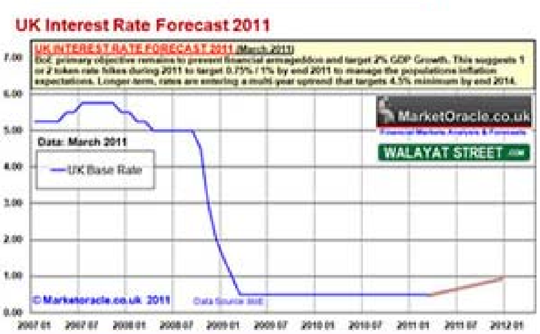
# The Interest Rate Mega-Trend

## Analysis and Forecasts for UK Inflation, Economy and Interest Rates

### Implications for Savers, Borrowers and Investors



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Financial Markets Analysis & Forecasts

## Nadeem Walayat

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March 2011

# The Interest Rate Mega-Trend

## Analysis and Forecasts for Inflation, Economy and Interest Rates

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By Nadeem Walayat



Market Oracle Ltd (http://www.marketoracle.co.uk)

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# INTRODUCTION

The Inflation Mega-trend Ebook of January 2010 correctly identified the start of the trend for persistently high UK inflation that looks set to continue for the whole decade.

This ebook represents an update for key forecasts for the UK economy, inflation, with the focus on arriving at a probable forecast for the UK base interest rate for 2011 and beyond, as well as consequences of rising global interest rates for workers, savers and investors.

As with the preceding ebook, please do bear in mind that I am a trader / investor, not a journalist / writer, so yes, I will have made some grammatical errors that I seek your forgiveness for in advance.

The analysis in this ebook was completed during March 2011 and comprises 4 chapters as listed below:

- ***UK Economy* - 9th August 2010**
- ***UK Inflation* - 17th January 2011**
- ***UK Interest Rates* - 8th March 2011**
- ***Implications of Rate Rises - 20th March 2011***

It is important that you are subscribed to my always free newsletter (http://www.marketoracle.info/?p=subscribe&id=1 - only requirement is for a valid email address) to ensure that you get the latest updates, as at the end of the day all forecasts are made on the basis of the probability of an outcome occurring which undoubtedly requires re-appraisal in the light of subsequent price action and events as the world is currently witnessing (March 2011) with the outbreak of Freedom in the middle east which has sent crude oil prices soaring to multi-year highs.

My next planned ebook's that I aim to complete during 2011 in order are:

- Stocks Stealth Bull Market Update 2011 - *March 2011* - Aims to replicate the highly accurate stock market analysis of the past 3 years.
- UK House Prices Forecast - *May 2011* - An in depth analysis of the UK housing market that will conclude in a trend forecast into at least 2013, which follows on from the highly accurate UK housing market analysis of August 2007 that called for a 2 year bear market into August 2009 (UK Housing Market Crash of 2007 - 2008 and Steps to Protect Your Wealth ).
- The Real Secrets of Successful Trading - *December 2011* - Detailed breakdown with examples of my Stock index focused trading methodology.

Your Interest Rate and Inflation Mega-Trends investing analyst.

Nadeem Walayat
20th March 2011

# CHAPTER 1

## UK ECONOMY 2010 - 2015

August 2010 - This analysis seeks to update my existing UK GDP growth forecast for the next 5 years. The analysis of December 2009 concluded in a trend forecast as illustrated below (31 Dec 2009 - UK Economy GDP Growth Forecast 2010 and 2011, The Stealth Election Boom ), with the most recent UK GDP data confirming strong growth data for the second quarter of 2010 of 1.1%, annualised to 4.4%, which caught the mainstream press, academic economists and even the City by surprise who had typically penciled in growth expectations of between 0.3% and 0.5% and remain firmly fixated on the prospects for a UK double dip recession.

### Existing UK GDP Forecast Growth Forecast 2010-2012, Preliminary 2013-2014

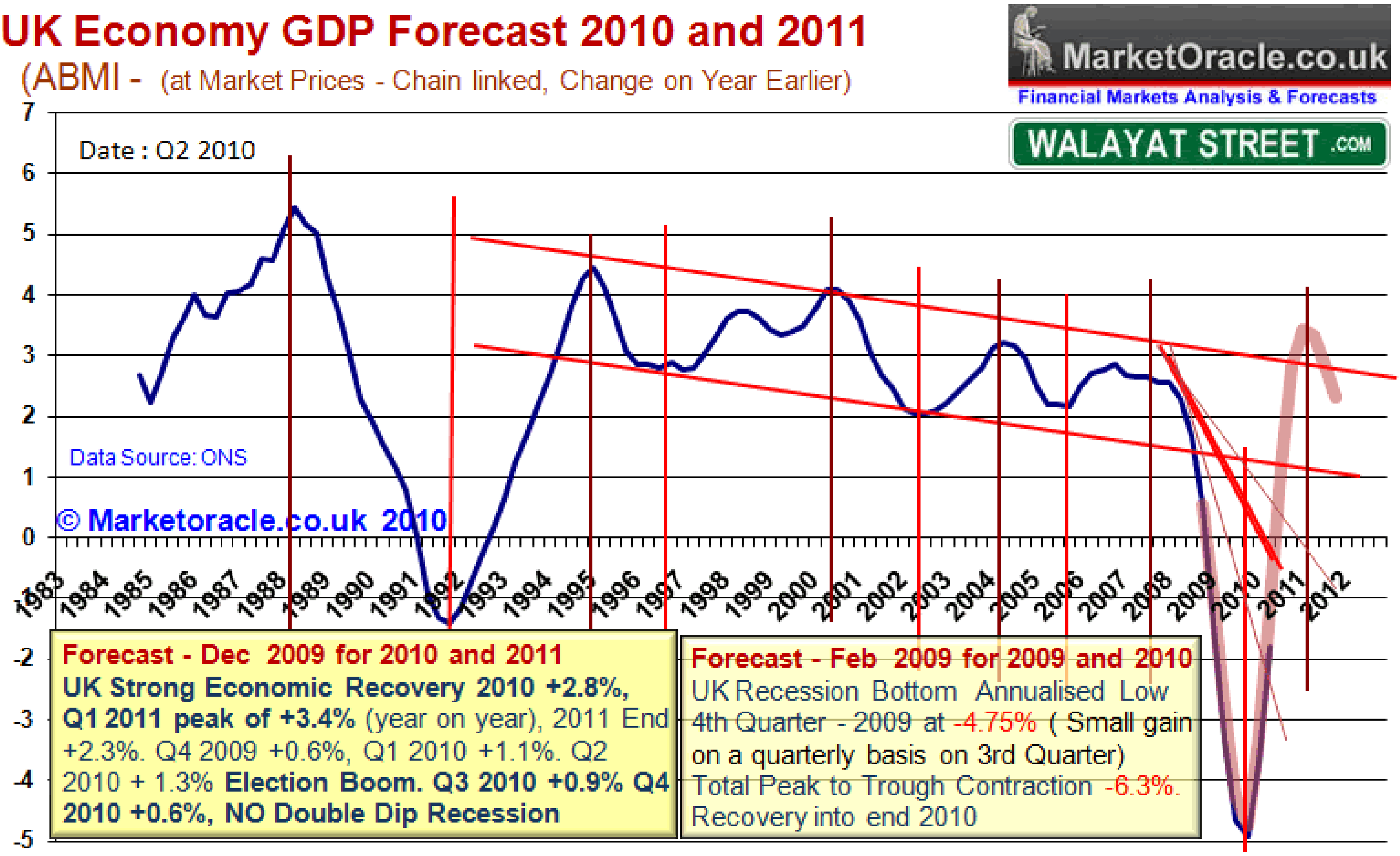
The UK economic GDP growth for 2010 Q2 came in at 1.1% compared against my forecast of December 2009 Q2 growth of 1.3% (31 Dec 2009 - UK Economy GDP Growth Forecast 2010 and 2011, The Stealth Election Boom ). The growth trend is inline with my forecast expectations that projected a strong economic recovery starting in Q4 2009 and for the whole of 2010 continuing into 2011 as illustrated below.

***UK GDP Growth Forecast Conclusion***

*The sum of the above analysis is for a strong economic recovery into the end of 2010 which given the pessimism today I term as the **Stealth Election Boom** that followed the Stealth Bull Market of 2009, the economic 'boom' will continue in to a peak in Q1 2011, which will be followed by weakness during 2012 and 2013 and strong recovery for 2014, and into a 2015 summer general election, breaking this trend down into GDP terms for end 2010 +2.8%, 2011 +2.3%, and taking account of the election cycle preliminary GDP projections for 2012 of +1.1%, 2013 +1.4%. 2014 + 3.1% with expectation of strong Q1 growth for 2015.*

*Therefore I just cannot see this double dip recession that the mainstream press and so called think tanks are obsessing over at this point in time, no year on year economic contraction or even a quarter on quarter dip is visible.*

*The following graph illustrates my trend forecast for quarterly GDP growth over the next 2 years 2010 and 2011.*




Growth for the first half of 2010 now stands at 1.5%, which compares favourably against my expectations for 2010 growth of 2.8% and compares against forecasts of academic economic institutions as the below table from the Inflation Mega-Trend Ebook illustrates (FREE DOWNLOAD) -

***UK Economic Growth 2010***

| *Forecaster* | *Forecast* |
|---|---|
| *European Commission* | *+0.9%* |
| *International Monetary Fund* | *+0.9%* |
| *David Kern, British Chambers of Commerce* | *+1.1%* |
| *Organisation for Economic Co-operation and Development (OECD)* | *+1.2%* |
| *Alistair Darling, Treasury* | *+1% to +1.5%* |
| *Bank of England* | *+2.1%* |

## Coalition Government Austerity Measures

The June 2010 Emergency Budget announced intentions to take £40 billion out of the economy during 2010-11, rising to a total drain of £113 billion per year by 2015-16 so as to cut the budget deficit from £156 billion per year down to £20 billion by that year. The key measures announced were -

- Spending cuts of 25% on non ring fenced budgets
- Public sector pay frozen for 2 years for those earning over £21k
- VAT Rise to 20% from 1st Jan 2011.
- Capital Gains Tax Rising to 28%
- Housing Benefit Capped at £400 per week
- Inflation indexation switch from RPI to CPI
- Child Benefit frozen.
- Disability Benefit claimants targeted
- Tax credit receipt income limits reduces.

- Corporation Tax 1% cut per year.
- £2 billion bank levy

Where the economy is concerned the policy that will have the most impact on the U.K. economy are public sector spending cuts that won't start to bite until October, with many of the cuts not materialising until well into 2011 which suggests that the real impact of the governments austerity plan won't be felt until Q2 2011. Coupled with the VAT rise from 1st of January 2011 implies significantly lower growth for 2011 than my original forecast of 2.3%.

## Coalition Government OBR UK GDP Forecasts

The coalition governments own independant body (though housed in the Treasury) for forecasting economic growth has revised its own expectations (June 2010), and are compared against my Dec 2009 forecasts (NW):

- UK GDP 2010 = 1.2 / NW 2.8%
- UK GDP 2011 = 2.3 / NW 2.3%
- UK GDP 2012 = 2.8 / NW 1.1%
- UK GDP 2013 = 2.9 / NW 1.4%
- UK GDP 2014 = 2.7 / NW 3.1%

As the most recent data shows the governments own forecast for UK GDP for 2010 has already become redundant as growth already stands at 1.5% for 2010. However 2.3% for 2011 matches my forecast of 6 months earlier which sends my own alarm bells ringing, though there is significant difference for 2012 and 2013 where the OBR / Government appear overly optimistic.

## Academic Economists Flawed Theoretical models

The academic economists that populate the mainstream press are obsessed with the demand side of the equation i.e. Keynesian stimulus that calls for every more deficit spending debt accumulation that will always FAIL to delivery, whilst at the same time ignoring the supply side of the economic equation that succeeded in resolving the 1980's mini-depression into an economic boom as a consequence of supply side changes to the UK economy. The coalition government appears to be following this working model as it takes an axe to Labour's out of control public sector spending and the deficit whilst laying out plans for cutting corporation taxes, even if income and indirect taxes such as VAT are on the rise.

The key to future economic growth is ONLY from the private sector, towards driving innovation, competitiveness and productivity and by cutting taxes and red tape as illustrated by the article (31 Mar 2010 - Solving Britain's Economic Crisis Through Micro Business Capital Investments and Credit ). The recent emergency budget illustrated the governments intentions to cut the budget deficit by means of a ratio of 80% of public spending cuts to 20% of tax rises which matches the shift towards a private sector growth orientated economy that had been increasingly crowded out by the last Labour governments policies of an out of control public sector spending binge.

Meanwhile frankly, clueless academic economists remain fixated on stimulus deficit spending to fend off an always impending "double dip" recession that their policy suggestions would actually turn out to be the prime drivers for bringing as illustrated below:

Telegraph - Britons' fears raise double-dip recession chance

The prospect of a double-dip recession in Britain is increasing with every month as consumer confidence dwindles to recession levels, a long-running study signaled.

Bloomberg - Blanchflower Says Budget `Certain' to Lead to Double Dip

Former Bank of England policy maker David Blanchflower said the spending cuts the government plans in its emergency budget tomorrow “look certain” to push the U.K. back into a recession.

“You can’t just decimate the public sector and assume the private sector will step into the hole,” Blanchflower said in an interview on Bloomberg Television’s “Countdown” in London today. “The danger now is we’re certainly going into a double- dip recession. I think that’s absolutely certain given what’s coming.”

Financial Times, Martin Wolf is worried that the concerted austerity of Germany, Britain and other industrialised countries may "destroy the recovery".

Guardian - Britain's leading companies increasingly fear the UK could suffer a double dip recession because of government public spending cuts and a renewed economic slowdown across the globe, according to a report released today.

Telegraph - A survey of chief financial officers (CFOs) by Deloitte found that a balance of just 24pc were feeling more optimistic in the second quarter, compared with 40pc in the first quarter.

It was the lowest level in 12 months, as the average CFO attached a 38pc probability to the chance of a double-dip, up from 33pc previously.

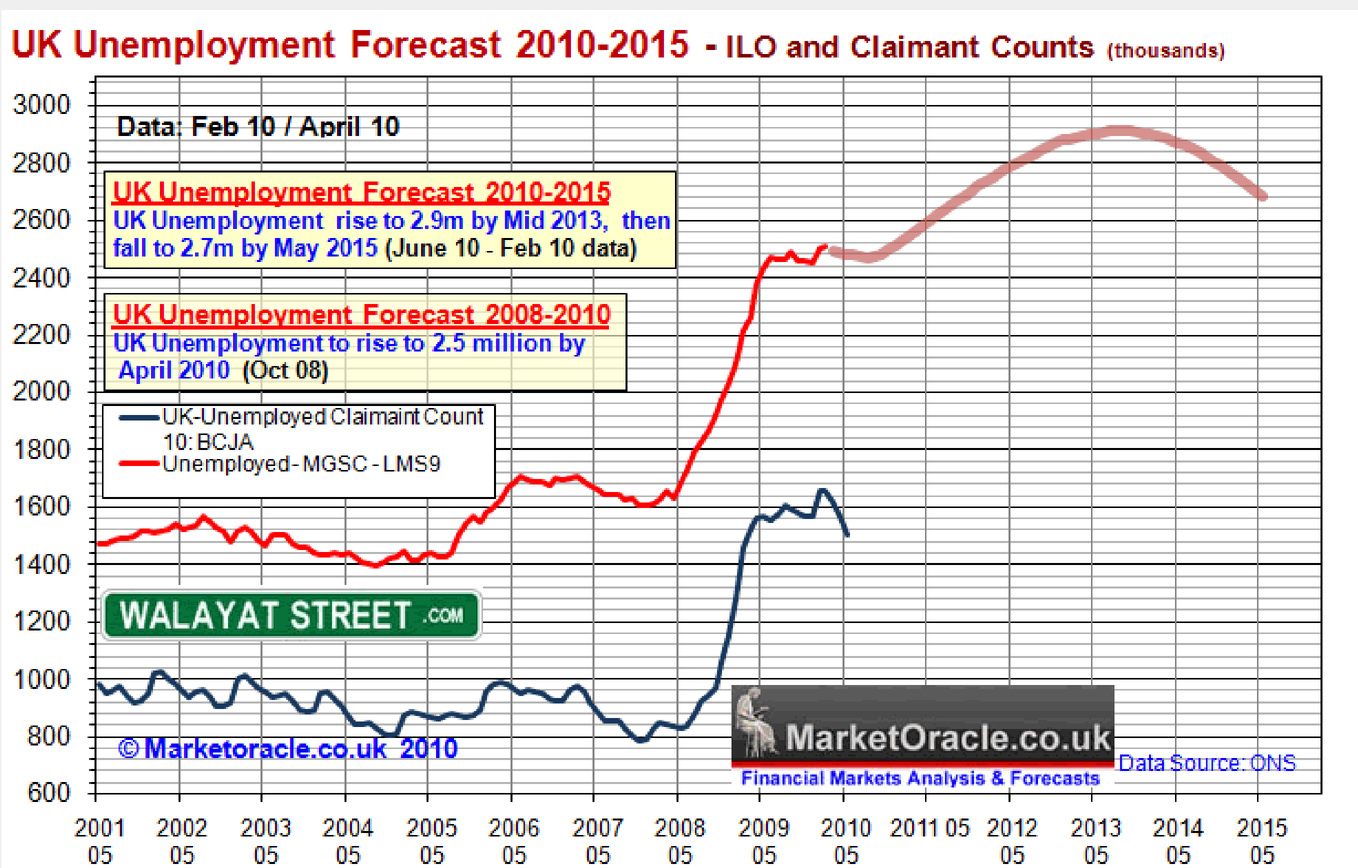
## Economic Coin Flips

Economic analysis is not a science or an art but the calling of a series of coin flips (as is stock market analysis), the actual determining item that flips into a final conclusion may be something inconsequential on its own, realising this will put analysts ahead of the curve. The Grand Media Star Wizards that propagate the press and academic institutions use formulae's and theories as smoke and mirrors to try and persuade you otherwise, but still at the end of the day come out with statements such as there is a 50/50 chance of a double dip recession, 50/50 chance of deflation, 50/50 of..... However without firm actionable conclusions such statements are pretty much worthless. The bottom line, despite the coalition governments severe but highly necessary austerity measures, the actual probability of a double dip recession is extremely low, so instead of a 50% coin flip, I would put it as low as a 15% probability.

## Coalition Government Election Boom 2014-15 Strategy

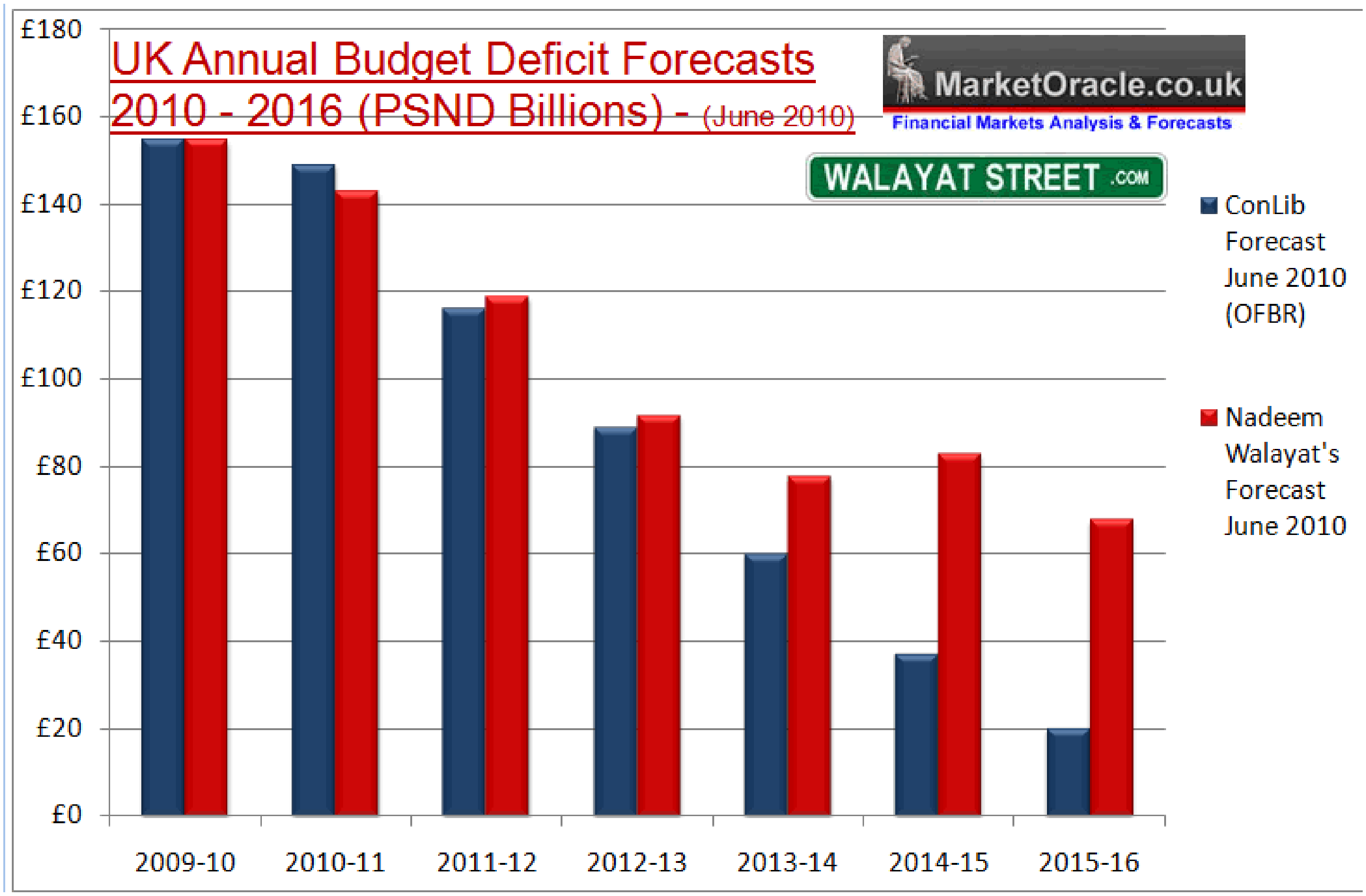
The governments intention to pull a potential 9% of demand out of the economy by 2015-16 means that the next 3 years at least are now going to result in weak economic growth as at least 1 million jobs will be lost (500,000 public sector and 500,000 linked private sector jobs) that are only partially offset by new private sector jobs created as illustrated by the UK unemployment forecast below (01 Jul 2010 - UK Unemployment Forecast 2010 to 2015 ).

> ***Final conclusion** - UK unemployment looks set to gradually rise to a peak of just over 2.9 million by mid 2013 before stabilising and starting to decline into a May 2015 General Election of just below 2.7 million against the governments forecast for UK unemployment to fall to 2 million by 2015 (OFBR - Peak at 8.1% this year before falling to 6.1%).*



Though beyond the job cutting phase into early 2013 we enter the electioneering phase of the Coalition government in the run up to the May 2015 General Election, that is likely to see significant tax cuts which will place the economy in a far stronger growth state, which by then will have significantly larger more productive private sector economic base than the current position where the public sector under the Labour government has mushroomed to an unsustainable 53% of the economy. This trend expectation is illustrated by my debt forecast (29 Jun 2010 - UK ConLib Government to Use INFLATION Stealth Tax to Erode Value of Public Debt ), that implies that the Government will abandon its deficit cutting austerity programme during 2013 so as to maximise the the potential for an election win in May 2015.




The coalition governments election boom strategy suggests that 2013 may turn out to see stronger economic growth than the 1.3% forecast of December 2009, with the forecast for 2014 of 3.1% remaining the most probable outcome.

## HMRC and Company Bankruptcies

During the recession the HMRC had agreed for many small companies to delay payment of taxes, now as the economy recovers it will be going after these small companies, a significant number of which will go bankrupt. The HMRC is chasing approx £10 billion which roughly translates into a potential of 100,000 company bankruptcies, thus adds to some downward pressure on the economy during the next 2 years against the OBRS more optimistic growth forecast.

## Why You should Not Pay any Attention to PIMCO on the UK Economy

the PIMCO $1+ trillion dollar bond fund on face value appears to be failing in all directions on the UK economy. A few weeks ago PIMCO's head Bill Gross was calling UK gilts nitroglycerine. Now he has apparently turned bullish on the UK economy and UK debt market, so has gone from imminent collapse to a strong bull in just a few weeks.

It seems obvious that if mega market moving funds of over $1 trillion want to buy a sizeable position in a market then the best thing to do is to talk the market down to accumulate into it, which appears to be what PIMCO has been doing which is reflected in sterling's strong trend, as instead of the Gilt market falling it has actually risen quite strongly since Gross's doom comments. The lesson here is to consider the media stars that do the rounds on the likes of CNBC and Bloomberg as either propagandists that are not going to tell you anything that you will actually profit from, as position's to be accumulated or academic economists trying to sell their latest books.

## Stocks and Housing Bull Markets Generate Economic Growth

As is usually the case, the press and academic economists remain permanently fixated on looking through the rear view mirror, writing reams and reams to explain what has already happened. Whilst their response to one of the greatest drivers for economic growth is to state that that the stock market is detached from reality. Yes I said DRIVER, not LEAD INDICATOR which is the consensus view that the stock market rises to discount future economic growth, which is not quite accurate, a rising stock market acts as a strong positive feed back loop that GENERATES economic growth, that GENERATES RISING Corporate Earnings.

This is why the vast majority of analysts that are fixated on valuations and corporate earnings conclude that stocks cannot rise because they are over valued by as much as 40%. When the reality is that the stock market TREND MANIFESTS the economic reality, as I pointed out in Mid March 2009 (Stealth Bull Market Follows Stocks Bear Market Bottom at Dow 6,470) whilst many prominent analysts were stating at the time that stocks could not rise due to the fact that corporate earnings were expected to collapse instead corporate earnings are now materialising to surprise to the upside which is despite the fact that the banks are not lending. I would imagine that the banks are viewing the surge in corporate earnings as a key indicator for increasing lending going forward to finance mergers and acquisitions, something that will NOT appear in analysis of rear view mirror statistics on bank lending.

The bottom line - The stock market as a whole does not FOLLOW or LEAD, it GENERATES economic activity. The trend expectations as of March 2009 remains for a multi-year bull market with the forecast trend road map for 2010 illustrated below -

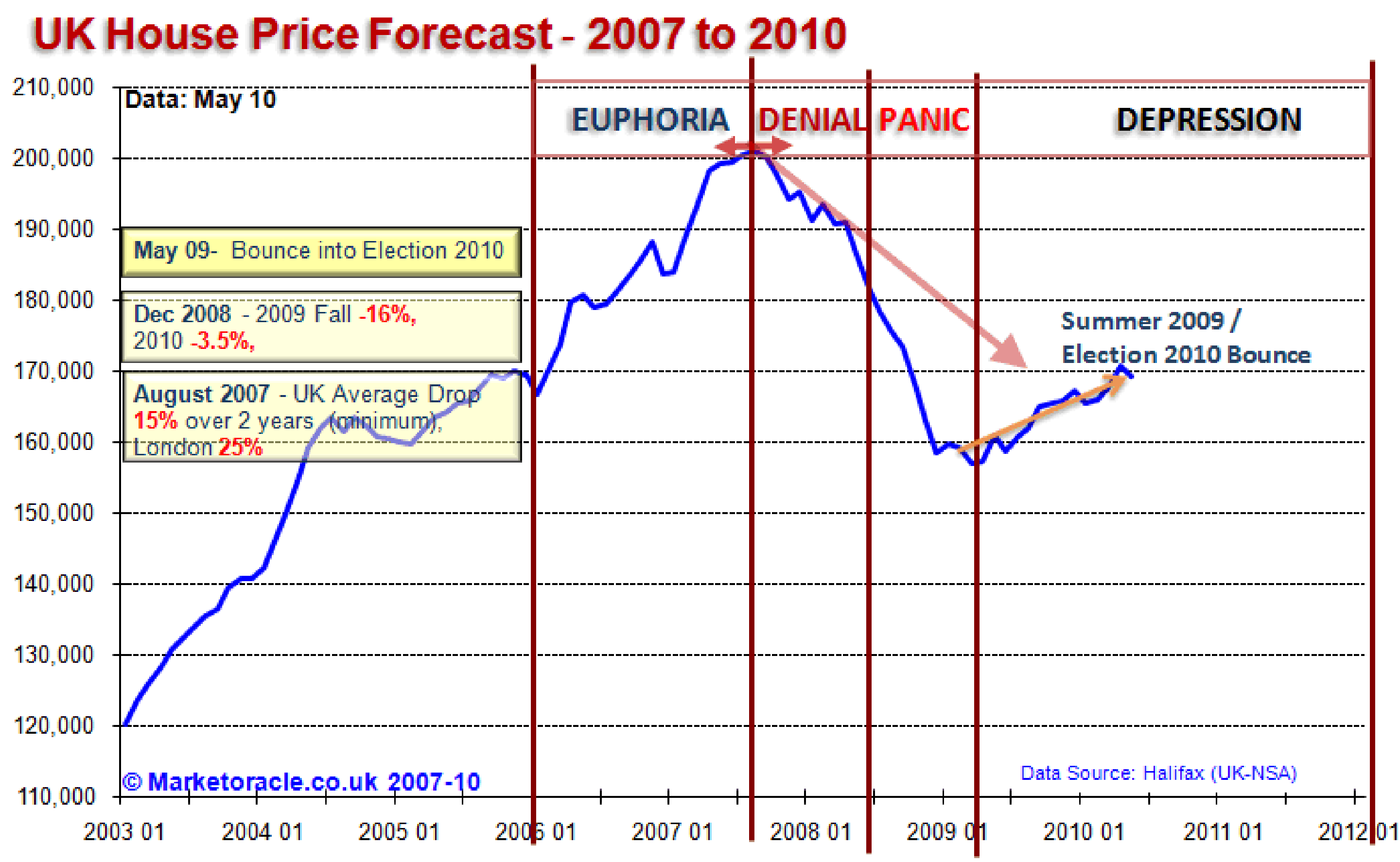

My forecast remains for the Dow to target 12k to 12.5k by late 2010, or about a 15% advance on the current level (10,653) which converts into upward pressure on GDP for the balance of 2010 and into 2011, so is not suggestive of a double dip recession at least for the rest of this year and into mid 2011, if anything U.S. growth may actually surprise to the upside, which is contrary to the current stream of 50/50 double dip recession coin flip commentary in the press.

The Dow's most recent price action has now fulfilled my last in depth analysis trend expectation of May 2010 (16 May 2010 - Stocks Bull Market Hits Eurozone Debt Crisis Brick Wall, Forecast Into July 2010 ) for the Dow to target a low to 9,800 during June to be followed by a rally to 10,700. My next in depth analysis is now pending to cover the period into October that will primary focus on the timing for the prospects of the break to a new bull market high and the quality of any corrective downdraft expected during October, to ensure you receive this in your email in box ensure you are subscribed to my ALWAYS FREE newsletter.

Many analysts point to falling government bond yields as being bearish for stocks, I would say NOW the complete opposite is true, bonds are in fact in a bubble, with safe high dividend paying stocks effectively dirt cheap. What's going to give ? Even lower bond prices ? I don't think so ! There is going to be a major repricing exercise that is going to send stocks sharply higher and bond prices sharply lower that will leave the majority of commentators rewriting what they are writing today to pretend they saw the repricing coming when the exact opposite is true!

Asset Prices - The same asset price inflation inducing growth can be applied to other major asset classes such as the UK housing market that has bounced by more than 10% off of the March 2009 lows, and personal savings that have acted as a drag on the economy as net interest rates being paid are less than half the official CPI inflation rate. However the overall wealth effect on future growth has been strongly positive taking all asset classes into account that is feeding into strong UK economic growth for 2010 into 2011 as we are witnessing in the most recent UK GDP growth data.

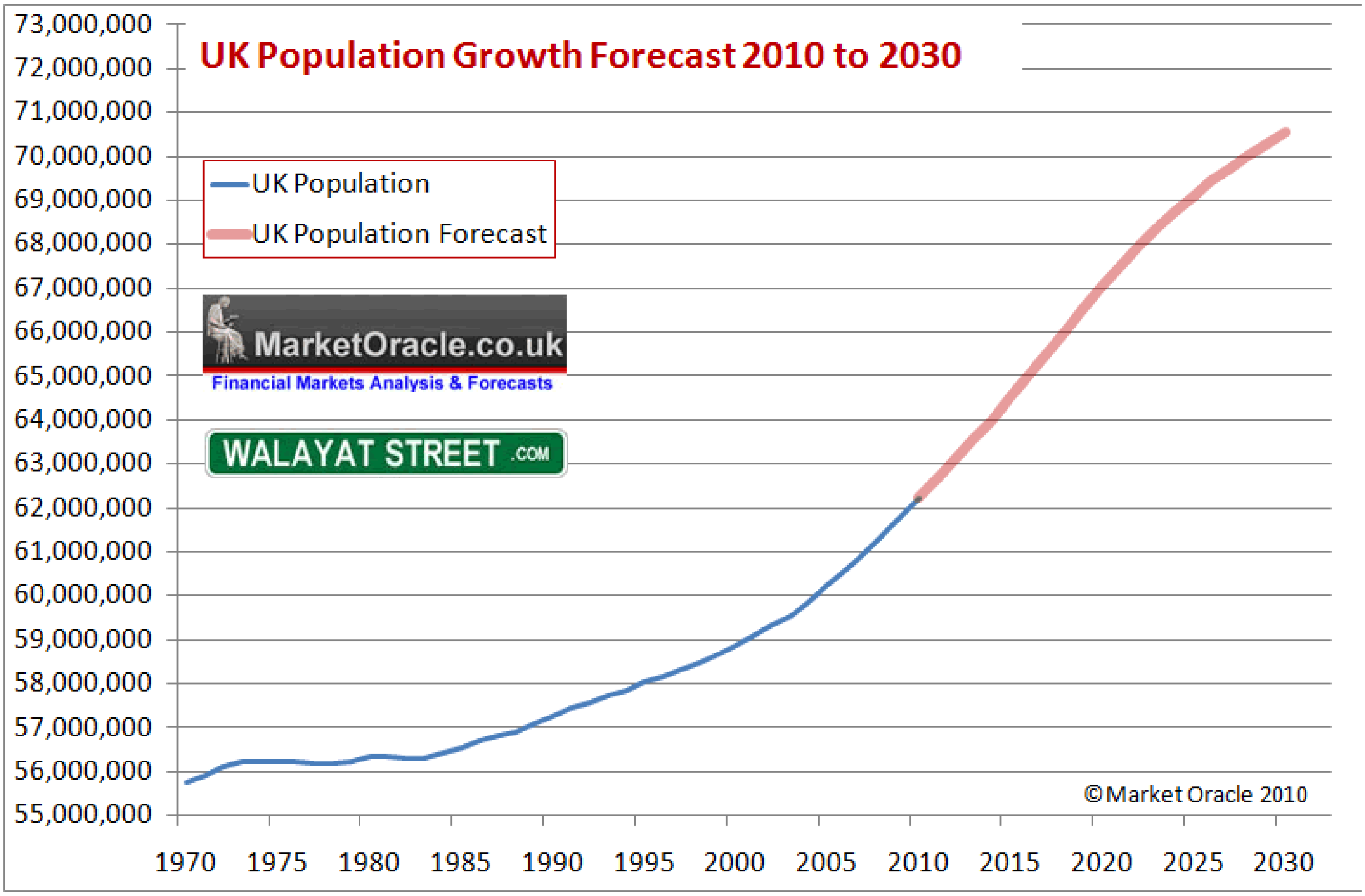



An in depth analysis of UK house prices that will culminate in an multi-year forecast ebook is now underway which I aim to complete within the next 6 weeks.

## UK Population Growth Driver

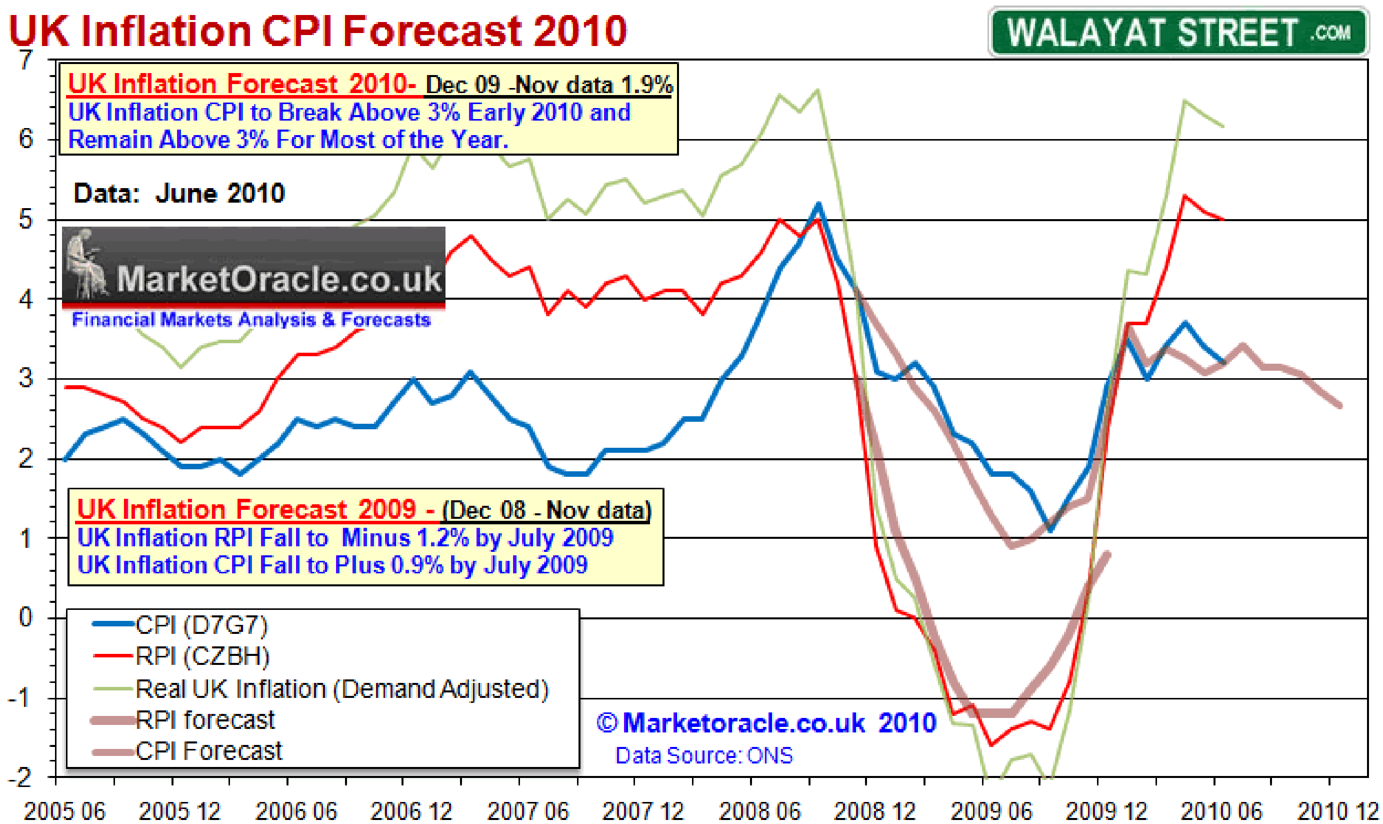
Whilst much of Europe's population stagnates, UK population continues to grow strongly as a consequence of a positive births / deaths balance and continuing immigration that contributes towards 1/3rd of the increase in Europe's annual population occurring in Britain. The recent UK population growth analysis article (02 Aug 2010 - UK Population Growth and Immigration Trend Forecast 2010 to 2030) concluded in the following forecast trend graph.




The impact of a rising population is to continue to put upward pressure on nominal GDP even if it means not much change in per capita GDP. Which also continues to feed the UK Inflation Mega-Trend.

## High UK Inflation Plus Low Growth Equals Stagflation

UK Inflation of CPI at 3.2% for June 2010 is exactly in line with my trend forecast for 2010 as of December 2009 that projected June inflation data of 3.2%. My analysis since November has been warning of a spike in UK inflation as part of an anticipated inflation mega-trend (18 Nov 2009 - Deflationists Are WRONG, Prepare for the INFLATION Mega-Trend ) that culminated in the forecast of 27th December 2009 (UK CPI Inflation Forecast 2010, Imminent and Sustained Spike Above 3%) and the Inflation Mega-trend Ebook of January 2010 (FREE DOWNLOAD) as illustrated by the below graph.



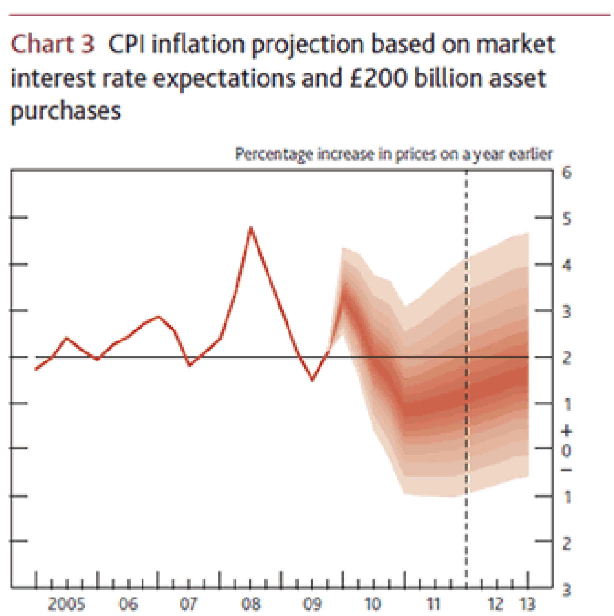

Inflation as illustrated at length in the INFLATION MEGA-TREND EBOOK, is a powerful stealth tax that the new government is using to first stabilise and then reduce the debt in terms of percentage of GDP that despite total debt increasing by 50% to £1.24trillion, the ConLib government aims to stabilise the debt at about 70% of GDP and then target a trend lower to about 65% of GDP by 2016.

