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# Nations search for a new world order

Debate over the nature of the links between national economies underlines their interdependence, says **Jamil Anderlini**

In the wake of the global financial crisis, most developed economies are still suffering from low growth rates, rapidly expanding debt loads and the threat of a "double dip" back into recession.

But in the so-called "emerging markets", economic growth has roared back and in many cases now exceeds pre-crisis levels.

Inevitably, this disconnect has reignited the debate over whether fast-growing, poorer countries have "decoupled" from richer, developed nations.

Leading the pack of resurgent developing economies is China, where the government is once again concerned about overheating rather than boosting growth.

Most economists agree that for all its soaring growth, China cannot pull the whole world out of the economic doldrums – after all, its economy is still only a third the size of the US's.

But its rapidly expanding consumer class and heavy demand for natural resources to feed its boom are credited with powering the rebound for exporters of raw materials and capital goods, such as Australia and Germany.

And China's middle-class now buys more cars than any other country's, while conspicuous consumption in huge cities such as Shanghai and Beijing is changing how many products are designed and marketed.

"The global recovery is highly uneven and increased differences in economic growth are a clear departure from the strong and synchronised expansion the world economy enjoyed before 2007," says UBS analyst Mansoor Mohi-uddin.

As growth surges in some economies, including Australia, Israel, India, Malaysia, Singapore, Brazil and China, their governments have been tightening policy for many months already.

By contrast, in places such as the US, UK, Europe and Japan, central banks have maintained their commitment to exceptionally loose monetary conditions

The public debt burden in various countries is divided along similar lines. Public debt as a ratio of gross domestic product in Japan, the US, Italy and the UK is forecast to reach alarming levels, but there are no such concerns in countries where growth has rebounded strongly.

The debt load has already prompted a crisis in Greece, which led to a steep decline in the euro and spread fear through much of the rest of the still shaky global economy.

This contagion is evidence to many that decoupling is still not really happening.

"Developing economies, particularly China, rely to a large extent on exports for their growth," says Edward Tse, China head for the Booz consultancy. "So when the EU, which is China's largest trading partner, had trouble earlier this year, there was a lot of concern in China about falling exports and damaged growth."

This fear of contagion in high-growth China provides an important glimpse of the hidden fragilities behind the positive GDP growth figures.

China's rapid V-shaped recovery in particular was the result of an unprecedented stimulus package that some economists have called the fastest and largest fiscal and monetary easing in world history.

The huge flood of easy bank loans and frenzied activity was largely channelled into infrastructure investment in a country where consumption's share of GDP was already the lowest of any country.

And much of the infrastructure spending was in fact diverted into the bubbling residential real estate market, where prices are now out of reach of most Chinese citizens.

Economists point out that while China may have pulled itself quickly out of the economic crisis in terms of GDP

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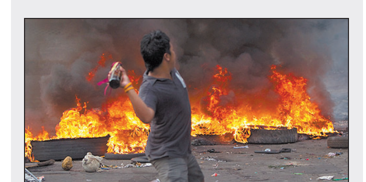

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**Road to ruin: China's middle-class now buys more cars than any other country's** Getty

## End of term

David Rubenstein, founder of the Carlyle Group, one of the world's largest private equity firms, says it is time to retire the label "emerging markets".

"The [term] was coined about 1991 to describe small, fast-growing economies such as Taiwan and Thailand," Mr Rubenstein told the FT.

The description has been stretched to describe virtually every economy outside North America, western Europe and the Antipodes, grouping China with tiny impoverished nations in Africa.

Many of my Chinese acquaintances argue that their nation has been the pre-eminent political and economic power for most of recorded history, so China can more accurately be described as "re-emerging".

Nearly a decade ago the Goldman Sachs sales and marketing department came up with "Bric" to describe the somewhat arbitrary grouping of Brazil, Russia, India and China.

That label, known in Chinese as the "four countries of the golden brick", has been taken up widely. Indeed, South Africa is lobbying furiously to be allowed to join it.

But it is time to come up with something better – and at the same time we can probably do away with "developing" and "developed".

In the wake of the financial crisis, the smugness conveyed by the term "developed" does not really fit any more.

Surely the luminaries at the World Economic Forum this week can come up with some better suggestions?

**Jamil Anderlini**

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# Nations seek new world order

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growth figures, the cost has been to exacerbate an already unbalanced and potentially unsustainable growth model.

While the Chinese economy continues its rapid ascent, few outside the country are questioning how long it can last. There are some who laud the birth of a "Beijing consensus" to rival the previously omnipotent "Washington consensus".

They ask whether the political and economic systems of more authoritarian states such as Russia and China can provide a model for developing nations that will challenge the dominance of western liberal democracies. China in particular is obsessed with projecting its "soft power" and presenting an alternative to the sometimes condescending influence of finger-wagging western politicians.

In Africa, rising powers such as Brazil, India and China are competing for resources and investments in a trend that some believe will bring enormous benefits for the continent but which others have described as "neo-colonialism".

But while western, democratic capitalism has been tarnished by the financial crisis, the Russian or Chinese models do not present the strong ideological challenge Communism once did.

Still, the global economic landscape is clearly shifting: China is the world's second-largest economy, a title held for four decades by Japan.

"The global economy is transforming into a multipolar environment," says Mr Tse. "We don't see true decoupling but there are clearly big shifts in relative economic power taking place."

As for whether Asia has decoupled from the Organisation for Economic Co-operation and Development economies, in the sense that its growth prospects are no longer determined by what happens in the west, Mr Tse says: "Not yet – and perhaps not ever, because economies are interdependent."

