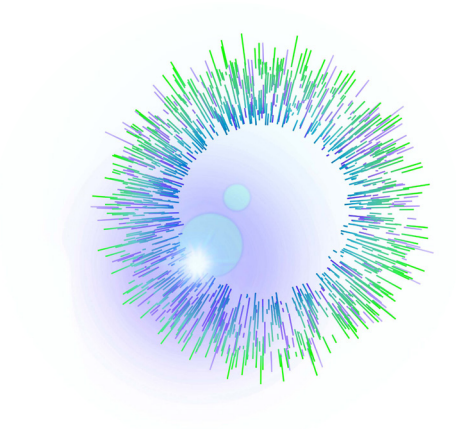
Deloitte.

Deloitte CFO Vision

5-minute read



The global panel debate – perspectives from our economists

Based on an event held on 29 November 2022

With major geopolitical events impacting markets, CFOs have become more pessimistic about the prospects for regional economies. Here, three of our Deloitte economists share their expectations for 2023.

Q How would you assess the outlook for growth over the next year?

Ira: Globally, we'll see slower growth, certainly. I think there will be a recession in Europe, and an acceleration of growth in China, but still very slow compared with history. In the US, my guess is we'll just about avoid a recession.
Although we're seeing significant tightening of monetary policy and fiscal contraction, declining real incomes and a very sharp drop in housing market activity, there are offsetting factors in the US. These include the fact that consumer spending and business investment continue to grow. Plus, the US has not suffered as much from the energy crisis. So, I think there may be a one in three chance of recession in the US, and a 90 to 100% chance for Europe. The bigger question is what happens in emerging markets, many of which are highly stressed. That could be a big negative for the global economy going forward.
Sitao: In the broader Asia-Pacific region, New Zealand and Australia are doing great. India is doing better than most of the emerging markets, which bodes well for this part of the world. North Asia is a different story. I think Japan remains weak and in China, growth will be around 4.5% next year.
Ian: The UK is already in recession and Europe has seen the biggest inflation shock in more than 30 years. And there's been an incredible switch away from Russian energy since February – Europe has reduced its use by 80%. But that tells you something about the price of energy and the pressure on lots of sectors, like bulk chemicals and manufacturing. If Germany goes into recession, it's extremely hard for the rest of Western Europe to avoid it. We're planning on the basis of a contraction in Eurozone growth in 2023 and a recovery in 2024.

Q At what level do you expect interest rates to peak and when?

Ian: In the UK, interest rates this time last year were 0.5% and they're now 3%. We think they'll peak around 4.5% to 5% in the second quarter of next year, which means the UK has done about two thirds of the tightening it needs to do. I think there's much more to come in terms of European rates, which are 1.5%. We're probably looking at a terminal rate around 3%, so a doubling of growth. One of the big stories for corporates and households in 2023 will be the effect of tighter credit conditions on an economy that, for 10 years, has had extraordinarily low interest rates.

> "There are a number of disruptions that have taken place that are here to stay, and companies will have to deal with that. One is the labour shortage – that's not going away." **Dr Ira Kalish**

Speakers

Host:
Anna Marks,
Partner and Global/NSE Board member and UK Vice Chair, Deloitte

Panellist:
Ian Stewart,
UK Chief Economist, Deloitte

Panellist:
Dr Ira Kalish,
Chief Global Economist, Deloitte Touche Tohmatsu Ltd

Panellist:
Sitao Xu,
Chief Economist, Deloitte China

Q Any perspectives from the US in terms of interest rates?

Ira: Inflation has already peaked, unlike in Europe, and has been decelerating. We've seen a change in consumer behaviour, from goods back to services, removing some of the pressure on supply chains. We've also seen a decline in oil prices and the economy slowing because of monetary and fiscal contraction. One could make the argument that the Fed has already done as much as it needs to do. However, we know monetary policy works with a lag. It could be that the Fed has gone far enough and just needs to wait but it won't because I think it wants to anchor expectations of inflation.
Its worry is that inflation becomes entrenched in market psychology, leading to maybe a wage price spiral. But that hasn't happened yet. In fact, real wages have declined. The rate is now at 3.75% and I think it'll peak at 5% in mid-2023 and then pause. Maybe, by early 2024, rates will start to be cut.

