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Global Economies – The Escalating Train Wreck Part 2

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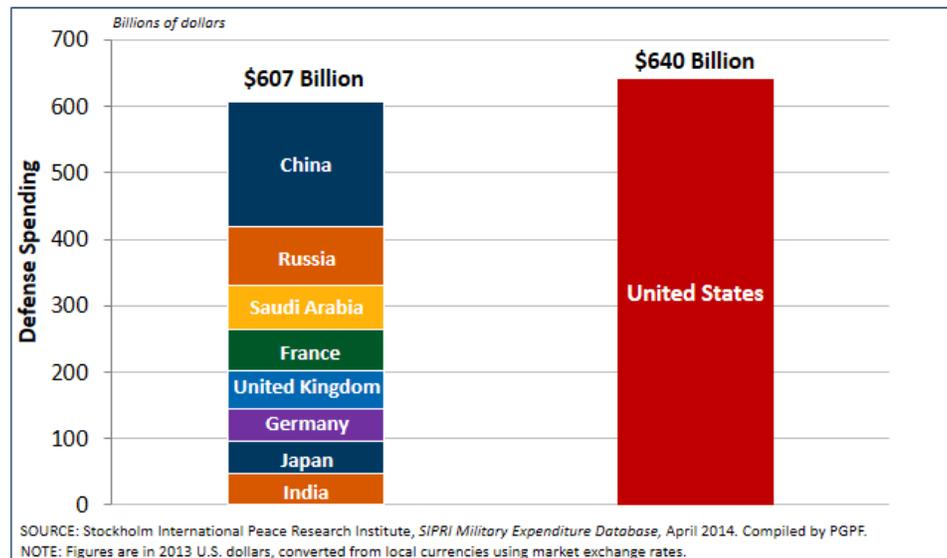
If China is the 800lb gorilla in the room then surely the United States is the 7 tonne Tyrannosaurus Rex. And just like we all love the dangerous T- Rex, we all love the U.S. for its larger than life cultural, political and military global impact, as long as its negative aspects does not affect us personally. America deeply influences the World in the way people dress (*jeans, t-shirts*), eat and drink (*hamburgers and coke*) transport themselves (*cars, planes*), communicate (*smart-phones, Google, Facebook*), arm themselves and conduct war (*shock and awe*). But just like the legendary T-Rex, at its worst, the U.S. is dangerous, violent and destructive, and often times can be detrimental to global health, economic or otherwise. In 2008, in the U.S., the corrupt practices involved in mortgage and consumer lending, euphemistically called 'sub-prime credit' (*which started at the consumer level and went all the way to the top of the biggest financial institutions in the Country*), practically brought down the entire global financial system; an event from which the World economies have still not recovered. And, its shock and awe capabilities in armed conflicts have destroyed nations, sometimes practically overnight. Even in those instances where the U.S. has lost or fought wars to a draw over many years: South Korea (*draw*), Vietnam (*lost*) Iraq and Afghanistan (*won/lost/draw; depending on who you ask*) the countries are never quite the same. Unfortunately, lately, its sheer economic size and military power has been used less than wisely and once again poses a potentially destabilizing factor economically. The U.S. is akin to a T-Rex, big, bold, predatory, and at this time, on top of the global food chain. Its internal and external policies, whether economic or military (*its military excursions are in most cases tied to its economic interests*) and their combined impact most influences global conditions, political and economic.



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The economic, cultural and military might of the U.S. is unprecedented in human history. Its reign at the top of the global power pyramid (*economic and military might*) over the past two decades is unchallenged. Its economy in 2015, at approximately \$18 Trillion per annum, is larger than the next three (3) largest economies (*China; Japan; and Germany*), and its annual military budget at approximately \$640 Billion (*est. April 2014 numbers*) is well over the defense budgets of the *next 15 countries put together!* See Chart below:



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Currently, economically and militarily, the U.S. is the only undisputed global 'Super-Power'. And just like similarly World dominant powers in the past (*unless it somehow corrects itself*) it is undermining its own strengths, and actively sowing the seeds of its eventual decline. The U.S. external and internal politics and policies of the past decades, are at times downright toxic to itself and the rest of the World. It is not the only country to act detrimentally towards itself and others, but its impact is certainly the greatest.

