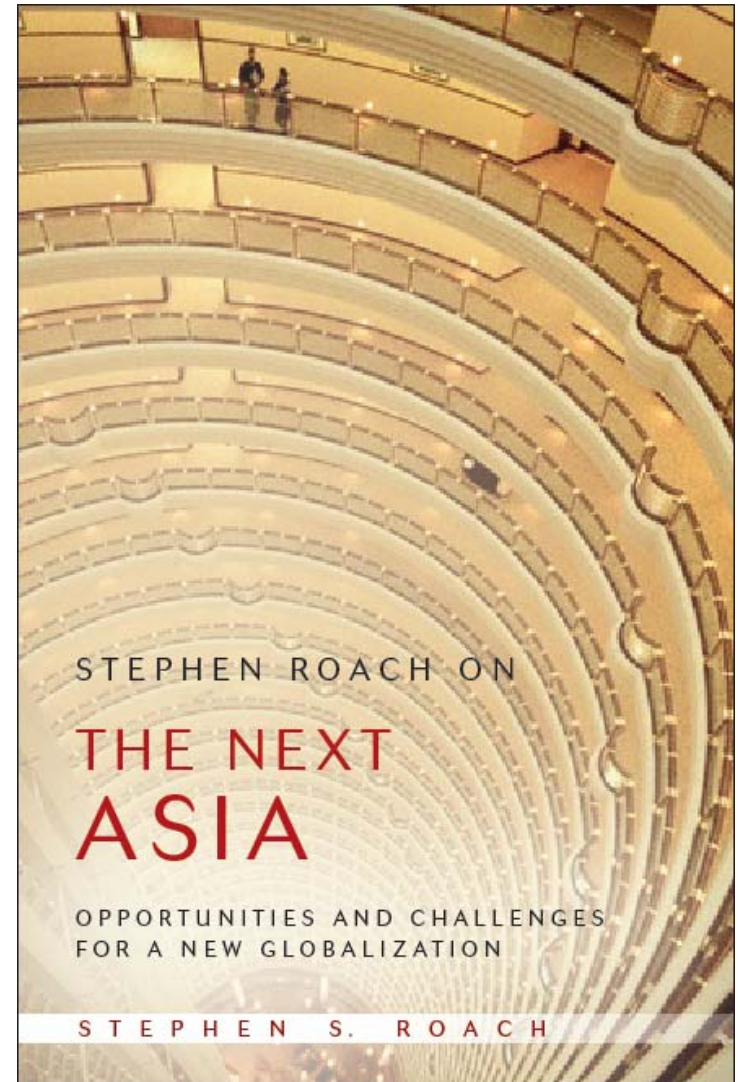


# The Next China

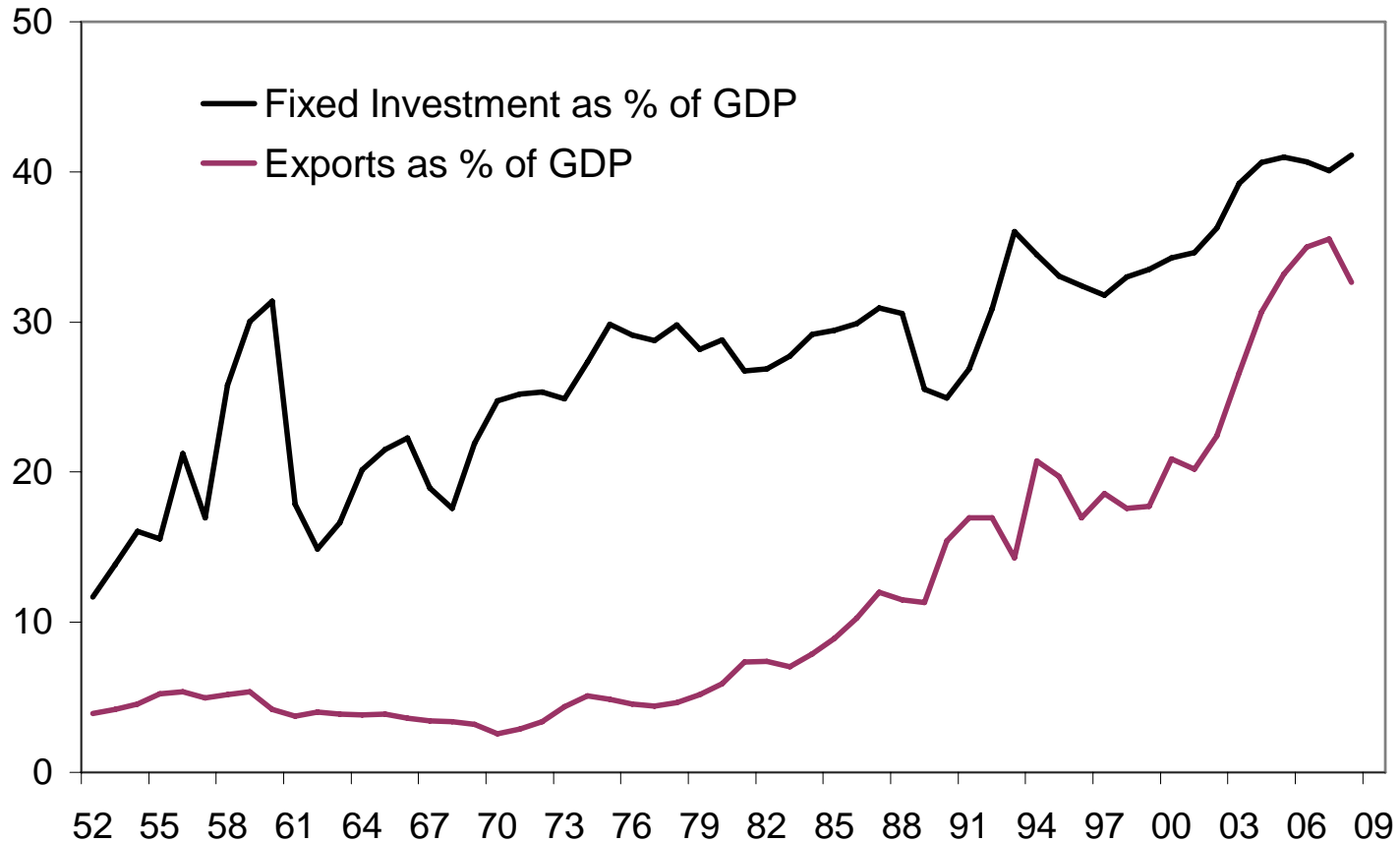
Stephen S. Roach  
Chairman  
Morgan Stanley Asia

**Asia Banking and Finance Conference**  
**Federal Reserve Bank of San Francisco**  
***San Francisco***  
***June 7, 2010***



# China's Growth Miracle

*"Unstable, unbalanced, uncoordinated, and unsustainable."*  
— Premier Wen Jiabao, March 16, 2007