But Asia's economic strength in particular has obviously increased relative to the west. As Mohamed El-Erian, chief executive and co-chief investment officer of Pimco, the bond group, points out, those arguing that decoupling is real were firmly in control before the freefall of the global economy in the last months of 2008.

Industrialising economies, particularly in Asia, were largely unaffected by the subprime crisis and were still growing rapidly in 2007 and into 2008.

Then, in the midst of the global turmoil that followed the collapse of Lehman Brothers, no economy was left unscathed and "recoupling" proponents emerged triumphant.

With much of the world recovering, and with a clear divergence between industrialised and developing economies, the decoupling camp is once again in the ascendant.

"To some, this round trip illustrates how flimsy market consensus can be," says Mr El-Erian.

As global leaders and executives gather in Tianjin, China, for the World Economic Forum this week, much of the debate will again involve the question of decoupling and what it means for the future of the global economy.

# China's 'market-Leninism' has yet to face biggest test

**State capitalism**

The state sector is not as potent as it might at first appear, reports **Geoff Dyer**

Last year, the writer and political analyst Ian Bremmer was invited to a meeting at the Chinese consulate in New York to discuss the global financial crisis. He Yafei, China's then vice-foreign-minister, asked the assembled group partly in jest: "Now that the free market has failed, what do you think is the proper role for the state in the economy?"

State capitalism is hardly a new phenomenon, but it is very much in the ascendant at the moment. Not only has the financial crisis sapped confidence in the sorts of free-market policies that Washington has promoted since the end of the cold war, but the continued rise of China with its particular blend of "market-Leninism" has given new respectability to the idea of the state taking a large, even dominant, role in the economy.

If Francis Fukuyama's *The End of History* seemed to define to intellectual zeitgeist of the early 1990s, then it is books such as Mr Bremmer's recent *The Rise of State Capitalism* that are dominating discussion at the moment.

"It's now much harder for westerners to champion a free-market system and easier for China and Russia to argue that only governments can save economies on the brink. After all, government spending has been essential for recovery in both America and China," says Mr Bremmer.

"The financial crisis has provided Beijing with new evidence that enlightened state management will offer protection from the natural excesses of free markets. This experiment will probably expand, and continue to exert a growing influence on the shape of the global economy."

There are plenty of other countries that operate a form of state capitalism, from Russia to the Gulf. Indeed, around three-quarters of global oil reserves are in the hands of state-owned energy companies. Yet, it is China that is the poster-boy for state capitalism.

A decade ago, the Chinese state sector seemed on the verge of collapse. In the late 1990s, hundreds of companies were forced to close and tens of thousands of workers lost their jobs. Yet the sector now looks to be in rude health.

According to a recent report by the body that manages the country's largest state-owned companies, their profits rose by 22 per cent a year from 2003 to 2009, when they accounted for 2.1 per cent of national GDP, up from 0.3 per cent in 1998.

Taking advantage of the crisis, China has been providing aggressive financial backing to its companies to go overseas and sign opportunistic deals in sectors such as energy and raw materials – hoping to forge new multinationals while securing supplies of vital commodities.

China has also been putting increased pressure on multinationals to hand over important technologies in return for access to its market. The authorities intend to make the know-how available to some of their own companies.

Under the rubric of promoting "indigenous innovation", China has introduced a string of policies – ranging from patent laws and technology standards to procurement policies and product approval rules – that many foreign technology companies believe are a huge threat to their intellectual property.

"With these indigenous innovation industrial policies, it is clear that China has switched from defence to offence," says Jim McGregor, a Beijing-based consultant and former director of the American Chamber of Commerce in China.

> 'With these indigenous innovation policies, it is clear that China has switched from defence to offence'

"Many single-industry and single-product companies could be destroyed in the process. Global markets are likely to become increasingly distorted, and the end result could be a chilling effect on innovation globally."

Yet it is easy to be overly impressed by the apparent potency of China's state sector. For a start, there is less to these companies' headline profitability than meets the eye. About half of those profits come from just four companies – China Mobile and the three oil and gas giants – which have semi-monopoly positions.

China may have the biggest banks in the world, but their profits would collapse if the government did not impose large interest rate spreads that penalise depositors.

Efforts to create national champions have faced many problems. China's two most successful car companies – Chery and Geely, which recently acquired Volvo – were not the ones that planners in Beijing chose to support.

At the same time, some of the potential threats from the resurgent state sector are also overblown. China's oil companies are not shrinking global oil stocks by inking long-term supply deals. Their investments in places such as Sudan and Iran, where western multinationals are barred for political reasons, are expanding international oil and gas supplies.

Most of all, the biggest challenge for the Chinese model is yet to come. Heavy state direction has worked in other countries, as it is working in China now, to develop heavy industry and manufacturing – which require ready access to capital – and to promote urbanisation.

Yet large bureaucracies have a much less impressive record at producing the innovation that Chinese leaders believe is crucial to the long-term future of the economy. That will be the real test for Chinese state capitalism.

# Ideology is the mortar for Brics' success

**New colonists**

Despite concerns, the investments are popular, reports **Richard Lapper**

China pops up all over Africa these days. Its construction companies build everything from roads and railways to football stadiums and airports. Its exports range from mobile phones to cheap shirts. And its own industry depends on a steady supply of iron ore from South Africa, copper from Zambia, and oil from Nigeria, Angola and Sudan.

