment in online casinos not only stopped, there was also a great deal of disinvestment by the gaming companies, which has had a major negative impact on the real estate market in Manila. Investment in the business process outsourcing industry would have grown much more strongly, especially since many US companies using facilities in India have tried to shift that business to other locations to take pressure off Indian facilities, which have been severely hampered by the COVID-19 pandemic. However, the pandemic has intensified in the Philippines too, so new investment could not go ahead.

Perhaps the biggest disappointment for the Philippines has been the failure of President Duterte's diplomatic shift away from the US to China to generate the new FDI from the Mainland that the president had been counting out. There has been a lot of talk about major investments, especially in infrastructure projects, but few of these investments have actually taken place and most probably never will. Probably more than any other country in the region, the Philippines is an example of how China's BRI has failed to live up to its billing. Now Mr. Duterte has entered the final year of his term and he has little to show for it in terms of the new investment he had promised to attract to the country. In 2019, the last good year for FDI, China was not even the Philippines' largest foreign investor. Singapore was. China was in second spot followed by South Korea.

Since the COVID-19 pandemic has intensified in the Philippines this year and the country has barely started to inoculate its population, the downturn in foreign direct investment has intensified. Approval statistics published by the government – which greatly exceeds the level of investment that has been realized – put the level of FDI in the first quarter of 2021 at a little more than US$400 million, 32.9% less than in the like span of 2020. The FDI commitments for the first quarter of this year were mainly driven by investments from Japan which accounted for 54.8% of the total, followed by Cayman Islands (5.8%) and South Korea (3.0%). Manufacturing received the largest share (23.4%), followed by real estate activities with 11.5%.

SINGAPORE

Comments

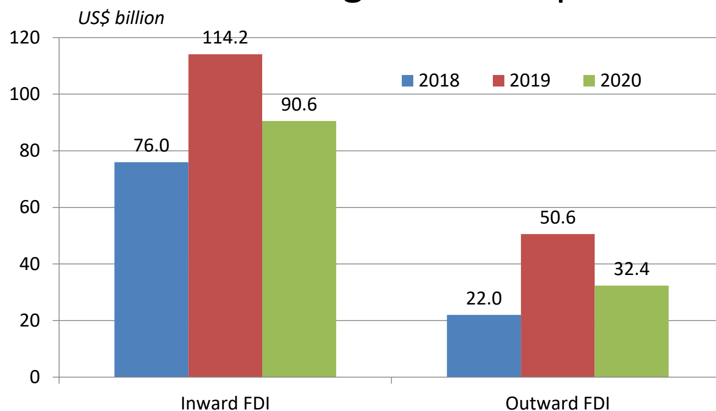
As the hub for channeling direct investment elsewhere in the ASEAN region, as well as being a major direct investor in its own rights through state-linked companies like Temasek and GIC, the sharp falls in both inbound and outbound direct investment flows last year points to the difficulties the entire ASEAN region is encountering due to the pandemic. FDI in Southeast Asia normally ranks among the most rapid in the developing world. However, last year it contracted by 25% to US$136 billion, with declines in investment in all the largest recipients. Singapore's results reflected this regional slump. The island's FDI inflows fell 20.7% from 2019 to US$90.6 billion, while its direct investment outflows dropped 36.0% to US$32.4 billion.

Direct investment activity should pick up a bit this year, but restrictions on international travel will prevent a return to normal for a long while yet. In the meantime, Singapore will have to re-evaluate some previous assumptions. For example, the US-China trade war is unlikely to result in as big a shift in supply chains as many were anticipating a year ago. This means more business will stay in China and less is likely to shift to Singapore's neighbors like Thailand, Malaysia, the Philippines, and Indonesia than many of these governments had been counting on. Less could go to Cambodia and Vietnam too in the short-term. Although these two

countries have attracted more FDI as Western brands shift their supply chains, COVID-19 has recently been intensifying in both these countries, which will interfere with travel and the ability to undertake new investments, which means less business for Singapore.

On the other hand, the slowness with which the region, including both India and ASEAN, have gotten on top of COVID means there has been more pressure to grow electronic wholesale and retails commerce. Most of this business is coordinated from offices in Singapore, so the island could receive more investment from IT companies using it as a base.

