

What's next?

By

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As every year, here are our core assumptions on macro scenarios which will underly corporate strategic options.

Let us have a dream. With efficient and swift vaccination campaigns, a recovery in 2021 is confirmed. This recovery is uneven¹. China beacons from afar with 8% growth in 2021 on top of 2% growth in 2020. Overall, fast-growing markets finish 2021 with a GDP 4% above 2019. The USA finishes 3% above 2019. Europe does not recover before 2022 at the earliest.

In this dream, the crisis already waves from a distance. Some countries and corporations move out stronger from the crisis. Others are strongly weakened. The world embarks on the next decade and beyond. What does it look like?

Babies no more

Let us go back to basics. Growth has three components: population growth, productivity gains and inflation.

As far as *population growth* is concerned, it has been on a long, historic downward trend. This trend is set to continue.

Outside Sub-Saharan Africa, the world's population was growing at close to 2% per year in the 1970s and at 1% in the 2000s and 2010s. It will grow at 0.6% between 2020 and 2030, 0.4% between 2030 and 2035 and 0.2% between 2035 and 2050². In North America and Europe, this is the continuation of a long-term trend. In fast-growing Asia and particularly China, it is a major shift (see below).

Sub-Saharan Africa will be the only geography with significant population growth. It represents 15% of the world's population in 2020. It will represent 17% in 2030 and 23% in 2050. As its income levels remain low, its share of the world economic output will probably stay at 2% despite population growth in the next fifteen years. If the region has to become an engine of the world economic growth, it is after 2035.

Note: unless otherwise indicated, growth rates by country or region are adjusted for inflation and in local currency / at constant exchange rates: they represent what the country or region "saw" or "will see" in real terms. Absolute GDP figures (or share of the world's GDP) are given in current nominal US dollars (with inflation of local currencies and inflation of the US dollar; with exchange rate effects): they represent how countries or regions compare when taking "everything" into account.

¹ The following figures are the latest IMF estimates as of March 23, 2021. Figures are in real terms (adjusted for inflation).

² The world (with Sub-Saharan Africa) has been adding around 0.7 billion to 0.9 billion people every decade since the 1970s. Given the increase in the base, that translates into a decrease in the global population growth rate. The absolute change in number of people is also set to decrease: between 2040 and 2050, the world will add 0.6 billion people.

In all the major economic regions, population growth is tapering at 2030 and stalling by 2050. *The two points that population growth was contributing to global growth in the past are going away.*

Still growing and shifting to Asia

The world economy has grown at 3% per year in real terms (i.e. adjusted for inflation) since the 1970s due to *productivity increase* on top of population growth (see table 1³).

Over 1976-2020, North America consistently represented between 32% and 25% of the world output and 50% to 25% of the world's growth⁴, finishing the last decade at the lower end of this range.

Europe represented 40% to 30% of the world output up until 2000 and it represents 25% now. It is not at the forefront of major development trends anymore (most conspicuously in digitalization). And in 2020, the region is disproportionately impacted by the crisis compared to North America, China and the rest of fast-growing Asia.

Japan first and then China contributed successively a significant share of the world's growth. Together, they delivered between 12% and 20% of it between 1976 and 2010. Between 2010 and 2020, China alone contributed 55% of the world's growth (filling in for the share that Europe would not contribute anymore).

The world was able to sustain 3% growth (adjusted for inflation) because of the shift to fast-growing markets, particularly fast-growing Asia.

Over the next fifteen years, global growth will still be at 3% per year (adjusted for inflation). The economy is not slowing down: it continues to shift to Asia. *Opportunities will be first and foremost in fast-growing Asia, thanks to continuous productivity improvements in this region.*

North America will grow in real terms between 1.5% and 2%. Its share of the world economy will drop from 27% in 2020 to 20% in 2035.

Europe is a risky bet. The "base scenario" is that it could hold its ground until 2030 (at 25% of the world's GDP), with a slight drop afterward (23% in 2035). Even that will require a strong survival reaction from states and corporations, with growth more than double what it was over the past decade, at 2% to 2.5% instead of 1% p.a. If Europe stays mired in structural issues, its share of the world economy would drop below 20%. *Europe's weight in the economic world in 2035 would be half what it was in 1980.*

China will be the first economy in the world by 2030 ahead of the US. Its share of the world economy will grow from 18% in 2020 to 26% in 2035.

