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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 – Now What?

Latest economic numbers coming out of China, Europe, and even the U.S. confirm the relentless deceleration of global economic activity, in spite of all governmental and central bank efforts worldwide to boost growth. Some of the major developed economies, such as the U.S., Germany, the U.K., Canada, Australia, and China, were the forlorn hope of the world for stable economic growth (*misguided, in our view*) but hope nevertheless, as most of the rest were on life support, and the BRIC economies had tanked by last year. Well, the hope faded fast as most of these economies contracted significantly in the first quarter and the inexorable decline continued unabated.

Over the past years as central banks and governments got more desperate to prop-up the sagging economies through continued credit and monetary easing, they only succeeded in inflating asset bubbles worldwide and were singularly incapable of boosting sustainable economic growth in the face of over capacity and low demand. China's economy has been nose-diving for the past year and a half; Euro Zone has been semi submerged for all intents and purposes, and currently, it barely has its nose above water at less than 0.5% growth rate; Japan, incredulously is fighting *DEFLATION* after possibly the most outrageous stimulative easing in history; the U.S. continues to struggle with erratic results and well below expectation growth rates; and the BRICs, (*Brazil, Russia, India, China - with the exception of India*) are basically in the economic tank.

Japan, the 'poster boy' of extreme Quantitative Easing (QE), is still struggling and on the whole Abenomics has failed to produce the economic activity warranted and expected by the gargantuan amount of monetary easing, the negative interest rates, and the steep depreciation of the Yen. All this was engineered by Prime Minister Shinzo Abe and his team, in an all out effort to lift the economy out of its decades-long slump. In spite of extreme measures,



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the Japanese economy barely managed to stay out of recession in the last quarter of 2014. The average person in Japan is struggling with higher domestic prices on staples due to the Yen's dramatic devaluation, and Japan's youth don't see much of a jobs future.

While the latest job figures out of the U.S. are recovering after a severely depressed first quarter, the labour participation rate of 62.7% is still at a three decade low, and many large corporations, including international banks, slashed thousands of jobs. The rest of the indicators were not encouraging either. Corporate earnings were disappointing on the whole, even with all the financial engineering employed by the management (*continued share-buybacks*), and capital investments continued to lag seriously. Large iconic corporations in the U.S. continued to struggle with top-line earning growth and some even with profitability. Earlier in the year, even the great 'Oracle of Omaha' Warren Buffett, felt compelled to warn the Federal Reserve not to raise interest rates too early (*he sees great economic weakness in the economy, in spite of his oft recurring positive messages to the contrary*).



Warren Buffett, Oracle of Omaha

But a great struggle is underway to avert economic disaster in China. The Bank of China has lowered interest rates three times in the last 6 months to forestall the economic dive. To underscore the weakness in the Chinese economy, a few weeks ago, the Premier Li Keqiang had announced new plans by the government to cut red tape and reduce costs for Chinese firms, to "*charge out into the world unfettered and rise up through facing competition on the global stage*". These additional measures being undertaken by the Chinese government, apart from the recent injections of more capital and easing of bank reserves to encourage lending, is to try and arrest the steep downward slide of their economy. These latest measures de-facto admit that the much heralded adjustment towards an internal-consumption-market is not happening fast enough to provide relief from the



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persisting external and internal weak demand, which is bringing the Chinese economy to stall speed. So the Government now wants to try and capture additional global market share to make up for the lack of adequate demand. In our opinion, it is *too-little-too-late* for such macro policies to have any meaningful impact on China's economy at this time.

According to the World Economic Forum "Global Competitiveness Report 2014-2015", China ranks #28 out of 144 ranked countries. Not bad all things considered but, for the purposes of halting, or meaningfully slowing down the current economic slide any time soon, these measures are not going to be good enough.

How the BRICS stack up	
The Global Competitiveness Index 2014-2015	Global rank*
China	28
Russian Federation	53
South Africa	56
Brazil	57
India	71

Source: The Global Competitiveness Report 2014-2015
Note: * 2014-2015 rank out of 144 economies

In being #28, China is well ahead of the rest of BRICs, but far behind the competitive export giants of the world, such as the U.S. #3, Germany #5, Japan #6, United Kingdom #9, Taiwan #14, Canada #15, and even France #23, South Korea #26 and Israel #27. In between there are many smaller countries that are ranked much higher such as Switzerland #1, Singapore #2, Netherlands #8 etc. While in the past decades, China has come up the competitive scale quite dramatically, its competitiveness of late has been waning as other smaller developing countries in South East Asia, like Vietnam, Philippines, Thailand and Malaysia rise rapidly on the scale, and challenge China's manufacturing competitiveness. Additionally, the existing giants have increased their competitiveness since 2007, such as the U.S. - up from #5 to #3; and Japan up from previously #9 to #6 now.

