Global Economic Outlook:

A growth recession

EDC Economics

Sept. 22, 2022

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

Canada

Executive summary

Global Economic Outlook: A growth recession

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To say that 2022 hasn't played out quite the way most have expected would be an understatement. Inflation above 40-year highs across much of the industrialized world, war in Europe and tensions in the South China Sea have only compounded the lingering effects of a global pandemic. As the world economy struggles to move beyond the impacts of COVID-19, we continue to face challenges not seen in generations. How policymakers and businesses navigate these challenges, and their level of success, will determine if the global economy falls into recession.

Central bankers in Canada, the United States, the Euro area and elsewhere are almost singularly focused on fighting inflation through a series of steady and significant interest rate increases. With headline inflation rates of nearly 10%, driven by supply shortages resulting from the war in Ukraine and ongoing COVID-related supply chain disruptions, most of the world's major central banks have swiftly reversed course on the accommodative policy approach that saw them through the pandemic.

While prices for key commodities have fallen back, on concerns around global growth, they remain elevated and subject to heightened levels of volatility. We don't expect much relief on food prices over the next year or so, given damage to agricultural lands and the displacement of labour in both Russia and Ukraine, to say nothing of flooding and drought conditions in other parts of the world. On oil, we expect West Texas Intermediate (WTI) crude to average $98/barrel this year, before settling back to $84/barrel in 2023. This, together with interest rate increases, the moderating impact of year-over-year price comparisons and weakening consumer demand should help dampen core prices next year.

In the U.S., the Federal Reserve has used supersized increases to push interest rates from 0.25% at the beginning of the year to 2.5% by the start of the third-quarter. While this has slowed inflation, it hasn't brought it down to its target. As a result, we expect the central bank to continue to increase rates aggressively, reaching 3.5% in 2023 and holding steady through the rest of next year. The swift move in U.S. interest rates, combined with accelerated balance sheet reductions, will reverberate across the American economy and throughout the world.

Executive summary (continued)

Global Economic Outlook: A growth recession

While we expect the U.S. to avoid technical recession, thanks to still-high pandemic-era consumer savings and an historically tight job market, we're calling for uninspired, below-trend growth of 1.4% in 2022 and just 0.6% in 2023. This doesn't leave much room for error, in light of prevailing market volatility, and so risks remain high.

The Bank of Canada will tread a similar path to that of the U.S. Federal Reserve, with interest rates peaking above neutral levels in 2023, before pulling back the following year. The Canadian economy is projected to grow by 3.2% in 2022 and 1.3% in 2023.

While the European Central Bank is also hiking interest rates, the first time in more than a decade, it faces a more challenging environment, and will only reach a high of 2.25% in 2023. On the frontlines of the Russia-Ukraine conflict and faced with Russia's determination to squeeze energy supplies as a political pressure tactic, Europe faces a difficult winter. Natural gas price futures have more than tripled in many countries from pre-war levels, forcing governments to develop plans for energy rationing. Uncertainty over supplies and surging prices will tear across economies and the continent, dragging the Euro area into recession this year and early next year, before posting essentially no growth in 2023.

One of the few countries where monetary policy is likely to be eased rather than tightened will be in China. The economic impacts of the country's zero-COVID-19 policies aren't forecast to improve in 2023, and the threat of lockdowns will keep consumers and business confidence on edge. At the same time, ongoing debt accumulation and overcapacity in the property sector will require policy support to stem wider economic impacts. Our outlook for China's economy calls for historically weak growth of 3% in 2022 and 4.9% in 2023.

The bottom line

The economic outlook for the world has weakened since the first half of the year, due to headwinds from a rare convergence of challenges. Going forward, there are many interdependent risks with global implications. Our autumn release of the Export Development Canada *Global Economic Outlook* sees global growth falling to 2.2% this year, and 2.6% in 2023. While we aren't forecasting a global recession, a fragile global economy leaves little room for error.

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Changes to the outlook

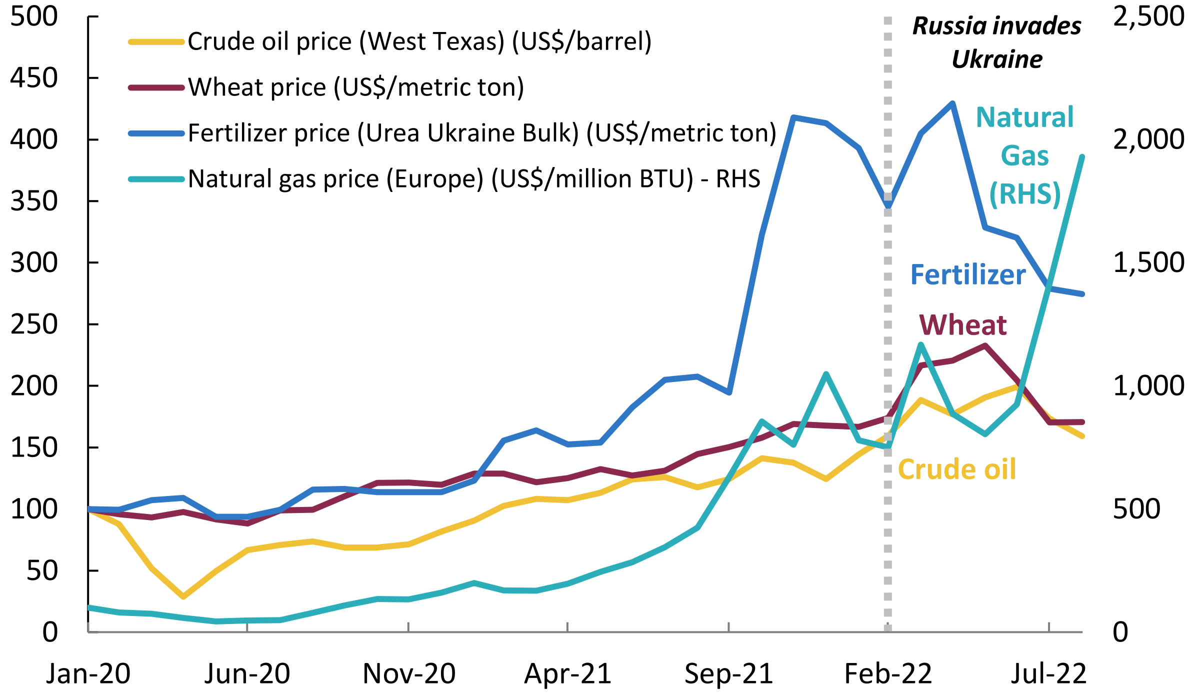
- EDC Economics has revised down its global growth outlook for 2022 (2.2%), followed by a pick up in 2023 (2.6%). While we expect the global economy to sidestep recession, growth will slow significantly in light of weaker demand, worsened by the lingering effects of the Russia-Ukraine conflict. Fortunately, supply chain disruptions are showing signs of moderating.
- Key central banks continue to raise policy interest rates faster and in higher increments to fulfil their commitment to bringing down inflation. Global inflationary pressures persist but are expected to moderate above historical levels. Prices for key commodities and oil have fallen back from their highs earlier this year. Consumer confidence has softened amid global growth concerns and financial market volatility remains quite high.
- The U.S. outlook is softer as the consumer reduces spending amid increased costs. Europe is facing multiple headwinds as manufacturing activity slows and access to vital energy supply is severely restricted. Emerging markets will need to contend with upward price pressures, higher interest rates and a stronger U.S. dollar.

Effects of the Russia-Ukraine crisis linger six months after invasion

The Russia-Ukraine war worsened pandemic-related stress in commodity markets driven by supply chain disruptions. Now, six months after the invasion, the impact persists in the form of broad-based price increases from crude oil to wheat and fertilizer to dairy.

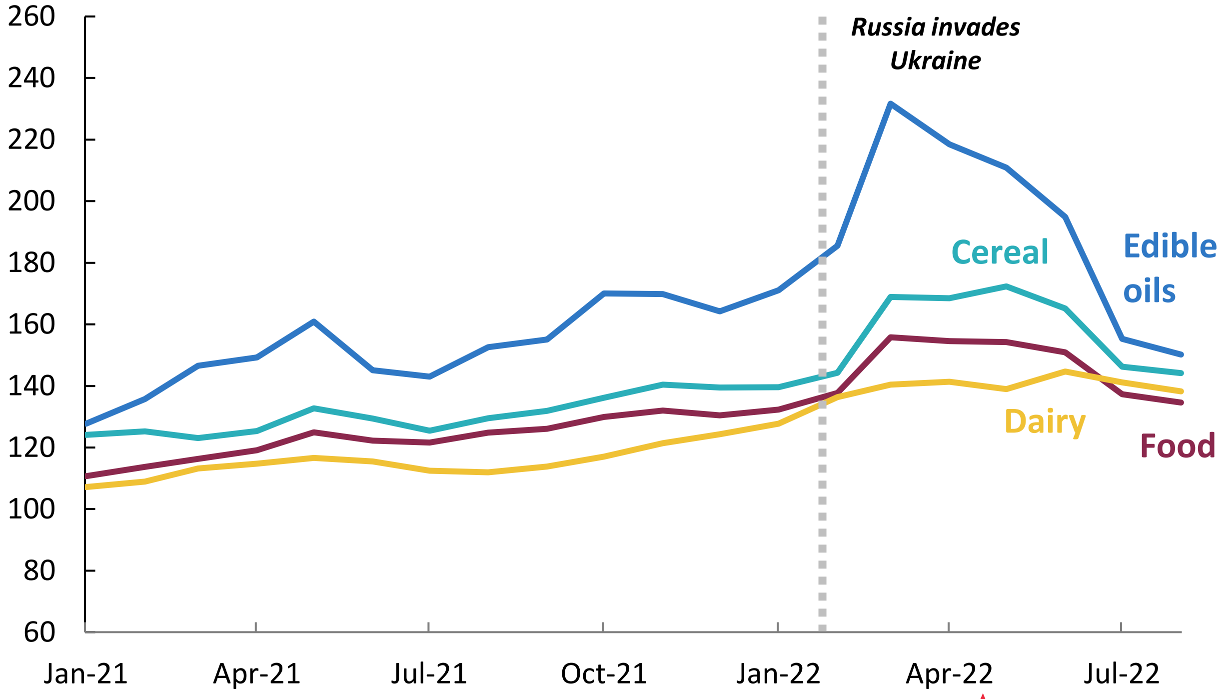
Key commodity indices

Index, January 2020 = 100



Food price indices

Index, January 2020 = 100, US$



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

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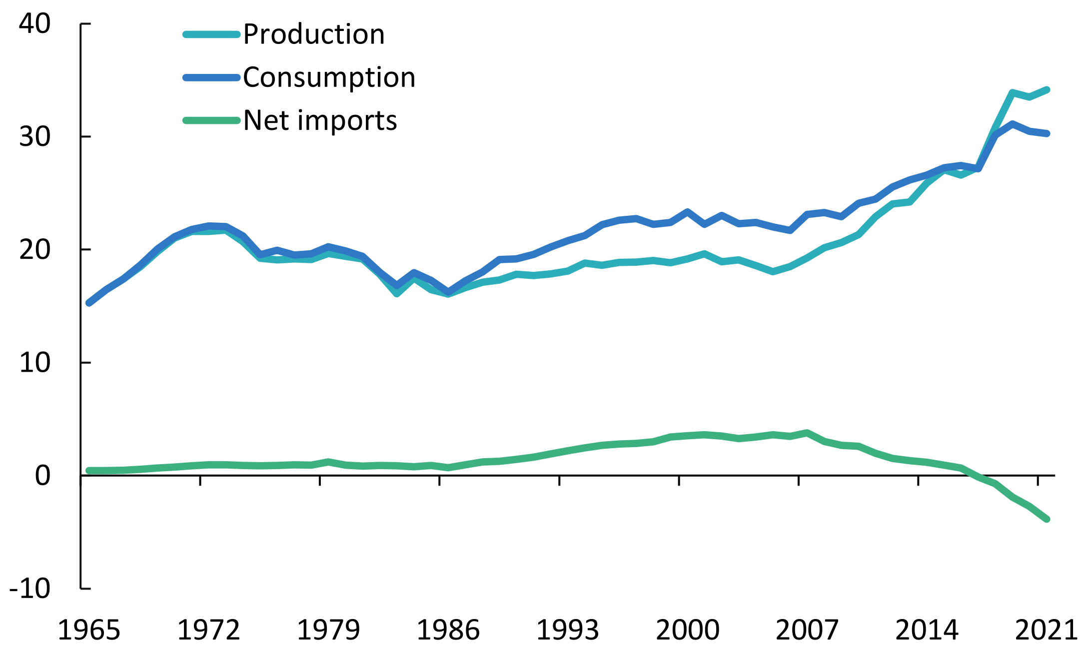
Europe preps for an uncertain energy winter as the U.S. ramps up gas exports

