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

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- Many pundits and investors are coming to the realization that we live in a world in which there is too much of too many things. There is too much debt of course, but also too much labour (as paradoxical as it may seem in an ageing world) and too much capital. This unholy alliance is the reason why **the next few years**, and possibly decades, **will consist of an economic environment characterized by low growth, low inflation, and as a consequence low interest rates.**
- This supply glut also applies to most commodities, ranging from cotton to iron ore. **Prices may fall further before coming back up again**. Take oil for example. The consensus in the market (with the exception of the oil majors) is that its price will go back to USD100, with a few bounces here and there. But (1) OPEC now appears impotent, (2) US shale output will soar back as soon as prices rise, and (3) both Iran and Iraq could soon also boost their output. In such conditions, a **lower oil price in the USD 40-50 range is not an outlier.** This would transform a commodity shock into a credit shock, which would then mutate into a market shock.
- If only one statement could capture the mood at the recent IMF / WB Annual Meeting, it would have to be C. Lagarde's observation that **current economic performance is "just not good enough"**. The IMF now estimates that growth in potential output in the rich world will not exceed 1.6% per year between now and 2020 (versus 2.25% before 2008). In emerging markets (EM), the deceleration will be even sharper: 5.2% per year versus 6.5% over the past 7 years.
- This IMF estimate for EM growth is over-optimistic because it does not consider the adverse feedback loop that stuttering growth generates. **First, it exacerbates governance issues; second it accelerates capital outflows**. Two different groups will be most affected: the countries where the growth in debt to GDP has been the fastest: China, Turkey, Thailand, etc.; and the countries over-reliant on commodity exports, such as Brazil, Russia, Colombia and Malaysia.
- An IMF official warning to which we ought to pay attention is that of a **"super taper tantrum".** When there is evidence that the Fed is about to raise its interest rates from the current near-zero levels, **spiking yields will wreak havoc on EM corporate debt with cascading effects in unsuspected corners of the financial world**, particularly in the non-bank sector. There will be short episodes when liquidity vanishes and volatility spikes.
- **Global central banks assets exceed USD22tr, and more than half of global government bonds yield less than 1%.** If it were not for the exceedingly easy-money policies pursued in most G-20 countries over the past few years, the global economy would be in severe depression. But such policies come with a downside, now all too apparent. **Savers are the hardest hit** – in the US alone, they are estimated to have lost USD470bn in interest rate income. More generally, (1) the search for yields and its resulting bubbles, (2) impaired credit intermediation and (3) its contribution to rising inequalities are the main unintended consequences of QE / accommodative monetary policies. **Pension funds and insurers will be forced to cut guaranteed products whose rates are way above what seems reasonable.**
- The Greek minister of finance Varoufakis had turned the game of chicken between Greece and its Eurozone partners into *Angry Birds*. He's now sidelined, but with GDP collapsing, the risk of a Greek default in the second half of the year remains all too real. **The uncertainty is now this: will a default be followed by an exit or not?** Nobody really knows. Much will be done to prevent a Grexit: it would be a calamity for Greece and a major shock for the Eurozone (the financial markets are complacent about contagion); but **should it occur, it will not destroy the monetary union, but on the contrary reinforce it.** From the perspective of policy-makers, political contagion matters more than the economic one. Syriza's failing and the ensuing pain that Greece will endure will pull the rug from under similar parties elsewhere in Europe, like Podemos in Spain.
- **The framework agreement signed on April 2 with Iran is not yet a nuclear deal, but it has the potential to entail momentous global implications**. In addition to attenuating some major geopolitical global risks (a military strike on Iranian nuclear capabilities, a possible closure of the Strait of Hormuz, etc.), these range from oil prices, which would effectively be capped at a lower level, to a détente between the US and Iran with the potential to unleash a wave of foreign direct investment and commercial activity in the *de facto* world's largest frontier market. All very bullish**! The major unknown relates to geopolitical dynamic the Middle East**: it could either precipitate a regional war, triggered by Saudi's concerns about Iranian encirclement, or progressively lead to a new regional equilibrium in which Iran peacefully dominates.
- Five years after the flash crash that caused mayhem in the equity markets, the trader suspected of causing it has been arrested. Apart from highlighting the inherent weakness of regulation in fragmented markets, the manipulation shows how **small causes can have monumental effects**. Thanks to the power of technology, in the high-frequency world, **one isolated person can unleash systemic risk**.
- Despite soaring stock markets, there is a mounting sense of uneasiness: the **pervasive feeling that the financial world is out of kilter**. A few traders and policy-makers are flagging up some of the looming risks in the credit market that are reminiscent of the subprime mortgage market before housing prices started to collapse in 2006. What are some of these big risks? (1) **US student loans** (USD1.3 trillion at the end of last year); (2) A **messy Grexit**; (3) **Oil prices falling again precipitously**; (4) a big **EM corporate** defaulting on some of its debt - like Petrobras that just put a USD2.1bn price tag on its corruption scandal.
- Apart from the credit risks above, all susceptible to cascade into market events, our list of major "must-watch" issues for investors and decision-makers: (1) **Greece's** looming default; (2) **growth deceleration in China** and its inevitable knock-on effect; (3) global **deflationary pressures;** (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; (6) **the UK general election** (May 7) and the impact of a possible "Brexit". 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.