## Bank of England's Worthless Inflation Forecasts

According to the Bank of England's forecast for UK inflation of 18 months ago (Feb 2009) - June 2010 CPI Inflation should by now be at 0.9%, instead of the actual rate of 3.2%. Whilst this years Bank of England Inflation Report (Feb 2010) of barely 6 months ago forecast that UK inflation by June should have fallen to about 1.8%, instead it is at 3.2% (see graph).

Therefore how credible have the Bank of England's persistent claims that the ongoing rise in UK inflation is just "temporary" and that it is forecast to fall to UNDER 1% by the end of 2010 (Feb 2010) ?

The Bank of England has a track record of being wrong 96% of the time in its inflation forecasts of where inflation will actually be in 2 years time, as the usual mantra is for UK inflation to magically converge to 2% in 2 years time, much as the graph on the right concludes towards.



## VAT 20% Inflation Surge Time Bomb

The ticking inflation surge time bomb has been primed to go off during early 2011 as a consequence of the ConDem governments emergency budget VAT hike from 17.5% to 20% that will likely result in an surge in Inflation to above 4% CPI and 6% RPI as I wrote of during the election campaign (05 May 2010 - [Greece Economic Depression Resulting in INFLATION NOT DEFLATION Surge]() )

> *A post UK election VAT hike to 20% from 17.5% is near certain to bring in extra revenue of about £13 billion per year. This will have the effect of both spiking inflation sharply higher and maintaining the ongoing longer-term inflationary mega-trend, therefore I would not be surprised that following the implementation of a VAT tax hike that CPI spikes above 4% and RPI as high as 6%! Which would further discredit the Bank of England's mantra of "Don't Worry Folks its Only Temporary".*

I wonder how many ordinary UK citizens will still believe the Bank of England's statements of temporary inflation when they see Inflation of CPI 4%+ and RPI 6% a year on. Will they still be willing to accept wage hikes of 2% or even freezes, or will they start to demand ever higher wage rises to match surging inflation and hence feed the the wage price spiral.

Therefore my expectations remain unchanged for the continuation of the high UK inflationary trend well into 2011 and beyond, with an in depth forecast for 2011 to follow before the end of 2010 that will aim to replicate the accuracy of this years forecast. Overall in economic terms this points to a long period of stagflation i.e. low economic growth plus high inflation.

## Low UK Interest Rates Only for the Banks

The Bank of England kept UK interests on hold at 0.5% last week as it continues its policy of IGNORING HIGH UK inflation that continues to stand above the Bank of England's 3% upper limit for the purpose of the BoE continuing to funnel tax payer cash onto the balance sheet of bailed out bankrupt banks as illustrated by the most recent banking sector profit announcements, most of which are fictitious as in actual fact the banks are not generating any profits because they continue to only partially write down bad debts. The only reason why bankrupt banks are announcing profits is so as to allow them to pay their chief officers huge bonuses as a reward for succeeding in conning the tax payers by means of threats of financial armageddon as inept regulators with themselves having one hand in the cookie jar watch on as they intend to return to commercial banking themselves so as to have their turn at getting a piece of the tax payer funded bailout pie.

The ways and means by which these fictitious profits are being achieved are many, such as The Bank of England loaning the banks at 0.5% which they then run along and invest at zero risk in longer dated UK government stock at 3.5% and thus make a 3% risk free profit with the tax payers money, meanwhile the ordinary tax payers who have been saving hard all their working lives are seeing the value of their savings being stolen by means of the stealth inflation tax as banks drunk on central bank cash pay a pittance of less than 2% in interest whilst even the official doctored CPI inflation rages at 3.2%, well above the BOE target of 2%. And not to forget the government adding insult to injury by TAXING the pittance of interest received at 20% for basic rate and 40% for higher rate tax payers.

Similarly borrowers are not receiving anywhere near 0.5% for loans and mortgages as most mortgage borrowers will be lucky to see any rate below 4% with many on rates of as high as 6% which is resulting in huge profit margins for the banks that continue to penalise their customers for their own mistakes. Where savers and borrowers are concerned Britain would be far better off with a nationalised banking sector that exists purely to service the loans and savings market rather than the bankster elite maximising the amount of money that can be stolen from tax payers, savers and borrowers by means of an officially sanctioned artificial banking system.

In all probability we remain sometime away from a point when the tax payer monies stop being funneled onto bank balance sheets which implies a continuing theft from savers of the the value of their wealth by means of inflation and interest income tax, which means continuing low interest rates, which is set against my forecast of January 2010: UK Interest Rates Forecast 2010-11: UK interest Rates to Start Rising From Mid 2010 and Continue into end of 2010 to Target 1.75% / 2%, Continue Higher into Mid 2011 to Target 3%. ([UK Interest Rate Forecast 2010 and 2011]() )

This requires in depth analysis to fully evaluate the impact of the coalition government hitting the reset button on the economy, which will follow in the next few days, to receive this in your email box ensure you are subscribed to my [Always FREE newsletter]().

The impact of continuing low interest rates 'should' act as a huge boost for the UK economy,however the bailed out banks are NOT Lending to small and medium sized businesses, this is illustrated by Lloyds TSB statements of increasing lending to small business by £24 billion, whilst hoping that people will ignore the fact that there has been NO increase in NET lending i.e. new lending is offset by repayments from businesses.

In total that banks have sucked an estimated £50 billion OUT of the economy instead of increasing lending by £60 billion as promised several times to previous Labour Government. Therefore the benefits of the 0.5% interest rates are only being reaped by the banks and not the wider economy. The impact of this is that the 0.5% interest rate is having little effect on the UK economy, therefore a rise in UK interest rates to 1% would similarly have little effect on the UK economy but would increase the cost of financing Britains huge budget deficit and the continuing tax payer bailout of the banks. The implications for the UK economy are for UK interest rates to be maintained at a low rate until more of the bank bad debt losses have been paid for by the tax payers.

However even when the banks become more liberal in lending, the boom years of 120% mortgages are not even apparent on a 5 year time horizon, which suggests consistently below trend economic growth for many years if not the rest of the decade.

The Bank of England has succeeded in inflating the bank share prices towards break even levels where the capital injection elements of the tax payer funded bailouts are concerned. This has prompted the bankster elite and their minions in the press to start calling on the government to sell its bank shares at break even levels, whilst conveniently forgetting that the capital injections of some £100 billion amount to a mere tip of the tax payer bailout of the banks iceberg of over £1 trillion, so effectively the bankster's return to the tax payer 10% of the pie in return for 90% of the cake. Instead the government should fully nationalise all the banks it has stakes in, which despite Liberal Democrat influences is not going to happen, so the coalition government will at some point follow the Thatcher trick of selling shares on the cheap to the general public in the run up to the May 2015 general election which will have an economic wealth effect as share buyers will be sitting on instant profits of as much as 30%.

The bottom line - The Bank of England is paralysed by the fear of Credit Crash II, therefore it is sowing the seeds of high inflation for many years if not more than a decade by NOT Acting to bring inflation under control during 2010, the price for which is being paid for by ordinary citizens.

## Stuttering Euro-Zone and U.S. Economic Recovery's

Europe - Europe has been reeling from the sovereign debt crisis shock waves emanating out of Greece, Spain and the other PIGS, however whilst the headlines of debt deflationary depressions may hold true to an extent for the PIGS, they do not speak for the other 85% of Europe, especially the industrialised north with Germany at the heart of the economic revival. especially as a weak Euro currency acts as a huge boost for German exports. Therefore the PIGS crisis has been hugely beneficial for Germany which despite having to bail them out looks set to enjoy a strong exports led economic recovery over the next few years. With other north european countries not too far behind. The effect of a strong recovery plus weak currency therefore suggests inflation and higher interest rates are not too far away for the eurozone which is contrary to the current mainstream press clamour of eurozone deflation, depression and calls to cut Euro zone interest rates when the exact opposite is more probable.

U.S. - The immediate focus of attention in the U.S. has been on abysmal U.S. jobs numbers that have seen no change in the headline U.S. unemployment rate of 9.5% which has barely changed from the recession peak of 10.1% registered in October 2009. Many commentators have concluded that this further confirms expectations that the U.S. is heading for a double dip recession.

Whilst the economic numbers do look bad when taken individually, especially in the face of the US governments and Feds ongoing fiscal and monetary stimulus which is contrary to the increasing austerity of Europe. However that can also be down to the fact that increasing the size of the government is NOT actually what is best for generating sustained economic growth as increasing the public sector by means of increasing debt just crowds out the productive private sector which will result in lower economic activity, especially as deficit spending is not sustainable. Therefore on the plus side many of the jobs being lost in the U.S. are state and federal public jobs whilst most of the jobs being created are private sector which as we can see are more or less canceling out in the headline figures but are a positive in terms of generating economic growth.

Also as is the case of the trend for UK unemployment, US unemployment is not going to suddenly fall and may even rise as companies will remain reluctant to hire until they see a government that is in firm control of the economy rather then one that apparently only knows how to press the print money button. So U.S. unemployment may yet have to peak, which does not bode well for the Democrats in terms of U.S. politics i.e. the mid-term elections in November 2010, which suggests continuing engineering (printing money) to artificially hold unemployment down until the elections are out of the way which effectively means delaying real economic recovery.

Looking at the markets once more to see what is actually happening against what should happen we see a stock market that is just 5% from its bull market peak which implies a growing economy and the U.S. Dollar that has gone into reverse gear that implies a weaker economy and low interest rates with more money printing. Whilst not signaling a double dip recession, it is neither signaling a strong U.S. Economic recovery therefore continues to suggest a low growth outcome as the most probable outcome for the U.S. over the next few years which is similar in expectations for the U.K. economy i.e. well below trend growth for 2011 to 2013.

Bottom line - The large industrialised export orientated areas of the Eurozone such as Germany are going to BOOM! Therefore the PIGS sovereign debt crisis is old news. The U.S. looks set to experience sluggish growth.

## China Boom Continues

The Chinese central planning capitalists are succeeding in slowing the over heating Chinese economy down towards a growth rate of about 8%, this is prompting the press and aspects of the BlogosFear to conclude that China is heading for a crash, collapse , as illustrated by Marc Faber's continuing commentary -

> India Times - China may 'crash' in next 9-12 months:

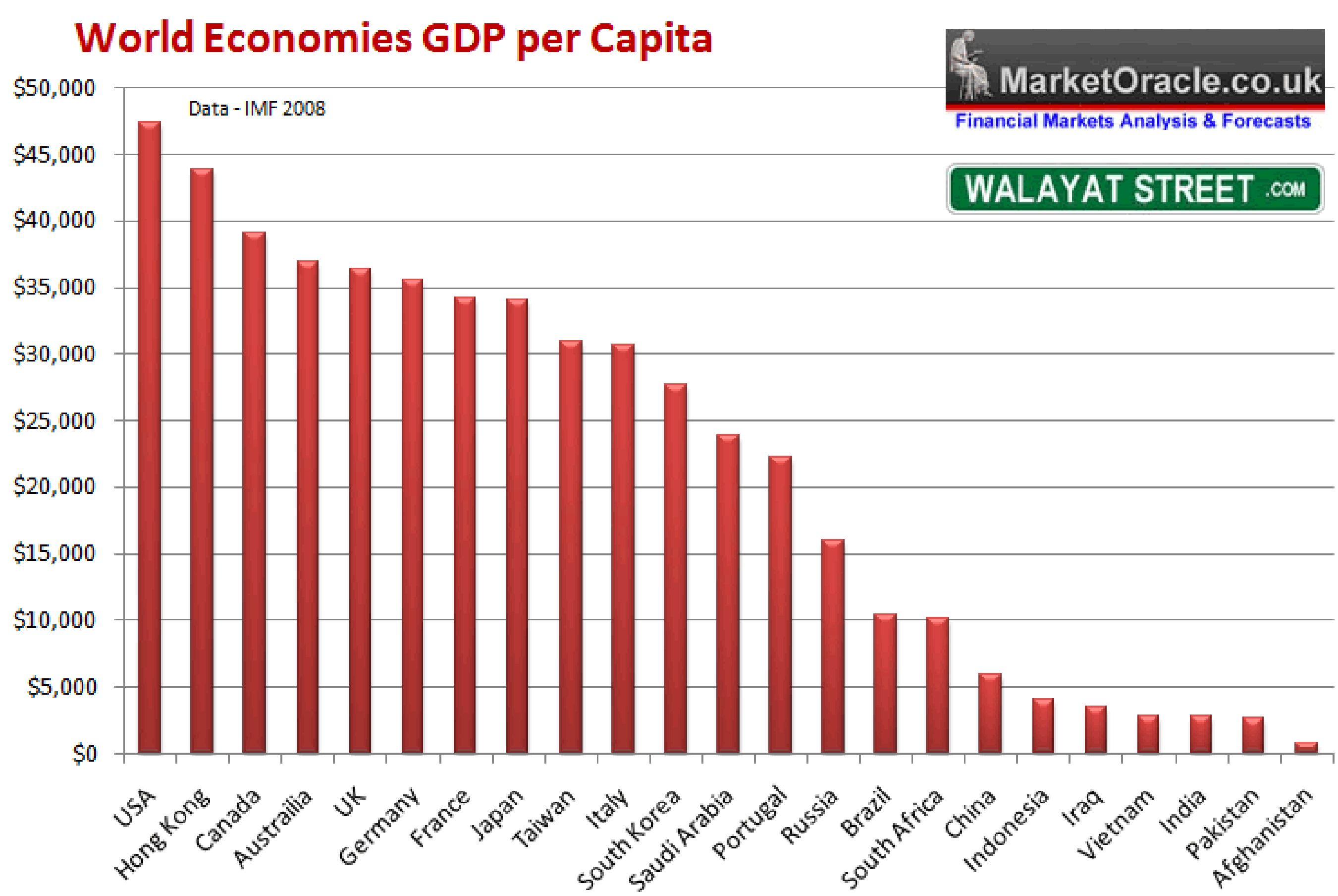
> Investor Marc Faber said China's economy will slow and possibly "crash" within a year as declines in stock and commodity prices signal the nation's property bubble is set to burst.

> "The Chinese economy is going to slow down regardless. It is more likely that we will even have a crash sometime in the next nine to 12 months."

This is in complete ignorance of the fact as illustrated in the Inflation Mega-trend Ebook (FREE DOWNLOAD), that the large emerging giants have the room to continue to grow at rates of between 5% and 10% for many more years -

Inflation Mega-Trend Ebook - Page 54

*And last but not least is the per capita graph capacity as illustrated by the following graph:*




*At the present, the mainstream press is busy worrying about the credit bubble in China, however the economic growth to date has barely bridged the huge gap between the emerging market giants and established western economies which implies a huge* *potential for the gap to narrow as manifested by strong growth in the emerging markets and below trend growth or even economic stagnation by many of the western economies which means that capital investments made today can be expected to return significant real capital growth over the next 10 years on the basis of real GDP growth that typically targets a growth increase of 100%.*

Therefore rather than economic collapse, the emerging giants are still a long way from hitting capacity constraints as measured by per capita output. There exists huge potential for increased productivity in asia whilst in the west huge over capacity as wages over the next decade or two as productivity and wages will continue to converge which implies strong growth for the likes of Chindia and low growth or even stagnation for the developed West.

This implies that investors should continue to take advantage of short-term stock market volatility that present excellent long-term accumulation opportunities as I pointed out 3 weeks ago for China (18 Jul 2010 - Stocks Stealth Bull Market Correction Generating China Buying Opportunity? ), just as many commentators were announcing that the Chinese stock market was heading for a crash when the SSEC was trading at 2,424, with the continuing benefit and real time experience for western investors of an appreciating Yuan currency as illustrated by the strong performance of the key China FXI ETF.

## Internet Information Age Boom Continues

Human eagerness to share information appears to be encoded in our genes which is why we have trended towards the creation of the internet that at present represents the pinnacle for free sharing of information and ideas that seeks to have an exponential impact on human productivity as the reach, depth and available supply bandwidth continues to expand. All of which implies both greater overall productivity & wealth and greater equalisation of earning power across the world. Where literally bright individuals can be stationed anywhere on the planet without restriction on earning and purchasing power. Therefore despite the dot com crash of the noughties, the worlds largest companies are increasingly listing huge internet based cash cows such as Google that are increasingly driving innovation in connecting the virtual world with the real world that concludes towards ever greater personal and corporate much as the mobile phone has achieved during the past 20 years and the PDA's during the past 5 years so will the expansion in human real life immersion into virtual work and play worlds that will develop over the next 10 years driving huge gains in human productivity and economic growth, wealth and prosperity that will branch out in all directions.

The internet information age has barely begun and where the west has a clear advantage over states such as China which lacks the necessary freedom of thought elements to compete against countries such as the UK and USA (as long as they don't converge towards where China sits).

In conclusion, the economies of the west, east and south contrary to much that you will read are not heading for a Deflationary Great Depression II, World War III or the end of civilisation just as the doom mongers at the end of the last millennium were stating. The western economies point to a period of below trend economic growth with inflation for the next few years, with the UK at the head of the list, U.S. in the middle and parts of Europe averaging third in line in terms of inflation / growth rate expectations.

## Quantitative Easing

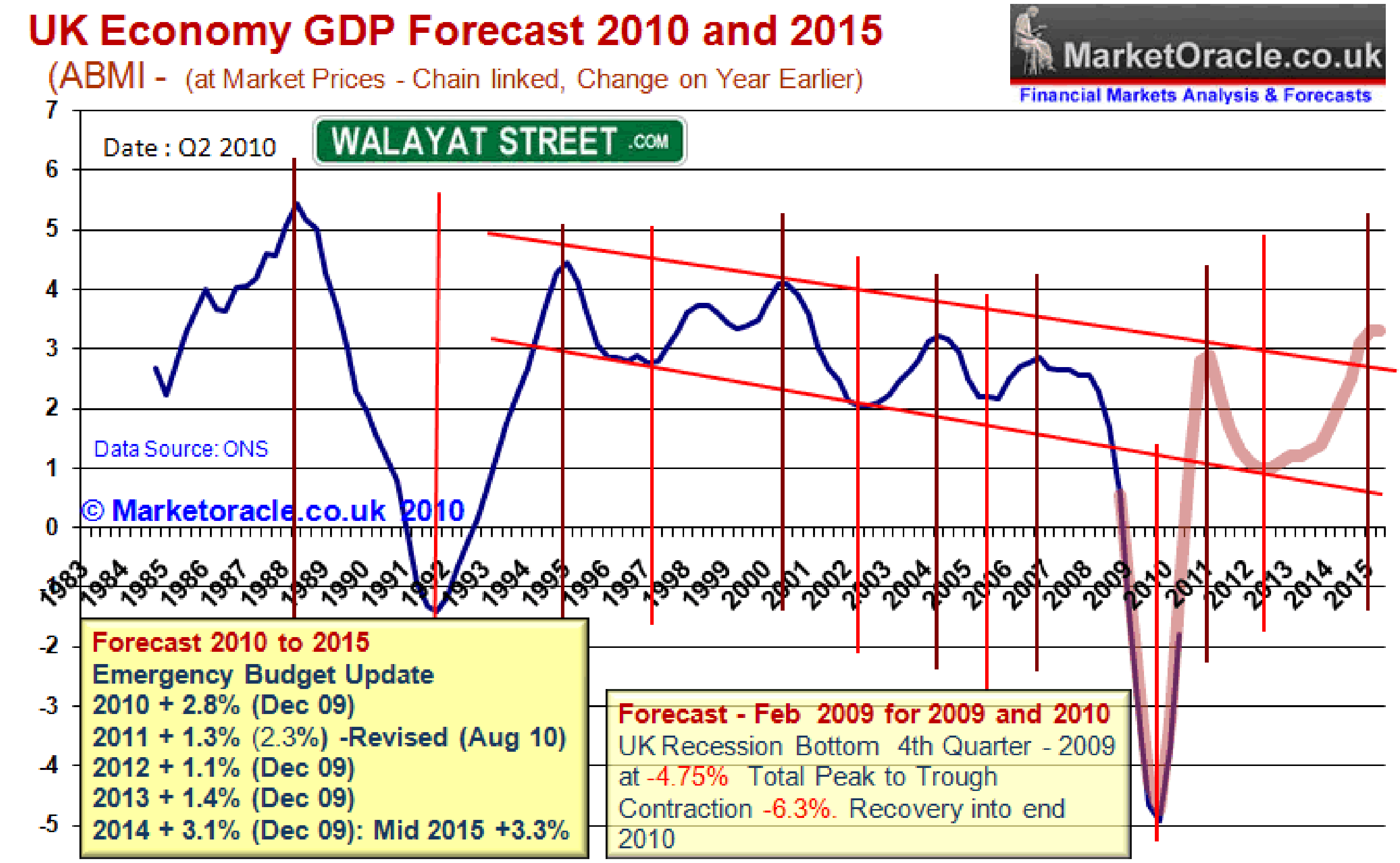
Talk of further QE had gone quite earlier in the year and remains so in the UK. However in the U.S. the talk of quantitative easing having ended in March 2010 has now been replaced with chatter for QE2. However, I have always maintained since March 2009 that once started Quantitative Easing is difficult to stop regardless of the statements emanating out of the central banks, as the only answer the governments have to weak economic activity is to continue printing money to inflate economies and asset bubbles.

## UK Growth Forecast Conclusion 2010-2015

The conclusion drawn from the sum of the above analysis is that the forecasts for years 2010, 2012,2013 and 2014 remain unchanged as per the original analysis and forecast of December 2009 (UK Economy GDP Growth Forecast 2010 and 2011, The Stealth Election Boom). However the original forecast for 2011 is now overly optimistic in the face of the governments recently announced severe austerity measures, therefore the forecast for 2011 GDP growth is revised lower to 1.3%:

- UK GDP 2010 2.8%
- UK GDP 2011 = 2.3% - Revised down to 1.3%
- UK GDP 2012 = 1.1%
- UK GDP 2013 = 1.4%
- UK GDP 2014 = 3.1%
- UK GDP Mid 2015 = 3.3% - NEW




The trend forecasts for the three years from 2011 to 2013 suggests that of a stagflationary environment of low growth and above trend inflation to be followed by an engineered election boom into May 2015 starting in 2014. Whilst growth for 2012 to 2013 is expected to be well below trend, however at this point I still do not see any signs of a double dip recession that the academics and the mainstream press have been obsessing over for the past year, in fact the London 2012 Olympics could see South East experience an early economic boom. However against this areas with large public sectors such as the North of England, Wales and Scotland, where there are city's where the public sector amounts to more than 70% of the economy probably will experience a double dip recession as the spending cuts start to hit during 2011 and 2012.

## Coalition Government Risks to the forecast

Risks to the Forecast are political, in that if the coalition government disintegrates resulting in an early general election during 2012 and 2013 then that would negate the balance of this forecast. If the coalition government can hold its nerve during these two years then it will lay the ground work towards an outright Conservative government. The problem here is that the likelihood of this will slowly dawn upon the Liberal Democrats during 2013-2014 who may then decide to pull the plug on the coalition government before they hand the Conservatives a victory in 2015. Therefore UK politics whilst quiet at the moment are increasingly going to start to heat up as the May 2015 Election nears, all of which bodes well for Labour to step in during a period of Coalition disintegration as voters by then will see the Labour debt fuelled growth years through rose tinted glasses.

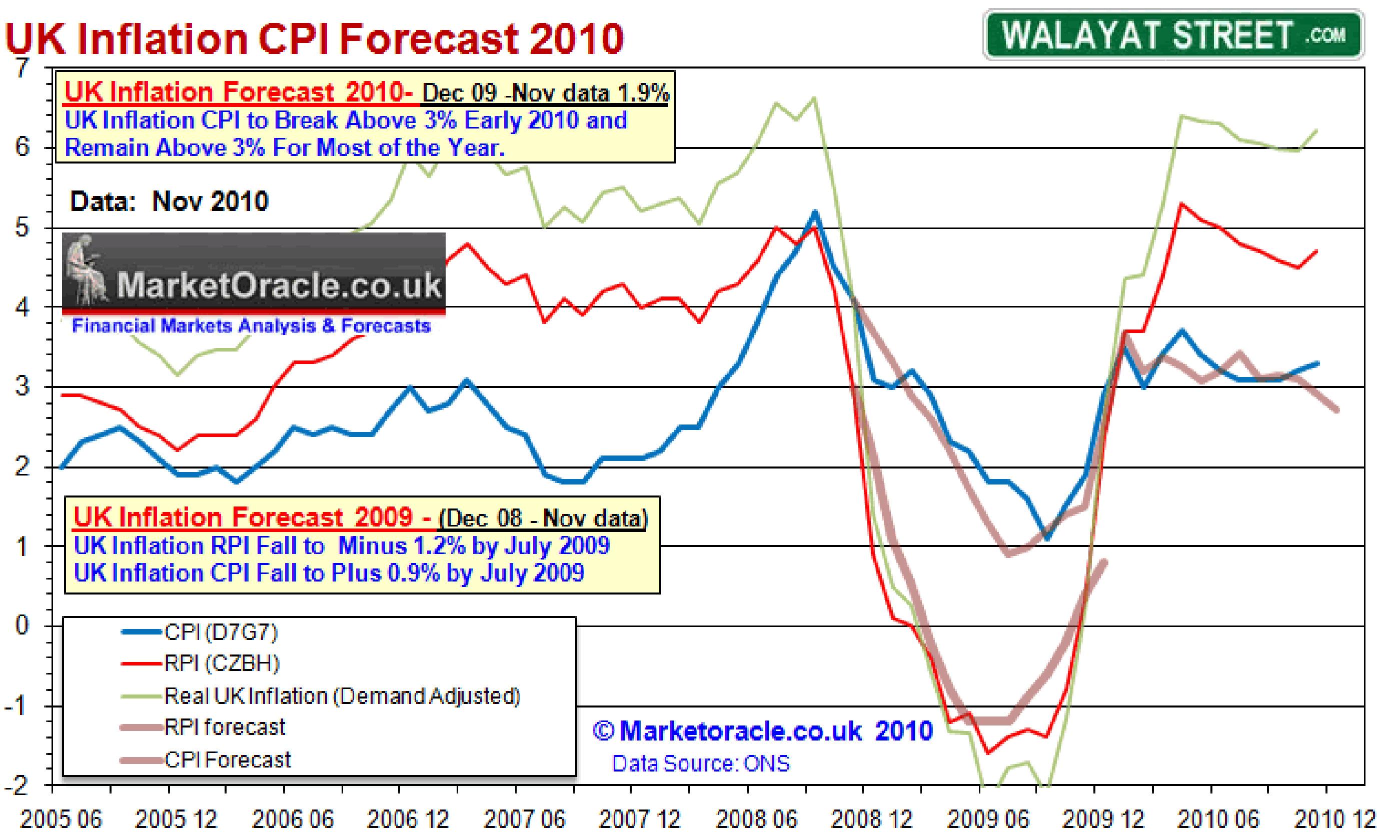
 

# CHAPTER 2

## UK INFLATION

JANUARY 2011 - The last UK inflation data came in at CPI 3.3% and RPI 4.7% for November 2010, with real inflation at just above 6%, this is set against a continuous mantra in the mainstream press by pseudo economists / journalists that high inflation of above 3% was always just temporary and that it would resolve in a sub 2% rate by the end of the year (2010). Now a year on the same people that had misguided their readerships for virtually the whole of 2010 into avoiding inflation protection strategies that the coalition government has proceeded to strip away during 2010 such as scrapping of the RPI linked Index Linked National Savings certificates in June 2010, and are only now warning their readership's of the consequences of persistently high inflation that looks set to continue during 2011.

This is set against my in depth analysis and concluding inflation forecast of December 2009, that UK inflation would spike to above 3% early 2010 and remain above 3% for virtually the whole year as illustrated by the below forecast graph (27th December 2009 UK CPI Inflation Forecast 2010, Imminent and Sustained Spike Above 3%).




The implications of high inflation for the economy and financial markets were further elaborated at length in January 2010's 100 page The Inflation Mega-trend ebook (FREE DOWNLOAD) that contained 50 pages of analysis and 50 pages of wealth protection strategies to protect and grow ones wealth during a sustained period of high inflation which would be used by the UK Government as the primary mechanism to stealth tax and erode the value of UK debt. One year on the Inflation mega-trend continues to gather momentum which means that the wealth protection strategies are just as valid today as they were in January 2010, that I will continue to update the status of during 2011.

## Bank of England Inflation Propaganda Reports 2010

High UK Inflation that has apparently surprised everyone to the upside for virtually the whole of 2010, by spiking and remaining above 3% from early in the year illustrates the tendency of the mainstream press to basically regurgitate the views of vested interests that beat the drum of always imminent DEFLATION for the whole of the year as High inflation was always just temporary and should be ignored by the general population.

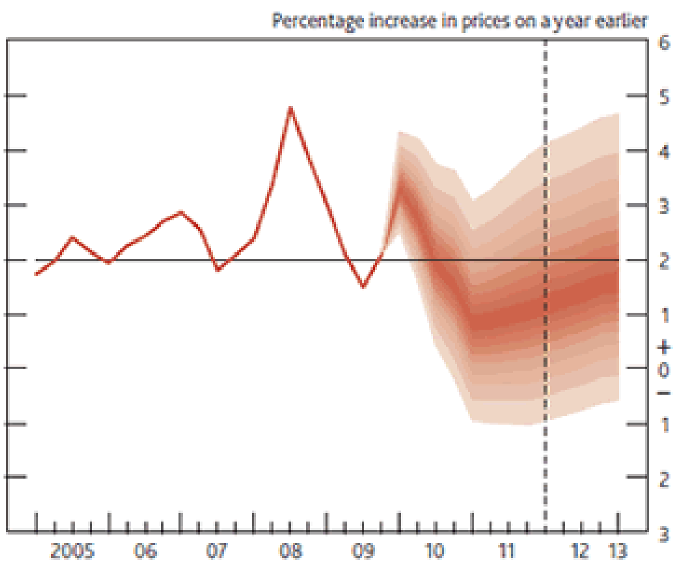
To look at the reason why high inflation has been ignored during 2010 we have to look beyond journalists, we have to look beyond academic economists that are paid to follow a school of thought that their pay masters want to push in the media. The place to look for the reason why high Inflation was ignored throughout 2010 is to the very top of the financial pyramid, to the Bank of England.

The connection that the mainstream press has never been able to make is that the Bank of England does NOT make Forecasts. Instead the Bank of England quarterly inflation forecast reports are nothing more than ECONOMIC PROPGANDA, that virtually always converge towards the Bank of England achieving its 2% Inflation target in 2 years time, despite the fact that historical analysis shows that the Bank of England FAILS in achieving its 2% target 96% of the time.

The following are the four quarterly Inflation forecast reports by the Bank of England issued during 2010 that were instrumental in academic economists and journalists in the mainstream press regurgitating the always temporarily high inflation mantra during 2010.

## Bank of England February 2010 Inflation Report

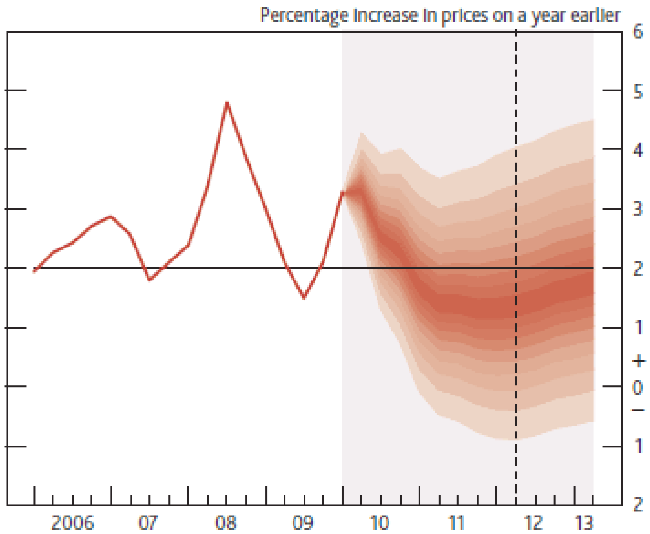
Chart 3 CPI inflation projection based on market interest rate expectations and £200 billion asset purchases




UK Inflation by Feb 2010 had as I anticipated spiked to above 3%. However the Bank of England's Feb 2010 Inflation Report forecast the spike as being temporary and to imminently to resolve in severe disinflation to target a rate of below CPI 1% by November 2010, instead UK Inflation for Nov is 3.3%.

## Bank of England May 2010 Inflation Report

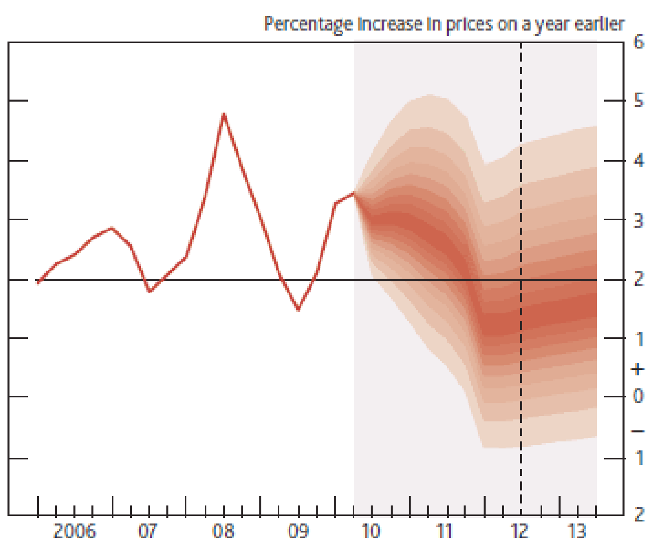
**Chart 3** CPI inflation projection based on market interest rate expectations and £200 billion asset purchases




The May 2010 Inflation report continued with the mantra of temporarily high inflation that would resolve in a rate of about 1.7% by the end of 2010, on the basis of spare capacity in the economy, the blatant flaw in the Bank of England's argument was the fact that much if not all of the spare capacity had been destroyed during the Great Recession of 2008-2009.

## Bank of England August 2010 Inflation Report

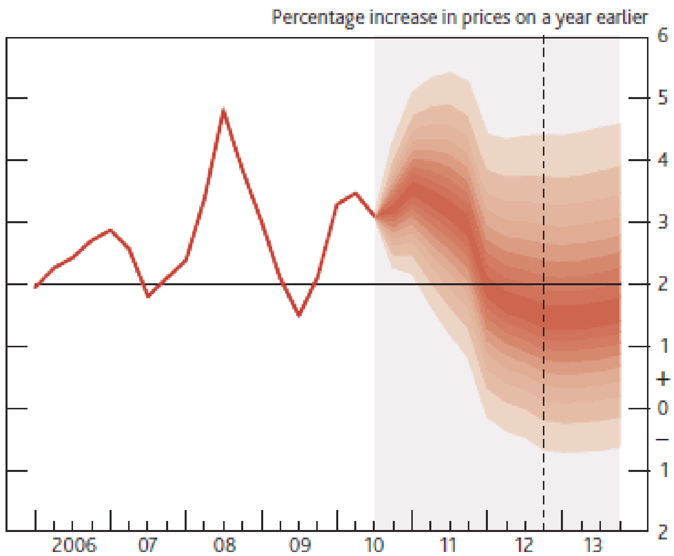
**Chart 3** CPI inflation projection based on market interest rate expectations and £200 billion asset purchases




The mantra of spare capacity, downward pressure on wages to resolve in disinflation continued in the August 2010 Inflation Report. However now with most of 2010 gone, The CPI target for 2010 was revised higher to 3% from 1% (Feb 2010), with CPI for 2011 forecast to again resolve in CPI 1%, and a sub 2% CPI in 2 years time.

## Bank of England November 2010 Inflation Report

Chart 3 CPI inflation projection based on market interest rate expectations and £200 billion asset purchases




The Bank of England's most recent Inflation Report ([November 2010](#)) now forecasts UK CPI Inflation to target an early 2011 peak of 3.5% before inflation falls to below 2% CPI by the end of 2011 to target a rate of approx 1.7%, and for inflation to remain well below 2% into the end of 2012, therefore supporting the Bank of England's persistent view that everyone should focus on the Deflation threat and ignore high inflation during early 2011 so as the Bank of England can continue to keep interest rates well below the real rate of inflation for the purpose of funneling savers and tax payers cash onto the balance sheet of the bailed out banks.

The 2010 Bank of England Inflation reports clearly illustrate the persistent trend as was the case for virtually every preceding year in that the Bank of England ALWAYS FORECASTS SUB 2% INFLATION in 2 YEARS TIME.

The Bank of England wastes millions of pounds each year on producing worthless forecasts, the Coalition Government should save this money by instructing the Bank of England to scrap its economic forecasting units.

Clearly the Bank of England relies on the gold fish memory of the mainstream press as the BoE seeks to revise inflation forecasts every quarter to always push forward sub 2% to two years forward, which is nearly always preceded by a trend to below 2% one year forward. In reality the quarterly inflation reports are just propaganda aimed at psychologically managing the populations expectations on the economy and inflation in the direction of where the BoE wants it to be, as the alternative would be to make the BoE's job harder.

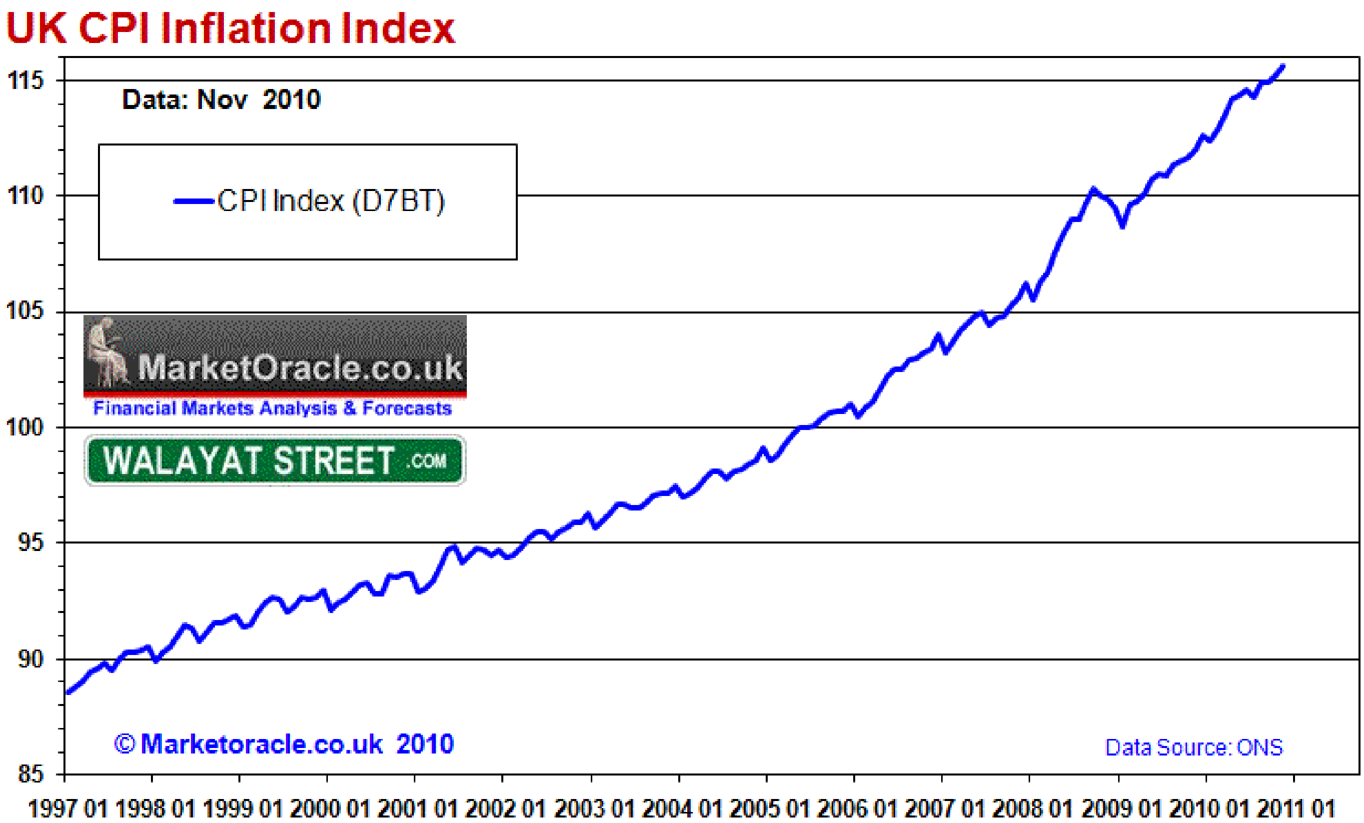
For instance if the Bank of England had stated that UK Inflation would be above its 3% target throughout 2010 then that would have ignited a wage price spiral that would have made the Bank of England's job at controlling inflation significantly harder, therefore it is much more convenient for the Bank of England to be seen to be wrong in its inflation forecasts than to attempt to accurately publicise probable inflation expectations. For instance if the Bank of England was not expecting high inflation during 2010 and beyond then why did the Bank of England's own staff pension fund switch from being 30% invested in inflation index linked government bonds to 70% during late 2009 ?

