Global Economic Outlook

A hard road ahead

EDC Economics

Jan. 12, 2023

Insights on the world's key economies, GDP growth, commodity prices, interest rates and exchange rates.

Canada

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Executive summary

Global Economic Outlook: A hard road ahead

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Winter driving isn't for the faint of heart. White knuckling your way through blustery conditions, across ice, slush and snow-covered roads is an all-too-familiar feature of Canadian life.

The global economy came careening into 2022 having navigated a series of peaks, valleys and blind curves. As the world emerged from a global pandemic, a policy-induced demand surge ran up against a flurry of supply chain disruptions, yielding inflation not seen in 40 years. Risk of overheating forced central banks to slam on the breaks, in a sequence of frequent and sharp interest rate hikes. Higher prices at the pumps and in grocery stores led consumers in Canada and the United States to draw down on excess reserves and rely on the continued strength of labour markets to help power them forward. In our winter *Global Economic Outlook*, EDC Economics expects the U.S. and Canadian economies to have accelerated by 1.8% and 3.4%, respectively, in 2022.

Both economies appear to now be moving into the right lane. As job and income growth let up, the reserve tank approaches empty, and the negative wealth effects of lower asset prices become a headwind, it's only a matter of time before higher prices and interest rates take their toll.

We expect Canadian growth to decelerate to just 0.2% in 2023, thanks to weaker commodity prices, softness in the housing market and elevated levels of consumer indebtedness. The U.S. economy won't fare much better, clocking growth of only 0.4%.

After a year of super-sized interest rate increases in both Canada and the U.S., that saw rates turbocharged by 4%, we expect both central banks to downshift early in the year before letting up completely for most of 2023. As monthly inflation falls closer to target, and growth eases, monetary authorities will likely consider a policy U-turn toward the end of 2023 and into 2024. But far from going into cruise-control, authorities will keep close watch of dashboard indicators and remain vigilant against the impacts of wage increases and any return of pricing pressures.

While the outlook for North America may have crested moving into 2023, Europe appears to have pulled over completely. In response to Russia's war on Ukraine, European economies are now managing a ban on Russian pipeline gas and sanctions on seaborn Russian crude, agriculture and fertilizer supplies. This has deprived the continent of the resources needed to lubricate its industrial engine and fuelled the runup in consumer prices.

Executive summary (continued)

Global Economic Outlook: A hard road ahead

As supply chains are rerouted, Germany and the region's other industrial centres will need to repair any resulting dents to their manufacturing capabilities in order to avoid permanent damage. At the same time, the region faces a fragile couple of winters, where inclement weather could exhaust its limited energy supplies, sending prices soaring and potentially smashing economic activity. While we expect Euro Area growth to slow to 0.1% in 2023, the outlook for Germany is more negative (-0.8%), due to its dependance on Russian natural gas.

With Europe's economy facing more hazardous road conditions ahead, the European Central Bank (ECB) will need both a foot on the gas and on the brake. We expect the ECB's policy rate to peak at a lower level than its peers in Q2 2023, and officials to start shrinking the €5trillion-worth of bonds acquired over the past eight years, while keeping a close eye on growth and financial stability.

The Chinese government will try to jumpstart its economy, helping growth overtake the 5% threshold in 2023, albeit moderately so. A complete reopening of the Chinese economy remains an upside risk to our forecast at this point. Other developing markets, meanwhile, will continue to be weighed down by the cost of food and fuel, simmering social tensions and deteriorated debt dynamics, in the context of a tighter global credit environment.

The bottom line

The global economy faces a challenging journey. While a global recession and deep economic contraction aren't in our base-case forecast, some individual countries will fall into recession and others will barely scrape the surface. Treacherous roads and whiteout conditions will make for slow driving and limited visibility of the hazards ahead.

EDC Economics expects the global economy to grow by just 2.3% this year, its slowest pace since the global financial crisis, with the exception of 2020. Slowing global demand and increased volatility will require Canadian exporters to tune up their risk management systems and stay alert. But those who're well-prepared will lead the pack to the open roads that lie ahead.

Changes to the outlook

- EDC Economics has revised down its global growth estimate for 2022 (2.5%), followed by a further slowdown in 2023 (2.3%). Excluding 2020, the global economy is set to grow at its slowest pace since the global financial crisis in 2008.
- As volatility and uncertainty persist, key central banks are inching closer to their target policy rate, but now shifting hikes to a slower pace. Household balance sheets are in a much better position compared to the global financial crisis.
- Recession risks have risen notably with key countries expected to dip into negative growth. Developed markets will enter recession while developing markets are set for slower growth. The outlook for the United States is softer, but Europe's economy will experience a severe recession. China's move away from zero-COVID-19 policies complicates economic policy objectives, but more government support is likely to occur to maintain growth.

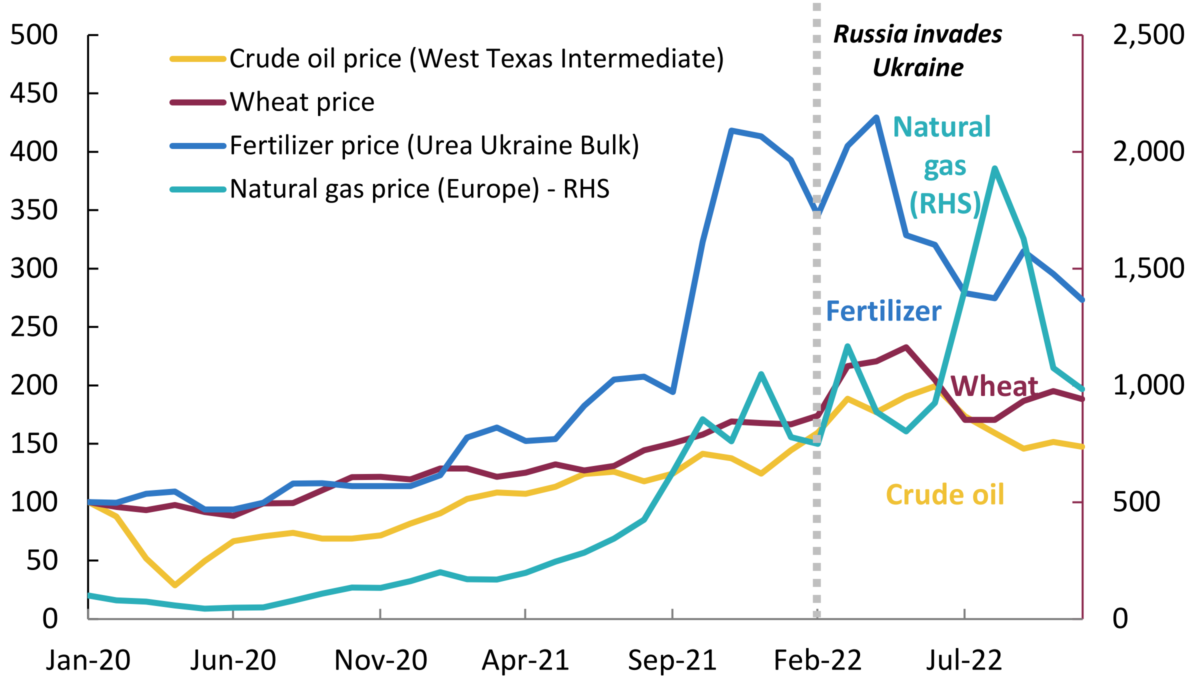
Macroeconomic context

Food and energy prices driving European affordability crisis

Commodity markets have been extremely volatile, driven by supply chain disruptions and worsened by the Russia-Ukraine war. Natural gas prices have come down after spiking, but remain higher than a year ago. European countries who depend on Russian oil and gas will face higher food and energy prices until the supply gap is filled. Inflation (excluding food and energy) is trending lower in most countries.

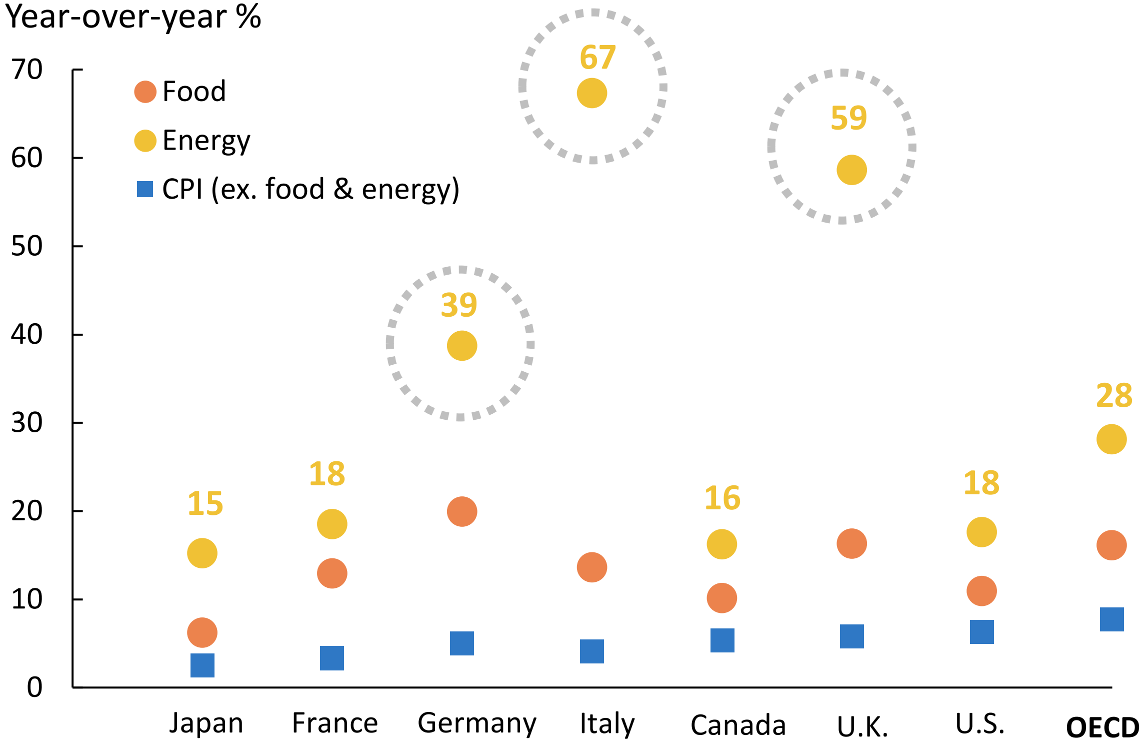
Key commodity indices

Index, January 2020 = 100



Consumer Price Index (CPI)

Year-over-year %



Sources: Haver Analytics, World Bank, UN & FAO, EDC Economics

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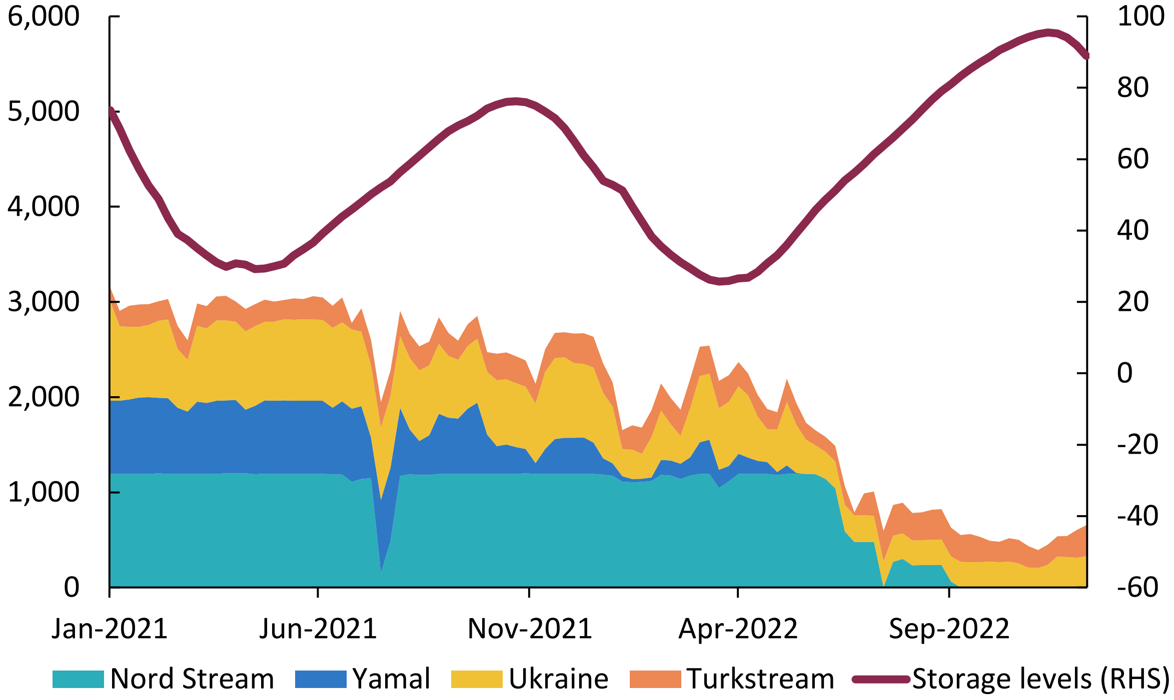
Europe faces a winter without Russian gas

European Union sanctions on Russian gas have stopped imports to all European countries excluding a small amount to Bulgaria. With an unusually mild fall, Europe had stored 96% of its total gas capacity by Nov. 13. Since this peak, temperatures have dropped, gas stockpiles have fallen, and the prices for energy are rising once more. Now EU households, firms and importers are working to stave off energy rationing measures until next spring.

