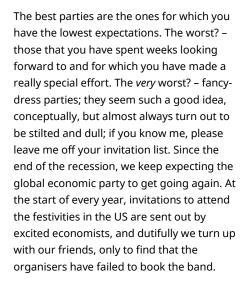


Party animals

Richard Jeffrey Chief Economist



So, it seems that once again a disappointing start to the year is going to result in a disappointing outcome - that is, if you started with high hopes that the US was about to enjoy an acceleration to 3% growth. That feeling that this cannot be 'it' in terms of global growth still seems to pervade the economics debate. There still seems to be a belief that we are merely enjoying the preparty drinks (I hesitate to say 'pre-lash' as this has distinctly the wrong connotations), but the real event has yet to begin. And, of course, that main event will be marked by a return to the rates of growth seen before the financial crisis, when the world seemed so much more fun.

The two economies that have probably been the most successful amongst the majors during the post-crisis period have been the US and the UK. Interestingly, over the past five years, both have recorded average annual GDP growth rates of 2.1%. Analysis of trends over very long periods suggests that growth around this pace can be supported largely by gains in productivity. As such, 2% momentum can be sustained with a minimum of cyclicality. Above this rate, growth tends to increase pressure within labour markets and also forces the pace of the investment cycle, thereby increasing the

overall amplitude of growth and inflation cycles. The mistake that monetary authorities made during the period prior to the recession was in believing that much faster growth was normal – ignoring the increase in debt, rising trade imbalances and significant asset price inflation that was associated with such rapid expansion.

For professional economists, this presents a problem. For those of us who have been practising for a reasonable time (the different definitions of the verb 'practise' being appropriate), our careers have been largely taken up with analysing and forecasting the various aspects of the business cycle. For the moment, however, this framework is no longer appropriate. I often hear comments to the effect that this growth cycle has already exceeded the normal upswing by a number of years, therefore it is about time we had a recession. Trying to impose historical average cyclical timings to the current growth phase represents a fundamental misunderstanding of cycles and the causes of cyclicality.

But for those who do still hanker after a good party, all is not lost. Unless productivity picks up, even 2% GDP growth will not be sustainable in the US and UK, because even these comparatively dull growth rates are putting increasing pressure on labour markets. This exposes another problem that often confronts professional economists that although we understand the general connections and relationships in the economies we look at, we are less good at determining timings and thresholds. Well before the financial crisis, many of us were warning that debt levels were becoming unsustainable, but they continued to rise for much longer without, seemingly, causing a problem... until they did eventually crash down on us. And so, in a different area of the economy, economists are currently sounding warnings that have to date not seemed justified. The warning is that tightening

labour markets will eventually trigger a more obvious upswing in the wage cycle.

This has to be true – our problem is simply in identifying the degree to which the labour market can tighten before this becomes apparent and the timescale within which this might take place. Fortunately, that is still not the only outcome. 2% growth momentum can, in my view, be sustained almost indefinitely if it is largely supported by productivity improvements and that remains the key to continuing growth in advanced economies. Currently, I am seeing some positive early signs in both the US and UK. It is not fancy-dress time, but it might be a moment when we are able to crack open a bottle of elderflower cordial.

This article is issued in the UK by Cazenove Capital which is part of the Schroder Group and is a trading name of Schroder & Co. Limited, 12 Moorgate, London, EC2R 6DA. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Issued in the Channel Islands by Cazenove Capital which is part of the Schroder Group and is a trading name of Schroders (C.I.) Limited, licensed and regulated by the Guernsey Financial Services Commission for banking and investment business; and regulated by the Jersey Financial Services Commission. Issued in Hong Kong by Cazenove Capital Management Asia Limited ("CCM Asia") of Level 33, Two Pacific Place, 88 Queensway, Hong Kong. CCM Asia is licensed and regulated by the Securities and Futures Commission. Nothing in this document should be deemed to constitute the provision of financial, investment or other professional advice in any way. Past performance is not a guide to future performance. The value of an investment and the income from it may go down as well as up and investors may not get back the amount originally invested. This document may include forward-looking statements that are based upon our current opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements. All data contained within this document is sourced from Cazenove Capital unless otherwise stated.

