Outrageous Predictions 2023: The War Economy

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Saxo Outrageous Predictions 2023: The War Economy

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2022 delivered a profound inflationary shock to the world, one that was brewing from the excessive stimulus of the pandemic response policies of 2020 and 2021, and then doubly aggravated by supply side disruptions and then in early 2022 by Russia's invasion of Ukraine. As we say farewell to an inflationary annus horribilis, many believe that we are somehow set to return to some form of normality on the heels of a hefty dose of central bank policy tightening. This year's Outrageous Predictions argue that any belief in a return to the disinflationary pre-pandemic dynamic is impossible because we have entered into a global war economy, with every major power across the world now scrambling to shore up their national security on all fronts, whether in an actual military sense, or due to profound supply-chain, energy and even financial insecurities that have been laid bare by the pandemic experience and Russia's invasion of Ukraine.

In 1910 Norman Angell wrote The Great Illusion, a best-selling book that made the rational argument that there was no way Europe could become embroiled in a serious war again because mutually beneficial trade had ballooned to enormous proportions in the preceding decades of prosperous peace. Sound familiar? Within ten years, Europe lay in ruins and four empires were dead, together with tens of millions of people, mostly soldiers dying pointlessly in a horrible war of attrition on stagnant fronts.

Fast forward to 2022 and the situation rhymes, as many were shocked to their core by the Russian invasion of Ukraine. Few could understand why Russia's leader Putin would risk war casualties and consign his country to economic hardship after two decades of booming and highly profitable export-driven trade, mostly in extractive commodities industries, chiefly with Western Europe and the rest of the world. The 2022 version of The Great Illusion logic proved to be the German principle of Wandel durch Handel, or the 'change through trade', actually a decades-old idea that it was worth trading with autocratic regimes because eventually prosperity would bring a natural progress toward democracy and the desire to follow the Western model. The fall of the Berlin Wall in 1989 rewarded the thinking in spades. Tanks rumbling across the Ukrainian border on February 24 of this year shattered the principle forever.

That day brought a war economy mentality to Europe on a scale not seen since 1945. And it's not just about the woefully inadequate military capabilities in Western Europe, but also about an industrial, Germany-centred model that has been rendered existentially challenged by Europe cutting itself off from cheap and plentiful Russian oil and gas. Three of our Outrageous Predictions for 2023 look at how Europe may respond to this predicament, one predicting eyeing the creation of an EU Armed Forces and another one spotting the political dysfunction taking shape in France and possibly accelerating us toward the next existential crisis for the EU. Finally, the UK could find itself suddenly far too small to pretend it can remain an independent actor in a suddenly much bigger world, as we outrageously predict that an 'UnBrexit' referendum is held next year.

But it won't only be Europe that experiences the war economy: it will be very much global in scope. The two great powers and now great rivals, the US and China, are settling into a war economy mentality as well with their escalating trade and technology rivalry. And satellite countries may find themselves hard pressed to stay unaligned in a 'trade cold war'. On the purely financial side of rivalry and arguably conflict, consider how China, major commodity exporters and others must have watched with awe as Russia's enormous externally held assets in the hundreds of billions of dollars were frozen almost overnight after its invasion of Ukraine. From now on, any country without a long-standing military alliance with the US will find it unacceptable to remain vulnerable to the weaponisation of the global USD system. So we pose an appropriate Outrageous Prediction on these powers holding a conference and agreeing a new reserve currency to avoid the USD system entirely. Don't expect the US to go down without a fight.

On the supply side of the war economy, the pandemic experience made it clear that far-flung globalised supply chains are an unacceptable risk for economic stability. The lack of basic tech components like lower-end semiconductors hobbled the car industry and even jeopardised the manufacture of defensive weaponry after the pandemic outbreak. In response to China's more aggressive stance on its One China policy and because Taiwan produces some 90 percent of high-end semiconductors, in 2022 the US announced the most dramatic industrial policy initiative since World War II, the USD 280 billion CHIPS and Science Act, of which over USD 50 billion in tax credits are aimed at encouraging semiconductor production on US soil. This will trigger multiples of that amount in actual investment. The EU passed its own smaller European Chips Act in early 2022. To boot, the US then moved with its strongest measure yet since Trump threatened and then enacted tariffs on Chinese goods: a total ban on exports of key high-end semiconductor knowhow and equipment to China, even by some non-US companies like Netherlands' ASML.

