

Asia Economics Comment

The Japanese are coming

It's done. Abe is in full control now. Yet his real test still lies ahead. He must urgently implement far-reaching reforms to make his economic revival stick. No matter whether he succeeds in the coming quarters or not, there is one effect that will be keenly felt: Japanese money will increasingly wash over Asia. Especially ASEAN. The contours of what's to come are already faintly visible. The cash will not cure all of the region's ills. But it will help to protect against downside risks from a sterner Fed and a wobbly China. This, perhaps, will be the more lasting effect of Abenomics.

We're on Eastern Australia time right now and the final results aren't in yet. But it appears that Abe has secured a majority in the upper house of parliament. At last, this will allow him to fire his third arrow, an aggressive reform program to unshackle the economy and revive dormant animal spirits. It's admittedly a tall order. Whether his policies will prove swift and far-reaching enough remains to be seen. Caution is warranted: we've heard such brave talk before only to be ultimately disappointed.

For the rest of Asia, however, the effects of Abenomics are beginning to be felt. And these will evolve in the coming months, proving more powerful than most currently expect. The Bank of Japan's massive balance sheet expansion is still in its early stages, but will eventually rival that delivered by the Fed under its third QE program. Much, though certainly not all, of the extra cash will flow into neighboring countries, such as Indonesia, Thailand, and Malaysia, and help accommodate the region's leverage cycle even as the Fed cuts back on its own injections.

But patience is warranted. As powerful as the BoJ's measures are, their effect will only gradually filter through to regional and global markets. Look closely, however, and signs of the impending lift are starting to become visible. For example, over the first half of July, Japanese investors bought USD 20 billion of foreign bonds after shedding their holdings for seven consecutive weeks. Higher rates elsewhere, while well-behaved at home, are evidently too enticing to ignore.

Much has been written about the potential surge of portfolio purchases by Japanese investors. For Asia, however, this may not be the channel that will prove most powerful. Japanese banks are likely to raise their direct lending exposure to the region. In the mid-1990s and mid-2000s, during the two previous BoJ easing cycles, it was Japanese banks, rather than portfolio investors, that transmitted a potent monetary kick across the region.

Will we see a repeat of this? It's too early to tell (hard data comes out with a significant lag). But it is clear that Japanese financial institutions are already seeking greater direct involvement especially in ASEAN. In recent months, Japanese banks have bought significant stakes in lenders in Thailand, Indonesia and Vietnam. Similarly, life insurers look poised to purchase, or have already acquired, local stakes in the same three markets. The growing involvement of insurance companies could ultimately draw in more portfolio investment as well.

Beyond financial flows, the other effect of Abenomics will likely be to spur foreign direct investment further. True, at the surface, this seems counter-intuitive since a weaker Yen should reduce the incentive for offshoring from Japan. However, it is not the production cost differential between Japan and neighboring economies that lies behind this new wave of Japanese FDI.

Rather, it represents a strategic shift by corporate Japan, with full government support, to more aggressively pursue market share abroad and establish profit centers beyond the country's shores that will provide an income stream for the ageing population back home. The BoJ's aggressive monetary easing is designed to accelerate, not retard, this process.

The upshot is this. Yes, Fed tapering raises volatility and delivers a stiff headwind to leveraged economies in emerging Asia. But, the BoJ's aggressive monetary easing - no matter whether Abenomics ultimately succeeds or fails - should in the coming quarters provide a welcome cushion. The large ASEAN markets look set to benefit the most. It's now up to Abe to make sure the local Japanese economy receives a lasting boost as well.

Frederic Neumann
Co-head of Asian Economics Research

Also check out these reports on the topic:

Frederic Neumann and Izumi Devalier - Op-ed in Wall Street Journal: Four not so easy reforms for Japan (February 2013)
[https://www.research.hsbc.com/midas/Res/RDV?p=pdf&\\$sessionid\\$=ZSZp6nzuF_sJ4fmV2e62lC6&key=LbgyFK5sfP&n=361875.PDF](https://www.research.hsbc.com/midas/Res/RDV?p=pdf&$sessionid$=ZSZp6nzuF_sJ4fmV2e62lC6&key=LbgyFK5sfP&n=361875.PDF)

