23 February 2023
Global Equity Research led by
Dr. Thomas Kenny, Director of Equity Research
information@cedrusinvestments.com

Current Geopolitical Tensions and U.S. Economy Slowdown Might Lead to Stagflation; Severe Recession Likely Averted after China's Reopening

Executive Summary

The COVID-19 pandemic that began to plague the global economy and our daily lives in January 2020 is the culprit of the latest round hyperinflation[1] that was more acutely felt in 2022 by people in many parts of the globe. This unprecedented public health crisis worldwide that led to widespread logistics issues and production disruptions draws a parallel with the 1970s oil supply shocks that featured embargoes, which were the result of geopolitical tensions in the Middle East. It is because both events cause prices not only crude oil and its refined products like gasoline but also a lot of other goods and services to go through the roof.

Surging energy prices are a major contributing factor to high inflation. West Texas Intermediate ("WTI") – the benchmark of U.S. sweet, light crude oil – was priced around US$3 per barrel until 1970. The oil shock in the 1970s sent the benchmark prices to as high as more than US$12 a barrel in that decade and above US$31 per barrel in 1981. As a result, inflation in terms of consumer price index ("CPI") in the U.S. spiked to a peak of around 12% yearly increase in December 1974 fueled by the wage-price spiral. Meanwhile, in January 2020, at the beginning of the pandemic, WTI was traded around US$50-US$60 a barrel. Output disruptions and logistics bottlenecks arising from the novel coronavirus pushed WTI prices higher in general afterwards. Following the special military operations conducted by Russia in Ukraine in late February 2022, WTI reached the recent peak of above US$130 a barrel in early March 2022, adding fuel to inflation. On a yearly basis, U.S. CPI thus far topped at 9.1% in June 2022. Meanwhile, consumer inflation in the Euro Area hit as high as 10.6% in October 2022 amid fears of natural gas shortages in winter.

One of the devastating outcomes of the 1970s energy crisis was the emergence of the stagflation, which refers to a state of an economy where high unemployment rate, significant price increases, and stagnation of economic growth co-exist. After the oil embargo in 1973, global GDP growth dropped to 1.8% and 0.6% in 1974 and 1975 respectively. During 2H 2022, stagflation was seen more likely, as inflation in the U.S. and the Euro Area continued to climb on a yearly basis to as high as approximately 10% for both major economies, while economic growth had lost some of the momentum as hyperinflation eroded purchasing power of households and hampered investment sentiment of corporations such that 2023 GDP growth outlook for the U.S. was cut to 1.0% and lowered to 0.5% for the Euro Area by the International Monetary Fund ("IMF") in October 2022[2].

Nonetheless, the U.S. job market has been particularly resilient though the country's interest rates were raised by more than four percentage points in 2022 alone. Despite amid escalating interest rates, the number of new jobs added to the U.S. economy had been impressive, with monthly additions of at least 260,000 throughout 2022. The expansion of the payrolls by 517,000 in January 2023, led by the 128,000 gains in the leisure and hospitality industry as the recovery of business and leisure travel continued to gather steam, is even more inspiring.

Central banks in many parts of the world have not done with rate hikes yet. Even though there has been a slowdown in headline and core inflation measured by CPI in U.S. and Europe, the absolute levels are still much higher than both the Fed's and European Central Bank's ("ECB") targets of 2% annually. Central bank officials

[1] Rapid, excessive, and out-of-control general price increases in an economy
[2] World Economic Outlook by the IMF – October 2022

IMPORTANT DISCLOSURES

CONFLICT OF INTEREST DISCLOSURE

Cedrus Investments Ltd. (“Cedrus”) does and seeks to do business with companies covered in research reports distributed by Cedrus, and Cedrus may or may not be an investor of the subject company and may have investment banking relationship with the subject company. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Cedrus will identify such companies in the reports of the companies covered. Therefore, investors should consider this report as only a single factor in making their investment decision.

For additional information, please send an e-mail to information@cedrusinvestments.com

For private circulation only. This report is prepared by Cedrus and is for informational purposes only and is not intended to be, nor should it be construed to be, an advertisement or an offer or a solicitation of an offer to buy or sell any securities. The information herein, or upon which opinions have been based, has been obtained from sources believed to be reliable, but no representations, express or implied, or guarantees, can be made as to their accuracy, timeliness or completeness. The information and opinions in this report are current as of the date of the report. We do not endeavor to update any changes to the information and opinions in this report. Unless otherwise stated, all views expressed herein (including estimates or forecasts) are solely those of our research department and subject to change without notice.

The information provided in this research report is not provided to and may not be used by any person or entity in any jurisdiction where the provision or use thereof would be contrary to applicable laws, rules or regulations of any governmental authority or regulatory or self-regulatory organization or clearing organization or where Cedrus is not authorized to provide such information.

This report does not take into account the specific investment objectives, financial situation, and the particular needs of any specific company that may receive it. Before acting on any information in this report, readers should consider whether it is suitable for their own particular circumstances and obtain professional advice related to their own investment needs and objectives. The value of securities mentioned in this report and income from them may go up or down, and investors may realize losses on any investments. Past performance is not a guide to future performance. Future terms are not guaranteed, and a loss of original capital may occur.

Neither the analysts responsible for this report nor any related household members are officers, directors, or advisory board members of any covered company. No one at a covered company is on the Board of Directors of Cedrus or its affiliates. The compensation for the analysts who prepare reports is determined exclusively by senior management. Analyst compensation is not based on investment banking revenues; however, compensation may relate to the revenues of Cedrus as a whole, of which investment banking, sales and trading are a part.

Cedrus does engage in investment banking. Cedrus does trade securities on a principal basis; however, Cedrus’ research analysts are prohibited from owning securities they cover through Research Reports.