Economic Perspectives

Navigating the Tottering Twenties

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Navigating the Tottering Twenties

- After the end of WW1, and a devastating bout of deflation in 1921, the global economy ‘roared’ in the 1920s, generating widespread prosperity as resources were redeployed from wartime destruction to peacetime construction.
- The financial ‘war’ of 2008-09, reprised in 2020-21, sets the stage for a very different global outlook. ‘Spare’ labour resources are being absorbed in the public sector and healthcare. State is constrained in its ability to reduce ‘wartime’ spending and is adding responsibilities. Inflation is untethered.

Why the "Tottering Twenties"?

- With few exceptions, US and China among them, only large, profitable private companies have the means to invest in emerging technologies.
- Responsibility for updating social and economic infrastructure falls predominantly to the state.
- Bigger government and stagnant living standards go together.
- In mature advanced economies, where the public sector has already a significant footprint, as public consumption grows, so private consumption slows or falls.

Why the "Tottering Twenties"?

- Polarisation of corporate experience to continue, with a profits crunch unfolding and credit access drying up for the zombies.
- Global financial system will have to cope with a delayed default cycle. Credit will tighten regardless of how many times the Fed hikes.
- Debt interest burdens of governments could rise very sharply.
- Next few years could be quite brutal, but also transformative.

Why the "Tottering Twenties"?

- Inflation likely to remain elevated for a few years, resulting in a significant reset of the general price level for Western countries.
- As global economy weakens, CBs will turn out to be paper tigers and inflation expectations will adjust to the new reality.
- CBs will focus their attention on financial stability and the suppression of credit spreads.
- Currencies will become increasingly volatile as countries' perceived risk profiles shift around.

Solving for strategy in 5-dimensional space

- Task of formulating a successful investment strategy for the Tottering Twenties has become fiendishly difficult: there are 5 dimensions.
- Macro-monetary regime change.
- De-globalisation/balkanisation of supply chains and international lending/borrowing.
- Prioritisation of safety and security.
- Tangible premium versus virtual discount: reversal of secular price trend in commodities vs services.
- Inter-generational wealth and income dynamics.

1. Macro-monetary regime change

- Western governments and central banks are in a bind: fiscal control can only be regained in the context of a strong private sector recovery; yet monetary control can only be regained by abrupt and significant credit tightening.
- Central banks can offset fiscal normalisation through liquidity injections, but only at the expense of even poorer inflation outcomes. Financial repression lives on, but CBs are losing their ability to suppress financial volatility and prevent a widening of credit spreads.

2. De-globalisation/Balkanisation of supply chains

- The replacement of global supply chains and networks based on cost optimisation with more localised supply chains based on resilience and redundancy.
- Balkanisation: the fragmentation of a larger whole into smaller segments or regions, which may be hostile or uncooperative with each other.
- S chains are being reconstituted to reduce dependency on unreliable or hostile sources.
- In some cases, new capacity is being installed domestically in the interests of national security.

Urgent prioritisation of resilience

- Strategies to secure future supplies of key raw materials, including oil, gas, lithium, iron ore, phosphate and rare earths, and strategic components, eg, chips, APIs and batteries.
- Massive public subsidies in the US, the EU, and Japan seeking to maximize self reliance in semiconductors by creating domestic supply chains, notably by building advanced on-shore chip foundries to reduce today's total dependence on TSMC and Samsung East Asian foundries for leading edge chips.

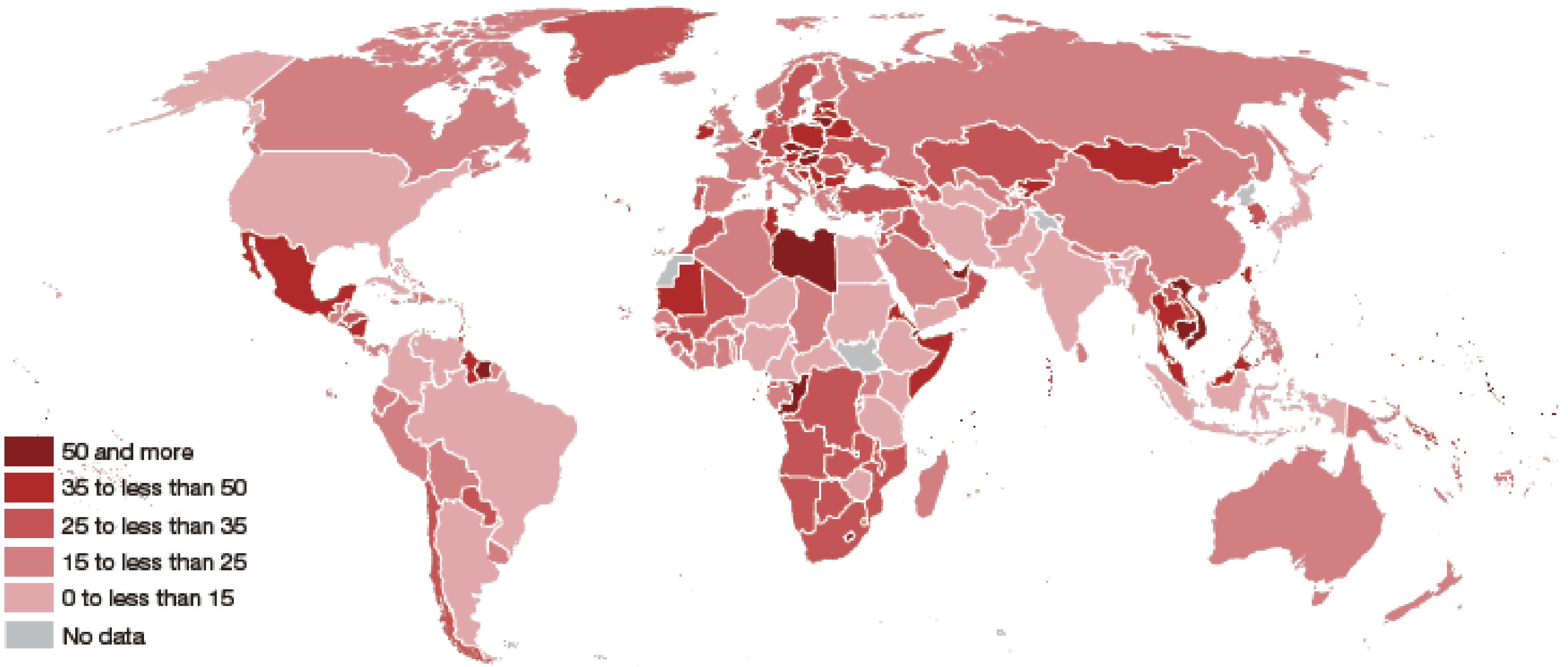
Urgent prioritisation of resilience

- The same is unfolding for batteries with China dominating the global supply chains in battery materials, smelting and refining, and component and battery cell making.
- Batteries are the 21st century's oil barrels as the world begins to take climate change seriously.
- Power generation, industrial transport, logistics and shipping will be critical sectors in building resilience.

