

Conference Keynote Address: “Making Sense of Turbulent Times”

Bill Emmott, Editor-in-Chief, The Economist

Thank you very, very much, Linda, for the kind introduction. I am delighted to be here before such a distinguished audience of such an excellent conference. I am fully aware that the essence of your business is international because the essence of my business and my concerns is international too. You have before you not an Englishman, not a British-based writer but rather someone who tries all the time and is paid all the time to take very much a world view. Indeed, I feel so compelled to be international that often I find I cannot remember where I am from. But also, audiences and people I meet cannot work out where I am from. During my time as a journalist, I have been told by people for example, until I start speaking in English, that they think I am Mexican because of my moustache. I have been told I must be Dutch because I look sort of like those in the Belgian-Dutch van Dyke paintings. One time, a few years ago, I was covering an oil producers meeting--the OPEC meeting in Vienna-- and I came down in an elevator and just outside the elevator, two journalists came up and tried to interview me because they thought I was Sheik Irani. And then finally, a few years later when I was in Moscow walking across Red Square, a friend I was with pointed out I had better put a hat on otherwise people might think I had come out of Lenin's mausoleum.

So, I am strictly international and my task today is strictly international. My task is to give you a world tour, a tour of the world economy but also of world

politics as it sets the environment for your industry. It is hard now to separate world politics and world economics. The two things cannot be seen as separate factors. It is also hard now to understand, to comprehend what is going on both in politics and in economics; because these are really quite extraordinary times. If you think back to last year, actually in my view, even before or after September 11th, one has to think of the amount of gloom, the amount of worry that we all had. Because of the turn of business in high technology, because of the gathering recession in the world's biggest economy, the United States, which many of us worried whether it might be quite a deep recession because the vigor of the previous growth had been so strong; in particular, the growth of the financial markets. And then along came September 11th producing more worries about terrorism and war, possibly oil prices getting higher if you have restrictions on supply. And all the other environments in which the other major economies of the world operate were of little help to counter the downturn in the United States. European economies were quite slow growing and actually proved to be more vulnerable to the attacks on September 11th, in terms of consumer confidence, than was the United States. And Japan was continuing its ten-year stagnation and general slide in terms of economic growth and therefore, not providing the hope that one might have wanted to balance America.

Now, though, things look very different, they look much better; they look much more rosey. The war against Al-Qaeda terrorists in Afghanistan has been fairly successful. President George Bush--rightfully in my view--stressed this was not going to be over quickly and what you have to look for was what he

called the patient accumulation of success. And that, I think, has been what has been patiently accumulated by the United States. It is good news to know that there has been no further successful terrorism attacks since September 11th. There is no fight back, at least yet.

What is most remarkable is how short and mild has been the recession in the United States. A remarkably short and mild recession in which the productivity boom of the late 1990's appears to have continued changing all past experience through recession. At the same time, there has been a really quite strong recovery in most of the East Asian economies and there are even beginning to be very modestly some better signals from the economy of Japan as well as some revival in Europe.

So, how can we make sense of this? Were we all mad to be so worried on September the 12th and 13th and 14th? Were we panicking too much about what this would mean not just for your industry, not just for travel more broadly but for the world economy? No, I do not think we were. I think that we need to try to answer these questions. If we are to understand the recent past, to understand the present and to understand where the future might be taking us.

Why have things turned so quickly from gloom back to better times? How fast might recovery be in the future? What political risks lie ahead in this politically turbulent era? What might the answers to those questions then mean for the travel sector broadly and then specifically within it for luxury brands, the sort

of brands that are going through travel retail outlets? And where might that mean that the world is going next? (By which I mean in the next five to ten years.)

