Economic Outlook

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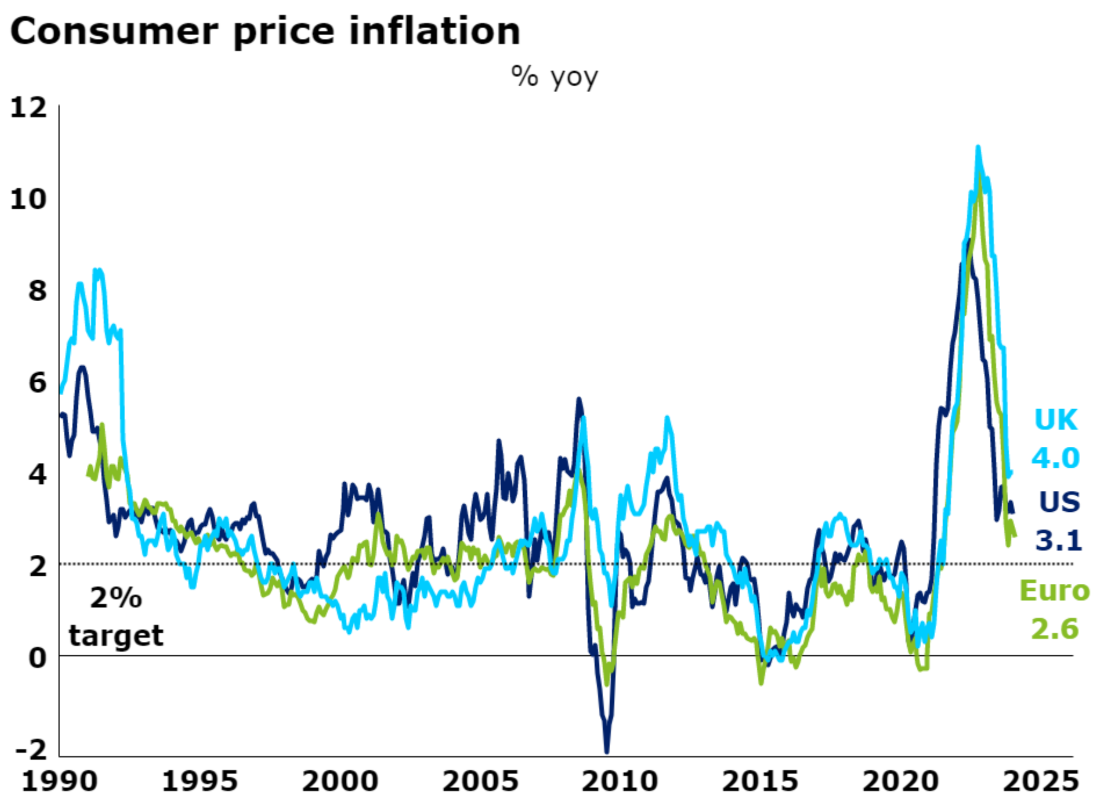
Global outlook

Global inflation and interest rates have been rising, but the worst is over

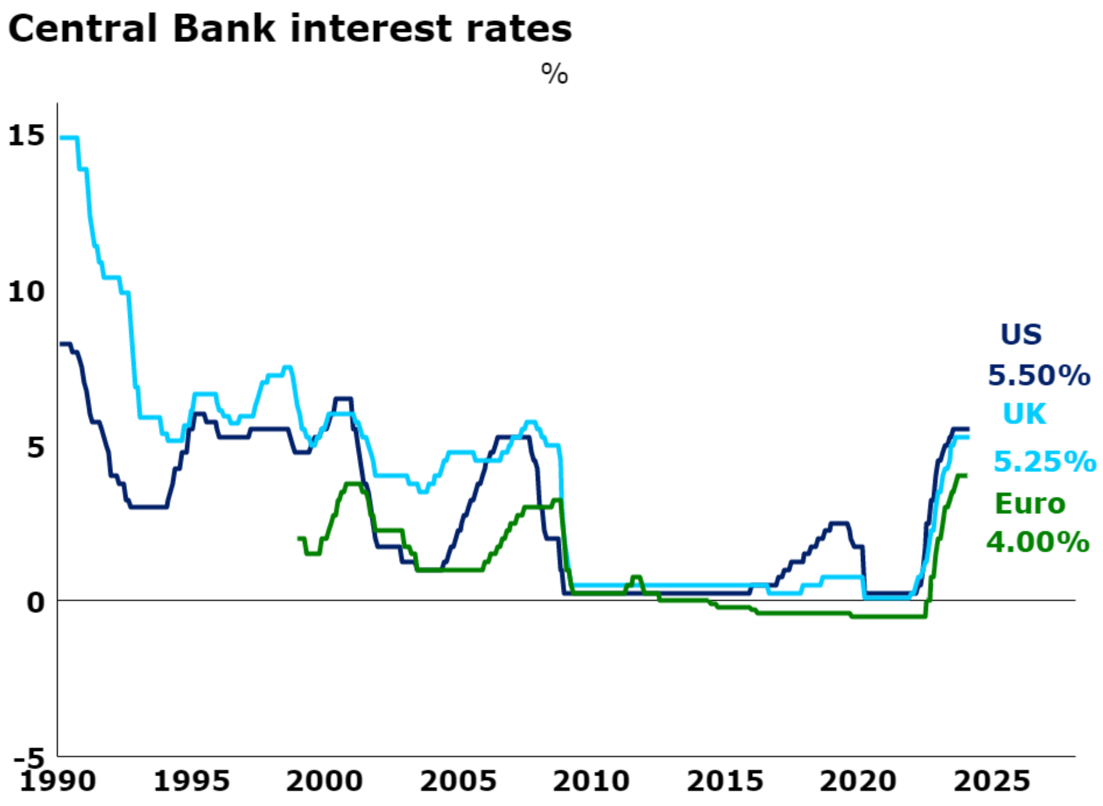
We have not seen this level of high inflation and high interest rates since the 1990s

Inflation in US, UK & euro area hit multi-decade highs ...



Source: LSEG Datastream

... which forced central bankers' hand

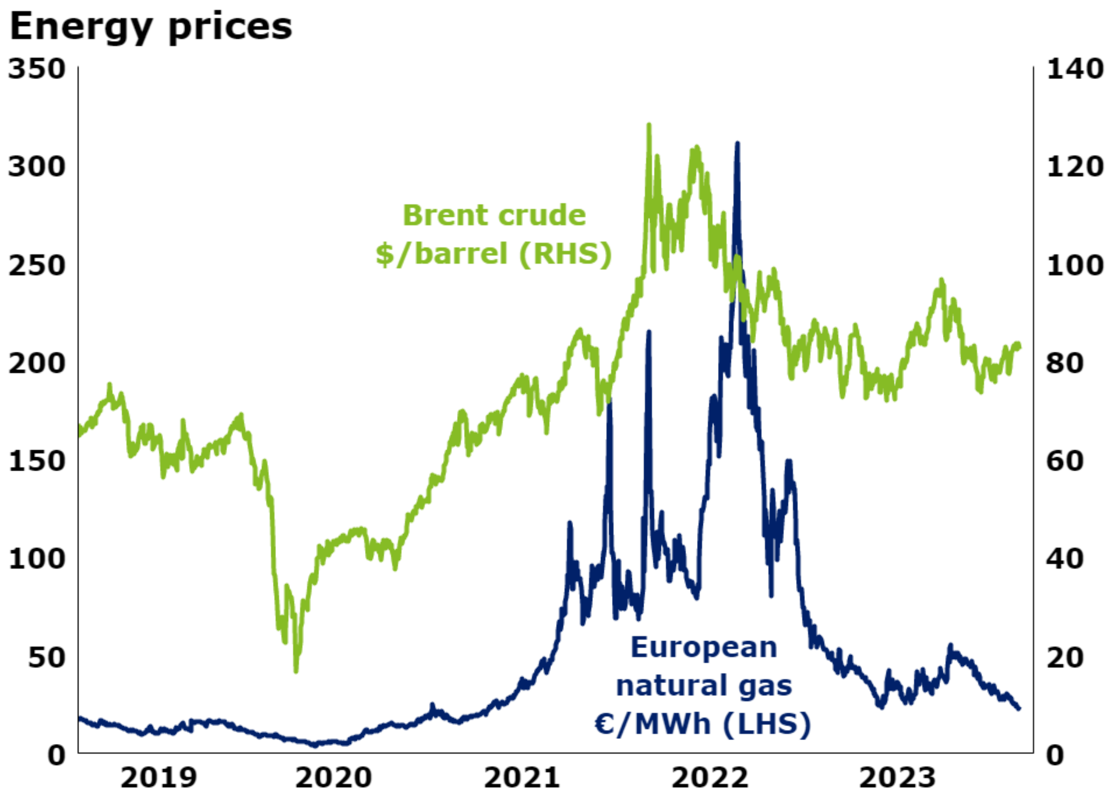


Source: LSEG Datastream; upper limit of the Fed funds target range shown

Lower energy prices and smoother supply chains have brought down inflation

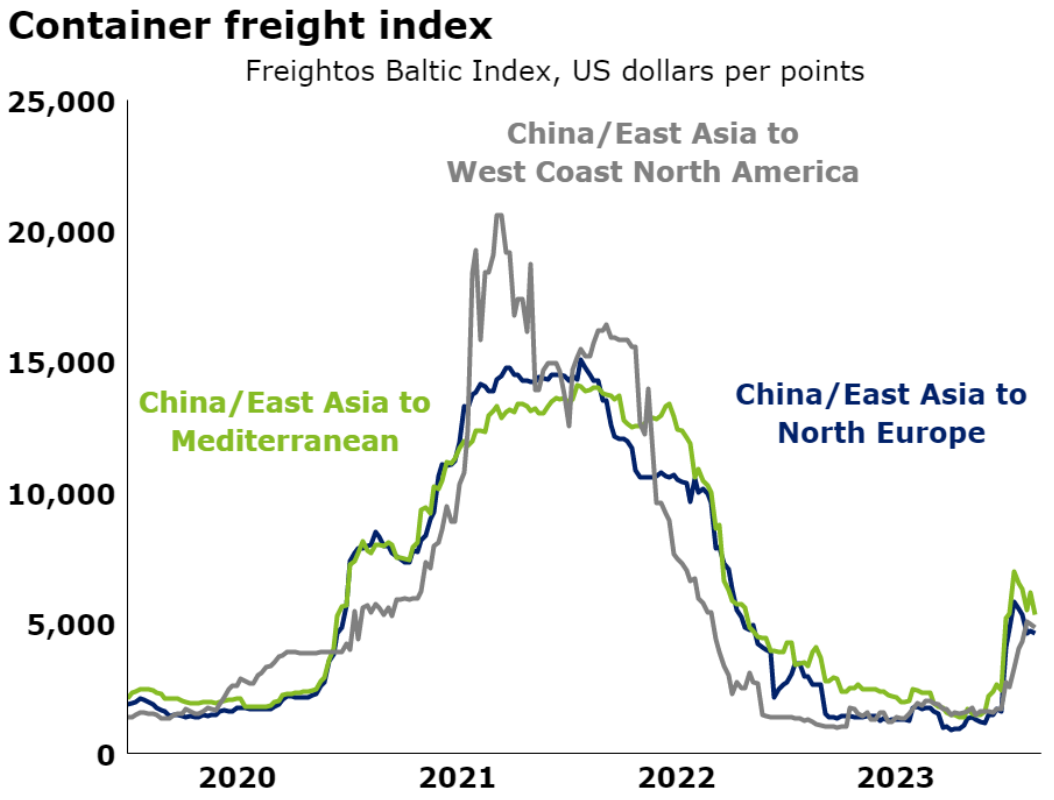
Despite interest rate rise, inflation has fallen due to lower energy prices and more elastic supply chains

Energy prices have come down from the post-Ukraine invasion peak ...



