
A Crystal Ball for 2012; A European View

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There is a long tradition that editors ask correspondents and colleagues to write a 'Crystal Ball' year-end piece – which requires either a brave soul or charlatan to accept. It's probably a recipe for disaster; readers might look at it and forget it – but the editor will remind you at year end just how irrelevant and inaccurate were your predictions – and ask you to write another which will hopefully be better than last year. .

I won't use any numbers. Numbers provide an opportunity to stop thinking about the wider context and just disagree with those numbers – as often as not because they are based on different assumptions to the ones you recognise.

This is a crystal ball from a European viewpoint. For the analytical among our readers, it might be interesting to compare it with views from North America.

The Euro; An Ongoing Saga

First – an examination of amalgam of politics and economics but especially the Eurozone.

I'm writing these notes at Christmas 2011 shortly after the 'Cameron Summit Veto' at a meeting of the 27 members of the European Union. – Basically the UK has no intention of paying significant sums to prop up an as yet unwritten recovery and long term sustainable survival plan for the euro. The UK is not a member of the single currency and short/medium term has no intention of joining.

Indeed, there is a strong feeling that Britain might well be better outside the EU altogether....but that is another story.

When invented the euro was 'a good idea at the time'. Many would claim it was created on a bed of sand as a fair-weather currency, and like many a club when it starts up, recruits members which, once established, are sometimes not of the quality it wants.

The Eurozone, countries which use the currency, has two distinct sets of members. The financially sophisticated and economically disciplined states of northern Europe – Germany, Finland, Sweden, Netherlands for example – and the Mediterranean states – Greece, Italy, Portugal and Spain which take a somewhat different attitude to balanced budgets.

Through lack of clarity, leadership and strong discipline, the Eurozone has allowed less financially diligent members to borrow way beyond their economically viable limits. Those debts are becoming prohibitively expensive

to service and, without significant economic growth there is a risk of default on sovereign debt as interest rates rise against the ballooning debt.

Without significant economic growth paying back those debts will be impossible and the recalcitrant states hope, miraculously, that Germany will bail them out.

The weak euro has been beneficial for German exports as the malpractices of other governments has held down its value. However, always in the back of the German psyche is the unspoken fear of hyperinflation re-emerging and destroying its strong economy.

When I began my career in the motor industry, I had a German colleague who, if we started talking unsustainable economics, would carefully take out of his wallet a fading sepia photograph of his father pushing a wheelbarrow piled high with currency. It was, we were reminded, enough to buy a loaf of bread that day – but not the following day.

Chancellor Merkel has an election to fight in 2012 and has to listen to her coalition partners and to an increasingly frustrated conservative electorate.

President Sarkozy too is running for re-election later in the year. His popularity is low at present and he appears to be trying to blame the United Kingdom at least in part for the Eurozone's ills. Some British eurosceptics with a sense of history might claim he still has Napoleon's work to complete. Pragmatists suggest he wants to replace the City of London with Paris as the European financial capital – but that is a secondary issue at present.

At the centre of the Eurozone crisis is the need for individual states to balance their budgets, install, monitor and manage economically acceptable budgets. 'A balanced budget' is a phrase not taken kindly to in some Mediterranean states and the necessary tax hikes, reductions in government and municipal services – and the very act of collecting taxes – is sufficient to bring protesters, particularly from the public sector, onto the streets.

The markets, the shadowy global lenders are concerned that neither the Keynesians nor the Hayekians have yet offered a viable route to recovery. The prize for getting the wrong solution is probably economic depression in Europe with contagion across much of the world.

Inward facing politicians still have to learn to separate two issues – the euro and credit, the self inflicted wound on the one hand – and control of global finance markets on the other.

The risk is that economically illiterate or idealistic politicians will try to fight two issues at once rather than resolving the currency issue first. Two nations – Greece and Italy have unelected governments and Spain has just elected a new administration set on an austerity policy

A fudge is no longer acceptable. Any significant economic problems could be catastrophic for the rest of the world.

So much for a highly simplified examination of the Eurozone saga. The implications for 2012 will be a huge amount of political pressure being brought to stabilise and then resolve the situation. That will mean some form of realistic treaty in first quarter, further austerity measures and slow economic growth but even that may be focused a few states.

