

LME Metals Seminar 2022

Monday 24 October, London and online



SETTING THE GLOBAL STANDARD



Economic keynote: global economic outlook

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Where is The Economy, is it still Global?

Sven Smit – Chair McKinsey Global Institute

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We see three other periods that resemble today, with a similar concentration of globally disruptive events and crossing points

Overview of selected systemwide, catalyzing events since WWII

1944-1946



Bretton Woods system

US dollar becomes global reserve currency



Global institutions

Establishment of UN, IMF, World Bank, and others



Atomic bomb

First use of nuclear weapon in war



Peacetime shift

Shift from wartime economy, regrowth (e.g., Marshall plan)

1972-1974



Fiat money

US dollar loses convertibility to gold



Oil crisis

Energy price spikes causing economic disruption



Stagflation

Recession with high inflation and unemployment



Japanese growth

Japan's GDP surpasses Germany's

1989-1992



Fall of USSR

Cold War tension dissipates and markets open



EU foundation

Maastricht treaty signed, paved the way for the Euro



Internet

WWW developed, first commercial ISPs launched



China's opening

Deng Xiaoping invigorates economic reform

2020-2022



Russia-Ukraine war

War in Europe, causing supply shocks



COVID-19

Pandemic takes >6m lives and disrupts livelihoods



Inflation leviathan

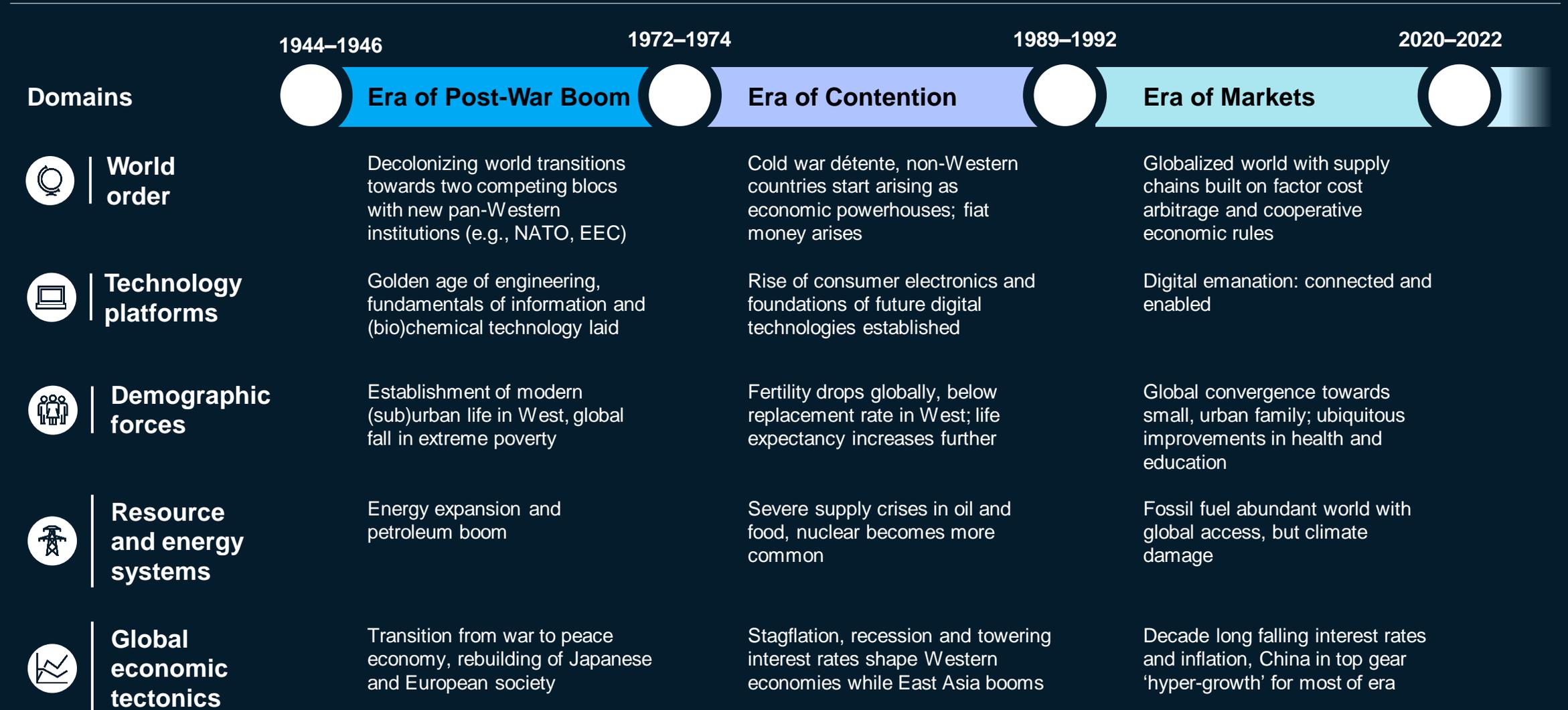
Highest levels of inflation in 40 years



China's ascent

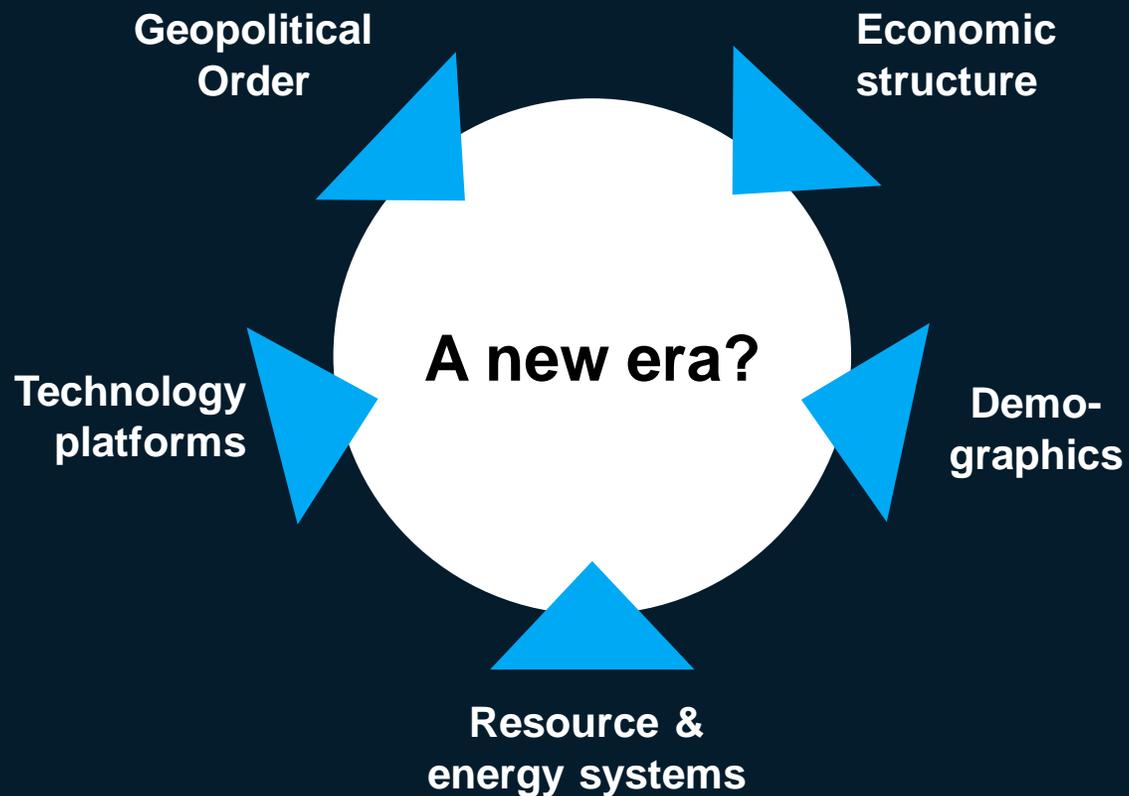
China's GDP overtakes EU, but no longer in 'hyper-growth'

Between periods of disruption, global events played out in thematic ‘eras’



Five factors that typically change when a new era begins such as post WWII, the early 1970s, and the early 1990s

What we are seeing today



Geopolitical order

- Russia invades Ukraine; China/India do not join condemnation
- US-China competition, Geoeconomic tools increasingly at work
- Evolution of Quad / U.S.-EU Trade & Technology Council

Economic structure

- COVID alters supply chain, labor market, inflation dynamic
- China slips out of 'top-gear' growth and searches for COVID-exit
- Corporate actors shift focus to stakeholder concerns

Demographics

- Global 'peak child' reached
- 'Baby Boomers' retire in West
- Dependency ratio for many countries at inflection point (now rising)

Technology platforms

- Saturation point close for smartphones and internet
- COVID-19 accelerated digital adoption by ~7 years
- Exponential AI innovation and cloud/edge/trust architecture

