FTI CONSULTING – STRATEGIC COMMUNICATIONS – PUBLISHED 06/02/2023

What Major Financial Institutions Expect for 2023

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You might have received most of these reports, from chief economists of major financial institutions presenting their expectations for the year to come. You even might have found the time to read some of them. We have read, analyzed and summarized for you in less than 10 pages 20+ of these most important reports.

Methodology

FTI Consulting has summarized the outlook for 2023 of major financial institutions and has drawn up a summary of key topics for the coming months. The scope of analysis includes the publications of the following institutions: Apollo, Bank of America, Barclays, BlackRock, BNP Paribas, BNY Mellon, Citi, Credit Suisse, Deutsche Bank, Fidelity, Goldman Sachs, HSBC, ING, JP Morgan, Lazard, Morgan Stanley, Natwest, S&P, Société Générale, UBS and Wells Fargo.

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Global Outlook

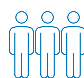
A new regime of sustained inflation and transition to sustainability.

The global economy is entering a new regime. As summed up by Blackrock, three long-term variables are playing out: aging populations, geopolitical fragmentation, and the transition to a lower-carbon world. 2023 could be the pivotal year ushering in this new regime.

- The **consensus places the world on a downward trend** and is unanimous with regards to the occurrence of recession in Europe in the first half of 2023. This would be soft, with an average estimate of GDP decline of -0.1%. The U.S. may show more resiliency, with a GDP growth of 0.4% thanks to its energy advantage, and face or avoid a mild recession.
- The broad sentiment is however very negative, as over 75% of fund managers think a recession is likely over the next 12 months – a level roughly on par with peak pessimism during the global financial crisis in 2009 and the COVID-19 pandemic in 2020.
- The greatest uncertainty remains **the extent of the Asian rebound**, especially the Chinese transition from a *"capital spending to one of consumption-led,"* noted Bank of America or Morgan Stanley.
- The extent of this transition may determine an **increase in commodity prices** and an appreciation of Asian currencies, explain Lazard and Citi. This would *"make it difficult for the Fed and other central banks to back off too quickly,"* completes UBS.
- The **Ukrainian war** and the potential escalation of the geopolitical conflict, **creating further disruptions** in the energy and food sectors, is the principal risk.

Inflation – Sustained and unlikely to reach pre-pandemic levels.

- There is consensus affirming that **inflation will cool globally over the year**. However, the Central Bank's targets are not expected to be reached, as inflation is forecasted to be around 4-5% in the U.S. and 6-7% in Europe.
- According to some institutions, the peak may be reached in Europe in early 2023. Blackrock insists that the world is entering a new regime: *"living with inflation."*



Labor market – Resilient and unlikely to fall.

- The **labor market is unanimously perceived as currently strong**, due to its status as the main component of the global economy's resilience. Markets will be paying close attention to it, as disruptions in employment could signal a rapid deterioration in the global economy.
- Blackrock focused on the **aging workforce, which creates a major transformation challenge for consistent economic growth**. Labor shortages contribute to the resilience that financial institutions attribute to the labor market.

Equity vs. debt market – Portfolio rebalancing for risk reduction.

Equities – Experiencing lower valuations due to a higher risk-free rate.

- Most institutions predict **a tough year for global equities**. U.S. quality stocks are considered more resilient than in other regions. There will be a continued rebalancing of portfolios in favor of private equity, after an already hard period for equities.
- Specifically, on valuation, Lazard explains that the ongoing increase in risk-free rates will naturally imply a higher discount rate.

Debt – Net inflows to bonds and corporate debt.

- Overall, economists see **a strong trend towards bonds in 2023, to provide a minimum hedge against riskier equities than in recent years.**
- With respect to bonds, institutions show divergent views. Many institutions, such as Lazard, Wells Fargo or HSBC, see opportunities in short-term bonds, while BNY Mellon or Morgan Stanley see an attractive entry point in municipal bonds from intermediate to long maturities. In any case, overall, the trend is clear: bonds, including corporate bonds, will see net inflows.

