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- The Importance of Liquidity for the Financial System
- Lessons from the Decline of Mighty Marconi
- Greenspan set to cut US interest rates further
- Labour Force Survey of Unemployment rises last month

**Financial Stability**

*Our present assessment is that, despite the scale of the human tragedy, these terrible events will have only a limited impact on the international economy and global financial system*

*IMF Press Release*

*12 September 2001*

**CENTRAL BANKS ACT TO PROVIDE LIQUIDITY FOR THE WORLD**

It will take time for the human and economic cost of this week's attack on New York and Washington to emerge. This is a time for reflection on these horrific events and also the sacrifice and courage demonstrated by the thousands caught innocently in the carnage.

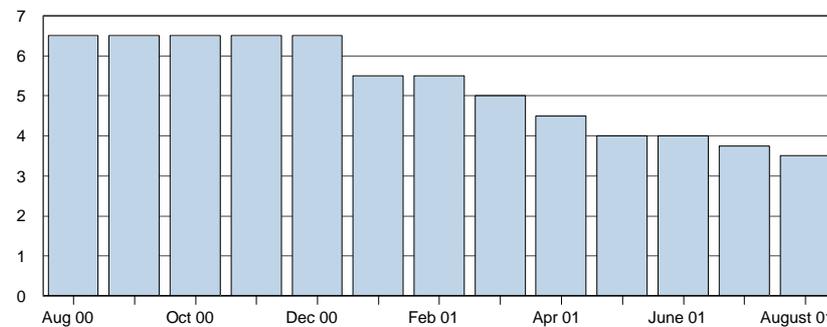
**IS THE GLOBAL ECONOMY HEADING FOR A RECESSION**

The world economy was already in a fragile state before the events of Tuesday 11th September. Organisations such as the International Monetary Fund (IMF) and the Organization of Economic Co-operation and Development (OECD) have already cut their growth forecasts for 2001. The USA was on the edge of a technical recession in the second quarter, and there are justifiable fears that the calamity experienced this week will shatter business and consumer confidence. Many economists point to the impact of the Gulf War in the autumn of 1990, when the invasion of Kuwait and subsequent Allied war with Iraq led to a collapse in confidence and contributed in part to a deep recession in the USA and United Kingdom. The immediate priority of the monetary authorities around the

*(Continued on page 2)*

**HOW LOW WILL US INTEREST RATES FALL?**

USA Federal Funds Discount Rate (%)



**Lessons from the Decline of Marconi**

How can a major conglomerate with a leading position in defence equipment and a cash pile of £2.6 billion fall from grace so quickly? And what is it doing to mount a recovery strategy?

For many years Marconi (formerly known as GEC) was a leading UK conglomerate. Under the leadership of Lord Weinstock, Marconi built market leading positions in a wide range of industrial markets, focusing in particular on defence equipment .

Despite being highly profitable and cash-generative, Marconi was widely criticised for lacking vision. Lord Weinstock presided over an ever-growing cash pile, ignoring shareholder pressure to invest the cash in new business opportunities. Marconi's share price suffered from what came to be known as a "conglomerate discount".

*(Continued on page 3)*

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**US Confidence**

*Businesses and consumers were already reeling from plunging profitability and surging unemployment. A bunker mentality could quickly develop, inducing businesses to further postpone investment and scaring consumers away from shopping malls and into cancelling vacations*

*Dismal Scientist*

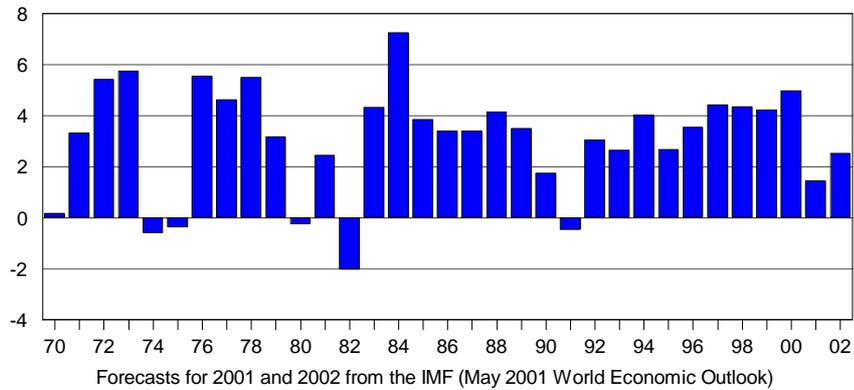
world has been to provide liquidity for banks and other institutions. Maintaining confidence in clearing and payments systems lies at the very heart of the 24 hour a day global financial network. The European Central Bank (ECB) for example, intervened this week in the money markets to pump some \$60 billion worth of liquidity into the European banking system. The Bank of Japan, already struggling to cope with an economy on the brink of a deep (semi-permanent slump) responded to large market sell-off of shares by injecting \$80 billion in liquidity.

