

Japan Looks for Economic Growth in Emerging Asia:

Annual APEC Meeting in Yokohama to Emphasize Balanced, Inclusive, Sustainable, Innovative and Secure Growth in Region

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Since the end of World War II, Japan has looked for economic growth in the United States and Western Europe, catering to the needs of businesses and consumers in the world's most developed markets. This strategy relied on building a strong export-oriented manufacturing capacity. The quality and pricing advantages associated with this model helped to transform Japan into the world's second largest economy.

Japan's success did not go unnoticed. Lower-cost competitors adopted similar models, and, over time, eroded the nation's competitive advantage. To sustain their competitiveness, many Japanese firms moved production offshore. This helped to lower their cost structure, yet global fundamentals again require adjustments to corporate strategies.

Stagnating demand in the US, European Union (**EU**) and Japan have made the advanced economies more challenging and incremental growth is increasingly found in markets such as Emerging Asia. This is a region that, loosely defined, consists of developing and emerging economies including the Republic of Korea, Hong Kong SAR and Chinese Taipei, as well as China, India, Bangladesh and the ten nations comprising the Association of Southeast Asian Nations (**ASEAN**), including Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Burma), Philippines, Singapore, Thailand and Vietnam.

The need to expand into these markets means Japanese firms and investors can no longer treat emerging economies as sourcing platforms with little regard to internal consumption. This is leading government

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and corporate leaders to formulate new strategies and policies to increase regional integration, growth and business activity in these markets.

Intra-regional organizations -- such as Asia-Pacific Economic Cooperation (**APEC**), which encompasses 21 members from developed and emerging economies -- provide a forum that is essential to build the consensus needed to enhance regional growth, efficiencies, free and open trade and greater economic cooperation.

Japan will host this year's annual meeting of APEC Economic Leaders in Yokohama, building on the success of last year's meeting in Singapore. One expected highlight is the adoption of a comprehensive Growth Strategy to promote balanced, inclusive, sustainable, innovative and secure growth in the Asia-Pacific Region.

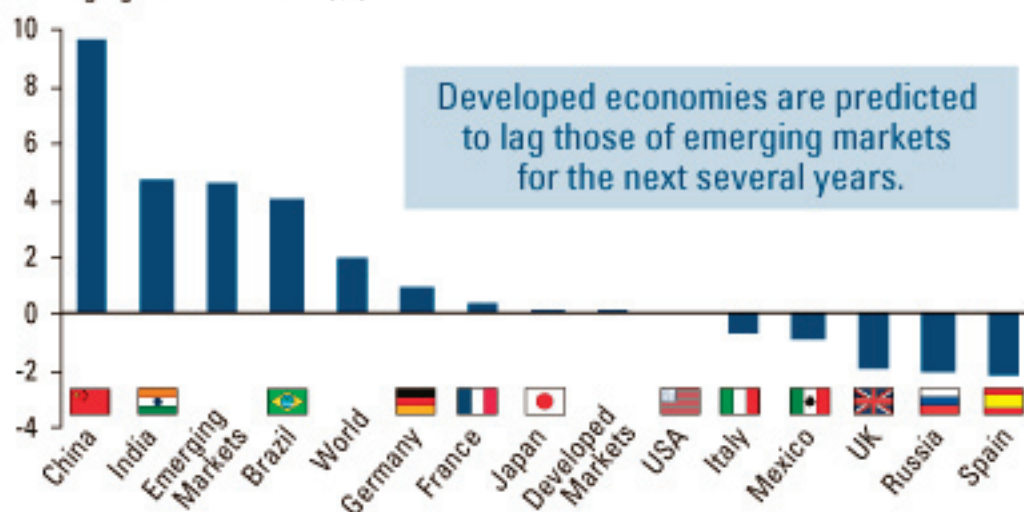
Japan Recognizes Rising Importance of Emerging Economies

The dynamics of the global economy are changing. During the past century, global economic growth was primarily driven by activity in the "the three locomotives," the US, EU and Japan.

Rapid globalization, however, is leading to new innovations, such as the proliferation of high-speed telecommunications and enhanced logistical infrastructure. This is resulting in a more connected, multi-faceted world. Economically, these changes allow companies to coordinate over long distances to optimize their supply chains and reduce their cost structure by moving production to developing economies. Building from a lower income baseline, stronger growth is helping to raise living standards and turn these developing economies into markets in their own right. As a result, they are now becoming the primary incremental drivers of global consumption and production.

Emerging Markets Leading Growth Around the World

Average growth 2009-2010 (%)



Developed economies are predicted to lag those of emerging markets for the next several years.

