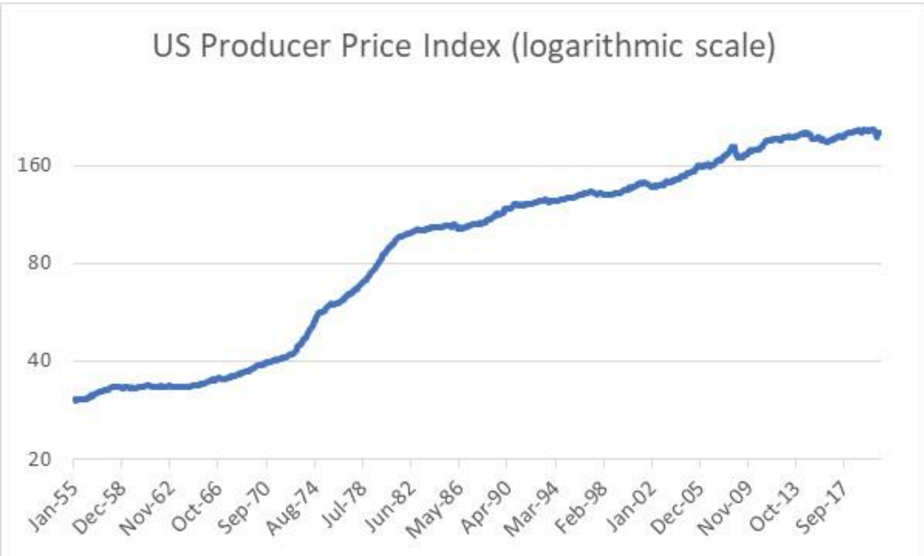
# THE END OF THE DISINFLATIONARY ERA

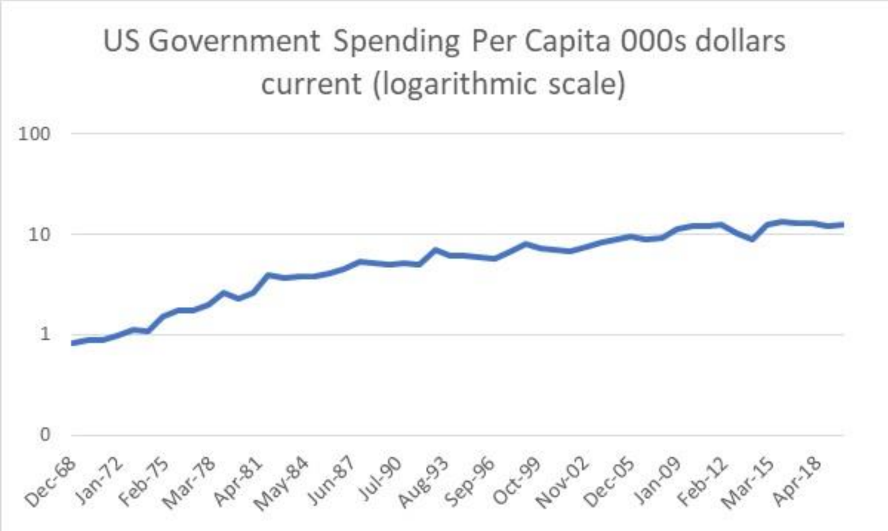
Russell Clark's
Market Views

"If the political winds have changed, the current 1.4% yield for a 30-year US treasury may seem as odd to people in 40 years' time as 16% in 1980s seems to us."

