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

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- **The global economic outlook is becoming increasingly deflationary**. The dual collapse in commodity prices and EM currencies, combined with and caused by the sharp deceleration in China, exerts strong deflationary headwinds that affect the rest of the world. A situation compounded by such global mega trends as ageing, technological innovation and rising inequalities that are deflationary by nature. As a result **persistent global weakness is the new normal.**
- The US is a case in point. Although in better economic shape than anybody else, and with an impressive growth performance in Q2 (3.7%, Y-o-Y), its core inflation still only rose by just 0.1% in July (Y-o-Y). **US growth doesn't seem sufficient to spur inflation towards the desired 2% threshold**, and so far, tighter labour markets (the unemployment rate is now at 5.3%) hasn't triggered wage inflation. **This makes it unlikely that the Fed will raise interest rates this year**.
- Somewhat perversely, the fact that China's economic weakness has now infected the rest of the world is a clear indicator of its increasing global influence. Markets took comfort in last week's monetary measures, but **they aren't sufficient and won't prevent China falling into recession** (growth under 4%). At 282%, its debt to GDP ratio has increased by 80 percentage points between 2008 and 2014 - the surest sign of an impending, full-blown crisis. What is a likely timeframe? As Dornbusch (an economist) famously said: "In economics, things take longer to happen than you think they will, and then they happen faster than you think they could."
- **The dogma of Chinese leadership's infallibility has been shattered**. Chinese policy-makers are overwhelmed - confronted with challenges that are immense (the economic model, social policy, the environment, geopolitics, etc.) and frustratingly complex (because they all conflate and exacerbate each other). Bad news from China will proliferate in the coming weeks because the leadership can't sustain the inevitable transition from an investment to a consumption driven model while simultaneously sustaining aggregate demand.
- The RMB's devaluation, albeit tiny, has set in motion a chain reaction of dramatic falls in many EM currencies. **This puts their central banks in a bind**. They face the dilemma of either raising rates, which supports the currency but inflicts pain on aggregate demand; or let the currency depreciate, which squeezes living standards. The end-result: protracted pain in EM and slightly lower global growth.
- Market consensus and common wisdom often misread as cyclical many phenomena that in reality are structural. The pundits' frequent failure to see these turning points and the reason businesses don't adjust to the speed of change until it's too late is because **transformation is never set by incumbents** (and it is they who forge the consensus and construct the common wisdom), **but by insurgents,** whose contrarian opinions tend to be initially ignored or disregarded.
- Low oil price is one such case. Powerful arguments support the likelihood of oil prices becoming permanently low (below the $50-60 range). **On the supply side, there is simply too much oil**, with producers ferociously competing for market-share while technology continues to bring down the marginal cost of oil. **On the demand side**, **global peak oil "in demand"**, spurred by climate regulation, lesser demand etc., **could occur much faster than most analysts realize.**
- The decline of consumerism is another. In the US and Europe, **more and more 'shoppers' tend to prioritize experiences over goods**: "doing things, not buying stuff". This behavioural shift is anchored in the growing body of evidence from neuroscience showing that it is experiences, not material possessions, that make us happy. As a consequence, department stores, but also retail and most luxury, are on a declining, secular trend. The winners will be: the wellness industry, travel & tourism, food & beverage, healthcare…
- **The recent bouts of extreme volatility and overshoots in the financial markets will endure**: high frequency trading (HFT) strategies - which create herding and rippling effects - now represent a growing and significant part of the trades (more than 50% of all stock trades in the US). In this robot / algorithmic-dominated world, not only do HFT trade faster than humans, but they also create more interconnectedness and opacity by lumping different market segments together into complex trading strategies. The end-result: (1) **nobody understands how this affects the markets** (apart from provoking stampedes) and (2) **the retail investors are the losers.**
- The hack of Ashley Madison, a website for extramarital affairs, is the first ever "real" large-scale hack in terms of its direct impact on people's lives. The private details of 33 million users have been released, with momentous personal implications. Aside from the dystopian nature of the site (with 33m paying male customers and very few female ones and almost all those bogus!), there are lessons to be drawn: (1) In today's world, **hacking is a multifaceted strategy** (in this case, hackers wanted to shut the site down for "moral reasons"); and (2) **The notion that personal information can remain private is now obsolete.**
- If all the above sounds a bit gloomy (with the exception of cheap oil that will boost global growth), let's find two reasons to be cheerful! (1) It is likely that the **traditional indicators** with which we are obsessed and take at face value (like GDP) **fail to capture major improvements in productivity**, such as the increased efficiency of household production (at no cost). (2) **We underestimate the way in which online markets may yield economic benefits**. McKinsey predicts that "online talent platforms" could boost activity by $2.7tr in the next 10 years. The number is perhaps questionable, but the direction is clear!
- In the coming weeks, "must-watch" issues include: (1) revelatory signs as to whether the recent market shock was a blip or not; (2) indications that China will implement large-scale fiscal policies to stimulate consumption – or not; (3) signs that deflationary trends are not transient (with a focus on PPI and inflation expectations); (4) the impact of the sharp fall of EM currencies against the $ - almost 20 countries have had a currency depreciation of more than 3%; (5) the impact that the fall in oil prices will have on commodity exporters (from those who may collapse imminently, like Venezuela, to those who face decades of decline and instability, like in the Gulf); (6) global geo-political turmoil, with a focus on the refugee crisis in Europe **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.**