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CORPORATE BALANCE SHEET TRENDS:

Semi-invisible, but critically important

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KEY TRENDS

CORPORATIONS: KEY TRENDS

Getting bigger over time and more companies reaching country-size balance sheets

- The combination of persistently low interest rates, the current technological leap and deepening globalisation is creating **ultra-large companies** across sectors.

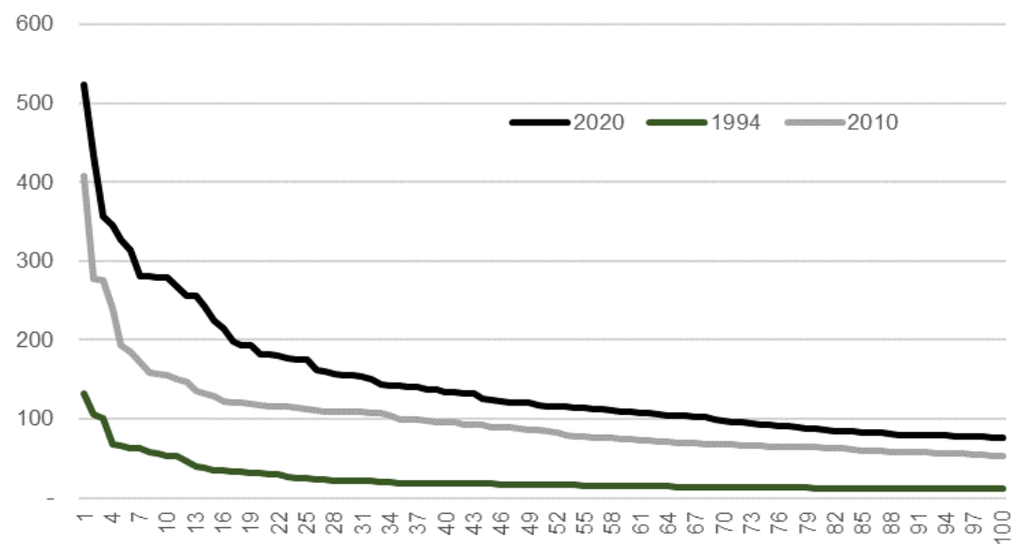
- This process is different from the past in two aspects:

a. **The size:** these mega-companies are as large as medium-sized countries, and are getting bigger.

b. **The frequency:** they can be observed in many sectors, and not just in banking and utilities, like used to be the case.

- The chart shows the rank of the top-100 companies globally – the 1 shows the largest one, 2 the second-largest, and so on.

12M rolling sums of revenues, USDbn of the top-100 global companies - Evolution since 1994



