Global Economic Outlook

Stuck in the doldrums

EDC Economics

March 30, 2023

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

Canada

Executive summary

Global Economic Outlook: Stuck in the doldrums

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Battered by wave after wave of pandemic shutdowns, rocked by supply chain shortages and pounded by war in Europe, the global economy now finds itself adrift, weighed down by stimulus debt and cost-push inflation, and surrounded by dangerous policy-generated market distortions.

In efforts to contain the surge in prices, central banks have hoisted interest rates at their fastest pace in a quarter century—with the U.S. Federal Reserve hiking rates by 475 basis points (bps), the Bank of Canada by 425 bps, and the European Central Bank (ECB) by 350 bps. While monetary tightening has helped slow inflation from its summertime clip, price increases remain well above their target speed and central bankers will now have to manage a choppy cross-current as growth begins to slow.

With savings rates having fallen from their pandemic highs, inflation eroding consumer purchasing power and higher interest rates sinking business investment, the world's largest economies run the risk of washing up on the shallow shoals of recession. Further increasing this risk are central bank commitments to firmly anchor inflation expectations, which continue to be buoyed by elevated costs for services and housing, and ongoing tightness in the labour market. We maintain that developed market central bankers will opt to build a pier a kilometre too long rather than one a metre too short, in their fight against rampant price pressures.

Given the need to balance inflation, growth and surfacing financial market hazards, we expect the Bank of Canada to remain moored to its current policy rate in 2023, before letting rates sink only in early 2024. Keeping close watch of financial markets, the U.S. Federal Reserve still has a couple more 25-bp rate hikes to go before summer. We then expect the Fed to tread water until it starts to pull rates back down, toward the end of Q1 2024.

These divergent policy paths will hit the Canadian dollar, as higher rates lead capital to flow into the United States, causing the loonie to plunge to an average of US$0.73 this year, before bobbing back to US$0.75 in 2024.

After a stronger-than expected Q1, the U.S. economy will manage only shallow growth of 0.9% in 2023. In 2024, we expect growth to rev up to 1.2%, pulled by stronger horsepower toward the end of the year. EDC Economics anticipates a very mild recession in Canada this year, with growth stalling at 0.1%. In the wake of stronger global growth in 2024, Canadian growth will accelerate to 1.8%.

Executive summary (continued)

Global Economic Outlook: Stuck in the doldrums

Across the Atlantic, the ECB will continue its cautious, but persistent rate increases through the end of 2023. Despite ECB tightening and the ongoing energy crunch, Europe managed to stay afloat through the winter, thanks to unseasonably warm winter temperatures and efforts to bear off Russian energy. As the effects of energy shortages work their way through the region's economies, however, and assuming a return to more normal winter and summer temperatures, growth is expected to slow. The Euro Area will barely stay above water this year, with growth of only 0.6%, before managing growth of 1.2% in 2024.

China's economy will be submerged by weaker global demand, as it plots its own reopening, following nearly three years of COVID-19 restrictions. Additionally, the lingering social effects of the lockdowns and the real-estate sector's menacing debt overhang will thwart Chinese consumer and business confidence. While we forecast China to hit its 5% growth target in 2023, this represents a sharp tack from its pre-COVID-19 trajectory. What's more, growth in 2024 will reach only 4.7%.

The combined drag of these forces on the global economy will result in global growth of just 2.4% in 2023, one of the weakest annual growth rates in recent times, with the notable exception of 2020 and 2008. Growth in 2024 will float to 3.2%, as the recovery gets underway.

The bottom line

The world's central banks have helped navigate the global economy through stormy seas and are now plotting a course toward calmer waters in 2024. But this year will see most major economies stuck in the doldrums, with notable dangers circling the waters, thanks to the unwinding of a decade's worth of unconventional economic policies.

Changes to the outlook

- EDC Economics has revised up slightly its global growth for 2023 (2.4%), followed by higher growth in 2024 (3.2%). Despite the unexpectedly positive economic data coming in for advanced economies in Q4 2022, most economies are entering a period of low growth.
- Central banks are committed to achieving price stability and have signalled that the tightening cycle is close to being finished. There's now more room for central bank policy divergence. While headline inflation is declining, core inflation in developed markets is proving to be much more difficult to bring down. The rapid rise in interest rates increases the risk to financial markets, increasing the possibility of liquidity challenges.
- Recession risks remain high in key countries. While Canada and Germany are going to face modest recessions, it's expected that the United States will have a softer landing and avoid a recession. China's reopening provides limited upside risk to the global economy.

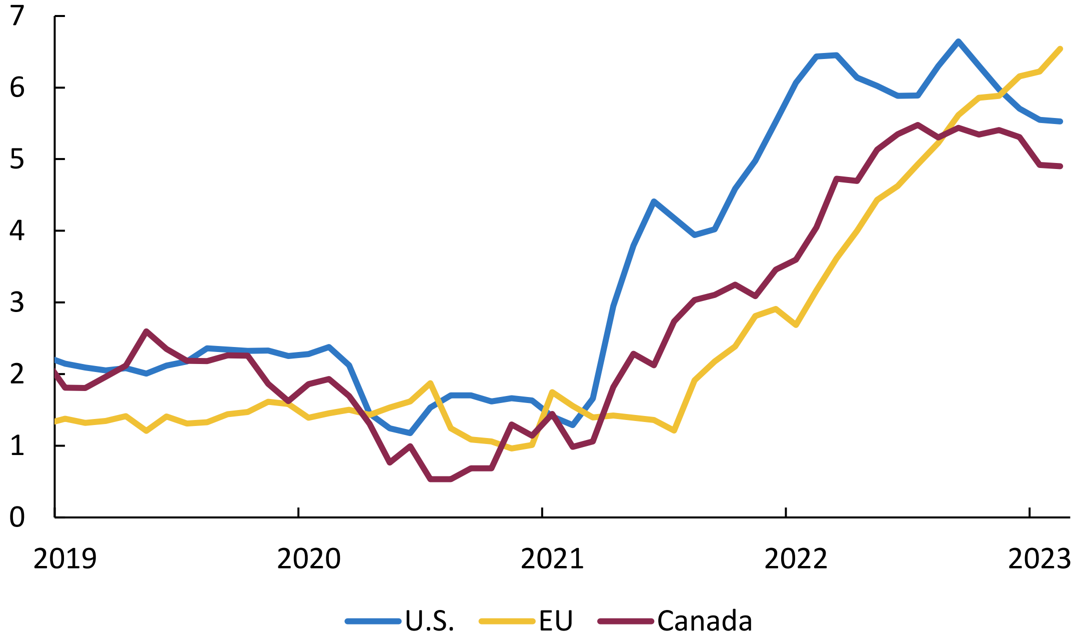
Macroeconomic context

Inflation is calming, but there's still a ways to go

Interest rate increases by central banks have slowed core inflation (excluding food and energy) in major regions, bringing it within striking distance of targets in Canada and other countries. But monthly inflation growth in the U.S. and EU remain high. Services and housing costs will take longer to tame despite weaker consumer spending.

