

thebigpicture

guideposts for the private investor

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thebigpicture guideposts for the private investor is published by *thebigpicture* Economics (ABN 71 040 787 936). The author, John A Robertson, while working in Australia, London and New York, has over 20 years experience in international financial and commodity markets, corporate strategy, financial and business evaluation and government policy. He has been Chief Economist and a director of a leading Australian investment bank. He has been a top-rated institutional equity analyst and has marketed investment advice in all the major international financial centres.

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DEVELOPING ASIA: REAL POTENTIAL, DIFFERENT TIMING

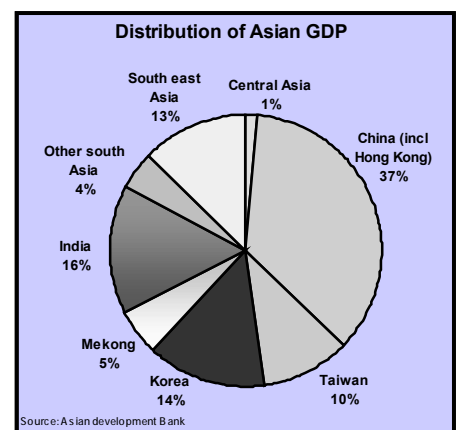
The announcement in the past week that China is to open negotiations on a free trade pact with the ASEAN group of countries highlights that this will remain one of the most vibrant regions of the world economy.

It is also further evidence of a determination within the region to reduce dependence on outside capital and resources to sustain growth.

This possibility of Asia establishing a momentum of its own signifies an important transition for the region: from being dependent for its growth on conditions in the rest of the world to the possibility of actually helping the rest of the world to grow at a faster rate than it might otherwise be able to sustain.

This is consistent with the long term economic evolution of the region.

- In the 1960s, it was a low cost manufacturing centre for European and US companies looking for alternative production sites as labour costs began to rise in their home markets. Asian goods, at this stage, were generally regarded as inferior to the goods which had been manufactured in traditional production centres. Asian manufacturing was the swing production. It was scaled up or down depending on the production needs of the home market.
- As population growth accelerated through the 1970s and 1980s, there was pressure to extend social infrastructure and significant quantities of development capital began to flow into the region.
- Meanwhile, the cost pressures in western market economies were forcing increasing numbers of manufacturers to relocate production permanently. Asia became a primary manufacturing centre for many major western companies.
- Falling political barriers began to create further commercial opportunities helping to boost consumerism in ways which were not possible previously.
- The 1990s technology boom brought with it another opportunity. Labour costs had been rising. Countries like Singapore and Malaysia, by the early 1990s, could no longer be considered appropriate centres for the manufacture of low value products. Just as textile and footwear production had once moved from Australia to Malaysia, it was now moving to the next generation of low cost countries. But Malaysia, Singapore, Taiwan and India had well educated, highly skilled work forces with a comparative advantage in new economy technologies.
- The broadening skill base and greater market liberalization are now encouraging a view of the region as a viable service centre for global finance and administrative purposes.



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ASIA: REAL POTENTIAL, DIFFERENT TIMING cont'd

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This description of the region's evolution is obviously highly generalized. For every country which can be characterized in this way there is at least one which falls outside the description. It is barely possible to speak of Myanmar and Taiwan, for example, as being part of the same developmental entity. Expanding the ambit to include the central Asian republics from what was the Soviet Union further erodes the capacity to generalize in this way.

Nonetheless, the developing Asian economies of east and south Asia do have characteristics in common which will help sustain a relatively high rate of regional growth for the foreseeable future. Even as some decline in importance, the continuing evolution of others will supplement the growth and sustain it for longer.

Developing Asia as a group has been growing at below its historical average rates of growth. From 7.0% GDP growth in 2000, growth decelerated to 3.7% in 2001 but the Asian development Bank, for example, expects growth to accelerate to about 5.0% in 2002 and rise further to 5.7% in 2003. The outcomes so far this year seem to bear out the improving performance.

ASIA: CONDITIONS FOR GROWTH

Political liberalization and growing sophistication in market institutions will continue to be key ingredients in determining whether the region fulfills its potential.

Where that occurs, economic progress will be more rapid than where it fails to occur. In countries like India and Singapore, for example, there is ample evidence that economic progress, improved living standards and relative economic stability came with reduced constraints on their entrepreneurial classes and economies being opened for competition. At the same time, Myanmar which had many of the same institutional and educational advantages which had come from British administration, became the antitheses of the open economy and has stagnated, at best.

The Philippines, another laggard, had once been regarded as a likely economic power in the region. Like Indonesia, however, its reputation for corrupt practices deterred investment and Singapore, Malaysia, Thailand and Taiwan, in contrast, thrived. Laos, Cambodia and Vietnam, less developed than some of these other countries, began to participate in the growing regional prosperity as they became more welcoming business environments.

