

## David Scott's - Market Watch

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### Reading Guide

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For those with a coffee and a little time – everything else

Portugal has become the third single currency member to confirm a bailout, with \$78.5 billion being sought to help stabilise the country's finances in an emergency loan. **This now takes emergency lending for the three distressed economies to £256 billion, just as speculation mounts that Greece, the country that started it all is plunged into a deeper financial whole, with talk of restructuring, which I believe is inevitable. Rumours swept through financial markets late on Friday that Greece was threatening to leave the eurozone and reintroduce the drachma.** Whilst this was furiously denied by Athens Europe faces the problem of Greek calls for new financial aid. On Saturday Greek Prime Minister George Papandreou urged "the EU in particular, to leave Greece in peace to do its job", but **Finance Minister George Papaconstantinou later warned that Athens may need more hard cash support.** "We need to plan our next steps for 2012 and 2013 so that Greece can either access markets or use the European council's recent decision that enables the European (rescue) fund to buy Greek bonds," This followed G20-eurozone talks overnight in Luxembourg where reports suggest that **Athens may need fresh funds from the European Union bailout mechanisms, above the 110 billion Euros (\$160 billion)**

**agreed a year ago.** French business daily Les Echos said Papaconstantinou secured tacit acceptance that Greece's political backers could make another 20-25 billion available if more cuts and accelerated state sell-offs failed. German and EU officials each denied that the Luxembourg talks represented a sharp deterioration, saying such talks "take place at irregular intervals" and did not represent "a crisis meeting on Greece". **Ideas thought to being considered include postponing the maturity of 65 billion Euros worth of Greek bonds this year and next, and pushing back deficit reduction deadlines, but this is thought to be unacceptable in Berlin.** The Greek public deficit for 2010 was recently revised upwards, from 9.4 percent of gross domestic product to 10.5 percent. The Kathimerini daily said Athens would need "two to four years" more than planned to meet a three-percent-of-GDP EU ceiling, taking the date beyond the electoral mandates of the big players like Germany and France." We think that Greece does need a further adjustment programme," said Luxembourg Prime Minister Jean-Claude Juncker, Europe's longest serving leader and chair of the Euro group of finance ministers after Fridays meeting, adding that **details would be discussed among eurozone and EU finance leaders in Brussels on May 16 and 17.** A deeper-than-anticipated national recession has combined with brutal cuts in public spending to hit Greek tax revenues and **it has already been given eased terms by EU leaders in the spring. the debt was extended to an average of 7.5 years (from about 3 years) in March and the interest cut by one percentage points any further reworking would put increased pressure on the fragile single currency zone.** Athens already owes more than a year-and-a-half of its entire economic output, some 340 billion Euros. Greece will need funding beyond the €110bn already promised to meet 2012 bond redemptions and with 2 year bonds yielding 24.5 per cent and 10-year bonds hitting 15 percent its euro area partners look the most likely source of funds at the moment. **One in three Greeks want their government to abandon a loan agreement with the EU and the IMF perceived to have sent the debt-hit country into a recession spiral, a poll found on Sunday. The opinion survey by pollsters Marc in Ethnos daily found 33.3 percent of respondents want Athens to abandon a rescue memorandum it signed last year "because it leads nowhere, even if this means bankruptcy." another 45.9 percent of 1,000 households contacted nationwide said Greece should renegotiate the terms of its loan rescue.**

**This is also occurring at a time when the wealthier creditor countries such as Finland and Germany start to question the cost of keeping the 17 nation euro economy intact.** Whilst there has been speculation that the rising political force in Finland, the True Finns may block the Finnish Parliamentary vote on the Portuguese bailout, this is looking increasingly unlikely, with the leader of the true Finns acknowledging in the week that they were unlikely to stand in the way of the current Portuguese package. Euro area countries will provide two thirds and the IMF one third of the Portuguese loan. The IMF loans for the first three years will be at 3.25 per cent, with the European portion higher. **Following the collapse of the former Portuguese government, a general election is set for 5<sup>th</sup> June and in the week Portugal estimated that the economy will shrink by 2 per cent in 2011, twice as sharp as it forecast in March, and by another 2 per cent decline in 2012, which goes against a forecast made earlier of 0.3 per cent growth. The Portuguese are therefore**

**looking at another two years of recession.** The German Chancellor Angela Merkel and Paymaster General during the week declined to pass comment on the Portuguese package and she is thought to be waiting until European Finance Ministers meet on May 16<sup>th</sup> to reveal her position.

