# ‘Another cycle of crisis in the offing’

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Chief Reporter

In the second part of the interview, Med Jones discusses the global recession visiting again even as the world economies are recovering, the lessons the governments and investors should learn. Excerpts:

***Q. Is it true that a second and much bigger cycle of economic crisis is looming large again, even as global economies are recovering?***

A. The short answer is yes. I spoke about that in 2007. I am concerned about the US, the UK and the EU in general, a crisis in Spain would constitute a greater challenge for EU policy makers because the Spanish economy makes up 12 per cent of euro-area GDP, which is close to double of Greece, Ireland and Portugal combined.

In addition to debt and inflation, EU still has challenges with ageing and lower population growth. The ongoing costs of supporting an ageing population and the law of diminishing returns will cause more burdens on the EU.

There is a real risk that by the time the US economy recovers from this financial crisis, they will enter another crisis driven by the much less publicised social security, medicaid and medicare debt and the burden of ageing baby boomers along with unmanageable national debt, large consumer debt and a real risk for a currency crisis.

All policies remaining the same, there are two possible scenarios, either another sharp correction (crisis) with quick recovery or a prolonged stagnation similar to Japan's lost decade. The bailout and the misallocated stimulus funds, the continued deficit spending, and the ballooning of the real uncalculated debt-to-GDP ratio of about 700 per cent as opposed to the official debt number of 90 per cent, and that is not counting the individual states' debt, the increased direct and indirect taxes to fund bad economic and business policies could pose the greatest risk to the US economy.

The current GDP recovery is driven primarily by debt-funded spending rather than private sector productivity improvements and exports. The problem is that Government spending is more than 40 per cent of US GDP, so when the government spending slows down and they will slow down to try to balance the budget, the private sector and the economy will be impacted significantly. Unfortunately, what hits the US economy will impact the world and we could experience another crisis.

Countries that have high Debt-to-GDP ratios and follow the same US economic policies will be hurt the most. Japan and some EU countries in particular Italy, Spain, Portugal, Greece, Ireland, Latvia and other countries will feel the most pain. In Latin America, Mexico and Central America, countries are more vulnerable due to their strong dependency on US economy. Add to that the long-term demographic trend, over the next 50 years; the US labour force is projected to grow at a slower rate. As a result, there are concerns about future growth of the U.S. economy. Despite the ageing of the baby-boomers, the U.S. labour force is in a better position than most countries in Europe and East Asia, which are facing shrinking workforces in coming decades. Japan, for example, is projected to see a 6 per cent drop in its labour force by 2020.

International Institute of Management (IIM) President Med Jones.

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But it is not all bad news. On the upside, the factors that are in favour of the US economy include the private sector innovations bringing export revenues, attracting foreign investments to undervalued assets, lack of governance and transparency in emerging markets makes US a safer investment destination.

One of the main reasons the US has been able to prevent the currency and the economy from collapsing, despite the latest wars, bad economic policies and massive currency printing, is because the dollar is the de-facto standard for international trade and the largest international currency reserve.

Luckily this time, not many international politicians have the will to push hard for alternative international trade and reserve currency. The US is running on the goodwill of the previous decades, once the dollar is replaced with a basket of international currencies, the US economy could crash, especially if the government does not stop its debt spending or go back to healthy production-based growth and investments.

What scares is the rising level of stress and distrust in the relationships between US and other countries. Luckily the globalisation of the economic activities and trade made all us invested in each other, so we are unlikely to see drastic decisions that could result in a global economic disaster, any push and pull will be done gradually and hopefully diplomatically.

So in the short term there is little risk of another crisis, but the US leadership should not forget that global competition is growing. Manufacturing, services, knowledge and innovation leadership gap is diminishing.

In the long term the dollar will eventually be replaced as the international trade and investment currency. If they do not fix the national economic problems in the short term, we will all face a bigger crisis in the mid and longer terms.

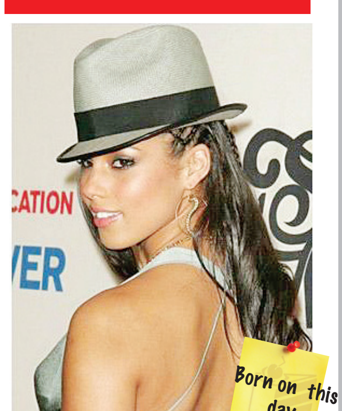
I know this sounds gloomy but I do not subscribe to the Prophets of Doom who are predicting socioeconomic collapse. I'm just being realistic about the risks and challenges, you asked me about the prospect of the crisis, but if you asked me about the prospects of recovery you will have a more upbeat answer. Make no mistake, US will recover, it is just the road to recovery is rocky with potential setbacks, and we have to pay for our mistakes like everyone else.