Source: Goldman Sachs Global ECS Research

China Forecast to be Biggest Contributor to World GDP Growth by 2017

As noted in a Euromonitor [report](#), "A new middle class is developing in emerging market economies as significant proportions of the population rise up from poverty in line with rapid economic growth. The expansion of this middle class not only provides competition for labor and resources but also enormous potential for global consumer markets. As a result, there will be a gradual shift in the dominance of global consumer markets from advanced economies to emerging market economies."

The report goes on to cite World Bank data that estimates the global middle class will almost triple from 430 million in 2000 to 1.2 billion in 2030. China and India alone will account for two-thirds of this increase. When measured on a purchasing power parity (**PPP**) basis, the IMF forecasts emerging and developing economies will overtake the share of world GDP held by advanced economies by 2014. Euromonitor states, "China is forecast to be the biggest contributor to world GDP growth by 2017, overtaking the USA and accounting for 18.4% of world GDP in PPP terms from 7.1% in 2000. India, with a share of 6.2% of world GDP in PPP terms, will be the third largest contributor toward world GDP in 2017."

Ranking of Market Size for Major Goods

	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th
Automobiles	China	United States	Japan	Germany	Brazil	France	Italy	India	United Kingdom	Canada
Desktop PCs	China	Brazil	United States	France	United Kingdom	Japan	Spain	Poland	Australia	Russia
Digital TVs	United States	China	United Kingdom	Germany	France	Italy	Japan	Spain	Brazil	Canada
Mobile phones	United States	China	Japan	France	India	Russia	Mexico	South Korea	Brazil	Germany
Toiletry products /cosmetics	United States	Japan	Brazil	China	Germany	France	United Kingdom	Italy	Spain	Russia

Note: Ranking for automobiles based on # cars and other goods on retail sales. 2009 Values for "toiletry products/cosmetics" and "automobiles," and 2009 for other goods. Shaded cells indicate Brazil, Russia, India and China (BRIC) countries. Sources: MarkLines, Co., Ltd. (automobiles), Euromonitor International 2010 (other goods).

At the same time, it is important to recognize even if a market such as China overtakes the US in terms of total GDP in coming decades as many analysts forecast, the US, as well as Japan and Western Europe will retain substantial leads in per capita income. For example, Morning Money reports, "where China still lags behind its closest economic competition is in the area of per-capita income. With a World Bank ranking of 124, China comes in at \$3,800 a year, which is a far cry from Japan, which is ranked No. 32 at \$37,870, and the United States, ranked No. 17 at \$46,513."

That said, basic mathematics dictates incremental growth, and demand will increasingly come from the developing world. To cite one example of the scale and potential, in 2009 the annual increase of cars sold in China alone nearly equaled the total number of cars sold in Japan. Rising living standards and slow movement toward PPP, as well as favorable demographics

and geographical factors, including supplies of natural resources, all favor growth in emerging economies. These trends will continue to propel engines of growth like the BRIC economies, as well as an increasingly integrated and vibrant ASEAN.

Greater Importance of Emerging Economies Leads to Shifts in Multilateral Governance

The political effects of these changes are already evident, and the importance of developing countries within multilateral institutions, such as the International Monetary Fund (**IMF**) and World Bank, is increasing. Countries such as China, Indonesia, Brazil and India are pushing for greater representation. The [New York Times](#) reported that as developing countries increase capital contributions to the World Bank, the voting structure has been realigned with “a shift in representation that will give them 47.19% of voting power, up from 44.06%.” Finance Ministers of the Group of Twenty (**G-20**) industrialized and emerging market economies met in Gyeongju, Korea in October and agreed on [proposed reform](#) of the IMF. This will shift country representation within the institution toward “large, dynamic emerging market and developing countries.”