As UK inflation remains at double the Bank of England's target rate, it came as little surprise in the week when the Monetary Policy Committee left **UK interest rates at 0.5 per cent for a record 26<sup>th</sup> Month.** The decision followed on from comments made earlier in the month from the Governor Mervyn King, who when speaking at the European Parliament in Brussels said that high levels of UK debt posed massive economic challenges and would be exacerbated by higher interest rates. **With Britons collectively owing about £1.453trn, higher interest rates will have a significant impact.** According to a report issued by the OECD on the 34 leading industrial nations that belong to the organisation, Britain's inflation rate remains comfortably ahead of the 2.7 per cent average. UK CPI inflation was 4 per cent in March and the Monetary Policy Committee has acknowledged that they are expecting it to hit 5 per cent in the coming months, before falling away thereafter. Since June 2010 Andrew Sentence has been calling for a UK interest rate rise and last week's meeting was the last for the member who has become known as the 'super hawk'. More recently, his call for a rate increase has been backed by Martin Weale and Spencer Dale, the Bank of England's Chief Economist. The expectation is that when the minutes are released for this meeting, all three will have again voted for a rate increase. **Mr Sentence is to be replaced on the Committee by former Goldman Sachs Chief Economist Ben Broadbent.** One of the main arguments of these members not voting for an increase is that they believe UK inflation will fall sharply next year due to the weakening UK and global economy, which is certainly backed up by economic data in the week. Another reason is they want to see the effects of the April implementation of the £81 billion worth of cuts in public spending and the £30 billion increase in overall taxation, which are planned for the next 4 years. **In its latest quarterly outlook on the UK economy, the Institute of Economic and Social Research has predicted that British GDP will grow by just 1.4 per cent this year, 0.2 per cent below the forecast from the Office of Budget Responsibility, who have already been adjusted their forecast since the March Budget.** The NEISR believes a combination of public spending cuts, higher taxes and rising inflation **will also result in lackluster growth of 2 per cent in 2012, rather than the 2.5 per cent predicted by the Government's independent forecaster.** In a separate report the organisation also forecast that the global recovery would slow this year after a strong bounce in 2011 due to higher oil prices and which is responsible for about half of the deceleration. It believes global growth will decline from 5.2 per cent in 2010 to 4.4 per cent for this and next year. However, it believes trade growth will be set to slow from 11.9 per cent in 2010 to 6.2 per cent this year. **Like me it believes that real house prices will fall, by 4.5 per cent in 2011 and by an average of 1.5 per cent per annum in the subsequent 4 years.** As UK growth forecasts get pulled back, this will create problems for the coalition's ambitions to scale back the amount of money that we, as a country, have to borrow to maintain current spending commitments. Over the course of the Parliament this figure has already increased by some £46 billion. **My fear remains that the UK is heading for a double-dip recession, brought on largely**

