Talking Asset Management with KPMG

Checking in with KPMG Americas Asset Management leads

Below is a transcript of *Talking Asset Management with KPMG*. In this episode, **Greg Williams**, National Sector Leader for Asset Management at KPMG U.S, hosts a conversation with a senior economist from KPMG Economics and Asset Management leaders from KPMG in Canada, Mexico and Brazil, exploring macro trends in the global economy and the impact on the asset management industry in the Americas.

Greg Williams:

Welcome to KPMG's Asset Management podcast and thanks to all of you for joining us today. I'm Greg Williams, U.S. leader for Asset Management, and today I'm joined by my fellow partners and Asset Management and Real Estate leaders in Canada, James Loewen, and Tom Rothfischer, Asset Management leader in Brazil, Lino Junior, and Asset Management leader in Mexico, Carlos Fernandez. We have a special guest with us today, Tim Mahedy in KPMG's Office of the Chief Economist in the U.S., and we've asked Tim to come to us today to share his thoughts on the macro trends are happening in the global economy. We are in a unique environment coming out of a pandemic induced recession. Something that I continue to say, we don't have a playbook for these because, at least in my lifetime, there hasn't been a pandemic.

So it's creating some unique and uncertain issues in the economy that we haven't seen before that I think is going to really create some opportunities as well as challenges for those in the asset management and real estate industry. So again, thank you for joining and I'm going to turn it over to Tim to give us some of his thoughts on the economy. And then the rest of us are going to come back and talk a little bit about what we're seeing on the ground as it relates to our clients in our industry. So Tim, welcome, and I'll turn it over to you.

Tim Mahedy:

Thanks so much, Greg. Great to be here. Thanks for inviting me. I'm excited to not only give my viewpoints and the viewpoints of KPMG Economics, but to hear about what's going on in these countries. As economists we're always kind of looking at data that's at least a couple weeks, probably a month or two old. And with these kind of moments we have where we're looking at potential turning points in the economy, it's helpful to hear what folks in the industry are looking at. So I'm very excited today. Just to quickly build on your analogy of the playbook – you're right. We don't have a playbook for the situation. We keep trying to write one and then we're tearing out pages as we go along because things are changing by the week. So it's like we're a football coach on the sidelines. Just every out pass we throw is incomplete at this moment.

It's a difficult situation to kind fit together what the economic narrative is. And I guess the place I have to start is kind where we are on the global stage. There's a lot to talk about and I'm going to draw some contrast as we talk today about what's going on abroad and what's going on in the U.S. There's similarities, but there's important differences. There's sources of strength in the U.S. that you're not seeing in some other places. And some of the shocks that we're experiencing are less severe in the U.S. But there are many things unfortunately on the global stage

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that are concerning. I don't have to list all of them, there's a lot of geopolitical tension, Russia and Ukraine, what's going on in parts of Asia, supply chain issues continue to persist, different global pandemic coming out COVID, what's going on with other diseases that we're starting to hear about.

There's a lot that is shocking our economy and more importantly, the shocks are happening sequentially. So in previous periods, you'd get a shock and kind of get a little bit of break between that shock and the next shock and of the economy would equilibrate. But we're just getting shock after shock, after shock. And it's done two things, it's made the economic data look confusing and it's also maybe more importantly brought forward and accelerated some kind of disturbing trends that were going on prior to the pandemic. I'm going to talk about a lot of this stuff today but the first place I'll start is in China.

Traditionally the last couple decades, at least the last 40 decades been a very strong economy and there are reasons to think that there are some weaknesses inside of that country, particularly in the property market that there are really going to win an economic growth. That's the world's second most important economy. That's outside of the geopolitical tension. You've got this really big economic forest that's slowing, and that's going to have some real implications for commodity markets, commodity exporters. So what many of them are in LATEM countries, there's going to be less demand for those goods especially if prices continue to go up and due to other factors. And so you've got this interplay between the slowing Chinese economy, what's going on in Russia, Ukraine, other tensions in Asia, and then a wrap all of that into the fact that we still haven't recovered from supply chain issues from the pandemic.

