



Economic Outlook 23-24: Keep Calm and Carry On

Allianz Research

15 December 2022



Economic Outlook: Key Messages

- **The energy crisis shaping the outlook for 2023-24.** We continue to project a moderate recession in major advanced economies (US, EZ, UK) at the turn of the year due to increasingly entrenched negative confidence effects, followed by a subdued recovery after mid-2023 and weak growth in 2024. Global growth likely to slow to +1.4% and recover modestly to +3.1% in 2024.
- **Global trade slowing despite easing supply side constraints.** New orders and backlogs of work are at their lowest levels since the pandemic in 2020. Global trade in goods and services to grow by only +0.7% in volume terms in 2023 and to contract by -1.3% in value terms.
- **Central banks remain determined in fighting inflation.** Inflation should continue to remain strong over the coming quarters (despite strong disinflationary base effects in 2023), with core inflation remaining rather sticky next year. Inflation to average 6.4% globally in 2023 before receding to 3.9% in 2024.
- **Fiscal policy will only partially compensate for the impact of the energy crisis.** In Europe, most of the current measures have been extended into 2023 for a total of more than 3% of GDP on average, which is about half of the Covid-19 packages.
- **The balance of risk remains tilted to the downside.** More energy supply constraints would require gas rationing in Europe, which would push 2023 GDP growth deeply in negative territory and increase the probability of a second year of recession in 2024. Higher for longer inflation would push central banks to hike more throughout 2023 increasing the risk of a policy mistake.

Capital Markets: Key Messages

The outlook for capital markets is mildly positive. Our economic scenario warrants a defensive tactical short-term positioning but allows for some long duration and re-risking towards the second half of 2023 and in 2024. The first half of 2023 will most likely follow the current volatile market dynamics as investors attempt front-run the recovery path. We expect fixed income (esp. IG Credit) to outperform equities in 2023.

- **Sovereign rates – A bit too early to overweight duration:** We expect a prolonged hiking cycle, with flattened yield curves next year → 10y US Treasury yield 3.6%/3.5% for 2023/2024 and 10y Bund at 1.9%/1.7% in 2023/2024
- **Corporate Credit – Optimizing the risk-return profile:** We expect a downturn cycle with relatively high yields but relatively few rating downgrades → IG and HY credit slowly crawling towards long-term averages (IG and HY at ~140bps and ~440bps in 2024)
- **Equities – Caution along the investment horizon:** Markets will remain challenging until real rates stabilize once central banks start their policy pivot is priced in → flat total returns in 2023 and ~5%-8% total return in 2024
- **Emerging Markets – Yields are high, but pressures have not left:** Rising yields and strong corrections over the last two years make EMs increasingly attractive. EM HC spreads below 350bps/300bps in 2023/24 and LC yields slightly below 6.5%/6.0% in 2023/24.

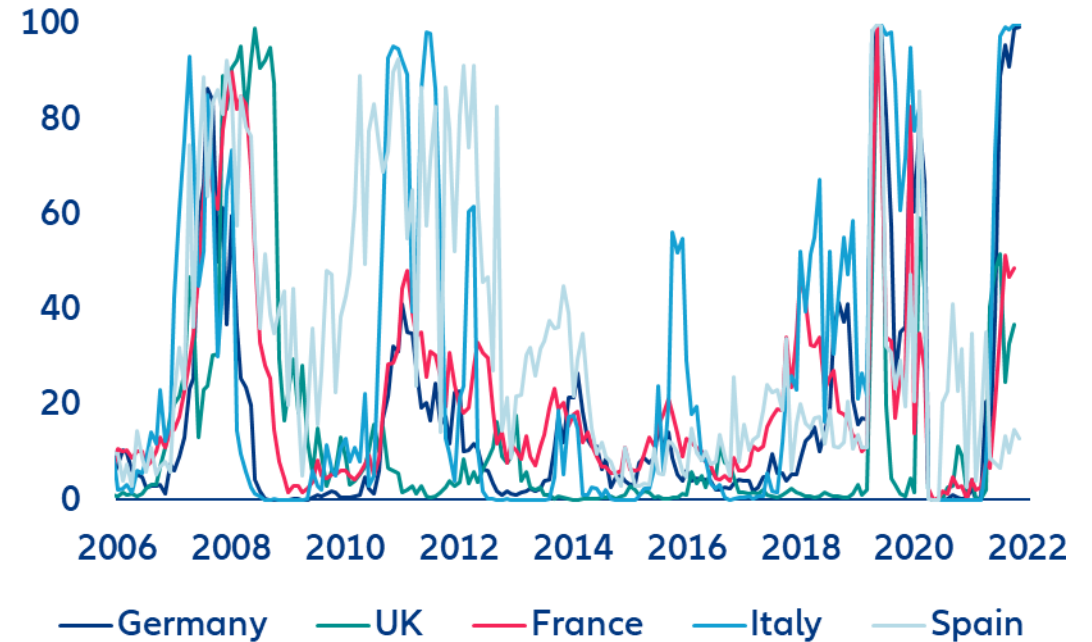
Global Outlook 2023-24

Global growth is losing steam

Global GDP Growth (%)

Growth (yearly %)	2020	2021	2022f	2023f	2024f
Global (PPP exchange rates)	-3.0	6.1	3.1	1.9	3.1
Global (market exchange rates)	-3.3	6.0	2.9	1.4	2.8
USA	-2.8	6.0	1.9	-0.3	1.6
Latin America	-7.1	6.7	3.3	1.2	2.2
Brazil	-4.2	5.0	2.8	1.1	2.1
UK	-11.0	7.5	4.4	-0.9	0.7
Eurozone	-6.3	5.3	3.3	-0.4	1.0
Germany	-4.1	2.6	1.8	-0.7	0.6
France	-7.9	6.8	2.5	-0.4	0.9
Italy	-9.1	6.7	3.8	-0.3	0.8
Spain	-11.3	5.5	4.6	0.2	1.2
Russia	-2.7	4.7	-2.8	-2.9	1.6
Turkey	1.9	11.4	5.1	1.9	3.8
Central and Eastern Europe	-3.3	5.3	0.3	0.2	2.5
Poland	-2.0	6.8	5.5	0.7	2.3
Asia-Pacific	-1.0	6.1	3.2	3.6	4.5
China	2.2	8.1	2.8	4.0	5.2
Japan	-4.7	1.7	1.4	0.8	1.1
Middle East	-4.2	3.9	5.6	3.4	2.6
Saudi Arabia	-4.1	3.2	10.2	4.9	3.1
Africa	-1.7	5.8	3.2	3.1	3.5
South Africa	-6.3	4.9	1.8	1.5	1.4

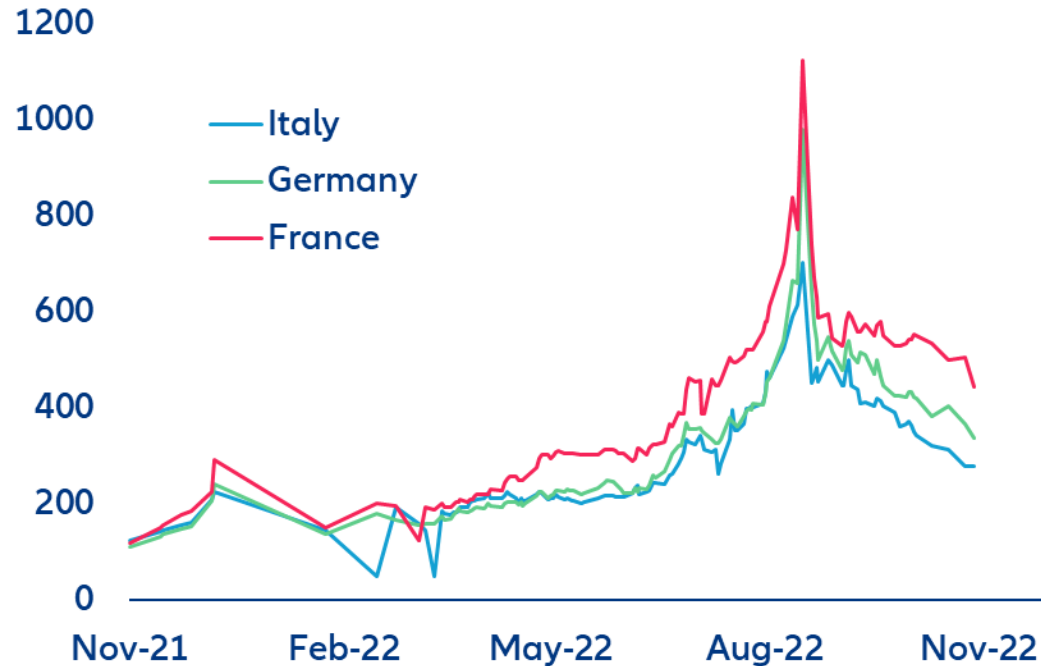
In Europe, recessions in Germany and Italy more likely



Sources: Refinitiv Datastream, Allianz Research

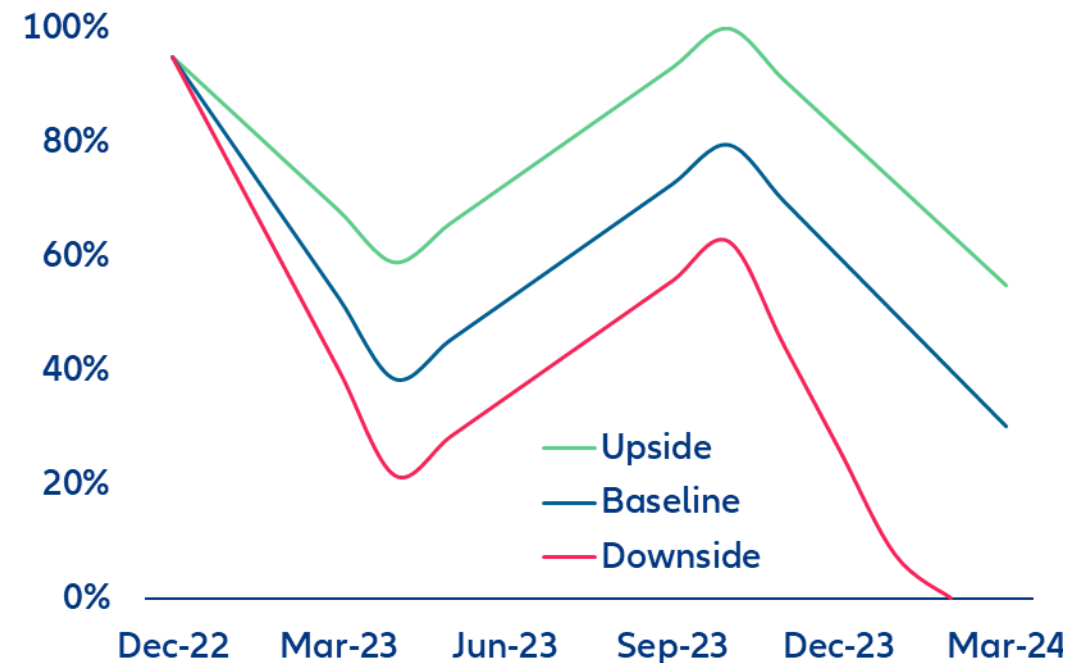
Energy gap: beware of next winter!

Year-ahead baseload electricity prices (€/Mw)



Sources: EPEX, Allianz Research

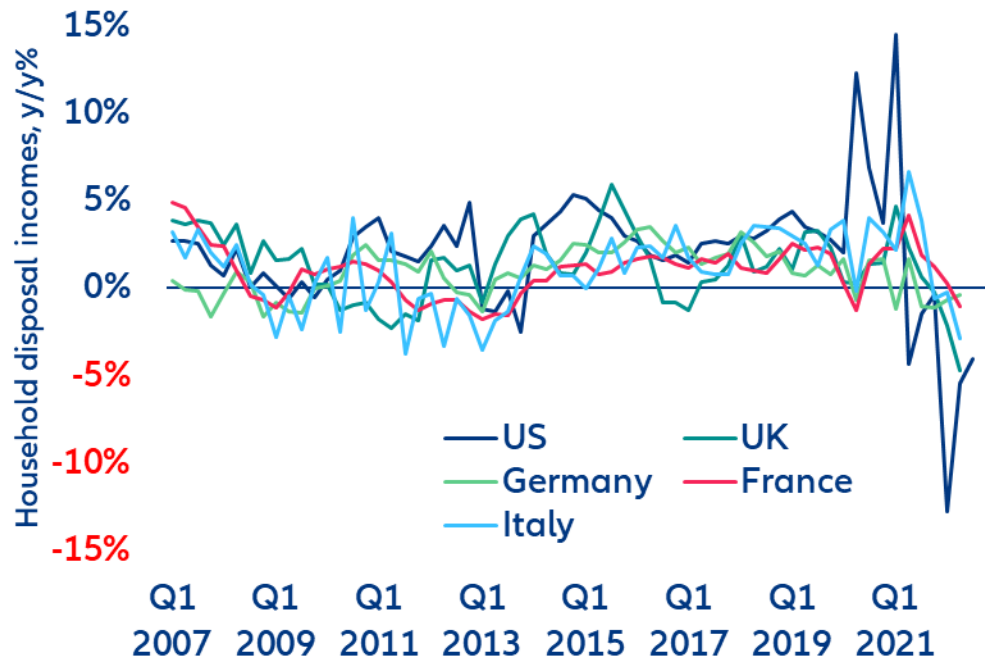
Europe gas storage scenarios



Sources: ENTSO-G, Allianz Research

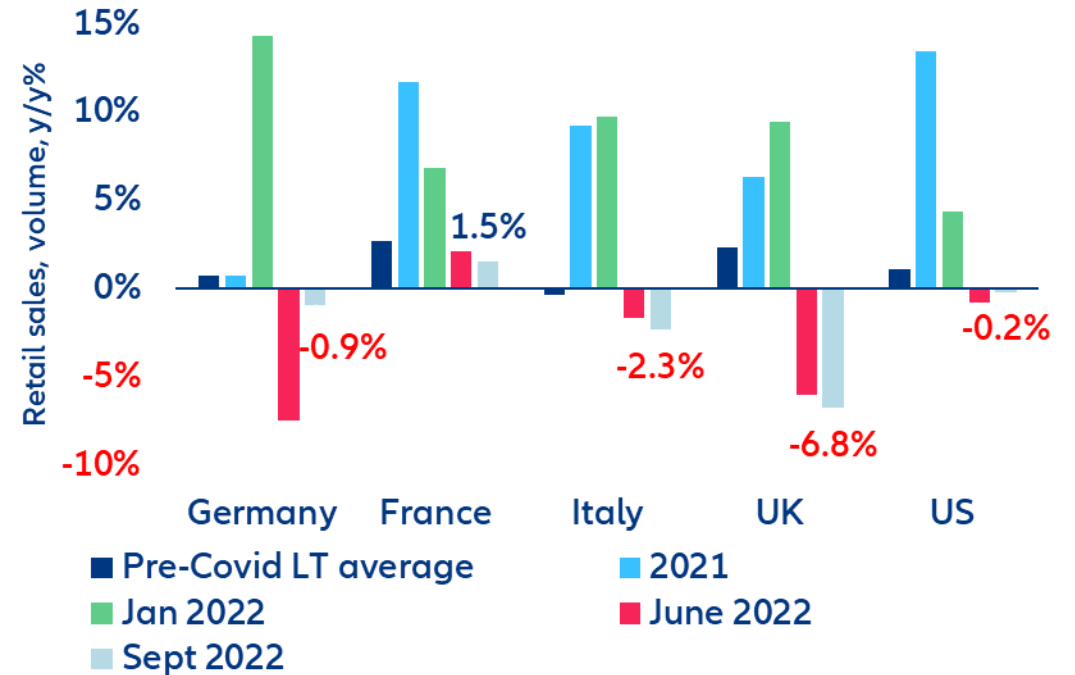
Lower incomes weigh on consumption

Households' real disposable incomes in contraction territory ...



