Viktor Shvets: Inflation, Interest Rates, Equity Outlook & more

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Erik: Joining me now is Viktor Shvets, global strategist at Macquarie Bank. Viktor was born in Kyiv, Ukraine and has lived in Hong Kong and China for the last 20 years. So needless to say, he has quite a bit of perspective in terms of different cultures and the geopolitical situation that the world now faces. Viktor, it's great to get you back on. I listened into our interview from one year ago, which was also about one month before the Russian invasion of your home city of Ukraine, which at the time when you were born was still part of the Soviet Union. The world has changed quite a lot. In our last interview, we discussed geopolitics. You predicted that politics would no longer contain geopolitics, and the geopolitics would become a bigger issue as time moves forward. Needless to say, you got that call, right. Any particular reflections on the Ukraine conflict and what it means to the global economy?

Viktor: Well first, thank you very much for inviting me. I still think that geopolitical and social polarization problems that we have been experiencing for the last 10 years will continue to build over the next 10 years, maybe 15 years, maybe longer. I really can't see how politics will be able to control either social tension, polarization tension, or geopolitics for a long time to come. But the interesting thing for me is not so much whether geopolitics will remain contentious, or social pressures will remain contentious. But rather, geopolitics and politics are more of a process. It's not an event. It doesn't mean that we kill each other every day, it doesn't mean that we confront each other every day, it doesn't mean that it blows up every day. I usually tell my fund management friends that it took Hitler 15 years to come to power. So it's a process, not an event. And so from an investment point of view, I think it's extremely valuable to try to identify periods where you think social and geopolitical pressures will really build up and create major problems, economic problems, political problems, disrupt supply and demand. And times when those pressures will be relatively subdued. In other words, instead of exploding, they're more likely to simmer. So the ultimate destination is still not good. I do think those pressures will build. But I think in 23 and 24, there is a possibility and a strong possibility that those pressures will become a little bit less pronounced. And there are reasons for that.

First, if you look at Russia-Ukraine, my view certainly for the last 12 months, was to say that whatever Russia wants Ukraine to do, Ukraine will never accept and whatever Ukraine wants Russia to do, Russia will never accept. That basically implies a stalemate, neither side wins. And yes, you're going to have regular attacks, particularly at the time when the ground is solid. So that's usually in winter or summer, but at the end of the day, neither party can succeed.

Ukrainians are not weak, they're strong, and they're determined, and Russia always looks weaker than it is, and always looks less capable than it is. And I think Russia will also continue to be a very strong opponent. So what it basically means for 23 and 24 in my view, the bulk of the economic, political and geopolitical impact of the Russia-Ukraine war is already behind us. The other question is, there's no destruction of either state, but the question is, at what stage will we start drawing our dotted lines on the map, because there is no resolution, there is no final resolution to this conflict. But it doesn't mean that the fighting goes on forever. Eventually, there will be some kind of not reconciliation, but at least dotted lines, whereby you sit here and I sit there and we agree to disagree, and 23 and 24 ought to be that period for Russia and Ukraine.

At the same time, if you look at other geopolitical hotspots, such as the South China Sea and Taiwan, I actually think through the next two years, The same would apply to Taiwan, in a sense that one of the lessons China learns from Ukraine is that number one, Taiwanese are going to fight. Number two, they're going to be armed. Number three, private US companies and the Pentagon will provide them an edge in cyber and cyberspace. I think they have to understand that China needs to restructure the armed forces and make them much more mobile and independent. And of course, they need to address the issue of economy and monetary system. Remember, Russia was isolated for eight years before this war, and even then Russia could not retrofit its system. China is the world's biggest trader. How do you retrofit a system like that against sanctions and other problems you will have in monetary ways? How do you do that? And the answer is, you can't. When people say, well, they should abandon the US dollar and sell US Treasuries, my answer is, by what? What are you going to buy? There is nothing else to buy and there is no substitute for the US dollar. And so China needs time to be able to rebuild trade routes, redirect trading of commodities, through direct trading of products, boom, other people, capital, information, gradually build different settlement systems. And maybe then the economy can be retrofitted.