But less well known is the fact that India and Brazil, two of China's fellow Bric nations, are deepening their ties with the continent as well.

In Angola, for example, Odebrecht of Brazil rather than any of the many Chinese construction companies is the biggest private-sector employer.

Three Indian companies as well as Brazil's Vale are exploiting coal reserves in Mozambique considered to be the biggest discovered since the early 1960s.

Indian pharmaceutical companies are doing a roaring trade in the region and although Brazil has focused its efforts on Portuguese-speaking Angola and Mozambique, its interest is much wider. Vale, the world's biggest iron ore miner, recently made a $400m investment in a Zambian copper mine, for example.

Under President Luiz Inácio Lula da Silva, Brazil has opened many embassies in Africa and the peripatetic leader has visited the continent several times since he was first elected in 2002.

This growing web of ties amounts to a "seismic economic" shift, according to a recent report by economists at South Africa's Standard Bank, one of the many continental financial institutions orienting their strategies around the Brics.

Trade between the Brics and Africa as a whole soared from $22.3bn in 2000 to $166bn in 2008 and, although China accounts for two-thirds of that amount, Brazilian and Indian commerce in the region is expanding equally quickly.

Indeed, overall, the Bric countries' share of Africa's total trade rose from 4.6 per cent in 1993 to 19 per cent in 2008.

What is more, the strong secular trend has been reinforced by the financial crisis of 2008, with China replacing the US as Africa's biggest trading partner in 2009.

"Asia's demand for Africa's resources has proved, in large part, recession-proof," wrote Jeremy Stevens, an author of the Standard Bank report. "The Brics have unequivocally attached themselves to Africa to ensure long-term economic growth."

This shift has not been uncontroversial. The single-mindedness of the Chinese drive into Africa has raised hackles. Thabo Mbeki, the former president of South Africa, famously warned three years ago about a new form of colonialism, prompting his government briefly to impose quotas on imports of Chinese textiles.

Human rights groups have criticised the way in which China has backed openly repressive governments in Sudan and Zimbabwe. Workers contracted by Chinese companies tend to be badly paid and work in poor conditions, and the Chinese tendency to employ Chinese workers rather than local labour has occasionally caused uproar.

"What bothers me is that no African has ever worked with a Chinese company and seen his life improve," said one young Ghanaian entrepreneur at a recent conference on Chinese investment in Africa.

On the other hand, many governments like their new partners. Chinese and Brazilian construction companies can be cheaper than European rivals. In 2008, China overtook the UK as the biggest source of foreign investment in Ghana, partly because Chinese groups committed to build roads and other infrastructure at a fraction of the cost of competitors.

"The Chinese build three roads for the same price that the Germans would charge to build one," said one Ghanaian official at the same conference.

Speed is another attraction for African government. In Mozambique, new coal deposits around the dry and dusty city of Tete have been developed phenomenally quickly by Brazil's Vale

> 'The Brics have unequivocally attached themselves to Africa to ensure long-term economic growth'

and Riversdale, a company in which Chinese, Brazilian and Indian companies all have significant stakes.

Steve Mallyon, managing director of Riversdale, says eight power plants in India and three steel factories in China are "screaming for product. Twelve months ago, China wasn't even on our horizon."

Connections with China, India and Brazil are also sought-after because they tend to reinforce the ideological predispositions of African governments, especially those formed by what were national liberation movements.

Big government – featuring strong regulation, nationalised companies and close links between political and business elites – has been one of the features of the Brics' success.

That is appealing to those African leaders who are distrustful of the market-based orthodoxy that has prevailed for the past two to three decades.

Martyn Davies, chief executive of Johannesburg-based Frontier Strategies, says officials from South Africa's governing African National Congress regard the success of the Bric economies as proof that the state should be doing more, not less, to nurture growth.

"Pretoria's interpretation of what's driving Brics is that it's very much a state-capitalist approach," he says.

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# Indian workers are not ready to seize the baton

**Demographics**

China's workforce is set to contract but India may be unable to benefit, say **Leslie Hook** and **Amy Kazmin**

Ask any cab driver in Beijing, and they can tell you without hesitation what ails their country: China just has too many people, they will say with a sigh.

But economists disagree, and as the population reaches a turning point — the number of entrants to the workforce may peak this year – the country is set for a difficult adjustment, with growing labour market pressures bearing on the workshop of the world.

That is a transition that China's neighbour, India – set to overtake it as the world's most populous nation in 2025 – hopes to capitalise on, as entrants to its labour market will rise annually for the next 14 years.

But many analysts are questioning whether India – with its overstretched, underdeveloped infrastructure and its poorly educated youth – really has the capacity to take up the slack.

"In all likelihood, India will not be able to benefit from this reduction in the growth of China's labour force, simply because India is not ready to have a manufacturing sector as large as China's," says Laveesh Bhandari, founding director of Indicus Analytics, the New Delhi-based economics research house. "Infrastructure is limited and too expensive, and the human capital base is not deep enough."

China, where the total workforce is due to start falling by about 2016, is already showing symptoms of a tightening labour market, with the country rocked this summer by a spate of labour disputes and strikes, by staff demanding higher wages.

The unrest has fuelled debate about whether China has reached its "Lewis turning point", named after Nobel laureate Arthur Lewis, who theorised that a developing economy's wages will rise sharply once labour demand from industry has exhausted available surplus labour from the agricultural sector.

> Goldman Sachs says that India's labour force will grow by 110m over the next 10 years, which could add 4 points to GDP growth

Some economists believe that China reached this tipping point in 2004, when manufacturers in the Pearl River Delta reported labour shortages – although pressures eased temporarily during the global financial crisis when demand for Chinese exports fell.

