# Investment Markets Research Team newsletter

## Economic research updates

**June 2011**

The Investment Markets Research Team headed by Stephen Halmarick is responsible for writing not only the travelling economist blogs also thought provoking economic pieces throughout the year which we have included in this newsletter.

We hope you enjoy these papers written by James White and we welcome any feedback or questions.


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## The move to a new equilibrium

Time away from the office, in a different part of the world, gives a fresh perspective, particularly when it is related to something as momentous as a wedding and honeymoon. I would like to share this perspective over the next week or so. I will aim to write a series of pieces on my thoughts about the global economic environment and identify those issues worth watching over the next 12 to 18 months.

I think it's important to put the events surrounding the collapse of Lehman Brothers into a broader context. For some, there's a belief that the worst crisis of most people's lifetime is never to be repeated and that no matter how slow the recovery, at least we'll never go back. I am not so sure. We may not have as significant a financial crisis but I think it is likely that substantial upheaval in other spheres is likely as the world shifts towards a new global equilibrium. The world defined by western powers and industrialised might has ended and a new global framework is required to reflect geo-political, technological and economic change. This new framework must accommodate the rise of China and, as discussed in Lilies in the field , a more disaggregated domestic and global economy. The framework must be financial, economic and, also, political.

To read more of this article please click here.

## The move to a new equilibrium – political change

This is Part Two of a series on the shift to a new global equilibrium. This piece looks at the political movement, embodied in the Tea Party, but seen elsewhere that has the potential to play a very disruptive role in the global political economy.

It's very easy to make fun of the Tea Party. Both its leaders and members, as amorphous as they are, are prone to all sorts of linguistic and semantic gaffes, in addition to the standard description of redneck. One only has to call to mind Sarah Palin and her comment that she can see Russia from her backyard – apparently she was speaking figuratively – to arrive at such a conclusion. For many, these failings make the group's message irrelevant; they seem little more than a passing fad, incapable of upsetting the US's two party hegemony.

To read more of this article please click here.

## The Tea Party gap

The charts in this paper very neatly summarise the rise of the Tea Party post 2009.

In the same way that the Arab Spring arose from economic issues (inflation, high youth unemployment), I see the Tea Party as being an economically motivated political movement. It is a party of people broadly excluded from the influence of big business, unions and national politics with the financial crisis and recession acting as a catalyst for its formation. People in small business have been largely excluded from the recovery – indeed, it's fair to say many are still in recessionary conditions.

To read more of this article please click here.

## The end of the eurozone

This is the third note in a series of notes outlining the backdrop for global markets financial markets in the coming 18 to 24 months. A key part of this outlook is the belief that the global economy will continue to experience semi-regular shocks; not quite as large as the shocks experienced in late 2008. The second crisis is obviously European, and the current eurozone will not survive.

The focus of financial markets seems to be on, perhaps not unsurprisingly, financial solutions. How can Greece and the other peripherals maintain liquidity? There is a belief that if trouble can be staved off to 2014 crisis will be averted. By 2014 austerity will have worked and a return to market-based financing possible. This is a false belief, in my opinion. Both economically but, more importantly, politically these austerity measures are unsustainable.

***I think there is a greater than 50% chance of a politically driven collapse in the eurozone.***

To read more of this article please click here.

## The Czechoslovakian experience

Earlier in the week I wrote on the possibilities of an end to the eurozone. This piece looks at the mechanics of a currency union exit by outlining the end of currency union between the Czech Republic and Slovakia in the break-up of Czechoslovakia. It provides some insight into what a Greek exit may look like.

In October 1992 the Czech and Slovak governments (effectively Czechoslovakia was a federal state) agreed to retain the Czechoslovak Koruna as the currency of each state post the break-up of Czechoslovakia which was to occur on January 1 1993. The agreement lasted just 38 days and is instructive for the current eurozone situation.

Slovakia was not as competitive as the Czech Republic. It largely relied on out-dated Soviet era heavy industry in comparison to a relatively more modern Czech economy. As a result Slovakia was failing to attract foreign investment, and therefore hard currency, in the same way that the Czech economy could. In addition, the Czech Republic started with a balanced budget but Slovakia was forced to run a significant deficit. In 1993 it was 33% of GDP but was just 7% by 1994. While politically the two countries wanted to maintain currency union, it became clear that it was not economically possible particularly because firms in both countries began to stock pile hard currency at the expense of domestic banks. By February 4 1993, a split was inevitable and it occurred on February 8.

To read more of this article please click here.

## Dead slow. And stop

This is the fourth note in a series looking at the outlook for the global economy in the next eighteen months. The first notes have dealt with the political environment and the probability of a collapse in the euro-zone. This note examines the outlook for the US.

- What's moving in the US, can't move in a full recovery with rising interest rates and a stronger dollar
- The parts of the economy outside the stimulus are only going backwards
- Gas and petrol prices and import prices tell the non-housing story of rising Australian household wealth and declining US household wealth

When I was growing up, I had a hockey coach who didn't think much of my running. "White", he said, "you have two speeds. Dead slow. And stop." I feel this is as good a description of the US economy, today, as any.

There are areas of the US economy that can provide some growth momentum in the coming months and years. Good examples include the housing industry (how much lower can it go); luxury shopping (the rich are getting richer with higher equity prices) and corporate balance sheets are awash with cash to be spent. But these represent cyclical opportunities in an economy that is hamstrung with a structurally failed policy; low interest rates and a weak dollar.

To read more of this article please click here.

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