If our thesis of the war economy proves correct in 2023, then we should expect persistent inflation even if it dips modestly around the beginning of the year. Throughout history, at least as far back as the Roman Empire, inflations are nearly universally associated with wars, as governments' priorities for war-linked spending crowd out other economic activity and debase the coin or paper currency of the realm. Here in late 2022, markets are expressing the strong conviction that inflation will collapse back to the pre-pandemic 'norm' over the next two years. That means that if inflation is even modestly more than half of the peak 2022 rate by late next year, outrageous outcomes are nearly a guarantee. The thinking goes that the coming recession and job losses will slam demand, easing price rises as wage growth slows. But investors risk over-estimating the likely recession's impact on inflation. With or without a housing and credit recession, the sovereign's almost inexhaustible needs to invest in the new priorities of the war economy will ensure a tilt toward more inflation risks. From securing long-term energy supplies to reshoring production to build local supply chains for vital goods and expanding military capabilities, any slowdown in demand from the private sector will be compensated, and then some, by public sector spending. And while central banks claim they are attempting to fight inflation, they don't really want 'too much success' in doing so. That's because in the long run, a heavily indebted sovereign will almost always reach for the slow bleeding default of inflation rather than austerity or outright defaults.

And remember as always: our Outrageous Predictions are not our baseline forecasts for what will happen in the new year. Rather, they are meant as an exercise in provoking thought on what unanticipated developments can shock our world and financial markets. All large market moves, after all, are brought about by something outrageous because a big market move requires a big surprise. In a world where central banks and, more importantly, governments are set to lose their battle with inflation, at least partly driven by self-interest, the risk is that markets will prove as outrageous as ever in 2023 and beyond.

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In 2016 he became responsible for the Quantitative Strategies team, which focuses on how to apply computer models to financial markets. He produces trading strategies and analyses of the equity markets as well as individual company stocks, applying advanced statistics and models to beat the market.

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Anders Nysteen joined Saxo in 2016 in the Quantitative Strategies group, and his primary focus is on developing mathematical trading strategies and asset allocation models.

Anders has a degree in Physics and Nanotechnology from the Technical University of Denmark and holds a PhD in Quantum Photonics.

Billionaire coalition creates trillion-dollar Manhattan Project for energy

Anders Nysteen, Senior Quantitative Analyst
Peter Garnry, Head of Equity Strategy

Already rising electricity demand is set to explode, not just from the current and planned electrification via EV's of our transportation fleets, but also due to the ongoing digitalisation of human activity and the exponential growth in data storage and transmission this creates. The data centre infrastructure needed to service the digital economy continues to grow apace and these centres may consume some 20 percent of global energy in coming decades. At the same time, the growth potential for energy looks highly constrained on the one hand by the unacceptably dirty climate-altering legacy fossil fuels and the frustratingly diffuse and intermittent alternatives like wind and solar.

In 2023, owners of major technology companies and other technophile billionaires grow impatient with the lack of progress in developing the necessary energy infrastructure that would allow them to both pursue their dreams as well as address the needed energy transition. Teaming up, they create a consortium code-named Third Stone, with the goal of raising over a trillion dollars to invest in energy solutions. It's the largest research and development effort since the original Manhattan Project that developed the nuclear bomb.

In addition to pure research and development efforts aimed at realising the potential of current and groundbreaking new technologies, the fund will focus extensively on integration as well, or how to combine new generation sources with the power transmission and energy storage infrastructure that delivers baseload, the Achilles' heel of current alternative energy solutions.

The fund also dedicates a significant chunk of its investment budget to artificial intelligence (AI), which has shown promise beyond prior expectations of what was possible in some areas of scientific research. A recent example is AlphaFold, an AI programme that made transformational progress in predicting the structures of proteins, a devilishly difficult computational task. The fund aims some initial AI efforts at solving the last wrinkles in solid state battery science, which will drive a leapfrog advance in EV adoption, due to far superior power density and faster charging times.

Market impact: *the companies that partner with the Third Stone consortium and can help realise its vision soar in value in an otherwise weak investment environment.*

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He focuses on delivering analysis of monetary policies and macroeconomic developments globally as defined by fundamentals, market sentiment and technical analysis.