So one of the lessons of the Russia-Ukraine war, to my mind, is likely to make Taiwan and the challenges less likely, at least in the near term. And so when I look at it, it doesn't mean that there won't be flashes of anger, of course, there will be. People tend to forget, if you think of West Berlin, there were all sorts of heart attacks. It was 1947 airlift, there was 1953 revolution in German Democratic Republic, there was 1956, there was 1961, there was 1968. But ultimately, West Berlin survived through this process. So there won't be heart attacks along the way, clearly, but I think at least in the shorter term, the probability of anything significant flaring up is actually down. And we can look at the Middle East and other in other sort of tectonic plate, globally, that again, I say the probabilities today a little bit less than what there were 12 months or 18 months ago.

So my conclusion from a geopolitical perspective is not to say that everything is resolved, nothing is going to be resolved. It's not to say that we're close to agreements, nobody will ever be close to agreement, but simply to identify, as I said, the times when you have a flare up, and at times when it's likely to become less pronounced. Also, remember from China's perspective, that the only time China would decide to invade Taiwan is if they're cornered externally, and only the United States can do it, and they're unlikely to do it. Alternatively, there is some kind of problem domestically within China, again, through 2023 and through 24. I just don't see it happening. So, to me, from an investment perspective, I think geopolitics will play a smaller role in the next two years than it did in 2022.

Erik: Let's move on and talk about inflation. There's a lot of people who sort of say that look, this was all about supply chains and COVID. It's over, it's behind us, we're headed back down to 2%. Forget about inflation, it's over, it's done with. Other people are saying not so fast. Maybe the peak from the COVID crisis is behind us. But there's a new secular trend here. Which is it and how should we think about inflation going forward?

Viktor: My answer is actually neither of those answers. One of the things I've been discussing for the last couple of years, is that we clearly don't live in the 1990s or 2000s. In other words, this was a period of 25 years, which was dominated by disinflationary pressures with almost no inflationary offsets. In other words, this was a period of digitization, financialization, and globalization with no offsetting elements. We're not in that period, but neither are we in the 1970s or 1980s, which was a period of consistently inflationary problems with very few decent inflationary offsets. I would basically describe it, we have both inflation and disinflation. The period closer to us is actually more like the 1930s than it is either the 1970s or 1980s or 1990s and 2000s. What does it mean? Well, basically what it means we still have a very strong disinflationary backdrop, what drives it? Well number one, financialization and addiction to asset prices and leverage, all of that is disinflationary. Number two, technology as it progresses, it is disinflationary. Number three, demographics, it is disinflationary. Number four, extreme wealth inequalities around the world. Again, disinflationary. But we also have elements of potentially inflationary spikes. What are they? Well, Black Swans and fat tails. Effectively, the way I look at it, normal distribution of outcomes is no longer the prevailing force. We in fact, having just too many black swans and fat tails. When you've got that kurtosis, or the volatility of outcome increases, and so that's going to be our world for the next 10 years with a much higher degree of volatility.

Now, where those black swans can come from, well, they can come from more geopolitics that we've just discussed, which is going to get more complex. The other area could be healthcare. In other words, again, disrupting supply and demand curves as we go forward. Is there anything else that generates inflation on a more consistent basis? Well, a lot of people bring up deglobalization. I actually disagree with that. I don't believe deglobalization is actually inflationary at all. We've been deglobalizing for almost 10 years and there is no inflationary evidence so far, and we will be globalizing more in the next 10 or 15 years. But I actually don't think there will be a great deal of inflationary pressures. But at the very least, you can argue that globalization is not disinflationary, the way globalization was in the previous 25 years. There are a couple of reasons why I think globalization is not inflationary. Number one, labor is a smaller and smaller component of the cost structure and arbitrage. Number two, unit labor costs in emerging markets have gone up a lot in the last couple of decades, which reduces the benefit of that sort of arbitrage. Number three, a lot of developed countries are now reindustrializing, particularly the United States in a very different fashion. It doesn't require labor, it doesn't require a lot of fixed assets. It's based around intangible assets, robotics, automation, it's much more flexible, lower cost reindustrialization that is occurring, and that should not be inflationary. And the final element is services. Remember, people don't think of services. And indeed, 20 years ago, services were a small fraction of merchandise trade. Today, services are 1/3 of the merchandise trade. You basically can't do merchandise trade without attaching services. And remember, services are very different dynamics to merchandise trade cost wise. So, I'm not a great believer that deglobalization is actually inflationary, but it's certainly not disinflationary the way it used to be.

