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US vs China: Watch the power game play out
21 Dec 2009, 1211 hrs IST, Andy Mukherjee, ET Now
Dr Faber, in the September issue of the Gloom, Boom & Doom Report you said that the future will be a total disaster with a collapse of our
capitalistic system as we know it. Three months later do you still stand by that assessment or did you underestimate the power of the governments to shore up the global economy?

Well, I think we had this huge intervention in the world but if you look at the cause of the financial crisis. The cause of the financial crisis was excessive credit growth and essentially the private sector has reacted rationally. After 2008, the private sector has reduced its leverage, in other words, the consumer credit is declining and business credit is also declining but this is being offset by a huge expansion of government credit. So total credit as a percent of the economy in the US is still growing. Now officially, the debt to GDP is 375%, it was 186% when the US went into depression after 1929. In other words, we start with a much higher debt level. In 1929 we did not have social security and we did not have Medicare and Medicaid and if you add this unfunded liabilities of Medicare and Medicaid and if you add Fannie Mae and Freddie Mac, that have been taken over by the government, we are talking about the debt to GDP of over 600%. In my opinion, in the long run, this is not sustainable. They will have to print money and the fiscal deficits will go up and the problem will be that one day when interest rates go up for whatever reason and may be next year or in three years time, the interest payments on the government debt will balloon and in say seven years time, the interest payments on the US government debt will be between 35% to 50% of tax revenues and when you are in a huge mess.

And so I believe that to get out of this mess, they will monetise and they will have all kind of stimulus packages and they will lead to high inflation and the standards of living of the typical household will go down and it will enrich a few people the elite essentially on Wall Street. But then to distract the attention, the US will escalate its war efforts and then all thing will collapse. But, you know, it can be in ten years time, could be in five years time, could be in three years time, could be 12 years time, who knows but that is essentially my long term very negative view. Now as an investor, you cannot sit there then I don't do anything at all because by being in cash you have zero interest so you have to do something and so I think that equities are probably a better place to hide than government bonds.

ET Video: Marc Faber on Gloom, Boom & Doom Report
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You have also said that somewhere in the future there will be a war and during what times commodity prices go up sharply, don't you think the threat of war is exaggerated given that nations have shown considerable restraint in international relations during this recession?

I think, the interest of the US and China are further apart than ever before because you have essentially declining superpower the United States and you have a rising superpower China and the current superpower the US will obviously try to contain the rise of China and China will want to have more say in global affairs and you can see their expansion everywhere in Latin America, in the Middle East even in the Indian Ocean, in East Africa and so forth. So that will lead to tensions. We are at war essentially in Iraq and we are at war in Afghanistan, Pakistan and these are wars in my opinion where there is no solution and this is not going to go away. It is going to escalate over time.

So does one then assume that you are still not very optimistic when it's comes to the US economy or the markets?

Basically, the problem of the United States is that they do not produce enough compared to the whole economy and that its net savings are very low. In other words if you have two countries or let's put it in more simple terms, you have two households or two businesses; one household spends everything it earns, one spends everything it earns pays out in dividends and borrows money to maintain the lifestyle of the owners of the family to buy a car, to buy a house, to buy appliances, mobile phones and so forth the other household or the other company - out of its earnings puts something aside and invest in education or in terms of a company in research and development or in new plans and in new machinery and so forth who do you think in the long run will be better off. Consuming means exactly what the word says consumption is you have a plate of food in front of you, you consume it then the food is gone and saving is to put it part of the food aside for the wintertime or for emergencies. So, in my opinion, US has badly abused its power to borrow money basically and has not saved at all in the last few years and obviously, in the long run, relatively speaking, your standards of living go down compared to countries like China and India where you have a high savings rate and where people then build factories and develop their infrastructure and develop the educational standards and so on. So if you look at 1950, the US is up here and the emerging economies are down here and now the US is still up here but is not up much and emerging economies stay close the gap, there is still a gap between the US and most emerging economies but you look at educational standards in the US, in many states of the US 20% of their people are illiterate you know this I mean horrible.

The recent rise in gold for the most part has been on the back of a weak dollar now that the dollar is strengthening should one get cautious on gold?

