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Viewpoints
FROM CHAIRMAN JIM O'NEILL

Greece vs. Japan vs. China vs. the US?

This past week, the 6th in the year 2012, has displayed a slightly different character to the previous 5 weeks with the equity markets losing their strong upward momentum. There have been some understandable reasons for this, not the least of which is the never-ending saga of Greece, which I shall discuss a bit more below, and the related challenges about resurrecting a credible and permanent European Monetary Union (EMU) from this mess. Despite this, my main message is – once again – to please keep this in perspective. Greece's economy is somewhere between $300 to $350 bn. Last year alone, China's GDP increased by $1.4 trillion, to $7.3 trillion. I reckon that means China has created the economic equivalent of another ½ of Greece in the 6 weeks of 2012 to-date. It is also the case that the evidence about a self-sustaining recovery in the US continues to build after yet another decline in weekly job claims, a rather reliable indicator.

For all those of you with persistent bearish tendencies, which seems to include most inhabitants whose lives have been dominated by the bond markets, take another look at Japan, where things seem to be getting more and more intriguing.

Greece and EMU.

For much of this week, markets have been glued to screens and TVs waiting to hear the latest news about who said what on Greek debt restructuring and their economic policies. As I remarked above and on many occasions, the world economic relevance of this is close to non-existent. What is relevant is both the precedent it may set for other so-called developed nations for debt restructuring as well as the future of the EMU. I don't want to devote this Viewpoint to this extremely important issue, but will offer a couple of brief thoughts.

Firstly, in terms of precedent, for me, the Greek rescheduling is ultimately relevant for what constitutes a benchmark in financial bond markets. So, of course, it is really important for the future structure of the EMU. But it is probably more important for all major bond markets, especially given the reality that the fiscal deficits and debt of the UK, US and Japan are much worse than the average of the Euro Area. As I shall return to below, this is especially important for Japan.

Secondly, with respect to the EMU, there is a most interesting article by Quentin Peel in Friday's FT in which he explores the mind of German Chancellor Merkel and the long term game plan. It is an important read. It essentially argues that she has decided to try and push for not just more fiscal union, but also political union. This will be a road full of potholes and remarkable challenges, but it is what I feel is the most likely path. The notion that the EMU will end because of Greek's immense challenges is not one that I think should be given too much attention.

Some Fresh Softer Data.

One additional complication for us all is that, after weeks of positive data surprises, some of it turned more mixed this last week outside of the US. China's January CPI , while dismissible partly due to seasonal issues, came in higher at an awkward 4.5 pct year-on-year, and if it doesn't fall sharply in February, that would give me pause to reflect, and probably others. At the other end of the spectrum, M2 money supply was softer than expected, which along with a weak PPI, suggests underlying inflationary pressures are weakening.

A number of Asian countries reported somewhat disappointing export data for January, which is obviously not a great sign (although it is not impossible that some of them, especially China and Japan, are losing competitiveness).

After Germany showed weeks of positive signs, especially for January, the waters were muddied in this past week with the release of the December data. On top of disappointing orders data and surprisingly soft industrial production numbers, the final export data for the year showed quite a bit of weakness for the month. Given that the usually reliable surveys for January were so good, as well as another reported decline in unemployment, it is tempting to dismiss these numbers as backward looking, but it also gives me pause to reflect a little.

What the final export data does still not reveal is the extent of the importance of the so-called BRIC markets for Germany. But, checking in with Goldman Sachs' Dirk Schumacher, he tells me that in the 3 months since November, the combined BRIC share is about 11.5 pct, higher than that of France, the single largest national market at 9 pct. China was itself around 6 pct, still just behind the Netherlands, the UK and the US, but it will soon leave these guys behind.

China Continues to Be the Real Key to Life.

As I mentioned earlier, in the 6 weeks of 2012 so far, China will have created the equivalent of ½ another Greece. Lots of fascinating anecdotes coming across my desk/inbox as usual. Some people sent me the FT story, which declared that Beijing office space has become more expensive than New York, according to Cushman and Wakefield, now $130 per square foot compared to $120. This is indeed interesting. But what was even more so, is that the comparable number in London is $239. Which should we worry about more?