And you've got a pretty precarious global economy that looks to be slowing pretty appreciably with high inflation in many places, quick and fast movements by many central banks and because of many fiscal policies that were taken during the pandemic. And again, we'll talk about some of the LATEM countries. You have high debts of GDP ratios, which means there's rollover risk with debt servicing. So you have all of these factors of coming together creating a lot of instability on the global stage. And the outlook I would say this moment is, we're not forecasting a contraction of global activity. That would be pretty severe but a significant slowdown for sure. And I would say some drivers of growth, Europe and China look to be at the center of that.

So maybe moving over to the U.S, to draw some contrast there, I've painted a pretty stark global picture. We're facing many of those same headwinds in the United States. So we've got inflation that's 40 year high. We recently saw inflation and pressures ease a little bit in the latest CPI report, at least that's what the headlines are going to tell you. There are reasons to be very concerned about that CPI report. Many of the drivers of inflation actually continue to look. You have many of the drivers that won't turn around quickly based on Fed policies, things like shelter inflation, which right now is somewhat resistant to interest rate increases, even though demand is cooling. Things like pandemic affected services, those type food pricing inflation, all of that stuff is kind of outside the Feds purview.

Even though we had a slowdown in the pace of inflation, it's still very high and those underlying factors are concerning. And so we've got high inflation. We've got the fastest pace of rate increases by the federal reserve since the mid-1990s, that is quite stark. It has a lot of implications for both the economy here, the dollar, what goes on abroad, what starts in the U.S. often spills over to the rest of the world. And there's a lot of uncertainty about where that policy's going to go over the second half of the year. We're already at what many of us consider to be a neutral policy stance. So what I mean by that is, the place where monetary policy is neither speeding up the economy nor slowing it down. As we go above in September, we're getting another rate increase, probably 50, maybe 75 basis points and then another, maybe 50 in November or December.

You're starting to talk about going pretty far above that neutral kind of steady state, that cruising control for the economy. And that starts to look pretty contractionary. And that significantly raises recessionary risks inside the U.S. Towards the end of this year but really into next year. We've talked about soft landings, that's a pretty difficult situation, a pretty short runway for monetary policy makers to land their plane on because we haven't seen inflationary pressures come down because of this uncertainty with geopolitics, the potential for more shocks this year unfortunately, there's really not much they can do unless they're will really willing to jack up rates, which is going to then turn into a significant contraction in consumer demand at a time when the rest of the world is looking pretty weak too.

So to add all those things up, it's not looking particularly strong for the U.S. economy. Now, why are we not in a recession right now? Where we just got our second quarter of negative GDP growth back at the envelope, kind of estimations generally tell you that if you get two negative quarters of GDP growth, that's a recession. Normally that's true. Going back to 1947, that has been true, but there have been rare moments in history where we have gotten two quarters of economic growth and it's not been deemed a recession. This is likely one of them. And the reason is really residing in the labor market. We got those two cores negative growth. And then right after that, we got employment data that showed the economy added over half a million jobs in July. That's very strong. And so it's not that labor market should be viewed as a four looking indicator, it should not be.

The unemployment rate and unemployment levels move around, they always tell you what's coming, but it is a buffer to a potential recession. So it's like the insulation in

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your home, if you're trying to figure out what's going on outside you'll know, if you have bad insulation, your buffer's weak, you'll know it's cold, but you wouldn't necessarily use that to tell you what the weather's going to be like in 10 minutes. And so that's kind of where we are with the labor market in terms of how we should be viewing that strength relative to what we're seeing as weakness in a lot of other areas.

Greg Williams:

In relation to that labor market which from a real estate in the U.S. it's always jobs that's what drives the real estate. When you look at that unemployment and I've seen your projections over the next couple years that you anticipate unemployment to stay relatively low historically speaking. The question I have though, the thing that's concerning me is that labor force participation rate is still I think below pre COVID levels. And just how much does that concern you about the labor force participation rate as it relates to dealing with wage inflation, dealing with GDP growth in the future? Because that seems to be a big concern of our clients about where are we going to get the workers and any thoughts on that?