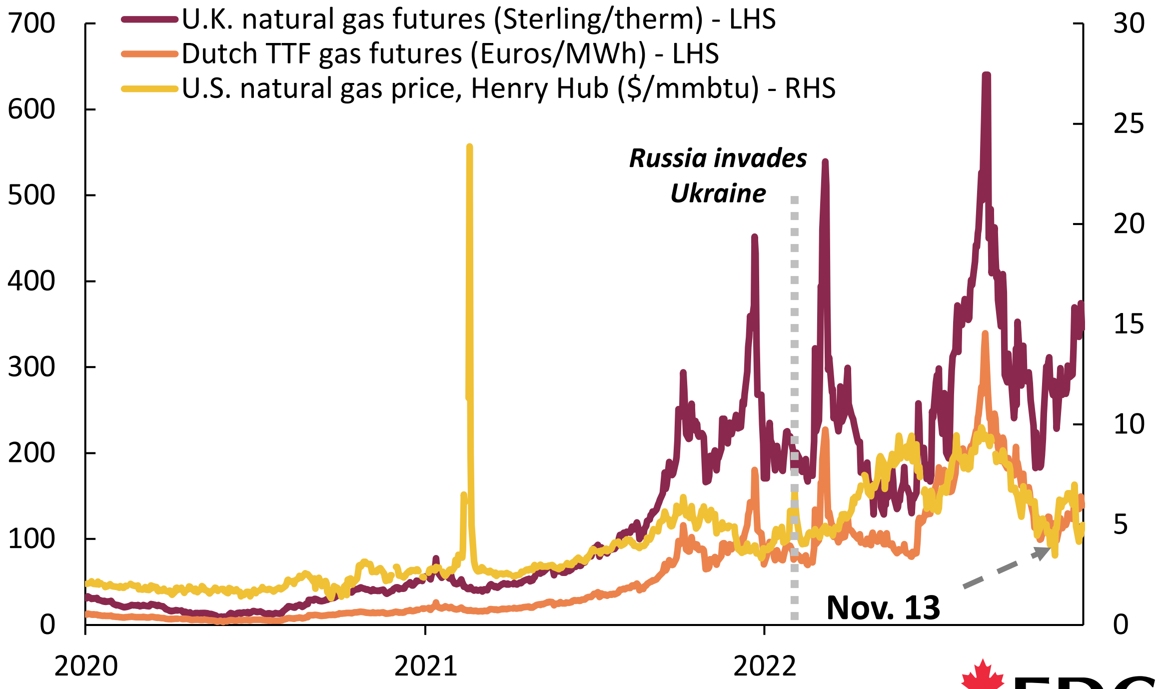
Russian gas flows into Europe and gas storage levels

Millions of cubic metres; percent of storage filled



European and U.S. natural gas prices

Daily



Sources: Bruegel, AGSI; Haver Analytics, EDC Economics

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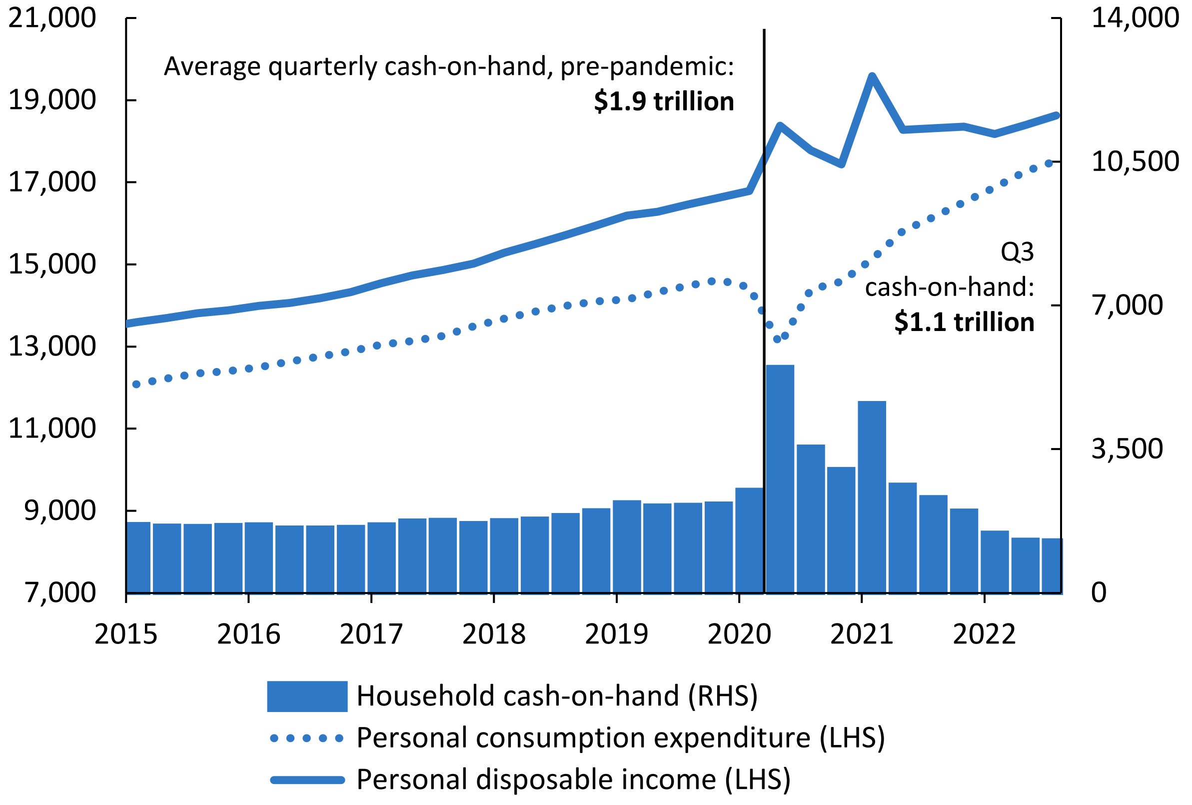
Consumer savings continue to be drawn down

Consumer spending led the economic recovery post-pandemic, but accumulated pandemic savings are beginning to shrink. High inflation rates and rapid interest rate hikes have increased the cost of living for most consumers. With costs rising, and savings diminishing, consumer demand is likely to be constrained in the short-term.

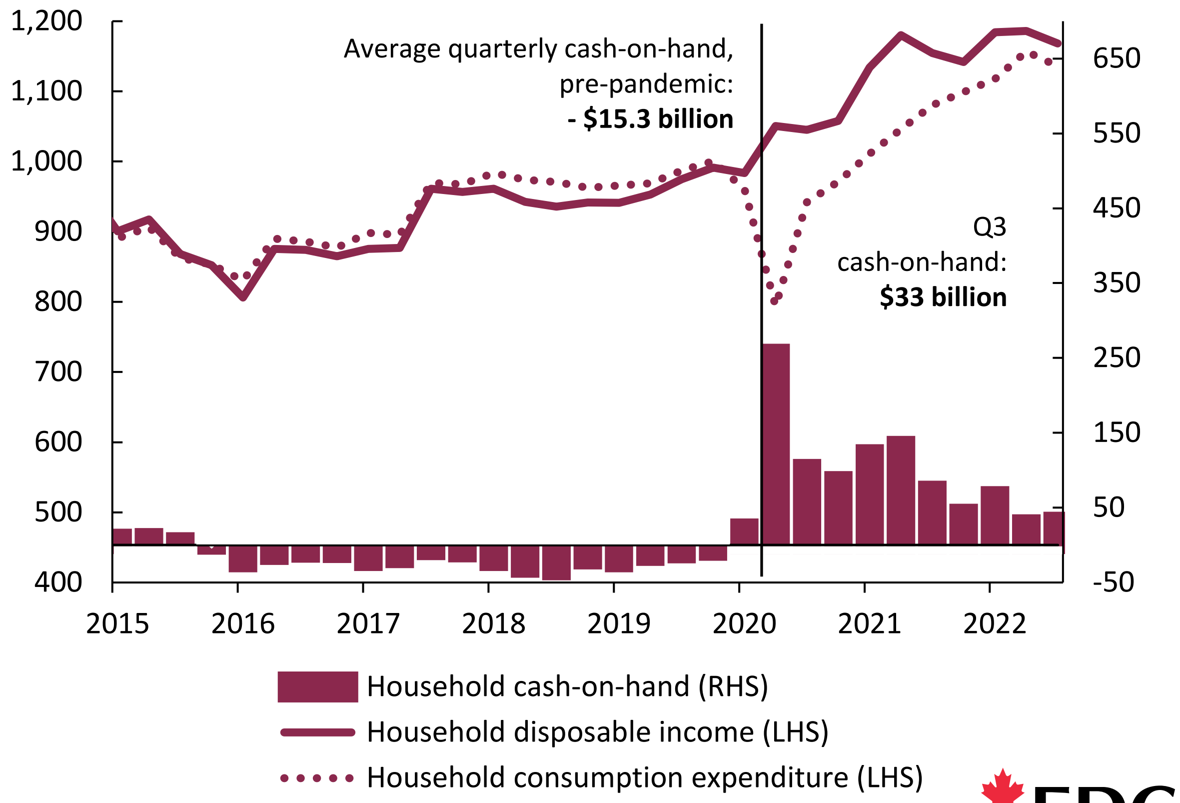
U.S. households' cash-on-hand

Quarterly, USD billions



Canada households' cash-on-hand

Quarterly, USD billions



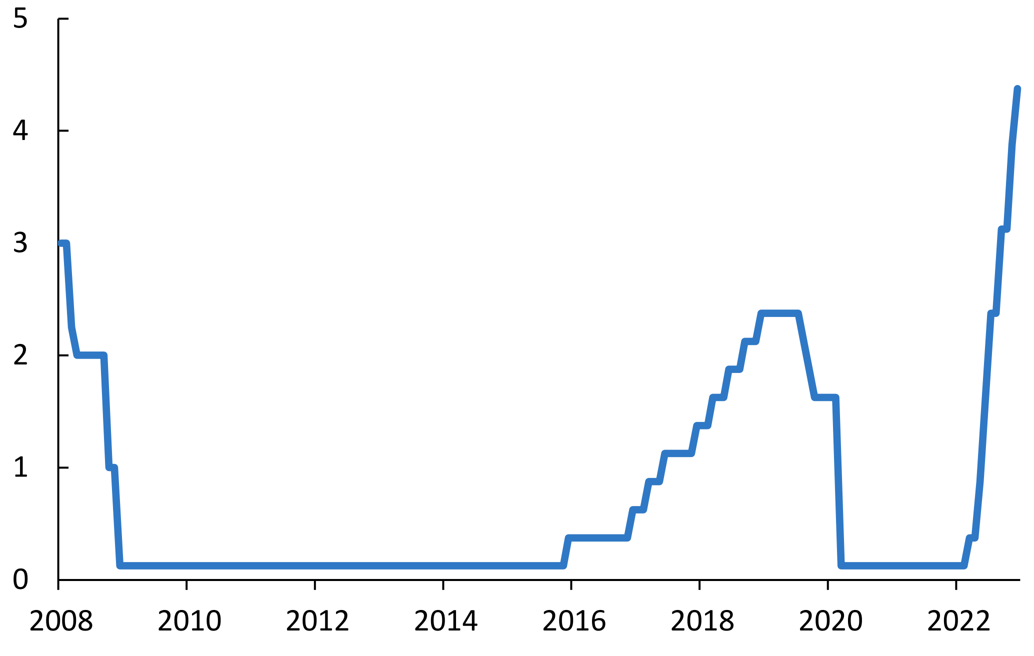
Sources: Haver Analytics, EDC Economics

Rising U.S. debt servicing costs to hit consumption and investment

The rapid increase of interest rates has levied substantial burden onto households and corporations by elevating all costs of servicing loans and mortgages. Household debt as a percent of GDP, shrunk over this period, but non-financial corporate debt has settled at record high levels. These firms now face unexpectedly high interest payments that will drain resources and dampen future economic activity.

