Now that everybody has the internet, all of the rich people are being cut down to size

Once everybody in the world could see that they were just being used as human cows to feed the rich 1%, the regular folks agreed that enough was enough. They launched their democracy uprisings, they stopped using Silicon Valley's abusive spyware, they said no to unfair wages, they turned their backs on the unfairly rigged stock market, they demanded equality in greater numbers than history had ever seen, they started implementing basic income plans, and they threw foreign resource exploiters out.

The rich people, and their bought-and-paid-for politicians, tried to scare people off of the internet. That didn't work. Now you have 2100 corrupt politicians and megalomaniac billionaires trying to stop 6 billion people from getting what they want. How do you think that is going to shake out? It is probably going to be like trying to use a leaf to stop a waterfall. For all of the attempts to slow the emergence; logic, history, volume demand and the reality of sociological physics say that halting the current big change is probably impossible. The old school white-hair politicians can't accept it, nor can they understand it. They are already, clearly, being caught fully off-guard.

Zero Hedge has posted a vast array of technical diagrams proving the assumptions that “the end of capitalism is nigh”; China has overtly created a plan to bring about economic change of a disruptive nature; every blog has a massive number of comments that applaud any news of a big economic crash. People love the market crashes, it seems. When Larry Ellison and Bill Gates are said to have “lost 45 billion dollars in one day” the main-stream is ecstatic. The world seems to be in heaven when a Rockefeller or a Rothschild takes a hit to their bank vault.

So here it comes. Prepare to watch the death throes of the Silicon Valley stock hype “unicorns”. Prepare to see big surprises in elections with delightful twists around non-traditional candidates, stay tuned for a few coups, a bigger “migrant crisis” as the whole world heads to your town, and history making fun you will never forget.

The largest group of humans, in the history of the planet, can't find work. The trumped up economic numbers, that some agencies toss out, are instantly dissected, on-line, for the PR shams that they are. The big shift is here. It is rolling along and nothing seems to be able to stop it.

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Debt, defaults, and devaluations: why this market crash is like nothing we've seen before

A pernicious cycle of collapsing commodities, corporate defaults, and currency wars loom over the global economy. Can anything stop it from unravelling?

By Mehreen Khan for telegraph.co.uk

A global recession is on the way. This truism of economics holds at any point in which the world is not in the grips of a contraction.

The real question is always when and how deep the upcoming downturn will be.

“The crash will come, but it would be nice if it came two years from now”, Thomas Thygesen, head of economics at SEB told over 200 commodity investors and analysts in London last month.

His audience was rapt with unusual attention. They could be forgiven for thinking the slump had not already arrived.

Commodity prices have crashed by two thirds since their peaks in 2014. Oil has borne the brunt of the sell-off, suffering the worst price collapse in modern history. Brent crude has fallen from $115 a barrel in the summer of 2014, to just $27.70 in mid-January.

We are in a very unusual situation where market sentiment is of a different nature to anything we’ve seen before   -Thomas Thygesen

Plenty of investors sitting in the blue-lit, cavernous surrounds of Bloomberg’s London HQ would have had their fingers burnt by the price capitulation.

• Mapped: How the world became awash with oil

“They tell you should start your presentations with a joke, but making jokes at a commodities seminar is hardly appropriate these days,” Thygesen told his nervous audience.

Major oil price falls have a number of historical precedents. Today's glutted oil market is often compared to the crash of 1986, the last major episode over global over-supply. Back in the late 90s, a barrel of Brent crude fell to as low as $10 in the wake of the Asian financial crisis.

A perfect storm

But is the current oil price collapse really like anything the world economy has ever experienced?

For many market watchers, a confluence of factors - led by oil, but encompassing China, the emerging world, and financial markets - are all brewing to create a perfect storm in a global economy that has barely come to terms with the Great Recession.

“We are in a very unusual situation where market sentiment is of a different nature to anything we’ve seen before,” says Thygesen.