Source: LSEG Datastream

... and supply chains are faring much better, despite recent turmoil in the Middle East

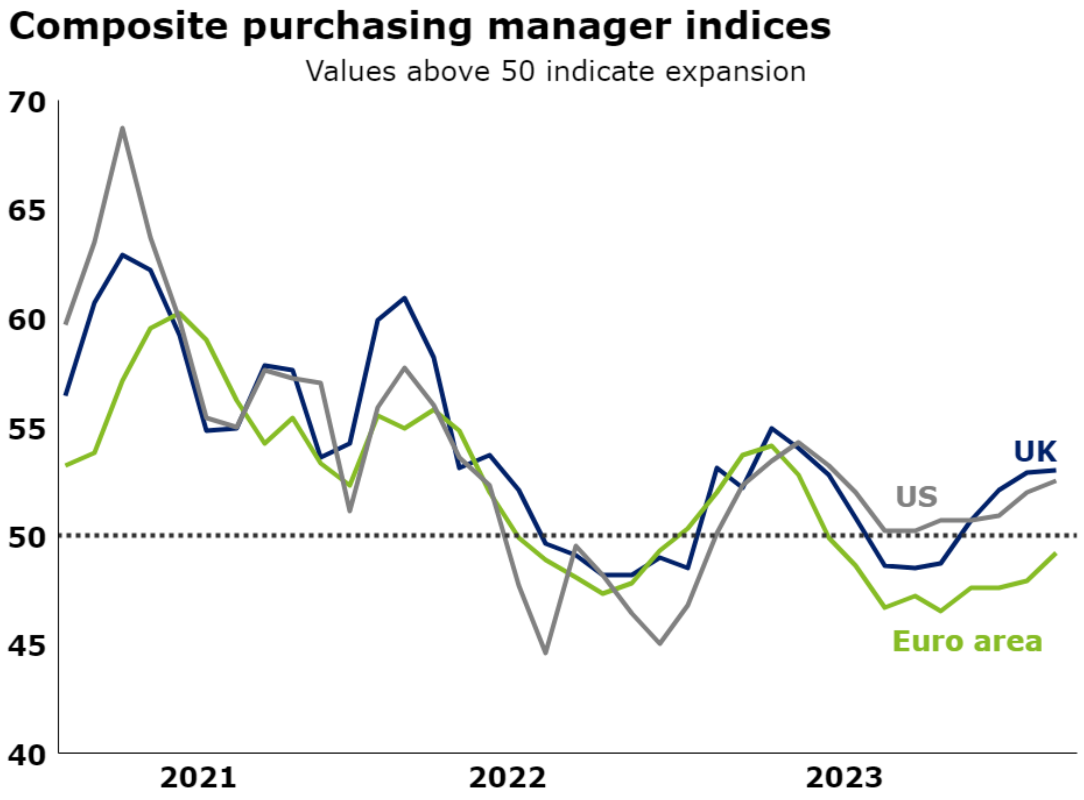


Source: LSEG Datastream

Despite the positive news on inflation, growth in advanced economies is slowing down

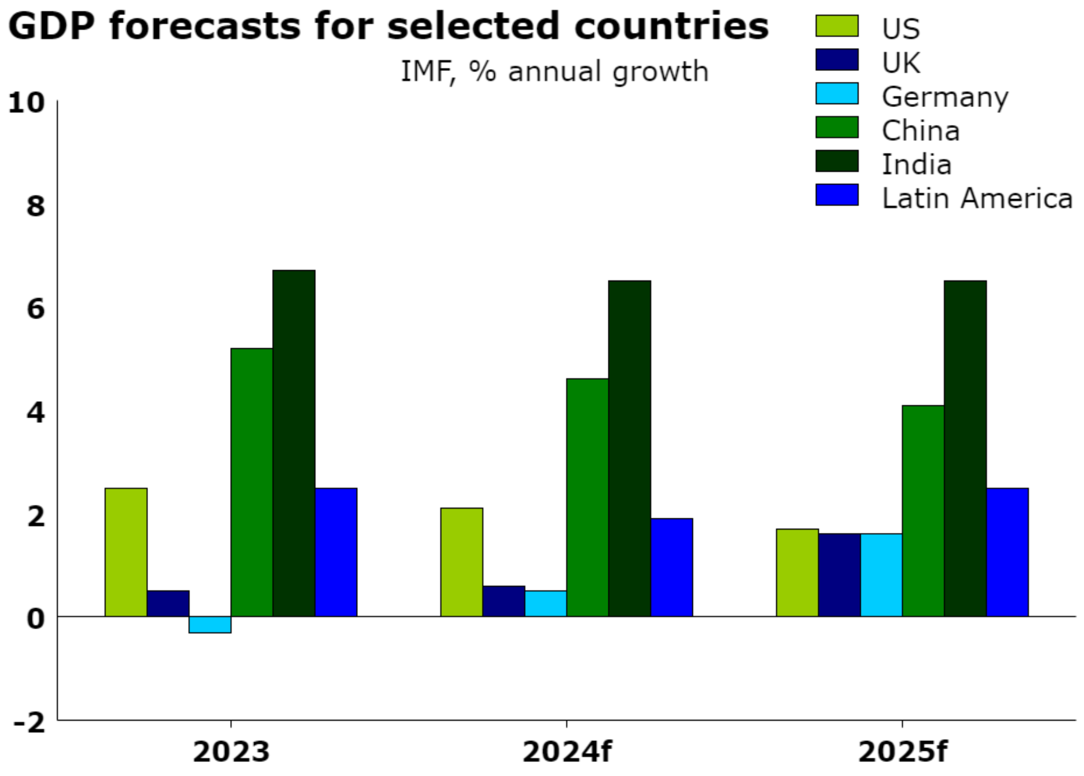
Higher prices and interest rates are starting to erode demand, especially in the UK and the Euro area

Growth in advanced economies slowed down this year …



Source: LSEG Datastream

… but it has been supported by emerging economies

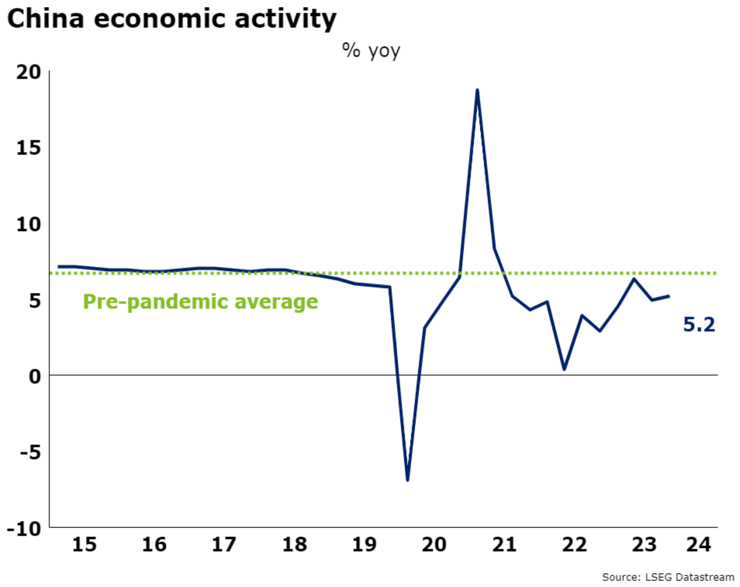


Source: LSEG Datastream

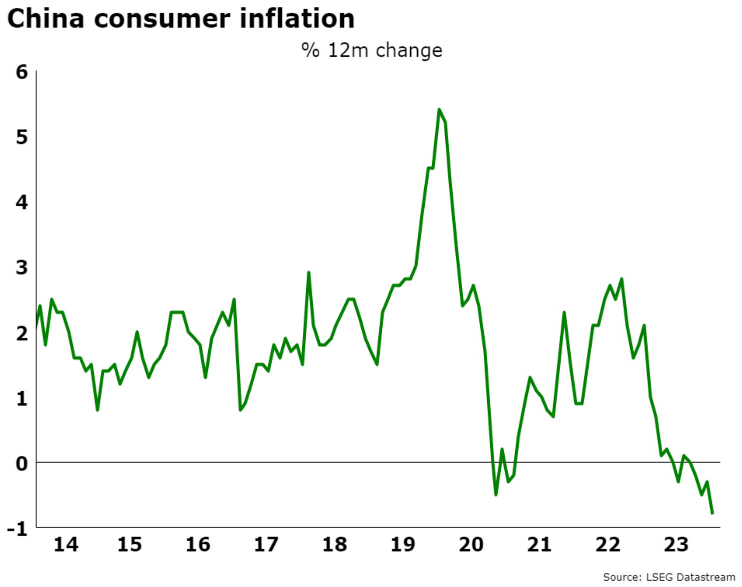
The slowdown in China may be good news for inflation but not much else

Slow growth in China is putting downward pressure on inflation but is hitting export markets and creates new risks

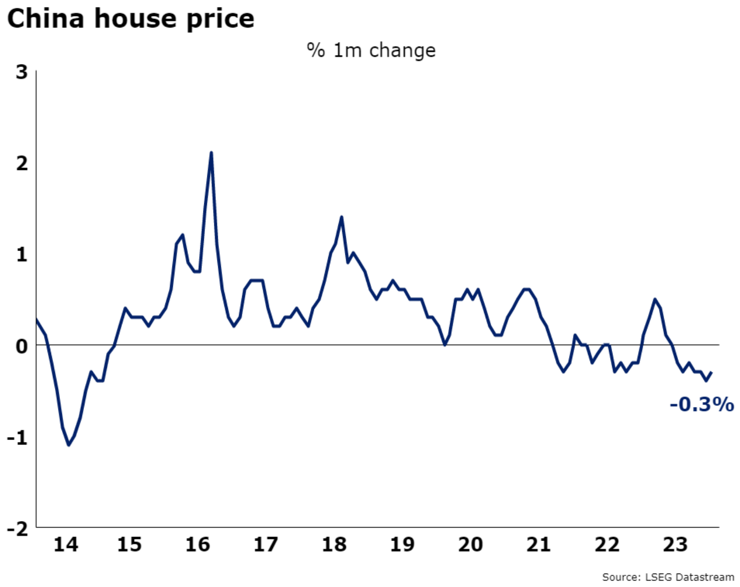
China's unprecedented slow down



China's deflationary problem



Contagion risk from real estate



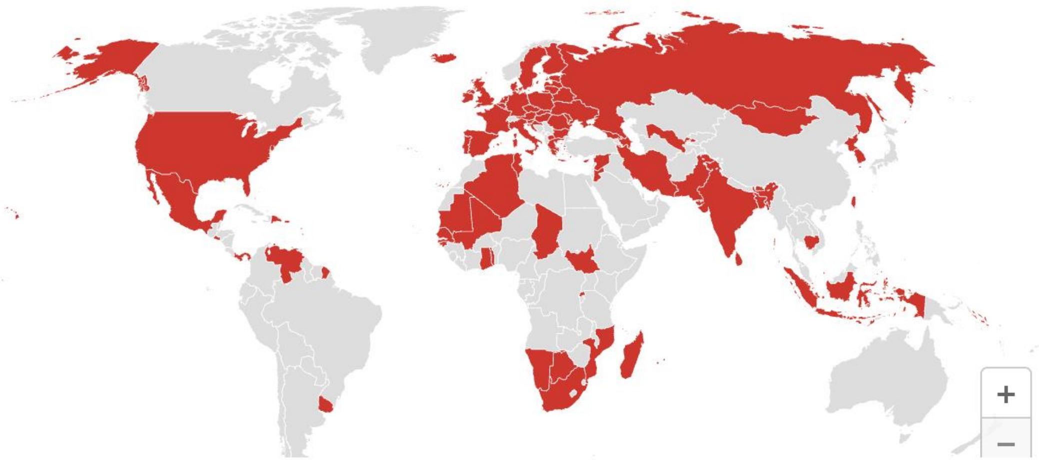
Domestic and foreign policy in 2024 are key risks

