A Global Perspectives White Paper

The Global Economy in 2014
5 Key Trends

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Introduction

Every year Global Perspectives publishes its annual white paper covering the 5 keys trends we see impacting the global economy in the year ahead.

This year we will look the major global economies and examine the major trends that will influence them over the next twelve months.

1. US becomes the engine of the world economy

In 2014 the US will continue to lead the world in its recovery from the economic crisis of 2008.

The pace of US economic growth is strengthening and this will be reflected in the end of QE as the Federal Reserve turns off the printing press in response to this solid economy recovery.

The US is the only major Western economy that has cleaned up the toxic legacy of 2008 - unlike in Europe where zombie banks still shuffle on and meaningful reforms are mostly non-existent. In America bad debts have been written down, banks have been recapitalised, property markets

have re-balanced and companies themselves are now far leaner.

The "Shale Gale" of cheap, nearly limitless energy is substantially re-shaping many parts of the US economy in a way we are still struggling to understand. It will also fundamentally alter the geo-political structure of the world, as the US moves permanently away from its addiction to Middle Eastern energy.

Gas in America is currently one quarter the price in Japan. Next year more US companies will move advanced manufacturing factories back on-shore from Asia, as the cost of energy collapses and years of 20% annual wage growth in China effectively prices these workers out of the market.

Most importantly for the US, as long term shortage in many key commodities such as food and water become apparent later this decade (with the population of the Earth currently increasing by 400,000 per day) much of this future crisis will pass America by. China on the other hand can't feed even 20% of its people. Anticipating a medium term return to the food export bans of 2008, China is buying up whatever farmland it can around the world.

America, has no such problem. It is completely food self-sufficient and always will be once it controls the world's largest bread basket in the Mid-West and the Mississippi delta.

Demography is destiny and America's population is young, mobile, entrepreneurial, highly educated and demographically stable. Most of Central and Eastern Europe's population structure is collapsing. Russia's is even worse and China is aging rapidly.

America may have its share of internal problems - a paralysed political system, glaring inequality, too much government debt and unpayable pension promises (as we saw in Detroit in 2013). But once again - as many times over the last century - the USA will be the motor that powers the world economy in 2014.

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2. Tapering pains in Emerging Markets

Across the world, as the Federal Reserve tapers its bond purchases, emerging markets will have to cope with a wall of money being hovered out of their economies and moving back into US dollars. This will cause widespread currency volatility across the continent and may lead to a series of local economic crises.

In China the Communist leadership seems determined to wring every last available drop of investment-led growth from its economic model. This will continue into 2014, but the day where Chinese productivity begins to stall is getting closer.

China will continue trying to move its economy away from infrastructure and state directed lending, to one led by consumer demand. To help achieve this difficult transition, it recently announced a number of important changes to its economic model, including modernising its property and business laws. It will be interesting to see if these changes are actually implemented on the ground.

It is difficult to know if China can achieve the transition to a consumer led society and not get stuck in the infamous “middle income” country trap - as has been the destiny for so many other countries in Latin America and Asia. The country’s economic growth may be stabilising but its financial system is still a Pandora's Box of bad debt. What the shadow banking sector contains is known to no-one outside the upper echelons of the Chinese Communist Party (and perhaps not even to them). 2014 could easily be the year of the Chinese Credit Crunch.

The wheels in India have come firmly off the carriage and the panicked imposition of draconian capital and commodity controls last year (mainly around Gold) has not stopped a creeping sense of economic crisis. It has also led to a huge increase in gold smuggling into the country, a trend that will continue next year as the country tries to cope with its balance of payments deficit.

Russia, despite holding the outrageously expensive Sochi

winter games, will begin a gradual decline in influence as growing access to cheap "fracked" energy brings to an end to its recent period of renewed economic power. Economic growth has stalled in Brazil and this has been reflected in nationwide protests against its rent-seeking state and needlessly high cost of living. The government there will be hoping the World Cup in Rio de Janeiro next year will lift the national mood.

The fragile economic environment in Asia next year will play out against a background of intermittent hostilities between some of its major players (including Japan, China and South Korea, to say nothing of an increasingly unhinged North Korea). Never in Asia's history have both Japan and China been as powerful at the same point in time.

It is often remarked how closely the situation in North West Asia resembles that of mainland Europe a century ago, where rising powers armed themselves and ratcheted up the sabre rattling.

With the centenary of WW1's outbreak next year, this coincidence will be lost on nobody.

3. Europe gets stressed

Europe will begin 2014 with its economy slowly starting to recover from the recession of the last few years - but make no mistake the Euro Zone crisis is percolating away in the background and threatening to erupt at the slightest provocation.

