



GENERALLY ACCESSIBLE

## Emerging Markets: Is Gold The New Tea?

LBMA, Berlin, 27<sup>th</sup> September, 2010

George Magnus, Senior Economic Adviser, UBS



## Tea Then, Gold Now

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Been around and used for centuries BC

Comes out of the ground

Used as means of payment and to reinforce status

Bathed in mystique, harbinger and signal of omens, major changes

Expensive, precious and highly valued by those (Europeans) that didn't have it

....but seriously....what explains the voracious demand for assets in EM, esp Asia, and what happens next?



1

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## EM Savings Boom

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- ◆ Effective demand for assets arises from wealth and savings accumulation
- ◆ Build-up in EM savings playing a significant role
- ◆ Largely concentrated in China, NIE's and fuel exporters
- ◆ A particular problem since 2002, ergo deliberate economic policies, and windfalls for oil exporters
- ◆ Growth drive vs 'slow-lane' financial products and services, asset gathering and investment
- ◆ Structural factors arising from the demographic dividend



2

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## It's Imbalances, and it's structural (U-PIGGY)

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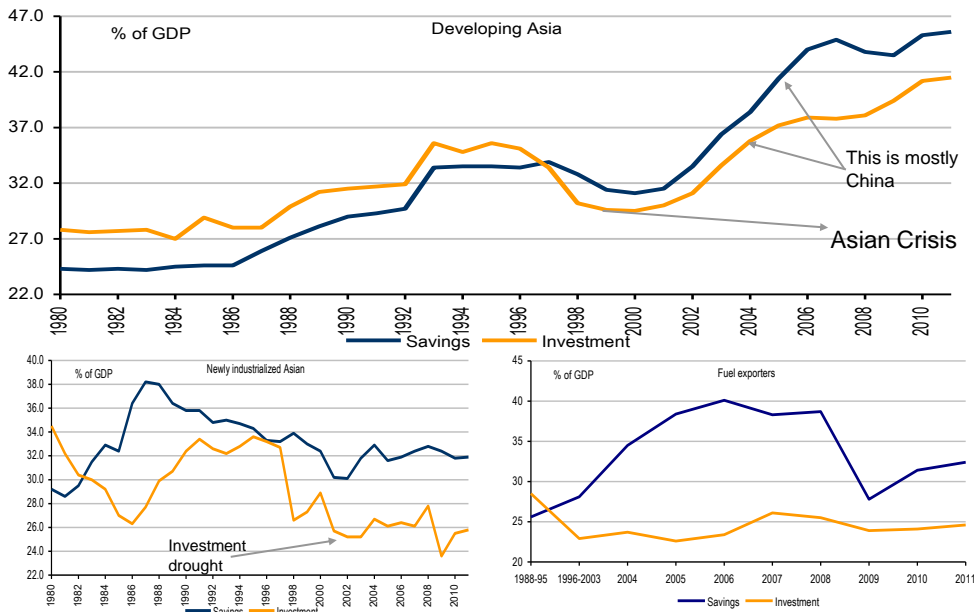
- ◆ Savings and Investment rates drive trade and capital flows that end up in assets
- ◆ But also determined by structural factors:
  - ◆ **U**rbanisation
  - ◆ **P**ublic spending (consumption vs investment)
  - ◆ **I**ndustry
  - ◆ **G**rowth
  - ◆ **G**DP per capita
  - ◆ **Y**outh and old age dependency



3

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## Savings and Investment Rates in EM

