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

Mr. Dhillon's experience includes start-ups, venture capital, seed funding, and heading companies in construction and international power development. His extensive experience gives him in-depth knowledge and intuitive insights into macro and micro, national and international, geo-political and economic realities and trends. He 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".



## Global Economies 2015 – Once More Off-the-Cliff, Dear Friends...

The United States set the trend, as it has done for so much that happens in the World, everything from fast food, cars, to clothes, music and movies, to technology, weaponry, to geo-political maneuverings, and to economic trends. It was the perennial advocate of the capitalist system over socialism and communism. It won that battle, and today most of the major economies practice some form of capitalism. And when things went wrong in the capitalist system, as they are prone to do with a freewheeling system, America found the solutions to fix them, and for the past four (4) decades it has done so by steadily increasing liquidity. And the rest of the World has faithfully followed. And why not, the U.S. has been the 'economic' undisputed heavy weight champion of the World for a very long time. But unfortunately this time it has led the rest of the World off the economic cliff through the improbable scheme of deliberately increasing debt, *exponentially*, to cure the ills and excesses of *too much past debt*. The fall since 2008 for global economies has been long and hard, and expensive, with no real end in sight.

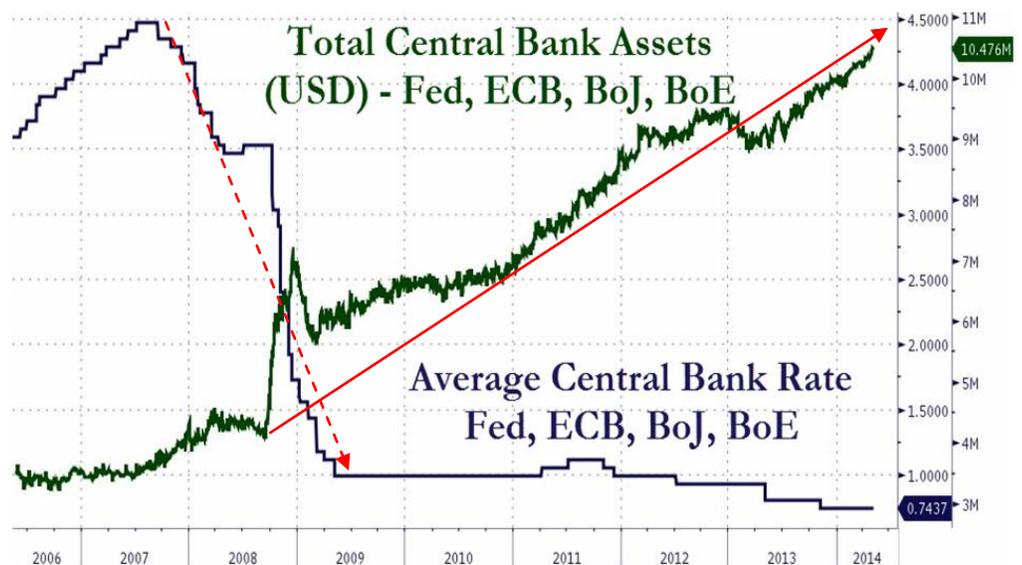
Compared to the rest of the World, America is the land of excesses; which to a large extent was a good thing. What an average person (*and not so average*) in most other countries could not dream off, in the United States it was common place. That made America the most sought-after destination of the under privileged, the down trodden, the ambitious and the aspiring, of the rest of the World. And for most of them, America delivered beyond their expectations. People of all nationalities, races and cultures, from countries where they had no status, rights, standing, let alone any real standard of

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living, came to America, and for most part, found all that they had hoped for - for themselves and their families. America was truly the closest thing to a truly egalitarian society in modern times. Even now, in spite of its many and growing flaws, America is still by far, for most, 'the Promised Land', compared to what they have in their own countries.

But now there are problems in the Promised Land. One of them is the economy. For the past four decades, except for brief periods, the economy was steadily expanding through the policy of ever increasing liquidity. And when the excesses from too much liquidity, and gutted regulations, led the economy of the cliff at the end of 2008, America chose the path to recovery through even greater excesses; ultra low interest rates and repeated rounds of quantitative easing. And the World Central Banks once again followed.



