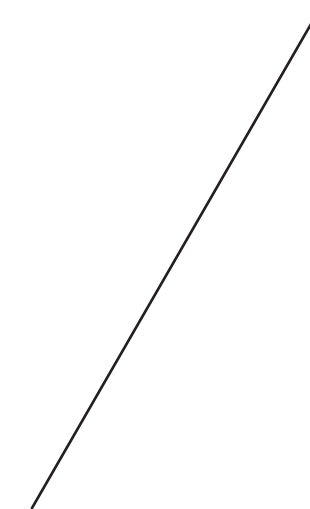


# 23

ANNUAL

FROM  
DARKNESS  
TO DAWN



GLOBAL  
MARKET  
OUTLOOK

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# SYNOPSIS

Declining inflation should allow central banks to eventually pivot to an easing bias. A recession seems likely in 2023, and equity markets may struggle. However, we think that a global economic recovery should be on the horizon by the end of 2023.

## KEY MARKET THEMES

While we expect economic news to deteriorate in 2023, it's possible the worst falls in equity markets have already occurred, given that markets are forward-looking and usually price in bad economic outcomes ahead of time. This may be the case if the U.S. experiences only a mild recession in 2023, versus a more severe downturn. On the other hand, markets may transition from the current *bad news is good* narrative that sees soft economic data as heralding a U.S. Federal Reserve (Fed) pivot to a *bad news is bad* scenario, where fears of a significant contraction in profits and jobs lead to further losses.

The main issue for 2023 is whether inflation pressures ease by enough to allow central banks to step away from rate hikes and potentially begin easing. We expect inflation will be on a downward trend as global demand slows. In our view, this should allow central banks to eventually change direction and set the scene for the next economic upswing in late 2023.

In the U.S., we believe a recession is the most likely outcome in the next 12 months, given the extent of monetary tightening. Market expectations are that the federal funds rate will rise from its current range of 3.75%-4.0% to around 5.0% by March 2023. However, with household and corporate balance sheets in good shape and no significant obvious economic imbalances—aside from inflation—we expect the downturn to be relatively mild.

In the eurozone, the outlook has improved marginally, as it now appears energy rationing will not be required and forced shutdowns of energy-intensive industries are unlikely. That said, a recession still appears unavoidable. In addition, more European Central Bank (ECB) tightening seems likely given the labour market pressures—at 6.6%, the region's unemployment rate is the lowest since the start of the common currency. Market expectations are for the ECB deposit rate to peak in the range of 2.75%-3.0% by the second quarter of 2023.



In the UK, a prolonged recession appears likely, as monetary tightening, fiscal tightening, the energy price shock and supply-side constraints from Brexit combine to create a challenging outlook. GDP (gross domestic product) has yet to regain pre-COVID-19 lockdown levels, but labour-supply shortages have driven the unemployment rate to the lowest level since 1973.

We believe 2023 should be the year that the Chinese economy eventually exits *zero-COVID* government rules, after having spent most of 2022 under intense restrictions. A key watchpoint for 2023 is China's struggling property market. The Chinese government has announced new support measures, but they do not appear large enough to create a sustained recovery.

In Japan, the country is set for a year of softer economic growth in 2023. Domestic demand is weakening and there is slowing demand for Japanese exports. Unlike the rest of the world, Japan is still operating below capacity, which means it doesn't face the risk of monetary overtightening.

We think inflation has likely peaked in Australia, which should allow the Reserve Bank of Australia to go on pause ahead of other major central banks. A less aggressive central bank would mean a lower risk of recession in Australia than in Europe or the U.S.

In Canada, we believe a recession is probably unavoidable in 2023, as the lagged effects of very tight monetary policy should soon catch up with overindebted households. In addition, a slowing global economy will be a drag on commodity prices, challenging exports.

## ECONOMIC VIEWS



### MILD U.S. RECESSION

A 2023 recession in the U.S. will probably be mild, with a lower-than-median decline in GDP and a smaller-than-usual rise in the unemployment rate.



### CHINA STIMULUS

We expect more support measures from China's government to improve confidence in the housing sector and to boost spending when the economy reopens.



### EUROZONE INFLATION

The eurozone inflation falling during 2023 as the region's economy weakens, potentially moving toward 2% by the end of the year—although this is dependent on energy prices stabilising.



### FED POLICY

The U.S. unemployment rate should rise by at least two percentage points in 2023 if the nation experiences a mild recession—creating the type of disinflationary pressure that would allow the Fed to begin easing.



### UK BASE RATE

Markets are predicting that the Bank of England's (BoE) base rate will rise from 3% currently to 4.5% by the second quarter of 2023. It's questionable whether the BoE will be able to lift rates by this much, given the direction of the economy.

## ASSET CLASS VIEWS

### Equities: Limited upside

Equities have limited upside with recession risks on the horizon. Although non-U.S. developed equities are cheaper than U.S. equities, we have a neutral preference until the Fed become less hawkish and the U.S. dollar weakens.

### Fixed income: Improved valuations for government bonds

Government bond valuations have improved after the rise in yields. We see U.S., UK and German bonds as offering good value. Japanese bonds still look expensive, with the Bank of Japan (BOJ) defending the 25-basis-point yield limit. Yields have risen sharply in most markets in recent months. The risk of a further significant selloff seems limited, given that inflation is close to peaking and markets have priced in hawkish outlooks for most central banks.

### Currencies: Strong U.S. dollar could weaken in late 2023

The U.S. dollar could weaken if inflation begins to decline and the Fed pivots to a less-hawkish stance in early 2023. The main beneficiaries are likely to be the euro and the Japanese yen. The yen could also appreciate strongly if the successor to BOJ governor Haruhiko Kuroda moves away from the current *yield curve control* strategy.



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## IMPORTANT INFORMATION

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