Real GDP growth	2022e	2023e	2024e	Real GDP growth	2022e	2023e	2024e
World	2.9%	1.8%	2.6%	Germany	1.6%	(0.7%)	1.3%
Europe	3.1%	(0.1%)	1.5%	France	2.5%	0.4%	1.3%
US	1.8%	0.4%	1.4%	Italy	3.5%	(0.1%)	1.2%
China	3.3%	0.6%	1.7%	Spain	4.5%	1.0%	2.0%
India	7.1%	5.8%	6.6%	UK	4.2%	(0.5%)	1.1%

Source: Average expectations from broker research, January 2023

Regional Outlook

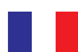
Europe – Long term competitivity at risk, but discrepancy among countries.

Eurozone – Some reshoring and sustainability prospects in the storm of the energy crisis.

There is a broad consensus to assume a recession, sustained inflation and fiscal constraints in Europe. Furthermore, the Chinese rebound and increase in energy needs may not help Europe to manage its commodity prices.

Other points have been proposed on the effects of the energy crisis:

- Although most institutions predict **a long-term hit to European competitiveness and industries**, positive insights include an ongoing *"European reshoring"*, according to Bank of America.
- Also, even if the downturn is the most priced in European equities, Lazard points out that *"Europe is likely to exit recession first."*
- Yet, as strongly advised by HSBC and BNP Paribas, **green infrastructure and energy remain the most favored sectors.**



France – The tariff shield may not prevent constraints on household consumption.

France's 2023 outlook is mainly focused on energy and social issues, including the government's ability to deal with households' constraints.

- Inflation in France is expected to be around 5-6%, not as high as in Germany or the UK, where it is expected to be closer to 7%, which may be a relative advantage for the French market.
- As mentioned in ING's outlook, France will experience a marked slowdown and higher inflation than in 2022. Despite the temporary "tariff shield" endorsed by the government to freeze rising gas prices, "energy bills will rise by 15% in 2023 compared to 4% in 2022," worsening the situation of already-constrained households. Besides, food and service inflation are expected to rise sharply in the first quarter.
- France's energy strategy is a key concern, as noted by Natwest, as the country plans to build six new large nuclear reactors starting in 2028 and eight more by 2050.

Germany – On the front line of the energy crisis.

Germany's competitiveness is threatened by the current energy crisis. Inflation could last longer there than in France. Its priority is to figure out how to move past its current energy crisis.

- The country also has other major challenges as ING pointed out, including **global supply chain frictions, the digitalization of an aging society**, and the modernization of Germany's infrastructure. The induced loss of competitiveness will provide *"an opportunity for highscale investments."*
- Furthermore, ING is not confident about the German government's ability to tackle these challenges with the fiscal stimulus efforts it announced this year. Inflation may last longer in Germany, as headline inflation will likely fall as a result of the gas price cap coming into effect at the beginning of the year, but core inflation will be stoked further by government stimulus, as Deutsche Bank noted.
- Households are changing their home installations slightly, as illustrated by Citi explaining that they are *"rapidly replacing gas heating with heat pumps."*

United Kingdom – Hunting ground in a state of deep financial instability.

For the UK, the consensus is for **a sharp contraction in the UK economy** through most of the first half of 2023.

- While the UK stock market continues to perform better than the state of the local economy would suggest, the severe cost of living crisis, weak sterling, and fiscal tightening should nevertheless weigh on performance.
- Inflation is expected to be more severe than in other areas, even in the event of a deep recession. As Fidelity said, the UK "may prove a canary in the coal mine," suggesting that what occurs in the UK may serve as a warning for other Western economies.

— More positively, Fidelity also believes that the UK equity market could become “an attractive hunting ground in 2023.”

— On long-term economic development, HSBC noted that “it is not clear whether the new prime minister Rishi Sunak can establish a more constructive trading relationship with the EU.”

United States – Mild recession with a resilient job market.

The overall outlook is largely favorable to the U.S. economy in 2023 compared to the rest of the world, except Asia in terms of pure growth. Nevertheless, there are still some issues to be addressed.

— Interestingly, the opinion is not unanimous as to whether the U.S. will be affected by a recession. The base case scenario of major institutions like JP Morgan and Bank of America is a “***mild recession in the U.S.”*** also in the first half of 2023, while Goldman Sachs estimates that *“the U.S. should narrowly avoid recession as core PCE inflation slows.”* The latter positive scenario will occur only if inflation fades quickly.

