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October 11, 1999
#43

THE Y2K REPORTER

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ALARMIST SHRUGS

Objectivism. I am no longer an alarmist about Y2K. I am just a skeptic now. There is no point in sounding the alarm any more with less than 90 days left to the century date change. I've attempted to provide an objective assessment of the likely economic consequences of Y2K. At first—over two years ago—I was alarmed by the lack of awareness of the problem. That's not an issue any more. Everyone on the planet Earth is certainly aware of Y2K. I believe that Y2K alarmists contributed to this development, without triggering any panic. In fact, there is no panic. Instead, complacency has increased and is widespread.

There has been a great deal of progress in fixing our computers to recognize that 01/01/00 will be the first day of 2000, not 1900. I expected there would be. But I am skeptical that it will be a nonevent as is widely believed now. I am concerned by the increasing complacency. Instead of preparing for still plausible worst-case scenarios, government and business leaders have convinced the public to expect the best possible outcome.

Hard data remain hard to find on the true readiness of vitally important public and commercial computer systems around the world. Almost all of the progress reports are not independently validated and verified. Given the lack of good information, I am hopeful that the upbeat progress reports provided by some organizations are accurate and reflect the universal readiness of key systems. But, I have my doubts. I am amazed that the optimists have virtually no doubts at all. Few of them will even concede that there is any risk at all of major disruptions. Indeed, I seem to be the only economist and investment strategist in the world who still expects a recession and a bear market in stocks. As a result, I've been called a doomsayer by some reporters. I say, "Since when has a recession been doomsday?"

Relativism. I've said it before, and I say it again: This is one forecast I would like to be wrong about. I hoped that by now the weight of the evidence would allow me to moderate my views. I think there is enough to rule out doomsday scenarios, but not enough to join the don't-worry-be-happy crowd. I am much less concerned about critical infrastructure systems, particularly electricity and phone service in the major industrial countries than I was 12 to 24 months ago. The providers have found that date fields and embedded chip systems are less important than was feared. On the other hand, I am more concerned about the weak links in global supply chains, especially as they might disrupt global just-in-time manufacturing and petroleum production and distribution.

When I first began to study Y2K, I concluded that a useful analogy was the 1973 oil shock, which triggered a significant global recession. Information, like oil, is a vital factor of production. If information technology systems malfunction or fail, a recession could be the major economic consequence. I still believe it is a useful analogy. Indeed, one of the consequences of Y2K might be disruptions in the energy sector.¹ But I no longer think that the Y2K scenario is likely to be as bad as the 1973-74 economic downturn and bear market.

The following table shows the five possible economic scenarios for 2000 with my subjective probabilities. I previously published this table in my *Y2K Reporter #41* (August 10, 1999). I still see a 70% chance of a recession. The most likely of the five scenarios, in my opinion, is a downturn which should be quite severe during the first six months of 2000. The recession could linger over the rest of the year, but signs of a recovery should be visible by the summer. My forecast anticipates real GDP declines of 7%, 4%, and 2% during the first three quarters of next year, and then a 0.5% upturn during the year's final three months.²

¹ "Year 2000 Energy Crisis?" September 1, 1998, http://www.yardeni.com/public/y_19980831.pdf

² For my latest complete forecast table see <http://www.yardeni.com/public/forecast.pdf>

Y2K Economic Scenarios & Probabilities

10%	Minor disruptions. Business as usual. Only a few problems, which will be fixed rapidly. Stock market moves much higher.
20%	Same impact as natural disaster. Business as usual within a few weeks. Stock market moves higher.
25%	Multiple problems cause modest 6-month recession. Real GDP down 1%-2%. Stock market down 10%-15%, then soars.
40%	Major global recession lasting 6-12 months. Real GDP down 2%-3%. Flight to quality. Deflation. Stock market down 30%, then heads toward 15,000 by 2005.
5%	Depression lasting 2-5 years. Blackouts. Social and political upheaval. Stock market...you don't want to know.

