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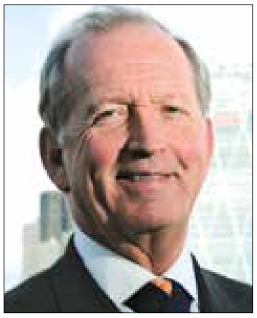
INTERVIEW WITH ALDERMAN ALAN YARROW

LORD MAYOR OF THE CITY OF LONDON



ALAN YARROW graduated from Manchester Business School. He left Dresdner Kleinwort in December 2009 after 37 years with the group, latterly as Group Vice Chairman and Chairman of the UK Bank. He was formerly Deputy Chairman of the FSA Practitioner Panel, Chairman of LIBA, Director of Complinet, a member of the Takeover Panel and of the Council of the British Bankers Association. He was appointed Chairman of CISI (Chartered Institute of Securities and Investment) in September 2009. He was also a member of the Chancellor of the Exchequer's High Level Stakeholder Group and was appointed Lord Mayor of the City of London in November 2014.

The Lord Mayor's annual trip to China is always a highlight of the City calendar. What was the background to this year's visit?

It all stems from a speech the Queen made during her State Visit to Ireland in 2011, in which she noted that our exports to Ireland were greater than those to Brazil, Russia, India and China combined – that's a country with a population of about four and a half million versus an economic bloc with about 2.8 billion. I think that was a big wake-up call for a lot of people – and it made the UK government realise that something had to change in terms of our global trading relationships.

There is a possibility that we might not be in the same situation with Europe in two or three years' time, and we're going to need to have other irons in the fire. The Germans do it, the Italians do it, the French do it – and they all seem to do it better than us.

Why do you think that is?

I think our focus on Europe distracted us from building relationships across the rest of the world. Europe is only one continent, and we need to remember that. The fact is we've got to get out there and sell our products and services – and I like selling the City, because it's an extremely good product. I'm always amazed at the discrepancy between the reception I get when I go to a country like Mexico, where they think the streets of London are paved with gold, and the attitude of the media in this country, which sees the City as an easy target.

What do you see as the UK's biggest attraction, in financial services terms, for a country like China?

Where do you want to start? We can offer them our technological expertise, our capital markets, and our capabilities across a whole range of professional services.

It all comes back to trade, and the importance of having a diversified portfolio. China doesn't want to spend all its money with the Germans, or the French, or the Italians, they want to spread their risk and invest in a variety of industries and economies – and the one truly world-beating industry we've got is financial and professional services.

We have the largest international financial market in the world, and we've got hundreds of years of experience to back it up – both good and bad. As I told some of the investors I just met in China, I've lived through eight bear markets, three of them nasty ones, and we often get it wrong. But we are willing to accept the fact that we got it wrong – and we are willing to share with them how we put it right.

How did that message go down, in light of the recent turbulence in the Chinese stock market?

I think they were glad to hear it. The fact is that the Chinese stock market is still very young: 85 or 90 per cent of it is made up of individual investors, basically speculating on the market – and that's very volatile. One of the most important messages I wanted to get across during my visit is that long-term institutional investors are critical shock-absorbers in volatile markets, because if you've got a thirty-year view, you're a value buyer, you're not a momentum buyer. Whereas if you're an individual investor in a country like China, you might have a five-minute view of a stock, or a day's view – but you're basically a day trader. On top of which many of them are heavily leveraged. But if you don't look at earnings per share, if you don't look at the cash flow, it's literally someone's latest tip.

What we are talking about is life assurance, pension funds – 30-year money, effectively – which is ideally suited for infrastructure spend. Those are the people who sell when the market is looking expensive and buy when it's cheap, and that's what gives you the shock absorbers at each end. The UK market is 85 per cent institutional – in China it's 85 per cent retail.

I'm not saying that's a bad thing, after all you've got to start somewhere, and speculation is quite a good way of starting a business. After all, the London market began with merchants taking risk on ships laden with mace or nutmeg coming back from the Caribbean or the East Indies. It all comes back to hunger and desire for profit, and harnessing those basic emotions to raise money for small companies, thereby creating jobs and growth. The trick is to harness the gambling instinct and put it to productive use in the capital markets.

Having spoken to policy makers, business leaders and investors during your time in China, what is your analysis of the economic temperature and sentiment in the country?