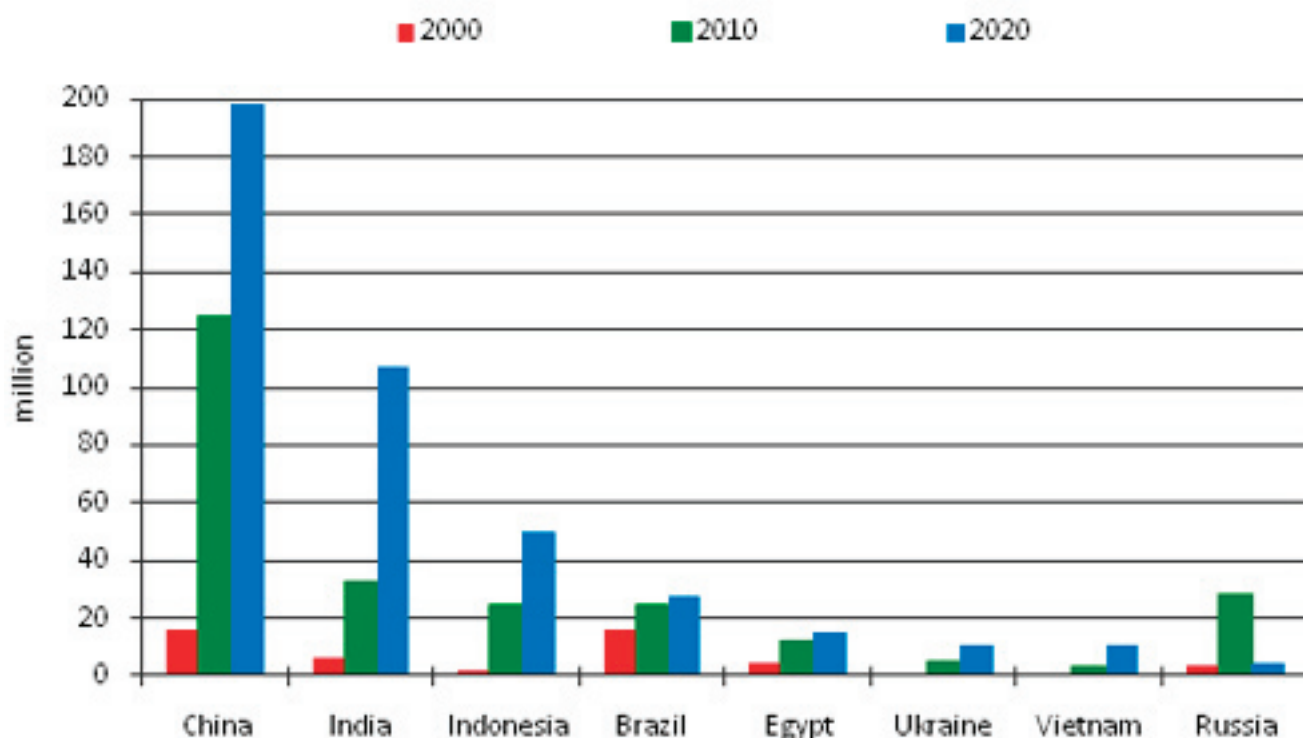
Emerging Asia Increasingly Drives Global Growth and Demand

The biggest potential within developing economies is likely to be in Emerging Asia. This is due to its size and scale, integration into global supply chains and the emergence of growing numbers of consumers with higher discretionary incomes.

Home to the world’s largest populations, many analysts believe China and India hold the biggest potential, followed by Indonesia and other economies that benefit from growth in the region. Increases in education, technical skills and capacity are key factors leading to rising per capita income. In 2010, for example, Euromonitor estimates households with annual disposable incomes of US\$5,000-15,000 as a percentage of total households will be 32% in China, 15% in India and 36% in Indonesia. In 2020, this will reach 46% in China,

41% in India and 58% in Indonesia.

Number of households (in millions) with annual disposable incomes of US\$5,000-15,000 in selected economies: 2000-2020

