

[Can we be in recovery if we are still in intensive care?](#)

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Summary

There is undoubtedly a technical recovery in progress. Economic indicators globally say so. However, is this really a recovery, or just the impact of the heady cocktail of fiscal and monetary "drugs" that governments and central banks continue to hand out? This analysis looks at the recovery from a UK perspective.

Analysis

The Bank of England has injected £200 billion of quantitative easing (which is 20% of the UK's GDP) into the UK economy. BoE also has interest rates at the lowest levels ever, and BoE was founded in 1695, so there is a bit of history here. Also keep in mind the over 30% depreciation of GBP versus EUR, the UK's major trading currency in export terms. Now if that level of monetary stimulus does not have an impact, we really are in trouble.

There are two problems with BoE's stimulus that add to the feeling that "something's happening here". Firstly, BoE is severely restricted as to what assets it can buy with its £200 billion. Of the £175 billion spent so far, £173 billion has been used to buy up gilts. BoE has authority to buy up to £50 billion of corporate bonds. Unfortunately, that is over 100% of total UK corporate bond issuance. The purchase of gilts has lowered long term rates generally, but has not led to the anticipated increase in credit creation. Broad monetary growth has been very low by historical standards despite the QE policy. A second, related, issue with QE is that the velocity of money has slowed considerably post-credit crisis. Hence the reason why BoE will have injected £200 billion, when the initial purchases were only £50 billion. It is the slower velocity that has caused BoE to keep upping its QE purchases.

What does all this mean? Well the impression is that much of BoE's QE is simply being "stored", and used to purchase risk assets. Equities in particular look overvalued. My personal experience is that any company announcing interim or full year results that does not also increase analysts' future earnings guidance, is suffering a 7-10% fall in price on the day the results are announced. I think this is a good proxy for the level of UK equities excess valuation. I think it is a good measure of how much the market will fall as and when BoE starts asking for its £200 billion back. I think it is also a good measure of the true state of the UK economy. Yes, it has stabilised, but that stability is entirely due to the aggressive fiscal and monetary measures taken by the UK government and BoE. As with any intensive care patient, removal of care prematurely can cause a very significant relapse.

The concern has to be that the recovery is not sustainable and, if concerns grow, we will see reversals in the value of risk assets that have recovered over the last 6-9 months (especially equities and commercial property). What makes all this harder to predict is that we have no historical benchmark. This type of fiscal and monetary stimulus, on a global scale, in an era of unprecedented capital freedom, has no precedent. My own view is that we are not heading for meltdown, but there are going to be more bumps along the way before we can say we have returned to a "normal" growth path. We continue to live in interesting times.