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The Course of the Exchange

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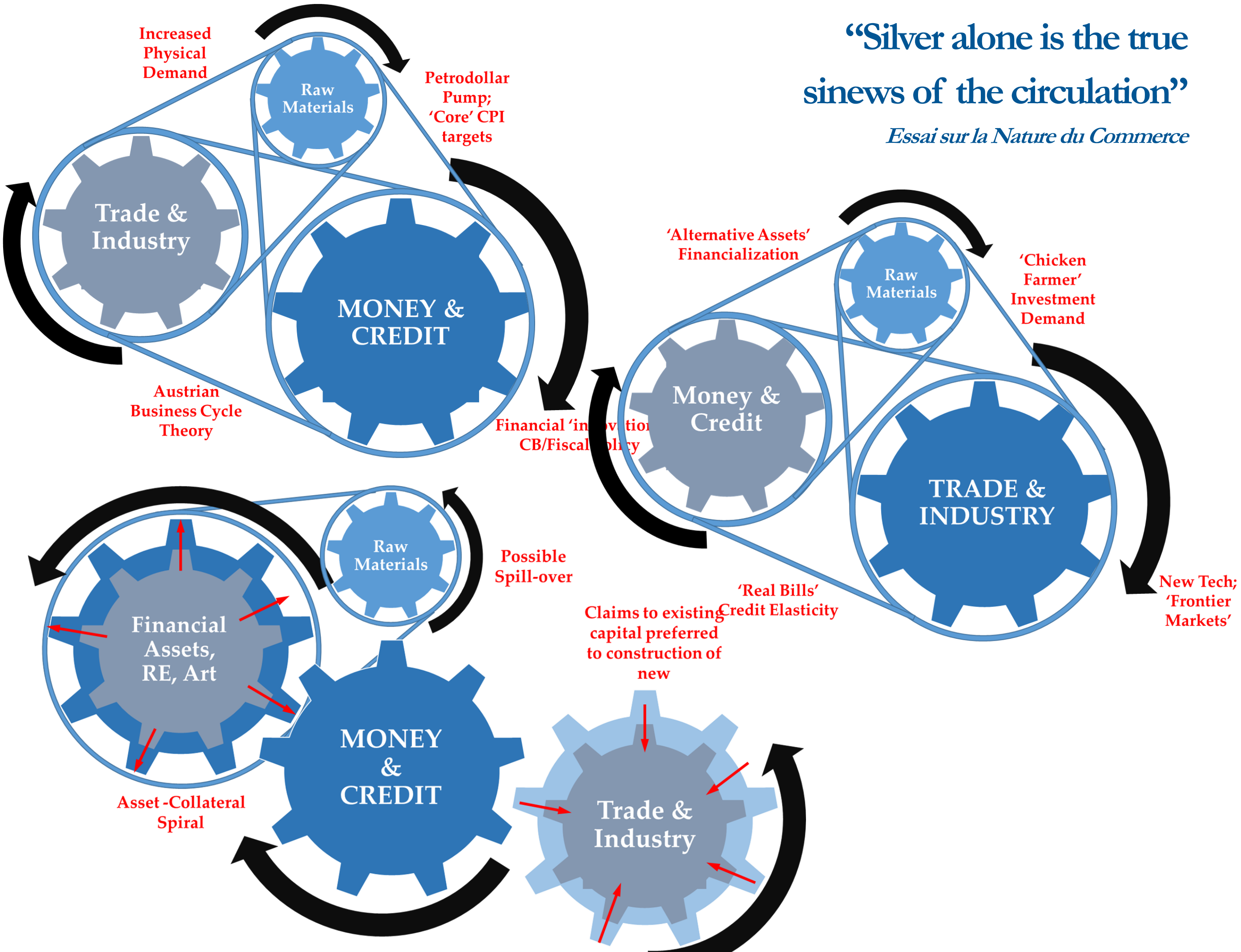


"Silver alone is the true sinews of the circulation"

Essai sur la Nature du Commerce

Volume I, Issue IIa

A Great Deal of Ruin

The Johnson government's approach to COVID19 has been a toxic mix of contradiction, vacillation, and jack-booted authoritarianism. There seems to be no exit strategy and no end in sight to the spiralling cost.