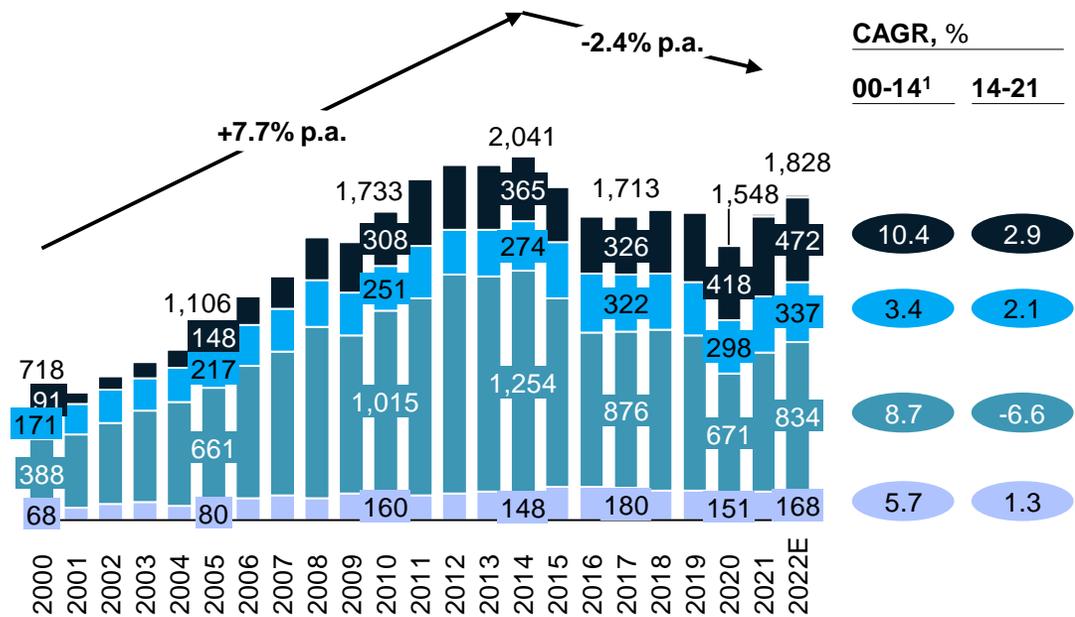
Resource & energy systems

- Under-investment in future energy requirements
- Historical peaks across energy commodity prices
- Energy security gains new salience, scramble to secure supply

Signals in the global energy system

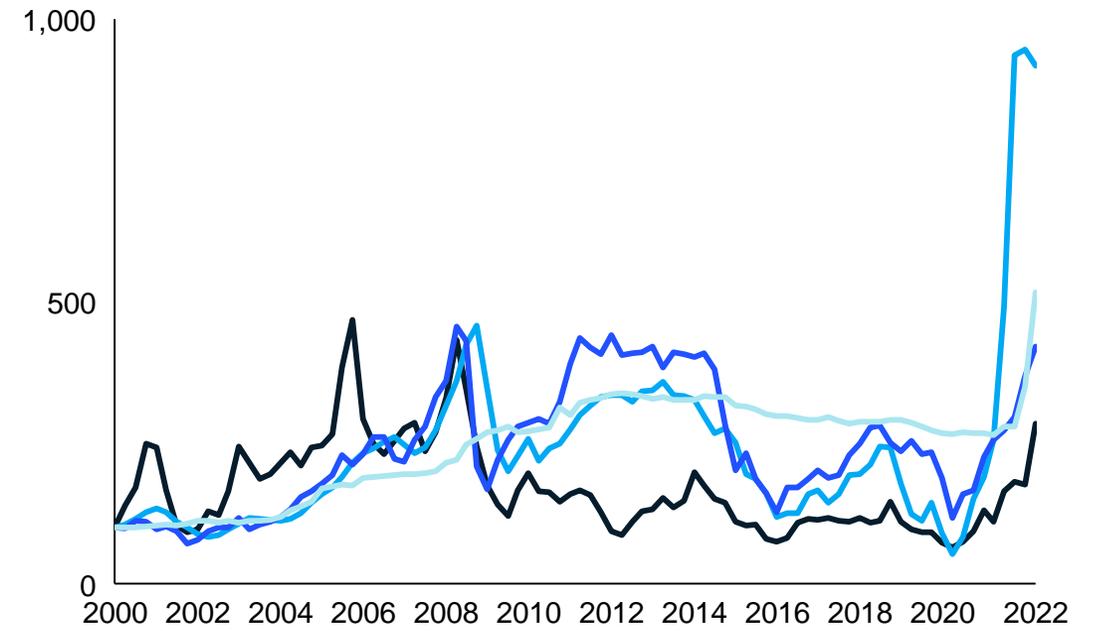
Clean fuels
 Renewable generation
 Electricity networks and storage
 Fuels
 Non-renewable generation

Global investment in energy supply \$Bn USD



The investment on energy have shrunk across all types

Indexed quarterly price of coal, gas, and oil² Price in Q1 2000=100



Price of fossil fuels have skyrocketed

1. Categories from 2000-2015 are estimates based on Global investment in energy supply over time (Figure 1.2).
 2. Quarterly price of Europe natural gas, US natural gas and Brent crude oil were from World Bank Commodity Price Data Pink Sheet. Quarterly price of coal was the price of coal in the US from Oxford Economics.

Lives and Livelihoods scenarios

Globally disruptive events and potential crossing points widening range of outcomes for Lives and Livelihoods

Preliminary

Changing world order and global economic tectonics

Pace, scale and depth of reactions to changes in the world order and structural shifts in economic operating environment

Sustained change & beneficial shifts in economic outcomes

Shifts in world order largely accommodated restoring supply/ demand imbalances in goods and labor markets, supply chain fluidity, and inflation expectations

Uneven change slowed by competing economic interests

Shifts in world order accommodated in part creating uneven resolution of supply/ demand imbalances in goods and labor markets, supply chain fluidity and inflation expectations

Disruptive change with hard-to-resolve economic transitions

Shifts in world order are disruptive impeding resolution of supply/demand balances in goods and labor markets, supply chain congestion, and inflation expectations



Platform standards bifurcate impeding progress of shifts

Geoeconomic concerns override energy transition goals slowing public/private spending impeding productivity gains

Platforms proliferate slowing pace and impact of shifts

Targeted public/private spending navigate geoeconomic concerns, raises productivity and moderates cost of energy transition

Platforms compete openly and raise impact/hasten shifts

Rapid public/private spending with few geoeconomic barriers accelerates productivity and affordable energy transition

Shifts in technology and resource energy platforms

Scale and breadth of commitment to efficiently scaling technology platforms and accelerating the shift of the energy transition

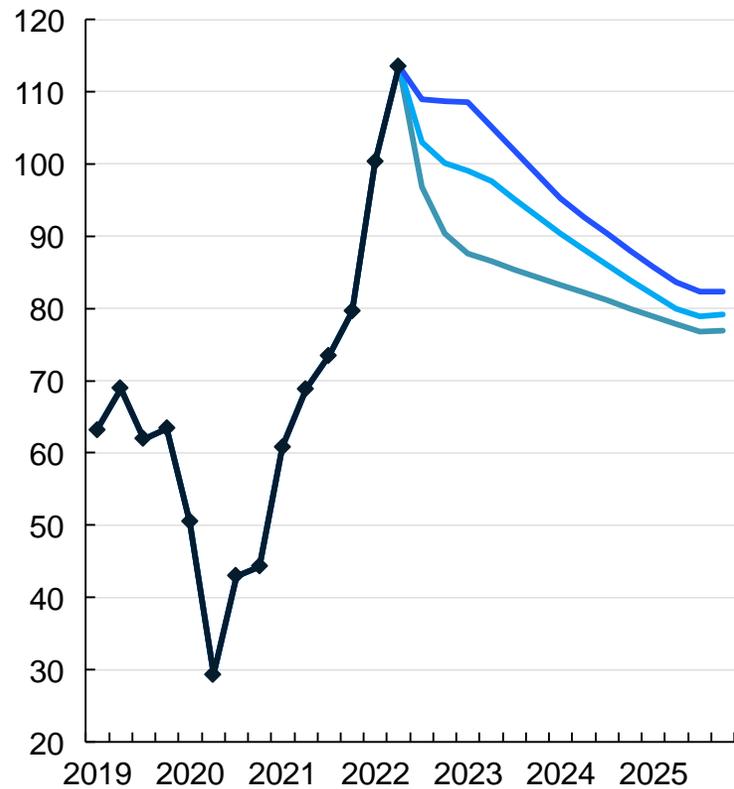
Key input prices – which are set globally – are likely to remain elevated for some time