Tim Mahedy:

Yeah, Greg, you hit the nail on the head for what's a real risk to the labor market over the next couple years. We had a chart in one of our charters, we've actually been using it for quite some time. It's a very simple chart from an economic standpoint, it's one time series but I love it because it's simple and it just makes a very clear point. This labor force participation rate has been declining for the whole economy, has been declining for two decades. What do I mean by that? Generally speaking, when you have a recession, you see folks leave the labor force because they lose their jobs and they decide it's not worth being around and they go and do other things until the labor market improves. So that drops your labor force participation rate. And then in an expansion, those folks come back in and your labor force participation rate goes back up.

That's traditionally prior to the early 2000s it's been the relationship and it really was boosted to the 60s, 70s and early part of the 80s as women entered the workforce. What we've seen since the mid-2000s is that we will, right before we enter a recession labor force participation rate will be, you know, 65%, then you'll have a recession or drop, and then it will come back up a little bit over an expansion, and it will end somewhere below that level relative to where it was before the recession. So it's declining over time despite very strong recoveries. After the global financial crisis, it ended up over two percentage points below where it was prior to the global financial crisis. So that was a 10 year expansion. So something is going on there to your point.

And COVID again, we saw the same relationship. We're still over one percentage point below where we were prior to COVID to the pandemic, that's concerning. And it should tell you going forward, let's say we get a recession, which is what we're talking about. Let's say the unemployment rate jumps up and you're right, we don't have it going to 8%, 9% that we saw it in the global financial crisis. We have it going to five and a half ish, 6% over the next 18 months, that's still would constitute a recession. That's a pretty stark jump from where we are now, but it's not the places you saw. It's not what you saw in 2008. So what does that mean? Well, for a couple reasons we can discuss that may mean that some folks leave and the demand for labor is reduced.

And so supply and demand come a little bit more imbalanced, but the second you have another expansion you're going to be right back in the same place that we're in right now, which is unable to find workers because the sadder line truth and the demographic truth that we are all now realizing, some have realized before this but I think it's really dawning on the rest of us is that our workforce is aging out and we are not replacing workers fast enough. And so when you get in this place where you get little reprieves from this labor shortage, you can expect until we start adding more workers or we start having a place where workers are needed less. Both of those things take a lot of time. You're going to continually find yourself in a very short labor market during expansions.

Tom Rothfischer:

So Tim, I'd be interested just looking at what's happening in Canada, immigration is a very significant growth factor for our economy. We had a total shutdown during COVID. I think we were shut down a little bit more than the rest of the world in some areas here in Canada but we're looking at really expanding our immigration for Canada 400,000 a year for the next few years, we're expecting 700,000 additional foreign students to come back into the country, which in those numbers may not sound big, but for a country that has 37 million people in it, it's a pretty significant impact for us and it's always been a very traditional area for us to focus on to generate growth. What are you seeing in the U.S? How do you see that having an impact, if at all, just considering the impact that it's having for us here, I'd be interested in your views.

Tim Mahedy:

It's a fantastic point, Tom. And one of the things, the U.S. arcane economies are fairly similar. There are differences that they tend to track each other. This is one of those big differences. And Greg, to go back to your point and Tom, you touched on this, your labor supply is important input into growth. That you need workers to be able to continue your growth path over a long period of time. And so Tom, when we think about that, you think what are the major inputs in labor supply? It's two things, it's people having kids and that affects you depending on where you're allowed to work and how quickly your parents kick you out of your house. 16 to 18 years later, sometimes 22

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if you need to go to college first, but the other place is immigration. And I don't want to speculate an immigration policy in the United States, but I would say we've seen a market slow down for many reasons.

Some of which are just from the pandemic and we've for a long time been short on immigration and workers from other countries in STEM industries and that has been one of the reasons that tech has seen such strong wage growth in certain places. And so if we don't turn those release valves kind of like you expect they're happening in Canada to bring in some additional workers through immigration, we're really relying on folks to have additional kids. And as a father of two with young kids, I can tell you it is expensive and hard to have kids in the U.S. There's a reason the birth rate is declining. Searching house prices is not going to help that. And so affordability, high inflation, not going to help that. If we look long term, you're making it more expensive.