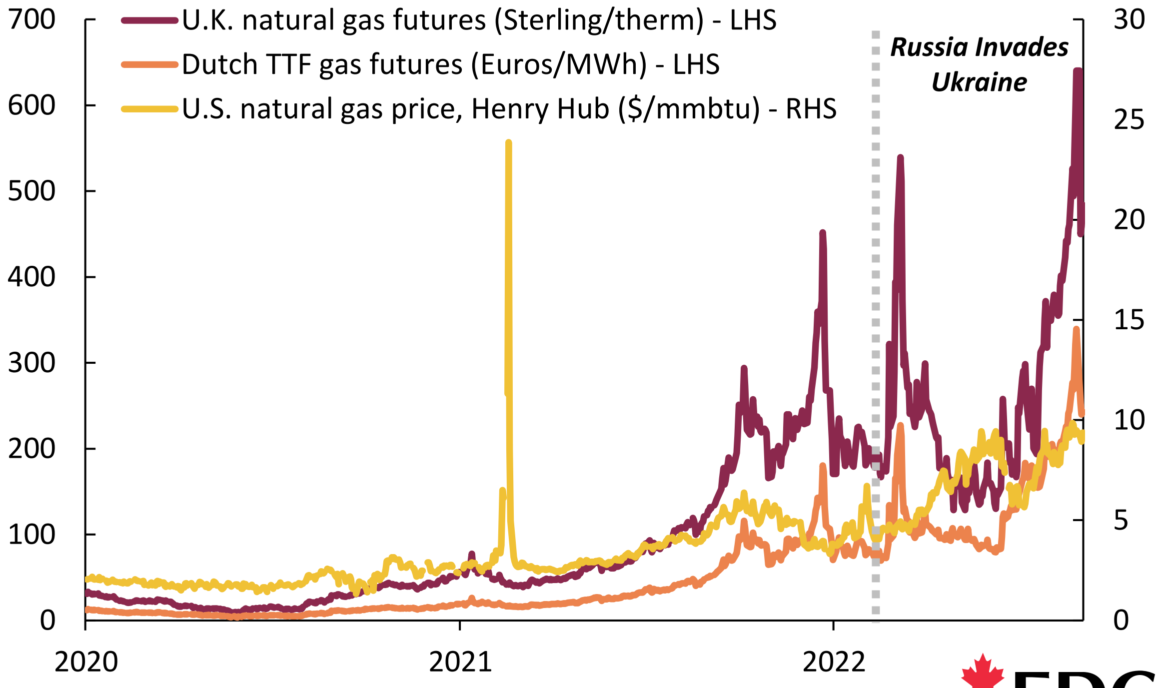
The Russia-Ukraine conflict and suspension of Nord Stream 1 pipeline has created a massive global energy shock threatening cross-border supply. As the U.S. ramps up natural gas exports to Europe, the latter's energy crisis is further intensifying as gas prices hit fresh highs. While gas and oil prices stabilize in North America, the upcoming winter energy season looks bleak for Europe.

U.S. natural gas production and exports

Trillion cubic feet



European and U.S. natural gas prices



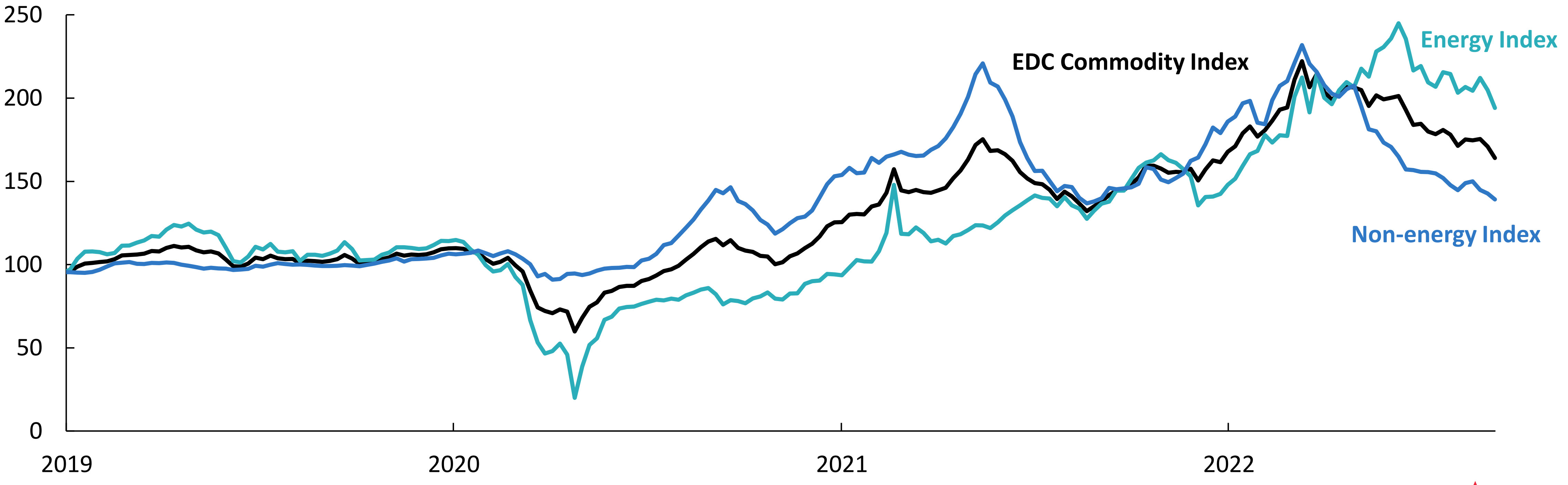
Sources: U.S. Energy Information Administration, Haver Analytics, EDC Economics

Commodity and input prices have fallen back from their peaks, but remain high

Despite the grain deal struck between Kyiv & Moscow in July and food prices easing from record highs, higher input costs such as fertilizer and diesel threaten food security in low- and middle-income countries. As food prices rise in developing nations, they place an outsize burden on vulnerable populations while adding headwinds for global economic recovery.

EDC commodity price indices

Index 2017 = 100



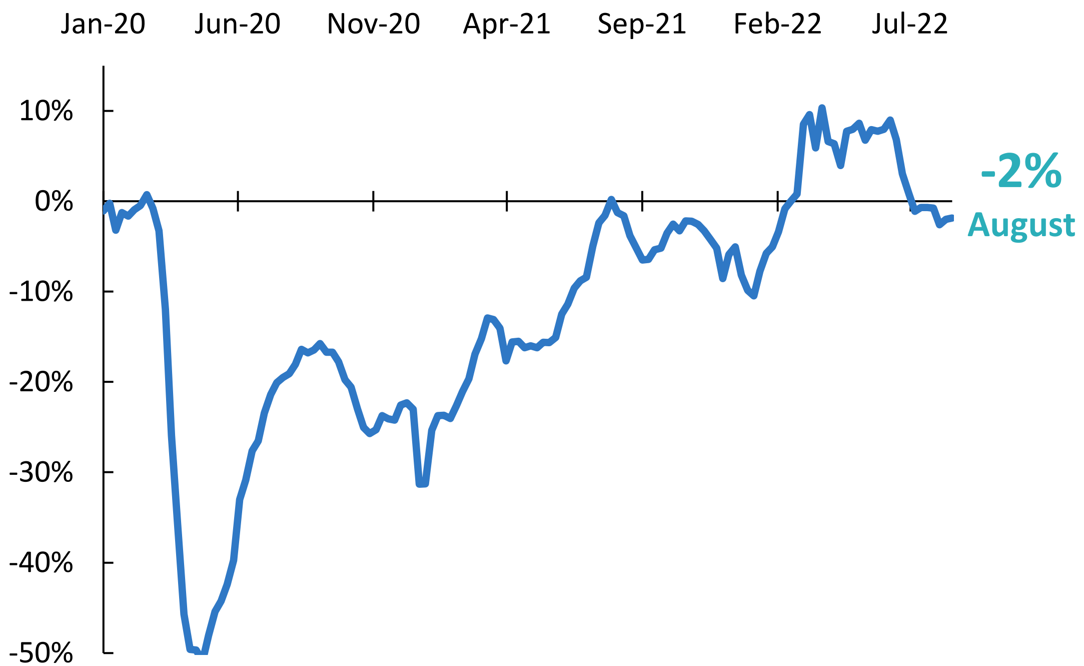
Data as of Sept. 9, 2022
Sources: Haver Analytics, EDC Economics *The Commodity Tracker*

Canadian economic recovery tracker reverses course

EDC Economics' *Canadian Economic Recovery Tracker* highlights key trends in Canada's economic performance during the recovery. Now sitting at 2% below pre-pandemic levels, the Canadian economy is showing signs of slowing. Weaker financial markets consumer confidence, and commodity prices led the decline.

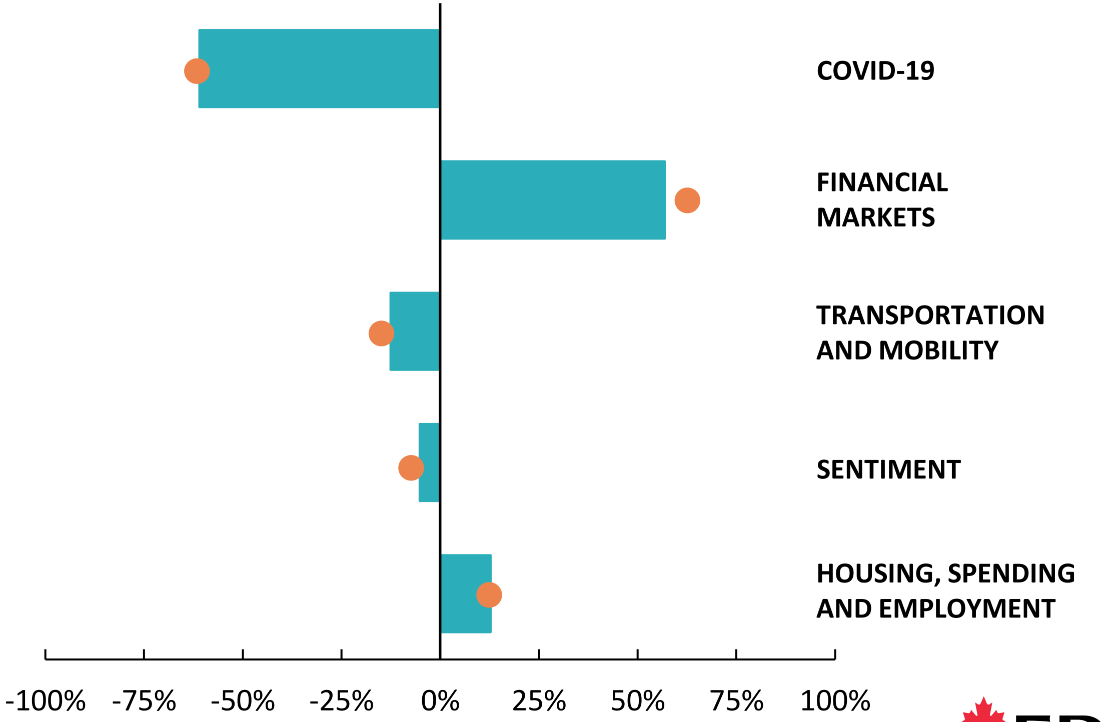
The Canadian Economic Recovery Tracker

Deviation from pre-COVID-19 baseline, August



Percent change versus pre-COVID-19 baseline

Orange circles indicate values for July CERT reading.



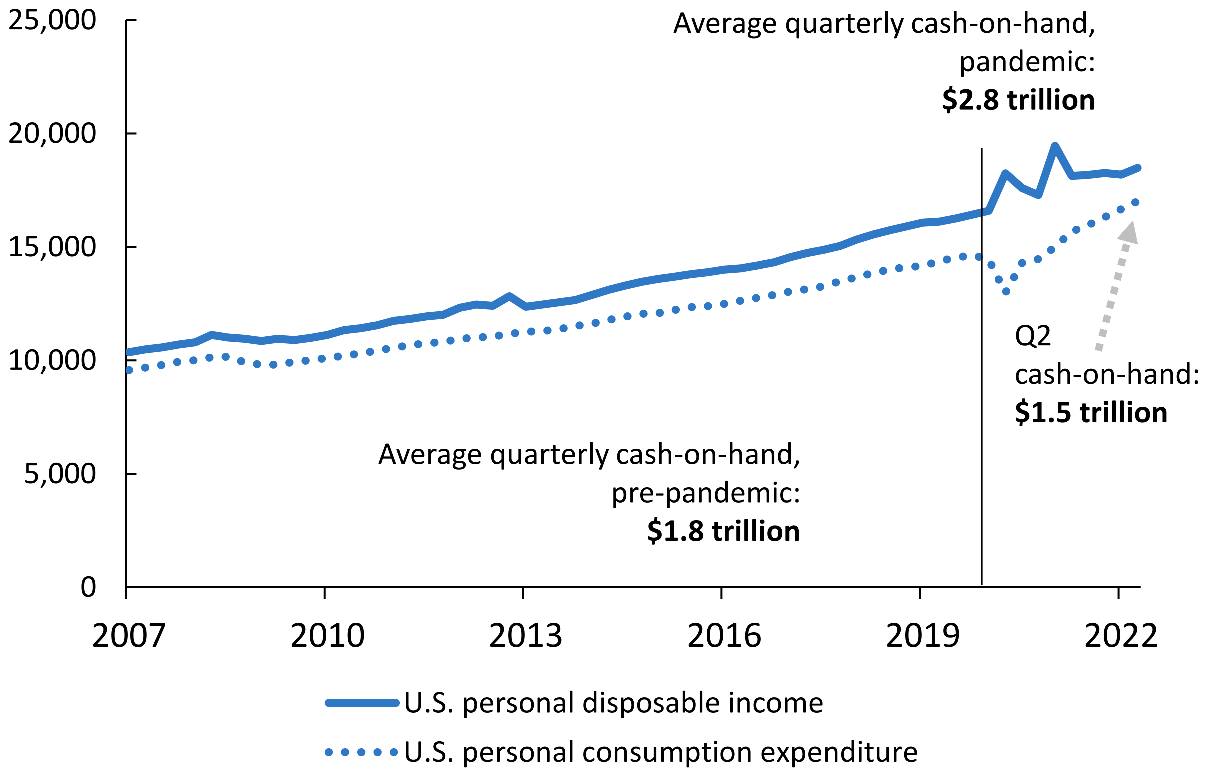
Source: EDC Economics

Consumers using savings to cover higher prices

Consumer spending led the economic recovery post-pandemic. With inflation much higher than anticipated, consumer purchasing power has eroded as broad-based increases hit affordability at the grocery store and gas pump. This has forced households to use some of their accumulated savings to cover the rise in prices. Canadian households used more of their savings and have less cash-on-hand.

