Global economic outlook

Macroeconomic outlook and impact on businesses

Week of July 17, 2023

EY Parthenon

Building a better working world

Agenda

- Global snapshot
- Country and regional outlooks
- Meet the team and explore our resources

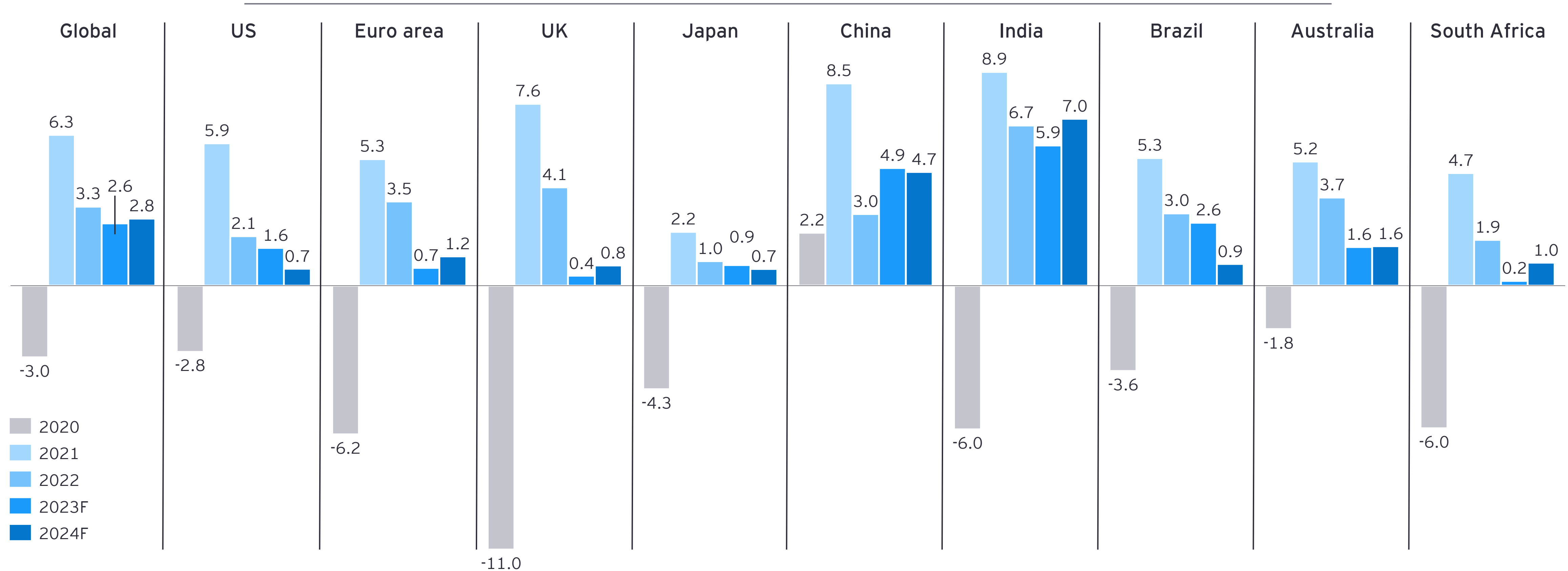
Disclaimer: This presentation is provided solely for educational purposes; it does not take into account any specific individual's or entity's facts and circumstances. It is not intended, and should not be relied upon, as tax, accounting or legal advice. The EY global organization expressly disclaims any liability in connection with the use of this presentation or its contents by any third party. Neither the EY global organization nor any member firm thereof shall bear any responsibility whatsoever for the content, accuracy or security of any third-party websites that are linked (by way of hyperlink or otherwise) in this presentation. The views expressed by the presenters are not necessarily those of the EY global organization or other members of the EY global organization or of any other company or organization.

The global economy is still in a rebalancing cycle post-pandemic, featuring slowing demand, supply-side deficiencies, persistent core inflation and rising interest rates

- Global economic activity is slowing, but the nature of the slowdown across major economies is far from homogenous. We anticipate global GDP growth will slow to 2.6% in 2023 — the slowest pace since 2001 outside of the global financial crisis and pandemic — and only accelerate modestly to 2.8% in 2024. Below-trend growth is expected across most advanced economies, with localized recessions in Europe, stall-speed growth in the US and Japan, and moderate growth momentum across most emerging markets, including notable downside risks to growth in China given the weakening of manufacturing and consumer spending activity.
- Labor markets around the world remain generally resilient, and while labor demand and supply are gradually coming into balance, labor market tightness is a common feature. Labor demand in some sectors like tech, manufacturing and retail is softening, but service sectors and construction continue to see generally strong employment trends. Labor force participation is gradually rebounding, supported in part by resilient labor demand, reduced health concerns, stronger wage growth and positive immigration flows.
- While global inflation is on a downward trajectory thanks to falling commodities prices, rebounding supply and easing final demand growth, core inflation (excluding food and energy) remains excessively elevated across most regions. The noteworthy exception is China, which is flirting with deflation. Elevated service sector inflation, still-high wage growth and, in some regions, strong housing cost inflation mean that the disinflationary process will take some time and run into 2024.
- In this context, the vibe from most advanced economies' central banks is "higher for longer." With central bankers viewing inflation risks as being tilted to the upside, they will generally favor overtightening to avoid additional inflation persistence. Over the past month, the Bank of Canada and the Reserve Bank of Australia resumed their tightening cycle, the European Central Bank (ECB) continued raising rates, the Bank of England surprised with larger-than-expected rate increases and the Fed signaled a higher terminal policy rate. We anticipate most central banks will continue to tighten monetary policy further into restrictive territory, with notable exception being the People's Bank of China loosening policy.
- Combined, this will undoubtedly put upward pressure on interest rates in the coming months and could exacerbate strains on the private sector with rising risks from "known unknowns" and "unknown unknowns." One of those known unknowns could come from a rapid tightening of credit and financial conditions. We know monetary policy affects economic activity with a lag. And with central bankers opting to take the risk of overtightening in the face of persistent inflation, a sudden tightening of financial and credit conditions could precipitate non-linear private sector responses with pullbacks in consumer spending and business investment that would plunge the global economy into a recession. A resumption of banking sector stress, commercial real estate fragilities and other unknown unknowns could trigger severe funding pressures on businesses, drive further bank failures and put significant strain on the availability and cost of credit.
- In the context of renewed global economic optimism, an upside risk to the outlook stems from a faster disinflationary cycle and a more rapid supply and productivity rebound supported by a faster labor market rebalancing, easing wage pressures and less cost passthrough. In this scenario, central banks wouldn't need to tighten monetary as much, thereby supporting stronger growth.

Source: EY analysis

In 2023, global GDP growth will likely be the slowest since 2001 outside of a recession, and economic activity is expected to gradually reaccelerate through 2024



1. Throughout materials, baseline and alternative forecast scenarios have been prepared by EY economics teams leveraging the Oxford Economics Global Economic Model.
Source: EY analysis

EY Parthenon

"Tour du monde" overview reveals most economies around the world are experiencing a slowdown, but the magnitude and breadth of the slowdown are far from homogenous

- **US:** There is scope for hope in this unique business cycle. Labor hoarding has so far translated into a limited drag on household income, and with inflation cooling real disposable income is now supporting a gradual consumer spending slowdown rather than a retrenchment. The Fed will maintain a restrictive monetary policy stance into 2024, leading to a further slowdown in economic activity. We see real GDP growing 1.6% in 2023 and expanding at a muted 0.7% pace in 2024.
- **Euro area:** The economy has proven more resilient than expected to the energy crisis. The euro area GDP effectively stagnated in Q4 2022 and Q1 2023, quelling previous expectations of an imminent recession. Falling inflation, lower energy prices and the recovery of tourism to pre-pandemic levels will support activity in the coming quarters, with GDP growing by 0.7% in 2023. As we expect the ECB to raise interest rates twice more this year and initiate the easing cycle only in mid-2024, high interest rates and subdued global growth will weigh on activity in 2024, resulting in a subdued GDP growth of 1.2%.
- **UK:** Economic activity remains subdued in the UK as ongoing strikes and extra public holidays have stymied activity in recent months. Elevated inflation will continue to erode household income and pressure the Bank of England (BoE) to tighten monetary policy further, thus constraining consumer spending and business investment. Tighter financial and credit conditions along with increased fiscal headwinds will likely constrain GDP growth 0.4% in 2023 and 0.8% in 2024.
- **Japan:** We anticipate real GDP growth in Japan will average 0.9% in 2023 and 0.7% in 2024, after a 1.0% expansion in 2022. Pent-up demand from the relaxation of COVID-19 restrictions, rebounding tourism activity (which remains about 30% lower than pre-pandemic) and rising wage growth should support consumer spending growth in the near term. Still, sluggish global growth will weigh on exports, while persistently elevated inflation erodes household spending power.
- **Australia:** The Australian economy has slowed, with real GDP rising just 2.3% in annual terms in Q1, but inflation and labor costs are still rising too rapidly, pushing the Reserve Bank of Australia to maintain a tight monetary policy stance. We anticipate the Australian economy will grow 1.6% in both 2023 and 2024.
- **India:** India's economic growth continues to exhibit resilience to global headwinds. Economic growth is expected to remain relatively strong at around 6% year over year (y/y) aided by the government's continued capex push, a moderation in commodity prices, and healthy balance sheets of banks and corporates. The Reserve Bank of India will favor holding monetary policy restrictive, and we anticipate India's GDP will grow 5.9% in 2023 and 7.0% in 2024.
- **China:** The post-COVID-19 reopening boost is rapidly fading, with weak consumer sentiment and slowing credit growth constraining consumer spending and real estate activity. While the savings rate will likely ease in the coming months, it remains excessively high, above 30%, meaning the consumer spending engine is insufficient to offset export weakness in the face of slowing global growth. We expect GDP growth to average 4.9% in 2023 and 4.7% in 2024.
- **Latin America:** A robust US recovery after the COVID shock along with higher commodities prices (for commodity exporters) led to a relatively strong post-pandemic recovery in Latin America. Most economies have exceeded the (admittedly shallow) pre-pandemic trend. Still the short-term outlook is less encouraging with the LatAm region expected to contract in the coming quarters, with a peak to trough GDP decline of 0.6%.
- **Middle East and Northern Africa:** The economic outlook points to an expected slowdown in FY23 on the back of slower global economic activity, tighter monetary policy to curb inflation and oil producers cutting supply to maintain a price floor. Growth is expected to modestly rebound in 2024.
- **Sub-Saharan Africa:** The SSA outlook is relatively promising, although elevated sovereign and private debt levels are concerning, especially for extremely low-income economies. Most African economies are unlikely to experience near-term recessions, but unsustainable levels of debt (and elevated debt servicing costs) will negatively impact fiscal and personal financial sustainability over the medium term.

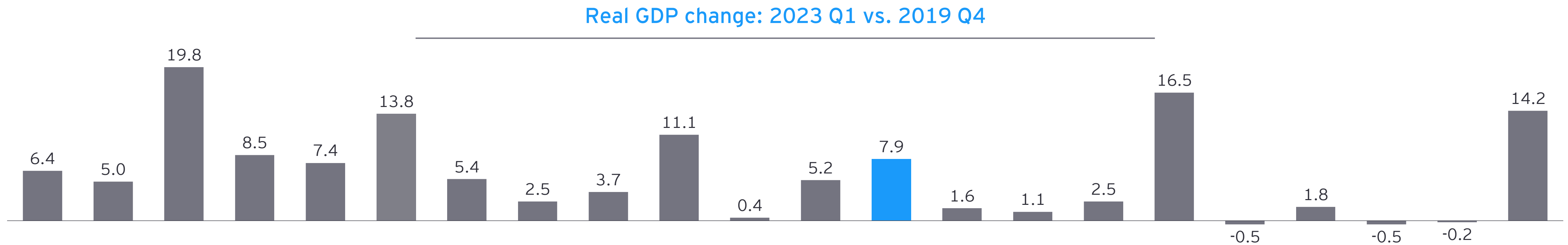
Source: EY analysis

EY Parthenon

Three years after the onset of the pandemic, most major economies are above pre-pandemic GDP levels but below pre-pandemic GDP growth trends

Real GDP level in 2023 Q1 vs. pre-pandemic trend (in percentage)[2]

Country	Value
Brazil	10.8
Nigeria	3.3
Turkey	2.1
Saudi Arabia	1.4
Australia	-1.0
Egypt	-2.0
US	-2.1
Italy	-2.4
Canada	-2.5
Poland	-3.2
South Africa	-3.4
South Korea	-4.0
World	-4.1
Japan	-4.1
France	-4.6
Euro area[1]	-4.8
China	-6.4
Germany	-7.0
Mexico	-7.1
UK	-7.7
Spain	-10.0
India	-13.0



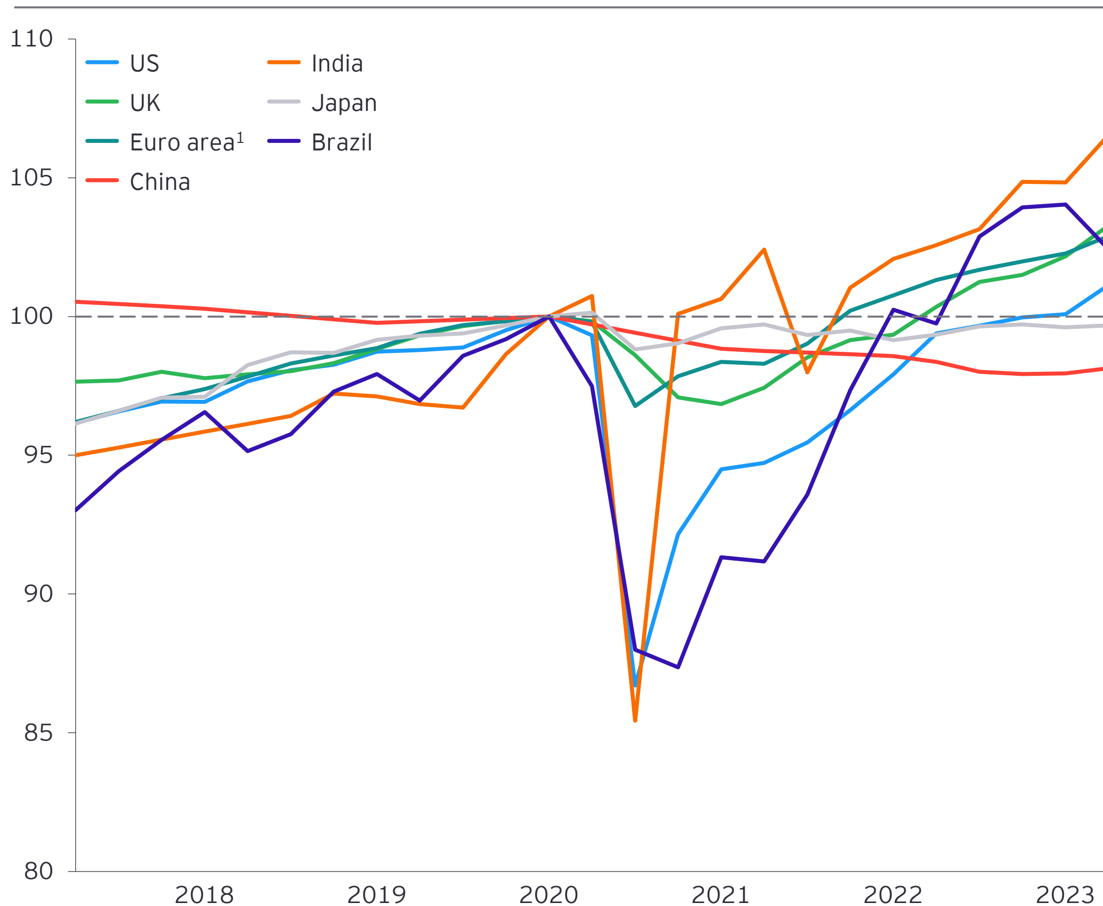
1. Euro area includes 20 countries.
2. Pre-pandemic trend based on average growth rate over 2014Q1-2019Q4.

