



Center for a
New American
Security



Triple Threat for Emerging Markets:
Each circle marks a risk to emerging economies. Indonesia, Brazil and South Africa are exposed to all three.



The Emerging New Asian Economic Disorder: Faultlines, Fissures, Fractures, and Failures

Presentation to the Institute for Global Economics
Seoul, Korea
September 11, 2015

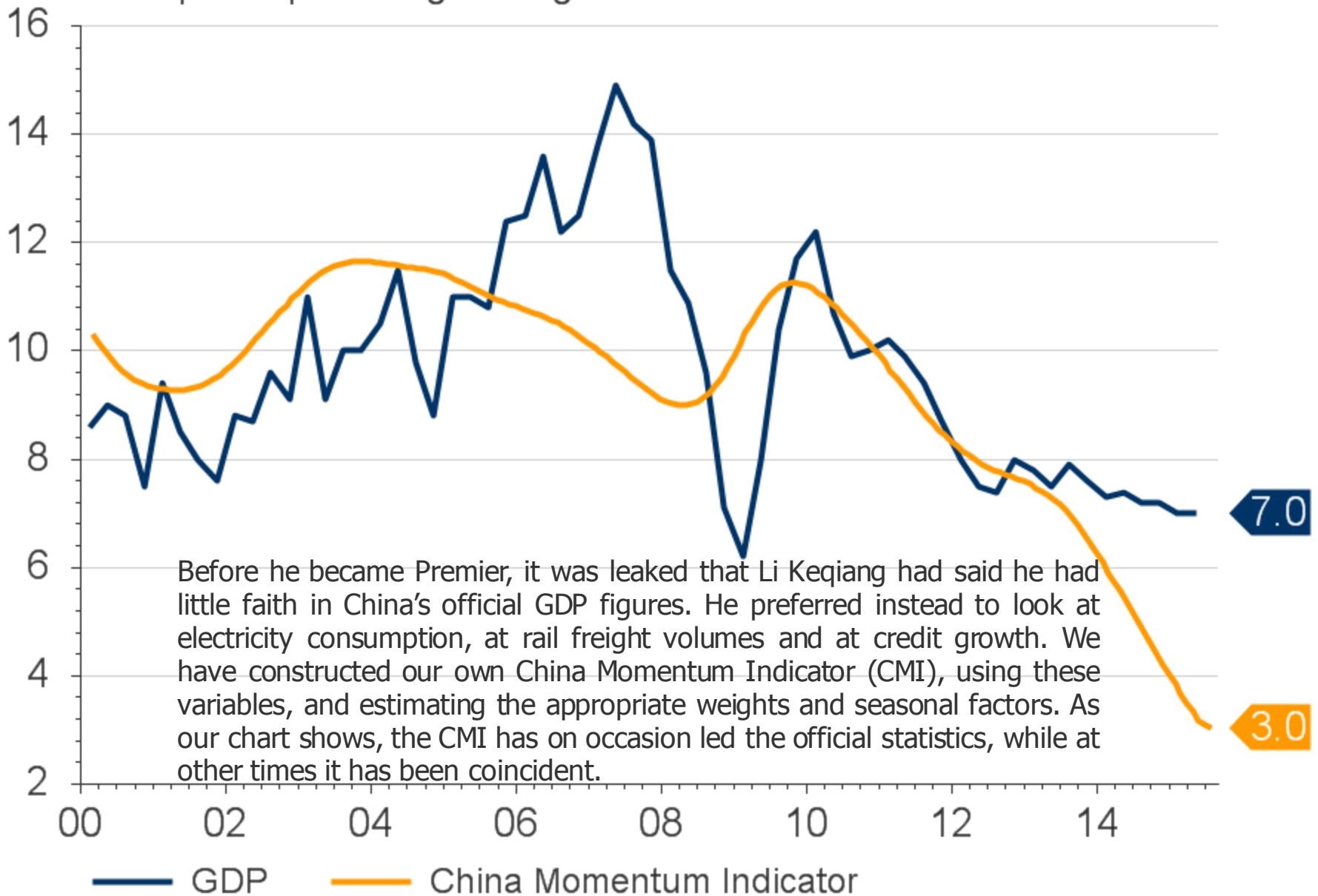


The New Asian Economic Disorder

- China's True Economic Growth Rate is Less Than 3%, China RMB remains 20-25% overvalued, and BOP could become strained in year ahead without revaluation.
- China's disorder is impairing its EM and DM trading partners and will lead to a greater global commodities and energy price collapse.
- New Asian economic disorder could turn into outright Asian financial and economic crisis without decisive reflation, structural reform, and free trade.
- China economic crisis is a Communist Party crisis. China becoming more nationalist, mercantilist, and expansionist.
- Asia's economic and political disorder is part of a broader decline of hegemonic and pol-mil-econ stability globally.

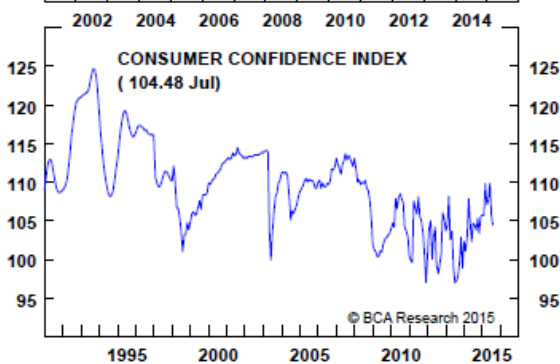
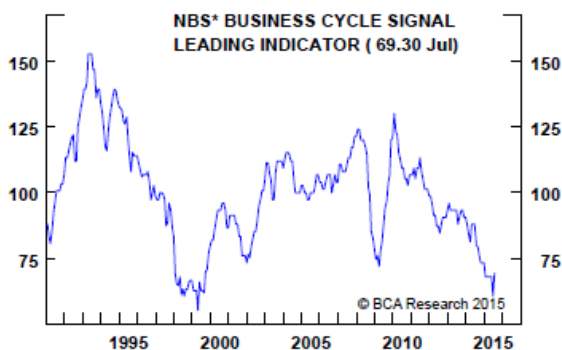
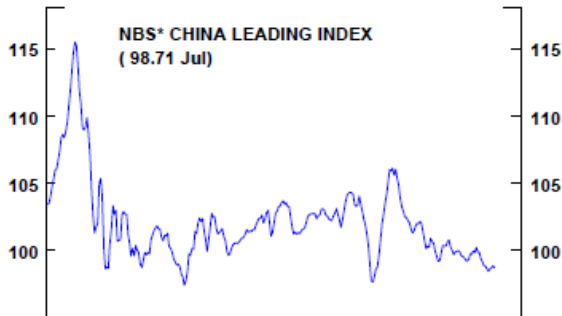
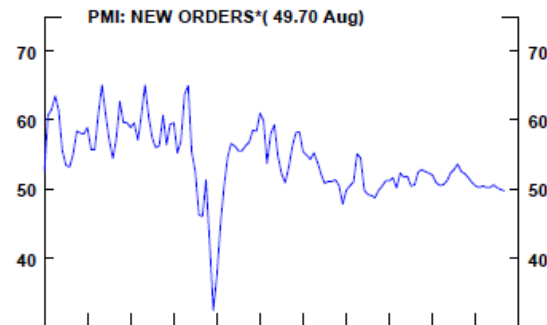
China GDP and CMI

Four-quarter percentage changes



Before he became Premier, it was leaked that Li Keqiang had said he had little faith in China's official GDP figures. He preferred instead to look at electricity consumption, at rail freight volumes and at credit growth. We have constructed our own China Momentum Indicator (CMI), using these variables, and estimating the appropriate weights and seasonal factors. As our chart shows, the CMI has on occasion led the official statistics, while at other times it has been coincident.

CHINA Leading Economic Indicators



*NATIONAL BUREAU OF STATISTICS OF CHINA

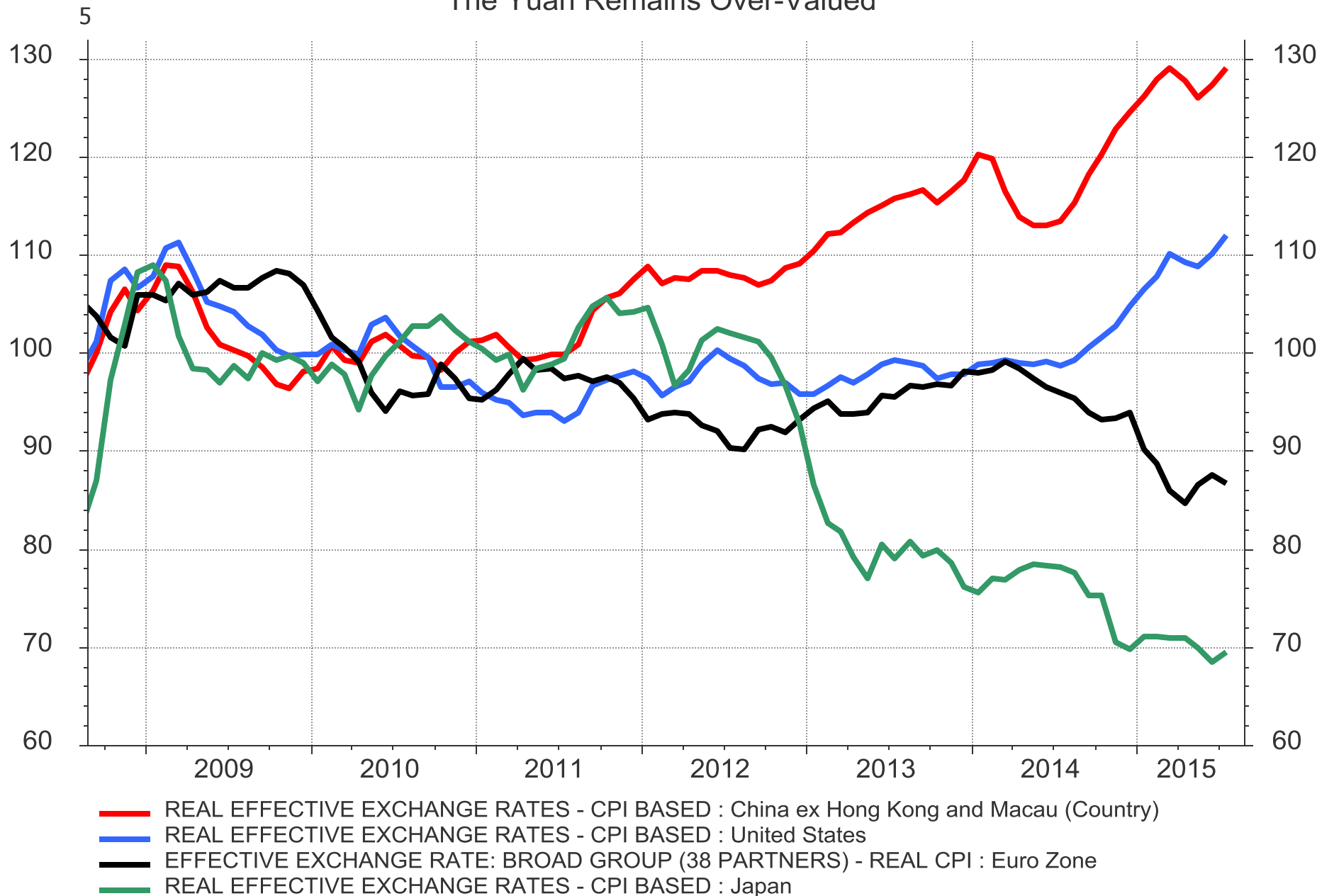
*SOURCE: NATIONAL BUREAU OF STATISTICS OF CHINA

All Leading
Indicators
Pointing
Down!

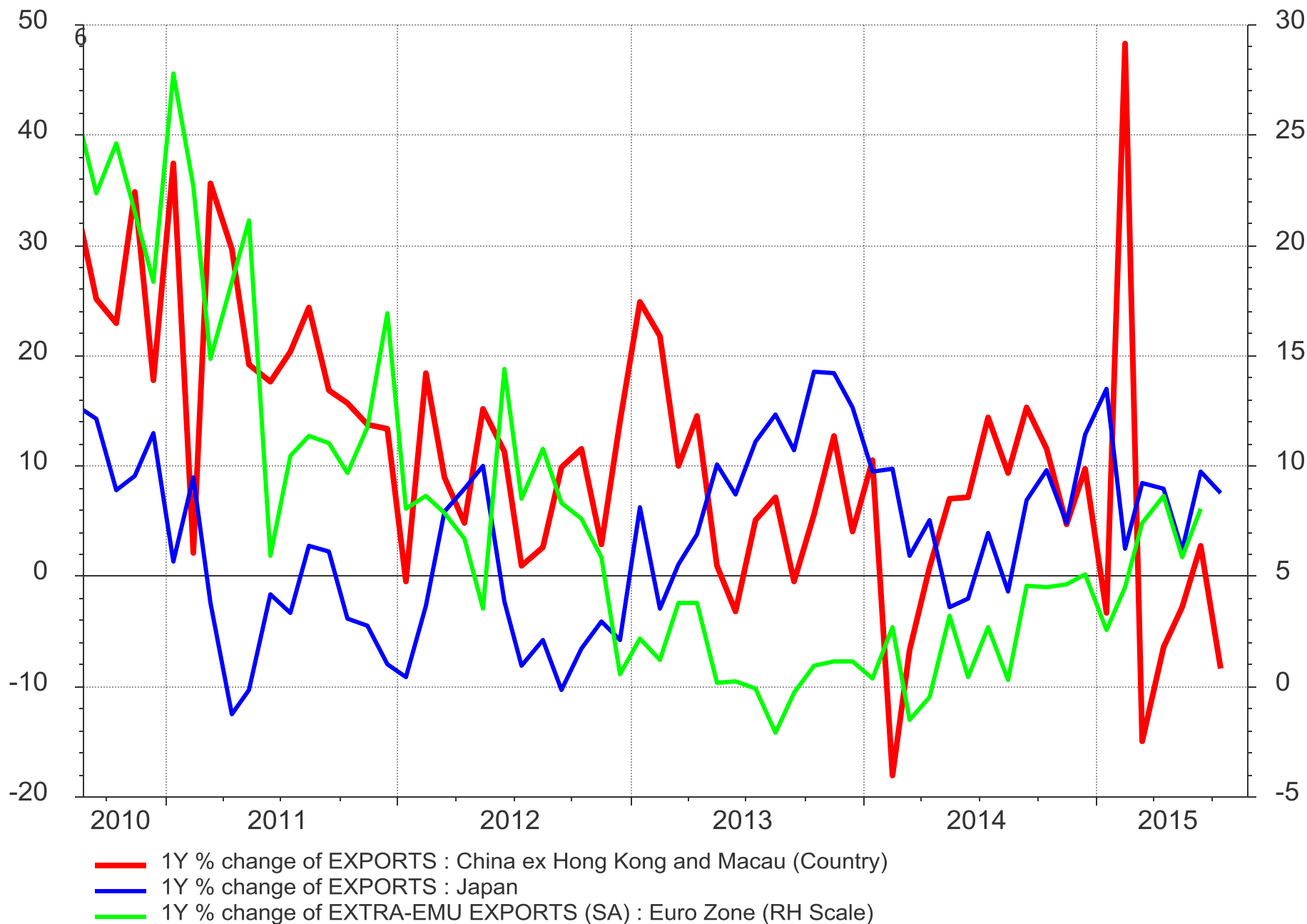
Source:
BCA Research

Huge Real Appreciation of the Chinese Yuan Since 2008

The Yuan Remains Over-Valued

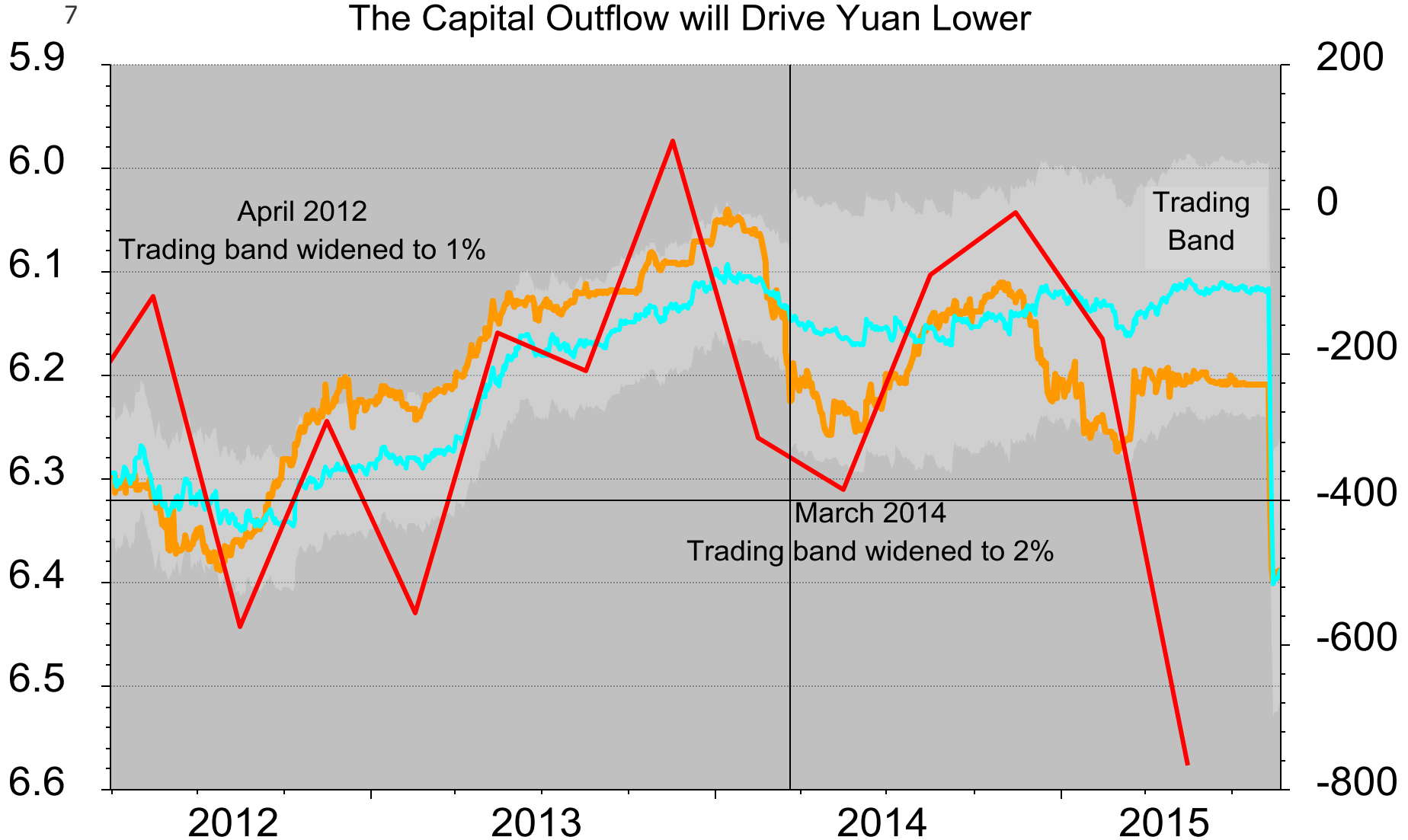


China Export Competitiveness Suffering Due to Overvalued Yuan...



