Truist Advisory Services, Inc.

Global Perspective from the Investment Advisory Group

IMF update – almost a trillion dollars too optimistic

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Executive summary

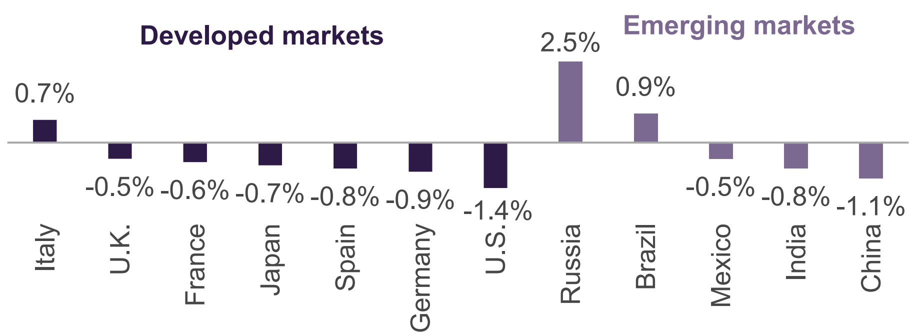
The International Monetary Fund (IMF) revised its 2022 global economic growth outlook downward from 3.6% to 3.2%, and the 2023 growth figure was downgraded to 2.9%. However, these revised estimates still expect global economic output to be over $100 trillion, above consensus estimates, including ours. We expect further downgrades to the IMF outlook during the rest of the year to the tune of another one percentage point, or $1 trillion less in nominal economic activity.

What happened

The IMF downgraded the 2022 and 2023 global economic outlook

After these downward revisions, the global economy is now expected to grow 3.2% in 2022 and 2.9% in 2023. The IMF downgraded the U.S. economy's outlook significantly by 1.4% percent since its April update. In contrast, Europe saw some benign downgrades as Italy's outlook improved with tourism-related sectors recovering post-pandemic. In contrast, China’s economic outlook was downgraded to 3.3% for 2022, noticeably below the Chinese government's official target of 5.5%. Russia's economic contraction is expected to be around 6%, revised up by 2.5%. Brazil also received an upgraded outlook, with external demand for agriculture and commodities improving noticeably.

Select outlook revisions vs. the previous IMF estimate (April 2022)



Data source: Truist IAG, IMF

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Our take

The recent downgrade is not enough to reflect the realities

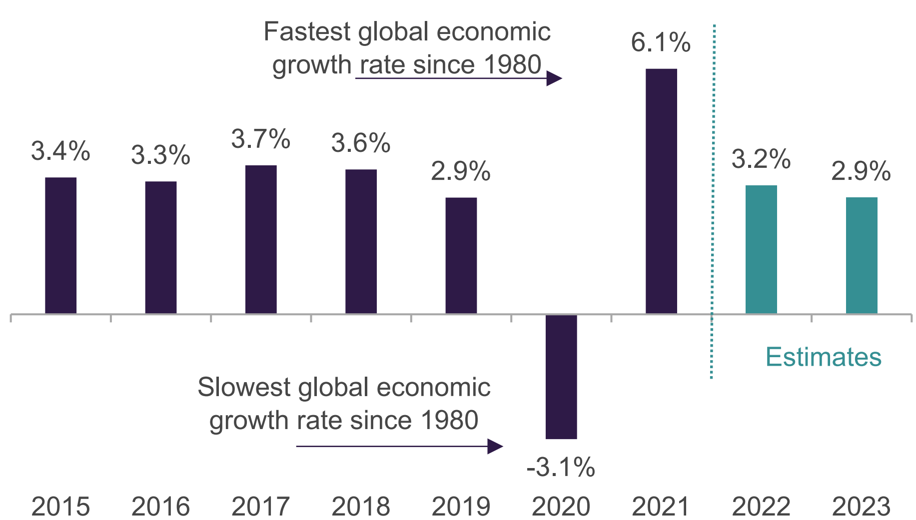
Before the Russian invasion of Ukraine in early 2022, the world economy was running on all cylinders and expected to grow by 4.4%. The bottlenecks in supply chains were slowly improving, pandemic-related social mobility restraints were being removed, and demand for goods and especially for services was robust. The invasion of Ukraine altered the course of the global economy. Investors faced a wider range of possible outcomes, such as Russia escalating aggression beyond Ukraine's borders, while full-scale sanctions on Russian energy put the world economy at risk of another recession.

