'May he live in interesting times'

Rarely have predictions for an upcoming year been so difficult and wide-ranging. But we are sure of some things, and we are doing our best to help you navigate this unprecedented uncertainty

3 calls for 2023: Recession, inflation and central banks

Carsten Brzeski on what he's expecting in 2023

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Goodbye to all that

'May he live in interesting times' is a Chinese proverb that many of us have heard, perhaps a little too often in recent times. The list of unprecedented crises gets longer by the year. 2022 was supposed to be the year of post-pandemic and post-lockdown reopenings. But it became the year of war, inflation, energy and commodity price crises, drought and floods.

It was also a year which saw a paradigm shift at major central banks, trying to fight inflation at all costs. It's where we said goodbye to low interest rates for longer and that easing bias. Central banks got all of us used to jumbo-size rate hikes and, at least in the US, the policy rate is almost back at levels last seen prior to other financial crises. 2022 was also the year of what the Germans call 'Zeitenwende' or 'game changer', at least for Europe: a war in the EU's backyard, which is still ongoing with no end in sight; an end to cheap energy, and an end to globalisation as we knew it.

Combined with the well-known longer-term challenges of population ageing, a lack of international competitiveness, and the never-ending debate on further European integration, Europe's to-do list is long. The chances are very high that the continent will have a hard time returning to a pre-crisis growth trajectory any time soon.

Different shades of recession

So what will 2023 bring? A natural reflex of many forecasters is to simply extrapolate recent trends and developments into the new year. And, indeed, many of this year's issues will also be prominent in the next: war, the energy crisis, inflation, trade tensions and even Covid are likely to affect the global economy significantly. This is not the moment to identify potential new black or grey swans… nor even pink ones. Our predictions and calls for 2023 reflect our base case: median forecasts backed by this year's events and assumptions.

We expect to see several different shades of recession in 2023. We should get a rather textbook-style recession in the US with the central bank hiking rates until the real estate and labour markets start to weaken, inflation comes down, and the Fed can actually cut policy rates again. Expect a recession that feels but doesn't read like a recession in China with Covid restrictions, a deflating real estate market and weakening global demand, bringing down economic activity to almost unprecedented low levels. And finally, look forward to an end to the typical cycle in the eurozone, where a mild recession will be followed by only very subdued growth, with a risk of a 'double dip', as the region has to shoulder many structural challenges and transitions. These transitions will first weigh on growth before, if successfully mastered, they can increase the bloc's potential and actually add to growth again.

The widest range of possible outcomes and forecasts

Inflation will continue to be one of the key themes of 2023. We expect it to come down quickly in America, given the very special characteristics of the US inflation basket, allowing the Fed to stop rate hikes and eventually even cut before the end of the year. In the eurozone, inflation could turn out to be stickier than the European Central Bank would like and also perhaps afford. Still, with interest rates entering restrictive territory in early 2023, the looming loss of economic wealth and a large need for investment, the bank will be forced to stop earlier than it perhaps might like. Or, alternatively, it could commit a policy mistake if it hikes rates far beyond mildly restrictive levels.

In any case, we are entering a year with the widest range of possible outcomes and forecasts in years. And this is not even taking into account potential blind spots such as the start of a pandemic or a war in Europe that markets simply did not have on their radar screens at the end of 2019 or 2021. It is both interesting and challenging, for the economy, for financial markets, for companies, for households but also for economists like us.

'May he live in interesting times'. A friend of mine just told me that this is actually not a Chinese proverb but more a curse. We shall see. In any case, Merry Christmas and a Happy New Year.

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