Fast-growing Asia outside China will represent 12% of the world's economy in 2035, similar to China in 2015. First in line, India's weight in the economy seems to be on a trajectory similar to China's with a thirty- to forty-year lag.

The economic world in 2035 should therefore have four major blocs: China (26% of the world economy), Europe (23%), North America (21%) and fast-growing Asia (12%).

China & other fast-growing Asia together will grow at 5 to 6% p.a. in the next fifteen years. It represents 25% of the world's GDP in 2020 and will represent 38% in 2035. For companies and

³ All figures in real terms (adjusted for inflation) unless otherwise indicated. If inflation is at 2%, 3% in real terms translates into 5% in nominal terms. Figures are also at constant exchange rates (growth is the same as real growth in local currencies). Projections over 2021-2025 are from the IMF (March 23, 2021). Projections beyond 2025 are from CERB (World Economic League Table, December 2020 edition).

⁴ Except over 2001-2010, when it only contributed 16% of the world's growth.

their management teams, this means production, markets, technologies, innovations, decision centers, teams... will continue to shift to the region as well.

China slowing down and getting old

Though its weight in the global economy will continue to rise, *China will experience a slow-down*: in a consensus scenario, it will “only” grow at 5% per year over 2020-2030⁵ and at “only” 4% per year over 2030-2040.

This slowing down is strongly related to the momentous trend on its population. *China in 2020 has the same population structure as Japan in 1990⁶ (see table 2). It will age at a similar speed.* Its population will peak in 2030, after which it will start declining (barring a change in immigration policies).

This trend is probably not enough to derail the rise of China’s economy to the top position. However, it will create tensions. It makes one wonder how long it can sustain growth every year without a recession since 1977. It will certainly change incentives and opportunities for businesses: increased focus on profitability; products, innovation, marketing targeted toward a fast-aging population...

Risk of partial de-globalization

Because of a range of factors—the squeeze of the middle class, climate change, limited energy & natural resources, tensions related to post sanitary crisis situations and overall geopolitical tensions—there are attempts at promoting some forms of de-globalization.

A full fragmentation of worldwide trade by country is hardly compatible with the pursuit of economic development given the repartition of resources, the economies of scale and the necessary intertwining of modern economies.

But a partial de-globalization may happen, with a few large enough major blocs around China, North America, Europe and maybe fast-growing Asia. In the 1970s, North America and Europe represented 70% of the world’s economy. In 2035, the four blocs will represent 80% of the world’s economy; China, Europe and North America will *each* have the same GDP as the entire world in the early 2000s⁷. This allows for a partial, economically sustainable, de-globalization, even if this would be less optimal than a full global world.

Likely but expensive and uncertain energy transition

The consensus is that the next decade is critical for global warming. But because of the cost of the transition, many do not consider strong reductions in carbon emissions (or carbon neutrality) to be realistic before 2050 at the earliest. Fossil fuels, on the other hand, could be all but depleted by 2070. Nuclear energy is the only low-carbon energy which is available in short term with the volumes required to sustain economic development, but it is subject to debate.

The overall picture is one of significant investments and strong lack of congruency between the different requisites: it calls for setting priorities and defining coherent plans at various levels. Beyond political postures, what will companies and governments be willing and able to achieve?

⁵ 5% in real renminbi adjusted for inflation. The renminbi is bound to appreciate against the dollar, because of a higher domestic consumption and the sale of USD-denominated assets by China to cover the spending related to its aging population. Hence, 5% growth in real renminbi over 2020-2030 could translate in 9% growth in current US dollars, i.e. just as much as over 2010-2020, contributing to China becoming the first economy despite its slow-down.

⁶ 12% of the population above 65; 55 to 60% between 25 and 64; 30% to 35% below 25.

⁷ In nominal terms (with inflation).

The return of inflation?

The end of low interest rates is likely, though probably not in the short term. With China aging, global savings production will at best stagnate in the next thirty years because the population most likely to generate it (working age below 64) will be flat unless there is a major shift in retirement conditions (health and law). Savings consumption, on the other hand, will increase: the population aged over 65 will go up 3% per year over 2020-2050 overall. By 2035, people over 65 will represent 35-40% of the number of people between 25 and 64 (vs. 15% in 1980). Spending in education will be massively replaced by spending in the health and support to the elderly.

