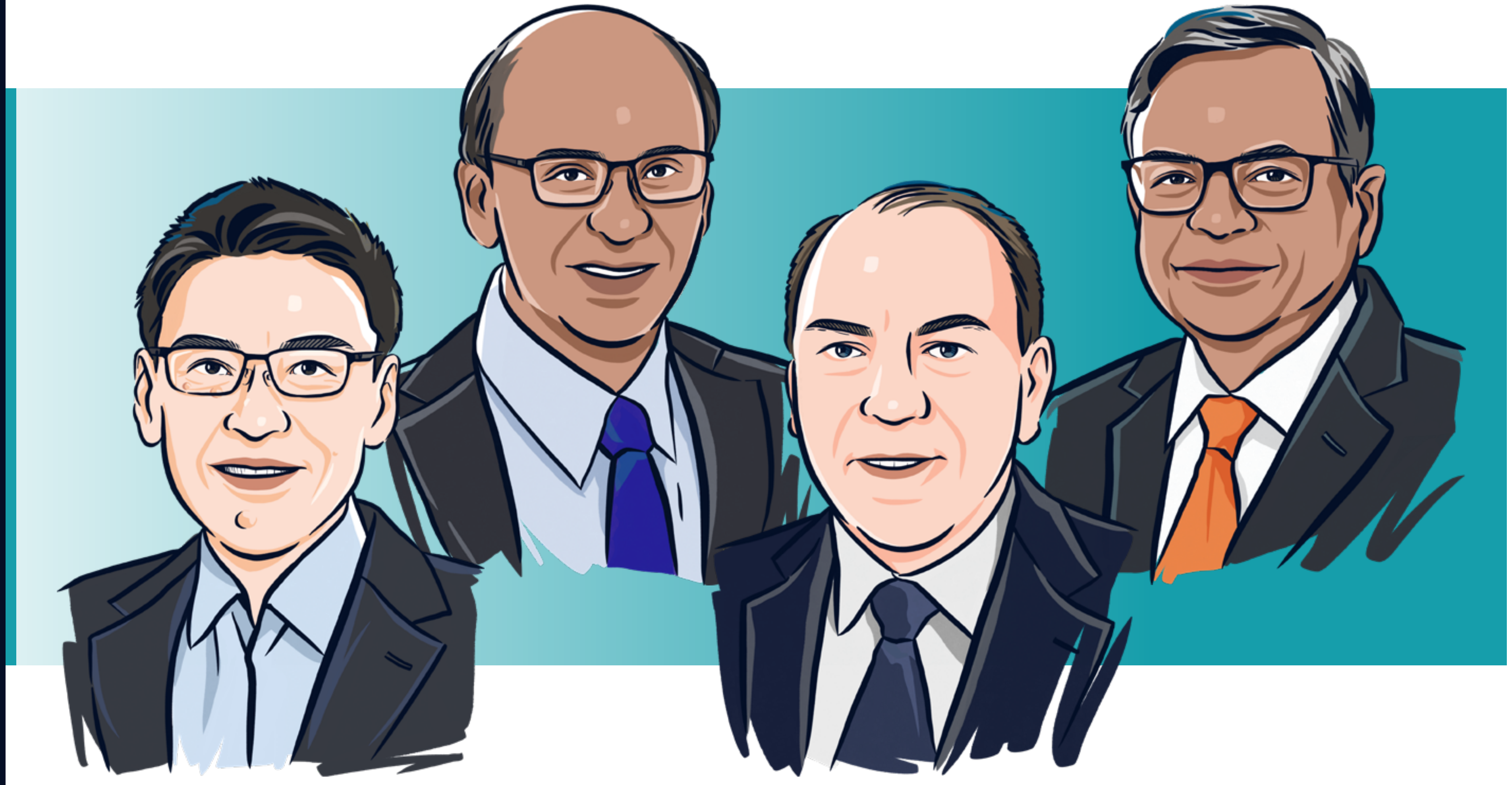
A Sustainable Future for *Policy*

This article summarises a panel discussion at GIC Insights 2021 with Tharman Shanmugaratnam, Singapore's Senior Minister and Deputy Chairman of GIC; Axel A. Weber, Chairman of UBS Group AG; and Natarajan Chandrasekaran, Chairman of Tata Sons.