Yuan Devaluation Dynamics

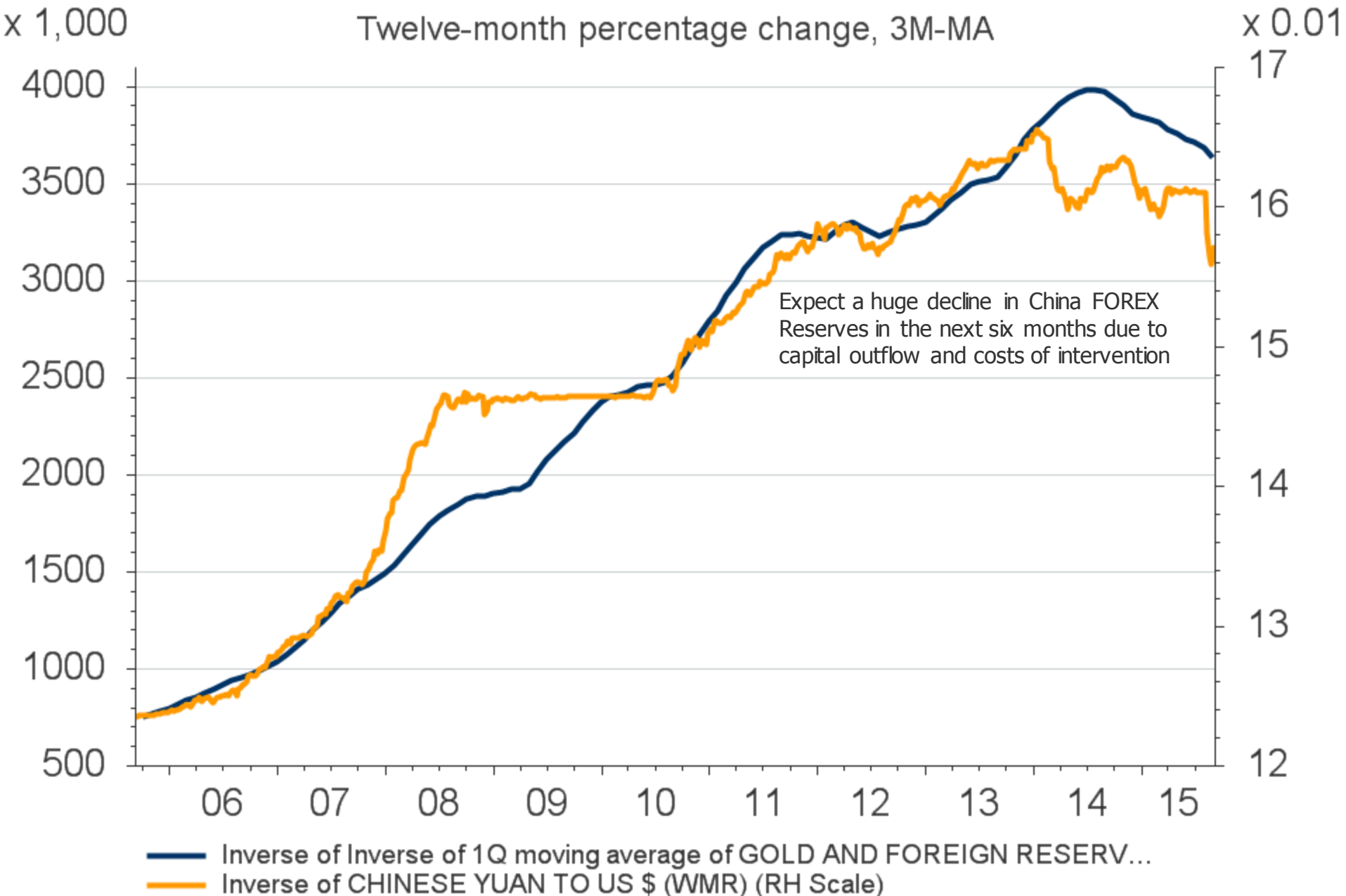
The Capital Outflow will Drive Yuan Lower



- Yuan/USD (Daily trading rate, inverted)
- Cross Rate - Set by PBOC (Daily trading rate, inverted)
- BOP - CAPITAL & FINANCE ACCOUNT BALANCE (NET) : China ex Hong Kong...

Source: Thomson Reuters Datastream/Fathom Consulting

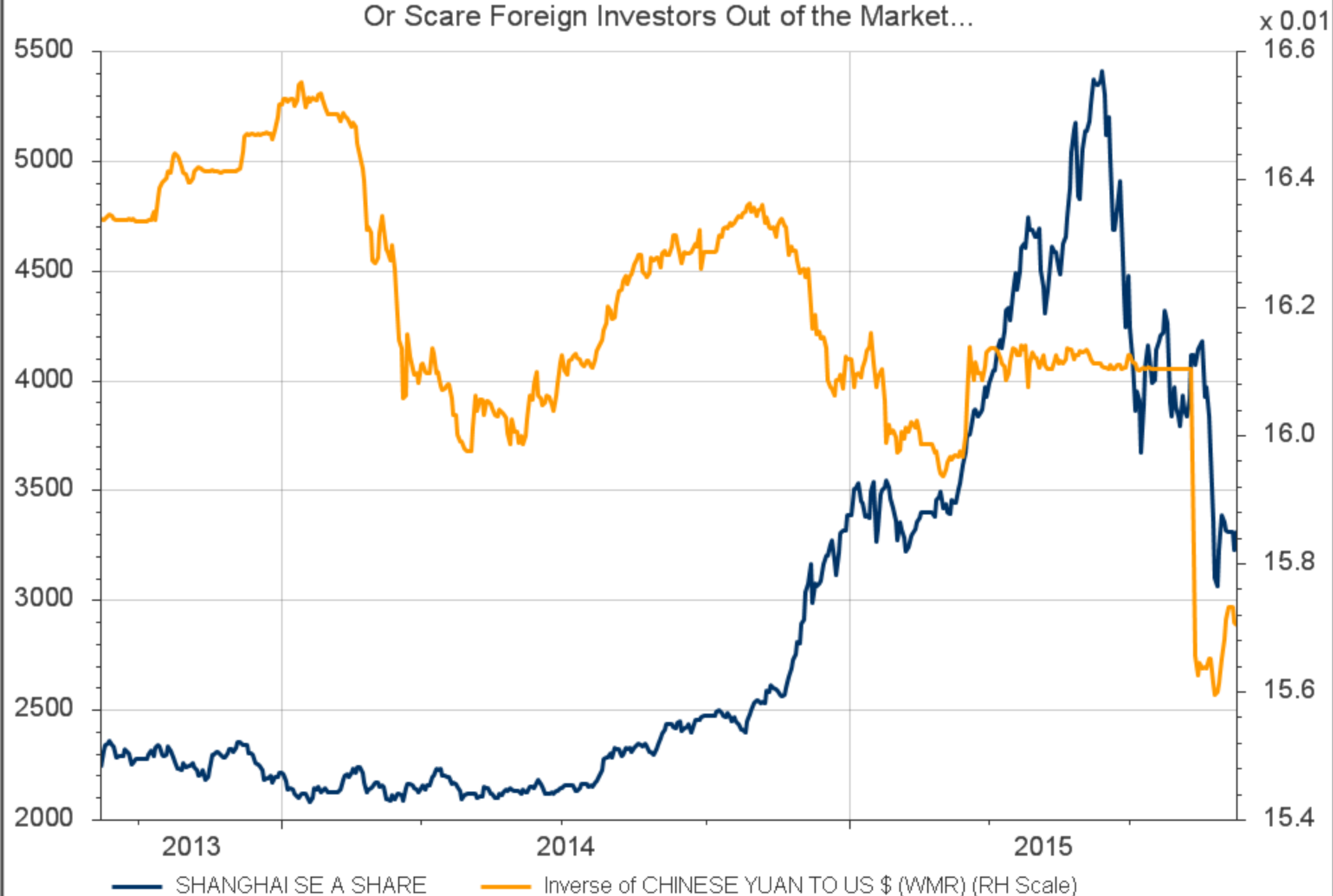
China foreign exchange reserves



Source: Thomson Reuters Datastream / Fathom Consulting

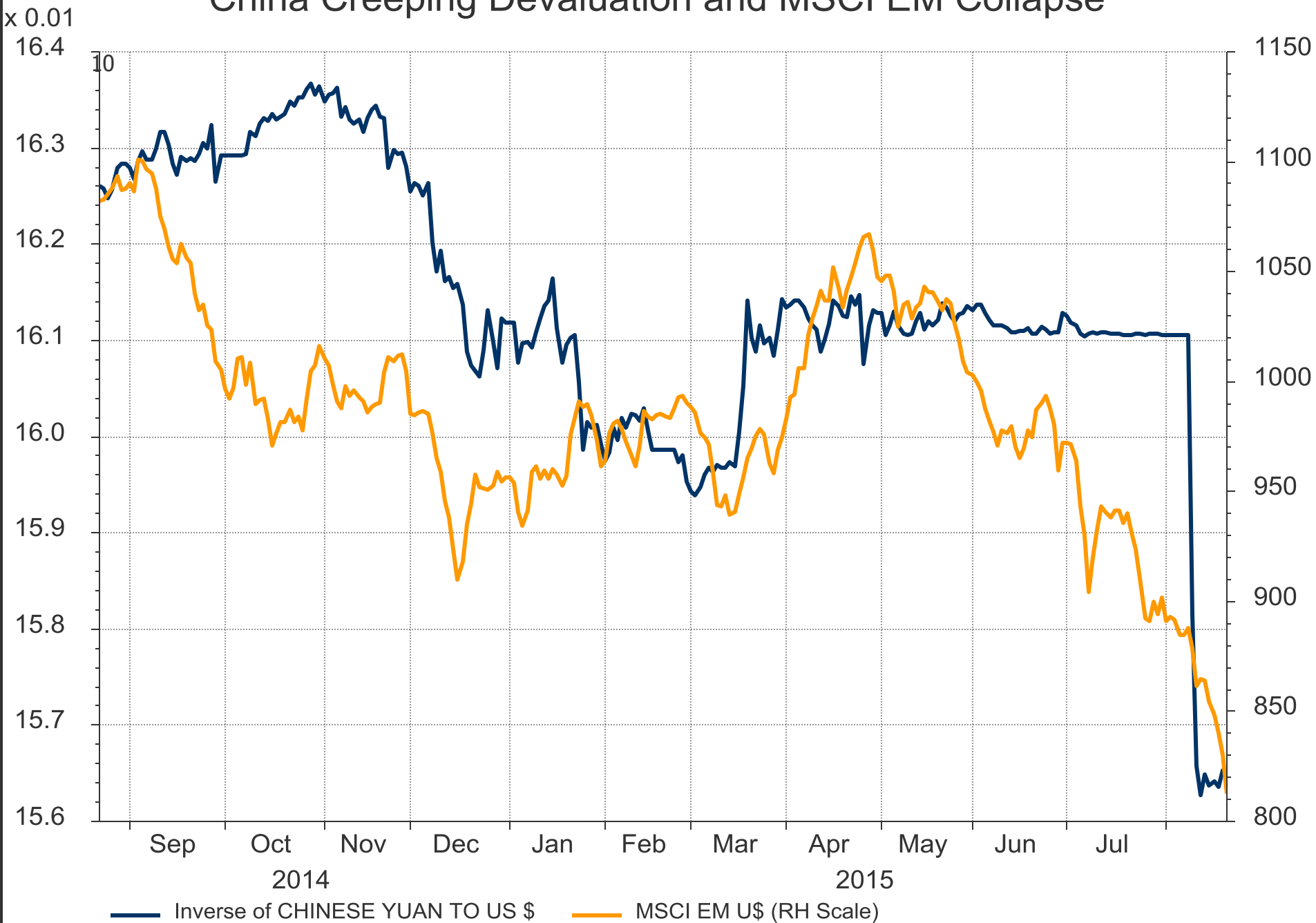
Will "Revaluation" Steady A-Shares?...

Or Scare Foreign Investors Out of the Market...



Source: Thomson Reuters Datastream

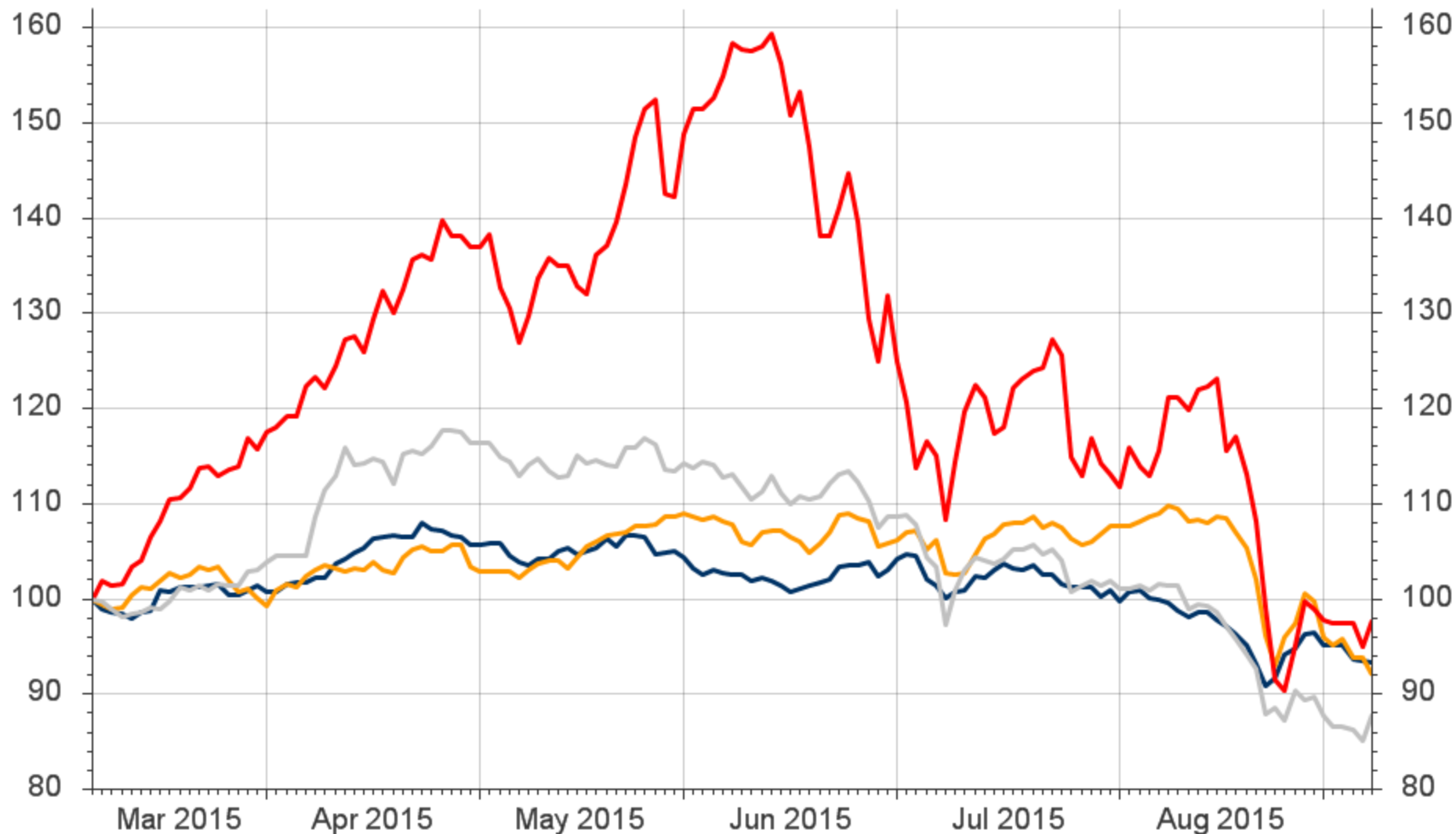
China Creeping Devaluation and MSCI EM Collapse



Source: Thomson Reuters Datastream

Shanghai "Shock Exchange" versus the Rest

Last Six Months

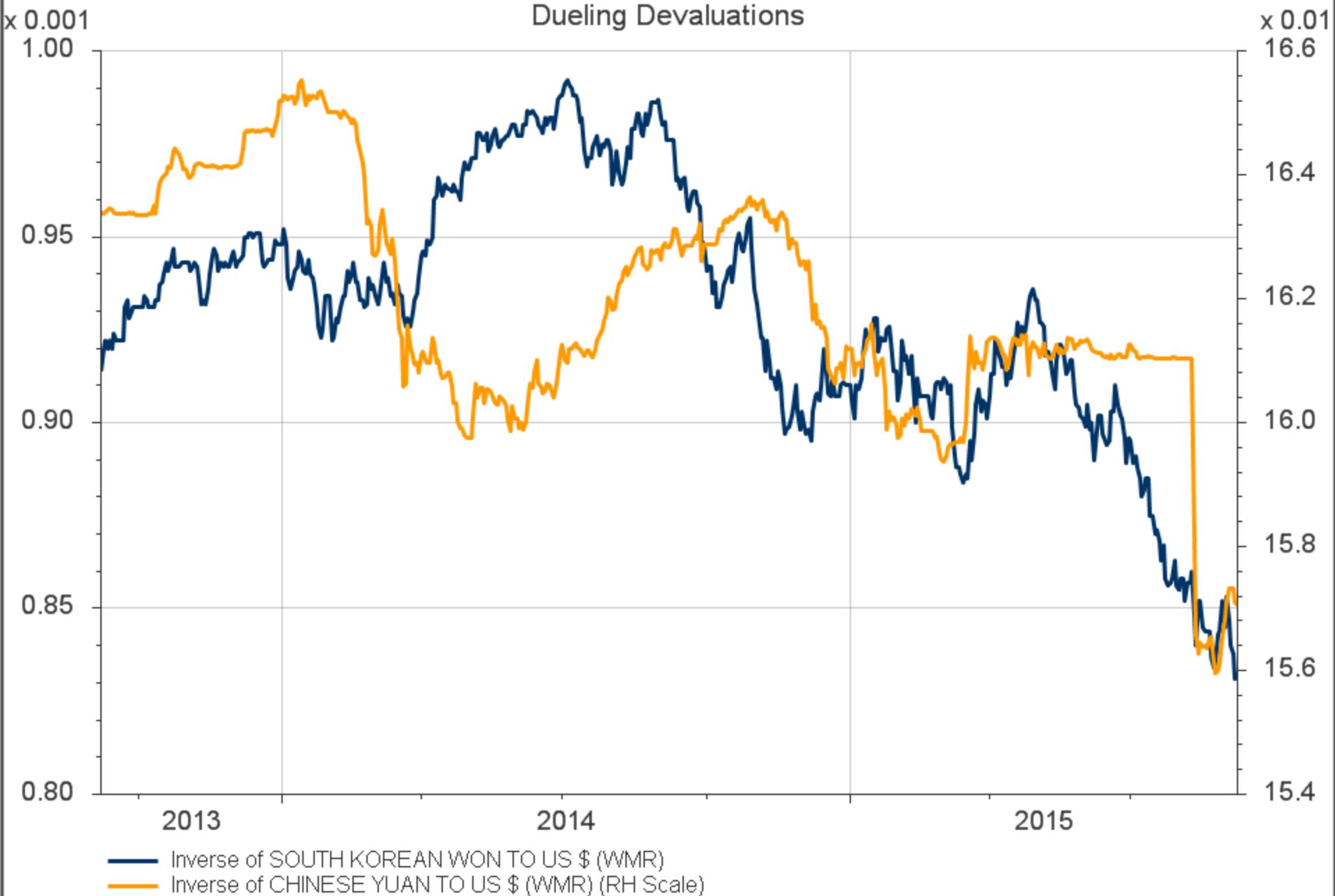


- Rebase KOREA SE COMPOSITE (KOSPI) to 100
- Rebase TOPIX to 100
- Rebase SHANGHAI SE A SHARE to 100
- Rebase HANG SENG to 100

