

BY RICHARD "JERRY" HAWORTH

---

## Central Banks... your frenemy

Politicians wax lyrical about how they desperately need money for critical spending. Nothing has changed over the millennia.

Over the last 30 years, USA has borrowed a seemingly ludicrous amount of money to fund "necessary" spending. They are not alone. Nearly all governments of all countries in the world have followed suit.

Having spent more than they receive in taxes (in simple terms), they finance the overspend by issuing bonds at an interest rate the market will bear.

Central banks play a pivotal role in aiding and abetting this spending by facilitating the financing, by artificially keeping interest rates low and in extremis buying the bonds themselves.

It all works fine and can carry on ad infinitum until... inflation pops its head up.

Which it has done.

Now central banks have reached an interesting juncture.

They have been your investment "friend" for many years, but there is a case that they will turn into your investment enemy.

Why?

They have reached/are near a logical limit as to how low they can keep interest rates with persistent inflation. They are selling, not buying, government bonds.

Governments, the profligate twin, have seemingly reached a limit as to how much more they can borrow and central banks, as to how much more they can monetize i.e. print without risking serious inflation.

Create too much inflation, interest rates will rise which will increase their cost of borrowing, making their debt situation even worse.

At the same time, crypto, private credit and the equity market etc., all of which are booming, are competing for the private and institutional savings. This leaves less available to finance the bond market which by the law of supply and demand (in the absence of QE), would cause yields to rise, making their situation even more intolerable.

Their "go to" is to grow the economy via fiscal stimulus, thus alleviating their dilemma, but the real economy is stalling, leaving only a few pockets of high growth like AI to do all the running. This doesn't really help their cause.

Why will they become your investment enemy? They need a crisis.

A crisis will lower their cost of debt servicing, allowing them to maintain the current level of spending.

A crisis will make the alternative investment pools look so unattractive that government bonds will seem a rational choice.

There is a clear motivation and incentive to create an investment crisis but the question is ... will they?

It takes a very cynical mind to envisage a government that doesn't have the man in the street's interest at heart, but when times get tough, it is everyone for themselves.

They might not even have to actively promote a crisis. All that is required is to let smoldering crisis embers burn and metastasize into a fully-fledged forest fire and then woefully cry, "Who knew?" like in 2008.

There are a few embers lying around the investment forest floor. . . . smaller banks, geopolitics, nosebleed valuations of highly concentrated stocks, climate related natural disasters. . . . and the most probable being something that isn't even on the radar yet. . .

It is ironic that governments spend their whole time talking about the fight against deflation but, in the short to medium term, it is exactly what they need.

Japan being a poster boy. . . they are ready to declare victory against deflation but are they ready for inflation and rising cost of debt servicing due to rising yields?.... nope.

They may be wise and use that wisdom to be our friend. . .or they may use it to be our enemy.

They will only be our friend if it is in their best interests. It is increasingly looking like it is not.

Or maybe I am overthinking it. Maybe they are just not that savvy. They spawn crises by their mere existence, their collective wishful thinking, their delusion and their excesses.

Maybe they do not expect a crisis even though history has a 100% track record of looming disaster on this current path of debt accumulation.

Does it even matter how aware they are?

We will have to endure the consequences just the same.

Who knew?

## **Disclosure**

Nothing in this document should be taken as investment advice, or an invitation to invest in any particular strategy or product.

Unless otherwise stated, all commentary and views expressed in this document are solely the opinions of 36 South Capital Advisors LLP. Any facts and figures in this document have been sourced through independent reading and research, and have not been independently checked and audited. We make no representation as to their accuracy.

36 South Capital Advisors LLP is authorised and regulated by the Financial Conduct Authority (FRN: 477881).