

Economic Views for Investors

by Roger Nightingale

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Politicians are good at photo-opportunities . . .

Is the G8 still relevant? The question was posed by the media as the grouping's political leaders met in Italy last week. The insinuation was that developed nations could no longer provide the inspiration and guidance needed by the international community. There was an unstated assumption that, since the economics baton had already been passed to developing countries, it was time for the *political* one to follow suit.

. . . but, like economists, bad at economics.

The media may have been asking the wrong question. It wasn't a matter of whether the appropriate politicians were in Italy, but of whether the problem was susceptible to political tinkering from *any* group. If not, and there was no reason to think it was, the world might have been a happier place, certainly a less polluted one, had all the politicians stayed at home!

The people want a solution to their tribulations . . .

Naturally, they didn't see things that way. They relished the opportunity of appearing in a flattering light. No matter that they'd comprehensively mis-analysed economics trends during the period leading up to the crisis, making matters worse rather than better, they still believed they were more the solution than the problem. They posed and preened, and the media went along with the charade. Deliberations were reported in detail: hours of television coverage and acres of newsprint were devoted to meaningless nuances of negotiation.

. . . and they look (*faute de mieux*) to their leaders to provide it.

The bottom line was something the critical observer knew beforehand: that there had been a bounce in activity in the second quarter, but that it was the consequence more of inventory rebuild than final demand recovery. The risk was, therefore, of a relapse later. If consumption had not begun to grow by the time that inventory was rebalanced, there'd be new softness.

Lots of policies will be implemented, therefore.

No time, said the Keynesian-interventionist majority, to cut public spending. On the contrary, it was possible that a second fiscal stimulus might have to be implemented. Oh no! That way madness lay, retorted the arithmetically-competent minority. There was no such thing as fiscal stimulus: taking resources from one person and giving them to another was a zero-sum procedure; it didn't (it couldn't) raise activity, but it could, by heightening debt, depress sentiment.

Most of it irrelevant and uncoordinated.

The communiqué to be issued at the end of the meeting would be full of optimistic clichés. But the reality was that nothing would have been resolved. Each country would go its own way, unpersuaded by the arguments of its neighbours. Anglo-Saxons would increase their public spending; Europeans wouldn't. The Japanese, fatalistically, were likely to compromise. The developing brigade, not knowing which way to go, would rage against the developed one.

GDP, having quickened in the second quarter, may slow again thereafter.

And the global economy? The chances are that it'd perform unsatisfactorily. In recent weeks, only China had produced strong numbers, and they were probably the result of an unsustainable fiscal boost. Was it possible that companies would carry on investing when sales were insipid? that banks would continue to lend when bad debts were rising? that local authorities would maintain infrastructure outlays when tax revenues were inadequate? Probably not.

Commodity producers, strong hitherto, will fare poorly.

The momentum of other developing countries was largely dependent on commodity prices, and therefore on activity in industrial countries. It was a sequential process; it started with consumers in one place and ended with raw material producers in another. The last element, like the end of a whiplash, was necessarily high beta. Unsurprisingly, therefore, countries like Brazil and Russia outperformed the global average when growth was fast, but underperformed it when things slowed down.

Their political status will sink with their economics virtuosity.

The idea that significant political power would be shared with the emerging world (while it was still emerging) was naïve. Japan and Germany hadn't been "elevated" to the top table until their GDP per head was higher than that of existing members. Nor would China be.

The PRC will make it to the top, but not for a generation.

If the authorities in Beijing were genuinely to object to the dollar's reserve asset role, let them select an alternative. If they had global ambitions for the Rmb, let them make the unit fully convertible. Let them also open up China's financial sector to competition. What was beneficial for the goods goose ought not to be detrimental for the services gander.

The danger is protectionism.

Politicians, meanwhile, would do well to ensure no slippage into protectionism. So long as they achieved that, there'd be eventual relief. And, given low interest rates and satisfactory corporate profits in the meantime, appreciating security valuations as well.

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