Source: Thomson Reuters Datastream

Won/\$ and Yuan/\$

Dueling Devaluations

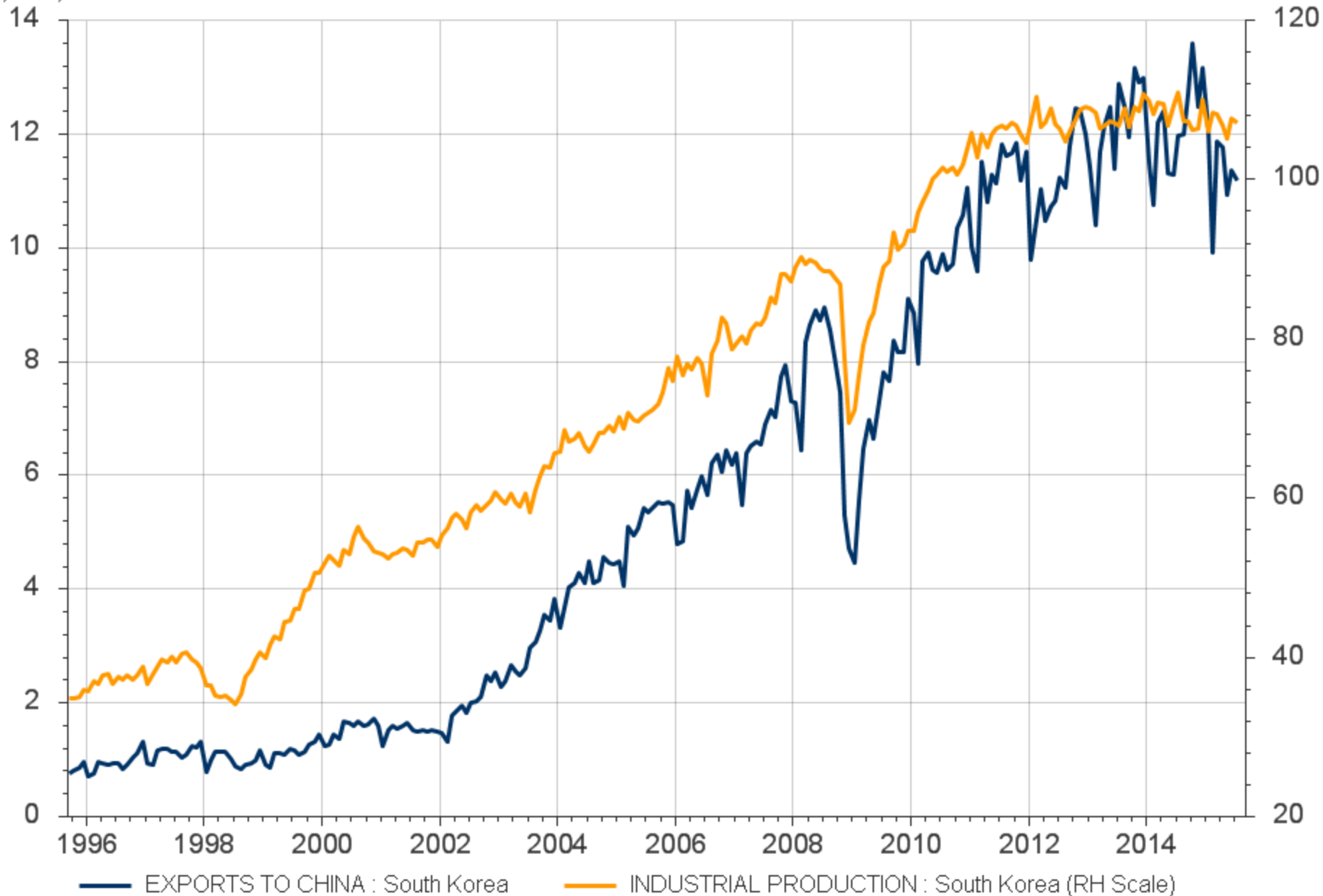


Source: Thomson Reuters Datastream

Korea and China

Hand in Hand

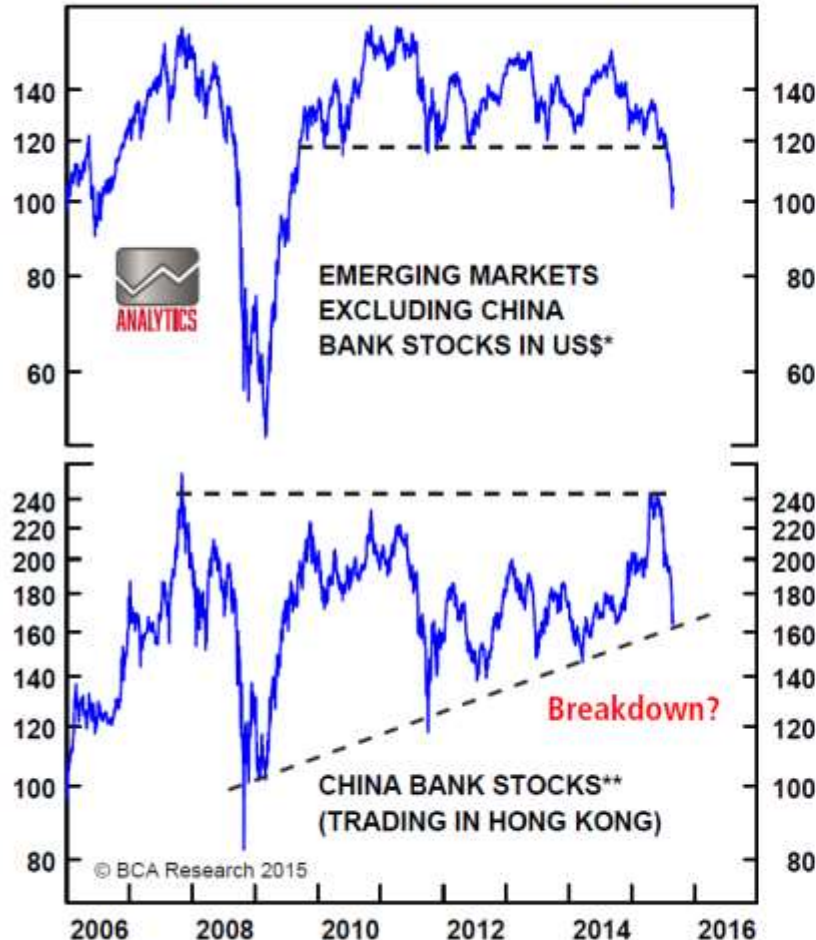
x 1,000,000



Source: Thomson Reuters Datastream

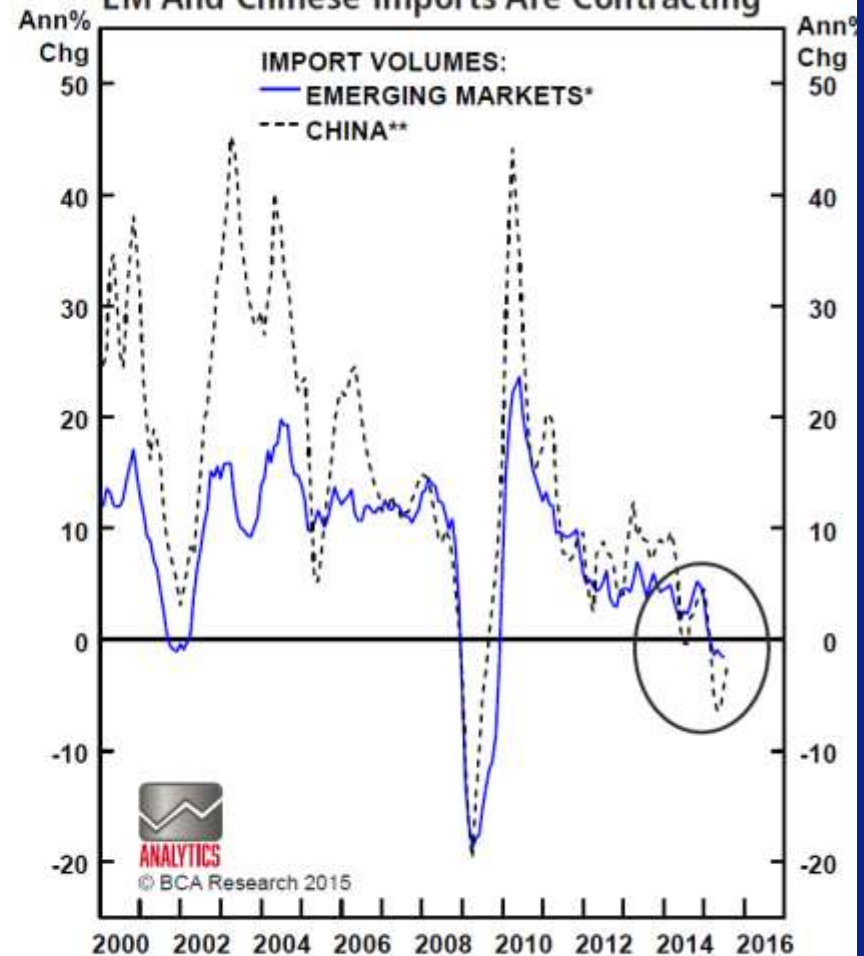
EM Stocks and Imports Breaking Down

EM Banks Stocks Have Broken Down



*EQUITY MARKET-CAP WEIGHTED AGGREGATE OF 18 EMERGING ECONOMIES;
 REBASED TO 100 AT JANUARY 2006
 **REBASED TO 100 AT JANUARY 2006;
 SOURCE: MSCI Inc. (SEE COPYRIGHT DECLARATION)

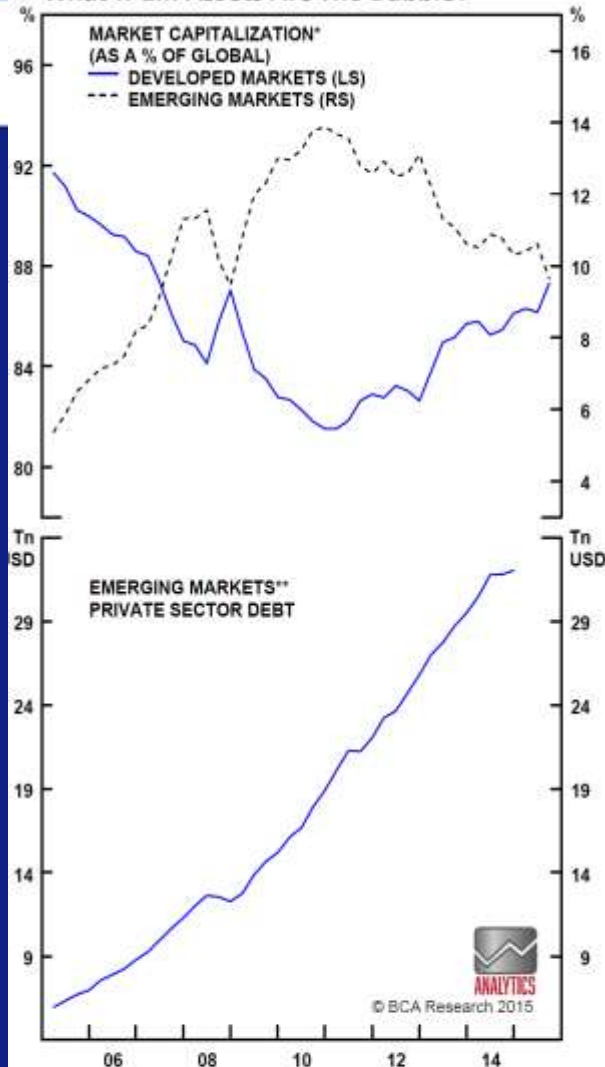
EM And Chinese Imports Are Contracting



*SHOWN AS A 3-MONTH MOVING AVERAGE;
 SOURCE: NETHERLANDS BUREAU FOR ECONOMIC POLICY ANALYSIS
 **SHOWN AS A 6-MONTH MOVING AVERAGE

EM CORPORATE Financial BOMB: Primed to Explode?

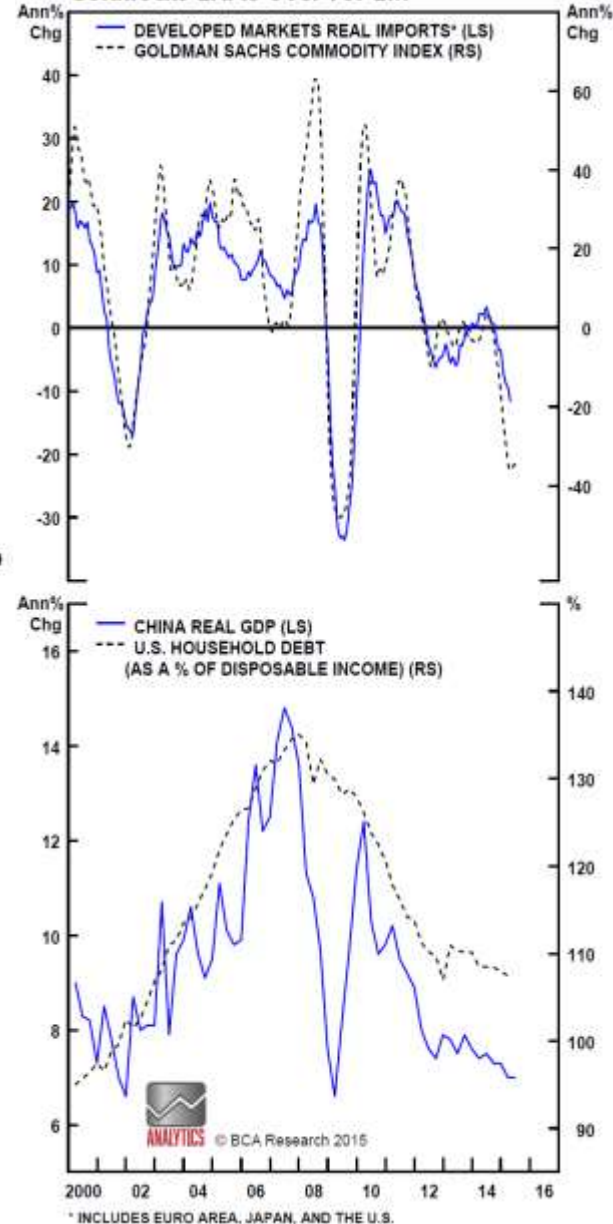
What If EM Assets Are The Bubble?



* SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).

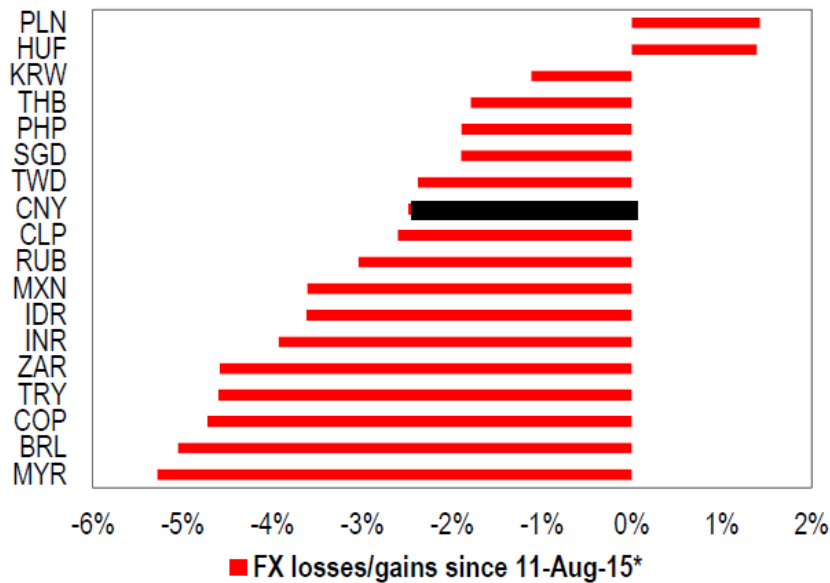
** SOURCE: BCA CALCULATIONS BASED ON IMF AND BIS DATA; CHINA PRIVATE SECTOR IS CALCULATED AS CUMULATIVE TOTAL SOCIAL FINANCING EXCLUDING EQUITY ISSUANCE BY NON-FINANCIAL CORPORATIONS PLUS NON-BANK INTERNATIONAL DEBT SECURITIES AND FOREIGN BANK CLAIMS ON NON-BANK CORPORATE SECTOR.

Goldilocks Era Is Over For EM



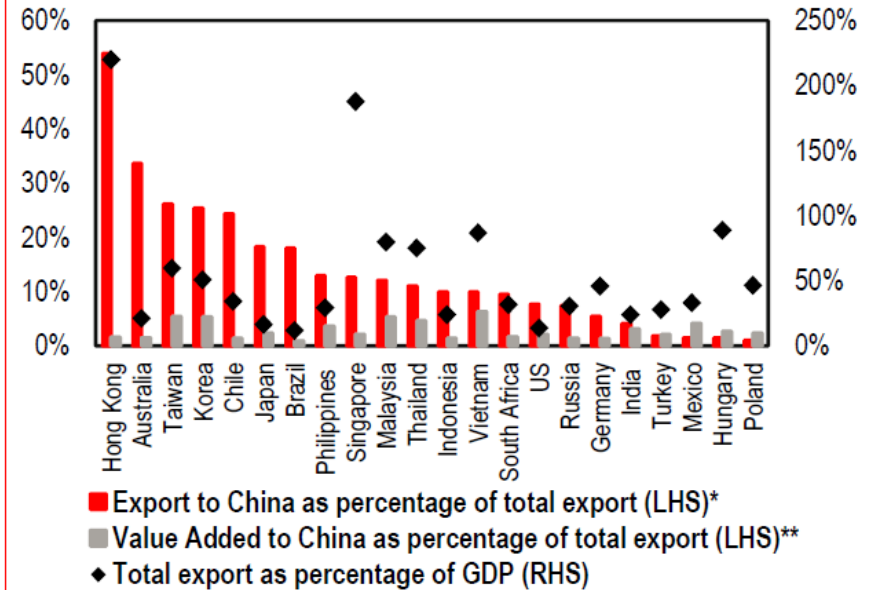
China Currency Shock on EM

Figure 4. EM currencies weaken after China's exchange rate reforms



Source: Bloomberg, HSBC. *China announced exchange rate reforms on 11 August.