All of the major central banks stand ready to cut short term interest rates if a collective loss of business and consumer confidence tips domestic economies into a severe downturn. Greenspan has already cut US interest rates seven times this year. The balance of risks for the US economy remains firmly tilted towards recession rather than inflation - despite the inflationary risks that come from a falling dollar. US interest rates may well end up below 3% in the short term. And, UK interest rates may move lower next month if evidence grows of a faster than expected slowdown in spending, output and employment.

These monetary policy decisions seem trivial in the context of the human suffering witnessed by the world this week. But it is some comfort that the global financial system seems (thus far) to be fairly robust in the face of such a sustained attack in its heartland. Traders in equity, currency and bonds markets live their daily lives in a fiercely competitive environment. But they cooperate to ensure the smooth functioning of the system. Relative financial stability will help to ensure a recovery in the real economy if and when the downturn occurs.

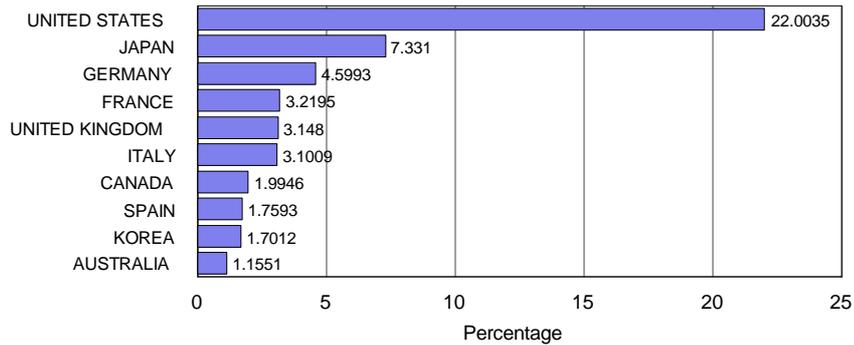
**ECONOMIC GROWTH IN THE UNITED STATES**

Annual % change in real national output



**SHARE OF WORLD AGGREGATE GDP IN 2000**

Source: International Monetary Fund (May 2001)



**Conglomerate Discount**  
*UK Companies who have changed strategy to address concerns about being "un-focused":*  
 Hanson  
 Granada  
 Kingfisher  
 Tomkins  
 GEC / Marconi  
 BT

Here, the City was effectively valuing Marconi at less than the sum of the individual parts of the group. The result was a change of management. Lord Simpson, previously at Rover Cars and Lucas, replaced Lord Weinstock as Chief Executive and Corporate Financier John Mayo was recruited as Finance Director. The new team revised Marconi's strategy to focus the business on the rapidly growing telecommunications sector, and disposing of "non-core", mature businesses in defence equipment.

For a while, the new Marconi regime seemed to be moving in the right direction. Through a series of major acquisitions, Marconi turned its cash pile of £2.6 billion into a debt of around £4 billion. As a result, Marconi became heavily focused on servicing the major telecommunications and networking sector, with major customers including Lucent, Alcatel and BT:

Marconi Division	Products and Services
Communications Networks	An international supplier of high-performance broadband solutions for the New Public Network and Modern Enterprise Networks
Communications Services	Plans, builds and operates networks for telecoms operators
Mobile Communications	Private mobile and strategic communications solutions
Systems	Data Systems (formerly Videojet) Medical Systems (formerly Picker) and Com-
Capital	Innovative high-tech start-up companies under the Marconi umbrella

**View of the New CEO**  
*"We have reshaped our core business to concentrate on those core activities where we are most competitively positioned.*  
*We are focused on matters within our immediate control with a particular attention to cost reduction and cash generation to reduce debt.*  
*Our operational review is a decisive response to the dramatic shift in fortunes of the global telecoms industry"*  
 Mike Parton, CEO  
 4 September 2001

**The Result**

Despite a short-term, but significant rise in its share price, Marconi has seen almost 95% of its share value lost during 2001.

