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CHEM ECONOMICS

Are We Destined for a Double Dip? Which Way Will We Go?

Last month, we investigated whether the U.S. is going to have a double-dip recession (*CEP,* Oct. 2011, p. 12). Since then, the consensus has evolved and the risk appears higher. What is a decision-maker to do? On the one hand, forecasters argue for a recovery, albeit a modest one. On the other hand, other forecasters argue that another recession will occur. Where is a one-handed economist when you need one?

A friend of mine — John Silvia, the chief economist at Wells Fargo — recently authored the book *Dynamic Economic Decision Making: Strategies for Financial Risk, Capital Markets, and Monetary Policy* (Wiley, 2011), in which he argues against linear projections of the key economic benchmarks (*i.e.*, growth, inflation, interest rates, exchange rates, and profits). Silvia says that, in decision-making, any framework must account for past mistakes and failures, be flexible, and allow for changing realities. He also emphasizes cyclical benchmarks.

Forecasts based on current trends, or estimates based on history, are unreliable in an environment that is changing rapidly or is uncertain. With high uncertainty about the direction of the economy, single-point forecasts are useless at best. The danger in single-point forecasting is that you will get it wrong!

So, the emphasis should shift from forecasting to foresight. One powerful tool for accomplishing this is scenario development. Rather than relying on one forecast, the decision-maker evaluates several possible futures or outcomes.

Using this more-flexible framework, analysts can evaluate conventional wisdom as reflected in the consensus outlook for the economy. Scenarios can then be constructed to reflect the greatest downside and upside risks to the consensus forecast.

Recently, the American Chemistry Council (ACC) developed several scenarios to better understand the uncertainty in these troubled economic times. In addition to the consensus view (which reflects ACC's survey of industrial-oriented economic forecasters), ACC examined "Recovery Re-engages" and "Another Recession" scenarios.

The accompanying chart summarizes these scenarios, along with their probabilities (P), in terms of the change in gross domestic product (GDP) from year to year.

In the recovery re-engages scenario, a pickup in business and consumer confidence along with a resolution of Europe's fiscal woes would result in higher consumer spending and investment, and the economy would quickly get back on track — with 2012 economic growth at a faster pace than the current consensus view. This, however, has a low probability.

Scenarios	Year-to-Year Change		
	2011	2012	2013
Consensus, P = 45%			
GDP	+1.6%	+2.1%	+2.8%
Chemicals* Production	+4.6%	+3.0%	+2.0%
Recovery Re-engages, P = 5%			
GDP	+1.8%	+3.3%	+3.5%
Chemicals* Production	+5.0%	+5.4%	+4.3%
Another Recession, P = 50%			
GDP	+1.3%	–1.0%	+1.3%
Chemicals Production	+3.8%	–3.3%	+3.0%
* excluding pharmaceuticals			

The another recession scenario assumes that the U.S. economy will be pushed into recession, the result of shaken confidence, the effects of the European crisis, and existing headwinds at play (low consumer spending, slumping wealth, volatile energy prices, etc.). These factors would be enough to push the U.S. economy below the stall speed and into a moderate recession. At this point, this has a probability near 50%. In this scenario, the economy (and the chemical industry) will actually shrink in 2012.

To create these scenarios, ACC examined a variety of economic benchmarks and their effects on the industry, employing a framework along the lines of what Silvia advocates. ACC also developed plausible storylines (or reasoning) that reflect each scenario. The results are striking in terms of their outcomes and, by extension, their potential effects on organizations. A consensus does not capture the possibilities.

Scenarios can be used by decision-makers for planning, developing strategies, testing specific decisions against alternative futures, and identifying opportunities, as well as for general corporate risk assessment. In short, scenarios help people to think and to better perceive future possibilities. Decision-makers can then establish signposts and indicators and monitor them to see which scenario is unfolding. Of course, this needs to be refreshed through time.

The future cannot be known with any certainty, but we can be prepared by evolving beyond the consensus single-point forecast. In combination with an effective economic framework, scenarios provide the structure for coping with uncertainty, change, and complexity.

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