Now, to answer those questions, you will find in my slides that I am indulging in a little branding of my own, shamelessly, marketing my own luxury brand. But that is because often the pictures we put on our covers are far more eloquent than the words that the editors find to put in the magazine. And the truth is that this one, I think, tells you most of what you need to know about the American recovery in the last nine months. House prices, booming in America, continue to boom in the second half of last year. That rise in the value of the most important asset that most individuals hold helped to support consumer spending in the United States through that period and through that supported the US economy through a very lean period. This occurred because of cheap money. The interest rates cut brought about by the Federal Reserve Board meant that this recession of 2001 was the first recession really since the 1950s and 1960s. During which interest rates have fallen in the early stages of the recession. All other recessions in recent memory have been caused by inflation which in turn, has meant interest rates had been raised during the early parts of the recession. This was the first one in which money was getting cheaper early on. That, I think, is the major reason why so many people could not easily foresee what was going to happen during the recession because we have not got the recent experience to learn from. At the same time there was cheap money, there was the fortuitous coincidence

of tax cuts from the new Bush administration which helps stimulate the economy. And in this economy, consumers were absolutely the key.

And I think to understand their continued spending, their continued confidence that supported the US economy, and thus supported the world economy; one must also understand the role of the labour market in the United States. Most people are worried about the very flexible labour market in which it is easy to hire and fire. The experience in the last twelve months in the United States suggests actually in this recession, the ease of hiring and firing seems to be reassuring to customers. Why? Because even as they saw unemployment rising and people losing their jobs, people as a whole in the United States seem to be optimistic that even if they lost their jobs, they would quite quickly find another. Because the labour market was so flexible along with the hiring, firing was also taking place. So this optimism meant the normal thing that happens during recessions which is that consumers react to worry about their jobs by quickly trying to pay down their debts and cut their spending, did not really happen. And so consumers were able to prop up the US economy.

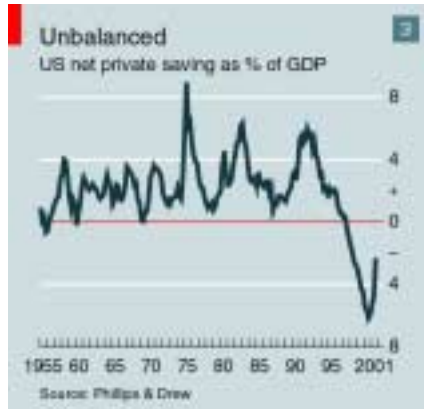
Where is it going to go next then? Is it if America is recovering, so will the world? Will the world rise as a bird or will it be weighed down by other factors in its stomach, like my bird there? I think that the likely path for America, which is then going to influence the rest of the world, is going to be good but it is not going to be a bumper feast. In particular, what looks to be emerging in the United States is, at least in its early stages, a recovery in the economy but not a recovery in profits. It is a profitless recovery because no company has

the power to raise prices. And in this recovery, competition is too intense and the pressure against raising prices is too strong.

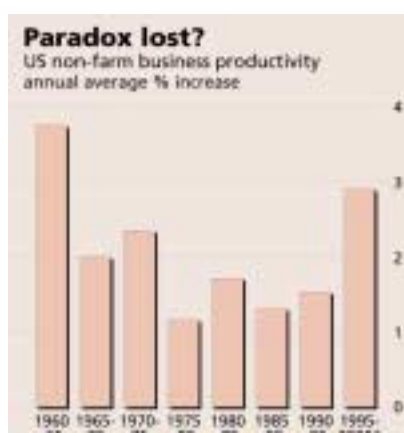
There is also, I think, a continued issue in the United States of the big debts that were built up during the boom years by companies to finance all their investments in computers and IT, and by consumers who built up a lot of debt to finance their luxury purchases. The existence of all that debts makes it unlikely that there is going to be a new surge in the near future in consumer spending or business investments.

Further ahead, I think the picture is going to continue to be quite rough, choppy, not bad but not wondrous because we are seeing emerged, I think in the United States, a combination similar to that in the 1980s. In the 1980s we had, what I think, were the wonderful politics of Ronald Reagan trying to bring the Cold War to an end but we also had the less wonderful economics of Ronald Reagan in which he produced a huge increase in the Federal budget deficit in the United States which helped to raise interest rates for companies seeking to finance their investments. I think George Bush, Jr. is copying Reagan's politics but he is also copying Reagan's economics. And that means, I think, over the next few years that the budget deficit grows, and so we will see pressure on long term interest rates rising and also questions, I think, about the future course of the dollar which has been so strong for so long.