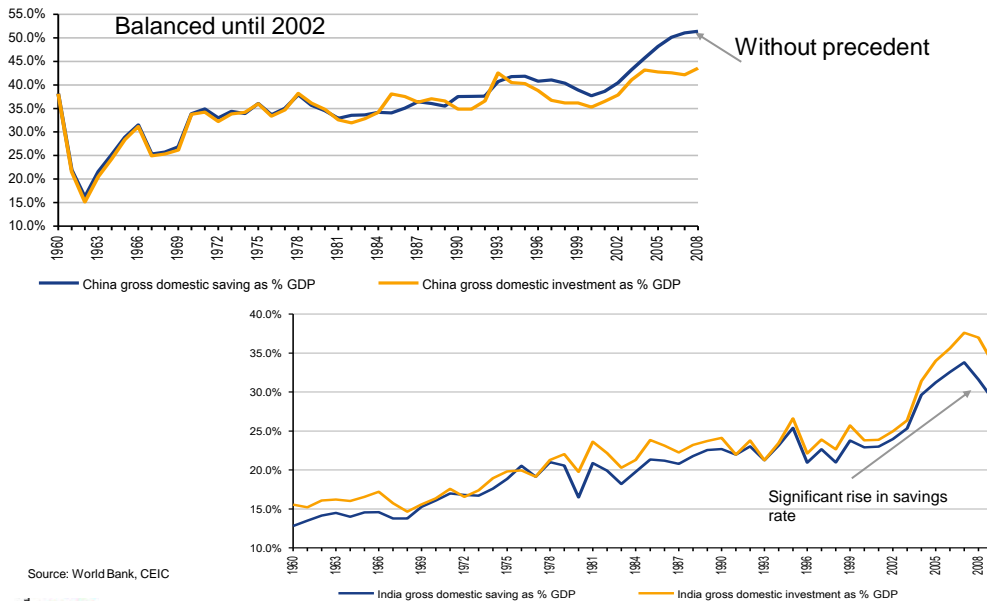


UBS Source: IMF, Haver

4

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## Savings and Investment Rates in China and India



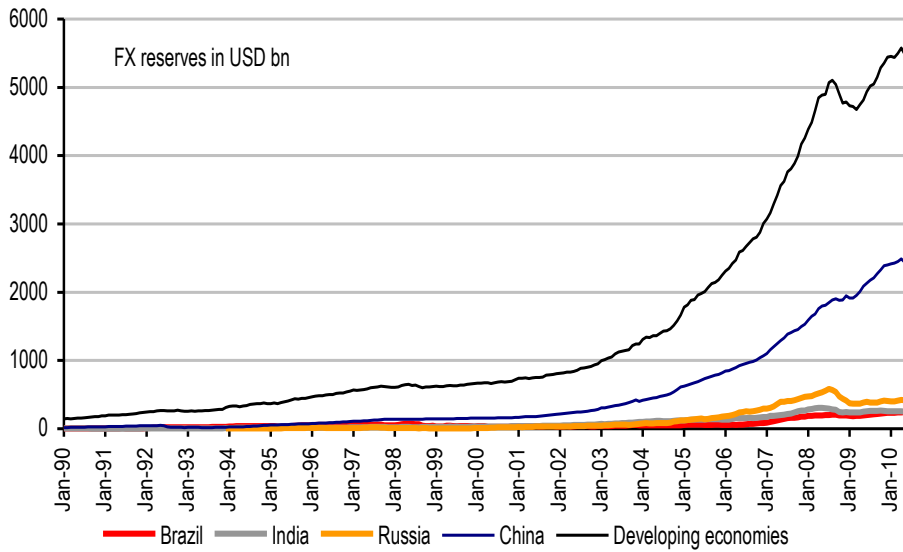
Source: World Bank, CEIC

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5

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## Saving Surpluses = Build-up in FX Reserves



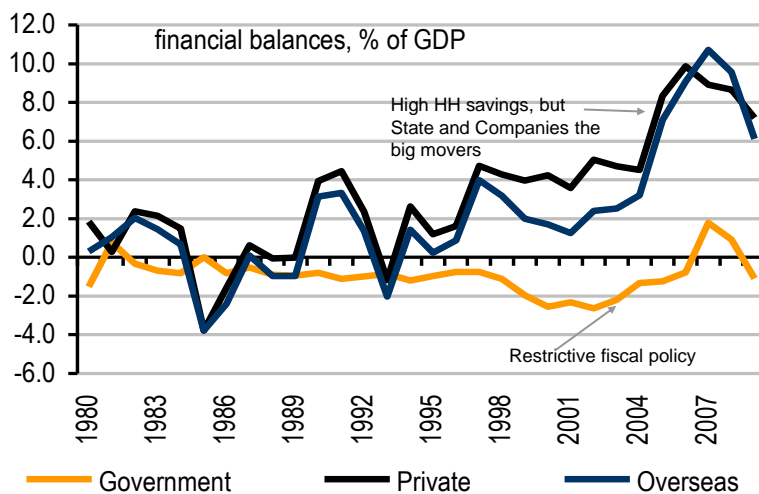
Source: IMF



6

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## China: Financial Balances



