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Macroeconomic Comment

A Growing Risk of Recession in Europe and the US

October 27, 2022, Peter von Elten

Due to misjudgments of the inflation trend and a delayed reaction to inflation dynamics, central banks are now forced to announce even more restrictive monetary policies – yet, the economic downturn is already entrenched. Interest rate hikes – both the expected and the ones which have already taken hold – are now affecting the economy, with a time lag of several months. Central banks are thus finding themselves under pressure to determine how far to tighten their monetary policies to establish the best balance: curbing inflation without stalling the economy. Despite this, the International Monetary Fund has published a forecast of a 3.2% global economic growth for 2022, yet this is likely to fall to 2.7% in the coming year. This further complex economic burden could result in an even sharper decline in growth.

Though national debt has risen sharply since the financial crisis, this was still bearable for a while thanks to extremely low interest rates and inflation. The inflationary ballooning of government debt to combat the impact of the COVID-19 pandemic and to support Ukraine, along with rising interest rates, has sparked fears that there may be renewed regional debt crises. This rise in interest rates will inevitably lead to a revaluation of many financial stocks, as has already been evident on stock and bond markets. The next crisis to emerge is in global real estate markets: Higher interest rates and an inflationary rise in construction costs, coupled with plunging real incomes, have put pressure on worldwide markets. Leading analysis firm, Oxford Economics, expects a significant decline in prices and activity in select key markets that have been particularly strong recently. These include Canada, Australia, New Zealand, the US, as well as some markets in the Eurozone. The US 30-year benchmark mortgage rate has more than doubled in the last 12 months to nearly 7%, while this year, demand has already fallen by a third.

Xi Jinping's Unlimited Power

China's state and party leader has used the 20th party congress to further consolidate his power for a third electoral term, removing any remaining critics. With this act, China is transforming from one-party rule to one-man rule, becoming increasingly repressive both internally and externally. The last pragmatic and reform-minded members have been removed from the central halls of power. One of these, Li Kepiang, was prematurely dismissed from his role as acting prime minister. Hu Jintao, Xi Jinping's predecessor, was apparently taken away against his will during the

party congress, in full view of cameras. Xi Jinping has now re-assembled China's highest governing body, the seven-member Standing Committee, as well as the entire 25-member Politburo, with those loyal to him – all exclusively men. The cult of personality has grown to such an extent that the new party constitution now enshrines the "Xi Jinping Thought on Socialism with Chinese characteristics for a New Era" as well as Xi's concept of a "common prosperity".

Absolute control and complete surveillance, coupled with repression, isolation from the outside world, increasingly aggressive nationalism and the utmost autonomy – these are his policies' guiding principles for the future. In his party congress speech, he repeatedly emphasized security as his nation's top priority, highlighting the threat of "serious international developments", unseen in a century. He also announced the continued modernization of China's armed forces and their powerful system of strategic deterrence. He has declared that his historic mission is to reunify China with Taiwan, and has promised citizens that the state will ensure prosperity for all, demanding their obedience in return.

The days of high growth rates are most likely long gone. Shrinking workforces, soaring debt, slowing productivity gains and severe challenges in the real estate market, where prices have fallen for 13 months straight, are weighing heavily on future forecasts. The cost of lockdown and the zero-Covid policy have also had a significant impact on future growth. International firms have struggled with China's strong state influence on corporate decisions within the nation, likely leading to a shift in new investments to other markets. Recent studies have shown that China will probably continue to be the world's largest economy, but will trail far behind the US and other Western powers in terms of income levels. A few days ago, the US government imposed unprecedented restrictions on the export of high-performance chips to China, including foreign suppliers who employ US technology. There has been an ongoing global struggle for supremacy in high-tech, which China, the US and Europe are fueling with vast state subsidies. The question remains if a totalitarian system that suppresses freedom of enterprise and research can become the world leader in innovation – this is hard to imagine. Meanwhile, the US-China struggle for dominance over social systems and a new world order is being fought more openly than ever, and could even trigger a new Cold War.

Immediately after the party convention, Hong Kong and mainland stock markets sharply corrected, as did the renminbi, which fell to a 14-year low. Xi's omnipotence and quest for state control over the economy, as well as newly prioritizing national security over economic growth, have driven most foreign investors to sell.

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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. Further-more, Mr. von Elten's passion is art; he is a co-founder of the gallery Elten & Elten.

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