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- As much of the world flirts with deflation or "lowflation", some pundits turn to Japan to claim "we can happily live with it". Their rationale: since 2009, Japan has grown by 3% per year in terms of real GDP per capita - faster than the US. Also, despite stasis and stagnation, it remains one of the world's richest, most "civilized" and organized country. **All true, but this can only last for a while**. At some stage, an adverse feedback loop makes it impossible for the governments to meet their obligations, particularly pensions and healthcare. **The major shock is no more than a generation away.**
- Structural deflationary headwinds such as ageing, globalization and rising inequalities make it possible to undertake quantitative easing (QE) on a scale unimaginable just a few years ago, without triggering inflation. **QE also alleviates the burden of sovereign indebtedness:** when a central bank purchases a sovereign bond with no intention of reselling it to the market, it receives from the Treasury interest on its bond before returning to the Treasury the profit it made from that interest income. Hey presto!
- **QE performs another trick: it transforms monetary policy into a fiscal policy tool**. By compressing interest rates and yields, it penalizes savers and pension funds – the equivalent of a tax on investors and a subsidy to borrowers. In consequence, the frontier between monetary authorities and publicly elected leaders is getting blurred. The ultimate lesson is this: in today's world, it's not the markets that call the shots - **governments reign supreme!**
- The fate of some multinationals is another sign of state supremacy. For years, the multinationals were held to be the ultimate repository of global clout and influence; but today, they often get caught in the crossfire between states. **Economic sanctions and shifting trade regimes make it difficult for large companies to navigate the tumultuous waters of the world economy**. Schlumberger is the latest company being fined for doing business with Iran. Some German companies are being hit hard by sanctions against Russia, and so on. These exogenous shocks cut into corporate profits in unexpected ways…
- **China cannot simultaneously pursue a target of 7% annual GDP growth and keep the mounting debt in check**. Premier Li's declared goal to do both is not possible: achieving growth of 7% is almost entirely dependent upon a debt increase in the form of rapid credit creation. Bringing the debt down, by contrast, is almost entirely dependent upon reigning in shadow lenders, local governments and state-owned companies, which would in turn cut a few percentage points of GDP growth. **One of the two has to give.**
- It is indisputable that the US labour market is getting stronger, with 11.5 million more people employed than five years ago and unemployment at 5.5%. However, a conundrum exists: **job growth has neither triggered growth in wages, nor growth in consumer spending**. The reason: many of the new jobs are low paying ones, due to the fact that in all developed economies **the share of labour as a percentage of national income is on a secular decrease.**
- By contrast, a modicum of nominal wage growth is starting to take place in Japan and Germany. Again, this is directly related to the very "visible hand" of their governments which are pushing hard for it (particularly PM Abe). **A global and significant increase in real wages** (between 2 and 4% depending on which country) **is the indicator to watch before deciding whether deflation will engulf the world or not**.
- Ever since the sovereign crisis erupted in 2010, we've been arguing that the Eurozone (EZ) would not be able to maintain its integrity unless the € fell to parity. We are almost there! **The € sharp depreciation, combined with the collapse in oil prices and quantitative easing has given the EZ a much welcome boost**. Is it a game-changer? No. Will it be sustained? Only if painful structural reforms are pushed through in southern Europe (that includes France). Merely starting with a "simplification shock" cutting red tape and some of the bureaucratic hydra would unleash much energy and entrepreneurial spirit.
- **The risk of Ukraine turning into a failed state in the heart of Europe is now all too real.** The country is on the verge of default while simultaneously an individual oligarch just used his private army to intimidate the state and other oligarchs. **Today's situation is reminiscent of "neo-medievalism",** with a country fragmented by overlapping authorities and multiple loyalties**.** Uncertainty and the ensuing volatility will endure because Ukraine lacks the institutions and the social capital required to stabilize the current chaos.
- Civil war in Yemen is a **proxy for the fault-lines between Shias and Sunnis and between Iran and Saudi Arabia**. The situation in the Middle East - where every country, with the exception of Oman is at conflict - evokes the 30 Years' War that devastated Europe until the treaty of Westphalia (1648), agreed out of exhaustion between the warring parties, put an end to it. At the moment Saudi Arabia is on the defensive while Iran has the upper hand, not only in Yemen, but also in Iraq, Syria and Lebanon. An Isis-provoked "accident" in Bahrain or in Saudi Arabia itself (in the Eastern province where the Shias reside and oil is extracted) would greatly exacerbate the Kingdom's feeling of encirclement and fragility - **a giant with feet of clay**.
- We often give examples of the extent to which the digital age is revolutionizing industries across the board. This includes our own… According to the CEO of Narrative Science, a 30-people company that specializes in "automated narrative generation", **90% of news will be generated by "robot-writers" by the mid 2020s,** most of it without any kind of human intervention (besides the design of the algorithm of course…). Although convinced that in the end, innovation will replace the jobs that are gone by new ones, **it's hard to dispute that in the short-term, technology will increase unemployment.**
- Our list of major "must-watch" issues for investors and decision-makers: (1) **Greece** – markets are too complacent about a possible Grexit or Greek default; (2) **growth deceleration in China**, despite more policy accommodation, and its inevitable knock-on effect; (3) **deflationary pressures not only in the Eurozone** but worldwide – 20 central banks have eased policy so far in 2015; (4) a **possible "distress loop" in the market for EM hard currency corporate bonds** – which now amounts to about $2tr**;** (5) **global geo-political turmoil**, with a focus on the proxy conflict between the Arab world and Iran, and Ukraine / Russia. For real-time or in-depth analysis on any of these, and if you are interested in prediction markets to better forecast some of the risks, please contact us.