Some of the rise in competitiveness is from the depreciation of currencies, especially for Japan, as it has willfully decimated the value of the Yen under Abenomics for precisely this reason. But conversely, the U.S. has had the most appreciating currency of all and still ranks as one of the most competitive nations. The steady rise of the Dollar is now becoming worrisome to the American Government and the Federal Reserve as it starts to impact American corporation's competitiveness and provides another reason for the Fed to rethink its plans for a rate raise. Additionally, with an active currency and trading war already on, which we see as continuing, it is going to be very difficult, if not impossible, for Chinese companies to gain appreciable market share in today's increasingly competitive global economic environment. We expect every move that China makes, to gain crucial market share, to be countered aggressively by other equally desperate countries. The fabled race towards the bottom.

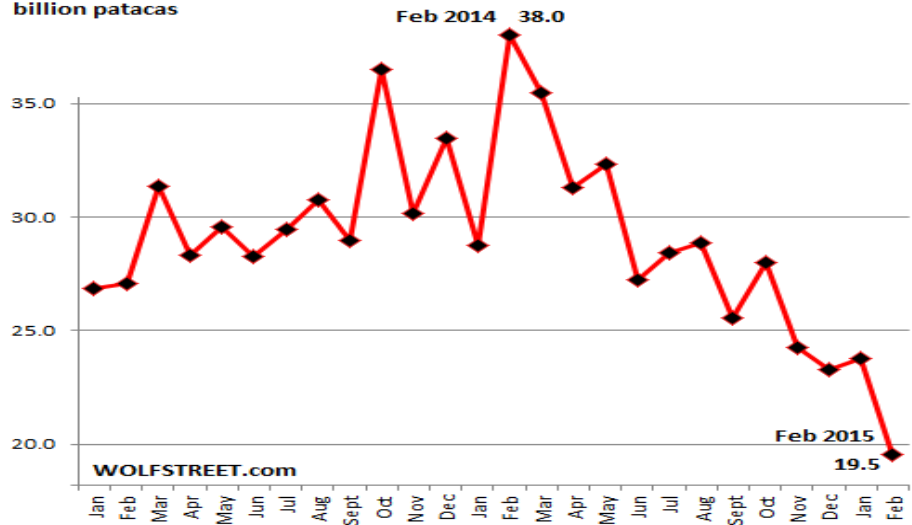
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We came across an interesting Chart by WOLFSTREET.Com (*below*) that shows the precipitous drop in revenues in Macau's gambling revenues as of February 2014. This is not an economic indicator that we normally look at, but it is significant in the steepness and steadiness of its dramatic slide. Part of the decline is no doubt due to the crackdown by China's government on conspicuous consumption by the rich and powerful, and on corruption in general, which would send serious gaming money into hiding, or abroad. But it is also, in part, a sign of China's current internal general economic condition and direction.

Macau Gambling Revenues

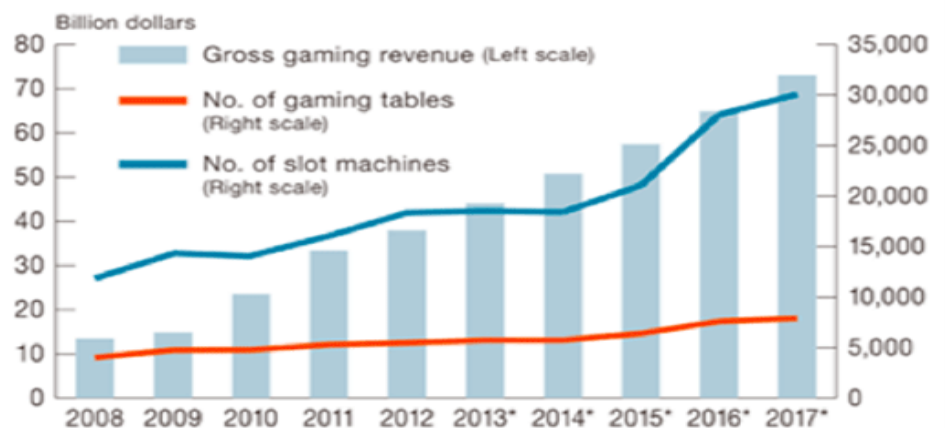
billion patacas



Source of data: Gaming Inspection and Coordination Bureau Macau

As a quick aside, the Chart below shows how the biggest and best in the business of research and prognostication *can be so wrong*. The stark difference in the estimated direction of the business and revenues in Macau from 2013 to 2017, by Goldman Sachs Research, and the subsequent reality (*above Chart*) is self evident and discomfoting.