Source: EY analysis

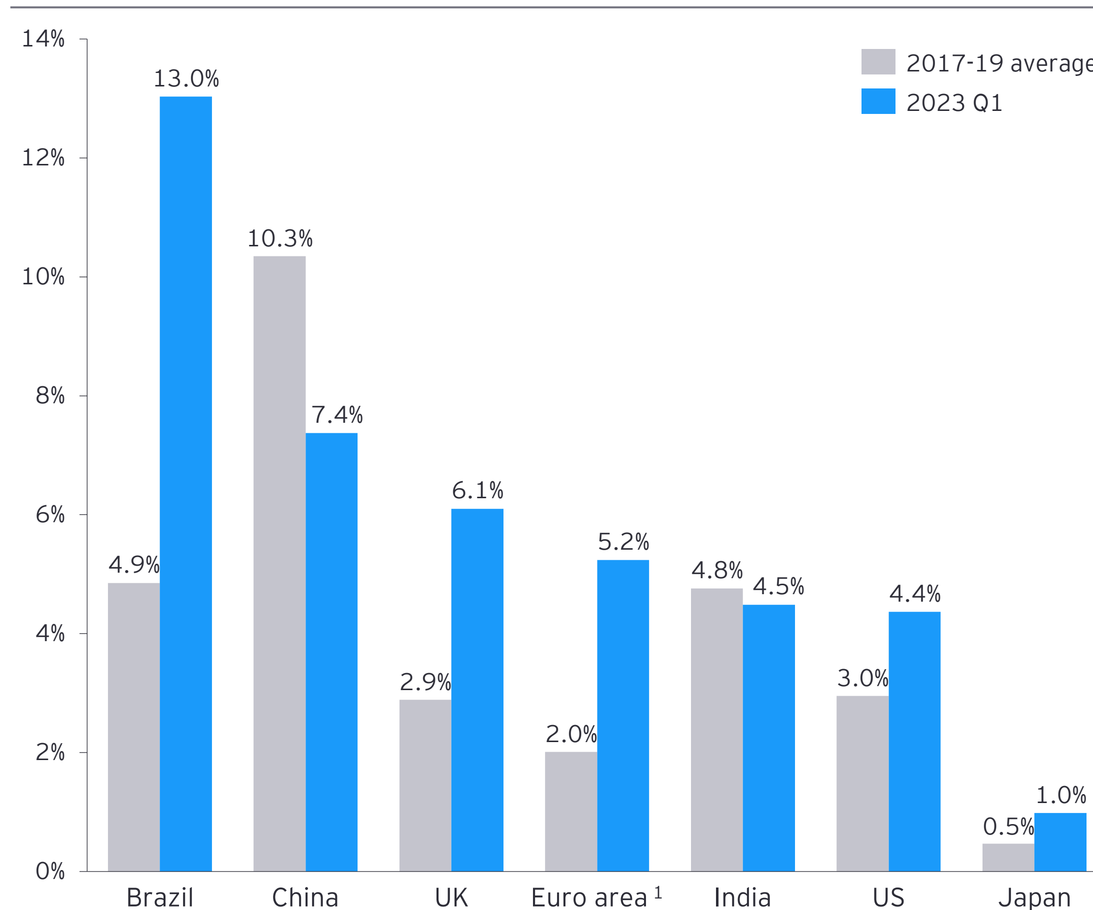
EY Parthenon

Across most major economies, employment has surpassed pre-pandemic levels; labor hoarding has led to tight labor market conditions and elevated wage growth

Employment-level index
2015 Q1 - 2023 Q1 (2019 Q4 = 100)



Y/y nominal wage growth rate
2023 Q1 vs 2017-2019 average



1.Euro area includes 20 countries
Source: Oxford Economics; FRED; Office for National Statistics

EY Parthenon

Slower global economic activity and reduced supply constraints have led to a notable easing in commodities prices, providing a welcome relief on the inflation front

Global Supply Chain Pressure Index
December 2015-June 2023

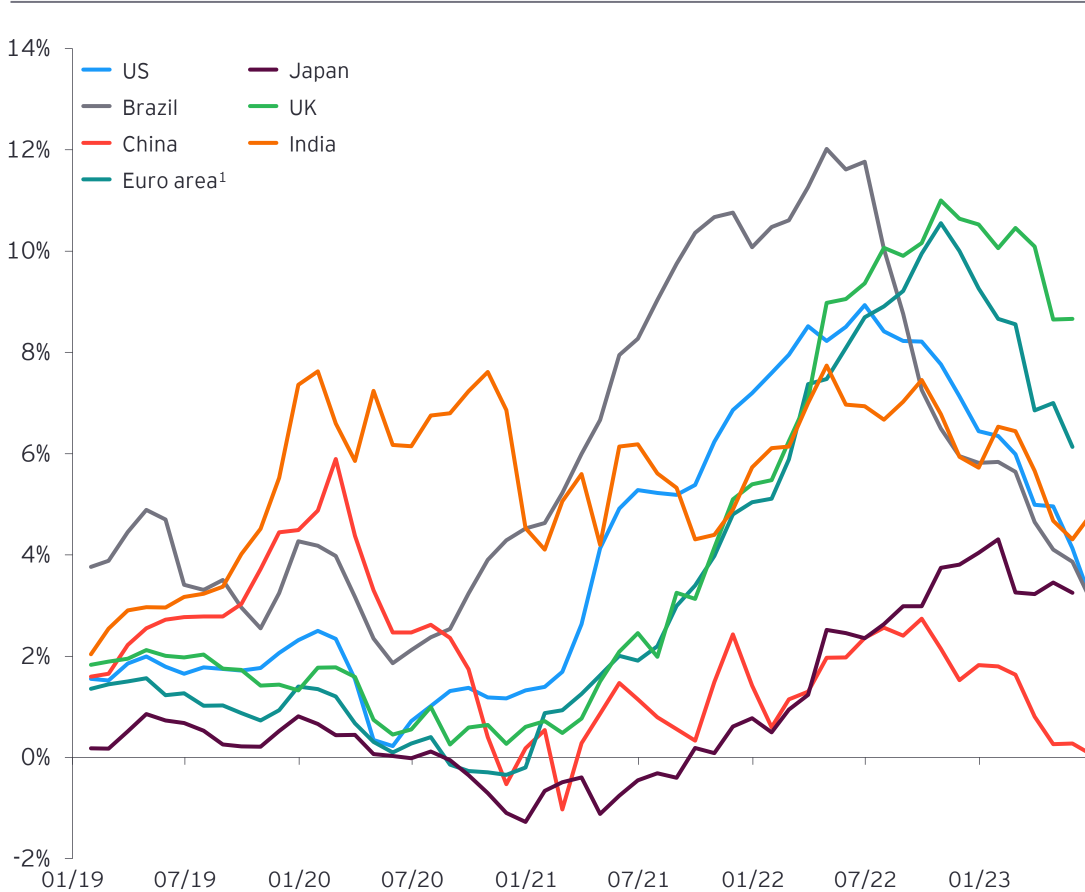
Global commodity prices
January 2010-June 2023 (2016=100)

Source: Federal Reserve Bank of New York; World Bank

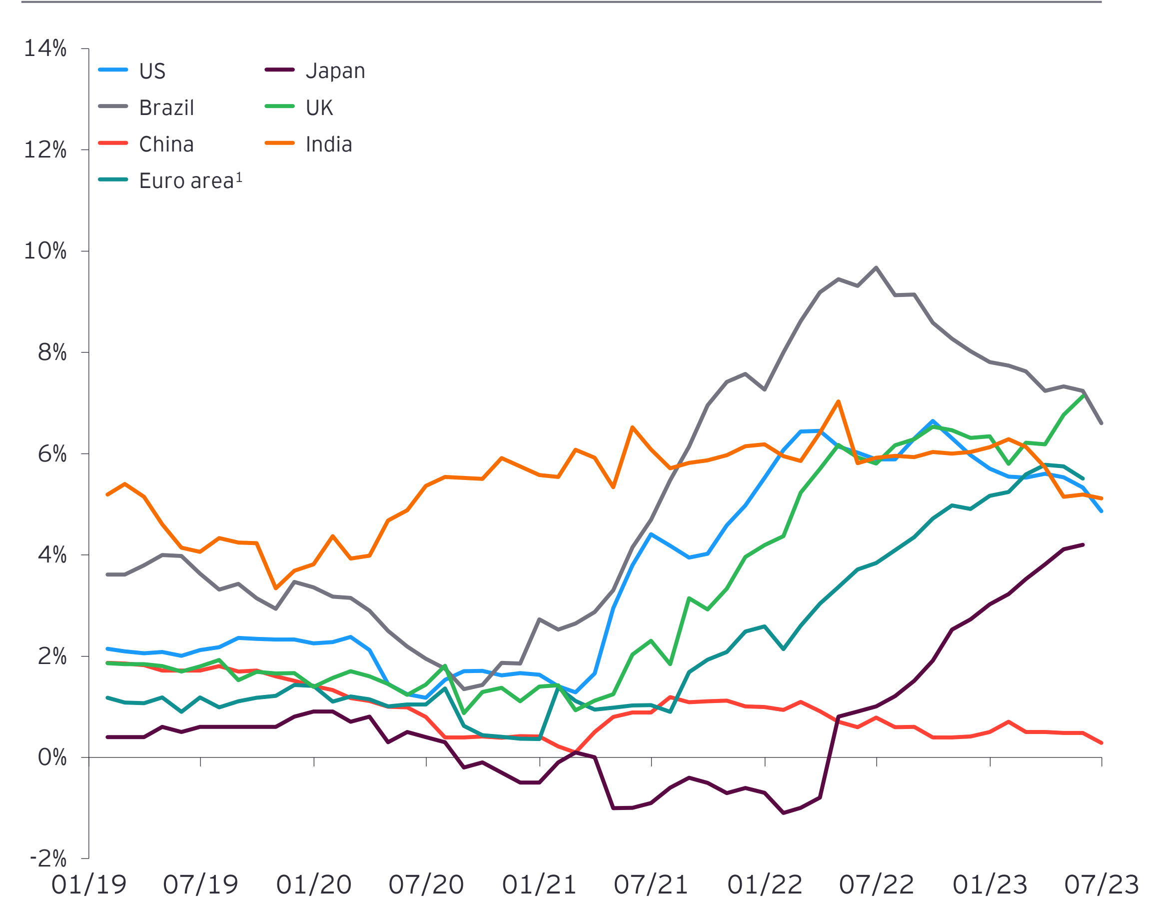
EY Parthenon

Global inflation is on a downward trajectory, thanks to lower energy, food and goods prices, but core inflation pressures are keeping central bankers on high alert

Y/y headline CPI growth rate
January 2019–June 2023[2]



Y/y core CPI growth rate
January 2019–June 2023[2]



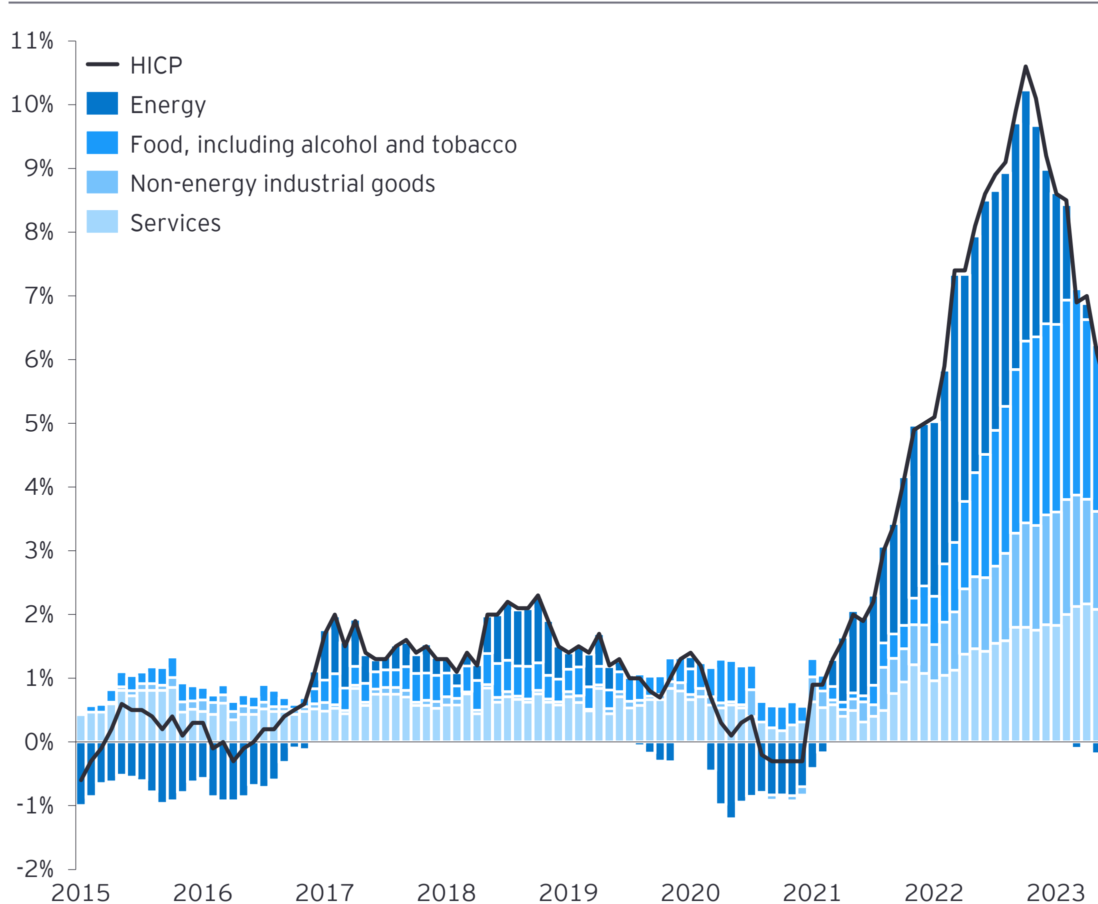
1. Euro area includes 20 countries.
2. Data for Japan, Euro area, and the UK is shown through May, while data for the US, Brazil, India, and China is shown through June due to data availability.

