

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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FDI: COMPETING FOR A SHARE

From once being openly hostile to foreign direct investment, developing nations are now competing for it on the open market. Companies have been increasingly dictating where funds are flowing.

There have been at least seven identifiable phases in the history of foreign direct investment.

- Prior to WWI direct investment was associated with colonisation often through government sponsored investment vehicles to gain access to commodities and products not readily available in Europe. Investment flows were inextricably bound with global strategic decisions.
- Between the wars there was more private sector investment with much of it directed toward resource exploitation. European and US based mining companies established their presence in Africa, Australia and South America, for example.
- During the 1940s and 1950s, as the shackles of colonialism were being cast off, the new generation of leaders opted for self development, sometimes autarky, in reaction to their perceptions of exploitation by the private investors and government protected companies which had gone before and been so intimately associated with colonialism.
- Throughout the 1960s and 1970s, foreign investment was heavily regulated as debates raged about the costs and benefits to host countries of allowing it to occur.
- Petrodollar funds did not come with the corporate or ideological strings attached but high interest rates and repayment requirements meant that the demands on developing nations were more intense than ever during the 1980s.
- International bank sponsored finance through official channels ended up being no less strict or demanding as a source of funding.
- With a sweeping change in the prevailing global intellectual view of private sector equity versus state ownership from the mid 1980s, corporate investment was admitted more freely with funds flowing according to where returns appeared to be greatest.

Developing nations appear to have accepted that a market-based system of capital allocation probably works best. This is by no means universally agreed but we are closer to the free market model than the autarkic, state ownership model which had once been so widespread.

In part, national governments have had little choice. None of the previous alternatives did the job for them. At least by basing their investment programmes around equity funding, governments force companies and their shareholders to also carry some of the risk. In the event that a development project or factory fails to reach its potential, the equity investor has to carry some or all of the consequences.

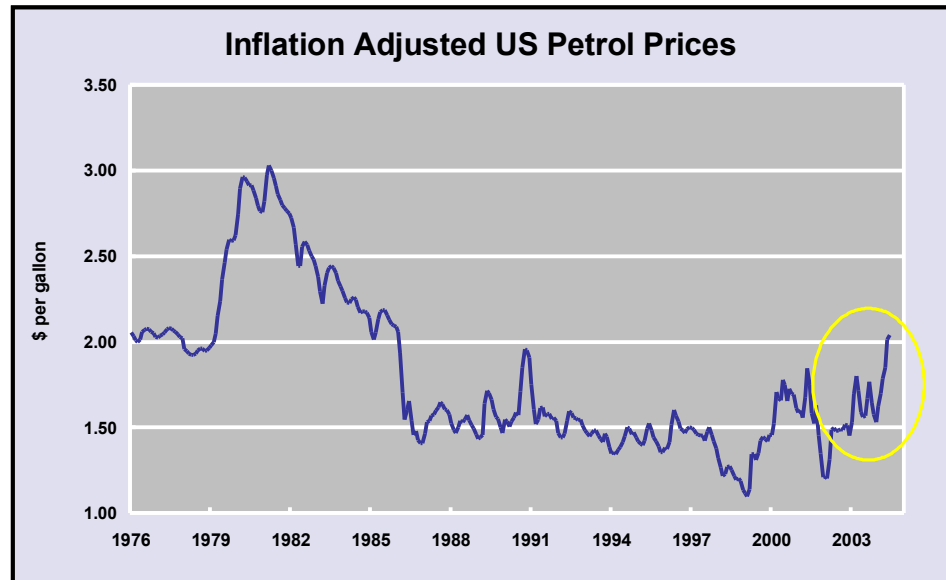
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Foreign Direct Investment Inflows to Developing Asia

	% of total
China	57.7
Hong Kong	15.0
Singapore	8.4
India	3.8
Malaysia	3.5
Korea	2.2
Taiwan	1.6
Viet Nam	1.3
Philippines	1.2

THE WEEKLY CHART SPOT

Inflation adjusted retail petrol prices are pushing toward mid-1980s levels in the USA. They are still 30% below their early 1980s peak but are hovering around levels which had a detrimental impact on economic activity. Twenty years ago, however, petrol consumption fell as high prices eroded real incomes. That is again the prospect: high prices might prevail for longer than expected but the resulting lower consumption will ultimately drive a market adjustment.



