

# Cashing in on the consumption economy for Asia

## Keeping pace with the changing consumer

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It is a great pleasure to be here in Singapore today to speak about a revolution taking place in global finance. The repercussions of this upheaval in world money are flowing through the fabric of international capitalism as the creditor nations of the world – many of which are found in this region of eastern Asia – slowly but surely gain the upper hand. We are witnessing a gigantic shift in the East-West balance of financial and monetary power. But although the effect will be felt in many spheres, one of the most profound will be in the field I the field that we are discussing here today – retail banking. There will be plenty of change and opportunity, risk and reward. And I am convinced that far-reaching advances in technology and methodology of retail banking will be registered here that will act as a benchmark for other parts of the world too

The wider questions need to be put into historical context. The curtain has now come down comprehensively on a 500 year period of western domination of Asia that was ushered in with the first seaborne journey to India by the sailor-navigator Vasco da Gama in 1498 and found its symbolic conclusion with the relinquishing of British sovereignty over Hong Kong in 1999. As we ponder on he implications of the ending of this epochal period of half a millennium, I am going to talk to you about the impact of these changes in the sphere of retail banking taking into account prospects for consumer development across the region; optimal bank strategies to exploit growth in consumption; and methods of avoiding pitfalls in the new environment – many of them based on various setbacks that have afflicted European banks as they face similar challenges in the West. Furthermore, I will gaze into the crystal ball and attempt some predictions for the future.

### I

First, let me go back briefly to the historical dimension. We are now experiencing a reversion to patterns before the late 15<sup>th</sup> century, when Asia was the most important power on the world economic scene. Asia' demise went hand in hand with a decline in military power as first the Iberian countries embarked on a conquest of South America

and China turned inwards, catalysed by the curious way in which the Chinese Imperial navy gave up the ghost for reasons that still today appear mysterious. Then came the rise of the European powers, in particular in the century 1750-1850, fuelled later by the flowering of the Industrial Revolution, as Europe extended its footprint across Asia. After the second world war we saw renaissance of Asia, driven first by Japan and then by the tigers Hong Kong, Korea, Taiwan and Singapore, and then a new wave of tigers Malaysia, Thailand, Indonesia and the Philippines, In between came the slow rousing 30 years ago of the sleeping colossus China and then, during the 1990s, the reawakening of that most archetypal of all the slumbering giants, India.

The recent changes on the charts of world economic and finance have been mapped out as a result of the financial crisis that erupted in 2007-08. This is referred to as the global financial crisis out of deference to the West but in reality it was a trans-Atlantic financial crisis because its causes lay in the economies of the developed countries of Europe and the US and its full effects were mainly limited to these countries too. It is worth reflecting that Asia has not had a full-blown recession – it has had a growth correction. Asia has not suffered the fate of banks being brought to their knees – they have suffered side-effects as a result of perturbations elsewhere but they have stayed solvent, in contrast to the position in the West when banks have had to be rescued through infusion of vast quantities of cash and guarantees in government money – that is, funds from the taxpayers.

With one of two exceptions in the area of real estate, Asia did not have the speculative bubbles of the sort that we have seen in the US and also in the members of economic and monetary union in Europe (but also, it has to be said, in Britain, a non-EMU member). And all this has meant that, where stimulus measures have been applied in Asia to offset the contractionary forces of the past two years, their effects have flowed directly into the economy – into markets, into production and into infrastructure – rather than to shore up the edifice of failed or failing banks.

One of the reasons for these contrasting fortunes was that Asia fully learned the lessons from its own period of financial convulsion in 1997-98, when individual countries came close to financial collapse. Afterwards they did their homework by strengthening their economic structures to ward off the threat of further such mishaps. Thus started a slow move under which the creditor nations acquired increasing economic muscle. It will assuredly be from a position of strength that these countries face the future.

## II

Let us look now at the overall economic picture. The nations of developing Asia on which I would like to concentrate today make up more than half of the world's population - 3.6bn people out of a total 6.7bn. at present it is indubitably the emerging economies of the world – led by what we call developing Asia that are leading the world out of the phase of economic downturn. These countries made up one-fifth of world GDP

in 1950, they make up 28% now and are on the way to accounting for 50% by 2030. Underlining the pace of recovery, these countries will grow by 8.6% this year – their fastest growth rate for 20 years.

Let me briefly elucidate six points about the status quo.

First, although monetary policy in the West is still extraordinarily loose in reaction to the 2008-09 downturn, credit policy has been tightened across Asia in reaction to signs that fast expansion is creating inflationary pressures.

Second, Asia shows extraordinary reliance and power to shrug off political and economic setbacks. A case in point that exemplifies the robustness of the whole region is Thailand, which has shown immense ability to withstand the pressures of a variety of setbacks over the last decade - SARS, bird flu, a tsunami, a coup. Yellow shirts and red shirts and yet it is still growing strongly as if nothing remotely was wrong and all the right ingredients for fast economic expansion were in place.

