BritishAmerican Business Inc: The Rise and Rise of Asia

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Good morning, ladies and gentlemen. Thank you for inviting me to speak at your breakfast today.

I chose my topic for this morning's breakfast, *The rise and rise of Asia*, before Christmas. Since then I, like you have been appalled to witness the scenes of devastation caused by the Sumatra earthquake and consequent tsunami that struck parts of Asia. Indonesia, Sri Lanka, India and Thailand bore the brunt of the destruction, especially in human terms. The death toll stands at over 150,000 and is still climbing. The number of survivors whose lives have been destroyed is far greater still. The response from governments, corporations, and above all, individuals, has been generous, but the task of rebuilding the affected areas will be a long one. Our thoughts are with all those affected by this terrible tragedy.

Awful though this tragedy has been, today it is my task to look beyond it and at the long term prospects for Asia, one of the world's most economically vibrant regions, and home to over half the world's population.

I chose *The rise and rise of Asia* as my subject today for two reasons. Partly because HSBC's roots are in the east. We were founded in Hong Kong and Shanghai in 1865 by a cosmopolitan group of merchants to finance international trade. Indeed for much of our history we were primarily an eastern bank. We have operated continuously in India, Sri Lanka, the Philippines, Malaysia and China for over 100 years, through thick and thin.

Our expansion into Europe and the US has mainly been the work of the last 20 years and although we now have a business with earnings broadly balanced between the Americas, Europe and Asia, our history gives us a special interest in the region.

Indeed, it was arguably the success of a number of Asian economies, notably Hong Kong, in the last 40 years that provided HSBC with a springboard to leap into Europe, the US and other parts of the world.

The Asian economic miracle allowed places like Hong Kong, Korea, Singapore and Taiwan to evolve from dire poverty in the 1950s to prosperous, productive economies, which rival the G7 countries in their economic sophistication and standards of living.

Today, Hong Kong is home to the world's largest private shipping fleet owner. Korea is home to leading edge electronics companies such as Samsung. Taiwan has the world's largest share of the semiconductor market. And Singapore is carving itself a niche in nanotechnology and microbiology.

At HSBC we have seen first hand the tremendous success that Asian people have achieved.

More important than the past, however, is our assessment of the future. The question now is whether a similar transformation will be achieved by Asia's, indeed the world's, two largest countries, with populations of over 1 billion people apiece. China and India.

At HSBC we believe developing markets will provide about half the growth in demand in the world economy over the next 25 to 30 years. And we believe that China and India will be core to that.

India and China today have 37 per cent of the world's people, but account for just 5.5 per cent of world GDP. By contrast, America has less than 5 per cent of the world's population and produces nearly a third of its GDP. In the long term, the gap is unsustainable. And will narrow rapidly.

In the 21st century we will see the re-emergence of two historic powers. Many people forget that for most of recorded history China was the world's largest economy and India the second largest. In 1820, China and India had about half of the world's population and the world's income. We in the west are sometimes guilty of viewing history from a shortsighted perspective.

re-emergence of two historic powers

Turning first to China.

It's become rather fashionable to quote Napoleon on China these days. Some 200 years ago he is reported to have said: "China? There lies a sleeping giant. Let him sleep! For when he wakes he will move the world." The frequency with which this quote is wheeled out is growing exponentially – rather like China's economy.

Because ever since China embarked on economic reform some 25 years ago, it is clear that the giant is awake and moving the world.

In the last 25 years, China's success has been nothing short of astonishing. Particularly when you consider how enormous the task of governing a country of 1.3 billion people is. As Premier Wen Jiabao once remarked: "Any small individual shortage multiplied by 1.3 billion becomes a big, big problem and a considerable amount of financial and material resources divided by 1.3 billion becomes really small."

China's success has been achieved by a peaceful revolution on an unprecedented scale. There has been a massive migration of people from rural areas to cities. China's urban population has grown from 172 million in 1978 to 460 million today – yet that is still only about one third of China's people.

People have moved from subsistence living to working in productive industries where they are beginning to have a disposable income. In 1980, 86 per cent of workers hadn't changed jobs in their working lives; between 1990 and 2000, 54 per cent moved to new jobs.

Most importantly for the Chinese people, growth has reduced poverty by an extraordinary degree. According to the UN, since 1979 the proportion of Chinese people living in absolute poverty has dropped from 25 per cent to around 2 per cent of the population. The UN World Food Programme is now urging China to become a donor instead of a recipient of its aid.