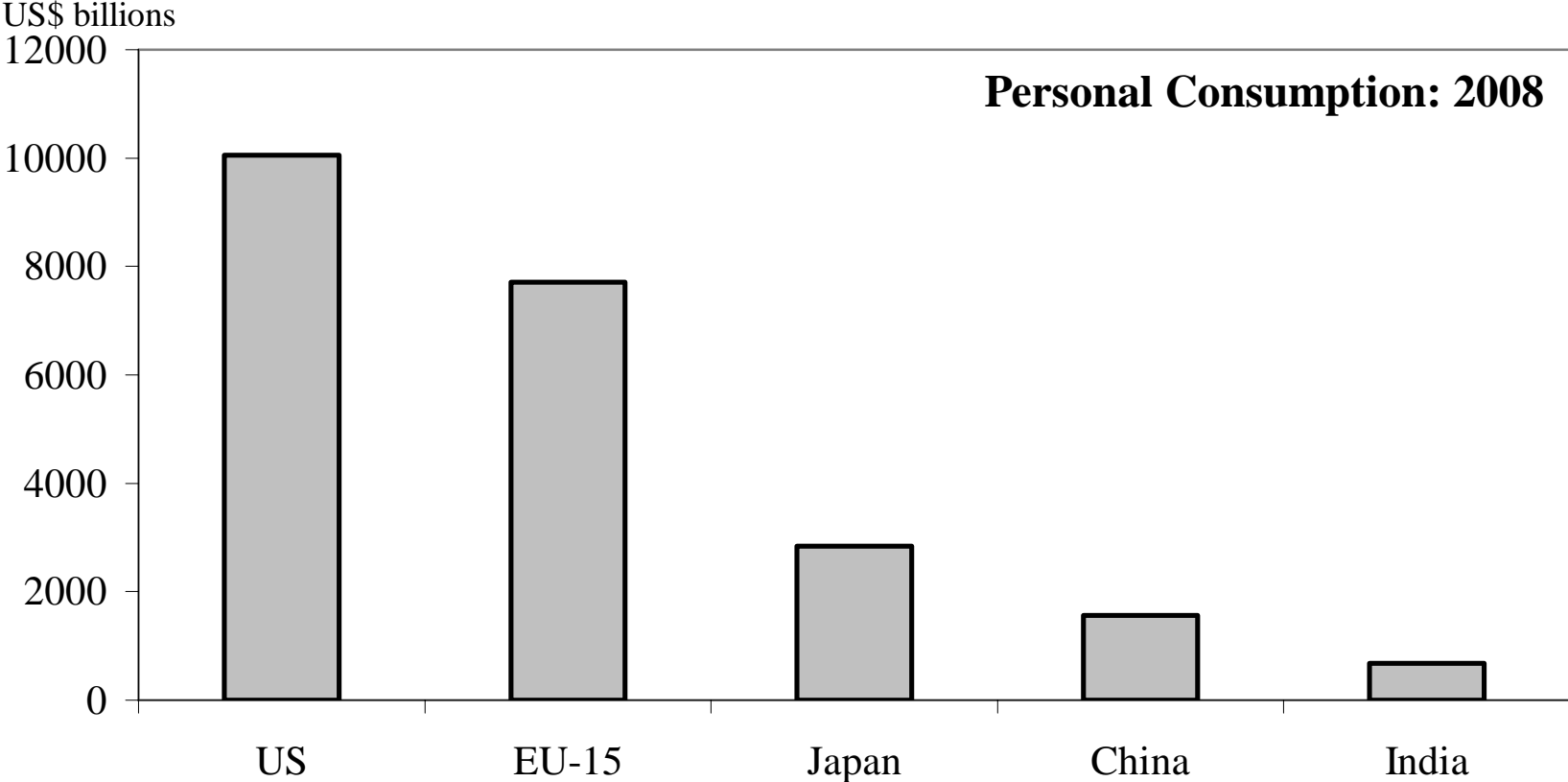


Source: CEIC, Morgan Stanley Research

Morgan Stanley

This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. This material was not prepared by the Morgan Stanley research department. Please refer to important information and qualifications at the end of this material.