— The U.S. benefits from a *“favorable view”* over international financial markets, quoting Wells Fargo. UBS expects **a depreciation of the U.S. dollar towards fair value**.

— Besides, according to the forecasts, job **losses should be contained for the coming year**. However, Barclays expresses concern that a restrictive Fed policy would lead to significant job losses for the U.S.

— It is also expected that **consumer demand will weaken**, although households still have a significant ‘excess’ of savings. According to BNP Paribas, these savings are declining and, it should be noted, are concentrated among high-income, low-consumption households.

Asia – China and India compete for growth.

China – A rebound not before 2Q23, whereas its model is at a crossroads.

Overall, 2023 will be a key year for the Chinese economy, which is transitioning from being capital spending-led to consumption-led.

— Other key trends will include global supply chain realignments, demographic change, debt deleveraging and a structural shift toward a consumption-led economy, according to Morgan Stanley.

— Regarding monetary conditions, they are considered reasonably accommodative with relatively low inflationary expectations by Fidelity.

— According to S&P, while in the context of COVID real estate has deteriorated in China, the comprehensive real estate policy **easing package announced** in November should help lay the groundwork for a possible recovery.

— A rebound in China may benefit the Western economies, but will also likely lead to higher commodity prices, complicating currency and monetary tightening against inflation, as pointed out by UBS or Lazard.

— For the long-term, Morgan Stanley is slightly reserved, commenting that *“**growth in China will be weighed down due to its high debt**, slowing working-age population growth and declining contribution from trade.”*

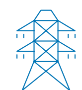
India – A bright spot, driven by manufacturing.

Most institutions believe that ***“Asia could avoid recession in 2023”,*** noted Citi *“even considering potential external weakness”.*

— Focusing on India, Citi and Deutsche Bank respectively highlighted the **notable investment boom** and capital inflows in the last year and the **strong growth in corporate profits expected in 2023**.

— As such, India looks like a *“bright spot,”* according to Barclays, driven by the **expansion of its manufacturing sector on a massive scale**, said Deutsche Bank, adding that “given the country’s continued strong economic momentum, it is difficult to see the Indian stock market as fundamentally overpriced.”

Sector Outlook



Energy – Higher or stable prices, maintaining a strong cash flow generation.

Since the invasion of Ukraine by Russia, **energy has become a priority**. In an attempt to become more self-sufficient, countries have begun altering their **energy supply chains and are seeking to invest further in green energy and renewables.**

- Economists expect secular supply constraints in the sector to *"persist for some time and ultimately see higher prices for the underlying commodities into 2023"*, writes Wells Fargo.
- Higher prices may continue to support the growth of traditional energy actors and the energy transition, as well as investments in renewables, according to Wells Fargo and Citi.
- Natwest expects nuclear power to take *"a larger share of the discussion."* Deutsche Bank further asserts that *"investments can be made in different parts of the renewable energy chain – production technology (e.g., electrolysers), distribution infrastructure (e.g., pipelines) and use technologies."*
- Citi highlights that **new and existing LNG supplies can fulfill the opportunity to achieve Europe's energy needs**, creating *"another kind of opportunity for investors."*
- More cautious on price increase forecasts, Credit Suisse noted that the **increase in non-OPEC supply should bring prices down to lower levels**. However, the sector *"should continue to generate substantial cash flow"*, according to HSBC.

Mobility – Decarbonation investments as a priority.

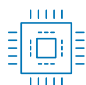
Major financial institutions highlight the opportunities in smart mobility, which Deutsche Bank defines as an energy-efficient, low-emission, safe, comfortable, and cost-effective form of mobility.

- This sector *"**has the strongest near-term support** in our view"* according to HSBC and is referred to as a ***"priority long-term investment"*** by Deutsche Bank.
- Investments are possible in companies that may benefit from energy storage technologies, autonomous vehicles, shared mobility, and new transport methods.
- However, Credit Suisse's Outlook is more reserved, as the transportation segment *"will surely be affected by slowing global growth and recession risks."*

Tech – Some tailwinds in a growth strategic sector driven by megatrends.

