

## What Shiller, Stiglitz and Rogoff Are Worrying About at Davos

By **Simon Kennedy** and **Enda Curran**

22 gennaio 2018, 01:01 CET

- China, debt, protectionism, Trump all seen as threats to growth
- International Monetary Fund to update economic outlook Monday

If things seem too good to be true in the global economy, they probably are.

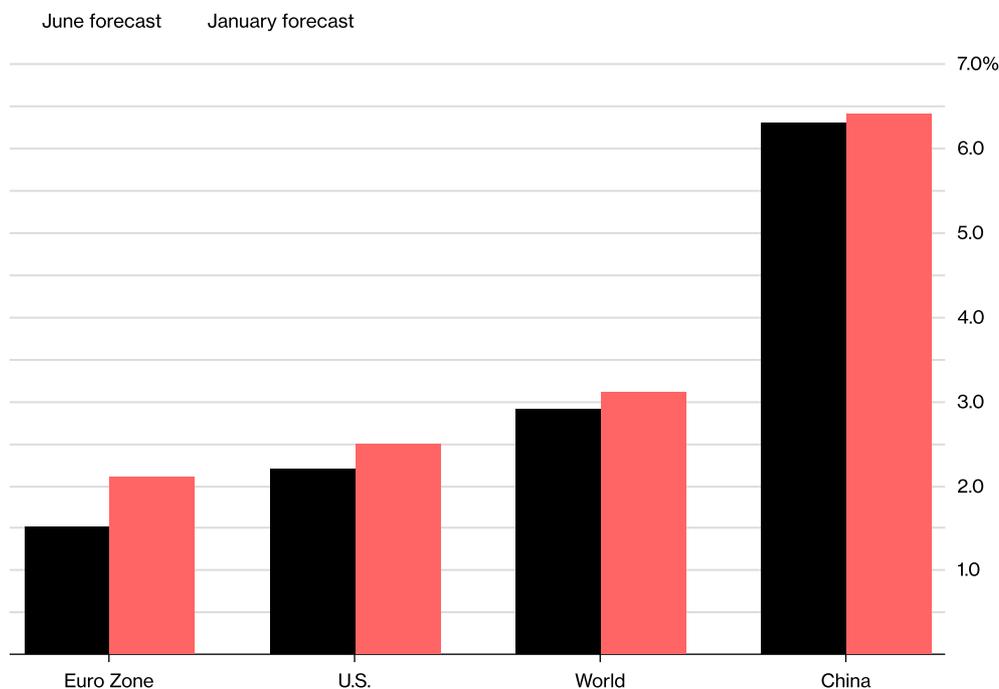
That's according to some of the investors, Nobel laureates and academics attending the [World Economic Forum's](#) annual meeting in Davos, Switzerland, which kicks off on Monday.

The fastest global growth since the start of the decade and strong forecasts for corporate earnings appear to be creating near perfect conditions for many investors, with stock buyers' optimism hitting an eight-year high. Equities worldwide are already up about \$3.4 trillion in 2018, with gains continuing even as major gauges flash overbought signals. Bitcoin is on a rollercoaster.

"Historically the stock market tends to affect the mood in Davos," said BlackRock Inc. Vice Chairman Philipp Hildebrand, who will be among the 3,000 visitors to the Alpine ski resort. "So if things stay as they are, I expect the mood will be good."

### Global Recovery Seen Gaining Steam

World Bank boosts its 2018 economic-growth projections for world and major economies



Source: World Bank's Global Economic Prospects report

The question is, can things stay as they are? Not all of those in Davos are sure they can.

"We are complacent at this moment," said Robert Shiller, the Nobel laureate from Yale University whose research covers the rise and fall of asset prices. He goes as far as to say there are potential parallels between today and 1929, when a plunge in stocks helped trigger the Great Depression.

Any correction would be “probably not as bad as 1929, but it could be disruptive,” Shiller said in an interview.

More upbeat is Harvard University professor Kenneth Rogoff, who argues the “long shadow of the financial crisis” is finally fading, so “growth will continue to outperform.” The International Monetary Fund will on Monday use Davos as a stage to update its economic outlook.