Sources: ADA Economics, Bloomberg

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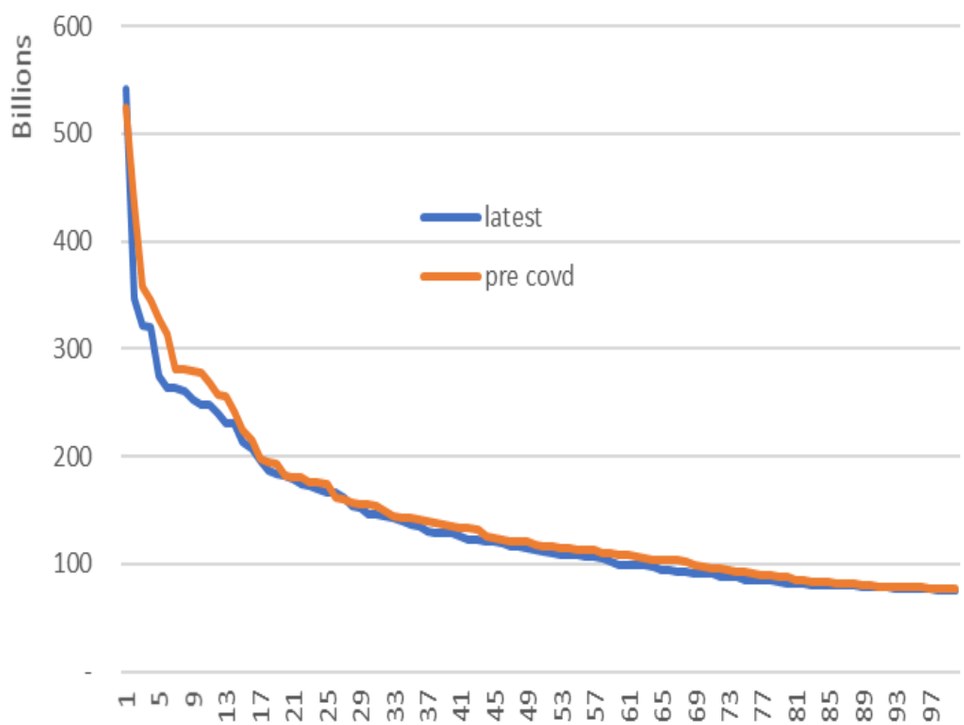
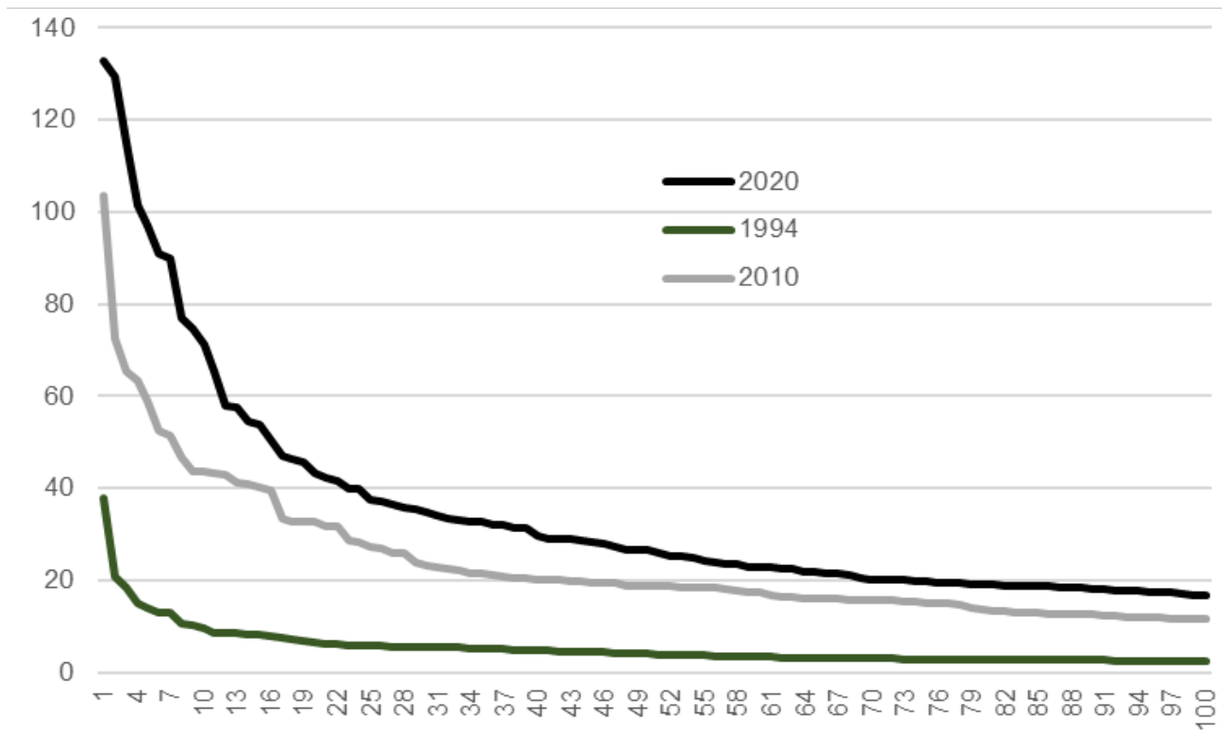
CORPORATIONS: Getting bigger over time & not affected by COVID-19

COVID-19 has dented some mega companies, but not the biggest, and most of them not significantly. (top-100 global companies in terms of revenues)

