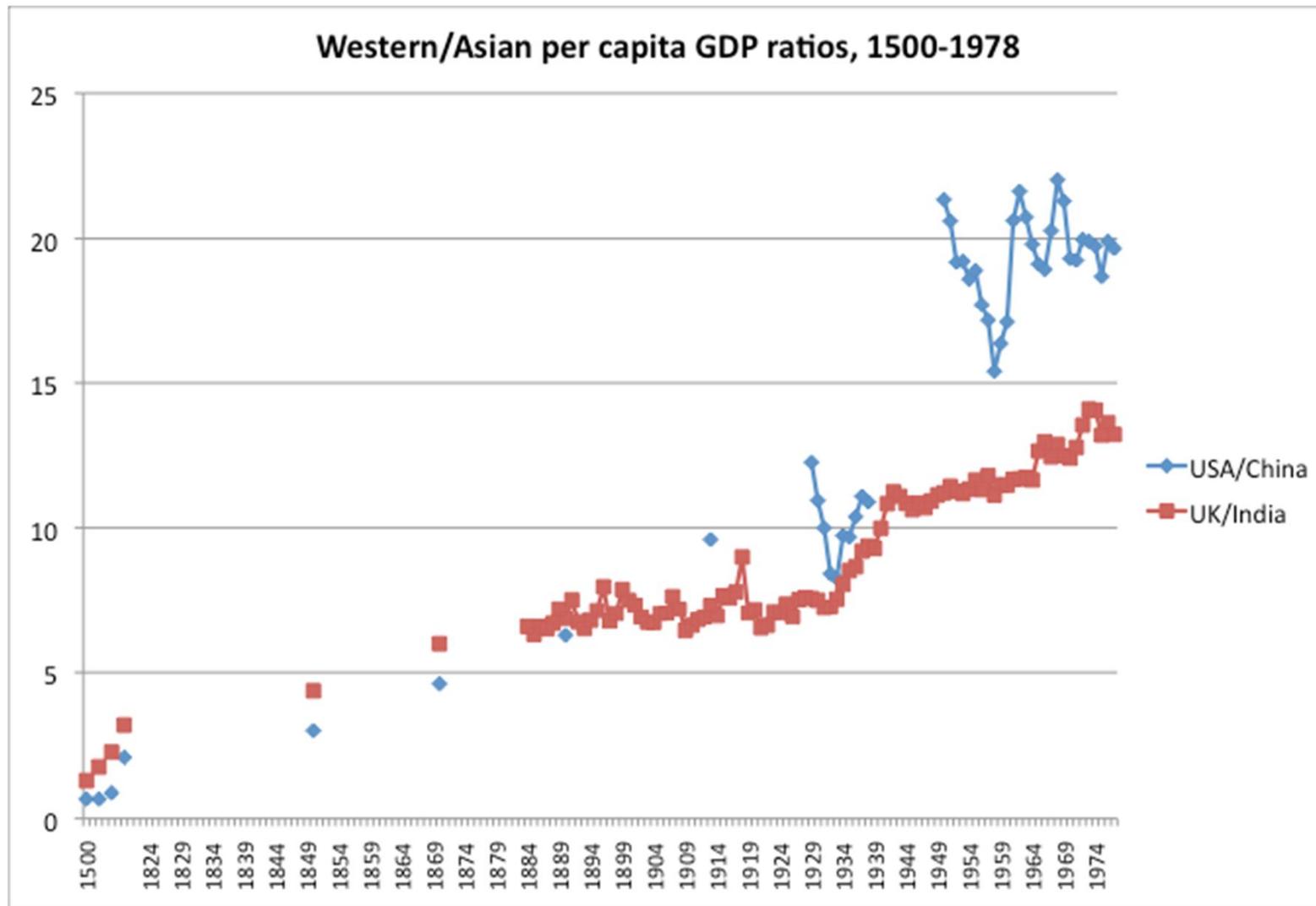


When East Beats West

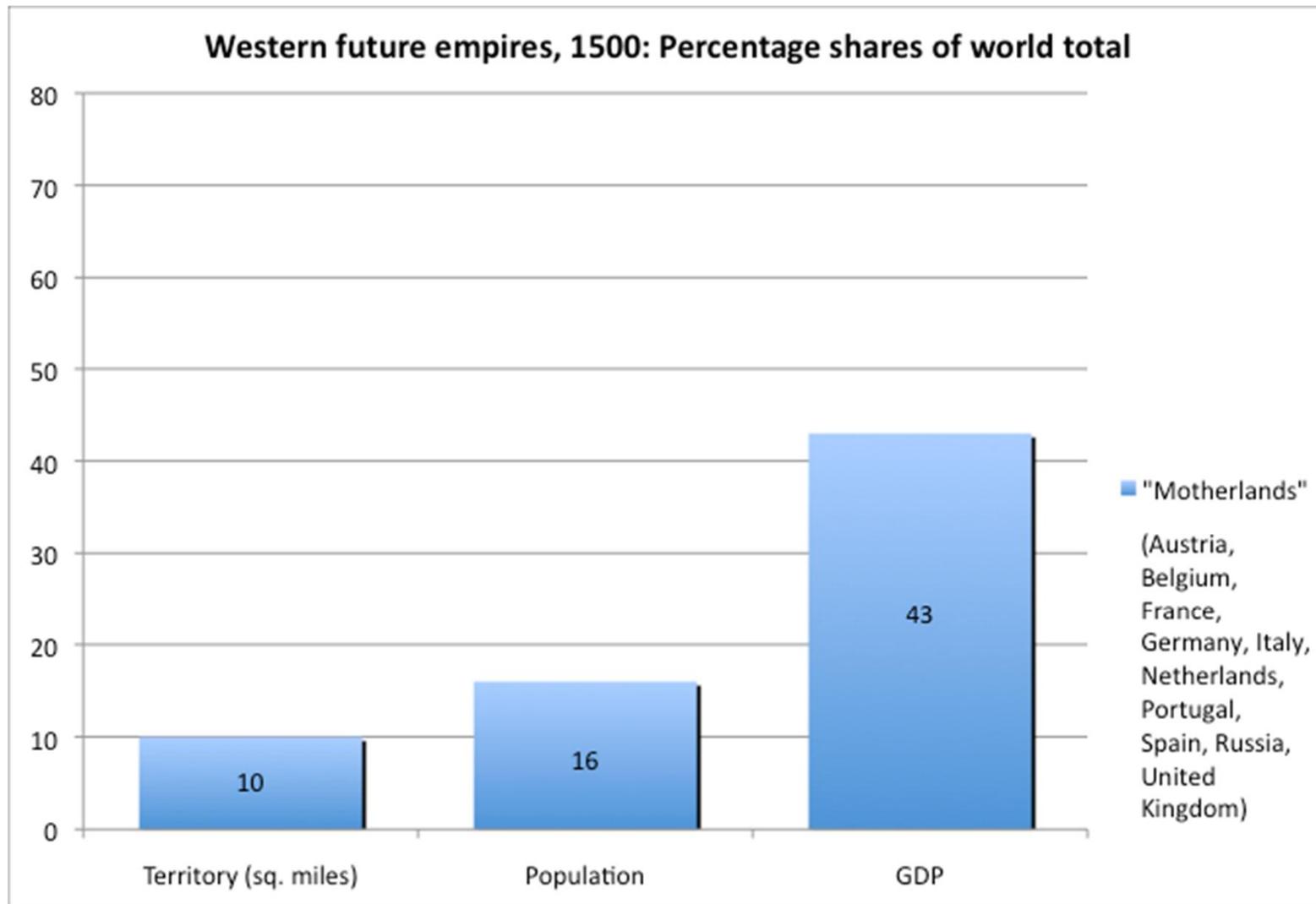


Frankfurt, February 28, 2011

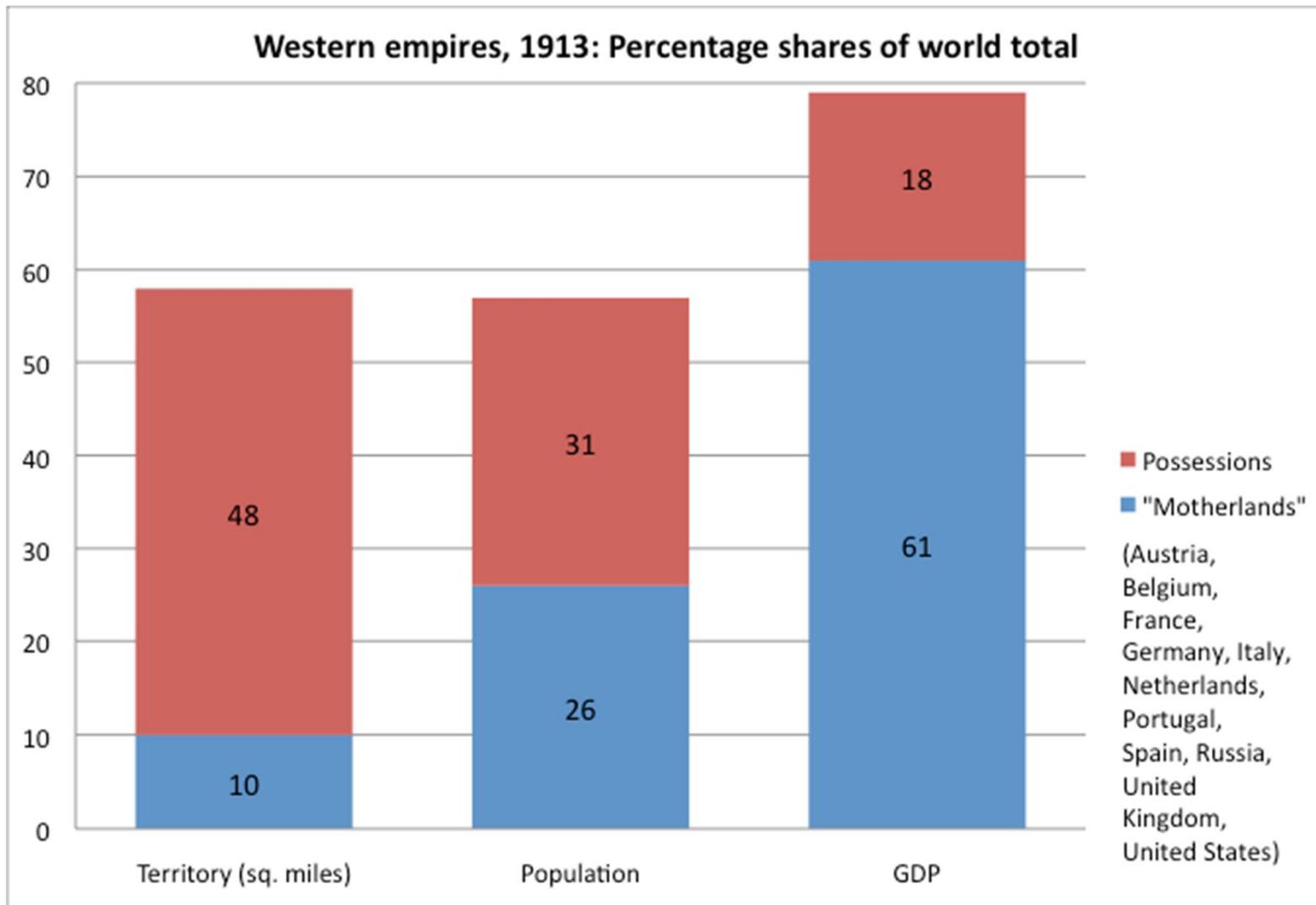
The West once dominated the Rest



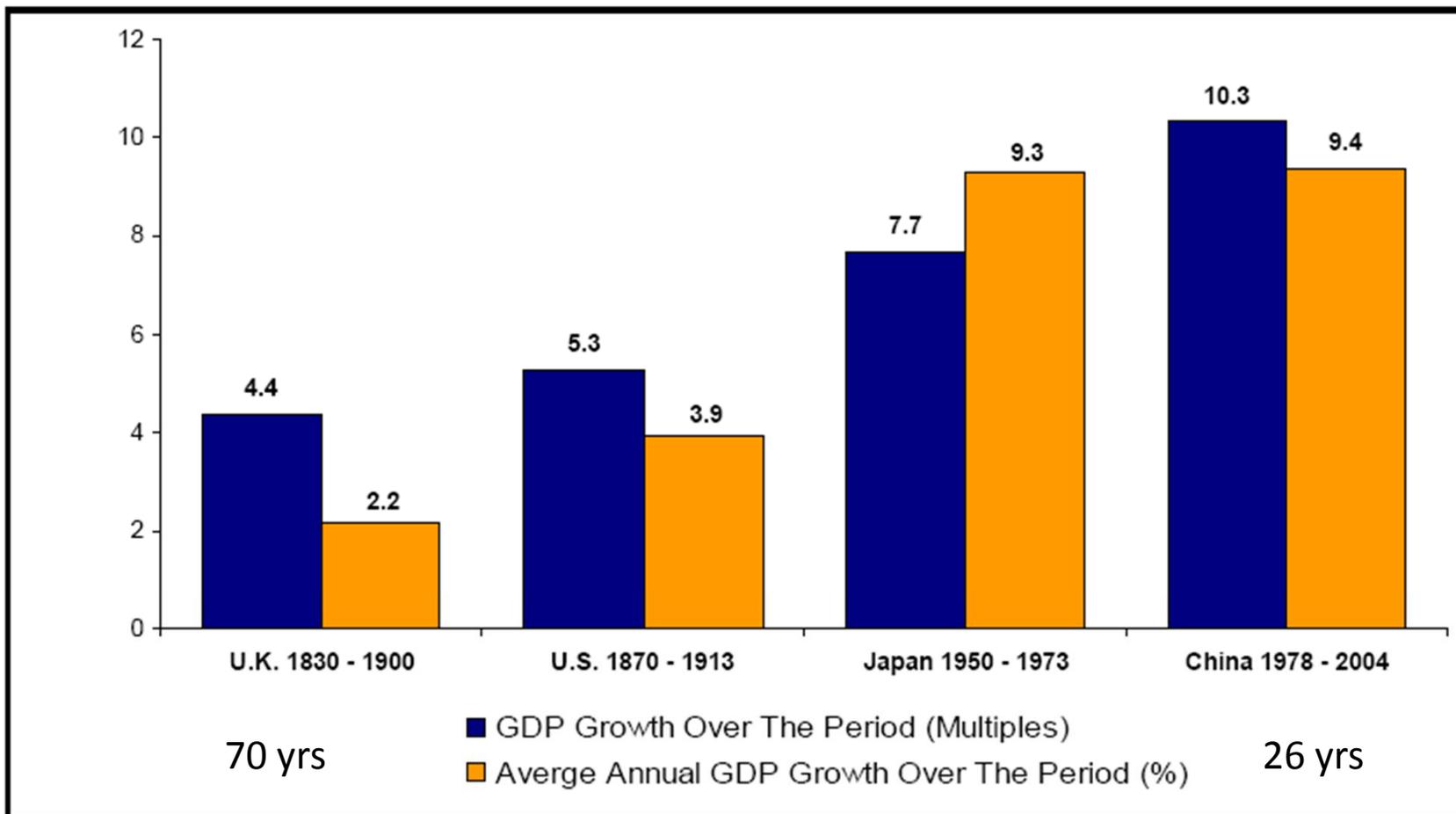
Not only economically ...