Higher geopolitical tensions make the election of the next set of world leaders even more crucial, especially when geopolitical tension are inflationary

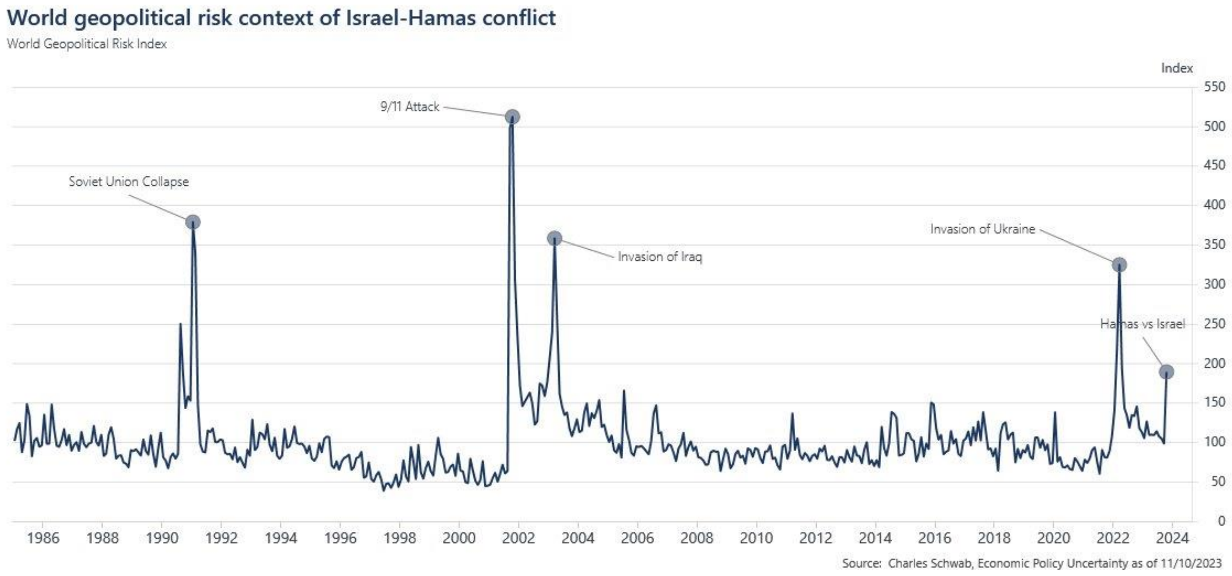
Half of the world will be electing their leaders this year…

2024: The Ultimate Election Year Around the World

National elections are scheduled or expected in at least 64 countries, as well as the European Union, which all together represent almost half the global population.



… at a time when geopolitical risk has been rising

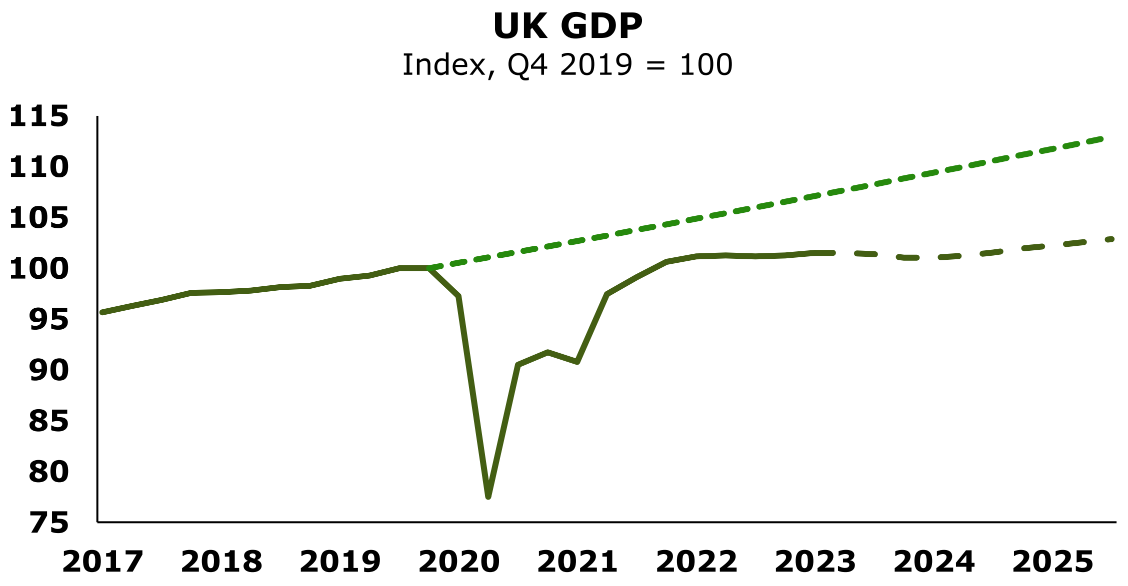


UK outlook

The UK entered a mild recession and recovery will be weak in 2024

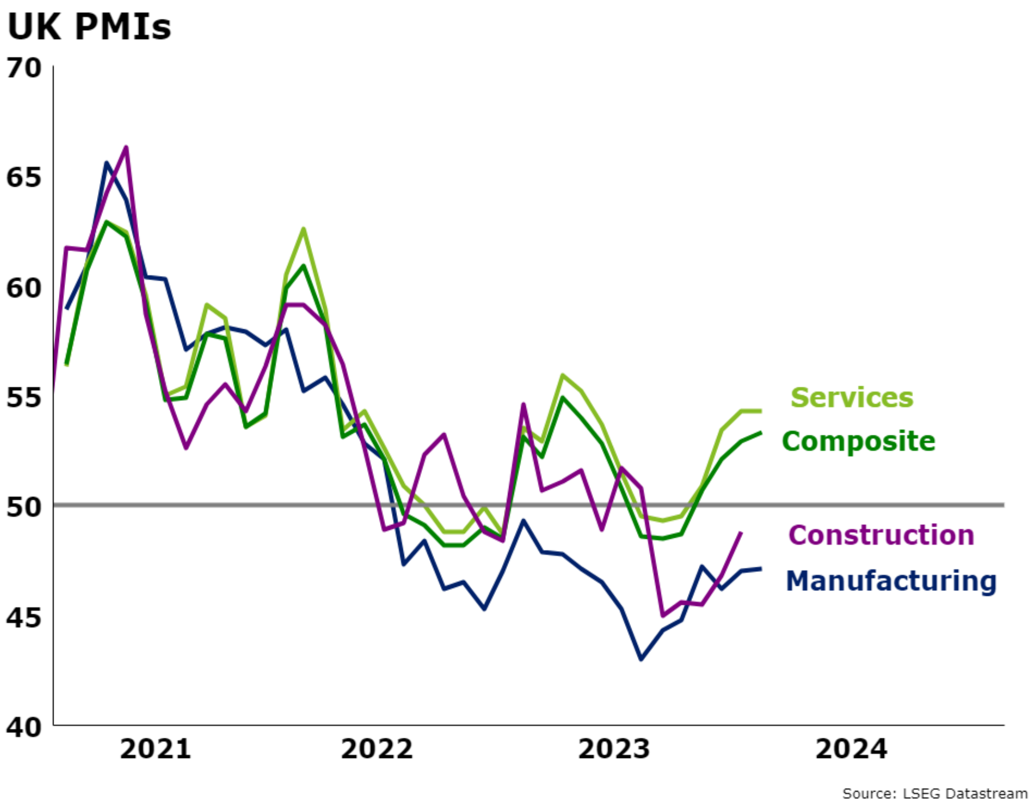
The economy has been more resilient than forecasts, but the UK entered what we forecast to be the mildest recession in modern history

