MACROECONOMIC *view*

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Economic outlook 2023 – After the peak of anxiety

Key highlights:

- The four shocks of 2022 (geopolitics, inflation, interest rates, China) will be less intense. The peak of anxiety is now behind us.
- Global disinflation is well underway for goods prices, but not yet for services.
- Market participants expecting a Fed rate cut as of this summer will be disappointed.
- Faced with high and persistent inflation, the ECB will be more aggressive than the Fed in 2023.

A major geopolitical shock, inflation at a forty-year high, unprecedented monetary tightening, and the Chinese growth engine stalling... this is 2022's legacy. We've had better starts to the year. These four negative factors won't just magically disappear, but we think they will abate and for some, even reverse.

In such a challenging environment, **growth forecasts** can't be optimistic. Last year, there was no sudden break in activity or trade, but rather a steady deterioration. At the global level, we estimate that real GDP growth has fallen from 4.8% year-on-year at the end of 2021 to 1.5% at the end of 2022, so on average growth was about 3%. Our forecast is around 2% for 2023, which is typically a stall zone in the event of a new negative shock. Barring the use of a nuclear weapon, the war in Ukraine no longer has the same disruptive potential, notably on the European energy sector, but remains a major factor of uncertainty. As the World Bank puts it, the global economy remains *"on a razor's edge"*.

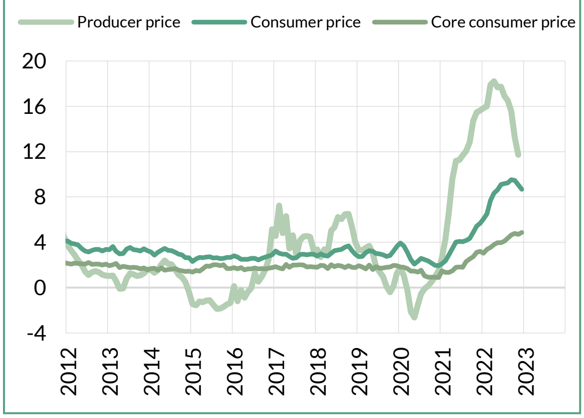
In developed countries, business climate, which started 2022 on an all-time high, ends slightly below the threshold of recession. New industrial orders have fallen sharply in recent months. Financing conditions have tightened. However, as private agents have emerged from the pandemic with healthy financial positions, they are not forced to deleverage in a hurry. In the US, households have even increased their use of credit and drawn on their savings to compensate for the inflation shock. More surprisingly, companies have not cut back on staff as is typical in downturns. Having experienced the worst labour shortages in 2021, they are keeping their workforce as a precaution. Adjustment is made at the margin by reducing working hours or temporary employment. It is difficult to say whether this retention of labour will last or whether it merely postpones a rise in unemployment. In the meantime, labour markets remain tight, keeping upward pressure on wages.

China is a special case. Last year, the economy weakened because of the cleansing in the property sector and more so because of severe health constraints. Without preparation of any kind, the authorities have just abandoned the zero-Covid policy, betting that the downsides of the virus circulating (cost in human lives, disruption of production) will be quickly outweighed by the benefits of economic recovery (rebound in demand and trade, lower unemployment). The lifting of mobility restrictions will be a breath of fresh air, but not a sustainable driver for growth as long as the issues in the construction sector are not resolved. Neighbouring countries in Asia will be the most likely to gain from higher Chinese spending. The effect on global growth, however, seems more uncertain, especially as the reopening of China may also have less pleasant side effects. The country represents such a big chunk of the demand for metals or energy products that a rebound in Chinese consumption could revive price pressures. You can't win on all fronts.

Notwithstanding that risk, the **inflation outlook** is now pointing in the right direction. Disinflation is underway at several stages of the price chain, whether for industrial inputs, energy, or manufactured goods. The first wave of the inflation shock that resulted from the disruption caused by the pandemic in 2021, has almost completely subsided. The second wave, which spread to services in 2022, is still growing but at a slower pace than a few months ago. This inertia is partly a reflection of wage pressures. Despite the intensity of the shock, medium-term inflation expectations have never deviated too far from their historical norm. They therefore remain an anchor point, towards which convergence will take place. We expect inflation to fall below 3% by the end of the year in the US and the eurozone. Not quite back on target yet, but close enough.

The outlook for **monetary policy** must balance these various elements as they push in different directions. Weakening business conditions call for slower rate hikes. On the other hand, resilient employment conditions are pushing for further tightening. Monetary tightening will continue in the coming months, but most of the ground has been covered. In the US, where monetary policy is already tight, the end of the tightening cycle seems near. However, nothing in the Fed's comments suggests that easing will be as swift as the markets had hoped for. There is room for disillusion here. In the eurozone, where the fall in inflation is delayed, the tightening is likely to be stronger and more lasting, which should encourage a strengthening of the euro.

GLOBAL INFLATION RATE (YOY; %)



Source : Thomson Reuters, ODDO BHF

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