September 2022

Shamik Dhar: Making sense of economic shocks

BNY Mellon Investment Management global chief economist Shamik Dhar discusses why recent events stand out in a particularly challenging past two decades for the global economy. Here he outlines how BNY Mellon's Global Economics and Investment Analysis team looks to make sense of it all.

Having spent nearly 40 years as an economist, Shamik Dhar has witnessed a variety of shocks to the global economy. But it is the past 20, he says, that have been the most eventful and turbulent.

BNY Mellon Investment Management's chief economist says the 80s and 90s threw up some stormy economic episodes, but it is the period between the dotcom crisis at the turn of the millennium and now that stands out in terms of its turmoil.

"Starting with the dotcom crisis and the geopolitical upheaval that followed 9/11, through to the great financial recession of 2007/08, then Brexit and Covid, and now the current situation – the war in Ukraine and the cost-of-living crisis – the world economy has been assailed by a huge number of really difficult shocks in the past 15 years," says Dhar.

Against today's tumultuous backdrop of rising inflation, the cost-of-living crisis and conflict in Ukraine, how does Dhar construct his outlook on the economy and markets? He says he uses an approach gleaned from his time as an economist at the Bank of England (BoE), which is to ask what the source of the shock is and what economic fundamentals it disturbs.

BoE learnings

Dhar joined BNY Mellon Investment Management (IM) in October 2018 in what was then a brand-new role: global chief economist. He had been an economist for 36 years, working in both the public and private sectors. Notable among his public sector gigs is a stint at the BoE between 1992 and 2000 where he formed his approach to economics under the tutelage of Mervyn King.

Dhar was at the BoE at a time when the UK economy was undergoing several huge changes. This included 1992's 'Black Wednesday' when a collapse in sterling forced the UK to withdraw from the European Exchange Rate Mechanism (ERM).

It was also a period during which Dhar says the BoE was becoming more professional and more "economics focused". This, he adds, was largely due to the efforts of King, who at the time was the BoE's chief economist before becoming governor in 2003.

Dhar says King was "enormously influential" on his career in terms of how he learned to think about the world, and it was within the walls of Threadneedle Street that Dhar acquired the skill of being able to combine rigorous analysis with clear communication.

"I essentially have a model of the world economy in my head, I learned about when I was at the BoE – and I still analyze most questions with reference to that model," he says. "However, I try my best not to use jargon, not to be too techie, or 'economist-like', because ultimately, you have to translate those technical insights into clear viewpoints."

Types of shocks

Dhar says the two key shocks an economy can experience are those of supply and demand. He notes the global financial crisis was a demand shock as it depressed demand throughout the North Atlantic, the effects of which lasted a long time. With demand shocks like this, Dhar says it is marginally easier to forecast certain economic indicators, for example that GDP and inflation would stay lower for longer.

In the case of the global pandemic, however, both supply and demand were affected, Dhar says, and at the time his take on the speed of recovery was against consensus. "My feeling early on was that once the shock itself had dissipated, the economy would bounce back pretty quickly, unlike in the global financial crisis. I was out of consensus on that."

The current situation is largely a supply issue, says Dhar. The Russian invasion came as a surprise, adding pressure to a global economy whose long run confidence and productivity growth had already been depressed. On top of that, Dhar argues there are a raft of significant structural changes occurring, including in the labor market, the move to net zero, digitalization and the geopolitical setup.

"All of those big structural changes are going on in the background and you must keep an eye on them, as well as the immediate impacts of all these shocks. So, in a way, I'd say that makes today more difficult than previous crises."

Inflation outlook

On the path for inflation, Dhar notes the problems with the economy throughout the 70s, 80s and 90s were largely related to rising prices, but he thinks 15 or so years of inflation-targeting experience should play to central banks' advantage. "I'm pretty confident they won't make the mistakes of the 1970s, even if the next year or two feels a bit tough," he adds.

That said, Dhar thinks the cause of the current situation comes down, in some part, to a misdiagnosis by central banks of the longer-term implications of the pandemic, at least in the case of the Federal Reserve and BoE.

He says: "Throughout 2020 and early 2021, most central banks, institutions and economists were assuming it would take a long time for economies to get back to where they were, unemployment would be high for a long time and there would need to be a lot of fiscal support. I think that was wrong and it informed a bias towards keeping monetary policy as loose as possible for much longer than was probably necessary.

"Yes, current inflation and the cost-of-living crisis is largely bad luck and the repercussions of the Russia/Ukraine war, but some of it is down to that miscalculation, so some central banks are having to play catch up."

Dhar thinks global inflation is likely to drop but the key issue is the level it settles back down to and whether it is consistent with central banks' inflation targets. He suspects central banks may have to raise rates higher, even if that leads to a recession.

Economic slowdown
Considering a potential economic slowdown, Dhar thinks a recession in the major economies – US, UK, Japan and Eurozone – could be likely due to two reasons. The first is rising energy prices and the associated cost-of-living crisis that could hit consumer spending. The second is interest rates rising and the monetary policy tightening needed to control inflation.

"I think the US is more vulnerable to a recession that's caused by the Fed, essentially one in which rates are going up to squeeze inflation out of the system," he says. "Whereas the UK and Europe are more vulnerable to the energy price squeeze, though the UK is also susceptible to tighter central bank policy."

Teamwork
As global chief economist Dhar also leads the BNY Mellon Global Economics and Investment Analysis (GEIA) team whose job it is to produce economic viewpoints and research in an array of formats: written reports, presentations, podcasts, video and face-to-face client work.

The team comprises six individuals split across London, New York and Singapore. Dhar is keen to note the "fantastic job" the team has done since he started at the firm, particularly over the past year with its economic shocks.

It is standard for major financial institutions to have a chief economist but what Dhar thinks makes his role unusual is BNY Mellon IM's multi-boutique model, which means he also has two major internal clients. The first is the investment companies with whom he and the GEIA team encourage macro debate, and the second is BNY Mellon IM itself where the GEIA team's research and outlook is leveraged by its global distribution teams.

"We can do that by producing interesting research that salespeople and product people can lean on when they're talking to clients."

But the thing Dhar enjoys most about the job? Interacting with the fund managers.

"We don't always agree, but it tends to be a stimulating macro conversation," he concludes with a smile.

Disclosure

This material has been provided for informational purposes only and should not be construed as investment advice or a recommendation of any particular investment product, strategy, investment manager or account arrangement, and should not serve as a primary basis for investment decisions. Prospective investors should consult a legal, tax or financial professional in order to determine whether any investment product, strategy or service is appropriate for their particular circumstances. Views expressed are those of the author stated and do not reflect views of other managers or the firm overall. Views are current as of the date of this publication and subject to change. This information may contain projections or other forward-looking statements regarding future events, targets or expectations, and is only current as of the date indicated. There is no assurance that such events or expectations will be achieved, and actual results may be significantly different from that shown here. The information is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be and should not be interpreted as recommendations. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission.

Recent market risks include pandemic risks related to COVID-19. The effects of COVID-19 have contributed to increased volatility in global markets and will likely affect certain countries, companies, industries and market sectors more dramatically than others.

BNY Mellon Investment Management is one of the world's leading investment management organizations, encompassing BNY Mellon's affiliated investment management firms and global distribution companies. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally.

Not FDIC-Insured | No Bank Guarantee | May Lose Value

BNY MELLON
INVESTMENT MANAGEMENT