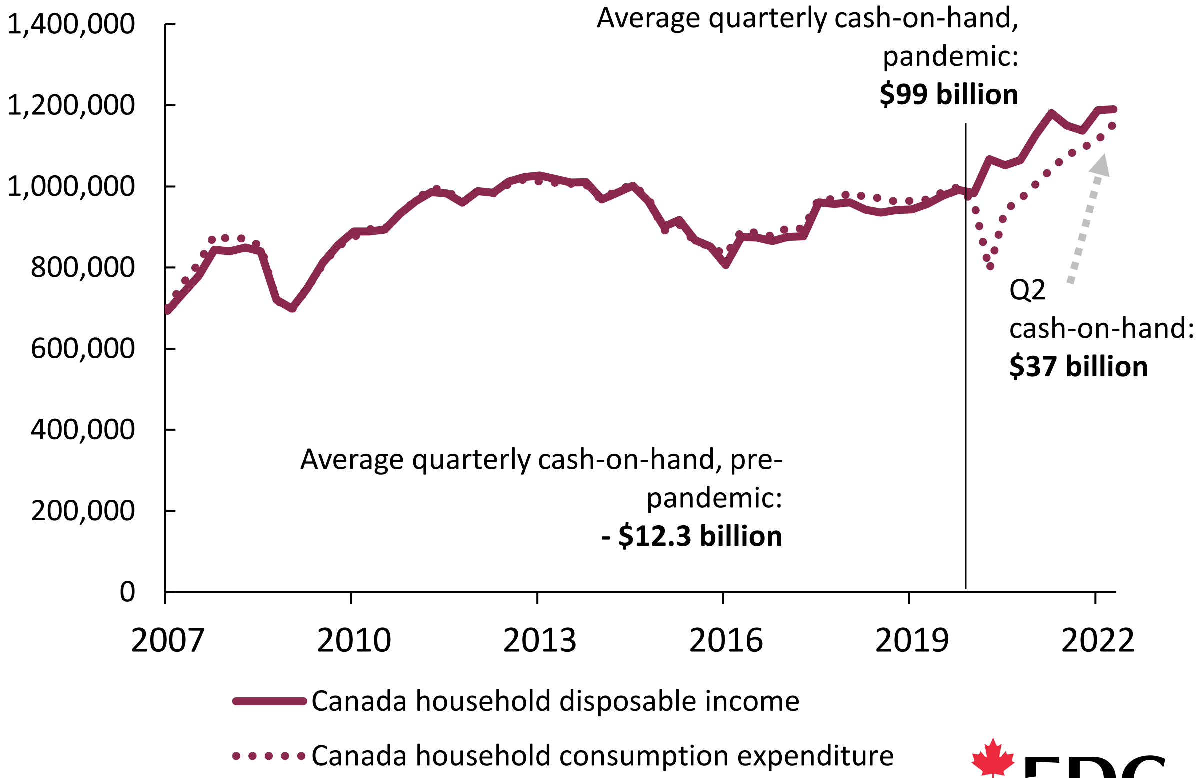
U.S. households' cash-on-hand

Quarterly, USD trillions



Canada households' cash-on-hand

Quarterly, USD millions



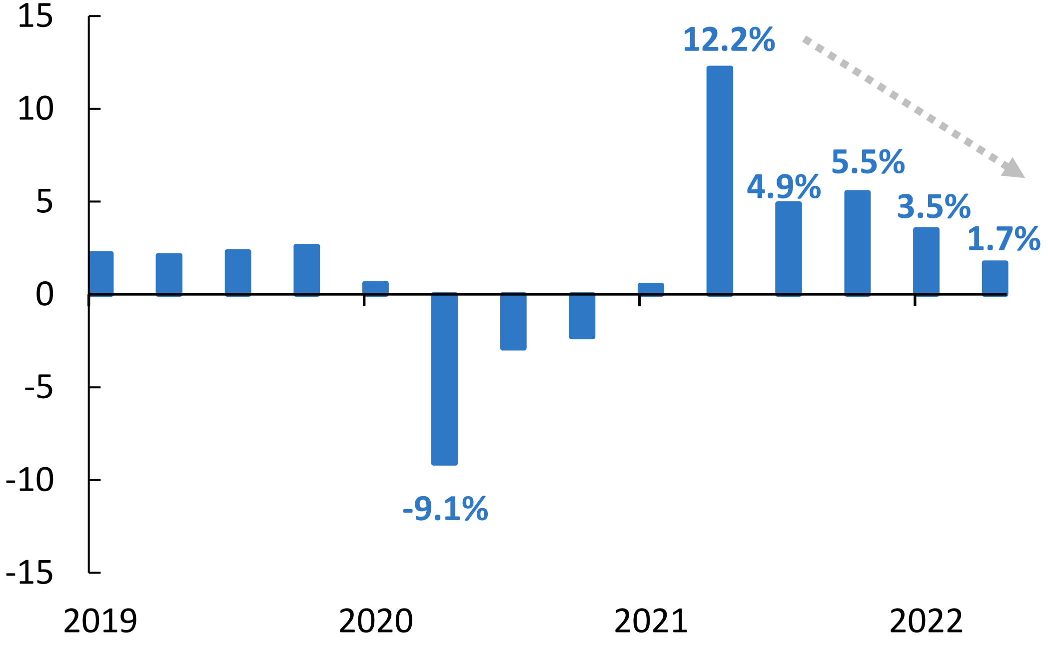
Sources: Haver Analytics, EDC Economics

The U.S. economy starting to slow down

Rising interest rates and lasting inflation threaten U.S. economic recovery post COVID-19. However, many sectors continue to show strength, labour markets remain buoyant and gas prices—a key contributor to headline inflation—have eased. However, as geopolitical risks mount and consumer demand weakens, businesses are expected to recalibrate operations. A cooling off the economy is well underway.