Source: Country central banks

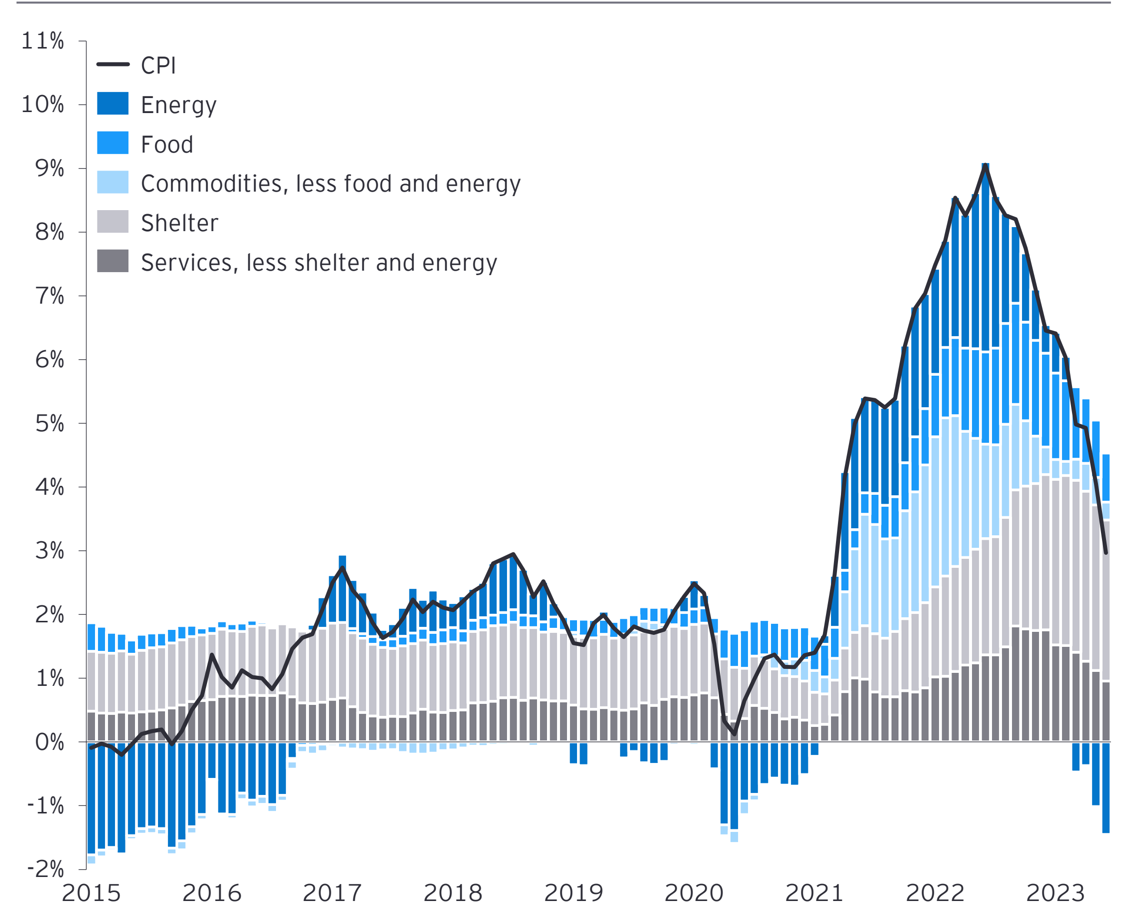
EY Parthenon

Easing commodities prices and supply constraints have pushed headline inflation lower, but core inflation remains excessively high, even as it eases more rapidly in the US

Euro area y/y percentage change in CPI[1]
January 2015-June 2023



US y/y percentage change in CPI
January 2015-June 2023

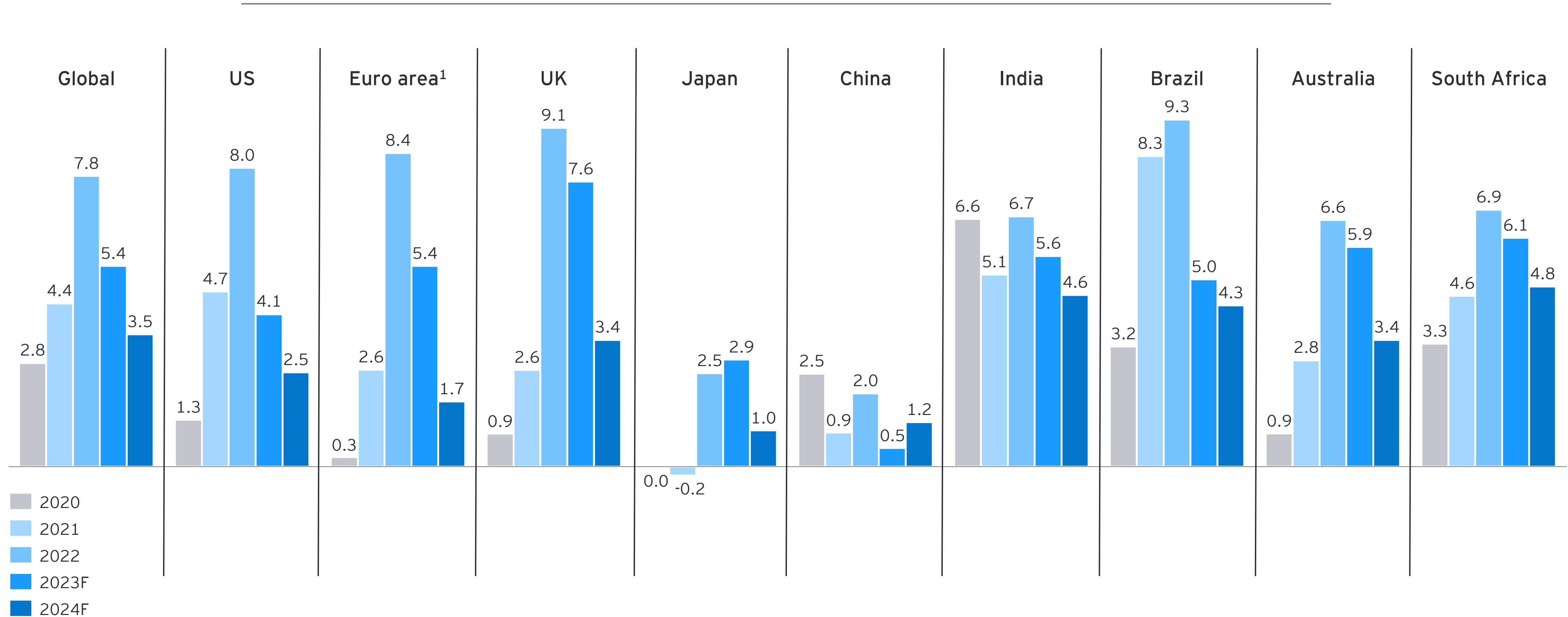


1. Contribution of core inflation is the sum of services (grey) and core goods (lightest blue).

Source: Eurostat; FRED; Bureau of Labor Statistics

EY Parthenon

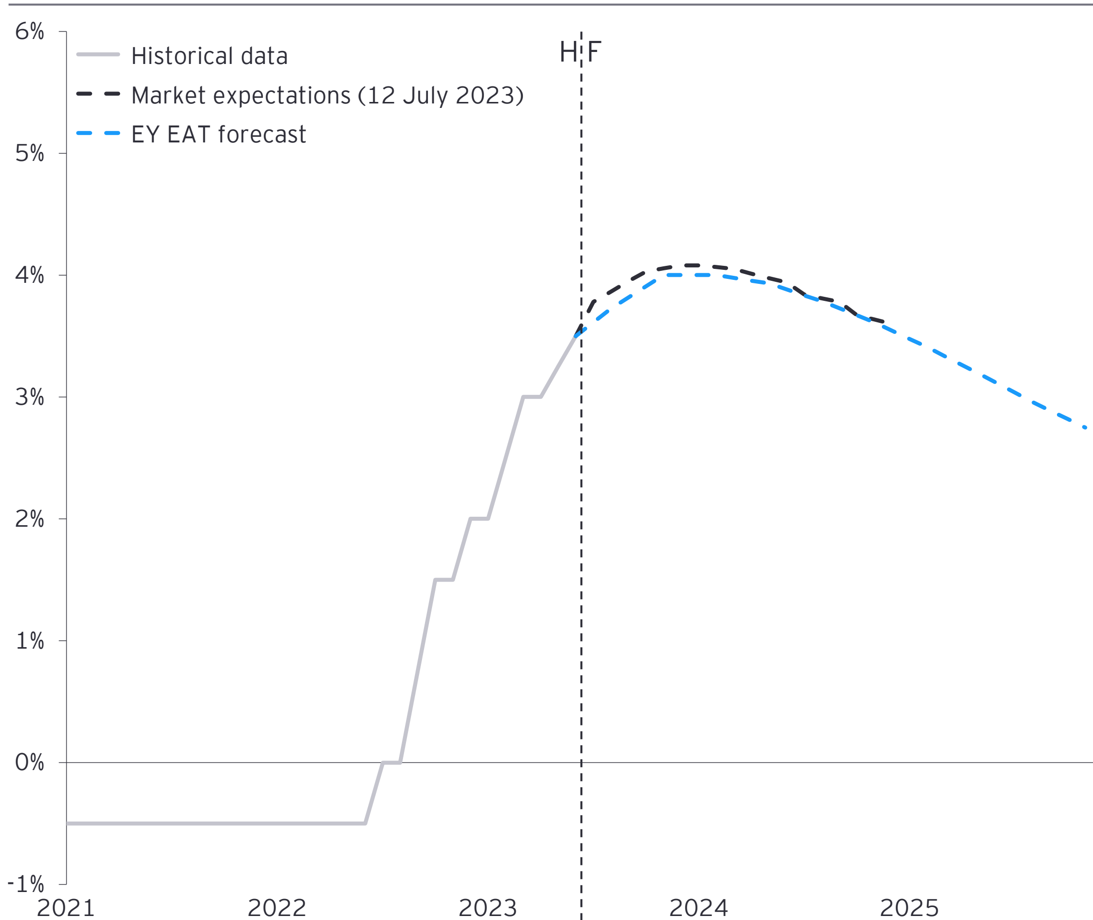
We anticipate headline inflation will cool rapidly in the coming months, but core inflation persistence will keep central bankers on high alert and favor tighter policy

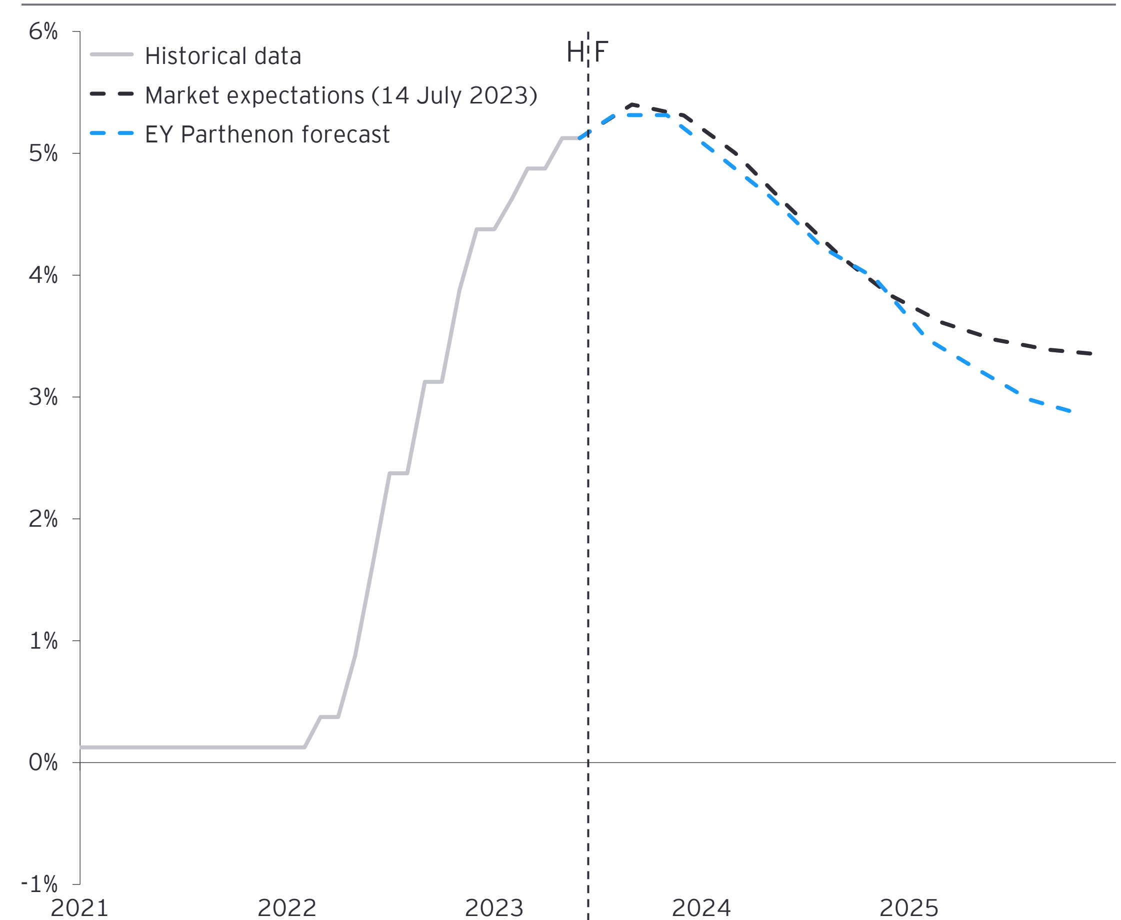


1. Euro area includes 20 countries.
Source: EY analysis

EY Parthenon

The central bank vibe across most major economies will be "higher for longer," with peak rates likely to be reached in the coming months and only gradual rate cuts in 2024





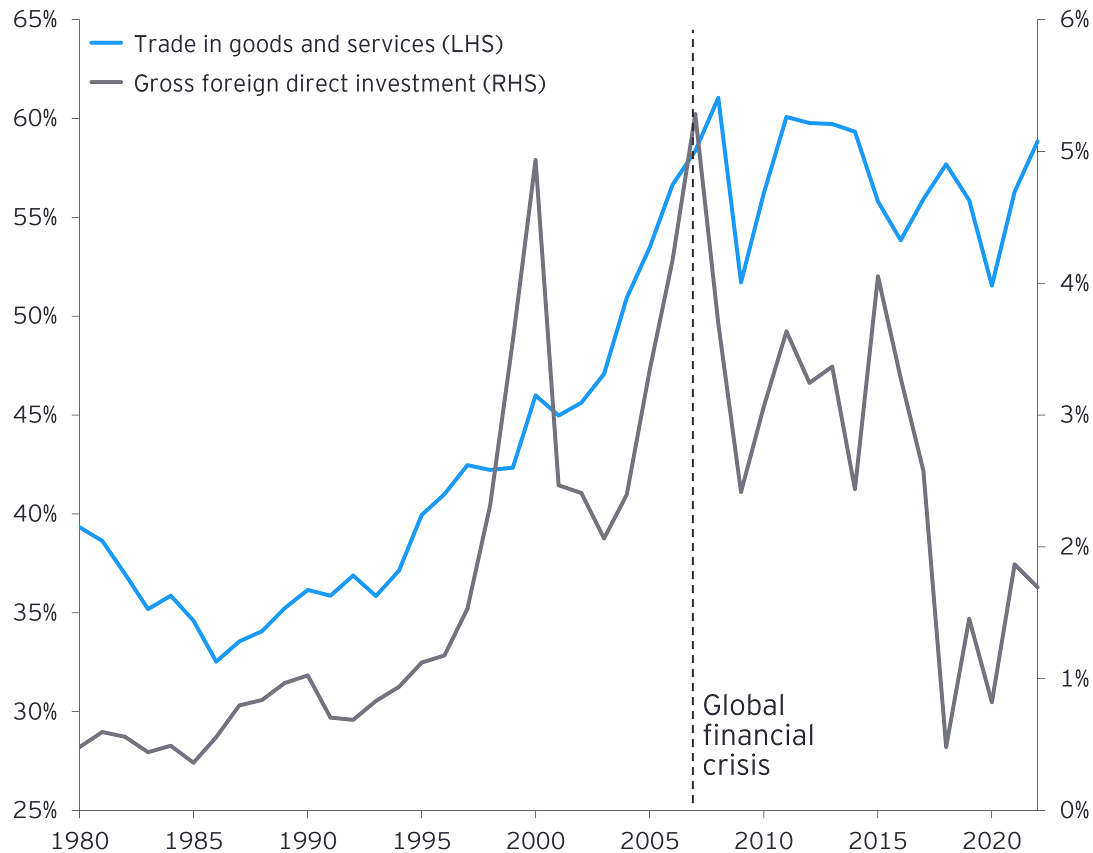
1. For the euro area on 12 July 2023, expected interest rates from Refinitiv; for the US on 14 July 2023, expected interest rates from Atlanta Fed Market Probability Tracker.

