

Deloitte.

A Lay of the Economic Land

Dr Edoardo Palombo, Economist, Deloitte UK

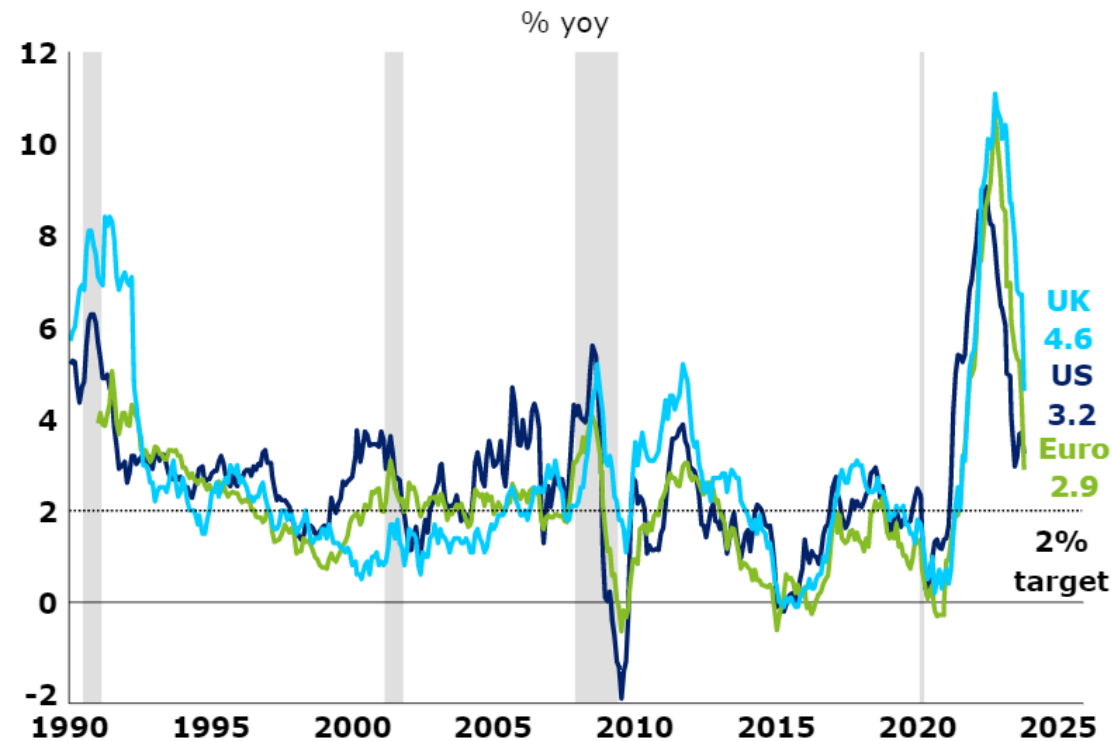
Global & UK outlooks

Global inflation and interest rates have been rising, but the worst is over

We have not seen this level of high inflation and high interest rates since the 1990s

Inflation in US, UK & euro area hit multi-decade highs ...

