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View from HQ.....

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One Economist's Opinion

How many times do we take the words of economists with a grain of salt – giving them same kind of half-respect we might offer a weatherman predicting a blizzard that is a week away? I have always held that kind of opinion myself – but for some reason, I found myself somewhat riveted to an economic forecast that I attended in January 2006. The economist used a prediction about the future of China and showed how closely their stability ties in with American's own economic trends.



Now two years later and seeing some of these predictions at least partially accurate, I thought I would share the highlights of this presentation with you – and let you decide if this gentleman is an economic Nostradamus, or perhaps just another weather prognosticator who misses a guess about an upcoming storm.

I attended a conference of the National Association of Wholesale Distributors (NAW) in Washington, DC in January 2006 and their keynote speaker was a gentleman named Alain Beaulieu from a company called Ecotrends. They have been utilized by Presidential administrations to provide economic forecasting to Presidential administrations and claim a 90% accuracy over the previous two decades.

What he had to say was not entirely encouraging in the short run. The summary of his ninety-minute presentation regarding the American economy is essentially:

2006 will be a GOOD year
2007 will be a GREAT year
2008 will be a SOFTENING year
2009 & 2010 will find our economy mired in a DEEP recession
2011 will see a re-emergence of a strong and vibrant economy.

We will pull ourselves out of this 2009-10 recession by the emergence of energy technologies coming from the United States which will replace and/or easily-supplement fossil fuels. Very much like the computer boom of the 1980's, our new energy technologies coming in the next five years will again resurrect America into the forefront of the world's economy.

Mr. Beaulieu spent a great deal of time discussing the status of China – a nation that plays a significant role for many of our American businesses. Here, his thoughts are more difficult to summarize, and as I found some of the information very interesting, I thought I would reproduce as much as possible of his comments on outlook for the Chinese economy, government and foreign policy.

He began with a discussion of the general American misconception about China: that most Americans believe that our jobs are going to China, or in some way their positions have been exchanged for Chinese labor at fifteen cents per hour. The elemental fallacies of that argument are key components in the 2009-10 recession that Mr. Beaulieu predicted above. Here's why:

(1) Americans suffer from a paranoia about our place in the global economy - mostly middle/lower class Americans that are losing jobs based on American manufacturers' re-tooling of their plants to compete (and as Americans, we always compete in a better/smarter way when we get confronted with international economic challenges). The FACT is that America is still FIRST in the world's GDP: 29.6% of it is the US, 11% is Japan, 6.5% is Germany, 5.4% is the UK, 4.9% is France and 4.2% is China. But if you asked every American you meet in a Wal-Mart, they would tell you that China is 30% and the US is 4%.

(2) Based on this global American misconception, it can be expected that China tariff parties could be used as an election tool when the Presidential posturing really takes effect after both parties have decided their candidate.

ViewfromHQ One Economist's Opinion (continued)

(3) The 2008 economy will truly soften - just in time for the Presidential election. The party taking office may take very seriously the idea that the time is right to deal with any "China issue" and impose a tariff of some kind on Chinese goods, or expand the floating of the Chinese dollar.

(4) This expansion of the float or the tariff will then create a bounce back in America. It will "look like" what that political party was trying to accomplish actually was taking effect - that is, when an American consumer goes to Wal-Mart to buy something, BOTH the Chinese-made and American-made version of the object will be the same \$1.25 price (prior to tariffs, the Chinese product was a dollar, but now with the additional tariffs their costs will increase to levels that will equal American-made products). Prior to this, and over the last ten years or so, Americans were treated to the ability of purchasing their goods at a lower price because they were manufactured in China. Therefore, most Americans will buy the "American-made" goods, somewhat because it is the same price, but additionally because the misfounded nationalism that caused the tariff would be accompanied with the kind of public relations cycle generated through the election. This will do two things - it will WEAKEN China, and it will cause immediate inflation in America. Americans, even though they are buying American products, are buying them at a higher rate than before.