UK growth to flatline until mid-2024 in base case…



Year	2023	2024f	2025f
GDP ann. %	0.1	0.1	1.3

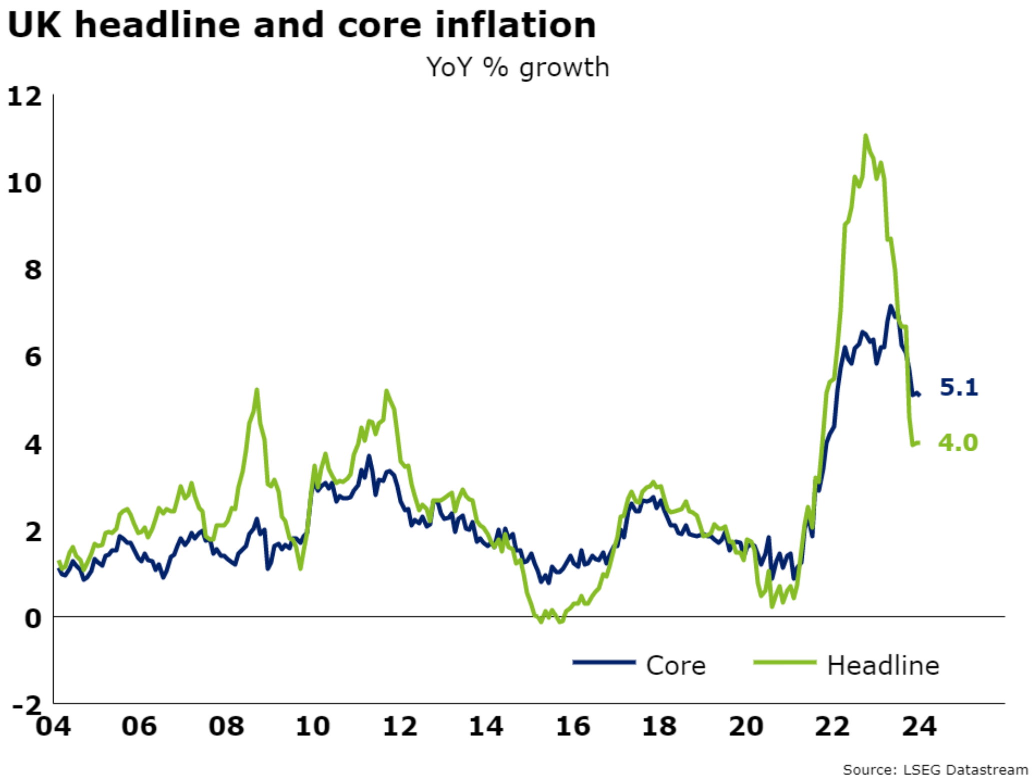
… thanks to a strong services sector



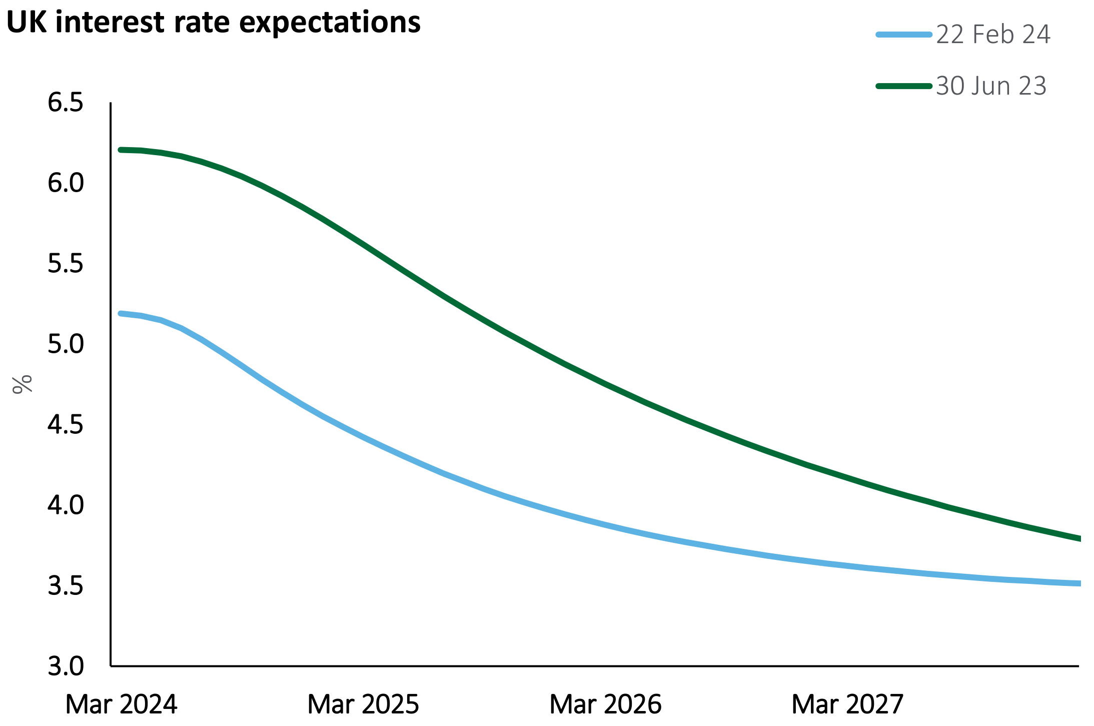
Inflation and interest rates have peaked faster than expected and interest rate

The pandemic and energy price shocks have been digested by economy and now inflation is falling, but not prices

Inflation has been falling faster than expected …



… meaning that Bank rate expectations are now lower

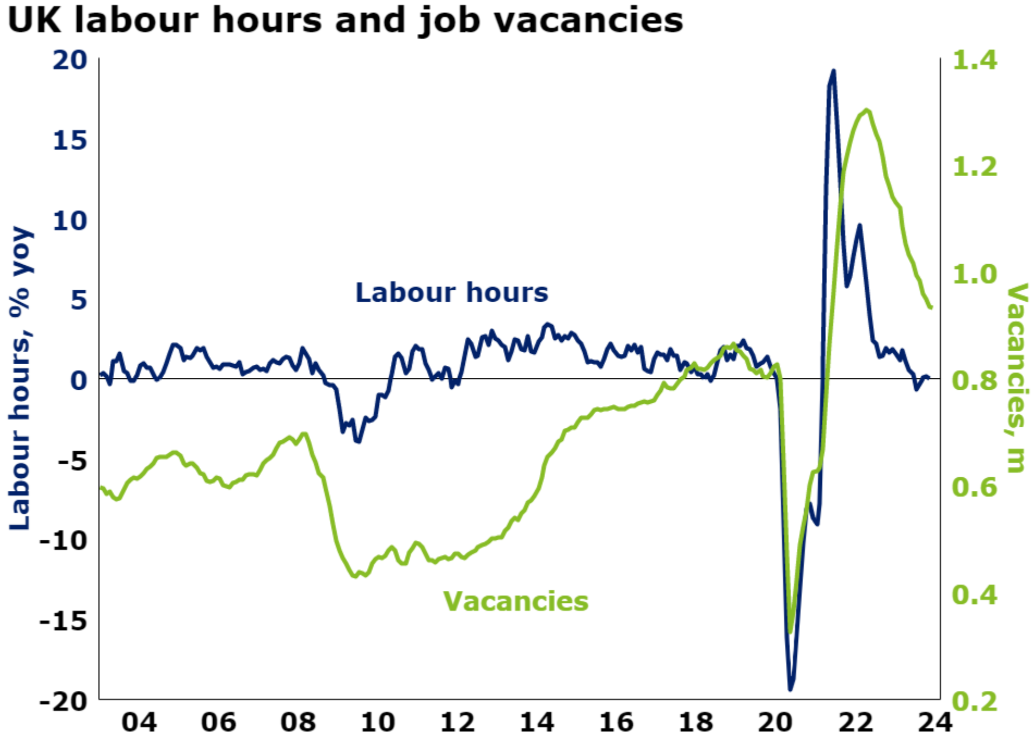


Source: Bank of England, updated 27/11/2023

A resilient labour market has meant that inflation is falling without a deep recession

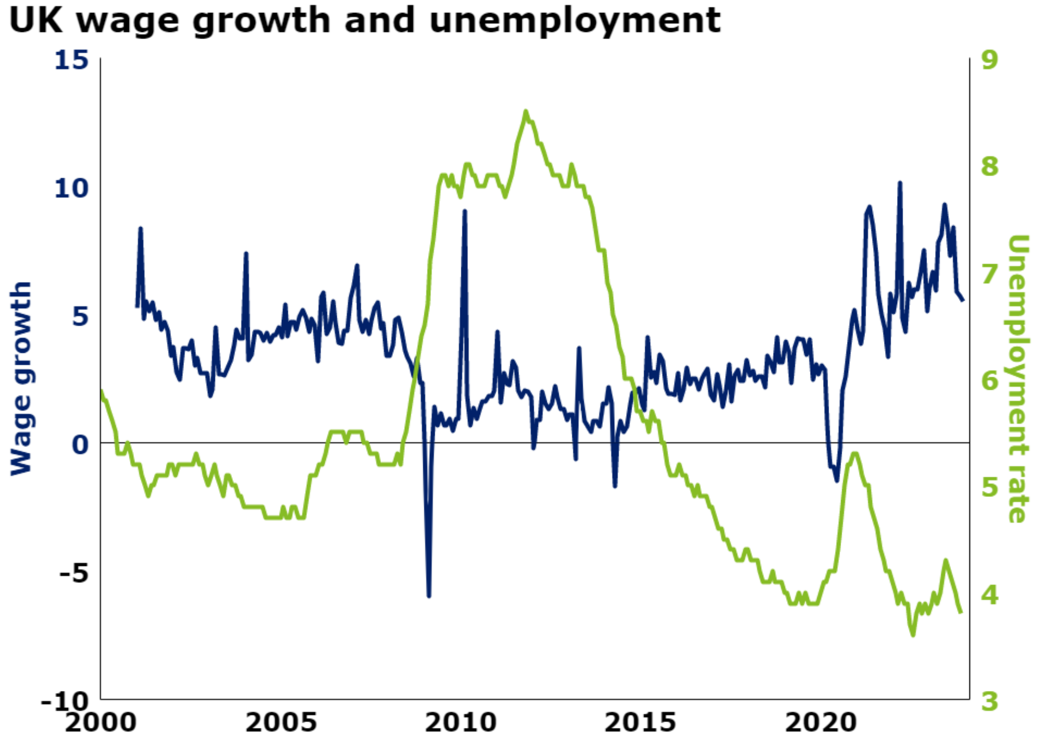
Higher interest rates have cooled down the demand for labour but firms have not been shedding workers, meaning that the labour market is still quite tight with wages now outpacing inflation