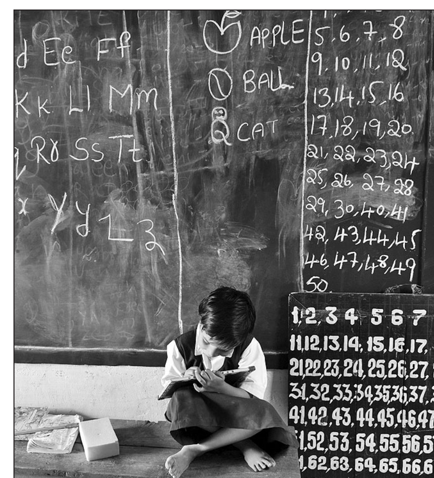
But this year, the manufacturing hubs of Guangzhou and Dongguan have both raised their minimum wages, and many companies are expanding leisure activities and improving food at their factory compounds in order to boost worker retention.

Companies such as Foxconn, the electronics maker, have also begun moving inland – closer to the areas where their workers hail from – hoping to make it easier to gain new recruits, and thereby forcing local factories to raise their wages to compete.

"The consensus is that China is probably approaching the Lewis turning point soon, based on recent developments in population growth and also the one-child policy," says Jiang Tingsong, senior economist at the Centre for International Economics in Australia.

Rising wages in the coming years are expected to drive manufacturers away from low-value-added sectors, while rising consumption by better-paid Chinese workers will play a bigger role in propelling the domestic economy.

Morgan Stanley has projected that Chinese labour's share of gross domestic product would rise from its current level of 15 per cent to at least 30 per cent by 2020, reversing



Training needs are not being met

the trend of the past decade, in which wage growth has trailed economic expansion.

"If wages rise, then the household share of national income must rise. That would be a very beneficial process and that would aid the economic rebalancing," explains Arthur Kroeber, managing director of Dragonomics, an independent research and advisory firm.

Yet some economists fret that tightening labour supplies will lead to slower growth and higher inflation.

Mr Jiang estimates that a 5 per cent reduction in the size of China's unskilled labour force could result in a 2 per cent slowdown in GDP.

In China's labour headaches, some Indians see opportunity. The UN estimates that India's population will rise by 26 per cent from 1.2bn in 2010 to 1.5bn in 2035, while its labour force will rise by 33 per cent to nearly 1bn.

By then, Indians of working age – 15 to 59 – will account for about 65 per cent of the population, making India the world's largest labour market.

Goldman Sachs says that India's labour force will grow by 110m people over the next 10 years, the largest addition to the global labour force, which could potentially add 4 percentage points to GDP growth over the next decade.

But what worries many Indian business executives, economists and policymakers is whether the country's economy can absorb the masses of aspiring workers, mainly from poor rural areas and with little or no training. While nearly 13m young Indians are entering the workforce every year, India's vocational training system has the capacity to train just 3.1m a year. Many young people lack even rudimentary skills.

"We do not have people who are actually functionally literate," says Mr Bhandari. "Most of our labour force is inappropriate for the mass manufacturing practices that China has excelled at."

# Eastern Europe tests limits of its resilience

**CEE region**

## Russia has been shocked into some soul-searching, says **Neil Buckley**

Little more than 18 months ago, prospects for much of central and eastern Europe looked bleak. This was the area hardest hit by the global recession, with fears of a regional meltdown akin to the Asian financial crisis of the late 1990s.

Many countries in the central and eastern Europe (CEE) region – in the past decade, a favoured destination for emerging-market investors – had gorged on cheap credit. Current-account deficits had grown, businesses and consumers had run up hefty foreign-currency debts.

When credit flows seized up and western Europe – the region's main export market – slumped, economic growth stalled and some countries had difficulty refinancing their debt.

Hungary, Romania, Serbia, Ukraine and Latvia turned to the International Monetary Fund for loans.

Yet there were no sovereign defaults, and a broader crisis was averted.

Countries' performance also proved more varied than expected – Poland became the only EU nation to avoid recession. Today, although generally brightening, the outlook is also varied.

A regional crisis was avoided in part thanks to international financial institutions. The Group of 20 summit in London in April 2009 ensured the IMF had enough funds to assist. The Vienna Initiative, brokered by the European Bank for Reconstruction and Development, ensured foreign banks that had become dominant players in the region did not withdraw financing.

Households and companies, too, proved surprisingly resilient, prepared to keep servicing their debts and endure government austerity programmes.

Falling imports because of recession, and lower energy prices helped shrink and reverse many countries' current account deficits. But budget deficits increased, thanks to stimulus and social protection costs, even in Poland. Many CEE citizens face a few more years of austerity to rein in public finances.

Broadly, however, despite fears that the reversal of fortunes could make citizens question the rush to embrace market economics in the past two decades, the crisis has led to no big shifts in economic policy.

Governments remain committed to a free-market approach, and – for those still outside – membership of the euro and the European Union. Even the eurozone's travails have not led CEE countries to reject membership. But most expect it to take longer to gain admittance – though Estonia has been accepted for membership from next January.

Some policy adjustments are being made. In particular, the EBRD launched an initiative in May to develop local-currency lending and capital markets to make the region less dependent on foreign capital and less vulnerable to downturns.

Yet, integration into the broader European economy is helping Poland, along with the Czech Republic, Slovakia and Hungary, lead the region out of recession.