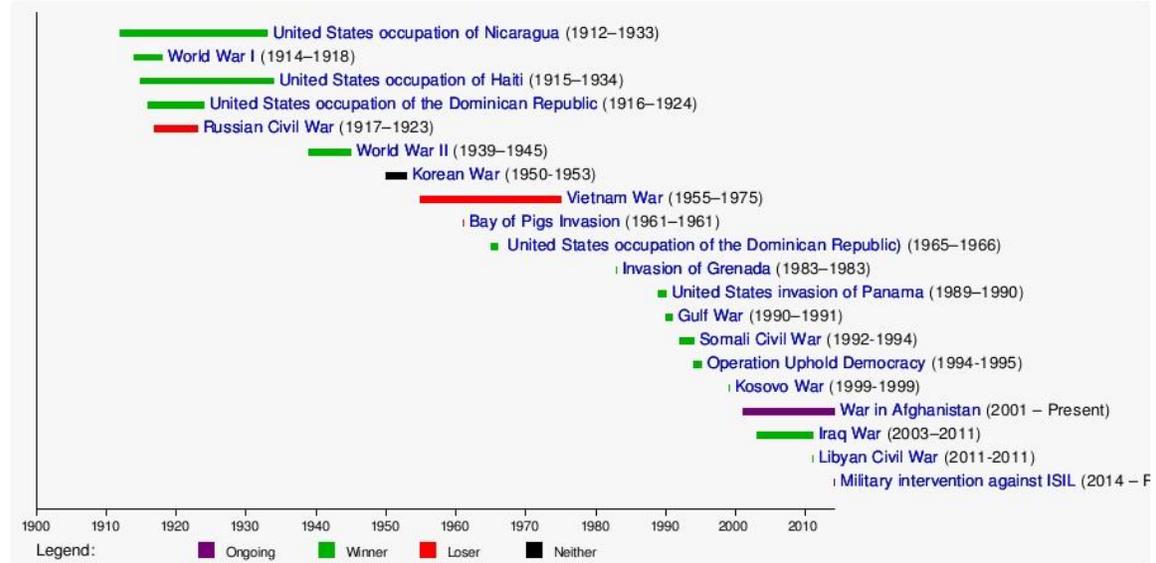
Since its very beginning, and for 244 years, the U.S. has been involved in some kind of armed conflict, and on a quest for perpetual war to feed its ever growing war machine, the 'military industrial complex', against whose influence President Dwight Eisenhower warned in his 1961 farewell speech, "In the councils of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military industrial complex". Well, so far and increasingly the Pentagon has had a dominant role in U.S. national and foreign policy. And although, for over 200 years the Country has been involved in some type of armed conflict, just the suggestion of resolving more of the international disputes through diplomacy, and ideological disputes through dialogue, bring roars of disapproval and accusations of weakness and cowardice from most of its leaders. And the American public expects that of its leaders. Below are just the 20th Century wars (1900 – present). The complete record of wars and armed conflicts that

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the Americans have been involved in, go back even further - from 1770 (source: *Wikipedia*).

1900–Present [\[edit\]](#)



This consistent state of war is vitally necessary for the mighty U.S. military industrial complex that has grown to a point that it needs the Hundreds-of-Billions, in budgetary defense spending, annually. Any talk of serious cut back to its budget is met with a gale of opposition from the army of lobbyists and the independent contractors, that represent the military-industrial complex who have grown fat over the past decades selling over-bloated goods and services to the armed forces (*where ordinary hammers can cost \$100 and the development of a new jet fighter can cost a cool Trillion, and counting*). No suckling wants to let go of the gushing teats of such a prolific, productive and bloated sow (*the Department of Defense*).

Below is an excerpt from a recent article from Time.com (*Source: Centre for Public Integrity/ Alexander Cohen Aug. 5, 2015*):

“The Pentagon’s top contractors sent an army of more than 400 lobbyists to Capitol Hill this spring to press their case for increasing the nation’s spending on military hardware, in a massive effort costing tens of millions of dollars of their own funds from April to June alone, according to an analysis of public lobbying data by the Center for Public Integrity.

The contractors are upset in part because most military spending has been capped for the past few years under budget controls meant to rein in government debt.”

