MONTHLY BAROMETER
PRESCIENT & SUCCINCT ANALYSIS OF WHAT'S OUT THERE

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- Yet again the IMF global economic for 2016 have been revised downwards by 0.2 percentage points - to 3.2%. Global growth remains weak and uneven, beset by financial, geopolitical and political risks. The best-performing economies, like the US, are growing at stall speed (0.5% in Q1), while the global economy is "faltering from too slow growth for too long" (IMF). In short: **global growth continues to lose momentum, with weak pricing pressures signalling poor world demand.**
- **BUT the Chinese reflation trick**, spurred by its massive fiscal and monetary stimulus, **has worked. It has succeeded in stabilizing economic activity and the markets,** buying time for China and the rest of the world. Much of the recent improvements, from the recovery in global manufacturing to better credit conditions or the frenzy in commodity futures, is almost entirely attributable to the Chinese stimulus.
- **HOWEVER**, this can only last for a few more months. **The Chinese recovery is fuelled by debt** (standing at more than 280% of GDP and with as much as $1.3 trillion in non-performing loans)**, rising faster than ever** at a time when it takes more than 5 yuans of new credit to produce a yuan of new GDP (put another way: new investments are increasingly inefficient). At best and helped by strong central control, the Chinese economy will slow sharply over the next few years, without triggering a crisis. At worst, it will decelerate abruptly and in a chaotic manner, triggering a global financial crisis. It's impossible to tell which will occur.
- After Obama's remark that if it left the EU Britain would find itself "at the back of the queue" for a trade deal, the implied probability of a Brexit dropped below 40%. Yet, the risk still looms large. Were it to happen, what would be the main consequences? (1) A market meltdown would unfold on June 24th; (2) Scotland's first minister would reveal her intention to push for a 2nd referendum on Scottish independence; (3) The Tories would call for a leadership election; (4) The two key promises of the "Leave" campaign – to control immigration while continuing free trade with the EU - would prove incompatible because the EU's internal market is founded upon the free movement of goods, capital, services and people; making it impossible to reach a Swiss or Norwegian-style deal. **A protracted period of radical uncertainty would ensue.**
- While a Brexit would be a net negative for the UK, it wouldn't have to be for the rest of Europe. We take odds with the consensus among pundits that a UK departure from the EU would trigger the unravelling of the European project. The exact opposite might happen. As the past five years have shown, **Europe gets its acts together and moves forward only when it finds itself in the midst of an existential crisis.** Staring at implosion may be the best antidote against implosion…
- The revelations contained in the Panama Papers will accelerate the **G20 move towards forced transparency** and the **efforts of governments around the world to curb what they perceive as corporate tax avoidance**. The US government backlash against tax inversion, the EU proposal to require global companies to report their tax-relevant information on each of the countries in which they operate (thus preventing them from shifting profits to lower tax jurisdictions) or Indonesia's crackdown on US tech companies that it accuses of not paying taxes in full, are all parts of a similar pattern. The Panama Papers will give rise to further societal risks by stoking the polarization between the have-lots and the have-less, and by further eroding trust between the elites and the "rest".
- With the benefit of hindsight, it comes as no surprise that **the risk of populism is now greater in the US and the UK than in continental Europe** (where the ascent of populism remains contained and as yet with no bearing on policy). The toxic combination of rising inequalities, stagnating real wages and shattered expectations was bound to affect the countries that tilt towards *laissez-faire* in the complex trade-off between efficiency and fairness. For investors and business executives, it means that whoever wins the next elections in the US and the UK there'll be more taxes, regulation, public intervention and distrust of globalisation and less free trade, freedom of movement and immigration.
- In The Third Wave (just published), Steve Case offers a contrarian insight that is worth pondering for those who invest in tech (and beyond!): in the future **governments will play an increasing role**, so "if you can't figure out how to work with government you're likely not going to be a successful Third Wave entrepreneur." It's fashionable among investors and geeks alike to deride the public sector and the role of governments, but as Case points out, **they will become ever more critical to business, as a regulator of course, but also as a customer**. The recent misfortune of many hedge funds who had bought into Allergan planned $160 billion takeover from Pfizer and were subsequently knocked by the US government crackdown on inversion tax deals epitomizes this point.
- For the first time ever, the US cyber force command (which comprises 5,000 people) has been publicly instructed by the US secretary of defence to carry out a cyber attack on ISIS. This constitutes **a critical milestone in the "normalisation" of cyber warfare.** Apart from the six "cyber-superpowers" (the US, the UK, China, Russia, Israel and Iran), experts estimate that more than 100 countries are now capable of conducting cyber-warfare operations. This raises huge moral, ethical and legal issues, as there are currently no rules of engagement and no clear demarcation between what constitutes warfare and what is merely crime. In the case of Iran, for example, it is feared that it may come to terms with the death of its nuclear ambitions by resorting to cyber as a new arsenal with which to threaten its adversaries.
- In the coming weeks, "must-watch" issues include: (1) a possible Brexit (June 23rd) and renewed concerns about a Grexit (€4.3bn due in July), (2) China, that remains at the epicentre of global economic and financial stress; (3) continued pressure on overleveraged EM, particularly their hard currency debt that has risen by a few percentage points of GDP due to exchange-rate depreciation; (4) the extent to which structurally lower commodity prices will affect the 67 EM resource-rich countries (from Venezuela, on the verge of collapse, to the sharp deceleration of growth and fiscal stress in the Gulf Cooperation Council) and banks, (5) the vast array of growing geopolitical and societal risks. **For real-time and in-depth analysis on any of these, or if you are interested in prediction markets to better forecast some of the risks, please contact us.**