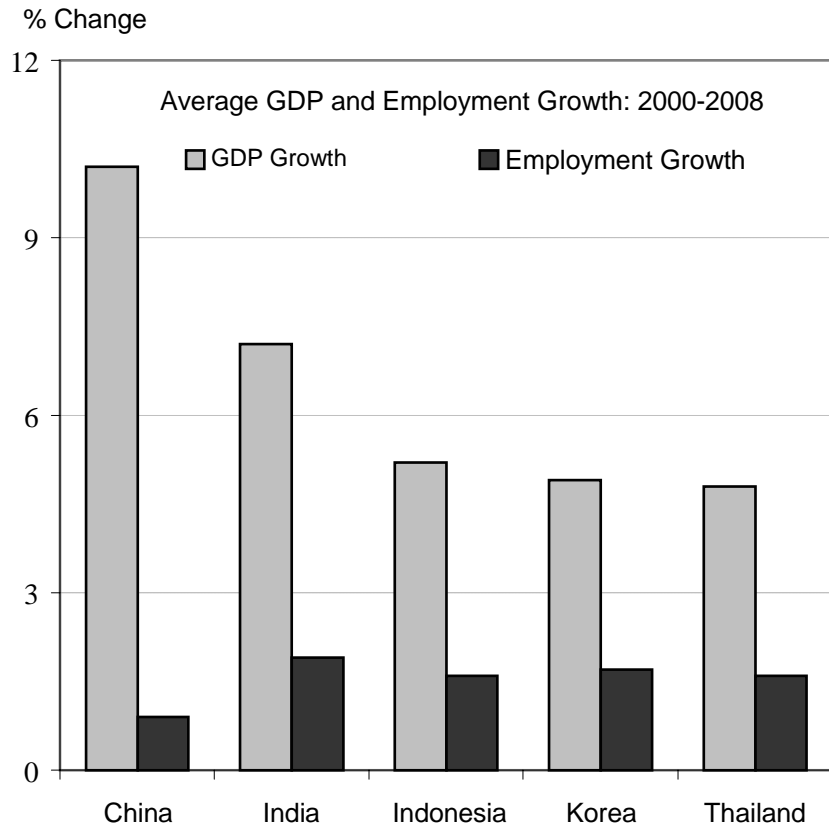
# The Global Consumer



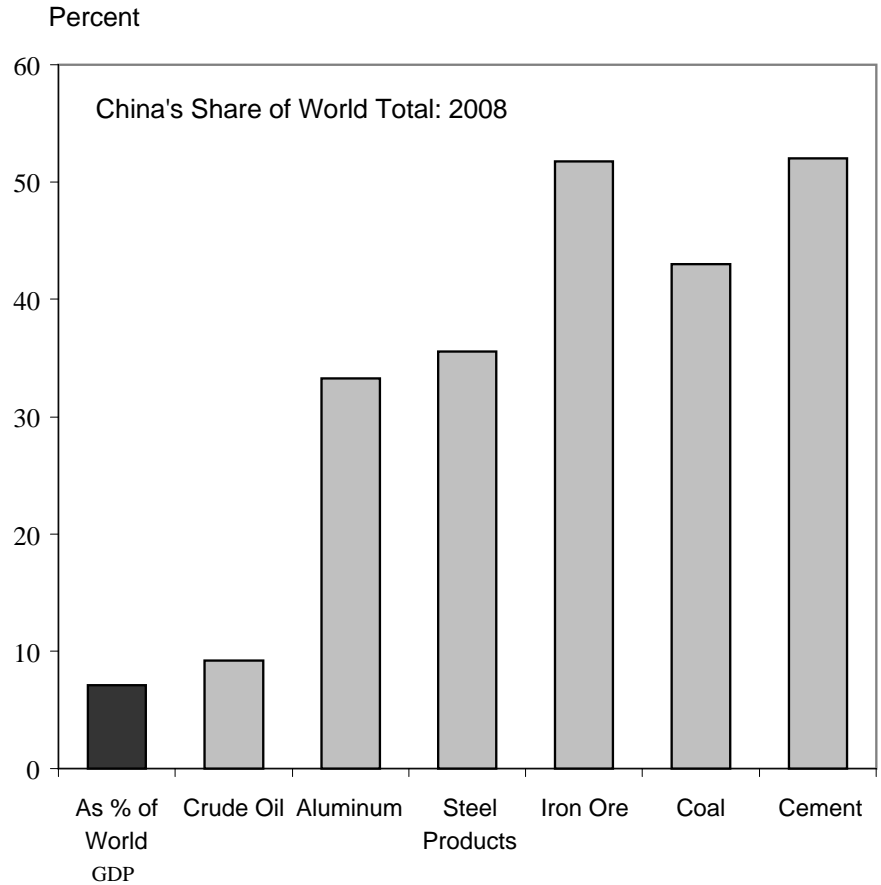
Source: National Sources, UN, Morgan Stanley Research

