

Economic Views for Investors

by Roger Nightingale

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Est annus horribilis

There's no longer any uncertainty about how severe the economic downturn will be; just about how long it'll last. It's known that it's going to be the steepest for a century, but not yet whether it'll span a matter of months or quarters, years or decades. That said, the perverse interaction of employment and sentiment, of asset valuations and monetary mismanagement, has raised the prospect of the worst of all worlds: a setback that is both steep and protracted.

Much more *horribilis* than people imagine!

Economists and politicians are resolutely upbeat. Most think the worst will be over by autumn. Many fear that, despair giving way to euphoria, inflation will re-emerge as a serious threat. The trouble is that such people have been profoundly wrong for years. A year ago, they saw no possibility of economic weakness; six months ago, a barely perceptible deceleration. They are, in other words, a counter-indicator: their optimism justifying other people's pessimism!

Jobs disappearing and living standards plunging

To the dispassionate analyst, GDP in much of the world looks set to fall precipitously in the first half of 2009 – at double digit annualised rates! And the driving force may no longer be an insufficiency of credit, but an inadequacy of paid employment. As joblessness soars, those without pay cheques will spend less *involuntarily*; those who still have them *voluntarily*.

The one feeding off, and reinforcing, the other

Given the decline in GDP at the end of last year, employment may now be falling at ¼% per month. What will that do to consumption? to GDP? and to prospective employment? It'll be a vicious circle. And not one that's likely to end soon!

Ever sector will be hurt; even, eventually, the bureaucracy!

The debility was initially associated with the finance and housing sectors. But it's already spread into the broader economy. Only the wretched public sector has thus far been spared. Not for much longer, though. With taxation collapsing, spendthrift public authorities will have shortly to be disciplined.

Governments have made things worse, of course

Fiscal expansion, the preferred response of many governments, is a busted flush – doing more harm than good. To take resources from one part of the economy and give them to another is a zero-sum activity. It relieves the latter, but only at the expense of the former. Bailing out the banks, for instance, merely condemned to oblivion the industrialists and retailers; impoverishing in the process countless consumers and pensioners.

The worker, his taxes likely to soar, has been crippled

In the final analysis, moreover, it'll be the taxpayer who foots the bill. The Browns and Darlings, Kings and Macphersons will be long gone. They'll be sunning themselves, far from the madding crowd, cocooned from harsh reality by their index-linked, DB pensions.

Come back Cromwell, our Chief of Men

The public sector borrowing requirement has risen to 11% of GDP! By whose authority? In the seventeenth century, under the pesky Stuarts, it was argued that there should be no taxation without representation. Have the people been represented recently? Has their Parliament been consulted? Isn't it time once again to stand up to the Scottish autocrats! Another 1688? Another 1649 perhaps?

The cyclical upturn may be anaemic; the prelude to a new downturn

Though the near term outlook is exceedingly grim, there may be an element of relief in the medium term. If the economy peaked in late autumn 2006, it'll likely trough in mid 2009. A true or false dawn? Possibly the latter: the risk is that the recovery will be mathematical rather than substantial. The weakness will diminish, but not disappear. And it'll give way, half a cycle later, in early 2012, to a new and virulent contraction!

Commodity producers will suffer; possibly China also

Which countries will be worst hit? Those that grew most strongly in the prior phase. The commodity producers are obviously vulnerable. Brazil demonstrated the potential in the fourth quarter; South Africa will shortly repeat the message. Worst hit, if protectionism should take hold, may be China.

And, as usual, the Europeans also

The *Schadenfreude* of Europeans will once again prove premature. Instead of performing more strongly than the anglo-saxons, they'll probably continue to trail: domestic demand limited by Commission-mandated inefficiencies; foreign sales constrained by ECB-enforced currency over-valuation.

Politicians? Frustrate their knavish tricks!

Politics will be transformed. It'll be out with the old and in with the new. Whether the new will be any better than the old remains to be seen. There'll be a focus on blame! Who was responsible for the disaster? Who asleep on watch? Incumbent politicians will deservedly get the bullet; central bankers too; regulators hopefully; the public sector generally!

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