

It really is different this time

Jonathan Pain | The Pain Report | 10 September 2013

I'm quite used to being alone and against the consensus. I believe the next decade is going to see the strongest level of global economic growth anyone today has ever seen.

There's so much to talk about today, so many exciting things happening around the world. I wanted to start my presentation today with the conclusion of my latest update which reads as follows – the decades ahead will see an era of prosperity, enlightenment and opportunity that very few are predicting.

Now, I'm certain that there are too many other people saying such a thing at this point in time. What is the reason for this extraordinary enthusiasm and optimism that I have for the global economy for the years, if not the decades ahead?

First and foremost, let's go to the largest economy in the world. I've had the great pleasure previously, boring you senseless with my concerns about the US. In 2013, I'm very pleased to say that we're seeing a meaningful and durable recovery in the US economy, predicated upon a dramatic turnaround in the US housing market, a renaissance of US manufacturing. I'm penciling in at least 3% growth in the second half of this year, which will carry on into 2014. I think that's great news. I'm continually perplexed and surprised that many of my colleagues in the investment industry don't share my enthusiasm for the US. Have they missed the reality that the US financial system has now healed? The latest earning season certainly suggests that the US banking system is robust and we're seeing positive credit growth. My view on the United States is that we're going to see significantly stronger economic growth over the next 18 months.

But what about Japan? The election of Shinzo Abe on 16 December was, in my view – and I expressed that view in *The Pain Report* at the time – a game changer for Japan. When was the last time you heard me say something about Japan? Let alone something positive? Times they are a'changing, as Bob Dylan said, with respect to Japan. The appointment of Kuroda to the Bank of Japan has unleashed one of the most extraordinary monetary experiments ever seen – a doubling of the monetary base in just two years with the objective of achieving 2% inflation. Is this plausible? Is this real? Is it going to work?

My view is that it has a reasonable chance of working. Now, many people feel that the Japanese will lose control of the Japanese government bond market and that this is just, once again, one of those moments in time where Japan impresses us with lots of rhetoric and then fails to deliver. I believe there is an undeniable improvement in both business and consumer confidence in Japan. That's great news for the Japanese people – and, lest we forget, Japan is still the third largest economy in the world. So, along with a very positive view on the US of

growth of 3% in the next 18 months, what are we looking at for Japan? Growth over the 12 to 24 months of, what, 2.5% to 3%? There's the largest and the third largest economies in the world, contributing again in a positive fashion to global GDP.

The big question mark is China. If you believe the Western media, we are moments away from the imminent implosion of the Chinese financial system. Burdened by extraordinary debts – particularly in local governments – and also the proliferation of wealth management products, leading to certain gloom is the narrative that the Western media, and also many of its analysts, have been telling us now for how long? Two years? Perhaps five years, in some cases.

My view on China is really quite straight-forward. Yes, we are seeing a deceleration of the Chinese economy. At the end of last year, the Chinese economy grew to a size of US\$8.2 trillion. It's inconceivable that we are going to see a 9% or 10% growth in an economy of that size.

Furthermore, we have a new administration in China, led by the President Xi Jinping and his deputy – his premier – Li Keqiang. I am incredibly impressed with both of these individuals. I believe they are reformists at heart, and they will continue to attempt to rebalance the Chinese economy.

What does that mean? It means a greater emphasis on domestic consumption and less reliance on fixed-asset investment growth and, moreover, exports. Also, they have been at great pains to impress upon us that they now wish to focus more on the quality of growth, rather than the quantum of growth. I've also written recently in The Pain Report that pollution is the number one concern now in China. All of these things suggest to me that we're likely to see a continued deceleration of the Chinese economy. But my view is that the Chinese authorities have now drawn a red line beneath 7% growth and they will defend that level of growth come what may. But this year and the next, we're probably going to see growth around about 7.5%, decelerating towards 7%.

Over the past two to three years, I've spoken at length about my concerns about local government debt in China and, in fact, I published a paper in 2010 highlighting that local governments had been accumulating too much debt. Three years later, we see many, many people concerned about the level of government debt – particularly at the local level. In recent weeks, the government has issued a statement that there will be a full audit of local government finances in China. That greater degree of transparency will be of benefit, obviously, to the financial markets.

