telescope N° 5
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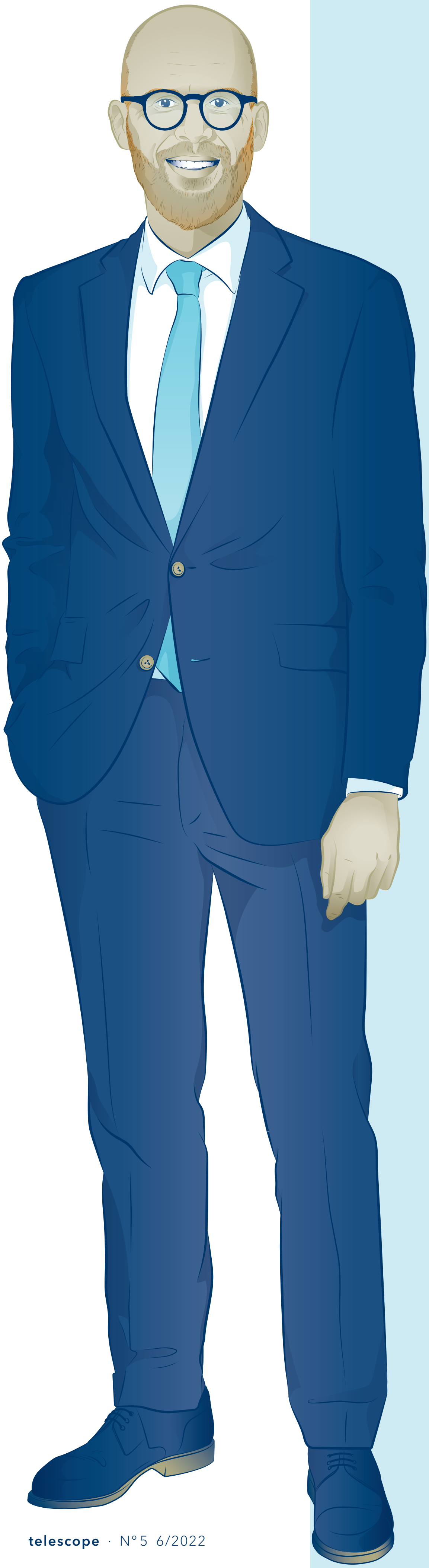
LIVING WITH DEGLOBALISATION

Global economic integration is being called into question, with important consequences for businesses and investors.

VP BANK



TREND REVERSAL

Dear Reader

Pick up any electrical appliance or toy and the chances are you'll find it was "made in China". This is globalisation in action – a world of unshackled trade and outsourced jobs.

But cracks are appearing in this economic model. Signs of deglobalisation are on the increase. The World Trade Organisation (WTO) is failing to make further progress in freeing up trade. On the contrary, trade is facing new obstacles (see page 4).

Global trade flows were already unsettled before the coronavirus pandemic disrupted supply chains. The situation has been made even worse by the war in Ukraine. Supply chain security has suddenly become an issue again, while sustainability is an added incentive to bring production closer to home.

Many firms are now thinking about reshaping their production processes. In the interview on page 16, Christoph Loos, CEO of the Liechtenstein-based construction supplies firm Hilti, explains how his company is tackling this issue. Hilti is one example among many (see page 18).

Investors are asking themselves whether deglobalisation is going to fuel inflation and thereby push up interest rates after four decades of falling borrowing costs. Fortunately, however, the narrative of more trade and less inflation is misleading (see page 10).

No one can predict how long economic deglobalisation will continue. It is a slow process, and investors should watch it closely.

I wish you a stimulating read.

Dr Felix Brill
Chief Investment Officer VP Bank

DEGLOBALISATION ON THE MARCH

After an explosive period of globalisation, the worldwide integration of economic activity is encountering headwinds. First came the financial crisis, precipitating a slump in direct investments. Then followed the trade conflict between the US and China, then the pandemic and now the war in Ukraine. We believe that economic globalisation has passed its peak for the time being. **Bernd Hartmann**

"Merger Monday" is what it's called in the financial markets. Two companies plan to merge and they hammer out the details over the weekend while the stock exchanges are closed. Then the merger is unveiled on the following Monday, and the markets discover that one company has been swallowed up by another. Throughout the 1990s and 2000s there were hundreds of such deals. The aim, especially in the case of cross-border mergers, was to expand into new markets and cut costs. In the manufacturing sector this often meant moving jobs to Asia or some other lower-wage location. Production processes and capital flows became increasingly globalised.

This globalisation trend is now faltering. Supply chains are currently being disrupted by the Covid pandemic, the war in Ukraine and economic sanctions. In fact, however, the malaise started much earlier, even before Donald Trump ignited the US-China trade conflict in 2018.

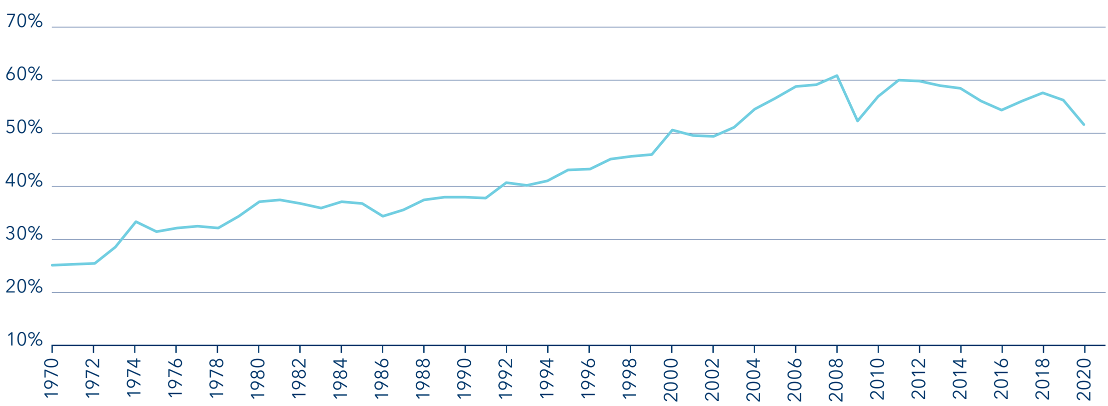
We can see with hindsight that the tipping point was the global financial crisis of 2008/09. Since then the volume of internationally traded goods and services has been growing more slowly than the overall economy, reversing a decades-long trend. International trade as a percentage of global GDP is edging downwards (see chart below). The fall in cross-border direct investments has been even more striking (see chart on page 9). Why is this, and where does the world economy go from here? In our view, four aspects indicate a phase of deglobalisation.

1. Protectionism and geopolitics

The financial crisis burst on the world at a time when globalisation had gone into overdrive. The integration of the emerging markets into global trade, especially the accession of China to the World Trade Organisation (WTO) in 2001, went hand in hand with the dismantling of tariffs and other trade barriers. Companies were able to cut costs and boost profits by relocating production to lower-wage economies, while consumers enjoyed the cost-of-living benefit of cheaper imports.

The massive setback to economic growth in the wake of the financial crisis raised the curtain on a period of increased protectionism. Even politicians in business-friendly parties became more critical of globalisation. Global trade negotiations ran into the sand. The WTO's "Doha Round" of trade talks that started in 2001 with the aim of facilitating trade in over 20 fields of activity was never concluded and is now regarded as a dead letter. Instead of global agreements there has been a growing trend towards regional trade blocs. The Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU was torpedoed by Donald Trump. But in 2018 the countries of

Faltering global trade



Global exports and imports of goods and services (as % of global GDP) the Pacific area signed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), leaving the US out in the cold. 2022 saw the creation of the world's largest free trade bloc, the Regional Comprehensive Economic Partnership (RCEP), comprising China, Japan, the south-east Asian economies, Australia and New Zealand.

These regional arrangements cannot conceal the trend towards greater protectionism. Trump attacked China directly, accusing it of unfair trade practices. In 2018 his administration began to slap tariffs on imported Chinese goods. An even more wounding attack was made on the Chinese telecommunications giant Huawei, which was shut out of 5G mobile phone infrastructure projects in multiple western countries amid charges of espionage. Trump's successor Joe Biden has adopted a more moderate tone, but in practice his position on China hardly differs from Trump's.