With hindsight, investing its money around the peak of the telecommunications boom, Marconi paid far too much for the businesses it acquired; businesses that today are worth far less than their purchase prices. And in another mistake, Marconi used cash to pay for the big deals. The cash mountain turned into a debt of around £4.4b when Marconi could have issued shares to pay for acquisitions whilst its share price was still riding high.

At the same time, by disposing of its non-communications businesses and putting all its eggs in one basket, Marconi placed a great deal of faith in its ability to be amongst the best in the business. That faith was misplaced. The members of the Marconi board were apparently amongst the last people in the industry to notice that sales of expensive, top-end telecommunications equipment were falling off.

**Recovery Strategy**

Now the focus is on Marconi's recovery strategy. Can it stem mounting losses, regain City confidence and remain as an independent company? The key aspects of Marconi's strategy are as follows:

1. Change in senior management—a new CEO (Mike Parton) and Chairman
2. Restructuring programme— 10,000 jobs lost as part of a plan to reduce operating costs by around £600 million per year
3. Disposal of Medical Systems division to raise short-term cash
4. Re-negotiation of debt facilities with a consortium of lending banks
5. Reduction in research and development spend, focusing on fewer products

## Unemployment Rises according to Labour Force Survey

Fears that the recent spate of high profile redundancies from companies such as British Airways and Marconi would send official unemployment figures higher in August proved unfounded. The claimant count measure (which includes only those people eligible to receive the Jobseekers' Allowance) fell by 6,000 in August to 945,6000, the lowest level since October 1975. This leaves the unemployment rate at 3.1% of the labour force— another twenty six year low.

But, the alternative measure of unemployment, calculated using the labour force survey showed a 13,000 rise in the three months between February and May 2001. The unemployment rate on this standard remained constant at 5.0%.

The total number of people in paid employment continued to edge higher. In the three months to the end of July, employment increased by 13,000 to a new record high of 28.155 million.

Pay pressures in the labour market remain flat despite the steep falls in unemployment over recent years. The annual growth of earnings for public (government) sector workers is now accelerating (reaching 5.6% in July) - a reflection of the increased demand for workers in education and health and above-inflation pay rises for several million public sector workers. However the growth of average earnings remains relatively stable at 4.6% - certainly not enough to worry the Bank of England for the moment— not least in the aftermath of this week's events in the United States.

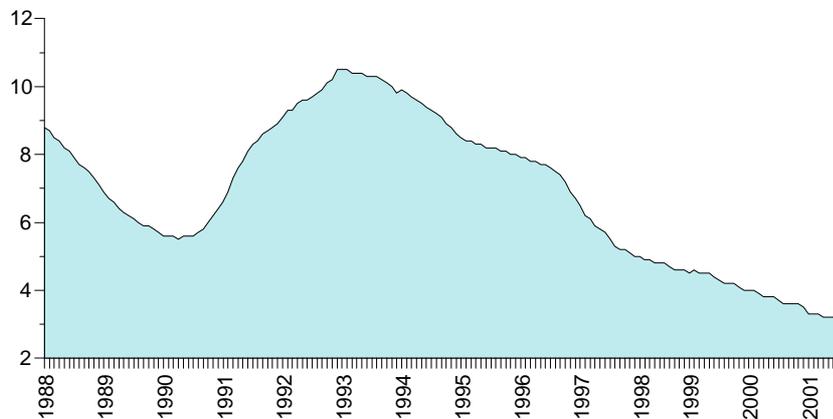
### Jobs Slowdown

*The news will increase fears that the UK's jobs boom - the linchpin of consumer confidence and household spending - may be over. Consumers' optimism has kept them happily spending this year, propping up an economy being dragged down by flat business investment and a downturn in demand from overseas*

*Financial Times*

## UK CLAIMANT COUNT UNEMPLOYMENT

Percentage of Labour Force



### THIS WEEK'S BEST OF THE WEB

Take time to visit our selection of great resources on the web.

**Dismal Scientist (Economics Portal):** <http://www.dismal.com/>

A superb US based economics portal site— providing everything you need to follow US economic developments

**Attack on America:** [http://news.bbc.co.uk/hi/english/business/newsid\\_1539000/1539558.stm](http://news.bbc.co.uk/hi/english/business/newsid_1539000/1539558.stm)

What will be the global economic impact of the terror attack on the United States (BBC News Online article)

**CNN News on the American Economy:** <http://www-cgi.cnnfn.com/news/economy/>

Unrivalled coverage of key developments in the US economy and US economic policy from CNN news

You can find all these resources and more at Tutor2u Resources: [Find us at www.tutor2u.net/default.asp](http://www.tutor2u.net/default.asp)