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“Over-Investment in Asia”

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“ASEM Conference: Investment and Its Financing:
What Causes Private Investment to Remain
Relatively Low in Asia?” Dec 16-17,2010, Mumbai,
India

Views expressed in this presentation are those of the
author and do not necessarily reflect the official views of
the Bank of Japan.

A Brief Introduction

- Title of the conference: “Investment and Its Financing: What Causes Private Investment to Remain Relatively *Low* in Asia?”
- My perception of the Asian economies : “over-investment” rather “under-investment”
- “Issue” is “inefficient investment”

Over-Investment

- High economic growth led by exports and **investment** (Charts 1, 2, 3)
 - Further enforced by recent fiscal stimulus
 - Rising ratio in China; substantial **quantitative** contribution to the global economy
- Some room for the discussions from a **qualitative** viewpoint

Chart 1

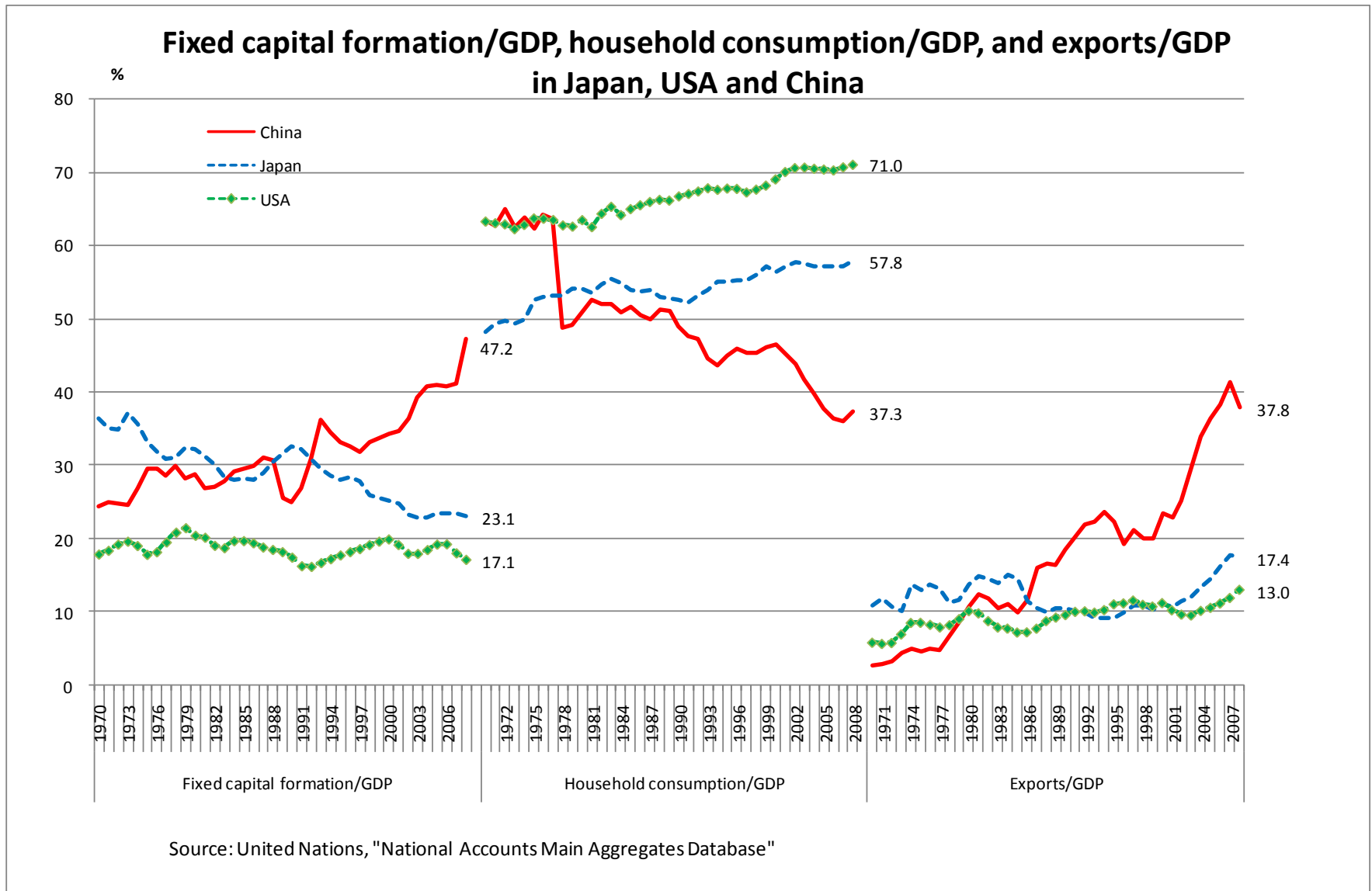
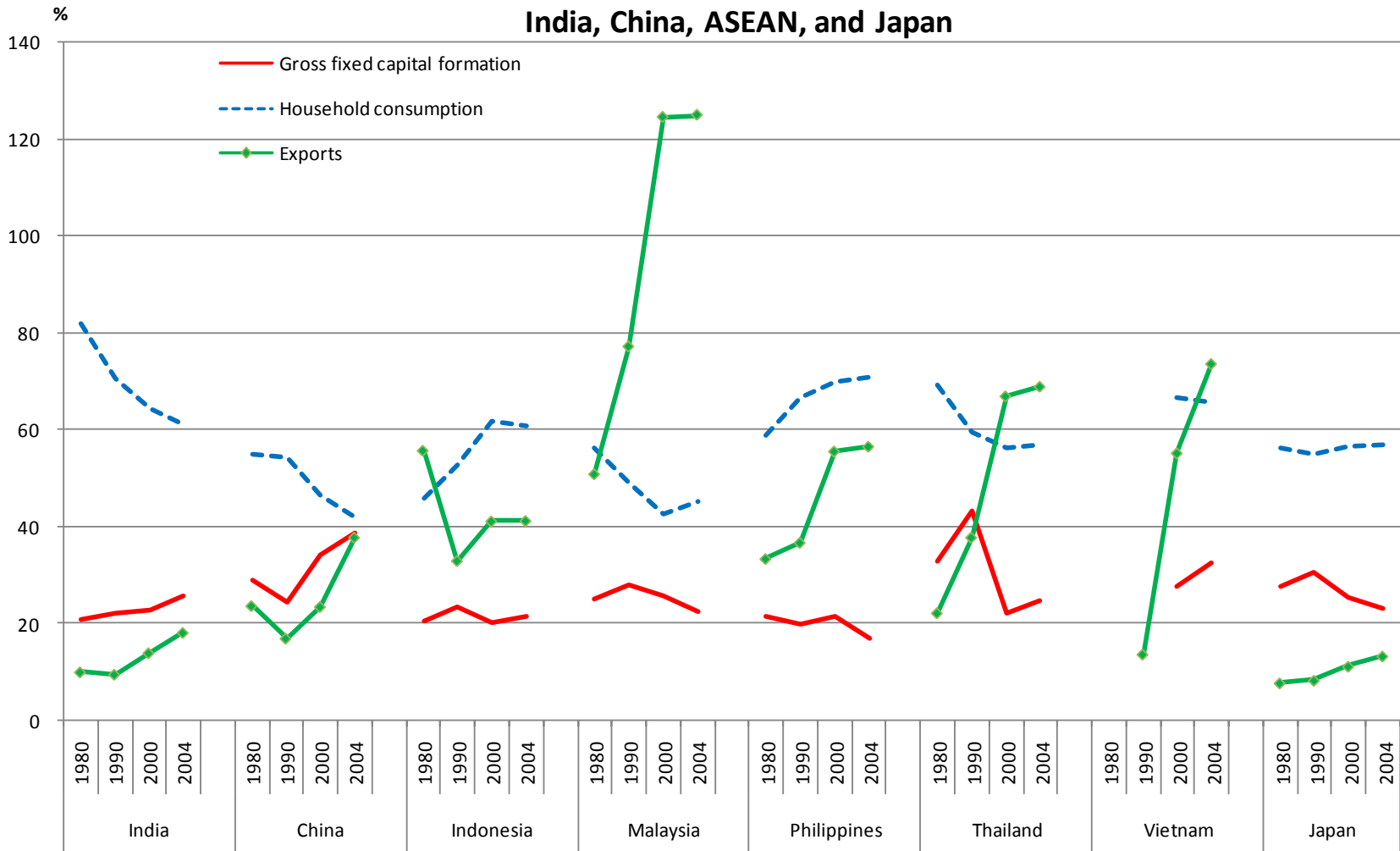