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French President Macron resigns

Christopher Dembik, Head of Macro Analysis

When President Emmanuel Macron won a second term in May 2022, he believed he could lead France on a royal road to carry out reforms. However, this was before the June 2022 legislative elections when his party and his allies lost their outright majority in Parliament, thus forcing Macron to make compromises. Needless to say, this is something he is not familiar with. Confronted with a strong opposition from the left-wing alliance NUPES and Marine Le Pen's far-right National Rally, the government has no other choice but to pass major laws and the 2023 budget by a fast-track decree—triggering the constitution's article 49.3. Nevertheless, bypassing lawmakers cannot be a way to govern in a democracy. Not in the long run, at least. Macron initially thinks about dissolving the Parliament to organise snap elections. Polls indicate this is not a solution, as it would still lead to a hung parliament. He therefore understands that he will be a lame duck for the next four years and he will not be able to pass his signature pension reform. Following the example of the founder of France's democratic system Charles de Gaulle in 1946 and in 1969, Macron unexpectedly decides to resign in early 2023. In a televised address, he criticises the opposition's standpoint of absolute blockage and announces he is retiring from politics. While France is preparing for a new presidential election, Macron decides to realise his long-time dream of establishing a start-up. Inwardly, he did not give up on the idea of returning to power. He hopes that his supporters and the silent majority will ask him to come back when France will fall into a political turmoil, as it happened for De Gaulle in 1958. Macron's resignation opens the door of the Élysée Palace to the far-right contestant Le Pen, thus causing a wave of stupefaction throughout France and beyond, and setting up the latest existential challenge to the EU project and its shaky institutional foundations.

Market impact: *Causes a wobble in the euro, but eventually the opposite as the sense of crisis galvanizes an broader anti-populist coalition under new leadership – French OAT sovereign bond yields converge with German Bunds.*

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Gold rockets to USD 3,000 as central banks fail on inflation mandate

Ole Hansen, Head of Commodity Strategy

In 2023, gold finally finds its footing after a challenging 2022, in which many investors were left frustrated by its inability to rally even as inflation surged to a 40-year high. It turns out that the key in holding down gold's potential was the market's mistaken consensus bet that inflation would prove transitory. Central banks largely anticipate that inflation will fall back to target within a mere couple of years, and even the market's own forward pricing of inflation risks predicts the same. And how was gold supposed to rally in 2022, especially in strong USD terms, if you can get well over 4.0 percent on a 5-year US treasury at a time when 5-year forward inflation rates are priced to drop below 2.5 percent? 2023 is the year that the market finally discovers that inflation is set to remain ablaze for the foreseeable future. Fed policy tightening and quantitative tightening drives a new snag in US treasury markets that forces new sneaky 'measures' to contain treasury market volatility that really amount to new de facto quantitative easing. And with the arrival of spring, China decides to pivot more fully away from its zero-COVID policy, touting effective treatment and maybe even a new vaccine. Chinese demand unleashed again drives a profound new surge in commodity prices, sending inflation soaring, especially in increasingly weak USD terms as the Fed's new softening on its stance punishes the greenback. Under-owned gold rips higher on the sea-change reset in forward real interest rate implications of this new backdrop. In 2023, the hardest of currencies receives a further blast of support from three directions. First, the geopolitical backdrop of an increasing war economy mentality of self reliance and minimizing holdings of foreign FX reserves, preferring gold. Second, the massive investment in new national security priorities, including energy sources, the energy transition, and supply chains. Third, rising global liquidity as policy makers move to avoid a debacle in debt markets as a mild real growth recession (certainly not in nominal prices, however!) takes hold. Gold slices through the double top near USD 2,075 as if it wasn't there and hurtles to at least USD 3,000 next year.

Market impact: *Spot gold rises above $3,000 per ounce and the VanEck Junior Gold Miners index quadruples in value.*

John Hardy joined Saxo in 2002 and has been Head of FX Strategy since 2007.