I have been expecting and almost predicting a fall of the dollar for about the last three years so I am the last person you should believe in any currency forecast; nevertheless, one day I will be right.



This single chart, I think, if you are still skeptical about why the US is not going to have a turbo charged recovery, this single chart is the one thing you should really look at. It shows net private savings, which means savings by companies and consumers, by households, and how it has developed as a share of GDP during the 50s onto 2001. What you see is what an exceptional period the late 1990s were when companies and consumers were borrowing huge amounts of money to finance their spending. That has to adjust closer to balance, it does not have to go to balance in the uptake of the line at the end really represents the recession of 2001 as companies and consumers did to some degree cut their borrowing. This does not mean you are going to have a new recession. But it does mean the ability of companies and households to put a surge of spending into build the economy up is quite limited just because of the negative graph.



You might also say what about productivity? There is going to be a surge of productivity. We still see productivity growing in the US; in the first quarter of this year it grew at record levels. What I say to that is, yes that is right. And the productivity growth in the US is very good for the long term. What this chart is aiming to show is that the recent productivity growth is not as extraordinary as the enthusiasm of the late 1990s, the new economy period suggested. What that period, the final bar on the chart, shows is that productivity growth in the late 90s was really only returning to the strong growth of the 1950s and 1960s. That means it is good but not extraordinary.



d. This chart shows how... that we have to therefore expect there is that it is going to be some time before it really gets a new surge of share prices. Even with optimism about the US economy, even with recovery, the Dow has hovered around 10,000 all of this year. The reason for that is the levels of evaluation are still remarkably high. So, I think in the world's biggest economy, there is quite still an uncertain and choppy outlook for the future; not bad but not fantastically good either.

There are things that have not happened that could have made things worse and that we need to be aware of possible factors in the future. Oil prices, if they were to rise sharply, would start to hurt the western economies. I do not think that is likely because I do not think any of the big oil producers have got an increase in pushing up oil prices and I also think the new warmth between America and Russia means that we've got a friend who also has oil wells and means that it can balance any oil embargoes from the Arab countries.

Second: possible turbulence in emerging markets; Argentina and its collapse. It has not produced any problems for any countries so far; I guess it could in the future but again, I do not think it is very likely.

We are seeing in the United States what I call post-Enron disillusion. In other words, the gathering understanding that the accounts of corporate America were often, shall we say, not as honest as they were made up to be. The world's most open and transparent capital market was actually not terribly open or transparent. I think that this disillusion, both with Enron and with Wall Street and their analysts, is still working its way through people's mentality, people's thinking about investments. But actually that dog, I do not think, is going to bark terribly loudly. I think investors have felt fairly sober about what the realities are. Of course, at the moment, we still have worries about mega-terrorism in the future and we still have worries about Japan but I am going to come back to Japan.

What are the wider prospects beyond a concentration on the United States? I think they are also positive. We do see in Europe movement in the right direction. European economies are being reformed, are becoming more deregulated. It is a slow process but a steady process and it is going in the right direction. So I would be quite bullish on Europe on a ten-year period.

I also think the bottom two items on this chart are ones we need to keep in mind all the time. Globalisation--although it is on hold for the moment--you are not seeing great waves of trade liberalization, because countries are under pressure. Nevertheless, the good news is it has not gone markedly into reverse. And I believe globalisation is going to continue to be a positive force in the world economy.

And technology remains a big driver, the pace of innovation has not slowed with information technology. I think one of the technologies for the future will be energy technology, the fuel cells, and the like.

Moving outside Europe and the US, I think you do have an extra bounce in this in East Asia. From the crisis in 1997 to 1998, a lot of good things emerged. Initially a fragile recovery. This cover of *The Economist* was probably I think in 1999, was after the initial bounce back from the crisis of 1997, 1998. And I think what has been good in many East Asian economies is the wake-up call that crisis produced has produced a process of continued reforms and strengthening of economies right across the region.

