Economic and Investment Review

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Prudential Corporation Asia
November 2004

Key messages

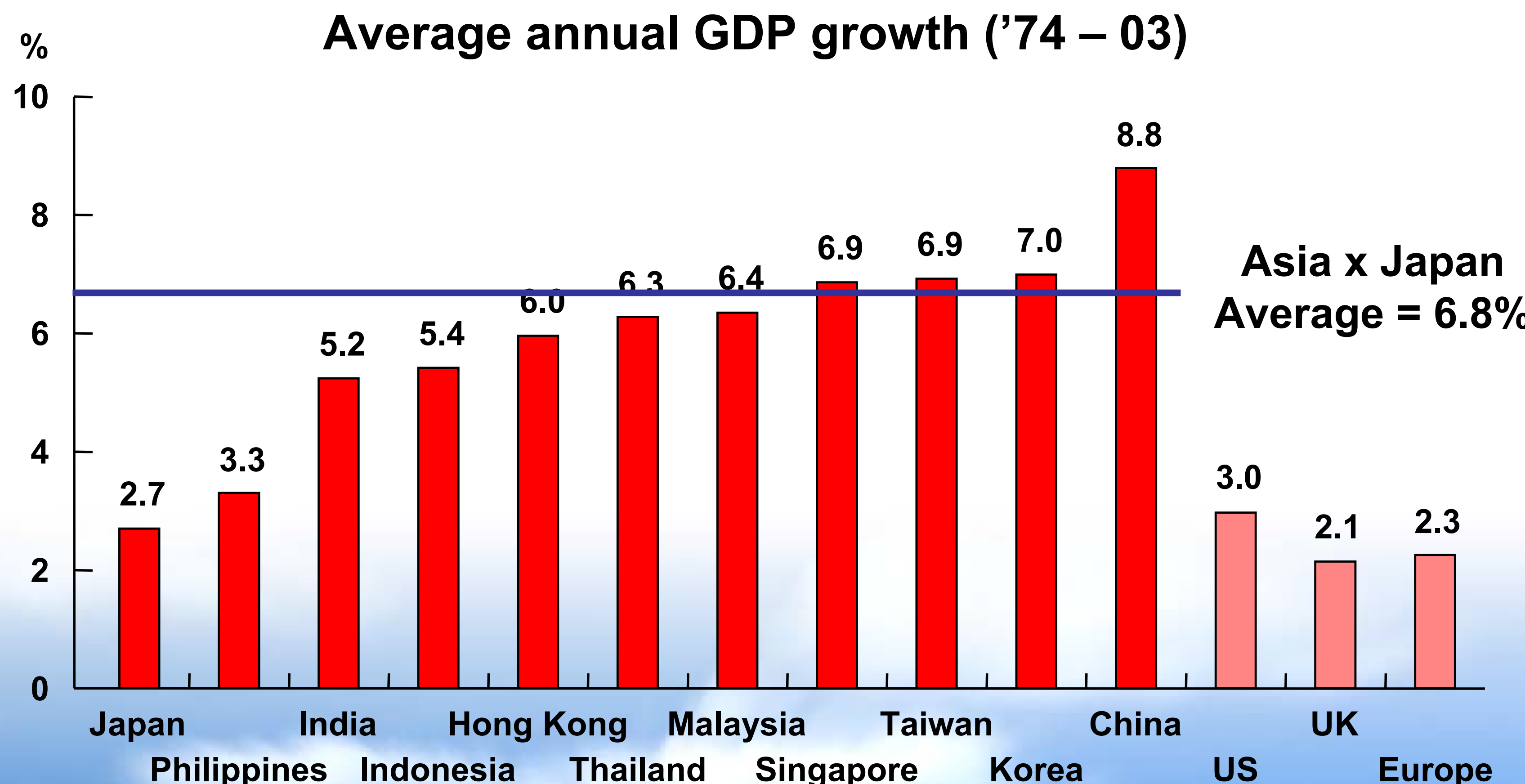
- Asia saves enormous amounts of capital and is fast becoming the world's provider of credit
- This has huge implications and opportunities for financial markets and Prudential
- These themes are playing out in Asia's new powerhouses, China and India

Asia's Massive Savings

"piggy bank economics"

Asia enjoys sustainable high levels of growth

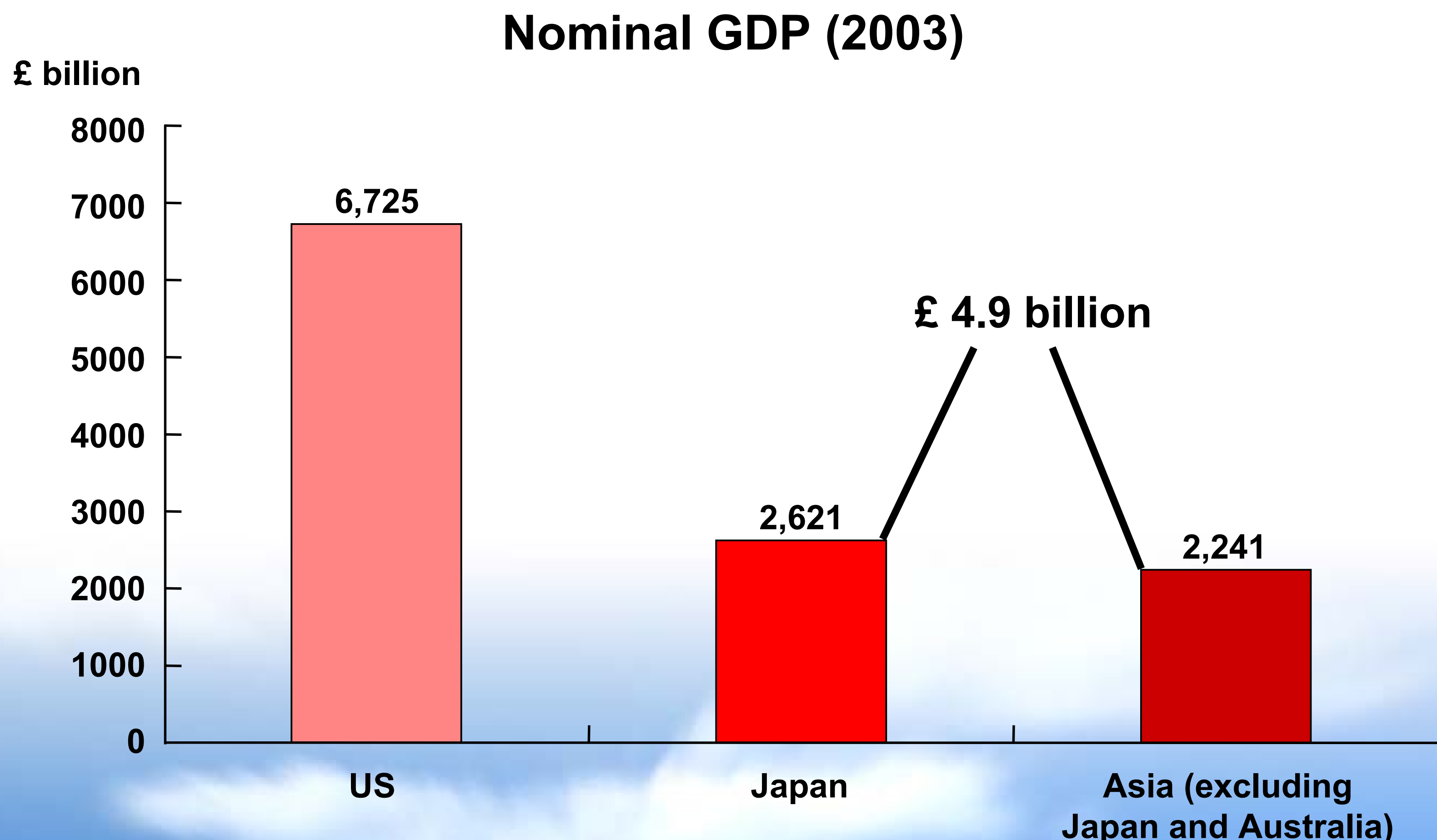
Asia has weathered many crises in past 30 years and has still seen average GDP growth rates twice as high as the US or Europe



Source : UBS, CEIC and Datastream

Asia now generates significant income annually

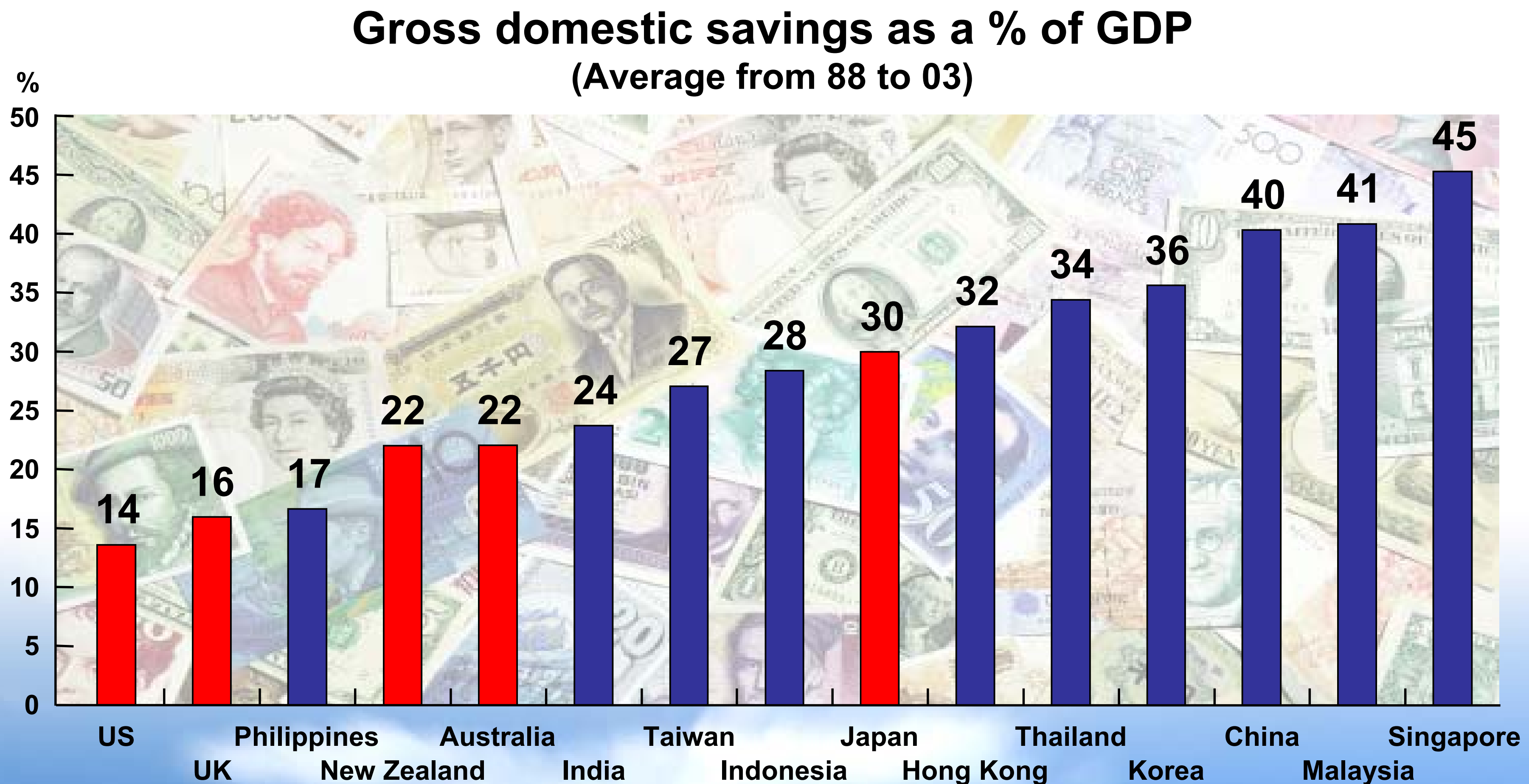
The rapid growth means that together Japan and Asia now generate 2/3 of the amount of annual wealth of the US



