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Ashok Dhillon has 40 years of front-line business experience in Canada and International markets.

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In Part I of this paper, we started by outlining the influence of the American Federal Reserve, particularly its actions post-2008 crash, on the other major Central Banks and their continuing policy in dealing with the persistent slow down in global economic activity since then, reflected in the current low Global GDP growth rates. And we highlighted China's and Japan's economies, the 2nd and 3rd largest economies in the World (*the two largest in the East*), and their current problems and prospects. In this Part II of our 2015 Fourth Quarter Report, we will look at the EuroZone, and the U.K., collectively the European Union (*or the "E.U." - one of the largest economic regions*).

Currently, and for some time now, European countries have been akin to 'barks of yore' - tossed about on economic and political stormy seas, far from their former native shores (*phrases from Edgar Allen Poe*), with their future still stormy and uncertain.



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At one time Europe was made up of individual and independent countries that arose and fell on their own particular circumstance (*barring World Wars*), and did individually what suited them best when faced with internal and external challenges.

But since their economic and currency union, they are all lashed together like a giant raft (*to stay with the above analogy*), and are unwieldy and difficult to maneuver, with raft-like movement when it comes to trying to correct, collectively, the individual imbalances that currently plague them.

Predictably, the collective unwieldy response to disparate individual problems is producing less than satisfactory results, both economically and politically, and is thereby stoking stormier seas for the foreseeable future.

There is a lot of political unrest and anger in Europe at this time. It is manifesting itself in the rejection of the Centrist political parties in favour of far-left and far-right politicians. This political angst is the culmination of years of frustration regarding economic stagnation, high unemployment, and lack of material progress, and issues of national racial diversity (*racially different citizens/residents, migrants - and now refugees*).

The seeming lack of material progress in the individual countries, and the general hardships the collective 'Raft' has been unsuccessfully struggling with, since 2008, is making the populations of these countries turn to those that preach more radical solutions to long standing problems, rather than stay with the main stream parties. So in France, Spain, Portugal, and even in Germany, the incumbent governments are under varying degrees of political threat and pressure from far-right or far-left politicians and parties.

If these countries turn towards the more extreme brand of politics, either to the Left or the Right, there will be the rise of much greater tensions on the whole, and along with the economic difficulties already being faced by the collective, the greater political divisions maybe enough to rupture the cohesiveness of the EuroZone, and ultimately the European Union.

Given the seemingly intractable economic and political problems currently facing the EuroZone, a lot of analysts think that the breakup of the EuroZone is eventually inevitable. We are not so sure. European members seem to be willing to put up with a lot of economic and political pain to stay in the EuroZone with the single currency, and in the larger E.U., regardless of the cost. Greece is a recent example of a country determined to stay a member, in spite of horrendous and prolonged pain and costs.

The European Zone with its single currency, and its freedom of movement for its member populations, is a visionary, brave and exceptional experiment, given the long and fractious history of its States. And given the difficulties of staying united amid such extra-ordinarily complex economic conditions, with such an unwieldy structure, the European countries, their governments, and their people, deserve a lot of credit for trying to hold it all together.

But, in spite of the collective will to work together, the EuroZone is still mired



in difficult economic conditions that have, like Japan's, refused to improve *materially* in spite of the European Central Bank's ('ECB') \$1.16 Trillion stimulus program, implemented since March of this year, till September 2016. The Governor of the ECB, Mario Draghi, had hoped that the stimulus package "should strengthen demand, increase capacity utilization and support money and credit growth".

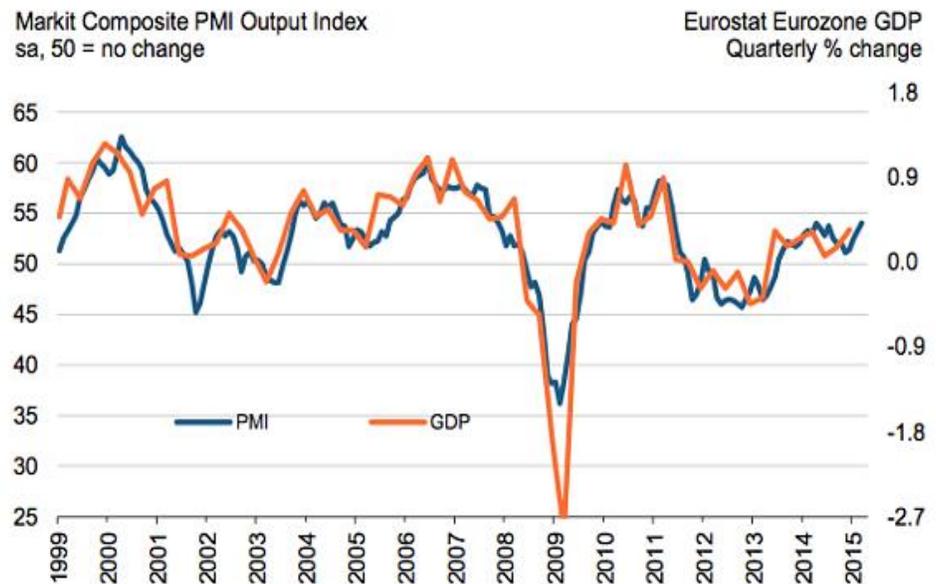
Since the QE was initiated, there have been some up-turns in economic and consumer/business sentiment indicators, but overall the picture is still grim enough for the ECB to have contemplated increasing the size of its ongoing QE. (He didn't, and instead, he lowered the key lending rate marginally, and extended the QE term by 6 months, much to the disappointment of traders and speculators, who had anticipated far more aggressive actions).

