AN ICY WIND IS BLOWING DOWN HIGH STREET

One factor that appears to have been overlooked by many investors and economists, during the past decade or so, is the fact that outsourcing and offshoring by European and US companies have caused there to be a glut of unskilled labour in the Western World.

The statistics with regard to unemployment/underemployment in the US and Europe are weighted toward the unskilled, labour element of the workforce, although this is never mentioned in reports.

Demand for unskilled labour in the US and Europe has been declining as many jobs, not requiring a knowledge of pseudo spherical geometry or celestial navigation, are exported to Asia – the People's Republic of China (PRC), especially – and India – mainly for call-centre operations.

The effect of this phenomenon, of course, is wage inequality in the US and Europe.

This, potentially, could be destabilising, socially.

Trouble may well be brewing among the disadvantaged.

It all came about when it was discovered that segments of international corporations could be exported to lower, labour-cost countries, thus boosting profit margins at home where an ever-competitive environment continued apace.

The immediate effect of outsourcing and offshoring was to the benefit of consumers in Europe and the US, as well as restraining inflationary pressures on the home front since the landed price of goods in the US and Europe, produced in low-cost countries, in part or in whole, were considerably cheaper than similarly-produced goods, domestically.

But there was a downside to this, too.

While technical innovations were required to be completed in highly skilled areas, such as Silicon Valley, California, and like areas in Europe, the finished technological results could be quickly sent abroad to low-cost areas of the world for use in production processes as required.

This development made it possible for enhanced, international tradability of services – call centre models in India for less skilled requirements – and computer programming in the PRC for higher-skilled, technological requirements.

The exploitation of such advantages conferred gains for the economies of the US and Europe and quite a number of other advanced economies, raising export prices, relative to imports.

But there have been costs, incurred along this path: The demand of unskilled workers has declined, markedly.

Ask Detroit about this matter and the answer will be forthcoming, fast and furiously.

The increase in the degree of wage inequality can, now, be measured against the number of unemployed, unskilled and semi-skilled workers and weighed against the situation that existed a decade or so ago.

Adjustment costs have been painful for many employees of the US and Europe as they note the pace of outsourcing and offshoring.

But the die is cast: There is no retreat to the ways of days of yore.

There is, however, a positive aspect to this situation, also: The increase in real purchasing power of the consumer, due to outsourcing and offshoring, in the main, has come to mean that real living standards have risen much faster than would otherwise have been possible.

Also, the relatively cheaper, foreign-produced goods and services, purchased in and through offices of the High Street, have held down the rate of inflation in both the US and Europe.

One has witnessed, of late, demands for higher pay from labour in the PRC, demands that, in many cases, have been met with some resistance by industrialists, based in the Hongkong Special Administrative Region (HKSAR) of the PRC.

The Government of the PRC has imposed new labour laws which are, already, taking their toll of industries' profitability, especially in the south of the country.

As one would expect, as labour in an area becomes more scarce than in the past, so demands are made for increases in take-home pay by entrenched workers – supply-demand factors kick in.

However, in the case of the PRC, with tens of millions of potential new workers, still living in rural areas of the country, this very large cache of workers, waiting to make their exodus from their existing situations in order to improve their lot by finding employment in the booming cities of the PRC and in the industrialised regions of the country, it will take a great deal of time before the labour costs of the country will approach the labour costs of the US and Europe.

At the same time, the pace of change, especially in the PRC, is slow; and, transference from rural living to urban living will take considerable time.

<u>The Price of Oil and its Immediate Effects</u>

The price of a barrel of light sweet crude oil, today, is about $US120.

This is about 4 times the cost of a barrel of crude oil at the beginning of 2004.

Since the beginning of this year, the price of light sweet crude oil has risen from about $US96 per barrel of light sweet crude oil, an increase of about 25 percent.

As the price of crude oil rises for whatever reason, it plays its inevitable part in helping to shape the economies of the world, leading to inflationary pressures.

There appears to be little chance of any near-term respite in the price of this strategically important commodity, especially since most of the world's crude oil comes from politically unstable areas, such as Nigeria, the world's eighth-largest exporter of crude oil.

As the price of crude oil continues to rise, it has a knock-on effect, reflected in increases in the price of other energy sources, such as electricity and gas.

Prices of other commodities rise, also, as the price of crude oil continues to climb from one historical high to another.

In US dollar terms, disregarding translation values into other *'hard'* currencies, the prices of other commodities have risen more than double.

Rapid economic growth, especially in the emerging markets of the world, as with the increase in the price of crude oil, has resulted in rapid increases in the prices of a host of agricultural and non-agricultural commodities.

Food prices have been raised due, in some degree, to the cost of transporting raw produce from rural areas to urban areas, domestically and abroad.

These pressures have been felt right down the supply chain.

According to international statistics, manufacturers' input price inflation, for the first quarter of 2008, to March 31, has risen more than 20 percent, Year-On-Year, which is the highest level since 1986, by the way.

As for output price inflation, it is running at about 6 percent, Year-On-Year, its highest level since 1990.

Consumer price inflation must, invariably, follow suit.

Inflationary levels will rise in the wake of these increases and central banks of the US and Europe will try to contain inflation, the weapon of choice, being interest-rate increases.

As one would expect, such action will impact on every aspect of the economies of the Western World; and, the plight of many workers will be exacerbated.

The economic outlook, at the present juncture, therefore, is uncertain and, perhaps, precarious.

The 62 consecutive quarters of growth of the economy of the United Kingdom must be relegated to history.

The same is true of the gains of the economies of the US and many parts of Western Europe.

Consumer spending is drying up because of a number of factors, driven, inter alia, by high energy costs, inflationary pressures, tighter credit requirements, and, of course, fear of what may transpire in the near future.

The crises with regard to the US subprime, mortgage-lending industry have visited most parts of the world; their presence continues to be felt.

There is more much trouble in store, regardless of protestations to the contrary.

The **I**nternational **M**onetary **F**und (IMF) has estimated that losses in respect of the subprime, mortgage-lending industry are at least $US450 billion (current market values).

Less than 66 percent of those known losses have been declared, thus far.

Consumer spending on goods and services has, historically, been partially secured by property.

Lenders, today, however, are withdrawing credit lines from many existing and would-be borrowers as caution has become the byword in the lending industry, internationally.

Increased caution on the part of lenders may be expected for the remainder of the year – at least.

Reduced availability of credit must impact on consumer spending habits: Merchants in the High Street will feel the impact of reduced spending in due course.

Also, high consumer price inflation and slower employment prospects will have a negative bearing on the growth of disposal income.

A cold wind is blowing down the High Street.

And, with the US economy, contracting at a pace, not seen since The Great Depression of 1929, one may only expect things to become a great deal worse before they improve, materially.

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