England, however, as it has never been blessed with a very parsimonious government, so parsimony has at no time been the characteristical virtue of its inhabitants. It is the highest impertinence and presumption, therefore, in kings and ministers, to pretend to watch over the œconomy of private people, and to restrain their expence, either by sumptuary laws, or by prohibiting the importation of foreign luxuries. They are themselves always, and without any exception, the greatest spendthrifts in the society. Let them look well after their own expence, and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will. Adam Smith, The Wealth of Nations, Bk II, Ch III

A Great Deal of Ruin

The headline, year-to-date drop announced this week in UK GDP was bad enough at -21.8% (do NOT even think about annualizing any of these numbers, as they routinely do in the US!), but there was worse buried within them, as just a little digging would quickly reveal.

For instance, to focus only on the quantity relating to government consumption expenditures, one finds they jumped 15.3% in the first half of the year when measured in actual £-s-d but simultaneously DROPPED 17.9% in real terms – i.e., after adjusting for price changes.

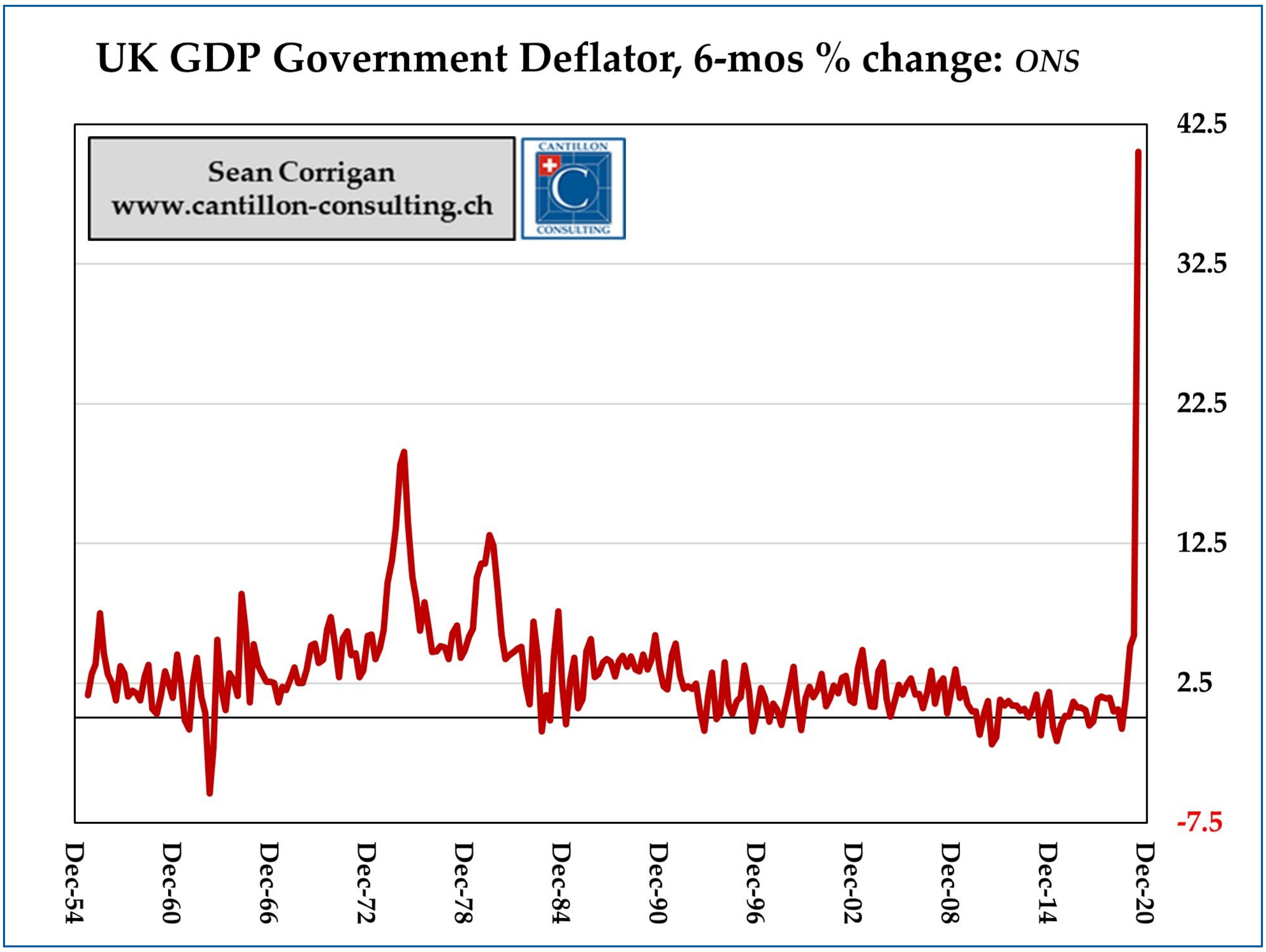
Now admittedly, since they lack any sort of free-market price, the issue of trying to assess the 'value' of the activities which the government undertakes, as well as of the products it provides (whether we like it or not), is well known to be problematical. But, nevertheless, this combination implies that the price of Leviathan's 'services' soared 40.5% in six months, an astounding leap of more than twice the scale recorded during the worst inflationary period of the 1970s.

