Morgan Stanley predicts economic collapse worse than depression

By Global Research
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Morgan Stanley's UK equity strategist Graham Secker painted a bleak economic picture for the United Kingdom. In his morning forecast, Mr. Secker warned that UK profits could fall by 60% in the current downturn – a worse performance than the great depression of the 1930s.

"We now forecast UK profits [will] fall by 60% across 2008 and 2009. While this sounds a rather draconian and hyperbolic downgrade, we believe it is realistic and incorporates the big losses that have come to light in the banking sector as well as a sharp drop in commodity prices (oil was $100 last September).

"Our forecasts assume that the banks sector makes around a £20bn loss in 2008 and 2009 and that the insurance sector makes no profit in 2008. The profile is much less severe if we strip out the banks – for example, our model suggests profits for the market ex-financials will fall 24% in 2009 post 15% growth in 2008.

"At this point we are also officially introducing a top-down 2010 earnings per share and dividends per share growth forecast of 0%. While this could be perceived as "fence-sitting", we think it accurately reflects both our uncertainties about the future and an underlying bias not to want to invest in assets based on the expectation of any economic or profit growth next year.

"If our expectation of a 60% peak-to-trough decline in UK profits is correct, this would mark an even worse outcome than that seen in the early 1930s when our data suggests profits fell by around 57%. However we do not consider this forecast unreasonable – prior to this downturn, we saw the biggest 5-year increase in corporate profits in the history of our data and hence it is not unreasonable to also expect the biggest bust.

"As bad as a 60% fall in profits is, it would have been even worse were it not for a big foreign exchange benefit. In the last six months US dollar/pound has fallen from 1.8 to 1.45 and, given the prevalence of US dollar reporters in the UK, this has boosted UK market earnings by around £10bn. On a 'constant currency basis' 2009 earnings would be nearly 10% lower than we currently forecast and hence our peak-to-trough drop would be approaching 70%. The most obvious example of this can be found in the energy sector where profits are set to fall 70% in US dollar terms on our analysts' forecast (oil price averages $35 this year), yet by just 50% in sterling terms.

"The sustained weakness in equity markets in recent months suggests that traditional equity valuations are rather irrelevant at the current time. In the second half of last year, this was partly due to the over-riding dominance of investor de-leveraging, in our view. In more recent times, however, we suspect that the irrelevance of valuations owes more to a complete lack of investor confidence in the correct level of earnings, dividends and even book value.”

You certainly can not accuse Mr. Secker of being early as UK stocks have already dropped 65% from their peak.

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