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

July 2017

- **The world's main economies are still growing in sync, but at a slower pace**. Next year, the slowdown will be greater than expected in the US (because of Trump's unfulfilled promises) and in the UK (due to Brexit uncertainty). The Eurozone remains one of the best performing economies, but can its (modest) growth be sustained without a strongly accommodative monetary policy? China's economy continues to surprise on the upside; paradoxically a sign of weakness as it means the authorities are underperforming in policy terms. This better-than-expected GDP performance is largely due to strong growth in coal and steel production and continuing unsustainable credit expansion - all things that the leadership wants to eliminate.

- In near-full-employment economies, the battle is raging between those who see inflation looming and those who argue that the economy is stuck in a lowflation environment. The traditionalists (who fear inflation) will lose. Leaving aside the strong structural deflationary forces (technology, ageing, inequality), there are **two economic reasons that explain why the relationship between inflation and economic slack has broken down**: (1) the world economy remains awash with the excess supply of highly fragmented global supply chains; (2) the increase in market oligopolies caused by a small number of powerful companies contributes to a decline in the workers' share of national income.

- **Oil prices** are another powerful global disinflationary force, and **a host of reasons suggest they'll be much lower for much longer**. Among them: (1) five countries having already committed to selling only electric cars in the near future (committing is not delivering but the trend is clear – there'll be more); (2) China having reached peak demand (according to the Chinese Academy of Social Sciences); (3) technological innovation permitting low-cost producers to extract ever-increasing amounts of oil.

- Nowhere is the phenomenon of market oligopolies more apparent than in the US with the dominance of "Big Tech" and in particular the "Big 5": Alphabet, Amazon, Apple, Facebook and Microsoft. A consensus on breaking them up is emerging - **not only because they restrain competition** (harming the consumer) **but also because they account for many ailments of today's economies** (making firms lazy: low rates of new business creation and low fixed capital investment). Their aggregate market cap of $3tr has fuelled the rally in the financial markets and the growth of many indices. Any move towards greater antitrust measures (like the EU imposing a $2.7bn fine on Google in June) would do the opposite: raise questions about their fat valuations and take the overall market in the opposite direction - down.

- Some pundits are now hinting that Brexit may not happen because the UK will fail to reach a trade deal with the EU. Such a scenario would be highly disruptive for the British economy and could thus swell the ranks of those wanting to reverse the decision to quit. However, **an exit from Brexit would be awfully complicated**. Britain would find itself obliged to re-accept the rules on everything it had decided to repel (free movement of workers, European Court of Justice, etc.) while having lost its seat at the EU table. **For the UK, there are currently no good options.** Its economy will slowly but relentlessly decelerate as consumers and businesses defer spending and investment decisions.

- **In south Asia and some African countries, automation and AI** (Artificial Intelligence) **could turn the demographic dividend into a societal nightmare**. The reason is "premature deindustrialisation": technological change (like robots replacing sewing machines) will negatively impact all those countries hoping to mop up manufacturing work for which China has now become too expensive. Nations like India, Pakistan and Bangladesh will find it much harder to absorb vast quantities of unskilled labour.

- New advances in AI combined with computer graphics can harness the power of voice and face-morphing technologies to produce "perfect" fake videos that will **expand the power of fake news and "weaponize" information even further**. Applications are far-reaching, ranging from political interference to stock manipulation.

- Climate change is now so much at the forefront that **companies and financial institutions could soon be compelled by regulators to divulge their exposure to climate risks**. The fact that eleven of the world's largest banks (representing $7tr under management) just committed to the UN-backed disclosure effort for information on new climate change related risks is a significant first step. The effect will be twofold: (1) pave the way for more sustainable / less carbon intensive investment alternatives; (2) exercise peer and public pressure on banks and other financial institutions that haven't yet committed to the plan.

- In the US, pets' spas in high-end resorts where dogs can attend reading sessions (!!!) and receive "blueberry facials", "mud bath treatments" and "pawicures" are expanding. A suite or a themed room costs about $200 a night (+ an extra $200 if the dog has trouble sleeping: a staff member will then sleep next to it). Leaving aside the silliness of this anthropomorphism, is it a **sign of a society dangerously prone to inequality excesses?** It finds an echo in Bill Emmott's new book. In "The Fate of The West", The Economist's former chief editor warns that moneyed elites "are the true sources of the sense of inequality that is currently threatening the openness that has enabled us in the West to flourish (…) and are the explanation for Trump, for Brexit, for Le Pen."

- Over the next few weeks and months, **"must-watch" issues include**: (1) The impact of QT (Quantitative Tightening or "balance sheet normalization" in the jargon) on the markets. Central banks worry about complacency and stretched valuations; (2) The impact of Trump's administration continued inability to deliver on the economy and the markets; (3) China's corporate debt – the major systemic risk to the global economy; (4) The USD gyrations and the wide-ranging impact of its current weakness on the global economy, from commodity prices to EM debt; (5) The vast array of growing geopolitical and societal risks, with a focus on the Korean peninsula, Venezuela and the Himalayas standoff between China and India (a reminder that China's rise to prominence will be messy). For real-time / in-depth analysis on any of these, please contact us!