ausnomics • FLASH update

30/10/2009

Crack the Champagne, the US is out of Recession

…but you might want to hold that thought. The announcement last night that the US had posted GDP growth of 3.5% should spur markets on in the short-term and temporarily delay the correction, but a quick glance at the numbers reveals things are not as rosy as it seems. Growth in GDP was led largely by the 'cash for clunkers' program which contributed 1.7%, or 48% of total GDP growth, with a large part of the remaining growth created by the government's $8,000 tax credit for first-time home buyers. It is important to understand that these types of government initiatives do not create lasting growth, they create 'statistical growth'.

When the government pays for someone to trade in their 'clunker' – a vehicle that is still functioning and probably could keep functioning for years – they are paying someone to destroy their property, something with real value. The short truth is that the destruction of anything of real value is always a net loss, a misfortune, or a disaster and whatever the offsetting considerations in a particular instance, can never be, on net balance, a boon or a blessing.

So while 'cash for clunkers' created positive gains according to GDP, a figure which measures all spending regardless of how destructive it is, it will not improve the long-term wealth (growth) of the nation. In summary, the latest GDP figures are nothing but a short-term burst of consumption created by the government. In real terms, taxes increased, personal income fell, disposable income fell and the savings rate sank, all while personal consumption increased, paid for by an increase in the federal deficit. This will not create lasting growth.

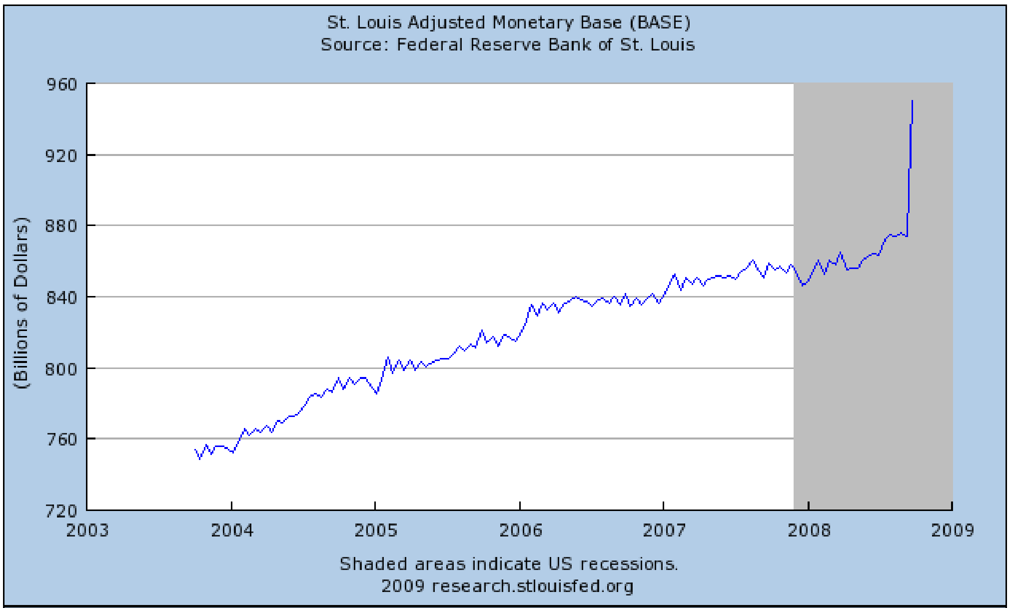
Australian CPI Up; Rate Rise Imminent

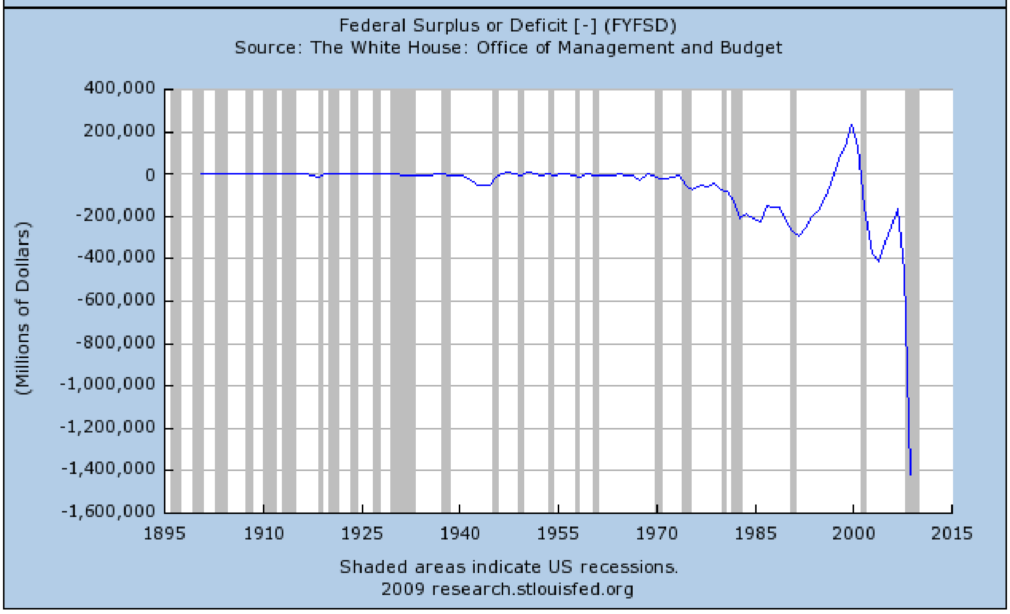
The latest CPI figures indicate that price inflation is coming (the 'basket of goods' the RBA measures increased by 1% QoQ) and the RBA will respond by hiking rates by an (*estimated*) 25 basis points on Melbourne Cup day in line with their inflation-targeting policy. We expect CPI inflation along with subsequent rate rises to continue into the new year.