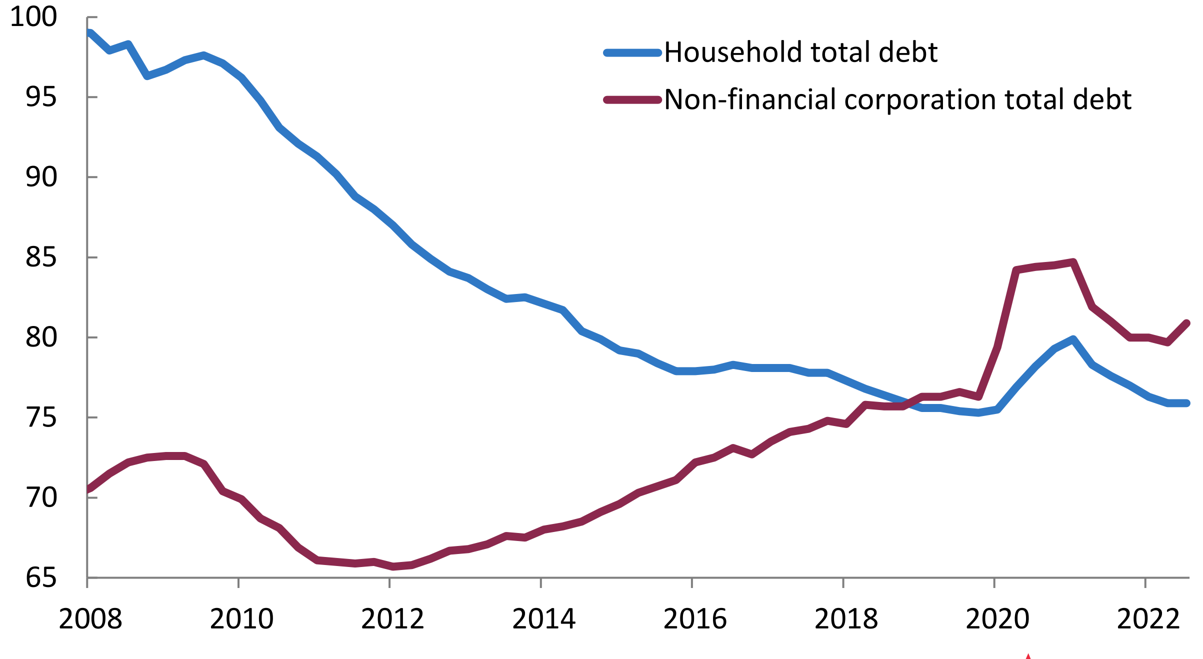
U.S. Federal Reserve funds target rate

End-of-period, %



U.S. private debt levels

% of GDP



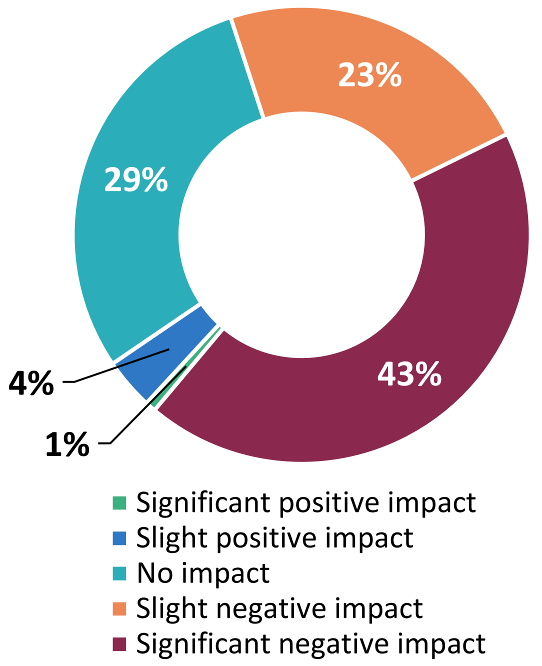
Sources: Haver Analytics, EDC Economics

Interest rates worsen borrowing conditions, debt burden

EDC's year-end 2022 *Trade Confidence Index* (TCI) found that 66% of respondents were negatively impacted by rising interest rates. Financing conditions have worsened, and with persistent deterioration of borrowing conditions, access to commercial credit will become more difficult.

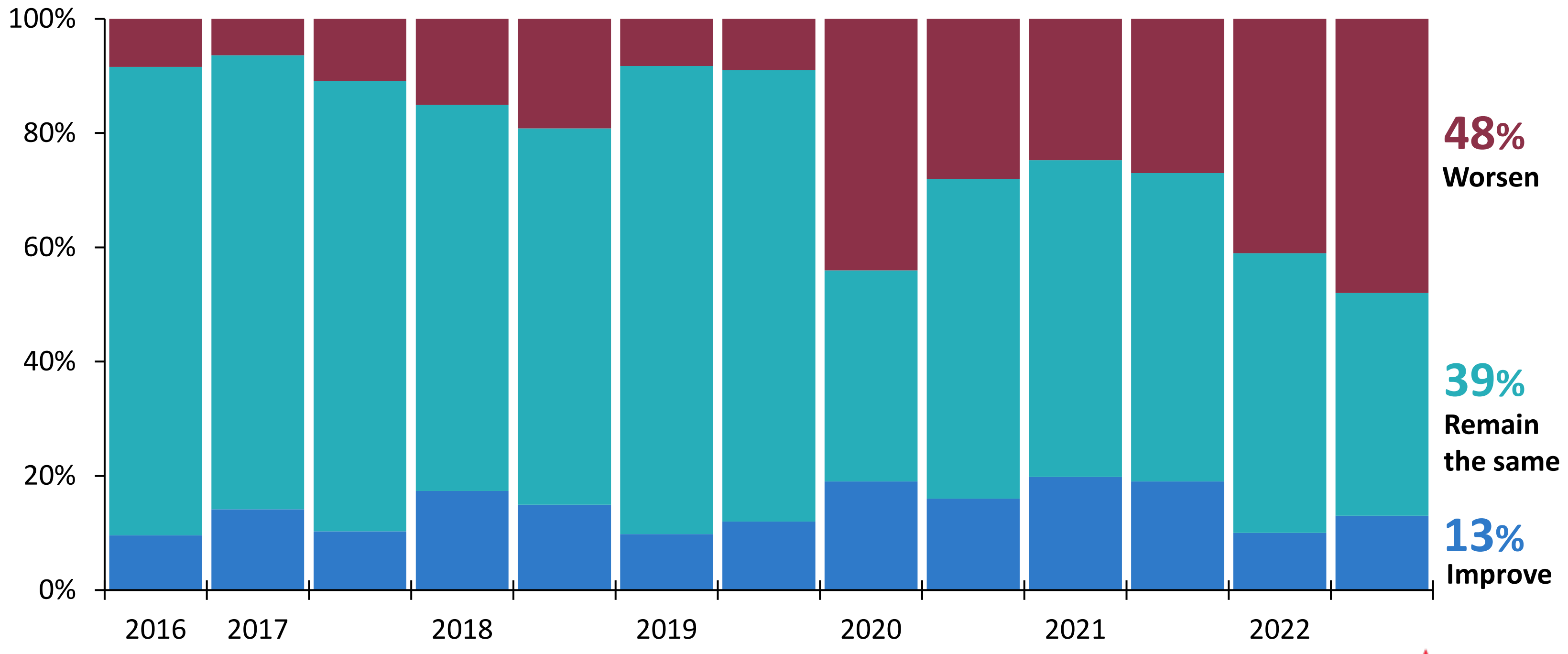
How have recent interest rate hikes impacted your business

% of respondents



Terms and conditions for obtaining financing in the next six months

% of respondents



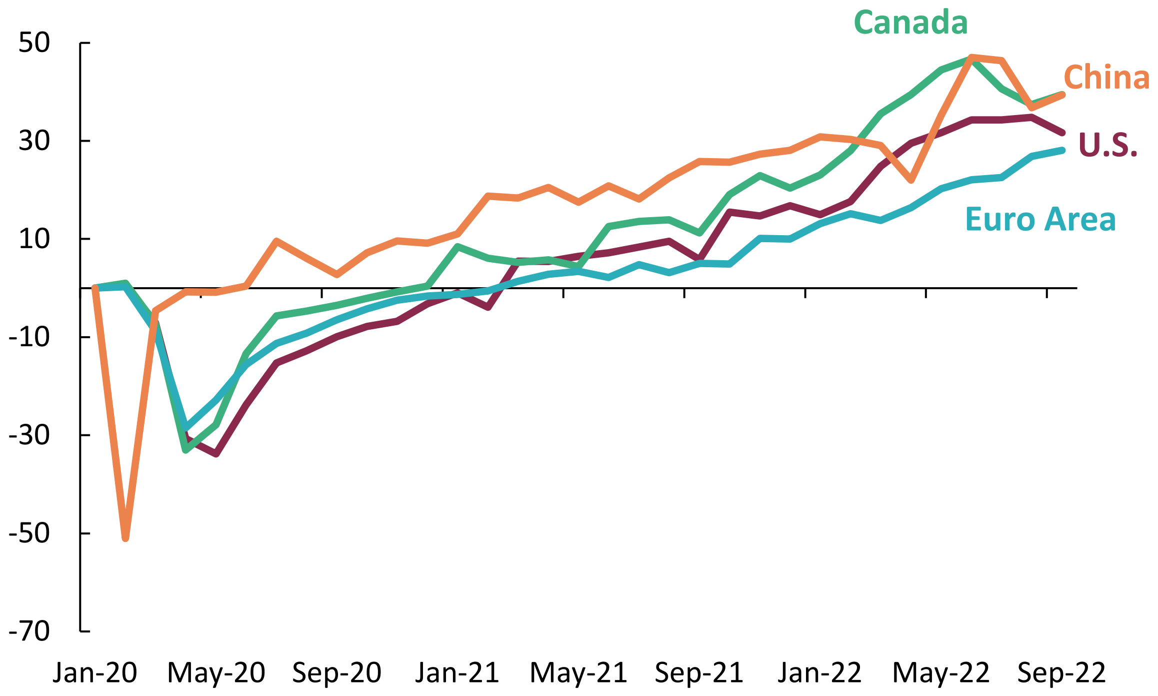
 Sources: EDC Economics, EDC *Trade Confidence Index (TCI)*

Service exports finally recover in most advanced economies

Following several quarters of sustained growth, merchandise exports are on the decline reflecting cooling demand and commodity prices receding from their peaks. In China, services exports have rebounded strongly. As the world preps for an economic slowdown and global goods trade slows, service exports might offer a hopeful note.