Sources: Refinitiv Datastream, Allianz Research

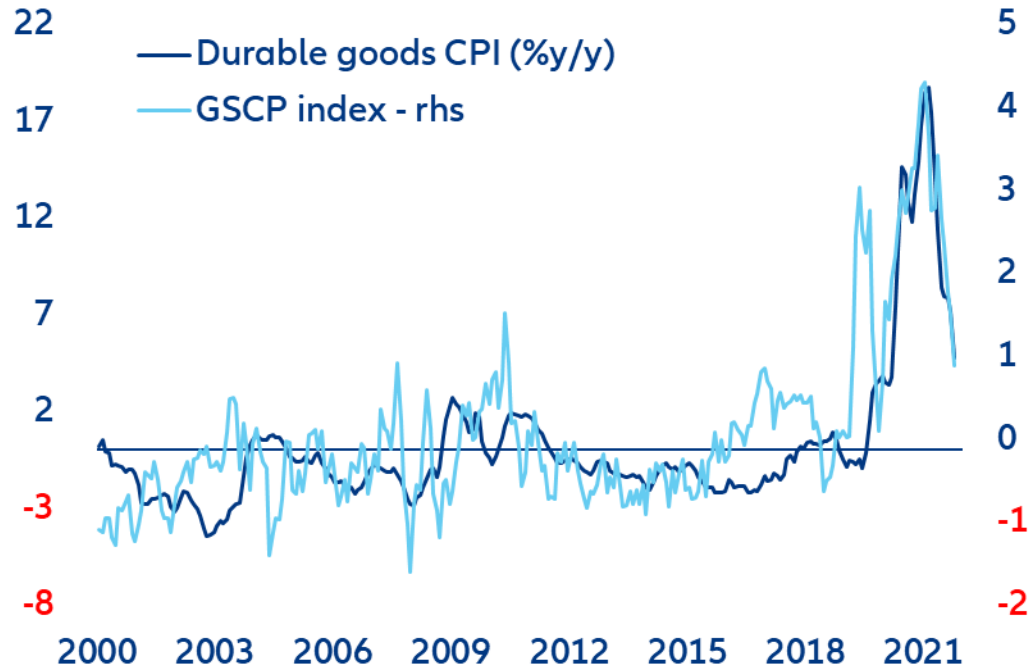
... being a drag on retail sales



Sources: Refinitiv Datastream, Allianz Research

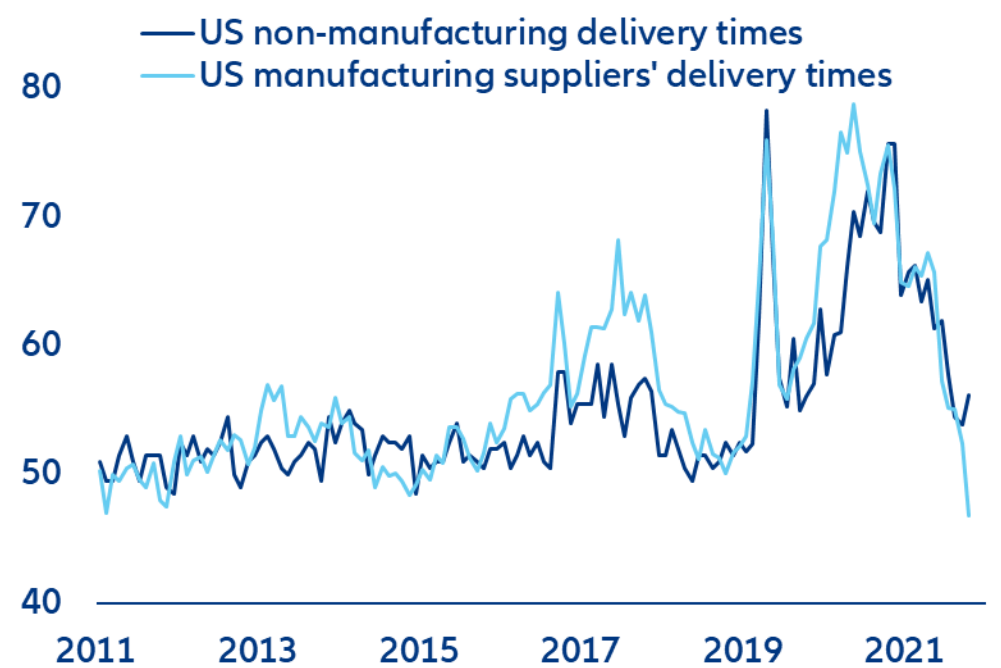
Declining supply side pressures

Global Supply Chain Pressure Index (GSCP) & US Durable Goods CPI



Sources: Refinitiv Datastream, Allianz Research

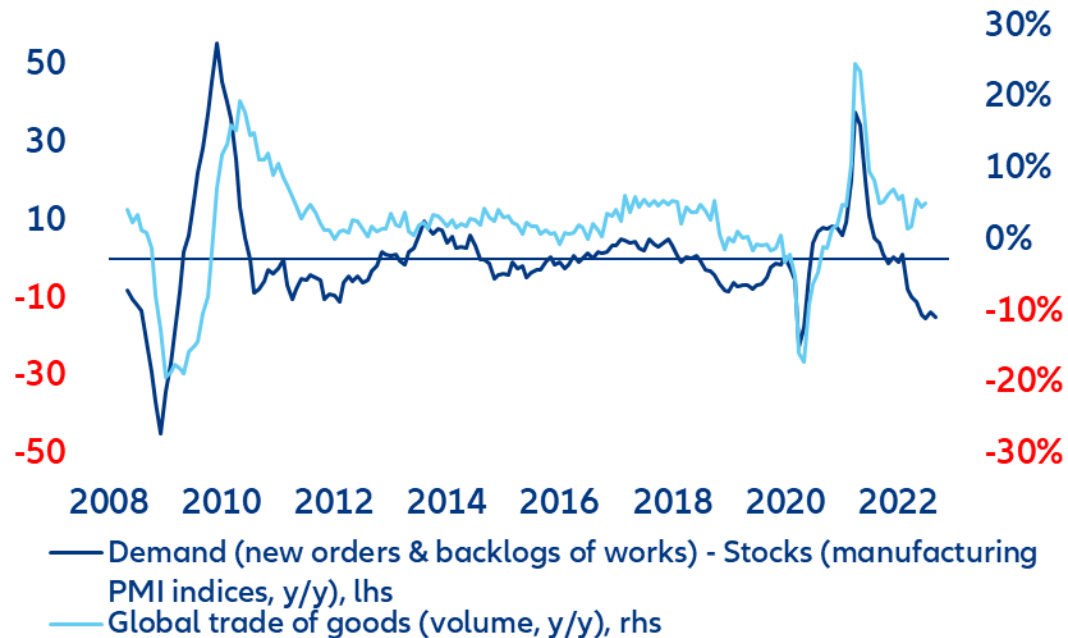
US: Small Business NFIB Survey & Headline CPI



Sources: Refinitiv Datastream, Allianz Research

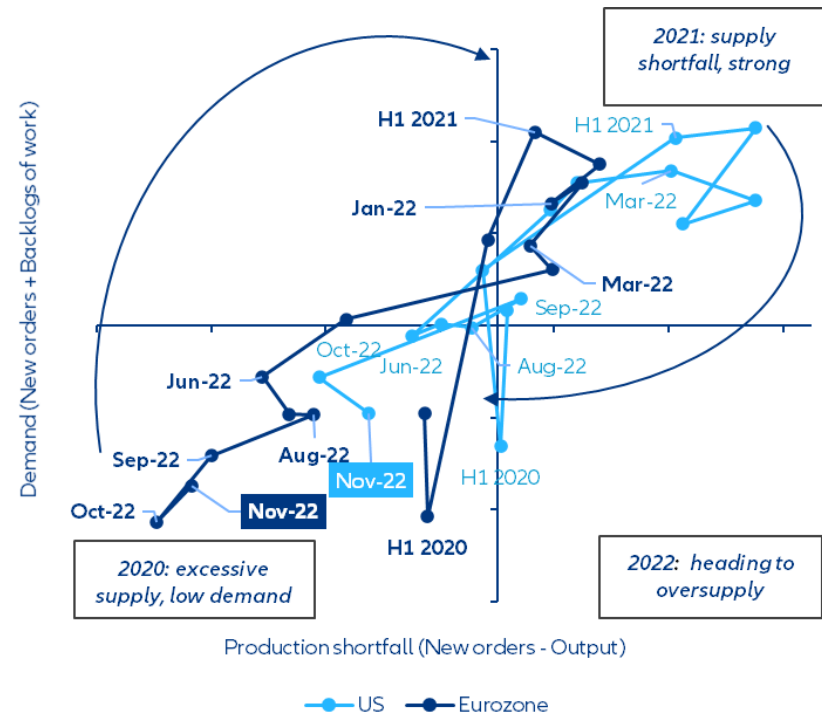
Slowing demand and oversupply

Demand is slowing fast...



Sources: Markit, Allianz Research

... with new orders and backlogs of work at their lowest level since the worst of the pandemic



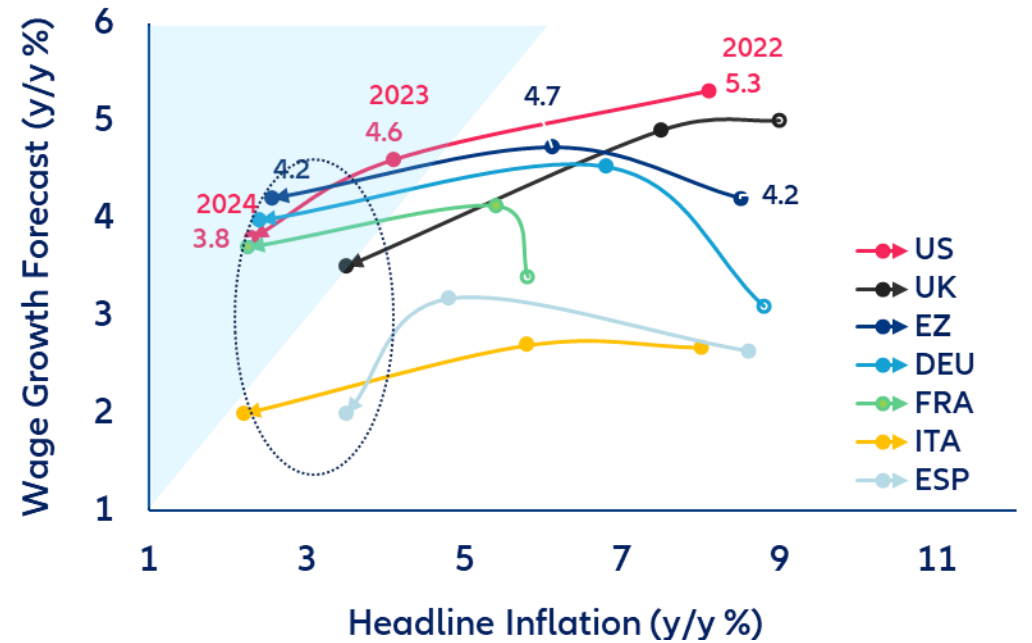
Sources: Markit, Allianz Research

Global inflation to remain >6% in 2023 amid slowly declining wage pressures

Global Inflation (%)

Inflation (yearly %)	2020	2021	2022f	2023f	2024f
Global	2.6	4.3	8.6	6.4	3.9
USA	1.3	4.7	8.1	4.1	2.3
Latin America	11.8	13.9	16.2	14.2	10.3
Brazil	3.2	8.3	9.6	4.8	3.6
UK	0.9	2.6	9.0	7.5	3.5
Eurozone	0.3	2.6	8.5	6.1	2.6
Germany	0.5	3.1	8.8	6.8	2.4
France	0.5	1.6	5.8	5.4	2.3
Italy	-0.1	1.9	8.0	5.8	2.2
Spain	-0.3	3.1	8.6	4.8	3.5
Russia	3.4	6.7	14.0	12.0	7.9
Turkey	12.3	19.6	72.6	36.1	20.6
Central and Eastern Europe	4.5	8.1	14.8	11.8	5.6
Poland	3.4	5.1	14.5	11.8	5.5
Asia-Pacific	2.2	1.7	3.7	3.2	2.7
China	2.5	0.9	2.0	2.2	2.4
Japan	-0.0	-0.2	2.3	1.9	1.5
India	6.6	5.1	7.0	5.8	4.7
Middle East	9.9	15.8	25.0	21.6	12.9
Saudi Arabia	3.5	3.1	2.5	2.6	2.1
Africa	10.0	12.4	17.5	14.1	8.8
South Africa	3.3	4.6	7.0	5.1	4.7

