

Session 3: Macro Outlook for the World Economy and Currencies

David McWilliams

Economist

I am going to talk very briefly about the outlook for the world, but I am going to be rather sceptical about it in the sense of being sceptical about the ability of people in our industry to forecast things. It refers me to a little story on central banking – I am a central banker – that should shed some light on other issues.

Many years ago in Ireland, we had a currency crisis, we had tried to pretend to the world in the 1980s and early 1990s that we were actually German, which, if you know Ireland and you know Germany, is a very difficult thing to transmogrify into. We kept with the Deutschemark as much as we could, and then of course sterling fell out of bed in 1992 and all eyes were on the Irish and how we were going to devalue. At the time unfortunately for us, our foreign debts were rather substantial and were held largely by German and Swiss investors.

Our interest rates went up to 102% overnight. Our reserves disappeared. Banks weren't giving money to anyone and businesses were closing down. The Governor of the Central Bank, who is a very august character, one of those in the traditional way of central banking. You know the way now that Chief Executives want to 'get down with the kids, and lay soft ball in the summer with the trainees'? Back then the opposite was the case. The Chief Executive or the Governor stayed as far away as possible from you and you from him, and that ensured your career progressed. Make no friends with people in senior positions and just get up.

I used to write the Governor's speeches on Europe for him, and they would come back with the corrections in Irish not in English. I remember when the currency was just about to go, and the bond market was seizing up, our Governor came to me and he said:

"You'll be aware that we're having a problem with the currency, will you go over to the Dorchester Hotel in London." What he didn't know was that I used to work as a kitchen porter at the Dorchester hotel, because all Irish students used to work in London or New York back then. He went on to say: "Would you please tell these people who are from Switzerland and from Germany that we are not going to devalue." Well, I had one of those Father Dougle moments. He asked me to do the presentation using PowerPoint, which I had never used. I spent a day trying to get up to speed and we went over the speech. I went over to the investors in a very shabby suit, looking like someone who had just made their communion. Because I didn't trust the PowerPoint, I put all the speeches about Ireland into a brown box. I put it on the escalator on Aer Lingus and on we went to London. I arrived in a large room at the Dorchester and there were 11 very rich-

looking people in the room. When Ireland looked poor back then, rich people actually smelled different to us. I arrived and introduced myself. I opened the box, and in the box were not the slides but six dozen golf balls. Immediately, all you could hear were these investors on their phones telling people to “sell that country at any price, anything you can get!”. I could feel the Irish market seize up under me. Ultimately, the people then left the room and I thought I was going to be back to being a kitchen porter, that I’d lost my career as an economist. One of the men had remained in the room though. He said: “Very impressive. Incredible ability to articulate difficult concepts fluently. Your ability to explain and communicate and link ideas together is really quite extraordinary. In fact, for somebody so young and with a smile on your face, your ability to lie for your country is phenomenal.” So I had been rumbled! The next thing he said to me was: “Would you like to lie for me?” So I asked him who he was. Now, back then, UBS was the biggest bank in Europe, and I had never heard of it. I thought that there were only two banks in the world – Allied Irish Banks and Bank of Ireland. He sat back proudly and said: “I am the Chairman of UBS.” Four weeks later, I was on the trading floor of UBS speculating against the very currency that I was charged to defend four weeks earlier. This is how I got into investment banking and leaving central banking. But also this made me sceptical about abilities to forecast currencies and economics in general, which is just simply a way of telling the story of the way you see the world.