Scenarios as of September 12, 2022

Preliminary

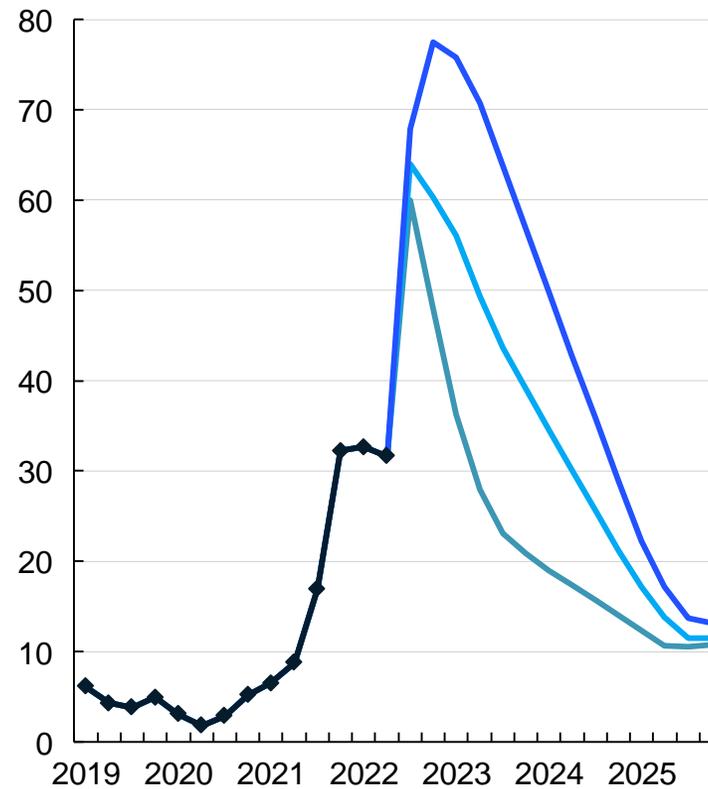
Crude oil, Brent

\$ per barrel



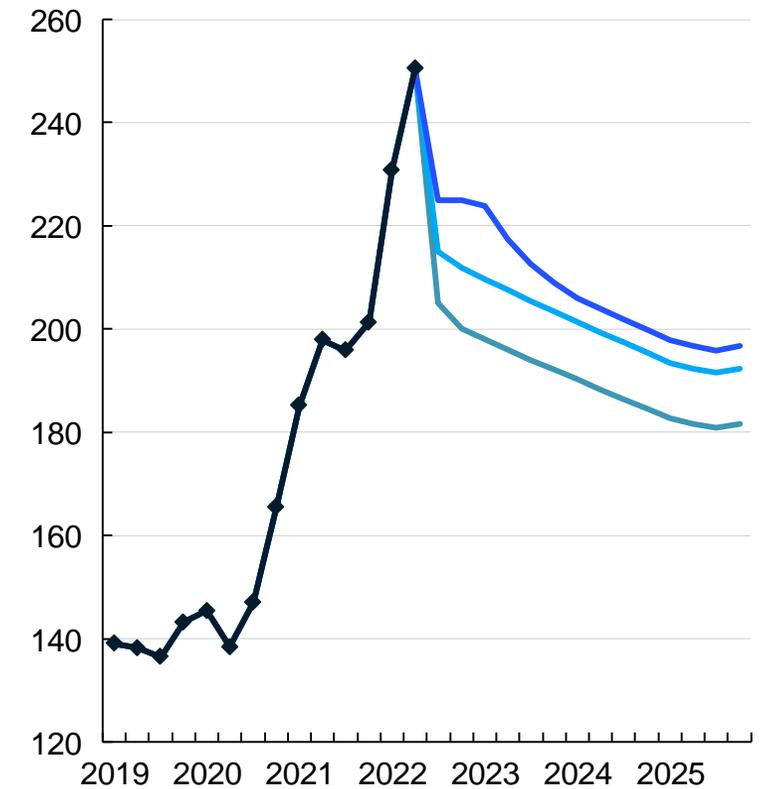
Natural gas, Europe

\$ per MMBTU



World food price

Index, 2005=100



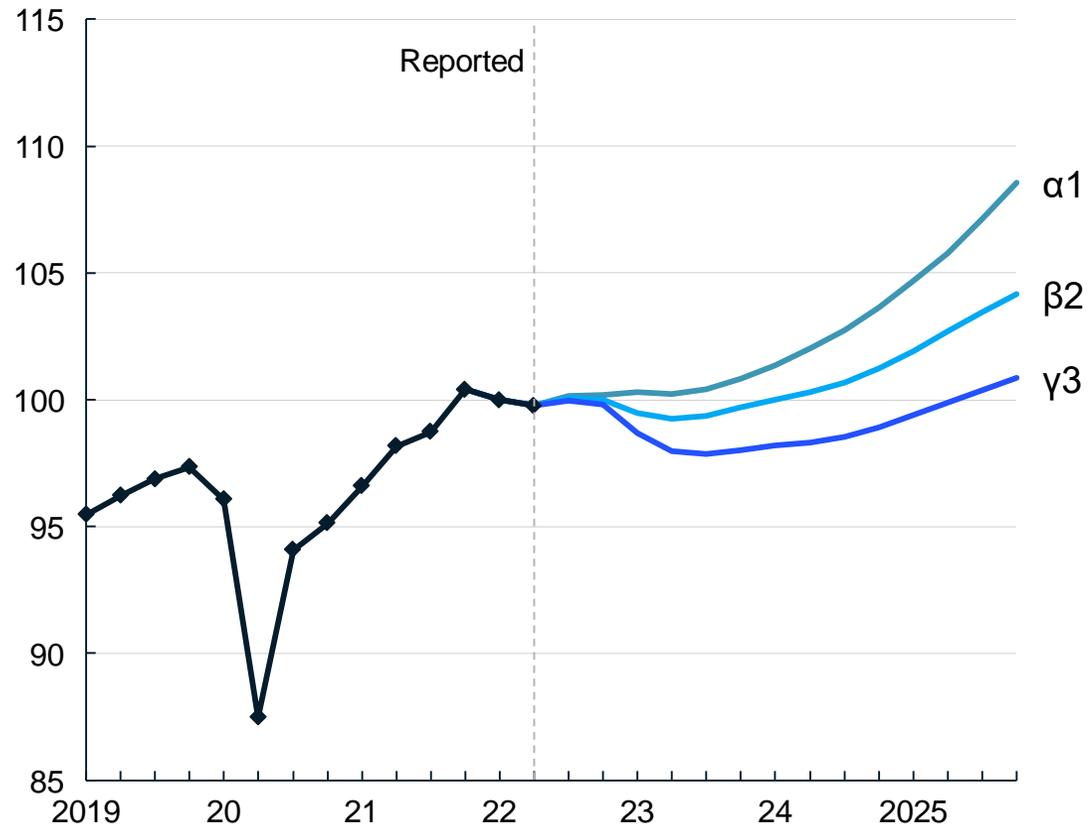
Real GDP – United States

McKinsey scenarios, September 12, 2022

Preliminary

Real GDP

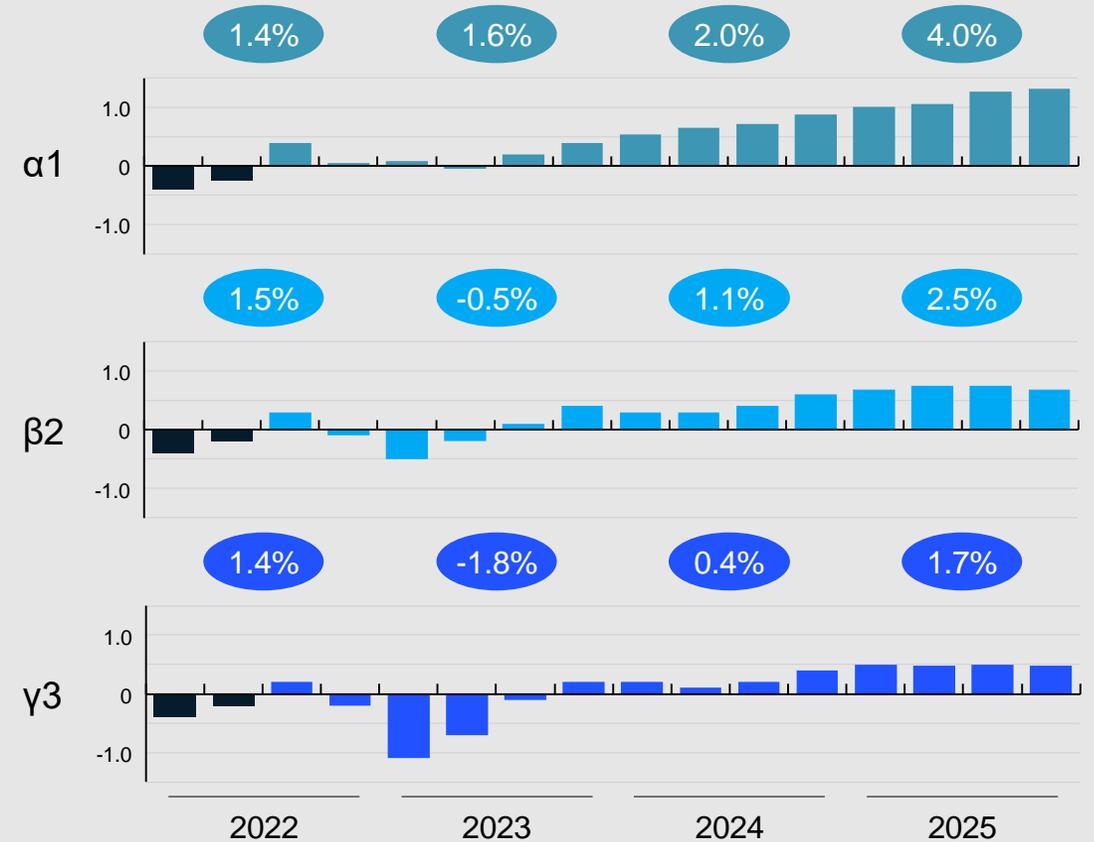
Indexed, 2022 Q1=100



Source: National statistics agencies; McKinsey analysis, in partnership with Oxford Economics

