A Global Perspectives White Paper

Global Perspectives

The Global Economy in 2013

5 key trends

By Shane Brett,
Managing Director
Global Perspectives

www.globalperspective.co.uk

Date 16th January 2013

Contents

Introduction

2013 is set to be a pivotal year for the world economy. Seismic changes are taking place across the globe, transforming major economies as they try to recover from the Global Economic Crisis of 2008.

In this White Paper we will examine the 5 key global economic trends shaping the World in 2013.

1. US economic recovery continues

The US economy is undergoing a slow, structural recovery from the debt-fuelled expansion at the start of this century. In 2012 the US economy grew at approximately 2% - far more than the Euro Zone or UK. Recently the US has easily been the best performing Rich World economy.

Despite the recent media fixation with the “Fiscal Cliff” and fear of the forthcoming debt ceiling negotiations, the long term is outlook for the US economy is broadly positive.

The housing market has stabilised and consumer confidence is slowly returning. The political instability of 2012 has been resolved by Barack Obama’s decisive election win. There is now certainty that Obama will be President for the next four years. Spending will increase on health as “Obamacare” becomes the established law of the land and the country gears up for its implementation

In 2013 the US will continue its astonishing windfall of cheap domestic energy. The US will start to seriously expand its exploration of Shale Oil. The Shale Gas story is well known. What is newer is the use of the same “fracking” technology to access colossal reserves of untapped oil in Texas (and especially) in North Dakota.

This year will see a relocation of energy intensive industries from around the world to the US, to take advantage of far cheaper gas prices (e.g. Gas in Japan is four times as expensive). This will result in trade disputes with its allies who will resent having important parts of their heavy industry move to America, while they are trying to come out of recession.

Short term the effects of on-going budgetary and debt ceiling crises in Washington may be uncertain, unpleasant and unhelpful, especially to an economy still in recovery mode. The fact that the unemployment rate is still so high and there is a general fear of economic fragility, underlines the scale of the 2008 economic crisis. The big unknown for the US is how the effects of massive money printing (Quantitative Easing) will affect the economy in the years ahead. Currency volatility is virtually guaranteed.

However the panic around the Fiscal Cliff or Debt Ceiling negotiations masks more important underlying economic trends. In a world of future escalating commodity prices the US is in the enviable position of being food (and potentially) energy independent. Crucially, it has a solid future demographic structure, with a young growing population. It also remains the world centre for economic creativity and new business start-ups.

Most of the world would be happy to have America’s problems.

2. Chinese Infrastructural Expansion

China is set to ramp up infrastructural spending in 2013. It will spend over 1Trillion Yuan (approx $157 billion) this year. This should provide a boost to the world economy (even if this spending is unsustainable).

The nature of China’s One-party system means that large infrastructural projects can be approved and implemented quickly. China is increasing infrastructural spending in an attempt to provide a soft landing for its economy, battered by faltering exports, a bursting property bubble and rampant wage price inflation.

The key point for China this year is whether this infrastructural spending will be wasted on empty airports and unused highways, or if it will be used to modernize the country and lay the foundations for a solid future economy.

Transportation, electricity and other similar infrastructure developments (e.g. road construction & port expansion) will

be the major cornerstone of China spending 2013.

The expansion of the Chinese electricity network will push up Copper prices. The government is planning to upgrade the electricity network for 500 million people – larger than the entire United States grid. The government is also planning to extend its high speed train network to a large number of second-tier domestic cities, in an attempt to drive growth and more even economic development. It is also building a huge number of nuclear plants around the country, to wean itself off filthy coal fired electricity plants.

Globally Chinese companies are starting to bid more aggressively for both US companies and domestic American contracts. This will be a cause of friction for the two countries over the next few years. The expansion of Chinese domestic infrastructural spending should be good news for commodity dependent economies like Canada and South Africa, even if the scale of its spending is far smaller than the stimulus of 2008 and its level of on-going infrastructural spending is unsustainable in the long run and will bring diminishing economic returns.

