Wealth through ingenuity.

On My Radar

October 4, 2012
By Steve Blumenthal

As I dive through a broad range of independent research each week, following are several ***bullet points*** I found important:

- **Multiplying Europe's fiscal suicide, by Ambrose Evans-Pritchard**
  Embedded in the article is a link to what I believe is important data showing that fiscal adjustments have had a much stronger negative effect on economic growth than the IMF's rule of thumb suggests.

  That rule: a 1.0% reduction in spending has a 0.5% reduction in growth. Ok – in English this means that if a country's annual gross domestic production (GDP) is $15 trillion and it cuts its spending by 1%, or $150 billion, the hit to future GDP growth is just 0.5%, or $75 billion. The thinking is that we have to tighten our belts and it will be just a little painful for a little while, but not a disaster.

  However, what we are seeing in real life in Europe is much different than the IMF's projections. For instance, in the U.K., the spending cuts that equaled about 4% of their GDP between 2009 and 2011 had a negative effect on GDP growth of -4% instead of the IMF projected impact of -2%. Even worse, in Spain, their government cut spending by 3.4% of GDP over that same period, which resulted in a hit to GDP growth of -7.1% vs. the IMF projected impact of -1.7%. These are big misses.

  Quoting Ambrose Evans-Pritchard, "So what went wrong? It is blindingly obvious. The IMF data – and indeed the more extreme theory of `expansionary fiscal contractions' (which the IMF does not endorse) – is based on past cases where individual countries were able to claw their way out of trouble by exporting to a healthy global economy, usually by devaluing first and often by slashing interest rates as well.

  Greece, Spain and Italy cannot devalue. Most of Europe is tightening fiscal policy in lockstep. They are all dragging each other down. **It is synchronized policy suicide**."

  http://blogs.telegraph.co.uk/finance/ambroseevans-pritchard/100020504/multiplying-europes-fiscal-suicide-technical/

- **In the U.S. we have run a $1 trillion dollar deficit each of the last four years.**
  Our government is spending $1 trillion more than we are taking in tax revenues – each year.
  Our GDP is $15 trillion dollars. If we reduce our government spending by $1 trillion, the reduction is -6.67% of our GDP. In IMF theory, this would impact our growth by -3.33%. In reality, the number is likely much larger. The debt laden fundamental backdrop remains a mess.

- **Sentiment is improving slightly – I continue to favor hedged equity exposure:**
  The daily sentiment has moved closer to the neutral zone from excessive optimism. The crowd sentiment poll remains in the excessive optimism zone. Click here for the charts.

With warm regards,

Steve

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