Well, there's no doubt that things are slowing down, that much is evident, but is that necessarily a bad thing? After all, I expect 5 per cent growth in 2015 is probably still greater than 15 per cent growth was in 2007 – it's still phenomenal growth, particularly when you think that people are worried America's about to overheat at 3.5 per cent.

As for falling copper prices, falling nickel prices, falling oil prices – is that good or bad for the world economy? Well, I'm afraid I'm old school – I think it's good for the world economy because it puts more money in consumers' pockets, and the consumer begins to spend a bit more.

These are natural balancing items. Prices go down, inflation's under pressure. Do I think deflation is a big problem? Potentially – but there are two different types of deflation: one is a commodity-driven one, but it's certainly not apparent in property prices.

Before the recent stock market 'wobble', the Chinese government's stated policy was that market forces should play a more decisive role in the country's economy. Do you think the experience of the last few months is likely to reinforce that view or reverse it?

First of all, they need to take stock and work out what went wrong. And I don't mean what went wrong with the market, because they know that – it had leverage, it was far too expensive, and it was far too high. It had to be brought back under control. Ironically, their problem was more to do with the regulatory measures that were taken to try and control events. We, in the UK, learned from the exit of sterling from the ERM – and more recently, the Swiss Government's efforts to control the value of the Swiss franc – that trying to intervene in the market on that scale simply doesn't work. It is one thing to try and take some of the volatility out of the short-term movements, but you can't change the overall trend.

I think it's been a learning experience, particularly for the regulators, and this is an area where we can help, because we've been in that position ourselves.

When something goes wrong on this scale, the first bullet to be fired is always at the short sellers. But short selling *per se* is not actually a bad thing, because it can help to get you closer to a realistic evaluation for a stock more quickly.

I think there are a couple of things that could be done to strengthen the market going forward though, and perhaps the most important of these is to improve the transparency of the official economic statistics – because if investors don't know where the figures are coming from, it's very difficult to arrive at a true valuation of an asset. The government needs to be much more transparent about what the figures are, where they come from, and how they are accumulated. Once you improve the collection of official statistics, proper analysis can take place and people can put a value on what they're buying.

The second point is the rule of law – including the rule of contract and dispute resolution. This is another area of expertise that the UK has, and one that we are happy to share.

Will the 'rebalancing' of the Chinese economy prove a challenge or an opportunity for the City?

Oh, I think there's a huge upside. I have no doubt that we are going to see Chinese companies coming over here to buy banks, insurance companies and private wealth management companies – Fosun has already bid for Kleinwort Benson, for example, and there are a number of other bids out at the moment. We have already seen a number of high-profile property deals, such as the acquisition of the Lloyd's building by Ping An Insurance Group, and this is only going to increase.

It all comes down to global standards. We are seeing more and more Chinese coming to the UK to learn English, and Chinese companies opening offices here, to improve their accounting and legal standards. The UK stands to benefit hugely from the Chinese demand for education, training and qualifications – and in turn, this will enhance the quality of Chinese businesses and institutions.

For the past thirty years, the Chinese economy has been dominated by the state owned enterprises (SOEs), but all the recent productivity gains have come from the private sector. Next year, the working population of China is going to decrease, for the first time ever, so they are going to have to get five per cent growth out of a falling working population – and this is going to have to come from the private sector, so they need to make their private sector more fungible and better placed to innovate.

I think the proposed Shanghai-London Stock Connect is going to give the whole process a fresh impetus. They need to iron out certain technical issues of course, because H shares aren't fungible to A shares (which have a 30 per cent premium) and if they're not fungible you don't get arbitrage, so you're not getting an equalisation of prices. But at the end of the day, you could have a situation where we're seeing a lot more Chinese companies being quoted on the London market as a dual listing.

The other major factor in London's favour is the internationalisation of the renminbi: over 42 per cent of global foreign exchange trading takes place here, twice as much as any other country, so if they want to grow their currency, we need to be involved.

Last year, China Construction Bank was named as the first RMB clearing bank in London – the first in the world outside Asia – while Bank of China fulfils the same function in Hong Kong. So, they're using their own institutions and spreading the institutional knowledge around, which is entirely sensible. But the next stage will be to allow branches of Western banks to do it in China, and again, that's another area where I think we can steal a march on the competition. F

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