

Economic Views for Investors

by Roger Nightingale

Stone walls do not a prison
make . . .

The industrial sector of the world economy is still benefitting from an inventory rebuild, but the effect on GDP is being offset, at least partially, by continuing softness in final demand. Personal spending, corporate investment and overseas deliveries are all falling. When inventories stabilise, therefore, in mid-2010 perhaps, the aggregate numbers may become worryingly weak again.

. . . nor inventories a boom!

Investors were given a taste of what might be in store for them with the publication last week of the US's labour market returns for June. The picture was one of huge job losses on the one hand, and a severe wage squeeze on the other. Hardly surprising, therefore, that workers lacked the wherewithal to indulge their consumer appetites; and thoroughly predictable that companies were choosing to cut overhead and investment as fast as they could.

Final demand is
disappointing

What of public spending? Was it possible that it could keep things ticking along? No way. Some Governments were still squandering resources as recklessly as ever, but nearly all said they intended to return to orthodoxy next year. And the few who had promised to continue to fritter away their taxpayers' money were losing the propaganda campaign. In Britain, for instance, the Prime Minister was barely able to convince the Chancellor of the virtues of public expenditure programmes. He was failing miserably with the voter.

GDP may be drifting in
H2 2010

The economics outlook was fraught with uncertainty, therefore. It looked as if the current cyclical upswing would be very anaemic; possibly insignificant by the second half of 2010. And, if that were so, the next cyclical downturn, due to begin early in 2012, might turn out to be devastatingly severe. The risk was that debility in the personal, corporate and public sectors would coincide; each element reinforcing the others.

Are world's leading central
bankers worried?

Did the world's authorities recognise the risk? Did they fret about implosion? Not at all. They focused more on a return of inflation than an intensification of recession. They busied themselves talking about the need to raise interest rates and rebalance the budget. They would probably have been enthusiastic re-arrangers of the deckchairs on the Titanic!

Clueless in Gaza, they
aren't!

If the worse should come to the worst, if recession should shift into depression, which countries would take the hardest knock? In general, those that had fared best in the prior period: commodity producers, on the one hand; emerging manufacturers, on the other. The one would be vulnerable to falling raw material prices; the other to protectionism.

But Canberra and Beijing
may be

Was that why the Australian Government, agonising about the world outlook, twitched nervously at the end of last week? Was that why Zeng Peiyan, a former Chinese Vice-Premier and now the head of a Beijing think tank, advocated international regulation of the reserve currency system? Was each giving verbal expression to mental turmoil?

The threat of protectionism
is rising

Zeng's remarks made no economics or financial sense, but probably weren't meant to. His objective was wholly political. He wanted to put pressure on the US, China's largest export market, to renounce protectionism. And he was fishing for allies in the rest of the world. The dollar's position as pre-eminent reserve currency was the excuse for the exercise.

And the EU is itching to
interfere

Predictably, the Europeans were predisposed to side with the Chinese. They've always been jealous of the status of the dollar, and relish the thought of regulating it out of favour. Could that be enacted as part of a "global financial restructuring"? What joy, if so, for the nihilist Brussels bureaucrat!

Nothing, of course, is ever
so bad . . .

Little wonder that securities markets tumbled at the end of last week. But it was less the prospect of economics softness that scared them; and more the thought of lunatics escaping from the asylum. When the economy is satisfactory, the inmates tend to stay, harmlessly, in their cells. When there's a crisis, they come out and make matters worse.

. . . that a bureaucrat can't
make it worse

Investors fear that the current optimism is fragile. If momentum were to falter, it'd be difficult to avoid the slippery slope to depression. And the authorities would be active in greasing the pathway. They did so in the thirties and seem intent on doing so now. Already widely distrusted, politicians, regulators and central bankers look set to be loathed.

Valuations to rise

Are investors right to be so worried? Possibly not. In depression, Government bonds would rally; and equities, so long as wages were sacrificed to protect profits, might well follow suit.

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