By contrast, the remaining , private components of the aggregate showed little difference between the two measures, undergoing a 22.2% nominal drop, a 22.8% real decline and therefore involving an insignificant 0.7% imputed price rise.

Government spending of such a devil-may-care nature is, of course, doomed to continue at these elevated levels throughout the duration of the 'War on COVID'. Even once the 'emergency' has passed, it will maintain a far stronger presence than heretofore, given all the 'New Normal', 'Build Back Better', 'Green New Deal' ambitions being vaunted by our political classes. Thus, the degree of waste and inefficiency implicit in these latest numbers is hardly reassuring for a country which has still not managed to overcome the damage to its finances wrought by the shuddering, 2008 end to the 'End to Boom and Bust' so hubristically declared during the first decade of the millennium.

To put matters into some sort of perspective, we can note that, over the first semester, for every £100 in the GDP total registered as being spent by the private sector, a record £36.10 was doled out by the state at those same rapidly-inflating prices. Two short years ago, the proportion was £22.80, some 35% less. Even the worst recessions of the past 65 years for which we have data pale into insignificance by comparison; the GFC's peak ratio being ~20% lower and the mid-70s debacle (which, some may recall, led to the country calling in the IMF for assistance) coming in close to 30% below the latest quarterly highs.

As we frequently note, informed of 'Gentleman Johnny' Burgoyne's epochal surrender at Saratoga, Adam Smith languidly remarked, "*There's a lot of ruin in a nation*." Boris Johnson and Rishi Sunak seem determined to find out just how much that is by pursuing their illusory Zero Covid policy and by promulgating their Narrative of Fear to a populace held in thrall to what we call 'Anti-Stockholm Syndrome' – that severe mental derangement where you become so infatuated with your captors that you refuse to contemplate doing what the sensible Swedes did.


