Investment Commentary
by Roger Nightingale

Our liberties are more threatened by Banking Institutions, than Standing Armies.

Thomas Jefferson, power should be taken from the banks (central as well as commercial) and restored, where it properly belongs, to the people

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The world economy is polarising:

The Japanese and European economies are probably still advancing, but the rate at which they are doing so is disappointingly slow. There's been a modest recovery in inventory and exports, but nothing at all in domestic final sales. That doesn't augur well for the future. If interest rates are shortly to be "normalised" (an essential pre-requisite for longer-term economics stability, claim central bankers), there's a sizeable risk that activity will retreat again.

the PRC and the US are quickening . . .

The US economy, thankfully, seems to have been performing rather more robustly. In the fourth quarter of 2009, GDP is estimated to have grown at more than 5½% per annum. Why were conditions there so different? Was it the irrepressible optimism of the American consumer? The bolder attitude of the fiscal and monetary authorities? Or the fortuitous devaluation of the dollar?

. . . the EU and Japan are slowing.

What caused the difference?

Nobody knows. But it was much the same in the aftermath of the 2001/02 recession. Americans engaged in a frenzied (albeit short-lived) spending spree in 2003, while Europeans and Japanese barely stirred. The ECB and BoJ were compared unfavourably with the Fed then; and doubtless will be again now.

Might it have been currency?

But it's the politicians in Europe and Japan who have most to fear. Their nightmare scenario relates to unemployment. Redundancies hitherto have been kept to a minimum by the prospect of an imminent and powerful recovery. If that expectation were to be questioned, if the illusion of near-term redemption were to be shattered, lay-offs might begin in earnest. Unemployment could soar—15 to 20% of workers becoming jobless! It's possible then that personal sentiment would collapse and a full-scale depression ensue.

Many in Japan and Europe will think so.

To guard against an eventuality of this sort, the ECB and BoJ are likely to be toying with the idea of devaluation. They'll have noted the benefits it conferred on the US (arguably, on the UK as well) and may wish to share them.

But it's difficult for central bankers to change their spots. In the short term at least, they'll risk not being taken seriously. Perhaps it'd be better, therefore, if there were to be a change in leadership.

Europe's monetary union looks unstable.

In any event, there's the prospect of powerful monetary cross-currents. If the Chinese authorities continue to tighten and the American ones begin to do so, credit whirlpools and currency eddies may become commonplace. Anything, in such circumstances, is possible. But most analysts believe the yen will be partially protected by Japan's negative inflation and strong trade surplus. And they expect that sterling, though vulnerable, will be modestly supported by Britain's perceived competitiveness. It's the EU's euro that'll probably bear the brunt of the disruption.

Many will regret its ill-judged foundation!

Germany's industrial virtuosity may prove insufficient to offset anxieties about delinquency elsewhere. The cost of saving Greece will sap the EU's strength for a generation. But the cost of not saving it will dent the Union's prestige for even longer. It's a lose-lose situation. What, one wonders, will future historians say of the *dozos* who designed the system in the first place? Will they be as dismissive as contemporary critics were?

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