It is still unclear whether there was any substance in the espionage charges against Huawei. But it is a fact that countries are increasingly adopting nationalistic industrial strategies. The Chinese government's "Made in China 2025" policy prioritises ten industrial sectors in which it wants Chinese companies to become world leaders. With government support, Chinese firms have embarked on foreign shopping expeditions to acquire key technologies. An example is ChemChina's acquisition of the Swiss agritech company Syngenta, which produces genetically modified seeds. Another example is the industrial robot maker Kuka in Germany, now predominantly in Chinese ownership.

But industrial policy is not the exclusive preserve of the Chinese one-party state. The European Union has launched the European Chips Act with the aim of bolstering Europe's semiconductor industry by creating a flourishing research and production ecosystem and a resilient supply network. EUR 43 billion is being set aside for this project, and subsidies will be offered to lure chip manufacturers to Europe. The stated justification for this initiative is the need to increase resilience to supply chain disruption (see point 2). Given that there is now hardly any appliance or machine that does not contain a microchip, this is a vital issue. Similar concerns apply to other forward-looking industries, e.g. battery manufacture. The dividing lines between justified supply worries, coronavirus relief and anticompetitive market distortion are not always easy to discern.

// China is not the only country pursuing an industrial strategy. //

2. Supply chain security

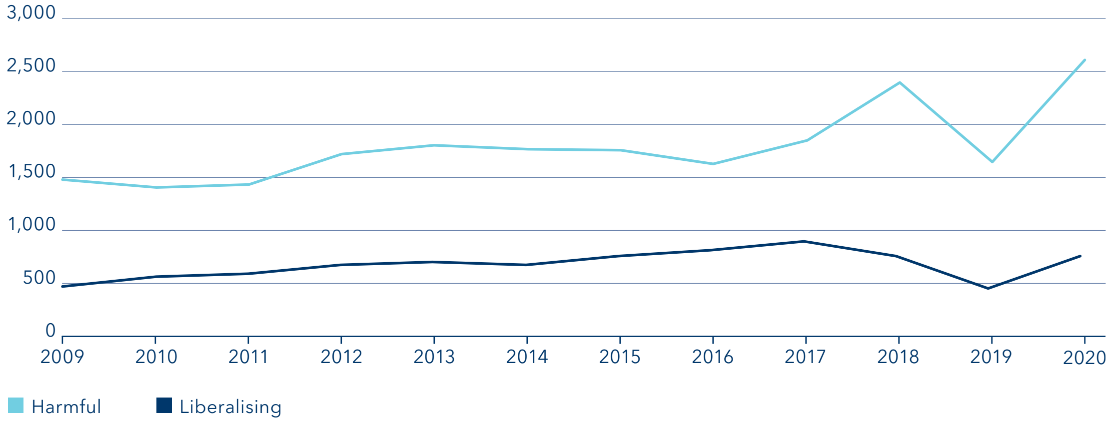
Globalisation enabled companies to make production processes vastly more efficient. Globally consolidated manufacturing means larger output volumes, resulting in higher capacity utilisation and economies of scale. Further savings have been achieved by downsizing inventories and simplifying the supplier network. High-volume production facilitates specialisation and an efficient division of labour, which in turn leads to qualitative improvements.

The drawbacks of a system focussed exclusively on efficiency were brutally exposed by the coronavirus pandemic. Deliveries were blocked by sudden closures of national borders. This was especially critical in the case of products whose manufacture is concentrated in only a handful of countries. According to a study by the European Commission, 80% of pharmaceutical agents are

What is globalisation?

The last 50 years have seen the emergence of a global market for goods, services and capital. This was made possible by an intensive interlocking of economies and the reduction of tariffs and other obstacles to trade. The trend was spearheaded by multinational companies, which exploited new technologies and spread their production facilities worldwide. Globalisation led to a relocation of jobs, mostly to emerging economies where wage costs were lower. The integration of the emerging markets into the world economy culminated in the accession of China to the World Trade Organisation in 2001.

Number of trade intervention policy measures implemented worldwide from 2009 to 2020, grouped by influence on trade liberalisation



produced in India and China. For penicillin the figure is 90%. During the first wave of the pandemic, some countries imposed temporary bans on the export of medical goods, thereby aggravating the emergency.

A maritime accident in March 2021 highlighted another disadvantage of consolidated supply chains. The grounding of the giant container ship Ever Given in the Suez Canal (see page 13) blocked this strategically vital waterway to Europe. During the six-day "traffic jam" 370 vessels were immobilised.

3. New technologies

Differential wage costs have been a major driver of globalisation. Companies were able to increase their profit margins by offshoring labour-intensive manufacturing processes to low-wage economies. Lately, however, wage costs in the emerging economies have risen while pay in the developed world has stagnated. The productivity-adjusted advantage has therefore diminished. Added to that, the advance of robot technology has paved the way for increasing automation, reducing the proportion of wages in overall production costs.

In the years ahead there will be a growing trend towards additive manufacturing processes. Technologies like 3D printing make it possible to manufacture small batches flexibly and cost-effectively in local facilities. This reduces the cost advantage of mass production at a central location and makes it easier for companies to tailor products to specific customer needs. The WTO estimates that additive manufacturing will knock 20% off world trade volume by 2060.

4. Costs of global trade

For many years globalisation was facilitated by dwindling impediments to trade. But it looks as if the international exchange of goods is going to get more expensive again. True, tariffs are still at a business-friendly level. But more non-tariff trade barriers are being erected than dismantled. These include technical quality requirements, quantitative restrictions, export subsidies and import quotas.

Such additional rules and hindrances make trading more complicated and therefore more expensive. Global Trade Alert has been tracking changes in the trade policies of all G20 members since 2008. It found that measures harmful to trade have increased by around 60% in the last five years, while the number of liberalisation measures has stagnated (see chart above).

International merchandise trade has also benefitted until now from low freight costs. For one thing, the prices of fossil fuels do not reflect the environmental damage that their use entails. For another, there is a significant gap between the costs of local transportation and overseas transport. The diesel used in lorries is highly taxed, whereas air freight is powered by tax-free aviation fuel and cargo ships can still run on cheap but dirty heavy fuel oil. But the days of low-price fossil fuels are numbered. As a part of its "Fit for 55" package aimed at reducing net greenhouse gas emissions by 55% by 2030, the EU plans to remove all tax exemptions on fossil fuels and to increase the tax on jet fuel step by step as from 2024.

In the EU the cost of foreign semimanufactures and finished goods will be increased by the planned Carbon Border Adjustment Mechanism, which is designed to protect domestic producers as their costs are pushed up by the transition to carbon neutrality. The idea is to discourage buyers from switching to goods imported from countries with laxer environmental standards by subjecting such goods to a carbon tariff. From 2026 importers will have to buy carbon certificates corresponding to the carbon price that would have been paid if the goods had been produced under EU rules. There are worries, however, that the mechanism might contravene WTO regulations.

Increased attention is being paid not only to environmental issues but also to social and humanitarian concerns. The Swedish fashion chain H&M, for example, has ended its collaboration with a Chinese yarn producer in response to accusations that H&M and other firms were profiting from Uyghur forced labour. In the age of social media, companies can no longer hide behind their suppliers – misdeeds quickly go viral. Some western countries, including Germany, are passing legislation to make companies legally liable for human rights abuses and labour law infringements by their suppliers.

Globalisation with a new face

A hard rain is falling on the globalisation trend. Economic, ecological, technological and political developments indicate that hyperglobalisation came to an end with the financial crisis and that a period of economic deglobalisation has started. This does not, however, signify the end of globalisation. The new conditions will inspire a process of rethinking and adjustment, resulting in new patterns of international economic activity and trade.

A complete unravelling of globalisation is not on the cards except in a few sectors where key national interests are at stake, notably relating to supply chain security or industrial policy. Pharmaceuticals are a possible example here.

> // More trade barriers are being erected than dismantled. //

The amount of relocation will depend on wage costs, transport costs and government incentives. In other fields companies will largely stick to an international division of labour, though in a reorganised form (see page 16).

Where production facilities are already in operation, economic considerations will tend to preclude a rapid relocation. But companies planning to enlarge capacity or make replacement investments will examine the location issue very carefully. To make supply chains more resilient, companies will look at options like inventory enlargement or the use of multiple suppliers from various countries (see page 18). Countries and companies will increasingly opt for regional integration in order to combine the advantages of globalisation with the need for security of supply. This lower level of globalisation does not necessarily mean that companies will be less internationally active.

