Policy Dialogue - Global Outlook and Opportunities for 2020

The outlook for 2020 is ridden with uncertainties. The slowdown of global growth is expected to continue, while risks of unsustainable corporate debt levels, volatile capital flows and disrupted supply chains due to geopolitical tensions also weigh on prospects. This presents potential financial stability issues as financial institutions are already challenged by the "lower for longer" interest rates and new players such as BigTech firms. Against this backdrop, financial institutions may need to explore innovative ways to remain profitable and competitive. These include making use of emerging technologies and considering alternative markets, including sustainable finance.

Mr Arthur Yuen, JP, Deputy Chief Executive, Hong Kong Monetary Authority, invited Mr Burkhard Balz, Member of the Executive Board, Deutsche Bundesbank, to give his views on European growth prospects for 2020, and the impact of the interest rate environment.

Mr Balz pointed out that growth has slowed around the world and Europe is no exception, but there has been a decline in unemployment and fiscal easing should support economic growth in the Euro area in 2020. Euro experts forecast that the pace of economic expansion should stabilize at 1.2 to 1.3 per cent in 2021–2022, he said, but the risks surrounding this scenario are tilted to the downside, especially with the recent escalation of geopolitical tensions in the Middle East and the continuous threat of protectionism and problems in many emerging markets.

Mr Balz expects inflation in the Euro area to decline marginally from 1.2 to 1.1 per cent in 2020, mainly because of lower energy prices within the Euro area, and to increase to 1.6 per cent   in 2022 because of expected stronger economic activity, robust wage growth and rising profit margins. Against this backdrop, in December the governing council decided to maintain the current very accommodative monetary policy stance to support economic growth, but Mr Balz said the unintended side effects of this prolonged policy should not be ignored. Although this is not evident at present, pressure on bank profits may cause banks to cut back their lending, and this would counteract traditional monetary policy.

Nonetheless, a long period of low interest rates may encourage market participants to take greater risks in search of higher yields, and over time that could cause a risk to financial stability. In general, systemic risks have increased in Germany in recent years, so the German macroprudential authorities activated the so-called countercyclical capital buffer last year for the first time, and other European countries have since adopted this measure. Mr Balz believes macroprudential policy should serve as the first line of defence against financial imbalances, but we should not be overconfident about the role it can play in addressing systemic risk. In the ECB Council, there is an agreement that the present monetary stance is currently warranted to achieve price stability.

"Monetary policy has contributed to the unusually low level of interest rates, but long-term interest rates are also a reflection of nominal growth expectations," Mr Balz concluded. "If potential growth is slowing, it has a depressing impact on the real rate of return. So raising the growth potential of our economies by strengthening competition and making labour markets more flexible will pave the way for higher real interest rates."

Asked about the outlook for Asia, particularly in relation to the China–US trade conflict, and whether the signing of the phase one trade deal in two days would change the landscape, Mr Martin Raiser, Country Director for China and Mongolia, and Director for Korea, World Bank Group, said that the World Bank considers the Asian economy to be fragile, with aggregate growth in the region, excluding Japan, falling moderately from 5.8 to 5.7 per cent, largely because of reduced growth in China from 6.1 to 5.9 per cent. The rest of the region should see some stabilisation, or even some decreases in Indonesia, the Philippines and Thailand.

The backdrop to this is the continued uncertain trade environment, Mr Raiser said, which affects a strong trading region like East Asia. For trade uncertainty to be overcome, some of the underlying structural issues that are causing trade tensions have to be addressed on a permanent basis.

There is also the possibility that in places like the US, where the credit cycle has had a record run, at some point risk perceptions could change, which would have ripple effects in some emerging markets. The last few years of record low interest rates have contributed to a fourth wave of debt accumulation, leaving several countries quite exposed to such a potential change. In China, for instance, there has been a fairly rapid build-up of debt, although in the past two to three years, attempts have been made which have clearly helped to contain a further rise in leverage in the financial system.

"Everywhere around the world there is a structural decline," Mr Raiser said. "Productivity growth has declined pretty much continuously around the world, which is a cause for concern, but it also presents an opportunity." In China, for example, there is still a lot of opportunity for productivity growth by operating the economy more efficiently. Greater competition through structural reforms will help China realise that potential and the same is true for quite a lot of emerging economies.

"But on the whole, we do expect the outlook to remain fragile, with the risks tilted on the downside," he concluded.

Mr Sergey Shvetsov, First Deputy Governor of the Bank of Russia, was asked for a quick forecast on where he thought oil prices were headed. Since 1998, oil prices have been a key issue in budget forecasting for Russia, he said. The lessons from 1998, 2008 and 2014 were taken into account, and now Russia has a more sustainable budget with more conservative figures. Russia considers US$41 to be the strike price and forecasts US$55 a barrel for this year and $50 for 2021. The situation in the Middle East is the source of the rise in oil prices, but Iraq, Syria and Libya have huge capacity to increase the supply of oil on the global market. There is considerable uncertainty about the future, Mr Shvetsov said, as oil substitutes like wind and solar energy are changing prospects for oil. In five years, the price of solar electricity is expected to be lower than the price of coal, and with the increasing numbers of electric and hybrid vehicles demand for fuel will fall. However the economies of the oil producers are no longer so dependent on oil prices, because in countries like Russia, the profitability of the oil companies has been reduced by direct investments in other sectors of the economy.

What is happening in Iran will not have a big effect on oil prices, Mr Shvetsov said, because Iranian oil is not a big factor at present and can easily be replaced by other OPEC countries. If the conflict spreads to other Gulf countries, like Saudi Arabia, that would be more serious, but Mr Shvetsov does not believe this would lead to a wider problem or affect oil prices.