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As part of the *Café Insights* series of interviews with insightful speakers, The Insight Bureau recently caught-up with Simon Baptist, Global Chief Economist for the Economist Intelligence Unit. I asked him about the state of the world economy and what we should expect from the rest of 2023.

[Link to audio recording]

Andrew Vine Hello, I'm Andrew Vine, and this is Café Insights. I'm the founder and CEO of The Insight Bureau, an agency representing top-level professional speakers. And this is a series of conversations that I have with individuals from the network, and today it's my great pleasure to be in conversation with Simon Baptist from The Economist Group.

Simon Baptist Hi, Andrew.

AV Hi. Well, it's great to actually see you. I know we do so much work together and we live in the same city-state, but we haven't really seen much of each other very recently, have we?

SB Yes, a disruptive couple of years.

AV I know, I know. Well, Simon, you are the Global Chief Economist for Economist Intelligence. What people will stop and wonder is, "well, hang on, The Economist is based in London, but you're the Global Chief Economist and you're based here." So how does that work? Tell us a little bit about your role.

SB So yes, how does the EIU's Chief Economist end up being in Singapore? Like a lot of things in the world, there's a little bit of strategy and a little bit of 'things just happened'. On the strategic side, of course, for The Economist and the EIU, like many companies, Asia is more and more central over the years. It's not only just a growth market, it's a big source of business, and for us, I mean Japan and China are two of our top five countries globally for our client base. And so over the years, our business has moved here, but we've been very UK- and US-centric in terms of our employee base. So we wanted to move more senior people out here. I originally came out actually in a local job or an Asia-based job and was running the region. And then when I got promotion to being chief economist and editorial director the company went, "You know what? There's a lot of benefits for us in having that position there. You don't need to move back to London if you don't want to." And I jumped at the chance not to move back to London.

AV Of course, I worked at The Economist for 13 years as well. I left in 2006. There was a reasonable presence in Asia, but nothing like it is today, and your second biggest office in the world is in India now.

SB That's right. The second biggest.

AV And Japan's grown and Singapore has grown too …

SB ..and China has been our biggest growth market.

AV Yes, of course. Well, look, as Global Chief Economist, I've got to ask you: What's the state of the world right now? I think many of us -- and many people in business -- used to feel that they were pretty good amateur economists, and actually, it was the economics that mattered, not the geopolitics, but life's got a little bit more complicated I think in the last few years, and even more so in the last couple of years. So, give us a feel of what the big movers and shakers are in terms of what's driving things right now around the world. What are the key things?

SB Look, Andrew, I think the global economy is probably not as bad as you think it is or not as bad as your listeners think it is. The mood music has been really negative for the last few months, but actually, quite a few good things have happened. If we think back to November 2022, when expectations were at their low point, we were all expecting zero-COVID in China to go on for at least another 12 months, or for the foreseeable. We were staring down the barrel of a gas crisis in Europe and German industry shutting down, and there were a lot of deep recession calls, including from us at the EIU. But then what happened is China had its surprise, shocking reopening, the European winter was really warm and so there was not a gas crisis, and those two things have really bumped up the growth outlook. If we look at where we at the EIU are at now as compared to in November, our growth forecasts are 25% higher. And we've just upgraded the US two weeks ago. We upgraded Europe about two months ago. And it's not a boom year. We're still at global growth about 2%, whereas 3% would be feeling more comfortable. But hey, 2% is a long way from zero. And so the mood music especially in business confidence, I think, is a lot weaker than the fundamentals. Certainly, our real economy forecasts are pretty solid.

AV Yes. And in particular, inflation has been the big worry for organisations. And we were beginning to get the narrative that the measures taken with interest rates has actually done its job. Is that correct, though, to make that assumption so early?

SB Yeah, I think inflation is falling, but slowly. And we would all love it to fall faster. Commodity prices are down a lot from the post-invasion peaks. And we are going to see a lot of jumping around in the year-on-year inflation numbers through March, April, May, as the 12-month-ago impact of the Ukraine invasion starts to fall out of the annual comparisons. So, inflation will ease over the year, but it probably will be November/December in most economies before, on a sequential basis, like month-on-month equivalents, it's getting back to what central banks are comfortable with.

AV Now, in your role as well, you lead the Asia business for The Economist Intelligence Unit. What about Asia in particular? I mean, you touched already on China, which is a good story, but how are we seeing that relative to the world economy?

SB Asia's still growing faster than the world, has been for a while, and then will continue to do so for a long time. Eventually, we'll probably get overtaken by sub-Saharan Africa as the growth hot spot, but that's probably a decade or more away from where we sit today. Asia in 2023, really, it's dominated by China's reopening. China is the biggest trading partner, biggest investment partner for most countries in the region. China had a hideous 2022 with its lockdown policies, and that reopening is going to lead to a big rebound in Chinese growth. But it's not going to be a permanent one. China's not a high-growth economy anymore. That era is over. We'll get a bounce back this year, but let's put China's bounce back in perspective. It will grow by 5 and a half to 6 percent, but Australia, when it had its reopening year, grew by 7 or 8 percent. And so China's bounce back is smaller than you'd expect for an economy with that growth potential. And there's a lot of headwinds: productivity, international geopolitics, investment trends, demographics, and they're biting now, being covered up by the COVID rebound, but through the rest of the decade, we'll see China's growth slowing. That'll be a big story for Asia, alongside India, and Indonesia we're going to see more often at the top of the growth leaderboard. When we look at the G20, they will be on the top more often than not over the next decade.