With all the effort of the governments and the ECB, since 2008, the growth rate of EuroZone economies was negative from 2011 till about mid-2013, when it finally crept up into positive territory, although barely, most of that time being under 1.0%. At the end of 2014 the growth rate flirted with going negative again, and the ECB initiated its \$1.1 Trillion QE, in March 2015, which devalued the Euro and boosted exports (See Chart on Next Page) which in turn marginally boosted the GDP and PMI (Purchasing Managers Index).

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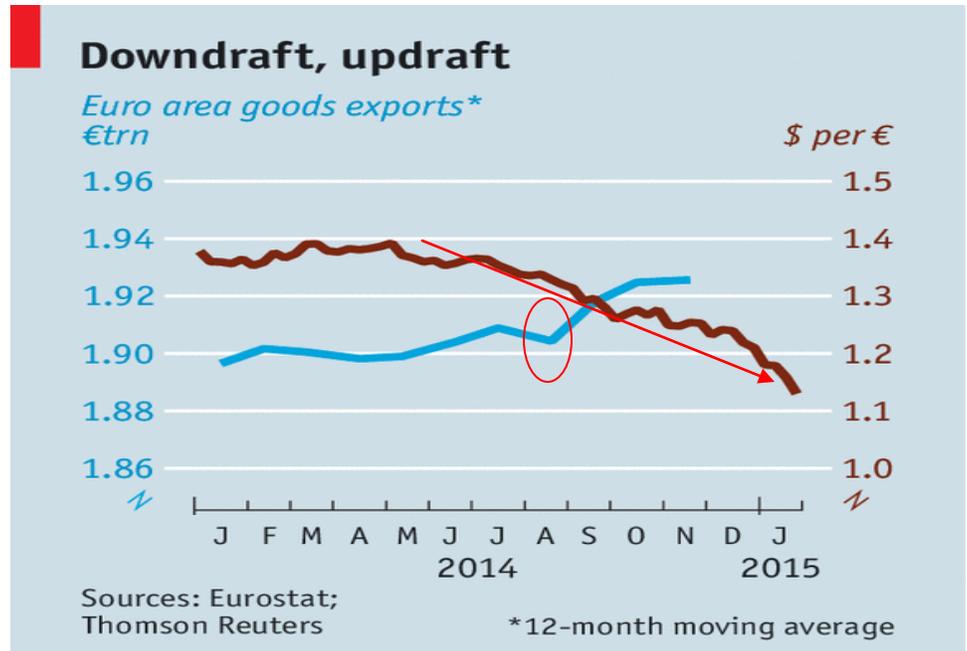
Markit Eurozone PMI and GDP



Source: Markit, Eurostat. GDP = gross domestic product

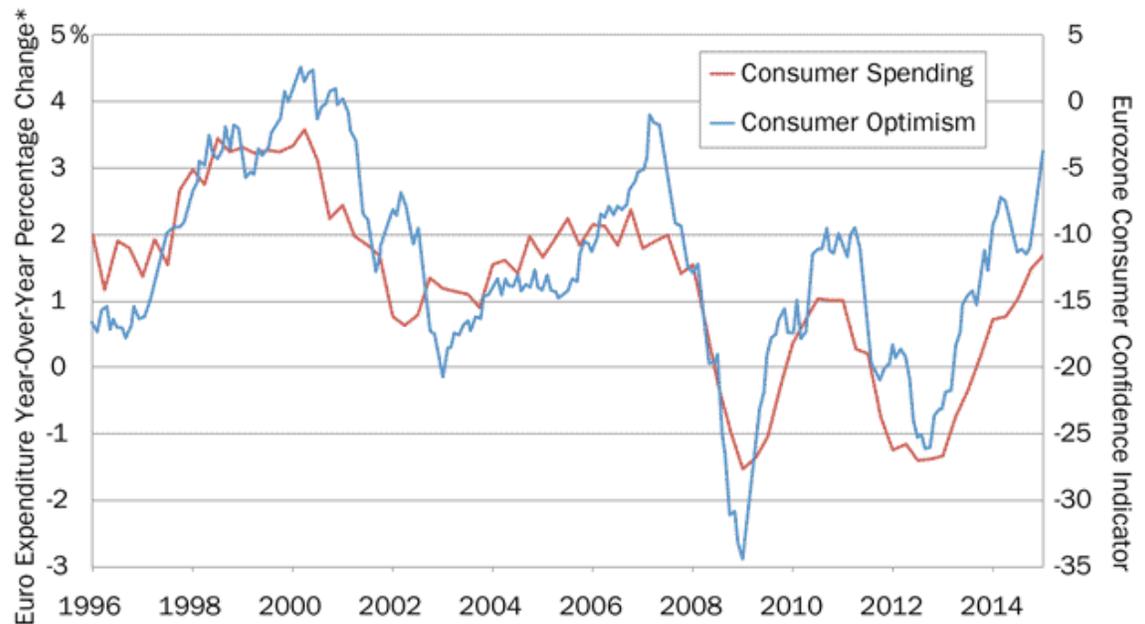
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Economist.com