More here - The Real Reason for Bank of England's Worthless CPI Inflation Forecasts

As expected, the Governor of the Bank of England continues with the mantra of ALWAYS temporarily high inflation even as the UK stands at cusp of a further spike higher in UK's Inflation Mega-trend towards breaking above CPI 4%. The facts are that the evidence clearly shows that the Bank of England HAS LOST CONTROL of INFLATION! (Perhaps it was never in control of inflation in the first place, just lucky to have benign economic conditions during the early Labour years).

Nothing illustrates the deflation delusion more than the following UK CPI Inflation index graph, which shows that the much hyped of Deflation during the Great Recession of 2008-2009 that academic economists still cling to has turned out to be nothing more than a mere inconsequential blip along the path of the Inflation Mega-trend (Free Download).




Perhaps its time for the Bank of England to come clean and confess that it no longer targets inflation but rather nominal GDP so as to give the illusion of economic growth. After all £200 billion of QE IS INFLATIONARY that the BoE itself instigated so as to inflate asset prices so as to inflate the economy. Off course the Bank of England has screwed it up because as well as inflating the economy they have inflated consumer prices well beyond the 2% target. But as long as the economy is weak the BoE will NOT risk a double dip recession by trying to reign in high inflation.

## Global Deflation Delusion Continued Throughout 2010

The deflation delusional fed by the worlds central banks and magnified by the mainstream press that gets regurgitated in the BlogosFear continued throughout the whole of 2010, and most notably in the US, where academic's marched their readerships into a bond market slump as elaborated upon in August 2010 ahead of the crash, that concluded in the following USB forecast graph (26 Aug 2010 - Deflation Delusion Continues as Economies Trend Towards High Inflation), that forecast US 30 year bonds would fall from 138 to a target of between 120 and 115 over the next 9 months, a trend that has subsequently transpired, whilst the delusional deflationists looking in the rear view mirror at QE1 pegged their expectations on QE2 resulting in a bond market rally, though missing the whole point that QE2 would trigger PURCHASES at the SHORT-END of the yield curve (which the Fed would be buying) which would be financed by SALES at the LONG-END of the yield curve. This FACT has YET to dawn on delusional deflationist's.

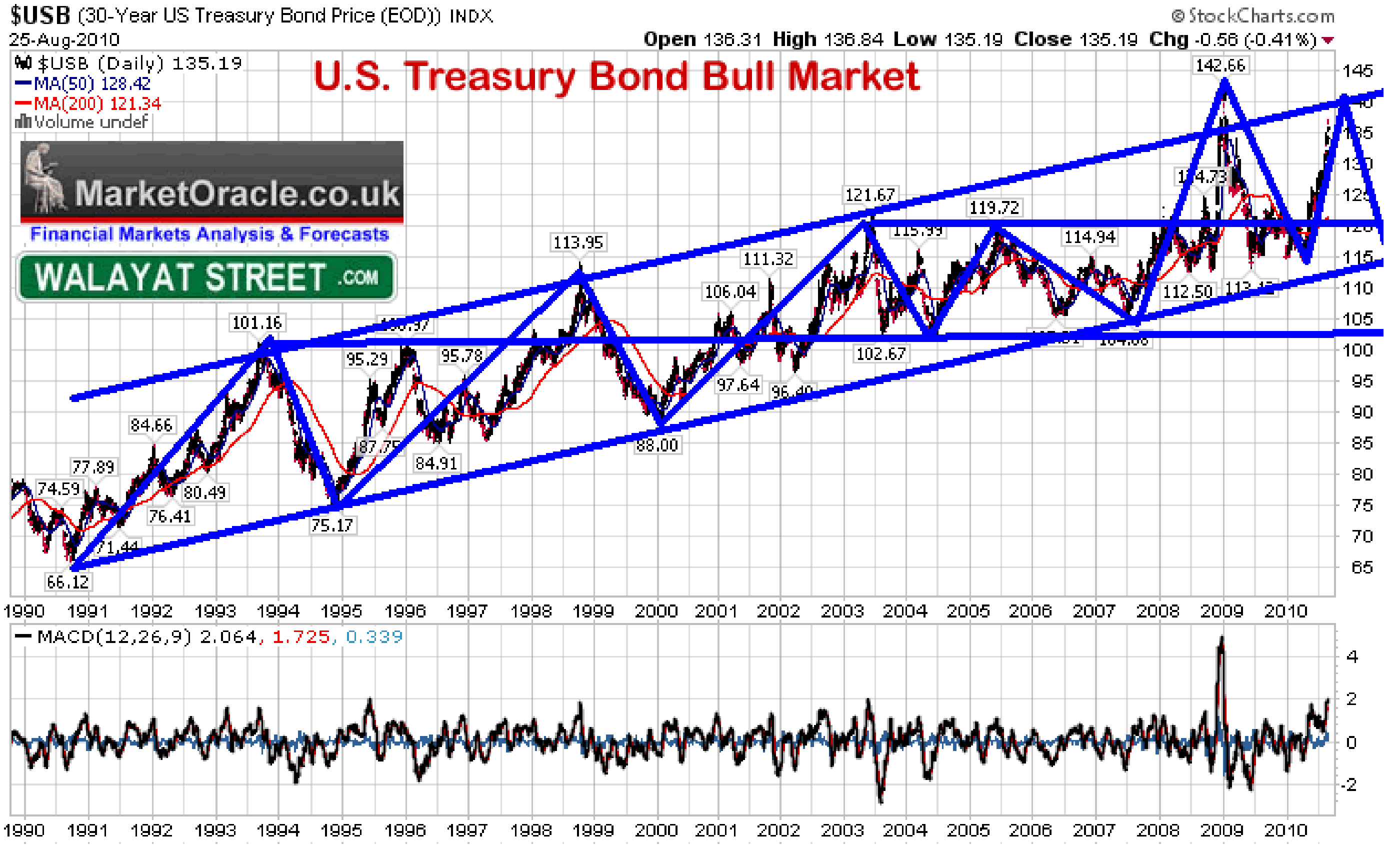



Chart courtesy of [StockCharts.com](StockCharts.com)

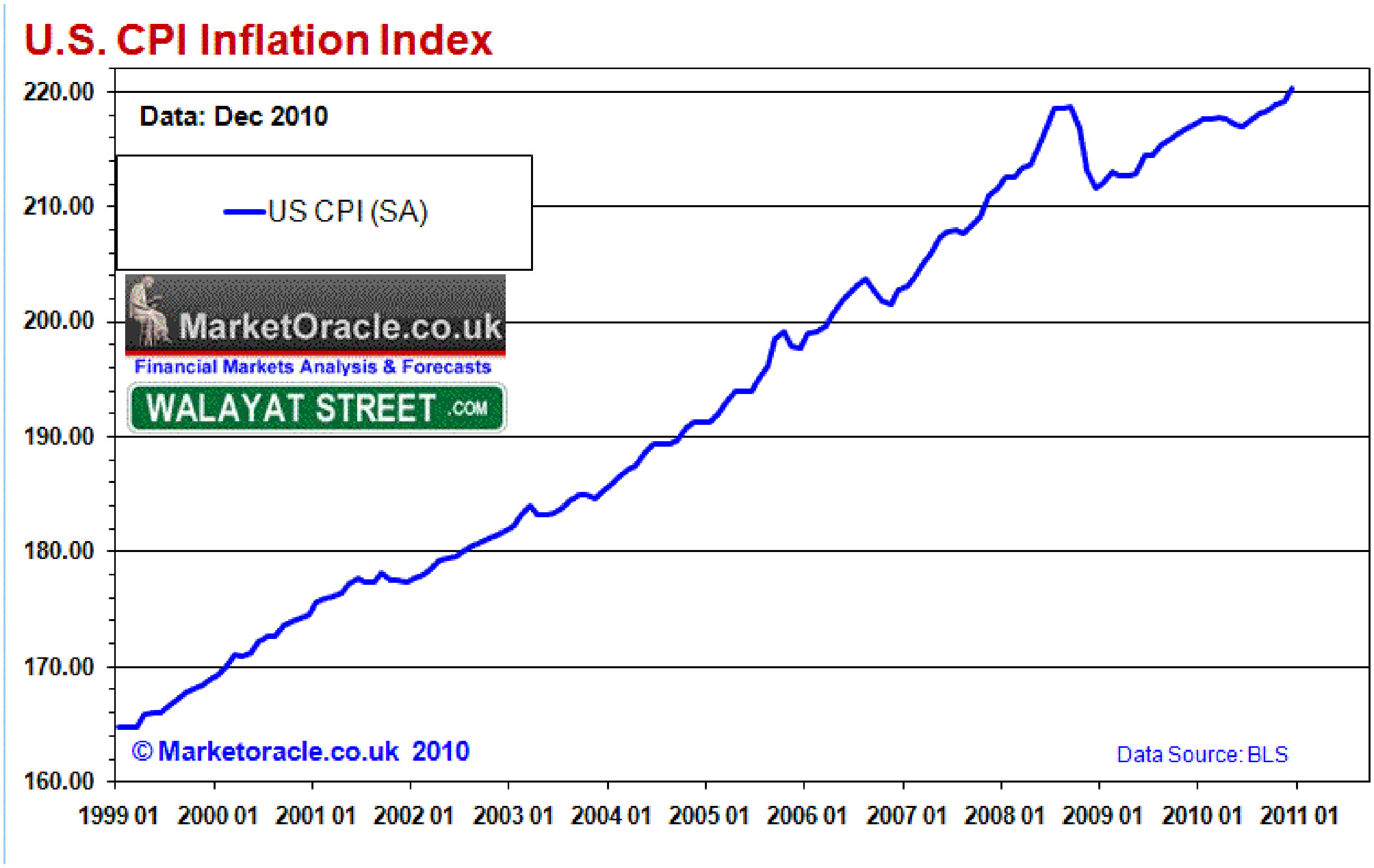
The deflation delusional continues to persist, where deflationists call upon anything other than the rising inflation indices to support ideological based thesis such as constructing nonsensical arguments that deflation exists if consumer prices are compared against the price of gold price to imply that the INFLATIONARY rise in the Gold price is a manifestation of DEFLATION because when priced in Gold (which has risen) then many consumer goods have deflated in price, despite the fact that 99.999% of the worlds population's transactions for consumer goods and services are NOT conducted in gold and furthermore ignoring the fact that the rise in the gold price is a manifestation of INFLATION, as the price of GOLD INFLATES in virtually EVERY FIAT Currency.

Further deflation propaganda fraud is perpetuated by academics and the mainstream press by pushing the low core inflation argument, though this has also risen sharply in recent months to stand at 2.7%. The basic argument here is that energy and food prices should be excluded when measuring inflation because off course everyone in the UK has stopped heating and feeding themselves. This is the drip, drip strip away anything that has risen that lies at the heart of the deflation delusion that amounts to nothing more than propaganda espoused by vested interests in the fiat currency, stealth inflation theft fractional reserve banking system.

## High Inflation Coming to the U.S. During 2011

The UK led the way in inflation during 2010 that many other economies such as the US and Euro-zone will play catchup to during 2011, thus it will be interesting to see what propaganda the deflationists come out with during 2011 to perpetrate none existant deflation as the following U.S. CPI inflation index graph clearly illustrates that US inflation has been on the rise since early 2009.




## UK Inflation Forecasting 2011

The UK Inflation Mega-trend is entering its second year, with the trend firmly in motion, this years Inflation forecast is an easier exercise to undertake than last years which required recognising an important juncture and attempted to map out a new trend that had yet to materialise so no Inflation Mega-trend Ebook necessary for 2011. It does not take a genius to workout that regardless of what the Bank of England's quarterly inflation propaganda reports state, that UK CPI inflation can be expected to remain above the banks 3% target for the whole of 2011. Therefore the question mark now is how high will UK inflation spike even on the highly manipulated official measure of CPI, let alone the more recognised RPI and on the real UK inflation measure that currently stands at just over 6%.

## VAT 20% Inflation Time Bomb Explodes

The VAT time bomb that has been ticking for the whole of 2010 exploded on 4th of Jan 2011 that will now likely result in an surge in Inflation to above 4% CPI and 6% RPI as I anticipated over 8 months ago during the general election campaign (05 May 2010 - Greece Economic Depression Resulting in INFLATION NOT DEFLATION Surge )

> ***A post UK election VAT hike to 20% from 17.5% is near certain*** *to bring in extra revenue of about £13 billion per year. This will have the effect of both spiking inflation sharply higher and maintaining the ongoing longer-term inflationary mega-trend, therefore I would not be surprised that following the implementation of a VAT tax hike* ***that CPI spikes above 4% and RPI as high as 6%!*** *Which would further discredit the Bank of England's mantra of "Don't Worry Folks its Only Temporary".*

I wonder how many ordinary UK citizens will still continue to believe the Bank of England's statements of temporary high inflation when they see Inflation of CPI 4%+ and RPI 6% in a few short months. Will they still be willing to accept wage hikes of

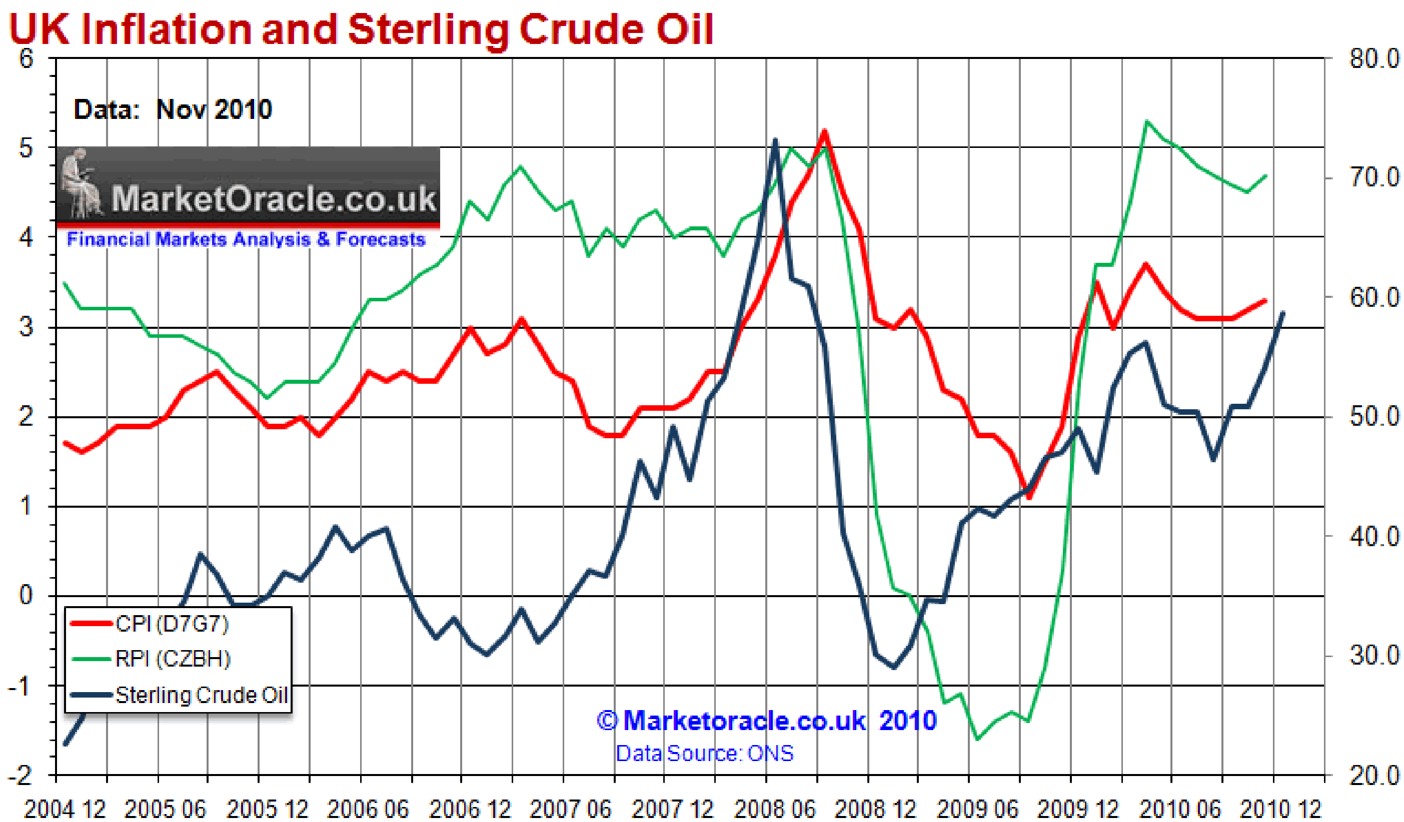
 

2% or even freezes, or will they start to demand ever higher wage rises to match surging inflation and thus feed the the wage price spiral, especially as real UK inflation looks set to break above 8%.

Therefore the VAT increase alone continues to point to an imminent spike to above 4% CPI and above 6% RPI, very early in the 2011.

## UK Inflation and Crude Oil

Whilst Gold bugs may connect rising prices with the Gold price, however where consumer prices are concerned Gold has zero impact. Consumer prices are in large part driven by food and energy commodity prices with Crude Oil as the King of all commodities for determining inflation trends. The below graph illustrates the trend for Crude Oil priced in sterling against UK CPI and RPI Inflation indices.




The graph shows a tendency for crude oil prices (in sterling) to act as a leading indicator for UK inflation of between 6 and 18 months. With normal expectations for a lead of between 6-12 months, depending on the overall state of the economy, which given that the UK economy is in recovery mode rather than in recession mode then the tendency will pull the lead against UK inflation nearer towards 6 months. The strong trend higher in crude oil during 2009 has resulted in high UK inflation throughout 2010. Crude oil during the past 12 months has manifested itself in a range with an upward bias of between 60 and 45, with the recent breakout in Crude oil signaling that 2011 is more than likely to see a continuation of the uptrend, though probably at a much shallower pace than during 2010, which is inline with expectations for sterling to firm against the dollar during 2011 and hence dollar price rises are expected to be more subdued when converted into sterling prices.

## Fuel Price Protests 2011

Crude oil prices are only part of the story as 2/3rds of the pump price is tax comprising of fuel duty and VAT. Therefore UK consumers are being hit by very large price hikes in petrol prices as VAT has gone up by 2.5% this month lifting petrol prices to a new all time high of above £1.30. With a further further duty rise of at least 4% coming in April 2011 that will act as a further accelerant on fuel price inflation that could again spark fuel protests during summer 2011 as last occurred in the UK during 2000.

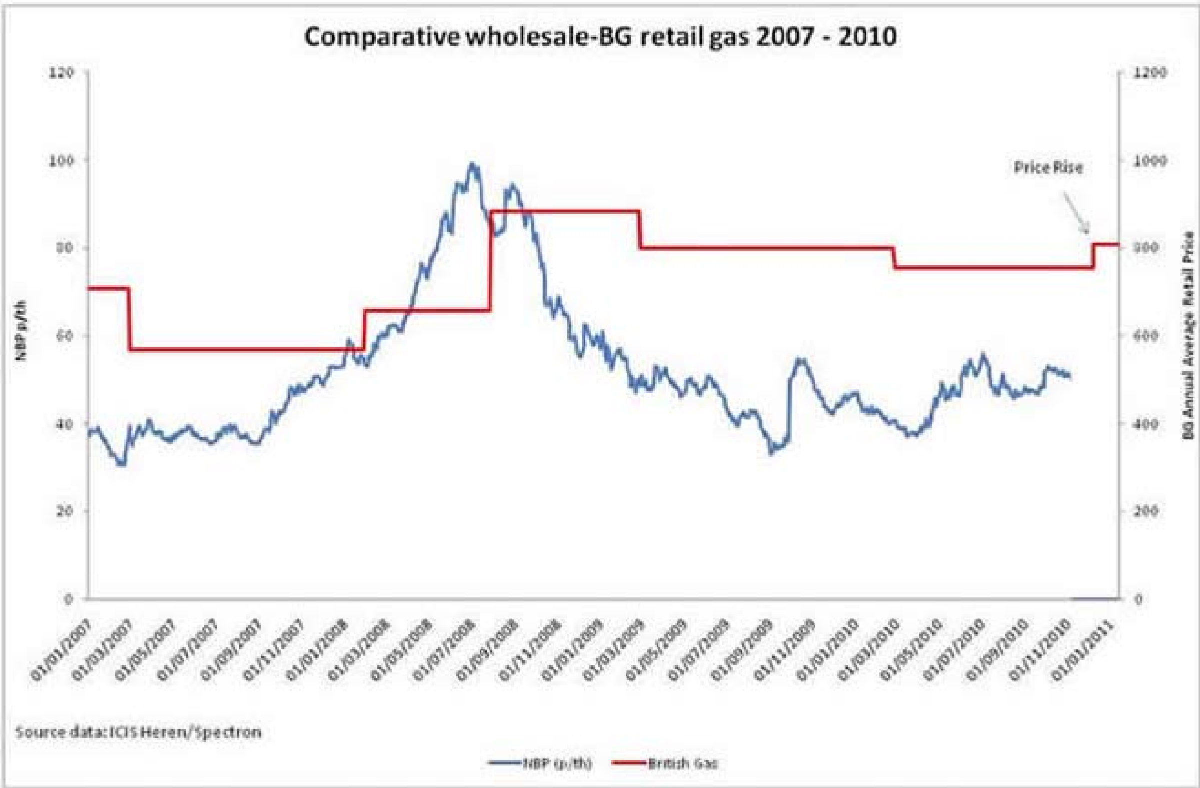
This suggests that UK CPI will receive several upward kicks during the year, which suggests an early year spike may be sustained into at least mid year as the coalition government seeks to tax consumers to death by lifting prices on demand inelastic commodities.

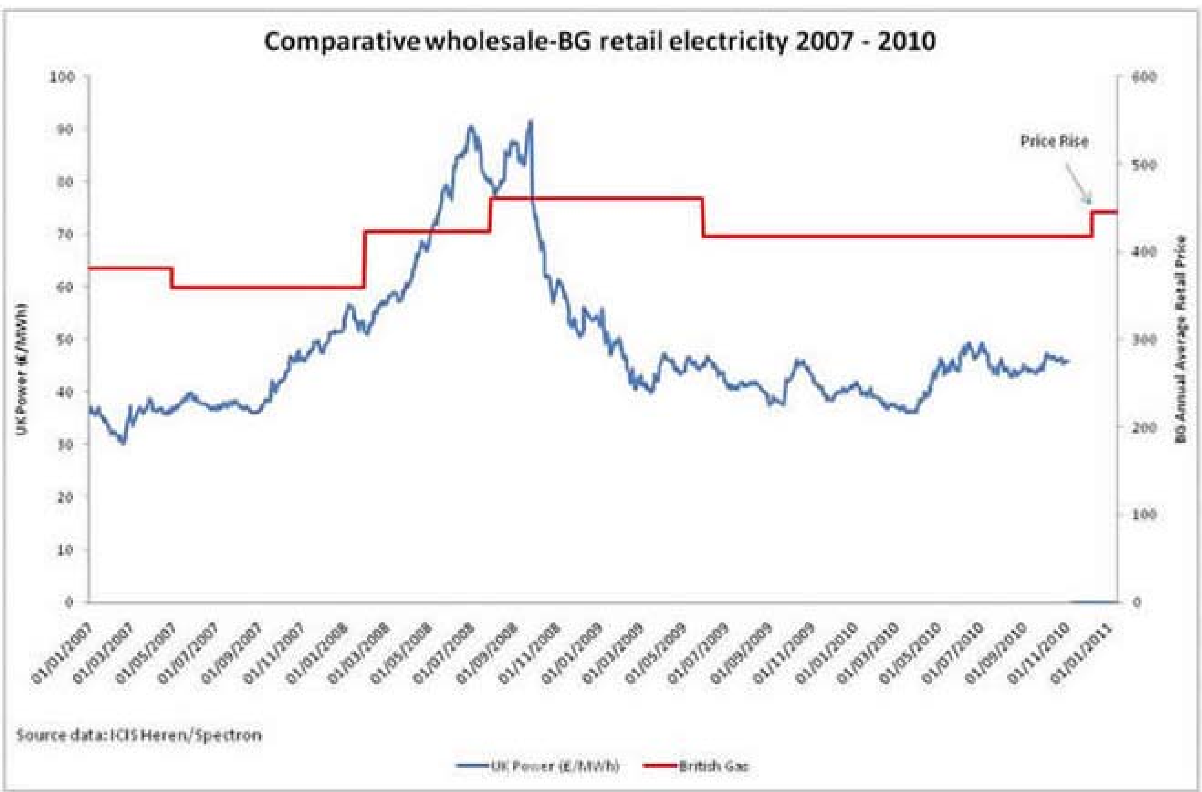
 

## British Energy Suppliers Ripping of UK Customers

Whilst crude oil has trended strongly higher, subdued market Natural Gas prices could have offered disinflation hopes for UK energy consumers. Unfortunately the monopolistic energy companies that supply Britain's Gas and electricity have been ripping of the consumers by announcing price hikes in recent months of an average of 7% that is resulting in huge rises in profits of near 100% for companies such as British Gas (owned by Centrica).

The British Gas price hike of 7% followed a 9.4% hike by Scottish and Southern which was followed by NPower's 5% and other providers that effectively operate as an energy supply cartel that allows them to charge monopoly profits on prices that do not reflect the market prices for gas and electricity as the following graphs by Consumer Focus illustrate:




British Gas and other energy providers are screwing the public by overcharging retail customers on Gas and Electricity by at least 40% even after allowing for an healthy profit margin as the British Gas price is 60% above the wholesale market price, which explains why British Gas profits have soared by 98%.

The recent energy prices rises of 7% will put further upward pressure on UK consumer prices that coupled with the food price rises of 5.5%, virtually ensures that UK CPI inflation will spike above 4% over the coming months.

## Global Food Price Inflation

The Inflation Megatrend ebook afforded investors an opportunity to protect their wealth by getting in at the very bottom of the food price inflation mega-trend during early 2010, which have subsequently soared in price as food commodity prices are starting to feed into global consumer price indices. Food prices during 2011 can continue to expect to deliver shocks to the upside as commodity prices target a break of the mid 2008 highs.

## Food Price Inflation Sparking Revolutions

Whilst people in the developed world increasingly grumble at rising food prices that tend to be rising at levels at twice the official inflation indices, however in the developing world where average wages are typically less than 1/10th of that of the West, food inflation is pushing literally starving unemployed and low wage populations towards revolution against dictatorships and totalitarian regimes as we are today witnessing in Tunisia which was sparked by the food price protests, the momentum of which has led to the collapse of the regime.

As high food price inflation persists then many more such regimes will come under pressure with even economic giants such as Totalitarian China not being immune to the consequences of populations that revolt against high food prices. Therefore expect more revolutions and countries such as China will attempt to export inflation abroad by revaluing their currencies higher which has the effect of boosting the value of foreign investments in China.

## British Pound and UK Inflation

Virtually all of the worlds major commodities are traded primarily in dollars, therefore sterling's trend against the dollar is an important determinant of future UK CPI inflation trend. As with crude oil, the actual inflation consequences are delayed by between 6 and 12 months, since sterling has trended lower for the past 6 months by about 4%, then this is suggestive of some upward pressure on UK inflation during the next 6 months, though a 4% fall in sterling does not translate in a 4% rise in UK inflation. Sterling's recent fall at best adds approx 0.75% to UK CPI over the next 6 months, which therefore confirms that UK CPI is likely to spike above 4%, and the more currency sensitive RPI by more.

To estimate the sterling impact on UK inflation during the second half of 2011, one needs to forecast sterling's trend into mid 2011. In this regard my last in depth analysis and forecast for the British Pound (04 Oct 2010 - British Pound Sterling GBP Currency Trend Forecast into Mid 2011 ) concluded in a forecast for sterling to target a volatile uptrend against the US Dollar to £/$1.85 by mid 2011 which represents sizeable 17% rally and therefore should the forecast transpire will act as a disinflationary force on the UK economy during the second half of 2011. Which suggests that the first half spike above 4% should resolve in a trend to back towards 3% during the second half of 2011.

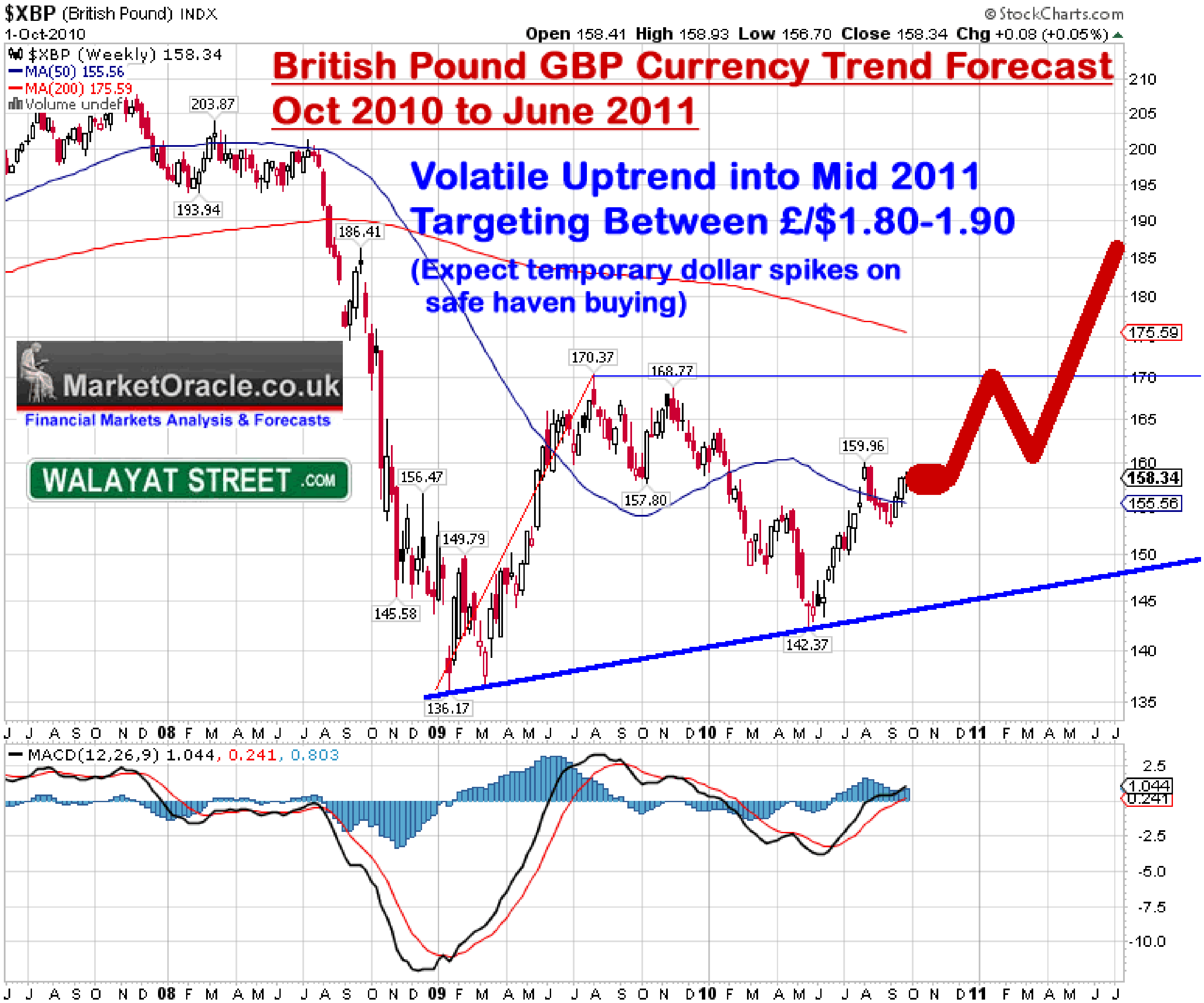


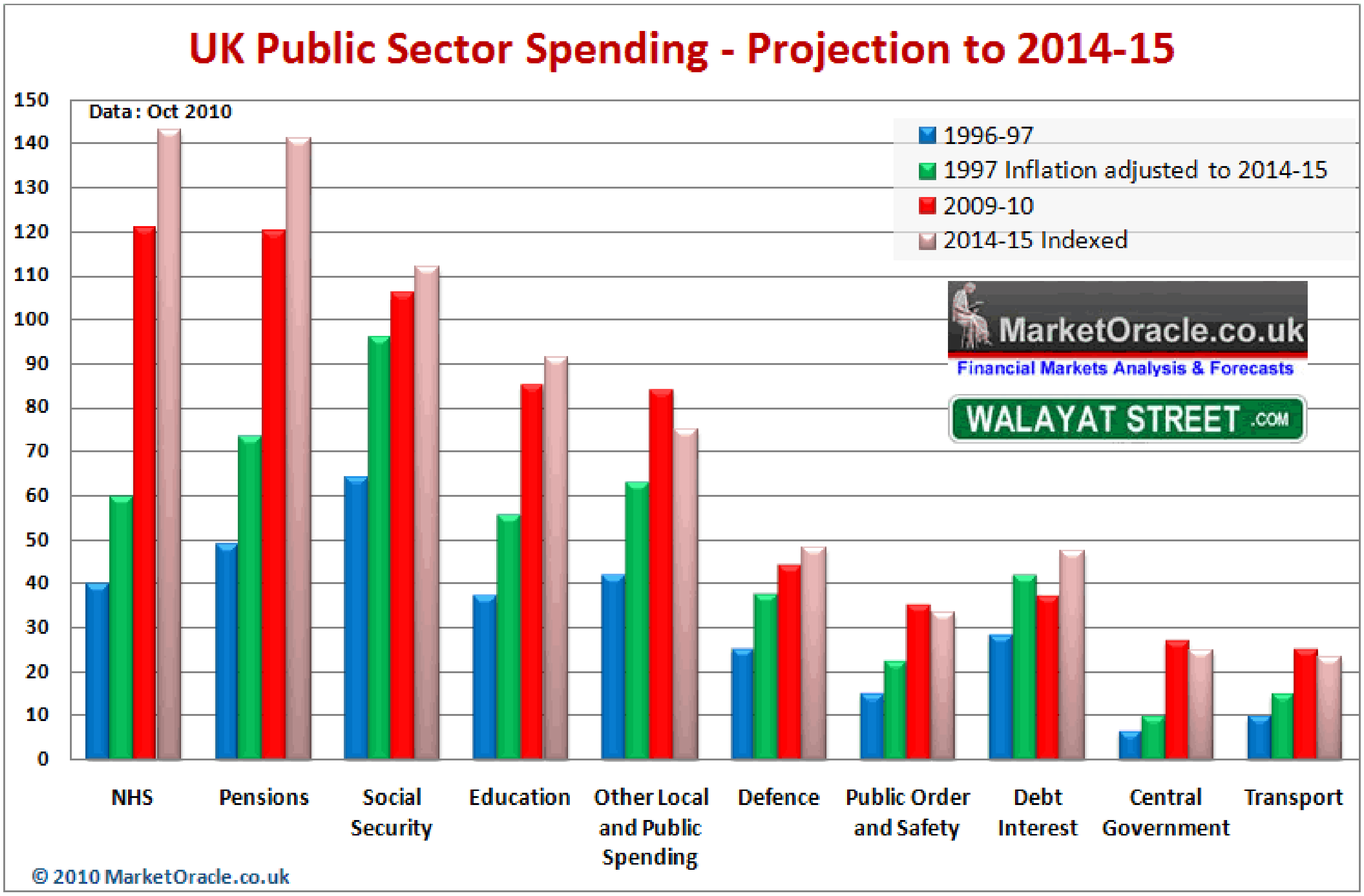

Chart courtesy of [StockCharts.com](http://StockCharts.com)

Sterling's last close at £/$ 1.5850 shows a significant deviation from the forecast trend of about 4%, which should this trend persist then implies a higher trend path for CPI during the second half of 2011 that could remain above 4% CPI. At this point I still favour a trend towards the mid 2011 forecast target and therefore conclude on this analysis CPI being below 3.5% by year end.

## UK Public Sector Spending Cuts

The following graph translates October 2010's announced cuts into spending department budget totals as phased in over the next 4 years (2014-15) after being indexed for inflation at 3% per year.



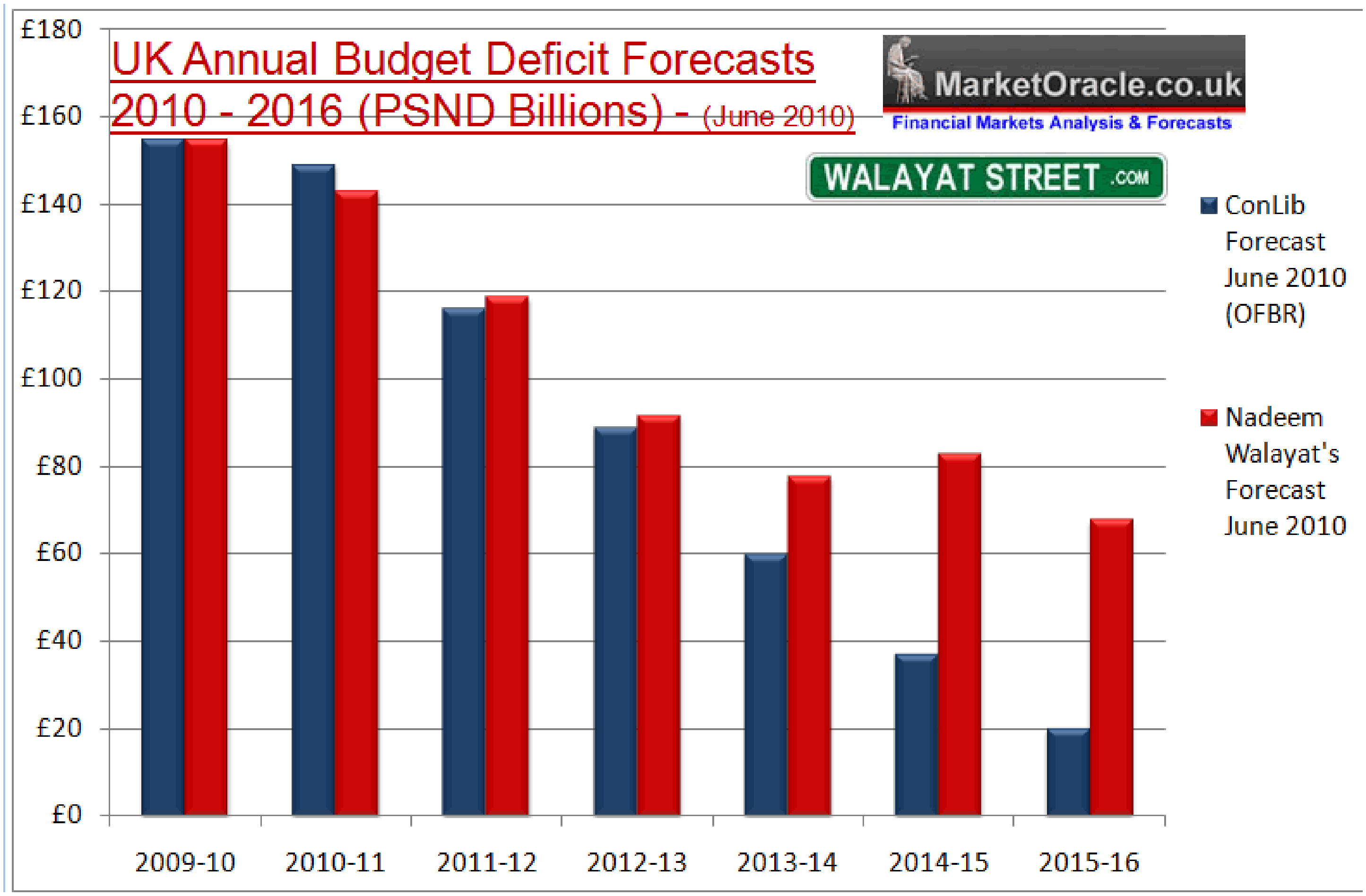

The graph shows that virtually every spending department will increase in nominal terms from 2009-10 to 2014-2015. Even budgets that have declared cuts of as much as 30% will barely see a nominal cut of 10%.

The fact is that EVERY year total UK government spending will INCREASE, from £680 billion for 2009-10 to £739 billion for 2014-15, which is IF the government manages to achieve its spending cut targets as a more probable outcome is for far higher total government spending.