... also politically

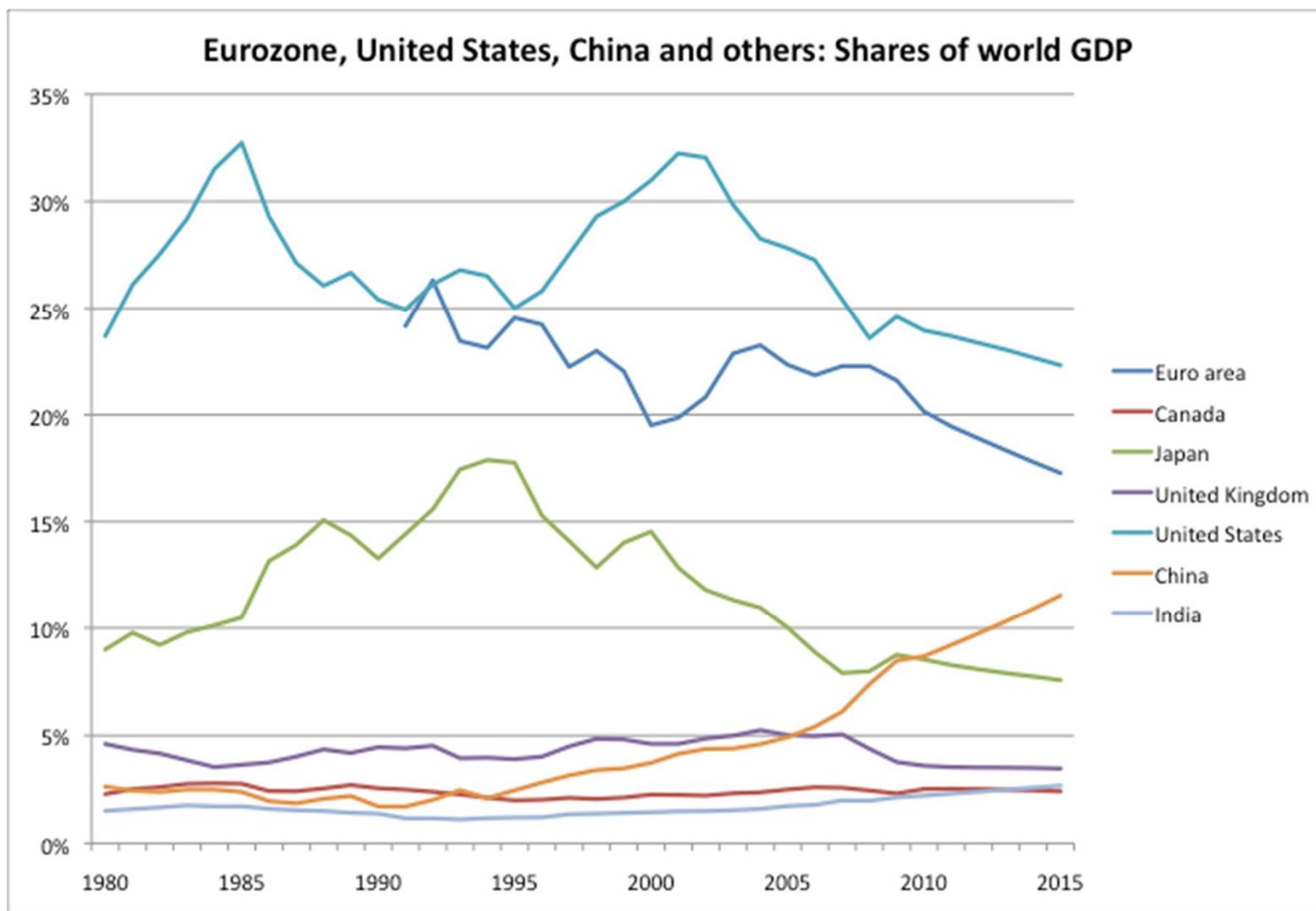


But Asia's industrial revolutions ...



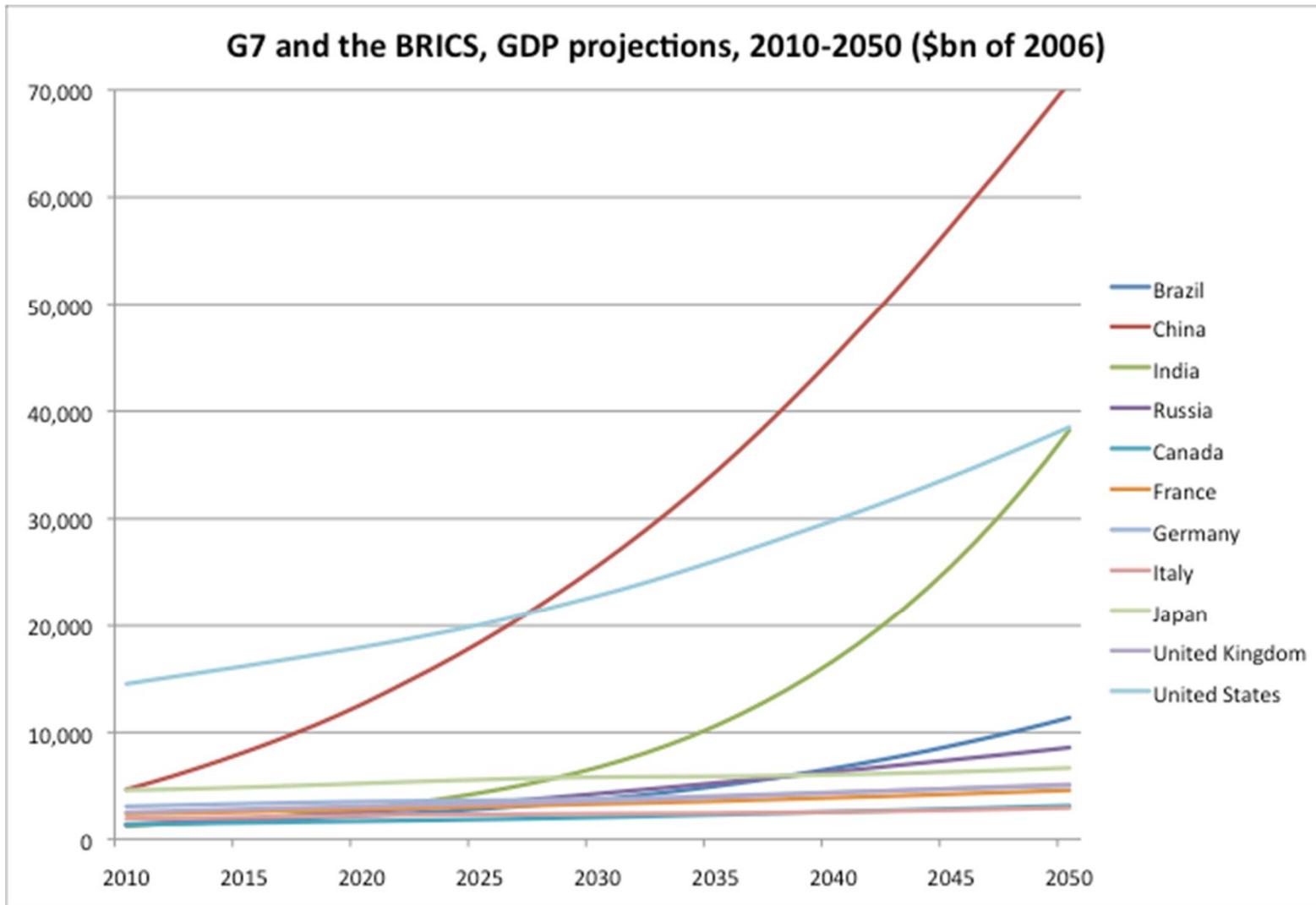
Source: Hu Angang, *Roadmap of China's Rising*; Angus Maddison, *Historical Statistics for the World Economy: 1-2003 AD*, SSGM

... mean the shift from West to East ...



