Go East

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One year ago in Washington, the heads of state of the world's 20 most powerful economies met for the first time in history. This was a defining moment.

From this point on, the future of our financial system would no longer be shaped by a handful of western nations. More than 4bn people – two-thirds of the world's population – would now have a seat at the table.

The world economy has passed a point of no return. The centre of gravity is shifting from west to east, and it is rebalancing from north to south. Everyone, every business and every nation will be affected by this shift.

I have spent most of my career in emerging markets, and sometimes the scale of change can be hard to grasp. Right now, India is adding 10m new mobile phone subscriptions every month – its total mobile phone users will soon hit half a billion. Meanwhile, Brazil is expected to export $160bn of commodities this year.

In terms of economic firepower, the so-called "E7" – which comprises China, India, Brazil, Russia, Turkey, Indonesia and Mexico – are already catching up with the more established Group of Seven. In 20 years, with a 40 per cent share of world GDP, E7 nations will dwarf the G7s.

Trade and capital flows between emerging markets will also increase – not just regionally, but globally. This will reinforce the virtuous circle of emerging market growth. Asia is already becoming Latin America's fastest-growing trading partner, and China has overtaken the US as the biggest importer of Brazilian goods.

virtuous circle of emerging market growth

Just a year ago, many questioned whether emerging markets could sustain growth through the downturn. Last month, I travelled throughout Asia, Latin America and the Middle East to meet more than 40,000 colleagues – and I was struck by one common theme: an almost tangible sense of dynamism.

HSBC's Emerging Markets Index shows that, in the third quarter of 2009, output in emerging economies rose to its highest level for a year. Employment is rising, too. The outlook is also strong: emerging markets are expected to grow by 6 per cent in aggregate next year.

This contrasts sharply with the sluggishness of many of the west's misfiring economies. A tale of two recoveries is now playing out. Next year, the growth gap between Europe and China will exceed 9 per cent as emerging markets drive the global recovery.

Parts of Europe may now be limping out of recession, but last month's data from the UK suggest we face a slow and rocky road to recovery. The biggest jolt may well have passed through the economy, but it is too early to claim victory, especially while unemployment is still rising. Everyone has his or her view on the "shape" of the upturn. Right now, the only likely scenario is that there may be further shocks and volatility ahead.

Meanwhile, the western banking sector has entered a period of significant and necessary change. There are three priorities. First, we need to end the belief that it is society's responsibility to bail out misadventure – either individual or corporate. Instead, society must empower consumers and businesses to make a more informed judgment about the choices they make and accept the consequences of their decisions. This can only happen through more education and greater investment in financial literacy.

Second, the need for strong, well-capitalised banks is indisputable. Many adjustments to capital ratios have already been proposed, but most have not yet been made. But there also lies a danger here. If capital ratios are increased before our fragile western economies stabilise, it may trigger three unintended consequences. The first is a rise in the cost, and a fall in the availability, of credit for the economy. The second is regulatory arbitrage. The third is the emergence of a shadow banking system, beyond the reach of regulation.

Finally, one of the key lessons from the crisis is that policymakers need to work together better. Those who pursue a unilateral agenda may win the regulatory battle, but they will lose the more important war for capital and investment. Capital is a finite resource, and it will go where it can be allocated most efficiently, not where it is hampered by politics or privilege. Financial markets in most developing countries are still small, relative to GDP. There remains considerable room for growth.

There are 2.8bn income-earning adults in emerging markets who are not yet part of the formal banking system, providing a prime opportunity for banks to grow their deposit bases. Wealth management will also start to come of age. China's richest 1 per cent will see their wealth grow by 11 per cent this year, and by 18 per cent in each of the five that follow. And, as workers generally save and prepare for their retirement, they will demand pensions, insurance and asset management products.

As economies mature, they will also demand deeper and more sophisticated financial instruments to ensure the efficient allocation of their capital.

Equity and corporate bond markets are the most obvious examples.

Today, for example, only a quarter of the value of Chinese corporations is listed on public equity markets, compared with more than 70 per cent in the US. Five of the world's top 10 financial centres, ranked by competitiveness, are now in Asia. Singapore and Hong Kong are already snapping at London and New York's heels. Of all of them, Shanghai's rise is surely the most remarkable. It is a powerful reminder of how quickly our financial world is changing.

It is also, in a sense, a reflection of a global economy coming full circle. After less than 200 years of British and American dominance, we are now returning to a multipolar economy in which China and India will again drive global growth. It may have taken an extraordinary crisis to drive the point home, but it is one that the world's financial institutions cannot ignore.