China is also facing a host of other problems across its economy and society (e.g. banking bad debts, an unhappy middle class, a choppy political leadership changeover and tension with its neighbours.

These issues will be examined in detail in the forthcoming Global Perspectives White Paper –

"**China on a Knife edge**".

3. German Election dominates Europe

In the European Union, the German election in September will completely dominate the year in Europe. The largest trading block in history will continue its incremental approach to the Euro Zone crisis. Angela Merkel will be seeking re-election and is keen not to upset the electorate by being seen to commit the German purse to further economic bailouts.

To date she has done an excellent job of disguising from her electorate both the true scale of the crisis and the size of the cheque Germany needs to write to hold the Euro Zone together.

Consequently prior to the election little substantive progress will be made in ending the Euro Zone Crisis prior to the election. Gradual reforms around the appointment of a Euro Zone Banking Supervisor will take place, but attempts to agree a cross-border deposit guarantee are unlikely to get far. Most importantly any attempt to move towards "debt mutualisation" (i.e. where the Euro zone countries jointly issue and guarantee debt) will be swiftly and firmly rejected.

Joint Euro Zone debt would drive up the cost of German borrowing and force it to properly backstop basket cases like Greece. Despite a gradual German realisation that long term debt mutualisation will be required; it is not a policy that Merkel can sell to the German people this year.

This means 2013 may bring disappointment to peripheral bail out countries like Ireland and Portugal who are faithfully implementing austerity packages. These countries hope to get a Greek style debt write off in the near future. Besides some opaque tinkering with Ireland's Promissory Notes, they will likely to wait until after the German election for any significant relief.

The main economies of Europe will teeter between zero growth and recession. Political crises will flare up in both Italy and Spain, while the UK will agree to hold some sort of referendum loosening its ties to the European Union. A major EU member has never done this before. It could have a huge effect on the future of the European continent.

4. Global Currency Volatility

The effects of widespread money creation (i.e. Quantitative Easing or "QE") by the Developed World's Central Banks have not been fully appreciated. This is the year these effects will slowly start to manifest themselves in the World economy. This will be represented by more widespread currency volatility.

The US Dollar and Euro may weaken significantly this year, or be subject to far more volatile exchange rate movements. The Australian Dollar in particular is laughably overvalued. Though the Aussie currency may remain strong for some time (if China continues its slow recovery), it is the most overvalued currency in the world now that its commodity export boom is subsiding, its domestic economy slowing and interest rates are on the way down.

The Chinese Rembindi will continue to strengthen, staying at the upper end of its permitted trading band for the foreseeable future. This may give the US Dollar and Euro some breathing space and lessen talk of currency manipulation in Washington.

The Euro, however, will remain volatile. The ECB engaged in massive money creation in late 2011 early 2012 (its "LTRO" operations). This 3 year program will have to be repaid at the end of next year and it will interesting to see what effects this has on banking industry in the Euro Zone. A flare up of the Euro Zone crisis (perhaps due to a Spanish or Italian bailout or re-election

crisis) will see the value of the single currency quickly plummet.

Finally while QE has prevented a very deep recession, it is important to note that this level of money creation is unprecedented and its outcome largely unknown. Historically from Rome and Byzantium in the 3rd and 10th Centuries, to Weimar and Zimbabwe in the 20th and 21st Centuries, massive currency debasement has always been a predecessor to high inflation and economic decline.

It seems likely that inflation will indeed start to rise in the years ahead as more money chases the same amount of goods. This was always the intention of the United States.

It is the only realistic way it can to devalue in real terms the size of its gigantic national debt.

5. Commodity prices begin to escalate

Commodity prices have been soft for the last couple of years, as the Rich World attempted unsuccessfully to resume economic growth. This downward price trajectory will come to an end in 2013. Commodities will begin to resume their upwards march.

The last ten years has seen the complete reversal of a century long decline in commodities prices. Bar oil, commodities prices declined progressively throughout the whole of the twentieth century. Food, metal and minerals all became much cheaper in real terms (by about 70%).

