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Markets & Trends 2023: Global economy on a ridge walk

- German economy to shrink by 0.6 percent
- Only gradual fall in inflation expected
- Balancing act between the need to tackle inflation and a weakening economy
- DAX forecast to end 2023 at around 16,000 points

The global economy is moving along a narrow ridge. Looking ahead causes even seasoned mountain hikers to break out in a cold sweat. Sheer drops into a yawning abyss lie on either side of that ridge. At the same time, quick decisions have to be made based on incomplete information about the further course of the route. The challenges for the “sherpas” in central banks and governments have rarely been as daunting as they are today. All of this provides the backdrop to Helaba’s Economic and Capital Market Outlook for 2023, which uses an Alpine setting as this year's theme.

For most people, the likeliest scenario is currently a plunge – a deep recession, to which Helaba Research & Advisory attaches a relatively high probability this year (30 percent). It is hard to imagine that conditions will soon clear up and give way to abundant sunshine – although sudden changes in the weather are commonplace in the mountains. However, this scenario, which goes by the name of family hike, has only been given a 10 percent likelihood. Our economists attribute the highest chance of 60 percent to their baseline scenario: a ridge walk.

Baseline scenario: “Ridge Walk”

Probability of occurrence 60 percent

The overlapping factors of Ukraine, the energy crisis and the fallout from the pandemic dominate events in 2022 as well as prospects for 2023. Far from having disappeared, the latter factor is set to feature prominently in 2023. Global supply chains have not yet returned to normal and changes in consumer behaviour have only partially rectified themselves in many places. “We are going to see a recession in Germany in 2023”, says Dr. Gertrud Traud, Helaba’s Chief Economist, while adding: “Our forecast is based on the assumption that hostilities in Ukraine will continue and that energy prices in Europe will remain high, although new sources of supply will emerge and efforts to save energy will yield results”.

The major economic blocs – the United States and the euro zone – will experience a recession but still achieve somewhat positive average growth rates of 0.5 percent and 0.2 percent, respectively, over the course of 2023. The German economy will shrink by 0.6 percent. Despite the weak cyclical picture, inflation will only gradually recede. In Europe, energy shortages will remain a significant factor. Consumer prices will rise by 5.3 percent in the euro zone and by 4 percent in the United States – more slowly than in 2022 but far above the targets of central banks.

Missteps would be very costly

When walking along a mountain ridge, any missteps are usually more consequential than when taking a leisurely stroll through the woods. That is why it is crucial to make the right political decisions. Central banks face the challenge of controlling inflation with just the right dose of tightening without triggering an unnecessarily severe recession. This is where a conflict is looming between central banks and governments that are attempting to compensate for the adverse impact of high inflation on real incomes. If these measures are poorly conceived, they have the potential to create the wrong incentives – not just on saving energy – and thus to indirectly put upward pressure on prices.

On a geopolitical level, a tendency towards the formation of economic blocs is emerging, with China and the United States at their respective nuclei. “Rather than a genuine process of deglobalisation, which remains a risk, at least for now we are only witnessing a realignment of globalisation”, explains Dr. Traud. This view is borne out by world trade growing by more than global production since 2020. Although terms such as “reshoring” and “friend-shoring” are prevalent in the media, they are not a factor shaping companies' actions. So far, their focus has remained on efficiency and, to an increasing extent, diversification of supply chains.

Alternatives for investors

The storm on the bond market is abating. Key interest rates should reach their cyclical peak by the middle of the year at the latest. This will create headroom for declining bond yields. The yield on 10-year German Bunds will touch highs for the year in the first six months and reach around 2.3 percent at the end of 2023.

Equities have already discounted the majority of negative factors. The most important conditions for equity markets to bottom out have been met: cheap valuations, very negative economic expectations, pessimistic investor sentiment and a technically oversold market. As equities lead the real economy by an average of six months, we anticipate a vigorous recovery in prices. By the end of 2023, the DAX should be approaching the 16,000 mark.

Real estate will be hit harder by higher interest rates than by the recession. There will be a modest price correction on the residential market. In the commercial segment, offices will prove more resilient than retail properties, which will struggle in the face of an enormous loss in purchasing

power due to high inflation.

Gold will rebound in 2023 as demand for the precious metal as an inflation hedge picks up again. As soon as an end to interest rate hikes is in sight, the gold price will consolidate towards 1,900 US dollar per troy ounce.

The US dollar will not be able to resume its upward trajectory as the Fed halts monetary tightening and will lose some of its appeal as a safe-haven currency. The EUR/USD exchange rate will be trading at around 1.10 at the end of 2023.

Negative alternative scenario “Plunge”

Probability of occurrence 30 percent

An escalation in geopolitical tensions is a particular focus as the trigger that pushes the economy over the edge. Both Germany and the euro zone as a whole are plunged into a deep recession, while the United States, as a net energy exporter, and China, as a beneficiary of cheap Russian commodities, are less severely affected. There is a strong correction in equities and yields on the bond market fall significantly. Real estate prices also see a substantial decline. The crisis provides a boost to the US dollar and the gold price.

Positive alternative scenario “Family Hike”

Probability of occurrence 10 percent

Decreasing geopolitical tensions seem to be a prerequisite for a “family hike”, which results in falling risk premiums on financial markets. Thanks to lower energy prices, this would alleviate some of the pressure on inflation – at least in the short term – and would mean there is no need for a significantly restrictive monetary policy. For this reason, there is only a modest rise in yields on the bond market while equity markets surge. The real estate market stabilises. As “safe haven” assets, there is less demand for the US dollar and for gold.

Markets and Trends



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