**through events elsewhere in the world and this will mean that these already increased borrowing forecasts will have to be increased yet again.** U.K. producer prices rose more than economists forecast in April, showing that inflationary pressures are building in the economy. The cost of goods at factory gates increased 0.8 percent from March the Office for National Statistics said on Friday, economists were looking for a 0.7 percent gain. From a year earlier, output prices rose 5.3 percent. Annual input-price inflation also accelerated to the fastest since September 2008. **The most influential part of the UK economy, the service sector, showed sharply slower growth in April, as Government cuts fed through to the private sector.** The Purchasing Managers Index fell from 57.1 in March to 54.3 and whilst it signals expansion, the decline is the biggest since the Lehman's shock. The drop in April partly reverses an unexpected surge in activity in March, which was also attributed to Government spending, as the public sector sought to spend what cash it had left last year, before the austerity of the 2011-12 financial year began in April. **British manufacturing activity also grew less than expected in April**, at its weakest pace in 7 months, and highlighted a sharp slowdown in new orders, suggesting further difficulties lie ahead. The Markit/CIPS Manufacturing PMI headline index fell to 54.6 in April; it's lowest since September down from a downwardly revised 56.7 in March and well below the 56.9 consensus forecast. The sector, which accounts for about 13 per cent of the British economy, grew 1.1 per cent in the first quarter according to official data. **The survey also revealed that output prices remain near to the March peak, suggesting that consumers will continue to face rising prices. New UK car registrations in April were down on the year, although when the effects of last year's cash-for-bangers scheme are removed activity was broadly flat.** Sales of cars to private owners however were sharply lower. The Society of Motor Manufacturers and Traders said that overall, new car registrations in April were 137,746, a decline of 7.4 per cent from the levels of 2010 when the car scrappage scheme was coming to an end. However, sales of cars to fleets were up 6.5 per cent from levels in 2010 to 77,172 units. Sales of cars to individual businesses were also up, rising 12.2 per cent to 6,794 units. But registrations of cars to private owners fell by 23.5 per cent to 53,835 units. The percentage of total new car registrations acquired by private owners was 39.1 per cent in April 2011. **The Construction PMI data showed that the housing sub-sector suffered shrinking output in April and across the sector staff continued to be shed for the 10<sup>th</sup> month in a row. According to the CBI's latest Distributive Trade Survey, British retailers said April was poor**, despite slightly better year on year sales growth, leading retailers to suggest that this month will be below normal. The survey found that 45 per cent of retailers saw the volume of sales rise in the year to April, whilst 24 per cent said they fell. The resulting balance of plus 21 was in line with expectations, although they are predicting no sales growth next month. **The British Retail Consortium said in its monthly price check that food prices in April had rocketed after wheat and other foodstuff rose sharply and transport costs escalated following the rise in oil prices. Food prices rose by 4.7 per cent, up from the 4 per cent in March.** Non-food inflation, which includes clothing and electrical goods, slowed to 1.2 per cent from 1.5 per cent, according to the survey, as retailers were forced to offer discounts to keep goods moving. The overall effect pushed up shop price inflation to 2.5 per cent since last year. Roger Bootle, Chief

Economist at Deloitte, said in his latest quarterly review that an expected rise in inflation to above 5 per cent this year, tax increases and public sector job losses will lead to an “all but certain” fall in household incomes. A fall in real incomes by 2 per cent he believes was certain this year, the equivalent of £780 a year per household and he does not believe that incomes will start rising again until the end of next year and were unlikely to get back to their 2007 peak before 2015. **This means that Britons will register 4 successive drops in spending power, the first time that this has happened since the Great Depression in the 1870s.**

**According to data from the Bank of England, new mortgage approvals rose to their highest level in 5 months in March with the number of mortgages approved for house purchases rising to 47,557, higher than the 46,283 average in the previous 6 months. Re-mortgage activity, however, which has picked up recently, slipped back. The slight pick up in mortgage lending comes as a growing number of house price surveys show prices falling in April. According to a Nationwide report released in the week, the average home lost 0.2 per cent of its value during the month, leaving it costing £165,609. The fall follows two consecutive months during which prices had risen, according to the Nationwide.** Throughout the 1990s and most of the noughties Britain's banks sold Millions of personal loans and mortgages with often unwanted, unneeded and unnoticed policies providing payment protection insurance (PPI). Supposedly these were meant to looking after borrowers' repayments if they ever fell sick or lost their jobs but they were also highly profitable for the banks. Following a recent court ruling, Lloyds under its new chief executive António Horta-Osório, last week broke ranks with other banks by setting aside £3.2bn to settle potential claims. Ahead of a legal deadline of Tuesday, rival banks – Barclays, RBS and HSBC – must decide whether to pursue, or abandon, an application for a Supreme Court appeal against the Financial Services Authority, which has ordered a retrospective payback to all customers affected. **The full compensation bill, according to analysts at Deutsche Bank, could reach £8bn.** Figures released by the Insolvency Service for the first quarter of this year show that 30,162 people were declared insolvent in England and Wales a fall of 15.5% on the same period a year ago and the fourth consecutive quarterly fall and according to the Insolvency Service this is the lowest level since the final quarter of 2008. The picture is bleaker for UK businesses as company liquidations rose 2.1% on the same period of 2010 to 4,121. The figures also showed that 3.7% more businesses were declared bankrupt compared to the previous quarter.