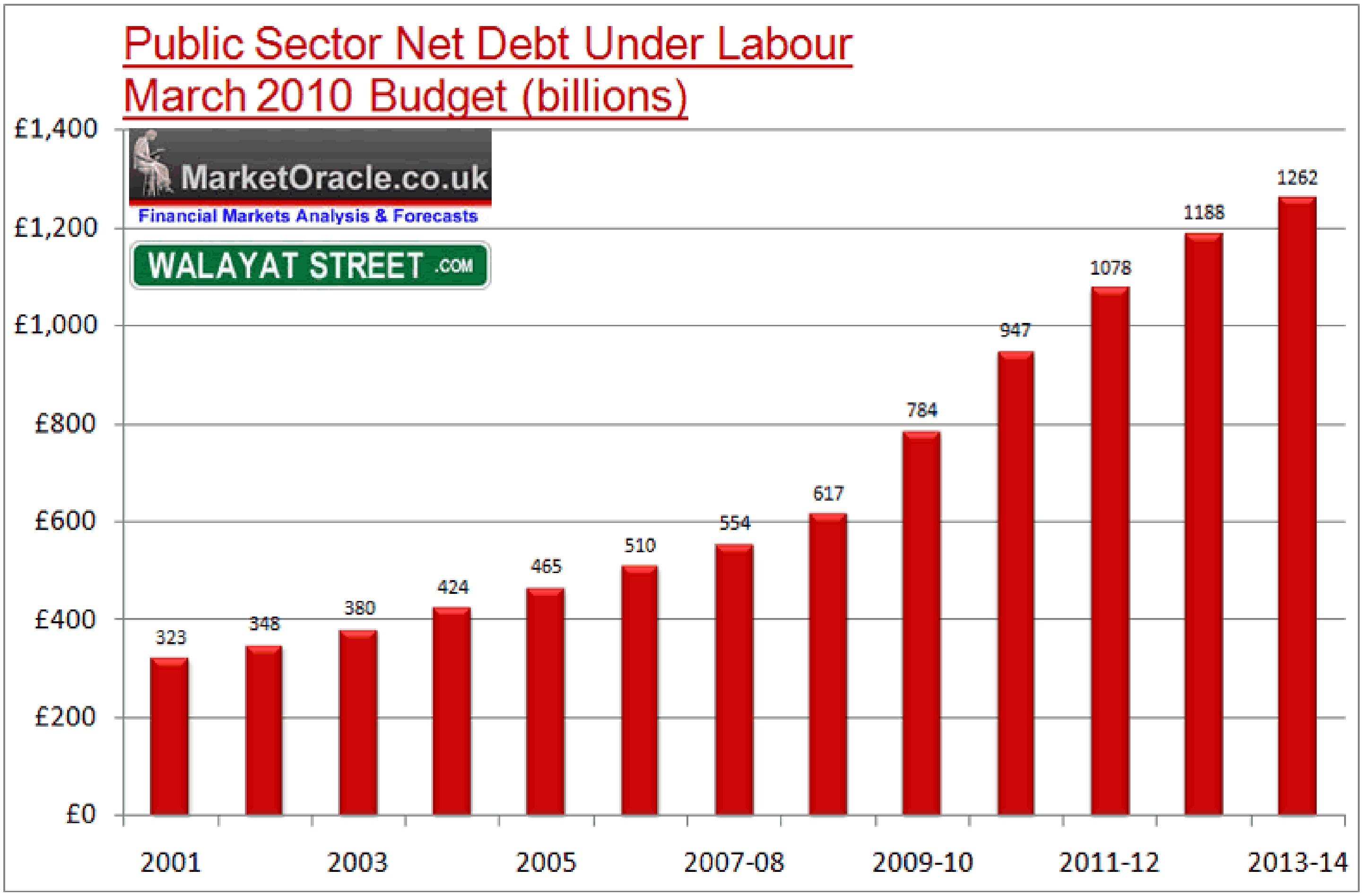
Clearly the coalition government has made a huge mistake in ring fencing the NHS, which under Labour had seen out of control spending and when coupled with pensions virtually accounts for the total increase in government spending over the next 4 years. The reason why NHS unions and worker representatives are demonstrating against NONE Existant cuts is because the NHS is so inefficient as an institution that just to stand it still requires annual increases of 7-8%, therefore INCREASING the NHS budget by approx 4% per year has a similar effect as a 3-4% cut, which illustrates why urgent reform if not outright privatisation of the NHS is still necessary to prevent this spending department from bankrupting Britain, as the NHS spending black hole succeeds in undermining all of the other spending cuts put together.

## Coalition Government Using Inflation to Devalue Growing Debt Mountain

As mentioned in the June analysis (29 Jun 2010 - [UK ConLib Government to Use INFLATION Stealth Tax to Erode Value of Public Debt]) the spending cuts will not prevent total UK debt from rising over the next 4 years by 50%. This is as a consequence of the budget deficit that will persist into the 3rd year of the cuts programme as illustrated below, which anticipates the abandonment of the cuts programme during 2013 as the Coalition government gears itself up towards generating an election boom into May 2015.



Therefore despite much anticipation in the mainstream media, the actual spending review did not contain any real surprises that alter Britains' path towards a debt mountain total of £1,262 billion for 2013-14, an increase of 50% on the 2009-10 total of £784 billion that is following the same debt trend trajectory as under Labour's March 2010 Budget.

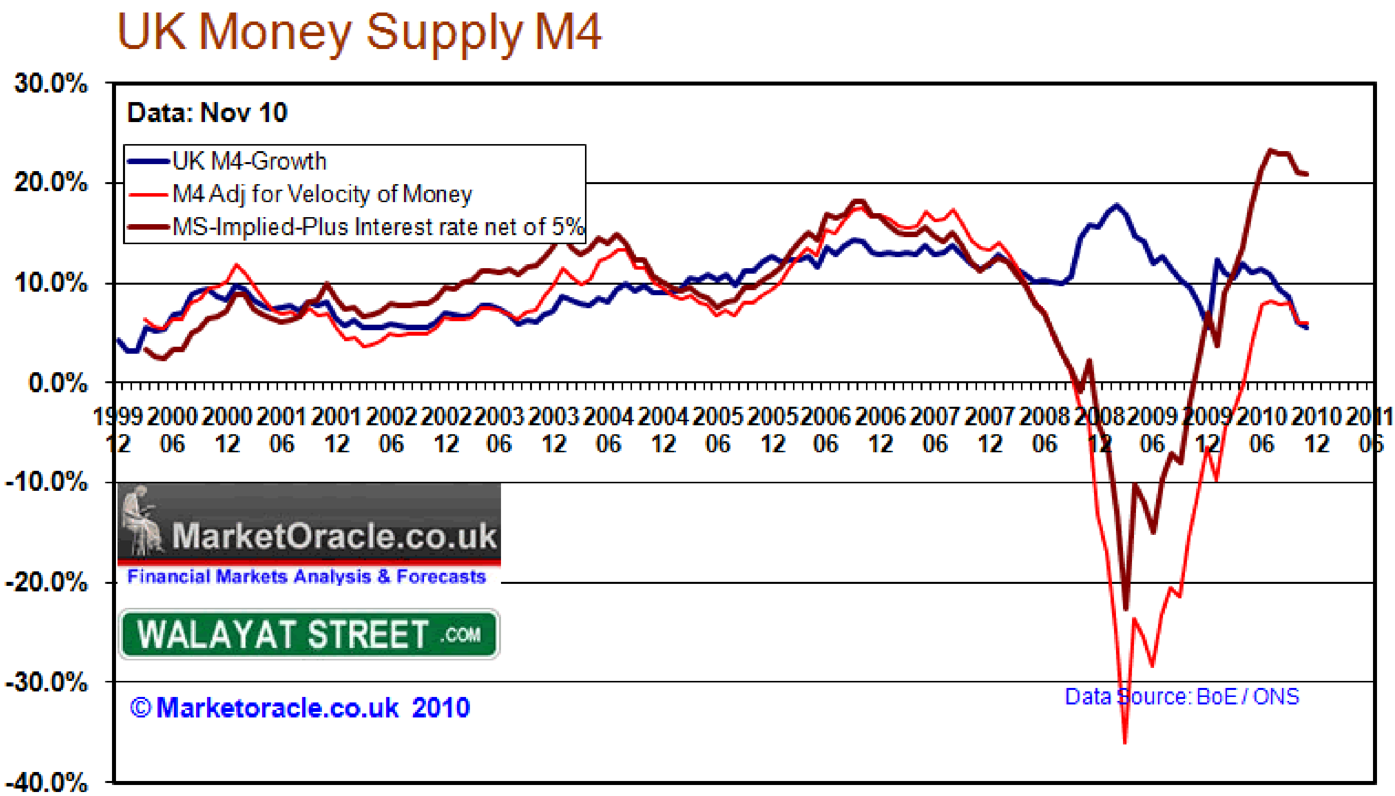



The impact of a 50% increase in total debt also implies at LEAST a 50% increase in ANNUAL debt interest payments towards £55 billion a year up from £34 billion for 2009-10, which also illustrates how clueless are those that argue the Coalition government is cutting too much too fast, when the alternative is a Greece / Ireland style crisis during 2011, resulting in the market demanding double or triple current interest rates for taking on the currency risk of lending to a country with an exploding debt mountain that it will NEVER repay in REAL terms as the debt burden would send inflation soaring and the currency plunging in an attempt at eroding the value of debt in real terms. This therefore continues to support the case of high UK inflation not just for 2010 or 2011, but for the next decade.

## Money Supply Adjusted for the Velocity of Money

The mainstream press and academics obsess over headline M4 data (blue line) throughout 2010 that implied falling UK inflation that never materialised.



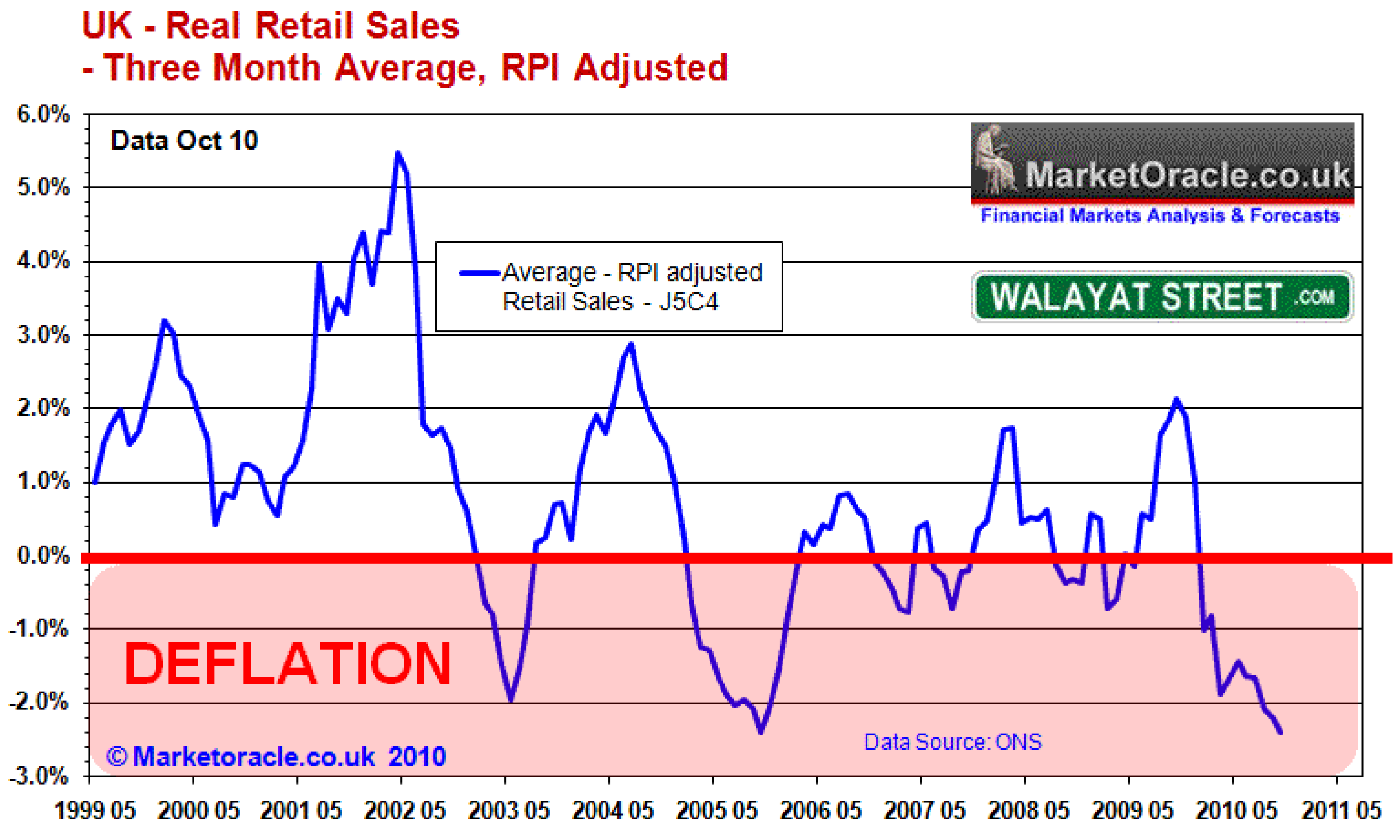

However as I voiced during each years inflation analysis and forecasts that the key to interpreting money supply data is to look at M4 adjusted for the velocity of money that during 2009 implied imminent extreme deflation that has come to pass and similarly for 2010 money supply showed the consequences of Quantitative Easing and near zero interest rates in that Money Supply adjusted for the velocity of money that bottomed from a crash into March 2009, and breaking higher on an accelerating trend that has continued into late 2010.

This suggests that the Bank of England and majority of economists remain mistakenly fixated on the headline M4 which has nudged to below 5% and therefore continue with the policy of Zero Interest Rates and Quantitative Easing. The actual graph shows Money Supply adjusted for the velocity of money tapering off after a strong trend higher throughout 2010, and the MS Implied having surged to new highs which matches the actual UK inflation trend that contrast against weak M4.

The trends for M4 Implied Adjusted imply expectations for UK CPI to trend in a range similar to 2010 during 2011 after the initial early 2011 spike.

## UK Retail Sales Deflation

The adjusted retail sales data shows that Labour's debt fuelled economic boost to the high street soon evaporated during early 2010, with UK retailers coming under a great deal of distress continuing up to the latest data release of October 2010.

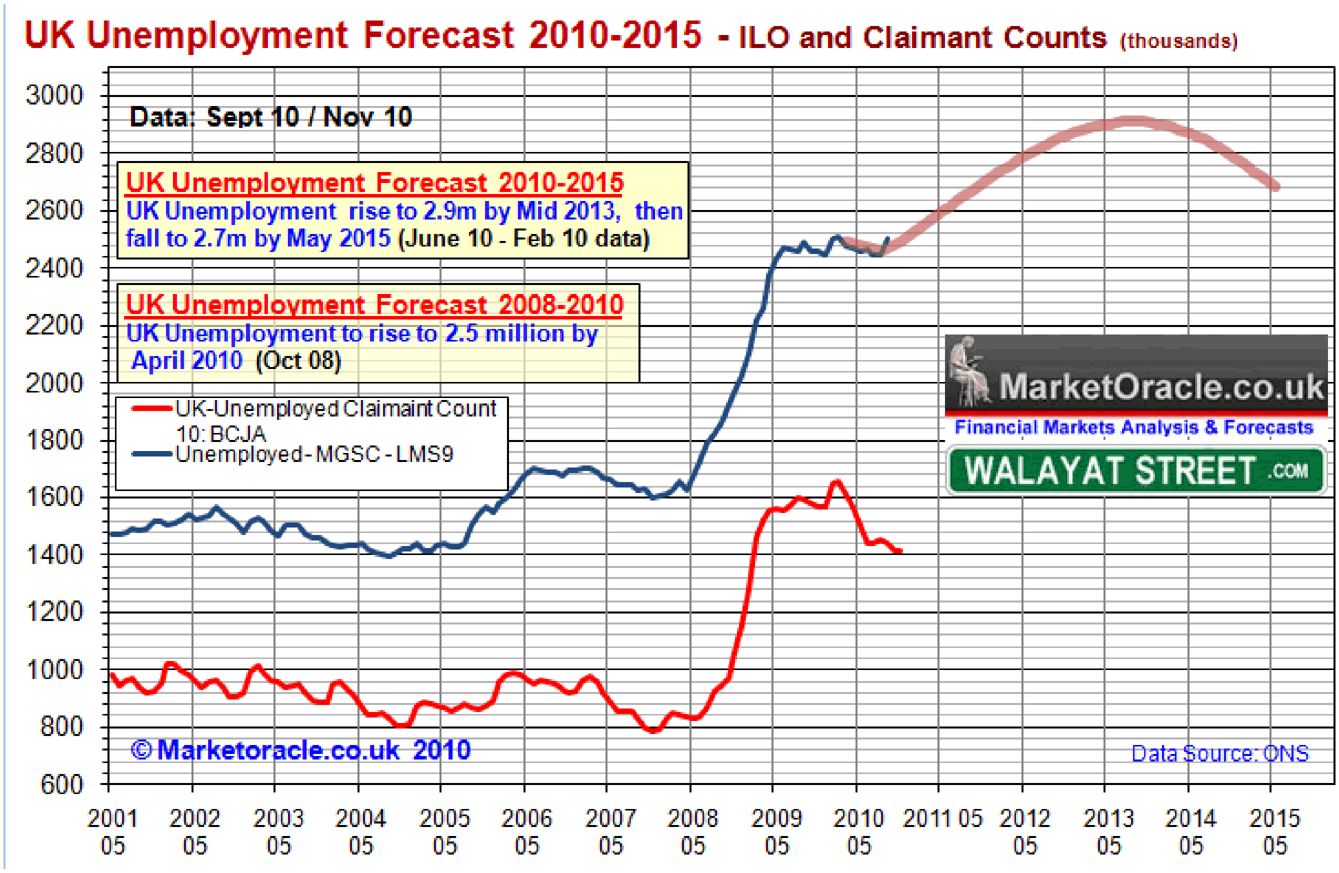



There is nothing to suggest that 2011 is going to be any better for UK retailers who are being squeezed by economic austerity, high inflation and the most recent VAT hike, clearly consumers are being squeezed hard which is making itself felt in the high streets which suggests a number of big name retailers could go bust during 2011.

This continues to support the growing conclusion of an early 2011 inflation spike resolving towards Inflation targeting a similar trajectory as 2010 for the remainder of 2011. Retailers left standing after a potential 2011 blood bath will have little choice but the raise prices in line with RPI inflation to try and fight their way out of deflation so as to survive.

## UK Unemployment

The fundamental flaw in the governments employment policy and OBR forecast for UK unemployment to hit 2 million by 2015 is the fact is that as many as 80% of the new jobs created by the private sector will go to E.U. migrant workers as identified in the UK unemployment forecast (01 Jul 2010 - UK Unemployment Forecast 2010 to 2015 ). The latest UK unemployment data is line with the forecast trend for UK unemployment to start rising in September and target a trend to 2.9 million by mid 2013 as illustrated by the below forecast graph.




The ongoing euro-zone debt crisis and resulting economic depressions in PIIGS economies is resulting in a huge number of migrant workers entering the UK workforce from especially Ireland, Greece, Portugal and Spain as identified recently (22 Nov 2010 - Ireland Bailout Consequences for Britain, Portugal Next? Stock Market Correction Over? ). Over 100,000 have migrated from Ireland alone over recent months which is set against total private sector job creations running at an average rate of about 30,000 per month, which illustrates that 80% of the new jobs are not going to be filled by UK unemployed citizens.

The government in part is aiming to address the migrant workers issue by attempting to force those on benefits that can work but chose not to work off of benefits, although most of the measures will not be implemented for several years.

The best response from job hunters to the weight of a rising trend in UK unemployment for several years would be to start thinking outside the box and contemplating self employment / business startups as the coalition government has promised to foster a more business friendly environment by cutting red tape.

Meanwhile those that are employed continue to be squeezed by average increasing by just 2.2%, which is well below even the manipulated official inflation CPI measure at 3.3%, and half the rate of the more recognised RPI at 4.7%, which actual real inflation of 6.2% triple average earnings.

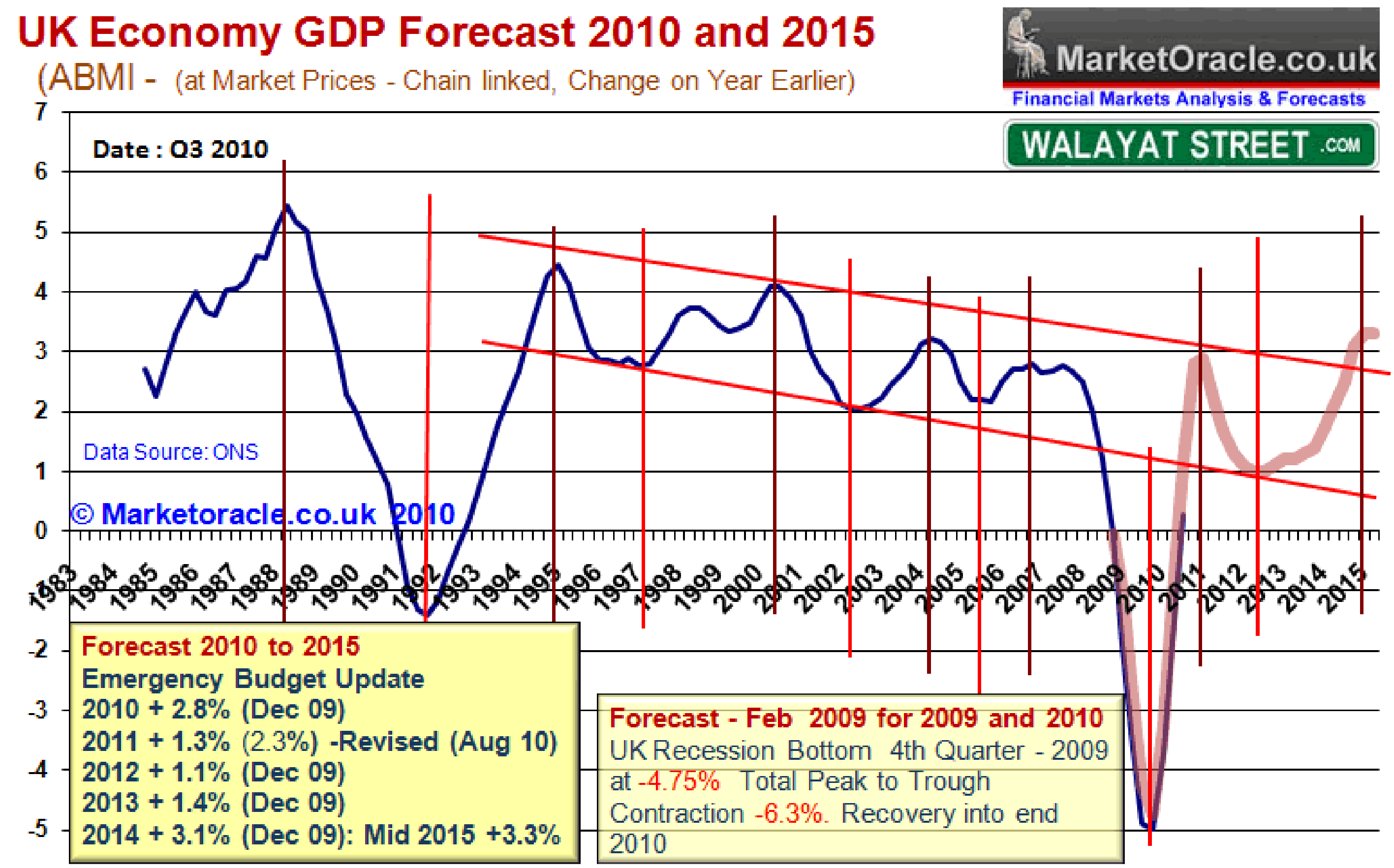
The overall impact of rising unemployment is neutralised by migrant workers creating new demand and thus putting upward pressure on prices.

## UK Economy

GDP Growth for Q3 of 0.8% was inline with my forecast of December 2009 (31 Dec 2009 - [UK Economy GDP Growth Forecast 2010 and 2011, The Stealth Election Boom]) that forecast Q3 growth of 0.9% which is set against Reuters poll of academic economists the day before that forecast GDP growth of 0.4%. The below graph illustrates the forecast trend for UK GDP (*ABMI chain linked at market prices, change on year* earlier). The UK GDP Growth trend forecast was updated following the June Emergency Budget that resulted in a revision for 2011 growth from +2.3% to +1.3% (09 Aug 2010 - [UK Economy GDP Growth Forecast 2010 to 2015]).

- *UK GDP 2010 2.8%*
- *UK GDP 2011 = 1.3%*
- *UK GDP 2012 = 1.1%*
- *UK GDP 2013 = 1.4%*
- *UK GDP 2014 = 3.1%*
- *UK GDP Mid 2015 = 3.3%*




As mentioned earlier, the Bank of England's actions as opposed to rhetoric suggest that the Bank of England no longer targets inflation but rather nominal GDP, given that the above forecast is for low economic growth over the next 3 years then that also suggests high inflation for the next 3 years.

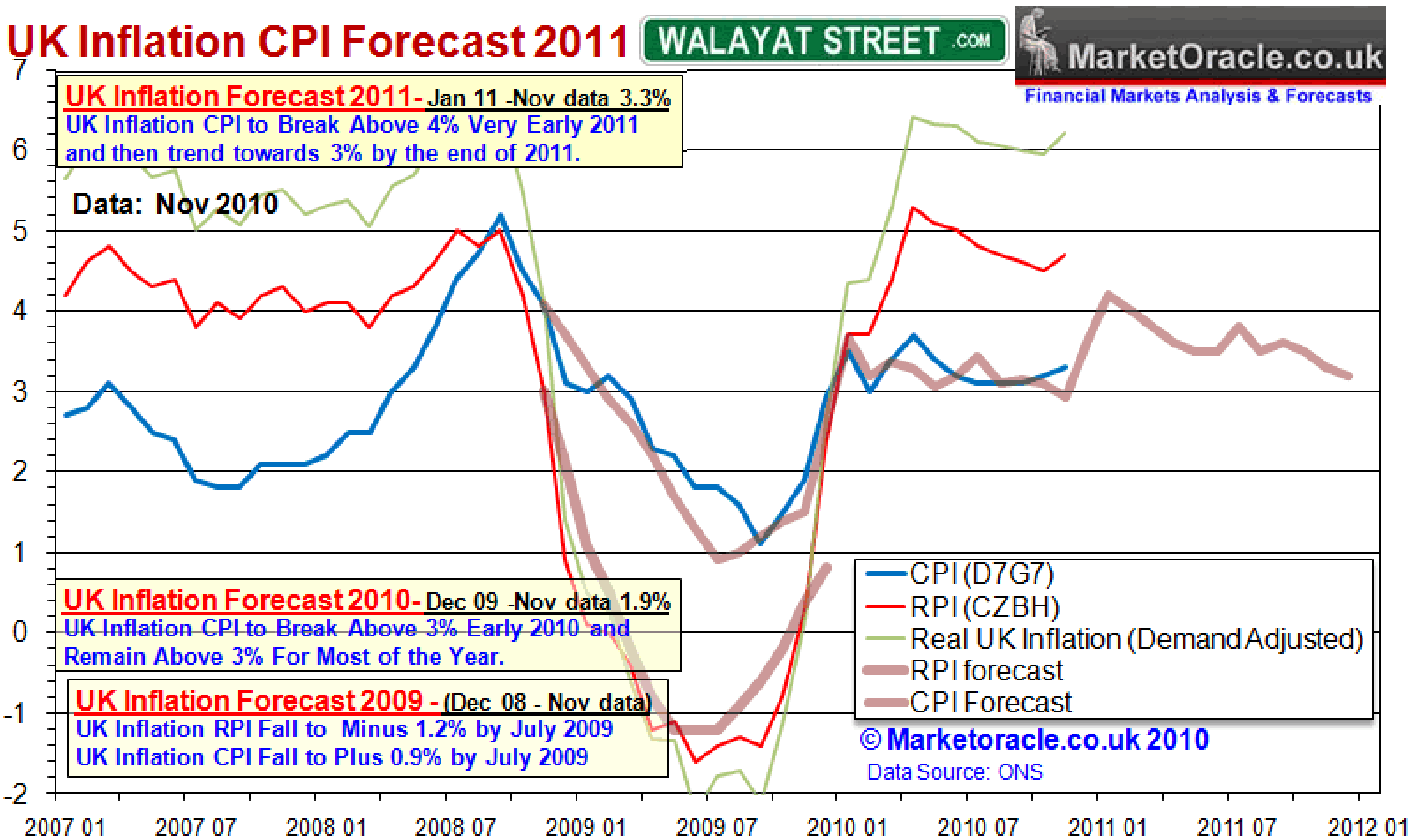
## Stagflation - The Invisible Depression

Low forecast economic growth of between 1% and 1.5% for the next 3 years plus high inflation of between 3% and 6% (CPI / RPI), implies there is enough margin for error in the GDP price deflator utilised by the government statisticians in estimating real GDP for there to be NO REAL growth for 2011-2013, which therefore means that the UK is entering a number of years of stagflation, the experience of which will be just as painful as the Great Recession of 2008-2009 as it will be mostly hidden from public view as the government hides behind phony statistics that imply growth and prosperity when REAL INFLATION ensures they will be losing just as much wealth if not more than they did during 2008-2009!.

## UK Inflation Forecast Conclusion

This analysis concludes towards UK inflation spiking higher to above 4% very early during 2011, possibly as early as on release of January 2011 data during mid Feb 2011. However this spike is expected to subside with UK CPI inflation then targeting a down trend into the end of 2011 towards 3%, with Inflation effectively in a range of between 3% and 3.5% for the second half of 2011, as illustrated by the below forecast graph.




## Risks to the Forecast

That crude oil goes super nova and targets a break of the 2008 high of $150, which would add at least 1% to the forecast CPI trend for 2011. Another upside risk is if sterling takes another big tumble towards multi-decade lows and not forgetting the wage price spiral kicking in as the workers of Britain refuse to be lied to anymore about temporarily high inflation and start demanding wage rises in line with inflation.

I see no downside risk to inflation because the Government wants / needs inflation so as to continue to monetize and erode the value of UK public debt.

## Protect Your Wealth

Inflation is a stealth tax that is being used by the Government and the Bank of England to a. Reduce the budget deficit (eroding purchasing power), and b. funneling tax payers and savers cash onto the balance sheets of the bailed out banks as savers are in receipt of interest net of tax at half the CPI rate and similarly average workers pay rise is near half the CPI and far below the RPI inflation measure of 4.7%.

At the end of the day savings/ capital taxes PLUS inflation are a means of taking accumulated wealth from the haves and redistributing to the have not's. Over the long run inflation ensures that those with accumulated wealth will ultimately lose most of it to the state (unless their funds are protected against UK inflation and taxation). Unfortunately the coalition government has accelerated the trend of stealth theft by withdrawing the National Savings Index Linked Certificates in June, that allowed the people of Britain to at least protect upto £15,000 (per issue) of their life time accumulated savings against RPI. Whilst also declaring a switch in annual indexation from RPI to CPI which means under reporting UK inflation by 1.5% against RPI and 3% against real UK inflation (6.2%).

The Bank of England is going to keep printing money which is a positive for asset prices such as stocks. For investors the strategy remains to invest in inflation wealth protection and growth such as agricultural commodities, gold, silver, metals and mining, TIPS, emerging economies such as China, India, Russia, Chile, Brazil, and developed economies such as Australia and Canada as their appreciating currencies will protect your investments purchasing power in sterling as covered at length in the Inflation Mega-trend ebook (FREE DOWNLOAD).

# CHAPTER 3

## UK INTEREST RATES

March 2011 - Britain's coalition government pressed the reset button on the UK Economy during summer 2010, as it has continued to make a plethora of tax raising and spending cut economic austerity announcements over the past 9 months in an attempt to get a grip on the Labour government's legacy of an out of control annual budget deficit of over £150 billion per year that risked bankrupting Britain.

These policies on face value imply severe economic distress for several years as they are implemented starting in 2011 and thus require the continuing lubricant of near zero interest rates backed up by quantitative easing aka money printing to inflate the economy (consumer and asset prices) in an attempt at offsetting public sector deflation so as to prevent a nominal double dip recession.

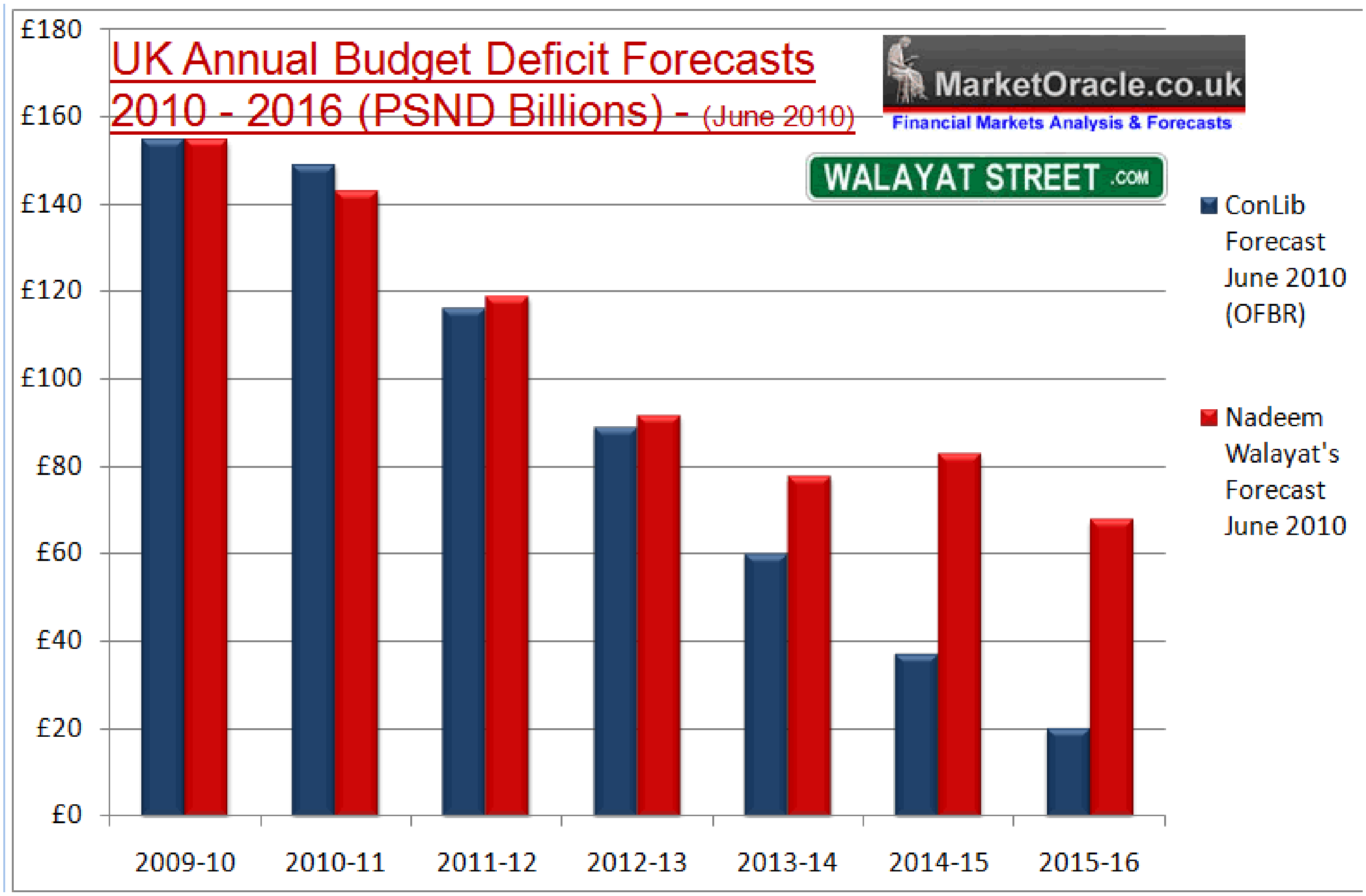
The big gamble that the coalition government is playing is that its programme for economic austerity will prevent market interest rates from rising as they have done so in the bankrupting PIIGS for the whole of 2010 and into 2011, pushing these economies into economic depression. The Coalition governments primary aim is to engineer an economic outcome that sets the scene for a spending and tax cutting induced mini boom into a May 2015 General Election that would favour at the very least a continuation of the Coalition government or more probably an outright conservative victory.

However the coalition government faces many headwinds during 2011 that could disrupt its economic plans, most notably soaring inflation that has long since left the UK official target of CPI 2% behind as well as internal political pressures as the Lib Dems buckle under austerity induced dissent , let alone external pressures form first the Euro-zone to more recently imploding Middle East states buckling under their own inflation mega-trends.

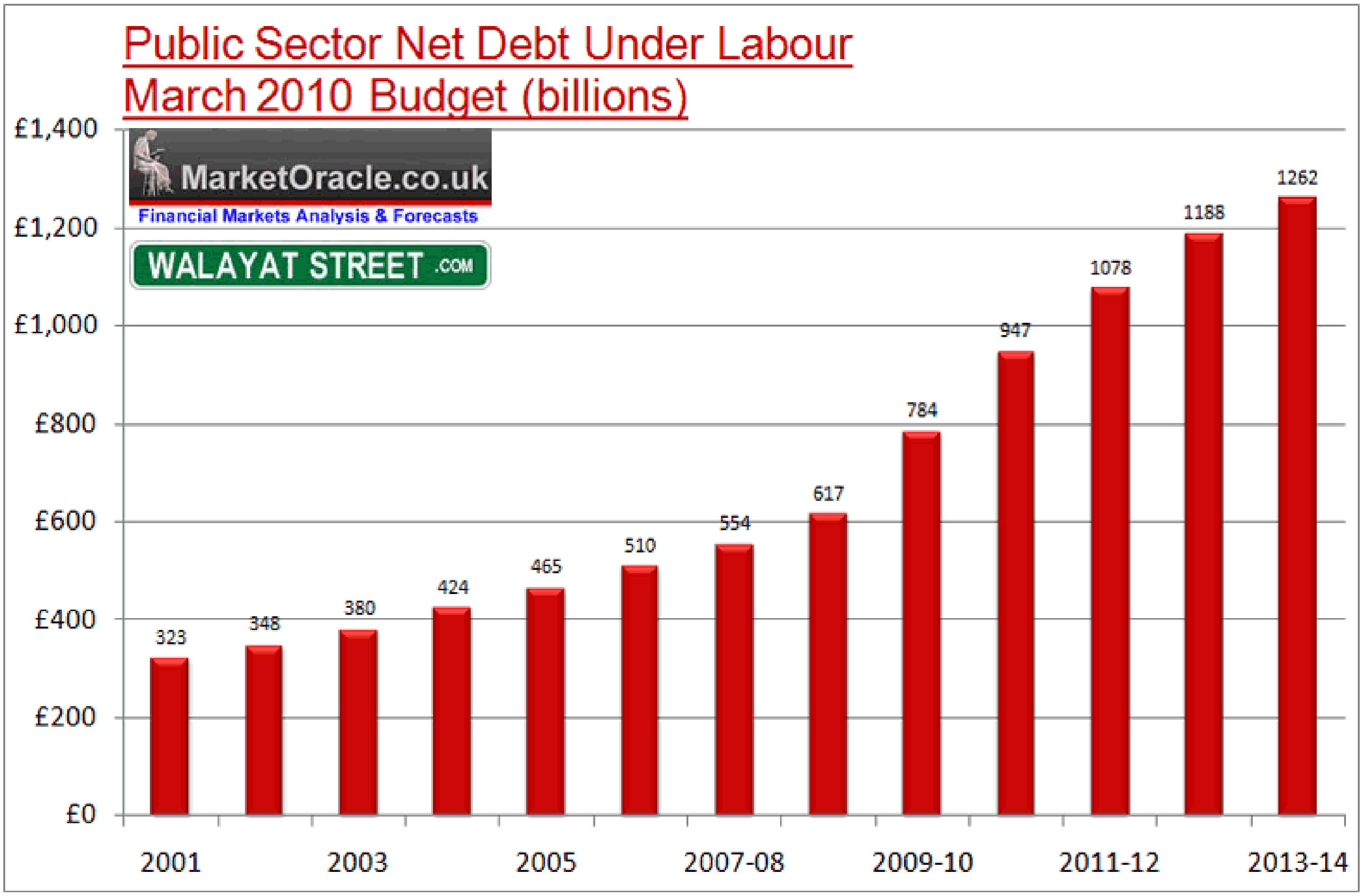
Therefore this analysis seeks to conclude in a trend forecast for UK Interest rates in determination of the degree to which the Coalition government will be able to manage to keep UK interest rates low (base and market) during 2011 to enable the target trends for the economy to be achieved.

## Labour's Debt Crisis Legacy Continues

As mentioned in the June analysis (29 Jun 2010 - UK ConLib Government to Use INFLATION Stealth Tax to Erode Value of Public Debt ) coalition spending cuts will not prevent total UK debt from increasing by over 50% the next 4 years. This is as a consequence of the budget deficit that will persist into the 3rd year of the cuts programme as illustrated below, which anticipates the abandonment of the cuts programme during 2013 as the Coalition government starts to gear itself up towards generating an election boom into May 2015.




Therefore the Coalition's spending review did not alter Britains' path towards a debt mountain total of £1,262 billion for 2013-14, an increase of 50% on the 2009-10 total of £784 billion (as per original analysis of June 2010).




The impact of a 50% increase in total debt also implies at LEAST a 50% increase in ANNUAL debt interest payments to £70 billion, up from £34 billion for 2009-10, which also illustrates the error in the argument of those that state that the Coalition government is cutting too much too fast when the facts are that it is not cutting any where enough to have any impact on accumulating UK debt.

Britain's current debt situation continues to target £118 billion budget deficit for 2011-12.

UK Interest Rates - The implications are for the continuing need to keep UK interest rates on hold for 2011 and beyond so as to service the ever expanding debt mountain.

## Coalition Government Policy Flaws

There are two major flaws in the Coalition Governments policies:

### 1. Socialist Frankenstein Coalition Government Targets Middle Class

#### Taxes

The Frankenstein coalition government is adopting socialist measures that squarely targets the middle class to pay for the price for Labour's incompetence, far worse than that which the labour government had planned to do by effectively taxing the middle class to over 70% of their earnings (40% Income Tax + 12% NI Tax + 20% VAT + 5.1% RPI Inflation (inflation is a stealth tax that the population has been conditioned to view as beneficial when it is actually an earnings and savings purchasing power destroyer).

