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Global Economic Outlook – 2016 (*Dangerous*)

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Source:Forbes

So far, the first quarter of 2016 can only be described as extremely eventful and volatile. The year opened with a bang with the financial markets taking a serious nose dive (*classified as a 'hissy fit' in the financial community's current vernacular*), in January, when the Federal Reserve ("Fed") dared to raise the key lending rate in December 2015, by a mere 0.25%, from the near zero percent it had held it at for years. That severe adverse reaction of the financial markets to the raising of interest rates, coupled with the sinking economies, backed-off the Fed and the other major Central Banks ("CBs") from trying to normalize the exceptionally low rates with even fractional rate raises. In fact, the European Central Bank ("ECB") and the Bank of Japan ("BOJ") went the other way, and ushered in a policy of 'negative interest rates', while the Fed retreated to periodic vague mumblings of promised and impending rate hikes, sometime in the near future, which keeps getting pushed out further as conditions continue to worsen.

The reason for this unseemly retreat of the major CBs is the fear of imploding the asset markets they have so assiduously inflated over these past 7 years, globally, in stocks, bonds and real estate. And, without the immediate interventions, if the inflated asset markets were to implode, they would destroy the ephemeral 'wealth effect' created by them over the past years, specifically to give the impression of a targeted economic recovery that they have touted for so long. Apart from the fear of pinpricking the bubbles created by them, there is the pesky problem of the perennial weakness in the supposed economic 'recovery' that just does not want to stick and continues to make a mockery of their collective efforts.

And that circumstance, of the CBs' continued interventions to defer an ever threatening collapse of asset markets (*if that support is removed*), and the

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persistently slumping global economy that will not heal with their stimulus policies, is the defining characteristic of the first quarter of 2016.

So what is new? The new, in a now old story of constant stimulus, ultra low interest rates, asset bubbles and weak economies, is the introduction of '*the bazooka*' of boosted stimulus programs and introduction of negative rates ("NIRP") by two of the largest CBs, the ECB and the BOJ, and to a great extent China's PBOC, and the repeated admission by the head of the most powerful Central Bank in the World, Janet Yellen of the Federal Reserve, that the American economy is too weak, after almost \$4.0 Trillion stimulus over 7 years and near zero rates, to withstand a fractional interest rate hike in the face of the exceptionally weak international economic conditions that pose as strong head winds to it.

The increasing admissions of defeat (*although still cloaked as partial victories*) have come after years of flat out denials of any weakness and frequent proclamations of victory. It is the most extraordinary obfuscated admission of defeat by such a powerful body that has had, so far, its unfettered way to try to restore economic health to the American economy by any means it saw fit, and by the example of its policies, led the other global CBs to similar paths and policies, and similar or worse results.

As for Europe and Japan, the novel part of the '*bazooka*', the decision to implement negative rates - on the positive side, have had the impact of a toy pea-shooter - and on the negative side, both Europe and Japan are still slumping economically, and financial markets-wise, as much as before or worse, with the added and greater risk of '*NIRP*' that is bound to create further problems in banks.

After the sub-prime crisis triggered the most unprecedented stimulus program undertaken by the Fed, the other major CBs gladly followed, and in fact have surpassed the Fed's example and set new precedents for stimulating their economies to the point of no return, and little effect. As the CBs' increasingly desperate policy measures produce significantly diminished results, they have become more risk prone and dared to venture into unknown charted waters of overinflated balance sheets, historically record high public debt, unprecedented stimulus programs, and now to the hereto unknown territory of negative interest rates, which at first blush seem to have produced decidedly unwanted negative results of rejection by the financial markets, with the accompanying '*hissy fits*'.

So the bottom line for the global economies seems to be, so far, ongoing stimulus, and continued inflating of asset markets, even though the results have gone from dubious to downright dangerous, and the equally stubborn and relentless weakening of the global economic condition that is now readily recognized by Janet Yellen, and the Fed, as '*international head winds*'. Couple all of the above with the roiling geo-political conflicts, and what comes into view is a global geo-political economic landscape simply crowded with flocks of potentially lethal black swans.

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In our view, and in the views of the traditional perma-bears, and the rapidly growing crop of new bears, the past post 2008 crash policies of the Fed and the other CBs have greatly aggravated the damage to the economies, that had had decades of too much liquidity, leading to rampant consumption and speculation (*in the West*) and that of course leading to the building of massive overcapacity and mal-investment globally, especially in China, and that had resulted in massive debt accumulation, all of which was further aggravated by rampant greed, speculation and corruption. The fixing and correcting mechanisms that the Fed and the CBs came up with post 2008; was to bailout the worst offenders; further boost liquidity; grow the debt; try and stimulate demand where there was none; thereby preserve overcapacity; and create the “wealth effect” thereby further boost speculation and asset bubbles that are now hair-triggered to implode – minus the most expensive and most elusive of holy grails - ‘sustainable economic recovery’ for all economies, and by default, the former good times for all levels of society and not just the top percentile. In spite of spending over \$50 Trillion since then, that holy-grail has eluded almost all the CBs.

So over the past year, the major CBs, particularly, Europe’s, China’s, Japan’s and the U.S.’s Fed, have been scrambling just to prevent bubble collapses, particularly in the stock markets, which took a number of serious tumbles over the past 12 months.