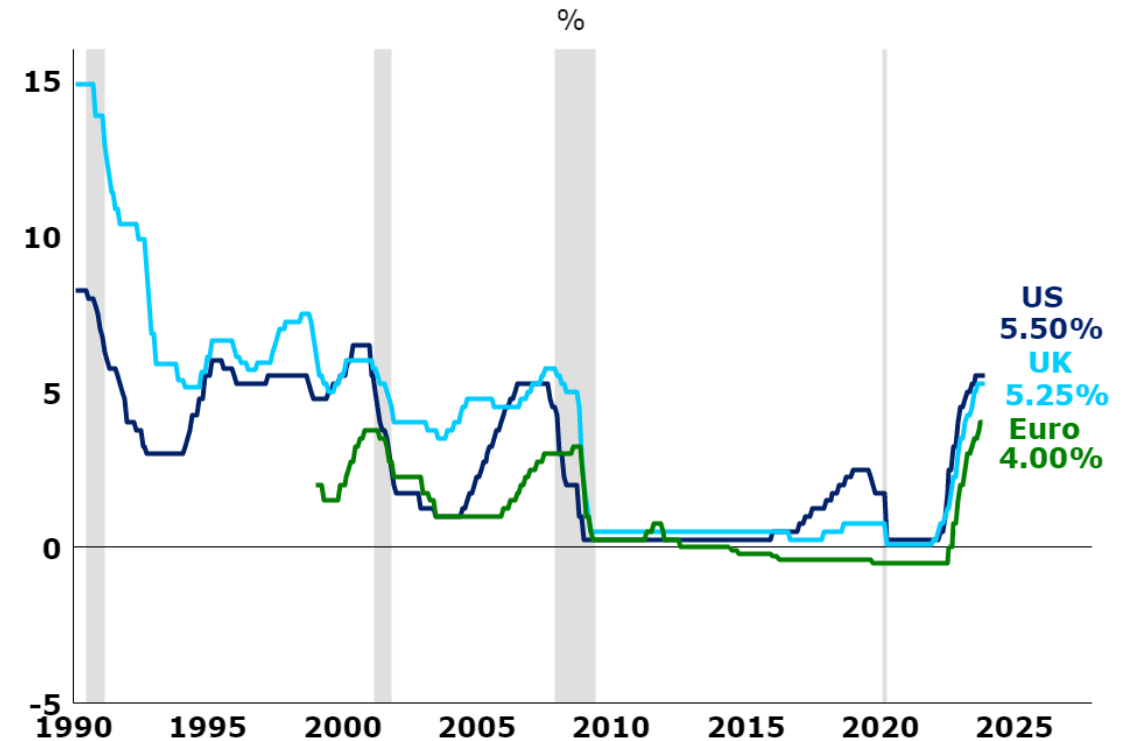
Consumer price inflation



Source: LSEG Datastream

... which forced central bankers' hand

Central Bank interest rates



Source: LSEG Datastream; upper limit of the Fed funds target range shown

Despite the positive news on inflation, growth in advanced economies is slowing down

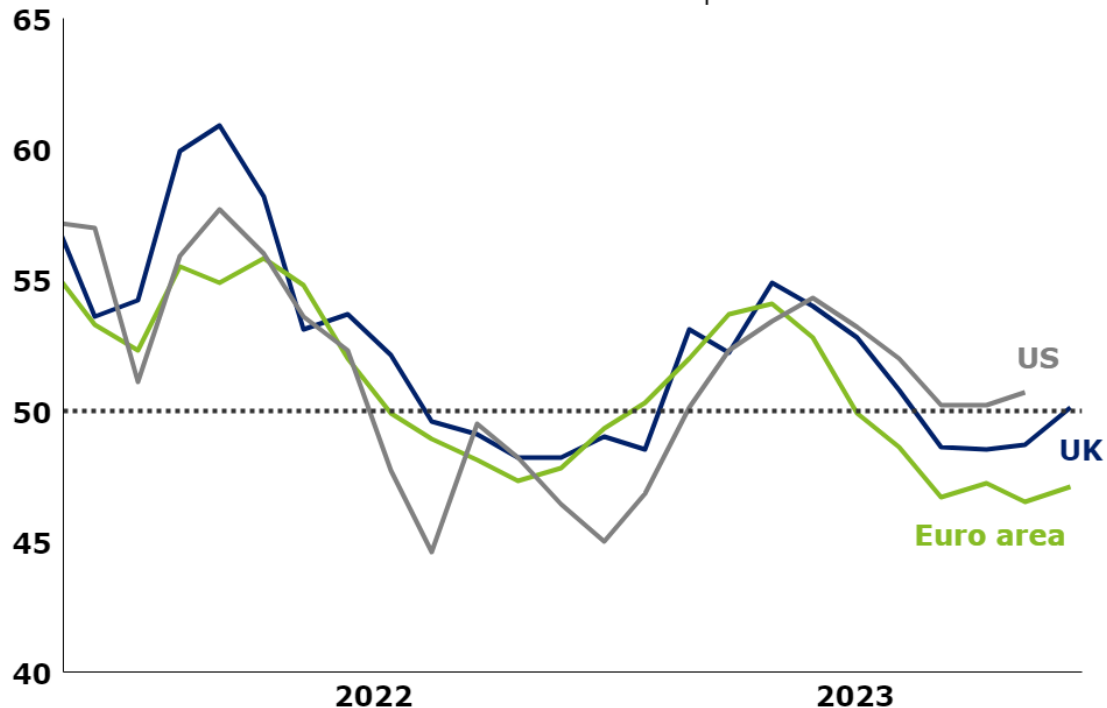
Higher prices and interest rates are starting to erode demand, especially in the UK and the Euro area

Growth in advanced economies slowed down this year ...

