

# WORLD ECONOMIC OUTLOOK – FINANCIAL MARKETS & THE BIG PICTURE

## HUGHES ECONOMICS – February 2021

The current review below updates probabilities for Financial Markets outcomes and the World Economic Order focusing on the emergence of China in coming years as a growing rival to current USA hegemony.

### WORLD FINANCIAL MARKETS

Three possible scenarios are proposed for the next 6 months:

1. **TINA**: There is no alternative and the Dow rises significantly to 34,000 – 40,000 (prior probability 19%).
2. **BB**: Bubble bursts and Dow corrects to 25,000 – 30,000 or 10%+ correction (38%).
3. **SQ**: Status Quo with no major moves for the Dow in the range of 30,000 – 34,000 (43%).

Prior probabilities were derived in a previous WEO briefing (see [hugheseconomics.com](http://hugheseconomics.com)). The news that Trump was not impeached was forecast accurately and no real changes in the markets eventuated. There appears no reason to change our probabilities from last time and we reproduce the last calculations below.

#### POSTERIOR PROBABILITIES FOR POSSIBLE SCENARIOS ON WORLD FINANCIAL MARKETS

Scenario	Prior	Likelihood	Joint	Posterior	Percent
TINA	0.188679	0.156128	0.029458	0.078484	8
BB	0.377358	0.359094	0.135507	0.361024	36
SQ	0.433962	0.484778	0.210375	0.560492	56
	<b>0.999999</b>	<b>1.000000</b>	<b>0.375340</b>	<b>1.000000</b>	<b>100</b>

Although the virus is still a problem world-wide, vaccination roll-outs continue and possibly we can see the light at the end of the tunnel. The markets seem firmly in the SQ mode at the present with a maximum Dow so far below 31,600. US credit markets suggest sectors other than hospitality related are doing well. Inflation may be starting to appear raising a question about the level of interest rates despite central bank affirmations that no rate rises are imminent.

### WORLD ECONOMIC ORDER

China's economic recovery continues. The USA still faces high virus levels, but vaccinations may contain any further major outbreaks. Possible scenarios as previously outlined are as follows:

1. **China**: China overtakes the US as world leader (prior probability 3%).
2. **Cold War 2**: The US and China compete for world leadership with major ramifications for some countries (19%).
3. **USA**: The US continues as world leader with China relegated to second place for the foreseeable future (78%).

Prior probabilities were derived in previous WEOs. China has signed a Comprehensive Agreement on Investment (CAI) with the EU. China's ability to sign agreements is unquestioned but keeping to them is another matter. Some skepticism is justified. Our previous orderings on the consistency of this "news" with the possible scenarios remains unchanged, with pairwise judgments still favouring the USA scenario.

#### CONSISTENCY OF "NEWS" WITH POSSIBLE SCENARIOS FOR THE WORLD ECONOMIC ORDER

Scenario	Pairwise Judgment	Compound Likelihood	Probability	Percent Probability
China	1.00	1.00	$1.00/6.0 = 0.166667$	17
Cold War 2	1.25	$1.00 \times 1.25 = 1.25$	$1.25/6.0 = 0.208333$	21
USA	3.00	$1.25 \times 3.00 = 3.75$	$3.75/6.0 = 0.625000$	62
		<b>6.00</b>	<b>1.000000</b>	<b>100</b>

While the CAI shows China's willingness to accommodate when it suits, more convincing evidence of continuing acceptable behaviour is needed. CPC policy towards the rest of the world needs to change to allow China to advance its cause as a world leader. The importance of SOEs to the CPC reflects the communist philosophy but sustains their market-distorting role in the Chinese economy and international trade generally. The CAI does little to counter this.

Posterior calculations incorporating the above “news” are shown below:

**POSTERIOR PROBABILITIES FOR POSSIBLE SCENARIOS ON THE WORLD ECONOMIC ORDER**

<b>Scenario</b>	<b>Prior</b>	<b>Likelihood</b>	<b>Joint</b>	<b>Posterior</b>	<b>Percent</b>
China	0.025974	0.166667	0.004329	0.008138	1
Cold War 2	0.194805	0.208333	0.040584	0.076296	8
USA	0.779221	0.625000	0.487013	0.915566	91
	<b>1.000000</b>	<b>1.000000</b>	<b>0.531926</b>	<b>1.000000</b>	<b>100</b>

A continuation of US hegemony is seen as a 91% chance (previously 78%) to continue at this point in February 2021. China has almost a negligible chance of assuming world leadership in the prospective future according to our calculations. The probability of Cold War 2 continues to recede but is still much more likely than a Chinese hegemony.

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