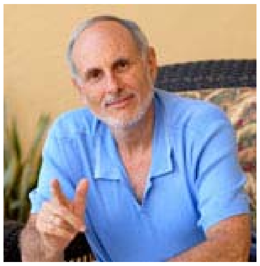
Looming Collapse of Russia, China and more …

by Martin D. Weiss, Ph.D. 01-05-09



I hope you've had a great start to your New Year!

At the same time, however, I trust you are not counting on the latest holiday rally in the stock market — or the most recent incarnation of the Obama rescue package — to transform 2009 into a positive year for the economy.

The reasons: In addition to the massive wealth destruction I told you about two weeks ago and the continuing debt collapse I've been warning you about for many months now, the overseas engines of global growth are also collapsing.

This does not negate my long-term view that certain overseas economies offer great future opportunities. But it does represent a major short-term threat to U.S. investors, U.S. companies and the U.S. economy as a whole.

The undeniable reality: The debt crisis that first appeared in the U.S. subprime mortgage market … then precipitated a Wall Street meltdown … and has now driven the American economy into its sharpest decline since the Great Depression … has now spread to the entire world.

It is driving the economies of Western Europe and Japan into an unprecedented tailspin. It threatens the economic — and potentially political — stability of Russia, China and several emerging market nations. And it's setting the stage for a global depression of epic dimensions.

Here are some of the most vulnerable major economies …

Russia Smashed by Oil Price Collapse

Never in modern history has the success or failure of a major emerging economy been so dependent on one single commodity! And never before has that commodity fallen so far and so fast as Russian crude oil!

Russia does have other resource and revenue sources. But in just the past six months, Urals crude, Russia's primary export blend, has plunged from a high of nearly $141 per barrel to a low of a meager $32.34 — a 77% crash that's pounded Russian stocks like a sledgehammer and sliced through the Russian economy like a serrated sickle.

The big dilemma: To balance its federal budget, Russia must get a *minimum* of $70 per barrel for its crude oil. But at $32 and change, it's getting less than HALF that amount. The entire country is losing money hand over fist.

No wonder Russia's stock market has plunged 72%, forcing 25 separate stock exchange shutdowns!

Transneft, the Russian oil transporter, is down from $2,025 in January 2008 to a recent low of $270. Gazprom, the natural gas monopoly, has lost more than two-thirds of its market capitalization since May. Meanwhile, Lukoil fell from a May peak of $113 to a recent low of $32.

Russia's oil-driven real estate bubble is also collapsing. That's why Russian construction and real estate giant Sistema-Hals lost more than 94% of its value last year alone … why PIK Group, another major construction giant, collapsed by 96% … and why the entire RCP Shares Index of Russian developers has sunk 92% since its record high in June 2007.

Ford, Renault and Volkswagen are halting production at Russian assembly lines. Unemployment is likely to surge to 10% and beyond. Massive amounts of foreign capital are fleeing the country.

In a desperate attempt to stem the tide, the Russian government has devalued the ruble 11 times since November, and thrown a quarter of its foreign currency reserves at the raging debt crisis.

But it's still not enough. Russia's primary source of revenues — energy exports — is in shambles; and unless crude oil prices could somehow DOUBLE in a big hurry, Russia's economic and financial decline cannot end.

Standard & Poor's has cut Russia's long-term debt rating for the first time in nine years, citing dangerous outflows and a "rapid depletion" of currency reserves. And more downgrades are in the offing. Even a major debt default is not unthinkable.

The biggest danger: Political upheaval and social unrest.

Even before this crisis, Russia's middle class earned less than $500 per month. Now, with the devastating plunge in oil revenues already in place, those numbers are falling to even lower levels. For a nation with a cost of living that rivals that of the U.S., Western Europe and Japan, the last thing the Russian people needed was a depression. Yet that's exactly what they're getting.

I visited Russia last year before the collapse in oil prices. I spoke to a variety of professionals and people on the street. And I stayed with friends who work in government jobs.

