Growth STRATEGIES

LA JOLLA INSTITUTE
Steve PonTell

Dr. Roger Selbert, Editor & Publisher
E-mail: roger@rogerselbert.com

Trend Analysis That Builds Business Decisions

3200 S. Barrington Ave. #4 ▪ Los Angeles, CA 90066
Telephone: (310) 721-6322

IN THIS ISSUE: ECONOMIC ASSESSMENTS AND PROSPECTS

1 – WAS THAT A STRUCTURAL OR CYCLICAL DOWNTURN?
2 – DOOM AND GLOOM, OR SWEETNESS AND LIGHT?

As reported in the *Wall Street Journal*, the US economy slowed sharply at the start of the year as businesses slashed investment, exports tumbled and consumers showed signs of caution, "marking a return to the uneven growth that has been a hallmark of the nearly six-year economic expansion." So which way from here?

In our first item we consider the nature of the downturn the economy experienced in 2007/08: was it structural or cyclical? In our second item we offer links to assessments both positive and negative on the economy at this point and going forward.

1 – WAS THAT A STRUCTURAL OR CYCLICAL DOWNTURN?

WAS 2007 A FLEXION POINT, WHEN EVERYTHING STARTED GOING DOWNHILL?

Tech entrepreneur Peter Thiel, co-founder of PayPal and the first outside investor in Facebook (he sold his initial $500,000 investment eight years later for $1 billion), has said he thinks globalization will slowly move to being in abeyance. If true, that would mean a slowdown in global trade, one of the engines of global economic growth in both developed and developing countries.

Thiel's record for spotting future trends and flexion points is impressive, so he is worth a listen. He said in a video interview with George Mason University economist Tyler Cowen that with the benefit of hindsight, we will realize that 2007 was not just the peak year of the finance boom, but also the peak year of globalization, like maybe 1913.

As Michael Barone points out at www.aei.org, Thiel's reference to 1913 was surely meant to be chilling. That was the last full year before the outbreak of World War I, a conflict in which about 16 million people died. In its wake, Communists took over Russia and Hitler took over Germany. The war made the world safe not for democracy, as Woodrow Wilson had hoped, but for totalitarianism.

Thiel adds that happily the decline in globalization hasn't resulted in a world war, at least not yet. But that's not the only possible damage, Barone explains. The globalization resulting largely from British policies – free trade, the gold standard – was not re-established after World War I. Instead, trade protectionism and unstable currencies led to the Great Depression.

In fact, world trade fell about 90% between 1929-33. The result was not, as current critics of globalization might suggest, good for the workingman. It was economic disaster, political instability and World War II, in which about 60 million people died.

Thus, 1914 was a flexion point in history. Is Thiel right in supposing, or fearing, that 2007 was a flexion point too? There are unsettling indications that the answer is yes, continues Barone.

One is that world trade, which increased at two to three times the rate of world gross domestic product in the years before 2007, has slowed since, to about the same rate as or slightly lower than the disappointing growth in world GDP. That's not good news.

International trade makes goods and services cheaper for consumers and creates new markets for producers. In the quarter-century from 1982 to 2007, it has moved hundreds of millions of people – especially but not only in China and India – from deep poverty to middle class comfort or better.

A second negative trend since 2007 is growing violence, which had declined drastically from earlier peaks but which, according to Australia's Institute for Economics and Peace, has been rising again since 2007. That's disturbing.

Thirdly, it's well known that economic growth in the years after 2007 has lagged behind pre-2007 levels. That is very worrisome.

Let's hope the post-2007 negative trends are temporary and limited, concludes Barone. But let's start thinking hard about how to reverse them.

NO ORDINARY DISRUPTION

Today our world is undergoing a dramatic transition due to the confluence of *four* fundamental disruptive forces – any of which would rank among the greatest changes the global economy has ever seen. Together, these four fundamental disruptive trends are producing monumental change.

So write Richard Dobbs, James Manyika, and Jonathan Woetzel in *No Ordinary Disruption*.

1. **The age of urbanization**

   The first trend is the shifting of the locus of economic activity and dynamism to emerging markets like China and to cities within those markets. These emerging markets are going through simultaneous industrial and urban revolutions, shifting the center of the world economy east and south at a speed never before witnessed.

2. **Accelerating technological change**

   The second disruptive force is the acceleration in the scope, scale, and economic impact of technology. Processing power and connectivity are only part of the story. Their impact is multiplied by the concomitant data revolution, which places unprecedented amounts of information in the hands of consumers and businesses alike, and the proliferation of technology-enabled business models.

3. **Responding to the challenges of an aging world**

   The human population is getting older. Fertility is falling, and the world's population is graying dramatically. While aging has been evident in developed economies for some time – Japan and Russia have seen their populations decline over the past few years – the demographic deficit is now spreading to China and soon will reach Latin America. For the first time in human history, aging could mean that the planet's population will plateau in most of the world.

4. **Greater global connections**

   The final disruptive force is the degree to which the world is much more connected through trade and through movements in capital, people, and information (data and communication). These three types of connections all paused during the global recession of 2008 and have recovered only slowly since. But the links forged by technology have marched on uninterrupted and with increasing speed, ushering in a dynamic new phase of globalization, creating unmatched opportunities, and fomenting unexpected volatility.

