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On Politics and Markets

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The doom and gloom rhetoric continues about the Eurozone. The latest fear is that the unraveling of the Eurozone is not too far down the road. Fingers are pointing to Spain – the supposed need for a 100 billion Euro bailout of Spanish banks. Of course, just one month ago, Euronews reported:

> Bank of Spain Deputy Governor Fernando Restoy said: "The auditors from the consultancy Oliver Wyman say – for the worst case scenario – we'd need capital of between 51 billion and 62 billion euros. Consultants Roland Berger, meanwhile, have a lower range of around 51.8 billion euros." The amounts are higher than the 40 billion that the International Monetary Fund calculated earlier this month, but less than the 90 to 100 billion that the risk assessment agency Fitch estimated. The Spanish central bank stressed the country's three major banks do not need further capital in this crisis scenario.

Eurozone and Euro are here to stay

Romney's Non-plan Plan

Preview: Obama needs a clear and bold energy plan

It is said that the markets know best – so the markets' demand for a more than 7% yield on Spanish sovereign debt must be something close to the cosmic truth about the price of money for Spain – as must be the notion that such yields portend the end for the Spanish economy. But markets have been wrong over and over again for decades. The assumption that markets know best ignores the normal market psychology that is always at play. This psychology is part of a feedback loop – and one of the major inputs is an international news media that spew stories of doom. What is also forgotten by markets is that real people with real brains, in government and elsewhere, have the capacity to act to avert real crises. Many may think this is wishful thinking, but it is rather the case that the converse assumption flies in the face of both history and human nature. Nobody wants to see either Spain collapse of its bank debt and recession, or the decades-long political project that is the Eurozone come unraveled. People will act, albeit in measured steps, not in the sort of lurches that markets like to see during a day's trading session.

It would be foolish to suggest that there are no bases for concern, but the negative noise from day to day too often drowns out the good news, and since 2009 there has been a lot of good news. The housing market in the United States seems to have bottomed out, and is on the rebound: "Over the last year, **home prices** have increased by **3.7%** since May 2011, and that annual gain was the largest yearly increase in home prices since September 2006, almost six years ago. . . . It was also the first time of four consecutive annual increases since the summer of 2007" (Seeking Alpha, July 25).

Economist **Jim O'Neill,** of Goldman Sachs Asset Management, cautions against too much worry concerning China, which is likely going to restart its GDP engines and turn out of its recent slump. As O'Neill said in March, China produces a new Greece every 11.5 weeks in terms of GDP (Benzina.com). O'Neill famously pointed out that China will likely overtake the US as the world's largest economy by 2027. While national pride may smart at that prospect, this means a burgeoning market for US goods and services, as well as a large source of capital for international businesses. As the IMF's **Markus Rodlauer** (Head of the IMF's China Team) has put it, just this week:

> China's economy has now been slowing for six consecutive quarters. This started early last year when the government deliberately put in place policies to slow the economy, which had been growing very fast. Now, on top of that, has come the global slowdown—mainly related to the euro crisis—that has slowed down the economy more than expected and somewhat more than the authorities had themselves probably intended. So, earlier this year, they switched gears and started to moderately support the economy to ensure a soft landing. So, we are seeing growth in China slowing down, as I have said, **but we don't see it slowing down too much**. GDP growth in the second quarter of 2012 came in at 7.6 percent, which was slightly better than expected. On current trends, **we expect growth of around 8 percent this year which, of course, is still formidable compared with other countries in the world.**

Moody's has turned negative on **Germany** (changing its outlook from Stable to Negative), but the triple-A rating goes unaffected. Of course, it is the *outlook* that gets all the news, not the triple-A rating. Germany remains the powerhouse of Europe, and it is unlikely that it is going to get sucked too far down into the muck of its southern siblings, so long as the German street has anything to say about it. Too much concern about Germany's economic stability seems unwarranted. While **Angela Merkel's** lean toward austerity may be overdone at a time when stimulus is needed, the counterweight and doubt it places on expectations that Germany can be treated as a demand deposit account is probably not a bad thing, all things considered.