The other element everybody brings up is ESG, particularly the E part of ESG. I'm worried about that part a little bit more than the globalization but again, I don't believe it's actually going to be significantly inflationary. But it's not disinflationary either. And so when I look at it, we have a very strong disinflationary backdrop. But against that, we will have regular spikes of inflation, when Black Swans and fat tails suddenly move us and disrupt us. And also, over time, when we start relying more on the fiscal tools, rather than just monetary, we're not doing it today. Because as soon as we got out of the problem of COVID, we basically pulled back the fiscal level, but we now know how to use it. And therefore every time there is a problem, we'll pull it up again. And when we do that, it will ignite another inflationary spike. As soon as we pull it back, that inflation will just drain away. And so when people say, "Do you think longer-term inflation now will be higher than in the past on average?" My answer, there will be no average. There will be highs and lows, but there will be no average. So I don't view it as a permanent state of affairs that we have inflation. Neither do I view it that disinflation is actually the permanent state of affairs. We'll be switching or the pendulum will be switching between one and the other. And right now, as we go through 23-24, I think both policymakers and investors will be surprised how quickly inflation will drain away. We don't, in my view, need to destroy demand in order for inflation to leak away. We just need to normalize demand and supply curves in goods markets, services market and labor market, which we're doing right now and progressing quite well. Unless there is another major upheaval coming and another major dislocation, inflation in my view will drain away but it will come back. All I'm saying is it's not a uniform sort of answer.

Erik: Okay, if we're going to have both inflationary and disinflationary pressures alternating so to speak, that begs the question of how that's going to translate into an outlook for both interest rates and GDP. So why don't we start with interest rates and we'll come back to GDP.

Viktor: Well, basically what it means that this idea that we're permanently repricing capital is incorrect, that what we're going to see is high rates and very low rates, we're going to retest again, 1% or less. And we're going to go up to 4% or more, and we're going to be back again. And therefore, this idea of repricing capital is unlikely to happen. Right now, and that's been my view since earlier 22 is that as we progress through the balance of 20 to 23, and 24, interest rates will be on a downside that we already have seen the peak of inflation, the peak of interest rate, the peak of commodity prices, and interest rates will become more accommodative. Now, the reason for that is very simple, that remember, this inflationary backdrop, it's very strong. And so unless you disrupt it, it comes back and disinflation increases, because think about this way, how do countries grow, they only grow by adding labor, by adding capital and by growing productivity. Now, no matter where you look, globally, our ability to add labor is declining rapidly. There are some exceptions to that, like India, but generally speaking, it's declining. Number two ability to have capital is constrained. And that leaves you with productivity. The problem is globally, productivity has been declining for almost three decades. And there is no reason to believe that suddenly, productivity will mushroom. So what it basically tells you is that you are gross past longer term contracts, it gets less and less, it's get shallower and shallower. If it contracts, that means neutral rates that you require in the economy can we will become more volatile. In other words, they will jump and they'll fall jump and fall more volatile than what they were in the previous three decades.

But over the longer term, they're not rising. Now, that basically, to me implies that interest rates over the longer term also will have to continue forward. This idea cheap money is the end, it's finished. To me, that's just nonsense. I can't see how that's going to happen, given what we discussed, given the demographics giving inequality given technology given financialization, debt levels and commitment to asset prices we have, I just can't see how neutral rates are going to go up to enable you to permanently reprice capital. So to answer your question is that we have already seen the highs of interest rates over the next two years they're going to fall, we can debate how much that comes back to the gross picture. And whether central banks must destroy demand in order to bring down inflation. My answer, as you know, is no. Because it's the that inflation that we have was not caused by excess demand. Most countries globally are still below the trajectory that we're on prior to COVID. United States is one of the few exceptions. But even the United States aggregate demand is only 1%. above where it would have been if there was no COVID. So to me, it's not so much excess demand, but rather disruption disruptions that caused this inflation. If that is the case, then you normalize that disruption and inflation comes off, disinflation becomes stronger until the next element will fall off. That is, either we have another health problem, or we have another geopolitical problem. Or suddenly there is disruption of supply in some form occurring. And over the next 10-15 years, we're going to get more of that, compared to what we had in a previous couple of decades. And that's what drives the inflation up and down. But if you start thinking of longer term, 10-20 years out, I think the line for interest rates is still are flat to down as we progress rather than repricing at some kind of a high level.

