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

July 2016

- **The "risky trinity"** (in the words of the BIS) of (1) unusually low productivity growth, (2) historically high global debt levels and (3) remarkably narrow room for policy manoeuver explains why **ultra-low interest rates, a symptom of apprehension about the future, are likely to persist**. This economic apprehension is exacerbated by a spate of non-economic fears about terrorism, resurgent nationalism, populism, a lawless world and so on. These dampen appetite for consumption and investment in a way that financial markets and economic models underestimate.
- **The global recovery is tepid and sluggish, but unlikely to grind to a halt**. In the economy that matters the most - the US - the downside economic risks are on the decline, with an improving labour market and inflation moving towards the 2% target. A Fed hike before the end of the year is now probable.
- Brexit is proving to be very disruptive for Britain, while having little impact on the rest of the world (for now). It will not scupper, as some feared, the tepid global recovery: the much trumpeted fears of contagion are constrained by the relative size of the UK economy (2.3% of the world). By contrast, most UK indicators are flashing red - both consumer confidence and business sentiment have fallen sharply since last month, while the composite PMI (output index) just dropped below 50 – the contraction level. Far from quelling discontent, the referendum has done just the opposite, **heralding the beginning of a painful process of negotiations, economic reversal and political turmoil.**
- In the Anglo-Saxon world, the credo of fiscal austerity is, or will soon become, a thing of the past. Whether it's Hillary Clinton, Donald Trump, Justin Trudeau in Canada or Theresa May's government in the UK**, fiscal stimuli - notably through infrastructure spending – are in the offing**. If this happens in unison and in a sizeable manner, it will boost global growth and will push up inflation expectations.
- A corollary of the point above is this: **in the two bastions of free-markets (the US and the UK), laissez-faire is irrevocably losing ground**. Whether it is Trump, Clinton or May, more government intervention to address inequalities and tackle vested interests, as well as a tougher attitude vis-à-vis the financial sector and rent-seeking, are a given and part of a global trend. Investors and business executives must prepare for the fact that **they will pay more taxes and that governments will become more intrusive**.
- For the past 18 months, world trade volumes have plateaued – an unusual occurrence normally associated with a global recession. The reasons are multiple, but one dominates: governments engaging in zero-sum commercial policies to capture market share from rivals. **Evidence of rising protectionism is everywhere**, impacting business and investment decisions. Already, some global companies such as GE declare that they will favour a strategy of localisation over that of globalisation. The bottom line for investors: **in the coming era of mercantilism, FDI will progressively substitute for trade** in a more fragmented market in which the competitive landscape will become increasingly biased against foreign companies.
- The Italian banking sector, saddled with €360bn of non-performing loans (roughly a fifth of GDP), is in bad shape, but the gravity of the problem is overblown by those in the international media and the investment community who describe it as a "more dangerous financial menace than Brexit". **The undergoing combination of triage, restructuring and recapitalization will ensure that by early 2017 the problem is under control**, and does not pose a risk of systemic fragility and possible contagion.
- The failed coup in Turkey is an unmitigated negative shock to the international system and the country itself. (1) It enables Erdogan to undermine democracy still further, and possibly even to reverse it. (2) With the purge of 60,000 academics, teachers, judges, journalists, civil servants, and of course security forces, the social fabric of the country is at risk of disintegration. (3) NATO and the west are at risk of losing a key ally and a pivotal country in a volatile region. **It's hard not to make the case that more chaos and conflict will ensue.**
- In the flurry of geopolitical concerns engulfing the world, **tensions in the South East China Sea stand above the rest**. The risk will increase: the peaceful rise of a global power is an extremely rare occurrence in history, and admonishing the Chinese to respect the international rule of law will be counter-productive.
- If it is proven that Russia is behind the leak of emails embarrassing Hillary Clinton and the Democratic party leadership, it will illustrate once again that **cyber warfare is now blurring the distinction between war and peace**. This particular case may seem benign, but such attacks, apart from attempting to influence an election outcome, generate long-term toxicity by undermining citizens' confidence in their own institutions and their political leadership.
- An insight from Richard Edelman, the CEO of a US PR company, sheds much light on how opinions are formed **in the age of social media** and why **facts no longer win arguments**. One of his firm's findings is that a "person like me" (e.g. a Facebook friend among the 1.7 billion regular users), is perceived to be a more credible source of information than a government leader or an authoritative person. In Edelman's words, we are now entering "a world of self-reference". Phenomena as diverse as the "Leave campaign" for the UK referendum, populism's growing appeal, or climate change's denial, tell us that **in the digital age of "information cascade", truth and facts can be, and often are, disregarded**. Social networks give us what we want to believe.
- In the coming weeks, "must-watch" issues include: (1) whether the data corroborates the US economy improved performance, and the impact on US interest rates, (2) how China deals with excessive indebtedness, and the policy - political tensions this creates; (3) continued pressure on overleveraged EM; (4) the impact of the renewed weakness in oil prices on resource-rich countries, (5) whether Japan and the Eurozone succeed in shoring up inflation expectations, (6) the vast array of growing, market-moving, geopolitical and societal risks, with a focus on the spate of "lone wolf" (most likely a misnomer) attacks / terrorism. It is uncanny that markets can remain so calm with so much uncertainty accumulating! **For real-time and in-depth analysis on any of these, please contact us.**