What most people don't realise is that the RBA is the culprit – rising prices are occurring because of the *monetary pumping* and *financial sector bailouts* the RBA engaged in back in late 2008/early 2009 as discussed in the October edition of Ausnomics. Inflation (monetary) is indiscriminate; its effect will be different on different parts of the economy. The same monetary pressure which in some parts of the economy may have reduced unemployment will in others produce definite and disastrous inflationary effects. The aggregate thinking and disregard of the economy's capital structure by academics, the RBA and the government necessitates that these important implications are neglected.

Market Correction is Happening Now

The United States public and mainstream media are finally waking up to the fact that their government has been recklessly spending, creating massive new 'initiatives' (i.e. health) without funding them, dishing out cheap credit to politically favoured sectors and telling businesses where and how to invest. Unfortunately the Australian media still has no clue that we have been doing exactly the same – the smokescreen that is China and the resources industry is, so far, covering up the evidence.





The Fed has been (not-so)secretly bailing out the banks with massive reserves that they pay interest on. It is actually quite amusing – economic fascism at its best! The Fed gives banks cash, pays them to keep it at the Fed/buy Treasury bonds (you see if they spend it – like the Australian banks have already done – it creates 'price inflation'), the banks simultaneously write off their bad debt and make a profit to boot. They then pay themselves big bonuses which the government criticises them for: funny, as all of that free money was dolled out to them by the government in the first place!

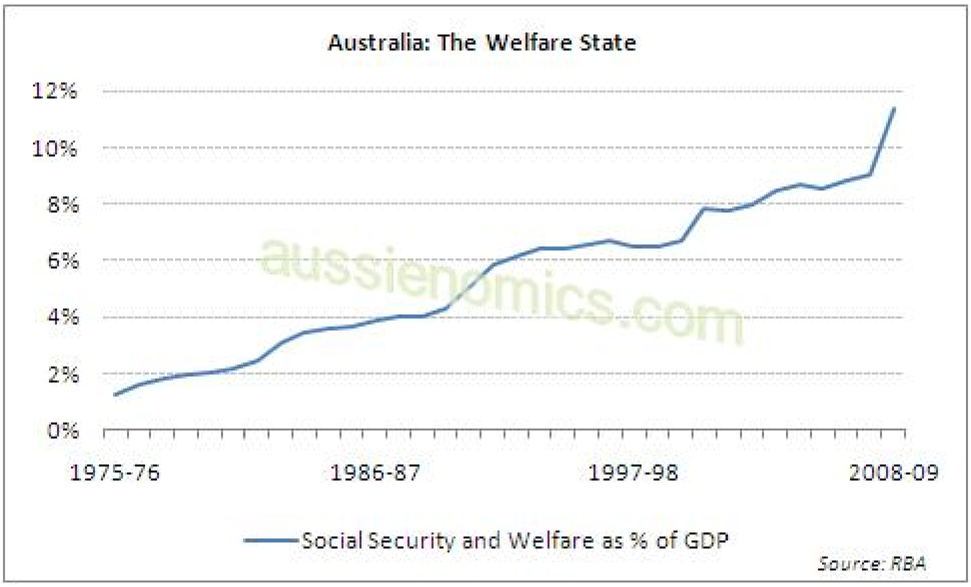
All of this bad news and growing anxiety could see the Australian market, as it has historically, follow the US-led correction.

Growing Public Angst

General Motors has asked for even more federal money to keep them going – surely the better option was to let them fail and allow the good parts (yes, they still have a lot of good assets and employees) to be bought and for the rest to necessarily liquidate. Unfortunately the government has declared their hand and they have to follow through to the end, something the public is growing concerned about. Further doubts about the health of the recovery will be raised over the next couple of months which should temporarily push the bulls to the side.

Australian welfare state keeps growing and growing and growing…

The big question is: how are we going to support this when resource prices eventually crash as they did back in the 1970s? Will we have another decade of double digit price inflation as the RBA tries to inflate away our public welfare, debt and other obligations?



Unless this trend changes, that is the most likely scenario. Rudd's national healthcare policy (no doubt to be unveiled as an election promise) and emissions trading scheme, if successful, will only add to the nation's commitments and future debt levels. Australia simply cannot afford these 'initiatives' – the resources boom won't last forever and the nature of politics is to spend spend spend with little regard for the future. As the late Dr. Adrian Rogers said, "…the government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for, that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it."

…Now for Some Political Economy: Why More Government is Not the Answer

To quote Gordon Gecko, the fictional character from the movie Wall Street, "greed is good!" The world runs on individuals pursuing their separate interests. History has shown us time and time again that the only way in which people have escaped from poverty are where they have had capitalism and largely free trade. If you want to know where people are worst off, it is exactly in the kinds of societies that depart from that. There is no alternative way of improving the lives of ordinary people than the productive activities that are unleashed by a free enterprise system.

As Adam Smith famously said in the Wealth of Nations (I.ii.2: pp 26-27), "…it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages."

Ask yourself this: how is political self-interest somehow better than economic self-interest? Where are these omniscient angels going to come from? With capitalism, the only people who can rise to the top and stay there are those who consistently meet the changing demands of the consumers. Under economic competition, people compete (earn economic profit) by best serving the consumer. By contrast, the worst tend rise to the top of the political ladder as there is a tendency for these people to both desire power and be effective at using it. Under political competition, politicians compete (earn political profit) by supplying wealth transfers to interest groups through legislation and regulation.

Just remember that the free market or "excessive greed" did not cause this crisis; political self-interest, market interventionism and mercantilist policies did.

And with that, have a great weekend!