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

March 2017

- As in February, robust data continues to support the global synchronized economic recovery. A rise in global trade is taking hold (in volume terms, it just reached a 7-year high), with PMI / manufacturing activity above trend. So is consumer confidence, lifting animal spirits. This said, **the rise of global populism and the policy uncertainty it entails means that "fat" tail risks abound**. For reasons we expand below, we believe that negative tail risks events are likely in the US while positive tail-risk events are more likely in the Eurozone. The fate of emerging markets (EM) much depends on what will happen in the US and China.
- The global benchmark 10-y US Treasury bonds currently yield 2.5%. With US core inflation now rising at a 2.8% annual rate and 5-y inflation expectations of a similar magnitude, they should be at 4%+. Structural deflationary pressures (ageing, tech) and sustained demand for USD assets explain this pressure on yields, but **unless interest rates return gradually to "more" normal levels, they could spark a violent shock.**
- We haven't found anybody able to explain to us how Trump's first budget blueprint has the capacity to buck the declining trend in US growth rates. **Following a short cyclical upswing (if at all), it would leave the economy stagnating at 1+% yearly growth.** The rolling back of decades of social democracy combined with the "deconstruction of the administrative state" advocated by Bannon would devastate the most vulnerable communities, sapping the country's lifeblood. The budget blueprint will never be accepted in its current form but it is indicative of Trump's modus operandi. After the health care legislation debacle, investors may start doubting the reality of tax reform and infrastructure investment. **Soon, the market will give up on the Trump reflation trade.**
- **Despite having a higher GDP / capita than most other rich countries, the US has a lower life expectancy and a much sicker population**. To a significant extent, "death of despair" accounts for this discrepancy. The increase in "white" deaths caused by suicide, drugs and other addictions is a trend unique to the US. It points to an economic and social dislocation of such proportions that some US pundits now claim that inequalities and accumulating despair among the white working class threaten the very existence of the "American republic".
- The recently released Global Happiness Report sheds some interesting light on why our obsessive focus on GDP growth may be so misplaced. The six European nations that rank the highest in terms of happiness lag behind the rest of the world in terms of GDP growth. Similarly, countries that rank the highest in terms of GDP growth lag behind in terms of happiness (China ranks 79th). The reason is this: once a certain level of wealth is achieved in GDP/capita terms, happiness levels depend less on growth and more on intangible factors such as accessible health care, a robust social fabric, generosity, freedom etc. **Sooner or later, the "tyranny of growth" will come to an end. Then, many of our social norms are set to change.** Values as different as empathy, responsible eating or respect for the environment will become the new "cool".
- **There is scant reason to be complacent about Europe, but beware of ignoring its upside potential.** Economically, (1) growth is picking up and (2) investment is just about to do so, while (3) deflation is receding. Politically, the populist risk, while very real, is overblown by the false equivalences drawn between continental Europe and the Anglo-Saxon world. In Europe, increases in real wages, lesser inequalities and decent social safety nets act as a buffer against tail risks à la Trump. If the political centre wins the semis in France and the final in Germany (as the Dutch PM put it after his country won the quarter-finals this month), **capital will flow in, benefiting European risk assets**.
- Renewed optimism in EM is predicated on the two beliefs that: (1) Trump's threat to unstitch the US from the rest of the world is un-realizable: global supply chains are much too intertwined for protectionism to take hold; (2) China's hard landing has been averted by credit creation – leverage ratio has doubled over the past 10 years, now amounting to 300%. We concur with the former but have our doubts about the latter. Chinese credit growth is well beyond the level considered as safe. **The inevitable credit crunch** will merely delay China's rise to prominence, but it **will wreak havoc on commodity countries and exporters**.
- The British PM has just pulled the starting trigger for the 2-y process of negotiating the UK's fiendishly complex and arduous exit from the EU. The unknowns are so numerous that exactly how it will pan out is anyone's guess – but it's most likely to end painfully for the UK (or what is left of it if Scotland leaves) and a bit less so for the EU. **It is certain to squeeze British living standards as inflation rises faster than nominal wage growth** (CPI just jumped to 2.3%, Y-o-Y).
- The "winner-take-all" (or most) principle now extends beyond the individual to encompass companies, particularly in industries that are highly concentrated**. "Superstar firms" are one of the reasons behind the shrinking labour share of income** that has coincided with a sharp rise in inequality and explains much of the current malaise and popular discontent. New research shows that inequality is rising between companies, with the most successful employees clustering inside the most successful companies. The Googles of this world offer generous salaries and benefits to attract the top talent they need while outsourcing everything that is non-core. In doing so, they create a feedback loop that adds to their own momentum, leaving everybody else behind. Policies to counteract this trend (anti-trust policies and better skills in particular) are hard to implement on a global level and take time. The phenomenon will endure, fuelling **global populism**.
- The greatest cause for global concern is **what happens when a major crisis** (economic, political, security, etc.) **strikes**. The global hegemon has abdicated its role while international law, migration, trade, the internet, no longer governed by global rules, are instead being turned into instruments of conflict. The global governance vacuum is scarier than ever.
- In the coming weeks, **"must-watch" issues include**: (1) What President Trump does and does not do, particularly in trade, tax cuts, infrastructure spending and deregulation; (2) The USD strength; (3) China; (4) European forthcoming elections in France (May) and Germany (Sept.); (5) The vast array of growing geopolitical and societal risks, with a focus on global rising populism. **For real-time / in-depth analysis on any of these, please contact us.**