

What lies beneath and what to expect from Q2-2023

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Cross-currents will continue to rock the economic boat

While we expect global economic growth to slow from 3.5 per cent in 2022 to 2.7 per cent in 2023, we see some significant cross-currents emerging beneath the surface of this broader slowdown. They will continue to rock the economic boat and contribute to ongoing choppiness in the medium term.

In the US and the euro area, growth is likely to slow sharply enough that it will feel like a recession. High consumer price inflation has forced central banks in both economies to raise rates sharply over the last year. We are now starting to see signs that this monetary tightening is slowing economic activity.

Financial markets have been rattled recently by the banking-sector stress in the US and Europe. While we do not see these issues becoming systemic, lending standards are likely to tighten further as banks turn more cautious, reducing access to lending for households and businesses. This could feed through to slower economic activity. Labour markets in the US and euro area have been resilient, with low unemployment supporting consumer spending. However, higher interest rates, lower credit availability from banks, and slowing economic activity are likely to translate into higher unemployment and weaker consumer spending over the coming months.

China's economy shaking off its COVID-19 legacy and emerging as global consumer

China's recent post-COVID-19 reopening is driving a consumer rebound, supporting regional and global growth. We expect China's economy to grow 5.8 per cent in 2023, up from 3.0 per cent in 2022. Household consumption is likely to contribute 4-4.5ppt to this year's GDP growth, up from 1ppt in 2022.

But how are these divergent economic trends in the US and China likely to impact the rest of the world?

Weaker US demand hurts everyone, as the US is still the world's most important consumer market; Canada, Mexico, the UK and India are particularly exposed. Slowing demand from the US and euro area is likely to affect the rest of the world through weaker trade flows. Export data for top Asian exporters such as Singapore and Korea are already showing weakness and a peak in the electronics cycle.

China has emerged as an important consumer globally, and a consumer-driven rebound there should partly offset the impact of a US slowdown on Asian economies such as Taiwan, Malaysia and Hong Kong, as well as Australia and Saudi Arabia. That said, the positive spillover from China may not be as large as in previous economic upswings, which have been more construction- and investment-driven. We see healthy labour markets and buoyant consumer spending in Asian economies adding further support to growth in the region, particularly in large, domestic demand-led economies such as India and Indonesia. Meanwhile, recovering tourism should provide a boost to Thailand and Malaysia. Asia also has limited direct exposure to the US banks facing difficulties, and the region's central banks have reiterated that their banking systems are well capitalised.

Challenging times ahead for Africa

We see growth in Sub-Saharan Africa to hold up at 3.5 per cent this year, as global shocks (such as slowing growth in major economies) are typically felt later in the region and with a lag. The main concern for Africa is that a slowdown in developed markets may trigger risk aversion, making it harder for some African sovereigns to access financing in international markets. With still-difficult refinancing conditions, some will remain at high risk of debt distress. In addition, growth in the region's two largest economies is weighed down by idiosyncratic issues (load-shedding in South Africa and a cash shortage in Nigeria), while still-high inflation raises the risk of further policy tightening.

A mixed Middle East picture

The Middle East saw robust growth rates in 2022; Saudi Arabia was the fastest-growing G20 economy, thanks to both strong oil prices and reforms in the domestic economy. GCC growth is likely to slow in 2023 on a smaller contribution from the hydrocarbon sector (given OPEC+ production cuts), though we expect momentum in non-hydrocarbon sectors to continue. Investors may question the readiness of GCC countries to provide significant financial assistance to weaker MENAP sovereigns such as Pakistan and Egypt in the absence of greater reforms in those countries.

A divergent inflation outlook

Just as there are divergences in the growth outlook, the inflation outlook also differs significantly across regions. Core inflation remains sticky in the US and Europe, particularly for services, but the accumulated impact of policy tightening over the past 12-18 months, along with tightening credit conditions, is likely to raise unemployment and lower services-sector wage growth. At the same time, lower energy prices and freight costs, along with easing supply-chain disruptions, should push other inflation components lower. Easing inflation and softening activity reinforce our view that the Fed and ECB are close to ending interest rate hikes.

In contrast, inflationary pressures remain low in China and are easing in Asia. In the ASEAN and South Asia (ASA) region, we expect policy rates in most economies to have peaked by the end of Q2 as inflation risks recede and the need to maintain a spread over US rates fades. In Africa, still-elevated inflation and FX weakness mean that policy tightening will likely need to continue for longer.

So all in all: the global economic picture remains highly nuanced. Things may change as the year progresses, but for now some interesting cross-currents would suggest that there might be a brighter year-end on the horizon.

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