RMI INVESTMENT MANAGERS

THE GLOBAL MARKET CONSENSUS ACCORDING TO DR MOHAMED A.EL-ERIAN

Speaking at the RMI Investment Managers Leading Insights seminar in Cape Town on 15 February, Dr Mohamed A. El-Erian said that global markets are displaying incredibly low measures of past, present, and future volatility – despite the unusual fluidity of almost every important geopolitical relationship in the world.

As chief economic adviser at Allianz, El-Erian has advanced insight into the causes of market fluctuations based on misinterpretation of the geopolitical climate. His address centred around the global consensus, and the danger of underestimating certain political events.

So, should we place hope in the global market consensus, or are there factors that have been overlooked?

+ GLOBAL MARKET CONSENSUS: THREE KEY INSIGHTS

“The consensus is more of the same, with the balance of risk to the upside. It is that everything that is happening in geopolitics is interesting, but it will not have a major impact on the global economy.”

Markets believe that the US will grow at 2% to 2.5% this year, that Japan will grow between 1% and 1.5%, and that China will grow at 5.5% to 6.5%.

The belief is also that Russia and Brazil will come out of recession, and that we will see global growth of 3.4%, an improvement on last year's 3.1%.

"That is the consensus – stable, albeit relatively low growth," said El-Erian. "It is incredibly well ingrained in the profession and markets love hearing this. They love the notion that there will be no major surprises in terms of economic developments."

Another element of the consensus is that central banks will remain systemically important, and that they will be both willing and able to counter any politically-induced volatility - again, a sentiment markets love to hear.

"The third element is that balance of risk has shifted to the upside," El-Erian added. "In the last few years the balance of risk was clearly to the downside, of deflation in Europe and a hard-landing in China. But today people believe that the Trump administration will be able to deliver on its growth elements and that the protectionist rhetoric will just be rhetoric."

The consensus, it seems, is positive – but is it justified?

+ THE DOLLAR: NO VOICE OF AUTHORITY

According to Dr El-Erian, the problem with this consensus is that it ignores two major sets of contradictions – one endogenous, and one exogenous.

“If you run the global economy according to the consensus, the US out-performs economically, the Fed delivers at least three interest rate hikes, and the dollar benefits from inflows,” El-Erian said. “But this time around the politics does not facilitate dollar appreciation.”

Global markets and investors have become accustomed to one voice of authority on the US exchange rate – the chair of the Federal Reserve. What’s more, his or her consistent message has always been in favour of a stronger dollar that drives US interests.

According to El-Erian, that is no longer the case, as the newly-elected president has started to add his opinions on financial matters.

As Dr El-Erian pointed out, “Now the president speaks about the currency, advisers to the White House speak about the currency, and what do they tell you? They warn about dollar appreciation. So, the one output of the consensus is a strong dollar, but that stronger dollar fuels pretty nasty political contradictions.”

AN IMPROBABLE REALITY

Having suggested that the dollar may not jump through forecasters' hoops in coming years, El -Erian presented a second fundamental problem with the current consensus – the disruptive power of established economies operating at low growth rates.

"(The market) assumes that you can continue to run sophisticated western economies at low growth, that is insufficiently inclusive and not suffer the consequences," he said. "It ignores the realities of the last 12 to 36 months."

El-Erian pointed out that if he had asked 12 months ago, what the combined probability was of the UK voting in favour of Brexit, of Donald Trump being elected president, of Italian prime minister Matteo Renzi having to resign after failing to get support for his constitutional reforms, and of 30% of global government debt trading at negative interest rates, it would have been assessed as very, very low.

This combination would also have been seen as highly disruptive – yet these things have happened with little immediate market impact. The problem then, is this dismissive attitude.

"Global markets have brushed them (the political anomalies) off. But in that process the consensus has ignored a very important signal. This is not noise, it is a signal – that the internal sets of tensions and contradictions of running sophisticated market economies at low speed and insufficiently inclusive growth are starting to become significant. And if we continue to run the global economy at low growth that will cause even greater disruptions."

TREAD CAREFULLY

The impact of major political events and faltering markets will only be realised in time. But one thing is clear – trusting the global market consensus purely because it offers superficial comfort is a dangerous choice.

Rather, tread carefully and remember that nothing is set in stone. From finances to politics, 2016 has shown us just how unpredictable people can be – a lesson that should not be forgotten.

DR MOHAMED A. EL-ERIAN

Dr Mohamed A. El-Erian is an internationally respected economist and financier. His extensive experience at the highest levels of both business and government make him a renowned speaker who offers unique insights. He was CEO and Co-Chief Investment Officer of PIMCO from 2007 to 2014, and the Chair of President Barack Obama's Global Development Council. He currently serves as the Chief Economic Adviser to the Allianz Group.