



GlobalEurope Anticipation Bulletin Nr 35

“To anticipate is to foresee in order to act”

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May 16, 2009

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1- Perspective

Global systemic crisis: June 2009 - When the world steps out of a sixty-year old referential framework

The financial surrealism which has been at the heart of stock market trends, financial indicators and political commentaries in the past two months, is in fact the swan song of the referential framework within which the world has lived since 1945.

Just as in January 2007, the 11th edition of the GEAB described that the turn of the year 2006/07 was wrapped in a « statistical fog » typical of an entry into recession and designed to raise doubts among passengers that the Titanic was really sinking¹, our team today believes that the end of Spring 2009 is characterized by the world's final stepping out of the referential framework used for sixty years by global economic, financial and political players in making their decisions, in particular of its "simplified" version massively used since the fall of the communist bloc in 1989 (when the referential framework became exclusively US-centric). In practical terms, this means that the indicators that everyone is accustomed to use for investment decisions, profitability, location, partnership, etc ... have become obsolete and that it is now necessary to find new relevant indicators to avoid making disastrous decisions.

This process of obsolescence has increased dramatically over the past few months under pressure from two trends:

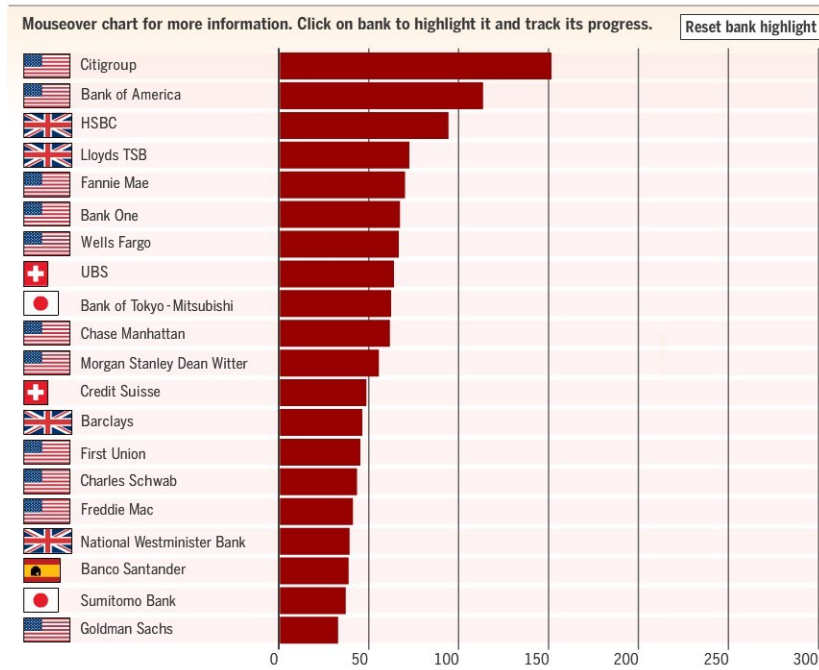
. first, the desperate attempts to rescue the global financial system, particularly the American and British systems, have de facto "broken navigational instruments" as a result of all the manipulation exerted by financial institutions themselves and by concerned governments and central banks. Among those panic-stricken and panic-striking indicators, stock markets are a perfect case as we shall see in further detail in this issue of the GEAB. Meanwhile, the two charts below brilliantly illustrate how these desperate efforts failed to prevent the world's bank ranking from experiencing a major seism (it is mostly in 2007 that the end of the American-British domination in this ranking was triggered).

. secondly, astronomical amounts of liquidity injected in one year into the global financial system, particularly in the U.S. financial system, led all financial and political players to a total loss of touch with reality. Indeed, at this stage, they all seem to suffer from a syndrome of diver's nitrogen narcosis – impairing those affected and leading them to dive deeper instead of surfacing. Financial nitrogen narcosis has the same effects than its aquatic counterpart.

Destroyed or perverted sensors, loss of orientation among political and financial leaders, these are the two key factors that accelerate the international system's stepping out of the referential framework of the past few decades.

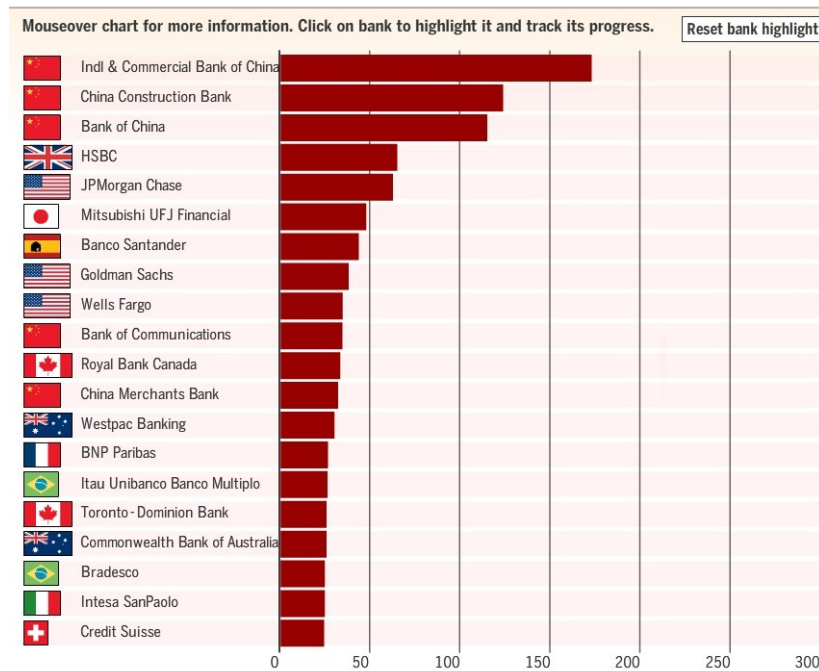
¹ At that time, our team added « *Just like always when change occurs, the passage by zero is characterized by a «fog of statistics» where indicators point in opposite directions and measurements provide contradictory results, with margins of error sometimes wider than the measurement itself. Regarding our planet in 2007, the on-going wreck is that of the US, that LEAP/E2020 has decided to call the « Very Great Depression », firstly because the « Great Depression » already refers to the 1929 crisis and the years after; and secondly because, according to our researchers, the nature and scope of the upcoming events are very different ».* Source: [GEAB N°11](#), 01/15/2007

Top 20 financial institutions by market capitalisation, \$bn, 1999 - 2009



Top 20 financial institutions by market capitalization in 1999 (USD billions) - Source: Financial Times, 05/2009

Top 20 financial institutions by market capitalisation, \$bn, 1999 - 2009



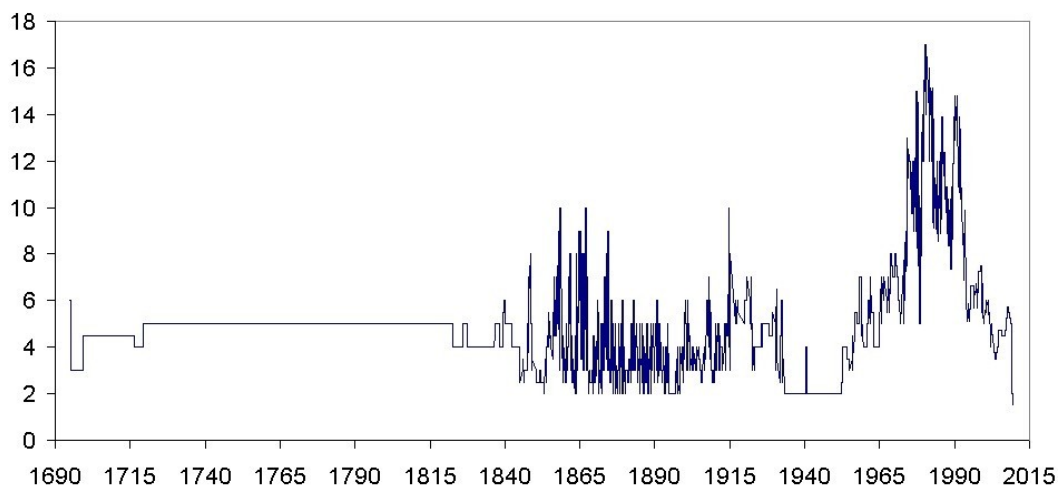
Top 20 financial institutions by market capitalization in 2009 (USD billions) - Source: Financial Times, 05/2009

Of course, it is a feature of any systemic crisis and easy to establish that, in the international system we are used to, a growing number of events or trends have started popping out of this century-old framework, demonstrating how this crisis is of a kind unique in modern history. The only way to measure the magnitude of the changes under way is to step back several centuries. Examining statistical data gathered over the last few decades only enables one to see the details of this global systemic crisis; not the overall view.