Consumer confidence has been up strongly over the past 3 years but is still in the negative territory, while consumer spending is growing positively at about 1.6%, buoyed by low interest rates, low energy, and general goods prices which are still trending down.



Source: FactSet Research Systems Inc., 3/29/1995 to 3/31/2015 for Consumer Spending; 3/29/1996 to 3/31/2015 for Consumer Optimism, seasonally adjusted

*Includes Household and Nonprofit Institutions Serving Households final consumption expenditures

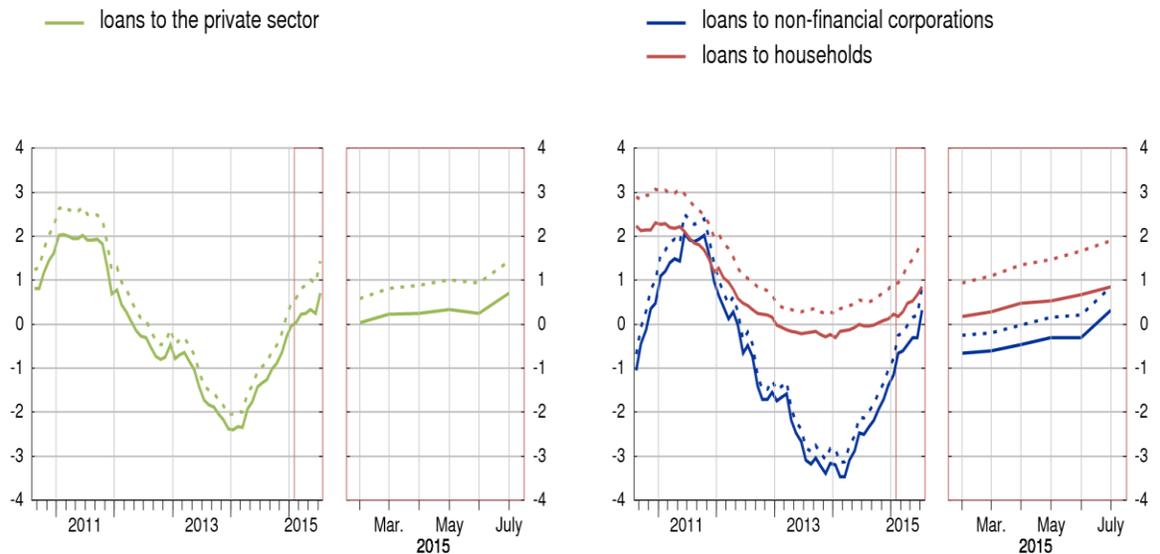
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In spite of general 'Easing' after 2008, EuroZone banks, which faced serious liquidity problems themselves, have been loathed to increase lending throughout the post crisis years, till early 2014. By this time the banks had deleveraged and M3 money supply had started to expand strongly, and lending to the private sector and households improved and continued well into this year. With the ECB's continued easing and encouragement, the banks should keep expanding their loan portfolios.

Euro area Monetary Financial Institutions (MFI) loans to the private sector

(Annual growth rates, adjusted for sales and securitization; new method as solid line, former method as dotted line)