Digital will remain a highly strategic sector in 2023. BNP Paribas reported that Gartner forecasts 5% growth in corporate IT spending in 2023.

- According to Credit Suisse, *"Companies are increasingly investing in **advanced IT infrastructure**, higher **processing power, collaboration** tools and newer **digital payment** methods. **Artificial intelligence** adoption should continue to expand as digitalization accelerates and the number of **Internet of Things** devices surges, paving the way for automation, virtual and augmented reality as well as **healthcare** technology."*
- **Cybersecurity** is also a sector that ***"should hold up well"*** according to BNP Paribas.
- Overall, the tech sector remains in the very short-term *"in turmoil because of higher risk-free rates, and layoff announcements are rising,"* noted Apollo. Global demand for tech, housing, and Covid-related products *"slows further,"* adds Goldman Sachs.



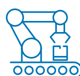
Semiconductors – Increased competition may improve products' availability

The status of the semiconductor industry is **not as alarming as one might have predicted**. Although still under pressure, *"the* ***shortage*** *of semiconductors* ***is easing,"*** considers HSBC.

- Citi considers that *"the* ***world's vast dependency on Taiwan-sourced semiconductors represents a concentrated supply risk."*** The Taiwanese and South Korean semiconductor industries have been hit hard by weakening demand and increasing global competition in technology, but may find interest in adding to their capacity in Europe and the U.S.
- According to BNP Paribas, semiconductor **demand may prove resilient in end-markets including the automotive sector**, where electronic content is increasing and inventories remain low, and datacenters, depending on the resiliency of spending to support cloud and AI initiatives. Most semiconductor stocks are trading near (or below) their worst-case scenarios, as investors have priced in inventory corrections across all end markets.
- Regarding valuations in the sector, they ***"have become more reasonable in recent quarters,"*** noted Wells Fargo.

Real assets – Infrastructure overcomes real-estate

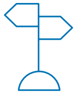
- **Infrastructure is seen as a hedging sector** in this period of inflation. BNP Paribas and Citi particularly mentioned green infrastructure, or any other infrastructure implemented in the clean energy transition. *"The selloff may present a potential long-term entry point,"* according to Citi.
- Infrastructure-related risks remain in China, according to Société Générale: *"China's exit from its zero-Covid policy could be a stop-start process and hampered by the weakening of its property and infrastructure sectors."*
- **Real estate, however, will suffer more than infrastructure**, being one of the most interest-sensitive sectors. The housing market has already started to be affected. For instance, HSBC has removed real estate from its high conviction theme, as higher borrowing costs may continue to weigh on real estate values.



Industrials – Macro-sensitive but driven by the transition to automation

- Being a long-term driven sector, eyes are turned to workforce shortages bringing opportunities for automation to the industrials. As Bank of America highlights, this is a bullish theme for productivity and efficiency gains, and *"industrial companies are benefiting from this."*
- According to Crédit Suisse, large Industrials is one of the sectors that is most sensitive to economic activity, especially the manufacturing and industrial production segments. The bank projects that *"goods demand is already in a recession and expect industrial production (IP) momentum to slow significantly."*

Bold views



Economists developed strong views entering 2023, away from common expectations, as follows.

- UBS and Morgan Stanley believe in a bullish global economic outlook for the year 2023. They predict a **possible resilience** likely to surprise investors. Similarly, JP Morgan and Société Générale predicted that the recession should be modest.
- Contrary to other institutions, Crédit Suisse perceives **current energy prices as *"unsustainable*** *as non-OPEC supply is set to rise and demand to slow."*
- As for the tech sector, Goldman Sachs, moving away from the other institutions' optimism, points to **a slowing down of global demand.**
- While also predicting a recession for Europe, UBS adopted a more optimistic tone than other institutions arguing that ***"the major drags on the world economy coming from Europe and China are poised to get better."*** Contrary to other institutions, Crédit Suisse remained **pessimistic regarding** the Chinese economy despite better monetary and fiscal conditions.
- **Only two institutions write about the metaverse:** Deutsche Bank and Citi. The latter looks like the most enthusiastic, noting that by 2030, *"the metaverse economy may be worth between $7.7 trillion and $12.8 trillion."*

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