tullett prebon

what happens next?

a quest for innovation

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strategy insights | issue one

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In this first issue of our new global strategy research product, we set out some of the topics that we are going to be exploring in future reports.

What comes next?
Critics might be right to contend that the near-catastrophe of 2008-09 may have killed off the post-1970s neoliberal Anglo-American economic model, but dreams of a return to Keynesian demand management are probably misplaced. What is the new consensus likely to be, and how will it emerge?

Dangerous imbalances
The world economy suffers from a series of imbalances – most notably between creditor and debtor nations – and the monetary system fails to reflect this. Is the dollar finished as the global reserve currency? If so, what might replace it?

Have we the energy?
Advocates of 'Peak Oil' might be wrong about reserves, but their critics' ripostes about abundant reserves are neat answers *to the wrong question*. Our research will explore the concept and implications of 'resource constraint'.

Adam Smith's legacy
Is economics 'dismal'? And is it even a science?

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Karl Marx famously believed that capitalism contained the seeds of its own destruction. Well, sorry, Karl, that was socialism. Capitalism is the only game in town. But – after the economy flirted with catastrophe in 2008-09 – which *form* of capitalism?

Put very simply, the post-War period divides into two distinct eras of economic orthodoxy. The Bretton Woods agreement of 1944 inaugurated an essentially Keynesian consensus which lasted until the 1970s, when it was replaced by a *laissez-faire* ideology variously labelled ‘the Anglo-American model’, ‘monetarism’, ‘neoliberalism’ or ‘the Washington Consensus’. The debt crash of 2008-09 suggests that this era, too, may now be drawing to a close.

Some Keynesian thinkers believe that the events of 2008 will inaugurate a return to demand management of the pre-1980s variety. This seems implausible, because history strongly suggests that the emergence of a new consensus is far more likely than reversion to a previous orthodoxy. But what will constitute the new orthodoxy? How long will it take to emerge? And how bad are the birth pangs likely to be?

This will be one of the critical issues to be examined in the new *Tullett Prebon Strategy Insights* research series. Our aim here will be to look at events through the prism of the new pattern that may be evolving. We believe that *all* prior assumptions – including the supposed inevitability of globalisation – are now open to question.

One big issue presents itself in this context: the massive imbalance between creditor and debtor nations. This in turn calls into question the viability of a monetary system in which the dollar is the global reserve currency – has a combination of American indebtedness and quantitative easing fatally undermined the ability of the dollar to act as the lynchpin of the global monetary system? If so, what might come next?

We’ll also be looking at energy, interpreted in its broadest sense. In mid-2008 – when benchmark Brent crude hit an unprecedented $147/b – there was much debate about the concept of ‘Peak Oil’. Followers of pioneering geologist M. King Hubbert[1] believe that we are fast approaching the point at which half of the world’s originally-recoverable reserves of crude oil will have been extracted. This moment, they believe, constitutes ‘Peak Oil’, after which supplies of petroleum will decline in a mirror-image of the dramatic increase in consumption which has occurred since oil was first used commercially in 1859.

[1] Marion King Hubbert (1903-1989) was an American geologist who worked at Shell’s research laboratory in Houston. His contributions to energy thinking went far beyond the ‘Hubbert’s Peak’ theory, which correctly predicted that US oil production would go into decline after 1970.

Nonsense, reply non-believers, who point out that consumption to date amounts to nothing like half of all originally-recoverable oil. This retort, though true, supplies a neat answer *to the wrong question*. The real issue, as we shall seek to explain, lies not in absolute reserves numbers but, rather, in deliverability. Naturally enough, the industry has had first recourse to the easiest and cheapest sources of oil – from here on, and though reserves remain substantial, both costs (broadly considered) and delivery ratios become the key issues.

The debate, too, about how to substitute for oil (and gas) is the wrong debate – the real issue is the critical equation which compares energy extracted versus energy expended in the extraction process. Any deterioration in this equation will have the most far-reaching consequences. We plan to publish a substantial assessment of the Peak Oil issue, but we aim, also, to examine the broader energy equation.

Some commentators even believe that the unsustainable trajectory of hydrocarbon consumption is just one of many 'dangerous exponentials', which extend from population growth via resource exhaustion to climate change and environmental degradation. If they were to be proved right, this might indeed confirm that economics is 'the dismal science'.