Figure 5. Taiwan, Korea and Singapore have significant real linkages with China



Source: World Bank, CEIC, HSBC. *Total export data for goods only; data as of 2014. **Total export data for goods only; data as of 2011.

China Shock to EM Exports

China's Imports Are Dominated By Commodities And Capital Goods

CHINESE IMPORT COMPOSITION*	
IMPORT ITEMS	% OF TOTAL IMPORT VALUE
MATERIALS (METALS, CHEMICALS AND OTHER CRUDE MATERIALS)	29.4%
INDUSTRIAL MACHINERY	26.3%
ENERGY (COAL, OIL, GAS AND ELECTRICITY)	13.7%
OTHER MANUFACTURED GOODS	8.8%
OFFICE MACHINES AND TELECOM EQUIPMENT	6.6%
ROAD VEHICLE AND OTHER TRANSPORT EQUIPMENT	6.1%
PROFESSIONAL INSTRUMENTS AND WATCHES	5.6%
FARMING AND ANIMAL PRODUCTS	3.1%
TOTAL	100%

*SHOWN AS A 12 MONTH MOVING AVERAGE, AS OF JULY 2015

IV. External Demand

Asian Export in Trend Decline...

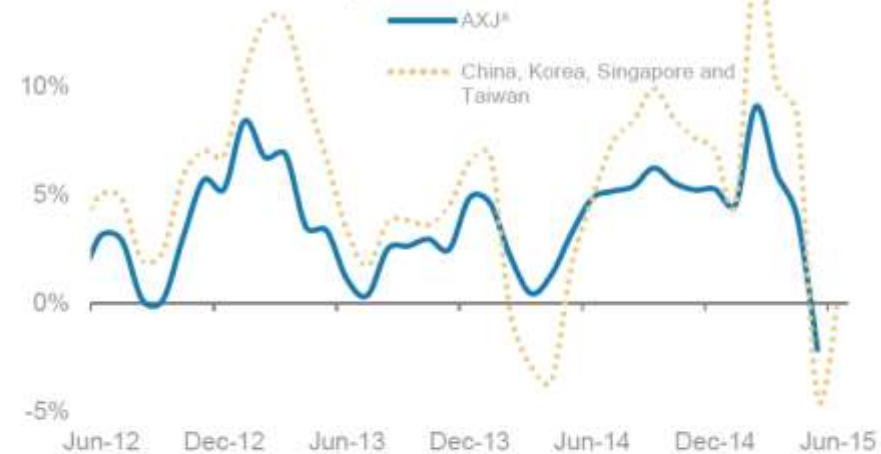
Exports Value Growth (YoY%)

APXJ Exports Growth*



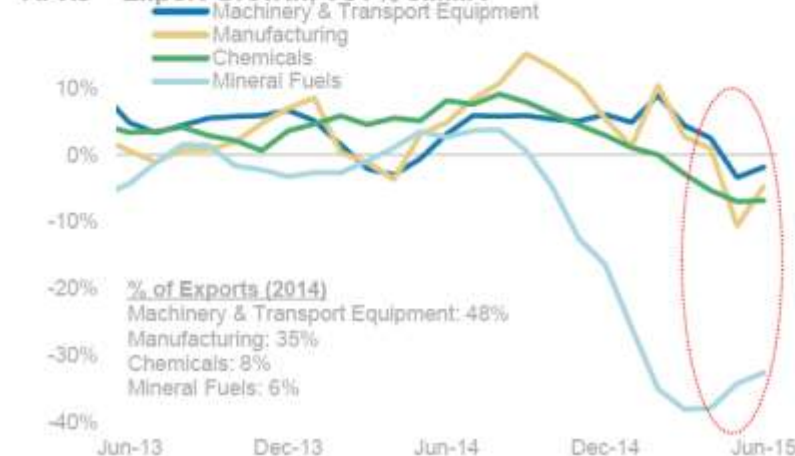
Exports Volume Growth (YoY%)

Exports Volume, YoY% 3MMA



Exports Growth by Key Product Segment** (YoY%)

APXJ** Export Growth, YoY% 3MMA



Mineral fuel exports has remained the key drag due to lower commodity prices, while exports growth of machinery & transport equipment and manufacturing improved at the margin.

Global Imports Volume Growth (YoY%)

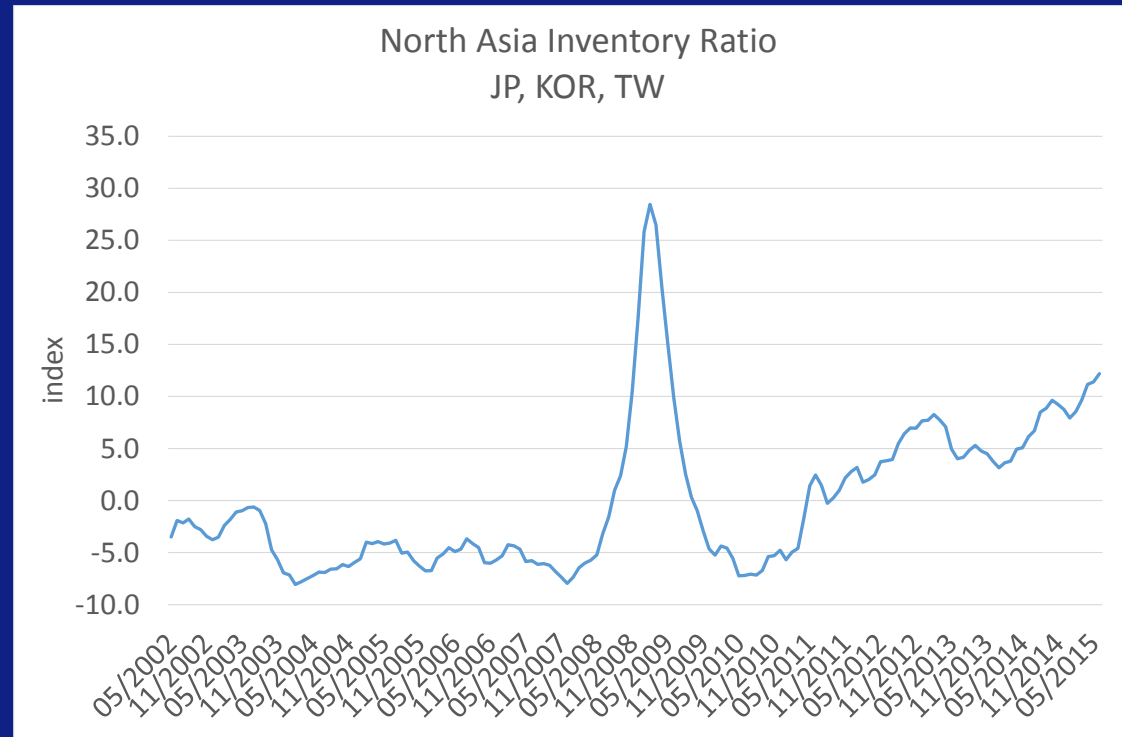
Imports Volume Growth, YoY% 3MMA



Import demand improving in DM countries while still weak in AXJ countries

Asian Inventory Liquidation (dumping?)

- Asian companies cannot afford to continue holding large inventories of unsold goods.
- However, faced with a weak world trade environment, clearing inventories is proving problematic.



The New Asian Financial Crisis will be Driven by Corporate Debt Defaults...

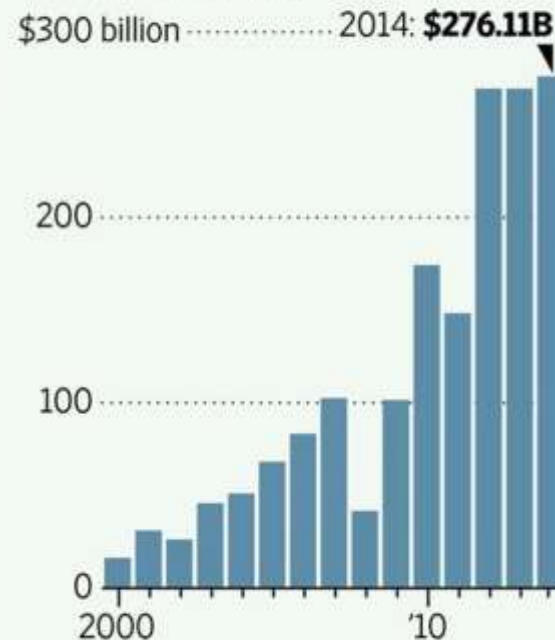
Dollar Damage

The U.S. dollar's surge is hurting companies in emerging markets that borrowed by issuing bonds in dollars instead of the local currency.

U.S. dollar vs. emerging-market currencies



U.S. dollar-denominated corporate bonds issued by year



Sources: Federal Reserve Bank of St. Louis (dollar index); Dealogic (corporate bonds)

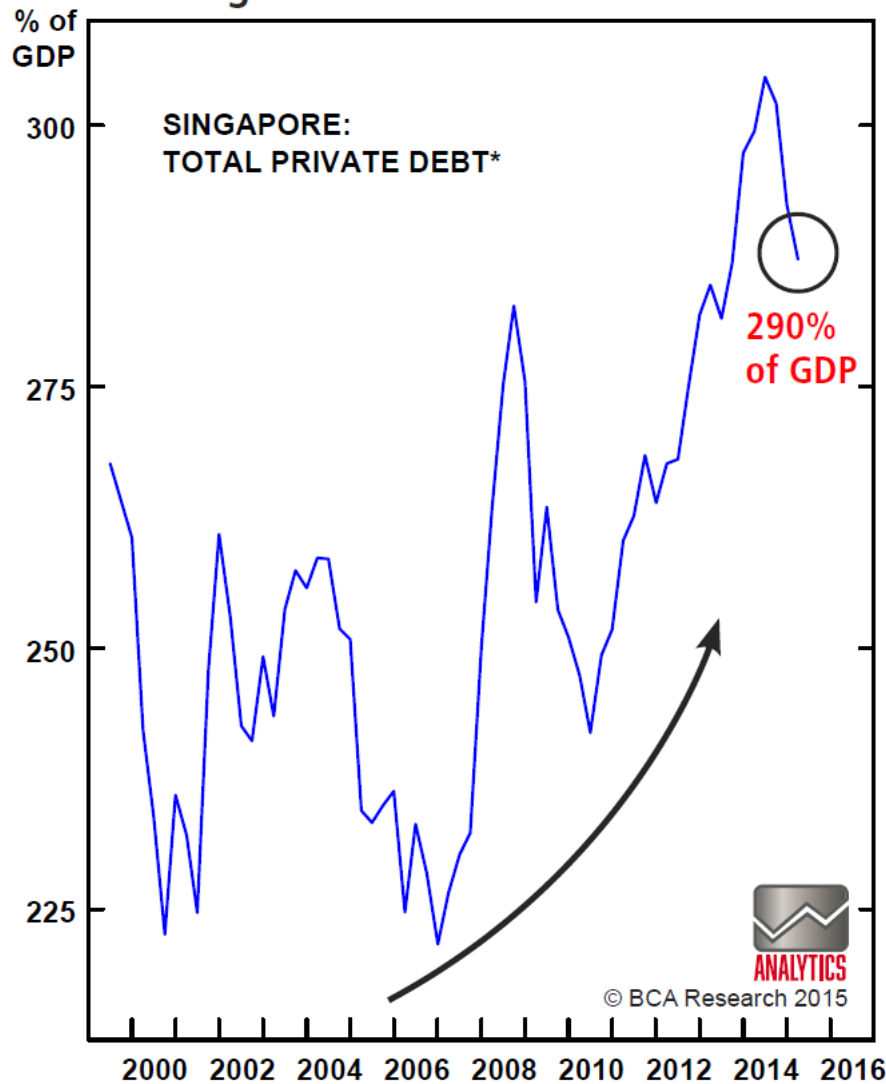
The Wall Street Journal

Table 1
EM Private Sector's Foreign Currency Debt

COMPANIES AND BANKS*	AS A % OF GDP	
	1996	CURRENT (AS OF END OF MARCH 2015)
MALAYSIA	27.7%	32.4%
CHILE	19.9%	31.1%
TURKEY	13.7%	26.8%
BRAZIL	10.5%	24.3%
RUSSIA	12.5%	23.6%
SOUTH AFRICA	10.9%	22.1%
PERU	10.5%	19.7%
TAIWAN	8.7%	19.7%
KOREA	24.2%	19.2%
THAILAND	59.1%	17.8%
MEXICO	14.0%	16.5%
COLOMBIA	10.5%	14.5%
PHILIPPINES	16.9%	12.7%
INDIA	6.5%	12.4%
INDONESIA	26.0%	11.3%
CHINA	9.3%	10.9%

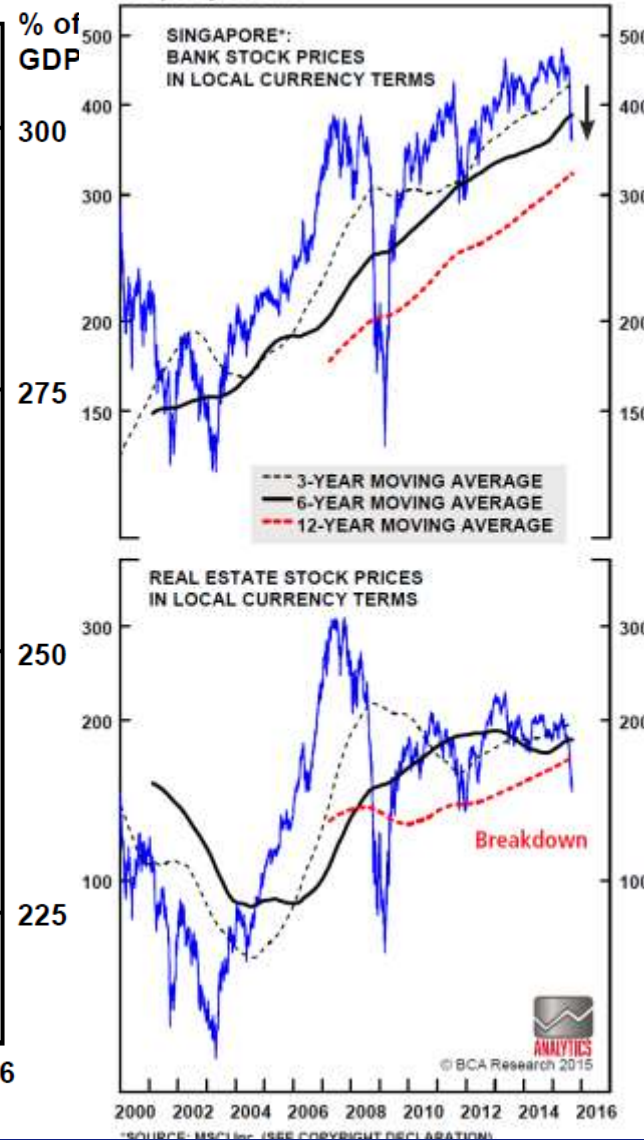
* INCLUDES NON-FINANCIAL COMPANIES' AND FINANCIALS' FOREIGN SECURITY DEBT AND LOANS; SOURCE: BIS

Singapore: Private Sector Leverage Has Surged



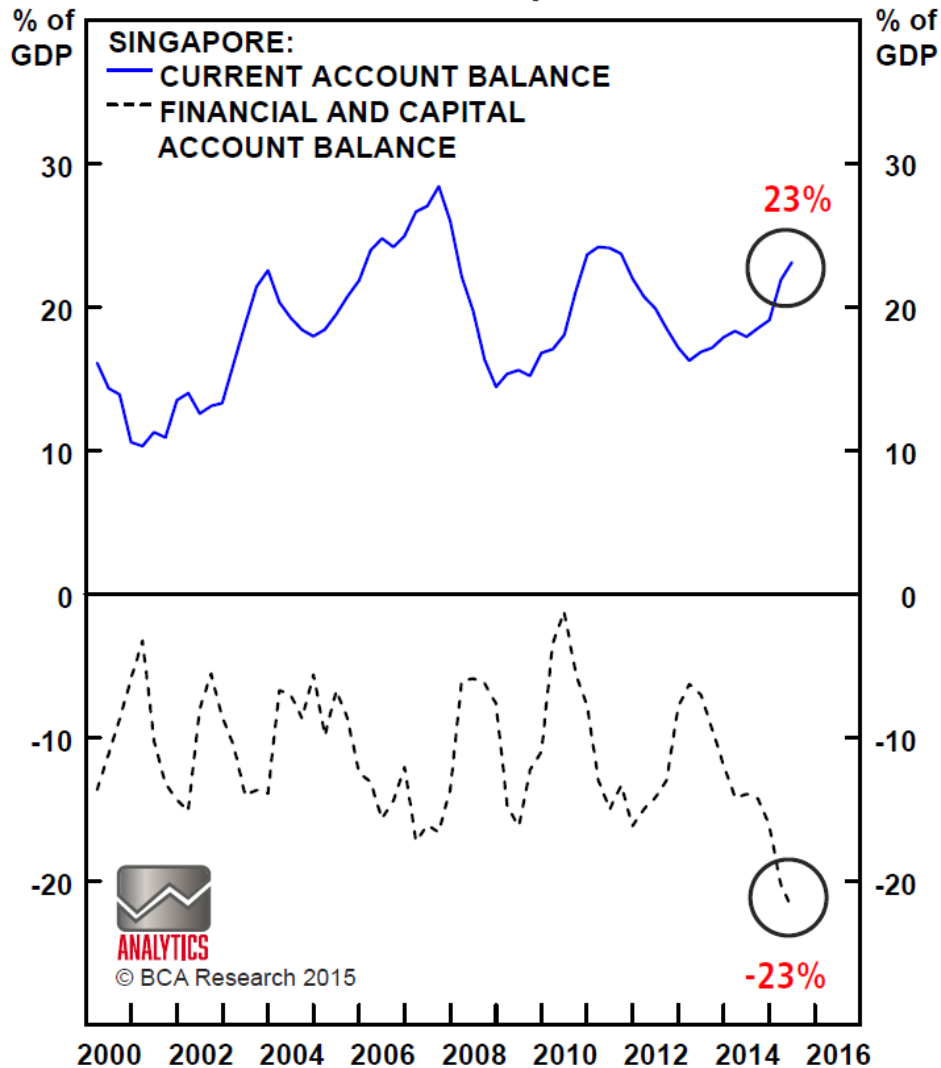
*EXCLUDING FINANCIAL DEBT; SOURCE: BIS AND IMF

More Downside In Banks And Property Stocks

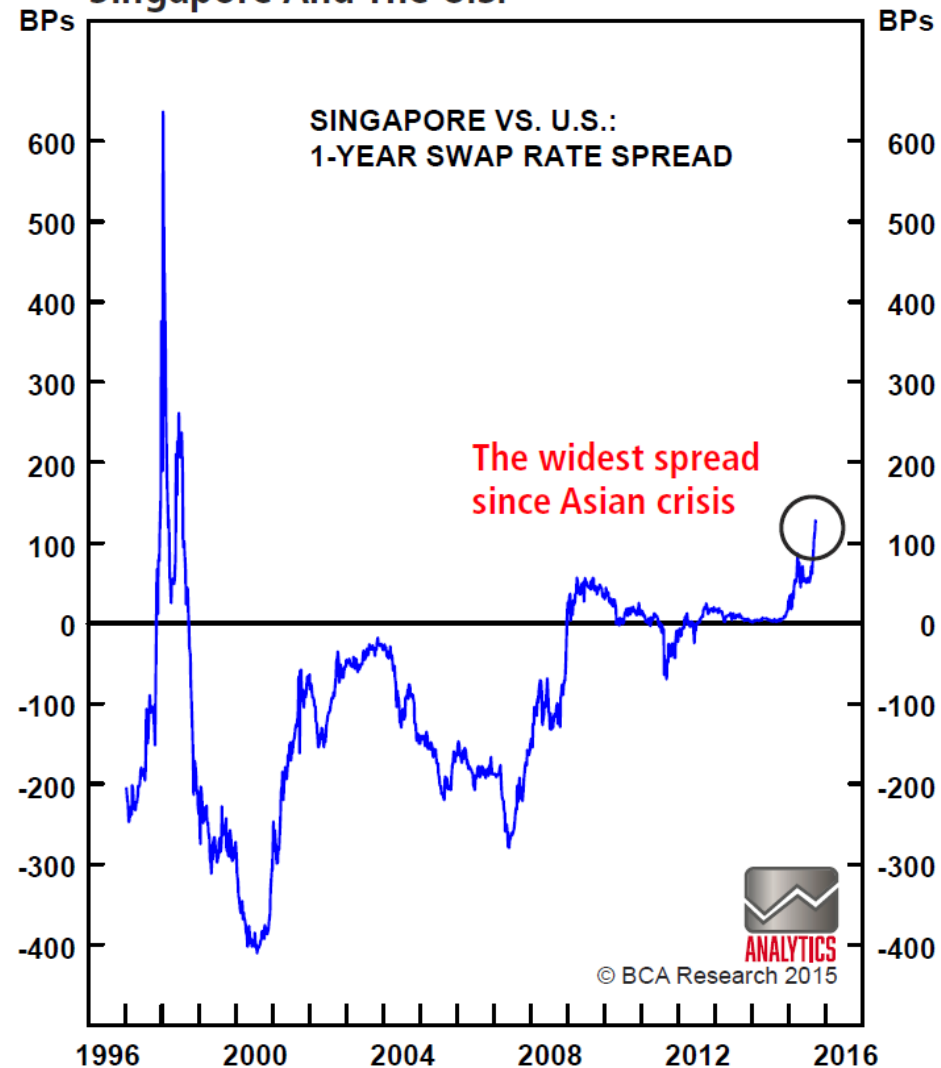


Will Capital Outflow Breakdown the Safest of Asian Currencies?