Source: ECB; Federal Reserve; Eurostat; EY analysis

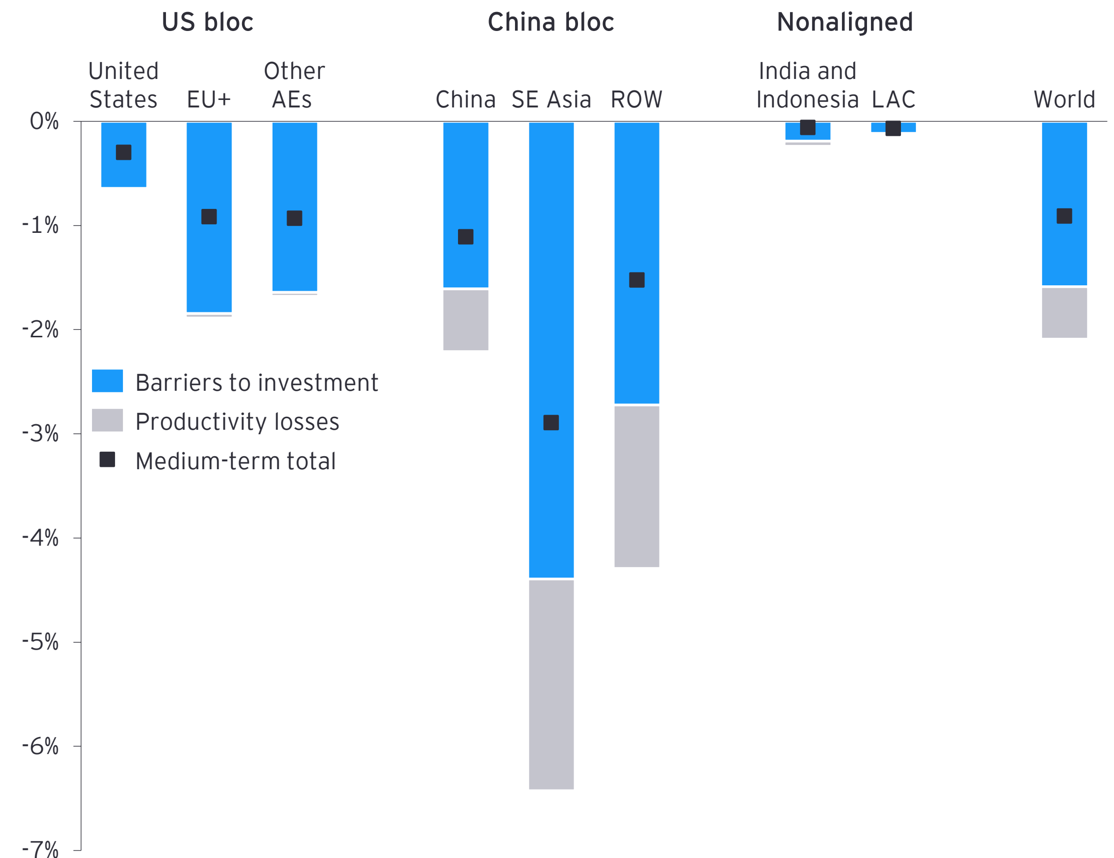
EY Parthenon

Geopolitical fragmentation and "slowbalization" could have short-term consequences in terms of growth, but they also weigh on potential growth, especially in emerging markets

Trade and foreign direct investment as a percentage of GDP 1980-2022



Impact of investment flow barriers on GDP[1,2] (Percentage deviation from no-fragmentation scenario)



1. Baseline fragmentation scenario represent barriers generating 50% decline in investment flows between China and US blocs, with no barriers with two nonaligned regions (India and Indonesia , Latin America and the Caribbean).
2. AEs = advanced economies, EU+ = European Union and Switzerland; LAC = Latin America and the Caribbean; ROW = rest of the world; SE = Southeast.

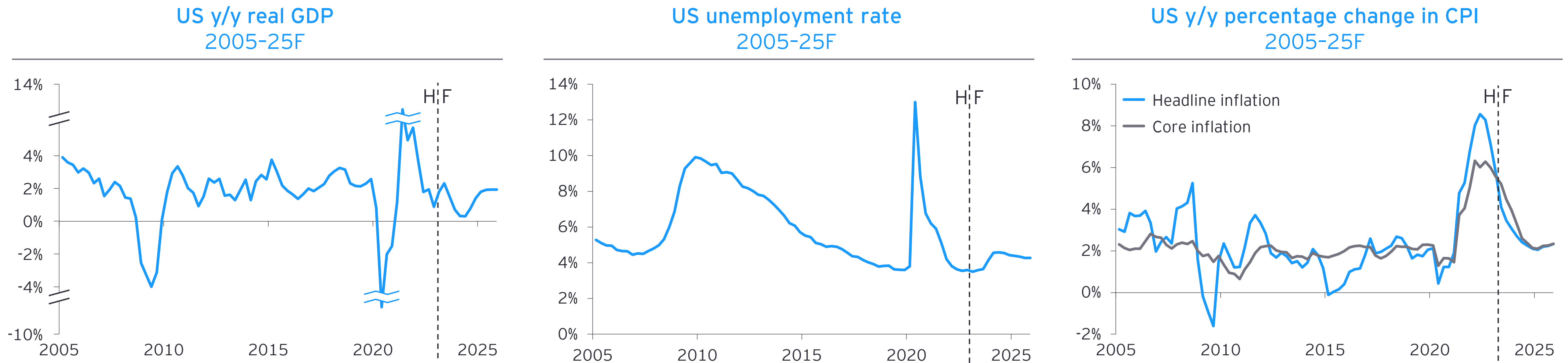
Source: International Monetary Fund; EY analysis

Agenda

- Global snapshot
- **Country and regional outlooks**
- Meet the team and explore our resources

EY Parthenon

We anticipate an ongoing slowdown, but no retrenchment in economic activity, with the unemployment rate rising toward 4.5% and inflation cooling toward 2% in 2024



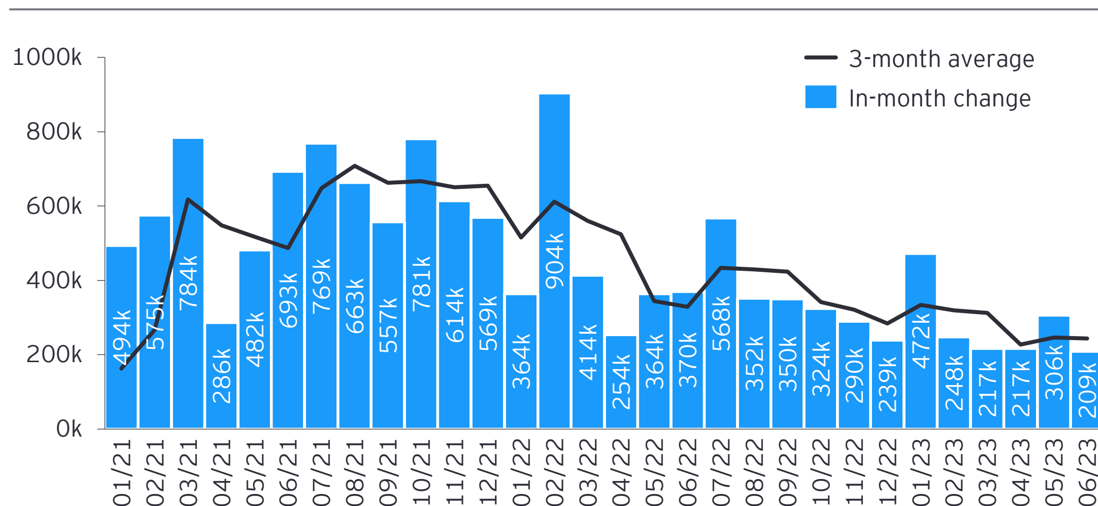
- There is scope for hope in this unique business cycle. Unlike in prior downturns, business executives have proven reticent to dispose of the pool of talent they struggled to hire, train and retain post-pandemic. This labor hoarding has so far translated into a limited drag on household income, and with inflation cooling, real disposable income is now supporting a gradual consumer spending slowdown rather than a retrenchment.
- Simultaneously, the need to address supply shortages across the economy has supported robust construction activity and prevented a severe manufacturing pullback — especially in autos, electronics and transit equipment — while better balance between labor demand and supply led to easing wage pressures.
- Consumer and corporate balance sheets remain generally healthy, even if some cracks are starting to appear. Households' excess savings are still elevated, around $1 trillion, even if they have fallen about 55% from their peak and are mostly concentrated among the top income quintile families. And inflation as well as inflation expectations are coming down, notwithstanding core inflation showing signs of more persistence than desired.
- These factors could certainly make one hopeful of an immaculate soft landing, where the economy cools just enough to bring inflation down to a sustainable pace of 2% without leading to a recession. Still, a realistic assessment of the US economy would highlight that there are notable headwinds from persistently elevated prices and costs, tightening credit conditions and rising interest rates. As the Fed continues tightening policy and interest rate hikes work their way through the economy, we still believe a recession is more likely than not, but we have lowered our recession odds to 50%. We see real GDP growing 1.6% in 2023 and expanding at a muted 0.7% pace in 2024.

Source: EY analysis

EY Parthenon

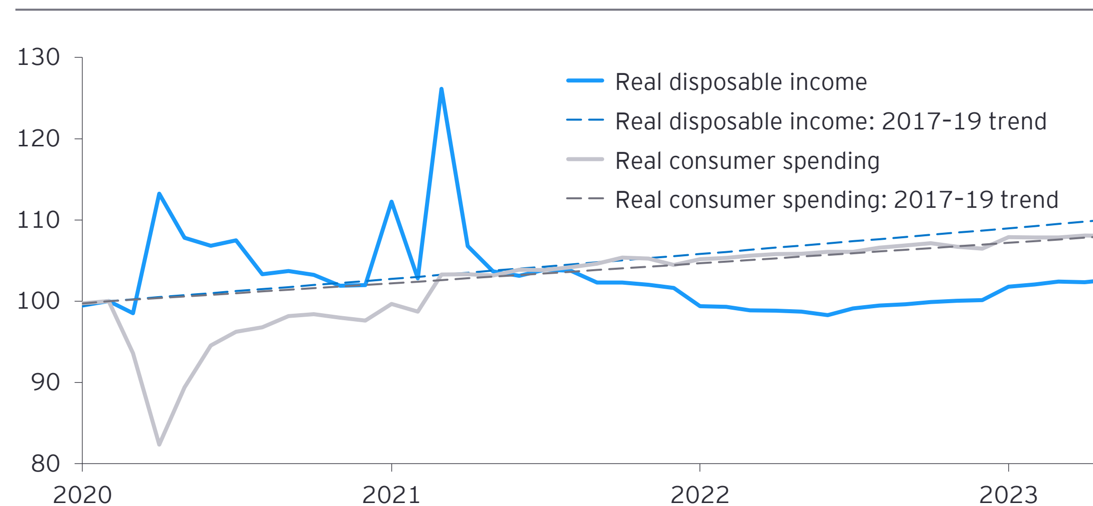
The labor market is showing some resilience, but a pronounced slowdown is likely in coming months with reduced hiring and a rise in layoffs

US month over month (m/m) change in total nonfarm employment
January 2021–June 23



- Midway through the year, the US labor market remains resilient. The economy added 209,000 jobs in June with the unemployment rate falling to 3.6% and wage growth stable at 4.4% y/y. Downward revisions to prior months' employment gains and weak job growth diffusion nonetheless point to softening employment momentum.
- Looking ahead, we expect job growth will deteriorate as companies grapple with softer domestic and global demand, weaker profitability, continued cost pressures and tighter credit conditions. Yet the labor market downturn could be milder by historical standards, with the unemployment rate likely to peak near 4.5% in 2024.
- Stronger immigration flows and rebounding productivity are two upside risks for the economy and inflation outlook.

US real consumption expenditures and disposable income
January 2020–May 2023 (February 2020 = 100)

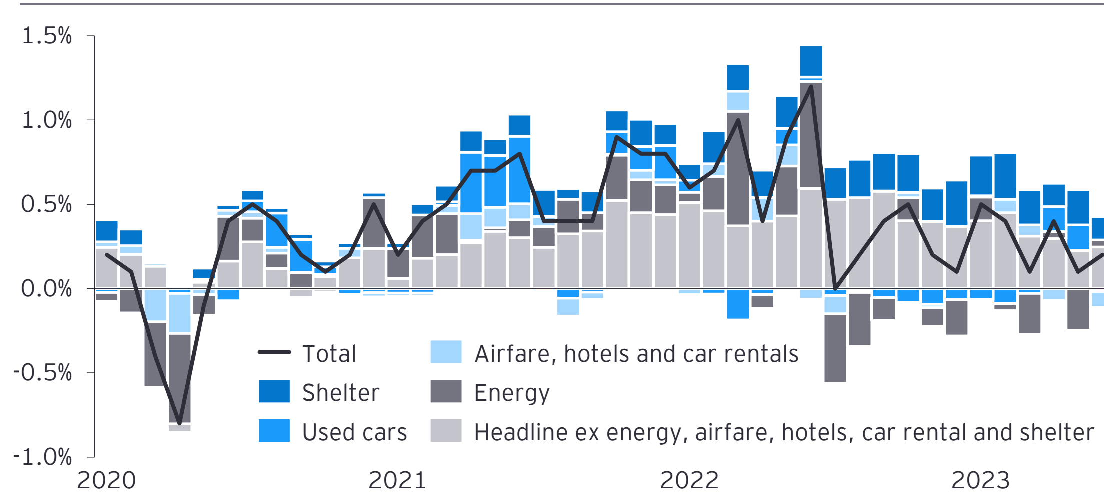


- The ongoing rebound in real disposable income – reflecting still-solid wage gains amid cooling inflation – represents a key support to consumer spending. Real disposable income rose 4% y/y in May, supporting consumers' purchasing power as they continue to face elevated prices.
- While consumers are still spending, they are becoming more financially cautious, as lingering inflation and the Federal Reserve's rate hikes take their toll. Looking ahead, we expect the slowdown in consumer spending to deepen in the second half of the year, as labor market gains falter, the buffer from excess savings shrinks and credit conditions tighten further. We anticipate consumer spending will advance a modest 1.9% in 2023 and 0.9% in 2024.

Source: Bureau of Labor Statistics; EY

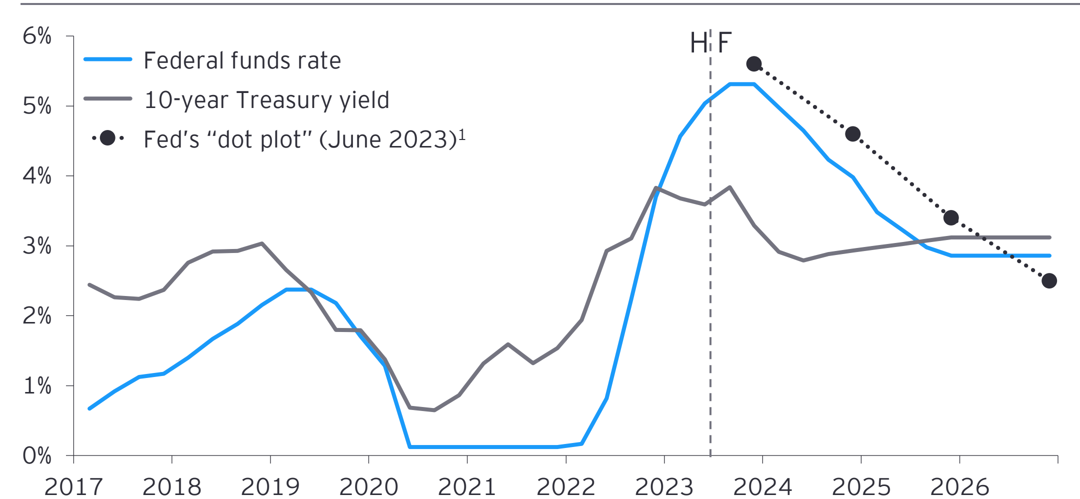
Reduced sequential momentum in inflation confirms the disinflationary process is well underway, despite latent core inflation stickiness

US m/m percentage change in CPI
January 2020–June 2023



- Sequential Consumer Price Index (CPI) momentum has eased considerably relative to last year, with falling energy and food prices and easing goods prices helping push inflation much lower. Headline CPI inflation fell sharply, down 1.0 percentage point (ppt) to 3.0% y/y in June – it's now 6.1ppt below its June 2022 peak and its lowest since March 2021. Core CPI inflation fell 0.5ppt to 4.8% y/y – it's now 1.8ppt below its September 2022 peak and its lowest since October 2021.
- Looking ahead, slower demand for goods and services, easing housing price inflation, and cooling wage growth will lead to faster disinflation in the coming months. We have already seen strong downward pressure on wholesale price (Producer Price Index) inflation indicating margin compression and import price deflation. But the disinflationary process is unlikely to be smooth and uniform.

