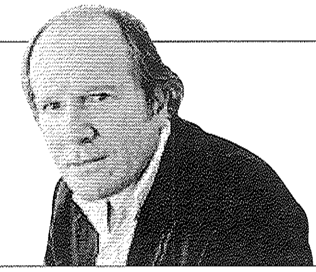
Opinion

John Updike: his style was as much a curse as a blessing
William Boyd, page 28



Trust me, the experts here don't know either

At Davos, steer clear of economic forecasts – but remember that things are unlikely to be as bad as the doom-mongers say

Anatole Kaletsky

According to a survey that greeted the 2,000 captains of industry, Nobel laureate economists and heads of government arriving in Davos for the World Economic Forum, confidence among them has "plummeted" and hopes of an economic recovery have "evaporated" in the past four months. Only 21 per cent of corporate leaders now expect their businesses will improve significantly (down from 50 per cent a year ago) and most of them hope for nothing better than a slow and feeble recovery over the next three years.

The good news is that captains of industry, Nobel laureate economists and heads of government are usually wrong about the future. Like the cover stories of *Time* or *Business Week*, "the view from Davos" is one of the more reliable "contrary indicators" of what will happen.

The reason why magazine covers and surveys of elite opinion are so often wrong is not because magazine editors and business leaders are stupid or irresponsible. On the contrary, these people are intelligent and responsible enough not to put a story on their covers or to express a strong opinion until they are sure it is right. And by the time all these distinguished people are sure enough about a trend to create an almost unanimous elite consensus, the chances are that almost everybody in the world has also recognised and acted on this trend — and therefore the trend does not have much farther to run.

It is a cliché of financial markets that the four most expensive words in the English language are "this time it's different". In every speculative mania, optimistic investors convince themselves that they have discovered some new magic ingredient that will make the current boom more durable than previous boom-bust cycles. And every time they turn out to be wrong.

But cynics who ridicule the gullibility of bullish investors forget that exactly same thing happens on the way down. Just as in every boom the bulls proclaim that "this time it's different" so in every slump the pessimists insist that the world faces unprecedented disaster and that this time the recession will not be followed by recovery, as it always has before.

And in a sense the pessimists are right — every recession and financial crisis really are different. This time, the driving force is an unprecedented credit crunch. In the 1990s it was the hangover from German reunification and the expulsion of Britain, Italy and Sweden from the European Monetary System; in the 1980s it was 20 per cent interest rates and a one-day fall in share prices which, according to statistical models, should only have occurred once in a billion years; in the 1970s it was the break-up of the Bretton Woods currency system, closely followed by an oil shock and inflation that nobody imagined possible.

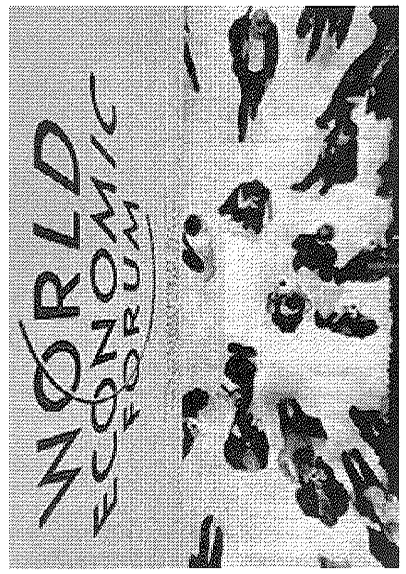
After each of these unthinkable disasters, the prophets of doom declared that capitalism was finished, that markets would never recover and this was the biggest crisis since the Great Depression. Yet every time the world economy recovered and capitalism survived. A lovely illustration of this syndrome was brought to my attention this week.

Dennis Gartman, a prominent US investment adviser, quoted an academic friend who had studied media reports of the US recession of the 1990s. This was a selection of comments from the US press in early 1991: "There is no question that this is the worst economic time since the Great Depression"; "Forecasts for a weak recovery in 1992 suggest the period since 1990 will be the worst for the economy since the Great Depression"; "This recession is hitting white-collar workers more heavily than any since the Great Depression of the 1930s." And so on.

Most of these comments were published near the low point of the 1990-91 recession — a recession that, far from being the deepest and longest since the 1930s, turned out to be the shallowest and shortest to date.

This is not to deny that many features of the present crisis really are worse than ever before. The collapse of global finance triggered by the Lehman bankruptcy really was the greatest banking crisis in history and the fall in output triggered by this financial panic really has been the steepest since 1981.

The upshot is that world economy does now face the greatest deflationary pressures since the 1930s. But against these deflationary forces some equally unprecedented expansionary forces are arrayed: the lowest interest rates in history; the fastest fall in oil and commodity prices; the biggest peacetime public works programmes; and, most importantly, a willingness and ability by governments to print money and support their financial systems with open-ended guarantees.



The Nobel laureates and captains of industry are usually wrong

So what can we say about the outcome of this tug-of-war between the forces of expansion or deflation? Only one thing for certain: no economic forecaster will predict what happens in the next year correctly, except by chance. This is not because economists are stupid, but because computer models they use are based on past experience — and at a time of unprecedented upheavals, computer forecasts are of no use.

Does this mean that all economics is useless? Not at all. But it does mean that we should not trust any quantitative forecasts produced by computers and return instead to qualitative reasoning about society and human nature. This is how the word economics was understood by Adam Smith, Joseph Schumpeter and Maynard Keynes and why the subject was called "political economy". These great economists never claimed to be able to predict the future. What they tried to do instead was to shed light on the social processes and political and psychological pressures that lead to the creation or destruction of wealth.

These qualitative economic theories tell us that the creative force of the profit motive, backed by the expansionary power of ultra-low interest rates and government deficit spending, will eventually prevail.

But political economy cannot tell us exactly when or how. It cannot tell us, for example, whether Britain and America will suffer more than continental Europe, as several of the spurious computer forecasts are suggesting — or whether the Anglo-Saxon economies will, as I believe, recover sooner because of their more flexible markets and policies. Neither can it predict what new industries and jobs will be created by market forces to fill the vacuum left behind by the demise of leveraged finance in the City of London and New York.

The masters of political economy should, however, leave us confident that in a capitalist system "something will turn up", as Mr Micawber put it — a much more reasonable expectation, in a market economy, than most people realise. And pretty soon what will turn up will be the world economy. Followed, a year or so too late, by the "view from Davos".