Here are three examples showing that we live in a time of change that occurs only once every two or three centuries:

1. In 2009, the [Bank of England](#) official interest rate has reached its lowest level (0.5 percent) since the creation of this venerable institution, i.e. since 1694 (in 315 years).

Bank of England official interest rate 1694-2009



Bank of England official interest rate since its creation in 1694 - Source: Bank of England, 05/2009

2. In 2008, the [Caisse des Dépôts et Consignations](#), the French government's financial arm since 1816 under all France's successive regimes (kingdom, empire, republic...), experienced its first yearly loss ever (in 193 years)².

3. In April 2009, China became Brazil's leading trade partner, an event which has always announced major changes in global leadership. This is only the second time that this has happened since the UK put an end to three centuries of Portuguese hegemony two hundred years ago. The US then supplanted UK as Brazil's leading trade partner at the beginning of the 1930s³.

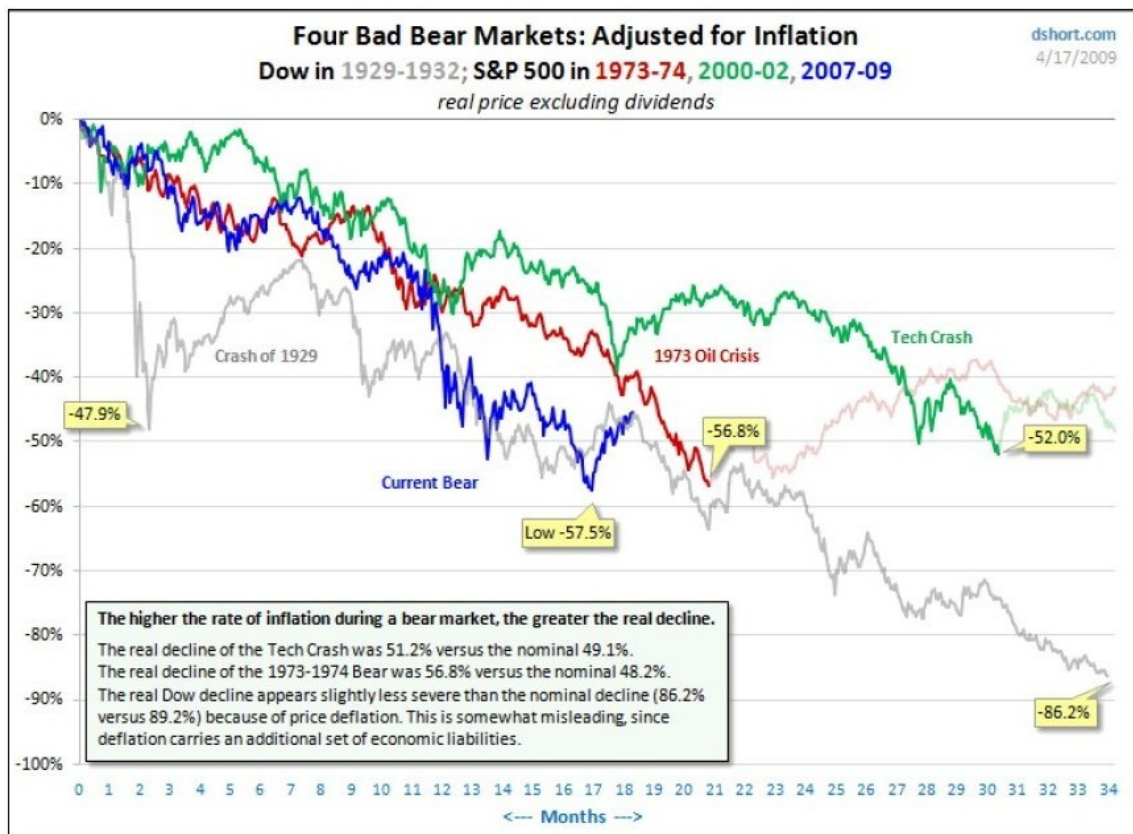
It is not worth reviewing the many specifically US trends popping out of the national referential framework compared to the past century (there is no relevant referential framework older than that in the US): loss in value of the Dollar, public deficits, cumulated public debt, cumulated trade deficits, real estate market collapse, losses of financial institutions...⁴

² Source: [France24](#), 04/16/2009

³ Source: [TheLatinAmericanist](#), 05/06/2009

⁴ Political leaders and experts insist on comparing the current crisis to the 1929 crisis, as if the latter were a binding reference. However, in the US in particular, current trends in many fields have moved beyond the events which characterized the « Great Depression ». LEAP/E2020 already reminded in [GEAB N°31](#) that relevant references were to be found in the 1873-1896 global crisis, i.e. more than a century back.

But of course, in the country at the heart of the global systemic crisis, examples of this kind are numerous and they have already been widely discussed in the various issues of the GEAB since 2006. In fact, it is the number of countries and areas concerned, which is symptomatic of the world's stepping out of the current referential framework. If there was only one country or one sector affected, it would simply indicate that this country/sector is going through an unusual time; but today, many countries, at the heart of the international system, and a multitude of economic and financial sectors are being simultaneously affected by this move away from a "century-old road".



Stock market trends – adjusted for inflation – during the last four major economic crises (grey: 1929, red: 1973, green: 2000, and blue: current crisis) - *Source: Dshort/Commerzbank, 17/04/2009*

Thus, to conclude this historical perspective, we want to emphasize that the stepping out of the century-old reference system is graphically visible in the form of a curve simply popping out of the frame which allowed ongoing trends and values to be represented for centuries. This popping out of traditional referential frameworks is speeding up, affecting increasing numbers of sectors and countries, enhancing the loss of meaning of indicators used daily or monthly by stock markets, governments, or official sources of statistics, and accelerating the widespread awareness that "the usual indicators" can no longer give any insight, or even represent the current world developments. The world will thus reach summer 2009 without any reliable references available.

Of course, everyone is free to think that a few points' monthly variation of a particular economic or financial indicator, itself largely affected by the multiple interventions of public authorities and banks, carries much more value on the evolution of the current crisis than those stepping out of century-old referential frameworks. Everyone is also free to believe that those who anticipated neither the crisis nor its intensity are now in a position to know the precise date when it will end.

Our team advises them to go see (or see again) the movie Matrix⁵ and to think about the consequences of manipulating the sensors and indicators of one's perception of given environment. Indeed, as we will examine in detail in our special summer 2009 GEAB (N°36), the coming months could be entitled « Crisis Reloaded⁶».

In this 35th issue of the GEAB, we also express our advice on which indicators, in this period of transition between two referential frameworks, are able to provide dependable information on the evolution of the crisis and the economic and financial environment.

The two other major themes addressed in this May 2009 issue of the GEAB are, first, the programmed failure of the two major economic stimulus plans: namely the Chinese and American plans, and, secondly, the United Kingdom's appeal to the IMF for financial assistance by the end of summer 2009.

In terms of recommendations, in this issue, our team anticipates the evolution of the worlds' largest real estate and treasuries markets.

⁵ In the [Matrix](#) series of movies, reality perceived by humans is created by computers. They think they live a comfortable life when in fact they live in squalor, but all their senses (sight, hearing, taste, touch, smell) are manipulated.

⁶The title of the second in this series of movies: « Matrix reloaded ».

2- Telescope

Programmed failure of US and Chinese economic stimulus plans: The “absorption capacity barrier”

Despite impressive budgets, the two largest economic stimulus plans to date - those initiated by the governments of the United States and the People's Republic of China - are doomed to fail or at best to slightly soften the worst consequences of the current crisis. Beyond the very different characteristics of these two plans and economies, LEAP/E2020 anticipates that, in the next few months, their implementation will face an insurmountable obstacle in the short term, the “absorption capacity barrier”.