These countries are in effect part of Germany's supply chain, and in the second quarter have seen double-digit year-on-year growth in industrial output.

"Czech companies don't produce things that are consumed in Germany. They produce things that German companies use in order to export," says Andreas Treichl, chief executive of Austria's Erste Group Bank, one of the region's big lenders.

> 'These countries have a very small tradeable sector, and in some cases significant foreign debt'

Recovery in the Balkans and south-east Europe is more sluggish, however, and the outlook weaker.

"This area has very little export capability," says Michael Landesmann of the Vienna Institute for International Economic Studies. "By and large, these countries have a very small tradeable sector, and in some cases significant accumulation of foreign debt."

The key to recovery in south-east Europe may be to encourage foreign investment into manufacturing and other export businesses by improving the investment climate.

The country where the crisis has provoked the biggest debate over economic policy is also the biggest economy in the former Soviet bloc – Russia.

The country's 8 per cent economic contraction last year was a sharp contrast to the resilience of the other "Bric" nations (Brazil, India and China) and the worst performance in the Group of 20 leading economies. It came as a shock to its leaders, who had expected Russia to be relatively unscathed.

The slowdown exposed the country's overwhelming reliance on Soviet-era industries, extracting oil, gas and other commodities – and its vulnerability when prices fall.

Largely as a result, president Dmitry Medvedev last autumn launched a campaign of modernisation of the Russian economy. "The nation's prestige and welfare can't depend for ever on the achievements of the past," he warned.

Mr Medvedev has spearheaded efforts to foster the development of high-technology industries in Russia, including construction of a "Russian Silicon Valley" at Skolkovo, near Moscow.

He has also signalled a shift from the confrontational approach of Vladimir Putin's presidency towards a more pragmatic stance, aimed at securing technology and investment from the west.

But some analysts question whether Moscow's top-down approach to developing high-tech business can succeed.

Nikolay Petrov, a scholar at the Moscow Carnegie Center think-tank, sums it up. "Russia needs a much broader modernisation of its whole political and economic system," he says.

# Ambitious goal reveals scale of task

**South Africa**

## Annual growth of 7 per cent for 20 years will be hard, says **Simon Mundy**

South Africa's successful hosting of the football World Cup boosted the country's international reputation, supporting its claim to be seen as one of the leading developing nations.

Yet the country's long-term challenges remain: skills shortages, cripplingly high unemployment, and inequality levels little changed since the end of apartheid.

The government has declared an ambitious goal of 7 per cent annual growth over the next 20 years, tying in with President Jacob Zuma's aim of joining the "Bric" group of big developing economies.

South Africa's average growth rate for the past five years was below 4 per cent, and the economy contracted by 1.8 per cent in 2009, as the global downturn hit.

But Pravin Gordhan, finance minister, said in August that the target could be achieved through steps such as invigorating the ailing mining industry, setting up training schemes to tackle soaring youth unemployment, and large-scale investment in infrastructure.

Many analysts think the country has potential to cash in on growing investor interest in Africa as a whole by positioning itself as a "gateway" to the continent.

The country's banks escaped the worst of the financial crisis, thanks in part to efficient regulation, and are well-respected overseas. Standard Bank, the country's biggest by assets, is present in 17 African countries, and others such as Nedbank – a target for the UK's HSBC – are looking to follow its example by moving into countries such as Nigeria.

Improvements in communications infrastructure are also likely to bear fruit. A submarine fibre optic cable linking South Africa with Europe and India came into operation last year, improving internet speeds and lowering costs. Two more are set to follow in 2011.

Once South Africa's internet speeds become comparable with those in most developed countries, it could challenge Dubai as a regional hub for companies doing business in the Middle East and Africa, says Vittorio Massone of management consultancy Bain.

Progress on the digital front should be accompanied by a rejuvenation of road and rail networks, as the state hopes to make up for years of underinvestment by spending R846bn ($116bn) on infrastructure over the next three years.

But concerns about the security of the electricity supply remain. Blackouts hit the country in early 2008 after Eskom, the state-owned electricity company, failed to create enough capacity to keep up with the growing economy. The blackouts stopped as demand eased during the recession, but supply is likely to be squeezed again before the 4,800MW Kusile power station enters service in 2013. And tariff rises of 25 per cent in each of the next three years are promised.

Mounting electricity costs are a big concern for the country's mining industry, which could not increase production enough to capitalise on the commodities boom that ended in 2008. Potentially lucrative coal exports to Asia are held back by a lack of rail capacity to the main export terminal, and there is concern across the mining sector at a lack of essential skills.

Output from the country's ageing gold mines continues to decline; the world's biggest producer for more than a century until 2007, South Africa has now fallen to fourth place.

Meanwhile, a dispute over mineral rights between the state and Kumba Iron Ore, a subsidiary of Anglo American, has provoked fears for the nation's reputation among investors.

Fears of political instability could add to investor jitters. The ruling African National Congress has been accused of seeking to curb press freedom through a proposed law that would drastically increase its power to keep information secret. Mr Zuma's position looks increasingly insecure, as allies who helped his rise to power lose patience with a perceived failure to achieve policy changes.

> Automobile makers lifted pay by 10 per cent, amid warnings it would make the sector less competitive

The state is resisting pressure for big public sector wage rises. And in August, automobile makers lifted workers' pay by 10 per cent, amid warnings that it would make the sector less competitive.

The government has said that big wage rises could jeopardise job creation – a crucial issue in a country where the official unemployment rate stands at more than 25 per cent.

