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

June 2015

- The macro backdrop for the rest of the year is the following: (1) **lower global growth** (around 3%) than expected; (2) higher headline inflation prompted by oil base effects, but subdued core inflation; (3) sharp deceleration of growth across emerging markets (EMs); (4) weak investment in high-income countries; (5) rising risk aversion and volatility as Fed tightening looms; (6) **rising social unrest** and political backlash caused by deflating expectations and technological disruption; (7) **rising geopolitical turmoil** caused by the gradual disappearance of US hegemony and the concomitant rise of multi-polarity.
- The risk of a **global recession provoked by the sharp deceleration of growth in EMs is rising.** The reasons are twofold: (1) Two of the BRICs – together accounting for 20% of global GDP – are in recession (Brazil and Russia) while a third (China) is exporting deflation to the rest of the world as it stutters. (2) Having significantly contributed to the growth in global trade over the past 15 years, **the 17 largest EMs are now acting as a drag**, having reduced world trade values by almost 1 percentage point in Q1 of this year.
- Bill Gates argues that innovation is taking place "at its fastest rate ever." This, he predicts, will lead to a "**supply-side miracle", with deflationary consequences for the global economy**. Whether one agrees or not with this techno-optimist view, it's hard to dispute that the digital economy and the low marginal cost society it entails are, *in essence*, deflationary. **There is a growing disconnect between the financial markets and those who think long-term**. The former now believe that deflation has been averted, as evidenced by higher sovereign yields. The latter view global trends (not only technology, but also ageing and rising inequalities) as pointing to a deflationary world. **"Permanent" low interest rates are a feature of such a world.**
- Furthermore, **financial repression will keep interest rates low for longer than many think.** Governments around the world have a keen interest in favouring borrowers at the expense of savers: they are themselves over-indebted (in aggregate, more so today than in 2007), and aware that low interest rates have the dual advantage of keeping deflation at bay while allowing cheap funding of debt.
- Behind any global risk, there is a corresponding set of opportunities. Nowhere is this more evident than with climate change. A plethora of strong signals indicate that the **transition to a low-carbon economy is moving ahead at full-speed**. In particular, the rise in "Green bond" issues ($100bn this year, up from $36.6bn last year and $11bn in in 2013) is the unmistakable sign that the change is for real.
- The first six months of Tsipras' government have been an economic catastrophe: the Greeks find themselves captive of a non-functioning economy at a time when the country faces either a (1) Grexit or (2) a protracted period of confusion and deadlock. Greece's fate now depends on the referendum of July 5th. Its outcome is likely to be a "yes", followed by a new coalition or new elections. Months of convulsions and disruptions will take place before the situation "normalizes", but **the current chaos may favour the least bad outcome**: Greece remaining within the Eurozone with terms eventually renegotiated in its favour**. Amidst the maelstrom there is perhaps a silver lining….**
- Globally, there are more millionaires (14.6 million) and billionaires (about 2,000) than ever, but **conspicuous consumption is on the wane**. As J. Rupert, CEO of the Richemont Group, said: **"In the future people with money will not wish to show it"**. This trend is driven by: (1) rising inequalities and perceptions of a looming class warfare; (2) the Chinese authorities' crackdown on corruption, which has brought to an end the rise of luxury goods sales in the world's largest growth market (and accounts for most of the 8.9% drop in Swiss watch exports in May). This is structurally bearish for luxury companies that sell products (jewellery, cars, etc.) rather than "experiences".
- In NYC, London, Sydney, Vancouver, Toronto and Auckland, the Chinese are now the biggest buyers of residential real estate. This portends a much broader trend: **the absolute dominance of Western global cities**, that offer a hedge to the new global superrich, and where power and wealth cluster. In these highly sought-after locations, **the value of housing may continue to rise relentlessly**, magnifying in the process the effect of growing inequality and inequitable income distribution.
- Uber lost a legal battle in California on whether a driver is an independent contractor or an employee; while in France, violent demonstrations took place with taxis protesting against the on-demand car-service. As the sharing economy develops, such situations are bound to multiply around the world, pitting "full" employees who benefit from a proper social safety net, against those who build – by choice or necessity – a portfolio of freelance contracts. Eventually, **governments will have to develop solutions that decouple the social safety net from full-time employment**. This is likely to be a lengthy and painful process: most governments are still stuck in the industrial era, **as yet unable to rise to the challenge of a highly networked society**.
- Coordinated jihadist attacks in Tunisia, Kuwait and France to "celebrate" the 1st anniversary of the Islamic state's caliphate are a potent reminder that **no country is immune from terrorist atrocities**. There'll be more, but by now, they've become part of our societies' DNA: we are "adapting" (with security now trumping freedom…). This is why **their effects on economic and investors' sentiments are either transient or even non-existent** (with the notable exception of countries likely Tunisia, where tourism revenues that constitute 15% of GDP are bound to be hit very hard). Our attention is fixated on the jihad, but **let's not forget the multifaceted dimension of terrorism**: since 9-11, terrorist attacks in the US by anti-government and racist extremists have killed almost 50 people, twice as many as those by Islamic fundamentalists…
- In the coming weeks, "must-watch" issues include: (1) Greek referendum - what follows and the possible collateral effects in terms of contagion; (2) growth deceleration in China and its inevitable knock-on effect; (3) the combined effect of Greece and the bursting of the Chinese stock bubble on risk aversion, (4) the nervousness about the "distress loop" in EM hard currency corporate bonds that will coincide with the Fed's first rate hike, probably in September; (5) global geo-political turmoil, with a focus on tensions between Russia and the West, and Saudi Arabia / Yemen. **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.**