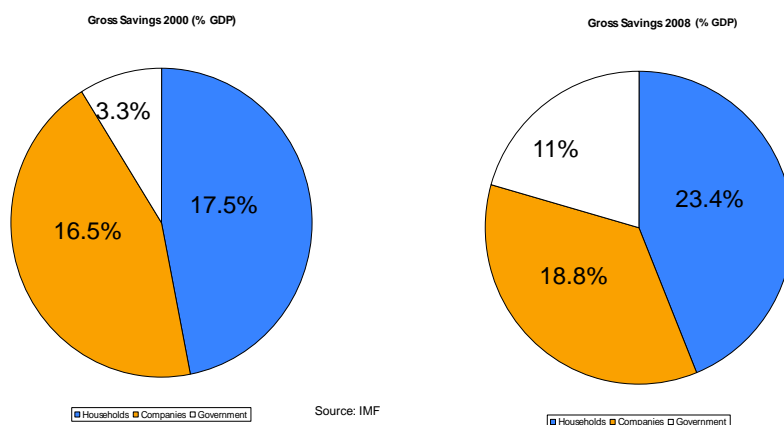
Source: IMF



7

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## China Gross Savings, 2000 and 2008



Total savings: 37.3% GDP to 53.2%, or +16%

The change on a par with Japan (55-70), Korea (83-00) and India (98-08)

The level is historically high, and each sector is relatively high

Accompanied by sustained external surpluses, ie. More than offsetting rising investment



8

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## What Accounts for the Boom in China's Savings?

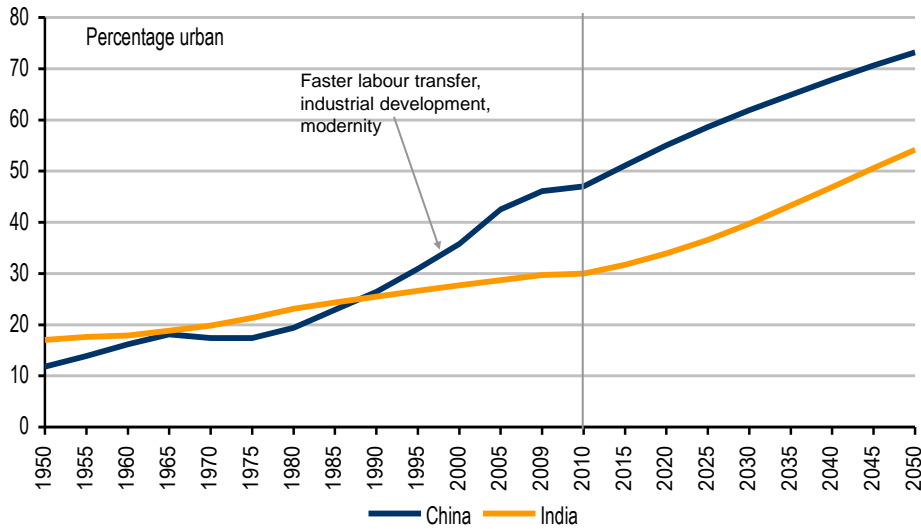
- ◆ *Non-demographic policies:*
  - ◆ Undervalued exchange rate and rigid fx regime
  - ◆ Corporate restructuring, and few residual claims on rising earnings (dividends)
  - ◆ Pension and social reform, weak soc sec
  - ◆ Government savings and investment
  - ◆ Private home ownership
- ◆ *Demographic factors:*
  - ◆ Fall in ag share of GDP (1980-08) of 20%
  - ◆ Equivalent gain in mfg, industry and services
  - ◆ Countryside left behind
  - ◆ Hukou (alien registration) system
  - ◆ Doubling of urban population share to 45%
  - ◆ Ageing: Fall in dependency ratio from 68% to 38% in one generation
  - ◆ Rise in WAP from 60% to 74%
  - ◆ One child policy



9

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## Urbanisation Rates, China and India