Urbanisation and industrialisation have almost halved the contribution of agriculture to the Chinese economy to under 15 per cent of GDP since 1978. Manufacturing and construction are now the core of China's economy, accounting for over half of GDP.

China is the world's largest producer of steel, coal, cement, fertilisers. In almost every industry China is making huge strides. I visited shipbuilders in Shanghai last week. China currently accounts for 13.7% of global orders for shipbuilding; second to South Korea, although a considerable way behind it.

And of course, China is the world's largest producer of a wide range of consumer products. It produces two thirds of all photocopiers, microwave ovens, DVD players and shoes and over half of all digital cameras in the world.

In 2003, China became the world's fourth largest trader of manufactured goods and there are more superlatives on the horizon. The WTO predicts that China will account for more than half of the global textile market following the end of the quota system. Shengzhou, in Zhejiang province, already produces one third of the world's total output of ties.

Statistics like these have resulted in China being labelled the 'workshop of the world'. And certainly, China's influence has been such that it has depressed the price of manufactured goods, to the point where Wal-Mart is able to sell a DVD player for less than $50 and falling. As the *FT* commented in December, "It is hard to overstate the shock and awe inspired in manufacturers by China's relentless annual economic growth." No wonder that dragon that economists worry about so much – inflation – has been so subdued.

China is dominating low-end markets, but manufacturers who comfort themselves that they will be content with that, and leave the value-added products to established American, European or Asian companies, are making a grave mistake.

China is moving up the value chain and will challenge the world not only in basic manufacturing, but also in highly sophisticated engineering and research. For example, Huawei Technologies, a leading Chinese hi-tech company, employs 10,000 R&D workers – almost half of its total workforce – and invests no less than 10 per cent of its sales revenues in R&D.

an emerging consumer market

The ambition of Chinese companies to become global players was also clearly illustrated last month, with the acquisition of IBM's PC business by China's Lenovo for US$1.75 billion – the largest foreign acquisition by a Chinese technology company to date.

But China is much more than just a major producer. As incomes rise, it is also emerging as a consumer market. A recent survey by the Chinese Academy of Social Sciences found that nearly half the people surveyed considered themselves to be middle class. And although on occupational criteria only 16 per cent would qualify, the survey is indicative of the aspirations of the Chinese people.

China's future growth will not all be export-led; it will depend upon meeting local consumer demand. Of course there is a sharp split in income, lifestyle and sophistication between the regions in China, roughly comparable to the differences across the expanded EU. Urban disposable incomes are much higher than in rural areas. But the seeds of what should become the world's largest consumer market have been sown.

And of course, a burgeoning consumer market brings opportunities for local and international companies alike, which some are already exploiting.

China's successes to date are not in doubt. But there are still challenges ahead. Strengthening the rule of law, building a social security system, dealing with corruption, the supply of energy, the strengthening of the financial system: all these are significant challenges.

As is tackling inequality. China's coastal regions have been the prime beneficiaries of inward investment and growth. This has resulted in a wide disparity in per capita incomes, often split on an urban/rural axis, which range from as much as US$3,300 in Shanghai, to just US$1,200 in Hainan.

The Chinese government is now trying to spread the benefits of China's growth more widely. Investment in the western regions in China is being actively encouraged through the Go West policy. And last year also saw the creation of the Pan-Pearl River Delta region to try and drive development to the interior. Although still in its early days, the Pan-PRD is a cooperative agreement that's been signed by all the governors of nine provinces and the CEOs of Hong Kong and Macau to develop infrastructure and eliminate tariffs.

The nine provinces, along with Hong Kong and Macau, are home to some 457 million people, and account for 45 per cent of China's GDP, so the opportunity is huge.

Uneven development across China's regions means that Western companies trying to work with China must beware the danger of oversimplification.

moving up the value curve

It is naïve to think of China as a single market; it is in fact a collection of markets. Mainland China comprises 23 provinces, five autonomous regions, and four municipalities, as well as numerous special economic zones, open coastal and border cities, export processing areas, bonded zones, provincial-level economic and technological development zones, and new and hi-technology development zones.

In short, there is still a tremendous amount to do. But looking back on what has been achieved to date, we at HSBC are optimistic for the future.

The Asian economic miracle produced a 40-year period of above average economic growth in countries like Japan, Taiwan and Singapore, and we might reasonably expect China to do the same.

