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Global Economics Intelligence

Global Summary Report January 2023

(data from December 2022 and January 2023)

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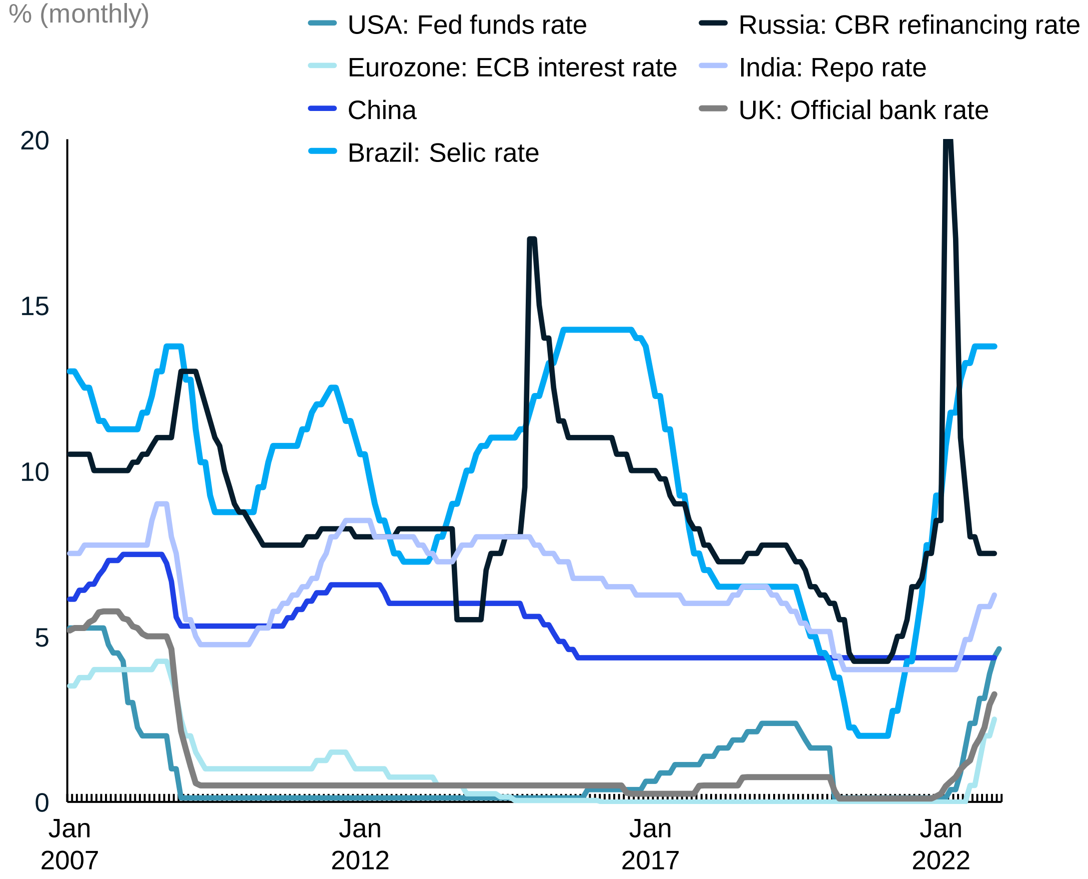
While energy prices have come down, core inflation readings remain high and central banks are sustaining a tightening course

Central-bank interest rates

% (monthly)



Growth in most surveyed economies exceeds pessimistic expectations; inflation moderates but is still high and central banks stay tightening course.

Despite the year's high inflation and energy uncertainty, world economic performance in 2022 is set to exceed earlier more pessimistic expectations. Growth estimates for 2023 and 2024 have also become less dire. Recently upgraded forecasts suggest that global growth in 2022 will be 3.2% (IMF, Conference Board). In most analyses, a slowdown of short duration is predicted for 2023, resulting mainly from stagnation in the developed economies, with a rebound in 2024.

The economies of the US and eurozone demonstrated resilience in the second half of the year. The US economy expanded at an estimated 2.9% in the fourth quarter and 2.1% in 2022 overall. The eurozone economy avoided a predicted contraction in the fourth quarter, expanding by 0.1% beyond the previous quarter and 3.5% for the year.

From the world's largest emerging economies, comparatively robust growth is expected for 2023. In India, where GDP expanded 8.7% in fiscal 2021–22 (March to April), the official GDP growth estimate for fiscal 2022–23 is 7%. In China, the pace of economic expansion slowed from 8.4% in 2021 to 3% in 2022. The main cause was disruption connected to the "zero-Covid" policy but weaker global demand and rising geopolitical uncertainty magnified the headwinds. China has since lifted key pandemic restrictions. At the World Economic Forum's January meeting, Liu He, China's vice-premier and top economic adviser, welcomed foreign investors, emphasizing that China's economy was set to improve significantly in 2023. The IMF recently upgraded its growth estimate for China in 2023 to 5.2% and early economic data are directionally supportive.

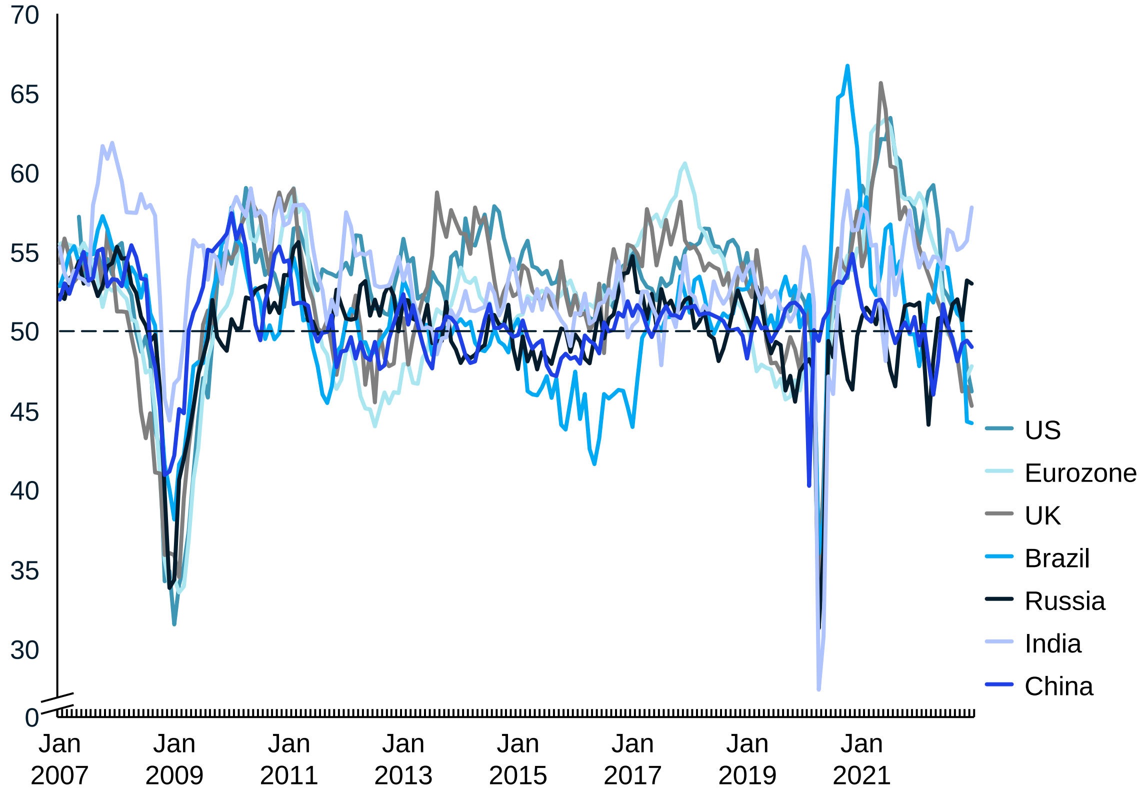
Recent global economic data have been mixed, reflecting both improved conditions and persisting downside risks, largely centering on inflation and geopolitical uncertainty. Inflation has begun to slow in both developed and emerging economies. Energy prices have come down, but core inflation readings remain high and central banks are sustaining a course of policy tightening (Exhibit 1). The US Federal Reserve implemented a small rate rise on February 1 (one-quarter point), bringing the policy interest rate to 4.5–4.75%. The Fed also signaled that further increases can be expected in 2023.

Source: Banco Central do Brasil; Bank of England; Central Bank of Russia; European Central Bank (ECB); New York Fed; Reserve Bank of India; McKinsey's Global Economics Intelligence analysis

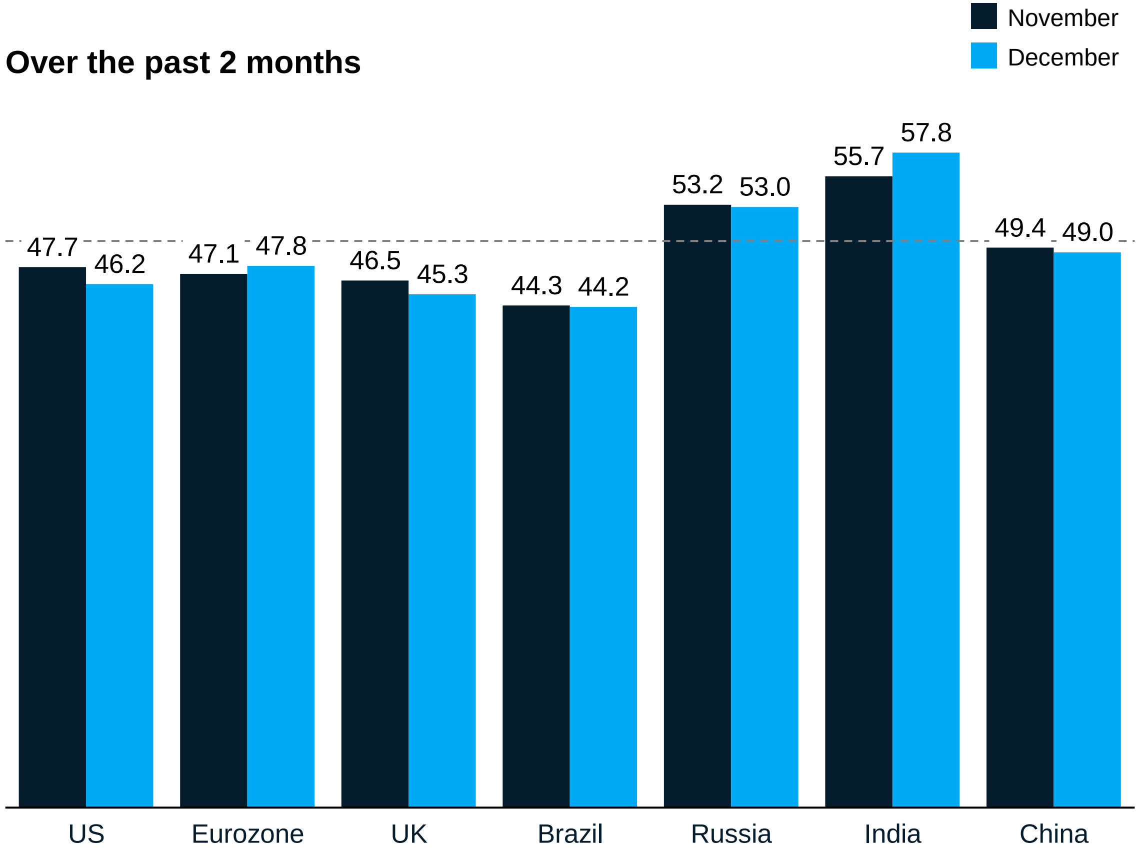
The manufacturing sector in most surveyed economies showed contraction in December; exceptions were India and Russia

Purchasing managers' index (manufacturing)

Diffusion index (monthly)



Over the past 2 months



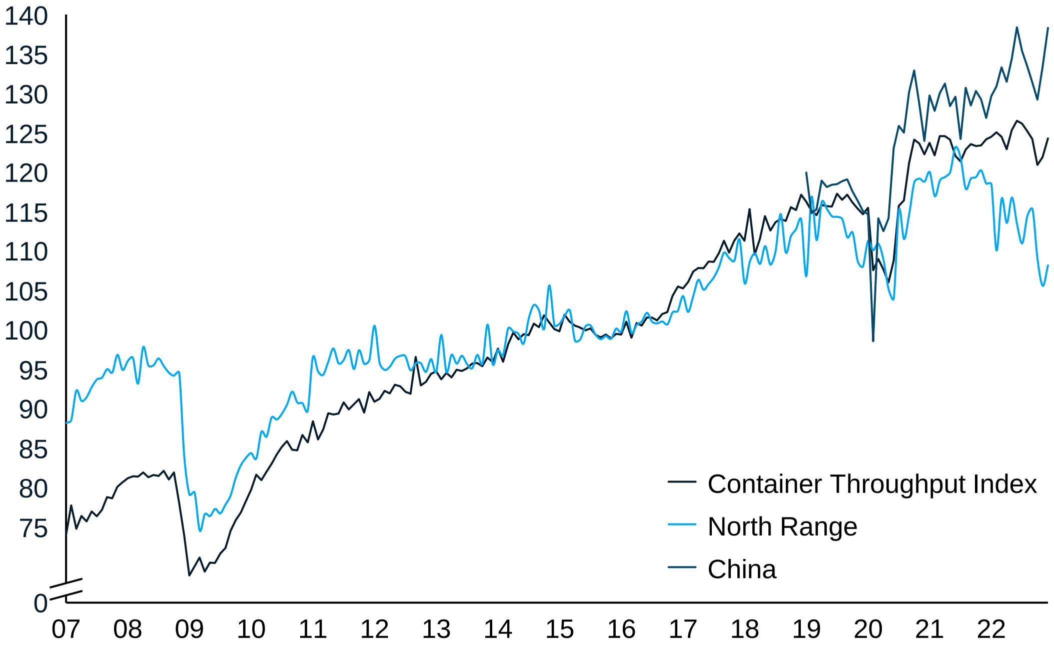
Note: A reading above 50.0 indicates an increase from the previous month, and a reading below 50.0 indicates a decrease. The country-level data are the PMIs for individual countries as sourced from Markit Economics and are not a breakdown of the JPMorgan Global PMI.

Source: IHS Global Insight; McKinsey's Global Economics Intelligence analysis

The most recent trade data, the Container Throughput Index for December, shows a year-end trade revival: the index reached 124.3 (121.9 in November) and both Chinese and European components improved

RWI/ISL Container Throughput Index

Index level, 2015=100[2]



1. The current flash estimate for the Container Throughput Index is based on data from 64 ports, which account for about 85 percent of the handling represented in the index.
2. On January 2020, the RWI/ISL Container Throughput Index changed its base year to 2015.
3. The North range index summarizes throughput of the ports of Le Havre, Zeebrugge, Antwerp, Rotterdam, Bremen/Bremerhaven, and Hamburg.

Note: The RWI/ISL Container Throughput Index provides timely information on short-term trends in international trade. The database covers 91 international ports, which handle about 60% of global container transhipment. The monthly data do not include figures for Dubai. Data is seasonally and working day adjusted.

Consumer confidence improved globally and in most surveyed economies, though the prevailing surveyed mood falls well short of optimism. High prices and consumer caution continue to constrain retail sales in surveyed economies.

Amid weaker demand and high input costs, the global purchasing managers' indexes (PMIs) for both manufacturing and services finished the year in shallow contraction (48.6 and 48.2, respectively). PMI readings for individual economies are likewise contractionary, with the notable exception of India, where readings for both manufacturing and services are robust (57.8 and 58.5, respectively) (Exhibit 2). It is also noteworthy that flash estimates for January are showing improvement.

In November, world trade volumes, as measured by the CPB World Trade Monitor, decreased –2.5% from the previous month (when trade also contracted), with lower volumes in all major regions. However, the most recent available comprehensive trade data, the December release of the Container Throughput index, shows a year-end trade revival: the index reached 124.3 (121.9 in November) and both Chinese and European components improved (Exhibit 3).

Unemployment rates in most surveyed economies remain stable and relatively low by country or region: 3.5% in the United States, 3.7% in the United Kingdom, 6.5% in the eurozone, and 8.1% in Brazil.

While producer price indexes have been going down, prices of some commodities, notably industrial and precious metals, lately increased. The price of copper climbed 10% in the new year, as demand surges from the energy sector. Food-price inflation has moderated but is still historically high.