UK GDP Government Deflator, 6-mos % change: ONS
Sean Corrigan
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42.5
32.5
22.5
12.5
2.5
-7.5
Dec-54
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Dec-66
Dec-72
Dec-78
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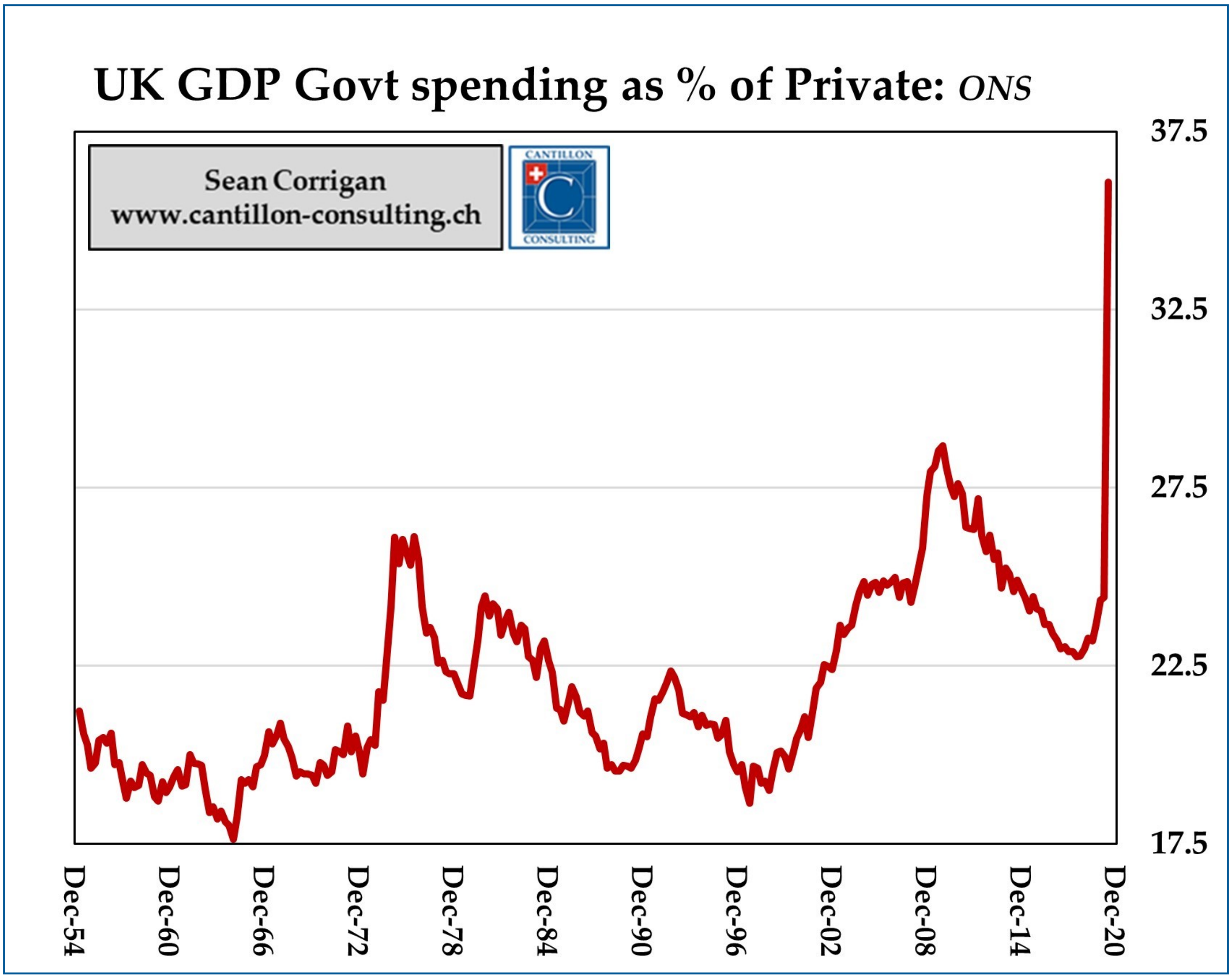
UK GDP Govt spending as % of Private: ONS
Sean Corrigan
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37.5
32.5
27.5
22.5
17.5
Dec-54
Dec-60
Dec-66
Dec-72
Dec-78
Dec-84
Dec-90
Dec-96
Dec-02
Dec-08
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Dec-20

Missing the Target

In all, the UK has so far suffered around 50,000 statistically excess deaths 'with COVID19 mentioned on the death certificate'. Six out of seven of these were 65 years of age or older, one-third of them succumbed in care homes and one-fifth in the hospitals where Scottish evidence suggests they probably caught it in the first place.

By contrast, data from a multitude of national samples implies the now infamous 'case fatality rate' for the general, under-65 population to lie somewhere around a fairly unexceptional 1 in 1000 – or 0.1% - mark.