Instead of producing in one location and then selling the goods worldwide, firms will increasingly produce goods where they are to be sold. Countries that are close to the economic centres of the western world, like Mexico and eastern Europe, stand a good chance of being integrated into regional trading blocs. Asian emerging nations will focus more strongly on trade among themselves. These shifts will give globalisation a new face.

MEASURING (DE-)GLOBALISATION

Global trends are hard to pin down. But it can be done.

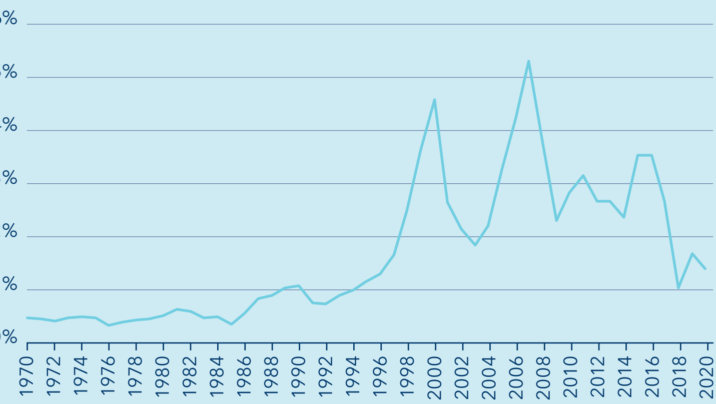
Dominik Pross

As with all long-term trends, (de-)globalisation is not an easy phenomenon to measure. A multitude of factors have to be considered when deciding whether globalisation or deglobalisation is happening and what the scale of the process is.

The KOF Globalisation Index published by the Swiss Federal Institute of Technology in Zurich is based on 42 variables and provides a realistic picture. But the complexity of the index's calculation means that it is inevitably backward-looking. The December 2021 update was based on data from 2019. Added to that, the indicators are affected by short-lived factors. A recession, like the one that happened in 2020, can cause even a reliable indicator to falsely signal deglobalisation.

In order to smooth out short-term fluctuations, we therefore need to look not only at the latest numbers but also at data series that stretch over many years. Our analysis is based primarily on two sets of statistics, which indeed point to deglobalisation: trade as a percentage of global gross domestic product (GDP, see page 5) and the net inflow of foreign direct investments as a percentage of GDP (see chart above).

Foreign direct investments worldwide



These data are available for most countries over an extended period and are updated regularly. Exports and imports as a percentage of national or global GDP show changes in the volume of merchandise trade. A continuous decline in this figure would indicate that consumption in the importing countries is being covered increasingly by goods produced domestically.

Foreign direct investments (e.g. buying up businesses, investing in factories) are also a key indicator. Emerging markets, in particular, are very dependent on inward investment. Vietnam and Bangladesh, for example, are still important manufacturing locations for foreign companies. A decline in the growth rate of inward direct investments would signal a possible change in the pattern of production. Even so, a decline in just one country is not necessarily a meaningful indicator. It could be due to local factors, like political changes. Only a decline in direct investments across an entire region or the whole world can be regarded as evidence of deglobalisation.

Taken together, trade and direct investments point to a changing pattern of trade and production. However, looking at just two indicators is not enough. We also need to factor in other qualitative and quantitative criteria (see page 4) and listen to what practical businessmen have to say (see interview with the CEO of Hilti on page 16). Political decisions regarding tariffs and subsidies are a further factor that has to be considered.

THE IMPACT OF TRADE ON INTEREST RATES IS OVERESTIMATED

Interest rates in the developed world have been on a downtrend for the last forty years. This is often attributed to the growth of international trade and the interlocking of financial markets. But researchers have raised doubts about this explanation and its implications for monetary policy.

Thomas Gitzel

When globalisation was at its peak before the 2008/09 financial crisis, it seemed obvious that a globally integrated economy would bring benefits for all. Internet access was spreading by leaps and bounds thanks to the triumphal progress of mobile phones, and online shopping sites like Amazon were creating an unprecedented level of price transparency, which consumers were eager to exploit. Buyers went straight to the lowest-priced offer and left expensive suppliers unclicked. As competition in the globalised economy now spanned the whole world, this helped keep prices down internationally.

If this explanation is accurate, globalisation should be reflected in lower import prices across the board, not just for consumer goods. The import-related portion of the price basket would become cheaper and put a damper on inflation. Moreover, if goods from abroad are less expensive because they are manufactured in low-wage economies, it is harder for employees in the domestic workforce to demand higher wages, with a resultant moderating effect on domestically driven inflation.

The message therefore seems to be that increased globalisation has meant less inflation. That, in turn, would mean a downward push on interest rates. In fact, however, this is not necessarily what happens, as we shall explain in this article. Conversely, deglobalisation does not automatically push interest rates higher.

> // Price movements abroad become highly relevant due to their effect on imported goods. //

Globalisation as a price driver

First let's go back a step: inflation, together with economic growth and exchange rates, is a major driver of interest rates. Central banks monitor these inputs carefully. Their primary task is to keep prices stable, which they try to do by adjusting their key interest rates. With this in mind, researchers have investigated whether globalisation has indeed contributed to falling interest rates over the past four decades and, if so, to what degree. The results are not straightforward. Globalisation certainly means that price movements abroad become highly relevant for domestic users, because they affect the prices of imported products and services. For example, if wages and prices in China move up, that can have direct implications for the inflation rate in the importing country.

This effect is intensified if there is no domestic substitute for the imported product. Examples are all too easy to find at present. Semiconductors made in Asia are now in short supply because of the pandemic and resultant lockdowns. But European producers do not have the capacity to plug the gap, because globalisation has meant that chip manufacture has been largely offshored.

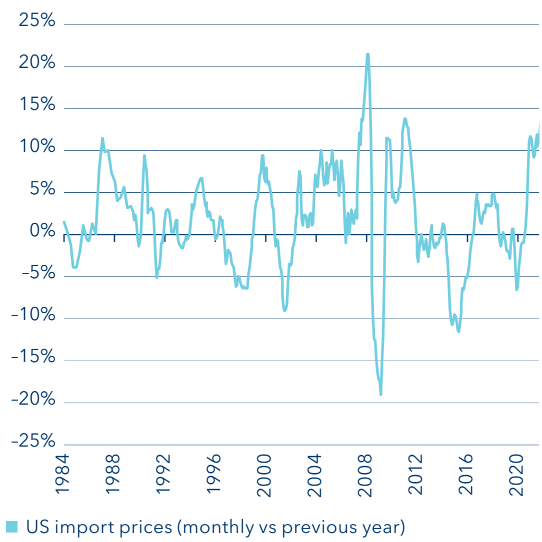
The chip famine in the automobile sector shows where this can lead. Production falters, and not enough new cars come onto the market. Consumers therefore opt for second-hand vehicles, with the result that prices of both new and used vehicles rise. Higher car prices have been a significant driver of inflation in the US and Europe since autumn 2021. At the same time, inflation has been additionally fuelled by higher import prices. Upping the domestic production of substitute goods would therefore be a way of reducing inflationary pressures.

Given that jobs have been relocated to low-wage countries during the last forty years of globalisation, one could assume that goods manufactured there would be cheaper and that this should be reflected in import prices. US statistics, however, do not clearly show this (see chart).

A part of the explanation might be the oligopolistic position enjoyed by globally active companies that dominate world markets, such as Amazon, Google and Microsoft. In these cases competition is limited, and that affects prices. Thus globalisation can actually stand in the way of lower inflation.

In a study published in September 2021 researchers at the European Central Bank came to the conclusion that globalisation has had no significant impact on the inflation trend in the developed countries during the last thirty years. A comparable study by the OECD produced similar results. The sharpest fall in global inflation was in the 1980s and 1990s, when the latest wave of globalisation was still in its infancy. Thus the empirical connection between an increase in international trade and inflation does not appear statistically significant.