## Government Spending Cuts

The policies announced to date only pay lip service to spending cuts on an out of control welfare state with the largest budgets that deliver no output for additional resources such as the NHS being ring fenced for growth. The consequences of this is that government spending will NOT be cut and instead continue to increase every year from £680 billion for 2009-10 to at least £739 billion for 2014-15.

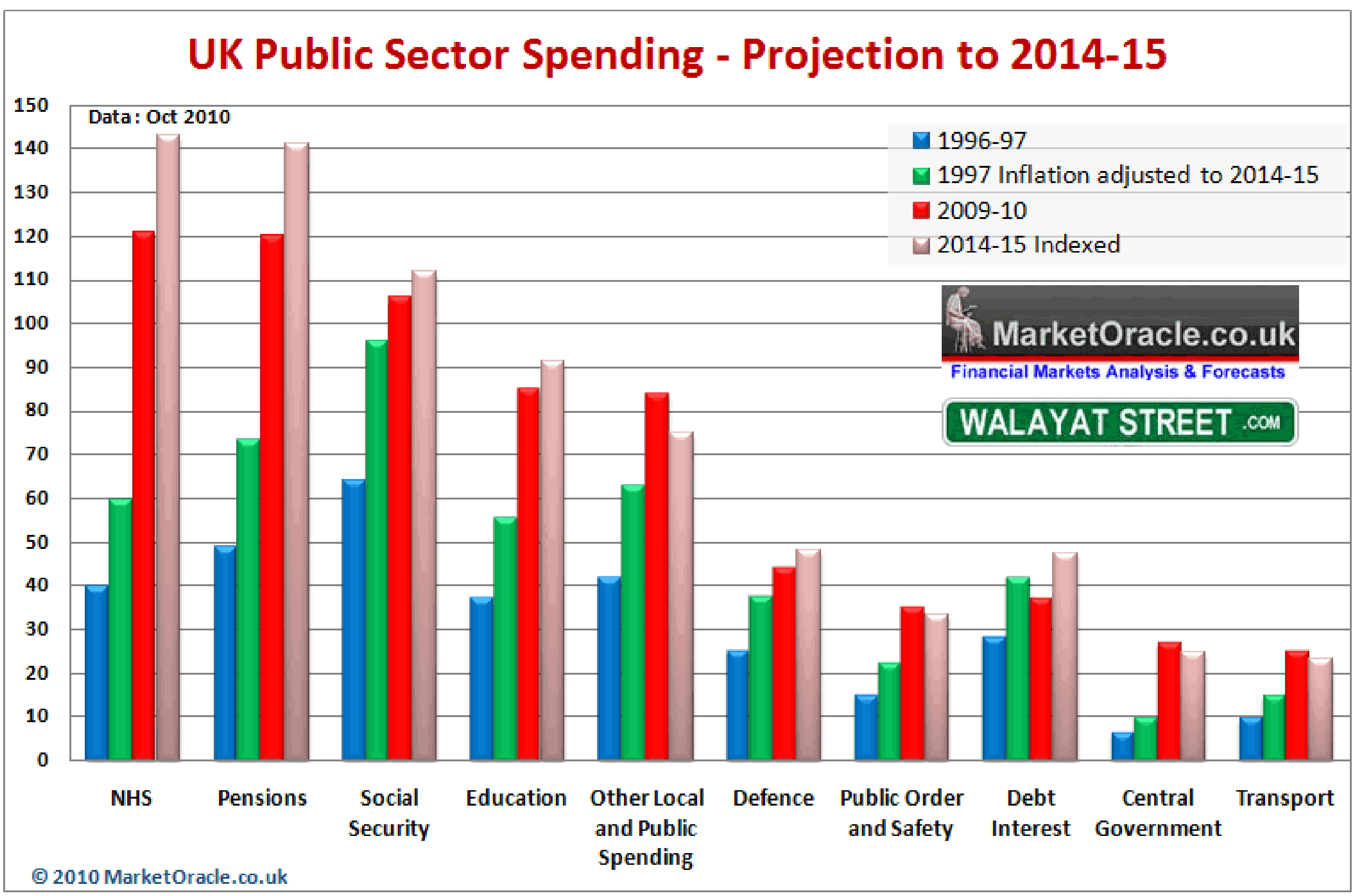
- Average 19% cut per government department over 4 years.
- 500,000 job losses
- Aim to eliminate structural deficit (£81 billion) by 2015.
- Additional benefit cuts of £7bn on top of £11bn already announced (mostly child benefit cuts).
- NHS and Education protected

There are two important factors to take into account when considering the headline grabbing statements of departmental cuts of upto 30%.

a. That the cuts will be phased in over 4 years.
b. That inflation of approx CPI 3% to 4% per year has to be considered.

This means that allowing for the impact of inflation AND phasing in means that actual spending cuts will be far less in both nominal and percentage terms because inflation annually will lift the spending budgets that are being subject to phased nominal cuts. For example a £100 billion budget in a year would rise to £103 billion after 3% inflation, therefore a £10 billion cut over 4 years would itself be indexed for inflation which it would not be if all of the the cuts took place in the first year. I.e. in the example £10 billion of cuts in the first year would result in a year 4 budget of £101.7bn, whereas phased in cuts of £10 billion would result in a budget total of £102.2bn as a consequence of inflation. Therefore as per the example, the total actual cuts over 4 years would be £23 billion against £40 billion if all if the £10 billion was immediately cut.

The following graph translates the announced cuts into spending department budget totals as phased in over the next 4 years (2014-15) after being indexed for inflation at a conservative 3% per year.



Therefore the coalition government is failing to implement ANY meaningful cuts in what remains out of control Government spending.

### Tuition Fees

The coalitions policy on tuition fees illustrates a government that is anti-education and destroying the ability of the country to generate future wealth.

1. Tuition Fees will rise from £3,300 to £9,000 saddling graduates with an estimated average debt of £40,000 with all of the consequences both psychological and financial in terms of credit ratings where the debt will impact on graduates for the next 30 years of their working lives.

2. That the debt interest will be at Inflation (RPI) Plus 3% (8.1%), against the current student loan interest rate of 1.5%.

3. Those that pay off their loans off early will be punished, and unpaid debt will be wiped out after 30 years.

4. Repayments will kick in for those earning at £21,000 rather than £15,000, which effectively punishes those that are more productive and acts as a disincentive to work harder, and every year workers delay working harder for higher pay means loss of potential tax revenue, which suggests that the Government is grossly over optimistic in what it expects these workers will earn in the future which is based on growth in graduate pay of the past 30 years when there were far fewer graduates who were NOT saddled and disincentivised to work with over £40k of debt that despite an average graduate repaying £80,000 over 30 years will still have outstanding debt of an estimated £18,000. Which means that perhaps as much as 50% of the monies loaned will never be repaid.

The overall effect is to make university education less palatable to all sections of the population as all will feel the financial and psychological pressure of being saddled with over £40k of debt as soon as they leave University and try and get their first entry level job, especially as the high interest rate ensures that the debt total will continue to soar at a rate that is greater than average earnings growth.

Instead of turning students into debt slaves for life, the government should view graduates as the countries life blood who will go on to become higher rate tax payers and therefore they should be incentivised to work harder for more pay and therefore pay more taxes, which is the exact opposite to the coalition governments policy

Key to the countries future is always in the quality of those that enter the Labour force, therefore education should be free so as to maximise the educated worker population pool that will maximise the higher tax payer base, after all middle class tax payers are taxed at an extortionately high rate of approx 70%.

UK Interest Rates - Whilst the mainstream press and vested interests in the public sector focus on headline grabbing spending cuts and tax rises, the facts are that a highly inflationary LARGE BUDGET DEFICIT will continue to persist regardless, that coupled with inflationary tax rises as the population responds by demanding higher wages to compensate, the Bank of England / government understands this as a policy for high inflation to devalue the value of the deficit and total accumulated debt, therefore regardless of what the Bank of England states publically, the actual policy is for high inflation plus low interest rates.

## 2. Protecting the The Socialist Banking System

The Coalition (as did Labour before) have let off hook those who are responsible for the financial crisis i.e. the banking sector with the Bank of England at its head.

Many mistakenly jump to the conclusion that capitalism was to blame for the financial crisis. However it was not capitalism to blame but socialism, because if there was any doubt in anyone's mind that the banking system that operates in all of the western countries is socialist, then the bailout and protection of the bankster's and their bonuses should have put that to rest.

The power to print electronic money is delegated from the central bank by means of fractional reserve banking which creates the booms and boosts between alternating trends of out of control credit creation followed by credit destruction with high inflation always seen as the solution.

BoE governor Mervyn King also apparently same to this conclusion :

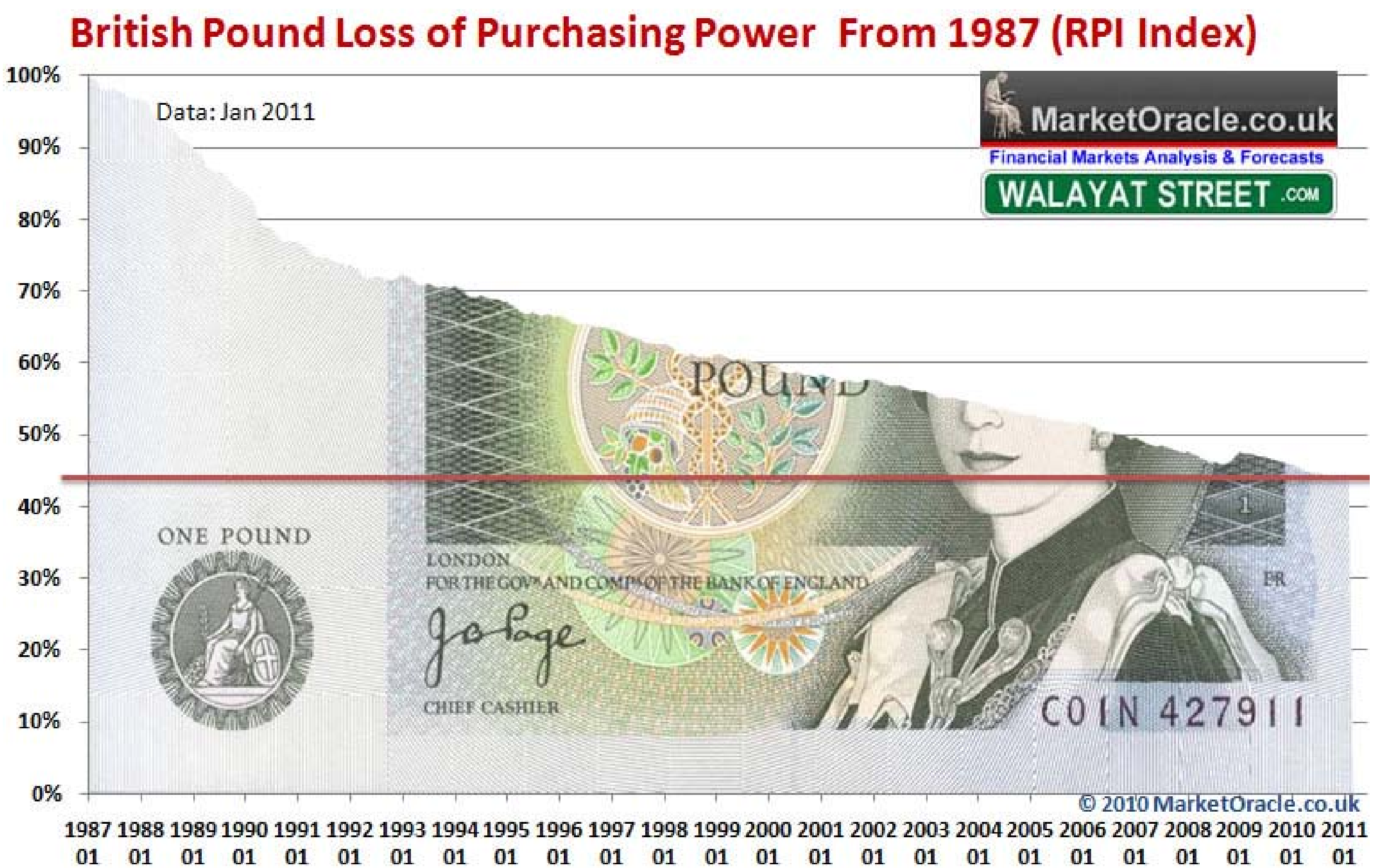
> *"Of all the many ways of organising banking, the worst is the one we have today."*

> *"What we cannot countenance is a continuation of the system in which bank executives trade and take risks on their own account, and yet those who finance them are protected from loss by the implicit taxpayer guarantees."*

However what Mervyn King will never acknowledge is the fact that the Bank of England is THE PRIMARY REASON why the banking crisis occurred, because it lies at the very heart of Britains fractional reserve banking system that allows bankster's to bank bonuses on the basis of fictitious tax payer funded profits and then dump the losses onto tax payers i.e. profits are privatised whilst the losses are nationalised.

The Bank of England will never allow real radical reforms to end the socialist banking system because that would result in an end to fractional reserve banking, and if there is no more fractional reserve banking then there is no need for the Bank of England to exist. Therefore Mervyn King is talking a load of nonsense that he does not even agree with as the Bank of England aims are to grab more power from Parliament so that more money can be fraudulently funneled into the hands of a few thousand bankster's that Mervyn King is literally the King of!

If the UK government were not in the back pockets of the Bankster elite then they would be taking powers away from the Bank of England instead of handing over more powers to the Bank to print money and inflate the wealth and purchasing power away of hard working citizens that have increasingly been turned into debt slaves, families now work twice as hard as they did 20 years ago with less purchasing power as a consequence of the theft of purchasing power by means of continuous money printing / credit creation (electronically) via the factional reserve banking system that continues to destroy the value of the currency in real terms as the following graph illustrates -




The only way to stabilise the value of money and prevent a future banking crisis (which is guaranteed) is to end fractional reserve banking so that Banks can only loan out what they have received in deposits.

Instead, our current fraudulent banking system exists where the Bank of England prints money that is loaned out on leverage to the bankrupt banks so that they can go and buy government bonds on even more leverage, resulting in huge profit margins for near zero risk.

The Banks then treat these government bond holdings as assets against which they can create many multiples of electronic money in the accounts of borrowers, loaned out at exuberant interest rates in many cases X20 the rate of the base interest rate that Banks can borrow at from the Bank of England.

The system is designed to generate literally unlimited profits for the bankster elite, and if the banks lend too much then the socialist banking system ensures that the ordinary tax payers will be forced to step in and bailout the banks at any cost and ensure that all bond holders are protected at 100%. This is NOT capitalism, this is socialism. Capitalism is a mechanism for the allocation of capital towards whichever business is profitable, and as long as the business is profitable the business is financed, if the business stops being profitable then capital is reallocated to other ventures that could prove profitable. Capitalism is not conjuring money out of thin air that is loaned out to ANY business whether it is viable or not amidst a credit boom (as there is unlimited money), and then when the bubble bursts have tax payers step in and cover ALL of the banking sectors losses after bank officers have banked bonuses on fictitious profits, leaving hollow husks behind for the tax payers to cover the liabilities of. That is not capitalism, this is fraud on the tax payers of Britain, far greater than any mafia don could ever hope to achieve.

Interest rates are near ZERO so as to allow the bankrupt banks to maximise the amount of profits they can make as they borrow at 0.5% and then leverage it up by the fractional reserve banking system to between X10, X20 and higher, then go on and buy government bonds at 3% which implies an instant profit 25% to 50% all courtesy of the Bank of England and Tax payers.

In America the tea party movement has risen up against the blatant frauds that are taking place such as Hank Paulson, the ex CEO of Goldman Sachs effectively engineering a £700 billion theft from taxpayers to the bankster's. Isn't it time for the middle class of Britain to also wake up to the fraud of the socialist fractional reserve banking system that seeks to destroy the value of a life time of savings?

David Cameron's coalition government is not showing any vision, instead it is magnifying the policies that the Labour government had planned to implement and even more eager to protect the Bankster Elite that many Conservative MP's hope to join on leaving office. So Britain does appear ripe for a Middle Class led Tea partyesk movement across Britain to cut taxes from 70% and out of control government spending and destroy the power of the bankster elite that the country remains firmly in the grips of.

UK Interest Rates - One of the primary objectives of Bank of England's is to continue to funnel tax payers cash onto the balance sheet of the bankrupt banking sector for which low interest rates is one of the primary mechanism as the Bank of England remains petrified of the potential for the Banking Sector to trigger Financial Armageddon.

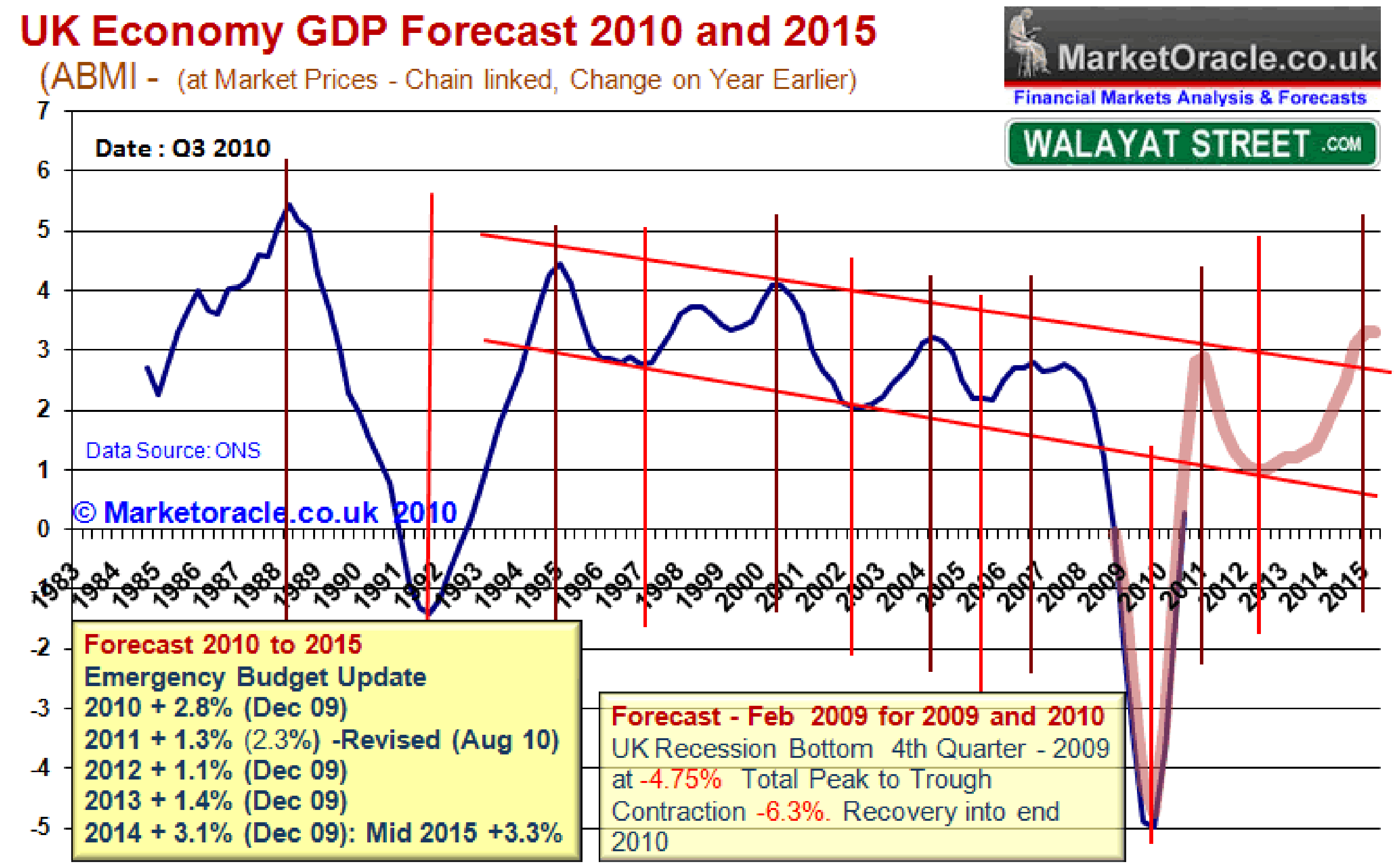
## UK Economic Growth Implication for Interest Rates

The UK Economy apparently went into reverse gear on the recent release of shockingly bad preliminary GDP data for Q4 2010 of -0.5%, against economist expectations averaging at +0.5%. George Osbourne and other Coalition government ministers immediately stepped forward to blame the weather. However the snow at worst accounts for 0.4%, therefore most of the drop of 0.6% (1% difference) is due to retrenchment ahead of austerity to bite during 2011 as private sector firms seek to protect themselves against weaker demand by bolstering balance sheets.

Therefore UK economy can be expected to recoup the -0.4% contraction due to weather during Q1 2011, which implies better GDP for Q1 than originally forecast as economic activity literally froze during December now takes place during January and February (barring further bad snow fall). Additionally the preliminary data is deemed to be overly gloomy, and thus can be expected to be revised higher from -0.5% towards -0.2%, therefore net difference between actual and expectations is estimated at 0.3%, far lower than the 1% headline difference as the UK economy is not quite as weak as the all of the press headlines suggest.

The below graph illustrates the forecast trend for UK GDP (*ABMI chain linked at market prices, change on year* earlier). The UK GDP Growth trend forecast was updated following the June Emergency Budget that resulted in a revision for 2011 growth from +2.3% to +1.3% (09 Aug 2010 - UK Economy GDP Growth Forecast 2010 to 2015).

- *UK GDP 2010 2.8%*
- *UK GDP 2011 = 1.3%*
- *UK GDP 2012 = 1.1%*
- *UK GDP 2013 = 1.4%*
- *UK GDP 2014 = 3.1%*
- *UK GDP Mid 2015 = 3.3%7*




My expectations remain for Growth of between 1% and 1.5% for the next 3 years.The Coalition government is constantly being pulled in two directions one socialist and one free market orientated. This makes it less able to react to bad economic news and therefore suggests that the coalition government is terrified at the risks of another recession over the coming years and rising unemployment. This suggests that the Coalition government will want to avoid interest rates rising for as long as possible,which also ensures further QE and therefore this part of the analysis points to continuing low interest rates throughout 2011.

UK Interest Rates - Contrary to the public statements of the Bank of England of targeting 2% inflation, the actual facts are that the Bank of England since October 2008 is more focused on targeting a minimum of 2% GDP, which given recent data illustrates a reluctance for the Bank of England to raise interest rates until it see's annual GDP north of 2%. However, the failure of the Bank of England to respond to high inflation is not sending a reassuring message to industry to invest, therefore to strengthen the economy, ironically the Bank should give 1 or 2 token rate rises.

Which also given the forecast trend therefore suggests a great deal of reluctance to raise interest rates during the next few years.

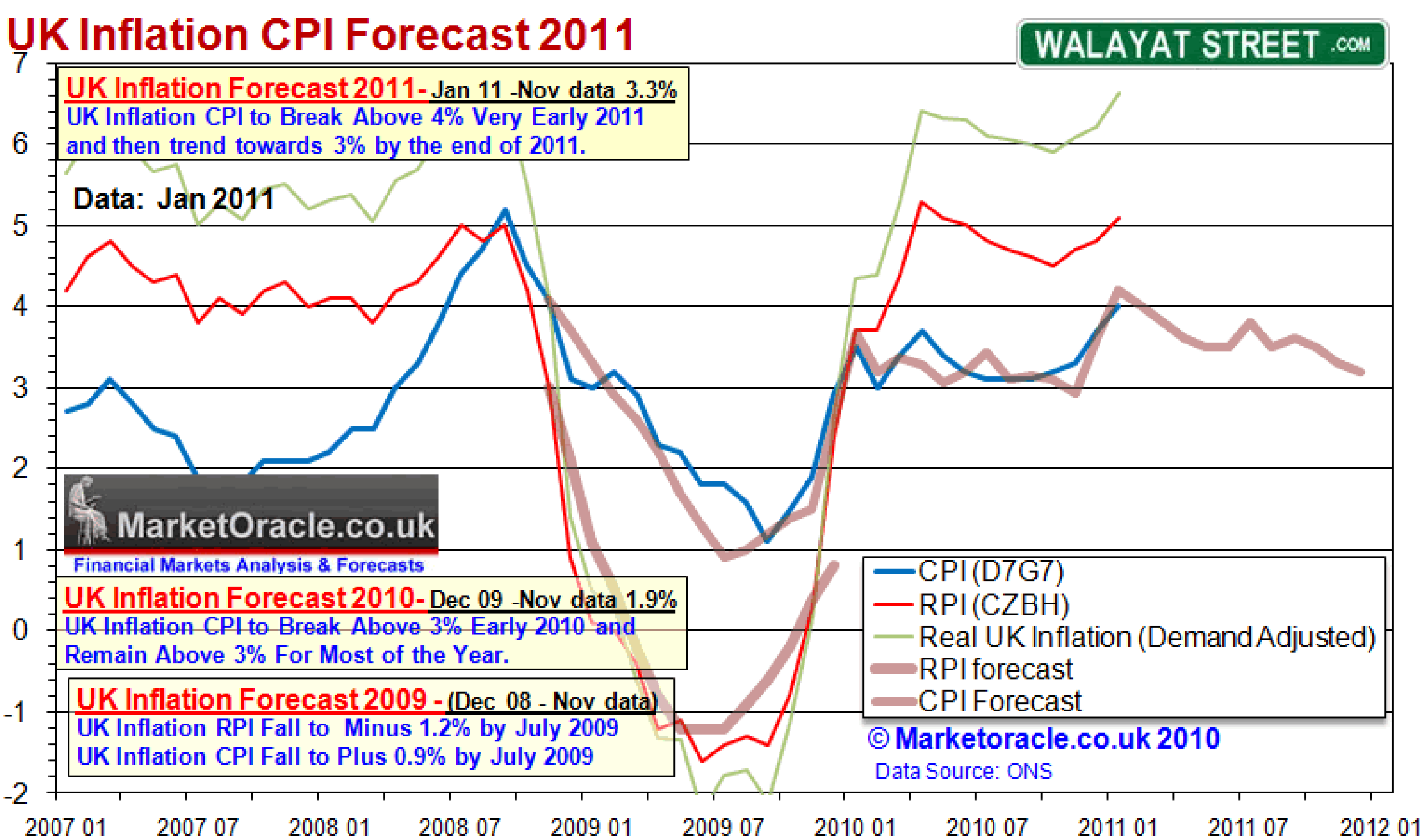
## Bank of England Ignoring Inflation, UK Stealth Government Debt Default Trend

UK Inflation for January 2011 leapt to CPI 4% from 3.7%, leaving the Bank of England Governor, Mervyn King to press print on another letter full of worthless excuses as to why high Inflation is still temporary more than a year on. The facts are that the Bank of England via its policy of HIGH Inflation is destroying a lifetime of accumulated capital of savers, as interest earned on savings after tax will be lucky to be at HALF the official inflation rate, never mind the actual inflation rate that is nearer to 6.6%, all as part of the continuing programme for the transference of wealth from tax payers and savers onto the balance sheets of the bailed out banks that generate fictitious profits on the basis of which billions are paid out in bonuses.

The more widely recognised measure of Inflation RPI stood at 5.1% and real inflation at 6.6%, as the official inflation indices have been systematically doctored to under report real inflation by successive governments for several decades resulting in serious and compounding under reporting of the real rate of inflation as experienced by the British population.

The Bank of England MPC members continue with their mantra of temporarily high inflation due to short term factors. One could cut and paste from any inflation statement from MPC members of the past 12 months to hear the same propaganda out of the Bank of England. The question everyone should be asking the BoE is when does temporary high inflation stop being temporary? Originally it was for a couple of months, now it is over a year, will high inflation still be temporary a decade from now? For that is how long I expect the Inflation Mega-trend to run.

The updated in-depth analysis and forecast for UK inflation for 2011 (17 Jan 2011 - UK Inflation Forecast 2011, Imminent Spike to Above CPI 4%, RPI 6% ) concluded in UK inflation spiking to a high of 4.2% early 2011, and thereafter trend lower towards 3% by the end of 2011 and therefore remaining above the Bank of England's 3% upper limit for the whole of 2011. The Bank of England's most recent Inflation Report forecast UK CPI of 1.7% by the end of 2011, however the BoE had forecast UK CPI of just 1% by the end of 2010 (Feb 2010), which is inline with the Bank of England's permanent mantra of near always imminent deflation so as to better manage the populations inflation expectations in their favour.




The UK government continues to stealth default on its government debt at a real inflation rate of at least 6% per annum, a price that is being paid for by all workers and savers. The population of Britain has been successfully conditioned by successive governments deploying the pseudo science of economics that appears to exist purely to enable governments to psychologically manage the expectations of their populations such as coming to believe that the stealth sovereign debt default trend is good for them.

INFLATION is pure and simple THEFT by the government for the primarily purpose of enabling governments to exist in ever expanding size and scope of interference in everyday lives for without INFLATION i.e. in a normal deflationary world, in which big governments would not be able to exist because accumulated debt would INCREASE in value, thus ensuring that large long-term borrowings could not be entertained in an 'normal' deflationary environment.

Yes given technological innovation then deflation should be the normal environment for an economy, if it where not for big governments with big ideas on how to stealth tax the populations wealth and spend it on even bigger and usually worthless projects. Another word one could use for deflation is productivity, each year the productivity of workers increases due to innovation and new technologies which means that the price of goods and services should fall as workers become more efficient in their production and thus the value of hours worked increases. Off course this only tends to happen in the private sector as the public sector ironically becomes LESS productive the bigger it becomes as the number of bureaucrats expands exponentially until the economy folds under its weight, as witnessed by the NHS where a tripling in the budget under Labour has basically resulted in a tripling in the number of bureaucrats employed. This puts the economy into a perpetual worsening state as the Public sector displaces the far more productive and competitive private sector both on the large and small scale, for example small local post offices have been closing across the UK due to lack profitability. However many councils have responded by stepping in to re-open some of the small post offices with grants of say £50k a year towards their running costs, therefore no tax paying private sector postal service will ever be able to again step in to provide a service as it cannot compete against a perpetually subsidised loss making local postal service.

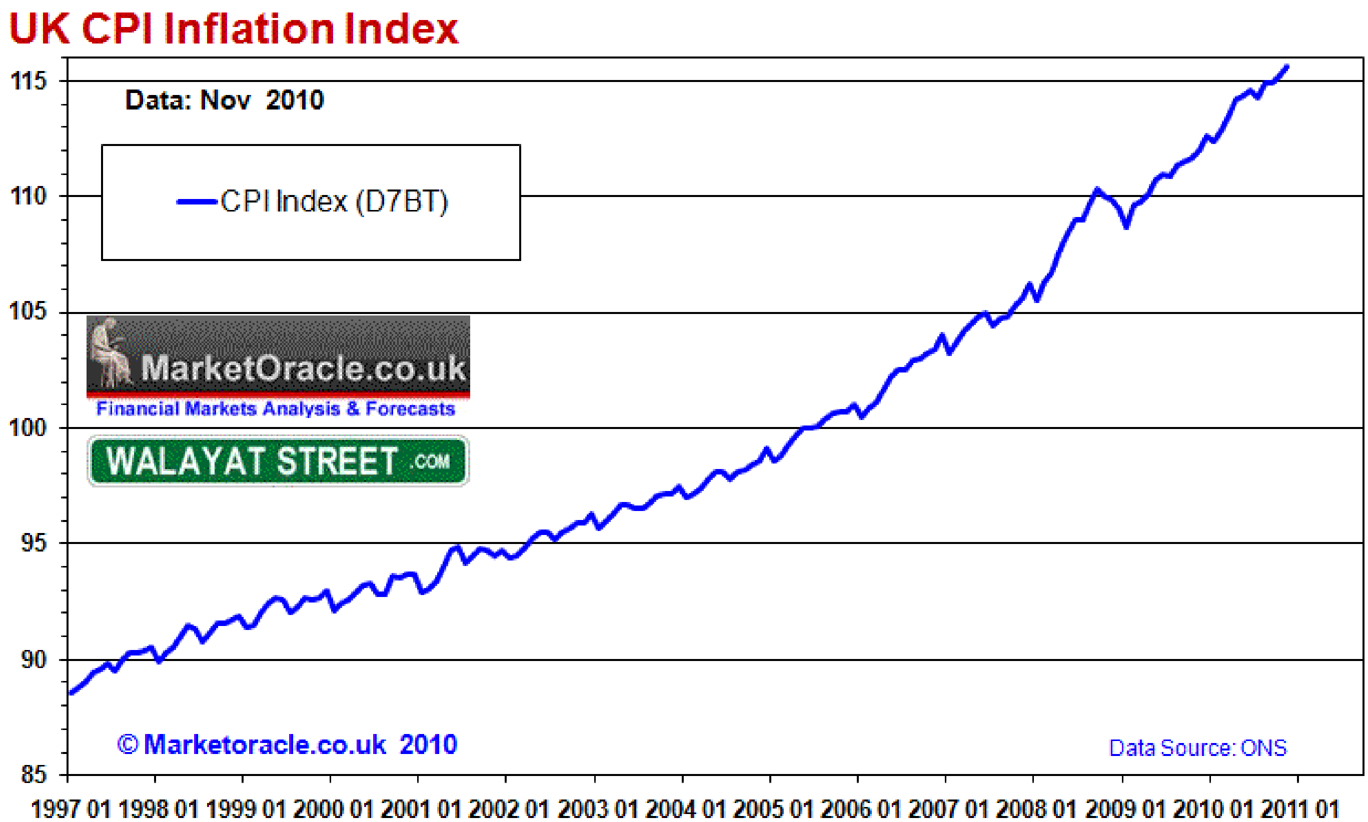
So in our topsy turvy government brainwashed world, we are repeatedly told that DEFLATION is bad, if not evil, and that INFLATION is good, something to leap with joy at the prospects of seeing our wealth disappear down the inflationary spiral. Governments love inflation because it allows them to expand the size of the state which is the natural instincts of ALL governments no matter the political party, as once politicians get into office then out goes the ideology that they used to get elected and off they run to enjoy the trappings of the state as they seek to make their mark on history.

You may at this point interject and state that the current UK coalition government is issuing statements left right and centre that it intends on cutting this that and the other to get a handle on the countries public debt mountain! Only one problem, the coalition government is not going to cut the debt at ALL! they can't cut the debt because the last Labour government has ensured that the gap between that which the government spends and earns is unbridgeable, all that the governments can do is erode the purchasing power of all workers and savers in the economy through inflation which devalues the value of the current total debt of approx £1 trillion with at least another £250 billion due to be added over the next few years, that THIS so called spending cutting government will rack up during which is why the Bank of England and Treasury pump out propaganda on the economy that never matches reality such as that the inflation rate is always destined to converge to 2% in 2 years time. for example if UK inflation compounds to 28% in 4 years time (RPI 5% per annum), then that means total debt of £1.2 trillion would be worth £864 billion i.e. Little change from the present! Hey presto the budget deficit is gone whilst the debt burden remains constant. But who has paid the price for this apparent miracle? The bond holders, savers and workers by means of inflation AND taxes on illusory nominal economic growth due to inflation.

## How Much of Your Wealth Has Been Squandered by the Last Labour Government ?

Well for that we have to take a look at the governments preferred inflation measure, the CPI index which despite under reporting real inflation still shows that the Labour government between April 1997 and May 2010 stealth taxed your wealth and earnings to the tune of 28% to give you the illusion of prosperity, whilst all the time enabling the government to go on an unfunded public sector spending spree to grease the palms of those who are most likely voted Labour. However the problem is that the greater the debt burden in terms of % of GDP then the greater will be the future rate of inflation, which currently looks set to wipe out another 28% of the value of your wealth during the next 5 years which will be WITHOUT the benefit of illusory inflation linked pay rises.



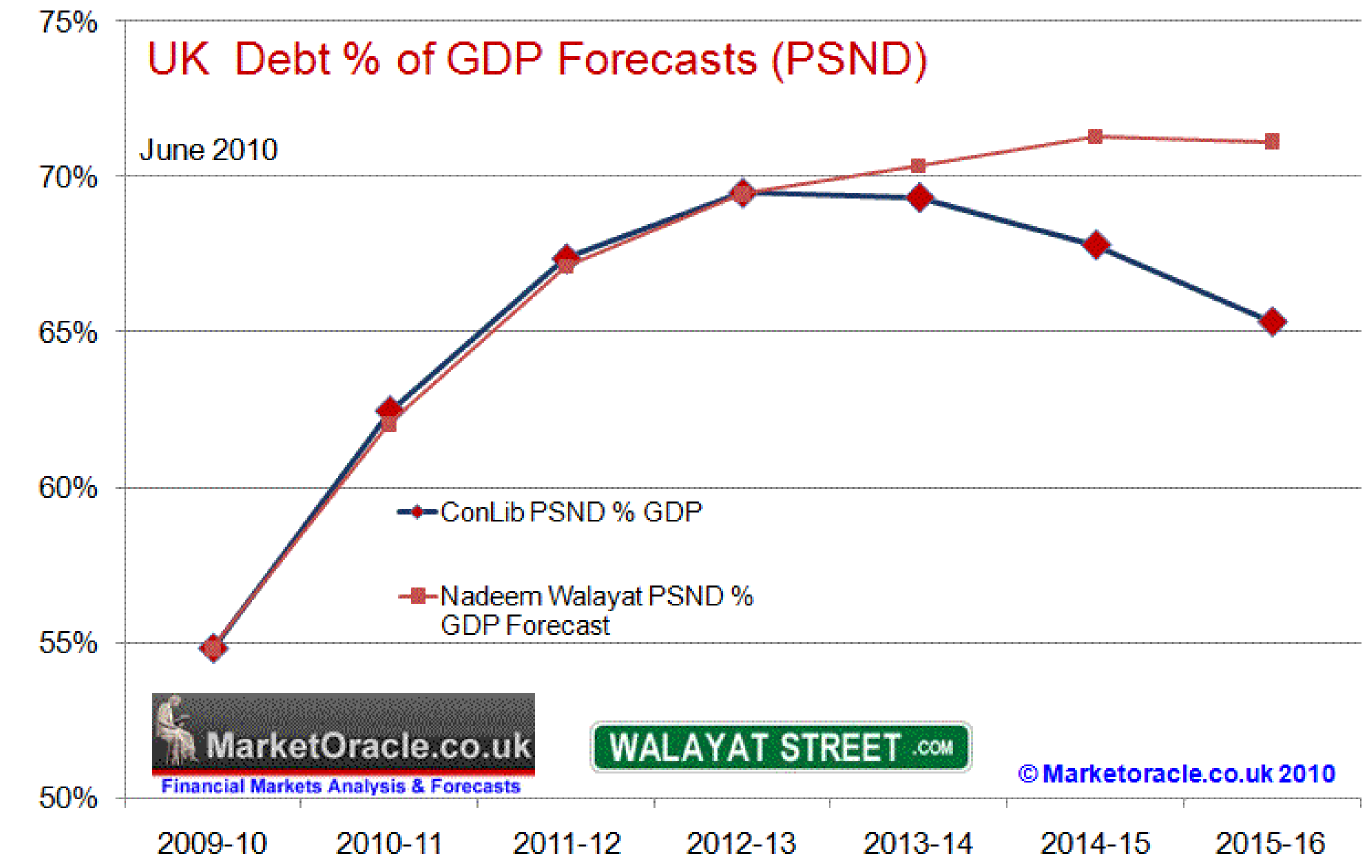

Savers at this point may argue that they receive interest on their savings or enjoy capital gains on invested assets (despite the financial crash and bankster designed fraudulently investment instruments that result in only making money for the financial institutions rather than investors). The government has thought of that too and steps in with ANNUAL taxes at the marginal rate on interest at 20% to 40% (depending on your tax band), and capital gains are also taxed. Which ensures savers / investors are going to find it very difficult to prevent the government from stealing your wealth as the system is designed to virtually guarantee that your wealth will eventually end up in the Treasury. On the other hand if there were no inflation then the rate of income tax on interest would not matter as you would always earn more than the inflation rate which is ZERO and neither would capital gains tax matter. Still it gets even better during deflation where due to increasing productivity general prices should fall so the value of your savings even if the rate of interest is ZERO increases, off course governments cannot allow for deflation because they are no longer able to steal your wealth.

## UK Interest Rates and Inflation Risks

So to gauge when UK interest rates will rise, we need to gauge what level of inflation will the coalition government consider as dangerous for the economy, as clearly 4% despite being above the BoE target is being ignored.

I suspect that the Bank of England and Government have privately long since geared themselves up for substantially higher inflation for many years, far beyond the upper limit of 3% which will come to be seen as period of low inflation as a consequence of the need stabilise public sector debt in terms of percentage of GDP especially if the government expects to achieve its target for debt at 65% of GDP by 2015-16 which I just do not see as being possible, the most probable outcome is debt stabilising at an inflation induced 71%.




UK Interest Rates - As mentioned earlier, the Bank of England's PRIME consideration is NOT the targeting of 2% CPI Inflation but 2% GDP, additionally the Bank of England also targets the monetization and devaluation of government debt and support for the bankrupt banking sector, so has multiple targets, the weight if which is favouring the maintenance of low interest rates. Risk is that the Bond Markets puke on the relentless supply of public debt, especially as the Government is expected to fail to achieve its deficit and Debt to GDP reduction target, impact probably delayed to 2012.

