

Money Matters

A series of weekly articles by Quintas Experts

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DON'T LOOK BACK in anger

In the last few weeks as markets fell sharply and focus returned to the financial soundness of individual banks it was hard not to feel some sense of déjà vu to the Lehman Brothers collapse which precipitated a global credit crunch. The response to that crisis from policy makers was swift as interest rates were slashed and governments stepped into the breach and enacted policies to shore up confidence.

It is now 3 years to the month since that crisis and as current events suggest a negative feedback loop reminiscent to 2008 it is worth revisiting the actions of policy makers.

Economies are made up of consumers, companies and governments who interact to produce economic growth. To produce sustainable growth the activities of consumers and companies (private sector) are most important with governments assuming a regulatory role smoothing out shocks and partially regulating the distribution of economic growth.

Post September 2008 governments globally were forced to assume a more central and active role, most keenly illustrated by the number of banks which were fully or part nationalised. Consumers and companies embarked on a huge deleveraging process focused on paying off debt and halting spending. Importantly, many governments embarked on spending programs and commitments to lower interest rates compensating for deleveraging in the private sector and keeping economic growth supported.

Three years on and reversals of government actions have facilitated the current crisis. Firstly, the European Central Bank increased interest rates and the EU proved unable to coordinate a response to debt worries. Secondly, the US government has begun to row back in its commitment to spending. The backdrop is that the private sector is only partially through its deleveraging process and is neither borrowing nor spending. This combination will only lead to deflation and continued erosion of confidence.

Government leaders need to depart from loose bureaucratic management. Strong commitments to lower interest rates and higher government spending are needed to allow the private sector to readjust their balance sheets, pay back debt and regain confidence that in time will allow them to spend and invest and provide a sustainable path for economic growth.

Government spending is not sustainable in the long term (unless we wish to move to a utopian Communist society) but at this moment in our brief free market history it is the only show in town and vital to keep the global economy on an even keel.

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