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Chief Economist's Corner: Resilience

Marketing communication

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Despite wars and trade policy tensions, the pace of the global economy has not slowed. Quite the contrary, in fact — but resilience is being tested by higher interest rates.

Despite the war in the Middle East, higher energy prices, continued tensions in international trade, and tighter financial conditions, there is fortunately no indication that the global economy is heading into a significant slowdown. This remarkable resilience is due in part to substantial investments in artificial intelligence, the defence industry, and the green and digital transition — investments that are expected to increase further in the coming years, not least in Europe.

Against this backdrop, growth expectations have also been revised slightly upward in most of the autumn forecasts currently being published by banks, ministries, central banks, and international organisations. There appears to be broad consensus that global economic growth both this year and next will be around 3%, or close to trend growth. However, there is also agreement that there is considerable uncertainty surrounding the outcome.

This is due not least to the fragile geopolitical situation. The conflicts in the Middle East and Ukraine weigh most heavily, but they do not stand alone. We need only look at China's ambitions regarding Taiwan, Argentina's renewed claim to the Falkland Islands, and the now hopefully resolved situation surrounding Greenland to understand that geopolitics has taken on a new and different role in shaping the economic outlook than has been the case for many years.

In the current situation, the blockade of the Strait of Hormuz and military actions targeting shipping in the Red Sea and oil facilities in the affected countries have an immediate impact in the form of longer delivery times, rising freight rates, and significantly higher energy and commodity prices. This increases cost pressures on businesses and hits households in the wallet. Added to this are the consequences of the drought that struck Europe over the summer, which further increases pressure on consumer prices.

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The mounting inflationary pressure is the primary reason why the ECB has already raised interest rates twice this year by ¼ percentage point each time. It is highly likely that the central bank will raise rates further in its efforts to anchor inflation expectations around the 2% target. The bank is particularly concerned that higher inflation may also give rise to so-called second-round effects, where wages and profit margins also begin to rise.

As is well known, the Danish National Bank follows the ECB through thick and thin, which means that higher interest rates are also on the horizon here at home.

In the US, the Fed has also raised rates to curb inflation — and this was actually good news, as the decision cemented the central bank's independence at a time when President Trump has done his best to demand that rates be cut rather than raised.

The fact that the new Fed Chair, Kevin Warsh, thereby dispelled any suspicion that he was the president's puppet has also restored some confidence in the US dollar, which has strengthened since the rate hike. And there is little doubt that we have not seen the last rate hike from the Fed in this cycle either.

Long-term interest rates have risen to their highest levels in the past 15–20 years in most Western countries, and there is no reason to expect significant declines in the long end of the yield curve within any foreseeable time horizon — unless a deep crisis hits the global economy.

On one hand, financing needs — and thus the competition for capital — are rising sharply, for public spending and investment, but also for private investment in artificial intelligence. On the other hand, there remains uncertainty surrounding the sustainability of government debt in a number of large countries, which increases the premium on investing in government bonds. This applies not least to the US, but also to European countries such as the UK, France, and Italy, which are struggling to meet demands for significantly higher defence spending, while expenditures related to demographic pressures, interest payments on debt, and combating the climate crisis continue to mount.

Nevertheless, I am of the view that the resilience of the global economy will prove to be sustainable. This is firstly because I suspect that interest rates are not yet high enough to put the economy into reverse. And secondly, because the forces set to drive development in the coming years are powerful and enduring — namely the enormous investments in defence and security as well as artificial intelligence. What that will ultimately lead to over the even longer term will be interesting to follow. Hopefully, something good.

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