Source : UBS, CEIC and Datastream

Asians save nearly a third of this income every year

Asian saves on average 31% of its annual income, more that twice as much as in the US where the savings rate is 14%



Source : Datastream, CEIC and UBS

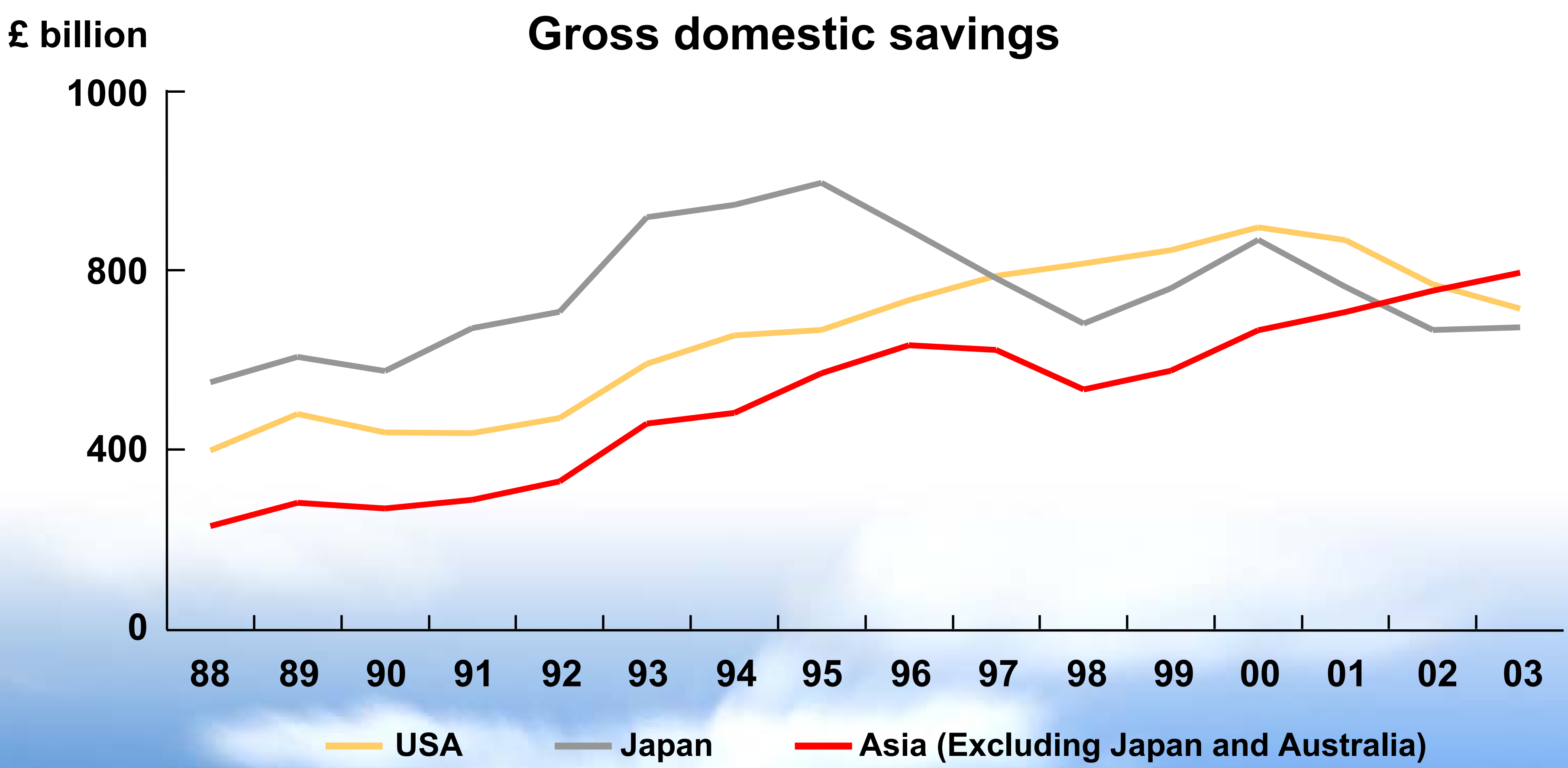
This propensity to save seems to be structural

The following potential drivers behind this trend suggest high savings will continue to be a feature in Asia

- **Cultural inclination to save reinforced by**
  - Limited social security
  - “Scare” of the Asian Crisis
  - Young populations
  - Large diversity in wealth with lots of people aspiring to be rich
- **Rapid urbanisation**
  - Shift away from poor rural farming economy
  - Breakdown of traditional, local family support groups
- **Increasingly educated population**
  - Higher numbers skilled workers
  - Growing middle class

Asia's annual savings now exceed the US

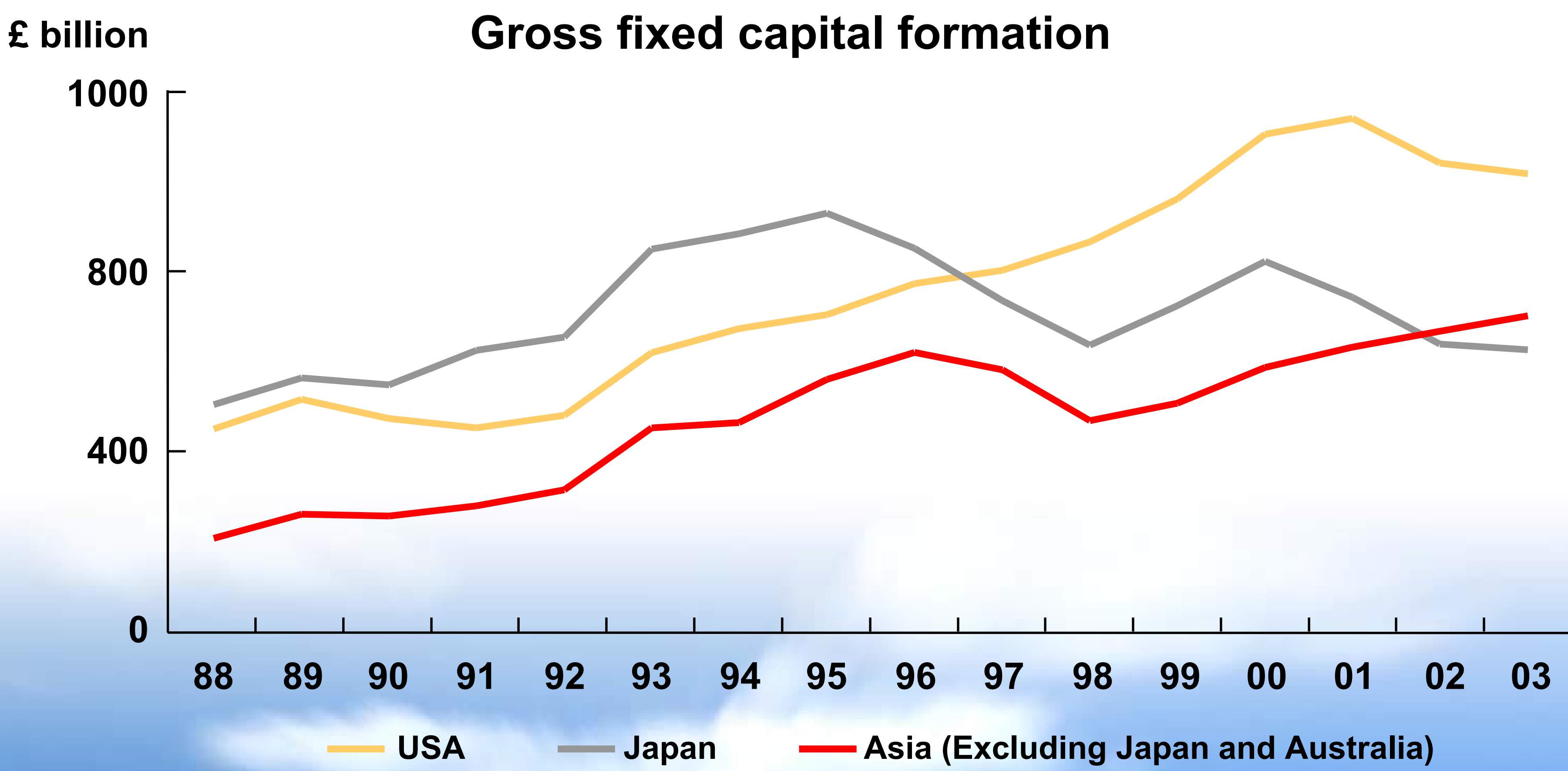
At £800 billion, Asia (ex-Japan) annual savings have risen nearly fourfold since 1988 and are now larger than the US or Japan, where the trend is declining



Source : Datastream, CEIC and UBS

Asia also has a huge investment demand for capital

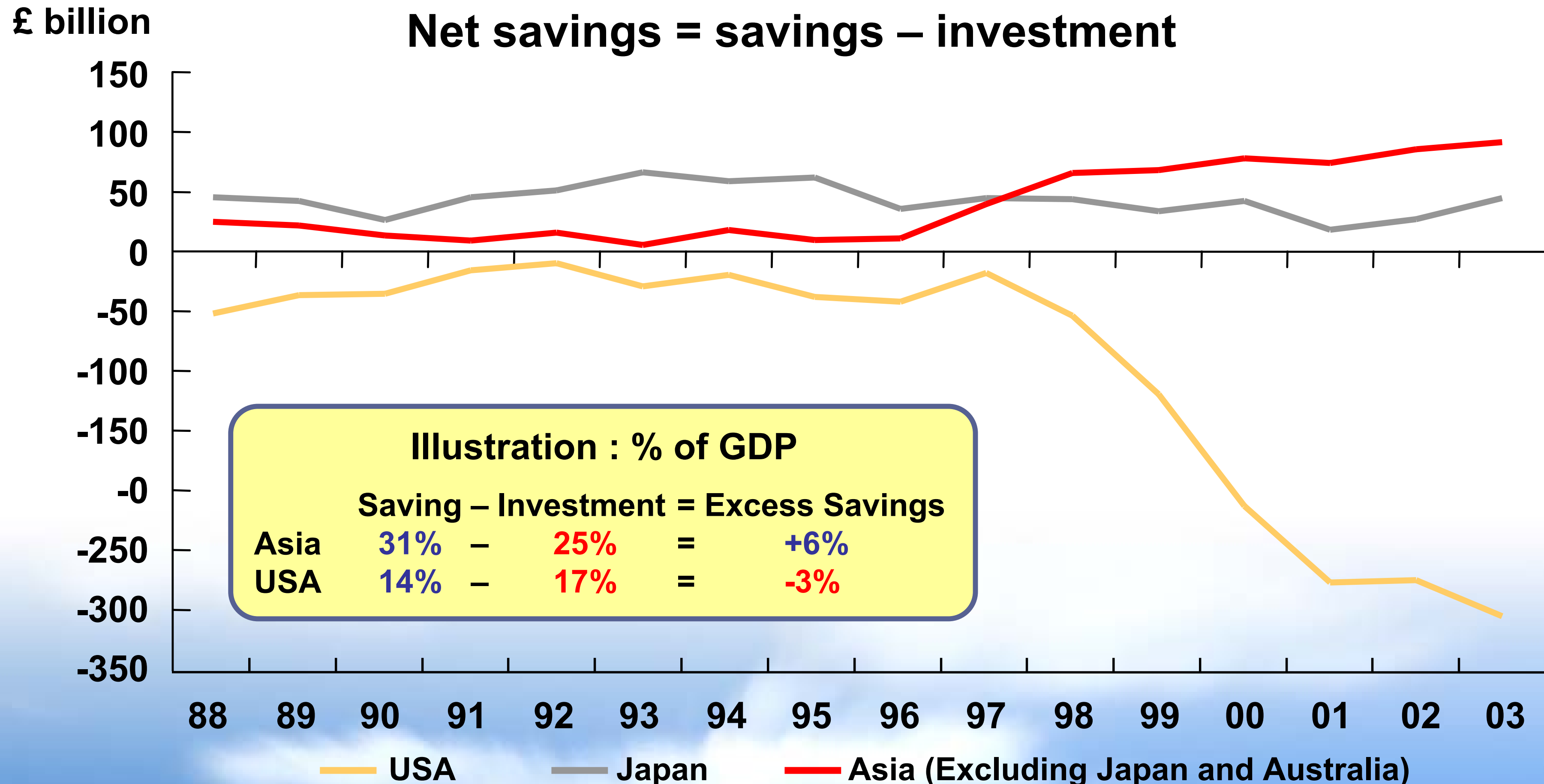
With £700 billion of annual investments, Asia will soon surpass the US as the worlds largest user of capital