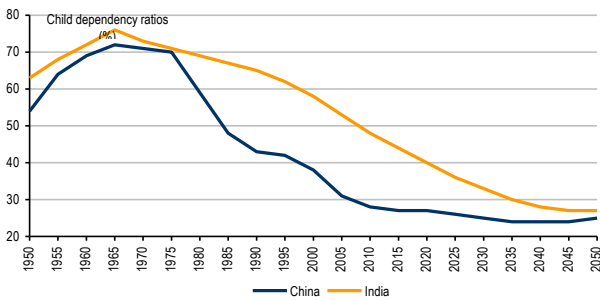
Source: UNPD



10

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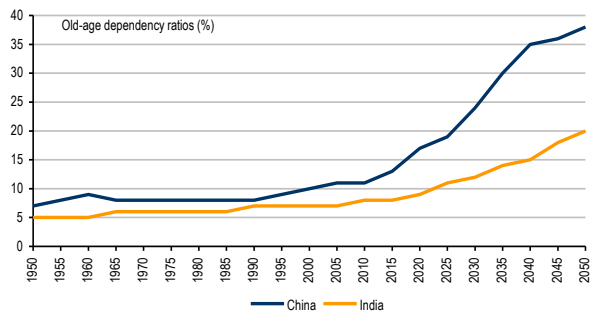
## China's demographic dividend passes to India



Source: UNPD

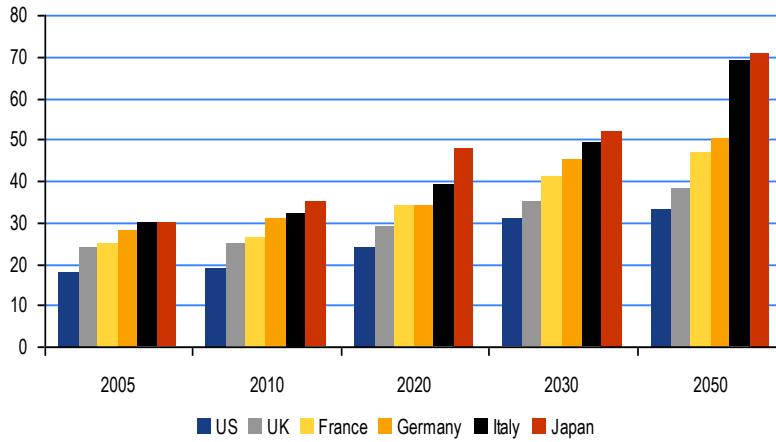


11



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## Old Age Dependency to Double in Advanced Economies



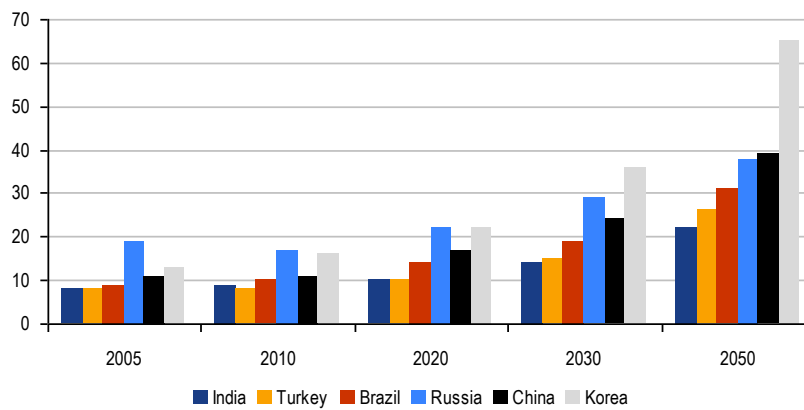
Source: UNPD



12

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## EM Old Age Dependency To Rise Sharply, Later



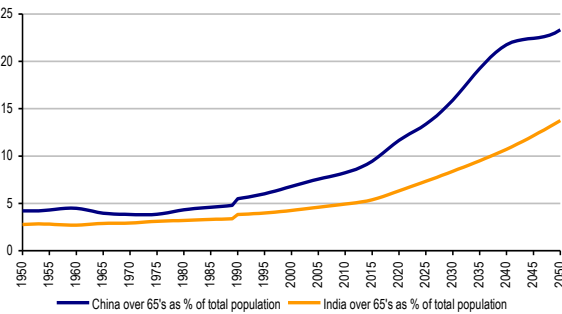
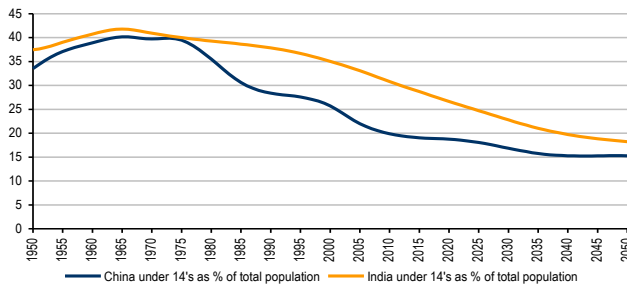
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13

