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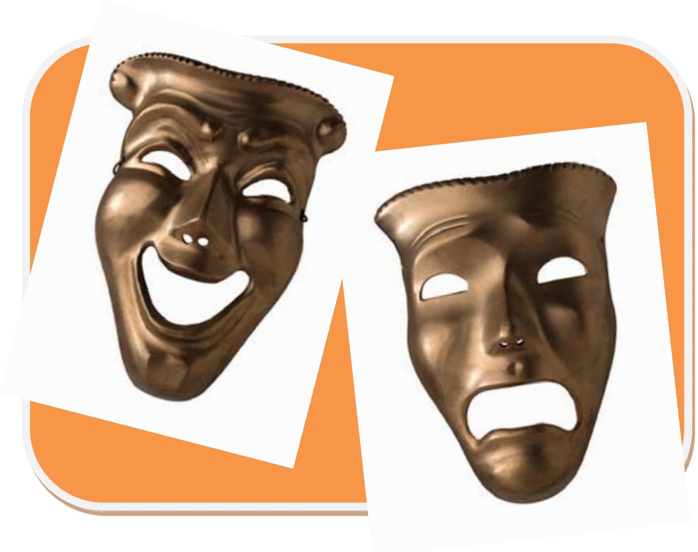


A look ahead at 2012

Unpredictable but not the end of the world!

It's hard to know whether we should laugh or cry whilst we wait to see how the world will turn but Europe is now painfully aware it will take years for their economic situation to ease. The absurdity of lending more money to service existing debt is not a solution – it's merely a fix to buy time to engineer something more acceptable. Sooner or later it the EU will need to write off more debt and settle on affordable repayment terms if it is to be more convincing.

Having done the deed on the USA, S&P have again cynically downgraded some 8 countries credit ratings which in turn will cause their interest rates on borrowings to rise with the consequence that their circumstances become even harder to fix. It's one reason why self-appointed rating agencies should be suspended in economic times like this. We all know the countries which are in trouble and should question what is to be gained when technically correct credit ratings do more harm than good in extreme times.

However, we do need to understand that this recession is unlike others because it is deeply rooted in global debt structures that cannot be reversed quickly. This will be a cause for the slow recovery and there is a need to acknowledge we are still **IN** a downturn not coming **OUT** of one. This is the first deep financial crisis since World War II and the shape of the situation in some parts of the world reflects a similar pattern.

So how bad is the EU really?

To answer the question it is *pretty sick.* To better explain that I have listed some snapshot data from 2011. The interpretations you need to know are the wider EU is made up of two sets of rankings i.e. the European Union (EU) is a *political union* of 27 states with an inner European Area (EA) of 17 *member* countries. Generally the EU is following the principle of 'printing more money' through the European Central Bank handing out loans over 3 year terms to the tune of €600bn+ partly aimed at helping small businesses. How this can be good medium term is yet to be played out with countries like the UK having already injected £850bn since 2007 to rescue their banks. The recent declaration by the IMF to lend even more billions may strike a hurdle, that being the difficulty in raising the funding from reluctant member countries.

Population sizes
EU = 500m
EA = 332m
Persons at risk of poverty
EU = 33m
EA = 30m
GDP growth as at 1Q 2011
EU = 0.8%

EA	**=**	**0.8%**

Public Balance (Finance) % of GDP

EU	**=**	**-5.3%**
EA	**=**	**-5.8%**

Government Debt levels % of GDP

EU	**=**	**80.4%**
EA	**=**	**86.7%**

Unemployment Rates (overall)

EU	**=**	**9.4%**
EA	**=**	**9.9%**

Youth Unemployment Rates (15-24)

EU	**=**	**20.6%**
EA	**=**	**20.3%**

Looking at these figures you can see why the youth in some EU countries are upset at their future prospects. The years of discipline required to pay down debt they did not create is the new 'enemy'. For example the austerity measures in Greece are causing record suicides up as much as 40% since January 2011.

Britain is holding itself out of the EU agreements because the deal would not allow them to veto future financial arrangements. Even so, the UK knows it will remain a strong player because of its importance to the EU generally.