Trade openness has become a risk factor

- Trade hubs (HK, Singapore) are especially vulnerable to the reordering of supply chains

Map 1.4 | **Trade openness index, 2020**
(Percentage)

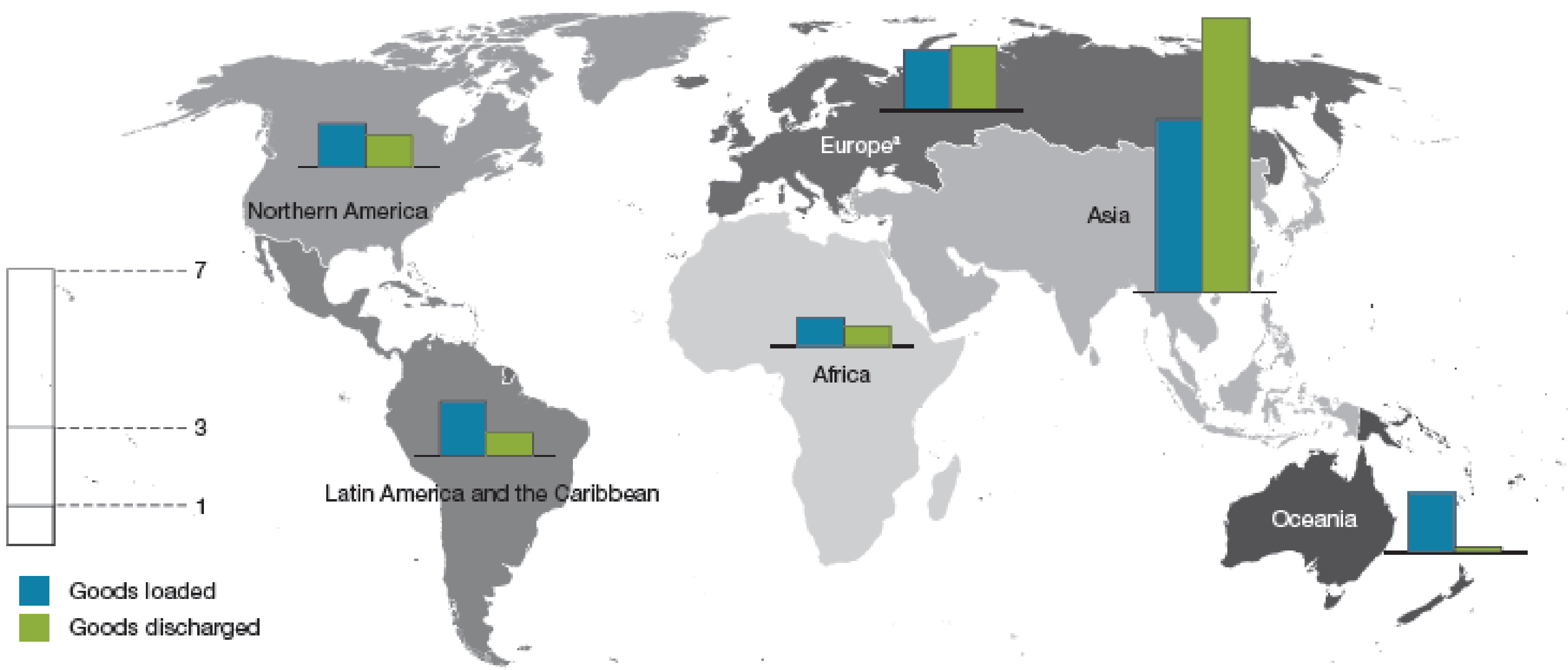


Note: This index measures the relative importance of international trade in goods relative to the domestic economic output of an economy. Exports are given equal weight to imports.

Asia relies heavily on Oceanic and Latin American cargoes

- Loaded = exported; discharged = imported

Map 5.1 **Tonnage loaded and discharged, 2020**
(Billions of tons)



[a] Including the Russian Federation and the French overseas departments.

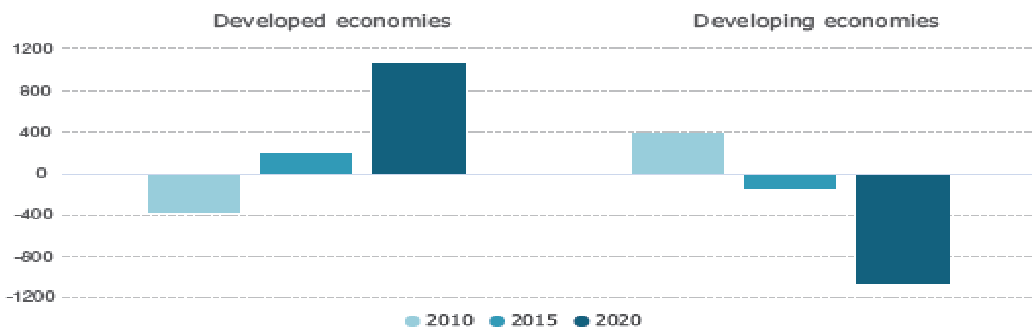
Asia has a deepening dependence on seaborne imports

Dry cargo

Group of economies	Loaded			Discharged			Balance	
	Volume (Millions of tons)		Annual growth rate (Percentage)	Volume (Millions of tons)		Annual growth rate (Percentage)	Volume (Millions of tons)	
	2015	2020	2020	2015	2020	2020	2015	2020
World[a]	**7 074**	**7 730**	**-2.2**	**6 879**	**7 545**	**-2.2**	**195**	**185**
Developed economies	3 222	3 461	-3.1	2 300	2 142	-11.2	922	1 319
Developing economies	3 853	4 269	-1.5	4 579	5 403	2.0	-727	-1 134
Developing economies: Africa	363	416	-0.9	364	372	-3.5	-1	44
Developing economies: America	1 044	1 093	-0.9	422	420	-2.8	623	673
Developing economies: Asia and Oceania	2 446	2 760	-1.9	3 794	4 611	2.9	-1 348	-1 851

[a] Annual world totals of goods loaded and discharged are not necessarily the same, given bilateral asymmetries in international merchandise trade statistics and that goods loaded in one calendar year may reach their port of destination in the next calendar year.

Figure 5.1.3 | Seaborne trade balance (Millions of tons)



3. Prioritisation of safety and security

- Graphic images of war in Eastern Europe, following hard on the heels of the lingering pandemic, have prioritised public concerns for safety and security.
- Escalating energy and food prices are motivating a desire for insulation against global events.
- The state is assuming an expanding role in meeting these concerns and devising better strategies for food and energy security.
- Elevated risk of threat from state-sponsored cyber-terrorism motivates private and public spending on cyber defences.