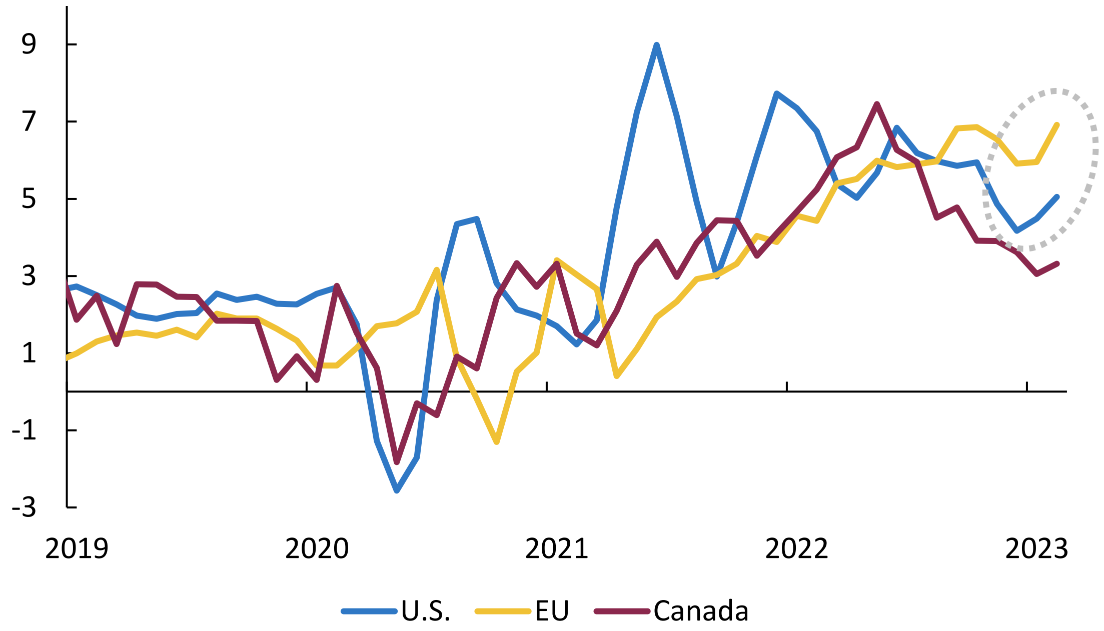
Core inflation growth is slowing, but not fast enough

y/y % change in core inflation, SA



…with monthly inflation growth still high

Three-month moving % change in core inflation, SAAR



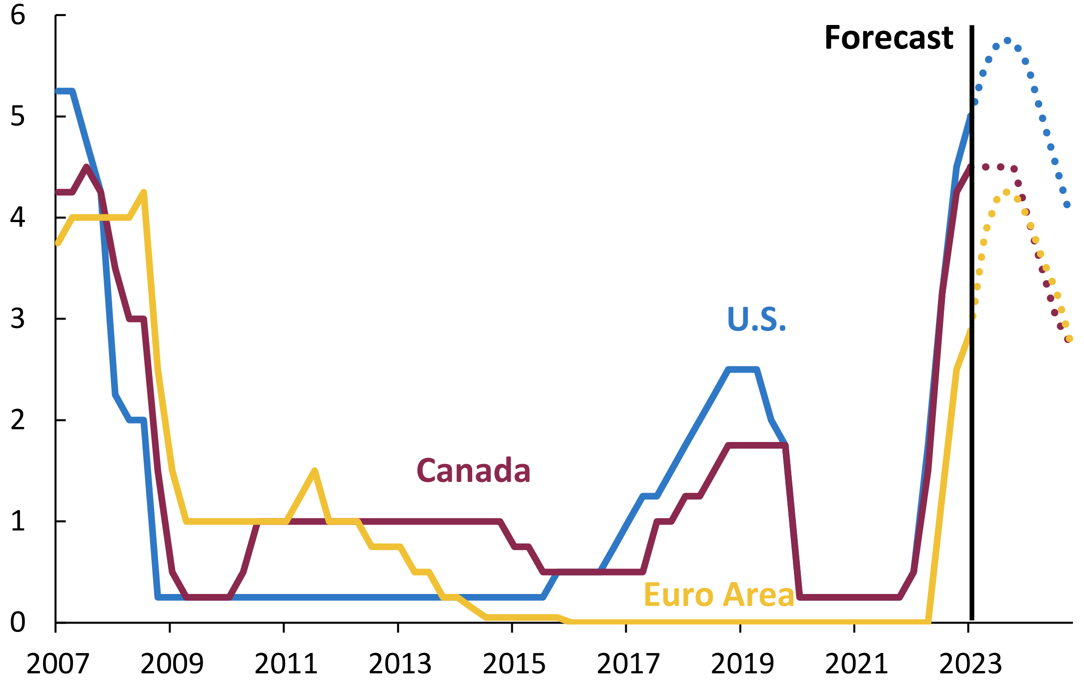
Note: Last data point is February 2023, SA = Seasonally adjusted, SAAR = Seasonally adjusted annual rate
Sources: Haver Analytics, EDC Economics

The end of the monetary tightening is near, but rates remain high

While most central banks remain in their tightening cycle, the pace of interest rate increases has slowed. The Bank of Canada is the first to pause rate hikes, marking a potential policy divergence between major banks, but others are expected to follow suit over the next few months.