Ten years ago this process came to an end.

In fact, in a matter of only a decade the whole of this decline was reversed. The price of vital commodities like Iron Ore, Copper and especially foodstuffs all began to rise sharply, as the BRIC countries vastly increased their commodity consumption. Only the global crisis of 2008 managed to sate this commodity price acceleration. Such was the size of economic crisis that many commodities collapsed in price.

This process is now beginning to reverse and the “Commodity Super cycle” will resume in earnest in 2013. Despite tepid or negative economic growth in the Rich World, China’s latest internal infrastructural expansion will boost demands for the main metal commodities (Iron ore and Copper).

The world is already facing a zinc shortage as the main producing mines begin to close in the next eighteen months. The world is also facing a shortage of phosphorous, which is a vital ingredient used to make fertiliser. Phosphorous has no replacement and it cannot be made. 85% of high grade phosphorous is controlled by one country – Morocco. We are running short and without it will not be able to feed the planets fast growing population.

The impact of increasing commodity prices will be most keenly felt in the production of food. The planet will add 140 million people this year (nearly two new Germanys). The rate of population increase is driving the underlying trend in commodity price escalation. 2013 will be the next stage in this process.

Bad harvests over the last few years' means high global grain prices may move higher if the climate remains volatile (as seems likely for the foreseeable future). Food riots took place in over 40 countries in 2007/8 and were a major reason for the political revolutions in the Arab world. Many important countries are unable to feed themselves (e.g. China, Israel) and depend on importing food from global grain and rice producers like the US and Thailand.

On a positive note, despite the increasing cost of commodity extraction and production, the melting of the North Pole ice caps means in 2013 new regular shipping routes will begin across the Arctic. In the years ahead this will be a major economic advantage to Russia, Canada, the US and Scandinavia.

Major technical investment is underway to try and extend falling yields on many foodstuffs. Renewable forms of energy are becoming cheaper and more competitive versus fossil fuels.

This process will continue in 2013.

The future of commodities will be examined in far more detail in "The Commodity Super cycle", the new book by Shane Brett, which will be released in Summer 2013.

Conclusion

The world economy is facing an important year in 2013. Governments will be trying to simultaneous end budgetary, economic and currency crises in China, the US and Europe. Against this background economic growth will start to pick up but will face twin headwinds of volatile currencies and increasing commodity prices.

It will be a challenging global economic environment.

Sign up for all Global Perspectives monthly White Papers at-

http://www.globalperspective.co.uk/#!whitepapers/c1a4e

Order the brand new book-

"The Future of Hedge Funds"

By Shane Brett

The last 2 decades have transformed the Hedge Fund industry from a niche investment segment to a massive global industry.

Global Perspectives
www.globalperspective.co.uk
Email: Shane@globalperspective.co.uk
Phone: +44 (0) 20 3239 2843

In this excellent and wide-ranging study of the Hedge Fund industry, Shane Brett examines the main issues and trends currently taking place, and analyses how they will affect the future of the industry.

This includes-

• Changing investor demands across the industry,

• New regulatory requirements - including FATCA, AIFMD & the JOBS Act,

• Future operational trends - including Operational Due Diligence & Managed Account Platforms,

• Emerging Service Provider opportunities – including Hedge Fund Administrators,

• Hedge Fund investment strategy - including new emerging investment opportunities,

• Best practice change management – how to manage Hedge Fund industry change.

The "Future of Hedge Funds" also examines the current and future global economic environment and what this will mean for Hedge Funds in the years ahead.

Available from Amazon in paperback here-

www.amazon.com/Future-Hedge-Funds-Trends-industry/dp/1481130226/

And for Kindle here-

www.amazon.com/The-Future-Hedge-Funds-ebook/dp/B00AHACY8Y

Global Perspectives

Global Perspectives
www.globalperspective.co.uk
Email: Shane@globalperspective.co.uk
Phone: +44 (0) 20 3239 2843