# China's Structural Deficiencies

## Labor-Saving



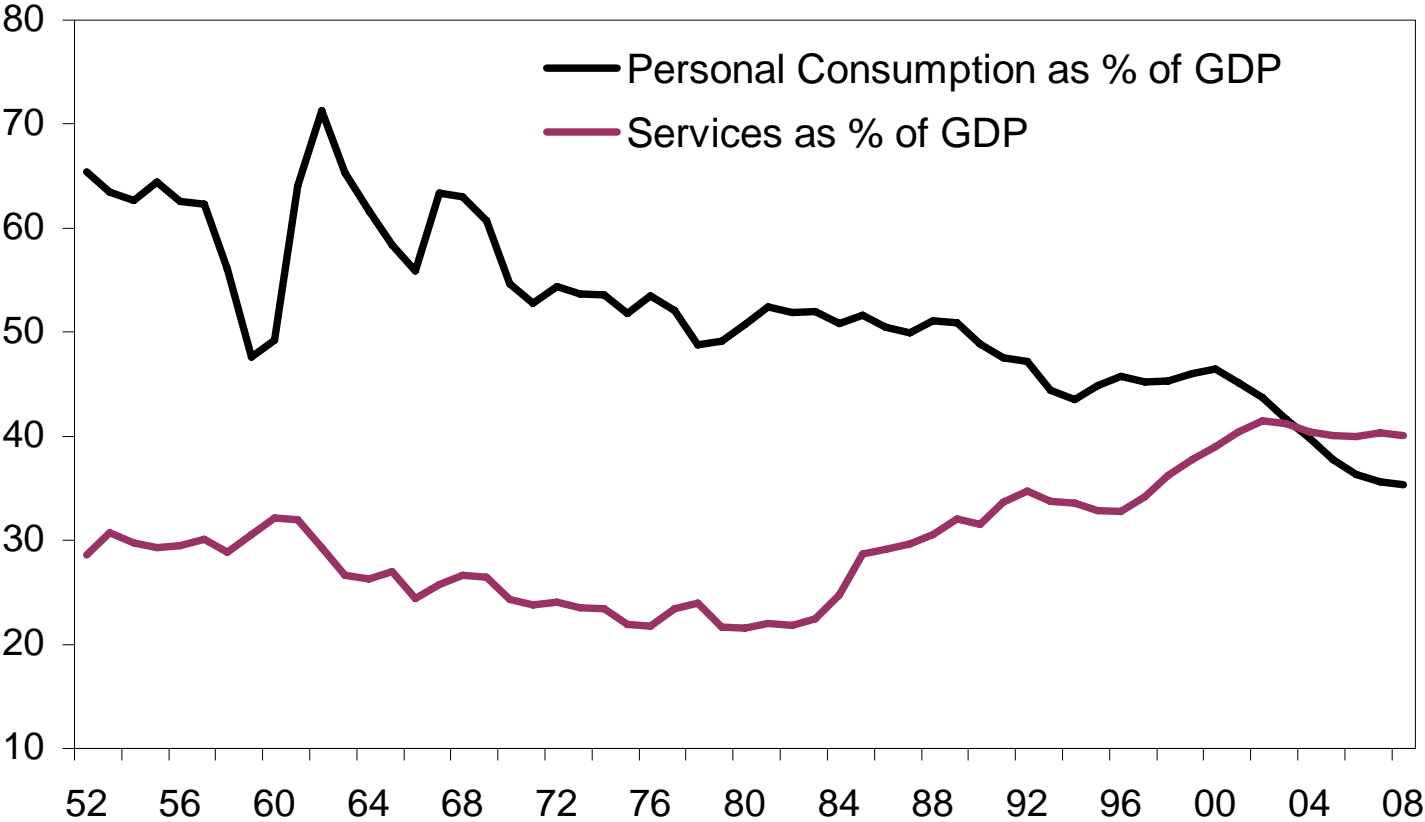
## Resource-Intensive



Source: Eswar Prasad, "Rebalancing Growth in Asia," *Finance and Development*, December 2009.