Inflation expectations implied in the yields of US Treasury products have declined to 2% for the medium and long-term, compared with 3.5% in early 2022. In January, the yields on government bonds have been declining. Equity markets in the US, Europe, and China have also been on an upward trajectory in the new year. The US dollar depreciated in December and January against the euro and the pound sterling (trading at $1.10 and $1.24 respectively on February 1).

Source: RWI/ISL; McKinsey's Global Economics Intelligence analysis

[Developed economies]: US equity markets improve in the new year; eurozone industry indicators slowly revive; GDP growth in developed economies exceed expectations.

United States

In advance estimates, GDP expands 2.9% in Q4 2022 and 2.1% for the year; with inflation still high at 6.5%, industrial activity and consumer spending moderate. Stocks begin year on an upward note.

In its advance estimates, the US Bureau of Economic Analysis measured 2022 GDP growth at 2.1% and the Q4 2022 growth pace at 2.9%. The pace in Q3 was 3.2% but the full-year growth pace was slowed by small contractions in the first two quarters (–1.6% in Q1 and –0.6% in Q2). Revised estimates will be released in February.

The US economy continues to show signs of slowing, amid high prices and high interest rates. The industrial production index slipped in the last two months of 2022, from 104.8 in October to 103.4 in December. In those months, the purchasing managers' index for manufacturing dropped into contraction territory, falling from 50.4 in October to 47.7 in November and 46.2 in December. In the flash estimate for January 2023, the rate of contraction slowed slightly, to 46.8. Analysts cite subdued demand and still-high input costs for the decline. The services PMI, meanwhile, has not had an expansionary reading since June. The flash estimate for January is 46.6, up from 44.7 in December, as services output continued to fall.

US retail and food service sales totaled $677.1 billion in December, –1.1% below November's level. Not surprisingly, given higher prices through the year, the total in December 2022 was 6% above December 2021 totals. Overall sales in 2022 were 9.2% above 2021 totals. The consumer confidence index (Conference Board) improved markedly in December, however, reaching 108.3 (101.4 in November). The assessment of current conditions was very strong (147.2); the expectations component of the survey improved slightly but remained low (82.4).

Due to higher prices, US export values remain far above pre-pandemic levels. Exports reached an historic high of $260.8 billion in August and then declined in subsequent months, to $251.9 billion in November. Imports dropped 6.5% in November, to $313.4 billion, resulting in a smaller trade deficit.

Prices are on a disinflationary trajectory, still rising but at a slower rate each month since June. In that month, inflation was 9.1%, close to a 40-year high; in each subsequent month since, inflation slowed, reaching 6.5% in December (7.1% in November). The December Survey of Consumer Expectations by the New York Fed shows that the one-year-ahead inflation expectation decreased to 5% from 5.9%.

(Continued on next page)

Source: BLS; Federal Reserve; NY Federal Reserve Bank, Redfin; U.S. Census Bureau; McKinsey's Global Economics Intelligence analysis

United States *(continued)*

In advance estimates, GDP expands 2.9% in Q4 2022 and 2.1% for the year; with inflation still high at 6.5%, industrial activity and consumer spending moderate. Stocks begin year on an upward note.

The US Federal Reserve tightened its policy actions in 2022, implementing seven hikes in the Federal Funds rate, bringing it to 4.25% to 4.50% in December. On February 1, the Fed made the first hike of the new year, of 25 basis points, bringing the interest rate to 4.5% to 4.75%. The Fed expects that further hikes will bring the rate above 5% in 2023, after which it will come down.

The Fed is also reducing its balance sheet, which neared $9 trillion. Early in 2022, it ended asset purchases (Treasuries and mortgage-backed securities) and since September has stopped replacing maturing bonds, cutting its portfolio by $95 billion per month. One market reaction to this process, known as quantitative tightening, has been an inverted yield curve: that is, the yield on shorter-term Treasuries is now higher than the yield on longer-term (10-year and 30-year) bonds, a development which some financial analysts regard as a recessionary signal.

The unemployment rate edged down to 3.5% in December (3.6% in November). New claims for unemployment benefits have stabilized at pre-pandemic levels (around 225,000 per week). Payroll employment increased by 223,000 in December, the slowest growth (apart from 2020) since December 2019. In 2022 overall, the number of new jobs rose by 4.5 million, down from 6.7 million in 2021, a recovery year. The labor-force participation rate, at 62.3% in December 2022, is slightly above where it was 12 months ago (62.2% in January) and 1 full percentage point below the pre-pandemic level (63.3% in February 2020).

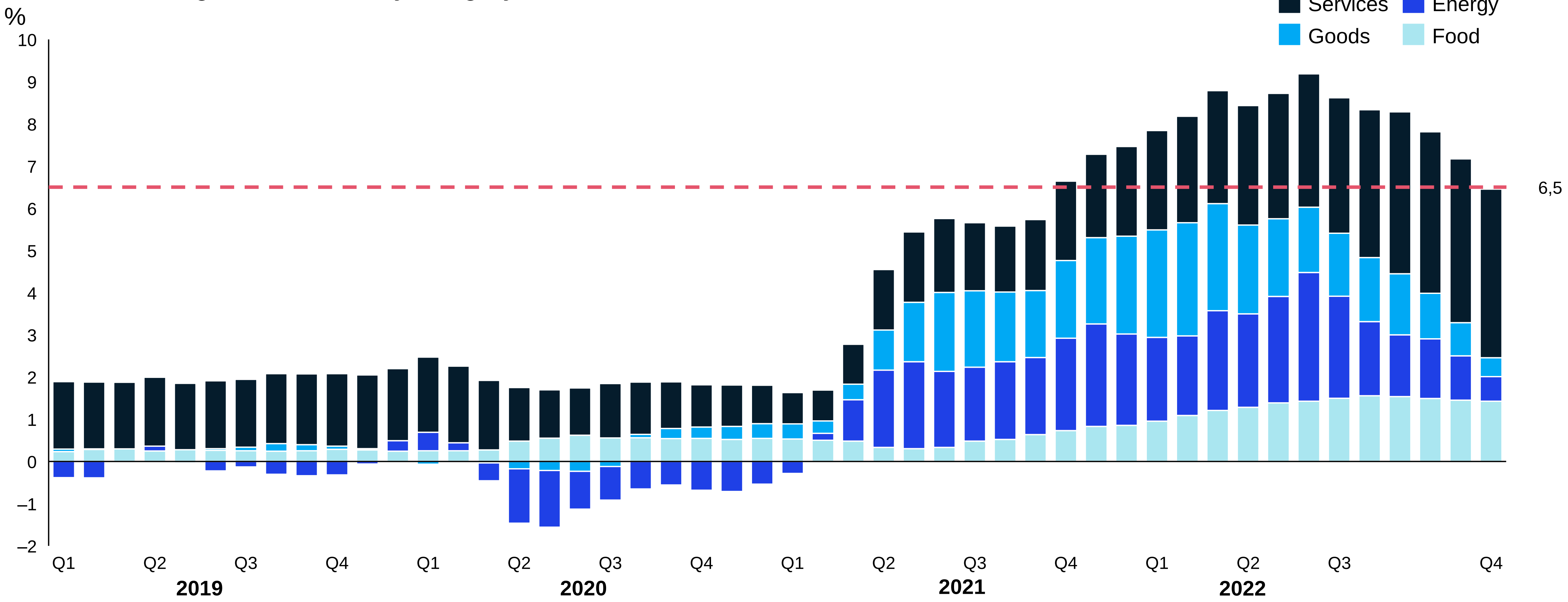
US housing prices have moderated since mid-year, with the median sale price of a home falling to $388,000 in December, only 1.3% above levels of one year ago. The number of homes sold decreased by 36.4% compared with December 2021 (data from Redfin). The average 30-year fixed-rate mortgage was 6.13% at the end of January, approximated 1% below the peak for 2022 in October and November.

In the new year, US stock markets have regained some lost ground. The S&P 500, which lost 19% of value over 2022, regained 3%, while the Dow Jones average, which lost around 9% in 2022, regained about 2.5%. The equities volatility index (VIX) has been declining since mid-December and has been below 20 since mid-January. The tech sector struggled in 2022, with announced layoffs by large companies totaling nearly 100,000. The Dow Jones index of US tech stocks lost more than one-third of its value in the year.

Source: BLS; Federal Reserve; NY Federal Reserve Bank, Redfin; U.S. Census Bureau; McKinsey’s Global Economics Intelligence analysis

The US consumer price index decreased in December to 6.5%, the lowest level in 14 months; the prices of goods and energy products dropped 4 percentage points

CPI annual change contribution by category



US industrial activity slips at year-end; inflation slows to 6.5% while the Fed makes a small hike in the policy interest rate; US stocks, battered in 2022, begin the new year on a positive note

Significant improvement | Improving | No significant change | Worsening | Severe decline

	Indicator category	Change vs prior month	Change vs pre-COVID
Macroeconomic	Consumer	No significant change	No significant change
	Business/industry	Worsening	No significant change
	Real estate	Worsening	Worsening
	Trade, external	Worsening	No significant change
	Prices	Improving	Severe decline
	Employment	Improving	Improving
Financial markets	Foreign exchange	Improving	Improving
	Equity	Improving	No significant change
	Debt	No significant change	Severe decline
	Credit	No significant change	Worsening
Government and policy	Public policy	No significant change	No significant change
	Public-sector health	No significant change	No significant change

At year-end 2022, the US economy shows signs of slowing: industrial activity retreats, consumer spending decreases, and the housing market cools; inflation slows to 6.5%; unemployment remains low

- The industrial production index slipped in the last two months of 2022, from 104.8 in October to 103.4 in December. In those months, the purchasing managers' index for manufacturing dropped into contraction territory, falling from 50.4 in October to 47.7 in November and 46.2 in December. In the flash estimate for January 2023, the rate of contraction slowed slightly, to 46.8.
- US retail and food service sales totaled $677.1 billion in December, –1.1% below November's level.
- Due to higher prices, export values reached an historic high of $260.8 billion in August and then declined in subsequent months, falling to $251.9 billion in November. Imports dropped 6.5% in November, to $313.4 billion, resulting in a smaller trade deficit.
- The average 30-year fixed-rate mortgage was 6.13% at the end of January, 1% below the peak for 2022 in October and November. The number of homes sold decreased by 36.4% compared with December 2021.
- The unemployment rate edged down to 3.5% in December (3.6% in November).
- Inflation slowed, reaching 6.5% in December (7.1% in November).

US equities index begin the year on an upward course; the tech sector retrenches; the Fed makes a smaller rate rise

- In the new year, US stock markets have regained some lost ground. The S&P 500, which lost 19% of value over 2022, regained 3%, while the Dow Jones average, which lost around 9% in 2022, regained about 2.5%. The equities volatility index (VIX) has been declining since mid-December and has been below 20 since mid-January.
- The tech sector struggled in 2022, with announced layoffs by large companies totaling nearly 100,000. The Federal Reserve raised the interest rate paid on reserve balances to 4.4 percent.
- The Federal Reserve increased the policy interest rate by 25 basis points, to a range of 4.5% to 4.75%. The Fed expects that further hikes will bring the rate above 5% in 2023, after which it will come down.

US budget deficit much reduced as pandemic emergency spending decreases; large government spending bill weighted toward defense spending.

- The US budget deficit was measured at $1.4 trillion for fiscal 2022 (October 2021–September 2022), much reduced from last year's deficit of $2.6 trillion. The smaller deficit was the result of slowing pandemic emergency spending and increased tax revenue from the reopening of the economy.
- On December 29, President Biden signed a $1.7 trillion spending bill that finances federal agencies through September and provides another large round of aid to Ukraine. The bill includes $772.5 billion in nondefense spending and $858 billion in defense spending.

Source: BLS; Federal Reserve; NY Federal Reserve Bank; Redfin; U.S. Census Bureau; McKinsey's Global Economics Intelligence analysis

United States year in review: looking back on 2022. . .

US economy expands 2.1% in 2022; unemployment fell to pre-pandemic lows but labor-force participation remains on a downward slide

- In its advance estimates, the US Bureau of Economic Analysis measured 2022 GDP growth at 2.1% and the Q4 2022 growth pace at 2.9%. The pace in Q3 was 3.2% but the full-year growth pace was slowed by small contractions in the first two quarters (–1.6% in Q1 and –0.6% in Q2). Revised estimates will be released in February.
- The unemployment rate edged down to 3.5% in December (3.6% in November). New claims for unemployment benefits have stabilized at pre-pandemic levels (around 225,000 per week). Payroll employment increased by 223,000 in December, the slowest growth (apart from 2020) since December 2019. In 2022 overall, the number of new jobs rose by 4.5 million, down from 6.7 million in 2021, a recovery year. The labor-force participation rate, at 62.3% in December 2022, is slightly above where it was 12 months ago (62.2% in January) and one full percentage point below the pre-pandemic level (63.3% in February 2020).

Inflation slowed to 6.5% by the end of the year; financial markets underperformed; the Fed tightened monetary policy

- Prices are on a disinflationary trajectory, still rising but at a slower rate each month since June. In that month, inflation was 9.1%, close to a 40-year high; in each subsequent month since, inflation slowed, reaching 6.5% in December.
- The S&P 500 lost 19% of value in 2022 and the Dow Jones average lost around 9%. The tech sector struggled in 2022, with announced layoffs by large companies totaling nearly 100,000. The Dow Jones index of US tech stocks lost more than one-third of its value in the year.
- The US Federal Reserve tightened its policy actions in 2022, implementing seven hikes in the Federal Funds rate, bringing it to 4.25% to 4.50% in December. The Fed also ended bond purchases and intends to unwind its balance sheet.

Source: BLS; Federal Reserve Board; IHS Markit; Moody's; The Economist Intelligence Unit; U.S. Census Bureau; World Bank

… and forward to 2023

Projected growth in 2023 is the third weakest in nearly three decades, overshadowed only by the global recessions caused by the pandemic and the global financial crisis. The United States is expected to grow substantially below potential, and their contributions to global growth will be far below recent norms….

– World Bank

We project real GDP growth in 2024 to be 2.0 percent on a Q4/Q4 basis, reflecting the start of a recovery following an anticipated 2023 contraction of 0.6 percent (down one-tenth from our previous forecast). We still expect a modest recession to begin in the first quarter of 2023 as the full effects of tightening monetary policy and weaker global growth weigh on the economy…

– Fannie Mae

The outlook for the economy in 2023 has dimmed appreciably over the past year…. The current SPF forecast for 2023 is that real GDP will increase by 0.8% and the unemployment rate will average 4.2%. With average real GDP growth close to zero thus far in 2022, another economic shock could push the economy into a recession. Indeed, some economists expect a recession in 2023 because of the need for further interest rate hikes to bring inflation back to the FOMC's 2% target. In his Nov. 2, 2022, press conference, Fed Chair Jerome Powell acknowledged that the path to a soft landing has narrowed.

– FRED, St. Louis

The outset of 2023, energy prices are off their peaks, inflation is no longer accelerating, and economic growth appears to be holding up. These positive signs make it tempting to expect a narrower range of potential macro-outcomes and, as in any new year, seek a fresh start. We see 2023 as a test of whether such a fresh start is now possible

– McKinsey & Company, in partnership with Oxford Economics

Eurozone

The eurozone economy likely expanded 3.5% in 2022; inflation slows and energy prices ease; exports increase. Croatia becomes the eurozone's 20th member state.

In 2022, the eurozone economy likely expanded by 3.5%. Forecasting institutions predict a slowdown for 2023, however, with estimates of GDP growth of less than 1%. The causes of the retreat are the global slowdown, the war in Europe, persisting high inflation, and tightening financing conditions. According to the ECB, the stalling economic activity will quickly change direction and recovery will begin in 2024.

Eurozone inflation slowed to 9.2% in December (10.1% in November), only the second month of what the ECB expects will be a year-long disinflationary curve. The main driver remains energy-price inflation but excluding energy, inflation was still high, at 7.2%. The latest reading for producer-price inflation was 27.1% for November (30.8% in October). The ECB estimates that inflation will reach 3.4% by the end of 2023, with a less certain path subsequently toward the bank's 2% target. The ECB has already signaled that in February it will raise its key interest rate to 2.5%, a hike of 50 basis points. Policy makers are divided on the size of the next raise, which will be announced in March. Most analysts expect the policy rate eventually to rise above 3%.

