Better-Management Newsletter 24 April 2015

The interconnectedness / USD8 trillion washing around / The hidden cost of debt / China's place in the sun / The Empire Fights Back / Gold to back the Renminbi / If the derivatives bubble explodes /

The interconnectedness

Today I will try to knit together the trends we have been seeing over the last ten years and simply provide a smorgasbord of articles from the mainstream media that support my thesis.

The primary drivers of world trade seem to be that the USA and EU are the main consumers of goods produced in low wage economies, of which the most significant has been China.

The USA, for one has been buying much of what it consumes by using export receipts and printing money (since the Vietnam War) at an average rate of USD500 billion each year for the last 15 years....

https://www.stratfor.com/weekly/chinas-new-investment-bank-premature-prophecy?utm_source=freelist-f&utm_medium=email&utm_term=article&utm_campaign=20150423&mc_cid=0e89734cd3&mc_eid=f6520e17b6

USD8 trillion washing around

So there is now about USD8 trillion washing around offshore.

To service the buyers, the low wage economies are the primary drivers of resource consumption. The growth in production of oil, gas, coal, precious metals, Iron ore, copper etc., has been driven in the main by China. Because China is acutely aware that she is dependent on foreign sources of energy and raw materials, she has been buying up overseas assets, using the surplus US dollars. For oil alone, China has supply agreements with Russia, Saudi Arabia, Venezuela, Iran, and a number of African countries that secure future supplies in exchange for massive loans (regardless of the needs of others).

But things are changing for China as REAL unemployment in USA and the EU climbed, REAL growth of demand started to falter. This showed up in the rapid drop in resource prices that commenced last year. China's growth has stalled and called into question the reliability of the official growth statistics.

The impact of diverting production away from OECD economies to China (and others) has led to a huge population migration patterns emerging. In the last 35 years there has been 500 million people move from the country to the city in China alone. Yet low wages have led China into a continued reliance in the export sector, with domestic consumption being rather slow growing. The offshore purchasing by OECD countries has forced them to place more reliance on the service and financial sectors of their economies, with many career opportunities becoming closed for school & university leavers.

Chinese wages are slowly rising and have now surpassed the low labour rates in places as diverse as Vietnam and Mexico. Chinese manufacturers now routinely buy from lower wage suppliers elsewhere in Asia. Even so the huge multi-nationals are at last diverting buying elsewhere. Energy prices are a factor and the USA has a low gas price, which, together with the use of robotics, is attracting some industry back to those US states offering tax breaks.

The hidden cost of debt

The hidden cost of debt formation and money printing has led to the increase in the real cost of food staples in poor countries. As a result the Arab Spring, Middle East wars and the emergence of religious terrorism throughout the Middle East and North Africa has forced millions of the poor and dispossessed to leave their homes. The poverty in those regions has been exacerbated by their own versions of the "Dutch Disease", the reliance of their individual economies on oil and gas exports that allowed countries to subsidise energy costs, until oil and gas ran low and they became net oil importers. This has left many former oil exporters (Egypt, Syria and Yemen to name a few) to have an upsurge of young people for who there can be no jobs and no hope. The pressures of northward and Southward migration are being felt in the Mediterranean exodus and the exodus into South Africa...with much suffering as a result. This can only worsen.

India, under PM Modi is attempting to modernise. The agrarian sector is now getting access to energy that makes many subsistence farmers exposed to the GE/mechanisation that has led to people in the OECD leaving the land in the 19th century. Farmers who cannot cope are more frequently committing suicide, and that is topical in India's media. But the migration of population from farm to city is still growing. India is still a low wage economy, but the black-outs, brown-outs and reliability of energy availability makes it still a rather unattractive place to do business. So Modi is attempting to change this by such means as building more nukes and chasing uranium supplies from Canada and Australia. Perhaps India could become the next China as a driver of resource depletion.

China's place in the sun

China's place in the sun will likely be determined by their demographic trends. The "one child policy" will mean that the population will soon start to rapidly age to catch up with Japan, so the Chinese leadership is starting to implement a programme of increasing its global influence on multiple fronts...geographic (via newly built islands and a chain of deepwater ports around the world), buying assets (using "surplus" US dollars), free trade arrangements, military (expanding the PLA), financial (infrastructure loans, banking linkages, low cost mortgages, replicating the IMF, World Bank and Asia Development Bank with its own version of those global institutions), emigration of Chinese to Australasia, north America and Europe.

In basketball terms, the Chinese are employing a "full court press".

Among the major powers, it is only the Chinese leadership that understands the reality of resource depletion. They also know that sooner rather than later the US dollar will go to zero. Their lip service to "climate change" is made for the same reason that my own is...because we are polluting the world with our waste streams and we are depleting the world's finite resources at a rate that is now unsustainable – EVEN IN THE SHORT TERM. The Chinese understand that resource depletion will lead to wars and the survival of the fittest (i.e. the best prepared). So they are making their play for global dominance to get their share now...while at the same time, only rocking the boats they have to and politely working within the current Anglo-American power structure. Once again, their oil strategy is an example. They have the rights to obtain access to more than 2 million barrels of oil per day above what they currently take, of which almost half is potentially available from their Venezuelan contracts. Softly, softly....