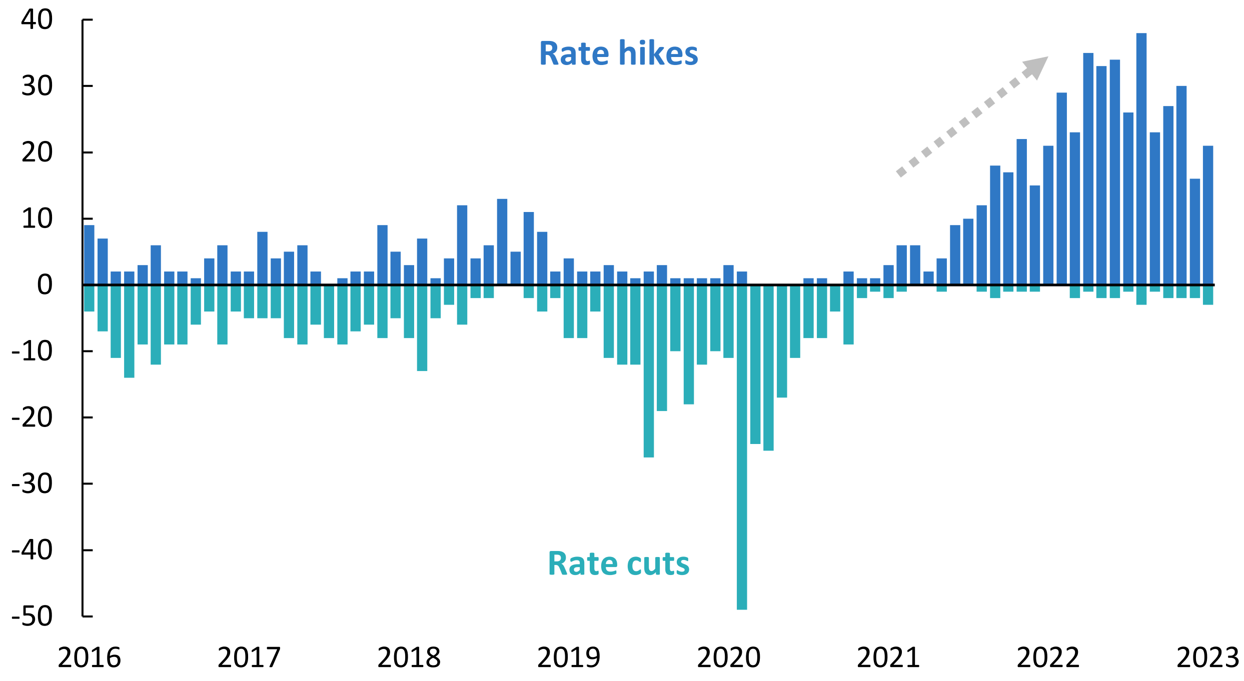
Policy interest rates

End-of-period, %



Monetary policy cycle

of central banks, by policy decision



Sources: Haver Analytics, EDC Economics

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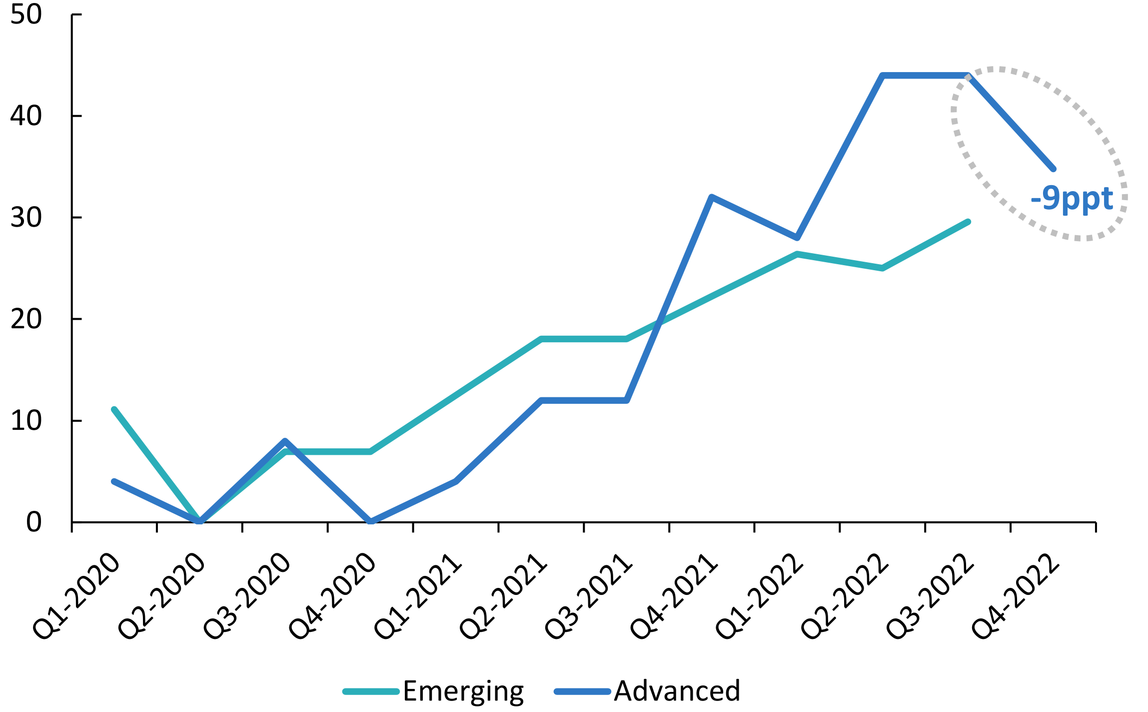
Global growth slowing while countries struggle with recovery

While most nations haven't recovered to pre-pandemic growth paths, there's now a growing list of countries falling behind. This is driven by the slowing of China and India. With China representing 32% of global GDP growth in the last decade, its newest GDP target is the lowest in recent history, making prospects for 2023 grim.

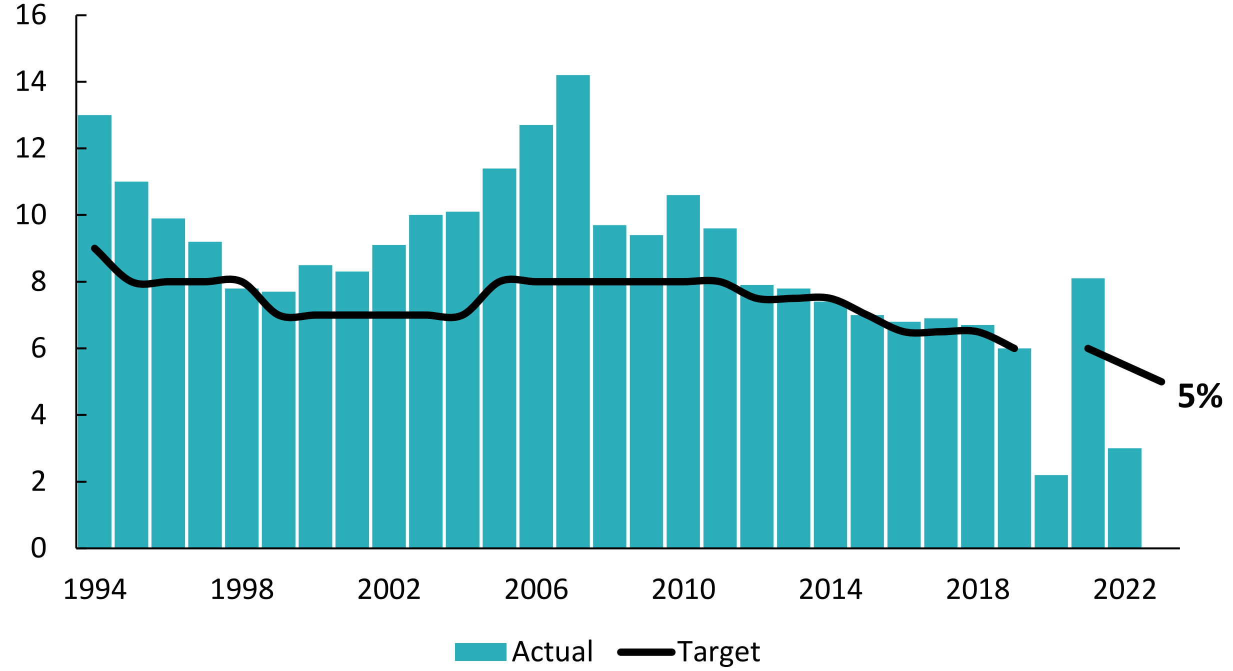
GDP growth recovery to pre-pandemic trends

% of selected-countries back to their 2018-2019 real GDP growth paths*



China's real GDP growth and growth rate targets

y/y % change



*Growth paths constructed using default Excel linear trend methods over 2018-2019 data; 25-advanced and 72-emerging economies chosen by data availability; Q4-2022 emerging values dropped due to data scarcity; all data seasonally adjusted and real GDP used with varying base years.