Source : Datastream, CEIC and UBS

Unlike the US, Asia is able to fund its own investment

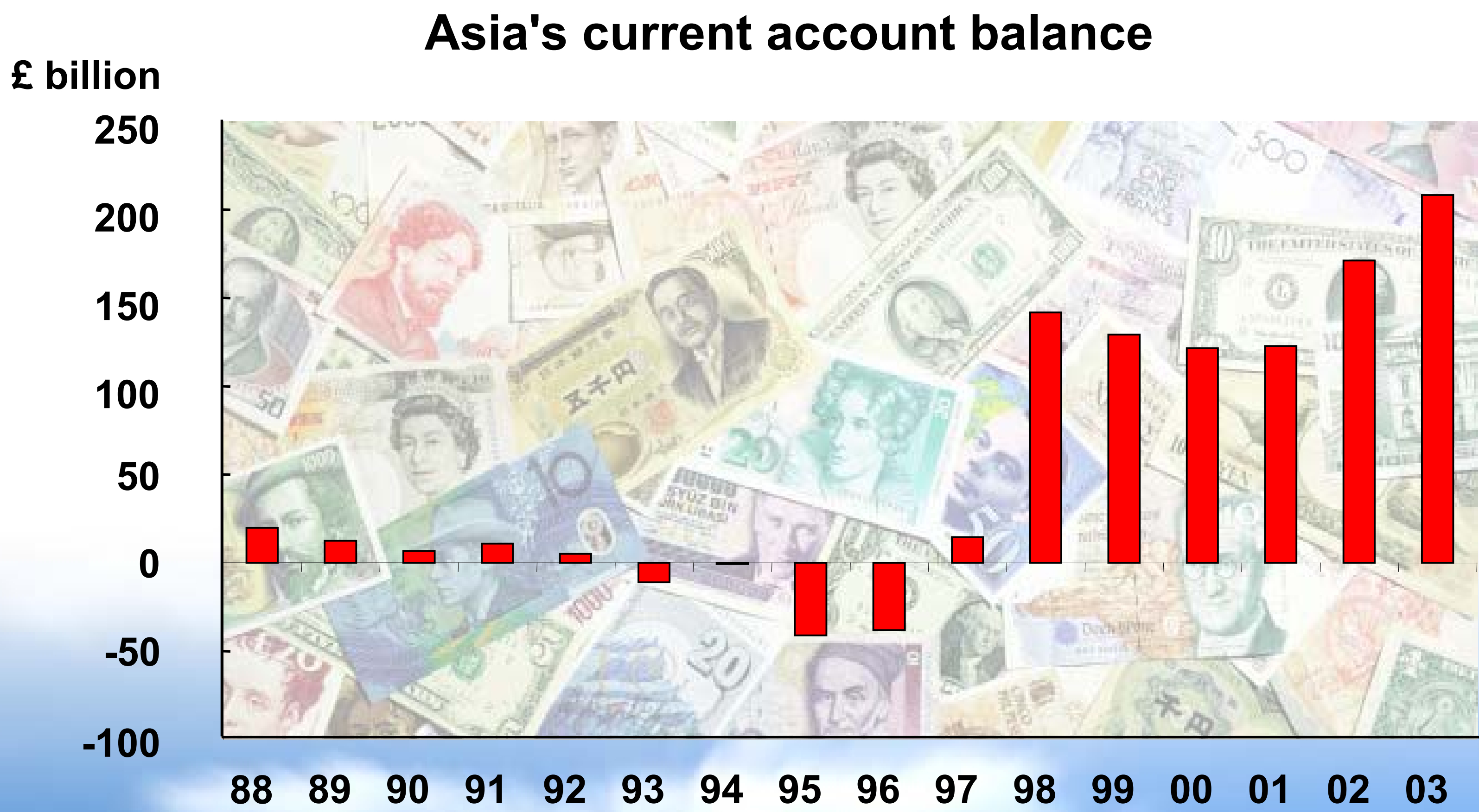
Asia saves £100 billion annually more than it needs for investment resulting in "excess savings", in sharp contrast to the picture in the US



Source : Datastream, CEIC and UBS

In fact, Asia is becoming the worlds largest creditor

Asia's current account (CA) surplus is clear evidence of the "excess savings" which at £200 billion p.a. means Asia is now the largest creditor to the world

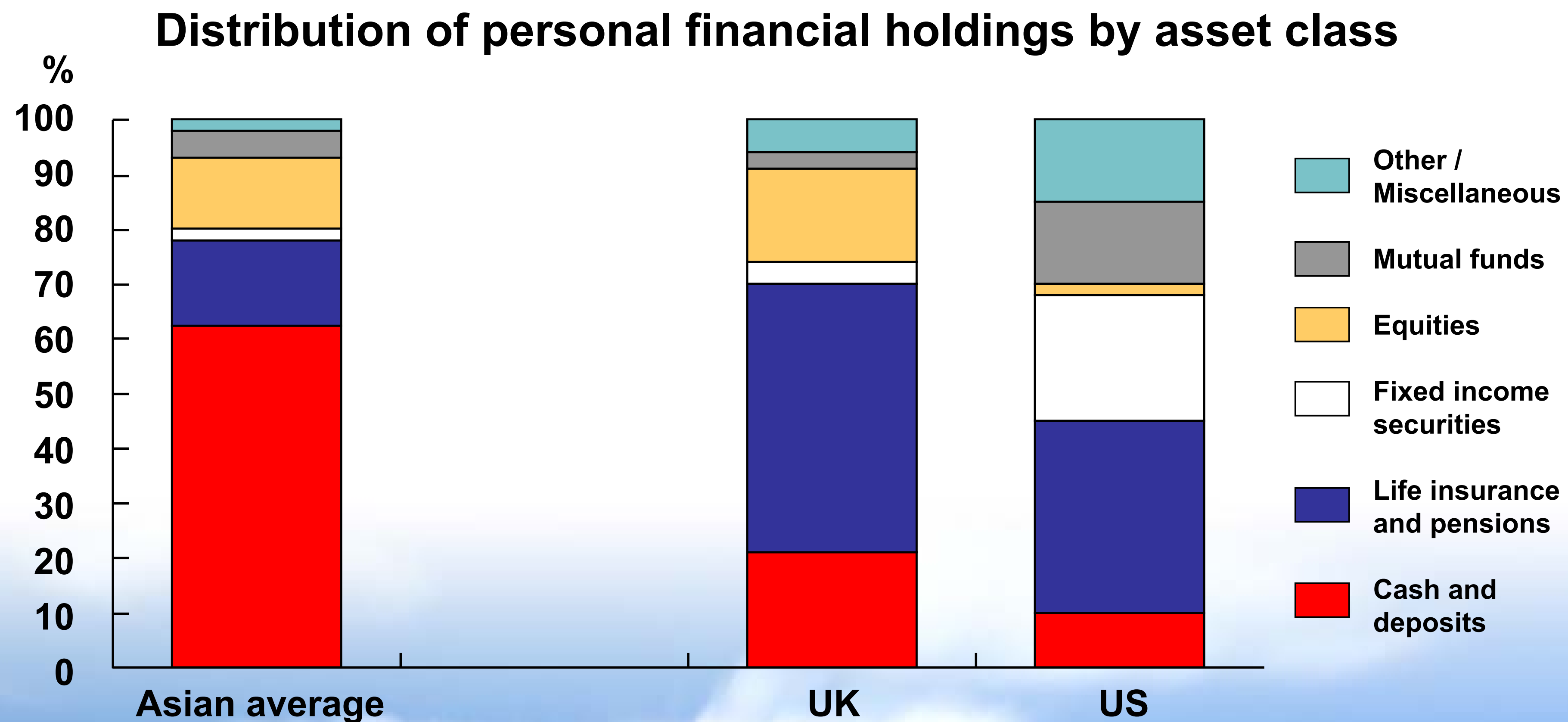


Source : UBS

Excess savings searching for a home

Asia's savings have not been invested efficiently

Most personal savings in Asia remain in low returning bank deposits



Source : Marakon in 02

Note : Asian average = simple average, not GDP weighted

Government policies may have distorted savings

Historically, several factors may have be preventing Asia's savings from being allocated efficiently to the highest returning investments

"Savings distortions" may result from two main factors

- **Government guarantees eg :**
  - Post Office savings Japan
  - CPF in Singapore
- **Monies trapped onshore due to capital controls eg :**
  - Malaysia, Taiwan and China