It a constraint that the European Union is familiar with, as it repeatedly faced it in the past twenty years, as a result of the increase of structural funds and the various enlargements. As in crossing the « sound barrier » in aviation, circumventing this obstacle requires the development of completely new procedures and methodologies whose implementation take many years. The European experience has shown that it takes time, lots of time in fact, to effectively spend hundreds of billions of Euros, Dollars or Yuans. But in the U.S. and Chinese cases, it is precisely the time that is lacking, thus ensuring that the economic stimulus plans will drift to two deadlock situations well-know to EU member States, i.e. waste and corruption on the one hand, unused funds on the other. In both cases the impact on growth will be null or even negative.

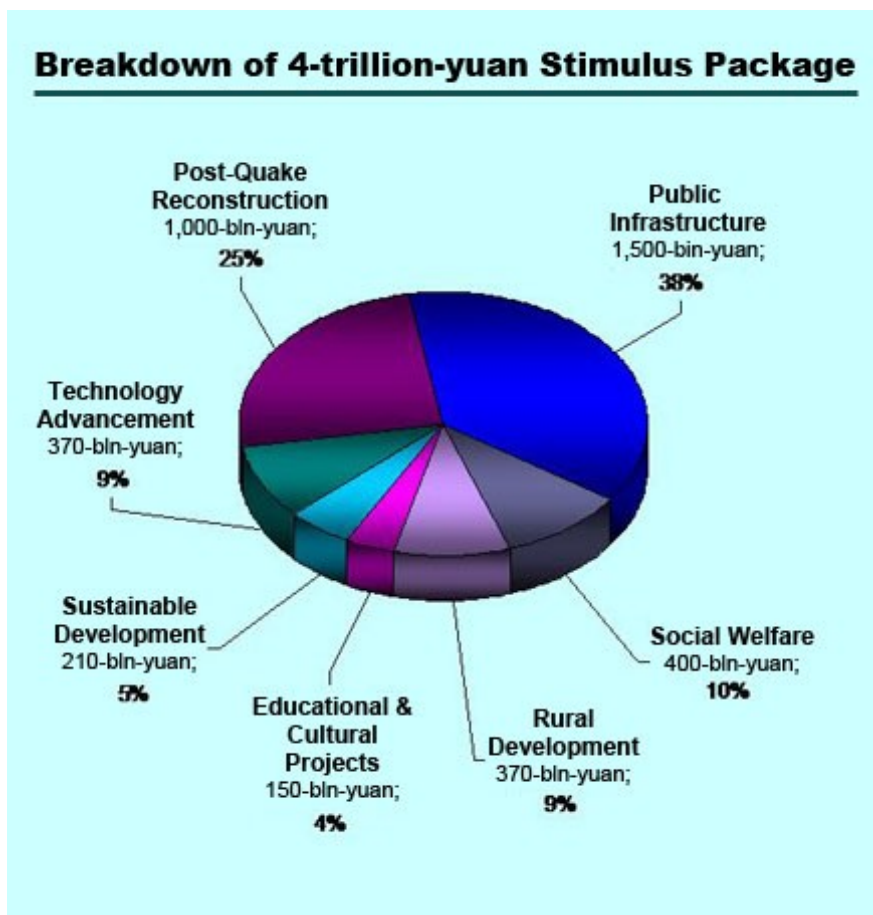
Chart 3: Debt and Other Key Data for the US Economy

Data Point	1Q 1982	Now
Credit Market Data		
Credit Market Debt As % Of GDP	172%	370%
Federal Debt As % Of GDP	27	45
Household Debt As % Of GDP	47	96
Financial Sector Debt As % Of GDP	22	117
Federal Deficit As % Of GDP	3.2	14.3
Household Character		
Household Debt Service Ratio	10.7%	13.9%
Mortgage Debt As % Of GDP	31	73
Mortgage Debt As % Of Disposable Personal Income	43	98
Household Liquidity As % Of Liabilities	145	81
Equities As % Of Household Net Worth	8.1	17.0

Source: www.contraryinvestor.com

Comparative evolution of major key data for the US economy between 1982 and 2009 - Source: *ContraryInvestor, 05/2009*

Before anticipating further the evolution of Washington’s and Beijing’s plans, LEAP/E2020’s team finds useful to review some European teachings as regards subsidies absorption capacity. As indeed, it is thanks to the European programmes, [structural funds](#) in the first place, then the [PHARE](#) programme and enlargement-related funds, that EU leaders and budget authorities discovered at the beginning of the 1990s the existence of this barrier related to a country’s capacity to absorb aids allocated to its economic development⁷. If this awareness also rose in the framework of development aid programmes, it is within the EU that it was possible to realize that even rich and developed countries could prove incapable of using allocated funds⁸. In the two concerned cases, US and China, it is this aspect that we deem relevant⁹.



Breakdown of Chinese stimulus package - Source: *Economic Observer Online*

⁷There is a vast European literature on this subject. Among many other studies, one published by the [University of Munich](#) on 10/01/2009 is particularly instructive.

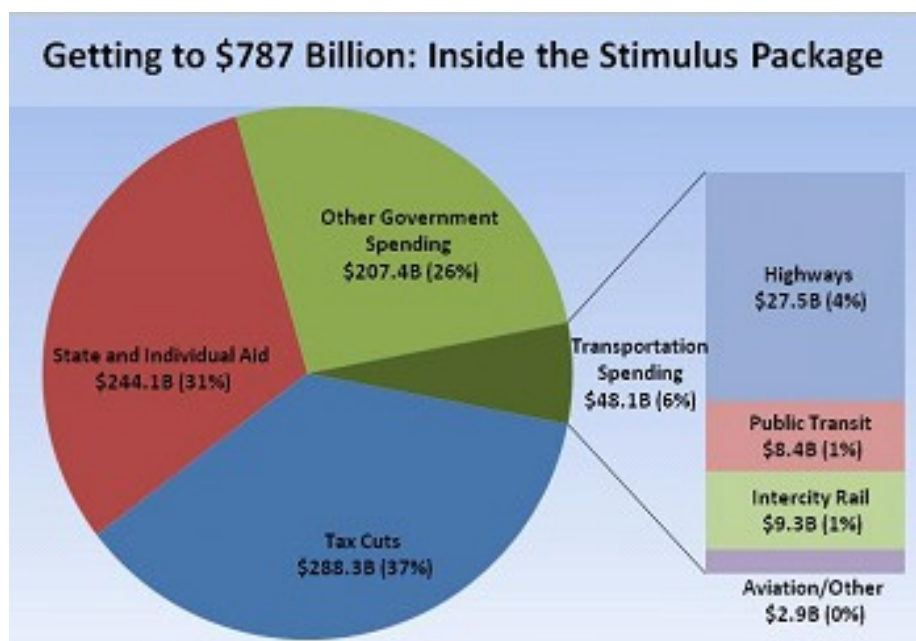
⁸ Even the very rich and developed Luxembourg, though it is packed with investment bankers and financial experts of all sorts, cannot make use of the small amount of European funds it is entitled to. Source: [Europaforum.lu](#), 07/02/2008. Furthermore, according to figures published in February 2009 by the European Commission regarding the use of the four Structural Funds (ERDF, ESF, EAGGF, fishing) over the 2000-2006 period, it appears that even good students like Spain can only spend 87% of the funds (despite more than twenty years of experience), and a founding member of the EU such as Italy stands at 85%. Poland, the largest of the EU’s new member states, only manages to absorb 76 percent of the available funds. Finland, Austria and Germany are in the lead with 95 percent. If we look at the Cohesion Fund, an instrument specifically designed for new member states and the main donor for large infrastructure projects, similar in this aspect with the American and Chinese stimulus plans, we observe that it presents the lowest absorption rate of all EU funding programmes, with an average of 65 percent only of the available money being used. In the case of this specific fund, Spain falls down to 75 percent and Poland to 52 percent. Only a few small member states manage to display good absorption rates, like Ireland with 80 percent, followed by Malta (80 percent) and Estonia (75 percent). The limited size of their infrastructure projects probably partly explains these results... not a very good omen for the absorption capacity of the large states and regions of the US and China. Therefore, a figure of 30% of non-absorption of their stimulus packages is very conservative.