No clear effect of globalisation

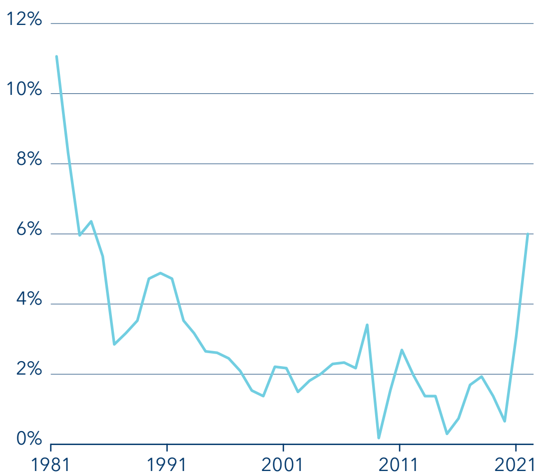


Influence of open financial markets

Although intensified world trade has had no substantial influence on the inflation trend, globalisation has not been without consequences for monetary policy and interest rates. Globalisation is not limited to trade and production processes but also manifests itself in the large-scale integration of international capital markets.

Thus European bond yields usually move in the same direction as their US counterparts, irrespective of economic developments in the eurozone. This impedes the monetary transmission mechanism; in other words, it makes it harder for the ECB to assert its monetary policy within the eurozone. The result is that borrowing can become more expensive in the eurozone without any action having been taken by the central bank. This frequently happens. When deciding policy, central banks therefore have to take account of developments on the global financial markets. This aspect plays a bigger role in their calculations than movements in import prices.

Inflation during globalisation



Average consumer price inflation in the industrialised countries (annual rate)

Effects of deglobalisation

If globalisation has had only a small impact on world inflation and hence on interest rates, then a period of deglobalisation should have no significant effect on price trends. That does not mean, however, that a reversal of globalisation has no consequences at all.

Businesses worry about the possibility that the benefits of globalisation will unravel, e.g. because costs will be driven up by massively increased freight charges (see page 18). A survey conducted by the Leibniz Institute for Economic Research at the University of Munich (the ifo Institute) at the height of the pandemic in 2021 found that around one in five German companies planned to switch production back to Germany.

In macroeconomic terms, the key question is whether the resultant costs can be passed on to customers (inflationary) or not (non-inflationary). Economists are largely agreed that the

> // A period of deglobalisation should have no significant effect on price trends. //

globalisation of the financial services industry affects the operation of monetary policy. If deglobalisation were extended to the financial sector by making capital market transactions subject to the same sort of restraints as those that are now affecting trade, the conduct of monetary policy would be much simpler. Central banks would then have greater scope for regulating interest rates.

THE "BIG BOX" HAS OPENED UP VAST POSSIBILITIES

Christina Strutz

For American entrepreneur Malcolm McLean, loading and unloading ships took too long and cost too much. By inventing the shipping container he made the process simpler, cheaper and faster.

Malcolm McLean's first job was as a filling station attendant. But it was not long before he started a trucking company together with his brother Jim and sister Clara, with himself as one of the drivers.

The idea of containerisation came to him one day in 1937, when he had to wait almost the whole day for cotton bales to be loaded onto his truck at the port of New Jersey. Wouldn't it be possible to put a trailer directly onto the ship instead of loading sacks, bales and cases individually?

It was not until April 1956 that McLean's first container ship, the "Ideal X", left Newark Harbour headed for Houston – containerisation was born.

The idea caught on. The "big boxes" protected freight from wind, rain and theft and could be shipped all over the world without the freight having to be reloaded. Since then, the mantra for international logistics and containerisation has been: bigger, faster and more cost-effective.

Containerisation has necessitated a massive reshaping of ports and shipping practices. The containers themselves have had to be standardised. In America they followed US specifications, but these sizes were unsuitable for European roads. Negotiations between Europe and America finally resulted in today's ISO intermodal freight shipping container. The standard TEU (twenty-foot equivalent unit) container has a volume of 33 cubic metres, while its big brother, the FEU (forty-foot equivalent unit), is 40 feet long (1 foot = 0.3 metre). Both are 8 feet wide.

Containers have made a decisive contribution to flourishing world trade. They enable almost anything to be shipped almost anywhere in the world.

But the advantages do not come without risks. In 2021 one of the world's biggest container ships, the Ever Given, with a capacity of 20,000 TEUs, ran aground in the Suez Canal and was stuck there for over six days, blocking the way for hundreds of vessels. According to the Allianz insurance company, the losses caused by the blocking of the canal amounted to over USD 9 billion a day. Added to that were salvage costs and the reputational damage and lost revenue suffered by the Suez Canal Authority.

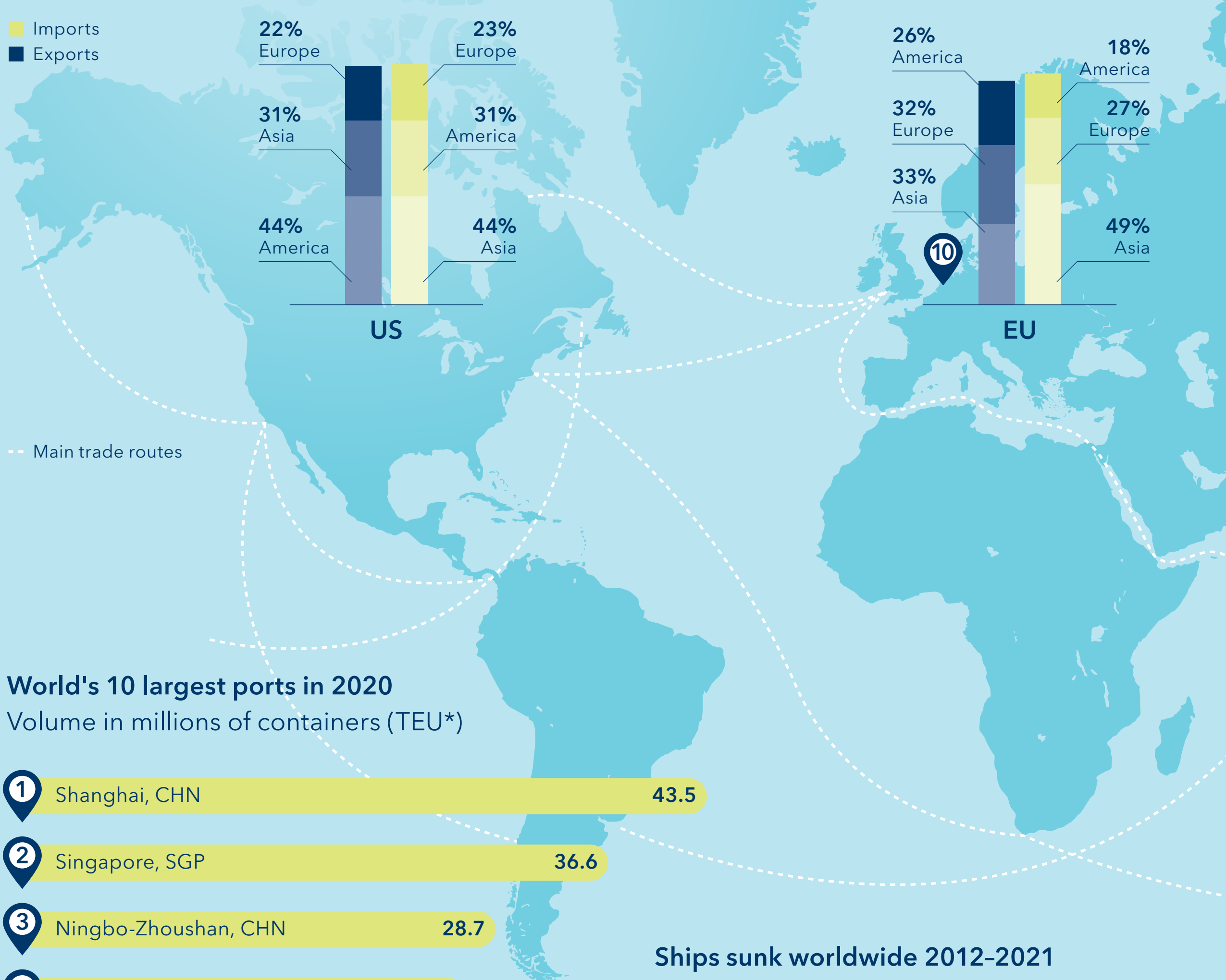
The world economy's dependence on containers has also been highlighted by the coronavirus pandemic. As a result of China's zero Covid policy, Chinese ports have repeatedly been closed, with containers unable to move. The resultant delivery bottlenecks have had painful repercussions on trade throughout the world.

However, containerisation lives on. The difficulties may have slowed its triumphal growth – but they have certainly not halted it.