Real GDP

Quarterly and annual percent change



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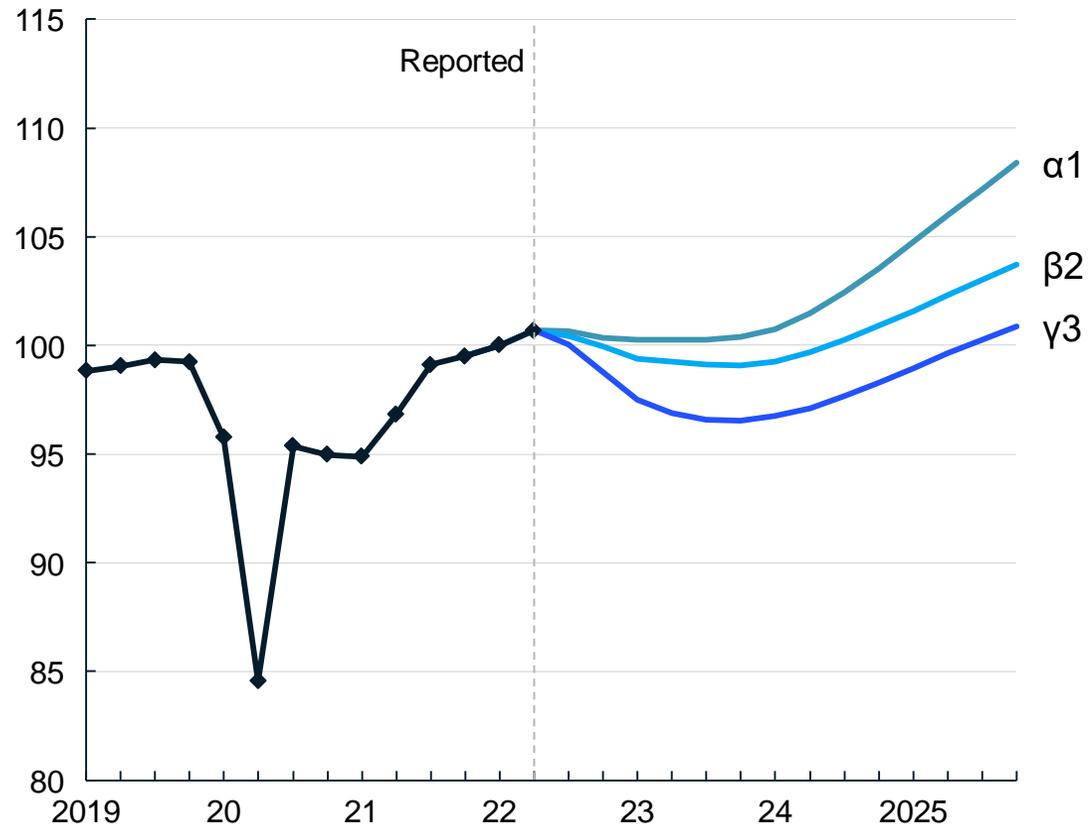
Real GDP – Eurozone

McKinsey scenarios, September 12, 2022

Preliminary

Real GDP

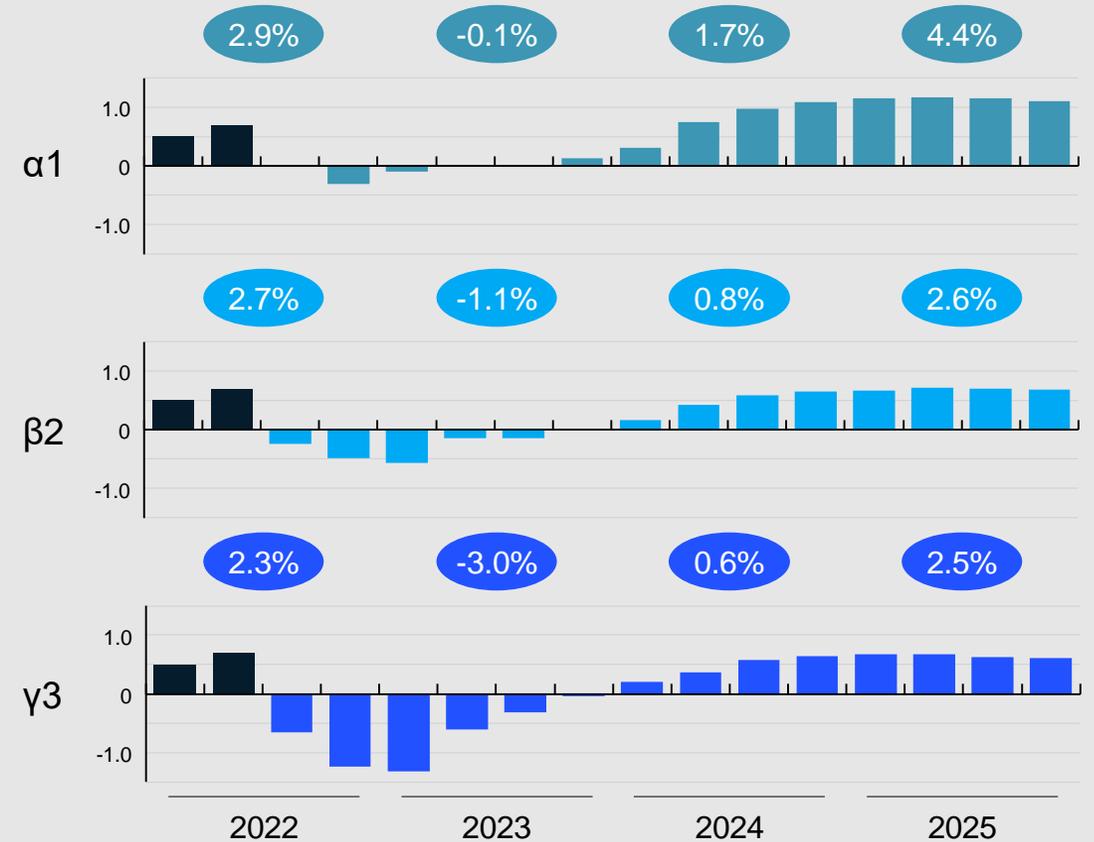
Indexed, 2022 Q1=100



Source: National statistics agencies; McKinsey analysis, in partnership with Oxford Economics

Real GDP

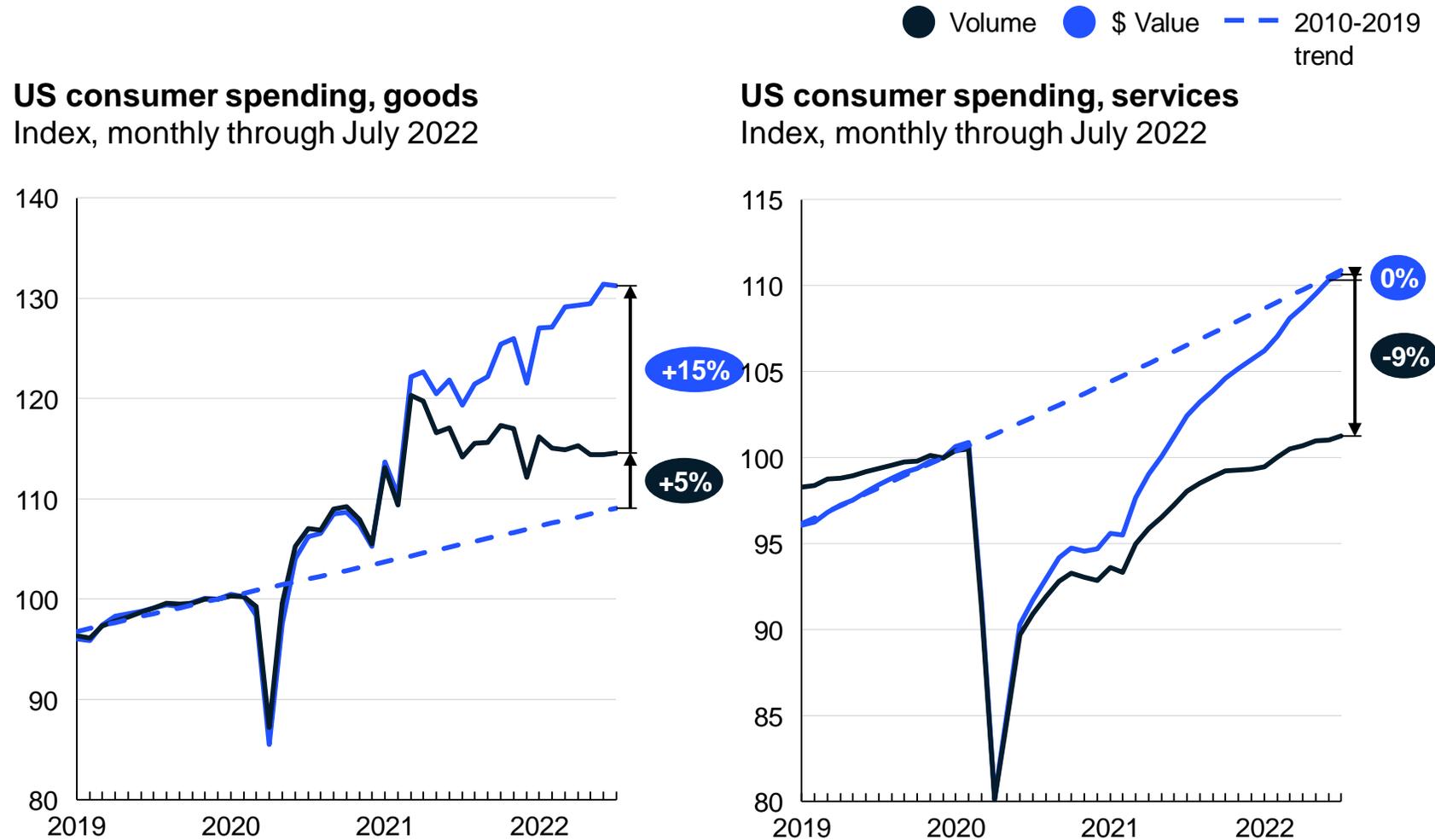
Quarterly and annual percent change



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US spending on goods increased significantly stretching supply chains to the limit