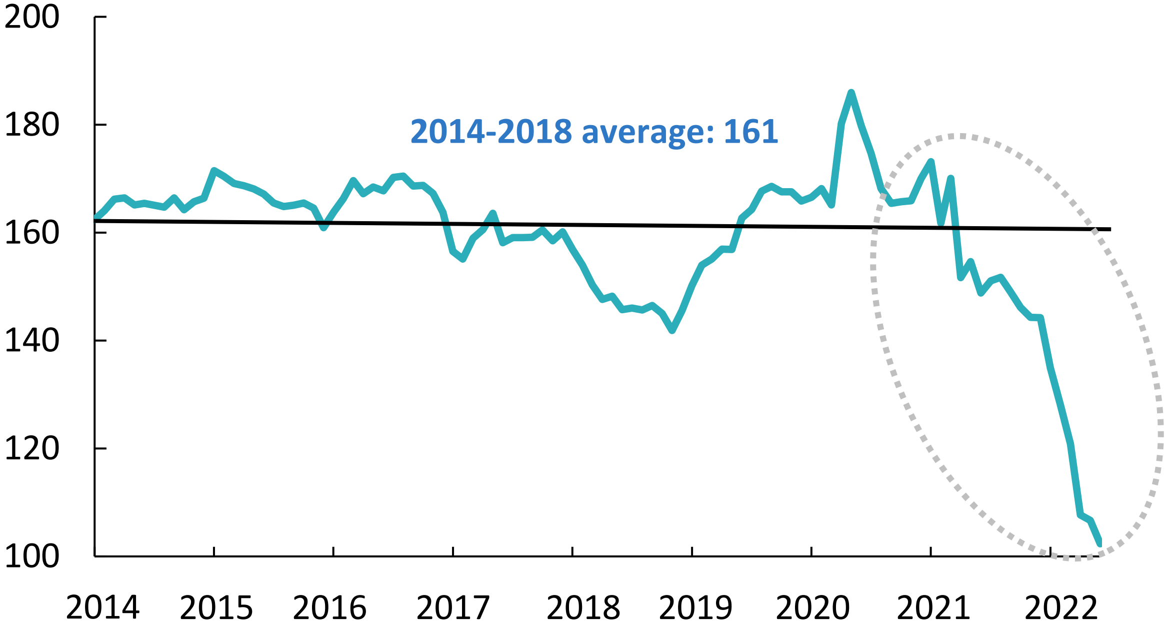
U.S. real GDP

Year-on-year % change, Quarterly



U.S. housing affordability index

Fixed rate mortgages (100+=more affordable), seasonally adjusted

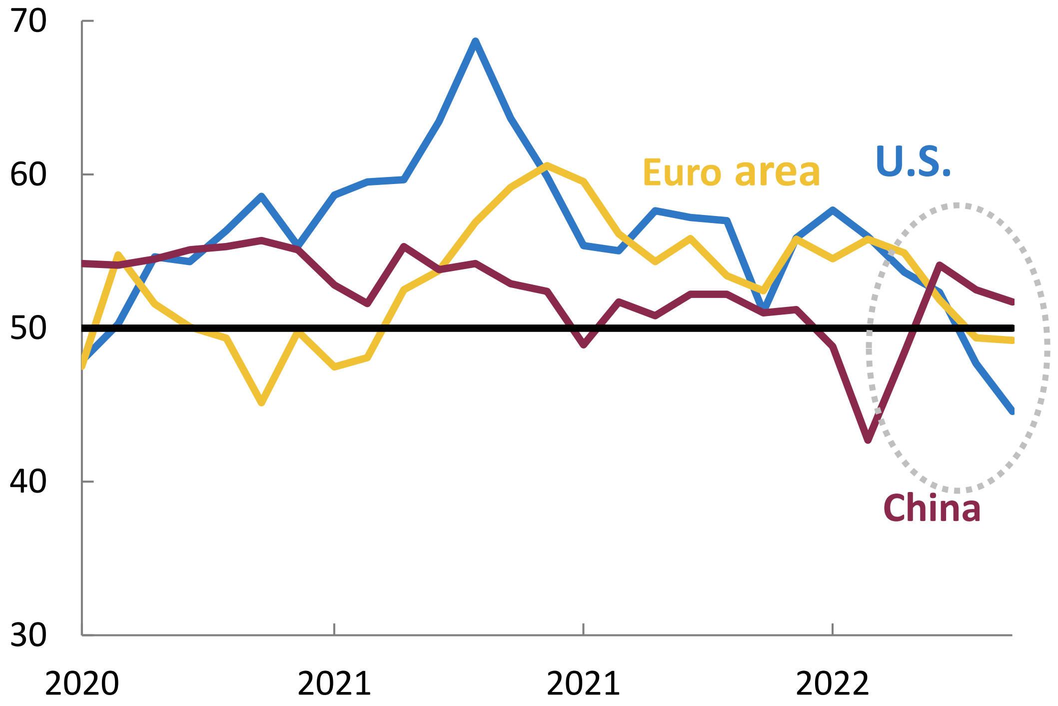


Post pandemic travel makes progress as manufacturing cools

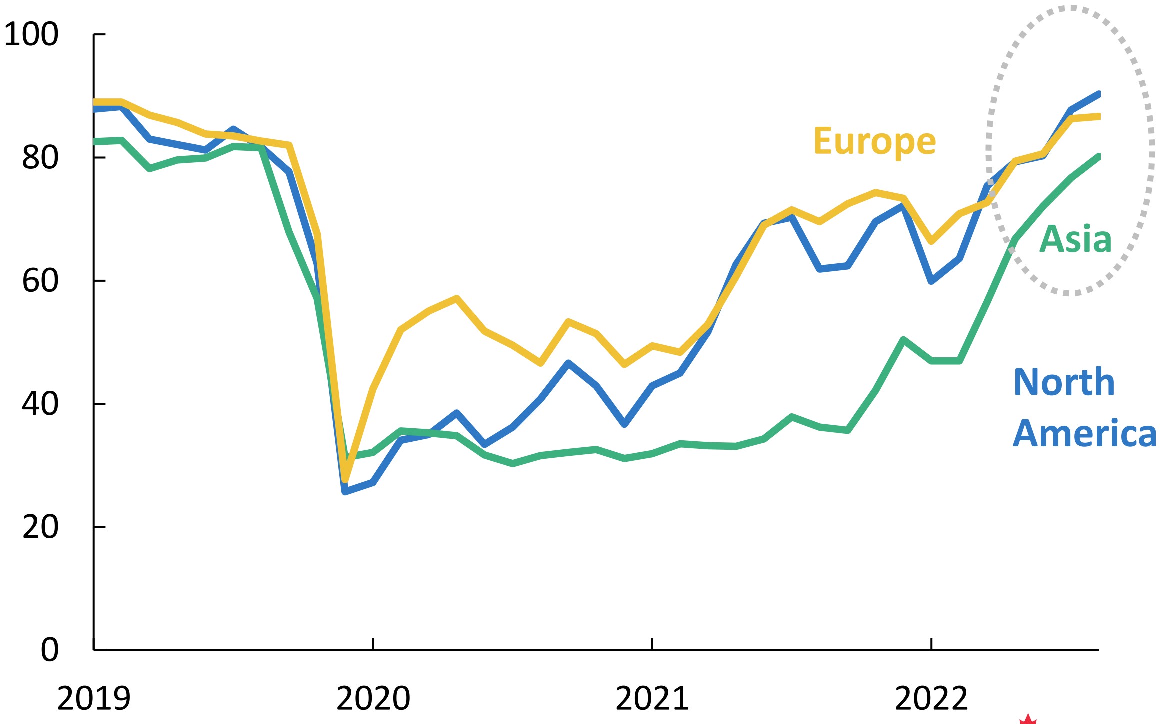
***Purchasing Managers' Indices* in China, the Euro area and the U.S. are on a downward trajectory. China remains in expansion territory but faces challenges amid COVID-19 lockdowns. Manufacturing activity is slowing as global economic activity moderates. International travel rallied during the peak summer travel months with growth in services trade making progress.**

Purchasing Managers' Indices (PMI)

50+ = expansion



International passenger load factor

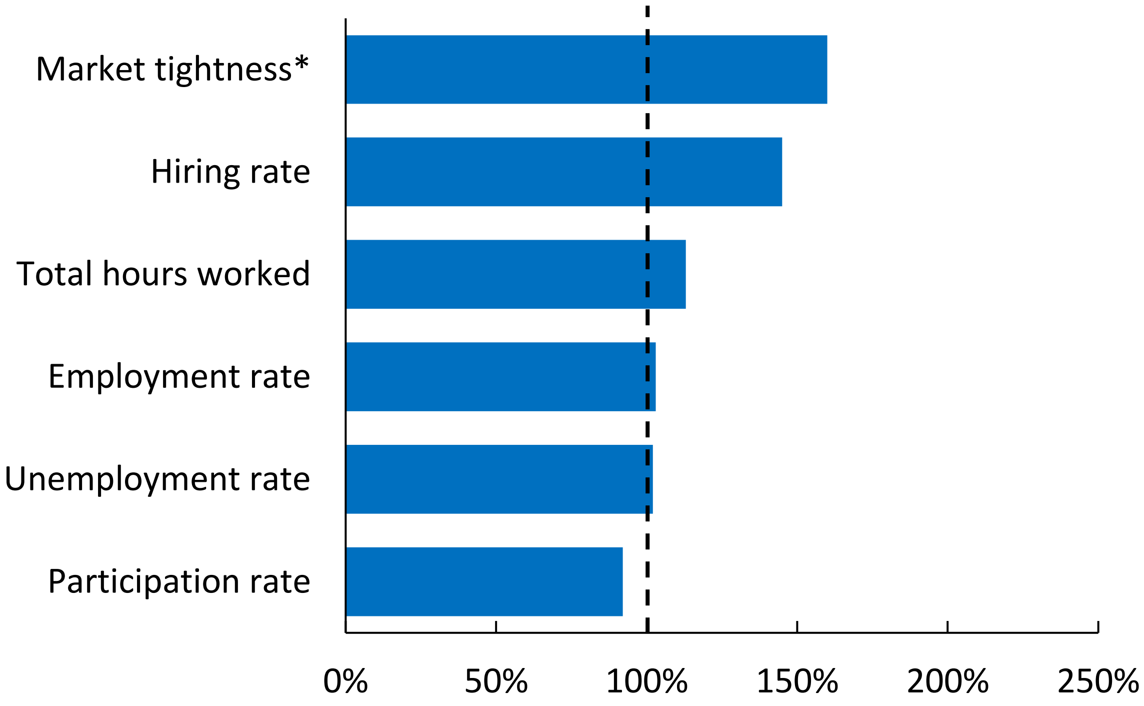


 Sources: Haver Analytics, EDC Economics

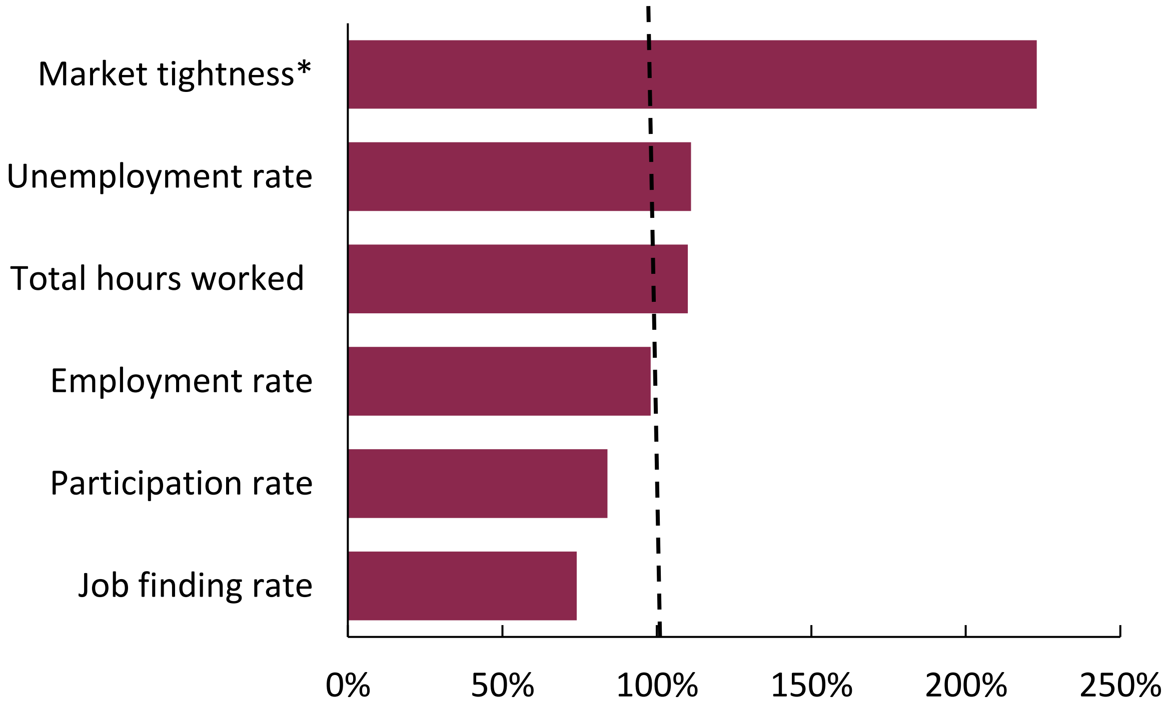
Labour markets remain tight

July 2022 data indicates that the U.S. and Canada labour markets remain tight. Compared to May, the Canadian indicators continue to worsen. Decreased labour force participation and employment rates strengthen adverse conditions. As the hiring rates (U.S.) and job finding rates (Canada) continue to fall, total hours worked increases in both markets. This indicates that negative impacts are likely being felt by both workforce and employer.

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.

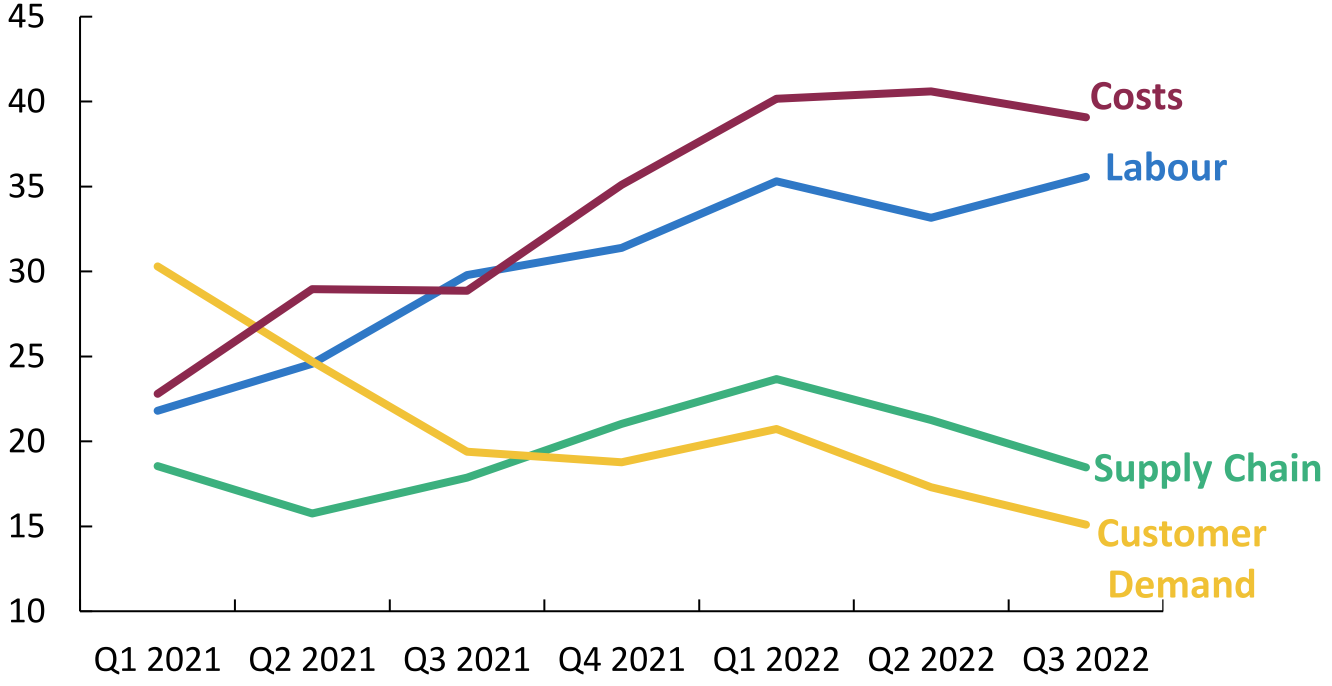
Sources: Haver Analytics, U.S. Bureau of Labor Statistics, Bank of Canada

Canadian labour market breakdown

Canadian businesses foresee labour challenges being one of their largest upcoming obstacles. Following the pandemic, accelerated retirements resulted in decreased participation rates for individuals over 55 years old. The size of the labour force remains below previous levels despite increased participation from individuals 25-54 years old. Concurrently, job vacancy rates remain elevated above historic levels.

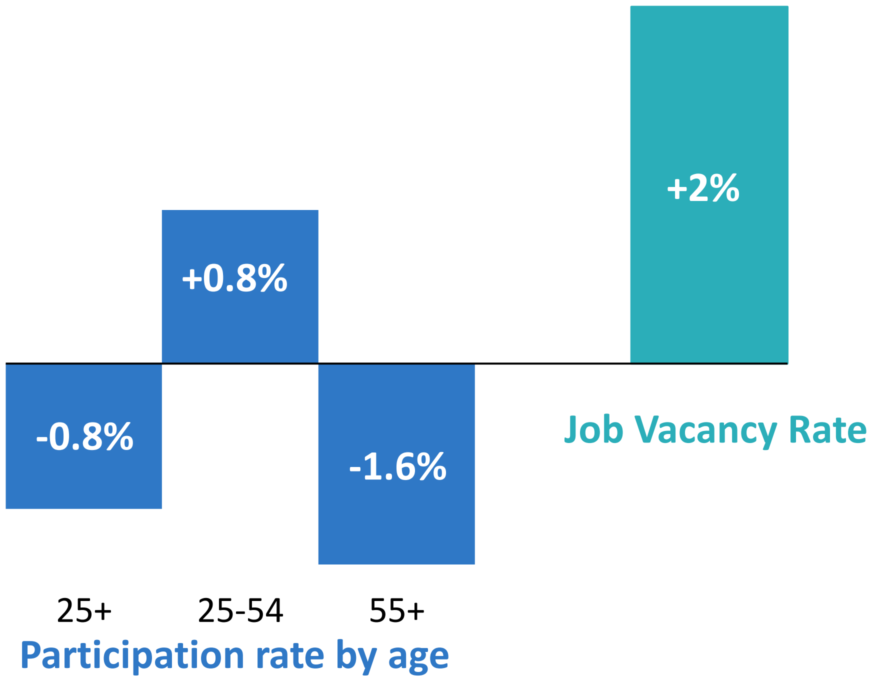
Expected business obstacles for the near future*

% of respondents by obstacle



Key labour force statistics

% change from 2018-19 average to most recent period**



*Note: Near future entails a three-month outlook. Data manipulation was completed in the same manner as the CCoC report. Obstacles not present in all periods were dropped.

