

AIR FREIGHT ASIA 2009 CONFERENCE, 8-9 September 2009

SESSION ONE: "Will the Global Economy Shift Towards Asia?"

The theme for this session was first coined in 2008 by Singapore-based Prof Kishore Mahbubani in his book "The New Asian Hemisphere - The Irresistible Shift of Global Power to the East" in which he predicts that by 2050, three of the world's largest economies will be Asia: China, India and Japan. This rise, Prof Mahbubani argues, is likely to lead to tension and conflict. The book explains how the worst case scenarios can be avoided.

Last month, the WTO chief economist, Mr Patrick Low said at a press conference that "The world economic crisis is expected to shift more economic power to Asia, where signs of recovery are showing sooner than elsewhere." Mr Low acknowledged that the world financial crisis has not been as severe in Asia as anticipated, particularly in the region's largest economies such as China and India. Even so, the trade organization's chief economist warned of several looming dangers to the region. He said the WTO fears that the worst crisis since the 1930's Great Depression may significantly alter attitudes towards free trade. 'The issue is really about whether attitudes towards trade, attitudes towards globalization, financial regulations, savings behaviour in large economies, whether these attitudes are going to change in such a way as to essentially create a long-term de-globalisation in the world economy,' Low said.

If the shift towards Asia materialises, as Prof Mahbubani predicts, it will not only have an impact on Asia in general and China, India and Japan in particular, but it will also have major economic and social consequences for the US, Europe and the rest of the world. Among other things, **the economic shift will create a fundamental switch of global trade flows away from the US and Europe. The question which the panel will try to answer is: Is this economic shift realistic, what impact will this have on cargo and logistics industry in Asia?**

The quick answer is "Yes, but..."

Before addressing whether there is, will be or can be a de-linking of Asia to the US and Europe and a significant imminent shift in global economic weightings to Asia, we need to review what is still happening. The picture is still mixed. We are, of course recovering from the worst economic shock in as least 40 years, even if the slope of the recovery is itself a cause for concern from a freight perspective (green shoots sometimes need a microscope to find, but there is no denying improvements from a deep correction). Thanks to extraordinary emergency injections of government debt-financed liquidity injections, we have experienced a stabilization of financial markets, which have reversed their panic levels and tilted back toward reflation of commodity and other bubbles in many sectors, albeit to lower bubble inflation levels for the moment.

To understand the emergency measures we need to first focus on money flows and injections into ailing banks and corporations – on two levels, the first of which was injection of public money into banks (public debt and moneys to specific institutions), and the second of which is the extraordinary reduction in the cost of capital (reduction of interest income to the public) for needing institutions. These actions to some extent represent efforts to perform quick fixes/resets on failed outcomes of failed capitalist games out of Wall Street and others. (Had the actions failed, Asia would have been cut down just as brutally as US-Europe...)

The first measure is now waning in urgency. But the second measure could be expected to remain in place longer than needed, based on past practices initiated by facilitators such as Greenspan. Official statements are to the contrary. But it will be actions that will need to be monitored. The longer capital costs are kept low, the longer and greater will be commodity and other bubble reflations. This is an extension of the pre-2007-08 game. One could hope central banks could learn from past quick fixes, but at the moment they appear not to. But of course there is much debate.

It is important to see that Capitalism in developed and key developing economies today depends on the managing of bubbles – this applies to Asia as well... (ie, not the official line that bubbles were not to be interfered with ... but that central banks and banks actively created/allowed bubbles in order to deal with leftover problems of previous downturns). I have often referred to the analogy of Dorian Gray and his picture in the attic, which reflected his true hidden condition... not his perceived image as he went about his parties. http://en.wikipedia.org/wiki/The_Picture_of_Dorian_Gray... **Is massive debt finance for repayment of past ills the biggest of Faustian bargains?**

From a freight perspective, however, real effects to demand in real economies could be more muted than reflations in financial and commodity markets, if unemployment remains ragingly high (and reflected better in other measures than official stats?) and debt reduction on still challenged property prices in the US and other key parts of the developed world remain a long term, re-structuring issue. Freight is a direct report to consumers. Asia is more negatively affected by this trend on levels ex-property market and stock market speculation.