This label is, in fact, inaccurate on both counts. First, economics need not be dismal, because it is concerned with the best use of scarce resources. Second, economics is in no sense a science, in that it cannot be subjected to the repeatable controlled experiments that are demanded by true scientific rigour.

The attempt to regard economics as a science can often squeeze out the irrational element which recurs because economies are human constructs – this seemingly-capricious element is the economic corollary of the "dignified" (but illogical) component that Walter Bagehot[2] identified in his seminal study of the British system of governance. The illogical element in an economy should caution us against a surfeit of theory – it would be perfectly possible to draw up a blueprint for turning, say, Britain into a world-leading growth economy, but it would be perfectly *im*possible to persuade electors and elected to opt for it.

The 'crash of 2008' – as future historians will no doubt label it – brought the global banking system to the brink of collapse, and we are by no means wholly convinced that the possibility of a repetition has been wholly eliminated. Benjamin Franklin famously said that the only certainties in life are death and taxes, but to this, in 2010, a third certainty can be added – the inevitability of big changes ahead.

This is an interesting time at which to start a new research service. In addition to conventional publication, our strategy reports will be posted on the Tullett Prebon website at **www.tulletprebon.com**, where we hope that our research will prompt some lively debates.

Dr Tim Morgan
Global Head of Research
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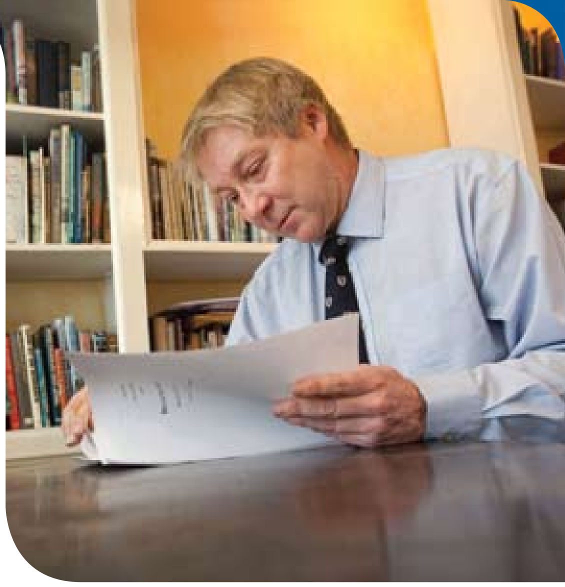
[2] *The English Constitution*, by Walter Bagehot (1826-1877) was published in 1867, but is still regarded as a masterpiece of constitutional analysis.



about the author

Tim Morgan read history and political philosophy at Emmanuel College, Cambridge before joining stockbrokers Wood Mackenzie as a trainee in 1982. He moved to Montagu Loebl Stanley the following year, shortly thereafter assuming responsibility for the firm's oil and gas research.