Here in the US, while we are living through wild gyrations in the equity markets akin to those on non-US markets, we are still trying to find our way out of the silly season that started in November 2008, when Congress decided to embark on a prolonged – and dangerous – food fight, leading to an approval rating of 9% -- lower than that of people who approve of polygamy and porn. (I'll have more to say about this in a future article, for it is no laughing matter, although it seems rather amusing at first blush.) We are also trying to find our way out of a very slow growth economy. Some hold that the slowness of growth has to do with Obama's embrace of Keynesian principles. Even if those criticisms are apt, Obama did not go as far with stimulus as some liberals would have preferred – **Paul Krugman** pops to mind first here. So even if one is from the Austrian School, and hates Keynesian pump-priming, Obama was moderate at best in his stimulus efforts, and especially in the form those efforts took. And he is not unlike his predecessor in this; let us recall that his predecessor did his own pump priming. Bush's

Economic Stimulus Act flushed some $150 billion through the economy. Now, the pump-priming baton has been handed from fiscal to monetary policy makers – from Congress and the President, to the Fed. But the fiscal policy makers are soon to be up at bat again, in order to avoid the fiscal cliff.

While some of Mitt Romney's criticism of President Obama seem apt, his plan is still too ideological in nature, and proffers the same list of Republican policies that have been offered up for years – even during the years that George W. Bush was President. This is from Romney's comprehensive plan for economic growth, titled *Believe in America – Mitt Romney's Plan for Jobs and Economic Growth*:

- Repeal and replace Obamacare and Dodd-Frank
- Review and eliminate Obama-era regulations
- Cap new regulatory costs at zero dollars
- Require Congress to approve all major regulations
- Reform legal liability system
- Issue an executive order to sanction China for unfair trade practices
- Issue an executive order to empower American businesses and workers

The amazing thing about the Romney plan is that it targets, in the person of President Obama, actual attempts to fix problems long brewing in the economy (the housing bubble, speculation by banks, excessive debt, inadequate regulation of certain key elements of the financial markets), without making much mention at all of the very conditions that demanded government intervention (Remember the Commodity Futures Modernization Act of 2000, which set to the side regulation of CDS and other derivatives?). The Romney plan could be recycled by Republican candidates election after election, as it is more of a general statement of (or of what used to be) conservative ideas – less government "interference" in the markets, lower taxes, "tort reform."

The problem seems to be that the specific ideas Romney proffers are very short on specifics. (Obama also lacks specificity in certain key areas of his plan, especially as regards a national energy policy, and I will have more to say about this in future articles). They are glosses and desiderata. Even if the Senate swung Republican, it is hard to see how Romney would be able to, essentially, resurrect Bush-era policies. The decision to pander to the TEA Party extremists (one of its *sans*-title leaders is **Representative Michele Bachmann**, who recently suggested that one of the Secretary of State's (of all people) closest aides is in league with the Muslim Brotherhood) has added credibility to the charge that Romney has no core principles or beliefs that he is not willing to sacrifice to get the requisite electoral votes. It is true that Presidential candidates of whatever party must do a fair amount of massaging to get votes, but Romney is too intelligent not to know that lashing himself to extremists is going to lead to a political train wreck some time down the road. His bet must be that once he has the presidency, he will cross that bridge when he gets to it.

The facts would seem to indicate that it is very unlikely that Obamacare or Dodd-Frank are going anywhere (just as the Eurozone and the Euro are not going anywhere), especially given the inertia both now have (full implementation of Obamacare is many months away, and Dodd-Frank mandated rules are still being hammered out by regulatory agencies like the S.E.C.). And Romney's pledge to slash non-security discretionary spending by $20 billion seems like a drop in the bucket – but it also seems like slashing the equivalent of the Department of Labor and the Social Security Administration, combined (their budgets are about $20 billion, combined). After so-called "security-related discretionary spending" there really isn't much left to go after, without essentially hollowing-out vital federal agencies, departments and programs. Romney says very little about what he would do with non-discretionary entitlement programs, or which discretionary programs he plans to gut.

As for the counterfactuals that Romney presents concerning "what could have been the state of the recovery, were Obama not in the White House," these can be brushed aside and replaced with the actual accomplishments of the administration:

- Over two years of private sector job growth, albeit not as much as we would all like
- Preventing the collapse of the US auto industry
- Adoption of the TARP (wisely devised under the Bush administration) to avert a financial collapse
- Implementation of a tax-cut weighted stimulus package that saved a number of municipalities from going under
- Withdrawal of US troops from Iraq and the restoration of domestic control
- Bringing justice to Osama bin Laden
- Winding down our US action in Afghanistan
- Reduction of thousands of federal public sector jobs.

That last point may not seem as if it is an accomplishment to some, but it does speak to Obama's commitment to reduce the size of the federal government wherever feasible: "But there is one area of job creation where President Bush clearly outshines President Obama: the public sector. Public sector employment is now down 608,000 workers since January 2009, a 2.7 percent decline. At the same point in President Bush's term, public sector employment was up 3.7 percent. If, over the past 40 months, public sector employment had grown at the same pace as it did in President Bush's first term, there would be 1.4 million additional people at work right now. That'd be enough to bring the unemployment rate down by nearly a full percentage point" (ThinkProgress.org).

