EDITORIAL

AT THE CROSSROADS OF ABUNDANCE, SCARCITY, AND DISRUPTION

Over the past three and a half decades, the world has undergone profound change. From a situation of balance in the early 1990s -the peace dividend, the Great Moderation, globalisation- we have ended up in a world characterised by geopolitical, economic (supply side) and environmental disruption. A distinctive and fascinating characteristic of this new era is the coexistence of abundance (data generation and dissemination, investment needs) and scarcity (shortage of skilled staff given population ageing, difficulty in finding financing). These developments raise important questions. What is my exposure to climate risk, AI, increasing economic fragmentation and interest rate levels, as a business, an investor, an employee, a government? How exposed are my clients? How resilient are my business model and investment portfolio to unexpected shocks? How robust are public finances? In a world characterised by abundance, scarcity and disruption, exposure analysis under different scenarios will play a central role.

The summer break offers time to relax and try to disconnect from the daily news flow. It also provides an opportunity to take a step back and look beyond the traditional data we need to digest all year long. What are key longer-term trends? How may they influence my investment portfolio or my company? Where are the risks and uncertainties? A useful starting point is to go back in recent history and observe how much the world has evolved. At the risk of oversimplifying and being accused of selective amnesia, one can say that over the past three and a half decades, the world has evolved from balance to disruption. 'Balance' refers to the peace dividend in the early 1990s following the fall of the Berlin Wall and the Iron Curtain. That meant that financing capacity could be redirected to investments in technology and the provision of public goods.

It is also linked to the Great Moderation, an era starting in the mid-1980s during which the variability of real GDP growth and inflation declined significantly[1], although it should be noted that, judging by several crises –the 1987 crash of Wall Street, the Asian crisis of 1997, the collapse of the large Long Term Capital Management hedge fund in 1998, the bursting of the bubble in technology stocks in 2000, etc. – financial market instability increased. A third aspect of balance was the drive towards globalisation as exemplified by China joining the World Trade Organisation in 2001. Fast forward to the 2020s and balance has given way to 'disruption' in geopolitics and national politics in many countries, with polarisation[2], and populism (Figure 1).

1 Source: The Great Moderation, Remarks by Governor Ben S. Bernanke at the meetings of the Eastern Economic Association, Washington, DC, 20 February 2004, Federal Reserve Board.
2 For a detailed analysis, see 'United States: The economic consequences of political polarization' , Ecoweek, BNP Paribas, 26 February 2024.

