

US GDP Down – Where Is The Consumer?

WASHINGTON – Was the low US 0.7 % GDP growth figure for the last quarter of 2015 just a glitch? (For the entire year the US economy grew at a semi-respectable 2.4%). Or is it a sign that the long, albeit anemic, recovery is running out of steam? May be the latter.

Consumer spending

The only positive element that allowed GDP to grow a little at the end of 2015 is some consumer spending growth, in particular a spectacular increase in car purchases, a trend that went on throughout the entire year. Well, this should be a good sign. Cars are big ticket items. Millions of new cars sold in 2015 means that millions of Americans have enough money to spend.

Yes, except that it is not so. Cars flew out of dealerships because easy credit was extended to practically anybody walking in. Easy financing terms, plus very cheap gasoline provided a huge incentive.

Buying on credit

The problem is that if modest GDP growth is mostly the result of millions of people buying stuff with money they do not have, pretty soon this game will be over. This time, as every other time, there is a limit as to how much people can borrow. And when that limit is reached, consumption will stagnate or collapse.

So, here is the thing. Decent 2.4% GDP growth in 2015, (even if we average it by including the 4th quarter sharp decline), largely driven to consumer spending is not a real indicator of economic health. And this is for the simple reason that this

spending is not sustainable. You cannot have an almost stagnating economy, with stagnating wages, and higher consumer spending, all at the same time.

Union Pacific management is worried

At a different level, we hear the same concern from top management of Union Pacific, the biggest freight railroad in America.

They are pessimistic about the future of the US economy, because they see a lot less volume traveling on their railroad cars. All key sectors are down: coal, steel, agricultural products, industrial goods, and consumer products.

Where is the consumer?

"Where is the consumer?", they ask. And this is because they know very well that sustained consumer demand is ultimately what generates increased volumes of goods transported on their freight trains.

Well, if the people at Union Pacific are worried about flagging consumer demand, we should be worried too. Freight volumes are a very good proxy for the entire US economy.

So, *"Where is the consumer?"* The consumer, despite lower gasoline prices that theoretically act as a nice tax cut, is staying home. And he is staying home because he has already got too much debt.

Yes, there are many more jobs. Unemployment is down to 5%, the historic norm. And this is good.

Low paying jobs

However, most of these new jobs are low paying. And this means that many newly hired people, after they have used most of their low wages to pay for rent, utilities and other basic necessities, have very little discretionary income.

A family of four surviving on \$ 25,000 or \$ 30,000 a year does not have the extra money to splurge on flat screen TVs and smart phones.

Hence reduced volumes on Union Pacific, and a very disappointing 0.7% fourth quarter GDP growth number. Can this change in 2016? Yes, it can, provided an income boost.

New growth?

And where will that come from? It would have to come from significant growth in spending by people employed in new competitive sectors. People who earn good money.

Bar tenders, store clerks, janitors, gardeners and nursing assistants simply do not have the spending power to create significant new demand. And without new demand, (you have to look at weak domestic demand in context with declining foreign demand due to a global slow-down), it is hard to see what would generate higher GDP numbers next quarter.

Reduced volumes on freight trains

I have the feeling that Union Pacific, in response to declining freight volumes, pretty soon may have to idle at least some of its locomotives and railroad cars, this way contributing to a national economic retreat.

Afghanistan Among The Most

Corrupt Countries In The World

WASHINGTON – Remember Afghanistan? Yes, that sorry nation in Asia, sandwiched between Iran and Pakistan. Presidential candidate Barack Obama, back in 2008, described it as the country where America should have concentrated all its military efforts, instead of starting a new “bad war” in Iraq.

War of necessity?

Well, now Afghanistan enjoys the dubious distinction of being one of the most corrupt countries in the world, according to Transparency International. Billions of foreign aid money, (most of it from the US), combined with poorly targeted military and security assistance funds, (sometimes untraceable), certainly contributed to this.

After he got elected, Obama called Afghanistan a “war of necessity”, as opposed to a “war of choice” like Iraq. We “had” to fight there, because, according to him, that was a just cause. Al Qaeda had its bases there. That’s where they plotted the 9/11 attacks.

Anyway, fast forward to today and Afghanistan, “just war” or nor, is essentially a disaster area. Sure, the US and its tired NATO allies have cut back their military forces deployed there. But only after having created strong and self-sustaining institutions, we are told.

Leaving the country in good hands?

