

The recession appears to be over, and economists are debating whether the recovery will be “U-shaped” or “W-shaped.” A “U-shaped” recovery is relatively straightforward- the recession leads to growth and the growth continues. A “W-shaped” recovery means that we experience a false recovery that is followed by a second recession. This is possible, even likely, because of the massive debt incurred by governments worldwide as they bailed out banks and ailing manufacturing companies. In a “W-shaped” recovery, bloated public debt and sagging exchange rates would force governments to raise taxes to balance their budgets and support high interest rates to attract foreign capital, both of which would hinder economic recovery.

The “U” vs. “W” debate has few people questioning the assumption that we will be out of the woods within a year or so in the worst case scenario. This may be a good time to remember the theory of “the long wave.” Business cycles are typically 3-10 years long and are driven mostly by production and inventory cycles, although the timing of the peak is also affected by less predictable factors such as social and political events.

The “long wave”, which lasts 45-70 years, is caused by intergenerational forgetfulness about the hard times experienced during the previous generation(s) and the practices that may have caused the severe downturn. For example, after the Great Depression of the 1930s, protective mechanisms were established such as the separation of commercial from investment banks, bank reserve requirements and the establishment of oversight policies. Generations later, some of these mechanisms had been dismantled by people who had never experienced the pain that led to their establishment in the first place. The long wave, also called the Kondratiev wave after Nikolai Kondratiev, a Russian economist who first observed the phenomenon in the 1920s, has been cited as an explanation for the major economic crises of the 1830s, 1890s and 1930s, and possibly now the one that started in 2008.

The downturns following a long wave are usually much longer and more severe than the upswings. This is because the business cycle is suppressed on the upswing by the shortage of resources, whereas there is no such constraint on laying off workers

in the downturn. If this sounds familiar, it may be because of the resemblance to what is broadly called “the jobless recovery” today.

Visibility to the future is complicated even more by the fact that if there is a “W-shaped recovery,” we don’t know how long or how deep the second dip will be. This means that even if we have a good strategy for the next 12-24 months, it may be just as hard to predict the pace of recovery from the second dip as it was from the first.

What if we are entering a down cycle that may last 5 or 10 years, or even longer? How would this change our supply chain decisions? Boston Strategies International would offer these words of advice:

- Keep capital investments tied to hard, cold facts. Make investment decisions based on facts and forecasts from sources you trust.

- Keep production and operations closely linked to sales by employing solid forecasting and demand planning techniques and structuring for flexibility.

- Avoid building up too much inventory (or capacity) before you are confident that the market needs it. Keep an eye on the extended supply chain and not just your own links.

In the end, these are basic principles that have proven to be sound investment and business management approaches for centuries. **D**

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“W-Shaped Recovery” or “Long Wave?”

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