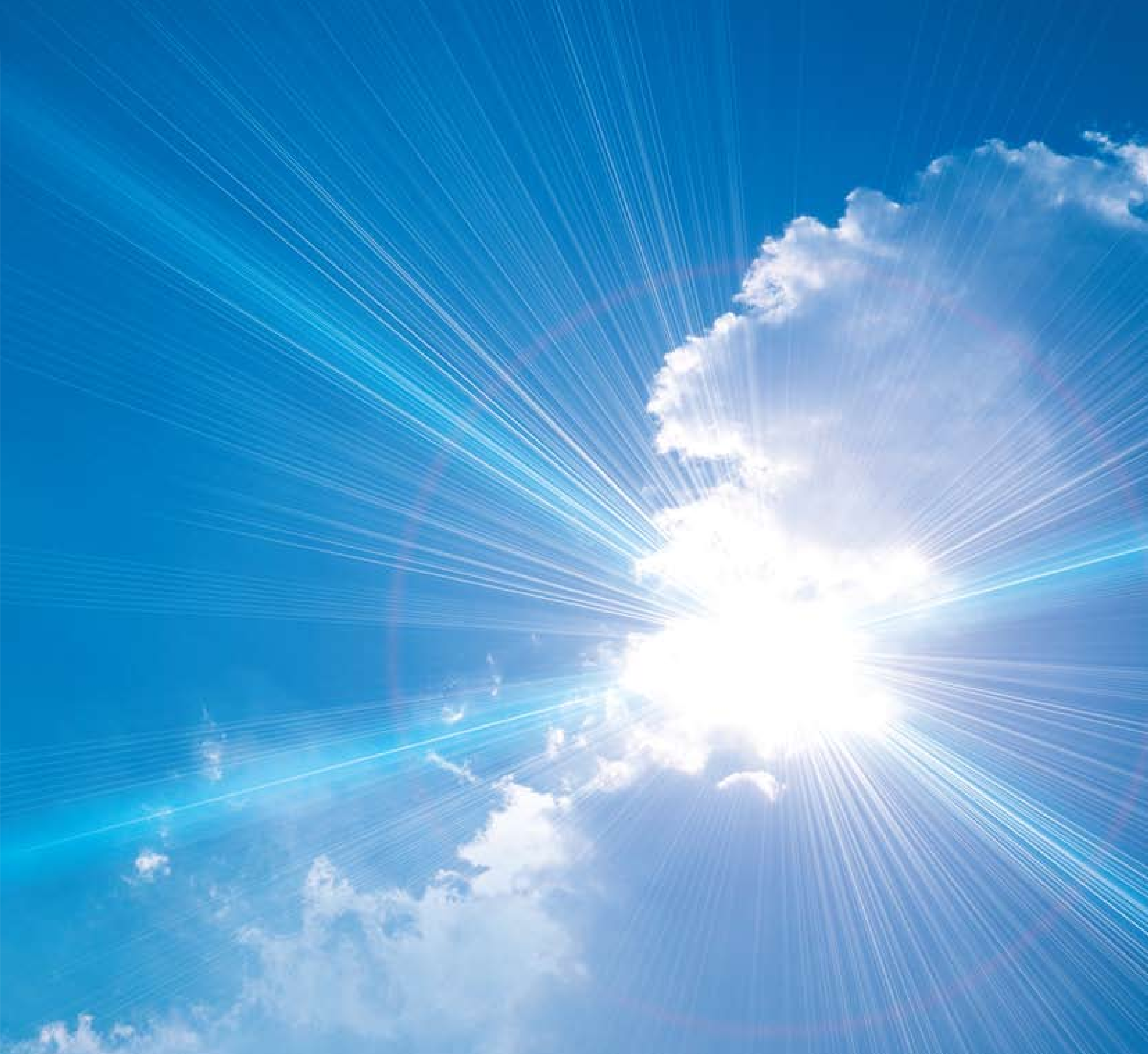
In 1985, he joined the stockbrokers WI Carr, which became part of Banque Indosuez in 1986. After a short period with a boutique broker, he established an energy sector research consultancy in 1990. During the 1980s, he had made two important decisions. First, that the prevalent earnings-based investment analysis was out-dated, and that the emphasis of research needed to shift to cash-based measurement of shareholder value creation. The second was that single-country research was inappropriate in an increasingly globalised economy. These decisions led him to develop the value-based VVM™ analysis system.

Between 1995 and 2006, Tim was consultant energy analyst at Collins Stewart, a stockbroking firm which achieved rapid growth on a platform of research originality and technological excellence. He joined Shore Capital Group, again as a consultant energy analyst, in May 2007, but, in February 2009, was invited to formalise a role that he had been carrying out for some time – that of economic and market strategist.

In this role, he attracted considerable notice for a report in which he warned that a decade of economic mismanagement had taken Britain to the brink of a "debt vortex". This built upon an earlier report which contended that recent UK economic growth had been largely illusory, being based upon debt escalation and the understatement of inflation. He also pioneered the three-part Matrix™ approach to investing in periods of high systemic risk.

Whilst retaining a keen interest in energy, his current research focus is on the implications of an accelerating process of change in the global economy. He believes that this process is exposing a series of major economic, financial and political imbalances, and that it is imperative that financial market participants be keenly aware of the structural implications of this process.

Tim's extra-curricular interests focus on defence issues, the environment, music and community involvement. He has a particular interest in warships, has published a book on the subject, and has relished time spent at sea with the Royal Navy, believing that few experiences can equal taking off from an aircraft carrier or participating in amphibious exercises with the Royal Marine Commandos.



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