... but it has been supported by emerging economies

Composite purchasing manager indices

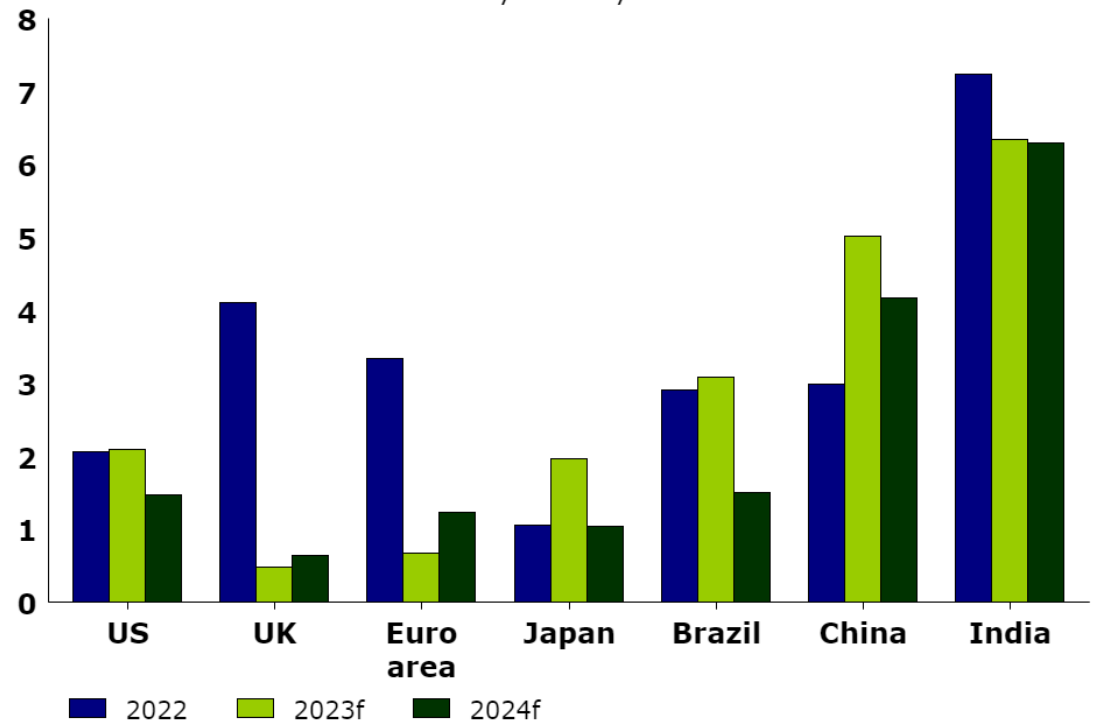
Values above 50 indicate expansion



Source: LSEG Datastream

IMF GDP forecasts

% year on year

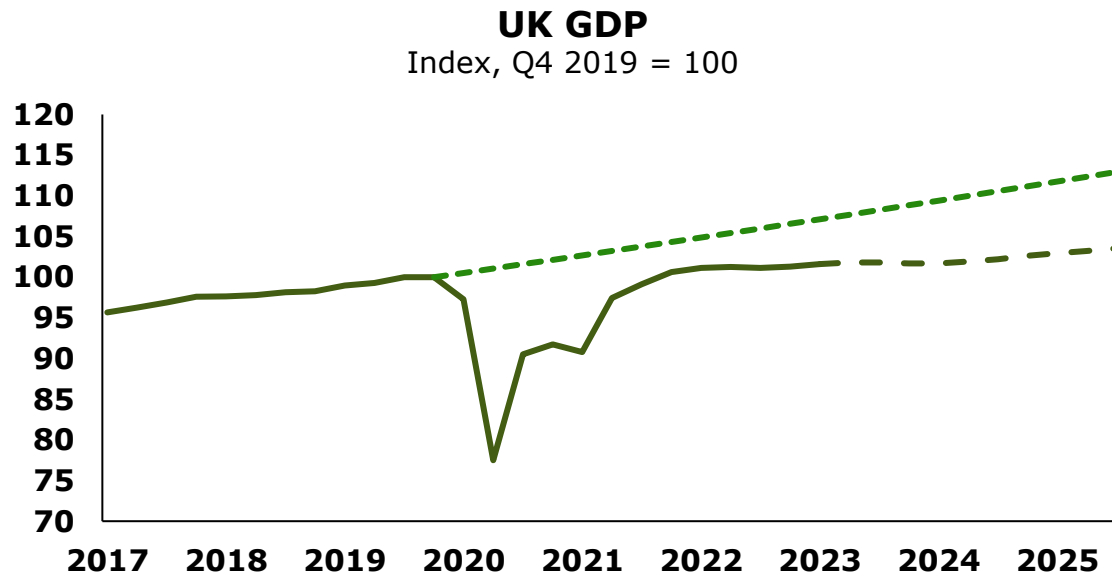


Source: LSEG Datastream

The UK to avoid a recession but growth to stagnate in early 2024 with a weak recovery