Portugal's ability to exist the bailout looks shaky and Greece can no more pay back its enormous dent next year than it could last year. A new Greek debt write off will be needed at some stage. This will likely follow some sort of Slovenian banking bailout. It is perilously close to that stage now.

Unemployment will remain scandalously high across the fringes of the continent and the Euro will spend the year overvalued as ever – largely due to China selling's its US investments and putting the proceeds into Euros.

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The threat of deflation will hang over much of Europe for the year ahead and if this starts to threaten the German economic heartland we may see the ECB start to engage in more unconventional monetary activity (basically QE) to boost inflation. Expect stiff resistance to this in Germany.

2014 could also be the year the bond market finally gives up on France, as it becomes clear that the country will not deal with its budget deficit (it hasn't balanced a budget in nearly 40 years) and the bond market may take fright. Tempers at home are increasingly frayed and next year will see more middle class protests at this section of French society is absolutely taxed to the hilt (to a higher extent than even in Sweden).

While the imposition of a new European banking supervisor will be a useful development, unless it clearly identifies a path to remove a bankrupt banking institution from the shoulders of its national government, it is not worth the paper it's written on. Ireland may have recently successfully exited its bailout but its population is been made to pay for the failure of its banks in full (despite promises of relief last year).

It is important to note that capital controls remain in place in both Iceland and Cyprus – their crises frozen in time and waiting comprehensive solutions (although Iceland is making headway).

Only in the UK is a large European economy making a solid recovery. The UK was the fastest growing economy in the G7 in 2013 and this will continue in 2014, as the country expands its financial, technology and financial services sector (particularly in booming London, the world's global capital).

The key European development next year will be the bank stress tests carried out by the ECB. Seeing as European banks are sitting on between €1.5 – €2 trillion Euros of bad debts (much of it unaccounted for) this will be a delicate balancing act for the regulator.

The ECB tests need to be seen to be stringent enough to seem credible, while at the same time not so stern that lots of important

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banks fail them. Indeed there is still no credible solution for providing capital for banks that fail the stress test. Europe's hard pressed tax payers will not take kindly to opening their pockets once again in 2014.

4. The Commodity cycle turns upward.

Institutional money is starting to flow back into the commodities space marking the end of the Bear commodity cycle. As economies improve the demand for the world's minerals, metals and commodities will start to increase. Institutions know this and are taking positions at the start of this new trend. Many miners and commodity companies have been absolutely hammered over the last few years. 2014 will be the year this starts to change.

The current price of many food stuffs does not accurately reflect the future demands on this industry. Particularly as the Earth's planet moves towards 9 billion and continues to increase at a totally unsustainable rate of 3 million people a week.

Similarly grades of many metals continue to decline as the easiest deposits of Copper and Iron Ore have been exhausted. Only in energy has the table turned, with the huge unexpected bounty of shale oil and gas. In other segments like minerals and metals the slow gradual running down of the Earth's reserves continues.

Indeed the collapse of commodity process over the last few years and the wiping out of many juniors explorers means that in a number of key metals (notably zinc) there is a shortage of new mines coming on stream in the next few years - just as commodity demands will grow.

Expect the price of many commodities to increase in 2014

5. Africa Rising

Africa only seems to make the headlines in the West when there is a famine, drought or natural disaster. But there is another African story taking shape quietly in the background. In 2014 many of the Top 10 fastest growing countries will be in Africa.

Interestingly this is not just a story of commodity extract and production. Non-commodity countries are also growing strongly. Inflation is low and trade with the rest of the world has increased markedly (particular with China).

Although the north of the continent will remain a fragile mess due to the fallout and instability from the Arab Spring, Sub-Saharan Africa is expected to be the fastest growing region in the World in 2014 (at 5.5% - a rate twice as high as the United States).

Infrastructure is starting to improve across the continent as new railways and ports are being built and opened for the first time since independence. South Africa, despites its own economic difficulties, has cemented its role as the continents leading economic power, setting up retail and telecommunications industries all across the continent.

In East Africa, Kenya is an expanding role model for mobile financial payments (number 1 in the world) and there is a growing start up technology industry in the country. In West Africa Lagos is now the largest city in Africa and is its commercial capital, while the Ivory Coast has recovered substantially from its civil war and is re-establishing itself as an important trading centre.

Despite the ongoing risks (terrorism from Somalia, Muslim/Christian conflict in Nigeria and particularly the nasty civil war in the Central African Republic - which has the potential to drag in other Africa states like in Congo in the 90's), overall the continent is calmer, better governed and more prosperous than any time since independence.

A small African middle class is starting to appear across the continent and this process will continue to escalate in 2014.

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