⁹ Ironically, it is partly these unused European funds which provide for the small economic stimulus plan initiated by the EU. Source: [SecteurPublic](#), 01/30/2009

Budget amounts covered by the U.S. and Chinese plans are about three times higher than the European funds facing the absorption capacity barrier. Indeed, the American and Chinese stimulus plans are endowed with USD 785-billion and YUAN 4,000 billion, or EUR 577-billion and EUR 430-billion each in 2009-10. USD 288-billion of tax-reduction related to Obama’s plan must be withdrawn to get the exact amount of money distributed by US administrations and agencies, i.e. EUR 365-billion. On a yearly basis, the available amounts correspond to EUR 182-billion for Washington and EUR 215-billion for Beijing.

By way of comparison, EU member states today receive a European co-financing for an amount of EUR 347-billion allocated on the Structural Fund over 2007-2013, i.e. around EUR 70-billion per year. Therefore it appears that the stimulus plans initiated by US and Chinese leaders require a capacity of absorption even higher than in the case of the European funds in the past twenty years¹⁰.

In terms of economic profile, we can consider that the diversity of situations and economic structures of EU countries provides a relevant sample for comparison with the diversity of American and Chinese situations. Like the EU, these two political entities have very large provinces or states whose GDP per capita varies greatly, whose population size and economic weight are very different and whose administrative, technological and economic infrastructures are also very different¹¹.



Breakdown of US stimulus plan - Source: EconomyLeague

We can highlight two major differences, however, that are relevant in terms of public aid. Broadly speaking, in the United States, the states’ administrative infrastructure is rather low, while in China, public administration at all levels is rather well developed. EU Member States are generally midway between these two extremes.

¹⁰ In the case of China, we can consider that the new budget is nothing but a small extension of the public funding already at the center of China's growth in recent years... which paradoxically makes it rather inefficient for opposite reasons to the US plan, as we will see further.

¹¹ And problems too ! For instance, in the United States, the richest state is on the verge of a bankruptcy, announced for July 2009 by Californian Legislature’s chief budget analyst. Source: [Los Angeles Times](#), 05/07/2009

However, several decades of European experience of major public programmes of regional and national economic development aid, have shown that if EU member states' pace and capacity of absorption vary from country to country, the main difficulties to absorb funds are linked either to the lack of administrative capacity (lack of training or policy planning, and lack of appropriate budgets), or to the adjournment of payments or delays in the adoption of operational programmes (i.e. to the completion of funded projects).

There is a vast literature in Europe on the issue of the absorption capacity of EU funds. Of course, it is mostly focused on those countries enjoying the largest amounts, in particular on two extremes, the 'very good students » and the « very bad ones », those who manage to make a good use of EU funds (at least in spending them) and those who failed to make any use of those funds, or even were suspended of their access to them. In the first group, we find for instance Spain and Ireland, while in the second group, we find Greece, Romania and Bulgaria¹². But countries like France or Italy have also faced problems of absorption capacity, involving the recovery by Brussels of billions of Euros not spent in time.



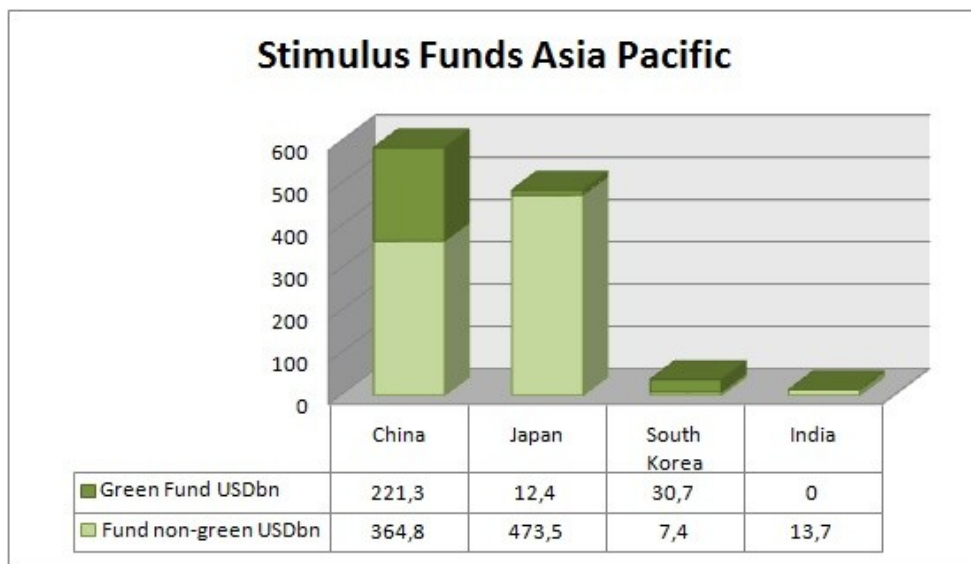
US employment map between February 2008 and February 2009 (blue: created; red: lost) - *Source: Bureau of Labor Statistics / NYT*

¹² Given the current economic situations of Spain and Ireland, their status as "good performers" with respect to the use of EU funds should be thoroughly reviewed as the real estate building bubbles experienced by these two countries are certainly not unrelated to their "good use" of EU billions. The EU decided to suspend the disbursement of EU money to Bulgaria because of a very strong corruption related to the use of these funds. It is well known that in Italy the various mafias have become specialized in misusing EU funds. And in France, the country's administrative centralization has long caused a significant under-spending of EU funds available.

For a decade, the EU has gradually put in place support mechanisms to strengthen the administrative capacity of the various public authorities involved in the use of EU funds to increase the efficiency of EU aid and ensure that it really benefits to the concerned country and its economy. This is done through specific training of political leaders (so that they understand the constraints related to the use of these funds). It is often necessary to explain to them that they need administrative teams well trained and properly staffed (otherwise, a bottleneck automatically appears at this level, limiting the number of eligible projects or increasing project validation delays); or else, that they must mobilize "real"¹³ supplementary funds in order to have access to EU aids often designed as mere complements of funds granted by the region or the state.

It is also necessary to set up administrative training sessions for the concerned civil servants to learn how to manage these plans of infrastructure development, employment support, support to SMEs, education, new technologies... All this takes time, much time. Procedures must be invented (at the European level in the case of the EU, and in the present case, at the federal level for the United States and national level for China), knowing that every bureaucracy loves to invent specific and complex procedures, therefore time demanding in terms of elaboration and fund distribution.

Then civil servants and local/regional partners (companies, agencies, NGOs, banks,...) must be trained to be able to use these procedures. Project initiators too (states, regions, towns, public institutions, companies, associations,...) must learn how to present projects likely to be eligible to the available aid. They must therefore create units inside their organizations (ranging from one person to entire teams according to the size of the project and the amounts targeted) specialized in this type of funding. Not to mention questions related to the control and evaluation of public funds' spending which add another level of administrative and financial constraint, as well as extra time¹⁴.



Asian stimulus plans (China, Japan, South Korea, India): breakdown between 'green' and 'non-green' funds (dark green: green funds / light green: non green) - *Source: Reegle, 05/05/2009*

¹³ Political leaders often think at the beginning that it is sufficient to claim having access to some extra local fund in order to activate an aid from the national or federal level. But, generally, many administrative verifications freeze the funding some time later.

¹⁴ For instance, in the US plan, weatherization aid favors Northern states. And, above all, we observe that in most cases, these aids are rather symbolic (more than half of the country is in the category of aid of USD 30 per eligible person, i.e. with low income). The cost of administrative processing of the aid is probably superior to the aid itself. Source: [USAToday](#), 07/05/2009

All these elements add on to one another, piling up like stones and forming the barrier of a country/region's capacity of absorption of massive public subsidies. Without adequate preparation, the aims of these policies are condemned, without exception, to break onto this barrier. And the euro, the dollar, or the yuan, invested with public power, generates less and less value-added, either because it cannot be spent, or because it is ill-spent. In the worst case, the effects of the economic stimulation can even be negative, entailing the creation of local/regional bubbles, the implementation of useless projects (or with no impact on the economy)¹⁵, the pure and simple substitution, with no value-added, to projects which would have otherwise been born¹⁶, and of course, the very worst case, the significant increase of corruption among the local and regional public administrations in charge of distributing these funds.