Goldman Sachs Research estimates for Macau



Source: Government of Macao Special Administrative Region, Gaming Inspection and Coordination Bureau, Goldman Sachs Research estimates

*Estimate

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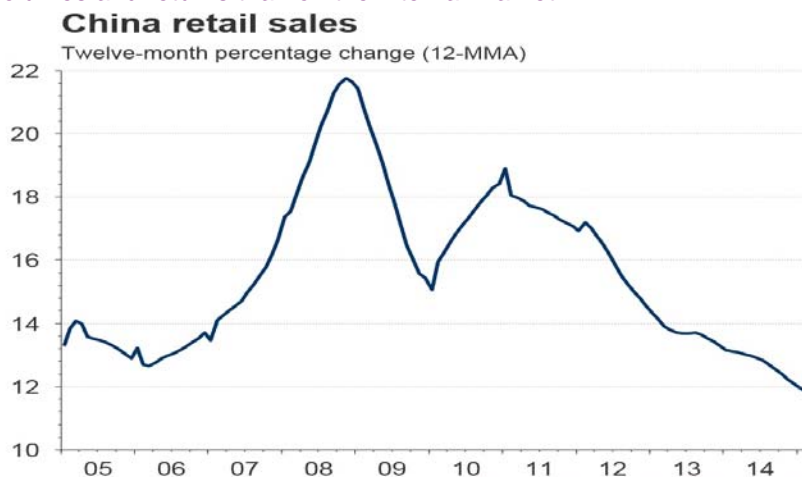
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The question whether China will have a soft landing or a hard landing has been debated for some time now. The subsequent Charts along with the ones on the previous page, showing the year long dramatic drop in business in Macau, would seem to indicate that China is already in a hard landing by the sheer steepness and length of the decline in business fundamentals.

Since our first Economic Reports in September of 2012, we have postulated that in our view, the lack of consumer demand, worldwide, would be the primary reason for the impossibility of an induced economic recovery by the Federal Reserve and rest of the central banks, regardless of the money injected into the financial systems. Since then and 7 years after the 2008 crash, the global economic realities have vindicated our consistent position.

Many international economic experts, both professional and amateurs, maintained that by and large China's economy was too strong, too rich (*the fabled \$4 trillion in foreign reserves*) and too controlled to be dragged down by the economic implosion of the West. We had begged to differ. The following Charts show categorically that China is experiencing the same implosion of business fundamentals that the West could not escape from post 2008 crash. In China's case it is the delayed reaction of the sharp and sustained contraction of consumer demand from the western economies. Now as the effects of the lack of global demand works its way through the Chinese economy, it is starting to make all the excesses and the significant mal-investment of the past years a liability and unsustainable.

The Chart below shows the destruction of China's internal consumer demand as the reality of the external global conditions took hold after what we had called the "Dead Cat Bounce" - the sharp recovery in early 2009. After the effects of the massive cash stimulus (*post 2008*) started to wear out, by mid-2010, the internal demand, as depicted by retail sales, started its inexorable, and what must be to the Chinese government, an alarmingly steep and steady decline. And hence, the resultant recent outward-pushing policy by the Chinese government, towards an aggressive expansion of their companies into the international market, where they hope to capture better volumes and returns than on the internal market.



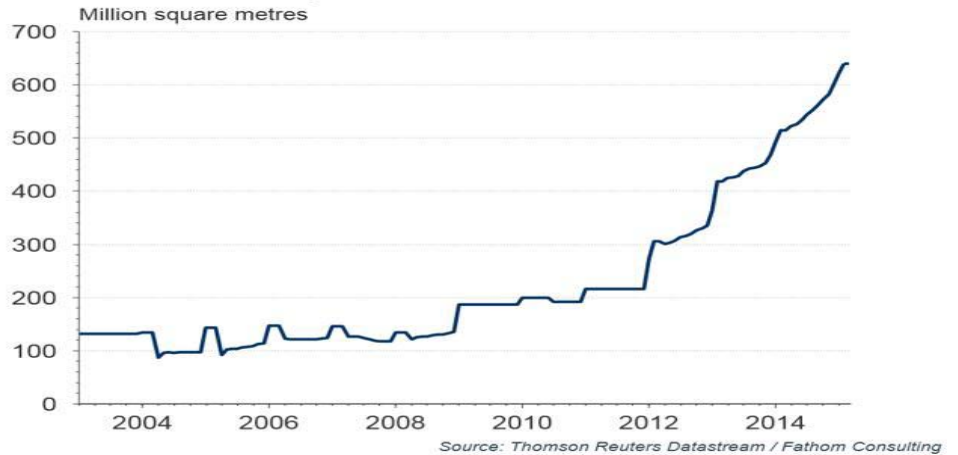
Source: Thomson Reuters Datastream / Fathom Consulting