12M rolling sums of profits, USDbn of the top-100 global companies

Evolution since 1994





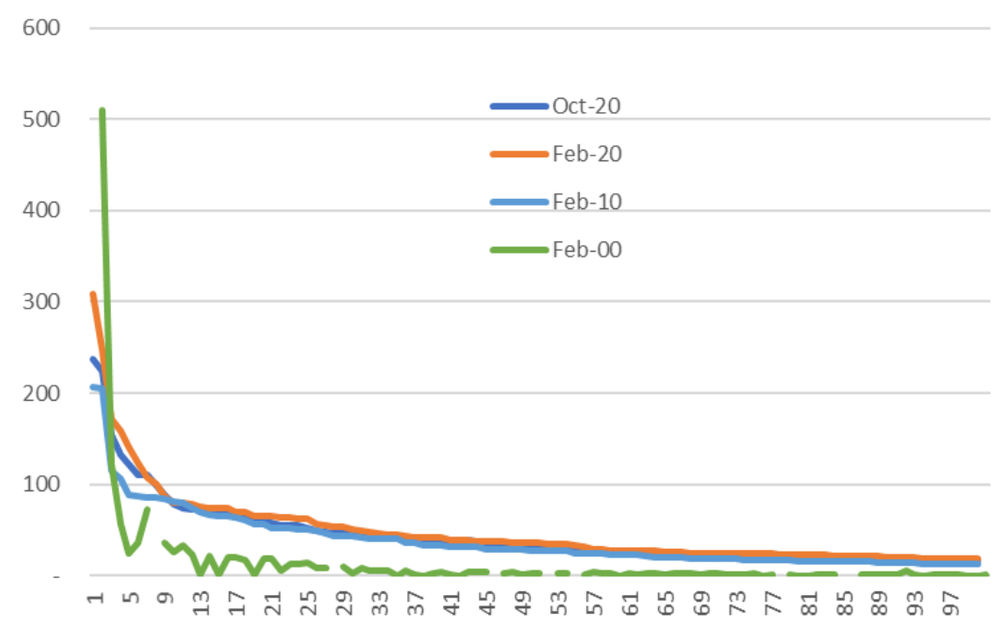
Sources: ADA Economics, Bloomberg

EUROZONE CORPORATIONS: KEY TRENDS

More large ones, but some realignment since the Euro launchsheets

- The situation in the Eurozone is slightly different: the single market is not perfect in terms of regulation.
- European economies have a much more SME-orientated economy than the US.
- Also, the Eurozone financial market is not as deep as the US market.
- Compare the pace of change in the Eurozone to the one in China (see the following slide) and that of the US, and it becomes evident who is "losing the race".

12M rolling sums of revenues of Eurozone* companies, EURbn of the top-100 companies
Evolution over the Euro period



*Sources: ADA Economics, Bloomberg *domiciled in one of the member states*

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CHINA: Rising super fast, but trailing the Eurozone and the US

