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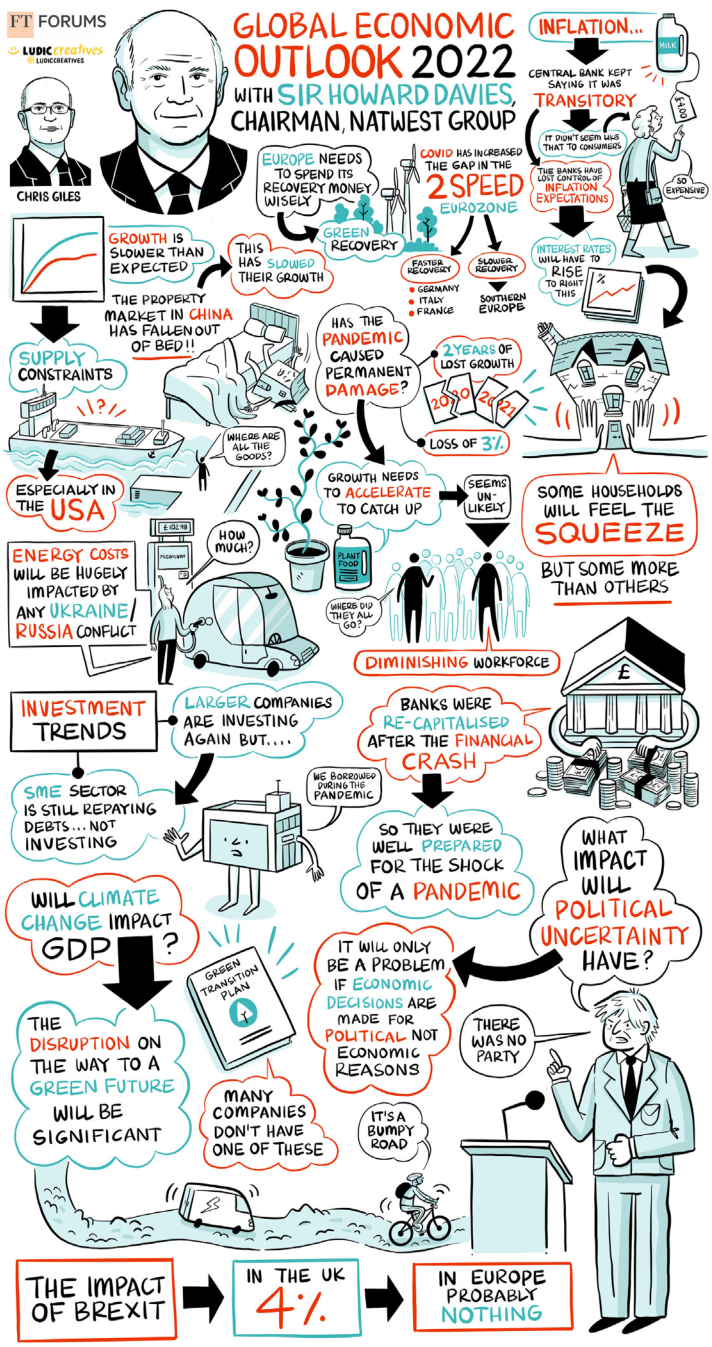
EVENT SUMMARY

THE GLOBAL ECONOMIC OUTLOOK IN 2022

27 JANUARY

SPEAKERS

Chris Giles, economics editor, Financial Times
Sir Howard Davies, chairman, NatWest Group



In the first event of 2022, Chris Giles, economics editor of the Financial Times, talked with Sir Howard Davies, chairman of NatWest Group, about the global economic outlook in 2022.

Here are the highlights of the event.

THE YEAR AHEAD IS HARD TO READ BUT GLOOMY PREDICTIONS LOOK SPOT ON

The IMF has predicted a challenging year for the global economy, pointing to supply constraints affecting economic recovery in the US. Immediately after the IMF forecast, however, Washington produced better-than-expected figures for gross domestic product.

Sir Howard Davies acknowledged that it looked as though the IMF had "egg on its face", but he said: "Over the 12-month period I think the IMF will probably turn out to be correct." The US and Chinese economies, the "two big growth motors", would both slow down.

American monetary policy would probably be tightened, Davies said. He pointed to interest rates "perhaps more negative than at any time in history". Given this, it was "not a surprise that the market is moving ahead". The US Federal Reserve would have to act. He suggested that this could be "more than the market expects".

China would have slow growth of between 4 per cent and 5 per cent, he said. Although monetary policy has been loosened to offset Beijing's strict zero-Covid policy and a struggling property market, Davies said this was insufficient to reboot the economy.

HOW THE PANDEMIC HAS ENTRENCHED THE NORTH-SOUTH DIVIDE IN THE EU

How has the pandemic affected the European economy? Davies pointed out that "there has been a two-speed eurozone since the beginning" caused by the poor competitiveness of southern European countries. This had "deteriorated in the first 10 to 15 years of the eurozone's existence" because the south was unable to offset cost pressures and could not match German productivity.

In the past two years the gulf had widened, Davies said. The sectors worst affected by the Covid-19 crisis – hospitality, tourism and travel – make a bigger contribution to Greece, Italy, Portugal and Spain than they do to economies in the north.

It remains to be seen how deeply these economies have been scarred, Davies said. "It is hard to see tourism coming right back to where it was." While "people's two-week holidays will survive", he doubted that shorter trips and city breaks would reach previous levels.