US interest rate forecasts, federal funds rate and 10-year Treasury yield
Q1 2017–Q4 2026F

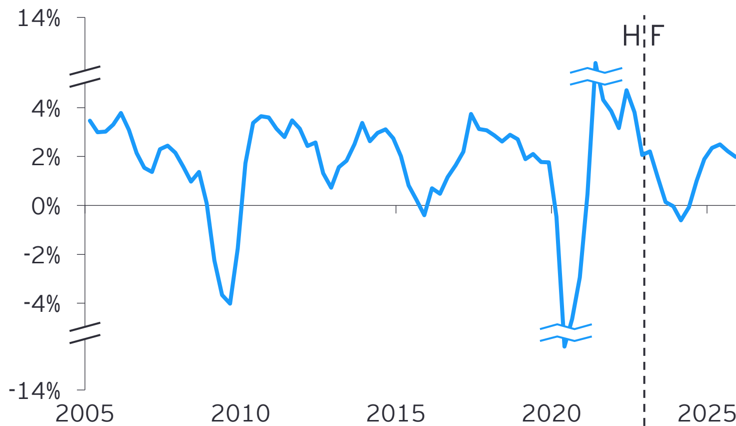


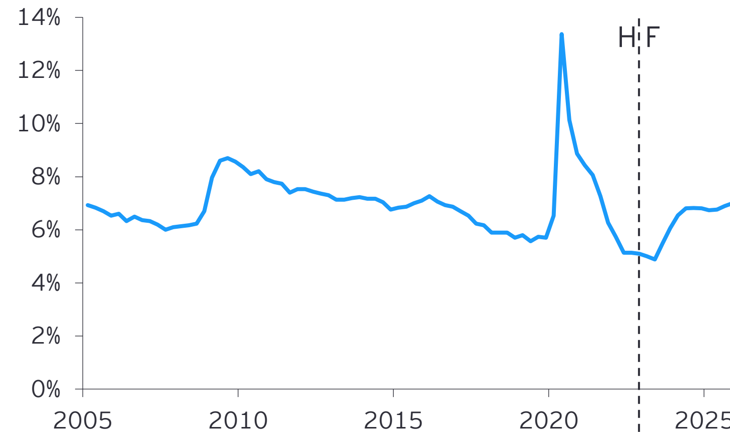
- The Fed maintained the federal funds rate range unchanged at 5.00%–5.25% at its June meeting but signaled two more rate increases are likely this year as officials remain concerned about core inflation being too high relative to the 2% target.
- Given our softer growth and inflation outlook, we anticipate the Fed will raise interest rates only once more to 5.25%–5.50% in July before holding rates steady throughout the remainder of the year as it assesses the impact of its tightening on the economy and inflation.
- While we do not anticipate rate cuts until early 2024, we foresee the Fed starting to discuss policy recalibration in the final quarter of the year, highlighting that, with inflation cooling, it will consider slowing cutting nominal interest rates to maintain real rates steady.

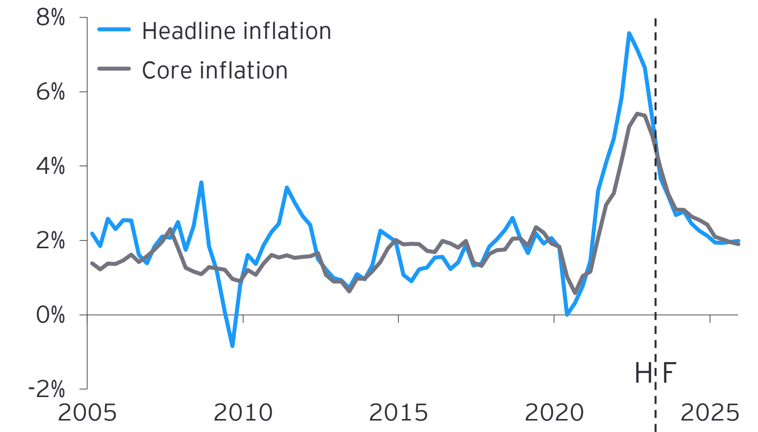
1. "Dot plot" charts the median interest rate projection from the Federal Open Market Committee. The projections for the federal funds rate are the values at the end of the specified calendar year.

Source: Bureau of Labor Statistics; Federal Reserve Board; EY

Canada is likely to enter a recession before year-end, with persistent inflation forcing tighter monetary policy and weighing on a fragile real estate sector





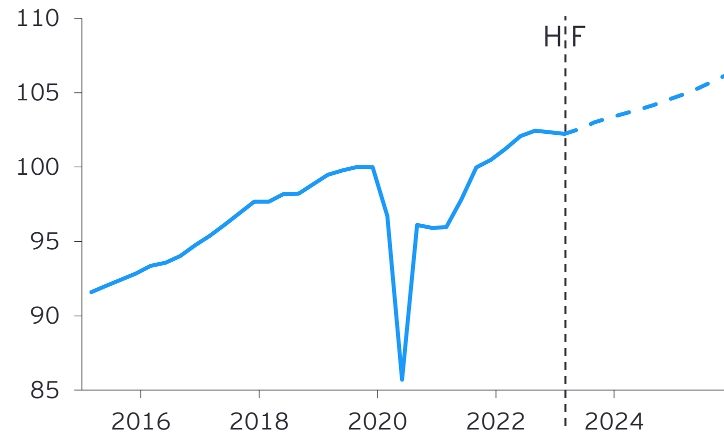


- The Canadian economy started the year strong, but forward-looking indicators continue to point toward a looming recession before year-end. Persistently elevated inflation continues to erode private sector purchasing power, while rising interest rates weigh on consumer spending, real estate sector activity and business investment. In addition, the external backdrop is likely to be less supportive of Canadian exports, with the US economy also cooling.
- Notwithstanding positive immigration contributions, a softening labor market, with unemployment creeping up and job losses being more diffuse, is likely to further strain households' incomes. The impact of the Bank of Canada's aggressive monetary policy tightening cycle has yet to fully filter through to the economy, and with financial and credit conditions expected to tighten further, the drag on economic activity will grow.
- Core inflation remains stubbornly high, around 4%. We continue to anticipate moderating inflation toward 2% in 2024 but foresee the Bank of Canada maintaining a hawkish tilt through year-end given the disappointingly slow progress toward the inflation target. Given the resumption of the rate hikes in June, with the policy rate now at 5.0%, and the hawkish forward guidance, we don't discount the possibility of further monetary policy tightening in 2023. What is more, any easing of interest rates is expected to be limited and very gradual in 2024.
- We anticipate that after a 3.4% advance in 2022, real GDP growth will average 0.9% in 2023 and 0.5% in 2024.

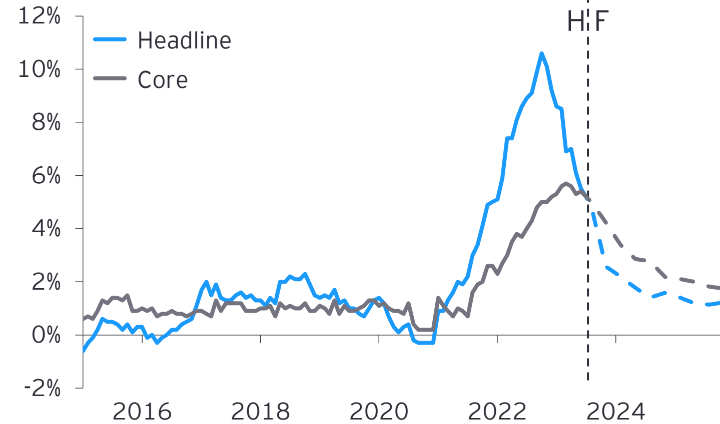
Source: EY analysis

Following stagnation, the euro area economy will likely rebound in H2 2023 on the back of easing inflation, but the ECB may remain hawkish due to sticky core inflation

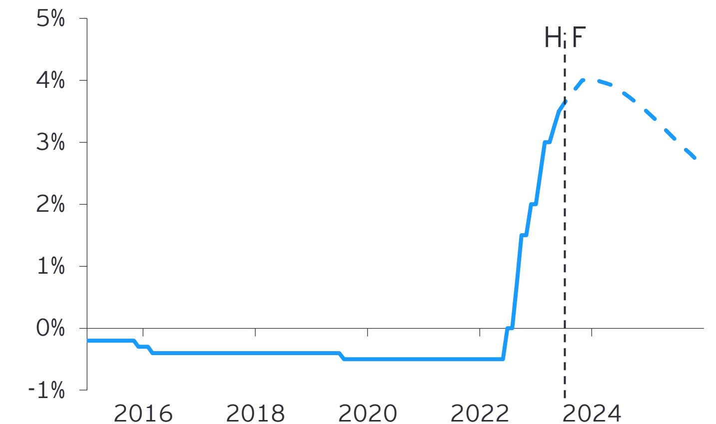
Euro area real GDP (index, 2019 Q4 = 100)
2015-25F



Euro area inflation (y/y)
2015-25F



Euro area deposit rate
2015-25F

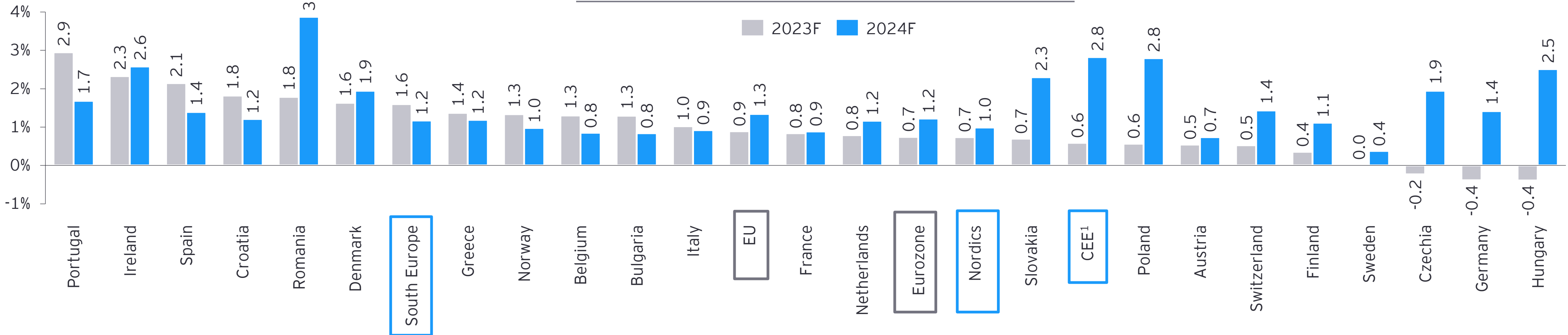


- The euro area economy has been slowing since mid-2022 and stagnated in recent quarters. Inflation exceeding nominal wage growth and tighter financial conditions have weighed on consumer spending and private business investment. Manufacturing activity has been particularly restrained amid a destocking of inventories, weakening consumer demand, a spending rotation from goods to services and higher interest rates.
- Economic activity is expected to gradually rebound going through 2024, supported by a decline in inflation and recovery in real incomes, as well as a further easing of supply constraints, recovery in the tourism sector and a gradual increase in external demand. The labor market remains resilient and continues to support consumer income and consumption. Still, the effects of monetary policy tightening are increasingly feeding through to the real economy, and the withdrawal of fiscal measures will also weigh on final demand. Overall, we expect modest GDP growth of 0.7% in 2023 and only gradual acceleration to 1.2% in 2024.
- Euro area inflation fell from its peak of 10.6% in October 2022 to 5.5% in June 2023, initially driven by declining energy prices and base effects. More recently, receding supply bottlenecks, slowing demand, and declining shipping and commodity prices have begun to filter through to core and food prices. However, disinflation is being slowed down by more persistent services inflation, reflecting tight labor market conditions and high wage growth in many countries.
- We anticipate that inflation will reach the ECB target of 2% in the first half of 2024, but core inflation will remain elevated through 2024. While underlying price pressures are moderating, they remain strong, and we anticipate two more hikes of 25 basis points (bps) by the ECB in July and September 2022. Since the ECB is more likely to err on the side of doing too much rather than too little, a fast decline in headline and core inflation measures may not be a sufficient condition for a policy rate cut in 2024 Q1, especially if nominal wage growth remains high and is not sufficiently absorbed by firms in their profit margins. In such a scenario, the ECB may hold rates steady until June 2024.

Source: Eurostat; ECB; EY analysis

EY Parthenon

Most EU countries will avoid recession in 2023 and grow at a modest pace with a notable exception of Germany; in 2024, economic growth will only slightly accelerate



- European economies will slow down in 2023, but most EU countries will avoid full-year GDP contraction. The cross-country variation largely stems from differences in the economic structure. South European countries (Spain, Portugal, Croatia, and, to a lesser degree, Greece and Italy) will be among the best performing economies, as the tourism industry is returning to pre-pandemic levels. Their activity will also be supported by increasing government investment financed from the EU recovery fund.
- On the other side of the spectrum, countries most reliant on the manufacturing sector (Germany, Czechia, Hungary) will see a full-year decline in GDP, as global headwinds, destocking and the pass-through from earlier increases in energy prices weigh on activity. These countries are also less likely to benefit from China's post-COVID-19 recovery, as the rebound has mostly been driven by domestic consumption and services sector activity, which led to less global spillover.
- In 2024, GDP growth in Europe will accelerate on average as lower inflation supports real income growth though high interest rates and a gradual withdrawal of the discretionary stimulus provided in response to the pandemic and the energy shock will continue to weigh on activity. The manufacturing sector should rebound, as external demand gradually recovers and real income growth supports domestic demand. As a result, we anticipate that growth in Germany will reach 1.4% in 2024. At the same time, the momentum in tourism and government investment will fade, with Spain seeing GDP growth slow down to 1.4%. CEE countries will stand out as they return to their (much higher) potential growth, supported by quick disinflation.
- While historically high post-winter gas storage levels in Europe have significantly reduced the short-term energy security risk, the balance of risks to economic growth remains tilted to the downside.

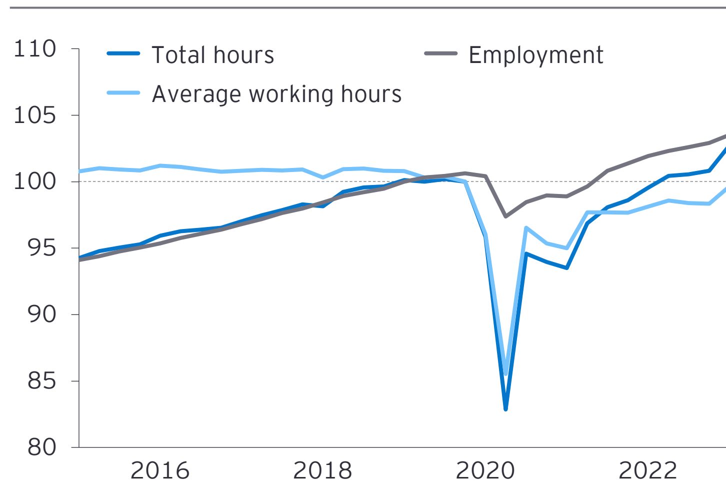
1. CEE includes Czechia, Hungary, Poland, Romania and Slovakia. Nordics includes Denmark, Finland, Sweden and Norway. South Europe includes Greece, Italy, Portugal and Spain.

