FROM TODAY to TOMORROW

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January 11, 2021

BEST WISHES FOR A HAPPY AND HEALTHY NEW YEAR IN 2021 – FORTHCOMING TRENDS

I wish you all a very happy and healthy new year. May you and your loved ones start the year ahead in the best possible circumstances.

2020 was a chaotic year in many respects – from the Covid-19 crisis to Joe Biden's election and the Brexit deal, 2020 was a year of great uncertainty. All observers tried as they might to draft projections, but it was nigh on impossible to assign probabilities to the world economy. Highly expansionary economic policy was designed to curb and manage these uncertainties, with the combination of government policy and central bank action proving to be effective.

However, this uncertainty did fast-track trend changes that were deemed small-scale yet are now shaping forces worldwide in both economic and political terms: China-US tension reflects this phenomenon.

If we look to the future, we can single out six aspects that are set to shape the post-2020 economy.

Firstly, public debt

Public debt was crucial in diffusing the effects of the health shock over time, and it has surged substantially: according to the IMF, the debt to GDP ratio stands at its highest since 1880. The risk for governments now is that they may have narrower leeway to act if the health crisis persists, and the conversation will turn to debt cancelation, which cannot occur in the euro area as all governments would have to unanimously approve this move – a possibility that no-one can envision. There is also a risk of losing credibility if the crisis picks up a pace, at a time when income and job market trends will become more uncertain. This approach could lose its effectiveness as a policy tool, while this loss of credibility may drive a social crisis.

This also means that macroeconomic adjustment could evolve and no longer solely involve public debt. Higher inflation could lead to different arbitrages in both time and space, and this rising inflation could come from a less coherent economy, with globalization changing, but also greater indexation to wages and insufficient indexation for pensions.

Secondly, the change in resource allocation

Entire sectors of the economy are set to be affected for the long term as a result of the crisis. Air transportation will probably no longer enjoy the same appeal and swift development it saw in the past. Meanwhile, information technology has already totally overturned our usual habits. Meetings will not all take place behind a screen in the future, but in view of the cost savings achieved, they will replace unnecessary trips. This will also mean that accommodation will have to be approached differently, as hotels depend a great deal on business trips to fill their rooms on weekdays. We will see changing strategies in several existing services sector, while other sectors will be the growth drivers of the future. This is the real shift that we need to grasp, although it is a challenge to work out just who the winners are likely to be.

Thirdly, the technological shock

The US-China battle all boils down to technological supremacy. This confrontation between the two heavyweights is fascinating, as on the one hand there are very well established companies – sometimes with virtual monopolies in developed markets – while on the other there is considerable state support to develop the technologies that will sit at the heart of industrial and service developments in the economy of the future.

The roll-out of remote working as well as so-called third-generation globalization or unbundling (automation of remote services and arbitrage of international wage differences without the physical movement of workers to Richard E. Baldwin) bring a new digital dimension to the world economy. New standards have been accelerated by the crisis and the challenge is now to set the technological standard, which is why tension will not disappear spontaneously.

Fourthly, polarization of the world economy

The world economy has become integrated since the start of the 1980s, initially via finance and the major role played by central banks, and subsequently at the start of the 2000s, with China's entrance onto the world trade stage after it joined the World Trade Organization (WTO). Financial globalization, espoused in the US under Ronald Reagan in particular and supported by technology, gradually unified the financial markets. China gave some power back to developing countries, as the country's size reversed the world production order: developed countries' output now accounts for less than half of world figures.

The Covid-19 pandemic along with China-US tension have transformed these situations. On the one hand, the pandemic fostered more of an "every man for himself" attitude in macroeconomic management, as each country has its own institutions and they were not all affected at the same point in time, while each country also needed to safeguard its ability to manage the labor market. On the other hand, China-US tension was not just economic and technological, but also political: the new aspect now is that China has a political dimension that Japan did not have in the past when it was a world tech heavyweight. This political dimension also draws on the size of the country and its population. Europe is slow to make its position known, and the continent has still to clearly assert its choice, as it is both friend of the USA but also dependent on China.