Source: resilience.org

Although the Federal Reserve ended QE in October 2014, its key interest rate has been held to near zero for almost seven (7) years. Most of the other major Central Banks have followed suit on keeping the interest rates low (*in Europe and Japan they are negative*), but in addition, they have continued to implement aggressive QE to try and foster growth.

But in Japan, Europe and China, try as they might with continuing massive QE programs, they have failed to turn the economies from their persistent slide into recessions, or near recessions (*Europe and Japan*), significantly declining growth rate (*China*), and anemic growth rates (*America*).

Collectively, the Global economies have been inexorably heading downwards as demand stays slack amid global overcapacity, and continued stimulus overextends inflated asset bubbles.

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Source: coffeeandcharts.com



Japan has been the poster boy for all-out 'Quantitative & Qualitative Easing' (QQE) method for breaking out of its decade's old economic slump. Upon the second election of Shinzo Abe as Prime Minister, QQE on a grand scale became the mantra for his Government, to try and break the economy out of the stagnation that it has been mired in since the late 1980s.



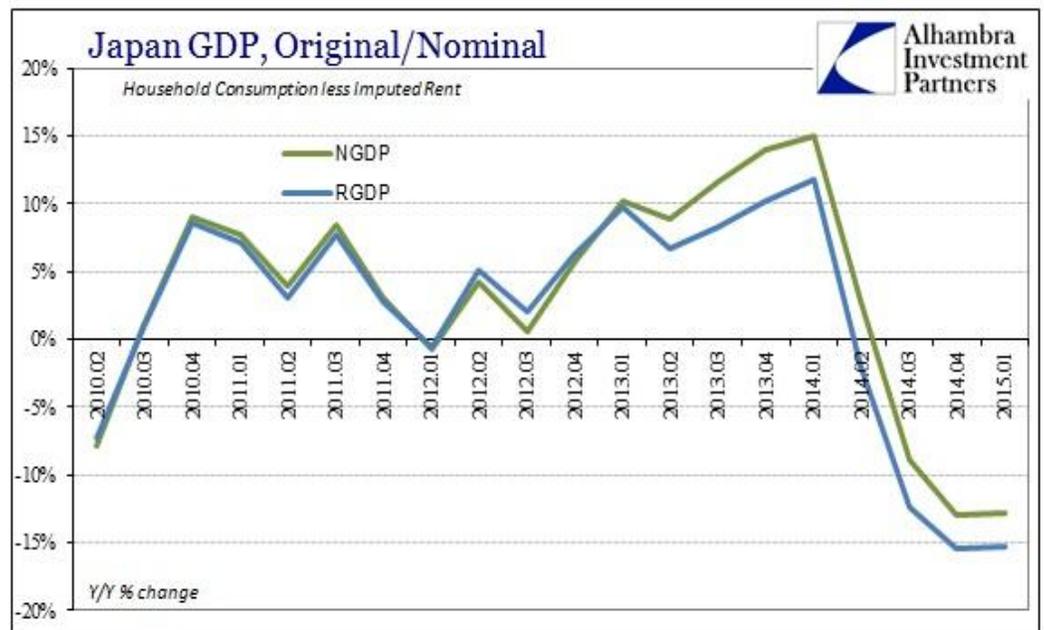
Shinzo Abe and his handpicked team, including Bank of Japan Governor, Haruhiko Kuroda, pledged to do everything in their power to and try and achieve escape velocity for the dormant economy with a minimal 2% rate of inflation as target. And to do that, Abe's Government, that came to power in December 2012, launched a massive ¥60 Trillion (*annual*) QQE in April 2013, and as the economy failed to gain momentum after almost 18 months, Abe's Government increased the QQE to an unprecedented ¥80 Trillion (*approximately \$650 Billion*), annually, in October 2014.

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In spite of launching the most audacious QE program by any government, and devaluing its currency most aggressively to record lows (*depreciation of over 40% since the launch of QE*), to make its exports more competitive against the other major exporters, Japan's economy has once again, as of now, slipped back into recession.

And even though the Government keeps promising action on its planned reforms, to-date there hasn't been much movement towards meaningful restructuring or reforms of the economy, which means that Japan's stock markets have soared on torrents of near free money while its economy languishes and sputters.