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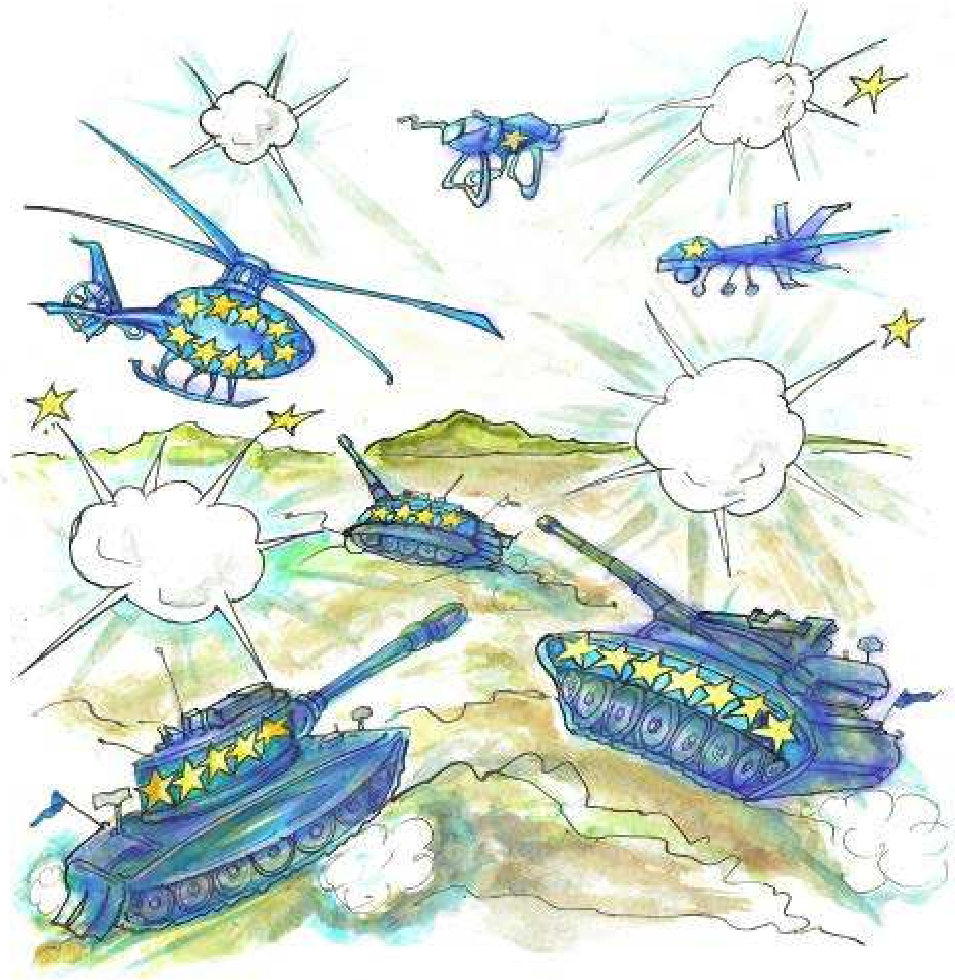

Foundation of the EU Armed Forces

Christopher Dembik, Head of Macro Analysis
John Hardy, Head of FX Strategy

Any real economic and political union must rank national security as one of its highest priorities, particularly when war looms on that union's very borders. Since the end of World War II, Western Europe found itself under the comforting umbrella of the US Armed Forces, both directly and via widespread participation in NATO. Since the end of the Cold War, national defence priorities faded further. They mostly only focused on the 'war on terror', a diffuse and immaterial threat in real terms even if it loomed large in the public's imagination, while the active theatres of that war were far-flung, chiefly in Iraq and its environs, and in Afghanistan. But Russia's invasion of Ukraine brought the largest hot war to Europe since 1945, and the 2022 US midterm elections saw a strong surge in the right populist Republican representation in Congress, with former president Trump likely set to declare his candidacy for president for 2024. In 2023 it becomes clearer than ever that Europe needs to get the union's defensive posture in order, being less able to rely on the increasingly fickle US political cycle and facing the risk that the US will entirely withdraw its old commitment to Europe, perhaps after a Ukrainian-Russian armistice. In a dramatic move in 2023, all EU members move to establish the EU Armed Forces before 2028, with the aim of establishing a fully manned and deployable land, sea, air and space-based operational forces, to be funded with EUR 10 trillion in spending, backloaded over 20 years. An EU Rapid Deployment Capacity force is designated for readiness before 2025, with participation from over 20 EU member countries. To fund the new EU Armed Forces, EU bonds are issued, to be funded based on keys of each member country's GDP. This drastically deepens the EU sovereign debt market, driving a strong recovery in the euro on the massive investment boost.

Market impact: *Leading European defense companies outperform broader European market by 25%, and new popular European defense ETFs are formed and enjoy strong investor interest.*

Charu Chanana is Saxo's Market Strategist based in Singapore. She has over 12 years of experience in the finance industry, across the equity and macroeconomic space covering global and Asian markets.