In the short term, this trend may not have a significant impact on real interest rates. The savings glut⁸ is real. Central banks are keeping interest rates low in order to fight the crisis. Easy money and stimulus policies are pushing investments in real estate and financial assets to record levels through money creation. The short-term risk is financial instability and inflation for countries overshooting on stimulus. In the long term, at around 2035 (with uncertainty on the timing), *the trend will put an end to the historic period of decreasing interest rates that the world has known since the 1980s.*

For governments, the magic cycle of increasing debt levels and decreasing debt service costs will be over. States will enter in this new aera in different shapes (fast-growing Asia vs. western countries, Northern vs Southern Europe ...).

Companies will have to manage their exposure to countries where the debt burden could become unsustainable. For their corporate debts, they will have to de-leverage (for the most exposed) and increasingly prioritize growth projects.

Overall

A global economy becoming largely Asian and with an increasing share of seniors with needs in health and medical spending (see tables 3 and 4).

Massive public spending to both recover from the sanitary crisis, finance the energy transition and support the elderly; in Europe, also to support the transition to modern industries (digital...) and to cope with the race between the USA and China for leadership (innovation, technologies, patents, critical industries...).

As a consequence, a likely return to inflation.

A question on rising interest rates and their impact on the ability for companies to sustain growth and valuation multiples.

A few sectors still capturing a significant share of growth, in some cases with government incentives: digitalization, robotics & automation (both manufacturing and domestic), health care (both to preserve and to restore it), energy transition (if financially sustainable). Probably an increased segmentation between products and services for the “younger, healthy elderly” willing and able to remain active and the “older” elderly. Increased differentiation between subsidized industry sectors and consumers, and sustainable ones not depending on the health of vulnerable states.

⁸ Net surplus of demand from savings before interest rates re-balance the gap with supply (investment opportunities).

Investments and innovation remaining high to adapt to these rapid changes in industry configuration and markets.

Selectivity in investments and competitiveness will be increasingly key. No getting away with strategic mistakes.

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Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their growth strategies, as well as private equity funds in the analysis and valuation of their investments.