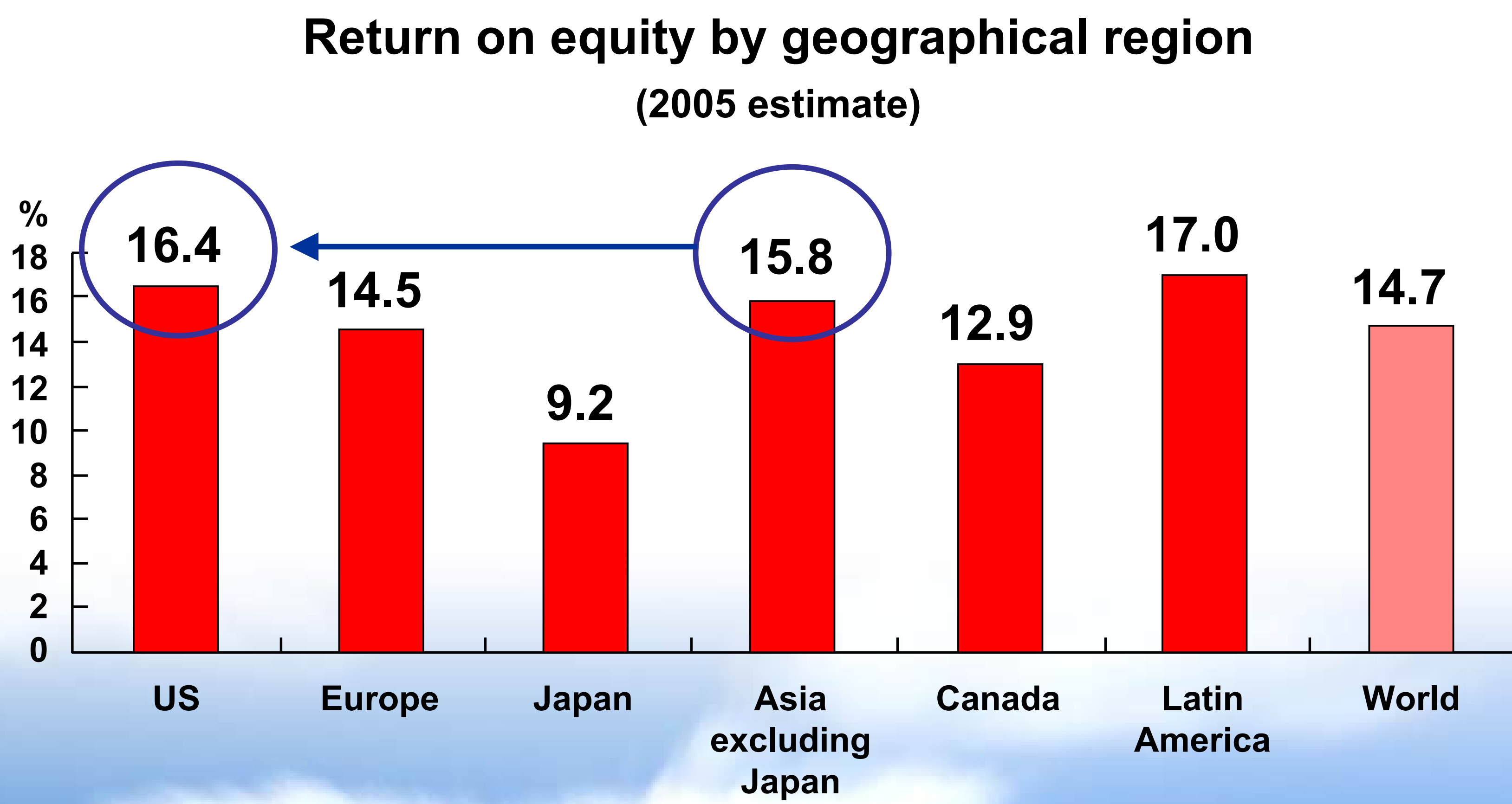
Deregulations and liberalization are improving capital efficiency

Recent moves to liberalise savings and investment restrictions in Asia will lead to more efficient capital allocation, creating opportunities

- **Privatisation of post offices Japan (eventually?)**
- **Privatisation of banks in Korea and Singapore**
- **Lifting of capital controls in Taiwan and Singapore**
- **Creation of MPF in Hong Kong**
- **Privatisations in India**
- **Foreign licenses for financial institutions in China**
- **Securitisation laws in several countries**

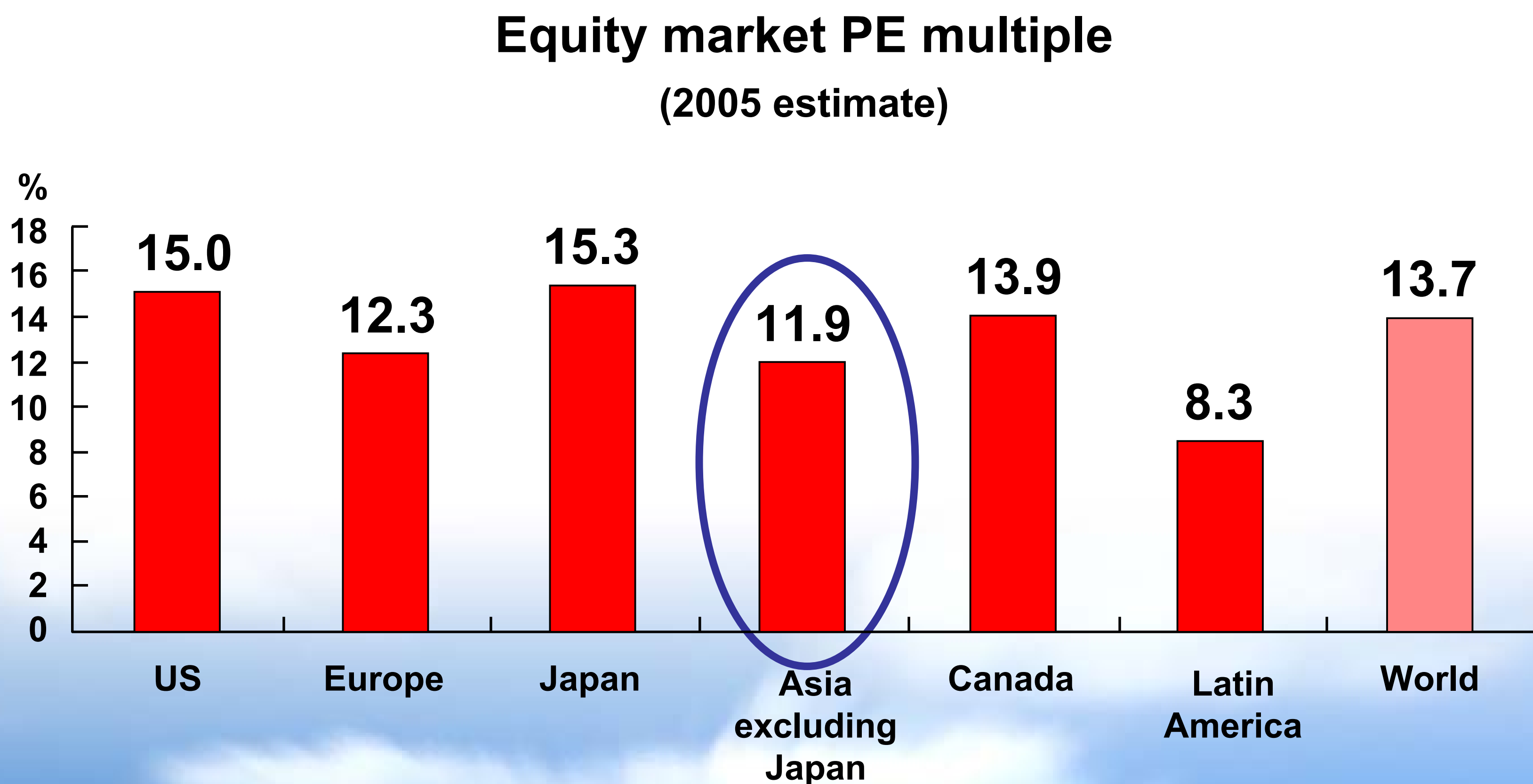
Higher returns on equity are a tangible sign of this

Asian companies are now generating similar returns on equity as in the US



This creates opportunities for Asian equity investors

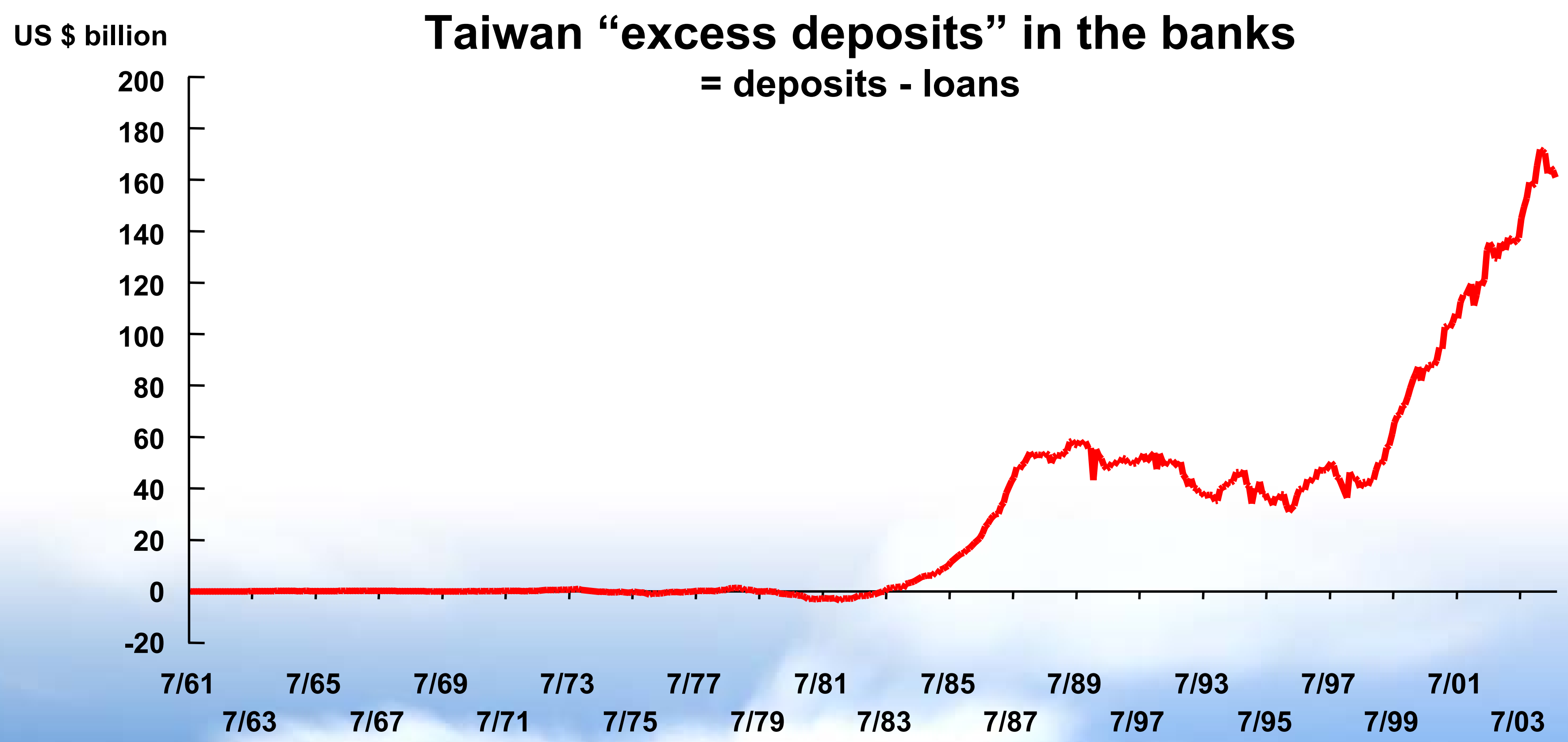
Despite the improved ROE, earnings multiples for Asian equities are amongst the lowest in the world as investors remain reluctant to fully price in this improvement