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## Fast Ageing in China, India Still has a Window



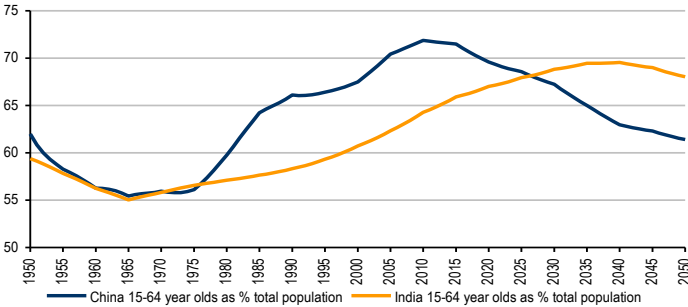
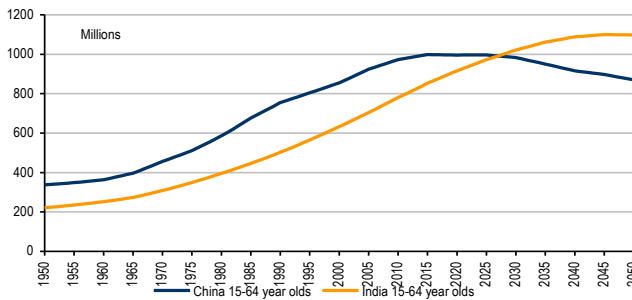
Source: UNPD



14

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## China's Workforce Will Contract, India's Expand



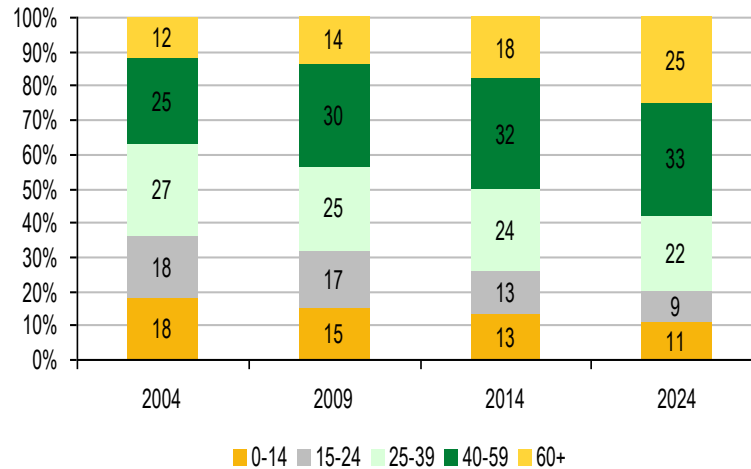
Source: UNPD



15

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## China's Ageing Population



Source: Globaldemographics



16

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## Savings are bound to start falling eventually.....

- ◆ Structural trends in economic structure and urbanisation tail off
- ◆ Shift to bigger consumption weight in economy, forced or voluntary
- ◆ Lewisian turning point, when mfg and urban wages take off
- ◆ Fall in corporate profits and savings
- ◆ Rapidly rising total and old age dependency ratio and younger WAP contraction as demographic dividend exhausted
- ◆ Widening of the social security net, as familial care and family enterprises fade
- ◆ Bigger government consumption to support growing demand for public services



17

## But Can The Global Economy Wait That Long?



In a global economic system, it takes two to tango: debtors and creditors

The debtors have been shocked into change, and the creditors have to follow

Risks: Failure of political leadership

Acrimonious trade and financial relations

Sovereign debt (US), Bubble and social risks (China)

Weak growth, de/in-fla-tion risks



All that glitters is....or is not....gold?