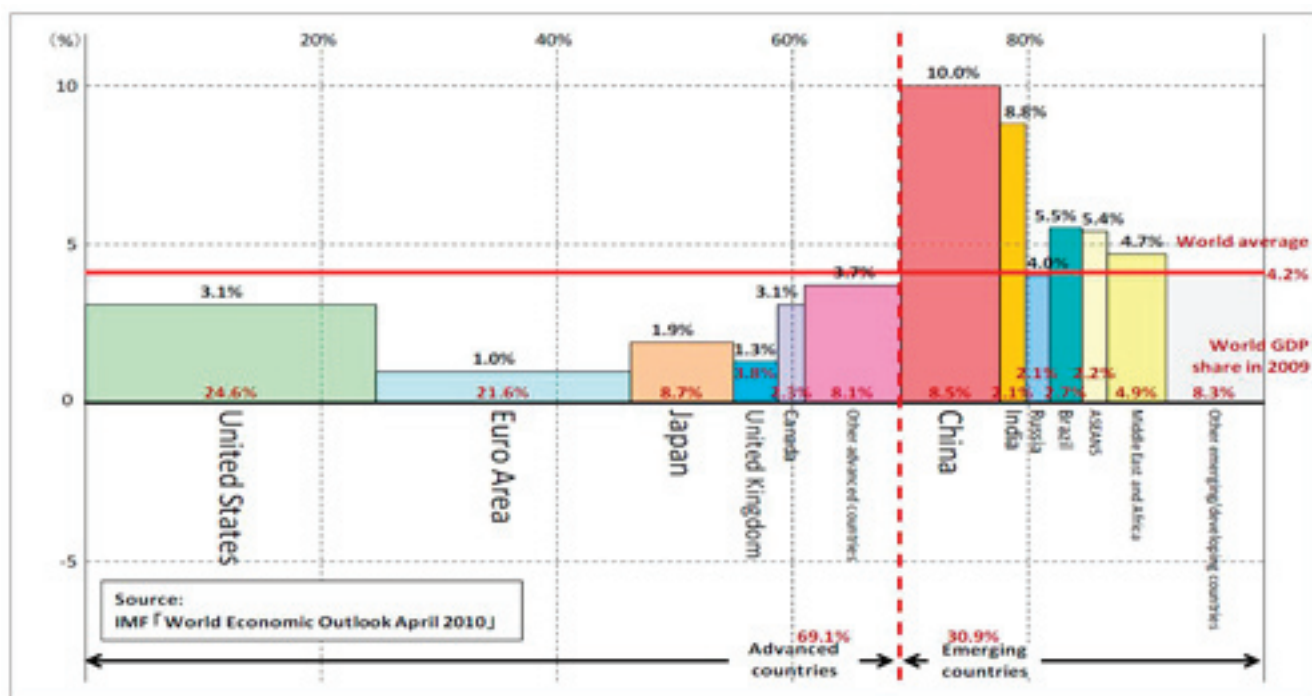


Source: Euromonitor International from national statistics. Note: Data for 2010 and 2020 are forecasts.

The importance of Emerging Asia becomes even more apparent when examining households with annual disposable income of \$5,000-15,000. Euromonitor reports households within all emerging economies are expected to reach 331 million in 2010 from 104 million in 2000. Emerging Asia will account for 62% of this amount in 2010 compared to only 33% in 2000. This will rise to 80% by 2020 with China and India accounting for 306 million of the 488 million households in this income band.

For this reason alone, Emerging Asia will play a more significant role in maintaining future global economic growth and stability. For example, despite the economic turmoil of the past two years, the [Asian Development Bank \(ADB\)](#) predicts Asia will grow 8.2% this year, revising its 7.5% forecast made in April. As seen in the chart below, this above average performance is essential to realize the IMF's 4.2% global forecast for the current year given subpar growth in the US, EU and Japan.

Emerging Market Performance Raises IMF Global 2010 GDP Projections



Sustained Growth in Emerging Asia Requires Increased Domestic Consumption

As most developing economies in Asia have sought growth through exports to the US and other advanced economies, domestic demand has not been important. In the current economic environment, however, their traditional trading partners can no longer continue absorbing these imbalances. A greater reliance on domestic demand is essential. Not only is

this necessary to sustain growth and momentum in these economies, it will also diffuse the potential for global trade tensions and create economic activity that will benefit the world as a whole.

Moving forward, the primary challenge for Emerging Asia will be its ability to shift toward a greater reliance on domestic demand and services. This point is emphasized by ADB Chief Economist [Jong-Wha Lee](#), who maintains these markets must rebalance growth through policies that maintain strong domestic demand and efficient allocation of resources. This includes a heightened focus on domestic consumption by improving the investment climate and social infrastructure. ADB and other public and private institutions also advocate an acceleration of financial development through initiatives such as development of a local currency, [Asian Bond Market](#) and greater regional integration.

Japan Adjusts Policies and Strategies to Expand in Emerging Markets

As the global economic environment evolves and emerging markets assume greater relative importance, Japanese government and corporate leaders are moving to accommodate these changes. Policy-makers are now working to adopt new strategies, policies and guidelines and to adjust existing initiatives to encourage and facilitate greater activity in these markets. The country also continues to place a heavy emphasis on maintaining strong relations with its traditional partners.

In recognition of these changing fundamentals, Japan's Ministry of Economy, Trade and Industry (**METI**) outlined a number of steps that need to be taken in its 2010 White Paper on International Trade, including:

a) *Targeting Emerging Markets*

- Greater focus on innovation and marketing to these economies;
- Strategies establishing specifications that address needs of these markets;

- Maintaining value of the “made in Japan” brand;
- Facilitating infrastructure development in Asia; and
- Promoting environment-friendly systems and practices.

b) Opening up Japan

- Facilitating the flow of human resources, goods, money and knowledge;
- Promoting Japan as a base for corporate and investment activities; and
- Establishing a good environment for knowledge-based economy and services.

c) Contributing to Development of Global Economic Frameworks

- Promoting regional economic integration, e.g., Economic Partnership Agreement (**EPA**) and Free Trade Agreement (**FTA**);
- Improving regional and global market environment, e.g., Bilateral Investment Treaties, Standards;
- World Trade Organization and Doha Development Agenda; and
- Japan-chaired APEC 2010.

While these changes are largely focused on Emerging Asia, greater attention and involvement is also being initiated in other emerging markets such as Latin America, Africa and the Middle East. Although Japan has had a presence in these markets for a long time, they have primarily served as platforms to source inputs, establish low-cost manufacturing or absorb excess production of products originally produced for advanced economies. This is prompting a reevaluation of strategies and approaches by Japanese companies.