That is partly a result of persistently low standards in schools: although South Africa spends 6.1 per cent of GDP on education, high school graduation rates have fallen in recent years thanks to largely undertrained teachers and an overly complex curriculum.

"It's one factor that has dragged down South Africa's competitiveness," says Danelee van Dyk, an economist at Standard Bank, who warns of widespread skills shortages in key industries and a growing burden on the welfare budget.

Broadly higher returns on investment in South Africa than in the developed world should ensure strong capital inflows for the foreseeable future. But, Ms van Dyk adds, the country's long-term future depends on improved education and the stimulation of labour-intensive industries.

# Instability takes its toll on the economy

**Thailand**

## **Tim Johnston** looks behind the headline economic figures after the latest unrest

Growth goes up in smoke: investment has been hit by political tensions Paula Bronstein/ Getty Images

Although Thailand's political turmoil this year seems to have had little immediate effect on the economy or investor confidence, long-term political uncertainty is taking an increasing economic toll.

Between March and May, 91 people died and almost 2,000 were injured in clashes between troops and demonstrators demanding the resignation of the government.

But despite the violence and the graphic pictures of street-battles outside some of Bangkok's most expensive real estate, little economic fallout has been apparent so far.

There have been two rounds of GDP forecast upgrades since the army cleared the protesters' encampment in the heart of the city, and most estimates now lie between 7 and 8 per cent.

The tourism sector – which accounts for some 6.5 per cent of GDP – took an initial hit, but numbers have recovered remarkably, and the country is back on target comfortably to exceed last year's numbers.

Investment, too, looks to be roaring forward, with applications to the Board of Investment in the first four months of the year up almost two and a half times in value terms year-on-year, and the Stock Exchange of Thailand retaining its position as one of the region's most lucrative this year.

It has outperformed the MSCI Asia Pacific Index by more than 25 per cent.

Even Fitch Ratings, which downgraded its outlook from stable to negative at the height of the unrest, recently said it was considering an upgrade to stable.

But if the headline numbers are good, they do not tell the whole story.

Many of the strong year-on-year growth figures are attributable at least in part to the low-base effect. Thailand's economy shrank by 2.9 per cent last year, the biggest fall in south-east Asia, and exports – which account for some 65 per cent of the economy – were down 14.2 per cent, allowing a wide margin for improvement.

And although applications to the Thai Board of Investment are up, disbursement of foreign direct investment inflows seem to be slow, bolstering anecdotal evidence that some overseas investors are moving cautiously.

The lack of fallout is partly attributable to the dynamics of the protest. Although the violence surrounding the demonstrations was ugly and disturbing, it was very tightly focused, and the unrest did not spread in fact or in spirit to the country's manufacturing sector, despite many of the protesters being drawn from the working class.

The unrest was just the latest and most damaging manifestation of tectonic social and political shifts that have been under way for years, as the country struggles to move from the paternalistic politics that dominated the early part of its economic development to a more inclusive democracy.

The result has been a cycle of violent protests, coups and short-lived governments, and that is taking its economic toll. One of the reasons the stock market was so resilient is that foreign investors had few assets to pull out: despite the stellar performance of the index this year, the SET is still trading at a 16 per cent discount to the rest of Asia excluding Japan in price/equity terms.

> 'Over the long term, we believe that Thailand's unsettled politics will keep GDP growth below potential'

The costs of the political uncertainty are clearest in the country's depressed investment record.

"Over the long term, we believe that Thailand's unsettled politics will keep GDP growth below potential –estimated at about 6 per cent a year. Thailand's many political upheavals during the past five years cannot be ignored and we believe that this has led investors to raise the country's risk premium," Phatra Securities said in a recent report.

Research by Phatra shows that Thailand's annual private investment has averaged 15 per cent over the past 10 years, 7 percentage points below its 40-year average of 22 per cent. Public investment is also significantly below the average, reflecting the inability of the rapidly cycling governments and a demoralised bureaucracy to keep state spending on track.

"If politics returns to normal and Thai governments are stable, it would be reasonable to expect public and private investment as a percentage of GDP to rise by 5-6 percentage points of GDP, moving investment as a proportion to GDP closer to the long-term average.

Foreign direct investment tells a similar story. Between 2005 and 2008, FDI was up 550 per cent in Vietnam, 80 per cent in Malaysia, and 12 per cent in Indonesia. FDI in Thailand managed a meagre 6.5 per cent increase.

The effects of long-term failure to address the underlying political tensions are already costing the country substantial amounts in lost growth.

Until politicians can provide a stable environment for local and foreign investors, Thailand seems fated always to underperform its competitors.

# Continent rides high after years of default and deflation

**Latin America**

## The region's image does not do it justice, says **John Paul Rathbone**

For many years, the predominant outside view of Latin America was of "a man with a moustache, a guitar and a revolver," as Nobel-prize-winning Colombian novelist Gabriel García Márquez once put it.

But the continent has changed. Despite the reality-distorting perception generated by headlines about drug-traffickers and emigration, there has been a quiet but profound transformation over the past two decades that some believe, may make the next decade its own.

The continent still has many poor people, but what is defining it now is its rising middle class.

In Brazil alone, over the past decade 30m people have joined the ranks of the middle class. This remarkable change has transformed the way consumer goods companies now treat the country. The story has been repeated throughout the region.

Since 2000, the region has been the one place in the world where inequality has fallen: both in relatively rich countries (such as Mexico) and in poor ones (such as Bolivia); in those with socialist style economies (Venezuela) and free marketeers (such as Colombia); in those with large Amerindian populations (Peru) or without (Argentina).