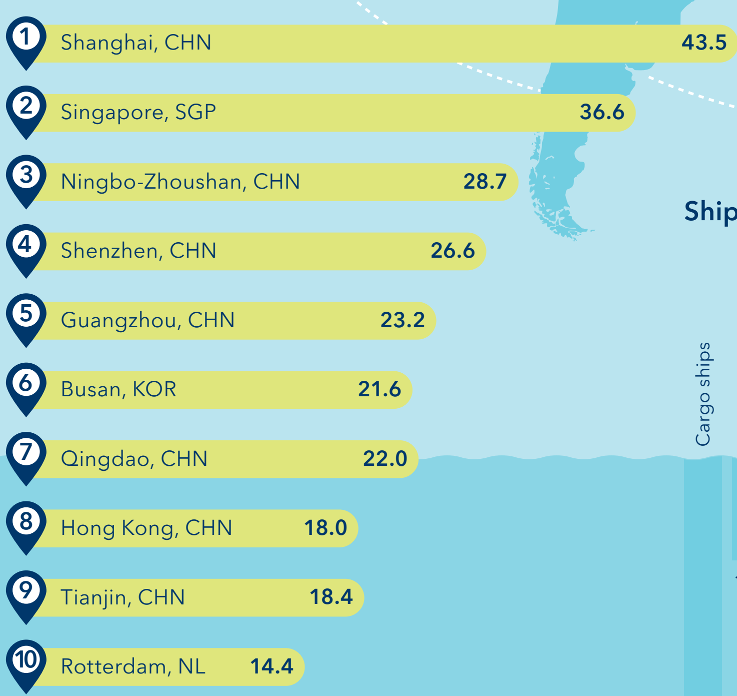
GOODS TRAVEL BY SHIP

Largest trading volumes are in Asia where nine of the ten largest ports are domiciled.

Imports and exports of the EU, China and US by continent (2021)
as % of the respective total (example: 23% of US imports are coming from Europe)

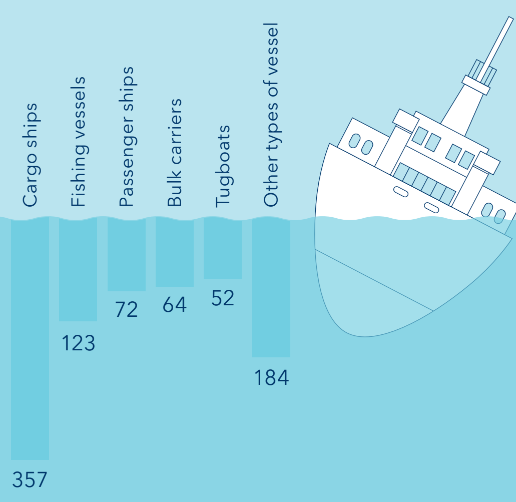


World's 10 largest ports in 2020
Volume in millions of containers (TEU*)

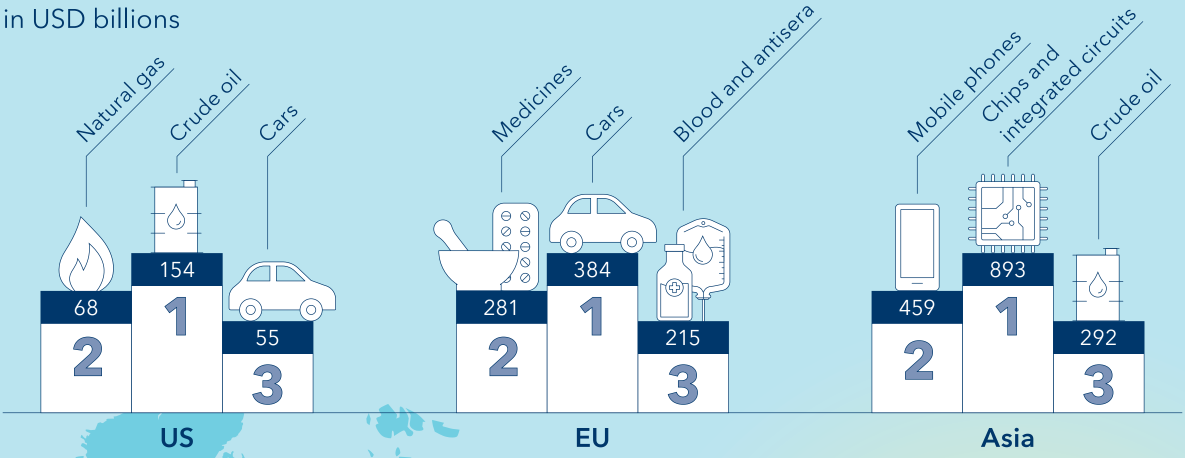


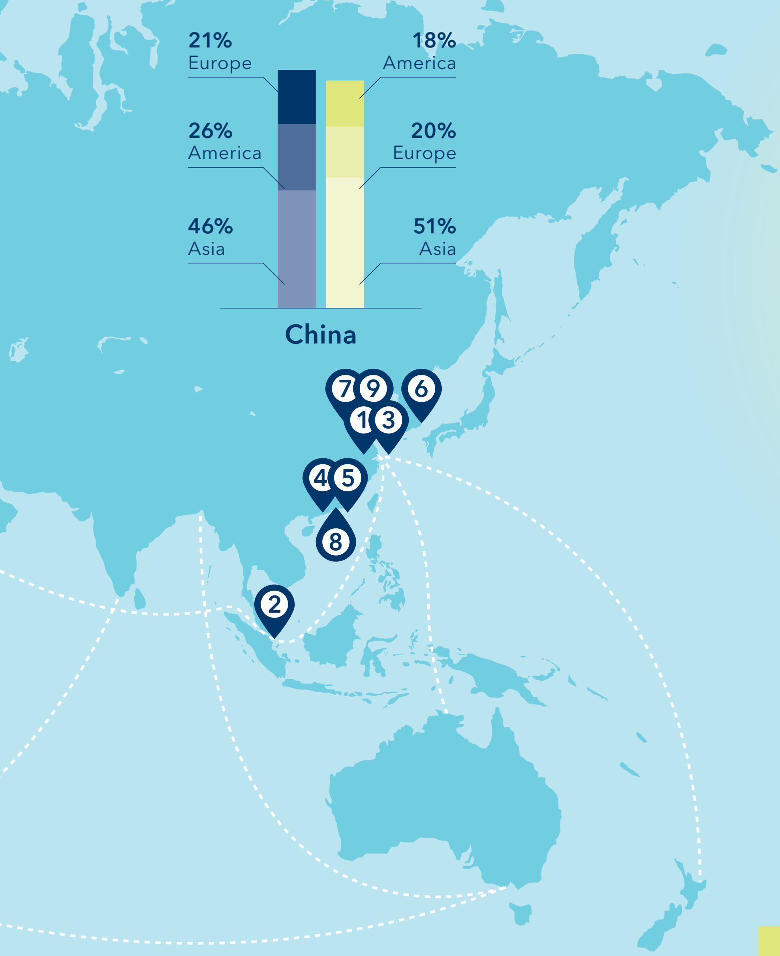
*Twenty-foot equivalent unit

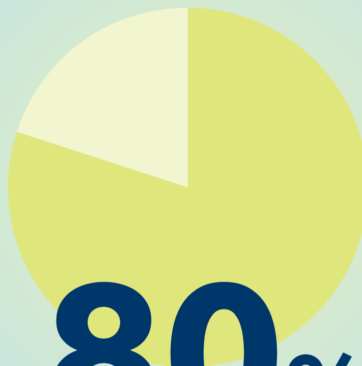
Ships sunk worldwide 2012–2021



Top 3 exports of US, EU and Asia in 2021
in USD billions

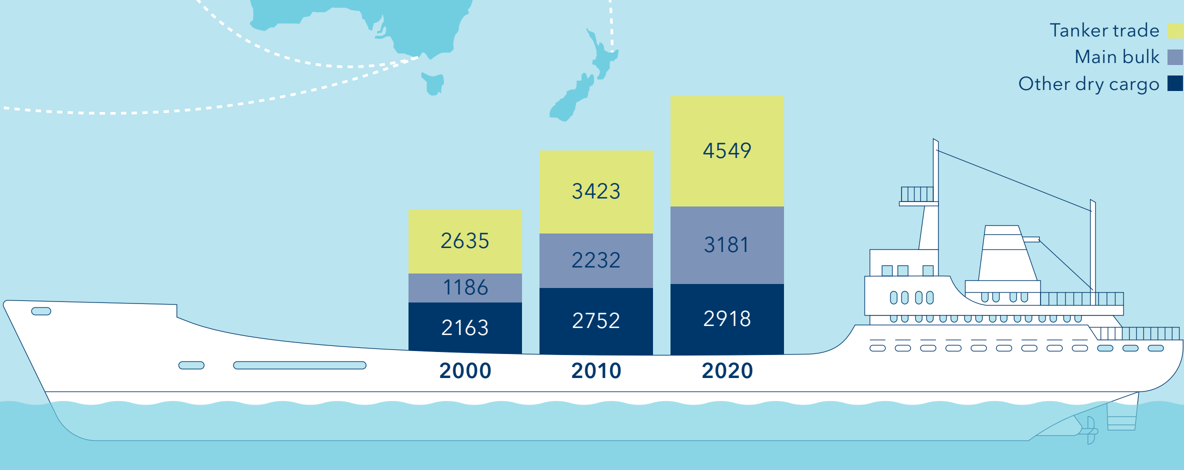






More than **80%** of global trade volume is transported by ship.