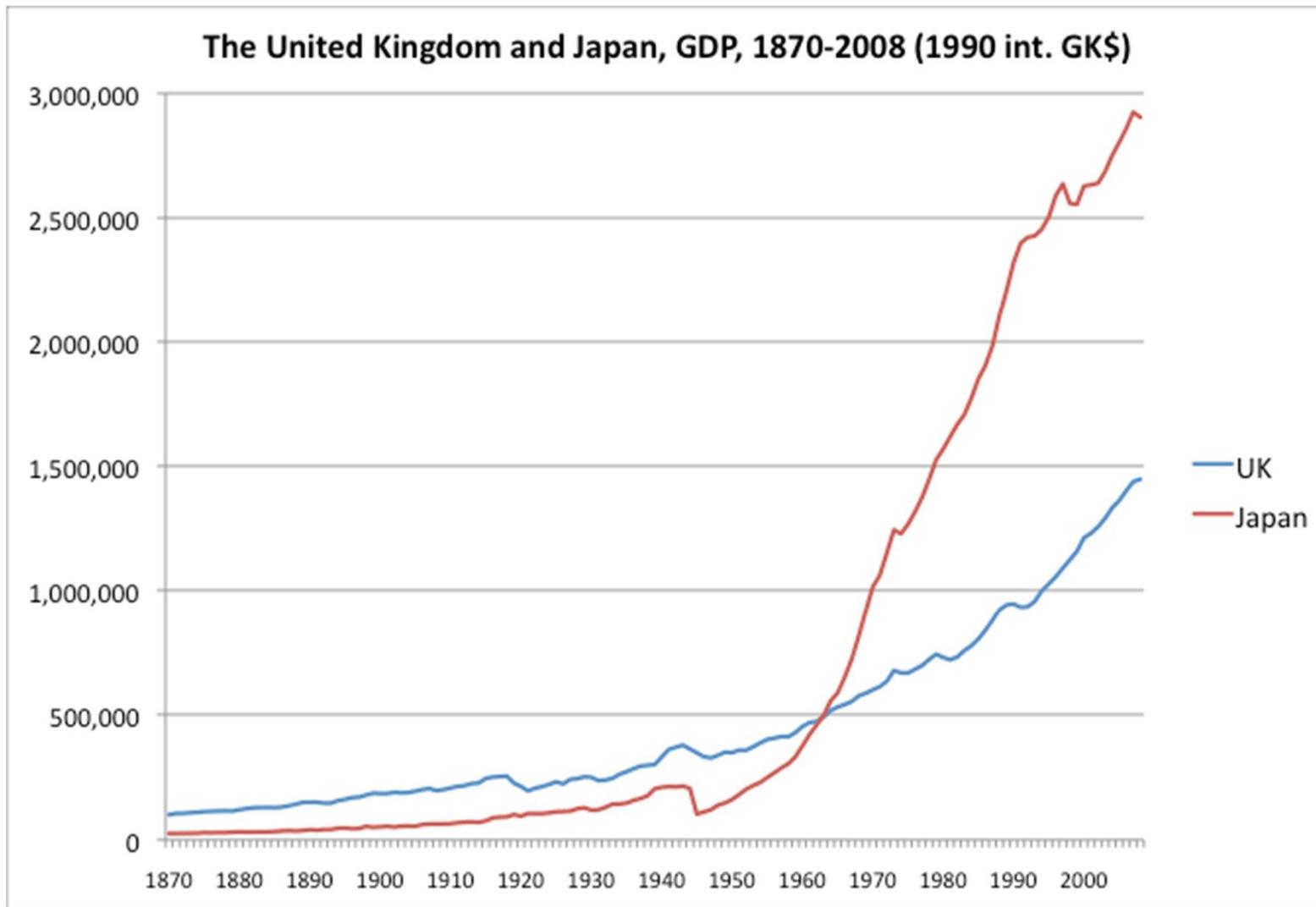
Source: IMF

... now looks unstoppable



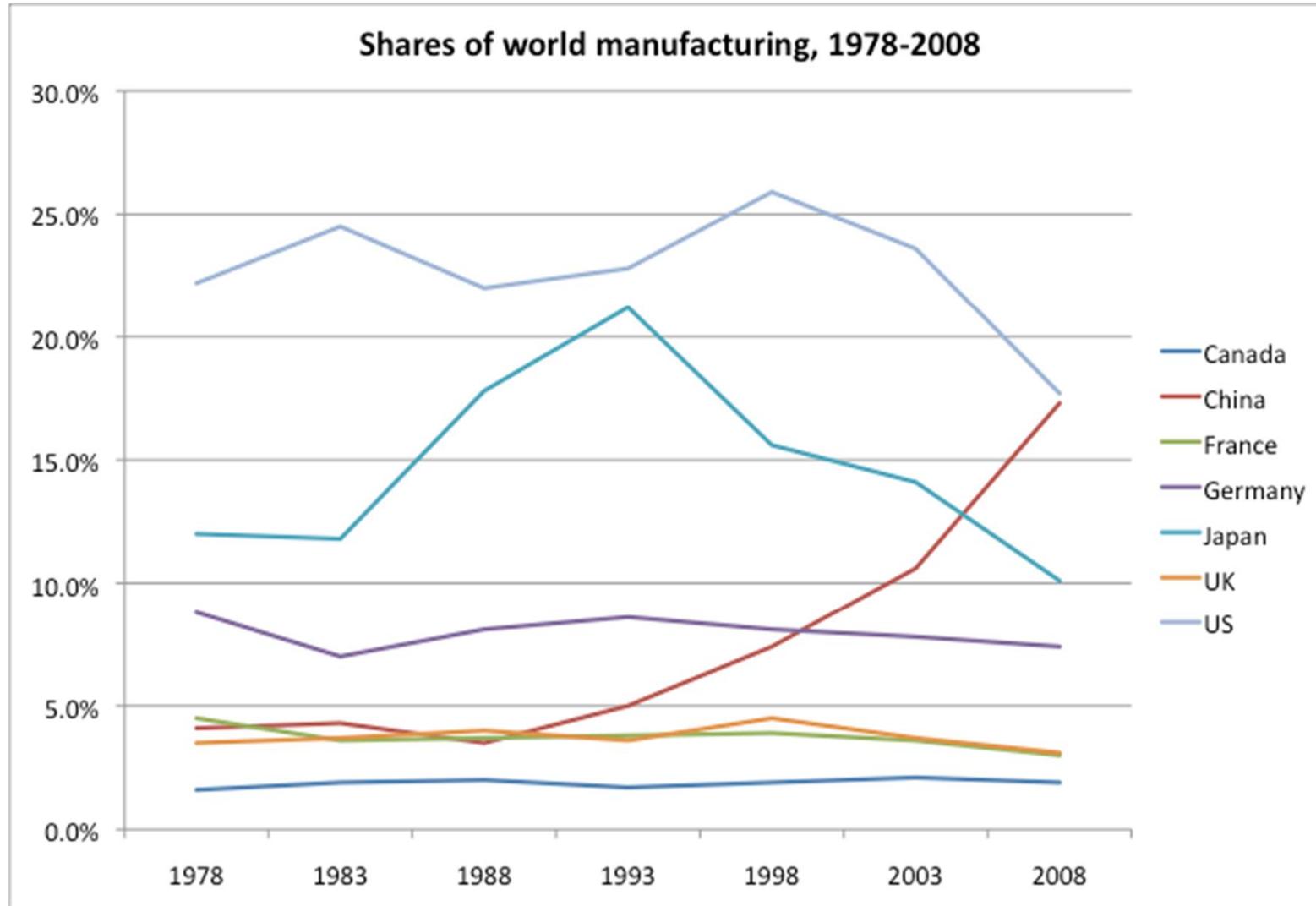
Source: Goldman Sachs

It's happened before



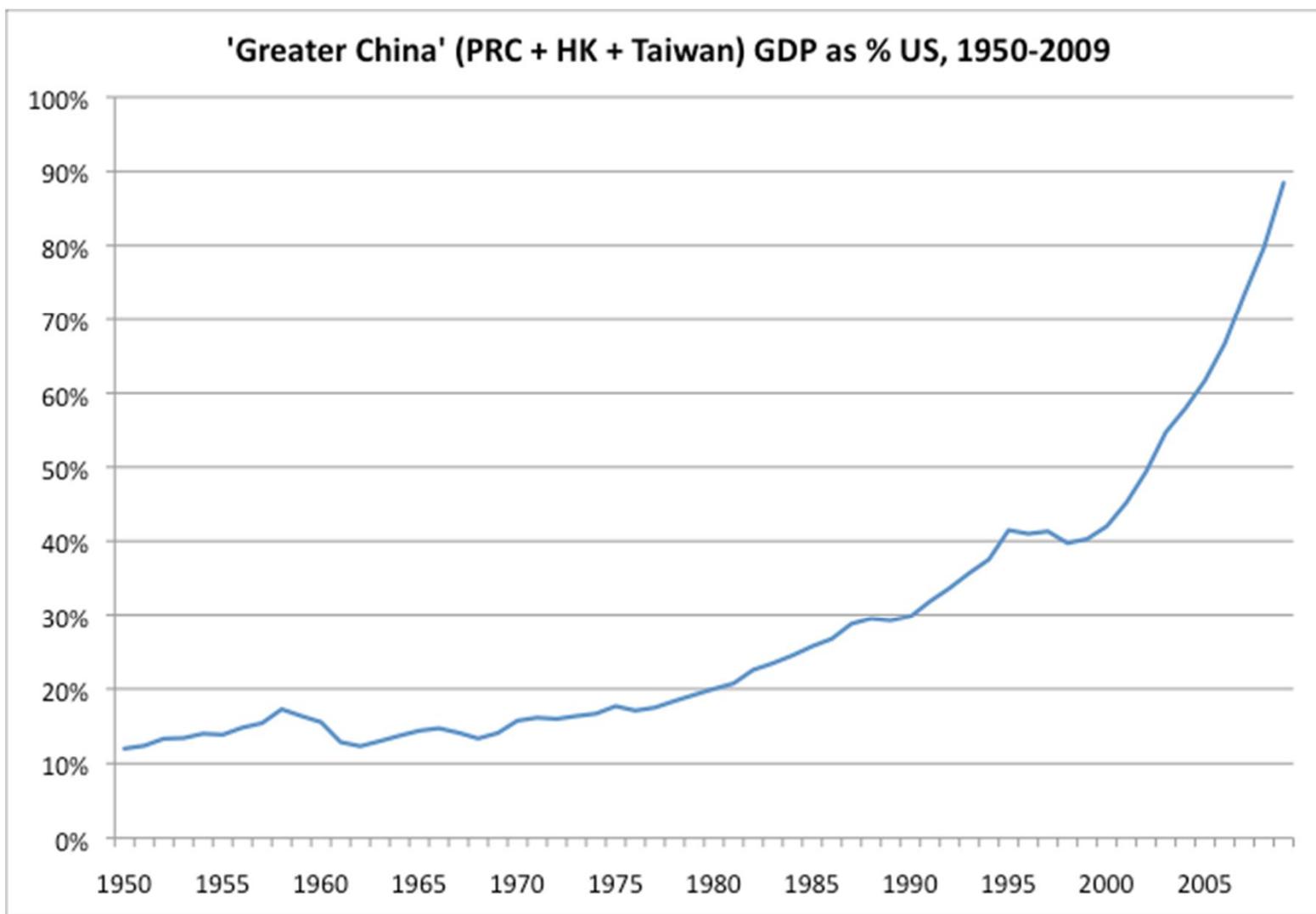
Source: Maddison

It's happened in manufacturing



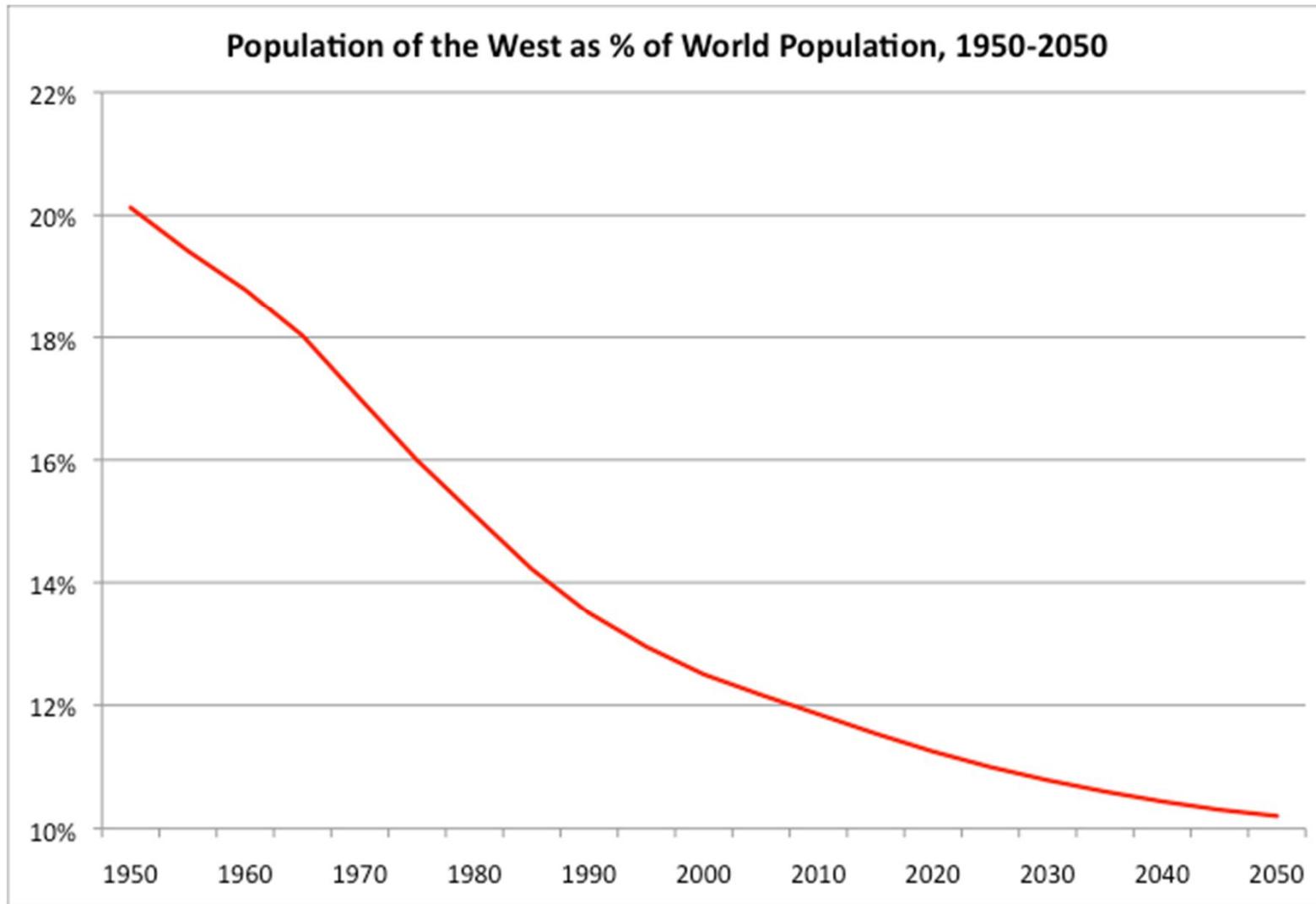
Source: UN

And the East is gaining fast



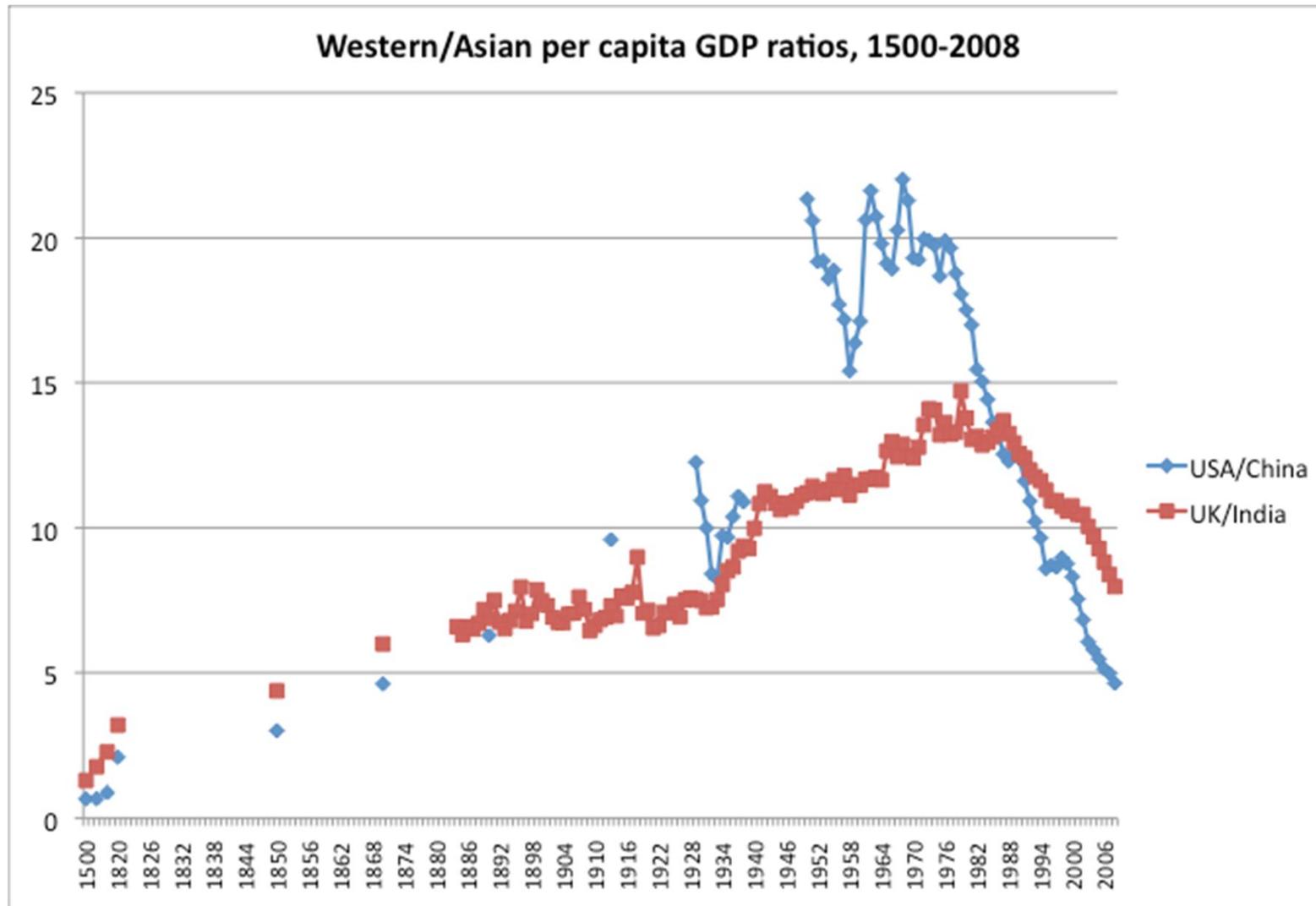
Source: Conference Board

The demographics are clear



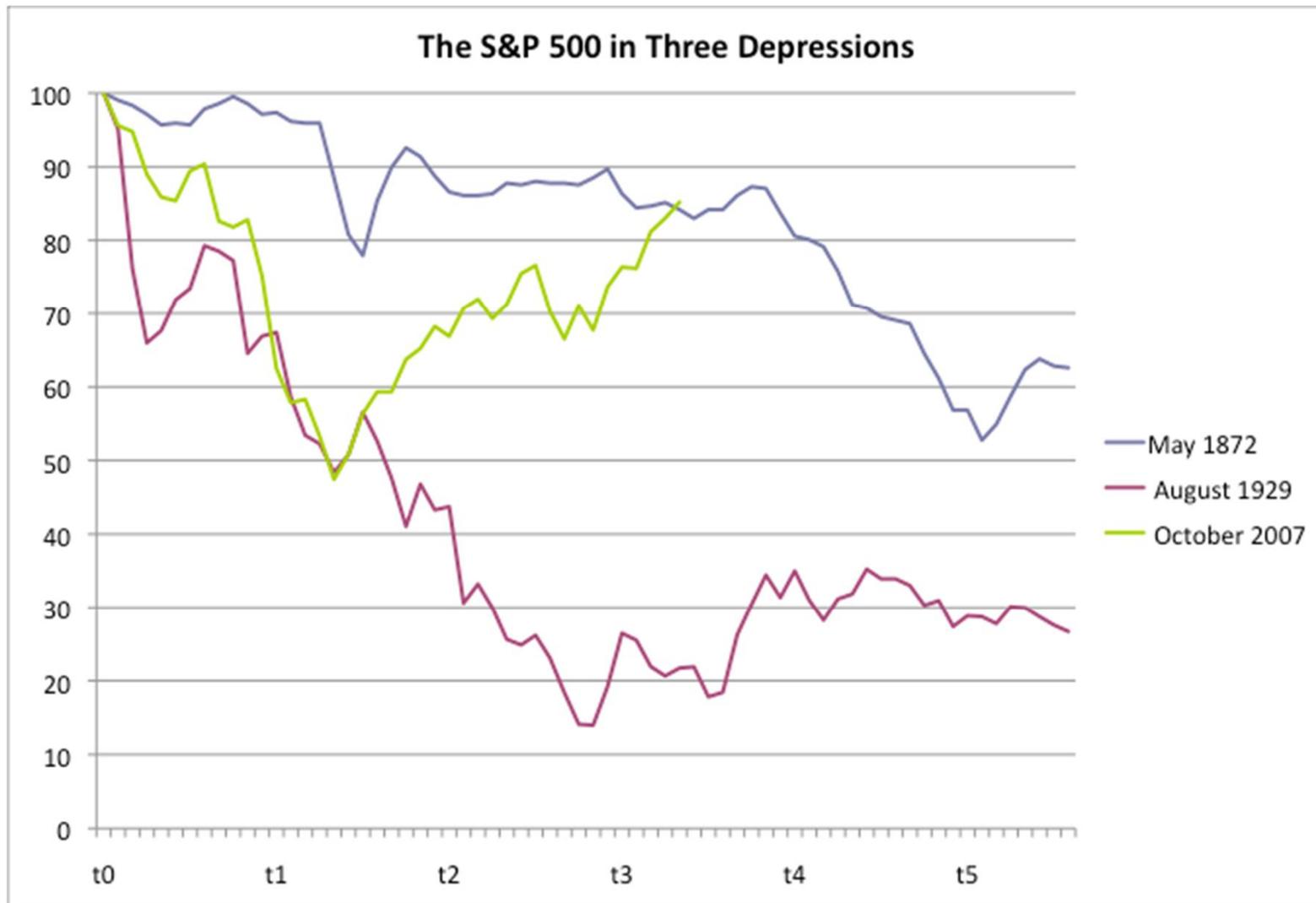
Source: United Nations

It's the Great *Reconvergence*



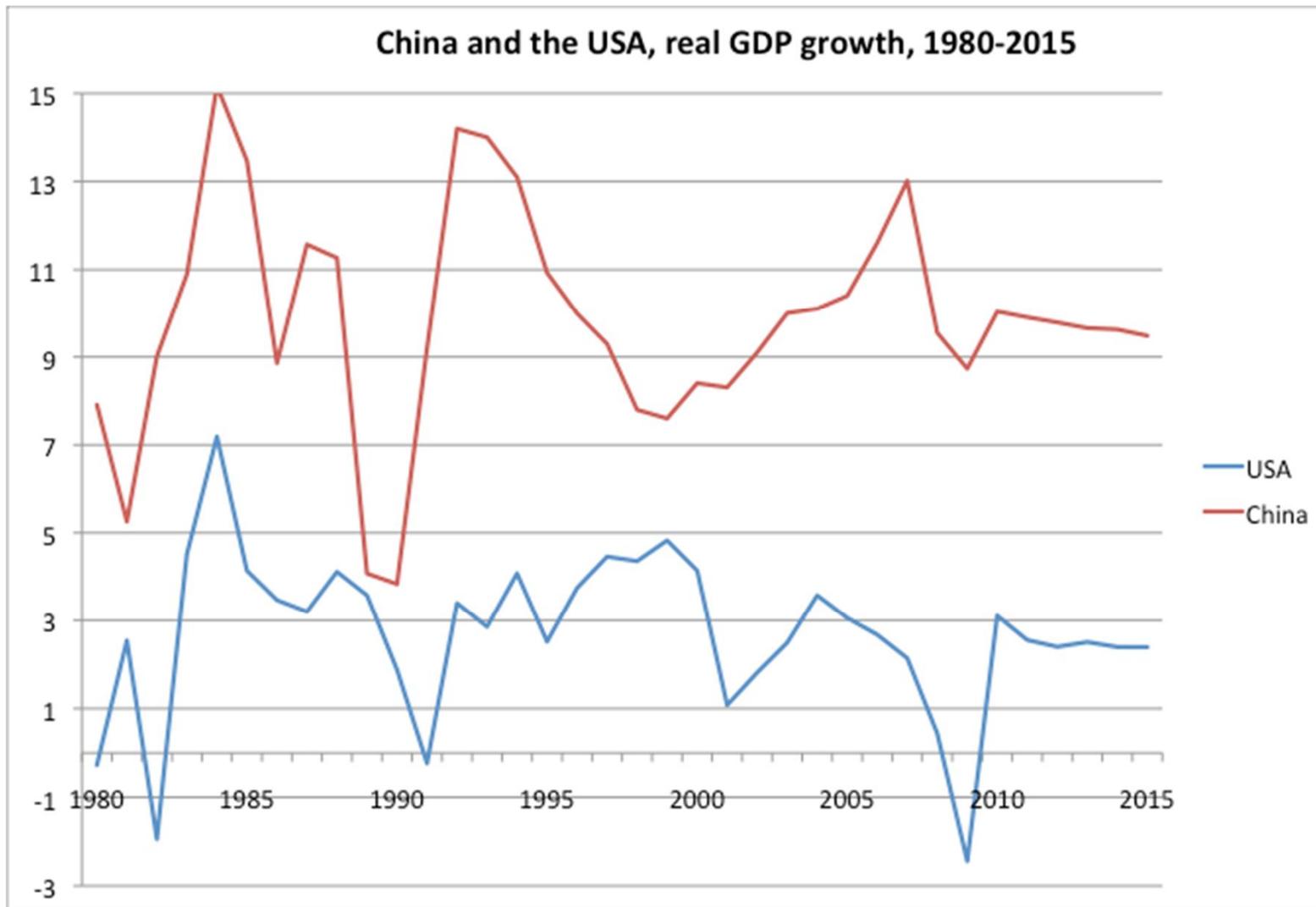
Source: Maddison

And the 'Slight Depression' ...



