2023 Economic Outlook

Serious risks for U.S. economy as recession looms

What leaders can do to not destroy corporate value in 2023

© 2023 Copyright Trade Capital Corporation. All Rights Reserved.

The TCC mantra: Back to basics, cash is king

Prelude: Companies will battle stagflation, inflation and demand compression.

Not the best news to start a forecast with – The United States is likely to head into a recession in 2023, and stagflation is almost a certainty. The Federal Reserve appears to be telling us that the way to battle inflation is through a recession, and right now the Fed is more concerned about inflation. Only when growth truly goes negative will the US be able to contain its rampant price pressures. TCC was pretty spot-on with our 2022 economic forecast, and while the gloomiest economists' predictions for 2022 did not come to pass, serious risks continue to loom over the global economy in 2023.

As the economy slows many countries also face the risk of falling into recession in 2023. In the US higher interest rates caused by the Fed's action against inflation will impact the housing market demand and will potentially raise unemployment. Inflation together with a strong dollar makes US goods expensive and hard-currency debts harder to service. Europe is already dealing with an intense energy crisis that is impacting its manufacturing sector and the general population, as it prays for winter weather to be benign. China is fighting a housing-market depression and the resultant instability caused by its zero-Covid policy and impulse-driven lockdowns.

Share prices took a beating in 2022 as corporations cut costs, laid off personnel, and deployed cost squeezes and hiring freezes. Ford Motor Company reported that its costs in the third quarter of the year were $1 billion higher than it had anticipated, for instance — an overshoot equivalent to about 25 percent of its adjusted operating profits in the second quarter. In the euro area, producer prices rocketed at annual rates exceeding 40 percent on the back of increases in energy prices. Yet even as costs surged, consumer demand remained strong, still sustained by generous fiscal stimulus deployed during the pandemic.

There is a likelihood that the first half of 2023 may bring about some positives. Europe has enough gas in storage to make it through a mild winter without a major crisis. Commodity prices will stay high and volatile, but merely not repeating their rapid ascent of 2022 will be enough to cause headline annual inflation to fall somewhat. This will take pressure off the Federal Reserve to a more moderate level.

Against this backdrop, TCC makes the following predictions for 2023:

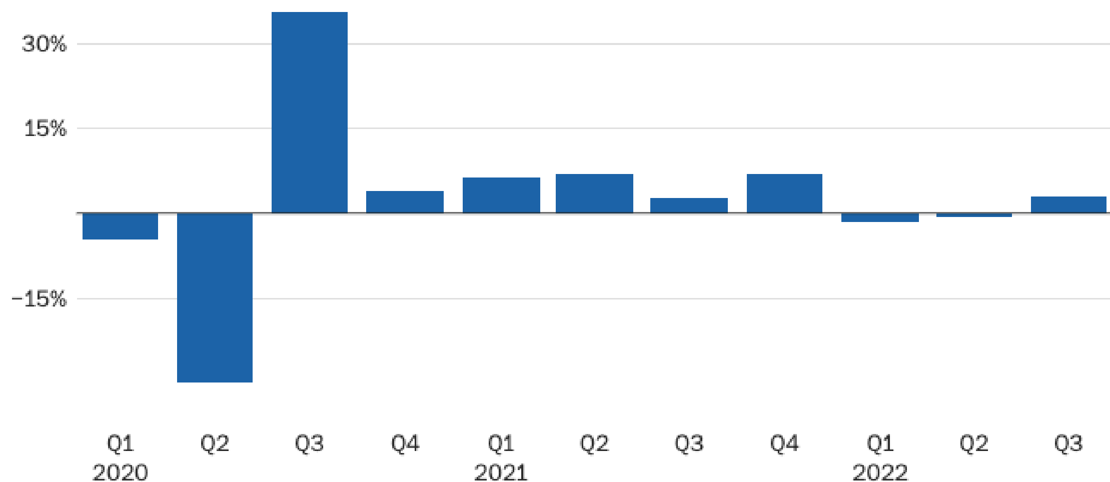
1. Overall, we predict a more likely *soft-landing scenario*, in which inflation starts to drop over the following six months and the Fed responds by reducing the frequency of rate increases. As a result, tighter policy could affect the entire economy without causing an extreme correction. It is anticipated that there won't be any more increases after May 2023. In this case, the stock market would see volatility and stay downbeat until the beginning of 2023, when markets would be able to adapt to a new monetary policy strategy.