Of course, this evolution was not without its problems. The so-called Asian economic crisis was so severe that it was a shock to the world economy as well as to the re-

gion but it also signaled that change was occurring. The business practices and relationships which had once kept wealth in the hands of a select few were unraveling. The crisis, itself, was a sign that the region was maturing.

Meanwhile, to emphasize that countries do have an economic life cycle, Japan, the original Asian growth economy began to falter. Once regarded as the model for how western economies should conduct themselves, Ja-

UN Population Projections					
Million people	1950	1975	2000	2025(p)	2050(p)
Europe	548	676	727	684	603
Northern America	172	243	314	384	438
Oceania	13	21	31	40	47
Africa	221	406	794	1,358	2,000
Asia	1,399	2,397	3,672	4,777	5,428
Latin America & Caribbean	167	322	519	695	806

pan's closely linked private and government sectors became the constraint on action rather than the strength it was once perceived to be.

Japan's inability to finance direct investment in the region at the levels which had once been anticipated has also constrained regional growth rates.

Behind all of these developments, however, were some extraordinary demographic changes with a continuing positive effect.

thebigpicture newsletter for the week commencing 16 September 2002 reviewed the global demographic outlook in 'The Demographic Big Picture: Older and African'. It highlighted:

- the demographic emergence of Africa;
- the aging of the global population; and,
- a slowing in Asian population growth from about 45.5 million people a year over the past fifty years to 19.6 million a year over the fifty years to 2050 accompanied by a rise in the average age from 26.2 years in 2000 to 38.3 years in 2050.

Despite a slowing in prospective Asian population growth rates, the potential Asian market would be expanding. By 2050, the United Nations projects the Asian region to have a population of 5.4 billion people compared with 3.7 billion at the turn of the millennium. Just under 60 per cent of the world's population would be located there.

These demographic changes are likely to be accompanied by further liberalization of the political systems, the continuing rise of consumerism, the growth of large metropolitan centres, an emphasis on improving the housing stock and personal living conditions and the emergence

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ASIA: GROWTH PRE-CONDITIONS CONT'D

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of a services sector to support the needs of the growing urban class. Together, this will deliver many of the changes in spending patterns which had been anticipated a decade ago but which failed to live up to expectations.

Thus Asia is likely to realize some of the raw potential which many western companies and investors had foreseen in the early 1990s.

ASIA: BUSINESS OPPORTUNITIES

High growth rates and improving living standards in Asia may not create the bonanza for western companies which had once been foreseen.

Remember how, in the early 1990s, every company was pressured into investing in China? Remember the refrain of business executives that if every person in China bought just one of my (fill in the blank), my profit would increase x-fold?

No doubt there will be business opportunities in the region and many companies will benefit from well-conceived strategies which deliver products and services cost-effectively into the region but circumstances are different.

The biggest difference is that companies from within the region now have a more secure footing. There was some sense in the exaggerated claims of the early 1990s that western companies would have an advantage because of their experience, technology and financial clout. There was a touch of arrogance in this. Certainly, some western companies do have some of these advantages. But there has been a transfer of knowledge over the years, financial capacity has improved and local enterprises have been freed from many of their shackles for sufficiently long that they are commercially far better equipped to participate in the emerging growth than they would have been a decade or so ago.

Competition in the region is likely to be intense. The region is likely to be the focal point for corporate strategies around the world. European companies trying to escape slowing economies being retarded by falling populations will come head-to-head with US global enterprises and regional companies to fight for a share of the Asian markets.

These companies will be experiencing above-average rates of volume growth supported by relatively strong incomes but the competitive constraints which had once protected profitability in these economies (at least for local companies) will have been dismantled. In all likelihood, there will be a free trade agreement in place incorporating ASEAN with China. No doubt, Japan, which had also foreshadowed a desire to enter such an agreement will be spurred into action. The USA which also has ASEAN on its list of potential free trade partners will react to avoid being outflanked. There might be no more competitive environment on the face of the earth.

The beneficial effect will be its impact on inflation. Re-

course to free trade agreements will limit the extent to which inflation differentials will be able to exist so that the gains made in recent years in containing inflation could be sustained.

AUSTRALIA & ASIA: GOOD NEWS & BAD

For Australia, the changes underway in Asia are likely to provide both good news and bad news.

The bad news is that, based on its current positioning and global relationships, Australia will be largely excluded politically from many of these developments. No-one needs Australia in this context. It has already appeared to lose any potential status as an honest broker having become associated politically with the USA, which has never had an affinity with the region, and the UK which has long forgotten that it was ever involved in the region.