Source: EY analysis

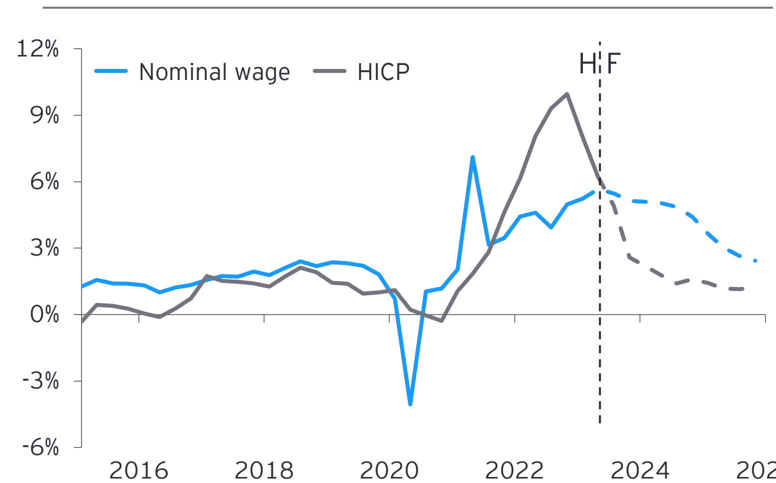
EY Parthenon

The labor market remains tight and is becoming an important driver of inflation as the effects of past supply shocks fade

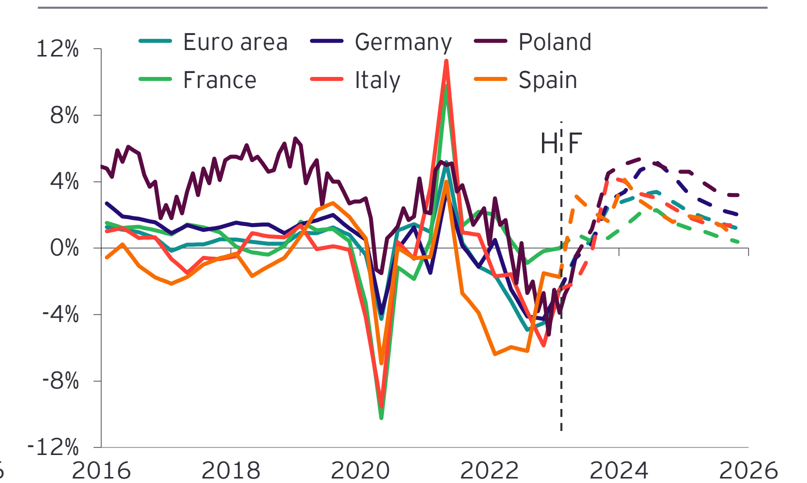
Euro area employment and working hours indexes
2015-23 (2019 Q4 = 100; SA)



Euro area y/y nominal wage growth and Harmonized Index of Consumer Prices (HICP)
2015-25F



Euro area real y/y wage growth[1]
2016-25F



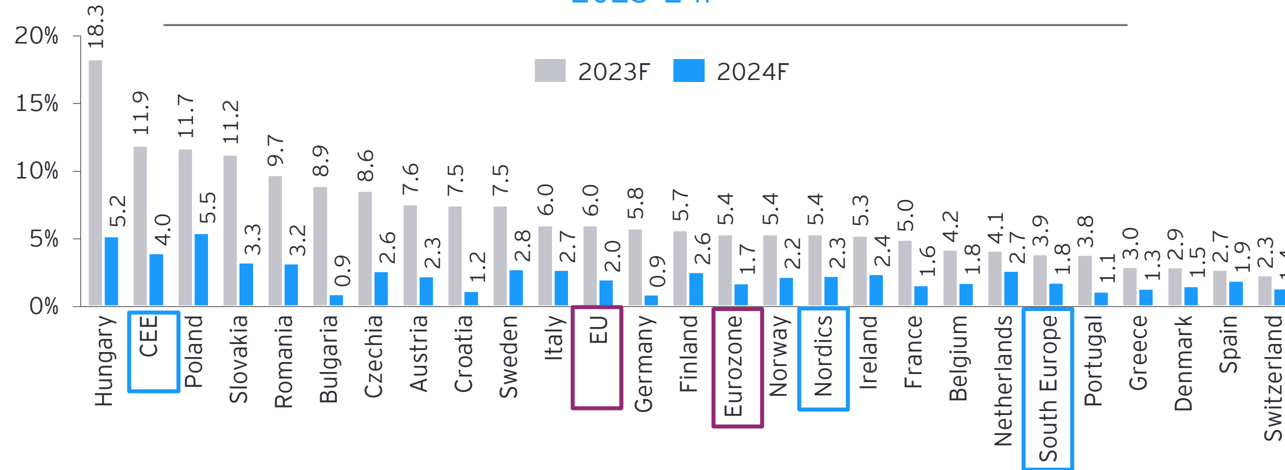
- Despite the economic slowdown, labor markets in Europe have generally remained resilient. Labor demand remains strong, with the job vacancy rate close to its highest level on record. Employment has continued to grow, reaching record high levels in many EU economies, while unemployment rates are at or near historical lows. This is partly due to structural labor shortages that have made companies hold on to their employees more than during past economic downturns.
- Since 2021 Q4, nominal wage growth in the euro area has lagged inflation, resulting in a contraction of real wages, which is unlikely to continue for much longer. With a tight labor market, workers are using their bargaining power to recoup lost income. As headline inflation decelerates, we expect accelerating real wage growth, which, after bottoming at -4.9% in Q3 2022, should turn positive in the third quarter of this year.
- High nominal wage growth, if not absorbed by firms' profit margins, poses a risk for a more prolonged cost-push inflation dynamic and more persistent inflation in services, which are on average much more labor intensive than manufacturing.
- Unfavorable demographic developments in Europe are likely to increase the role of migration policies and stimulate investment in labor-saving and productivity-enhancing technologies.

1. Real wage growth is a three-month moving average for Poland and quarterly data for other economies.

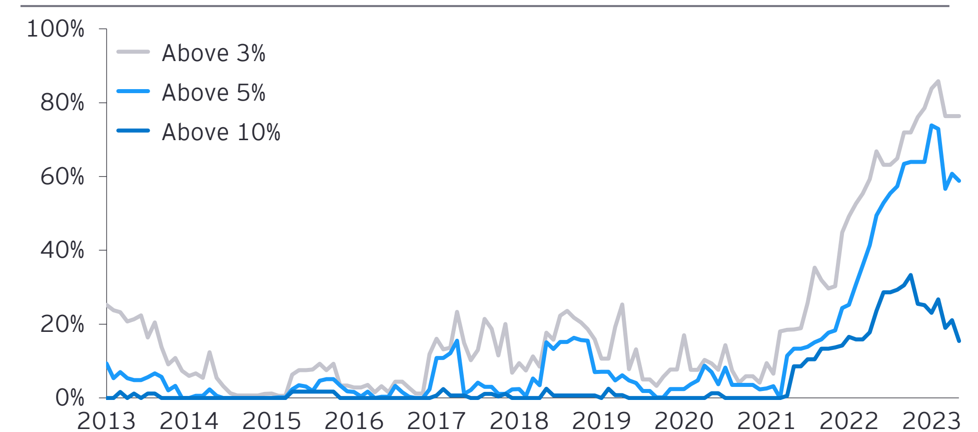
Source: Eurostat; Statistics Poland; EY analysis

Most EU economies will see inflation near or at central bank target by the end of 2024; in CEE, particularly Poland and Hungary, inflation will remain elevated for longer

Euro area HICP y/y inflation growth
2023-24F



Euro area share of product categories by y/y price growth threshold
2013-23



- Inflation in EU countries peaked in 2022 Q4–2023 Q1 and is now quickly decelerating. The disinflation was initially driven by declining energy prices and base effects, but more recently, core and food price inflation rates have also begun to ease, as the effects of previous supply shocks have started to fade and demand faltered.
- While trends in inflation are similar across countries, inflation levels vary significantly, primarily due to differences in the sensitivity to commodity price shocks as well as differences in labor market tightness. CEE countries exhibit the highest inflation rates due to their fossil-fuel energy mix, higher shares of food and energy in inflation baskets, relatively tight labor markets, and past exchange rate depreciation. Southern Europe, on the other hand, exhibits the lowest inflation in the EU as labor slack, despite declining, remains relatively large.
- Disinflation is proceeding faster where inflation was higher, where energy prices fall faster due to government regulations (e.g., Spain) or measurement issues (e.g., the Netherlands and Belgium, where only new energy contracts enter into CPI calculations), or where demand is particularly subdued (Czechia). In Spain, headline inflation has already fallen below the 2% target.
- As the effects of supply shocks fade, we expect inflation in most countries to return relatively close to central bank targets by 2024, with the euro area inflation averaging 1.7% in 2024. Two clear exceptions are Poland and Hungary, where tight labor markets, expansionary fiscal policy and the phase-out of temporary VAT cuts will keep inflation elevated for longer, with headline inflation returning to targets only in 2025 or 2026.

Source: EY analysis

EY Parthenon

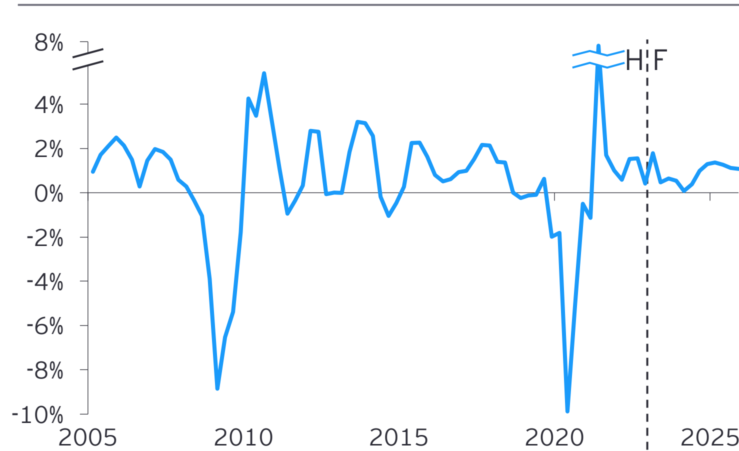
Our baseline anticipates subdued UK GDP growth amid challenging fiscal and monetary policy headwinds, persistent inflation and softening employment trends

- Economic activity in the UK remains subdued. Ongoing strikes and extra public holidays have stymied activity in recent months, but the bigger picture is that GDP has now been stagnant over the 18-month period since the immediate post-pandemic bounce. We expect the economy to avoid an outright technical recession in 2023 and 2024, but the long and variable lags of monetary policy mean that uncertainty is unusually high.
- Elevated inflation will continue to erode household real incomes and pressure the Bank of England (BoE) to tighten monetary policy, constraining consumer spending and business investment. Tighter financial and credit conditions along with increased fiscal headwinds will constrain GDP growth to 0.4% in 2023 and 0.8% in 2024.
- A correction in housing prices is currently in progress with rising mortgage payments weighing on activity. Falling house prices will lead to a negative wealth effect while weighing on confidence and consumer spending activity. However, consumers can still call on pandemic-era savings to cushion the blow, and household balance sheets are more robust than in 2007-08. We are therefore expecting a "correction" with prices falling around 10% to 15% off the back of reduced transaction volumes, rather than a price "crash" as we are unlikely to see the forced selling and bank repossessions that characterized the early 1990's housing crash, or the post-GFC period.
- With headline inflation cooling to 7.9% in June and core inflation moderating slightly to 6.9%, the BoE is likely to favor a 25bps rate hike in July after a 50bps rate increase in June. We then expect one more final 25bp hike, to 5.50%, and a first rate cut in Q2 2024. With forward-looking indicators suggesting inflation will fall further in the second half of 2023, and the labor market now decisively cooling, our monetary policy forecast is more dovish than those of investors, that expect a peak Bank Rate of 5.8% and the first cut to be delayed until late 2024.

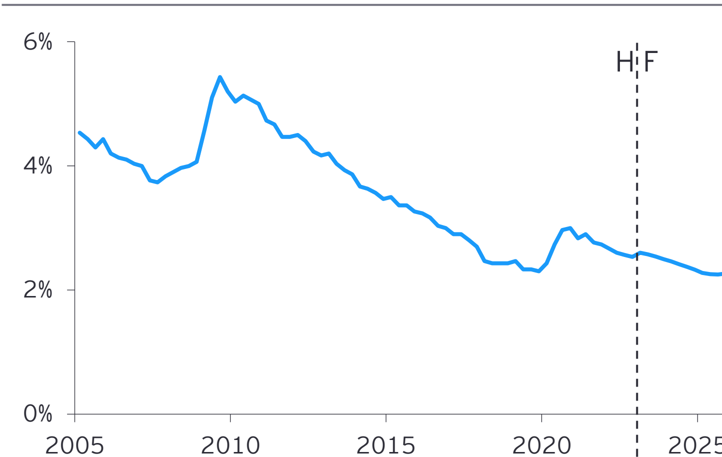
Source: EY analysis

Modest growth is expected in Japan, with some support from stronger wage growth but lingering constraints from elevated inflation and weak global growth

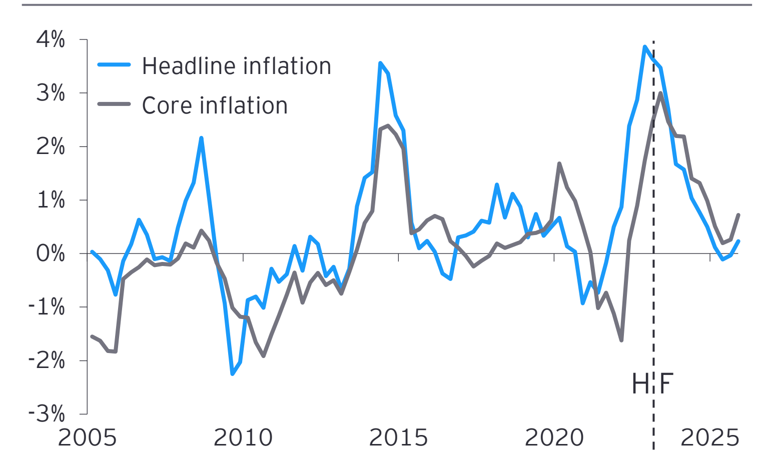
Japan y/y real GDP 2005-25F



Japan unemployment rate 2005-25F



Japan y/y percentage change in CPI 2005-25F

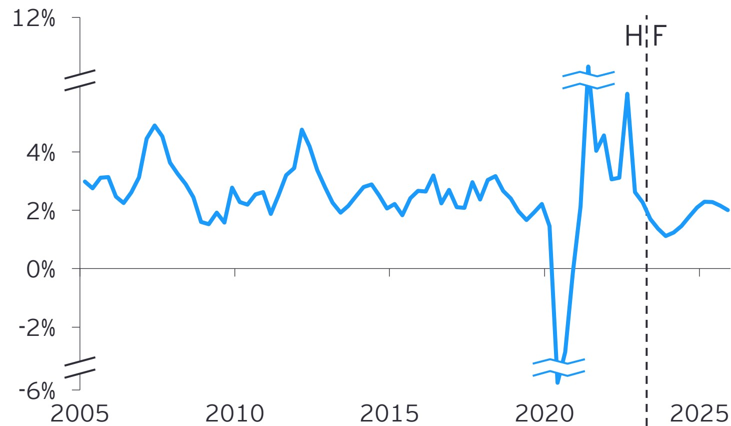


- We anticipate real GDP growth in Japan will average 0.9% in 2023 and 0.7% in 2024, after a 1.0% expansion in 2022. Pent-up demand from the relaxation of COVID-19 restrictions, rebounding tourism activity which remains about 30% lower than pre-pandemic, and rising wage growth should support consumer spending growth in the near term. Still, sluggish global growth will weigh on exports, while persistently elevated inflation erodes household spending power.
- Employment momentum remains resilient, and the unemployment is hovering near pre-pandemic level amid ongoing labor shortages. Consumption momentum is expected to remain moderate with some support from faster inflation-adjusted wage growth while business investment will likely tread sideways with support from rebounding auto production being offset by weak global demand. Stronger productivity growth and decarbonization efforts could represent a medium-term tailwind to growth, however.
- Inflation remains near its four-decade high, with ongoing pressures from food and import prices and greater pass-through of higher input costs onto consumers. We anticipate elevated core inflation pressure will persist into 2024, with an upside risk from faster wage growth momentum stemming from recent wage negotiations. Thereafter, reduced pricing power and cooling inflation expectations should lead to an easing of inflation.
- The Bank of Japan (BoJ) is seen as favoring a dovish approach in the face of what it perceives to be a transitory acceleration in inflation. Governor Kazuo Ueda recently announced a review of the BoJ monetary policy framework, which could last 12 to 18 months, potentially buying the BoJ some time in adjusting policy. Still, more inflation persistence could lead to a tweak in the yield curve control the tolerance corridor on the 10-year Treasury yield as hinted by former BoJ officials.