So then you really need that immigration release valve. And so that's where I would come out, you're absolutely right about the Canadian economy and that being a pretty big tailwind. And we could use some version of that in the United States, however that ends up policy or the end of the pandemic where we could definitely use that. So you do really great. These are really great questions around kind of what lies ahead of us even after this recession. And maybe this is a good place to stop for a second and talk about maybe a medium term view. There's a lot of headlines right now about inflation there, a lot of viewpoints out there, a lot about recession. We talked about that's a pretty likely outcome, but I think there's something that we should all be thinking about over the next 10 years. And that's that there's a sequence of factors and things that are going to likely converge that make the next decade in terms of economic variables and economic stability look a lot different than the previous couple decades.

And this is where we history may not repeat but it sure does rhyme. If we're looking back at the 60s and 70s, we had high inflation, there was then required a very active Fed, probably it was high inflation than we have today and a more active Fed than we're probably going to need. But the condition was very similar that required a pretty much shopping at the knees of the economy to get inflation and inflation expectation under control. And then you have what we call on economics, the great moderation, which sure you got ups and downs. You had recessions, you had a really bad goal of financial crisis but for the most part, the economy was fairly stable. Inflation was stable, expectations were relatively stable. That's different than what you see in a lot of other countries.

It happened in the U.S. and Europe and Canada, advanced economies with critical central banks, New Zealand, some parts of Latin America, but that may be changing. With climate change with more pandemics, with geopolitical tensions on the rise, with the changes of the global political order, domestic political issues in many of our countries, those things are going to intersect to create more volatility. There's money to be made in that but there's also it means that there's going to be a lot of turning points. And so when I'm thinking through this and I'm thinking through periods of volatility and what that means in developing countries and what that means for the dollar. Let me start with oil producers and just take an example of what I think this means for this particular industry, pretty much across the board around the globe.

So investments in oil production usually require a good amount of stability and forward thinking and forecast of pricing because it's a 10 year investment. What we're seeing in the United States and then actually in a lot of places, is that the volatility and prices, which by the way did not start during the pandemic. It's been more volatile each decade that we've gone since late in the 80s has continued to weigh on investment in this industry. Occasionally you get a, I'm not saying we didn't see investment in the 80s but very recently we've seen a curtail of it and we have seen kind of periods of up and down in investment in this industry over the last 20 years, Fracking in the U.S. really brought it online but then you see price decline, recession up as it just kind of plummets out.

What we're now hearing for many places is that oil investments in the U.S. has really taken a hit. One of the reasons, not giving a lot of the reasons being that it is hard to forecast prices because of volatility. That is just the kind of Canary in the coal mine in my view of what many industries will be facing, which is really uncertain conditions and policy rates that go up and down a lot in the U.S. and abroad. And you can see this in many Latin American countries and the latest inflation numbers from Brazil showed a pretty stark month over month decline in inflationary pressures. The policy rate is still very high. It's not the highest it's ever been, but it's high. And the central bank is saying, "Hey, we just had a pretty good month in terms of deflationary actually pressures. We're still probably going to raise rates," and because there's so much uncertainty around what's going on and what's coming next.

That's similar but also different than what's going on in Mexico, where you still have inflation of hitting very high highs and central Fed that continues to have to get ahead of that. And there's a same story in the U.S, Canada also struggling with where do you go? The U.S. is raising rates, we have to raise rates. They started later than us. Are they behind the curve? I mean, there's just so many questions around this. These countries tended to have monetary policy that was more or less aligned, not always, but in the previous decades, that's probably gone. And so when you start looking around and go, where are these structural issues? I look at three things, one, inflation in the country. So it's high across the board. Two, what's the central bank doing to address it. That's both a positive and negative high rates should help bring down inflation. It also makes borrowing costs high. It raises all kinds of issues and potentially causes recessions.

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And then the third piece that I think we all recognize in our countries is that many of our governments took countercyclical fiscal stances to offset the demand shocks of the pandemic, which really caused death to GDP ratios to go very high. And so now you're in a situation where you've got high death GDP ratios, rising borrowing costs, including for sovereigns and a lot of uncertainty and high inflation. So it's not going to take a lot to tip the whole thing over. Some countries will be more vulnerable than others, but really to go back to the playbook analogy, we're just ripping pages out, because we don't know. We haven't played in on this field in this game for a very long time, but it just looks like there's going to be a lot of volatility. And so now that I've kind of painted this whole picture, maybe it would be a good idea to talk to people who actually work in the economy and understand financial markets and just kind of throw the question out there. Does this sound crazy? Is this what you're seeing on the ground in your countries?

