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EXCLUSIVE: Breakfast Briefing Debates Sluggish Europe, Geopolitical Jitters And China



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News Analysis

The risk of inflation taking hold in the eurozone is no cause for concern but the rigidity of the European economy remains a major factor in preventing a rebound, a recent Breakfast Briefing event, hosted by the publisher of this news

service, heard recently.

Speaking a day after financial equity market volatility spiked sharply to levels not seen since the financial crisis and bond yields fell unexpectedly, the event held at the Carlton Club in London was a chance for wealth management professionals to get a handle on the state of the world economy - and geopolitics. The event was entitled Global Economic Outlook: Recoupling Growth And Inflation and sponsored by **Skagen Funds**.

One of the central features of the eurozone - and broader world economy - for some time has been the combination of ultra-low, or even just negative, real interest rates on the one hand, and a period of relatively subdued inflation, on the other. This challenges some of the fears that central bank quantitative easing will trigger inflation, Torgeir Høien, portfolio manager of SKAGEN Tellus, a bond fund, told the audience.

"We are looking at the long-term implications of a zero-interest rate policy...that is part of the problem that is scaring the markets right now," he said. "Expectations of inflation are still falling despite all the efforts of the central banks. Despite the easy money, money in fact is getting tighter," he continued.

IMF

Jonathan Bell, chief investment officer of private investment office Stanhope Capital, was asked about recent International Monetary Fund comments on the global and eurozone economic situation, noting that the IMF expects UK and US rates to lead the way up while other regions lag; that it urges investment spending, examining banks' balance sheets, and has said that financial markets had been "too benign".

"We are now all a bit more aware of risks [after recent market falls]," Bell said, highlighting the spoke in measures of equity option volatility, such as the VIX Index.

"Banks still need to do more to clear up their balance sheets. I am also in favour of more being done on the monetary side," Bell said.

Silvana Tenreiro, who is Professor in Economics at the London School of Economics, said that despite some apparent disconnections, there is - as she likes of the late Prof. Milton Friedman have pointed out - a long-term link between aggregate growth of the money supply and inflation. Sooner or later, QE on a sufficient scale, she said, will have an impact on prices. "There will come a point where it will increase the inflation rate."

"In the short run, the link is less evident, because monetary policy tends to be expansionary in response to weak growth and deflationary pressures, hence the correlation can be even negative in the short run; this does not mean that monetary policy cannot affect inflation---quite the contrary: inflation would be even lower without monetary expansions," she said.

The fourth panellist, Martin Graham, chairman of Orade Capital Group, said this of inflation: "There has been inflation in asset prices...it has been all the wrong things and driven up the market."

He went on to say that a lesson from Japan is that monetary policy alone cannot fix an economic malaise.



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The panellists were asked about some political subjects, such as the risks that the UK decides at some point to leave the European Union.

“There is a small club outside the UK (Norway, Iceland and Greenland)...we have a free flow of labour, capital and services. We have our own sovereignty and people are very happy about that. It would be good to have the UK in there,” Høien said. Orade’s Graham said there has been his view a “poor quality” of public debate about the UK and the European Union: “There is a huge perception that we would be better off outside the European Union. There is a real political risk for me.”

Stanhope’s Bell asked the rhetorical question: “Do we want to come out of the European Union and follow laws it makes anyway, or stay in the EU?”

Turning Eastward, Bell commented on China, and noted that the country has a high savings rate, carrying the risk of significant wastage. On the other hand, he said affordability of housing in China - relative to real wages - is improving, not worsening, as it is countries such as the UK. Rules on lending and collateral also will limit exposure of China borrowers to any slowing in the property sector, he said. There are some issues around shadow banking, etc, but the central government in China has huge reserves and has a relatively low amount of debt, he said.

Graham, asked about the same country, said: “I see more Ferraris and Maseratis in China than in Mayfair and I think we should be fairly sanguine about the prospects for China.” As for Skagen’s Høien, he said he expects Chinese growth rate to moderate and he also challenged the idea that China needed to be a consumption-led economy since ultimately, all growth comes from the supply side. “What China needs is a more liberal capital market and more liberal financial market,” he said.

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