The idea is that the well-trained Afghan soldiers, (yes there is irony here), will soon be able to take care of Afghanistan’s security entirely on their own. Indeed, after billions and billions of dollars spent in Afghanistan, America can leave the country (although not entirely) with a high

degree of confidence that there is a democratically elected government in Kabul that can rely on (US and NATO trained) loyal and efficient armed forces in its continuing fight against the ever resilient Taliban.

One of the most corrupt countries in the world

Yes, if it only were so. Afghanistan is an unmitigated disaster. No real economy, except for opium production. The Afghan forces fight, sometimes well, sometimes not so well. But the Taliban threat has not receded. And, guess what, there are astronomic levels of corruption that, for sure, involve the NATO trained military and the police, among others.

At least some Afghans are aghast. According to Tolo, an Afghan news site, "A new annual study of Transparency International illustrates Afghanistan, Somalia and North Korea as the most corrupt countries among 176 in the world".

"Afghanistan is the second most corrupt country in the list of 176 countries ranked in the report" Tolo continues. "Meanwhile, Executive Director for Integrity Watch Afghanistan (IWA) Mohammad Ikram Afzali is concerned over the Afghan government's anti-corruption campaign and recommended a number of changes to this drive".

"The fight against corruption should be the top priority of the National Unity Government [NUG]. There should be a political will for this purpose," he said.

"The NUG has not implemented its promises it has made for overcoming the endemic corruption in the country," said Nasir Temori, a researcher at the IWA.

The Chief Executive of the NUG, Abdullah Abdullah, in a session with UN and other humanitarian organizations said they are committed to fighting endemic corruption.

"There is no doubt in the NUG's mind it is serious about the

fight against corruption in public offices," he said.

The NUG leaders in the first day in their office vowed to overcome corruption in government offices and bring transparency in government contracts and other processes that pave the way for this problem. [Bold added]

"Not only government but the people, the civil society and the private sector are responsible to join hands and fight corruption in the country," said the president's deputy spokesman Sayed Zafar Hashemi."

It did not happen

Well, whatever the National Unity Government pledged about fighting corruption, it simply did not happen. Trying to help, the US and other countries poured literally billions and billions of dollars into Afghanistan in an effort to modernize its institutions and its economy, and there are only negligible results. And this is in part because a massive amount of foreign aid money was stolen through corruption, embezzlement, and other illegal means.

Bad aid policies

To make things worse, corruption aside, US official aid was often spent on stupid or insane projects. Recently the news came up of a compressed natural gas (CNG) refueling station, funded by the Pentagon, that ended up costing in excess of \$ 40 million. Yes that \$ 40 million for a refueling station, when comparable projects in neighboring Pakistan would cost no more than \$ 500,000.

Did this 140 times cost overrun happen just because of an extravagant level of stupidity and incompetence? May be we shall never know. The US run Task Force in charge of this insanely wasteful project cannot provide proper documentation.

And this an American project. This was not run by the Afghans.

While this example is truly egregious, if this level of mismanagement is even remotely indicative of how things were planned and organized under the “just war” umbrella, you can understand why Afghanistan is an utter US foreign and security policies failure.

Interestingly enough, nobody says anything about any of this in Washington. It is true that President Obama inherited the Afghan conflict from George W. Bush who started it in 2001. However, after almost 8 years in the White House, he owns it. And yet it seems that he is not held accountable.

A disaster

Sadly, the Afghan “just war” turned into a chronically ill patient completely unable to get better and take care of himself. In the meantime, everybody, from the ruling elites to the policemen in the villages, is busy stealing and extorting.

Is there a “Plan B” for Afghanistan? I doubt it.

US Economy and Public Finances Deteriorating – Candidates Talk About Something Else

WASHINGTON – While we wait with trepidation for the outcome of the Iowa caucuses that will finally begin to shape the race

for the Democratic and Republican nominations, none of the candidates really care to discuss in any detail the actual conditions of America, both its economy and public finances.

On shaky ground

Let's make this simple. The US economy is on shaky ground. A lot of the rather modest (2%) economic growth that we had since the end of the 2008 recession is due to free money doled out by the Federal Reserve for an absurdly long time.

Energy bust

And now, some of that growth is gone, for good. Thanks to Saudi Arabia and its all out oil production policy that depressed prices, the massive energy boom that America enjoyed until 2014 is over, killed by oil at \$ 30 a barrel. More than 100,000 high paying jobs have vanished in about a year. More losses to come as more US energy companies go bankrupt, or have to retrench.