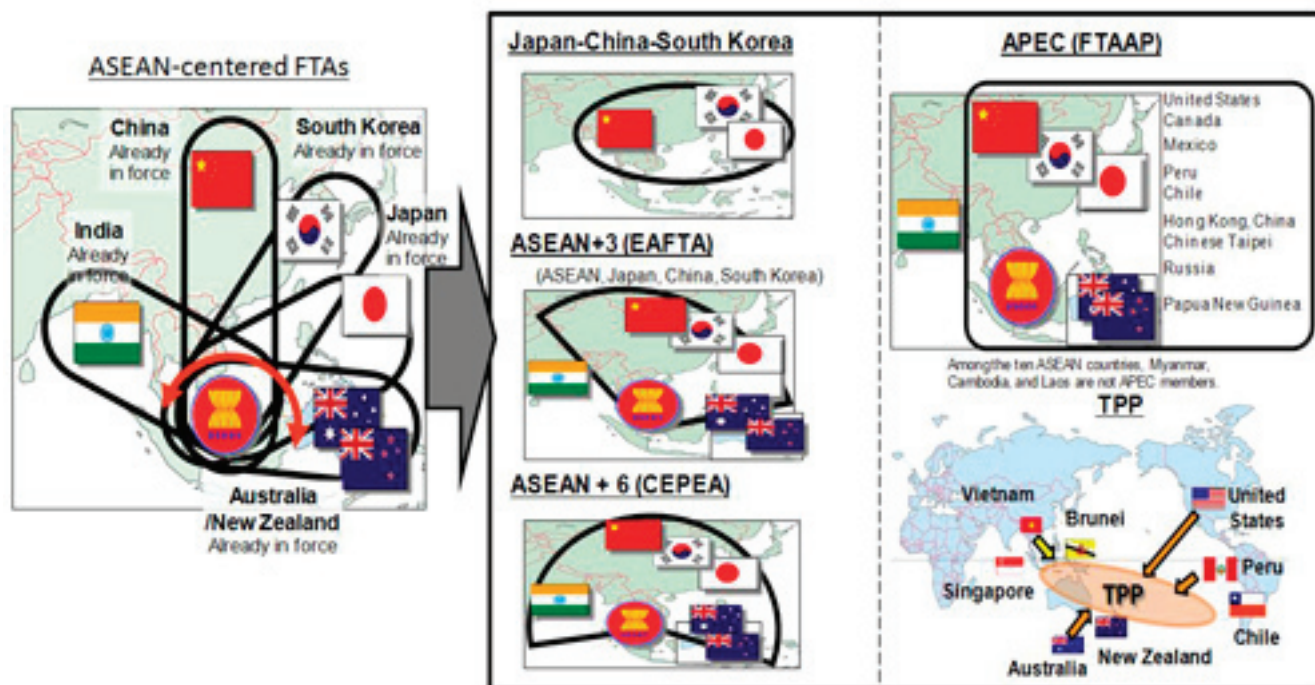
Japan Seeks to Promote Greater Regional Integration Through Asia-wide FTAs

A major component of Japan’s strategy is establishment, inclusion and participation in a range of FTAs. To date, efforts to promote Asian economic integration have largely focused on integration within an [ASEAN Free Trade Area \(AFTA\)](#), and [five ASEAN-centered FTAs](#) concluded individually with Japan, the Republic of Korea, India, China and Australia/New

Zealand.

To build on these achievements, Japan is now actively considering a number of broader agreements. These include a potential agreement between Japan-China-South Korea, an East Asia FTA (**EAFTA**), which seeks to join these three countries with ASEAN, the Comprehensive Economic Partnership for East Asia (**CEPEA**), which would build on the EAFTA framework by including three additional countries: India, Australia and New Zealand. A proposed APEC-wide Free Trade Area of the Asia-Pacific (**FTAAP**) is also in the planning stages. In addition, as of early November, Japan is considering whether to participate in a Trans-Pacific Partnership (**TPP**) Agreement.

Toward Asia-wide FTAs



To further realize the goal of a more integrated Asia, organizations such as APEC, ASEAN, the newly-established [Economic Research Institute for ASEAN and East Asia \(ERIA\)](#) and institutions such as ADB are also introducing multilayered frameworks in the Asia-Pacific region to enhance economic development and sustainability issues.

