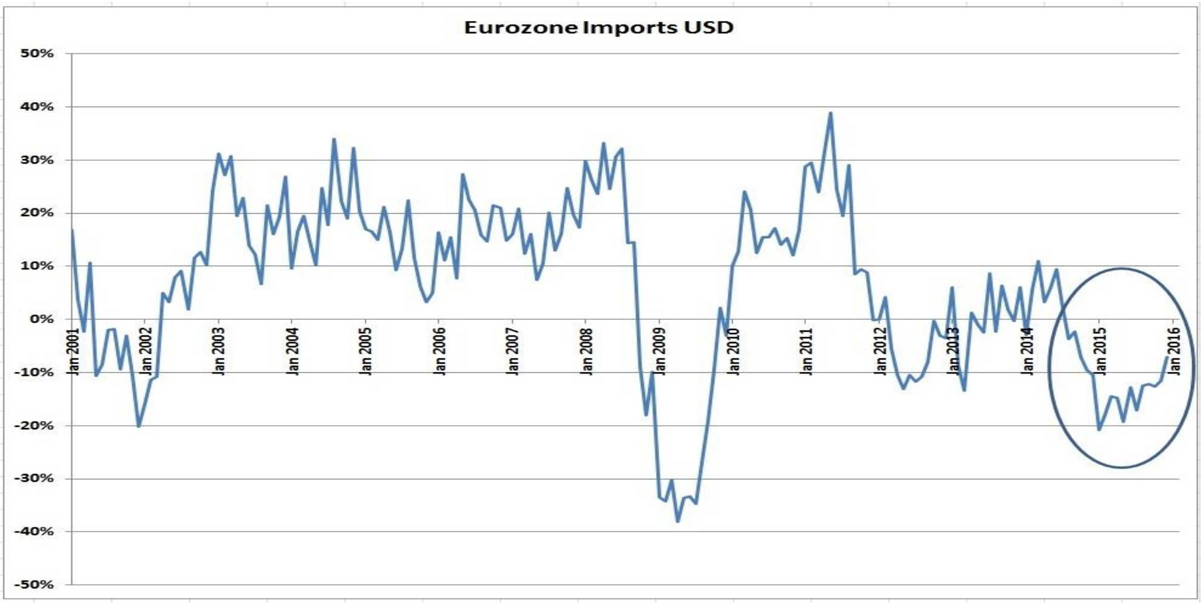
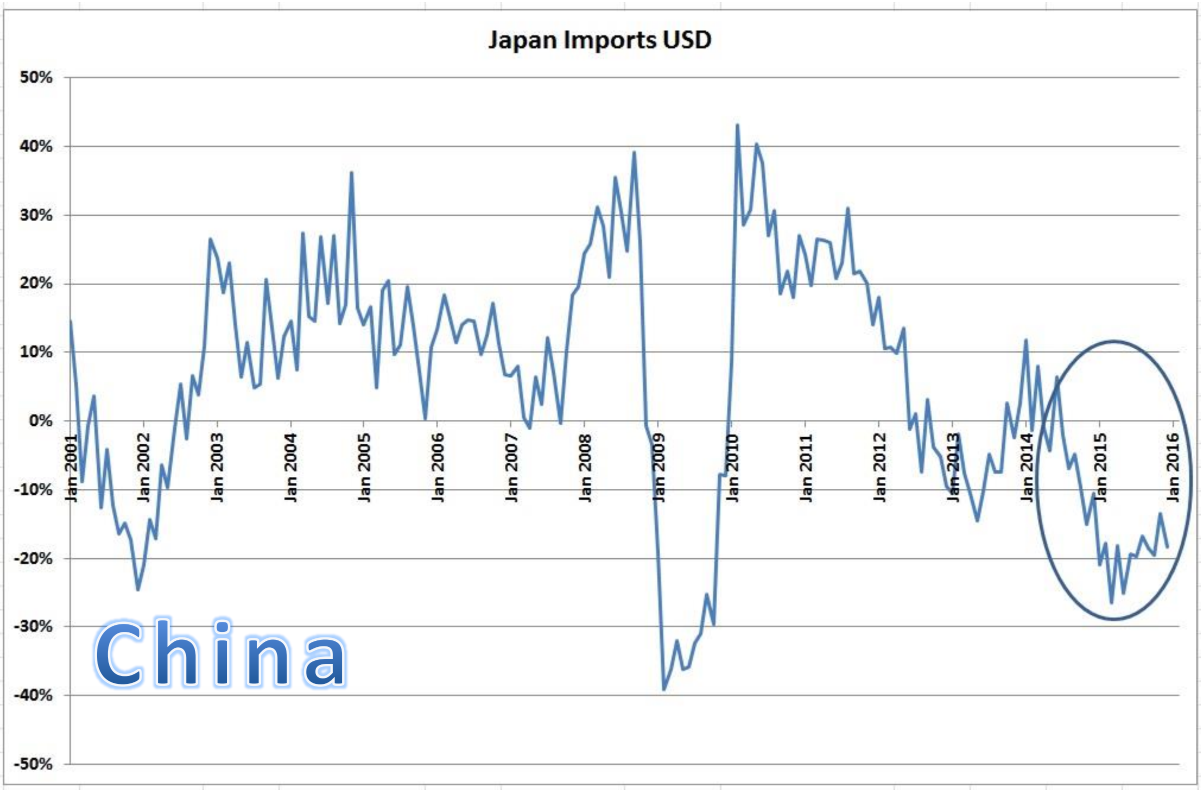
A Recession Is Unavoidable

