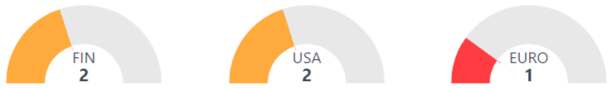
Forecasts (%)	USA	Eurozone	Finland
2020 Q1	-1.3	-3.6	-4.6
2020 Q2	-9.5	-12	-3.2
2020 Q3	7.4	12.6	2.6
2020 Q4 (nc)	0.8	-0.7	-1.4
2020	-2.6	-3.7	-6.6
2021 Q1	0.1	-0.1	1.9
2021 Q2	-0.1	-1.0	-2.1
2021 Q3	-1.1	-2.3	-2.6
2021 Q4	-1.5	-2.9	-4.2

Deprcon indexes



OUTLOOK FOR THE WORLD ECONOMY: JANUARY

Forecasts (GnS Economics, OECD, Q-to-Q): Our *nowcasts* for Q4 have continued to improve, which is indicated in the final figures for 2020. The outlook for 2021 remains bleak, however.

We are currently assuming that the European banking crisis will start between Q2 and Q3. However, as we stated earlier, if existing debt-moratoria are extended and the Recovery Fund of the EU is ratified, the onset of the banking crisis could possibly be postponed even longer.

As we warned in December, massive uncertainty lurks, haunting economic forecasting at the present time.

China stimulus: China continued to push massive amounts of debt-based stimulus into the economy in December, even though the pace fell a bit (see Figure 1). In 2020, aggregate financing of the real economy broke all previous monthly records except for last February and December. We expect debt-stimulus to have continued at a very high rate in January.

ECONOMIC INDICATORS

United States, January (December)

Richmond Fed manufacturing: 14 (19)

Empire State manufacturing; 3.5 (4.9)

Dallas Fed manufacturing: 4.6 (26.8)

Manufacturing PMI:[1] 59.1 (58.3)

Service PMI: [2] 57.5 (54.8)

US Consumer Confidence:[3] 89.3 (88.6)

China, December (November)

Caixin manufacturing PMI:[4] 53 (54.9)

Service PMI:[5] 56.3 (57.8)

Eurozone, January (December)

Manufacturing PMI:[6] 54.7 (55.2)

Service PMI:[7] 45 (46.4)

[1] Values above 50 indicate growing output, while values under 50 indicate declining output. Figures were obtained from TradingEconomics.

[2] From TradingEconomics.

[3] The Conference Board.

[4] From TradingEconomics.

[5] From TradingEconomics.

[6] From TradingEconomics.

[7] From TradingEconomics.

THE OUTLOOK

Many countries in Europe are in “full-lockdown” mode and unemployment claims once more border on 1 million in the U.S. Daily economic indicators have improved marginally from the December lows, but renewed virus fears have pushed them back down again in some countries.[8] Manufacturing continues to recover across the globe driven by massive debt-stimulus in China. While the service sector continues to recover in the U.S., the opposite is the case in Europe.

Troubles in Europe are mounting. The government of Italy fell on Tuesday. Major insurgence against the lockdowns is on its way at least in France and in the Netherlands. In Finland, opposition against the Recovery Fund of the EU is growing. If Finland rejects the package, the Fund fails and short-term uncertainty is likely to increase, possible significantly. With the political crisis in Italy, speculation about an imminent exit from the euro may start once again. This may foment volatility in the bond markets especially if the ECB takes a political role and reduces its purchases of Italian bonds. While this may sound unlikely, the ECB has in fact acted politically in the past as, for example, when it quite unexpectedly refused to increase the Emergency Liquidity Assistance to Greek banks in the summer of 2015.[9] This forced Greek banks to close their doors and presented the Government of Greece, led by PM Alexis Tsipras at the time, with the difficult choice of either accepting ever-more drastic austerity or creating a “new drachma” to support the banks. Effectively, the latter would have meant the exit of Greece from the Eurozone. We know, of course, what policy PM Tsipras eventually chose.

Chinese leadership has issued statements according to which it will keep the monetary support to the economy at “sufficient” levels. This signals that China will continue to run debt-stimulus in record volumes. Beijing has also taken a very tough stance towards bank failures with forced bailouts, mergers and takeovers. It thus seems that China will maintain domestic financial stability, while providing support for the global manufacturing sector through raw debt-stimulus in coming months.

