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Juking the stats

ASSISTANT PRINCIPAL: "So for the time being, all teachers will devote class time to teaching language arts sample questions. Now if you turn to page eleven, please, I have some things I want to go over with you."

ROLAND "PREZ" PRYZBYLEWSKI (a former policeman): "I don't get it, all this so we score higher on the state tests? If we're teaching the kids the test questions, what is it assessing in them?"

TEACHER: "Nothing, it assesses us. The test scores go up, they can say the schools are improving. The scores stay down, they can't."

PREZ: "Juking the stats."

TEACHER: "Excuse me?"

PREZ: "Making robberies into larcenies, making rapes disappear. You juke the stats, and majors become colonels. I've been here before."

TEACHER: "Wherever you go, there you are."

- From the HBO TV series 'The Wire'.

At the end of last week, pictures of fruity girls jumping for joy at their A Level results managed to push the grim stock market news off the front pages for a while. Pictures like this:

Or this:

Or this:

(Sources: The Manchester Evening News, This Is Staffordshire, Bristol Evening Post, but primarily It's Sexy A-Levels !)

The publishing rules are quite straightforward. Fruity girls should be front and centre. Boys should either not be shown at all, or should be relegated to the back row. Exam certificates should ideally be shown, otherwise the leapers tend to look slightly mental. Sapphic hugging is permitted, but leaping, by fruity girls, is undoubtedly preferable. This image from The Guardian, for example, breaks all the rules, and you can tell:

So much for an examination system that awards a pass to 97.8% of its candidates, or the quality of which can be affirmed when the CBI points out that 22% of businesses are forced to provide school and college leavers with remedial English lessons.

But the A-Level system is just one of the more overt examples of 'juking the stats'. When it comes to the financial system and economic reporting, government is the very nonpareil. John Williams' widely followed ShadowStats gives some examples of how US economic data has been manipulated over recent years:

- During the Kennedy administration, unemployment was redefined with the concept of "discouraged workers" so that the unemployment rate fell;

- If Lyndon Johnson didn't like the growth that was going to be reported in the GNP, he sent it back to the Commerce Department, and he kept doing so until Commerce got it right. The Johnson administration was also responsible for gimmicking the accounting that hides most of the federal deficit;

- The Carter administration was caught deliberately understating inflation;

- As former Labour Secretary Bob Reich explained in his memoirs, the Clinton administration had found in its public polling that if the government inflated economic reporting, enough people would believe it to swing a close election. Accordingly, whatever integrity had survived in the economic reporting system disappeared during the Clinton years. Unemployment was redefined to eliminate five million discouraged workers and to lower the unemployment rate; methodologies were changed to reduce poverty reporting, to reduce reported CPI inflation, to inflate reported GDP growth;

- The second Bush administration expanded upon the Clinton era initiatives, particularly in setting the stage for the adoption of a new and lower-inflation CPI and in further redefining the GDP and the concept of seasonal adjustment..

And when manipulated economic data can no longer hide the truth from the investing public, the next step is to prohibit any form of expression of trading negativity (i.e. short selling), or better yet, to propose taxing the business of trading altogether. So in response to a systemic crisis of confidence in the debt dynamics and political leadership of the euro zone, French President Sarkozy and German Chancellor Merkel propose a Tobin Tax on financial transactions that would mostly affect the UK, which isn't even a euro zone member, but which does happen to be the financial centre of Europe.

The financial media are proposing a wide variety of theories to account for the latest eruption of nervousness in the markets. We think the fundamental reasons are quite easy to articulate. That which is unsustainable by definition cannot indefinitely last. What cannot be paid back will not be paid back, whether it is Greek debt, Irish debt, or US debt. With every data release – no matter how 'juked' by the statisticians – it becomes more painfully obvious that the developed economies of the West will not be able to generate sufficient economic growth to service their accumulated debts ***and*** maintain generous welfare provisions, so something will have to give. Possibly both. Desperate administrations are responding to this end-of-empire moment by ever more desperate attempts to reflate, primarily by the politically expedient route of money printing. Forty years after President Nixon took the US dollar off gold, the marginal investor is increasingly keen on getting back on, because gold is the last true haven against currency debauchery. A debt-based monetary system cannot survive widespread default, at least by conventional means (repudiation), so bond market investors in fundamentally less creditworthy sovereign markets will have their wealth appropriated by inflation instead. Investors flocking into conventional Gilts and US Treasuries are going to be horribly burned; it is only a question of when.

There are two epic historic precedents for the crisis we now face. One of them is the 1930s Great Depression in the US, the other is the post-bubble recession / depression endured by Japan over the last two decades. After both instances, there are reasons to believe that the duration of these crises might have been shortened if the authorities had allowed the free market to operate, rather than resorting to the sort of stimulus that allows zombie companies and banks to shuffle on, consuming taxpayers' capital in the process. It is abundantly clear that the western monetary authorities are now pushing on a string: if people don't want to borrow, reducing the cost of borrowing to the zero bound just distorts the capital structure and sends wholly the wrong signals to the market. (It also starts putting the foundations in place for the next financial crisis.) At the same time savers are impoverished through zero deposit rates and increasingly uncomfortable levels of price inflation, and search in desperation for somewhere other than cash deposits as a store of value (which brings us to gold, again).

The recession (which we would otherwise suggest we are re-entering, but which we suspect we never really left in the first place) is not responding to 'conventional' stimulus ***because it is not a conventional business cycle recession***. In the words of Richard Koo it is a balance sheet recession: the private sector is deleveraging even with interest rates at zero. And as Felix Zulauf has rightly observed, confidence in currencies, policy makers and central banks is going down the drain.

If Japan does prove to be the yardstick, both US Treasury and Gilt yields will probably go much lower than their already pitiful current levels. That does not mean that you should join the sheeple crowding into them, because many of them are economic agents not necessarily buying for price or return-sensitive reasons – giant sovereign wealth funds, for example, for whom liquidity trumps everything. But in the midst of a global balance sheet recession, it does not automatically make sense to buy equity market dips, as investors over the last half century have been conditioned to behave. Capital preservation for the rational investor trumps everything else. Having some dry powder while the global financial system recalibrates itself does not seem like a terrible policy.

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