Erik: Let's move on to GDP and the recession outlook. A lot of people had predicted that we would be in a very deep and painful recession by right now. If that's the case, at least as of Tuesday afternoon as we're speaking, the S&P didn't get the memo. What do you see in terms of a recession in 2023? Are we still likely to have one and what's the GDP outlook?

Viktor: The way I basically described it 12 months ago that we have three possible scenarios. And remember, S&P earnings per share is much more driven by global GDP, not by the US GDP. The correlation r squared against global GDP is much higher compared to what it used to be 20 years ago when it was primarily driven by US GDP. So I basically had three possible scenarios. Number one is that we have a soft landing Goldilocks, that would imply the global GDP in 2023 will grow somewhere around 3% or Up until about six months ago, almost everybody were roughly in that category. Now, to me, the probability of that scenario occurring is very low. It's maybe five 10%. Now, what's my base case? My base case is what I described as skirting, global recession. What do I mean by that global population growth rate is about 1%. So if you have global GDP growing between one and a half to 2%, that basically means you're skirting you're very close to recession, some countries will be in the shallow recession, some countries will grow much slower, but you're not in a fully sort of fledged recessionary globally climate. Now, to me, it's the most likely outcome. And the reason for that is that as I said earlier, I do believe inflation will come off. As inflation comes off, central banks will start changing their communication policies, which they already started to do, actually, at the end of 22, in December, when they start talking a little bit more about gross and inflation, not just about inflation. But as we progress at 23. And 24, I do expect interest rates will be caught I do expect Qt will. And as we progress with 23, there is a possibility of QE into 2024. So policy settings will start changing fiscal settings in 2022, global fiscal negative Delta, particularly in the US was incredibly large. So in other words, the governments were pulling back. So deficits were rapidly falling in 2023, we still have a negative delta, but nothing like 22. In 24, in a lot of countries, it turns positive outside of the United States, but by 25, even in the US, that fiscal delta will become positive. So both monetary and fiscal policies will start changing. If my view is correct, that we do not have any problem of embedding inflation in a labor goods or financial markets, inflation will fall off, that opens an opportunity for policymakers to balance growth versus inflation, and much more constructively than what they otherwise would have done. So that's one area why I don't believe we need to destroy demand. And the other area is the fact that there is really no systemic fractures right now, in our financial system. When people say, Oh, my God, you know, US households lost over $7 trillion, which is like a combination of the Japan and Korea GDP combined. largest number ever. But people tend to forget to argue that this only gets you back to late 2021. And compared to pre COVID households are still 25% better off than what they were. Similarly, people are discussing housing market and that it is contracting. Yes, it is very, very true. But in terms of prices, we only back to earlier 22. And in terms of inventory levels, we only had three months or less of inventory at the time when demographics in a lot of countries, including us are still growing. So to me, when they look at housing markets, when they look at a high yield market, look at the high yield spreads. They barely moving above four, four and a half percent, even for triple C debt, which is basically bankrupt companies that can't even reach 10%. So whether you look at a high yield market, whether you look at a housing market, where they look at destruction of wealth, but they look at emerging markets, seeing how emerging markets have survived the third strongest ever appreciation of US dollar through 2022. And the harshest increases in interest rates, how they survive?