Not that we estimate that the procedures invented for European fund distribution are an unsurpassable model for the American and Chinese economic stimulus plans. On the contrary, we find EU procedures very heavy, bureaucratic and non transparent, and they could definitely be improved in the sense of more flexibility and user-friendliness, namely for a better access of small players (SMEs, NGOs...), who happen to be net job creators (and a major target of both the Chinese and US plans).

But, according to LEAP/E2020, lucidity is required. Administrations do not have a tendency to produce simple, easy-to-implement and light programmes, quite the contrary. In the United States, the intervention of Congress in the process can only result in complexifying even more the general framework provided by the Obama administration¹⁷. In China, the country's bureaucracy and historic centralism¹⁸ will not avoid a very heavy accompaniment procedure of the stimulation plan¹⁹. In both cases, the local and regional levels (states, countries, towns in the US; provinces, districts and cities in China) are deprived of the training and experience required to handle the procedures of implementation²⁰. But the European example proves that the human factor cannot be significantly improved without several years of training and the involvement of supra-local/regional levels in contributing to define the priorities²¹. This phenomenon is common to all EU member states, developed or not developed. This clarification is meant to cut short any simplistic claim that « ok, but in my country, it is different! »²². Indeed there are differences, but in the context of new programmes and new procedures combined to strong requirements in terms of spending these subsidies on concrete projects, constraints remain fundamentally the same.

¹⁵ One of the priorities of the Chinese plan - improving the health system, especially in the countryside - is undoubtedly a useful idea, but it is unlikely to have any impact in the short term to counter the economic crisis. Source: [EastAsiaForum](#), 04/02/2009

¹⁶ In the EU, these funds may marginalize performing economic players for the benefit of players mostly endowed with the administrative capacity of accessing to EU funds. No doubt that in the United States and in China, this configuration also exists.

¹⁷ We can already see that the transparency of the economic stimulus plan, which was a requirement of the American President, despite the creation of a dedicated website to monitor aid, is already compromised. On this website indeed, it is impossible to find any precise information on the projects because the agencies responsible for implementing the program will only be able to provide this information by October 2009, and "maybe" (which surely means in the administrative language "not before") spring 2010 ... i.e. when it will make no sense anymore. Source: [USAToday](#), 05/06/2009

¹⁸ In fact, one could say that the Chinese plan is a repetition of what is already being done. Source: [Msnbc](#), 04/17/2009

¹⁹ The first bureaucratic aberrations have already been observed, for instance with this injunction made to the civil servants of the district of Gonggan (province of Hubei) to smoke at least 23,000 packets of locally produced cigarettes in order to stimulate the economy of the district. If, following the outcry sparked by this news the decision was reversed, there is no doubt that everywhere in the country similar "à la lettre" applications of the aims of the economic stimulus plan take place. Source: [ABC](#), 05/04/2009

²⁰ In fact, a number of first-hand analyses already show that in the US, the states find it difficult to use the money of the Obama plan, in particular because the crisis forces them to lay off staff when the plan's implementation would enhance staff needs. Moreover the states find it hard to understand the plan's procedures and aims (such as « jobs retained and jobs created »). Source: [Reuters](#), 04/24/2009

²¹ For instance, the problem of aging water mains in a large part of the US is not properly addressed by the Obama plan, with only USD 6-billion allocated to this aim when it is in fact a major cause of spillage (numerous and increasing leaks) and an issue of public health. For comparison, the US Environmental Protection Agency (EPA) estimates that USD 335 billion are needed over 20 years to maintain the water system. Source: [New York Times](#), 04/17/2009

²² The US gave a disastrous example of its capacity to manage a comprehensive economic reconstruction plan in Iraq, while China has not yet demonstrated its ability to handle wide-ranging programmes of reconstruction, such as those following an earthquake.

Top 10 Worst Job Loss Periods	
December 2007 - Current	5,738,000
August 1981 - December 1982	2,838,000
March 2001 - May 2002	2,221,000
September 1957 - June 1958	2,216,000
November 1974 - April 1975	2,164,000
October 1948 - July 1949	1,764,000
July 1990 - May 1991	1,584,000
August 1953 - March 1954	1,378,000
May 1960 - February 1961	1,256,000
April 1980 - July 1980	1,159,000

Top 10 worst job loss periods: *US Bureau of Labor Statistics / Christian Hill*

In conclusion, LEAP/E2020 believes that, given the European experience of the problem of absorption capacity, the huge amounts involved in the two programmes to stimulate the Chinese and American economies, coupled with a proactive policy of urgent results, will essentially result in a tremendous waste of public funds combined with increasing difficulties to ensure the proper use of the allocated amounts.

This second aspect could also increase the political pressure to spend the money by any means by the end of 2009 rather than have to conclude to a patent failure of the stimulus plan due to large amounts of unused subsidies (it is possible to imagine that 30 percent are not used in the end). Of course, it would be at the expense of the economic efficiency of the money spent.

For all these reasons, our team estimates that these two plans will have a marginal impact on the evolution of the crisis in the US and in China²³. They will temporarily and marginally contribute to curb the rising unemployment²⁴. Until fall 2009 at the latest, they will contribute to slow down the pace of the economic decline in these two countries²⁵. But all in all, they will mostly result in significantly and sustainably increasing the US public deficit²⁶, and in greatly reducing China's financial reserves²⁷.

²³ Like in the United States but in a very different legal context, Chinese employees lose a lot more than their work when they are laid off: they lose their social protection. Beijing's problem today is to develop a « European style » system of social protection soon enough to avoid the bursting out of a political and social crisis. The race does not appear very promising. Source: [Asia Times](#), 05/06/2009

²⁴ But the figure of nearly 25 million American unemployed or underemployed has already been reached, thus seriously questioning the little-argued announcement on 3 million jobs to be created by the Obama plan. As anticipated by LEAP/E2020 more than 2 years ago, it is now becoming a common opinion that the US middle class has been sacrificed and is now sinking in poverty. Sources: [MyBudget360](#), 05/09/2009; [Der Spiegel](#), 04/23/2009

²⁵ Not in a very visible way obviously, if we consider the hundreds of cargo ships trading water off Singapore, one of the largest trade ports between Asia and the US. Sources: [New-York Times](#), 05/12/2009; [Telegraph](#), 05/12/2009; [ChinaSpeakersBureau](#), 04/24/2009

²⁶ The federal state aid ranks for the first time as the main source of income of US states. This new reality will be difficult to modify in the years to come and will weigh heavily and sustainably on the federal budget. Sources: [USAToday](#), 05/04/2009; [New York Times](#), 05/03/2009

²⁷ China is turning more and more clearly to regional solutions and multiplies partnership agreements with Japan and Asean. Source: [China Daily](#), 04/29/2009



Import and export prices - Source: Econoday, 04/09/2009

In the field of public policy and economic development, time cannot be bought. And in a systemic crisis, time is precisely the determining factor, as illustrated by the methods to reduce the absorption capacity barrier. Paradoxically, smaller budgets can prove more manageable and therefore more useful to stimulate the economy. Similarly, efficiency will increase if the funds are channeled through existing circuits, based on procedures well known to the various participants. However, these circuits must be ready in advance!

To understand all these aspects, it is necessary to realize that money does not become a real economic activity by mere electronic bank to bank transfer. Washington, where Obama's economic policy is in the hands of financiers, could only ignore the fact; while Beijing, where political will is a state religion, could not even think about it.

United Kingdom: Meeting with the IMF at the end of summer 2009

Thirty-three years ago, between March and December 1976, the world faced the consequences of the oil crisis and the United Kingdom was compelled to call the IMF for financial support (USD 3.9-billion, the largest loan ever granted at that time by the institution)²⁸. According to LEAP/E2020, the United Kingdom is about to renew its appeal to the IMF²⁹ by the end of summer 2009. The respective evolutions of the British economy, Sterling pound and London's financial centre are converging towards a major crisis at that time, forcing the country's leaders to find external solutions as a matter of urgency. An Icelandic-type of scenario is underway in the United Kingdom³⁰, or a remake of 1976³¹.