Nor has this trend jeopardised growth. Latin America, this year, will grow on average 4.5 per cent – twice the US level, and four times that of the eurozone.

By and large, the region has embraced high finance. Emblematic of that, the Brazilian oil company Petrobras is about to launch the world's largest ever share offering. At as much as $84bn, it will be used to exploit Brazil's deepwater oil reserves that are, by some counts, larger than Russia's and Kuwait's.

Petrobras, however, is only one of the continent's new corporate leaders.

Vale, the world's largest iron ore company with operations as far away as Guinea and Zambia, no longer considers itself a Brazilian company but a global one, as does JBS – the world's largest meat and protein producer.

In the rest of Latin America, other companies, such as Colombia's biggest lender, Bancolombia, are also increasingly looking abroad, although first to their immediate neighbourhoods. The same is true of its larger Brazilian peer, Itau Unibanco, Latin America's biggest lender by market capitalisation.

The region has also embraced democracy – Cuba notwithstanding and with all the caveats that Venezuela requires. On October 2, for example, Brazil will probably elect a new president – and, for the first time since democracy, without an associated financial crisis. Furthermore, Brazil's next president will most probably to be a woman, Dilma Rousseff.

In a continent usually thought to be characterised by social conservatism and "macho men", this is another marker of change.

> Latin America has largely already dealt with problems now facing the developed west

But then, Argentina already has a woman president (Cristina Kirchner); Chile just had one (Michelle Bachelet), and the leader in Peruvian polls ahead of elections next year is a woman (Keiko Fujimori).

The processes of the past 20 years that have wrought such changes have not been easy. Indeed, debt default, deflation, and how to grapple with gaping budget deficits, are problems the west now has to face. Latin America has largely already done so.

For the most part, the result of this role-reversal is leaner economies, often with constitutionally stipulated spending limits, low overall debt, independent central banks, and a hardy and battle-weathered corporate sector.

There are alternative visions – less pragmatic, more quixotic, and highly heterodox, as espoused by Hugo Chávez in Venezuela. Yet his ideas no longer command the same respect they did only a few years ago.

That is largely because the country's prolonged recession patently shows that Mr Chávez's model does not work. Rather than look to Venezuela's president for anti-imperialist inspiration (or fun), most regional leaders are now embarrassed by his hyperbolic diatribes.

If there is a weak point in the story, it is the degree to which Latin America's rising prosperity is due to the commodity price boom, which has had two effects.

It has bolstered government accounts, so allowing higher social spending. Foreign investment into local commodity-producing companies has meanwhile helped sustain capital flows into a region that still does not save enough to meet its needs – which also explains Latin America's relative financial openness compared, say, with Asia.

As such, even if higher commodity prices represent a structural shift in world demand, it also means the continent cannot escape a global double-dip recession.

However, trade accounts for only 40 per cent of the combined output of the region's seven largest economies – Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

Their fast-growing domestic economies, combined with low debt levels and high foreign reserves, means many are confident Latin America will be able to weather any coming storm better than most.

# Credit set to spur spending

Income disposal: low income tax, low debt levels and rising wages indicate good prospects for retailers Bloomberg News

**Russia**

In spite of the crisis, consumers are keen and able to spend, says **Charles Clover**

Russian consumers are making up for years of Soviet Union deprivation by spending on everything from cars to couture, and few are inclined to stop them.

Developed countries are counting on growing consumer demand from the Bric nations (Brazil, Russia, India and China) to pull the world economy back from the brink of recession.

Russia is the richest of the Brics, in per capita terms, and a rapidly emerging middle class with disposable income has captured the imagination of investors. Russia's two publicly listed retail chains, X5 and Magnit, both trade a significantly higher multiples to earnings, 30 and 25 respectively, than the developed market average of 13.

Dmitry Kryukov, chief investment officer of Verno, a hedge fund that invests in Russia, says this reflects the high growth prospects for retail, which translates into generous predictions for the country's consumption in general.

However, he cautions that these multiples are too high: "Everyone is taking the retail sector seriously, but right now it looks a little overheated."

Overall, he says that it is wise to bet on growth. Russia still lags behind the developed world in the levels of most consumables per head, from autos to plasma screen televisions.

More importantly, most Russians feel it is their birthright to have a western standard of living. If past trends continue, they may not be too far off. Low income taxes and low debt levels, combined with a doubling of real wages over the past decade, have given many Russians high disposable incomes.

Renaissance Capital, the Moscow investment bank, sees Russia's disposable income per capita growing 17 per cent in dollar terms, year on year, to $7,483 in 2010.

Ulyana Lenvalskaya, a retail sector analyst at Renaissance, says the expansion of consumer credit, which accounts for only 15-20 per cent of sales in Russia, would help spending.

This is good news for struggling European auto manufacturers that see Russia as the next high-growth market. In 2008, just before the global economic crisis, Russia's consumption of autos touched an annualised level of 3m, larger than Germany and momentarily the largest market in Europe, though sales collapsed soon after and have not recovered fully.

Meanwhile, the luxury goods sector is the one where Russian consumers have punched above their weight since the fall of communism. Porsche, sold more cars in Russia than it did in the US in 2008, according to the Association of European Business, based in Moscow.

However, as a result of the crisis, tastes for bling are in decline.

Just over half of Russians surveyed by Boston Consulting Group last year said they planned to cut spending on holiday travel, and 42 per cent on fashion accessories.