ABUNDANCE, SCARCITY AND DISRUPTION

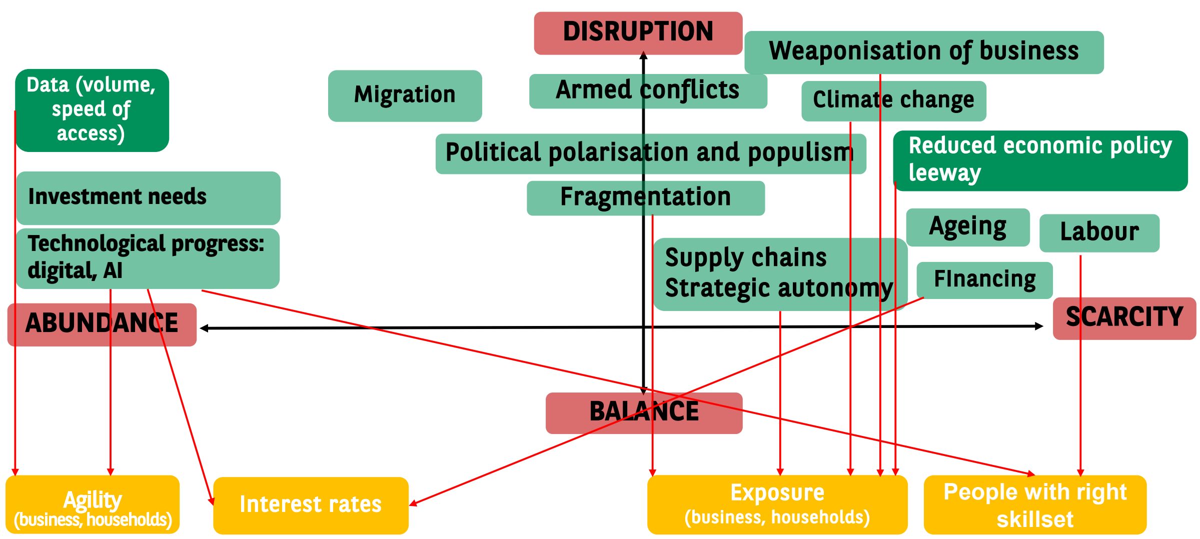

FIGURE 1

SOURCE: BNP PARIBAS

These developments in turn are impacting the economy, as analysed in geoeconomics[3]: the push towards protectionism, the US-China decoupling, the weaponisation of business and friendshoring[4], the focus on strategic autonomy[5], etc. Other factors have been or continue to be highly disruptive. The COVID 19 pandemic has shown the fragility of long and complex supply chains, triggering efforts to make them simpler, more diversified, and hence more robust. Climate change is disruptive because it leads to new sources of risk but also to a huge investment effort to change the energy mix and to increase the energy efficiency of economic activity whilst lowering its carbon footprint.

A distinctive and fascinating characteristic of this new era is the coexistence of abundance and scarcity. There is abundance in terms of data generation, the ease of access to data and the speed of information dissemination. There is also an abundance of investment needs, linked to the disruptive forces discussed previously as well as to technological progress, including artificial intelligence. Scarcity relates to the reduced policy leeway (monetary policy, but even more so fiscal policy, given elevated public debt levels in many countries) and to labour shortages that follow from population ageing and evolving requirements in terms of skills. Financing capacity is high in an absolute sense but, compared to the huge investment needs, can still be relatively scarce. Spending in the context of the green transition, AI-related investments, defence spending, the reorganisation of supply chains, etc. implies a big increase in financing needs and it remains to be seen how they will be met through a combination of higher interest rates, increased supply of credit, an increase in the savings rate or a delayed implementation of these investment plans. These developments have important implications for firms, households, and governments. For firms, agility will be key in terms of exploiting already available information and tapping into new sources of data by using artificial intelligence[6]. This comes on top of that other priority, making the green transition work. A necessary though not sufficient condition will be having staff with the right skillset. Companies, households and governments will need to pay attention to the cost of financing. In this new era, it is unlikely that inflation would drop significantly below the central banks' target and stay there. Moreover, the financing requirements will probably put a floor under real interest rates. Considering that so many changes are occurring simultaneously, the word exposure is taking a central role (Figure 2). What is my exposure to climate risk, AI, increasing economic fragmentation and interest rate levels, as a business, an investor, an employee, a government? How exposed are my clients? How resilient are my business model and investment portfolio to unexpected shocks? How robust are public finances? In a world characterised by abundance, scarcity and disruption, exposure analysis under different scenarios will play a central role.

William De Vijlder

ANALYSING EXPOSURE

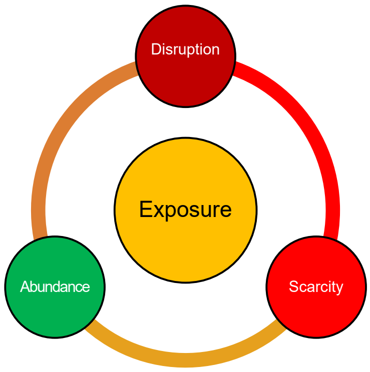

FIGURE 2

SOURCE: BNP PARIBAS

3 *'The world is moving away from a rules-based system where economic integration was seen as an end in itself to one where geopolitical considerations increasingly dictate policy decisions and the extent of economic openness.'* Source: Moritz Schularick, Project Lead of the CEPR Research Policy Network on Geoeconomics, Geoeconomics | CEPR.
4 *'We're pursuing an approach I've called friendshoring: seeking to strengthen our economic resilience through diversifying our supply chains across a wide range of trusted allies and partners.'* Source: Remarks by Secretary of the Treasury Janet L. Yellen on the Biden Administration's Economic Approach Toward the Indo-Pacific, 2 November 2023.
5 For a detailed analysis, see JRC Publications Repository – 'Shaping and securing the EU's Open Strategic Autonomy by 2040 and Beyond' (europa.eu).
6 For a detailed analysis, see : Artificial intelligence and the (un)known (un)knowns, EcoTV, BNP Paribas, 11 July 2024.