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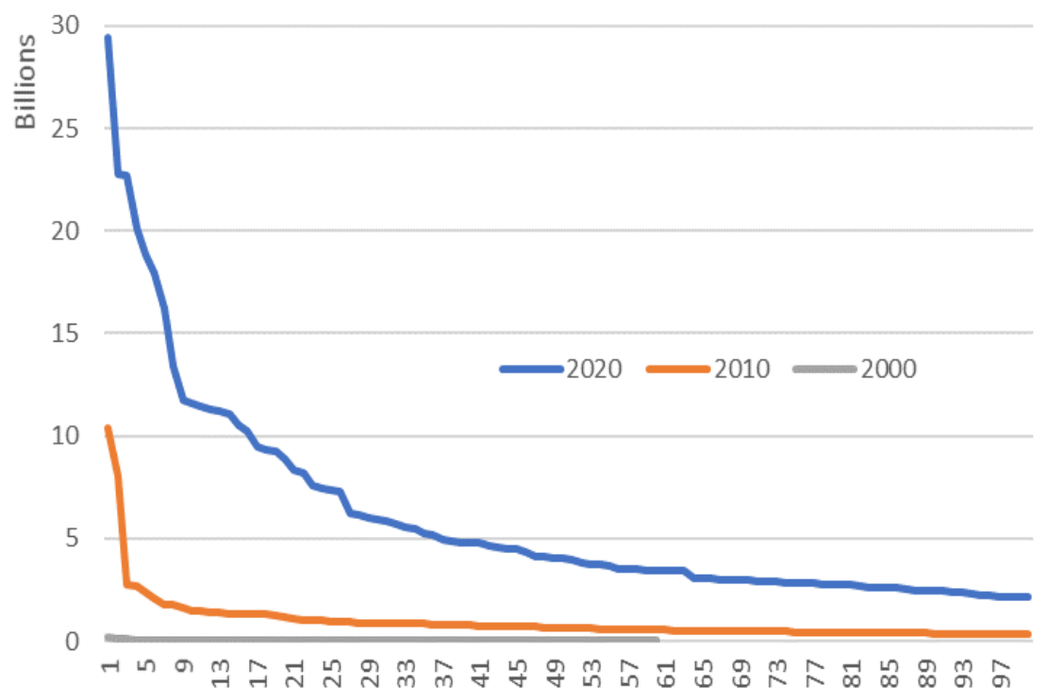
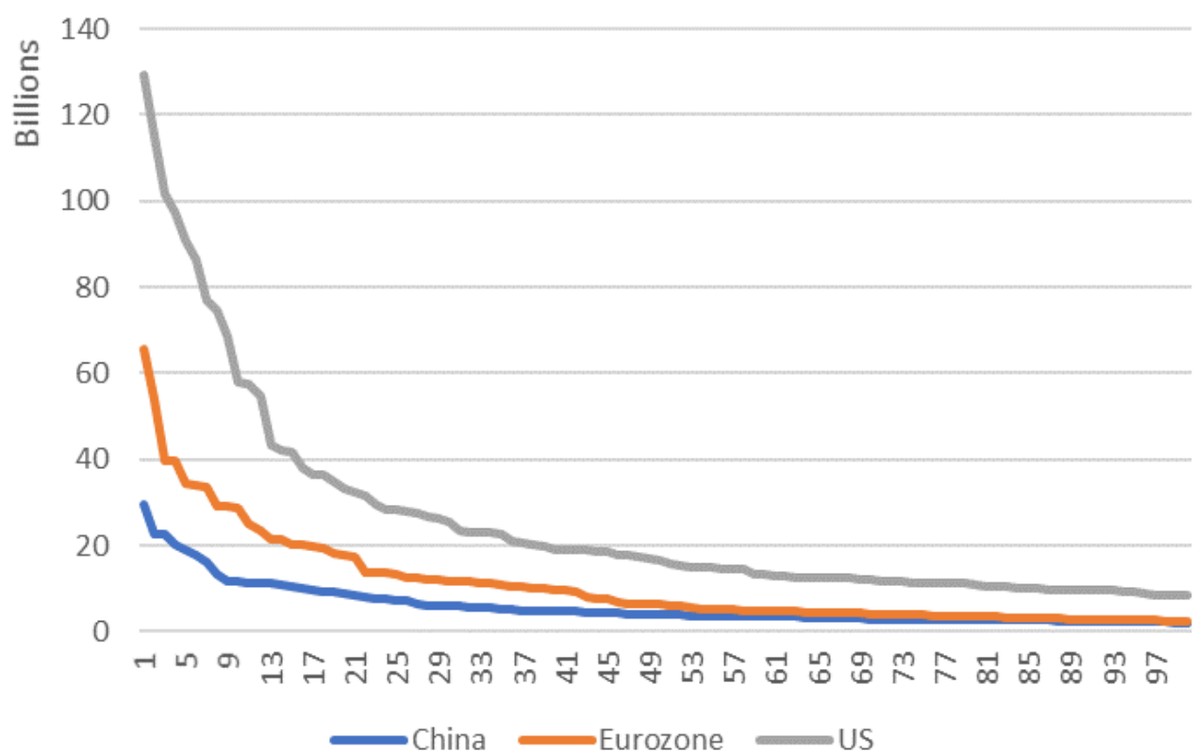
12M rolling sums of revenues or profits: the top-100 companies in China over the past 20 years (lhs) and the pre-COVID-19 profits of the top-100 companies in China vs. the Eurozone vs. the US (rhs)





*Sources: Bloomberg, ADA Economics *domiciled in one of the member states for the Eurozone, domiciled only in China*

IMPLICATIONS

IMPLICATIONS: IMPORTANT FACTS

These are some implications that we believe are very important:

I. Crowding out of SMEs, which weakens living standards' prospects and reduces productivity in the long run

II. Companies' "hoarding of cash" impairs the monetary transmission mechanism/central banks are creating equity prices and housing prices bubbles as a policy strategy

III. Inflation is harder to measure and with an upward (long-term) trend

IV. Sources of funding for the balance of payments change: other investment is as big as portfolio investment/NFCs treasury allocations are critically important for exchange rates trajectories

V. Financial deepening of a country is impaired as small companies and countries with shallower financial markets are able to capture relatively small global inflows

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LARGE COMPANIES, need large cash buffers in absolute amounts