Greg Williams:

Yeah, Tom, James – do you want to start with Canada and what you're seeing in Canada?

Tom Rothfischer:

Maybe I'll give it a start, Greg. Certainly I'm talking to the real estate folks in our industry and I have to tell you, I've never met a real estate person that isn't optimistic. So I have to say what we're hearing is a sentiment of cautious but optimistic. I mean all of these issues that you're talking about with regards to inflation and interest rates, clearly are causing people to pause. We've seen transaction volumes go down. We've seen certain development projects, canceled and house prices, which are very important to the Canadian economy. They're down over 18% in the year. So that's all very significant. And depending on what paper you read, you'd think the sky is falling but when you peel back the onion a little bit, the Canadian economy did grow again in Q2 to your point while interest rates and inflation is currently high, it's not really expected to be that way in the midterm or long term, even gas prices and food prices have come down.

Our job numbers, they certainly weren't as good as the U.S, but overall the unemployment rate remains low. So there's certainly a reason to pause but no one that we're talking to is panicking. Maybe just to round it out. Before I hand it over to James, the things that I would have people think about when it comes to the Canadian economy, we already talked about immigration and how important immigration is to Canada. Maybe a bit of a reminder, it's pretty obvious but we are a commodity based economy. So the prices that have come under pressure over the last couple of weeks and months clearly cause an issue for us. But just to make the point again on housing, we in Canada, we're twice as reliant on the housing market for economic growth and prices, they have come down but they're still pretty high. They've been going up for three years so far. There could be a decrease in housing prices of 20%, that still doesn't get us anywhere back to where we were before. And that continues to perpetuate an affordability issue. We continue to have rental rates increasing significantly, which I know you're seeing in the U.S. And all of that leads to continued concern about the impact this will have on discretionary consumer spending and the sustainability of consumer, which is really important to us for our economic growth. So you add onto that, what is our government potentially going to do to combat the political pressures they're facing on affordability? These are all things that I don't have an answer to, but what we're talking about and what we're concerned with and what I think you have to consider if you're looking at what's happening in the Canadian market. Now I'll leave you with one final thought. This whole concept of workforce considerations.

The fact that in our various industries in Canada, as I'm sure you're experiencing elsewhere in North America, we just can't find the people that we're needing to meet the needs. We have shortages of candidates everywhere, wages have gone up significantly. And quite frankly, in urban centers such as Toronto, we struggle getting people back into the office. And this is just creating a whole new dynamic that is really taking up the energy of executive teams to figure out what type of hybrid model do we need to put in place to keep productivity in place, to keep culture in place and to keep businesses going. So Tim, that's what we're looking at. Greg, That's what we're hearing. James, I'll hand it over to you to speak from an asset management perspective.

Greg Williams:

Let me first talk about the U.S. real estate in contrast, a very similar, very optimistic. And I think when you talk to people in the industry, they're looking at this uncertainty without this playbook and saying, what is this going to mean? Because if you look back in history and I've been the real estate business a long time, when real estate's about to go into recession, you say, well, we're over levered. Well in the U.S. we're not levered by any means. Well, you're overbuilt. We still have a lot of supply demand imbalance in a lot of areas. Well, you're operating income, ours must be poor. Now we've got significant rent growth even in this year. I think they look and say, what is it that can go wrong? And I think that the pause in transaction volume and deploying is saying, I'm not sure I can read these tea leaves because, as you said Tim, we keep ripping out the playbook of how is this going to come out.

But I think that in the U.S. from a real estate perspective, even in spite of the fact that most people believe we're going to have a recession in the next two years, not a lot of concern that they're not going to be able to weather that recession. And even the rise in interest rates, if you look at where they are today, a lot of the people have been around a long time said, it's not that bad an interest rate. If you

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look at historic standards, so the same thing in the U.S, it's really just where's the workers going to come, because it's all about jobs. And I think in the U.S. I'll echo you Tim, we need immigration reform to really get our immigration system working again so we can get workers into the U.S. I think that's probably one of my biggest concerns going forward. So very similar to that. So James didn't mean to interrupt, but I'll throw it back to you. Talk about the asset management in Canada.