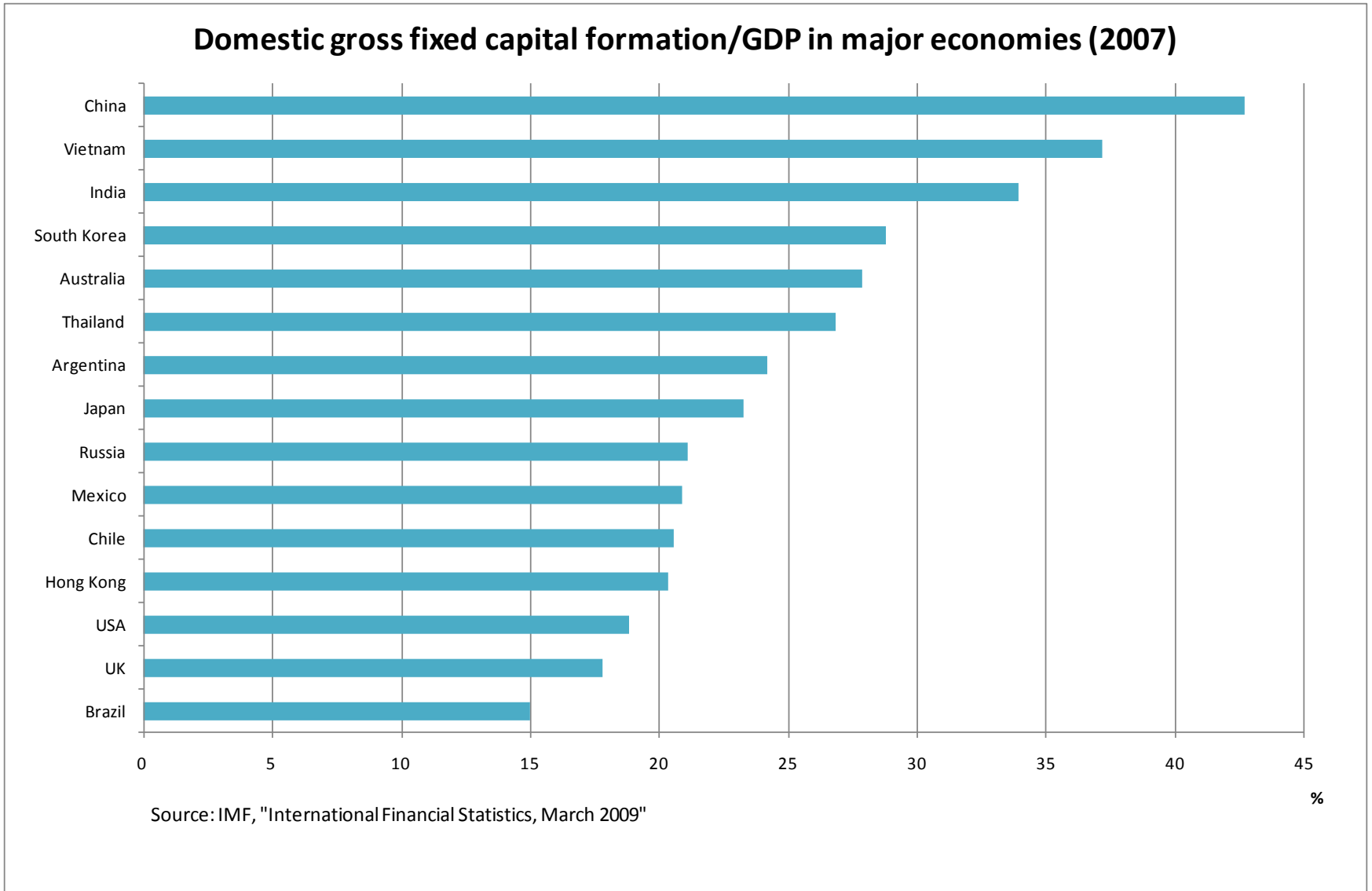
Chart 2

Household consumption/GDP, gross fixed capital formation/GDP, and exports/GDP in India, China, ASEAN, and Japan



Source: World Bank, "World Development Indicators"

Chart 3



Source: METI (2009)

Inefficient Investment

- Efficiency of investment: marginal capital coefficient (Table 1)
 - “Duality of investment”: “knife edge” growth theory by R. Harrod, i.e. over-investment resulting in Inflation (excess demand)/deflation (over-capacity)
 - Although the coefficients in high-growth periods are generally high, the number for China stands out.

Table 1 Comparison of marginal capital coefficient of Asian countries during the economic growth era

	Economic growth era (year)	Average of real GDP growth rate (%)	Average of investment ratio (%)	Marginal capital coefficient (%)
S. Korea	1986-1990	9.65	30.09	3.12
Indonesia	1989-1993	8.30	26.79	3.23
Malaysia	1992-1996	9.56	40.37	4.22
Philippines	1986-1990	4.74	19.01	4.01
Thailand	1987-1991	10.94	34.99	3.20
Japan	1966-1970	11.56	33.50	2.90
China	1981-1989	9.95	26.80	2.69
	1990-1999	10.00	31.66	3.17
	2000-2004	9.18	37.65	4.10
	2005-2009	11.36	54.30	4.78

Balanced Growth?

- Hypothetical Q
(which is better?)

(Country A) 10% growth with fixed $\text{inv./GDP}=40\%$

(Country B) 6% growth with fixed $\text{inv./GDP}=20\%$

w.r.t. a) balance between consumption and inv.

b) energy consumption, pollution

Problems of Inefficiency (1)

1. Industrial structure

- If the labor force is abundant: labor-intensive industries are desirable.
- Jump from labor-intensive to capital- and technology-intensive industry; from “flying geese” to “leap-frogging”.
- A severe unemployment problem remains despite the continued high growth of the economy.
- Developments of service sector

Problems of Inefficiency(2)

2. Inefficient consumption of energy and resources (Chart 4)

- High elasticity of energy demand to growth induces inflation of commodity prices.
- China: its share of GDP in the world economy is around 6–10%, its share in world steel production was 47% and its share in world steel demand was 42% in 2009 (Chart 5)