International trade by ship
in millions of loaded tonnes



Tanker trade: crude oil, refined petroleum products, gas and chemicals
Main bulk: iron ore, grain, coal

For sources see page 26

"OUR WATCHWORD IS MULTI-OPTIONALITY"

For a long time it made sense to produce in one location for the whole world. But punitive tariffs, the pandemic and the war in Ukraine have changed that. Christoph Loos, CEO of the Liechtenstein-based construction supplies specialist Hilti, explains why.

Interview: Clifford Padevit

Mr Loos, have we entered a period of deglobalisation?
Big changes are certainly under way in the global division of labour. And this will tend to lead to less globalisation rather than more.

What does that mean in practice?
For a long time we all had the idea that the trend was towards greater global division of labour, so companies could produce where costs were lowest and supply the whole world from there. Unfortunately, such an approach now looks naive. We saw this in the trade dispute between the US and China, when tariffs were imposed overnight. And the pandemic has resulted in lockdowns that have closed off whole countries.

How does Hilti respond to this?
We need a setup with more options. We want to have various facilities in different parts of the world so as not to be reliant on just two or three countries. That does not necessarily mean less globalisation, but it does mean changes.

What has been the effect of the war in Ukraine?
We are sorry about Russia. Financially, Russia was about three percent of our business, so we can live with losing it. But it causes us a lot of regret, because it was a really fantastic operation. We moved into Russia after the collapse of the Soviet Union and ultimately employed 1,300 people there and were leaders in almost all our Russian markets. Now that has all fallen apart. It was a really super team.

What about the longer-term consequences of the war?
People are increasingly thinking in categories again. Who can we trust? Who not? That probably means producing a bit closer to home. This is a complete break with the last thirty years, and it will tend to lead to less globalisation. The trend towards sustainability works in the same direction, mainly due to the need to reduce transport distances.

You are now working on your business strategy for 2030. How do you adjust to these developments?
The central theme of our supply strategy is keeping various options open: multi-optionality. We don't work with a scenario that says we trust the Americans more than the Chinese and will therefore shift everything to Europe and the US. The Trump experience showed what can happen in America. We want to be in a position where, if something happens somewhere in the world, we can shift our production accordingly. For example, who knows what will happen in China and Taiwan in the long term? At present our "local for global" setup in China is functioning well. But we want to be prepared. And if it turns out that change is unnecessary, then so be it. It will just be a matter of having incurred some additional costs. That's like an insurance premium that we have to accept.

So were Donald Trump's punitive tariffs just a prelude?
They were a wake-up call. If you build a global supply chain and try to work out where to manufacture a particular product for the world market, you have to make assumptions. If the parameters suddenly change and you face import duties of 40% or 50%, the calculation is completely transformed. That is what happened with the Trump administration, and it caused an enormous loss of confidence. We had to shift the production of steel nails from China to Mexico so as to avoid US tariffs.

But surely it is not usually as simple as that, is it?
No, because we manufacture technically sophisticated products for which we need a minimum volume and a lot of expertise. We usually have two production facilities for each product group, and we can't simply turn two into five. We are now working on making it three or four, but that obviously takes two or three years. It means smaller factories that are less efficient. That pushes up costs, but our supply chain becomes more robust.

Can one simply find the same expertise elsewhere, for example the same level of expertise for electronics as in China?
It's difficult. Clusters have arisen in various parts of the world, for example electronic products and mobile phones in China. There are only five or six countries in the world that can offer comparable competence. So you go where you can buy electronic components, but not everything will operate as smoothly as in China. We therefore try to nurture new partners and build long-term relationships.

Multi-optionality is more expensive. Can you simply pass the higher costs on?
It's an effort. We are now having to make price increases that I've never experienced in my twenty years with Hilti. The price of steel, for example, has doubled. We can't pass on everything, so there is an impact on our profit margins.

How is Hilti affected by the current supply problems?
There are stresses and strains all over the place. We face shortages and huge transport difficulties. It started in 2021 and has got worse since. Even when we manage to buy what we need, we still have to get it to the right place. We are experiencing shipment difficulties that affect customers on a massive scale that has never happened before. We have a substantial backlog of orders that we can't deliver.

Which products are affected?
All forms of electronics, including chips. Electromechanical components for control mechanisms. Steel is an issue, as are basic chemical products like plastics. The supply of battery cells is also inadequate.

This all started with the pandemic. How has Covid changed Hilti as a global player?
We are a company that places great emphasis on relationships and teamwork. Personal contact is very important. Then there are our direct sales. Our representatives travel a lot in order to be close to customers. This will also be important in the future. We are travelling more again, but it will not be as much as before the pandemic.

PROFILE

Christoph Loos has been CEO of the Hilti Group since 2014. Headquartered in Schaan in the Principality of Liechtenstein, Hilti is well-known for the distinctive red cases in which its tools are delivered. A German national, Dr Loos was appointed to the Executive Board in 2007, first with responsibility for finance and development and later in charge of emerging markets and global energy & industry. At the end of this year, after 21 years with Hilti, the 54-year-old will step down as CEO and become Chairman of the Board of Directors.

Note: The opinions expressed in this interview may differ from those of VP Bank.

RESHAPING OF SUPPLY CHAINS GETS TOP PRIORITY

The global interlocking of merchandise flows, production processes and technologies is reaching its limits. This confronts businesses with new challenges. Many firms are considering a move back to their home base.

Marcello Musio

Business activity in many economies and companies is based on integrated logistical networks that link together producers, suppliers and consumers around the globe. Since the 1990s, or even earlier, cross-border supply and value chains have become an essential feature of the world economy. According to a joint study by the World Bank and other international organisations, this globalisation process was a major factor in the meteoric expansion of international trade in the decade preceding the financial crisis, bringing many advantages and opening up a multitude of new opportunities.

Profiting from globalisation

More than 36 million jobs in the EU depend on exports to third countries. According to the EU Commission, every billion euros worth of exports to non-EU countries supports 13,000 jobs in the EU (2017). Companies have been eager to exploit the momentum that globalisation generates. Take the German automobile industry, for example. BMW operates an integrated globe-spanning production and sales network with more than three dozen factories in Germany, South Africa, China and the US.

The financial crisis of 2008/09 put a spanner in the works. Rampant uncertainty, exacerbated in Europe by the debt crisis, led to a wind-down of international investment. Global net direct investments have still not returned to their pre-crisis levels (see page 9). International trade relations got a further knock when former US President Donald Trump ignited conflicts with several of America's trading partners. Punitive tariffs and countermeasures caused a substantial disruption of world trade.

Global clusters

The weaknesses inherent in the cross-border integration of merchandise flows and production processes were laid bare by the coronavirus pandemic. The "produce where labour is cheap" mantra no longer universally applies. Increasingly, the trend is towards "produce where your customers are", especially in view of the drastic changes in wage levels in various parts of the world since the 1990s. The Dutch group Philips, for example, is now manufacturing its higher-end electric shavers in the Netherlands again, having repatriated this line of business from China. Philips says that a production engineer in Shanghai is now just as expensive as one hired in the Netherlands.

This reflects the geographical clustering of production as a result of the increased division of labour in the global economy. The phenomenon is especially visible in China. According to the Swiss lift and escalator manufacturer Schindler, 70% of all components for the lift and escalator industry worldwide are now produced within 100 kilometres of Shanghai.