## Global Inflation

Those in other countries such as the United States are on a similar path to the UK, which similarly implies much higher future inflation as a consequence of their own stealth debt default trend. In fact the longer the U.S. Fed delays in forcing up US interest rates then the higher it will have to spike in the future as the larger will be the debt burden to deal with in terms of % of GDP. Therefore academic expectations for Deflation in the USA (deflationistas have become more rare in the UK) is a continuing construct of delusional freakanomics.

## Deflation Delusion Persists

You still continue to hear a lot of deflation in the BlogosFear and mainstream press, however the whole deflation argument is a delusion the reasons for which I covered at length in an earlier article (26 Aug 2010 - Deflation Delusion Continues as Economies Trend Towards High Inflation). Basically deflationists are living in either the 1930's or somewhere in ageing population shrinking Japan. They are not living in either the UK or the USA or much of the rest of the world. Deflation in our fraudulently fiat money printing central bank governed world cannot exist, not whilst governments run budget deficits that continue to pile on ever more debt that demands inflation to erode its real value away as already mentioned earlier and the price for which is being paid for by the CURRENT generation not future generations which is another consensus driven myth that exits purely to condition the population into accepting the frauds of deficit spending, debt accumulation and inflation.

Delusional deflationists that populate the mainstream media have been instrumental in ensuring that the likes of the stocks stealth bull market (02 Feb 2010 - Stocks Stealth Bull Market Trend Forecast For 2010) will continue to run for many years because they miss the most fundamental fact that asset prices are leveraged to consumer prices.

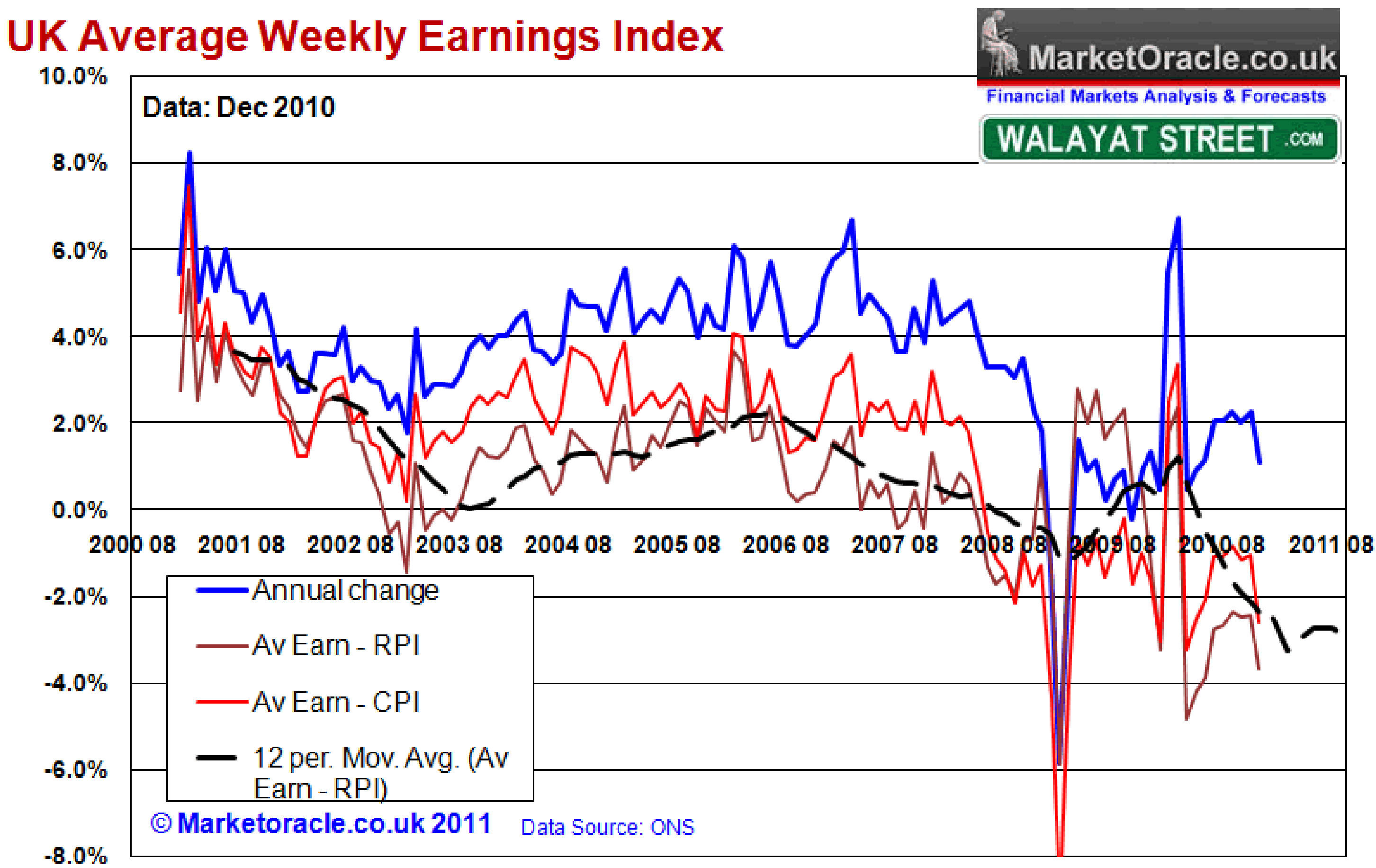
Deflationists say don't worry if the data does not fit, just change the methodology, as I warned would happen nearly a year ago that once proved to be wrong the deflationists will attempt to either rewrite history or change the definition of what inflation actually is which is precisely what is happening today (18 Nov 2009 - [Deflationists Are WRONG, Prepare for the INFLATION Mega-Trend ]).

Such as attempting to change the debate from Deflation vs Inflation to Deflation vs Hyperinflation ! When Hyperinflation is the END GAME ! When populations PANIC and lose confidence in the currency and hence dump it for anything from consumer goods to hard assets, which in our fast moving financial world probably mean that hyperinflation would occur within a matter of hours rather than months as Weimar Germany experienced during the 1920's. So hyperinflation is akin to market crashes i.e. something that cannot be forecast as to when it will occur but rather one can protect themselves from in advance of by engaging in Wealth INFLATION PROTECTION strategies rather than following the bankrupting deflationists recommendations such as parking ones money in cash or government bonds which are guaranteed to lose you ALL of your money as the first signs of hyperinflation would occur in the bond and currency markets, long before prices in the shops soar and the lagging official inflation indices surge higher!

## Inflation and Tax Rises Crush Britain's Middle Class, Real Earnings 25% Drop!

UK annual earnings grew at an annualised rate of 1.1% (December 2010), this compares against the official UK inflation rate of CPI 4% and the more recognised RPI at 5.1%, with the real UK inflation rate as experienced by most of the people of Britain running at 6.6%.

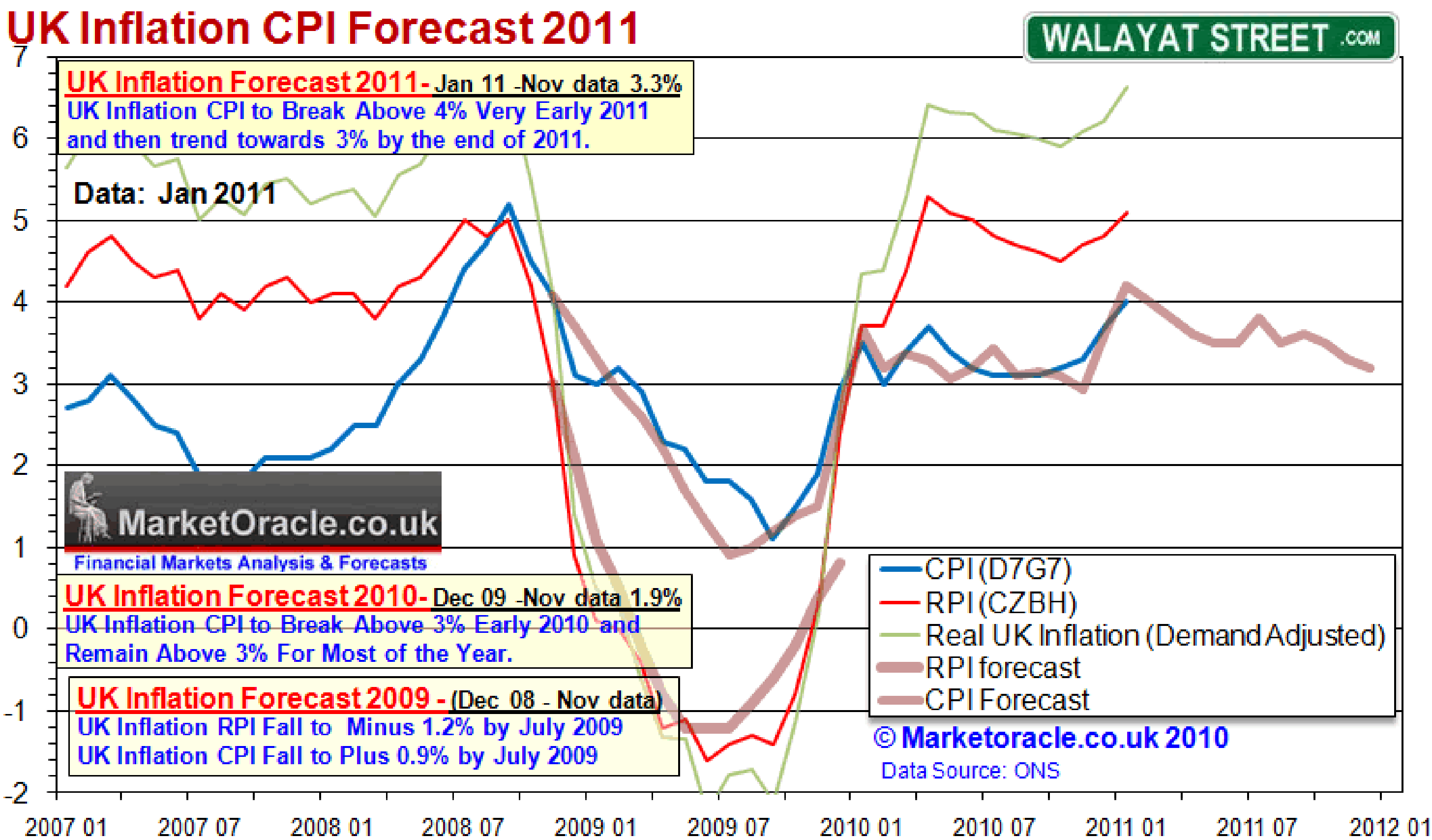
Clearly Britain's workers are being squeezed hard by a multitude of government policies that manifest in negative real earnings growth as the government seeks to use the stealth tax of inflation to erode the value of the ever expanding public debt mountain, where at least half of the annual budget deficit is as a direct consequence of the fraudulent actions of the banking sector, the price for which is continues to be paid for by the workers of Britain.




The UK Average earnings graph illustrates the real terms loss of purchasing power of earnings against both of the official inflation measures (CPI, RPI) which may surprise many to learn is not a recent phenomena but that the trend of negative real earnings growth has been in force since mid 2008 and is now approaching 3 years of punishment for workers for the crimes of bankster's that makes a mockery of the propaganda being pumped out by vested interests in the banking sector and coalition government that the tax payer is sitting on profits on banking sector capital injections (which I will came back to later in this article).

The in-depth analysis and forecast for UK inflation for 2011 (17 Jan 2011 - UK Inflation Forecast 2011, Imminent Spike to Above CPI 4%, RPI 6% ) concluded in UK inflation spiking to a high of 4.2% early 2011, and thereafter trend lower towards 3% by the end of 2011 remaining above the Bank of England's 3% upper limit for the whole of 2011. However, crude oil going super nova as a consequence of the breakout of freedom in the middle east, that could result in the oil price spiking as high as $200 would see UK CPI break above 7%, resulting in a far worse blood bath for the workers of Britain than the on going bankster bailout feeding frenzy.




## Middle Classes To Lose as Much as 25% of their real earnings.

Whilst the poor can rely on benefits and the rich can rely on capital growth to profit from asset markets being inflated by the central banks far beyond the official inflation indices. However that leaves 70% of the British population that class themselves as being middle class to feel the full force of the Inflation and economic austerity mega-trend.

Whilst many students (middle class wannabe's) have woken up to a near tripling of the debt burden they will be placed under, however, the situation for Britains vast middle class is set to get far worse than that which even the dire inflation outlook implies because on top of the inflation stealth theft of wealth and wage purchasing power there are a series of tax rises and benefit cuts due to hit the middle class workers of Britain and especially those with children as taxes rise such as national insurance, and tax allowances are cut, and benefits (tax reimbursements) such as tax credits are reduced and in many cases totally withdrawn which means middle class workers could be hit by an additional loss of earnings purchasing power of 5% per annum on top of the real inflation theft of at least 3% per annum, none of which features in any Bank of England or Government economic propaganda report.

Whilst trying hard to refrain from using expletives here, but the middle class of Britain is truly FQ&*ED! Middle class families will typically be poorer by between 15% and 25% by April 2013, as from Jan 2013 many benefits will be cut such as the universal tax free child benefit payments being ripped away that alone amount to a loss of 7% of disposable income for a £45k wage earner with 3 children, that is destined to break the backs of many a middle class family fighting hard to stay above water in the wake of soaring prices.

Tip - The way for workers to avoid loss of child benefit is to ensure each parents taxable earnings are below £42,375, one way to achieve this is to make a payment into a personal pension fund that would bring taxable earnings to below £42,375. There are a number of other mechanisms such as salary sacrifice and using cash ISA's to have savings interest excluded from taxable earnings.

To illustrate the severity of the situation, the loss of 15% to 25% of real earnings needs to be compared against the accumulative loss of purchasing power of approx 4% under Labours disastrous last 2 years in power, as Labour effectively sought to bankrupt the country so as to maximise seats won at the May 2010 General Election and deliver the Conservatives a scorched earth economy as I began warning of since at least mid 2009 (31 May 2009 - Labour Governments Bankrupt Scorched Earth UK Economy for the Conservative Government ).

There will be a great deal of pain, for worse than anything experienced during that of at least the past 30. The workers of Britain need to prepare themselves for this pain by taking action now to both protect their wealth and pay down debts as this trend given the governments persistently high budget deficit that continues to accumulate a ever higher debt mountain is likely to last for the whole of this decade.

The net result of the inflation and economic austerity mega-trend will be that a decade from now half of the middle class will have disappeared and have been forced to join the working class. It is not too incredulous to suggest that where the middle classes of Egypt is today is where the middle class of Britain will be in 10 years time, the politic consequences of which will be for the re-birth of socialism which will mean far greater long-term economic pain for everyone!

## Inflationary Wage Price Spiral

The risk that the Bank of England and Government is running is that people feeling real pain of contracting real earnings see through the Smoke and Mirror statistics of nominal growth and realise that persistent high INFLATION is pure and simple THEFT of their wealth and start demanding far higher pay rises than the official inflation rate, which I am sure that the implementation of the austerity cuts will act as a triggering mechanism for, this will make all workers far more militant and therefore many more strikes will breakout during 2011 and into 2012-2013 as the middle class of Britain revolt against severe contraction in earnings and erosion of wealth.

The effect of many more striking workers will be INFLATIONARY, because even marginally less goods and services produced act to force up prices, a ratcheting up effect, the higher inflation goes the less control the government or Bank of England will have over inflation as it will become LESS responsive to future interest rate hikes because people start to lose faith in the currency, as they don't want to hold onto something that is fast losing its value, they want to get rid of it, SPEND it on goods and services that they will find increasingly difficult to purchase with diminishing real wages.

Governments are always playing a dangerous game with inflation because governments NEED inflation to DEVALUE the DEBT, but populations REACT to persistently real high inflation by increasingly demanding higher pay far beyond that of discredited official inflation indices i.e. to make up for the shortfall in tax rises and benefit cuts that is expected to range upto 25% per annum loss of purchasing power by April 2013, and thus become highly reluctant to hold onto fiat currency as they seek to consume goods and services as soon as possible, and savers seek out hard assets or alternative currencies.

Another point to consider is that the spark for high inflation has already been lit by the budget busting mega black hole across the Atlantic that is burning the worlds reserve currency as though there is no tomorrow, in which respect there is no way that the British Pound will be able to escape its event horizon as both the dollar and sterling are heading for the same final destination regardless of volatility between the currency pairs that gives the illusion of a rising pound.

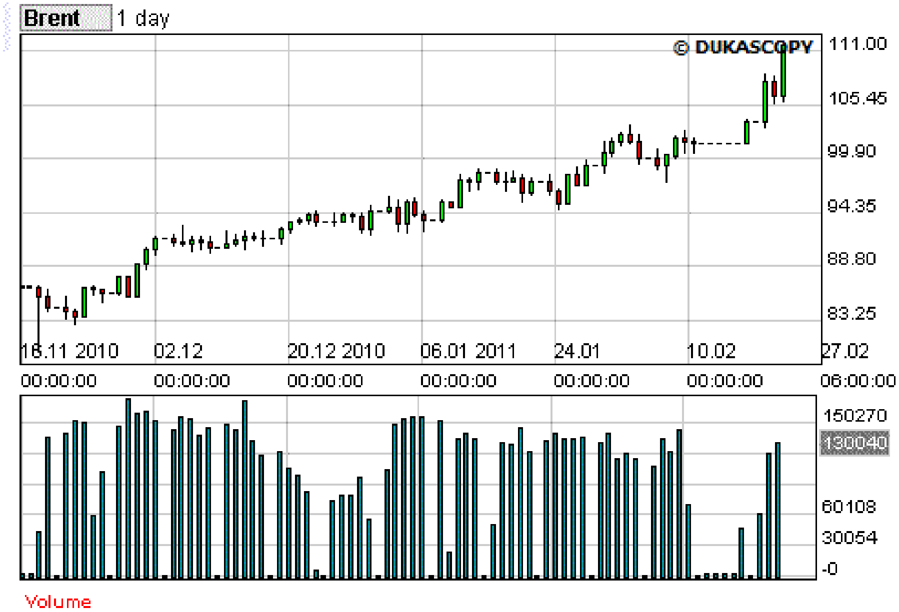
The implications for UK interest rates will be covered in my next in depth analysis and concluding forecast to be imminently completed, ensure you are subscribed to my always free newsletter to get this analysis and forecast in your email in box.

UK Interest Rates - The Bank of England primarily fears the wage price spiral, ironically raising interest rates could contribute towards igniting the wage price spiral as it would put the highly indebted workers of Britain under even greater stress that would manifest in worse civil unrest, strikes and more forceful wage demands. Therefore as there is no sign of an imminent wage price spiral given average earnings growth of just 1.1%, rate rises during 2011 would be counter productive.

## Crude Oil Goes SuperNova Implications for Inflation and Interest Rates

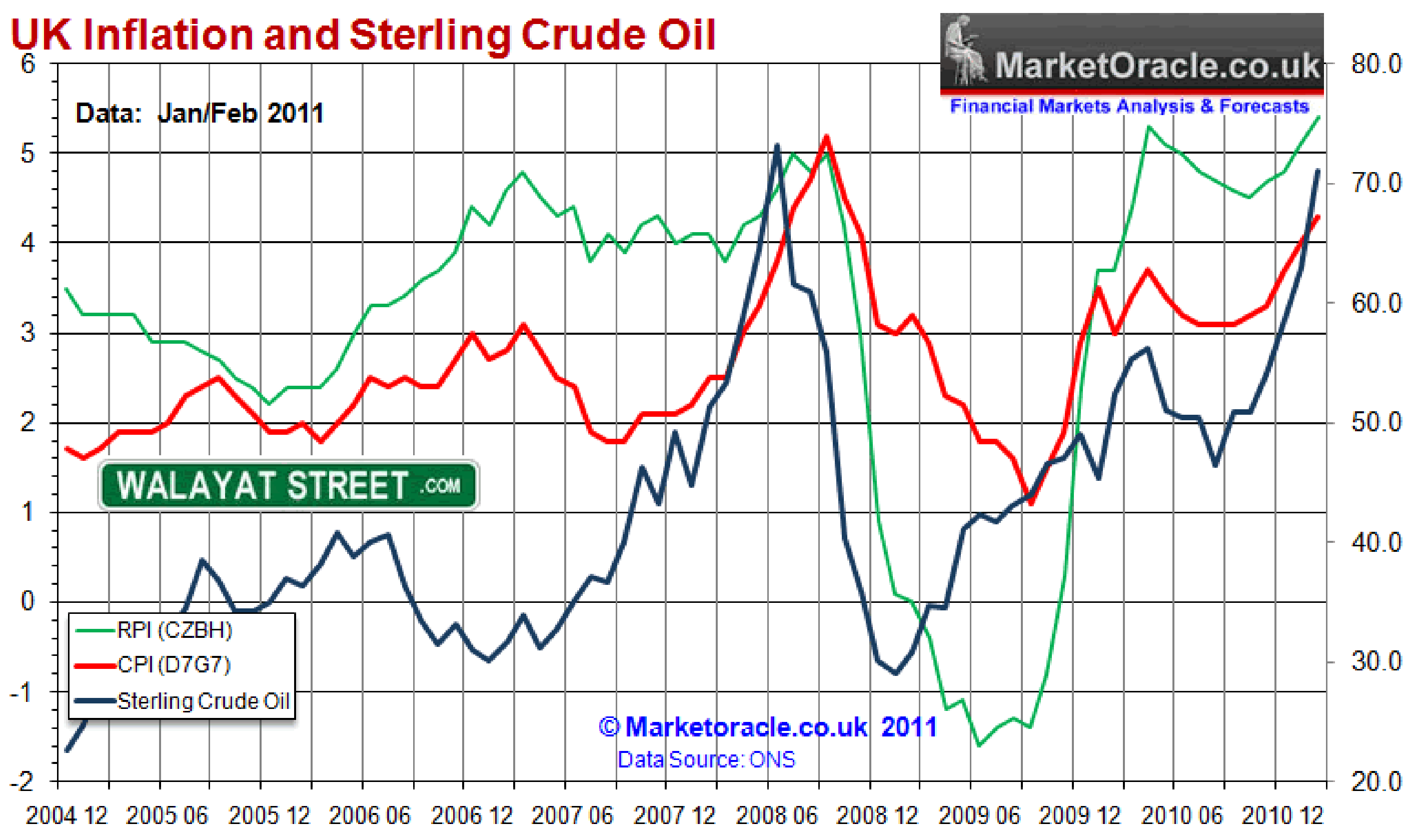
The inflation forecast for 2011 warned that the key risks to the forecast were all to the upside and specifically if Crude oil were to go super nova during 2011, subsequent events starting in Tunisia, magnifying in Egypt and now exploding in Libya have sent crude oil prices soaring into the stratosphere as speculators pile into a panic sparked trend, where Brent Crude has now spiked higher to $115 on the spot market, up $40 from the recent trading range of $75 and leaving the US WTI Crude presently lagging behind at $101.




Brent Crude oil of $115 if sustained would translate into an inflation rate of CPI 5%+ as prices at the pumps are ratcheted higher by at least 7p per litre, however the explosion taking place in the middle east appears to be just beginning as the freedom storm turns to the oil rich gulf states with the mafia dictatorship of Saudi Arabia at its head. However it is not necessary for the these mafia chiefdoms to actually collapse, rather the risk alone is enough for speculators to pile in and producers hoard crude oil in lieu of higher future prices, that could send the crude oil prices soaring to first break the 2008 $150 peak and then target a break of $200 amidst a short-lived mega-spike.

Whilst it is not possible to forecast where crude oil prices will exactly peak, however it is possible to estimate where Brent crude of $150 would translate into an UK CPI Inflation rate of 6%, and $200 of 7.5%, especially given the fact that Sterling today is much lower than where it was during the Commodity spike of mid 2008 as the below graph illustrates that crude oil in sterling is already within touching distance of its all time 2008 high rather than which is suggested by the dollar price that the mainstream press mistakenly exclusively focuses upon.



The above graph shows a tendency for crude oil prices (in sterling) to act as a leading indicator for UK inflation of between 6 and 18 months. With normal expectations for a lead of between 6-12 months, depending on the overall state of the economy, which given that the UK economy is in a slow recovery mode then the tendency will pull the lead against UK inflation nearer towards 6 months. The strong trend higher in crude oil during 2009 has resulted in high UK inflation throughout 2010. The current surge in sterling crude oil prices, even if it succumbs to some profit taking in the short-term looks set to translate in a summer UK CPI inflation rate of 5%+.

UK CPI Inflation at 5%+ would make a mockery of the deflation fools that populate the Bank of England's Monetary Policy Committee that have mistakenly beaten the deflation drum for the whole of 2010 and into 2011. Inflation of 5%+ would put increasing upward pressure on UK Interest rates as the markets would force the Bank of England to raise interest rates so as to continue to service a still huge government budget deficit via the bond markets that targets £120 billion for 2011-2012. Therefore the outcome as I first voiced over 6 months ago (26 Aug 2010 - Deflation Delusion Continues as Economies Trend Towards High Inflation ) would start to manifest itself in that the Bank of England would both raise interest rates AND print money so as to monetize government debt as the market interest rates would otherwise have to be far higher than what has been an increasingly irrelevant base interest rate would imply i.e. above 4% for 10 year gilts.

UK Interest Rates - Crude Oil being sustained in the range at $110 to $120 would result in Bank of England being forced by the market to raise interest rates to hold sterling debt (government bonds) as well as reduce commodity price pressures by pushing the British Pound higher regardless of the consequences for lower economic growth.

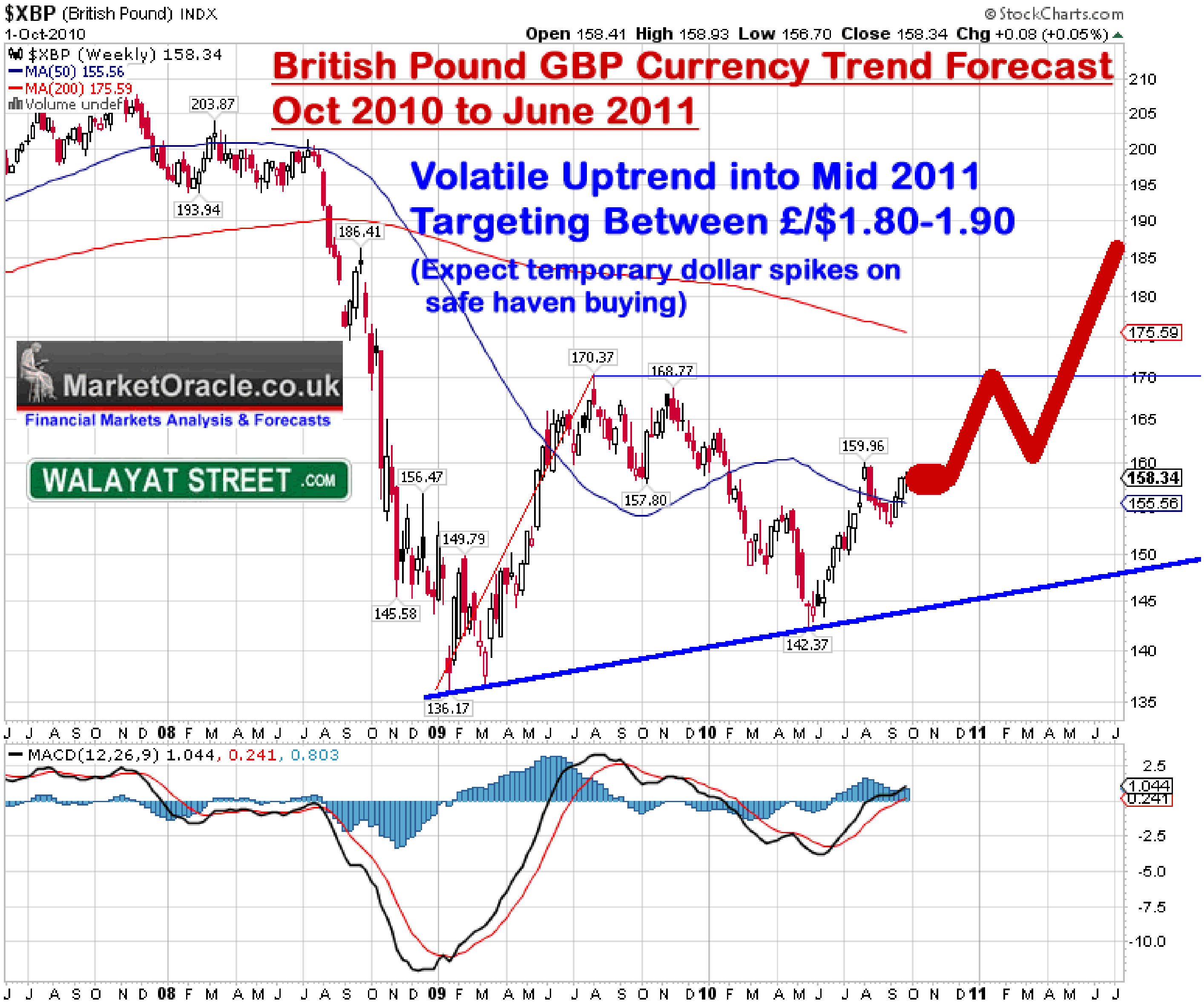
UK Interest Rates - Crude Oil being sustained north of $150 would result a global recession and trigger panic at the Bank of England and around the Coalition Governments Cabinet table, this would result in interest rates being kept low, and more money printing so as to generate economic activity regardless of the inflationary consequences.

## British Pound, Inflation and Interest Rates

Sterling's bounce of of the December floor of £/$1.54 to currently hover around £/$1.62 illustrates market confidence in the new governments austerity measures relative to that of the United States and even more so when one looks at the bankrupting PIIGS of the euro-zone.


My last in-depth analysis and concluding forecast for was for a volatile up-trend towards a target of £/$ 1.85 by Mid 2011 as illustrated by the below graph (04 Oct 2010 - British Pound Sterling GBP Currency Trend Forecast into Mid 2011 ) .




Though as is always the case, a rise in sterling is just a manifestation of the relative volatility between currencies that are all in state of perpetual free fall against one another due to the fact that the money via various means such as fractional reserve banking, or more overtly Quantitative Easing is constantly being printed therefore currencies are constantly losing value that is measured by the inflation indices, whether official CPI 4%, RPI 5.1% or more realistic MO 6.6%. Therefore holders of any fiat currency should seek to minimise the time for which it is held as holders cycle between differing asset classes.

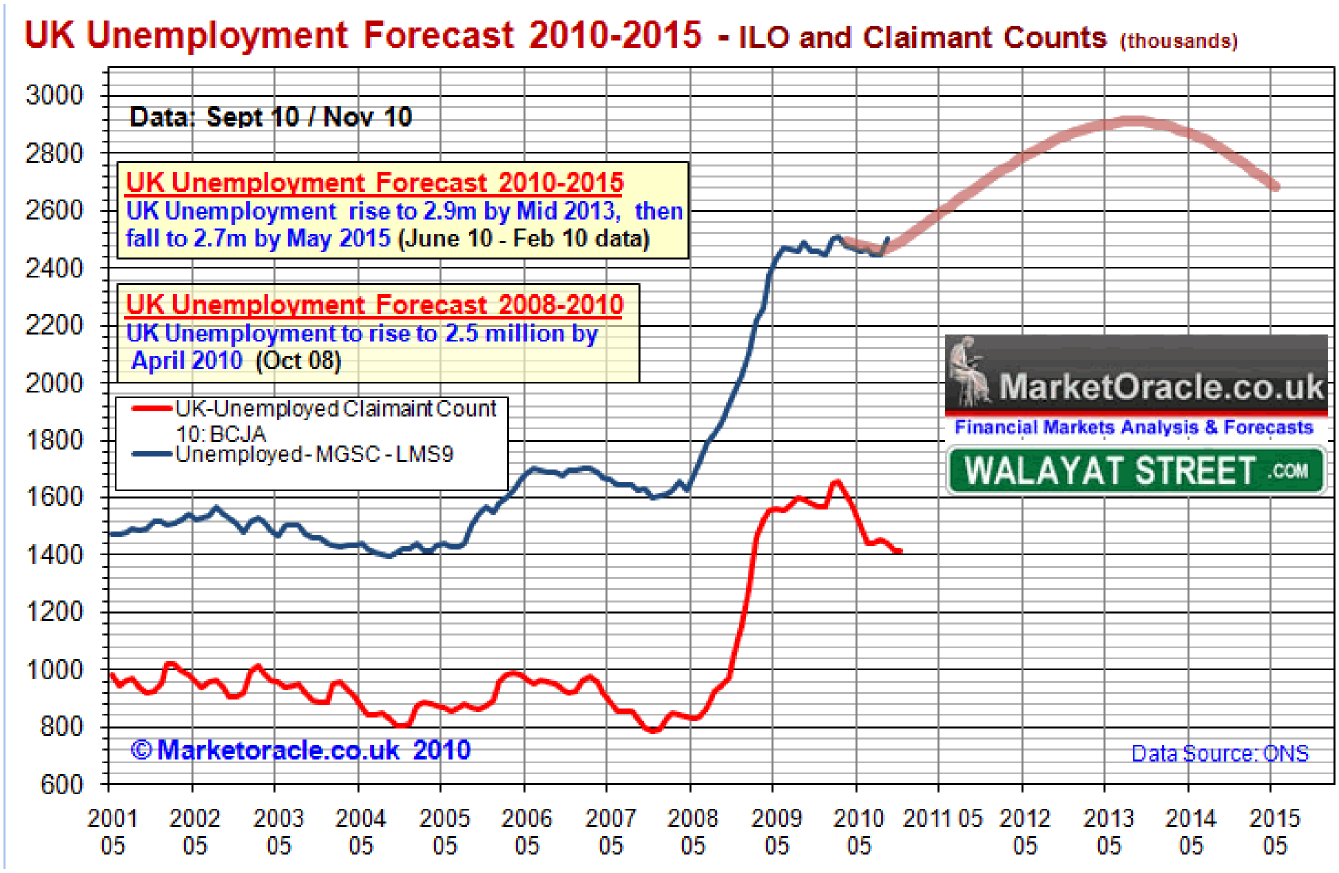
Whilst an upward trend in sterling will reduce inflationary pressures and thus make interest rate rises less likely, however contrary to the consensus view of academic economists, that interest rises drive currencies higher. In actual fact currencies, in this case the British Pound acts as a leading indicator for interest rates in that sterling starts to rise well before interest rates start to rise, anywhere from 1 to 2 years before hand, given that sterling bottomed in Jan 2009 and then again in May 2010, a minimum lead time of a minimum of near 1 year now exists for base interest rates to start to rise.

UK Interest Rates - Sterling trend leads UK base interest rates by usually between 1 and 2 years, which given the two lows of Jan 2009 and May 2010, buts sterling into this time window that signals rises in base interest rates. The consensus academic view is therefore wrong that interest rate hikes push currencies higher, when the actual fact is that interest rates follow currency trends, instead academics will focus on why a strong currency means interest rates should not rise, which is the exact opposite (so wrong as usual).

## UK Unemployment

The fundamental flaw in the governments employment policy and OBR forecast for UK unemployment to hit 2 million by 2015 is the fact is that as many as 80% of the new jobs created by the private sector will go to E.U. migrant workers as identified in the UK unemployment forecast (01 Jul 2010 - UK Unemployment Forecast 2010 to 2015 ). The latest UK unemployment data is line with the forecast trend for UK unemployment to start rising in September and target a trend to 2.9 million by mid 2013 as illustrated by the below forecast graph.




The ongoing euro-zone debt crisis and resulting economic depressions in PIIGS economies is resulting in a huge number of migrant workers entering the UK workforce from especially Ireland, Greece, Portugal and Spain as identified recently (22 Nov 2010 - Ireland Bailout Consequences for Britain, Portugal Next? Stock Market Correction Over? ). Over 100,000 have migrated from Ireland alone over recent months which is set against total private sector job creations running at an average rate of about 30,000 per month, which illustrates that 80% of the new jobs are not going to be filled by UK unemployed citizens.

The government in part is aiming to address the migrant workers issue by attempting to force those on benefits that can work but chose not to work off of benefits, although most of the measures will not be implemented for several years.

The best response from job hunters to the weight of a rising trend in UK unemployment for several years would be to start thinking outside the box and contemplating self employment / business startups as the coalition government has promised to foster a more business friendly environment by cutting red tape.

Meanwhile those that are employed continue to be squeezed by average increasing by just 2.2%, which is well below even the manipulated official inflation CPI measure at 4%, and half the rate of the more recognised RPI at 5.1%, which actual real inflation of 6.6% triple average earnings.

The overall impact of rising unemployment is neutralised by migrant workers creating new demand and thus putting upward pressure on prices.

Implications for Interest Rates - This is another unstated economic indicator that the Bank of England targets, therefore a forecast trend for rising unemployment over the next 3 years implies that the Bank of England will be reluctant to raise interest rates.

## Bank of England Remains Paralysed By Fear of Financial Armageddon

Since August 2007 when the credit crisis first broke the Bank of England has been in near perpetual state of panic, always opting to do nothing rather than something. For instance during 2008 the Bank of England should have been cutting interest rates but instead it kept them on hold at 5% as it remained paralysed by the fear of inflation right up until the world peered over the abyss at financial armageddon.

### Lehman's Bankruptcy

The Lehman's bankruptcy irrevocably changed the financial world as within a matter of days a chain reaction of the worlds banks going bust pushed the world towards financial armageddon as the following video illustrates just how close the U.S. Financial System came towards total collapse. At 2 minutes, 20 seconds into this C-Span video clip, Rep. Paul Kanjorski of Pennsylvania in February 2009 explains how the Federal Reserve told Congress members about a "tremendous draw-down of money market accounts in the United States, to the tune of $550 billion dollars." According to Kanjorski, this electronic transfer occurred over the period of an hour and threatened a further $5 trillion to be drawn out triggering a total collapse of the Financial System, which prompted Hank Paulson's emergency $700 billion TARP bailout action.


Video Served by Youtube

Even on the brink of financial armageddon the Bank of England remained in a state of near total paralysis, it took Gordon Brown to announce the first emergency interest rate cut on October the 6th 2008 from the Prime Ministers Despatch Box rather than by the Bank of England MPC, following which the Bank of England was effectively instructed to ignore inflation and keep cutting interest rates all the way to 0.5% by March 2009 where they have remained for the past 2 years.

### Why are the Banks Still Bankrupt ?

Because the banks are leveraged up to the hilt, forget X10, or X20, some banks such as Lehman's were leveraged at over 50X capital. Nothing much has changed, the exposure of UK banks as illustrated by the derivatives market is of several magnitudes greater than the total economic output of Britain, there are no if's or but's, the Bank of England remains paralysed by fear of FINANCIAL ARMAGEDDON, because there is no way that the country can cover the total exposure of Britain's banking sector without going bankrupt i.e. hyperinflation. Which is why the BoE will remain reluctant to raise interest rates for many years as well as continue to print money to funnel to the banks.

### The Cost of Near Financial Armageddon

The cost to the world, just in terms of lost economic output as against where the economies were trending towards is put at £11 trillion, with the economic cost to Britain at about £250 billion, this is on top of all of the £1 trillion of bailout costs and banking sector liabilities.

## Bankster's Holding a Gun to the Heads of British Tax Payers

The bankster elite are holding the tax payers of Britain hostage under the threat of financial armageddon, the fraudulent banking sector converts the tax payer funded profits into hard cash that the bankster elite pockets as bonuses.

The BoE lends the banks at 0.5% that then go off to buy government bonds (yes the greedy fools also used BoE bailout cash to buy PIIGS debt just before they started to go bust) on leverage and then the BoE prints money to buy the bonds back from the banks at 3% thus generating an instant profit in the region of 55% RISK FREE. If that is not evidence of a Bankster Elite controlling the real levers of power i.e. the ability to print money than what is ? It also explains why the banks are not lending to businesses and individuals as why should they take on the risk of lending when they can make many times that risk free.

I may be starting to sound like a broken record but Britain DOES need a government that cracks the back of the fraudulent fractional reserve banking system that would make the Bank of England redundant. Until that happens the fraud will continue which manifests itself in the twin forces of debt slavery and high real inflation (currently 6.6%). Instead the Bank of England is successfully manoeuvring itself to grab more power from Parliament with Mervyn King making worthless propaganda statements in the mainstream press.

At this point in time the only way individuals can fight against the fraud is by not borrowing and turning themselves into perpetual debt slaves for life and not depositing funds into the banks, instead invest in other asset classes such as stocks, housing, commodities etc., which whilst they may be volatile at least you will stand some chance of keeping pace with real inflation as opposed to the pittance of sub inflation TAXED interest rates that the Bankster elite throw as scraps to savers that they treat as suckers as they walk through their branch doors.

To achieve its twin policies, the Bank of England aided by he UK Treasury has been engaged in a game of smoke and mirrors to try and mask reality from the public which it cannot do so in terms of real inflation experience. First the banks required capital injections to boost their capital reserves. Then, he banks received £200 billion in QE so as to maintain capital ratios to enable them to monetize government debt at a huge profit margin, i.e. borrow at 0.5% from the Bank of England and lend to the government at 3.5%, resulting in a clear profit of 3% - leveraged by X20.

Many other smoke and mirrors are being used to brain wash the population with propaganda such as that the tax payer is sitting on a profit from bank capital injections, whilst conveniently ignoring the £100 billion+ of bad loans that have been written off that will never see the light of day again such as those at Northern Rock, and not forgetting the fact that these bad debt losses dumped onto tax payers will be claimed for by the bankrupt bailed out banks to set against future corporation taxes for many years, so the fraud on tax payers will continue to an even greater extent as tax payers finance fictitious profits that are offset by losses also covered by tax payers.