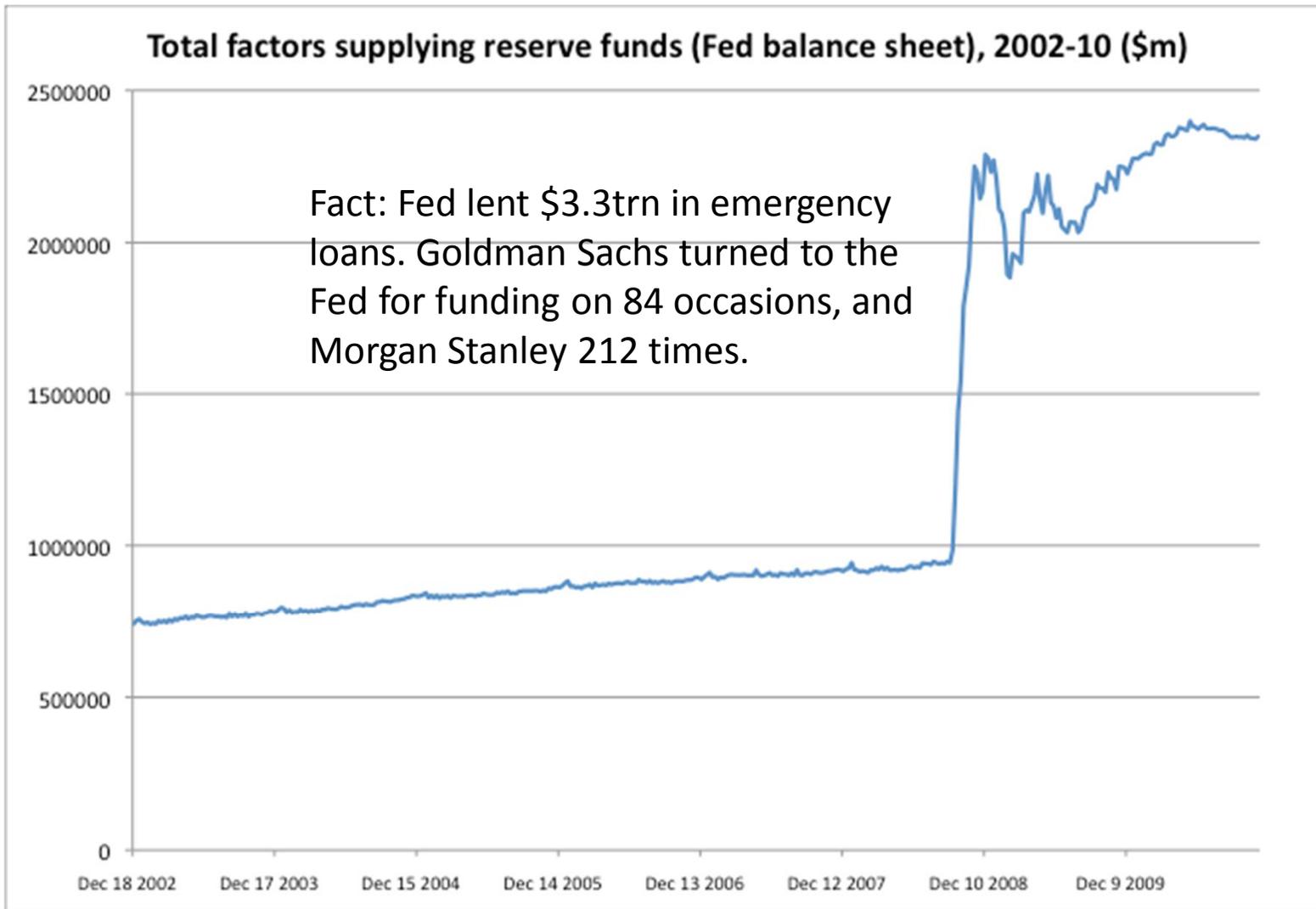
Source: Economagic

... has just speeded things up



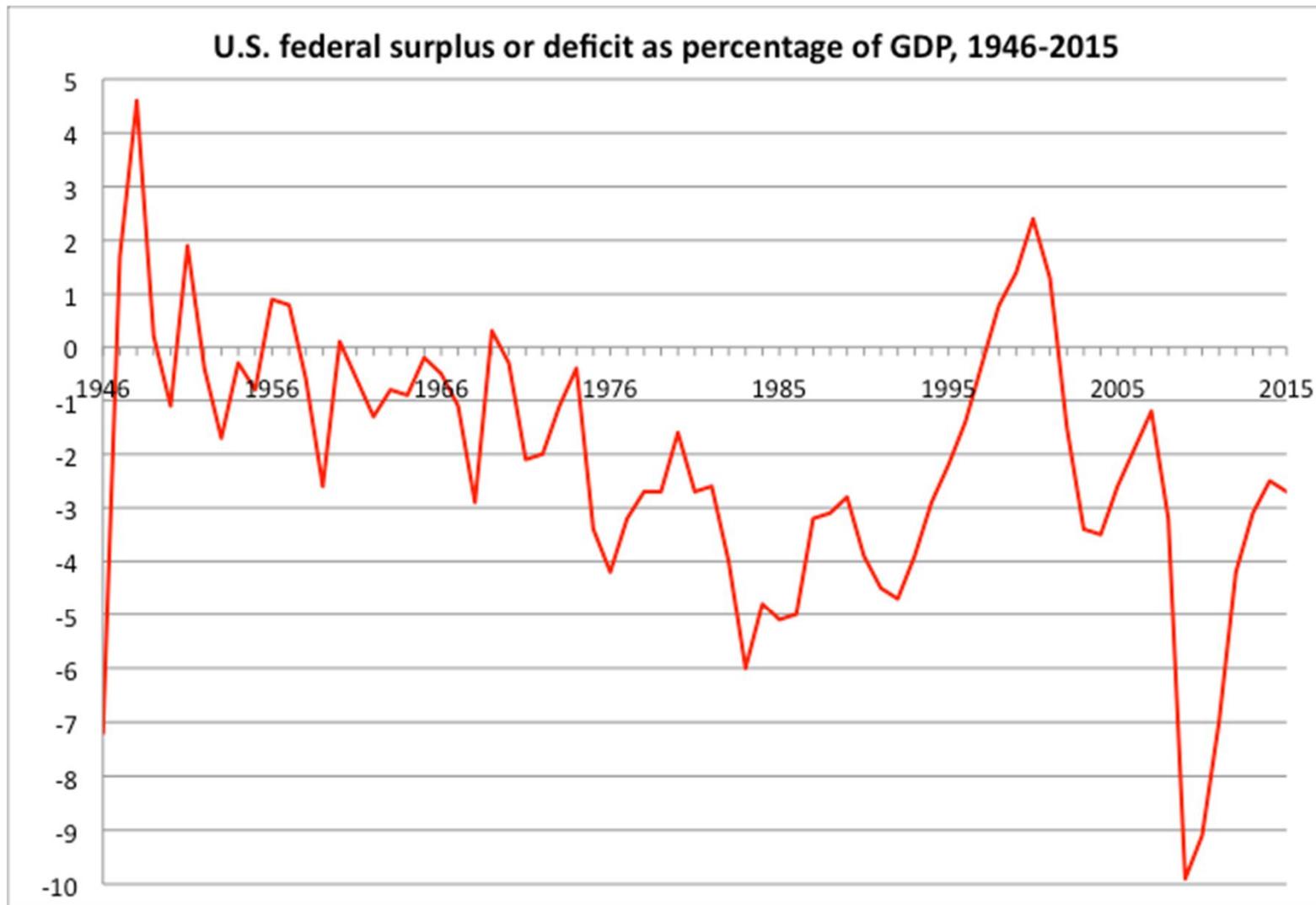
Source: IMF

We tried monetary stimulus (QE1)



Source: Federal Reserve

And fiscal stimulus



Source: White House; CBO

But now comes the hangover

Debt/GDP and Debt/Revenue (2009)¹

	Debt/GDP (%)	Revenue/GDP (%)	Debt/revenue (%)
France	77.6	48.0	161.7
Germany	73.2	44.3	165.3
Greece	115.1	36.9	312.2
Ireland	64.0	34.1	248.4
Italy	115.8	46.6	187.5
Portugal	76.8	41.6	184.8
Spain	53.2	34.7	153.2
United Kingdom	68.1	40.2	169.2
US (federal government)	53.0	14.8	358.1

