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

April 2017

- **The IMF global growth forecasts are on the move again, but for the first time in six years they're on the up.** They now anticipate global GDP will rise by 3.5% this year and 3.6% in 2018, the same as last October's forecast. Albeit a rather tepid performance, policy-makers are taking solace from the fact that the cyclical recovery in all the major world economies is strengthening in unison. Barring a fat tail negative shock like protectionism, there are good reasons to remain confident that **the global economy will continue to trundle along over the next year or so**, supporting risk assets.
- Will the upswing translate into sustained, long-term growth? Unlikely. The impact of structural headwinds to growth like ageing, stagnant productivity, rising inequalities and over-indebtedness are well understood. Less so is the effect that the younger generations, in particular the millennials, will have on future growth. **The trifecta of: (1) rising underemployment or unemployment, (2) rising student debt, and (3) rising property prices, makes them asset-poor and debt-rich**, the worst possible combination for spurring investment and consumption.
- If recent productivity growth had mimicked its pre-crisis trend, high-income countries would today be enjoying 5% higher output and better living standards. The burning economic question is: can technology extract the world's economy from the productivity hysteresis in which it is currently stuck? The hope is that yes: **AI will conjure a productivity breakthrough. Perhaps**, but to date it is more a source of anxiety than inspiration due to the feared effect of structural unemployment. **More business investment and trade are the solution**. According to a recent IMF paper, a 1% decrease in tariffs on inputs leads to a 2% increase in productivity, while a 1% increase in the share of migrants increases productivity by 3%.
- Globalisation is alive and kicking! Despite the wave of populism engulfing many countries in the world, and the associated protectionist rhetoric, **global trade is rising again**. The volume of world trade was 4.2% higher in February compared with last July. This notable increase could of course go into reverse if the protectionist rhetoric turns into action.
- In the US, the first 100 days of the Trump's presidency prove that **the institutional "checks and balances" perform well**. In all likelihood, the same would happen in other democratic regimes. Should the far right come to power in France or elsewhere, the system would prevent them from pushing through some of their more extreme promises and policies (like exiting the Eurozone). Populist policies are by nature unpredictable, but **the quality of democratic institutions puts a floor on the downside and imposes limits in terms of their dangers**.
- The populists have just lost in France, as they did a few months ago in Austria and the Netherlands, and as they will in Germany. Many reasons explain this divergence between continental Europe and the Anglo-Saxon world, but two stand out: (1) life, for those who are disadvantaged, is on average less precarious in the EU than it is in the US and the UK; (2) inequalities and the sentiment of unfairness are also less pronounced. Angst is not a passing phase, but **higher government expenditures** and lower economic growth **may be the price to pay to keep populism at bay**.
- In the US, **there is a perplexing disconnect between buoyant soft data** (sentiment indicators) **and disappointing hard data** (sales and investment). This paradoxical situation will only be resolved when, and most importantly if, the administration policies fulfil expectations about tax reform and deregulation. If Trump does deliver on its promises, then hard data will catch up. If he doesn't, soft data will plunge and so will the markets.
- The current **"retail apocalypse" engulfing the US** is a foretaste of things to come in the rest of the world. It offers a vivid example of the profound disruption that the internet and AI can inflict to one particular industry. This year, almost 9,000 US retail locations are expected to close, with shopping malls having a very hard time (their shares will be hammered). The transition to online shopping creates unexpected consequences and negative externalities. The most stunning example of the former is the **"personalization" of price**, now dynamically adjusted in real time (like the price of a can of soda in a vending machine depending on the weather, or the price of book depending on our web history). An example of the latter is the siege of delivery trucks choking cities with traffic. **On average, each American now generates demand for about 60 tonnes of freight per year**. This entails yearly congestion costs estimated at $28bn (17% of total US congestion costs) in wasted hours and gas. Not to mention the negative effect on air-quality.
- As trite as the observation may seem, good policy depends on sensible policy-makers, endowed with an ability to listen before making the necessary compromises that public policy always entails. **What if President Trump had a mental disposition that led to sub-optimal or just "bad" policy decisions?** This taboo subject bears a critical importance for future financial returns. Current market expectations depend on assumptions that leaders make rational decisions. They've already priced in the possibility that the US policies necessary to support the reflation trade won't be enacted. But expectations may be dampened further by the President's "irrational" or "unorthodox" behaviour, particularly in trade and foreign policy. US coal shipments caught in the crossfire of the US-Canada lumber trade war offers a good example of that.
- Over the next few weeks and months, **"must-watch" issues include**: (1) What President Trump does and does not do, particularly with regard to trade, tax cuts, infrastructure spending and deregulation – watch out for heated arguments about Trump's tax plans and protectionist policies; (2) China, where growth remains dangerously debt-dependent, although the situation will be managed until the 19th National Congress in the Autumn; (3) The second round of presidential elections in France (May 7) and Germany's forthcoming elections (Sept.). In the Eurozone, it is Italy's weaknesses of persistent low growth combined with a fragile financial sector that poses the greatest political risk (elections are due in Spring 2018); (4) The impact of rising interest rates in the US and a resulting stronger $ on emerging markets; (5) The vast array of growing geopolitical and societal risks, with a focus on the Korean peninsula and global rising populism. **For real-time / in-depth analysis on any of these, please contact us.**