Singapore so far has not benefitted much from China's BRI programs. In theory, it could have carved out a very profitable niche role for itself by offering to participate in projects in the region as a direct investor if the projects met Singapore's commercial and governance standards. Beijing could have used Singapore to help depoliticize the projects and help them gain economic credibility. As it has turned out so far, this has not happened – which is quite possibly a reflection of both the low standards of many of the projects and of the extent that politics figures into them as a main motivating factor.



Now President Biden has come up with a plan to use the G7 to set up some sort of counter to China's BRI. Presumably Mr. Biden believes like-minded developed countries can offer better standards and still be competitive with China. If this actually turns out to be the case, Singapore might have an interest in joining in the new US-led initiative, but the odds are so strongly stacked against Mr. Biden's idea ever getting off the ground that, like the BRI, it will not be of major interest to Singapore or affect its direct investment flows one way or the other.

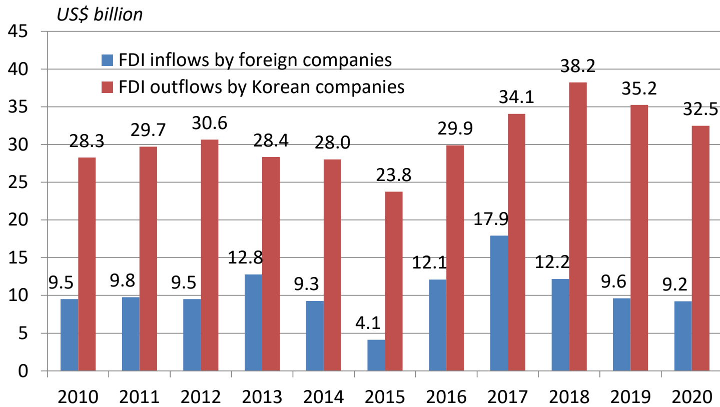
SOUTH KOREA

Comments

Korea has become more important as a direct investor overseas than as a site in which foreign investors are buying out Korean businesses or setting up greenfield projects. Flows in both directions slowed sharply last year due to the COVID-19 pandemic, but the majority of the decline was posted in the first half of the year. The fall moderated sharply in the second semester, and so far this year both direct investment inflows and outflows have been growing.

In balance of payments terms, the decline in foreign direct investment in Korea on a net basis actually began back in 2018. After reaching a peak of US$17.9 billion in 2017, net inflows by foreign direct investors fell a total of 48.5% for the next three years, totaling only US$9.2 billion in 2020. However, in the first four months of this year, net inflows by foreign investors bounced back 72.6% over the like span of last year to US$5.0 billion. New industries such as artificial intelligence, big data, cloud computing, eco-friendly vehicles, and bio-health

products have been receiving most investor attention. In contrast, FDI in more traditional manufacturing and in most services weakened.



Foreign direct investments by Korean companies have been running three times more than FDI inflows by foreign companies for a number of years now. Even in 2020, when FDI net outflows by Korean companies fell 7.8% to US$32.5 billion, they were running three and a half times more than FDI inflows. In January-April of this year, direct investments abroad by Korean companies increased 67.5% to US$14.1 billion.

Seoul has never thrown cold water over China's Belt and Road Initiative, but it has not actively supported this program either. As a close ally of the US, Korea is likely to be more enthusiastic in supporting US President Biden's recent proposal for G7 and other like-minded democratic countries to cooperate on a global plan to do more to compete against China on some sort of grand infrastructure plan. In fact, neither of these foreign ideas are likely to have a big impact on how and where Korea invests internationally. Korean companies rather than the government will drive the country's foreign investment push. They will probably remain big direct investors in both Mainland China and the US, which are Korea's two major markets.