Moderated by Jeffrey Jaensubhakij, GIC's Group Chief Investment Officer, the conversation focused on policy responses to key global economy challenges including rising inflation, sustainability, and inequality. The panellists also shared their perspectives on global growth, and opinions on what central banks should do going forward.

Tharman Shanmugaratnam
Senior Minister, Republic of Singapore
Deputy Chairman, GIC

Natarajan Chandrasekaran
Chairman, Tata Sons



Jeffrey Jaensubhakij
Group Chief Investment Officer, GIC

Axel A. Weber
Chairman, UBS Group AG

Rising inflation and interest rate outlook

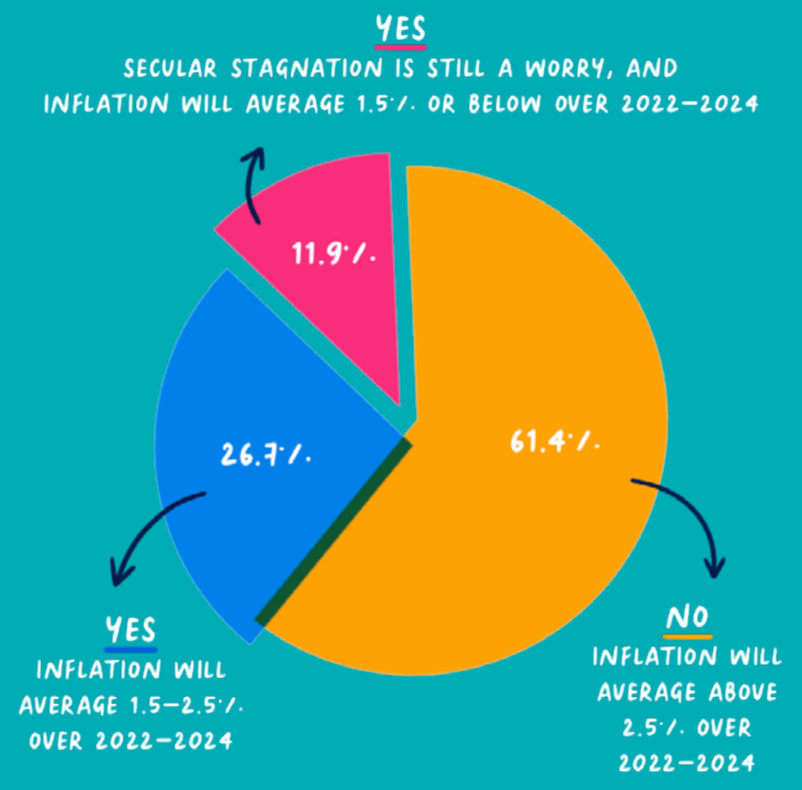
With growth strong and inflation rising, the Federal Reserve has announced tapering measures, a move expected to be followed by rate hikes in 2022. Despite inflation likely to remain above average targets, the panel expected US rate increases to be moderate over the next few years.

The panel thought the European Central Bank (ECB) would taper its balance sheet at a slower pace and move rates only a year or two later. The ECB was expected to exit negative rates but not move strongly into positive territory. Likewise, other central banks in Europe would not see much of a tightening cycle.

For emerging markets, the immediate concern was to pre-empt capital outflows in the face of developed market rate hikes. Indeed, some had already hiked rates as inflation started rising.

The panel discussed India's numerous policy and reform measures including corporate tax, goods and services tax, insolvency and bankruptcy policies, and the inflation target framework. These, together with asset monetisation plans, including the privatisation of airports and infrastructure, would support sustained growth despite potential global monetary tightening.

Central Banks globally have signalled a desire to target average inflation at 2.0%. Current inflation is well above that – do you expect this to be transitory?



Policymaking needs to normalise

The pandemic has accelerated a policy paradigm shift with counter-cyclical fiscal deficits financed monetarily by central banks. This trend started prior to Covid-19 in advanced economies, with the pandemic leading to further surges in deficits and the need to finance them and keep interest rates low. Hence, central banks have become de-facto less independent over time.

The panel assessed that the cone of possible economic outcomes was wide. The sharp rise in inflation and energy prices were already examples of unexpected shocks. Faced with a lack of full knowledge and wider uncertainty, central banks needed to avoid basing policy on too definitive a view of the future.