Source: Eurostat, CBO, Morgan Stanley Research

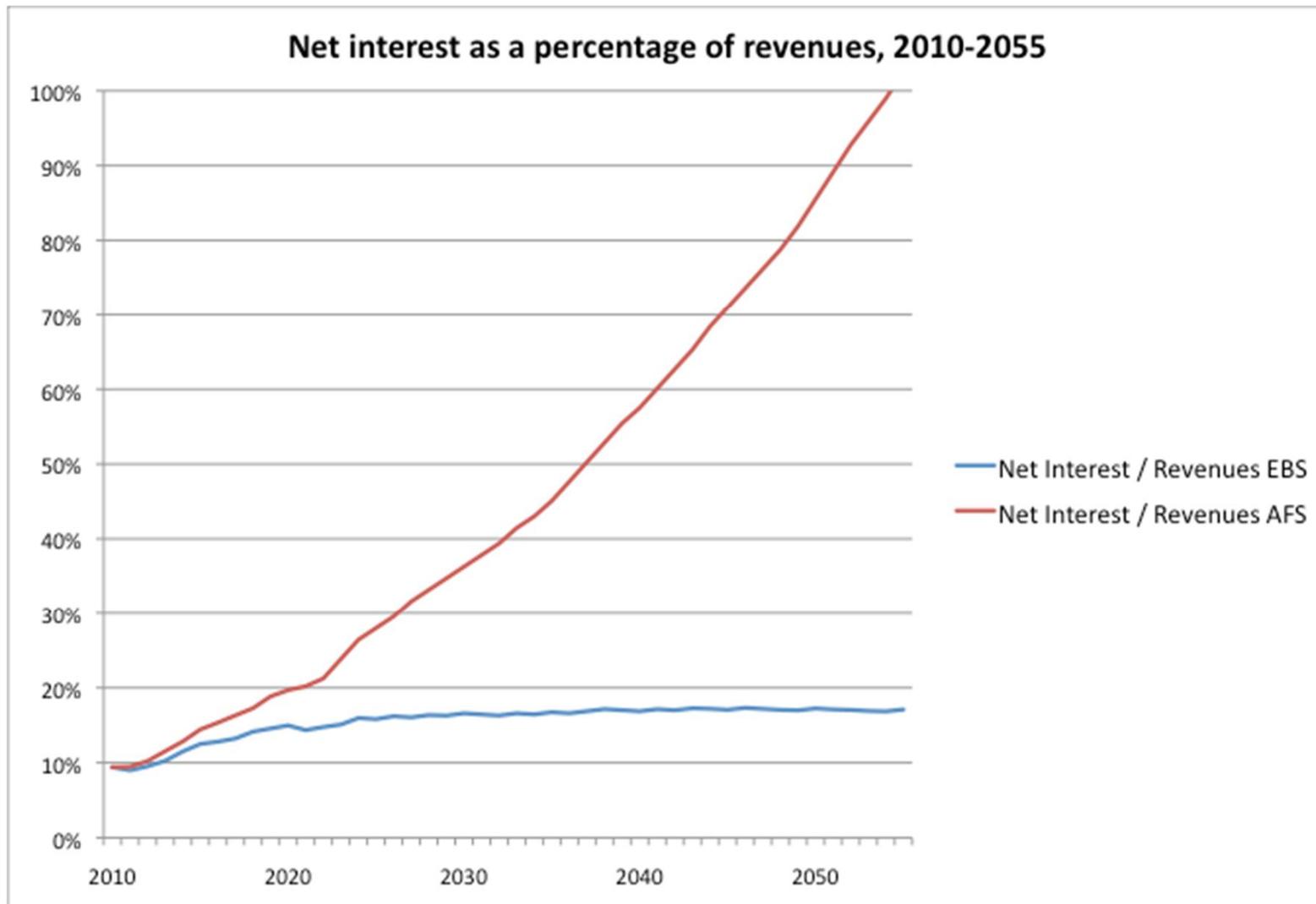
PIGS 'R' US

Debt/GDP and Debt/Revenue (2009)¹

	Debt/GDP (%)	Revenue/GDP (%)	Debt/revenue (%)
France	77.6	48.0	161.7
Germany	73.2	44.3	165.3
Greece	115.1	36.9	312.2
Ireland	64.0	34.1	248.4
Italy	115.8	46.6	187.5
Portugal	76.8	41.6	184.8
Spain	53.2	34.7	153.2
United Kingdom	68.1	40.2	169.2
US (federal government)	53.0	14.8	358.1

Source: Eurostat, CBO, Morgan Stanley Research

Some nasty fiscal arithmetic

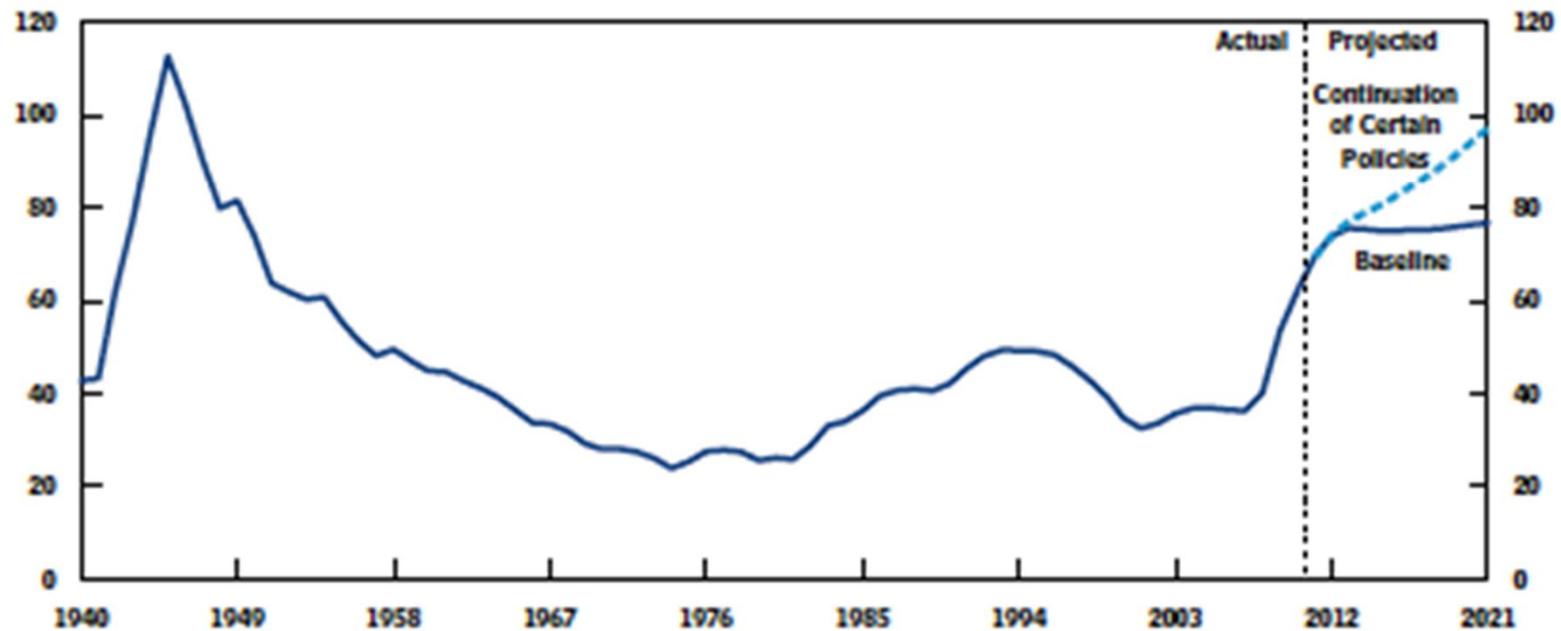


Source: CBO

The American fiscal problem ...

Federal Debt Held by the Public—Historically, in CBO's Baseline, and with a Continuation of Certain Policies

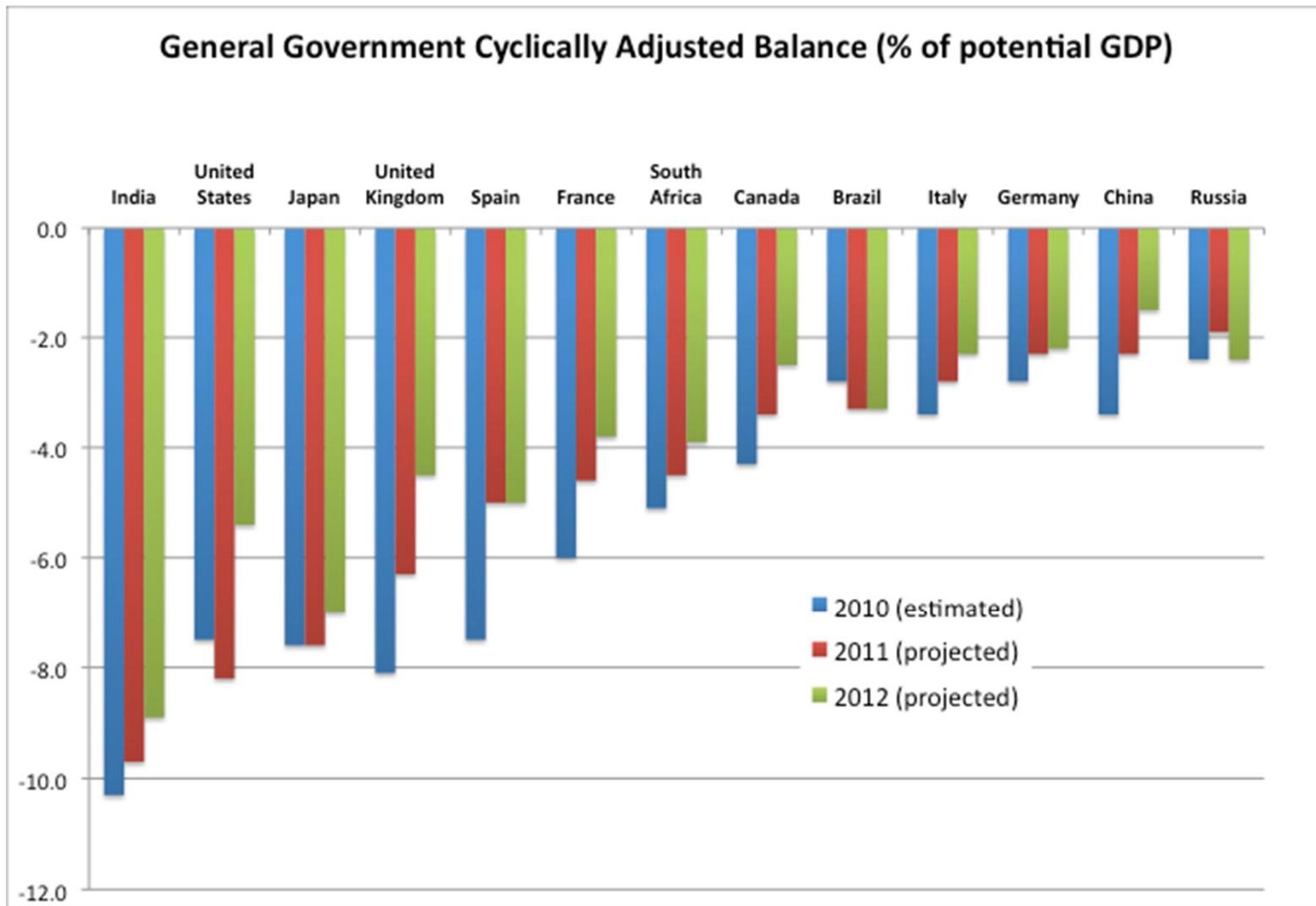
(Percentage of gross domestic product)



Source: Congressional Budget Office.

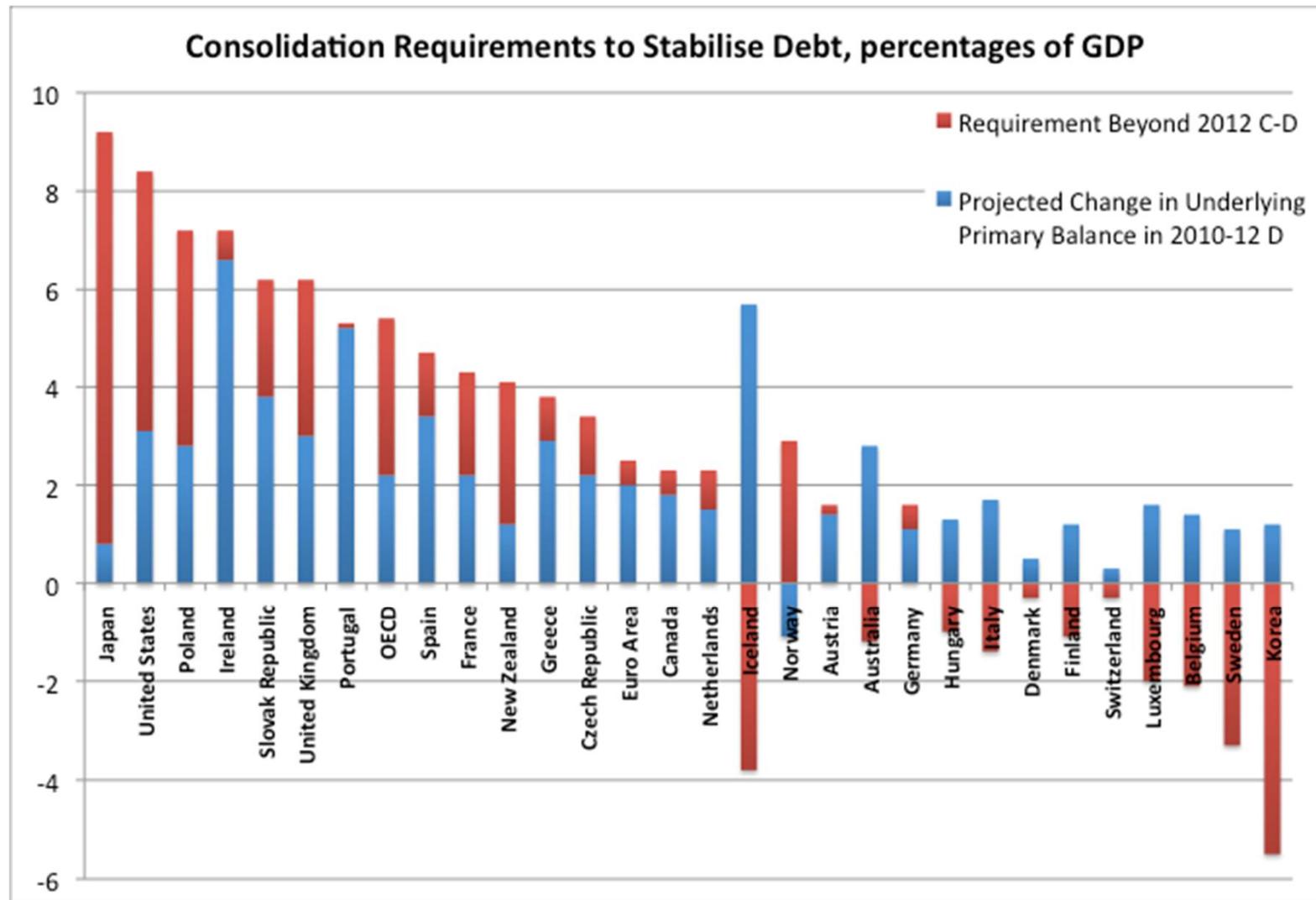
Note: The projected debt with the continuation of certain policies is based on several assumptions: First, that provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312) that originally were enacted in 2001, 2003, or 2009, or that modified estate and gift taxation do not expire on December 31, 2012, but instead continue; second, that the alternative minimum tax is indexed for inflation after 2011; and third, that Medicare's payment rates for physicians are held constant at their 2011 level.