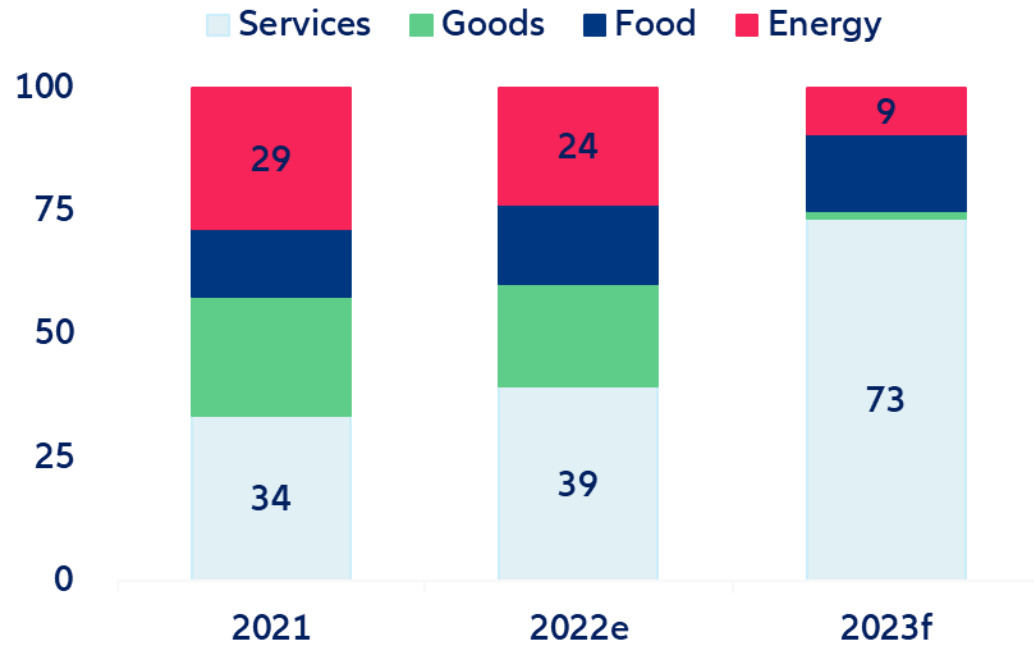
Wage Growth and Inflation



Sources: Refinitiv Datastream, Allianz Research

Energy inflation still main inflation driver in Europe

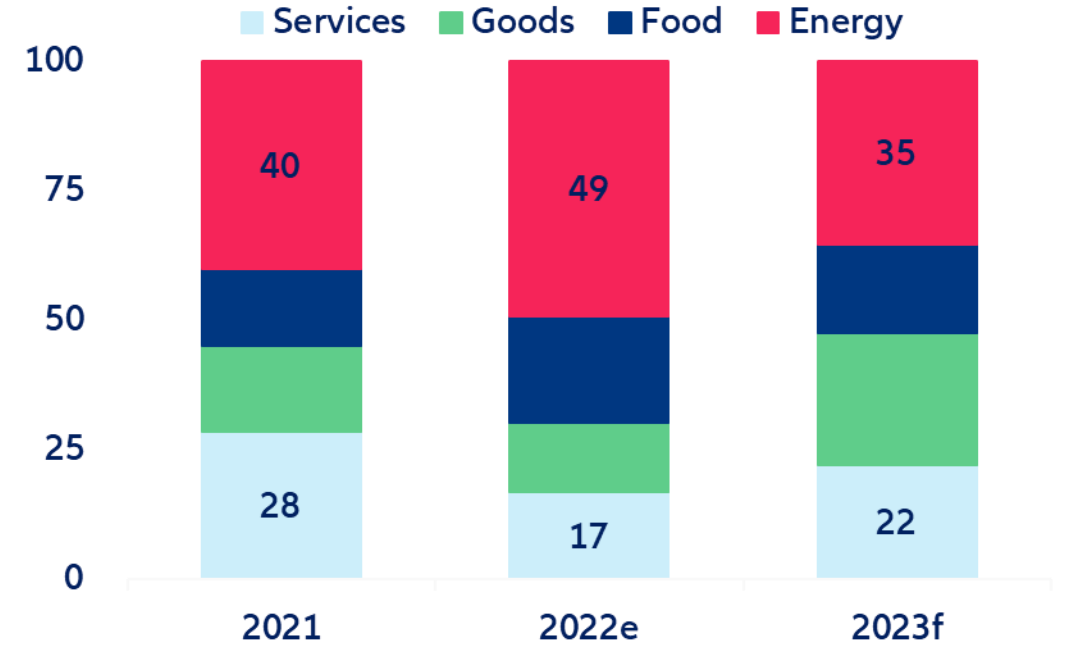
US: Decomposition of Headline (CPI) Inflation



Sources: Refinitiv Datastream, Allianz Research

Note: avg. contribution in pp based on quarterly y/y%, component model, Dec. '22

Eurozone: Decomposition of Headline (CPI) Inflation

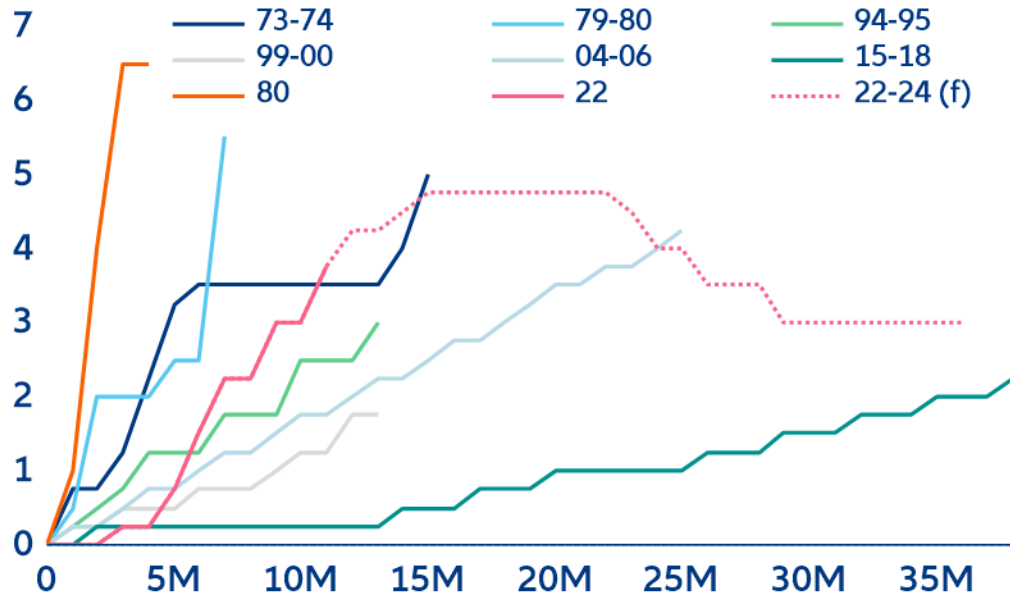


Sources: Refinitiv Datastream, Allianz Research

Note: avg. contribution in pp based on quarterly y/y%, component model, Dec. '22

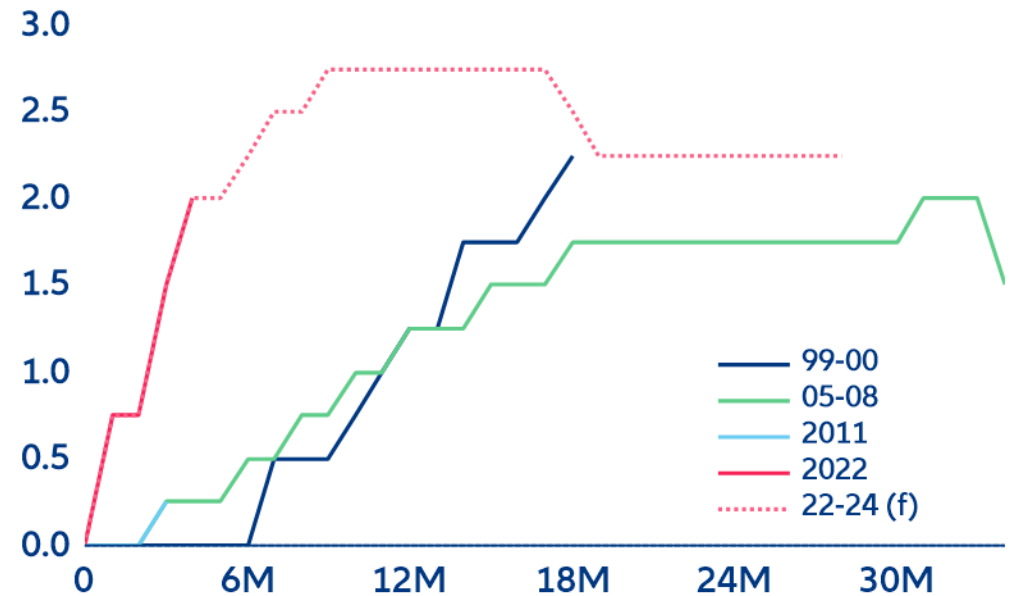
Rate hikes less steep but protracted

US: Policy rate hiking cycles (%)



Sources: Refinitiv Datastream, Allianz Research

Eurozone: Policy rate hiking cycles (%)



Sources: Refinitiv Datastream, Allianz Research

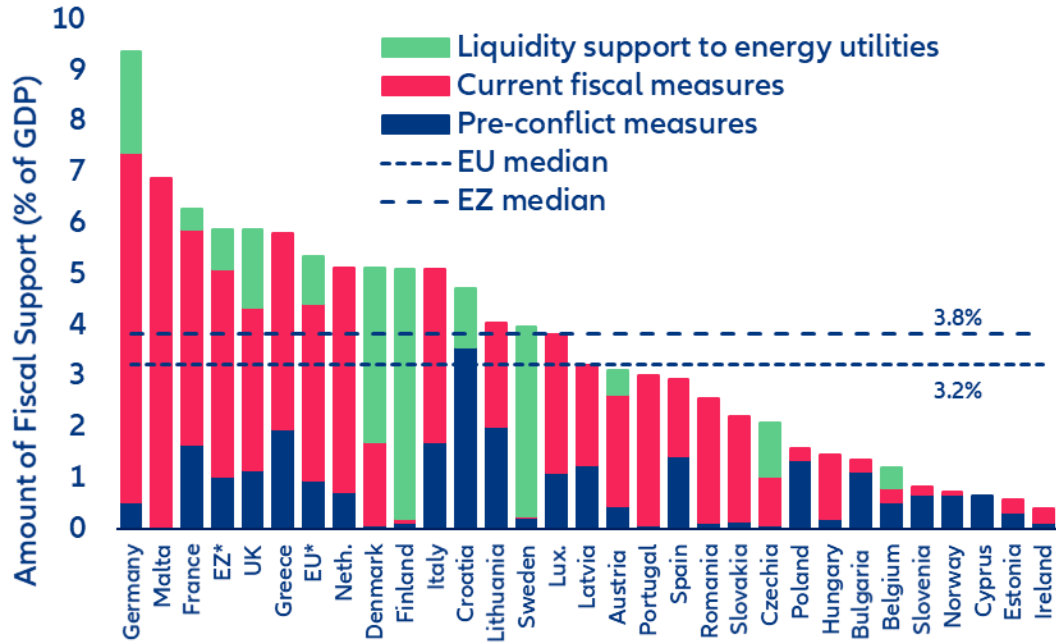
More than EUR600bn in energy support measures in Europe

Impact	What	How	Corporates					Households				
			DE	FR	ES	IT	UK	DE	FR	ES	IT	UK
Revenue measures	Transfers and price caps	Electricity price cap/subsidy	✓	✓	●	●	✓	✓	✓	●	●	✓
		Gas price cap/subsidy	✓	✓	✓	●	✓	✓	✓	✓	●	✓
		Grants and energy vouchers	✓	✓	●	●	●	✓	✓	✓	✓	✓
		Interest rate subsidies (mortgages)	-	-	-	-	-	✗	✗	✓	●	✓
		Fuel subsidy	✓	✓	✓	✗	✗	✓	✓	✓	✗	✗
	Taxes	(Energy) tax cuts	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
		Tax deferrals or tax credit	✓	●	●	✓	✗	✓	●	●	●	✗
		Levy on windfall profits	✓	✓	●	✓	✓	-	-	-	-	-
Furlough	Easier access conditions	✓	●	●	✓	✗	✓	●	●	✓	✗	
Below-the-line measures	Loans	Debt guarantees and loans	✓	✓	✓	✓	✗	-	-	-	-	-
	Equity stake/nationalization	for energy utilities	✓	✓	●	●	✓	-	-	-	-	-
Structural measures	Insolvencies	Temporary suspension / easing of insolvency law	✓	✗	✗	✗	✗	●	●	●	✗	✗
	Debt moratoria		●	●	●	●	✗	●	●	●	●	✗

Source: Allianz Research. Note: ✓=announced/in place, ●=likely to be announced, ✗ = unlikely to be announced, - = does not apply

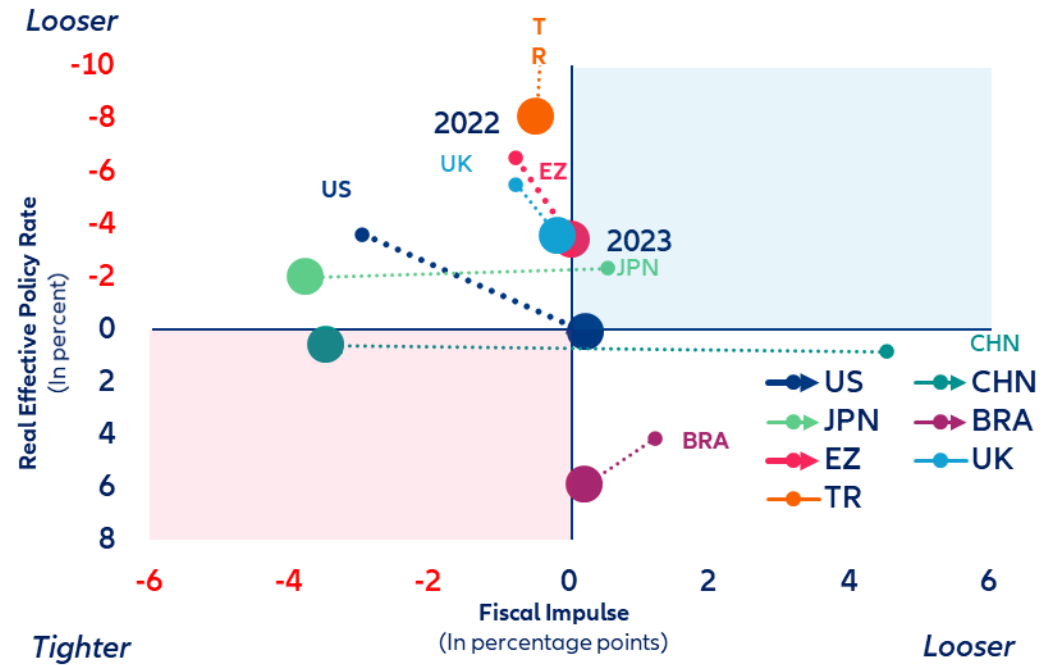
Fiscal support >3% of GDP as financing conditions keep tightening

Europe: Fiscal Support Measures to Fight the Energy Crisis (% GDP)



