

Towards a New Global Economy: Re-Defining Asia's Role

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Ladies and gentlemen, I'm delighted to be here today – it is an honour to be asked to open this inaugural event of the Fung Global Institute.

When the centre of the global economy shifts so does its intellectual centre.

We can see this shift in action today as emerging economies begin to exert their influence on the global policy agenda.

It is only just over a decade since China's accession to the WTO. At the time it was a highly controversial move. How much has changed in those 10 short years.

Few could have foreseen then that China would now be a leading participant in the G20.

Or that Europe would agree to concede two seats on the IMF's executive board to make way for faster-growing economies.

Or – more remarkably – that Europe's leaders would go cap-in-hand to Beijing for help with their own debt crisis, as they did last year.

The financial crisis and the ongoing economic stagnation in the West, particularly in the eurozone, have fast-forwarded the transition of economic power.

Asia's role is being redefined in our lifetimes. And great powers need great thinkers.

We need to work harder to understand better the fundamental transition in world affairs that we are witnessing, and to acknowledge the challenges that it represents.

That's why the creation of the Fung Global Institute is so welcome. It has the potential to be a centre of new thinking behind the new global economy – to be the think tank for the Asian Century.

And so I am going to use my remarks this afternoon to suggest three areas where I believe new thinking and leadership is needed.

But first I want to give you a sense of the new global economy as we see it at HSBC. Our own research indicates that the so-called 'emerging' economies, which have now emerged, will power global growth over the next four decades.

They will contribute twice as much growth as the developed markets over this period – and by 2050 they will be bigger collectively than the developed markets.

Trade will be one of the primary engines of this growth as the new 'South-South' connections revolutionise the global economy.

As faster-growing markets link-up, creating new connections between Asia, the Middle East and Latin America, trade and capital flows between those areas will grow significantly – increasing tenfold by 2050.

The scale of the opportunity is huge in part because the economic borders between many faster-growing nations are still high.

Removing these borders, such as tariffs and restrictions on migration, won't be easy but work is already underway.

Countries in Asia have already formed new political alliances. China is building ties around the world and trade deals with Latin America are becoming commonplace.

Asian markets are going to be hugely attractive. There are 26 economies globally which will have an average annual growth rate over 5% to 2050. 10 of them are here in Asia: beyond China and India this includes the Philippines, Malaysia, Bangladesh and the central Asian countries of Uzbekistan, Kazakhstan and Turkmenistan.

Factors such as high standards of education and rule of law will be key.

The OECD's Pisa tests suggest that China's education system is overtaking many countries in the West – with Shanghai leading the pack.



As a result of this, and other factors, we project that China's income per capita will grow by more than 800% between now and 2050.

And yet, by 2050, the seismic shift in the global economy will have only just begun.

Even after this progress, and by then as the world's largest economy, income per capita in China will still be only 32% of that in the US – and so potential for further growth will be substantial.

So that's a glimpse of the world as we see it. But of course there will be many challenges along the way which will require new thinking and new approaches.

The first challenge is to ensure we learn the lessons of the past few years.

I was in Hong Kong in 1997 and worked closely with Joseph Yam, as Chief Executive of the HKMA, in responding to the Asian crisis. We also worked with the central banks of Thailand, Malaysia and others to help them resolve the problems that the crisis brought to a head.

And it was in part this experience that informed HSBC's response to the Global Credit Crisis in 2007. HSBC's top markets team, including myself and a number of key colleagues, had been stress tested for real in Asia 10 years earlier.

Asia was learning the lessons of the crisis – to avoid bubbles and hold large FX reserves – just as many Western economies were walking into trouble. Let's take a couple of examples.

First, the UK. Like elsewhere in the west, UK bank lending conditions loosened significantly from the late 90s. Mortgage spreads halved. And mortgages were available for 125% of a property's value.

The result was an unsustainable housing boom and a household debt-to-GDP ratio over 100%. That boom spurred on consumers and the visible trade deficit expanded from 1 to 7% of GDP.

This was financed by capital inflows, aided by high UK interest rates which in turn put upward pressure on the UK's currency. The strong pound supported the idea that the whole system was sustainable.

When it unwound sterling fell 30% in trade weighted terms, and against the US dollar it fell from a peak of 2.11 in November 2007 to a low of 1.35 just over a year later.

Second, take a look at the situation in the eurozone, the stresses are strikingly similar to those caused by the dollar-peg in Malaysia, Thailand and Indonesia in the 90s.

Those economies suffered from an inappropriate, inflexible peg, which created capital inflows that were ultimately unsustainable.

This is exactly the unwinding which we're seeing in Greece and Spain today.

In both of these examples the lessons of the Asian crisis, of building up excessive leverage and inflexible exchange rates, were not learned.

As a result, Europe is having an emerging markets crisis.

And the policy response to the crisis means that much of the developed world has joined the Bank of Japan in providing cheap liquidity to the financial system.

Since 2007, the US Federal Reserve, the Bank of England, the European Central Bank and the Bank of Japan have expanded their balance sheets by more than 5 trillion dollars.

Combined, their balance sheets now total more than 9 trillion dollars.

Inevitably this liquidity will look to the faster-growing markets in search of greater yield.

So, while in the past few years we have seen credit expansion and property bubbles in Brazil and China, though in China's case more domestically created by the fiscal expansion of the first quarter of 2009, by and large the evidence is that Asian markets <u>have</u> learned the lessons of 1997.

