

# G20 to the rescue of globalization

June 10, 2019

- **The ministerial G20 meetings took place this weekend in Tokyo, Japan**
- **Current nationalist geopolitics are reducing the pace of globalization that technological change has been nurturing, potentially fostering a global recession, that could be mitigated or postponed by appropriate policy responses**
- **In our view, this will be the most important G20 meeting since 2008 when the group was first created, as global coordination is needed again**

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**The ministerial G20 meeting.** Finance ministers and central bank governors of the twenty largest economies in the world attended the G20 ministerial meetings this past weekend in Tokyo, Japan. The main objective of these meetings is to prepare the agenda for the G20 presidential annual meeting that will be held at the end of the month in Osaka, Japan (June 28<sup>th</sup>-29<sup>th</sup>). The G20 country members account for 86% of global GDP (please see Table 1 below). It is worth noting that this will be the G20 fourteenth annual meeting, following the one held last year in Buenos Aires. Next year, Saudi Arabia will be leading the G20. In our view, this will probably be the most important G20 meeting since 2008, when the group was first created, as global coordination is needed again. A Banorte delegation attended the meetings.

**Table 1. G20 GDP**  
% of world and G20 nominal GDP

|                 | % of World  | % of G20     |
|-----------------|-------------|--------------|
| <b>G20</b>      | <b>85.8</b> | <b>100.0</b> |
| United States   | 24.5        | 28.5         |
| China           | 16.3        | 19.0         |
| European Union* | 7.5         | 8.8          |
| Japan           | 5.9         | 6.9          |
| Germany         | 4.5         | 5.3          |
| India           | 3.4         | 4.0          |
| United Kingdom  | 3.2         | 3.8          |
| France          | 3.2         | 3.7          |
| Italy           | 2.3         | 2.7          |
| Brazil          | 2.2         | 2.6          |
| Canada          | 2.0         | 2.3          |
| South Korea     | 1.9         | 2.2          |
| Russia          | 1.8         | 2.1          |
| Australia       | 1.6         | 1.9          |
| Mexico          | 1.4         | 1.7          |
| Indonesia       | 1.3         | 1.5          |
| Saudi Arabia    | 0.9         | 1.0          |
| Turkey          | 0.8         | 0.9          |
| Argentina       | 0.5         | 0.6          |
| South Africa    | 0.4         | 0.5          |

Source: Banorte with data from the IMF (2019e)  
\*Excluding Germany, United Kingdom, France, and Italy to avoid double accounting

**The G20 is focused on six topics.** In our view, the G20 attendees were focused in six major topics. Three based upon the current state of things, and three taking into account more structural issues: (1) Current heightened geopolitical issues; (2) economic deceleration; (3) policy response; as well as (4) technological change and inclusive growth; (5) how demographic dynamics are shaping growth; and (6) the importance of ESG (Environmental and Social Governance) at all levels (as it is shown in Table 2, below).

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In this context, the relationship among the aforementioned factors is that current nationalist geopolitics –brought up mainly due to the lack of inclusive growth and demographic dynamics–, are reducing the pace of globalization that technological change has been nurturing, potentially fostering a global recession that could be mitigated or postponed by appropriate policy response and ESG.

**Table 2. Current focus of the G20**

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|                                   |   |
|-----------------------------------|---|
| <i>Current state of the world</i> |   |
| 1                                 | Geopolitics                               |
| 2                                 | Economic deceleration                     |
| 3                                 | Policy response                           |
| <i>Long term</i>                  |   |
| 4                                 | Technological change and inclusive growth |
| 5                                 | Demographics                              |
| 6                                 | ESG                                       |

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Source: Banorte

**Tougher geopolitics arising in the U.S.** After the midterm elections in the U.S. back in November, it seemed that the incentives for U.S. President Trump shifted to a more conciliatory stance, rather than the aggressiveness that characterized his anti-migration and anti-trade rhetoric. We experienced a less belligerent stance for some time. Unfortunately, this changed right after President Trump decided to stand up from the negotiating table with China a few weeks ago, and now even more with the tariff threat on all Mexican imports. Although for the time being this last issue has been settled, the risks associated with these threats has shifted other countries’ perception on how to deal agreements with the U.S. The issue that we noted was most discussed in the ministerial G20 meetings about this was how president Trump dared to use trade tools to tackle immigration issues. Moreover, the other discussion was about the rationale behind this unexpected turn and what could be the outcome.