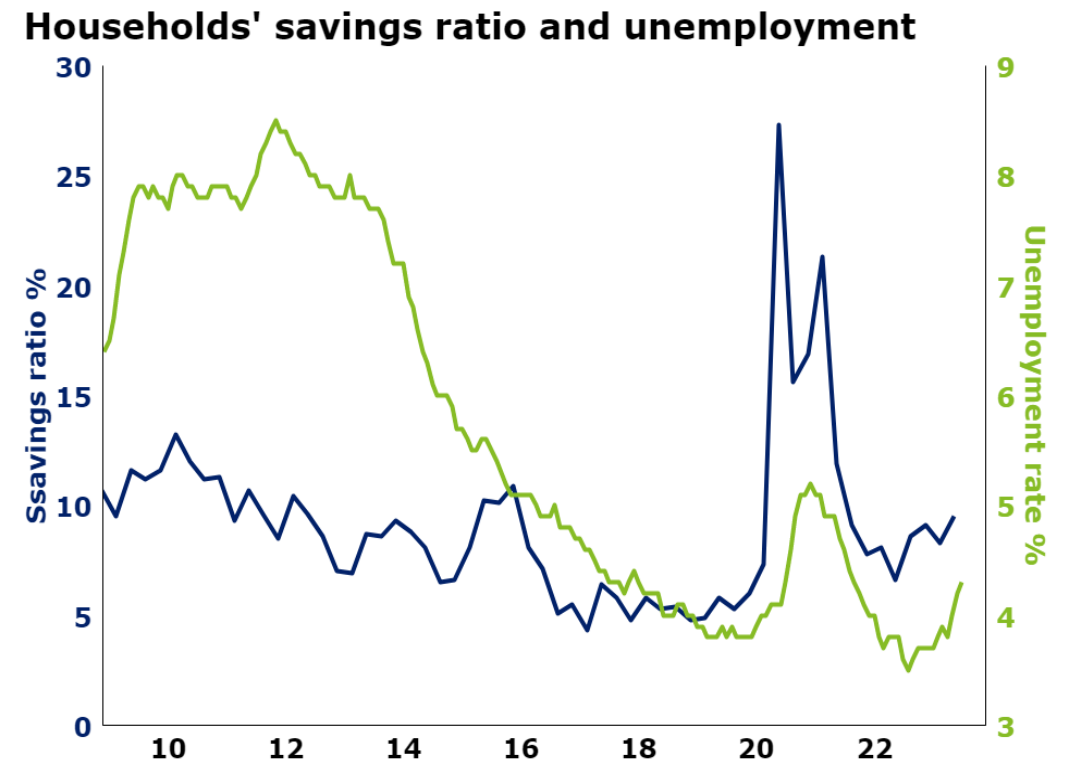
The economy has been more resilient than forecasts, and we expected the mildest recession in modern history

UK growth to flatline until mid-2024 in base case...



Year	2022	2023f	2024f
GDP ann. %	4.3	0.5	0.4

... thanks to a resilient labour market and forced savings



Source: LSEG Datastream

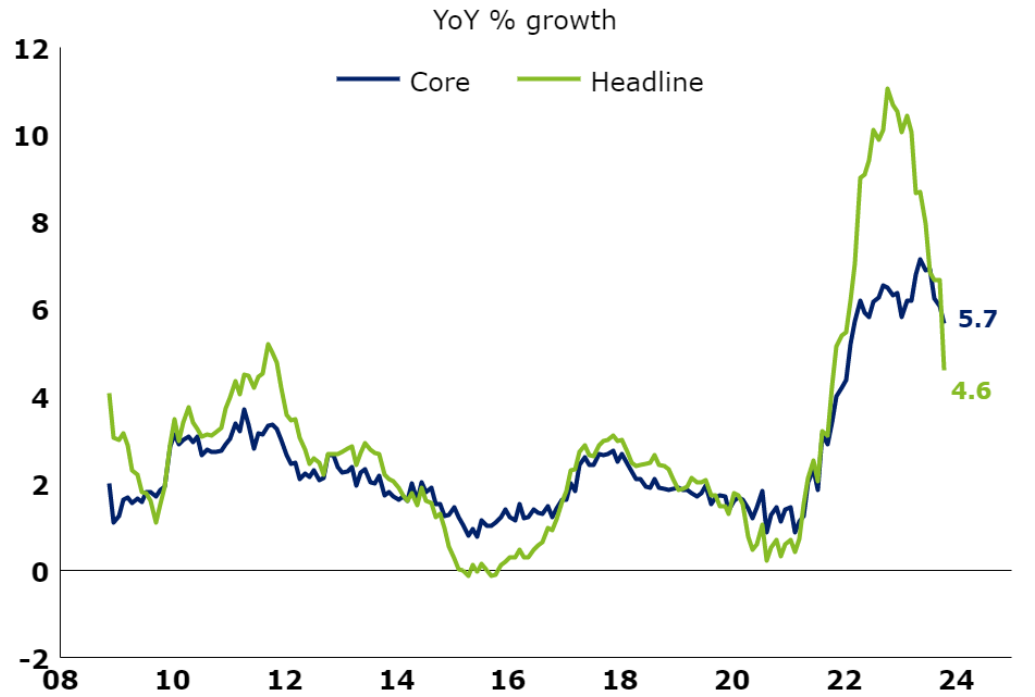
Inflation and interest rates have peaked faster than expected and interest rate

Pandemic and energy price shock have fed through to the economy causing inflation to fall

Inflation has been falling faster than expected ...