The new administration by President Biden is committed to continue large-scale financial support programs in the U.S., especially with former Fed Chairman Janet Yellen installed at Treasury. The current Fed Chairman, Jerome Powell, has also signaled that the Fed will keep maximum support for the financial markets in place. However, the biggest short-term risk for the world economy lays in the financial markets of the U.S.. They are definitely in a bubble! For example, the yields of junk bonds have reached historical lows, even while the US is still in recession (see Figure 2 below)! This does not make any sense. Frothy valuation levels in the stock market and ridiculously inflated bond prices harbor the risk of serious correction or even catastrophic collapse, with all the negative economic consequences this implies for the highly-financialized U.S. system. This correction may already be on its way.

However, we do consider that if an asset market collapse ensues in the U.S., the Fed is likely to be able to stop it, one more time. But after the next markert bailout, the jig may be up. As we have repeatedly warned, liquidity alone cannot uphold the financial markets, especially when the real economy continues to give way beneath them.

The artificial support that governments and central banks have provided to corporations and the financial markets has made the global economy increasingly fragile. The economic body-blow delivered by the pandemic and ensuing lockdowns is likely to be realized in its entirety during the spring, when the debt moratoria finally end and fiscal support programs terminate in Europe and the U.S.. Political uncertainties are also likely to continue to increase.

So, while the next two to three months may be ‘smooth sailing’ (assuming that the financial markets do not collapse), economic prospects are likely to grow dimmer through the spring. Thus, preparedness continues be the watchword for the way forward.

[8] See Bloomberg.

[9] See, e.g. Bloomberg.

Be safe!

Appendix: Figures

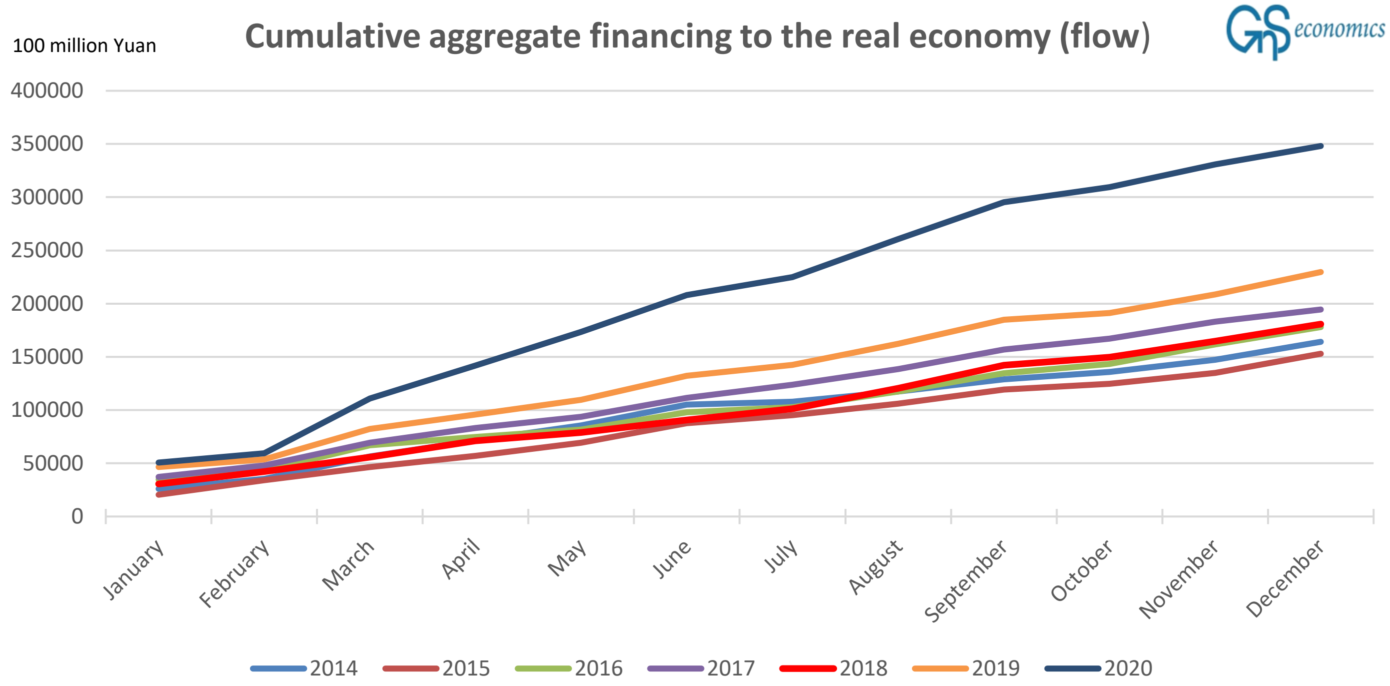


Figure 1. Yearly cumulative aggregate financing to the real economy (flow) in China. Source: GnS Economics, People's Bank of China