To what extent deglobalisation will take hold remains to be seen. But one thing is certain. The risks involved in cross-border value chains now loom larger in companies' calculations. Hence the growing talk about "reshoring" (shifting production back from emerging markets to the industrialised countries) or "nearshoring" (creating production networks closer to home). The Liechtenstein-based construction supplies specialist Hilti provides a vivid example of this (see interview with the company's CEO on page 16). Business leaders now recognise that supply chains are a crucial growth factor.

Higher costs

In February 2020, just before the outbreak of the coronavirus pandemic, the World Economic Forum advised companies to explore nearshoring options for shortening supply chains. Many companies have already responded and are adapting their strategies to the changing architecture of global trade.

// Stihl has ditched just-in-time production in favour of maintaining well-stocked inventories. //

Volkswagen's head of procurement, for example, has started to monitor individual suppliers and also the firms that supply to suppliers in order to achieve multi-tier supply chain visibility. If necessary, the company is prepared to incur higher costs for components and warehousing. Another example is the German company Stihl, the leading manufacturer of power and chain saws. In the wake of the financial crisis of 2008/09, Stihl decided to reshore the production of critical components, ditching just-in-time production in favour of maintaining well-stocked inventories. The German logistics company Dachser sings from the same song sheet. It owns over 170 warehouses around the world and believes that warehousing capacity will play a critical role in stabilising supply chains in tomorrow's trading environment.

Relations between buyers and suppliers have also been reshaped. In reaction to the worldwide semiconductor famine last November, for example, automobile makers Ford and General Motors entered into a strategic agreement with the chip manufacturer GlobalFoundries. The boundaries between lines of business are getting blurred. Courageous firms do not wait for supply chains to fall apart. The clothing retailer American Eagle has forked out USD 350 million on the purchase of Quiet Logistics, which runs a network of logistics centres with state-of-the-art robot technology.

New jobs

In a globalised world there are many ways of building a new supply chain or optimising an existing one. Inditex, a Spanish clothing company and parent company of Zara, has shifted 10% of its production from Asia to Morocco and Turkey. Companies like General Motors, Boeing, Ford und Intel have reshored thousands of jobs in the last two years. General Motors' battery production will now be located in Michigan, where a new centre for lithium-based products is planned. According to the US nonprofit organisation Reshoring Initiative, around 1,800 American firms plan to reshore parts of their business this year, potentially generating around 220,000 new jobs in the US.

These examples show that globalised production and trading systems are losing their shine. Companies have started to adapt and are discovering how challenging the readjustment process can be, especially with regard to the impact on costs and profit margins. Here we see a direct effect of ongoing deglobalisation.

FRED KINDLE

Top manager Fred Kindle was CEO of Sulzer and then of ABB. He explains what drives him and why it is a privilege to work sometimes on Sundays.

Clifford Padevit

// Tackling challenges brings personal growth. //

Fred Kindle

Far above Schaan in Liechtenstein, Fred Kindle sits in his home at the large dining table with a view over the Rhine valley. Amid the mountains of his home country, 63-year-old Kindle can look back on an international career in which he has scaled the mountainous heights of the business world. And his success has been well founded.

As a student, top executive, board member and entrepreneur in a private equity firm, Kindle has always been ready to take risks: nothing ventured, nothing gained.

"I wanted to prove myself in international competition," he says. "That involves challenges, but tackling them brings personal growth." A glance at his career shows the truth of this.

He started as a consultant with the international consulting firm McKinsey, first in New York and later in Zurich. After four years he switched to the industrial conglomerate Sulzer, where in 1992 he was appointed head of the Chemtech Division. He was still in his early 30s. At that time this Swiss company was in the throes of a major restructuring. Kindle was appointed CEO in 2001 and ended the restructuring process in dramatic fashion: half of Sulzer's industrial business was sold off, enabling the company to focus on the remaining core sectors.

The business magazine "Bilanz" described the qualities that enabled Kindle to pull this off: laser-sharp judgement, an immediate grasp of essentials and readiness to take unpopular measures (see the Sulzer example). These qualities prompted the then chairman of the Swedish-Swiss company ABB to invite Kindle to become CEO of ABB in 2004. When Kindle parted company with ABB four years later, its share price dropped by 8%.

Anyone who thought that Kindle would simply move on to another CEO position was misjudging him. "I wanted to develop myself further," he explains. So he became an operating partner with Clayton, Dubilier & Rice, a private equity investment firm that buys up companies, improves their performance and then sells them on. Kindle stresses that he is not a financial wheeler-dealer. What attracted him to Clayton, Dubilier & Rice, he says, is that it is a sort of "operational McKinsey". Being a partner involves investing one's own money. "Risky, entrepreneurial, exciting" is how he sums up this London-based period of his life.

Kindle now sits on various boards of directors, but unlike many managers he is happy to adopt a lower profile. He has left the boards of Zurich Insurance and rail vehicle maker Stadler, and his involvement with the financial service provider VZ Holding will end in 2023. His most time-consuming position now is on the board of the French electrical engineering group Schneider Electric, where he has been intimately involved with the supply chain problems caused by the pandemic. He himself is happy to be able to travel again. "Video calls are quick and efficient, but genuine interpersonal interaction, the 'social glue', is lost." He is not the sort of manager who just sits at head office and telephones.

"These days I can decide my own working time," says Kindle. When the weather is good he can play golf or go hiking and then make up for it by working in the evening or on a Sunday. "That's a huge privilege."

My best investment

Education

"I am now 63 years old and have various options to choose from. I have had success and good fortune in life, but the key to success was a good education – that was my best investment. I didn't make things easy for myself. I studied mechanical engineering at the ETH in Zurich and later I took an MBA at the Northwestern University in Chicago. I wanted to prove myself in international competition."

My worst investment

Solar energy shares after Fukushima 2011

"After the Fukushima disaster I judged that nuclear power was dead, at least for the time being. It was clear to me that there would be a big push towards green energy – wind or solar. So I bought shares in three solar energy companies, which then lost almost 80% of their value within six months. The lesson is that one should not look solely at growth potential but also at the structure of the industry. China promoted green energy, and the price of solar panels plummeted."

CHALLENGING TIMES FOR CENTRAL BANKS

Felix Brill

It's easy to be clever with hindsight. Few central bankers would admit as much publicly, but it's what many of them will be thinking as they sit behind closed doors discussing whether the measures they have already taken or announced will be enough to get inflation under control.

The second half of 2022 is not going to bring a definitive answer. Even so, several factors that have fuelled inflation in recent months are set to weaken or disappear. Economists like to distinguish between special factors and underlying trends, especially in relation to energy prices. But the crux of the matter is that special factors, like a gas embargo for example, can happen at any time and push prices up. If recent months have taught us anything, it is that trend simulations can be useful but do not provide an accurate forecast of inflation.

Recession or not?

Central banks underestimated the growth of inflationary pressures and did not act quickly enough. But now they have to bite the bullet. The Fed has signalled that it intends to raise its key interest rate at each of the four FOMC meetings scheduled for the second half of this year. It has already started to reduce its holdings of Treasuries and mortgage-backed securities in order to scale down the liquidity previously created. The European Central Bank is expected to make an initial rate hike in July, and even the cautious Swiss National Bank may decide to tighten.

Will this be enough to tame inflation? That is what the financial markets are asking. But inflation cannot be viewed in isolation. The follow-up question is: what will the central banks' actions mean for economic growth? This, we believe, will be the core question facing the financial markets in the coming months: are we heading for recession?

Stay defensive

Leading indicators are already painting a bleaker picture. Surveys show that businesses and consumers are much less confident about the economic outlook than they were six months ago. Consumers' high inflation expectations are not a good sign. Inflation means a loss of purchasing power. As this expectation takes hold, households will increasingly feel the need to tighten their belts.

For central banks, inaction is not an option. But the more energetically they react, the greater will be the braking effect on the economy. In this environment, investors should keep their portfolios defensive and not rush to buy optically cheap equities. As for the bond markets, the process of adjustment is still in progress. Despite higher bond yields, the interest rate risk is therefore still substantial. With this in mind, we have reduced our underweighting of government bonds but not eliminated it completely. In this environment alternative investments like gold and insurance-linked securities are more important than ever as a means of reducing portfolios' vulnerability to events on the fixed income and equity markets.

