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May 23, 2014

Conflicting Messages – Designed to Confuse

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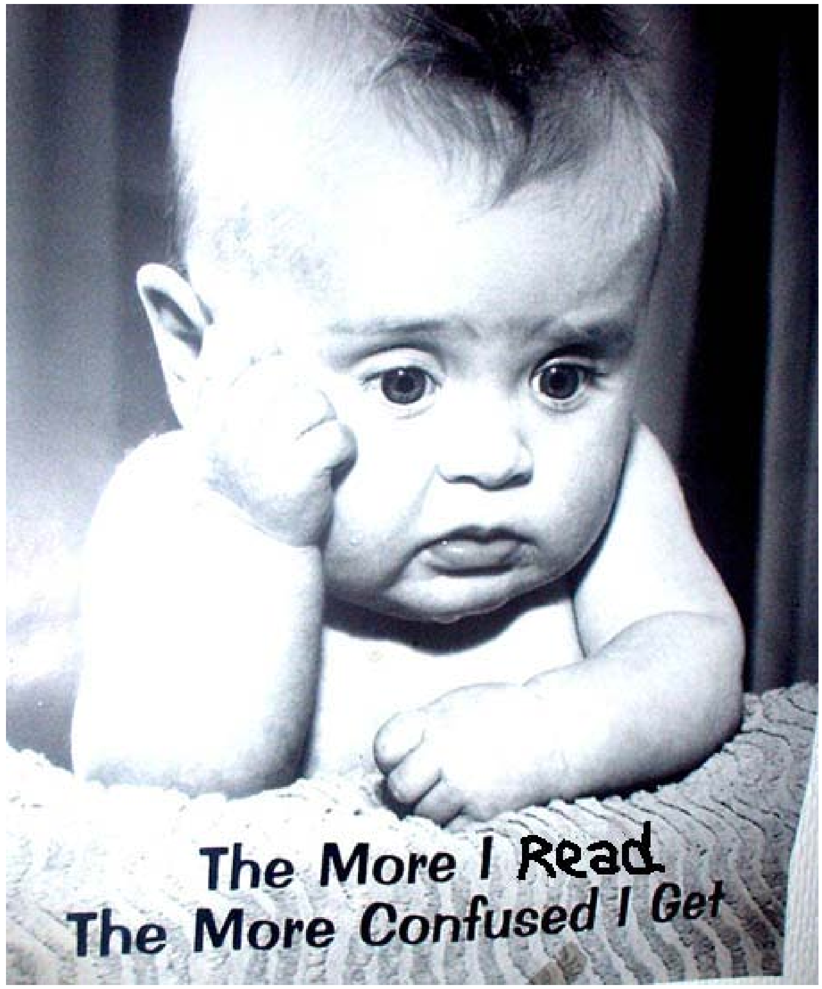
Mr. Dhillon has worked and negotiated with highest levels of Governments in Canada and India. He has pursued and won mandates to develop power plants in Canada, and foreign jurisdictions such as Hungary, Iran, Pakistan and India with uncompromising ethical standards. His extensive experience in securing and negotiating multi-hundred million and billion dollar mandates in power project development, gives him in-depth knowledge and intuitive insights into macro and micro, national and international, geo-political and economic realities and trends.

Mr. Dhillon has been invited to speak on international business at various forums, including as an expert witness for the Standing Senate Committee, Government of Canada, on “The Rise of Russia, China and India”.



The average person around the Globe is bombarded by conflicting news daily about the state of their world, and then told not to worry because everything is fine and mending. With the daily whipsaws of the financial markets (*still trending up*) and the conflicting economic news (*still trending down*), it’s a wonder that the beleaguered ‘Joe Public’ doesn’t have a permanent whiplash and requires a neck brace. To paraphrase a line out of the movie ‘Apocalypse Now’ - ‘the bulls**t piles up so high, you need wings to stay above it’. For example, a news headline in today’s Reuters News said “Euro zone business stays strong, China mending’, then the article goes on to contradict its own headline. No wonder everyone is so confused. Well, we have stayed steady ‘on message’ as we’ll show by this article.