The difference with 1976, is that the « US big brother » is himself thrust into a similar process of general bankruptcy and that the « Cold War » is over³², that the crisis today faced by the world is even more dangerous than the oil crises of the 1970s³³, that the Sterling pound has become secondary among international reserve currencies³⁴ and that no more North sea oil is to be discovered to create a miracle³⁵.

This anticipated crisis will therefore painfully affect the entire British population who only saw, until now, the beginning of the upcoming social and economic collapse³⁶. As a matter of fact, the IMF does not believe in the "optimistic" economic and budgetary outlook presented by the Chancellor of the Exchequer Alistair Darling in his recent budget³⁷.

²⁸ Source: [UK National Archives](#)

²⁹ Most probably in parallel with a European Union aid because the IMF alone, even endowed with more funds, would be unable to save the United Kingdom, according to Philippe Maystadt, president of the [European Bank of Investment](#). Source: [MoneyWeek](#), 04/24/2009

³⁰ As anticipated by LEAP/E2020's team more than a year ago.

³¹ Sources: [New York Times](#), 04/14/2009; [Times](#), 03/28/2009; [Le Devoir](#), 04/12/2009

³² With the hindsight of history, it is now acknowledged that James Callaghan, Prime Minister at that time, has to beg the United States for a relaxation of IMF conditions for the Parliament to agree on this decision. One of the arguments that convinced Washington was the fact that UK would otherwise have to withdraw its troops from West Germany and be unable to buy Polaris nuclear missiles. The general context of the Cold War therefore greatly helped the 10 Downing Street's point of view to prevail in Washington. But these conditions no longer exist and today's British government is a lot more helpless vis-à-vis the international community. Source: [BBC](#), 12/29/2006

³³ Contrary to the oil crisis, the current crisis is affecting each and every country in the world, with no exception. While, during the second half of the 1970s, London was able to attract massive amounts of « [petrodollars](#) » to bail out The City, this time there is no region in the world willing to put its financial surpluses in the UK. In fact the opposite process is underway, considering British banks' collapse.

³⁴ With a market share of around 3% of the international reserve currencies, the British Pound is not really a key component of the international monetary system unlike in the 1970s. The introduction of this small article in the [Jakarta Post](#), dated 03/17/2008, on reserve currencies, perfectly illustrates this trend.

³⁵ Source: [Wikipedia](#)

³⁶ The British must also be prepared to work beyond 70 years-old for their country's public expenditure to be in control in the coming decade. There is no doubt that the rest of the world (via the IMF) will exert all the necessary pressure to put under control UK's public expenditure. Source: [Telegraph](#), 05/06/2009

³⁷ Source: [Telegraph](#), 04/27/2009



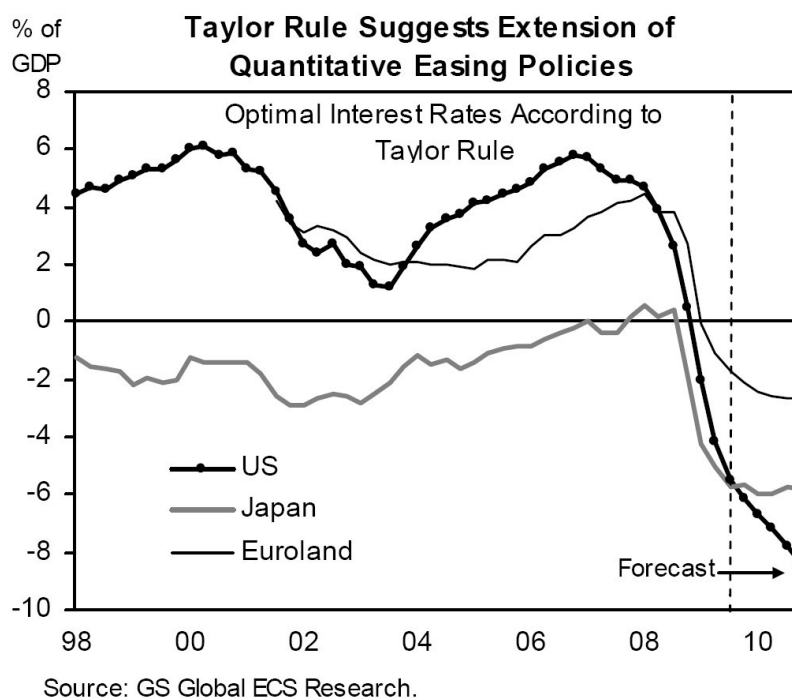
British GDP (blue: quarterly; black: yearly average) - *Source: UK National Statistics, 04/24/2009*

Indeed, to avoid defaulting on its debt, the Bank of England has no other choice than increase the pace of « quantitative easing », in other words its purchases of, first, UK treasury bonds (Gilts) to finance the growing public deficit (officially, GDP's yearly deficit amounts to 12 percent, but in fact it is probably closer to 16-17 percent, while the debt is moving towards 100 percent of this GDP); and, second, other types of assets "of uncertain value" issued by financial institutions, companies or even households (via mortgage loans). Just like what is happening in the United States, but without the US financial, economic and strategic surface, the British central bank must take the place of the country's financial players and foreign investors who energized the City in recent years³⁸. If the economy does not rebound and if, on the contrary, the crisis gets worse in the coming months, the Bank of England will be confronted to an impossible mission by October 2009³⁹: avoiding a collapse of the Pound, avoiding a quick rise in British interest rates⁴⁰, and sustaining the government's economic stimulus plan and the rate of public expenditure.

³⁸ The City is now trying to assess its chances of survival as a major global financial center. It is time for humility, as the [New York Time](#) titled on 04/28/2009.

³⁹ Indeed it is one of the rare British institutions who did not share the general euphoria that prevailed among financial markets, media and government officials these past few weeks. Source: [Telegraph](#), 05/14/2009

⁴⁰ In terms of interest rates, the Bank of England, as well as its American and Japanese counterparts, is at the bottom. It is therefore compelled to resort to « quantitative easing », an expression translated in most languages by « printing press », to counter the financial effects of the crisis. The chart below presents an estimation of all the work awaiting the « printing press » in the countries listed in order to curb the recession. This estimation results from the application of the [Taylor rule](#), a rule professing to be able to identify the ideal interest rate for a given economy's real and potential GDPs to converge. This chart shows that all these rates are now negative under the impact of the crisis, in particular in Japan and the United States. According to our team, in the current situation, British rates should be even lower than US ones, approaching -10%. These rather theoretical considerations nevertheless enable to measure the scope of the task awaiting the Bank of England and to anticipate the purchase of hundreds of billions of Pounds of British treasury bills.



Optimal interest rates according to Taylor rule (bold black: US, bold grey: Japan, thin black: Euroland) -
Source: Goldman Sachs, 05/2009

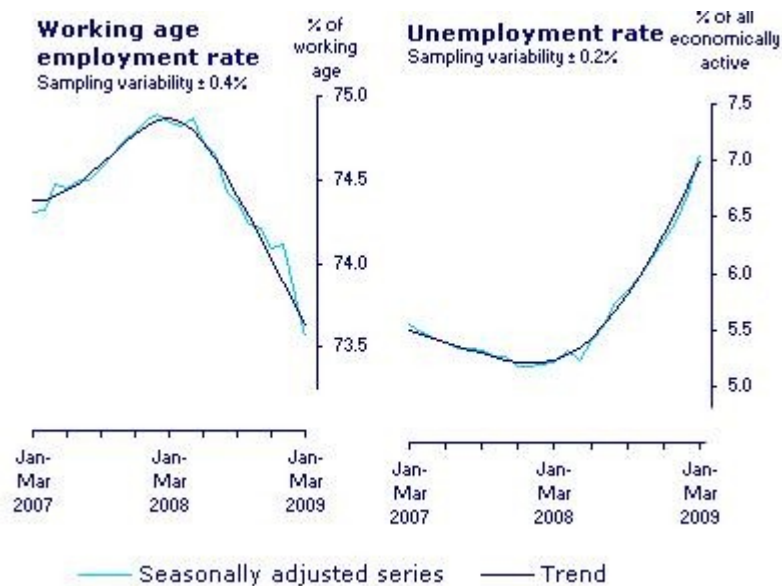
By next July, the first waves of massive unemployed people will no longer be entitled to employment benefits, and recently graduated students will arrive on the labour market. In the meantime, the Bank of England will have announced a new substantial increase in Gilt purchases, driving the Pound below the symbolic rate of 1£ = 1 €. In this context, the state of British financial institutions will continue to deteriorate, affected by corporate bankruptcies, rising unemployment among their individual customers and vanishing foreign investors (or even departure of British high incomes as a result of the recently announced tax increase⁴¹). In this situation, banks will be forced to ask for new public bailouts (whatever Barclays or HSBC may say), thus inducing a third wave of the British financial crisis⁴², at a time when it will not be possible for the government to increase further its already outstanding public debt. As a matter of fact, severe cuts are already underway in the military field (like in 1976), for instance in a large programme like the Eurofighter's⁴³; as well, of course, as some serious financial difficulties in the field of public infrastructures⁴⁴. Social consequences of this list of events will gain heavy momentum during summer 2009.

