Not a People's Republic - an empire

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We often say that money managers are not paid to forecast, but to adapt. The challenge, of course, is knowing what to adapt to. For example, an investor picking up a copy of today's *Financial Times* will be left scratching his head over the importance of the Greek crisis to the future of the eurozone, the likely impact of coming US Federal Reserve rate hikes, and how the deepening oil supply glut will affect global markets. In our latest Quarterly Strategy Chartbook, we elected to bypass all these hoary old questions to focus solely on what we believe to be the single most important macro-trend of our time: China's attempt to transform itself from a typical (if large) emerging market into an empire (see [China] A Dream of Asian Empire).

In his must-read book *East And West*, Cyril Northcote Parkinson recounted the rise and fall of empires across the Eurasian landmass since the beginning of civilization, and proposed that "one of the strongest motives for human interference [in another country's affairs] is the spectacle of fumbling ineptitude. 'Oh, for heaven's sake,' we burst out, 'I'll do it for you!'" Of course, one can argue these words, written in 1963, reflect the author's cultural upbringing, no doubt loaded with a hefty dose of Rudyard Kipling's "white man's burden". For, at the end of the day, the main driving force behind empire-building is usually an attempt by the center to source commodities ever more cheaply and, in turn, to churn out manufactured goods for sale ever more profitably to the periphery.

Of course, empires through history have found that building the roads (or railways or ports) was the easy bit. Maintaining security along those roads, and getting along with the locals, proved more challenging. This is why maintaining an empire is an extremely costly (and ultimately temporary) exercise. And it is why empires have always needed their own currencies (whether sterling for the British Empire, the US dollar for the post-war American era, or the euro for the 1980 to 2010 attempt to build a European empire).

Simply put, building an empire on somebody else's dime is a non -starter, which is why, given its geopolitical ambitions, China today has little choice but to embrace the internationalisation of the renminbi.

Now the interesting bit for investors is that growing empires usually breed strong currencies. As the empire expands, more trade gets denominated in the empire's currency, more companies need working capital in the empire's currency, and more individuals begin to save in the currency of the empire. At the same time, wealth-creators at the empire's fringes buy assets at the seat of the empire's power, and real estate at the center of the empire appreciates disproportionately. A clear example over recent decades, has been the growing use of the euro as a store of value, a unit of account, and a currency of exchange. As the "European empire" expanded to the east, the demand for euros kept growing and the euro was, for a couple of decades a "structurally strong" currency.

Today, as China starts to roll out its own imperial project, should we not expect use of the renminbi to grow, not only across Asia, but perhaps also as far afield as Europe and Africa? And won't this new structural demand for renminbi help to keep Chinese interest rates low, and the currency strong, at least while the Empire is expanding?

This does not mean China will necessarily be successful in its attempt to build an empire. For a start, Beijing lacks a genuinely efficient diplomatic service, which historically has been a prerequisite for peaceful expansion. As Parkinson observed, "the mere ascendancy of the one civilization... must eventually create an atmosphere of resentment. Nor is the hostility directed against tyrannical rulers as such. Hatred springs rather from being treated, however kindly, as inferiors". Already, in most of its imperial bridgeheads (Angola, Sri Lanka, Myanmar), China is experiencing mounting political resistance, caused by the heavy-handed treatment of locals by Chinese businesses (which, to use Parkinson's words, are often not shy of treating the local population as "inferior").

Nevertheless, the geopolitical reality remains that - at a time when the European empire has visibly stalled, the American empire seems to have lost its appetite for foreign entanglements (look at the mess it has left behind in the Middle East), and the Russian empire is fighting a rear-guard action for global influence - the Chinese empire is laying railroad tracks across Eurasia, pushing roads into Indochina, and building pipelines through Pakistan. If all else is equal, this at the very least argues for a stronger renminbi going forward, and lower Chinese interest rates as more people, companies and governments start to save increasing amounts in renminbi.

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