On the one hand, rising production costs and political risks are likely to limit future interest in China mainly to projects that focus on production for that market rather than for using China as a export base. The means Korean companies will be looking for alternatives to China for this purpose. So far, Vietnam seems to be the country that is receiving the most interest from Korean companies, but they are also looking at other ASEAN countries like Indonesia and Thailand. Some of the biggest single greenfield investments could be in the US. This is such a big market for Korean companies that a number of factors are prompting Korean companies to invest more there, especially in products like semiconductors. Samsung Electronics alone is considering an investment of as much as US$18 billion to build a chip-making factory someplace in the US. Latest reports are that Samsung is leaning toward Austin, Texas, as the location for its first EUV production plant outside of Korea.

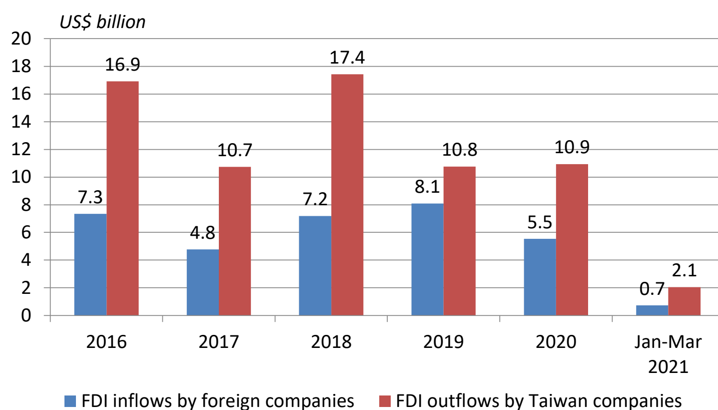
TAIWAN

Comments

Taiwan companies have to walk a political tightrope when it comes to deciding on and implementing their foreign direct investment strategies. Most have focused on Mainland China, but these investments are carefully scrutinized by Taiwan's own regulatory authorities. The deterioration in China-US trade relations has made it even more sensitive to locate certain types of export-oriented investments in China. Because of rising labor and other production costs in the Mainland, it makes sense for Taiwan companies that manufacture computers, servers, smartphones and telecom infrastructure gear on behalf of brands such as Apple, Dell, and Google to concentrate less on production in China and more on setting up shop in Southeast Asia, India and elsewhere.

Other Taiwan companies in particularly hi-tech industries, such as Taiwan Semiconductor Manufacturing, are coming under increasing pressure to invest directly in the US and not to supply major Mainland companies like Huawei Technologies and Phytium Information Technology. Because Taiwan depends heavily on continuing support from the US to protect its autonomy against the threat poised by the Mainland, the island's companies really have no choice but to be very sensitive to Washington's political priorities.

Taiwan would be one Asian country that would actively participate in any regional or global infrastructure program like the kind President Biden is proposing the G7 organize. Beijing has not allowed Taiwan companies to participate in its Belt and Road Initiative, dangling participation as a carrot to pressure the Taiwan authorities to make concessions at the negotiating table. This was probably a mistake on Beijing's part and lucky for Taiwan, since the BRI programs could have done more harm than good for Taiwan. It would be interesting to see what pressure Beijing could apply on the US and G7 to bar Taiwan's participation in the new US initiative, but it has been successful in stopping the US from inviting Taiwan to participate in other joint efforts like the Trans-Pacific Partnership Pact, and would probably find a way to keep Taiwan out of a new infrastructure investment initiative too. In any event, this is probably a moot point, since it is very unlikely that the new US initiative will ever get off the ground in a meaningful way.



Sources: UNCTAD and Central Bank of Taiwan

Taiwan's door to foreign investment is relatively open to any sources other than Mainland China. However, actual FDI inflows have never been very large, and they have declined sharply since the start of the pandemic. In balance of payments terms, the inflow of equity and investment fund shares by foreign companies declined 31.6% in 2020 to US$5.53 billion. In the first quarter of this year, they fell a further 56.4% to only US$732 million.

In contrast, FDI outflows have held up better. This is because many Taiwan companies have responded to their major foreign clients' attempts to diversify supply chains away from China by investing in places like India and Thailand, while others have stepped up their direct investments in the US. For example, Taiwan Semiconductor Manufacturing Co. has announced plans to build a US$12-billion semiconductor plant in Arizona. Because of these investments, the outflow of equity and investment funds from Taiwan by the island's companies actually rose 1.7% last year to US$10.9 billion. However, in this year's first quarter, the outflow declined 21.9% from the like span of 2020 to US$2.1 billion.