They are ready to protect their domestic economies from asset bubbles and over-leveraging – while striking a balance to remain open to global trade and capital and all the benefits that globalisation has delivered in the past decade.

In addition their financial systems are better regulated and there are more direct controls. China in particular has pursued a careful approach to keep economic expansion at a manageable level.

As Asia enjoys superior growth, it will increasingly attract risks such as this glut of cheap liquidity.



Learning from the mistakes of the past is the best firewall we have to ensure they are not repeated. And this is an area where Europe should take its lead from Asia

That brings me to the second challenge, which is to examine the politics of the new global economy.

We must consider how Asia can assert an appropriate influence, reflecting its growing profile in world affairs and its own interests in the resolution of key questions in the global economy.

Chief among these questions must be the future of the eurozone.

Speculation about the fate of Europe's single currency is rife.

Banks with significant exposures are being downgraded. The yawning disparity persists between the periphery and core – between the surplus and the deficit nations.

Debt remains too high. Across the industrialised world, income levels are around 10% lower than pre-crisis projections had suggested. Despite a huge monetary and fiscal stimulus, there has been no return to business as usual.

The financial system is far from healthy. The eurozone capital market is under massive stress, interest rate spreads remain incredibly wide and the volume of available credit continues to subside.

Against this backdrop, we think there are four essential steps to ensure that the Eurozone remains intact:

First, Europe-wide deposit insurance provided by the European Banking Authority.

Second, an EU Troubled Asset Relief Programme provided by the European Financial Stability Facility or, in due course, the European Stability Mechanism, to recapitalise Europe's banks.

Third, a clear path towards fiscal union or a fiscal concordat, and policies to narrow imbalances between member states.

Fourth, eurobond issuance to refinance troubled sovereigns.

Clarity and leadership on these points will be vital – along with a clear plan for how governments can be supported to achieve growth alongside austerity.

Clearly all of this will depend on some form of fiscal union.

Sadly, at the moment, there is no evidence of the political will necessary to make this happen. In particular from the stronger countries, all of whom will lose out massively should the Eurozone eventually collapse.

Of course, looking beyond Europe, broader issues persist. The gravitational pull of the faster growing markets is proving to be more destabilising than many had expected.

The structural decoupling witnessed over the last decade or so – with faster growing nations powering forward while industrialised nations are left languishing – has shifted relative prices and wages.

Commodity prices are up, Western wages are stagnant and, as a result, real incomes in the West are not robust enough, hampering debt repayment.

People talk about a two-speed European economy. In fact we are looking at a two-speed global economy. And there are potentially significant consequences to this.

In the West politicians are beginning to assert control over new areas. Central banks risk being embroiled in politics: their independence is being tested.

Getting the politics right will be vital to easing political tensions, preventing new imbalances and supporting the future growth I have described.

This brings me to the third challenge, which is to test our assumptions more vigorously.

What are the unseen factors which could undercut our vision of the future?

Few saw the financial crisis coming until it was too late.

The dangers of consensus and group-think are real – we saw them in 1997 and in 2007, and the consequences of the latter are still being felt.

We can't afford to compromise the growth which will improve the lives of hundreds of millions of people over the coming decades.

We need iconoclasts – we need new thinking, and organisations like this Institute will be the ones to provide it.



For example, the world is expecting the role of the faster-growing markets to change as they move from being producers to consumers.

Taking the broadest definition, Asia's middle class is now 740 million – and growing fast. For many multinationals, Asia's consumers are already vital.

Together, mainland China, Hong Kong and Taiwan accounted for approximately 20% of Apple's 39 billion dollars of revenue in the first quarter.

In China, official data suggests that domestic consumption accounted for 77% of GDP growth in the first quarter. That compares with a 55% share last year. Retail sales also continue to rise – up almost 15% in the first four months of 2012.

But the notion of the 'middle class' encompasses a wide-range of income levels.

In China, the wealthy middle class spend 32% of their income on food, compared to the less wealthy middle class's 41%.

And so, a sudden shock, such as a rapid rise in food or energy prices could effectively wipe out chunks of the new middle class almost as fast as they have been created.

And there are other demographic issues to consider.

China's population is ageing rapidly. Today 25% of Shanghai's residents are over 60. By 2050 a third of the entire population will be over 60 – that's 450 million people. This creates two issues.

First – that a faltering labour supply starts to undercut growth – and we have already seen shortages of labour in some areas.

Second – as a result of the one child policy, each young worker could potentially be looking after six elderly dependents.

This points to the need for an enhanced savings infrastructure – but also to a broader challenge. In each of the areas I have discussed, financial services will need to play a greater role.

The revolution in trade must be matched by the development of stronger capital markets. Asian financial centres will need to continue to grow rapidly to support expanding capital flows – and to support the internationalisation of the renminbi.

We all have a responsibility here.

The world is more interconnected than ever before, we are witnessing huge and rapid changes – and these factors are combining to create more and more uncertainty.

For leaders today – whether in government or business – the primary challenge has become managing complexity in the face of this uncertainty.

In order to do this, every institution has to be clear about its purpose and its values and ensure that these are well understood both within and outside the institution.

Managing complexity also requires strong governance and consistent standards.

At HSBC we have learned a great deal from the experience of the past few years. We have put in place a strategy and structure designed to help manage complexity and thereby facilitate and support the creation of the new global economy.

We are committed to continuing to learn and to playing our part in meeting the challenges and realising the opportunities that lie ahead.

I know that the Fung Global Institute is equally committed to this – and so I look forward to working with you in the years ahead.

Thank you.