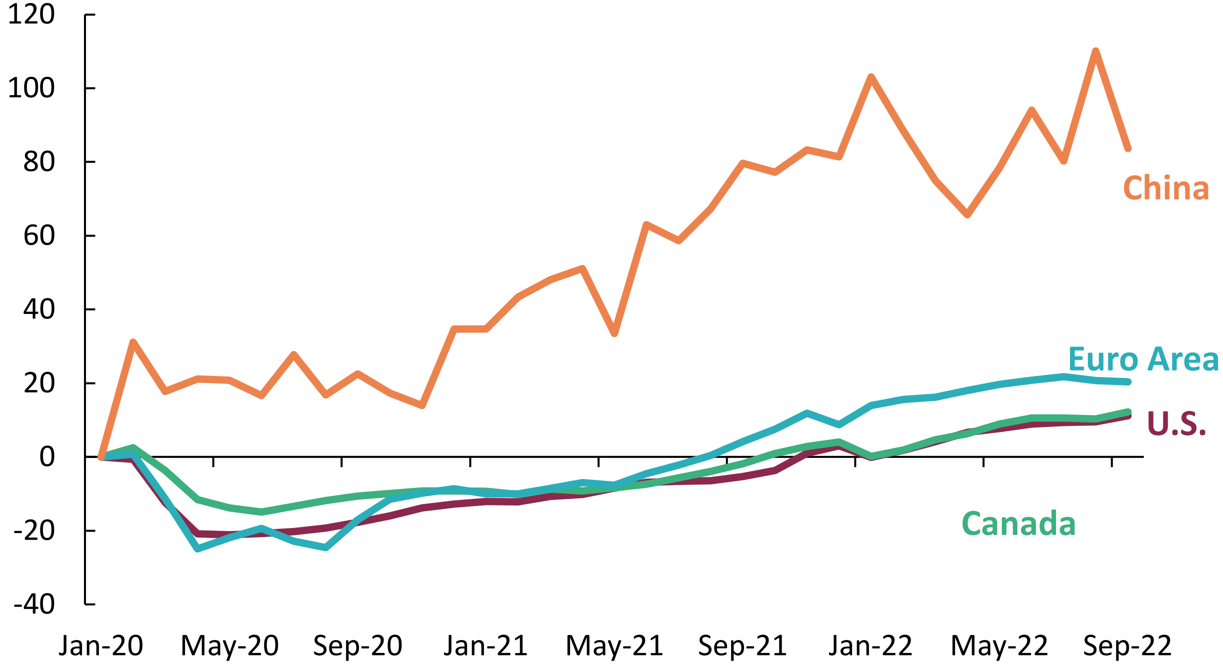
Merchandise trade

% change since January 2020



Services trade

% change since January 2020

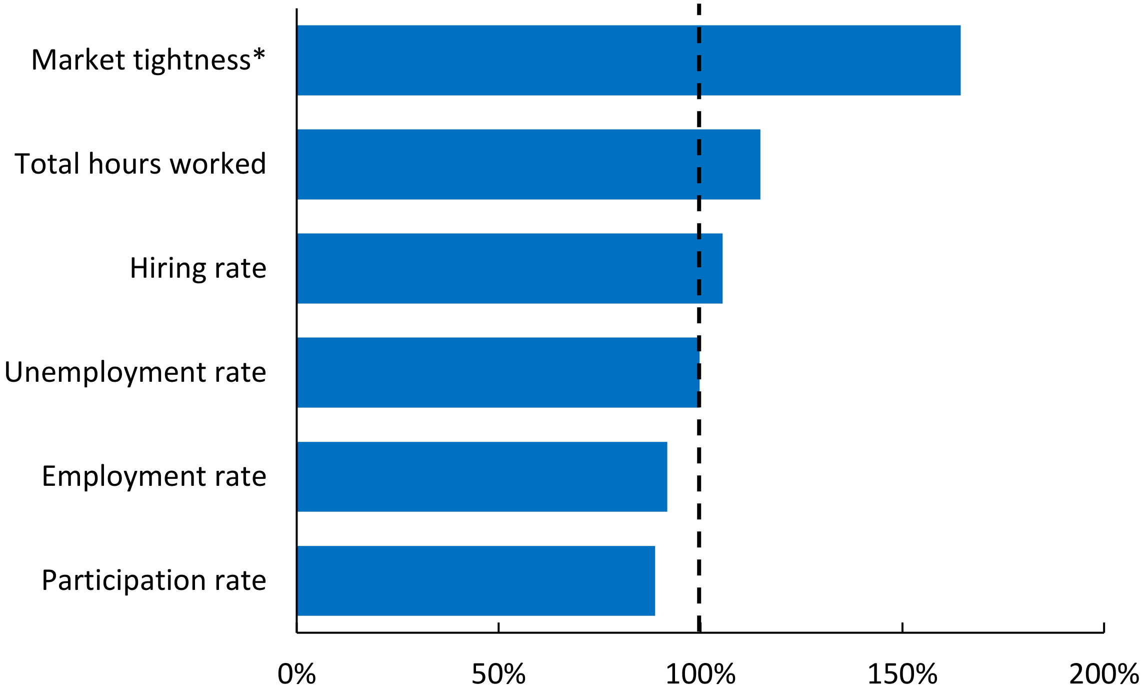


Sources: Haver Analytics, EDC Economics

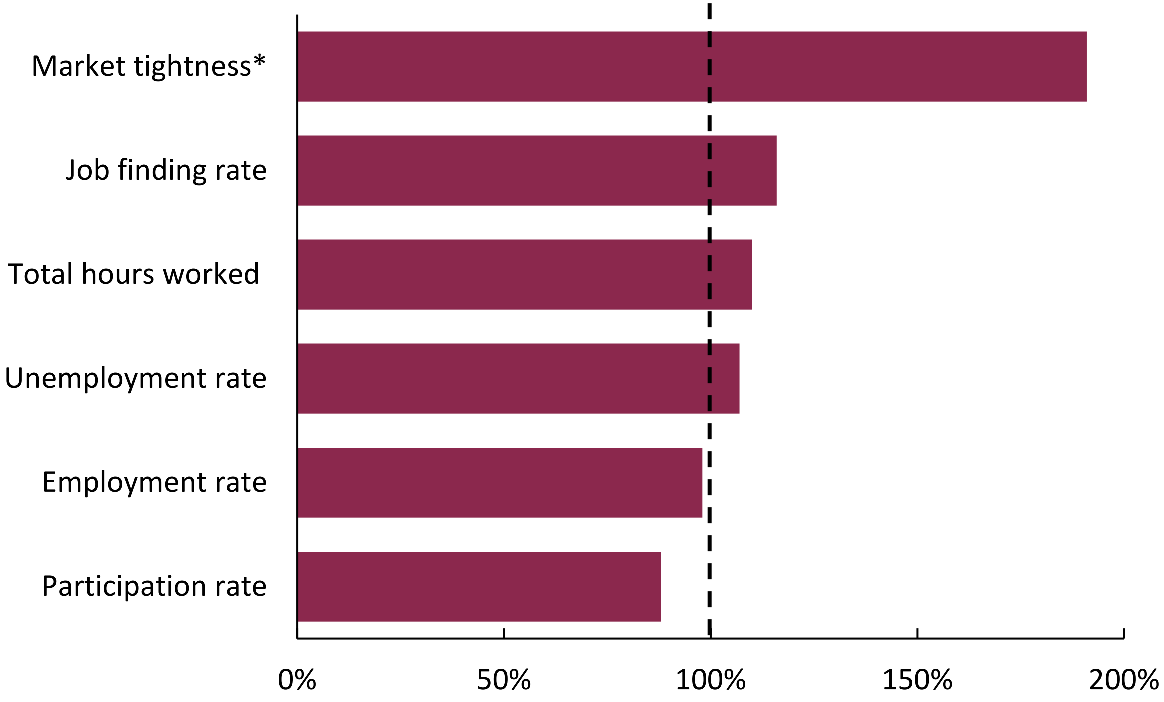
Tight labour markets are loosening up

In newly released data, both Canada and the U.S. experienced substantial month-over-month drops in their market-tightness and hiring rates. For the U.S., this was accompanied by a decrease in participation and employment rates, which suggest a decrease in labour demand. Canada's outcomes were the opposite, which may indicate a slower loosening of the labour market.

U.S. labour market conditions



Canada labour market conditions



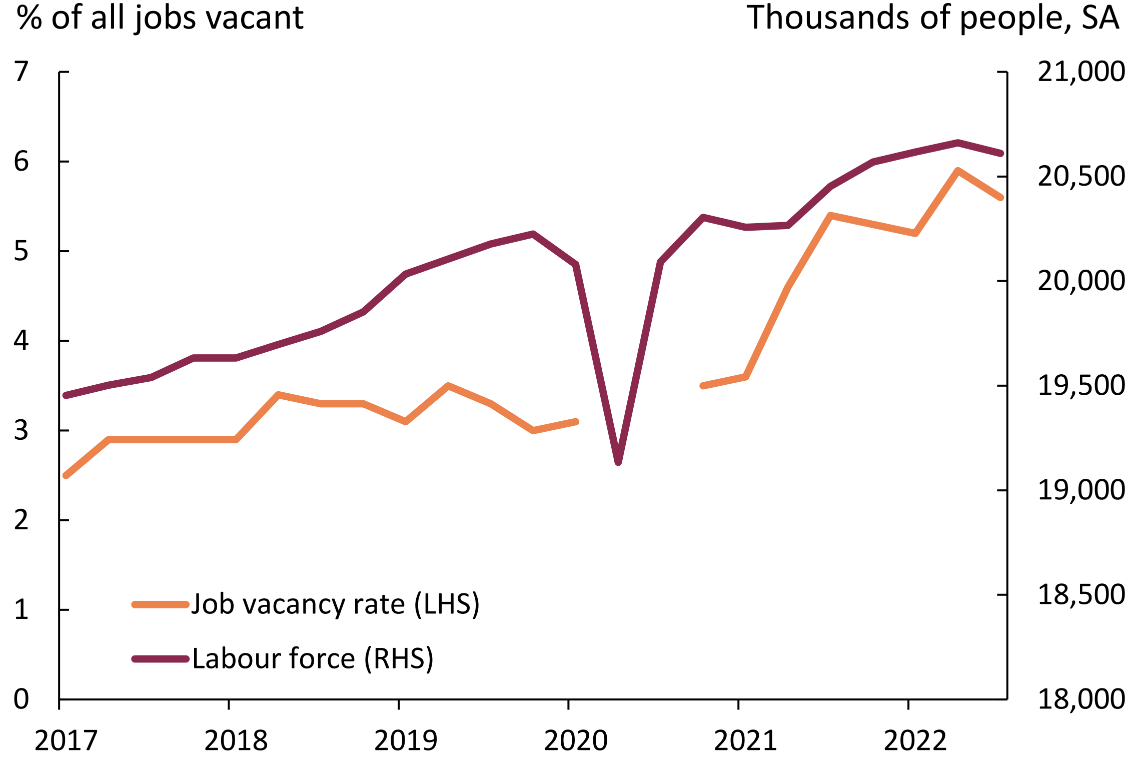
Note: The recovery of each indicator is depicted as progress bars, where the current value of a measure is compared with its crisis trough and a benchmark value (2019 monthly average).
*Market tightness is computed as the ratio of job openings to total unemployed.