The European Central Bank on Thursday indicated July as a possible date for its next rate hike and insisted Greece would not have to restructure its debt. ECB president Jean-Claude Trichet commented that, "The monetary policy stance is still very accommodative, we will continue to monitor very closely all developments". **He spoke after the bank's governing council held its benchmark lending rate at 1.25 percent, and pointedly did not use the accepted code word "vigilant" to describe its stance. This has led observers to conclude that ECB rates will not be raised in June, but that they may be a month later.** The European Central Bank is also facing a new problem, **on Tuesday it failed for a second consecutive week to fully**

**neutralise the inflationary impact of funds it had spent buying government bonds to combat the region's debt crisis.** Since launching its controversial government debt-buying programme a year ago, the ECB has insisted that it was not embarking on "quantitative easing". By reabsorbing an equivalent amount from financial markets, it was able to ease fears expressed by Germany's Bundesbank that the programme was creating inflation risks. At the start of the week the ECB was due to reabsorb €76bn, the total amount spent under the bond-buying programme so far, but banks only offered €62bn. In the previous week, the ECB had also failed to reabsorb the required amount. Overall these operations have failed five times in the past year. The latest setback was the result of higher market interest rates, which deterred banks from leaving funds at the ECB. **Manufacturing output in the eurozone powered ahead last month but fuelled concerns that a two-speed recovery will leave faltering southern European countries increasingly behind.** A strong performance by German and French factories helped Eurozone manufacturers enjoy their best start to a year since 2000, although marked slowdowns in Spain and Italy increased fears of a two speed recovery. Markit's purchasing managers' index (PMI) for the Eurozone rose to 58 in April, up from 57.5 in March as output and new orders rose faster than expected. Germany's output expanded for the 19th consecutive month, to 62 points. Greece was the only nation to report a sub-50 reading, signalling contraction. Spain slipped closer to the 50 and Growth also slowed in Italy. **Spain's struggling economy showed signs of recovery with 0.2 per cent growth and eased market fears that it would follow Portugal and need a bailout.** According to Bank of Spain figures released in the week showed year-on-year growth reached 0.7 per cent, saying that the country had "decoupled from the group of countries most affected by the tensions on sovereign debt markets". Sounding a note of caution, the bank added: "In the opening months of 2011, the Spanish economy continued growing at a weak rate against the background of the progressive recovery in the world economy, but one not free from the emergence of fresh causes for uncertainty." Spain has forced troubled its savings banks, laden down with debt from the collapse of the property boom, to strengthen their balance sheets, made it easier to hire and fire workers, extended the retirement age to 67 and sold off state assets. The public deficit hit 11.1 per cent of GDP in 2009, the third-highest in the eurozone after Greece and Ireland, before falling to 9.24 per cent last year. Despite meager growth the economy has the highest unemployment rate in the developed world at 21.29 per cent, with nearly five million out of work.

Silver fell 3.8 percent to \$34.84 a troy ounce on Friday afternoon after hitting a record above \$49 last Friday. On Friday Silver prices plunged for the fifth consecutive day as the grey precious metal suffered its biggest correction since the billionaire Hunt brothers cornered the market in 1980. **The week saw a sharp reversal in the of fortunes for silver which until this week's 25 per cent drop had been up 56 per cent since January and a spectacular rally in which the metal soared 175 per cent between August last year. The volatility in silver has been exacerbated by a series of increases in margin or the amount of cash that investors must set aside to trade each contract by CME Group, which runs the silver futures exchange in New York.** CME has raised its margin requirements five times in the past 15 days. Investors

must now pay \$14,000 per silver futures contract, worth about \$180,000 at current prices. The rate will rise to \$16,000 on Monday.