While the meeting’s forecasting track record is patchy, delegates occasionally get the big calls right. Back in 2007, global growth seemed solid and stocks were soaring, yet former U.S. Treasury Secretary Lawrence Summers said that “it’s worth remembering that markets were very upbeat in the early summer of 1914.” Nouriel Roubini of New York University predicted a “hard landing.”

The financial crisis proved both correct. Here, according to some who will be in Davos, are the potential threats to the current outlook.

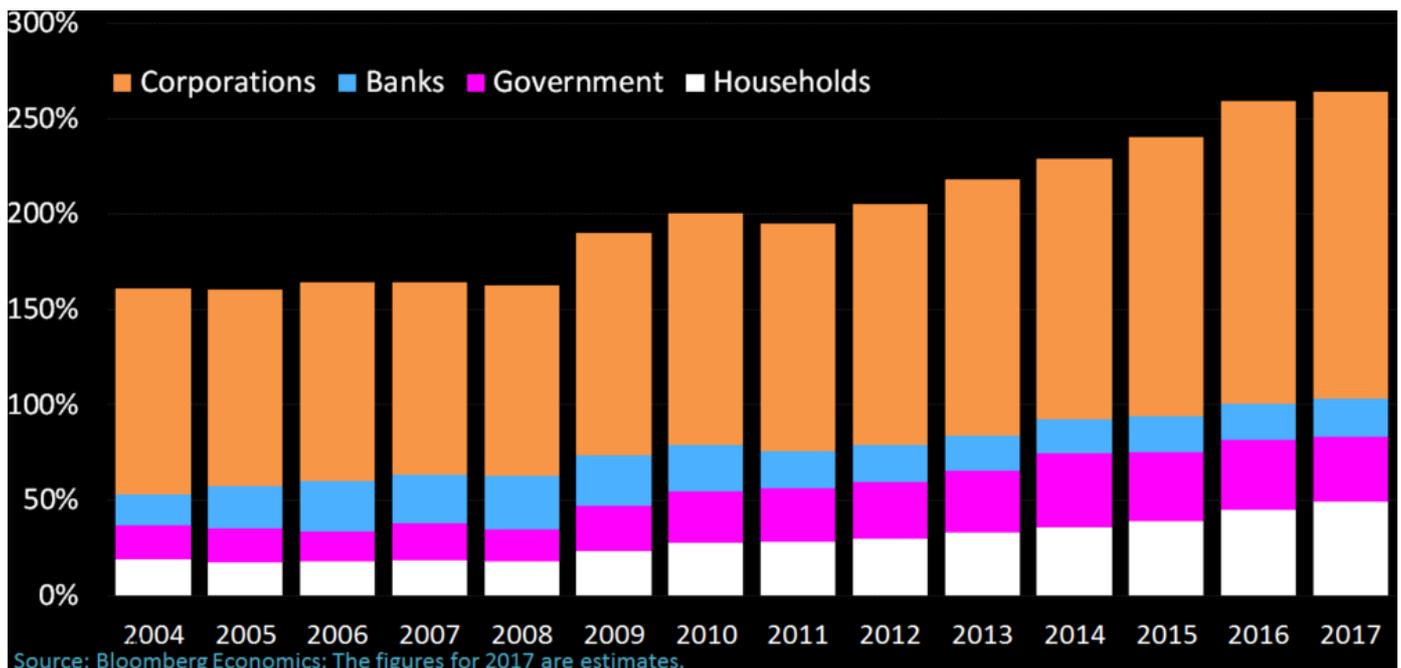
**CHINA**

The world’s second-largest economy surprised on the upside through 2017, but is beginning to show renewed signs of cooling. A plan to reduce risk in the financial system has slowed credit growth, but the country’s debt pile, equivalent to about 264 percent of gross domestic product in 2017, remains a concern.

How the Chinese authorities rein in borrowing without tipping the economy over will be one of the year’s biggest challenges.

“I think of China as probably being the epicenter if we got hit by a global recession,” said Rogoff.