**Most recent period entails July 2022 for participation rates and Q1 2022 for job vacancy rates

Sources: Canadian Chamber of Commerce (CCoC) Business Data Lab/Statistics Canada

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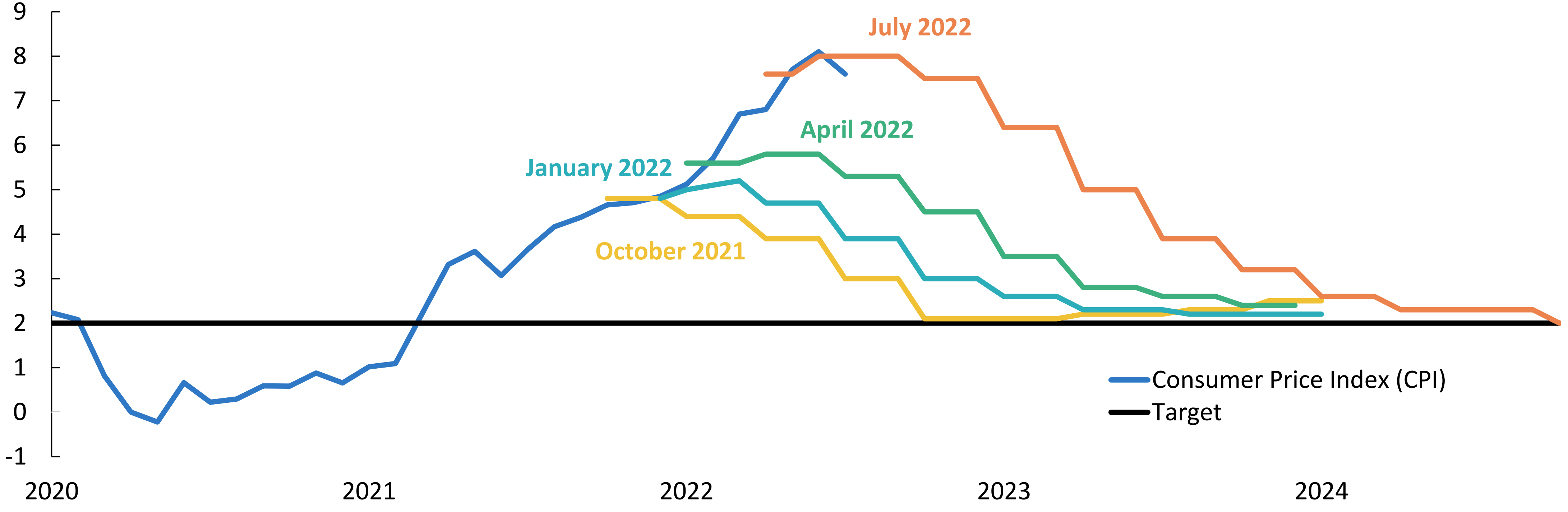
Inflation trajectory shifting

Canadian inflation accelerated to a multi-decade high during the summer months. However, July inflation data is showing signs of a peak. The Bank of Canada anticipates inflation to remain above its 2% target throughout 2023. As policy rates rise rapidly, inflation is expected to return to target by 2024 as near-term GDP growth slows.

Bank of Canada inflation forecasts

Monthly year-over-year % change in consumer prices

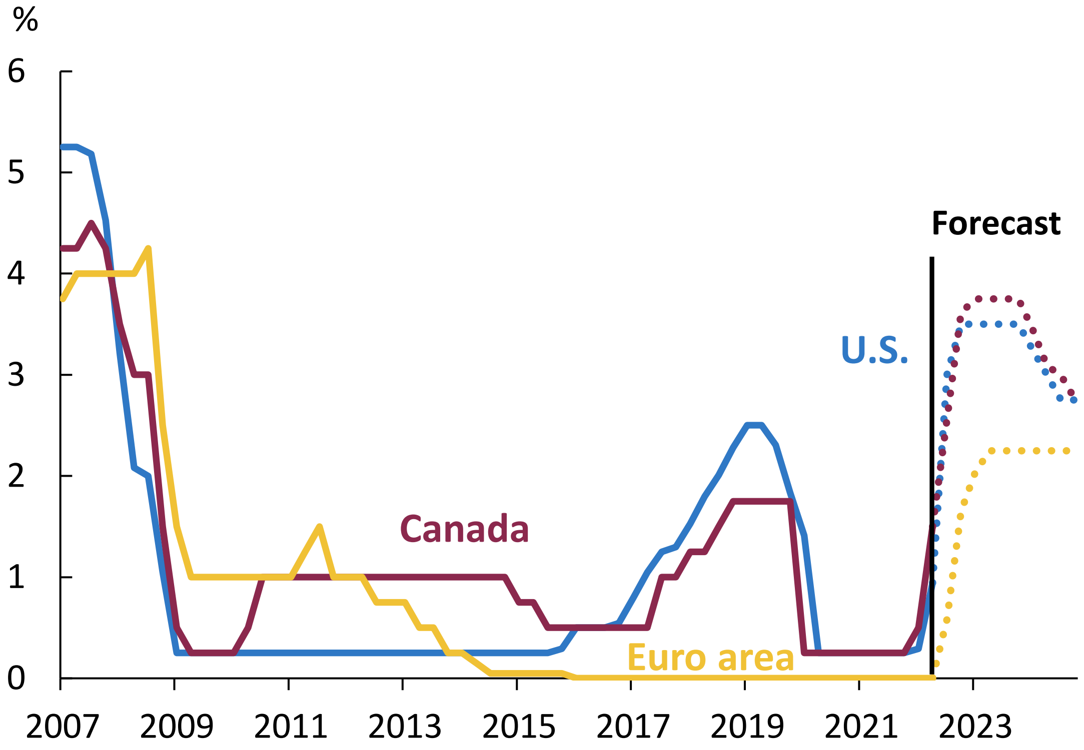


 Sources: Bloomberg, Bank of Canada, Haver Analytics

Central banks take swift action against rampant inflation

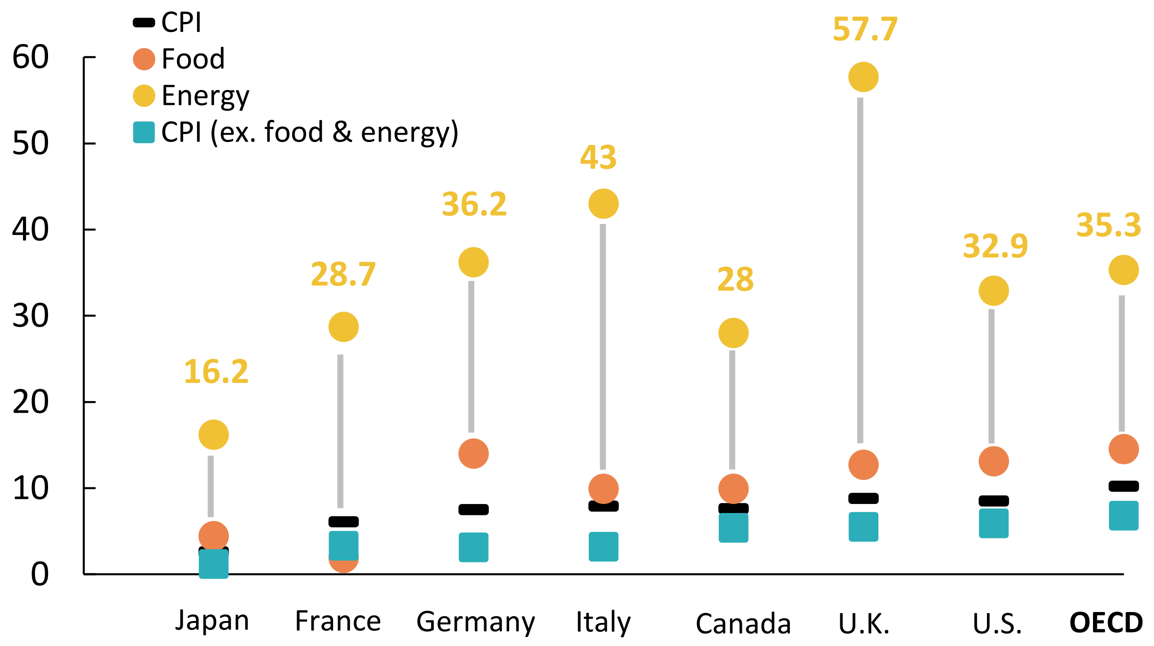
Central banks have set out on a mission to end high inflation. The Bank of Canada, Federal Reserve and European Central Banks delivered supersized policy interest rates hikes, with promise of more. Central banks expect inflation to be higher in the near-term but are committed to tapering inflation expectations and a potential wage-price spiral.

Policy interest rates



Inflation

Consumer Price Index (CPI), year-over-year %, July 2022



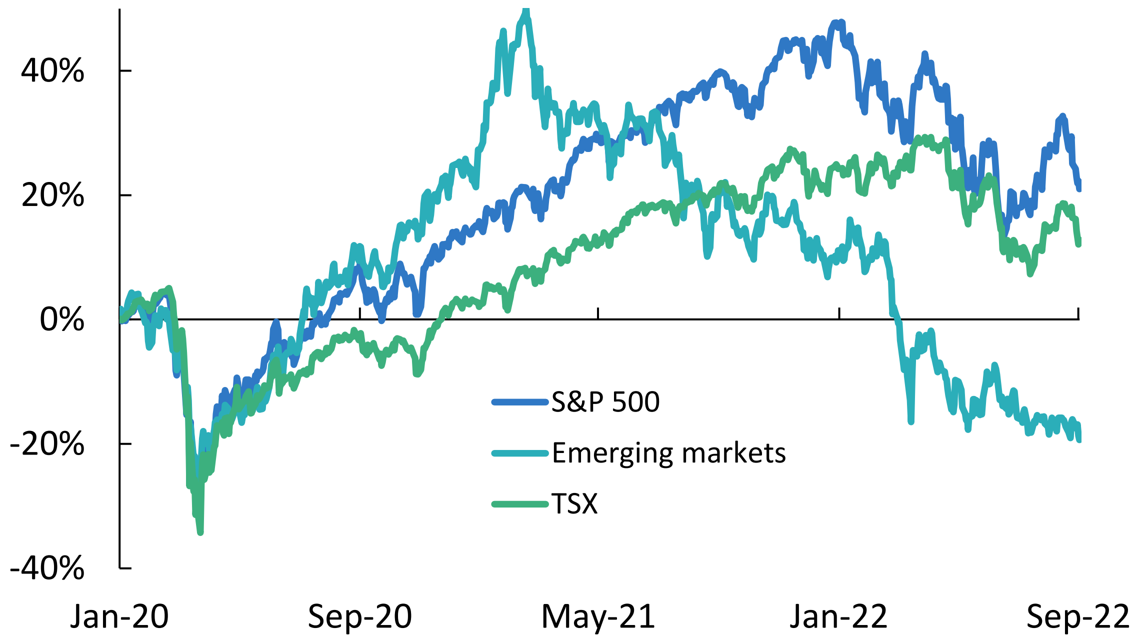
Sources: Haver Analytics, Organisation for Economic Co-operation and Development (OECD), EDC Economics

Markets expect further tightening of monetary policy

Government bond prices continue to rise amongst speculation about how far central banks will go to tighten monetary policy in the upcoming months. With markets pricing possibilities of consecutive rate increases and threats of looming inflation ensue globally, equity markets have become more volatile in the last few months. As investors look for quality, emerging market bond spreads have started to rise.