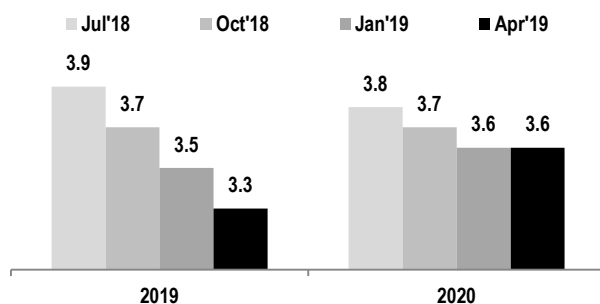
**Economic rationale or fear.** The discussions that took place in the ministerial G20 meetings about President Trump’s unexpected stance were in two fronts. One the one hand, appealing to economic rationale, after suspending the tariff imposition on Mexican imports, the hostile stance towards China trade negotiations could end at the G20 meeting by the end of the month, particularly as this meeting would take place after June 18<sup>th</sup>, when president Trump intends to announce his reelection campaign in the U.S. This would fulfill two objectives: (1) Attract the attention of the more conservative U.S. citizens, particularly in the Midwest; and (2) avoid an early recession. However, the other set of discussions in Tokyo were more in the front of President Trump using ‘the fear factor’ to win 2020 election. The idea behind this is that old conventional wisdom on politics says that during a major conflict Americans would be more willing to continue with a presidential leader regardless of their particular political preferences. If this is the case, then triggering an earlier recession –even during the reelection campaign–, is no longer an issue, politics would replace any economic rationale. For the time being, tariffs on Mexican imports did not materialize, although uncertainty prevails about new threats, coupling to the concerns of a world that could experience a full-blown trade war between the U.S. and China. We consider as feasible a scenario where hostilities would cease towards the end of month.

**A full-blown trade war could end up bringing forward a global recession.**

What nobody doubts is that an open trade war between China and the U.S. would not only clear any ambiguity about experiencing a global recession at some point but would bring it forward to have it as soon as this year. As we have mentioned earlier, the expansionary phase of global cycles has lasted around five years on average since the 60's. We are now observing the ninth year of global economic expansion. In this context, market participants have been quite concerned in the past few years that a recession could hit the world, just because of the statistical concurrence.

**IMF global growth forecasts**

% yoy, bi-weekly frequency



Source: IMF

**IMF growth forecasts**

% yoy

|                           | 2018       | 2019       | 2020       |
|---------------------------|------------|------------|------------|
| <b>Global</b>             | <b>3.6</b> | <b>3.3</b> | <b>3.6</b> |
| <b>Advanced economies</b> | <b>2.2</b> | <b>1.8</b> | <b>1.7</b> |
| United States             | 2.9        | 2.3        | 1.9        |
| Eurozone                  | 1.8        | 1.3        | 1.5        |
| Germany                   | 1.5        | 0.8        | 1.4        |
| France                    | 1.5        | 1.3        | 1.4        |
| Italy                     | 0.9        | 0.1        | 0.9        |
| United Kingdom            | 1.4        | 1.2        | 1.4        |
| Japan                     | 0.8        | 1          | 0.5        |
| <b>Emerging markets</b>   | <b>4.5</b> | <b>4.4</b> | <b>4.8</b> |
| China                     | 6.6        | 6.3        | 6.1        |
| Brazil                    | 1.1        | 2.1        | 2.5        |
| Mexico                    | 2          | 1.6        | 1.9        |

