EDOUARD CARMIGNAC'S LETTER

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

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Dear Investor,

The upcoming exit from the pandemic – it's about time! – confronts us with an unprecedented situation. For over a year now, our lifestyles have been disrupted, and whole swaths of the world economy have been shut down. As the vaccination campaigns prove successful to varying degrees – depending on whether you're American, European, Chinese or from elsewhere in the emerging world – we'll be able to give freer rein to our long-suppressed lust for life.

The question is how extensive and how enduring the recovery we so yearn for will be. Not only will economies be flush with abundant savings in the coming months, but the US and European governments also intend to accompany our exit from the virus-driven recession with huge fiscal stimulus programmes. The various US rescue plans this year will amount to 13.6% of the country's

GNP – a far cry from the 6% of GNP budgeted for in Europe. And next year, large-scale infrastructure projects are scheduled to begin on both sides of the Atlantic as a means to prolong the economic recovery.

The timing of these major stimulus programmes – just as we're emerging from a slump – is as surprising as their defiance of financial orthodoxy. How can that be? The surge in national debt levels brought on by the pandemic has made the budgetary profligacy of our rulers politically acceptable. Mr Biden, who is keen on seeing his party win the midterm elections in November 2022, is sending the US deficits sky-high. Though showing greater restraint, Europe is set to loosen the purse-strings further as we head towards dicey elections for both the CDU in Germany (October 2021) and for Emmanuel Macron in France (May 2022). The twin imperatives of safeguarding public health and safeguarding employment provide ample political grounds for such "binge-spending". Docile central banks will likewise continue to brush aside the issue of government debt sustainability for as long as inflationary pressure stays low. Better still, Fed Chairman Jerome Powell now claims that even with a temporary increase in inflation at the end of the pandemic, he may not depart from his dovish monetary policy. So it seems that the notion of Immaculate Conception recently introduced into finance by the pandemic has more staying-power than one might have thought.

Is the fiscal and monetary caffeinated cocktail being served in the economic re-opening phase enough to justify the current stock-market euphoria? While corporate earnings undoubtedly stand to benefit from an economic recovery, rising interest rates – a reflection of the threat that inflation may shoot up and stay high – would put a dent in company valuations. Accordingly, the current upward trend in interest rates could persist as upbeat reports on economic indicators are released – along with alarming inflation figures – in the coming weeks. The task at hand will be to submit such data to serious scrutiny to gauge whether the upward pressure on prices is likely to endure. But if, as we're inclined to believe, inflation recedes at the end of the pandemic to a more moderate level due to secular deflationary trends (demographics, technology) – not to mention a slower-than-expected eradication of Covid-19 worldwide – the thrill of Immaculate Conception might just send equity markets soaring to previously unenvisioned heights.

Yours truly,

Edouard Carmignac