

Economic Views for Investors

by Roger Nightingale

The decline was ferocious;
the advance has been anaemic

The economic recovery is not going well. Although activity has risen in the last eight months, it's done so exceedingly slowly. Momentum in the States in the third quarter was pedestrian; in Japan in the same period, it was almost non-existent.

And now it's faltering

What's gone wrong? Why haven't easy money policies implemented by central bankers during the last eighteen months worked their customary stimulative magic? Arguably, because the world's current economic imbalances are not cyclical, but secular; the resulting debility not recessionary, but depressionary.

The parallels with the thirties
are uncomfortable

Although there's lots of extra liquidity around, banks are unwilling to lend, and non-bankers to borrow. Everybody wishes to strengthen his balance sheet. To this end, spending is being cut by consumers and businesses alike. It'll take a change in psychology to cause growth to revert to potential. And that may be years hence, even decades!

Governments now, as then,
pretend they know what
they're doing

Predictably, Governments have wished not to appear bemused by the crisis. They've wanted voters to see them as competent and prescient! To this end, not being able to think of anything sensible to do, they've sanctioned huge increases in public expenditure. They've claimed such measures would help lift overall activity. And much of the rest of society has gone along with the proposition.

They obviously don't

The reality, of course, is that fiscal policy is a zero-sum game: it *redistributes* resources, but does not (cannot) *augment* them. Initially, therefore, the heightened public spending (and the concomitantly enhanced public borrowing) were thought to be largely irrelevant to the progress of the economy—a political indulgence, but neither reflationary nor deflationary.

They may be making things
worse, not better

That view has changed in the last couple of weeks. And it's been sentiment that's caused the rethink. Investors have taken fright at the size of borrowings and have been reluctant to acquire the bonds of some Governments. The rating agencies (pandering, as usual, to the prejudices of their customers) have cut the ratings of some big spenders, and have threatened to review those of others.

What the gold standard did
in one period, the EMU
does in another

The result has been a perceptible increase in the costs of borrowing of the delinquents. Greece has taken a pounding, and Ireland likewise. They're locked into an exchange rate nightmare from which there's no easy escape. And, compounding their woes, they're shortly to be hit by penal interest rates on the one hand and savage expenditure cuts on the other.

Public spending needs to be
cut severely

The message is clear: in a crisis, don't raise public spending; it makes things worse not better. Even Darling, one of the least perceptive of today's politicians, sees the dangers. The man who previously championed the fiscal stimulus no longer does so. He fears that Britain's ratings will go the way of those of other high rollers, and is trying to get the country (and himself) to be seen as prudent again!

Darling is clueless

His autumn budget, though, was a mess. It *talked* about public sector restraint, but *delivered* nothing. Most conspicuously, it was pusillanimous on the issue of labour costs. It opted for slower rates of increase of pay rather than cuts, and slower rates of recruitment rather than sackings. Most disappointingly, it made no mention of ending the iniquity of public servants' retiring at 60, and of their receiving thereafter inflation-adjusted, taxpayer-financed, DB pensions.

Last week's package . . .

Fatally, Darling's budget went for higher National Insurance Contributions. Did he think the way to preserve employment was to tax it? Did he think that foreign inward investment might be encouraged by making it less attractive to the sponsor?

. . . was embarrassing

His banker bonus proposals were childish. They'd be hopelessly unenforceable. But the cost of pretending to implement them would be sizeable. It was a lose-lose situation. Was he stupid, or did he think we were?

Asset prices are worried by
the thought of sovereign
default

Securities markets have been dominated for a week or so by negative psychology. Although the fundamentals—in the form of negative inflation, negligible interest rates and satisfactory profits—are quite bullish, investor anxiety has been more than compensatingly bearish. Which will win in the future? Probably the former, but there might be a worrying hiatus in the near term.

Anxieties are over done,
but powerful nonetheless

In Britain, with an election in the offing, and with an Opposition driven more by expediency than principle, there are a number of risks. It would be unsurprising if investors were to take a wait-and-see approach. They're nervous about the incumbents and also about the alternates. Regrettably, therefore, a good deal of money might go overseas in the short term, and not return until the colours of the new administration become clearer.

Contact us... Visit our website www.sippolutions.com for further information on our SIPP products and services. Alternatively, contact Roger Nightingale on 01858 419300 or email rnightingale@sippolutions.com or visit www.rogernightingale.com.

Disclaimer

This document is the opinion of Roger Nightingale and does not represent the opinions of Pointon York SIPP Solutions and is for your private information only. We are not soliciting any action based upon it and whilst information contained herein is based on sources we believe to be reliable, its accuracy is not guaranteed and may be incomplete. Any opinions expressed are Roger Nightingale's current opinions as of the date appearing on this material only and are subject to change without notice and might not be followed up on a specific ad-hoc document. This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Pointon York SIPP Solutions. Investment professional use only. Not for public distribution.