Source : UBS

Excess savings stuck in banks also creates opportunities

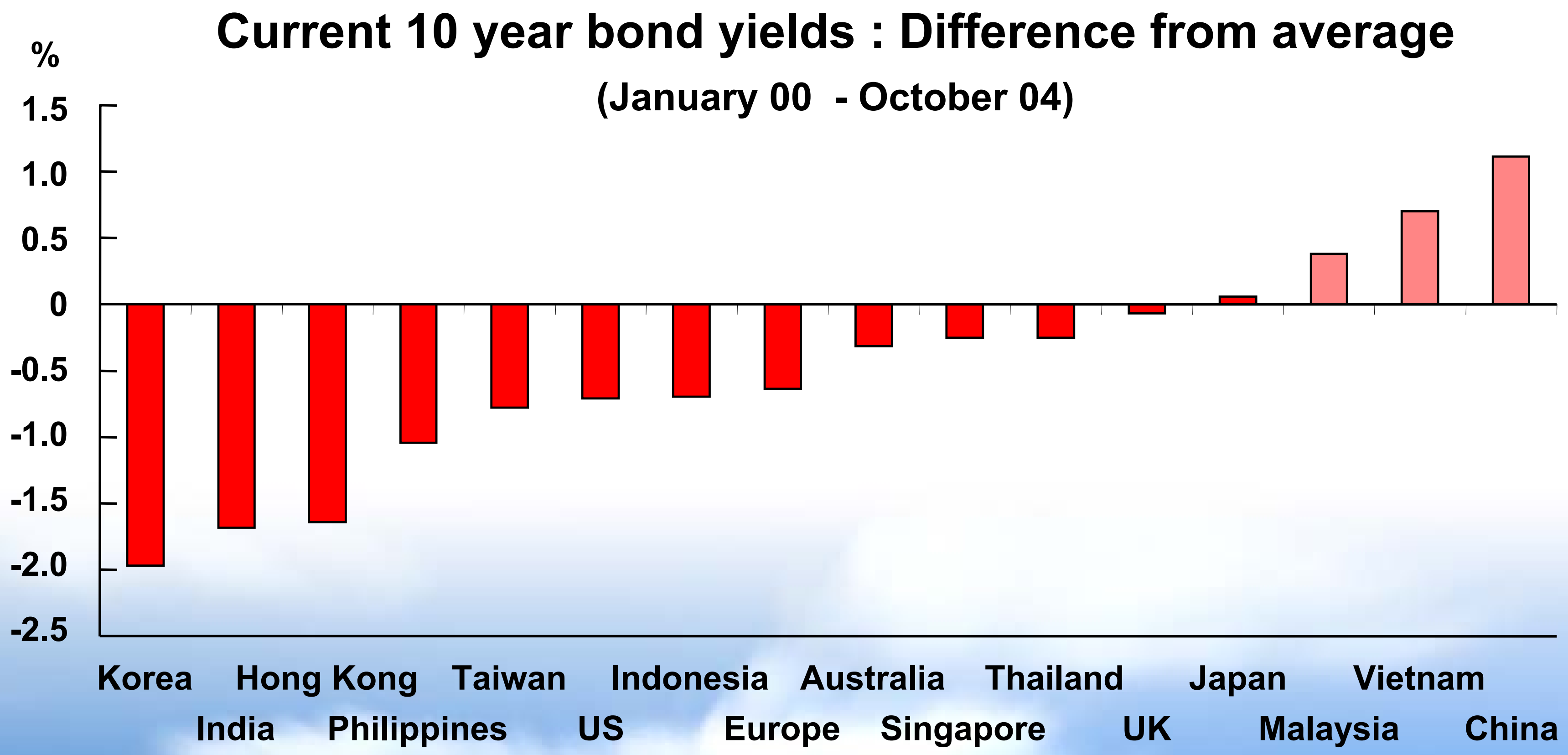
Even where loan growth accelerates, banks are unable to on lend all of these excess savings and must park the cash in the bond market



Source : Datastream, CEIC and UBS

This excess bank liquidity may be depressing bond yields

Global bond yields are significantly below recent averages, creating opportunities to benefit from rising bond yields as this excess liquidity gets withdrawn from the banks and more efficiently invested (into equities) or spent



Source : Prudential, Bloomberg

China and India : Emerging giants

Why are China and India so important to Prudential?

- **The potential for growth in financial services is enormous**
- **Sustainable growth leads to higher incomes and purchase of financial products**
- **Strong growth in China and India spurs growth in the rest of Asia**
- **We are very well placed with successful operations in both markets**

China

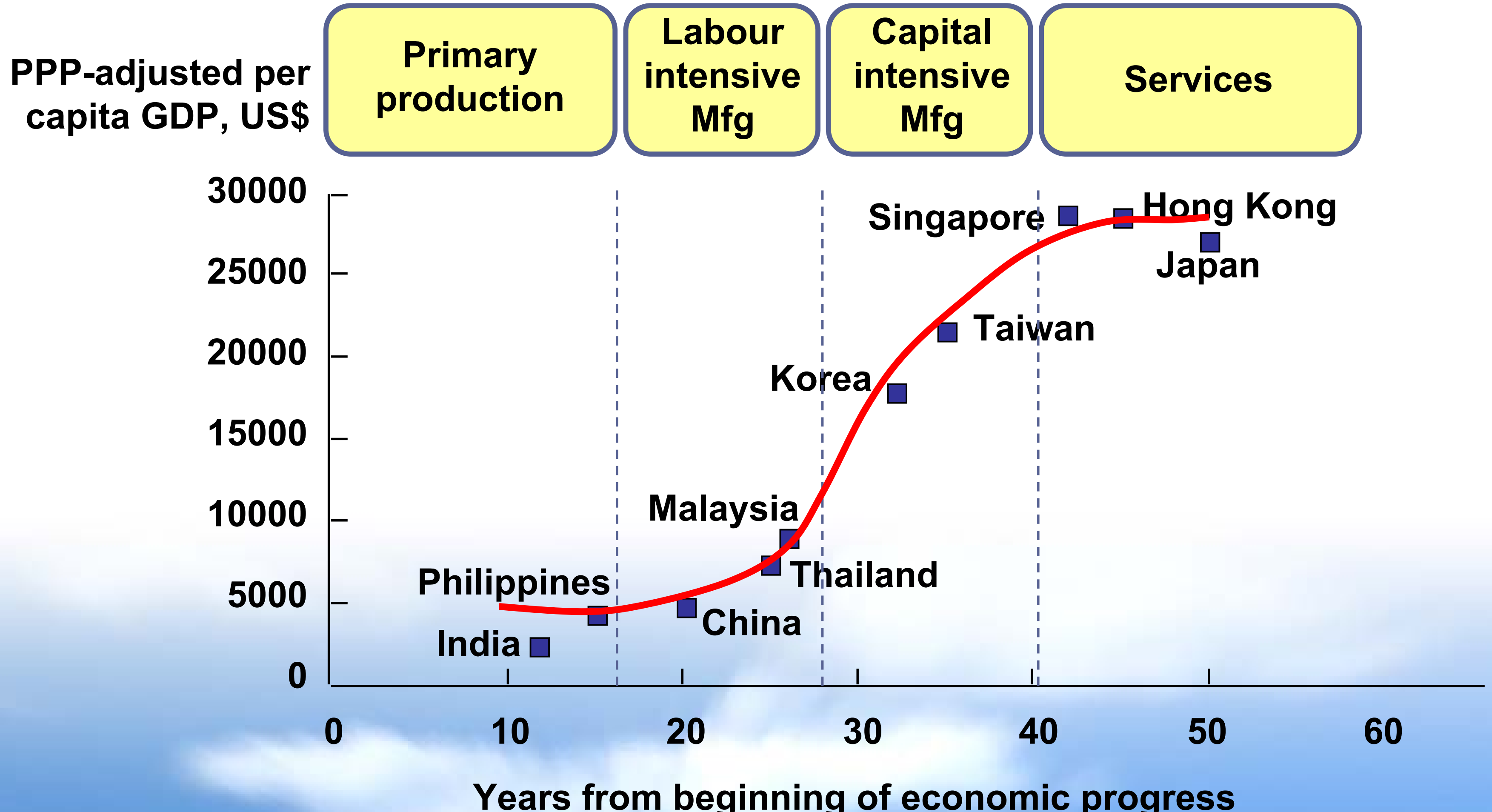
Will the move towards a market economy improve the quality of growth?

India

Will India grow above historic trends are reach full potential?

S-curve for income growth in Asia

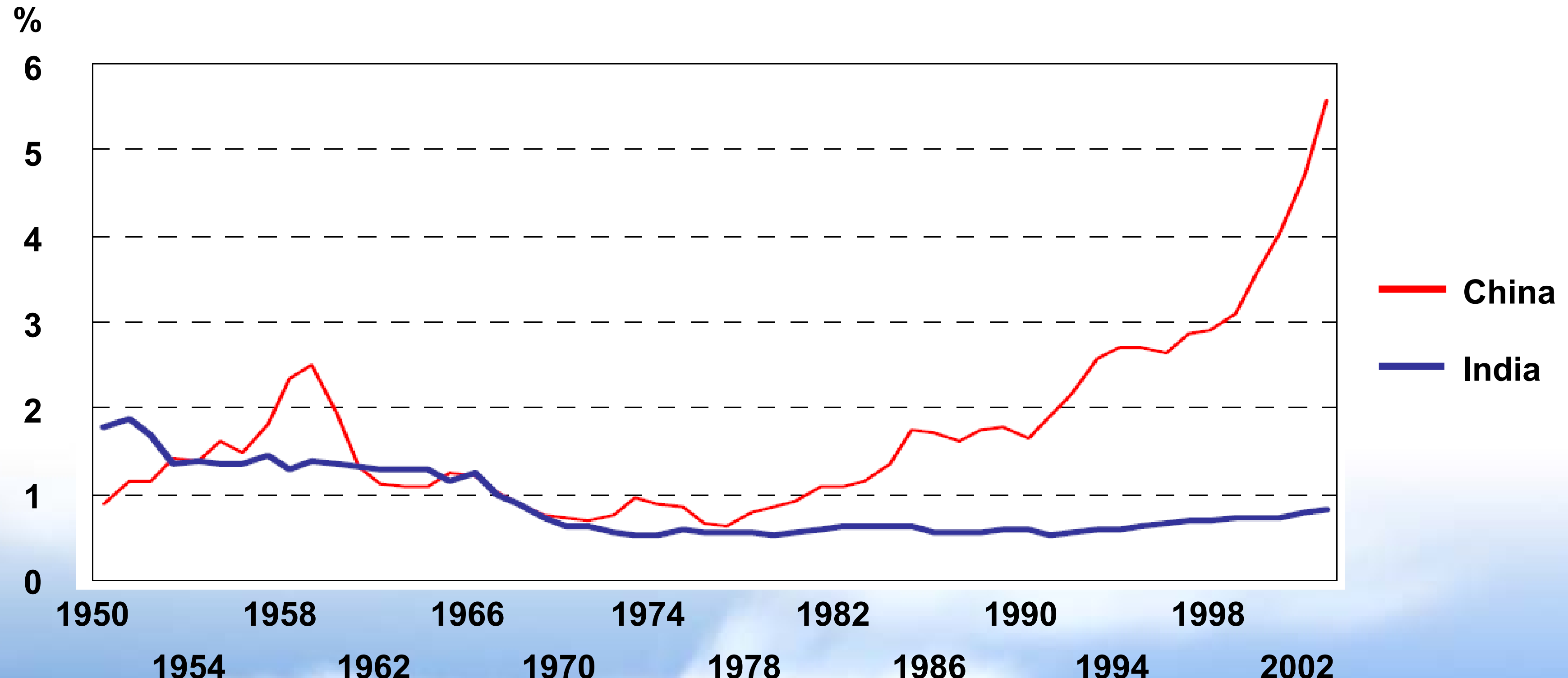
China and India have huge potential for income growth as they move from primary production to service based industries