A *less likely hard landing scenario* involves inflation growing pervasively across the economy, necessitating the Fed to enact even higher interest rates, causing the economy great harm in the process.

2. GDP growth in 2023 – globally muted.

Global GDP growth in 2023 is forecast to climb 1.6 percent. Developed Market growth is forecast at 0.8 percent, US growth is forecast at 1 percent, Euro Area growth is projected to come in at 0.2 percent, China's economy is forecast to grow 4.0 percent and Emerging Market (EM) growth is forecast at 2.9 percent in 2023.

More broadly, the US economy has rebounded after unexpectedly shrinking in early 2022. An increase in government spending and a narrowing trade gap, with American retailers importing less and exporting more, helped gross domestic product late in the year. But economists warn that those gains could be short-lived as major parts of the economy, including housing and consumer spending, continue to moderate. The irony is, we are seeing the strongest growth of the year when things are slowing.



Source: U.S. Bureau of Economic Analysis

3. Global trade and manufacturing – new opportunities and partnerships

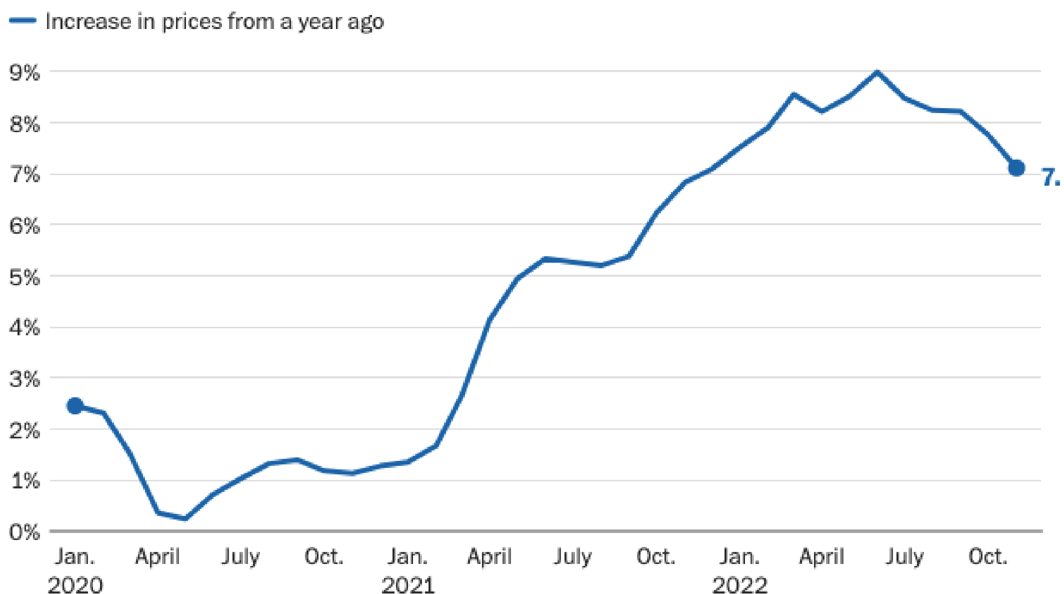
It isn't just the housing market that's in free fall. Americans are spending less on other big-ticket items, too, such as furniture, cars and appliances that were in high demand early in the pandemic. As a result, US manufacturing — considered an early indicator of where the economy is headed — has been on a steadily downward path.

The world will see changing international trade relations. While US-China relations remain tense, new opportunities for EM countries other than China may arise from the restructuring of crucial supply chains. We predict new partnerships between the United States and Latin America, Southeast Asian nations unaffiliated with China, and India, in sectors including consumer and industrial goods. In the meantime, we anticipate China will maintain the efforts it first cultivated through its Belt and Road infrastructure initiative to pursue economic union with some of those same nations.

4. Inflation – to subside, though not dramatically.

Americans are finally beginning to feel relief after months of rapidly rising prices on basics such as food, fuel and rent. Overall inflation has fallen for five straight months and is expected to continue its descent in 2023.

From chicken wings to used cars, inflation begins to ease its grip. Several goods - including bacon, doughnuts and potatoes - have actually gotten cheaper in recent months, as pandemic-related product shortages and transportation tangles have gotten sorted out. Larger expenses such as utilities, health care and airline tickets have also become more affordable.