Eurocoin, a leading indicator, remains in negative territory but improved to –0.23 in December (–0.62 in November). Energy prices remain above historical averages. The price of natural gas (Dutch TTF futures) rose sharply in November before plunging in December and falling to €56 per megawatt hour by the end of January. The price is one-third its December 2022 high but still five times what it was before Russia invaded Ukraine. The Brent crude price has begun to climb, lately reaching $86 per barrel, as markets expect more intense demand from China in the coming year.

Industrial activity has been subdued in the eurozone, but the latest data are becoming less negative. The purchasing managers' index (PMI) for manufacturing reached 48.8 in the flash estimate for January (47.8 in December), the fourth consecutive month of improvement. The services PMI broke into expansion territory in January, reaching 50.7 (49.8 in December). The industrial production index has measured growth over 2021 since August.

Due to high energy and commodity prices, the eurozone trade balance has been negative since November 2021, when ten years of trade surplus ended. Nonetheless, in November, exports rose fast and the trade deficit declined from €27 billion to €12 billion.

European equities have been recovering since October. The Eurostoxx 600 index is now about 6.5% below its peak in January 2022. The euro has appreciated against the US dollar, reaching $1.09 per euro. The Italian–German 10-year bond-yield spread stabilized at 2.0%; the yields rose respectively from 3.8% to 4.2% and from 1.9% to 2.2%.

As the European Commission works on a comprehensive green energy plan, the Swedish state-owned mining company LKAB announced that it discovered the world's largest deposit of rare-earth oxides. These elements are essential in the production of electric vehicles and consumer electronics. Europe currently imports almost all of its supply from China.

On January 1, 2023, Croatia (population 3.9 million) became the 20th full member state of the eurozone and transitioned from the kuna to the euro.

Source: Banca d'Italia; ECB; European Commission; Eurostat; Haver Analytics; McKinsey's Global Economics Intelligence analysis

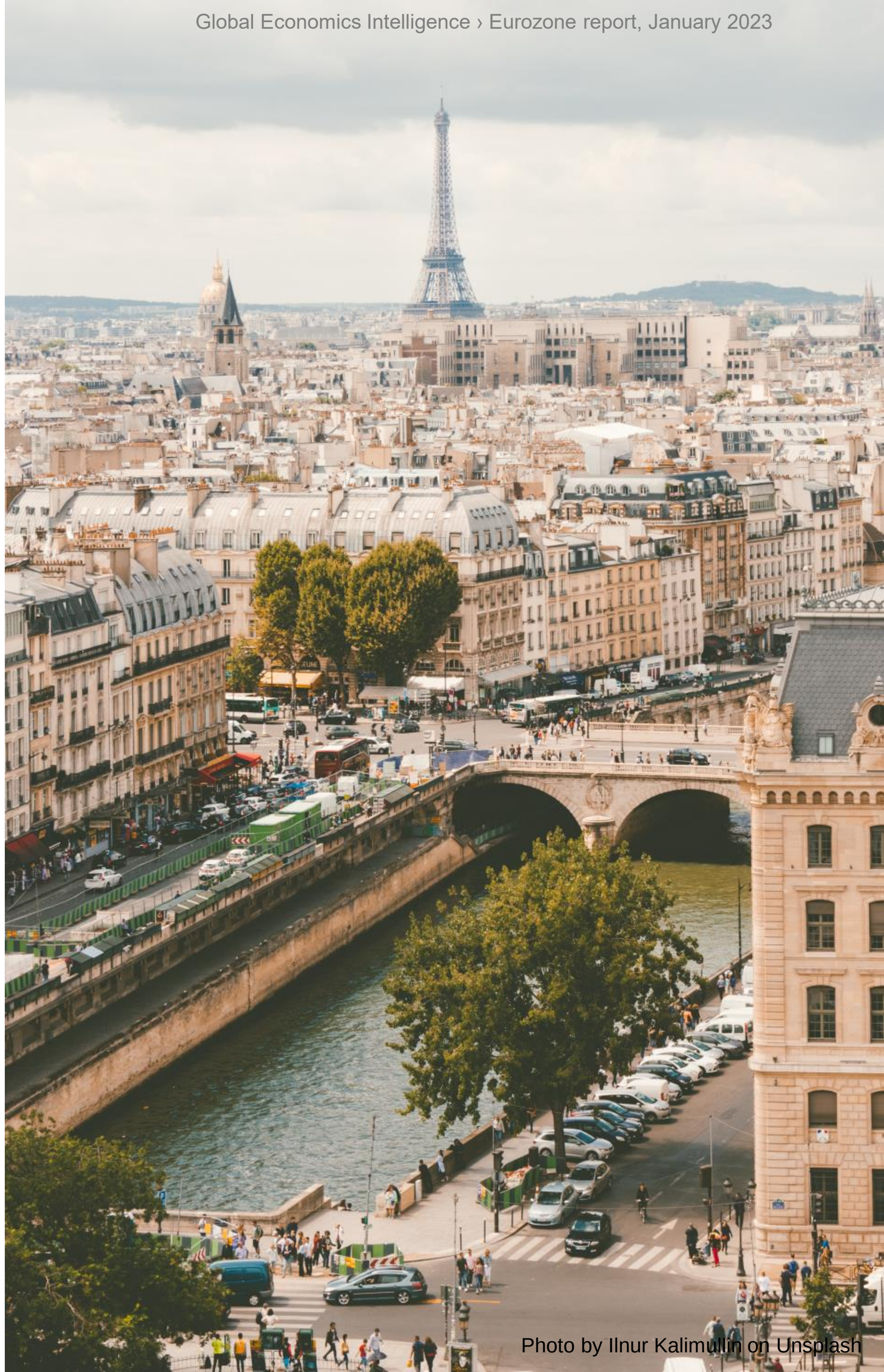
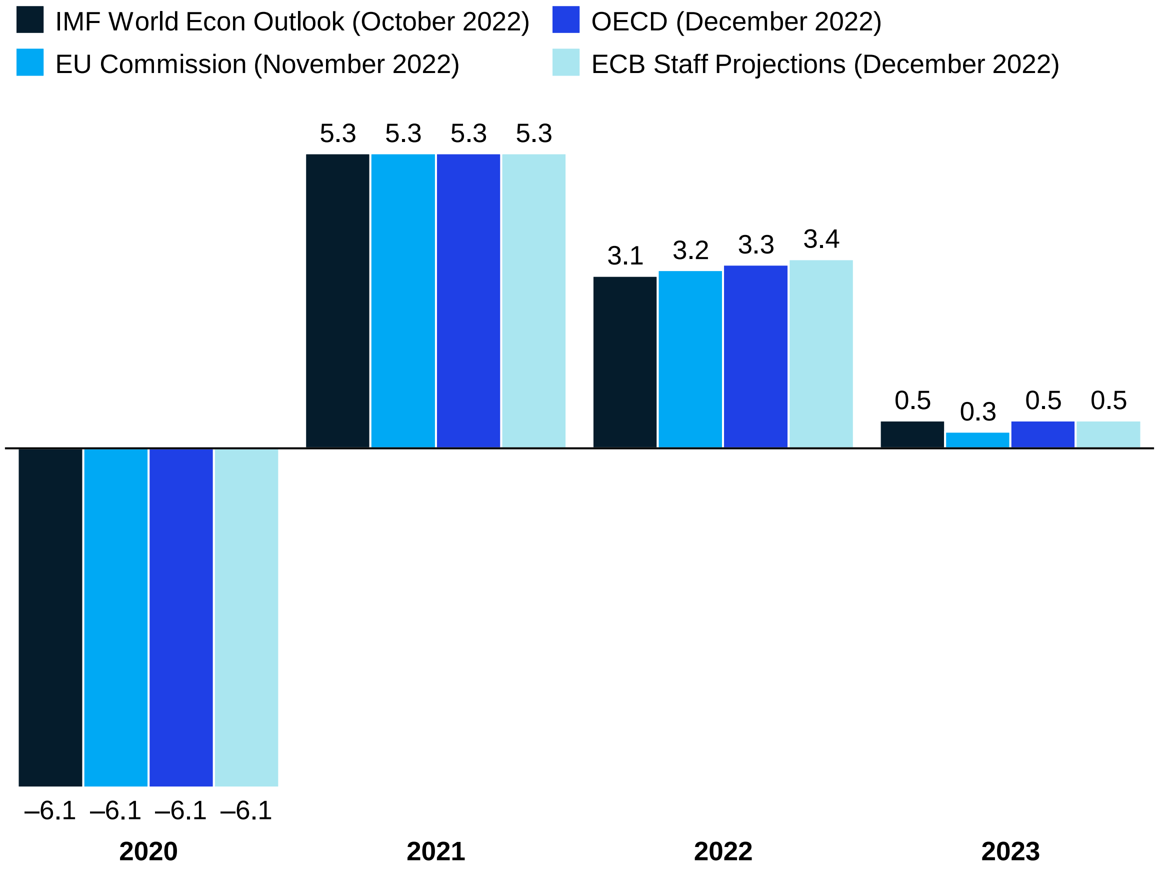


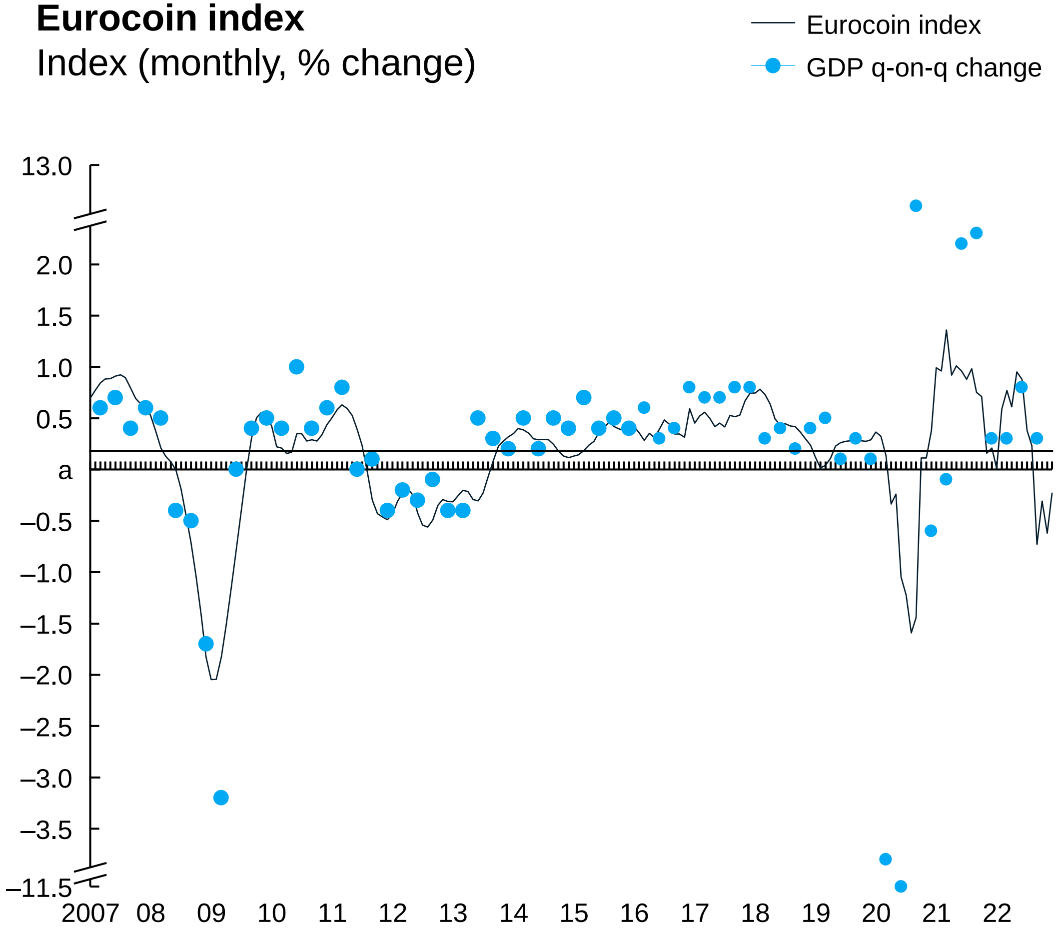
Photo by Ilnur Kalimullin on Unsplash

Recent eurozone growth projections have been upgraded; leading indicators improve but are still in negative territory

Eurozone real GDP forecast from main institutions, 2020–22
Year-on-year, constant prices (% change)



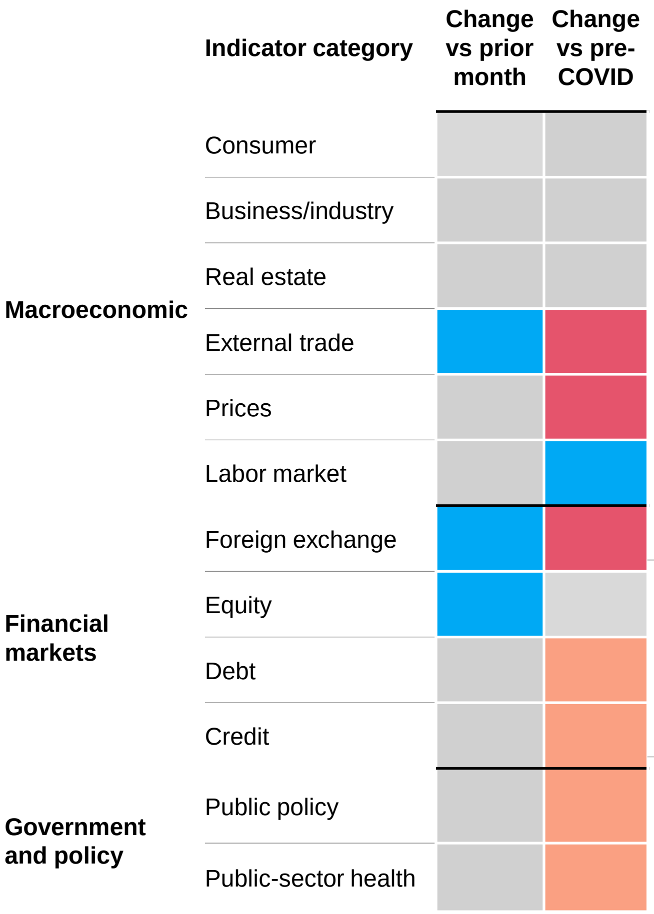
Eurocoin index
Index (monthly, % change)



Source: Banca d'Italia; European Commission; Eurostat; Haver Analytics; McKinsey's Global Economics Intelligence analysis

Inflation is only beginning to slow in the eurozone and is still a drag on real disposable income; industry indicators are slowly improving; stock markets continue year-end gains

Significant improvement | Improving | No significant change | Worsening | Severe decline



Industrial production is slowly recovering against high inflation and low consumer confidence and retail sales

- Retail sales improved by 0.8% m-o-m in November but fell –2.8% compared with last year's mark.
- The consumer confidence indicator (European Commission) reached its historic low mark in August (–28.7) and is becoming slowly less bleak (–20.9 in January 2023). The business confidence index remained in positive territory in December but at its lowest level of the year.
- The purchasing managers' index (PMI) for manufacturing reached 48.8 in the flash estimate for January (47.8 in December), the fourth consecutive month of improvement. The services PMI broke into expansion territory in January, reaching 50.7 (49.8 in December).
- The industrial production index has measured growth over 2021 since August.
- Construction and real estate indexes were down slightly in November compared with the previous month.
- The eurozone trade balance has been negative since November 2021, when ten years of trade surplus ended. Nonetheless, in November, exports rose fast and the trade deficit declined from €27 billion to €12 billion.
- Eurozone inflation slowed to 9.2% in December (10.1% in November), only the second month of what the ECB expects will be a year-long disinflationary curve. The main driver remains energy-price inflation, but excluding energy, inflation was still high, at 7.2%. The latest reading for producer-price inflation was 27.1% in November (30.8% in October).
- The unemployment rate remained stable and low at 6.5% in November; youth unemployment rate was 15.1%.

European equities continue to recover; Italian and German 10-year bond yields rose; the euro appreciated

- The Eurostoxx 600 index is now about 6.5% below its peak in January 2022.
- The euro has appreciated against the US dollar, reaching $1.09 per euro.
- The Italian–German 10-year bond-yield spread stabilized at 2.0%; the yields rose respectively from 3.8% to 4.2% and from 1.9% to 2.2%.
- Loans to businesses and households increased by 0.6% and 0.2% m-o-m and by 8.3% and 4.5% over 2021, respectively.