Sources: Haver Analytics, U.S. Bureau of Labor Statistics, Bank of Canada

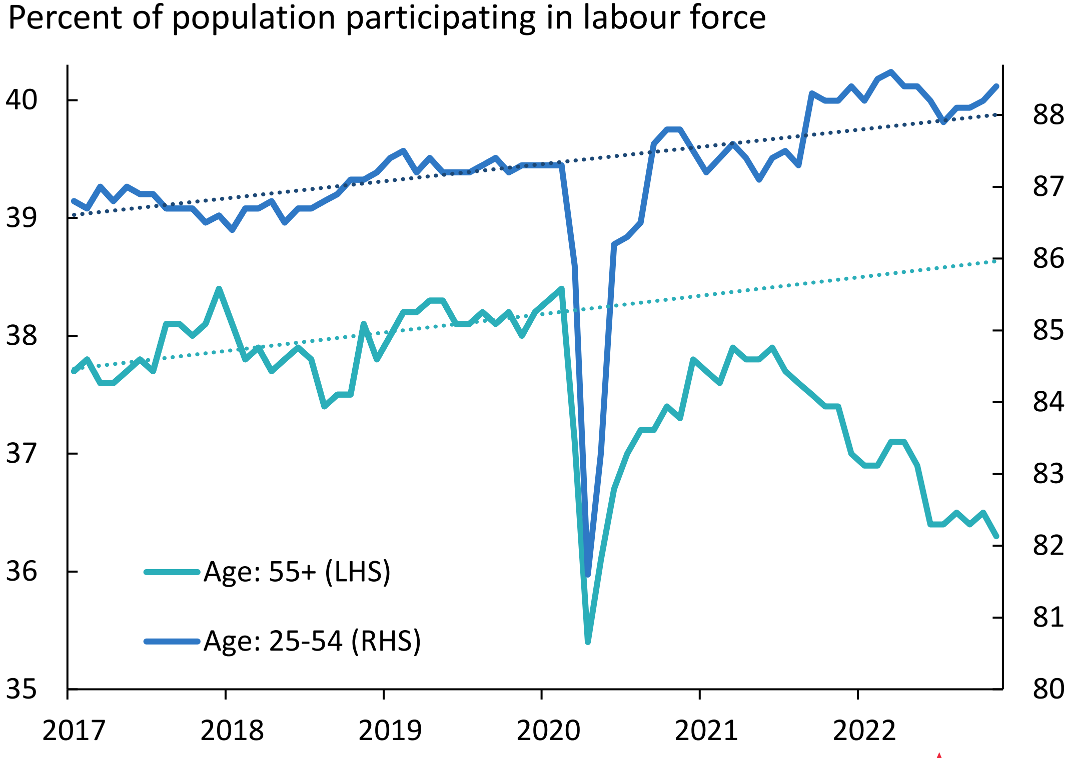
A closer look at the Canadian labour market

Canadian job vacancy rates rose 2.4 percentage points above the pre-pandemic average, to 5.6%. With both total employment and vacancy rates rising, labour demand is a prime suspect for current Canadian labour market tightness. Adding to the mix is a drastic drop in senior (aged 55+) participation rates, which is only partially satiated by a slight increase in participation from the core workforce demographic (25-54).

Canadian job vacancy rate and total labour force



Canadian participation rate by demographic*



*Dotted trend lines are constructed using January 2017 – February 2020 as pre-pandemic values.

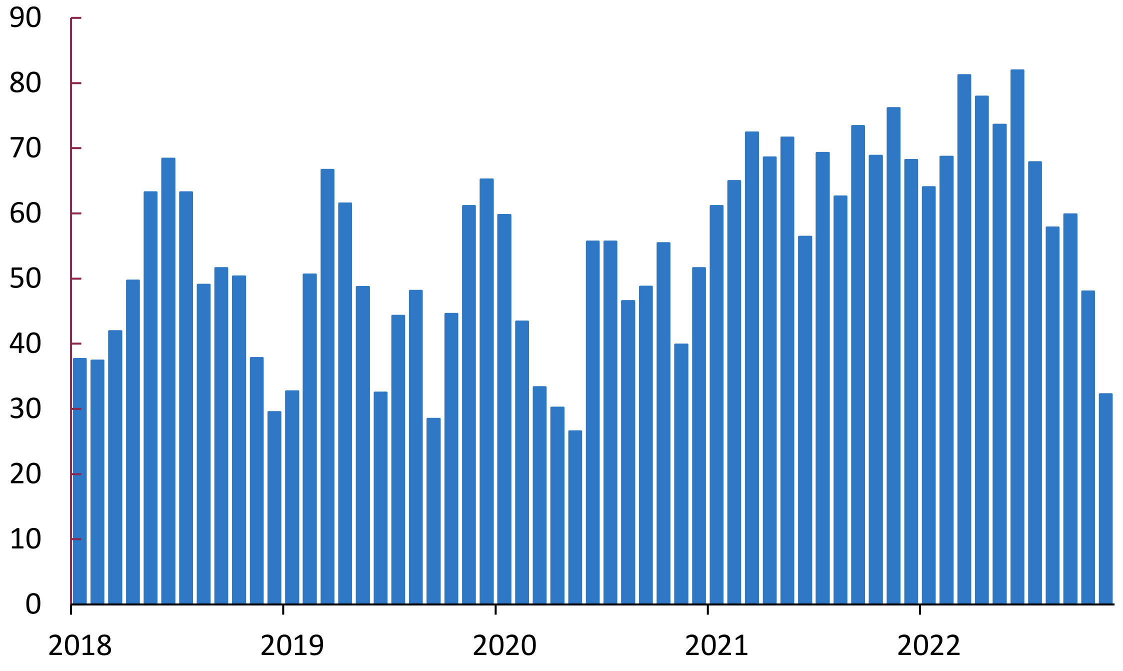
Source: Haver Analytics

Inflation trajectory shifting

Inflation hit multi-decade highs in many countries. However, the tide may be turning as inflation has come down alongside a massive wave of central bank hikes. Prices will remain above trend throughout 2023, despite softer demand and tighter monetary policy. Some countries with a higher dependence on imports of energy and commodities will face elevated prices in the near-term.

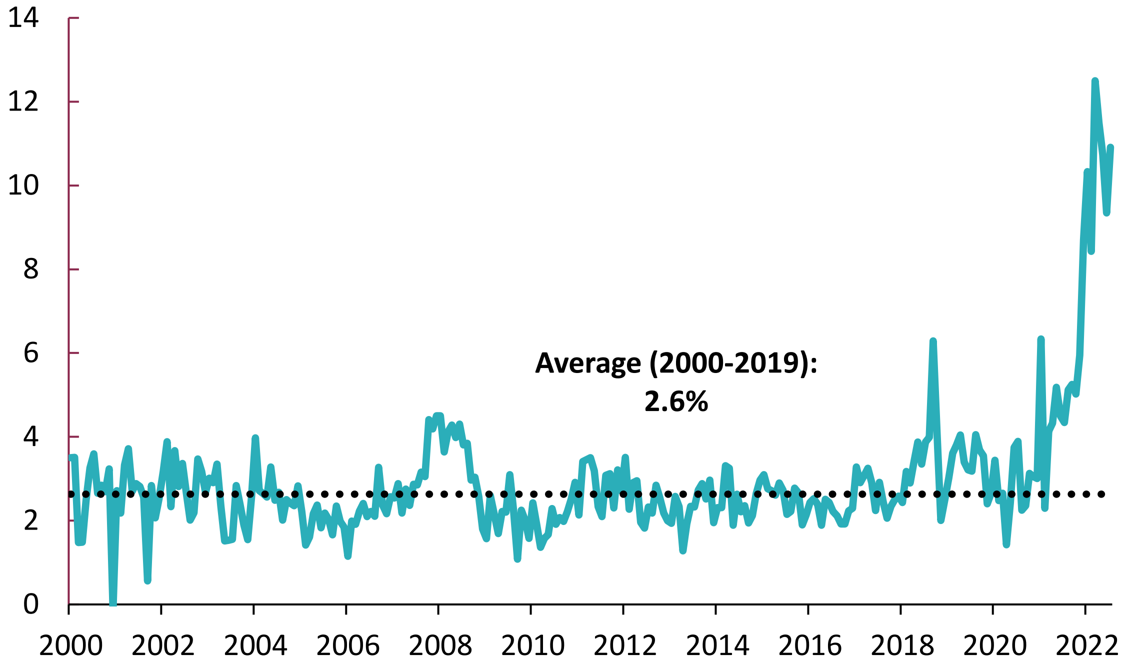
Inflation growth is slowing

of countries with accelerating month-over-month consumer prices



Core Inflation has long way to reach trend

Mean core inflation, y/y %



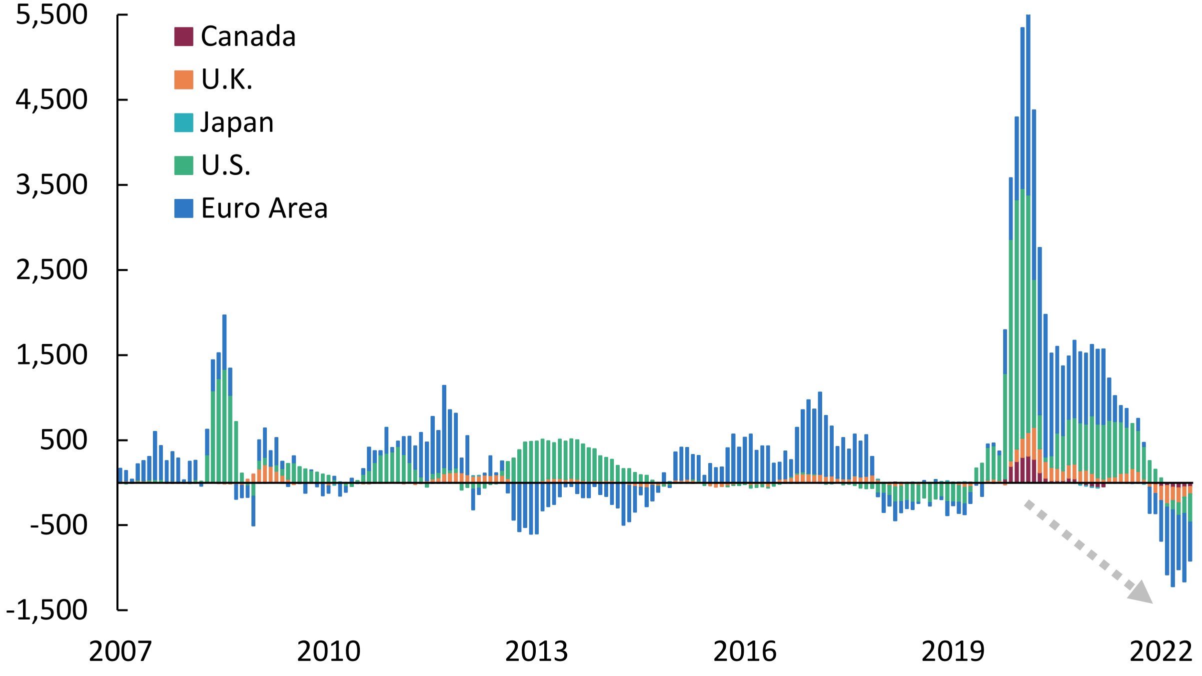
Sources: Financial Times, International Monetary Fund *World Economic Outlook, October 2022*

Central banks enter restrictive territory with rates and liquidity

Central banks around the world have taken extensive policy action to control inflation. In addition to raising interest rates, central banks have continued to unload trillions of dollars from their balance sheets. As monetary policy becomes contractionary for many countries, these actions are beginning to taper inflation expectations and prevent wage growth from becoming entrenched.