Even today, as the incumbent President tries his utmost to reduce the defense budget, tone down the aggressive rhetoric, and extract the Country from its existing wars, and tries to keep America from entering into new ones, he faces a constant barrage of criticism from frighteningly parochial,

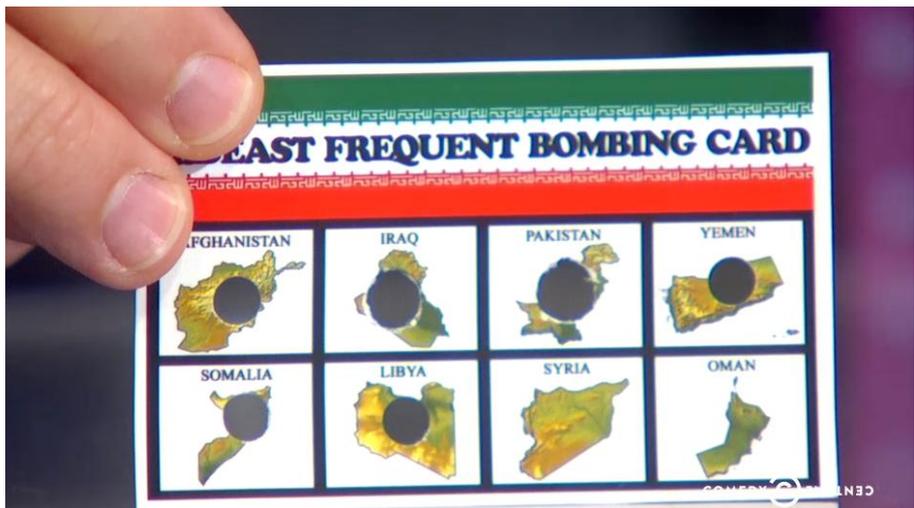
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blinkered, and narrow minded Senators and Congressmen, who consistently and loudly declare him to be weak, cowardly and un-American. And for the most part they consider the rest of the World just a convenience or a hindrance to their peculiar and alarming vision of a 'strong America' (*to borrow a phrase from Donald Trump's electioneering*) where American might is always right. Additionally, *the loudest critics are in turn influenced heavily by determined defense industry lobbyists who promise more jobs for the constituencies of the Senators and Congressmen if the defense budget increases, and threaten job cuts if the defense budget shrinks.* The powerful lawmakers in Washington are held hostage by the even more powerful in industry, and the most powerful on Wall Street. The good of the public is consistently lost in the constant roar of special interest group's whisperings in government's ear.

Gearing up for their Republican nomination for the coming Presidential elections, the Republican hopefuls routinely call for the President's blood (*figuratively speaking*) and the blood of their enemies, and their new target has been Iran. To appear to be 'war-like' in America is to come across as fearless and strong. To openly declare for diplomacy and peace is to be weak. The culture of war is now so openly entrenched in America that President Obama gets opposition from within his own Party if he seems to be favouring diplomacy over armed action towards America's constantly renewed list of new and old enemies.

To the rest of the World, America has become the caricature of a dangerous child with a loaded gun that keeps pointing it at everybody, while everyone around it ducks. Additionally, having the World's most precious commodity, oil, can be dangerous for a country's national health. As Jon Stewart has so famously put it (*and we paraphrase*), 'you better not have oil, or we will bomb you'. For countries in the Middle East that have had significant oil resources, that has been no joke, or a very discomfiting one.