Asia imports almost half its commodity foods

- Exports of raw food by origin & destination, 2020

Agricultural raw materials

Origin	Destination					
	World	Developed economies	Developing economies			
			Total	Africa	America	Asia and Oceania
World	**235 230** (100)	**117 130** (50)	**117 443** (50)	**6 344** (3)	**8 254** (4)	**102 845** (44)
Developed economies	145 477 (100)	89 088 (61)	56 345 (39)	3 807 (3)	5 448 (4)	47 090 (32)
Developing economies	89 753 (100)	28 041 (31)	61 098 (68)	2 537 (3)	2 806 (3)	55 755 (62)
Developing economies: Africa	10 780 (100)	3 376 (31)	7 399 (69)	923 (9)	69 (1)	6 407 (59)
Developing economies: America	24 082 (100)	9 480 (39)	13 994 (58)	134 (1)	1 509 (6)	12 352 (51)
Developing economies: Asia and Oceania	54 891 (100)	15 185 (28)	39 704 (72)	1 480 (3)	1 228 (2)	36 996 (67)

Note: Percentage of exports to the whole world in parentheses.

Asia has a food deficit of US$150bn per annum

- Exports of food by origin and destination, 2020

All food items

Origin	Destination					
	World	Developed economies	Developing economies			
			Total	Africa	America	Asia and Oceania
World	**1 581 569** (100)	**916 364** (58)	**663 485** (42)	**86 349** (5)	**81 758** (5)	**495 379** (31)
Developed economies	946 990 (100)	666 401 (70)	279 643 (30)	36 877 (4)	44 863 (5)	197 903 (21)
Developing economies	634 579 (100)	249 963 (39)	383 842 (60)	49 472 (8)	36 895 (6)	297 476 (47)
Developing economies: Africa	59 249 (100)	28 030 (47)	31 174 (53)	14 871 (25)	447 (1)	15 857 (27)
Developing economies: America	231 068 (100)	107 423 (46)	123 022 (53)	10 886 (5)	30 949 (13)	81 186 (35)
Developing economies: Asia and Oceania	344 262 (100)	114 510 (33)	229 646 (67)	23 715 (7)	5 499 (2)	200 432 (58)

Note: Percentage of exports to the whole world in parentheses.

A third of Asia's fuel imports come from outside Asia

- Exports of fuels by origin and destination, 2020

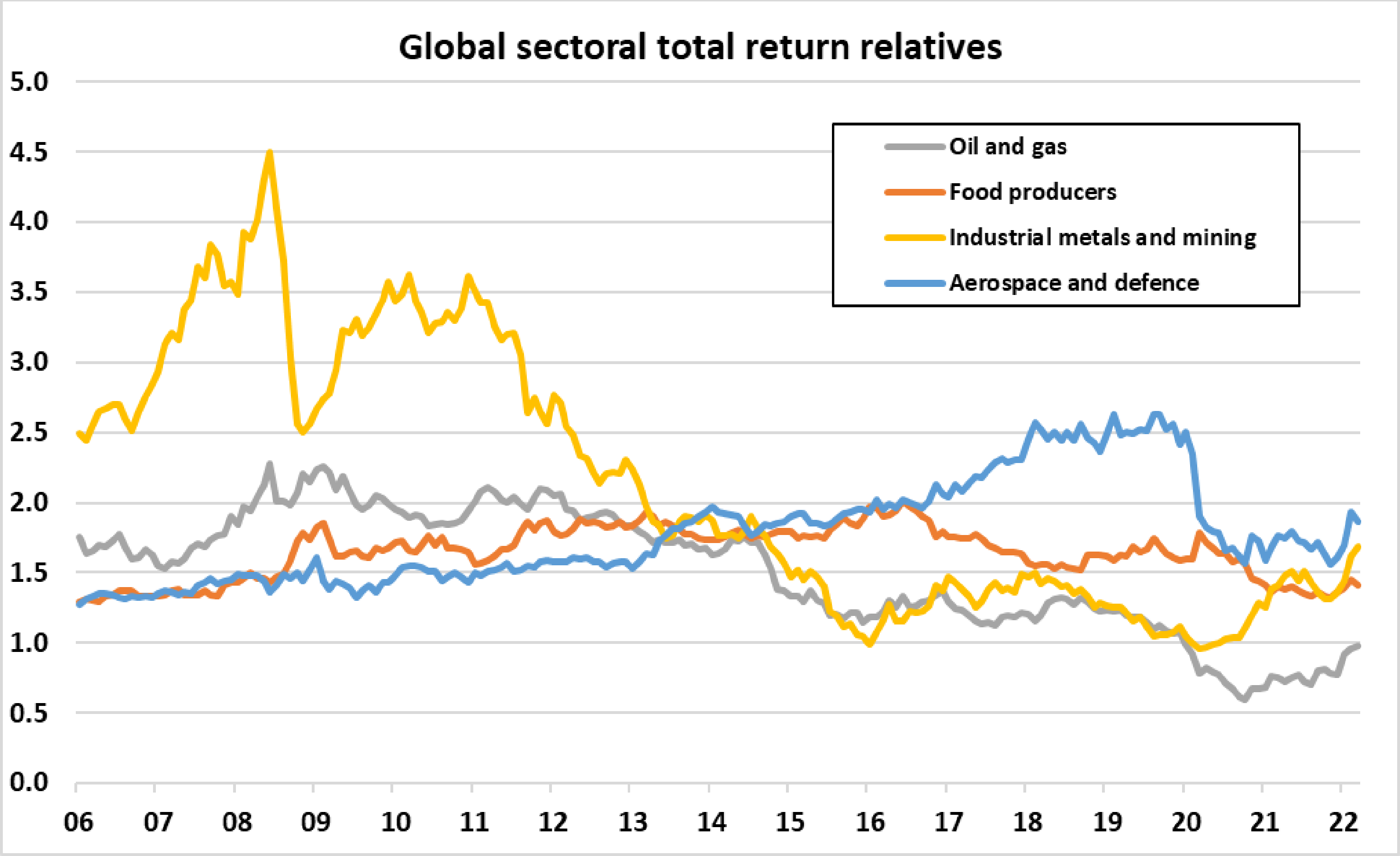
Fuels

Origin	Destination: World	Developed economies	Developing economies: Total	Africa	America	Asia and Oceania
World	**1 496 044** (100)	**667 991** (45)	**792 961** (53)	**61 150** (4)	**89 168** (6)	**642 643** (43)
Developed economies	685 892 (100)	431 079 (63)	233 507 (34)	23 107 (3)	62 994 (9)	147 406 (21)
Developing economies	810 152 (100)	236 912 (29)	559 454 (69)	38 043 (5)	26 174 (3)	495 237 (61)
Developing economies: Africa	112 196 (100)	47 285 (42)	63 708 (57)	11 882 (11)	2 734 (2)	49 093 (44)
Developing economies: America	75 711 (100)	17 860 (24)	47 009 (62)	478 (1)	17 386 (23)	29 144 (38)
Developing economies: Asia and Oceania	622 245 (100)	171 766 (28)	448 736 (72)	25 683 (4)	6 054 (1)	417 000 (67)

Note: Percentage of exports to the whole world in parentheses.

