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Q&A-Middle class will fuel growth in Asia; Higher rates a tailwind for insurance: Roy Gori, Manulife Financial Corp

Regardless of trade shocks, Asia's growing middle class in will help fuel growth and benefit diverse companies when U.S. and Europe have weak forecasts, **Roy Gori, chief executive officer of Manulife Financial Corp** told the Reuters Global Markets Forum in Davos, Switzerland on Monday, January 16.

"The growth that we see in Asia is at least double what we see in the rest of the world. We've been clear that our goal is for Asia to represent 50% of our business profits by 2025 and we feel very good about that ambition and that target," he said.

Manulife's insurance business will do well under higher rates and wealth management from customers conscious about balanced portfolios, but Gori anticipates higher unemployment on the cards for Canadians, raising the risk of mortgage defaults.

Following are edited excerpts from the conversation:

Q: What are your expectations in terms of global growth for 2023 and 2024, given the aggressive pace of interest rate tightening and its associated effects?

A: I think there's a greater degree of uncertainty in terms of the outlook for 2023 and 2024 or two years out than at any time in the last decade. I think it's a function of central banks around the world fighting vigorously to contain inflation and they're using higher rates as the tool to do that. But the actions that they take today will take nine months before they see the effect. There's a lot of uncertainty as to what it would take to contain inflation, because there are both supply side factors as well as demand side factors. My expectation is that inflation is going to be stubbornly hard to contain to below 3%, let alone the 2% target that many of the central banks have actually targeted or forecast as they go. I think more realistically for 2023, that we'll see inflation between 3% to 4%, which in my opinion translates into central banks' need to maintain higher interest rates. I think at the very minimum, we'll see three 25 basis point rate hikes from the Fed. They may pause to see whether the actions that they've taken were sufficient or not, but in my opinion, I think we're going to see higher rates and higher rates for some period of time. I'm not of the belief that the Fed will have over hiked and therefore will need to sharply cut rates. If they do have to cut rates, it may be by 25 basis points or 50 (basis) points. But I'm not seeing a 200 (basis) point rate cut in the outlook of 2023 or 2024. That trends into significant implications for GDP (gross domestic product) growth and for unemployment. My base case scenario is that the U.S. or North America, U.S. and Canada will see growth in 2023 of between 0% and 1%. I think Europe will struggle to even get to that level of growth. I do feel though that Asia will see 4% to 5% growth. The pure demographics of Asia and the middle class growing are going to be significant factors fuelling growth, regardless of the trade shocks that are going to be seen. I think technical recessions, two quarters of negative growth, are not necessarily a big problem in their own right. I don't see an outlook that has us with negative growth for four to six quarters. And if you want to call that shallow, I think you can, (but) I don't think it's without pain.

But if you go back to four decades, the rates that we're seeing now are really still very modest by comparison. We've seen in the last two decades, a lot of organisations spawn off the back of lower rates where borrowing money was very cheap and therefore a very big accelerator of growth. You didn't necessarily need to have the most comprehensive business strategy to do reasonably well with lower rates. With higher rates, it's going to be a little bit harder.

Q: Are you not worried about the Federal Reserve overtightening?

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A: I am not. I think there is enough force at work that will cause the Fed to pause when they've seen that they've raised rates to at least the 5% mark. I think with inflation coming down steadily as we saw recently, we saw expectations were met as it relates to lower rates, I think it would be sensible for the Fed, after perhaps several more rate hikes, to pause for a period of time rather than to continue down an aggressive path and then have to reverse course. I think that will be a more sensible outcome. That's what I'm seeing is the base case scenario.

Q: Where do you see opportunities for growth in this environment?

A: We've had four decades at lower rates and that's been a headwind for us. Insurance companies benefit from higher rates. So we see that as a tailwind. The other big advantage I think we have as an organisation that hasn't really gained as much currency in the past decade is the global diversity of our franchise. We're a business that spans three geographies, Canada, the U.S. and Asia. When all boats are rising, the benefits of diversification aren't really that significant or aren't that important. We've seen through COVID the demand for insurance increase quite significantly. On the other side of the equation on the wealth front, we've seen consumers now appreciate the importance of having a balanced portfolio. Those trends are going to continue and that certainly I think bodes well for us. The final thing I'd say is that in a higher rate environment, it's going to force organisations like us to be more efficient. Driving an agenda of cost management and digitisation to drive efficiencies to therefore help combat the challenges of inflation are going to be par for the course, certainly for us another and other organisations, and I think that driving of efficiency is going to be a theme that we're going to see much more of. I think there's a significant opportunity ahead and we have new technologies like AI, robotics, quantum computing that are going to provide in my opinion, an exponential lift in efficiencies for organisations that are investing early in those technologies to leverage the efficiencies that should be attained.

Q: Has China's amendment of its zero COVID policy affected the outlook of your business?