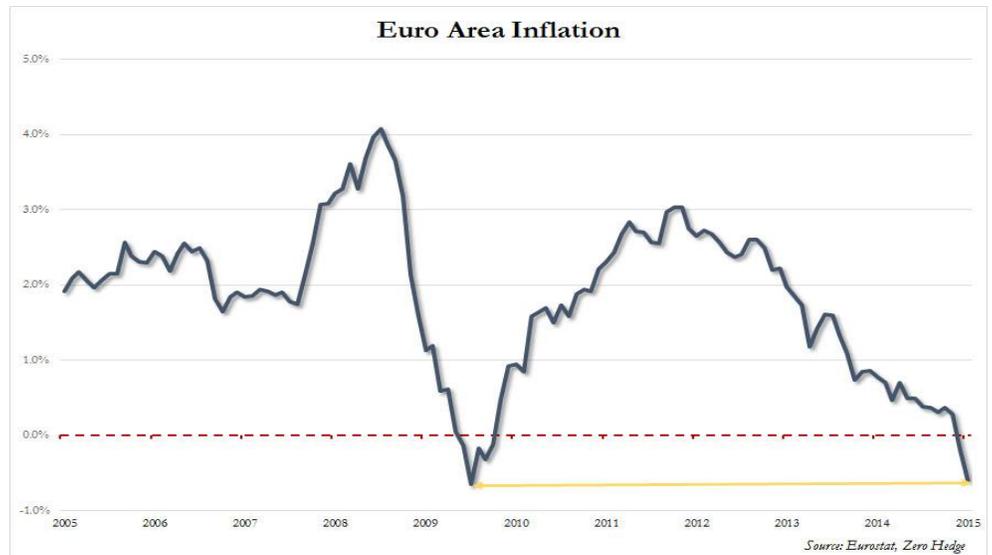
Source: ECB Eurosystem

In spite of the significant stimulus program undertaken by the ECB, and its committed 'Easing' stance, the effect on the EuroZone economies has been marginal to-date. Growth rates, after picking up a bit in the earlier part of this year have once again dipped. And, the latest inflation numbers are in the range of 0.1%, barely above deflation. The threat of deflation seems real enough.

It is this threat of deflation and the lack of meaningful results vis-à-vis the stated goals at the start of the QE program, and new threats emanating from some of the slowing/crashing major emerging markets (*China, Brazil, Russia*) that were prompting the ECB Governor Mario Draghi to contemplate increasing the stimulus much ahead of the end of its term, next September. But there were just enough green shoots in the economies for the ECB to moderate its anticipated additional stimulus actions, and implement a softer response to the very real threat of persistent deflationary trend (See *Chart on Next Page*).

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Source: Eurostat, Zero Hedge

It is our contention that Europe’s myriad economic, social and political problems will make it just as resistant to additional stimulus as Japan’s economy has been so far, and the reasons are very similar, and structural. There is a general lack in internal and global demand since 2008, and furthermore, that demand continues to slacken as global economies resist stimulus and succumb to overcapacity. China’s economic deceleration along with its dramatic asset markets implosions, and Russia’s contraction have impacted European economic powerhouses such as Germany, who for a while, almost singlehandedly buoyed up the EuroZone with its export prowess. Now, that boost is waning, and things could get a lot worse.

Figure 27: Chinese imports from Germany have slowed in recent months to below 3% Y/Y



Source: Thomson Reuters, Credit Suisse research

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Figure 26: German exports to Russia are already down by more than 20% Y/Y

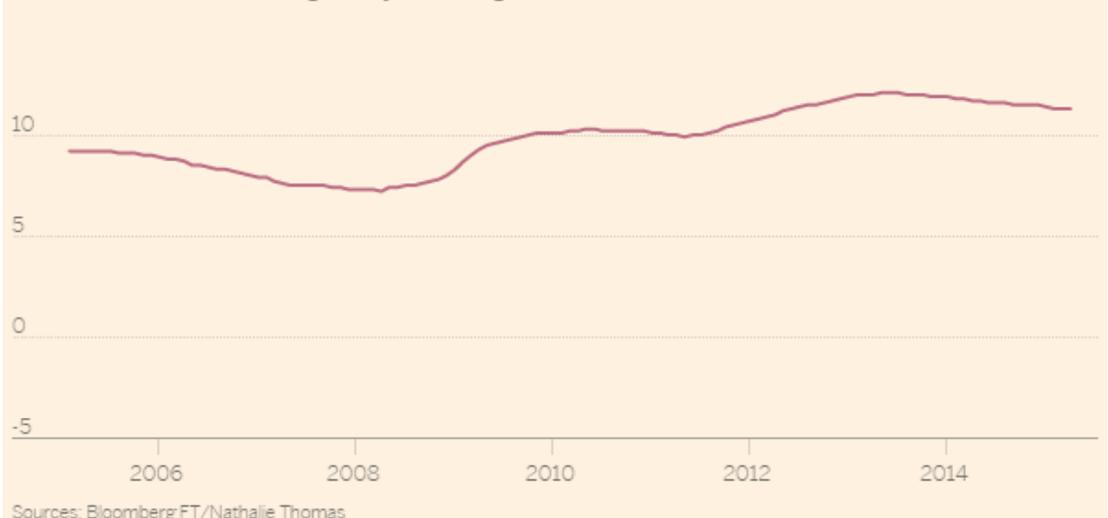


Source: Thomson Reuters, Credit Suisse research

Additionally, unemployment in the EuroZone has been very high, for advanced economies, since 2008, well into the double digits. Unemployment (*collectively*) is still estimated to be above 11%.

