

## Stuck in the twilight zone between stagnation and recession

For the global economy, the first half of the year was packed with action. The remainder of the year will see a further weakening of the global economy, a rapid fall in headline inflation, and a dearth of central bank rate cuts



### Our three calls for the remainder of 2023

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It's halftime for 2023 but not halftime like at the Super Bowl with Snoop Dogg, Shakira or Rihanna. It's halftime of the economic year, and economists are taking a deep breath with no singing or dancing (even if some of us might have hidden talents). It is simply the moment to assess the first half of the year and to sharpen our minds (and calls) for the second half.

For the global economy, the first half of the year was packed with enough action for an entire year. An energy crisis in Europe that was avoided thanks to a mild winter and fiscal stimulus. A reopening of China that is more sluggish and wobblier than hoped for. A banking crisis in the US and Switzerland which hasn't ended in a global financial crisis as feared. Unprecedented central bank tightening and gradually retreating inflation, with the latter not necessarily the result of the

former.

Against this backdrop, the age-old question of whether the glass is half-empty or half-full comes to mind. Should we cherish the current resilience of many economies and the financial system as things could have become much worse? Or should we moan about the missed opportunities, lacklustre growth and a still very long list of potential risks? As is so often the case, the truth is probably somewhere in the middle.

Looking ahead, the risk for every forecaster is the temptation to spread optimism and predict an upturn of almost everything towards the end of the year (or the end of the forecast horizon as many traditional macro models do). We are more cautious. The fact that things didn't get as bad as feared does not automatically lead to a return of optimism or a surge of economic activity.

In fact, the structural themes of the last few years are still pressing and impacting the economic outlook. Think for example of geopolitical tensions, the war in Ukraine, demographics, climate change more generally and more specifically the energy transition, and high government debt. It is impossible to tell how and when exactly these factors will affect growth or an inflation forecast profile but we definitely know that these effects are here and they are here to stay.

Let's be a bit more precise and come back to economic developments in the second half of this year. Bold or not, we have three major calls for the remainder of the year:

- Further weakening and not strengthening of the global economy.
- Headline inflation will retreat faster than central banks currently think.
- Rate cuts are a 2024 but not a 2023 story.

Let's look at these three calls in more detail. The global economy will further slow down and "slowcessions" are likely in several parts of the developed world. The Chinese reopening will continue to stutter, the US economy is likely to experience a winter recession and the eurozone will remain in this twilight zone between stagnation and recession.

Besides negative base effects from energy and food prices, the cooling of many economies will lower wage pressure, reduce inflation pipeline pressures and will increasingly lead to price discounts. Headline but also core inflation are likely to come down faster than central banks anticipate towards the end of the year.

The phenomenon of "slowcessions" is a new challenge for central banks. Reacting to a more pronounced cycle is much easier as it takes much longer to identify a "slowcession". Until central bankers have realised that we are in a "slowcession" for good, they will continue hiking rates, not cutting them. If we are right, central bankers will adjust to the new reality in the last months of the year, acknowledging weaker growth, broader disinflation and no further need for rate hikes.

It might not be as eye-catching as Janet Jackson and Justin Timberlake, but it is definitely an exciting view of the global economy. Have a good summer.

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