

- Just how bad was 2016? We won't know until we can compare it to 2017! **Despite the reality of better global living standards than ever before, today's world** (particularly in the West) **is suffering from a prevailing sense of angst and frustration.** Globally the Chinese are the least gloomy: 41% of them think that the world is getting better. However, in Saudi Arabia, the US, Germany and France (the most pessimistic country), the downbeat numbers are respectively 16%, 6%, 4% and 3%. What explains this disconnect between what so many of us think about the state of the World and the reality? It goes beyond the endemic negativity bias that plagues us all: our perceptions are shaped by **expectations**, which increase in proportion to our living standards. In addition, computing the improvement "on average" is meaningless for those whose expectations have been shattered by stagnant real incomes and a growing sense of unfairness. In politics, like in economics and finance, everything that matters takes place at the margins.
- After years of monetary easing and ultra-low interest rates, monetary policy has ceased to be the only "game in town". This, combined with the anticipation of fiscal activism, is pushing **yields and inflation higher.** The fundamental question is: by how much will interest rates rise? As US interest rates creep higher, others will follow. However, **powerful structural factors will continue to exercise downward pressure on global yields:** ageing, rising inequalities, low productivity growth, concerns about what the future holds and the concomitant rise in savings, etc. The conclusion: **yields will rise, but historically low interest rates will persist.**
- In the coming months, **the dollar strength will be one of the dominant "economy stories", with far-reaching global implications.** At a macro level, it will put renewed pressure on overleveraged EM with high levels of dollar-denominated debt that rely on volatile capital flows for their financing needs. At a micro level, it will make life for US exporters more difficult, and conversely favour European and Japanese exports. It will also complicate China's economic policy by endangering the authorities' efforts to stabilize the yuan exchange rate, possibly forcing them to tighten monetary policy at a time when the debt to GDP ratio is at a record high (250%). **Default risks will consequently rise.** Fitch estimates that Chinese non-performing loans (NPL) stand at 15-21%, versus an official number of 2%. These tensions are exacerbated by capital outflows, which totaled USD530bn in the first ten months of 2016.
- Despite recent improvements in the economic data, **US GDP growth will disappoint by remaining subdued:** in the 2% range - well below the 3-4% annualized economic expansion promised by Donald Trump during his campaign. The key reasons are twofold: (1) barring a technological miracle, productivity growth will remain weak; (2) so will the growth in the labour force, particularly if immigration becomes more restrictive.
- There are multiple uncertainties regarding Trump's precise plans, but **his future policy stance over trade constitutes by far the single largest risk to the global economy.** More generally, increased populism around the world and mounting scepticism towards free trade pose a threat to global economic growth. Free trade doesn't benefit everyone and creates disruptive asymmetries in advanced economies, but if the risk of greater protectionism materializes in a substantial manner over the course of 2017, **there will only be losers – no winners.** If mercantilism (the idea that global trade is a 0-sum game) prevails, the universe of investible stocks will shrink to companies focused on domestic consumption in large, closed economies.
- If there is just one lesson to be learnt from Yahoo's cyber debacle (more than 1bn accounts were compromised in the largest data breach in history), it is this: **don't skimp on cyber-security.** The necessity of this simple rule is made even more acute by the changing nature of cyber mischief making: it's no longer just about subtraction, but also about addition... Until recently, we only had to worry about information being removed from our computer, but increasingly, compromising material (like child pornography) can be planted in a victim's computer. Old-style *kompromat* updated for the digital age is back with a vengeance.
- **AI (Artificial Intelligence) and DNA editing** (the possibility to alter the natural world) **are the two transformative, fast-progressing technologies that will revolutionize the next few years.** They'll bring many good things - fewer diseases and "cool" tools rendering our lives easier, healthier and possibly more productive, but they will also raise fundamental issues. In the case of AI, it is the spectre of rising technological unemployment: labour-substitution effects will eventually replace lost jobs with new ones but with a time lag. As for DNA editing, manufacturing life will prove to be a salvation as much as a hazard: apart from some intractable ethical issues, it comes with mind-boggling risks of errors and manipulation.
- The upcoming inauguration in Seattle of Amazon.go - the first grocery store with no cashiers and no checkout lines - epitomises the above point regarding automation and jobs. In the US alone, there are currently 3.4m cashiers, 4.5m retail salespeople and a further 2.4m workers who restock and move cargo around. Not all will lose their jobs and many will transition to a new profession, but the concurrent uncertainty leaves more than 10m people in just one industry fearful about their professional future. Inevitably these new job-swallowing technologies (e.g. automated supermarkets, driverless trucks or delivery drones) will create anxiety and exacerbate inequalities – fertile ground for populism. To contain this trend, the "winners" from globalization and technology need to compensate the "losers". **Making this happen will dominate the political and economic agenda in 2017. More income redistribution is therefore a given, hence more taxes and greater regulation.**
- In the coming weeks, **"must-watch" issues include:** (1) what President Trump does and does not do – particularly in terms of his infrastructure plans, trade and fiscal expansion, (2) the way in which US – China relations evolve: a radical uncertainty and a key risk to global economic and geopolitical stability; (3) China, that remains at the epicentre of global economic and financial stress, and whose corporate debt woes continue to grow; (4) the extent to which the USD strength will affect countries (in particular overleveraged EM) and companies; (5) the vast array of growing geopolitical and societal risks, with a focus on rising populism (a source of policy unpredictability), and Russia / Western relations. **For real-time / in-depth analysis on any of these, please contact us.**