

Economic Views for Investors

by Roger Nightingale

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Long on wishful thinking and short on analysis, . . .

Economics data have been less than buoyant for several weeks. The recovery that characterised the second quarter seemed to be running out of momentum in the third. There was still progress, but it was pallid. It was not reinforcing itself.

. . . politicians (and economists) have been optimistic recently

Predictably, most politicians ignored the warning signs. They thought they'd already dealt with the problem. At the G20 meeting in London, they were irritatingly full of themselves. Preening and strutting before the cameras, they sought to take credit for this spring's revival, but to deny responsibility for last autumn's setback! If they could work the prestidigitation, they hoped there might soon be improving poll ratings. And, possibly, shortly afterwards, the re-election of incumbents!!!

No longer

Some hope. Weak data have forced them to recognise that the problem might still be in its early stages. If that should be so, there'd be no respite for the poor politicians. Even those recently installed would be likely to find conditions difficult.

Unemployment is lurking

A lot will rest on labour markets. They're both lagging and leading indicators. They reflect past levels of output on the one hand, and influence future levels of consumption on the other.

The Americans' problem is not yet over

American employers, as always, were quick to lay-off workers in the late winter and early spring. That set the scene for much lower numbers of dismissals in the summer. Indeed, it began to be forecast that the trend would continue: that the moderating rate of deterioration would turn into the beginnings of a genuine improvement. Extrapolating the second differentials, some economists projected the beginnings of net recruitment by the middle of next year.

It may scarcely have begun

The new anxiety is that conditions will soften again. The inventory rebuild was an essentially temporary phenomenon. And so was the huge increase in public spending. If, at their height, these considerations hadn't stimulated sustainable growth, the outlook was bound to turn dreary again. It has! The pessimists used to fret that activity would sag in the second half of next year: it may be that it's begun a little earlier!

It certainly hasn't yet in Germany!

The prospects for Europeans are no more encouraging. Germany, the most efficient member of the EZ, has not yet begun to sack redundant workers. Although GDP has fallen 7%, employment is down barely ¼%. Why? Nobody is sure, but there's a suspicion that many employers chose to delay their cost cutting operations until after the Federal elections had occurred. They wanted a "business-friendly" Government and were prepared to put up with a temporary loss of profits to achieve their objective.

Have companies there been playing politics?

The thesis will now be tested. The electoral mission accomplished, businesses will possibly shed staff. How many? It depends on GDP, of course, but the downside is huge. If employers were to start to sack just 5% of their workers, and if that were to lead to a collapse in consumption, the downwards trends might become self feeding. It could go to 10% and, worse, be unstoppable.

And China? Will it be saved by its competitiveness?

Would Asia be safe in such circumstances? Of course not. Although it might be technically feasible to replace overseas sales with domestic ones, it'd be psychologically difficult to do so, verging on the impossible. As soon as exports softened, employment would deteriorate, and that'd undermine consumption.

In a depression, all boats sink. And those that rose fastest. . .

At the moment, China is using public funds to boost investment. But the process is unlikely to last; it sows the seeds of its own destruction. The extra capacity will be, not a boon, but an embarrassment. When it comes on stream next year, it will intensify the economy's imbalances: the enhanced supply will overwhelm the still inadequate demand. Unable to sell what they're producing, companies will resort to shedding labour. The extra public spending will have been instrumental in provoking the very labour market imbalances that the authorities were keen to avoid!

. . . in the one period have furthest to fall in the next

Depression is not inevitable, but it's a much higher probability than the consensus is prepared to acknowledge. Central bankers privately acknowledge as much. They concede that, for the next year or so, interest rates will remain at current levels. And, if activity should start to slip, they'd have to step up their purchases of financial assets.

Asset values will probably rise nevertheless

Would that kick the economy into faster growth? Not necessarily. But it would lift asset prices. Funds can't do nothing. If not deployed in the real economy, they drift into the financial markets.

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