Source: Consumer Price Index, U.S. Bureau of Labor Statistics

1TCC

5. Interest Rates – expect tapering.

The Fed has raised interest rates seven times in the past year. Although the central bank controls just one interest rate — the federal funds rate, which banks use to lend money to each other overnight — its actions have an almost immediate impact on all types lending, including mortgages, car loans and credit card rates, all of which are getting costlier. More debt, higher fees means credit card borrowers face mounting burdens.

The almost 500 basis points of expected cumulative hikes is already delivering a commensurate tightening of financial conditions, which we believe will tip the economy into a mild recession later next year. With a slowing in aggregate demand, the unemployment rate will likely rise to 4.2 percent by the end of next year. 10-year U.S. Treasury yields are expected to fall to 3.4 percent by the end of 2023 and real yields are expected to decline.

For 2023, it is no surprise that inflation and Fed rate policy remain top of mind for investors. With inflation already showing signs of softening, the Fed delivered a 50 basis points hike in December, before dialing down the tightening pace further and delivering 25 basis point hikes at both the February and March meetings. It is expected to pause rate hikes thereafter.

6. Commodities - global oil market would remain tight but balanced.

Commodity price forecasts for 2023 — with Brent Crude averaging $90 per barrel, WTI averaging $83 and gold averaging $1,860 in the fourth quarter of 2023. There are strong reasons to expect a relatively robust 1.3 million barrels per day (mbd) of oil demand growth next year, despite expectations for the global economy to expand at a sub-par 1.5 percent pace in 2023. There is still substantial room for a cyclical rebound, driven by a continued normalization of demand for mobility fuels like gasoline, diesel, and jet fuel to pre-Covid levels.

For base metals, 2023 will be a transitional year, with prices once again re-testing the lows approached earlier this year around mid-2023. The outlook for precious metals is more positive and expected to end 2023 higher.

7. Currencies – Dollars rise may soften.

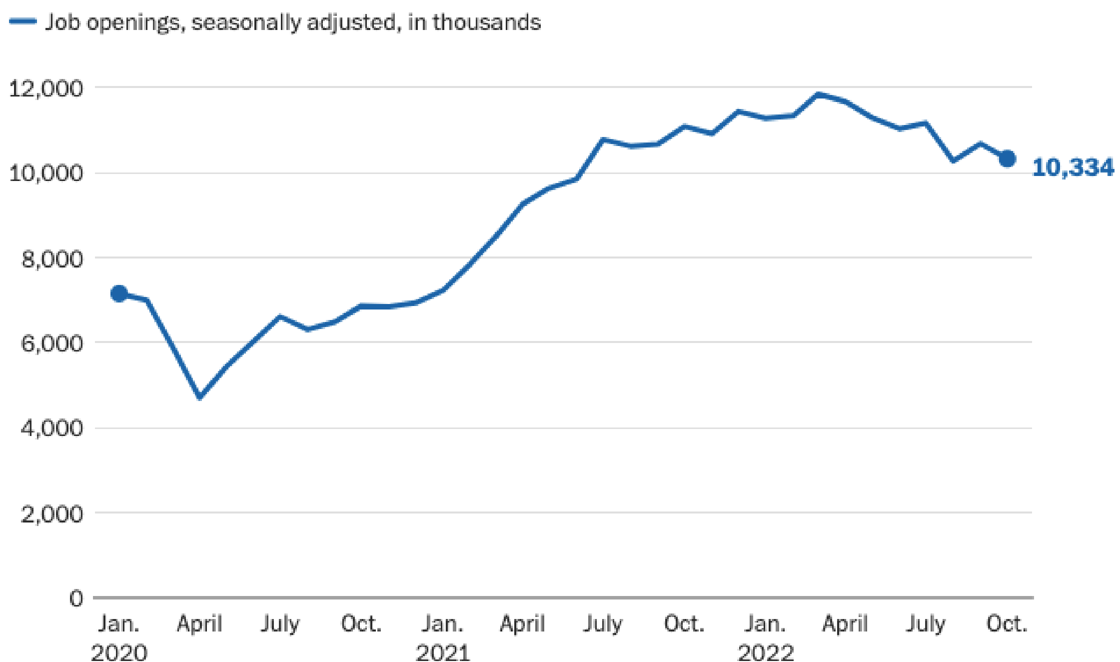
The US is predicted to do better than many of its advanced economic competitors in the coming year, and the Fed's continued maintenance of high interest rates should encourage further investment into the US and support the dollar's strength. The US dollar would peak towards the end of the first quarter of 2023, according to a UBS forecast from late September. As the Federal Reserve's rate-hiking cycle reaches maturity and relative economic growth outside of the US improves, we might observe a decline in the value of the dollar. EM nations may benefit from the relative appreciation of their own currencies while the dollar may decline. Furthermore, rising global demand may result in higher commodity prices for exporting nations like those in Latin America.