Sources: Haver Analytics, EDC Economics, World Economics, Financial Times

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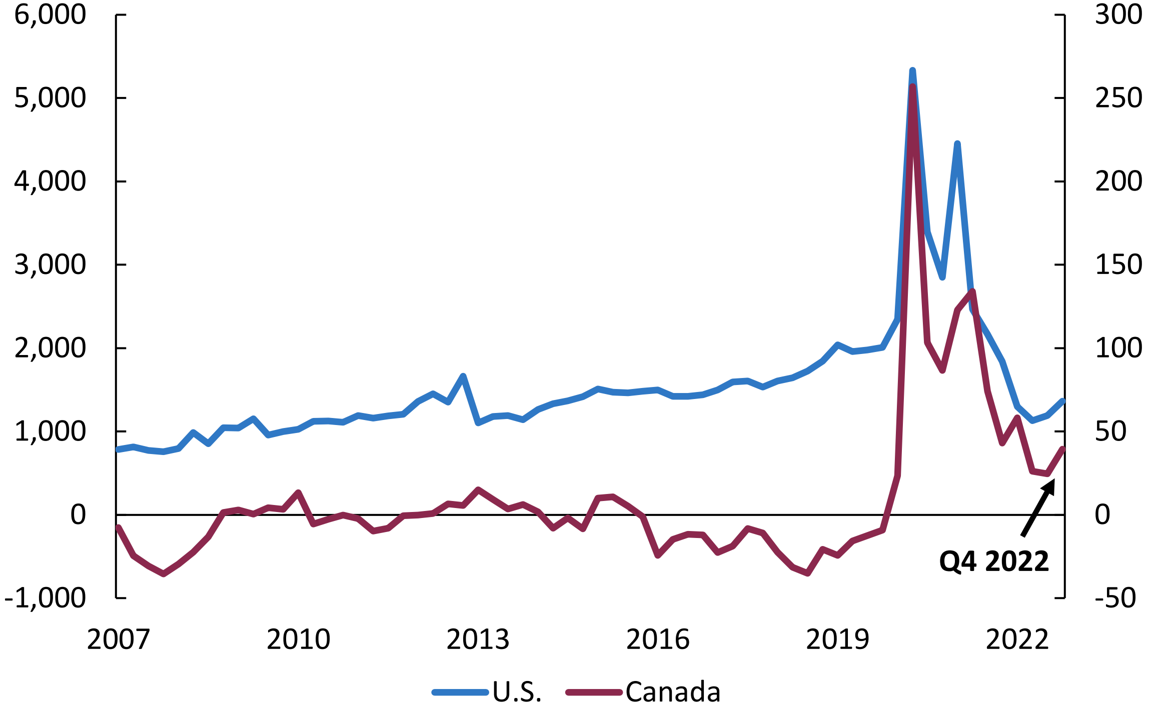
Consumer savings elevated, but not for everyone

Consumer cash-on-hand grew throughout the pandemic and then fueled economic activity, after reopening led to a surge in spending. But by Q3 2022, these surpluses were largely depleted. These values once again trending upwards, but chiefly in the highest income brackets. Lower income brackets are worse off than before the pandemic, which will constrain consumer demand into 2023.

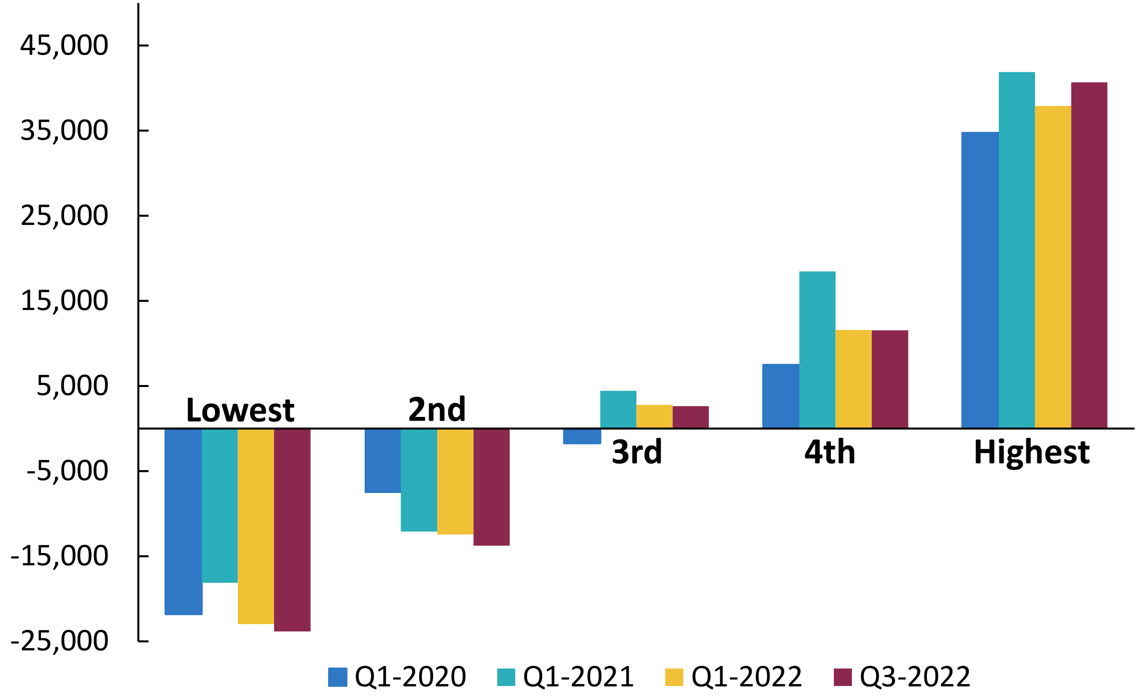
Cash-on-hand

Quarterly, USD billions



Canada cash-on-hand by income quintile

Quarterly, CAD millions



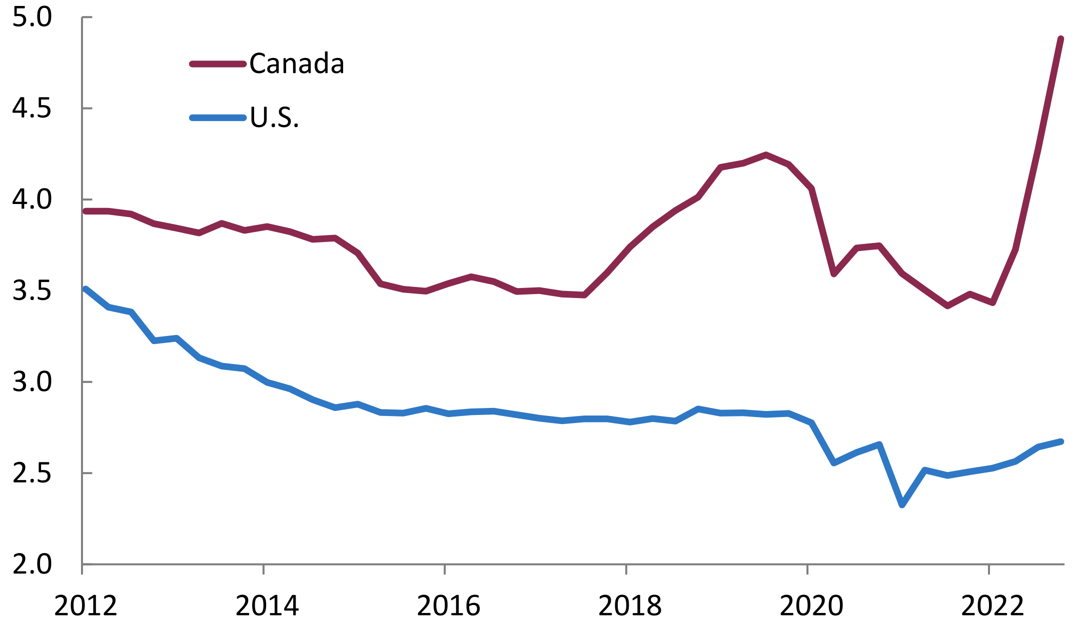
Sources: Haver Analytics, Statistics Canada (Table: 36-10-0662-01), EDC Economics

