CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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Down, but Not Out

The World Bank, in its latest Global Economic Prospects report released earlier this month, warned that the global economy is perilously close to falling into recession this year. It said the world economy could register one of the weakest rates of growth seen in recent decades in 2023, following a year of very high inflation, worsening financial conditions and Russia's invasion of Ukraine.

This follows similar downbeat assessments for 2023 published towards the end of last year by the IMF and OECD. They added that the risks to the outlook were skewed to the downside and so an even weaker outturn was quite possible. Very high inflation combined with likely interest rate hikes of 400-500bps in many major economies have greatly increased the risks of a recession in 2023.

Indeed, the view of many forecasters is that inflation cannot be beaten without tipping economies into recession, especially when sharp hikes in interest rates are required. This was the widely held view at last week's World Economic Forum in Davos, with two-thirds of the economists surveyed there expecting a global recession in 2023. Furthermore, the Global Composite PMI has been below 50 since August and thus in contraction territory. This usually signals a period of very weak economic activity ahead.

Financial markets, though, have been rallying in the past couple of months, suggesting increasing optimism that a severe downturn may be avoided. In this regard, some real economic data have continued to come in ahead of expectations in recent months. Better than expected GDP data have been published in China and Germany for the fourth quarter, with monthly estimates of UK output performing better than anticipated in October and November also. Meanwhile, solid US GDP data are expected to be published later this week for the final quarter of last year.

Labour markets remain tight, with no sign yet of a rise in unemployment amidst continuing high levels of job vacancies. Meantime, inflation has turned the corner and started to move lower. The marked declines in energy and food commodity prices since last summer suggests that CPI rates could see sharp falls in 2023. This would alleviate the marked downward pressure on real household disposable incomes seen in the past year. With inflation in decline, central bank rates are also expected to peak in the coming months, which is helping improve conditions on financial markets.

Supply chains have also started to normalise after three years of COVID related disruptions. Furthermore, 2023 growth forecasts for China are being revised upwards as it abandons its zero-COVID strategy. A strong rebound in China will have significant positive spill over effects for the global economy. Meanwhile, both consumer and corporate balance sheets are holding up well, aided by fiscal supports which are boosting cash balances.

Thus, it may be that the global economic downturn will not be as sharp as previously anticipated. Indeed, ECB Council member, Villeroy, commented last week that "we should be able to avoid a recession this year", adding he would not have thought this three months ago. Overall, the global economy is still in for a challenging year in 2023, but the downturn may prove to be less severe than previously feared.

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