

## WORLD ECONOMIC OUTLOOK

### Hughes Economics – September 2020

In a previous WEO, 4 scenarios were outlined for the future world economy in the face of the Covid-19 outbreak. These scenarios with their probabilities were:

- Bath-Tub recovery: prolonged unemployment and slow growth – 0.043 probability or 5%
- V-shaped recovery: fast return to pre-Covid-19 activity levels – 0.043 probability or 5%
- U-shaped recovery: only a few months of reduced activity, then normality – 0.306 probability or 30%
- New Normal: slow, steady growth from now on but with some reversals – 0.608 probability or 60%

The V-recovery now appears a non-starter in view of continued virus trends. The hospitality sectors world-wide appear under great stress ruling out a quick return to pre-virus GDP levels in most countries. The US Fed does not appear to have any radical strategy for recovery and quite possibly monetary policy in any one country is not up to the task, although the US is the world's largest economy. The presidential election may resolve the lack in leadership and reduce uncertainty, but this is 2 months away. The Fed's stated policy is to maintain a low interest rate environment for the foreseeable future. At the same time it wishes to promote a higher inflation rate (incompatible?) perhaps to inflate away current debt levels. Something like another Marshall Plan (post WW 2) does not appear conceivable at this point, but it would certainly be a confidence boost to the world economy. Perhaps encouraging Germany and Japan to support any such US initiative, although they have their own plans for a return to normality. China's Belt and Road Initiative now appears a tailor-made solution for the world's current predicament. Taking all news to date, we conclude that the New Normal will hold from this point on and turn our focus to financial markets. Three scenarios are postulated:

- TINA – there is no alternative: Markets move higher with a Dow of 30,000+ and no major moves in the gold price within a range of \$1900 - \$2000 per ounce.
- BB – bubble bursts: Market correction in the range of a 10% - 30% fall with the Dow in the range of 20,000 – 25,000 and gold in the \$2000 - \$3000 per ounce range or possibly higher.
- SQ – status quo: Markets stabilize around current levels with Dow at 28,000 and gold in the range of \$1900 - \$2000 per ounce.

**SCENARIO LIKELIHOODS BASED ON CURRENT SITUATION**

Scenario	Pairwise Judgment	Compound Likelihood	Likelihood	Percentage Likelihood
TINA	1.00	1.00	$1.00/5.05 = 0.198$	20%
BB	1.80	1.80	$1.80/5.05 = 0.356$	35%
SQ	1.25	2.25	$2.25/5.05 = 0.446$	45%
<b>TOTALS</b>		<b>5.05</b>	<b>1.000</b>	<b>100%</b>

The above pairwise judgments show BB nearly twice as likely as TINA (i.e. 1.80) but with SQ only significantly more likely than BB at this point and hence a pairwise value of 1.25. This is at the lower end of the "significant" range. Resulting scenario likelihoods or probabilities are shown in the above table.

Although the focus is on US markets, the Dow and the gold price, world financial markets would follow to some extent outcomes on Wall Street. All scenarios have a significant chance of panning out. The US presidential election run-up will clearly play a large role in determining future levels for the Dow etc. The above scenarios follow a time horizon to the point where the next President is decided and accepted by all parties in late November and hopefully before Christmas.

The scenarios collectively cover the outcome of a significant rise or fall in the Dow and other consequences, or maintenance of the status quo with a sequence of marginal movements up and down in the Dow etc.