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Debt versus Growth
Biden and Signals from China

President Biden's geopolitical activism coupled with financial objectives is setting new standards in international markets. Extensive injections of liquidity (i.e., Quantitative Easing) from central banks will provide new opportunities and, as usual, new dangers. When first introduced, influxes of capital, like seen during the pandemic, were tools to mitigate deflation concerns in 2008. Post-crisis, these measures acted to propel the US towards a digitized economy with razor-sharp marginal costs. Finally, the global pandemic forced issuing bodies such as central banks to introduce new liquidity measures to prevent a catastrophic global recession. Due to multiple intense rounds of liquidity injections, the combined balance sheet for the Federal Reserve, the European Central Bank (BCE) and the Bank of Japan reached 20 trillion dollars, up 15 trillion since 2008.

Consequently, the disconnect created by measures such as Quantitative easing between the financial and real world fundamentally changed the distribution of wealth both between and within economies and social classes. As a result, in terms of sovereign public debt, 2020 saw an increase of 9'300 billion dollars (17.4%), reaching record highs of 62'500 billion dollars, an increase corresponding to a seventh (14.8%) of global GDP. Overall, global debt is more than three times more than the global GDP.

Moving on to geopolitics, the primary beneficiary of the financial activism carried by central banks has been China. In the last decade, the country led by Xi Jinping has been able to attract quite the capital inflow. Its vigorous growth, coupled with a lack of opportunity in western economies – mainly due to rising public debt (mainly in Europe) and excessively liberal ideologies – have allowed China to enter the stage as a global and well-established player.

To their credit, the Chinese were able to allocate fiscal stimuli of the same size as the US while having an economy the third of the size of the American one at that time. The efficient allocation of capital allowed the Chinese economy to satisfy global demand. At the second turn of the 21st century, Xi Jinping does not hide the ambitions to revolutionize his country's economic structure. By ramping up the production of quality goods for the local market, China will minimize their dependency on imported goods while also betting on Chinese exports as a strategic asset. China's early recovery from the pandemic allowed the country to promote exports that enable a 116 billion dollar fiscal deduction. In addition, fiscal expansion from western economies financed by debt and centered towards consumption allowed China to report first-quarter GDP growth of 18.3% due to flourishing exports.

Moving on to the US, Joe Biden maintained the tariffs set by Donald Trump, confirming China's danger to the American economy. But, unlike his predecessor, the harshness of Biden's approach serves as an instrument to bring Xi Jinping to the table and work towards a multilateral agreement needed to smooth differences between the two powers. For Biden's plan to succeed, his strategy needs to have at the center an effort to weave relationships (cut short by the previous president) with historical allies to reinforce the relative strength of the American state. As a result, the forgotten European Union regained crucial importance (in tandem with Russia) to underpin China's sole focus on Taiwan and bring some attention out west. Even with Putin, the initial attacks (which were harsh) seemed to, in a way, define terms and roles before working on common interests given the border between Russia and China.

In the European Union, Italian Premier Mario Draghi seems to agree with Biden's strategy given the common sentiment that without the 'new world,' the old continent will never complete the vision created by, amongst others, De Gasperi, Jean Monnet, and Adenauer. Italy, which has always been one step behind in the European context, finds itself in the center of Atlantic alliances thanks to one leader. The question is, can everything depend on one person? Surely not. But, as history shows, one man's intuition can make the difference when making crucial decisions. On another note, Joe Biden's plans could also include England, which, along with France, possess atomic bombs. Although the possibility could arise, in proper Irish fashion, President Biden will most likely need another leader than Boris Johnson. To keep up with China, England will need to leverage the historical connections with India through leaders such as Rishi Sunak, the well-respected Chancellor of the Exchequer (finance minister). Like England, the US will also be able to leverage Kamala Harris's connection to India.