At Saxo, she focuses on delivering investment strategies based on global macroeconomic analysis and monetary policy developments.

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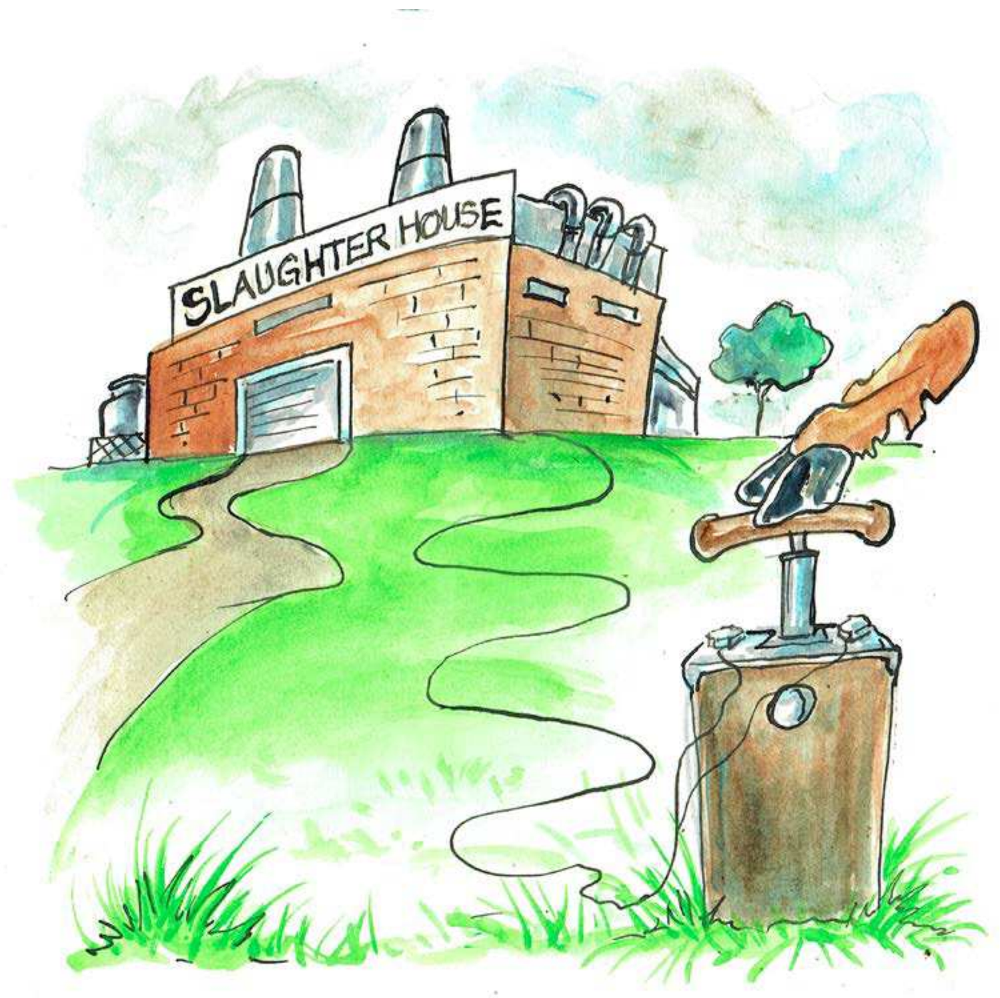

