

To: Oakmont Corporation

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DABERIAM XLVI

February 2009

Global Economic Indicators

World Economic Growth (IMF Figures + Projection)	2009	0.50%	2008	3.40%	2007	5.20%
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Base rates: 30 January 2009	USD	0.25%	EUR	2.00%	GBP	1.50%
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MSCI World Equity Index	30/01/2009	188.488	31/12/2008	181.894	YTD %	3.63%
Gold (PM London Fix \$ per ounce)	30/01/2009	919.50	30/12/2008	869.75	YTD %	5.72%
Oil (WTI Crude \$ per barrel)	30/01/2009	41.68	31/12/2008	44.60	YTD %	-6.55%

It is now clear from every piece of news that the world economy is *up a creek without a paddle* – or perhaps one should say, every country is at sea without a paddle! The bankers who were in charge in the last major credit crisis in the early '80s have all retired and the lessons learned forgotten. Added to this, the relatively benign economic climate of the last six or seven years has lulled governments and Central Banks into a complacent attitude towards debt. The economic models that are currently used have been created to fit recent economic history and modellers always forget that, when the fundamentals change, models cease to work.

It is worth remembering that as late as the end of the 19th Century, with a belief in determination it was thought possible that a well-educated man could know everything. By the end of the 20th Century, these beliefs were still popularly held but were fatally challenged by evolutionary thinking and then quantum mechanics. Complexity in science and business grew rapidly, and even exponentially, as Moores Law took hold in computer technology at the end of the 20th Century.

Today we are faced with a scientific world where people at the top of different disciplines do not necessarily understand each other's work. In industry, commerce and finance complexity is the rule. We have seen a massive break down in the global financial system, appearing first in London and New York and spreading out across the interconnected economic world. Starting in 2007 with the collapse of a bank in the UK and finally global trade coming to a virtual halt in October 2008 with the collapse of Lehman in the US.

We know from evolutionary thinking that all systems need checking or they will spin out of control and collapse – examples in nature and engineering are abundant: rats

arriving with ships on Pacific islands destroy ground nesting birds; diseases introduced by man into the Americas devastate the indigenous population, and steam engines need 'regulators'. In commerce the use and control of monopolies is well understood and in banking regulation has always been needed to prevent bubbles and fraud. Unfortunately, as it is said of Generals, regulators are always fighting the last bubble or fraud, and if there has not been a problem for a long time, the regulators become intellectually lazy.

Today we are facing two simultaneous bubbles of global proportions. One, the East-West trade deficit. The US and the UK making up a large percentage of global GDP, were growing their economies on borrowed money. The Chinese and Asian industrialisation in general produced the money to lend to the West to buy their products. Western government and Central Banks were able to claim the end of inflation as imported goods were cheap and kept interest rates low, they enjoyed the increased revenue from GDP growth that was fuelled by borrowing. Everyone is happy except that economics 101 predicted it was going to end in a recession, but timing a bursting bubble is always a problem

The second phenomenon has been a raft of new banking organisations and financial instruments that grew to facilitate the huge debt recycling that was financing global GDP growth – this second bubble is much more vicious and much less well understood. It was also the more dangerous as the regulators, even if concerned, were complacent and not expected to act as their masters in Government were reaping the benefits from the growth, and taking the credit.

The growth in world trade started to stall, probably some two years ago as the price of commodities generally took off, from an already rising trend, in 2007, precipitating concern that inflation had risen from the dead. Added to this, Chinese labour costs started to rise, along with the currency, producing increasing costs for the debt laden buying public in the West.

The Central Banks' reaction to inflation is conventional and we saw rising interest rates and tightening of the money supply, causing stress in our stretched global banking system. The herald of the economic bubbles bursting was the collapse of Northern Rock, a savings and loan institution in the UK that had been generously given banking status by a regulatory change initiated by the UK's Chancellor, now Prime Minister, Mr Brown. The public and the banking system started to panic, causing the tidal wave across the Anglo-Saxon system.

Politicians inevitably became involved in an incredibly complicated domino effect that resulted in a basically political decision to allow Lehmans to collapse in September 2008. World trade came to a virtual halt as the global banking system froze. Ships could not be loaded as the systems of trade credit broke down. What was going to be a nasty recession, in the space of a few months turned into a potential global depression. Headlines reported the global shut-down of the motor car industry, oil prices declining by upwards of 70%, commodity prices in general collapsing, and unemployment rising at a phenomenal rate. The impact on China, where its export driven economy has laid off some twenty million people in the space of a few months, demonstrates an unprecedented global phenomenon.

It is really unsurprising that Governments have been unable to react fast enough. The speed of change and its global nature is unprecedented and politics, by its very nature, is virtually unable to deal with a problem that is only anticipated.

The question has to be, what next? In historical terms, the speed of the economic collapse on such a global scale is unprecedented. The speed of the reaction of national governments is also unprecedented. The massive stimulation to national economies will probably, sooner rather than later, have a dramatic effect.

Debt is being transferred at an unprecedented scale on to the books of Western governments. The natural reaction of individuals is to save, but the consequences of the crisis and its economic solution will also be in the destruction of huge amounts of debt, the corollary being the destruction of the savings that supported that debt. In crude economics the unwinding of the debt instruments that have fuelled economic growth, can only be done at the expense of future economic growth, i.e., the banking spiral works in both directions. It's difficult, however, to believe that politicians can resist the pressure to mitigate the pain so there is an inevitability that accumulated Government debts will be dissipated by the onset of inflation, perhaps in only two to three years time.

In the meantime there are signs that the rate of decline is slackening and will probably flatten out in the relatively near future. The now universal gloom and despondency, as with so many universal beliefs, is probably indicating that we are near the bottom of the trough. The question, therefore, is the shape of the trough! We could slide into economic oblivion or achieve a miserable economic climate for the foreseeable future.

As an optimist, there is a high chance that the near vertical decline could reverse and the gloom turn to optimism by the end of the year. It's worth remembering that, statistically, year on year comparisons will start to feel and look better even if economies just stabilise at a new lower level. The speed of change, because the world is so interconnected, is more than likely to surprise us on the upside, as it did on the way down.

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