New York's main oil contract, which on Thursday slid more than eight percent its heaviest one-day fall since September 2008 to close below \$100 a barrel fell further to close at \$98.53 a barrel, futures prices fell about 15% during the week. Brent North Sea crude, which slumped more than \$10 Thursday, slipped again on Friday afternoon after making up some lost ground in the morning to close at \$110.30. **Goldman Sachs, which in April predicted last week's major correction in oil prices, said on Friday that oil could surpass its recent highs by 2012 as global oil supplies continue to tighten.** The Wall Street bank, seen as one of the most influential in commodity markets, said it did not rule out a further short-term fall after Thursday's near record drop, especially if economic data continued to disappoint. But the bank reaffirmed its traditional long-term bullish view of oil. **JP Morgan took the bold step of raising its oil price forecasts for this year by \$10 to \$130 in the third quarter.** Goldman Sachs' analysts said in a research note. "We continue to believe that the oil supply-demand fundamentals will tighten further over the course of this year, and likely reach critically tight levels by early next year should Libyan oil supplies remain off the market." Goldman was one of the first banks to predict \$100 oil last decade, in 2005 when prices were closer to \$50 a barrel, but it stayed bullish for some time after oil peaked at \$147 in 2008.

The cash market for Gold closed the week at \$1,481.00, down from its Thursday close and off from its record high of almost \$1,570 last Friday. Gold for June delivery recorded a weekly loss of 4.2% to close at \$1,491.60 an ounce. **Mexico's central bank bought more than 90 tonnes of gold between January and March, according to figures from the International Monetary Fund, this is as The World Gold Council says it expects central banks in emerging markets to be the biggest buyers of gold in the medium term.** Mexico now owns 100.15 tonnes of gold up from the end of January number of 6.84 tonnes. The purchase is equivalent to about 3.5% of annual mined output and takes Mexico to 33rd place on the list of the world's top gold holders. The US is the largest official holder of gold, with 8,133 tonnes with China the sixth largest at 1,054.1 tonnes. **At the start of the week billionaire hedge-fund manager John Paulson said that Gold could hit \$4,000 an ounce over the next three to five years.**

**According to the Food and Agriculture Organisation of the United Nations Global food prices remained steady in April following eight months of sharp increases.** A fall in sugar prices and a decline in rice helped stabilise the index, but international prices of nearly all other food commodities remained flat. Maize prices rose 11% and wheat increased 4% in April 2011 as a result of unfavorable weather and planting delays. Providing normal weather conditions prevail, the FAO's latest indications point to a recovery in world cereal production in 2011 in response to high prices. World wheat production is expected to increase by 3.5% and rice to go up by 3%. "Although the early outlook for cereal production in 2011 is good, weather in the coming months will be critical," said FAO grain analyst Abdolreza Abbassian. He added: "Production prospects

for 2010 were extremely favorable at this time last year but unfavorable weather conditions between July and October changed that outlook drastically."

It is not just the prospect of slowing growth in Asia owing to monetary tightening that has hit material prices. There is also some hard data weighing on commodity sentiment. **China's Purchasing Manager's Index (PMI) in April, which traditionally serves as both a gauge of the strength of the spring revival in economic activity and the peak for the calendar year, declined for the first time during the month since 2005.** China's April PMI fell 0.5 points to 52.9, representing the weakest showing for the measure of China's factory production during April since China began calculating it more than six years ago. It appears interest rate hikes and stiffer lending requirements imposed by policy makers are finally starting to take effect. On Friday, China's government warned the country could face widespread electricity shortages during the summer and this is likely to hamper construction and manufacturing activities.