Chart 4

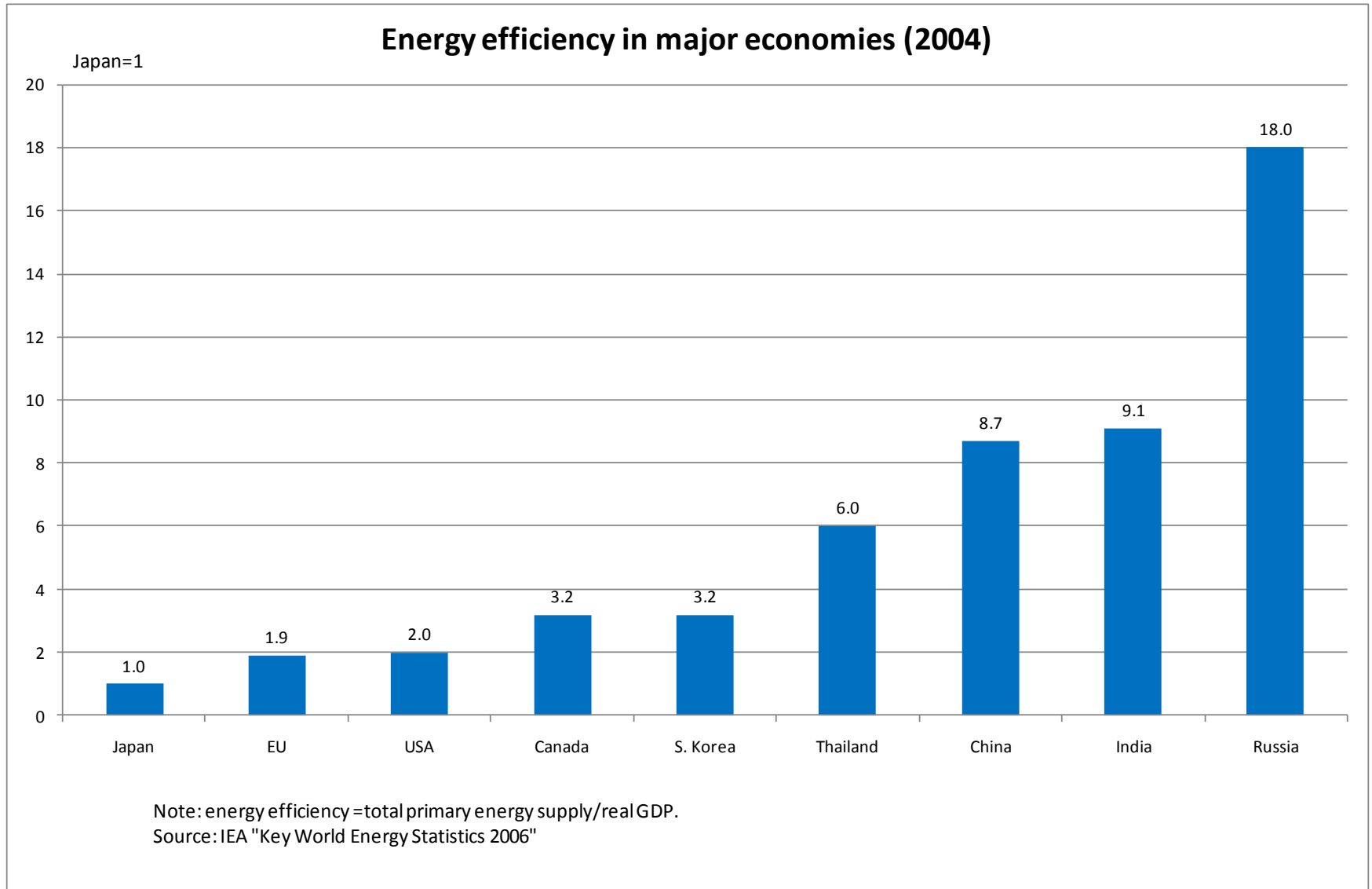
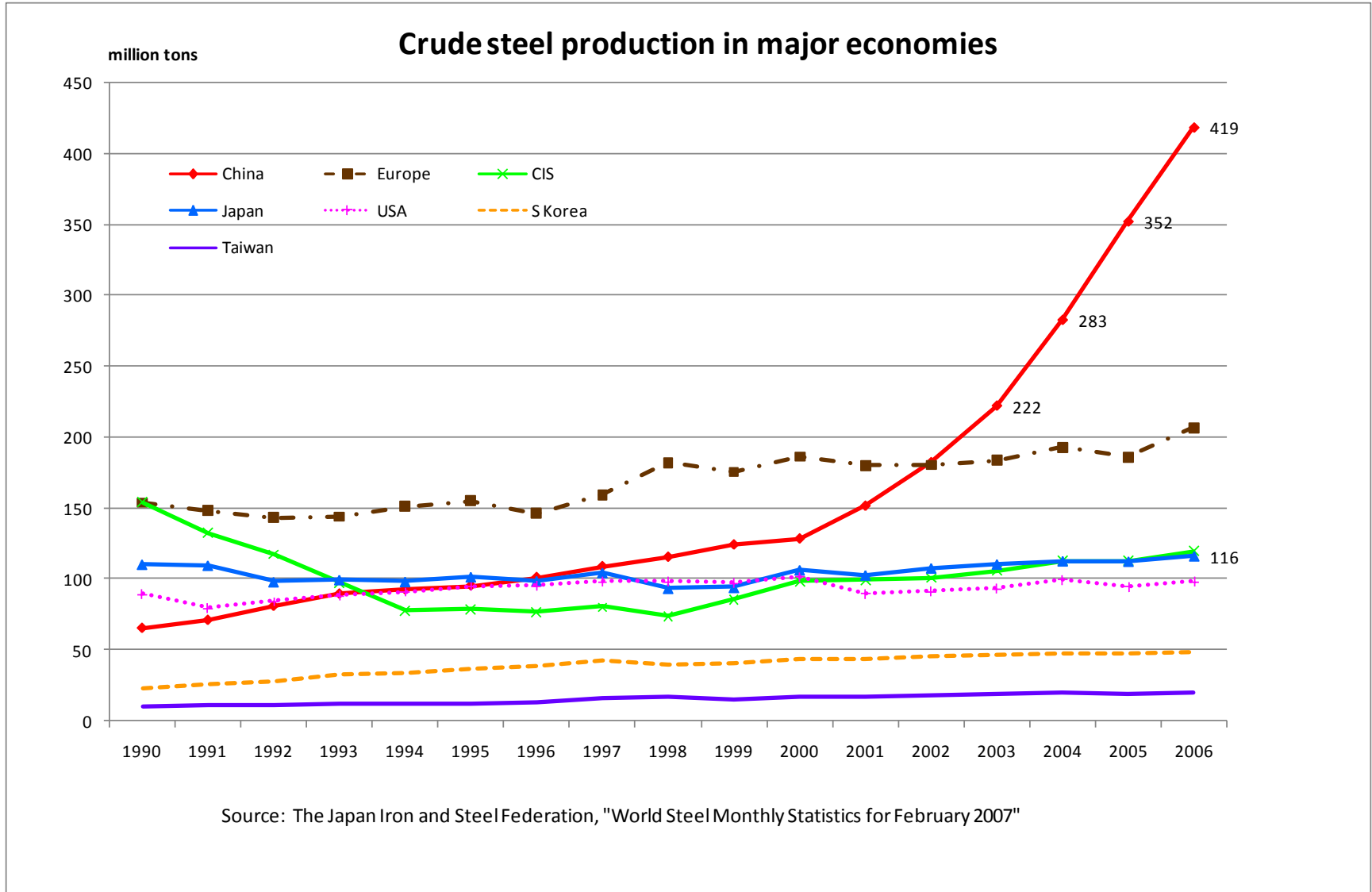