Critical raw materials for green tech found in Sweden; Croatia admitted to the eurozone

- As the European Commission works on a comprehensive green energy plan, the Swedish state-owned mining company LKAB announced that it discovered the world's largest deposit of rare-earth oxides. These elements are essential in the production of electric vehicles and consumer electronics. Europe currently imports almost all of its supply from China.
- On January 1, 2023, Croatia (population 3.9 million) became the 20th full member state of the eurozone.

Source: European Commission; Eurostat; Haver Analytics; United Nations; McKinsey's Global Economics Intelligence analysis

Eurozone year in review: looking back on 2022. . .

2022 at a glance

The central bank expects GDP to have grown by 3.4% in 2022

- Compared with 2021 levels, real GDP increased 5.5% in Q1 2022 and 4.2% in Q2 before slowing to 2.3% in Q3. Eurozone GDP is expected to have grown by 3.4% in 2022 (European Central Bank).
- With high energy prices eroding disposable incomes, consumer demand and sentiment weakened in 2022.
- Unemployment continued to decline throughout the year.
- Tighter financial conditions took a toll on small businesses.
- Supply chain disruptions have been easing.

Financial markets lost ground in the first three quarters; the central bank began to tighten monetary policy in the face of high inflation

- After reaching their all-times high at the beginning of the year, equity markets lost momentum, negatively affected by geopolitical tensions and weak consumer sentiment. Stocks began to recover in October.
- ECB ended a decade-long experiment with negative interest rates; the key rates now range from 2.0% (deposit facility) to 2.75% (marginal lending facility).

Russian attack on Ukraine has triggered the biggest geopolitical crisis in Europe since the Second World War

- The war has caused a severe humanitarian crisis. The European Union responded with efforts to isolate the Russian economy, resulting in a tectonic shift in Europe's energy supply.

Source: ECB; Eurostat; IMF; OECD; World Bank

… and forward to 2022

Perspectives on 2023

High levels of natural gas inventories and ongoing efforts to reduce demand and replace Russian gas with alternative sources imply that the euro area is expected to avoid the need for mandated energy-related production cuts over the projection horizon, although risks of energy supply disruptions remain elevated, in particular for the winter of 2023–24. Over the medium term, as the energy market rebalances, it is expected that uncertainty will decline, and real incomes will improve.

As a result, economic growth is expected to rebound, also supported by strengthening foreign demand and the resolution of remaining supply bottlenecks, despite less favorable financing conditions. The labor market is expected to remain relatively resilient to the coming mild recession, reflecting labor hoarding amid still significant labor shortages. Overall, annual average real GDP growth is expected to slow down markedly, from 3.4% in 2022 to 0.5% in 2023, and then to rebound to 1.9% in 2024 and 1.8% in 2025.

– European Central Bank

After a strong first half of the year, real GDP growth is projected at 3.3% in 2022 and only 0.5% in 2023 owing to Russia's war of aggression against Ukraine, monetary policy tightening, and the global slowdown. Growth is projected to rebound to 1.4% in 2024 as consumption and investment pick up. Inflation is set to decline only gradually, remaining above target in 2024, fueled by elevated energy prices and tight labor markets. Risks remain tilted to the downside as cold winters and further disruptions in energy supply would hit growth while pushing inflation higher.

– OECD

United Kingdom

The Office for Budget Responsibility (OBR) expects the UK economy will have expanded by 4.2% in 2022 overall; the economy slightly contracted in Q3 2022, as fears of an impending recession increased. Inflation eased in December, and the unemployment rate increased slightly.

The Bank of England (BoE) estimates a GDP decline of –0.1% in 2022 Q4 and estimates that the economy will remain in recession through 2023 and the first half of 2024. Household consumption remains weak, and most housing market indicators have continued to soften. Surveys of investment intentions have further weakened. Labor demand has begun to ease but unemployment remains low.

Estimates of the 2022 growth pace vary, from 3.6% (IMF) to 4.1% (OBR) to 4.4% (OECD). The OBR estimates the economy will contract –1.4% in 2023; the forecast further estimates that, as energy prices and inflation drop, and short-term interest rates fall from their peaks, annual GDP growth will pick up to 1.3% in 2024. Growth is expected to be stronger in 2025 and 2026, and the output gap will close by mid-2027.

The UK manufacturing sector ended 2022 on a weak footing, with output, new orders, and employment all falling at faster rates. Domestic and overseas demand remained lackluster, as clients faced rising costs, increased market volatility, and (in the case of EU-based clients) Brexit-related complications. The purchasing managers’ index (PMI) for manufacturing has been in contraction for six consecutive months. The reading for January 2023 was 46.7 (45.3 in December).

The services PMI slowed to 48 in January (49.9 in December), the fourth month of contraction. Price pressures remain elevated, amid a challenging business environment, with firms cautious about hiring staff. Cost of living pressures and high inflation have continued to depress consumption, while uncertainty characterizes business decision making.

Growth in average total pay increased to 6.4% in the three months to November 2022, but real wages declined by 2.6% year-on-year. The unemployment rate for September to November 2022 increased by 0.2 percentage points on the quarter to 3.7%, still below pre-pandemic levels, indicating that demand for labor may be slowly easing. The number of job openings decreased by 75,000 in the fourth quarter of 2022 compared with the third quarter. This was the sixth consecutive quarter in which the number of openings declined, falling in 14 out of 18 industry sectors. Nevertheless, the vacancies-to-unemployment ratio remains at a very elevated level.

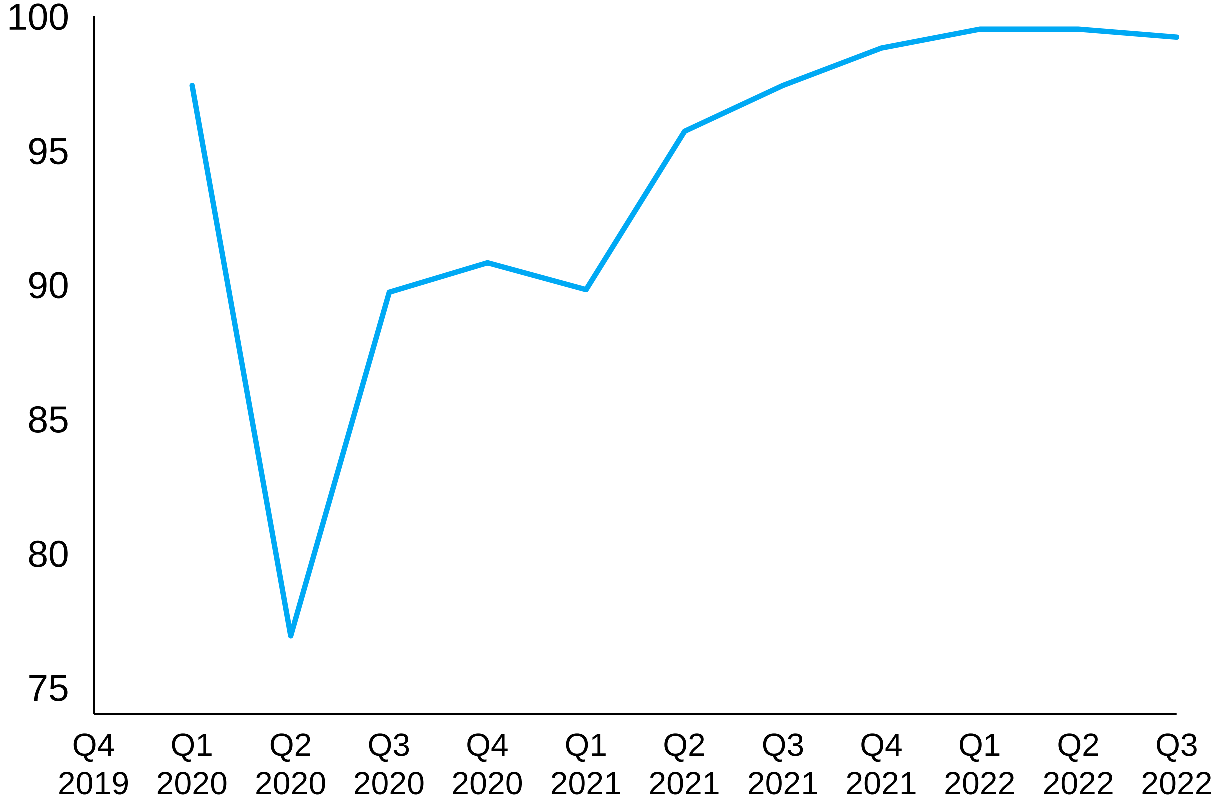
Inflation eased slightly in December to 10.5%, down from 10.7% in November, but remains at one of the highest levels seen in 40 years. The lower reading was driven by a significant fall in petrol and diesel prices. This was however partly counteracted by an above-average rise in food and services prices, a development likely to put the most pressure on lower-income households. The Bank of England voted in December to increase the bank rate by 0.5 pp, to 3.5%. The BoE has also continued its quantitative tightening program. According to the OECD, monetary policy tightening is expected to continue, with the bank rate reaching 4.0–4.5% by Q2 2023 and remaining at that level until the end of 2024.

A series of labor strikes and industrial disputes have occurred in key sectors (eg, rail transport, healthcare) as workers walked out over pay and conditions exacerbated by the cost-of-living crisis. One of the UK’s largest unions announced ten further days of strike action over the coming weeks, as a standoff between the government and ambulance workers intensifies.

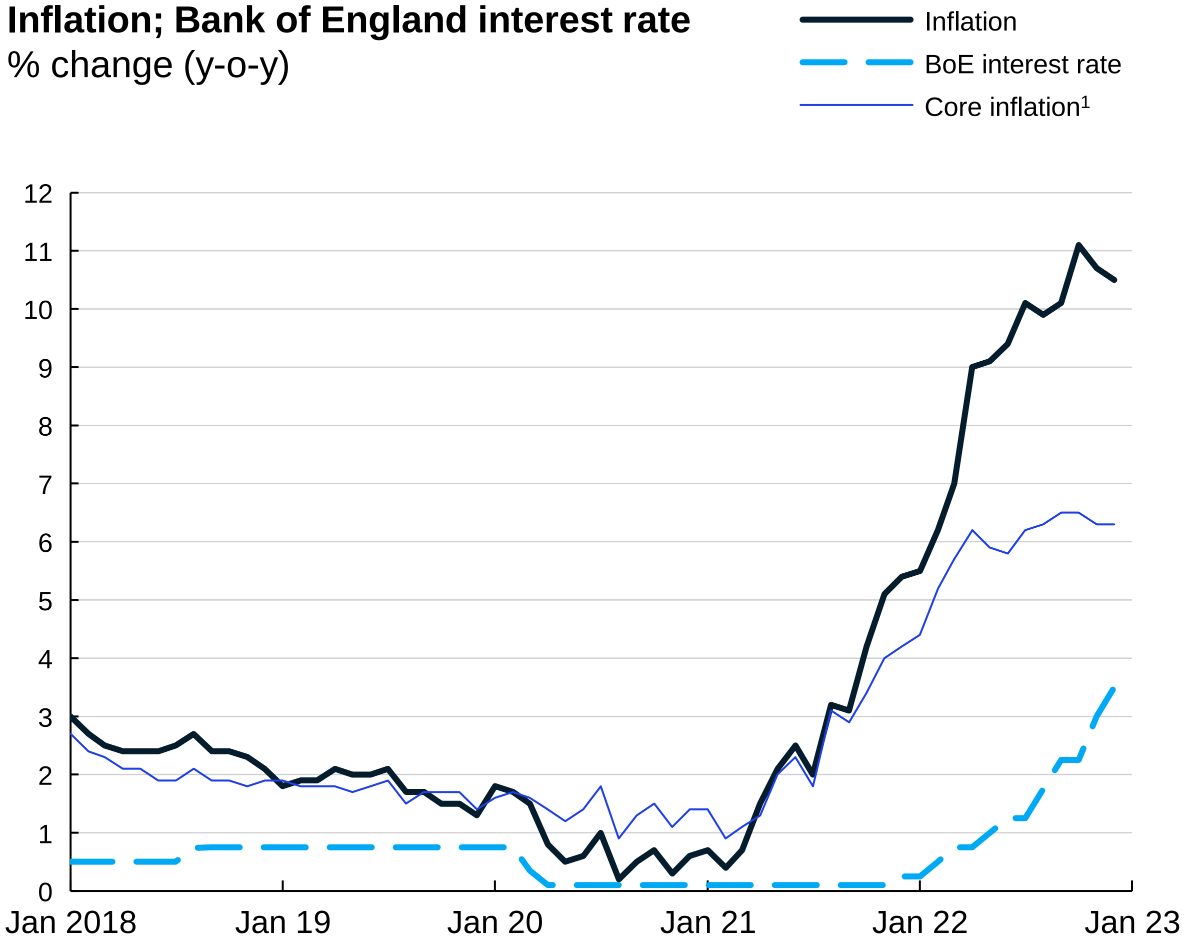
Source: Bank of England; IMF; OECD; Office for Budget Responsibility; Office for National Statistics; McKinsey’s Global Economics Intelligence analysis

Projections for UK GDP growth in 2023 are in near-zero or negative territory, but were upgraded slightly for 2022, while inflation has eased from record-high levels

UK GDP growth, Q4 2019 – Q3 2022
Index, 2019 Q4 = 100



Inflation; Bank of England interest rate
% change (y-o-y)

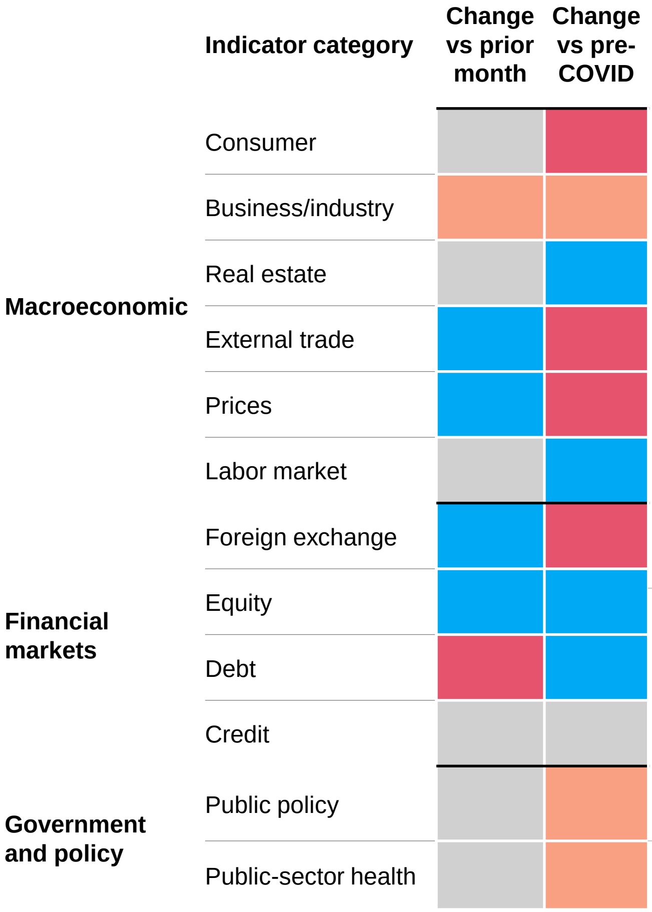


1. The specific measure excluding energy, food, alcohol, and tobacco is the one typically referred to as “core” by the ONS.

