

Tuesday, October 30, 2007

Are economic cycles that easy to predict?

I'm currently reading Joseph H Ellis' *Ahead of the Curve - A Commonsense Guide To Forecasting Business and Economic Cycles*. So far there are a couple of refreshing departures from conventional consensus, like his views on "recession".

The idea of an economic recession should be an objective measurement of reality, instead, in today's climate it simply isn't discussed in polite company. According to the politicians, it'll never happen.

Ellis argues that whether we are headed for recession is academic, because recessions are lagging indicators of a down cycle, not leading ones. By the time a recession hits, he says, a lot of the economic damage has already taken place.

What really matters, according to Ellis, are a series of leading economic indicators and a shift in the way we measure economic data....

In a nutshell: it all starts with consumer spending. Consumer spending drives business industrial output and services, which in turn drives capital expenditures which then drives jobs. Employment numbers then, are another lagging indicator. No need to panic if the numbers come out badly, he says, because it may really be indicating a trough in the cycle.

It seems simple, and common sensical. I'm looking forward to reading through but I find it hard to reconcile some of the underlying fundamentals from my doom-and-gloom bear mentality to normal run-of-the-mill business cycle thinking.

Ellis does acknowledge that there are some abnormal imbalances in the system now, like the large US deficits (and he wrote this book in 2004! They're much worse now), he considers them of secondary importance to the cycles, not prime movers.

The problems I see off the top of my head are these:

Interest rates have been artificially suppressed - far below normal market rates for far too long. So consumer spending in the US has not been driven by rising wages and earnings these last number of years. They've been largely driven by unnaturally accelerated consumer borrowing.

Employment statistics aren't real - these figures just aren't accurate.

"Jobs created" aren't actually derived from counting real job creation, they are largely statistical constructs based on "hedonic adjustments".

People whose unemployment benefits run out are no longer counted as "unemployed".

No matter what happens, the number always comes out as 4.5% anyway. If Ford, GM, IBM and GE fired everybody in their workforce tomorrow, next month's number will be 4.5%

Inflation is not reported accurately - with oil over \$90 a barrel and the US dollar at all time lows, pretty well everything costs more, much more to US consumers. Yet inflation figures are reported "ex-food and ex-energy". To make matters worse, in strict terms inflation describes an increase in the supply of money, but aggregate money supply M-3 reporting was getting too scary, so it was simply discontinued.

I'll be interested to see where Ellis goes with his reasoning that the abnormal imbalances are secondary factors that don't really perturb the consistency of the overall cycle, and perhaps he is right, it may just be a matter of degree and intensity when the cycle turns.

Blog Export: Exile From the Herd, <http://www.privateworld.com/>

But given that of late, most economic data reporting produced by the government is subject to farcical adjustments and revisions that make the numbers more politically acceptable so as to not be out of line with the government party line on reality. It may be hard to track any business cycle based on economic data. Add to this the relatively new phenomenon of derivatives and we may really be into uncharted territory.

Posted by Mark Jeftovic in Armchair Analysis at 20:49