The 2015 Outlook: A Matter of Life and Debt

January 2015

Caroline Miller
Managing Editor
The Debt Supercycle’s Final Inning: Leverage Transferred To The Public Sphere

Debt Burdens Rise Amid Weak Growth...

...Hindering Efforts To Restart The Credit Cycle

% of GDP

WORLD TOTAL DEBT EXCLUDING FINANCIALS

% of GDP

G7 MONEY VELOCITY*

* GDP DIVIDED BY BROAD MONEY. SERIES REBASED TO JAN. 2008 = 100. BROAD MONEY BASED ON M3 MONEY SUPPLY, EXCEPT FOR U.S. WHICH IS BASED ON M2 MONEY SUPPLY.

SOURCE: GENEVA REPORT ON THE WORLD ECONOMY, SEPTEMBER 2014.

© BCA Research 2015
The U.S. Credit Cycle: Deleveraging Advanced But Credit Impulse Remains Weak

Little Consumer Appetite For Cheap Credit…

- **U.S.: HOUSEHOLD DEBT**
  - **PERCENT OF DISPOSABLE INCOME**
  - **TIME TREND (1960 - 2004)**

  ![Graph showing household debt as a percent of disposable income](Image)

  *still high*

- **MORTGAGE APPLICATIONS: PURCHASE INDEX**

  ![Graph showing mortgage applications index](Image)

  *shown smoothed except for latest datapoint. Source: Mortgage Bankers Association.*

...Small Firms Also Reluctant to Re-lever

- **U.S.: PERCENT OF COMPANIES BORROWING REGULARLY**

  ![Graph showing percent of companies borrowing regularly](Image)

  *percent of borrowers who reported borrowing at least every 3 months. Shown smoothed. Source: National Federation of Independent Business.*

No recovery
Funding Government Deficits: Financial Repression Works...Until It Doesn’t

INTEREST RATE - GDP GROWTH DIFFERENTIAL (%) vs PRIMARY BALANCE AS A % OF GDP

Primary deficit and interest rate above growth

Primary deficit and interest rate below growth

Primary surplus and interest rate above growth

Primary surplus and interest rate below growth

NOTE: BASED ON IMF DATA.
Cheaper Oil: A Net Economic Positive... But It’s Complicated
U.S. Growth: Solid But Not Stellar

Home Price Appreciation Past Its Peak

Real Income Growth Remains Tepid

U.S.: S&P/CASE-SHILLER HOME PRICES 20-CITIES

Ann% Chg

U.S.: REAL AVERAGE HOURLY EARNINGS*

Ann% Chg

* TOTAL PRIVATE NONFARM, ALL EMPLOYEES.
The Pace of Deleveraging Is Ebbing…

**EURO AREA: NET LENDING TO HOUSEHOLDS AND BUSINESSES***

* SHOWN SMOOTHED. LOANS ADJUSTED FOR SALES AND SECURITIZATIONS.

SOURCE: ECB.

---

But Headline Inflation Keeps Dropping

**CONSUMER PRICE INFLATION:**

- **EURO AREA**
- **GERMANY**
- **EURO AREA PERIPHERY***

* GDP-WEIGHTED AVERAGE OF GREECE, IRELAND, ITALY, PORTUGAL, AND SPAIN.
Japan: Durable Growth Revitalization Remains Elusive

No Wage Growth Means Low Overall Growth

Weaker Yen Has Yet To Galvanize Exports

* Source: J.P. MORGAN CHASE & CO.
** Shown smoothed.
China: Growth Slowing But Not Collapsing

Policy-Induced Deleveraging...

But Plenty Of Fiscal Flexibility

CHINA: PROPERTY PRICES*
- BEIJING
- SHANGHAI
- SHENZHEN

CHINA: GENERAL GOVERNMENT OVERALL BALANCE*

GROSS GOVERNMENT DEBT*

* SOURCE: CENTALINE; INDEX COVERS PRIMARY AND SECONDARY RESIDENTIAL, OFFICE AND RETAIL MARKETS.

* SOURCE: IMF WORLD ECONOMIC OUTLOOK, OCTOBER 2014; INCLUDES FEDERAL, PROVINCIAL, AND LOCAL DEBT.
Valuation Ranking Of Developed Country Government Bond Yields

* Ranking is based on how far current real yields are from their historical average, expressed in number of standard deviations.
Valuation Ranking Of Developed Country Equity Markets

* RANKING IS BASED ON HOW FAR CURRENT CYCLICALLY-ADJUSTED PRICE-EARNINGS RATIO IS FROM THE HISTORICAL AVERAGE, EXPRESSED IN NUMBER OF STANDARD DEVIATIONS.
Emerging Market Equities: Vulnerable To More Downside

Valuations Are Not Cheap...

particularly given likely earnings contraction

Emerging Market Equities: Vulnerable To More Downside

Particularly Given Likely Earnings Contraction

Emerging Markets:
Price-to-Earnings Ratio*

- Equal Sector-Weighted**
- Market-Cap Weighted

Emerging Markets:
Earnings-Per-Share* (LS)
M1 Growth** (RS)

* Calculated as stock prices divided by price-to-earnings ratio; shown as a 6-month moving average in local currency terms. Source: MSCI Inc. (See copyright declaration)

** Equity market-cap weighted aggregate of 20 EM economies, shown advanced.
Emerging Market Bonds: Currency Weakness Erodes Credit Quality

Debt Servicing Costs To Rise On Weaker FX

...Not To Mention Balance Sheet Deterioration

EMERGING MARKETS:
- CURRENCIES* VS U.S. DOLLAR (LS)
- SOVEREIGN SPREADS** (INVERTED) (RS)

* EQUITY MARKET-CAP WEIGHTED; REBASED TO 2010 = 100;
SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION)

** EQUITY MARKET-CAP WEIGHTED INCLUDING 13 EMERGING ECONOMIES;
SOURCE: J.P. MORGAN CHASE & CO.

EMERGING MARKETS:
- CORPORATE HEALTH INDICATOR* (LS)
- CORPORATE SPREADS** (INVERTED) (RS)

* USING STANDARDIZED RATIOS; ABOVE 0 MEANS GOOD HEALTH;
BELOW 0 MEANS POOR HEALTH.

** CEMBI BROAD CORPORATE SPREADS; SOURCE: J.P. MORGAN CHASE & CO.
Commodities Have Been A Terrible Investment In Real Terms, Over The Long Run

REAL* RAW INDUSTRIALS PRICES (In US$ Terms)

- TREND**
- TREND +/- TWO STANDARD DEVIATIONS

* ADJUSTED BY U.S. GDP DEFLATOR.
** TIME-TREND FROM 1800 TO PRESENT.
The U.S. Dollar: Seemingly Invincible For Now

USD Strength Is A Residual Of Global Weakness

But The Euro Poses A Threat To Dollar Bulls

*BASIC BALANCE* = CURRENT ACCOUNT PLUS NET PORTFOLIO AND FOREIGN DIRECT INVESTMENT.