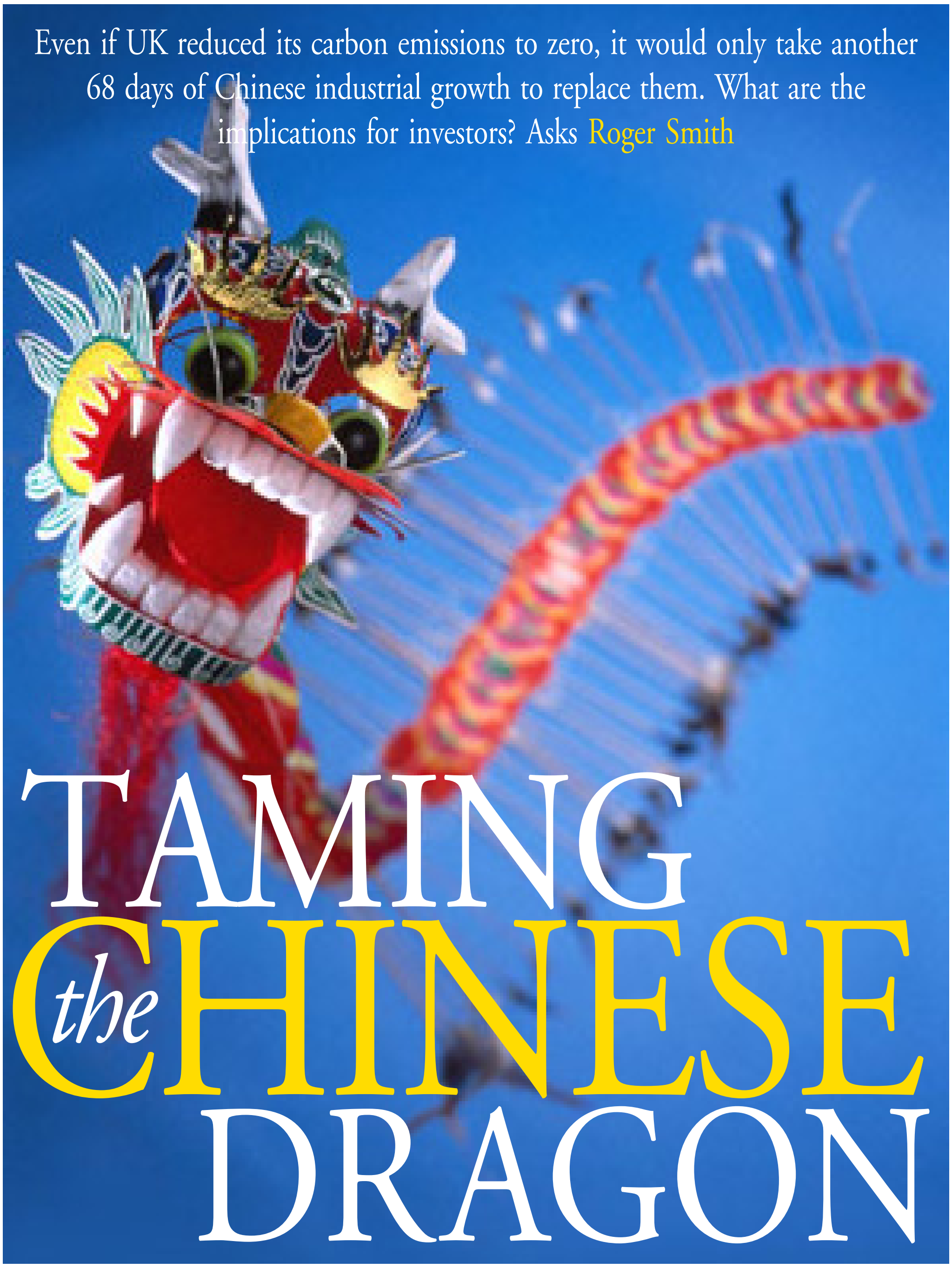


TAMING *the* CHINESE DRAGON

Even if UK reduced its carbon emissions to zero, it would only take another 68 days of Chinese industrial growth to replace them. What are the implications for investors? Asks Roger Smith

If you have seen the remarkable film by Al Gore (who used to known as "the man who was going to be the next President of the United States") you may wonder if we can do anything to save our planet. Indeed, the Liberal Democrat Council of Richmond on Thames has already caused its residents to focus on the issue of vehicle pollution and downsizing.

Whatever we achieve to reduce carbon emissions in the UK, the matter is largely out of our hands. Yet, the great industrial powers, the USA and now China, can make a real impact.

The emerging giant

I have invested in Asia since 1979 for clients and have watched an incredible story emerge. We are on the verge of "a massive transfer of wealth from West to East" says Marc Faber, the legendary professional investor. In his recent newsletter, *The Gloom Boom* and *Doom Report*, I gleamed a great deal. Europe has seen virtually no increase in income per capita over the past 20 years while the Chinese figure has doubled every decade over the past 25 years.

