

Economic Views for Investors

by Roger Nightingale

The financial crisis isn't over: it's moving from developed economies to developing ones

The Latvian Prime Minister, speaking on television last week after the failure of a Government bond issue, tried to calm the anxieties of international investors. He acknowledged that the country was in the midst of an economic crisis, but denied that there would be a change of strategy. He was determined that the country join the EuroZone. To this end, the first priority would be a reduction in the size of the fiscal deficit. Currently in excess of 12% of GDP, it would be cut to 3%.

And it's getting more virulent in the process

No easy task. GDP was already falling precipitously. Slashing public expenditure and hiking taxation would (at least temporarily) make things worse. But, said the PM, it was a price worth paying. Long term viability would compensate for near term pain.

Latvia, handicapped by official intransigence, won't survive in its current form

Really? Was he sure that he'd get the viability he craved? Did he think the EZ scored well on that front? Did he suppose that the ECB's policies had promoted competitiveness in Germany or Italy, Spain or Ireland? Did he judge companies in the EZ to be more innovative than those in the US? Did he think workers in the one less vulnerable to unemployment than those in the other?

It should be adopting an Anglo-Saxon model, not a European one

The reality, of course, is that Europe performs less well than the Anglo-Saxon world on just about every criterion. So why does the Latvian PM nevertheless want to join the EZ? Probably because he thinks membership is the best route to sizeable subsidies from the Commission. He may be right. The German Chancellor will approve of Latvia's commitment to fiscal orthodoxy. A cheque may already be in the post.

It's unlikely that even German largesse will be able to bail it out

Will that be enough to hold the line? Probably not. Latvia is seriously uncompetitive. At current exchange rates, it may need prices to fall 10% relative to Germany's, 40% relative to America's, to re-establish external equilibrium. How can that be accomplished? Only by a savage economic setback. The PM may think the price one that's worth paying, but the electorate probably won't. It'll let its views be known at the next poll!

Things are not much better in the rest of Eastern Europe

Things are much the same in the rest of Eastern Europe. From Baltics to Balkans, the picture is one of crisis and disarray. It needn't have been thus. If central bankers had been better economists and politicians better democrats, priorities in the past would have been different and problems at the moment less severe.

And Germany itself, the European icon, is failing

Will the Eastern Europeans learn from their mistakes? Will they choose their role models in the future more carefully? Probably not. It'll take more than a single financial shock to change prejudices. It might require years of grinding debility before scales fall from eyes.

Does the Federal Chancellor recognise the problem?

Interestingly, Angela Merkel, herself an Eastern European, has not yet begun to see the world as it is. In a departure from the usual protocols last week, she criticised the ECB for being too monetarily lax, too sympathetic to the Fed and B-of-E. It'll all end in tears, she said. Aggressively expansive credit policies are the problem, not the solution; they'll exacerbate the imbalances in the longer term, even if they lessen them initially.

No. She blames the US, the UK. Even the ECB!

She has a point. But the *Realpolitik* of the issue is that a problem delayed is one half-solved. If the crisis can be put off until the excess supply has run its course, the threat of depression will evaporate. In the meantime, the ECB (and the Fed and B-of-E) will discreetly note that the performance of Germany's economy in the recent past has been disastrous—and that it was no less appalling in the thirties. Difficult to argue therefore that Berlin's authorities were over-imbued with insight on either occasion!

By comparison, Britain's attractions are rising

In Britain in recent sessions, sterling has been strong and the securities markets enthused. Why? Because the probability of Gordon Brown's early demise keeps rising. Members of the Cabinet may be reluctant to tell him to go, but the electorate is less squeamish.

There'll be a surge of enthusiasm when Brown goes

In the Municipal and Federal elections, Labour will be humiliated. It'll no longer be possible for the Prime Minister to say he's getting on with the task set him by the electorate. It'll be clear that the electorate has quite different plans for him. It'll want him to go. Reluctantly, but inevitably, he'll do so.

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