CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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Many Headwinds Make for Difficult Landing

The latest quarterly update from the OECD on the outlook for the global economy was published last week. In a downbeat assessment, it notes that the impact of tighter monetary policy is becoming increasingly visible, business and consumer confidence have turned down, and the rebound in China has faded. Thus, although there was a stronger than anticipated start to 2023, helped by lower energy prices, this is not expected to be sustained. GDP growth in 2023 and 2024 is projected to be sub-par, at 3.0% and 2.7%, respectively. Not only that, the OECD says the risks to the outlook remain tilted to the downside.

The OECD says that the primary reason for the subdued global growth outlook is the substantial monetary policy tightening required to rein in inflation. The main message emanating from nearly all the policy meetings of the main central banks in the past couple of weeks has been, that while the tightening cycle may be close to, or at an end, interest rates are going to have to remain high for a considerable period of time to bring inflation back down to its 2% target. While headline inflation is declining, core inflation remains persistent in many economies, held up by cost pressures, rising wages and margin widening in some sectors.

However, it is not just a restrictive monetary policy stance that is weighing on global growth prospects. Other factors are also at work. The IMF in its Economic Outlook published in the spring commented that the prospects for growth over the medium term seem dimmer now than at any time in recent decades. Looking out to 2028, it projects that global growth will average around 3% per annum, the lowest medium-term forecast it has published since 1990.

This reflects numerous factors besides higher rates, including the progress some large emerging economies, such as China and South Korea, have made in raising standards, and thus are now moving into a slower growth phase of their development cycle. It also reflects weaker labour force growth, with many developed economies at full employment. Technological change is also slowing down.
Meanwhile, increasing geo-economic fragmentation, and growing protectionism with rising trade barriers, are contributing to a slowdown in international trade, which is impacting negatively on the world's highly integrated supply chains. Governments are also faced with growing budgetary pressures from rising debt burdens and ageing populations. It all adds up to a challenging macro-economic environment.

A big risk for central banks, in the context of all these headwinds to growth, is that if they keep monetary policy as restrictive as it currently is for a prolonged period of time, then the chances of a hard landing (i.e. recession) become greater. Fed Chair Powell has consistently cautioned that a soft landing for the US economy will be difficult to achieve and only last week said he would not call it a baseline expectation.

Central banks appear willing to risk a hard landing for economies in order to achieve their goal of getting inflation back down to 2%. This is not surprising as they view a failure to restore price stability as the biggest risk of all to living standards and long-term economic prosperity

Oliver Mangan
Chief Economist
AIB

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AIB Customer Treasury Services
DUBLIN / CORK
aib.ie/fxcentre

Customer Treasury Services NI
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aibni.co.uk/fxcentre

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aibgb.co.uk/fxcentre

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