A country agrees to ban all meat production by 2030

Charu Chanana, Market Strategist

More than a third of the cereal grains grown globally are used for animal feed and around 80 percent of global arable land is used for grazing animals, some of it claimed from former forest and even rainforest areas. This drives a staggering loss of biodiversity, together with other local environmental impacts like soil erosion and pollution of local water resources from both animal waste and excess fertiliser use on feed crops. On a global scale, food production is responsible for one-third of all planet-heating emissions, with the use of animals for meat accounting for twice the pollution from producing plant-based foods. Many thought that the energy shock of 2022 would see countries backing down from the commitment to climate as priorities suddenly shifted to merely avoiding blackouts and keeping warm in the coming winters. But we can't overestimate the rising commitment, particularly in Europe, to climate priorities, even in the face of the current energy shock. And climate change and related policy isn't just about energy, but also food. To meet the target of net-zero emissions by 2050, one report estimates that meat consumption must be reduced to 24 kg per person per year, compared with the current OECD average of around 70 kg. Countries most likely to consider the food angle on climate change will be those that have legally binding net-zero emissions targets. Sweden has pledged to reach carbon neutrality by 2045, while others like the UK, France and Denmark are aiming for 2050. But a carrot and stick approach rarely works, and in 2023, at least one country looking to front-run others in marking out its lead in the race for most aggressive climate policy, moves to heavily tax meat on a rising scale beginning in 2025. In addition, it plans to ban all domestically produced live animal-sourced meat entirely by 2030, figuring that improved plant-derived artificial meats and even more humane, less-emissions intensive lab-grown meat technologies will have to satisfy appetites to help save the environment and climate.

Market impact: *Equities like traditional "ESG-lite" Tyson foods suffer steep drawdowns until they begin investing in sustainable and even lab-grown meat.*

Jessica Amir joined Saxo with over 14 years' experience in financial markets. She focuses on providing strategies, investment inspiration and ideas; sharing insights in a relatable way, often free of financial jargon. She guides investors and traders through macroeconomic factors, key themes, and uses fundamental and technical analysis. Jessica regularly speaks at industry events, as well as on TV, radio and online; being featured across platforms such as ABC News, SBS World News, Bloomberg, Wall Street Journal, the Telegraph, Yahoo Finance, Reuters and Morningstar. Her prior roles include; lead senior market analyst and presenter with Bell Direct (BFG), head of news and content at Sequoia Financial Group (SEQ) and financial adviser with AMP and CBA. She also worked as a TV financial Journalist, where she interviewed Australian Prime Ministers and Federal Treasurers.

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UK holds UnBrexit referendum

Jessica Amir, Market Strategist

The record brief tenure of UK Prime Minister Liz Truss in 2022 made the UK policy dilemma clear: supply side tax cuts and demand-boosting subsidies for energy are a toxic cocktail for a country's bond and currency markets when that country runs massive twin budget/trade deficits. Taking over from the Truss-Kwarteng duo in 2022 was the Rishi Sunak-Jeremy Hunt duo, who only deliver depressing fiscal austerity via tax hikes and spending cuts. Does it increase the sustainability of the UK debt trajectory? For a time, maybe. But it's just an alternative toxic cocktail to a crack-up inflationary reset that Truss-Kwarteng might have delivered, had it been given a chance. In 2023, Sunak-Hunt manage to take Tory popularity ratings to unheard-of lows as their brutal fiscal programme throws the UK into a crushing recession, with unemployment soaring and, ironically, deficits soaring too as tax revenues dry up. Public demonstrations break out, demanding that Sunak call snap elections because of the lack of a popular mandate. Amidst the economic ruin, polls even in England and Wales indicate second thoughts on the wisdom of Brexit. Many note that the overwhelming majority of the young generation were in favour of Remain in the first place, with over 80 percent of 18- to 24-year-olds voting Remain, versus nearly two-thirds of those aged 65-plus voting to leave, many who have since passed away and very few of whom are still in the labour force. Sunak finally caves and calls an election, resigning to allow a new Tory profile to take charge of the battered party. Labour leader Keir Starmer, noting the popular support for a second Brexit referendum and the Lib Dems surging in the polls as they clamour for a new referendum, runs on a platform of non-alignment on the Brexit question but supports a second referendum to rejoin the EU along the lines of the David Cameron deal struck before the original 2016 referendum. A Labour government takes power in Q3, promising an UnBrexit referendum for November 1, 2023. The ReJoin vote wins.

Market impact: *after a weak performance in early 2022, GBP recovers 10 percent versus the EUR and 15 percent versus the CHF on the anticipated boost to the London financial services sector.*

Steen Jakobsen first joined Saxo Bank in 2000 and has served as both Chief Economist and Chief Investment Officer since 2009.

He focuses on delivering asset allocation strategies and analysis of the overall macroeconomic and political landscape as defined by fundamentals, market sentiment and technical developments in the charts.

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Widespread price controls are introduced to cap official inflation

Steen Jakobsen, Chief Investment Officer

Inflation will remain a challenge to control as long as globalisation continues to run in reverse and long-term energy needs remain unaddressed.