This means that China may only be halfway along its amazing economic journey. Yet it is already the world's seventh largest economy - or if you look at it on a purchasing power parity basis, the second largest, after the US. Goldman Sachs forecasts that China will overtake the US as the world's largest economy by 2040, a prediction that *The Economist* recently suggested might be too cautious.

The timing does not matter, but we do need to prepare ourselves for a powerful and exciting re-emergence of China on the world scene. The pace of change in China has been so rapid, and so extraordinary, that people are only now beginning to adjust intellectually to the reality of China as a world power.

In virtually every industry in the next 20 years, China will make its presence felt, but I am not sure to what extent the West has really taken this in.

One way or another, China is taking its place on the world stage and, in my view, should be welcomed.

I have dwelt for some time on China's influence on the world economy, but I would also like to touch, albeit more briefly, on India.

While China has been cleaning up in the manufacturing sector, India has been developing a parallel reputation as the services centre of the world. In some ways, China and India are mirror opposites, as is succinctly demonstrated by the fact that China has excelled in hardware and India in software. China makes the chips and electrical components; India writes the code that powers the hardware.

This reflects the countries respective areas of excellence: China excels at building infrastructure, buildings, bridges, roads. India shines in its developed education system, its familiarity with the English-language, and its common law system.

India's GDP grew an estimated 5.8 per cent in 2004 and is forecast to grow by over 6% in 2005 and 2006. These are excellent numbers, and beyond the sort of growth an industrialised nation might hope to achieve, but I think perceptions of India's achievements have suffered by comparison with China.

Last year, India was ranked the third most attractive FDI destination in the world by AT Kearney's FDI Confidence Index behind China and the US.

Along with China, India is cited as the most attractive FDI destination in both the short term – the next three years – and the medium term, 10 years out.

While manufacturing has led China's renaissance, it is the services industry that is doing the same for India. Liberalisation of trade and investment regulation, an increase in FDI and a well-educated and English speaking workforce – India is the largest English-speaking nation after the US – have all combined to create something of a boom in areas like business process outsourcing and software development.

To use HSBC as an example, we now employ around 10,000 staff in India, two-thirds of whom work either in our global resourcing centres or in software development. That is to say, much of the work we are doing in India is being done on behalf of subsidiaries overseas.

Like China, India is moving up the value curve in the areas where it excels as well. Where offshoring work was initially confined to back office processing, companies are now undertaking high-value work such as software development, medical diagnostics and financial research.

As with China, India's growth is helping create a consumer market. The market for cell phones, for example, is expanding very fast and, in October, the number of cell phones in India overtook the number of fixed line telephones.

The rise of consumer markets in China and India will have important implications not just for global corporations wishing to enter these markets, but also for the capital markets of the world and for governments' fiscal policies.

Today, America's fiscal and current account deficits are being funded mainly, and relatively cheaply, by Asian savings. The central question is this: will the two trillion dollars of central bank reserves in Asia continue to be invested primarily in US government treasuries in the long-term?

I think it unlikely. More importantly, so does Alan Greenspan. He was recently quoted in *The Economist* saying: "Given the size of the current account deficit, a diminished appetite for adding to dollar balances must occur at some point."

China is a country with one of the world's highest savings' rates, often quoted at 40 per cent, which is high even in a region with high savings' rates. As China grows, its high savings' rate will inevitably mean the creation of ever-larger pools of investible domestic capital, alongside the huge inflow of FDI and a strong reserve position.

This creates a huge opportunity for China to mobilise this domestic capital to complement the inflow of external capital.

The challenge here is for this pool of savings to be recycled and invested efficiently. In the next few years, we expect to see the emergence of more sophisticated capital markets in China to handle the process of intermediation efficiently. In time, we expect Asian savings to be recycled in Asia rather than in New York or London. We envisage Asia having its own huge capital markets.

Ladies and gentlemen, let me draw some conclusions. If China continues on its present growth path, its economy will be equal in size to that of America in less than 30 years. India too will become more and more influential.

This is not just an economic phenomenon. The rise of China and India will have a major effect on the balance of influence in international relations. I would go further and say that the economic modernisation of Asia is the most seismic consequence yet of the globalisation of human commerce.

The balance of influence is tipping; and the world will move from an era of economic domination by a small group of wealthy nations mostly in the West, to one where power is more evenly shared, as the East takes its place on the world stage.