

## Tullett Prebon Research, a blog by Dr Tim Morgan

### Don't they get it?

by Tim Morgan on January 11, 2013

A recurrent theme for me this year is likely to be the disconnect between government policy and economic reality, a disconnect evident in the US, in Britain and in Europe. Progress cannot be achieved unless facts are faced, and voters are told the truth.

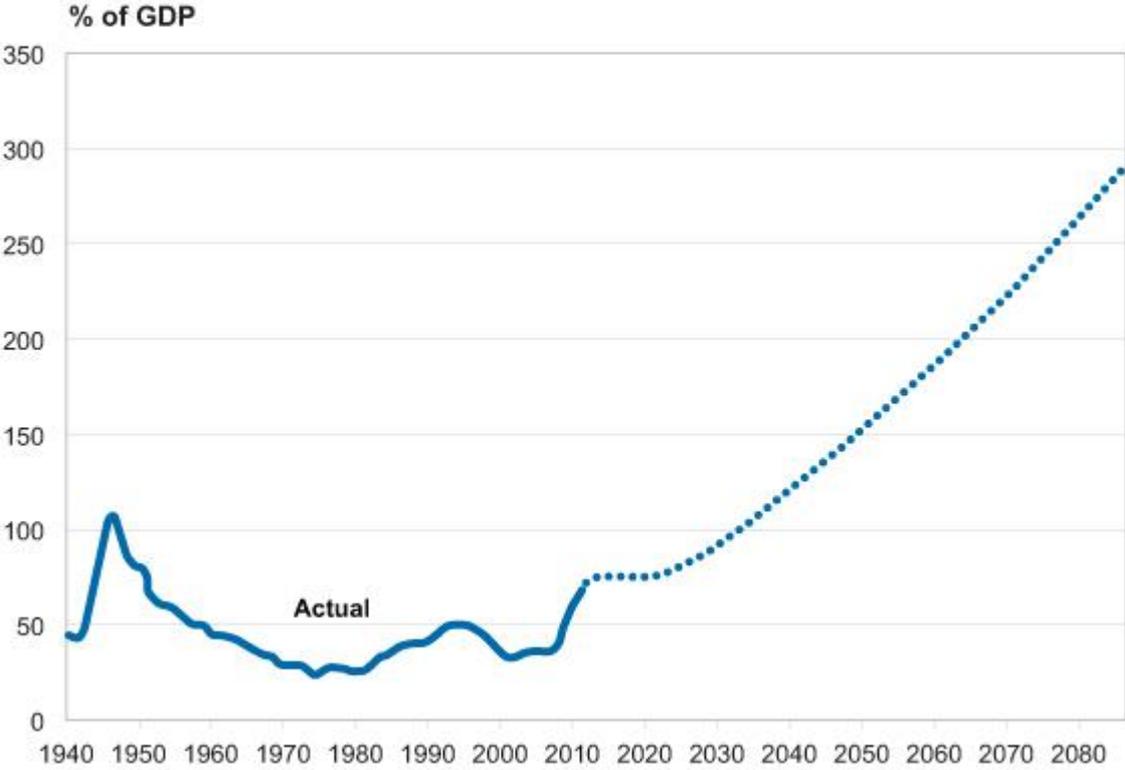
One of the pitfalls which professional historians do their utmost to avoid is the application of hindsight. They must be sparing in their judgments because, whilst the historian knows the eventual outcome, his subjects did not. Even so, some of the things that leaders (and societies) have done in the past remain baffling, and inevitably prompt the "what if?" question.

Why did hard-headed Dutch burghers bid the prices of tulip bulbs up to the present-day equivalent of perhaps £500,000? Why, in the 1930s, with Germany's armed forces still puny, didn't the Western democracies act to stop Nazism in its tracks? Why did Japan attack the US in 1941, when their naval planners knew that a war could have only one outcome? Why did investors bid up no-income, no-cash-flow "tech" stocks whose value could be measured only by the grim statistic of "cash-burn"? Why did regulators in America, Britain and elsewhere ignore the obvious recklessness of their real estate bubbles?

It's easy to scoff at historical blunders like these. But what are historians of the future (and their leaders) likely to make of what is happening in the West right now? One of the biggest problems facing many Western economies today is that political leaders are in near-total denial about the economic and fiscal facts.