Over the past year, the Fed has been forced to tighten aggressively, outpacing every tightening cycle over the last three decades. In currency markets, further dollar strength is still expected in 2023, but of a lower magnitude and different composition than in 2022. The Fed pause should give the dollar's rise a breather. Additionally, unlike in 2022, lower-yielding currencies like the euro are expected to be more insulated as central banks pause hikes and the focus shifts to addressing slowing growth — but this in turn makes high-beta, emerging market currencies more vulnerable.

8. Job and employment – to soften.

The job market has for months been a bright spot in the economy. The unemployment rate of 3.7 percent remains near historic lows, and many employers say they're still desperate to find and keep workers. Importantly, there hasn't been a meaningful rise in layoffs even as hiring has slowed.

However, economists warn that the labor market is likely to get shakier in 2023, as the Fed's tightening works its way across the economy. Barclays, for example, expects the unemployment rate to rise to about 5 percent next year, which would translate to more than 1 million job losses.

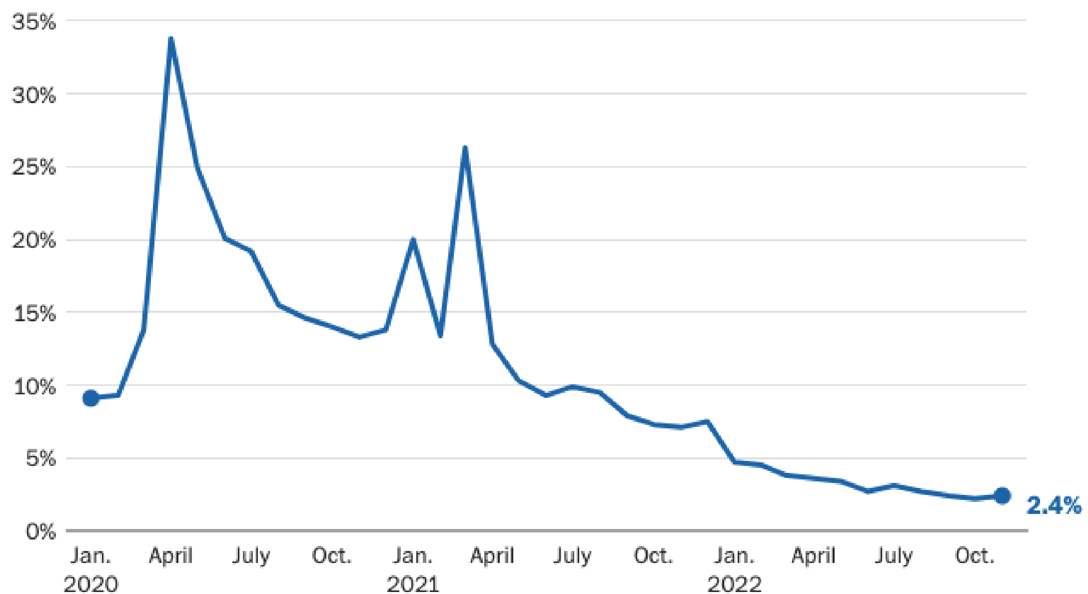


Source: U.S. Bureau of Labor Statistics via FRED

9. Personal savings – surpluses and buffer cushions depleted.

Most Americans have remained employed and perhaps gotten raises in the past year. But a lot of those wage gains have been depleted by persistent inflation. More people are dipping into their savings accounts without replenishing them. The personal savings rate has fallen significantly in recent months and this is already leading into compression in consumer demand.

Consumers with a cushion of savings from lockdown have mostly exhausted their post-Covid excess cash and for the first time are getting hit by a broadening negative wealth effect from all assets simultaneously. This proverbial snowball should continue to gain momentum next year as consumers and corporates more meaningfully cut discretionary spending and capital investments.