Source: US Bureau of Labor Statistics adjusted to 2004 prices by *thebigpicture* Economics

FDI: Competing For A Share cont'd

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In many respects, this is preferable since the cost of failure does not necessarily push a country toward default. However, being unable to mount a compelling case as a destination for funds could leave a country by the wayside. Countries trying to attract funds need to display some combination of:

- large local market;
- rising standards of living;
- low cost labour;
- an educated and skilled work force; and,
- a central government able to enforce contractual obligations.

A country with all of the above is likely to win the largest share of the investment funds on offer. Unsurprisingly, China has scooped the foreign direct investment pool in Asia.

Nearly three quarters of the foreign direct investment reaching Asia flows into China and Hong Kong. Flows of direct investment to developing Asia have increased threefold over the past decade despite the Asian economic crisis in 1997/98. However, of the increase, over 70% is attributable to funds going to Hong Kong and China.

Developing Asia, as a whole, has also lost a share of the global flow of foreign direct investment. From receiving an average of 19.3% of the world total during 1991-93,

its share had dropped to only 10.6% in 1998-2000.

According to the Asian Development Bank¹, from whom all these statistics are drawn, the total stock of foreign direct investment in China is equivalent to nearly one third of the country's GDP. There are some countries such as Malaysia and Viet-

Average Annual Investment Inflows to De-

US\$ billion	1991-1993	1998-2000
China	14.3	41.6
Malaysia	5.0	3.5
Hong Kong	3.9	33.8
Singapore	3.9	11.1
Thailand	2.0	5.6
Indonesia	1.8	<1.5
Taiwan	1.0	2.7
Philippines	0.9	1.6
Korea	0.8	8.0
India	<0.8	2.4
Viet Nam	<0.8	1.5

nam which have higher stocks of foreign investment having also cultivated foreign investors as part of their development

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1. Asian Development Outlook, Asian Development Bank, April 2004.

US: Still Expanding cont'd

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cession or is expanding.

Overall the signals are still positive. The latest employment report suggested that growth had stalled over the past couple of



months. However, non farm payrolls have risen by 1.1% over the year to July and at an annual rate of 1.9% over the latest three month period. Only getting a 32,000 gain in payrolls in July was a disappointment given the expectations which had been raised but there is probably not enough other evidence through the door to change the prognosis.

Industrial production growth has shown a

FDI: Competing For A Share cont'd

strategy, but there are also several such as India, Korea and Thailand which have noticeably lower levels having sought to generate their development from internal funds.

The literature on foreign direct investment remains ambivalent about its benefits and costs with its impact tending to be uneven across countries.

In practice, the investment itself might not deliver attractive outcomes for the host country unless the host can take advantage of it through the right combination of domestic market institutions, favourable political culture and an entrepreneurial spirit which supports a broadening of the private sector.

Ironically, companies are likely to find countries more attractive the better able they are to extract the benefits from their investment to create a self-sustaining economic growth path. Contrary to much of the 1970s academic and political debate,

similar pattern to employment. Output has risen by 5.6% over the year to June and, with two months of the three in the June quarter being relatively strong, the quarterly annualized rate of improvement touched 6%.

Meanwhile, the pace of personal income growth remained at buoyant 6%+ rates. The increase of 6.2% over the year to June permitted a 5.7% rise in consumption spending as well as the first rise in household savings in a year.

Finally US business sales growth is hitting ten year record levels. Unfortunately, this series is not as timely as the others. Since it only takes us as far as May, we cannot use

the data to contradict or confirm the most recent signals being given by the employment data, for example.