To facilitate involvement by Japanese firms, Japan's government is facilitating corporate involvement through several public finance institutions. The most prominent of these are Nippon Export and Investment Insurance (**NEXI**), the Development Bank of Japan (**DBJ**) and the Japanese Bank for International Cooperation (**JBIC**):

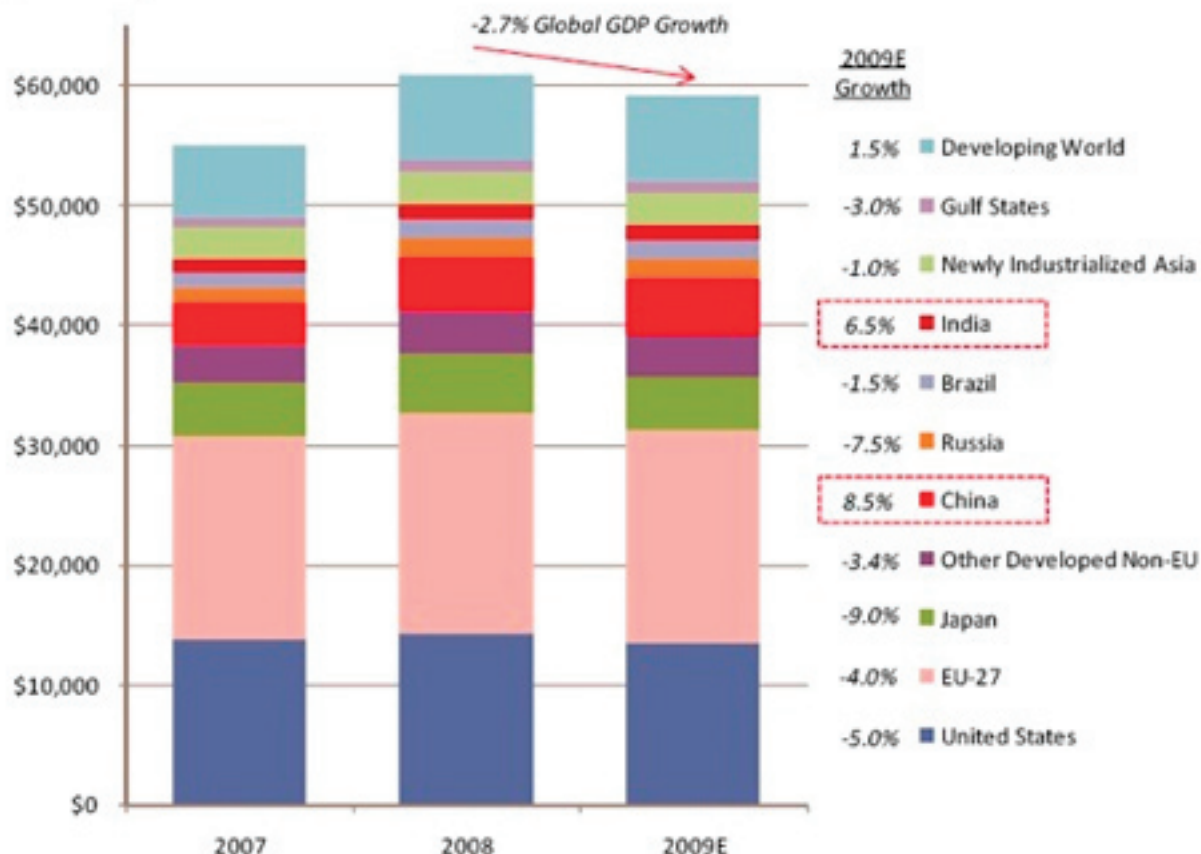
- [NEXI](#) plays a similar role as the Export-Import Bank of the US, supporting foreign trade by reducing the risks associated with overseas transactions such as war and prohibitions on foreign currency conversion. For example, [Reuters reports](#) NEXI recently entered a deal to insure a loan from Bank of America to help finance Japanese companies doing business in emerging markets.
- [DBJ](#) is a government-owned financial institution that offers [financial services](#) to supplement those provided by commercial financial institutions. DBJ often helps to streamline financing of [companies and projects](#) in developing countries by coordinating with institutions such as the World Bank's International Finance Corporation (**IFC**).
- [JBIC](#) provides [policy-based finance](#) that contributes to the sound development of Japan and the international economy. It focuses on improving finance operations in emerging markets to promote overseas development and the competitiveness of Japanese industry, especially to facilitate access to natural resources.

US and Developed Markets Balance and Support Global Development Efforts

When one talks about the potential of Emerging Asia, its improving fundamentals and the opportunities that will be realized through further economic integration, it is important to remember this is the promise of incremental growth -- and the US, EU and other advanced nations are likely to constitute the largest share of global GDP for many decades. This is true even if the most optimistic forecasts are realized. Advanced nations also provide balance, stability, capital and support to global development efforts.

Further, while movement toward greater domestic demand is essential to sustain growth in emerging economies, the US, EU and Japan continue to serve as important markets for goods and services. Additionally, as emerging and developing economies in Asia mature and demand increases, they will be stronger candidates for investment, as well as destinations for products sourced from the US and other developed economies. The global economy as a whole will be stronger as a result.