Q Why is UK productivity so low?

Ian: This is probably the Holy Grail of economics. It's gone badly wrong in the UK since the financial crisis – even before then it was showing significantly lower levels of productivity compared with other G7 economies. I think it's a combination of things. It's the way in which uncertainty and political volatility, particularly around Brexit, has restrained risk appetite and investments. There was scarring during the financial crisis. Also, we lag internationally in terms of vocational training, our public infrastructure is not in the top tier and there are questions around the availability of finance, particularly for small and growing businesses.
The UK has some of the most productive companies in the entire world. It also has a long tail of low productivity economies and what the data shows is that companies operating in the same sector, if they're foreign owned, will be much more productive. I think what that's telling you is, assuming all these factors are fixed, there are companies that are much better at extracting productivity than British ones.

Q Is the Chinese economy on the brink of a sharp asset value contraction?

Sitao: I would say the market is still investable, but you have to quantify policy risks. We're seeing the attitude towards the zero-COVID policy and I think that's a very good test. It's really about how leaderships should view and weigh cost versus benefit. There's a huge difference between Western and Asian culture, and particularly Chinese culture. I think leaders will never admit mistakes but sometimes they quietly change course. My prediction is they will moderate some of these approaches very soon, for example, there has been a big announcement on rolling out the vaccine for people over 80.

Q What do you think the magnitude of corporate insolvencies will be?

Ian: Insolvencies tend to be highly cyclical. I think, next year, we'll see that the slowdown is under way. As Ira said, monetary policy lags so we'll see more signs of stress in the real economy, in terms of arrears, late payments, insolvencies and unemployment. Those are the conditions that prevail in a recession.

Q Are you concerned about current US/China trade relations?

Ira: I don't think we're likely to go back to the friendly relationship that existed prior to Trump, and there are a number of reasons for that. One is we had Trump and we had tariffs, and they were popular even though they damaged the US economy. And Biden hasn't reversed those tariffs. Rather, he has imposed even more draconian restrictions on China. Meanwhile, the Chinese regime has become more statist and authoritarian. But both sides probably recognise that there are still common economic interests and there's a great deal of trade and cross-border investment. I suspect that when Biden and Xi met recently they agreed to disagree on the things that are disagreeable, but not throw out the benefits of the economic relationship.

> "[On US/China relations] I don't think we're going to go back to a strategic dialogue between the two countries, but at a working level I think there will be discussions." **Sitao Xu**

Sitao: I take a more sanguine view for the following reason – in the past six months there were echo chambers in both countries due to internal politics, Party Congress and mid-term elections and, finally, we've got these out of the way. That's a positive. Secondly, I think the meeting between the two leaders was more than just that. There were backdoor channels between the two countries. Right now, there are a lot of low hanging fruit items that can be done.

> "There has been a profound change, certainly in this country, in the nature of work. It's probably the biggest change we've seen since the invention of the modern office." **Ian Stewart**

Q Will recent world events and the pandemic cause lasting change to corporate behaviour?

Ian: If you're running a business for an economy that's predictable you run it in a different way than you would if it's much less predictable. There will be a greater emphasis on resilience and balance sheet strength, and the change in the nature of work. Also, we're seeing a consistent focus on technology, improving services, productivity, and all things digital. The other thing is the energy transition – and it goes far beyond energy, it's an industrial revolution.
Sitao: For a very long time, corporates have taken low interest rates for granted and this is particularly true in Asia. In terms of rates of return over the next few years, I think you will really need to adjust your expectations in a very, very significant way.
Ira: This new way of working changes how we manage labour, and businesses are not investing in office buildings and shopping centres, they're investing in digital transformation. Then we've had massive supply chain disruption – we've learned supply chains are more fragile than we used to assume. Companies and governments will also have to deal with a new world where climate change is disruptive to what they do, and they will have to find solutions to that.