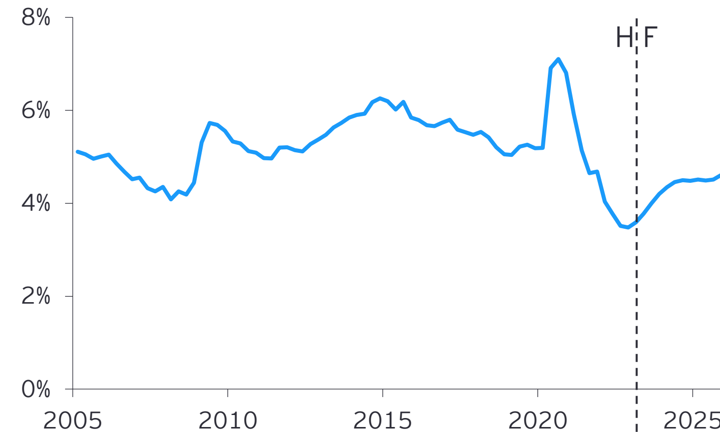
Source: EY analysis

The Australian economy is weighed down by persistent inflation and rising interest rates, but robust labor market conditions continue to support consumer spending

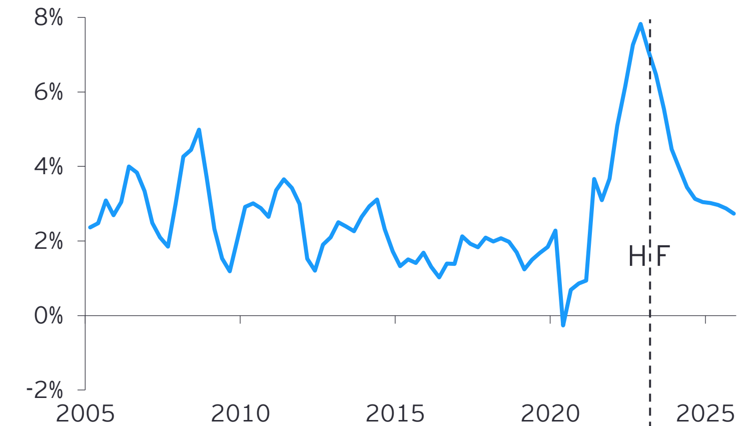
Australia y/y real GDP
2005–25F



Australia unemployment rate
2005–25F



Australia y/y percentage change in CPI[1]
2005–25F



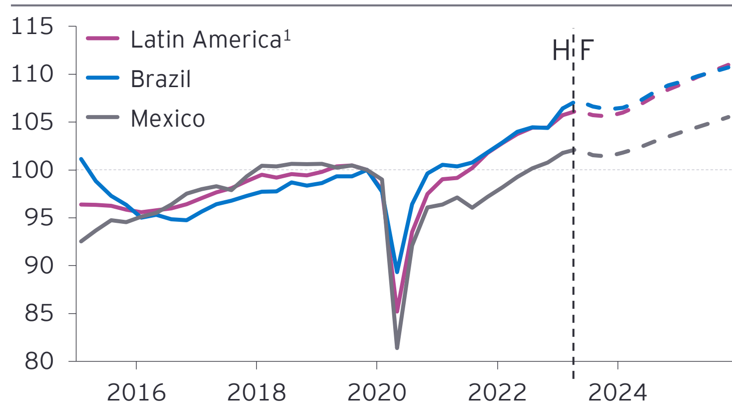
- The Australian economy has slowed, with real GDP rising just 2.3% in annual terms in Q1, but inflation and labor costs are still rising too rapidly, pushing the Reserve Bank of Australia to maintain a tight monetary policy stance.
- Households are feeling the brunt of the monetary tightening, with consumption slowing to 3.5% in annual terms in Q1, having been very strong in the period immediately after lock-downs ended. Higher interest rates, persistent inflation and negative real wage growth are also impacting spending decisions. Households are mainly slowing discretionary spending even if demand services, such as travel, hotels, and cafes and restaurants, remains buoyant. It is likely household spending would have slowed more had it not been for the high proportion of households with low fixed rate mortgages, the strong labor market, savings buffers built up during the pandemic and the recent rise in household wealth.
- Private business investment remains solid despite the challenges. Businesses also continue to exhibit strong demand for labor. The unemployment rate is near a three-decade low of 3.4%, and the participation rate is at a record high. Labor shortages remain a significant constraint on activity despite renewed immigration flows. Job vacancies have eased but remain close to record highs. Wages in Q1 rose by 3.7%, which is the strongest annual growth in over a decade.
- We anticipate the Australian economy will grow 1.6% in 2023 and 1.6% in 2024, after a 3.7% expansion in 2022.

Source: EY analysis

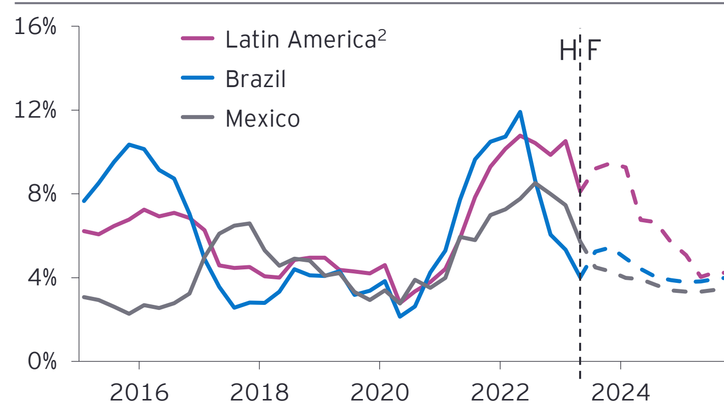
EY Parthenon

While LatAm economies have performed relatively well since the pandemic, they are now set to enter a shallow recession as headwinds are mounting

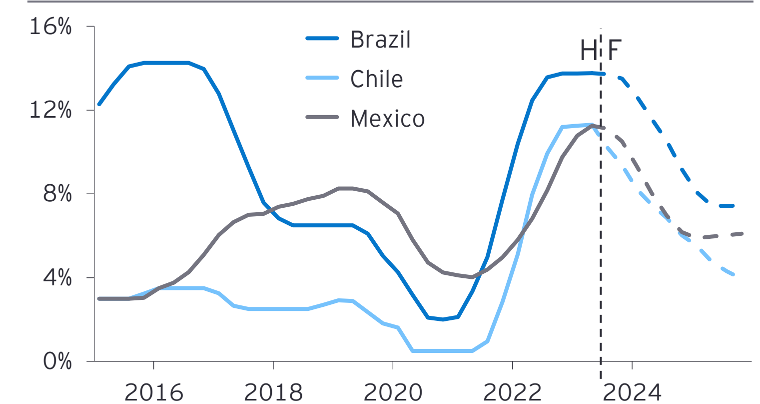
LatAm real GDP (index, 2019 Q4 = 100) 2015-25F



LatAm y/y CPI inflation 2015-25F



LatAm interest rate 2015-25F



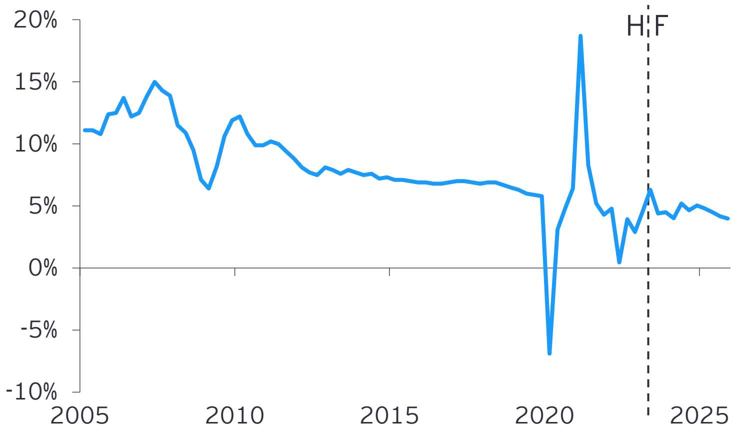
- A robust US recovery after the COVID-19 shock along with higher commodities prices (for commodity exporters) led to a relatively strong post-pandemic recovery in Latin America. Most economies have exceeded the (admittedly shallow) pre-pandemic trend, with Mexico being a key exception.[3] Still, the short-term outlook is less encouraging, with Latin America expected to contract in the 2023H2, with a peak to trough GDP decline of 0.6%.
- Domestic and international monetary policy tightening, a slowdown in global industrial activity, and weak growth in the US will weigh on activity in Latin America. On an annual average basis, the economy will nevertheless increase by 1.9% in 2023 thanks to a strong 2023H1 and a positive carry-over effect. Growth will reaccelerate through next year supported by mildly stronger global growth and easing monetary policy, though a negative carry-over will cap annual GDP growth at 1.3%.
- Brazil, as a net exporter of raw materials and agriculture products, benefited from high commodities prices in 2021 and 2022. Even though growth surprised to the upside at the beginning of 2023 thanks to stronger agricultural output, GDP is expected to decline over the second half of 2023 as a result of a deterioration in terms of trade, weak global demand and tighter financial conditions. Mexico's GDP has shown similar resilience at the start of 2023 but is also expected to contract in 2023H2 on the back of weaker growth in the US and fiscal consolidation efforts.
- In Latin America, inflation increased to similar levels as in advanced economies, though by LatAm standards, it was not an extreme inflation episode. Both external factors (high commodities and industrial prices) and strong domestic demand contributed to stronger price pressures. Inflation has already started to decline, though the timing differs somewhat across countries; disinflation is almost complete in Brazil, while it remains elevated in other economies like Colombia. Inflation is set to return to inflation targets (which tend to be higher than in AEs) by the end of 2024. Argentina is an outlier, where inflation keeps on going up (currently exceeds 100%) due to the monetary financing of the budget deficit.
- LatAm central banks tightened monetary policy earlier and more aggressively than in advanced economies. In most cases, the tightening cycle has already been concluded. Given relatively high interest rates and ongoing disinflation, monetary policy easing is likely to begin earlier — in some cases already this year. Both in Brazil and Mexico, we expect the first rate cut to come in September, though in Mexico this may be delayed given the stickiness of core inflation and further monetary policy tightening in the US.

1. Excluding Venezuela.
2. Excluding Venezuela and Argentina.
3. An outsourcing services ban introduced in 2021 Q3 led to a permanently depressed value added in business services (in April 2023, it was over 40% below the February 2020 level).

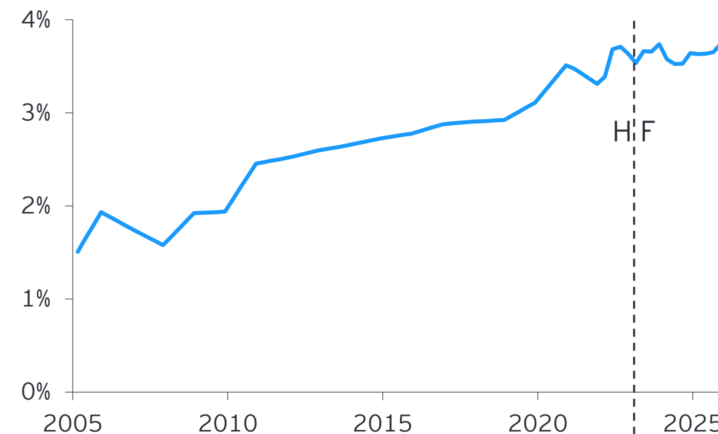
Source: EY analysis

China to experience lackluster growth amid industrial sector slack, high precautionary savings, elevated youth unemployment, and property sector and export weakness

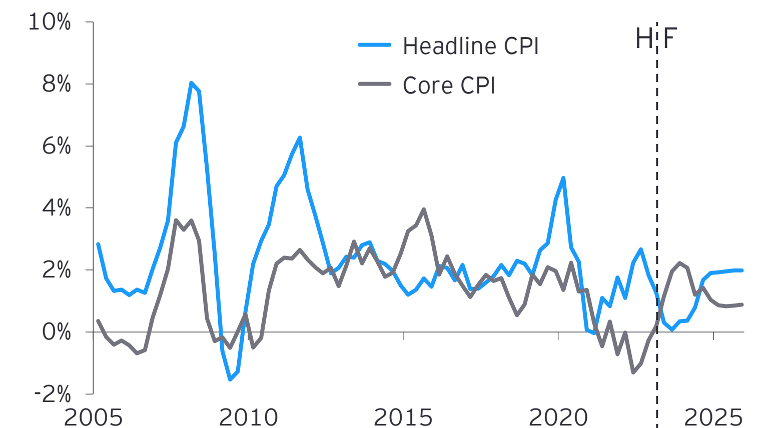
China y/y real GDP
2005–25F



China unemployment rate
2005–25F



China y/y percentage change in CPI
2005–25F

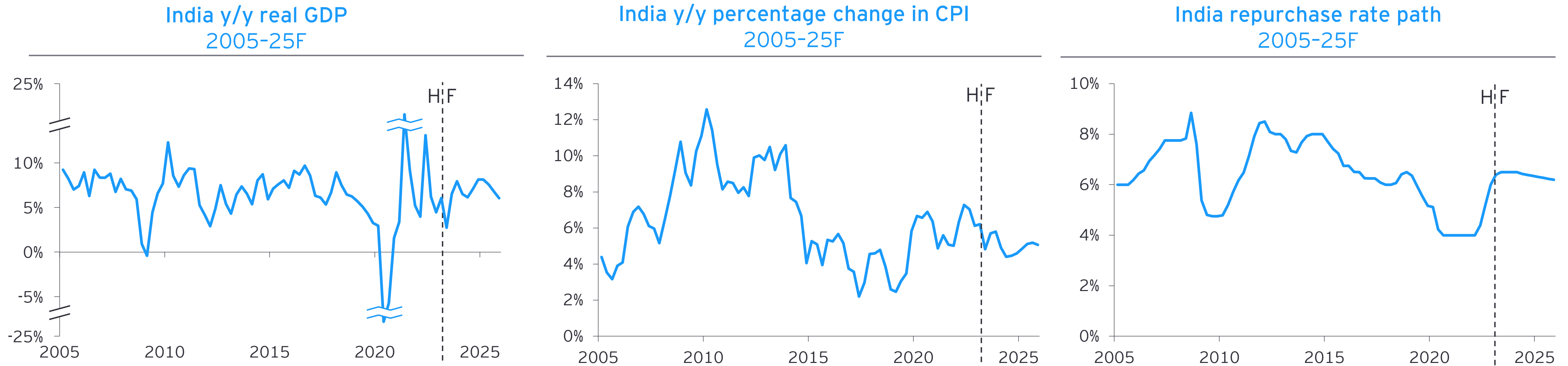


- The post-COVID-19 reopening boost is rapidly fading, with weak consumer sentiment and slowing credit growth constraining consumer spending and real estate activity. While the savings rate will likely ease in the coming months, it remains excessively high, above 35%, meaning the consumer spending engine is insufficient to offset export weakness in the face of slowing global growth. This is especially true given the elevated youth unemployment rate of over 21% — double the rate pre-pandemic — and the moderate pace of wage growth around 7%–8% (vs. 10% pre-pandemic).
- Weak investor and business confidence continues to weigh on stock prices and limit domestic and foreign investment. Lower profit growth comes at a time when debt-servicing costs have risen, thereby constraining business investment activity and manufacturing output. Private fixed assets investments contracted 0.1% in May year to date amid an apparent inventory destocking cycle.
- Within the housing sector, activity is under ongoing pressure, with new home sales by the 100 biggest real estate developers down 28% relative to last year. With authorities wanting to avoid repeating the excess leverage errors of the past, we anticipate gradual and targeted property sector stimulus measures, including an ease in home rebuying conditions and a push to increase local government bond issuance to finance property developers. Still, with private sector confidence weakened and risk appetite being limited, credit easing won't be the silver bullet. We expect GDP growth to average 4.9% in 2023 and 4.7% in 2024.
- The issue in China is not inflation; rather, it's the risk of deflation amid declining commodities prices and slowing final demand. CPI inflation is likely to be close to flat in the coming quarters — well below the People's Bank of China (PBoC) 3% target — while producers will decline. In this context, the PBoC will continue to favor easing monetary policy, thereby exacerbating downward pressure on the renminbi. Authorities are also considering additional fiscal support measures to stimulate growth in the property sector.