Sources: Bruegel, national authorities, Refinitiv Datastream, Allianz Research

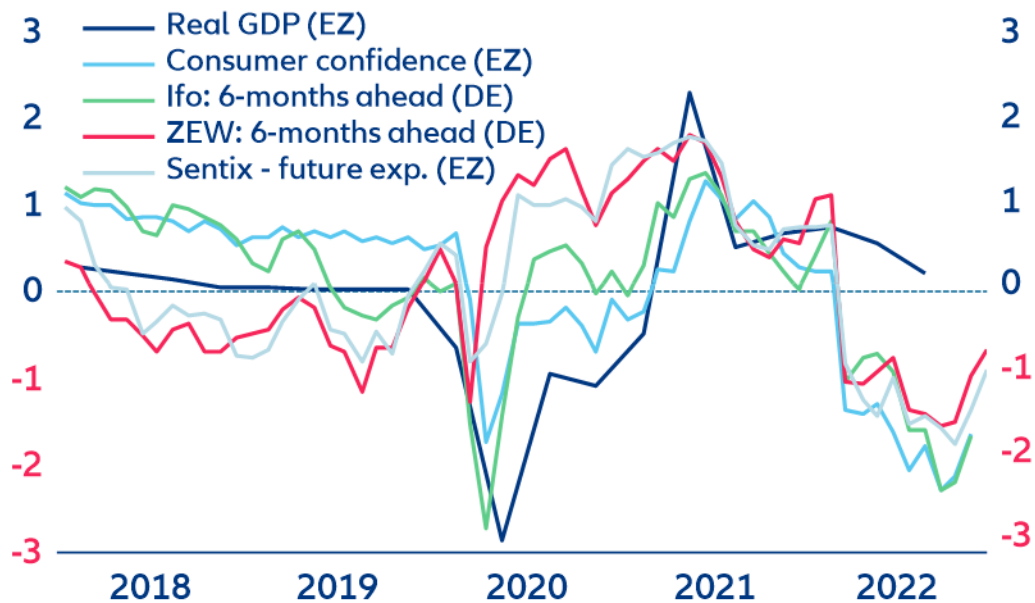
Fiscal Impulse and Monetary Stance in Advanced and Emerging Economies (pp)



Sources: Refinitiv Datastream, Allianz Research

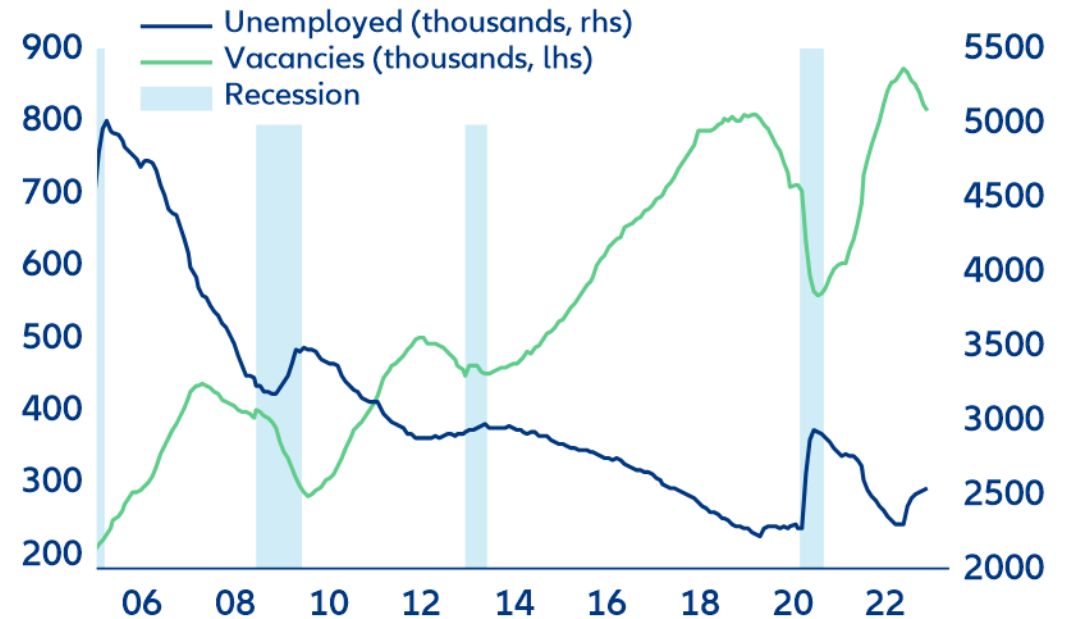
Momentum has defied gloomy surveys, thanks also to labor markets resilience

Eurozone GDP vs. confidence indicators



Sources: Refinitiv Datastream, Allianz Research

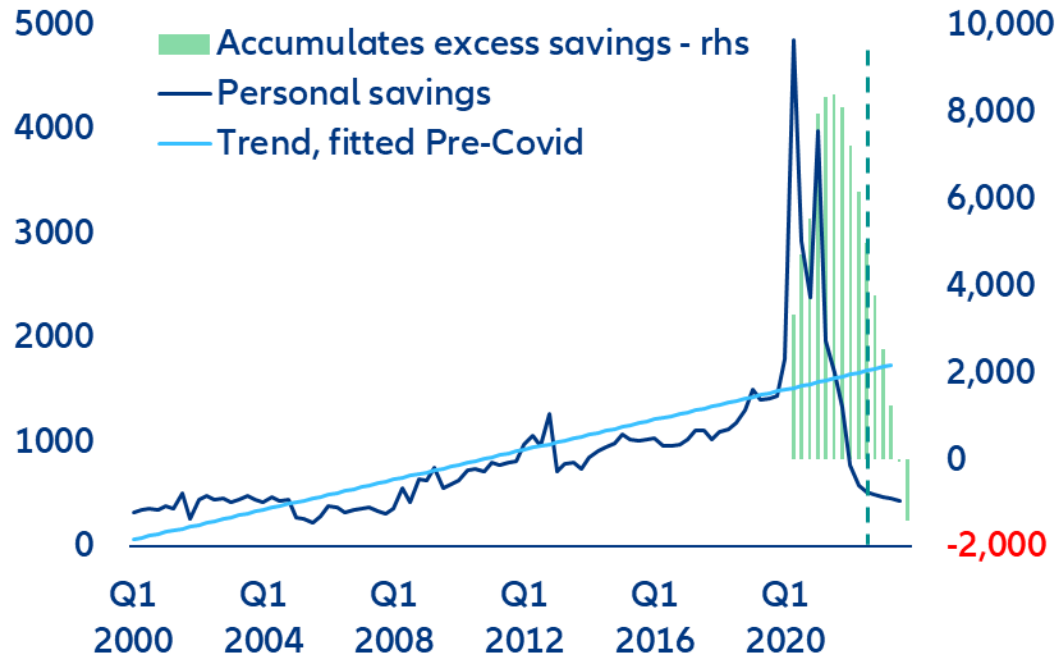
German labor market indicators



Sources: Refinitiv Datastream, Allianz Research

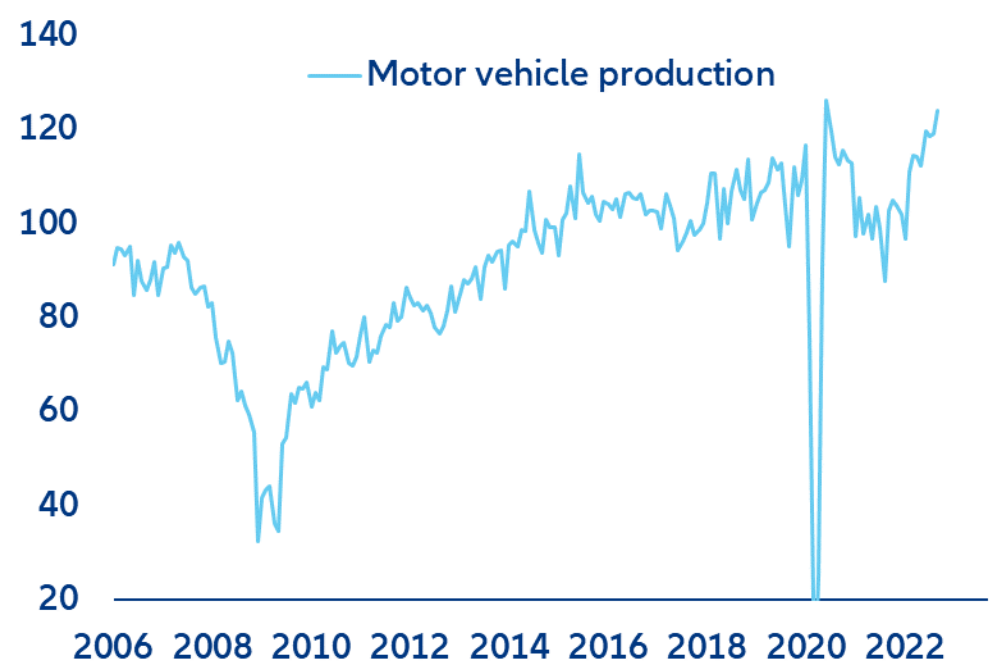
Excess savings & supply-side repair support the US economy for now

Households are digging into their savings in order to keep spending



Sources: Refinitiv Datastream, Allianz Research

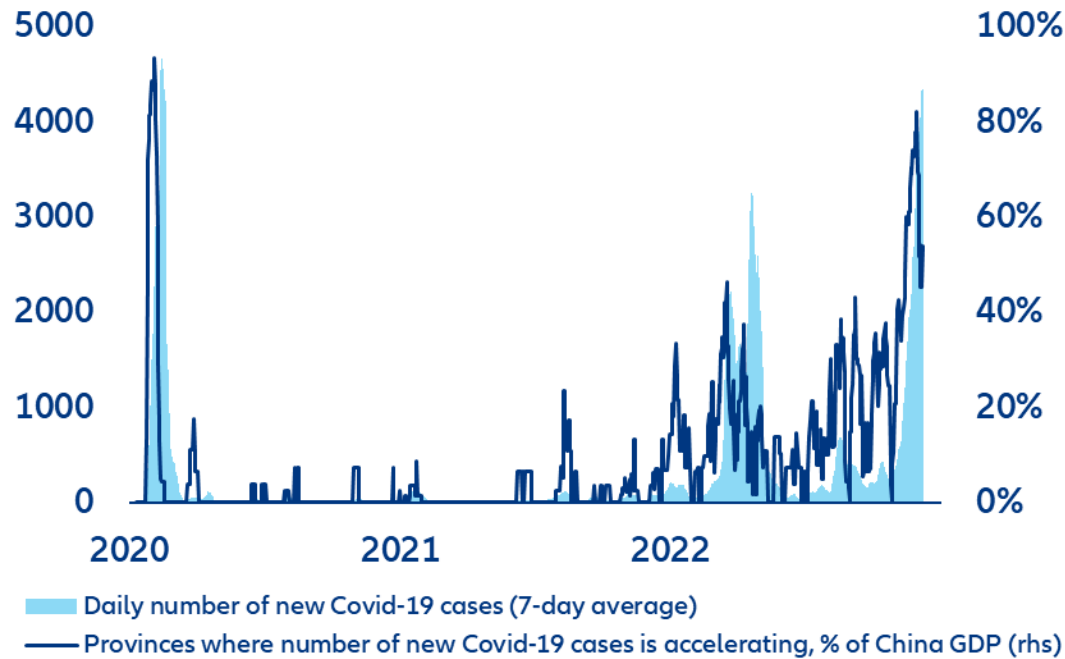
Motor vehicle production is powering ahead thanks to an easing of supply shortages



Sources: Refinitiv Datastream, Allianz Research

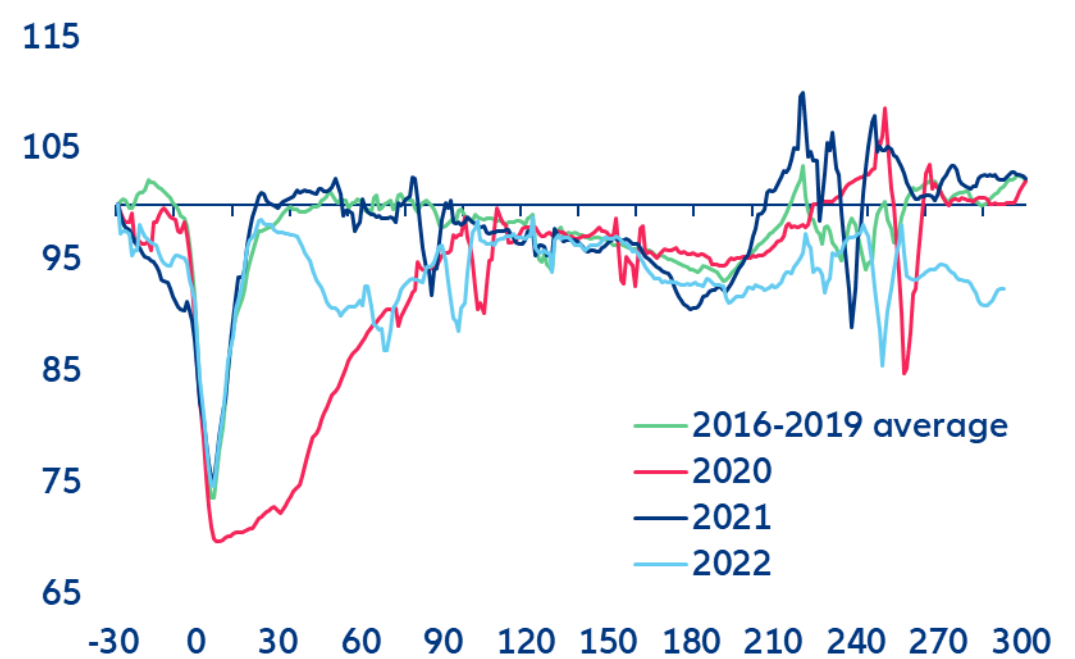
Covid-19: recent easing of restrictions won't prevent difficult winter months

Covid-19 outbreaks in China



Sources: Macrobond, Allianz Research

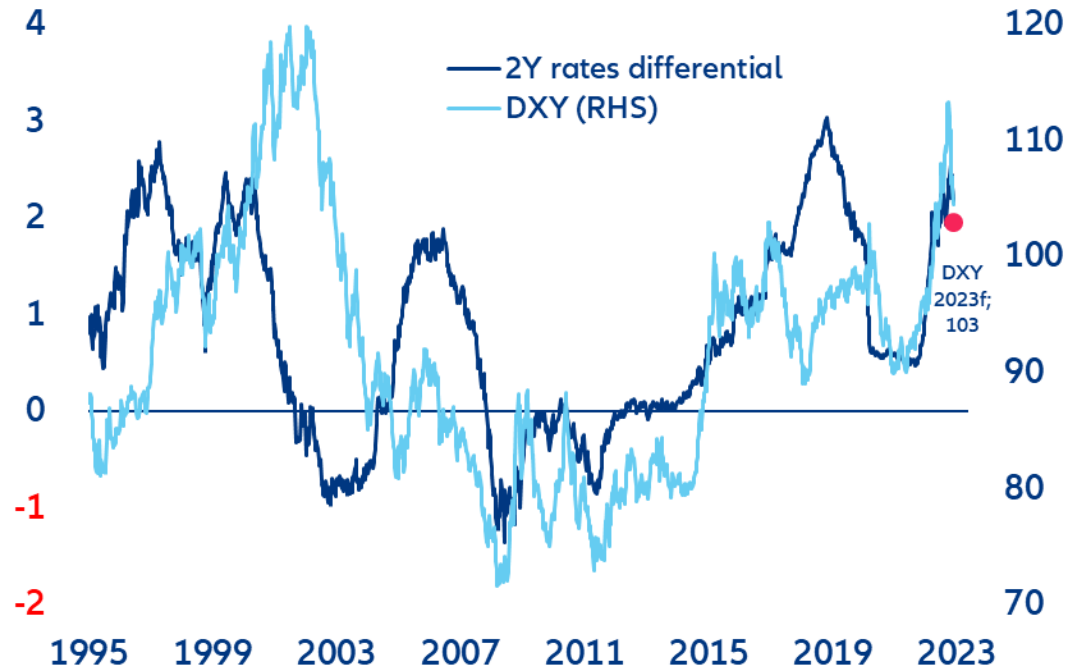
Traffic congestion index* (100 = 30 days before Chinese New Year)