// Are we heading for recession? //

ADJUSTING TO DEGLOBALISATION

Bernd Hartmann

01 Invest globally – now more than ever

Investors should not be misled by the retreat of globalisation into making their portfolios less international. If the economies of individual countries are less interlinked, their performance will be less synchronised. That should lead to reduced region-to-region correlation in investment portfolos. In this environment an international investment approach is even more important, especially for opportunity-oriented investors in low-growth regions like Europe.

02 Picking winners

Freight and shipping shares have profited from scarcer capacity and higher freight charges during the pandemic. But changes in supply chains, higher transport costs and increased local production will create big challenges for this sector. The dividing line between losers and winners is a fine one. Merely transporting goods from A to B is not enough. Customers will be looking for intelligent warehouse logistics and smart services.

03 Automation/robotisation

The reshoring of production from low-wage economies threatens to push up labour costs. It is not even certain that enough skilled workers will be available. So reshoring only makes economic sense if the new production facilities are highly automated. Robotisation is therefore a key factor. Robot technology is playing a growing role not only in industry but also in other spheres, for example medicine. Automation and robotisation can make the relocation of production to high-wage countries economically viable.

04 Small and mid caps

Multinational companies have profited from globalisation. They were big enough to exploit its benefits for themselves and their shareholders. Smaller companies were often left on the sidelines. But small and mid caps tend to excel in innovation and flexibility and often have a better knowledge of local conditions, which is a significant asset in a more localised world. It should be remembered, of course, that this market sector is cyclical and less liquid. Buying will therefore be appropriate when recession worries subside and the financial markets stabilise.

SOCIAL GLOBALISATION HERE TO STAY

The world may well be embarking on a period of economic deglobalisation, but social interconnectedness is not following suit. Four examples. **Clifford Padevit**

Economic globalisation is not a one-way street. Countries that specialise in the manufacture of goods for world markets (China is an obvious example) are having to face up to this fact. The centralised production model is being called into question as producers move back to their home base or look around for less distant manufacturing locations (see pages 4 and 16).

Transport, warehousing and the supply of intermediate products are issues that affect the production and sale of everything from plastic toys to automobiles. But there is more to life than this, though household consumption certainly makes up a large part of demand in the economy.

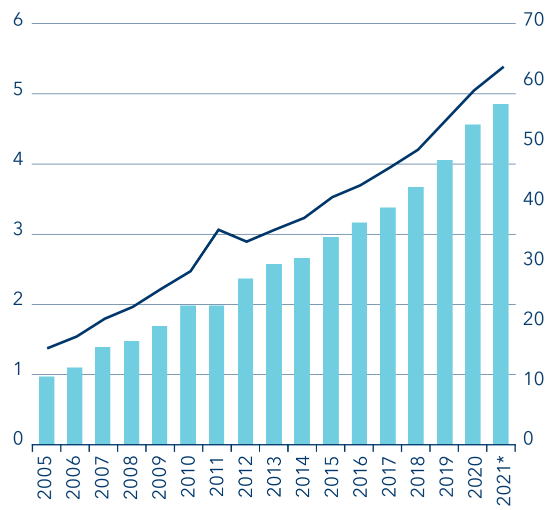
Even if economic globalisation is interrupted or reversed, the same does not automatically have to happen in other spheres. In this article we look at four examples of societal themes and developments that are resistant to a trend reversal.

1. Internet and social media

According to the International Telecommunication Union (ITU, an agency of the United Nations), 4.9 billion people around the world now use the internet. That is almost two out of every three people on the planet, and the number has grown steeply during the pandemic. These days internet access mostly means tapping a smartphone. The ITU estimates that 95% of the world's population now lives within reach of a mobile phone signal.

For a great many people, global connectedness is therefore not an illusion – it is an everyday reality. Email plays a part here, but the main facilitators are social media apps like Facebook, Twitter, Instagram and Telegram. Anyone can now create or join a network without having to

Surging internet use



Internet users worldwide in billions
As % of world population (r-h scale)
* ITU estimate

worry about national frontiers. A Twitter user in Bogotá follows someone in Manila. A photographer in Lucerne is in dialogue with a graphic designer in Johannesburg. We live in a world of communication without borders. Thanks to the might of the # (hashtag), globe-spanning groups can exert real influence, as in the case of #arabspring, #metoo and even #fridaysforfuture. The international networking of human beings via modern forms of communication cannot be slowed or reversed.

2. Tourism

Tourist numbers are growing worldwide. The trend is clear, despite the abrupt downturn caused by restrictions imposed in reaction to the coronavirus pandemic. The United Nations World Tourism Organisation (UNWTO) identifies the rise of the middle class as a key cause of the enormous growth of tourism over the last 70 years. More and more people can now afford foreign holidays. Other factors are low-cost air travel and the internet. Online searches make it easy to book cheap flights and hotels.

Tourism is now a major sector of the economy. According to data produced by the World Travel & Tourism Council in collaboration with Oxford Economics, tourism was generating about 10% of global GDP before the pandemic. UNWTO reports that tourist arrivals grew by over 50% to 1.5 billion in the period 2010 to 2019 (the year before Covid), but then dropped by over 70% in the first Covid year (2020). Nevertheless, the crowds of holidaymakers that thronged the airports this spring, especially at Easter, prove that travel fever is far from dead.

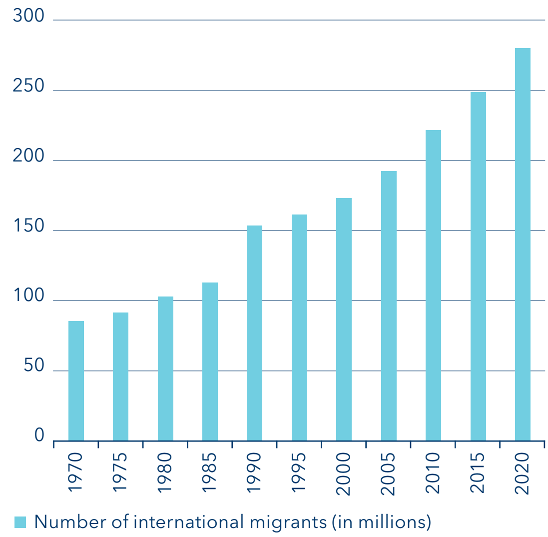
Tourism is admittedly not as unproblematic as it used to be. Air travel pushes up CO_2 levels, unless the emissions are offset. Moreover, the tourism industry is heavily dependent on trends in disposable incomes. Even so, the urge to seek out foreign lands is unstoppable, especially when people are bombarding each other with holiday photos and videos via social media.

3. Migration

Today's interconnected world has also facilitated a huge rise in international migration. The latest annual report of the International Organisation for Migration (IOM) estimates that there are now 281 million international migrants worldwide. That is getting on for 4% of the world's population. Around 40% of them are refugees, but the majority migrate in search of gainful employment.

International migrants have long been an economic factor. Having moved away from their country of origin, they send large sums of money back home. The IOM estimates that these remittances totalled USD 702 billion globally in 2020, up from USD 128 billion at the turn of the century. International migration is an unstoppable phenomenon, whether involuntary (e.g. caused by the wars in Ukraine and Syria) or driven by economic motives. A further driver, according to the World Bank, is climate change, which could force 200 million more people to leave their homes by 2050.

International migration has increased



4. Culture

Just as businesses endeavour to sell their products on world markets, artists and art galleries are on the look-out for international buyers. Helpfully, the number of millionaires in the world has almost tripled in the last twenty years or so. According to the Boston Consulting Group's latest Global Wealth Report, the dollar millionaire count climbed from 8.9 million in 1999 to over 24 million in 2019.

The Art Basel and the London Frieze art fares are good examples of the globalised art scene. Prestigious museums are also following the trend. The Louvre in Paris has opened an offshoot in Abu Dhabi in the United Arab Emirates, and the Guggenheim Foundation with its museums in the US and Europe is also planning an Abu Dhabi project. In other areas of the arts, too, globalisation is an irreversible reality. The streaming of music and films is now standard. Bands and pop acts make world tours, and so do symphony orchestras.

In all the arts, new influences inspire creative ideas. An end of cultural globalisation, with artists and performers withdrawing behind national or linguistic borders, is inconceivable.

These four examples show that globalisation has long been a dominant trend in key areas of life. Economic adjustments will, of course, have a bearing on many areas of human activity. But the global networking of like-minded people keen to discover new places and cultures is here to stay.

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