

# Weekly Perspectives

Website: [www.lomam.com](http://www.lomam.com)

Email: [info@lomam.com](mailto:info@lomam.com)

[iraj.pouyandeh@lom.com](mailto:iraj.pouyandeh@lom.com)



## A Weekly View of Global Economies

5 September 2006

The US housing market is looking weaker and this has increased speculation that the Fed may be worried about a slide in household spending and will be reticent about any further monetary tightening. However, recently-released minutes of the Federal Open Market Committee meeting held on August 8, point to plenty of uncertainty among its members about what course of action to take.

But housing isn't the only factor that figures in consumer spending. There are a number of other important influences that are far from weak. The unemployment rate is quite low, income growth is strong and real interest rates have yet to approach anything resembling onerous levels.

Meanwhile, those households who have fixed-rate liabilities, and assets that are essentially floating-rate, are doing quite well in a rising interest rate environment. Also, as mentioned previously, while nominal interest rates have increased, rising inflation has meant that the real cost of borrowing is still quite low in historical terms.

In some quarters there is rising suspicion that Bernanke, the Fed chairman, is a softie who is willing to tolerate higher inflation in order to ensure stronger growth. According to this point of view, the risk is that at the first indication of stressful squeals from households and the Wall Street crowd he will rush to open the gushers and fill the trough with liquidity.

And it must be said that Americans have been spoiled in the past with a plentiful liquid diet and cheap money from abroad. It has been estimated that without the willingness of Asian central banks to feed the addicted Americans, interest rates in the US would be about 150 basis points higher than where they are now. In the event that the Asians put an end to this scheme, we will quickly find out the limits of the Fed's ability to ease monetary policy.

Smarter central banks are taking every opportunity to slowly diversify out of dollar assets. Also, among Middle East oil exporters, who are as important as the Asians in terms of their dollar surpluses, there are moves being considered to reduce the role of the dollar. Any progress in this regard will have consequences for US interest rates as well as exchange rates.

A barrier to carrying out such plans is the Saudi regime which is a client of the Americans. The Yanks are willing to overlook the royal family's backward and authoritarian rule as long as

the royals remain in the American camp. But one wonders how long the loving relationship will last.

You may recall some of Americans' former close allies in the Middle East: Saddam Hussein and Osama Bin Laden. Now they are referred to in the vilest terms. So don't bet your money that the Yanks and the Saudis will remain friends forever. But if you do bet, be sure to use the greenback and not a more valuable currency.

We have always been sceptical about the claim that central banks are adept at fine tuning the desired economic outcome. Those who point to the bankers' achievement in generating low inflation and decent growth - - at least in some countries over the past decade or so - - forget that the real causes may have been structural factors such as globalisation and productivity growth resulting from the implementation of new technology.

This made the task of managing inflationary pressures a lot easier as mistakes in following an excessively expansionary monetary policy were offset by rapid productivity growth and intense global competition. It is quite possible that such trends may lose some of their momentum in the future; forcing authorities to make policy in a more challenging environment that will really test their skills.

It is gratifying to see that not all economists suffer from myopia, basically focus on a few Fed meetings rather than taking a longer viewpoint. One exception is Kenneth Rogoff who in a paper presented at a recent Fed gabfest in Jackson Hole, Wyoming was also sceptical about the central banks' success rate.

The bankers' performance may be akin to that of investment professionals. Many such individuals have been lauded as financial geniuses. In fact, with the passage of time it becomes evident that their skills were mediocre. What helped them was luck. They were in the right place at the right time and reaped the rewards. When circumstances changed, so did their luck.

*Iraj Pouyandeh*  
*Strategist / Senior Portfolio Manager*

*Prior to joining LOM Asset Management, Iraj Pouyandeh worked for Sun Life Financial in Toronto, advising on the global economic and financial outlook and strategy for the company. He manages the LOM Equity Growth Fund.*

The information in this newsletter is for general use only; it is not intended as specific investment, financial, accounting, legal or tax advice for any individual and should not be relied on as such. LOM makes every effort to ensure that the contents herein have been compiled or derived from sources believed reliable, however LOM does not warrant the accuracy, timeliness, or completeness of this information and material and expressly disclaims liability for errors or omissions in this information.

**LOM** LOM Asset Management Limited  
27 Reid Street  
Hamilton, HM 11  
Bermuda  
441-295-6999

Licensed to conduct Investment Business by the Bermuda Monetary Authority

The material herein may not be reprinted, in part or in full, without prior expressed consent in writing from LOM Asset Management Limited