

Weekly Perspectives

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A Weekly View of Global Economies

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It was noted in the previous column that the US economy benefited from a confluence of positive technological developments that acted synergistically to enhance productivity growth from the mid-nineties onwards. However most of the benefits of those earlier changes have already been realised. So, to get a repetition of what occurred in the tech-boom period we would need to have another set of interactive technologies to drive productivity growth.

Unfortunately, there does not appear to be anything on the same scale as the nineties phenomenon occurring currently. Therefore, it is not unreasonable to expect a more modest contribution to growth resulting from technological transformation. Needless to say, technology is a fast-changing field and, according to the gurus, it is moving at a more rapid pace now than ever before. So we should always be on the lookout for important applications that may have wide-ranging impact and fast diffusion.

The United States had first-mover advantage in the technologies that were developed in the nineties. Other countries were slower to adopt and implement the new stuff. This means that they have yet to experience the full benefits of techniques, methods, hardware and software that have already been fully implemented in the US. If this view is correct, then we should expect productivity growth, resulting from this source, to tend towards convergence - a slower pace of advance in the United States and a faster one in Europe and Japan.

There is also the issue of structural change, involving factors such as more flexible labour markets and less onerous business regulation. The US has enjoyed a decided advantage, in this regard, for a long time. So any reforms that Europe and Japan can carry out will enhance their competitiveness vis-à-vis the United States. Progress is still too slow but changes are indeed taking place.

Some German firms have been able to negotiate better deals with trade unions after threatening to move operations to Eastern Europe and further afield. Meanwhile, corporate Japan has been shedding some of its surplus "salaried men", thereby increasing efficiency. Previously, these middle-managers were shuffled around the corporation rather than made redundant.

Apart from the impact of technology, the growth potential of the economy also depends on capital spending and changes in the supply of labour. Looking at the experience of the US economy, business fixed investment (which includes high-tech spending), as a percentage of GDP, rose significantly during the nineties and fell precipitously during the recession in 2001.

It has risen only grudgingly over the past few years and is still well below the levels attained during the boom period. The slower increase limits the rise in capacity growth. In terms of the impact on efficiency, workers who have more equipment to utilise are more productive.

The potential growth of the economy is generally the sum of two factors, the growth of labour productivity and of labour supply. As noted above, growth in labour productivity may slow down because of a slower increase in business capital spending as well as less revolutionary high-tech developments. Growth in the labour supply may be constrained by a slowdown in the growth of the working-age population as well as the labour-force participation rate.

Analysts studying the issue have revised flawed official data and come to the conclusion that the growth of the working-age population is slowing down. Part of the reason for the slower growth is related to lower levels of immigration, as a result of the post-9/11 security clampdown and tighter border controls. There is also the demographic aging of the population.

However, America's demographic profile is actually more positive for economic growth than those of most European countries or Japan. These societies are ageing faster than America, putting greater pressure on the young to finance the retirement of the old. In addition, immigration has up to now been a source of dynamism and flexibility for the US economy. By contrast, Europe and Japan have generally discouraged migrant inflows even though they are badly needed.

It also appears that labour participation rates in the United States are no longer rising. This is the result of three principal factors. First, real wage rates are growing relatively slowly, reducing the incentive to join the labour force. Actually, real compensation per hour has risen healthily over the past few years. However, this measure includes bonuses, as well as gains from exercising stock options. In other words, it is biased towards employees at the higher end of the pay scale. A more appropriate measure is real average hourly earnings, and it has barely grown in recent years. This is in accord with the mood of the average worker who is rather sceptical about how well the economy has been performing in recent years.

Second, the baby-boom cohort is moving nearer to retirement age, and the participation rate for older-age groups is relatively low. So, as the proportion of workers in the total labour force that fall in the old-age category increases this drives down the average participation rate for the economy as a whole.

Third, the female participation rate in the labour force, which had been rising for many years, may have reached a plateau. In the past, the rising female rate had offset the falling male participation rate.

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