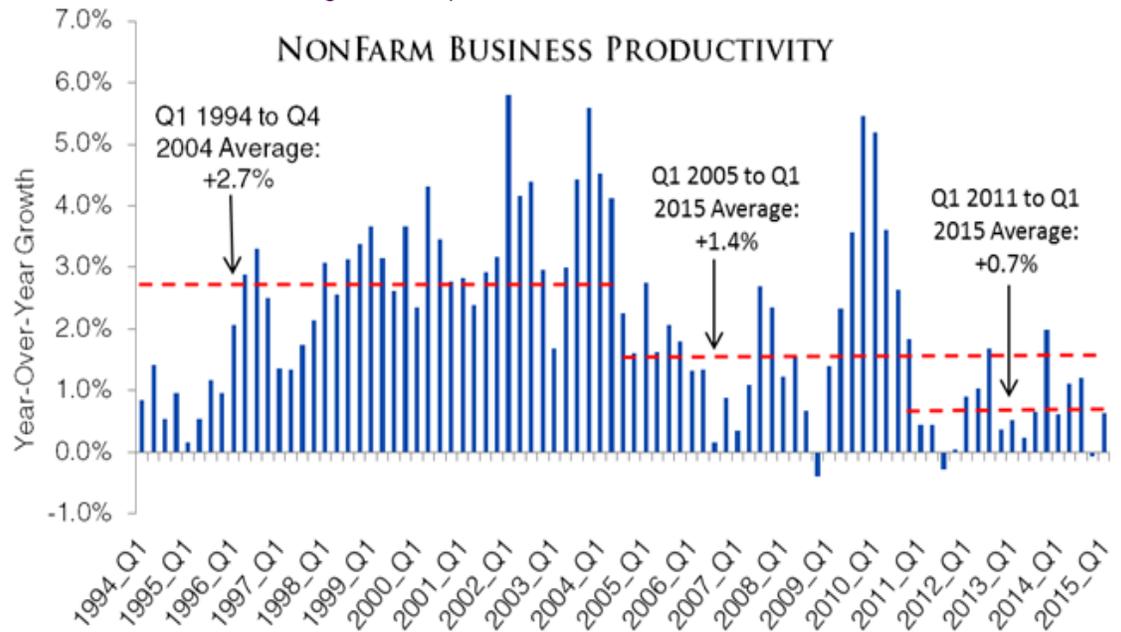


From Jon Stewart's The Daily Show

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Yet so far, seemingly, America's many indiscretions has done it little harm, as it is still the richest and most dominant nation on earth. But, and there's always a 'but', it now seems to have developed vulnerabilities, both in its ability to start and sustain major wars, and more importantly, to foster sustainable economic growth. It may be because in the past three decades, both the activities, war and economic growth, have been fueled primarily through debt, and not though its past legendary business productivity, which has been declining over the past 2 decades.



Source: Bureau of Labour Statistics

To get a longer term perspective (50 years) on 'Real Output per Hour, Non-farm Business Sector':



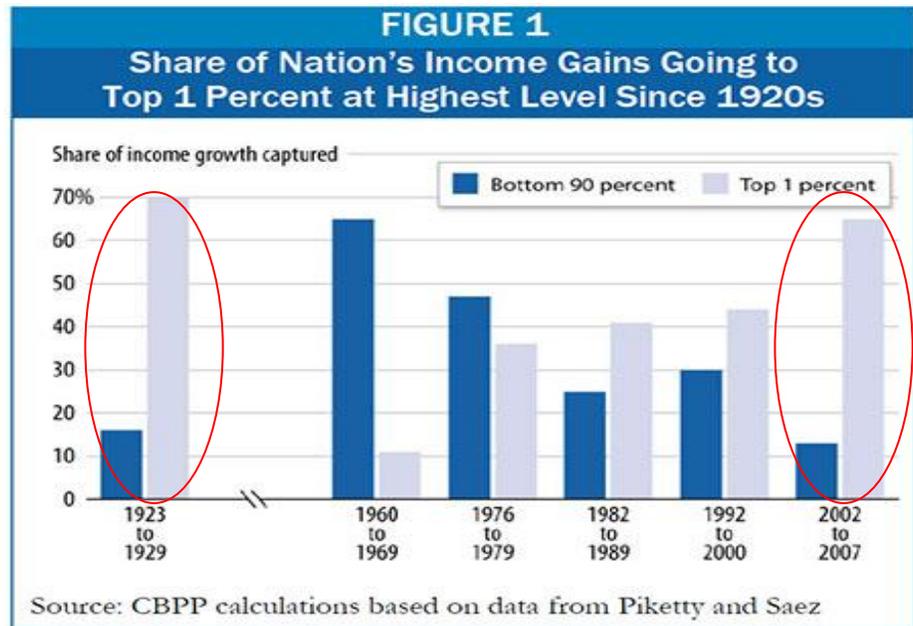
Note: Data for 1974 begins with the fourth quarter.
Source: U.S. Department of Labor, Bureau of Labor Statistics, and Haver Analytics, "Productivity and Costs," Real Output per Hour, Non-Farm Business Sector.