Easy credit

And what about the good news, like higher consumer spending? Well, the stunningly large 2015 car sales were financed almost entirely via easy credit extended to practically anybody walking into any dealership. (Some analysts talk openly about "*sub-prime auto loans*"). With these kinds of credit tricks it is easy to jack up GDP figures. The problem is that you cannot keep doing this for ever. When consumers who do not earn that much (their incomes have been stagnating for decades) have used up all their credit, then what? Is it just a coincidence that Wal-Mart is planning to close a large number of stores?

True, we have had significant employment growth. But most new jobs are low paying, and many of them are only part-time. Where will the new economic growth come from? From massive new consumption driven by store clerks and janitors who make \$ 20,000 a year?

High dollar hurts exports

US exports have been hit and will be hit by a deteriorating global economy (this means less demand) and by a high dollar that makes Made in the USA products more expensive. For the moment, manufacturing output is relatively steady. However, thanks to automation, this sector will not create many new jobs.

Jittery markets

Are we headed towards a recession? Probably not any time soon. Still, with modest growth and declining corporate earnings, we are barely treading water. It would only take a bit of bad news (look at the Wall Street jitters anytime something strange comes out of China) to wipe out many of the newly created restaurant and hospitality jobs.

Of course, compared to weak Europe or Japan, let alone disaster zones Brazil or Russia, the US is doing much better. But this is not a robust, resilient economy built on the production of valuable goods that give America a strong competitive edge. Sure, we still have many IT giants. But there is only one Silicon Valley in America.

Fiscal picture getting worse

Sadly, we have to add to this a slowly deteriorating fiscal picture. With due credit to President Obama, it is true that after years of gigantic federal deficits that added massively to the national debt, more recently US public finances have improved –a great deal. the US Federal deficit is now down to less than 3% of GDP for 2015.

However, this will not last. A combination of increased discretionary spending and the higher costs of all key entitlement programs due to an aging population will cause an increase of the Federal budget deficit beginning in 2016. According to the Congressional Budget Office, a non partisan,

research and analysis public body, the US Federal deficit will go from \$ 439 billion in 2015 (2.5% of GDP) up to \$ 544 in 2016, (2.9% of GDP).

The rising cost of entitlements

And any fair estimate of the increased costs of Social Security, Medicare and Medicaid –the largest Federal entitlement programs – indicates that year after year the deficit outlook will get progressively worse.

Entitlements will soon absorb 15% of GDP (now it is 13.1%). Higher deficits mean higher cost of debt service and the reduction of discretionary spending, including defense.

Obamacare does not pay for itself

And there is more. The just released numbers on Obamacare enrollment do not look good. The new people who signed up for medical insurance are mostly old and sick. The young and fit did not enroll in sufficient numbers. And this means higher costs for the system. Since most of the new, needy “patients” receive Federal subsidies to pay for their brand new medical insurance, soon enough Obamacare’s extra costs will add to the deficit.

Not a catastrophe

For the time being these numbers, while worrisome, do not look catastrophic. And in fact they are not. But they indicate a bad trend of higher costs and higher deficits, notwithstanding higher tax revenue. And here why this is happening. As new births keep declining, while more and more Americans get older and live longer, the cost of well-meaning social programs designed in another era, (Social Security was designed in the 1930s), at a time in which retirees were expected to collect benefits only for a few years before they died, will keep growing.

Candidates do not talk about any of this

Given the above, it is obvious that entitlements reform should be on top of any serious candidate's list of policy priorities. But it is not. Sure, some of them have presented fiscal reform plans. But they are mostly attention grabbing tax cuts ideas. They fear that any serious talk of real reform amounting to benefits cuts for millions of Americans would amount to political suicide.

So, here is the thing. This elections year should be an opportunity to focus on the real issues affecting America: a fragile economy and deteriorating public finances due to entitlement programs no longer in line with current and future demographic trends.

No serious talk about policy

But no, the candidates do not talk about any of this. This year we have had a mixture of political theater, lunatic plans to redistribute wealth, populism and empty grandstanding. Between the crazy ideas pushed by socialist Bernie Sanders and Trump's bravado, mixed with his endless recitations of his good poll numbers, there is no room for seriously talking about anything.

A bizarre President or a weak one

As I said, Thank God America is not in a serious crisis. But we see a once vigorous society that is slowly deteriorating, while those who want to run the Republic peddle fantasies to people who just want to be duped. My hope is that this unusual political season that started as vaudeville will finally get serious. But I would not count on it.

Sadly, we will end up either with a bizarre president (Trump, Cruz or Sanders), or with a weak one (Clinton) who will do nothing to change course.

Major Economic Reforms In Saudi Arabia?

