Funding the Future

It's the coincidence of sentiment that provokes fear in...

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I wrote this in 2o10:

The quantitative easing programme might be considered a short term success, but as we note, the benefit has been captured almost entirely by the financial services sector whilst further asset boom and bust cycles are, at least potentially being recreated with resultant risk to the economy. These are undesirable long run outcomes when the real aim is to get the UK economy working again.

Sometimes the long-term takes a while to arrive, but it always does. Yesterday saw the biggest fall in tech shares in the USA since February 2009. Overnight the Far East markets moved into bear territory for the year, with 20% falls in value being recorded this year in some cases.

In the short term the primary reason for such moves is fear. That fear is well founded. Look at the risks:

* Trade war;
* Populism;
* The end of international cooperation;
* Brexit;
* Rising dollar interest rates tipping many countries into debt crisis;
* Excessive personal debt in far too many countries;
* Trump's wholly artificial tax boost to the US market losing its impact;
* The impact of quantitative easing on asset prices unwinding;
* Strained middle east relations;
* Rising oil prices that almost always signal the onset of a downturn;
* Falling consumer confidence.

It would be easy to expand that list. Each of these factors creates a risk. They are all happening simultaneously.

Of course, there is no reason why markets should collapse now. But there is rarely a specific reason why markets should collapse ever, barring one thing, and that is the coincidence of sentiment that provokes fear, and mass selling. Whether that is what is happening at present is hard to say. But the possibility is real. So far markets have fought back against a collapse: each downturn has seen a recovery, almost certainly as short sellers have taken profit. Whether that remains possible is open to doubt.

There is good reason for saying that. The fundamentals of the excessive market valuations for shares to which I have drawn attention for a long time all relied on reality being ignored. One of those realities that was ignored was QE: the money it delivered into markets papered over the cracks of 2008. 2008 was the second reality that was ignored: it revealed that the prevailing economic logic in use was time expired, but this fact has been ignored and the system has been maintained on borrowed time. Third, institutionally money has been programmed to arrive month in and month out to prop up failing stock markets, because that is what pension and life assurance contracts do, even when it is against the interests of those paying the premiums for that to happen.

The difficulty always comes when the realisation dawns, collectively and often in unison, that markets have not reflected the underlying facts that were apparent to all who wished to see them in the market, but which were collectively ignored. The reality is that:

* Markets are failing to meet the needs of many: relative poverty is growing even if absolute poverty is declining;

* Markets are not answering the big questions about our future, such as how to tackle climate change;

* Markets are being rigged for the benefit of a few, and this is now obvious;

* Markets are opaque and have collectively deceived society;

* Banking is not delivering appropriate credit for the creation of new, real economic activity;

* The belief that the government has had to stand back and let these failing markets function has been incorrect;

* There is no popular political narrative to support an alternative to failed markets meaning that when the realisation finally dawns the chaos is more worrying;

* A period of adjustment is, then, inevitable.

If that period of adjustment is not starting now it will be soon. What we have cannot be sustained any longer. We are in for a deeply uncomfortable ride.