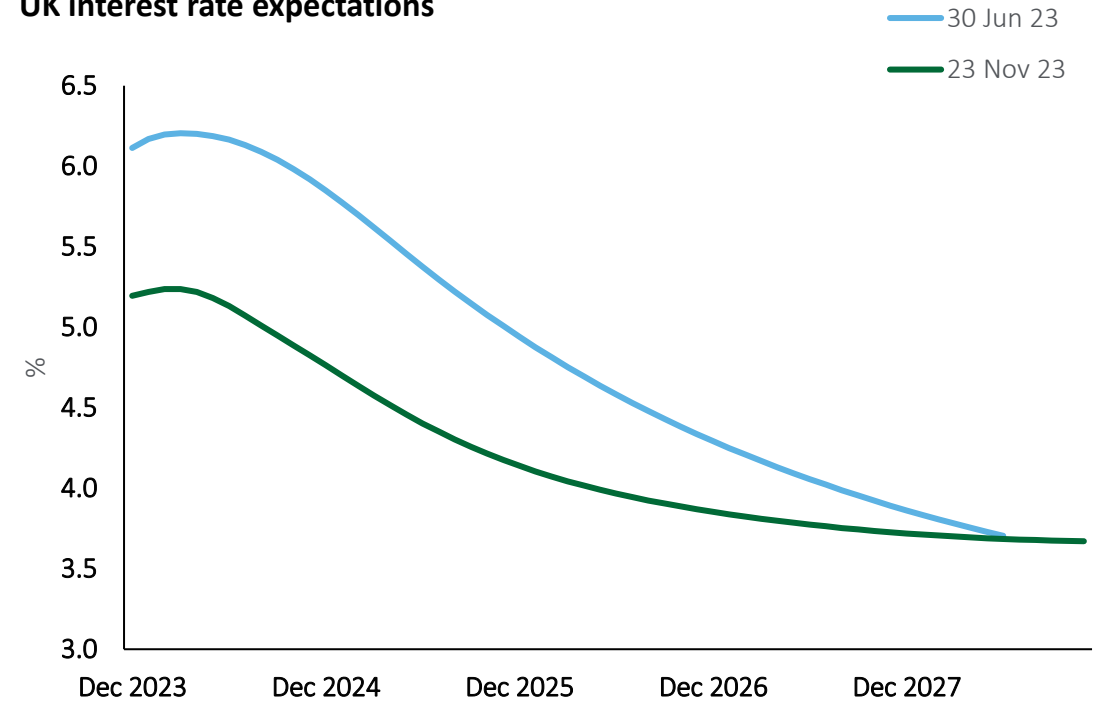
... meaning that Bank rate expectations are now lower

UK headline and core inflation



Source: LSEG Datastream

UK interest rate expectations



Source: Bank of England, updated 27/11/2023

What does this mean for corporates?

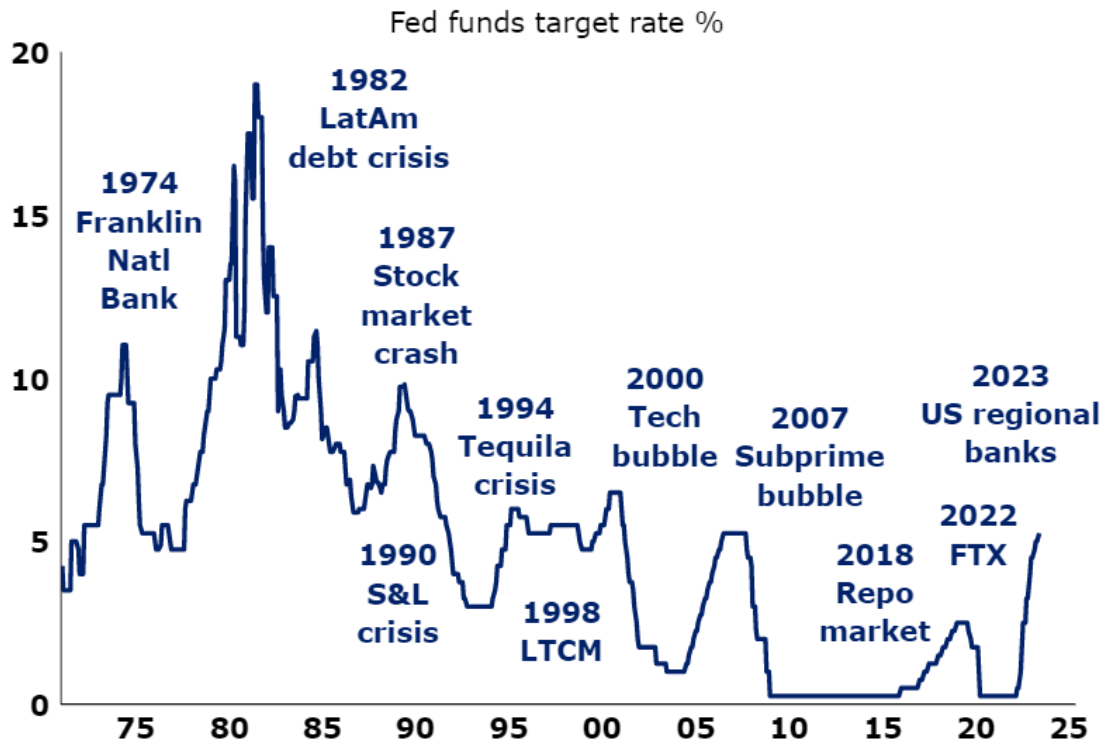
Interest rates in advance economies have reached pre-GFC levels

Higher interest rates have tightened financial conditions generating risks and central banks need to balance inflation and growth with financial stability.

