MB
REPORTS

# #1 AN INSIDER VIEW FROM DAVOS 2022

## Preamble

This is a distillation of personal notes taken during officials and unofficial sessions complemented by many private conversations at this year's WEF Annual Meeting in Davos. Its structure follows the conceptual framework that defines the Monthly Barometer – looking at the big picture and what's coming through the prism of the five interdependent macro categories that matter the most: (1) economics, (2) the environment, (3) geopolitics, (4) societal issues, and (5) tech. The few quotes are attributed only when reported in the media. The many insights derived from personal conversations remain unattributed, but any community member wishing to learn more about any specific point can get in touch. We'll happily respond!

## INTRODUCTION

Writing a Davos report is an eminently subjective exercise. It can only capture a tiny fragment of the hundreds of sessions (official and private) and hours of private conversations taking place during the AM. In addition, it cannot escape the biases inherent in such an exercise. Two worth mentioning: (1) **Western centricity**: the AM22 sounded very much like a Western / Transatlantic lovefest: there were no Russians due to the war, few Asians due to Covid, and so on. (2) **Elites inward-looking**: Vanessa Nakate, an Ugandan climate activist, summed it up: "This is a place of the elite. (They) have a limited vision because they do not know the reality on the ground (…). People are in their own personal bubbles." It often, but not always, felt like it! Among most participants, empathy seems in short supply. On the first night, walking along the Promenade, it occurred to me how hard it is to be 'virtuous' (or 'conflict-of-interest' free in a business setting) and how much success depends on Faustian bargains: the 'Ukraine House' stood almost next to the MBS Foundation from KSA – not a paragon of human rights' observance!

If just one word had to be used to distil what came out of this year's meeting, it would be **ANXIETY**. The mood in Davos was not a happy one. The key values espoused by the WEF — globalization, liberalism, free market capitalism, representative democracy — are all under severe attack. And this year, everybody seemed to realise that multiple risks are conflating with each other and exacerbating one another. These are of course, context and business-dependent, but at the top of the Davos' agenda and in no particular order, three big concerns dominated: (1) **the war in Ukraine** and the myriad of problem it poses to everybody (from European energy security to global hunger), (2) the catastrophic path of **environmental degradation and climate change** (with still an inordinate number of deniers and cynics ), and (3) the risk of an **impending recession**.

## 1) <u>ECONOMICS</u>

### <u>The outlook</u>

The economic horizon has darkened with the war. Kristalina Georgieva, the managing director of the IMF, expressed these concerns unambiguously: "**the global economy faces perhaps its biggest test since the second world war**". She added: "I'm wary of the risk that we are going to walk into a world with more fragmentation, with trade blocs and currency blocs, separating what was up to now still an integrated world economy." Accordingly, the mood among CEOs was anxious and dour about the economy. Many of them made comparisons with the 1970s, fearing that inflation will remain persistently high and concerned that a recovery will take years. European central bankers disagreed, committing to bring inflation down to 2% in 2024. Jane Fraser, Citi's CEO, predicted a "**brutal winter for markets**".

I heard no one make a convincing case that we'll avoid a recession. Prudently, Georgieva and other senior execs from international organisations argued that we might avoid a global recession, but without conviction ("we might have a recession in some countries, but not everywhere" she said). Much of the case rests upon the trajectory that the war in Ukraine will take, and the impact this will have on commodity prices that are eroding global growth and intensifying global inflationary pressures. A discussion about Italy showed the extent to which **the economic outlook has taken an unexpected turn for the worse**. At the beginning of the year, Italy was looking forward to the implementation of much needed structural reforms and buoyant growth, underpinned by the combination of PM Draghi's robust leadership and the release of EU funds. But with the war and the commodity shock, the Italian economic outlook has just turned so bleak that a recession this year is conceivable. This has dramatically dampened animal spirits and might turn into a self-fulfilling prophecy.

The greatest problems will arise in **emerging markets and low-income countries that are falling dangerously behind**. In some of them, the situation will amount to a tragedy (defaults, famine, impoverishment). Their problem will become a global problem via the traditional contagion channels – most notably social unrest and uncontrolled immigration.

