Perfect Storm – energy, finance and the end of growth

London, New York, Singapore, 21 January, 2013: More than 200 years of economic expansion may be drawing to a close, says a new report from inter-dealer broker Tullett Prebon.

The global economy is facing a lethal confluence of four critical factors – the fallout from the biggest debt bubble in history; a disastrous experiment with globalisation; massaging of data to the point where economic trends are obscured; and the approach of an energy-returns cliff-edge - explains Dr Tim Morgan, Global Head of Research at Tullett Prebon in Perfect Storm – energy, finance and the end of growth.

“Combined, these factors have started to throw more than two centuries of economic expansion into reverse,” says Dr Morgan. “If the energy surplus ratio continues to decline as it has been, the economy as we know it is finished.”

The unwinding of the ‘energy dynamic’ which makes growth possible is the most important of the four critical trends identified in the 84-page study. In 1990 it took one unit of energy to extract 40. Today the ratio is barely 17:1 and it is set to pass the critical 10:1 point in the coming decade. As our ability to substitute cheap energy for human effort declines, the foundations of the economy are undermined.

This profound and irreversible trend combines with three superimposed effects. The first is the bursting of the ‘credit super-cycle’ a three-decades-long borrowing binge that created the biggest bubble in economic history. In 1980, total debts of American businesses, individuals and government were 168% of GDP, little higher than in 1945, the study shows. But by 2009 that had soared to 381%. The massive escalation in Western indebtedness is one amongst a host of indicators of “a state of mind which has elevated immediate consumption over prudence throughout much of the world,” says the study. Short-term thinking is blinding us to critical longer-term risks.

As governments wrestle with the fall-out from the 2008 financial crisis “a dire chapter of recklessness is poised to end in money-printing, hyperinflation and collapse,” Dr Morgan predicts.

Globalisation, meanwhile, has proven a “vast folly” for the West, the report argues. Outsourcing manufacturing to emerging countries enabled companies to boost profits but hollowed-out the Western economies. The process of globalization has distorted the normal relationships between production, consumption and debt beyond the point of sustainability, the report says. “The West is in deep (and perhaps irreversible) trouble because it has consumed more, just as it has produced less.”

Meanwhile, data distortion obscures the scale of the crisis. Decades of methodological changes have clearly left US inflation understated, exaggerating economic growth and masking the scale of unemployment. Fiscal data is often distorted too, says the Tullet Prebon study, citing evidence from the International Monetary Fund and elsewhere to show that many governments have used accounting devices to understate their borrowings. In 2010, for example, though UK government debt was 69% of Gross Domestic Product,
adding civil service pensions and other commitments took total liabilities to 173%, the report says.

Will the economy really unravel and can we do anything about it? “Economies will lurch into hyper-inflation...while social strains will increase,” the report says. The ‘magic bullet’ would be the discovery of a new source of energy which can reverse the winding-down of the energy returns equation. But a technological miracle seems unlikely, it says.

“In the absence of such a breakthrough, really promising energy sources (such as concentrated solar power) need to be pursued together...with social, political and cultural adaptation to ‘life after growth’.”

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For further information please contact:

Media
Charlotte Kirkham Nick Woods
M:Communications M:Communications
+44 (0)20 7920 2331 +44 (0)20 7920 2348
kirkham@mcomgroup.com woods@mcomgroup.com

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