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

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- **The global economy is about to enter its "third dip"** (after the subprime and the Eurozone crises). The IMF just revised downwards its 2016 forecast for global growth to 3.4% (from 3.6%) and the World Bank to 2.9% for real GDP growth (down from 3.3%). Most likely **these figures will end up being lower**: they invariable are! If, as these institutions contend, a sustained reduction of one percentage point in growth among the BRICS reduces growth in emerging markets (EM) by 0.8 percentage points and in the world by 0.4 percentage points, **global growth in 2016 will not exceed 2.5% - at best**. There are two main reasons for this: (1) China's growth will decelerate further (below their estimate of 6%+); (2) low commodity prices will hit Brazil, Russia and South Africa harder than anticipated.
- **In 2016 all EM will come under severe stress.** Circumstances combining substantial, yet rising, capital outflows with the end of a credit binge mean that any room for manoeuver to soften the blow will be further squeezed. **The EM corporate debt denominated in USD** (4.4 trillion in total – four times higher than in 2008) **is particularly at risk.** Some of it is "camouflaged" sovereign debt: bonds that offer implicit sovereign guarantee without appearing on the governments' balance sheet. Beware of the day when bondholders call into question this implicit sovereign backing (as they did with Dubai World in 2009).
- When trying to gauge the future health of an economy, a simple rule works best: **look at what the smart local money is doing**. Entrepreneur and investor decisions as to whether to keep their capital at home or to export it abroad tell us much about the direction in which a country's economy is going. By this standard, **new figures for China are ominous**. Last year, net capital outflows amounted to USD676bn. They accelerated in the last quarter, thus it seems likely that the RMB will depreciate beyond the 6% of the past 5 months, possibly by another 10-15%.
- If this happens**, the risk of the world entering a wave of currency devaluations is bound to rise**. It will start in the economies of South-east Asia (those most exposed to the China risk: South Korea, Singapore and Taiwan) before spreading and eventually impacting the pegged currencies of the Middle East, notably the Saudi Arabian riyal. In the process, **it will exercise a deflationary effect on the global economy.**
- Albeit that concerns about China triggered the recent plunge in stock markets around the world, **the risk of real contagion tends** nonetheless **to be overblown**. Despite being a formidable and growing economic powerhouse, China "only" represents 15% of global GDP in nominal terms and 17% in PPP terms. The USD2tr that China spent last year on goods and services from the rest of the world corresponds to no more than a thirtieth of the world's GDP (USD60tr without China). **While a Chinese hard landing would reverberate around the world, it wouldn't necessarily equate to a global economic catastrophe** - unless you happen to be a resource economy, particularly in Africa, highly dependent on Chinese commodity imports.
- **It is doubtful that the fall in oil prices** (75% from peak to trough over the past 18 months) **will translate into a significant boost of global GDP growth**. This time is truly different and the rule of thumb according to which a 10% fall in oil prices boosts global growth by 0.1 – 0.5 percentage points won't apply. Three reasons why: (1) oil countries are being hit so hard that their plummeting demand (consumption and investment) is affecting the rest of the world, (2) such low oil prices are dampening animal spirits because they reflect collapsing demand and the potential risk of a global recession, (3) the risk that the fall in energy prices triggers a deflationary spiral exists.
- The IMF and the World Bank just arrived in Azerbaijan to negotiate a USD4bn emergency loan package. If agreed, **this will be the first of a series of bailouts destined to rescue a commodity-producing country from economic, financial, and possibly social, collapse**. Other candidates for a bailout include: Brazil, Ecuador, Venezuela, Nigeria and Kazakhstan (a perfect storm is brewing in Central Asia)**.**
- Over the past few weeks, several high-profile hedge funds have thrown in the towel, announcing they were redeeming funds because "it was becoming more difficult than ever to accurately forecast macro variables". It is a sign of the times that some among the most astute market participants see the world as being "un-investible". This tells us two things: (1) Non-quantifiable risks (geopolitical, societal, environmental, etc.) are growing and becoming in the process investment-relevant, rendering the task of investors increasingly difficult (since these risks cannot be priced). (2) More and more, decision-makers seem to be overwhelmed by the growing complexity of the world - **the "anxiety of impotence" was a pervasive sentiment at this year's WEF Annual Meeting in Davos**.
- The Sunnis-Shias rift is casting the Middle East into a vortex of dangerous instability and unpredictability. All of a sudden, **countries like Saudi Arabia that looked strong now seem dangerously fragile**. Its proxy conflict with Iran is likely to play out in civil wars in Iraq, Syria and Yemen. As a result, the life of OPEC as a functioning cartel is effectively at an end. The current noise about OPEC and Russia rebalancing the oil market is just that - noise…
- A disturbing manifestation of rising inequalities is **the growing disconnect between the elites and those who feel disenfranchised or dispossessed** (the large majority). The latter now reject categorically the views, ideas and solutions proposed by the former, and are turning in ever-greater numbers to populism. The risk is real and growing, but less acute in the rich world than in EM. Despite the apocalyptic stance of much of the media, the stability of the Western world is not in jeopardy. The quality of its institutions and its numerous shock absorption mechanisms act as safeguards for investors, business and society as a whole. The same cannot be said for most EM.
- In the coming weeks, "must-watch" issues include: (1) China, that remains at the epicentre of global economic and financial stress; (2) continued pressure on EM hard currency debt and its feedback loop on EM economies; (3) the impact of lower commodity prices on commodity exporters; (4) how consumption and sentiments hold in the US and the EU – the sign of whether they'll be able to resist the EM turmoil, (5) the vast array of global geopolitical and societal risks with a focus on the Middle-East and the way its troubles are spreading to Africa and Europe via the refugee crisis and terrorism. **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.**