Source: IMF, Morgan Stanley Research

China and India : Share of world exports of goods and services

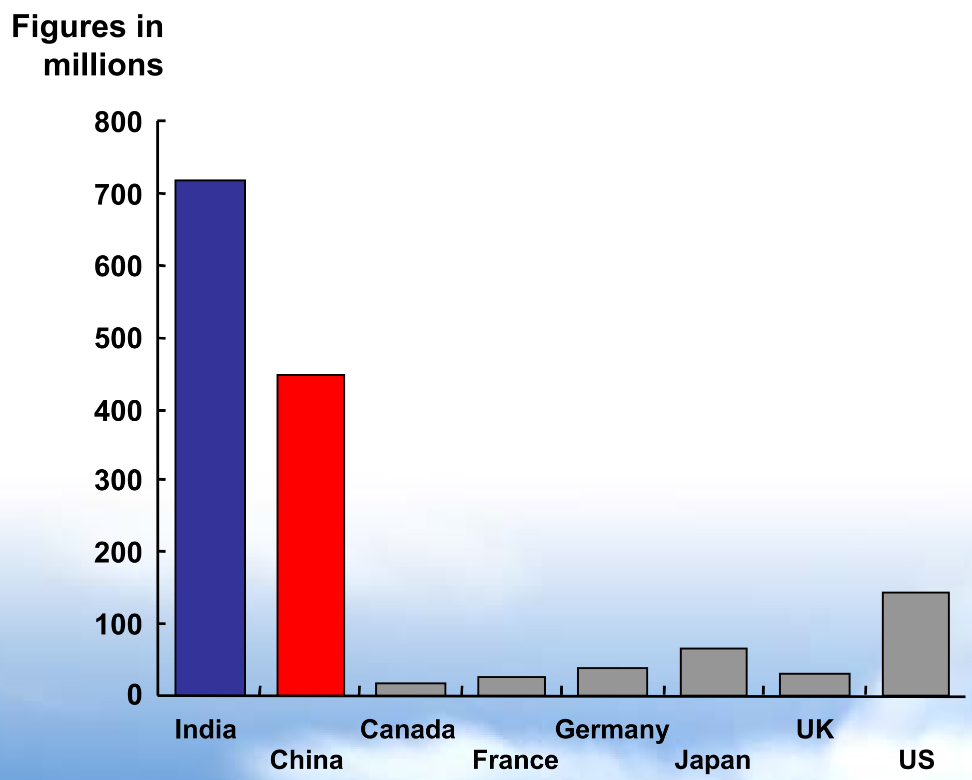
China initiated economic deregulation in 1978 and its economic growth rates increased dramatically. China's share of global exports has doubled since 1998 and is six times India's. India began economic reforms in 1991 and has yet to reach full potential



Source : WTO, Morgan Stanley Research

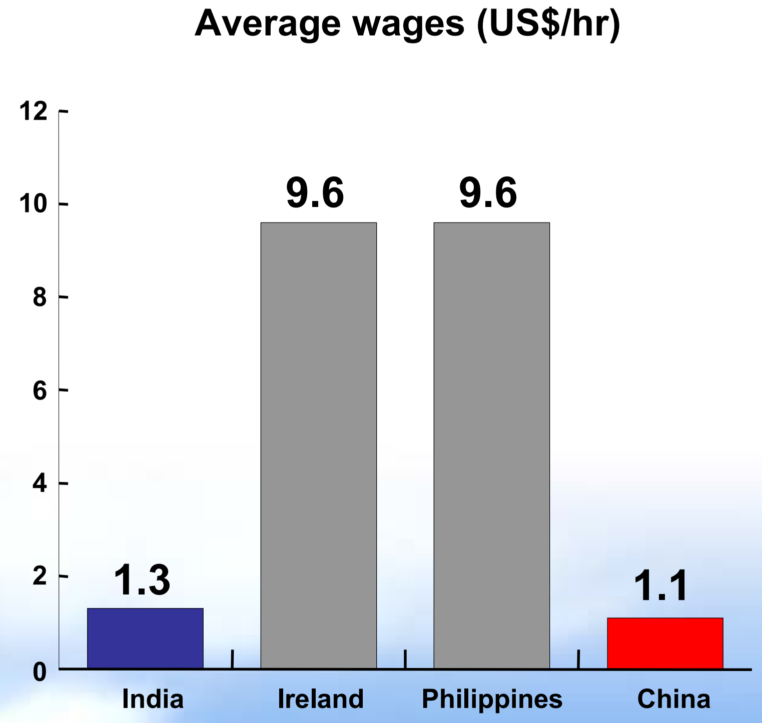
China and India : Labour advantage

A large, educated labour force provides manufacturers and exporters with an abundant supply of low-cost high-skilled workers. Largely agrarian economies with surplus labour in countryside



Source : IMD World Competitiveness Yearbook, 2001

Labour cost competitiveness in ITES

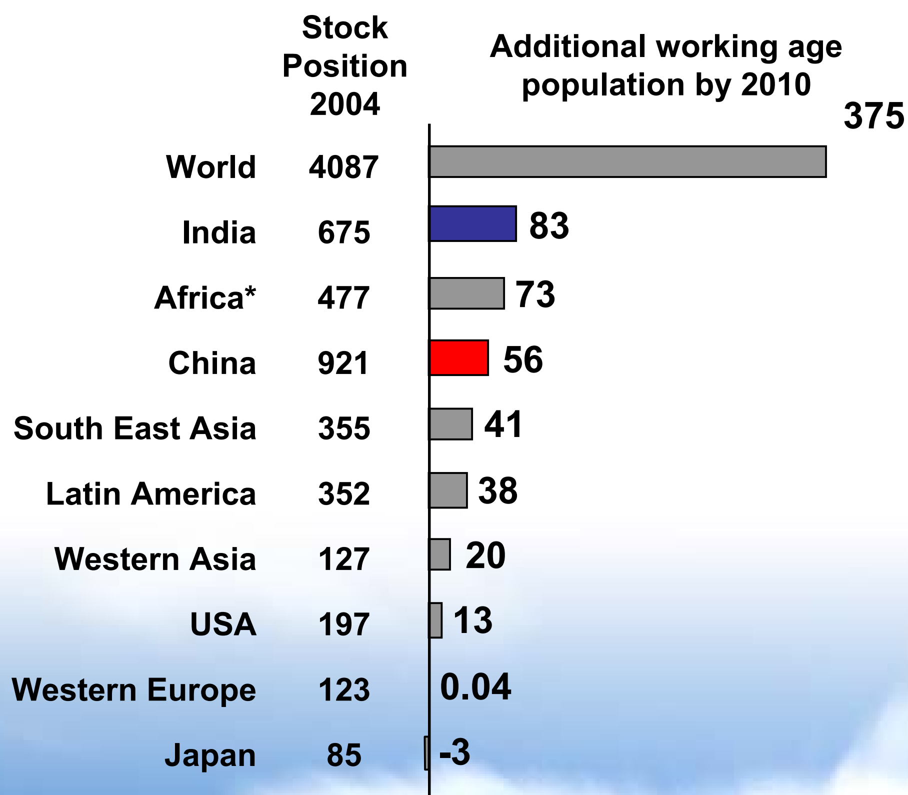


Source : IDA, World Bank, Tata Statistical handbook, Edelweiss, Frost and Sullivan

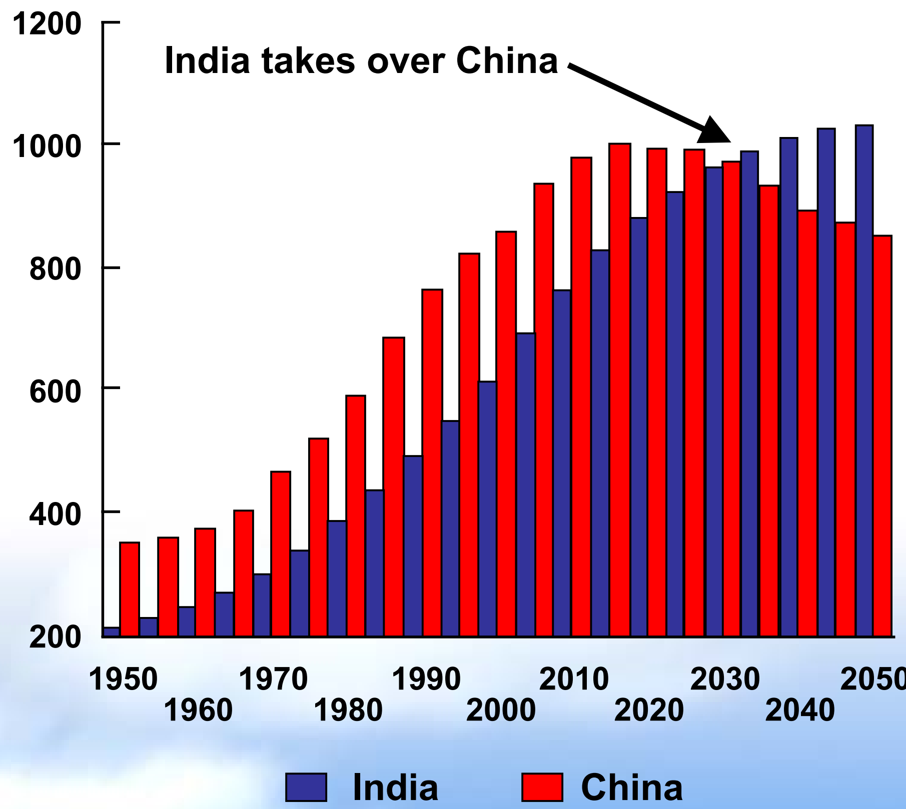
China and India : Positive demographics

China and India account for 40% of world's working-age population and will add 139 million workers in next 6 years

Global Growth in working-age population (15-64) over the next 6 years (million)



China and India : Working population age 15-65* (million)



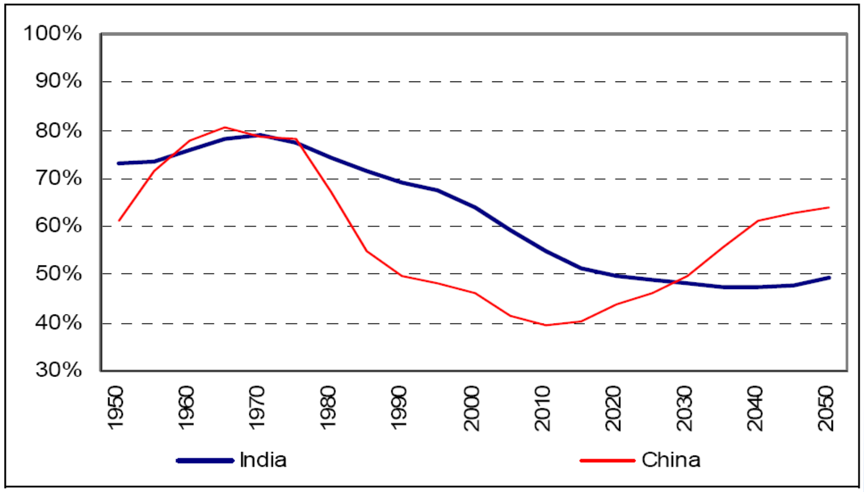
* Note : Africa includes a group of 56 countries
Source : UN, Morgan Stanley research

* People who could potentially be economically active
Source : UN

China and India : Positive demographics

China has created a virtuous cycle : Increasing productive workforce → higher savings → greater investment.
India's age dependency ratio will fall over the next 20 years

China and India : Age-dependency ratio (%)



Age dependency = Prop. of non-working to working population.

