BELVOIR
CAPITAL AG

November 28, 2022

Macroeconomic Comment

Slight improvements in the global economy

November 28, 2022, Peter von Elten

Inflation and how to tackle it remain the western world's dominant economic issue. The **US Federal Reserve** is determined to fight inflation by continuing to raise interest rates into next year, even risking a recession. However, the US inflation rate has been falling slightly for a few months now, raising hopes that inflation may have peaked or even passed. Meeting minutes of the US Federal Reserve point in the same direction, as they cite that this monetary authority could be slowing its pace of interest rate hikes. Falling prices for energy and raw materials, as well as an easing of supply chains and freight rates, are a sign that things are already cooling down – a precursor for falling inflation rates. Yet, a sharper slump in business activity was visible in the interest-sensitive construction sector, which has not only suffered from rising interest rates, but also from higher material and labor costs. On the other hand, the strength of the labor market and robust conditions of most firms point against a large economic slump. The US government's three economic development programs will continue to support demand and investment for years to come. With a total budget of over 1.8 trillion dollars, the US intends to strengthen its infrastructure, production of semiconductors, climate protection and its social security system over the next 10 years.

Europe finds itself in the eye of the storm – unleashed by the war on its borders, as well as upheavals and missteps in recent years. The extremely high energy costs for households and businesses, alongside possible energy supply bottlenecks in the coming winter, have all had a negative impact on consumption and investments. The cost of living has risen significantly as a result of inflation rates reaching over 10%. Despite state support programs, poorer households will find themselves disproportionally affected by financial hardship. In fact, the vast government subsidies, intended to mitigate energy costs, are simply artificially depressing the reported inflation rate. In Germany, for example, a EUR 200 billion package has been announced as a form of economic defense against the consequences of the war, aiming to keep energy costs affordable. Despite an obvious downturn, the European Central Bank has no choice but to battle inflation with rising interest rates. Belated and lagging rate hikes have weakened the euro against the dollar, causing even more expensive imports and fueling inflation. It's clear that Europe will not be able to avoid a recession – albeit a slight one – as leading institutes forecast that Germany, its largest economy, will experience negative growth next year.

Unity in **Europe** will come under strain by the pressure from this winter's **wave of migration**. Many countries are facing enormous challenges from energy and housing shortages, high financial burdens, and the threat of social unrest. The crisis is evident in the right-wing political shift in countries such as Italy and Sweden, as well as the growth of right-wing extremist parties in France and Germany. These have been deliberately stoked by Russia, in an effort to destroy Ukraine's infrastructure.

In contrast to the US and Europe, **China** has eased its monetary policy to counteract a sharper slump in growth, triggered mainly by the economic consequences of its **zero-Covid policy** and its **smoldering real estate crisis**. China is currently reporting record high Covid-19 cases of almost 40,000 per day, though this number seems infinitesimally small in comparison to Europe's. China's population has been growing more frustrated with the strict policy, and this has now bubbled over into protests against Xi Jinping. In order to stabilize its real estate market, the government is providing additional loans of over USD 160 billion to property developers through its state banks, among other measures.

The **OECD** is not expecting a global recession but is instead **forecasting growth rates of 3 and 2.2% for this year and the next**. India is likely to report the strongest growth next year, ahead of China, at just under 6%. Asia will remain the main driver of global growth over the next two years. Inflation rates should come down significantly, primarily due to the base effect in energy prices. However, these will remain above the 2% target given by central banks for years to come, due to structural reasons.

November was marked by **significant activity in global foreign policy**. Both President Biden and Chancellor Scholz met President Xi Jinping for private talks for the first time in their respective capacities. As leaders of vastly different social and economic systems – both vying for geopolitical and economic dominance – Biden and Xi were not expected to reach any kind of rapprochement. Nevertheless, they managed to have important dialogues on global issues such as climate change, food security and the war in Ukraine. Chinese leadership distanced itself from Russian threats to use tactical nuclear weapons, stating a loud and clear warning to Putin. The meeting with Scholz had an overall more cooperative tone, as Germany's business delegation focused on the trade relations so vital to Germany. However, Europe is facing a difficult balancing act amidst the looming cold war between the US and China. It will remain dependent on the US for military and technological support for a long time to come. Thus, in exchange for American support, the US will no doubt demand Europe's loyalty at the expense of relations with China.

The **G20 summit** in Indonesia, the **ASEAN summit** in Cambodia, and the meeting of the Asia-Pacific Economic Cooperation (**APEC**) have highlighted the global shift towards Asia. China and the US are continuing to clash over exerting maximum influence in the Asia-Pacific region and the South China Sea.

COP27 in Egypt was a disappointment to many. Even though a 'loss and damage' fund was set, amounting to several 100 billion dollars, countries did not commit to making specific contributions. A portion of this aid has already been promised to South Africa, to phase out its use of coal, providing a model to other countries severely affected by climate change. Countries reaffirmed promises to limit global warming to 1.5 degrees Celsius, but given the current state of climate change, this now seems unachievable.

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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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