Unlike previous pre-recessionary eras, the current sell-off has seen commodity prices, equities and credit conditions all move in dangerous lockstep.

The S&P 500 trading pit at the Chicago Mercantile Exchange

Although a 75pc oil price collapse should represent an unmitigated positive for the world’s fuel thirsty consumers, the sheer scale of the price rout is already imperiling the finances of producer nations from Nigeria to Azerbaijan, and is now threatening to unleash a wave of bankruptcies across corporate America.

It is the prospect of this vicious feedback loop - where low oil prices create financial tail risks that spill over into the real economy - which could now propel the world into a “full blown crisis” adds Thygesen.

So will it materialise?

The world economy is throwing up reasons to worry, as the globe's largest emerging markets have shown signs of deterioration over the last six months, says Olivier Blanchard, the former long-serving chief economist of the International Monetary Fund.

My biggest fear is precisely that the dramatic shift in mood becomes self-fulfilling
Olivier Blanchard

“China’s growth is probably less than officially reported. Russia and Brazil are doing very badly. South Africa is flirting with recession. Even India may not be doing as well as was forecast,” says Blanchard, who left the Fund after seven years late last year.

As it stands however, he says market ructions still represent a classic case of “herd” behaviour.

“Investors worry that other investors know something bad, and so just sell, although they themselves have no new information.”

Blanchard spent seven years firefighting the worst financial crisis in history at the IMF

But a tipping point may well be approaching. According to Blanchard’s calculations, a 20pc decline in stock markets that persists for more than six months, will translate into a decline in consumption of between 0.5pc to 1.0pc.

“This would be a serious shock. My biggest fear is precisely that the dramatic shift in mood becomes self-fulfilling”.

The first domino to fall

For now, oil-induced financial stress is concentrated in the energy sector.

With Brent set to languish around $30-35 barrel for the rest of the year, prices will persist below the $40-60 barrel break-even point that renders the bulk of US oil and gas companies profitable.

Spreads on high yield US energy corporates have soared to unprecedented highs. “They make Lehman look like a walk in the park” says Thygesen.

More than a third of the entire US high yield bond index is now vulnerable to crude prices remaining low or falling even further, according to calculations from Oxford Economics.

As a result, 2016 is set to see the first wave of corporate bankruptcies in the oil and gas sector. Highly leveraged US shale companies will be the first be picked off. Should escalating defaults have a further depressant effect on oil prices, it could unleash a tidal wave of corporate bankruptcies in the world’s largest economy.

Conditions that usually pave the way for mounting defaults are currently met in the US
Oxford Economics

Indebtedness is not just the scourge of the US. Globally, the oil and gas industry has issued $1.4 trillion of bonds and taken out a further $1.6 trillion in syndicated loans, driving the sector's combined debt to $3 trillion, according to the Bank of International Settlements. They warn of an "illusion of sustainability" that could quickly turn toxic as the credit cycle unravels.

The question exercising the minds of economists and investors is the extent to which this contagion could metastasize beyond the energy sector, as banks cut off credit access, loans turn bad, and financial conditions enter a critical tightening phase.

“Conditions that usually pave the way for mounting defaults – such as growing bad debt, tightening monetary conditions, tightening of corporate credit standards and volatility spikes – are currently met in the US”, says Bronka Rzepkowski at Oxford Economics.

Such levels of financial distress, more often than not, portend a global recession.

In every instance of the US high yield spread rising above its long-term average, a recession or financial crisis has been nigh, says Rzepkowski, who cites 2011 as the only time the markets sent out a false signal, lulled by the Federal Reserve’s mega quantitative easing programme.

US shale break-even prices remain closer to $60 a barrel

We are not there yet, but worryingly for market watchers, a series of other indicators are also flashing red.

Global equity markets have endured their worst start to a year since the dotcom crash. To paraphrase Nobel prize-winning US economist Paul Samuelson, Wall Street has predicted nine out of the last five recessions, but the current turbulence has an ominous precedent.