Source: IMF, WBMS, BP, CRU, Morgan Stanley Research

# China's Untapped Macro Potential



Source: CEIC, Morgan Stanley Research

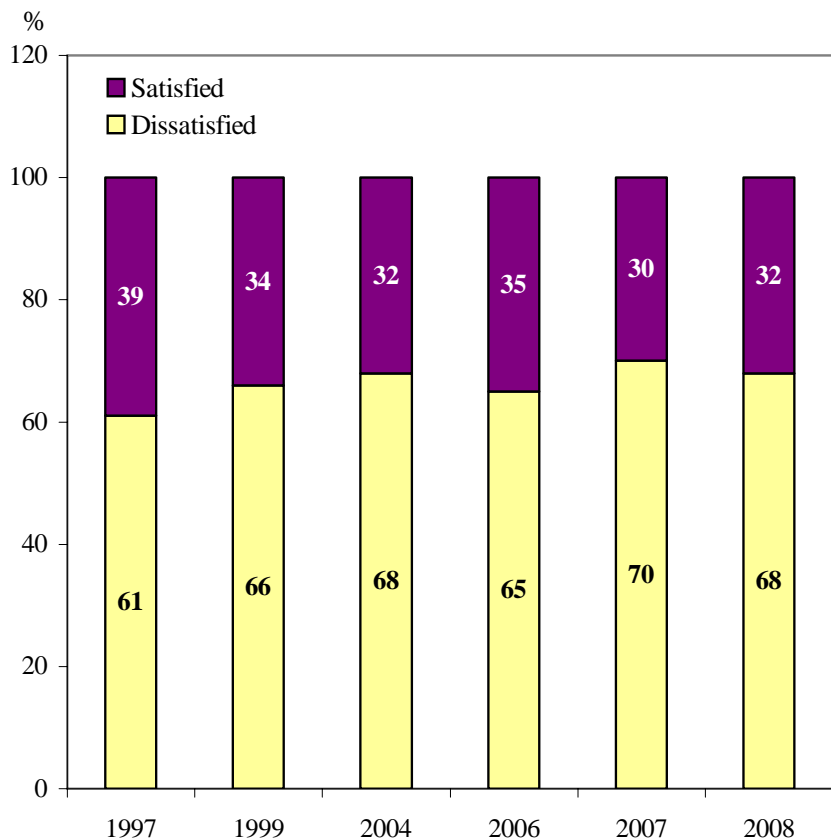
# Asia's Unbalanced Macro Structure

| Shares of GDP                | 1995  | 2000  | 2008  |
|------------------------------|-------|-------|-------|
| <b>China</b>                 |       |       |       |
| Private Consumption          | 44.9% | 46.4% | 35.3% |
| Investment                   | 40.3  | 35.3  | 43.5  |
| Net Exports                  | 1.6   | 2.4   | 7.9   |
| Household Saving Rate        | 29.5  | 27.5  | 37.5  |
| <b>Other Developing Asia</b> |       |       |       |
| Private Consumption          | 67.3% | 65.1% | 58.4% |
| Investment                   | 25.9  | 25.0  | 23.6  |
| Net Exports                  | -7.6  | -1.4  | 2.9   |

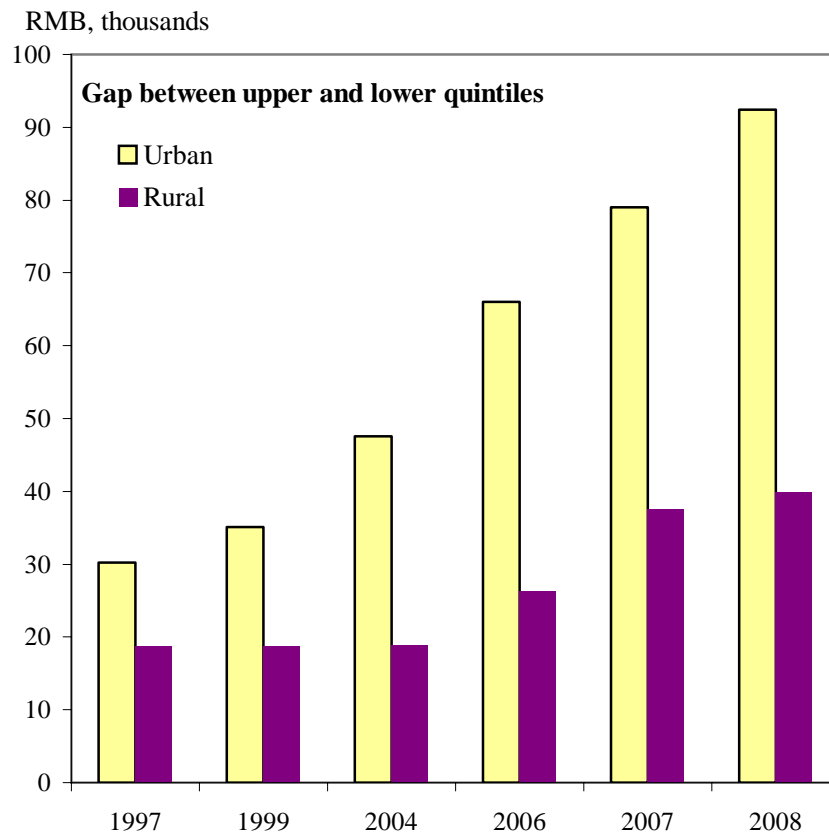
Source: Eswar S. Prasad, "Rebalancing Growth in Asia", Cornell University, July 2009