Firms have pared back vacancies and hours …



Source: LSEG Datastream

… but unemployment is still historically low

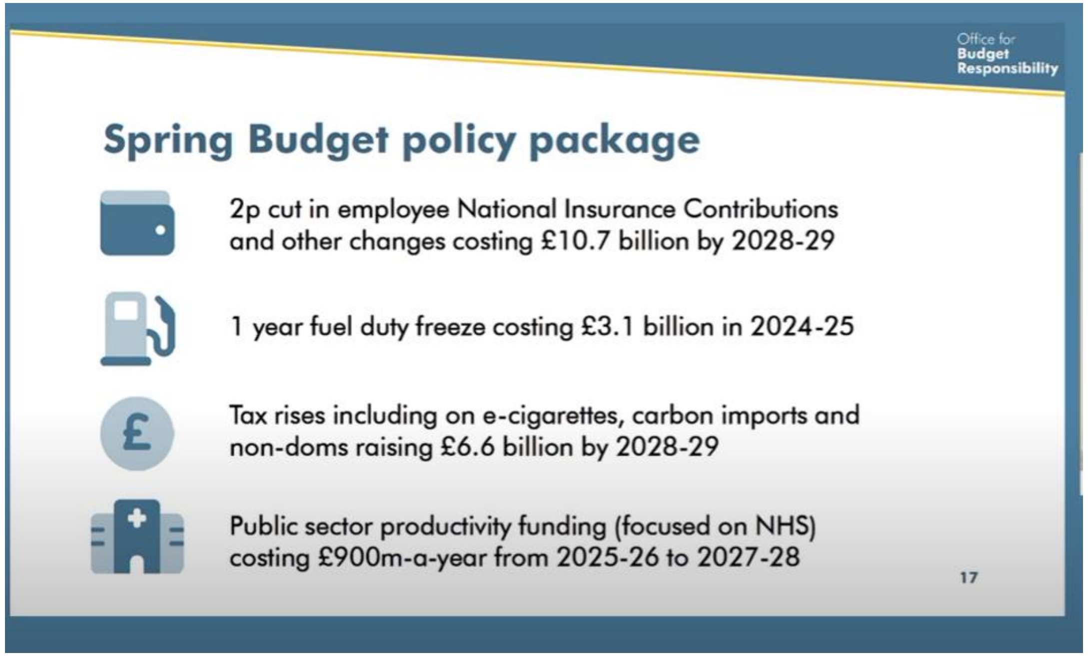


Source: LSEG Datastream

UK chancellor used a brighter outlook from OBR to ease fiscal policy

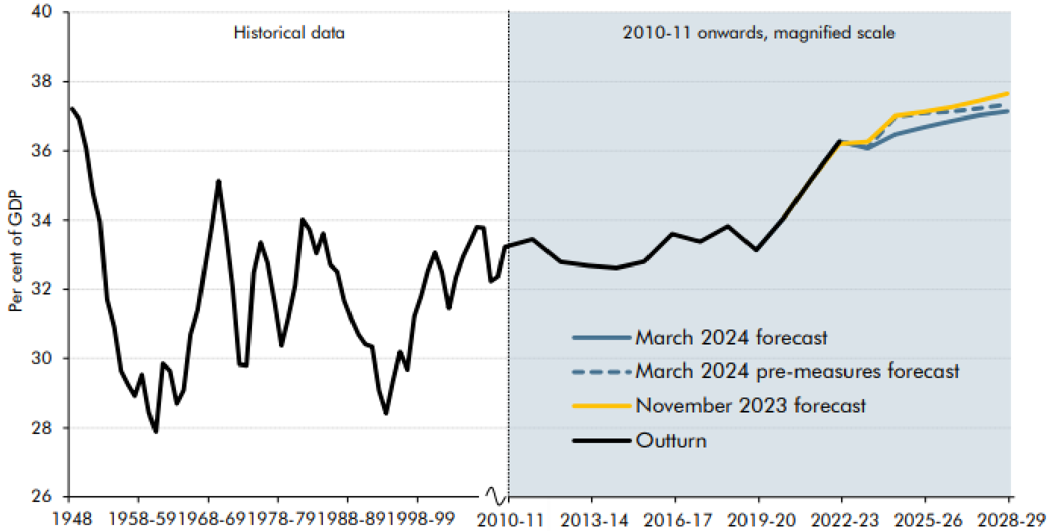
Higher growth and lower inflation and interest rates have given the UK chancellor some headroom; however, the fiscal plan still relies on heavy departmental cuts and an optimistic outlook

Headline NICs tax rate cut and fuel duty frozen…



… but the tax burden still to rise

Chart 4.1: National Accounts taxes as a share of GDP



Source: ONS, OBR

What does this mean for corporates?

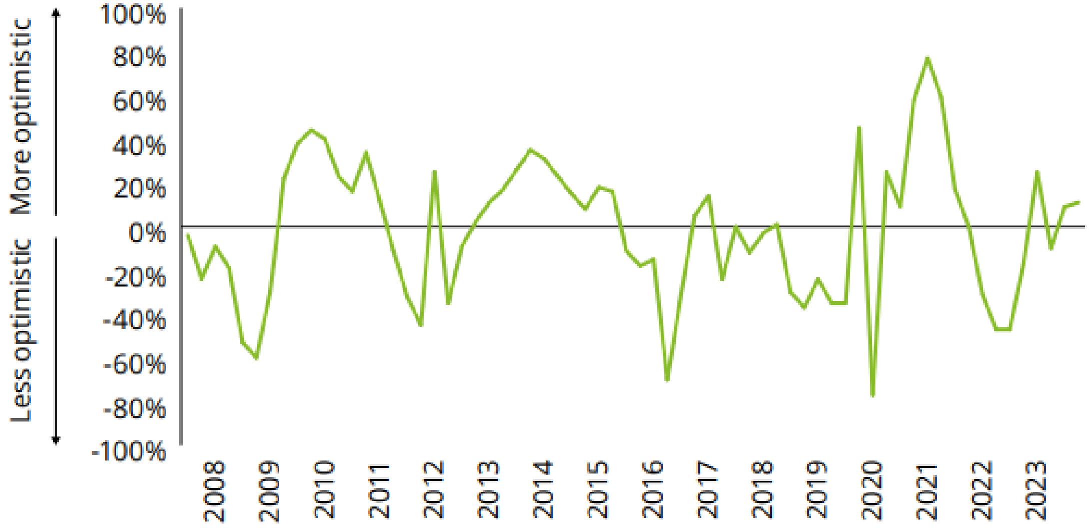
UK Business optimism rebounding in the second half of 2023

Despite the UK entering a recession, corporate are more optimistic going forward

CFOs optimistic has risen to above average levels…

Chart 1. Business optimism

Net % of CFOs who are more optimistic about the financial prospects of their business than three months ago



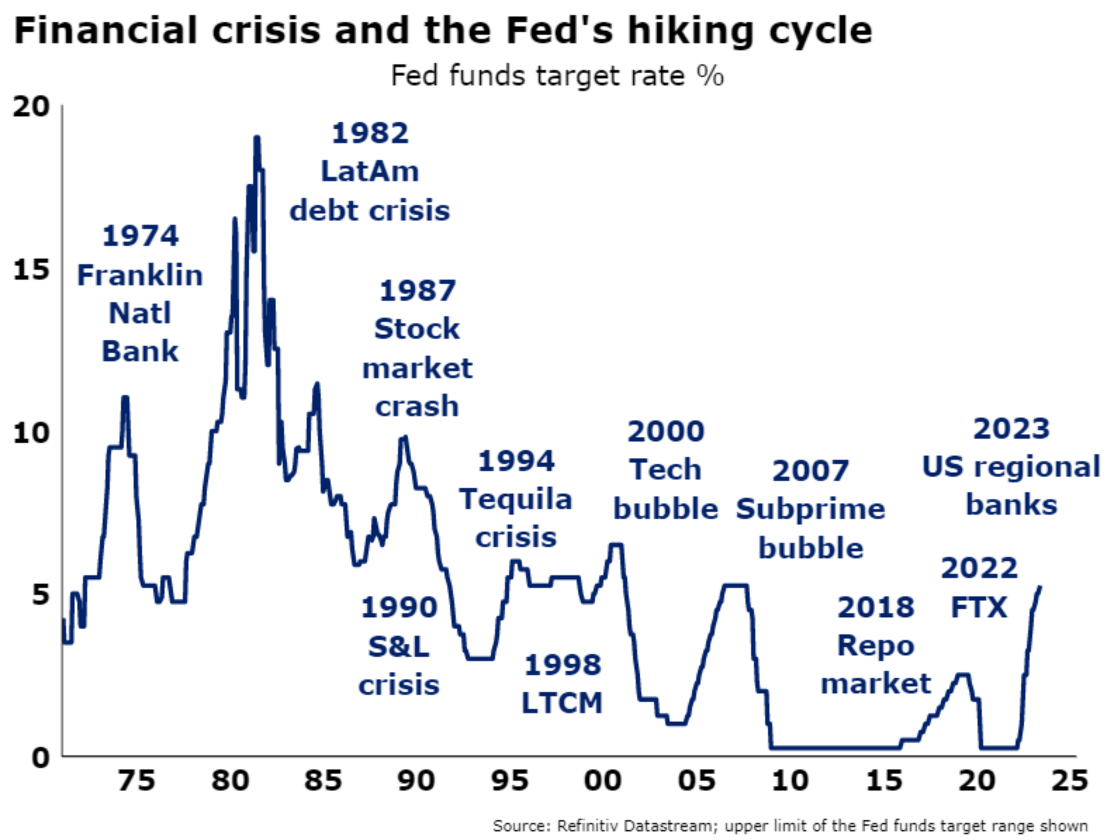
… but this a reflection of large corporates and not SMEs

- Sentiment among UK CFOs rose for the second consecutive quarter and is running at well above average levels.
- Though subdued relative to long-term measures, corporate risk appetite has risen to an 18-month high.
- On balance, CFOs are optimistic about an improvement in their own companies' prospects in 2024.
- These findings may seem at odds with recent economic news, particularly a contraction in Q3 GDP and forecasts of sluggish UK growth in 2024.
- The large corporates represented in the survey panel are generally better able to manage periods of stress than smaller and medium-sized businesses (SMEs).

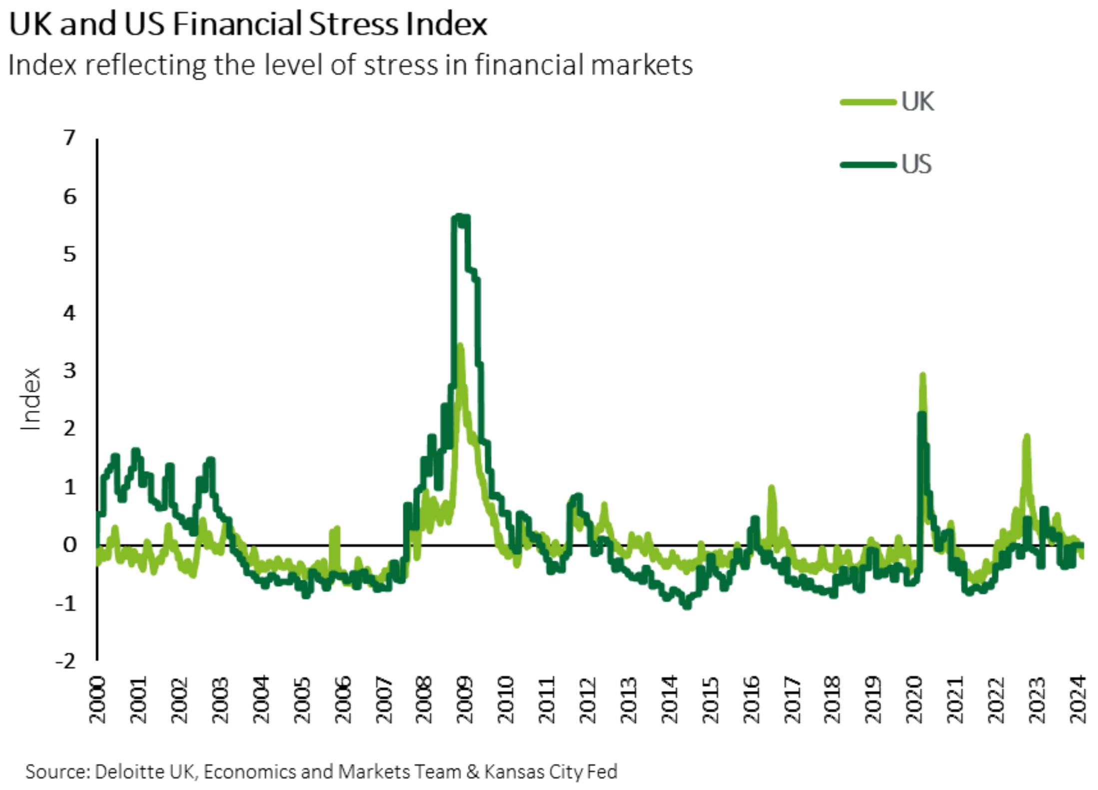
Interest rates in advance economies have reached pre-GFC levels

Higher interest rates have tightened financial conditions generating risks and central banks need to balance inflation and growth with financial stability.