Hiking cycles always stress financial markets...

... and this time it is no different

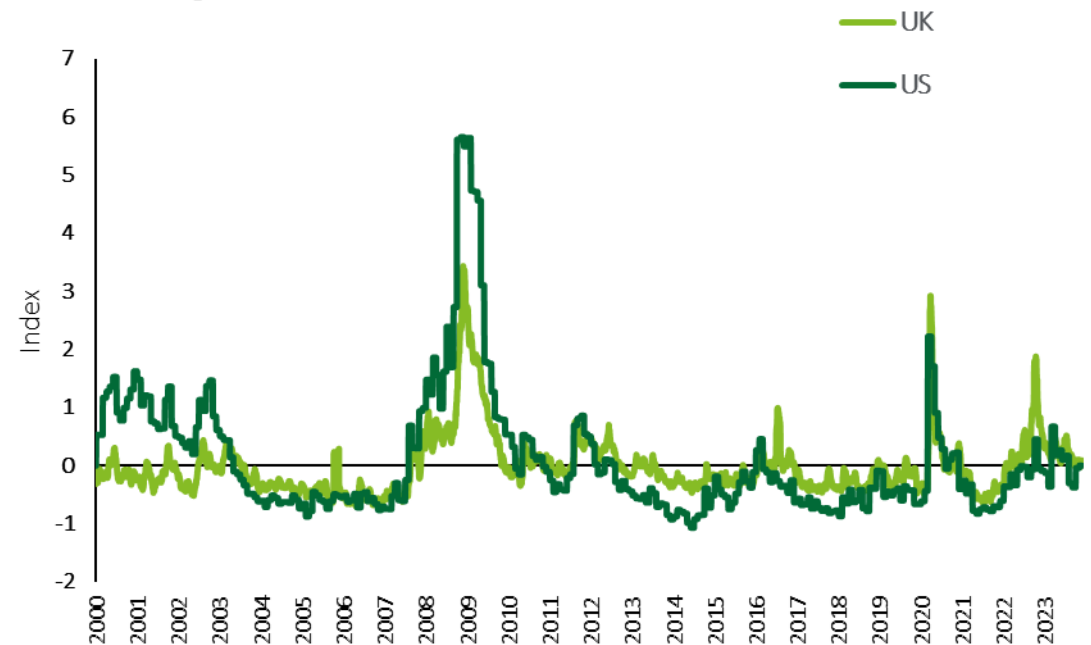
Financial crisis and the Fed's hiking cycle



Source: Refinitiv Datastream; upper limit of the Fed funds target range shown

UK and US Financial Stress Index

Index reflecting the level of stress in financial markets



Source: Deloitte UK, Economics and Markets Team & Kansas City Fed

Higher financial stress is tightening credit for corporates

Higher borrowing costs make corporate financing much harder, especially through bank borrowing

Credit is more costly and much less available...

... making corporate fall out of love with debt

Deloitte CFO Survey: cost and availability of credit

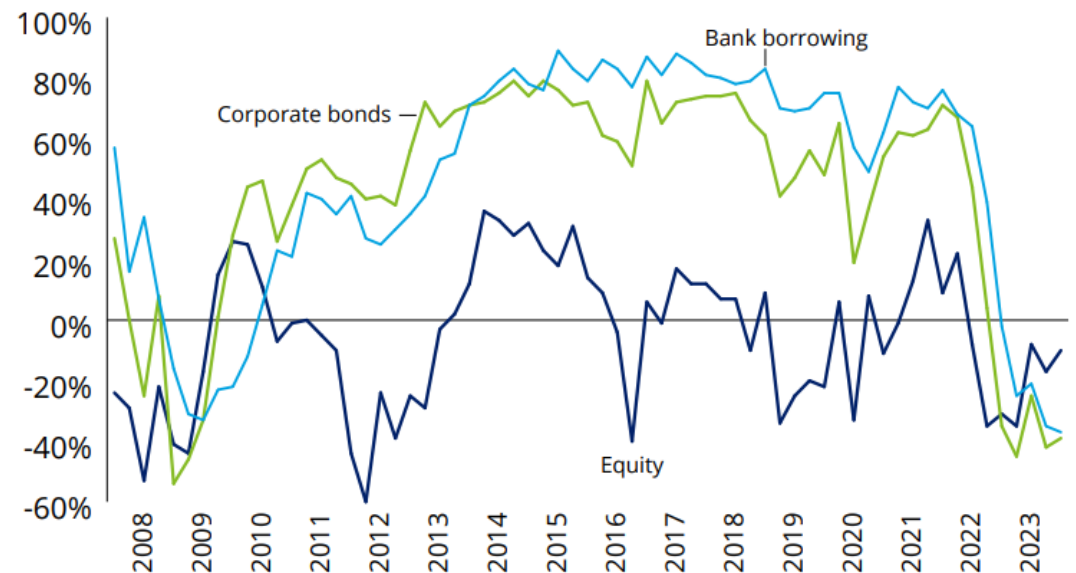
Net % of CFOs, large UK corporates



Source: Refinitiv Datastream

Chart 7. Corporate financing

Net % of CFOs who rate the following sources of funding for UK corporates as very or somewhat attractive



Commercial Real Estate is also adjusting to a new normal

Along with higher interest rates, CRE is dealing with a shift in working and living patterns post-pandemic

Commercial Real Estate has been underperforming ...

