



## Our product principles and development

*We are extending our signature 'Watch fors' to our new products*

The sentiment that “*the current situation is more than usually uncertain*” tends to be overworked. However, currently that arguably is indeed the case. Perhaps on only two previous post-WWII occasions – the 1973/74 oil price crisis, and the 2008 financial crisis – has there been so much uncertainty about what factors stand to drive economies, and what the consequences will be.<sup>1</sup>

This has caused us to reflect anew on what we do; how we do it; and how best to present it.

### Our 'Watch fors'

In such novel times, historical experience offers disturbingly little help. The natural tendency is to fall back on *a priori* reasoning, or even just *a priori* beliefs.<sup>2</sup> And this is when analysts and forecasters tend to make their largest mistakes.<sup>3</sup>

Because of this we have, for some years, concluded our fundamental analytic pieces with one or more 'Watch fors' – developments that, were they to occur, would support, challenge, or at the limit refute, the basis of our argument.<sup>4</sup>

Not only is this good methodological procedure: it also has another virtue. Readers today are plied with continuous streams of data and policy announcements such that many feel besieged. Hence we have increasingly come to see it as incumbent on us also to sift that flow of data, and extract just those few that throw light on the solidity or otherwise of the underpinnings of our analysis.

These twin considerations – the need to make analytic foundations clear, and to focus on just the most informative data – lead us now to extend the ethos of our 'Watch fors' to our entire suite of products.<sup>5</sup>

### Global Letters, Comments, and Focus

In these pieces we analyse not only the customary demand side of economies, but also supply-side influences, which are becoming increasingly influential and are worthy of systematic attention – climate change; technological change; demographic change, structural policies, inequalities, ESG, and more.

### Our new World View

Periodically – a number of times per year – we present our judgement on what seems likely to happen over the coming twelve months or so. We present this as:

- A 1-page summary of the most important drivers, outcomes, and 'Watch fors'; and
- Many pages of endnotes that detail the key elements of our analytic framework, and present the most important empirical evidence.

### Our new Key Developments & Chart of the week

Each week we select, from the plethora of the previous week's data and policy announcements, the handful that seem to us to be the most important for illuminating whether, or the extent to which, our *World View* is on the face of things being supported, or challenged, by the evidence. Thus this entire document is a crystallisation of 'Watch fors'.

We also present a *Chart of the week* that bears on one of the most important issues.

### Economic Risks

In turn, but before changing our *World View* in any major way, it is necessary to take periodic stock of the accumulating evidence. Monthly seems an appropriate frequency. So in *Economic Risks* we review the past four weeks' worth of economic and policy developments,<sup>6</sup> and assess how much of a challenge to our view they cumulatively represent.

To the extent that this review proves significant, we in turn update our *World View*. And thereby the circle is complete!■

<sup>1</sup> **The 1973/74 episode** saw a novel combination of an OPEC embargo on oil exports to western economies; a quadrupling of the price of internationally traded oil; and the morphing of the initial upwards shock to the global price level into a full-blown price-wage-price spiral. (Amongst the major economies there was just one exception to the inflation part of this story – Germany).

**The 2008 financial crash** too had a novel cause – the creation of insufficiently understood, and inadequately regulated, financial instruments that were disseminated in such vast quantities that when the resulting leverage collapsed it caused a financial crash throughout the Western world that was the largest since the Great Depression of the 1930s.

<sup>2</sup> Often these can be traced back to the orthodoxy prevailing at the time that analysts learned their economics.

<sup>3</sup> A striking feature of the 1973-74 episode is that forecasters around the world made what was – and remains – one of their largest ever forecasting errors: an underestimation of the resulting fall in GDP at the OECD level by, on average, fully 4 percentage points.

The evidence from what was the first international post mortem of economic forecasts, covering the period 1967 to 1892, suggested that the largest forecasting errors tend to be made when an economy is hit by a shock that is both novel and large (say 1% or more of GDP). This conclusion would seem to have continued to hold right through to the present day. For more, see Llewellyn J., and Arai, H., 1984. *International aspects of forecasting accuracy*. OECD Economic Studies, Autumn. Available at <http://www.oecd.org/dataoecd/61/27/2502379.pdf> And see also Llewellyn, J., Potter, S., and Samuelson, L, 1985. *Economic forecasting and policy – the international dimension*. Chapter 6, p. 101. Routledge and Kegan Paul.

<sup>4</sup> Were economics a physical science, that evidence would be obtained by designing and carrying out repeatable experiments under controlled conditions, so as to find out which prior(s) best fit the evidence. But economics cannot be a science in that sense: it is not possible to run an economy sequentially under different sets of (say) policy regimes just to find out which theory works best.

But neither is economics a non-science. It has rules of logic; identities; adding-up constraints – and oodles of data. Hence, to the extent that statistical and econometric test(s) can make due allowance for key factors that cannot be held invariant, theories can be tested against evidence.

<sup>5</sup> A description of each product in our *Macro series* is listed below:

**Macro series:** Well-researched tightly-edited regular pieces on themes and issues of current or prospective national, regional, or global significance, extending beyond high frequency commentary, these often challenge consensus thinking.

1. **World View** sets out, in 1 concise page, our judgements, generally in qualitative terms, of the likely behaviour over the coming 12 months or so, of the current principal drivers of the world economy, and the prospects for the key economic and market variables of concern to investors and firms. It also lists the most important developments to watch for to see if economies and markets are, or are not, evolving as expected. The evidence on which these judgements are based is set out as comprehensive endnotes. (Occasional.)
2. **Key Developments & Chart of the week** presents, in 1 concise page, what, in our judgement, represent the past week's most important individual data, policy, or other developments. They are selected because they best reveal the extent to which our understanding of the most important relationships remains sound. A Chart of the week that bears on one of the most important issues is also presented. (Weekly.)
3. **Economic Risks**. A tight, 1-page, monthly publication which points up key economic, policy, and political risks that will affect the near-term outlook, generally 3-12 months ahead. Risks concentrates on areas where we consider there are strong grounds for challenging consensus thinking. (Monthly, 12 per year.)
4. **Global Letter**. A succinct, generally monthly, 1-page publication, which focuses on a major theme of global significance. The *Global Letter* seeks to be thought-provoking and strategic. (10-odd per year.)
5. **Comment**. A 1-2-page publication which identifies and analyses – early – major drivers of forthcoming economic and market outcomes. These drivers include not only the purely macroeconomic, but also policy, technological, demographic, and climatological influences, that stand to have significant implications, whether fairly immediately or over a run of years, for markets, investors, and businesses. Particular attention is paid to risk, and hence developments to watch for. (30-odd per year.)
6. **Focus**. Pieces which generally concentrate on a single topic, examined in particular depth, and hence somewhat longer than our signature *Comment* pieces. (Occasional.)

<sup>6</sup> The basic variables that we aim to cover for each region relate to:

1. Current drivers of the economy
2. What the outlook/recovery hinges on
3. Announcements in respect of:

- Monetary policy; and
- Fiscal policy

Data releases in respect of:

- GDP and stand-out sectors
- Inflation – headline and core
- Employment, unemployment, and bankruptcies
- Debt – public and private
- Consumption, savings, and investment
- Credit demand and supply
- Risk asset valuations