Volume has slowed as impact of inflation begins to take hold



+\$1,218B

Cumulative nominal spending on goods above trend since January 2020

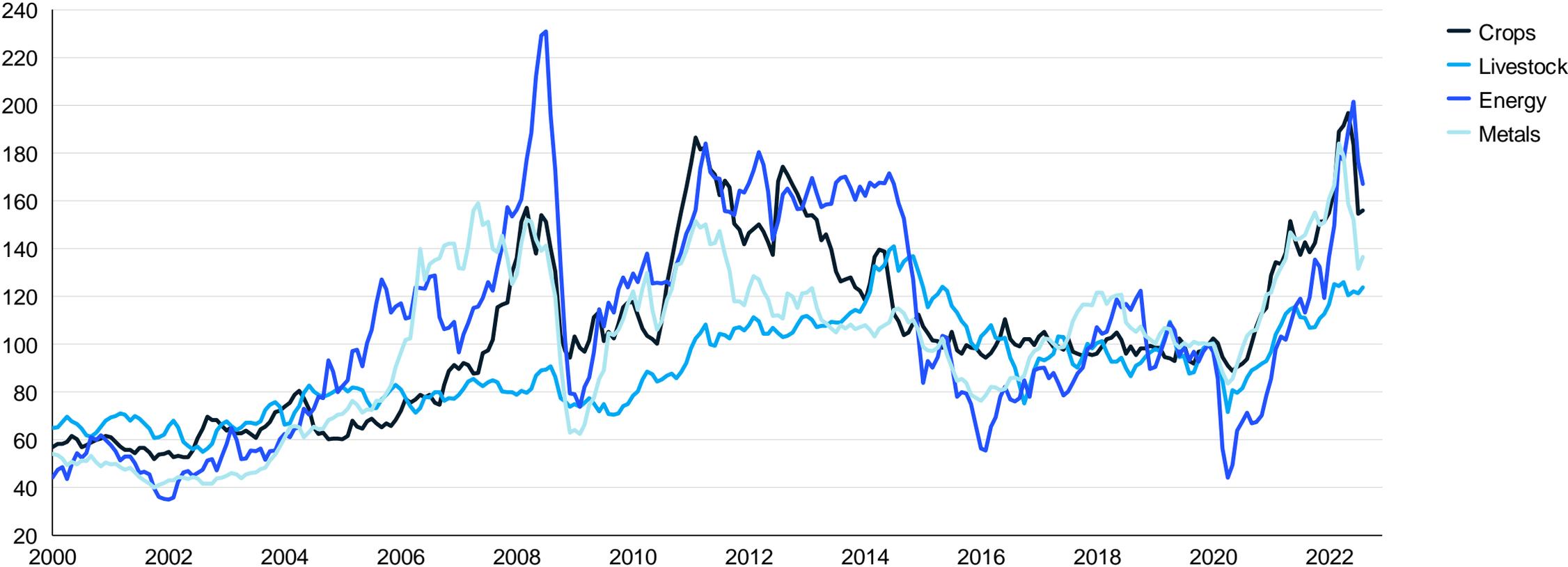
-\$1,680B

Cumulative nominal spending on services below trend since January 2020

Commodity prices have come of their highs driven by Russia's invasion of Ukraine

This slowdown will play through to CPI and PPI inflation in coming months

Commodity prices, sector-based baskets
Index, December 2019=100; monthly through August 2022



Source: Goldman Sachs, Haver Analytics; McKinsey analysis

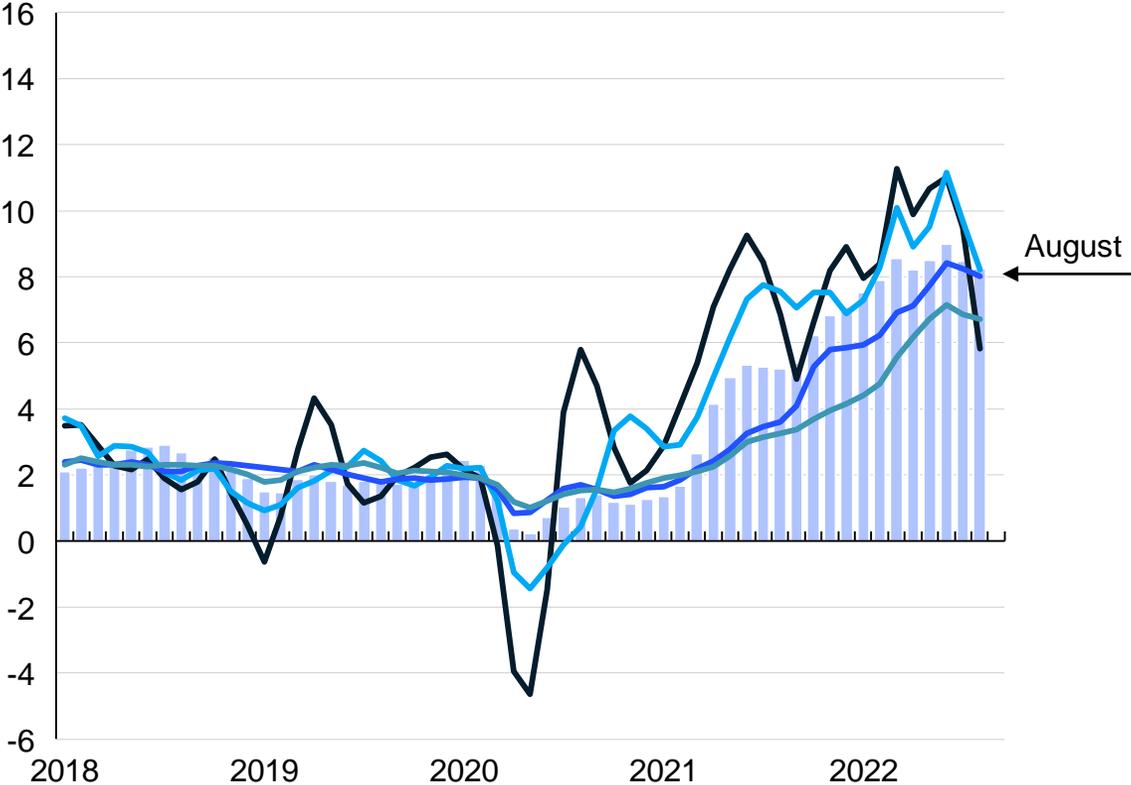
August CPI reading suggests the acceleration in US inflation is behind us, while Eurozone prices continue to grow at faster pace

Central banks may still move more aggressively than even revised market expectations have anticipated

— 3-mo — 6-mo. ■ 12-mo. — 18-mo. — 24-mo

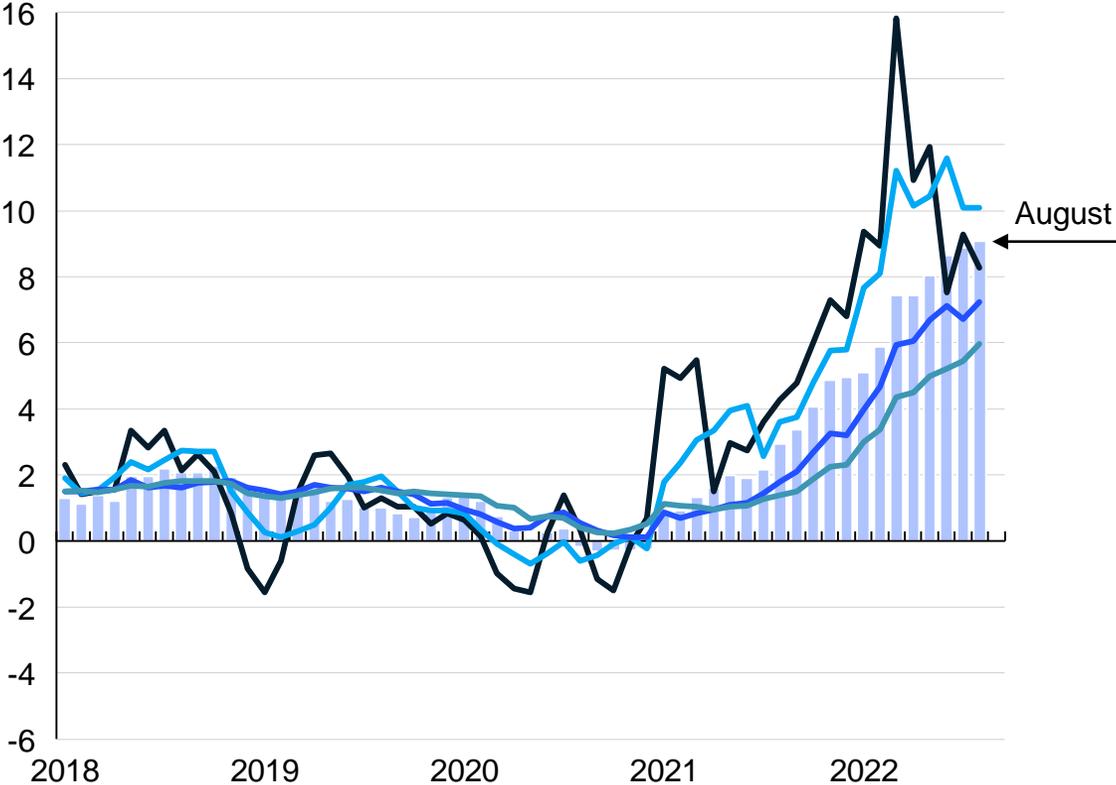
Change in Consumer Price Index (CPI) - US