WASHINGTON – What is going in Saudi Arabia? Probably too much. We have now an odd stew of engineered low oil prices that created huge economic and fiscal constraints, in Saudi Arabia and in other oil-producing countries, mixed with a new “Master Plan” for the country that includes extremely ambitious reforms unlikely to succeed.

Low oil prices

Let’s look at oil prices. We know that the Saudis have willfully caused the global oil prices collapse that began in 2014, and continues today, by refusing to cut their massive output (in excess of 10 million barrels a day) when crude prices became soft on account of the extra supply created (in a very short time) by US shale oil producers.

With Saudi Arabia opposed to production cuts, the OPEC cartel had no choice. They had to endure the consequences of dramatically lower prices until Riyadh will change its mind. So far, it has not.

What is the end game?

Why is Saudi Arabia doing this? Who knows really. I believe that this is an anti-Iranian move, and by extension, a move also directed against Shia dominated Iraq.

We know that for a while at least Saudi Arabia can afford to lose billions of dollars, the result of the lower prices it

has imposed, because it can count on a significant financial cushion, in the neighborhood of \$ 628 billion.

A huge price

Still, it is clear that the Kingdom is already paying a huge price. The Saudi state depends almost entirely on its vast oil revenue to finance all public expenditures. Dramatically lower revenue means huge public deficits. Last year the shortfall was almost \$ 100 billion. Again, the Saudis can afford to do this, at least for a few more years. But, at some point, their reserves will be gone. And then what?

Major reforms announced

But this is not the only major development underway in Saudi Arabia. No, there is plenty more going on. Just as the Royal Family running the state is adjusting its policies to the lean years it has created, it came out with a new plan aimed at transforming the country. And this is no exaggeration.

The plan has been developed under the guidance of Prince Mohammed bin-Salman, the 30-year-old son of King Salman and now deputy Crown Prince. The young Prince (who is also Minister of Defense) is in charge of the Council of Economic and Development Affairs. The Council is a new institution established in January 2015, and placed in charge of planning future economic policies.

Privatizations, and a lot more

Here are the highlights. There will be large-scale privatizations, including health care services. There will be a deliberate effort to move Saudi citizens away from cushy state jobs *and into a soon to be created private sector* (I am not making this up) that will not rely on the established oil economy. (Currently, two-thirds of all Saudi workers are employed by the state). There will be an end to fuel subsidies and other freebies.

In other words, the plan is to make Saudi Arabia into a modern, vibrant, innovation-driven, private sector-led economy, no longer dependent on its enormous hydrocarbon resources.

Slim chances of success

In principle, this is not at all a bad idea. In practice, it all depends on the time line and the quality of both the plans and the execution. Let's say this plainly. Usually these Grand Reform Plans do not work. And they do not work because the objectives are unrealistic, because people resist change, because sleek blueprints drawn by highly paid consultants fail to take fully into account the drag created by entrenched cultural habits and traditional mind sets. And in most cases all participants under estimate how long it takes for anything of substance to be implemented, and become eventually self-sustaining.

Abenomics failed

Look, Prime Minister Shinzo Abe has essentially failed in his noble attempt to revitalize Japan. He called it "Abenomics". And there was a lot of suggestive imagery built to support it. Abe talked about arrows in his quiver and how they would reach their targets. But it simply did not work.

And yet Japan is a highly advanced industrial democracy, with many world class companies, a modern state, and lots of highly educated people. Nonetheless, Abe's Grand Plan, did not work. There is too much inertia, there are too many political, institutional and cultural obstacles. The Japanese people are unable to get out of their complacent, (and in the end self-destructive), mind set.

Now, if modern Japan cannot quickly embrace and own a vision of vibrant change, what makes Prince Mohammed think that sleepy Saudi Arabia, a country in which most people do nothing, (large numbers of foreign workers have been hired to

perform most tasks), while oil money subsidizes the entire economy and society, will do much better?

In Europe, welfare reforms almost impossible

Welfare and subsidies create dependence. Of course, in theory it is possible to wean people away from dependence on public largesse. But it is extremely difficult. Look everywhere.

In Europe all entitlement programs are essentially untouchable. Greece had to get all the way to the edge of the abyss before any political leader would accept the notion that the government had to reduce unaffordable social programs.

In other words, it took complete financial ruin before real reforms (this means cuts) could be contemplated. And even under those extreme circumstances reforms were fiercely resisted by most citizens.

Better results in Saudi Arabia?

Given these examples, one needs a truly heroic level of optimism to believe that Saudi Arabia will eagerly embrace change and quickly transform itself into some kind of Big Singapore in the Middle East.