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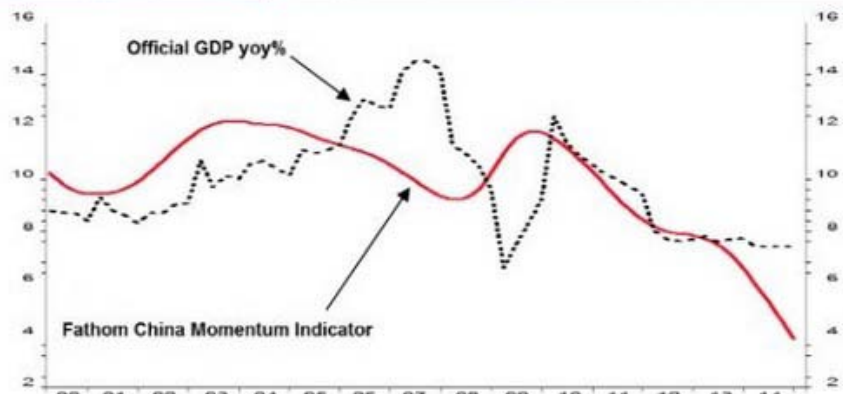
The effects of the unprecedented expansion of credit into real estate construction, post 2008, to artificially boost economic growth in spite of a lack of any real demand, is apparent in the steep increase in vacant floor space since 2012. And as the government injects more cash into the system now, to try and prevent a full blown collapse, the vacancy rate is not going to drop appreciably. Plus, as the general economic conditions continue to deteriorate, the surplus floor space could take many years to be absorbed into productive utilization. This mal-investment in excess real estate and other redundant infrastructure has become the poster child of over reliance on stimulus through investment, post 2008, into unproductive areas. The sheer size and cost of this mal-investment is now a liability through non-performing debts, making vulnerable its banks and other financial institutions.

China floor space vacant



Some of the experts that we consider as particularly knowledgeable on China, such as Anne Stevenson-Yang, and the Professor of Finance, Michael Pettis, at Peking University in Beijing, have maintained that the official numbers regarding the growth rate of China's GDP are suspect. We have always felt and stated that, having had considerable experience in working with other large emerging market governments. So we have been more in-line with the Chart below, estimating a growth rate that is *significantly lower* than the current official government number of 7%.

Chinese GDP growth widely acknowledged to be well below new 7% GDP target already!



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The government's ability to control numbers notwithstanding, the reality of China's economic hard landing is indisputable. The previous Charts reflect nothing but what in any other economy would be considered a hard landing. Because of the 'command' nature of the economy any and all really damaging defaults in its public or private financial institutions are covered by China's government, as are all publicly-owned corporations. But, regardless of its power to control internal matters and shape internal and external numbers and perceptions, China's government had no choice but to start 'fessing-up' to its deteriorating and difficult position vis-à-vis the economy. It is by no means going to become transparent, but recent pronouncements designed to lower and shape internal and external expectations, speak to the direness of China's economic slide.

China's overall position is very fragile in our estimation. Any major financial, economic or political shock, external or internal, could send China into a tail spin that would be extremely detrimental to the global economic stability. It would seem to us, having observed the buildup of the extremely distorted global financial markets of today that a financial shock is almost inevitable sooner rather than later. The increasing volatility, and the recent spike in government bond yields in Europe may be early tremors of troubles to come.