James Loewen:

Thanks Greg and Tom. I tend to be a little bit more hawkish than Tom and that's because he's been in industry that has grown for the last three decades and I think real estate will be fine in Canada. There's still supply issues, there's still going to be demand from immigration and so on. So I think that part of the story is okay. We are seeing bankruptcies and proposals go up in the last couple of quarters. So that trend is worrying and I think the other thing not to harp on the real estate side of it anymore, but the one thing is that we have a lot more people with variable rate mortgages than the United States. It's almost actually reversed in terms of how many people have variable rates. So as those costs go up, there is some worry about how that's going to impact people.

And are we going to see more consumer bankruptcies. And then I think the only other thing that I would say, and I echo the points on the labor side, we are starting to see layoffs in the tech sector in Canada and financial services, asset management, real estate need all of those people and more. And so we've got to get those people retrained and we've got to attract them. And that's really a real key because certainly we're still seeing labor shortages across our industry. And then the other piece of that tech slowdown is we have a lot of asset managers and financial services companies that made a lot of money off of all of the tech unicorns in the last year that we've seen in Canada on the West Coast, in Montreal, in Toronto and so where are those returns going to come from in the next six months to a year, I think is people are going to be searching for that and that's going to be a challenge. Not to end on more depressing, not in Canada but there definitely are. There's going to be some challenges at least for the next year.

Greg Williams:

James, I think that's that uncertainty of where is it going and where those opportunities going to come from? I think you're seeing across the globe. So Lino, what about Brazil? What are you seeing on the ground in Brazil?

Lino Junior:

It's funny because we are seeing a lot of similarities between countries or what is going on after the pandemic but in Brazil, not different from other countries. So we had inflation above the target and in order to contain inflation Brazil Central Bank rose the interest rates from 2% to 13.75%. I think analysts here think that maybe they will have one more increase and then they will stop. But definitely if you put 10 economists together, everyone will have a different view. But the fact is that Brazil Central Bank rolls interest rates to contain inflation. And last month we had the deflation. So, that's something that beginning to be under control. Another thing that we are seeing here that is the unemployment rate is also under control, not unemployment rate rose little bit during the pandemic, but then now it seems to be under control.

It's very important to say as well that this year is a president election here in Brazil. And as part of that, so President Bolsonaro is giving incentives to the low classes in Brazil to control at these boundaries of these people and also in order to help him on his reelection project. And one of the things that our minister of finance also is mentioning is that, it's during the crisis that you see opportunities. And one of the things that we are discussing in Brazil is that the way the countries will operate after the pandemic and the Russian Ukraine War will be different. And Brazil can play a very significant role on that because people will think twice and continue to operate with Russia and China, and we can play a very important role, not only because of, be more close to the U.S. for instance, but also to have important commodities that we can play that role on the economy side.

So this is on the macro economies, I think on the asset management industry. So we are seeing the industry very resilient, the assets under management, they continue to grow, but because of this increase of the interest rates. So we are seeing the shift of the structure projects to more fixed income projects. So people and managers would like to get the advantage of the high interest rates to have good profitability of their portfolios. We are also expecting for this year 2022, two important regulatory rules on the asset management industry. The first one will be the new rule for liquid funds in Brazil. And the second one will be the new rule for the distributors. So I think this will be important rules that will be very favorable for administrator and managers in Brazil. So another thing that we are seeing, it's an increase of investments in private equity, inventory capital and credit in real estate.

Some managers are saying that prices because of the crisis, they are with a very opportunity view, very low. And it's the moment to invest. We are seeing international investors investing in Brazil to get their advantage of the prices. And another thing that we are discussing is that the distribution platforms, they had a very good increase in Brazil over the past years, but they are now consolidating with the major digital banks. I think this is a trend that we are seeing here. So I think this is what we are seeing on the Brazil asset management industry.