**<u>Putting the brakes on globalisation</u>**

What's happening to globalisation was high on this year's Davos agenda. As the economic historian Adam Tooze reminded us, it's impossible to bring it to an end ("It's B.S. Ending globalization. Life as we know it would cease to exist (…). When people say this, they're either naive or apocalyptic - it's a bad way of thinking about the problem"), however a retreat from globalisation is occurring for all to see. It seems that the future is **regionalization** - the global economy may be reorganised along regional blocs aggregated around geography but also common values and similar forms of governance. Businesses concurred. As one example, the European president of Procter & Gamble International Operations said that regional supply chains are here to stay: "90-plus percent of what we're going to be selling in Europe will be produced in Europe. That's a profound change, which I think is going to be a lasting one."

**<u>Food crisis</u>**

The impending global food crisis is at the crux of economics and geopolitics. Many speakers denounced the way in which Russia uses hunger and grain as a weapon to wield power by blocking ships and bombing warehouses. Ursula von der Leyen said the EU is working to free 20 million tons of wheat by opening "solidarity lanes," financing transportation and stepping up European production. Several European countries are supporting the idea of naval escorts in the Black Sea to ensure that supplies reach developing nations. According to David Beasley (the executive director of the World Food Programme), the current situation threatens **widespread global starvation and migration**. He reckons that up to 323mn people are "marching towards starvation" and 49mn are "knocking on famine's door" in 43 countries, observing that "every 1% increase in hunger [leads to] a 2% increase in migration," In his opinion, this is "**a perfect storm within a perfect storm**."

As a result, food is now a key policy priority. The UAE minister of climate change and the environment said that "food systems to tackle the global crisis in agriculture will be given as much weight as energy conservation" at the COP28 conference scheduled next year in her country. She emphasized (1) the need for a sharp increase in innovation, (2) the importance of keeping markets open (to prevent famine) and (3) the necessity to reduce meat consumption and food waste.

## 2) THE ENVIRONMENT

This year, the environment and climate change took a back-seat - our most consequential existential threat eclipsed by the war in Ukraine and fears of an upcoming recession.

**The failure of climate action is painfully obvious**. Despite innumerable commitments in Davos and elsewhere from governments and corporate leaders, a huge and widening gap exists between promises and the hard policies required to enact them and start making progress. John Kerry (the US special presidential envoy for climate) made that clear: "If we don't do enough between 2022 and 2030, you can't get to net zero in 2050 (…). We must deploy renewables six times faster than we are now. We must cut coal five times faster than we are now. We must adopt electric vehicles 22 times faster than we are now." In a different setting, Mark Carney (the UN special envoy for climate action and finance) gave a sense of the magnitude of the task ahead: "**We need an energy transformation on the scale of the industrial revolution at the speed of the digital transformation. And therefore, we need a revolution in finance**."

By now there is widespread consensus among scientists that time is running out to close the emissions gap and limit global warming to 1.5C. There is also a general recognition that climate change and environmental degradation are accelerating in a way that most scientific models hadn't predicted. The task for governments is gigantic at a time when many past commitments are not being implemented. The absence of an affective global governance mechanism makes it also much more difficult to agree on anything.

### Measuring ESG is key

Despite all the brouhaha about ESG and the burgeoning culture war in which it is being engulfed, there is a widespread recognition among business that they must adequately measure their environmental, social, and governance (ESG) factors to best promote transparency and comparability. This is vital to both investors and insurers and can only be done via a **set of global standards on ESG reporting across different jurisdictions**. Currently, overly complex, and imperfect standards for ESG disclosure create massive confusion and are beyond reach (too expensive) for most companies, particularly SMEs. Emmanuel Faber (chair of the International Sustainability Standards Board) pledged to develop a new framework in "a way that is practical and proportional" and with standards as streamlined and simple as possible, but this did not prevent a raging debate in private meetings. Many global companies and industries are racing to implement their own ESG frameworks and metrics, and increasingly demanding that companies in their supply chains abide by them as well. In parallel, the SEC and the European Commission are pursuing their own specific discussions. There were fears among some business participants that in the future they'll be compelled to adhere to **three different sets of standards**: those from the SEC, the EU and the ISSB.

