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PRIVATE BANK



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As Bergos' Chief Economist, Dr. Jörn Quitzau is covering macroeconomic trends. He previously worked at the Financial Times Deutschland, Deutsche Bank Research and most recently Berenberg. He was a lecturer in economics at the Frankfurt School of Finance & Management for ten years and has been a non-resident fellow at the American-German Institute (AGI) in Washington D.C. since 2014.

INFLATION WILL KEEP CENTRAL BANKS BUSY FOR LONGER

Jörn Quitzau, chief economist at Swiss private bank Bergos, is convinced that the forthcoming European soccer championship will not boost the German economy. For him, what Germany needs is structural reform and a reliable economic policy. Structurally higher inflation and the way the central banks react to it will be a thrilling question going forward. And with interest rates higher there is likely to be renewed focus on countries with large amounts of debt outstanding, like the USA.

It may be spring time for the German economy, but the real summer is still some way off, is how Jörn Quitzau, chief economist at Swiss private bank Bergos, puts it. The country that was for many years the engine of growth for the European economy has been performing below par over the last few quarters. Uncertainty about inflation, higher interest rates and the state of the world in general, along with an indecisive economic policy, have brought the economy to a standstill. On top of that come the structural issues that are acting as a drag on growth in Germany.

At the moment the country is enjoying a cyclical upturn again. In the first quarter, the economy expanded by 0.2% and leading indicators are starting to turn upward. The Ifo Business Climate Index has risen three times in a row, a reliable sign that a positive economic turning point has been reached. "The things that were holding the economy back have started to weaken. People have largely come to terms with the shocks of the past few years. Wages are increasing and consumers are getting more confident," says Quitzau. He still expects the recovery to be hesitant, though, because the problems have not all been overcome. However, the second half of the year could see things picking up further.

European soccer championship an economic non-event

Quitzau does not see the start of the European soccer championship on June 14 as providing any boost to the hosts Germany. The "Sommermärchen 2006" ("summer fairytale"), when Germany last hosted a major tournament, had no impact either, despite frequent claims to the contrary. Back then Germany was in a similar situation to now, and gross domestic product (GDP) suddenly shot up more than 3%. "But that was nothing to do with hosting the World Cup – it was the hike in VAT at the start of 2007 pulling consumption forward into the fourth quarter of 2006," he explains.

One positive impact at the time was a considerable improvement in perceptions of Germany. “We will have to wait and see if that can be repeated. The effect on image could just as well be negative if trains and planes don’t run smoothly, the weather doesn’t cooperate or there are fan riots,” warns Quitzau. All in all, he sees the soccer championship as an economic non-event.

The structural issues that caused the economic slowdown in Germany are still there. But Quitzau thinks total doom and gloom are being exaggerated: “Industry is contracting, but the country is not totally deindustrializing. Growth is weak – it’s not collapsing entirely. The economy could be much stronger if the structural reforms needed are put in place.” There is a great deal of work to be done in cutting red tape and dealing with the shortage of skilled workers. Companies also need an economic policy they can count on; at the moment it is jumping back and forth too much.

Southern European countries strong, USA robust

Economic performance in Europe is similar to that of Germany, but on average better. Southern countries like Greece, Portugal and Spain in particular are growing strongly. The reforms brought in during the euro crisis are paying off. These countries are also benefiting especially strongly from the Next Generation EU stimulus package.

The USA is acting as an economic stabilizer for the world economy. “The way things look right now, the US economy is not going to have either a hard landing or a soft one – the high economic growth rates are just going to come back to normal,” is how Quitzau sees it.

Higher inflation a concern for central banks

In most countries, inflation is heading downwards and getting close to central bank targets. The Swiss National Bank already cut interest rates in March. Inflation in the country was lower than in most other countries, partly because a relatively large proportion of prices are controlled by the government and partly because the strong franc makes imports cheaper.

The European Central Bank will likely cut for the first time in June, with two more steps following over the course of the year. “The Fed will not act until later in the year. It’s hard to say exactly when. But the next step will be down, not up, as some people have been saying,” forecasts Quitzau.

Exactly how the central banks will react to future moves in inflation is uncertain. “Regardless of the recent jump in prices, we have been saying for some time that structural issues will push inflation over the 2% level,” says Quitzau. The shortage of qualified workers is pushing up wages and driving up product prices. Deglobalization is also driving costs. The third factor affecting manufacturing costs is CO₂ pricing. “Central banks may be compelled to act again to keep inflation under 2%. Or – as I expect – they will come up with arguments as to why inflation may be higher, at least temporarily,” he argues.

The debt brake could be a role model

Another uncertain issue is the problem of government debts, which have emerged as a renewed focus of attention as interest rates have risen. The average remaining maturity of government bonds is a good indicator of the funding challenge facing some countries. In Switzerland, where the level of debt is a modest 40% of GDP, the figure stands at 10.5 years. In Germany government bonds have to be rolled over every seven years on average, in the USA every six. “That’s a challenge when outstanding debt is 125% – especially when US fiscal policy is loose and adding to the pile. It will be interesting to see when the capital markets start to get cold feet about whether things can go on like this indefinitely,” remarks Quitzau. Alongside the USA, there are several countries in Europe that should be aiming to put their public finances on a more stable footing, including France and Italy. Quitzau’s recommendation: “Germany shouldn’t be thinking about abolishing the debt brake – it should try to export the idea of sound public finances.”



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