Japan's failure to induce economic growth in spite of the most aggressive QE program in the World should be a stark warning to the rest of the governments that QE is not the answer to stagnant or low economic growth rates, without major structural changes and meaningful reforms. But unfortunately, it is clear that collectively, and following the example of the Federal Reserve's example post the 2008 crisis, all major governments are committed to QE as the only real solution to the lack of economic growth, in spite of the less than confidence inspiring economic performances of economies subjected to aggressive QE since then.

Japan will continue to struggle with its barely growing economy, regardless of its massive QQE program, as the deep structural changes needed internally to kick-start sustainable growth are not being implemented by the Government. 'Reforms' were part of the 'Three Arrows' economic rejuvenation plan of Shinzo Abe, but some of them represent the core of Japanese traditions in its entrenched business and social cultures. Therefore, such reforms never got tackled meaningfully, such as inflexible labour laws,

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crony capitalism, corruption in high places, gender inequality that mitigates severely the potential contribution of women to its businesses, protection of its agriculture and business from foreign competition, and highly restrictive immigration policy. Additionally, with no 'new blood' coming in through immigration, and with one of the world's worst demographic trends, Japan's productive labour force is shrinking with no reversal in sight.

Apart from its internal handicaps, 'Japan Inc.' faces ever increasing and tougher competition externally from newer manufacturing power houses like China, South Korea, and the rest of the emerging countries of South and East Asia, and Eastern Europe. Even a re-tooled America poses an increasing threat. So Japan, while still a relatively prosperous and advanced country, faces a host of problems that will continue to depress its growth rates regardless of its Government's steely resolve to do 'whatever it takes' to break out of its semi-permanent growth rate flat line.

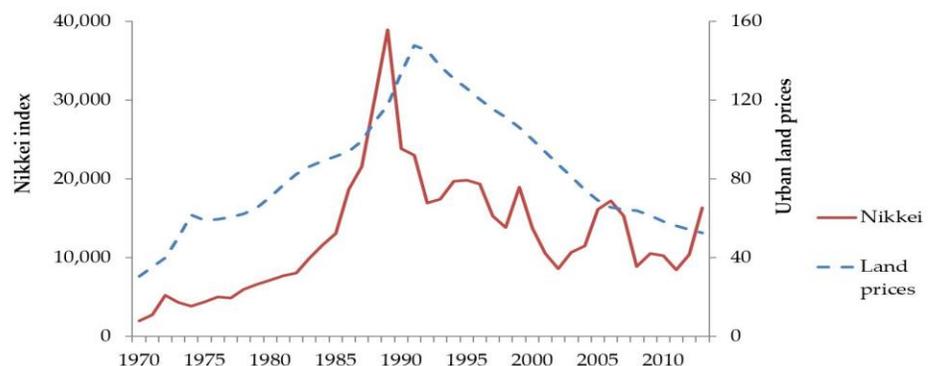
For the past decades, China became the poster boy of economic miracle growth, and replaced the 1980s Japan as the indestructible economic power house. In our past posts, we have often commented on the past adulation showered on China by the West for its economic prowess, as too similar to what was showered on Japan when it was considered an unbeatable economic powerhouse. All renowned Universities in the West taught 'Masters Classes' in 'Japanese Business Management', and books were written and speeches given on the superiority of Japanese business acumen. Some of us remember those days fondly. Now nobody is touting Japan's exceptionalism, or its business models.

For the past two decades China was being similarly idolized. Now as China's 'economic miracle' unravels, reality is once again coming to the fore.

Today, China faces a host of economic and resultant social problems that make Japan's problems in late 1980s pale in comparison. In Japan, back then, there was a huge asset market bubble in the financial markets, in equities and in real estate (*See Chart Below*), and it predictably collapsed, driving the powerhouse of an economy into decades of stagnation. China is facing similar adjustments as its stock and real estate markets deflate (*Charts on the next page*), and its legendary performance cools.