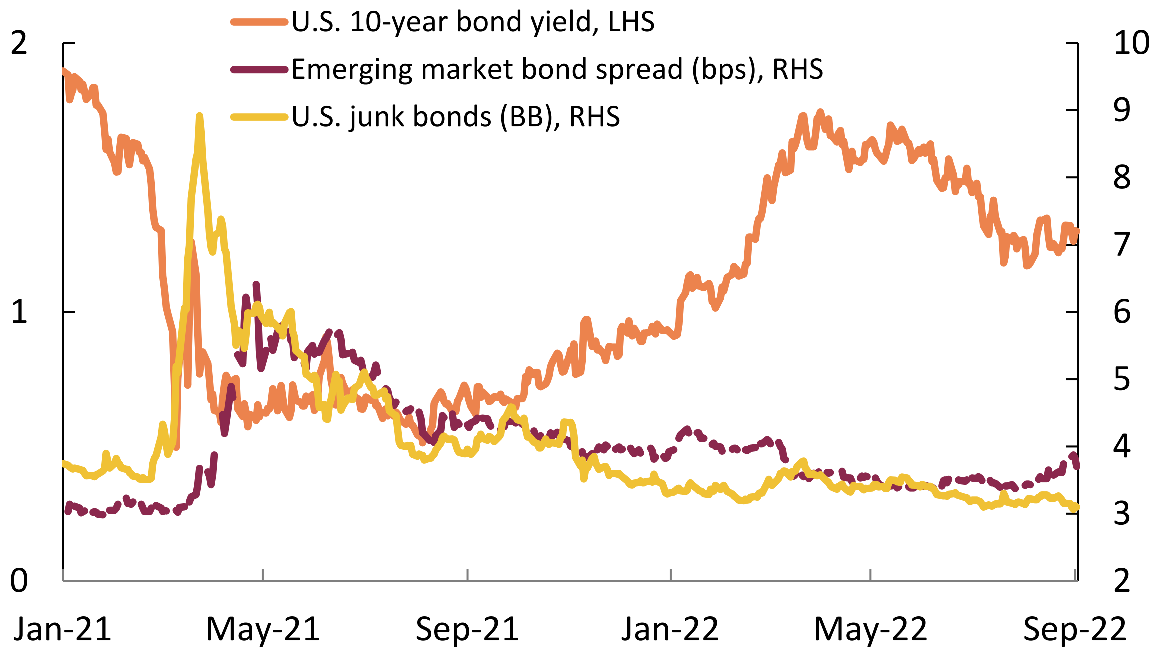
Equity markets

% change since Jan. 1, 2020



Debt markets

%



Data as of September 2, 2022

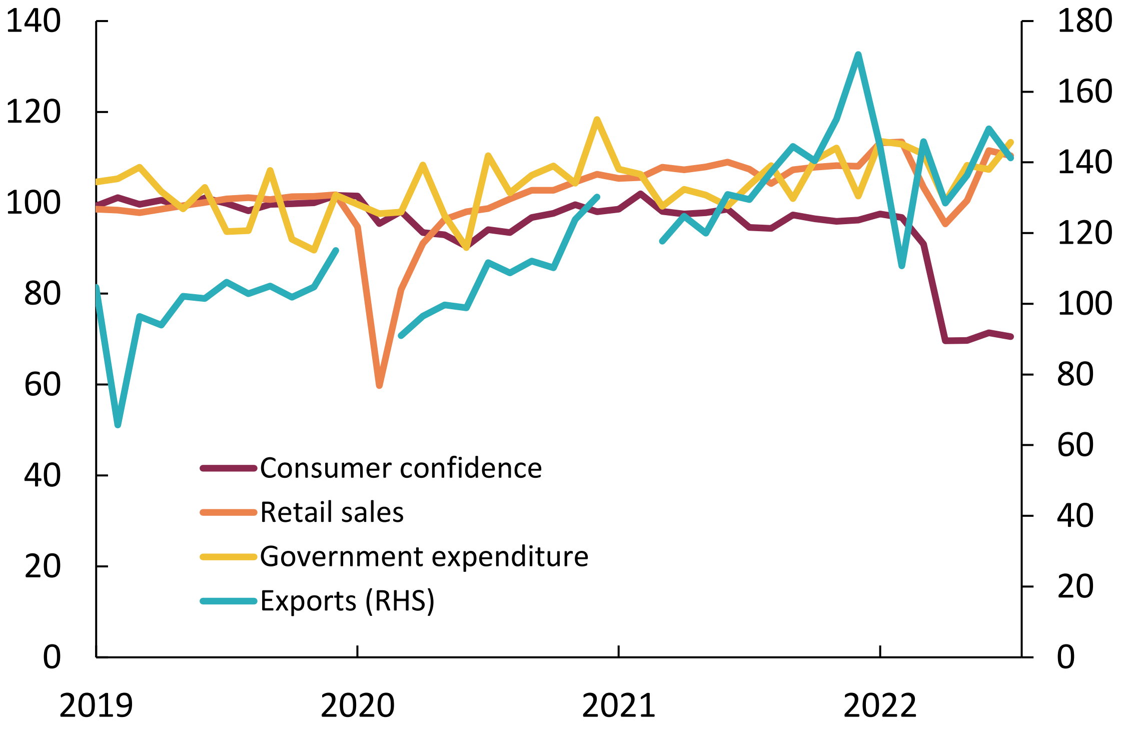
Sources: Haver Analytics, EDC Economics; *EDC Global Financial Markets*.

China's slowdown, growth fundamentals and zero-COVID-19 policy

China's central bank cut policy interest rates for the second time in 2022 (deviating from global norms) as the economy showed further signs of deteriorating economic momentum. Exacerbated by the zero-COVID policy and threats of looming lockdowns—sluggish retail sales growth, weak consumer confidence and the escalation of the property crisis threatens the Chinese economic growth miracle. However, government expenditure and export orders remain steady.

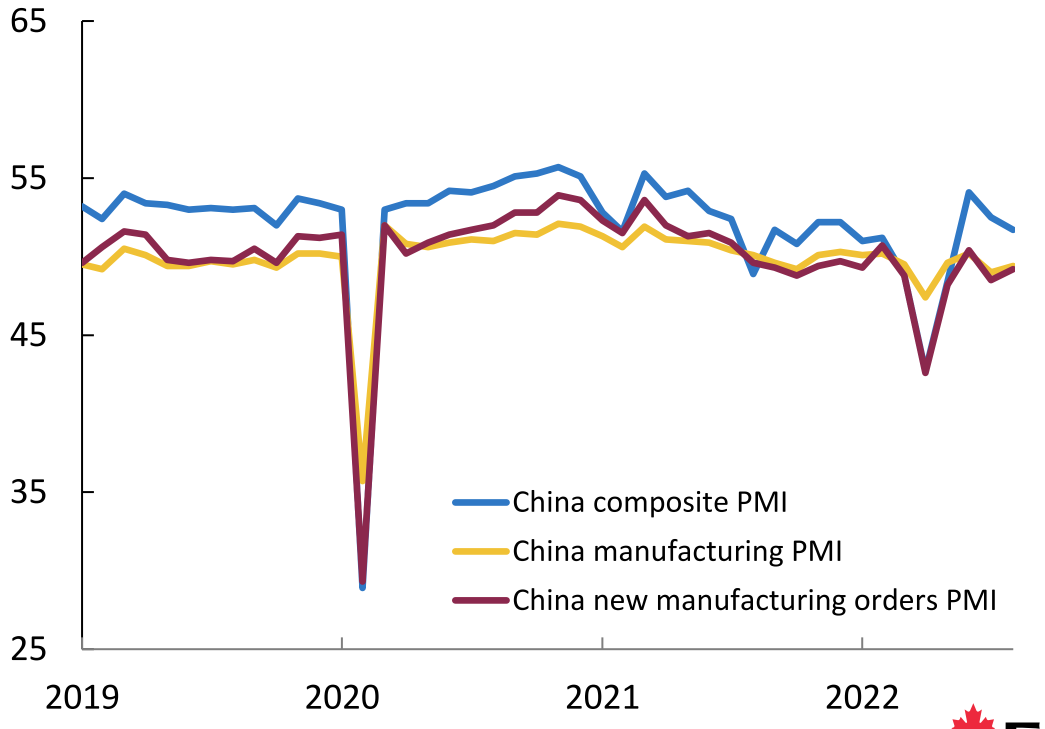
Economic indicators

Index 2019 average =100, Seasonally adjusted Yuan



Purchasing managers' indices (PMI)

50+ = Expansion



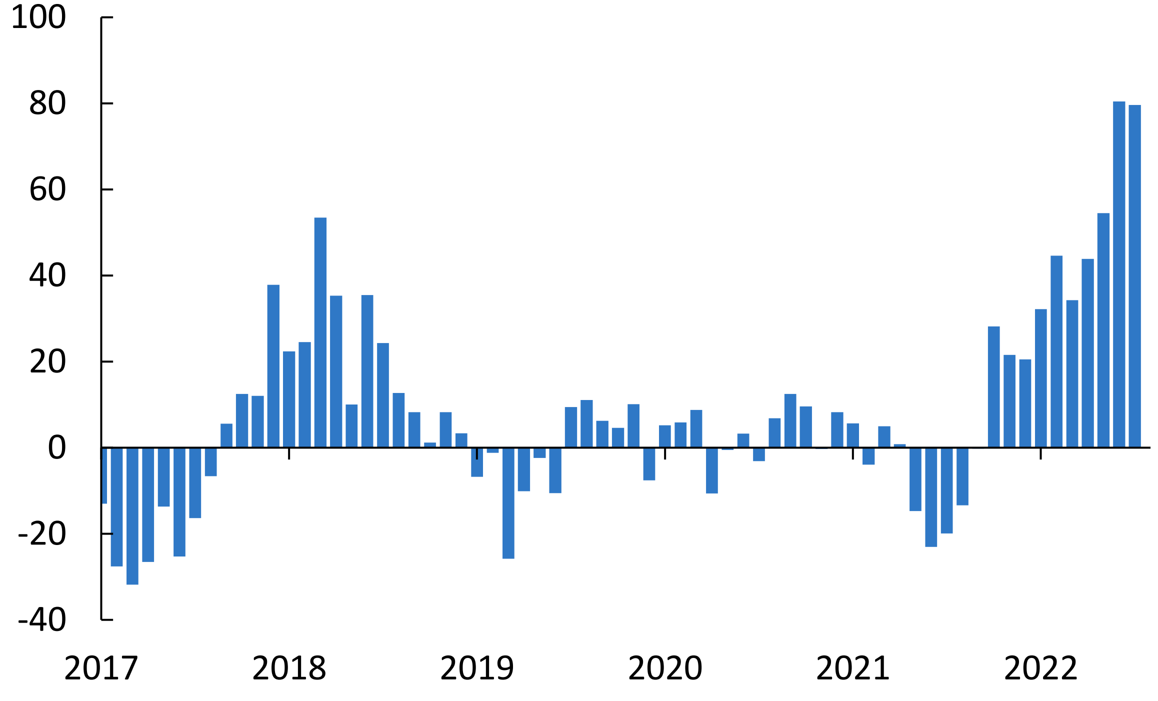
Source: Haver Analytics

Supply chain congestion reverses

The stress on supply chains continues to ease. The queue of ships waiting to unload has decreased, resulting in less congestion at key ports. In addition to this, some industries are now seeing their inventories swell to recent record highs.

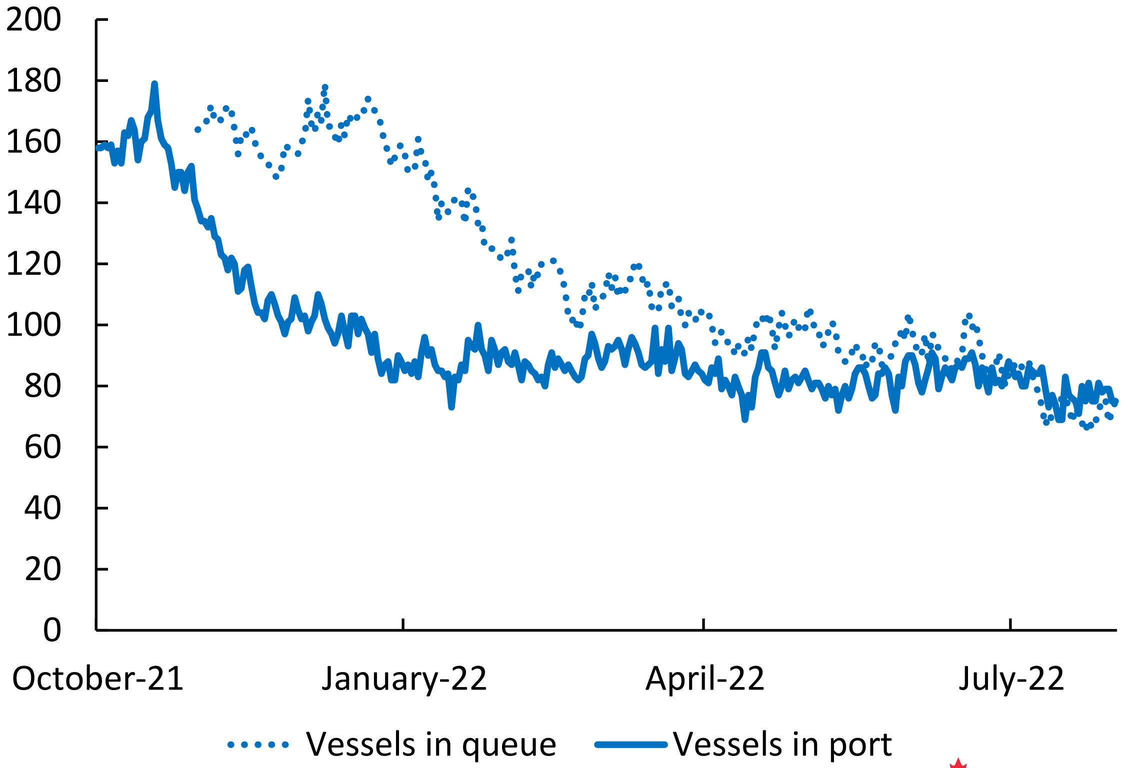
South Korea chip inventories

Year-over-year percentage change in semiconductor stocks



Los Angeles/Long Beach vessel traffic*

Number of vessels in port and queue, daily



*Note: This chart data only reflects vessels that are docked within 40 kilometres of the port