# Headwinds for the Chinese Consumer

## Saving Sentiment



## Income Disparities: Urban vs. Rural



Source: The Gallup Poll of China: Nationwide Polling, 1997-2008

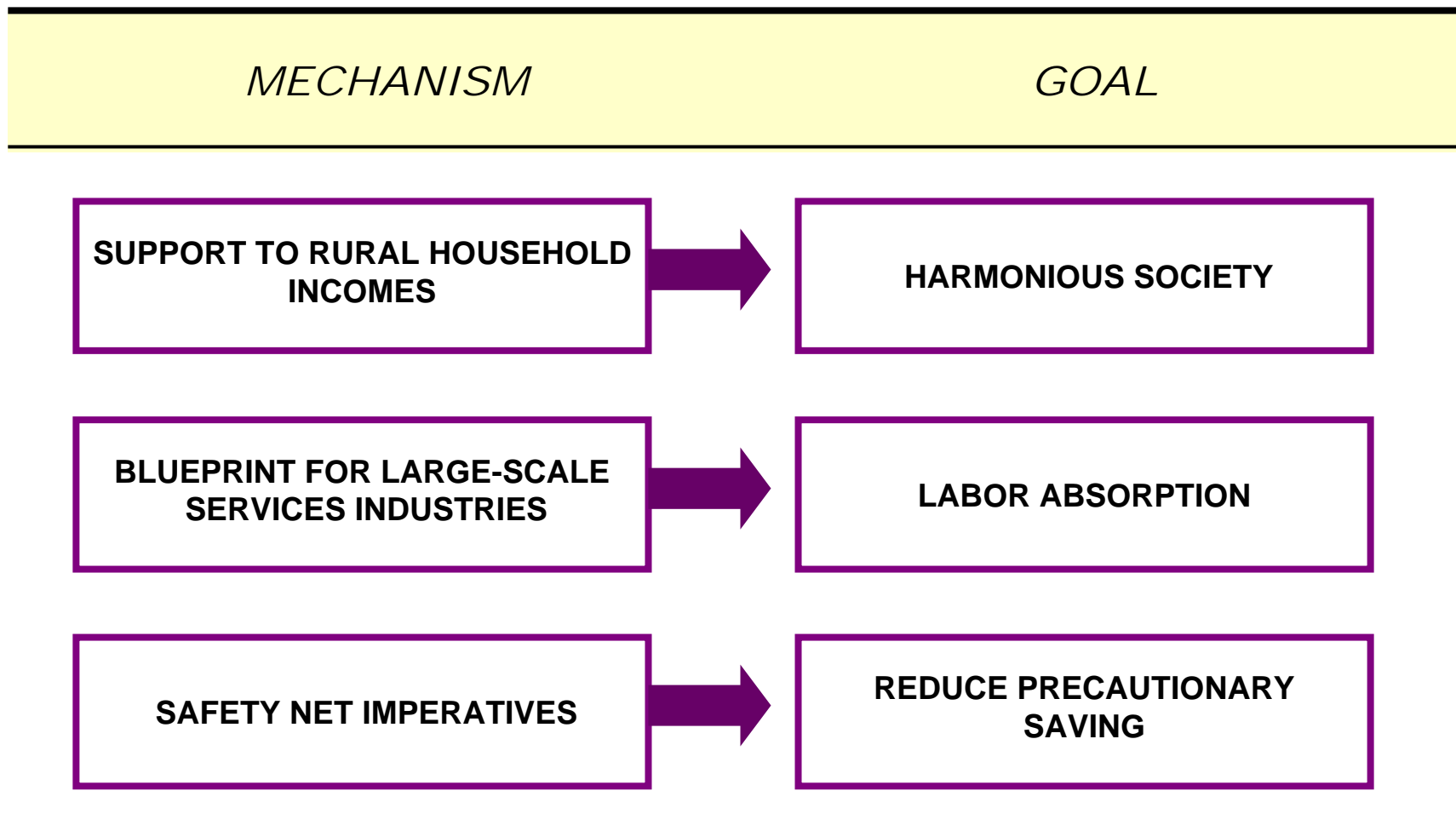
# The Opportunities for Chinese Services