This is a country that lives under a heavy blanket of religious conservatism. It is an absolute monarchy in which basic human rights are unknown. Women are second class citizens. It is a nation where, beyond oil and refining oil products, there is essentially no other industry. And this is the soil where the leaders want to plant the seeds of innovation and modernity? Good luck to them.

May be in 20 years

Look, assuming a perfectly modulated plan and a 20 to 30 years time horizon, some real changes may be possible. But the impression here is that Prince Mohammed is in a hurry. The perception is that we want everybody to get busy, right now.

“Give me a private sector-led, non-oil economy, today”.

So, here is the thing. It is good to have bold dreams of modernization. But in the case of Saudi Arabia, this new reform plan looks a lot like lunacy.

Aldous Huxley: The Political Candidate Sold On TV As Deodorant

WASHINGTON – “Three years before Kennedy’s inauguration, Aldous Huxley argued in *Brave New World Revisited* that the modern methods “now being used to merchandise the political candidate as though he were a deodorant positively guarantee the electorate against ever hearing the truth about anything”.

Spinning

The above quote is taken from an interesting book review essay by David M. Shribman, editor of the Pittsburgh Post-Gazette, (*The Power of Persuasion*, [The Wall Street Journal](#), January 22, 2016). The book reviewed is *Republic of Spin* by David Greenberg.

The theme of the book is that American politicians have been consciously manipulating information to further their interests for the longest time.

But it is with the advent of television that old “spin” acquired a true industrial dimension.

The candidate as merchandise

And I found Huxley's notation made so long ago remarkably prescient. At that time Dwight Eisenhower was still President. And yet Huxley understood the perverse effect that TV (still in its infancy at that time) was going to have on the substance of political debates . He realized that politics had entered the mass media era. And he also realized that TV would become an incredibly effective tool –in fact by far the main tool– for both marketing politicians and for manipulating the voters.

Henceforth, the political candidate and the elected office holder would be treated mostly as a product to be sold. And therefore the handlers would present only the favorable sides. Therefore, no truth about anything anymore.

Of course, one could argue about how much truth was actually delivered to the public before the advent of television. The "Yellow Press" and slanderous accusations were not invented in the 1950s. Plenty of material going back to the very origins of the American Republic.

TV political commercials

Still, here we are today, in this media saturated environment. During campaigns, the TV political commercial, ever slanted, ever tendentious, quite often openly false and slanderous, is not only the norm, it is in fact the primary instrument used by all campaigns to reach large audiences. This is where most of the money raised by candidates ends up. It is used to pay for air time. No money, no way to produce and let millions see the commercials. No commercials aired in large media markets, no chance to deliver the candidate's message, and therefore slim or zero chances to win.

In these TV political ads records are routinely misrepresented; achievements are magnified or altogether invented. Enemies are vilified. Opponents' character assassination is the norm. Complicated international

political dynamics are reduced to stupid simplifications.

Nobody complains

And nobody complains. This is the accepted and some times celebrated way in which candidates bring their case to distracted and uninformed people who in most cases do not have the time or the interest to beef up their knowledge on “the issues”. And so it is all about images, background music, and emotional language hopefully leading to persuasion. And if it takes tricks or outright lies to sway voters, so be it. “This is the way it is done”, all the pros will tell you.

What Huxley wrote almost 70 years ago is as true as ever. We have entered the era of lies routinely delivered by all candidates. But nobody seems to care. The one who can present his/her case in a few seconds in a persuasive way, however untruthful the whole thing may be, has a far better chance to win.

The truth does not matter anymore. And it seems that no one cares that much.

Is Donald Trump Really Unstoppable?

WASHINGTON – Regarding the Republican primaries, much can and will change in the next few week, after at least some voters will have had a chance to cast their ballots. Still, we know that Donald Trump is way ahead, mostly because he was famous before entering politics, and because a plurality of Republicans really like his confrontational, blunt language.

Image above all

But, is there more about Trump that makes him so compelling? No. That's about it. Trump came into the race with the huge plus of national name recognition, thanks to a long-running, popular TV show he hosted. This proved to be a huge asset.

Add to this significant advantage Trump's uncanny talent for taking outrageous positions on controversial issues, (foreign trade, immigration, Muslims in America, terrorism), and we have the whole package: the no-nonsense, anti-establishment, self-made man (being a billionaire does not hurt) who is going to change the course and the destiny of America.