Moving on, Switzerland decided to end the negotiations with the EU regarding the institutional agreement, an important step for both parties involved. Europe's struggle to achieve the unity needed stems also from the inability to respect the individuality and identity of citizens, which, in too many cases, has led to rebellions and, in turn, the rise of populism. Overall, when negotiations resume, European leaders will have to respect the Swiss federalism felt by so many citizens. For Switzerland to accept, the EU will have to modify the requirements from those that apply to other member countries, especially those regarding identity. In the meantime, Switzerland could leverage the relationships previously created with China and the US to find its place in Biden's geopolitical landscape.

Going back to the US, the new president plans to spend up to 8'200 billion dollars until 2031. President Biden plans to take advantage of the eagerness to spend that has risen after the pandemic to reshape American society giving a central role back to the middle class. Although the plan is ambitious, it will surely come at a cost. So how will this massive spending be financed? The president plans to increase the inflow of fiscal capital as well as increasing debt. Accordingly, the national deficit will increase to 1.8 trillion dollars in 2022. It is then bound to slightly decrease to then rise again to reach almost 1.6 trillion by 2031. So, overall, President Biden needs a solid economy to finance the spending. According to the President, the US will enjoy a 2% growth - net of inflation - with unemployment stabilizing under 4%. The new administration also assures that after some post-pandemic peaks fueled by spending, inflation will not go beyond 2 or 3%.

So, what should investors look out for? The main tradeoff in the market (and in Biden's plan) now is the balance between inflation and growth. As far as 2021 is concerned, Biden's strategy should pay off due to the high growth fueled by accumulated savings. Will the situation persist? For now, even though inflation will surpass the 2% target, the trend is not thought to continue given the peculiarity of the current situation. Therefore, central banks will bet on a historic economic expansion to subsequently increase rates and slow the liquidity injections down only in the presence of self-sustaining growth. The implementation of such a strategy can be seen from the Central Bank of Canada that has to deal with an ever-growing commodity market showing no signs of a slump. Even the usual "sell in May" was relatively short-lived with all these policies in mind.

The fact that an ex-president of the Fed leads the US treasury, the Italian prime minister, used to guide the European Central Bank that is now led by an ex-finance minister in France highlights the possible coordination between fiscal and monetary policies. Overall, it is easy to see why the US 10-year bond has fluctuated around 1.6% while the German Bund- after almost reaching 0- has regressed to -0.15%. The Biden-Yellen-Powell connection will do everything to maintain ample market liquidity until the first phase of the strategic plan has been accepted while the BCE -whose economic cycle is delayed – will wait to slow the flow of liquidity.

So, is everything back to normal? Almost. By nature, the markets tend not to respect speed limits when the tank is filled. Funds that short volatility keep acquiring liquidity, but we all know what happens once the wind changes. In terms of the US, the focal point is the dollar, which Biden will have to collect enough of to finance debt. To not over depreciate, inflation has to moderately increase while growth has to enjoy a violent spike, which has been the case for 2021, but we will need to wait and see if such growth is sustainable and will continue next year.

Through direct methods, China is leading by example when it comes to maintaining market stability. First, in February, it acted to slow market growth. Then, by deliberately attacking a player like Jack Ma, it sent a clear message regarding control of the tech sector. Third, it intervened to gain more control on cryptocurrencies, and now it is attempting to depreciate the Yuan against the dollar given the depreciation of the USD of around 10% this year. In Washington, although with different methods and instruments, Joe Biden is on the same trajectory. In terms of strategy, other than goals regarding sustainability set by the Paris agreement, Biden is also pursuing a more inclusive strategy for financial markets. Overall, the most important thing is to keep the dollar solid.

But, as Henry Kissinger once said, the issue is not whether or not the 21st century will belong to China but whether or not Western economies will collaborate with China (and vice versa) to promote growth. From experience, Kissinger is not too optimistic. But, given the current monetary strategies backed by Biden and others, there is an added objective that allows the financial system to celebrate, at least for now.