

18 May 2015

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The recovery of many economies from the global recession of 2009 has been weak, and forecasts have been revised down more than up in the years since. Consequently, there are now valid questions being asked about whether low economic growth is the result of temporary headwinds or of a more fundamental shift. This latter view was encapsulated by eminent US economist Larry Summers when, in late 2013, he revived the concept of secular stagnation to refer to a permanent situation where it is not possible to have interest rates at a low enough level to balance savings and investments while also achieving full employment. Secular stagnation refers to more than just slow growth. Slow growth may be the result of any number of temporary phenomena, such as political unrest, poor policy choices or the bursting of a financial bubble. Under secular stagnation more permanent factors lead to growth being low for an extended period of time. According to the theory, economies suffering from secular stagnation will exhibit some combination of increased savings and reduced demand for investment. In normal economic periods, the interest rate (which is in effect the price that brings saving and investment into balance) will decline until the induced fall in savings and rise in investment returns them to equilibrium.

This mechanism breaks down when the required real interest rate (that is, the interest rate adjusted for inflation) falls below zero and there is low inflation. Balancing saving and investment in this situation can require nominal interest rates to remain well below zero for an extended period. In many developed nations we have reached this point.

Let's look at the drivers that are creating such an environment whereby savings rates climb. The ratio of savings dollars to investment dollars have climbed in the developed world after 2008. However, in the developing world (emerging markets) you would expect investment to outweigh savings especially China. Wrong! China is the world's largest emerging economy with a GDP of over 4%. Savings rates are at 106%. Singapore, a darling of the investment markets, has savings rates of 160% over investments. Germany, an economic power house and job stability machine, along with the Netherlands, resource rich and well funded public programs, have national savings rates of 150% over investments. Even America, once known for having the world's poorest savings rates has a ratio of 80% savings to investments.

How does this play out for you and I? Basically, cash is not being invested to create opportunity and economic growth but being stockpiled for many reasons mentioned above. The main factor is the overall uncertainty of global growth. In Canada, we were spared for the most part. Other nations and investors have not fared as well. Actually, even as a Canadian, if your portfolio did not focus on Canada between 2005-2007, you would have been dealt the same fate. This also helps explain why Canadian savings rates have fallen to all time lows. The combination of well paying jobs, low interest rates, strong public services and GDP have made Canadians feel safe and able to take on more risk through buying real estate and investing in markets.

Around, the globe the confidence is just lacking, forcing everyone to save more and more for a potential rainy day. Capital investing is not wide spread. Tactical capital is being concentrated into specific sectors and markets which in turn has driven equity share prices to near record highs.

Central banks around the world have been slashing interest rates to force money out of savings into investments. This however is not working at present except for America. Europe, China and Japan can not seem to get their people to invest.

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Why is America the bright spot? As unemployment numbers continue to improve, so should the confidence of the average American. At some point, wage inflation, not unemployment becomes the focus of analysts and policy makers. Encouraging signs show that wage inflation (though isolated) is present in communities and sectors across America. As job quality improves, confidence rises, savings decrease while investments increase along with home sales in both new and existing homes.

In my last article, my concerns about potential economic woes for Canada are really not alarming. Why? Let's go back and refer to what causes stagnation: political uncertainty, labor unrest, job insecurity, the inability for pay raises to keep up with cost of living. All of these are signs, which are present in different regions of Canada but not across our nation. Lastly, recovering oil prices will only allow our Lonnie to remain stubbornly above 80 cents American hurting manufacturing. These issues each on their own create no single worry for Canada. However, if these issues coalesce concern is well merited.