

## Nothing *left* on the balance sheet's right-hand-side, nor anything *right* on its left-hand-side.

That was the mess into which the banks had got themselves in 2008. It's the mess out of which the rest of us are having to pay now to extract them.

When in office, the previous Fed Chairman analysed data skilfully.

In a television interview last week, Alan Greenspan was asked his interpretation of the spate of soft economics data that had been published in June. The numbers appeared to reflect reality, he said. Activity in the States and many other parts of the world had slackened significantly in the early summer. But it wasn't yet clear whether the deceleration would turn out to be ephemeral or protracted.

He still does. Much now turns on how economies respond to the banking mess.

The big unknown was how economies would deal (or not deal) with the longer term implications of the banking failure. At the height of the crisis, fearing systemic collapse, the authorities had transferred huge sums of money to the banks. They'd done so by a sleight of hand. It wasn't real spending, they suggested, just a temporary loan. It'd not ever have to be repaid; not at any rate by the taxpayer!

Paying down the debt is going to be a hard slog.

Untrue, of course. The bailiff has been knocking at the door for some time already. In Europe, in Greece most obviously, he's demonstrated what he can do to those who can't, or won't, pay. And the reaction elsewhere? Panic! Countries that have been somewhat similarly reckless in the past have been keen to demonstrate extreme fiscal orthodoxy in the future. Over the next five years, if the schedules are to be believed, many countries will be seeking to cut public spending (and raise gross savings) by 5% of GDP.

The pace of activity will probably weaken.

And what effect will that have on their economies? Nobody's certain, but the probabilities are generally negative. Perhaps the early effects of America's extra saving were making themselves felt in the data published last month. Greenspan didn't say that. But he did note that the customary route out of recession wasn't being followed this time.

Is that what's been holding back the US recently?

Though credit had been expansive and interest rates low, there was no exuberance in consumer spending. Production was growing only moderately, therefore; and so was employment. The self-reinforcing mechanism that usually transformed initially mild upturns into subsequently strong booms was being blocked. Every time the wage-earner got additional income, he had to use it to pay off his own debt (or, more likely, that of his bank).

Will it do something similar (or worse) in the UK?

In Britain, where the size of the banking bailout was bigger, the constraint on activity has been stronger. Likewise, the change in attitude of the Cameron-Clegg combo. Where previously they'd favoured tree-hugging indulgence, they now opt for bean-counting austerity.

Spending cuts in the *demi-paradise* look set to be sizeable.

They spent six months agonising about footlingly unimportant cuts that added up to an irrelevant £6bns. And then, almost overnight, slashed multiples of tens of billions of pounds from pensions and (maybe) Health. Higher Education is probably the next target; and rightly so.

Education, probably not excluded.

Half the country's Universities (possibly two thirds) provide neither the taxpayer nor the graduate with value for money. The former pays an extortionate bill, but gets only what the sixth-former provided twenty years ago. The latter is saddled with £25,000 of debt and no job to help him pay it off. It was a vanity to open second-tier Universities in the past. It will be a kindness to put them out of their misery in the future.

The squeeze in the year after next is going to be particularly bad.

At the moment, the business cycle is still in its growth phase. It troughed at the end of 2008 and isn't due to peak until autumn 2011. The two years thereafter might be very difficult. If, by then, public spending cuts are in full swing, but the private sector is still cautious, another downturn will be on the cards. It'll not be a double-dip, so much as two recessions separated by a barely perceptible recovery.

But inflation and interest rates . . .

Inflation will be low, of course; possibly negative. Pay settlements will have been the driving force. In the public sector, in particular, there'll be enforced flexibility: no rises for several years; possibly significant cuts! And commodity prices may also fall. Corroboratingly, the consensus forecaster, a usually reliable counter-indicator, is still looking for increases!

. . . will be negligible, and . . .

That'll allow the authorities to keep interest rates at negligible levels. The only rationale for raising them will be evidence that commercial banks were getting up to their sub-prime mischief again. And, even then, there'll be other methods of disciplining the miscreants.

. . . security valuations rising.

The markets? They'll rise. The last few sessions demonstrate the potential. Valuations are low. Given half a chance, the indices will break into new ground.

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