Interest rates hit household and corporate finances

Households and corporations face elevated costs of servicing loans and mortgages due to higher interest rates. Households in Canada face a disproportionate impact in the housing sector, including greater mortgage interest payments. Non-financial corporate debt has settled at record high levels, with corporations issuing bonds in advance of a steep increase in interest rates.

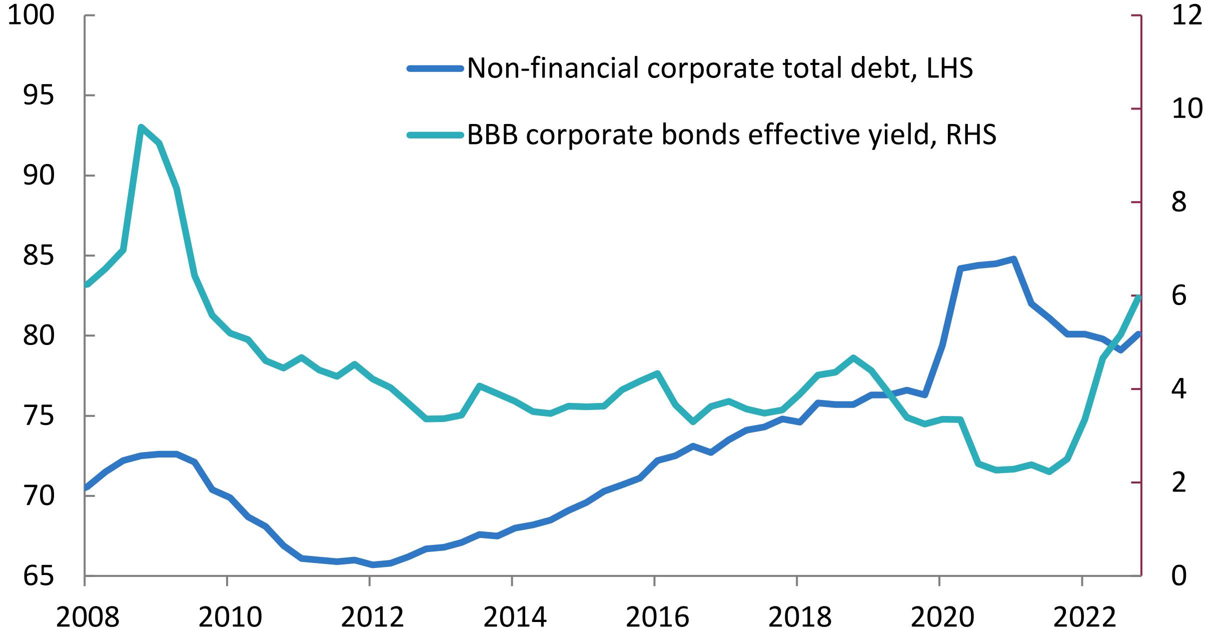
Housing interest taking greater share of income