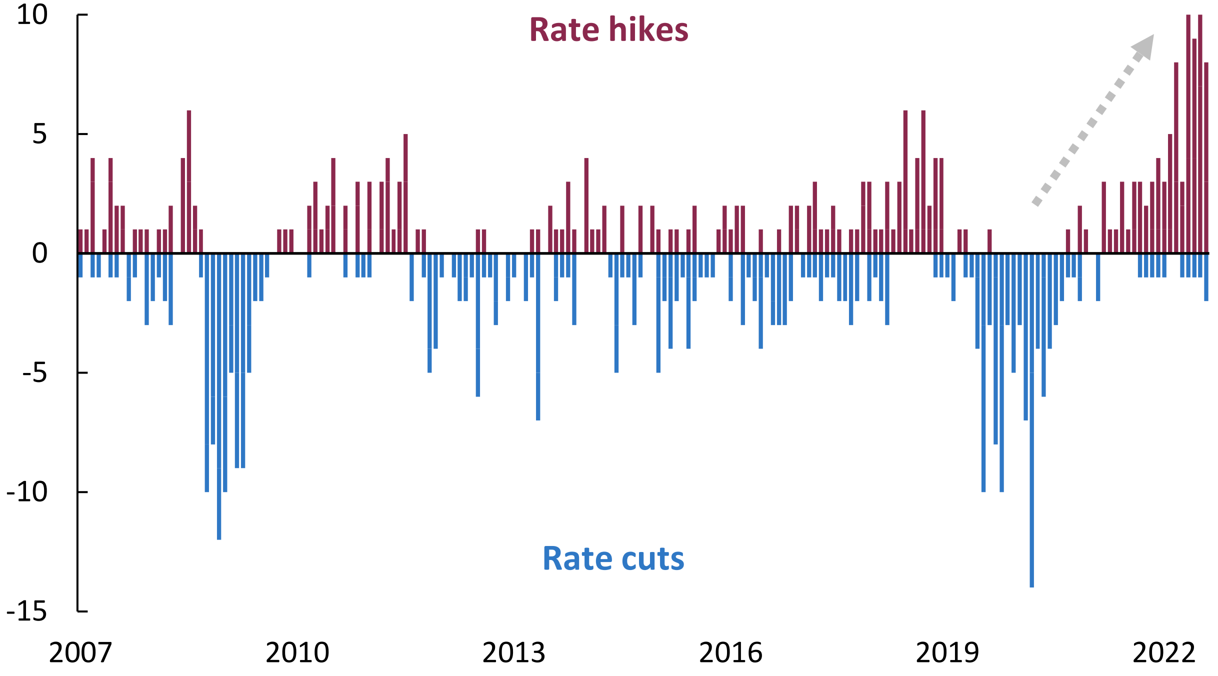
Central bank balance sheets

6-month change in balance sheet position, billions of USD



G20 monetary policy cycle

of central banks



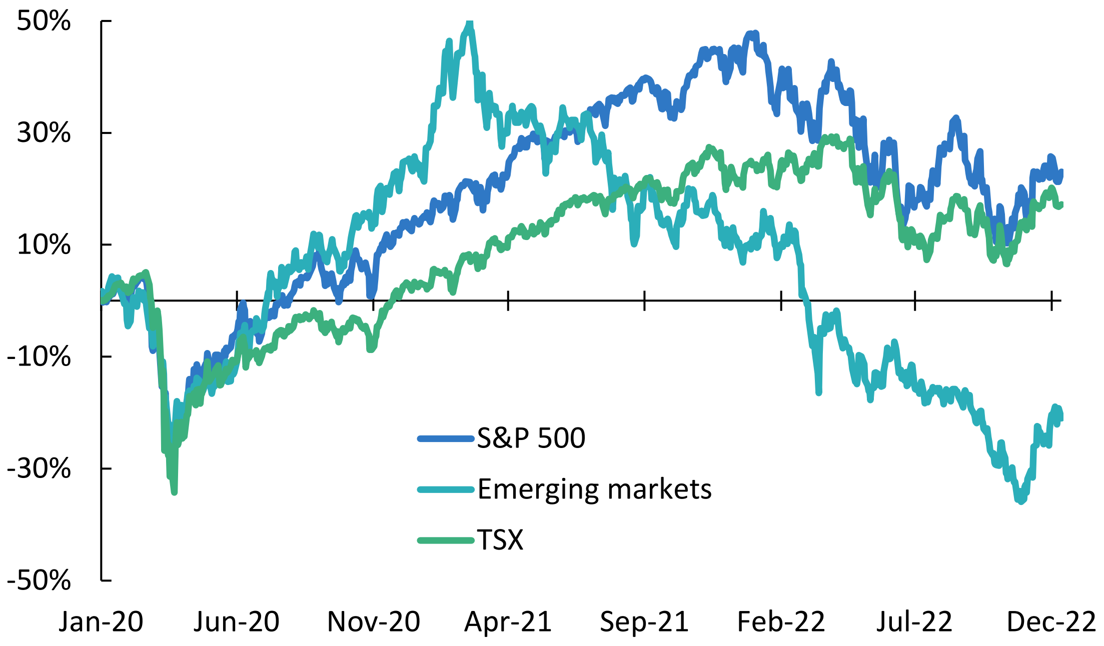
Sources: Haver Analytics, Organisation for Economic Co-operation and Development (OECD), EDC Economics

Markets settle as inflation shows early signs of cooling

With interest rate hikes slowing down, financial markets are showing initial signs of stabilizing. Easing inflation continues to support the equity markets rally despite central banks indicating rates will stay higher for longer. Falling U.S. treasury bond spreads show that markets are pricing and preparing for an upcoming global slowdown.

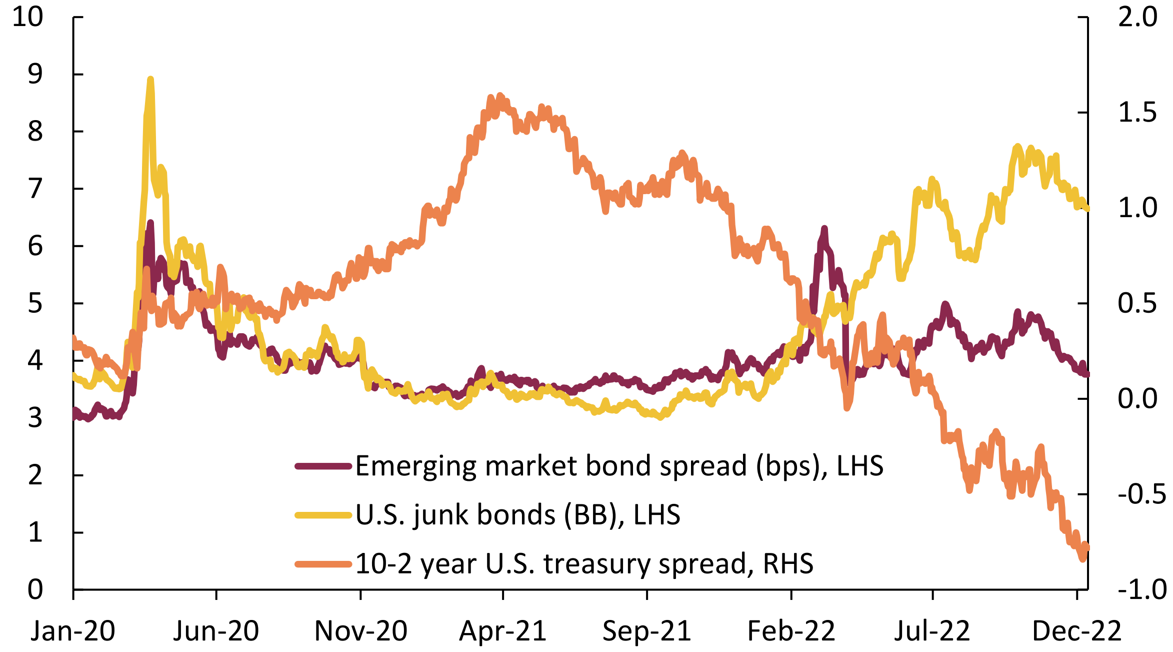
Equity markets

% change since Jan. 1, 2020



Debt markets

%



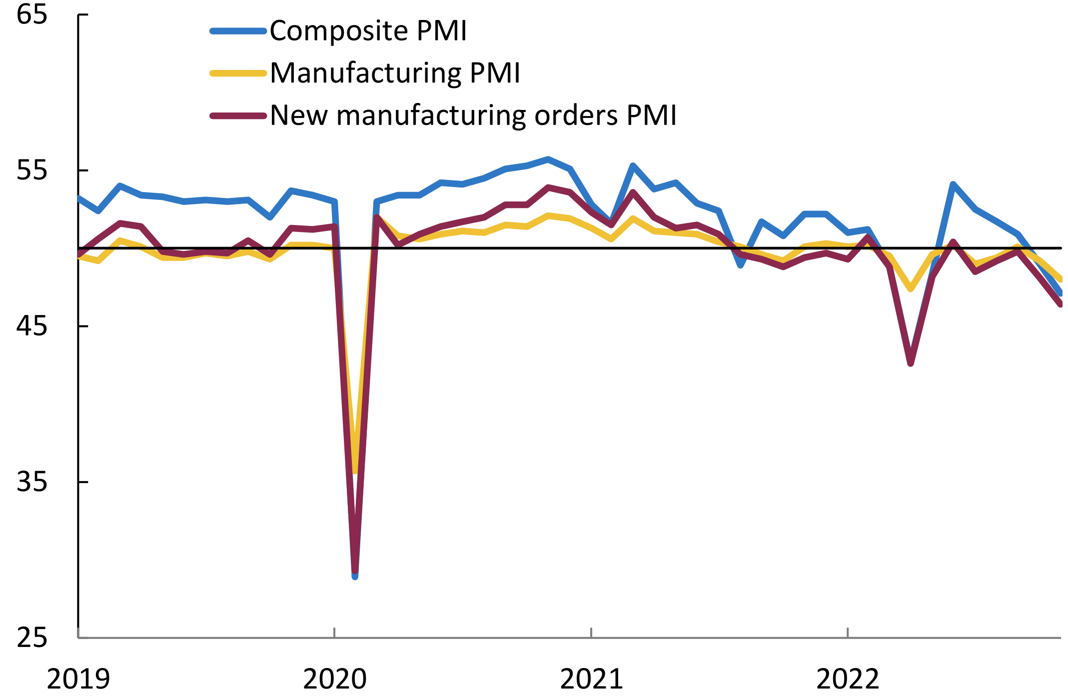
Data as of Dec. 13, 2022
Sources: Haver Analytics, EDC Economics *Global Financial Markets*.

China’s slowdown and evolving zero-COVID policies

China faces downside risks with ongoing zero-COVID or dynamic containment policies and continued challenges with the property market. Leading indicators such as PMI manufacturing orders and new export orders continue to contract fuelled by U.S. decoupling and global growth slowdown. However, Chinese policymakers are actively ramping up supportive measures to minimize any negative impact.