**Currently almost no one is predicting China's economy is set to fall off a cliff as Most GDP growth estimates for 2011 range from 8 per cent to 9.5 per cent, compared with 10.3 per cent in 2010. But if these number get pulled back again, which I think is likely, then the Market will react badly.** The Brazilian Central Bank President has reiterated that it will continue to raise interest rates for as long as required in order to bring soaring inflation under control. The government target is for 4.5% by 2012 and currently inflation sits at 6.44%. **In the week India's central bank increased its key interest rate by half a percentage point, its ninth hike in just over a year.** The bank, which warned that persistent inflation has become a threat to growth in Asia's third-largest economy, said the short-term lending rate or repo rate will rise from 6.75pc to 7.25pc with immediate effect. Reserve Bank Governor Subbarao said. "Current elevated rates of inflation pose significant risks to future growth." adding that "The Reserve Bank will continue to persevere with its anti-inflationary stance," **The bank expects economic growth to slow to around 8pc this fiscal year, from 8.6pc last fiscal year. This is lower than New Delhi's projection of 9pc growth.** The bank said also expects inflation for the fiscal year to average 6pc, with the potential to rise. It said inflation would remain close to March's 9pc for the first half of the fiscal year, before softening in the second half, despite pressure from high oil prices which could force New Delhi to raise regulated petrol and diesel prices adding to consumer inflation.

During the week US Treasury Secretary Timothy Geithner secured more time for Congress to negotiate a deal to increase the borrowing limit for the US. Stalemate over budget talks means the US risks defaulting on its debts because it will be unable to borrow beyond its \$14.3 trillion (£8.6tn) limit. **Geithner had previously said the deadline for a deal was 8 July. But in a letter to Congress he said that better tax receipts meant the deadline could be extended to 2 August.** Deutsche Bank on Wednesday Bank said it had been hit by another lawsuit in the United States over property loans, a day after the US Justice Department sued it for \$1 billion for mortgage fraud. The lawsuit filed Tuesday by the US Justice Department in New York federal district court, said that MortgageIT, acquired by Deutsche Bank in January 2007, insured 39,000 home loans worth more than \$5 billion with the Federal Housing Administration in the decade to 2009. The mortgages were "recklessly" approved by the

company in "blatant disregard" of whether the borrowers would be able to make payments on them. Both the bank and MortgageIT "made substantial profits through (the) resale of these FHA-insured mortgages," many of which later ended up in default, the complaint said. U.S. companies added more jobs than expected in April, but the unemployment rate rose for the first time in five months, with the economy's recent slowdown likely to limit future gains. **Non farm payrolls rose by 244,000 last month, as the private sector posted the strongest employment gain in five years, the Labour Department reported on Friday. The March data was revised upward slightly to show an increase of 221,000 jobs, from a previous estimated gain of 216,000. the unemployment rate, which is obtained from a separate household survey, rose to 9.0% last month from 8.8% in March,** the first increase in the jobless rate since November, when it hit 9.8%. Economists had forecast payrolls would rise by a smaller 185,000 and that the jobless rate would remain unchanged at 8.8%. Although **The US economy has added some 1.5 million jobs over the past year, there are still seven million fewer jobs than the U.S. had before the downturn.** Friday's report showed private-sector employers, which account for about 70% of the work force, added 268,000 jobs in April, the biggest rise since February 2006. In March, employment in the private sector rose by 231,000.

**On Wednesday the Bank of England will present its latest inflationary report, which will be read with keener interest than normal.** The reason for this is that inflation remains at double the Bank of England's target and the document will be used to justify the reasons why base rates have not been increased. The justification is likely to revolve around, the forecast that economic recovery is still uncertain and weak, together with the fact that its recent upturn is due to short term factors, which will not last much longer and, thus, inflation will fall sharply in 2012. Figures in the week are likely to be generally positive, with the British Retail Consortium on Tuesday expected to say that retail sales in April were stronger than in March. Official figures on industrial production on Thursday are also likely to confirm that UK industrial production rose strongly in March. The same day, the National Institute of Economic and Social Research will publish its estimate for GDP in April. It is expected to say that GDP in the last 3 months will have grown by about 0.6 per cent, suggesting a steady recovery. **Probably some of the most important data in the week will be out of China, when on Wednesday inflation numbers are expected to show it running at around 5.5 per cent, 1.5 per cent higher than where it was 6 months ago, adding to fears that the economy is overheating.**

