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PRESCIENT & SUCCINCT ANALYSIS OF WHAT'S OUT THERE

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- **The synchronized economic recovery continues to make headway**, but the US and China, the engines that propel the global economy, are set to decelerate soon. We give below the reasons why Trump's 3% GDP target is unrealistic and why US growth is likely to disappoint. As for China, monetary tightening to contain financial excess is inevitable, lest a crisis comes first. All hopes for brisker, sustainable global growth are pinned on innovation rescuing the world from stagnation. It might but no time soon. The key reason is that today's innovations improve how we consume existing goods and services rather than producing new ones or reshaping the way we make them. **The impact on productivity is therefore limited.**
- **Macron's victory comes as a huge relief to the Eurozone, but it could be no more than a respite.** If the French president can't deliver tangible improvement in people's living standards, the populists will win the next election: the forces which propelled them in the first place (rising inequalities and deep anxiety about the future) aren't about to go away. Beyond favouring structural reforms (that only go so far in terms of growth) and hoping for a productivity boost triggered by AI, what else can be done? Although costly in terms of economic growth, inclusive welfare policies and a strong social safety net will remain the best defence against rising populism.
- **Britain's decision to leave the EU and Trump's tirades against the "old" continent will serve to make the EU stronger**, not weaker. Macron's strong espousal of the EU plus Merkel's exhortation that: "We Europeans must take our destiny into our own hands" suggest that: (1) The markets' (fading) conviction that the Eurozone or the EU will disintegrate will be proven wrong in the foreseeable future; (2) There'll be a push towards greater integration, whatever form it may take. In the end, however, EU success won't be possible without Germany making a gesture in the form of an increase in domestic wages.
- The US economy is firming but unlikely to shift into higher gear and reach 3% GDP growth. **Consumer spending picked up in April but will remain sluggish for structural reasons**. Surveys and the data are at odds: US consumers, although confident, are spending little. At 4.4%, the unemployment rate is near a 10-y low, but productivity is falling and real wages aren't rising enough. **Anxiety about a possible jobless, automated, future also prompts more saving and less spending,** a trend exacerbated by the fact that 40% of all Americans spend up to half of their income servicing their debt. This is why reluctant US personal consumption (the lion share of GDP at 70%) will continue to hold back economic growth.
- For those who invest in emerging markets, the debt restructuring imposed by the International Bank of Azerbaijan (IBA) on its creditors is both a warning and a taste of things to come. Bondholders had assumed that the country's largest bank was just "too-big-to-fail", inferring that a 6% yield on a quasi-sovereign risk was a safe bet, but IBA was the canary in the coal mine. In the coming months, **there'll be more nasty surprises for those invested in countries that suffer from lower oil revenues and currency depreciations**.
- So far, we got it wrong about rising volatility. The opposite has happened: **despite the avalanche of policy uncertainty unleashed by President Trump, market volatility is at near record lows**. Why? Leaving aside technical explanations, investors seem to underplay the relevance of political and geopolitical events in terms of future economic performance. This reasoning is flawed: economics and politics are so deeply intertwined that they can't be considered separately. As the realization that Trump's politics are harmful to the US economy kicks in, volatility will resume. Then, **the "Trump short" will become a compelling investment theme.**
- **A backlash against "big tech" and the "on-demand"** (or sharing) **economy is brewing**. The reasons are manifold, ranging from the industry's hubris to the "serfdom" status of too many employed in the gig economy, from privacy invasion to tax issues and so on. The day is nigh when the big tech executives replace the bankers as the new villains. Big tech is particularly vulnerable to image related issues: on average, 30% of its corporate earnings depend on relationships with stakeholders, from governments to activists. Therefore, **the risk that current lofty valuations will be impacted by a regulatory/societal backlash is quite considerable.**
- **The One Belt One Road (OBOR) recent high-level gathering was a celebration of China's new global influence**. The OBOR initiative, a modern version of the Silk Road, aims to invest USD1tr in infrastructure across 60 countries linking Asia, Africa and Europe. It forms the backbone of China's economic and geopolitical agenda. If it succeeds, it will draw countries and global business into China's orbit, reshaping the contours of globalization and putting an end to the era of Western-dominated ideologies and institutions. Even if the plan doesn't succeed in its entirety, partial implementation will be enough to cement China's rising influence at a time when America's is on the wane.
- Evidence that the Russian authorities did interfere in the US and French elections is incontrovertible. What remains unclear is the extent to which the practice of "weaponizing" leaks by altering and falsifying the hacked documents was used. **This makes it exceedingly difficult to dissociate what is true in a leaked document from what has been planted as disinformation**. For now the preserve of state actors, this could soon become common criminal practice targeting companies and messing-up financial markets. It's easy to imagine soon-to-be scenarios in which mixing fakes into leaks alters a business' P&L or the trading of a financial instrument.
- Over the next few weeks and months, **"must-watch" issues include**: (1) What Trump can and cannot do, in particular whether his legislative agenda can progress and the impact of some headwinds (like the FBI investigation) on US policy; (2) China, where growth remains dangerously debt-dependent (debt to GDP is at nearly 300%); watch out for signs of stress in the country's $9.7tr bond market and a crackdown on shadow banking; (3) Whether Macron succeeds in pushing forward essential labour reforms that will spur animal spirits throughout Europe; (4) The impact on emerging markets of rising US interest rates and a resulting stronger $; (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, contact us!