CONCLUDE THE AUTHORS:

These four disruptions gathered pace, grew in scale, and started collectively to have a material impact on the world economy around the turn of the 21st century. Today, they are disrupting long-established patterns in virtually every market and every sector of the world economy – indeed, in every aspect of our lives. …

This can play havoc with forecasts and pro forma plans that were made simply by extrapolating recent experience into the near and distant future. Many of the assumptions, tendencies, and habits that had long proved so reliable have suddenly lost much of their resonance. We've never had more data and advice at our fingertips. Yet we work in a world in which even, perhaps especially, professional forecasters are routinely caught unawares. That's partly because intuition still underpins much of our decision making.

Our intuition has been formed by a set of experiences and ideas about how things worked during a time when changes were incremental and somewhat predictable. Globalization benefited the well established and well connected, opening up new markets with relative ease. Labor markets functioned quite reliably. Resource prices fell. But that's not how things are working now—and it's not how they are likely to work in the future. If we look at the world through a rearview mirror and make decisions on the basis of the intuition built on our experience, we could well be wrong. In the new world, executives, policy makers, and individuals all need to scrutinize their intuitions from first principles and boldly reset them if necessary. This is especially true for organizations that have enjoyed great success.

While it is full of opportunities, this era is deeply unsettling. And there is a great deal of work to be done. We need to realize that much of what we think we know about how the world works is wrong; to get a handle on the disruptive forces transforming the global economy; to identify the long-standing trends that are breaking; to develop the courage and foresight to clear the intellectual decks and prepare to respond. These lessons apply as much to policy makers as to business executives, and the process of resetting your internal navigation system can't begin soon enough.

There is an urgent imperative to adjust to these new realities. Yet, for all the ingenuity, inventiveness, and imagination of the human race, we tend to be slow to adapt to change. There is a powerful human tendency to want the future to look much like the recent past. On these shoals, huge corporate vessels have repeatedly foundered. Revisiting our assumptions about the world we live in—and doing nothing—will leave many of us highly vulnerable. Gaining a clear-eyed perspective on how to negotiate the changing landscape will help us prepare to succeed.

2 — DOOM AND GLOOM, OR SWEETNESS AND LIGHT?

DOOM AND GLOOM

We are entering the first stage of a bursting bubble. Over the past 6 months we had a tremendous drop in true discretionary consumer spending. Wholesale trade is down $100 billion over just the last four months. Only one of the past seven months has had positive growth in new orders for US manufacturing. Inventories are up, business spending has slowed, capital expenditures are down. If things do breakdown as they did in 2008 the pain and suffering will be much worse this time around. The reason is that median net worth is down 40% from where it was just before the last collapse. Total unemployment is already twice what it was prior to the last downturn. Debt levels, both individual and public are at record highs. All of that means a much worse bottom than last time.

Disaster is inevitable when the two-decade-old stock bubble bursts. Since the mid-1990s the US economy has experienced three different bubbles: the 1990s dot-com bubble, the mid-2000s housing bubble, and now another bubble that includes stocks, bonds, tech startups, certain segments of the housing market, higher education, and much more. This new bubble is creating a temporary economic recovery that will end in another crisis.

Discouraged, dissatisfied, out of work: a jobs story

Workforce participation rate drops to 1978 level. Why is this important? Because as long as the true employment rate, that of the civilian employment to total population, remains at depression levels, there will be no increases in average hourly earnings.

Sixteen signs that the economy has stalled out and the next economic downtown is here.

#3 In one out of every five American families nobody has a job

#5 The rate of homeownership in the United States has just hit a 25-year low

#7 Only 37% of all student loan borrowers are actually up to date on their payments

#11 Retail sales have not dropped this rapidly since the last recession

#12 Wholesale sales have not dropped this rapidly since the last recession

#13 Factory orders have not dropped this rapidly since the last recession

#14 Credit requests are being declined at a rate not seen since the last recession

#15 Export growth has gone negative for the first time since the last recession

#16 62% of all Americans are currently living paycheck to paycheck

Is the US already in a recession?

Ten charts which show we are much worse off than just before the last economic crisis

Declining business dynamism means declining social mobility

New orders look recessionary

SWEETNESS AND LIGHT

Over time, the negative impact of the strong dollar should fade and low oil prices will become a net positive for the economy, with households spending out of higher real incomes. A pattern of slowing GDP just before a consumer spending boom takes off is consistent with what happened the last time a big rise in US crude oil production drove down gasoline prices beginning in 1986.

Another challenger to secular stagnation theory: The end of the debt supercycle. Anemic recoveries reflect the post-financial crisis phase of a debt supercycle where, after deleveraging and borrowing headwinds subside, expected growth trends might prove higher than simple extrapolations of recent performance might suggest. The US is at the end of this cycle, and growth might surprise to the upside vs. current expectations.

Economy has momentum

Prime working-age population growing again. The movement of younger cohorts into the prime working age is a key story in coming years. The prime working age population peaked in 2007, and appears to have bottomed at the end of 2012. The good news is the prime working age group has started to grow again, and should be growing solidly by 2020. This should boost economic activity in the years ahead.

Get ready for eighteen years of a growing economy

The era of middle-class stagnation is finally over. Goldman Sachs economists say they expect real median household income to grow significantly faster over the medium and longer term than in the dismal 1973-2013 period. And the main reason why is that they see signs that the widening of the US income distribution is leveling off.