China purchasing managers’ indices (PMI)

50+ = Expansion

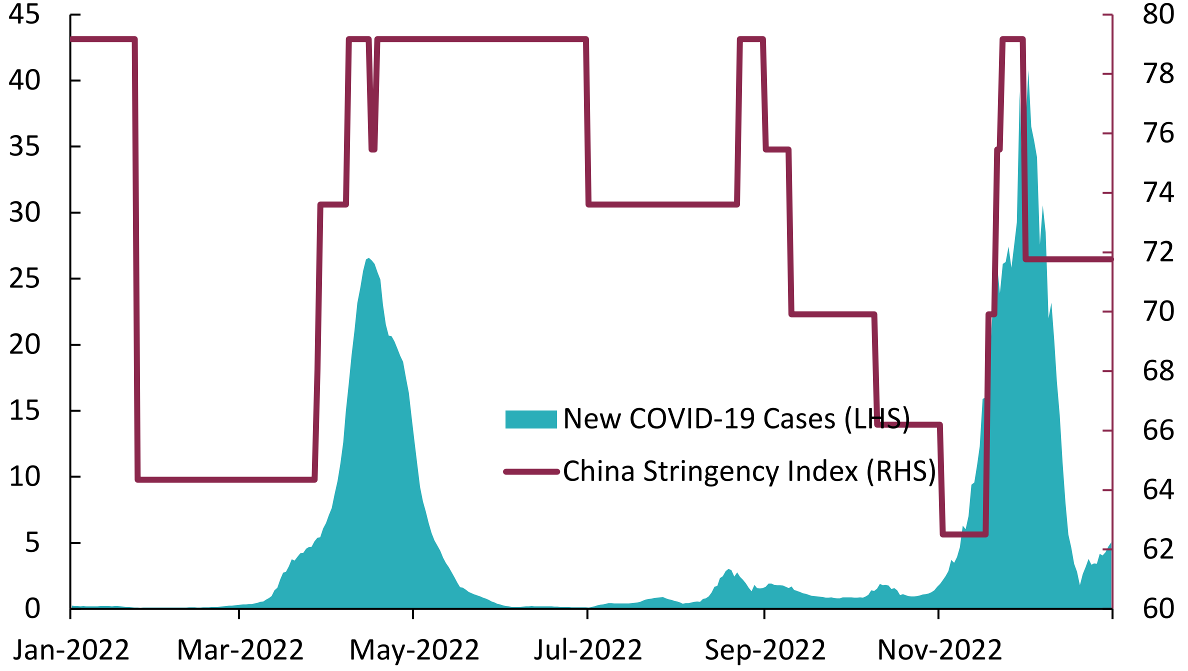


New COVID-19 cases, China

Thousands, smoothed average

Stringency of government restrictions

Index value, maximum=100



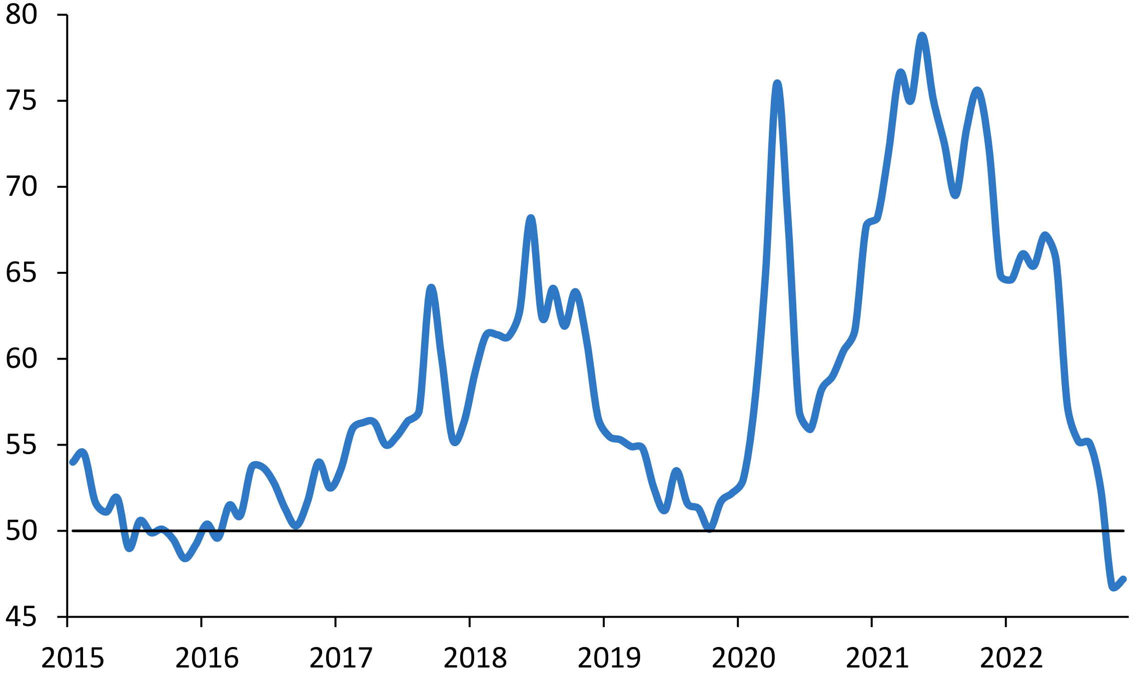
Sources: Haver Analytics, EDC Economics, Johns Hopkins Coronavirus Resource Center, Oxford University.

Supply chains ease while delivery times fall

Overall U.S. supplier delivery times are coming down for the first time in over five years. Compounding this is rapid declines in supply-chain pressures and costs, with November values currently around December 2020 levels. With an economic slowdown on the horizon, easing supply chains and burgeoning inventories are likely to contribute to easing inflationary pressures.

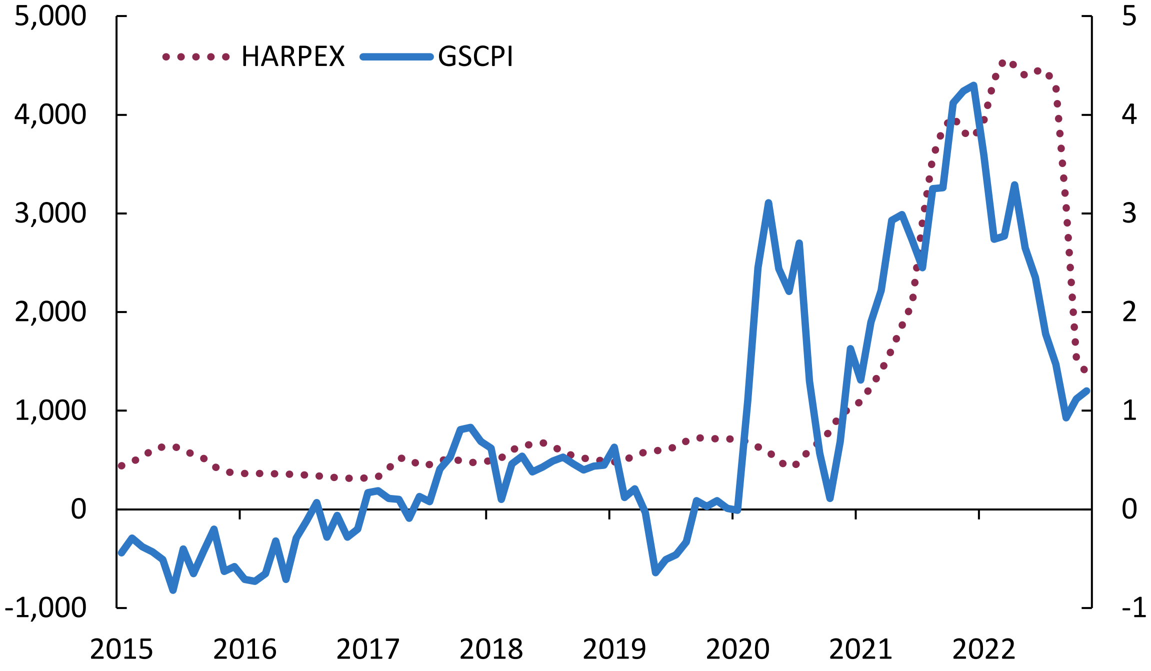
U.S. delivery times index

Above 50 is increasing delivery times, SA



Supply chain pressure and transportation costs*

GSCPI: Standard deviation points; HARPEX: NSA, Jan. 2001=1000



* HARPEX is the Harper Peterson Time Charter Index which tracks the transportation costs of shipping container costs, GSCPI is the Global Supply Chain Pressure Index

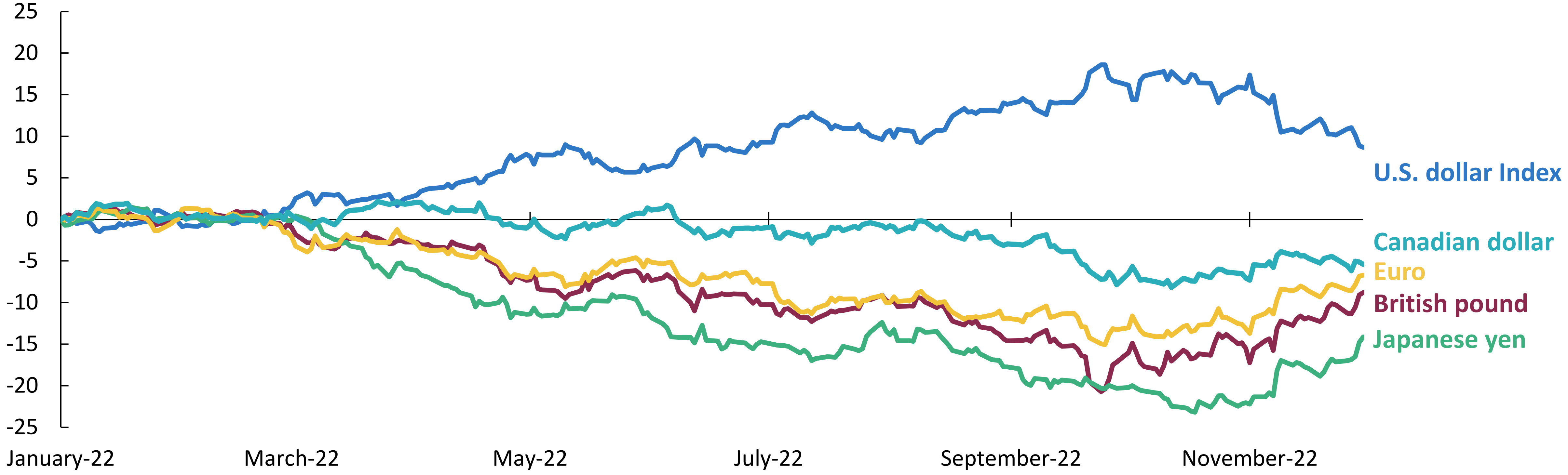
Source: Haver Analytics

Currencies begin to converge

The U.S. dollar made substantial gains since the Federal Reserve led the central bank rate hiking cycle in March 2022. Due to this, any U.S. denominated debt became more costly to service and imposed strain on countries around the world. Now currencies are beginning to converge as central banks signal a slowing of rate hikes.