Greg Williams:

Thank you, Lino. Very helpful. And Tim, I'm hoping you don't think the U.S. has to go to a 13.5% interest rate to cool off inflation.

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Tim Mahedy:

No, that's the number we hope not to see.

Greg Williams:

No. What is your magic number before I turn it over Carlos? Where do you think they're going to have to go before they reach a point that they started to cool inflation and can stop the interest rates hike? Do you have a view on how high you think they're going to have to take them?

Tim Mahedy:

Right now we're looking at 4% by the end of the year, could go a little bit higher in the first quarter of next year, four and a half. But Lino was talking about double digits, so we'll leave it there. It's all relative and this is one of the things about volatility is Brazil has traditionally had more ups and downs in the rates, a very credible central bank, but they've still had to do more ups and downs in the interest rate than we've had to do in the U.S. last 20 years. Greg, you probably remember the before times but we were talking one and a half super percentage points back in, even in the 90s, it was like 5%. And so there's just been a lot more volatility. So our view is that 4% even though it's a lot less in other places, it's still going to be quite contractionary.

Greg Williams:

And in historic standards, four in the U.S. is not necessarily that high. I think we've kind of had a period of time. Like you said, in the last 10, 20 years, it's been historically low and we've kind of got addicted to those low rates and maybe it wouldn't be that bad to have an increased rate going forward to be a more stable economy moving forward. But I know that's beyond my pay grade. So Carlos, what about Mexico? What are you seeing in Mexico?

Carlos Fernandez:

Well, prior to Lino speaking, I was seeing we had a really high rates, but after hearing Lino, I think we're doing okay. I'm going to start by saying and very consistent with what team already mentioned. The name of the game here in Mexico. Now it's two things and it's pretty consistent with the region. It's inflation and rates. If we talk about GDP, we're estimating a 1.5% growth for the year, which is way lower than the one we had for last year which was around 4.8%, not enough to offset the previous one, which was a negative almost 9%. Mexico was pretty badly hit by the pandemic. And we're estimating a GDP growth the 1.2% which is lower than these years but it's from what we've seen, unless you tell me otherwise it's consistent. A lower GDP growth for next year is consistent with what's happening in a lot of countries.

We talk about exchange rate, it's been stable and we think it's going to remain like that. The most relevant thing like I said, it's inflation and rates. A lot of corporate investors are anticipating that bank of the Mexico, which is Mexico Central Bank. The Mexican Fed, if you will, will end the year over 9% and provided this is true. This could be the highest rate we've had over a decade. It's little lower than Brazil's 13.75%. I think it was what Lino mentioned, inflation continues to increase during July. We had a higher inflation than actually expected, and it was a high expectation mainly driven by food and electricity and together with the fact that again, this was already brought up by Tim that the United States just recently increased their rate. I think it was 75 BPs. These two things will likely make Mexico Central Bank to increase their rate in a similar way during their coming meeting, which is in a couple days from now. We're expecting inflation to continue growing during this semester and end up with a 7.5% for 2022.

And we don't see that decreasing in the first semester of 2023. I think it'll be the second half of 2023, where we going to see a little slowdown of inflation. So all this being said and trying to put it in the asset management context, what we're seeing now and considering how volatile the markets have been and the low expectations a good piece of the market has on the equity side. We're seeing a shift more towards setters, which are the government funds. Those provide investors here in Mexico with higher yields, given the higher rates we're having than many of your typical to put it in some way, portfolio mixes, while bank of the Mexico's rate is used for the interest that banks charge setters. These government banks are used for interest paid by banks. So when bank of Mexico increases the rates, so the setters and it's been interesting to see this again, shift to setters and going away a little more looking for the safe side of the investment.

That happens and it's an interesting thing with domestic investors. One of the things we're seeing now is foreign investors going away from setters, not because of the rate per se, it's more not political but all the implications that investing in government bonds in Mexico may have. So it's more of a domestic thing. That's again, what I have to say as it relates to Mexico, which again is I guess consistent with what we've heard from Tim and my colleagues before Greg.