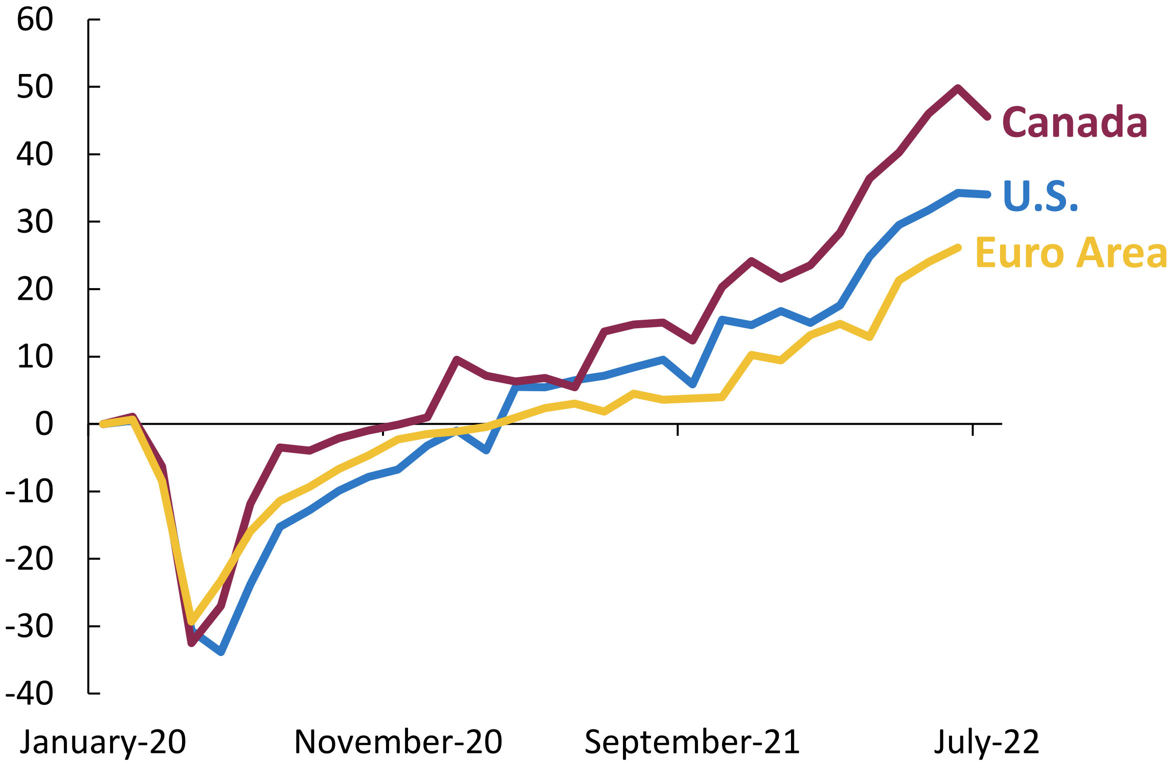
Sources: Statistics Korea/Haver Analytics, EDC Economics

Exports remain high with signs of cooling

Services and merchandise exports have fully recovered and remain high. Canadian and U.S. merchandise show slight signs of slowing. European and Canadian services are also beginning to slow.

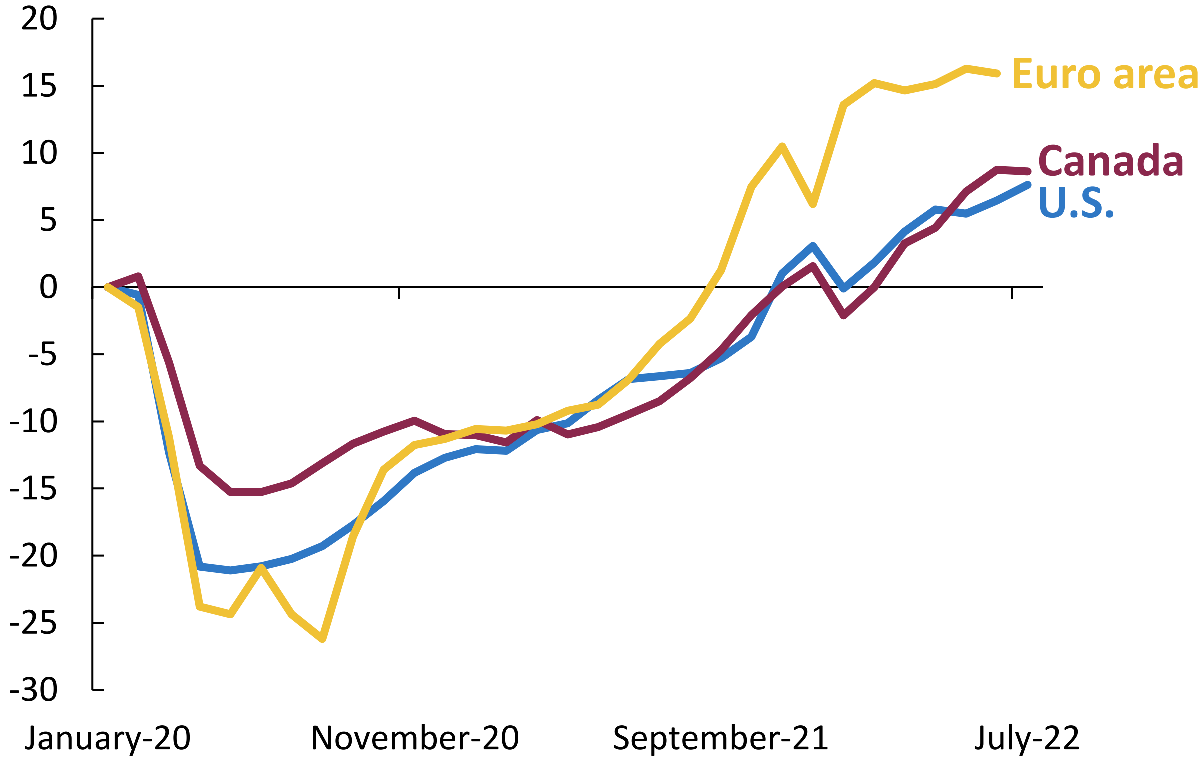
Merchandise exports

% change since January 2020



Services exports

% change since January 2020



Sources: Haver Analytics, EDC Economics

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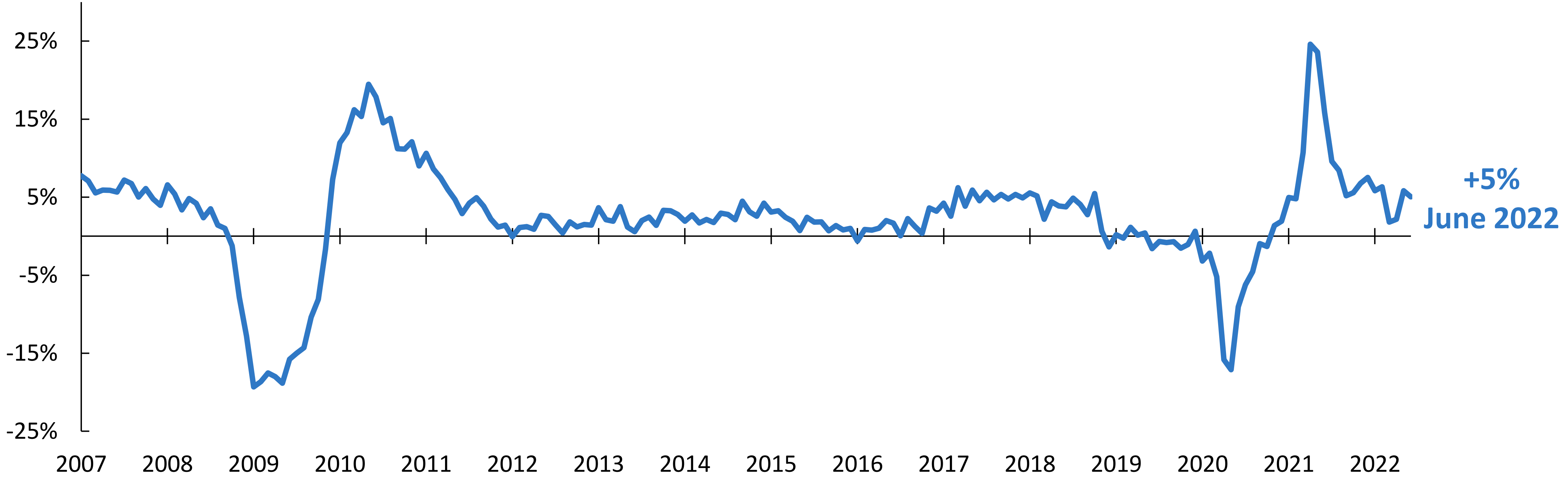
Global goods trade growth returns to normal levels

In contrast to the large increase in country exports, we see trade volumes remain largely unimpacted. This trend is similar for both the U.S. and the Europe. This indicates that most regional trade gains were likely due to price changes and not increased trade volumes.

Global merchandise trade volumes

Annual % change



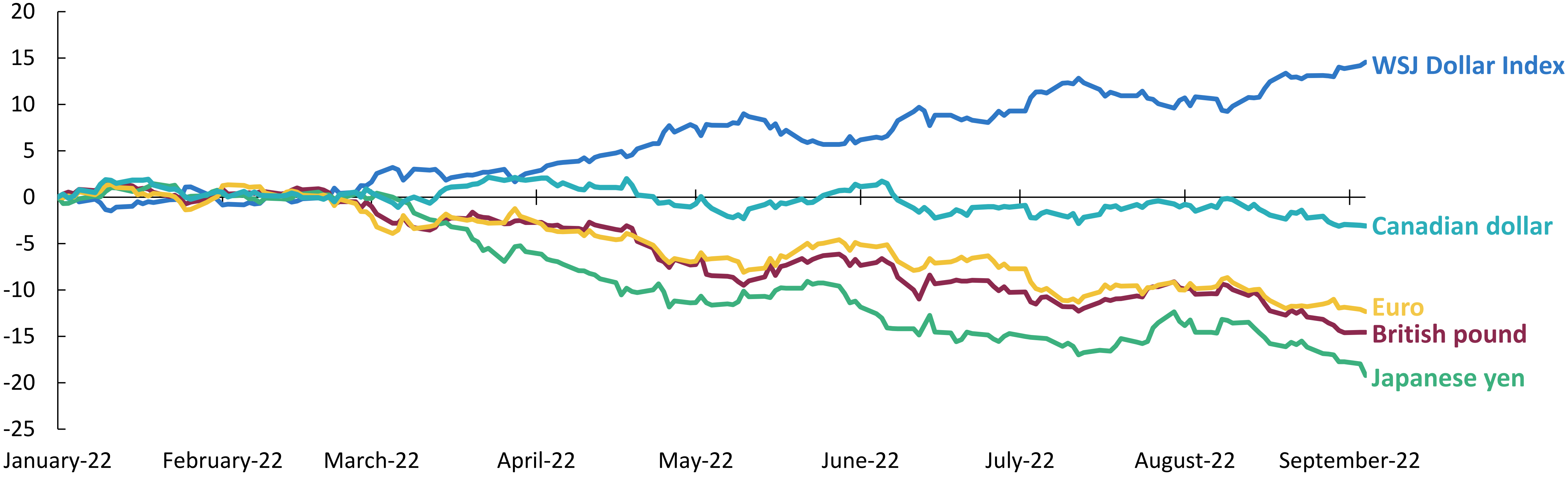
Sources: CPB Netherlands Bureau for Economic Policy Analysis, World Trade Organization.

The U.S. dollar takes off

The U.S. dollar has made substantial gains since the Federal Reserve began rate hikes in March 2022. Due to this, any U.S. denominated debt will now be more difficult to service. This increases the strain on high debt economies and increases the possibilities for future sovereign debt troubles.