Source: Bank of England; IMF; OECD; Office for Budget Responsibility; Office for National Statistics; McKinsey’s Global Economics Intelligence analysis

High inflation and energy uncertainty continue to drag on consumer sentiment; UK industrial production weaken; bond yields and pound stabilize

Significant improvement | Improving | No significant change | Worsening | Severe decline



Inflation still near historic high; consumer and business confidence both remain low; industrial production weakens

- Retail sales volume dropped by 1% in December 2022, bringing it 1.7% below pre-COVID-19 (ie, February 2020) levels.
- GfK's Consumer Confidence Index increased two points in December to –42 from – 44 in November. However, UK consumers are struggling due to the cost-of-living crisis driven by rapidly rising food prices, domestic fuel bills, and mortgage payments.
- Monthly production output fell by 0.2% between October and November 2022, and is now 2.5% below February 2020.
- The UK Manufacturing PMI fell to a 31-month low of 45.3 in December (from 46.5 in October) and has remained below the neutral 50.0 mark for five successive months; the Services PMI rose slightly to 49.9 in December, indicating a stabilization of activity amid a challenging business environment.
- Monthly construction output remained flat in November 2022, the fourth consecutive monthly growth reading, and 3.1% above pre-pandemic levels. The UK trade balance has been in deficit since September 2021. The trade deficit narrowed by £6.5 billion to £20.2 billion in the three months to November 2022, driven by a decrease in goods imports from non-EU countries which is linked to falling fuel prices.
- The annual rate for the UK CPI eased slightly to 10.5 in December (10.7% in November). Core inflation (excl. food, energy, alcohol, and tobacco) was 6.3% in December (unchanged from November). Producer input prices rose by 19.2% year-on-year in October 2022 (down from 20.8% in September), and producer output prices rose by 14.8% (down from 16.3% in September).
- The unemployment rate for September to November 2022 increased by 0.2 percentage points on the quarter to 3.7%. The unemployment rate for people aged 18–24 increased to 9.8% (from 9.4%, on a three-month rolling basis).

UK equities level off; the 10-year gilt stabilizes following recent market turmoil; the pound strengthens against the dollar

- The FTSE 100 gained around 3.7% during the past month and now exceeds by around 1% the peak reached in February 2022. As of 23 January, the pound is trading at 1.24 against the dollar, after almost reaching parity in late September, an all-time low.
- The daily yield of the UK 10-year gilt has stabilized at around 3.4%, as of 23 January, down from historic highs of over 4.6% seen in mid-October, but well above rates of around 1% a year ago.
- UK government debt remained at 101.9% of GDP in Q2 2022, 15.5 pp above the EU average, while the deficit rose to 7.2% (from 2% in Q1 2022); loans to businesses remained broadly stable and loans to households increased.

The latest in a long-running series of train strikes brought the UK to a standstill in December, in addition to strikes by NHS, Royal Mail, and Border Force staff

- The government has announced controversial anti-strike legislation to enforce "minimum service levels" in key public sectors, including the NHS and schools. If passed, the law would allow bosses to sue unions and sack employees if minimum levels are not met.
- Prime Minister Rishi Sunak has ordered an ethics adviser to investigate the Tory party chairman's tax arrangements, with the opposition calling for his resignation and criticizing his appointment by Rishi Sunak.

Source: Bank of England; Office for National Statistics; McKinsey's Global Economics Intelligence analysis

United Kingdom year in review: looking back on 2022…

2022 at a glance

GDP growth in 2022 is estimated at around 4%

- UK real GDP increased quarter-on-quarter by 0.7% in Q1 2022 and 0.2% in Q2, before contracting by 0.2% in Q3. UK GDP is estimated by most forecasters to have grown by roughly 4% in 2022, but a record-length recession is anticipated in 2023 and likely 2024.
- The war in Ukraine triggered the biggest inflation shock seen in more than 40 years. Inflation and weak demand dampened business sentiment and performance—in the first three quarters of 2022, company insolvencies were 76% higher than in the same period in 2021.
- Without the fiscal support to households and businesses provided by the Energy Price Guarantee and other measures announced since March, the Office for Budget Responsibility estimates that the recession would be 1.1 percentage points deeper.
- Persistent supply chain issues and skyrocketing energy prices began to ease towards the end of 2022.
- The unemployment rate is close to a 50-year low and, as of the end of 2022, wage growth in the private sector was accelerating.

The FTSE 100 ended 2022 up almost 1% y-o-y; the BoE began a program of quantitative tightening amid growing inflation concerns

- Markets were rattled by Liz Truss's "mini-budget" announcement in September, with the pound hitting an all-time low against the dollar and gilt yields surging.
- The Bank of England responded to record inflation with aggressive interest rate rises and quantitative tightening.

Source: Bank of England; IHS Markit; IMF; OECD; Office for Budget Responsibility; Office for National Statistics; The Economist Intelligence Unit

… and forward to 2023

Perspectives on 2023

On average, economists expect the UK economy to contract by 1% in 2023, with the UK underperforming most of its peers. There are several reasons for this divergence—over half a million workers retired early during the pandemic, shrinking the productive capacity of an economy that also suffers from chronically low investment. Brexit will continue to constrain the supply of labor from the EU and weaken trade.

The Office for Budget Responsibility expects UK real household disposable incomes to be 6.5% lower at the end of 2023 than at the end of 2021, a massive reduction in spending power which feeds through to weak consumption and GDP growth. Unemployment will rise from 3.5% to peak at 4.9% in the third quarter of 2024. Rising prices will erode real wages and reduce living standards by 7% in total over the two financial years to 2023–24 (wiping out the previous eight years'' growth), despite over £100 billion of additional government support. The squeeze on real incomes, rise in interest rates, and fall in house prices are all expected to weigh on consumption and investment, tipping the economy into a recession that will last just over a year from Q3 2022.

The Bank of England agrees with the OBR's estimates. It projects a GDP contraction throughout 2023 and 2024 H1, as high energy prices and materially tighter financial conditions weigh on spending, with a return to growth in late 2024 or 2025. Downside risks include embedded high inflation, another spike in energy prices, the emergence of a financial crisis, and a continuation of the war in Ukraine.

[Emerging economies]: China’s growth slowed to 3% in 2022 but a new-year turnaround is expected; India sustains robust growth path despite external headwinds; Brazil’s new government withstands attack on institutions.

China

GDP expanded 3% in 2022 with investment driving half of the growth. Retail sales and housing sales contracted; fixed-asset investment grew 5.1%, trade expanded 7%, and new bank lending set a record level.

In 2022, China's GDP expanded 3%, reaching USD 17.9 trillion. The growth pace was considerably slower than that achieved in 2021 (8.4%), a bounce-back year after the pandemic lockdowns in 2020. The pace was also below pre-pandemic levels (6% GDP growth in 2019). The causes included the global slowdown and efforts within China to control COVID-19 outbreaks. While forecasting institutions predict a continued global slowdown in 2023, GDP growth estimates for China show an acceleration, ranging from 4.8% (UN) to 5.7% (Morgan Stanley).

China ended its "zero-COVID" policy beginning mid-November. However, weakening external demand resulted in slowing exports from China in November (–8.7% year over year) and December (–9.9%). The slowdown affected overall annual growth in trade in 2022, which was 7% for exports and 1.1% for imports. (Trade had grown explosively in 2021—by 29.9% for exports and 30.1% for imports—reflecting increased pandemic demand after the low base 2020).

For the year, fixed-asset investment growth slightly accelerated in 2022, to 5.1% (4.9% in 2021). By sector, manufacturing investment grew at 9.1% (13.5% in 2021); infrastructure investment accelerated significantly, at 9.4% (0.4% in 2021).

Real estate investment, however, retreated by –10% (4.4% in 2021). The overextended housing sector heavily contracted in 2022: land area purchased for housing fell –53.4% while sales revenue declined –28.3%, floor space sold declined –26.8%, and the average price for housing fell by –2%.

Retail sales were roughly stable, contracting –0.2% after 12.5% growth in 2021. Sales of consumer goods expanded by 0.5% (11.8% in 2021) while food service sales contracted –6.3% (18.6% in 2021). New social financing totaled RMB 32 trillion in 2022, increasing by 2.1% y-o-y.

The surveyed urban unemployment rate stood at 5.5% in December 2022 (5.1% in December 2021).

At the World Economic Forum meeting in Davos in January, Liu He, China's vice-premier and top economic adviser, met Western business leaders, stressing China's reopening. He welcomed foreign investment and emphasized that China's economy would improve significantly in 2023.

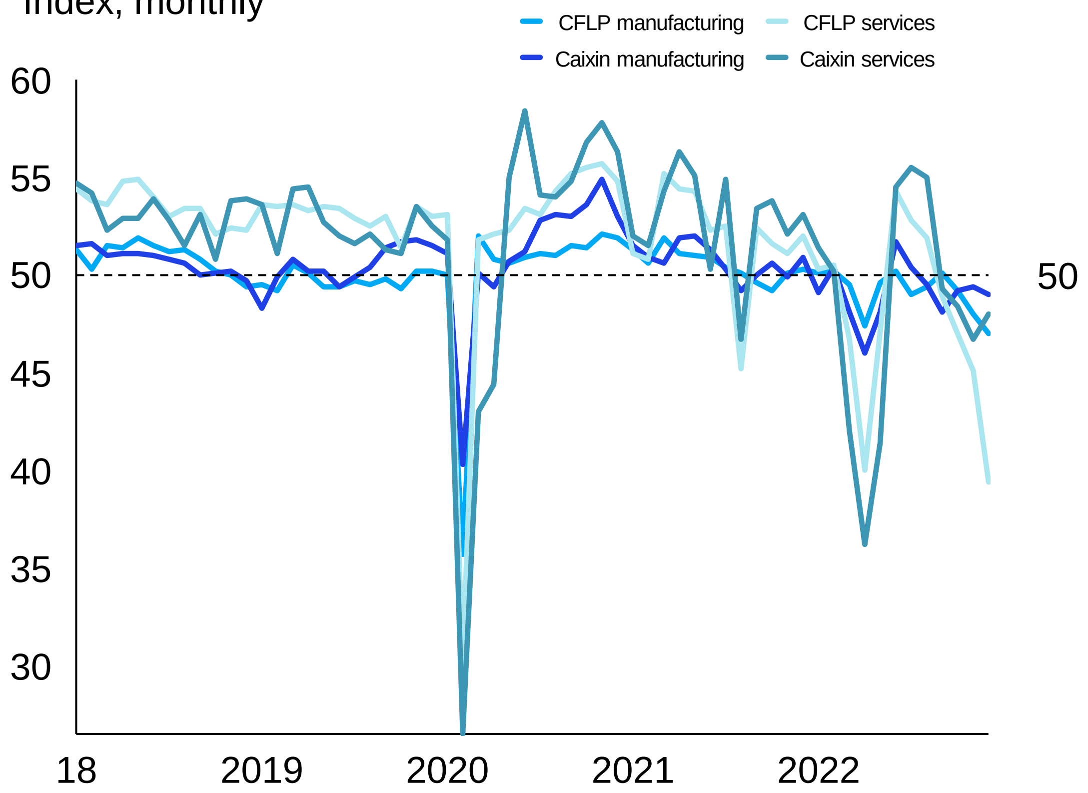
Since the end of China's zero-COVID policy, authorities and health experts have attempted to track the spread of the illness. According to a study by Beijing University, the number of infections may have totaled 900 million. On January 21, an expert at China's CDC estimated that 80% of the population could have had the virus. The CDC also released data indicating that the infection rate peaked by the third week in December and has since fallen sharply. Daily clinic visits topped out at 2.9 million (December 22) and have since fallen to 110,000 (January 23).

Source: CEIC; McKinsey's Global Economics Intelligence analysis

In China, manufacturing and services PMIs fell deeper into contraction in December; stock indexes improved

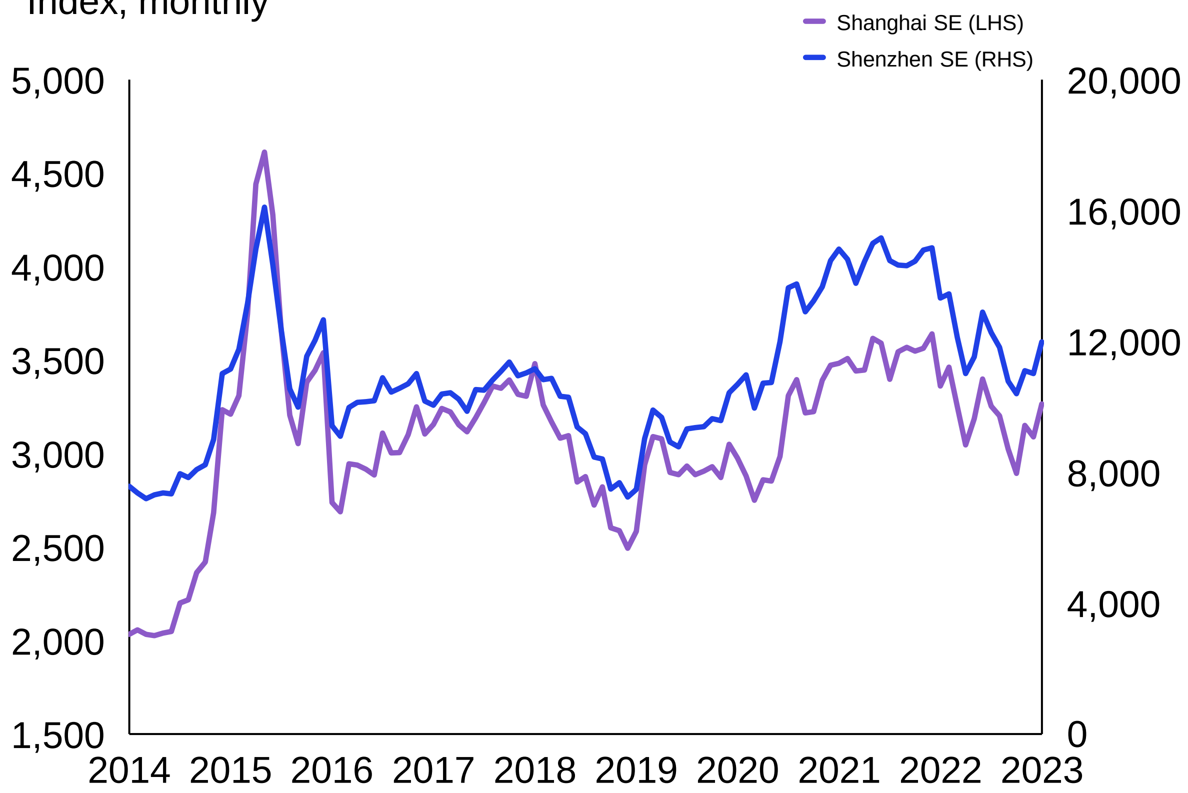
Purchasing managers indexes (PMI)

Index, monthly



Stock market indexes

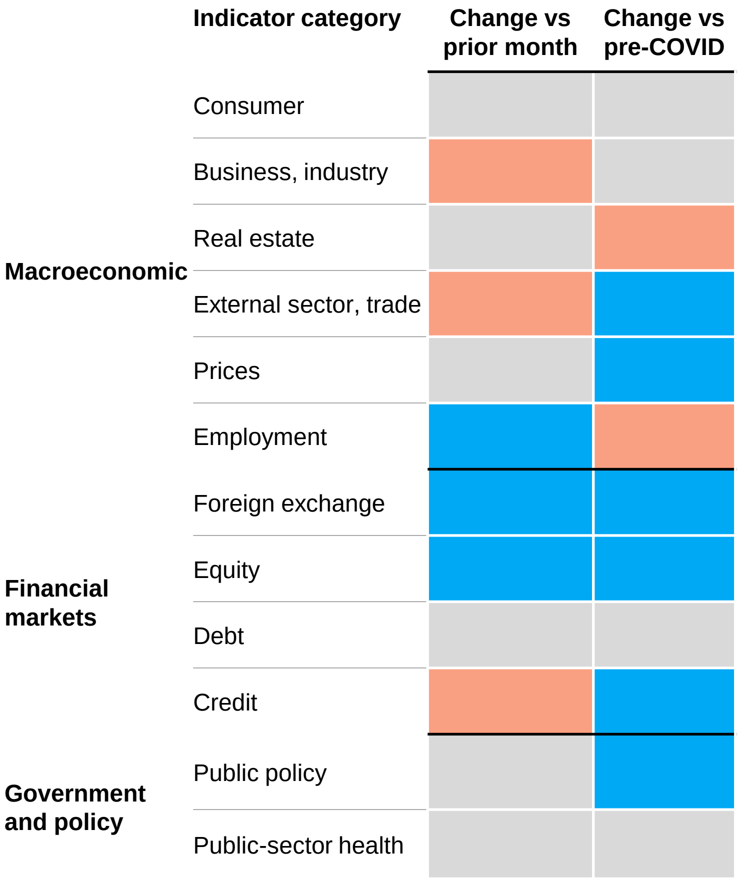
Index, monthly



Source: CEIC; McKinsey's Global Economics Intelligence analysis

Retail sales contracted less; trade and industrial activity weakened at year end; forecasting institutions estimate China's GDP growth at 4.8% to 5.7% in 2023

Significant improvement | Improving | No significant change | Worsening | Severe decline



Retail sales contracted less in December; the purchasing managers' index (PMI) fell for both manufacturing and services sectors; trade continued to decline

- The contraction in retail sales narrowed to –1.8% y-o-y in December (–5.9% in November).
- The official manufacturing PMI continued to decline with a reading of 47 in December (48 in November). Both the subindices for production (44.6) and new orders (43.9) suggest softening supply and demand. The official services PMI was hit harder, dropping to 39.4 in December (from 45.1 in November), the second-lowest level since 2020. The services slowdown coincided with the peak COVID-19 infection rate.
- Trade weakened at the end of the year, as exports contracted –9.9% (–8.7% in November) and imports contracted –7.5% (–10.6% in November).
- Inflation remains low, with consumer price inflation at 1.8% in December (1.6% in November) while producer prices deflated again at –0.7% in December (−0.3% in November).