The problem, as is so well known now, that the stimulus and ultra low interest rate policies that were consistently applied throughout those years and are still being stubbornly adhered to, did not trickle down and create the kind of wealth effect that had been hoped would support the ‘real economy’ of these countries, or regions, and in fact these policies exacerbated the same problems that were brewing prior to the 2008 crash.

The European stock index started its downward trajectory in early part of 2015, pressured we are sure, with the multitudes of serious economic problems creating and exacerbating plenty of old and new growing social and political problems faced today that are creating serious doubt and fear. And as can be seen by the first Chart #1, the plethora of growing problems has continued to push the stock market downward ever since. And each rally has failed to reach the previous highs, while setting lower lows.

Along the way the Euro Stoxx 600 was amply helped by the subsequent collapses in the Shanghai Index in June of 2015 (*next Chart #2*), and in August (2015) by the serious correction in the Dow Jones (*the Chart following Chart #3*). These stock markets, and Japan’s Nikkei Index, were falling from the highly elevated levels that the Fed and the other CBs had driven them to with their ultra inflative policies, to create their much ballyhooed ‘wealth effect’. With the underlying economic fundamentals consistently weakening, the markets just couldn’t hold their floating highs, particularly with the confidence in CBs waning globally.

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It took an estimated \$54 Trillion, collectively, over 7 years to boost the post crash recovery, globally, to its current anemic state, and to push the financial markets to their record highs. But it has taken less than a year to destroy Tens-of-Trillions worth of the 'wealth effect' around the World, including the expensively purchased confidence of powerful institutional investors, who had put complete faith in the ability of the CBs to cover their risk, while they gamboled gleefully in search of gobs of easy money, with the seemingly endless supply of Central Bank printed no-cost money.

Now that confidence is destroyed and there is fear in the markets. Everyday everyone is aware that the music could stop at any time and they may be left standing without a chair.

The massive correction in China in June 2015, and the persistent corrections subsequently were a reminder that even the most powerful and controlling governments cannot control levitating markets that are pushed up by easy money, and the pure speculation encouraged by that easy money. What is happening so far in four of the largest financial markets is a steady series of downward drops, followed by rallies that just don't make the previous highs, and don't last very long. This pattern 'normally' portends a significant and final correction. We say 'normally' because the CBs could again intervene massively to exacerbate and delay the inevitable, particularly as their effectiveness is not what it once used to be.



CHART #1 Source: ZeroHedge

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Chart #2

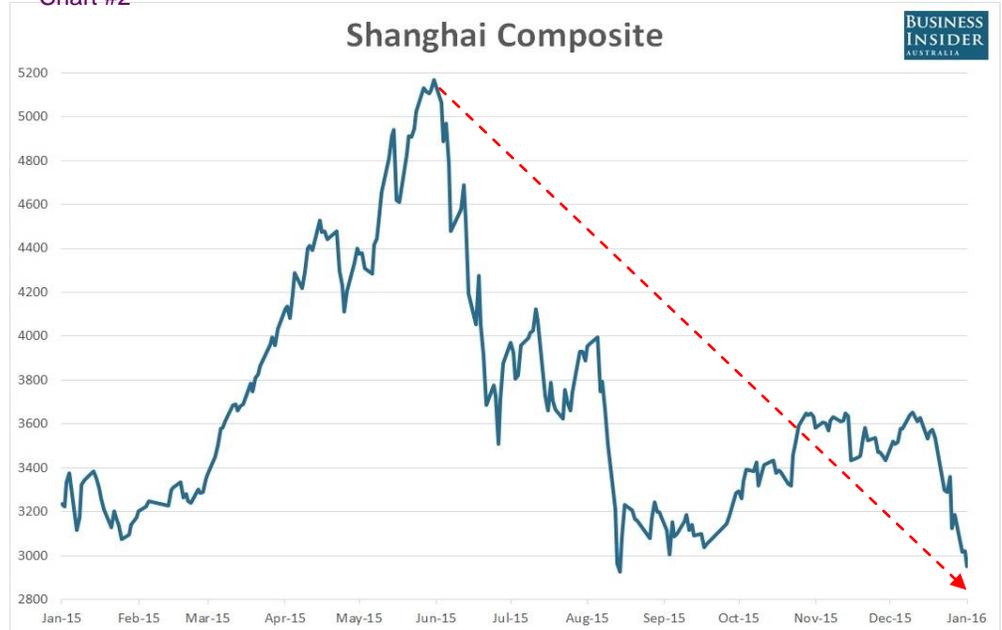


Chart #3

The Dow closed below its August 2015 closing low.



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Chart #4

Nikkei index since October 2014



Source: Bloomberg



These past three months, in the face of collapsing markets and continuously weakening economies, the Fed and the other major CBs are trying to 'talk up' and 'shore up' the markets, and the slumping sentiment, with low and negative rates, and further massive cash infusions. In the case of Europe, Japan and China active support through cash stimulus is still very much the policy. But in the gathering storm of ever greater deterioration in global economic and political conditions, and continuing slackening demand, it is inevitable corrections in financial markets, and rationalization of global overcapacity will continue.

MSCI World All-Country Index



CHART #5 Source: zero hedge

Under such conditions, 2016 looks increasingly dangerous.