Why It Had To Happen?

(Published: 31/05/2011)

The how and when are usually easier to write about, but the why is always extremely difficult. Economists, historians and politicians will be arguing about the why, not just for years or decades to come, but for centuries! In hindsight it will appear that the last 20 or so years have been some kind of illusion. People in the future will look back to this time and ask "how could that have happened?"

There are many different ways of looking at why The Five Act Drama had to happen but for now we can take just three reasons why the great depression of the 21st-century had to take place. Firstly, if we look at it from a purely macroeconomic viewpoint we can say that from approximately 1992, global interest rates were held artificially low and this set the environment for a financial assets bubble of unprecedented proportions. From the mid-1980s onwards it can also be seen that the economic growth in most western economies was being financed through massive credit expansion.

In the economic theory behind business cycles one always concludes that all asset bubbles eventually burst and asset prices return to the price level at which the bubble began. On that basis we can predict a return of financial asset values to around 1992 levels.

Some typical predictions therefore include the DJIA falling below 2342, S&P500 below 291, gold falling to below US700/oz, silver below US$5.00/oz, property prices to pre 1992 levels and oil falling to US$12.00 per barrel. These figures appear irrational in light of current prices levels and the economic environment we are experiencing at time of writing this article in May, 2011.

The second way we can look at "why it had to happen" is to view economic cycles that ebb and flow through the life of an economy. In particular many western economies have completed a growth phase of their economic life cycle and have entered a protracted phase of economic contraction. Some of these economies, namely the UK, most European economies, Japan, China and the USA are seeing the interaction of several levels of economic cycle activity coming together resulting in the large contraction phase we are now entering. For example, if we look at the UK, we can see various economic cycles concluding which extend back as far as the beginning of the industrial revolution.

When we examine the economic cycles of different countries we can see some countries not being as badly affected as others. In fact, some countries will hardly notice the large contraction being experienced by most western economies. Notably India stands out as one economy that will hold their own or move ahead whilst others contract. Others include Singapore and Australia.

Finally, the third aspect we can see having a large impact on the depth and severity of this contraction phase is the level of interference and manipulation of politicians and bureaucrats in the market process. In the hubris of the good times of the late 90s and mid 00s, many politicians and bureaucrats were heard boasting that they had their hands firmly on the levers and buttons of the economy. Indeed, excessive regulation and involvement in market processes, combined with a lack of understanding of the consequences of their actions is slowly but inexorably leading over the next 5 to 10 years to a high level of suffering for many people.

Some of these factors include artificially depressed interest rates thereby inducing a credit induced inflationary business cycle. Governments now consume a greater proportion of GDP resulting in wastage and misappropriation. The monopolisation by government agencies of the money printing process is another and the ability of the state to assume debt on behalf of their citizens yet another. Probably the most dangerous of all shifts was the decision by President Nixon to totally repudiate the already ailing gold standard in 1971. In fully endorsing fiat money, politicians and bureaucrats untied themselves from any natural accountability in having a store of value to back money. They were free to inflate and borrow without restraint. Since then money supply and debt has expanded resulting in a confiscation of wealth via inflation and a massive rise in the indebtedness of governments and people around the world.

Indeed, economic growth has in the last thirty years been financed through credit expansion. Currently we see the US Federal Reserve completing its second quantitative easing program (June, 2011) with concerns being raised that there needs to be another easing program because the US economy is not reviving as quickly as hoped. Little concern is shown for the loss of real savings needed for the recovery of the economy – devalued by money supply pumping and eroded by non-productive bubble activities. At the same time, we have witnessed excessive regulation in people's lives with an attendant loss of civil liberties.

The irony is that at no time will politicians and bureaucrats accept "mea culpa" for the decisions they have taken. This lack of accountability will create massive anger and resentment by peoples around the world in response to the coming collapse in economic activity and the resultant high unemployment levels. Social mood, which has been intermittently deteriorating over the last 10 years is about to turn very bad. Social mood will continue to deteriorate until The Recovery and the War.