### The Japanese asset bubble

Sources: Nikkei and Japan Real Estate Institute



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China's predicament today can be summed up by the following: *shrinking external and internal demand - resulting in gargantuan overcapacity in manufacturing; massive overbuild in redundant infrastructure - resulting in massive mal-investments and mountains of bad debt.*

It all adds up to years of slowing growth, rationalization of over capacity with possible job losses (*even though the Government will do its utmost to preserve jobs at all cost to prevent social unrest*), eventually the writing-off of massive amounts of bad debt used in building redundant infrastructure, the possible collapse of some segments of its financial markets, such as shadow banking and related financial institutes, and the further deterioration of its stock and real estate markets. The two charts below indicate the sharp corrections in the stock market (*June 2015*), and the real estate markets, that started in mid-2012 and is likely to continue as the economy weakens further. (*On November 27<sup>th</sup>, 2015, the Stock Market dropped another 5%*).

### Shanghai Composite Index



### China's housing correction was led by expensive coastal cities

Area of housing sold in 40 major cities, by city grouping

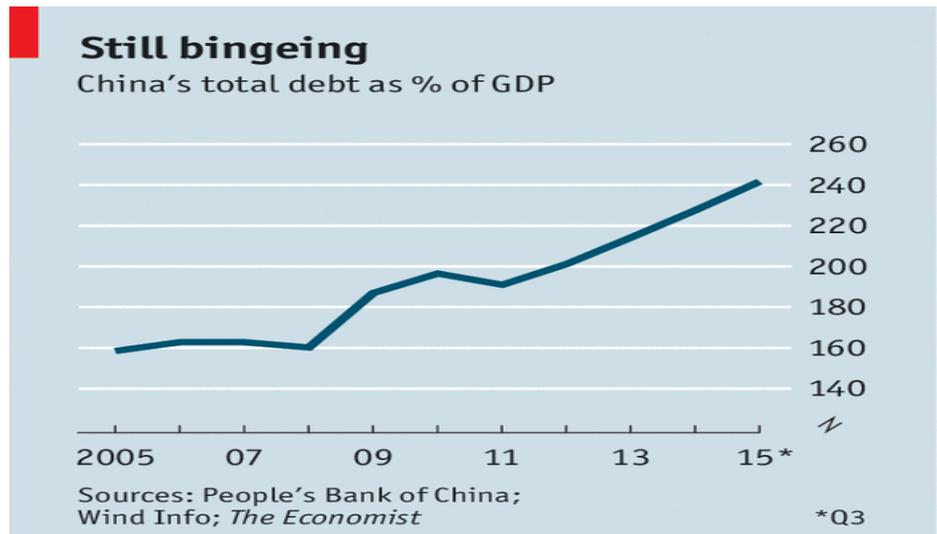


CEIC, Gavekal Data/Macrobond

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China's speculative excesses in the stock and real estate markets were similar in price rise to Japan's, but Worlds apart in scale and scope and therefore potentially far more destructive over the longer term. As the Chinese population feels the negative impact from job insecurity, investment losses in stock and real estate markets, they are going to become a lot more defensive in their spending and further exacerbate the slow transition to an internal consumption economy, as external demand continues to remain weak globally. The true extent of China's economic slow down can be ascertained by the steady and steep decline of both imports and exports (2nd Chart below) since the rebound in 2009, after the massive injection of cash (QE) post 2008 crash, and the subsequent and frequent QE since then (below).



Economist.com



All economic indicators within China are pointing downwards while its problem of significant overcapacity in most areas grows as demand slackens, and manufacturing competition from other emerging countries heats up, prompting the Chinese Government to devalue its currency.

### China Devalues the Yuan by Most in Two Decades

The move signals policy makers are bolstering efforts to support exporters and boost the role of market pricing. The People's Bank of China called it a one-time adjustment.

