# Rise of the machines - how will the EMs keep pace?

Pippa Malmgren | Principalis Asset Management | 27 March 2014

The emerging market meltdown raises an interesting question. Will the devaluations render them more or less competitive? In theory, devaluations ought to leave a country more competitive. But much depends on the level of inflation you start with.

India, South Africa and Argentina, for example, were already experiencing enough upward price pressure to provoke heightened and even unrealistic wage demands. With the devaluation, import costs and wage demands will rise substantially.

Whirlpool bumped up the price of washing machines in Argentina by 30% immediately after the 23% devaluation in February 2014. Any country that has to import food or energy is going to find the cost of living rising sharply. So we can expect further wage demands to ensue and cost pressures to increase across countries from Asia to Latin America.

Most of the media attention has focused on Argentina and Turkey but the range of countries that have been knocked around by devaluation is much larger. The 19% devaluation of the tenge in Kazakhstan will undermine the competitiveness of much of the rest of Central Asia from Tajikistan to Kyrgyzstan. The combination of devaluations in Argentina and Venezuela will impact on the rest of that continent. The Chilean, Colombian and Uruguayan pesos were already under pressure before the EM meltdown but will be under more now. Nigeria's plans to devalue are bound to turn the screw on South Africa, which is already suffering from a significant drop in the currency.

## CHINA'S DEBT MOUNTAIN

It may seem that China managed to escape the devaluation, but suffers for lack of it. The overvaluation of the renminbi is, however, contributing to an ever increasing debt problem.

And, now that regional neighbours have cheaper, less expensive currencies, China's relative lack of competitiveness is more apparent, thus exacerbating the debt problem.

Let us understand how severe the debt problem in China really is. It forced an unknown party in the country to engage in a record US$3 billion bailout of China Trust Equals Gold, an event many describe as "China's 'Lehman Brothers' moment".

Is it just pure coincidence that the EM devaluations and the collapse of the biggest Trust in China, and attendant record interventions by the PBOC, happened at nearly the same time? Perhaps so, but the events raise many questions. How big is the debt problem in China? It is said that the assets managed by its 67 major trust companies have risen by 60% in a year.

Can the problem possibly be resolved if the Chinese cannot devalue?

This raises another fundamental question – can devaluations really restore competitiveness if inflation is undermining it as well? Things have changed in recent years. Devaluation now merely worsens the already reduced competitiveness of many emerging markets.

## THE ROBOTIC REVOLUTION

But we also face a technological jump that they may, or may not, be able to keep up with.

Devaluation and robotics are a new combination on the landscape of the global economy. The labour component of manufactured goods has collapsed worldwide. But rising labour costs in EM and falling ones in the developed world have begun to push the location of manufacturing and other endeavours away from 'cheap' emerging markets and back to the industrialised nations.

The introduction of robotics accelerates this trend. Foxconn, nearly the largest employer in China with 1.2 million employees, recently announced the biggest ever order placed for robots. It intends to have 1.4 million by the end of this year. The company has also announced a joint venture with Google and is in discussions with The Chocolate Factory, the firm that just bought DeepMind, an artificial intelligence business, for half a billion US dollars.

As the production side turns more and more toward robotics, the skill required will be in service – endeavours in which EM countries, so far, have little skill. EM workers may be cheaper due to devaluation but can they leapfrog into a robotics world where the required skills reside mainly elsewhere?

Then there is the 3D printing revolution that sounds gimmicky today but already looks set to revolutionise costs and the location of production and change the definition of what is possible. From mining to energy extraction, 3D-printed spare parts will reduce the time lags and costs associated with ever deeper drilling. In the food arena, 3D-printed food will combine Ferran Adrià's chemistry of flavour with proteins that used to be considered unpalatable to create foodstuffs that will, over time, vastly diminish food shortages and take the pressure off food prices. From The Chocolate Factory's artificial intelligence activities to the 3D printing of chocolates at home on a new ChefJet Pro, the world of production is undergoing a revolution.

In another example, prosthetics for children used to be expensive and short-lived given that kids keep growing. But now a €10,000 artificial arm can be 3D-printed with similar mobility for €10. Add bioengineering to the mix and we'll soon see 3D-printed organs and limbs as well.

This is a revolution of the first order. Even the West may not be ready for this let alone the EM countries.

Whether the latter can innovate fast enough to keep up is an open question. Those brave enough to go international, to learn about brands and offer service, are the ones to watch. So instead of decrying the globalisation of the Foxconn's of the world, we ought to encourage it.

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