RMB appreciated against US dollar; stock market gained value; credit and money supply tightened

- In the last quarter of 2022 and into 2023, the RMB appreciated 2.8% against the dollar, trading at RMB 6.8 = USD 1 by January 26.
- The Shanghai stock index gained 5.7% and the Shenzhen index gained 8.8% in value by January 20 compared with levels at the end of December.
- New social financing totaled RMB 1.3 trillion in December (RMB 2 trillion in November), falling –44.6% (–23.7% in November).
- M2 growth was 11.8% in December (12.4% in November).

Growth forecasts for 2023 show acceleration for China despite continuing global slowdown

- The UN and IMF, for example, estimate GDP expansion in 2023 will be 4.8% in China; Morgan Stanley recently revised its estimate upward, to 5.7% GDP growth.
- Most analysts predict a difficult first quarter but a faster recovery thereafter.

Source: Bloomberg; CEIC; McKinsey's Global Economics Intelligence analysis

China year in review
Looking back on 2022. . .

2022 at a glance

China's GDP growth was 3% in 2022; consumer confidence was hit hard

In 2022, China's GDP expanded 3%, reaching USD 17.9 trillion. The growth pace was considerably slower than that achieved in 2021 (8.4%), a bounce-back year after the pandemic lockdowns in 2020. The pace was also below pre-pandemic levels (6% GDP growth in 2019). The causes included the global slowdown and the efforts within China to control COVID-19 outbreaks.

China ended its "zero-COVID" policy in December. However, weakening external demand resulted in slowing exports from China in November (–8.7% year over year) and December (–9.9%). The slowdown affected overall annual growth in trade in 2022, which was 7% for exports and 1.1% for imports. (Trade had grown explosively in 2021—by 29.9% for exports and 30.1% for imports—reflecting increased pandemic demand after the low base 2020).

12.1 million new jobs were created in 2022 (12.7 million in 2021); the surveyed urban unemployment rate was 5.5% by the year end (5.1% in December 2021); individual disposable income increased 2.9% in 2022, in line with GDP growth.

Monetary policies were eased to support economic activities; RMB depreciated against USD

New total social financing increased by 2.1% in 2022 (–10.1% retreat in 2021). The People's Bank of China introduced RRR (reserve requirement ratio) and LPR (loan prime rate) cuts to better support economic growth.

The RMB depreciated 9.2% against USD and foreign reserves decreased to USD 3.1 trillion (3.3 trillion in 2021).

Health authorities ended the zero-COVID policy beginning in mid-November

The CDC released data indicating that the resulting increased infection rate peaked by the third week in December and has since fallen sharply. Daily clinic visits topped out at 2.9 million (December 22) and have since fallen to 110,000 (January 23).

. . . and forward to 2023

Perspectives on 2023

We are revising up our forecast for China's real GDP growth to 5.2% in 2023 (from 4.7%). China will experience an initial rebound in consumption, driven by pent-up demand, but the recovery will be relatively mild, owing to the negative impact of zero-covid on personal incomes and the absence of household-focused stimulus. Similar to consumption, private investment will also take time to rebound.

– EIU

We project China's GDP growth rebound to 4.9% in 2023, led by domestic consumption and helped by property stabilization. We expect exports to decline and infrastructure investment to slow despite government support. We foresee CPI inflation rise to 3% in 2023 and USD-CNY trade at 6.8 at end 2023.

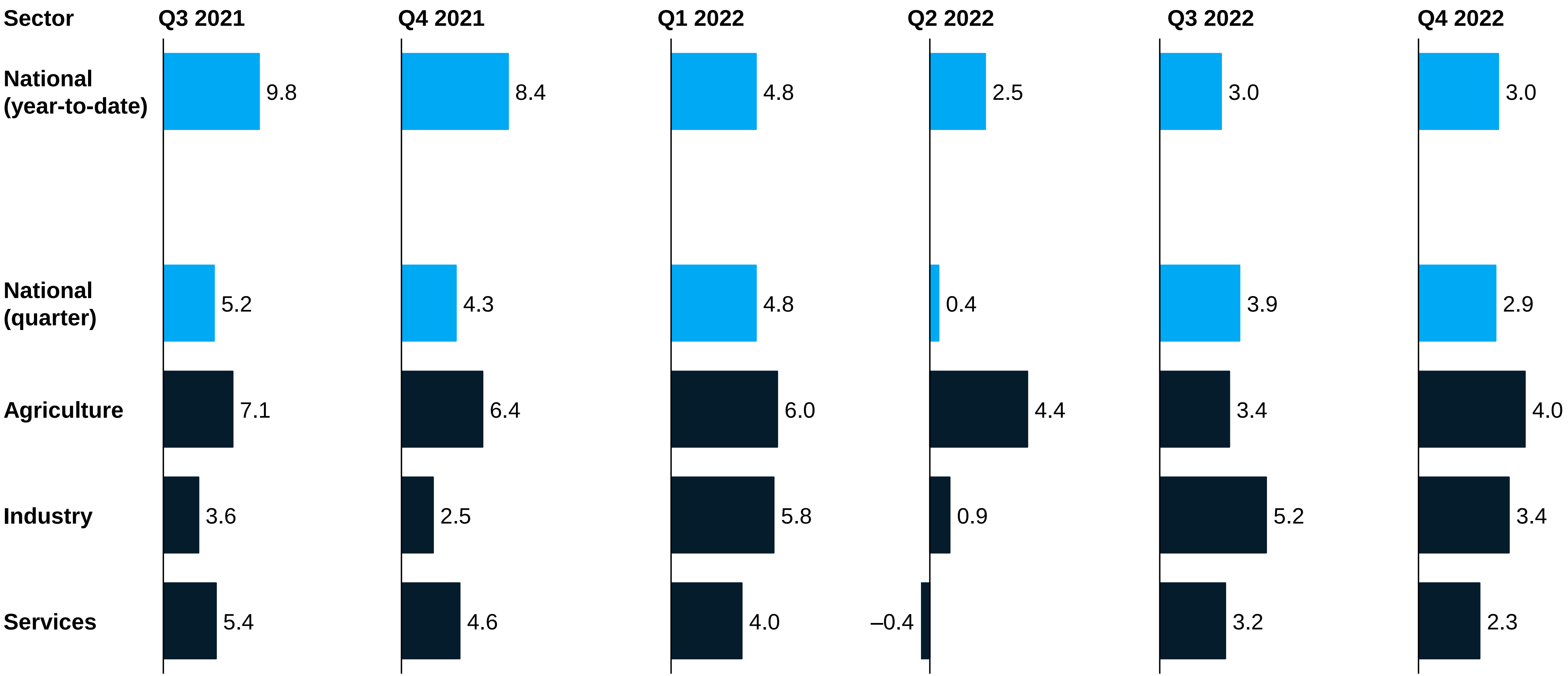
– UBS

We expect GDP growth to pick up to around 5% in 2023. The housing market could stage some recovery in 2023. The service sector would clearly benefit from any loosening of Covid restrictions that may emerge during the course of the year.

– Schroders

China’s GDP grew by 3% in 2022 as fourth-quartergrowth slowed to 2.9% amid a surge of COVID-19 infections

Real growth of value added by sector



Source: CEIC; McKinsey’s Global Economics Intelligence analysis

India

The economy is expected to grow 7% in 2022–23 and moderate the following year. Inflation continues to decline and industrial activity accelerates.

The Indian economy expanded at an annual rate of 6.3% in the July–September quarter, following the post-lockdown rate of 13.5% in the previous quarter. India measures growth in its fiscal year, from March to April. In fiscal 2021–22, GDP expanded 8.7%. The National Statistics Office expects the growth rate for fiscal 2022–23 will be 7%. An official government economic survey suggests that growth will slow somewhat in fiscal 2023–24, to within a band of 6.0% to 6.8%.

The economy is therefore growing at a robust rate, despite difficult external conditions. The economy was stung by high energy and food costs earlier in the year. Inflation reached a nine-year high in April (7.8%). At that time, the Reserve Bank of India (RBI) raised the key repo interest rate from 4%. The RBI continued to raise the rate, which reached 6.25% in December; a small raise is expected for February, to 6.5%. The RBI's inflationary band is set at 2–6%, and inflation dipped below 6% in November (5.9%). In December inflation fell again, to 5.7%.

Passenger vehicle sales increased 7.2% year-over-year in December, with sales of more than 235,000 units. This is the eighth consecutive month in which 2022 car sales exceeded 2021 levels, making 2022 a record year.

While the RBI's bi-monthly consumer confidence index (current conditions) remains below the 100 mark, the metric has been improving since July. In November the reading was 83.5 (80.6 in September).

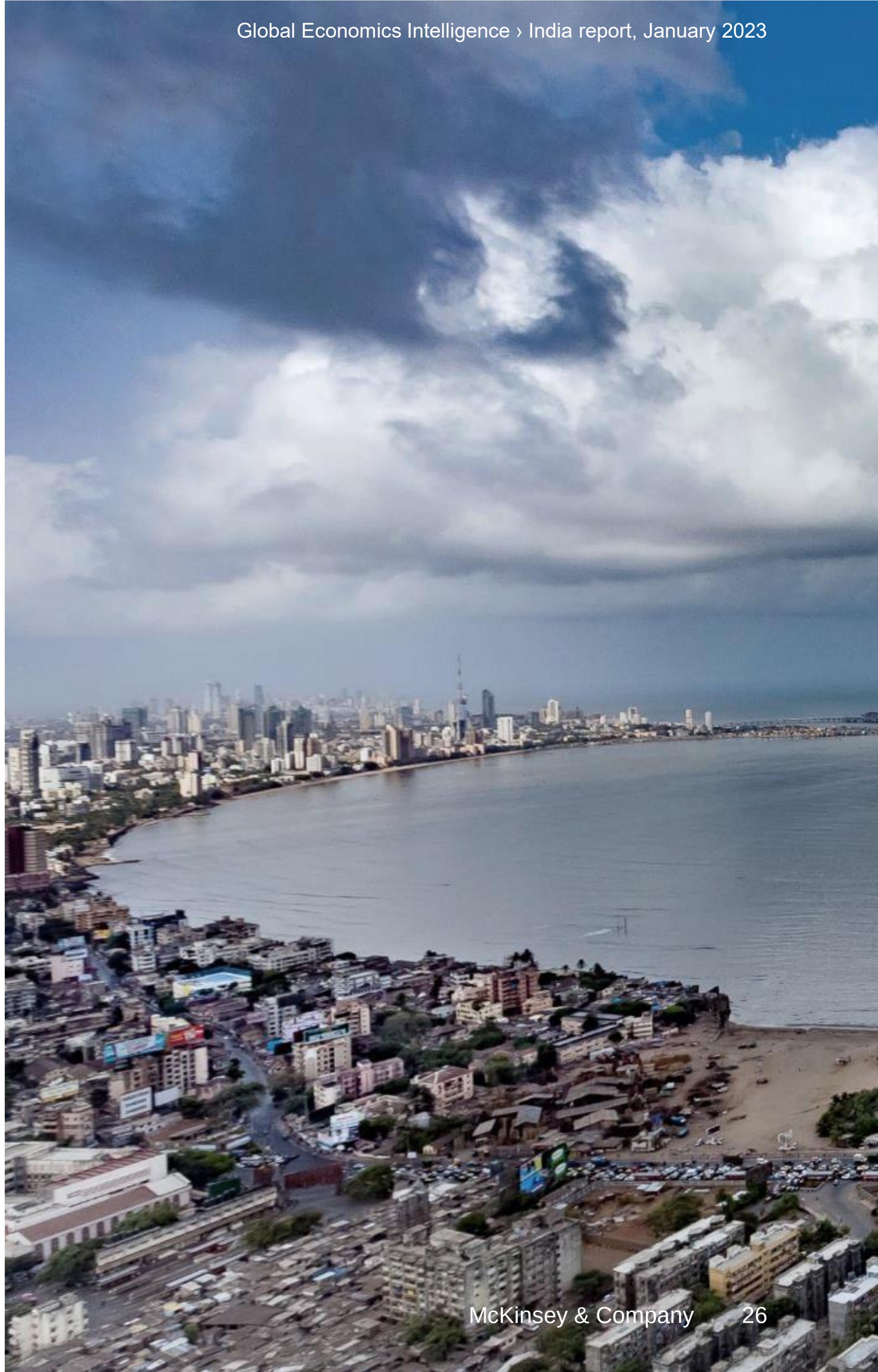
Trade continues to underperform on weaker global demand. In December exports totaled $34.5 billion ($32 billion in November), a decline of 12.2% on an annual basis. Imports totaled $58.2 billion ($55.9 billion in November), a year-over-year decline of 3.5%. The balance of trade was –$23.8 billion.

Manufacturing ended the calendar year with strong growth. The industrial production index recorded 7.1% year-over-year growth in November, with 6.1% manufacturing expansion. Mining output rose by 9.7% and power generation by 12.5%. The purchasing managers' index (PMI) for manufacturing rose to 57.8 in December (55.7 in November), the 18th straight month of expansion and the fastest in over two years. Output, new orders, and buying levels were the highest in many months; manufacturing employment gained for the tenth straight month. The services PMI also climbed, reaching 58.5 (56.4 in November).

The BSE Sensex equities market reached an historic high around December 1 but has since given up around 6% in value. The rupee depreciated against the dollar during calendar 2022 but stabilized since early December, trading at 81.6 at the end of January 2023. The unemployment rate slightly increased in December, to 8.3% (8% in November).