Sources: Macrobond, Allianz Research. Note: */ population-weighted average of 100 cities

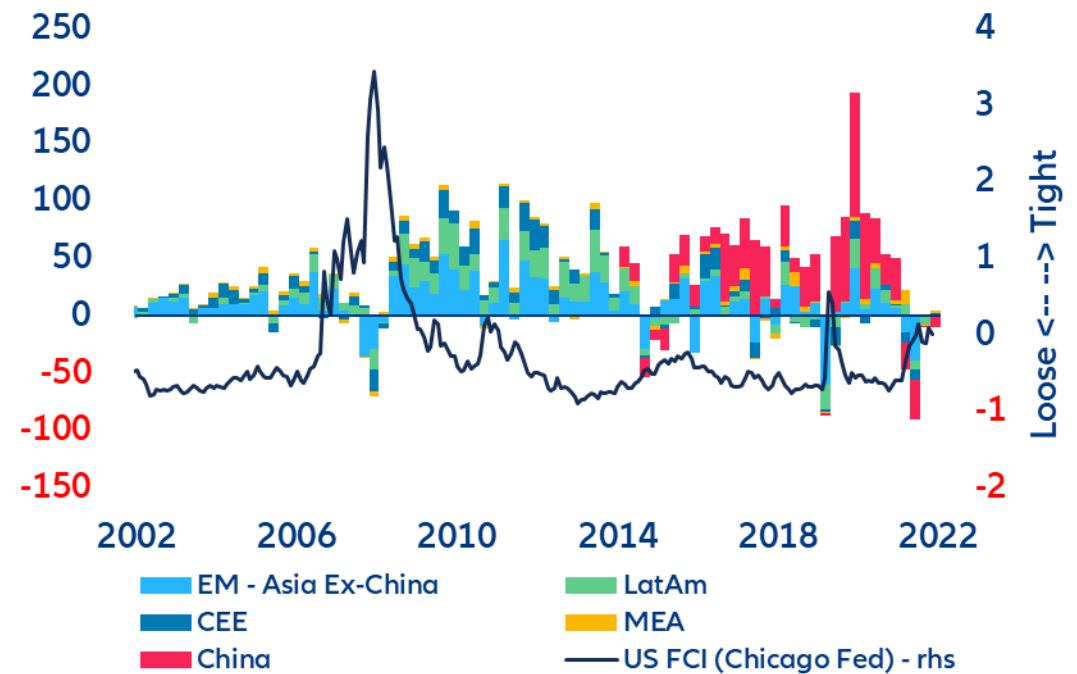
Strong USD and pressures on capital flows to continue

US Dollar Index (DXY) vs 2Y rates differential



Sources: Bloomberg; Allianz Research

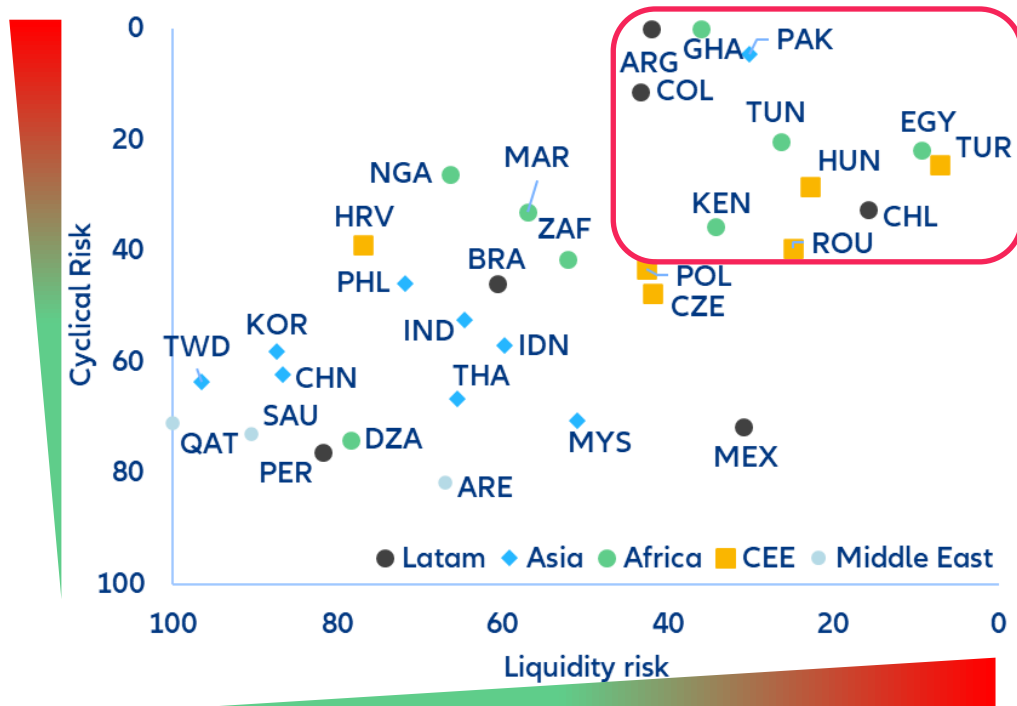
Capital Flows (USD Bn)



Sources: IIF; Refinitiv Datastream; Allianz Research. Note: Monthly flows aggregated by quarter. Flows are aggregated as soon as they are reported, but different countries report the data with different lags.

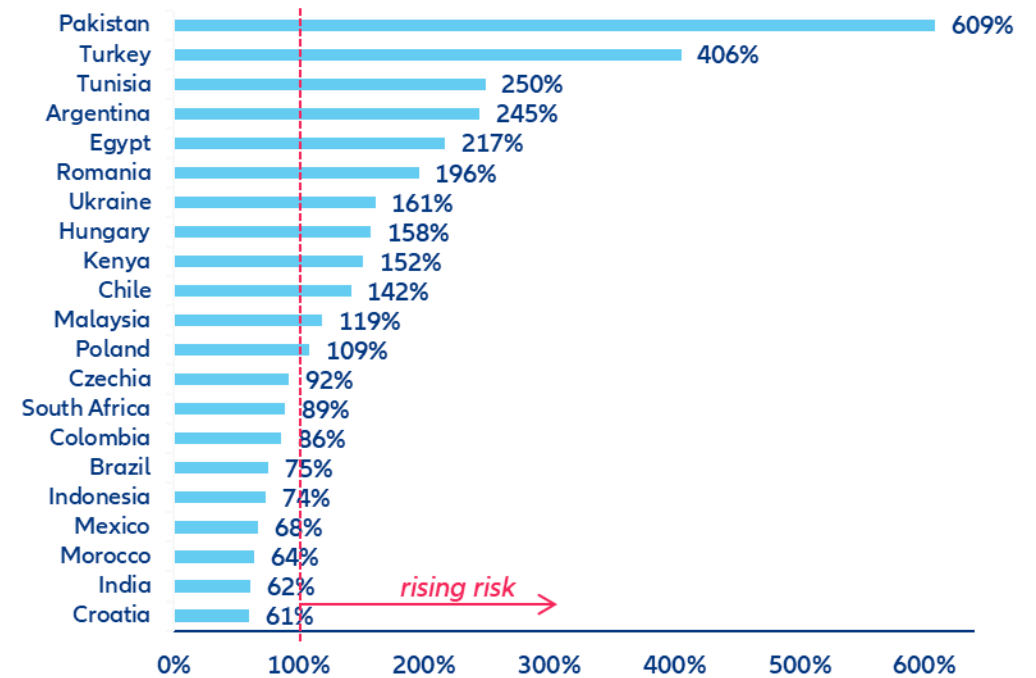
EMs at risk of sudden stop on the back of global liquidity tightening

Vulnerabilities to sharp AE's monetary tightening



Sources: Refinitiv Datastream, Allianz Research

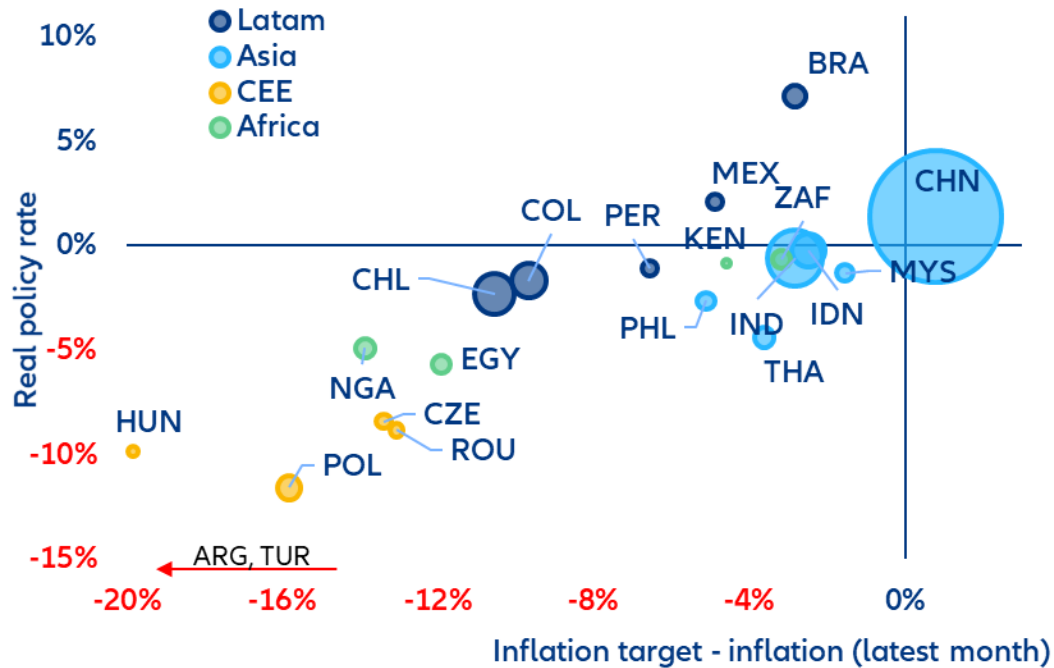
Gross external financing requirements (% of FX reserves)



Sources: Refinitiv Datastream, Allianz Research

As inflationary pressures will peak by Q1, most EMs will stop raising rates in 2023

Inflationary pressures



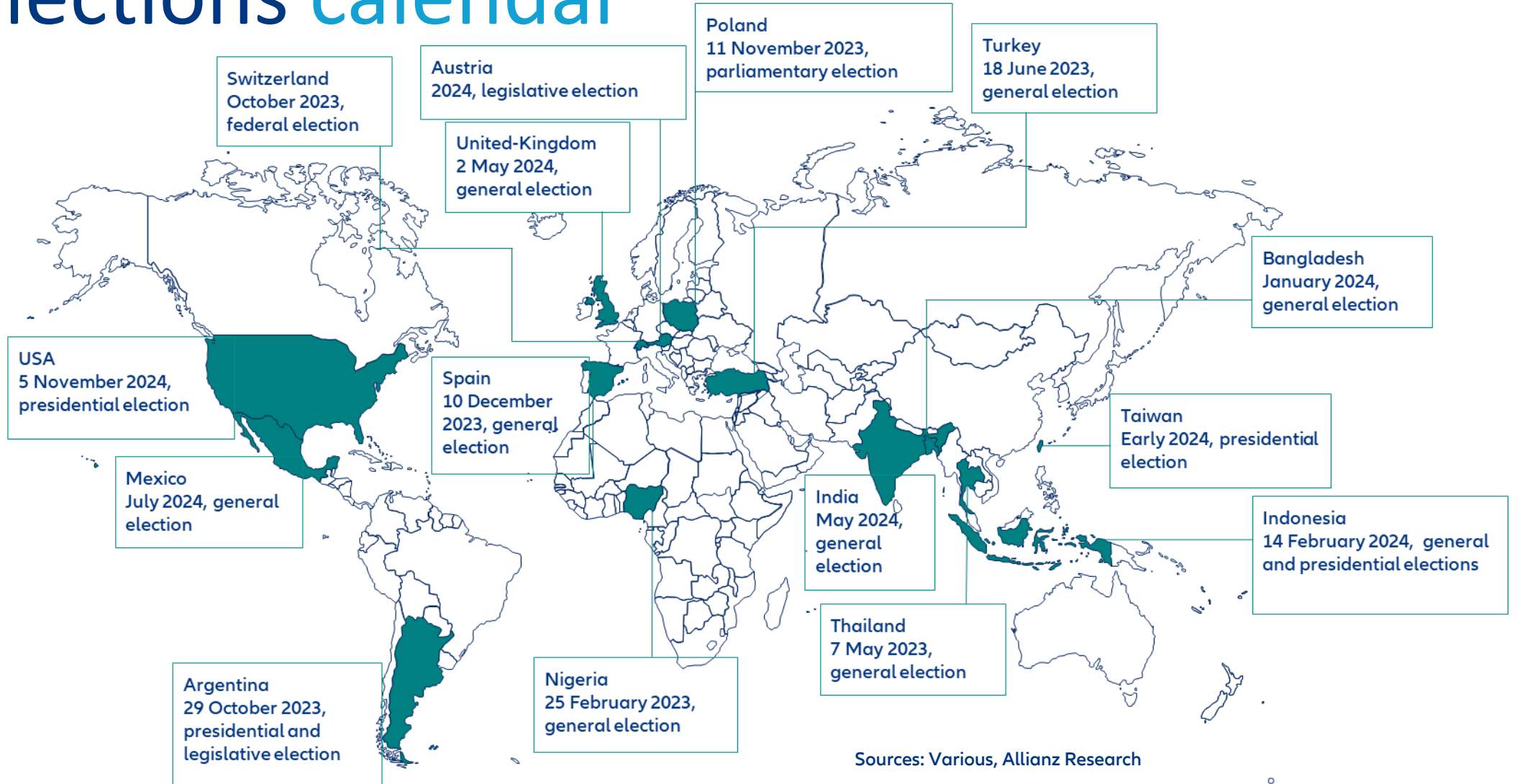
Sources: Refinitiv Datastream, Allianz Research. Note: Countries that as of today have not fully adopted an inflation target are not represented in the chart. Of those, Algeria and Morocco are the ones with a more negative real interest rate. Gulf countries, the monetary policy of which is used to support the USD peg are also excluded.