Chart 5

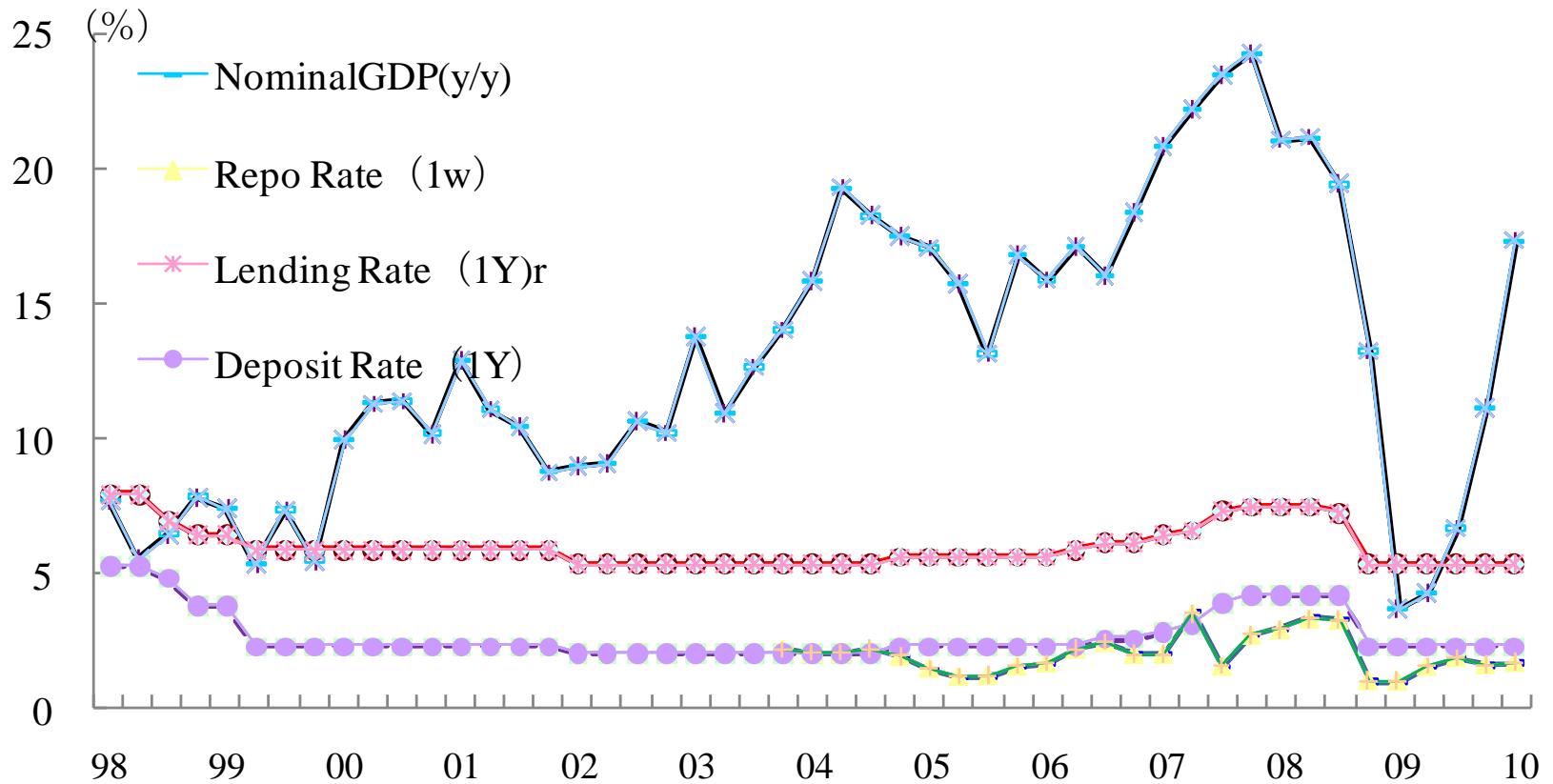


Background of Inefficient Investment

- Real factor: the promotion of urbanization of rural areas, led by the central and local governments
- Financial factor: *cheap capital cost* (Chart 6)
 - Although the economy's growth rate has been high, interest rates in China have been kept at *low levels*. In addition, they have *not been flexibly adjusted*.

Chart 6

China: Nominal GDP growth and interest rates



Banking Sector

- Low interest rates for lending (and deposit) rates
- The wide interest margin between lending and deposit rates (Table 2)
 - Banks can increase their profits simply by expanding their lending volume.
 - Increase investment

Table 2 Interest rate differences in Japan and China

	Japan			China	
	End of 1970	End of 1985	End of March 2010	End of 1991	End of March 2010
Long-term lending	8.50	7.20	1.600	9.00	5.40
Short-term lending (a)	6.25	5.50	1.475	8.10	4.86
Short-term deposit (3 months) (b)	4.00	3.50	0.059	3.24	1.71
(a) - (b)	2.25	2.00	1.416	4.86	3.15

Challenge

1. Deregulation and liberalization of the banking sector

- More discretion to set interest rates, efficient allocation of funds
- However, deregulation/liberalization become a challenge after a financial crisis
- Gradual approach

