SayeNvest Caps

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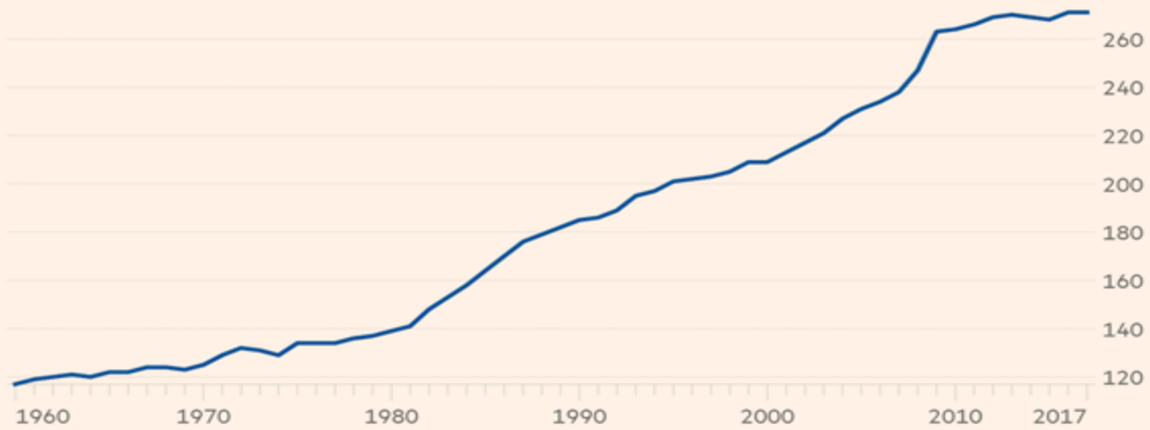
Economic Outlook August 2020

V, L, W? An alphabet soup of economic forecasts. But what forecast can you trust? Often free advice does not come free since everyone has an agenda and wants to tell you to sell you hope or fear and corresponding financial or investment products. We here at SayeNvest want you to think and make decisions that are best for you, your business, and your family. Therefore, I want to present you with the economic scenario that we think is the most likely. Please note that none of this is investment advice, and it is for educational purposes only.

In 2008, the world was in a liquidity crisis. The central banks could print their way out of it since businesses, for the most part, were solvent and sustainable. However, now, over ten years and trillions and trillions of more consumer, corporate, and government debt later, the situation looks different. We know from longitudinal studies that debt-to-GPT ratios over 90% tend to be harmful to the economy. Most of the world experiences much higher and rising debt levels. Furthermore, even before COVID-19, there were numerous tail-tell signs (like the reversing yield curve and deteriorating performance of midcaps) that the twelve-year economic expansion in the US and many other countries is coming to an end. COVID19 was just the match for an already precarious situation.

Total debt as a % of GDP, weighted average of 14 advanced economies*



* G7, Australia, Finland, New Zealand, Norway, Portugal, Spain, Sweden. Debt includes credit to households, government and non-financial corporations
Source: Mian, Straub & Sufi; IMF; Jorda-Schularick-Taylor Macrohistory Database; New Zealand Treasury
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I am an economist who does not believe in precise predictions, but I believe we can split up what is happening in three phases. One was the shock phase when the virus hit, and many countries decided to put in drastic measures like shutting down huge chunks of the economy. Now, we are in the second phase, the phase of hope. Most strict lock-downs have been lifted, and the markets have been recovering. However, I believe we are at the end of this phase, and we will soon sober up and face the reality that we are in a solvency crisis. More and more businesses will falter, and there will be stark deflationary tendencies on the economy. This will also affect real estate markets. However, the effects will be seen a tad later since many real estate markets are somewhat protected due to many forbearance measures still in place, and it will take time to see the results of that. In July, 32% of Americans have not paid their housing payments in full. This overall situation is especially frightening when realizing that even before COVID more than 50% of US Americans had equal or less than three months of savings.

However, the deflation occurring in the real economy will be masked by stark asset price inflation, which comes from the quantitative easing running non-stop around the world. However, one cannot print the economy into prosperity, and one certainly cannot print oneself out of a solvency crisis. However, one can certainly delay it and cause more distortions.

What does this mean? Bankruptcies, continuous high unemployment, slow growth, deflation, and asset price inflation since all the newly printed money seeks an ROI.

Another reason why we should be skeptical, especially in the US, for a quick recovery is the fact that the eventual recovery from the Great Recession (2007-2009) was due primarily to the entertainment sector. Now, we live in a world where roughly 50% of all restaurants are wiped, where concerts, plays, etc. are canceled and the organization of sporting events are unclear. These jobs won't recover anytime soon. Thus, at this point, an economic situation resembling a W is more likely. There is more to come and investors will continue to scramble to find a safe haven for their assets.

In the next newsletter, we explain how this scenario will affect the dollar and subsequently, the worsening situation for developing countries.

Wolf von Laer, PhD

An economist by training, Wolf writes about monetary theory, regulation, cryptocurrencies, and financial markets.

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