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The fundamental political/economic structure of America, democracy and capitalism, is still sound. But over the past three decades, both the political and economic agenda seems to have been hijacked by the very powerful hawkish few, to the detriment of the majority, whether in foreign policy or in economic matters. The public has not benefitted by the constant state of war, neither has it benefitted by the torrents of liquidity unleashed by the Federal Reserve over the past decades that has gone primarily to benefit of the top 10%, un-proportionately.

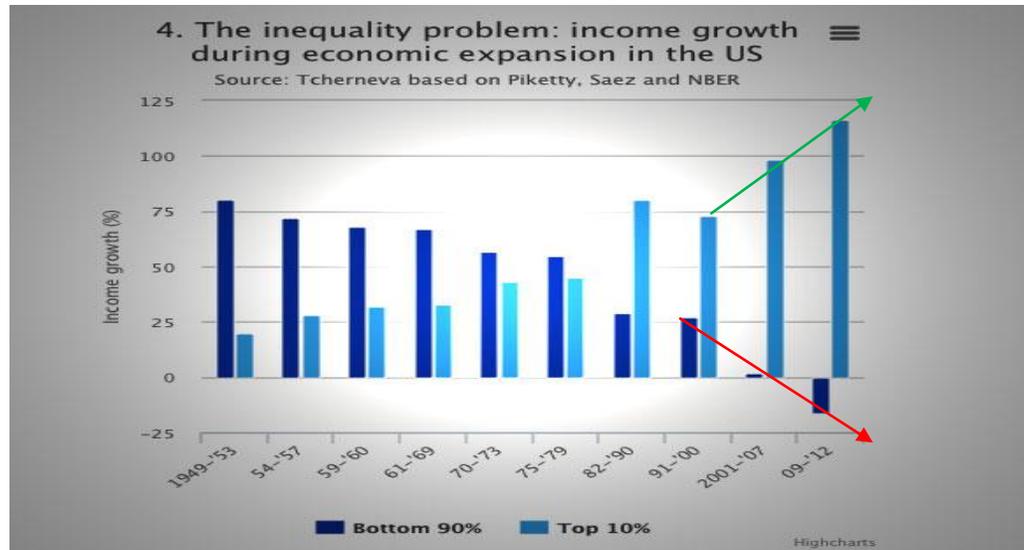
On the economic front, America no longer has more or less equitable wealth creation and distribution system. Its vast and productive 'middle class' has been steadily deteriorating in financial well being, the number of 'poor' have been increasing, and the 10% 'Rich' have been having a field day, and have seen their portion of wealth sky rocket (*see Chart below*). Such extreme disparity (*and it's still growing*) in wealth distribution, does not bode well for the Country's economic future, and is inherently unstable and ultimately unsustainable. The degree of wealth disparity that is now a reality (*according to Professors Piketty and Saez*) was only present prior to 1929, before the Great depression!



America was truly the land of opportunities and dreams, because it was perhaps the only country in the World where an ordinary citizen could be more or less 'equal' and partake in the good life. Perhaps the only country that did not have an entrenched privileged Class, and its ordinary citizens controlled a large portion of the nation's wealth. Those realities have been changing over the past decades, till from the 1990s, the wealth concentration has swung so dramatically as to make the old Czarist Russia look fairer by comparison. The past decades of Federal Reserve's credit expansion have been particularly brutal for income growth for the 90% of the public, and downright spectacular for the top 10% (*see Chart on following page*).

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Such dramatic *concentration of wealth* in the hands of so few is generally associated with the 'Third World Countries', and certainly not with the wealthiest of the 'First World'. And while America still leads the World in overall wealth, increasingly, it is all going to a ridiculously few in number. This trend, if not dramatically reversed (*and the chances of that happening are not good at this time*) spells the eventual decimation of the American dream, its much vaunted values of equality and fairness, and eventually the Country's global power. Some of that erosion in power has already taken place. America's power came from the extraordinary political freedom, inventiveness, productivity and great wealth equality among the majority of its ordinary citizens. Over the last three decades all those factors have been compromised, and America has gone from the World's largest creditor nation, to the World's largest debtor nation, living now on borrowed money and borrowed economic time. Inherently, to be a debtor is to be weak.

