Economics Notes for Investors

Roger Nightingale 12 March 2010

Pointon York SIPPsolutions

In order for the Cycle not to crash, the Rider has usually to keep it going forwards.

It's the same in economics and transportation. Children are quick to learn the technique; Central Bankers slower.

The "periodicity" of economics cycles is helpfully regular.

It looks as if the world economy "troughed" in early 2009. If so, it's currently more than a year (almost a quarter of a cycle therefore) into recovery. And that means it should be experiencing something close to "peak" growth rates!

"Levels" of activity trough a quarter of a cycle before "Growth" peaks.

In some parts of the world, it probably is. In China and India, for instance, the reported numbers suggest that growth has been well up to the standards achieved in comparable periods of previous cycles. In Australia and much of Latin America, the picture has been equally good. But, in the old industrial world, it's quite disappointing. If today's growth rates are as good as they're going to get in the current cycle, there's much to be worried about the medium-term future.

Which means we should currently be steaming ahead!

Least bad amongst the underperformers has been the US. Its numbers have been bouncing back quite well in recent months. And it's no longer just the consumer who's contributing to the revival; the exporter's doing so as well. A softer dollar and much lower unit labour costs have worked wonders for competitiveness. Where, previously, overseas sales were a drag, they're now a spur.

The numbers from America and Japan, though, are disappointing.

Japan has also made some progress, particularly in industrial exports, but the overall picture is not good. Domestic consumers are gloomy and not inclined to spend freely. Retail sales have recovered from last year's slump, but not by enough to persuade local businessmen to invest or recruit. Fiscal considerations, meanwhile, remain dire. Tax revenues have undershot targets and that has set a limit on public sector outlays.

Those from Europe, awful.

Bringing up the rear, as usual, has been Europe. Over-governed, over-regulated and over-taxed, the region is dispirited and failing. It underperformed during the credit-fuelled boom in the earlier years of the decade, it sank more quickly than the average in the correction, and it has grown more slowly than the average during the recovery. It lacks competitiveness and its capacity to innovate, once formidable, is now emasculated.

And from Britain, just as bad.

Britain is as badly placed as Europe. Its public finances are a disaster; its educational standards pitiful; its institutional infrastructure crumbling. An election is coming and the main contenders for office demonstrate a comprehensive misunderstanding of the problems, let alone the solutions.

If it's bad now, what'll it be like . . .

It all looks rather gloomy for the "Old World." Assuming the usual chronology applies, the next eighteen months will be difficult, and the year or so after that dreadful. In the first period, there'll still be advances, but at progressively slower rates; in the second, a return possibly to retrenchment.

. . . in the weak phase of the cycle?

In Europe's case, annualised growth that's been in the 1 to 2% range during 2009 might slip back to negligible rates in the one period, and to negatives in the next! Just how bad things get will depend crucially on conditions in labour markets.

Unemployment could rocket.

Employees were not shed in normal numbers during the contraction. Perhaps employers thought the recovery would be as steep as the contraction, and that it would be sensible therefore to hoard labour. If so, employment is going to remain very vulnerable to shifts in employers' perceptions.

A nuclear explosion!

If businesses were to start to think that the best of the recovery had occurred and that activity in the next couple of years would fall below a critical level, they'd probably take decisive action. It's not impossible that an initially huge shakeout in employment would trigger a subsequently reinforcing reaction! Fewer workers prompting lower consumption, still weaker activity, and still lower employment; lower tax revenues leading to yawning deficits, investor disenchantment, higher real interest rates, and yet lower employment!

Will money therefore be kept loose? Probably.

It's a doomsday scenario. And, not until well into the next recovery in 2012, will the danger have receded. In the meantime, have the monetary authorities the intelligence to keep credit easy and interest rates low? Probably, but not certainly. Every few months, one of them frightens us by saying that he thinks that containing inflation is more important than preserving activity!

And markets'll probably rise. But central banks don't fill us with confidence!

That's invariably been the signal for equity markets to plunge. But, thus far at least, the threats have come to nothing. There's always been a reassessment of economics prospects, a reversion to monetary sanity and a new surge in valuations. Will it continue? Yes, but not forever. At some stage, if history is anything to go by, the dogs of war will be let loose.

Contact us . . . For further information about Pointon York's SIPP products and services, call Natalie Oliver on 01858 419 371 or visit the corporate website at www.sippsolutions.com. Alternatively, contact Roger Nightingale, by telephone, on 01858 419 300; by e-mail at rnightingale@sippsolutions.com, or browse his web site at www.rogernightingale.com.