Capital Outflows Have Offset The Current Account Surplus

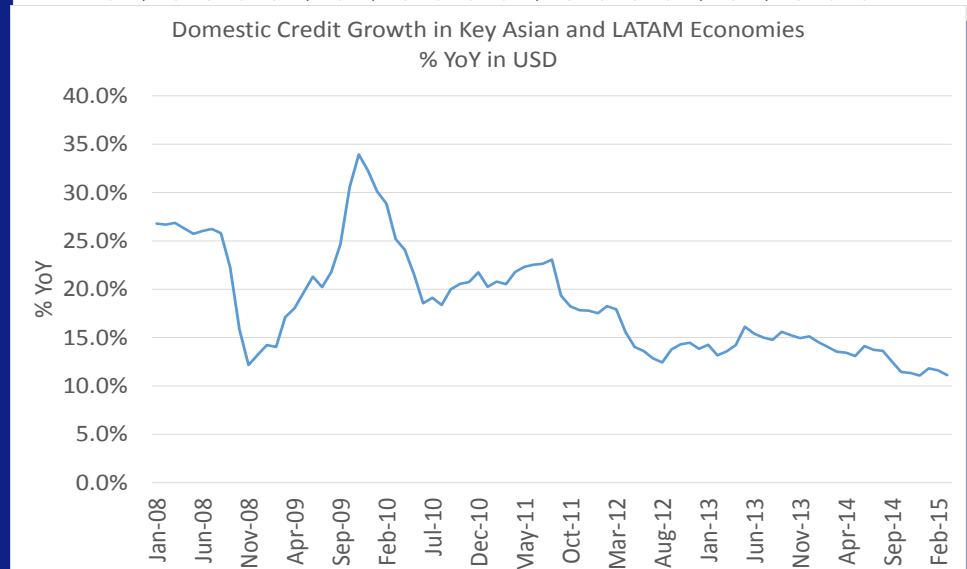
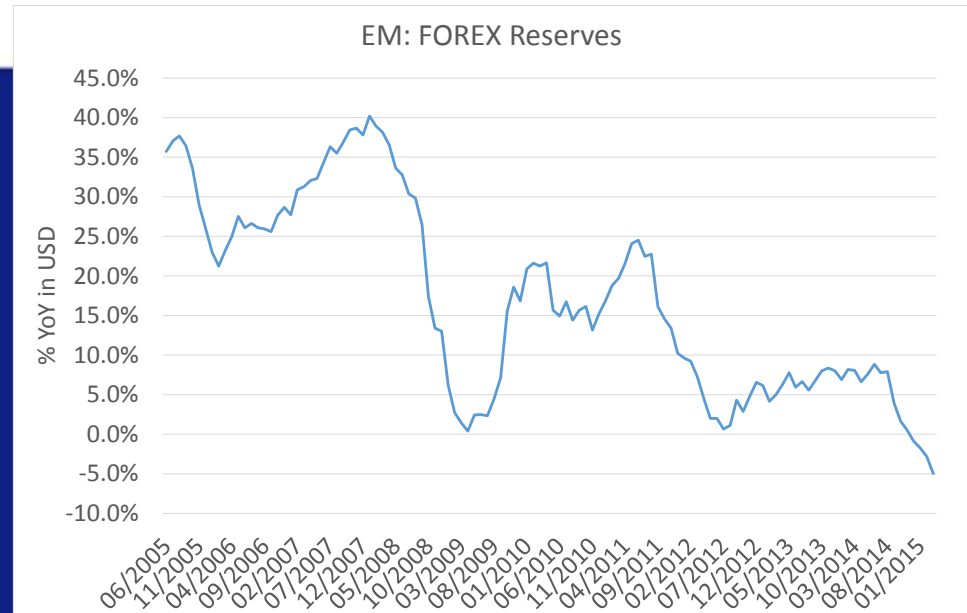


Interest Rate Spread Between Singapore And The U.S.

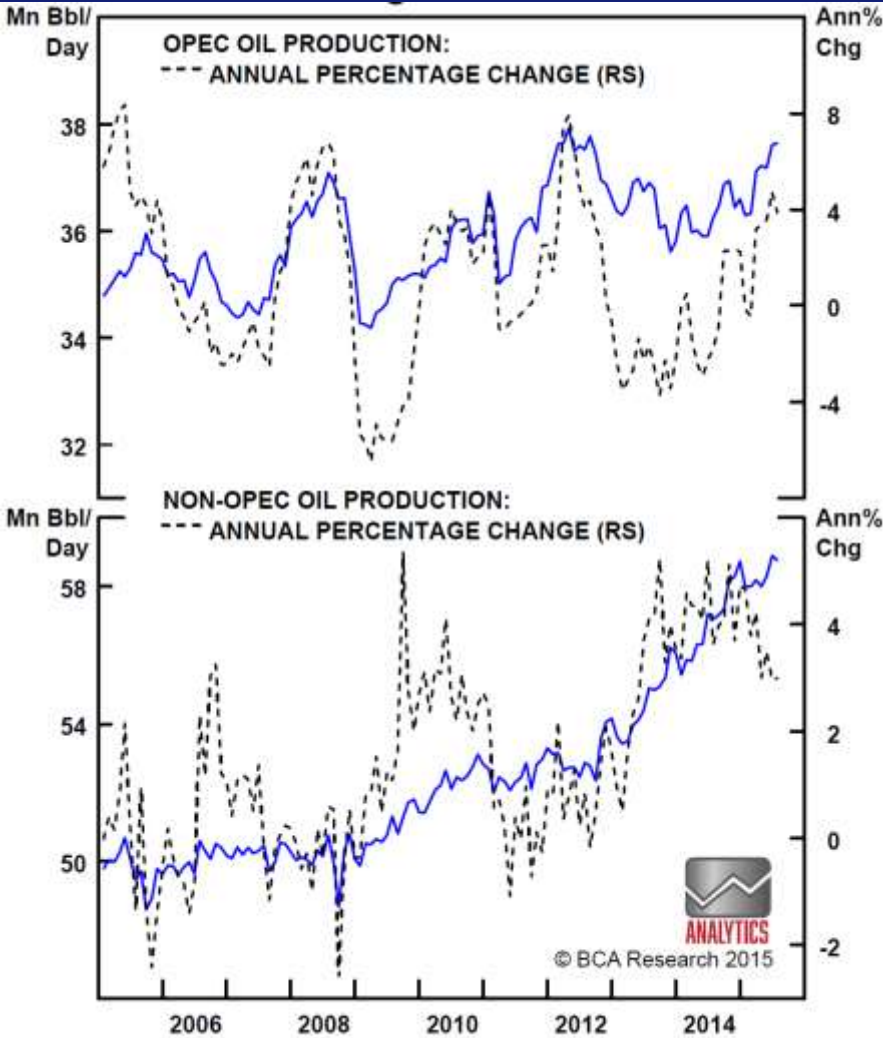


But Surpluses Not Large Enough

- Asian nations have accumulated huge currency reserves as a buffer against a repeat of the previous Asian financial crisis.
- However, even these mammoth surpluses are not large enough to fund all of the credit outflows.
- Hence, the countries are losing FOREX reserves.
- Lower reserves imply lower rates of reserve money growth and therefore a (deflationary) cooling in their domestic credit cycles.

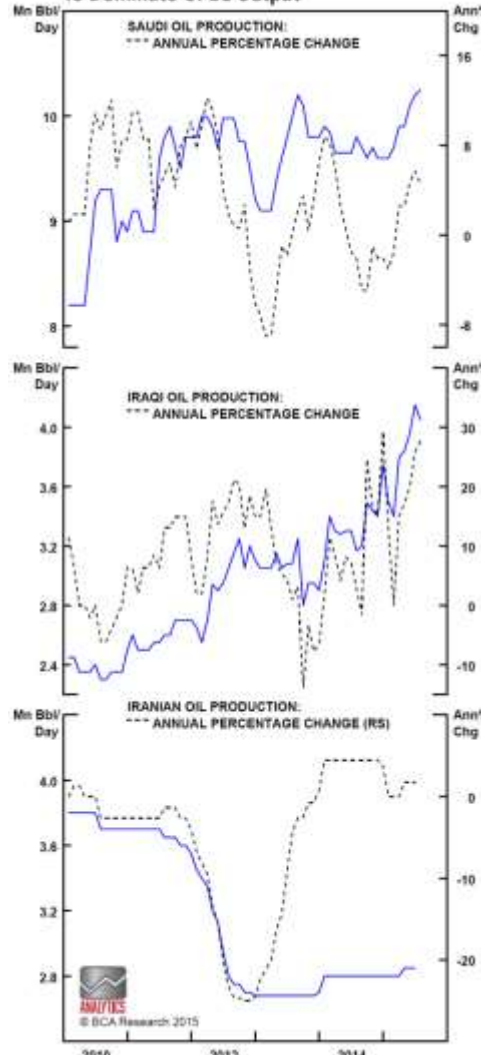


Oil Bubble has Burst OPEC Flood Continues



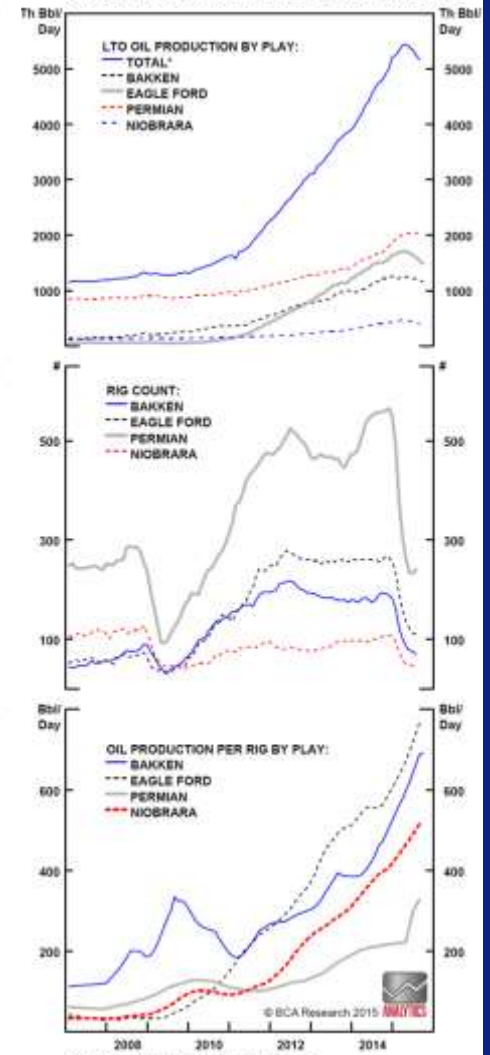
SOURCE: U.S. EIA

Saudi, Iran And Iraq On Track To Dominate OPEC Output



SOURCE: U.S. EIA

U.S. LTO Production Will Drift Lower Into 2016

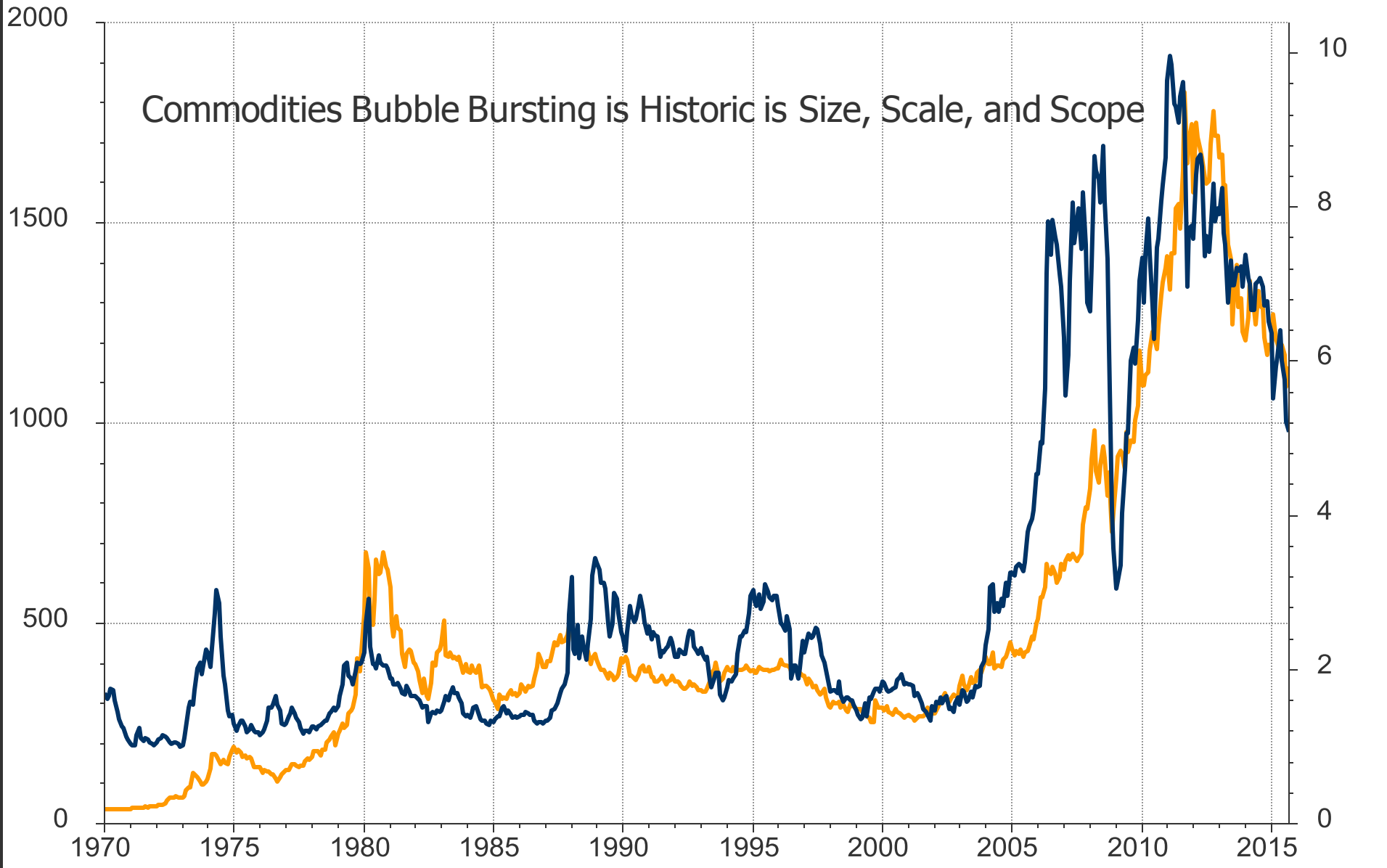


A Long Tale of Gold, Copper, and Inflation then Deflation

Metals Industry Heading for Large Scale Insolvency

x 1,000

Commodities Bubble Bursting is Historic is Size, Scale, and Scope

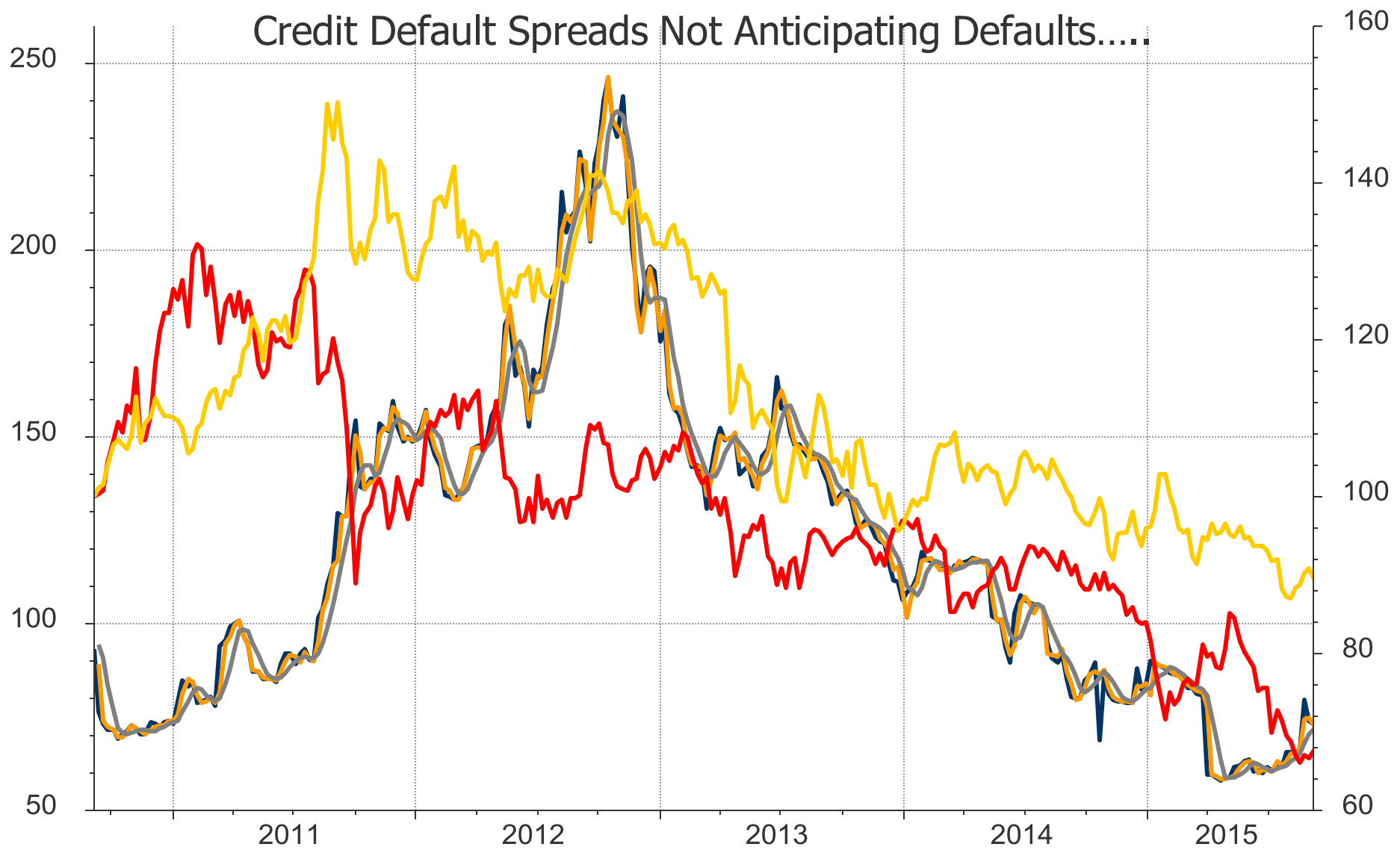


— LME-Copper Grade A Cash U\$/MT (RH Scale)