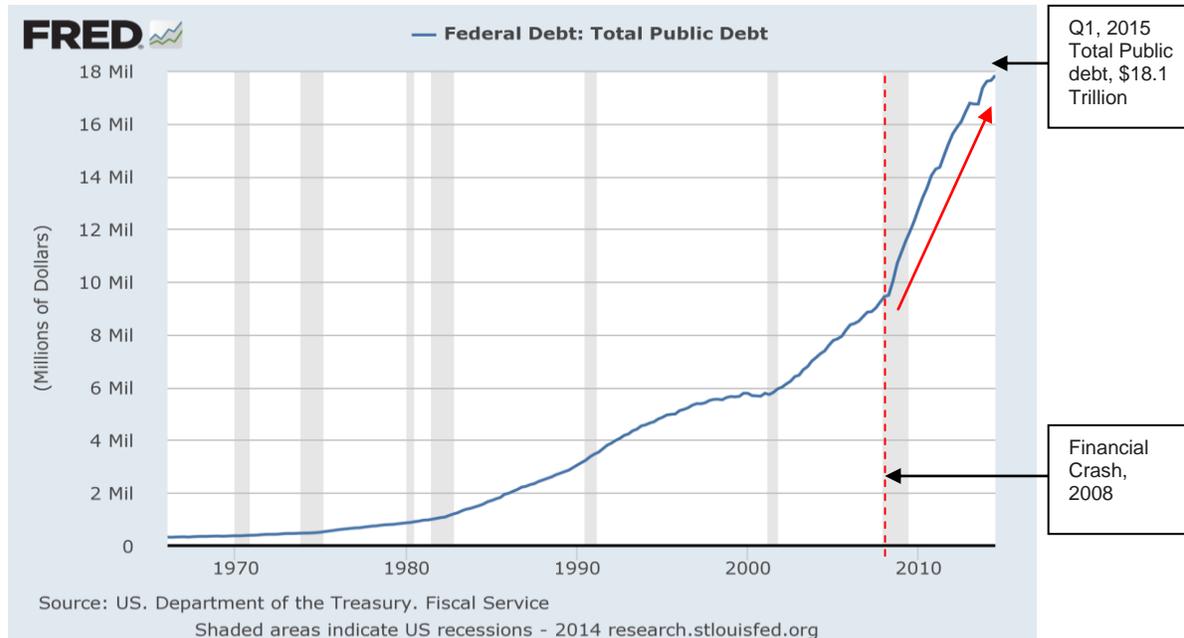
In our last Report (*May 2015*), we had predicted a slowdown in the U.S. GDP growth for the rest of this year, and possibly a recession in the coming months against majority expert consensus. We seem to be on track for both those predictions. We still do not believe the U.S. economy can buck the declining economic global trend and grow independently. The external economic disasters that are brewing in China, Japan, Europe, Russia, Brazil, and others, are too much of a gale force head wind for the American economy to remain unaffected. And then there is its own internal disaster in the making. On the one hand the anemic force-fed economic growth, and on the other hand the Fed force-fueled asset bubbles of the last six years, that are now threatening to implode. Lay on top of it all, the most massive unproductive public debt burden in its history, and you have an economic disaster threatening.

Now we know that there are plenty of economic experts that do not believe that the amount of a country's debt is material to its economic soundness.

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We agree to a point. That point being where the debt taken on is producing net return, net of the debt's cost. In today's economies and for most of the major ones, that point of 'productive debt' was left behind decades ago. This last hockey stick curve in debt has for the most part fueled rampant financial market speculation, massive corporate financial engineering to boost declining earnings, and outright financial institutional fraud, (*the admissions of non-guilt, coupled with ever increasing record sized financial penalties, with the odd imprisonment of the lesser bank employee is still very much underway*). What the out-sized debt has not produced is material relief, or out-sized wealth creation for the overwhelming percentage (90%), of the over indebted and underemployed citizens. The Country is over loaded in unproductive debt that is enriching too few through the Federal Reserve's pumped and overextended financial and asset markets. Plus it now faces external shocks. To borrow a much used phrase, 'It is not going to end well'. And the end seems increasingly near and foreboding.

