MarketWatch

EMERGING MARKETS REPORT

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Japan may fuel flow of capital to emerging markets

By Myra P. Saefong, MarketWatch

Reuters

A firefighter walks around rubble near a burning factory damaged by an earthquake and tsunami in Sendai, northeastern Japan.

SAN FRANCISCO (MarketWatch) — Some emerging markets may be poised to see a fresh flow of capital as multiple disasters in Japan and strength in the yen drive Japanese investors to overseas markets, experts said Monday.

Japanese multinational corporations and financial institutions may “accelerate their diversification away from Japan into emerging markets,” said Matt Lasov, practice leader of Frontier Strategy Group’s Quantitative Analytics, though that’s not likely to happen until after the rebuilding efforts begin in Japan.

“Japanese firms have traditionally lagged American and European firms in

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New video shows smoking reactors: Japan's defense ministry releases video footage of smoking reactors at the crippled Fukushima nuclear power plant.

Power shortages to hit profits

Tokyo Electric Power says electricity supply capacity will fall short of demand at least through the summer, and analysts weigh the impact.

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emerging markets," he said. "This event may be the catalyst that pushes Japanese competition into emerging markets."

At the same time, "low interest rates and the strength of the yen will help Japanese firms facilitate investment overseas," he said.

The yen has fallen against the euro (U.S.:EURYEN) and the U.S. dollar (U.S.:USDYEN) for the last two sessions after global central banks Friday intervened to depress the yen, which had shot up to a post-World War II high on speculation Japanese companies would have to sell overseas investments to raise cash for rebuilding efforts.

Still, the yen is trading more than 2% higher than it was before a 9.0 earthquake and 30-foot high tsunami wave hit Japan on March 11, resulting in the deaths of at least 8,805 and leaving more than 12,000 missing. Economists have estimated the natural disasters will shave about half a percentage point from economic growth this year. Read latest in Japan blog.

Overblown worry

The destruction and subsequent crisis at a damaged nuclear plant north of Tokyo led to expectations that Japan's overseas investment could wither under rebuilding efforts.

"One concern is that capital investment from Japan could dry up in the wake of the earthquake as the focus shifts to rebuilding and reinvestment at home," economists at Capital Economics said in a recent research note. Read earlier story on risk to Brazil, other global markets from Japan repatriation.

That concern, however, is "overblown," the economists said.

"Liquidation of assets in emerging Asia to fund rebuilding does not seem to be a significant threat, given that most of Japan's regional assets are not liquid financial assets, but rather productive capital," they said.

Also, "at a time when production within Japan is impaired, it makes even less sense to wind down operations elsewhere in Asia," they said. "Japan is likely to stay invested in Asia as a natural hedge against operational, market and currency risks."

Benchmark indexes in China and India have declined since the earthquake, while Brazil's index has climbed.

China's Shanghai Composite (SHANGHAI:CN:SHCOMP) has fallen 1.6% and India's Sensex (BOMBAY:XX:SENSEX) is down 2.7% since March 10, the day before the earthquake. Brazil's Bovespa (BOLSA:XX:BVSP) is up around 1%.

Australia, China to fill gaps

Japan's struggles will impact the region's emerging market economies in different ways.

"Japan's massive rebuilding efforts, which should take at least 5 years, could provide a stimulus to some emerging markets," said Usha Haley, chaired professor of International Business at Massey University in Auckland, New Zealand.

Analysts at Capital Economics said "commodity exporters such as Australia, Indonesia and Malaysia are well-placed to respond to the expected surge in demand due to rebuilding and potential energy shortages in Japan."

"South Korea and Taiwan are well positioned to fill in the gaps created by the disruption to electronics production," while the Philippines is perhaps the most vulnerable given its heavy trade and investment links with Japan, they said.

The direct damage to Japanese manufacturing facilities due to the disasters has not been severe, the analysts said, but "potential power shortages add uncertainty to supply."

Nissan Motor Co. (PINK:NSANY) (TOKYO:JP:7201) said Sunday that it will start parts production and vehicle assembly operations this week in Japan, becoming the first car maker to restart its entire auto production process after the quake. Read more about Japanese auto firms' output plans.

Overall, a threat to supplies from Japan may benefit some of Japan's competitors, some analysts said.

"It looks like China will be the likely near-term beneficiary from the tragedy," said Joe Giamichael, head of China research at Global Hunter Securities. "Heavy industry has ground to a halt across Japan and Chinese producers are likely to see the demand flow from export clients."

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Joe Giamichael, Global Hunter Securities

Economists at Capital Economics said manufacturers in Taiwan and Korea are most likely to see higher production and revenues.

"Korean auto and tech manufacturers may benefit if supply chains remain broken for longer than expected and if those manufacturers don't rely on components from Japan," Frontier Strategy Group's Lasov said.

Playing a key part

But many manufacturers do rely on components from Japan.

"Japan is one of the largest investors in emerging Asia and closely connected to the supply chain on a range of manufactured goods," said Haley, who is also author of New Asian Emperors, which includes a discussion of Japanese investments in East Asia.

William Gamble, president of Emerging Market Strategies, said he wouldn't really consider Japan "the competition."

"It is more part of the supply chain" and from that stand point, it "could hurt certain EMs like Singapore and Malaysia and China," he said. Japan's earthquake "will no doubt accelerate a longer-term trend to diversify the supply chain."

It's important to remember, however, that the average Japanese company has "not lost [its] intrinsic value," said David Pankiw, a partner at Cubic Financial Advisors in Hagerstown, Maryland. "The car manufacturers, for example, can produce/sell cars all over the world."

Given that, Pankiw said he sees Japan's disasters as having more of a short-term impact on emerging markets.

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