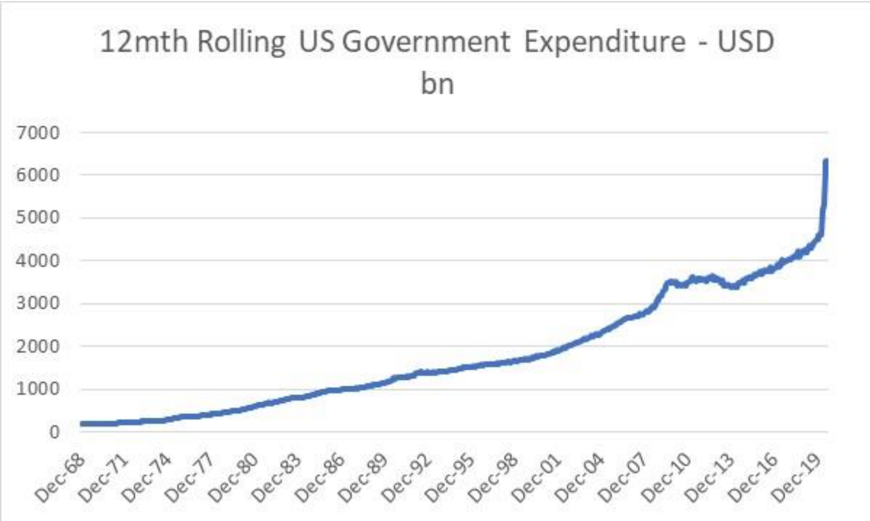
The political and economic era that began with Thatcher and Reagan in late 1970s looks to be dead. The Thatcher/Reagan reforms were all centred around breaking the power of unions, free trade, free capital flows and allowing market pricing to allocate assets as efficiently as possible. These policies have been in place for so long, and their key tenets so accepted, that to challenge them placed you in the fringe of politics. However, Abenomics, Brexit, and President Trump, have shown that in the west at least, these policies are dead. While it is easy to dress the Thatcher/Reagan reforms in the ideal of liberalism, their key economic driver was to deal with surging cost of production that blighted the US and UK in 1970s. On this basis the policies were a great success. (All charts sourced from Bloomberg – except where noted)



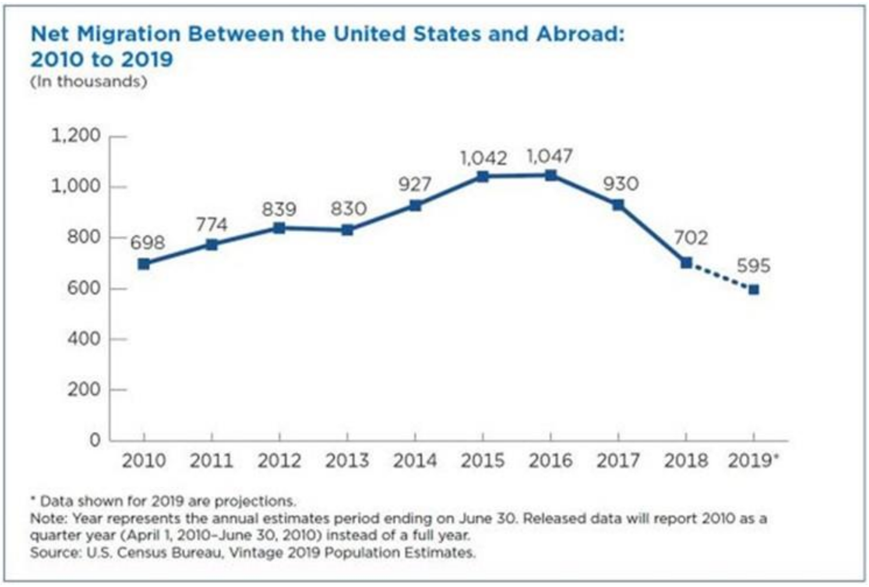

Perhaps the most recognisable Thatcher/Reagan policy, was that of small government. The clearest way to see small government policy at work is to look at the US Federal Government spending on a per capita basis. In 1980 government spending growth slowed dramatically. All numbers are nominal, so in a real basis, government spending per capita has barely grown.