In my opinion, China will continue to be the major mover for the next 5-10 years. By then I anticipate we will be nearing the end of the industrial age of oil and the derivatives bubble will likely have burst, taking the global financial system down...for reasons I will go into in a later email. Today's news items are as follows:-

China's exports and factory activity is reflecting the reduced global demand...from Seeking Alpha...

"**China's factory activity declined** at its fastest pace in a year, according to HSBC/Markit's Purchasing Managers Index. PMI fell to 49.2 (est. 49.6) in April, beneath the 50-point watermark that separates growth from a contraction. In Japan, manufacturing fell to 49.7 (est. 50.8), dropping below 50 for the first time since July 2014."

China is forced by a WTO ruling, to scrap export duties for critical minerals...but there will be some upward price revisions to offset the lower cost to Japan and Europe (according to my sources)... from Seeking Alpha...

"**China said Thursday it will scrap export duties** on rare earths and some metal products, including molybdenum, tungsten and some aluminium products, effective May 1. Beijing is attempting to boost exports, which fell 15% Y/Y in March. Currently, China levies export duties of 15-20% on rare earth products, while molybdenum products carry export duties of 5-20%. Stocks: MCP, REE, AVL, GSM, GMO, OSN, REMX."

The Empire Fights Back

"The Empire Fights Back". The USA is gaining manufacturing in Texas, to take advantage of incentives and use artificial intelligence to offset higher wage costs...from Seeking Alpha...

"**The gulf coast will see $100B** in new industrial projects, leading to "tremendous growth in the use of natural gas," Kinder Morgan (NYSE:KMI) CEO Richard Kinder predicts. The growth of gas production in the Marcellus and Utica shales has profoundly affected the flow of gas, which has historically flowed from the producing regions of Louisiana and Texas to markets in the northeast. Separately, Nomura was bullish Wednesday on the E&P sector, issuing Buy ratings for MRO, PXD, EOG, CLR, APC, NFX, RRC, CNQ, CXO, ECA and SU, while not predicting a V-shaped rebound in crude oil prices."

Energy starved Japan, now understands the bigger picture and realises they must restart their reactors, regardless of the sensitivities of the population...from Seeking Alpha...

"**Uranium stocks surged** Wednesday after Japan approved the reopening of nuclear reactors. CCJ +3.6%, DNN +8.3%, LEU +11.4%, URRE +10.45%, UEC +20%, URZ +6%, URG +9.7%, UUUU +6.9%."

Gold to back the Renminbi

China wants to have the Yuan included within the currencies used to determine IMF SDRs. In addition, China has been aggressively stockpiling gold with which to back the Renminbi. They have always maintained they only have 1,054 tons but the true figure could be anywhere between 3,500 and 7,000 tons...

http://seekingalpha.com/article/3092916-how-imf-dealings-influence-chinas-gold-reserves?source=email_macro_view_gol_pre_met_4_16&ifp=0

and,

http://seekingalpha.com/article/3093016-china-may-announce-its-gold-reserves-are-2nd-largest-in-world?source=email_macro_view_gol_pre_met_2_14&ifp=0

If the derivatives bubble explodes

Just a short note here about silver. 80 years ago China had a silver based monetary system, but since that time the role of silver as a strategically important industrial metal has grown, so the Chinese government now collects silver, just as it does, the hoarding of heavy rare earth elements. But the role of silver as a money is now rather obscure. Gold has the monetary role even though it is used in minute quantities in smart phones etc. The Chinese (and Russians) understand that if the derivatives bubble explodes, they must hold gold to back the Renminbi (and Rouble).

While you got a link to Art Berman's report on the shale funding Ponzi yesterday, this article linked below on major oil production trends does give some insight into how levels are changing in various countries. Regrettably for the US shale producers they will be in the next batch of losers...

http://seekingalpha.com/article/3093296-opec-tight-oil-and-russia?source=email_macro_view_com_1_21&ifp=0

Towards the end of the above link, there is mention of Renaissance Capital. This is a Moscow based fund, I think it is owned by New Zealand's billionaire Chandler brothers (well one of them at least). We seldom see reference to Chandlers' businesses in this part of the world.

Behind a paywall is an article that says that the USA fears a Lehman-like problem in the EU, if Greece exits. However it is more likely that Greece will try to remain in the EU while dishonouring its debt obligations, so that sort of eventuality will likely be carefully finessed. The USA also does not like Greece cosying up to Russia...

http://www.telegraph.co.uk/finance/economics/11559497/US-alarmed-by-Greek-energy-alliance-with-Russia.html

New Zealand and specifically Auckland has a major problem with migration. The migration criteria have been set by successive governments to boost economic growth. Unfortunately more than 60% typically settle in Auckland and this is driving house prices skywards. Just a pity that Government takes the credit for growth and blames local government for the negatives...

http://www.interest.co.nz/property/75148/net-migration-hit-56275-march-year

Within 20 years at this rate, Auckland will be a Chinese city.