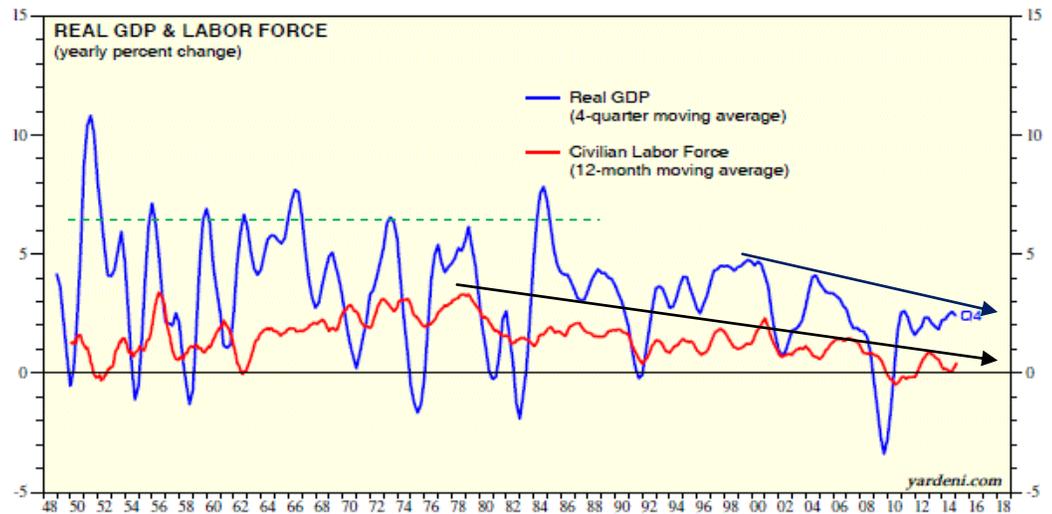


The above Chart does not worry some of the global economic experts, those that believe that unlimited liquidity (*stimulus*) by governments is the only proper action to take in a recession or a depression, till sustainable economic recovery is attained. Again, we agree in principle and to a point, but every crisis is different and is due to different causes, and those causes must be addressed for a country's economy to reverse its decline. This past 'Great recession' of 2008, was due to the decimation of financial discipline over decades that resulted in the Federal Reserve led global Central Bank's excesses in liquidity, which in turn led to unfettered global consumption. Additionally, that type of excess liquidity always leads to an increase in greed, which in turn usually leads to an increase in fraud and corruption. Which, the corruption in the financial community in the States, brought the debt fueled global party to a jarring halt in late 2008.

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Since then the governments, the Federal Reserve and the rest of the Central Banks did not try and correct the structural imbalances that had developed in the global economies due to the excess liquidity, instead they doubled down again - on more and more liquidity. That has exasperated the problem which is so starkly represented in the two Charts, above and below - too much debt creating too little economic activity. The Chart below shows the steady decline in the 'Real GDP' year-on-year (yoy) percentage change and the yoy percentage decline in the number of people working in America. This is after the greatest run of credit expansion by the Federal Reserve, over the past three decades.



Source: US Department of Commerce, Bureau of Economic Analysis and and US Department of Labor, Bureau of Labor Statistics...

The Federal Reserve continues to threaten an initial interest rate rise from its 'zero rate' policy, but the incoming weak economic 'data' so far has kept it from doing so. With the global situation increasingly deteriorating, we will not be surprised that the Fed postpones the interest rate raise yet again - in spite of increasingly frantic calls from nerve wracked financial market traders of, 'do it already!'

If the Federal Reserve buckles under the pressure it might be the proverbial straw that broke the camel's back. But in our view, it does not quite matter what the Fed does now, as it won't change much the end game, which is set. The governments and their Central Banks chose not to address the underlying problems plaguing the global economies, but chose instead to throw more and more printed money at the asset markets. This flood of cheap money created a speculative binge in the asset markets worldwide, but particularly in China and the United States, which insure an economic implosion in these two countries. And where these two countries go economically, the World goes.

To be continued. (Part 3, will address Japan, Russia, Brazil, Canada and Australia)