It basically tells you that emerging market universe is no longer structurally weak asset class over the last 10 years, they generally just they just made sure that the debt is control, external liabilities that control the duration is controlled, etc, etc. There are some problems in the end. So usual sub suspects, Argentina, Turkey, et cetera, but for the bulk of emerging market universe, a much better position. So one of the interesting thing I find is today, there is not many structural fault lines that can suddenly aggravate opposition in a meaningful way, to me digital assets was one of those areas to watch. But it's just was quite remarkable. So far, how we manage this process was a limited degree of damage. So economists exhibiting resilience exhibiting sort of lower than most people would have expected degree of vulnerability. And so to me, those two things combined, basically says that number one, policymakers will have a room to better manage the economy over the next 12-18 months rather than just fighting inflation. And at the same time, I don't really see the cracks in the system. Now what will be a fully fledged destruction of demand? Well, that will happen when a global GDP goes down in terms of growth rates to what's 1% or less, in other words equivalent to global population growth. Now, what does it do for earnings per share? The relationship between GDP and earnings per share is not perfect, because there are many other variables in there, there is a fax and many other things, but there is a relationship. If you were to grow at roughly 3% globally GDP, that usually translates into 10-15% earnings per share growth rates for most places. If you grow more like one and a half to 2% global GDP, which is my assumption, which are what are called skirting a global recession, then earnings per share should be around zero. And if you if you grow global economy at 1% or less, then earnings per share should drop at least 10 to 20%. So, the interesting thing I find is that the analysts right now when they look at the global portfolios or US SPX numbers, we have an emerging market numbers. Over the last six months, analysts brought saying the US expectation from 10% EPS growth rates to two or three. In a global portfolios from 9% to around two in emerging markets, from 13-14%, down to around four or five.

So, there has been a very significant contraction of earnings per share expectations were 23. Now, if my scenario of skirting global recession is correct, then earnings per share numbers are still high. But they're not astronomically high anymore, because you're getting very, very close to zero. Now, that would imply that yes, you need to pull back earnings per share a little bit more. But what about risk free rates or equity risk premium, which creates a multiple, a P/E multiple. Now risk free rates are already down. In my view, they'll continue going down as we progress of the next four months, and equity risk premiums, which now relatively modest in the sense that just on an average historical level could contract a little bit more, because in the US, for example, you might go from four and a half to maybe three and a half percent. What it basically tells you that we've avoided the worst possible outcomes, we have avoided bankruptcies, we have avoided massive calamities. And so to be the way I look at it, yes, you need to pull down the earnings, but risk free rates and equity risk premiums will be lower, that means multiples are high. And that basically tells you not a great returns out of equities, because one compensates the other, but nevertheless, no need to have a 25-30% derating of equity values. That will only happen if the third scenario prevails, that is we must destroy demand in order to avoid stickiness of inflation. And therefore global GDP goes down to 1% or less, then there is no doubt that there is at least 25-30% that would need to be wiped out. But to me the chances of that happening. They're there but probably no more than 25%. So there is much better chance that I think we're going to skirt global recession. And by the way, World Bank just cut back their numbers for 2023 to 1.7%. And remember, given institutional constraints, they're usually the last one to do the reduction. And so that might actually mark the bottom of the cycle for GDP forecast. A more interesting question to me, therefore, if I'm correct, that we are right at the bottom of those forecasts, what will happen in 24 because a lack of recession, meaningful recession implies a lack of recovery. And if you think of earnings per share estimates for 24 pretty uniformly everybody is at around nine to 13% a rebound that might be problematic when they get there.

Erik: Viktor, let's talk then about the equity outlook just in the last couple of days. As we're speaking on Tuesday afternoon, the S&P has moved back above both its 200-day moving average and the 38.2% retracement of the overall big move down from the highest to the bottom that we had in the last few months. So is the worst behind us? Is it all uphill from here? What do you see for the equity market?

Viktor: No, it's not an uphill battle. Basically, what I've just described in my sort of base case scenario, is that we're skirting a global recession. That implies a potential very shallow recession in the United States and eurozone. It implies the emerging markets probably will grow more than three and a half percent in 2023, which is not a recession but given that their population growth rate is much faster, it's near recession levels. And that implies earnings per share growth rate should be around zero. As I said, the US analysts already brought down their numbers from about 10% EPS growth rates six months ago to something around two to 3%. I think there is probably two or 300 basis points to go down on those numbers. And then you have a question of risk-free rates and equity risk premiums. And as I said earlier, I think risk-free rates within 12 months will end up somewhere around two and a half to three rather than going into four. And I think equity risk premiums also will notch down from the current level in real terms of about four and a half. Now, that implies an expansion of the multiples. And so my view about six nine months ago was that in my course scenario, S&P should be trading between 3600-3700 and just over 4000. That's where it ought to be.