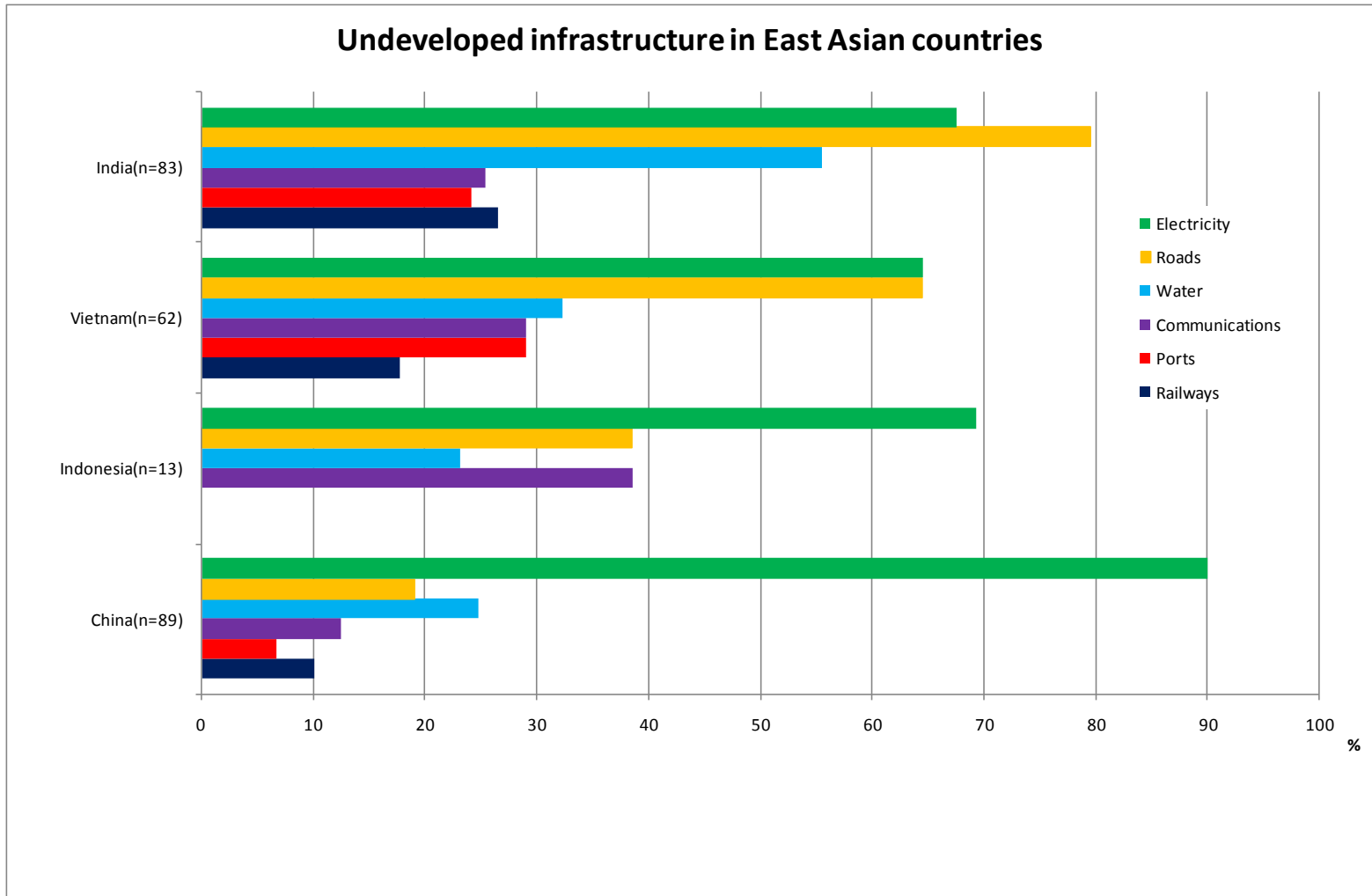
2. Developing bond markets

- Provide alternative opportunity for investment
- Enhance risk assessments of corporations and the sharing of them through bond pricing

Public-Sector Investment

- Still a huge amount of room for public investment to improve industrial infrastructures (Chart 7)
- Taking account of the rapid progress of the cross-border production
 - E.g., Asian Highway, Seamless Asia
 - More involvement of private-sector interests

Chart 7



Note: The bars indicate the elements of infrastructure considered to be underdeveloped by companies that chose "underdeveloped infrastructure" as a response to questions about "issues in promising countries."

Source: JBIC, "Survey Report on Overseas Business Operations by Japanese Manufacturing Companies 2006"

Supplement

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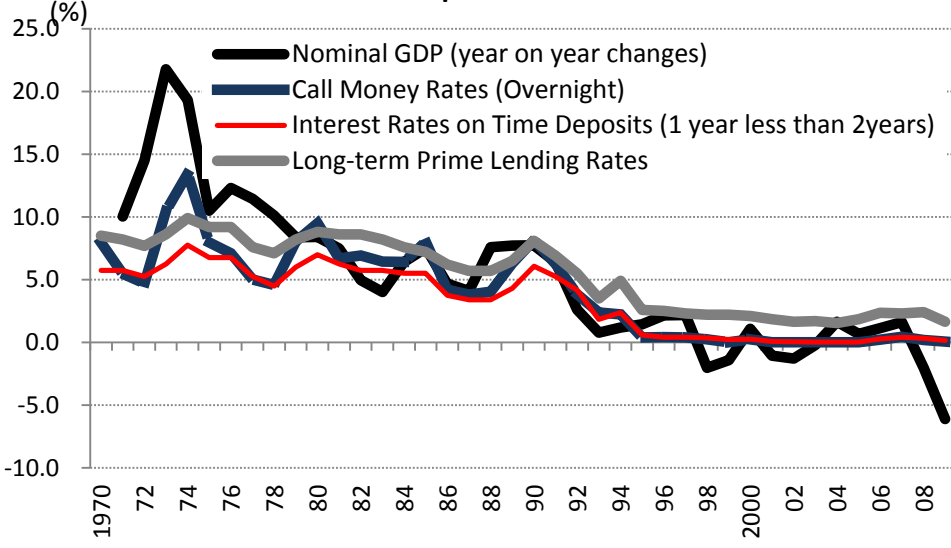
Financial Aspects of Investment in Asia

