

*From the Desk of...*

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Issue No.42 - August 2009

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## **Green shoots or pink slips? Graeme Maxton argues the case that 'green shoots' in the global economy is fanciful.**

'I find for the prosecution', said the judge with a dark and sombre tone. He took off his half-moon glasses and stared into the courtroom seeking some sort of response. The defence lawyer lowered his gaze, sensing defeat.

'The evidence is perfectly clear to me', continued the judge gruffly. 'The defence has put forward a weak case for economic recovery, for so-called green shoots, if you will. Their case is badly flawed. Before I give my sentence, I will review the evidence presented to me.'

The defence have told us that there is a recovery under way. They have told us that stock markets around the world have rebounded strongly, that France and Germany have come out of recession, that exports have begun to recover and that the fiscal stimuli and savage interest rate cuts have begun to have the desired effect. They have told us that many economic pundits agree that the consensus forecasts are all predicting growth nowadays, even if it will be weak for a while.

To the untutored eye, such arguments may sound compelling. But, ladies and gentlemen, they are nought but poppycock and waffle.

It is natural enough, of course, that we should try to remain optimistic in such times. They are in many ways unprecedented. The worst economic crisis for 70 years, perhaps longer. To look on the brighter side is the nature of mankind. It may also be the nature of mankind to be greedy however, to talk the situation up, in an effort to profit from it. Such is the character of too many financiers, rating agencies and, dare I say, even central bankers.

The evidence of this supposed upturn is, in reality, scant. Yes, stock markets are up. But have the underlying profits of the companies whose value is measured on these markets, grown or declined? Most have declined. Have their businesses grown or shrunk? Most businesses are smaller than they were a few years ago. Demand for most products is lower – as are prices – and consumer confidence remains weak. So, I ask myself, where is the underlying strength of these businesses? What has caused their value, and so the stock markets, to rise? My conclusion is that it is nothing but hopeful forecasts, greed and the chance of profit. After all, may I remind you, several such rallies also happened during the Great Crash. There is nothing remarkable here.

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Those defending the case for green shoots also point to France and Germany, which have reportedly come out of recession. That is what the central bankers and economists are telling us for now. Be aware though that preliminary figures are often restated later, and

often downwards, as in the UK and US recently. And what sort of recovery is this anyway? Germany has seen exports collapse. They may have risen slightly in the last three months, but they remain almost 50% below their peak. Is this really to be regarded as a recovery? It seems more like the weak pulse of life, of mere survival. Besides, most of the so-called recovery is actually due to a massive give-away, a boost to the car business. This has falsely stimulated the consumer market and carries risks for the future. As so many new cars have been sold recently, demand will be weaker in the future. I see nothing strong, sustainable or compelling about these recoveries.

And what of these massive fiscal stimuli and interest rate cuts? What have these achieved? Have they boosted spending? The answer is no. They have been used to recapitalize banks, prop up failed mortgage and insurance companies and keep the financial system from collapse. That is well and good. It was necessary. Interest rate cuts have also stopped many people falling further behind on their loans, staving off further problems. Yet I find that neither is sustainable. The debts that have been built up will force a generation of Americans and many Europeans to live with a much lower standard of living. Moreover these government debts cannot be increased any further now, for fear of economic or currency collapse. Similarly, to fund these new debts, the governments concerned must now raise money and to do that they will have to raise interest rates. So low-cost borrowing cannot last much longer either. Taxes will have to rise too, which will make life harder for those already struggling to pay their bills. They will cut their consumption yet further. I conclude that we will come to regret the folly of such policies. They have ladled on yet more debt and delayed the inevitable correction in asset values.

**“And what of these massive fiscal stimuli and interest rate cuts? What have these achieved? ... they have ladled on yet more debt and delayed the inevitable correction in asset values.”**

Let us now turn to the case for the prosecution. Let us start by looking at the very foundation of economics. Let us look at supply and demand. Today, the world is suffering from excess supply – too many producers, too many factories, too many suppliers – and insufficient demand. When and how can this balance be restored?

For suppliers, the answer is simple. They must wait until demand returns to the level they need or they must cut capacity until supply comes back into line with the new level of demand. So when will the previous level of demand return? This is where the biggest problems lie. Demand is driven by consumers and by governments. The main sources of demand are north America, Europe and Japan, accounting for more than 70% of the global total. The other parts of the world may continue to grow but if demand in these main markets does not recover, it is almost impossible for the developing countries to make up any shortfall. China, for example, is less than 8% of world GDP. A 10% increase in Chinese consumer demand is worth just

over \$100bn to world producers. On the other hand, a 5% decrease in consumer demand in the US and Europe removes ten times as much - \$1trn – from the world economy. So it is the developed markets that count.