Top 20 world GDP in US $trillion

World GPD represents $76trillion expressed in US dollars with 47% of it ($36trn) coming from three regions:

Country	GDP Value
USA	$15.0trn
EA	$11.0 = combined $26trn
China	$10.0 = combined $36trn

The individual GDP rankings are:

USA	$15.0trn
China	$10.0
Japan	$ 4.5
India	$ 4.2
Germany	$ 3.0
Russia	$ 2.8
France	$ 2.2
UK	$ 2.2
Brazil	$ 2.2
Italy	$ 2.0
Mexico	$ 1.6
Spain	$ 1.5
Korea	$ 1.4
Canada	$ 1.3
Turkey	$ 1.1
Indonesia	$ 1.0
Australia	**$ 1.0**
Iran	$ 0.8bn
Taiwan	$ 0.8bn
Poland	$ 0.7bn

The EU is important to world trade; when you put the EU and the USA together they represent a large slice of world purchasing power. Obviously when their customer's purchasing power falls they too slow down and this is exactly what China has been taking steps to counter. China's forecast GDP growth rates have been throttled back to around 7-8% from the present 9% (and from the past highs of 13%) which will reduce their need for resources. However, there is a more serious issue lurking behind any quoted GDP growth rates coming from China (see notes later).

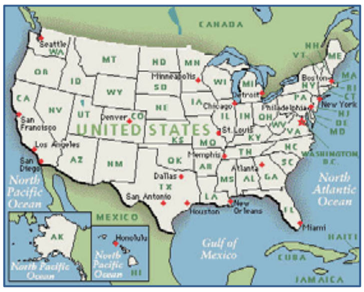
USA – the world's largest economy

What about the USA – it's recovering isn't it?
Well here are some 2011 figures on the US economy to provide comparisons to the difficulties within the EU:

US National debt	= $15trn
- (GDP is $15trn too)	
Budget deficit	= $1.3trn
Trade deficit	= $725bn
- ($325bn deficit with China)	
Internal mortgage debt	= $13trn
US personal debt	= $16trn
Federal expenditure (annual)	= $3.6trn
Federal tax income (annual)	= $2.3trn
Debt held by foreign countries	= $4.9trn
Total national assets	= $78trn

Population	303m
Official unemployment	13.3m
Actual unemployment	24.0m (17%)
US workforce	141m

The USA like the EU is highly geared with debt. This is the cause of much of their present internal political debate. To relieve the jobless rate they must create hundreds of thousands of jobs in order to show a significant effect longer term. That of course rests with many of the States and the recent reports of 20,000 jobs being created in one particular month provides an insight into just how far they have yet to claw back. The US will struggle with its economy like most of the western world for a number of years. No wonder they are beginning to withdraw from costly expenditures like armaments and fighting foreign wars (Iraq was estimated to have cost them $1trn).



However, the USA is further along the debt reduction path than some other countries albeit their mortgage redemption recoveries have helped and been underway since 2008. The EU countries are still going into debt recovery phases and so lag the US by 2/3 years in that regard.

China

We all understand that China is a fast growing nation and now number 2 in the world but still well behind USA. However it has an inherent problem; Chinas 440m peasant farmers expect the nation's wealth to trickle down to provide a better standard of living - but this is not happening. If GDP were to fall below 7% it would signal that levels of growth are stalling (meaning even less trickle down) which could result in embarrassing unrest in the rural districts for the ruling elite. The first signs of this unrest are occurring as there is growing militancy against the Government practice of taking farm land for property development with the millions made going to developers and local Governments. The Chinese property markets are out of control with much investment based on speculative real estate growth. Added to this their city population imbalances v. rural has grown to 51%. Their cities have for the first time in history exceeded the total rural populations (the western sickness). Too much unrest including the recent Wukan street demonstrations could end up giving nightmares to the Central Party. Already the Government has ordered police to improve their handling of demonstrators and complaints from the public.

We can expect the global slowdown to flow through to China's export trade because many of its western customers are basically broke. As mentioned in earlier papers after my visit to Shanghai in 2010, we can expect China to internalise to bring about its own soft landing.
Our present Government must not turn a blind eye to such a possibility with a Carbon Tax about to make us less competitive. In Australia's two speed economy the macroeconomic saviour will be the billions of dollars to be expended in mining developments (gas in particular) which whilst the growth curve will slow, will still require thousands of workers to join the sector.