AV I was going to ask you, I mean, has there been a general diversification of assets or interests with corporates as they see China kind of well, not stall but I mean, slow down significantly?

SB There has been a lot of diversification, and it's now starting to be real. And we've been talking about it for a while. It's been talked about by companies in boardrooms as something that should be discussed, but maybe action hasn't been taken, and now investment decisions are being made. I've spoken to specific clients who are asking the EIU questions like, "I want to move my factory from China because it's too risky being subject to tariffs in the US. Where should I put it? Thailand? Malaysia? Mexico?" These are the kind of questions that are getting asked. And there is more diversification, and that's about protecting yourself from some of the geopolitics. And they feel it in China too. I was in China two weeks ago. My first trip back, the experience of being the only foreigner in the queue at Beijing airport, so visitors are not back. At least, they weren't two weeks ago. And the mood there is quite subdued. You'd think they'd be celebrating the end of zero-COVID, which, of course, it's been such a hideous personal time for people living in China as well. So, the end of that is something to celebrate, but the business mood is apprehensive because it's hard to get FDI. It's hard to do outbound. Everyone's talking about Taiwan and Ukraine, and they're worried about government policy flip-flopping. We've had big flip-flops on COVID policy, on approach to the property sector. It's on, it's off. The tech sector crackdown's on, it's off. It's on, it's off. And so there's a lot of apprehension and lack of confidence about future investments and where growth will come from.

AV We were talking about India just earlier as well. I mean, how do you see India?

SB India's in an inflection point, and there's some elements that are driving it. I mean, one is it's a beneficiary from the post-COVID working trends. Jobs that can be done from anywhere, well, India is a great location for those kinds of jobs because it's got a good time zone, it's got a well-educated workforce, and it's cost effective. And the idea that your CFO could be in India and not in HQ in Europe or the US would have been laughable in 2019. Now it's highly plausible. And so it's benefited from that move. And India has actually gotten better as a place to do business. I've got my criticisms of what the Modi government does and doesn't do in many areas, but to give it its credit, you have to say it has improved the business environment in a meaningful way. And in many areas over the next five years, according to the EIU's business environment rankings, India is going to score more highly than China on things like regulations around foreign trade and investment, around support given to the private sector. It will lag behind on infrastructure compared to China, but it's meaningfully overtaking or closing the gap. And over the long run, what drives investment and business confidence is the long, slow slog of improving the policy environment for firms, and a bit of that has been done. I think enough has been done that we'll see a change in India's investment.

AV Yeah, and talking about business confidence, of course, The Economist Intelligence Unit has The Economist's Intelligence Corporate Network as part of its offering, which is very intimate. I used to work in that side of the business as well, where senior executives get to not only hear and read what you're thinking but actually discuss it amongst their peers. How is business confidence and sentiment at the moment in Asia?

SB Yes, just back from two and a half weeks on the road, seven different cities, meeting our corporate network clients and sharing [in?] what we think is going on and getting the pulse of what they're looking at. I mean, I mentioned China before. So, the mood there, quite subdued even though you'd think they should be super happy. There's more positivity in Hong Kong. It also had a very difficult lockdown, and I think the Hong Kong mentality is a bit more raw capitalism - go get it - than you see on the mainland. And so they're ready and excited to take the opportunities from their rebound. There's a lot of thinking about supply chain relocations and the opportunities and the risks that's posing for firms in the region. For example, in Seoul, they are cautiously optimistic about how these changes in supply chains, especially semiconductors, but also electric vehicles, can help their economy. They've got, to be fair, a great track record of being able to correctly identify and jump on the right investment trends and what sectors are going to take off. So South Korean firms are kind of looking with a little bit of excitement and also an understanding that, "We need to adapt to this stuff or we won't be successful."

AV Well, you mentioned sectors. I was going to ask you this because, obviously, you looked at a number of key industries, obviously financial services and healthcare and tech and energy, [whether they were?] winner or losers perhaps in this scenario. I mean, how would you see various sectoral development?