Charlie Sean

The article opens with the line *“Private business activity in the euro zone grew at just under its fastest pace in three years this month, while contraction in China’s vast manufacturing sector slowed to its weakest pace this year, surveys showed on Thursday”.*

The past three years in the euro zone have been as close to a depression as

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one can get without actually being in one. So the fact that private business activity did not even match the one time fastest growth rate, in one of the worst economic periods in the euro zone is ***not*** a good sign. Then it goes on to say "*But in Europe, only drastic price cuts helped stop a further slide, after a sharp slowdown in factory growth"*. Does "drastic price cuts" sound like what the headline had said "Euro zone business stays strong" to anyone? It gets better, *"The slowdown kept alive worries about dangerously low inflation"*. One has to wonder how "worries about dangerously low inflation", in other words, the possibility of actual 'deflation' can equate with "business stays strong"?

Additionally, the article goes on to say " *The ECB is expected to cut what little it has left of its main interest rate and push the deposit rate below zero next month, a Reuters poll predicted this week."* Well, again, the European Central Bank being forced to cut its leading interest rate to '*below zero percent'* is hardly a resounding endorsement of a strong business environment. In fact it seems to be quite the opposite, a level of deterioration of economic conditions that are requiring further and extreme stimulation by way of negative interest rates.

From the direction of current trends, a lot of the euro public isn't buying the positive spin either, and in the upcoming euro zone elections, they may threaten the integrity of the euro zone itself with their choices of the political parties they mean to vote for. In our view, which does not swing and fluctuate with daily data changes, but stays with the overall trend, the business and political situation in the euro zone is far from 'strong' and in fact may rapidly deteriorate further.

On the China "mending" part, the article starts with "*The economic picture was also mixed for the world's second-largest economy, China*." Then it goes on to state that China's PMI (*Purchasers Manufacturing Index*) "*rose to 49.7% in May from April's 48.1 reaching its highest since December and beating the median forecast of 48.1 in a Reuters poll*". Firstly a one month

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rise in the PMI index does not a "mending" make of the Chinese economy which is beset with problems that go far beyond the manufacturing sector.

A proper "mending" process will require sustained improving numbers and not blips from Government intervention as has been happening in the current quarter. The article goes on to state positive sounding indicators next, "*Sub-indexes measuring output as well as domestic and foreign demand all recovered sharply*", but immediately counters the positive line with a very negative sentence next, "*But factory jobs were shed for the 13th month and the overall index was still pointing to contraction*."

Over all, the Chinese economy is in big trouble, as anyone who follows such things knows it, and as the Chinese Government has been acknowledging numerous times of late. The Government's set target growth rate of 7.5% for this year has already been breached, and now the struggle to try and maintain it above 7% is their challenge.

Of course the 800 pound gorilla in the room, when talking about China's economy, is its real estate and credit bubble, which has the size to do similar or greater damage to the Global economy that the credit and housing bubble did in the U.S., at the end of 2008.

The Chinese Government has the advantage in trying to deal with its real estate and credit bubble, with the benefit of hind sight and the knowledge and experience gained in dealing with the 2008 crash, and by studying the causes and triggers of the U.S. credit and housing market crash. But China's problem is the sheer size of its problem. It added in the past five years $14 Trillion in accumulated credit, going from $9 Trillion to over $23 Trillion, which is more credit than the U.S. banking added in its entire history. Now that's saying something.

