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DABERIAM XVI

As always it is interesting to sit and think about the direction of economies. On a global basis economic momentum is slowing. This is a good thing as the last eighteen months or two years' growth rates have been well above a sustainable level. However, the statistics that show slowing economies cause alarm and despondency as a lot of them demonstrate changes in the rate of change. Couple this with the tendency of people to extrapolate in straight lines and you see there is a quick conclusion that disaster is around the corner.

The rate of change of growth in the US from over 5% to probably just over 3% in the current year does **not** necessarily mean that next year will be only 1 or 2%. As things stand the US consumer driven growth appears to have slowed down which is excellent. This will probably have the effect of improving the US balance of trade and taking some of the inflationary pressures out of the economy.

China's rate of growth is also slowing from unsustainable levels, also good news, although some predict the slow down of growth will continue until there is an economic crisis. On the face of it this seems unlikely.

The political climate, however, is less benign. The growth in democracy in various countries and the freedom that this brings is good news economically but as the more free countries appear, it leaves the totalitarian states with fewer friends, and these cornered animals are more dangerous. North Korea is a case in point and sadly the activities of the communist government in Uzbekistan are only too clear a warning of this kind of danger.

The political stability of the world over the last ten years has meant that many in Government have forgotten how rhetoric can get out of hand. Here again there are dangers, the Japanese/Chinese argument over the Japanese school textbooks' reporting of history became over heated. There are many historical flashpoints and countervailing land claims, or should I say, island claims, between two countries. Taiwan's provocative political stance on independence is also dangerous but that said, the Chinese Government is unusual in that many of the best brains in the country are in the Chinese Civil Service and their handling of the country's economy and politics has been masterly in the last fifteen years or so.

Europe as always is producing bizarre economic phenomena. The French Government is going through hoops trying to stop their people expressing their deep-felt negative views of the EU. The German Chancellor is lambasting investment institutions for assisting in the restructuring of the sclerotic German industrial structure. In the UK, the newly elected Government is endeavouring to paralyse the

legislature with a huge programme of new laws, many announced “on the hoof”. The Prime Minister, we heard the other day, wants to prevent football clubs being taken over by “foreign investors”! Government by “sound bite” is the rule. A report comes out saying standards of literacy are declining; the next day an announcement that spelling will no longer be marked in English exam papers. An announcement that people can get burnt by hot water; Government response, every hot water tap (faucet) will have to have a thermostat restricting the temperature etc.!

The election recently fought in the UK was depressing in the extreme. Labour policy by “sound bite”; Conservative policy criticised and then mimicked the same technique. By contrast, the Liberal Democrats excelled in what can only be described as high-waffle policies. While Mr Howard seemed to be bereft of policy or strategy, but at least did have only one Australian political sound bite advisor, Blair’s campaign suffered from interesting conflicting thoughts. Blair seems to be the epitome of US President Warren Harding, a President created at the beginning of the last Century by a lawyer lobbyist and a newspaper editor.

The current worrying political phenomena are a product of global prosperity and a lack of real crisis issues. The danger is that we sleepwalk into some really nasty problems. The growth in the rhetoric of protectionism, if turned into legislation, will cause some nasty self-inflicted wounds on the EU and USA economies.

The Green movement in Germany, while espousing concern for the environment and the virtues of Kyoto force the closedown of another Nuclear Reactor in Germany to be replaced by a coal-fire power station!

Backing away from politics, and barring some unanticipated catastrophe, the major Western and Asian economies are set to grow comfortably. Before the end of this year I suspect many institutions, with their consultants in the lead, are going to have to consider buying equities as any pick-up in growth and/or inflation is going to leave Bonds very vulnerable. In these highly volatile markets with the huge weight of money in Hedge Funds and alternative investments, small movements in sentiment will cause the markets to move very rapidly.

While I understand the Governments around the world wishing to issue very long Bonds, 30-year, and even 50 year, I cannot understand why anyone would buy them; the risk/reward ratio defies any logic for an investment of this duration.

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