



Holland Views

UK Policy plate spinners

A local friend of ours is a great woman, huge fun to be around and always one who wants to get the party started early. However, I always think there is one thing about her that helps her outlook on life...annoyingly she never gets hangovers.

The seat is hardly warm under Mark Carney's bum yet he is determined it seems to immediately show that his style of bank governance is a little different to his predecessor (so much for a considered committee view!). As he rushes to make his mark on monetary policy and likely broaden its definition, I think we should maybe look at him in a similar light to our local friend i.e. as one who is keen to get the party started early but who worries little about hangovers.

When Mark Carney was appointed this spring we did background research on him and concluded as follows:

"That Carney's Bank of England will look a lot more like Bernanke's Fed in both policy actions and communication we think is now likely a given. The Sterling exchange rate seems not to take that view. The difference in our conclusion is maybe, due to our cautious UK housing view leading us to worry that the UK could still be a long way behind the US in the economic cycle. As a result the UK and Sterling could have, from here, a much longer period of non-conventional monetary measures to come we suggest." **Holland Views April 2012**

As such, that Sterling fell yesterday vs. the Dollar in response to Mr. Carney's announcement is no surprise to us. It is as clear as it was in April that the US and UK are at very different points of the economic cycle and thus anything but ongoing weakness in Sterling vs. the dollar in the coming years seems highly unlikely (My Family and I are off to Florida in two weeks time whilst we can still afford it!). As a result of his determined policies for a while Mr Carney could be every British citizens favourite central banker, young, good looking (I am told) and keen to stoke the fire of the asset so dear to all British hearts; **housing and property**. No wonder he and the chancellor get on so well.

Lower for longer

With interest rates now flagged to be lower for longer the London boom will thus likely continue with more and more capital arriving and housing and commercial property values elsewhere in the UK likely to benefit more due to continued low borrowing costs and relative price attractiveness vs. the capital. But will this be a recovery or just another asset boom later followed by a bust? Depressing Sterling genuinely helps exporters but we still think the internal asset value effect of such policy is dangerous, a point not lost on Mervyn King.

With such low interest rate policies having worked so well in the US to stabilise and then recover asset prices and the economy surely we, and others, should support this policy route for the UK? The only reason we do not is simple.

It is due to the starting price of assets (London Commercial Property and UK residential Property) before money printing and ultra low interest rates started. In the US in 2009 property values (and the stock market) had arguably already fallen to levels that were cheap against not just interest rates but nearly all measures of longer term affordability. This could be assessed looking at PE's for the stock market or price to earnings ratios (i.e. real long term affordability) for houses and their owners.

But the decision to print money was a global one, or at least co-ordinated by the UK and US. As their (the US) economy is 6x the size of ours it was their assets prices plummeting through unjustified levels of affordability, thus threatening a deflationary slump, that justified the ripping up of the global central bank rule book. The effect (of money printing) on the US economy was stabilisation and asset price recovery and then ultimately the broader based economic recovery now being witnessed. Arguably what the UK needed at that time was to let residential property values fall further but support banking and liquidity, as hard as that would have been, but that did not/could not happen.

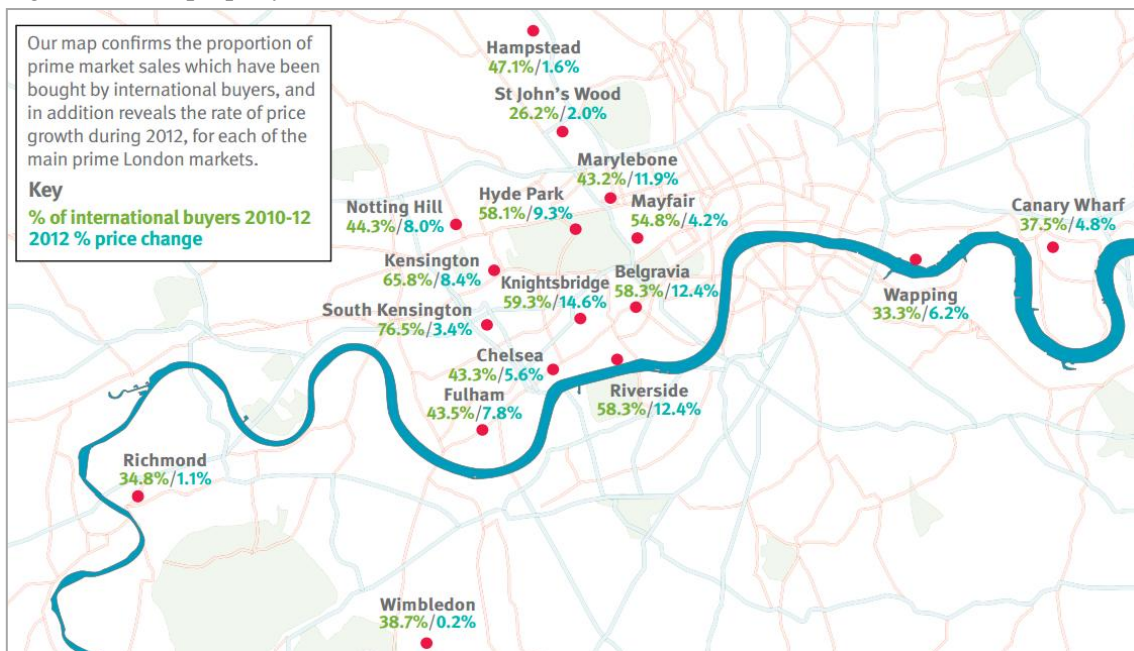
What is good for the goose...