... as corporate demand for offices have fallen

UK Commercial REIT

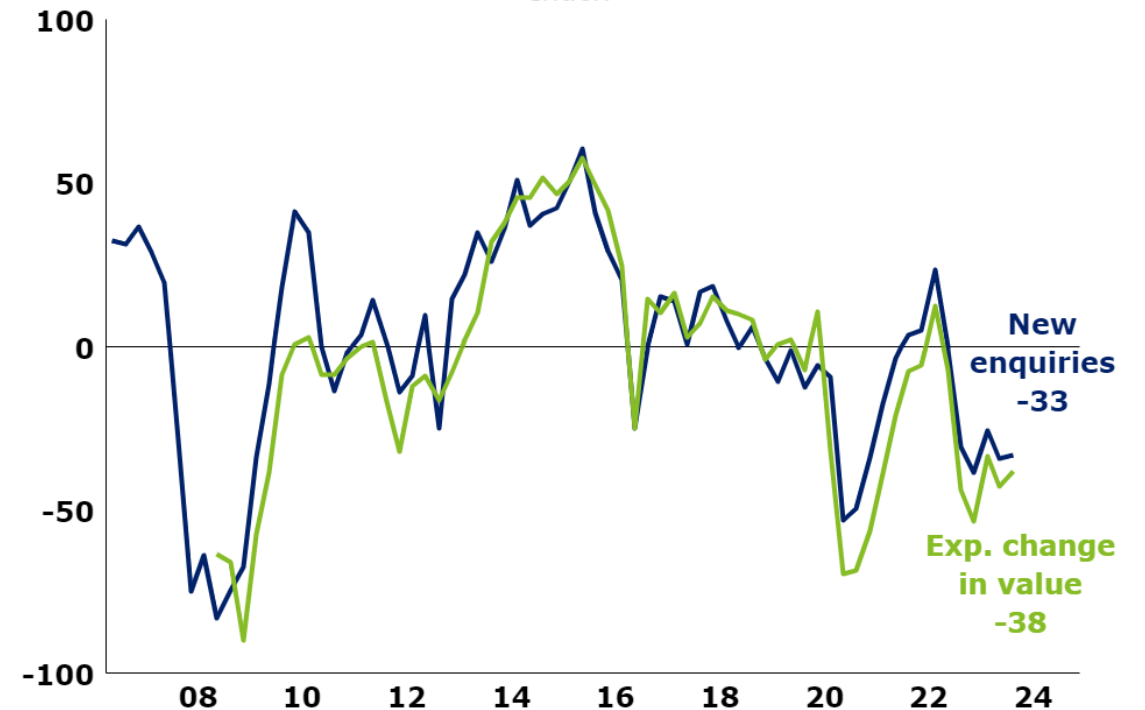
rebased to Jan 2020



Source: LSEG Datastream

RICS Survey: Offices

Index

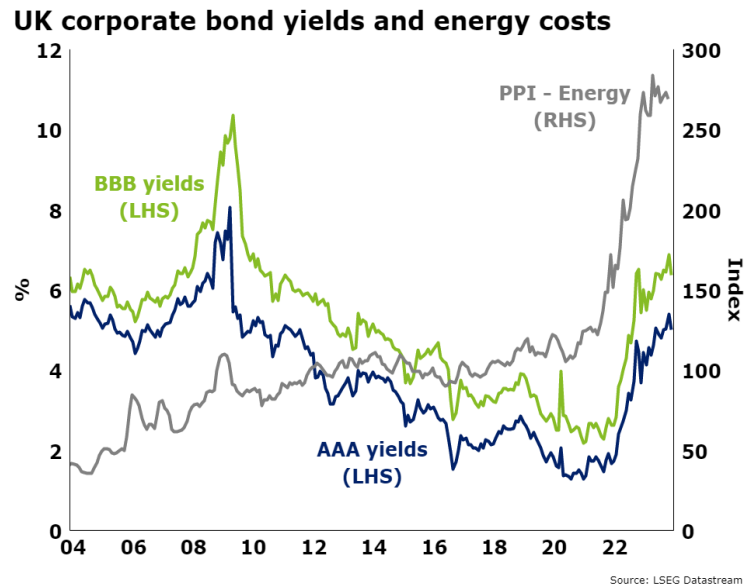


Source: LSEG Datastream

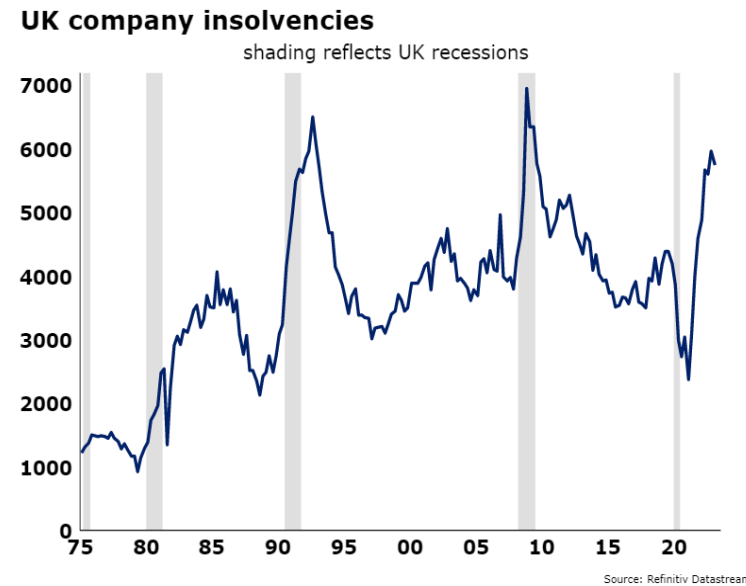
Corporates insolvencies have risen but mainly due to small businesses so far

Higher interest rates and the War in Ukraine have increased the cost base for many businesses, causing energy-intensive and over-leveraged companies to suffer

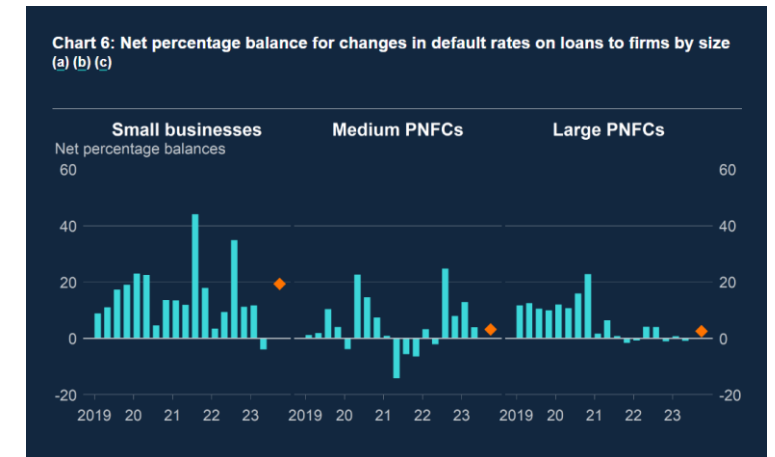