Last year I was in Saigon and noticed the switch in fashion goods manufacture. For example, I bought a 'genuine' Polo shirt for $A10 which are now being manufactured there (cheaper of course) but of the same quality as before. Vietnam is moving in this direction to be the lowest cost supplier.

Australia

Prediction: I was sure of my prediction of a rate cut before Xmas and I am confident of another one in February this year – because again economic performance points towards a cut rather than anything else. Of course the Reserve Bank can be unpredictable but I must applaud their recent decisions and I think they are presently still on the ball.

Retailing: Why would it surprise any thinking person that retail spending would be down this year (and this Christmas) as it was entirely predictable! We already know that costs are rising; that domestic discretionary spending is falling; that consumer are saving to get ***rid*** of debt; that unemployment is rising and will continue to do so in the New Year and that Australia's internal retailing problems are caused by shrinking purchasing power.

The many signals sent by 'name' retailers like Kodak going into administration; Yahoo showing evident signs of needing to be saved; Fletcher Jones who chose receivership; Myers who are closing stores; Billabong who put assets up for sale and threaten to close 12 stores; JB Hi-Fi who issued profits warnings plus the earlier failures of the Colorado Group, Borders and Angus & Robertson illustrate the real effects of a slowing domestic economy. We don't need to be geniuses to read those signals.

I was surprised at the hypothetical assessment from Merrill Lynch that if Myers closed some its icon stores and they were replaced by numbers of smaller speciality retailers, Westfield's earning per share and its net tangible assets would rise. One would have hoped that Westfield's experience with anchor tenants wouldn't allow them to swallow that assumption as it's much better to negotiate to hold a Myers than fill the gap with smaller brand stores you can find everywhere. I can only assume that is what happens when you apply mathematical equations to retailing – which is built on the emotional values of the women of the world who are responsible for 70%+ of all buying.

Unemployment: It will become evident from 1Q of 2012 that corporate employers will continue laying off staff. Australia will be in for a round of unemployment activities from the smaller and larger companies, the financial sectors and some export and manufacturing areas like the marine and automotive industries where the main auto players are down some 20,000 vehicle sales each over last year. Many companies have and are already pruning staff numbers quietly so yes, Australia's underlying unemployment rate will rise in 2012. For exporters this will continue whilst the $A remains artificially high, the effect of which has been adding to their costs for the past 2 years, will eventually wear their competitiveness down.

Banks: We will have to watch the Banks reactions to interest rate decisions by the Federal Reserve as already there are signals they will act unilaterally (meaning ignoring rate cuts). How they can plead for consideration when they consistently make super profits during a downturn is beyond me. Their shareholders must love the dividends but for organisations that are central to the economy it's a bit of a sad joke to pull out the old excuses of the cost of borrowing; the need to maintain credit ratings and a readiness against future threats. However the new excuse will be that they are on watch because of the EU situation and the global economic decay.

This year: The lessons for small business and other entities in Australia during 2012 are fairly clear:

1. **No boom in 2012**; this year will not provide any sudden rise in trading fortunes; it will be hands to the grindstone stuff. This is due to the overabundance of competing businesses including retailing outlets across the Australian markets amongst which there is little differentiation.
   Just ignore the goofy pushers who will tell you the '7 best ways to riches in 2012'. The tough guys will win this year i.e. those who fight back with innovation and perseverance. Much of the 'great' advice coming from these self-styled retail guru's is beyond the small players budgets.
   The Not-for-profit organizations such as Clubs, Institutes and Associations will have a harder time holding in their subscription paying members who will question the value.

2. **Internet trading** will continue to rise as its convenience, price competition and fast delivery systems lures users to shop on the net. It is of course, the King of Virtual Swap Meets. As Bill Shorten announced recently the Government is considering the payment of GST for purchases under $1000 which is a response to big retailer's complaints. However, don't think online trading is an instant bonanza (it doesn't necessarily suit every retailer) but competing may help ward off some of the competition.

3. **Education by distance learning** is on the rise and there will be more aggressive use of remote connections to sell stuff, save costs, travel and time. There will be a rise in the use of gadgetry, touch technology and video messaging as we are acclimatised to the world of 'vision buying and selling'. It will be annoying when it becomes overdone but it will play its part in the communications war game.