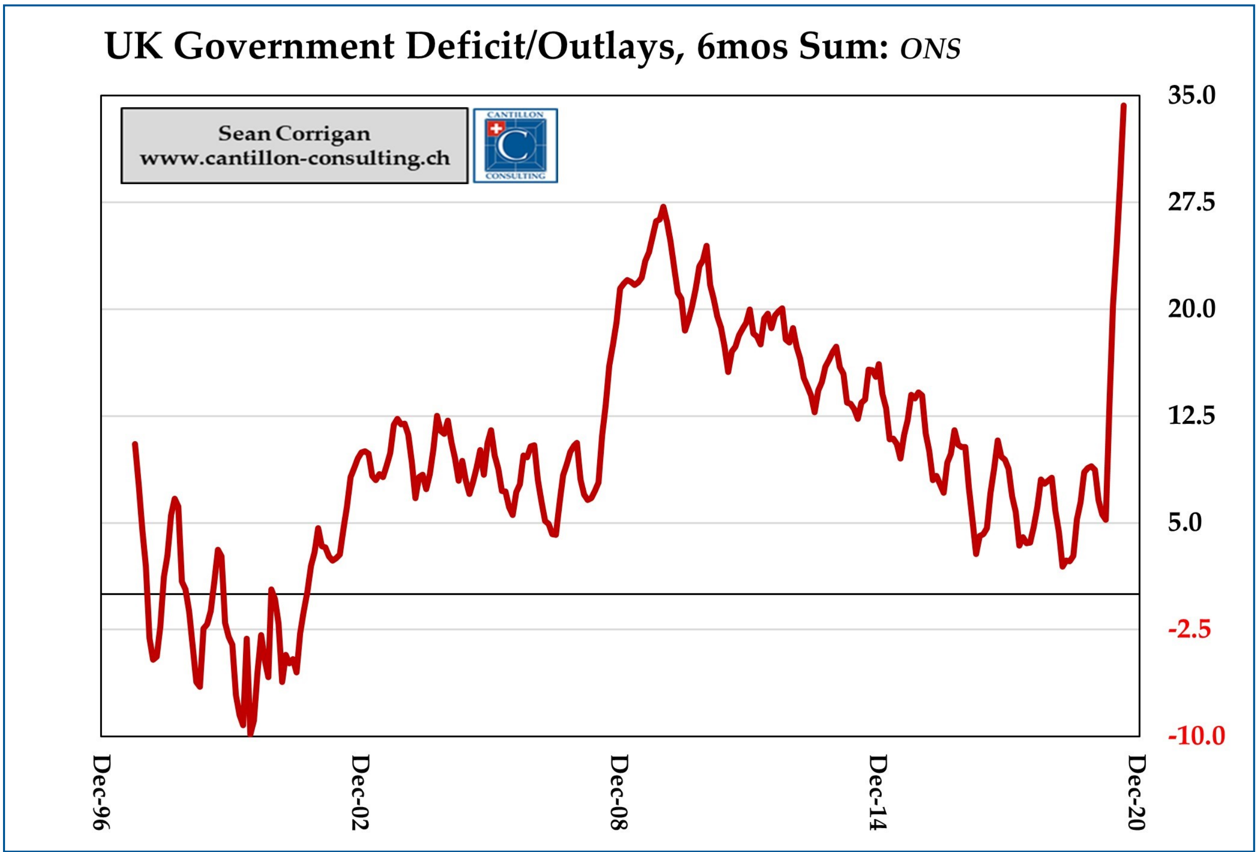
So what we have here is a disease largely of the very old, the very sick – or both; one, moreover, whose spread has been highly nosocomial – by which we mean that a good number of the worst afflicted contracted the virus in a setting where their health and welfare were supposedly being professionally looked after.

At the same time, government has borrowed almost £150 billion more than it did in 2019 (and, in QII, effectively borrowed ALL of its contribution to GDP). The somewhat cold, but nonetheless unavoidable, arithmetic leaves us to reckon that government has therefore spent almost £3 million per death - and counting.

Do you suppose better management could have lowered both the death toll AND the cost? For example, by concentrating efforts – as the undeniable evidence (and not the Chicken Little epidemiological models) strongly counsels us to do - on protecting the identifiably vulnerable, treating the sick - with or without COVID19(84) – and setting everyone else free?

Deep Impact

Even before the Johnson Junta – and its satellite Sanitary Soviets in Wales, Scotland, and Northern Ireland - became fully committed to the latest programme of curfews, travel restrictions, and their accompanying interdiction of normal social intercourse, full fiscal year projection for UK borrowing even *before* the July package was a startling £370bln. We are thus still very far from putting a brake on



the consumption of the nation's scarce capital.