The panel discussed the need for central banks to be building enough capital and liquidity buffers in monetary policy and financial regulation to reserve ammunition to combat likely shocks. There was, more broadly, a need for greater discipline in policymaking — returning to neutrality in both monetary and fiscal policy during normal times, so as to be able to respond robustly during crises and provide resilience. Normalising, said the panel, would be an urgent task for central banks over the next few years, especially as the effectiveness of close-to-zero or even negative interest rates in stimulating the economy had become increasingly limited.

Most emerging economies had no choice but to run a more normal policy, given the disciplining effects of the markets. However, the more advanced economies, particularly those with reserve currencies, needed to exert their own discipline in reverting to running normal policy settings in normal times, rather than maintaining abnormal policies for extended periods.

Urgent need to address sustainability

The panel noted that the pace and irreversible nature of climate change meant that transitioning towards a more sustainable future was the most critical challenge facing the global economy.

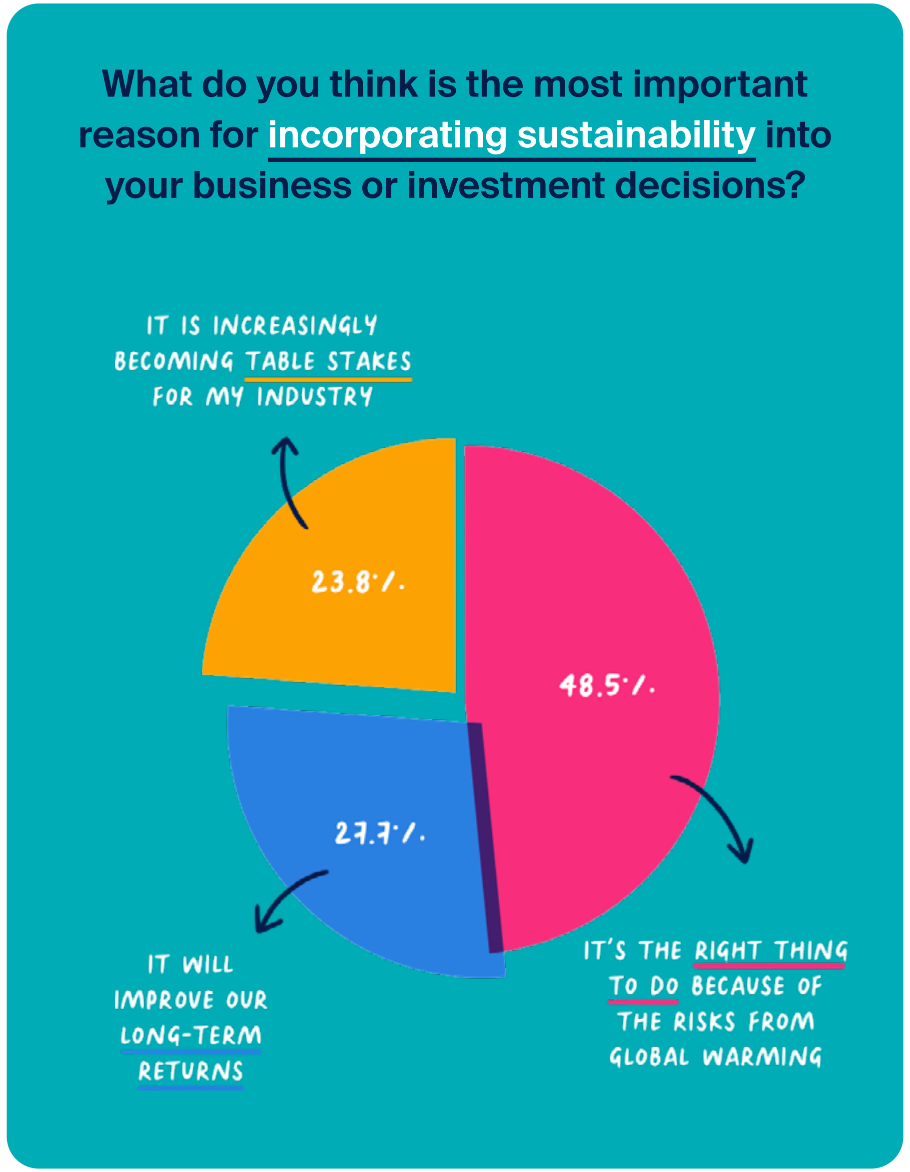
This challenge involved completely transforming current energy usage patterns between now and 2050, and would require investments of US$120 to 160 trillion,[7] equal to the size of the global equity market.