⁴¹ Source: [Telegraph](#), 05/10/2009

⁴² Source: [Guardian](#) : 05/08/2009

⁴³ Source: [Financial Times](#), 05/14/2009

⁴⁴ Source: [Guardian](#), 05/10/2009



Working age employment rate & unemployment rate (light blue: seasonally adjusted series / dark blue: trend)
 - Source: UK National Statistics, 05/12/2009

Economically, monetarily and financially speaking, the summer 2009 will be a particularly difficult period of UK's modern history, with the IMF at the end of the road, according to LEAP/E2020.

Three strategic advices and recommendations

1. Which indicators to trust in this crisis?

In the current framework of a historical change of referential system, it is important to focus on reality and therefore to follow the indicators and information on the economic activity (instead of the financial activity) coming from the economic players themselves (instead of governments and lobbies).

Indeed, as discussed in the introduction to this GEAB N°35, the ongoing change of referential system, combined with the huge-scale manipulation of the entire financial sphere over the past year, has resulted in a complete loss of reliability of financial indicators and/or any indicator measuring the situation of global financial players. Bank statements on their present or future profits and on the value of their assets, indicators of the situation of a particular market of financial products... the whole world of finance is telling absolute nonsense in an attempt to save itself. Financial markets' fundamentals are so much manipulated to avoid new bankruptcies that, according to LEAP/E2020, no one really now knows what is going on any more. One thing only is certain: in the absence of an economic rebound at the end of summer 2009, this whole house of cards will collapse once more, as all private and public strategies elaborated in the past year were based on that hope... a perfectly vain hope, according to our team. In any case, please, stay away from the financial sector!

As regards states and other supervising authorities, they in fact do not understand much more to the situation. They are content with running after banks' capital needs and manipulating all available indicators for economic players and the general public to believe that the worst is behind them⁴⁵. An example of manipulation of assessment operations is provided by the "stress test" of US and now EU banks⁴⁶. The aim was to convince everyone that things were nearly okay and, not blushing of the obvious manipulation, it is the conclusion they came to – except that they failed to convince anyone.

But beyond the financial indicators, states also fiddle more and more the unemployment figures which, all countries included, only reflect 50 to 70 percent of real job losses, according to our team. The more the situation will worsen, the wider this gap between statements and reality will be, as indeed politicians and bureaucrats always prefer lying than acknowledging their failures. They convince themselves that this attitude is legitimate because it is their duty to "gain time". However, in the field of unemployment, they fall victim to their own communication. Indeed, we often heard those final declarations from official economists (from among those who discovered the existence and severity of the crisis while reading newspapers' headlines) claiming that the unemployment rate is a delayed indicator, a « retarded » indicator so to speak. This is probably a very interesting opinion, maybe even true in a « classical » non-systemic crisis, but in the present case, it is false. The scope and rising pace of unemployment have built up a huge wave, destroying consumption, investment, and jobs, that will really start affecting the US, UK, Eurozone, Japan and China this summer. This time, unemployment is not a "retarded" indicator but an advanced one which is generating its own phase of the crisis⁴⁷.

⁴⁵ It will become a growingly difficult exercise considering the tens of millions of new unemployed accumulating in every region of the world.

⁴⁶ About these « stress tests », LEAP/E2020 wishes to highlight the fact that the one conducted by the US government was a complete masquerade. Besides the fact that the current reality exceeds by far the worst scenario envisaged by the test (which guarantees bad surprises at the end of the road, in a few months from now), the appalling spectacle of « regulators » (the US government) negotiating with the ones « regulated » (banks) illustrates how justified was LEAP/E2020's recommendation to the G20 regarding the need to launch external investigations on the situation of the market places of London, New-York and Switzerland. Indeed, the only concrete element highlighted by this « [US stress test](#) », is that US banks still have a major problem of solvency (their acknowledged USD 75-billion bailout needs probably represent one tenth of the amounts really required by 2010). As long as no independent observer goes there to understand what is going on, Wall Street will remain a financial "black hole". Regarding the recently announced project of « [European stress test](#) », LEAP/E2020 expects it to be a similar attempt to conceal real problems. However, the polycentric nature of the EU and internal competitions between states, EU institutions and financial centres could provide the opportunity for a real dive into the reality of what is going on in London in particular. In terms of "mischief between friends", the EU is never disappointing.

⁴⁷ It is in fact a decisive factor of the phase of geopolitical dislocation anticipated to start at the end of 2009.

In summary, you should follow closely the evolution of international trade, the results and forecasts of carriers and producers in key sectors: metallurgy, electronics, commodities,... Don't waste too much time on services; they have a natural tendency to be difficult to quantify besides their yearly results. In the past few months, many companies, in the US in particular, reduced all their costs; otherwise they would have published even worse results. But we can expect these worse results to reappear in the next few months.

A last indicator to bear in mind: big equilibriums. They enable to anticipate the general direction of ongoing changes. For instance, from the table below which gives the detail of global assets under management, we can make a fairly good estimation of global wealth in assets. Indeed if we compare these assets to the « ghost-assets » (USD 30,000-billion according to LEAP/E2020's latest estimations), we can observe that the ongoing crisis is about to suppress around 30 percent of the value of global assets. Considering that, according to today's estimations, a maximum of USD 10,000 billion worth of assets have vanished yet, we can consider that only a third of the crisis has elapsed.

Chart 9: Global Assets under Management

Fund Type	As of End	\$ Billion
Private Wealth	2006	\$37,200
Pension Funds	2007	\$28,228
Mutual Funds	2007	\$26,200
Insurance Companies	2007	\$18,836
FX Reserves	2007	\$7,341
Sovereign Wealth Funds	2007	\$3,300

Source: http://en.wikipedia.org/wiki/Global_assets_under_management

Global assets under management (2006-2007) - Source: Wikipedia

2. Real estate: When to buy, where?

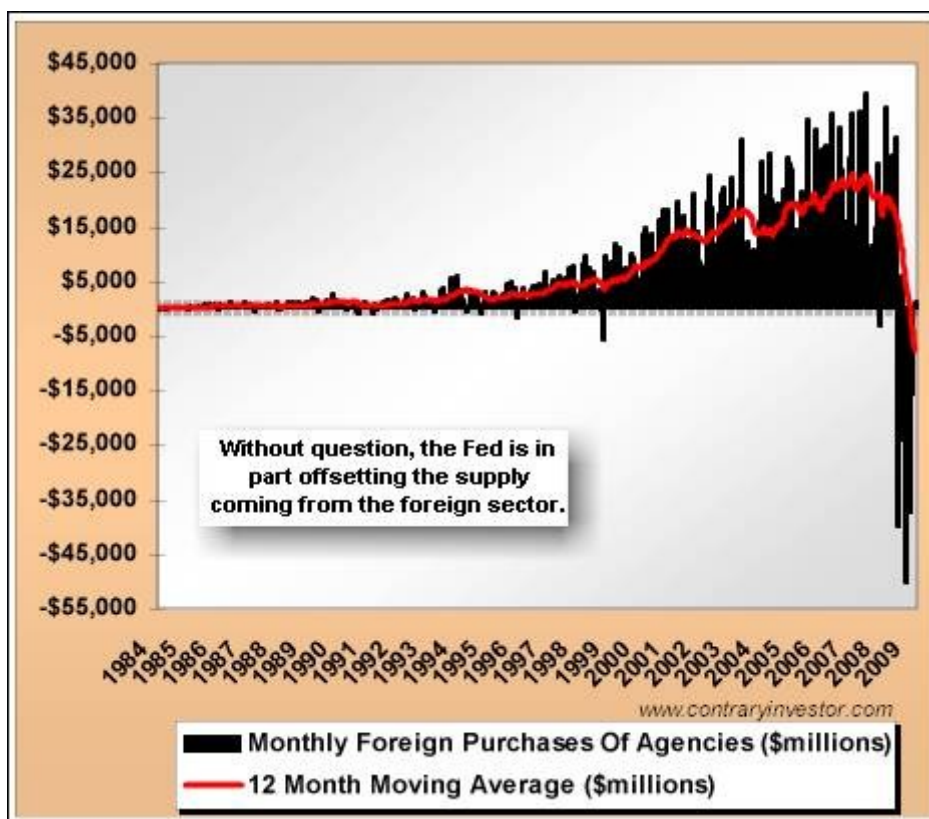
Everywhere commercial estate (hotels, malls, offices) is weakening, as anticipated by LEAP/E2020 a year ago already. In fact, it is the next major cause of banking failure, in the US and UK namely, involving small banks in particular. Residential estate keeps plummeting, whatever the professionals of good news may say. According to LEAP/E2020, this market must be avoided by any means, everywhere!