THAILAND

Comments

Foreign direct investment in Thailand has been in a nosedive for the past two years. According to UNCTAD, which measures actual flows on a balance of payments basis, foreign investors in Thailand cut their direct investment by 72.5% in 2019 to US$3.1 billion, while in 2020 the net flow of direct investment by foreigners turned into an outflow of US$6.1 billion, i.e., there was disinvestment.

Official government figures do not paint nearly this dark a picture, but that is largely because the Thai authorities report only direct investments they have approved, not the actual implementation value. In the first quarter of 2021, foreign investors signalled their intention to invest US$3.9 billion in new projects in Thailand. According to the Board of Investment, this was 80% more than foreign direct investment applications in the same quarter of last year, but that is not as promising as it sounds: 2020 was a disastrous year, with FDI applications declining by more than half. Early this year the authorities set a US$10 - US$13 billion target, 44% up on year, for FDI in the nation's flagship economic reform program, but so far only US$2 billion has been earmarked for it.

Political and social instability are one factor hurting foreign investor confidence, but far and away the biggest negative influence is the pandemic. With the vaccination of the population progressing at a snails' pace, the spread of COVID-19 is virtually out of control. The pandemic is slowing completion of FDI plans and more investors are asking for their proposals to be put on hold.

Most of the new applications have come from South Korea, China and Singapore and mainly involve investments in the medical, electric, electronics, construction, and real estate sectors. The biggest single investment is in a joint South Korean-Thai medical project. The medical sector has been attracting most interest among foreign investors since the surge in COVID-19 cases began late last year. Interest is also increasing in projects designed to improve production efficiency, particularly in energy production and environment protection.

More Chinese and other foreign investors are now focused on smaller projects. Many of the Chinese are looking at investments of no more than Rmb 100 million (US$15.6 million) despite the financial incentives offered to investors. Focus is less intense than it was on the US$43-billion flagship development program in the Eastern Economic Corridor (EEC), between Bangkok and the eastern seaboard, although the authorities claim that applications for investment projects there are still increasing. A recent survey in China by a major Thai bank, Siam Commercial, found investors' sentiment towards Thailand to be "very bullish" and that interest in service industries was growing rapidly.

However, talk is cheap. Most of the EEC projects are years behind schedule. The high-speed railway linking Bangkok's three airports should begin operating in 2023, but probably will not open before 2028. Delays in expropriating land for the railway structure and arguments between the Thais and the Chinese builders over finance and technicalities are mainly to blame. Work on the new deep-sea port and harbor in Rayong province is held up by disputes with local fisheries that are claiming compensation for damage suffered by construction work on their fishing grounds. The so-called Aviation City has been depleted in scope by the withdrawal of Airbus from a service and maintenance center for international airlines that they were to operate with Thai International Airways.

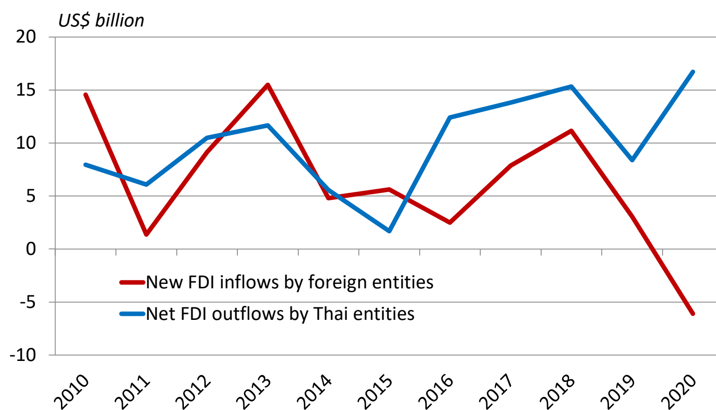
The Thais pushed hard for the EEC development to be integrated with China's controversial BRI. Prime Minister Prayuth Chan-ocha said the merger would ensure China's ongoing commitment in Thailand. He has extolled the BRI as the "heart and soul" of Thailand's national development." Another minister said it was no less than "the new hope of the world." Those opposing Thailand's deepening alignment with China are silent. The Thai-Chinese Chamber of Commerce in Bangkok has been urging the government to "beef up" connectivity between its development program and China's BRI.