In this last quarter or so, the UK government has already passed the first Bernholtz yardstick of not covering more than 60% of outlays with revenues and is well on the way to meeting the second by running a deficit fast approaching 25% of GDP. The significance of this is that these are thresholds which the good professor's work suggests are commonly crossed by countries in immediate danger of undergoing hyperinflation.

The basic mechanism for an outbreak of that devastating economic pathology is that a government whose finances are in such acute disarray cannot hope to cover the gap through taxation or by tapping into the nation's savings. It must therefore resort to the printing press, however self-defeating it must know that ultimately to be.

It is therefore chastening to learn that, during April-August inclusive this year, the combined public borrowing requirement has reached £174 billion; total gilt issuance, net of redemptions, has amounted to £238 billion and the Bank of England's take-up, via its innocuously named, 'Asset Purchase Facility', has, not entirely coincidentally, come to £242 billion (to which sum another $12 billion was added in September).

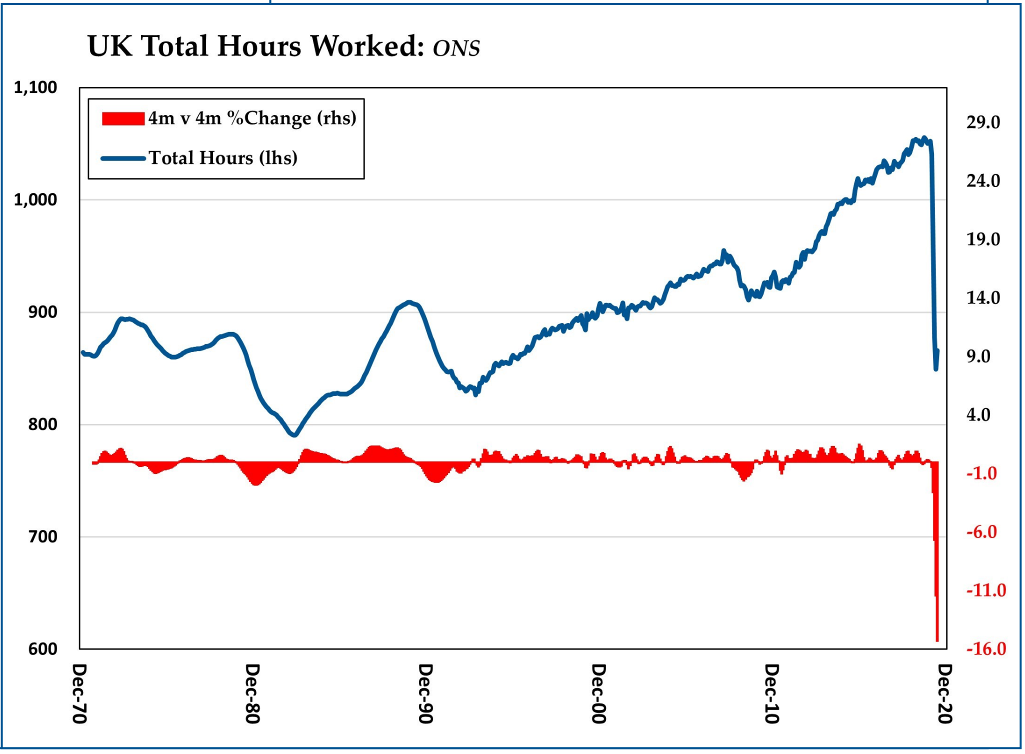
This is as prime an example of 100% debt monetization as you are likely to find, even if its effects have been understandably muted thus far by what we call the 'Ben Gunn scenario'. By this we mean that each household 'bubble' has been marooned on its own little Treasure Island and so has been unable to spend anywhere near as many of the pieces of eight piling up in its coffers as it might.

However, note that while total hours worked by our Coronavirus Castaways have fallen to levels last seen almost five decades ago when there were a quarter fewer jobs and a third fewer people to fill them, this has not stopped them from launching a notable assault on the housing market. Since the spring, prices have accordingly risen by their most in four years and mortgage approvals (admittedly making up for the deep, lockdown lows) have bounced back to a level only surpassed at the height of the 2006/7 mania.