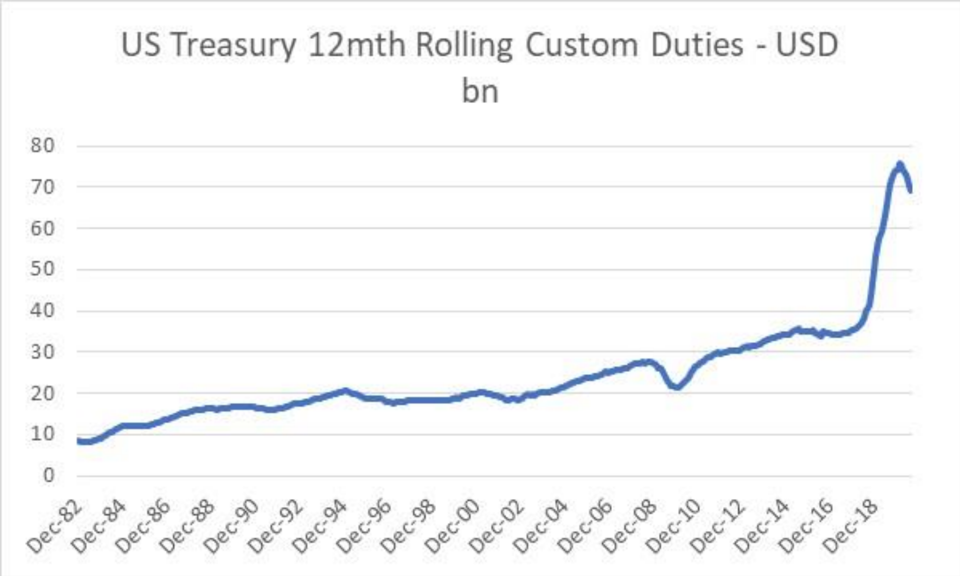

The election of President Trump saw US Government Spending increase, and with Covid-19, spending has increased rapidly for nearly all countries. While it is possible that government spending may fall once Covid-19 passes, austerity as has been conducted for the last 10 years looks politically impossible.



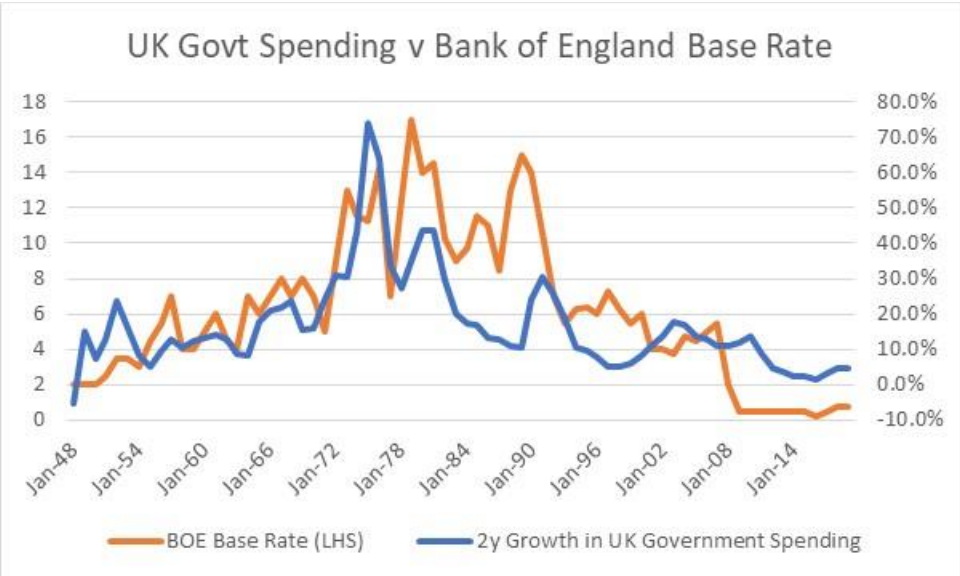

With the Brexit vote, the UK chose a path that swapped free trade and free labour movement with its largest trading partner, for more freedom to choose trade and labour policy. This is still a work in progress. However, President Trump has had more freedom to roll back other features of Reagan/Thatcher revolution. High levels of migration, that helped keep labour costs under control have been reduced.



We have also seen the return of custom duties as a source of revenue for the US government.




All of this analysis leads to a conclusion that we are heading back to an era in which most investors are unfamiliar. Probably the key takeaway, is that market forces are no longer the main driver of asset prices, but government policy. Given the political losses the left-wing parties in the US and UK have suffered, my best guess is that rising real wages and benefits is the key policy focus now. While market participants focus on GDP estimates, and excess capacity, for views on inflation and interest rates, perhaps the better guide is the rate of growth in government spending. The growth in UK government spending in early 1970s was a better indicator of higher interest rates, just as collapsing spending growth in 2010s, was a sign of lower interest rates.




If this analysis is correct, then market estimates of inflation are assuming drastic spending cuts in the next one to two years. This could be true, but if it is not, inflation could rise dramatically. It is noticeable that the Conference Board Consumer Inflation Expectation Index has surged in recent months.


Political change often catches markets unaware, as they did in 1980s, when US 30-year treasuries yielded 16% before falling dramatically. If the political winds have changed, the current 1.4% yield for a 30-year US treasury may seem as odd to people in 40 years' time as 16% in 1980s seems to us.

## INFORMATION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