**China’s Debt to GDP by Sector**



**GLOBAL DEBT**

It's not just China. [Global debt](https://www.bloomberg.com/news/articles/2018-01-05/global-debt-hits-record-233-trillion-but-debt-to-gdp-is-falling) <<https://www.bloomberg.com/news/articles/2018-01-05/global-debt-hits-record-233-trillion-but-debt-to-gdp-is-falling>> rose to a record \$233 trillion in the third quarter of 2017, more than \$16 trillion higher from the end of 2016, according to the [Institute of International Finance](#). Private non-financial sector debt hit all-time highs in Canada, France, Hong Kong, South Korea, Switzerland and Turkey.

As interest rates begin to increase, borrowers might start to feel pain even though the ratio of debt-to-GDP has fallen as growth accelerated.

"We've seen the world leverage up," said Tim Adams, the institute's president who will be in Davos. "It's been an incredibly low rate environment which I suspect is going to change."

## INTEREST RATES

The trigger for the end to that environment could be an inflationary surge that forces central banks to dump their piecemeal approach to reversing the emergency stimulus of the past decade.

With economies expanding so quickly, commodities prices are picking up and manufacturing gauges are pointing to supply constraints. The U.S. also just slashed taxes, and some big employers, like Walmart Inc., are beginning to lift wages.

"We could start to see inflation rising more than most people think in financial markets which means the Fed and other central banks will have to raise rates sooner and faster," said Nariman Behraves, chief economist at IHS Markit. "That could rattle things up."

Rogoff said the "biggest vulnerability" in markets would be a sudden reversal in the trend toward lower inflation-adjusted borrowing costs.

## PROTECTIONISM

The trade issues that failed to flare up last year [could do so](#) in 2018. President Donald Trump has threatened to tear up the North American Trade Agreement and a pact with South Korea. There's also a U.S. investigation into allegations that China steals American know-how, and Trump warns he might slap tariffs on Chinese goods, especially steel.

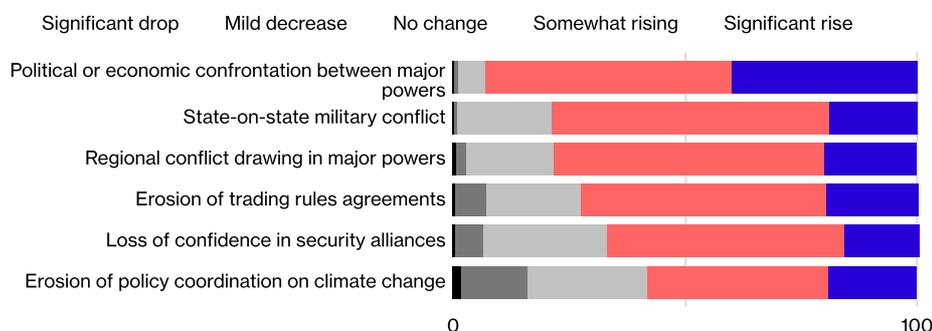
"Once there is a major breakdown in trade there is a race to the bottom," said Dominic Barton, managing director of McKinsey & Co. "It's important the fragile system we now have continues. We shouldn't underestimate the potential for disruption."

Margareta Drzeniek Hanouz, a member of the WEF's Executive Committee, said "there is still a danger that the multilateral trading systems could break down as we know it because there are a lot of risks on the horizon."

## POLITICS

### Davos Doom-Mongers

The WEF asked global leaders if they saw geopolitical risks rising or falling versus 2017



Source: WEF Global Risks Report 2018

North Korea is saber rattling amid Kim Jong Un's quest for a nuclear-tipped missile. Uncertainty lingers across much of the Middle East as tensions grow between the U.S. and Iran. Syria remains a tinderbox. In Europe, there is still no new government in Germany and Britain's outlook is obscured by Brexit.

"If you could isolate the economics from the politics you would be optimistic about what is happening, but unfortunately you can never isolate the economics from the politics," said Nobel laureate Christopher Pissarides, who teaches at the London School of Economics.

**TRUMP**

Trump makes his debut in Davos this year, days after comments that took aim at African nations and the U.K. He still plans to ban travelers from predominantly Muslim countries, build a wall along the Mexico border and has taken an aggressive approach to North Korea.

“The most significant political risk is the United States,” said Nobel laureate Joseph Stiglitz of Columbia University. “Uncertainty is bad for the global economy.”

— *With assistance by Jeanna Smialek, Catherine Bosley, Vonnie Quinn, Adrian Leung, and Dani Burger*

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