The total amount of liabilities that the government has dumped onto the backs of tax payers exceeds £1 trillion that has an economic impact valued at £60 billion per year in terms of debt servicing costs that is not being reimbursed.

UK interest Rates - As the primary purpose of the Bank of England is to protect the banking sector which effectively means to do the bidding of it's Bankster elite brethren by allowing them to generate huge artificial risk free profits, this means that the BoE will delay raising UK interest rates for as long as it possibly can resist market pressures to respond to HIGH Inflation.

## Quantitative Easing

The policy of Quantitative easing that began in March 2009 has so far pumped £200 billion that contrary to the deflationistas rants of the past 2 years has contributed towards high inflation in the UK for the whole of 2010. The primary purpose of quantitative easing is to force interest rates lower across the yield curve by firstly buying government bonds from financial institutions i.e. monetization of the governments budget deficit by printing money and funneling profits onto the balance sheets of the banks. By artificially forcing interest rates lower, this pushes inflation higher and savings interest rates lower thus forces savers to spend and thus generate economic activity rather than lose the value of their savings as real inflation is far above the rate of interest being paid on savings. Whilst at the same time the Bank of England pumps out economic propaganda to the population to ignore high inflation so as to avoid a wage price spiral from taking hold i.e. losing control of high inflation as occurred during the 1970's

The bottom line is that Quantitative Easing does not benefit the real economy, the ordinary tax payers of Britain, virtually ALL of the benefits are for the bankster elite by enabling them to make huge fictitious profits that are subsequently paid out as bonuses. In fact QE has the opposite effect of that which the gullible mainstream press suggests to that of boosting the economy as the Banks are making risk free profits are therefore LESS eager to take on risk and lend to business and individuals than before. The governments are happy for QE to continue for it masks the true dire state of the countries finances as they artificially keep interest rates low, whilst at the same time pumping out phony doctored inflation indices such as the CPI which tend to be approximate HALF the real rate of inflation that the population actually suffers.

UK Interest Rates - The Bank of England's default position is to do nothing, therefore it will have to be dragged kicking and screaming by the market to raise interest rates. The bond markets have already responded to the prospects for higher market interest rates against which the Bank of England and other central banks are printing money to buy government debt to try push low interest out further along the yield curve.

## Bank of England Failure to Understand Global Monetary Flows

The Bank of England appears to be stuck in time warp where they think global money flows stop at the white cliffs of dover, despite the fact that London is at the heart of the worlds financial system through which approx $1.7 trillion flows on a DAILY BASIS. US rampant money printing coupled with phony inflation statistics (Shadow states says it is at 8% instead of 1.4% official CPI), is resulting in huge flows of dollars magnified by the fractional reserve banking system, this flood of dollars is enough to send global inflation soaring, as especially developing nations fight to maintain a peg to a freefalling U.S. Dollar thus giving the illusion of currency stability. So the Bank of England instead of factoring in the impact of £200 billion of Quantitative Easing needs to factor in how much of US Fed money printing has flooded into Britain, given the inflationary trend this suggests an equivalent of another £200 billion of QE as a consequence of Fed money printing.

UK Interest Rates - The flood of liquidity is far greater than that implemented by the Bank of England, which implies a rate hike is more likely.

## Global Bond Market Thirty Year Bull Market Is Over

My analysis of August 2010 correctly concluded that the global sovereign bonds bull market was about to imminently end and forecast that the surrogate for the global bond market, the US 30 Year Bond was targeting a sharp downtrend from 138 to between 120-115 by March 2011 (actual low 117 during Feb 2011)(26 Aug 2010 - Deflation Delusion Continues as Economies Trend Towards High Inflation).

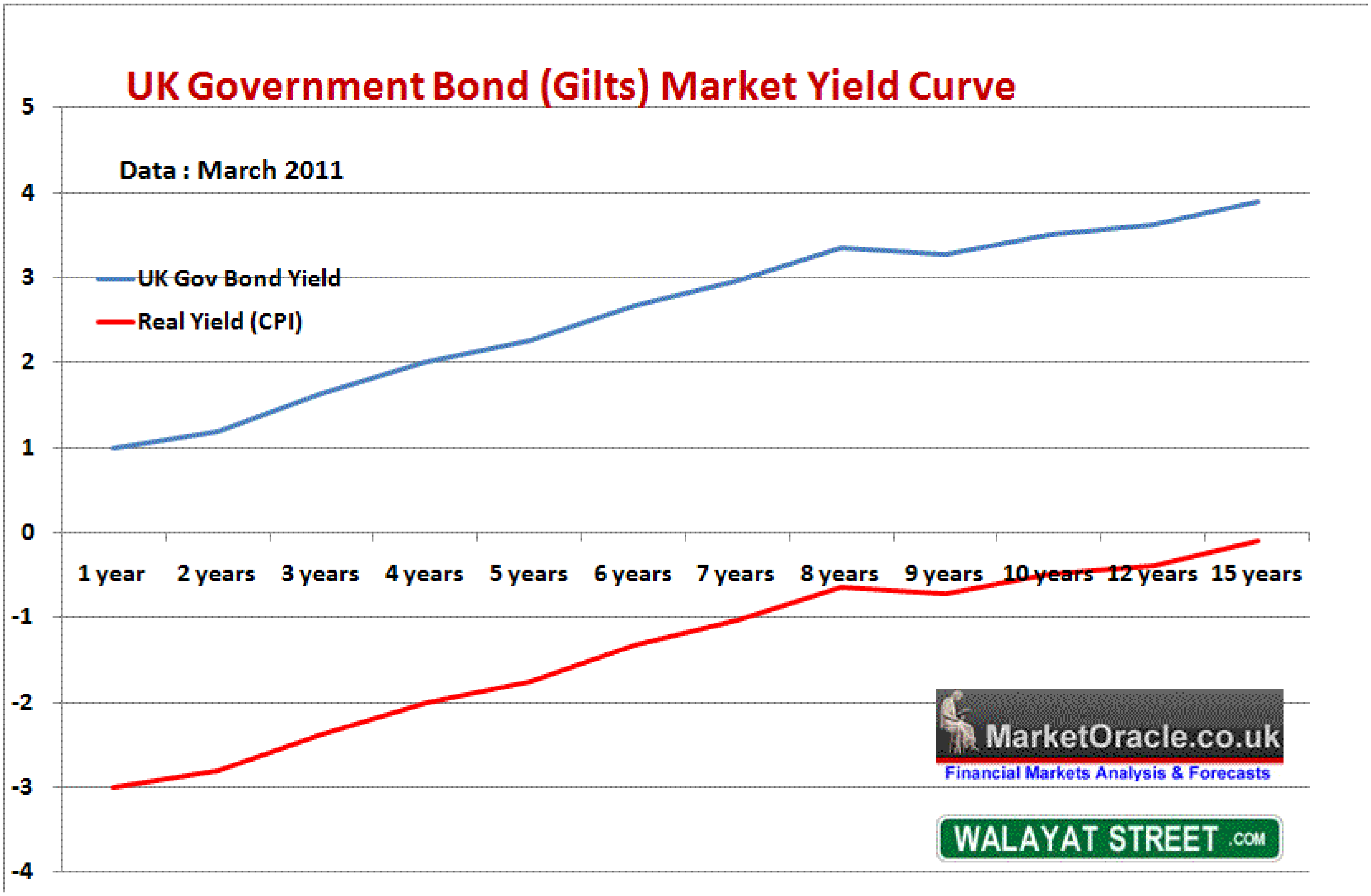

Since August 2010, the UK 10 year bench mark gilt interest rates have risen sharply from 2.8% to stand more than 1% higher at 3.85% as evidence of rising bond market interest rates in response to persistently high inflation, and continuing new supply of UK debt that will trigger demands for further QE as the Bank of England monetize's government debt so as to keep market interest rates artificially low.

The last bull market in bonds lasted 30 years, therefore I expect the bond market downtrend / yield uptrend to continue for many years if not over a decade and so far the market has done nothing to negate this long standing conclusion.

## UK Bond Markets Yield Curve

The Bank of England is artificially keeping the short-end of the yield curve depressed by means of its base rate linked money market operations (short-term loans to the banks) and attempts to suppress longer term yields by means of quantitative easing. As money is far cheaper at the shorter end then this is where the banks seek to borrow and then reinvest at the longer end at far higher rates that is being met by ample supply of bonds from government budget deficit that is still more than 10% of GDP.




The yield curve graph illustrates that all government bonds upto 15 years maturity yield less than the rate of inflation (CPI). Therefore suppression of the short-end with a 0.5% base rate serves the twin purposes for generating artificial bank profits (leveraged positions) and monetizing government debt. The Bank of England wants to keep interest rates suppressed at both the short and long ends for as long as possible. However with across the board negative yields it is being forced by the market to raise short-term rates so as to keep longer-term rates from rising further as raising short-term rates sends a message to the bond markets of lower future inflation.

Therefore a small interest rate hike to say 0.75% or 1% would make it easier for the government to finance its debt as longer-term rates should fall as the market discounts lower future inflation and growth, i.e. a flattening of the yield curve.

The worst case scenario and which is the more probable outcome in the longer term is of stagflation where the yield curve remains steep as interest rates rise.

## How high could yields go?

Well the long-term trend for bonds is that of a trading range i.e. US interest rates ultimately could be heading towards the 1981 peak when US interest yields hit 15% and UK government bonds tend to trade at a premium to US bonds so if US rates hit 15% UK rates could be a percent or two higher.

Whilst 15% is NOT going to happen during 2011, however this does illustrate the long-term direction of trend which will continue to put upward pressure on the base interest rate that the Bank of England is keeping artificially low when compared to the market interest rates, i.e. UK base interest rates at 0.5% ONLY SERVE the bankster elite as I have elaborated upon at length.

## Why have bond investors Been Blind to the inevitable crash ?

Because most are bankster's who's only focus is the short-term so as to maximise bonus payments that are monetizing government debt by means of highly leveraged positions which is why the bankster's are making huge profits by borrowing at 0.5% from the Bank of England then buying longer dated government bonds at more than 3.5% on leverage of say X20 (usually much higher) that converts into a profit of 3% X20 = 60%! This demand has the effect of depressing gilt yields down so bond prices rise thus another 20% profit is made for every 1% rise in the bond price. Off course during a bond market crash leverage works in reverse as a mere 10% drop converts into an instant 200% loss (at X20 leverage) and another bankrupt too big to fail bank for the tax payers to step in and bailout again.

This also suggests an anomaly is possible, of high inflation with low interest rates, because the bankster elite are enticed into perpetually financing government debt at low long-term interest rates in exchange for huge profits, as what do the bankster's care if the inflation rate is at 6% and the base interest rate is 0.5% because they can buy borrow at 0.5% and buy bonds at 3.5% for a profit of 60% against an inflation cost of just 6%, this thus prevents long-term bond market interest rates from rising as is normally the case i.e. long-term interest rates are usually positive (above inflation). Which effectively means that governments are able to ROLL OVER MATURING LONG-TERM DEBT AT INTEREST RATES BELOW THE RATE OF INFLATION!!! i.e. A mechanism for Maximising debt default through high inflation! Which is the ultimate purpose of Q.E. - The consensus (academic economists) view is that governments have to roll over maturing debt at HIGHER interest rates as a consequence of HIGHER inflation.

However the interest rate risks are transferred to the currency markets and this also suggests that the risk of hyperinflation is higher as the system is geared towards perpetually increasing debt until the bubble bursts amidst an hyperinflationary panic rather than mechanisms for less severe normalisation of debt due to just high inflation but rather an hyperinflation outcome.

The bottom line is that the bond market / low interest rate bull market is over. The markets are SHOUTING HIGHER INTEREST RATES LOUD AND CLEAR. At this point in time the Bank of England is putting the Coalition Governments deficit reduction strategy in jeopardy by continuously failing to control inflation as a consequence of NEGATIVE real interest rates.

UK Interest Rates - As mentioned earlier in this article, there is no end to the amount of new debt that will be issued that will continue at above £100 billion a year for the next 5 years at least. Therefore the Bank of England will try hard to prevent interest rates from rising by buying government debt from the banks by printing money. Therefore the base rate will be kept low to keep sending signals to the bond market that the Bank wants low interest rates across the yield curve. However the bond markets are clearly putting upward pressure on market interest rates as a consequence of inflation which on balance suggests a series of token rate rises this year.

## Banks Still Not Lending

The reasons the banks are not lending is because they are still effectively bankrupt 3 years on from the start of the credit crisis in August 2007 when the credit markets first froze, banks continue to rebuild their balance sheets by means of borrowing cheap money from the central banks at the short-end and investing it in government bonds at the longer end thus effectively receiving money for nothing, as well as acting as a mechanism for financing the governments huge budget deficit. Of course bankster's being bankster's were not satisfied with 3% for UK 10 year bonds, so 2 years ago they viewed the higher rates of the PIIGS as even more free cash, off course now that the likes of Greece, Ireland and Portugal are destined to default, which means even more losses the banks are sitting on that means even more bailout cash from UK tax payers to cover the losses, which therefore suggests lower interest rates for much longer as the bankrupt banks remain determined to Bankrupt Britain.

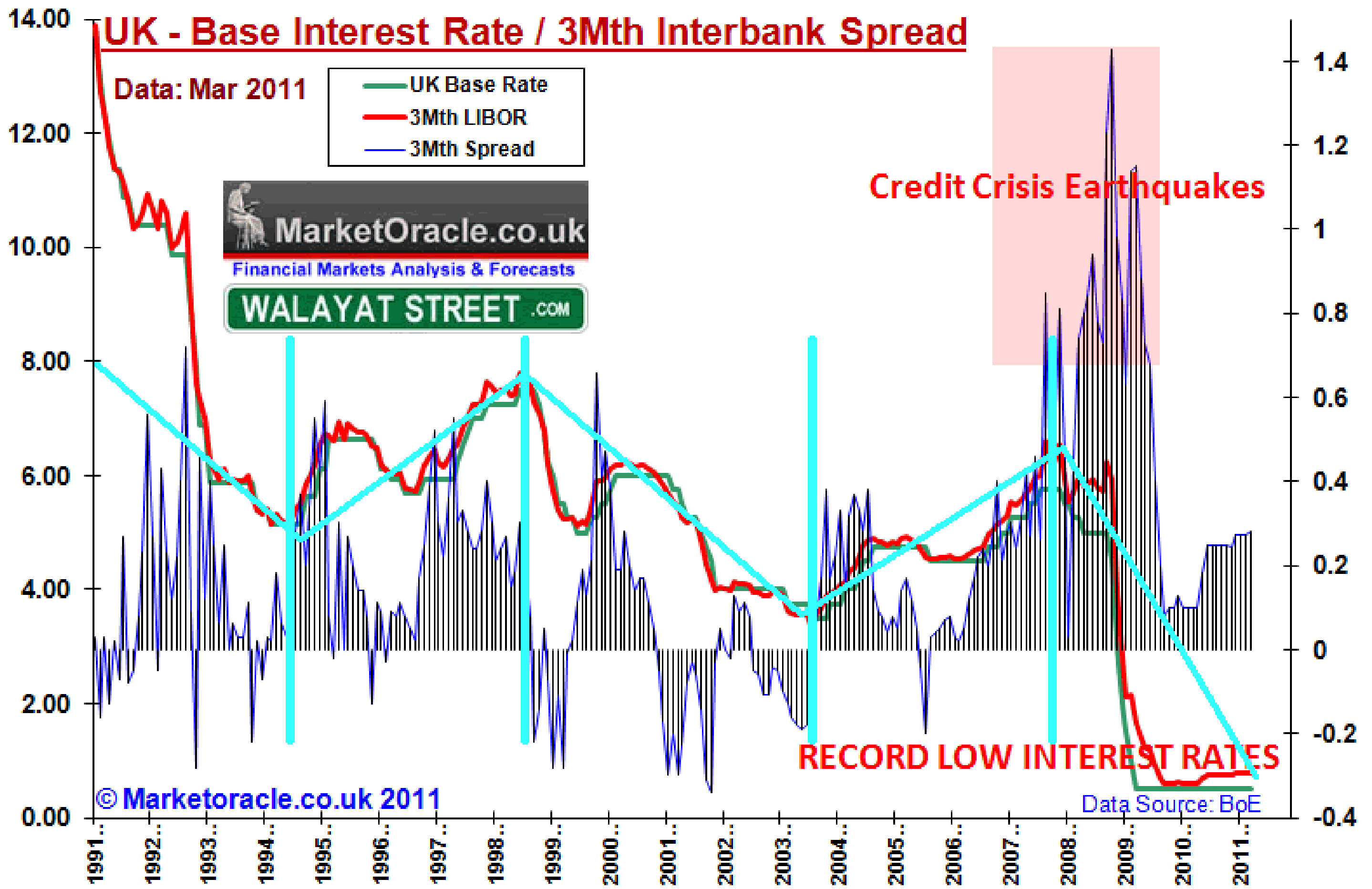
The only answer is firm regulation that breaks up the banks, else the UK tax payers will be forced to keep bailing the banks out for another decade.

Most financing of corporations is via bank lending as opposed to the capital markets therefore this impacts onto corporate sector growth. Whilst the government owns large chunks of Britains banking sector however the fact that the banks are not lending continues to show that it does not control them, this continues to imply low interest rates and easy money for the banking sector to continue rebuilding their balance sheets. Perhaps the British government could learn something from China, where the government tells the chinese banks exactly how much to lend and they are expected to lend virtually exactly that amount. Instead in Britain the tail wags the dog and the government bows to the whims of the bankster elite as the politicians prep themselves for post Parliament directorships on the board of banks and financials.

## Base Interest Rate / LIBOR Analysis

The below graph shows the spread between 3 Month LIBOR and the UK Base Interest rate which illustrates that the credit crisis did not just appear out of the blue in September / October 2008 but began over a year earlier in August 2007 when the interbank money markets froze as a consequence of the fictitious mark to market valuations on sliced and diced collaterised debt obligations that the banks had accumulated. Whilst the central banks began to attempt to unfreeze the credit markets through a number of increasingly desperate actions during the subsequent 12 months, however all of these measures failed which resulted in a series of credit crisis earthquakes culminating in the September 08 Lehman's bankruptcy which galvanised governments and central banks to literally throw everything they had to bring the inter bank interest rates down, which in the UK included cutting the base interest rate to virtually zero by March 2010 and pressing the monetary nuclear button of printing money and forcing the tax payers to guarantee more than £1 trillion of bad bank debt which succeeded in bringing the base rate / LIBOR spread down to within historic norms, but at huge cost to bank customers including borrowers and savers as banks are making unprecedented profit margins as illustrated by the spread between mortgage standard variable rates and LIBOR of as high 4% against historic norms of less than 1%.




Cycles Analysis - UK Interest rate raising and cutting cycles tend to last between 3.5 and 4 years. The last peak in UK rates was in October 2007, this would put the current rate cutting cycle at 3.5 years and thus signaling that the UK base interest rate is primed to enter into a 3 to 4 year rate hiking cycle.

Cycle Target - Suggests that the soon to be starting rate hiking cycle targets a base interest rate of at least 4.5%.

Trend Analysis - Suggests the initial trend higher to 2% over the next 12 months. So if rates start to rise mid 2011 then they would target 2% by mid 2012.

UK Interest Rates - Trend analysis is clearly suggesting a series of rate rises by mid 2011 to target 2%, to be followed by several more years of rate hikes that targets a minimum rate of 4.5% by end 2014.

## The Interest Rate Buffer

With the base interest rate at 0.5% there is no buffer for future rate cuts as a consequence of future crisis, therefore the Bank of England is aware that it needs to rebuild a buffer to deal with future inevitable crisis i.e. a trend towards normalisation of interest rates, the fact that it has not event started to do so is indicative of continuing paralysis at the Bank of England

## Formulating an Interest Rate Forecast Conclusion for 2011

The final UK interest rate analysis for web publishing on 8th March 2011, despite being split into two halves was reduced by approx 15%, however all of the 22 key factors of analysis are contained within the UK Interest Rates Forecast Matrix below.

Despite all of the analysis, it would be an understatement to say that it has been difficult to arrive arrive at a forecast conclusion for UK interest rates in what amounts to an highly manipulated artificial financial system where there is effectively NO MARKET, as the Bank of England operates under the remit of printing money to buy government bonds via the banks to force interest rates lower, whilst at the same time ignoring inflation of CPI 4% which demands an interest rate of at least 4.5%.

Basically in formulating an interest rate forecast I am having to evaluate NOT when will the Bank of England act to curb inflation but at what point will investors in government bonds react to dump gilts and put market pressure onto the Bank of England to raise interest rates, and then at what point will the Bank of England act to pre-empt this market pressure.

Therefore it is not a question of trend but what is the minimum level UK interest rates should be normalised. the clear answer to that is that UK interest rates at a minimum should be above the CPI inflation rate which currently stands at 4.%. However a more accurate indication for UK inflation is measured by the RPI rate which is currently at 5.1%. which implies that should the Bank of England be forced to act today by the bond markets, then interest rates could rise rapidly, perhaps in a matter of days to between 4% and 5.5%.

In this regard the new coalition government has given the economy some breathing space by making many noises of getting to grips with the budget deficit over the next 5 years. The big question mark is WILL the coalition be able to hold together as it TRIES TO IMPLEMENT austerity measures, as that WOULD be the trigger the market is waiting for to force the Bank of England to raise interest rates.

So to determine when UK interest rates could be forced higher, I am going to have to identify the key stress points and anticipate when could the coalition government experience maximum stress that would be associated with maximum market stress against artificially low interest rates, and thus the point most likely to result in interest rate normalisation.

The following matrix condenses down the disparate economic and market forces that are driving UK interest rates during 2011 and beyond.

**UK interest Rate Forecast 2011 Matrix** (5th March 2011)

MarketOracle.co.uk
Financial Markets Analysis & Forecasts
WALAYAT STREET .COM

**Key**
Red - Factors Favouring Interest Rate Hikes
Blue - Factors Favouring Interest Rates being kept on Hold

| Interest Rate Factor | Analysis / Rates implications |
|---|---|
| British Pound | Sterling is forecast to strengthen against the Dollar by mid year (£/$1.85) which will help reduce inflationary pressures, that will be taken by academic economists to signal low interest rates. However sterling LEADS base interest rates by upto 2 years, given the last lows of Jan 2009 and May 2010, this implies interest rate hikes are now more probable. |
| Crude Oil $110 | Crude oil is soaring. Brent Crude Oil of $115 equates to 5% CPI, $150 (2008 high) equates to CPI hitting 6%, $200 of CPI 7.5%.<br><br>Crude Oil of $110+ is sustained requires interest rate hikes to prevent wage price spiral risks and raise sterling to reduce imported inflation. |
| Crude Oil $150+ | Crude Oil of $150+ if sustained would trigger another global recession, interest rates would ne kept low as governments panic in the face of sharp economic downturns. |
| Civil Unrest | The working and middle class of Britain will be crushed during the next few years, and will increasingly become more militant, therefore low interest rates to reduce pressures of civil unrest |

| | |
|---|---|
| Financial Armageddon Fears | The BoE continues to fear financial armageddon which requires interest rates to be kept low and unlimited support for the still bankrupt banking sector. |
| Global Bond Bear Market | My Analysis of August 2010 correctly identified an imminent peak in US Treasury Bonds and to start a multi-year global bear market, that has subsequently come to pass over the past 9 months, UK 10 year gilt yields have already risen by 1%, that confirms the trend for rising interest rates, with official rates playing catch-up. The Bank will fight hard to prevent market interest rates from rising, so suggests a token rise from the BoE to alleviate market pressure. |
| Global Money Flows | Flood of central banks printed monies from the likes of the Fed add to BoE QE, implies rate hikes are more likely. |
| Global Interest Rates Rising | The developing world and the likes of Australia have already raised rates in response to inflation, who will next to start? USA, UK or Europe ? Odds favour the former Bundesbank Hawks at the ECB being first to raise rates this year, possibly as early as April 2011, the BoE will probable delay acting until June / July. |
| Government Growth Policies | In a nutshell, there aren't any, taxes are rising, and costs for education and innovation are rising. Therefore there is nothing from the government to spark growth other than printing money. |
| Government Spending Cuts | No real cuts in government spending, spending will continue to increase every year for the next 4 years, requires high inflation and low interest rates to real value of spending. |
| LIBOR | The mainstream press does not understand the LIBOR market by concluding a higher forward rate of 1.5% implies this is where Interest Rate will rise to, which is an incorrect assumption as 12 month LIBOR is normally nearly always 1% above base rate. |
| Money Supply | M4, and adjusted for the velocity of Money is turning lower again, this is suggestive of rates on hold |
| Sovereign Debt Crisis | The Eurozone PIIGS have gone quiet, but remain bankrupt and in economic depression as they cannot print money and devalue debt. Britain's response is to batten down the hatches for future debt crisis, which requires continuation of ultra low interest rates. |
| Tax Rises | Tax rises are inflationary as it puts pressure on prices and wage demands, which requires a rise in UK interest rates. |
| Trend Analysis | Suggests a series of rate rises by mid 2011 to target 2%, to be followed by several more years of rate hikes that targets a minimum rate of 4.5% by end 2014. |
| UK Debt | Public debt continues to grow, targets £1.2 trillion by 2015, requires high inflation and low interest rates to finance debt, this will continue for 2011, but beyond the market is not going to put up with it and demand far higher rates, especially as debt (PSND) passes 100% of GDP. |
| UK Economic Growth | Bank of England is targeting 2% GDP, Weak growth for the next 3 years requires continuing low interest rates else risks a double dip recession. However raising rates from 0.5% to 1% will make little difference to the economy especially given high inflation. |
| UK Housing Market Support | The Bank of England is forced to support the housing market with low UK interest rates as another house price crash would trigger another banking crisis. |
| UK Inflation | Soaring inflation demands a rise in interest rates to prevent the wage price spiral from igniting. |
| Wage Price Spiral Risk | Currently average earnings are running at just 1.1%, well below inflation so do not require interest rate hikes, especially as rate rises would put workers under greater pressure and thus be counter productive. |
| UK Unemployment | The Governments forecasts are wrong, UK unemployment targets a rise to 2.9 million which requires low interest rates. |
| UK Retail Sales | The distressed retail sector will increasingly pass on price rises to consumers hence higher inflation, suggestive of net pressure for an interest rate rises, however this is offset against retailers going bust putting pressure on the Banks, therefore points to reluctance to raise rates. |

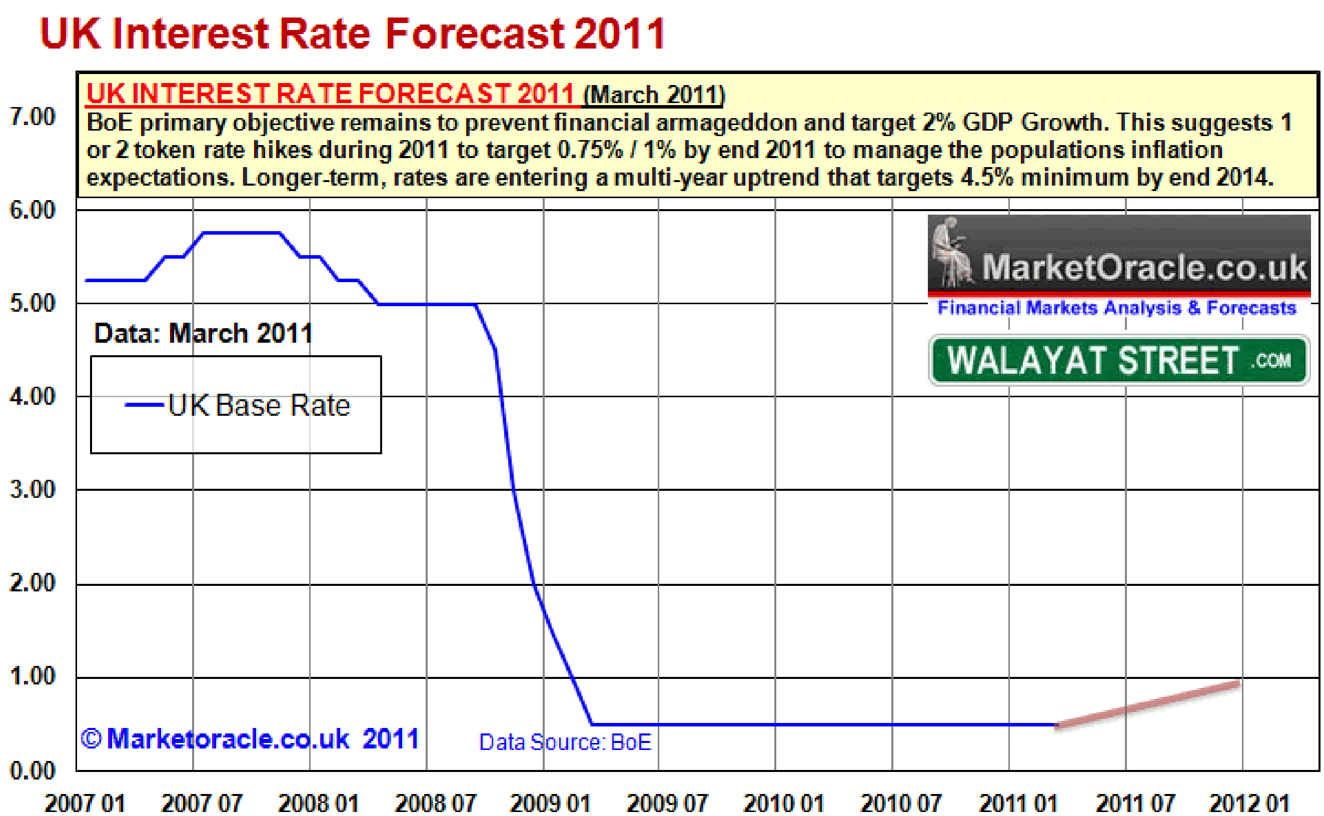


The matrix concludes in 13 factors in favour of interest rates remaining on hold against 9 factors in favour of rate hikes.

However, contrary to what many may observe as one walks the calm streets of Britain, our financial system remains on the brink of total collapse that could take place at any time as a consequence of huge loss making positions in the monster $1.5 quadrillion derivatives market. Therefore the Bank of England's primary objective remains for the prevention of financial armageddon by means of bolstering bank balance streets, which includes inflating asset prices and nominal GDP, after all everything else, including high inflation is nothing compared to the social consequences if ever bank ATM's stopped spitting out pound notes to account holders, as after a banking collapse, a collapse of civil society would fast follow. Therefore regardless of public statements, the Bank of England remains highly reluctant to raise UK Interest rates during not just 2011 but for several years more.

## UK Interest Rate Forecast Conclusion

For the Bank of England to achieve its twin primary objectives of preventing financial armageddon and generating economic growth, then it needs to both print money (QE) to monetize government debt and generate easy profits for the banks to rebuild balance sheets, which requires low interest rates whilst at the same time attempting to use smoke and mirrors economic propaganda to manage the populations inflation expectations to prevent the wage price spiral from taking hold, which is suggestive of only 1 or 2 token rate hikes during 2011 to thus target 0.75% or 1% by the end 2011. Therefore the mainstream press and academic economists are running way ahead of themselves by some even suggesting that UK interest rates could hit as high as 3% this year and many more suggesting 2%.




Therefore the Bank of England will both continue printing money AND raise interest rates, which confirms my conclusion of some 9 months ago that will still remain invisible to the mainstream press and academic economists right up until the point it actually happens when much rear view mirror looking commentary will flow in the press.

26 Aug 2010 - Deflation Delusion Continues as Economies Trend Towards High Inflation

***What to Expect in the Future***

***The Bank of England WILL RAISE INTEREST RATES AND PRINT MONEY*** *- This is contrary to anything you will hear anywhere else as the consensus view is that QE and Zero interest rates are complimentary, they will NOT be as we move forward! Because the* ***Bank of England Will have no choice but to attempt to DEFLATE PRICES whilst INFLATING the Economy*** *to achieve this it MUST RAISE Short-term Interest rates WHILST KEEPING LONG-TERM interest rates low. To achieve this the Bank of England needs to BUY Bonds and Stocks whilst forcing demand for consumption and wage increases lower. This WILL become the consensus view AFTER the FACT, perhaps in 6 months time ? Just as the mainstream press is ONLY NOW, 9 months on, starting to slowly wake up to the Inflation Mega-trend with the likes of the FT only coming to conclusions on the Bank of England Inflation targeting very recently, something that I came to several years ago!*

***FT - FT audit casts doubt on Bank's forecasts*** - ***9th August 2010***

*The forecasts used by the Bank of England to set interest rates are biased and contain little useful information, a Financial Times audit has demonstrated.*

## Rising Interest Rates Will be Good for the Economy

Contrary to what you may read in the mainstream press pumped out by academics and vested interests, a small rise in UK interest rates would be good for the economy because Britain's savers who for several years have had their interest funneled into the banks, will start to see this interest gradually made available to them for consumption.

Additionally increasing interest rates will prompt people to save and invest more and thus provide capital for economic activity as opposed to the current situation of where the government soaks up much of the savings to finance the annual budget deficit therefore depriving industry of capital.

## When will Interest Rates Rise?

According to the mainstream press rates could rise in May, but the mainstream press is wrong 90% of the time. Two scenario's exist, the former is for an earlier April rate hike to coincide with possible ECB action. The more probable is the first rate rise to occur later in June or July as that would better time with economic data. The second more speculative rate rise will probably coincide with a rate hike from the ECB well into the second half of 2011.

## Crude Oil Risks to the Forecast

As mentioned in the inflation forecast of mid January, that the key risks are that crude oil goes super nova ($150+) that sends inflation soaring to 6%, which would make Britians debt financing a problem and the market demand for higher interest rates in the order of 3%+. The subsequent freedom revolutions in the middle east have propelled crude oil (Brent) 20% higher to $110+, this if sustained will feed into higher inflation during 2011 that could see CPI above 5%, with the risks of even higher inflation later on should $150 be achieved and maintained. Whilst the consequences for crude $110 are higher interest rates, crude $150+ would be lower interest rates because it would trigger another global recession as cash is sucked out of oil consuming nations and deposited into the oil producing nations (those that have not collapsed into chaos), therefore government policy response would be to panic to generate economic activity much as occurred following the Lehman's bankruptcy.

## Risk that the Bond Market will Puke on UK Sovereign Debt

To see what will eventually happen to market interest rates for British sovereign debt we need only look at the Euro-zone PIIGS, that is where Britain's future likes i.e. a doubling, then tripling of market interest rates because the Coalition Government has FAILED to HALT the accumulation of new debt (PSND), we are fast heading for public debt at 100% of GDP and beyond, and the higher the debt to GDP goes the higher will be the interest rate demanded to buy effectively British junk paper. Yes, the bond markets could puke on the relentless supply of UK debt in which case all bets are off and its off to the interest rate spike races as the only answer the Bank of England will have is to print money and buy government bonds from the puking banks.

This failure to get a grip on debt and deficits illustrates the failure of the academic economists that populate the Bank of England and offer advice to the Government to understand economics. In that as debt to GDP grows, it gradually swallows up all available financing for the corporate and business sector which contracts instead of growing. This is a recipe for economic disaster! This debt crisis is not just limited to Britain but the big monster economy across the atlantic is one step ahead of Britain on the path towards where the likes of Greece and Ireland are today and then there is Japan which is in permanent depression with debt at over 200% of GDP like a noose around it's economies neck.

## The UK Interest rate Mega-trend

UK interest rate rises during 2011 will mark just the start of a multi-year mega-trend as the Bank of England always remains one step behind the economy, where indecision and failure to act will magnify the need for future rate hikes to far beyond anything one can imagine today, therefore whilst the conclusion is for 1% by end of 2011, expect rates to continue being ratcheted higher for the next 3 years at least (remember the neutral rate should be ABOVE RPI), and I would not be surprised by UK interest rates hitting 10% during the decade, in fact, given the UK's debt trajectory, I would not be surprised if interest rates hit 15%, especially in the wake of a PIIGS style buyers strike.

All central banks are similarly act behind the curve with rates being dragged higher behind rising inflation. Therefore the people of Britain (and rest of the West) should gear themselves up for the dawn of a new era of HIGH interest rates AND HIGH inflation, where the start of the Inflation mega-trend was correctly identified in-depth over a year ago.

Your wealth is being systematically stolen by high real Inflation and dumped onto the balance sheet of the over leveraged banks, protect your wealth now from the inflation mega-trend whilst you can because you may not get much of a chance to act amidst an inflationary panic as people dump fiat currency for anything that will preserve its value (Inflation Mega-Trend Ebook FREE DOWNLOAD).

In closing, 2011 interest rate rises will just be the beginning of a mega-trend, Britain and much of the west is bankrupt, they will default on debt by means of high real inflation as a consequences of printing money and monetizing debt which points to a decade of stagflation, this conclusion remains unchanged as of the January 2010 Inflation Mega-Trend Ebook.

# CHAPTER 4

# Implications of Interest Rate Rises

## The Crushing of Britain's Middle Class

As mentioned earlier in this analysis, Britain's middle class is about to be crushed by inflation and tax rises, benefit cuts to an extent that they have not experienced during at least the past 30 years. This will undoubtedly hit those sectors hard that rely on the middle classes for commercial activity, such as the retail sector, tourism. Assets such as housing can also be expected to be hit hard, which will be covered in my next series of analysis (ensure you are subscribed to my always free newsletter to get this in your email in box). The only pause in the nightmare that the middle class face will be for 18 months or so in the run up to the May 2015 General Election, afterwards it will be more of the same pressure on real earnings, with even greater uncertainty as a consequence of the wage price spiral igniting which will act to accelerate the loss of earnings purchasing power and life time accumulated savings.

Pensions - Today there is talk about raising the retirement age to 66, in 10 years time the talk will be on raising it to 86!

## Implication for Savers - Negative Real Interest Rates Continue

Firstly, continue to protect your savings from the risk of financial armageddon, which I last updated in November 2010 (Protect Savings & Deposits From Banks Going Bankrupt! ).

Secondly, realise that the stealth tax of real inflation (currently 6.6%) ensures that the value of money / cash is continuously being eroded away towards nothing in the long-run, so holding cash should be seen as temporary as one cycles between more inflation proof assets, which is especially true under the current high debt and deficit market conditions when debasement of the currency is accelerating, though masked by the fact that all currencies are in free fall against one another.

As market interest rates will lead the artificially low UK base interest rates higher, therefore the most valid response from savers is to avoid fixing rates, especially at the short end where 1 year fixed rate bonds barely beat instant access savings account rates and are well below even the official inflation rate.