EM: Expected policy rates in 2023-2024

		Interest rate		Interest rate forecasts		
		Latest	2021 Avg.	Mid-2023	End 2023	End-2024
Latin America	Argentina	75,00	38,00	75,00	75,00	60,00
	Brazil	13,75	4,81	13,75	12,00	11,00
	Chile	11,25	1,29	11,25	8,50	7,50
	Mexico	10,00	4,42	10,50	9,75	9,00
	Colombia	11,00	1,94	11,00	9,00	8,00
	Peru	7,50	0,77	7,25	6,25	5,25
Asia	China	3,65	3,85	3,55	3,45	3,45
	Indonesia	5,25	3,52	5,75	5,50	5,00
	South Korea	3,25	0,65	3,50	3,00	2,25
	Malaysia	2,75	1,75	3,25	3,00	2,75
	Taiwan	1,63	1,13	2,00	2,00	1,75
	Philippines	5,50	2,50	5,75	5,00	4,50
	Thailand	1,25	0,50	2,00	1,75	1,50
	India	6,25	4,00	6,50	6,50	6,00
Eastern Europe	Czech Republic	7,00	0,98	6,75	5,50	2,75
	Poland	6,75	0,37	6,50	5,75	3,75
	Romania	6,75	1,35	6,75	6,25	4,00
	Hungary	13,00	1,21	12,50	8,50	4,50
	Russia	7,50	5,98	6,50	6,00	5,25
	Turkey	9,00	17,58	7,00	28,00	17,00
Africa	South Africa	7,00	3,54	6,00	5,50	5,00
	Kenya	8,75	7,00	8,50	8,00	7,00
	Algeria	3,00	3,00	3,00	3,00	3,00
	Morocco	2,00	1,50	2,75	2,75	2,25
	Egypt	13,25	8,25	14,00	14,00	12,00
	Nigeria	16,50	11,50	17,50	17,50	13,00
Middle East	Saudi Arabia	4,50	1,00	5,25	4,50	3,50
	United Arab Emirates	3,90	0,38	4,65	3,90	2,90
	Qatar	5,00	2,50	5,50	5,00	4,00

Sources: Refinitiv Datastream, Bloomberg, Allianz Research

Elections calendar

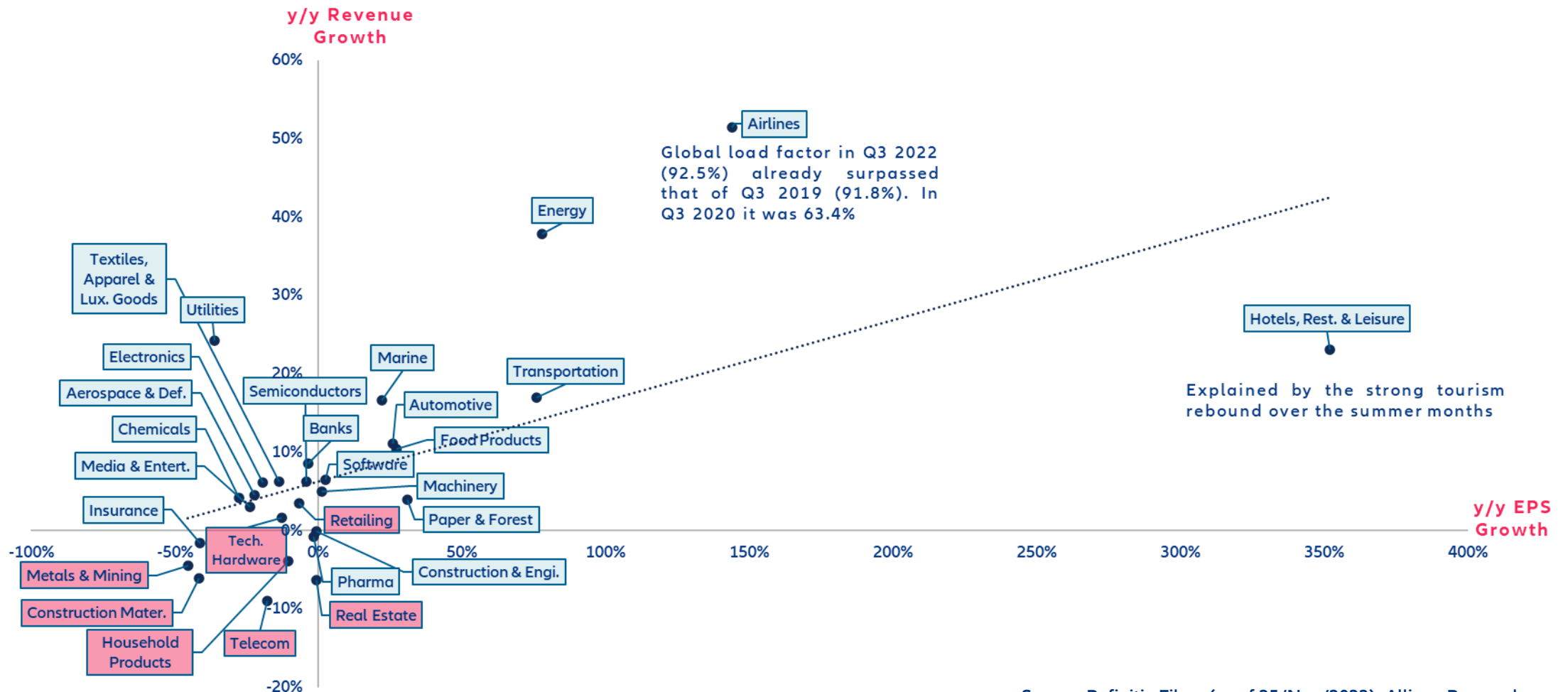


Sources: Various, Allianz Research

Corporate Outlook

2023-24

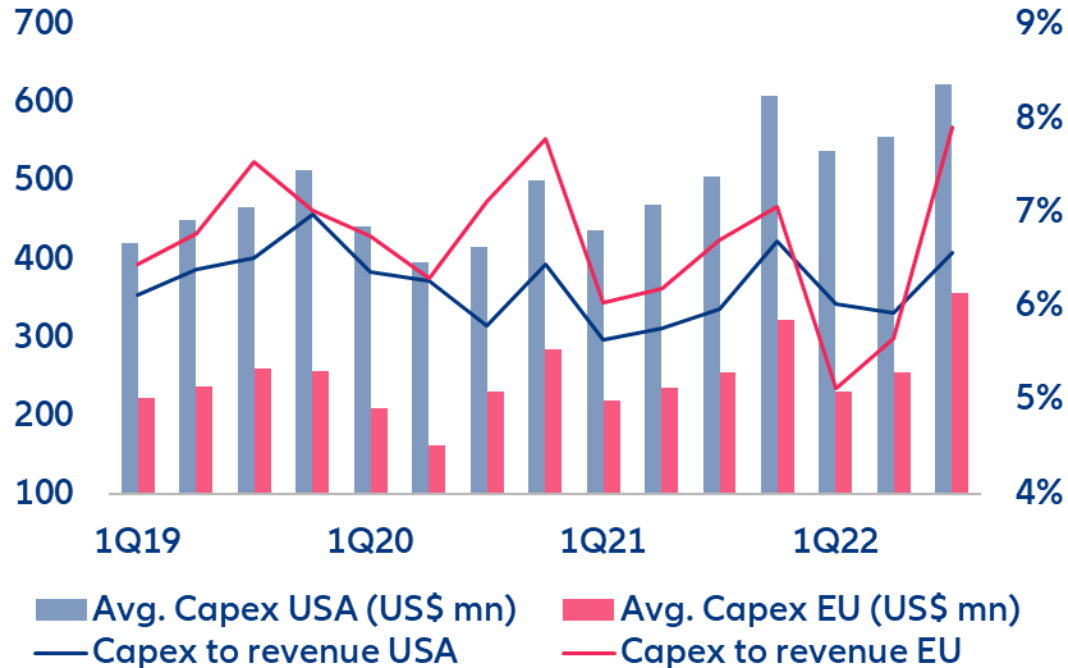
Some sectors are already tumbling



Source: Refinitiv Eikon (as of 25/Nov/2022), Allianz Research

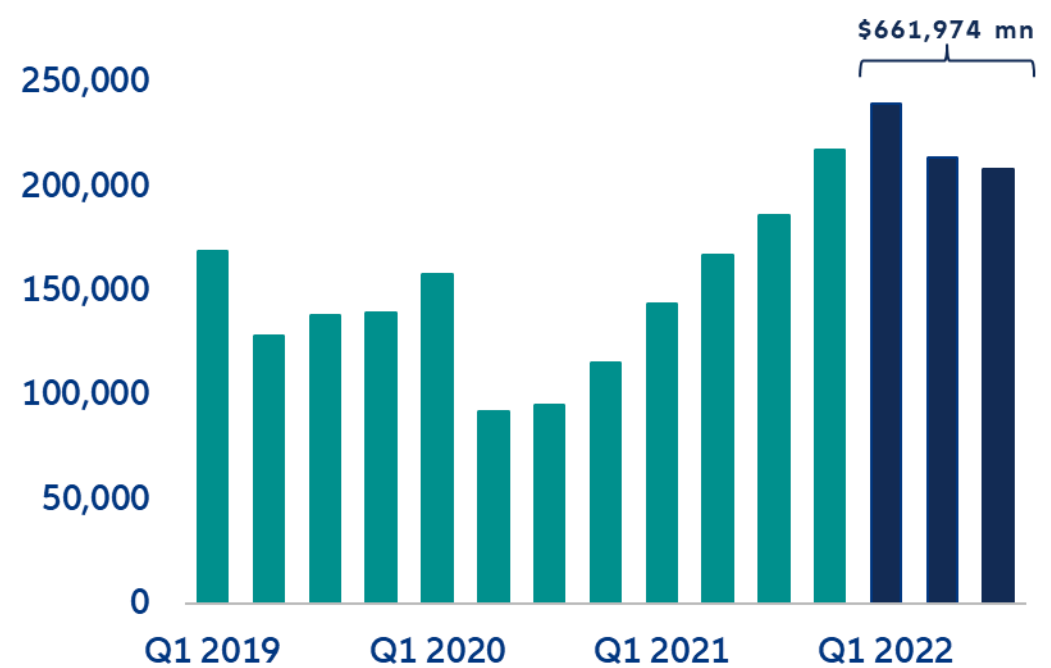
Post-pandemic cash overflow is being used on capex and share buybacks

S&P-500 and Stoxx-600 (NFC)



Sources: Bloomberg; Allianz Research. Note: NFC=non-financial corporations

Cash used for shares repurchase
(S&P-500, NFC, US\$ mn)

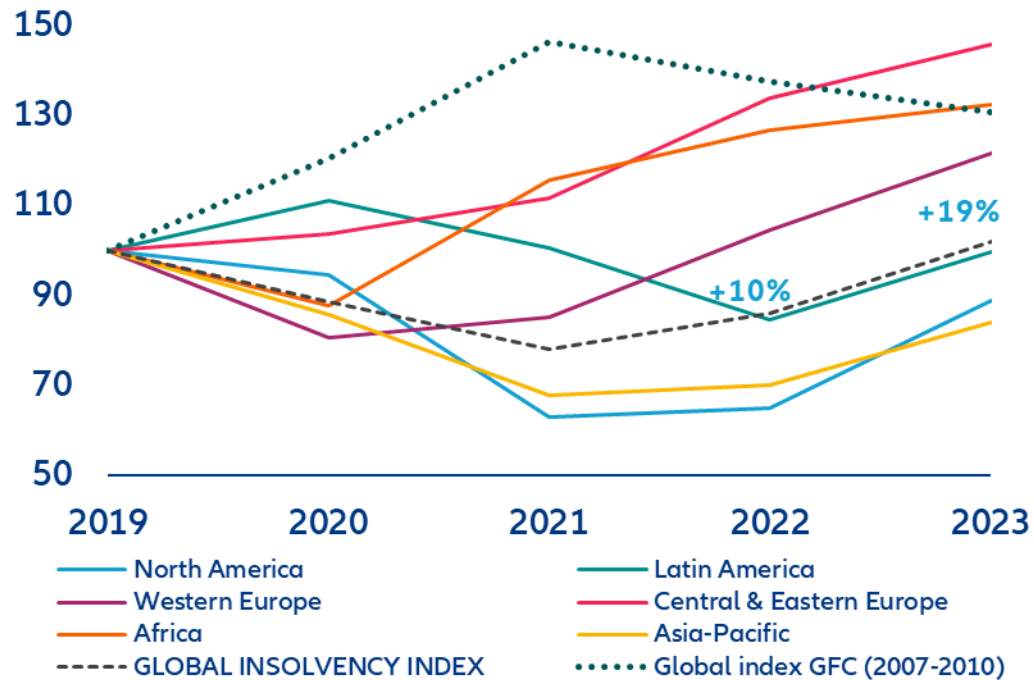


Sources: Bloomberg; Allianz Research

Further acceleration in 2023 (+19% at the global level)

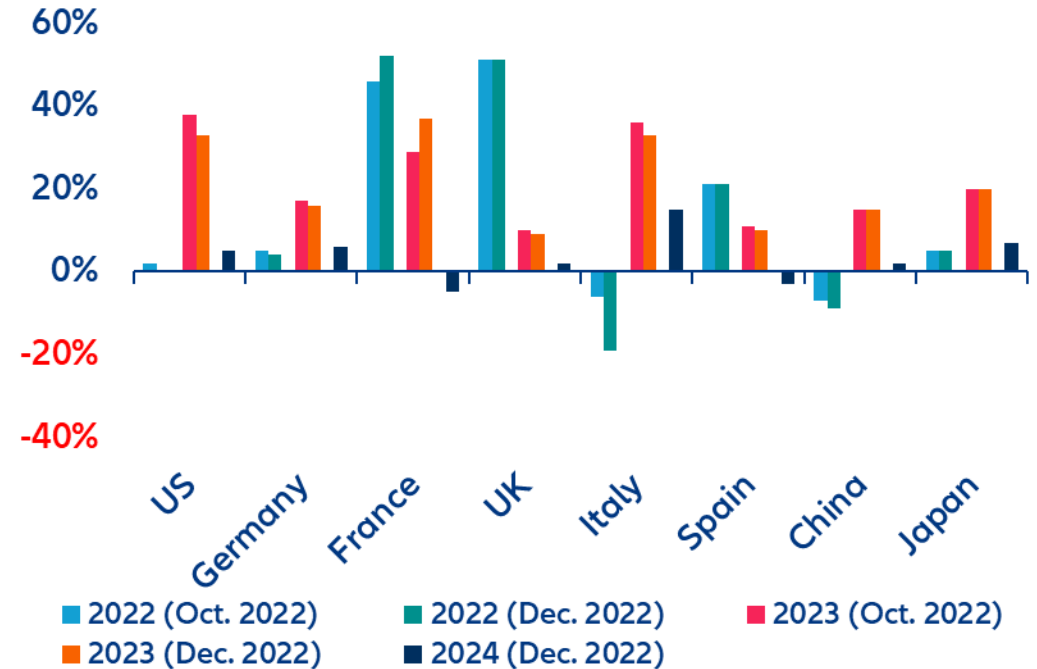
October scenario

Global and regional insolvency indices, yearly level, basis 100 in 2019



December update

key countries (provisional figures)