... is by no means unique



Source: IMF

Gaps are hard to close via austerity



Source: OECD

Just ask the Irish



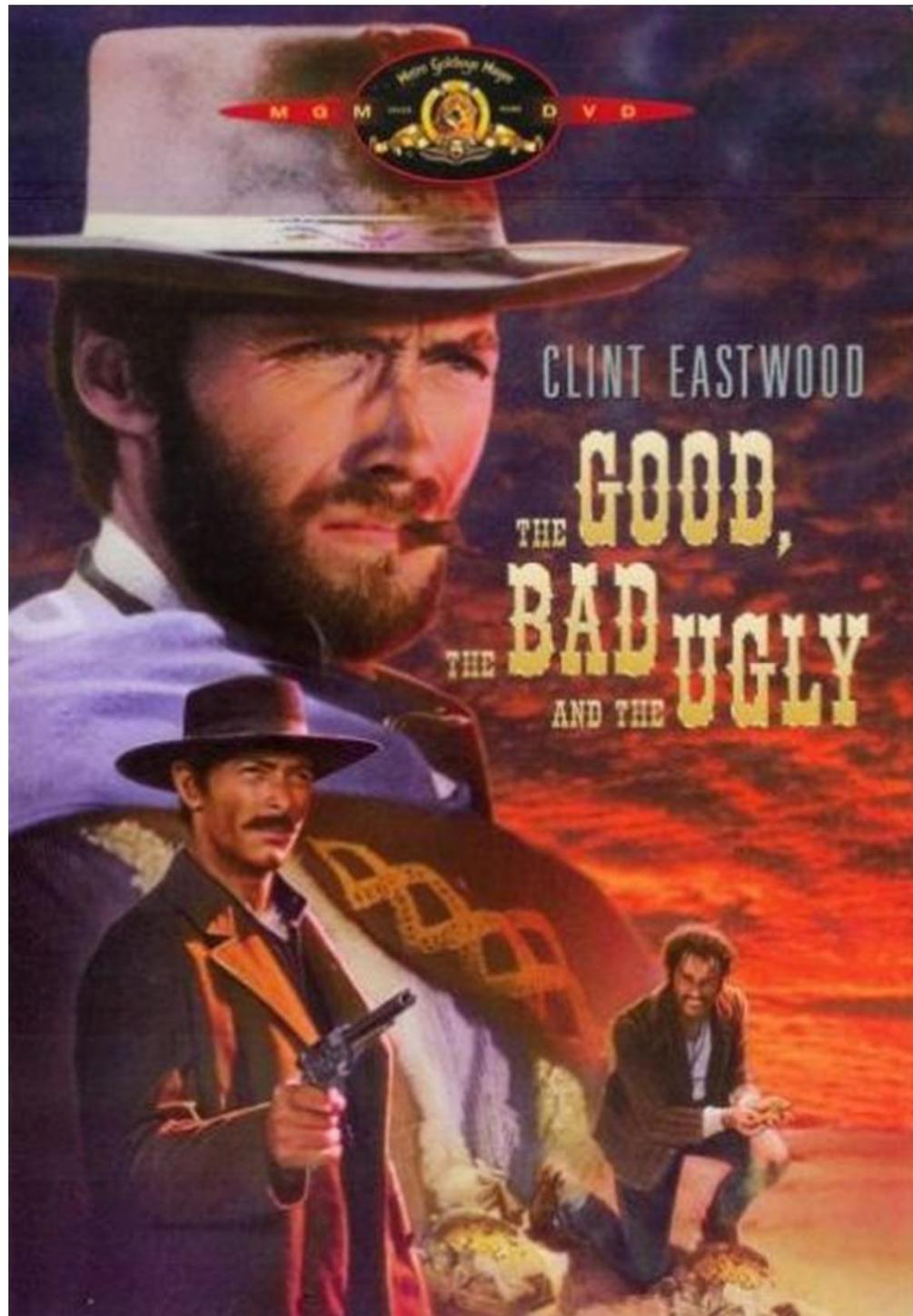
Socialists in (above), Greens out (right)



So anticipate a decade of asset sales



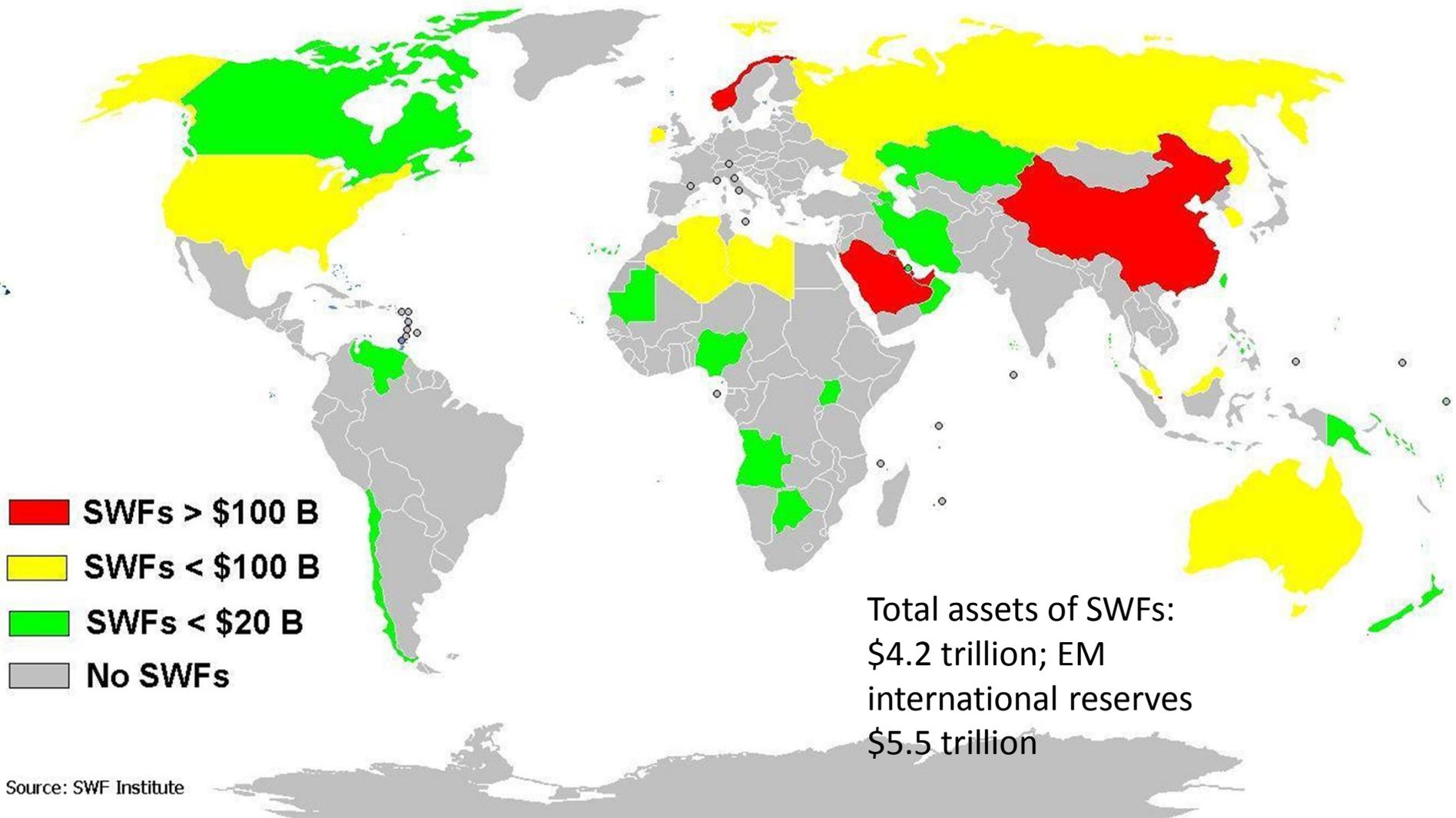
Chad Crowe



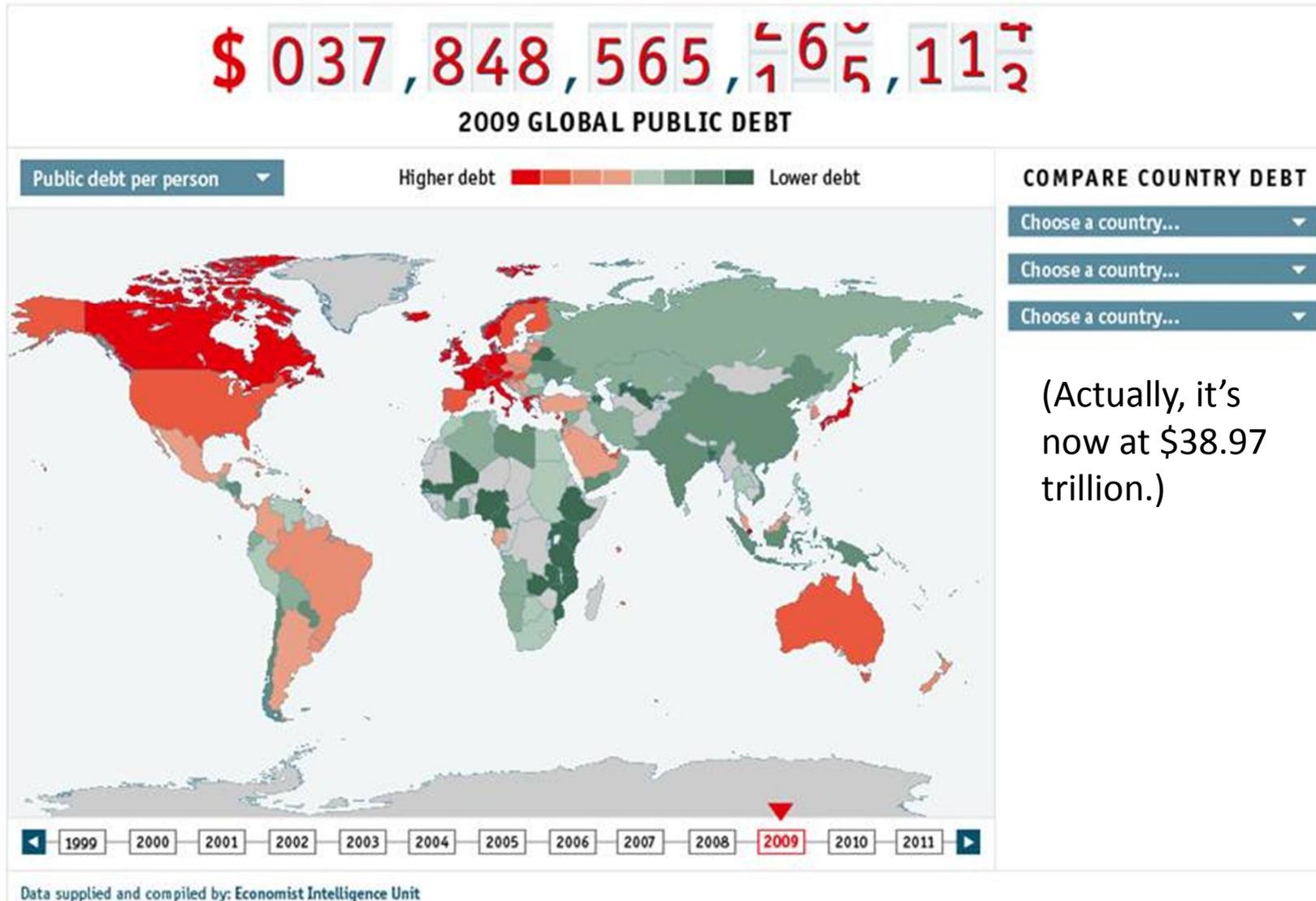
‘In this world, there are two kinds of people, my friend ...



... Those with loaded guns ...

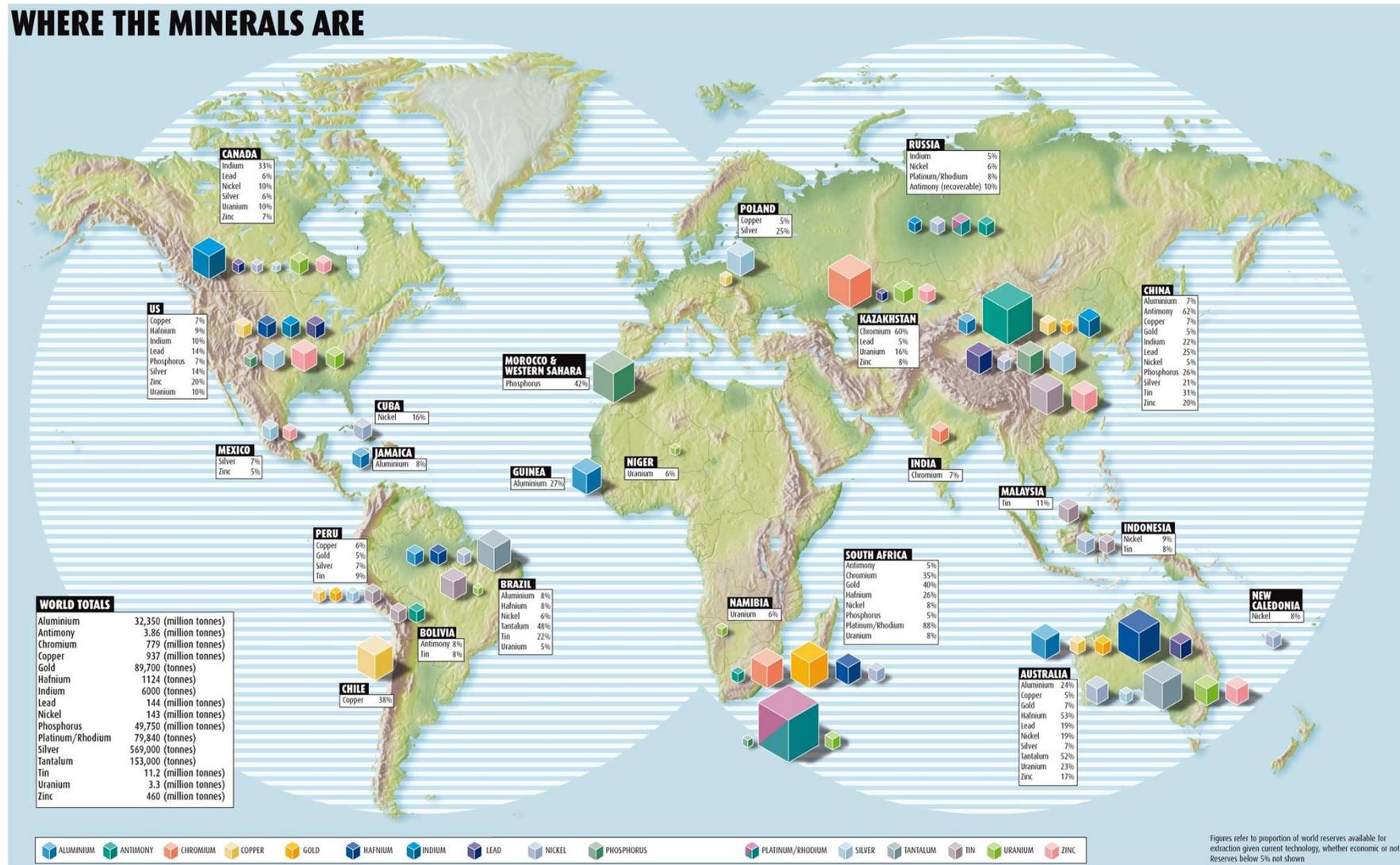


... and those who dig.'