Ultimately, I continue to be a believer in the Chinese story. I know I've been saying that for many, many years, in fact possibly a decade. I believe I delivered my first major speech on China at PortfolioConstruction Conference 2003 entitled "A sleeping giant wakes". Ten years later, I continue to believe in the China story, albeit we have to get used to slower growth. So I'm going to say this fair and square – I am not a subscriber to the so-called "hard landing"

theory for the second largest economy in the world.

Combined, the three economies of the US, China and Japan comprise approximately 40% of global GDP. And, the big three, in my view, are performing reasonably well. And let's all remember, that if we see growth of 3% in the United States, and 2.5% to 3% growth in Japan, that 1% lift in growth in the United States and Japan will make up for an awful lot of slowing in the Chinese economy. Net/net, the 40% of the global economy, in my view, is likely to continue to perform reasonably well.

At last year's PortfolioConstruction Forum Conference I had the great privilege of being introduced by Archbishop Desmond Tutu, and many of you may have seen my speech "[Africa, the new old continent](#)". A year later I continue to be very, very positive on Africa. I was born there, so I have a bias, but I hope that in the last 12 months, many of you have seen more and more evidence of an extraordinary economic rejuvenation in the oldest continent on planet Earth. I remain committed to my view expressed at Conference 2012, that the continent of Africa will grow at around 6% plus, which is really great news.

What are the other great economic regions?

Well we can't not mention Europe. First of all, let's talk about the United Kingdom. Recently, we've seen confirmation that that manufacturing sector in the UK is showing signs of quite significant growth. There's been a certain change of mood in London and the broader UK. Much of it may well have been driven by their success in various sporting arenas. Not only did the Lions conquer the Wallabies, a Briton won the Tour de France, a Scotsman won Wimbledon, and more latterly, alas, the English retained the Ashes. So some of their enthusiasm and confidence might be driven by their success on the sporting fields. But I believe that the UK economy is turning the corner. That's great news.

What about the rest of Europe? First of all, I'll make the observation – and it's perhaps somewhat more unfair, even controversial – that the European banking system is essentially rotten. Yes, it will continue to deleverage. Yes, there are many, many problems in Europe and I'm not going to attempt to sugarcoat the economic pain that lies ahead. But, for the first time, we're seeing signs of an economic pulse within the Eurozone. This is great news. We've had a much better than expected Italian GDP report in early August, and all of the manufacturing surveys – the PMI surveys across continental Europe – are showing an acceleration in activity. So all in all, I look for an improvement in Eurozone GDP as we come towards the end of 2013. And guess what? In 2014, we could well see positive growth across the Eurozone.

So to summarise so far – growth of 3% in the US, 2.5% to 3.0% for Japan, 7.0% to 7.5% for China. And, in 2014, 1% plus growth across the Eurozone and the UK turning the corner. All in all, my global GDP map is beginning to look pretty attractive. And of course, I've spoken about Africa.

What about Latin America? Let's be brief. Brazil has gone through an undeniable soft patch,

so I expect growth there of 2.5% to 3.5% perhaps in 2014. There are better signs coming out of Mexico and, if you add Colombia and Venezuela and others, I don't think that will make that much of a difference. But, I don't see any kind of catastrophic collapse in Latin American growth.

What of India? It has been through a very painful economic period, much of its own making. Most of India's wounds are self-inflicted. It has the potential, as we all know, to grow at 7%, 8%, perhaps even 9% per annum. In recent times, growth has really fallen away to just under 6%. But, I believe in the next five to 10 years, with a little bit of luck, the Indian economy will accelerate somewhat into the 6% to 8% band where it really should be. So I'm not really that gloomy about India because at the end of the day, it is the second most populous country in the world albeit that there is so much work yet to be done in India. We know the challenges in India – corruption, regionalism and, of course, appalling infrastructure. But, slowly but surely, I believe India will improve in the years ahead.

One of my favourite countries around the world in the past few years has been Indonesia. The Indonesian growth rate disappointed somewhat – we just had the second quarter GDP result a few days ago with growth of only 5.8%, below the 6% growth rate that we've all become so accustomed to for Indonesia. It is a great medium to long-term story. It's the fourth most populous country in the world. It doesn't get a fair press – particularly in the Western media. Too much of our attention is on Islamic terrorism, tsunamis and the like – and not about the extraordinary changes taking place within Indonesia. I continue to be very positive about the Indonesian economic outlook.