Kumiko Okazaki, Masazumi Hattori,
and
Wataru Takahashi,
Bank of Japan

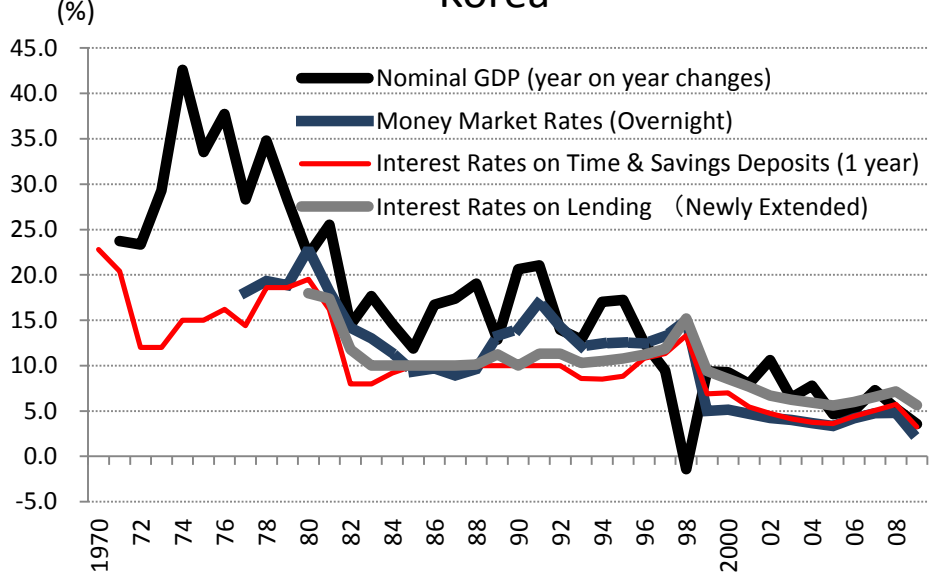
- Focusing on the financial background for investment
- Wide interest margins are observed in China and Thailand; the lending rate is rather high in Thailand
- Margins are stabilized in Japan and S. Korea