— Gold Bullion LBM U\$/Troy Ounce

Source: Thomson Reuters Datastream

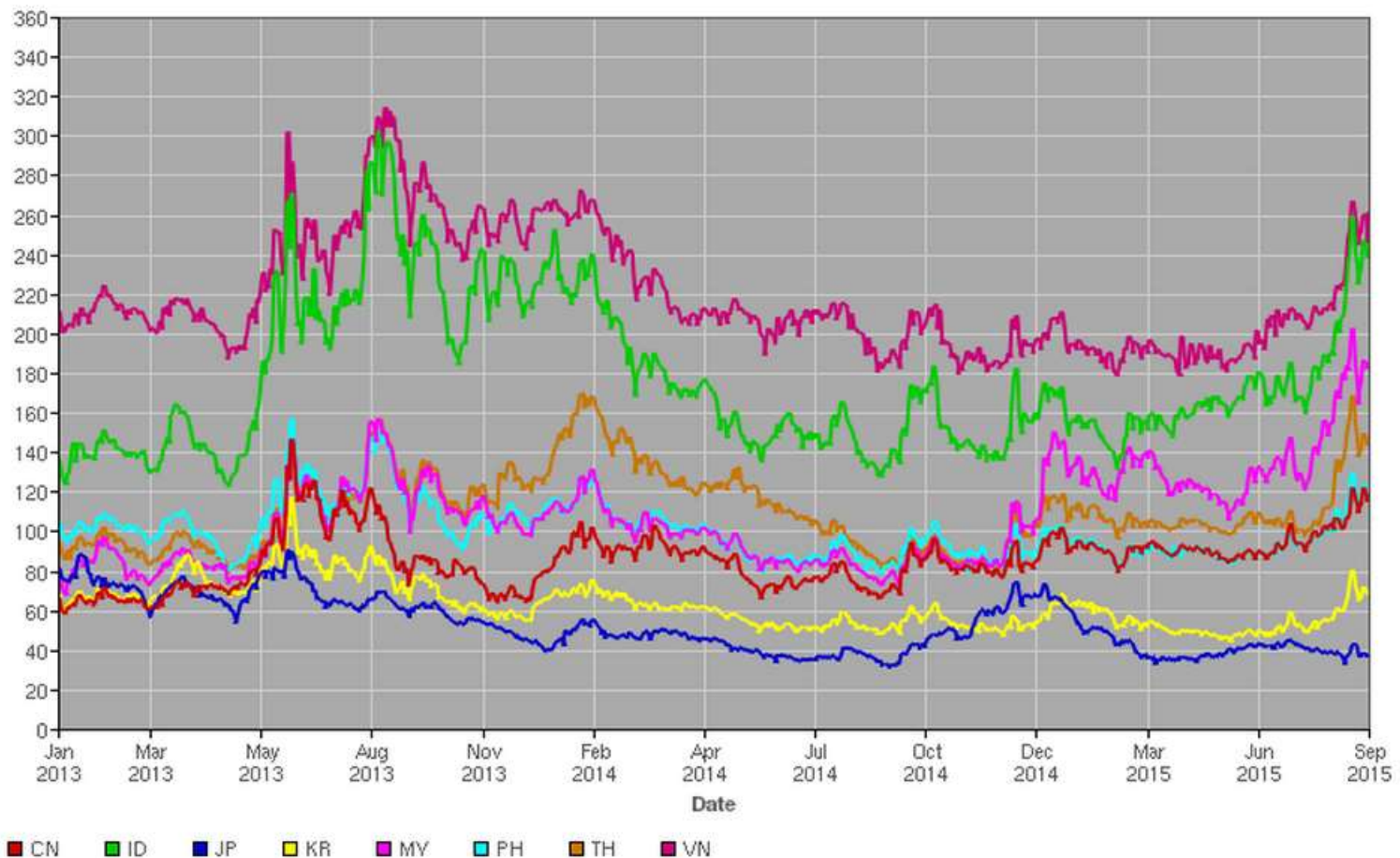
Credit Default Spreads Not Anticipating Defaults.....



- DS ASIA MTLs/MINING 5Y CDS INDEX (Y) - SM
- 5D moving average of DS ASIA MTLs/MINING 5Y CDS INDEX (Y) - SM
- 20D moving average of DS ASIA MTLs/MINING 5Y CDS INDEX (Y) - SM
- Rebase LME-Copper Grade A Cash U\$/MT to 100 (RH Scale)
- Rebase Gold Bullion LBM U\$/Troy Ounce to 100 (RH Scale)

Asian CDS Still Not Predicting Credit Crisis

Emerging East Asia CDS - Senior 5-year

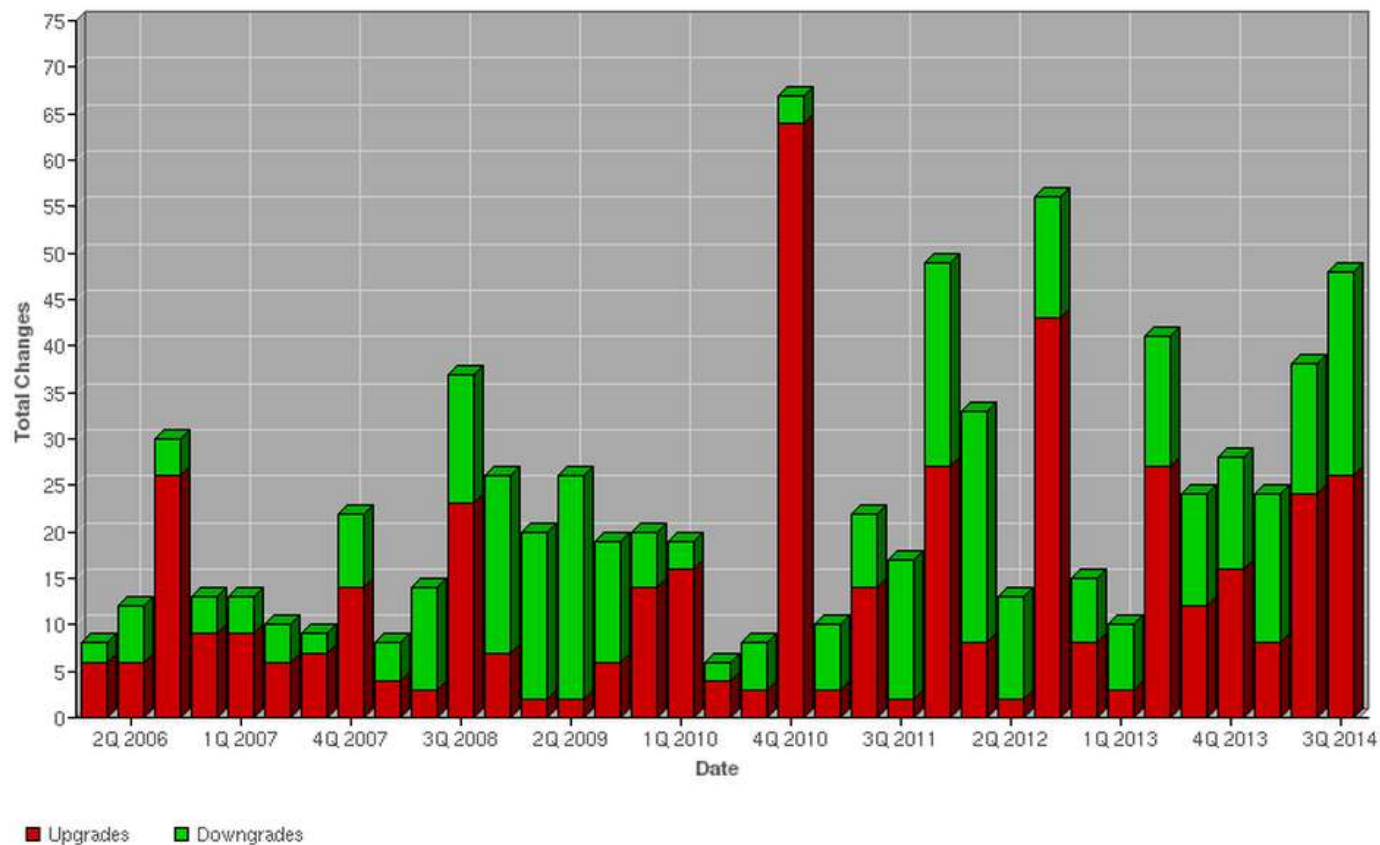


EM Credit Ratings Deteriorating

Credit Rating Trends

Data vary across markets. For details download spreadsheet.

 Downloadable Spreadsheet



2025: Shifting Global Landscape

Relative Certainties

- A global multipolar system is emerging with the rise of China, India, and others.
- The relative power of non-state actors - businesses, tribes, religious organizations, and even criminal networks—also will increase.
- Continued economic growth—coupled with 1.2 billion more people by 2025—will put pressure on energy, food, and water resources.
- **The potential for conflict will increase owing to rapid changes in parts of the greater Middle East and the spread of lethal capabilities.**

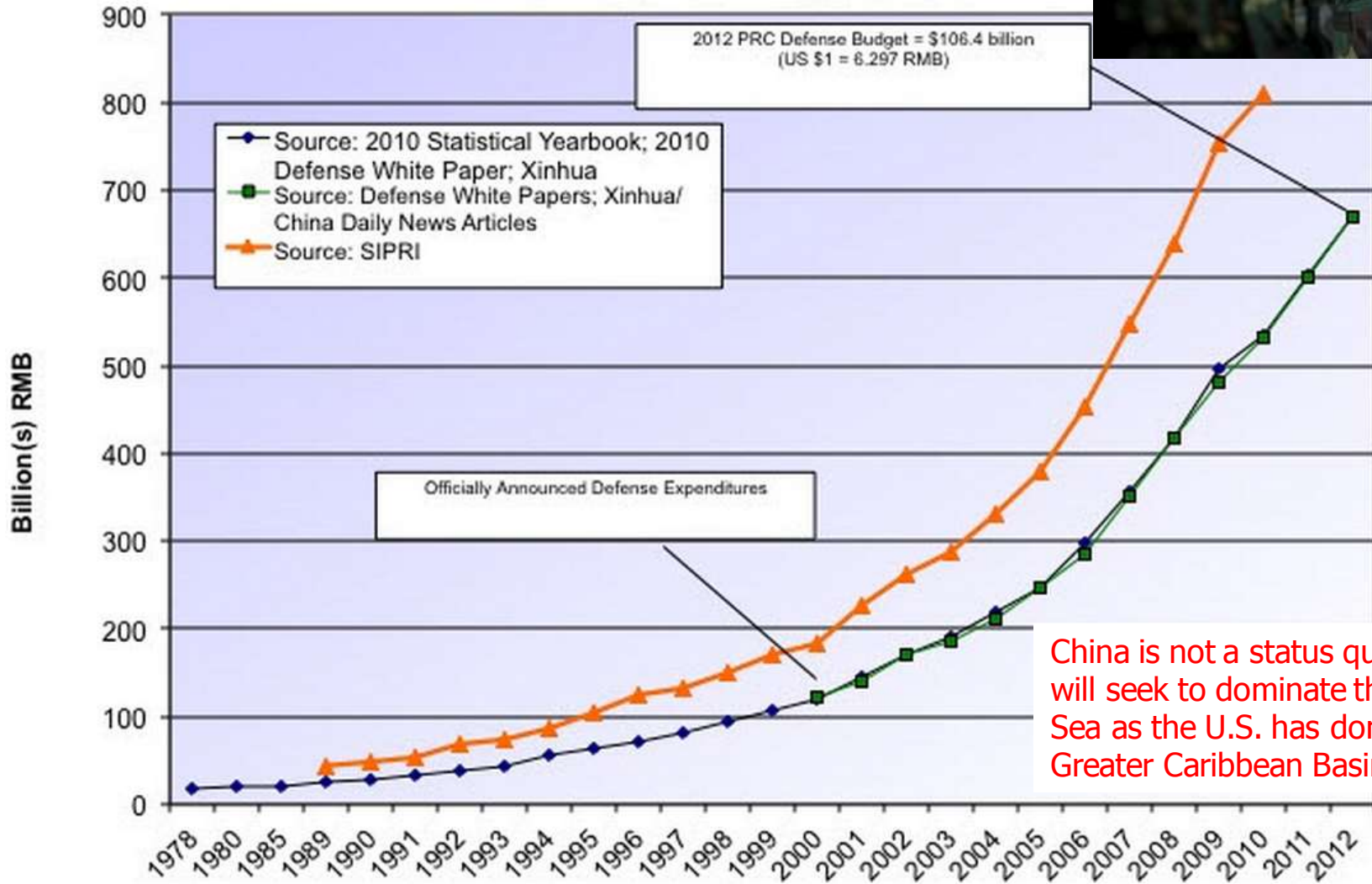
Likely Impact

- **By 2025 a single “international community” composed of nation-states will no longer exist. Power will be more dispersed with the newer players bringing new rules of the game while risks will increase that the traditional Western alliances will weaken. Rather than emulating Western models of political and economic development, more countries may be attracted to China’s alternative development model.**
- **Shrinking economic and military capabilities may force the US into a difficult set of tradeoffs between domestic versus foreign policy priorities.**
- Unless employment conditions change dramatically in parlous youth-bulge states such as Afghanistan, Nigeria, Pakistan, and Yemen, these countries will remain ripe for continued instability and state failure.
- The need for the US to act as regional balancer in the Middle East will increase, although other outside powers—Russia, China and India—will play greater roles than today.

“For the first time, in modern history at least, Asia’s military spending is poised to overtake Europe’s... China is doubling its defence budget every five years and India has just announced a 17% rise in spending this year, to about \$40 billion.” *Economist*, March 24, 2012



Chinese Defense Spending



China is not a status quo power. It will seek to dominate the South China Sea as the U.S. has dominated the Greater Caribbean Basin

South China Sea Incidents Rising



Reefer Madness?



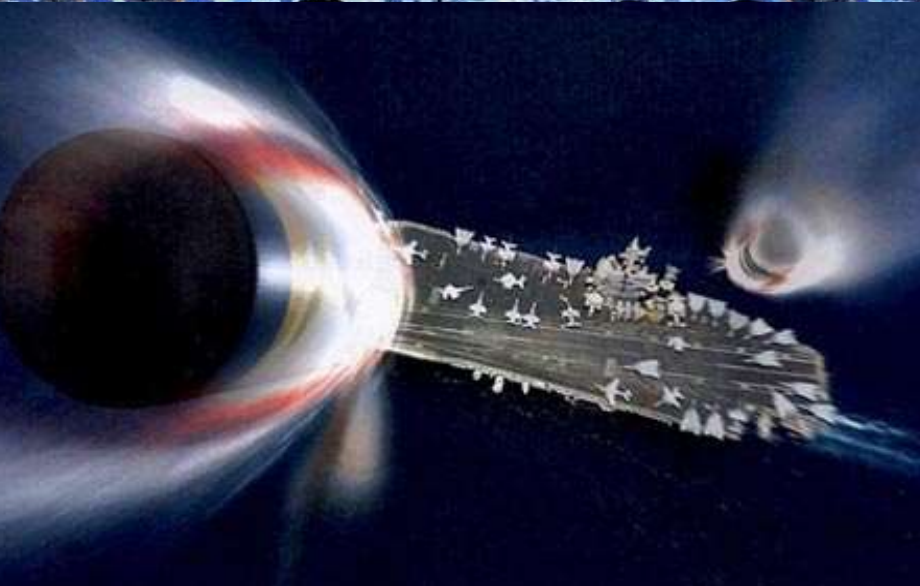
Source: UNCLOS, CIA



IHS JAMES

During the anti-Japanese military parade, national flag guards walked a total of 121 steps, symbolizing 121 years of the Chinese people's fight against aggression since 1894, when the Sino-Japanese War of 1894-1895 began.

China Militarizing for "121 Steps" War?



OPINION | January 27, 2012

China's Cyber Thievery Is National Policy—And Must Be Challenged

It is more efficient for the Chinese to steal innovations and intellectual property than to incur the cost and time of creating their own.

By MIKE MCCONNELL, MICHAEL CHERTOFF AND WILLIAM LYNN

Only three months ago, we would have violated U.S. secrecy laws by sharing what we write here—even though, as a former director of national intelligence, secretary of homeland security, and deputy secretary of defense, we have long known it to be true. The Chinese government has a national policy of economic espionage in cyberspace. In fact, the Chinese are the world's most active and persistent practitioners of cyber espionage today.

Evidence of China's economically devastating theft of proprietary technologies and other intellectual property from U.S. companies is growing. Only in October 2011 were details declassified in a report to Congress by the Office of the National Counterintelligence Executive. Each of us has been speaking publicly for years about the ability of cyber terrorists to cripple our critical infrastructure, including financial networks and the power grid. Now this report finally reveals what we couldn't say before: The threat of economic cyber espionage looms even more ominously.