Last year 34 per cent of Russians, an 11 percentage point rise from 2008, said they intended to "trade down" in one or more categories of goods, meaning they would buy lower-quality or lower-status labels, according to the BCG study.

## India Diligent shoppers offer opportunity to manufacturers

For decades after India's independence from British colonial rule, Indian consumers were starved of choice.

During the socialist-era "licence raj", nearly everything – automobiles, home appliances, phone connections, airline seats – was in short supply because of New Delhi's restrictions on private sector activities, import controls and the inability of lazy state monopolies to meet demand.

Consumers, therefore, took whatever they could get, often after a long wait, and were generally grateful. Not any more.

Today, after two decades of liberalisation, Indians are among the world's most demanding consumers, as they navigate a fiercely competitive market.

"People say that Indians want things cheap, cheap, cheap," says Whitney Foard Small, Asia Pacific and Africa communications director for Ford Motor Co, which conducted extensive research on Indian consumers before launching its small car, the Figo, this year. "No. They want things that represent a good purchase for their hard-earned money," she says. "It's about value for money."

Bindu Sethi, chief Asia Pacific strategy officer for Grey, the advertising agency, says: "Today's customers are much more discerning."

Before purchasing any big-ticket item, whether a vehicle or a phone, many Indians go on the internet to research specifications and manufacturers' prices.

And then they will look for the lowest price. "They are diligent about shopping – careful buyers, who really do the research," said Ford's Ms Small.

Indians are also big fans of websites such as Mouthshut.com. Its 4m visitors a month check out consumer reviews for products and services ranging from electronics to banking and restaurants to holidays.

"Reviews are becoming an important determining factor," says Faisal Farooqi, Mouthshut's founder.

Consumers also challenge companies to respond quickly to complaints.

"A majority of brands in India have failed to give perfect after-sales service," said Mr Farooqi. "Indians are very vocal. They will make a big deal about it."

When it comes to non-durables, though, Indians are still more traditional. Grey's Ms Sethi says: "They tend to make a list before they go to the store, or send the list to the store."

That is changing, though. "Today, the retail outlet is no longer just a store, it's a school where they go to learn about new products," says Ms Sethi. "It will be a huge opportunity for consumer goods companies.

"When Indian consumers go to a hypermarket, they do what the rest of Asia is doing: they want to make the choice in the store."

**Amy Kazmin**

Focus on value: Ford's Figo

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# Asian customer is now the king

**China**

Increasingly, the rest of the world will be offered what the east wants, says **Patti Waldmeir**

The new Buick LaCrosse luxury sedan, which is helping revitalise GM's fortunes in the US, has a back seat largely designed for Chinese entrepreneurs. Levi Strauss, the oldest American jeans name, came to China to launch a new cheap jeans brand to sell around the world.

As China gains superpower status in global consumer markets – the biggest vehicle market, second largest luxury market, the superlatives go on and on – its consumers are increasingly influencing what the rest of us buy.

Nationalistic US consumers may not like the idea that their cars are increasingly built to please Chinese tycoons, but that is the reality of a world whose automotive centre of gravity has shifted decisively to the east.

That means not just selling and building cars in China, but designing them there too. GM's Pan Asia Technical Automotive Centre in Shanghai was instrumental in designing the new LaCrosse: some of the design features that many consumers love about the LaCrosse back seat – extra legroom, extra controls for radio, heating and cooling –- were designed for China.

"In China, the owner of a car such as a LaCrosse tends to be driven during the week. So he or she wants extra comfort in the back," says a GM spokesman in Shanghai. "So when developing the new LaCrosse – which is sold in the US and China – we paid special attention to the back seat. Customers in the US will benefit from this."

It is not just the global auto industry that is seeing a shift in the balance of power toward China: all the big global consumer goods companies know they cannot afford to fail there.

China not only has 1.3bn potential consumers, it has the fastest growing middle class in the world. And to make things even better, the Chinese government is working hard to encourage them to spend more.

The decision by Levi Strauss to choose China as the place to launch a cheap jeans brand for emerging-market consumers, brought the mighty American legwear – once a potent symbol of all that is right about capitalism and wrong about communism – cap in hand to woo the all-powerful Asian consumer.

Terence Tsang, head of the new global brand Denizen, said it was the first time Levi had launched a global brand outside the US. It is aimed at 18-29-year-olds in China, Singapore, South Korea and, eventually, India.

Levi's jeans in China are currently priced too high for such consumers. The Denizen brand will cost less than other Levis, but 10-15 per cent more than local brands. Mr Tsang says the buyers will pay the premium for a trouser from a company "with so much heritage in jeanswear".

But the new jean will not just be specially tailored on price. Mr Tsang says Denizen will also compete on

> China not only has 1.3bn potential consumers, it has the fastest growing middle class in the world

fit – often a problem for Chinese buying American jeans.

"Chinese consumers complain their hips are narrower, their bottoms are smaller and their legs shorter," compared with the average American, says Shaun Rein of China Market Research in Shanghai.

Denizen may reflect a trend beyond jeans: multinational consumer goods companies, which have long been able to reap big profits by selling premium brands to China's brand-crazy consumers, may increasingly have to go downmarket.

Adidas said recently it would launch cheaper products for "affluent poor" in China, and expand aggressively in smaller Chinese cities.

Consumer goods company executives, both Chinese and foreign, love to quote a seminal McKinsey report predicting China would have 1bn city dwellers by 2025. Watch what they want – it may dictate what the rest of the world buys.