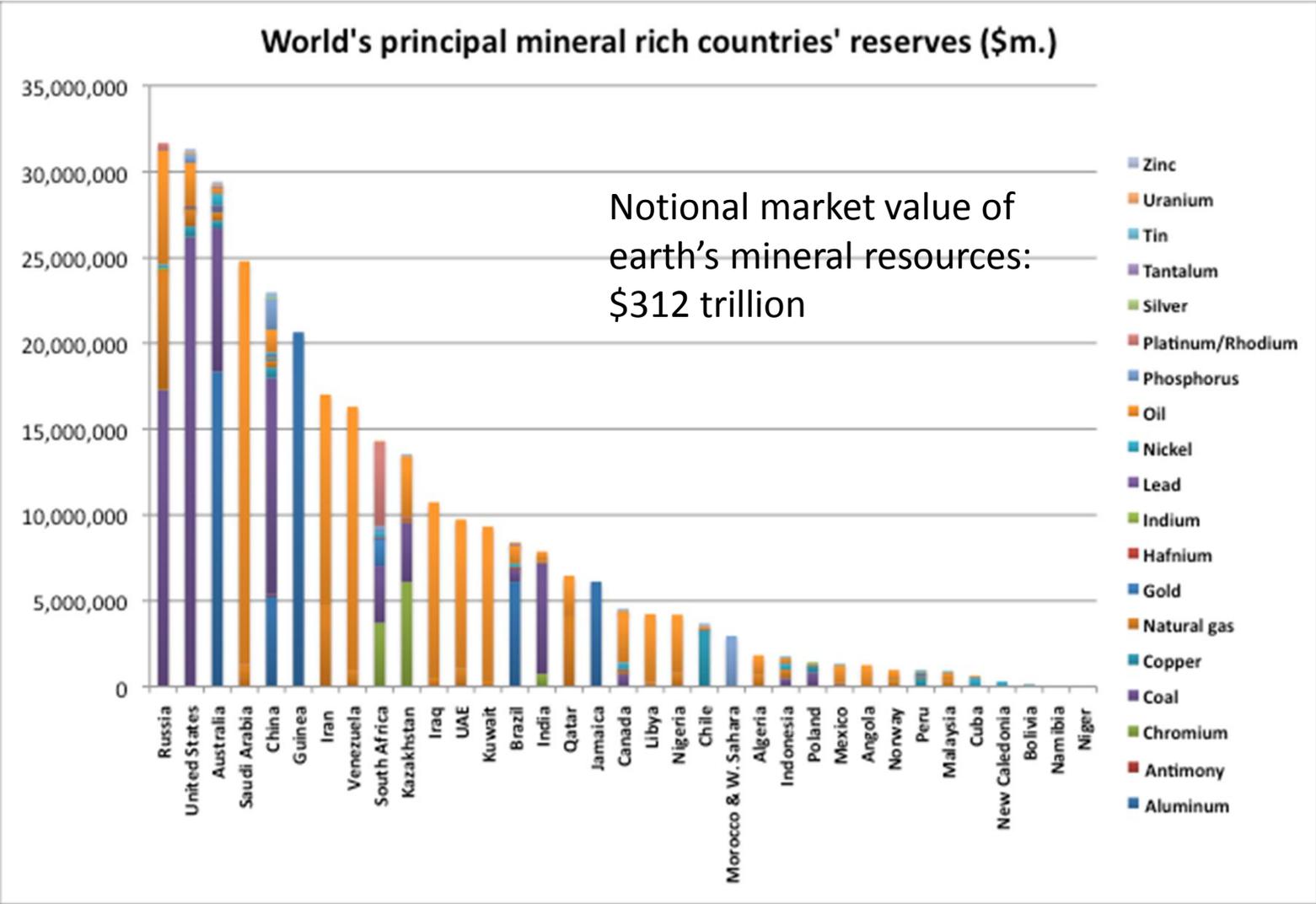


But not everyone has buried treasure

WHERE THE MINERALS ARE



And not all of it is for sale



Source: New Scientist; BP

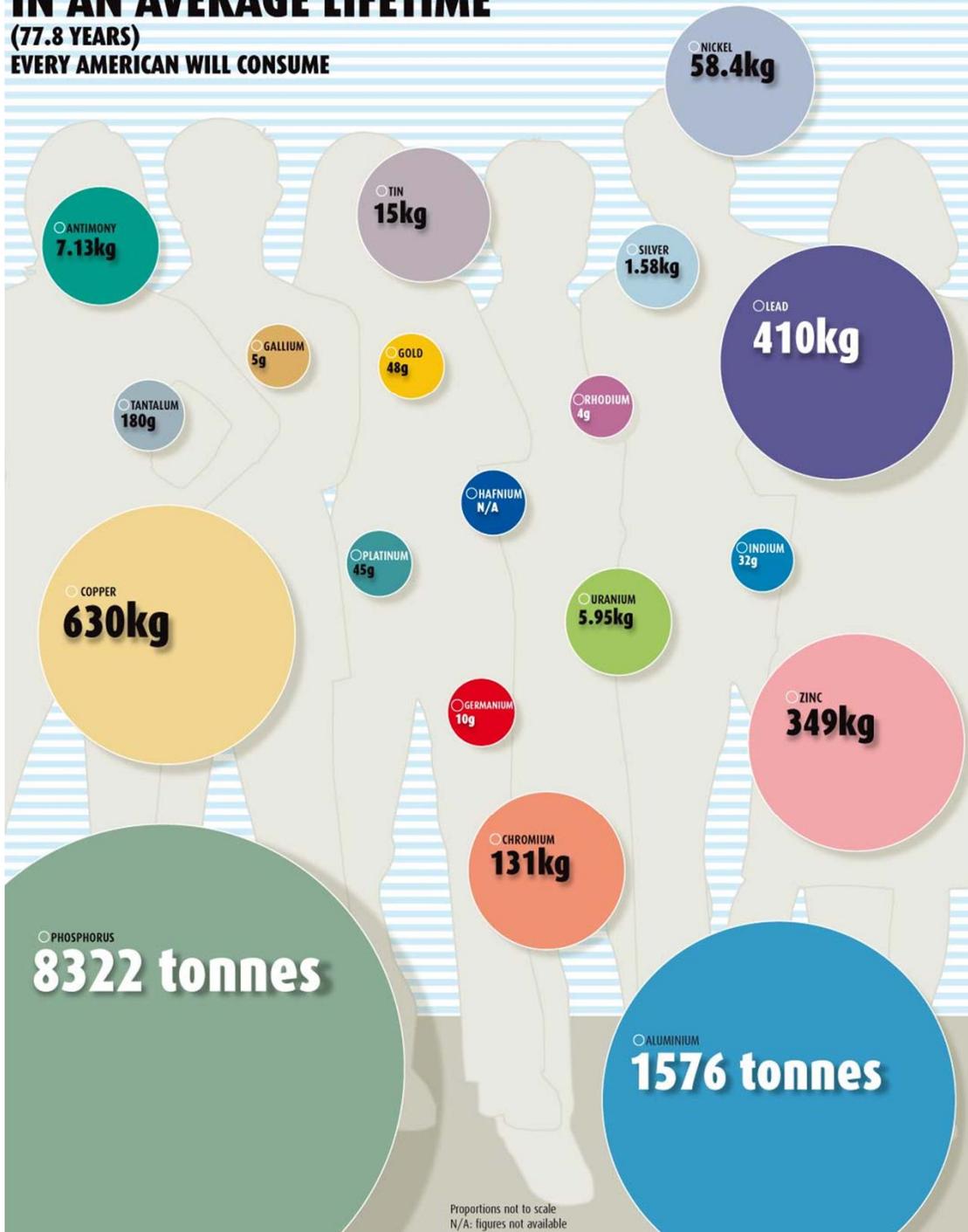
Problem 1: Supply

- “ Earth’s natural resources are greater than we know but not infinite
- “ If rest of world consumes at half U.S. rate, we have 17 years of tin left, 13 years of indium (LCDs for flatscreen TVs) and antimony (flame retardant materials), 9 years of silver and 8 years of lead
- “ Even copper would all be gone in 38 years

IN AN AVERAGE LIFETIME

(77.8 YEARS)

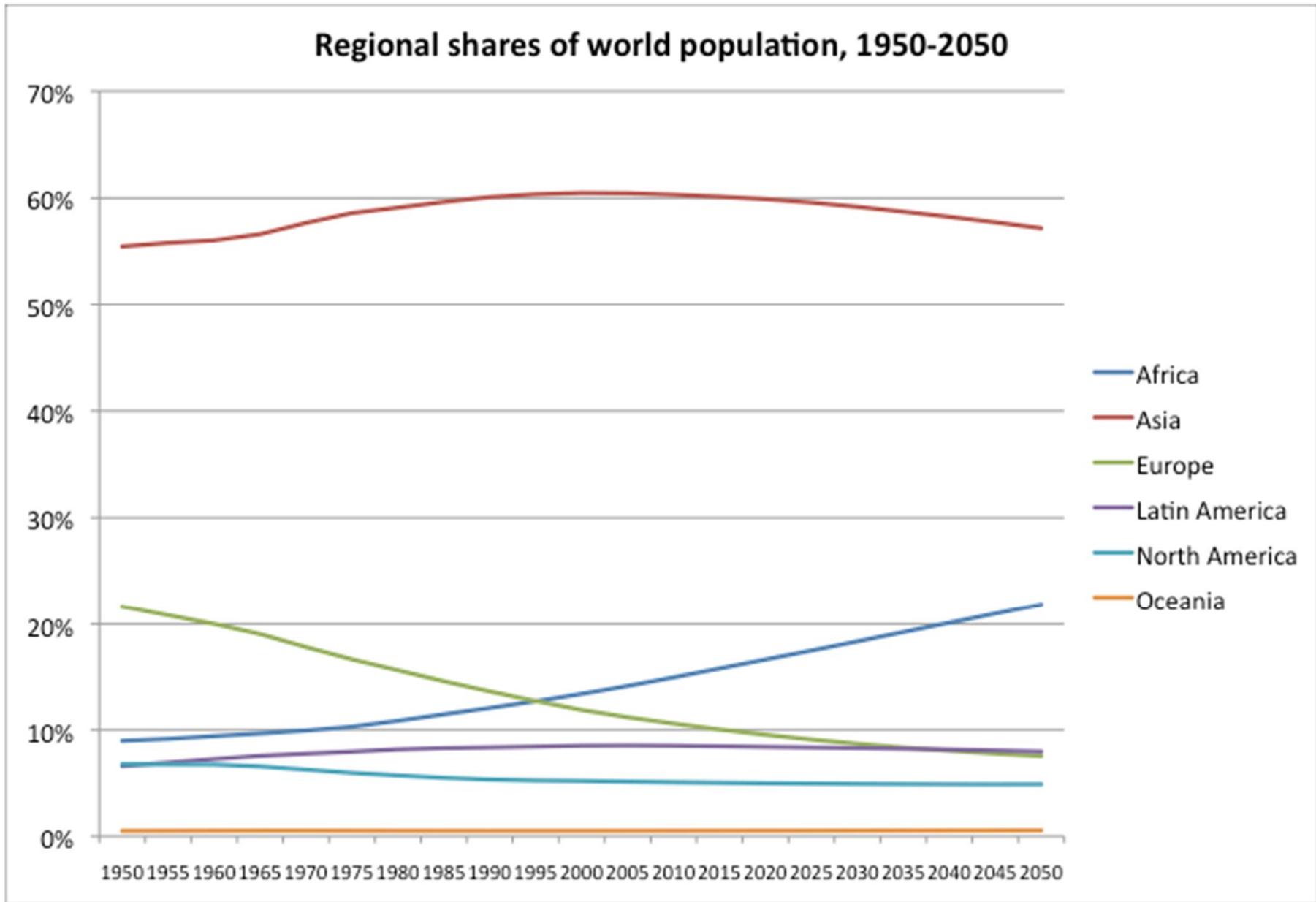
EVERY AMERICAN WILL CONSUME



Proportions not to scale
N/A: figures not available

Problem 2: Demand

- “ Population is soaring in Africa and Asia
- “ World population will grow by 2.2 billion between now and 2050
- “ 43% of increase will come in Africa and 48% in Asia
- “ Asia can generate jobs by the billion, but African can't



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat

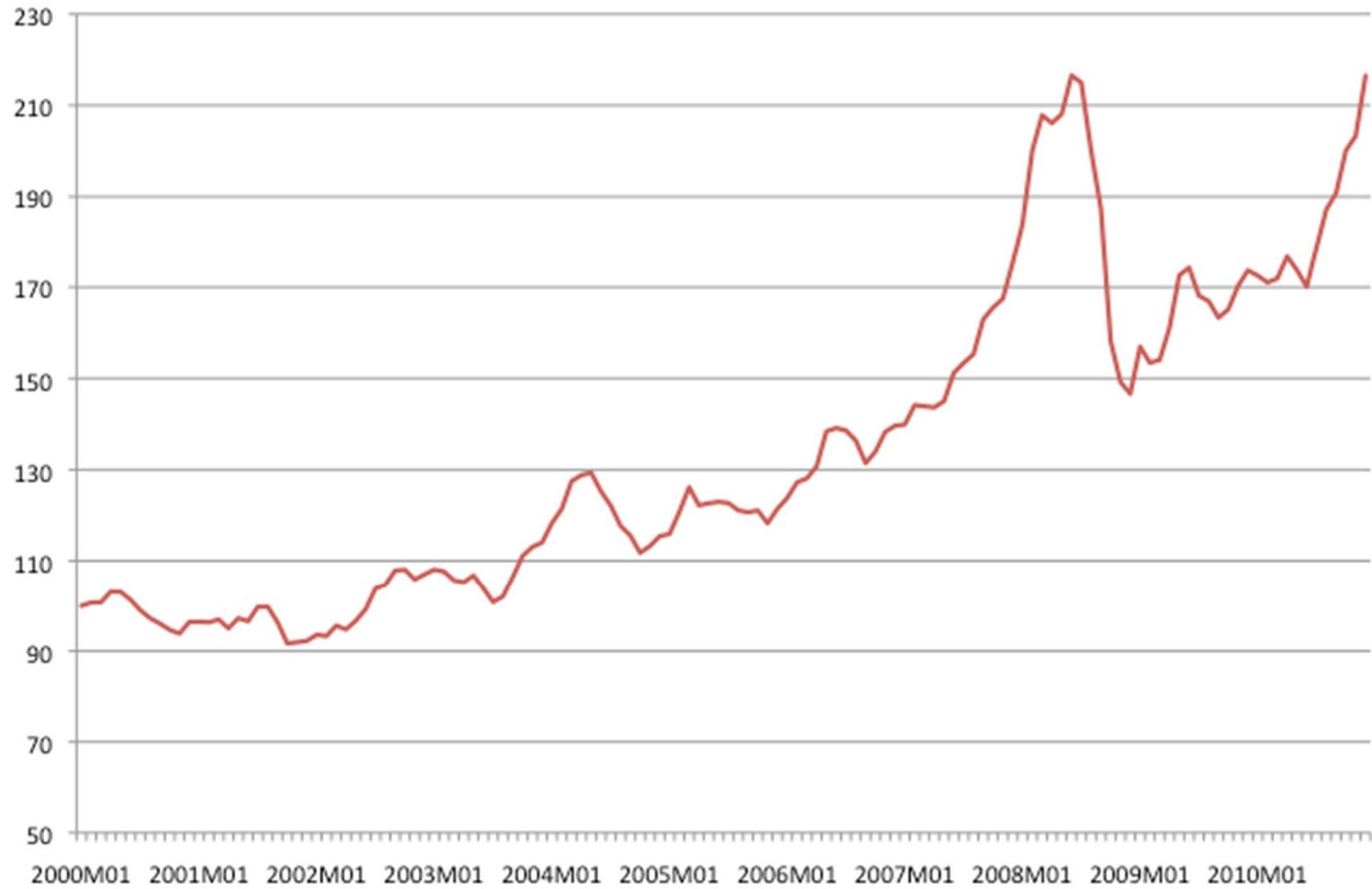
Problem 3: Prices

- “ All commodity prices are up, not just minerals
- “ Food and non-food commodities correlated
- “ 24 month change:
 - . Food +43% (sugar 162%)
 - . Energy 82% (oil 115%)
 - . Industrial raw materials 105% (cotton 210%, rubber 267%)
 - . Metals 124%
 - . Only losers?