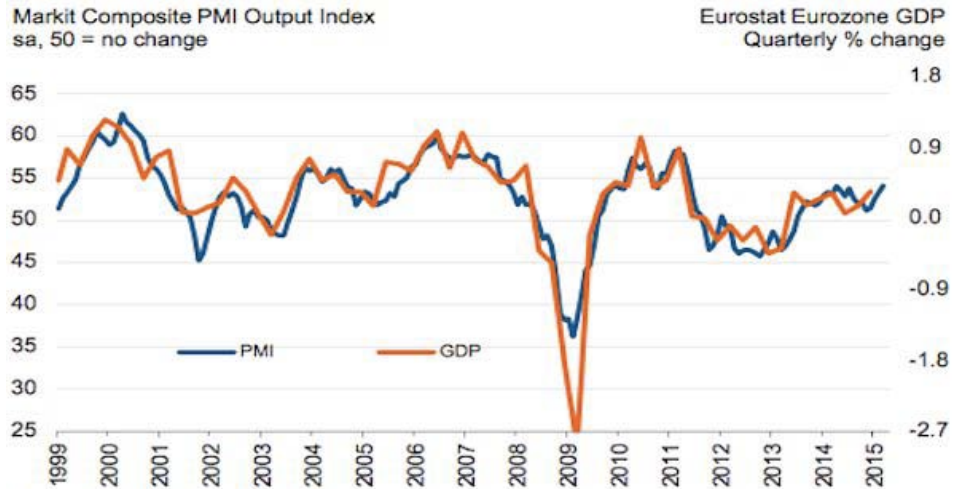


The Euro Zone is still struggling mightily to stay above zero growth. With its single currency and widely disparate economies that are needing specialized solutions to their own particular problems, some of which are frightening in their complexity and scope, we do not see any positive material change taking place in the Euro Zone economies any time soon, in spite of the ECB's current quantitative easing program. The kind of economic woes that the Euro Zone countries are facing, particularly the Southern economies of Greece, Spain, Italy, Portugal, and even France, of being generally uncompetitive in an increasingly competitive global environment, saddled with huge debts, and with their still shockingly high unemployment rates, it

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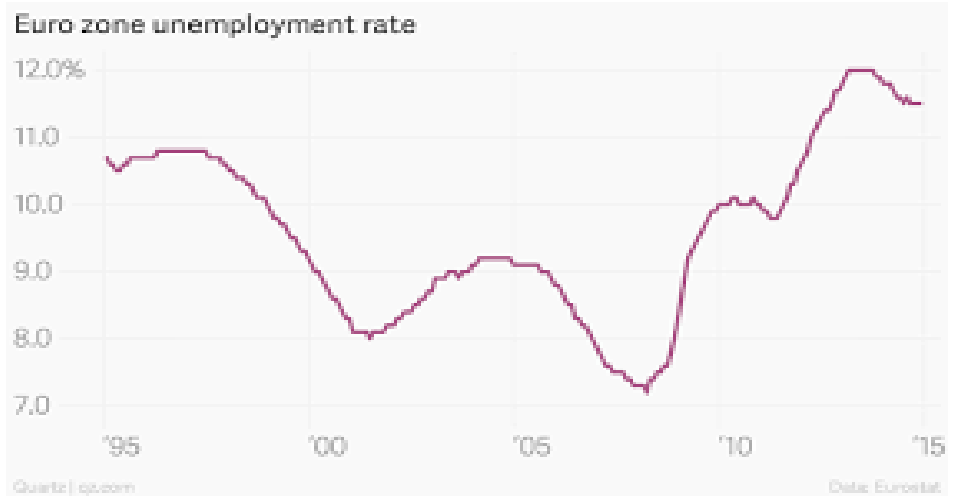
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will take much more than a nine-month, Trillion-Euro, bond-buying program to solve their collective problems. The Chart below shows the continuing economic struggle of the Euro Zone.



Source: Markit, Eurostat. GDP = gross domestic product

Average unemployment among working age adults is still higher than 20 years ago. (Chart: Eurostat)



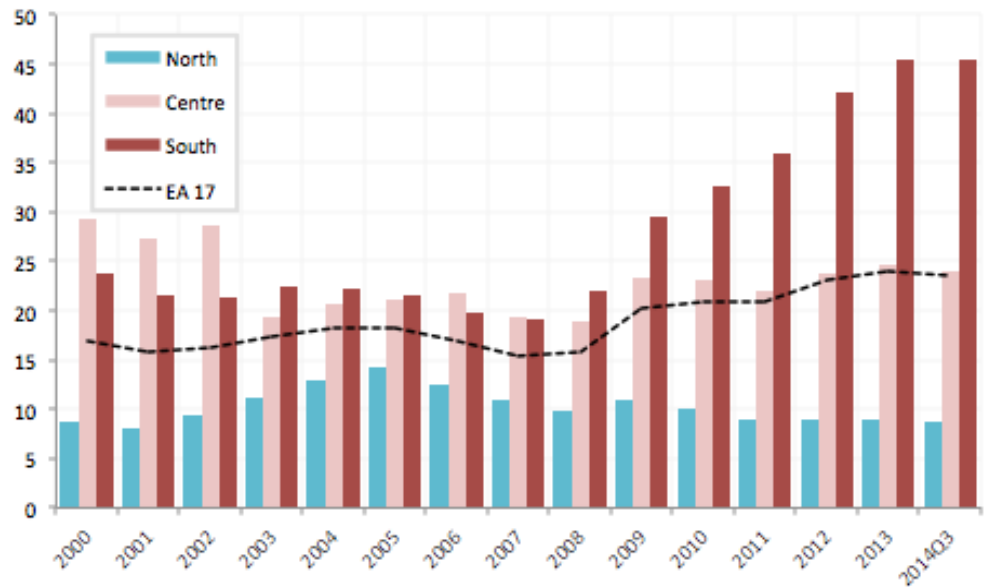
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And youth unemployment, on the average, across the Euro Zone is near 28%, while southern European countries are still averaging rates of 45%!!