Source: U.S. Bureau of Economic Analysis via FRED

10. Home sales – under pressure.

The run-up in mortgage rate has had a direct impact on the housing market. Home sales have fallen for 11 straight months, and construction of new single-family homes is at its lowest level since May 2020, when much of the country was shut down. There are also indications that soaring home prices have now stabilized in many parts of the country, a trend that economists expect to continue in the coming months. Housing inventories will stay longer in the market before being sold, absence of outbidding wars.

11. Energy - Implications for the democratic world.

Average gasoline prices, which peaked at about $5 a gallon nationally this summer, have retreated from record highs, thanks in part to a decline in global demand.

In 2022 an energy shock caused chaos in Europe and much of the world, fueling inflation and making a recession more likely. The crunch caused by Russia's invasion of Ukraine has been painful. By September 2022 a third of the rich-world inflation rate of 9 percent was attributable to energy. President Vladimir Putin's strangling of gas supplies to Europe forced firms and consumers to cut consumption by a 10 percent year on year and sparked fears of deindustrialization. Europe's scramble to import liquified natural gas by sea sent its global price soaring, leading to brutal cutbacks in poorer countries.

In 2023 the world will still be grappling with unstable oil and gas markets but will also redouble its efforts to create an energy system that is cheaper, cleaner and more secure. In the short term they will embrace investment in polluting fossil fuels in return for security. In the long term they will adopt state-led industrial policy in an attempt to accelerate a renewables build-out.

12. Supply chains – disruptions to continue.

Albeit for different reasons than in 2020 and 2021, supply chain issues will persist in 2023. These interruptions might be more subtle and widely spread than the collapse brought on by Covid-19, but flexibility in supply chain architecture will once again be crucial. Sellers will need price protection in the face of rising expenses, while buyers will want the freedom to adjust quantities in reaction to shifting demand. Many obstacles will arise. Mary Barra, General Motors CEO, also expects issues problems from the pandemic, such as semiconductor shortages and strained supply chains, to persist into 2023 despite improvements each quarter.

13. Stock market – not best times for IPOs.

It isn't just personal savings accounts that have taken a hit in the past year. The stock market, which rose to meteoric highs in January, spent the rest of the year on rocky terrain. Highflying tech stocks that soared during the pandemic have seen some of the largest declines in recent months. Shares of Facebook parent company Meta have plunged nearly 70 percent in the past year, while shares of Amazon are down 55 percent. Overall, the S&P 500 index has lost 20 percent of its value from a year ago, wiping out trillions in investments. After a year of macroeconomic and geopolitical shocks, investors responded by derating the S&P 500 price to earnings (P/E) ratio as much as seven times, while some speculative growth segments crashed 70-80 percent from highs.

Although fundamentals have been resilient throughout these shocks, this year's constructive growth backdrop is not expected to persist in 2023. Fundamentals will likely deteriorate as financial conditions continue to tighten and monetary policy turns even more restrictive. The economy is also likely to enter a mild recession, with the labor market contracting and unemployment rate rising to around 5 percent. Whilst this may not be the best time for IPO's share buybacks may accelerate with caution due to liquidity constraints.

14. War in Ukraine – Russia risks instability.

There is growing opposition to President Putin at home. When Putin, invaded Ukraine on February 24, 2022, his objective was to landgrab independent foreign territory, deprive it of sovereignty and its national identity, and convert it into a failed state. After fierce resistance from Ukraine, its statehood and its identity have resulted in a stronger nationality and global acclaim. Putin now finds Russia in a desperate and weak state he was expecting Ukraine to be in.

This is turning Russia into a failed state, terrible economy, uncontrolled governance and borders, private militias, a fleeing population, moral decay, and a real possibility of civil war. As confidence in Ukraine's ability to withstand Russia's onslaught has gone up, there is now significant concern about Russia's stability and ability to survive through the war with Ukraine. There is a serious possibility of Russia becoming ungovernable and this could be an even bigger problem for the world.

15. Food Security – Global hunger, a problem of price and availability.

The world is entering 2023 in a hunger crisis. The World Food Programme (WFP), a UN agency that co-ordinates the distribution of food aid, estimates the number of people facing acute food insecurity jumped from 282 million at the end of 2021 to a record 345 million in 2022. As many as 50 million people will begin 2023 on the brink of famine. With governments still reeling from the Covid-19 pandemic and grappling with slowing economic growth, many of those people could be starving in the coming months. Until now, the problem has largely been spiraling prices rather than availability.