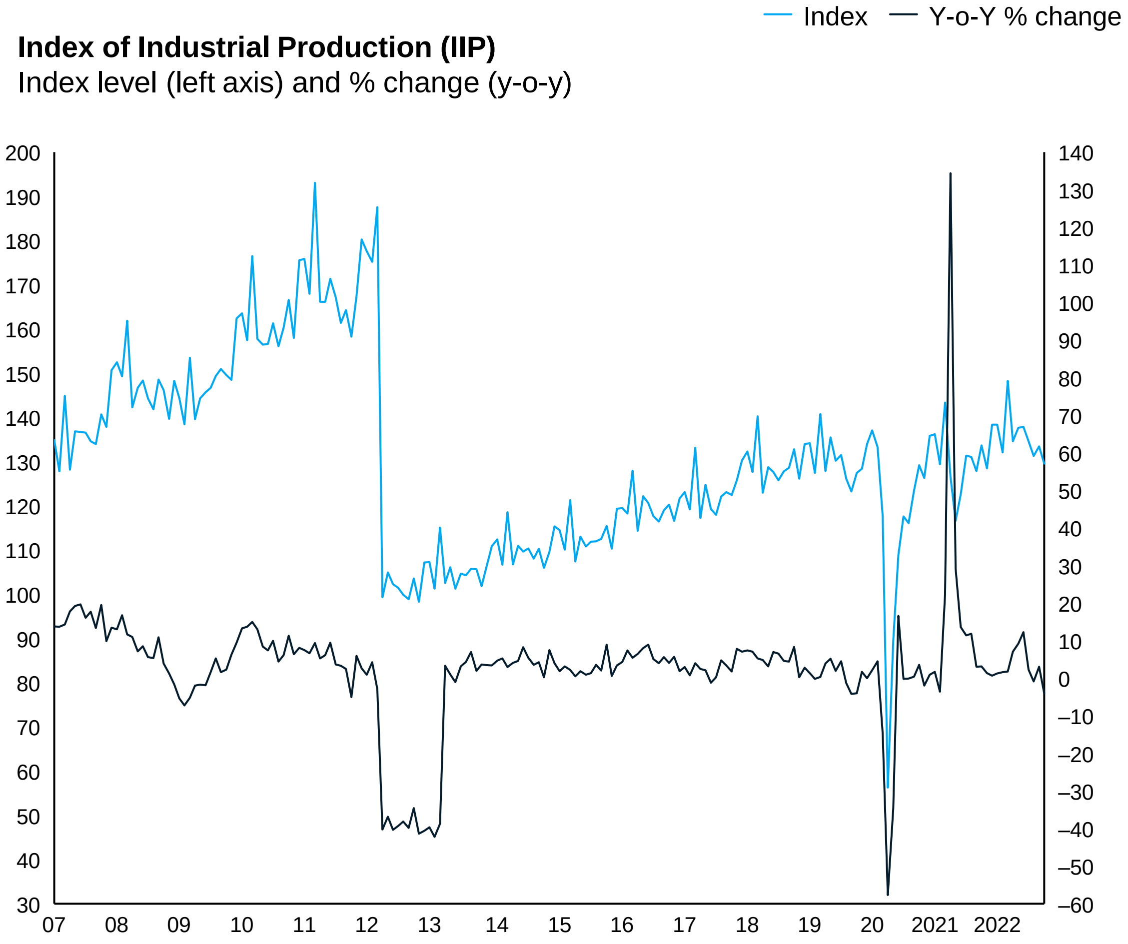
Hindenburg, a US-based financial research firm issued a report in January on Adani Group, India's largest conglomerate, accusing the company of stock manipulation and accounting fraud. The report triggered a sell-off of investments in Adani companies, resulting in a market capitalization loss of $65 billion. Group CEO Gautam Adani, Asia's richest man, has denied the allegations, which include concerns about government collusion.

Source: Havers; IHS Markit; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation (MOSPI); Reserve Bank of India

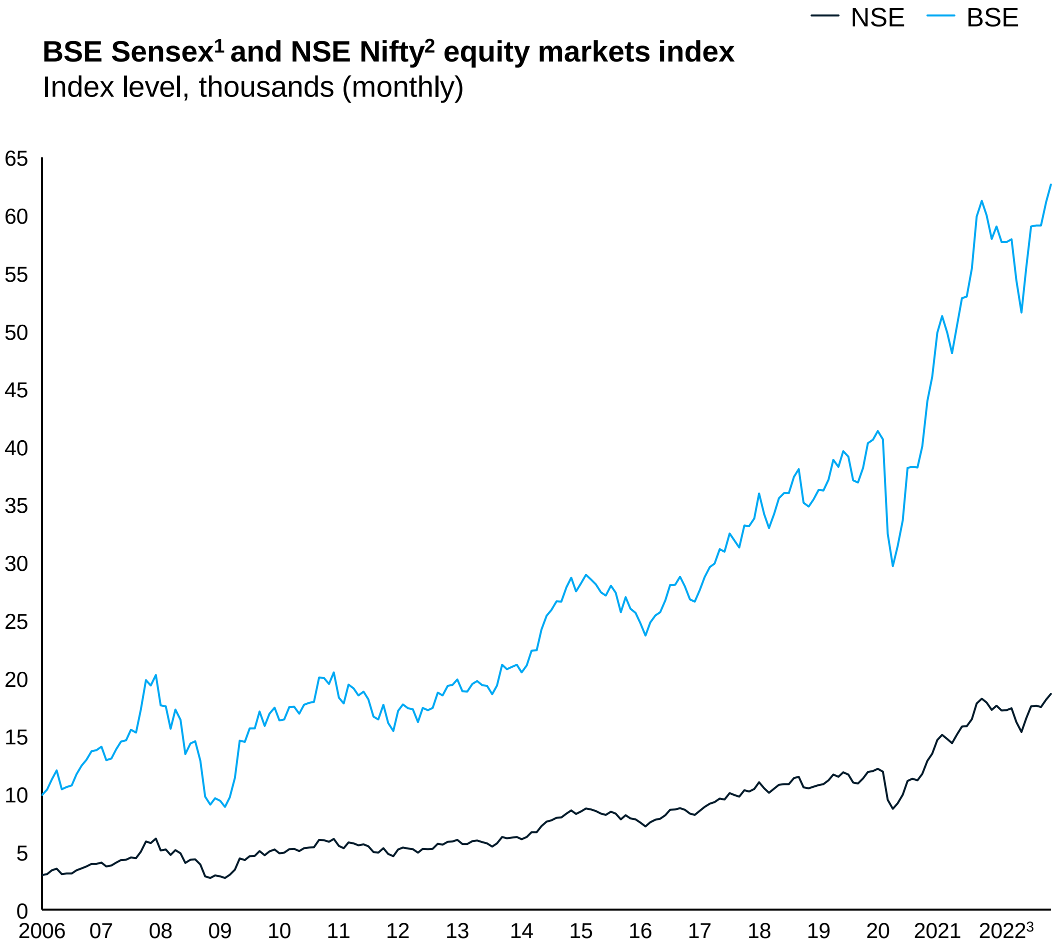


India's industrial production increased 7% y-o-y in November; the NSE and BSE stock exchanges ended a two-month bullish streak, dropping around 3% in value during December

Index of Industrial Production (IIP)
Index level (left axis) and % change (y-o-y)



BSE Sensex[1] and NSE Nifty[2] equity markets index
Index level, thousands (monthly)



1 BSE: The Bombay Stock Exchange (Sensex) is a value-weighted index comprising the 30 largest and most actively traded stocks.
2 NSE: The National Stock Exchange of India (Nifty) consists of 50 major stocks weighted by market capitalization.
3 Updated to December 14, 2022.

SOURCE: *Economics Times*; Ministry of Statistics and Programme Implementation (MOSPI); McKinsey's Global Economics Intelligence analysis

In December, inflation eased again in India and industrial activity expanded fast; trade momentum continues to soften on weaker external demand

Significant improvement | Improving | No significant change | Worsening | Severe decline

	Indicator category	Change vs prior month	Change vs pre-COVID levels
Macroeconomic	Consumer	No significant change	Improving
	Business, industry	Improving	Improving
	Real estate	No significant change	No significant change
	External sector, trade	Worsening	Improving
	Prices	Improving	Worsening
	Employment	Worsening	No significant change
Financial markets	Foreign exchange	No significant change	No significant change
	Equity	Worsening	Improving
	Debt	No significant change	No significant change
	Credit	Improving	Improving
Government and policy	Public policy	No significant change	No significant change
	Public-sector health	No significant change	No significant change

Industrial production expanded in November 2022; consumer and producer price inflation eased in December and manufacturing and services expanded fast; in the latest data, trade momentum continued to weaken

- Passenger vehicle sales increased 7.2% year-over-year in December, with sales of more than 235,000 units. This is the eighth consecutive month in which 2022 car sales exceeded 2021 levels, making calendar 2022 a record year.
- The industrial production index recorded 7.1% year-over-year growth in November, with 6.1% manufacturing expansion. Mining output rose by 9.7% and power generation by 12.5%.
- The purchasing managers' index (PMI) for manufacturing rose to 57.8 in December (55.7 in November), the 18th straight month of expansion and the fastest in over two years. Output, new orders, and buying levels were the highest in many months; manufacturing employment gained for the tenth straight month. The services PMI also climbed, reaching 58.5 (56.4 in November).
- Trade continues to underperform on weaker global demand. In December exports totaled $34.5 billion ($32 billion in November), a decline of 12.2% on an annual basis. Imports totaled $58.2 billion ($55.9 billion in November), a year-over-year decline of 3.5%. The balance of trade was –$23.8 billion.
- Consumer inflation fell again in December, to 5.7%, the lowest mark this year (5.9% in November), as food-price inflation slowed. Wholesale price inflation continues to fall fast, easing to 5% in December from 5.9% in November.
- The unemployment rate increased to 8.3% in December (8% in November).

A bullish streak in equities ended in December; the rupee weakened against the dollar and euro

- The BSE Sensex equities market reached an historic high around December 1 but has since given up around 6% in value.
- The Reserve Bank of India (RBI) reported reserves of $573.7 billion on January 20 ($572 billion on January 13).
- After depreciating to an all-time low against the dollar in December (83), the rupee stabilized at 81.6 at the end of January.

The repo rate increased by 35 basis points; foreign-exchange reserves increased; new COVID-19 cases remain low

- The Reserve Bank of India raised its key interest rate, the repo rate, to 6.25% at its December meeting and is expected to make a small hike in February, of 25 basis points (to 6.5%). Since the RBI began raising the repo rate in April, inflation has fallen steadily and is now within a band of 2% and 6% set by the RBI.
- COVID-19 cases remain stable and low in India; the vaccination rate is 69% (full dose according to Our World in Data, December 22).

SOURCE: McKinsey's Global Economics Intelligence analysis

Brazil

The central bank restates its commitment to keep interest rates high amid economic slowdown; inflation falls to 5.8%; government successfully repels attack by Bolsonaro supporters, jails many attackers.

The latest GDP growth data date from the third quarter, when the pace dropped to 0.4% (1% in Q2). Economists ascribe the slowing growth in the second half of 2022 to unfavorable external conditions and the cumulative effects of high interest rates. Beginning in early 2021, as inflation rose above 5%, the central bank began swiftly to raise the policy interest rate (Selic rate), which was 2%. Inflation peaked in April, at 12.1% and the last interest-rate hike, to 13.75% was made in August. Since then, inflation slowed to 5.8% (December). In a recent report, the central bank relayed its intention to keep the policy rate at its current height, until inflation converges on target rates of 3.25% in 2023 and 3% in 2024. The central bank estimates GDP growth will be 2.9% in 2022 but slow to 1% in 2023.

In a further communication the bank stated it would “pay particular attention to future developments in fiscal policy and, in particular, their effects on asset prices and inflation expectations, with potential impacts on the dynamics of prospective inflation.” This was a reference to the pledges of the new president, Luiz Inacio Lula da Silva, to resume the social spending and poverty-reduction policies that characterized his earlier presidential terms.

Brazil’s industrial production index has shown growth in each of the last four reported months (to November 2022). For the full year, production is less than it was in 2021. The purchasing managers’ index (PMI) for manufacturing remained well in contraction territory for a second straight month, at 44.2 in December (44.3 in November). Subdued demand for exports has been behind the year-end slowdown. The services PMI shows soft expansion at 51 (51.6 in November).

The consumer confidence index (FGV) fell in January to 85.8 (88 in December). In negative territory since 2014, it was especially gloomy after the pandemic’s onset. In late 2022, however, readings began to improve, remaining above 80 since August. Retail sales picked up during that time as well. In November 2022 sales improved 1.5% on an annual basis (2.7% in October).

Trade retreated in December, with exports totaling $26.6 billion ($28.1 billion in November) and imports totaling $21.8 billion ($23.6 billion in November).

In the most recent measure, the unemployment rate fell for the ninth consecutive month, to 8.1% in November (8.3% in October).

The Bovespa equities index has been on a (somewhat bumpy) recovery path since mid-December, gaining 8% in value to January 27. The index stands at around 14% below its historic high, reached in June 2021. The real has slightly strengthened since the beginning of the year, and is trading at 5.1 per dollar (January 27).

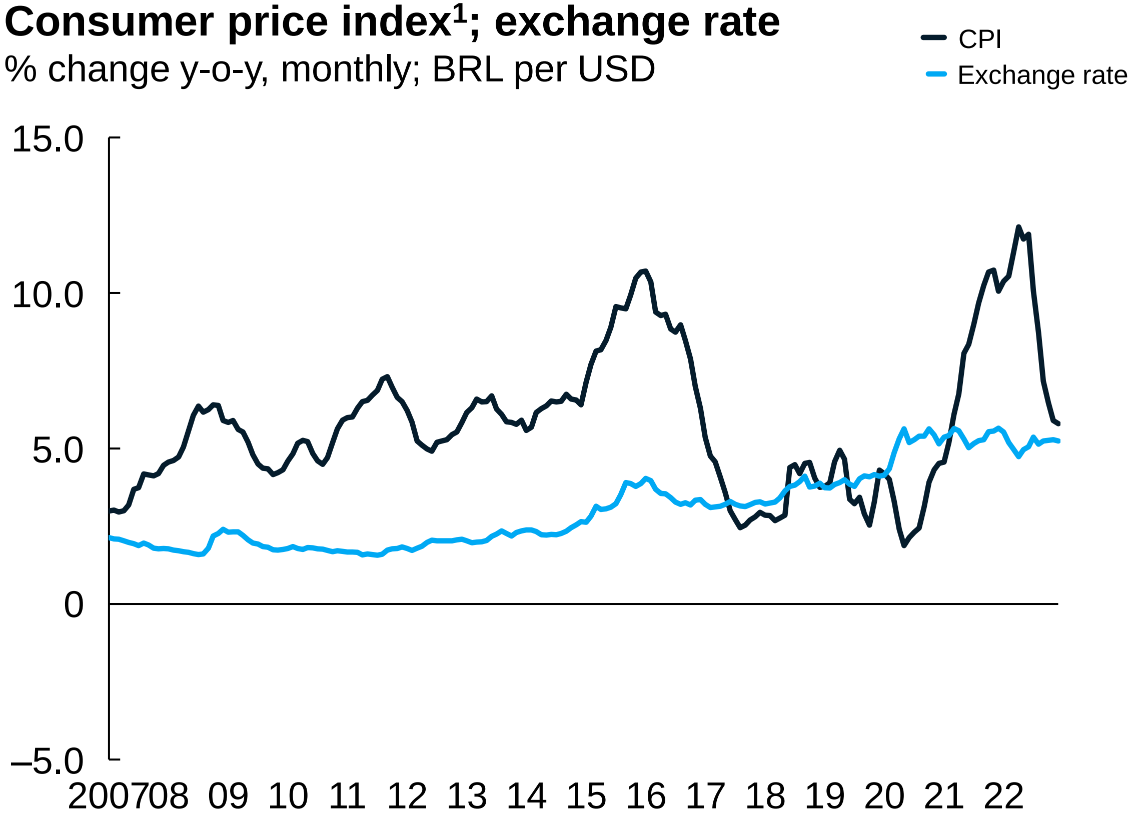
President Lula da Silva stepped up security measures around government buildings, including the national congress, the supreme court, and presidential offices. These were attacked by Bolsonaro supporters on January 8 to protest the outcome of the election. More than 1,150 participants were arrested. The attackers planned further protests and called upon the military to overturn the election, in keeping with Bolsonaro’s own public pronouncements. However, further attacks on the government have not materialized.

Source: Haver Analytics; Instituto Brasilièro de Geografia e Estatística (IBGE)

Inflation continued to ease in Brazil; the real and the Bovespa equity index strengthened in the new year

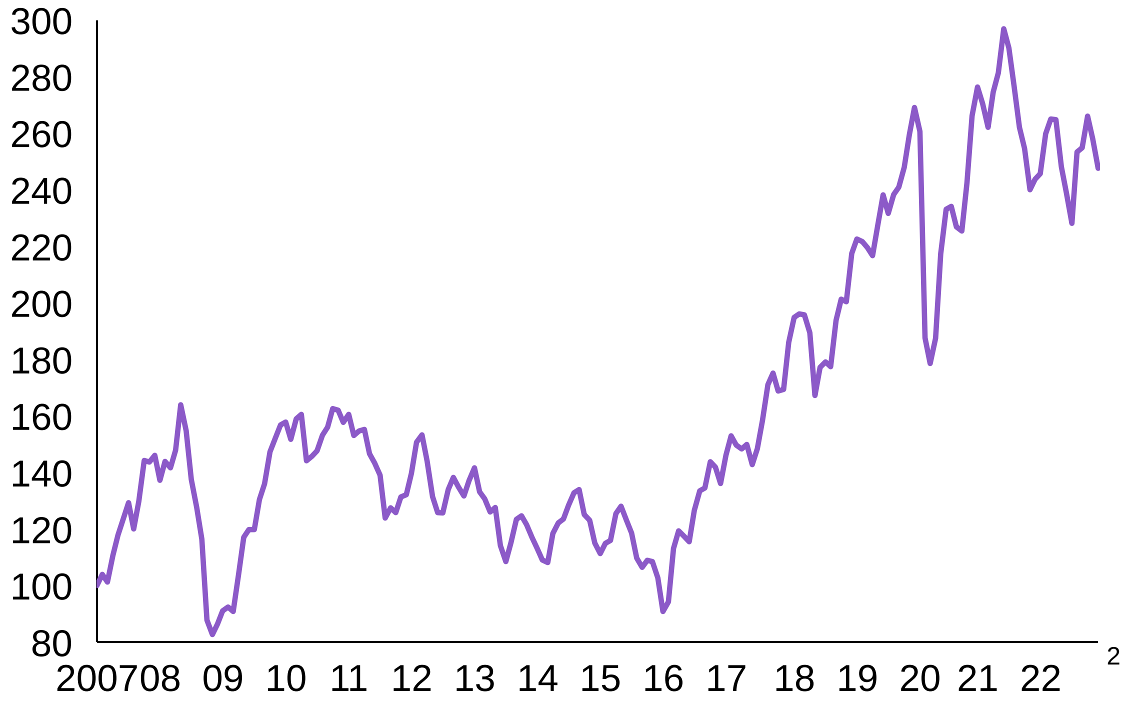
Consumer price index[1]; exchange rate

% change y-o-y, monthly; BRL per USD



Bovespa index

Indexed to January 2007 = 100



[1] National Consumer Price Index (extended IPCA), 1993 = 100, not seasonally adjusted; % change in CPI in local currency (period average) over previous year. The central bank's target inflation rate for 2022 is 3.5% with a margin of error of 1.5 percentage points.
[2] Data through November 30, 2022.