|   | China<br>(Urban Workforce) | United States |
|---|----------------------------|---------------|
| <b>Total Employment (Millions)</b>                | 120.2                      | 131.6         |
| <b>Primary</b>                                    | 8.0%                       | 2.1%          |
| <b>Secondary</b>                                  | 37.6%                      | 13.0%         |
| <b>Tertiary</b>                                   | 54.4%                      | 84.9%         |
| <b>Government</b>                                 | 10.7%                      | 17.1%         |
| <b>Private Services</b>                           | 43.7%                      | 67.8%         |
| <b>Wholesale &amp; Retail Trade</b>               | 4.2                        | 15.1          |
| <b>Transportation</b>                             | 5.2                        | 3.1           |
| <b>Utilities</b>                                  | 2.5                        | 0.4           |
| <b>Information Services</b>                       | 1.2                        | 2.1           |
| <b>Financial Services (including Real Estate)</b> | 4.6                        | 5.8           |
| <b>Education</b>                                  | 12.6                       | 2.3           |
| <b>Healthcare</b>                                 | 4.5                        | 12.4          |
| <b>Professional &amp; Business Services</b>       | 4.1                        | 12.6          |
| <b>Leisure and Hospitality</b>                    | 2.6                        | 9.8           |
| <b>Other Private Services</b>                     | 2.2                        | 4.2           |

*Note: For China, employment structure is for 2007; for the United States, data are for January 2010. Source: National Bureau of Statistics of China and US Bureau of Labor Statistics.*



# Pro-Consumption Agenda for China's 12th Five-Year Plan



# Benefits of Chinese Rebalancing

- Macro sustainability
- Narrowing of income disparities
- Lighter, cleaner, greener GDP
- Trade windfalls for Korea, Japan, and Taiwan
- Defuses currency tensions

# A Brief History of the World

## Shifting Mix of Global GDP

|              | Western Europe | FSU        | United States | Japan      | China       | India       |
|--------------|----------------|------------|---------------|------------|-------------|-------------|
| 1500         | 17.9%          | 3.4%       | 0.3%          | 3.1%       | 25.0%       | 24.5%       |
| 1600         | 20.0           | 3.5        | 0.2           | 2.9        | 29.1        | 22.5        |
| 1700         | 22.5           | 4.4        | 0.1           | 4.1        | 22.3        | 24.4        |
| <b>1820</b>  | <b>23.6</b>    | <b>5.4</b> | <b>1.8</b>    | <b>3.0</b> | <b>32.9</b> | <b>16.0</b> |
| 1870         | 33.6           | 7.6        | 8.9           | 2.3        | 17.2        | 12.2        |
| 1913         | 33.5           | 8.6        | 19.1          | 2.6        | 8.9         | 7.6         |
| 1950         | 26.3           | 9.6        | 27.3          | 3.0        | 4.5         | 4.1         |
| <b>1973</b>  | <b>25.7</b>    | <b>9.4</b> | <b>22.0</b>   | <b>7.7</b> | <b>4.6</b>  | <b>3.1</b>  |
| 1998         | 20.6           | 3.4        | 21.9          | 7.6        | 11.5        | 5.0         |
| <b>2008</b>  | <b>17.1</b>    | <b>4.4</b> | <b>18.6</b>   | <b>5.7</b> | <b>17.5</b> | <b>6.7</b>  |
| <b>2015e</b> | <b>15.9</b>    | <b>4.0</b> | <b>18.3</b>   | <b>5.5</b> | <b>17.8</b> | <b>7.6</b>  |

Note: Based on 1990 International (PPP) Dollars; FSU is Former Soviet Union.

Source: Angus Maddison, *The World Economy: A Millennial Perspective*, OECD (2001); IMF, Morgan Stanley

# Disclosures

This communication is not a product of Morgan Stanley's Research Department and is not a research report but it may refer to a Morgan Stanley research report or the views of a Morgan Stanley research analyst. We are not commenting on the fundamentals of any companies mentioned. Unless indicated, all views expressed herein are the views of the author's and may differ from or conflict with those of the Morgan Stanley's Research Departments or others in the Firm. For additional information, research reports and important disclosures, see <https://secure.ms.com>.

The information provided herein has been prepared solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell the securities or instruments mentioned or to participate in any particular trading strategy. This information is based on or derived from information generally available to the public from sources believed to be reliable. No representation or warranty can be given with respect to the accuracy or completeness of the information, or with respect to the terms of any future offer or transactions conforming to the terms hereof.

This report does not provide individually tailored investment advice. It has been prepared without regard to the circumstances and objectives of those who receive it. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages them to seek a financial adviser's advice. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. Morgan Stanley Research is not an offer to buy or sell any security or to participate in any trading strategy. The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized.

Copyright © by Morgan Stanley 2010, all rights reserved.