No substance

Never mind that there is almost no substance behind all this. Never mind that Trump's policy positions are a mix of populism, bravado, and hot air. In this climate, vagueness and superficiality are no hindrances. They simply do not matter.

How Trump looks on TV, combined with his wealthy businessman credentials and his outrageous language, seems to be a good enough qualification to be the next President of the United States.

So, what we have now, at least for a robust plurality of potential Republican voters, (30% or more), is a deep fascination with the new and different, (and Trump is both), in an otherwise unexciting environment dominated by shopworn professional politicians.

"I am ahead, therefore I am the best"

The perverse thing in all this is that being popular is now a considered a solid argument for attracting more followers. Indeed, in his public appearances, Trump talks mostly about his standing in the polls. *"I am ahead. And this is irrefutable evidence that I am the best candidate. So, don't*

be stupid. Be smart and jump on board".

So, here is the thing. Trump, with the significant support of various conservative media outlets has created this new truth. *"Being popular equals being right". "If a candidate is ahead in the polls, in fact outdistancing all the others, this means he must be the best choice". "He is a winner, the others are losers". "The people say so. And the people by definition are right".*

Majorities can be wrong

The argument is of course deeply flawed. Large majorities can be and have been very wrong. And Trump, at least for now, is far from having large ***national majorities*** behind him. He is significantly ahead in a contest that involves a relatively small, (even though decisive when it comes to picking a GOP nominee), number of Republican voters.

Rally around one candidate

That said, the only way to change this dynamic is to produce a more plausible but equally interesting alternative to Trump. For the moment this has not happened.

The now despised "Republican Establishment" has a few possible candidates. But because there are many, (Christie, Kasich, Bush and Rubio), they fragment the favors of moderate Republicans. Besides, by wasting energy fighting one another, none of them projects the aura of inevitability that Trump so skillfully managed to create around himself. With Trump at 30% or more, there is nothing hot about Rubio who is at 11%.

Sure, it can argued that if all the fragmented support going a bit to Chris Christie, some to Marco Rubio, another bit to John Kasich, and a few drops to Jeb Bush would coalesce behind just one of them, while all the others would exit the race promising to support whoever is chosen as the strongest candidate, much would change.

Yes, there could be a new momentum and new excitement behind Marco Rubio, (for instance), if he became “the” standard-bearer of the new and improved, yet still reliable, traditional Republicans.

Don't wait

At some point this will happen. At some point the number of candidates will have to shrink. But the longer they all stay in the race, bickering with one another, this way fragmenting the votes of moderate supporters, the more difficult it will be later on for whoever survives to rally the troops. By that time, Trump may have become truly inevitable, on account of previous victories in the early primaries, and the momentum that comes with them.

Look, predicting outcomes in this strange environment is extremely difficult. However, it would be both smart and patriotic for the moderate Republicans to decide, now rather than a month from now, who among them has the best chance to win the nomination.

Change the dynamics of the race, now

Having decided that, all the others would exit the race throwing their sincere and enthusiastic support behind the one remaining. This could generate new interest and momentum.

Whereas, to the extent that Christie, Kasich, Rubio and Bush still insist in fighting one another, while fighting against Trump at the same time, the chances of any of them prevailing are very slim.

Emerging Markets Crisis Dragging Down The Global Economy

WASHINGTON – Will emerging markets in crisis drag down the global economy? Probably not. But they have added and will continue to add to the negatives.

Enormous debt

Consider this. According to the WSJ, *“foreign banks have lent \$ 3.6 trillion to companies in emerging markets, and foreign investors hold, on average, 25% of local debt in developing economies”*.

Now, a lot of these credits were used to finance added production capacity in key commodities producing industries. But we know what happened. China, after its fantastic, multi-year buying spree simply stopped buying. China cannot absorb more.

And therefore commodities collapsed, dragging down all the investors, and those banks that financed them.

Ripple effects

That said, it is important to note that this negative trend is not confined to the companies operating in the sectors directly hit. It also affected other unrelated sectors that were hoping to ride the wave of economic growth fueled by the extra revenue created by sky-high commodities prices.

For instance, the WSJ points out that *“Indonesian telecom PT Trikomsel Oke Tbk. nearly doubled its debt from 2012 to 2015, as it rushed to open hundreds of retail stores across the country. But the firm’s revenue collapsed after growth in South-east Asia’s largest economy fell to six-year lows”* . Now

the company cannot pay back its bonds, “and already defaulted on \$ 460 million of its debt”, according to the same WSJ story.

Well, this means that there are huge ripple effects, not limited to Indonesia. Indeed, Japan’s Softbank Group, an investor in PT Trikomsel, is now taking losses on account of this failed growth strategy.