■ China Yuan, U.S. Dollar Exchange Rate

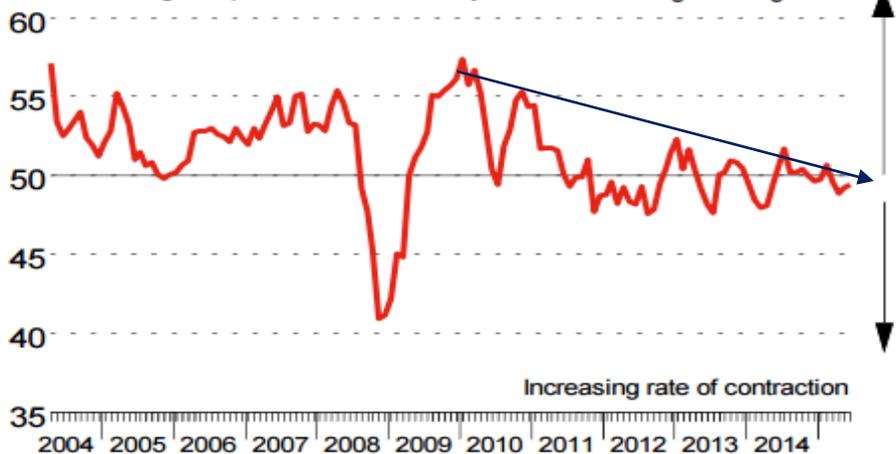


Manufacturing has been in a steady decline since the rebound in 2009, reflecting the collapse in overall demand from the West, and no meaningful rise in internal consumption.

### HSBC China Manufacturing PMI

50 = no change on previous month, S.Adj.

Increasing rate of growth



Sources: Markit, HSBC.

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Auto sales, which was one of the few bright lights in China's economy for the past three years, has now also succumbed to the overall and continuing economic deterioration, adding another industrial sector to China's already bloated manufacturing overcapacity.

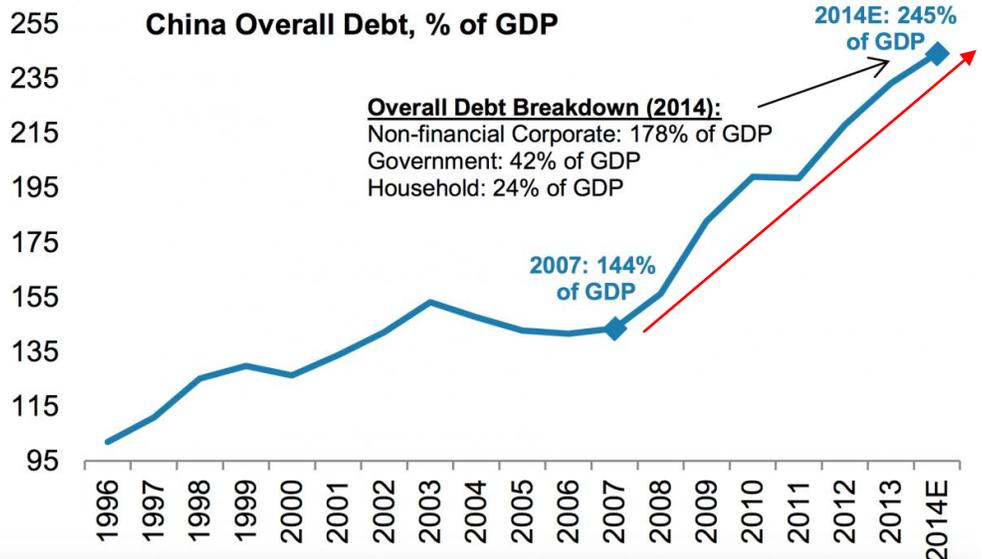
**Fig 47 Auto sales growth slowed in June**



Source: Wind, Macquarie Research, August 2015

The Chinese Government is fighting its downward economic plunge with unrestrained liquidity in every aspect of its economy, making its debt to GDP ratio soar to almost 300% in 2015.