Global GDP by Region (2007 – 2009E)
(\$ in Billions)



Source: Hayman Advisors from Thoughts from the Frontline newsletter

For this reason, it would be a mistake to believe expansion into emerging economies means a lower commitment to advanced economies and traditional alliance and trading partners. For example, the importance Japan continues to accord its relationship with the US and its belief the US can make a major contribution to the development of Asia was noted by former Prime Minister H.E. Dr. Yukio Hatoyama, in his [speech](#) delivered at last year's 2009 APEC summit in Singapore. Former Prime Minister Hatoyama stated, "Of course developing Asia is not free of problems. In this regard, the presence of the United States has been playing and will continue to play an important role in ensuring the peace and prosperity

of Asia, including Japan. This is one of the greatest reasons that Japan continues to regard the Japan-US alliance as the linchpin of Japanese foreign policy ... Together with you, I would like to welcome this commitment.”

Further, emerging Asian nations are also eager for the US to play a more active role in the region. In a 2008 speech, for example, at an event organized by the United States Indonesia Society (**USINDO**) in Washington, D.C., Indonesian President Susilo Bambang Yudhoyono’s proposed stronger bilateral relations, within an initiative that has since been developed into a [US-Indonesia Comprehensive Partnership](#). This program encourages engagement between the US and Indonesia to improve security and economic cooperation.

In the partnership, the two countries seek to exchange professional, technical, and cultural experiences. In late 2009, for example, an [agreement](#) was signed to establish a Peace Corps program in Indonesia. Further, both countries pledged to enhance environmental security. Such agreements allow for greater exchange of ideas and broadening of common economic and security goals.

APEC Annual Meeting in Yokohama to Further Balanced, Inclusive, Sustainable, Innovative and Secure Growth in Region

APEC is a forum consisting of 21 Pacific Rim member economies. The forum was established in 1989 to strengthen the Asia-Pacific community by enhancing economic growth and prosperity in the region. Following the success of other regional economic blocs, such as the EU, and given the increased importance of regional economic integration between countries in the Pacific Rim, APEC’s primary strategy to achieve growth is focused on promoting regional free trade and economic cooperation.

According to its [charter](#), APEC attempts to achieve goals strictly through dialogue; it is “the only international intergovernmental grouping in the world committed to reducing barriers to trade

and investment without requiring its members to enter into legally binding obligations.”

Countries Represented in APEC



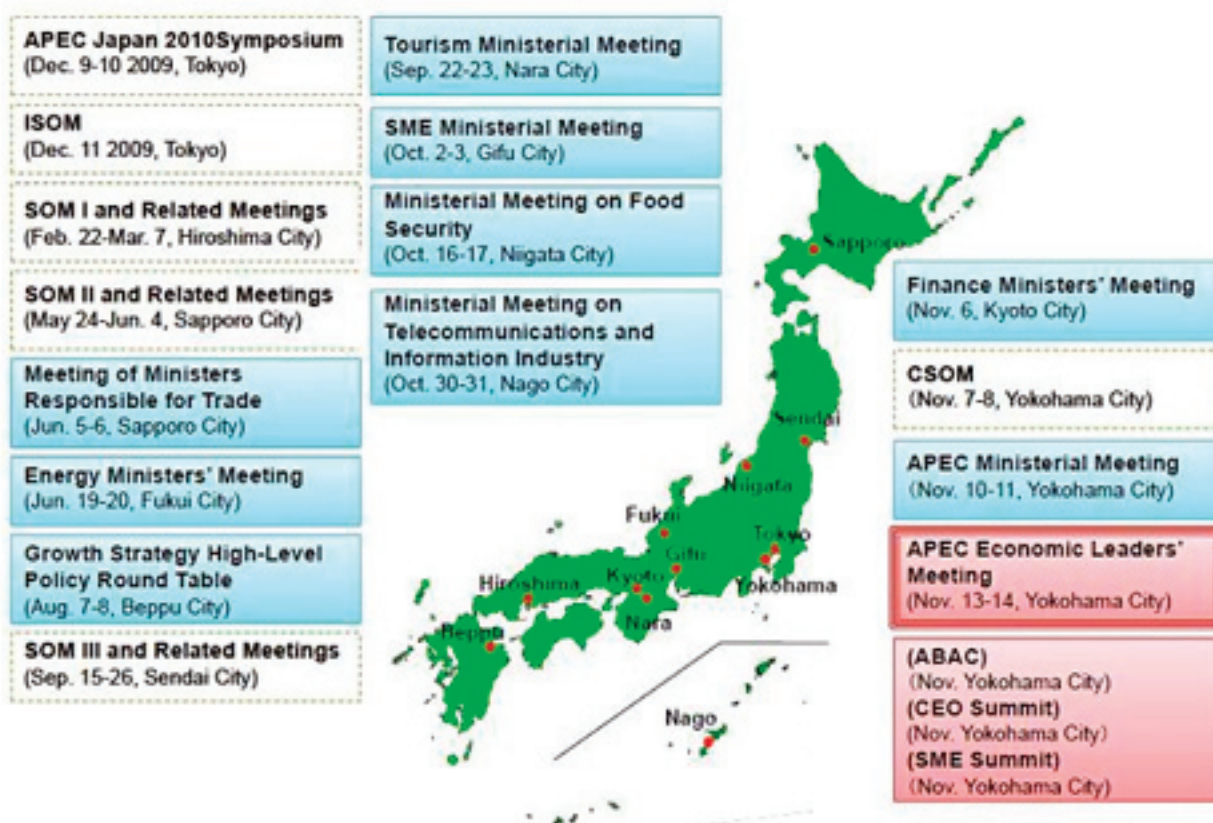
The importance of APEC is reflected by global production and population accounted for by member economies. According to APEC, the 21 member economies account for