China and India : Savings and age dependency trend

(%)	1960s	1970s	1980s	1990s	2002
India					
Age Dependency[1]	77.8%	76.8%	71.6%	66.9%	62.2%
Savings[2]	12.6%	17.5%	19.4%	23.1%	24.2%
Investments[3]	14.7%	17.6%	21.2%	24.5%	23.7%
China					
Age Dependency[1]	79.0%	74.8%	57.4%	48.1%	44.4%
Savings[2]	26.1%	34.8%	34.8%	40.6%	42.0%
Investments[3]	25.6%	34.7%	35.4%	38.5%	39.4%

1. Ratio of non-working to working population. 2. Gross national savings rate. 3. Gross capital formation.

Source : UN, CIEC, CSO, Morgan Stanley Research

China and India : Different growth models

Historic growth has been accomplished with different economic models.
New industries are rapidly emerging in China and India.
The two development models are converging

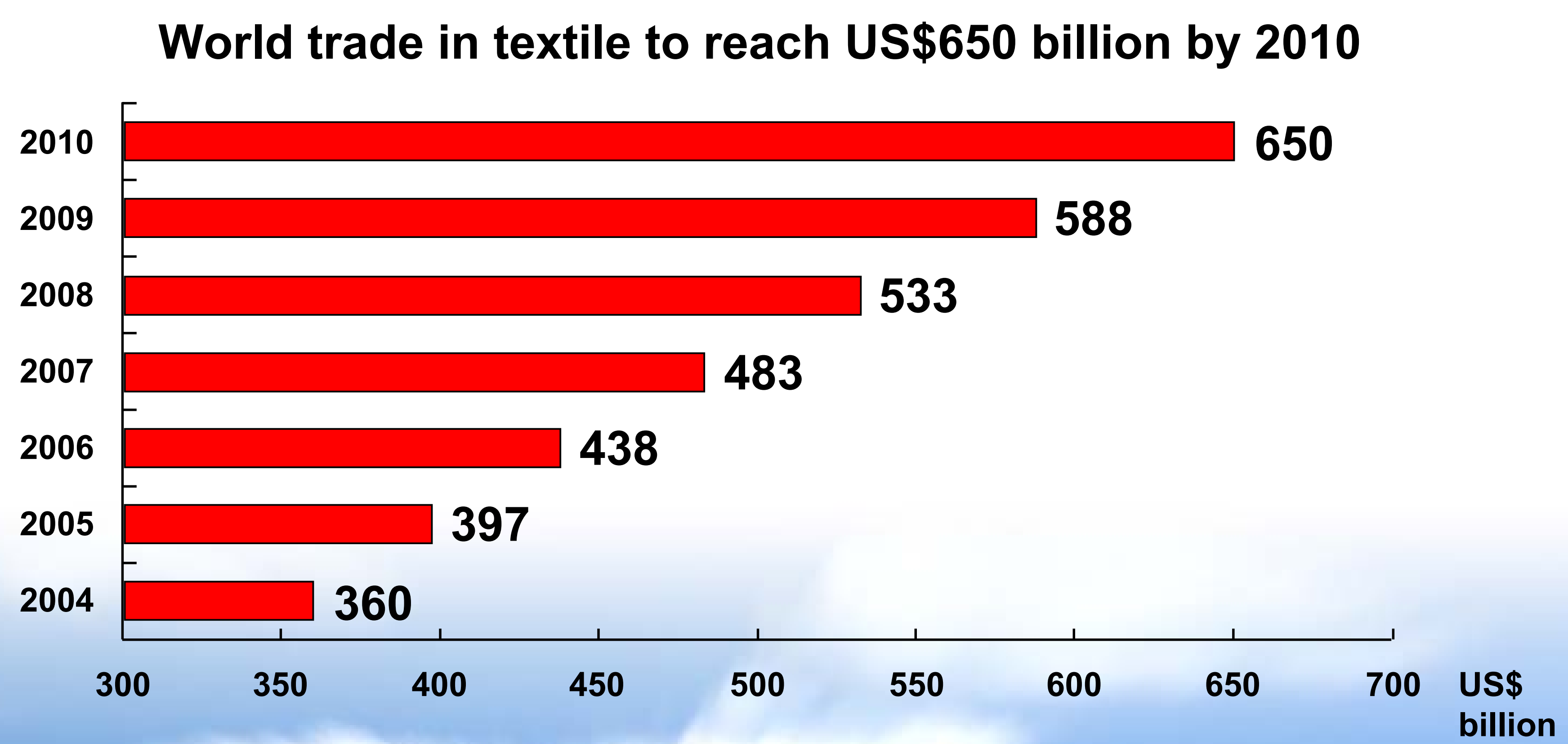
- **China's growth relies on foreign direct investment, whilst India's growth relies more on domestic private sector**
- **China is rapidly becoming a global manufacturing stronghold, and India is establishing itself as an important centre for outsourcing services**

	China	India
Existing core industries	Electronics and machinery, toys, textile and clothing, lower-end IT equipment.	Software and IT services, resources industry, pharmaceuticals and leather.
Emerging growth industries	Petrochemicals, IT equipment, automobiles, services, machinery and equipment.	Toys, auto and auto components, textile and clothing, engineering and capital goods.

Source : Prudential Asset Management Hong Kong (PAMHK)

Textiles : A new source of growth

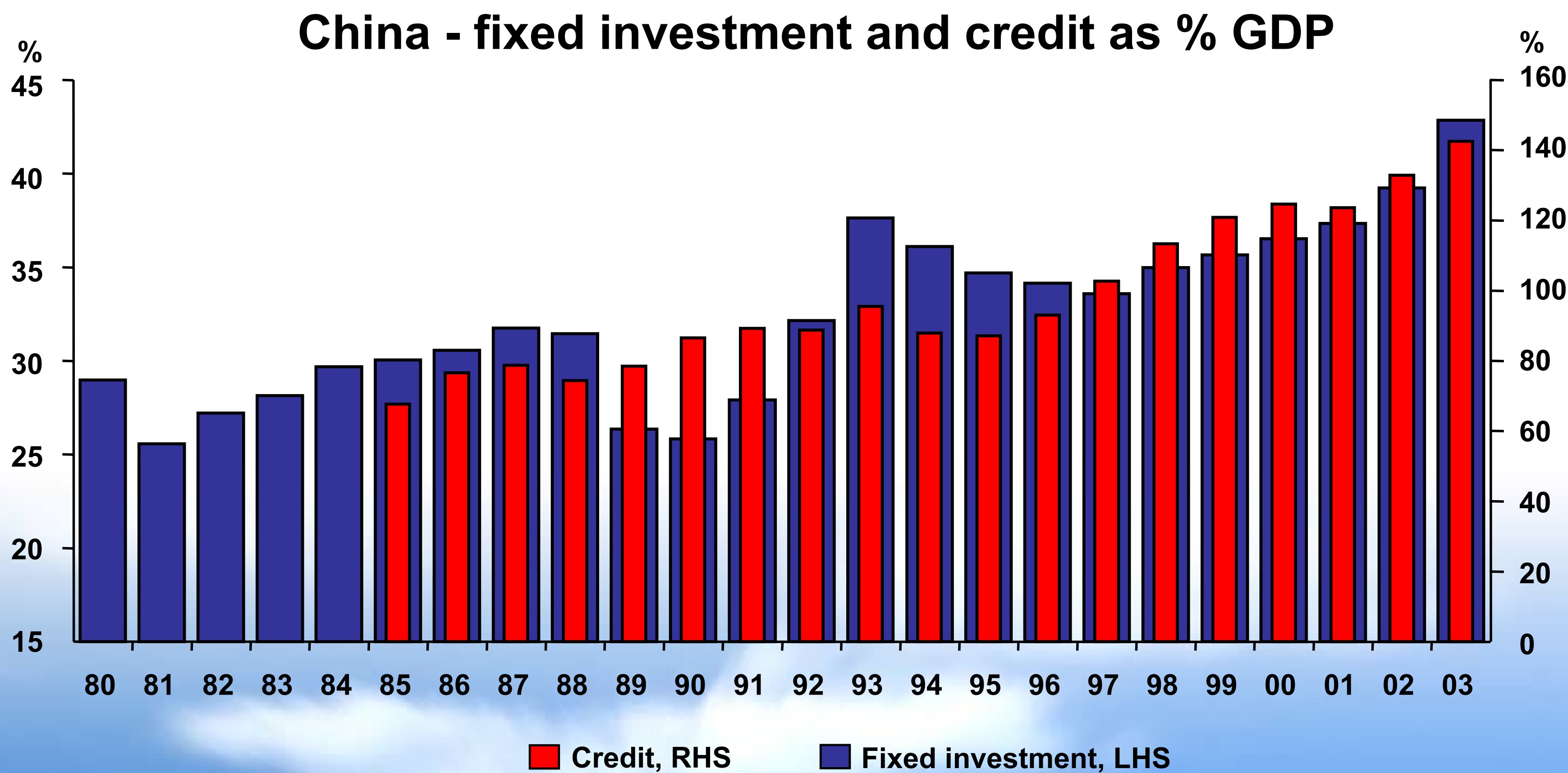
China and India should take larger share of global trade after textile quota removal in 1Q 2005



Source : KSA Technopak

China : Credit and investment risk

China's growth has been fueled by rapid investment and credit growth, with inefficient investment a key risk. Looking ahead, as elsewhere in Asia, we expect more efficient capital use and consumption to emerge as drivers of growth

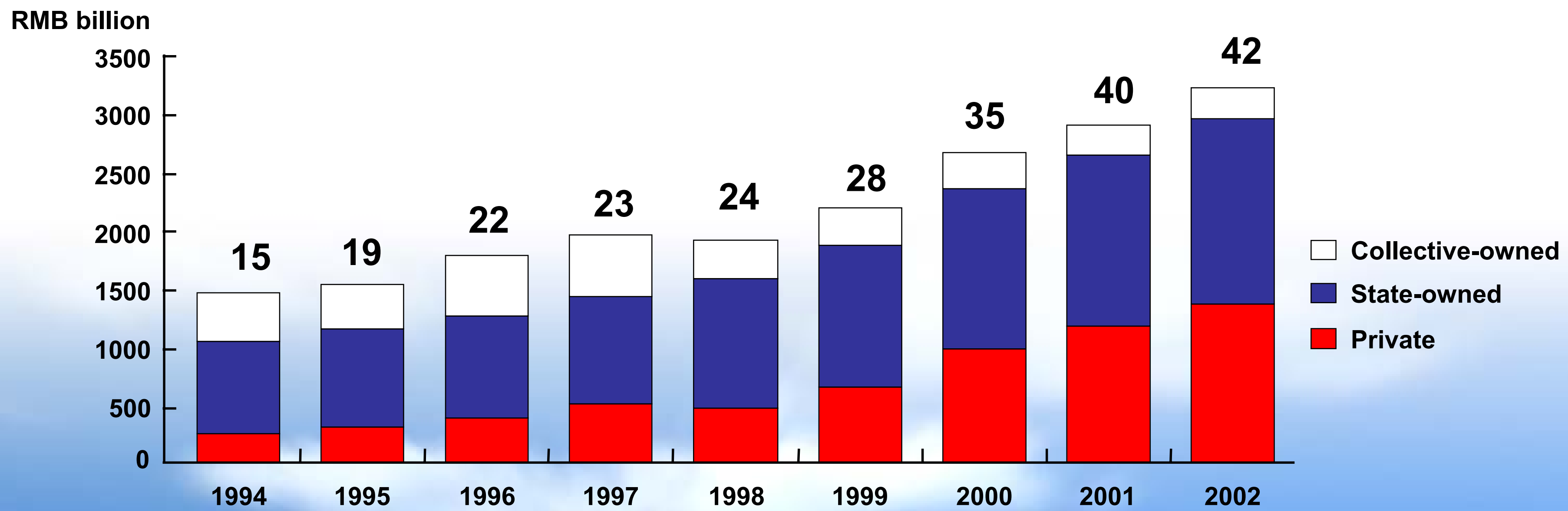


Source : CEIC

China : The rise of the private sector

The quality of Chinese companies is improving along with more return based investment decisions. The private sector is increasing its share of the industrial pie