Something has gone wrong with global demand. The 4 biggest economies in the world are the US, Eurozone, China and Japan. Combined, they have a GDP of nearly US$55 trillion or 70% of the world's GDP.

The next 4 charts show what has happened to the YoY growth in their imports (measured in USD).

They're all shrinking.





A lot of people have argued that this is the result of lower oil prices i.e. oil related imports are shrinking in value mainly due to the collapse in oil price. However, if you examine all the charts closely, you will notice that imports were already on the declining trend even before the oil price began to fall in the 2nd half of 2014.

The present and recent state of oil prices is shown in this table.

	2014	2015	2016YTD
Average Price of Brent Crude	$99.45	$53.60 (-46%)	$32.34 (-40%)

Whatever effect oil has on the imports of these key regions, the magnitude of the effect in 2016 will remain roughly the same as long as oil price remains well below $40.

In other words, whether it is oil or some other factor or both, it seems likely that the deterioration in imports will continue.

The scary part is this shrinkage of imports (disappearance of demand?) has occurred during a period of exceedingly easy monetary policy.

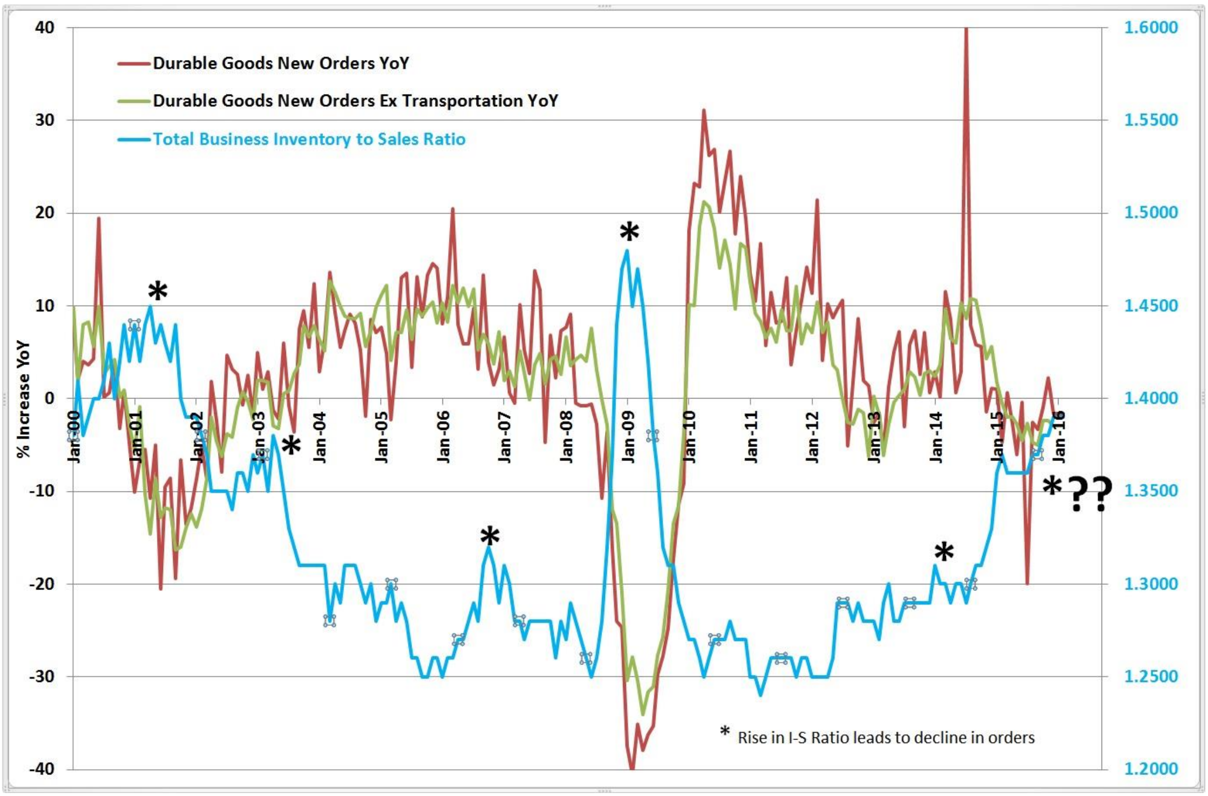
But there is worse news to come. The following chart shows the US Total Business Inventory to Sales Ratio.

As of Dec 2015, the ratio has soared to levels that resemble the situation in the the 2008 crisis when demand suddenly collapsed. But there has not been any collapse in demand in the US, on the contrary consumption and investment have been reasonably healthy. This rise in inventory to sales has occurred in a fairly positive US economic environment.

But in my view, it may represent widespread complacency by US businesses. The next chart shows the S&P500 since early 2012 (the point when the inventory to sales ratio began to rise).

The S&P500 index has fallen 9% since the beginning of 2016 after a long climb since 2009. This magnitude of correction has not been experienced since the financial crisis period. It is sure to make businesses rethink their risks.