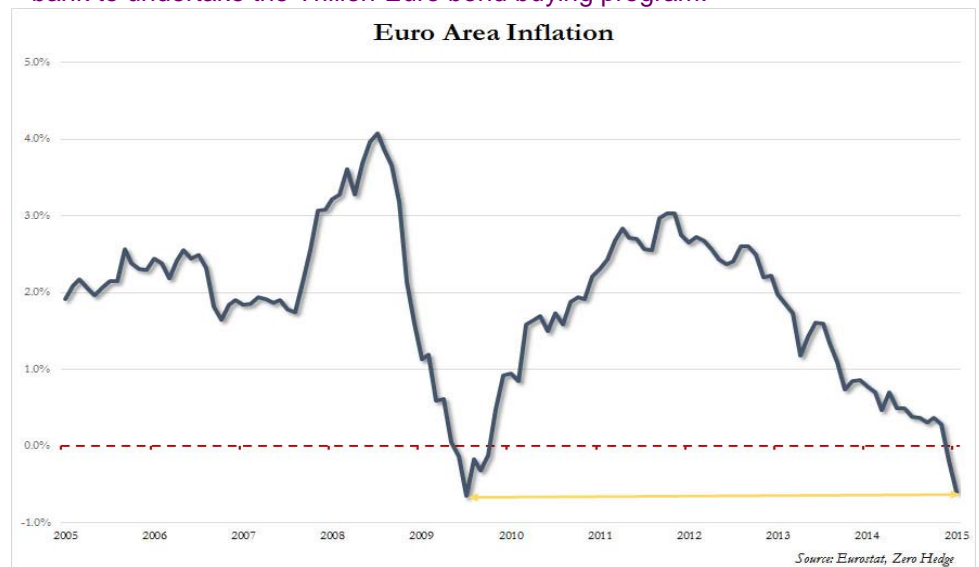
For all intents and purposes, and by any other name, these are 'Depression' like numbers.

Youth unemployment rate (< 25 years old) - group weighted average



With economic growth rates struggling to stay above zero, even if growth picks up somewhat as the result of the 1.1 Trillion-Euro Bond buying program, we don't see the unemployment rates changing materially any time soon. The individual countries of the Euro Zone need to become and stay competitive, and therefore must rely on technological advancement and experience to recover economically. Neither of those two requirements are good for significant job creation, particularly for the disenfranchised youth.

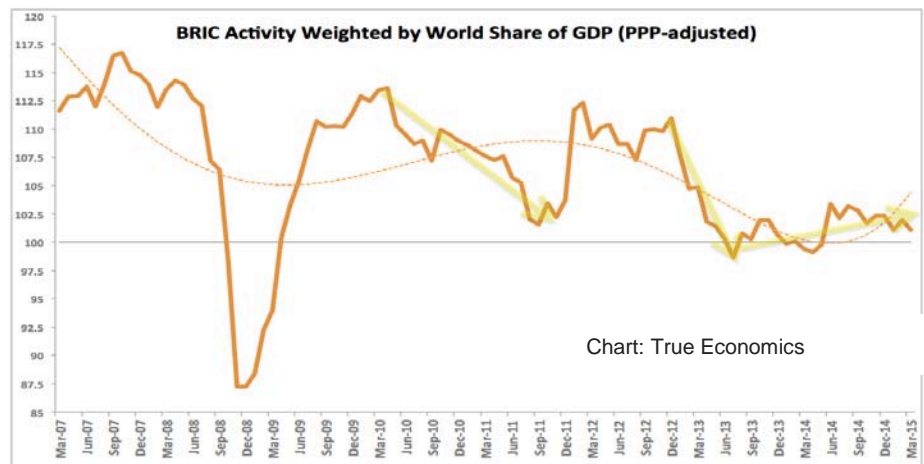
The next Chart shows the reality that finally triggered the European central bank to undertake the Trillion-Euro bond buying program.