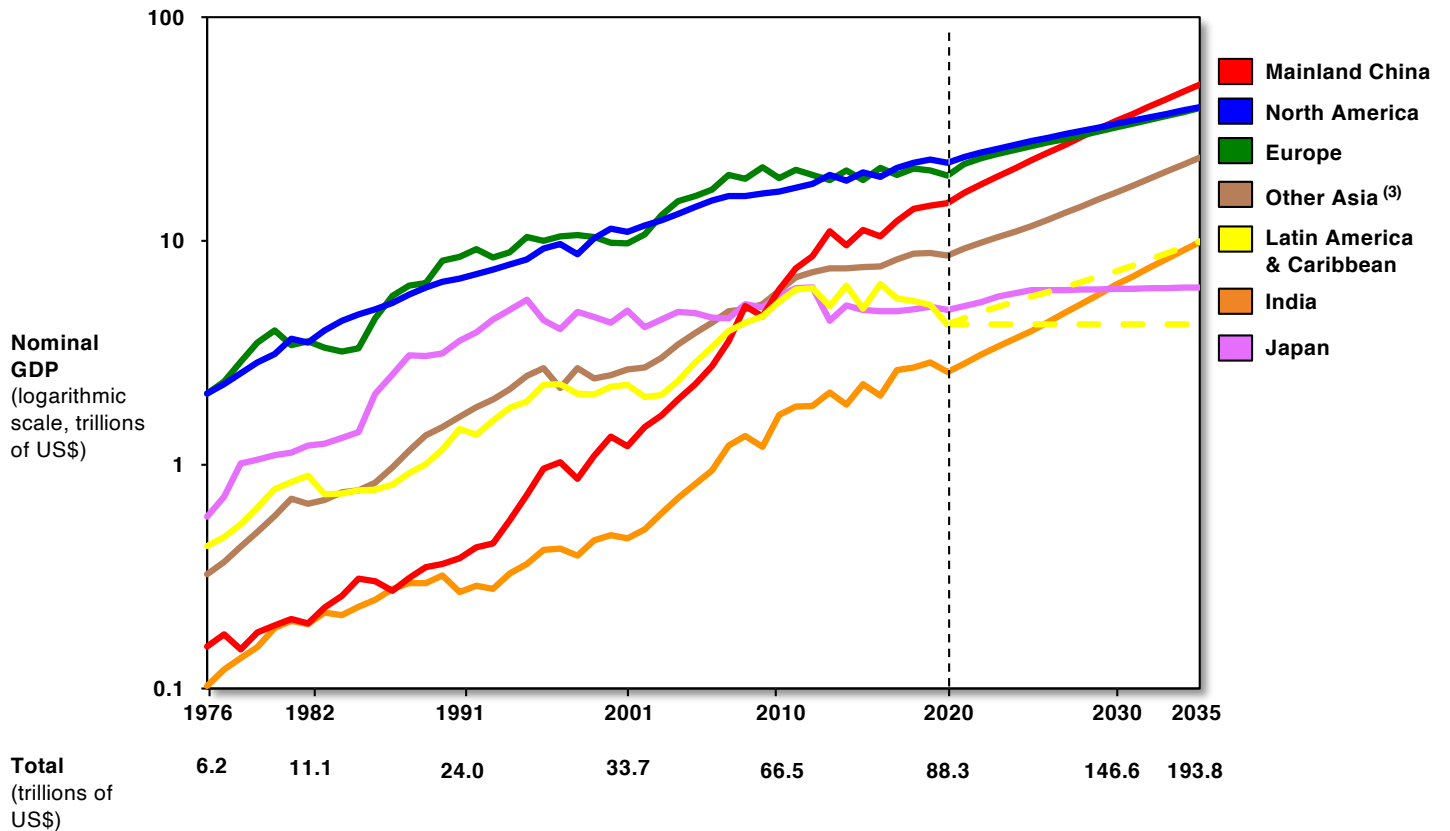
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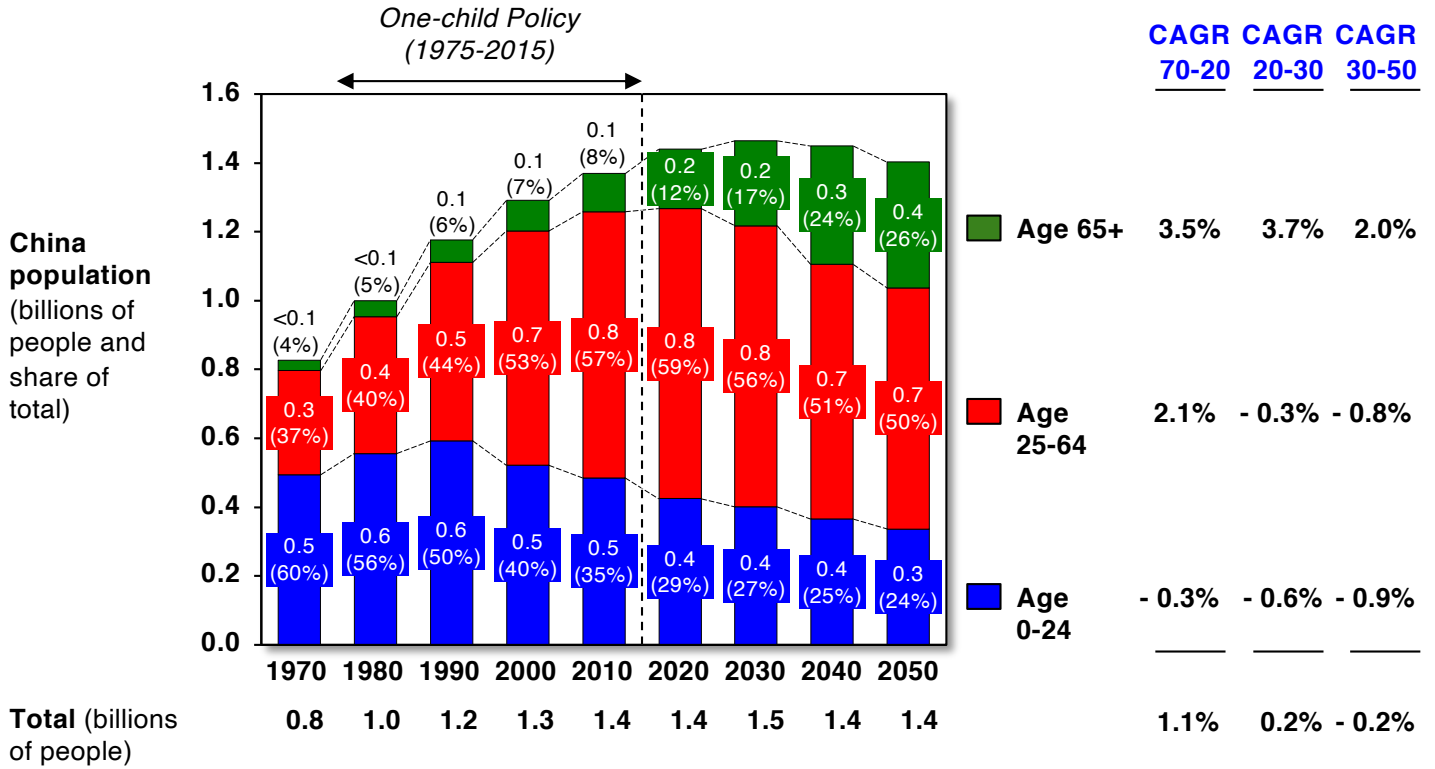
- Table 1 -
Annual nominal world output (1) (2)
 1976-2035



