The Insight Bureau

Café Insights

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As part of the *Café Insights* series of interviews with inspiring speakers, The Insight Bureau recently caught up with Yuwa Hedrick-Wong, a highly-respected independent economist with over 25 years of experience as a global economist and business strategist.

AV: Hello and welcome to another in the series of Cafe Insights. I'm Andrew Vine, the CEO of The Insight Bureau and today I am in conversation with Dr. Yuwa Hedrick-Wong. Welcome back to Singapore again.

YHW: Thank you, nice being here.

AV: Yuwa is an independent global economist and business strategist. He is the Chief Economist with MasterCard Center for Inclusive Growth. It's great to see you back in Singapore. What brings you here this time?

YHW: Oh this time we are now in the final preparatory stage to launch a partnership with the Singapore Management University to conduct research in the region to look at inclusive growth and its potential and its impact and what it really means for the economic future for this very diverse and dynamic region.

AV: Terrific. Well while you were here I wanted to pounce on the opportunity, as I've done before, of your take on where we're heading in terms of the global economy. It has been a very tumultuous time, it's been one where we seem to have dodged a few bullets in terms of some disasters and we were just wondering really whether you feel that the worst is behind us now and we can enjoy a more stable, sustainable recovery in the global economy.

YHW: Well, I think there's no question that the worst is behind us, if we define the worst as being the immediate aftermath impact of the global financial crisis. But the second half of the question, are we going to return to some kind of stable, reliably set kind of recovery, I think that is not on the cards because since the crisis what we have seen is the global economy moving into a very different phase of evolution. It is moving in a direction that is diametrically opposite from the pre-crisis decade where, as we all know well, the abundance of easy money, credit created, the 'rising tides lifting all boats' phenomenon, emerging markets seem to be destined to emerge as well and hence you know I have been calling this future as a future of multi speed global economy. And so the overall premise that I hold is that the link that was so evident between the emerging markets and the developed economies and some have referred to it as the great convergence, fundamentally severed since the crisis. We cannot count on the same kind of relationship where strong growth in developed economies is necessarily followed by strong growth in the emerging markets. I think markets are very much on their own. We have to learn to examine markets through a different kind of lens to understand how they perform on their own as opposed to being lifted up by some kind of global trend.

AV: Well we'll return to that when we talk a little bit more about the emerging markets but before we do, I just wonder whether we really are out of the woods in terms of Europe. I mean with America, you were one of the first to actually point to a number of success factors that would be in the US economy's favour. The problems in Europe don't seem to have been solved yet.

YHW: No, not at all. I think Europe, or the Euro zone to be precise, has purchased temporary stability at a horrific cost, social, economic and political cost. The fundamental issue of how to resolve the need to transfer funds from the north of Euro zone to the south has not been resolved, both from the point of view of institution, the point of view of political economy, social consensus and so on. All these are hard work that is yet to be done. And the stability has been purchased by the bureaucrats, making a compromise, and to me it's a disastrous compromise that is strategically ineffective, that is costly, that is temporary and that is, they don't want to socialise the debt. Nor do they want contagion so they went half way. They would lend to the crisis countries at penalising interest rates with really severe demerits for austerity. That's what we ended up with today.

AV: Well you haven't been a proponent of austerity measures as a way of solving this problem. The US has been through a number of quantitative easing phases, is this what Europe needs?

YHW: Well, Europe needs growth fundamentally -- economic growth. And that is you know, in any debt crisis, the best way to get out of it is that you want to be able to sustain a reasonable economic growth but moderate inflation; that is the best of all possible combinations. Austerity satisfied in the Euro zone the demand of the north, what I call the 'Old Testament' mentality – you punish the sinful, right? Ok, so that will satisfy that the German electorates and the Bundesbank and so on. But the cost is horrific. It's a generational tragedy unfolding in front of our very eyes in the crisis countries. When you think of youth unemployment that is about 50% and this requires a decade long period to recover. So we are literally staring at the whole, you know the coming decade, it's a decade of repair, reconstruction, recovery. It's a lot of hard work ahead for the Euro zone. So the crisis is by no means over.

AV: So it's going to be a long drawn-out process

YHW: Very much so, yes

AV: The way people have been looking at the emerging markets has been interesting because you know, a few years ago, everyone was extremely bullish, in fact overly so, and had a tendency I think, to paint the emerging markets with one brush, which you've never been a fan of…

YHW: I have been rubbishing the BRIC concept for a long time!

AV: Exactly; what do you think we should be analysing each market in its own merit.

YHW: Well, to begin with, I think the developed economies themselves are dividing into different groupings. You have the US, which is an outstanding performer in the last few years since the crisis, in terms of the recovery, in terms of its ability; it really speaks volumes of its private sector's resilience and ability for regeneration because it has dysfunctional politics, let's face it, right? It's a dysfunctional government, politics is abysmal worst, yet the private sector can continue to power ahead. It's tremendous. So you have the U.S. literally stands alone. You have Japan; it's likely to be in stagnation for the foreseeable future. Then you have the Euro zone stuck in this long process of repairing all the damage, structural reforms yet to be done and so on. So from an emerging market universe perspective, suddenly we are not talking about there being a developed market universe out there that's pulling the emerging markets ahead. That's number one. Number two is that within the emerging markets if you look at the collapse of the commodities market, the collapse of the world price of oil, very quickly you can say the emerging markets should be divided into two camps; the exporters, those who are highly dependent on resources and energy exports and those who are actually importers of resources and energies; they benefit very differently in this environment. And then within the emerging markets there are the beneficiaries of the collapse of the commodities and oil prices. Again you can divide them into those who can generate inclusive growth and those who cannot. Because inclusive growth is a growth that can create the middle class, they can generate more domestic demand - consumption. Actually that's the new lens we need, to understand the emerging markets, this domestic demand which has two components, domestic investment and domestic consumption. When growth is more inclusive, these two components then work in a mutually reinforcing fashion. A virtuous circle can be set in motion. That's the key, I think, to understand the future of emerging markets.