Higher energy prices led to higher inflation, and higher inflation led to much tighter financial conditions than expected. China's zero-Covid policy led to full lockdowns of major cities for months, and restrictive social mobility measures curtailed consumer demand.

In our view, the IMF's growth downgrade is still too optimistic. We expect further downgrades when factoring in the faster-than-anticipated slowdown in the world's top two economies, the U.S. and China, and Europe facing a difficult winter with Russian energy supplies at risk.

Overall, the global economy will likely lose 2% of real economic growth from earlier estimates, achieving close to 2.4%. As the world economy is around $100 trillion, each percentage point loss of growth equates to a $1 trillion loss in economic output. With a 3.2% growth estimate, the IMF is almost a trillion dollars too optimistic for the world's 2022 economic output.

Global economic growth



Data source: Truist IAG, IMF

Inflation is a major obstacle for global economic activity

Ukraine, also known as the world's bread basket, lost significant infrastructure and the ability to export agricultural produce due to the war. Sanctions on Russia and Belarus are also hurting global food production, as they are the world's top two fertilizer producers. Sharp rises in food prices have already started to cause social unrest in countries like Sri Lanka, Peru, and Pakistan, with more to come later this year. Prices remain elevated as China's zero-Covid policy continues to strain global supply chains with semiconductors, materials, labor shortages, and transportation-related bottlenecks, while demand is still at robust levels.

Central bankers forced to combat inflation

Global inflation trends were already rising before the invasion of Ukraine. The inflation shock due to the war pushed central banks to react more forcefully. Global monetary authorities have a herculean task ahead to achieve a reversal in inflation expectations without creating a global economic recession. Other than the Bank of Japan, all G7 countries' central banks have raised rates, many at the fastest pace in recent history, and are expected to do more to tighten financial conditions, including reducing central bank balance sheets.

Europe, the epicenter of the global economic slowdown

The invasion of Ukraine altered the course of the global economy and has changed the geopolitical landscape for the next decade and possibly beyond. Russia, Ukraine, and Belarus are at the epicenter of the crisis, and countries closest to the epicenter will be disproportionately affected. A sudden stop of Russian gas to the European market could have spillover effects, possibly rationing energy to European manufacturing lines. The results are already visible with the European Union's recent agreement to cut gas consumption by 15%.

Challenging times require strong leadership, and, at the worst juncture, Europe lost two critical leaders. The U.K.'s Boris Johnson had to resign due to a myriad of scandals, and Italy's Mario Draghi had to leave with political support withdrawing. The lack of leadership in Europe creates a void, and in this void, autocratic leaders like Russia's Vladimir Putin could take advantage of the situation to achieve alternative agendas.

International risks are tilted to the downside

Even though the forecasted figures do not reflect the severity of the slowdown, the IMF rightfully notes that the risks to their global economic outlook are tilted to the downside. Debt distress in emerging markets like Sri Lanka, Pakistan, and Argentina are becoming more visible. Italian yield spreads in Europe have widened against German equivalent bonds, indicating more challenging times ahead. The property sector crisis in China and Covid-related mobility restrictions pushed China further away from its goal to achieve a 5.5% economic growth target this year. High inflation and correspondingly tighter financial conditions could cause severe disruptions in financial markets, especially in highly indebted countries.

Bottom line

At the beginning of the year, we were on the same page with the IMF's outlook for the world economy growing around 4.4%. However, a wider range of outcomes came into play after the Russian invasion of Ukraine. Inflation has reached levels not seen since the 1970s, forcing central banks to introduce much tighter financial conditions. The world's largest economy, the U.S., is not immune to the global slowdown but should weather the impact much better than Europe, which relies on Russian energy and industrial metals. The looming energy crisis in Europe could have repercussions on global growth and the inflation outlook. We continue to recommend U.S. assets relative to those overseas, especially the ones closest to the epicenter of the Russia-Ukraine conflict.

Disclosures

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