Reading the Runes for 2012 - What's that coming over the hill!

It's been nearly four years since the high speed credit engine ran out of rail in 2007, and several triple **A** first class banking carriages were taken back to the depot for major repairs, costing the British taxpayer £64bn.

The Bank of England, controller and protector of the UK financial system, was quick to chastise both greedy drivers and inept conductors' and their regulatory network that had not built in sufficient safety measures. It hurriedly constructed a temporary safety lane (quantative easing) by swapping electronic cash for debt to 're-fuel' the banks with fresh capital, creating cash buffers which, in turn, kept interest rates low.

The government's 'it wasn't me guv' appeal for alleviation based on the premise that nobody could predict that the 'credit-train' would actually crash, was dismissed by the press and public alike. Even an elementary knowledge of banking practice would have revealed the inevitable end-game, given the scale of 'off balance sheet' liabilities, an over-borrowed Western economy, collapsing US property prices, a record hike in oil prices and a 'light touch' (tell us when you're in trouble) regulator.

The EU Failed to Engineer a Breaking System

Four years of under-investment and over cautious spending later reveals that our major corporations are swimming in cash, the banking system has been stabilised and global GDP (driven by Eastern consumer demand) is at twice its' level of ten years ago. The stage should be set for global recovery particularly as Eastern economies continue to expand and green shoots start to appear in the US where private sector hiring increased by 325,000 people in December and car sales were up by 8.7% in 2011 over 2010.

Yet Europe's braking system has not stopped its sovereign carriages from running out of track. Now, with almost all Europe's economies carrying large numbers of passengers simply not capable of paying their fare, bankruptcy is still definitely the cards. Such was the state of Euro finances that Chancellor Merkel's attempt to go 'cap in hand' to Obama, (who is trying to bail out his own 'debt-train' in an election year), have failed.

To make matters worse a global 'whip-round' by the International Monetary Fund revealed there is insufficient spare cash among the western economies to contribute, and the hope that China can take some €300bn out of its bedroom drawer to lend to its ailing western customers, has largely faded.

We now rely on the Europeans Central Bank's policy of printing money and 'lending it' to vulnerable banks, to buy the debts of our ailing European brethren, to bail us all out. The emergency services have invoked the final disaster recovery plan, and it HAS to work.

Will we Gently Hit the Buffers?

The major British and European banks are well capitalised – pumped up by their central banks, they have plenty of cash to withstand the super-winds of a 'normal' recession. However no system could survive the default of major customers such as Spain and Italy, and the consequential trail of banking bankruptcies, and loss of export revenues that this will cause. With a potential bail-out in play it's still 50-50 as to whether the train will gently hit the buffers or smash through the terminal at the end of the line. Quantitative Easing can't go on forever, can it?

Sources –
* This is Money.com
**Liveoilprices.co.uk

What the Analysts Think is Likely to Happen

Analyst's estimates are wildly unreliable. For example in March 2011 analysts were predicting an imminent rise in interest rates and modest growth - both predictions were abandoned one month later. Here we discuss some of the current predictions.

1. It is likely that interest rates will remain low until 2015?

The Centre for Economics and Business Research has predicted interest rates will remain low until late 2015, although analyst's opinion ranges from 2013-2016. Most are agreed that the going will be tough for 2012 Investment in new plant, and technology will be cautious and household demand will continue to be depressed, particularly as public sector redundancies kick in.

However the markets are already signalling a fall in Treasury prices which indicates that money is on the move back into shares, while the US has ended its quantitative easing programme, signalling perhaps that interest rates will rise sooner rather than later.

2. It is likely that inflation will continue to fall? – inflationary pressures still persist.

Inflation reached 5.2% (RPI) in October, and fell back to 4.2% in January, and is predicted to return to its 2% target by 2013.

In the past, predictions have been woefully inaccurate. While in the short-term inflation may fall, there are indications of longer term inflationary problems due to the devaluation of sterling (which has depreciated by 25% since 2007), and the effect of quantitative easing. (It is estimated by Fathom Group that QE has raised UK inflation by between 0.75% and 1.50% to date)*.

Given that a US recovery may be underway, and that sterling may well devalue on the foreign exchanges further to encourage exports, the dollar may strengthen against sterling. As world commodity prices are priced in dollars, this will increase input costs, pressurise margins and increase factory prices. In turn this will dampen demand, if this occurs it is likely that inflation will exceed the 2% rate predicted in the longer term.

The immediate concern is that the economy will stagnate and price rises will occur in any case – stagflation – as happened in Japan.

3. It is Unlikely that Fuel Prices Will Rise?

Oil prices climbed around 14% in 2011**, and Global Energy Studies predicts an average Brent crude price of $111 for 2012. However oil prices will be affected by recession in the Eurozone and will be pressured downwards, although it is felt that OPEC will reduce production to maintain high prices and the boom in Eastern economies will continue to keep prices at around current levels.

The global jury is out on oil prices, which have traded between $104 and $128 per barrel in 2012. Analysts maintain that if oil prices breach these upper limits, it may tend to keep going northward.

Sources –
* This is Money.com
**Liveoilprices.co.uk

Business Levels to Rise?

Many corporate balance sheets are cash rich, having preserved cash to repay debt and bolster their share value. The manufacturing sector (which has declined its share of GDP from 25% in 1990 to 15% now) is looking good,expanding on the back of a 6.9% rise in exports for 2011.

Significant export potential remains. The UK exports three times as much to Ireland as it does to China, which is now the largest global car market and is forecast to continue to grow further over the next two decades. However some consider China to be 'wild territory' with little regulatory or legal protection for foreign investors.

Smaller organisations have, up until now, feared that investing in agencies in China is high risk and would rather consider other options such as the Middle East, the U.S., South America and South Africa. Nevertheless China is sucking in imports of over $1.4 trillion dollars worth of goods in 2011 and now houses global manufacturers, has an aggressive infrastructure building programme and a cash surplus of over $3 trillion. As marketing, financial and legal frameworks become more stable and familiar; China will represent a lower risk profile and become a more attractive proposition for exporters.

ECB Holds the Key

It is the European Central Bank (bolstered by IMF Funding) that holds the key to all our prosperity in 2012. It has adopted 'quantitative easing' by printing billions of Euros to create liquidity, improve their bank's balance sheets, buy government debt and depress interest rates.

In return the ECB is demanding greater control over domestic budgets, and will probably get it, as their over-exposed members including France, Spain, and Italy will prefer to succumb to a higher authority than suffer Armageddon.

Should the ECB succeed it will herald a new age of fiscal control, so sadly lacking in the Eurozone, but so well demonstrated at the Federal Reserve in the US. Yet, in any case, it will still take many years for beleaguered countries to repay their debts, and so we can only look forward to subdued Eurozone growth over the next five years.

It's likely that the EU will avoid meltdown, and although Government measures will be ultimately be effective they will take time, probably five to ten years before debt is diminished and investment fuelled growth takes hold.

In the meantime trends are indicating a gradual swing towards recovery, and if this occurs the biggest fear will be a surge in inflation, which can only be defeated by an increase in productivity brought about by investment in more efficient infrastructure and technology.

As for the UK, success will depend on our ability to fuel domestic demand by ploughing cash into modernising our infrastructure, the pace at which we can marginalise our energy import bills (for both oil and gas) and promote our exports.

It's ultimately down to the entrepreneurial spirit of the manufacturers, service providers and their supply chain to identify and take advantage of new markets, and invest in the right plant, technology and people in order to improve productivity and the quality and timely delivery of products and services in order to engineer profits and growth.

Sources –
* This is Money.com
**Liveoilprices.co.uk