The dollar has been weak but the other currencies are not much better either because they are tied to the dollar one way or the other or they are not tied to the US dollar they have gone up against the US dollar but basically the ECP in Europe is also money printer and the EURO has many problems as well as other currencies that were strong against the US dollar. So what can happen is that essentially the dollar is very strong but gold still holds or even goes up. If you are a European or if you are Swiss may be you decide to shift some money into gold and especially we have now in the world $7 trillion in foreign exchange reserves up from a trillion in 1996. So we have gone up in the foreign exchange reserves, in international reserves seven times. The price of gold has had gone up seven times over that period of time and in Asia we have essentially central banks that hold including Japan 70% of the $7 trillion and they have by enlarge less than 2% of their reserves in gold. So I think that a lot of central banks will follow the example of the Reserve Bank of India. By the way, the Reserve Bank of India deserves applause they have done a very good job by enlarge, is very well run central bank.

In terms of Indian equities which are the best places you would like to invest?

Well I am not specialist on Indian you really have to ask the stock picker in India but I would say I am the Chairman of the India Capital Fund and the Manager Johnson is overweight banks. He likes the banking sector and I can see why because in the western world the banks are over leveraged and they have still huge problems coming along as a result of there exposure post residential and commercial real estate but in India the banks are relatively sound. They did not play in the CDO market and mortgage backed securities market and all kinds of speculative activities and so forth. So they are relatively clean and obviously as the population grows and that's we still have in India 700 million people who leave in the countryside most of them probably don't have bank account. They are going to go have bank accounts and they are going to have insurance policies and so for sense or. So for the banks that are well run there is a huge opportunity.

Is the Indian real estate sector still a major play for Marc Faber?

Well I like real estate in emerging economies and in particular in Asia and in particular in India because I can see in India urbanisation will accelerate and there will be entirely new cities coming up. So I think there is a big opportunity in Indian real estate in the long run. Now if you of course buy a condo at the peak of the market may be in 2007 there may be the price will go down for two or three years and so forth buy say as a business to develop real estate in India both in terms of integrated commercial residential centres where you have units that are commercially let out and then you have a shopping centres, movies and hotels and then service departments and condos and that has a huge potential.

The reason I ask about real estate is because many of our real estate companies here in India share the same characteristics as those of the US economy if you well because they carry major debt and devalued assets on their books and face very sluggish demand?

Yeah, yeah that's the problem they are over leveraged but say some day they will learned lessons and no longer use the leverage. In Hong Kong after 1997 property prices dropped 70% none of the big developers went bankrupt, why, because the property developers in Hong Kong are family owned. The families they are relatively conservative, they are all filthy rich, they are all billionaires and they use a leverage of may be 20%, 80% this equity. In Hong Kong most properties actually have no mortgages. Same in Singapore lots of well to do families I know they own entire buildings no leverage, not a single mortgage.

One trend that we are observing in the mergers and acquisition markets is that though outright M&A volumes are not really picking up in a major way we do see some alliances coming through for instance Volkswagen and Suzuki globally and also here in India United Breweries and Heineken, do you think this is really the way forward for M&A?

Well I think the both will happen because obviously through alliances you can gain market share exposure into new markets and you can cut cost because say you are partner in India or where it is can takeover the distribution and even the production of your product and suppose but I think at the same time we will also have a lot of still takeovers and you see the crisis basically the purpose of a crisis is to clean the system that's why I am against any kind of intervention and supporting companies. You should let them go bust because by supporting any company basically you support the weak participants but in economics, in the capitalistic system the strong should survive and not the weak. The weak should be eliminated and so they are eliminated, they learn lessons and thereafter so you should not reward weakness, you should reward strength. But having said that in a crisis like we had in 2008 the well managed companies, the well financed companies swim above above the other because they still have cash flow, they still have money to carry out R&D and they have money to carry out expansion weak competitors they don't have that money so the gap widens between the strong players in the world and the weak players and there is a huge opportunity with the strong players.

What are the key commodities that you are currently bullish on?

Well I was very positive about sugar and I think it may still go up but I think there are two commodities right now that standout in terms of being incredibly depressed; one is wheat in real terms inflation adjusted its at the 200 years low and I would essentially look at agriculture commodities at the present time. They have all come down and they haven't rally the much compared to industrial commodities which had big moves, copper has doubled, oil has doubled and so forth and the other one is natural gas very cheap. But it is not so easy for the individual investor to play these commodities but these if you ask me which ones are very depressed these are the two that are extremely that strike out as being very depressed.

How are you looking at the Asian and European economies because although they are bouncing back they remain critically dependent on the US consumer don't they?