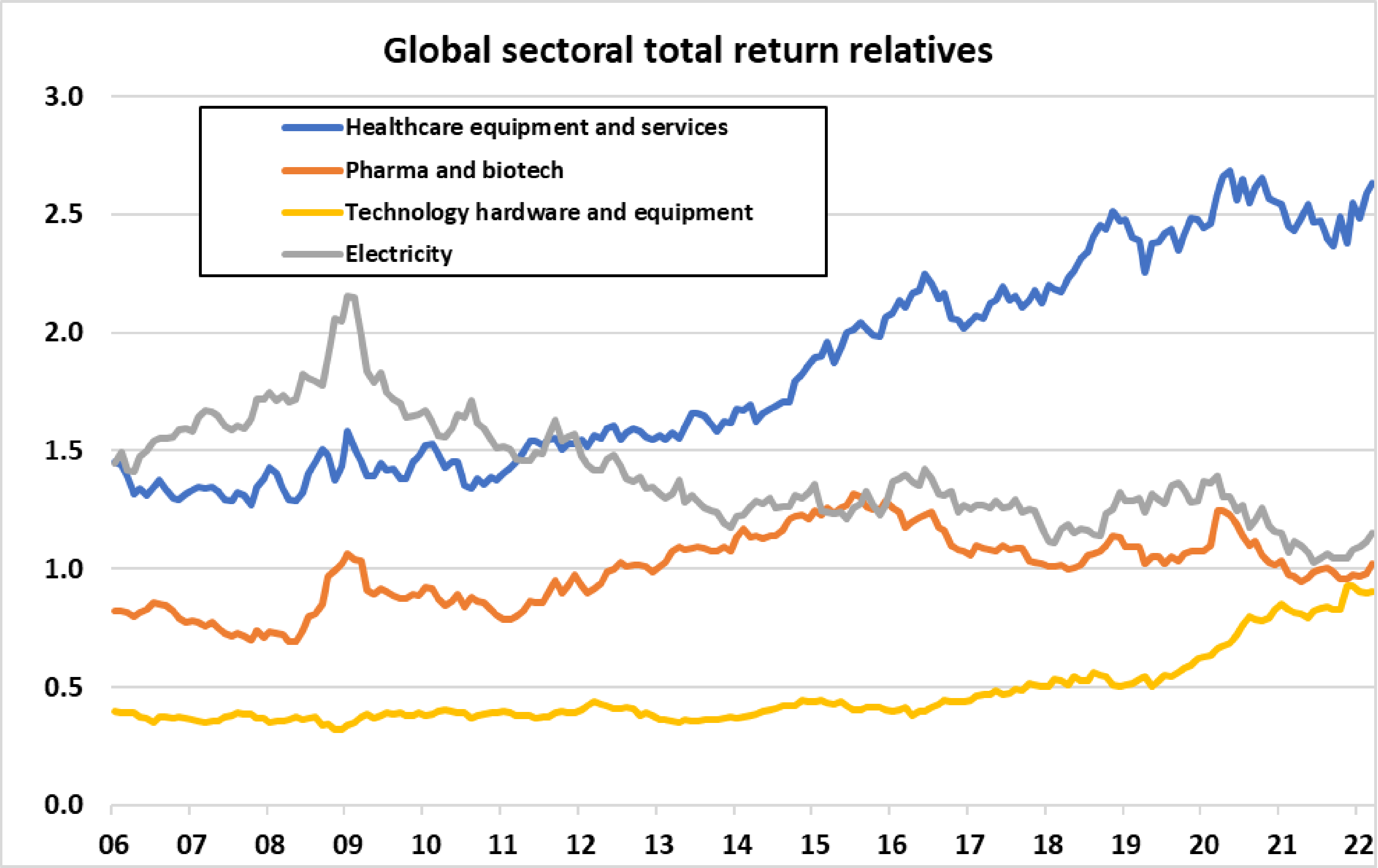
Potential sectoral beneficiaries of ‘safety and security’

- NB Aerospace took a massive hit from Covid-19



Potential sectoral beneficiaries of 'safety and security'

