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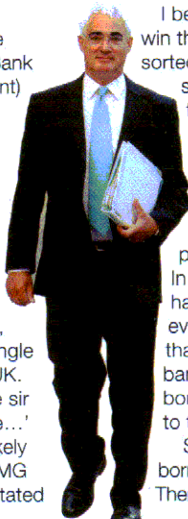
The biggest hangover in history

***Jonathan Davis** argues that if the banks were forced to mark to market, it would be obvious that they are once again headed for some serious financial trouble...*

As it is widely known, 10 percent of all shops are empty. Those tenants that survive will find it very difficult to meet rents over the next 6 to 12 months and Begbies Traynor, major insolvency practitioners, warn that approximately 150 retail groups are in serious trouble. As property loans are becoming more difficult to find than Osama Bin Laden and interest rates have effectively only one direction to go (The Bank of England can hardly cut from 0.5 percent) there will be another huge set of bank losses to come in the commercial arena.

We do not have access or resources to analyse internal data. However, a good estimate of the losses to come over the next year or two is somewhere between £100bn and £200bn. The banks simply do not have these kinds of reserves. Technically, if mark to market were here, we would find there is probably not a single bank or building society solvent in the UK. It'll be like Oliver all over again – 'Please sir (or rather Mr Darling), I want some more...'

Using Treasury forecasts, which are likely to be underplaying reality, the amount HMG owes will rise inexorably for years until (stated and explicit) borrowings are over 100 percent of national income by 2013. The Government is borrowing this amount to bail out the reckless bankers (and equally reckless borrowers) and to get the economy moving again. At least that's what they want us to believe.



I believe it is simply a cynical move to try to win the next election by pretending they have sorted the problem. Obviously, when you pump so much money into the system you're going to have short-term positive outcomes – slowing down the rate of company busts, fewer home repossessions, more new cars sold, a slower increase in unemployment and a general boost to the economy.

The problem is that at some point the piper needs to be paid. Who is the piper? In this case it's the global lenders who have handed the Government more money than ever borrowed in peacetime. Much more even than when Denis Healey in 1976 practically bankrupted the country and Britain had to borrow from the International Monetary Fund to tide us over.

So, how do we pay for it? How will we get our borrowings down? How do we pay the piper? There are essentially three ways:

A) You default on it as countries like Argentina did
B) You bring back inflation to wipe out the real value of the debt
C) You raise taxes and cut Government spending.

I do not see any painless solution in there. Something has to give, be it higher taxes, lower council services, fewer teachers, lower (or later) pensions, less support for the unemployed - all leading to a smaller economy.

To do nothing would be even worse. In that circumstance, our currency would plummet and interest rates would go through the roof (far quicker than they likely will anyway). The result of that would be further decimation of property prices, household spending and an even steeper and more sustained rise in unemployment.

Ultimately, the government (whoever it is by this point) will try to do mostly C but they will be forced to have B in due course, by the global bond dealers. No political party is telling the public how bad it actually is. However, luminaries such as Sir Howard Davies (ex-FSA CEO) and Mervyn King have. And many others.

As I have said many times, this society has had the biggest party in history for at least the past 10 years up to last year. Now comes the biggest hangover in history. It will continue, given our national debts, for many years. Its time to face it: the economy is shot to pieces.

The Office for National Statistics announced in October the sixth consecutive quarter of falls in the economy – the longest period since records began in 1955 and I'd wager the longest since the 1930s. You are now watching 'Great Depression II – Harder and More Gruesome'.

Actually, it wouldn't be surprising at all if the next two quarters showed narrow growth as there's an election next year. Whether red or blue, the economic result will be similar.

> It is essential you preserve your capital during this period of the greatest wealth destruction in living memory

Looking at the results from the Dow Jones during the Crash 1929 to 1932 the current collapse is following the 1930s crash very similarly. In the last one, stocks were very sharply down in 1929 by 44 percent and then rallied by 48 percent over the next six months. The S&P 500 fell around 50 percent from October 2007 to early this year and has rallied 65 percent since March due to huge government stimuli in the first 'V' to take place.

Ultimately, the US market went down 89 percent in the 1930s. When you say it quickly it's not so bad. Until you recall the realities of that result. I can remember people of my grandparents' generation joking they got an orange for Christmas.

It is essential you preserve your capital during this period of the greatest wealth destruction in living memory. We are still in deflation as wealth destruction outweighs money printing. Inflation will creep up on us to perhaps five percent by 2015 and 1970s style by the end of the next decade after it goes parabolic. From when inflation returns, you will need to preserve your purchasing power. Property will not help you.

Inflation will come as our currency collapses and the bond dealers raise our interest rates for us, whatever central banks will do - which will likely be to hold short term rates as low as possible for as long as possible - which will further fuel inflation.

As for commercial property – well the institutions are raising funds again. The amount they're raising and investing is a small fraction of the losses that are bound to appear. It's the biggest suckers' rally of all time, like residential, bonds and stock markets.

Yet weren't the institutions raising finds like billy-o in 2005, 2006 and 2007? They are not there to make money for you, the investor. They are there to amass funds, take large fees and then sell themselves on. More than 50 percent of people say they couldn't survive financially if their bills rose by £100 per month. And they will, according to the life assurer Bright Grey. Look at unemployment, the debts of Government, households and banks, business investment levels (down more than a fifth in the last year), the Government stimulus - which will end at some point, the high deposits needed for mortgages, the real (actually achieved) loan rates and Government spending cuts to come (Government is 30 percent of the economy).

Just watch after the next election and into 2011/12. I expect taxes to go up and Government spending to fall, a resumption of the house price crash, the commercial property crash, the stocks crash, a rise in home repossessions, commercial defaults and corporate and personal bankruptcies, a currency collapse and rising loan rates.

The piper is being paid and that piper is our society's standard of living.

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