

The Jagged Line of History: How Libya Confirms a Trend Rather than Refutes It

Every historical trend moves in a back-and-forth pattern. Every progressive step is at some point met with a step backwards. This is especially true when political control is concerned. Despots and monarchs, who by definition do not rule with a defined term in office, do not often realize when their terms are up.

The poster child for the labor pains this transition to democracy is causing is Libya. The country has been for the past 41 years in the control of one man whose name Western sources spell at least four different ways. Muammar Qaddafi took control of Libya through violence and has used the same to keep himself in power. Using the vast wealth generated by the sale of the country's oil, Colonel Qaddafi has retained a large army of African mercenaries to fight his own people on his behalf. Family members, including his own sons, occupy positions of authority in the elite military units loyal to Colonel Qaddafi. Efforts to impair Libya by freezing assets have yet to bear results. It is rumored that the Qaddafi family is sitting on over \$6 billion in gold in Tripoli, perhaps more.

The rebel forces aligned against Qaddafi are at best a rag-tag army. The dictator deliberately put the best military equipment and supplies in the hands of those most loyal to him. For this reason the military conflicts have been rather one-sided. Add to this the fact that Qaddafi has ordered his hired mercenaries to kill his own people to suppress their desire to oppose him. The end result was the air support of a host of countries including the United States on the rebels' behalf. It is hoped that with time the rebel forces can be properly trained and equipped to take the country over. This will not be a quick solution, but compared to the enmity generated by America's unilateral invasion of Iraq and Afghanistan, it is probably a wise one.

In Bahrain the situation is similar but more complicated. There military forces from neighboring Saudi Arabia have assisted the monarchy in wiping out an opposition movement that sought to eliminate the Bahrain King and cabinet. Previously talks had been progressing to turn Bahrain into a constitutional monarchy in the manner of Great Britain. More radical parties joined the talks and demanded that the monarchy be eliminated.

The more radical participants in Bahrain are said to be proxies for Iran. Saudi Arabia and Iran are the two largest powers in the Middle East, and both are trying to use the Arab awakening to their own advantage. Iran's involvement is ironic since the goals of the protests thus far have been secular in nature. No doubt Iran is worried that secular democracy is a threat to the influence of the religious leaders who have led that country since the fall of the Shah. While the Saudis also feel the heat from democratic reforms, Saudi Arabia lacks the population and economic crisis faced by Iran. A constitutional monarchy would be a non-violent way for Saudi Arabia to transition to democracy over time.

Finally, Yemen is showing a template of how to deal with a less violent leader than that of Libya. The Western condemnation of the escalating violence there has led its leader of 32 years, Abdullah Saleh, to announce he will step down at the end of the year. Betting is that the date will be moved up. Like the Arab awakening in Tunisia and Egypt, the protest in Yemen started out peacefully and became violent after security forces tried to suppress dissent. The influence of Iran in Yemen is not as prominent as Bahrain.

The bottom line is that change is coming to the Middle East. Previous stereotypes of Arabs being incapable of forming secular democratic institutions are being undermined by the progress of Egypt in voting in a new constitution and Tunisia in planning to hold elections that are promised to be free and fair. History is one of the ebb and flow of human development. At this time the flow seems to have it.

Japan

As if all the Middle Eastern conflict was not enough to hold the world's attention. The magnitude-9 earthquake and attendant tsunami have caused damage equal to four times that of Hurricane Katrina. The death toll is projected to be close to 20,000 by the time all dead or missing can be tabulated.

While Japan as a country will survive the disaster, not all the towns will be rebuilt. The little secret about Japan is that the population is about 20 percent less than at its peak. Thus some of the towns will simply not be rebuilt, and survivors will be relocated into some of the country's surplus housing.

To rebuild its transportation and infrastructure, Japan will have to relax restrictions on immigration to permit enough foreign workers to come into the country. Japan has resisted large-scale foreign immigration for decades. Given the aging nature of its population, it may now have no choice. Without foreign workers, the rebuilding will take almost half a decade longer than it would otherwise.

The Economy

Economic conditions continue to improve. Exports are increasing at a close to ten percent annual rate compared to last year. Manufacturing is adding jobs even as automation makes factory work more efficient and less labor-intensive.

State and local government employment is at this point the only category to show negative changes in employment year over year. This is due to the tax income pressure faced in most states due to property tax receipts being down. Service industries such as restaurants, retail and the like are showing gains but not to the extent seen at this stage of the economic cycle. Bottom line: jobs are being created but not fast enough to make up for the losses in 2008-9. We have still not fully recovered from the employment levels seen in the last cycle peak.

Interest Rates

Interest rates have declined due to the safe haven status of the US Dollar in times of crises such as the earthquake in Japan. Such declines tend to prove temporary until the crisis runs its course.

Looking ahead, the winding down of the stimulus measures may result in higher interest rates towards year end, even with a slowdown in economic growth. With less liquidity in the financial system, interest rates may rise to attract depositors. Also, with complete write-off of capital equipment in 2011 there will be a drive to purchase and put in place items that are often paid for over several years. This should increase loan demand and interest rates as well.

Inflation

With so much labor underutilized, it is difficult to come up with a plausible scenario for material inflation this year. A service-oriented economy such as the United States does not spend as much on food, energy or raw materials as a developing economy. Developing countries would feel the increases in these areas more keenly and will continue to raise interest rates to offset the inflationary effect of these trends.

The Stock Market

After a seven percent pullback in the month of March, the stock market seems to be back on track to continue to grind upwards. Lower interest rates are supporting higher stock prices, as are higher earnings in industries as varied as auto makers to construction machinery.

The market will start to factor in a relative decline in the pace of economic activity after mid-year. However, a relative decline is not the same as an absolute decline. Furthermore, there may be a case for higher economic activity in 2012 depending on the pace of exports.

After this first advance and correction, the market will likely become more discriminate in what goes up. Since housing is not expected to lead this cycle, companies with exposure to international sales as well as domestic manufacturing and exports will be the shining stars of the next market leg up.

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