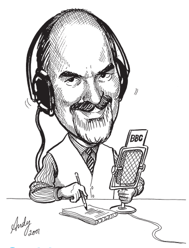
A backward economy like China, he asserts, can industrialise faster than a mature one like the USA. China's dependence on the USA is diminishing as Asia grows. China is developing new commercial friends in Latin America and Africa, new exclusive sources of all important oil from Sudan and Nigeria. The Asian region as a whole is becoming less export dependent on the USA and if the USA goes into recession more US industry could be outsourced to Asia to compete.

Then there is the population of 3.6bn compared to 300m just achieved in the USA. It could take China 50 years, says Marc Faber to become the world's leading economic power. It is difficult for my generation of post war baby boomers to imagine a world where the USA is not, like the Romans in their day, totally dominant. China is much more resilient to a global downturn as it has massive foreign exchange reserves (US$960bn) and no debt, unlike the USA, with massive debt (US$800bn). The two superpowers have become uncomfortable bedfellows as China lends it surplus current account reserves to USA. Any default would stop its flow of interest payments and cause an international dollar crisis.

Commodities look good

The rise of Asia bodes well for commodities investors. Agricultural commodities may be cheap, but will be needed in huge quantities as wealth increases. The temporary fall in oil prices may be just that, as China currently uses 1.7 barrels of oil per head as against the USA's 27 barrels of oil per head per day. Metal prices are set to rise with 84% of Chinese car buyers being first time buyers! As global confidence declines in the dollar so gold will be in demand again.

The Chinese growth rate last year was 9.9% against an expected 8% and this year it is running at 11% so far. The forecast slowdown has not happened. Many new companies



Smith: an inconvenient truth

are coming to the market and previously non-tradable shares are being made available. Three million graduates are joining the job market each year. It has raised the lending rate to avoid the economy overheating. Its currency, the Renminbi or Yuan, now un-pegged from the dollar link since July, long held down so their exporters had a competitive advantage. China's intention, as far as one can see, is to let its currency strengthen gradually. Since July it has been quite volatile, signalling that its central bank will not be pushed by anyone and "the currency is not a one way bet" says *The Economist* (September 2006).

A state pension surplus

China is embracing our world in more ways than one. The latest news is that it has asked two US fund managers to manage its state pension fund of $30bn(!). We haven't even got a state pension fund, let alone one in surplus! Today's UK pensioners are paid for by workers and employers from *current* National Insurance receipts, leaving nothing for the future! Perhaps we should follow the Chinese example and create a state pension fund and let the stock market growth pay for some of our future liabilities?

Spend now, pay later

Chinese consumer debt offers an interesting insight. There have been calls in China to ban the promotion of credit cards to students who are getting into debt with the Government claiming parents are often left to shoulder the burden of their children's over exuberant consumption – sounds familiar?

Chinese students polled by the Dragondata China Consumer Financial Sentiment Report 2006 thought it was unreasonable to owe more than 1000 renminbi (US$125or £67). How our offspring could learn from the Chinese! Yet the banks offer them credit limits of as much as 20,000 Yuan (US$2500). No change there then! Workers by contrast were happy with debt of no more than 4000 Yuan (US$500). Females had higher debt than males: *plus ça change*…!

But *times are a changin'*, China's richest entrepreneur is the world's richest self-made woman, Zhang Yin. She started her waste paper business in 1985 with 30,000 Yuan enduring "financial hardship, cheating business partners and intimidation from local mobsters" according to the *Daily Telegraph 13 October 2006.* In 1990 she moved to Los Angeles and created America Chung Nan, now the leading exporter of paper in the USA, with the aim of recycling waste into packaging for the Chinese consumer goods sector. Her company Nine Dragons Paper was listed on the Hong Kong stock market in March and the *Hurun Report* Rich List puts her personal fortune at $3.4bn.

China is once again becoming a great economic power. While we all enjoy cheap imports, it is at a cost. Just as we must come to terms with its might, the Chinese must heed our warnings on global warming or else its great economic dream will suffer from a ruined planet.

Convenient smoke screen

The UK government's multiple tax raising initiatives: (Council tax up 300% for better off neighbourhoods, higher road taxes, road tolls and new tax to fly penalties on top of excessive petrol duty and airport tax are being cynically introduced as green tax measures. Yet the new Stern 700 page Report on Global Warming, also conveniently calling for increased taxes on the non complaining British worker, is a smokescreen (sorry, carbon emission). We are being manipulated to think, with apologies to George Orwell's *Animal Farm,* green taxes good, other taxes bad (but necessary – sorry!).

Even if the UK reduced its carbon emissions to zero it would only take another 68 days of Chinese industrial growth to replace them! (source: BBC Radio 4, 21 October 2006). It makes Richmond's effort look honourable but futile until the Chinese dragon is tamed!

Finally, something else to mull over…

"Men only go bad once they are rich ; women have to go bad to get rich" old Chinese proverb (*The Sunday Times)*

The views expressed are those of the author and not of Foster Denovo Ltd. Sources: Money Week 13 October 2006, BBC Radio 4 and Dragondata 3 October 2006. ❖

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