

Economic Views for Investors

by Roger Nightingale

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The economy is crashing; no sign of respite.

The world economy seems still to be deteriorating. It's not just that activity is falling, but that it's doing so at progressively steeper rates. The closing quarter of 2008 was dire, but the opening one of 2009 promises to be much worse.

Stocks are being cut and workforces downsized.

Inventory is the immediate problem. It's too high, given current sales levels. Production is going to have to be cut severely, therefore. Labour is a secondary, but possibly more intractable, anxiety. Employment is too high because, except in the US, lay-offs have been far too moderate. They'll have to be quickened in 2009. That'll undermine personal outlays, cause cuts in capital spending, and intensify the need for reductions in inventory.

The next six months will be horrible.

The bottom line is the certainty of a savagely weak near-term and the probability of a persistently depressed medium-term! Sadly, most Governments affect not to appreciate the seriousness of the situation. Their forecasts are bizarre, and their remedies risible.

Hapless Europeans don't know what's hit them.

As usual, it is the Europeans who are the most embarrassing. Successive revisions have lowered estimates of activity, past and prospective, but seem not yet to have dented the insouciance of the EU's authorities. GDP fell at an annual rate of more than 6% at the end of last year, and is thought to be crashing at one of 10% at the moment, but the Commission and Central Bank are unfussed!

If in doubt, though, have a lunch!

What did they do last weekend? Assembled, at considerable expense to the taxpayer, for an elaborate lunch! They spent four hours in fatuous deliberation but decided nothing. While Ireland and Greece were burning, Spain and Portugal smouldering, Barroso and Trichet merely fiddled.

Poor old Austria!

Eastern Europe, meanwhile, was going from bad to worse. The old Warsaw Pact countries had sought security and prosperity within the EZ, but hadn't appreciated the trap that was being laid for them. Today, they are uncompetitive and unloved: they can't live with the euro, but neither can they live without it. Russia is their steadfast enemy, but Europe only a fickle friend.

It's going the way of Iceland and Ireland?

How is Austria to survive the turmoil? It was looking good when its stakes in Eastern Europe were highly prized. It's looking vulnerable now. Is it another Iceland or Ireland? Is its banking sector too large in relation to its GDP? If debtors renege, might Austria go under as well? Yes!

Commissioners never fail to amaze their audiences!

Commissioner Almunia had thought Europe was safe. He kept repeating the Trichet mantra that monetary orthodoxy implied economics safety. It didn't. It turns out, amazingly, that GDP is not boosted by protractedly severe monetary policies!!!

The ECB, likewise.

The cyclical peak in the European economy occurred late in 2006. Interest rates should have been cut beforehand, not raised afterwards. Was it so surprising that, the brakes being applied when the economy was struggling uphill, activity stalled? What had people expected?

China is bemused.

It's not just in Europe that Government officials are pretending a complacency that's unjustified by the data. That's the picture in China also. Last week, Premier Wen argued that the 8% growth target for 2009 was still attainable. Absolutely; and watch out for air-borne pigs!

It doesn't know how to handle economics weakness.

Activity in the PRC hit a brick wall at the close of 2008. There is no official figure for seasonally adjusted growth between the third and fourth quarters, but unofficial estimates suggest something close to zero. What had happened? The same old story: exports fell, inventory rose and workers became fearful of unemployment. A potent mix, and one that was unlikely to be reversed in the near future. Activity would soften for at least a year before it quickened again.

India has a little more experience, but not recently.

The picture was much the same in India. The authorities were sticking to the script but didn't expect anybody to take it seriously. They said that growth in 2009 would be about 6%, but they knew that they'd be lucky if there were no contraction!

Thank goodness for government bonds.

Is there any good news? Yes, government bonds are rallying. The conjunction of low interest rates and falling inflation was helpful, but it was only when Central Bankers decided additionally to buy stock in the open market (quantitative easing) that prices rose furiously. Is there much further for them to go? Yes. So long as there's to be a depression rather than a recession, the rally will have legs: longs possibly doubling in price!

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