Eurozone unemployment rate

Joblessness in the euro area is gradually decreasing



Sources: Bloomberg FT/Nathalie Thomas

Youth unemployment has been atrociously high in countries such as Greece and Spain at over 50%, and some of the other countries were experiencing rates well above 20%. Youth unemployment is still too high (See Chart on Next Page), and while better than before, we do not expect to see real material change in the near term. This is a major cause of dissatisfaction among the young people of Europe, particularly those that are additionally disenfranchised due to their racial or ethnic background. Such dissatisfaction provides a fertile ground for recruitment, for the no-good-doers of every

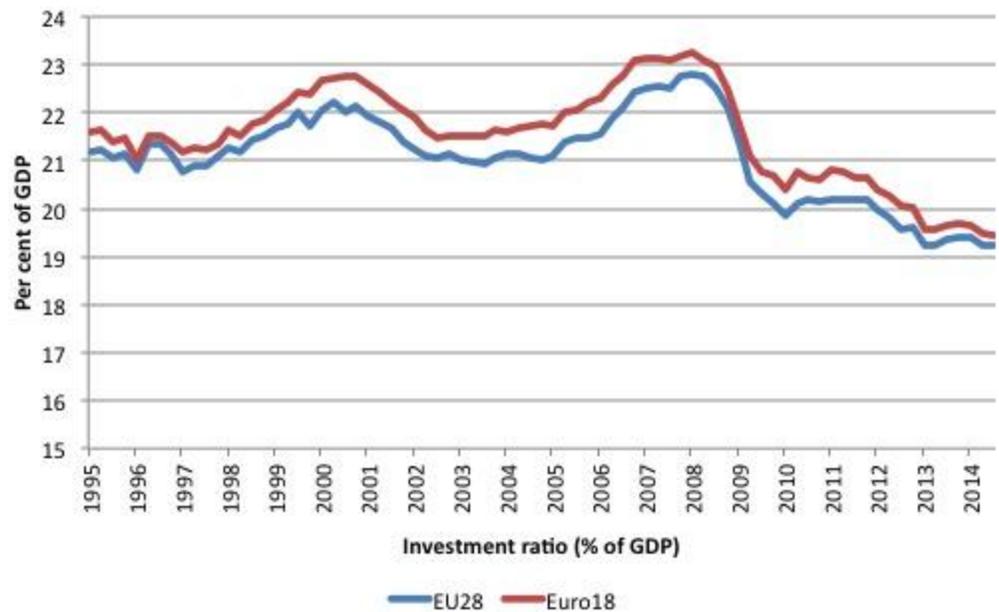
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political and religious strife. The recent influx of masses of desperate refugees could further exacerbate that problem, for quite some time.



Government and private sector investment in Europe dropped substantially after the 2008 financial crisis, and it never did recover.



In summary, overall economic conditions in Europe are still challenging. The purposeful weakening of the Euro by the ECB is helping the exports, which in turn is boosting manufacturing and the GDP, though the growth rates are still very marginal. Although, the boost to various sectors of the economies through the devaluation of the Euro could be short lived as every other equally desperate exporting country like Japan, South Korea, China, and all others, including the U.K. and the United States, will counter Europe's efforts to boost exports by the devaluation of their own currency, as has been happening, or by other means necessary. It is as we had stated a couple of

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years ago, the global lack of demand, and conversely global overcapacity, has created the conditions where each country, or economic region, is forced into a 'beggar thy neighbour' policy, resulting in a persistent deflationary cycle.

Growing deflationary pressures are the primary concern of the ECB. And although the general consumer and business sentiment is improving and there are small 'green shoots' in the EuroZone economies, by and large, the economic conditions are still too negative to give the ECB or the governments any real comfort that the EuroZone is really on the mend.

External factors such as the increasingly severe deterioration of most of the large emerging market economies such as China, Brazil, Russia and South Africa, and the chaos in the Middle East, are having a direct negative impact on the European economies - economically and politically.

Years of economic turmoil, and the recent influx of hundreds of thousands of Middle Eastern and North African refugees, are creating increasing political turmoil that could lead to Left-of-Centre governments to come into power in Spain on December 20th, 2015, and the Right-of-Centre party 'Front Nationale' to gain ground in France, and be possibly in a position to win the election in 2017, however remote that chance may seem at this time.

Portugal, that had its national election this past October, had an indecisive outcome with no clear winner, allowing its President to ask the Right-of-Centre party that had been ruling prior to the election, to form the next government. But that Government was toppled at the first opportunity by a coalition of Left-of-Centre parties that had been opposed to the austerity plan for Portugal demanded by the rest of the EuroZone governments. The result being that Portugal is now facing the same internal struggles and uncertainties as Greece did a few months ago, regarding its way forward. The struggle between the political Right-of-Centre parties and the Left, is whether to bow to external pressure to implement and maintain austerity measures, or to go their own independent way, defying their 'Creditors' and the European Commission with greater spending, and thereby threatening the economic unity and structure of the EuroZone.