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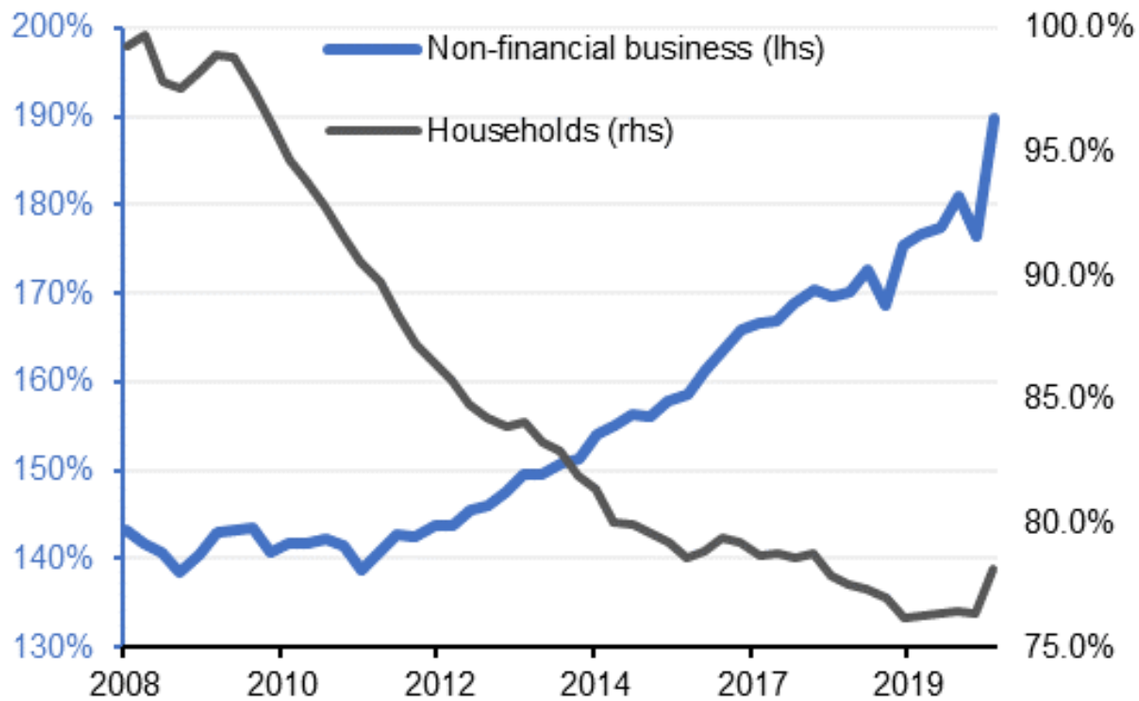
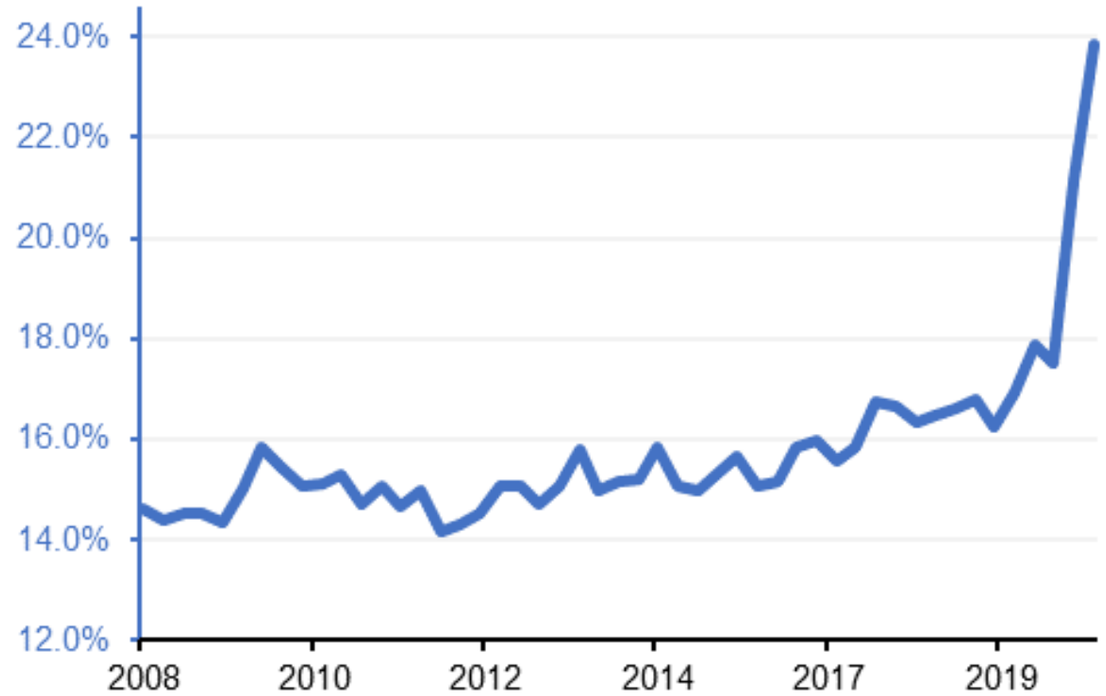
Debt to GDP of the private sector (US)



