World Economic Forum photo

Letter From Davos, 2018

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After Xi Jinping's victory lap at last year's World Economic Forum annual meeting, it was the man whose unlikely ascension to the White House fueled the Chinese president's triumphalism in the headliner slot this year. While a surge in global growth and Donald Trump's tax policies buoyed markets and the people who move them, fears of complacency were commonplace. BMO Financial Group Vice-Chair Kevin Lynch conjures Allan Greenspan and warns against irrational exuberance.

The theme for Davos 2018 was a combination of optimism and realism: "Creating a shared future in a fractured world." President Donald Trump's last-minute decision to attend and speak added political drama, celebrity interest and a deep funk among adherents of a liberal, globalist trading order.

A surge in economic growth, synchronized across the global economy for the first time since the onset of the financial crisis a decade ago, shaped the mood at this year's World Economic Forum annual meeting to an extent that not even Trump and the forces of populism and nationalism could fully dampen. Business leaders, particularly from the United States, sounded almost euphoric as they ruminated on

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what the stimulative effects of U.S. tax reform, lighter regulation, soaring stock markets and surging economic activity would do for business prospects in 2018 and beyond.

Decrying the dangers of complacency, Christine Lagarde, head of the International Monetary Fund, repeatedly employed the metaphor attributed to John Kennedy: "The time to repair the roof is when the sun is shining." The IMF managing director warned that we are enjoying a cyclical economic burst, not a new higher growth normal, and we still face a longish list of structural growth inhibitors, economic and social vulnerabilities and geopolitical risks. These include: poor productivity and spotty innovation; excessive and growing inequality; rising protectionism and declining international coordination; financial fragilities; and growing trust deficits between the governing and the governed. Much of the discussion at Davos 2018 was about the nature and extent of the required repairs.

A parade of Western political leaders made their way to the Swiss Alps to attempt to shape these debates, unlike last year when their voices were missing in in action and cleverly supplanted by President Xi Jinping of China.

President Trump, the first American president to address the WEF since Bill Clinton in 2000, had Davos on tenterhooks all week, dominating the corridor conversations as he no doubt intended. In the end, he delivered a speech that took a victory lap for the strong American economy, broke no new ground on his international trade agenda, and declared that America First was not America alone—to considerable scepticism. His Cabinet secretaries were less publicly benign, with Treasury Secretary Steve Mnuchin appearing to talk down the U.S. dollar and Commerce Secretary Wilbur Ross appearing to talk up trade wars.

Elsewhere on the political podium at Davos, President Emmanuel Macron of France clearly won the vision and leadership award with an address that could have been titled "France is back". Macron's speech was cleverly aimed simultaneously at global investors, European partners and the French public: a renewed French economy within a renewed Europe leading the charge to renew the international liberal order. Prime Minister Theresa May of the U.K., ensnared in the Brexit labyrinth, gave a speech that only deepened feelings of doom about the path forward for the U.K. and Europe. German Chancellor Angela Merkel, still waiting for her coalition and clearly playing second fiddle to President Macron, was nonetheless a clear and strong voice against the forces of populism, nationalism, protectionism and isolationism in Europe and across the pond.

Prime Minister Justin Trudeau used his Davos speech to reaffirm Canada's leadership on the issue of gender equality, both at home and at the upcoming G7 meeting, which Canada will chair. Gender equality and women's rights were core themes at Davos this year, and Trudeau's message clearly resonated widely. At the same time, policy uncertainties around NAFTA, U.S. tax changes, trade diversification to China, pipelines and regulatory competitiveness clouded the "Canada narrative" at Davos among the international business community and investors who would otherwise be attracted to Canada's social advantages over the United States.

The Chinese presence, building on President Xi's 2017 Davos speech, which supplanted the traditional American embrace of globalization and liberalized trade, was an effective mix of tech behemoths (Alibaba, Tencent, Baidu), articulate government policy advisers, omnipresent Chinese media and a global technology leadership narrative.

So, how well did Davos 2018 succeed in tackling its stated objective of "creating a shared future in a fractured world?" Given the extent and depth of the fractures, and the absence of an immediate crisis demanding attention, it is probably not surprising that neither a clear narrative nor a common path forward emerged. However, a number of pivotal issues surfaced.

First, with respect to the accelerating global economy, there was some concern we are at risk of "irrational exuberance", to use Alan Greenspan's famous term, in the strongly optimistic business response to the surge in economic growth, which may be more cyclical than sustainable for most economies.