Such internal economic uncertainties and growing political unrest (*Spain's election is next, and there too a Left-of-Centre party threatens to win*), and the refugee problem, which has exacerbated tensions between countries and governments; and external events, such as the on-going unraveling of the economies of China, Russia, Brazil and South Africa, may prove too much for the EuroZone to overcome in spite of greater easing.

Multiple QEs, in the U.S., Japan and China, have so far produced less than satisfactory results, as those economies remain under the constant and tender ministrations of their Central Banks, without which they would swoon even faster.

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The United Kingdom (*England, Scotland, Wales and Northern Ireland*), the U.K., has been a member of the *E.U.* almost from its inception, but has had a love hate relationship with the idea. The internal debate about the extent of its integration with the *E.U.*, and its capitulation to *E.U.* policies, is still actively on. The current Government of David Cameron has promised the public a 'Referendum' before the end of 2017 (*probably early 2016*) to ask whether the U.K. should remain a member of the *E.U.*

So far, every time such a question has come up as part of prior elections, going all the way back to the 1950s, the British public has voted to stay in the *E.U.* But over the past few years a lot of questions remain regarding the issues concerning greater integration being contemplated by the *E.U.* members, access to the larger trade market but at what additional national costs, and of course of late, the most divisive issue of all, people migration and acceptance of refugees throughout the member States, are issues being actively debated.

The Government and the British people have always recognized the value of being a part of the *E.U.* and its huge trade market, but they have been loath to give up too much of their sovereignty, and the ability to act independently, and certainly not their currency (*pound sterling*) for the single currency of the EuroZone: the Euro.

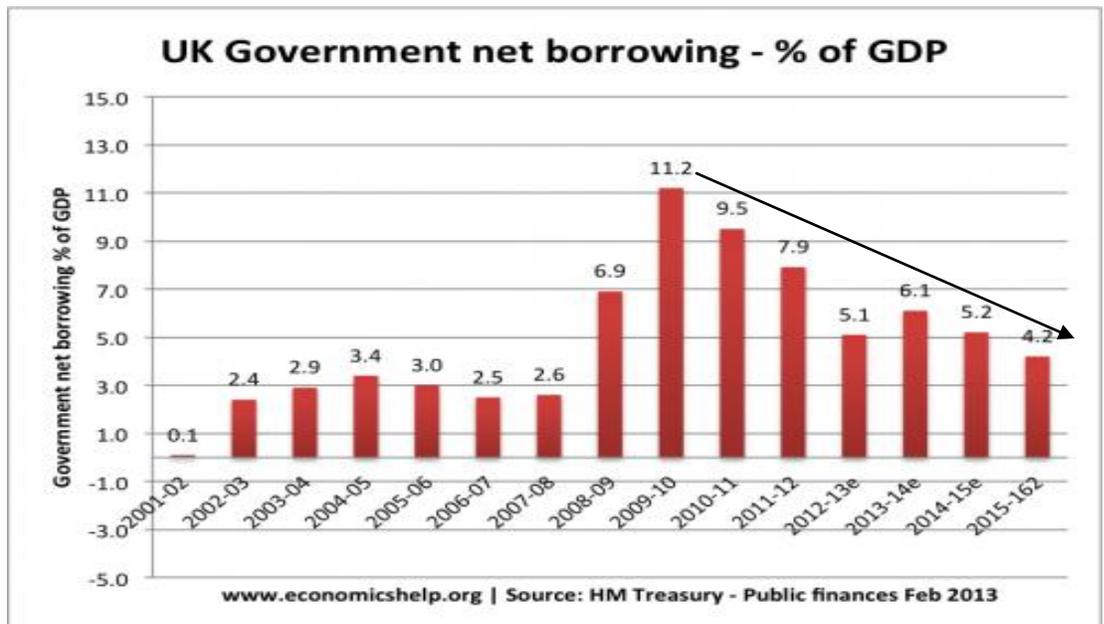
This semi independence (*being a member of E.U. but keeping its own*