It is an issue, most visibly, of the US repairing its consumer balance sheet while the US as a nation tries to regain its footing in the world economy (or at least understand how it is losing a part of its long term footing...). Europe has at times been described in better condition, yet at times has also been listed as a borderline patient. It is safe to say that Southern and Eastern Europe have serious issues to contend with....

To the issue of Asia's further emergence onto the world stage. Yes, it is in a position of taking a more significant role on the world stage. But ironically it must embrace practices which during much of the 20+ years the US has failed at. It must learn to live more dangerously – but not as dangerously as the US lived.

On one level, Asia will gain influence – such as China throwing its weight toward the IMF and reducing dependence on the US dollar for trade and financial flows. At the same time, the mix of China, Japan and the Rest of Asia economic weight will shift. Japan may yet still lose more weight on relative basis.

China is the key – we all know...

On a more important long term level, China and other Asian nations will need to generate more depth and breadth of economic activity, including some of the US practices which went out of control. This will be most challenging as it involves changing the DNA of social behavior toward just a right mix, without going overboard.

For example, China will need to get investors to invest using investment tools and not to speculate as much with large hammers. It will also need factory owners and city governments that recognize the social cost of pollution, and consumers who respect intellectual rights of brand owners. We will also need to see consumer behavior patterns evolve such that we are not just looking at the elites shopping in Hong Kong and other key consumption areas, but wholesale development of China's interior. The infrastructure needed will be transport, consumer finance, health services, etc. To be sure most of us recognize this. But we tend to ignore the time dimension in the calculation.

To ignore how long a full or close to full integration of China's economy into the global economy will take is to ignore that Asia's growing influence on the world economy – and even its ability to offer a lifeline to the global financial system – will take decades more to fully develop.

So as to solving the ills of the financial crisis by turning to Asia OR Asia lifting itself by its financial bootstraps to breakaway from the ills of the US and other developed economies will continue to be a pursuit and not an achievement for quite some time.

Core issues, as seen from early Sept 2009:

- **Intra-Asia freight movements** will shift down from 50+/-% destined outside Asia gradually, as I-Asia trade becomes more influenced by Asia demand. It will not be simply within just a few years that massive amounts of finished products will be inward bound into China than out of China. But the ratio should continue to improve and also be part of a rebalancing of trade which remained off balance post Asia Crisis
- **Trans-shipment** suffered even more than export flows in this downturn
- **Import flows** (which will be shorter distance and require growth in more med-size transport assets!!) will not make up for lost export flows for some time and must be targeted by Asian governments as part of a social transformation which will require the use of greater debt and financial instruments, but not to harmful levels such as in the US
- **Asia outbound flows** of -15% in 2009 will reverse back to positive but the slope of the recovery will be determined by developed country consumers. For US consumers to switch back to +20% would represent an unwanted return to over-consumption...not a desirable return to yesteryears. Current evidence of slow road approach is US consumer credit fell a record \$21.6bn in July 2009 (10% drop). Large amounts of Asia/China factory production will need to remain idle or be mothballed. This has contributed to changed migration patterns in China, and is ultimately desirable but must be further supported. Once successful, this will contribute to a stronger internal economy for China
- **China inbound flows** are misleading and not to be fully counted towards evidence that Asia can break away from developed country dependence (It's also a different discussion). Commodity utilization efficiency must continue to accelerate, while pollution levels must decline rapidly. Inbound flow analysis must be separated into container and bulk for better understanding of import make-up, but the inbound story is broadly recognized as a bulk story not container or air freight story, though there is ample room to examine the growth of supply chains inbound into China. ... China must continue to increase efforts to modulate inflows to not drive up its own production costs in an environment of still wasteful utilization....
- **Asia and China** will eventually have to deepen economic growth away from entrepôt economies such as Hong Kong, Singapore, etc... and in China from coastal cities (of course there has been some, and on an accelerating basis, but additional levels of quality growth need to be targeted, as most understand)
- **Japan's experiences** – as an Asian example – must be better understood and mistakes learned from. In building out China and Asia's economies, will governments and business leaders really want to end up with high national debt levels and a stronger public investor squirreling away saving... and with state policies having ground down growth to snail like levels?