The links with BRI and particularly with China's giant telecom company, Huawei, may alarm some foreign investors, especially those with plans to invest in service industries related to communications, energy, security, defense, transportation and science research. Numerous western countries including the US, the UK, France and Australia have banned Huawei from participating in 5G developments.

Three months ago, the charge d`affaires at the Chinese embassy in Bangkok launched the Huawei ASEAN Academy (Thailand) and said it highlighted the increasing Thai-Chinese cooperation on digitalization and innovation. Huawei, he added, had done everything to help Thailand become the first country in the region to have 5G commercial services. The Thai-Chinese partners say the Academy and the EEC developers will combine forces in a collaboration that will lift the digital transformation of industry in Thailand and ASEAN to another level. Those behind the Academy say it is to provide digitalization training courses to 6,000 Thai workers this year and 30,000 in 2024.

Thailand has become a larger international investor, second in ASEAN after Singapore, according to the OECD. Outward FDI by Thai investors totaled US$17 billion, exceeding the inward flow by US$6 billion. Most of these funds have been going into financial services and manufacturing in neighboring countries. The biggest Thai commercial bank, Bangkok Bank, acquired Bank Permata in Indonesia for US$2.3 billion. Thai billionaire Charoen Sirivadhanabhakdi, who back in 2013 used his Thai company, Thai Beverage, to acquire Singapore-based Fraser and Neave, is now using that Singapore investment (now called Frasers Logistics & Commercial Trust) to buy six warehouse properties across Europe for S$548.7 million (US$414 million) as the company seeks to benefit from increased demand for storage amid an e-commerce boom. Thailand's huge CP conglomerate led the purchase of British supermarket Tesco for US$9.9 billion. Thai electricity generators are investing in power generation in the region including a new power plant in Vietnam at Loc Ninh, scene of a major Vietnam-war battle half a century ago.

Thailand Now a Bigger Source than Destination of Direct Investment



Source: UNCTAD

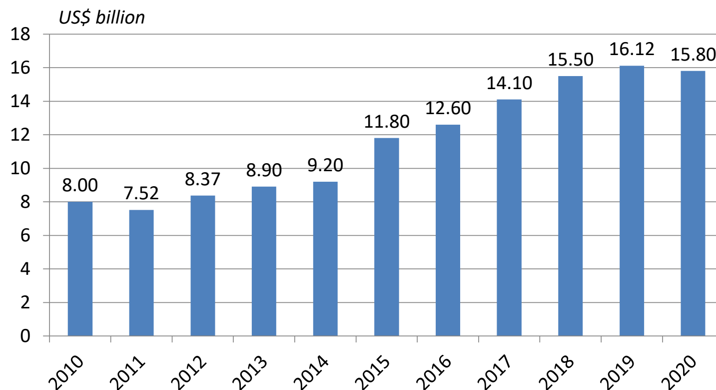
VIETNAM

Comments

Vietnam's experience in recent years speaks volumes about the relevance of Big Power investment schemes like China's Belt and Road Initiative and the G7's new counter-initiative, whatever it is eventually called: they mean very little in terms of a country's ability to attract important new foreign direct investment. Hanoi's deep suspicions of China have prevented Vietnam from participating in the BRI program all along; Vietnam does not want to become overly dependent on the Mainland for its economic needs and has therefore shunned China's BRI. While Vietnam might be more friendly toward the G7 initiative, Hanoi is unlikely to spend much time wooing projects that get the G7's good housekeeping seal of approval. Those investments, mostly from countries like Japan and South Korea rather than from the US and the EU, will be based on criteria decided upon by private companies making the investments, not by the governments of their home countries.