If however, you think that we can have a really soft landing, that said to me, it's only 10% probability, and therefore global GDP expense at something like 3%, then you have a golden law, you have earnings per share, that quickly will be revised back up to around 10%. Growth rates. Yes, a risk-free rates will back up again into high threes, low fours, but equity risk premium will collapse because that we've just got the best outcome. So it's a perfect outcome of rising earnings and rising multiples. That's where you will put yourself at about 5000. If however, you think that a global demand must be destroyed, and global GDP growth rate has to go to 1% or less, implying at least two or three quarters of 50-60 pips a quarter on quarter declines in the US, for example, so much deeper recession are both in the US as well as globally, then earnings per share will drop 10-20% minimum, you will find margins in the US will go from 12% to probably eight, maybe even less. In that scenario, yes, the risk-free rate eventually will fall to 1% or less. But equity risk premium probably will go to 8-9%. Because it's really bad outcome. So it's a very poor outcome of declining earnings and declining multiples. And that will start putting you at 2700, sort of 3000 on the S&P. So this is your three outcomes. And so for the last six, nine months, I was saying, you know, 3600-3700 for the S&P. That's where you want to be.

Now, does it mean that we can't fall below 3600? No, it doesn't mean that. But as far as I can see economic growth rates resilience of the economy, leading indicators on the second derivative. In other words, the pace of decline has already turned for the last several months, when I look at the lack of fractures in the financial markets. When I look at all of that, I just think the chances of having such a destructive outcomes is diminishing on a daily basis. So to answer your question, that's what I said earlier, I don't think you should be looking for high returns. But what you can assume that this idea that we must retest the previous low and potentially go below that. To me, that's extremely unlikely. Now, when we go then into 24, the question that becomes extent to which the global economy will rebound and related issues, whether it's China, whether its inflation, the extent to which it rebounds, and what does it do for earnings per share, and whether in fact, the analysts are too high for 2024. So that will put a new sets of sort of numbers for for people to think about. Now, a lot of analysts said, Look, first half of 23 are going to be poor, second half of 23 is going to be much better. I don't agree market is a forward discounting machine. People are almost on the cost of basically agreeing that it's not going to be an economic Armageddon, central banks are already hedging their bets, communication strategy is already changing. I don't think we need to go through market Armageddon, and they'd get a really solid recovery in the end of 23. In other words, we don't need to go to 3600 and then go up to 4500 or something like that. I really don't buy that market should be discounting all of this news earlier part of the year, which I think what the market is doing right now.

Erik: One asset that is trending sharply higher is gold, which is up fully 20% from where it bottomed in the beginning of November. What's driving the move higher and is it set to continue?

Viktor: Well, I'm not a gold specialist, but the only thing you always work with gold is is real interest rates. So when real interest rates going up and remember in the US real interest rates in September-October reached as high as 1.7-1.8%. Now real interest rates are now down to about 1.2-1.3%. And the expectation that real rates just will continue falling off as we progress forward. So I don't think people are buying gold, necessarily because they expect an Armageddon to occur or some kind of a meltdown of a global monetary system. I don't think that's what's playing it. I think it's really real rates that is that is driving it. And if it's true, that real rates will have to continue coming down, then that should provide support for gold. But I said, I'm not a I'm not a gold specialist.

Erik: Viktor, let's talk about the reopening of China, which has been widely anticipated. And frankly, as far as I can tell, a lot of Western observers are kind of confused and not sure what to make of the situation. How should we be interpreting that? What should we expect? And does it have an impact on inflation looking at