Japan is the big question of the region. The big questions we are all asking ourselves: will Japan collapse? will it reform? will it get out of its ten-year period of rich stagnation, of a sort of genteel slow decline? My answer is I think it will. I will be optimistic actually if I thought it was about to collapse because my hope is there should be a crisis in Japan because I think a crisis is what the country needs to produce a radical shape-up in politics which is really what is obstructing reform. I believe the foundations for a strong revival in the Japanese economy would really show themselves to be fundamentally very sound. My expectation is there will not be a near-term crisis and I cannot see any reason why in the next year or so there will be crisis. And I therefore think what Japan would be doing would be what we English used to call in describing ourselves. We describe it as “the politics of muddling through” of just working your way through gradually. The process of reform and that is the likely outcome in Japan, slow reform that does gradually make things better but does not produce any rapid revival. In the near-term, I think perhaps the biggest risk for Japan is actually the strong Yen as the dollar declines; the dollar is on a gradual decline. If the dollar is to decline sharply, the biggest worry for Japan actually is the Yen will increase in value and this would hurt Japanese exports. That would be good, of course, for Japanese travellers.

There are good prospects elsewhere in the region. I think India is slowly reforming and unlocking its growth. I think China, too, is the great changing, the great reforming, the great emerging country of the region. The key questions facing us are about China over the next twenty years. The question of whether economic reform is going to be able to deal with the big challenges

it is facing: dealing with the state-owned enterprises, dealing with an insolvent banking system, for example. I think in the long-term, one should be optimistic about that. The reason why China has such an excitement about it, such potential, is there is so much energy to be released by those reforms and so much determination to make those reforms. One should be sober, though. As these changes are necessary and as they are done and as freedom spreads through the country; so there are political risks, so the challenges for the communist party leadership in managing that change will be great. So I think China's future is going to be bumpy but in the longer term, it is going to be very warm.

Now as we deal with this emerging economic optimism that I have been putting, we need to lay it against the political risks. We can see in the economy rather remarkably, business as usual has returned. The difficult question, I think, is for the world to work out whether or not we really are politically back to business as usual. I think we are not back to business as usual. But I think not really for quite positive reasons. We do face some really big political risks ahead of which this is my top list of the six most important political risks. And on this slide, I have given my personal rating about how important these risks are likely to be for the world. What is difficult in analyzing--as a writer or commentator--all risks, political risks, is really to work out whether they are of local importance or they could have a global impact. My ratings out on the chart:

I think the Israeli-Palestinian conflict is an awful conflict which does have wider implications but I only give it 4 out of 10 because I actually do not think any of the parties involved in it with the single exception of Iraq has any interest in stimulating a wider war. Therefore, I feel it is going to be an awful site for us all but not liable to produce world-affecting consequences. The danger of Al-Qaeda terrorism is much better. I think Al-Qaeda and its networks will try again to bring about massive terrorism and I will explain in a few moments why I think they continue to be the biggest threat to the world. India and Pakistan again are facing off with a lot of new tension over terrorism in Kashmir, over their disputes over Kashmir. I think that like Israel and Palestine, this is likely to be more of a local problem than a global one but also, I think, although there is a great deal of pride involved in that conflict, there is also sanity and I believe that in the conflict the United States is in a good position to broker up a peace.

Iraq and what happens to it: I have given a very low rating to it. Clearly this depends a great deal on Israel and Palestine, what happens in Iraq. I believe there is almost a 100% chance there will be an American-led invasion of Iraq during the next twelve to eighteen months. I think in the short term, that will be rather frightening and there will be short-term effects on the travel industry as happened with the Gulf War in 1991. But I have given it a low risk rating because I feel although it is going to be bad in the short term when the invasion happens, it will be good in the long term. It will actually represent a reduction of risks in the world over the long term--once Saddam Hussein has been toppled and once a new start has begun--therefore in America's

relationship with the Arab world after that. So I feel that actually would be a good thing.

