

Murray's Market Letter

We read the other day (Ruth Lea in the Spectator) that "Very hard decisions will have to be made if the public finances are to be rectified." The writer (referring to Great Britain) is not alone. Politicians, economists and all manner of experts throughout the English-speaking world are saying pretty much the same thing, namely that, given the will, things can be fixed.

It's amazing, but nobody has the guts to say it's too late, the situation here, there and everywhere is too far gone to be fixed. The three most touted remedies for government finances (cut public sector spending, raise interest rates or raise taxes) are just not going to happen. Policy makers may try, but any such moves will backfire. After all, the only thing that has recently kept most of the Western world (certainly Britain and Canada) alive has been ever expanding public sector largesse. Right or wrong, the beneficiaries have been the people who have driven housing, car markets and so on for the past decade. Cut largesse and you cut GNP, you cut tax revenue and face higher unemployment costs.

Cut the handouts and we would have the opposite of the situation which prevailed in the 1950s in America when more jobs meant more cars, more overtime at GM with autoworkers buying more houses, this in turn being good for Weyerhaeuser (lumber) and GE (refrigerators) with their workers in turn earning lots of overtime and buying more cars. Good times begat more good times. America was so prosperous that foreigners had to pay a tax for the privilege of holding US debt, whereas today there are 35 million Americans on food stamps.

Raising interest rates is also a non-starter. We are all so indebted, so broke, that we can only pay the existing interest burden by relying on the printing press. The US, for example, with about \$12 trillion (and rising) of government debt, would face an extra \$120 billion on the budget deficit for every 100 bp increase in rates. It boggles the mind to hear respected economists blithely forecast much higher rates if, say, (official) inflation picks up.

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As for raising taxes, well, it's not on politically or even economically. Raising the tax rate is only likely to damage the tax base and produce no net benefit to government finances. Interestingly, Germany (no stranger to deficits) recently proposed a €35 billion tax cut, certainly for political reasons, possibly to help weaken the Euro. This leads to...

The one remedy policy makers will try in their efforts to improve government finances: devaluation. But at the end of the day this will only cause more speculation, manipulation and churning of currencies. There will be winners and losers, but, on balance, the cost of doing business will be increased.

As never before, policy makers are damned if they do and damned if they don't. The economy reminds us of the guy who goes for his medical check-up with scans and all, and is advised by the doctor that lung cancer is galloping through his system. The guy says "I guess I'd better quit smoking" and the doctor replies "Why quit now? The damage is done, there's nothing we can do at this stage." That's like our economic system today, but officialdom won't admit it.

But the gold market knows it. It seems to be giving us three messages. 1) The Indian purchase must surely, once and for all, put to rest the idea that gold has been demonetized. On the contrary, its monetary role is returning with a vengeance. 2) Gold at new highs (in nearly all currencies) is stating that the economic problems are un-fixable. 3) Gold is leading a global flight out of money. Other commodities will follow, and also hard asset refuges such as the better parts of stock markets.

Cutting loose from Bretton Woods forty years ago permitted finances to go haywire and now the Western World is starting (just starting) to pay the price. Dreams of "fixing" the system must be replaced with a pragmatic, hard-nosed survival mode. And that doesn't include holding currencies, any currencies.

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