Source: IMF WEO April 2019

**The current landscape requires a timely but prudent policy response.**

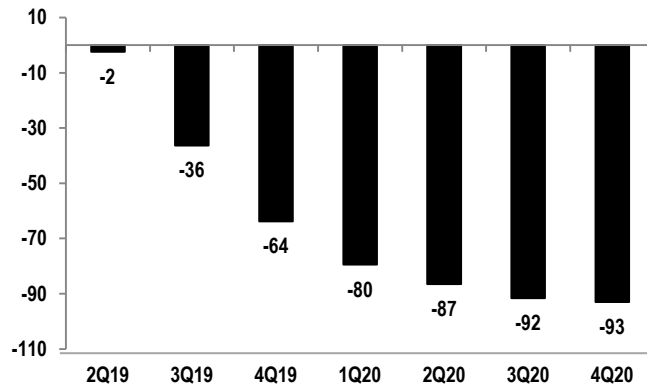
One of the key discussions among the participants gathered this year in Japan was centered on the policy response from governments and central banks. On one hand, it was acknowledged that the world is in a better shape *vis-à-vis* 10 years ago when the great crisis of 2008/2009 took place. Under this assessment we should think about the strong likelihood of a timely countercyclical policy implementation to tackle the headwinds to the global economy. However, on the other hand, policy makers are more constrained than before given the current levels of interest rates and indebtedness, suggesting the need of a more strategic and prudent approach when using their policy tools. Overall, the actual landscape grants them with enough time to respond to a challenging outlook, but with a limited room to maneuver.

**A dovish monetary stance.**

In terms of monetary policy, central banks have shifted to a more dovish rhetoric this year. It is important to bear in mind that the Federal Reserve hiked the Fed funds rate by 100bps last year, with the latest rate increase in December. In contrast, as of today (6 months later) the market is pricing in 64bps of implied rate cuts for the remainder of this year and a total of 87bps in a 12-month horizon. There is a strong debate about this scenario between investors, recognizing that Fed's response will be conditioned by the degree of the protectionist measures from President Trump and their effect on the economy and inflation. Other major central banks have more arguments to ease monetary conditions but with less leeway, this is the case for the ECB and BoJ. Geopolitical risks are also undermining economic activity and confidence in the United Kingdom (*e.g.* Brexit), resulting in a more dovish tilt from the BoE.

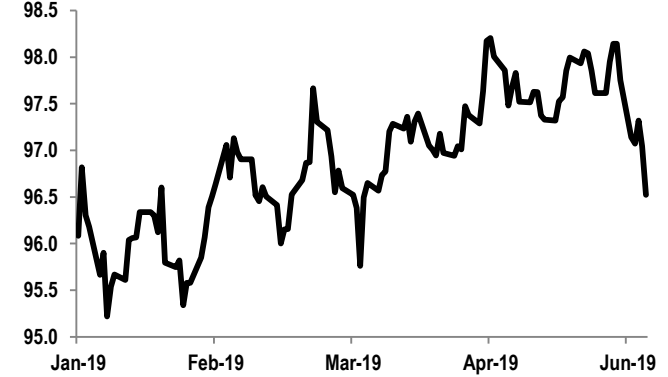
Some other central banks in advanced economies have already started cutting rates, such as New Zealand and Australia. When analyzing the EM spectrum, central banks are also depicting a dovish bias. Overall the better economic stance of the U.S. compared to other G20 and spread of interest rates have resulted in a USD recovery in a year-to-date basis. Most of participants concurred that the market is overly optimistic with its pricing of rate cuts for the Federal Reserve. Moreover, they are aware of better growth dynamics in the U.S. relative to most of the G20 countries. These two arguments support the idea of a USD additional relief rally in 2H19.