There has been significant coverage on **Glencore**, the IPO, which is planning a \$12 billion initial public offering, although the floatation will not be available to general members of the public. **Not unlike Blackstone, the private equity house which timed its floatation to the maximum and then saw its share price fall away sharply, I believe the Glencore float could be a firm sign about the top of the commodities market in the very nearer term.** Indeed, since the announcement was made, we have seen a sharp sell-off in commodities, although this is unlikely to affect the outcome of the floating. **What investors must remember is that the floatation is an opportunity for the Directors to offload shares and, as such, anybody**

**proposing to buy the stock must ask themselves why they want to be buying stock off some of the sharpest minds in the industry, who have themselves decided that now is the time to get money out.**

**After Thursday's referendum on electoral reform, there are growing concerns that this will put significant pressure on the Government's junior coalition partner, although speculation that they may quit the coalition looks wide of the mark, as I believe that they are committed to cutting the UK's deficit. The position of Nick Clegg, the Deputy Prime Minister, looks increasingly difficult. He has already lost popularity for breaking a promise in last year's election, not to increase university fees and now Mr Clegg faces the charge of throwing away a historical opportunity to change the electoral system with a lackluster campaign.** There is a growing view that he may not lead the Party into the next election in 2015, with Chris Hulme, one of his Cabinet colleagues being seen as positioning himself to take that position, by recently confronting David Cameron, the Prime Minister, over how the Conservatives have fought a 'dirty' referendum campaign. Whilst there will be lots of comment about the referendum weakening the coalition, I do not believe that this is actually the case. **The Government's core deficit reduction plan is already under way and both parties will remain unpopular until the pain is forgotten and the economy starts to grow again.** This is not anticipated to happen for a while even under the coalition's optimistic view and going to the electorate now, when their popularities are probably at their lowest ebb as austerity measures bite, would be handing a golden opportunity to their electoral rivals.

**Investors' risk appetite fell sharply this week, with sharp falls across most asset classes. The Reuters-Jefferies CRB basket of resources slumped 4.9 per cent on Thursday, its fifth worst fall ever. For bonds, equities and commodities all to move generally in the same direction is unusual and is normally a sign of a decline in investors' risk appetite, and a sign that we are entering a more difficult economic period.** The most obvious reason for this, as I have continued to suggest, is the ending of quantitative easing in the US, which has been solely responsible for ensuring that the US economy has grown recently, whilst the fundamental problems have not been addressed. US house prices are at near new lows and a major drag on the economy. **Fannie Mae, the troubled US mortgage finance company, on Friday reported a return to losses for the first quarter as it announced it would seek an additional \$8.5bn from the US Treasury.** The company, which finances almost half of all US mortgages, **reported the net worth of its assets as minus \$131.1bn at the end of March,** and indicated that it was unlikely ever to earn more than the dividends owed to the Treasury on preferred stock issued as part of its bail-out. As I expect US home prices to continue to fall, as in the UK, this is going to create increasing headwinds for the general economy. **Ultimately, until the average person on the average wage can afford the average house, then there are significant imbalances and these need to be worked through until the housing market can be put on a more sustainable footing.** This adjustment, of course, takes place at a time when Government and personal finances in the west remain overly stretched producing further strong headwinds. **According to a recent McKinsey study the age of**

**deleveraging will produce a fundamentally different economic environment than the one most people recognise. The report suggests that this will last anywhere from 4-6 years.** If this deleveraging is orderly, as now appears to be the case in Britain, or more resembles my worries about Geek implosion, it will create a profoundly different economic world from the one we have lived in for 60 years. Since the Second World War the world has been defined by ever-increasing amounts of borrowing an outright reduction in borrowing or even a significant slowing of the rate of growth is a whole new economic and political ballgame creating an uncomfortable new norm for the populations of the west.