Source: Haver Analytics; Instituto Brasilièro de Geografia e Estatística (IBGE); McKinsey's Global Economics Intelligence analysis

Brazil’s financial markets improve in the new year; the most recent data show declining manufacturing activity and trade

Significant improvement | Improving | No significant change | Worsening | Severe decline

	Indicator category	Change vs prior month	Change vs pre-COVID levels[1]
Macroeconomic	Consumer	Worsening	No significant change
	Business, industry	Worsening	Improving
	Real estate	No significant change	No significant change
	Trade, external	Worsening	Improving
	Prices	Improving	Severe decline
	Employment	Improving	Improving
Financial markets	Foreign exchange	Improving	Worsening
	Equity	Improving	Worsening
	Debt	No significant change	No significant change
	Credit	No significant change	No significant change
Government and policy	Public policy	No significant change	Severe decline
	Public-sector health	No significant change	Severe decline

Consumer confidence dips in new year; retail sales remain positive while inflation and the unemployment rate continue to decline

- The consumer confidence index (FGV) fell in January to 85.8 (88 in December). In negative territory since 2014, it was especially gloomy after the pandemic’s onset. In late 2022, however, readings began to improve, remaining above 80 since August.
- Retail sales picked up during that time as well. In November 2022 sales improved 1.5% on an annual basis (2.7% in October).
- Industrial business confidence increased to 93.3 in December (92.1 in November) The industrial production index has shown growth in each of the last four reported months (to November 2022).

The purchasing managers’ index (PMI) for manufacturing remained well in contraction territory for a second straight month, at 44.2 in December (44.3 in November). Subdued demand for exports has been behind the year-end slowdown. The services PMI shows soft expansion at 51 (51.6 in November).

Trade retreated in December, with exports totaling $26.6 billion ($28.1 billion in November) and imports totaling $21.8 billion ($23.6 billion in November).

In a ninth consecutive monthly decline, inflation decreased to 5.8% in December (5.9% in November). Prices dropped for transport, food, and housing.

The unemployment rate dropped to 8.1% in November (8.3% in October).

The Bovespa equities index, real improve

- The Bovespa equities index has been on a (somewhat bumpy) recovery path since mid-December, gaining 8% in value to January 27. The index stands at around 14% below its historic high, reached in June 2021.
- The real has slightly strengthened since the beginning of the year, and is trading at 5.1 per dollar (January 27).

The government successfully repels attacks by Bolsonaro supporters; Brazil, Argentina propose common currency

- The January 8 attacks on government buildings by Bolsonaro supporters were successfully repelled and hundreds of attackers were jailed. Calls by the attackers for further actions have not materialized.
- To further economic integration, the governments of Brazil and Argentina announced discussions on a common South American currency; the intention is to use it for both financial and commercial flows in order to reduce costs and external vulnerability.

[1] January 2020 is used as reference for pre-COVID-19.

Source: Banco Central do Brasil; Fundação Getulio Vargas; Haver Analytics; Instituto Brasilièro de Geografia e Estatística (IBGE)

Brazil year in review: looking back on 2022. . .

2022 at a glance

The growth pace of 2021 and early 2022 slowed; GDP growth in 2022 is expected to be 2.9% and 1% in 2023; inflation eased to 5.8% in December but interest rates are very high

Brazil's economy experienced partial recovery in 2021, with GDP expanding 4.6% after the pandemic contraction of –3.9% in 2020. The pace of growth was sustained in the first quarter of 2022 (1.2%), before slowing in Q2 (1%) and Q3 (0.4%). The central bank estimates the GDP pace for the full year of 2022 at 2.9%. The central bank suggests that slowing global conditions will result in Brazil growing only 1% in 2023.

High commodity prices buoyed Brazil's exports in 2022, which attained record-high growth, especially in the first half of the year. A slowing global economy and weaker demand, as well as high interest rates, constrained production in the second half.

Beginning in early 2021, as inflation rose above 5%, the central bank began swiftly to raise the policy interest rate (Selic rate), which was 2%. Inflation peaked in April, at 12.1% and the last interest-rate hike, to 13.75% was made in August. Since then, inflation slowed to 5.8% (December).

The unemployment rate climbed above 14% during 2020 and 2021; it began 2022 at 11.2% but has declined in each month since March, reaching 8.1% in December.

At the end of the year, the real gained ground but the equities market deteriorated

The Bovespa index improved in early 2022 but deteriorated in the second half of the year; investor concerns were raised around a tense election. The market has improved in the new year.

The real appreciated in 2022, from 5.5 to 5.3 at year-end; it has since strengthened further.

Lula da Silva was elected as the new president

Lula da Silva narrowly defeated Jair Bolsonaro in the presidential runoff election on October 30. Lula pledged to resume the poverty-eradication programs that characterized his previous tenure in office while restoring protections for Amazonia and indigenous Brazilians. Since taking office he has emphasized the need for government policies to tackle the cost-of-living crisis.

On January 8, the Lula-led government successfully repelled an attack on government buildings by Bolsonaro supporters protesting the outcome of the election. More than 1,150 participants were arrested. The attackers planned further protests and called upon the military to overturn the election. However, further attacks on the government have not materialized.

Source: Banco Central do Brasil; World Bank; World Economic Forum

… and forward to 2023

Perspectives on 2023

For 2023, the forecast for economic growth remained at 1.0%, influenced by the expected global slowdown and the cumulative impacts of domestic monetary policy. The uncertainty surrounding the forecasts is higher than usual due to external (monetary policy, Ukraine, and China) and domestic factors (fiscal framework and stimulus in 2023).

– Brazil's Central Bank

Fiscal policy has a particularly pertinent role at this juncture for Brazil as the country looks to pursuing a social, economic, and environmental recovery through more investment and improved service delivery. Sound public finances will be a cornerstone of the Brazilian government's agenda, both for its ability to respond to shocks and its importance in shaping future development outcomes. For Brazil's incoming government, financing a robust social assistance package is a priority. The decline in infrastructure spending is also of particular concern.

– World Bank

Fernando Haddad (Finance Minister) acknowledged that the new government is grappling with a challenging financial outlook due to high levels of social spending, among other factors. The minister reinforced his previous pledge that Brazil will end 2023 with a primary budget deficit of 1% of the gross domestic product. Haddad added that the private sector has a role to play in fostering sustainable and inclusive development. The corporate sector still needs to take tangible action for the environment, gender equality, inclusion, sustainability, energy transition, and human rights.

– World Economic Forum

Russia

GDP is estimated to have contracted between −3.4% and –4.5% in 2022; domestic consumption has been resilient though months of double-digit inflation have eroded household income.

According to official Russian statistics, GDP contracted –4.1% in the second quarter and –3.7% in the third quarter, after expanding 3.5% in the first quarter of 2022. As of the end of 2022, external forecasting institutions estimate a full-year contraction ranging from –3.4% (IMF) to –4.5% (World Bank). For 2023, the estimates range from a GDP contraction of –2.3% (IMF) to –5.6% (OECD).

On an annual basis, the industrial production index has been in negative territory since April; on a monthly basis, however, the index has improved in each month since June, with the latest reading at 1.6% in November (5.3% in October).

Economic performance by sector is varied, with industries dependent on external suppliers highly constrained. The production of passenger cars was down –79% in November (year-over-year), for example. The output of energy products varied. The Economy Ministry reportedly expects natural gas output to have retreated 12% for the year overall, with exports down by 25%. Petroleum output remained comparable with prewar levels through the year, according to external sources (S&P Global). Fixed investments were surprisingly resilient, growing by 4% year-over-year in Q2 and slowing to 3% in Q3, with, however, a more increased role for state-owned enterprises and the government itself.

Domestic consumption has also been resilient, partly as a result of depressed imports. The purchasing managers' index (PMI) for manufacturing remained high at 53 in December (53.2 in November). These are the highest readings in six years. The services PMI, however, fell deeper into contraction, at 45.9 in December (48.3 in November). Real disposable household income, furthermore, remains under stress of double-digit inflation. Despite the inflation, retail sales remain below levels of one year ago by between 8% and 10%. The last unemployment rate reported was 3.7% in November.

Consumer inflation was 11.3% in December (12% in November), the lowest level since the invasion of Ukraine, but still far above the central bank target of 4%. The central bank left its key interest rate at 7.5%, estimating that inflation will slow to between 5% and 7% in 2023 before reaching the target in 2024.

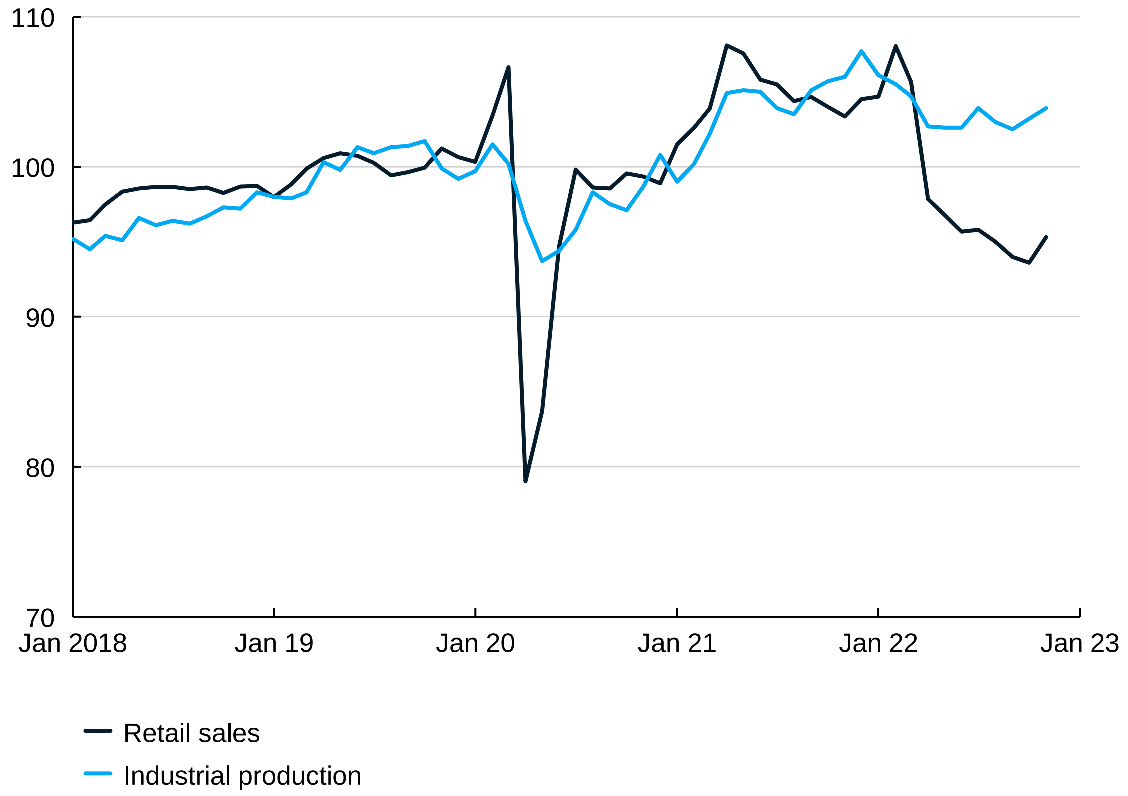
Along with economic contraction, nominal budget revenues have declined. Fiscal spending has also accelerated with steady fixed investment growth and military expenditures. The central bank reports that in 2022 the budget will incur a deficit of –2.3% after the small surplus in 2021 (0.4%). The ruble is lately trading at 69.5 per US dollar.

Note on the Russia section: The Russian government has restricted data releases on the performance of the economy. The details in this report are based on the latest available information from external sources (including S&P Global and BOFIT, the Bank of Finland Institute for Emerging Economies), as well as from Rosstat (the Russian state statistical agency) and the Central Bank of Russia.

Source: BOFIT; Oxford Economics; S&P Global

Industrial production lately improved while retail sales remain 8–10% below 2021 levels; current account has lately fallen sharply

Industrial production and retail trade
Index, 2019=100



Current account
Billion USD

Source: Central Bank of the Russian Federation; Federal Statistics Service; Haver Analytics

Russia year in review: looking back on 2022. . .

2022 at a glance

Invasion of Ukraine causes severe humanitarian and economic crisis while raising geopolitical tensions

- On February 24 Russia invaded Ukraine and fighting is ongoing. The invasion adversely affected relations with Western countries, which have come to Ukraine’s aid and attempted to isolate the Russian economy, affecting its production capacities.

GDP contracts in 2022 and is expected to contract further in 2023

- According to official Russian statistics, GDP contracted –4.1% in the second quarter and –3.7% in the third quarter after expanding 3.5% in the first quarter of 2022. As of the end of 2022, external forecasting institutions estimate a full-year contraction ranging from –3.4% (IMF) to –4.5% (World Bank). For 2023, the estimates range from a GDP contraction of –2.3% (IMF) to –5.6% (OECD).
- Consumer demand and sentiment started on a positive note but declined sharply in April, reflecting weak real incomes and uncertainty related to war.
- The slowdown in industrial production was less prominent. Positive fixed investments and government activity supported selected sectors.
- Net exports contributed positively while imports declined.

Financial markets remain in hibernation; the central bank balances policy decisions between high inflation and economic recession

- Inflation remained in double-digits through the year but has lately been slowing.
- The central bank hiked key interest rates and introduced capital controls; monetary policy has since been eased to support the economy.
- Volumes traded on equity markets have been slight since March 2022.

Source: BOFIT; IHS Markit; Oxford Economics

… and forward to 2023

Perspectives on 2023

Russia’s GDP in 2023 may shrink by further 1.9%. Private consumption will remain the key drag on growth, expected to remain below pre-war levels, driven by heightened propensity to save boosted by uncertainty. Relatively resilient in 2022 fixed investment picture is going to change as sanctions will curtail earnings in the hydrocarbon sector, leaving less room for investing in the sector. With external markets remaining off for Russian borrowers, any fixed asset purchases will have to be financed by domestic borrowing.

Government consumption will be the main engine of growth, on the back of much higher military spending. As import volumes recover only gradually, net exports will also continue contributing to growth, although to lower extent than before.

– Oxford Economics

Real GDP will likely shrink by 3.1% in 2022 and 4.1% in 2023. Private consumption will be a key drag on near-term growth, led by job losses, disruptions of supply chain, online trade, and travel. Real disposable incomes will likely dive, owing to double-digit year-on-year inflation. Fixed investment activity will suffer from the combined effect of capital flight and the exit of major firms. Heavy sanctions will likely undercut exports. However, falling domestic demand is likely to continue trimming imports, offsetting the drag from contracting exports.

Consumer price inflation should average 6.2% in 2023. Inflationary risks will remain high owing to supply-side shortages resulting from trade and business sanctions and boycott by hundreds of international businesses.

– IHS Markit