Vietnam does not need to play politics to please those governments. Rather, it needs to offer an environment that meets the needs of the foreign investors. Vietnam has been doing so ever since 2013, when a combination of factors caused the inflow of FDI into the country to start growing in ways that made Vietnam look like the preferred site for foreign companies compared with other ASEAN nations. The FDI sector in Vietnam

currently accounts for around 22% of the GDP and 70% of the exports. The sector has been responsible for almost 3.7 million direct and 5-6 million indirect jobs in Vietnam.



Source: UNCTAD

Several factors contributed to Vietnam's success in attracting FDI. First, Vietnam recognized that some foreign companies were starting to cool on China as an investment destination and were thinking in terms of a China-plus-one strategy. Vietnam went out of its way to make it self the Plus One – and it did so better than any other country in the region by stressing its cost advantages to China, especially in terms of labor, as well as pointing to its geographical proximity, the large size and relatively low age of its labor force, a currency that follows closely the movements of the US dollar, and political stability. Hanoi negotiated favorable treatment for Vietnam's exports to the US and the EU. It was not about to allow itself to enter a trade war with these major markets. Moreover, in contrast to other developing Asian countries, including India, it took real steps to reduce bureaucracy and streamline government processes, for example by implementing e-tax and e-custom services. It also ordered the country's state-owned enterprises to stop competing with FDI projects.

These steps helped to spur the growth of FDI from 2013 through 2019. Last year, there was a decline in FDI because of the pandemic. UNCTAD figures indicate that new FDI fell about 2.0% on the year to US$15.8 billion. However, this was still much more than other countries in the region received. Moreover, despite the recent intensification of the pandemic in Vietnam and the continuing restrictions on foreign travel to the country, FDI has somehow managed to begin to recover this year. FDI into Vietnam rose 6.7% from a year earlier to US$7.15 billion in January-May 2021. Additionally, FDI pledges, which indicate the size of future FDI disbursements, increased 0.8% in the year to US$14 billion. According to May 2021 data, the five sectors receiving the most investment capital include: 1) processing and manufacturing; 2) electricity, gas, water, and air-conditioning; 3) real estate; 4) wholesale and retail trade; and 5) professional, scientific and technical activities. Singapore was the top source of FDI pledges in the period, followed by Japan, South Korea, China, Hong Kong, and Taiwan.

It could take a few years before FDI inflows surpass their record levels of 2019. Indeed, FDI cannot expect to fully recover until international travel approaches previous levels – and that does not seem likely this year and maybe not even in 2022. However, to shorten that interval as much as possible, it is imperative that Vietnam up its vaccination rate. So far, it is lagging behind most other countries in the region, with only about 2% of the population currently having been vaccinated. It if cannot overcome this obstacle, the country's attractions to foreign investors could weaken substantially. However, precisely because of this risk – and because the local population would be extremely reluctant to take a vaccine manufactured in China – the government is likely to reach out for emergency help from Korea and Japan, as well as the US and Europe. In view of Vietnam's growing economic importance to these countries and to their desire to support their own influence in Vietnam against advances by China, the foreign governments might well give Vietnam preferential access to the vaccines.

EXCHANGE RATES

Currency	*6/25/21*
Chinese renminbi	6.4562
Hong Kong dollar	7.7633
Indian rupee	74.29425
Indonesia rupiah	14,425
Japanese yen	110.89
Malaysian ringgit	4.1560
Philippine peso	48.5330
Singapore dollar	1.3428
South Korean won	1,127.35
Taiwan dollar	27.88
Thai baht	31.820
Vietnamese dong	23,025

Commercial middle rate expressed in terms of US$1.

Published by:

Political & Economic Risk Consultancy, Ltd.
20th Floor, Central Tower
28 Queen's Road, Central, Hong Kong
Mailing address: G.P.O. Box 1342, Hong Kong

Tel: (852) 2541-4088
Fax: (852) 2815-5032
E-Mail: info@asiarisk.com
Web site: http://www.asiarisk.com

The material in this report may not be reproduced in whole or in part without permission in writing from the publisher. While every effort has been made to collate, check and present without ambiguity all data contained herein, the variety of sources from which they have been assembled and differing methods of reporting render verification oftentimes impossible. Thus, they are published without warranty.