Third, Asia is not suffering from the public debt burden which has risen to such a significant extent in the US and Europe as a result of the packages of measures to halt the last two years' economic decline.

Fourth, following the 1997-98 Asian crisis, the countries of the region have tightened their macro-economic and financial surveillance to improve stability and growth prospects. These measures, including a very importance hub being developed here in Singapore by the group of Asean plus Three (India, Japan and Korea) – form a significant area for improved economic coordination from which the West can learn.

Fifth, savings rates throughout the region are still very high, but in coming years as consumption picks up steam they will decline – a development that will have important repercussions for the West as this will reduce the flows of capital towards the US and Europe.

Sixth, China has enacted the biggest and fastest economic stimulus package the world has ever seen, mostly channelled into real estate and infrastructure, rather than consumption. The real estate bubble that has ensued adds up the most substantive blot on the horizon since this could end in either economic or political unrest and this would certainly act as a huge damper on world growth. The biggest test for the Chinese authorities will be to engineer a rebalancing of the economy away from bricks and mortar and export growth towards internal consumption. That way we may eventually see the rise of that much-vaunted figure: the Chinese consumer.

### III

Where will all this lead? I'd like to list now six broad trends to watch for the future.

First, when looking at the international ramifications of the rise of the Chinese economy, we can say that what used to be known as the Washington consensus – with regard to,

say, foreign investment and governance of economic arrangements with other countries – is being replaced by the Beijing consensus. In general, in Asia the image of capitalism has not been tarnished by the economic crisis – but the new models of capitalism as practised in different parts of the world such as Africa will have a much stronger Asian overlay than in the past.

Second, if we look at models of retail banking in the west and other industrialised economies, then I believe some of the models developed and carried out in places like Singapore will find application in other parts of the world.

Third, these Asian models of retail banking will witness an inflow of creativity and ideas. You will be attracting a cocktail of the brightest and best people that can act as an important catalyst for positive change.

Fourth, as you know, there has been a general reshaping of the regulatory landscape for banks, with a tightening of capital reserve requirements under the Basel III arrangements decided only last weekend. Some governments, regulatory authorities and financial institutions in emerging economies, and especially those outside the Group of Twenty, have been complaining that they are being unfairly treated by having to submit to a kind of collective punishment for crimes that they had not committed. However I do not believe that these countries' banks will be hit excessively hard by the new regime. Indeed, they may well sustain a competitive advantage as they emerge from the downturn in much better shape than rivals abroad.

Fifth, a lot has been said and written about the “too big to fail” syndrome in the banking world. Paradoxically, a phase of consolidation and concentration is now under way in world banking in which the stronger and bigger banks get bigger and stronger as a result of the competitive and regulatory changes now under way – and the smaller and even mid-sized ones become weaker and may well go to the wall. A “winner takes all” trend is clearly visible. So in a few years, and depending on when the next big mistakes are made in banking, we may well be back to “too big to fail” with a vengeance.

Sixth, we cannot ignore demographic changes. On present trends, India will take over from China in 2025 as the world's most populous country. Labour shortages are starting even now to make themselves felt in China. The country faces a dire picture regarding social security and pensions for a population that will be shrinking and ageing. Everyone admires what China has accomplished in the past 30 years. But I predict that the most exciting country to watch in coming decades will not be China but India.

#### IV

Where are we now in the present cycle? We have had a V-shaped recovery in both East and West – but the pace has been very different. In the West, the decline has been abrupt, the recovery hesitant. In the East, it's the other way around. Take Singapore, for example – GDP was down 2% last year, up 10% this year. Or Taiwan – down 2% last year, up 6%

this year. And China itself has steamed on, growing 9% in 2008, 10% in 2009, with the growth rate only slightly lower in 2010.

One of the biggest stories, with big repercussions on banks and banking, has been the diversification of trade and investment in the emerging economies towards more so-called “south-South” interrelationships in which western companies and western banks effectively become disintermediated.

One of the most important trends for developing Asia is the rise of the middle-class consumer. We are witnessing the rise of a new class of consumer who will have effects spreading out well beyond Asia. These people are the key to a rebalancing of economies away from exports and towards indigenous growth – and an area where retail banking will be of enormous importance. It is not an exaggeration to say that the dynamism of the Asian consumer will have similar results to the rise of the American middle-class in the 1950s period of post-war affluence.

According to a recent study by the Asian Development Bank, this category – defined in the fairly loose band of registering consumption of \$2- \$20 a day - now makes up 56% of the population in developing Asia (1.9bn people) compared with 21% in 1990 – and will grow to 75% by 2030. Consumption across the whole area will thus move up from only one-third of that in the OECD area to 43% of world-wide consumption by 2030. The overall figure for emerging Asia consumption will grow more than sevenfold from \$4.3tn in 2008 to \$32tn in 2030.

It is instructive to look at which countries have the biggest share of middle class consumer populations, as we can see here where the growth will be. The five countries with the largest shares at present are Malaysia, Thailand, Azerbaijan, Kazakhstan and Georgia. The five with the lowest shares are Bangladesh, Nepal, Laos, Uzbekistan and India.