However, it is likely that the residential housing market starts stabilizing in the course of the first semester of 2010 in the Eurozone (Spain and Ireland excluded). After summer 2009, those who wish to return to this market could be interested in starting to search, but without any haste because the decline will continue for several more months.

In the United States and the United Kingdom on the contrary, the decline will last at least another year, as the number of foreclosures will continue to grow under the double impact of rising unemployment and a new wave of defaulting mortgages.

Recreational real estate (Morocco, Tunisia, Costa-Rica, ...) must still be avoided, which can only continue to tumble in the coming year.

Condos also must still be avoided. Even if your situation is sound, the crisis affects the economic situation of the other co-owners, and can result in bad surprises.



Foreign purchases of US Agencies's bonds (Fannie, Freddy,...) - Source: *ContraryInvestor*, 04/2009

3. Bonds, Treasuries: Which ones to chose?

We insist on the fact that it is urgent to get out of US Treasuries, Gilts and, generally, all bonds issued by highly indebted governments involved in « quantitative easing », or « printing press ». We remind that 30-year US Treasury Bonds lost 20 percent of their value in six months.

On the contrary, when a state is not over-indebted and is not involved in money-creation, these are interesting securities, especially when they are protected from inflation, knowing that inflation is around the corner at the end of summer.

Regarding corporate bonds, make sure that the company has a good cash flow and not debts. Avoid by any means those who do not have both characteristics.

In the United States, beware! Look what is happening to Chrysler and GM: small shareholders are being ripped off by the US government in charge of rescue plans⁴⁸.

⁴⁸ Even if, seen from Europe, a rescue plan orchestrated by FIAT leaves most observers, including LEAP/E2020, bemused!

May 2009 GlobalEurometre - RESULTS

GlobalEurometre 05-2009	Yes	No	No opinion
1. Do you think that the EU will be able to develop and adopt a reform of its institutions before the next European elections (in June 2009)?	1%	99%	0%
2. Do you think that a permanent political and economic Eurozone secretariat should be established?	93%	6%	1%
3. Do you think that Euroland Summits should be established each quarter, prior to the EU Summits?	94%	6%	0%
4. Do you feel that your country's government is reflecting your people's expectations regarding European development?	2%	97%	1%
5. Is your country's government reflecting your own expectations' regarding European development?	1%	99%	0%
6. Do you think that the Eurozone countries have to build a response of their own to the global crisis, independently of other European Union member states?	80%	19%	1%
7. Do you think that the government of your country is adequately reacting to the crisis?	7%	93%	0%
8. Do you think that the European Central Bank should keep on reducing its main interest rate?	6%	76%	18%
9. Are you afraid of losing your job in coming months due the global crisis?	21%	67%	12%
10. Are you afraid of losing money in coming months due to the global crisis?	66%	32%	2%
11. Do you think that the US Dollar will collapse against all major world currencies in the coming months?	87%	12%	1%
12. Do you think that the global crisis will be over in 2012?	13%	73%	14%
13. Do you think that the USA can save its car industry?	1%	92%	7%
14. Do you think that UK will be able to avoid calling the IMF for help in coming months?	20%	67%	13%
15. Are you afraid of social and political unrest in your country?	58%	36%	6%

⁴⁹ Each month, GEAB surveys a panel of 200 European pollsters

May 2009 GlobalEurometre - ANALYSIS

EU governance: Near to zero credibility for the institutional relaunch of the EU before the June 2009 election / Very large majority remains in favour of the creation of a permanent Eurozone secretariat and the holding of a Euroland summit prior to each EU summit / A new record high is reached in gap between people's expectations and leaders' actions / A larger majority is in favour of a specific Eurozone response to the global crisis / A near unanimity again in the number of those polled having a negative opinion regarding the adequacy of national governments' response to the crisis / A large and steady majority estimate that the ECB must stop lowering its main interest rate / The number of individuals who fear losing their jobs because of the crisis has increased / Steady large majority worry about losing money because of the global systemic crisis

The loss of credibility concerning the institutional relaunch of the EU before summer 2009 is now complete; indeed negative opinion on this subject is now in excess of 99 percent (versus 98% last month). The June 2009 European election, characterized by an almost total lack of political campaign, will undoubtedly reflect the unanimous opinion and severely sanction the two major political power in Europe (socialists and conservatives).

The number of respondents in favour of the creation of a permanent Eurozone secretariat stabilized at a high level (93 percent). As regards the holding of Euroland summits every quarter, prior to each EU summit, favourable opinion rose significantly in May: 94 percent versus 88 percent last April.

The percentage majority of respondents in favour of a specific Eurozone response to the crisis (independent of the rest of the EU) has also increased significantly: they now represent 80 percent of those polled versus 65 percent in April.

Citizen dissatisfaction with the EU elite rockets to the sky again as regards the adequacy between national governments' measures and citizens' expectations (97 percent and 99 percent of negative opinion). As a matter of fact, after last month's slight improvement, people's opinion regarding the actions taken by their national governments against the crisis is near-unanimously negative (93 percent). As assumed in our commentary last month, the improvement was an effect of mass communication on the G20 summit.

A steadily large majority (76 percent versus 78 percent in April) estimate that the ECB must stop its policy of main interest rate reduction. Unfortunately, the ECB, in continuing to lower its interest rate, has decided to ignore the views of Europeans in this regard. This is unfortunate because, according to LEAP/E2020, citizens in this area are much more lucid than the Governing Council of the ECB.

Fear of losing one's job because of the crisis has increased, now reaching 21 percent of those polled versus 13 percent last month. Fear of losing money because of the crisis remains stable, though a largely majority feeling (66 percent versus 64 percent last month).

EU/Rest of the world relations: Slight increase in the large majority who expect a collapse of the US dollar in the next few months / A steady majority think the crisis will not be over by 2012 / A near-unanimity estimate that the United States are not able to save their car industry / A large majority believes UK will not avoid calling the IMF for help before the end of summer 2009 / A majority worries about risks of social and political unrest in their country

With 87 percent of those polled expecting that the Dollar collapses in the coming months (versus 84 percent last month), we observe another slight increase in the Europeans' doubtfulness of the ability of the US dollar to hold its value.

The majority of respondents estimating that the crisis will not be over by 2012 have slightly reduced: 73 percent versus 75 last month. It is a very small variation compared to the abundance of official statements and articles predicting the end of the crisis for tomorrow (probably because they cannot predict it for yesterday).

The Europeans are very relevant observers of the role to be played by FIAT, a European company, in rescuing US car industry; however they unanimously come to the conclusion that the US will not be able to save their car industry. Is it the state of the US car industry or the characteristics of the "European savior", or maybe both, that make them so pessimistic? The future will soon decide.

It will also be the case in knowing if the UK will have to call the IMF for help by the end of summer 2009. A large majority (67 percent) think that the British government will not be able to avoid this situation. A majority of the respondents also fear the emergence of social and political unrest in their country.