Nearly all wars have brought price controls and rationing, seemingly as inevitable as battle casualties. The list of precedents stretches at least as far back as the Roman emperor Diocletian trying to set maximum prices for all commodities in the late third century AD. Over the last century-plus we saw comprehensive price controls and rationing in the two world wars. And even without the context of war, price and even wage controls were implemented during the peak statist years under UK Prime Minister Wilson and even US President Nixon.

2022 has also seen early and haphazard initiatives to manage inflation. Taxes on windfall profits for energy companies are all the rage while governments are failing to use the classic tool of rationing supplies. Instead, they are actively subsidising excess demand by capping heating and electricity prices for consumers. In France, this simply means that utilities go bankrupt and must be nationalised. The bill is passed to the government and then to the currency via inflation. Then we have the likely doomed effort by western officials to cap Russian energy prices from December 5. The intent is to starve Russia of revenue and hopefully cheapen crude oil export prices everywhere, but it will likely do neither.

In a war economy, the government hand will expand mercilessly as long as price pressures threaten stability. The thinking among policymakers is that rising prices somehow suggest market failure and that more intervention is needed to prevent inflation from destabilising the economy and even society. In 2023, expect broadening price and even wage controls, maybe even something like a new National Board for Prices and Incomes being established in the UK and the US.

But the outcome will be the same as it is for nearly every government policy: the law of unintended consequences. Controlling prices without solving the underlying issue will not only generate more inflation but also risking tearing at the social fabric through declining standards of living due to disincentives to produce, and misallocation of resources and investment. Only market-driven prices can deliver improved productivity and efficiency through investment. Looks like we'll have to learn the lesson all over again in 2023 and beyond.

Market impact: *please see Outrageous Prediction on gold rocketing to USD 3,000.*

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OPEC+ and Chindia walk out of the IMF, agree to trade with new reserve asset

Redmond Wong, Market Strategist, Greater China

Summary: Recognising the ongoing weaponisation of the USD by the US government, non-US allied countries move to leave the USD and the IMF to create an international clearing union (ICU) and a new reserve asset, the Bancor (currency code KEY), using Keynes' original idea from the pre-Bretton Woods days to thumb its nose at the practices of the US in leveraging its power over the international monetary system.

While less than a fifth of international trade is destined for the US, over a third of international trade is invoiced in USD and nearly 60 percent of global foreign exchange reserves are USD. The ban on transactions with Russian sovereign entities in February 2022 after Russia's invasion of Ukraine sent shockwaves across countries not allied militarily with the US as the magnitude of the ban far exceeded sanctions on Iran, Venezuela and other countries in recent decades. These countries wonder whether their US assets—and even EUR, JPY and GBP assets—could be subjected to freeze orders imposed by the US Treasury and other US allies overnight.

Many have speculated that the Chinese renminbi might become the new reserve currency, but China has shown no interest in abandoning cross-border capital controls. Another important aspect hampering the use of CNH in trade is that many non-US allies are wary of China's rise in influence and power.

Rather, a natural solution for China and its many trading partners, particularly energy and other commodities exporters, would be to find a new non-national currency reserve asset upon which to trade. They find inspiration in British economist John Maynard Keynes' playbook for reconstructing a post-World War II international monetary system without a hegemon. In an epochal conference convened in Astana, Kazakhstan, leaders from OPEC+ countries, mainland China, Hong Kong, India, Brazil, Pakistan, Central Asia countries, and tens of African Union countries gather to establish an ICU based on a new accounting unit and reserve asset: to establish an ICU based on a new accounting unit and reserve asset: the Bancor (currency code KEY). The KEY can only be held by member central banks and is used as an accounting unit to settle international trades and as a reserve asset. The new KEY is indexed to a basket of traded commodities with crude oil having the largest weight. The currencies of member countries are backed by the KEY at fixed exchange rates and are adjusted according to relative current account shifts among member countries. All the ICU member countries of the newly created monetary union withdraw from the IMF. Saudi Arabia and Hong Kong end their currency pegs to the USD.

Market Impact: *Non-aligned central banks vastly cut their USD reserves, US treasury yields soar and the Dollar falls 25% versus a basket of currencies trading with the new Bancor asset.*

John Hardy joined Saxo in 2002 and has been Head of FX Strategy since 2007.

He focuses on delivering strategies and analyses in the currency market as defined by fundamentals, changes in macroeconomic themes, and technical developments.