The question is, how do I see the world? I refer to it in terms of kitchens – I don’t know about the UK, but what happened to kitchens in the last 10 years? When did we need to land an entire platoon of American marines in our kitchens, in terms of space, because Irish and British people spent a fortune on kitchens, 4x4s (which you need because the mudslides in Kensington are shocking), we spent money on all sorts of

things. Now, we in the English-speaking world have got to pay all that money back. We don’t have it. These huge imbalances we are seeing really stem from our ludicrous consumption over the last 10 years, which we in Ireland and to a degree in Britain and certainly in the States made a national past time. The question then is who is going to pay for all of this? It’s very interesting. I was out at the Scott Memorial this morning and I saw a group of Chinese tourists taking photographs of old British servicemen, and I said to myself that this is very interesting. What is happening obviously, in terms of global imbalances, is that China is doing to us what the Americans did to Europe after the Second World War. All these old gaffers who fought the Second World War out there, getting photographed by Chinese tourists demonstrate this imbalance. China as we know is getting trapped. China wants to spend dollars but can’t mention divesting from dollars because every time it does, what happens is that the dollar plummets and the value of its foreign exchange plummets. So exactly like the Americans did to us Europeans after the Second World War, China is going buy real assets and, with those real assets, it’s going to do two things. One is that it is going to lay off American risk, and this is a crucial aspect. I spent three months making a documentary for Australian TV in China in the last year and it struck me that this was almost a constant refrain from Chinese people I met, and when talking about Chinese people you meet on the streets that are aware of what is going on. They will lay off American risk by giving worthless American dollars to people who own commodities so that China can own real assets and, in so doing, divest themselves of their American exposure. That is happening, we know that China is lending money to Russia, Venezuela, Kazakhstan, Brazil, etc.

So when Marks said that the proletariat was going to seize the means of production, he was right. The Chinese proletariat are going to seize our means of production using our money, in a way to escape the delinquency

of the Anglo Saxon world, which is simply printing money to pay for last year's excesses. What we are doing is borrowing from tomorrow to pay for yesterday. That will go on and clearly has huge implications for your business and for the dollar. There is no way around this. It comes from our delinquency, but we will have to cure ourselves. Clearly, the currencies that we print – sterling, dollars – the more you print of them, the more they will decrease in value at some stage.

The second big global phenomenon also has positive ramifications for your business, the commodities game. It is not just peak oil, but peak everything. We now live in a world where we have got to come to terms with something very simple – six billion consumers crashing into the finite resources of this planet. Ultimately, what we will get is a situation where the United Nations says that, in 2040, we will have to double global food production simply to feed the 60 million new babies born every year in the world. That is the population of Britain coming into the world, every year. They need to be fed, they need energy, and where are we going to get this from? We are not just looking at peak oil, but everything else. Think about food for a minute. Again, as people in the commodities business, not necessarily just in the gold business, this is a crucial aspect. If you think about all the great apocalyptic Malthusian scenarios – we face a Malthusian future. That is very serious because, up until now, we boosted agricultural yields with fertiliser, which we never had the Malthusian issue in the 70s and 80s of a population boom. We could always feed ourselves. But fertiliser comes from petro-chemicals. As the price of petrol rises and the price of oil rises, and it will, then the price of food will rise. As the price of food rises and the population expands, this is a reasonably apocalyptic outlook for humanity. There is always the good side, which is that people in this room, brokers and traders, working in commodities, will go through what seems to me the most significant structural upswing, which will be

absent in any changes in monetary policy, which will happen whatever happens to the financial markets, and whatever happens to the ramifications of the delinquent Anglo Saxon consumer boom of which we paid in Ireland a small reasonably immodest part. It strikes me now as I leave you that, notwithstanding professionals at UBS who've clearly never lied to anybody (that was a trip of the tongue from the Chairman), notwithstanding what's happening in the financial markets even if the decline of the dollar and the movement out of the dollar into other assets is moderate and moderated, and even if, for example, we see gentle movements down the dollar, China has to get out of dollars progressively, in the same way that the world got out of sterling progressively. From when those older gentlemen were fighting in the 1940s onwards, the decline of sterling was gentle, progressive but unbelievably precipitous in terms of where it has gone. It seems to me that the dollar will go the same way. That is the big issue financially. The second big issue is the peak everything. This is very good for your business. There is always a silver lining.

Thank you very much.