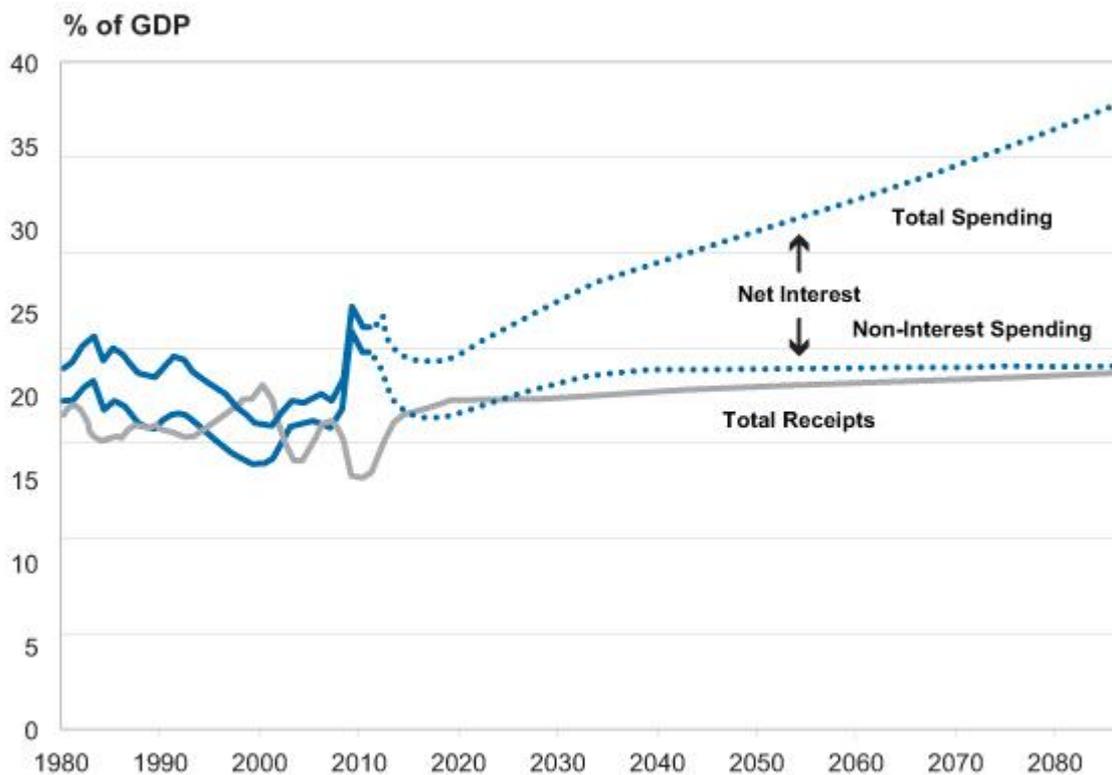
Charts K & L below – taken from official sources – show that the future trajectory of US public borrowing isn't a mystery at all. Debt escalation is baked into the cake. In the absence of fundamental reform, Federal debt has started to 'turn exponential', meaning that it will escalate *of its own accord* (through compounding interest) *even if primary deficits are brought under control*.

History and current policy projections for debt held by the public, 1940-2086\*



\*Source of data: 2011 Financial Report of the US Government, US Treasury Department

### History and current policy projections for Total Spending, Net Interest, Non-Interest Spending, and Total Receipts, 1980-2086\*