### The importance of nature

Most of our community members are aware of our good4nature initiative, so our emphasis on the critical relevance of nature as an asset won't come as a surprise. In Davos, many senior execs don't yet seem to grasp the **intimate connection between biodiversity and climate**. They are the two sides of the same coin and cannot be dissociated from each other. Frans Timmermans, the European Commission Vice-President, reminded AM participants that the world faces a biodiversity crisis as well as a climate crisis. Even though the biodiversity crisis is not yet treated with the same urgency as the climate crisis, it requires significant attention from policymakers and investors. As an example, insurers increasingly focus on the role that nature-based solutions play in protecting against some of the impacts of climate change. This brings to the fore the critical importance of policies and incentives. During a discussion on deforestation in the Amazon in which bankers sang the praise of "financing the forest", the Harvard economist Ricardo Hausmann threw in a bucket of cold water. It's worth quoting him in full. "Let me tell you how distorted this market is. Europeans are willing to pay $100 per ton of CO2. The equilibrium price in Colombia has been hovering between $3 and $5. A hectare captures about five tons a year for about 20 years, and then it stabilizes. At $5, that's $25 per year. They put half a cow per hectare. You need two hectares for one cow, in that region. Half a cow is worth more than $25. So you'd rather put a cow than leave the forest… The prices are not there yet, because the markets in Europe don't know if the forest they're paying for is going to be there tomorrow. They don't know if they're paying for reforestation, because that's going to create a new incentive: to deforest, so that you can reforest."

# 3) GEOPOLITICS

Geopolitics was at the core of this year's AM, by now firmly entrenched in the decisions that those global corporates present in Davos must make. Nothing crystallises this point better than business in Russia Since the war started 1,000 companies (including many WEF members) have exited the Russian market, this is 5 times the 200-company withdrawal over 20 years from South Africa caused by apartheid. This 'exodus' - unprecedented in scale and impact – illustrates how geopolitics, economics and societal issues collide.

The war in Ukraine has fundamentally changed the atmosphere, and to some extent the raison d'être, of the World Economic Forum. Over the past three decades, geopolitical rivalries were superseded by the ode to globalisation: politicians (including Putin) came to Davos to pitch business leaders and celebrate the virtues of investing abroad. This is no more. The whole world has ceased to be a potential market. The relentless expansion of globalisation has now been replaced for a frantic quest for security. **Energy security, food security, physical security, water security, health security – you name it, its security has become a priority**! As globalization contracts, the world is fragmenting into national and regional blocs – economic, financial and currency blocs. Traditional trade flows are in peril, and the same goes for capital flows. Private discussions were all about regionalisation, nearshoring, reshoring and onshoring. As already stated in the economic part, the overwhelming consensus is that the three-decade era of globalisation is slowing, and possibly going into reverse. **Protectionism is on the rise**, and so are the 'values' associated with it: nationalism, protectionism, nativism, chauvinism, and sometimes even xenophobia. System decoupling is becoming a reality. The few business executives with whom I could have a candid and realistic conversation confided to me that that conducting business abroad is Increasing difficulty. China is the most obvious case, but someone pointed out to me how surprises are of necessity unexpected and can occur all of a sudden, like Pakistan's decision (on the eve of Davos) to ban the import of "all non-essential luxury products" in the hope that this might stabilize the current account deficit. Albeit unworkable - what is the definition of an "essential luxury product "?! – it happened. In short, country risk seems to be everywhere. When confidence was expressed (rarely), it came from settings that were plainly ridiculous. I went to a session on "China Investment and Economic Outlook" put together and moderated by Caixin (a prominent Chinese media group) in which the word 'geopolitics' was not uttered once. Those Americans present duly paid lip service. It was laughable.

**<u>The war in Ukraine</u>**

This was undoubtedly the centrepiece of this year's AM, with many sessions and private conversations devoted to it.