Changes in the composition of consumption have an effect reaching well beyond purchases of electronic and electrical goods, or in booming sales of cars or mobile telephones. These shifts have strong repercussions on societies. There will be a transformation – just as there was in America and in other western countries – as a result of people moving into higher-paid and more sophisticated jobs with more security of tenure, better working conditions and stable benefits. And this will have repercussions in an area ranging from spending on higher education and travel and building up of financial cushions for pension benefits and elderly care.

What are the optimum strategies under which banks will meet the needs of this rapidly growing consumption economy and consumer society?

The dictum “know your customer” is immensely applicable here. Based on developments in the retail industry in Europe, banks will have to copy some of the tenets of large retail chains in tracking customers’ tastes and encouraging customer loyalty and “stickiness”

through various techniques and promotions. Retail firms have been greatly more innovative in these areas compared with banks, and banks would do well to copy them.

Banks will have to extend the range of services to meet changing lifestyles. Using the power of IT and telecommunications, this includes services to meet greater needs and aspirations in the field of foreign travel, education – both for the offspring but also for the parents as they undergo further training or “life-long learning” – consumer credit (including in the area of “green” technology and environmentally-friendly goods and services) , and in healthcare and benefits.

In the area of savings and investments, banks will be called upon to do much more than simply promote pensions planning. As people grow more wealthy and spend more of their time in leisure activities as well as in foreign travel (including that connected with their own or their children’s study abroad), retail banks will be asked to help plan not simply retirement but also each active decade in an individual’s developing life.

This will have a self-feeding effect as Asia’s banks spread across the world in support of their customers. For reasons of life-style and wealth, I see the rise in the next 20 years of the Asian ex-patriot in the same way as you in Asia have grown accustomed to the American, British or western expatriate (some with good characteristics, others less so) over the past couple of hundred years.

## V

Now let me gaze a little more deeply into the crystal ball. Here are 10 predictions for future developments that, I believe, will have an impact on retail banking not just here, but also in other parts of the world.

First, related to technology. Just as with high-speed trains, Asia will develop technologies in retail banking that will outstrip the west and will be imitated by other countries.

The second area is related to what I call integrated finance. Banks will have to offer their customers services on both sides of the balance sheet – credit and debit. Integrating these offerings – e.g. strong packages of personal loans and mortgage loans along with higher-yielding deposit facilities and personal investments in securities and funds – will add up to a powerful combination.

Third, there will be new types of corporate finance models for Asian banks. I am convinced that Asian currency bonds will undergo very strong development in coming years both because of growing demand for funds by corporate and public sector-backed borrowers in the region, and also because investors around the world are adjusting their asset allocation idea and diversifying into a greater range of currencies as a result of the separate anxieties that are weighing on the two main investment currencies, the dollar and the euro. Banks with a strong issuing activity in Asian bonds may be able to feed off their retail distribution network to provide very important investor support for their issuance – similar to the way that the German banks build up the D-Mark bond market in the 1980s

and gave a great fillip to their profitability at the same time as developing their own capital markets.

Fourth, I'd like to say a few brief words about investment banks. Chinese, Indian and other Asian institutions will assuredly be building up their own investment banking activities which will no longer have to rely on American names and American staffing to provide them with clients and with franchises. This is happening already. Asian banks are not too keen on the new-found (but old) American policy of separating retail and investment banking activities because they feel that their integrated banking model has done nothing wrong and breaking it up would bring a competitive disadvantage – which is why they are determined to stay as they are, and why I believe they will get their way.

Fifth, the international changes in capital ratios and reserve requirement will be, if anything, a competitive advantage for Asian banks.

Sixth, in regulation and surveillance, we are seeing a shift to more Asia-orientated activities, including in the Asean-inspired hub being constructed here in Singapore, which may eventually end up with an Asian-orientated IMF-type structure developing for the Asean countries.

Seventh, there will be takeover opportunities for retail and other banks herein Asia. The lesson from Europe- where there has been no thoroughgoing large-scale banking merger between France and Germany, despite these two countries sharing a common currency – is that you ignore at your peril cultural differences between companies that are being merged or taken over in this way.

Eighth, there is a strong link between progress in manufacturing – still an enormous area for Asia, even in relatively high-cost countries such as Singapore - and banking. The people who work in manufacturing are sophisticated employees who will be demanding more and better services from their banks – and hopefully getting them.

Ninth, all this means that the areas in which these banks will be operating will be environments of increased technical, financial and social sophistications – shifts that have implications for the constant upgrading in the services the banks offer.

Tenth, you must factor into the equation the typical Asian attributes of hard work, perseverance and dedication, and bring in too the Asian flair for successful intermingling of cultures. Then for Asian banks with strong brands, strong leadership and strong creativity – but those which at the same time stick to their customers, do not get carried away with all sorts of fancy tricks and products and keep their feet on the ground – all this will add up to a truly powerful, world-beating combination.