Viktor: China theoretically, can have an impact on every single thing globally, primarily because not only it's a second largest economy and the largest trader, but it's also a massive consumer anything from 20-30 to 80% of almost all commodities. So the way China opens up and the way they stimulate could have a significant implications for inflation, particularly in the second half of 23 and earlier part of 2024. Now, my view for the last few months was, I was surprised how chaotic China's opening was, I was anticipating that opening will be very gradual towards the middle of 2023. And then much more a boss later on. Instead, it was very chaotic and very rapid. And so the question then becomes, what does it do now in the first quarter, and by most of the second quarter, I think this opening will actually depress demand in China. And therefore China actually will negatively impact both GDP growth rates globally as well as inflation. But then as we adjust to a much higher COVID, infection rates as a healthcare system stabilizes as consumers come back. And remember, the buildup of savings in China is broadly equivalent to what happened in the United States a couple of years ago. And so when they come back and start drawing down the savings, that's where Chinese economy in the second half of 23, could start zooming at 70%, quite easily. And that will go into the first half of 2024. So the question then becomes how China is going to grow. Because one of the things Chinese leadership been trying to do for the last two or three years, is to avoid further deterioration in efficiency of capital utilization. Essentially, over the last 15 years, China put just too much capital into the system. And so if you think of incremental capital output ratio, how much do you get out of deploying capital. They've deteriorated from $3 to $1, to eight to $10, for every of investment, for every dollar of GDP. And so China tries to constrain to which capital a deterioration of efficiency of capital occur.

Now, that basically implies that they tried to contain infrastructure in real estate as much as possible. And it is infrastructure in real estate that provides bulk of the impact in the commodity markets. And so to me, it's more than likely that China will do that they will continue constraining it. Yes, it will be more demand from households consumption, yes, it will be burning probably at least 600,000, maybe 7-800,000 extra barrels of oil, as we go towards the end of the year. But that is not enough to overcome weakness everywhere else globally. And so my view remains that China could dislocate global economies that could dislocated demand that could dislocate supply and inflation, but more likely, they will be mightily inflationary, but no major dislocation primarily because, as I said, what China trying to do, where China trying to invest, how China is trying to grow, the other thing to remember is that a lot, a lot of capacity will come into the marketplace to capacity that was constrained over the last couple of years. And that implies some of the disinflation will also start coming through in the global system. So to me, if I were to think of three most important things to watch out over the next 1218 months, one of it will be clearly healthcare and any possibility globally that with this market demand supply curves. Secondly, will be geopolitics again, that we're going to dislocate it. And the third one was China. And how does China recover? And what sort of growth rates China will be able to maintain after they recover from, from COVID? A lot of people say, wouldn't you evicting click policy errors? My answer is no. I think the probability of perpetuation of policy errors right now is actually very low. To me, those will be the three key elements to watch.

Erik: Now, a lot of people have become very concerned that a conflict between China and Taiwan might be imminent. But I think you said earlier, you're actually fading that. Why do you see that as less likely?

Viktor: Primarily because of what happened in Russia-Ukraine, and how the West reacted to what happened in Russia-Ukraine, that gives in my view of China a pause, they need to think, how do you fight? What army do you need? What resources do you need? They also need to think of retrofitting their monetary system, the economic system much more than what they would have thought about it prior to Russia-Ukraine war, because they said you can't escape it. You can't just say, well, I've got to sell US dollar. And say buy what? You buy Yen, it's not going to help you. Euro? It's not going to help you. Pound sterling? It's not going to help you. What are you going to do? You're going to buy camels and sands and exchange, you know, camels for oil? How are you going to structure it when remember, the liquidity of Russian Ruble market or Iranian currency market, or even Renminbi is a fraction of what China needs. There are very few currencies and securities that can provide the type of liquidity that the world's second largest economy and the world's largest trader demand. And so to me, that doesn't mean that China will not lash out regularly, they will. It doesn't mean that there won't be tensions, there will be. But I think the probabilities of anything major happening in 23-24, probably even beyond that is actually lower today than what they were prior to Russia-Ukraine war. When we last time talked in January 2022, I would have thought it's probably higher probability than it is today.

Erik: Viktor, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners a little bit more about what you do at Macquarie and where they can follow your work.

Viktor: Sure, I am I'm a global equity strategy at Macquarie capital, based in New York now. I was based for 10 years in Hong Kong with Macquarie, and what I do is essentially equity strategy, global Asia-Pacific. And the best way to sort of to get hold of what I do and write every day is to become a client of Macquarie.

Erik: Patrick Ceresna, Nick Galarnyk, and I will be back as MacroVoices continues right after this