Russia and Ukraine were among the top five global exporters of barley, maize and sunflower products in the world. When war broke out, supplies of many staple foods were seriously affected. The countries worst affected were among the poorest in the world. Sudan, Tanzania, and Uganda, for example, relied on Russia and Ukraine for over 40 percent of their wheat imports. But the effects were felt everywhere. Global food prices soared as other countries, including Argentina and India, responded with trade restrictions. Emergency-relief efforts everywhere were hit because the WFP usually buys half of the wheat it distributes from Ukraine.

16. Europe – Reeling under pressure.

Reeling under high inflation, higher interest rates, consumption depression and a war in the region, Europe will remain under serious pressure in 2023. The European Central Bank anticipates that the annual average real GDP growth will be 3.1 percent in 2022, a sharp decline to 0.9 percent in 2023, and a recovery to 1.9 percent in 2024.

17. Emerging Markets – muted growth.

At 2.9 percent in 2023, EM growth looks to remain well below its pre-pandemic trend, slowing modestly from 2022. EM excluding China is expected to slow to a below-trend 1.8 percent with wide regional divergences.

In China, the full-year 2023 growth forecast is 4 percent year-over-year, where two quarters of below-trend growth are assumed as the economy loosens Covid restrictions.

18. China – The biggest unknown.
The biggest known unknown of 2023 is China. With a shift in China's policy toward stimulus and pro-growth, we can expect that China will start to put economic growth ahead of some of its objectives for social stability and security. By the start of the new fiscal year in April 2023, we also envision a potential end to China's zero-COVID policy. The private consumer sector might experience a significant recovery with a full reopening, which would increase China's inflation-adjusted GDP growth from below 3 percent to 4.2 percent in 2023. Importantly, China is not dealing with high inflation or rising interest rates since it chose a fundamentally different policy approach to Covid than most of the West. This provides Beijing with a sizable stimulus runway. Also China's political unpredictability over its relations with Russia and Taiwan will remain a constant concern for its trading partners.

19. India – likely to be the only high growth economy of 2023.
India, the true anomaly, is on course to have GDP growth of 6.2 percent in 2023 and 6.4 percent in 2024, and three megatrends, supported by the nation's sophisticated digital infrastructure, are positioning India to overtake Japan and Germany and become the third-largest economy in the world by 2027. India has the conditions in place for an economic boom, fueled by offshore, investments in manufacturing, and energy transformation.

20. The risk of a financial crisis.
As interest rates have risen rapidly, the possibility of something breaking in the financial system increases, making it imperative to consider also the third recession type. Financial markets have delivered a terrible performance in 2022 as shocks disrupted markets and policymakers slammed the breaks. It is some comfort that the tightening of financial conditions has been driven primarily by falling valuations and volatility, which are less systemically threatening than tightening driven by funding or credit risk.

While that suggests a financial crisis is not underway, rising rates, particularly after a long period of extraordinary ease, push up the risk of financial accidents, not unlike the FTX saga. Today, visible signs of an emerging balance sheet problem are hard to spot. Delinquencies, charge-offs, and bankruptcies remain modest. Credit spreads remain compressed. And capital ratios remain healthy. However, the conditions are more and more accident-prone—we can never dismiss financial risks.

How should businesses respond?

Geopolitical tensions, war and a global pandemic have been the highlights of 2022. Businesses already grappling with soaring inflation as a result, no have to contend with high interest rates (aka cost of capital), high inflation, and economic stagnation.

What are corporate leaders to do? Certain remedies such as advance purchases and hedging are handy but may cause liquidity issues as companies look to preserve precious liquidity. It's a *damned if you did, damned if you didn't* situation. This is where TCC can uniquely deliver value.

The TCC Mantra – back to basics, cash is king.

Companies looking to hedge against risks without compromising liquidity and cash flow may find supply chain finance the penicillin to their intense supply chain woes. At TCC, this is our mantra: Let's get back to basics, away from the perils of just-in-time inventories that didn't account for the intense disruptions caused by Covid or climate. Capital deployments are inevitable in order to keep factories running and cash is king — especially when it can offer doubled benefits of accelerating payments, build inventories, and create stickier, stronger buyer-supplier relationships.