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Global Economy – Still Unraveling!

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Ashok Dhillon has 40 years of front-line business experience in Canada and International markets. He incorporated his first construction company in 1974, and since then has founded and led companies in construction and international power development.

Over the last 20 years Mr. Dhillon, has led and worked with top Canadian talent in the legal, engineering and accounting firms, such as Fasken Martineau, Russell & DuMullen, Stikeman Elliott; Hatch, Moneco Agra, New Brunswick Power, SNC Lavalin; and Ernst & Young, Arthur Anderson, and Grant Thornton. And in London, worked with Perkins Couie and Morgan Grenfell. Mr. Dhillon's companies have partnered and worked with Pan Canadian Oil & Gas, WestCoast Energy, TransCanada Pipelines, and international companies such as AES, Enron Power, Hyundai Heavy Industries.

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".

For two decades the West and the East were in a mutually satisfying dance in an ever cooperative economic embrace. The West was providing the unabated consumption and capital and the East was providing the cheap goods and services to support that consumption. The resource rich countries were providing the raw materials and were prospering hugely in the bargain. This co-dependent economic relationship was working so well, and was so beneficial for all parties that it created an unprecedented global economic boom that lasted for decades. No one could have predicted the current breakup and the great unraveling that is taking place today.

The consequences of the 2008 crash are now making all countries retract, as each region and country looks to heal itself from the significant economic/political damage done by the crash.

In our earlier reports on this topic, we had said that two decades of unbridled consumption in the developed Western economies had been responsible, in the main, for the strong growth rates of the emerging markets. They supplied and fed the West's consumption, which in turn had created jobs and wealth in those countries, and fueled their voracious appetite for commodities. Once that unmitigated consumption in the West came to an abrupt and inevitable end, it had a predictable negative economic impact on the growth of the emerging markets. Five years after the 2008 financial crash, emerging markets including China and India are experiencing declining demand in the West and are therefore dramatically slowing, and in turn are steadily scaling back their demand for commodities and energy, thus locking East and West in a downward spiral of declining GDP growth.

Annual global GDP numbers (IMF): 2010 – 5.3%; 2011 – 3.9%; 2012 – 3.5%; 2013E – 3.3%. (2013 estimate may be a bit optimistic) The global economy is still, predictably, unraveling.

From the rebound in 2009-2010, (we had called it the "dead cat bounce") the major economies have been slowing steadily, with annual GDP declines in spite of the best efforts of their respective governments and Central Banks to boost growth. That means that quantitative easing Worldwide has done little to stimulate economic growth till now, and as China and India feel the full impact of lessened demand from the West, they themselves are going to impact the West more negatively. In Canada, we have felt the brunt of the downturn in demand for commodities.

The problems in China and India are just starting. Both countries face a myriad of internal problems that are going to get worse with the

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slack in international demand for their goods and services. China is decidedly more important to the global economic activity than India, as much more weight is rightly given to China's economy than to India's. But we think China's economy is in deeper trouble than its official numbers suggest. We have said previously, that all government numbers are to be looked at a bit skeptically, so if China's official economic figure for GDP growth rate is stated to be 7.7% in 2013, it may be quite possible that the real number is lower. If that is the case, then the repercussions to resource exporting countries like Canada are going to be that much more severe, and for a longer term than has been anticipated so far.

[*Ever wonder why government estimates always seem to be much lower than the real numbers that come out later? All governments, due to their consistent need to look their best at all times, almost always massage their numbers upwards or downwards depending on what suits their purpose the best, at that time. In these difficult times, optimistic growth numbers are most likely. To be fair, this is not confined just to governments. In the private sector companies do their utmost, sometimes by dubious accounting methods to massage the numbers, at times with help from their auditors, to meet expectations, or beat analyst's estimates regarding their earnings.*]

China's internal problems will grow as its economy slows. Its 20 year investment fueled GDP growth through its State Owned Enterprises (SOE) has been building serious imbalances and risks in its financial and banking sector. It's oft mentioned overcapacity in industrial production is also of problematic proportions. Its ever widening wealth gap between the urban and rural populations is a real cause for concern for its new leaders, and the level of endemic corruption is undermining the trust of its population. These problems, together with the constant threats that autocratic governments normally fear, pockets of insurrection which could conflagrate into a larger rebellion, make for a tinder box upon which China's government is always sitting.

These risks are real and pose a threat to China's national stability if they manifest, and therefore represent a possible risk to global economic stability. China desperately needs the West to recover and start consuming Chinese products at the pre 2008 levels. That unfortunately is not likely to happen any time soon. And while the new leadership is implementing policy to stoke internal consumption and demand, long entrenched habits cultivated through sheer necessity, such as high saving rates in the absence of any social safety net, are going to be hard to break. Therefore, a materially slowing Chinese economy means trouble at home, and abroad.

India, although not as influential globally as China, in economic or political terms, is still a heavy weight in Asia through its sheer size. India is now experiencing: stubbornly high inflation rate resulting in persistently high interest rates; declining external and internal demand; reduced capital investment and

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industrial production; negatively impacted services sector; reduced internal and foreign direct investment; and a messy, wildly inefficient, corrupt political and bureaucratic system that is sapping foreign and national confidence. What India has going for it is its internal consumption, which is still about 60% of its GDP. That fact gives India greater resilience and self reliance than China, in a period of protracted global down turn. India does not have the economic power to replace China as the lead economic engine, which together with the United States was expected to pull the global economic train back on track. Additionally, India does not have the almost limitless capacity of China to purchase raw materials internationally, both extracted and in-ground, and therefore cannot drive the global commodities market as China does. India's traditional weak governance and institutional incapacity is its perennial Achilles heel. But its resilient economy based on internal consumption and a stronger service sector, will continue to support a much slower but steadier growth rate in the range of 4.5% to 5%.

