Economic overview

November 2021

Paradigm shift?

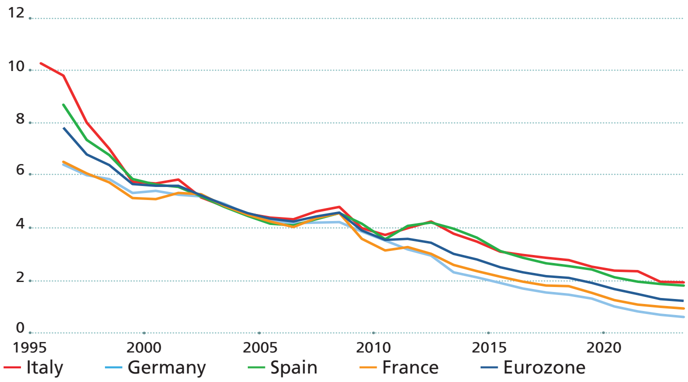
The rising **public debt** in the wake of the Covid crisis is not only a consequence of the recession, but also the result of a reorientation of economic policy. Budgetary orthodoxy is being set aside in favour of ambitious economic stimulus programmes. In Europe, the Maastricht Treaty criteria have been put on hold for the time being and public debt ceilings have been eased. Due to the pandemic, households and companies needed massive and rapid financial support and governments took the place of private players who were forced to save. Not only did public spending help limit the impact of the crisis, but it is **currently having a knock-on effect on business investment**.

Moreover, the falling interest rates on government bonds since the mid-1990s - despite a virtually uninterrupted increase in government debt - is also **a sign of the excessive demand for government debt securities on the part of investors due to rising savings worldwide**. Abundant liquidity (private savings and central bank purchases) can more than cover government needs and bond issues, making for attractive financing conditions.

Little by little, international institutions, such as the International Monetary Fund (IMF), are making a paradigm shift and moving away from their austerity policies. This is all the more so as debt leads to growth through the purchase of long-term securities. Debt sustainability is closely linked to both the evolution of interest rates and growth. If GDP rises faster than debt, the repayment risk is reduced (sustainability - stability and/or reduction of the debt-to-GDP ratio). Low interest rates contribute significantly to this by reducing debt service. **Debt increases, costs less and stimulates domestic growth**.

Interest expenses

As a % of public debt



Source: Refinitiv Datastream

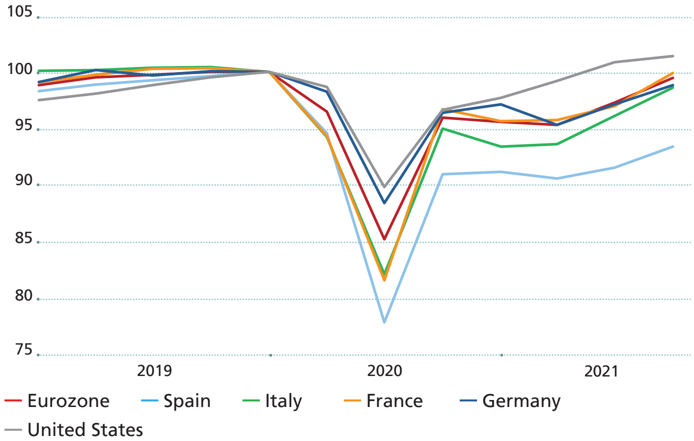
The government's use of funds thus becomes a determining factor in the sustainability of debt. The debt must trigger investment, which in turn should provide for future growth. As proof, the Standard & Poors rating agency has just raised its outlook for Italy. Due to better growth forecasts and structural reforms, the outlook is now "positive". The agency emphasises that "growth is the key to reducing high levels of debt relative to GDP", echoing the new doctrine promoted by Italian Prime Minister Mario Draghi.

Growth was robust in the eurozone in the third quarter. Economic activity has not yet returned to its pre-crisis level but the region is catching up. Inequalities persist between countries. France has already returned to its pre-crisis level, thanks to quarterly growth of 3% and dynamic household consumer spending. In contrast, Spain is still lagging behind.

Moreover, **the United States has entered a phase of moderation**, which was expected. After an acceleration in economic activity during the first part of the year, the momentum is now slowing down. Economic activity is returning to normal. However, the manufacturing sector should continue to provide dynamic growth in the coming quarters. Economic activity is still well oriented **in Switzerland**. As a small, innovative and export-oriented economy, it benefits from **strong international trade and economic relations with Asia**, and the outlook is promising. According to the IMF, the volume of trade should increase by 10% in 2021 and 7% in 2022.

Evolution of GDP

Index rebased, 31.12.2019 = 100



Source: Refinitiv Datastream

Despite the moderation in the pace of growth in the United States, the investment outlook remains positive. It is supported by international trade and government programmes, especially in the US and Europe. This is creating a knock-on effect and will be a source of profitability. Corporate results were again exceptional in the third quarter: corporate revenues and margins were better than expected and remain well oriented for 2022. Profits are expected to increase by 11% in Switzerland, 7% in Europe, 8% in the US and 16% in China. Stimulus programmes are catalysts for companies and we recommend remaining invested in equities, while favouring selection based on the growth prospects of companies. **This includes companies focused on the megatrends - energy, demographics and digital**. The confirmed outlook for the industry also makes it possible to continue selecting **companies in certain more cyclical sectors, that supply niche products and are well represented in European and Swiss small and mid-cap companies**. We have been applying this strategy to our portfolios since the beginning of the year.

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