Annualized percent change, through August 2022



Change in Consumer Price Index (CPI) - Eurozone

Annualized percent change, through August 2022



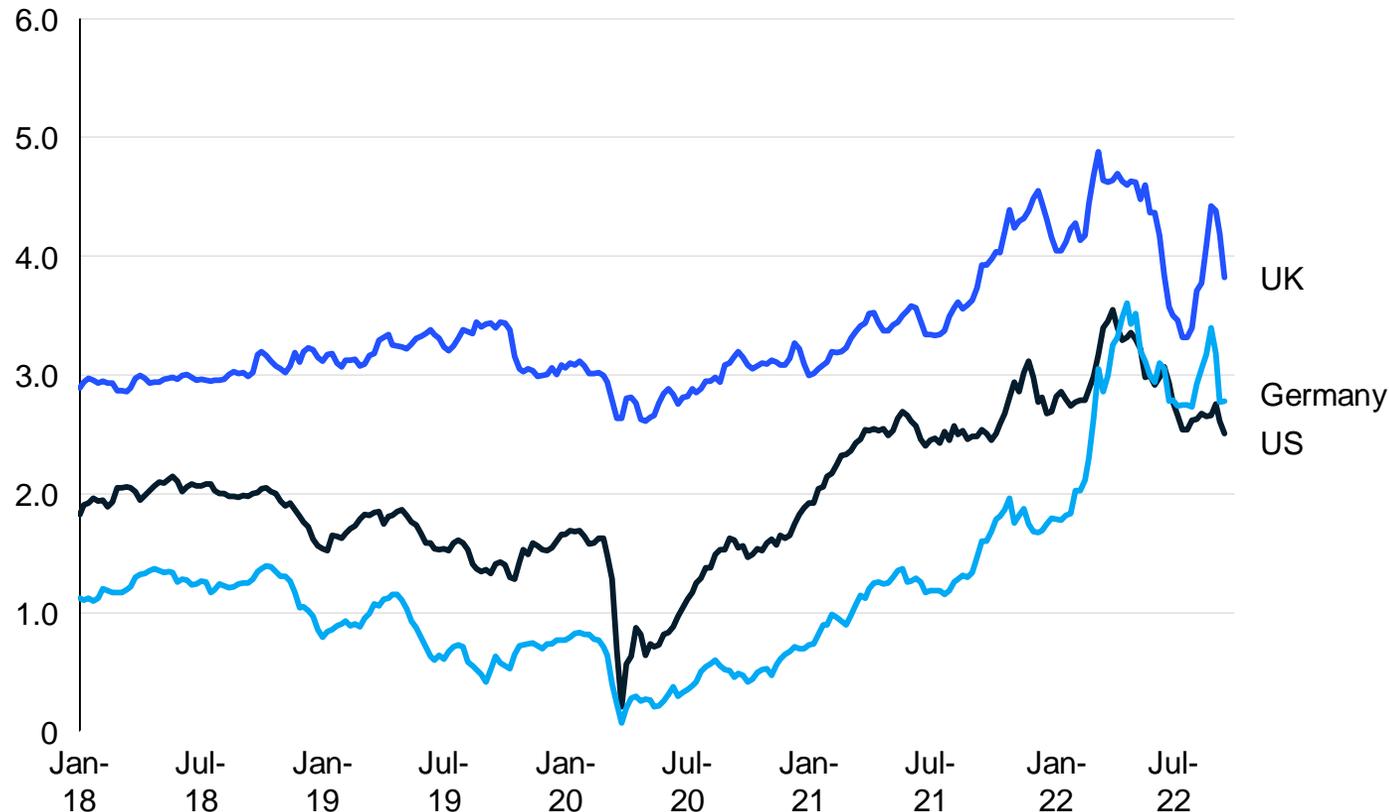
Source: BLS, Federal Reserve Board "Transcript of Chair Powell's Press Conference July 27, 2022," McKinsey analysis

Central banks continue to hold the “hearts and minds” of bond market participants

Medium- and long-term inflation expectations remaining at 2-3%

5-year market-based inflation expectations

Percent, weekly through September 9, 2022



Source: BLS, Haver Analytics, Federal Reserve Board, McKinsey analysis



Based on its current assessment, over the next several meetings the Governing Council expects to raise interest rates further to dampen demand and guard against the risk of a persistent upward shift in inflation expectations

— European Central Bank Policy Statement, September 8, 2022

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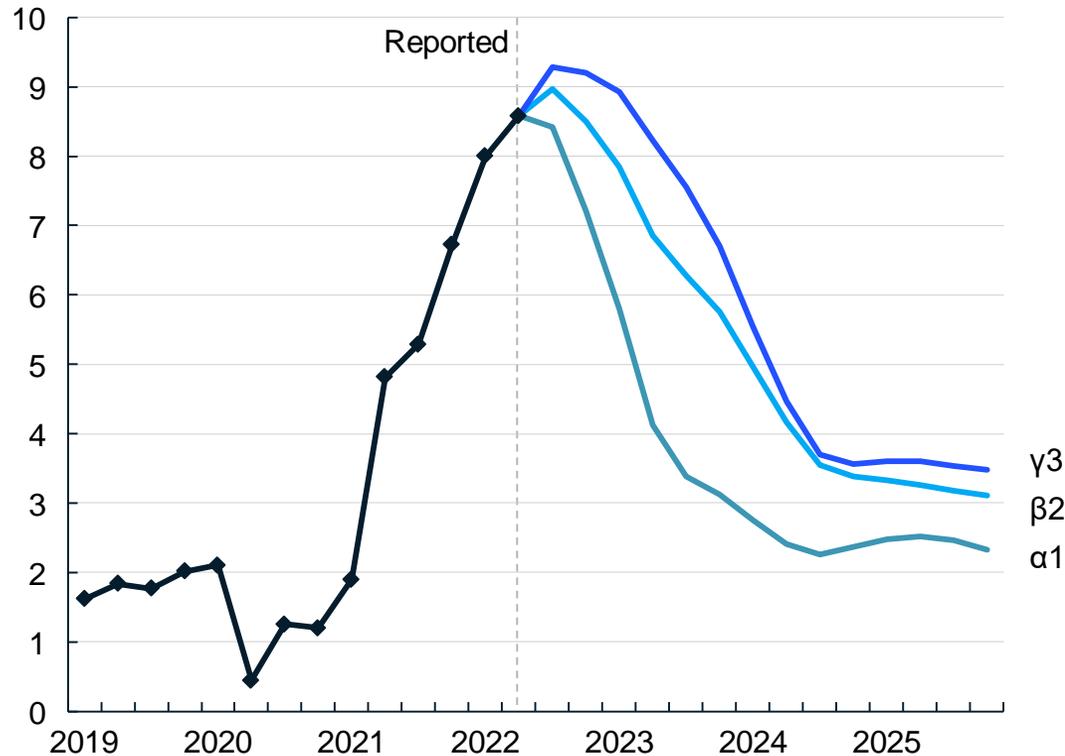
Inflation and FED policy—United States

McKinsey scenarios, September 12, 2022

Preliminary

Consumer Price Index, quarterly

4-quarter change



Consumer Price Index, annual

Annual change

Scenario	2022	2023	2024	2025
α1	8.1%	4.1%	2.5%	2.4%
β2	8.5%	6.6%	4.0%	2.5%
γ3	8.8%	7.8%	4.2%	3.7%