What struck hardest was the stark realisation that **there is no endgame in Ukraine**. The West (or NATO) needs a plan, but it does not seem to have one. At the moment, **two broad and opposite schools of thought co-exist**. (1) According to the first one (composed primarily by the US, Poland, and the Baltics) Russia must be punished for its aggression to such an extent that it will not try again - it must therefore be 'weakened' by military means and not be offered a face-saving compromise that would only enable future aggression. Its proponents argue that if the West had reacted more firmly when Putin invaded Georgia in 2008 and seized Crimea in 2014, he would have been deterred from attacking Ukraine in 2022. (2) The other camp also wants Ukraine to win the war (naturally!), but it emphasizes that even if defeated, Russia will remain a nuclear power and the largest country on the continent. It stresses that Russia will have to be part of any new security order built in Europe and that Ukraine will need to cede some territory if the fighting is to end. Countries like Germany, France and Italy bend towards this camp. In Davos, Henry Kissinger and Graham Allison made their case by stating that Ukraine should cede territory to Russia to reach a deal and end the war. The Ukrainians vehemently disagree. President Zelensky unsurprisingly said that it is up to Ukraine to decide which territorial goal they choose to fight for.

So what's next? There were in Davos heated discussions about how the war could possibly end and much ambiguity about what this means. Could Ukraine 'win' and it if does, what would it mean? Would victory consist in pushing the Russians back to where they started on 24$^{th}$ February? Or would it entail taking back the territories occupied since 2014 (Crimea and two regions of Donbas)? And If the Ukrainian leadership decides that its armed forces should lead a counteroffensive to recover all of its territory, would the west continue to help? What could trigger the lifting of sanctions against Russia? And what would an eventual settlement look like? The various panels that addressed these issues fell short of providing an answer. The 'consensus' (if there is one) is threefold: **(1) nuclear escalation remains a real concern, (2) the war will most likely be prolonged, with no clear path to a resolution**, **(3) Vladimir Putin is betting that time plays in his favour.** Regarding the latter point, several participants expressed their concerns about how Europeans will respond when food and energy prices spike higher after the Summer. Will unity continue to prevail? Not a done deal.

As an aside, I was surprised by the number of people wondering whether the Americans had overplayed their hands by 'militarising' their sanctions. Someone observed that all over the world, countries and businesses are now pondering whether they might, one day, for a mistake or something they hadn't seen coming, become victims of US sanctions. Therefore, even though it's exceedingly difficult, the global interest in diversifying away from dollar-based assets is rising.

**A US 'civil war'**

No session directly tackled this issue in Davos, but a US civil war, or protracted violent civilian unrest, would be such a consequential problem with such innumerable and grave worldwide consequences that I spent hours discussing whether it might happen, mainly with American friends and contacts.

As readers of the Monthly Barometer will remember, we've been warning about possible violent social unrest in the US, and their investment consequences for a few years now. While I was in Davos, I came across two things that aroused my curiosity and prompted me to go back to the drawing board. The first was an op-ed by Thomas Friedman (who was at the AM) in the NYT warning about the **possibility of a protracted civil war in the US**. After an off-the-record lunch with President Biden in the White House, Friedman wrote: "I wonder if he (the President) can bring us back together. I wonder if it's too late. I fear that we're going to break something very valuable very soon. And once we break it, it will be gone — and we may never be able to get it back. I am talking about our ability to transfer power peacefully and legitimately, an ability we have demonstrated since our founding. The peaceful, legitimate transfer of power is the keystone of American democracy. Break it, and none of our institutions will work for long, and we will be thrust into political and financial chaos. We are staring into that abyss right now." The other was the release (also during Davos) of an official report by Canadian national intelligence experts affirming that their country faces new threats from a most unlikely source: the US. "The United States is and will remain our closest ally, but it could also become a source of threat and instability". In a subsequent interview, one of the co-chairs of the task force confessed that there are "serious risks of democratic backsliding in the US" that are "not theoretical" and could make Canada's democratic institutions less secure.