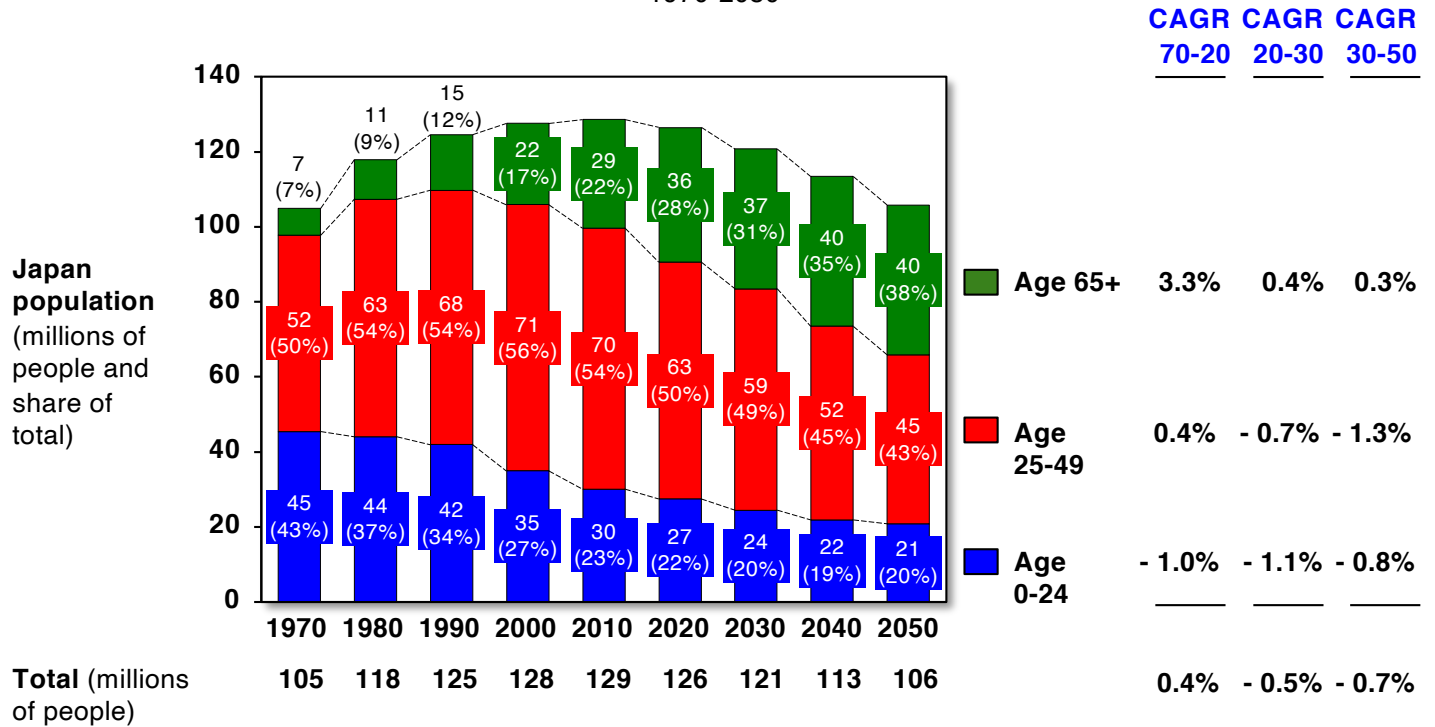
(1) Data in nominal terms i.e. with inflation, converted to current US dollars at current exchange rates; (2) Data before 2019 from the World Bank. Projections from IMF (2020 to 2025; as of March 23, 2021) and CEBR (2025 to 2035; as of December 2020);(3) Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan (figures not available before 1990)
 Sources: World Bank, Haver Analytics, IMF, CEBR, National Statistics of R.O.C., Estin & Co analysis and estimates