Mortgage interest payments as % of disposable income



U.S. corporate debt

% of GDP
%

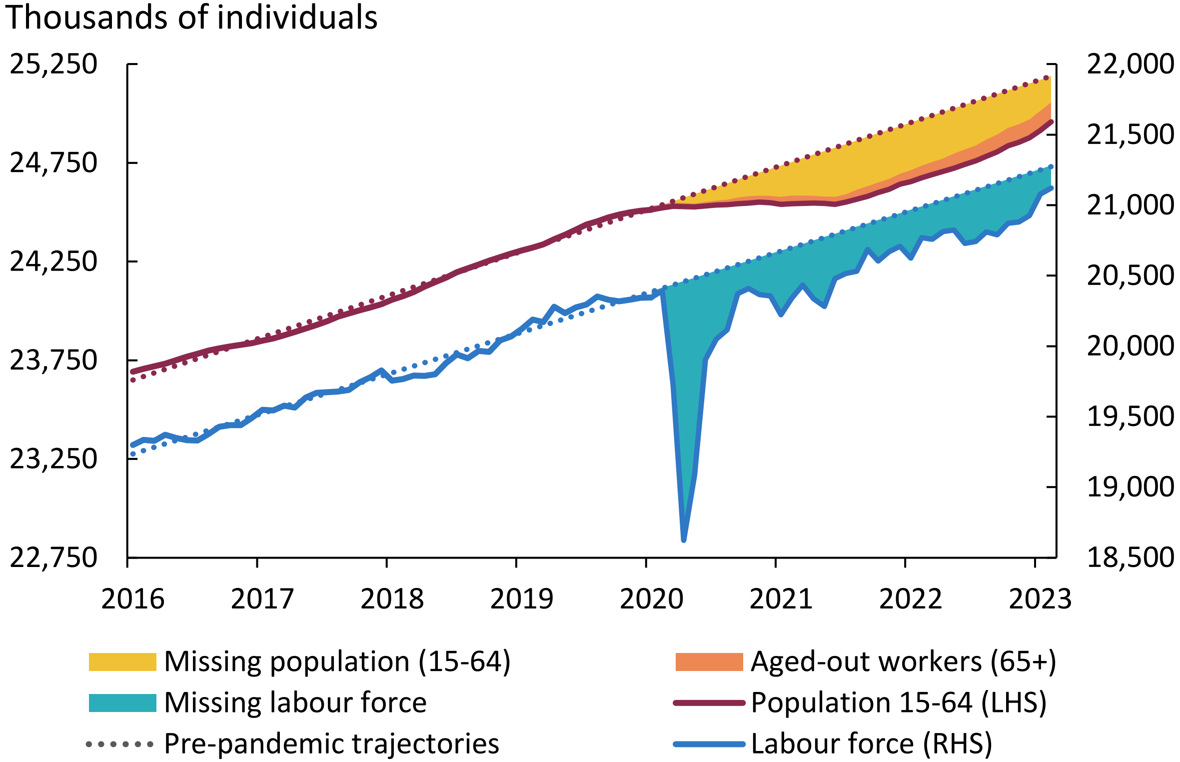


Sources: Haver Analytics, EDC Economics

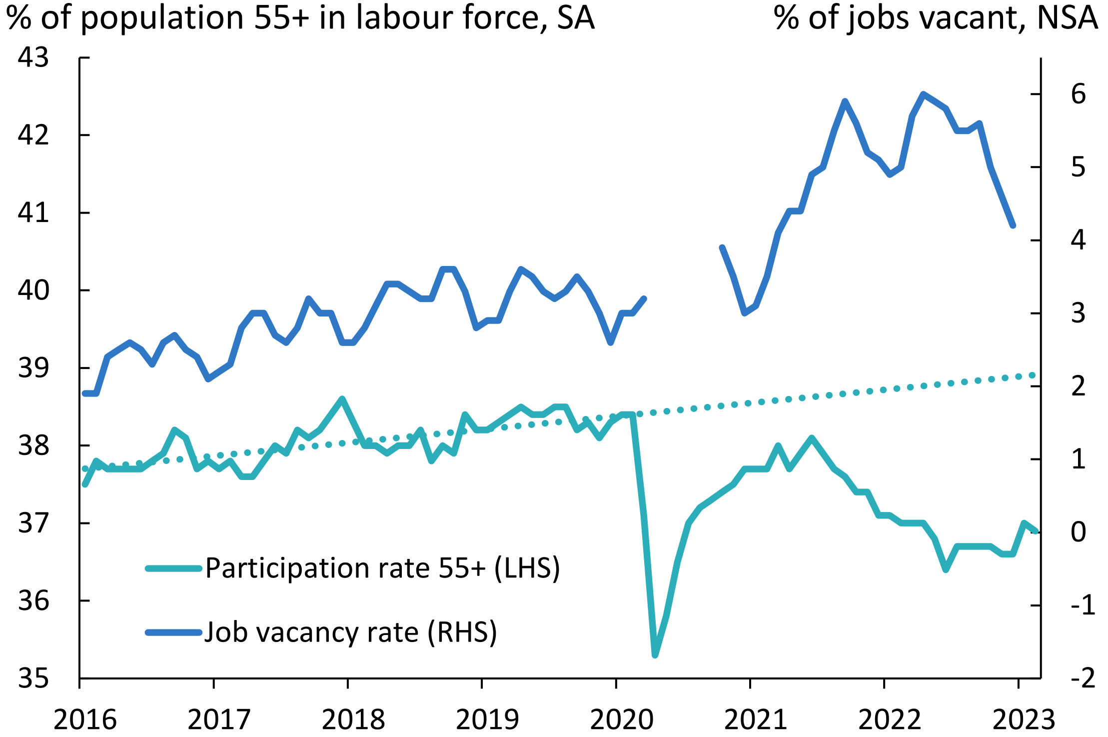
Canadian labour markets losing older workers

The tightening of the Canadian labour force has been attributed to an aging (65+) population, increased deaths, and a reduction in the participation rate of older (55+) workers. As a result of increased borrowing costs and weaker demand, job vacancies are coming down, but it will take time to adjust to the demographic shift in the labour force.

Canadian workforce below pre-pandemic trajectory*



Canadian job vacancies and participation rate



*Pre-pandemic trajectories constructed using linear trend methods over 2016-2019 data; all data seasonally adjusted.

Note: NSA = Not seasonally adjusted

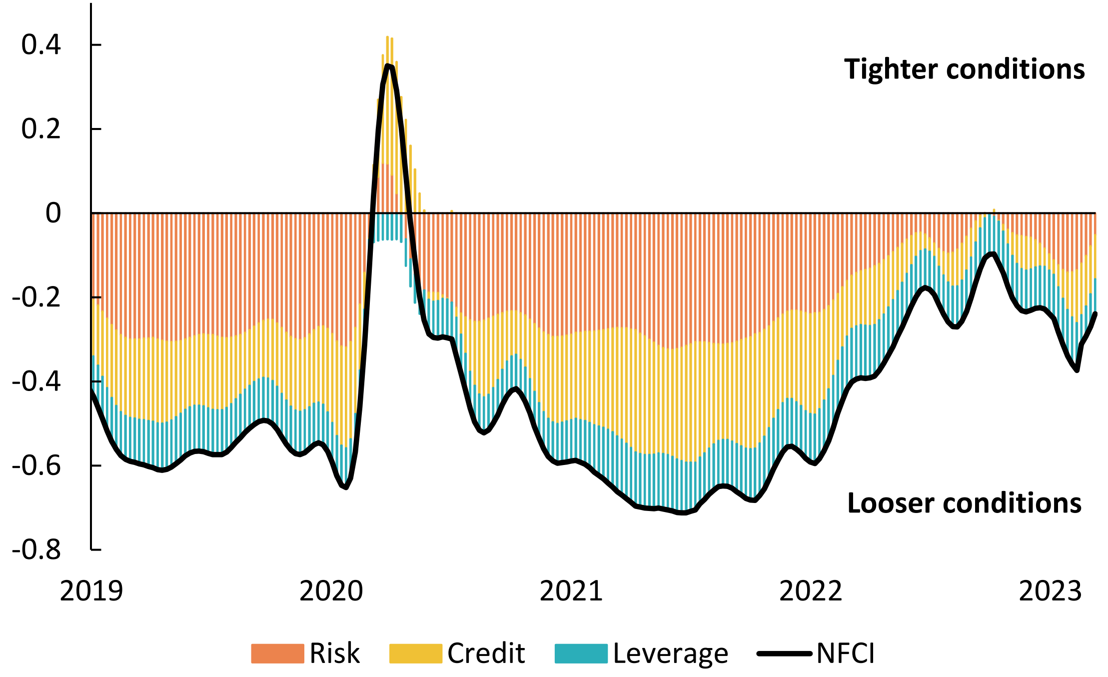
Sources: Haver Analytics, EDC Economics

Markets volatile amid rate uncertainty despite inflation cooling

Easing inflation is welcome news, but central banks are set to maintain high rates, keeping treasury bond yields up. Financial markets continue to be volatile. But despite recent high-profile bank failures, risk of systemic credit contagion remains low.