SB Right, the question in my mind is financial services … For the record … [laughter]

AV ... it's 22nd of March …

SB … yes, let's see what happens in a few days' time. But yes, the banking sector is clearly under a lot of stress. Now, it's an interesting dynamic because for many banks, higher interest rates are a net positive because it improves their interest income. And so for retail banks, it's generally a plus. The challenge that is being revealed at the moment is that balance sheets were not robust enough for high interest rates. And in a sense, this does look like a corporate governance failure on the part of institutions and then also maybe regulators because interest rates have gone up a lot. But 12 months ago, we were talking about interest rates going up, and they may have gone up by more than expected but if your balance sheet as a bank wasn't ready for that, I think that was an avoidable error, especially when your bank's whole business model is about profiting from a mismatch in assets and liabilities. There will always be a mismatch, but they are supposed to be the systems to regulate that. And I think it means that we're going to see, like after 2009, a further tightening in regulation. I think that will come in the financial sector. The other element in finance that's interesting is the slight breakdown in the ease of moving capital across borders. And we obviously have Russia, but other places like China, as well, looking to diversify away from the US dollar. And it is getting harder for financial institutions to operate across borders. And that's going to be a loss of scale, again, which we did also see after 2009, but I think those trends will move fast. COVID showed us that regulators and governments, in a sense, are ready to jump on opportunities to increase the scope of government. And with the wounds of 2009 being not that long ago, I think we'll see more action ahead of the curve this time.

AV I mean, some sectors like tech were also booming during the COVID time, and obviously, there's been quite high-profile layoffs and contractions and no one can possibly replicate what they were doing before. How is the tech sector kind of managing this, do you think?

SB Tech is the extreme case of the adjustment to higher costs of capital. So, you have higher interest rates, cost of capital is more expensive, so that means the pressure to show returns is then higher. And when I can get 6% in some bond somewhere or 9 or 10 percent in a one-year-term deposit account in a bank, then the hurdle to put my money into something that won't pay off for a while is obviously a lot higher. And so a lot of your stupid money that had been flowing into tech, get funding for anything from anywhere, see, that has faded or that's gone and there's been a lot of withdrawal of capital after that. But the fundamentals of the sector as something that will drive the economy for the next decades are still totally there. All the public money is going into very specific tech bets: electric vehicles, batteries, semiconductors. They are the three key things that are getting a lot of money from China, from the US, from Japan, and even a bit from Europe.

AV AV: And I suppose other things like AI and other things that are enabling businesses to transform.

SB Yes, and everyone knows this is what will be driving growth in the future. And one of the great economic questions for the next decade is will China's state-led approach of trying to develop, for example, a semiconductor industry or an unbeatable lead in battery technologies, can they do it without the kind of competition and enterprise environment and freedom of speech and freedom of thought that you have in the US? And economic theories that we all learn at high school, at least in the West, would tell us that the US system is the way to get innovation to happen, and we'll really see how true that is, if China can replicate that with a state-led approach.

AV And the other area that I thought I should touch on because I know this is something you've looked at and studied quite a lot is around environments and sustainability. You've been following what's happening with COP quite closely and reporting on that. I'm just wondering whether some of the steam has kind of come out of this with what's going on just recently in world affairs.

SB The area where I'm watching sustainability a lot is in regulation because regulation is a long, long way behind where it needs to be globally. And governments have now come out with various goals. I mean, essentially everyone's got some form of net zero by mid to late century, some definition. Every economy around the world, by and large, has that now, but the policies to get there are nowhere near implemented. The EU is perhaps the only exception where policy settings are probably just about right. The rest of the world, absolutely not. And so it's either going to happen that we're going to have a very rapid tightening of policy over the coming decade or two or we'll have to give up on the goals and accept a lot more climate change and then a lot more adaptation investment as a result. For me, that's the key issue. And I think in some ways, the ESG focus has been a bit-- I'm not sure it's been unhelpful, but it's been a slight distraction in that voluntary action by individuals and companies will never get you there. It has to be done through tax and regulation that's applied universally. And until we get that, action is just not going to be sufficient.

AV Yes. Well, I was just thinking as we look forward to 2023, the second half of the year, you've already hinted that you're much more positive about the way things are going to develop. Not everybody is. What keeps you awake as an economist thinking about what could go wrong with 2023?

SB I mean, looking towards the end of the year or early 2024, there is still clouds of recession on the horizon with the high interest rates that will have an impact on consumption and investment. So, we've delayed when we're worried about recession from now to 6/12 months' time, but that risk is still very much there. There's still a lot of risk militarily around the world. Ukraine, obviously, could get better, could get worse, either way. Very worried about Taiwan and conflict in the East and South China Seas. Not our core forecast, but it's a risk that would have very high consequences and is plausible enough that we should be worried about it. Climate risks will be increasing up the agenda, so more droughts and floods and other climatic events affecting harvests, and that could cause another big spike in inflation and food prices. And then finally, financial stability, and how the world adapts to higher interest rates. And this is partly about the banking system, but it's also about markets and about firm-level investment and how a more permanent, higher cost of capital can we get to a new equilibrium without disruptive events.

AV Terrific. Very good to see you again, Simon. Thank you very much for spending some time with me.

SB Right. Good to chat.

AV Okay. Take care.

Simon Baptist is the global Chief Economist at the EIU, based in Singapore. He is responsible for providing intellectual leadership for the EIU's macro coverage and ensuring that economic and political analysis and forecasts are the best available for international decision-makers. He is responsible for managing a global team of economists and editors in Beijing, Hong Kong, London, New York and Singapore.

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