A: I think so. I think it was inevitable for China to move away from the COVID zero policy and to open up as most other countries have done. It happened probably sooner than most had expected or forecast. Whilst in the short-term that poses some challenges for China and related countries, I think it bodes well for the second-half of this year. For our business, we've got a significant presence in Asia, a diverse portfolio of countries that we operate in. I do think that China reopening will certainly bode well for China economy and the Hong Kong marketplace, but it will also be I think an impetus for growth in Asia and quite frankly, global growth will benefit from the China reopening as well.

In our sector, we really haven't seen a turnaround at all. We've operated in China since 1897. What's put us in good stead is that we've always played the long game and I think that has earned us the credibility with key stakeholders, regulators, consumers, employees, and advocacy groups. We haven't seen any change in policy that makes it more attractive or less attractive. If anything, the trend line over the last three decades has been for more opening up within China, to companies like ours for us to do more business and we're seeing that trend continue, we haven't seen that change at all.

Q: Is the company working on plans to cut jobs if the economy slows as many economists expect?

A: It's really not top of mind for us. The reason why, is that we see such significant growth opportunity. We are in growth mode. We have this phenomenal opportunity within Asia and the growth of the middle class is undeniable. There are two billion people in the middle class today in Asia that's forecast to grow to 3.5 billion in the next decade or less. That is fuelling significant growth. We are growing at more than double or triple the GDP in most of the markets that we operate in. We're investing organically to grow our business and it also means that we are possibly looking at inorganic opportunities for growth as well. We have been on a trend line to increasing the number of head count that we have in the markets that we operate in globally. Now the counterforce for us is that we are digitising our business. We're taking away jobs that are low value add. But even with that force, we still see that we're going to be growing our workforce and that is not a trend that we're expecting to change.

Q: Would it be right to say you're looking at Asia to drive business for the next at least two years if not more?

A: We definitely see Asia as our primary growth engine. We still are very excited about the opportunity for growth within the U.S. and Canada and there again, our biggest opportunity is coming off the back of the COVID crisis where consumers have realised that they didn't have enough protection and coverage. We're seeing demand for our products increase quite significantly and that's fuelling significant growth in those markets for which we are we're well established, and we've got a strong presence. But obviously the growth that we see in Asia is at least double what we see in the rest of the world. We've been clear that our goal is for Asia to represent 50% of our business profits by 2025 and we feel very good about that ambition and that target.

Q: Would you be able to tell us what kind of growth rates you're targeting in Asia?

A: We haven't established a target per se that we've made public. Generally we see that we will grow at a much faster pace than GDP growth (of those markets) and we see that our Asia franchise will grow at double the pace of the rest of our franchise. The other thing that we're very excited about is our wealth and asset management business. That is our fourth business line when we look at our global operations and there also we see tremendous opportunity to grow and for us to offer differentiated solutions.

Q: Is the company worried about the possibility of more Canadians being at risk of defaulting on their mortgage?

A: One of the biggest challenges that I think every economy is going to grapple with is that higher rates will mean serviceability of debt will be more challenged. I think prudent lenders will have put in significant buffers and would have been very conservative with their lending practices. Which is certainly the way we have operated our bank with more prudent conservative mindset. But this is a big challenge globally with higher rates. Consumers have been used to near zero rates for decades and as a result, their appetite to borrow has been very significant. We've seen debt levels as a percentage of household spending or even household incomes increase very significantly over the last four decades. Higher unemployment is certainly on the cards, as is a challenge of debt servicing.

Q: Do central banks have their blinders on inflation, therefore not seeing peripheral issued that could get bigger?

A: My view is they are more broadly looking at the wider and broader implications of higher rates. I think they need to be very clear about their mission to tackle inflation and most central banks have a dual mission of tackling inflation and maintaining adequate unemployment levels. But given that inflation is the bigger problem right now, inflation rates are significantly higher than historic norms. And unemployment is still very modest. I think they're right to signal their desire to go after inflation as the number one priority. But I think we're going to see a softening of language from central banks as we see inflation rates coming down towards that 3% to 4% range that I predict is where it'll land in 2023.

Q: What impact do you expect from mortgage rates and defaults and debt servicing on lending products, property values and the broader Canadian economy?

A: Higher rates will put pressure on GDP. Which is why my expectation is that GDP growth will be quite modest for the next couple of years, zero to 1% when historically North America, we've seen 2% to 3% consistently over a very long period of time. That's been fuelled by lower rates, but it's also been fuelled by globalisation and we're seeing a pivot away from the era of globalisation that we've seen. I think there will be pressure on the consumer in 2023 and 2024.

Q: What plans do you have for the wealth and asset management business this year?

A: We're going to see an acceleration of ESG (environmental, social, and governance) related products in the asset management space. This has been an area of focus for us, not just over the last two or three years when it became more popular, but for the last two or three decades, we've been one of the biggest investors in nature-based solutions. I really do believe that in 2023, we're going to see a strong pivot towards nature-based solutions and ESG slash climate related products.

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