Against this backdrop, my take-away from my multiple conversations is this: several American serious thinkers and decision-makers agree that the likelihood of a 'civil war', or serious and violent unrest, is high. They are of the opinion that the US is either close to or descending inexorably into an era of populism and ideological fanatism that might culminate in a Trump victory in 2024. And then what happens? One prominent DC figure said: "**He'll undo everything**. To figure out what might happen, replace Biden with Trump in today's war context: there'd be no sanctions against Russia, no armaments delivered to Ukraine, 0 progress regarding the fight against climate change, no ratification of the global tax deal, etc.". Some thought that this scenario was so extreme as to be impossible to contemplate. "It is just too horrible" said one! Various other interlocutors went into the details of the primaries that had taken place while they were in Davos. Some took comfort in the fact that 24th May was a respite in the sense that two Republican incumbents in Georgia (Brian Kemp, the governor, and Brad Raffensperger, the secretary of state) had kept their seats despite being challenged by Donald Trump. Others pointed to the fact that Marjorie Taylor Green (a far-right conspiracy theorist) had won her GOP primary in Georgia and Sarah Sanders (Trump's former press secretary) had won in Arkansas. Across America, several candidates who adhere to Donald Trump's false claims of widespread election fraud also won Republican primaries for governor, senator and attorney general on 24th May. They join a group of election deniers who won nominations in Ohio, Pennsylvania and Michigan.

The electoral jury is out, but the bottom line is this: many Davos participants expressed their worries about **America's drift towards autocracy and the paralysing political divisions**. The country fissuring or braking apart is not any more a geopolitical or societal outlier. This represents a monumental geopolitical risk for the rest of the world, and for the US, a deep societal risk that could cascade into innumerable other risks.

## 4) SOCIETAL ISSUES

There were few conversations about the crux of the issue (inequalities), even though a few lonely CEOs and many of the academics and activists present in Davos recognize that "**inequality is the next big crisis"** (as Peter Bakker, the head of the World Business Council for Sustainable Development – WBCSD – said). The AM took place at a time when it was announced that the average compensation package for chief executives of S&P 500 companies had soared by 17.1% in 2021 (to a median $14.5 m) while most real incomes are falling. It seemed like many of the warnings that Klaus Schwab and I expressed in The Great Reset (July 2020) and The Great Narrative (December 2021) about the absolute necessity to make the system fairer are still going unheeded. Simply put, the labour share of global income remains too low, or conversely the profit share of global income too high. As one prominent academic observed: **"this pisses people off"** – hence the dissatisfaction, anger, resentment, frustration, polarisation that characterize societies in most of the rich world. For one Emmanuel Faber (Danone's former CEO, now chairman of ISSB) acutely aware of the gravity this represents, there are dozens, if not hundreds, in denial about the significance of what this means.

Only one session in the official program was devoted to taxation. In it, Mathias Cormann, the head of the OECD, acknowledged that the historic' global tax deal on multinationals that his institution had brokered would be delayed until 2024. In private conversations, some doubt that this fundamental agreement will ever be implemented. It has two pillars: the first one involves the reallocation of some profits from major multinationals like US tech companies to countries where they made their sales. The second pillar implements a global minimum corporation tax rate of 15%. The first pillar faces opposition from Republican senators. If the Democrats lose control of the House of Representatives in November's midterm elections, it will not be ratified in the US.

### ESG

For the first time at this year's Davos, it became clear that **ESG is now engulfed in culture wars**. Who would have thought that last year? Clearly, greenwashing permeates corporate activity to a dramatic extent and ESG is beset with critical problems of measurement and standardisation, but surely these problems should be addressed to strengthen ESG standards, not to abolish them? Although the Davos crowd tends to be rather enlightened, the clamour against ESG is mounting. Elon Musk was not in the magic mountain, but he had a chorus of sympathizers who agree with him that "ESG is a scam".

The culture war dimension of ESG was laid bare by discussions in Davos of what had happened the week before at the FT Moral Money summit in London. Stuart Kirk, global head of responsible investing at HSBC's asset management division, went into a climate rant, comparing climate change to the Y2K bug, affirming that the "apocalyptic" warnings of climate breakdown from former Bank of England governor Mark Carney were "unsubstantiated and self-serving", and asking: "Who cares if Miami is six metres underwater in 100 years?" His cynical tirade was full of false equivalences and theoretical inconsistencies, but it made a splash in the media and the ESG community. Stuart Kirk bas now been suspended, but several commentators affirm he's been "cancelled", highlighting the risk that ESG is just about to become a polarising, highly politicised, issue. Increasingly, **it will become impossible to reach a societal consensus on fighting climate change, biodiversity loss, gender or race inequality and many such 'ESG' issues**. They'll be nothing that facts, expertise, science and research can do.