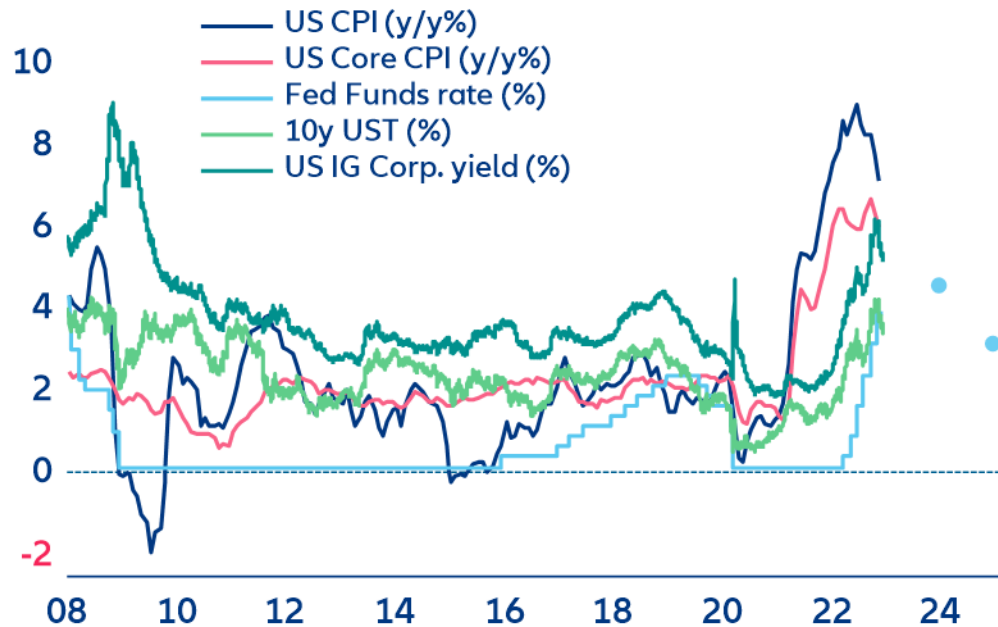
Sources: National institutes, Allianz Research

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Market Outlook 2023-24

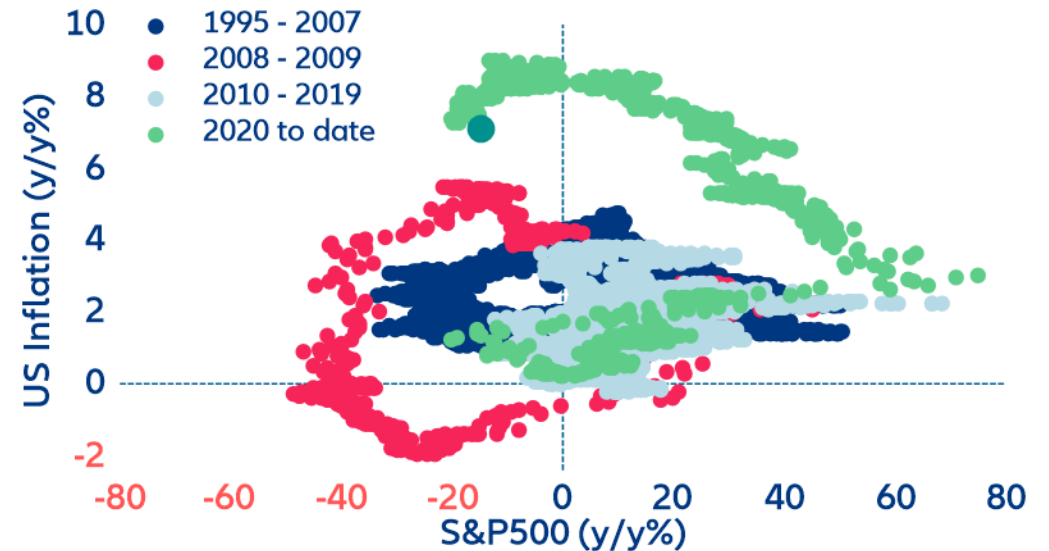
Caution! A bad macro reading can immediately spook markets

Inflation and monetary policy expectations still dominate capital markets performance



Sources: Refinitiv Datastream, Allianz Research. Note: The circles indicate the expected 12m and 24m ahead market-based Fed Funds rate

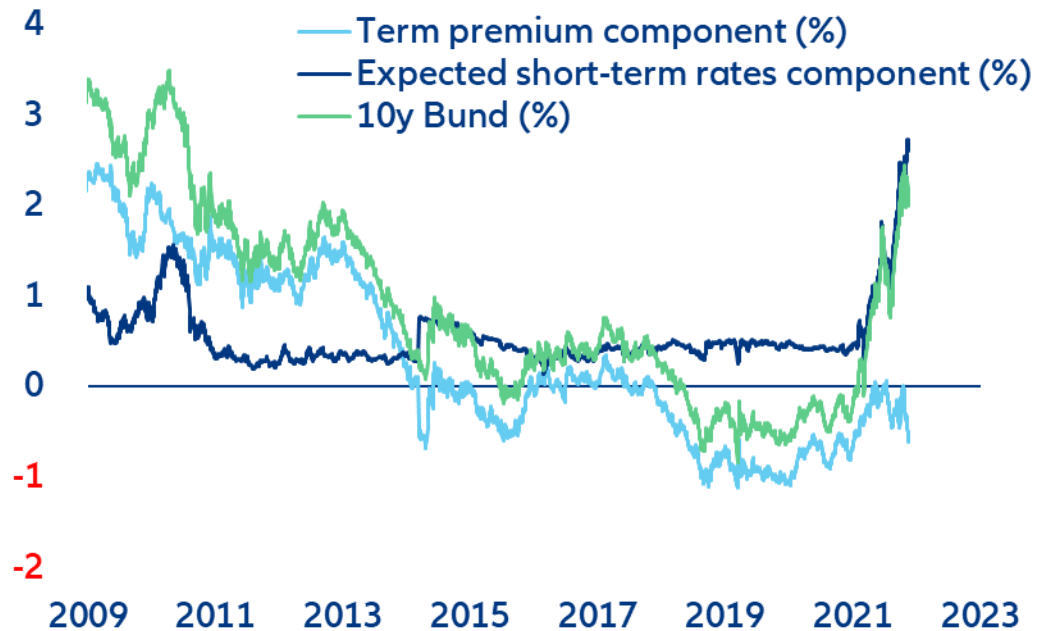
Inflation levels are still too high for equities; Historically, 3 to 4% tends to be the upper limit



Sources: Refinitiv Datastream, Allianz Research

Do not expect fundamentals to drive market performance until 2024

The long-end of the curve remains dependent on the short-end and isolated from fundamentals



Sources: Refinitiv Datastream, Allianz Research

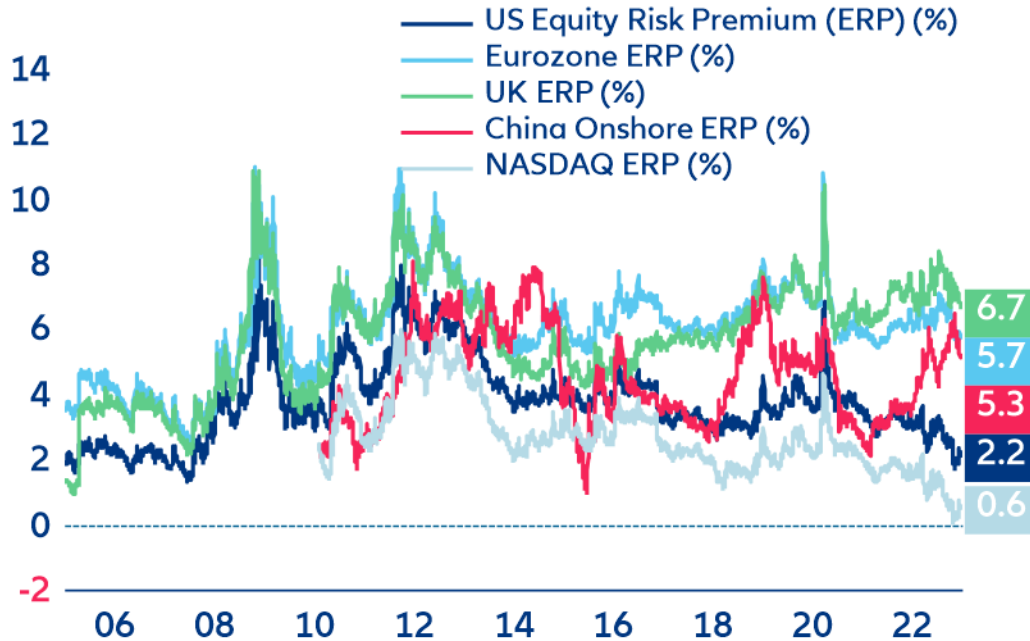
Fundamentals will start to kick in once the monetary policy wave is over (i.e. 2024)



Sources: IBES, Refinitiv Datastream, Allianz Research

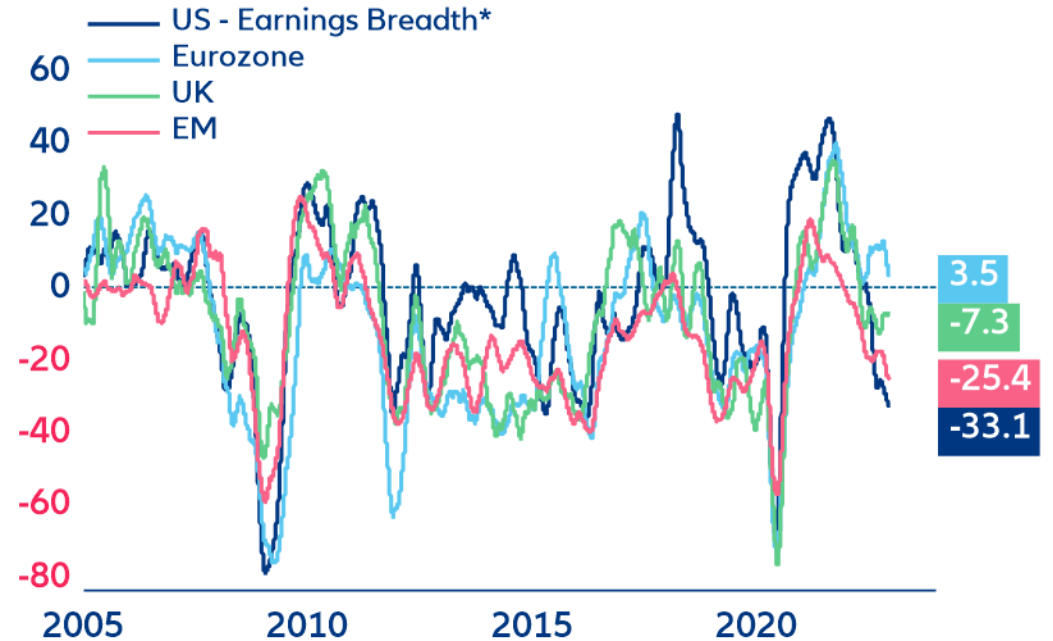
Regional divergences will accentuate cross-country/region performance

Eurozone and UK Equities look relatively cheap while US equities are still on the expensive side



Sources: Refinitiv Datastream, Allianz Research. Note: 12m Forward Earnings are used for the Earnings-based ERP computation

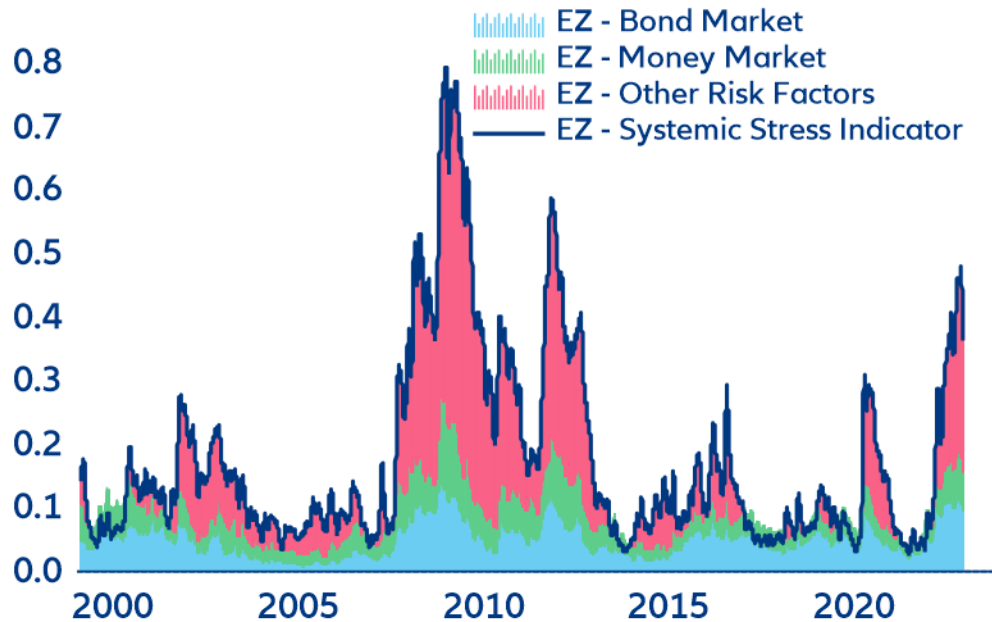
Markets recurrently recognize the heterogeneity of the current economic environment



Sources: Refinitiv Datastream, Allianz Research. Note: earnings breadth: * # of EPS upward revisions - # of EPS downward revisions as a % of total # of estimations

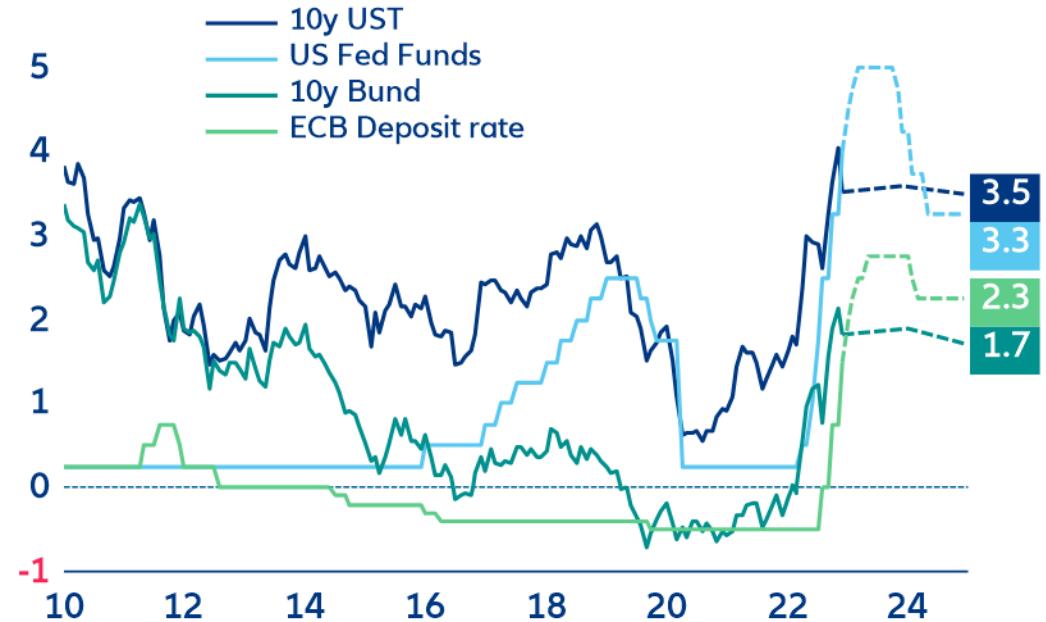
The long-end of the curve will continue to be dominated by monetary policy

While the bond market discounting machine is only waiting for the policy pivot risks remain high ...