4. **Technology already allows connecting** and networking to gather dispersed inputs which bring with it the promise of lowered outgoings for adopters. Many of the now normal corporate activities and the associated costs encountered in housing employees in corporate buildings would virtually disappear. Interestingly we have found some unpalatable ways (e.g. telemarketing & answering services) but we are yet to find the palatable ways that make it attractive for everyday tasking – but it's coming.

   How prepared are you to undertake internet trading as part of your service?

5. **Customers will be fickle** as there are many shopping, pricing and paying choices for them now. Those owners who take steps to build and hold customer relationships will do better than those who don't. Odds are many businesses will do this too so you must be sincere. For those businesses not tied to a static location it's time to use your mobility to engage with new and desirable clients and improve communications with existing ones.

6. **Markets will continue to be commoditised** as pricing fighting continues but pricing isn't everything (it may look like it), it's the initial lure. So back up purchases with guarantees, replacement warranties and quality products. Don't argue with customers returning goods – do a 'Bunnings' – chuck it in the bin and give them a new one without question. It works!

7. **Time for every business to rethink strategy.** More tired and marginal businesses will fail during this year so revamping should be a priority now. One enigma of business is that as more businesses grow in a sector the more they solve their problems the same way. As these common practices are adopted they end up operating the same way too and find it hard to change. The default position from the growing competition is to price fight and the weakest fall through lack of innovation or working capital.

   Some marginal sectors are experiencing record failures due to this phenomenon as their weak margins and high overheads spell the end of the business. So review products and services and don't be afraid to change the way you do business. Remember, benchmarking for excellence only works until the next best benchmark comes along. The winner then is the one who created it. So don't be afraid to copy good ideas and improve on them. Creating your own higher benchmarks can be a business multiplier especially when it comes to customer service and operating standards.

8. **Run the business as lean as you can** to conserve cash flows. Don't spend capital when you can maintain equipment rather than replace it. Extend the life of motor vehicles, computers and technologies where it's sensible.. Obviously you can't let essential equipment wear out but make replacement decisions based on intelligent replacement policies..

9. **Spruce up customer service**. It almost defies belief the way service has fallen off at a time when it should be a priority. It has become obvious that the spark is lacking. So many staff appear unmotivated one imagines it is part of a 'downturn syndrome'.
   Owners must keep their in-house standards up and lead by example. The customer ***IS*** always right because what's the alternative – to win the argument and lose them? Remember the Bunnings policy. Nordstrom's became famous for their one line customer service policy to staff:

   "Always send the customers away happy".

10. **Pricing strategy will be paramount** and businesses must create their own margin compensation across the product ranges to balance margins given away. It's a sensible approach and it can be done without hurting trade. A lot of businesses lose thousands of dollars per year because they are not diligent in using compensation tactics.

    Note: Opportune has a free paper available on how to do this, just email us to receive it

11. **Whatever you do, be the best at it** and say so – but you had better live up to it. Customers don't need you, you need them. They have multi-channel choices offered by both wholesalers and retailers and bargain hunting has become the name of the game right now. The TV enticement companies offering bargains are growing in number (and so are the mysterious retail prices quoted upon which the so-called savings are based. So are the trading sites which offer almost anything such as eBay, are enjoying growth because the consumers are what they want at prices they can afford. Many have to as its all they can afford in nay case. So be creative with your advertising and play to your strengths. After all, that should be your core business anyway and the business has to stay fit.

General comments:

Australia isn't isolated and that's partly why I write about economies beyond our own. For example, our six largest export markets by rank are:

China
Japan
Korea
India
USA
United Kingdom

Our six largest import markets by rank are:

China
USA
Japan
Singapore
Thailand
Germany

So you can see how we are tied to our largest markets of China, Japan and the USA. If they catch a cold we get the shivers. Especially China and the USA as Japan's economy has not done much for the past 10 years, funnily enough they are probably the more stable for it.
Other countries are now approaching China to test the water on acquiring assistance and we will see the parade of Prime Ministers as they trudge along to see what help they can get. It's probably going to be good time for China which likes to buy other peoples goodies.

Here at home we have woken up to the fact that we had better check how much of our country and its businesses Chinas has acquired. They have quietly bought into Australian assets with particular attention to agricultural and food sources. The Government has announced a survey will be undertaken to determine the extent of China's investments. We may be in for a surprise at what they find!

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