Nonetheless, the strength of business sales has been so striking that one would have to factor in some deceleration in succeeding months. Some reduction in growth, therefore, might not be too serious and still consistent with an economy on a sustainable growth path.

there is little sense now that investments are being pursued to take advantage of weaker host nations.

These trends reinforce the basis of the

Stock of Foreign Direct Investment Selected Countries		
% of GDP	1990	2000
China	7.0	32.3
India	0.5	4.1
Korea	2.3	13.7
Malaysia	23.4	58.8
Thailand	9.6	20.0
Viet Nam	4.0	46.7

'China story' which has captivated many investors. In focusing on China, however, some sight is being lost of who is missing out and what that might be signaling about business conditions in those locations.

"Developing nations appear to have accepted that a market based system of capital allocation probably works best. This is by no means universally agreed....In part national governments have had little choice. None of the previous alternatives did the job for them."

US: STILL EXPANDING

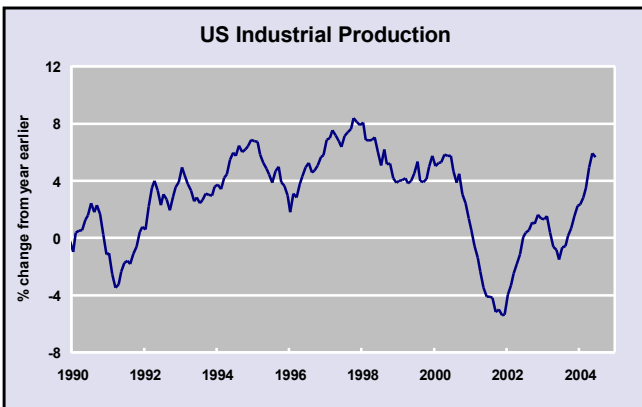
The flow of US economic statistics seems to have lost some of its lustre of late especially if the reaction of the US stock market is any guide. The balance of evidence seems to be pointing to an economy finding a more sustainable growth path and not one floundering.

When *thebigpicture* last reviewed the US economic condition at the beginning of April 2004, it concluded that the US economy was moving into the northern Spring with a bounce after having made heavy work of establishing a sustainable recovery during 2003.



Federal Reserve to lift interest rates aggressively. It would be able to maintain its “measured” approach to the task of set-

ting interest rates. Even something less than measured might be possible.



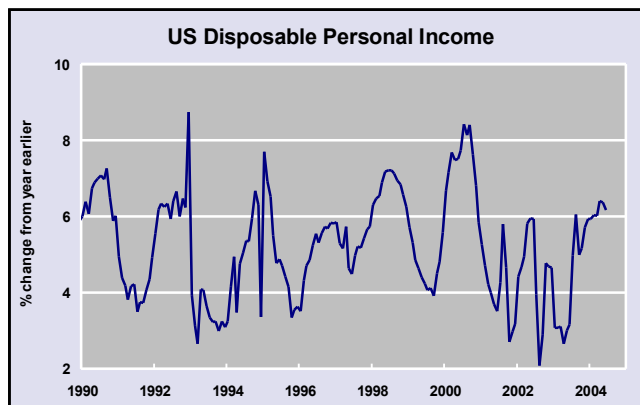
thebigpicture has been tracking the condition of the US economy using four guideposts:

- employment,
- industrial production,
- disposable income, and
- business sales.

These four indicators are consistent with the principal activity measures used by the National Bureau of Economic Research (NBER) as guides to the position of the US economy in the economic cycle. The NBER is the organization that officially defines

However, the momentum was so strong in some instances that it was not plausible for growth to remain so strong indefinitely. The best outcome would have been for some easing in growth to more sustainable rates. Expressed in terms of GDP growth this would imply deceleration from the 5% of the first quarter of 2004 toward 3%.

Such a slowdown would not be a cause for concern if it represented a possible ongoing rate of growth. It would be consistent with an expanding economy and with minimal inflation effects providing little incentive for the



whether the US economy has been in re-

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