And there, demand will remain very weak for many years to come. Indeed it is likely to decline further. Government spending throughout the region must be cut to pay for the foolhardy rise in debt. Consumer spending will decline too, as taxes grow. As businesses gradually adjust to the lower level of demand, unemployment will increase further, cutting consumption even more. Roughly one million people are being laid off in the US every two months now. Even if the rate of lay-offs slows, the numbers out of work will grow. This will undermine any fledgling recovery in house prices. Rising home repossessions will push them further down.

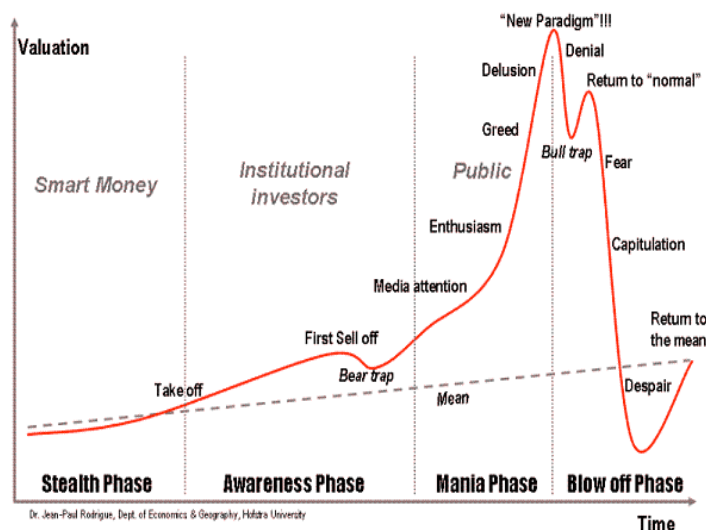
Unemployment will also increase the rates of defaults on credit cards and car loans. This will bring further problems to the banks too.

On top of this there is a demographic problem. Baby-boomers, those born in the 1950s and 1960s, who make up the wealthiest spending group in the developed markets, are facing a crunch. Their savings have been eroded. Their houses have dropped in value. Their pensions have been decimated. In a few years, when the dust begins to settle, they will realise that they are within a decade

or so of retirement and have a much smaller financial cushion left than they once imagined. They will struggle to retire. Of course this will not be the same for everyone. But it will certainly be the case for the majority. These people will focus their efforts on saving, on patching their retirement funds, on selling their remaining assets to pay for their elderly care and medical bills. They will not be

buying fancy 4x4s or eight pairs of jeans a year as they did in the boom years. Those days have passed.

Let me remind you ladies and gentlemen. The economy of the world goes through very long and very distinctive phases. We have become used to booming markets and rising growth. It is not always



so. Bear markets are usually prolonged. Indeed, the shortest bear market of the 20<sup>th</sup> century lasted 17 years. So we are in for a long haul.

I therefore find that all this talk of 'green shoots' is fanciful. It is the stuff of fools and bairns, as my Scottish grandmother used to say. Indeed, I find that we are entering a period of greater risk when such talk of recovery may not just be foolish but dangerous. An even larger downturn beckons which all this empty talk of recovery could mask. We are putting our faith in band-aids and headache tablets

when what we need are tourniquets and radical surgery. The shadows of death, which many believe loomed over the western capitalist system a year ago, do not withdraw so easily.

What and how might a further crisis come? And what might it mean? That is hard to predict. But it seems

to me very clear that there are cracks that are being papered over. There remains the risk of further banking turmoil, another Lehman. And there are countries like Latvia, the Ukraine and even the UK

which are vulnerable to a financial or currency crisis.

Is this likely to be a V, U or W shaped recession, is a question often asked. Based on the evidence presented here, it is more like a set of stairs, a series of Ls, each step leading us further down where we can pause for breath before descending further. Eventually they will lead us to the bottom. Only then we can work out how to climb back up.



Ladies and gentlemen, this very unfortunate case is one of deceit and ruin. It only remains for me to give my sentence. For the West, ten years without hard labour or indeed without much labour at all. For the rest of the world, a decade of reform.'

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### About Graeme Maxton and The Insight Bureau

Graeme Maxton is a writer and commentator on world business, Asia and the automotive industry. The Insight Bureau represents a resource network of individuals, including Graeme Maxton, for speaking engagements and client events, as well as providing confidential, in-house briefings. Mr Maxton is an expert chairman and moderator of business dialogue at conferences and client forums around the world.

The Insight Bureau provides speaker placements and briefings as a service that helps achieve a better understanding of the world in which we do business and ultimately enables companies to make better business decisions.

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