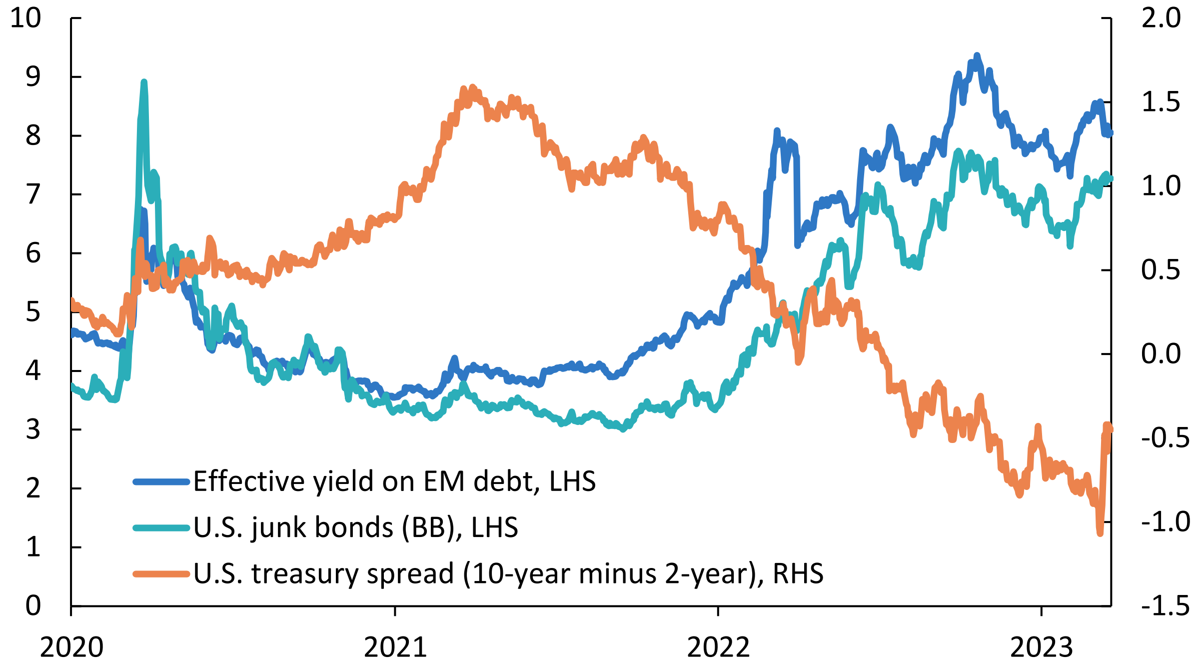
U.S. National Financial Conditions Index (NFCI)

Contributions to index, standard deviation



Debt markets

%



Data from NFCI as of week of March 17. Debt data as of March 20, 2023.

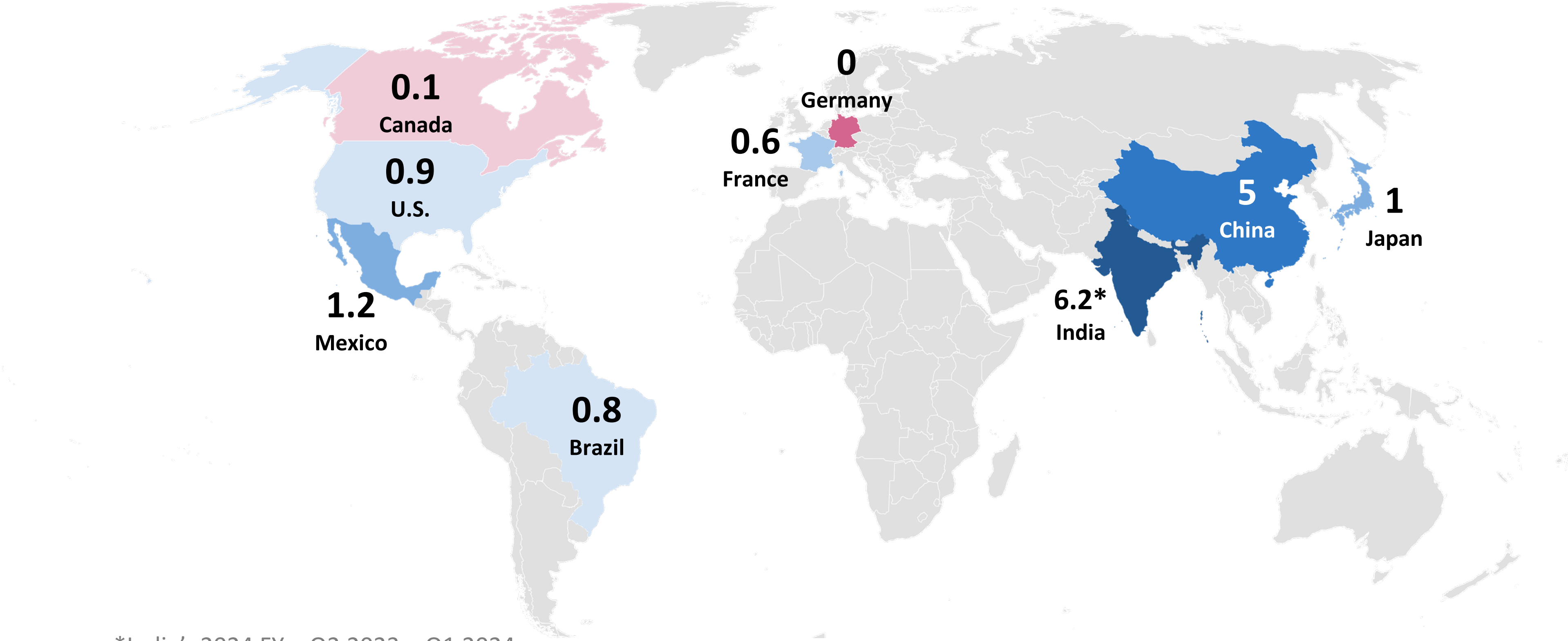
Note: Effective yield on EM debt calculated by adding the three-year U.S. treasury yield-maturity and the JP Morgan EMBI bond spread.

Sources: Haver Analytics, Federal Reserve Bank of Chicago, EDC Economics Global Financial Markets.

