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Macroeconomic Comment

Global Economy – Growth Shifts to the Next Year

October 25, 2021, Peter von Elten

Full order books and short-time working are not a contradiction in terms in many countries at present, as prolonged distortions and bottlenecks in supply are affecting the pace of growth. The OECD and IMF are scaling back their economic expectations for this year and instead raising their forecasts for next year in the hope that the economic obstacles currently in place can be removed. The reasons are multi-layered:

- The **pandemic** continues to unsettle. New foci continue to flare up, restricting economic activities regionally and temporarily. By the end of the year, 40% of the world's population will have been vaccinated, according to the World Health Organization.

- **Supply bottlenecks** and **staff shortages** are slowing down the economy and affecting more and more international supply chains. The automotive industry and other sectors that use electronic components are being hit particularly hard. Industry efforts to focus on greater supply chain resilience rather than efficiency optimization are taking time and costing money.

- The **sharp rise in energy prices worldwide** is a major factor in the rampant inflation. The risk of a wage/price spiral grows the longer the state of elevated **inflation** continues with unchanged expansive monetary and fiscal policy. Companies are progressively passing on the increased costs to consumers. The expected high demand during the Christmas season creates scope for price pass-throughs. Although central banks continue to point to base effects and temporary distortions, they now see themselves called upon to reconsider their expansionary monetary policy.

- At the upcoming **climate summit** in Glasgow at the end of October, the awareness will prevail that the measures discussed or pledged so far will be far from sufficient to achieve the goal of limiting global warming to 1.5%. The **transformation of the global economy** towards climate neutrality by the middle of the century, which is still in its infancy, is already beginning to have an impact on the cost structures of companies and has contributed to the distortions on the energy markets.

- **U.S. obstructionism** continues. Raising or eliminating the debt ceiling and the trillion-dollar programs to rehabilitate infrastructure and address social imbalances remain blocked.

- With determination, increasing control of companies and sharp interventions in various sectors of the economy, **China** is pushing ahead with the **restructuring of the economy**

that it has announced for years. Qualitative growth and independence from foreign countries in strategically important fields such as technology are central concerns. With a hard hand, companies are increasingly being sworn in to the goals of the top party leadership. China's increasing isolation is costing growth and unsettling international corporations in the further development of their activities in the country. The government-imposed lowering of debt limits for **real estate companies** has triggered a crisis in this sector of the economy – so important in China – spearheaded by the second-largest company, Evergrande, with debt of over $300 billion. China will hold the responsible parties accountable, but will ultimately be able to contain the crisis and avoid contagion to other sectors of the economy.

- Economic indicators for the **euro zone** fell to a six-month low in October, with export-dependent Germany being particularly hard hit and fearing further weakening growth in the fourth quarter. Dependence on China, especially in the automotive sector, is having an impact. Next year the €750 billion European recovery program will provide increased economic stimulus.

Japan – Global Pioneer of Ultra-Expansionary Monetary and Fiscal Policy

The Liberal Democrats (LDP), who have been in power for many years, have appointed 64-year-old **Fumio Kishida** and former foreign minister as successor to Prime Minister Yoshihide Suga, who resigned prematurely. The hoped-for generational change failed to materialize. Lower house elections will be held at the end of this month, which will almost certainly confirm Kishida as prime minister. Kishida stands firmly by the Japan-U.S. alliance and is committed to a free and open Indo-Pacific region. In view of the Chinese threat, he plans to further strengthen national defense. To revive the economy after the Corona downturn, he wants to pass a stimulus package of several US$100 billion. He also promises a new form of Japanese capitalism to distribute wealth more equitably.

Like other leading industrialized nations, Japan is aiming for **climate neutrality by 2050**. After the Fukushima nuclear disaster ten years ago, Japan had largely shut down its 54 nuclear reactors and relied on imported coal and gas, which now generate 70% of its electricity. To meet climate targets, Japan plans to use more nuclear power again and must greatly expand renewable energy. The country also sees itself as a pioneer in promoting hydrogen as the energy of the future.

With a gross national product (GDP) of over US$5 trillion, Japan is still the **world's third-largest economy**. Since a massive real estate and stock market crash in the early 1990s, the country has struggled to date with low growth and intermittent deflation, which it is trying to counter with

ultra-easy monetary and fiscal policies. Despite extreme government debt, which is expected to reach 260% of GDP by the end of this year, the country continues to enjoy a good credit rating in the financial markets, as it has borrowed mostly domestically and is also the world's largest net creditor. The Bank of Japan (BoJ) was the first of the leading central banks to make large-scale purchases of its own government bonds to finance government deficits. The BoJ's total assets amount to about €5.4 trillion, or more than 120% of GDP (compared to about 58% of GDP for the ECB). In order to stimulate the economy and support the stock market, the BoJ has been buying Japanese stocks in the form of ETFs in the order of more than US$50 billion annually since 2010.

Despite all government support measures and a zero interest rate policy for many years, Japan has not succeeded in significantly accelerating growth and driving inflation up toward 2% as planned. The technologically highly developed country can serve as an example that even extremely expansionary monetary and fiscal policies can hardly generate sustainable growth in times of a shrinking and aging population and weak productivity development.

The Japanese equity market is considered to be favorably valued in a historical context and compared to other equity markets and is underrepresented in international portfolios, according to experts. The broad TOPIX index is currently valued at just under 14 times estimated earnings over the next twelve months and is therefore relatively cheap compared to the MSCI World (17.7x) and the S&P (20x). Decades of stock market losses are likely to have undermined the confidence of the international investment community, despite a recovery in prices in recent years. In addition, the state has already become the largest investor through the central bank's share purchases and is increasingly reaching its limits with its annual purchases.

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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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