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Q&A-Sense of relief for markets and policymakers around macro conditions; MDB reform vital: Jay Collins, Citi



A palpable sense of relief is evident as China's reopening and the hopes of less aggressive rate hikes from the Federal Reserve brighten the macroeconomic picture, **Jay Collins, Vice Chairman, Banking, Capital Markets, Advisory at Citi** told the Reuters Global Markets Forum on Thursday, January 19.

"We have had a global paradigm shift in markets toward a benign environment across asset classes. Don't underestimate that change of feeling in the room of Davos," Collins said on the sidelines of the World Economic Forum's annual meeting.

However, a number of substantial challenges face the global economy, especially vis-à-vis the relationship between developed and developing economies, and reform of multilateral development banks to encourage lending to "riskier" countries is vital, he

added.

Following are edited excerpts from the conversation:

Q: What are your thoughts on the U.S. Inflation Reduction Act and the controversy it's caused with Europe?

A: I wasn't really prepared for the backlash from Europe and the number of conversations of Europeans that have raised it. It isn't a World Trade Organisation issue. The U.S., and Europe aren't going into a trade war because of the quality of the relationships and what that would mean vis a vis Putin and the war, but that doesn't mean it's not a tough issue. There is a clarity that the U.S. can't go back into Congress and re-legislate. That's not on the table given the dynamics on the Hill. So the question then is executive branch purview over the implementation of the IRA. In a way that is within the bounds of the law, but that would allow the Secretary of Commerce and others to the intent. What's pretty clear to me is this was never really the intent. That's important because that that changes the way -- at least the US -- is thinking about the China paradigm. The competitiveness paradigm versus a protectionist paradigm. So there will be a need in Washington to look at the flexibility of executive branch implementation and the partnerships that could be developed to still allow supply chain components.

I know everybody is scrambling to reread (the IRA). I am. Then there's also the European response, and it's clear, both in public and very much in private how serious an issue it is. Number one, it's clear to me that there will be a response. It is interesting that there will be intra-European debate and not complete agreement on exactly that response. I think one of the most important elephants in the room is the allocation mechanism of who actually gets what. In terms of just distribution of this effort within the EU -- the size of it, its nature, and those that are saying 'let's not tip for tat a war here and to find ourselves at the WTO, we will find a way.' One thing that I would say will be very much on the table and debated in Europe, is not just the fine tuning of a response to IRA and its content, but because the COVID money was spent, the coffers are bare. You don't have this money this time around, it's much more difficult and it's much more politically sensitive, and again, that's just in three days of meeting here listening to people. It unfortunately has become an elephant in the room.

Q: How do you see that impacting the rest of the world, especially people who are not living in the U.S. or Europe?

A: Let's put this in in climate transition terms. One could argue that prior to IRA, the Europeans had taken the lead in funding the energy transition -- it's technologies, the carbon rate mechanisms -- that term means all of the incentives and disincentives, and the regulatory and policy world. Of course China and India and others have moved, but the U.S. had not done that yet. There are those in the environmental space that say competition like this between the U.S., Europe and the United States and China

and India, everyone trying to spend to find accelerated ways to fund transition is a good thing, and the more competitive that is the better. (For) a lot of the global firms that will drive the capital toward the technologies and energy transition, funding accelerated mechanisms to transition is a good thing for the world. I had an Asian minister the other day say though, 'what's the technology transfer component of this? I'm part of this. I'm early retiring coal, I'm committing on my NDC, but how do I get that push to me?' The answer to that question is another theme that is in the room of energy transition strategy of Davos, which is transmission.

Everybody is absolutely concerned that we've been so focused on renewables and the cost curve for renewables has dropped so fast that it is so viable, that the question becomes is the grid ready? Is the infrastructure there? Are the agreements across countries and the permissioning there? Whether it's undersea cable, oversea transmission lines, we as a world are way behind on understanding that you cannot transition without transmission. What you have now as a lot of the discussion is moving to actually implementation. If I can produce hydrogen in North Africa, let's say, or in some place very sunny where the cost is two to three cents, I mean very low cost. How do I get it out? There is a couple of conversations, one of massive new investment that will have to happen to get it out. Transport, shipping, transmission lines. There are also CEOs of major industrial players here that have said to me, 'we may have to move steel to them.' We can actually, if we produce the steel where the low cost energy is, we can build it so that the hydrogen is just taken right there and the chain is completed and we don't have to worry about the extraordinary barrier that Egypt could have low cost hydrogen but the off-taker in Europe's not ready to off take.

So maybe what we will see hopefully in many emerging markets economies is if they are a low cost producer, and the likes of the leaders of the that energy transition world like Secretary Kerry are saying 'leave your gas in the ground.' That we can now find a solution where more investment can be made to help transition them better at a lower cost because the capital is going to go. The other side of that coin for many emerging markets countries that are on the front line of trying to get that investment are saying that's another sucking sound of money that will go to the U.S. instead of here. Because as choices get made of where to invest and develop technology and who goes first, the U.S. has now created an incentive structure that is anti- competitive and that will mean that it's harder for me to attract global countries to my country. And I certainly respect and understand that view.

Q: How does that get transport transferred to poorer countries to emerging economies who may not, as you said, have the access to funding given these latest measures?