Source: China National Bureau of Statistics; EY analysis

EY Parthenon

Our baseline suggests sustained economic recovery and an extended pause on the policy rate



- India's economic growth continues to exhibit resilience to global headwinds. At 7.2% y/y growth in FY23, the Indian economy remains among the fastest-growing large economies.
- In FY24, economic growth is expected to remain relatively strong at around 6% year-over-year aided by government's continued capex push, moderation in commodity prices, and healthy balance sheets of banks and corporates. A weaker external demand environment and a possible adverse impact of El Nino (partly offset by the possibility of a positive Indian Ocean Dipole) on agriculture outlook could pose downside risks to overall economic growth.
- In recent months, headline CPI inflation has moderated to within the central bank's target range of 4% (+/-2%) aided by favorable annual comparisons, a decrease in input prices, monetary policy tightening and supply-side measures. Ongoing uncertainty about the monsoon rainfall continues, which could pose near-term risks to the inflation outlook.
- The Reserve Bank of India (RBI) maintained a "hawkish pause" in its June policy meeting, keeping the repo rate unchanged at 6.5%, after cumulative rate hikes of 250 basis points since May 2022. The RBI's inflation projection of 5.1% y/y in FY24 (down from 6.7% y/y in FY23) and a reinforced commitment to aligning inflation with the target suggest that the central bank will not be in a hurry to cut rates this year.
- We anticipate India's GDP will grow 5.9% in 2023 and 7.0% in 2024.

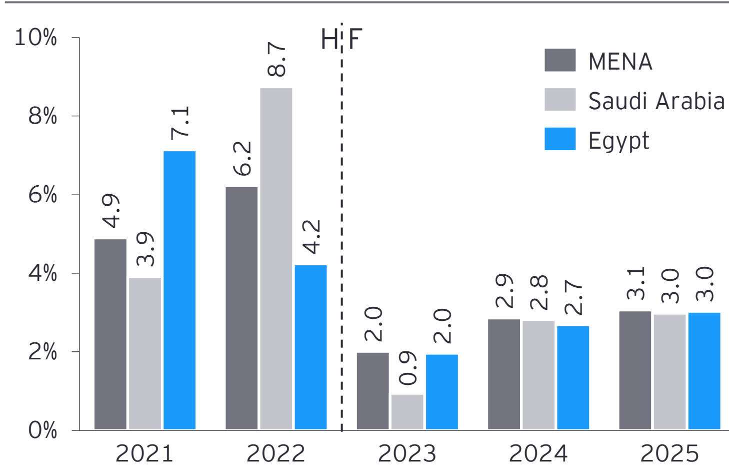
1. Real GDP growth numbers are for financial year (e.g., 2010–11 refers to April 2010 to March 2011).

Source: Reserve Bank of India; Refinitiv Eikon; EY analysis

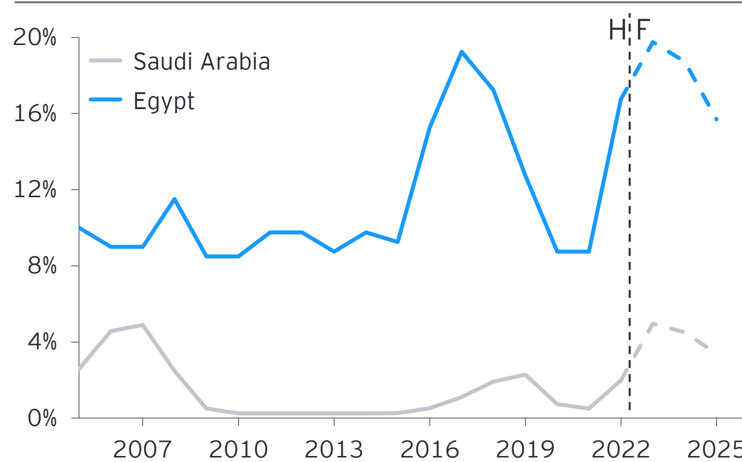
EY Parthenon

The MENA economic outlook improves beyond 2023, but uncertainty remains high amid idiosyncratic downside risks

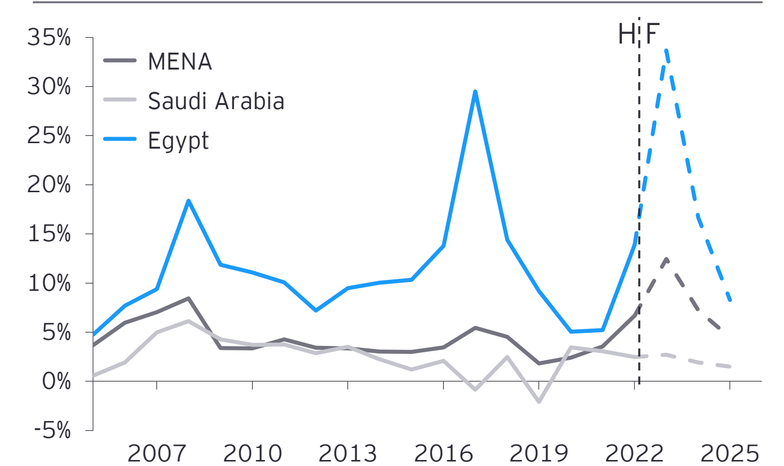
MENA, Saudi Arabia and Egypt y/y real GDP 2021-25F



Saudi Arabia and Egypt interest rate 2005-25F



MENA, Saudi Arabia and Egypt y/y percentage change in CPI 2005-25F



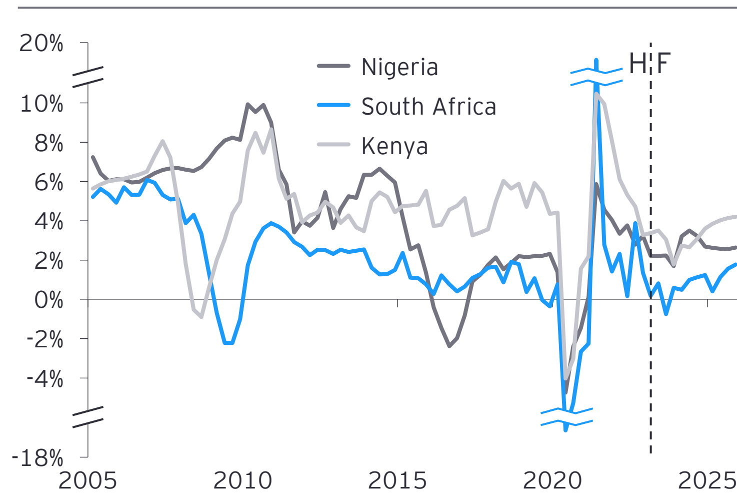
- The outlook for the Middle East and Northern Africa (MENA[1]) points to an expected slowdown in FY23 on the back of slower global economic activity, tighter monetary policy to curb inflation and oil producers cutting supply to maintain a price floor. Growth is expected to modestly rebound in 2024.
- The sustained oil production cut is expected to weigh on Saudi Arabia's economic growth forecast this year. Production will fall again as Saudi Arabia has vowed to maintain the 0.5m barrels per day (b/d) production cut in June and cut by 1m b/d in July and August, with a possible extension. Global recessionary fears, as the global monetary policy tightening cycle continues, could outweigh the impact of oil supply cuts on crude oil prices. In turn, this may cause the fiscal balance to fall short of the government's target for FY23 (0.4% of GDP). However, non-oil GDP should protect the economy from a possible contraction, as purchasing managers continue to display optimism.
- The foreign exchange liquidity crunch is keeping its grip on Egypt's economy, with the impact of previous devaluation cycles reflecting on headline inflation, which recorded an all-time high of 35.7% in June 2023. The continuing surge in inflation may increase pressure on Egypt's central bank to raise interest rates further this year. The Central Bank of Egypt opted to keep its monetary policy rate at 18.25% during two consecutive meetings, as it assesses the overall impact of the cumulative 1,000bps increase since March 2022. Consequently, reduced consumer spending has slowed economic growth, estimated around 2.0% in 2023 (vs. 4.2% in 2022).

1. MENA includes Algeria, Bahrain, Egypt, Iraq, Israel, Kuwait, Morocco, Oman, Qatar, Saudi Arabia and United Arab Emirates. For CPI, GDP weighted average.

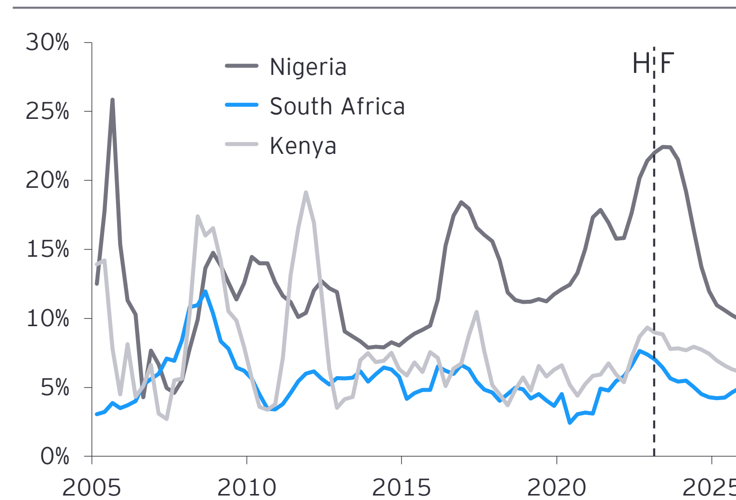
Source: EY analysis

Excluding some lagging economies, real economic activity is set to remain relatively strong across Africa, with inflation and interest rates set to decline post-2023

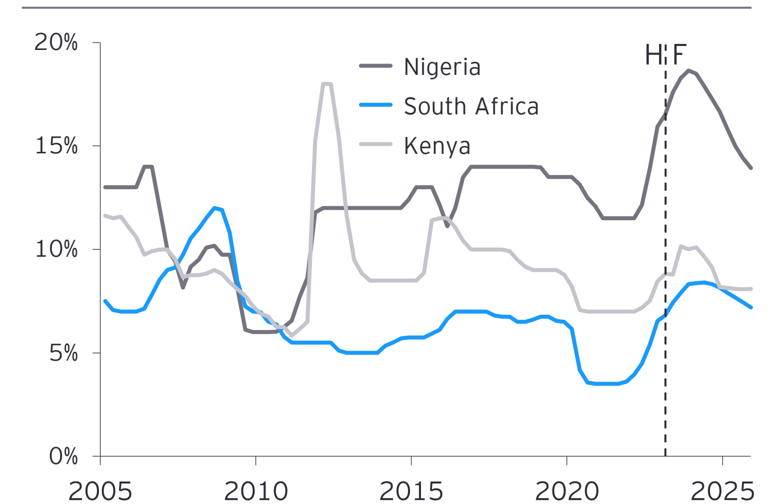
Sub-Saharan Africa y/y real GDP 2005-25F



Sub-Saharan Africa y/y percentage change in CPI 2005-25F



Sub-Saharan Africa repurchase rate path 2005-25F



- The Sub-Saharan African (SSA) outlook is relatively promising, although elevated sovereign and private debt levels are concerning, especially for extremely low-income economies. Most African economies are unlikely to experience near-term recessions, but unsustainable levels of debt (and elevated debt servicing costs) will negatively impact fiscal and personal financial sustainability over the medium term.
- South Africa's economic performance – among the worst of the SSA economies – has been weighed down by load-shedding (rotational power cuts) and geopolitical tensions with the United States and the EU in the wake of its perceived support of Russia. These geopolitical tensions will likely be to the detriment of South Africa's trade and investment relations with the United States and EU.
- Nigeria's new president has started implementing structural reforms in the wake of his victory. These reforms include the application of a floating exchange rate (to ease liquidity constraints) and the removal of fuel subsidies, aimed at rooting out corruption and improving fiscal sustainability.
- Kenya's economic performance remains robust, with inflation set to decrease and foreign trade set to ramp up as a result of the ratification of a new trade agreement with the EU (with a primary focus on agricultural exports from Kenya). Government expenditure is rising rapidly with positive economic growth spillovers but growing fiscal sustainability risks.

Source: Statistics South Africa; Intelligence Fusion; EMIS; Central Bank of Nigeria; PwC; EY analysis

EY Parthenon

Agenda

- Global snapshot
- Country and regional outlooks
- **Meet the team and explore our resources**

EY Parthenon

Meet the EY contributors to the global outlook and further explore content

Global/US

Gregory Daco
Chief Economist – Global & US
New York, US
gregory.daco@parthenon.ey.com

Lydia Boussour
Senior Economist – Global & US
New York, US
lydia.boussour@parthenon.ey.com

US Macroeconomics team webpage

Global/EMEIA

Marek Rozkrut
Chief Economist – Global & EMEIA
Warsaw, Poland
marek.rozkrut@pl.ey.com

Maciej Stefański
Senior Economist – Global & EMEIA
Warsaw, Poland
maciej.stefanski@pl.ey.com

EMEIA team webpage

UK

Peter Arnold
Chief Economist – UK
London, UK
parnold@uk.ey.com

ITEM Club

UK Economics for Business

Oceania

Cherelle Murphy
Chief Economist – Oceania
Canberra, Australia
cherelle.murphy@au.ey.com

Oceania Economics

Middle East and Africa

Angelika Goliger
EY Africa Chief Economist
Johannesburg, South Africa
angelika.s.goliger@za.ey.com

Armando Ferreira
Economic Advisory MENA Leader
Dubai, UAE
armando.ferreira@ae.ey.com

India

Pramod Chowdhary
Senior Manager,
EY Global Delivery Services India LLP
Gurgaon, India
pramod.chowdhary@gds.ey.com

EY Parthenon

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

About EY-Parthenon

EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their ecosystems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized – helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

© 2023 Ernst & Young LLP.
All Rights Reserved.

US SCORE no. 20443-231US
2307-4275575
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com