(5) To combat inflation, the Fed will raise interest rates as they always do. This will create a series of events, which are ultimately the end of the "Perfect Storm." Americans overwhelmed with debt will fail, the housing market will be upside down for a series of years, and our country at around 2009 will be mired in a deep recession. Remember that the 1980's recessionary cycle was caused initially by heightened gas prices during the Carter administration and over speculation. They never had to have the secondary influence of sizeable global economies competing for our business, and throw in the factor that with the instability in Iran and the world's oil availability, there could be additional factors that push this 2-3 year recession to deeper troughs than our country has seen in some time.

(6) At the same time, China, now depleted of its greatest resource for shipping cheap goods, will have to confront its own issues. Here's why the tariff imposed by any Presidential administration will be the "last straw" in their own house of cards:

(a) 7 of the 10 most polluted cities currently exist in China;

(b) 400,000 of China's 1.3 billion population die each year of respiratory ailments caused by pollution;

(c) Only 15% of China's water supply is drinkable, (d) China still lives in a "one Emperor- six pockets" society - that is, their families have one child, which they hope and actively work towards being a boy (the "one emperor." The "six pockets" refers to the six family members older than that boy which he will be charged to support over the course of his life in their version of social security.)

(e) Because of the vast majority of young men to young women (estimated at 125 million more young men than women) in China, there are growing health related and violence concerns that will require attention by Chinese leaders.

(f) When China went to a western economic model for their "manufacturing" cities, they eliminated Communist entitlement programs that provided basic necessities to the aged, the infirmed, etc. These people now need help desperately, and with the Chinese government making less through their imports to the United States, finding that money will be difficult.

(g) The violence in China will continue to increase - in 2004, there were 70,000 - seventy-thousand! - incidents of "civil unrest" involving 100 or more individuals throughout China. This number will grow with the increasing tensions as discussed above.

(h) Did I mention that the original 15 cents an hour wage that brought China to the forefront of the manufacturing community years back has been increasing 25-50% each year? Part of getting the "good" from western countries - their money - includes getting the "bad" - and that involves workers who are not simply content to work in sweat-shops for pennies an hour - they want benefits just like their American counterparts.

(i) Therefore, the Communist government of China now has to seek solutions on these domestic upheavals all of which are already happening to them, and will only look bleaker in three years when they are being taxed by the US. They currently already have the largest standing army in the world, and as the "one emperor" scenario continues to play out, they will be funneling more and more of these men into their army. The army and the Communist government operate on two channels, they are each in some ways autonomous, and the army will not al-

ways do what the government tells it to. Either way, the government at some point will be confronted with the question: "How do we deal with the great downturns now affecting our society?"

(j) A potential answer to this question, as offered by Mr. Belelieu is simple: Go to war. The Chinese will invade Taiwan, and the Americans - with a treaty intact since the 1950's - are obligated to protect Taiwan from Chinese invasion. The result will be either a sizably bloody conflict in 2009 or 2010 - or else a back down from the Americans on tariffs to avert the invasion. Tariffs that never needed to be induced, as China was already on its decline during the 2008 American Presidential election.

(7) The situation with China will only deepen the American recession. Not because they are "stealing our jobs" or causing some great global economic calamity with their 4% of the world's GDP, but because Americans overreacted to their threat and imposed the sanctions or floats in the first place that sent them spiraling into complete instability.

(8) Confrontations with Iran and their new government could create an additional conflict in the Middle East - also involving the import of Iranian oil. Gas prices will hit record highs in the United States - additionally fueling the recession.

(9) In advance of all of this, the US has funneled billions of dollars into private enterprises working to create fuel resources that will eliminate the need for foreign oil dependency. The American people will again be brought out of a recession in 2010 or 2011 by the introduction of advanced new energy technologies, which will fuel vehicles, homes, and all aspects of life. These technology introductions will again bring America to a powerful leadership position in the world that will last an additional thirty to forty years.

As always, this is one economic bureau's opinion about the future - but given the relative prominence of this group, I was more inclined to pay attention to their forecast than many others I have heard. Although it certainly appears that we are in for some difficult times, if this forecast is accurate, then if we have the ability to "weather the storm" - then there are some profoundly positive economic times as we enter the second decade of the 21st century.