Widespread damage

And this is not an isolated case. The outlook is equally grim for Brazil, South Africa and Australia. So, here we go: bad debt, financial losses, bankruptcies, lower revenue, growing unemployment. Is this mix deadly? Probably not. But it is bad both for the countries affected and for the world.

Emerging countries now account for a larger percentage of the global economy. Much was said about how a new, self-confident middle class capable and willing to spend on more cars, and more consumer goods would help boost the global economy. Well, this will have to wait. These countries are in serious trouble. Amid crises and depreciated currencies, the new middle class is a lot poorer, these days.

So, what does this mean for the global economy? It means another wet blanket on growth. The commodities producing countries and their lenders are in trouble because of lack of demand. This means that they will buy less from the West. Lack of demand in China and elsewhere means lower growth in Brazil. A poorer Brazil will buy less from Europe or America.

China drags down all its foreign suppliers

By itself this would be bad, but not catastrophic. But here is the thing. China financed its gigantic investment spree with astronomic levels of new debt. This debt will never be recovered, simply because the investment-driven bubble burst.

So, what does this mean? Well, China sits on enormous cash reserves, so it can weather the storm. Still, this capital will be used to plug holes rather than fund productive investments. As China slows down, its under performing economy drags down all the Asian countries that have become an integral part of China-centered supply chains. Think South Korea, Taiwan, Thailand, and also Japan. Their exports to China are down.

Is America insulated from all this?

Where does this leave America? Much has been said about the fact that the US economy is not so dependent on exports. Many US firms trade domestically, say between Connecticut and Colorado. Not many depend on exports. And US banks are not exposed to Chinese debt.

Still, as the whole world slows down, rather fast, can the US be the only island of growth and prosperity? I doubt it.

Ayatollah Khamenei Warns About US “Deceit And Treachery”

WASHINGTON – According to [Reuters](#), Iran’s Supreme Leader Ayatollah Ali Khamenei on Tuesday approved the lifting of sanctions against Iran, the first major economic benefit coming out of the nuclear deal reached last year with Washington and other Powers.

America is still the enemy

Still, in case we had any doubts, he stressed that nothing has

changed regarding the fundamentals of US-Iran relations:

“I reiterate the need to be vigilant about the deceit and treachery of arrogant countries, especially the United States, in this (nuclear) issue and other issues.”

Well, hopefully one day this hostile rhetoric will vanish. We have been told by the Obama administration that Iran is becoming nicer, more willing to behave accordingly to international rules.

Wishful thinking in Washington

May be so. Still, for the moment, open anti-Americanism continues to be the official doctrine. We better not forget this. Wishful thinking regarding positive transformations within Iran, unsupported by facts, is not good guidance for US foreign policy.

Bernie Sanders For President?

WASHINGTON – It is truly bizarre that a significant percentage (more than 30%) of potential Democratic voters are considering Vermont Senator Bernie Sanders a serious candidate for the White House. So serious that, according to the polls, he might even win in the early Iowa and New Hampshire contests.

Ultra-liberal

But how is this possible? Senator Bernie Sanders is an unreconstructed, old-fashioned ultra-liberal (in fact he calls himself a socialist) who proposes silly leftist reforms, wealth redistribution via dramatic tax changes, and other pie

in the sky egalitarian policies. This stuff is junk.

He does not look real

And yet Sanders is considered a legitimate contender. Nobody is laughing when his candidacy is mentioned. But they should. Indeed, if you watch Sanders on TV and listen to him, he looks like a very credible Saturday Night Live comedian impersonating the stereotype of the crazy old liberal politician ranting about injustice and the rights of the downtrodden masses.

But Sanders is not a caricature. He is real. So real that he shares the podium with Hillary Clinton, the anointed establishment candidate. And he is making life a little difficult for her. If he wins in Iowa and New Hampshire, as he may, this would embarrass Clinton.

Sanders will not win the Democratic Party nomination. I see no path to victory. But the fact is that this elderly gentleman who really looks like the crazy uncle in some old comedy show is actually taken seriously by the public and by the media covering the campaign.

Republicans have a much bigger problem

I do recognize that the Republicans have a much bigger problem when it comes to "strange" candidates. Donald Trump is not just a "curiosity", a thorn in the side of an establishment candidate. He is actually leading among all Republicans, by wide margins. And the runner-up, Texas Senator Ted Cruz, while slightly more polished, is yet another unreliable populist.

