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INVESTING IN YOUR INTEREST

EDOUARD CARMIGNAC'S LETTER

Edouard Carmignac writes on current economic, political and social issues each quarter.

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Dear investor,

Economists of all kinds have been expecting, since the start of this year, a recession to arrive. Whether they're a Vladimir or an Estragon, waiting for the titular Godot from Samuel Beckett's classic, the recession has not arrived. This absence may not bring us to reflect on the meaning of life, but it will at least make us question the atypical trajectory of post-Covid growth.

The sudden halt in economic activity sparked by the discovery of the rapid transmissibility of SARS-Cov-2 prompted budgetary largesse aimed at compensating households for lost income. As a result, surplus household savings of around 11% of GDP were built up in the United States. Although on a smaller scale in Europe, these surpluses were nonetheless bolstered by a variety of "whatever it takes" policies.

Replete with comfortable savings and having tasted the charms of "remote-resting", often disguised as remote-working, many employees have shown a real reluctance to return to the workplace. As a result, business owners, faced with the difficulty of finding a suitable replacement workforce, have been forced to incentivise existing workers to stay, especially as persistent inflation has allowed them to absorb related costs, with rising prices offsetting the earliest signs of an activity slowdown.

Faced with inflationary pressure fuelled by unprecedented fiscal largesse, Central Banks appear powerless. The use of interest rate hikes and liquidity reduction is proving ineffective. Yet it's weakening banks and having an impact on the foreign exchange market that is difficult to predict.

What is the outlook for investment markets? On the face of it, the cocktail of hardly controllable inflationary pressure mixed with high interest rates is toxic for the valuation of all assets. But one must not forget central bankers are far too concerned about the massive effect withdrawing supportive measures could have on debt sustainability at a time when Western populations' pain threshold is very low. Real interest rates should therefore remain fairly low, positively impacting investment and growth. What's more, the fall in commodity prices caused by the Chinese economy's difficulties, reduced pressure on supply chains and limited scope for companies to raise prices in a weaker environment, should encourage inflation to fall faster in the coming months.

This scenario of "immaculate disinflation", without a visit from recession, may seem too idyllic. But it is possible. Although, it would leave Vladimir and Estragon waiting even longer for Godot...

With this in mind, wishing you a peaceful summer.

Yours truly,

Edouard Carmignac