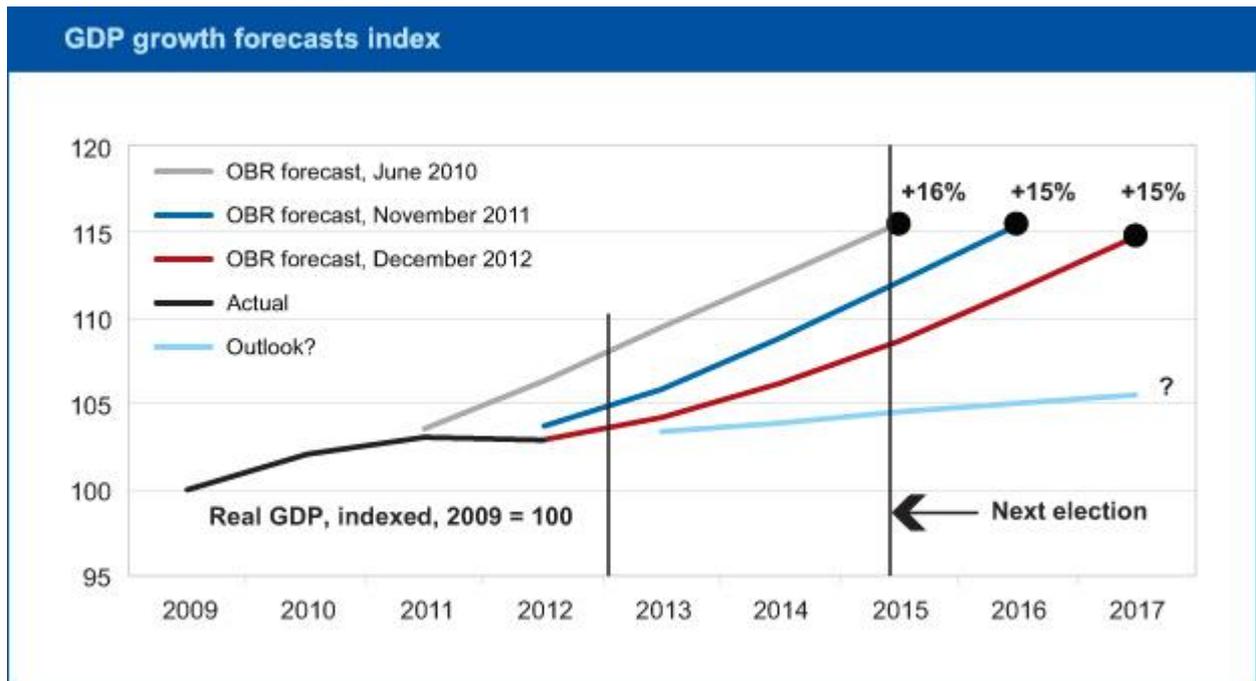


\*Source of data: 2011 Financial Report of the US Government, US Treasury Department

Why, for that matter, are US, UK and other government bond markets still so buoyant? We already *know* that the point is approaching at which government debts can barely be serviced, let alone repaid. We *know* – and we knew even before the Fed and the Bank of England gave us the broadest of hints about dropping their inflation targets – that governments are going to use inflation to destroy the real value of accumulated debts. Having experienced the bitter chapter in which Paul Volcker and others tackled inflationary legacies, we *know* what happens when inflation takes off. We *know* that inflation steals value from investors and the general public.

Faced with this, has Congress, or Parliament, taken resolute action? No. Instead, the surreal idea of minting a \$1 trillion dollar coin has been given serious air-time. You really couldn't make it up. In Britain, a government fearful of unpopularity has retreated into a Micawberish assumption that "something will turn up". Well, something will indeed "turn up" – in America as well as in Britain – but it isn't going to be something that we're going to like.

Don't worry, says Britain's Office for Budget Responsibility (OBR). Growth will arrive, despite all evidence to the contrary. According to the OBR, the economy is always going to be about 15% bigger five years from now, the only problem (see chart below) being that "now" keeps being pushed ever further into the future.



In her *Adventures In Wonderland*, Alice grew to a much greater size by drinking from a bottle labelled “Drink me”. Where growing the economy is concerned, governments in America, Britain and elsewhere are still trying to find the magic potion. Some think it’s labelled “austerity”, whilst some think it’s “stimulus”.

Both have been tried, and neither has worked. Stimulus? Britain has run deficits of 35% of GDP over four years, has printed £375bn (25%) through QE, and has run near-zero interest rates since 2009, yet the utter failure of the stimulus elixir hasn’t stopped some (like Ed Balls) calling for another, bigger swig from the bottle. Austerity? Better ask the Greeks about that one.

In short, our current economic model has failed, and there is no going back to Keynesianism. So why isn’t someone crafting something new?

Where politicians are concerned, it seems that anything – even minting a \$1 trillion coin – is preferable to facing facts.

Yet the facts are simple enough. Britain and the US are much poorer than they were. In fact, since the pre-2008 “boom” was actually borrowing masquerading as “growth”, it’s truer to say that they are poorer than they thought they were. These are borrowing-junkie economies, incapable of growth in the absence of continuous debt fixes. Take away even half of the deficit (which is what the fiscal cliff really amounted to) and you plunge the US into recession. Cut just £3bn from a £200bn benefits bill and you are accused of heartlessness. Where is the reality in any of this?

It would be all too easy to dismiss British and American politicians (of all persuasions) as being blissfully ignorant of the economic realities. In fact, I suspect that some may be all too well aware that they are presiding over failed systems for which the only question is “when”, not “what”. Their last refuge, it seems to me, is to put off the evil day for as long as they can.

Personally, I believe that the British and American electorates could face the facts if these were put before them truthfully. But truth, as many politicians know, is a dangerous substance, best handled with care – and saved for special occasions.