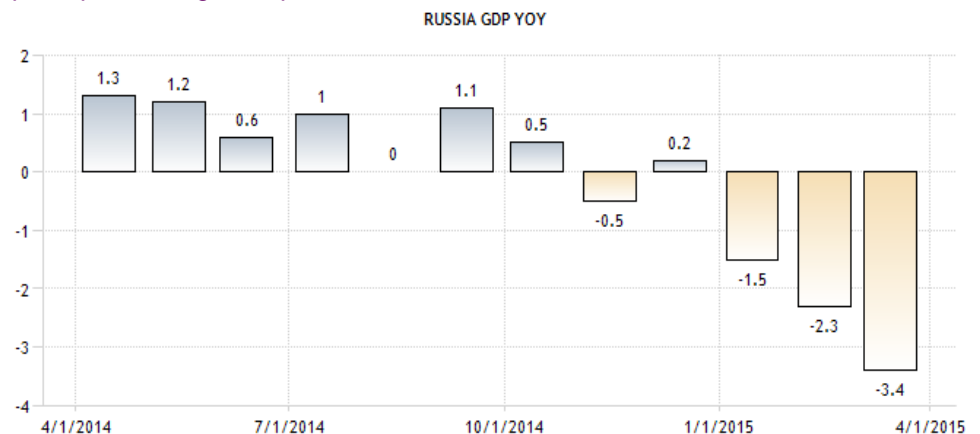
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In spite of the early post 2008 financial stimulus, and sustained credit easing, the Euro Zone was steadily sinking into deflation, the trajectory of which kept gathering momentum. We feel, with the continuing global economic slowdown, and its resultant trade and currency wars, the Euro Zone is going to find it difficult to meaningfully reverse the deflationary trend. The Euro Zone is facing the same challenges that Japan faced in the past decades of deflationary stagnation, and probably for the same reasons. Collectively it is caught in the same forces of: un-competitiveness, corruption, business and banking cronyism, along with its own unique challenge of a having a single currency representing a multitude of disparate national economies with different needs. It is obvious that without greater political and financial integration, Euro Zone economic problems are going to be near impossible to resolve in the near and mid-term.



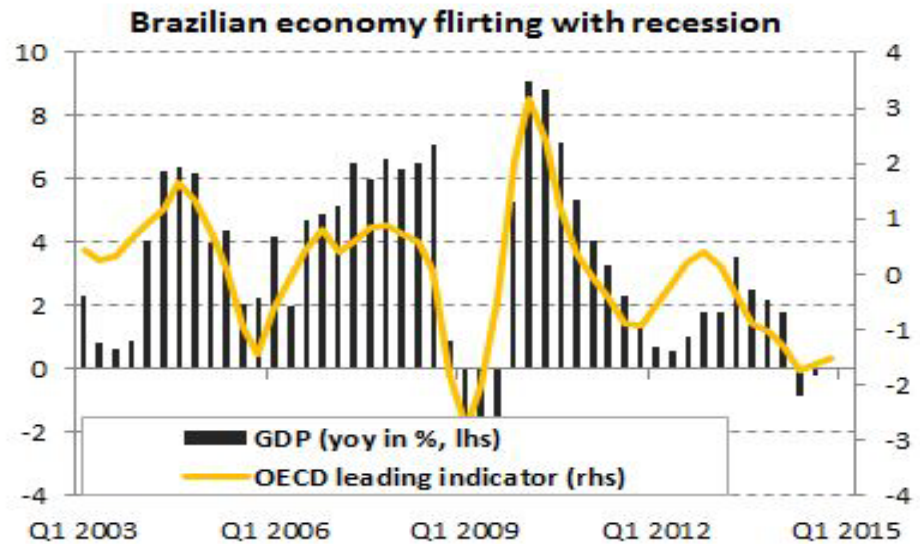
With the Euro Zone in an economic struggle that we don't believe the European Central Bank's QE program can meaningfully alleviate on a sustainable basis; with China and Japan struggling to hold ground, and failing, on an ever steeper and slipperier economic slope; with the U.S. probably facing the prospects of an oncoming recession; and with the BRIC countries mostly decelerating, with the exception of India, (see *Charts below*), we feel the remainder of this year, overall, will bring more economic bad news and perhaps the long anticipated financial shock in the financial markets.



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Of the BRICs, India and China will both post positive growth, but Russia and Brazil are deep into negative growth territory. The Russian and Brazilian economies are expected to contract the most in 2015.



Additionally, the Middle East and most of Africa is riddled with conflict and destruction, and for most part South America is struggling with its two largest economies (*Brazil and Argentina*) in what has been a free fall. That leaves South Asia and East Asian economies showing relatively strong growth rates. Is that enough to avert the relentless global economic contraction? We don't think so.