While India faces many internal challenges like China, it does not face the potential system changing upheaval and threat from its own people that is Chinese government's constant fear. Corruption is endemic in both countries. In India it constricts significant inflow of direct foreign investment, prevents desperately needed social, economic, structural change, and thereby slows overall development of the country and holds a vast majority of its population in poverty. Corruption also makes India ineffective and inefficient as a global player, undermining its size and potential in the international arena, and exacts a heavy discount on it as a nation. In China, corruption does not undermine its effectiveness or heft as a global player, nor does it exact a discount in its international dealings. Its governing body's single minded, cohesive and most effective foreign policy, coupled with its incredibly successful management of its internal disparate issues (so far), combined with its wealth generating capacity, has given China an international profile and clout that India can only envy, but cannot emulate. But corruption in China has the capacity to destroy the nation as it is structured today. The Chinese government recognizes the threat acutely and its new leaders are moving to try and mitigate it and deflect it before it brings systemic change.

Whether it is successful in its attempts, is a difficult question to answer. On the one hand China's record, to implement that which is good for China has been most impressive. But insatiable greed is difficult to root out once it has taken hold at the governing level. From there it just flows down to a nexus between the government apparatus and business, and then to the general population, which gets trapped in an inescapable system that is inherently corrupt. In all countries, the fact that those who are responsible for monitoring it and routing it out, are themselves the most guilty, disallows any real change and meaningful reform.

India can stay corrupt and still remain intact in its present form. China threatens its very structure if it is not successful in curtailing the rampant corruption that has grown as fast as its wealth generating capacity has. In China the repression of its people does not allow for a safety valve for the anger of its people to vent. In India, for most people, venting is a national pastime.

Russia's economic performance is deteriorating, and has been overall disastrous these past years. Industrial production never really recovered from the best days of the old USSR, and Russia has been primarily living off of its resource revenues, oil, natural gas and coal. Euro Zone's depression like conditions, along with the slowing global economy, does not bode well for Russia in the near term. While it is

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courting China and Japan as energy development partners, any meaningful exports are still years away. Moreover, under the current regime, competition in business and politics has been effectively crushed, leaving full control of the country and the economy in the hands of a very few, who have enriched themselves to a stunning degree at the expense of the nation. The corruption at the top levels is now legend, and prevents Russia from embarking on sound political and economic reform policies, that would allow it to tap into its enormous potential. Russia will not embark on an active, meaningful, reform agenda anytime soon. Which means it will struggle in the coming years, and therefore will not be able to contribute to the global economic growth rate materially now when it is needed the most.

Brazil, the other BRIC economy, after showing some real promise post 2008 crash, being the first economy to 'recover', is now facing some serious problems. Its exports to its largest trading partner dropped off dramatically, as China's economy retracted sharply. Inflation in food and consumer goods is becoming a problem for the ordinary person putting severe pressure on living standards. With economic growth stalling, and prices in essential items rising, the Government of Brazil finds itself in a difficult position of having to raise interest rates to slow inflation rate, which has been a serious problem in the County's past, but thereby further slowing the economy. This year Brazil's economy is expected to grow at 0.09%, a significant drop from the past year, and it is quite likely it may not meet that target. Facing the prospect of rising prices and interest rates, resulting in public and worker dissent, falling commodity demand and stalling economic output, Brazil has some very difficult economic times ahead.

The IMF (International Monetary Fund) projects the developed economies to average a 1% growth rate in 2013, and the emerging markets to average collectively a 3% growth rate during this year. These numbers may be optimistic if any of the myriad risks facing the individual economies manifest themselves. Even if nothing worse than the current situation prevails, these global GDP numbers are a steady and dramatic fall from the highs of post crash 2010 recovery rates. The Global economy has declined steadily since 2010 and that decline has accelerated this year to the point of the developed economies being for all intents and purposes in another recession, and the

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major emerging economies falling back to growth rates not seen for a decade.

As we have consistently maintained, the current irrational exuberance in the stock markets is based on the unprecedented liquidity that Central Banks have pumped into the major global economies, recreating asset bubbles in equity, bonds and real estate markets. If one is an active professional trader, then these markets are truly heaven sent, but for the average long term investor these are perilous times indeed. The coming contraction in global liquidity and the inevitable rise in interest rates, in spite of all assurances to the contrary, will once again trigger the stampede to the exits, as usual leaving the average investor holding the bag.

Some are convinced that these inflated assets are sure signs of economic recovery. We see a global economy that had once been productively interdependent, now unraveling into disparate zones or individual economies that are having to look to themselves to manage their many economic and resulting social problems, stabilize their falling outputs, try and foster growth in the face of reduced external and internal demand, and cope with the political fallout internally.

Our purpose is to inform and prepare our readers in their near and long term planning, for the realities of the geo-political economic trends, and how they may be affected by them in their personal lives, businesses, and their investments.

- The trend according to us, and we have been consistent and correct so far, is still downward with serious overhang of extraordinary risk from Europe and the slowing emerging markets.
- The slowing emerging markets will continue to put long term pressure on the commodities and energy markets.
- The excess liquidity and the historically low interest rates are directly and irrationally boosting equity, bond and real estate markets, making them ripe for a triggering event: reversal of liquidity or higher interest rates, economic or political shock in Europe, or further sharp economic contraction of China, India and the rest of emerging markets.

The fundamentals of the geo-political economic trends are very negative. While there are some signs of small positive developments, for instance fractional improvements in economic performance indicators, overall they are too small, inconsistent and prone to reversals, to give any real comfort that a solid recovery is taking hold in any major region or economy. On the contrary, global GDP numbers as well as geo-political economic fundamentals of most countries, all point to the continuing unraveling of the global economy, with risk rising in all asset classes.