***Q. What progress have countries made in recovering from global crisis?***

Last year was of uneven global recovery. The good news is that global trade has recovered, and should continue to do so. The bad news is that the real estate, consumer credit problems, and sovereign debt in the world's largest economies have not been solved yet. About 22 countries, including several EU-member states requested IMF's help.

As expected, technically, the recession has ended in US and we saw modest GDP growth, however in my opinion, real recovery is measured with the growth of employment.

## QUOTE OF THE DAY!




**‘I would hate to make music and people love me for something that isn’t me.’**

**ALICIA KEYS, 1981**

# economic

The good news is that rate of unemployment has slowed down significantly, but it's a long way to recover to the previous levels before the crisis. My concern is that this growth was fuelled mainly by government debt spending, bailouts, banking accounting manipulations and massive money printing.

The price of such recovery will have to be paid in the coming years and with interest. Economies that had weak fundamentals with high budget, trade and investment deficits and high debt to GDP ratio will continue to struggle. The list includes US, Italy, Spain, Ireland, Iceland, Latvia, Dubai and others.

On the other hand, China, India, Australia, Brazil, and the GCC weathered the storm much better than US and Europe. The question for 2011 is how resilient is the recovery?

In general, I believe it is positive, but not without policy risks, that remains to be seen. There are more deflation risks in Europe and US and more inflation risks in emerging economies. In general, I see the world economy growing from US$62tn in 2010 to US$64tn in 2011.

However the distribution of that growth will remain uneven; the emerging economies, which represent about 30 per cent of the global GDP, will contribute 75 per cent of that growth. Oil exporting countries, China, India and most of Asian countries are set to experience strong domestic demand in 2011, driven by private consumption and infrastructure spending. I'm more optimistic about eastern economies and less optimistic about the West.

***Q. What lessons can the world learn from the global economic crisis?***

For the political leadership, the main lessons are:

Lack of regulation is as bad as over-regulation. Although I believe that Governments should not regulate free market choices, I believe they should regulate to protect investors against conflict of interest and negligence by investment bankers and advisors.

Short-term policy orientation to solving problems or growing the economy can have adverse effects in the long term with a huge price to pay.

Never forget the fundamentals, countries that quit producing real products, spend more than they produce, ignore education, burden their middle class with higher taxes, and continue to import millions from other countries that are willing to work harder for less, bail out failed businesses and reward bad behaviour instead of investing in good businesses, will eventually lose their leadership and wealth.

Countries that allow foreign lobbies, special interest groups and extreme nationalist movements to dominate their foreign policies will end up creating more enemies and wasting their valuable resources in defending their own security.

The global economic landscape is not like it was after World War II, at that time, the US had no real competition in rebuilding war-destroyed countries, with the new global knowledge and global competition, if you take your eye over the economic ball someone else will pick it up.

Globalisation of markets, competition, partnerships and risk management should carry far more weight in the designing of strategic national development plans.

***Q. What lessons can the investors learn from the global financial crisis?***

For the investors, the lessons are:

Be careful what advice you buy, even if it is for free, my advice included. I was in Geneva in 2009 giving a keynote speech to a group of the wealthiest families in the world along with their top investment advisors and bankers and many of them lost money not because they could not foresee the crisis but because they invested with fraudulent investment schemes like Bernard Madoff. Economists and financial analysts are not much better, most of them are academic professors or quantitative analysts, with little or no real-life business experience, and very few have strong knowledge of the business drivers and qualitative forces that drive investment and operational decisions.

Investment by imitation is not an investment strategy. So do not invest in an asset just because everyone else is doing so or because the largest investment bank has invested in it.

Informed investors can make money in any environment including recessions. More millionaires were made during the great depression in the US than any other time and more millionaires will be made globally because of this crisis than ever before. In my opinion, the markets now are full of undervalued assets that can make you rich; the trick is to know how to pick them.

Educate yourself before you invest, if you know something that others don't, you will make a lot of money.

I always tell my clients, success in the investment world is all about decision-making. If you are an investor or a CEO, do not invest in an asset, a project or a product line, if you are not sure that the information is complete and accurate.

Making the right investment decision requires a detailed set of information about macro and microeconomics conditions, markets, sectors, industries, companies, qualitative and quantitative analysis, fundamental and technical analysis, behavioural finance and risk management. The ability to distinguish between valid and invalid assumptions, more important vs. less important information, and to control the emotions of fear and greed during the ups and downs of markets is key to the success of the investor.