Over the last 45 years, the S&P500 has suffered a loss of more than 12.5pc on 13 occasions. Six of these have given way to a recession in the US, providing a more than 50pc probability that a global downturn is just around the corner.

In Europe, stocks have now fallen by 10pc in the last six months.

“Of the 14 previous occasions equities have had a similar decline, seven have been associated with recession, with lacklustre returns thereafter,” says Dennis Jose at Barclays.

He notes investors have begun to pile into “defensive” stocks, such as healthcare and consumer industries.

“The weighting in defensives has increased to the highest levels seen since 1980 suggesting that investors may have already embraced the risk of a recession.”
Dollar danger

Macroeconomic indicators from the world’s largest economy are also beginning to turn sour. The US has already fallen prey to a manufacturing collapse. Service sector data for December showed the slowdown is spreading to the dominant driver of economic growth.

“The shine has come off the US”, says David Folkerts-Landau, chief economist at Deutsche Bank.

He notes the economy is “firing on one cylinder” with consumers the sole bright spot in an environment of still weak capital investment, and a crippling exchange rate that is hurting exporters and squeezing corporate profits.

“It is not a very healthy situation,” says Folkerts-Landau, who forecasts US growth will fall below 2pc this year. “That is a precarious number.”

A crucial part of the story has been the relentless appreciation of the US dollar. The greenback has risen by more than 22pc on a trade weighted basis since mid-2014.

The effects have been felt far beyond the US. The soaring dollar has put record pressure on China’s exchange rate peg, forcing Beijing to burn through its reserves with interventions amounting to $140bn-a-month in December to protect the renminbi.

Meanwhile, China’s capital outflows have accelerated to $676bn, according to the Institute of International Finance.

This policy bind - known as the “Impossible Trinity” of managing a fixed exchange rate, maintaining independent monetary policy, and a open capital account - means a devaluation of some magnitude is all but inevitable.

• Has China lost control of its currency?

“It will definitely be in the double digits”, says Folkerts-Landau. “We will be lucky if the depreciation will be in the lower double-digits by the end of the year.”

“Once you anticipate that, and you are sitting in Indonesia or Latin America, it has an immediate impact on how you think about the world”.

A weaker renminbi would unleash a new wave of deflation in an already fragile global environment, and hasten the pressure on emerging market exchange rates as the world’s currency wars would renew

apace.
Federal reverse?

What, if anything, could halt this pernicious cycle of events from unfolding?

In the short-term, analysts are unanimous: all eyes are on the US Federal Reserve. The central bank's first rate hike in seven years last December has come to look frighteningly premature in the space of just eight weeks.

I have no doubt that the Fed would expand QE
Olivier Blanchard

Events have forced the Fed's policymakers to take to the airwaves and soothe fears that another four rate hikes are on the way this year. It is a welcome sign for jittery markets, but may not be enough to convince them that the Fed will be nimble enough to reverse course and begin easing should financial conditions worsen.

Others, like Blanchard, are more sanguine about the ability of central banks to ride to the rescue again.

"I have no doubt that, if there was such a decrease in consumption, or if the strong dollar proved to affect net exports more than is forecast, or any other adverse event for that matter, the Fed would wait to do further increases" he says.

"And if things got really bad, I have no doubt that the Fed would expand QE."

Oil prices meanwhile are widely expected to rebound from their depths by the second half of the year, as dwindling investment and the buckling of the vulnerable shale players begins to bite on production levels.

This in itself presents its own set of challenges. The lower oil prices fall, the faster buyers are expected to flood back in, with violent upward movements already in evidence over the last ten days.

In the longer term, even the postponement of the next global recession will do little to assuage fears that world could find itself defenceless against another round of mania, panics or crashes.

Two of the world's three major central banks have slashed interest rates in to negative territory. Monetary tools will need to be deployed more creatively, perhaps going as far as injecting stimulus directly into the veins of the economy.

Should the world manage to ride out the perfect storm of 2016, next time round, answers will be difficult to find.

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