A: The question of just transitions in its early days was about jobs. And as you transition out of coal to renewables, or you transition from brown to green, there is a displacement in those economies. And there's a need to re-educate, train, redeploy and socially support workers in the transition.

Technology transfer is a more complicated but very related subject. If I am -- and by the way my experience most recently with it was advising GAVI and Covax through the crisis in terms of the diversity of global south production - and one thing I am absolutely sure on is if you do not have a strategy and a plan, it will not happen. Much of this, whether it's in the healthcare space or whether it's in the energy space, the training (and) education of workers of a technical nature to prepare them for the high end kind of jobs that we would be talking about.

If you're an investor, a sponsor of a project in the energy transition space. I don't know a minister at that table that won't say 'let's talk about the technology transfer. Let's talk about the workers'. The days where in the infrastructure space you said 'I want this done' and the Chinese showed up and did. everything and went home, that that's never happening in this world. So I think by definition it is a part of the To Do List of any discussion of investment related to energy transition.

Q: Is the world going to stay more fragmented and is anti globalization going to be the new trend?

A: I think the paradigm has shifted radically. First and foremost, I have never in 35 years of my career seen the likes of this tension of the West versus the global South. There's almost an emotional response to what's happening now and the overwhelming number of forces that have worked against the so-called global South from food inflation and energy crisis to long duration COVID, fiscal and now extraordinary debt challenges, and the inability to fund themselves and their budgets as a result of all of that. The pointing of the global South to the West in terms of the money that was printed to bail the global West out of the COVID crisis and the reversal that creates a strong dollar and global outflows that many ministers will say 'I had nothing to do with that. You guys fixed your problem and look at look at where I am at the end of all this. I can't take it anymore.' That friction is enormous. The West has to respond. The good news is we woke up on January 2 and the paradigm shifted. There is a sense of a benign 2023 that did not exist when we went home for Christmas. It's not that all of the data radically changed, but it changed enough to hit the recalc button on literally everything. The market conclusion that we've hit peak inflation, the market conclusion that we haven't seen fantastic progress on a broad based deconstructing of inflation. But it's a sense that we've peaked and what that really meant is that people said actually, we're not going to have a 5.5% terminal rate. It's 5% or south of that. That's the anchor, upon which the paradigm shifted. The terminal rate is 5% or lower. the Fed may hold for longer and that

means we have the end of the strong dollar, the end of the perception that the rate differential can continue to spread and drive fund flows out of the emerging markets and into the dollar. Every EM minister has said we have to talk again now because what we strategized on how bad 2023 would be in terms of a debt crisis is kind of starting to feel different in a matter of weeks. So now what do we do?

Equity and fixed income EM markets are moving and we're not done. So that's I think, critical in terms of that change. The other thing that's changed radically, is the dependence on the market. On the China recovery and that has translated through to a light switch from off to on. We're now open for business and pent up savings will result in massive consumption. All of the assumptions now are that not only could we see a doubling plus of China growth and a second-half that is off the charts, but a view in Europe and a view in some of my Asian friends particularly that this is a softening of a backend of the year recession scenario. There is clearly some risk that this transition may not go politically or healthcare wise as well as some might think, but the Chinese are clearly telling everyone at Davos that we are back and we're back strong. The Chinese messaging in the past ten days to the world has changed, my sense is that there is a coordinated re-messaging of a softer, friendly China from the top because so many people are talking about it so fast.

Q: What is your view on the role big energy should take in the climate transition discussion, especially with COP28 coming up – is it right for them to take a greater leadership role?

A: Should big energy be in the room? There are very mixed complex views on that. But I would remind your listeners or readers that amount of capital that is necessary to transition does not exist in the public sector. The private sector can only fund the large sponsors of energy technology and credit and capital that allows them to invest at speed and scale in the transition process. If you had defunded the automobile industry – instead we're going to watch your capital expenditure percentages move toward electric vehicles away from combustion engines and no one expected that the response to Tesla or the demand for EV's could move that fast. The largest energy companies in the world are feeling very good about technology right now. Some of them are actually committed to transitioning at speed and want to be in that room. "Leadership" is a powerful word I wouldn't use, but "balanced inclusiveness" is a word I'd use.

Q: Any final thoughts for us?

A: We have had a global paradigm shift in markets toward a benign environment across asset classes. Don't underestimate that change of feeling in the room of Davos. Second, the realization of the West that the global South is angry and there has to be ambitious, radical willingness to break glass to respond in all ways. Third, as we look forward to COP28 we have moved to a much more practical implementation. Because of the United Arab Emirates and their COP 28 leadership, the sovereign wealth funds will be in a room. By the way, forget where their money came from for a second. They are focused as an investor group on climate and therefore that's going to be a big thing.

One last thought, we are on track to fail with Multilateral Development Bank (MDB) reform. If everything I hear is correct it will only be marginal reforms to capital that allow for new lending, but we will lend the same way. Very few people are prepared to break glass on the model and the model is broken. The model does not take risks. Investment grade investors can't this level of non-investment grade risk. So with the MDB's don't reform themselves structurally so that they mobilize. And what I've said to the CEO's of the MDB's here is just change one thing. Benchmark everything to mobilization rates. Tell the teams in the trenches that their incentive structure is designed, not about how much they lend, but about how much they mobilize. Very quickly you'll have to redesign the whole toolkit.

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