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The fifth point is the fight against inequality

Looking to globalization, we can observe that inequalities between countries have tended to decrease considerably, as the global extreme poverty rate – those living with less than USD1.90 per day – stood at its lowest in 2017, yet inequality within each country has been on an uptrend.

The recent pandemic has changed both these dimensions. Firstly, a great number of emerging countries are set to be dented by the pandemic-related economic shock, and the poverty rate is likely to increase again as many emerging markets' economic activity hinges on the outlook in developed countries.

Secondly, if we look to inequalities within each country, we can see they are considerable across the board, whether before redistribution (France) or after (US). Clear choices therefore need to be made, as we can see that the median citizen's economic situation is generally weaker when inequalities increase. The increased role of fiscal policy in steering the macroeconomy will certainly have a major impact, as differences in wealth owned are very closely connected to the valuation of financial assets. The steady drop in interest rates since the start of the 1980s has considerably contributed to the revaluation for all financial assets and hence the greatest fortunes. This situation is now in the past, as nominal interest rates are very low for a sustained length of time, while real interest rates will be negative, and the economy is set to shift more towards economics and less towards finance.

The sixth point is sustainable growth

The health crisis has triggered a greater awareness of the need to consider our environment, with the ecological benefits of lockdown periods crystal clear to all. Yet no-one really wants to take on board the income downgrade required to make this kind of situation sustainable for the long term. But looking beyond this impossible choice, decisions must be made with the long view in mind, as the harmful effects of greenhouse gases for example are only visible several years down the line.

Energy sources must be substituted very swiftly to curb the delayed effects outlined, and it is crucial to roll out aggressive strategies right now if we are to reach net-zero emissions by 2050. This requires major public and private investment, which is needed now, and is a pre-requisite for maintaining a solid income and job trend, although other measures will certainly also be needed. Tomorrow will be too late.

Conclusion

This environment is obviously highly restrictive as the macroeconomic balance has been upended by the health crisis in a context that was already under pressure. Zero interest rate monetary policies go back further than the current crisis, as does China-US tension, productivity gains were lower, and while public debt admittedly surged during the crisis, it was well and truly on the up beforehand. The Covid-19 crisis has further underscored macroeconomic imbalances that were already visible, while also adding to them, as some business sectors will now need to be reinvented. Overall, the Covid-19 crisis means that we need a different take on the economic model, and this will make for fascinating observation over the years ahead.

In the short term, the challenge for 2021 will be to apply economic policy to manage the macroeconomic situation. State intervention put economic adjustments worldwide on hold in 2020, as countries sought out a solution to the health crisis. However, this action has continued at the start of 2021: the UK has just taken more restrictive lockdown measures, as has Germany, while restrictive policies in France will not change for quite some time. Will States maintain the same efforts as in 2020 or will governments begin to reduce these moves? There are two possibilities in this situation: on the one hand, countries can deploy more limited resources, forcing households and companies to absorb the adjustment. This involves greater default risk for companies, along with an increase in jobless numbers as the various security mechanisms will let more slip through the cracks. Or on the other hand – an option I do not think is appropriate for the moment – they can swiftly revisit fiscal rectitude. Given the current outlook, any overly hasty moves would hark back to the challenging 2011-2012 period, which it is better to avoid.

My perception is that governments will maintain a strong presence in 2021, although safety nets will let more slide through the cracks. Macroeconomic adjustment will no longer solely involve upping public debt and selling it to the central banks. The new balance will mean greater inflation – at least temporarily. This would firstly support the reallocation of resources, similarly to the situation in the 1970s after the first oil shock, when inflation facilitated adjustments. With the ongoing active approach from the central banks, this will lead to negative real interest rates to ultimately encourage economic stakeholders to look more to the economy. This would also support public debt management by offering out greater leeway for governments. This is my take on the period out to 2025. Inflation will be dictated more by internal than external considerations, in a reversal compared with the globalization period, and will outstrip goals set by the central banks. The ball is in governments' court now, rather than central banks'.