Cash * to GDP of non-financial corporations (US)



*Sources: Bloomberg, ADA Economics; *deposits of all maturities in USD and FX, plus money market funds*

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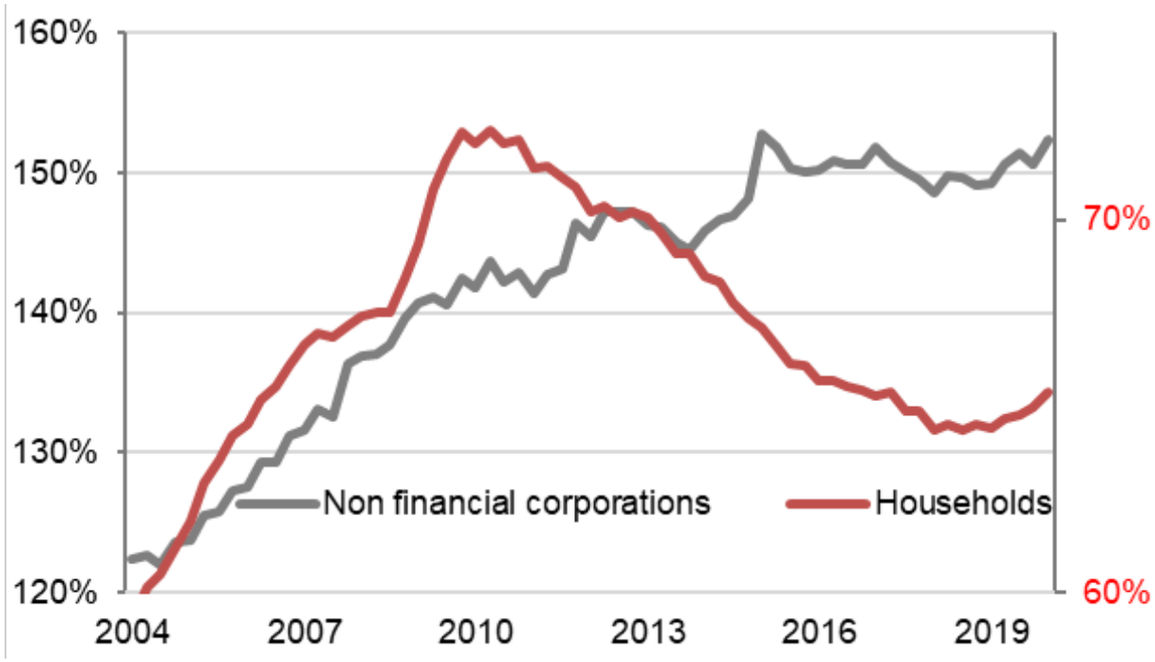
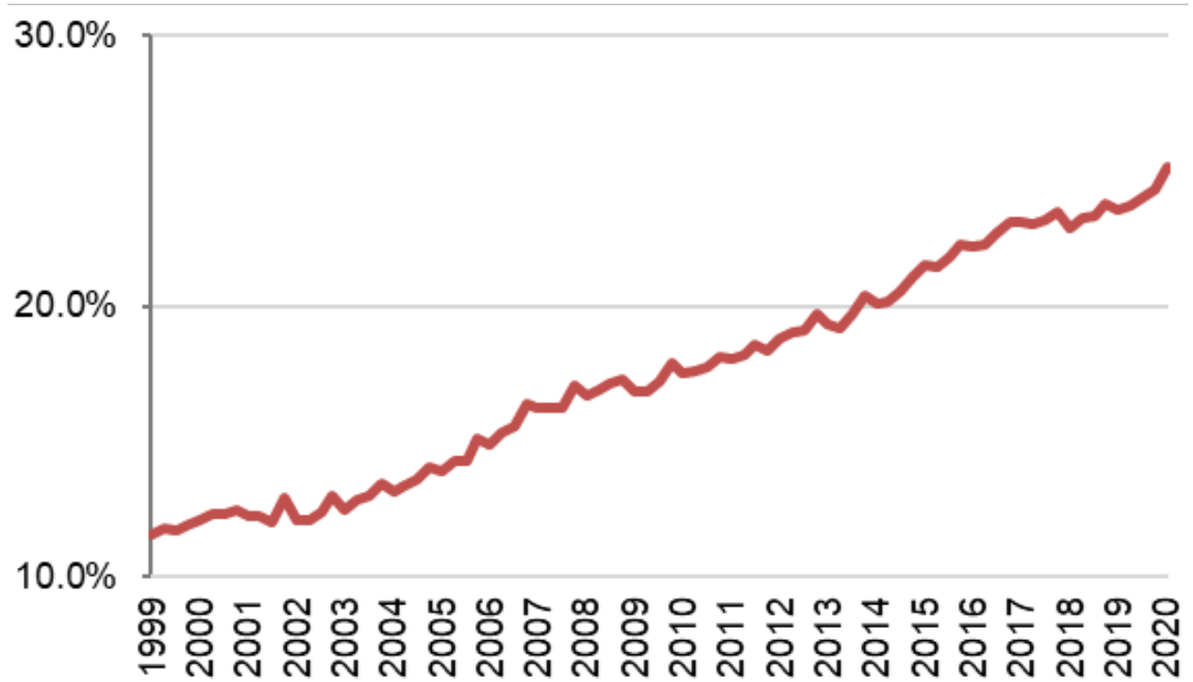
Debt to GDP of the private sector (EZ)



