Tullet Prebon Research, a blog by Dr Tim Morgan

What happens next to the global economy?

by Tim Morgan on May 10, 2013

If you subscribe to conventional interpretations of economics, and if, also, you are inclined to take official assurances at face value, then you might believe that normality has been restored after the near-disaster of 2008. On the other hand, if you share our view that a distinction must be drawn between the 'real' economy and its monetary counterpart, you will not be surprised at the view, set out in a new report, that major value-destruction remains inevitable.

The Tullett Prebon strategic analysis, set out in detail in Perfect Storm, is that we need to think in terms of two economies, not one. The first – 'real' – economy is a surplus energy equation, and is weakening markedly now that the indicator for energy surpluses (known as the energy return on energy invested, or EROEI) is in sharp retreat.

This poses a problem, because the second economy – the real economy's shadow, monetary proxy – embodies value claims that far exceed realistic forward capabilities. Since the huge gap between the two must in some way be eliminated, the implication has to be that value must be destroyed within the monetary ("claims") economy.

Thus far, very little value destruction has been accomplished. Inflation, which can destroy the real value of past debt commitments, seems inevitable, and QE is likely to play a role in this as soon as the velocity constraint ceases to prevent quantitative increases in the money supply from translating into price escalation.

However, and as our new report explains, the "cash paradox" will prevent quantity-driven inflation from carrying the entire burden of claim destruction. Degradation of the future value-claims embodied in the monetary system is, therefore, bound to include hard as well as soft defaults. Thus far – with some minor exceptions such as Greece and Cyprus – hard default has been avoided, but the inevitability of failure has been postponed, not prevented.

The double-whammy here for holders of cash and quasi-cash assets is that value loss is likely to be compounded by accelerated expropriation as governments seek new ways to grab private assets in order to prevent the top-heavy ship of state from capsizing.

Resource-deficient developing countries are the most exposed, but it would be foolhardy to suppose that all developed economies are risk-exempt. Risk is appreciable where economies are fundamentally weak – as is the case both in France and in the southern Eurozone countries – and is even more pronounced where, as in Britain and Japan, economic weakness is compounded by high levels of debt.