Problem 3: Prices

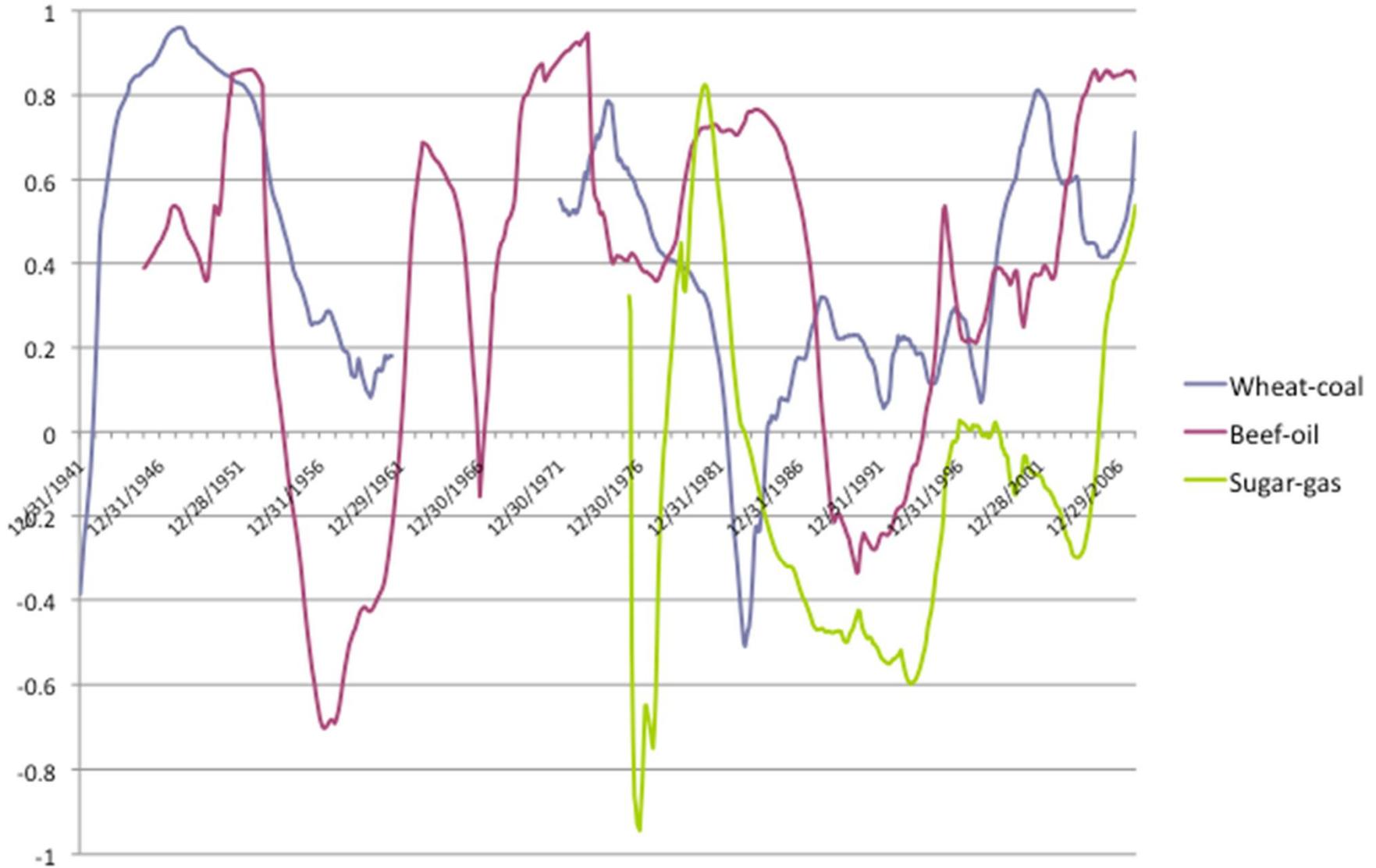
- “ All commodity prices are up, not just minerals
- “ Food and non-food commodities correlated
- “ 24 month change:
 - . Food +43% (sugar 162%)
 - . Energy 82% (oil 115%)
 - . Industrial raw materials 105% (cotton 210%, rubber 267%)
 - . Metals 124% (iron ore 148%)
 - . Only losers? Natural gas, logs, olive oil, chicken, rice, shrimp – also oranges

Global food and beverage price index (Jan 2000=100)



Source: IMF

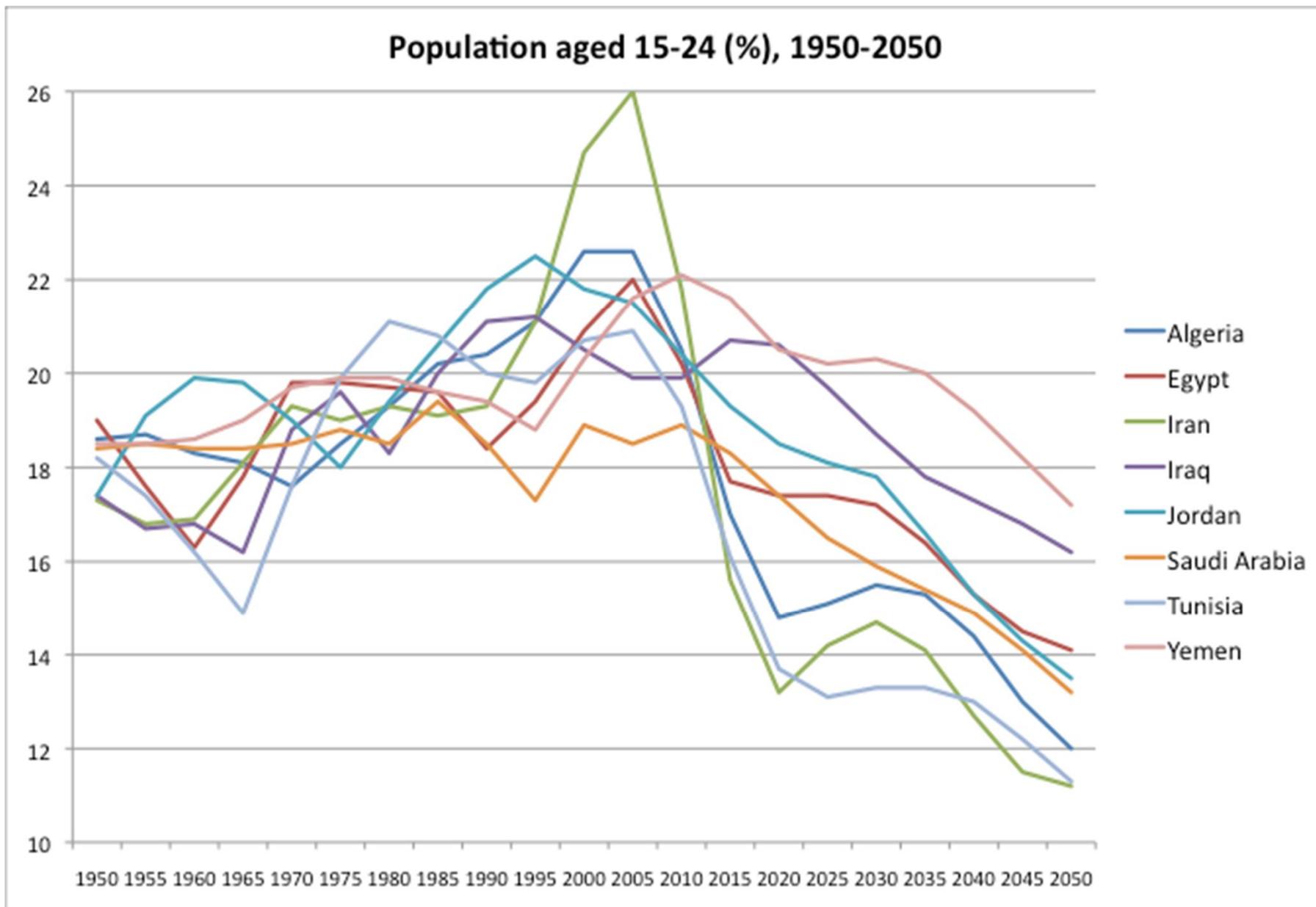
Food to fuel price correlations, 10-year rolling windows, 1941-2007



Source: Own calculations

Problem 4: Revolution

- “ High food prices have disproportionate effect low-income countries where food accounts for a large share of household budgets
- “ Other predictors of revolution / civil war
 - . Authoritarian regime 30+ years old
 - . Youthful population
 - . High youth unemployment
 - . High cellphone and Internet penetration



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat

What happens next?



A Libyan protester on a tank in Zawiyah holds sign reading: 'Our demand: Freedom'

Are we heading back to the 1970s?

Note: CPI today
1.7%; using 1990
methodology
5.0%; using 1980
methodology 9.1%

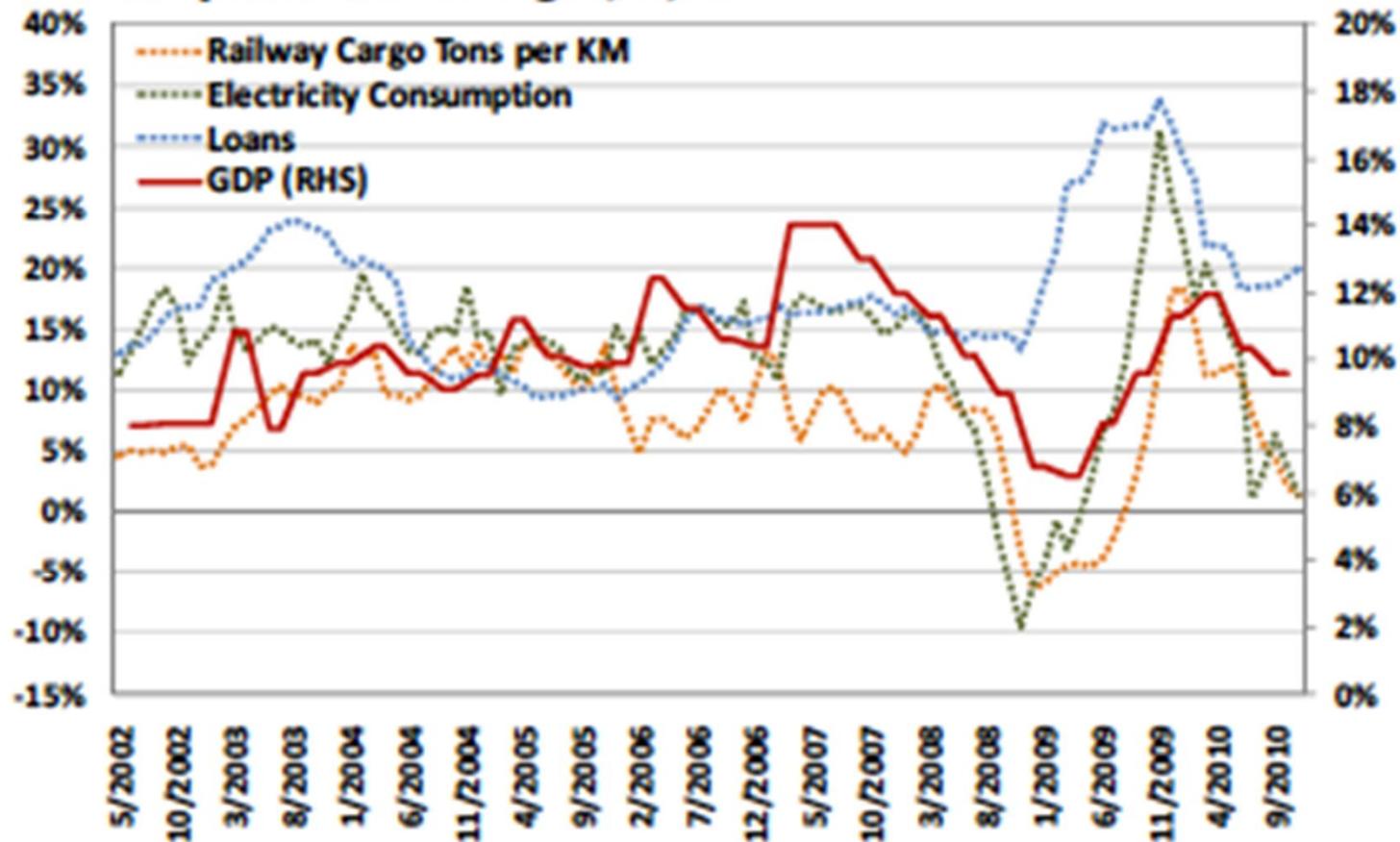


G. G. G.
THE MILWAUKEE JOURNAL

"This may not be as simple as I thought!"

Or will fear of 'jasmine' make the Chinese brake harder?

GDP, Loans, Railway Cargo and Electricity Consumption (% change yoy*)



Source: NBS, CEIC, RHG; *3mma for loans, cargo and electricity

The end of Western predominance?

- “ ... after five hundred years when the West ruled the Rest
- “ The fiscal crisis of the Western economies is chronic
- “ It can be solved only by asset sales to the rich Rest
- “ But supply and demand factors are ratcheting up commodity prices
- “ And generating political instability in *some* emerging markets
- “ The key decisions of the year will be taken in Beijing not Washington

The Slight Depression is a symptom ...



... of a bigger global shift