At Davos, the IMF revised upwards its estimates for global growth (Chart 1) to 3.9 per cent for both 2018 and 2019, signalling a broad-based and

Chart 1: UPDATED IMF FORECAST

	2017	2018	2019
Global	3.7	3.9	3.9
China	6.8	6.6	6.4
U.S.	2.3	2.7	2.5
Euro area	2.4	2.2	2.0
Canada	**3.0**	**2.3**	**2.0**
Japan	1.8	1.2	0.9
U.K.	1.7	1.5	1.5
India	6.7	7.4	7.8
Mexico	2.0	2.3	3.0
Brazil	1.1	1.9	2.1
Russia	1.8	1.7	1.5

synchronized global upswing. U.S. tax cuts are stimulative, particularly in the near term, as are monetary and fiscal policies in most countries. Euro area and U.S. growth is considerably stronger, Asian growth is continuing to be robust, and firmer oil and natural resource prices are supporting better growth prospects in commodity exporting countries. Stock markets, particularly American, are extremely buoyant, the U.S. dollar has retreated from its highs of recent years, and volatility is rock bottom.

So why *not* be exuberant? For a number of countries, Canada and the United States included, this burst in growth is mainly cyclical, and will largely close remaining output gaps that date back as far as the financial crisis and the energy price collapse. Certainly not bad news, but as economies approach capacity, stimulative demand translates more into higher inflation (and higher interest rates) than it does into stronger growth, and the economy's growth rate moves back towards its potential or structural growth path. In the case of Canada this potential growth path is lower than current growth, likely well below 2 per cent, due to anemic productivity performance and shrinking labour force growth. Reflecting this, the IMF forecast shows Canada down-shifting from 3 per cent growth last year, best in the G7, to 2 per cent growth next year.

Hence the caution on breaking out the bubbly until countries tackle the "roof repairs" Christine Lagarde warned about—poor productivity, weak innovation, inclusiveness gaps, financial vulnerabilities and risks to the global trading system.

Second, on the international trade front, how do countries wanting to sustain the rules-based multilateral trading system respond to the U.S. Administration's apparent cult of trade victimhood? This narrative combines a mantra that the U.S. has been hoodwinked in every multilateral and regional trade agreement it has signed, and a seeming world view that bilateral agreements where the U.S. can exert maximum leverage is the way forward for us all.

U.S. Commerce Secretary Wilbur Ross certainly set a certain tone for how a U.S. administration with an avowedly America First policy prism sees the past, present and future of trade. His view of China's pro-globalization stance: "They are good at free trade rhetoric but not free trade actions." His view of existing American trade agreements: "There is an accumulated pile of debris from previous U.S. trade policies and agreements that need to be dealt with." His view of multilateral trade agreements: "We prefer bilateral agreements which are more efficient to negotiate." Not surprisingly, many others did not find common ground with these views.

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Canada's Foreign Affairs Minister Chrystia Freeland made a strong pitch that NAFTA has served all three countries very well, it can and should be modernized, and all countries have to shore up public support for free trade, which is why Canada is pushing a "progressive trade agenda." Her Mexican counterpart, Secretary of Commerce Ildefonso Guajardo Villarreal, was equally strong in his defence of NAFTA, took issue with Canada's progressive trade agenda, arguing that you cannot ask trade agreements to solve domestic social issues, and posed the rhetorical question to Ross that, if trade agreements are responsible for American trade deficits, how can he explain that America's largest trade deficit of $350 billion is with China, a country with which the U.S. does not have a trade agreement. On various Davos panels, American business CEOs spoke favourably about NAFTA from their perspectives and cautioned that the way to modernize NAFTA is not by ripping it up.

Third, there is a growing "techlash" towards technology behemoths such as Facebook, Google, Amazon, Twitter and others, driven by concerns about their dominant market positions and their control over enormous amounts of personal information and how they use it. This shift in mood against big tech was quite evident at Davos this year, with several prominent speakers advancing the analogies to "big oil" and "big tobacco", neither of which big tech is accustomed to being compared to.

Europe is clearly leading the charge on both the tech competition and data usage fronts, for a variety of reasons including an absence of homegrown global tech players. China is clearly at the other end of the spectrum, with few data privacy or usage regulations and a clear strategy that data can become a Chinese advantage in the global competition to dominate AI and machine learning. The U.S. is somewhere in between these two positions, sharing with China the dominant global tech titans but facing growing consumer concerns about how their personal data is being used and who should profit from it. The U.S. is very wary of Chinese strategic tech intentions and very anxious about cyber security risks, concerns that were common to all countries, with the financial sector from a number of advanced economies debating whether to consider new cybersecurity partnerships with government.