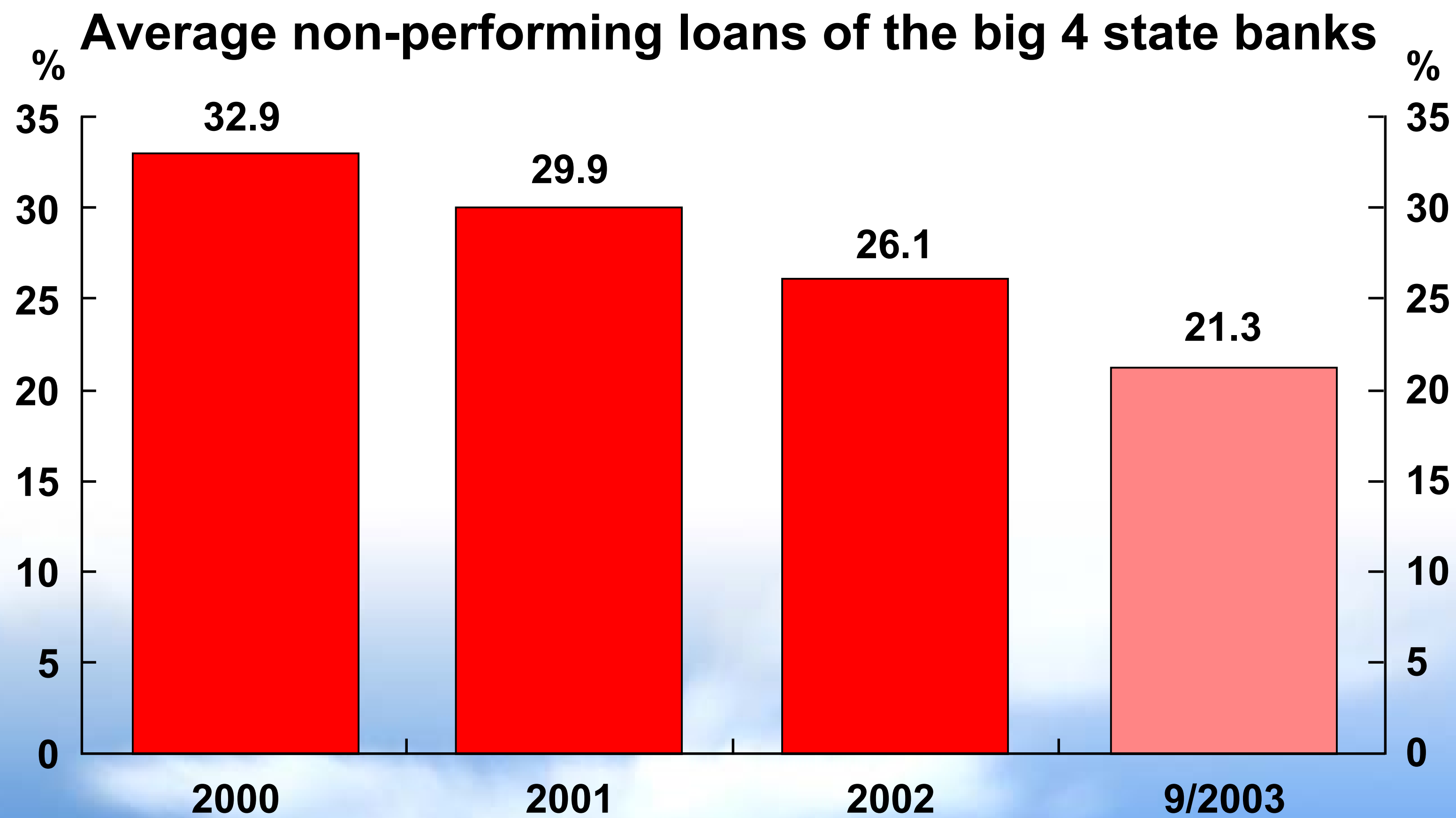
- Private companies generally possess better management than state-owned enterprises account for an increasing share of industry
- Private sector growth is a result of rise in entrepreneurial class and university funded research and development
- State owned enterprises are listing their prize assets. These companies are a models in restructuring for inefficient state sector



Source : CEIC, January 2004

China : Growth despite its banking system

Banking reforms are now top priority. The big four state banks to be listed by 2007. An efficient and stable banking system can increase savings into productive investments



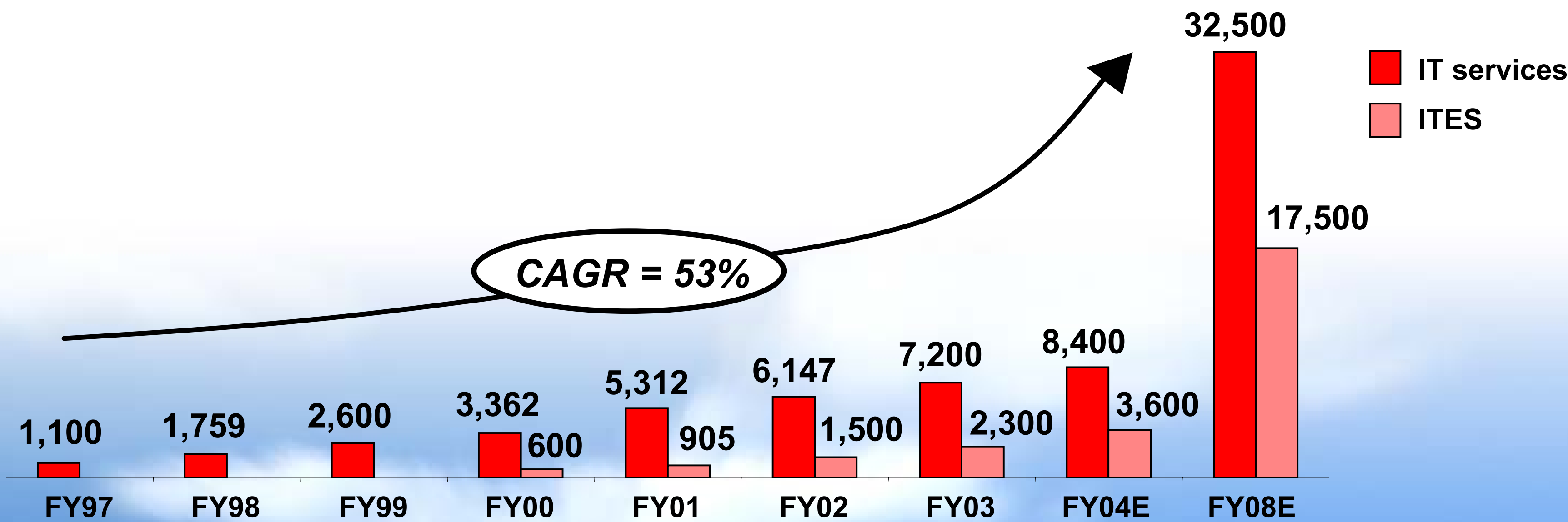
Source : China Banking Regulatory Commission

India : Services has been the growth driver

India continues to move up the value chain in tradeable services such as software and pharmaceutical

- 230 companies out of the Fortune 500 already outsource software-related services to India
- India produces a vast supply of English speaking IT engineering graduates

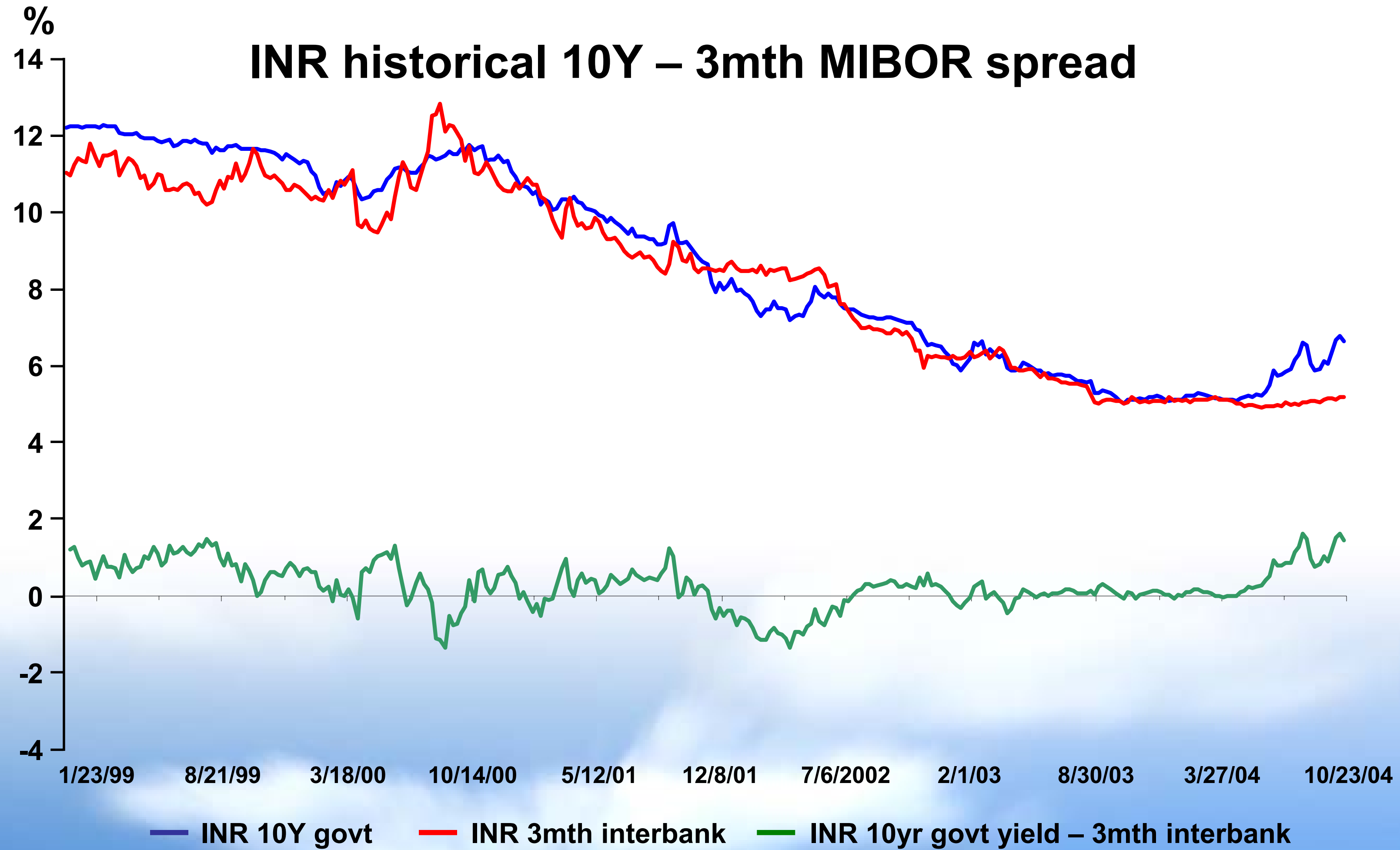
IT and IT-enabled services exports (US$ million)



Source : Nasscom, 2003

India's cost of borrowing has fallen dramatically

India's government bond yields have halved in the last 6 years which will boost gross fixed capital formation



India : Structural impediments to growth

**The issues which have held back growth are well known.
There are some positive trends although reform implementation is slow**

Unfavourable tax structure	Low savings rate	Low FDI	Large fiscal deficits
Inadequate infrastructure	Bureaucratic government	Inflexible labour laws	

- **India's demographic profile is positive for savings and investment**
- **The Government is planning to reform and simplify the tax structure**
- **India has made significant improvements in telecom, highway and port infrastructure**
- **Many sectors have been opened up to FDI such as telecom and aviation**

Summary

- High savings have turned Asia into the world's largest creditor
- Deregulation will allow Asia's excess savings to be invested more efficiently. Great opportunities exist for experienced financial product providers
- Personal savings in Asia should shift from low returning bank deposits to other asset classes such as life insurance, pensions and mutual funds
- China and India are set to become the new economic powerhouses of Asia. The penetration of savings and protection products is low
- China and India's income growth should be rapidly boosted by favourable demographics

Opportunities for Prudential…