AV: So when you look at the developing world, which are the examples of bright prospects from your inclusive growth analysis.

YHW: Now contrary to a lot of the media headlines that you may have seen about China to slow down, to me that's precisely the good news. That means China is rebalancing. China actually today has an investment-led slow down. So it's weaning its dependency on this investment-led model. Domestic consumption is gearing up, for the first time in the last two years. For the first time in thirty years, domestic consumption services are contributing more than half of overall economic growth. So that's a very, very encouraging sign and, that what a rebalanced China will look like; the head line GDP growth will be lower but the quality of growth would be higher. China will be importing more for domestic consumption on a per unit GDP basis as compared with the past. India has a very, very good chance if it can really tackle some of the tough structural reforms both in terms of labour market liberalisation, addressing its infrastructure deficit to have a very, very promising domestic consumption led growth story in the making. So I am quite bullish about that. Within a regional sub-Sahara Africa, for instance, it turns out a lot of non-commodity exporting, non-oil exporting countries are doing very well precisely because they can generate domestic demand. Growth is becoming more inclusive. In places like Ghana, in places like Ethiopia, for example, not in Angola, not in Zambia, not in Nigeria. So there are individual emerging markets that are really beginning to excel on the basis of domestic demand and of inclusive growth.

AV: You've just written about this in the latest GEMS Bellwether report which we will be circulating in the next week or so. I am just wondering, it seems to be a much more complex world for international companies to be operating in because you do need to pay much more particular attention to what is happening in individual markets as opposed to groups of markets. So I was wondering what kind of advice you have for the way international companies have to think about the world economy and the markets they are investing in.

YHW: Well, step number one is to really abandon the old paradigm. For the longest time a lot of global companies operated with grouping different countries, you know, in sort of different matrices high-growth, low-risk, high-potential and so on and so forth. Well, I don't think that would apply any more in the global economic environment. What we need is really independent, individual country analysis. I think the new lens to understand countries and markets in this environment is domestic demand. Interestingly enough, Tolstoy famously said -- *All happy families tend to be happy because of the same reasons whereas unhappy families tend to have very specific reasons for being unhappy, different specific reasons.* I think the same applies; countries that can get domestic demand right seem to have same sort of configurations of policies and conditions. As I said, growth has to be inclusive, the middle class has to expand, people tend to be optimistic, therefore the consumer market is creating new opportunities for new business investments -- a virtuous circle of domestic consumption and investment. But, for the unhappy families of the emerging markets, they all have different reasons for failure and that's where the complexity sets in, so we need a deeper country specific insights going forward.

AV: We have just seen oil prices at the lowest level they have been for many years. Is this good news for the world economy or is it really indicative of some pretty serious demand deficiency?

YHW: Well, I think, overall, it *is* good news because there is a massive income transfer would occur in world price of oil compared with the peak just over a year ago it is about $3 trillion a year in income transfer from the oil producing countries to the oil importing countries. Especially in non emerging markets the benefits extend beyond just consumption because the balance of payments position is strengthened as a result, which would reduce currency volatility with all the benefits that comes with such stability. So, actually the downside for me is over the longer term, the current extremely low price of oil is going to hurt investment in the alternatives. To me, that's the downside. Effective tax policies, to be honest, could then remedy this but there's not a hope in hell we could see that happen. By that I mean, governments should say, you know, we will actually put a tax on oil consumption. If the world price of oil is below, say $70 per barrel, we will tax it up to $70 but the tax revenues earmarked for alternative investment or research, but that's not going to happen. So it's going to hurt, the alternative development. I think, to be honest, that is precisely the strategy of Saudi Arabia. Their cost of production remains above $5 per barrel. So they are actually killing many birds with one stone.

AV: You are generally optimistic, I think, in terms of the way you view the world but I wonder what are the things that worry you, that keep you awake as we turn into 2015, you know, what could spoil our day.

YHW: Well, a number of things, you know, I think within say time horizon of next 12 years could really rock the global economy. If there's another eruption, a major eruption of crisis in the Euro zone, which could happen, so I think the market in pricing more or less are this massive quantitative easing by the European Central Bank and should the European central Bank disappoint the market, there will be a chaotic unwinding of all sorts of positions and that will not be, *cannot* be easily contained within Europe. And so that is number one. Number two is, I do worry about Russia. Russia is a declining power and it is at the most dangerous phase of its decline. It still has enough muscle to do something to try to arrest the decline and so they are prepared to take risks. And they want to take risk before it is too late. So we are actually in a very dangerous zone, as it were. That being said, I think there's quite a number of potential upsides as well, you must mention those. Closer to home here in southeast Asia, the ASEAN Economic Community (AEC) and we can factor in all sorts of delays -- foot-dragging -- which is unavoidable, will mean a very, very profound transformation of this region.

AV: And the delays are acceptable because the direction is in the right way.

YHW: Exactly. But also they are managing the integration this time, the ASEAN, are managing it in a very pragmatic fashion, and there are long checklists that they go through and review every year for all the member countries. So I am quite impressed with their approach and I really think that the potential benefit is massive for the region.

AV: Well thank you very much indeed for spending a little bit of time with us today. We will look forward to seeing again through the year.

YHW: Thank you Andrew, pleasure is always mine.