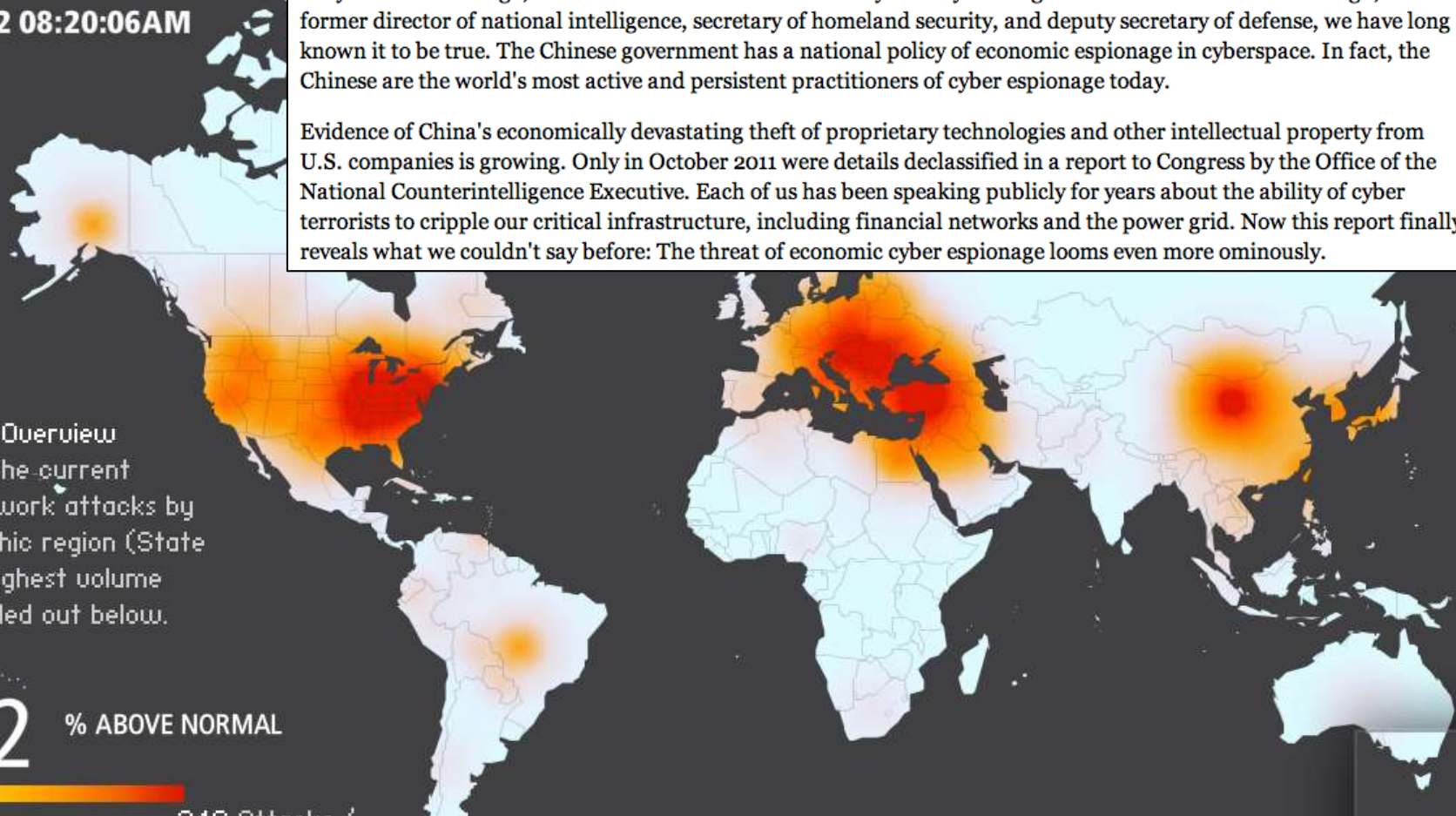
Real-time Web Monitor

MAY 04, 2012 08:20:06AM

Attack Traffic Overview

Displayed are the current number of network attacks by major geographic region (State or Country). Highest volume regions are called out below.

43.82 % ABOVE NORMAL



Why be worried about the global system?

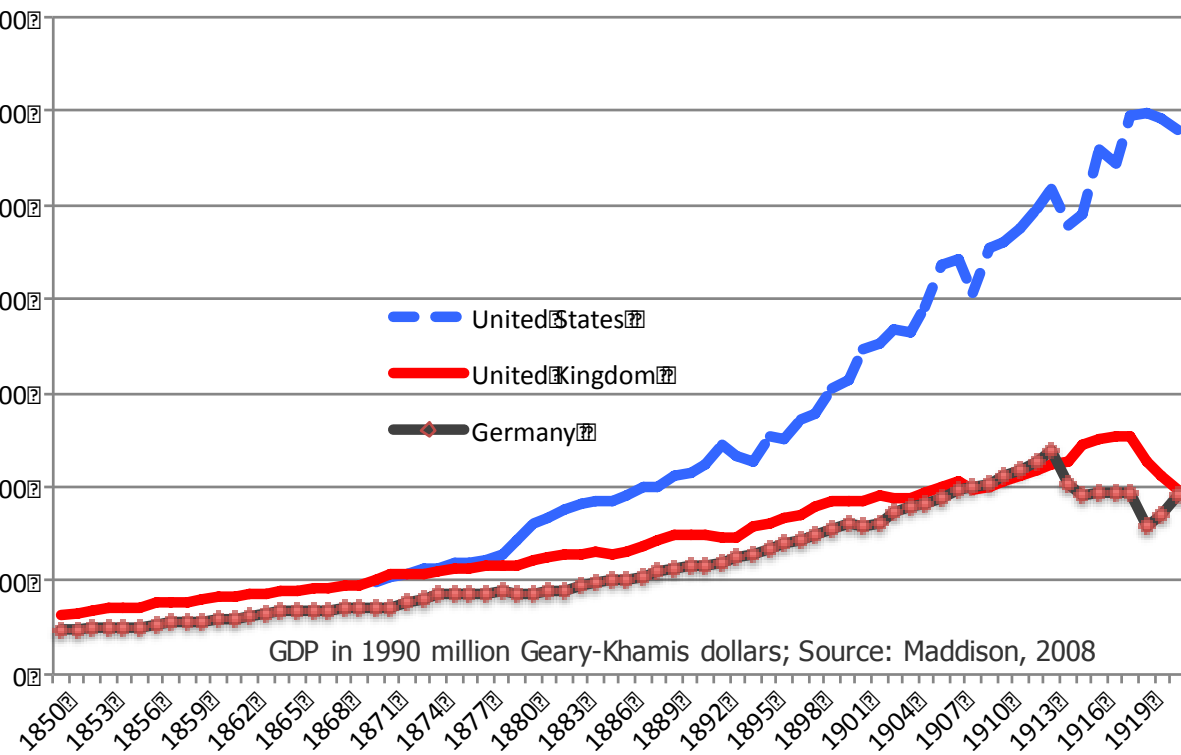
- The pre-WW I breakdown in the long cycle, balance of power, and hegemonic stability may be repeating itself.
- There is no historical precedent for a stable transition to multi-polarity among competing powers.
- China is on course toward a “militarized hegemony” in Asia, while America is a “reclining power” whose actions don’t match its rhetoric.
- The dark side of globalization is expanding.
- The world of warfare is flattening.
- Much depends on whether the US can become a “globalist power” again and not just a power trying to shield itself from a dangerous globe...

1870 – 1914: The Era of Convergence 1.0

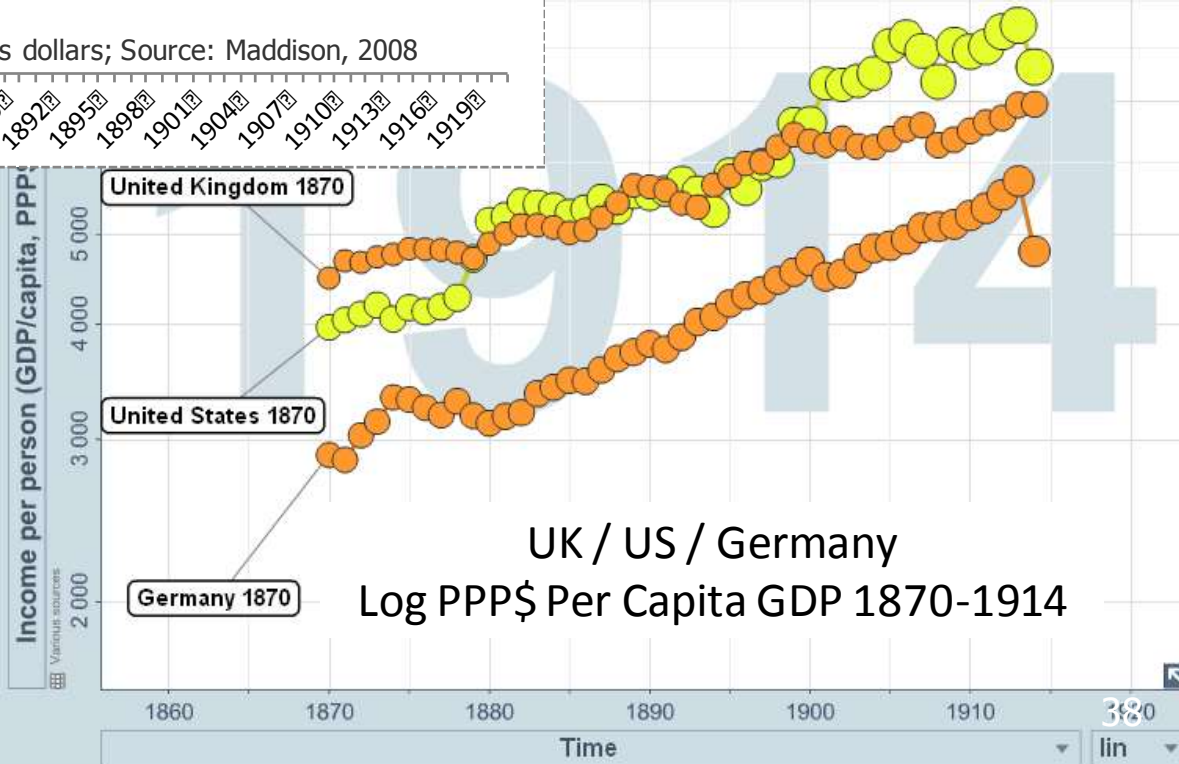


- 1870 to 1914 represented the high water mark of 19th century globalization. Globalization involved increasing transfers of commodities, people, capital and ideas between and within continents.
- Intra-imperial tariff reduction and the widened use of the gold standard deepened trade
- Intra-European and extra-European trade reached a high point in 1913. European trade roughly quadrupled in real terms between 1870 and 1913
- Prices for everything from commodities , such as wheat, to manufactured good steadily converged.
- Cross-border capital flows and foreign direct investment boomed. Foreign assets accounted for 7% of global GDP in 1870 but nearly 20% by 1900-1914 (a level of integration not met again until 1970).

The Great Growth Wave 1850-1920



GLOBALIZATION 1.0



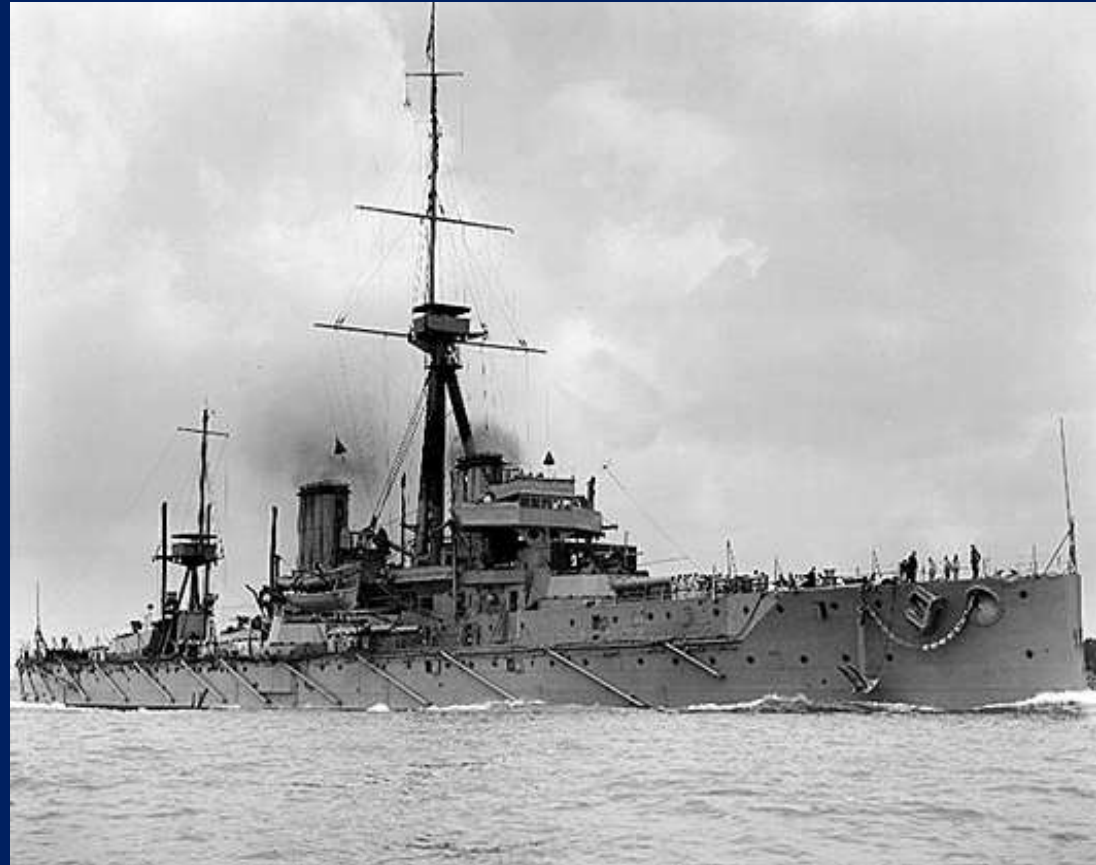
Anglo-German Naval Race, 1904-1914

“It is generally admitted that the present rivalry in armaments in Europe— notably such as that now in progress between England and Germany—cannot go on in its present form indefinitely.” Norman Angell, *The Great Illusion*

Summary - Dreadnought Class Ships Completed or Completing by August 1914

Countries in order of first dreadnoughts - totals exclude German Blucher, French Dantons and Russian Black Sea Fleet dreadnoughts building.

Britain	34	5 lost
Germany	24	(Blucher lost)
Japan	8	1 lost
U.S.A.	8	-
Austria	4	2 lost
France	4	(Danton lost)
Italy	4	1 lost
Russia	4	(1 Black Sea ship lost)
Total	90	9 (plus 3)
	(50 Allied, 28 Central Powers, 12 later Allies)	



HMS Dreadnought, 1906

British Growth Before and After the Great War

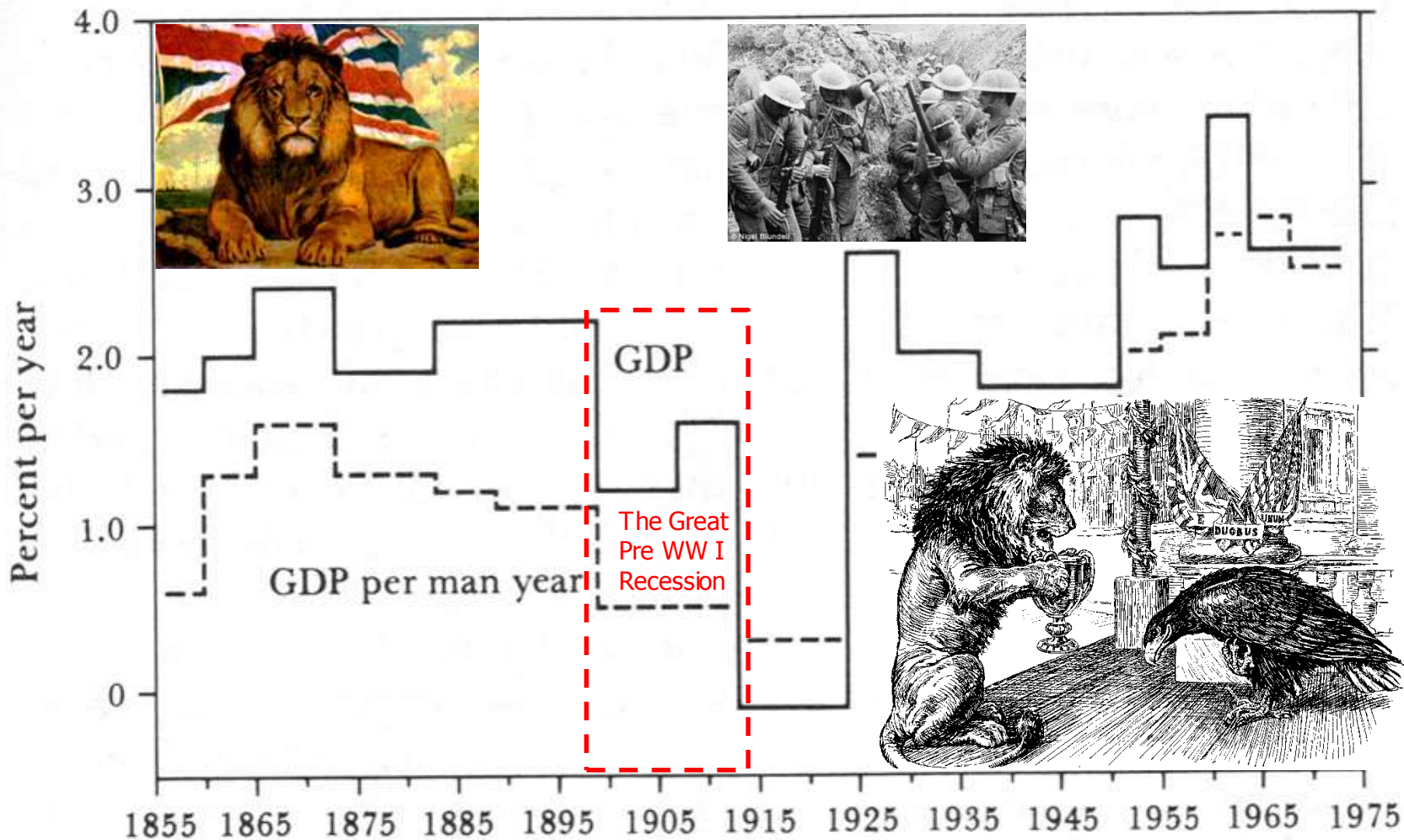


Fig. 2.1. Growth of gross domestic product and gross domestic product per man-year between cycle peaks, 1856–1973