2. Nominal GDP and Interest Rates

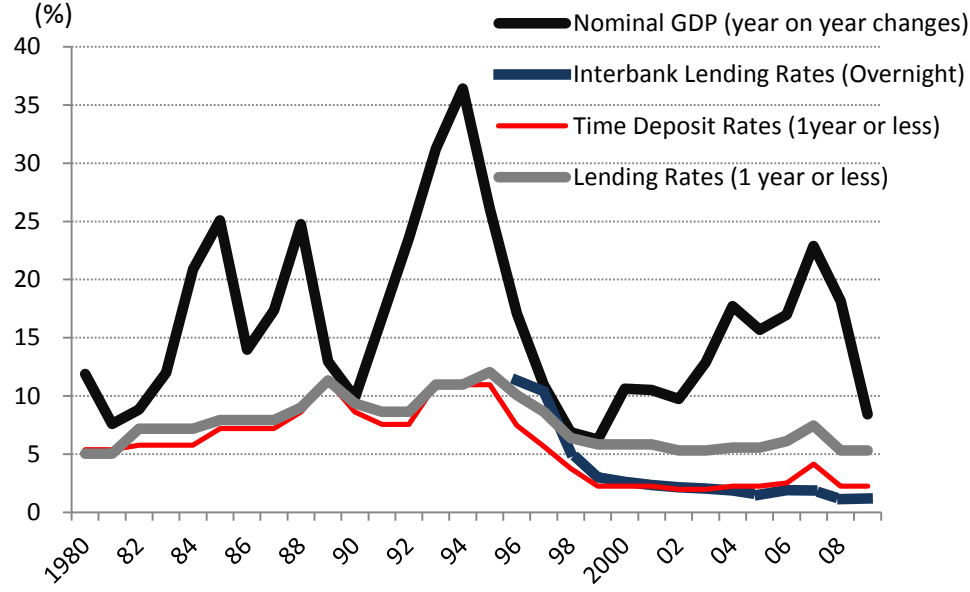
Japan



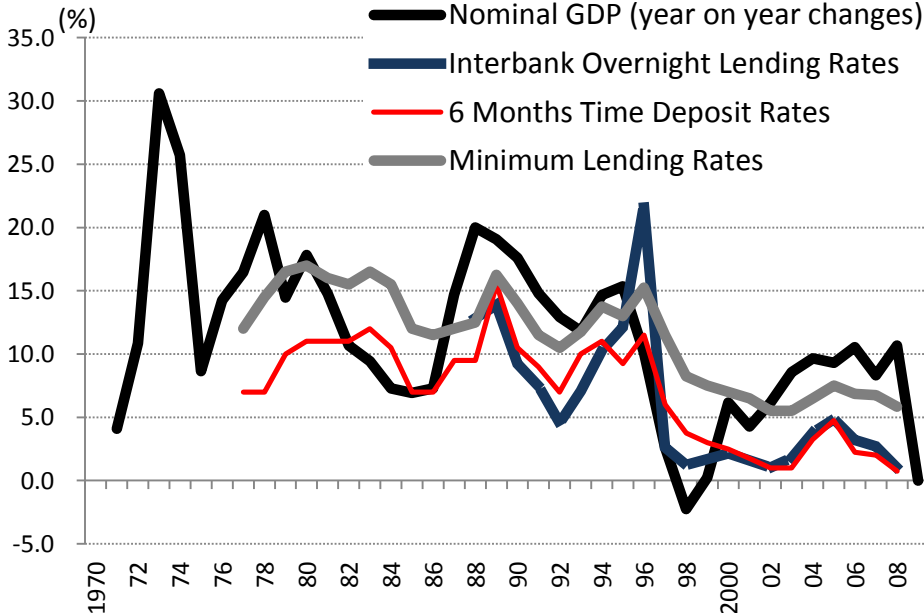
Korea



China

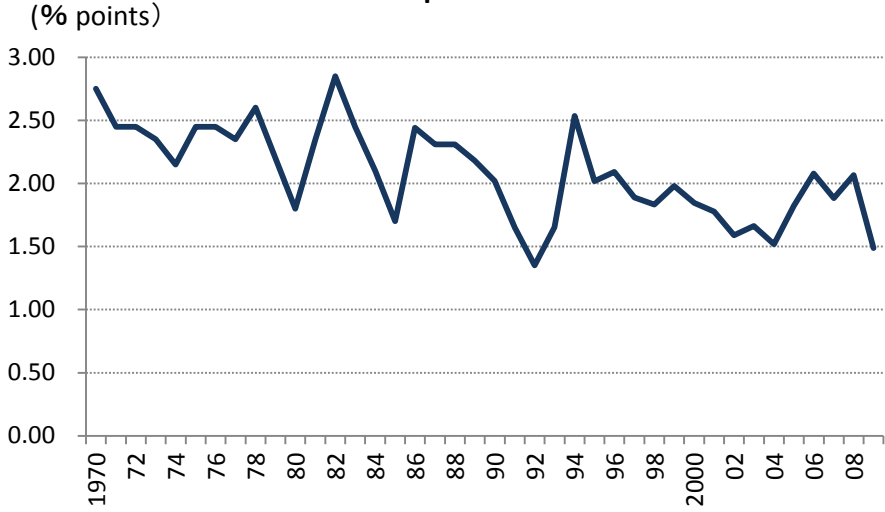


Thailand

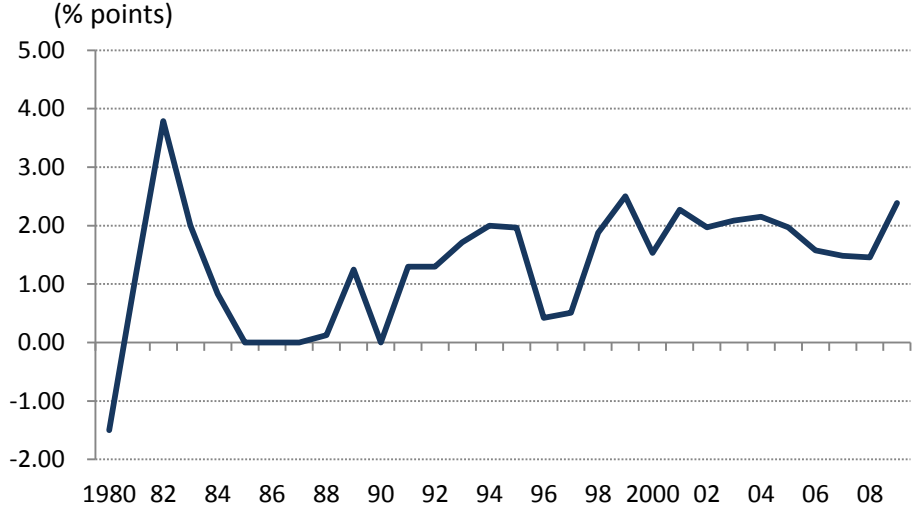