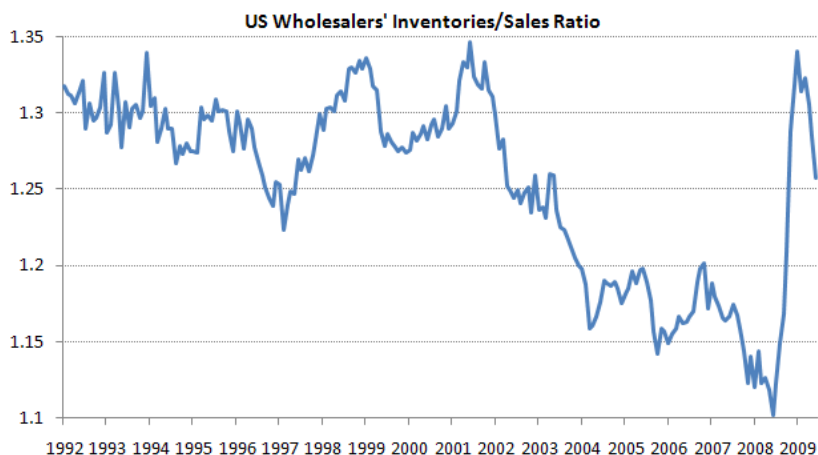
Panel I discussion on Asia’s rise and related issues (including a few side discussions):

De-globalization and potential protectionism: There has been evidence of near-shoring emerging. But this is not and is not likely to be the larger trend. The forwarding business has been at the epicenter of the global recession. Even Vietnam growth has been hit and has even taken down export targets for 2009 and taken GDP growth expectations down from the 8% to the 5% range...And China deceleration has been well covered. But N China has proved more stable in export downturn than south China...and N. China has more growth given long term laggard issues...Korea’s trade with China has been a topic for discussion

China has overtaken Germany as leading exporter: There is a need to unpack this from cyclical and structural perspective. ... Germany has legacy core trade with neighbors that when stripped out means this happened long ago...

Asia’s potential for growth: Asia has a number of varied economies where business has to be grown internally before connecting the pieces. This is often misunderstood MNCs generally are still in need of managing extended global supply chains. In Vietnam, for instance, “factories on wheels” represent all sorts of challenges for supply chains...

Inventory re-stocking: There has been an improvement in recent weeks, with examples being some garments businesses switching from sea to air due to re-stocking requests. But batch size requests appear smaller at moment. **Reference chart using most recent data to Jun-09 (1992 – Jun ’09)...sales deceleration improving relative to inventories**



Source: Datastream

Container rebound: questions as to service quality as current artificially high load factors create a rush effect. Short-term profit focus has led lines to chase higher paying cargo for better bookings. Still some 200 ships idle....

Can we tell structure of rebound from current market? No we can’t...we need to get away from the peak season of 2009. Yes, there is a potential improvement for inventories and demand appears a little better. But extracting long term trends from current nascent rebound is very difficult. Inventories and overall demand will be better seen post peak season. But ... “the parked freighters are not coming back soon...”

(Note: one of our contributors had several months ago come up with a differentiated forecast for a spike in trade growth around back to school and into Fall ’09, but that the follow through would not be strong...Let’s continue testing the rebound’s strength)