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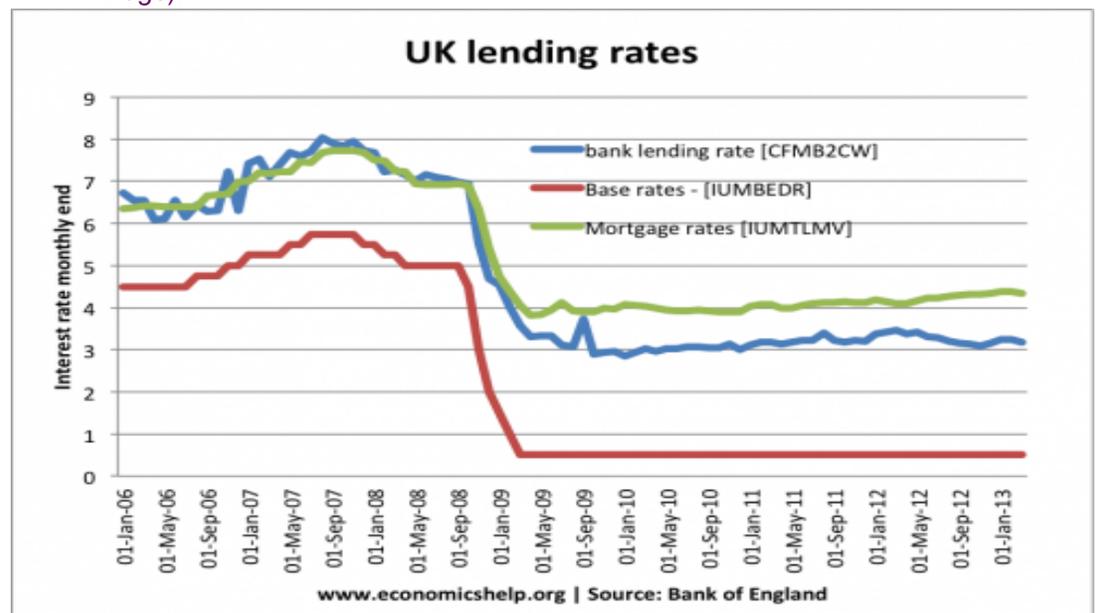
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currency) has helped the U.K. deal with the post-2008 crisis independently from the other EuroZone economies, which were shackled by not having their own currency.

Breaking from the majority, the U.K. Government in 2010 decided to curb spending and instead adopted austerity measures. Unlike Greece, Spain and other EuroZone economies that were forced to adopt austerity measures by the creditors, the British Government slashed programs and curbed public borrowing, voluntarily (*Chart below*).



In spite of the effects of the monetary stimulus injected after the 2008 crisis, and the dramatic drop in the Bank of England (“BOE”) key lending rate (*Base rate*) to 0.5%, and being held there (*Chart below*), the U.K. economy felt the impact of lower government spending almost immediately (*See Chart on Next Page*).

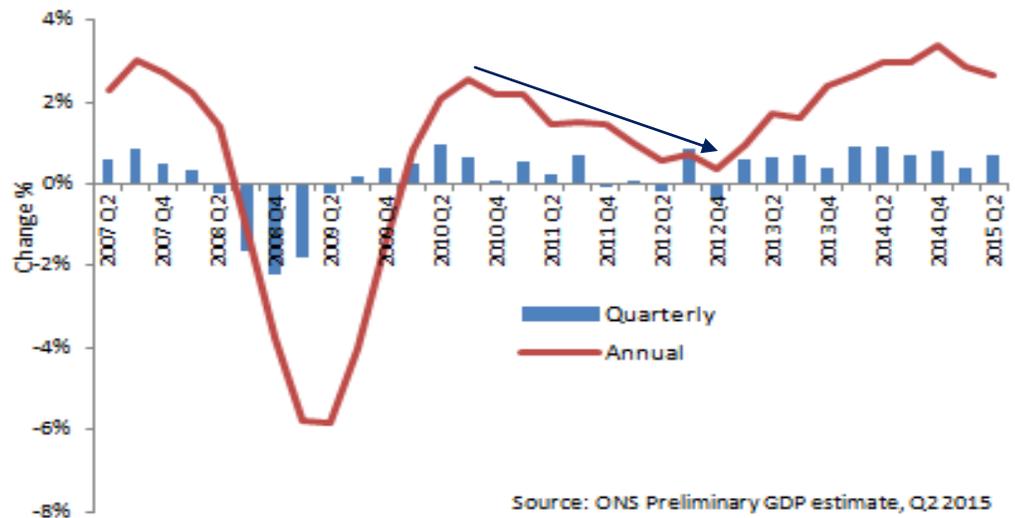


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The economy started to show the effects of the government's actions and growth rate became unstable through the latter part of 2010 – 2011, before it dropped significantly in 2012 and into early 2013, and threatened a double dip recession.

Chart 1: UK GDP



In latter part of 2011, BOE injected additional 'Stimulus' of £75 Billion for a total of £275 Billion, to boost the economy and try and prevent recessionary momentum which seemed to be gathering speed (See Chart Above). Of the major Central Banks, BOE was quick out of the gate and one of the most aggressive in the scope and size of its QE (See Chart on Next Page). The BOE has held its balance sheet steady since then by reinvesting the proceeds as the bonds in its portfolio mature. So while the U.K. Government, by cutting back spending, has broken stride with most major governments that are still spending big to boost economic activity, the BOE has generally been in line with other major Central Banks, in 'easing mode', through holding interest rates exceptionally low, and by significantly expanding and maintaining its Balance Sheet.