Hiking cycles always stress financial markets…



… but so far regulation has kept stress down



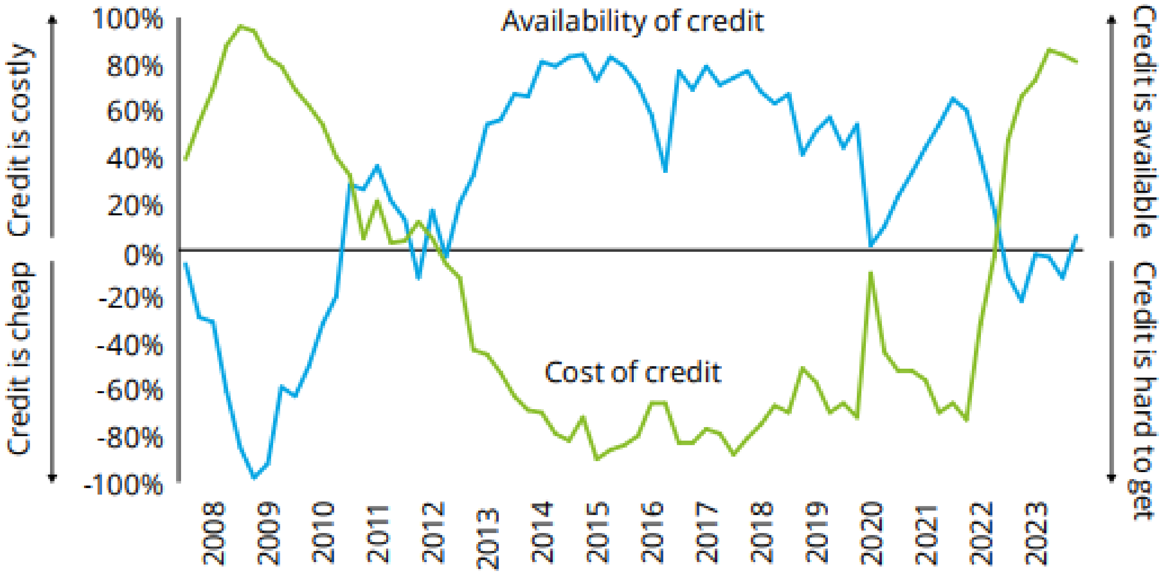
Higher financial stress is tightening credit for corporates

Higher borrowing costs make corporate financing much harder, especially through bank borrowing

Credit is more costly and much less available...

Chart 4. Cost and availability of credit

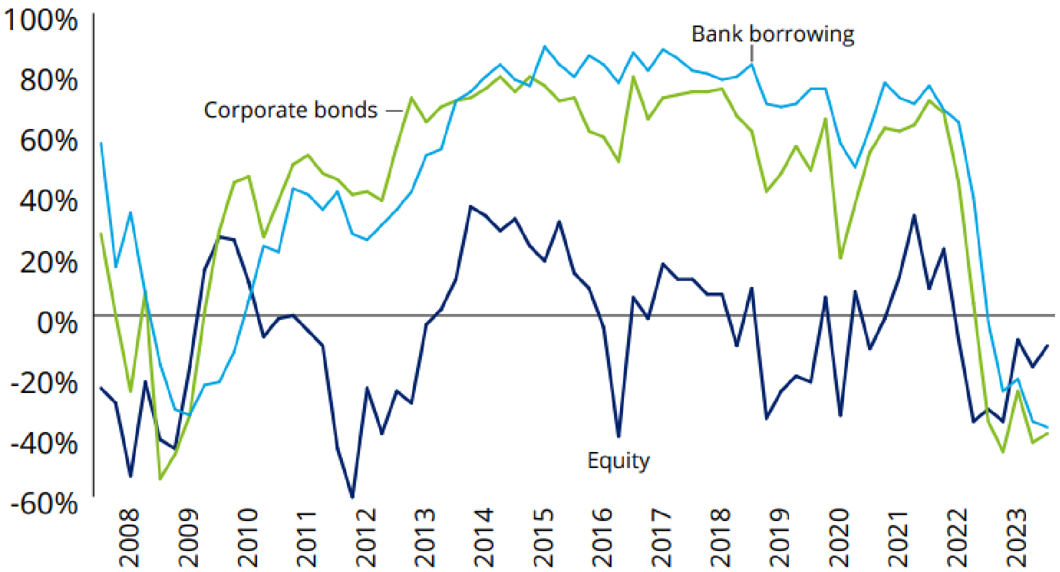
Net % of CFOs reporting credit is costly and credit is easily available



... making corporate fall out of love with debt

Chart 7. Corporate financing

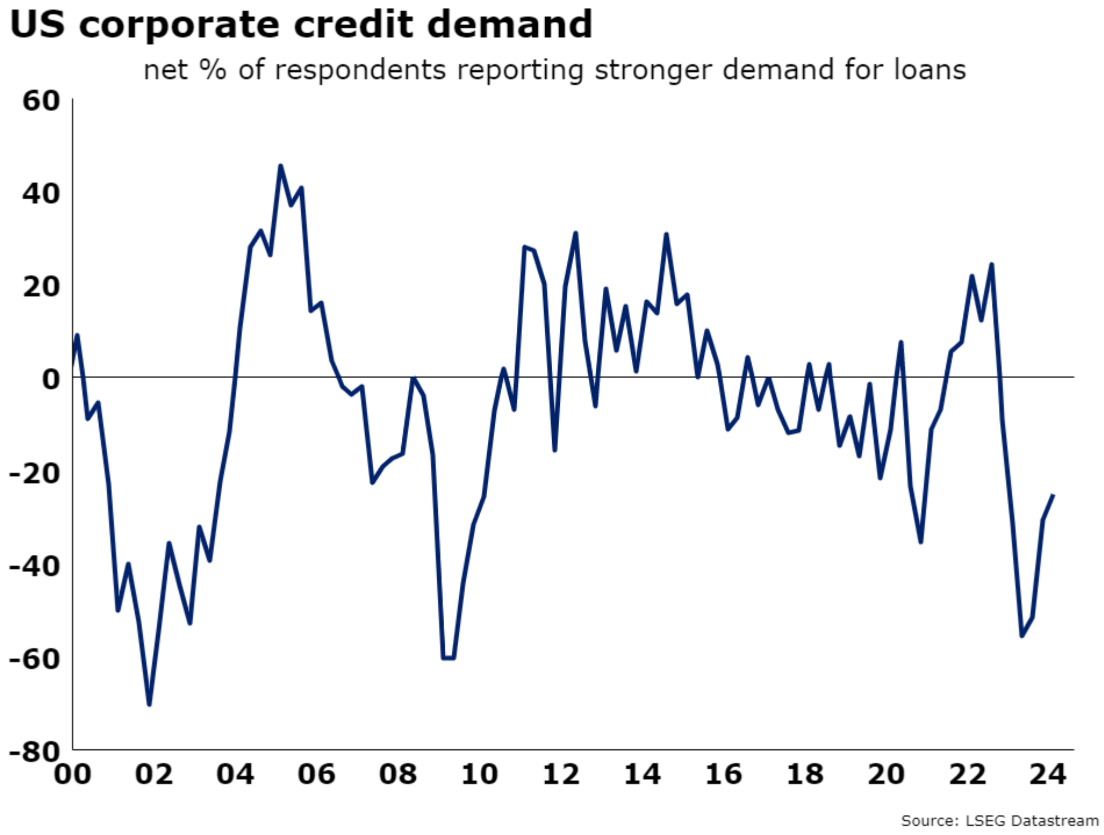
Net % of CFOs who rate the following sources of funding for UK corporates as very or somewhat attractive



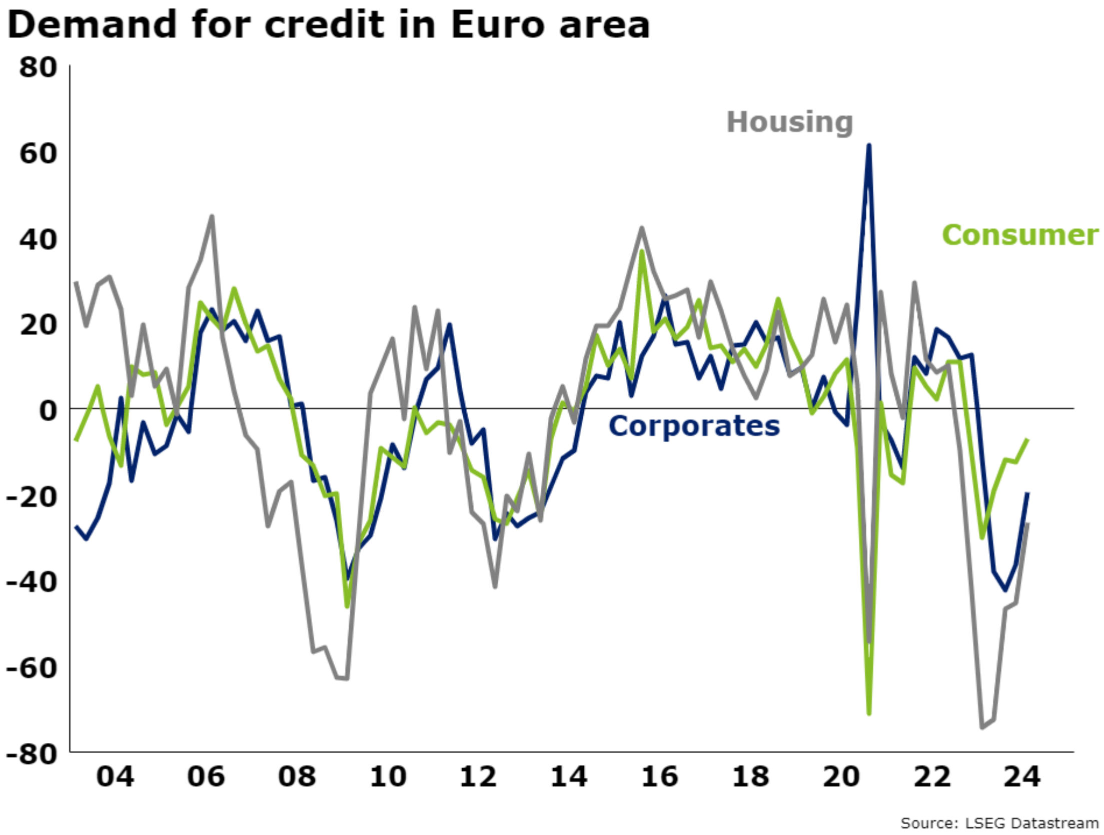
The US and the Euro area are also seeing lower credit demand

As the Fed and the ECB increased rates and bank tighten credit conditions, corporates in the US and EU are scaling back demand for credit