Cash * to GDP of non-financial corporations (EZ)



*Sources: Bloomberg, ADA Economics; *deposits of all maturities in USD and FX, plus money market funds*

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EUROPE IS CHANGING! The transition makes it vulnerable

Europe is changing!
The transition makes it vulnerable

These are some facts that we believe are very important:

I. Crowding out of SMEs angers the electorate indirectly, creating political friction over and above that related to other issues

II. Italy is heavily influenced by this process and the growth trajectory will not improve enough even with the recovery fund plan

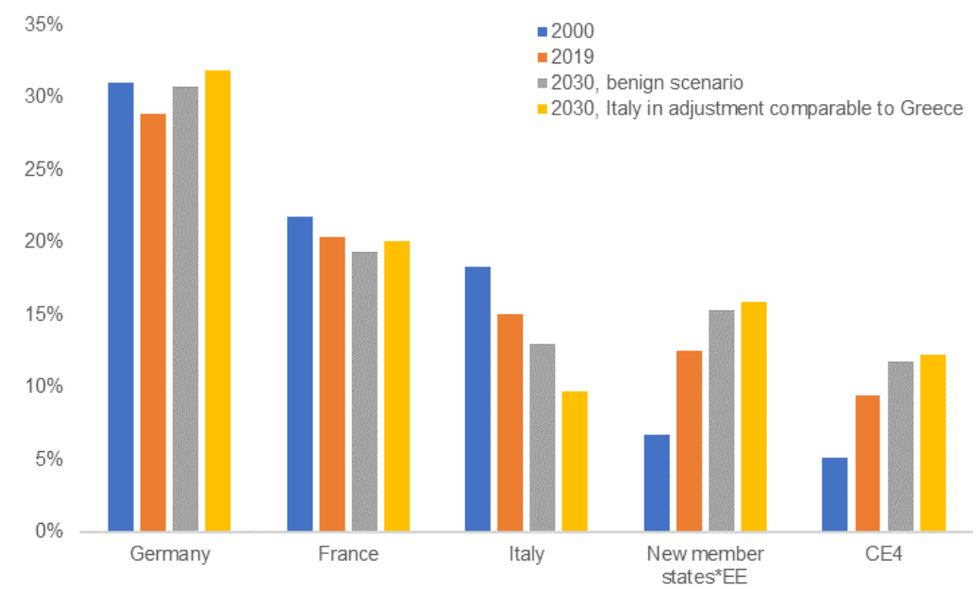
III. European leaders are missing their real comparative advantage in today's world – they do not have the global reserve currency nor the sheer population size of China. Any future trade agreement with India will worsen the problem

EUROZONE: KEY TRENDS

The economic and geopolitical downturn of Italy vs. the rise of "new" Euro candidate countries

- What might happen in the next 10 years?
- The importance of Italian GDP in the Eurozone relative to the weight of eastern Europe – even in a "benign scenario", where Italy avoids a massive shock, like Greece, Italy is losing businesses, talent and, thus, potential GDP.
- This realignment has profound implications for the internal political equilibrium of Europe, the foreign policy of Europe and the stability of the Euro.

