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THE VIEW
RICHARD HARRIS

Changing economies

While price changes in the US dollar, oil and bond yields last year seem to belie economic theory, these moves will generally be positive for markets

Those who observed the 100th anniversary of the first world war last year recall that the terrible carnage resulted in a change in the old world economic order. The global economy swung from being pound-centric to dollar-based. Currencies moved from being backed by gold, to taxation-backed paper money. It led to government policies directed more towards the many rather than the privileged few, especially in Western Europe.

Those theorists who designed the world included John Maynard Keynes, who had experience in academia, government, and especially the markets. Global economies have evolved since.

So do last years' large and unexpected price changes in the US dollar, oil, and bond yields reflect economic revolution rather than evolution? This activity has occurred despite any significant global bubbles elsewhere and with few direct linkages between the movements.

In 2014, the markets were betting on evolution but this week were spooked by the row between the European Central Bank and Germany, which again raised the spectre that Greece might leave the euro zone. That could set off a chain reaction of events made worse by the big moves in dollar, oil and interest rates.

It is somewhat irritating to non-Americans that US policies, the domestic economic structure, their position in the global economy, and just plain good luck, have created clear blue water between them and the rest of the world. Such divergence between 3 per cent US annual growth and precious little elsewhere, topped with the possibility of US interest rate rises, meant dollar strength of nearly 13 per cent over the euro in the past six months.

The oil price continues to flow downwards, now down 55 per cent in half a year, pulled down by overproduction by old and new producers alike. Oil had barely fallen in the past four years, compared with other commodities, while usage of petroleum products becomes increasingly more efficient.

The true mystery continues to be the long-term fall in interest rates. Policymakers believed they had become better at managing monetary policy, delivering lower inflation and in producing real economic growth. Quantitative easing threw all monetary caution to the wind, printing money, which theoretically should have led to inflation. The opposite has happened. The US long bond soared this year with annual yields down by a third to around the 2 per cent mark.

Money currently has little time value; you can borrow almost free, yet we are still confident in its intrinsic value because the US dollar is in demand and the price of gold has not moved. Our old theories of money are not working, to the serious discredit of economic theory. Where is the new Keynes?

Technology has depressed prices, destroyed and cheapened jobs, and opened our eyes to a robotic world. So personal consumption remains low and discontent is high as, no matter how hard young people work, it is difficult to earn enough to advance.

Mixing discontent with democracy may lead to a nationalistic or left wing backlash in any of the general elections in Greece, Britain, Portugal, Spain and Turkey this year. The victors may seek to move wealth from the recent winners to the losers. Even in countries without elections the same economic challenges have to be managed or the leaders will have to take the blame.

John Maynard Keynes

> **Our old theories of money are not working, to the discredit of economic theory**

My base case is still for evolution to prevail over revolution. The big moves in the dollar, oil, and interest rates are generally positive for markets. The high dollar will transfer US strength to the rest of the world through cheap imports. Europe will eventually reflate and move back into slow growth. China will continue to modernise its economy, while it waits for Western growth to take its exports.

The oil price fall is good for the world as long as business failures in the oil exporters are containable and are not contagious. Despite historically low interest rates, we are unlikely to see significant interest rate rises in 2015. The hope is that the central banks do not add so much fuel to the fire today that we end up with hyperinflation in a few years by delaying interest rate rises too long.

There must be few better times in the US – or Hong Kong – to be an entrepreneur, with low interest rates, a strong currency to buy resources, cheap labour, and technology improving in your favour.

However, there is a fearful realisation by the markets that there is not much left in reserve for a big bailout. And bailouts might be needed as the losers from the rising dollar or falling oil are exposed. One day, those who are too big to fail may have to be left to fend for themselves.

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