Not all is lost though! Surveys from Edelman released in Davos show that most people believe that CEOs must speak out on such issues as climate change and discrimination. Overall, 77% percent of respondents said CEOs have a responsibility to address societal issues, and 68% said they thought business leaders should help shape policy, specifically on discrimination and prejudice. In addition, the youth (underrepresented in Davos) is champing at the bit. Those in Davos may have a proclivity for activism (otherwise they wouldn't be there in the first place), but it seems to me that the older and current generations underestimate **the youthful generation in general's propensity for activism**.

## 5) TECHNOLOGY

**Optimism**

Most tech people in Davos believe in the innate ability of technology to solve some our most intractable problems. Whether it's inflation, energy, climate change or supply chain: every tech person seems to have a tech solution up her sleeve. Hence, **the tech execs assembled in Davos exuded optimism**, confident that their industry would emerge from the current crisis even stronger. "It's a blip", confided a tech executive when asked about the current problems. There might be a bit of volatility moving forward, she added, but "our job is to look through it and keep investing." My personal 'jury' and that of many others is still out as to whether this is perceived as hubris or not, and whether tech innovation will eventually unleash productivity – a major conundrum in economics and the test case as to whether growth can expand solidly and sustainably. A friend who edits a prestigious science journal confided to me that tech innovation continues apace but with many unsuspected stumbling blocks along the road. AI and deep learning are one of them - not delivering on their promises. Tech is only for discerning investors!

**Crypto and the metaverse**

In Davos this year, tech was overwhelmingly about crypto and the metaverse, both in the congress centre and on the Promenade where blockchain, crypto and the metaverse were all over the place – including in a church turned into a Filecoin Foundation-sponsored CNBC venue. I participated in an immersive learning experience offered by Meta which I found uninspiring and inconclusive (it consisted in meeting animals in the Amazon Forest and was very crude – to put it mildly). This said, there is so much money pouring into the Metaverse that technology will most certainly progress at a rapid pace. The potential to be surprised persists.

The AM took place against the backdrop of the crypto industry having just lost $500bn in the recent market meltdown. Among the early proponents of crypto and blockchain investing, there are basically two camps. (1) Those who still believe in the "democratizing prosperity" that blockchain will afford and who want to be "at the forefront of this disruptive world" that will shift the global balance of power." Some, like Andreessen Horowitz are doubling down their crypto bets (launching a new $4.5bn crypto fund), convinced that the future holds a 'golden era' in which blockchain technologies and new core internet protocols will do very well. (2) Others who've completely changed their mind about the appeal of crypto. Scott Minerd, the CIO of Guggenheim Partners, is one of them. He observed that "**no one has cracked the paradigm in crypto**", and after having predicted two years ago that Bitcoin would reach $400,000, he now says that it will fall to $8,000 in a market dominated by "a bunch of yahoos."

To get clarity on the significance of the Metaverse, I attended a session in which all panellists offered a different interpretation of what it is: "The next iteration of the internet…the part where it gets less flat" (Chris Cox, chief product officer, Meta); "A single shared place we would inhabit together as humans" (Philip Rosedale, founder, Linden Labs);  "A new form of expression" (Omar Sultan Al Olama, minister of state for AI, digital economy, and remote work applications, UAE); "The seamless merging of our digital and physical worlds" (Peggy Johnson, CEO, Magic Leap). Confused? Next month's MB Report on crypto / web3 will try to make sense of all of this.

## CONCLUSION

Among the plethora of quotes that I collected in my notebook, two seem appropriate to conclude this report. President Zelensky, when asked about how the war has changed his approach to life, responded: "**I realized very simple things are the most important ones.**"
In the train on my way back from Davos, I read this (extracted from *The Art of Stillness: Adventures in Going Nowhere* by Pico Iyer): "As I came down from the mountain, I recalled how, not many years ago, it was access to information and movement that seemed our greatest luxury; nowadays it's often freedom from information,

the chance to sit still, that feels like the ultimate prize. **Stillness is not just an indulgence for those with enough resources — it's a necessity for anyone who wishes to gather less visible resources**."