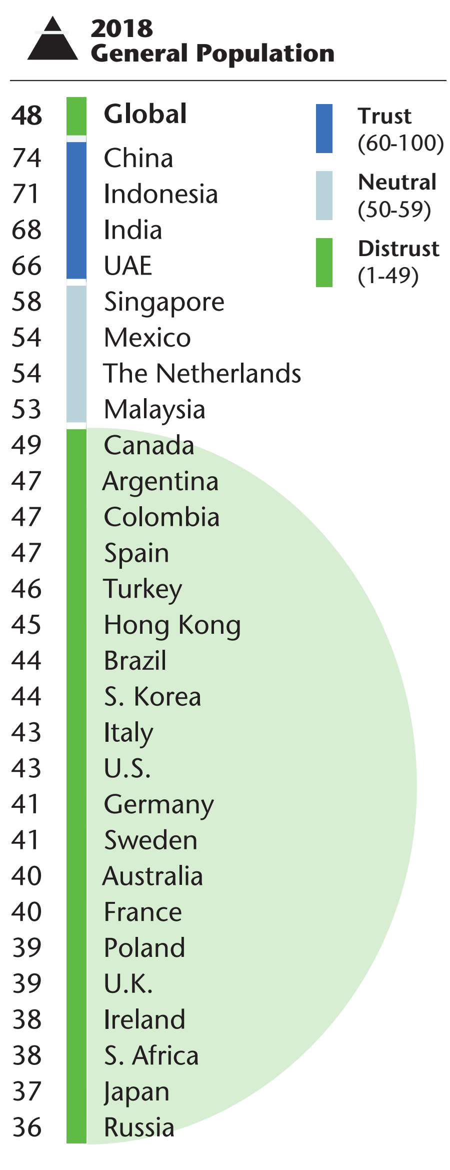
Another aspect of the myriad tech talks at Davos focused on how to respond to the public's growing angst about the impacts of massive technological change on work and society. Future jobs yet to be created are unclear while the risk to existing jobs is only too clear. Anecdotally, there is a growing realization of the magnitude of the jobs at risk, with Amazon's recent cashier-less checkout putting, potentially, the 3.5 million cashier jobs in the United States at risk just as the advent of autonomous trucks places the almost 5 million long distance U.S. truck drivers at risk.

How do individuals reinvent themselves for the new world of work? How do societies retrain and reskill huge swaths of the workforce? What are the respective roles of government, business, educational institutions and individuals in all this? Will governments attempt to protect jobs or people in this transition? Should countries respond to concerns about the ethics of algorithms or the values embedded in a technology-driven society, and if so, how? More questions than answers, but the intensity of the public and political discussions around these issues is heating up.

Fourth, trust, or the lack there of, was a constant theme at Davos this year. To provide some quantitative context, Edelman released at Davos its 2018 Global Trust Barometer (Chart 2), which surveys trust in some 25 countries with a focus on the general population's trust in the core institutions of government, business, media and civil society (NGOs).

The results point to trust deficits (less than 50 per cent of the general population expressing trust in the four core institutions) in a majority of countries including Canada. Among these trust deficit countries, the U.S. experienced a "staggering lack of faith in government" according to Richard Edelman. For the first time, media is the least trusted institution globally and interestingly this is driven by a sharp drop in trust in platforms and by a sharp rise in concerns about fake news. On the business side, there was a significant uptick in trust-ability and heightened expectations: business is now expected to be an agent of change instead of waiting for government. If there was an emerging consensus at Davos, it was that excessive and rising inequality is not only a driver of growing distrust, but also a key risk to sustained growth over the medium term.

Chart 2: 2018 TRUST BAROMETER



For Canada, there were mixed messages. Companies headquartered in Canada were the most trusted across the 25 countries surveyed. However, Canada was among the countries experiencing overall trust deficits, with government (46 per cent), business (49 per cent), media (49 per cent) and NGOs (50 per cent) taken together garnering the trust of less than 50 per cent of Canadians according to the 2018 Edelman Trust Barometer.

In summary, Davos 2018 was a good reflection of the conflicting forces at play in today's fractured world. On the one hand, economic growth is unexpectedly strong, unemployment rates are at lows not seen in decades, stock markets are booming, interest rates remain below any definition of normal, and technology firms are churning out mind-bending new gadgets. At the same time, the rising geopolitical risks and growing trust deficits are daunting. Ian Bremmer, CEO of the Eurasia Group, characterized these imbalances as: "Let's be honest: 2018 doesn't feel very good. Yes, markets are soaring and the economy isn't bad, but citizens are divided, governments aren't doing much governing, and the global order is unravelling."

Global order requires establishing and enforcing clear rules of the game for how globalization will work in a highly interconnected, multipolar world that is in the midst of a technological revolution. The Washington Consensus, which provided that framework for many years in a very different global context, is no more. If a new consensus is to be found, will it be driven by reinvigorated Western leadership (a Paris consensus?), by the new worldview of China (a Beijing consensus?) or from elsewhere? Hopefully, next year's Davos will shed more light on where common ground is to be found. P

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