Forecast

2023 growth outlook

Real GDP growth, %



2.4%
World

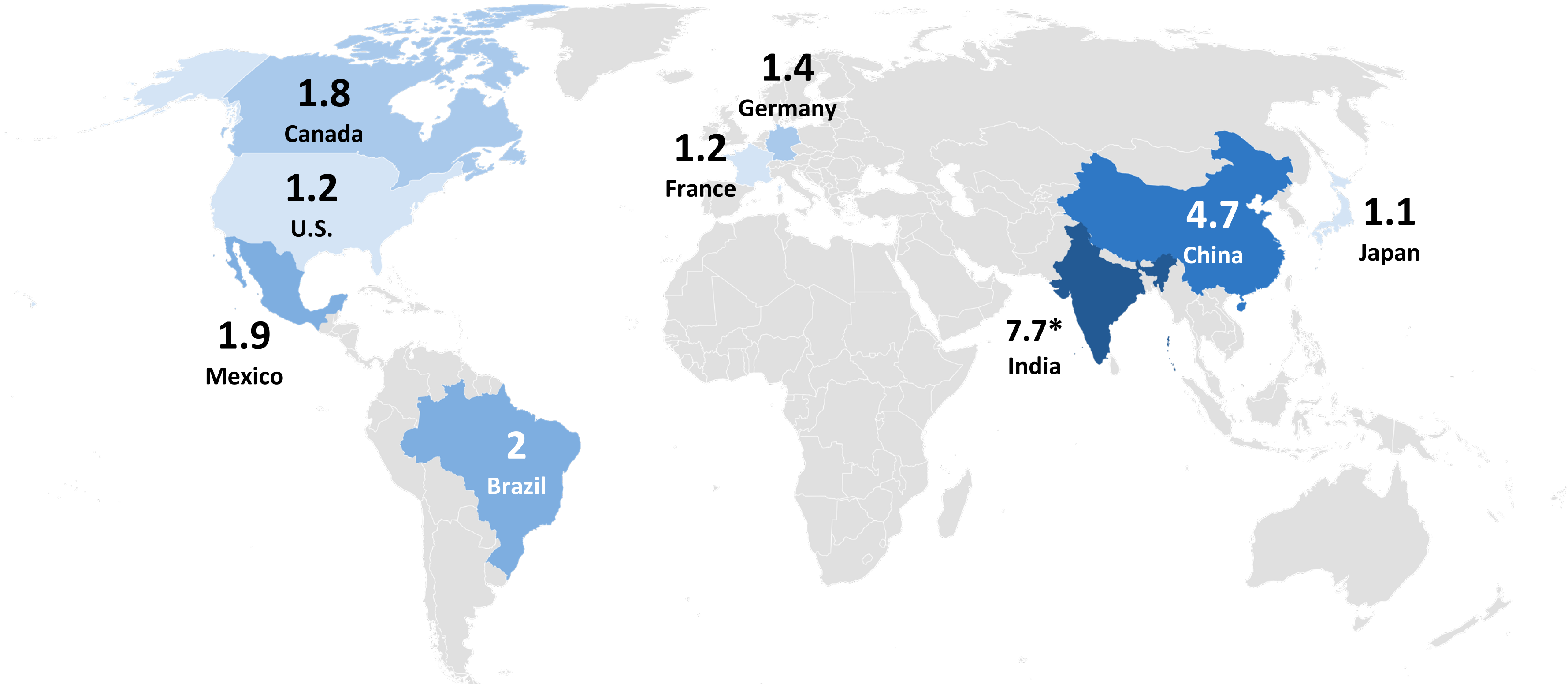
0.7%
Developed

3.7%
Developing

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

2024 growth outlook

Real GDP growth, %



3.2%
World

1.4%
Developed

4.5%
Developing

* India's 2025 FY = Q2 2024 – Q1 2025
Note: Red shading indicates a recession
Source: EDC Global Economic Outlook, March 2023

Real GDP growth

Global Economic Outlook (Annual % change)	2022	2023*	2024*
Developed countries	**2**	**0.7**	**1.4**
Canada	3.4	0.1	1.8
United States	2.1	0.9	1.2
Eurozone	3.5	0.6	1.2
Germany	1.9	0	1.4
France	2.6	0.6	1.2
Japan	1.3	1	1.1
Developing countries	**3**	**3.7**	**4.5**
China	3	5	4.7
India	7	6.2	7.7
Brazil	3	0.8	2
Mexico	3.1	1.2	1.9
World	**2.6**	**2.4**	**3.2**

Note: * denotes the forecast period. India's forecast based on fiscal year (2024 FY = Q2 2023 – Q1 2024, 2025 FY = Q2 2024 – Q1 2025)
Source: EDC Global Economic Outlook, March 2023

Changes from previous forecast

Global Economic Outlook Real GDP growth (percentage point change)	**2023***	**2024***
Developed countries	**0.3**	**-0.5**
Canada	-0.1	-0.5
United States	0.5	-1.2
Eurozone	**0.5**	**-0.1**
Germany	0.8	0.9
France	0.3	0.1
Japan	-0.1	-
Developing countries	**-0.1**	**-0.1**
China	-0.3	0.1
India	-0.2	-
Brazil	0.7	-0.4
Mexico	0.4	-0.3
World	**0.1**	**-0.3**

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

Currencies and interest rates

Global Economic Outlook		2022	2023*	2024*
Currencies	**Exchange rate**			
U.S. dollar	**USD per CAD**	$0.8	$0.73	$0.75
Euro	**USD per EUR**	$1.05	$1.08	$1.10
Euro	**CAD per EUR**	$1.37	$1.48	$1.46
Interest rates, annual average				
Bank of Canada, *Overnight target rate*		1.93	4.48	3.5
U.S. Federal Reserve, *Fed Funds Target Rate (Upper limit)*		1.86	5.33	4.96
European Central Bank, *Policy interest rate*		0.58	3.81	3.42

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

Commodity prices

Global Economic Outlook	2022	2023*	2024*
Brent Crude Spot, *USD / barrel (bbl)*	$100.78	$84.7	$80.2
West Texas Intermediate, *USD / bbl*	$94.6	$79.83	$75.4
Western Canada Select, *USD / bbl*	$75.02	$59.83	$58.4
Natural gas, *USD / MMBtu*	$6.37	$3.35	$4.2
Gold, *USD / troy ounce*	$1,801	$1,820	$1,680
Copper, *USD / tonne*	$8,813	$8,813	$8,618

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

Key forecast assumptions

1. Recession risk

Global headwinds outweigh tailwinds. Monetary policy in developed markets remains focused on containing inflation, despite risks of triggering a modest recession. Developing markets are experiencing greater challenges. Although the Federal Reserve will eventually lower interest rates, terminal rates will be higher than that of the past decade and spreads on emerging market debt will be elevated.

2. 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. Central banks are committed to bringing down inflation back to target ranges, even if a recession occurs. Interest rates are likely to be higher (more restrictive) than otherwise would be the case in a low-growth environment. There's room for policy divergence between the U.S., Canada and the European Union (EU). China will likely keep accommodative measures in place to support their property market. Additionally, emerging markets will be forced to react to rate increases occurring in the developed world, even in the face of weak domestic conditions.

3. Financial conditions

EDC Economics' baseline outlook doesn't anticipate a systemic financial crisis, although risks are rising as cash balances in households, businesses and sovereigns deteriorate. Financial market turbulence, notably in equity markets, currencies and bond spreads will continue. Corporate default risk is higher now because of a global recession. Global real estate pressures will continue. Sovereign defaults and balance of payments crises are occurring in a growing number of markets. Although mounting in larger markets, pressures have largely been contained to markets with smaller GDP or global financial importance.

4. Russia-Ukraine

The baseline sees the Russia-Ukraine war settling into a stalemate. Fighting will continue but armed conflict isn't expected to spillover beyond Ukraine. Western sanctions against Russia will remain in place beyond the forecast period. Despite these sanctions, Russia continues to export a significant amount of commodities at steeply discounted prices. This impacts Russia's economy, but the availability of supply has reduced risks of a supply crunch. Commodity exports where Ukraine holds a large share of production, will continue to have price support.

5. U.S.-China relations

The rise of China as a global power has shifted the balance of power in relation to the U.S. EDC Economics expects the U.S., EU, and other bilateral relations with China to continue to be constrained and susceptible to increased uncertainty. We don't foresee a material improvement in relations between the U.S. and China with possibilities of mutual retaliation in key sectors.

6. 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.

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 February 2023.

Key upside risks

- Inflationary pressures could ease markedly toward the end of 2023. This would reassure central banks, bringing the Federal Reserve to cut interest rates sooner than in baseline forecast.
- Investor sentiment improves, driving equity markets higher and government bond yields down globally. Most currencies strengthen relatively against the U.S. dollar.
- A more resilient economy global economy emerges as inflationary pressures are contained and supply in the economy improves. Despite disinflation, commodity prices aren't the source and rather return to supply-demand fundamentals.

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 keeping the U.S. dollar strong. 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.

Note: The timing of upside and downside risks begin in Q3 2023

Disclosure

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