- Power generation and supply is a Cinderella sector

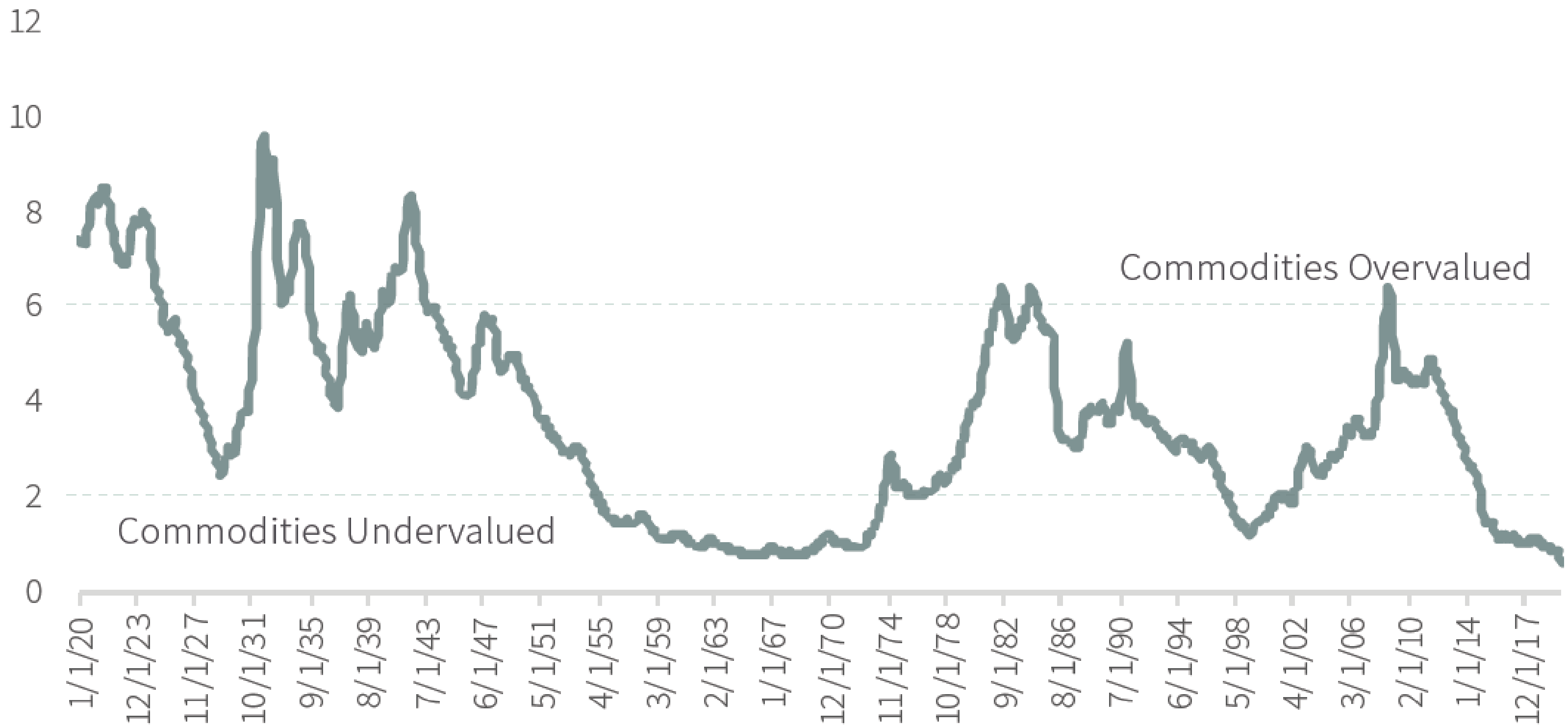


4. Tangible premium versus virtual discount

- The secular bear market in natural resources and manufactured goods, relative to consumer and business services, may be ending.
- Increased extraction costs, deteriorating energy trade-offs, environmental objections to mining and quarrying etc. have reduced capex and slowed the development of new resource capacity.
- Labour cost is being stripped out of service provision as technological solutions become more widely adopted, bringing down fees and charges. Premium pricing is on the way out.

Commodity prices may be staging a recovery vs S&P

- Ratio of the Goldman Sachs Commodity Index to S&P500



Source: G&R Models, Bloomberg.

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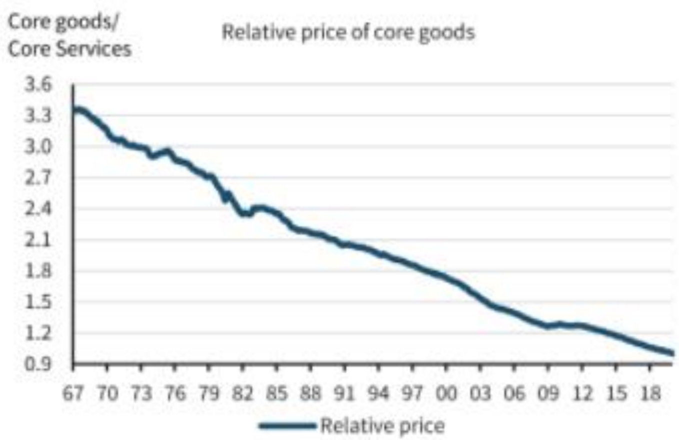
Relative price of core goods to core services has turned

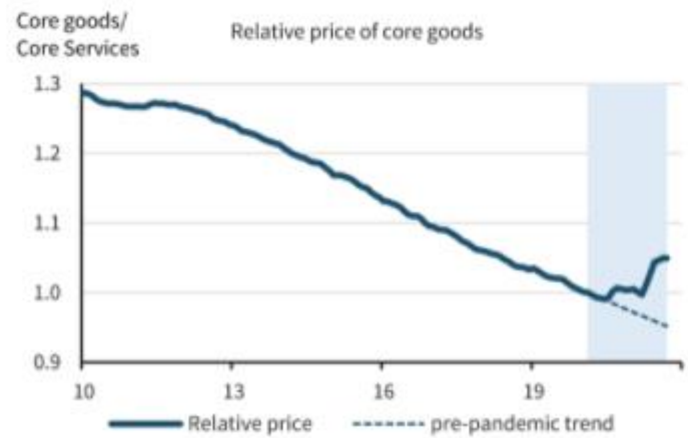
- Disruption to mercantilist business models

Figure 2. The relative price of core goods has been on a steady decline for several decades...



