Six years on, still little fruit: Part 1

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Whatever a young man's fancies turn to at this time of year, this grumpy old man tends to think of an article published by The Gold Report,[1] having interviewed longwave economic forecaster, Ian Gordon, just over 6 years ago, which laid down its position clearly in the opening line:

Never mind that fruit trees are blossoming all over the Northern Hemisphere. A whopper of a winter in the Kondratieff cycle is far from over.

Ian Gordon elaborated the Longwave Principle as follows:[2]

"The basis of the Longwave Principle is the Kondratieff Cycle. Russian economist Nikolai Kondratieff developed his thesis on this in the 1920s. The cycle lasts approximately 50 to 60 years. I call it a lifetime cycle, because we live only one cycle in a meaningful way. For that reason, it is also very difficult for anyone to recognize where we are in the cycle because we haven't lived in that period before.

"For example, we are now in the depression stage, but no one really refers to it that way. I do believe we are in depression because the real number on U.S. unemployment is somewhere around 17%. That to me is a depression."

This longwave cycle and its more advanced cousin, the Minskyan cycle of stability,[3] have pervaded my own thought processes for many years. I'd also see the labour participation rate as being more significant than mere official unemployment statistics. The human capacity utilization rate reflects broader capacity underutilization; but with the added complexity that human beings react very differently to property or plants & machinery, if they are underutilized. This is because labour underutilization generally tends to equate with poverty, deteriorating living standards and large scale malnutrition, even in developed economies.[4]

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[1] https://www.streetwisereports.com/pub/na/ian-gordon-ignore-the-illusion-of-spring

[2] *idem*

[3] http://www.economist.com/blogs/buttonwood/2014/05/investing-3

[4] David Dooley & JoAnn Prause, *The Social Costs of Underemployment*, Cambridge University Press (2003)

Ian goes on to explain the Four Seasons Principle:[5]

"I've broken the cycle into the four seasons, and others have done the same—with Spring being the birth and rebirth of the economy, Summer being the time when the economy reaches its fruition, Autumn being the feel-good period. Kondratieff called Autumn the plateau period because it's when the economy levels out and it's also the season – always – of massive speculation in stocks, bonds and real estate.

"There are indications of each season changing, and you have to know where you are in a cycle to be able to predict where you're going…. We went into Autumn between 1980 and 1982 and similarly between 1920 and 1921. Four events anticipated each of those Autumns. One was a peak in interest rates, second was a peak in prices, third was a bear market in stocks and fourth was a recession.
[…]
"And then you go into this massive speculation in stocks, bonds and real estate in the Autumn because once the Federal Reserve takes interest rates quite dramatically down from the peak, money floods into the banks. It's also the season when you get the biggest build-up in debt. Any debt chart in the United States, for instance, shows that the debt really starts to take off at the beginning of Autumn.

"When the big speculative bull market ends, it indicates that we're going into Winter. And Winter is when all the huge debt that's been built into the economy is wrung out, through either payback or – in most cases – bankruptcy. Creditors and debtors alike suffer very, very much during the Winter period. It causes a crisis in the banking system because banks are the biggest creditors. If you look at the last Winter after the 1929 stock market peak, 10,000 U.S. banks failed by 1933. In fact, when Roosevelt became president, he closed all banks for 10 days and sent in examiners. Banks deemed to be okay were allowed to reopen, and basically the doors stayed closed on the rest.

"So, we're now in the Winter. I've argued the real peak in the stock market occurred in 2000; that was certainly the speculative peak on the NASDAQ. At that time, too, consumer confidence peaked. Alan Greenspan decided he didn't like Winter and to save the American economy from a depression, he cut interest rates from 6% to 1%, and pushed enormous amounts of money back into the banking system to try to refloat the economy. He did that to some extent, but in effect, he really built up the debt level to absolutely unmanageable proportions and particularly in the housing market, which resulted in this huge speculative phase in real estate.

That housing market bubble burst, and it has a lot further to go on the downside. The stock bear market that began after the NASDAQ peak—and it has never gotten anywhere close to that level since—began for the Dow in October 2007."

[5] https://www.streetwisereports.com/pub/na/ian-gordon-ignore-the-illusion-of-spring

However Gordon believes that we're facing a new and more severe Kondratieff Winter paradigm this time:[6]

"This is the first Kondratieff Winter in which the entire world has been subjected to a fiat system. It's so much easier through the printing process to try to stave off the bad days. As I've said, Greenspan made it appear that Winter hadn't started by printing all this money. And we did have a bear market. The Dow dropped—what?—35%, and the NASDAQ dropped almost 80% into 2002."

The synchronized actions of central banks,[7] shorn of the policy constraints that prevented the worse missteps of policymakers in the time when currencies were linked to gold, has enabled the Second Great Depression to be deferred but ultimately, most likely worsened.

However the removal of the destructively high levels of debt from the global economic and financial systems seems certain to have only been delayed and not avoided. In that sense, this time is different. Thanks to central bankers, it will almost certainly ultimately be much, much worse. As this is a new experiment, though, we can't really know how much worse it will be or how long they can defer the *Day of Reckoning Up*.

Therefore, like myself, Gordon sees the build-up of speculative debt that leads to Kondratieff winter as being an essentially deflationary force:[8]

"I am very much a deflationist. Taking the debt out of the system is in itself a deflation process. You can see it in falling housing prices. As debt comes out of the housing and mortgage markets, it deflates prices. We're going to see the same in stock prices. Wealth is being reduced considerably, and that is deflationary.

"A lot of people who argue for inflation say that all the money being printed eventually has to go through the banks back into the economy. But it's like being on a treadmill. You running as fast as the treadmill goes, but you don't get anywhere. The Federal Reserve is printing copious amounts of money trying to re-start the economy. Unfortunately, the rate of debt being taken out of the system eventually will overwhelm their ability to do that."

But we don't know whether ultimately is now imminent or still some time away. With the season of long weekends, hot weather and ongoing drought, it may be worth being sensitive to increasing risk in Thailand.

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[6] *idem*

[7] http://www.econotimes.com/Synchronized-central-bank-stimulus-sets-off-global-market-rally-111155

[8] https://www.streetwisereports.com/pub/na/ian-gordon-ignore-the-illusion-of-spring

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