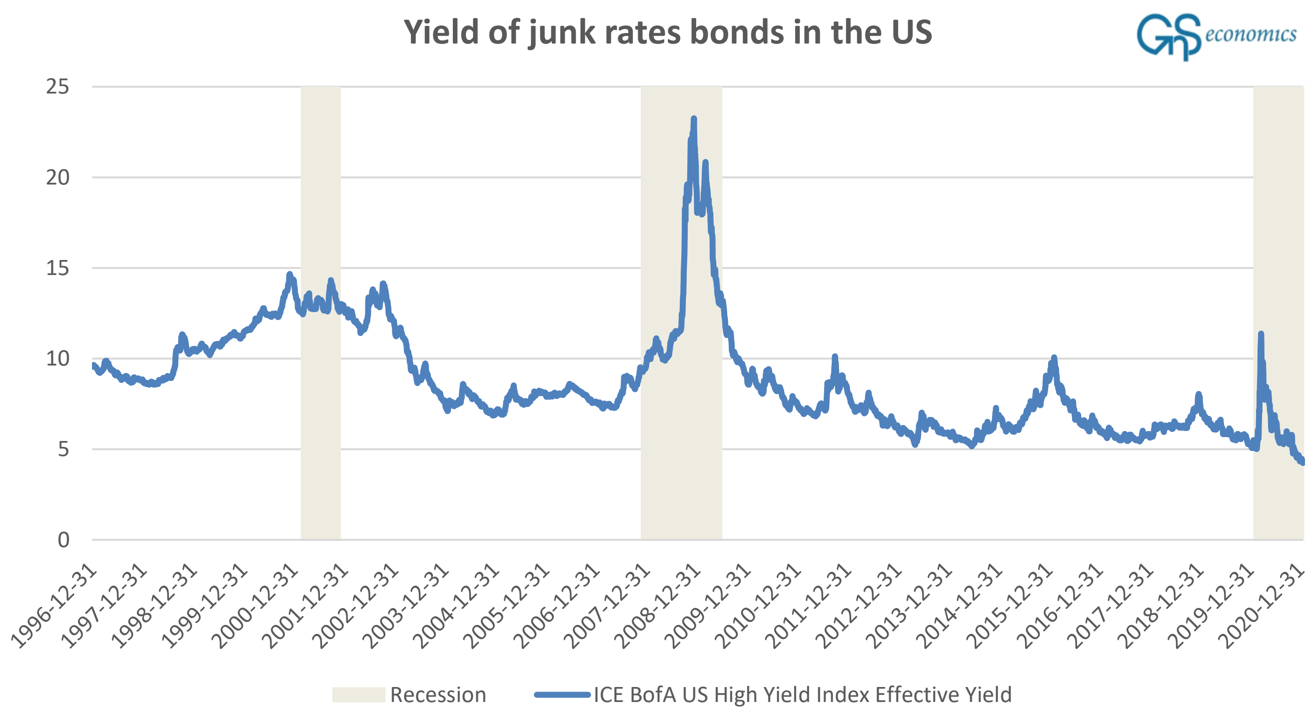


Figure 2. Effective yield of US dollar denominated below investment grade rated corporate debt. Source: GnS Economics, St. Louis Fed

Appendix: The Deprcon -index

Deprcon is a **close proximity estimate** on the outlook of the **economy** and **financial markets**. In practice it is assumed to cover the next 1-2 quarters.

Values above three indicate an economic expansion and values below three indicate a downturn. If the indicator gives a value of 3, it signals that the economy is at a turning point. Value 2 gives a recession -warning, while value 4 signals a start of an expansion. Extreme values indicate either that an economy is in danger of overheating (5) or that is heading to a recession/depression (1).

We construct the estimate using information on the stock market, financial markets and our recession and crisis probability forecasts. This means that even if an economy is growing strongly, our outlook for it may be negative if recession and/or crisis probabilities are high.

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