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Macroeconomic Comment

Global Economic Development

April 13, 2021, Peter von Elten

The International Monetary Fund (IMF) has raised its previous forecast for global economic growth in 2021 from 5.5% to 6% and also increased its forecast for 2022 to 4.4%. In contrast to its much more negative assessment last October, the IMF now expects the advanced economies to more quickly recover the losses suffered as a result of COVID-19. Compared to pre-pandemic forecasts, gross domestic product (GDP) is expected to be less than 1% lower by 2024. The pandemic will have a greater impact on developing countries, for which the IMF expects a decline of 4% over the same time period. This is explained by the fact that the developing countries were able to deploy significantly fewer resources to combat the pandemic.

The IMF cites the following three reasons for the more positive assessment:

1. Most countries have weathered the second wave of the pandemic with much smaller economic losses. The passage of the Biden administration's $1.9 trillion American Rescue Plan will make America the engine of the global economy and pushes global pandemic support programs to $16 trillion, or nearly 20% of global GDP. By far the largest portion of the above plan is expected to flow into the economy this year.

2. Countries such as the US, Japan and Europe have largely been able to protect the incomes of the population.

3. Vaccine development and production has progressed much faster than originally expected.

Meanwhile, the Biden Administration is substantiating its infrastructure plan, also called the "American Jobs Plan," with targeted funding of $2.3 trillion spread over the next eight years. This plan, by virtue of its funding, is closely tied to a bold Biden Administration proposal to reform corporate taxation. This targeted reform includes the following three components:

1. The corporate tax rate, which was cut from 35% to 21% under the Trump administration, would be raised to 28%. This would generate an estimated $2 trillion in additional revenue over 15 years.

2. Eliminate international tax loopholes and impose a minimum tax of 21%.

3. Large international companies should partly be taxed on the basis of their sales in the respective host countries. This has long been pursued by the OECD and would require international cooperation.

The US and UK see themselves as leading the fight against a more than 20-year trend of permanent erosion of corporate taxes. Increased taxation of corporate profits, high incomes, and large fortunes is being raised in many countries as part of the fight against rising inequality and to finance the high costs of the pandemic; and this is likely to spark a global tax debate.

Developing and Emerging Countries

Recently, the Secretary General of the UN and the head of the IMF independently warned of a debt crisis for medium-sized and smaller developing countries. Last year, five smaller countries besides Argentina failed to meet their obligations. An estimated 120 million people have fallen below the poverty line as a result of the pandemic. To deal with the debt, the G7 countries helped the IMF create an additional $650 billion in special drawing rights.

The economic, political, and health conditions of developing countries are so heterogeneous that only a look at individual countries can be meaningful. Countries, such as Turkey, with large current account and budget deficits, significant foreign currency external debt, low foreign reserves, and a weak currency coupled with high inflation (over 16%) and central bank interest rates (19%) will only be able to avoid a payment moratorium with the help of third parties. Countries with a high dependence on tourism have suffered greatly and will need a longer period of time to regain pre-crisis levels.

In general, developing countries have only been able to use about a quarter of the fiscal rescue funds available to industrialized countries relative to their GDP during this crisis. As a result, the developing countries were forced to implement tough reforms in some cases. In the medium term, this should offer them better growth opportunities after the pandemic compared to the highly developed countries, which have postponed reforms and are having to cope with a sharp increase in debt. Developing countries are currently burdened by the rise in interest rates in the US combined with a firmer dollar, but should also benefit from the strength of growth in the US and China.

India

India's development status is difficult to classify. With a population of over 1.3 billion people, the country is only slightly behind China and will overtake it in a few years due to its young population and higher birth rate. With a gross domestic product of approximately $2.87 trillion, it ranks fifth in the world, equal to the UK and France. However, with an annual per capita income equivalent to about $2,100 (China $10,500, France $42,000), India is in the bottom quarter of all countries, on the same level with Kenya and the Ivory Coast. The neighboring Bangladesh, long called the poorhouse of the world, is now on the same level with India in per capita income and is often seen as the next success story, comparable to the rise of Vietnam. The main reasons cited for India's comparatively weak development are its excessive bureaucracy, weak infrastructure and, above all, its backward agriculture. An estimated 45% of India's labor force still works in the unproductive and small-cell rural sector, which generates only 16% of total GDP and leaves India at the level of a developing country. However, the total GDP of the vast country qualifies India as an emerging economy, and in some high-tech areas it already occupies the status of a highly developed industrial country. GDP has slightly more than doubled in the last ten years. The ambition to reach $5 trillion by the end of 2024 has been postponed by the government with reference to the pandemic. The stock market, as measured by the BSE Sensex Index, has quintupled in the same period that GDP has doubled, which is likely to provide a significant boost to growth. The pandemic has hit India particularly hard. With about 13.5 million reported infections and a much higher number of unregistered cases, India matches with Brazil and is only behind the United States. The strict lockdown has contributed to a massive economic slowdown of about 10% in 2020. Growth of up to 10% is forecast for 2021, although the recent wave of COVID-19 cases could lead to a correction. Estimates suggest at least a temporary loss of 100 million jobs, mostly in the vast army of informal workers. Despite multiple government cash injections, banks were already a weak link in the economy before the pandemic. They could slow down the recovery in the coming years due to capital shortages and limited credit supply. However, India is benefiting from rising tensions between China and the West, which sees India as a counterweight to an increasingly aggressive China. Billion-dollar investments by companies such as Google and Facebook are displacing Chinese firms in advanced mobile technology. Germany is now India's most important European trading partner. Firms such as Volkswagen, Bosch, BASF, Bayer, and Adidas maintain significant production facilities. Overall, India benefits from high inflows of foreign investment.

Prime Minister Narendra Modi, who has been in power since 2014, describes himself as the founder of a ''New India.'' As a Hindu nationalist, he wants to put religion back at the center of the state, back to the country's cultural roots and at odds with the secular constitution. Modi, who rules in an increasingly autocratic manner, has initiated a number of necessary reforms but has

made significant errors in implementing them. These reforms include the fight against corruption through a currency conversion, the introduction of a nationwide value-added tax and, most recently, the urgently needed but highly controversial pro-competitive measures in agriculture.

Despite significant tensions in its neighborly relationship with China, the Indian government was still courting Chinese leader Xi Jinping in late 2019. However, the recurring border war in the Kashmir region reached a new climax in mid-2020, with at least 20 Indian soldiers killed. India sees Kashmir as an internal affair, while China occupies autonomous Tibet. The Himalayan region enjoys major geopolitical importance as a border area with its arch-enemy Pakistan and as the headwaters of all of South Asia's major river systems. Through economic development programs, China has gained considerable influence over India's neighbors Pakistan and Bangladesh. India intends to significantly reduce trade with China and seeks close security cooperation within the so-called Quad Group, which consists of the United States, Japan, Australia, and India. The US sees both economic and geopolitical advantages in closer cooperation with India. Even though in recent years some expectations have been disappointed and the country is currently struggling with a record wave of COVID-19 diseases, the stock markets have run hot and India remains a promise of a better future, not least due to its democratic constitution and legal system, which make it close to the West, and because it already plays a significant role in the field of future technologies.

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Mr. von Elten has decades of experience in the banking industry. Since 2008 he has been a member of the advisory board of BSZ AG, which took over IFP AG in 2014 and thus became Belvoir Capital AG. He enjoyed an international career at JP Morgan for close to 30 years. He returned to Switzerland as General Manager of Schroder & Co Bank AG from 1995 to 2003. Furthermore, Mr. von Elten's passion is art; he is a co-founder of the gallery Elten & Elten.

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