COVID-19'S EFFECT ON THE UK ECONOMY? ABOUT 3 PER CENT

Asked about the long-lasting effect of the pandemic on the UK, Davies said the calculations were "tricky" and economists' views varied remarkably. Despite this, he offered an answer. He said that last November the British economy was "pretty much exactly where it had been two years before" when the annual growth rate was 1.5 per cent. Given this, he reasoned that the UK had lost about two years' growth, or 3 per cent.

From this, he concluded that although the UK had been hit, there would not be an "absolutely massive long-term impact".

THINGS TO WORRY ABOUT: A RUSSIA-UKRAINE CONFLICT, RISING INTEREST RATES, US-CHINA TENSION AND THE NORTHERN IRELAND PROTOCOL

"There are all kinds of things that could go wrong [in 2022]," said Davies. On Russia-Ukraine, he considered the probable effect of Russia's build-up of troops on the Ukrainian border. "If there is a conflict, that's going to be quite damaging for confidence. Even if there isn't a hot war, the impact on energy prices could be quite enduring," Davies said.

Germany was “heavily dependent on gas from Russia” and this reliance was made worse by the decision by Angela Merkel, the former chancellor, to close nuclear plants. That decision “looks increasingly curious in retrospect”.

Turning to interest rates, Davies said that these could rise to counter rising inflation, which may lead to unexpected events. He said that previous interest-rate rises had resulted in “strange disruptions”. “You discover that there are people who were over-leveraged and over-exposed,” he said. Such people became “casualties”.

Davies then considered the bad blood between the US and China. He said that “if it weren’t for the Russian thing, we’d probably still be talking about US-China tensions, which haven’t gone away”.

He then considered the saga of the UK’s post-Brexit relationship with the EU. “Tedious issues” such as the Northern Ireland protocol – part of the Brexit agreement signed between the UK and the EU – had become “a sort of sideshow” but these, too, had not gone away. “We have queues [of lorries] on the A20 outside the port of Dover to prove it,” he said.

WHAT HAS BEEN THE COST OF BREXIT TO THE UK AND EU ECONOMIES?

Davies was asked about UK inflation hitting a 30-year high. He said he was actually “encouraged by the revival of inflation”. Why so? “Because it may be the trigger that gets us back into a slightly more sensible relationship between savings and investment.”

WATCH OUT FOR AN INCREASE TO 2.5 PER CENT IN INTEREST RATES BY THE END OF NEXT YEAR

At one point in 2021 inflation hit a near 30-year high in the UK (and a 40-year high in the US). Central bankers talked about the rise being “transitory” as it reflected temporary issues as the global economy came out of the Covid-19 lockdowns.

Now, however, the word “transitory” has been retired, as the US Federal Reserve put it, and inflation looks as if it is here to stay. How will central banks react? How high could interest rates go? “The Fed’s ‘dot plot’ suggests that they may get to 2.5 per cent by the end of next year,” Davies said.

This is “more than the markets are expecting”, but “quite plausible”. It would probably be “a bit less” in the UK “and a bit less again in the eurozone”, he said.

THE COST-OF-LIVING CRISIS IS ABOUT TO HAPPEN – BUT IT WON’T AFFECT EVERYONE

Energy prices and inflation are rising and the UK government has pledged to go ahead with a national insurance levy to fund improved health and social care. Davies said that “on average, it looks as though real earnings are going to fall”. This would force people to “use up” their pandemic savings but not everyone would be hit.

People who live off pensions or unearned income will not be affected by the rise in national insurance, he said. Davies estimated that “there will be quite a few people in the workforce who will be able to attract significant pay rises”, notably those in the digital and technology sectors. “They won’t face real reductions.”

THE IMPACT OF POLITICAL UNCERTAINTY ON BUSINESS

Davies said his “feeling is that [Johnson’s predicament] hasn’t, curiously, had a massive impact on people”. Yes, business leaders and investors “read the papers just like everybody else but it doesn’t cause them to say: ‘Oh, Christ! We ought to stop investing.’ They regard it as a kind of soap opera which is going through an exciting phase.” If, however, this situation changes and they “see unwise, unreasonable and very political decisions being taken in economic areas” in order to divert attention from “partygate”, then opinion could change.

WILL GDP BE AFFECTED IN THE MEDIUM TO LONG TERM BY CLIMATE CHANGE AND THE TARGETS TO REDUCE EMISSIONS?

“It will be to some extent,” said Davies. While he “broadly buys the argument” that a green transition can be engineered to deliver economic benefits, he predicted that “the disruption on the way could be considerable”.

While big companies have set out how they will reduce carbon emissions (in a way they can afford), he said that a large number of small- and medium-sized companies “don’t have a plan for transitioning”. As a result, the road ahead would be “bumpy”.

DOES HOW WE ARE THINKING ABOUT THE TRANSITION TO NET ZERO MAKE YOU THINK AGAIN ABOUT PROJECTS SUCH AS A THIRD RUNWAY AT HEATHROW?

When he was chair of the Airports Commission in 2015, Davies recommended the expansion of Heathrow. Now traffic growth forecasts “have been torn up” because of the pandemic. There was a case to rethink the timing of a third runway but “in the end”, there would be a need for additional capacity. The case for a third runway “remained valid”.