Source: BLS, Haver Analytics, Barclays Research

Figure 3. ...until the pandemic, which led to a sharp reversal

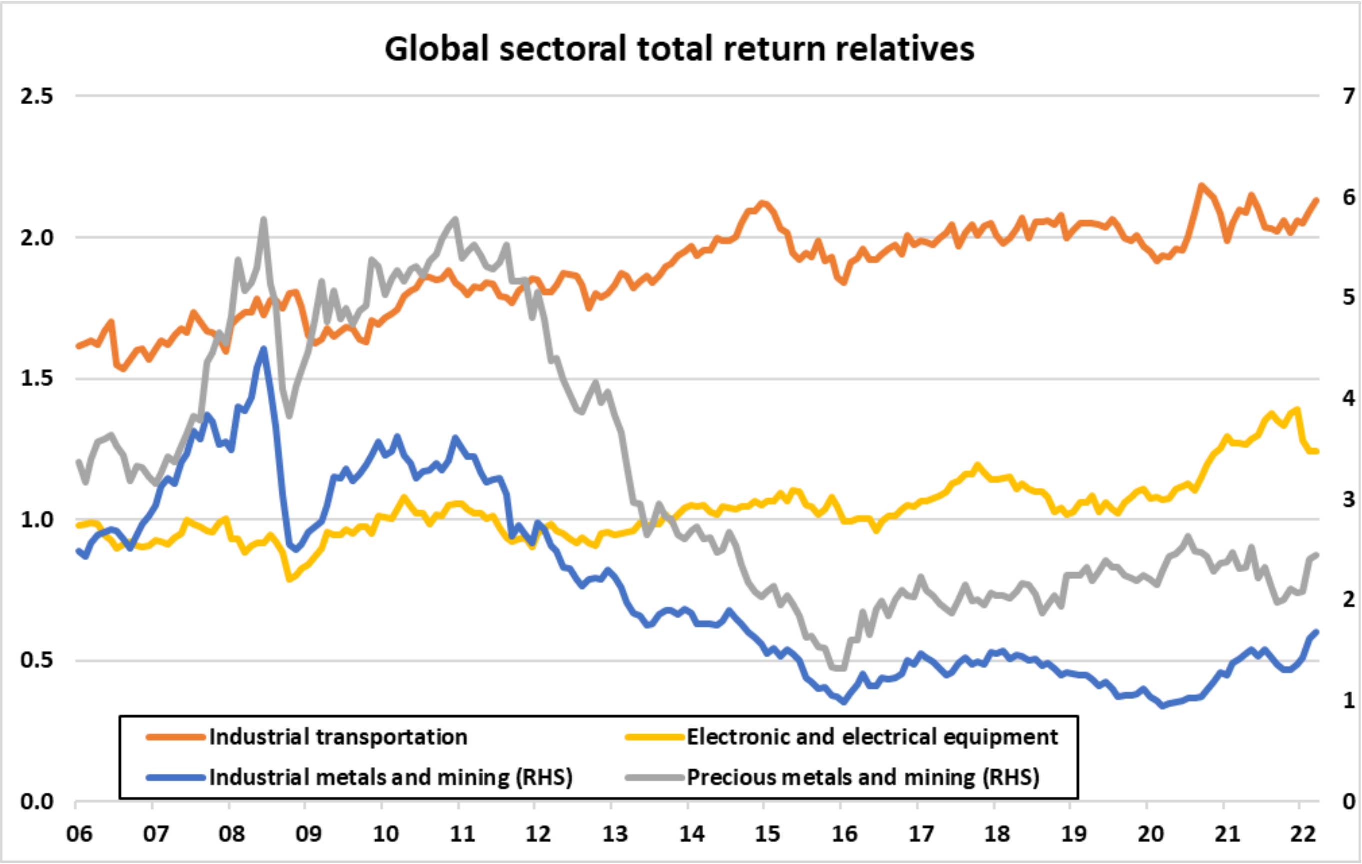


Shaded area equals COVID-19 pandemic

Source: BLS, Haver Analytics, Barclays Research

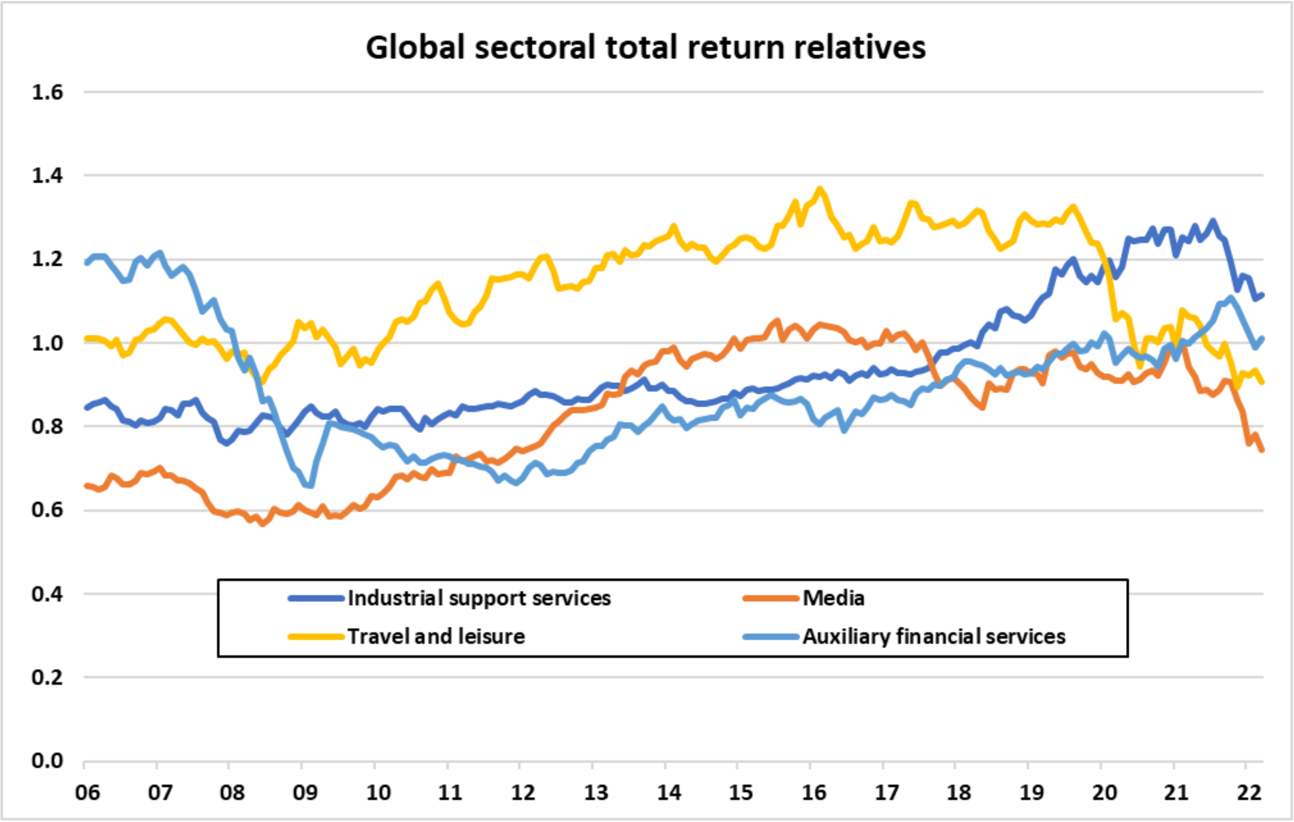
Potential beneficiaries of 'tangible premium' thesis

