WORLD ECONOMIC OUTLOOK – FINANCIAL MARKETS & WORLD ECONOMIC ORDER
HUGHES ECONOMICS – December 2021

The current review below restates probabilities for Financial Markets outcomes, the World Economic Order focusing on the US versus China and the possibility of another depression. As another demonstration of the methodology favoured here, the origins of the COVID-19 virus are examined in the paper on this website *Thinking Probabilistically IV*.

WORLD FINANCIAL MARKETS

As stated previously, three possible scenarios are proposed for the next 3 - 6 month as listed below in order of increasing likelihood. The Status Quo as defined below is seen as most likely to continue.

1. **BB**: Bubble bursts and Dow corrects to 30,000- or a 10%+ correction.
2. **TINA**: There is no alternative, and the Dow rises significantly to 40,000+.
3. **SQ**: Status Quo with no major moves for the Dow around 35,000 – as of 3/12, the Dow is at 34,580.

Probability calculations below for the above scenarios are explained in *Structuring Probability Assessments* available at https://doi.org/10.17265/1537-1506/2020.05.003. See also *Thinking Probabilistically* available at https://doi.org/10.17265/1537-1506/2021.05.002. Both papers are also available on this website, as is a related paper *Thinking Probabilistically Revisited*.

PROBABILITIES ON FINANCIAL MARKETS FOR UP TO THE NEXT 6 MONTHS

Scenario	Pairwise Judgment	Compound Likelihood	Probabilities	Percent Probabilities	
				Current	Previous
BB	1.00	1.00	1/8.0 = 0.125	12	16
TINA	2.00	1.00 X 2.00 = 2.00	2.00/8.0 = 0.25	25	24
SQ	2.50	2.00 x 2.50 = 5.00	5.00/8.0 = 0.625	63	60
TOTALS		**8.00**	**1.00**	**100**	**100**

The Omicron virus mutation has roiled the markets at the start of December. Clearly this will be a key factor in coming weeks. News that a lot of cash is "sitting on the sidelines" offers some support to the market at this point. Central Banks are now muting the "transitory inflation" scenario and the Fed has also indicated it is prepared to taper bond buying early. The Powell reappointment favours the Status Quo scenario if only to reassure markets that Fed policy will remain steady, although perhaps now with a more hawkish outlook. The November jobs added for the US at 210,000 was much less than the 2021 monthly average of 555,000. The November total could be revised upward following the pattern of recent months. The current probabilities above are unchanged from November.

WORLD ECONOMIC ORDER

To restate all the possibilities, we have, in increasing order of likelihood:

1. **China**: China overtakes the US as world leader or Chinese hegemony.
2. **Cold War 2**: The US and China compete vigorously for world leadership with major ramifications for some countries.
3. **USA**: The US continues as world leader with China relegated to second place for the near future.

These scenarios will play out over the next 10 years. Current probabilities are calculated below:

PROBABILITIES ON THE WORLD ECONONOMIC ORDER EVOLVING OVER THE NEXT DECADE

Scenario	Pairwise #	Compound Likelihood	Probabilities	Percent Probabilities	
				Current	Previous
China	1.00	1.00	1/31 = 0.032	3	2
Cold War 2	10.00	1.0 x 10.00 = 10.00	10/31 = 0.323	32	16
USA	2.00	10.0 x 2.00 = 20.00	20/31 = 0.645	65	82
TOTALS		**31.00**	**1.000**	**100**	**100**

No change is proposed in the probabilities for possible World Economic Orders. In the November calculations, Cold War 2 gained in likelihood at the expense of USA hegemony, but this is still seen as a very likely 65% chance in December. The CPC leadership continues to sing in disharmony with the rest of the world.

The Taiwan situation looks particularly combustible, although the history of Gibraltar shows these problems are not unprecedented and can be managed. Of course, the stakes are much higher in the South China Sea. The *Financial Times* recently quoted the head of the UK's MI6, Rupert Moore as saying, "The Chinese Communist party leadership increasingly favour bold and decisive action particularly on national security grounds. Beijing believes its own propaganda about Western frailties and underestimates Washington's resolve. The risk of Chinese miscalculation through overconfidence is real." Comments like this make the Cold War 2 scenario seem more likely, justifying its doubling in likelihood over recent months (see Table above). Other Chinese tactics could ultimately affect the power balance in the region. Moore also warned about the possibility of "debt and data traps." Countries borrowing from Chinese state banks include Laos, Papua New Guinea. Sri Lanka, Maldives, Brunei, Cambodia, Myanmar, and Tonga. And the Port of Darwin is operated on a 99-year lease by a Chinese company. Of course, China's Belt and Road initiative could be seen as a great project which comes at just the right time as a potential aid to restoring world prosperity.

WORLD FINANCIAL STATE

Earlier in 2021, we added a fourth category of **Depression** to possible world scenarios. Below we assign this scenario a 10% chance, increasing slightly this month over the previous 7% chance. Scenarios in order of increasing likelihood are as follows:

D or Depression: High inflation and continued COVID-19 pressures, policy mistakes and global financial collapse.
MR or Mild Recession: Unemployment rises with hospitality and other sectors remaining subdued with ongoing virus problems.
MB or Mild Boom: Low interest rates and no major upsets allow markets to rise steadily for the next 6 months for 10%+ gains.
SQ or Status Quo: All markets steady, significant but not rampart inflation, continued but containable COVID flare-ups.

A mild boom (MB) is currently seen as equally likely as MR. The Omicron virus variant has now entered the scene. Just how this will play out into 2022 is problematic. The SQ scenario is still seen as most likely, but with a slightly reduced likelihood. Probabilities for all scenarios are detailed below:

PROBABILITIES ON WORLD SCENARIOS FOR THE NEXT 6 MONTHS

| Scenario | Pairwise Judgment | Reciprocal Matrix | | | | Eigenvalues | Probabilities | Percent Probabilities | |
		D	MR	MB	SQ			Current	Previous
D	1.00	1	1/2	**1/2**	**1/5**	.171499	0.1	10	7
MR	2.00	2	1	1	**2/5**	.342997	0.2	20	15
MB	1.00	**2**	1	1	2/5	.342997	0.2	20	22
SQ	2.50	**5**	**5/2**	5/2	1	.857493	0.5	50	56
TOTALS						**1.714986**	**1.0**	**100**	**100**

In the above table we first calculate a perfectly consistent reciprocal matrix using the pairwise values in column 2. These are the values just below the main diagonal in column 3 in the above table. The principal eigenvector for this matrix is shown in column 4. The normalized probabilities are then shown in column 5. These probabilities are the same as would be calculated using the minimal three pairwise judgments and serve to demonstrate the more complicated method of probability derivation. Of course, the DM could use different pairwise values for the non-adjacent events (shown in bold in the above table) and derive a slightly different distribution to that shown. There may be good reasons for using this pairwise information on the non-adjacent relative likelihoods thereby making the final distribution more "correct." For example, if the SQ/D pairwise value is reduced to 3 from 5 above (the SQ likelihood over D now less with the November jobs report), the resulting percentage probability distribution using the principal eigenvector method becomes 12%, 21%, 21%, 46%.

Word Count 1185, 4th December 2021.