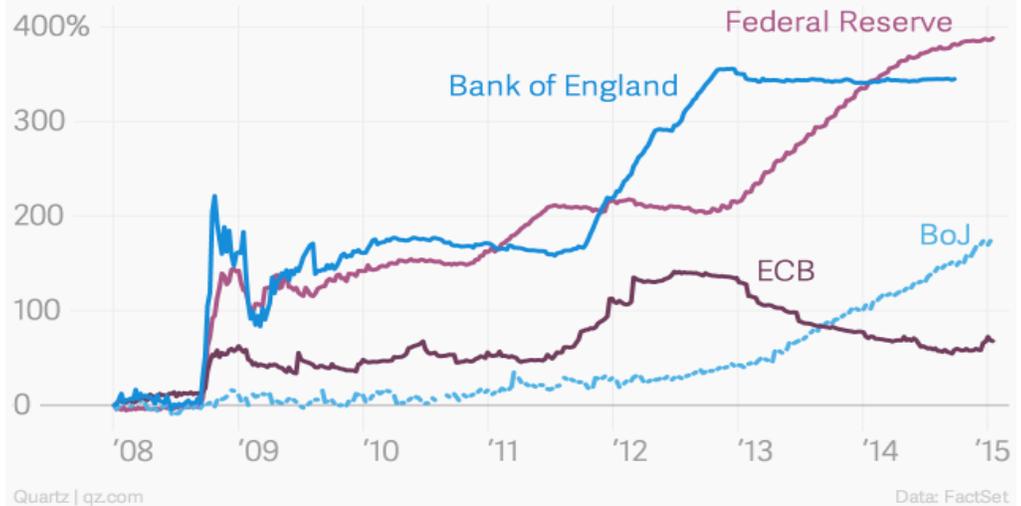
UK CENTRAL BANK BALANCE SHEET



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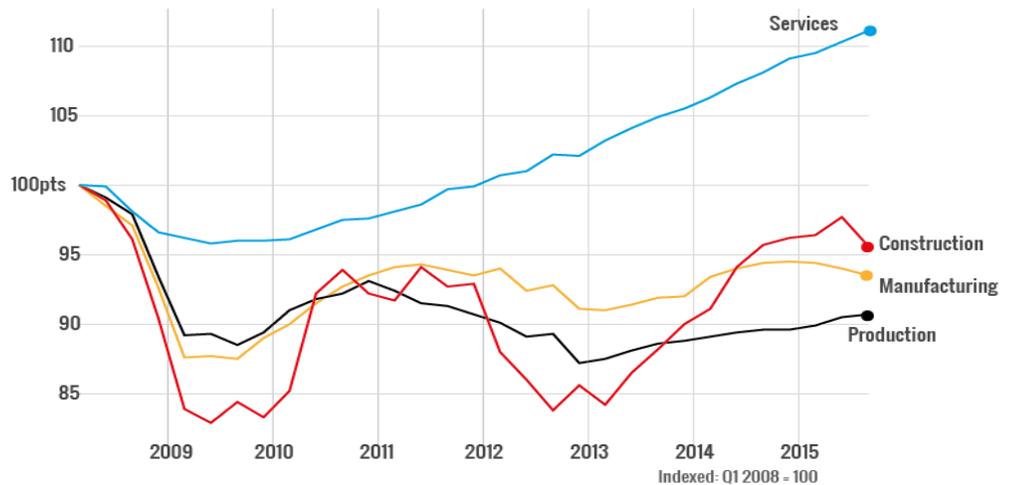
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Central bank balance sheet growth, since 2008



In the latter part of 2015, except for the 'Services' component of the Economy, its biggest at about 78%, all other sectors are showing signs of weakness, and have started to contract.

Growth in the services sector is outstripping the rest of the economy



Source: Office of National Statistics

The effects of continuing lower government spending, resulting in less domestic spending, along with deteriorating external economic conditions, resulting in lower export volumes, and lower consumer confidence and consumption, the U.K. economy, in our opinion, is going to deteriorate further in the coming year.

The Economy is also reflecting the reality of our times, a persistent deflationary trend (See Chart on Next Page). In fact the economy is barely out of deflation territory according to the Consumer Price Index ("CPI") which is hovering near 0 (zero), in spite of ultra low interest rates, ongoing ECB stimulus, and significant outside investments from all troubled areas, particularly Middle East

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and China. In recent years the U.K. has been the preferred investment destination.

Inflation March 2005-July 2015
Percentage change over 12 months



Source: ONS



And, retail sales (*Chart below*) which had been fairly strong the past two years due to consistently softening prices [*Retail Price Index (RPI), above chart*] are showing signs of contracting at the end of this year.

UK retail sales



Source: Markit, ONS via Ecwin.

The EuroZone, the E.U. and the U.K. have internal/external threats and challenges to meet and overcome, to stay intact as the E.U., and to stabilize economically and politically. For all of them all it won't be easy. For in-spite of the efforts of the respective Central Banks, ECB and BOE, the other major Global economies are continuing to grind downwards, inexorably. And, it will be very difficult for these economies to buck that trend, and resist that tide.

To be continued ...