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Asia's Influence on the World Economy

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Ladies and Gentlemen,

Distinguished members of EUMA,

It gives me great pleasure to speak to you today and to share a few words with you about emerging or high growth markets in general and about Asia's Influence on the World Economy in particular.

Your motto of the conference "Think East – Work West" is well chosen and you will have an amazing programme over the next two days ahead of you, packed with expert statements and workshop on such fascinating subjects such as intercultural training or Tae Kwon Do. I know from experience that such events are extremely difficult to organize and without doubt your team responsible for the programme of this conference did an excellent job.

In the next 30 or so minutes, I will not be boring you with Gross Domestic Product or GDP statistics and I cannot cover all Asian countries.

Instead, I will shed some light on the history and on the evolution of the Asian heavyweights China and India and I will say a few words about the “newcomer” Vietnam.

I will try to explain why certain countries became “en vogue” at one stage and why Asia’s influence on the World economy increased dramatically during the past 3 to 5 years.

I can only scratch the surface in my speech but I trust that you will hear more on Asia’s importance from other speakers later on.

My personal background is China – so I start with **China**. I lived and worked in Hong Kong for 7 years between 1995 and 2002 when I set up and managed the offices of a German bank. During that period I experienced the high and the sudden end of the first Asian boom.

What we experienced then was really an “Asian boom” and not as we experienced in the past 5-6 years a China boom.

Multinational corporations like Volkswagen, Nestle and Procter & Gamble were already invest in China then but unlike today, China was nowhere near today’s dominant position as destination for Foreign Direct Investments (FDI).

In those days the “Asian Tigers” (Korea, Thailand, Malaysia, Indonesia), caught a lot of attention from Western investors and they displayed considerable self confidence and pride on the Global investor scene.

Some of you might remember watching on TV the Indonesian Minister of Technology Mr. BJ Habibi and the former Chancellor Gerhard Schröder talking about Indonesia's ambitious plans to start its own car industry.

By the way, this conversation took place in German as Mr Habibi studied and worked in Germany and spoke the language fluently.

Most of the ambitious plans of the Asian Tigers to close the gap to the Western world at high speed, or even better pass them, disappeared when the Asian crisis started in summer of 1997, leading to the collapse of many Asian currencies and economies and ultimately to the start of a new Asian scenario in the beginning of this millennium.

Some Asian countries managed to recover from the crisis such as Korea, Malaysia and Thailand but some others seemed to have disappeared completely from the radar of Global investors such as Indonesia and the Philippines.

The reasons for this asymmetrical development were partly political – some countries are more stable than others- but also and predominantly owed to the fact that China all of a sudden conquered and occupied the minds of decision makers in industry all over the World. I am sure many of you in the room can remember this vividly.

In those days, Western investors were lured by the perception that China would offer a single market of more than 1 billion people and a low cost production base for export – all in one go.

After 12 years working abroad I joined KPMG in Germany in 2002 and I returned to my hometown Stuttgart. I started what was then called the “China Desk” of KPMG and between 2003 and 2006 my team and I accompanied around 80 investments by German companies, mainly Joint Ventures in the automotive sector, in China.

When watching the media or talking to my clients during those years it often seemed that the only topic on the minds of investors was China. It was then when Dr. von Pierer, the former CEO of Siemens, made the famous statement: “Doing business in China is risky but not being present in China at all is even more risky”

Starting in 2006, what I call the China Madness has gradually disappeared as it became more and more difficult to find and negotiate attractive deals with Chinese State owned and private companies.

Also, international and local competition increased in China and China lost some of its cost advantages. All-in, China stopped being the “flavour of the month”.

Why did China become expensive?

Many migrant labourers from China’s poor West and North who traditionally flooded the export oriented factories in Guangdong Province adjacent to Hong Kong suddenly preferred to stay on their fields as rising food prices made this more attractive.

Other reasons for upwards cost pressure were the new labour law which asks for the payment for overtime, and increasing cost for raw materials and energy.

All of you can feel the increased cost of energy in daily life.

So producing in China became less attractive.

Some economist already announced that China will stop being the World's dominant exporter of cheap products and will start being one of the World's most important exporters of capital.

From the world's workbench to the worlds financier ?

Looking at China's incredible USD 1,700 billion of Foreign Currency Reserves China this sounds like a very convincing assumption. USD 1.700 billion is a phenomenal amount of cash and it means that China could for example buy all Dax companies in one go – if it wanted and knew how to the investment.

We come back to China's Foreign Currency reserves and China's role as a Global investor later on in my speech.

As China lost in attractiveness as an investment destination, another major Asian player emerged: **India**.

Looking back to the late 1970s when China opened up for foreign investments, India and China were equal in most measurable parameters such as GDP per head or cars or telephones per 1000 inhabitants.