So, to summarise, I just can't see where the OECD or the IMF are coming up with their numbers, continually downgrading economic projections for the remainder of this year and into next year. The bottom line for me is the extraordinary monetary policies that are being pursued – pretty much from Washington to Wellington – are now gaining traction, particularly in the United States. Growth is picking up even in the Eurozone, with expected growth next year at around 1%.

I suppose, really, this is all about confidence. I don't subscribe to the notion that we ever had a global financial crisis – it was always a Western financial crisis. No bank in Latin America, Africa or Asia required any government assistance. It was and is a Western financial crisis. This was born in the US, and was a virus that spread through the US and into Europe. This is about confidence – following the so-called WFC of 2007 and 2008, we then fell straight into the Eurozone crisis and, more latterly, many analysts and certainly the Western media are talking as I said earlier, about the imminent implosion of the Chinese economy. There is much to be concerned about and as I've written in recent *Pain Reports*, the market is climbing the proverbial Wall of Worry. But, in my view, there is so much to look forward to.

Ideologically, we are now more united around the world than we ever have been. It's hard to find a genuine Communist out there any longer. The ideological union between nations is that much stronger today. Plus, also we live in a digital age of much greater transparency and

connectivity.

In a geo-political framework, I sense that we're likely to see the pursuit of greater political pluralism, the democratisation of many parts of the world – and, yes, in decades from now we will be talking about the democratisation of the world's most populous nation, although that's not a subject for us today. But, ultimately, I'm incredibly optimistic that the world our children and our grandchildren are inheriting is a world that is more united, with greater cooperation between the great nations. If I can just cast your minds back to recent events when the new President of China, Xi Jinping met with President Obama at Sunnylands, California. So much of the Western press were negative going into that summit, but what came out of it? Two individuals who basically pledged themselves to some greater degree and higher level of cooperation in the years and the decades ahead. I look forward in the decade ahead, to an age of enlightenment, an age of prosperity, that very, very few people today are predicting. I'm quite used to being alone and against the consensus in terms of my views but I am somewhat surprised – if not disappointed – that so little of the Western media are picking up on how exciting the decade ahead is likely to be. In fact, I believe that the next decade is going to see the strongest level of global economic growth that anyone in this room today has ever seen. That's a punchy forecast but I'm quite confident in making that prediction.

So what about investing? What kinds of things can you take out of this?

I'm on the record – and I suggested to all my subscribers in November 2012 – that they look to sell down their government debt in their portfolios, and buy equities. To me, that was like making the same call that I made prior to the technology bubble bursting in March of 2000. Government bonds at that time were the most expensive in history. In fact, purchasing government bonds in October/November 2012 was like taking out a call option on deflation, on recession, if not outright depression. I urged my subscribers to shift their portfolios to a greater exposure to equities. Why? Because equities are – for all intents and purposes – a call option on opportunity, on prosperity. And that is the type of environment I see over the next decade. There will be an enormous amount of volatility. All these moments in history are marked by significant volatility. The kinds of changes we are likely to see as we adjust to what I've described as "the new reality" will have many pot-holes along the path. You have to be nimble, flexible, and adaptive. It is those who are flexible and adaptive that will thrive. We need to have open minds – but, ultimately, our long-term goal is one where I see a greater degree of prosperity and enlightenment, a greater degree of harmony. I have got an extraordinary amount of optimism and enthusiasm for where I see the world going ahead.

Some of you might remind me that the geopolitical reality at the present time is somewhat concerning. We have, effectively, a coup d'état in Egypt and the replacement of a democratically elected President Morsi. Quite an interesting development. However, across in Iran, we have a new President Rouhani, who I believe is a pretty good guy and who has replaced Ahmadinejad, who I've spent many years talking to you about since his election in

2005.

Be very, very carefully about the prism through which you view the world. Never forget that bad news sells newspapers. Think very carefully about some of the jaundiced and biased positions that are contained or inherent within the Western media. Open your eyes to the great opportunities in Africa, open your eyes to all the wonderful opportunities available across the Asian region, and open your eyes to the prospect of an era of enlightenment and opportunity none of us in this room have ever seen before.