The euro exchange rate is suffering.

The United Kingdom has its own austerity programme in place and working and the AAA sovereign debt rating holds.

Western Europe, in 2012 and beyond with the possible exception of Germany, can expect an austere medium term future.

From Russia with Love?

An equally challenging 2012 election scenario is the 'planned re-election of Premier Putin for another term as President'. December has seen more 'unapproved anti Putin demonstrations' than seen in Russia since the last revolution. A Russian contact summed it up 'Putin has overstepped accepted Dumas election rigging this time'. While Putin will 'win' the election – his real test will come in how he deals with the newly empowered, emboldened and challenging electorate.

To a politician in what has been an absolutist system there may be a huge challenge in having to manage an economy when other peoples' opinions have to be taken into account. Will the present apparatchiks be able to stomach this new form of government? The results of this election could have unintended consequences for a decade.

A lot of promises have been made regarding a better future but Putin's promises are closely tied to the price of oil staying at \$110 per barrel or more.

Mother Russia and its predecessors have been through many rounds of quasi-democracy and revolution, but each time Russia has moved back to a central unelected autocracy or dictatorship. The unknown this time is the influence of globalisation and global communications. Russians are travelling internationally – and returning home. Equally, they have access to global communications and languages. Will these changes lead to other long term change?

The US Enigma

To the Europe based commentator the United States, is already close to a state of 'international policy lockdown' until the presidential election is over, a new president installed with the associated aftermath of changing the administration.

Given what appear in Europe to be some of the extreme views of opposition candidates and the apparent impossibility of achieving a compromise – ‘anything could be possible with regard to federal government, economic policy – or defence’. The loss of AAA credit rating sends a message to the rest of the world.

What will be the impact of the end of the Iraq war and the rapid rundown in Afghanistan? What will be the impact on the economy?

Just how fast will the US economy recover – and in what direction? Agriculture is doing well with exports to China but for how long? The automotive industry is busy replacing rust buckets – but the mortgage market is still apparently depressed. Will the rapid development of shale oil lead to energy self sufficiency in North America – but will it be moderated by the nascent agreement on global warming.

China – Behind the Forbidden City?

A further political scenario must be watched in 2012. There are important elections towards the end of 2012 in China at which the next generation of party officials will be rubber stamped into office. What will be their global policies? A growing number of officials’ children are being educated in the west – and those children are often being moved into career appointments – what might be the future impact?

But there are issues closer to home.

China is currently facing a rising wave of social unrest. In 2011 there were about 120,000 incidents of social unrest, many of them very minor but they are becoming more serious highlighting increasing job losses, wages and work conditions with well supported campaigns against political corruption and land appropriation as well as climatic degradation.

China’s real estate sector, which represents about 10% of GDP is arguably the most important single industry in the world because of its consumption of steel, copper and household materials, is wavering. Post 2008 credit expansion was of enormous benefit to the sector. The ratio of credit to GDP jumped from 120% to almost 170%.

Since 2010 China has been trying to put the credit genie back in the bottle. In turn there has been a drop in property transactions and prices. Deja vu elsewhere would suggest escalating property prices fuel growth. For the third successive month there have been falls in average property prices; in some Chinese cities prices have fallen by as much as 30% while elsewhere there are up to two years of unsold inventory.

The sound of liquidity evaporating from the property sector is an all too familiar issue in the west.

Additionally local authorities are running into problems as a result of loan repayment problems from their last burst of expansion and anticipated land sales not materialising.

The Chinese policy would appear to be heading back towards one of self sufficiency even if that means buying up vast tracts of agricultural land elsewhere in the world to go with its huge investments in raw materials.

Recent announcements regarding the discovery of shale oil deposits could ease one of China's biggest concerns and could change the whole balance of energy politics.

North Korea – A new issue

The death of the Great Leader and his replacement by a 29ish year old virtually unknown and untested Great Successor may suggest 2012 could be a period of instability in the nuclear arms in North Korea.

It may take a few months for the situation to resolve itself but, like Iran, its a problem that demands urgent resolution.

