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Macroeconomic Comment

Prospects for the Global Economy at the Start of the New Decade

January 22, 2021, Peter von Elten

Most economists and financial experts are unusually unanimous in forecasting a strong upturn in the global economy for the current year, which the financial markets have already anticipated with record levels of stock indices. The prerequisite is the successful containment of the pandemic through an extensive vaccination program.

At global level, the recovery by the end of 2021 should make up for the severe slump in economic output in 2020. However, the Western industrialized countries, including Japan, will not return to pre-crisis levels until 2022, while the emerging economies will exceed pre-crisis levels before the end of 2021, mainly thanks to the strong performance of China. The rise of Asia remains the most important trend from a global perspective.

In the battle for global dominance, China has gained further ground on the USA. China's gross national product is expected to grow by more than 10% in total during 2020 and 2021, while the USA will remain close to stagnation over the same period. According to the latest forecasts, China will replace the USA as the largest economic power as early as 2028, which is almost 5 years earlier than previously predicted. The chaotic circumstances surrounding the change of power in the USA, the years of wrangling over the UK's exit from the EU, and the EU's protracted negotiations to resolve the crisis have reinforced China's and other authoritarian states' belief that they are more effective to democratically governed states in the competition between social systems.

In addition to the advanced recovery in Asia, the expected upswing will essentially be supported by three pillars:

- Continuation of extremely low interest rates in conjunction with excessive liquidity provision by central banks.
- Massive stimulus measures by governments at the cost of continuing sharp increases in government debt.
- Huge consumption pent-up demand.

Risks to this positive scenario include unexpected complications in dealing with the pandemic as well as higher inflation, at least in the short term. The force of the economic measures, which are unprecedented in magnitude, combined with the massive pent-up demand, could lead to a surge in demand meeting reduced supply and thus allowing price exaggerations. In the healthcare sector as a whole, costs will rise in the longer term because the staff shortage that already existed before the crisis has worsened and can only be offset by higher wages. Other service sectors will also have to catch up. Raw material and energy prices have already risen selectively. Nevertheless, the rise in inflation is likely to be a temporary phenomenon. The dramatic increase in government debt, the aging of the population, high spending on healthcare, years of weak productivity growth, expiring government support programs and growing pressure to consolidate budgets will depress growth in subsequent years and tend to have a deflationary effect. Beyond the next few years, however, the question arises as to whether further increases in government debt combined with extremely low interest rates and excessive liquidity provision by central banks will not undermine monetary stability to a much greater extent. The world is caught in an interest rate and debt trap, leading to the paradoxical situation that any increase in debt levels must be accompanied by an extension of low interest rate policies by central banks in order to avoid a dramatic economic collapse. However, permanently low interest rates exacerbate the inequality and division of society, because the inflation of material assets that has prevailed for years primarily benefits wealthy strata, while the financial assets of the poorer strata of the population have been shrinking in real terms for years and undermining old-age pensions.

Europe - Strengthening Autonomy in an Increasingly Bipolar World

In the digitized world, Europe has lost the leading position it was able to maintain in the analog world. National barriers prevented a common European standard for the digital economy and thus a strong single market. In the aftermath of the financial and economic crisis, Europe focused on consolidating budgets for too long, partly due to the already high national debt of individual countries, and invested too little in future technologies, with the result that productivity hardly grew at all and many companies - around 30% according to official estimates - digitized their business processes too late or not at all. During the pandemic phase, EU companies will cut back their investments by at least 30%. Europe runs the risk of being increasingly ground down between the USA and China and is challenged to bundle its own strengths. After seven years of negotiations, Europe concluded an investment agreement with China shortly before the end of last year. This is a step towards an independent foreign economic policy, even if there is the risk that the agreement will run counter to the interests of the new US administration.

Faced with an ever-widening innovation gap with the US and China, and under the devastating impact of the pandemic, Europe has pulled itself together and achieved a historic breakthrough with the €750 billion reconstruction fund. For the first time, the EU is acting as a major debtor on the international stage on behalf of the 27 countries, but in its own name. The allocation of almost €400 billion from this program as non-repayable grants, which will particularly benefit countries severely affected by the pandemic, is a strong show of solidarity and reaffirms the effort to prevent economic imbalances in the EU from growing further. While countries such as France, Italy and Spain suffered losses in gross national product of up to 10% in 2020, Germany was able to limit the losses to 5% thanks to its stronger industrial base and export strength. From the recovery program, more than 50% is to flow into research, digitalization, climate change and specifically decarbonization, as well as into a European healthcare program. With the adoption of the above-mentioned recovery program with funds to be drawn down over the next 7 years, the EU budget for the years 2021 to 2027, amounting to almost €1.1 trillion, was also approved. Even before the adoption of the above programs, EU institutions had launched three programs for overcoming the pandemic amounting to a total of € 540 billion. Europe should therefore not lack the financial resources to launch a strong economic recovery once the pandemic has been overcome. However, the fall of the Italian government over the Italian "recovery plan", which has now grown to a volume of € 310 billion over 4 years, illustrates the dangers of the distribution struggles that large funding volumes cause.

Conclusion

The already clearly visible recovery of Asia, the multi-trillion dollar support and reconstruction programs planned by the new US administration, and the huge programs already adopted by the EU justify confidence that the global economy will recover significantly once the pandemic is over. However, the global distortions and collateral damage arising from the large increase in debt and the increasing conflation of extremely expansionary monetary and fiscal policies will weigh on growth in the coming years.

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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 holds various board mandates and was previously a member of the board of directors of Fortune Wealth Management AG, Zurich. Prior to that, he was General Manager of Schroder & Co Bank AG, Zurich, 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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