Longer term, I think one of the biggest risks to the world has to be China dealing with the political challenges that I have described but also then dealing with the issue of Taiwan. It is just simply a logical problem for the two countries to deal with and I think, as China faces its difficulty of political reforms, so the role of Taiwan could increase within China's politics as nationalism becomes an important force. So I think, in the long term, resolving that issue between China and Taiwan is going to be highly important and also, therefore, highly risky.

And finally, North Korea. I think North Korea is absolutely strictly a local issue and therefore, I do not think it is going to awfully affect the world.

So the broad picture is with quite optimistic ratings about those risks, that I think the risks are being lessened by some very important massive changes in the world, that are rather like the changes that took place after 1945.

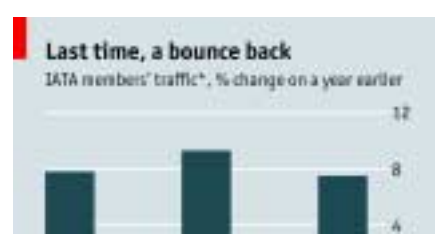
Some of the structures of the old world have been able to be changed since September the 11th. The US has become much more empowered and engaged in altering world politics because of the need to fight terrorism.

Russia, exemplified this week by the summit between President Putin and President Bush, is joining the West, finally, I think, ending the Cold War. The removal of Saddam Hussein from Iraq will bring to the end a headache from

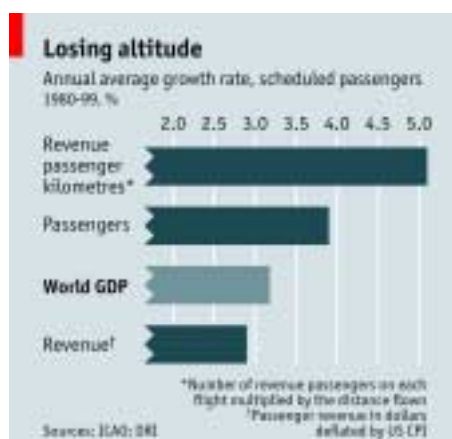
the 1990s and I think it will bring about the possibilities of a new start with the Arab world amid I think a very welcome sign of leadership from Saudi Arabia within the Middle East.

And finally, there is a new alignment of interest with the United States among a wider range of countries that makes me feel good about how we can deal with these risks. We need to put against it the ambitions of Al-Qaeda and Osama bin Laden. I think the right way to think of those ambitions and the dangers and therefore a way to make ourselves continue to fight him, is to think of Lenin. Think of the man who resembles me. Lenin had his first attempt at revolution in Russia in 1905. They finally got control of Russia in 1917, twelve years later. Terrorists, and that is what Lenin was in those days, are non-state actors as we call them. Now terrorists do want to get hold of countries because countries have resources and countries really have the power in the world. I think Osama bin Laden is bound to want to try to get hold of a country. Pakistan, Egypt or Saudi Arabia are the obvious ones. Therefore the setback that he has had in Afghanistan should only be seen as setbacks, rather as 1905 was for Lenin and we have to keep on fighting him.

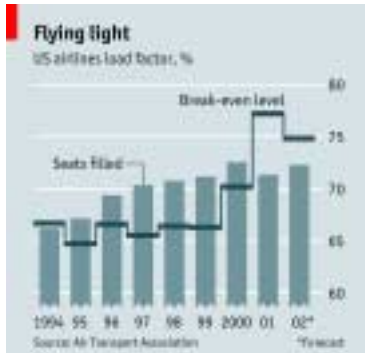
What does this mean for you, for the industry? Let me briefly give you some thoughts on that. It is broadly a good picture with globalisation in intact, technology spreading and America helping to keep the peace. I think that means we can be optimistic of the trends that have built your industry, of globalisation--which is spreading affluence in more and more countries--and an increase in international travel are going to increase in the future.