Pessimism. Y2K is not the sole premise of my recession scenario. It is my opinion that the US stock market is a speculative bubble that could be burst by Y2K troubles.³ Currently, there is so much complacency that the market is vulnerable to any Y2K-related bad news. Last year's financial crisis may turn out to be a very relevant model for next year. Prior to the crisis, credit spreads were very narrow. Bankers had confidence in everyone, even in the Russian government. When the boys from Moscow defaulted, counter-party risk spreads widened sharply. Currently, we seem to have complete confidence and trust in one another's assurances of Y2K progress, readiness, and compliance. It wouldn't take too many Y2K-related screw-ups to puncture the bubbles in irrational confidence and exuberance.

Optimism. Given the paucity of reliable data, I've attempted to develop some additional insights from various sources:

- 1) In Congressional testimony, I called on the Securities and Exchange Commission (SEC) to require more corporate disclosure in annual and quarterly filings.⁴ The SEC did just that in a guidance memo issued July 1998. I continue to provide a database of these disclosure statements on my web site.⁵ I've read every one of them for the S&P 500 companies since the third quarter of last year. I've continued to compile the limited metrics available on the percentages of Y2K budgets spent. In my latest analysis, using data for the second quarter of 1999, I found good progress, supporting the overwhelmingly optimistic tone of the disclosure statements. But I also found lots of laggards.⁶
- 2) I've interviewed some of the world's top Y2K experts and leaders in public conferences broadcast over the Internet. I've conducted five of these every 100 days closer to the century date change. The last one (T-100) was first broadcast on September 23 and included the Y2K Czars of the US and UK, the US State

³ *Topical Study #46*, "Irrational Exuberance: Earnings Growth & Stock Valuation," September 20, 1999, <http://www.yardeni.com/topical.html>

⁴ See my November 4, 1997 Congressional testimony http://www.senate.gov/~banking/97_11hrg/110497/witness/yardeni.htm

⁵ <http://209.10.30.36/Y2K/Y2KFind.asp>

⁶ http://www.yardeni.com/public/y_19990909.pdf

Department's Inspector General, and the head of the International Y2K Cooperation Center of the United Nations.⁷ They too were mostly optimistic, but they didn't promise that Y2K will be a nonevent and they were concerned about global readiness.

- 3) Finally, I've partnered with CIO magazine and Information Systems Audit and Control Association (ISACA) in a public-interest forum to conduct polls of IT professionals with direct Y2K experience. Using my web-based polling system at www.peoplepolls.com, we sampled their lists of over 30,000 e-mail addresses. We received close to 1,000 responses in our June and September polls.

In September, an overwhelming 90.4% said they were still optimistic or more so about Y2K. That's truly remarkable. I am puzzled that IT professionals are so optimistic about the impact of Y2K on their organizations. The September poll results suggest that their overall upbeat assessment is not justified by their specific responses. They are clearly predicting a victorious outcome, which may be raising complacency levels too high.

I am especially concerned that the September poll shows that only 44% are expected to finish all phases of their project by the third quarter, down from 75% who predicted they would be done by now in the June 1999 poll! The latest poll shows that 43.4% expect they will finish during the fourth quarter, which is a startling increase from the 16.3% who had anticipated such a late completion date in the June poll. On the positive side, 19.1% said they were completely done as of the September poll—a solid increase from the 8.4% in midyear—but still too low given how little time is left.

In light of these findings, it is also worrisome to see nearly 30% report that they were behind schedule as of the September poll. Also behind schedule, apparently, are third-party software vendors. More than one-fifth of respondents were still waiting for Y2K-compliant versions of such mission-critical programs.

There has been virtually no change in the rather lax approach to assessing vendors since the June poll. Only 13% are conducting on-site inspections to verify readiness. The rest are relying on questionnaires, telephone interviews, and informal conversations. Given all the slippages that have occurred and may continue to unfold, it is alarming to see that nearly one-third are either still formulating contingency plans or have none at all.

As one of the only economists who has been predicting a Y2K recession, I was hoping that the latest poll results would give me the opportunity to moderate my forecast. Unfortunately, I can't do that. I hope that in the next and final poll during late November, the optimism of the Y2K-remediation community will be supported by a surprisingly fast dash to the finish line before the date changes to 01/01/00.

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⁷ <http://www.y2kactionday.com/>