Yeah sure but I think the world has to learn that the US is no longer as relevant as it was 20 years ago to the global economy. I mean the share of the US in the global economy has diminished very substantially you have higher car sales in China than in the United States and by the way car sales today in emerging economies including Indian, Latin American, China and so forth are larger than in the G-16 countries. In other words it is larger than in Western Europe to US and Japan combined so also oil consumption in emerging economies today is larger than in the developed countries. So we are dealing with the totally new world. There has been a huge shift in the balance of economic power between the rich countries, the arrogant countries of the west and the emerging economies that are coming up and that also will lead to tensions in my opinion political and geopolitical tensions.

How do you view this entire brouhaha about global warming and climate change, is a settlement really possible and what kind of opportunities are there for investors in this?

The global warming alarmists and they may be right I don't know I am not a scientist but even the scientist don't know for sure. There is a huge money behind global warming issues. If you have a energy conservation and you have this global warming with carbon credits it's a huge business opportunity. Although huge business opportunity not to do anything about it so the two sides are antagonised by each other and they are going to fight it out like crazy and the global warmists they will say the others don't understand anything and the others will prove that the global warm is that in the past 1000 or 2000 years. There were period during which there were waves of warming climates and then waves of cooling climates. The last 10 years incidentally the climate has cooled down, it has not become warmer but I have to admit when I go to Switzerland you know the glaciers are smaller than 30 years ago that I agree but I hear both arguments I cannot tell you what is the reality. I just don't know, I am an economist, I am not the scientist and even the scientist disagree with each other.

So does that meant that crude oil prices will just keep rising and renewable sources of energy will simply not take off?

I would not take off for a long time and believe me crude oil is still the cheapest alternative for energy and I live in the North of Thailand I mean the people in the countryside they still drive the motorcycs they are not giving to have a motorcycles with batteries but too expensive. So in emerging economies in the last 18 months although we had a huge collapse in economic activity globally their oil demand still growing and in the developed world it is going down and so forth I am convinced that in Asia the oil demand over the next 20 years will more than double so we consume today in Asia 22 million barrels a day. We will go to something like 40 million barrels. The oil production in the world is 85 million barrels of oil a day and every year we find new oil but we use much more oil than we find new reserves so essentially the reserve level in the world is going down. So eventually I suppose we will have much higher prices.

What do you say to someone like Tom Friedman who believes that after information technology the next big thing is going to be environmental technology?

Well I am in favour of energy conservation. I mean I don't think one should waste either energy and a lot can be done by building more energy efficient buildings and driving smaller cars and energy efficient engines and so forth. But I am now not sure that the whole world will have solar panels on the roof and will have windmills in the garden and I don't know I haven't made the calculation but I presume that a lot of energy conservation measures use a lot of energy to produce them is like etanol is probably not energy saving at all.

Can we then infer that Marc Faber is totally and utterly negative on everything American?

Well I think the most obvious for me is that we had a US government bond rally 1981 when yields were still at the peak 15.84% until December 18th 2008 when the 10 years treasury yield fell to 2.08% and the 30 years to 2.53%. Since then yields on US government bonds have gone up somewhat on the 10 years we are over 3.5% but I believe that yields in American government bonds will go up a lot in the next 10 years for two reasons either we have more inflation and then economic recovery and so interest rates will have a rising trend to start with or we will have more inflation and that will mean that people will not want to own US government bonds or the foreigners will not want to buy them and 50% of US government bonds are in the hands of foreigners and the fed has monetise massively mortgage pack securities and US government bonds if they start to withdraw the liquidity injection which I think they cannot do but let say if they gain sanity and they would withdraw their monetising then obviously yields would go up and the third reason they will go up is that the credit worthiness of the US government will go down. In other words if you have a depression in the US and that's the argument of the deflation is, if you have a depression bonds will be good investment. No, they were not be a good investment because the fiscal deficit will then balloon and to stay around $2 trillion annually then the interest payments on the government debt will go up dramatically and it will become one day questionable whether the US government can ever repay their debts repay they would not be able to do anyway that is out of the question which is pay the interest on the debt will be a problem one day.

So Marc Faber what are your keen investment themes and ideas for 2010?

I avoid US government bonds I think as a contrarian you really want the contrarian play. You should buy Japanese stocks and Japanese banks this is the absolute contrarian play. Nobody is interested in Japan all the funds have withdrawn money from Japan they have given up on Japan I guarantee you the economy would not do well, forget about the economy the population is shrinking but you can have an economy that does not do well but the companies do well that is a big difference and I think the Japanese banks are very depressed. All the banks in Asia have actually recovered very strongly but not the Japanese banks so as a contrarian play I would look at that.