But India and China, the two biggest countries by population, are very different:

India is a democracy with strong federal states and China is a communist centrally lead country,

India has a history of entrepreneurism and China is still dominated by state owned companies run by politicians,

India has the advantage of the English language (although you sometimes wonder which language Indian speak when you talk to them over the phone...)

And India has a sound legal system based on the one of its former Master England.

– so at first glance, India is much better positioned to become an economic power.

So where are China and India today?

China just hosted the most impressive and remarkable Olympic Games ever. Only very few countries in the World could have put up such a perfect show.

In 2007 more cars were produced in China than in Germany,
China is the World's biggest producer of trucks,
China has the largest number of mobile phone users globally,
China operates a Transrapid Maglev train between Shanghai International Airport and the Pudong business district, which even Germany cannot afford,

China has some of the most efficient, modern and biggest airports...
I could go on and on ...

And India?

Despite all the advantages mentioned before, India is still a difficult country to invest in.

India suffers from an incredible bureaucracy – a legacy from the British colonial system,

India has non-existent or poor infrastructure, everybody who tried to move from one Indian town to another knows what I mean,
and India has a social structure which foreigners can simply not understand.

India has caught up with the Western World in some areas such as the Information Technology and Pharma but in many others e.g. the car Industry, India has a lot of catching up to do. India's standard car is still based on a FIAT model from the 1960s...

However, there is something very positive and remarkable about India.

India has a prominent elite of businessmen and entrepreneurs who have received excellent education and who are very active and experienced with investments in Europe or in the US.

We get back to the role of Indian entrepreneurs later.

The third Asian country I would like to introduce to you is **Vietnam**. Communist Vietnam, the former Indochine, famous for defeating the French and the Americans in the last century and also famous for its odd shape (1.000 km long but less than 200 wide), recently joined the World economy as a low cost producer of manufacturing goods.

French is still spoken by mostly elderly Vietnamese but a remarkable number also speak German because they were sent to study at East German Universities in the sixties and seventies.

Vietnam with its 70 million inhabitants will never become as important as China as a market or production base but many companies decided to invest in Vietnam to reduce their dependence on China as part of a “China plus 1” strategy (Meaning having a production base in at least one other country besides China).

Vietnam is not a complete newcomer as a manufacturer. Over the past 20 or so years, Vietnam has accumulated a lot of experience in the production of complex textile products, high quality bags and rucksacks and especially of sophisticated sports shoes.

Over the past 3-4 years, however, interest in Vietnam experienced a real boost and managed to attract several billion USD in FDI and investment funds focused on Vietnam managed to collect a multiple of this amount from international investors.

In many cases, the collected funds are still sitting in bank accounts waiting to be invested as competition is tough for the few good Vietnamese assets which are up for sale.

This “investment pressure” drove asset prices up and created what is called an “asset bubble”, which recently burst.

It also caused massive inflation of up to 25%, which lead to a steep decline in interest in Vietnam as an investment destination.

It remains to be seen if and when the Vietnamese Government manages to tighten monetary control, increase investor confidence and put the country back on track.

I stop my historic journey here and reflect on the influence of Asia on the global economy.

I have touched on the importance of China, India and Vietnam as investment destinations. I will now focus on the importance of the heavyweights China and India as global investors.

Today, Asia is a large part of the world economy, and the most dynamic.

Asia has been an engine of growth for the world economy for the past several decades; and, as it has grown in economic size, so its contribution to world economic growth has increased.

The world needs Asia and Asia needs the world.

To understand this dependency better, I would like you to look at 3 questions in the remaining time:

1. How did China manage to accumulate foreign currency reserves of USD 1,700 Billion and how can this money be used to influence the economic world order?
2. Why do we hear so much about Indian entrepreneurs and their successes and what are their plans?
3. How is Asia affected by in the current financial crisis?

First question: China's currency reserves.

China has been keeping its currency RMB (peoples' money) pegged to the USD at a fixed rate for many years and only recently let it appreciate by a small percentage.

The Western world and especially the US have had an ever increasing appetite for cheap products from China. The US supermarket chain Walmart alone buys goods for several billion USD per year in China.

The US as a country imports more goods than it exports which leads to what is called a “trade deficit”. The trade deficit has been widening month by month.

If you spend more than you make you can either steal the money to bridge the gap or borrow.

In today’s world, stealing is not an option, so the only way to finance the deficit was and is by borrowing money from the outside world.

It is a well known fact that the US trade deficit was and is predominantly financed by China!

Here are the mechanics:

Without exchange rate control, currencies fluctuate freely following the principle of supply and demand. You see this every day in the news when the USD / Euro or USD / Sterling rates are quoted.