- Metals remain in deep bear market territory



Potential casualties of 'virtual discount' thesis

- Telecom services are another candidate

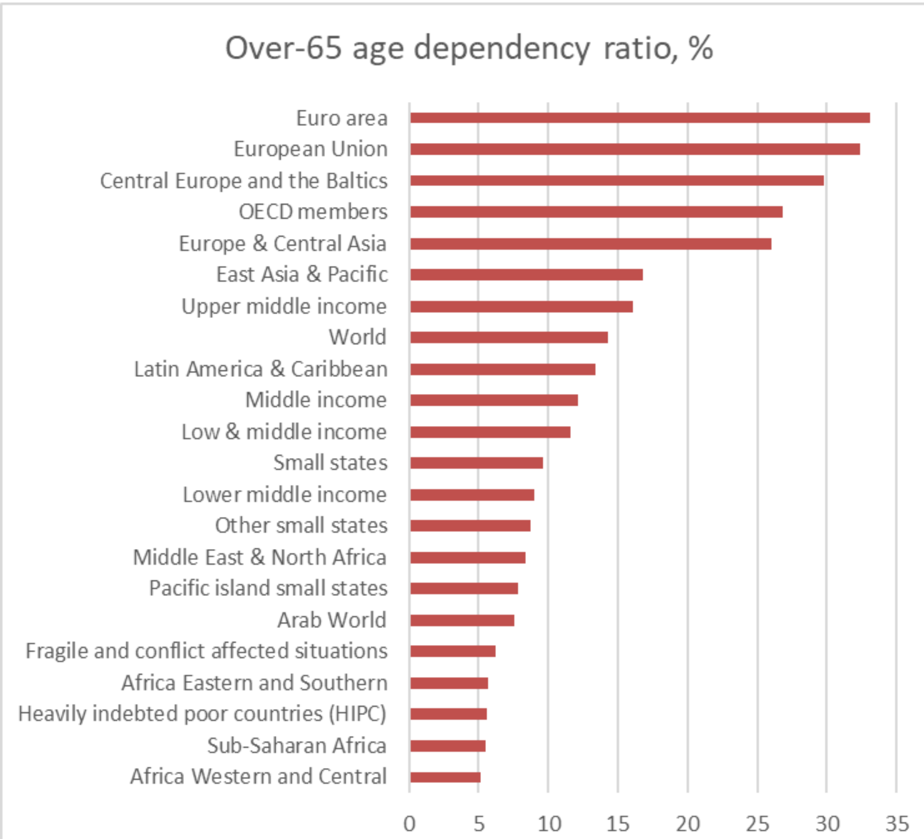


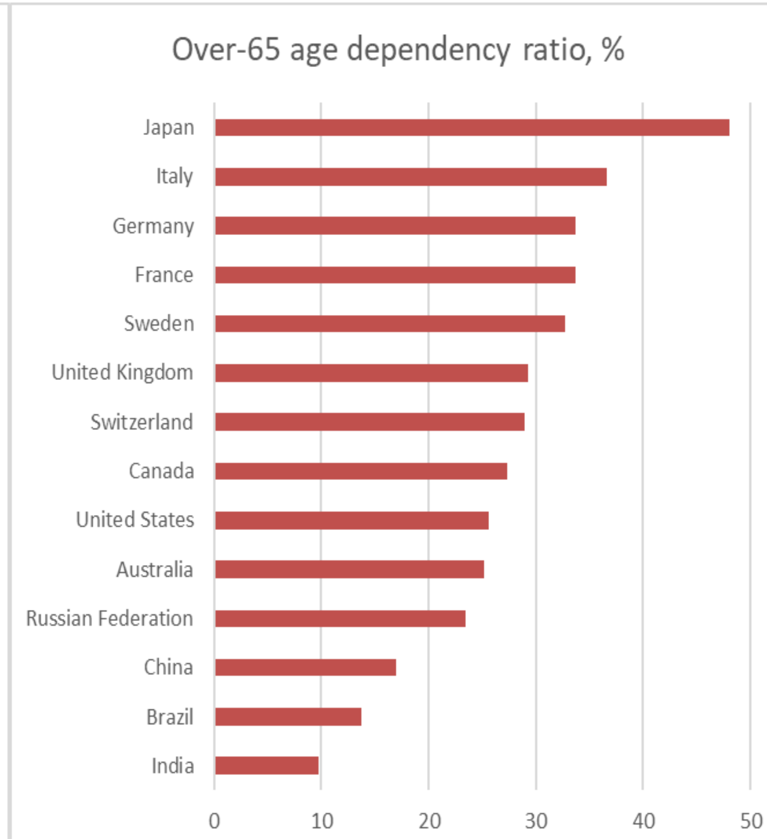
5. Inter-generational wealth and income dynamics

- Loss of inflation control, as it becomes persistent and entrenched, poses a potent threat to the wealth of the older age cohorts but boosts the earnings power and balance sheet position of indebted younger age groups.
- This transfer of economic power is mirrored in the political dimension, where the interests of prime-age working population will be reflected in the choice of political leadership and policy leanings.
- Nations with high old age dependency ratios will be most vulnerable to a shift in economic power.

Financial repression is bad news for retirees

- Scaling down the real incomes of pensioners





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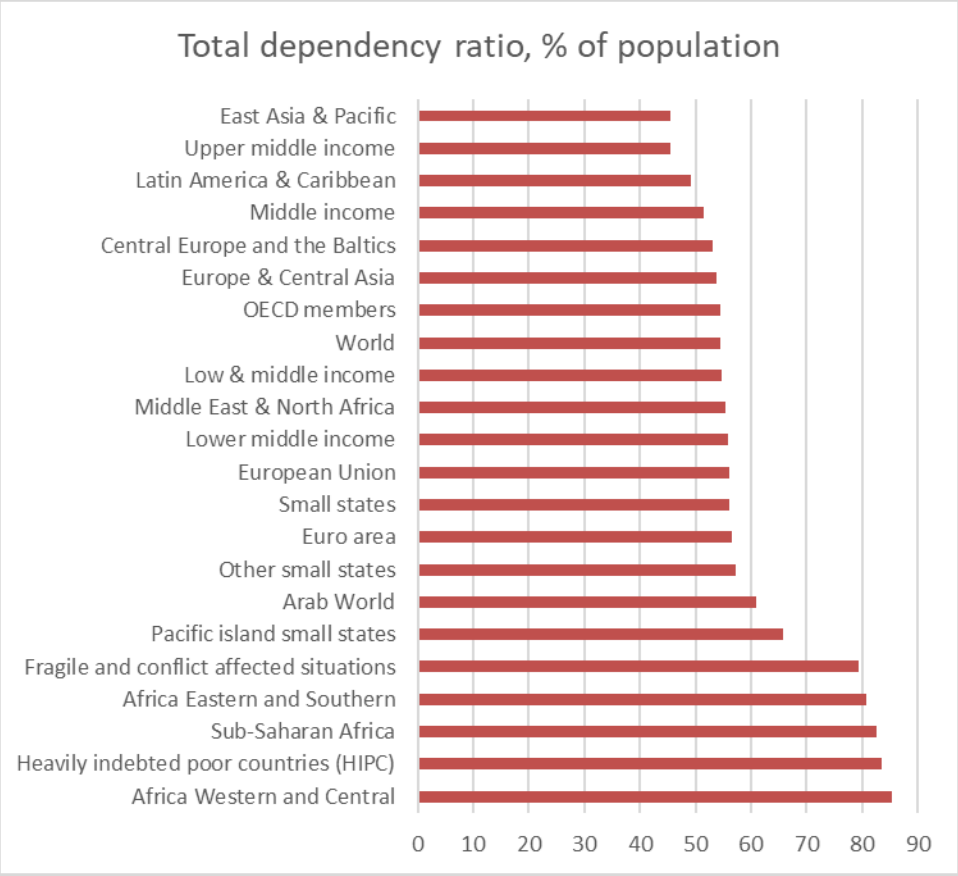
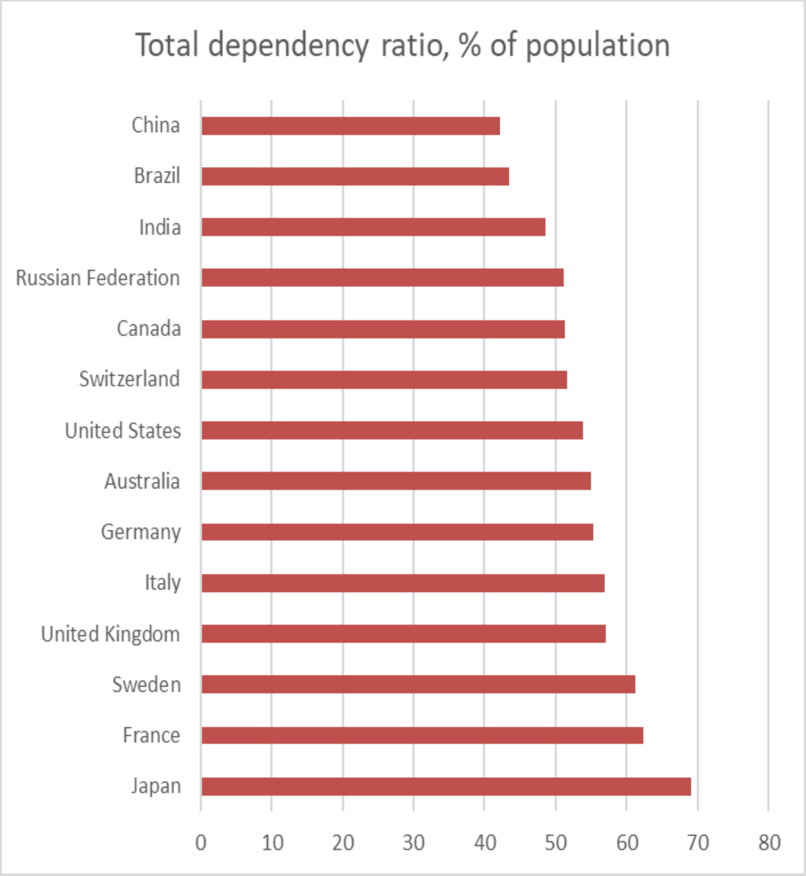
Low dependency burden is a source of resilience