Populists with no credible programs

So, here is the issue. A majority of the Republican and a sizable minority of the Democratic voters seem to have lost their minds. They now believe that populists with fiery oratory (this is what passes for "authenticity" these days)

but no credible programs would make good presidents.

Of course, it is still very early. Nobody voted yet. Today's high poll numbers may vanish later on. However, when so many adult Americans express full confidence in would be leaders who peddle fantasies, there is reason for concern.

The system does not work anymore

It is obvious that the established political process is not working anymore. Too many Americans feel alienated. Well, unless we really want to see bizarre outsiders in charge, the traditional political forces should do something –and quickly– to restore genuine confidence in our institutions by putting forward fresh and sound ideas that address real problems, while resonating with the millions of Americans who now feel left out.

“The Economist” Mocking China

WASHINGTON – It is no surprise that The Economist's cover this week is about China. The Shanghai Stock Market is almost in free fall, notwithstanding highly publicized state interventions (unthinkable in real market economies) to stabilize share prices. And we know about the zigzagging yuan, China's currency, in the midst of what appears to be policy confusion at the Central Bank.

“Everything's under control”

But what is interesting is that The Economist chose mockery, as opposed to a serious, even dramatic title, to depict the situation. The cover shows a drawing of a dragon with a

totally terrified expression racing downhill (to nowhere), while a disheveled President Xi is struggling to stay in the saddle. The title says: *"Everything's under control"*.

This is important. The Economist's editors could have chosen a different cover to introduce a story of serious economic troubles in the world's second largest economy. For instance: a picture of a stern looking President Xi, with a title saying something like: *"China in peril?"*.

Satire, not reverence

But no, they chose mockery instead to portray a deteriorating economic situation. Well, this may not be the most irreverent satire. But it is satire nonetheless.

And I think that this needs to be noted, because of the sharp contrast with the almost reverential tone of most China coverage that used to be the norm until recently.

In awe of China's leaders

Indeed, until not too long ago, most western media were almost in awe of China. After all, this was the country that had done the impossible: 30 years of uninterrupted growth. Imagine that: 10% a year added to GDP, year after year. No other country had done that.

The Chinese technocrats in charge of economic policies were depicted as all-knowing, super smart technocrats, armed with refined long-range strategies that we mere mortals could not even begin to comprehend, and the super human gift of infallibility.

Show the cracks

Well, now there seem to be huge cracks in the splendid Chinese economic edifice. The meteoric rise is over. In fact, more and more western business media openly say that most likely the real rate of growth in China is much lower than the still more

than respectable 7% (if it were true) officially declared by Beijing.

Publish the bad news

There seems to be less reluctance to publish “the bad stuff” that at least indirectly contradicts official rosy numbers. For example: in 2015 there have been 2,774 unauthorized strikes in China. This is up from 1,379 in 2014, according to The Economist. These strikes (all of them illegal) are a sign of growing restlessness, possibly of major troubles brewing. And, by the way, the authoritative Caixin survey of the manufacturing sector just recorded the 26th consecutive month of decline.

Clueless leaders

Let’s be clear. Nobody is suggesting that China is about to fall apart. But it is suggested, in fact declared, that China’s heroic days are over. It is also argued more or less openly that the Chinese leaders are sometimes clueless, especially when it comes to managing financial and monetary affairs. As The Economist put it in the same issue: *“The past six months have been hard on the reputation of China’s economic managers. Their attempts to bring troublesome stock markets to heel border on slapstick”*. **“Slapstick?”** Yes, this is comedy, not tragedy. Hilarious levels of gross incompetence.

And, finally it is taken for granted that the Chinese publish inflated growth statistics that nobody believes anymore.

Now it is alright to mock

Well, I think that when it becomes alright to make fun of completely humorless leaders who want to be taken very seriously all the time, then we enter a different dimension.

The cartoon message is that these stern looking people who

want to appear in serene control of everything in truth do not know what they are doing, while they deliberately lie about the extent of their problems. Sure *“Everything’s under control”* –they tell us– while the scared dragon races downhill, towards nothing.

Meaning: *“Sorry guys, we do not buy the old super-performing China story anymore”*.

This hurts

I believe that this scared dragon cartoon on the cover of one of the most influential news magazines in the world hurts more than any title that would criticize the merit of specific economic choices.

This cover story does not say that China is pursuing wrong-headed policies. This funny cartoon says that this a bunch of clueless amateurs, clearly out of their depth.

I am sure that to be dismissed with a laugh hurts a lot more than to be criticized.

The China Myth is officially dead; and Thank God for that!