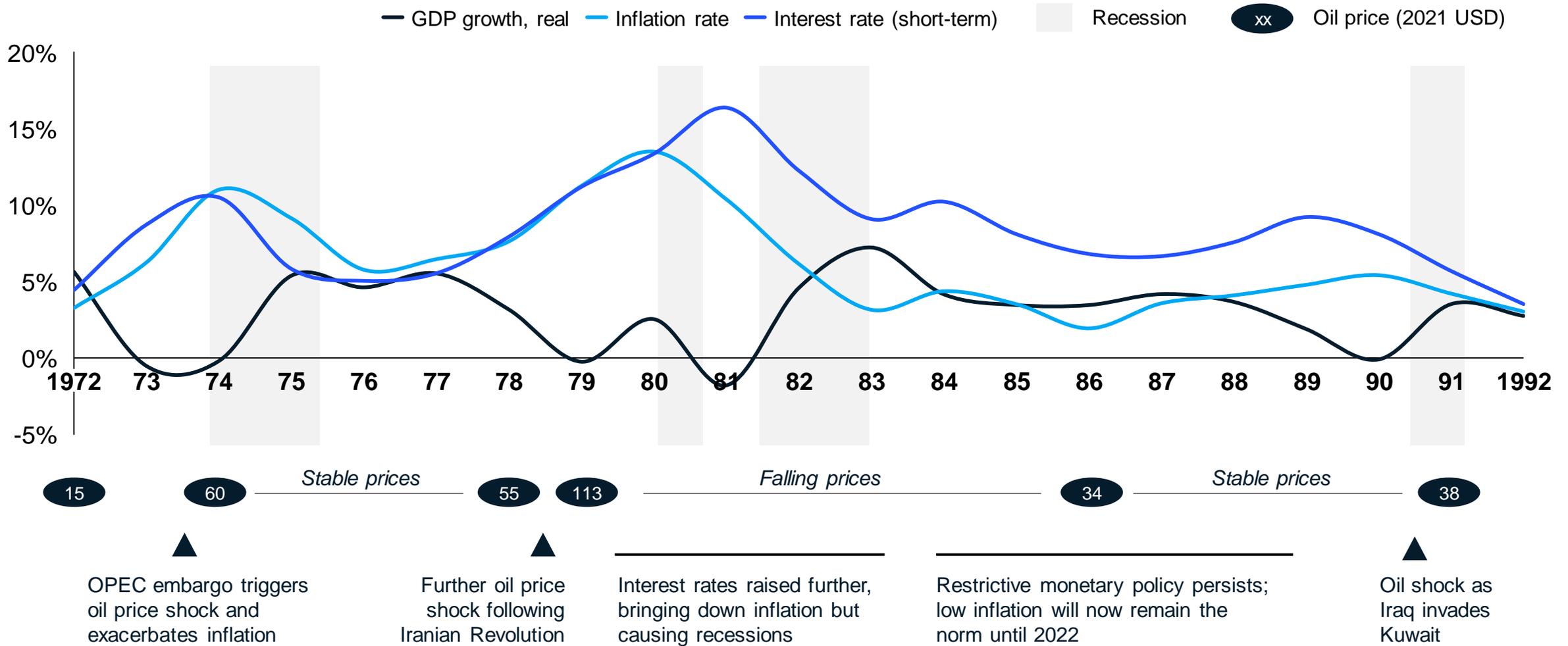
Federal funds target rate

Percent, scenarios as of September 12, 2022



Let's look back at the stagflation era

US real GDP growth, inflation, interest rates, and recessions¹; oil price (Dated Brent, 2021 USD)

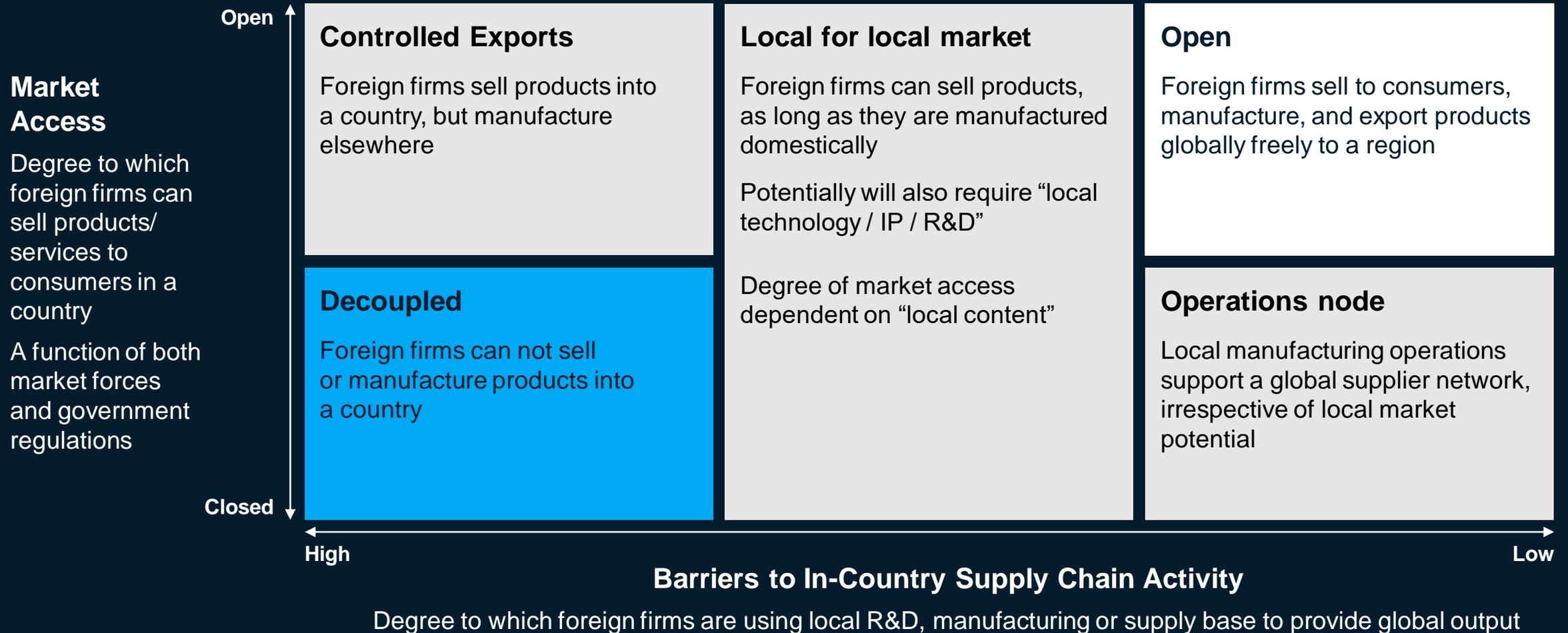


1. GDP growth indexed to 2015 USD; inflation given by year-on-year Consumer Price Index (All Urban) % change; short-term interest as the Federal Funds Effective Overnight Rate; recessions as dated by NBER

Going into the next Era: direction of travel, and big forks in the road

Domain	Current direction of travel		Forks in the road
	From	To	
 World order	Unipolar Global Moderate	Multipolar Regional Polarized	Polarize in to 'blocs' vs. strengthen global institutions and support multi-lateral co-operation Return to political centrism vs. hyper-polarization
 Technology platforms	Few cases of AI outperformance	Myriad cases of AI outperformance	Policy environment enables speed of innovation vs. exercises caution (i.e., privacy, AI safety) Progress enabled by open co-operation vs. IP-protected institutions
 Demographic forces	Young world Communicable diseases	Ageing world Non-communicable diseases	Invest in health to add 'life to years and years to life' vs. prioritize other expenditure (e.g., social care for elderly, defense) Be radical in addressing social inequality (e.g., wealth, health) vs. continue with current policy levers
 Resource and energy systems	Climate neglect High spend on fossil fuels	Climate 'priority' Low spend on energy (incl. renewables)	Invest rapidly to ensure 'well below 2C' global warming vs. continue current pace to avoid economic, social, and local environmental cost of energy transition
 Global economic tectonics	High productivity growth 'Catch-up' growth Low leverage	Low productivity growth Capital deepening High leverage	'Belt-tighten' to deleverage vs. try to innovate and boost productivity to 'outgrow' debt

Five potential future trade archetypes are emerging



Eight tests for building resilient growth mindsets

Are you ready for a next Era and the coming winter?

1

How prepared are you to handle your known vulnerabilities?

2

How equipped are you to weather a combination of fast-moving, unknown challenges?

3

What early-warning indicators are you obsessing over to anticipate the scale and speed of disruption?

4

What disruptive competitor moves might re-shape your industry?

5

What actions - or reactions - do you anticipate from your financial, supplier, and societal stakeholders?

6

Are you poised to take advantage of new opportunities that present themselves?

7

Can you support consistent, fast, and flexible decision-making - without succumbing to organizational fatigue?

8

Do your management team and board have the muscles needed to navigate an inflationary, recessionary environment?

"You cannot overtake 15 cars in sunny weather – but you can when it's raining." Ayrton Senna



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Apply history's lessons learned to overcome today's uncertainty



Deploy a new playbook. Companies that survived or did well in the last two years may not do so in inflationary or recessionary environments. Leverage board experience on learnings from earlier crises



Prepare for both entry and exit from recession. A potential recession will likely be shallower and shorter than in the past. Focus on seizing opportunities as you emerge from the downturn



Go bold on scenarios, rather than error-prone forecasts. Forecasts are nearly always wrong, and “miss” key events (e.g., pandemic, slowing globalization, supply chain woes, inflation). Use scenarios to inform operationalization



Radically enhance Finance, since the cost of being wrong is high. Finance now must consider evolving macroeconomic factors to an extent not faced in decades. Higher rates mean near-term cash flow and earnings are at a premium. Tighten links between Finance and the frontline