Speaking of which, the China Daily appears to have embarked on a major sales pitch around the world. According to some, they were being given out for free at the Liverpool Street station in London this week, which given they had an interview with yours truly; I was rather impressed about that. I was also sent an email picture showing that it was also being handed out in Washington DC. Now quite why the China Daily, in English, is set to be so appealing to such audiences is quite a topic for discussion, but the very fact they are pursuing it, is also interesting.

Then to top it off, I was sent a most interesting article in *China Briefing* from January 27 that includes a breakdown of China's 2011 GDP by province this week, all collective $7.3 trillion of it. As part of it, there is a really cool map that shows in great clarity how the strongest growth rates are moving westward and north. But what intrigued me the most was just the sheer scale of some of these places. I counted 10 that have bigger economies than Greece, 4 of which are more than double Greece, three of which are big enough to individually register in the top 20 economies of the world – Guangdong, Shandong and Jiangsu. Four provinces now have GDP per capita above $10,000, based on the official data. I suspect in reality, it is many more. Take a look for yourself at the link below:

http://www.china-briefing.com/news/2012/01/27/chinas-provincial-gdp-figures-in-2011.html

Japan Challenges Rising. Has the Moment Arrived?

I have found myself wondering more and more this week whether we should drag a few aging macro (and non macro) hedge fund guys back on to the scene, as the scenario when many of them lost fortunes in back in the 1990's and Noughties seems to be more and more coming to the fore. You all know about the debt/GDP ratio of 220 pct, the declining household savings ratio to close to zero (while the overall national savings rate is higher, as a result of the household rate, it is declining), the trade balance moved into deficit in 2011, the current account surplus was the smallest in over 10 years, and of course, 10-year JGBs yield less than 1 pct, and the Yen trades at $77.65 and EUR 102.45. What you might not know if you are not an equities specialist or read the Nikkei Weekly, is the following that I picked up from a quick scan of my copy; "With Sony mired in confusion, Stringer passes baton to Hirai", "Changing Market Conditions forcing Japan carmakers to shed old strategies", "TV manufacturers scurrying to reprogram themselves, and then in Friday's FT, "Revitalisation of industry shoots up the political agenda".

Why is any of this now especially relevant? It may not be. But it may. Greece being "resolved" one way or another will either cause the bears to search elsewhere or make people focus on countries with impossible debt burdens. Japan is one of those. At a minimum, it seems to me that the days of Japan's "happy depression" are coming to an end, and an era of some sort of "creative destruction or destructive creativism" is coming. It will probably mean a much weaker Yen, higher JGB yields, and if they can get away with it, perhaps stronger equities.

The US Still Showing Better Signs.

In contrast to other parts of the world, the US has continued to report encouraging signs, although even here, this week it wasn't uniform. Amongst the most encouraging parts, following on from the better-than-expected January payrolls, the latest weekly job claims declined further. The possibility of a reinforcing circular turn in the economy and employment is rising in my view. That is without getting too carried away with things afoot in the housing markets. This past week, Tom Teles and his colleagues have published an extremely interesting paper on a possible turn in the housing market, which is something I have felt is coming. This could be a source of major consensus underestimation for the US economy in the months and quarters ahead and trends here need to be watched really closely.

Chance for Those Awaiting a Pull Back to Start Investing?

While the immediate Greek issues will dominate financial market headlines over the weekend and early next week and give the bears all the ammunition they have been searching for these past few weeks, more objective participants should be thinking about using this set back to take a more objective stance. Unless the fall out of the Greek debt restructuring results in some fresh challenges for Italy and Spain, I remain unexcited about it.

In contrast to this, I do remain excited about a certain football match this weekend, and our chances of getting revenge on “them”. Have a good one.

There will be no Viewpoint next week.

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