3. Interest Rate Spreads (Lending Rates Minus Deposit Rates)

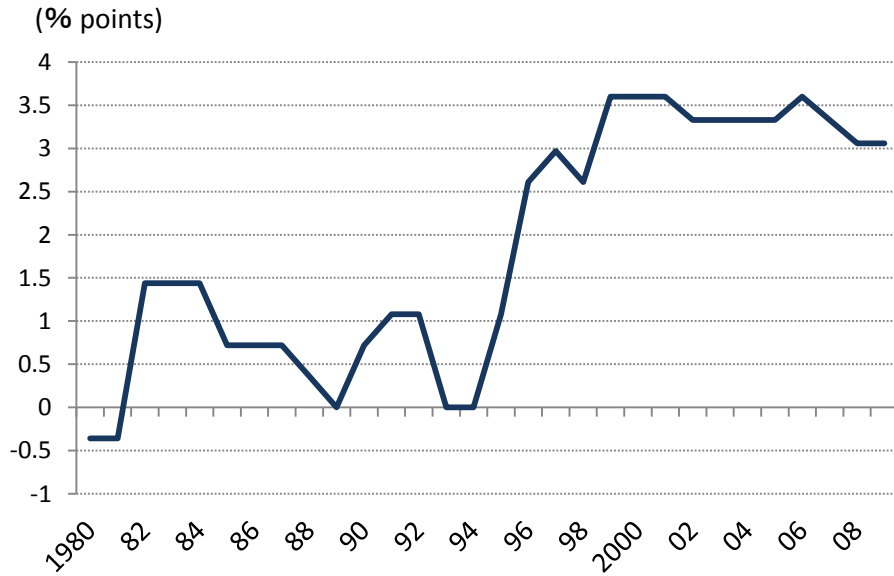
Japan



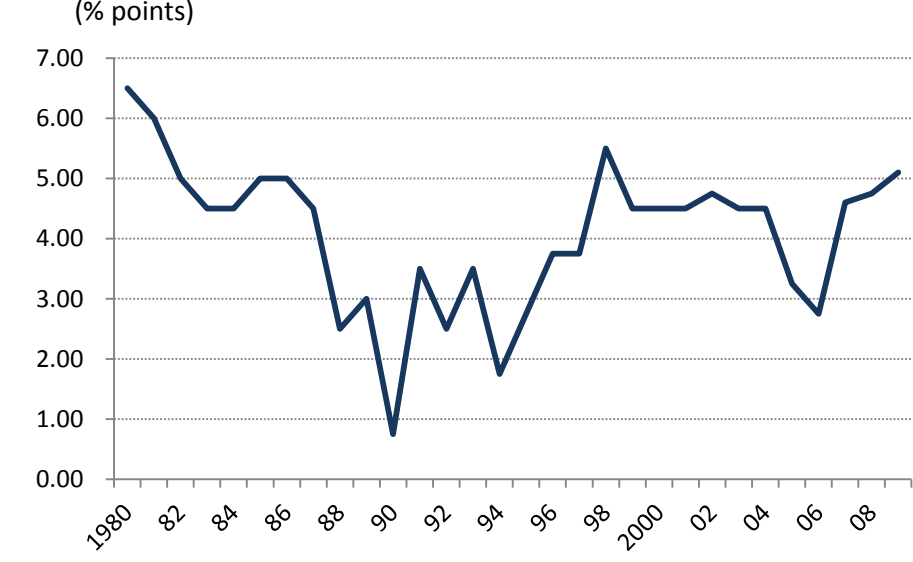
Korea



China



Thailand



ご清聴ありがとうございました。

Thank you