“approximately 41% of the world’s population, approximately 54% of world GDP and about 44% of world trade.”

APEC Growth Strategy to Recognize Multifaceted Challenges to Regional Development

Development of APEC’s Growth Strategy is being coordinated by Japan, the host economy for this year’s annual meeting. Following comprehensive discussions among APEC member economies, the parameters of a multifaceted strategy were agreed upon at the High-Level Policy Round Table in Beppu, Japan last August. Development of this strategy will be finalized and announced at the annual meeting in Yokohama.

APEC Japan 2010 Meetings



Recognizing the multifaceted challenges that affect progress in the region, the Growth Strategy will seek to initiate long-term sustainable development through growth in five key areas:

- Balanced Growth: Initiatives to unwind imbalances within and across APEC economies through effective macroeconomic policies and structural reforms that complement G20's efforts to pursue balanced growth in the region;
- Inclusive Growth: Promoting policies in fields such as job creation, human resource development, small and medium-sized enterprises and entrepreneurship development while creating new economic opportunities for women and more inclusive access to finance;
- Sustainable Growth: Enhancing energy efficiency and development of a low-carbon energy sector by improving access for environmental goods and services, development of green industries and energy conservation activities;
- Innovative Growth: Improving environment for research and development and regulatory infrastructure conducive to innovation, such as those related to technological applications, digital prosperity, professional workforce mobility, protection of intellectual property rights and standardization; and
- Secure Growth: Provide a secure environment by promoting new and coordinated policies in fields such as counterterrorism, prevention and countering of emergency preparedness, pandemic diseases and food security.

Emerging Asia Presents Significant Opportunities to Firms and Investors

The need to rebalance the global economy has opened the door to greater opportunities for investment and business activity in emerging and developing economies. While one cannot forecast the future with certainty, strong fundamentals, favorable demographic trends and rising numbers of households earning incomes that provide higher levels of discretionary income, all indicate markets such as Emerging Asia will increasingly serve as the incremental drivers of global growth and demand moving forward.

Companies and investors in Japan and the US need to recognize and embrace these trends. That is because these markets are almost sure to assume accelerating shares of global GDP, and it will be hard to maintain growth and competitiveness without an expanded presence in these economies. This will require a new orientation that views the developing world as a growth market -- rather than simply as a production platform and venue that can absorb products that cannot be sold in their domestic economies.

On the government side, special care is needed to maintain movement toward this rebalancing. This is vital both to diffuse the potential for trade tensions during this often painful adjustment. It is also needed to ensure these markets have the physical and soft infrastructure and capacity necessary to absorb capital and sustain rapid economic growth while maintaining the social and political stability and environmental integrity that is vital if this transformation is to succeed.

Forums such as APEC are extremely important to maintaining positive movement in this direction. This month's annual meeting in Yokohama promises to build on initiatives launched last year in Singapore and announcement of a comprehensive Growth Strategy will provide further impetus and guidelines that will help lead to balanced, inclusive, sustainable, innovative and secure growth in the region.

Future APEC summits in Hawaii and Russia should reinforce this plan by focusing on region-wide structural reform, entrepreneurship, job creation and improvements in security and both hard and soft infrastructure. This will serve to provide the region with a greater capacity to absorb capital and open the door to a wide range of new business and investment opportunities. It will also help to maintain growth and momentum for the benefit of businesses and consumers around the world.

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For more information, contact:

Kenichi Kawamoto
Executive Director
JETRO New York office
Tel. +1-212-997-0400
Email: Kenichi_Kawamoto@jetro.go.jp

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