The Chart below indicates global economic growth to be sub-par for 2015. (Source: UBS estimates)

Figure 1: Global GDP growth versus trend



Source: UBS estimates

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Considering how ineffective 'top down – trickledown effect', asset inflating, gross wealth and inequality creating QE has been over the past 7 years, to engender sustainable growth, it is mystifying why this is the only economic stimulus plan governments, their expert advisors and the central banks can come up with, over and over again. And when it fails, as it generally has over the past 7 years, this is exactly the same plan they turn to once again; as they all are doing currently.

It all reminds us of a quote attributed to Albert Einstein: *'Insanity – doing the same thing over and over again and expecting different results'*.

We came across an article lately in the defense of central bankers and their 'one trick pony act' of quantitative easing, by the renowned economist Nouriel Roubini, who strongly criticized all those who were criticizing the central banks and their endless QE operations.



In it he commented that most of those who were criticizing QE as the preferred method to try and foster economic growth worldwide, were certainly no economists, did not understand economics and were rank amateurs, criticizing that which they did not understand. In effect he was saying that the central banks had no choice but QE, and while direct investment into building much needed infrastructure would have certainly helped, the governments really didn't have the money. This article made us question two of his assertions:

1. If economists, and only economists (*who are the only experts on economic matters*) understand it all so well, why then do they fail so miserably, and get it all wrong more often than not?
2. Granted that most governments don't have a lot of money nowadays, but then why weren't the tens of TRILLIONS used for QE worldwide, used to build critically needed infrastructure, as he mentioned, instead of being used to inflate asset prices to "create the wealth effect", that only resulted in top-end financial speculation, making the already favoured and rich simply richer, the poor poorer, and created gross inequality, had little to no trickle down wealth effect, and to-date has failed miserably in its mission to foster worldwide sustainable economic recovery? Phew!

As most central bankers continue to rely almost solely on QE, to try and fix a global economic system that remains clearly broken, and more Trillions disappear into the black hole of 'bond buying plans', perhaps such answers are only to be found in the complex economic theories that only great economists understand, because they certainly allude us amateurs who only have street level, real life business experience.

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And, did Janet Yellen just have an Alan Greenspan 'irrational exuberance' moment the other day, when she warned of equity prices being a tad high? Below is the excerpt from Greenspan's 1996 speech:

*"Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets. We can see that in the inverse relationship exhibited by price/earnings ratios and the rate of inflation in the past. But how do we know when **irrational exuberance** has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?"*

— "The Challenge of Central Banking in a Democratic Society", 1996-12-05

It is amazing how appropriate those comments seem to be in today's global economic and financial markets environment.

So now what?

Well, the global economic activity will continue to decelerate under the weight of debt, lack of demand, the absence of any meaningful structural reforms in the last 7 years, and geo-political conflicts. Therefore job and economic growth will be erratic and weak at best in most countries, while political, social and financial instability will increase dramatically. The singular and myopic strategy of relying solely on QE to fix post 2008 global economic problems, without undertaking any meaningful structural reforms, has resulted in a larger and more unbalanced financial structure with little to no economic stability.

The continuing QE adds daily to that structural imbalance while remaining quite ineffective in fostering stable economic activity, except of course to keep asset markets buoyant and bubbling. The World now awaits the day when the realization sets in that QE will not succeed in fostering sustainable global economic recovery, ever, and therefore endless QE will further distort worldwide asset markets that are dangerously out of sync with global economic realities. While financial markets almost always anticipate

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economic realities 6 to 9 months in advance, that relationship between the economies and the financial markets has been severed for the past 7 years because the central banks have been unconditionally supporting the financial markets, and underwriting their risk. Yet even with the unprecedented intervention of the central banks, reality must prevail and distortions in the markets must correct.

As global output continues to grind down and central banks' efforts become even more ineffective, and default on repayment of some sovereign bonds become a possibility (*Greece or some other geo-political economic trigger*), on that day the asset markets will correct to reflect global economic reality, interest rates will rise sharply to reflect the true risk, and the overly indebted and maximally stretched global financial system will be tested once again.



In the meantime, we foresee inflation starting to re-emerge in the U.S., and the U.S. heading towards a recession; the Euro Zone getting a bit of a temporary bump up from the Trillion-Euro QE, but essentially remaining mired in its intractable geo-political economic problems; Russia, Canada, Australia and Brazil contracting due to a lack of global commodity demand and the resultant low prices; China continuing to struggle with prolonged economic contraction and battling internal economic and social instability; Japan facing further struggles with its outrageous QE, its demographics and competitiveness, and the resulting low morale of its citizenry; the Middle East will continue to be a power and proxy playground of its dictatorial rulers, the super powers and the zero sum age old Shia/Sunni war. South America and Africa have always faced serious economic and political problems, and will continue to do so.

The bright spots?

For some stability and sustainable growth rates, some of the South East Asian economies, and India.