As interest rates have risen, credit demand fell…



… but there are signs of a recovery as markets expect cuts

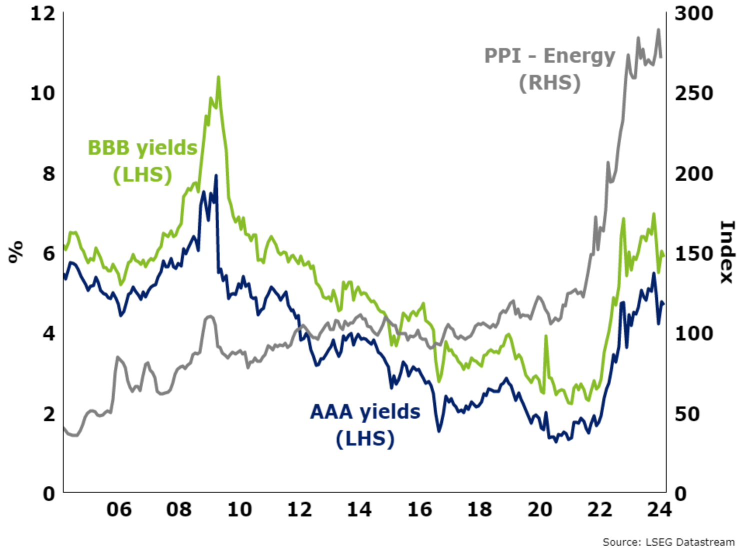


UK corporates insolvencies have risen but mainly due to small businesses so far

Higher interest rates and the War in Ukraine have increased the cost base for many businesses, causing energy-intensive and over-leveraged companies to suffer

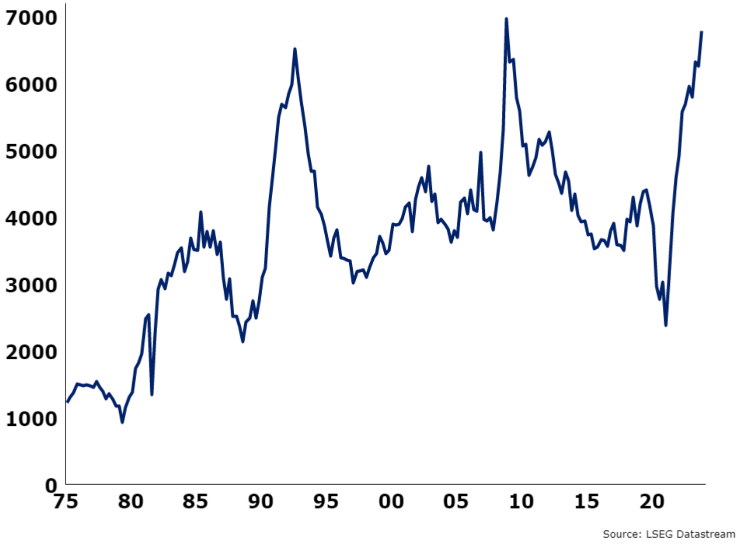
Higher corporate costs

UK corporate bond yields and energy costs

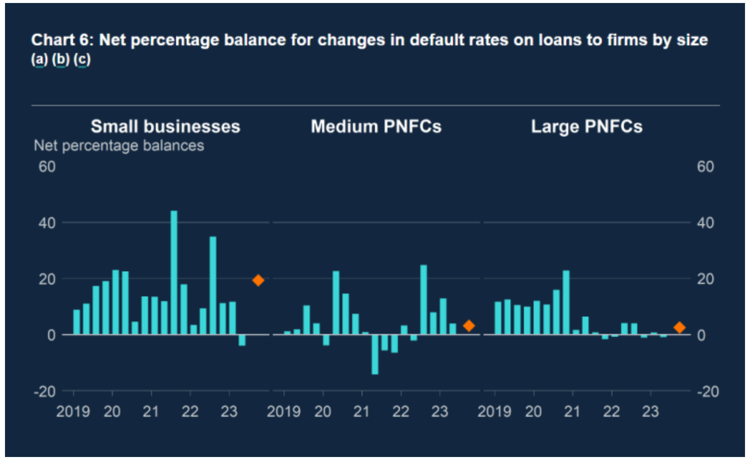


Rising insolvencies

UK company insolvencies



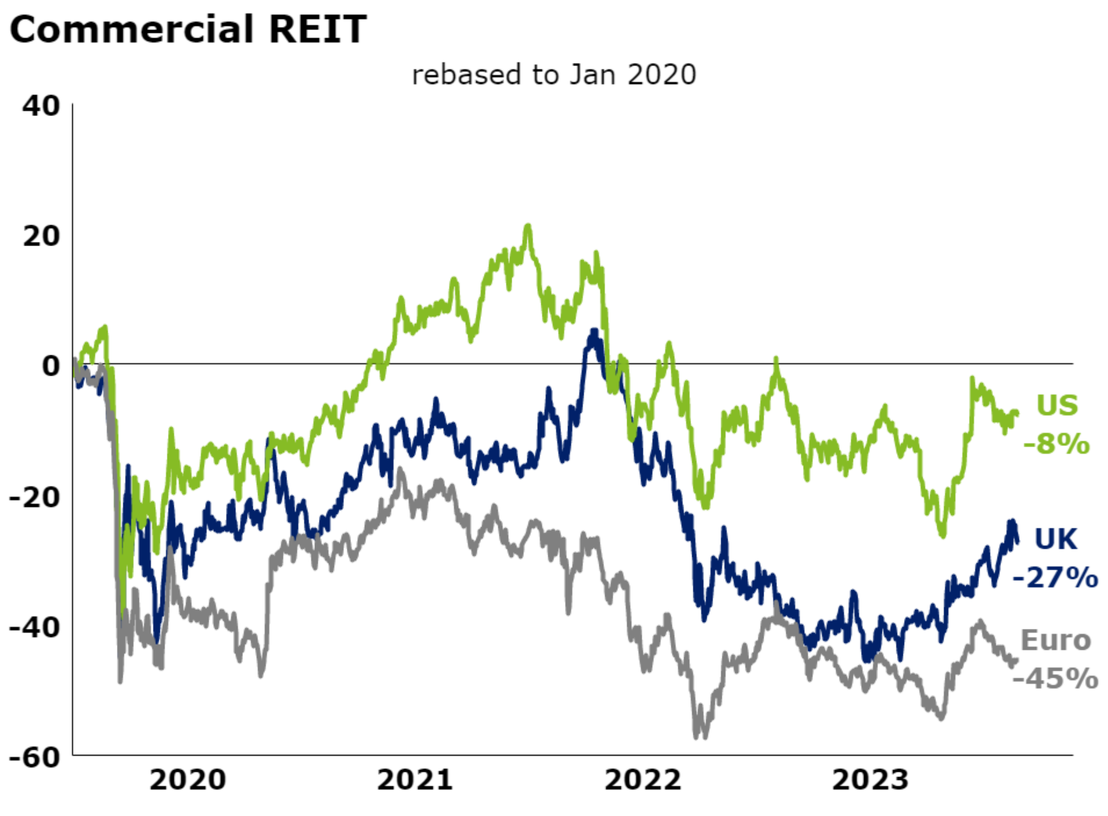
Lenders expect defaults to rise further



Global Commercial Real Estate is also adjusting to a new normal

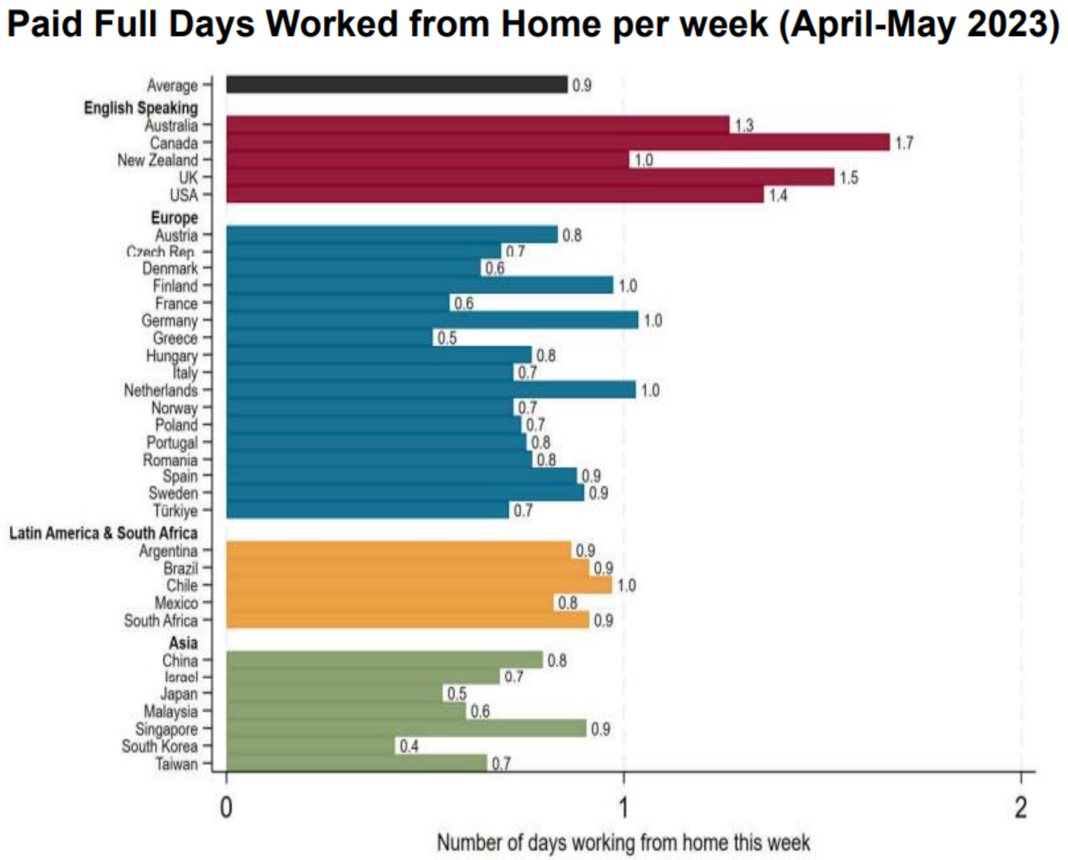
Along with higher interest rates, CRE is dealing with a shift in working and living patterns post-pandemic

Commercial Real Estate has been underperforming …



Source: LSEG Datastream

… as WFH is becoming the new norm

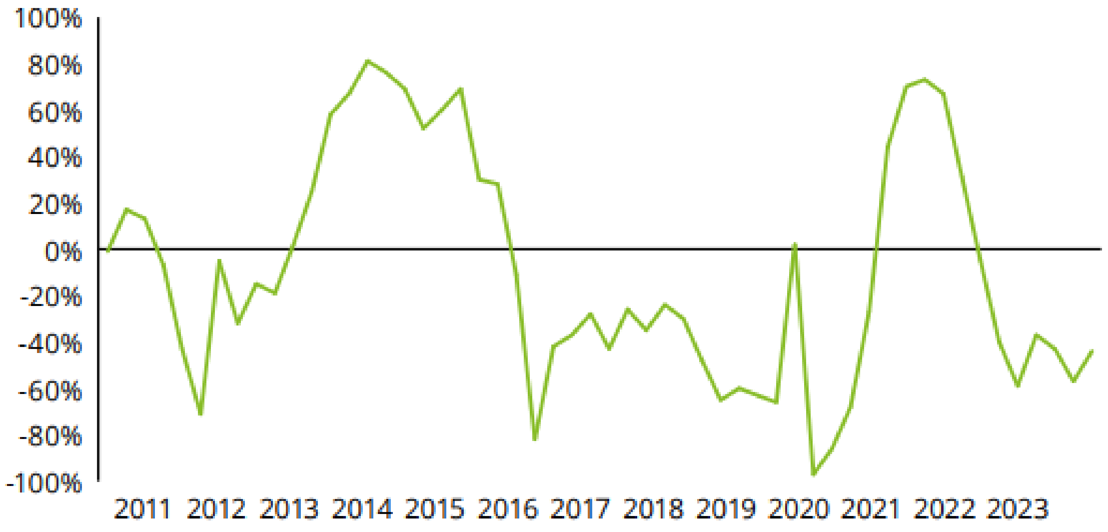


Inflationary environment has also tightened the labour market

Although the labour market is starting to show signs of slack, corporates have faced difficulties in hiring and retention in one of the tightest labour markets in memory