It is going to be, I think, a tougher time for the travel providers, the airlines than it is going to be for the retail and branding sectors. Aviation firms themselves face a difficult long-term environment. Traffic is growing again and will continue to grow in the future. But it is going to stay hard for the aviation firms to make money in this environment because they are dealing with three difficult trends: 1) an increase in low-cost airline competition, 2) blockages because of regulatory factors between countries, against the ability to build economies upscale in the aviation industry because mergers are so difficult and 3) the democratisation of travel as it becomes larger and larger but cheaper and cheaper. There will be a bounce back of traffic. This is what happened after the Gulf War. After recession, it came back quite quickly.



The longer-term trend is not good for the aviation industry. Because although traffic has been rising, the top bar (revenue passenger kilometers) actual revenue has been rising more slowly than world GDP because of pricing



This chart is about US airlines only but it shows that the breakeven level for US airlines has been rising because of the factors that I have been describing. So for them, I think, it is going to be tough. But it is going to be much better, I think, for the brands sold through airports, through your retail outlets. All of the trends that have been dominant in the last twelve years are, I think, long-term trends, not just a single decade trend. Of globalisation, of spreading middle class affluence, of emerging autonomy for individuals within newly enriched countries, of the task of consumers to have to deal with information overload that brands can help you with because of the channeling effect it has on your information and the growth of aspirational and positional preferences.



This is just a chart of share prices of the three big publicly quoted luxury brand companies, LVMH, Richemont and Gucci which do show what a beating their share prices took in 2000, 2001 by the weakening global economy, by a slippage of Japanese spending that was described earlier and by September 11th. But I think this is temporary. The basics are still there.

Higher and higher
Wealth by region of high-net-worth individuals*
\$trn

	North America	Europe	Asia	Latin America	Rest of world	Total
1997	5.9	4.8	4.0	2.5	1.9	19.1
1998	6.9	5.6	4.4	2.7	2.0	21.6
1999	8.1	6.7	5.4	3.1	2.2	25.5
2000	8.3	7.2	4.9	3.3	2.8	26.5
2005†	13.0	10.5	7.3	4.8	4.1	39.7

*Those with investible assets of \$1m or more †Forecast
Sources: Merrill Lynch; Cap Gemini Ernst & Young

This table shows a forecast of the spread of high net-worth individuals around the world, the top end of the market, how wealth is being created and how it is also being spread wider and wider. Forecasts can, of course, be wrong. Indeed, they usually are. But they are usually wrong in the details rather than in the direction and I think, in this case, the direction is absolutely right. And the trends we have seen are going to continue, particularly, the democratisation of luxury. The spread of luxury brands to a lower and lower segment of income as people use brands to satisfy their aspirations and, one hopes, use *The Economist* to satisfy their aspirations as well as a particularly economically viable luxury brand.

The overall picture is good, I think, for your industry and for the world. I like to use this winemaker's term, "paranoid optimism". A winemaking friend of mine from the south of France tells me he is always optimistic that this year's

harvest is going to be the best one ever, that the opportunities to make the best wine he has ever had better than they ever been. But he is just paranoid, that there are risks that bad things are going to come along, disease or rain at the wrong time might ruin things. And that, I think, is the right phrase to shape our thoughts about the world's future.

I want to leave you, Ladies and Gentlemen, with a world ordered by three words. The first one is *inspiration*. This is, I think, a fabulously inspiring period in world politics and world economy with America acting truly as a sheriff, as a leader with the world converging in economic terms, with spreading trade and the spread of capitalism and with technology building development still further into the future.

The second word is *perspiration*. There are formidable political risks ahead that we are going to have to roll up our sleeves and try to deal with through Winston Churchill's words of "blood, sweat, toil and tears".

But also the final word is *aspiration*. We really can aspire to deal with these risks, to see our way through this tough world and to find some enormous opportunities for the future. If we can deal with those risks, the opportunities for the world in the next 10 to 15 to 25 years really are the best they have ever been in history.

And, Ladies and Gentlemen, that would be fantastic for your industry, it would be fantastic for the world and our task is to get ourselves there. Thank you very much for listening.