Greg Williams:

Terrific. Thank you, Carlos. And appreciate those comments. Tim, when you think about the Latin American, Canada say the America is here, you made some comments earlier about with China and Russia and the instability over there, that it may create opportunities for more regionalism. I'll put it that way versus globalism. Do you think that you're seeing a permanent move there or is this one of those things? Well, looks like it's going to be that a couple years, we're going to tear up that playbook. I mean what do you see, or some of those shifts are hard to come back once they shift as well. So maybe you could expand on that a little bit.

Tim Mahedy:

This is a great play, I'm going to stick sports metaphors and it's an area I feel safe in, but one of the fascinating moments about right now is that because we don't have

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this play, because we don't really know how to approach this. You could say that we've sharpened our minds. So if you're up big in a game, he's a football analogy, 45-0 if you talk soccer three now, your defense lacks a bit. That's what the last couple decades were. We kind of knew what was going on. We got surprised once in a while, but most of these economies, a big were fairly stable. Each one has gone through things, there's commodity super cycles in LATEM. And there was the Mexican Paso crisis and things like that. But relative to human history can really far back, it was a moderately stable period that we got three now.

And so now we're in a place where the game is tied and our minds need to sharpen a bit. And this is in some ways why maybe all this talk about recession may be helpful because we're kind of foreseeing it. We don't tend to do this very well as economists and we're kind of foreseeing it. And so that is allowing businesses to kind look for the arbitrage. You're kind of mentioning Greg and we've heard kind of from Lino and Carlos and James and Tom there's differences here that you provide opportunity and we're thinking about it and we're looking for them as opposed to just going, it's another good year. And so I don't want to downplay that again, because there are shifts in the last couple decades that there were material, but this could be a whole new ball game. And so when you go into that and you say, well, what does this mean for the global economy?

If I'm thinking through what does reshoring mean? What does onshoring mean? It does seem likely that I don't want to say we can get away from globalization. I think that's an overstatement. Minerals exist where they exist, oil exists where it exist, lumber exists where it exists. We can't really change that. What we can do if you're looking to kind of, let's say shore up your supply chains, because one argument you could make is that our just in time supply chains were inappropriately pricing risk over the last 30 years is to move kind of intermediate or even final production, closer to markets. Where are the biggest markets in terms of consumption of goods, U.S, Europe, China and so countries like Mexico, to your point, Greg could really benefit if, say, companies decide to move some of the final production closer to U.S. markets, but still capture that wage differential between the U.S. worker and a Mexican worker.

So that's a potential boom, but that's going to take a long time. So it's not going to happen right now, but also being like you mentioned, it's not going to just reverse itself. So these are the decisions that when I talk to clients, when I talk to other economists, when I talk to folks out in the real world, they're saying, we're thinking about these in the material way and in ways we hadn't thought about them before. And so that tells you there's opportunity here, there's places you can go if you're an asset management. If you're looking for it and digging in a little bit to see there's differences between countries and the shift in markets is really going to provide places and opportunity for growth. And I think that reassuring of final production is one place to definitely look in LATEM for sure.

Greg Williams:

And thank you for that. And I think as we come close to the end of our time in our industry, a lot of our participants volatility is opportunity. And so I think that when we look at this market where we say is uncertainty, because we don't have that playbook, there's going to be a lot of opportunity created for our clients, not as much comfort in foreseeing the future. We've had an economy that's been growing rapidly for a number of years, but I think for many parts of our industry, this is the time for them to shine and use their skills and their knowledge to really create value for their investors. And we continue to see significance amounts of capital. I mean, the rise in private capital continues to increase in the off space, particularly I don't see that going away at all.

And so that capital's going to get deployed. And so I think the markets off of historic transaction volume mind you, so even though we've taken a pause, there's still transaction volume out there. I think you're going to continue to see that be strong as we move forward. And the hope is that if we do have "a recession" whenever the economist decide to define it as a recession, that it will be in a mile, there will be something we move through quickly. But again, I want to thank all of you, the panelists for being here and thank Tim, especially for joining us to this group. We'll definitely have you back. And to all those that are listening, please reach out to any of us with any questions or comments or suggestions. We'd love to talk to you. Our contact information will be there. And with that being said, we wish everybody a good day and hope to speak soon.

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