Sources: ECB, Refinitiv Datastream, Allianz Research

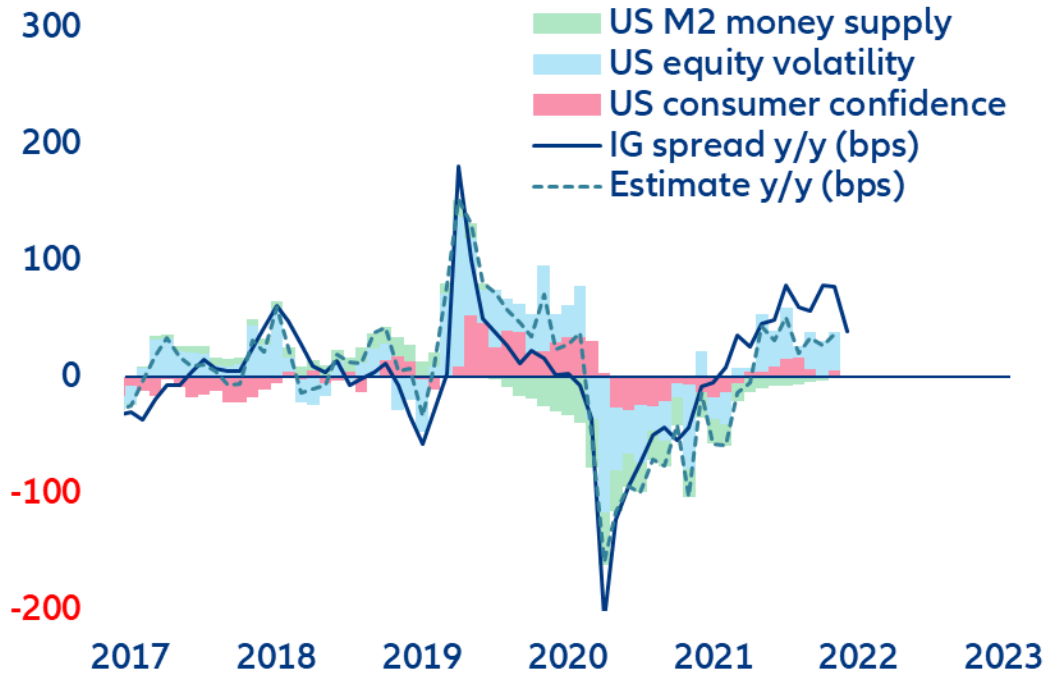
... LT yields have fully embraced our policy rate scenario leaving little room for higher yields



Sources: Refinitiv Datastream, Allianz Research

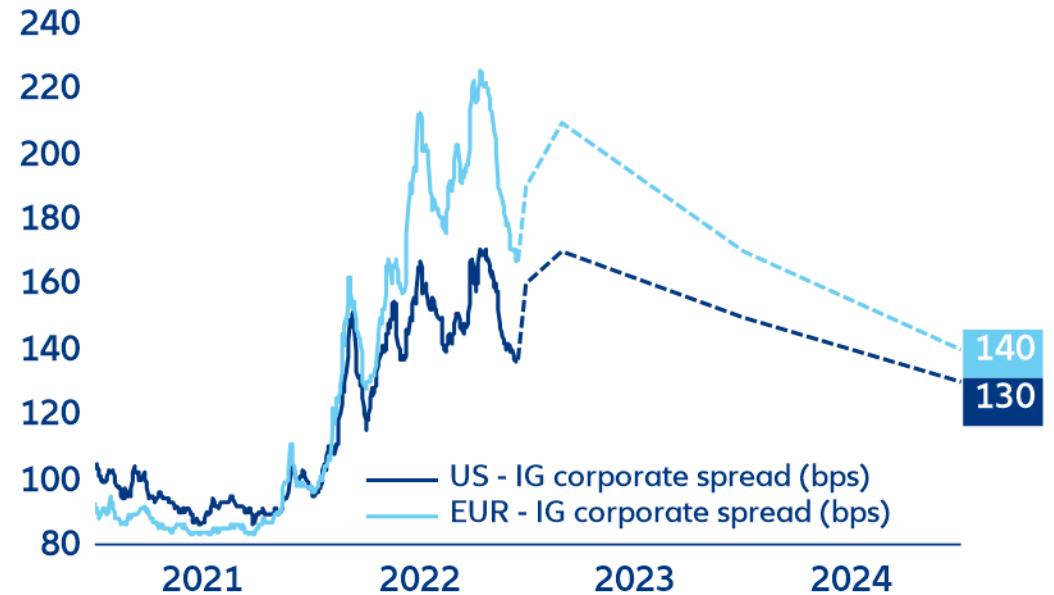
In this highly volatile environment high quality credit is likely to outperform

Economic fundamentals and financing conditions do not concede a structural credit rally



Sources: Refinitiv Datastream, Allianz Research

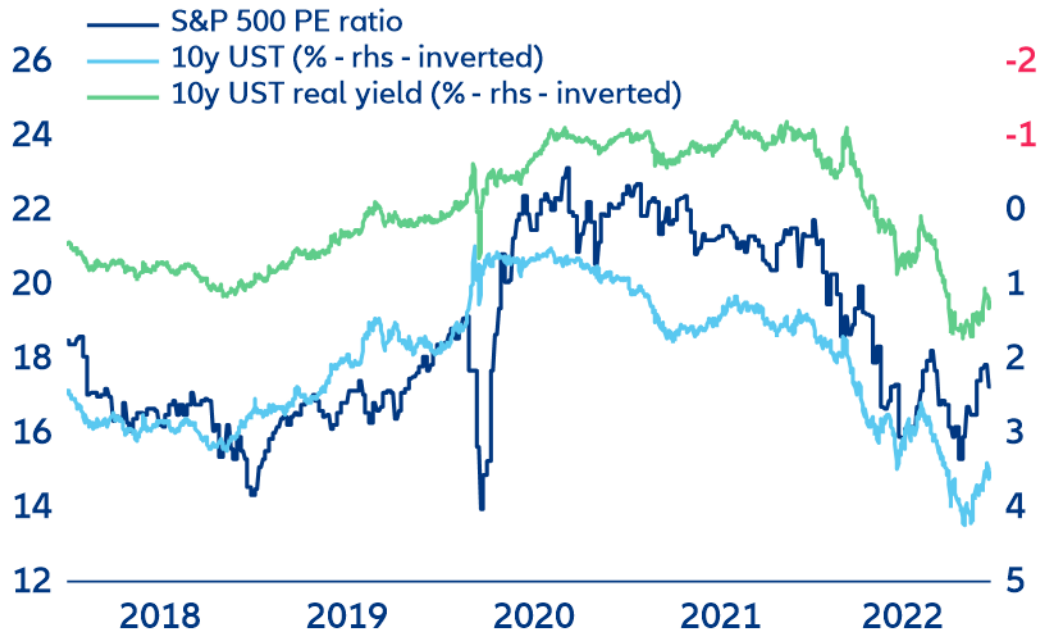
Staying alert is paramount but 2023 may prove quite interesting for high quality credit markets



Sources: Refinitiv Datastream, Allianz Research

Equity had a good run for the past 10y, 23-24 are unlikely to follow the trend

Moves along the short and long end of the curve will continue to put pressure on equity valuations



Sources: IBES, Refinitiv Datastream, Allianz Research

Persistent economic uncertainty will put a lid on equity returns in both 2023 and 2024



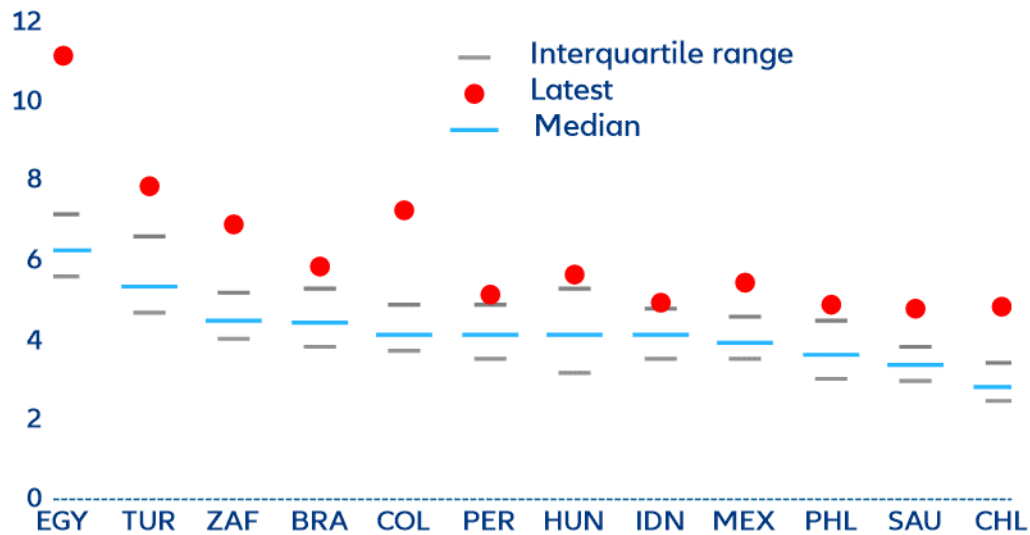
Sources: Refinitiv Datastream, Allianz Research

EM Sovereign high yields but high pressures

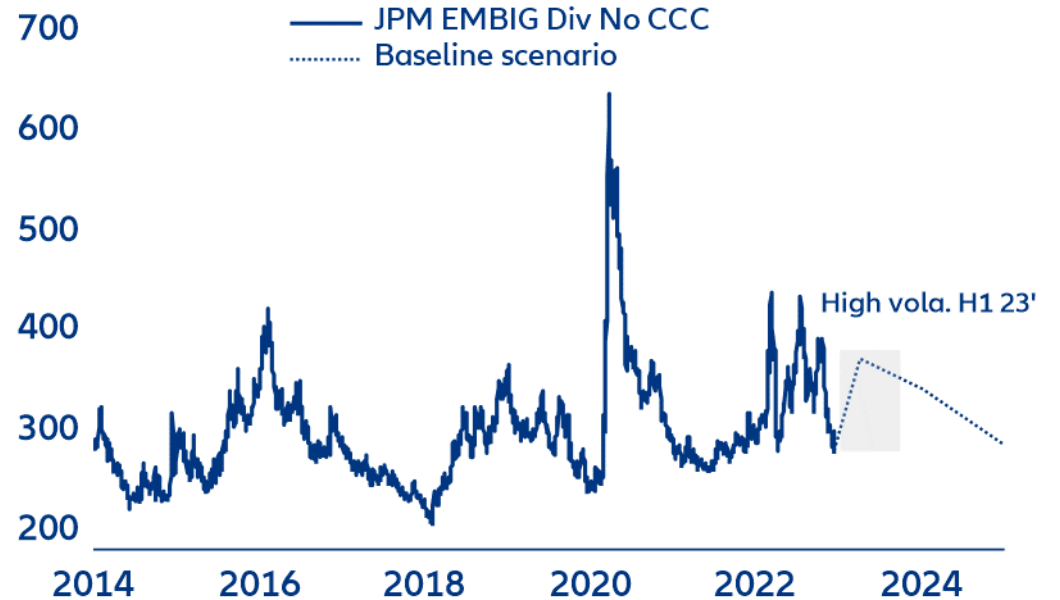
EM yields look attractive, allowing for nice returns for long-term holders, ...

... but the Fed and the global slowdown are still there: Volatility is not over!

Distribution of benchmark yields of USD-denominated bonds



Sources: Refinitiv Datastream, Allianz Research. Note: distribution of spreads over the last 15 years.



Sources: Bloomberg, Allianz Research

2023 will be a coin toss but 2024 should allow for some decent returns

Capital Markets: Eurozone and US

year-end figures

year-end figures	Last	Unit	Baseline			
			2021	2022f	2023f	2024f
EMU						
Government Debt						
Policy rate (ECB deposit rate)	1.50	%	-0.50	2.00	2.75	2.25
Policy Rate (MRO)	2.00	%	0.00	2.50	3.25	2.75
10y yield (Bunds)	1.93	%	-0.2	2.10	1.90	1.70
10y EUR swap rate	2.6	%	0.3	2.80	2.20	2.00
Italy 10y sovereign spread	192	bps	136	210	180	160
France 10y sovereign spread	49	bps	37	65	50	40
Spain 10y sovereign spread	104	bps	77	100	85	75
Corporate Debt						
Investment grade credit spreads	167	bps	98	190	170	140
High-yield credit spreads	501	bps	331	520	540	460
Equity						
Eurostoxx (total return p.a.)	-8 ytd	%	23.4	-10	6	7

			2021	2022f	2023f	2024f
US						
Government Debt						
Policy rate (upper)	4.50	%	0.25	4.50	4.25	3.25
10y yield (Treasuries)	3.50	%	1.5	3.75	3.60	3.50
Corporate Debt						
Investment grade credit spreads	137	bps	98	160	150	130
High-yield credit spreads	437	bps	310	480	510	440
Equity						
S&P 500 (total return p.a.)	-14.8 ytd	%	28.7	-15	2	9

Capital Markets: UK, Emerging Markets, FX

year-end figures

year-end figures	Last	Unit	Baseline			
			2021	2022f	2023f	2024f
UK						
Government Debt						
Policy rate	3.00	%	0.25	3.50	4.00	3.50
10y yield sovereign (Gilt)	3.3	%	1.0	3.20	3.75	3.25
Corporate Debt						
Investment grade credit spreads	192	bps	115	220	200	160
High-yield credit spreads	651	bps	390	650	680	550
Equity						
FTSE 100 (total return p.a.)	5.2 ytd	%	18.4	4	3	7

			2021	2022f	2023f	2024f
Emerging Markets						
Government Debt						
Hard currency spread (vs USD)	283	bps	295	320	335	290
Local currency yield	6.8	%	5.72	7.1	6.4	5.9
Equity						
MSCI EM (total return p.a. in USD)	-18.5 ytd	%	-2.2	-20	7	7

			2021	2022f	2023f	2024f
Others						
Foreign Exchange						
EURUSD	1.065	\$ per €	1.137	1.03	1.06	1.11
Commodities						
Oil Brent (yearly avg.)	83	\$ per Bbl	78	97	96	90
Natural Gas Dutch TTF (yearly avg.)	132	€ per MWh	69	170	173	150

Sources: Refinitiv Datastream, Allianz Research

Thank you!