**Cumulative implied movements in Fed Funds rate**  
Basis points, using interest rates futures



Source: Banorte with data from Bloomberg

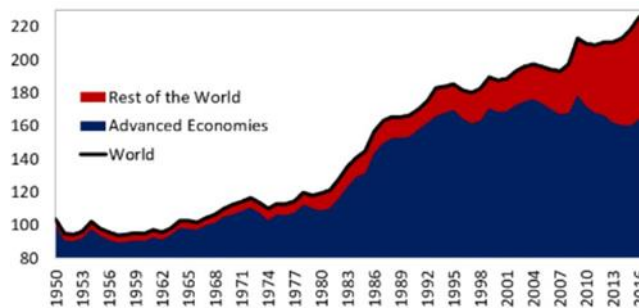
**DXY Index**



Source: Banorte with data from Bloomberg

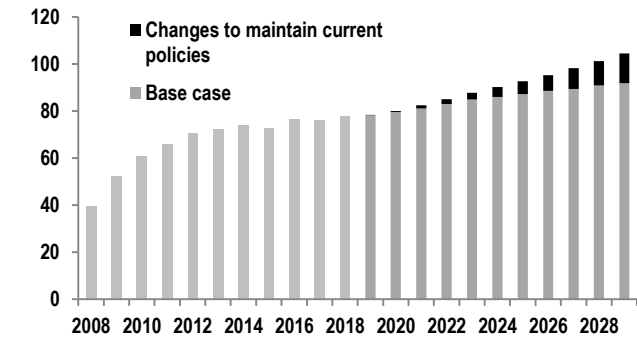
**Limited potential fiscal response.** Regarding fiscal policy, current debt levels are reducing the governments’ capacity to implement counter-cyclical measures. This was one of the main concerns stressed out during the meetings and is seen as a systemic mid-term risk. This situation also bedevils any coordinated policy response if the global economy decelerated in a stronger way under tougher trade conditions given the current disputes between the U.S. and the rest of the world.

**Contributions to global debt**  
% of GDP (weighted average)



Source: IMF “New Data on Global Debt”

**U.S.: Debt held by the public**  
% of GDP



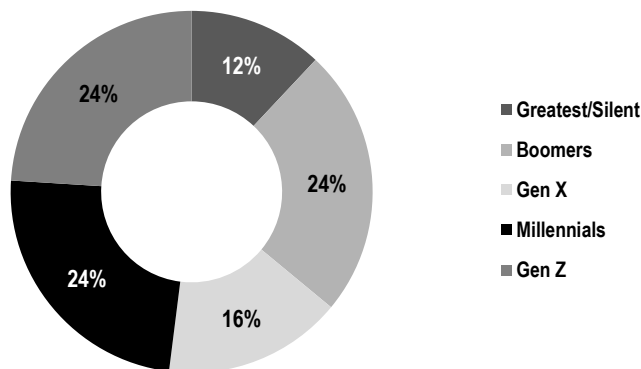
Source: CBO

**Tech, fintechs, and data.** A longer-term topic that has been in the agenda of the global events (e.g. World Economic Forum, IMF, G20) is how the increasingly fast technological change is shaping the world. This time, the discussions that predominated were more in the sense of financial institutions, rather than on its impact in short-term unemployment or other also interesting topics.

Financial institutions are heavily regulated. This has been one of the reasons why it has been said that small startups had and will probably struggle for some time, particularly in terms of credit, more than systems of payment. However, more and more we are hearing that financial institutions will change and grow into tech ecosystems, similar to the Apple Store model. A bank will probably sell products from other financial institutions via its own channels and selling its own products through other financial institutions' channels. This is not new. However, we have not heard this in such an open way for financial institutions. Moreover, data usage, management, storage, and security continues to be the most pressing issue. In fact, this is the first time we hear about the potential creation of a 'data central bank', in which blockchain technology could be used to enhance a digital identity system.

**Demographics shaping a new world.** Investors have been increasing their concerns about the demographic changes worldwide, as they represent a headwind for public policies and corporate strategies, but also a good business opportunity. Demographics have also played a key role in migration, one of the toughest topics in the international agenda nowadays. From the policy perspective the question among investors is the degree of preparation and understanding of governments, especially in aging population regions such as Europe and Japan. Another concern is finding a longstanding solution to the migratory phenomenon without interfering with other spheres in the political spectrum (such as trade disputes today). From the bankers' standpoint, demographics require a change in business plans, taking into account that nearly 50% of the world's population is either in the millennial or the Gen-Z cohort. The combined technological and demographic forces can be disruptive for the traditional financial industry but can foster new business opportunities. In China, for example, the young population is keen to experience new things, increasing the success of fintech firms in terms of new payment systems, cash management and even online lending. This new business model has been observed in other countries with similar demographic conditions, as innovation and digitalization has reshaped transactions.

**Population by generation**  
%



Source: Nielsen

**Financial institutions eager for increasing sustainable practices.** The financial industry has been experiencing a deep transformation in terms of ESG policies in order to tackle the challenges of today with a more sustainable approach. The relevance of an ESG driven strategy has been analyzed with two different dimensions. First, investors and shareholders have been increasing their exposure in sustainable-driven assets as part of their increasing commitment towards social and environmental practices. Second, the client base that demands ESG practices has increased considerably, showing a new consumption behavior. According to participants, the success of ESG within the organization also depends on the degree of involvement of employees. This is why business models need an holistic viewpoint.

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|                  |  |
|------------------|--|
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