- Table 2 -

Demographics of China
1970-2050



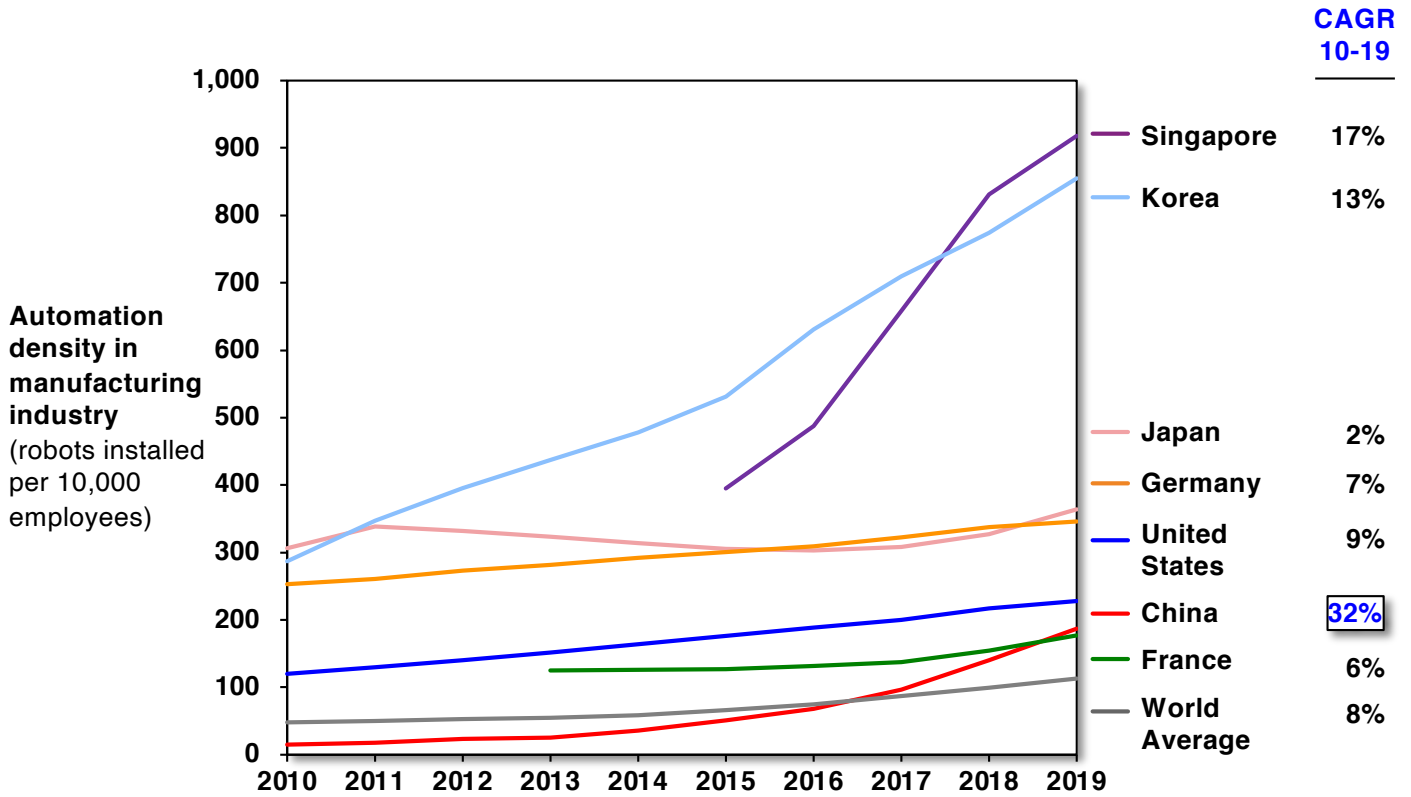
Demographics of Japan
1970-2050



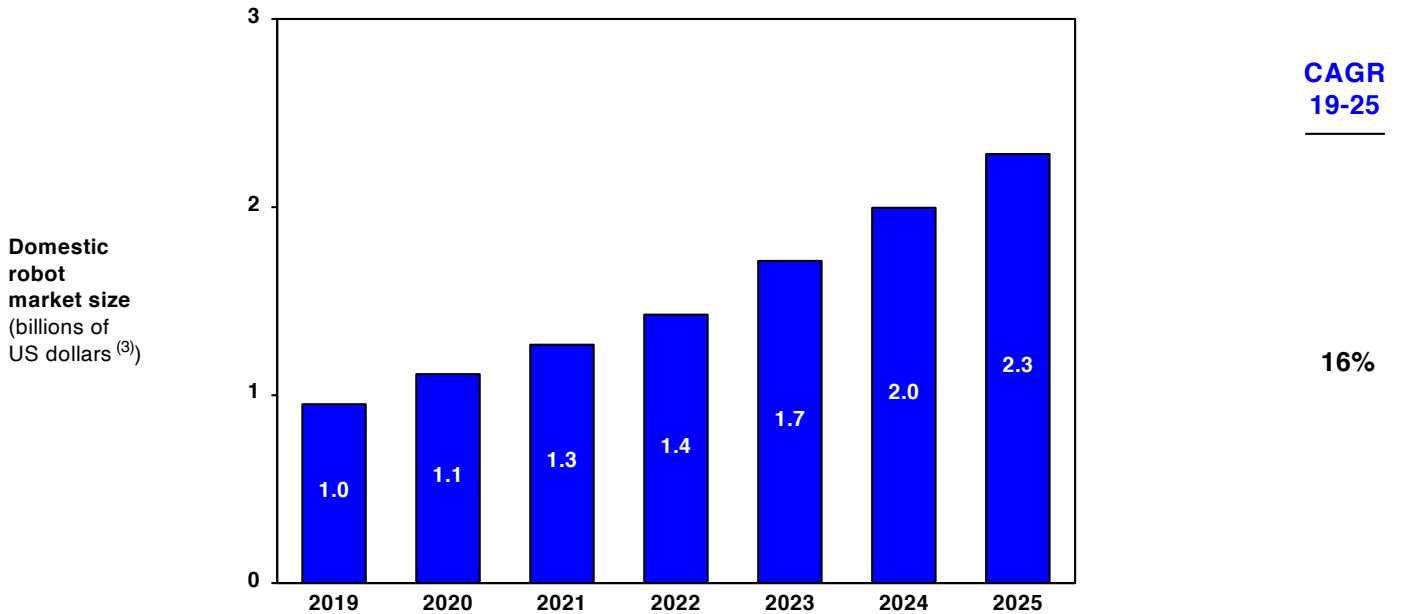
Note: (1) Data from 2020 to 2050 was projected assuming medium fertility variant
Sources: United Nations, Estin & Co analysis and estimates

- Table 3 -

Penetration of robotics in manufacturing in selected countries
2010-2019



Domestic robot market size in Japan (2)
2019-2025



(1) All industries; (2) Distribution and transportation robots, medical and nursing robots and household robots; (3) At constant USD / JPY = 106

Sources: International Federation of Robotics, Nomura Research Institute, Estin & Co analysis and estimates

- Table 4 -

Breakdown of expenditures for one-person female households in Japan ⁽¹⁾

	Aged < 30	Aged > 70
Average age	25	77
Food	17%	22%
Housing	26%	10%
Fuel, light, and water	5%	8%
Clothing and footwear	6%	5%
Medical care	2%	5%
Transportation	4%	2%
Communication	6%	3%
Culture and recreation	12%	12%
Social expenses (gifts...)	4%	14%
Other	18%	19%
Consumption expenditures	100%	100%

(1) 2015 statistics

Sources: country statistics, World Bank, Kumano Hideo (Dai-ichi Life Research Institute), Estin & Co analysis and estimates