

Video transcript

The Southern Silk Road

Bronwyn Curtis (BC): Hello, I'm Bronwyn Curtis. After centuries of western dominance, the rules of global economic growth are being rewritten. Today, new trading routes are connecting Asia, the Middle East, Africa and Latin America. This so-called south-south trade is bypassing Europe and is also bypassing the United States. Stephen King is HSBC's Group Chief Economist. He studied the emergence of these new trading patterns, and his latest research report is called the *Southern Silk Road*. Stephen joins us here in the map room of the National Maritime Museum to discuss these developments.

Stephen, thank you very much for joining me. You've written this piece about the *Southern Silk Road*. What do you mean by that?

Stephen King (SK): Well, the original silk road was across Asia. This was an extraordinarily important trading route across land. And what I'm really talking about is a 21st-century version of that trading route, but, rather than being confined to Asia, it's including Asia but also Latin America, Sub-Saharan Africa, the Middle East. And all these kinds of connections begin to come through and of course, where the original silk road was very much based on land, this one's based on land, sea, air, the electronic ether, all these extraordinary connections being made.

We look around the world, and we're very used with the idea of the States trading with Europe, or the States trading with Japan, or China increasing trading with both the US and Europe. But what we tend to forget is that there's a huge new opportunities to trade what we may describe as the south-south bases. In other words, it's all about connections, particularly in the southern hemisphere. But the kind of lost connections that haven't really been there in the past, particularly between countries in the Latin America, Sub-Saharan Africa, and of course, all that feeding through into Asia. In many ways, this southern silk road is south-south opening up a trade is a blast from the past because if you go far back enough into history, you'll find that there were tremendous connections not just through the silk road of land but also throughout the Indian Ocean, important trading routes between India, the east coast of Africa, Indonesia, China. We're talking about a re-creation of this but on a very much more global scale than we've seen so far.

BC: These so-called BRIC countries already have very big domestic economies, so why are they so interested in building trade as well?

SK: Well, one reason for the trade is that some of these economies have things that the others want so the obvious one here is commodities. Brazil's a chock-full of commodities as is Russia, whereas China and India tend to have to import their commodities from other parts of the world. So the connection between those countries are becoming ever more important. But also, we know from the experience of the developed world in the 1950s and the 1960s, if you can open a country up to trade, first of all, the trade is turbocharged. The growth you see is much faster than GDP. Because it is so turbocharged, it means that countries can specialise. They can begin to benefit from the so-called comparative advantage, and that process of specialisation on the global level means that all countries can benefit. As the borders, the economic borders that restrict trade at the moment between the

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SK: (cont.) southern nations, are beginning to reduce, in those circumstances the chances of seeing a really extraordinary period of economic growth become that much higher.

BC: It almost sounds too good to be true. Are there any obstacles to this growth in trade?

SK: There are lots of obstacles out there. It'd be foolish to suggest that this is a kind of a smooth natural process that will continue forever more. One of the obvious obstacles is that countries still disagree with each other. The relationship between China and India frankly could be quite a lot better than it currently is. People in both countries have long memories. Think back to 1962 when there was a modest conflict between those two countries. They see each other as, perhaps, rivals rather than countries that can mutually support each other. And it's also obviously a concern in Washington about the growth of China and the fact that China will importantly have to protect its economic interest elsewhere in the world. If you want to do that, history tells you have to have a pretty decent Navy. There's always the question of China's Navy on the high seas bumping into America's Navy. It's something which we haven't got answers to yet. So there are a bunch of issues that are out there which are a big uncertainties but the key message really is this: the opportunity for opening up trade, opening up capital flows is going to be a decisive factor in influencing growth in the emerging world. The work that my colleague Karen Ward did earlier this year *The World in 2050* pointed out that China would be the biggest economy in the world, with India being the third-biggest. But they won't get there unless they begin to open up trade with each other. So I think the important point here is trading with the States or trading with Europe is fine, but these parts of the world are growing very, very slowly. If the emerging nations collectively are going to grow quickly, they are going to have to increasingly trade with each other.

BC: We've already seen quite a lot of investments between these emerging market countries. What are the best examples of that?

SK: Well, last year, we had the second-biggest M&A deal in Brazil, which was a deal with the Chinese oil company. The biggest M&A deal in Argentina last year was again with another Chinese oil company. China, of course, invests very heavily in parts of the Middle East, in Iran, also Africa, and in Sudan. But India, of course, has been acquiring all sorts of western assets. A good example of course recently is the acquisition by Tata of Jaguar. So, a lot of examples of where the emerging nations with relatively deep pockets are beginning to acquire assets in other parts of the world.

Also, importantly, I think, the way which the emerging nations are developing begin to produce products that are effectively suitable for themselves, but bear in mind that, in the emerging world, per-capita income is mostly actually pretty low still. Because they're low, the kinds of goods and services that are purchased in, say, China or India or elsewhere may be of different quality, different style of what you might typically see in the States or in Europe. A good example of this is cars. If you're a first-time buyer of a car, say, in India, the chance you going to buy a very expensive Audi or BMW are rather remote. You'll be onto something more like a people's car to a certain degree. But, of course, if these cars are being produced for the Indian domestic market, well, of course,

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SK: (cont.) increasingly, you can sell these cars into other parts of the emerging world, where, again, per-capita incomes are quite low. Well, look at Chinese car production around the world. It's not just centred in China itself – it's also all over the Middle East and parts of Latin America. So you begin to see global emerging market production platforms being created, which are associated with these cross-border investments.

BC: Does this considerable build-up in trade mean we are going to see faster growth in the use of the renminbi?

SK: I think so. The thing about the situation in the world today, we have lots of uncertainties about paper currencies in general. One of the reasons why gold prices so high. People are increasingly nervous about the dollar, about the euro. One obvious reason which is the western world is still very heavily in debt, and printing money is one possible way of trying to get out of your obligations to a certain degree. But when you think about these flows of south-south trade, the way they're funded through capital flows in the south-south bases, you begin to recognise increasingly it's China, rather than the US, who call the shots. By doing so, it'll increasingly choose – in fact demand – to exchange with other countries on the southern basis in renminbi rather than dollars. So over time, over decades, really, rather than just a handful of years, over time, you can imagine as a consequence of this huge turbo-charging of south-south trade that we find ourselves where the renminbi begins to challenge the US dollar for global reserve currency status.

BC: Given this change in the global economy, are there investment implications?

SK: Well, an obvious implication, of course, is thinking about investing in the emerging world because you've got very strong growth but also very strong growth in trade between these different countries. In fact, the growth of trade will probably double the growth of GDP so the connections begin to expand in the years ahead are extraordinary. So it's important to think about the kinds of companies that can produce goods for all over the emerging world rather than one particular country, thinking about the kinds of capital flows that may generate business and financial institutions around the world and all these things, I think, are important things. But ultimately when you think about the world in 20 or 30 years' time, it'll increasingly be dominated by the emerging markets. So any investor, I think, has to have a big focus on the emerging world as part of his portfolio.

BC: Stephen, thank you very much.

SK: Thank you.

BC: I've been speaking with Stephen King, HSBC's Group Chief Economist about his new report on the *Southern Silk Road*. You could read more of his research on our website. Thank you.