

Bloody Unlikely

Stuff that's least expected to happen:

About the Euro, Congratulations are in order as its impossible to present the least likely scenario since the Europeans have got themselves into a position where anything can happen. Consensus seems to be Greece exiting the Euro, everyone else staying, Germany and France agree to closer fiscal union, the ECB being happy with this and printing their merry way into inflationary heaven. Next most likely is that the Europeans simply delay and delay and never come to any credible solution over their problem and the market throws its arms in the air and walks away. Bond yields from Germany to Greece spike and the ECB is forced into debt monetization. Least likely is Europeans miscalculating how much slack they have, some bank somewhere has lied on their stress test and defaults. The ECB steps in to bail them out but its too late because the market is doing a runner on a whole swathe of European banks. In a queueless run, cash is simply wired out of the European banking system and a whole bunch of banks become public property. The sovereigns are faced with a huge bailout bill which only more worthless paper can finance so the Euro goes into free fall and we have stagflation in Europe. Highly unlikely. The Euro breaks up but the European Union holds together. Mass nationalizations, some defaults, 7 years of famine, but a stronger more robust more efficient economy without the artificial self inflicted encumbrance of a common currency. European brands and intellectual property thrive and the region becomes an export engine of growth. Now that's what I call unlikely.

The US economy seems to be in a recovery. It has been an export led recovery and likely to persist as long as Europe doesn't deteriorate too much further. The USD needs to be weak for this to continue. Consensus is that the recovery will take hold but that it never really accelerates and we get a period of slow growth. The long shot scenario is that the muted recovery gets the housing market going. With the amount of leverage in housing, if there is the slightest recovery, with the Fed holding rates down across the yield curve and possibly buying more mortgage debt, banks may start lending to home equity again which would lead to a credit fuelled boom. Unfortunately this will likely store up more problems for the future but we are not looking that far ahead. Another low probability scenario is that the current

recovery is merely a lagged indirect effect of China's infrastructure binge on resources boosting the resource rich Americas which form the US's largest export markets and that China falters and the US economy sags back into a mire of recession and divisive politics. The Fed defaults to QE mode and the whole US economy sinks into a Japan Lost Decades scenario. Unlikely. Thin. Surely not.

China has been driving the world economy for the last 3 years on the back of its resource consumption so it is important to understand what's going to happen there. Consensus has been that China will successfully engineer a soft landing by which is meant lower inflation, circa 4%, with growth stable above 8%, widely regarded as the number that will absorb the annual cohorts joining the labour force. Until the last 2 weeks China had been tightening monetary policy and restricting credit creation to dampen asset price inflation and excess capacity accumulation in selected industries. With inflation numbers showing clear signs of slowing China has been able to lower reserve ratio requirements on their banks in a sign that either policy has worked or the economy is weaker than expected. The low probability event is that the official numbers have been fictional and the shadow banking system's debt has accumulated to breaking point, the structured credit vehicles are unable to refinance themselves and there is a sudden need for a backstop provider of credit, the central government, which puts their balance sheets into Grecian territory. The employment numbers turn out to be a lot weaker than published, held up by the counting of the unpaid and employed who have been waiting for paychecks for months, and things come to a head during the Chinese New Year when businesses fail to reopen. Very unlikely. Lehman likelihood unlikely.

Not to be morbid but we haven't had some serious global scale fisticuffs in a long time. In the last 30 years we have had plenty, and having plenty always makes everyone happy and less likely to have fisticuffs. The poor are less likely to complain about income inequality, the oppressed are less likely to complain about not having a voice, the rich are less likely to complain about taxes, exporters are less likely to complain about tariffs, etc etc etc. Unfortunately, the plenty that we had was mostly borrowed from the future. And that future, unfortunately is today, and the bailiffs are at the door. Suddenly nobody is as accommodating as they used to be. And what of the progress of the last 5 decades? Arm someone whether it be with arms or intellect and when the going gets tough, they will eventually attack

you with your own weapons. When the going gets tough, suddenly democratic elections are more closely fought, votes more equally divided, tempers more easily frayed, and dissatisfaction abounds. Fisticuffs? Unlikely, if you are given to the traditional analytical tools of having nothing but a ruler and a penchant for extrapolation. Bloody unlikely.

Economic model. Before the fall of communism we in the 'free world' were pretty clear in our minds that capitalism was the 'right' model. Its easy to identify the right model when one has a negative example. Its not so easy when one loses one's foil. Without a nemesis capitalism has veered into uncharted territory. Our efforts to save the financial system in 2008 and our ongoing efforts to keep the ship on an even keel have led to interesting socialist fixes. Yet so dire are circumstances that our entire attention is focused on dealing with symptoms rather than root causes that we have compromised our philosophy and live from day to day. What model might emerge from these crises? This is really hard to see.