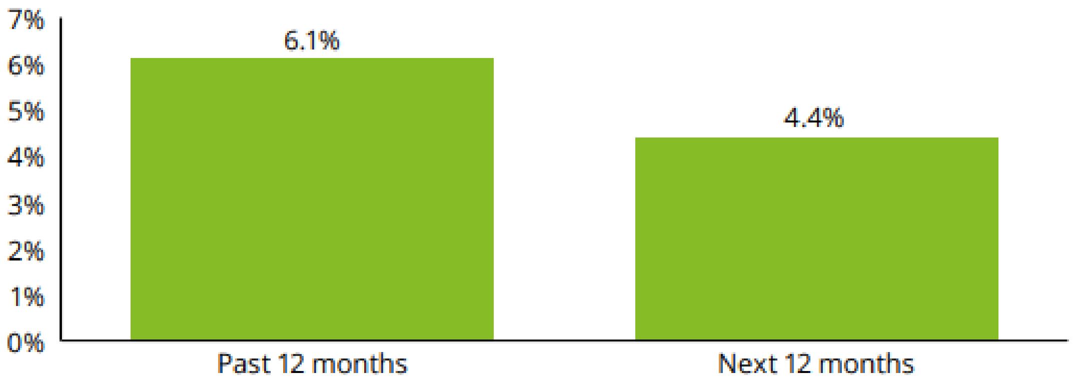
Corporate have lost the appetite for hiring…

Chart 6. Outlook for corporate hiring
Net % of CFOs who expect UK corporates' hiring to increase over the next 12 months



… due to rising wage expectations and costs

Chart 7. Wage expectations
CFOs' median reported increase in average wages in their business over the past 12 months and their expectation for the next 12 months



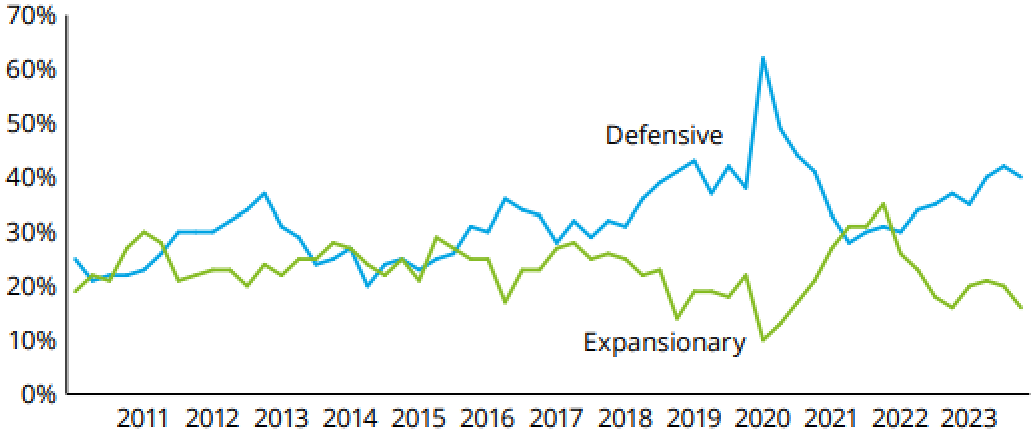
All these pressures are pushing corporates to be more defensive

Even if the UK does not enter a recession, most corporates feel and behave as if they are in one

Corporates are scaling back investment and retrenching...

Chart 11. Expansionary and defensive strategies*

Arithmetic average of the % of CFOs who rate expansionary and defensive strategies as a strong priority for their business in the next 12 months

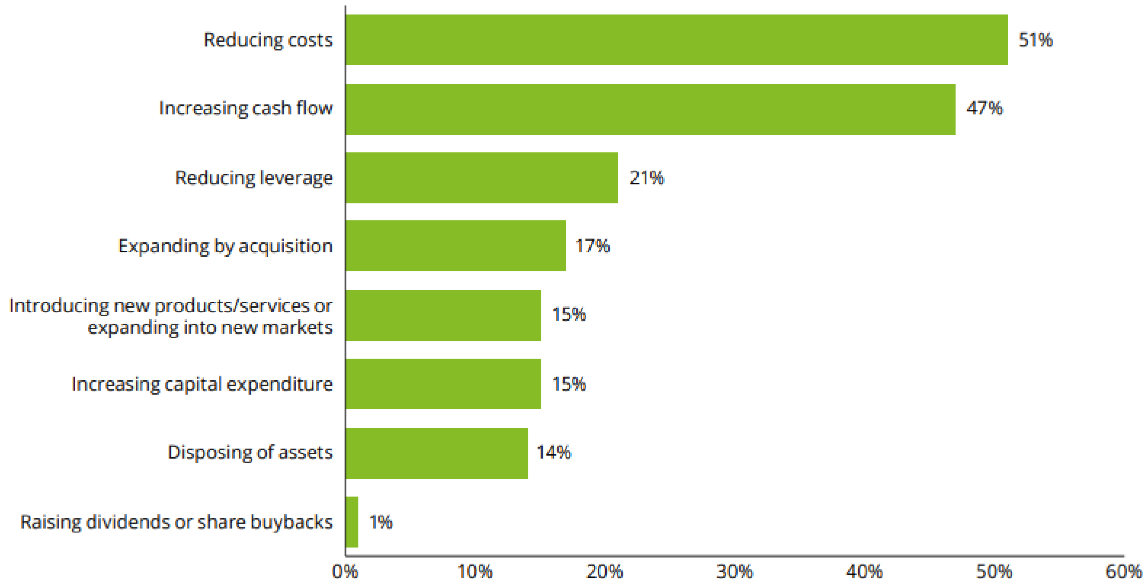


* Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure. Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

... to reduce costs, increase cashflow and deleverage

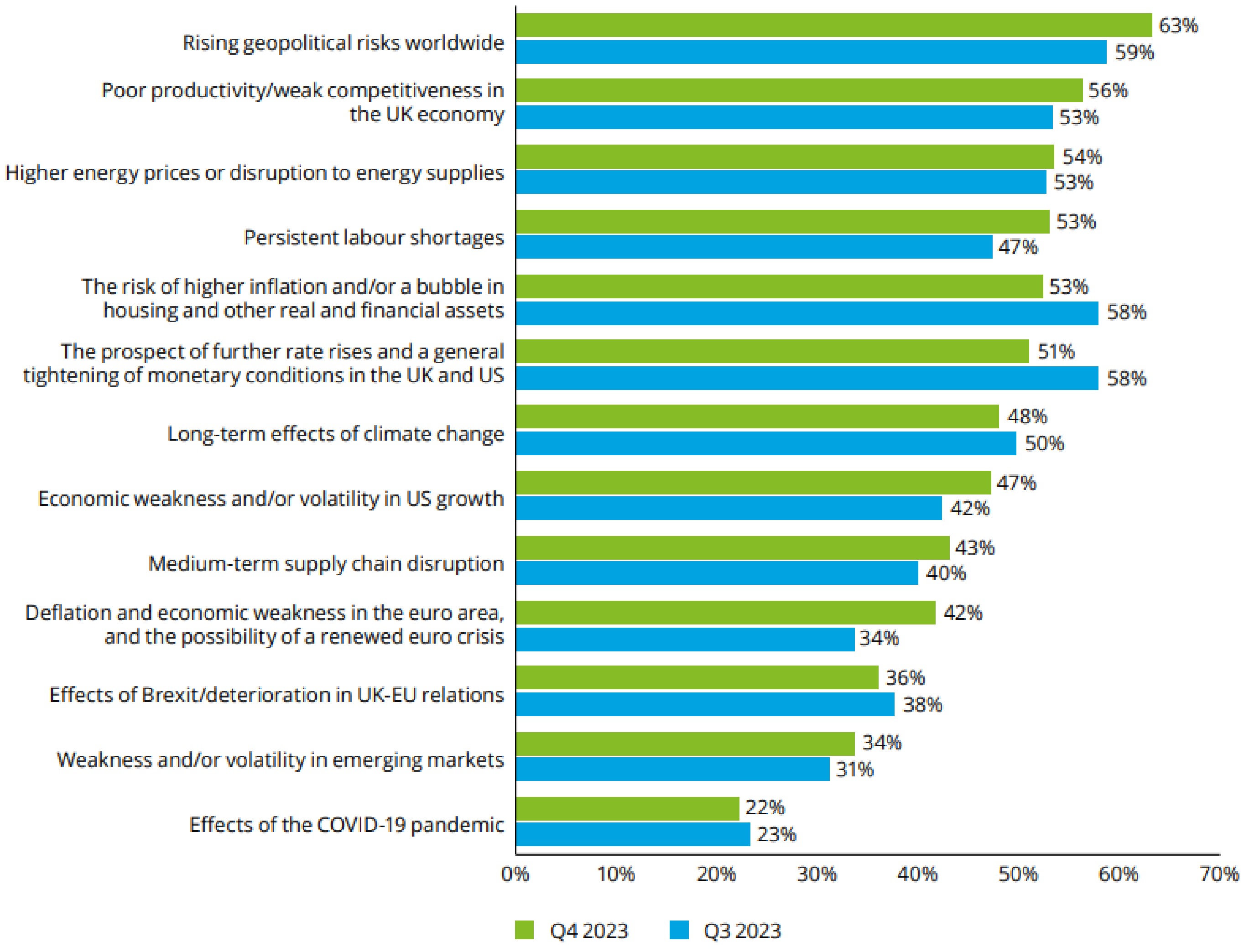
Chart 10. Corporate priorities in the next 12 months

% of CFOs who rate each of the following as a strong priority for their business in the next 12 months



While inflationary worries are not the priority anymore, new risks have emerged

Chart 9. Risk to business posed by the following factors
Weighted average ratings on a scale of 0-100 where 0 stands for no risk and 100 stands for the highest possible risk



Weak recovery and geopolitics top risks

- **Geopolitics** remains on top of CFOs' worry list, likely due to the conflict in Israel and Gaza.
- There is also increased anxiety about **poor productivity/weak competitiveness** in the UK economy
- **Higher energy prices or disruption to supply is seen as the third biggest risk** but remains well below the levels seen in the second half of last year.
- **Concerns about labour shortages have ticked up**, **having** fallen in the previous two quarters.

Summary

To sum up…

Key takeaways and risks to look out for

Outlook

1. Inflation and interest rate have peaked
2. Advanced economies and China to drag down global growth
3. UK to stagnate late 2024

Upside

1. Pandemic and energy shocks are in the past
2. A resilient labour market supported consumption
3. Emerging markets to provide global growth

Downside

1. Geopolitical conflict reignites inflation
2. Financial stress and labour markets could worsen
3. China’s slowdown brings down advanced economies