



**R&R Weekly Column**  
**By Brunello Rosa**



## 2023 Outlook: A Year of Stagflation, Part 2 (Policy and Markets)

Last week, [we discussed how 2023 will be a year of stagflation from a macroeconomic perspective](#). We discussed how the global slowdown, which will translate in outright recessions in several countries (a third of the global economy, [according to the IMF](#)) will be accompanied by still-high inflation. Inflation may fall for cyclical reasons (including the fall in energy prices recorded in the last few months), but will remain sticky and elevated for a series of structural reasons discussed in [our 2023 Global Outlook](#) and mentioned in our latest column. This week, we discuss the implications of this macroeconomic outlook for policy and markets. Regarding policy, we discuss fiscal and monetary policy in turn.

*Fiscal policies* will be inflationary in the next few years, including 2023, as governments will have to fight “wars” on at least five fronts. 1) *Hot and cold wars* lead to larger budget deficits that are eventually monetized and tend to cause higher inflation. 2) *The war against global climate change* will be very expensive as countries transition to new form of energy consumption. 3) The war to prevent the next *global pandemic* will be very expensive ex ante or ex-post if we don’t prevent it and end up with another costly Covid-style pandemic. 4) *The war to prevent social strife* in face of rising inequality will be expensive as social spending, transfers and lower taxes for workers and left-behind households. 5) *The tech war in which AI, robotics and automation* will lead to job losses that require stronger social safety nets for those experiencing permanent tech or trade-related unemployment.

All these five “wars” over the next decade will lead to greater public spending, transfer and lower taxes for the those “left behind”, while the ability to raise taxes is constrained by politics and economics. Thus, higher budget deficits that will crowd out growth if financed with debt; and the eventual monetization of such deficits as a “debt trap” will force central banks to wimp out and blink.

Regarding *monetary policy*, with inflation much more persistent than central banks currently expect in 2023, central banks will have to either hike much more than they currently signal, thus triggering a more severe hard landing and financial markets distress; or they will need to blink and wimp out, in which case inflation expectations get de-anchored, price-wage spirals ensue and higher inflation persists. We believe that central banks will be pressured to stop tightening or even easing if there is a hard landing; and in presence of negative supply shocks and a wage-price spiral even a hard landing may not push inflation low enough towards target.

So monetary policy and fiscal policy risk being inconsistent one another, and this will cause plenty of headaches to policymakers. Additionally, central banks will face a dilemma of countering price instability (with higher rates) or financial instability (potentially, by continuing or resuming asset purchases).

What are the implications for markets? In our global outlook we discuss several scenarios, depending on how the macroeconomy and policy evolve. In a nutshell, in our baseline we expect equity prices to continue their descent, as inflation proves stickier than expected, and central banks are forced to keep rates high for longer. As a result, we also expect higher short- and long-term rates in all major jurisdictions. In the currency space, we expect the USD to weaken against its major currencies as their central banks catch up with the Fed in terms of policy tightening. As inflation remains elevated, and interest rates high, we expect alternative investments (private equity, crypto, real estate) to continue suffering. On the other hand, we expect digital infrastructure investments to continue doing well in coming years.

### Our Recent Publications

- 🌐 [Investors Hope For An “Ordinary” 2023](#), by Filippo Ramigni, 30 December 2022
- 🌐 [Argentina: Political Crisis, Economic Uncertainty](#), by London Politica, 29 December 2022

- 🌐 [Global Outlook 2023: A Year Of Stagflation](#), by Nouriel Roubini, Brunello Rosa and Nato Balavadze, 23 December 2022
- 🌐 [The Ukraine War Requires Israel to Strike a Challenging Balance](#), by Giorgio Cafiero, 22 December 2022



Looking Ahead

**The Week Ahead: Headline EZ Inflation To Cool; Unemployment Rate To Stay The Same In US And EZ; PMIs To Rise In EZ And UK**

**In the US**, December's unemployment rate is expected to remain at 3.7%. NFPs are seen increasing by 200K (p: 263K). In December S&P Global services and composite PMIs are seen decreasing to 44.4 (p: 46.2) and 44.6 (p: 46.4).