It was imperative to shift the multilateral discussion away from that of costs or burden-sharing towards one of opportunity. The private sector had to be mobilised, as responding to climate change will be a lucrative race to develop cost-effective technologies that could be scaled globally.

Providing the right incentives to achieve collective investment in global public goods would also be key. It was noted that most technologies critical to facilitate a timely transition were not yet bankable or investable.

The public sector has to play a pivotal role by de-risking these investments to allow private capital to come in much more actively into renewables, long-distance transmission and storage, amongst others.

The developing world was still not attracting sufficient capital for its low-carbon transition, as the perceived risk remained too daunting for private capital. International organisations, multilateral development banks and regional development banks were still focused mainly on lending money. Instead it was suggested that shareholder capital should be deployed by these institutions to de-risk investments through first loss guarantees and the like. They would then be able to leverage capital markets and thus scale up the impact of their capital.



Importance of addressing intergenerational inequality

The panel discussed the distribution of the burden of debt between today's and future generations. Spending financed through debt should require a good rate of return, because the cost of the debt burden was being placed on future generations. For instance, total government debt of 350% of GDP in a country where only half the population was in the active workforce, is equivalent to the current generation borrowing roughly seven years of total income from future generations who would then need to work that much longer to put finances back into balance. Addressing this intergenerational inequality was imperative. If not, the ability of future generations to enjoy the same levels of welfare and wellbeing would be at risk.

The panellists warned that young protestors marching in the name of climate change might be representing future generations sounding a wake-up call amongst current generations. More innovative ways of creating equity between current and future generations must be found in order to ensure climate justice. Yet, the pandemic has forced government policymaking into crisis management mode at the expense of the long-term consequences of the policies.

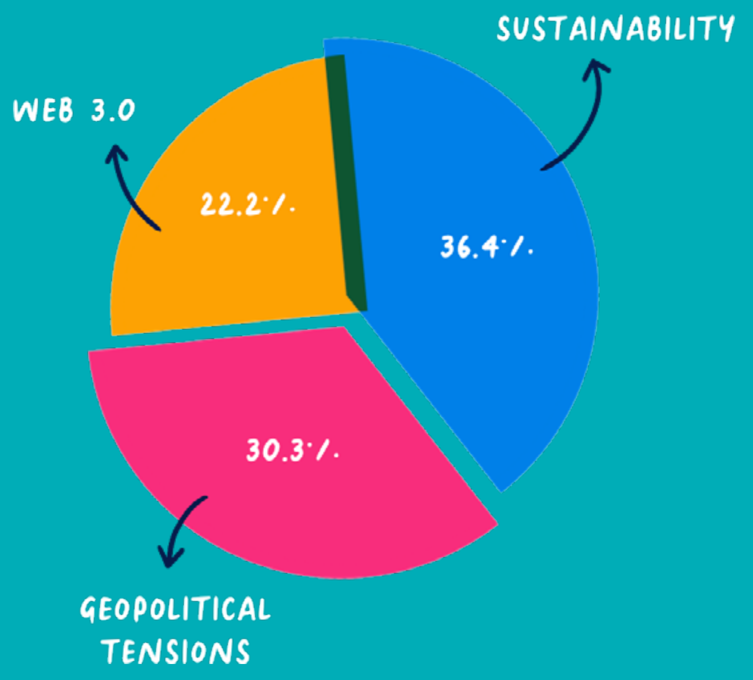
Panellists reflected that progressive politics had typically translated into more spending and larger deficits, but now required a different form of fiscal activism. Progressivity that took into account future generations required examining the shape of the fiscal curve and not just increasing spending or pushing repayment out further. In addition to progressive taxation, spending specifically targeted to spur social mobility, productivity, and upgrading in various forms would be far more effective leading to the "growth of the economic pie" and a cycle of optimism.

"... addressing this intergenerational inequality (is) imperative. If not, the ability of future generations to enjoy the same levels of welfare and wellbeing would be at risk."

Allocating resources and capital for a more sustainable future

The panel concluded that there would be an immense need for capital over the next 20 to 30 years, even before taking into account another catastrophe or pandemic. However, policymakers, governments, investors and businesses needed to be extremely disciplined. It was not a question of making the money available, but also vigilance over what the capital was spent on. Private capital has a role to help governments create a future that is better, more affordable, and sustainable for all.

What is the likely biggest game changer for your business in the next three to five years?



7. UBS (2021). *How will US$140 trillion of investment be allocated across the energy supply chain?*

GIC

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