Clouds on the horizon

The spectre of rising inflation is spooking the markets. There is a prevailing view in the market that the only good news is bad news. In other words, fewer new jobs created and higher-than-expected unemployment numbers are good news for the markets, as policy-makers will hold off hiking interest rates and pulling back quantitative easing, which have artificially propped up markets for more than a decade. Of course, the long-term repercussions of ever rising debt are too dire to contemplate, but the cost of servicing the current debt pile with rising interest rates in the absence of inflation eating away some of the debt is equally problematic.

At the time of the global financial crisis in 2008, the UK government had £1tn of debt – which, by the time of the global pandemic, 12 years later, had risen to £1.8tn. It now stands at £2.2tn after Her Majesty's Treasury spent £407bn trying to rescue our lives and livelihoods during the first 18 months of the pandemic.

Tax rises, beyond that of corporation tax announced in March and National Insurance contributions in September, are inevitable, but tax rises have repercussions on human behaviour and people's propensity to work less hard if they are keeping less of the reward. So, tax rises will not help solve our debt problem and less so our long-standing productivity conundrum.

> **"Less demand for online shopping, working and entertainment pushed back the growth rates of the so-called Covid-19 beneficiaries"**

It is calculated that every one percentage point rise in the base rate will cost the Treasury another £25bn to service the national debt – that's a lot of tax rises to service rising interest payments. To some, the only viable solution lies in the issue of a new 'corona bond', like the war loans after World War II. This is parked in the Bank of England for, say, 60 years, with a 50 basis points coupon or 0.5% annual interest payments for long-term investors seeking a gilt-edged, risk-free return.

Inflation and debt aside, what else is keeping investors awake at night? A growing litany of concerns, from supply chain disruption, soaring gas prices, rising wage demands and looming tax hikes, to media-inspired panic at the petrol forecourts and supermarket shelves. After panic buying loo paper and pasta last year – and houses in the intervening year, encouraged by the stamp duty holiday – the great British public turned its focus towards hoarding Christmas presents ahead of the festive season. Human psychology at its damaging worst.

This troubled backdrop is reflected in the market, where rising bond yields have depressed highly valued tech stocks. When risk-free returns become available, it is harder to justify stratospheric valuations for future growth, especially as that growth and its valuation are held back by the rising cost of money. Hence, the recent retreat of many of the expensive e-commerce plays.

Interim results in September showed a slowdown in online penetration as the population came out of house arrest and spent more time and money in the real world. Less demand for online shopping, working and entertainment pushed back the growth rates of the so-called Covid-19 beneficiaries, while the pandemic-induced delays in the supply chain reduced the flow of goods. And, as we know, it's all about supply and demand.

The global shortage of chips – a notoriously cyclical commodity, even in the absence of global pandemics – recently pushed the valuation of Apple, the world's largest company, into 'correction territory' (that is, down 20%) while bumping up the valuations of second-hand car dealerships. Surely some mistake? The world's finest business worth less and wheelers and dealers worth more? It's supply and demand again, stupid. With electric cars and autonomous vehicles the future, the far-from-stupid person on the street is buying a second-hand car in the face of supply shortages and delayed new models, and as a hedge on future e-developments.

Meanwhile, China, the world's engine for growth of the past 30 years, is facing its own property boom and bust. Evergrande, the country's second-biggest property developer, is struggling under a $300bn debt pile and threatening to default on its interest payments. It is estimated that China has enough empty houses to accommodate 90 million people. This could have far wider implications beyond China, where it has had the domino effect of shutting out other developers from the global bond markets, with only one developer successfully tapping overseas bond investors since the Evergrande crisis surfaced in September. It is an ill wind that blows from the east....