

Economic Views for Investors

by Roger Nightingale

Mathematicians are irritatingly precise; economists, insufferably imprecise

Economists lack intellectual rigour. There's a tendency for their pronouncements to be more heavily influenced by wishful thinking than dispassionate analysis. Last week, demonstrating the phenomenon, many started talking about a revival in activity.

The one group understands differentials, the other doesn't

Their problem was a muddling of "levels" and "growth;" of "first" and "second" differentials. The scribblers had spotted the one and interpreted it as the other: they'd perceived a moderation in the rate of deterioration to be an improvement. The reality (probably) was otherwise. While it was possible that the former had occurred, it was almost certain that the latter hadn't.

Economies are contracting less quickly; they're not growing!

Bank lending, industrial production and retail sales seemed all to be contracting less quickly than hitherto, but there was no hint of a reversion to growth. Instead, it looked as if there'd be an ongoing phase of decline. Indeed, there was an anxiety that, if the thirties were anything to go by, the debility would last for a decade, possibly a generation. And, even when output eventually started to grow again, the advance might be anaemic—insufficient, therefore, to keep employment at satisfactory levels.

And unemployment means they won't be for some time

It was the labour market that most worried the authorities. In Europe and Asia, the outlook was particularly poor. Layoffs hitherto had been minimal. Employers had been hoping that a revival in demand would make redundancies unnecessary. But, with activity still softening, albeit at a slower pace, it could only be a matter of weeks before the dams burst and unemployment surged.

Depression is more likely than recovery

When that happened, sentiment would plunge and spending collapse. Economies would enter upon a vicious circle of deterioration: supply being cut to match inadequate demand; employment falling in consequence; softer sales the inevitable result.

Governments are impotent

In such circumstances, the authorities would be powerless. Lower interest rates would be of limited value: the cost of finance reduced, but the fear of unemployment remaining. And higher public spending ineffective: tax revenues scarce, and the appetite for government debt non-existent.

Especially those that have wasted their resources on rascally bankers!

Worst of all, pensions provision would be a catastrophe. In Britain, in the eye of the economics storm, the Treasury had misapprehended the situation so thoroughly that they'd chosen to bail out good-for-nothing Scottish bankers at the expense of virtuous English taxpayers. The one group was now luxuriating in limitless indolence while the other was fretting about perpetual penury. A whole generation of pensioners had been devastated. What the unspeakable Brown started with his raid on superannuation schemes ten years ago, he'd finished with his recent indulgence of compatriot bankers. The man had a great deal for which to answer. History would judge him harshly; so would the electorate.

Europe and Japan look more vulnerable than the UK

Curiously, bad as things are in the UK, they seem to be even worse in much of the rest of the world. That's not the way the forecasters had envisaged things. The IMF, the OECD, the EU and virtually the whole of the Investment Banking community had reckoned that Britain's delinquent credit behaviour in the past would traumatise its growth in the future. But the data, thus far, say otherwise.

Likewise, Commodity Producers and Emergers

It's Germany and Japan, their industrial virtuosity notwithstanding, that have been devastated by the inventory correction. It's Ireland and Spain and Iceland that have paid the price for monetary excesses; Brazil and Canada and Australia that have had their living standards undermined by deteriorating terms of trade; India and China, superstars when world trade was growing briskly, that have found themselves exposed and vulnerable under the threat of proto-protectionism.

Weak currencies have boosted activity

Arguably, it's been the slightly less awful performance of the British economy that accounts for the slightly less awful performance of London's securities markets this year. Elsewhere, there's been unqualified gloom; in the Scepter'd Isle, comparative resilience.

Vide the US and UK

Why? The currency. A 25% devaluation, unmatched by faster inflation, has worked wonders for competitiveness. Industry has been boosted a little; finance and tourism have declined only moderately; and education has been a big winner.

Time for the euro to fall again?

Will the benefit persist? Only as long as the currency differential does. The probability is therefore that the trend will reverse. The euro, in particular, looks set to fall. It may be that the scales fall from Trichet's eyes and that he'll deliberately undermine the currency. But it's more likely that the market will do what has to be done, Trichet resisting to the last. In any event, a 35% correction would be justified.

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