Is the Arab Spring a Flash in the Pan?

The Arab Spring will continue to impact on global industry. While the most dramatic changes have been along the Mediterranean littoral, absolutist governments have been replaced by a mishmash of Islamic groups which may, or may not be fundamentalist.

Always the problem with the overthrow, whether internal or external, of a one party state is that one is never sure who or what will come to power.

The Arab Spring is now the Arab Winter and it will be interesting to see what emerges over the next 12-18 months. There are no real signs of new regimes and thinking coming to the fore.

Iran, Persian not Arab, is a simmering problem which has been left too long unresolved. Some form of resolution of issues between Iran and the West is necessary sooner rather than later.

President Ahmadinejad claims he is creating nuclear energy not weapons. Others would disagree. Iran is currently isolated. The current writer has been there a number of times over recent years and found the people to be delightful but the degree of isolation comes when older people to whom I have been lecturing say 'Prof – please speak proper English – we don't understand this modern stuff'.

With Ahmadinejad threatening to blockade the Straits of Hormuz and stop oil passing through the price per barrel would certainly rise – and what might that do to global economic recovery? Remember, the Straits are barely twenty

miles wide with four miles of designated navigation channels. Some 40% of the world's oil passes through the Straits.

And Climate Politics?

The as yet relatively unreported and analysed positive outcome of the Durban conference on climate change should lead to a new treaty by 2020 – with further global development to follow. The challenge will be whether the fine words can be turned into a viable and implementable programme to reduce greenhouse gases can be implemented. Just how far will the intentions be diluted? Canada has already opted out of the Kyoto agreement.

Elsewhere investment is moving east not only into China and India but the surrounding countries, Industries like mining and energy are needed long term to support those growing economies. 2012 will see such patterns continuing and a new opportunity is appearing over the horizon at least in China – shale gas. If the recently announced finds in China are all they are cracked up to be, global energy demand patterns could be drastically reshaped.

The Global Automotive Industry

And the automotive industries? One has to think 'electric' even if small volumes. The key issue is perhaps not manufacturing investment but the commercial and technical deals being forged to produce low cost high capacity environmentally friendly batteries. No pressure then.

A further prediction is that the global automotive industry is just starting to think seriously about 'total mobility'. The role of the car in the continuum of transport alternatives is starting to come under scrutiny – how does the car fit in – how will the smartphone link the car to other methods of transport? Is the future role of the OEM to provide vehicle and finance with which to acquire it? 2012 could well see some radical thinking starting to emerge.

Elsewhere, 2012 is likely to see a migrating industry away from the mature markets to the new and developing opportunities of Russia, Asia and Brazil. There may also, in those markets, be investment in used car activities. An efficient mechanism is necessary to be able to release the equity in the current vehicle before a new one can be bought.

For the last decade the Chinese auto market has been hailed as the saviour of the global motor industry. GM sells more cars in China than in its home market. Could the boot now be about to change to the other foot?

Geely, the giant Chinese motor manufacturer which, among other companies, owns Volvo cars, is planning to start exporting to cars to Western Europe in 2012. In the case of the United Kingdom for example, the mid size Emgrand EC7 is expected to undercut the highly popular Czech built Skoda Octavia by some \$3000 – about 10-15%. Geely will not be the only player looking to export to the west – Great Wall could be here first.

From an economic strategy, from a global viewpoint, Chinese car exports could well set a completely new global pricing model in the industry.

2012-12 could well see a paradigm shift in the balance of the global automotive industry in the same way that first Japanese motor manufacturers started with economy cars and then spread out from their bridgehead, followed a decade or so later by the Koreans – and now the Chinese?

Some of us of a certain age will remember the phrase ‘cheap Japanese products’. That was followed by the Koreans – what next?

Some Conclusions

Predictions always need to be hedged. A long dead country doctor of my acquaintance had a sure winner before babies sexes could be determined before birth. ‘Simple – you write one sex in the medical notes and tell the would-be parents the opposite. You have a 50;50 chance of being right. If they complain that you were wrong, you show them the notes and claim they must have misheard you. If you were right they will praise you.’

Happy New Year.