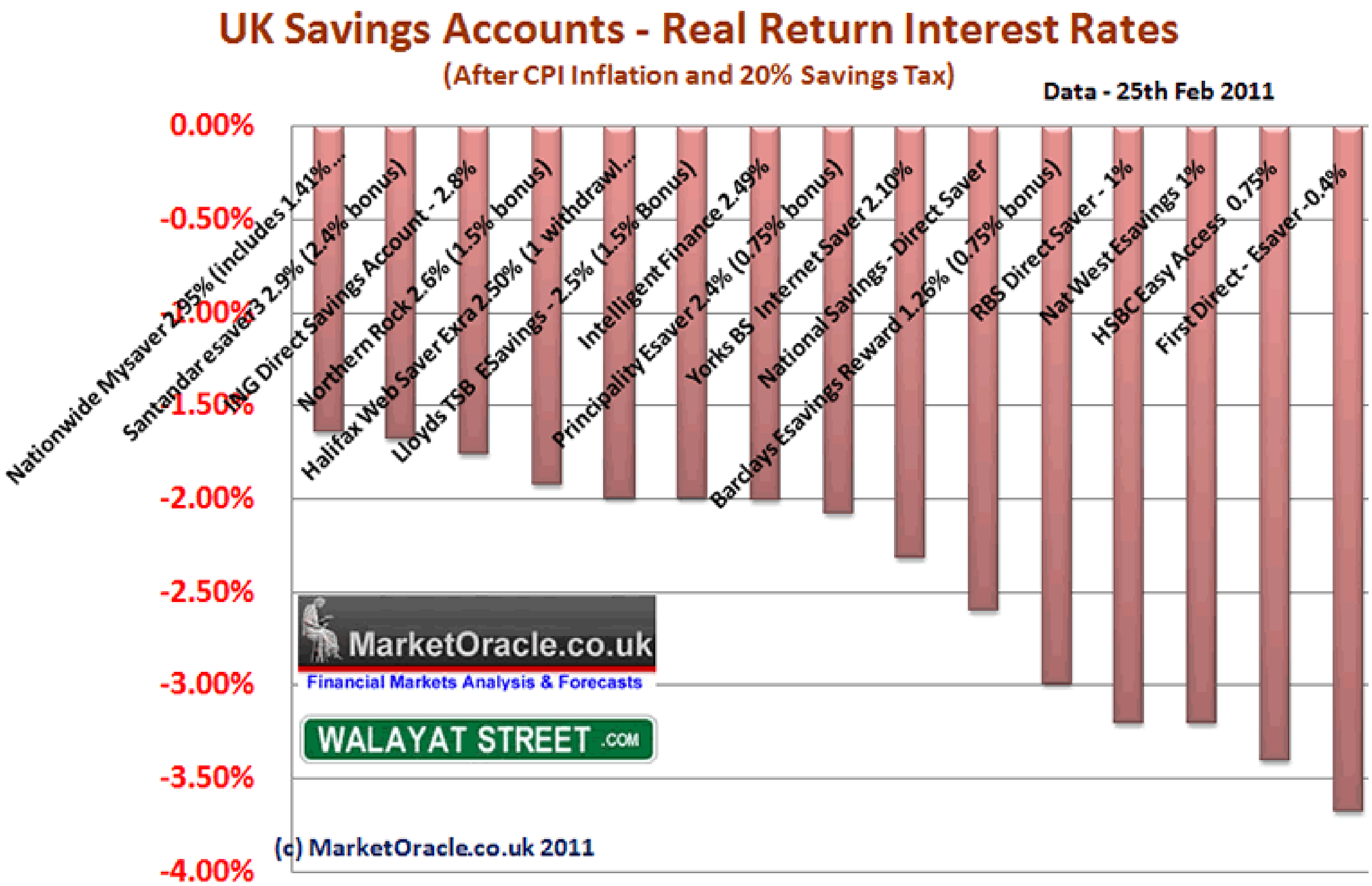
As with late 2008, savers will again at some point have the upper hand to enter into multi-year fixes at rates far higher than the rate of inflation - (08 Oct 2008 - UK Interest Rate Forecast 2009 ):

***Savers** - To reiterate what I have been saying over the last 6 months, savers still have a a golden opportunity to lock in high fixed savings rates which in the UK are above 7% . These rates won't stay around for much longer, were talking perhaps in the days rather than weeks or months. So the time for action is now ! - Yes, banks can go bankrupt but savings are protected which includes accumulated interest. **In the UK the protection is for the first £50k per banking group**.*

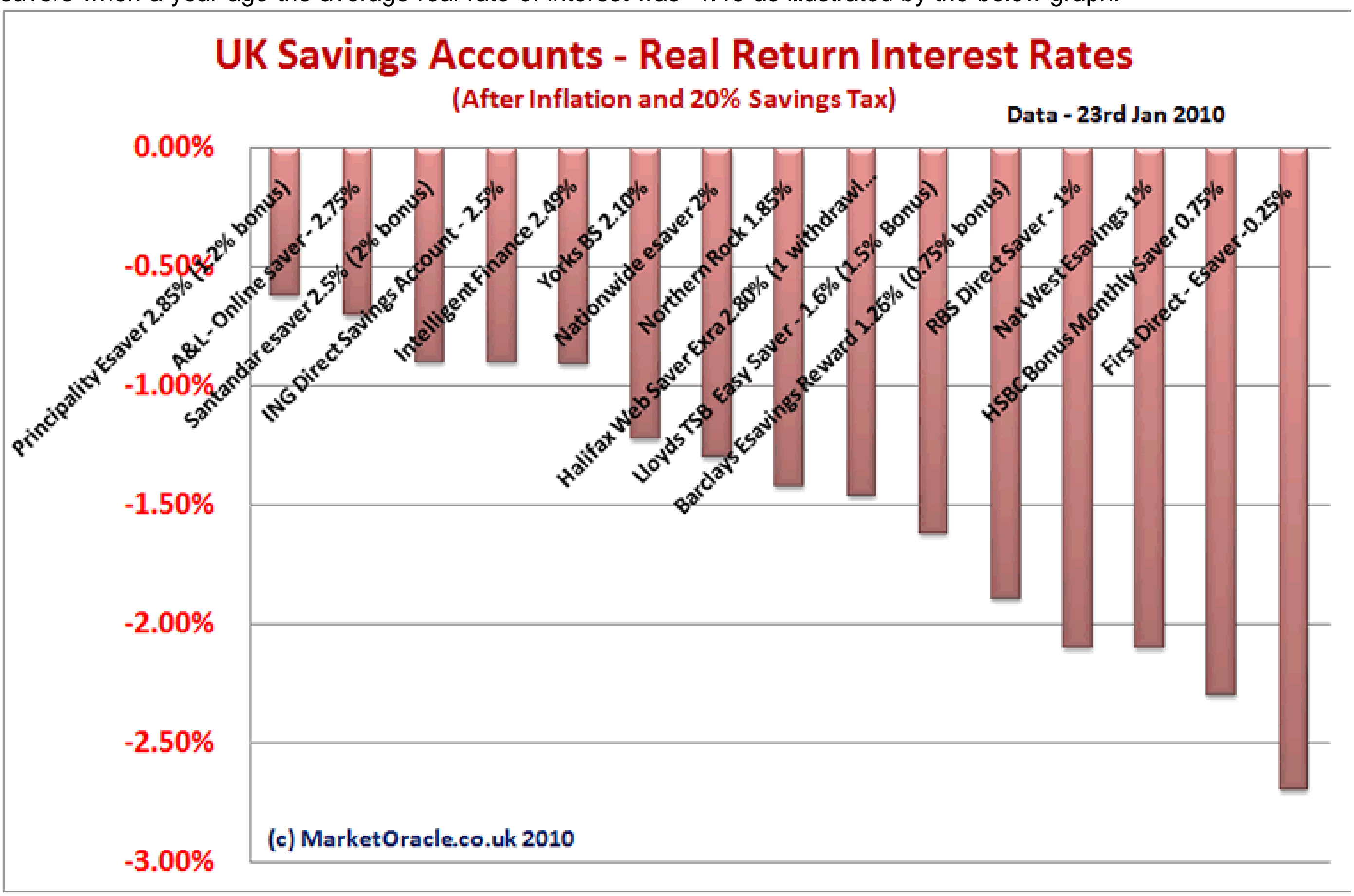
I will endeavour to again prompt savers of such opportunities once more, but unfortunately that opportunity does not appear to be visible for at least the rest of 2011. So the focus for savers must continue be to limit loss of wealth whilst maintaining risk free exposure in terms of capital.

The following analysis is of instant access savings accounts after allowing for the fact that most savers in Britain pay 20% tax on all savings interest. The table below illustrates that not one single bank or building society is paying savers a real return on the funds they have deposited in the banks instant access accounts. The real loss of value on savings is anywhere from -1.6% at the Nationwide to -3.68% with First Direct. Also many of these accounts are subject to the banking sector trick of including a bonus component that is usually limited to no more than 12 months before rates are dropped to a mere pittance of as low as 0.1%.




The average of market savings interest rates stands at minus -2.43%, and illustrates a continuing deterioration of the position of savers when a year ago the average real rate of interest was -1.48 as illustrated by the below graph.



UK Savers continue to subsidise the bonus paying banks as there is NO REAL RETURN on savings. Savers require a return of 4.8% to just break even after inflation and the 20% savings tax. Therefore there is no real good news for UK savers for at least another year as the Government and Bank of England continue to force savers to subsidise the banking sector, spend their savings so as to generate economic activity, and take greater risks with their capital in the stock, bond and other higher risk asset markets.

## Cash ISA's Alternative Option for Small Savers

Cash ISA's being tax free favour tax payers and are especially beneficial to higher rate tax payers. If you have already utilised this years ISA allowance of £5,100, savers should still ensure that they check the interest rates being paid on ALL of their cash ISA accounts on a regular basis, especially for those accounts that have matured as the banks and building societies are notorious for including 1 year bonuses that disappear on anniversary or dumping matured fixed rate accounts into pittance paying cash ISA accounts paying as little as 0.1%. i.e. 1/30th the rate of a typical top paying instant access account, which on an ISA account balance of £5,100 means the difference between receiving £5.10 or £153 in interest per annum.

### Tricks Banks and Building Societies Play on ISA Savers

One of the biggest tricks that the banks and building societies tend to play on ISA savers is to offer a lower interest rate on ISA's than similar non ISA saving accounts, which in some cases means wiping out all of the tax free benefits of a Cash ISA account for basic rate tax payers. Yes it is highly unethical behaviour by a banking sector that tax payers are still being forced to pay for, whilst the bankster's pay themselves billions in bonuses on the basis of fictitious tax payer funded profits. However there are other benefits to ISA's in terms of tax credits and self assessment tax returns, where the interest earned is not counted.

## RPI Inflation Index Linked Bonds

One of my favourite low risk inflation wealth protectors, the National Savings Index Linked Certificates that gave RPI+1% TAX and RISK FREE were withdrawn from the market in July 2010. That leaves the Government Index Linked Bonds (Gilts) where the capital and interest are linked to the RPI inflation index (5%), therefore offer investors who are prepared to take on some capital value volatility, an inflation proofing yield that beats any other savings product currently on the market.

There are a number of new inflation proofing products on the market such as Bonds from Yorkshire Building Society and the Post Office (Backed by the Bank of Ireland UK). That pay RPI + 1.5% per year over a long 5 year term but there is no annual compounding of inflation or interest so it will not perform as the current rate of 5% (RPI+1.5%) implies, the actual return would be more equivalent to 5.7% Fixed Rate 5 Year Bond with annual interest compounding. Still it could be a good option for desperate savers seeking yield at a little higher risk than fixed rate bonds, as 5% RPI per year would convert into gross 32.5%.

The Post Office bond compares against the current market for a 5 year fixed rate bond at 4.5% which would gross to 24.5% after 5 years, the risk is that if inflation is lower than so will be the return be lower (deflation would be +1.5% minimum per year).

The big negative is that the interest is taxable, unlike the NS&I certificate which was tax free. There is a tax free version from the Yorkshire Building Society that utilises the cash ISA wrapper, however this version is NOT the same as that offered by the Post Office. There is NO annual 1.5% added to the bond, nor are the annual RPI rates locked in which means the product carries higher risk if deflation ever bites as in a worse case scenario you could just get a return of 1.5% after 5 years!

### How does it compare to the Post Office bond ?

Utilising the same example of RPI of 5% as used for the Post Office bond, the York's ISA bond would gross 29.1% (yield 5.25%) as opposed to 32.5% (yield 5.7%), and market fixed rate bonds of 4.5% grossing to 24.5%. Clearly the Yorkshire Building Society Bond illustrates the trick of giving cash ISA savers a lower return, for basic rate tax payers the net return on the PO bond is 26% (19.5% higher rate tax payers), but the Yorkshire Bond is higher risk.

The Post Office bond is therefore the better option for non and basic rate tax payers. The York's Cash ISA Bond is better for higher rate tax payers but limited to £5,100 per tax year. As mentioned earlier the Index Linked Government stock may offer a better alternative for experienced investors (capital volatility) as you are NOT locked in for 5 years, therefore can time exits.

Also, always keep in mind the FSCS compensation limit of £85k (Euro 100,000) per banking group.

## Implications for Borrowers - Mortgages

Whilst retail market interest rates will rise, unfortunately for borrowers the bankrupt bailed out banks never significantly CUT lending rates as they concentrated on expanding their profit margins to unprecedented levels. Therefore mortgage SVR's have already already been raised to 4%, this then perhaps suggests SVR rates of between 4.5% 4.75% by year end. Those seeking to fix mortgages ahead of base interest rate hikes may be shocked to discover the greedy bankster's have already put up fixed rate mortgages by 0.5% so far this year to average around 4.5% for 2 year fixes (plus fees) with more to come following actual rate hikes.

If you are considering fixing your mortgage then the time to act is NOW! Especially as the very best fixes are fast disappearing from the market place.

### Tracker Mortgages

As the interest rates on fixed rate mortgages have risen, tracker mortgages have seen interest rates fall to new lows, where typically trackers for LTV 75% or less range between 2.9% to 3.5%. Mortgage providers are clearly trying to entice borrowers into products that will track interest rates higher and thus ensure profit margins on mortgages of as much as 3% are maintained no matter how high rates go.

So mortgage borrowers tempted by a current low 3% trackers need to factor in that interest rates rising to 4.5% by the end of 2014 (less than 4 years) would yield an tracker interest rate of 7.5%.

## Bond Market Investors You Have Been Warned!

If you have not already acted on my unequivocal conclusions of the past 9 months to dump long dated bonds (government and corporate) then you need to urgently revaluate your bond portfolio, as significant interest rate rises disproportionately hit longer dated bonds as the markets adjust to the stagflationary environment of a steep yield curve (initial rate rises may result in longer yields falling due to a temporary flattening of the yield curve). The best strategy for bond market investors is to move towards the shorter end of the yield curve (to protect against capital volatility) and as always steer clear of all bond funds such as the ETF's! Remember We are Now in a BOND BEAR MARKET, that will not just last a few years, but decades! So don't be seduced by any corrections in yields on panics and safe haven buying, as volatility will be high and real returns will increasingly turn negative as the markets realise that stagflation is the most probable outcome, and there is also increasing risks of outright default on corporate's with much speculation in the mainstream press of US municipal bonds heading for default (though I don't understand why as the central bank can just monetize the debt ).

The prospects for US government bonds appears even worse than that of the UK, because the U.S. Government / Fed appears far more eager to print money without end as a consequence of a series of never ending Quantitative Easing programs. As ever, QE is infectious and as one central bank prints money to buy its government's bonds so do they all follow suit, therefore the bond bear market will definitely be global, the manifestation of this money printing madness will be in mutually destructing currencies as they all continue free falling together resulting in HIGH inflation which feeds back to reluctance of the market to buy government bonds and hence triggers more QE money printing by central banks and so the trend accelerates towards an hyperinflation crash event, whilst the vested interests continue to pump out non existant deflation propaganda in the mainstream press.

Apart form avoiding government bonds, more experienced investors / speculators can entertain shorting bonds for which exist a multitude of trading vehicles from short ETF's to short futures positions.

### Are All Bonds Bad ?

Well, not the ones that pay a real return! I.e. beat the real rate of inflation. The reason I write this is because during the financial crisis of 2008 and into 2009 there were several bond market panic events that generated huge profit opportunities in especially the corporate bonds sector.

Today we continue to witness such events with sovereign PIIGS debt and as mentioned earlier in US municipal bond market, where the actual risk of default as opposed to mainstream press generated copy is low, i.e. would the US central bank allow states to default on their debts ?

Therefore investors should always be prepared to seek opportunities in market panic events or crisis of confidence, which U.S. Municipal bonds appear to be at this point in time as they generate tax free income for US tax payers so in theory should be yielding less than Treasuries but instead are yielding significantly more and it is in markets such as this that are less manipulated by the central banks where the interest rate rises are manifesting themselves first and therefore presenting opportunities for income starved savers.

## UK Housing Market Crash Phase 2?

After 2 years of 0.5% base interest rates home owners have become conditioned to low interest rates as being the norm and are not prepared for the consequences of rising interest rates that will squeeze home owners hard, especially as 90% of customers are on SVR mortgages that rise in step with interest rates, typically a base rate rise of 0.5% would translate into a £62 monthly increase on a £150k mortgage and 1% rise would translate into a £132 monthly increase which would be on top of the governments scheduled tax rises and benefit cuts thus pushing many households over the edge into forced sales to downsize properties and pay down mortgage debt or risk repossession.

### House Price Falls Ahead Look Certain

The fact is that all record low interest rates have done is to push the pause button the house price crash that began in late 2007. Therefore rising interest rates implies that the crash will resume as the twin forces of fewer buyers coupled by a surge in supply put increasing downward pressure on house prices, especially as panicky many home owners who have waited for the last 2 years to sell set to rush over the coming months.

As house prices fall so will the number of home owners being pushed into negative equity increase, thus perpetuating a vicious cycle for further falling house prices as negative equity prompts a surge in repossessions as there is no general election on the horizon to tempt the government into buying home owner votes as the last Labour government had done during its support for the housing market during 2009 and 2010.

To complicate the trend expectations there is the factor of high inflation which is supportive of nominal house prices, which many market commentators fail to appreciate the year on year consequences of and thus delude themselves of apparent housing market stability when the reality is that home owners feel the pain in terms of loss of real terms value. Therefore as interest rates rise, high inflation can be expected to cushion nominal house prices but it will not be reflective an particular healthy housing market.

My next series of in-depth analysis will conclude in a trend forecast for the UK house prices for several years, aiming to replicate the accuracy of housing market analysis and forecasts of the past 4 years such as as - 22 Aug 2007 - UK Housing Market Crash of 2007 - 2008 and Steps to Protect Your Wealth

***The UK Housing market is expected to decline by at least 15% during the next 2 years. Despite the 2012 Olympics, London is expected to fall as much as 25%. UK Interest rates are either at or very near a peak, as there is an increasingly diminishing chance of a further rise in October 2007. After which UK interest rates should be cut as the UK housing market declines targeting a rate of 5% during the second half of 2008. The implications for this are that the UK economy is heading for sharply lower growth for 2008.***

Ensure you are subscribed to my always free newsletter to receive this in your email in-box.

## Interest Rate Trends Impact on the Stock Market

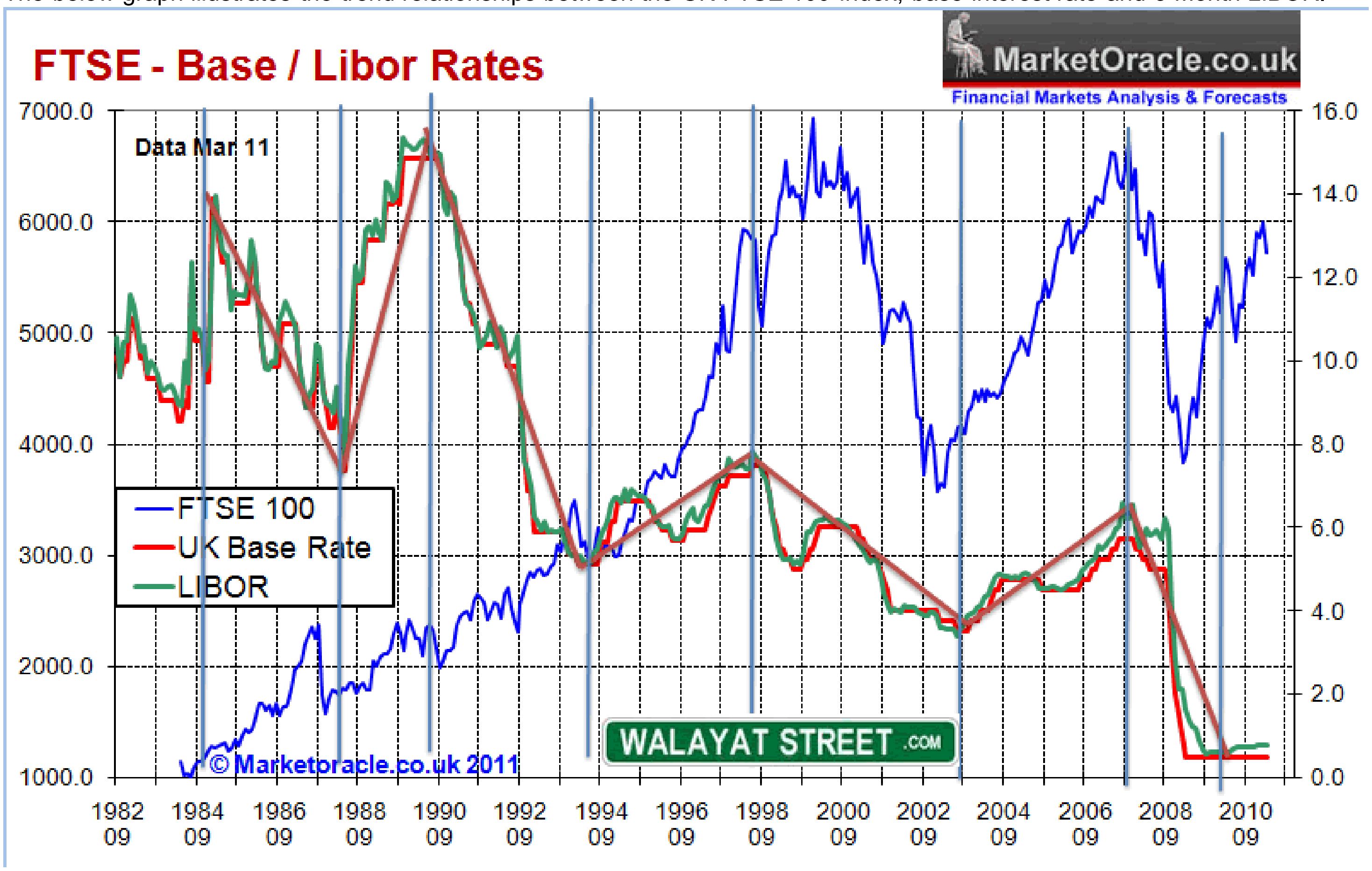
The consensus view as continuously pumped out in the mainstream financial press and further regurgitated at length in the blogosfear is that rising interest rates will negatively impact upon stock price trends due to higher yielding bonds competing against stock dividend yields as well as acting to suppress economic activity and therefore corporate earnings growth.

However much of this consensus view is perpetuated by highly public perma-bears who have consistently wrongly called for the demise of the stocks bull market of the past 2 years, as they continue to call for an always imminent end of the so called 'bear market rally' despite the fact that the past 2 years has witnessed one of the greatest bull runs in history.

Therefore increasing prospects for a rise in interest rates from record lows as a consequence of bailing out the bankrupt banking sector has prompted the perma-bears to perpetuate the consensus view that rising interest rates will be bad for the stock market which this analysis seeks address.

## UK Base Interest Rates and the FTSE 100 Index

The below graph illustrates the trend relationships between the UK FTSE 100 Index, base interest rate and 3 Month LIBOR.




The key point is that there is a greater probability for rising stock prices when interest rates are rising then when interest rates are falling (the exact opposite of the consensus view).

Stock markets tend to bottom and enter into a bull market long before interest rates start to rise, which makes sense in that stock markets are a risk based leading indicator of economic activity whereas central banks are nearly always acting behind the curve to curb the consequences of having kept interest rates too low for far too long and thus have over stimulated the economy as we have witnessed with the Bank of England paralysis on UK interest rates for the past 2 years.

Therefore on its own, the UK base interest rate rising will have no effect on the current stocks bull market. Instead the key danger for the stock market will be when market commentators start to contemplate when interest rates should be cut, the good news is that we are many years away from such a situation which will follow a trend of rising interest rates, followed by an interest rate plateau before rates are again cut, which the mainstream press will at that time wrongly conclude as positive for the stock market.

## The Dow and U.S. Interest Rates

My in-depth analysis of near 9 months ago during August warned of the U.S. Treasury bond bubble that was primed to burst and enter into a multi-year bear market (26 Aug 2010 - Deflation Delusion Continues as Economies Trend Towards High Inflation ) since which time US bonds have fulfilled the initial bear market trend as illustrated by the below forecast graph that has quite closely matches the actual outcome that also implied technical bounce would take place from the support area of 115-118 (currently underway).

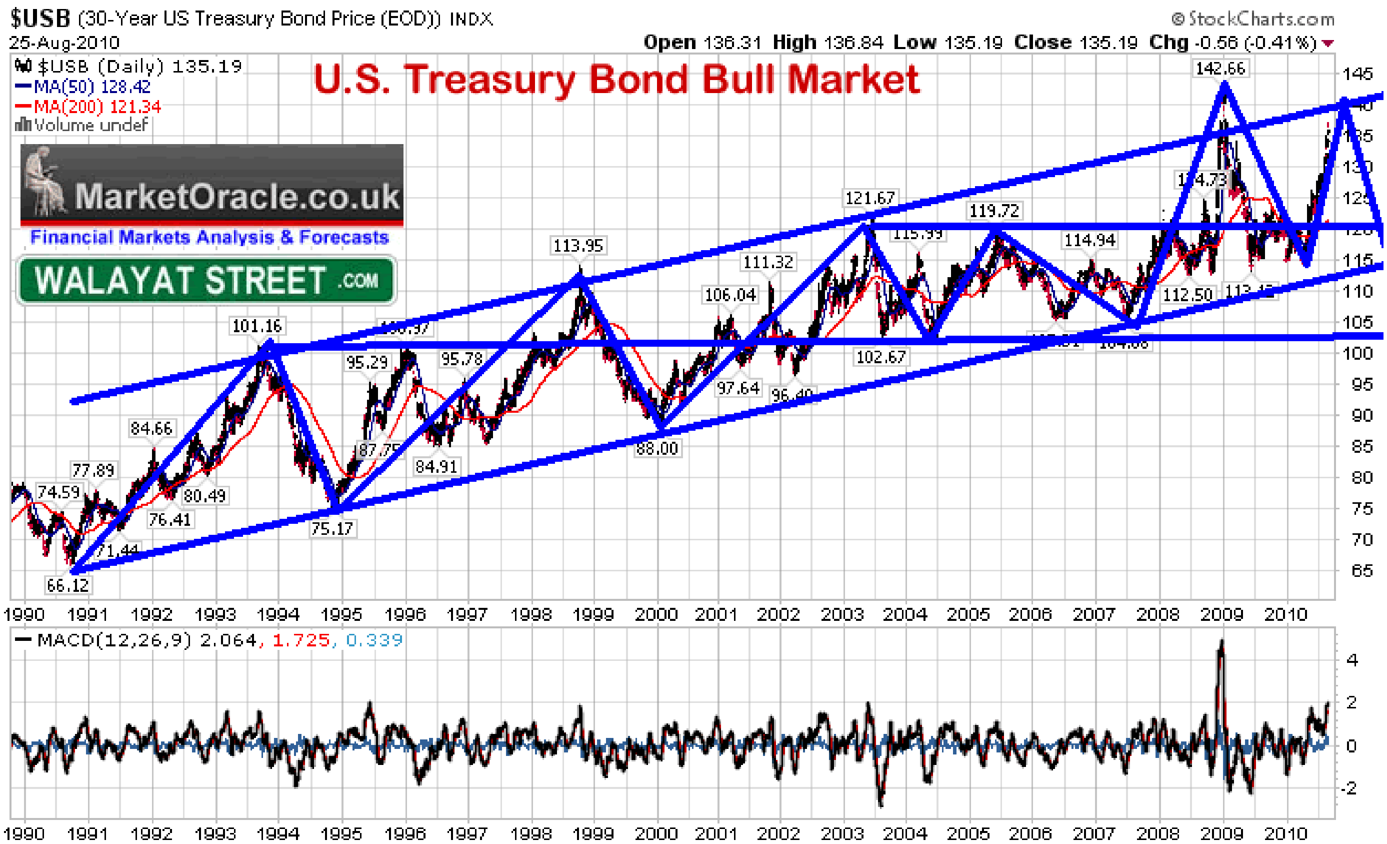
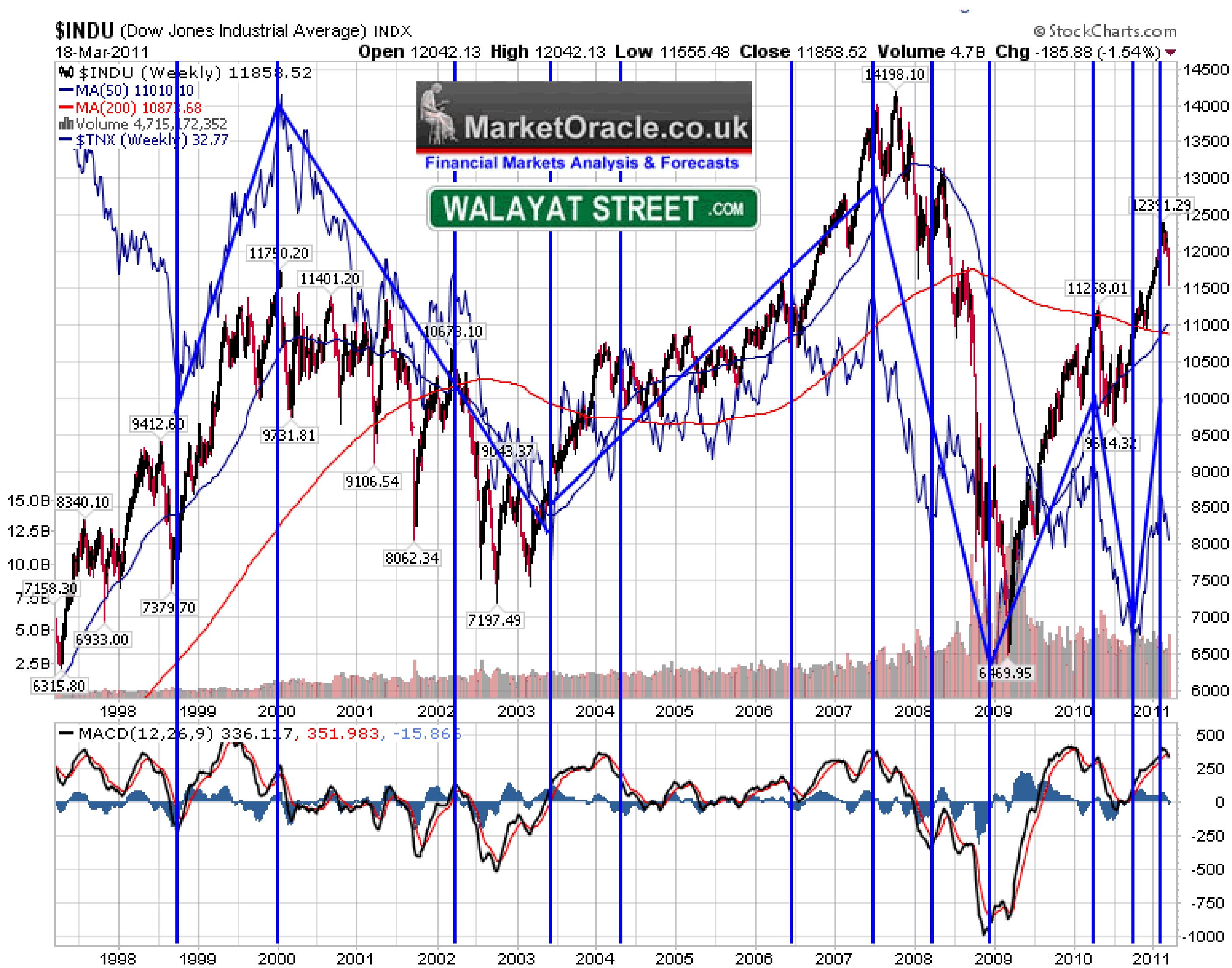



Chart courtesy of StockCharts.com

## Dow Consensus Interest Rates Myth Busted

The long-standing widely held consensus view that rising interest rates are bearish for stocks and falling interest rates are bullish, has many concluding that rising U.S. interest rates will be bearish and thus act as another in a series of busted triggers for the long called for bear market to resume.

## U.S. 10 Year Rates




The above graph illustrates that rising long yields are accompanied by rising stock prices and falling long yields are accompanied by falling, stock prices after a lag of upto 6 months.

## U.S. Short Rates


The above graph illustrates that rising short yields are accompanied by rising stock prices and falling yields are accompanied with falling, stock price trends (after a lag).

The U.S. Interest rate and Dow analysis confirms the earlier FTSE analysis that stock market rallies LEAD interest rates higher rather than interest rates leading stocks which is again another consensus myth that does not match reality. The reason for this is because generally rising interest rates are a sign of a strengthening economy, and falling interest rates are a sign of a weakening economy and thus stocks react BEFORE evidence of economic strength or weakness materialises which is when interest rate decisions are taken as a lagging action. This implies that RISING interest rates WILL NOT HAVE A NEGATIVE IMPACT on the stock market as the STOCK MARKET LEADS INTEREST RATES HIGHER.

- When interest rates are high - Stocks are in a bubble and Bonds are cheap.
- When Interest rates are low (like now) Bonds are in a bubble and stocks are cheap (no matter what the P/E ratio's imply or where the index is trading at)

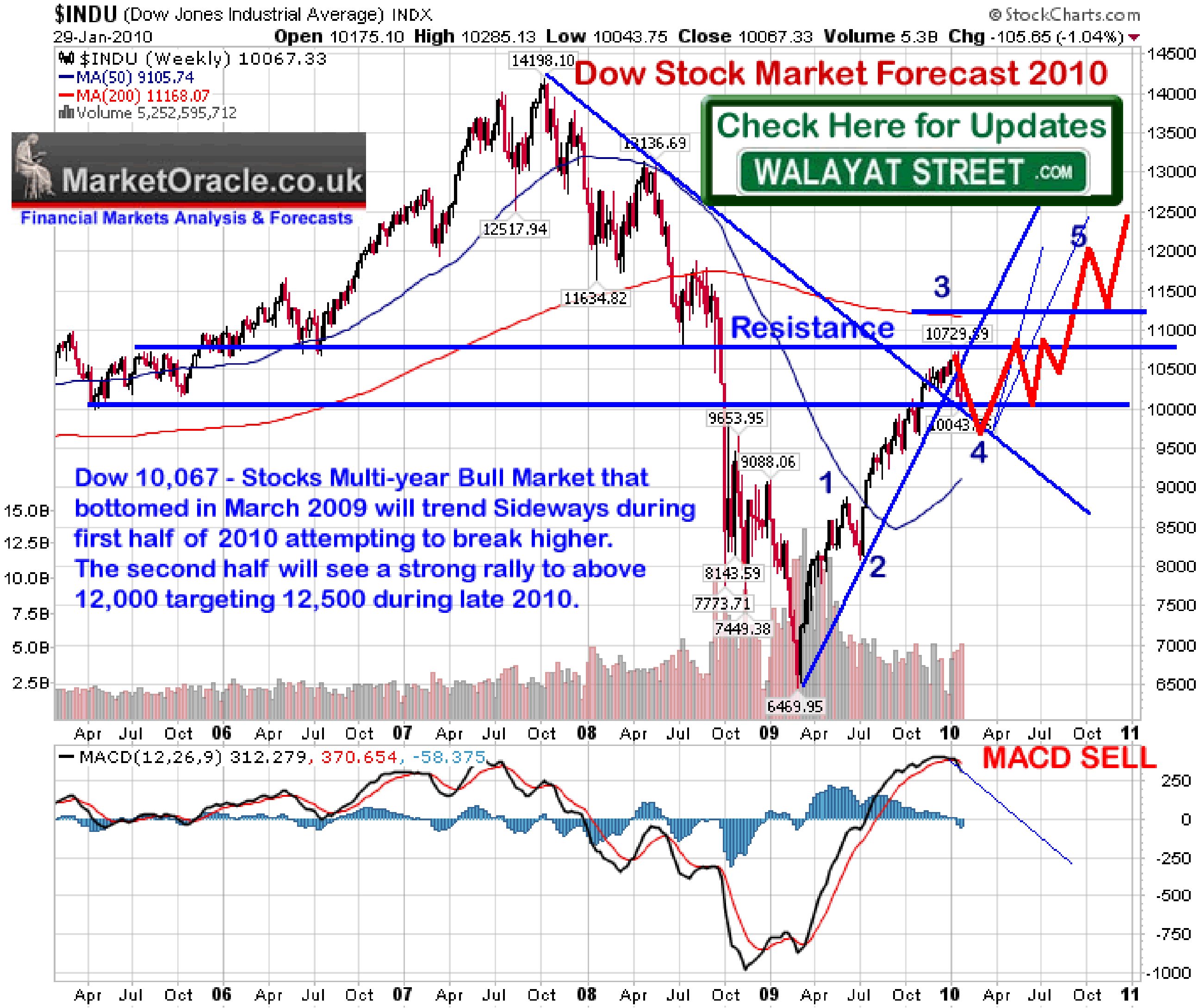
Bottom Line - Rising interest rates are generally bullish for the stock market and given the fact that official interest rates have yet to rise is suggestive of a continuation of the stocks bull market for some time (on the interest rate measure).

My next immediate in-depth analysis and ebook to be completed before the end of March 2011 will be for a stock market trend forecast conclusion for the remainder of 2011. Ensure you are subscribed to my always free newsletter to get this analysis and concluding forecast in your email in box that aims to replicate the highly accurate analysis for 2010.

Stock Market Trend Forecast for 2010 - 02 Feb 2010 - Stocks Stealth Bull Market Trend Forecast For 2010

***Dow 10,067 - Stocks Multi-year Bull Market that bottomed in March 2009 will trend Sideways during first half of 2010 attempting to break higher. The second half will see a strong rally to above 12,000 targeting 12,500 during late 2010.***



Last In-depth Analysis - 18 Oct 2010 - [Stocks Stealth Bull Market Dow Trend Forecast into Jan 2011]


Last Interim Analysis - 24 Jan 2011 - [Dow Stock Market Index Interim Trend Analysis and Forecast Update]

*The above analysis is concluding towards **probability favouring continuation of the trend higher to the Dow 12k target by early Feb**, when the market can be expected to consolidate the advance of the past 6 months and **enter into a significant correction that at this point suggests a 10% decline**, so tighten the stops and take the ongoing rally to bank profits which is the number one AIM of trading / investing!*

## Implications for Gold and Silver

Gold and Silver investors (who have managed to hang onto their positions) have enjoyed another bumper run as Gold has put in a series of new record highs whilst Silver has rocketed ahead to double in less than 12 months. Whilst Gold investors may be fixated on the weak dollar, in reality the dollar (and all other currency) gains are more as a consequence of central banks printing money to monetize government debt and driving down interest rates to below the official rates of inflation.

Therefore negative real interest rates are one of the primary driving forces for the commodities bull markets as savers fight to maintain purchasing power of their life time accumulated wealth as they gradually seek out protection in more inflation proof assets as cash and bonds have failed to provide a positive return for several years.

As mentioned earlier whilst official inflation is at CPI 4%, real UK inflation is at about 6.6%, whilst according to shadowstats it is 8% in the US against CPI 2.1% . Therefore theoretically interest rates on long dated government bonds could typically near double for real interest rates to turn positive and turn gold and silver into bad investments. However it is not as simple as that because gold and silver prices are leveraged to real interest rate trends, for instance a 100% rise in the silver price is in no way shape or form related to an 8% real inflation rate and approx -4% real yield on US 10 year bonds. What this implies is that the gold and silver bull market will be pricked long before real interest rates actually turn positive as it will be a case of the prospects for the future trend in interest rates.

So whilst the world looks set to experience a decade of high real inflation that will provide upward pressure for gold, silver and most commodities even if rates rise towards historic norms over the next few years, investors need to guard against being swept away by bullish sentiment, especially as gains of as much as 100% per annum (Silver) can easily be followed by price crashes wiping out much of the gains regardless of what fundamentals would suggest.

The fundamentals remain for an overall positive outlook for gold and silver whilst real interest rates from the short-end outwards remain negative, i.e. Negative U.S. 1year T Bills minus official CPI constantly entices cash savers to seek out riskier assets such as gold and silver.

### The Dangers of ETF and Futures Positions

The vast majority of gold bullion investments are not leveraged and therefore not particularly sensitive to interest rate changes. However the past decade has seen a flood of paper gold and silver as evidenced by expanding open positions on the commodities exchanges and advent of hugely popular ETF's such as GLD and SLV, where many positions held are highly leveraged and thus sensitive to interest rate changes. The big question mark is what would happen if during a loss of confidence in paper that is associated with interest rate spikes. It is not inconceivable able to imagine that there will be a great deal of divergence between bullion prices and futures / ETF prices as occurs for example with the Natural Gas ETF's.

Therefore those that seek precious metals as a form of insurance may be best advice to stick to actual un-leveraged bullion investments rather than funds or futures positions.

### Gold and Silver Insurance

Beyond the fundamentals of real interest rates, there is also the factor of insurance against loss of confidence in fiat paper, be it currency or bonds as both are effectively the same that can be printed to infinite extent, unlike gold and silver which cannot be printed. Therefore in a crisis of confidence in fiat paper, then despite soaring interest rates to above the rate of official inflation, gold and silver can still be seen to outperform paper which is therefore dependant upon the money printing policies of each individual government.

In fact in a crisis of confidence all assets would fall in real terms as demand is destroyed by soaring interest rates, but in relative terms gold should still result in greater purchasing power than the nominal value may suggest i.e. if the gold price falls by 30%, but house prices fall by 50%, then you can still buy 20% more property with your gold, same goes for Gold against other assets.

As mentioned several times already, the central banks are hell bent on destroying all currencies therefore something that both cannot be printed and is a concentrated store value which regardless of price volatility will remain one of the best insurance policies against wealth destruction that the central banks are engaged upon.

Bottom Line - Gold Investors should keep real interest rate trends in mind for entry / exit timing purposes. Silver investors can expect far more price volatility. Investors should expect serious divergence in the pricing of paper gold and silver (futures and funds) and bullion as interest rates spike higher. However perpetual currency debasement and central bank money printing ensures that gold is one of the few asset classes that should continue to retain purchasing power especially if real interest rates remain negative.

## About the Author

Born in 1968 in the city of Rotherham, UK. Nadeem Walayat became one of the original computer geek's of the late 1970's before the term was applied to computer enthusiasts, owning his first computer a ZX80 in 1980 and soon thereafter set up his first software company in 1983 at the age of 15, writing machine code utilities for the Dragon 32 computer under the company name of Pegasus Software Services, which he later changed to Walayat Software and Network Systems (Walsoft).

Nadeem went on to discover the financial markets during 1985 and began trading the stock market in 1986, having discovered the means to trade commodity futures and more importantly stock indices such as the Dow Jones via spread bet trading in late 1986 thus triggering a 25 year trading career which has seen many highs and lows including having beaten the 1987 Stock Market Crash.

Apart from being an active trader, Nadeem continued his professional development and worked as a corporate accountant for 15 years until 2008, as well as remaining an active programmer for more than 30 years, hopping from programming language to programming language as information technologies have evolved.

By 2005, Nadeem's 20 year trading experience and 30 year programming experience afforded him the opportunity to develop the Market Oracle website with the primary objective of freely sharing his analysis, trading ideas and methodologies, which has gone on to become one Britain's most popular totally Free quality resource for economic & financial markets analysis and debate on the internet that continues to constantly evolve towards becoming one of the worlds key quality free financial market analysis hubs.

He currently resides in Sheffield, England with his wife, three children and father, and remains fully focused on trading and sharing of his analysis as a firmly private person who shuns the media spot light. His most recent analysis can be viewed at walayatstreet.com

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