This does not mean that Australian companies will be excluded but the advantages which they might have once had from being independent of power blocs will have been lost. They will have to survive on their own merits which, in some cases, will be considerable, but this will be in an increasingly competitive environment for them.

Proximity to the region might be an advantage to the extent that Australia remains a welcoming environment for people in the region seeking educational services and safe holiday and leisure destinations. This will also be to Australia's long term advantage as it will foster networks of individuals which will facilitate understanding and, in due course, a closer business and political connection.

Proximity is, however, a double edged sword. It will mean that Australia is sitting on the edge of one of the most competitive regions in the world. This will place downward pressure on domestic prices. From a macro-economic point of view, there will be a beneficial effect on Australia's inflation rate and interest rate structure. It will also mean that Australian companies will tend to lose any domestic pricing power they might have had. Successful companies, in such an environment, will be those which can survive on their merits. This will require market development and operational skills of a higher order than might have been required in Australia in the past.

In the longer term, however, this will be a beneficial environment because companies will have to become competitive to survive and reflect the comparative advantages which Australia might have in supplying the region.

Australian companies have shown that, put to the test, they are able to be competitive with the rest of the world in technology and manufacturing. They do, however, suffer from having a relatively small domestic market upon which to base their production and this has disadvantaged many of them as they seek out overseas markets. On this score, many have failed because their financial

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AUSTRALIA & ASIA: GOOD NEWS & BAD CONT'D

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and managerial resources have been stretched too far.

Perhaps one of the advantages of living on the edge of such a dynamic region is that Australian companies will be better able to rely on market development activities rather than acquisition of existing businesses to further their development.

One of the causes of failure among Australian listed companies has been the pressure on them to gain footholds in established western markets, something which has required, given the desired time scale, the purchase of an existing company. This has often resulted in acquisition of second rate assets.

Since the Asian markets are less well established than those in Europe and north America, the acquisition imperative might not be there to the same extent. Management might also be easier simply because of the geography and the time zone. The flip side is the lack of cultural identity with the region which creates risks for managers having to develop markets and create operations in collaboration with people

with whom they are unfamiliar and with whom relationships must be developed and suspicions broken down before success can be thought likely.

Even so, Australia is likely to do well in the areas in which it already excels such as technology, construction, high value manufactures, food based products and professional services. It will probably remain true, however, that Australian companies will only be second or third tier players in the region because international companies as well as those native to the region will be seeking to position themselves there.

It is also likely that more opportunities will be available to currently unlisted companies than the companies listed on the ASX. Many of this latter group have decided in recent years to make the USA or Europe the focal point of their activities. While many of them continue to have interests in the region, their expectations were so badly damaged during the 1990s that their ambitions have been downscaled significantly and, with them, their resource commitment.

“The bad news is that, based on its current situation, Australia will be largely excluded politically from many of these developments. No-one needs Australia.... It has already appeared to lose any potential status as an honest broker....”

As is so often the case, the first attempt at an investment fails. The second attempt extracts the value which had originally been foreseen. The danger for Australian listed companies is that they are too scarred (and scared) by their earlier experiences.

A key guidepost for investors in judging whether a company has a sustainable growth strategy, therefore, is whether companies, despite their involvement in Europe and north America, manage a continuing engagement in the Asian region.

GDP Growth - % change from year earlier							
Country	1996	1997	1998	1999	2000	2001	2002 Q2
Brunei	1.0	3.6	-4.0	2.6	2.8	1.5	-
Cambodia	4.6	4.3	2.1	6.9	7.7	6.3	-
Indonesia	7.8	4.7	-13.1	0.8	4.9	3.3	3.5
Lao, PDR	6.9	6.9	4.0	7.3	5.7	6.4	-
Malaysia	10.0	7.3	-7.4	6.1	8.3	0.5	3.5
Myanmar	6.4	5.7	5.8	10.9	13.7	10.5	-
Philippines	5.9	5.2	-0.6	3.4	4.0	3.4	4.5
Singapore	7.7	8.5	-0.1	6.9	10.3	-2.0	3.9
Thailand	5.9	-1.4	-10.6	4.5	4.7	1.7	5.1
Vietnam	9.3	8.2	5.8	4.7	6.8	6.8	-
ASEAN	7.3	4.1	-7.1	3.6	5.8	2.9	-
China	9.6	8.8	7.8	7.1	8.0	7.3	8.0
India	8.1	4.8	6.5	6.1	4.0	5.4	6.4
Taiwan	6.1	6.7	4.6	5.4	5.9	-1.9	4.0
Korea	6.7	5.0	-6.7	10.9	9.3	3.0	6.3

Source: Asean Surveillance Coordinating Unit (ASCU) database & Asian development Bank

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