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Is the Consensus wrong?

- **Broadly speaking, the consensus thinks 2016 will be a repeat of 2015**
- **Growth to move sideways, inflation to stay low, CB policies to diverge**
- **We look for potential surprises**

By now, most sell-side economists have published their views for 2016 (see ours here). With the party season approaching, we thought we'd save our readers the effort of ploughing through these vast volumes by identifying the main themes for them. This year, spotting consensus ideas is easy, because many of these reports are saying the same thing. Depending on your psychological disposition and how much faith you put in economic forecasts, this uniformity of ideas will either reassure you about the 2016 outlook, or leave you feeling slightly uneasy. Either way, here are the consensus ideas, plus some quick thoughts on what could go wrong/right:

1) **2015 redux**: After years of expecting stronger growth in year t+1 (i.e. reversion to a higher average growth rate), only to be disappointed, the consensus has learnt its lesson and now expects 2016 to look a lot like 2015 (i.e. simple extrapolation). Perhaps it's a lack of imagination, but few on the sellside are prepared to forecast either a major downturn or a decent acceleration. Instead, there is a lot of talk about slower potential growth rates. Most economists expect the developed economies to prove resilient in 2016, with the EMs either grinding lower or achieving a modest bounce. In the meantime, everyone is listing the same downside risks – namely China, Fed tightening and geopolitics.

   Potential surprises: Clearly plenty of scope for surprise, in both directions. With everyone giving up on the US economy, the hurdle for a positive news is low, especially now public and private sector balance-sheet repair is over. Europe could also provide some good news, if the long-awaited capex revival kicks in. On the downside, China's slowdown could have wider repercussions than most are assuming, especially with intractable financial spillovers. 2016 could also be the year Abenomics backfires (something nobody is thinking about).

2) **Lowflation**: The sellside expects a modest pick-up in inflation, mainly on base effects from energy. But most expect inflation to remain below central bank targets in 2016.

Potential surprises: With labour markets tightening in the US, Japan and parts of Europe, inflation could rise more quickly than everyone expects. This would be a problem for bond markets, still pricing a fair amount of deflation risk. On the other side, a further deterioration in EM prospects could push commodity prices down, compounding the threat of second-round effects and currency wars. What if China devalues, this time in a more meaningful move?

3) **The gradualist Fed**: Some are warning about the impact of Fed policy, but everyone expects only modest tightening and a small rise in yields – typically less than three 25bps hikes in 2016. Sellside economists typically fall somewhere between dovish market pricing and hawkish Fed guidance (the 'dots').

   Potential surprises: The Fed will certainly start 2016 cautiously, wanting to avoid a repeat of the taper tantrum. Thereafter, investors will need to watch US wage trends particularly closely, since an acceleration in earnings might alter the Fed's view about how much slack there is in the labour market, leading to more aggressive tightening. For the Fed to hike less than the sellside expects, we would need to see a US slowdown, another USD surge, or serious market volatility.

4) **Policy divergence**: Just like 12 months ago, policy divergence is a big investment theme for the year ahead. In 2016 the Fed will be raising interest rates, while the ECB, BoJ and PBOC will be continuing to ease.

   Potential surprises: Central bank policies have diverged in 2015, as sell-side economists said they would, but it has taken all year to get there. This highlights greater interdependency between central banks than is often assumed. As we explained recently, we may already have passed the maximum point of divergence between the ECB and the Fed, which suggests the ECB could become more hawkish in the second half of 2016. A synchronized global slowdown would also kill the divergence trade, halting the Fed's attempt at normalization.

5) **The strong USD:** Related to the divergence trade, if you think the major central banks will continue along alternative policy paths, then you probably expect the dollar to appreciate further. At least that's how the sellside sees it, another a continuation of what they were forecasting 12 months ago.

   Potential surprises: If the case for ECB stimulus fades in 2016, the euro could rebound – especially as the weak currency is hard to square with the region's record current-account surplus. Or, since talk of policy divergence is now so consensus, perhaps the USD has appreciated enough already. In real trade weighted terms, the currency is back to long-term historical levels, while its recent strength has already damaged US profits and the manufacturing sector.

So there you go, dear readers, now there is absolutely no reason to read our rivals' research – LSR, your one-stop macro shop!

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