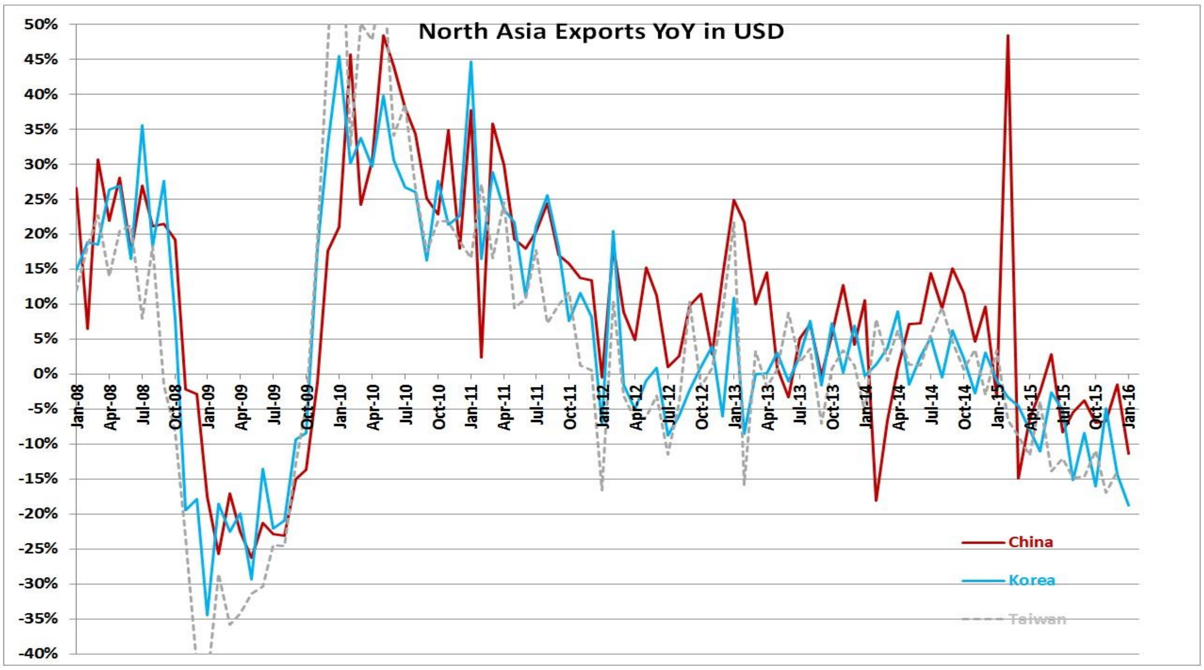
The direct transmission of this will be via the US Durable Goods Orders (next chart)



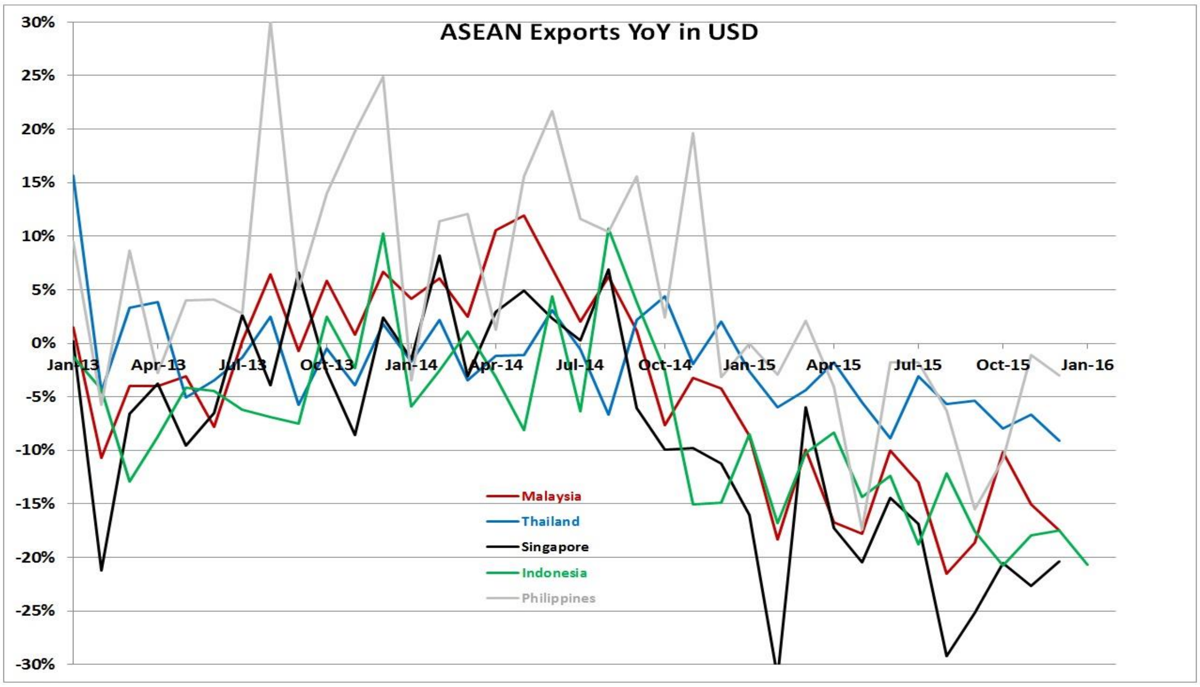
Historically, every spike in the Total Business Inventory to Sales Ratio has been followed or accompanied by a fall in the Durable Goods Orders. The latter has already been struggling throughout 2015. With the way the inventory to sales ratio is spiking, I believe those orders figures will get steadily worse.