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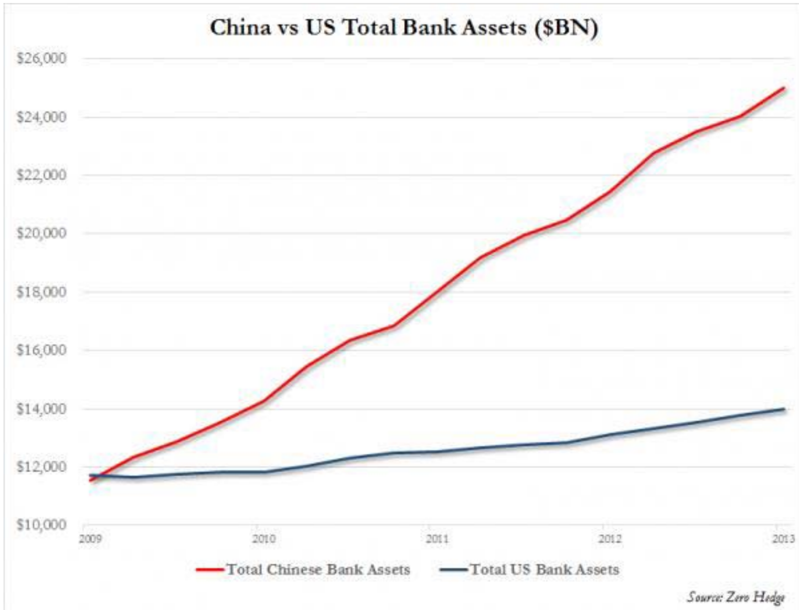
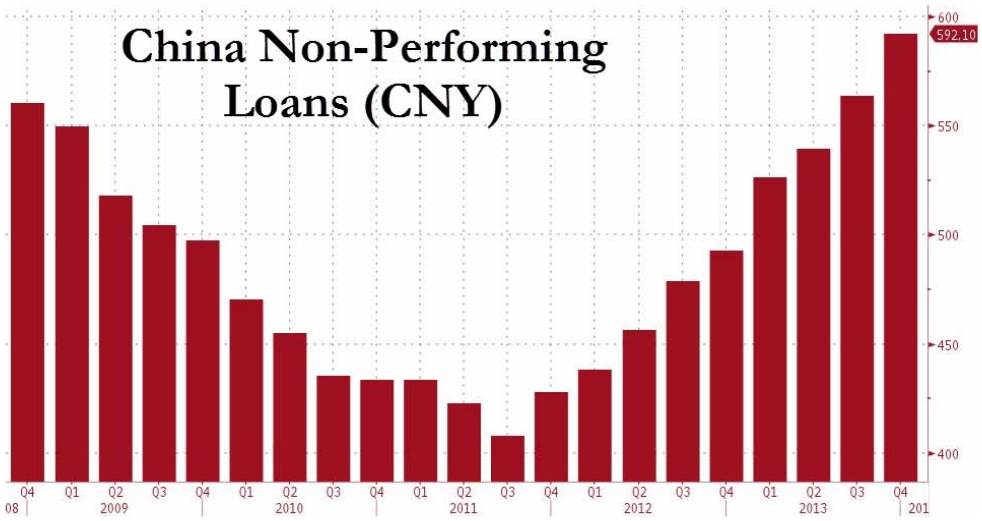


The sheer scope of overbuilding and its related debt is staggering. The Chinese real estate and credit bubble is deflating now, and the Chinese government is trying to control its rate of deflation to a safe soft landing. The question is, will it be able to? As the Chart below shows, the rate of non-performing loans are growing dramatically, at the same time as real estate sales and prices are starting to decline. As everyone is well aware, deteriorating credit conditions and deflating real estate markets do not bode well for any country or economy. We see China further deteriorating rather than "mending".



Not to pick on Reuters, we just happened to pick this article at random, but the daily assurances that permeate the news as to how everything is improving, albeit slowly, backed by the majority of experts that reinforce such a view sighting fractional shifts in numbers and indicators, succeed in numbing the public into believing that everywhere, generally things must be getting better. Yet, we see the underlying structure in all major economies as

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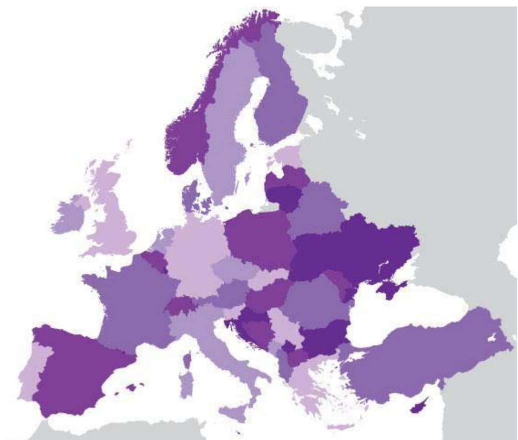
weak and fractured, and in places such as the euro zone and China, we see major cracks widening. We neither see “business stays strong” in euro zone, or “China mending”.

In our ‘Economic Report’ at the beginning of the year, we had indentified the U.S. as having the best prospects *in the near term*, and Europe and China as facing some very serious structural problems that could fracture their economies. We still see it that way, even with the dangers of the U.S. asset markets having a serious correction in the short term.



The Global geo-political situation has worsened from what we had anticipated at the start of the year, with real flash points of political and economic turmoil in South East Asia, Eastern Europe, North Africa and South America. All these further disruptions to stable global economic activity can only make things worse rather than better. Therefore any reassurances that conditions are improving or mending are, in our view, at best premature and at the worst misleading to the public.