Performance of select currencies

Percentage change since Jan. 1, 2022

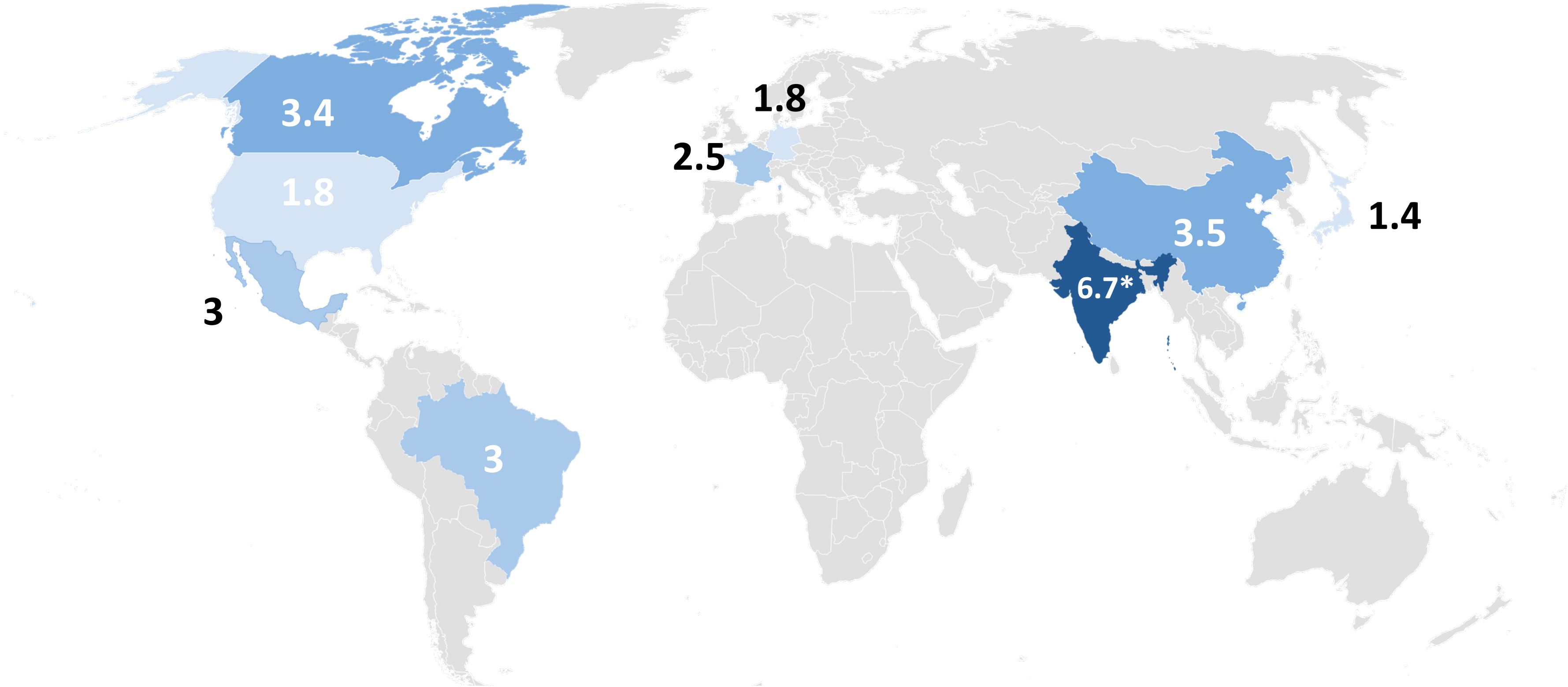


Sources: Wall Street Journal (WSJ) Markets, Haver Analytics

Forecast

2022 growth outlook

Real GDP growth, %



2.5%
World

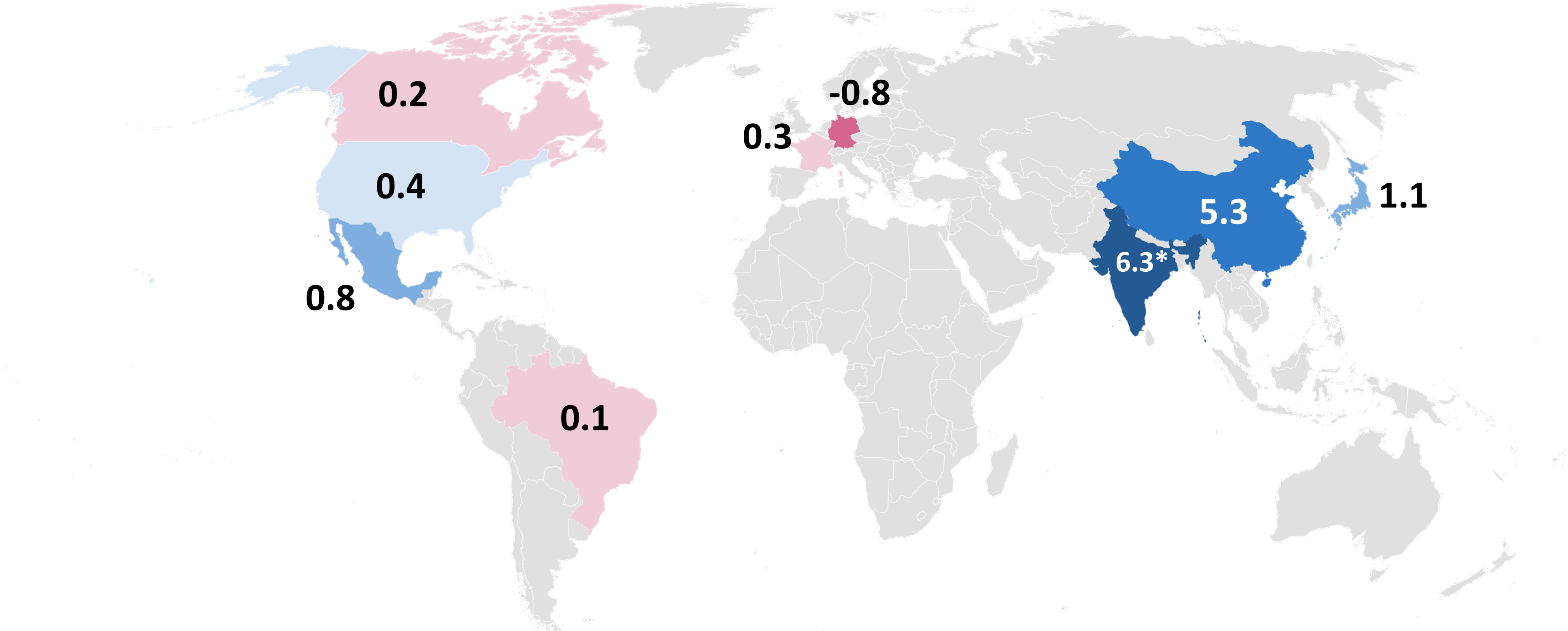
1.9%
Developed

2.9%
Developing

* India's 2023 FY = Q2 2022 – Q1 2023
Source: EDC Global Economic Outlook, January 2023

2023 growth outlook

Real GDP growth, %



2.3%
World

0.4%
Developed

3.8%
Developing

* India's 2024 FY = Q2 2023 – Q1 2024
Note: Red shading indicates a recession
Source: EDC Global Economic Outlook, January 2023

Real GDP growth

Global Economic Outlook (Annual % change)	2021	2022*	2023*
Developed countries	**5.2**	**1.9**	**0.4**
Canada	5	3.4	0.2
United States	5.9	1.8	0.4
Eurozone	5.3	3.2	0.1
Germany	2.6	1.8	-0.8
France	6.8	2.5	0.3
Japan	1.7	1.4	1.1
Developing countries	**6.6**	**2.9**	**3.8**
China	8.4	3.5	5.3
India	8.8	6.7	6.3
Brazil	5.3	3	0.1
Mexico	4.9	3	0.8
World	**6**	**2.5**	**2.3**

Note: * denotes the forecast period. India's forecast based on fiscal year (2023 FY = Q2 2022 – Q1 2023, 2024 FY = Q2 2023 – Q1 2024)
Source: EDC Global Economic Outlook, January 2023

Changes from previous forecast

Global Economic Outlook Real GDP growth (percentage point change)	2022*	2023*
Developed countries	**-**	**-0.4**
Canada	0.2	-1.1
United States	0.4	-0.2
Eurozone	**0.3**	**-0.1**
Germany	0.1	-0.6
France	0.1	-0.5
Japan	-	-0.7
Developing countries	**0.5**	**-0.2**
China	0.5	0.3
India	0.2	-1.6
Brazil	0.3	-0.5
Mexico	0.9	-0.9
World	**0.3**	**-0.3**

Note: * denotes the forecast period. Green shading represents upward adjustments; red shading represents downward adjustments.
Source: EDC Global Economic Outlook, January 2023 relative to September 2022.

Currencies and interest rates

Global Economic Outlook		2021	2022*	2023*
Currencies	**Exchange rate**			
U.S. dollar	**USD per CAD**	0.8	0.77	0.73
Euro	**USD per EUR**	1.18	1.05	0.99
Euro	**CAD per EUR**	1.48	1.37	1.36
Interest rates, annual average				
Bank of Canada, *Overnight target rate*		0.25	1.93	4.59
U.S. Federal Reserve, *Fed Funds Target Rate (Upper limit)*		0.25	1.86	4.96
European Central Bank, *Policy interest rate*		0	0.61	2.92

Note: * denotes the forecast period.
Source: EDC Global Economic Outlook, January 2023

Commodity prices

Global Economic Outlook	2021	2022*	2023*
Brent Crude Spot, *USD / bbl*	70.68	102.68	90.91
West Texas Intermediate, *USD / bbl*	67.98	96.42	81.89
Western Canada Select, *USD / bbl*	54.55	77.05	65.26
Natural Gas, *USD / MMBtu*	3.85	6.48	5.30
Gold, *USD / troy ounce*	1,800	1,795	1,665
Copper, *USD / tonne*	9,318	8,754	7,075

Note: * denotes the forecast period.
Source: EDC Global Economic Outlook, January 2023

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Key forecast assumptions

Global fiscal policy

Fiscal policy won't contribute to economic growth as governments focus on rebalancing public finances following abnormally high levels of pandemic-induced spending. In addition to unwinding stimulus, there's an additional push to further reduce spending as debt servicing costs increase due to higher interest rates. The impact of higher rates is greater due to increased leverage than in pre-pandemic. Fiscal policy manoeuvring will be even more restrictive for countries who face deteriorating risk ratings.

Monetary policy

While the pace of inflation is expected to slow, most countries will remain above recent historical trend and well-above central bank targets. Global central banks reacted strongly to inflationary pressures with frequent and sizable increases in policy rates. As the pace of inflation eases, central banks will continue to tighten their policy rates, but supersized increases are expected to give way to more smaller increments. Central banks are committed to bringing down inflation back to long-term targets and recessions assist in this objective. Interest rates are likely to be higher (more restrictive) than otherwise would be the case in a recessionary environment. Additionally, emerging markets will be forced to react to rate increases occurring in the developed world, even in the face of weak domestic conditions.

Recession risks

In Canada, EDC expects a mild technical recession, driven by high levels of indebtedness, slowing consumer spending and a decline in investor confidence. The downside is mitigated by strong labour markets and services sector. While no recession is expected in the U.S., growth will be uninspiring, despite a relatively strong labour market and consumers sitting on excess savings.

In Europe, a pronounced recession has already started and is exacerbated by curtailed supplies of natural gas, which will persist beyond 2023. A recession is forecasted in developed markets, while developing markets see slower growth but not a technical recession. The global economy is set to enter a recession, which the International Monetary Fund (IMF) defines as GDP growth of less than 3%.

Financial conditions

EDC Economics' baseline outlook doesn't anticipate a systemic financial or sovereign debt crisis. But vulnerabilities emerging in early 2022, have deteriorated further. Financial market turbulence, notably in equity markets and corporate bond spreads, will continue due to economic and political headwinds and resulting shift in investor risk appetite. Corporate default risk is higher now because of a global recession. Similarly, currencies and real estate will continue to face pressures. Sovereign defaults and balance of payments crises are occurring in a growing number of markets. Pressures have largely been contained to markets with smaller GDP or global financial importance.

Russia-Ukraine

The baseline sees the Russia-Ukraine war settling into a stalemate. While fighting will continue throughout the next 12 months, armed conflict isn't expected to spillover beyond Ukraine. Western sanctions against Russia will remain in place beyond the forecast period and the negative impacts on global energy supplies will continue. Russian oil will find international buyers (at steeply discounted prices), but natural gas supplies will decline sharply. This will have a significant impact on global liquified natural gas (LNG) prices as Europe competes for shipments. Additionally, the coming winter will see significant impacts on Europe as higher gas prices curtail economic activity.

Key risks to the forecast

Given rapidly changing global events, there's a higher-than-usual degree of uncertainty around this forecast, which incorporates information available as of November 2022.

Key upside risks

- A more expansive drawdown of consumer savings above baseline forecast, which leads to stronger-than-expected consumer demand. The likely possibility of the upside risk begins in Q3 2023. Recent leanings by the Chinese government in favour of growth and away from zero-COVID-19 policies also add to possibility of this scenario.
- Business investment enables governments to reduce their spending programs more rapidly than in the base case, excluding Europe. Increased consumer spending would decrease the risks of larger government balance sheets.
- Inflation is higher than long-term trend, but is contained by the rise in business investment and digitization, which boosts productive capacity of the economy, preventing the economy from overheating.
- Countries, sectors, or individuals may face increased challenges in this scenario, but absent of becoming a systemic crisis across major developed or emerging markets.

Key downside risks

- The downside scenario sees a recession in both developed and developing markets, with less potential for economic policy to cushion the impact. The U.S. is negatively hit but less than other countries.
- Tighter monetary policy than otherwise would be in a recession. Developing markets are forced to raise rates further to stem any balance of payments or currency risks.
- Higher debt is an increasingly significant issue for the corporate sector, developing markets and households. The sudden tightening of financial conditions increases default risk and widens bond spreads for some developing markets. Higher personal debt-to-income ratios increases risks to the real estate sector and smaller businesses.
- Higher country risk impedes access to global capital markets. Liquidity and solvency challenges for developing markets increases with political risks mounting due to inflation and recession risks.

Disclosure

Ce document est également disponible en français.

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