To assume this money printing decision was, and is now, right in the UK ignores the simple fact that the housing stock in London and outside (at the time of intervention) was over- not underpriced. Residential housing was then down a mere, and temporary, 10% from its multi-decade peak. Thus the UK needed liquidity and improved solvency of its banks in 2009, it did not need a prop to assets values, but that is what we got. All that has happened since then is built on this erroneous premise. By way of an insight I remember an economist friend who was travelling a lot between New York and London in 2008-9. He observed around that time: *“Manhattan feels like it is having a depression, London like is just having a bad day”*. However we still got the same medicine as the patient on life support.

Bubble economics

Some of you will differ in your view towards housing and we can of exchange much different data all trying to prove our respective points.

Fig. 1: London property bubble?



Source: Knight Frank

We would just ask those of you with normal (but likely still privileged) levels of wealth to quietly consider what you have as your current net worth and how much of that money was saved by you from working income and how much has come from, often tax free, property ownership. Then to consider that state of the finances of someone who has had a similar career working in Germany where there has been no property bubble. We also think the chart above courtesy Knight Frank is a fascinating insight into what we all know is occurring in London. Are we all as clever as we think, or just lucky in which country and where we live?

To those in finance, property and housing we observe this. Enjoy the party that Mr. Carney is keen to keep going for it may last a long while yet, particularly in an economy that is so interest rate sensitive, but beware of the law of unintended consequences and hangovers.

On incentive bias and time frames

This Thursday I went to a dinner to listen to Boris Johnson speak. As a fan of outspoken and non-consensus politicians (and Boris) I eagerly awaited the prospect. He was awful. A lazy and egotistical presentation given to an out of London audience about how great London was and thus how great he was. In turn then how lucky we were to live near such a City. With the London Mayor keen to take praise for every train that runs on time and every medal won by a GB athlete I have to conclude that he is sadly not likely someone remotely interested in considering the effects on normal Londoners or other UK citizens if current housing values were one day realised to be false. He will likely have a different job by then.

Whilst on the subjects of political timescales and housing a mention of the chancellor's quite brilliant, and yet idiotic, policy of 'Help to Buy' must be made. (It is brilliant at a political level, idiotic at an economic one). All are now familiar with this scheme to lend money to those who cannot afford it to gamble on property prices. I am sure we have heard this record before...? Interestingly the Government is lending this money because the *reckless* and *greedy* banks are not prepared to make these *profitable* high loan to value mortgages to low income would be home owners... umm it makes you think does it not? We really are not, and try hard not to be political, in our economic observations, and if anything I lean firmly to the right, but this is just a policy designed to stop house prices falling over before a 2015 general election.

A last thought on incentives and time frames returns us to Mr Carney. His *successful* economic policies in Canada will likely be judged better in 5-10 years time than now. Here too we will likely not know of his lasting success until after his 5 year tenure has expired. All would be wise to realise that some of today's central bankers and their incentives are not so different from those widely observed and criticised in the commercial banks.

The people I would most like to have a beer with

The economics professors at Harvard and Oxford who taught the likes of Boris Johnson, Mark Carney and George Osborne would be great people to meet up with (introductions gratefully accepted). Would they applaud their famous protégés or quietly weep into their beer? Each of these men has been very very, well educated. Thus in quiet moments they likely do realise the longer term consequences of what their actions today might entail, but in public they must come across as uber confident as to the route ahead. We should remember their likely private doubts not their public level of conviction.

They will likely reason with themselves however ‘*what else can I do?*’ in the same way the likes of Greenspan and Bernanke did when deciding not to stand in front of the US Housing steamroller. After a while they likely convince themselves that because nothing has gone wrong it isn’t going to. Recent financial events have shown us that brilliant, eloquent (not you Boris) and extremely well educated people can still make huge mistakes. Incentive and consistency bias play a huge part as Munger has taught us.

As always...concentrate on businesses

We spend little time on macro views these days preferring to try and find mispriced equity assets. Despite the above we do still seek equity investment ideas in the UK (having updated investors with our views on a few last week). We also find them in unlikely places from Greece to Italy and even Korea at present as problems throw off opportunities. That said our best hunting ground in the last year or two has been the US for high quality franchises, exposed to what we suggest is a more robust economic recovery than many believe and a better currency.

Today is a sunny Wimbledon Men’s semi-final day. So enjoy the sun and the tennis but remember that despite all of Boris’s self belief, George’s policies and Mark Caney’s new economic broom, the sun does not always shine on economies or currencies that prop up possible mispriced assets. I am off to Boots to stock up on hangover remedies for 2016+(?) while stock last.

With kind regards to you all

Andrew, Ramsey & Mark

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Note - I have just read that Boris studied classics and George Osborne Modern history - Surely there was some economics in the syllabus?

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