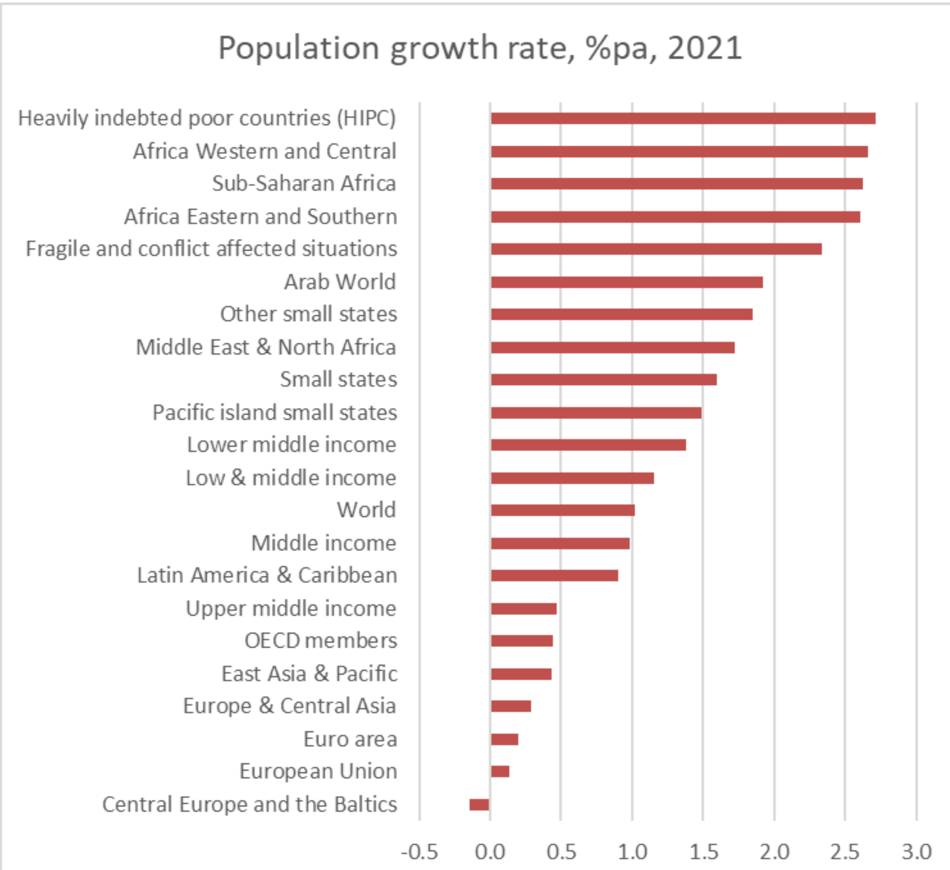
- China and Latin America have the advantage

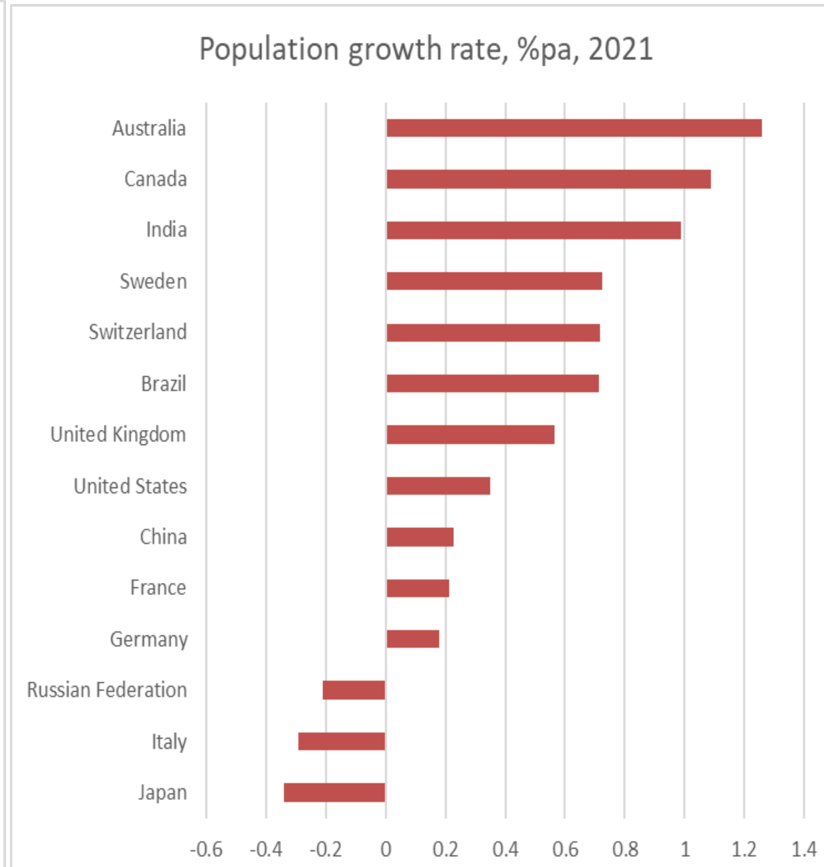




In high income nations, population growth is a positive

- Net migration drives Australian & Canadian growth





Tentative conclusions

- Real returns to conventional bonds are likely to be negative for the next 3 years.
- DM equity markets will be de-rated significantly as future earnings are discounted more aggressively.
- Prefer low duration/lowly valued investments with physical/tangible assets or dominant market positions in sectors with intangible assets.
- Select equity exposure by sector over country or region, but bond/currency exposure by country.
- Corporate credit is entering a bear market.
- Residential real estate will be a protective asset.

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