The relative weight of the GDP of key member states to the Eurozone



*Sources: *Eastern Europe refers to all member states that entered the EU from 2004-onwards, bar Malta and Cyprus*

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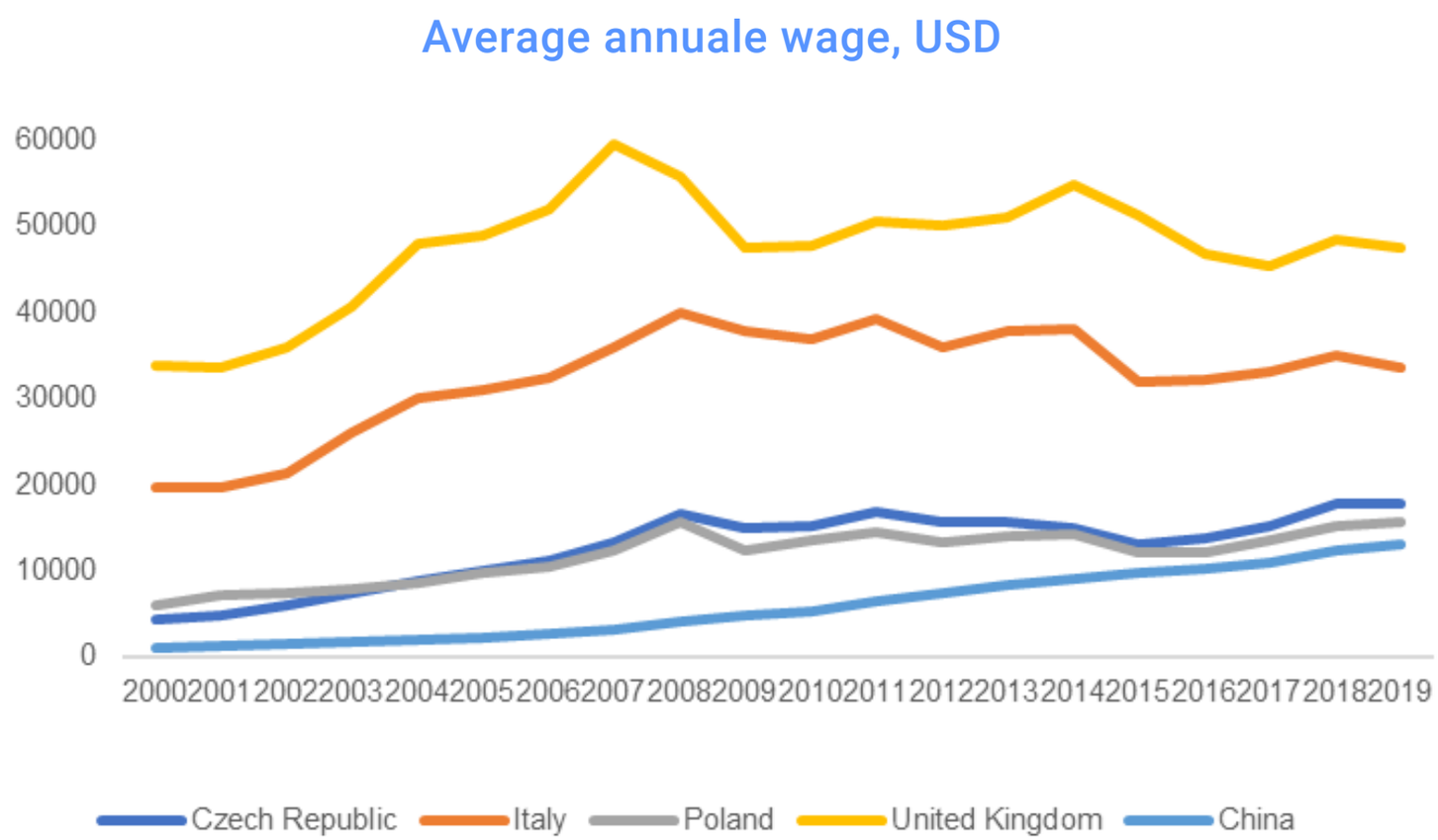
WAGE CONVERGENCE: China is the most successful, but Eastern Europe is successful too

The chart below does not do justice in showing the dynamics of self-employed incomes!



Sources: ADA Economics, CEIC

CONCLUDING REMARKS

These are some facts that we believe are very important:

- Polarisation of companies' balance sheets erodes potential GDP.
- In turn, this means that the neutral interest rate will fall – that is, the interest rate compatible with trend growth.
- This means that, in future, even small interest rate increases will trigger a recession in the Eurozone and/or in the US.
- Neutral rates have converged between the US and the Eurozone, and are, in our view, in the range of 0.50-1.00% – this is 100bps lower than our estimate for the US pre-COVID-19.
- Potential real GDP growth is NOT falling in central Europe, in our view – but the region cannot detach itself from weakening fundamentals in its biggest trading partner. This is what Brexit is about!

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