Performance of select currencies

Percentage change since Jan. 1, 2022

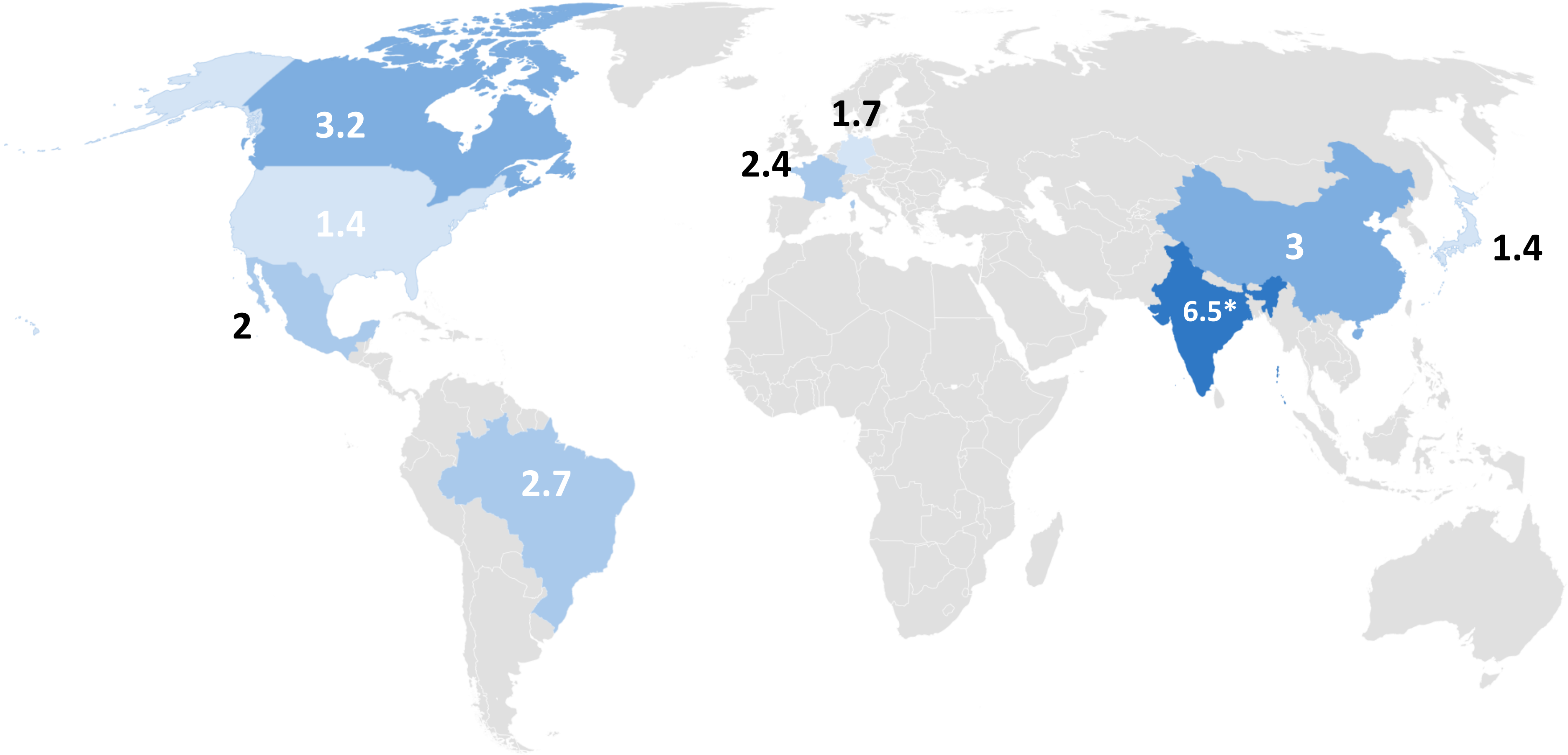


Sources: Wall Street Journal (WSJ) Markets, Haver Analytics

Global Economic Outlook

2022 growth outlook

Real GDP growth, %



2.2%
World

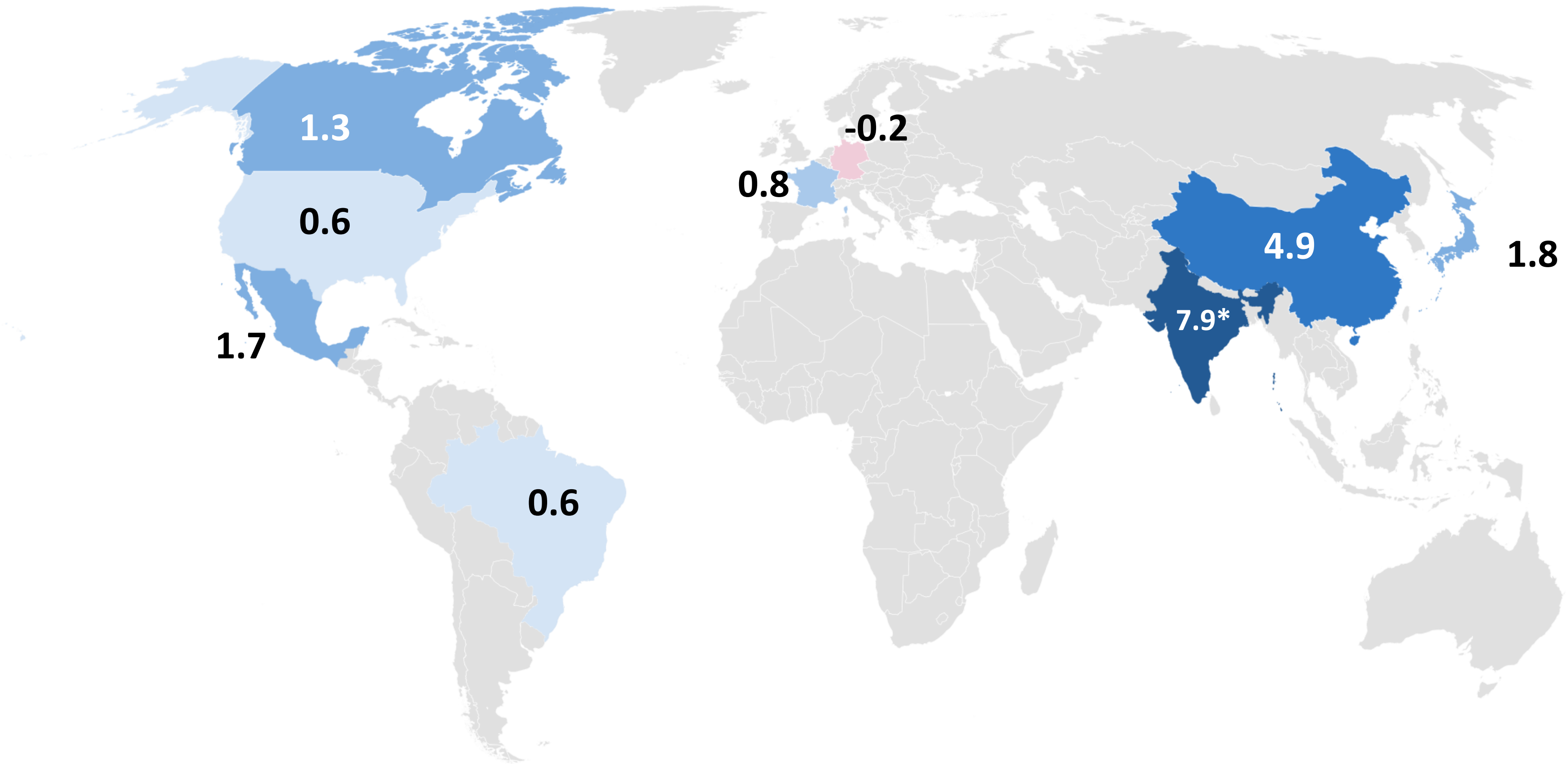
1.9%
Developed

2.4%
Emerging

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

2023 growth outlook

Real GDP growth, %



2.6%
World

0.8%
Developed

4%
Emerging

* India's 2024 FY = Q2 2023 – Q1 2024

Source: EDC Global Economic Outlook, September 2022

Real GDP growth

Global Economic Outlook (Annual % change)	2021	2022*	2023*
Developed countries	**5.2**	**1.9**	**0.8**
Canada	4.5	3.2	1.3
United States	5.7	1.4	0.6
Eurozone	5.3	2.9	0.1
Germany	2.6	1.7	-0.2
France	6.8	2.4	0.8
Japan	1.7	1.4	1.8
Emerging countries	**6.8**	**2.4**	**4**
China	8.4	3	4.9
India	8.8	6.5	7.9
Brazil	4.9	2.7	0.6
Mexico	5	2	1.7
World	**6.1**	**2.2**	**2.6**

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, September 2022

Changes from previous forecast

Global Economic Outlook Real GDP growth (percentage point change)	2022*	2023*
Developed countries	**-0.3**	**-1.4**
Canada	-0.5	-0.8
United States	-1.2	-1.6
Eurozone	**0.7**	**-1.9**
Germany	0.1	-2.1
France	0.3	-0.4
Japan	-0.4	-0.5
Emerging countries	**-0.8**	**-0.2**
China	-1.2	0.1
India	-1.7	0.7
Brazil	1.2	-0.4
Mexico	0.2	-0.8
World	**-0.6**	**-0.7**

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

Currencies and interest rates

Global Economic Outlook		2021	2022*	2023*
Currencies	**Exchange rate**			
U.S. dollar	**USD per CAD**	0.8	0.78	0.75
Euro	**USD per EUR**	1.18	1.04	1
Euro	**CAD per EUR**	1.48	1.35	1.33
Interest rates, annual average				
Bank of Canada, *Overnight target rate*		0.25	1.9	3.75
U.S. Federal Reserve, *Fed Funds Target Rate (Upper limit)*		0.25	1.67	3.5
European Central Bank, *Policy interest rate*		0	0.56	2.2

Note: * denotes the forecast period.
Source: EDC Global Economic Outlook, September 2022

Commodity prices

Global Economic Outlook	2021	2022*	2023*
Brent Crude Spot, *USD / bbl*	70.68	101.51	86.45
West Texas Intermediate, *USD / bbl*	67.98	97.70	84.25
Western Canada Select, *USD / bbl*	54.55	81.31	65.86
Natural Gas, *USD / MMBtu*	3.85	6.96	6.74
Gold, *USD / troy ounce*	1,800	1,800	1,618
Copper, *USD / tonne*	9,318	8,743	7,464

Note: * denotes the forecast period.
Source: EDC Global Economic Outlook, September 2022

Key forecast assumptions

Global fiscal policy

EDC Economics expects that fiscal policy will be a drag on economic growth going forward. Restoring public finances will likely continue to be a priority for countries with deteriorated public finances due to the pandemic. Additionally, governments will aim to reduce debt servicing costs as interest rates move higher. Emerging markets with limited fiscal flexibility will face increased difficulty.

Monetary policy

Inflation rates soared to multi-decade highs in the first half of 2022 for many countries. Inflation is expected to be higher for longer and remain above historical trend. Central banks have begun monetary policy normalization with interest rates rising faster and in larger increments than previously expected. It's expected that central banks will be data dependent and need to stay above their "neutral rate" in order to control inflation expectations despite economic conditions.

Financial conditions

Economics' baseline outlook doesn't anticipate a systemic financial crisis. However, there are vulnerabilities that have emerged catalyzed by globally synchronized monetary tightening. Financial market turbulence, notably in stock markets and corporate bond spreads, will continue due to economic and political headwinds and resulting adjustments to investor risk appetite. Similarly, commodities, currencies and real estate (with a lag) will face pressures. Sovereign defaults and balance of payments crises are occurring in a growing number of markets but have largely been contained to smaller markets. EDC Economics' baseline outlook doesn't anticipate a systemic sovereign debt crisis but an increase in defaults and balance of payment problems are likely.

Supply chain disruptions

Shipping prices continue to ease but remain elevated. Although supply chains have generally improved, the situation differs across various sectors and regions. EDC Economics' base case outlook expects supply chain disruptions to last until mid-2023, potentially improving from decelerating global economic activity.

China

China's zero-COVID-19 policy is contending with the immense impacts of the pandemic on the outlook for the Chinese economy. China's future growth prospects face downside risks, which include deleveraging, an aging population, U.S. competition, and shifting from an investment-focused to consumer-led growth. China is likely to support their vulnerable real estate sector from slowing.

Russia-Ukraine

Russia's invasion of Ukraine continue to have far-reaching consequences on the global economy. Specifically, agriculture and energy prices remain elevated and are expected to be volatile over the forecast period. Natural gas supply to Europe has been severely impacted. The baseline forecast assumes the conflict is at a stalemate. Western sanctions imposed on Russia are expected to remain in pace for the foreseeable future.

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 Aug. 25, 2022.

Key upside risks

- A more expansive drawdown of consumer savings and slow removal of macro-policy supports could result in a stronger-than-expected recovery, releasing pent-up demand into the economy.
- Stronger-than-expected consumer demand and business investment enables governments to reduce their spending programs more rapidly than in the base case. Increased consumer spending would more than offset the impacts of reduced fiscal stimulus.
- Inflation is higher than trend but is contained by the rise in business investment and digitization, which boosts productive capacity of the economy, preventing the economy from overheating. Additionally, monetary policy moves would be well-communicated, balanced and gradual to prevent systemic risks. Interest rates are elevated but remain below base case.
- 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 emerging markets beginning in early 2023 due to faster-than-anticipated U.S. monetary policy tightening. Poor alignment on tightening with market expectations has a significant negative impact on financial markets, which impacts real economic activity.
- Monetary policy comes from both higher interest rates and quantitative tightening despite slower growth, in line with base case.
- Higher debt is an increasingly significant issue for the corporate sector, emerging markets and households. The sudden tightening of financial conditions increases default risk and widens bond spreads for some emerging markets. Higher personal debt-to-income ratios squeeze economic spending activity.
- The Russia-Ukraine crisis has presented significantly higher commodities prices, stock market volatility and flight to quality. Emerging market risks have risen and include higher political risk, erosion of purchasing power and access to financial markets.

Disclosure

Ce document est également disponible en français.

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