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Macroeconomic Comment

Global Economy in Conflict between High Growth and Overheating/Inflation

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The OECD has once again raised its expectations for global growth this and the next year, now forecasting 5.8% this year and 4.4% next year. The International Monetary Fund even expects 6% for this year. This is considerably more than the 3.5% slump in the first year of the pandemic. Leading indicators increased again in May, raising concerns about overheating and inflation, especially in the US, where stimulus measures have been and continue to be particularly distictive. The Federal Reserve Bank justifies its extremely expansionary monetary policy despite the strong upswing referring to the danger of still high unemployment. However, several economists attribute the delayed recovery in the US labor market to overly generous payments to laid-off workers who are in no hurry to return to the labor market. In addition, many companies used the crisis to further streamline their processes and become more digital. Large companies are currently offering incentives, including higher wages, to fill vacancies that are at record levels. The 4.2% annualised inflation spike reported in April was surprising, and a further increase near 5% is expected.

However, there are good reasons why a majority of experts believe that the inflation phenomenon is temporary. The government-imposed closure of entire sectors of the economy has undermined the principles of the market economy, as have the subsequent, enormous government rescue programs. The biggest drivers of inflation at present are energy, commodity, and logistics prices, which fell sharply during the pandemic and are now rising substantially from a low base. The high savings surplus and catch-up effects are currently fueling consumption, supported by an expansionary monetary and fiscal policy, which seems excessive at this stage of the economic recovery. A clearer picture will only emerge as many government programs are scaled back. In the US and parts of Europe, the situation is aggravated by the fact that the housing market is empty and prices are being passed on both for buying and renting. Temporary shortages of building materials such as wood and steel are delaying and increasing the cost of new housing projects. Even though pressure on the FED to scale back monetary stimulus is growing, no rapid change is expected. Stocks and bond markets have so far reacted calmly in anticipation of declining inflation in the coming year.

Germany to face Elections that could lead to Historic Upheaval

Compared with other countries in Europe, Germany has withstood the pandemic well, with economic output down 4.9% in 2020. With expected growth of up to 4% this year (German government) and 4.4% next year (OECD forecast), Germany should return to its pre-pandemic level in the first quarter of 2022. An important reason for the relative strength during the crisis was the high share of industrial activity and export capability, with China's early recovery as a major export market helping significantly. Another reason was the comparatively low level of government debt, which allowed the downturn to be cushioned with a total of 300 billion euros in government funds. However, after the federal election in September 2021, what was prevented by government subsidies during the pandemic is likely to worsen: more insolvencies, rising unemployment and additional burdens on small and medium-sized businesses. The good crisis management, however, conceals longer-term effects of policy fatigue under Chancellor Merkel, who has governed for 16 years, the first four years and the last eight in an increasingly divided coalition of CDU/CSU and SPD. For many years, the coalition thrived on reforms under Merkel's predecessor Schröder, but these benefits have increasingly diminished. The euro, which is far too weak compared to Germany's economic strength, and globalisation have played a major role in enabling the strong industrial nation to build up a dangerously high dependence on exports. Surpluses in the current account, negligence of its own infrastructure (digitisation/education/schools, failure to modernize the administration) and the debt brake have made it possible to achieve budget surpluses for several years. A large part of the budget went into various social benefits and will permanently burden budget management in the coming more difficult years. For too long, Germany has lived from its substance. From 2015 to 2019, growth has already fallen behind the average of the Eurozone. According to the OECD, Germany occupies an inglorious top spot among the 37 OECD countries in terms of taxes, social and energy costs.

This September, a new government will be elected in which, according to current forecasts, the Green Party will play a significant role. Chancellor candidate Annalena Baerbock and her party are pursuing a rigorous climate policy, want to further expand social benefits, and enforce high moral standards in international trade. Like all other leading parties, the Greens are promising huge, state-led investment programs, to be financed mainly by new debt but also by higher taxes. The already stricter CO2 requirements from Brussels, as well as the recent ruling by Germany's highest court to rework climate targets, are negatively affecting Germany's industrial base. The goods produced in the country for exports leave a heavier footprint at home, even though these goods produced with high environmental standards contribute globally to improving the climate. The German economy's heavy dependence on the Chinese market, especially in the all-important automotive sector, will be a burden in times of growing hurdles in doing business with China. Finally,

Germany will have to make high solidarity contributions to the EU and make up a significant part of the financial shortfall caused by the UK's exit. Germany as a business location runs the risk of being overregulated and overburdened by the state and losing competitive advantages.

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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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