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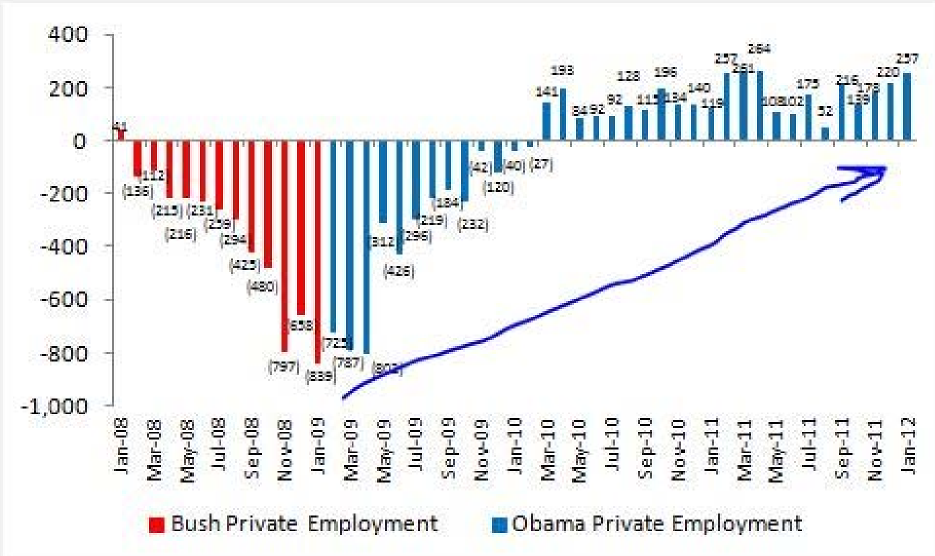
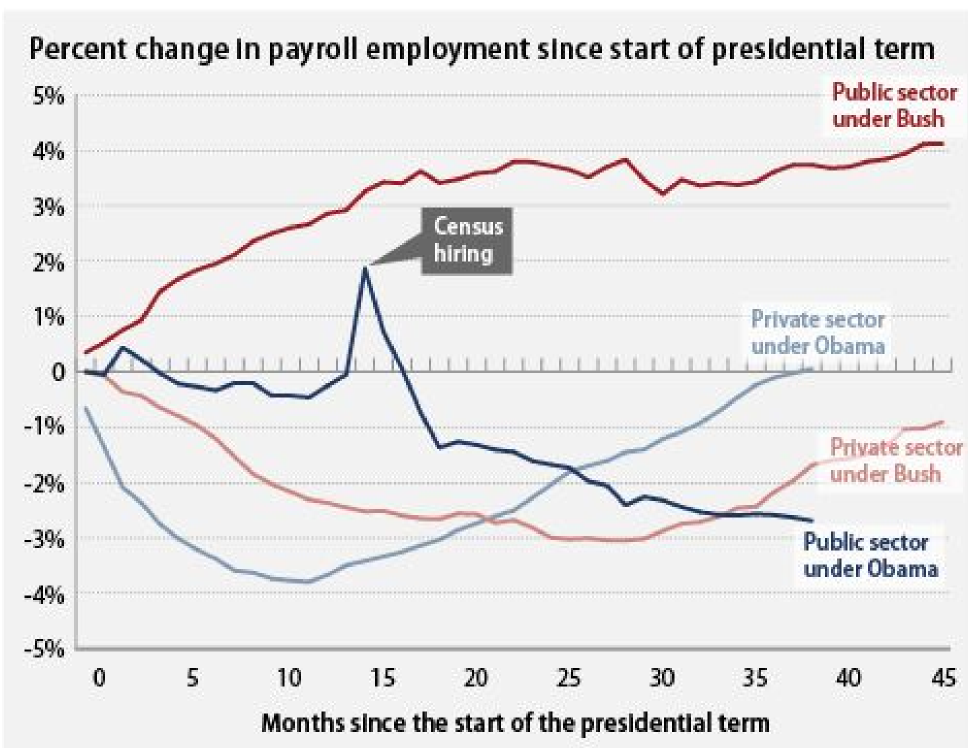


Change in Total Private Employment (in thousands), Source: U.S. Bureau of Labor Statistics



Source: Bureau of Labor Statistics and ThinkProgress.org