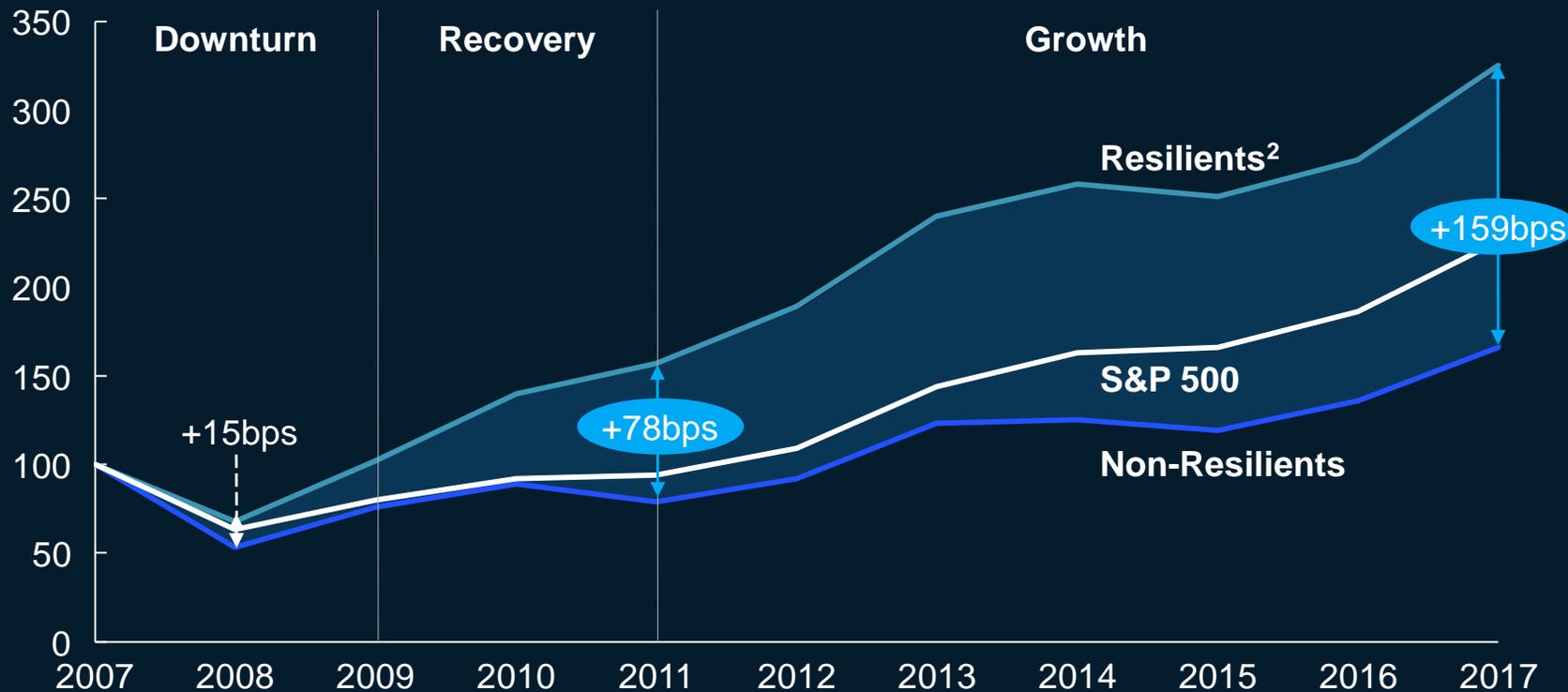


Focus now on resilient growth. Embrace actions now to withstand shock and future unknowns while preserving a growth mindset (e.g., acquisitions)

History teaches us that resilient companies are much more likely to come out as winners – especially during crisis

Last Updated June 30, 2022

TRS performance of ca. 1,000 global companies¹ during the 2007-08 Financial Crisis



Resilient companies achieve + ~ 100bps TRS driven by...

Outperformance in earnings throughout the cycles and revenues in the recovery

Faster and harder moves on productivity, preserving growth capacity

Divestments in downturn phase, **acquisitions** when recovery started

Operational and financial optionality

In practically all sectors, resilient companies demonstrate similar attributes

1. Total returns to shareholder; calculated as average of sub-sector medians performance of resilient and non-resilient. Includes 1,140 companies (excludes FIG & REITs)

2. Resilient companies defined as top geometric mean TRS quantile by sector.

Source: CPAAnalytics, MSCI, McKinsey Analysis

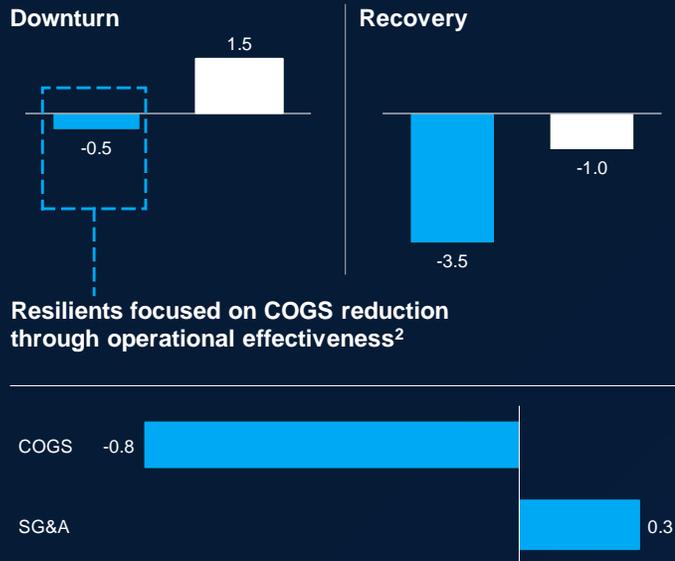
What did resilient companies do differently?

■ Resilients ■ Non-Resilients

Based on historical research

Resilients moved faster, harder on productivity; preserved growth capacity

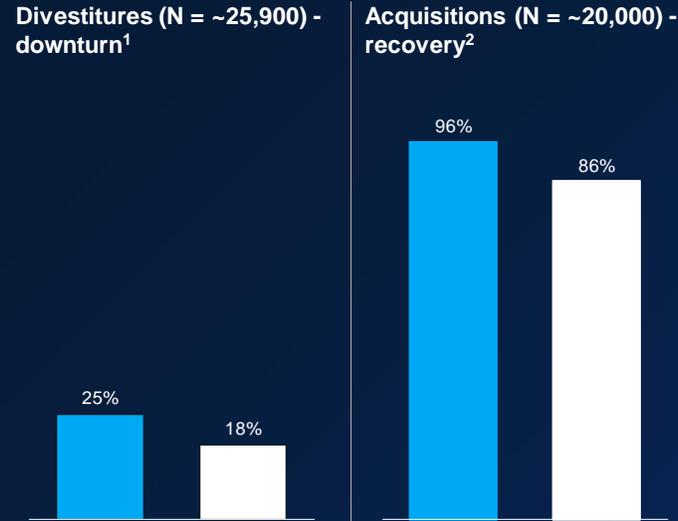
Operating costs¹, % of revenue change



Note: Calculated as an average of different sub-sector medians for 'Resilients' and 'Non-resilients'. Excludes financial companies and REITs
 1 Operating Costs = COGS + SG&A - D&A. Change in Op cost (as a % of revenue) between 2007 and 2009 for Downturn period and 2009 and 2011 for Recovery period; 2 Resilients' revenue grew at the same time period; COGS and SG&A not adjusted for D&A (D&A is the primary driver for the discrepancy between operating cost and sum of COGS + SG&A)

Resilients divested more heading into the downturn and acquired more as the recovery started

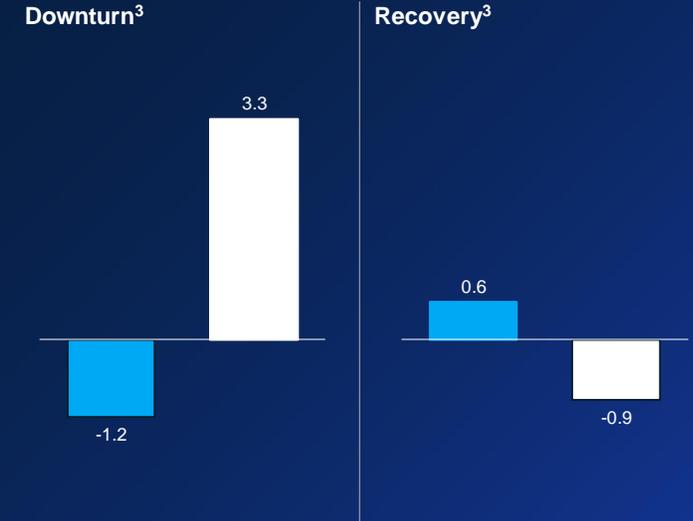
Avg. of sector median divestment (or acquisition) %
 As % of value of transactions



Note: This analysis excludes financial companies, and REITs. This analysis was conducted using fiscal years
 1 Downturn is defined as all deals announced between 2007-2009; 2 Recovery is defined as all deal announced between 2010-2011

Resilients created optionality early in the recession – operational and financial

Change in Leverage ratio, (Debt¹/Capital²)



Note: Calculated as an average of different sub-sector medians for 'Resilients' and 'Non-resilients'. Excludes financial companies and REITs
 1 Total Debt (book value) = Short Term Borrowings + Current Portion of Long Term Debt + Current Portion of Capital Lease + Long Term Debt + Long Term Capital Lease + Finance Division Debt Current + Finance Division Debt Non Current; 2 Capital = Total Common Equity + Total Preferred Equity + Minority Interest + Total Debt.; 3 Downturn is defined as 2007 and 2009; Recovery is defined as 2009-2011

Resilient companies ("Resilients") defined as top TRS quantile by sector

Source: McKinsey Quarterly Q2 2019, [Bubbles pop, downturns stop](#); CPAnalytics; Capital IQ

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