Izumi Devalier - Going Abroad: Japan's strategic FDI push (June 2013)
[https://www.research.hsbc.com/midas/Res/RDV?p=pdf&\\$sessionid\\$=ZSZp6nzuF_sJ4fmV2e62lC6&key=kIKDTNeXcW&n=375983.PDF](https://www.research.hsbc.com/midas/Res/RDV?p=pdf&$sessionid$=ZSZp6nzuF_sJ4fmV2e62lC6&key=kIKDTNeXcW&n=375983.PDF)

Leif Eskesen - ASEAN perspectives: waiting for Japan to reflate (July 2013)
[https://www.research.hsbc.com/midas/Res/RDV?p=pdf&\\$sessionid\\$=ZSZp6nzuF_sJ4fmV2e62lC6&key=0UAF32lBpi&n=377181.PDF](https://www.research.hsbc.com/midas/Res/RDV?p=pdf&$sessionid$=ZSZp6nzuF_sJ4fmV2e62lC6&key=0UAF32lBpi&n=377181.PDF)

Izumi Devalier - Japan Economics Comment: Q&A on the upper house elections (July 2013)
[https://www.research.hsbc.com/midas/Res/RDV?p=pdf&\\$sessionid\\$=ZSZp6nzuF_sJ4fmV2e62lC6&key=2ZzKfzRxNt&n=379192.PDF](https://www.research.hsbc.com/midas/Res/RDV?p=pdf&$sessionid$=ZSZp6nzuF_sJ4fmV2e62lC6&key=2ZzKfzRxNt&n=379192.PDF)

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Frederic Neumann

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document does not provide individually tailored investment advice and should not be construed as an offer or the solicitation of an offer to buy or sell any securities or to participate in any trading strategy. The information contained within this document is believed to be reliable but we do not guarantee its completeness or accuracy. Any opinions expressed herein are subject to change without notice. HSBC may hold a position in, buy or sell on a principal basis or act as a market maker in any financial instrument discussed herein.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments (including derivatives) of companies covered in HSBC Research on a principal or agency basis.

Analyst(s) are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Chinese Wall procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Additional disclosures

- 1 This report is dated as at 21 July 2013.
- 2 All market data included in this report are dated as at close 21 July 2013, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

* *Legal entities as at 8 August 2012*

'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Bank Canada, Toronto; HSBC Bank, Paris Branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Brasil SA – Banco Múltiplo; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR

Issuer of report

The Hongkong and Shanghai Banking Corporation Limited

Level 19, 1 Queen's Road Central
Hong Kong SAR

Telephone: +852 2843 9111

Telex: 75100 CAPEL HX

Fax: +852 2801 4138

Website: www.research.hsbc.com

The Hongkong and Shanghai Banking Corporation Limited ("HSBC") has issued this research material. The Hongkong and Shanghai Banking Corporation Limited is regulated by the Hong Kong Monetary Authority. This material is distributed in the United Kingdom by HSBC Bank plc. In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient.

This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR.

This material is distributed in Japan by HSBC Securities (Japan) Limited. HSBC Securities (USA) Inc. accepts responsibility for the content of this research report prepared by its non-US foreign affiliate. All US persons receiving and/or accessing this report and intending to effect transactions in any security discussed herein should do so with HSBC Securities (USA) Inc. in the United States and not with its non-US foreign affiliate, the issuer of this report. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. In the UK this material may only be distributed to institutional and professional customers and is not intended for private customers. It is not to be distributed or passed on, directly or indirectly, to any other person. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF).

Any recommendations contained in it are intended for the professional investors to whom it is distributed. This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. The decision and responsibility on whether or not to invest must be taken by the reader. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)

In Canada, this document has been distributed by HSBC Bank Canada and/or its affiliates. Where this document contains market updates/overviews, or similar materials (collectively deemed "Commentary" in Canada although other affiliate jurisdictions may term "Commentary" as either "macro-research" or "research"), the Commentary is not an offer to sell, or a solicitation of an offer to sell or subscribe for, any financial product or instrument (including, without limitation, any currencies, securities, commodities or other financial instruments).

© Copyright 2013, The Hongkong and Shanghai Banking Corporation Limited, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited. MICA (P) 118/04/2013, MICA (P) 068/04/2013 and MICA (P) 110/01/2013