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Japan pegs USDJPY at 200 to sort out its financial system

John Hardy, Head of FX Strategy

Japan mobilised hundreds of billions of USD in its currency reserves in 2020 to defend the Bank of Japan's (BoJ) unmoved monetary policy and the JPY itself as the BoJ refused to hike the policy rate from -0.1 percent or to lift the yield cap on 10-year Japanese government bonds at 0.25 percent. As 2022 rolls into 2023, the pressure on the JPY and the Japanese financial system mounts again on the global liquidity crisis set in motion by the vicious Fed policy tightening and higher US treasury yields. Initially, the BoJ and Ministry of Finance deal with the situation by slowing and then halting currency intervention after recognising the existential threat to the country's finances after burning through more than half of central bank reserves. But as USDJPY rises through 160 and 170 and the public outcry against soaring inflation reaches fever pitch, they know that the crisis requires bold new action. With USDJPY soaring beyond 180, the government and central bank swing into motion. First, they declare a floor on the JPY at 200 in USDJPY, announcing that this will only be a temporary action of unknown duration to allow for a reset of the Japanese financial system. That reset includes the BoJ moving to explicitly monetise all its debt holdings, erasing them from existence. QE with monetization is extended to further lower the burden of Japan's public debt, but with a pre-set taper plan over the next 18 months. The move puts the public debt on course to fall to 100 percent of GDP at the end of the BoJ operations, less than half its starting point. The BoJ policy rate is then hiked to 1.00 percent and all yield-curve control is lifted, which allows the 10-year rate to jump to 2.00 percent. Banks are recapitalised as needed to avoid insolvency and tax incentives for repatriating the enormous Japanese savings held abroad see trillions of yen returning to Japanese shores, also as Japanese exports continue to boom. Japan's real GDP drops by 8 percent on reduced purchasing power even as nominal GDP rises 5 percent due to cost of living increases, but the reset puts Japan back on a stable path and establishes a tempting crisis-response model for a similar crisis inevitably set to hit Europe and even the US eventually.

Market impact: *USDJPY trades to 200 but is well on its way lower by the end of the year.*

Peter Garnry joined Saxo Bank in 2010 and is the Head of Equity Strategy.

In 2016 he became responsible for the Quantitative Strategies team, which focuses on how to apply computer models to financial markets. He produces trading strategies and analyses of the equity markets as well as individual company stocks, applying advanced statistics and models to beat the market.

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Tax haven ban kills private equity

Peter Garnry, Head of Equity Strategy

In 2016, the EU introduced an EU tax haven blacklist identifying countries or jurisdictions that were deemed 'non-cooperative' because they incentivize aggressive tax avoidance and planning. This was in response to the leaked Panama Papers, a trove of millions of documents that revealed tax cheating by wealthy individuals including politicians and sports stars. However, that blacklist excluded the biggest tax havens, in part due to effective lobbying. Thus, the global tax haven ecosystem continues to thrive. And it's not just wealthy individuals that are heavy users of tax havens—entire industries such as private equity and venture capital also leverage tax haven vehicles like offshore feeder funds to attract capital from foreign investors in different tax jurisdictions. As the war economy mentality deepens further in 2023, national security perspectives turn increasingly inward to industrial policies and the protection of domestic industries. As defence spending, reshoring and investments in the energy transition are expensive, governments look for all available potential tax revenue sources and find some low-hanging fruits in haven-enabled tax dodgers. It is estimated that tax havens cost governments between USD 500 and USD 600 billion annually in lost corporate tax revenue.

Based on advice from economic advisors that tax havens offer little economic purpose, the OECD agrees in 2023 to move to a more aggressive stance on tax havens, launching a full ban on the largest tax havens in the world such as the Cayman Islands, Bermuda, The Bahamas, Mauritius and the Isle of Man. The ban means that corporate acquisitions in OECD countries cannot be made with capital arriving from tax haven entities and only from OECD countries or countries that adopt OECD transparency standards on capital, which would include automatic exchange of information, beneficial ownership registration and country-by-country reporting. In the US, the carried interest taxed as capital gains is also shifted to ordinary income. The EU tax haven ban and US change to the carried interest taxation rule jolts the entire private equity and venture capital industries, shutting down much of the ecosystem and seeing publicly listed private equity firms dealt a 50 percent valuation haircut.

Market impact: * *The iShares Listed Private Equity UCITS ETF takes a massive hit.*

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