The Decline in British Pre WWI Productivity and Growth

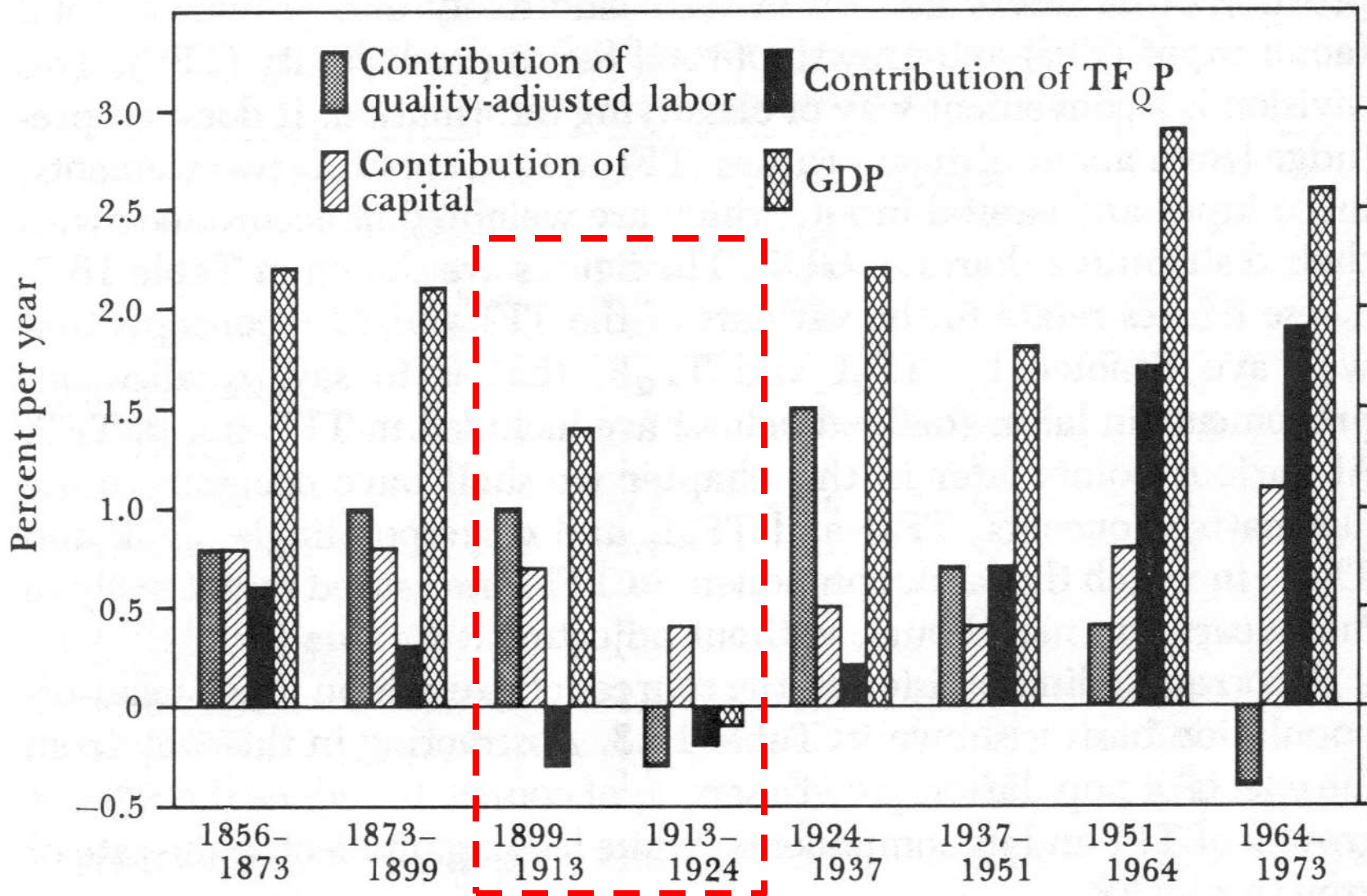
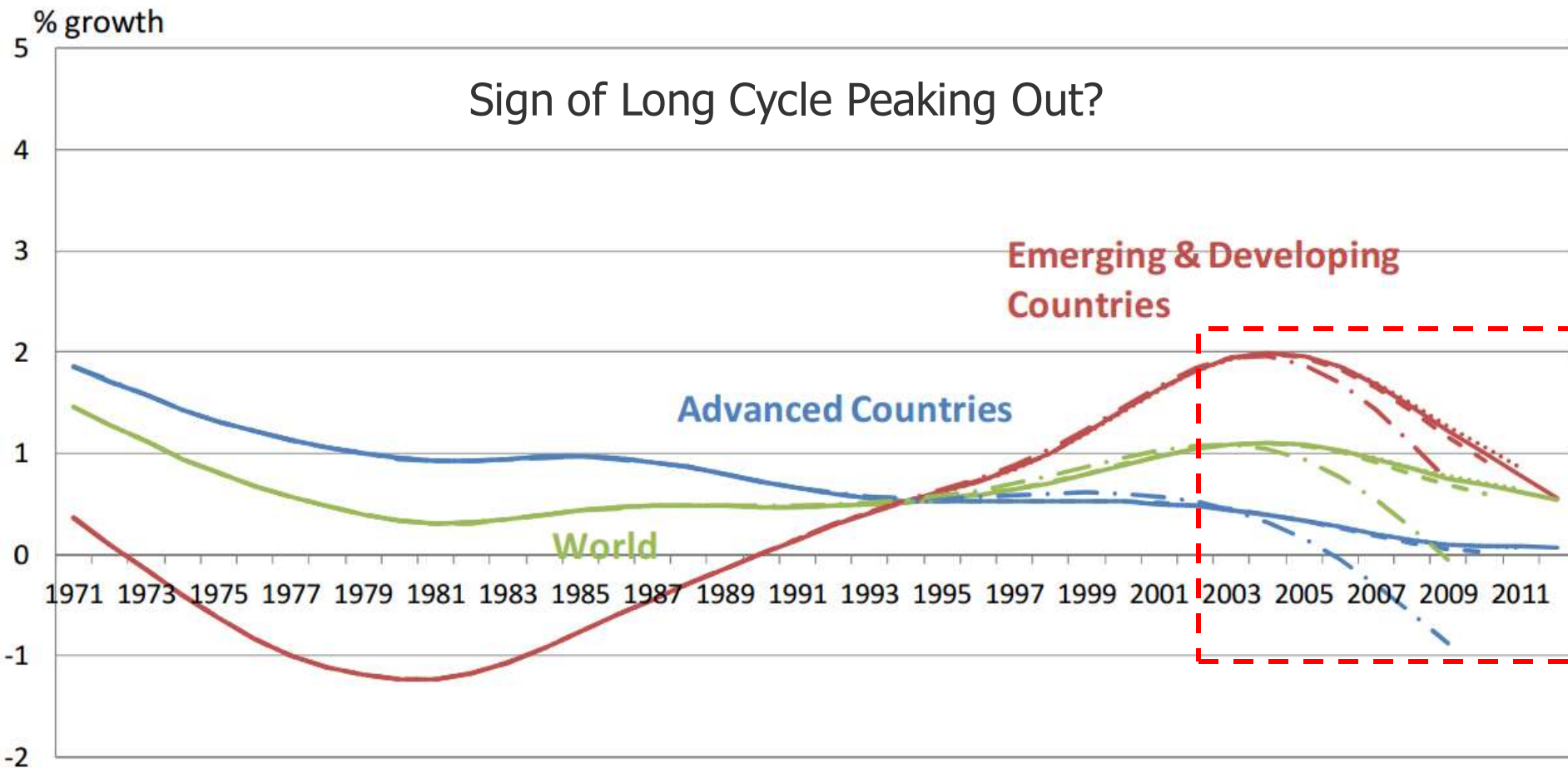


Fig. 16.1. Growth of gross domestic product and its sources by period, 1856-1973

Trend growth of total factor productivity



Source: The Conference Board Total Economy Database™, January 2012

American Hegemony is Waning Globally

US Hegemony Under Stress:

- Free trade system in decay
- Global financial status diminished
- Declining use of the dollar
- Bulging fiscal imbalances
- Anemic economic recovery compared to norm
- Involvement in long, costly wars
- Fraying alliance systems in Europe and Asia
- Increased isolationist thinking
- Rising strategic rivals in Asia and Middle East
- Shrinking US naval power





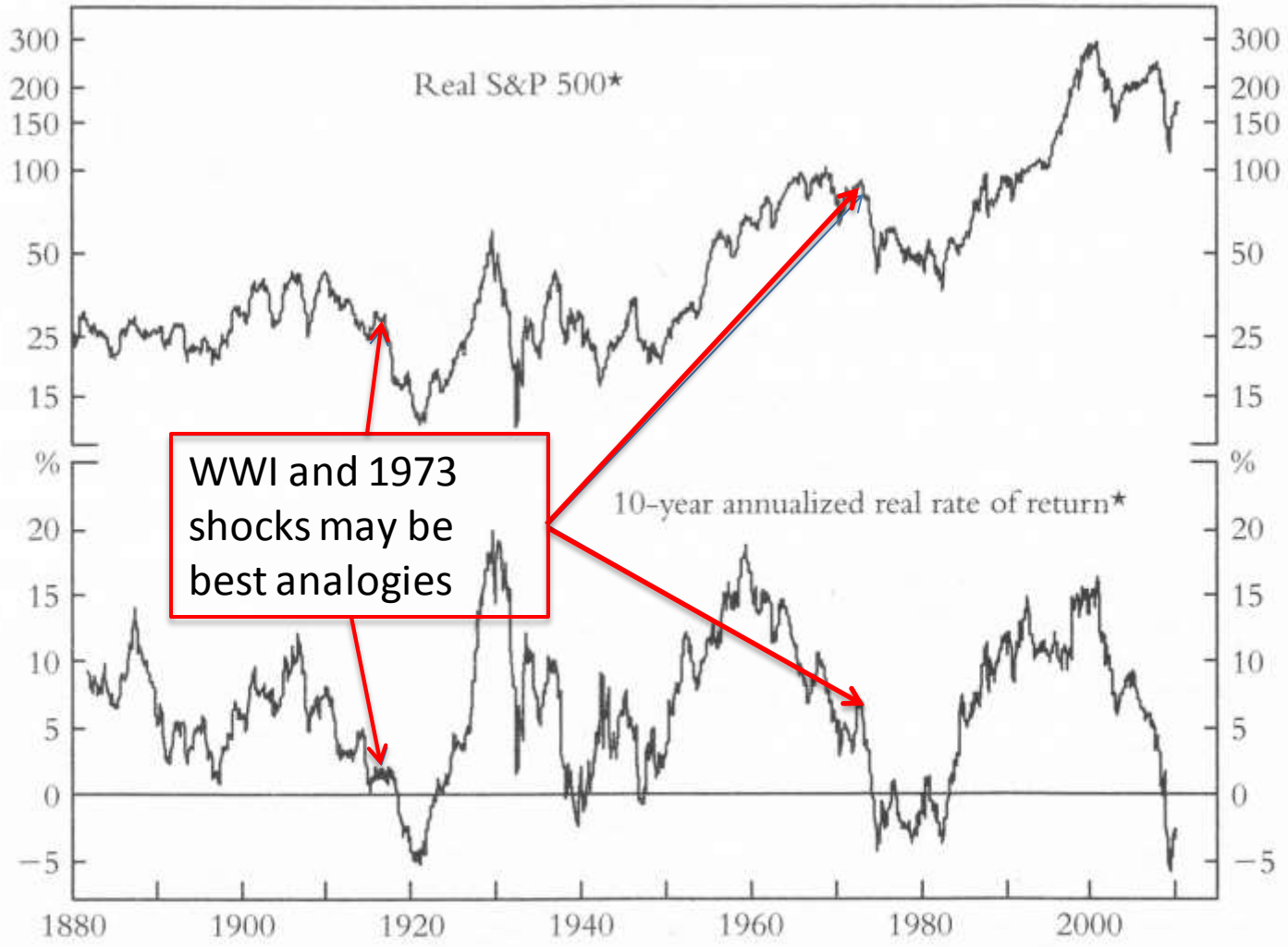
What forces and scenarios could set the free world back?

War

- Historically wars have had the greatest impacts on global economic conditions and broken long cycles
- War is the most likely of the most impactful forces but often most difficult to foresee.
- Potential scenarios:
 - Saudi vs. Iran – Gulf Conflict = “Muddle East Meltdown”
 - “Implosive Conflict” on the Korean peninsula
 - South China Sea - Chinese “Monroe Doctrine” vs. US/Japan
 - India vs. Pakistan nuclear war
 - India vs. China conflict
 - Catastrophic cyber attack



Previous War Shocks to the Long Financial Cycle



S&P 500 and 10-Year Annualized Real Rate of Return

*Deflated by consumer prices.

Source: Chart courtesy of BCA Research Inc.

Source: Anthony Boeckh, *The Great Reflation*



North Korea: Global Menace

- North Korean government becoming a problem for both ROK and China. Is forced reunification ahead?
- North Korea is determined to test and deploy a nuclear capable ICBM (ICBM): KN-08
- North Korea is the #1 proliferation threat in the world
- North Korea's stockpile of enriched uranium is sufficient to manufacture dozens of weapons in the coming years
- There is no internal need for HEU bombs, there is a sufficient plutonium bomb arsenal. NK HEU is for sale...
- How much would Iran pay for a nuclear arsenal?
- Why did Iran and DPRK sign a Science & Technology Agreement on Sept 1, 2012 (ala 2002 S&T Agreement with Syria that led to Al Kibar?).

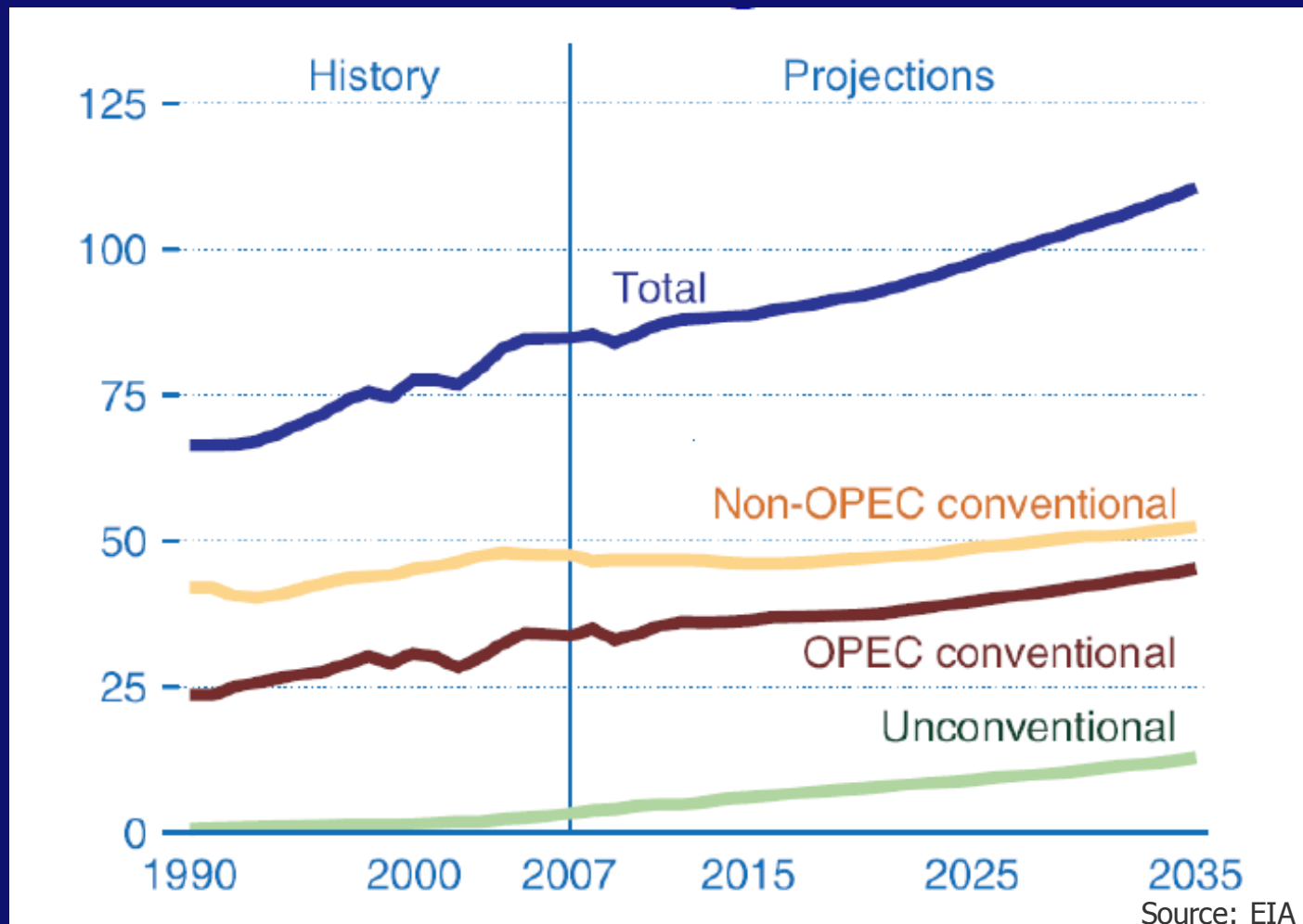




Flash Points: The New “Muddle East”

- Despite the promise of democratic reform, the “New Middle East” has gone from miracle to muddle in the last 36 months.
- ISIL is ascendant across Sunni-Caliphate.
- Iran/Hezbollah and Saudi/UAE are at WAR. Saudi using oil as a weapon – expect Iran (backed by Russia to fight back). Energy War?
- P5+1 with Iran is likely to trigger a nuclear arms race, not stop one!
- Further Middle East instability poses a major geo-strategic stability threat.
 - The world economy runs on Middle East oil and spiking gasoline prices—driven by ME instability—impact consumer confidence globally.
 - Middle East economies are broke, broken, or breaking down.
 - Potential for intra-state conflict over oil and water is growing.
 - Growing danger of trans-regional conflict.
 - Potential for breakdown/breakup of Syria, Iraq, and Libya is growing
 - The US broke the Middle East balance of power but isn’t “owning up”

Dependence on Middle East Oil Rising



Where the World Could End...

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- The US has propelled regime failure in the Middle East but is not actively supporting new regime construction for fear of being perceived as interventionist...
- We've created two major pockets of geo-political instability at central crossing points for rising powers in SW Asia and the Middle East and are retreating...Our pivot to Asia is perceived as more of a retreat to Asia.



Conclusions: History doesn't repeat itself, it just rhymes



- Asian economic disorder could turn into outright Asian financial and economic crisis without decisive reflation.
- China economic crisis is a Communist Party crisis (one that Lenin would recognize as the contradictions between Communist Capitalists and the people). China becoming more nationalist, mercantilist, and expansionist.
- Chances of China turning 114 step march into a turn back the time move against Taiwan and liberating Korean peninsula by 2017 rising...
- As a "policing power," the US in recline, potentially in decline.
- The world remains leveraged to Gulf oil and the Middle East is in the first stage of outright Sunni-Shia war that could eventually go nuclear.
- There are many endogenous reasons for the long economic growth and financial market cycle to be peaking out – an Asian economic and financial crisis followed by a major oil shock could cause much more rapid decline.
- A breakdown in the balance of power/ multi-polarity is not inherently benign
- Does a pre WWI-like downturn of an economic long cycle matter to the future of the world system or "is this time different?"
- A US-led globalization renaissance is possible (America's economy remains resilient and technologically dynamic) but would require an unprecedented political, economic, and cultural shift outward ala post-WWII.