**Persistent Rise in Leverage**

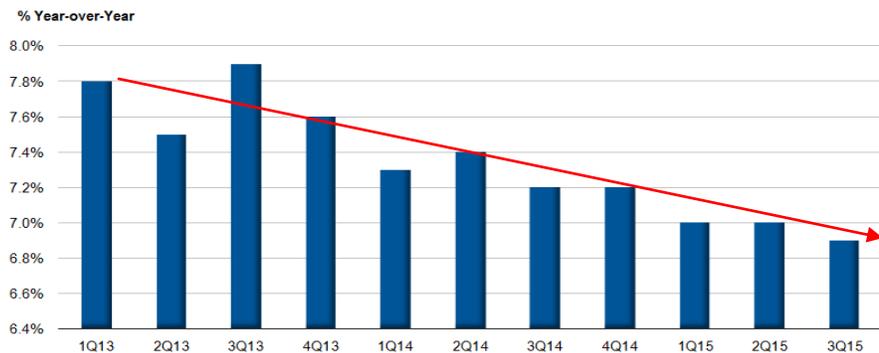


Source: Businessinsider.sg

## China GDP Growth



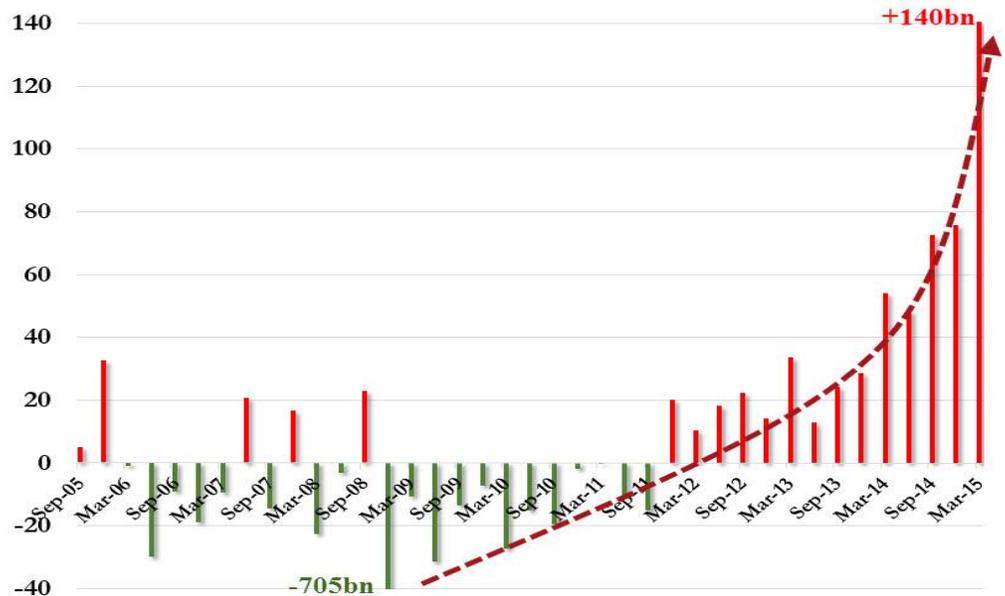
First Quarter 2013–Third Quarter 2015



Source: National Bureau of Statistics of China.

As China continues to desperately attempt a 'soft landing', through greater and pervasive 'easing', and the overall debt continues to grow to unprecedented levels, the risks of a financial breakdown becomes ever more likely. The Chart below demonstrates the growing and impending danger of defaults picking up significant momentum and volume.

### China Non-Performing Loans QoQ Change (CNY bn)



Source: Zero Hedge

As China's economy unravels from years of single-minded 'growth-at-all-cost' policy, and the price exacted for such single mindedness is the severe degradation of its environment, entrenched corruption at all levels, massive mal-investment, external and internal negative pressures that will continue to undermine the government's desperate attempts to stabilize the deterioration in asset prices, leading to further financial risks, all of which will continue to contribute to China's current and prolonged hard landing.

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It is not only us in the West that have serious doubts about China's near and mid-term economic well being. Most of the elite, the most powerful and well connected have been moving large amounts of their cash abroad and investing it in the 'safer and more stable' investments in North America, England, Europe and Australia. Just this year alone, it is estimated that over \$600 Billion came out of China; over a \$100 Billion each, in the months of August and September alone. In contrast, approximately \$50 Billion used to be the *annual* out-flow from China prior to 2015.

Clearly the sentiment and the level of confidence has shifted dramatically within China as the reality of the economic "new norm" (*much lower growth rate*), coupled with the crackdown in corruption, and the recent sharp and serious corrections in the stock and real estate markets, discourage the rich and powerful from keeping their wealth there. When the insiders start to bail there is more serious trouble coming.

Before China can stabilize, it will experience serious setbacks in its asset markets, financial institutions, and overall employment rates. Additionally, China's troubles adversely impact other major economies, of course, and their continuing troubles will impact China and trigger further deterioration in its fundamentals. China will have to 'clean up' in all areas, for years, before it can stabilize again and turn itself around.

With the second and third largest economies (*China and Japan*) in a losing fight against economic contraction, in spite of years of continuous QE, devaluation of currencies, and exceptionally low interest rates, it is difficult to envision a positive outcome for the rest of the world any time soon. And of course, the troubles of the global economies don't stop with the problems of Japan and China, unfortunately there is a lot more to come.

*To be continued ...*