Asia, being the workshop of the world, will bear the full brunt of this correction.

Already, exports from powerhouses like China, Korea and Taiwan have been falling all through 2015.



Ditto for ASEAN.



Observe that the magnitude of ASEAN's falls is much larger than North Asia.

There is a sentiment all around that exports from Asia have already been so bad, they cannot get much worse.

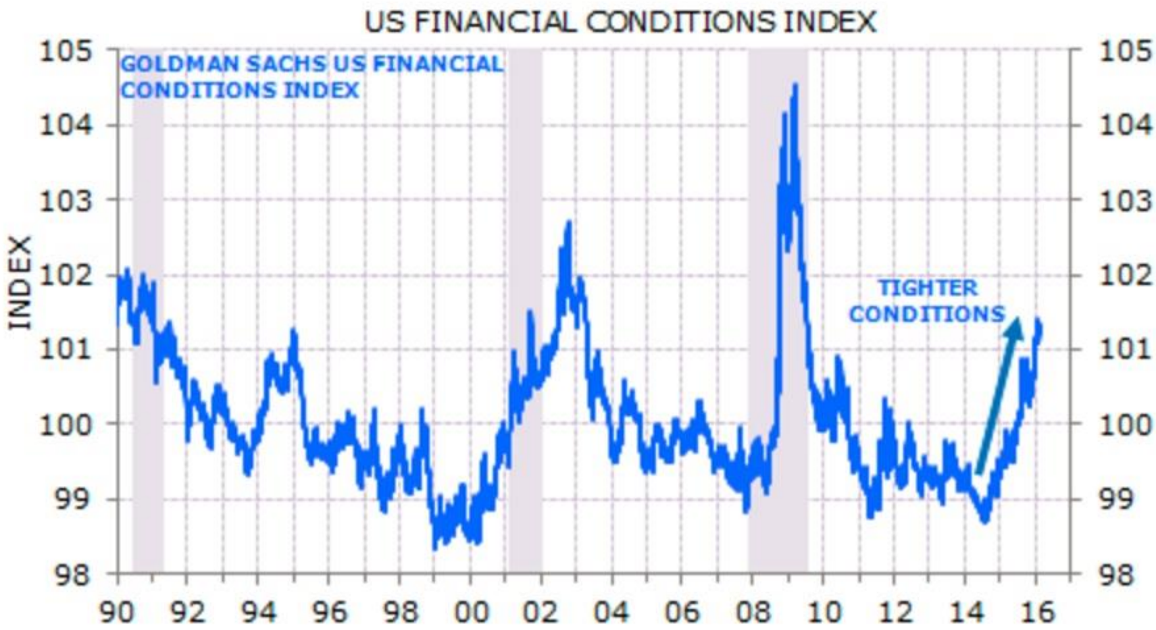
I disagree.

Just watch how miserable life gets when US businesses start trying to bring down their inventory to sales ratios!

This morning, a friend of mine, a very experienced financial markets watcher who usually seems to know where to look for the right signal and avoid the noise, forwarded me the following.

"Wider credit spreads and a higher US$ have significantly tightened US financial conditions. There are warning signs that this tightening will slow growth in coming quarters.

On most measures US financial conditions have significantly tightened over the past 18 months, despite only one small increase in the Fed fund target rate. Exhibit 1 shows the Goldman Sachs US financial conditions index, originally developed under Bill Dudley, now New York Fed president. It suggests that conditions are now as tight as when the US entered its past two recessions."



I don't need any more convincing.