When interest rates in one country are higher than in another one, investors buy bonds in the currency with the higher interest rates to maximise their yields.

Because of the increased demand, the “price” of the currency appreciates to a point where investors become cautious as they fear the reverse of the trend or where interest rates have to be lowered in order to stop over heating of the economy.

Reality is a little more complex but the model explains why freely fluctuating currency conversion rates are important and regulate themselves over time.

As the Chinese Government controls the exchange rate of its currency, the situation is different.

When Walmart takes delivery of goods from a Chinese manufacturer, Walmart pays for the goods in USD.

The manufacturer receives USD into his bank account and has to hand over the USD to the Chinese State as the State controls all foreign currency exchange.

The manufacturer receives RMB at the rate set by the State and he uses the money to pay his workers and buy raw material.

If the manufacturer wants to import machinery or raw material he has to apply for permission to exchange local for foreign currency at the rate set by the State.

As China is constantly exporting more goods than it imports, there is a constant flow of USD into the State's coffers. This is called a trade surplus.

If China had allowed its currency to float freely, the currency would have appreciated because of the high trade surplus and the resulting demand for its currency.

Appreciation of the currency would have meant that the manufacturer would have received more RMB for the USD price he quoted to his overseas clients.

The excess RMB would have boosted his profit margin and he could have used the money to pay higher wages, invest more etc.

So very simplistically, by keeping the exchange rate low, the State accumulated wealth on the expense of its businesses and citizens.

We said already that China has been financing the US trade deficit for many years so it is fair to say that America is dependent on China financially but could China stop investing into US treasuries at all?

The answer is no. China has no choice but to keep investing into USD treasuries and financing the trade deficit or else the US consumer will have to stop buying cheap products from China. This would increase unemployment and would cause social unrest – and the Chinese government has to avoid both at all costs.

However, China uses some of its savings to do other investments.

The current 5 year plan by the Chinese Government, however, encourages Chinese companies to invest overseas. We have witnessed the beginning of this trend.

We saw the sales of the first small to mid-size Western companies to Chinese investors, we hear that China is buying natural and energy resources all over the World especially in Africa.

We heard with interest that that the only other bidder for Dresdner Bank, next to the successful Commerzbank, was China Construction Bank.

Also we watch very carefully what investments China Investment Corporation (CIC), a USD 200 Billion “sovereign wealth fund” capitalized with some of China’s currency reserves, intends to take.

So far, Chinese firms have mostly acquired minority stakes to get a first foot into the door,
to learn how business is done in the West
and to get access to technology and distribution channels

but I have no doubt that over the next 5 to 10 years several major European or American companies will change hands to Chinese owners

Second question: Why are Indian entrepreneurs so successful and what are their plans?

Indian entrepreneurs usually have a substantial family background and excellent education. Many of them established businesses some 30 to 40 years ago or inherited mature businesses from their fathers.

Most of them are charismatic leaders and excellent operators. 100 years ago, there was a saying: if you can make it in New York, you can make it any where.... The same applies for India.

If you can establish and run a successful business in the diverse and complex environment of India, the likelihood to success on Global scale is pretty high.

Who would have thought even 5 years ago, that the prestigious luxury car maker Jaguar-Land Rover would be bought by an Indian business man. Jaguar and Land Rovers, the crown jewels of British industry, appointed supplier by her Majesty the Queen an Indian company?

Well, as with China, we have to get used to this.

Indian investors will buy production, research and development and distribution assets all over the World.

Indian investments are usually strategic and very well thought through.

Strategic means that the investor is not predominantly interested in quick financial return but uses the newly acquired business to complement, strengthen or improve his existing operations.

Third Question: Asia's role in the financial crisis.

Nobody can tell how bad the crisis will get and when it will be over.

Having learned the lessons from the Asian crisis, central banks in most Asia countries have been keeping financial institutions under close supervision and regulated investments overseas.

Consequently and luckily, they are therefore not as hard hit as banks in the West.

The general slow down in most major economies will hit Asia too.

Western consumers are in fear of losing their jobs and income or have already lost it.

They have less money to spend and will buy fewer goods, also from Asia. Companies have less money to invest, also in Asia.

As credit becomes scarce and more expensive, sovereign wealth funds of rich countries in Asia, mainly China and Singapore but also wealthy individuals from India and Thailand will probably profit from low Asset value and invest in top class companies.

So the crisis will speed up the transfer of assets and know-how into Asian hands

Ladies and gentlemen, distinguished participants, speakers and guests

I hope I could shed some light on Asia's influence on the World economy. I used simplified examples but they helped to illustrate the underlying principles.

I wish you all a successful and enjoyable conference

Thank you for having me here today and thank you for your attention