From everything I had read, I had anticipated signs of greater prosperity. Instead, I was surprised to see how little average citizens had benefited from the recent years of rapid economic growth. Yes, they have more access to a wider variety of goods that were scarce during the Soviet era. But most professionals — such as teachers, doctors, nurses and government employees — are still living on the edge of poverty.

Equally surprising is the popular disgust and disdain for the government. Public opinion surveys and press reports may indicate broad support for the Kremlin's foreign policy, and they seem to be accurate. But support for domestic policies is another matter entirely.

My view: Any major disappointment with respect to pocketbook issues could lead to major political changes, the outcome of which is largely unpredictable.

China Far More Vulnerable Than Expected

China's extraordinary expansion of the past decade fueled booms in global trade, commodities and emerging markets. It was a major growth engine that turbo-charged Australia, Brazil, Southeast Asia and even Japan.

Now, however, that engine is grinding to a screeching halt. Indeed, when historians look back to major pivot points of this global economic crisis, they will undoubtedly point to the abrupt end of China's boom.

Many of us assumed that because China's economy was growing so quickly — at a breakneck pace of 10% or more per year — it could easily afford to slow down by a few percentage points and still be in far better shape than most other economies.

But now I seriously question that theory. Indeed, more often than not, companies, industries and entire nations that enjoy the biggest booms are also vulnerable to some of the biggest busts.

Instead of a mere slowdown, as many still seem to expect, China's economy could suffer a wholesale collapse.

Exports, which still represent two-fifths of the Chinese economy, are already sinking fast. And the domestic economy, much of which depends directly or indirectly on the revenues flowing from exports, is also beginning to sink.

Warning signs are everywhere: Stocks, down 60% just in the last 12 months; imports, down 17.9% in November alone; foreign investments to China, off 36.5% last year.

In response, the government has slashed interest rates and pledged a $582 billion stimulus package. But that's mere pocket change compared to China's trillions in vulnerable exports.

Moreover, it has done little to help millions of small- and medium-sized businesses which are already shutting down and laying off millions.

A big problem: 45% of the Chinese government bailout is earmarked for the cement and housing industry. Meanwhile, cash-flow problems are sweeping through the entire economy, downing airlines, manufacturers and property companies.

Airlines like China Southern and China Eastern, for example, have been losing money hand over fist. China's auto sales are plunging. Its shipbuilding industry is in a tailspin. And its real estate market is collapsing.

Next, expect surging unemployment … mass reverse migrations from urban centers to the countryside … spreading popular unrest … and a major challenge to authority. Chinese leaders have already admitted that an economic downturn would test their ability to govern. Now, that downturn is here — and the ultimate test, on the near horizon.

Meanwhile …

India, also heavily dependent on foreign demand for its goods, is suffering its worst export slump in recent memory. Overseas shipments plunged 12.1% in October and *another* 9.9% in November, forcing companies like Tata Motors, India's biggest truck maker, and Hyundai Motor to cut output, fire workers and shut down factories.

Brazil, which was growing at a record pace until the third quarter, has suddenly frozen in its tracks. Much of the foreign money it counted on has vanished, leaving acute capital shortages in its wake. Auto sales have gone dead, leaving biggest-ever inventories of unsold cars. Credit, abundantly available just a few months ago, is now gone.

Japan has been slammed by its worst recession since World War II … with stock prices plunging to new 18-year lows … industrial output suffering the largest monthly drop since records were kept … Toyota reporting its first loss in 70 years … layoff victims filling tent parks … and worse.

Everywhere from Argentina and Mexico to Australia, New Zealand and even the once-rich Middle East, the worldwide debt crisis, the bust in commodities and the sharp slowdown in global trade are transforming massive booms into instant recessions.

It's happening fast and it's accelerating. Government rescue programs aren't nearly enough to turn the tide. And it's another key reason you must approach 2009 with great caution.

Stick with safety. Don't veer from the course I have laid out for avoiding the dangers. Wait for the truly big price declines ahead before reinvesting!

Good luck and God bless!

Martin

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