**In the EZ**, in December, headline inflation is expected to ease off to 9.7% y-o-y (p: 10.1%), whereas core inflation is likely to stay unchanged at 5.0%. Also in December, S&P Global manufacturing is expected to 49.1 (p: 48.5). Composite PMI is also seen rising to 49.1 (p: 48.5). November's retail sales are seen contracting by 3.3% y-o-y (p: -2.7%). On a monthly basis, retail sales are expected to recover by 0.5% (p: -1.8%).

**In the UK**, in December S&P Global/CIPS manufacturing PMI is expected to fall to 44.7 (p: 46.5), whereas services PMI is likely to increase to 50 (p: 48.8). Composite PMI is expected to also rise to 49 (p: 48.2).

**The Quarter Ahead: Russia Launched Missile Attack; Silva Takes Over In Brazil; IMF Warns 2023 Will Be Tough On Global Economy**

**Russia launched the missile attacks on New Year's Eve**. As officials reported, key infrastructure in Kyiv was targeted by drones, causing heating outages. Ukrainian forces shot down 45 drones on Sunday and claims to have killed 400 Russian soldiers in a missile attack on the occupied Donetsk region. Zelensky hailed the "sense of unity" in country in his first address of 2023.

**Lula da Silva was sworn in as Brazil's president**. He also led the country between 2003 and 2010. In his first speech, Lula promised to rebuild a country, which he found in "terrible ruins". Lula was arrested in 2018 for corruption and money laundering and was behind bars during Bolsonaro's 2019 inauguration. His convictions were later overturned.

**IMF Managing Director Kristalina Georgieva warns one-third of world's economies are projected to be in recession this year**. She said as the three big economies, the US, EU, China are all slowing down, 2023 will be a "tough year". IMF forecasts global growth forecast to decline from 2.9% in July to 2.7% in October. The world's second-largest economy, China, is expected to advance at or below global growth for the first time in 40 years as COVID-19 infections surge, following the removal of ultra-strict zero-COVID policy.

Last Week's Review

**Real Economy: Manufacturing PMI Increased In EZ; Loans Decreased In EZ; Japan's Unemployment Decreased**

**In the EZ**, in November, loans to households and loans to companies edged down slightly to 4.1% y-o-y (c: 4.1%; p: 4.2%) and 8.4% (c: 8.6%; p: 8.9%) respectively. In December S&P Global manufacturing rose to 47.8 (c: 47.8; p: 47.1).

**Among the largest EZ economies**, S&P Global manufacturing PMI rose. i) in Germany manufacturing activity increased to 47.1 (c: 47.4; p: 46.2); ii) in France, the manufacturing sector also rose to 49.2 (c: 48.9; p: 48.3); and iii) in Italy, manufacturing PMI edged up to 48.5 (p: 48.4) as expected.

**In Japan**, in November, the unemployment rate fell to 2.5% as expected (p: 2.6%).

**Financial Markets: Stocks Slide; Yields Were Up; Dollar Is Down. While Oil Prices And Gold Prices Increased**

**Market Drivers**: The major indexes ended lower with the S&P 500 producing its worst annual result since 2008. Still high inflation and aggressive monetary tightening policies as well as geopolitical concerns weighed on investor sentiment. On the other hand, positive signals on supply chains and China's relaxation of COVID rules drove investor sentiment. The UST 10Y yield rose to the highest intraday level since November 14<sup>th</sup>, 2022.

**Global Equities**: Decreased w-o-w (MSCI ACWI, -0.1%, to 605.38). The US S&P 500 index fell (-0.1% w-o-w, to 3,839.50). In the EZ, share prices were down (Eurostoxx 50, -0.6% w-o-w, to 3,793.62). In EMs, equity prices moved up (MSCI EMs, +0.2%, to 956.38). Volatility increased to 21.7 (VIX S&P 500, 52w avg.: 25.5; 10y avg.: 18.2).

**Fixed Income**: w-o-w, the 10-year US treasury yields increased (+13 bps to 3.88%). The 2-year US Treasury yields rose (+10 bps to 4.43%). The German 10-year bund yield rose (+17 bps to 2.56%).

**FX**: w-o-w, the US Dollar Index was down (DXY, -0.7%, to 103.3; EUR/USD +0.8%, to 1.07). In EMs, currencies increased (MSCI EM Currency Index, +0.3% w-o-w, to 1,660.6).

**Commodities**: w-o-w, oil prices rose (Brent, +1.7% to 85.9 USD/b). Gold prices increased w-o-w (+1.2% to 1,826.2 USD/Oz).



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## Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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