Price inflation, then, is primarily now a matter of things the state is spending its newly-printed monies on, of financial assets, and now possibly of tangible ones, too. Conversely, things which would be the target of the joint demands of highly-constrained individual consumers and padlocked company purchasers have hardly stirred into life, despite the sizeable monetary overhang.

Paying the Piper

As we have said since the start of this sorry episode, a more general outbreak of higher prices will therefore have to await the oft-postponed restoration of our liberties. At that point, some will choose to pay down their debts and some to spend. Some of the latter will find fulfilling their heart's desire comes



cheap as its provider tries to transform his dusty stockpiles into much-needed ready cash. Many more, however, are likely to find their providers' productive capacity has been throttled and his costs appreciably raised. That inevitable battle of supply versus demand is yet to be fought, but the more the state exerts its influence on both, the greater the likelihood is of a sustained rise, not a fall, in prices.

In the meanwhile, the standard of living is declining in other, more indirect ways than through obvious price inflation. With that in mind, it should be noted that the burden on the public fisc with which we have dealt here is merely the most visible component of the toll of foregone incomes, ruined businesses, lost freedoms, blighted futures, and foreshortened lives which has been exacted under the various contra-virus measures as they are enacted with bewildering frequency and often contradictory intent.

Before this sorry episode has run its course, the monetary cost to the private sector, as well as to the government, will be gargantuan: the non-monetary ones are likely incalculable.

Incidentally, for those charged with the management of others' savings, if we use the annualised quarterly deflators to calculate an effective real Gilt yield, we get not so much a car crash as an asteroid impact. Can't be all that supportive for sterling, surely?

Bravo, again, Boris!

Sean Corrigan

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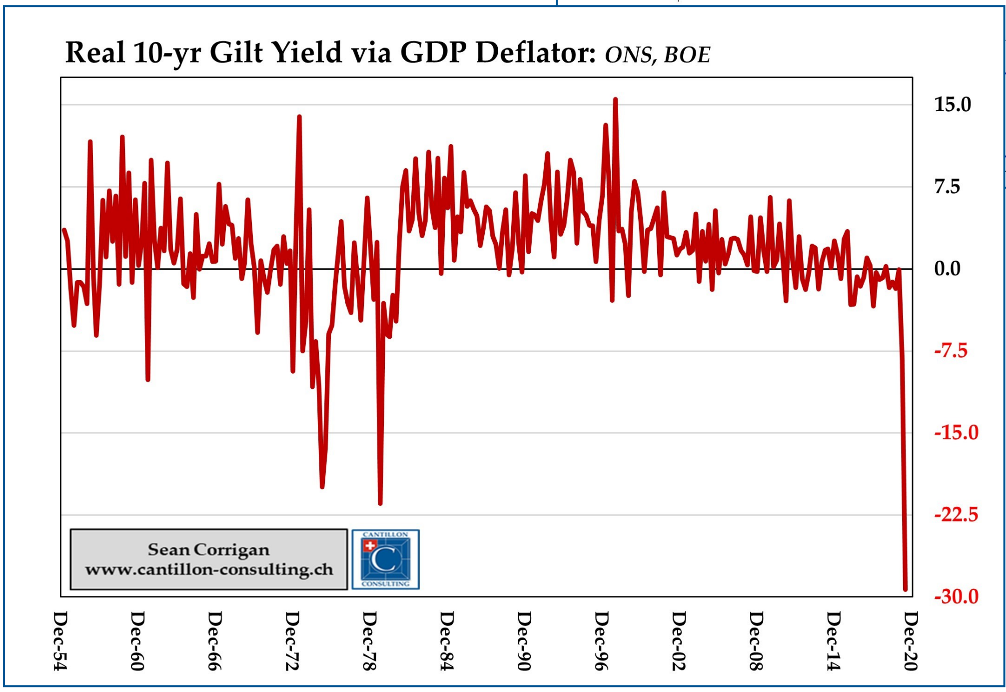

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