Higher corporate costs



Rising insolvencies



Lenders expect defaults to rise further



Inflationary environment has also tightened the labour market

Although the labour market is starting to show signs of slack, corporates have faced difficulties in hiring and retention in one of the tightest labour markets in memory

Corporate have lost the appetite for hiring...

... due to rising wage expectations and over-capacity

Chart 11. Outlook for corporate hiring

Net % of CFOs who expect UK corporates' hiring to increase over the next 12 months

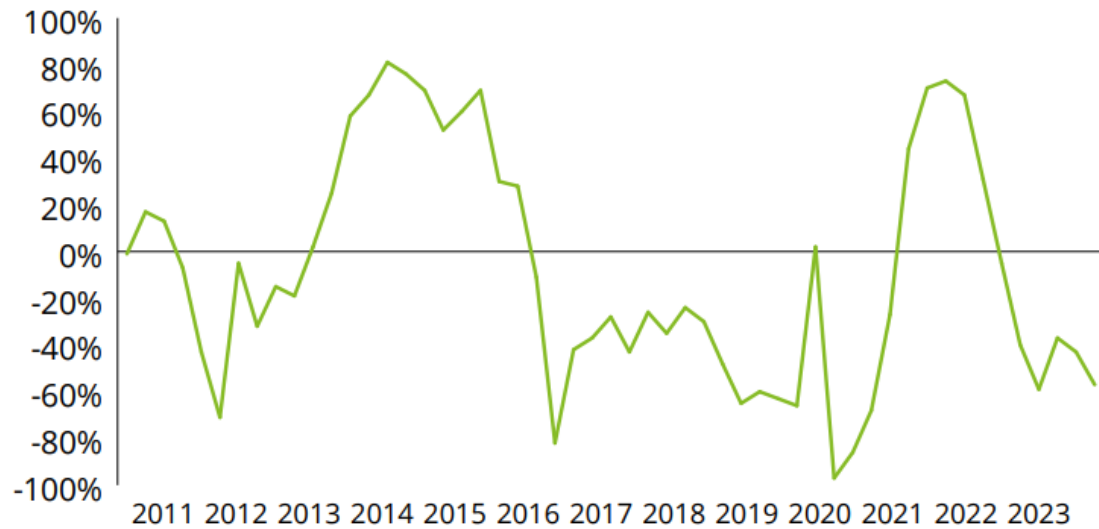
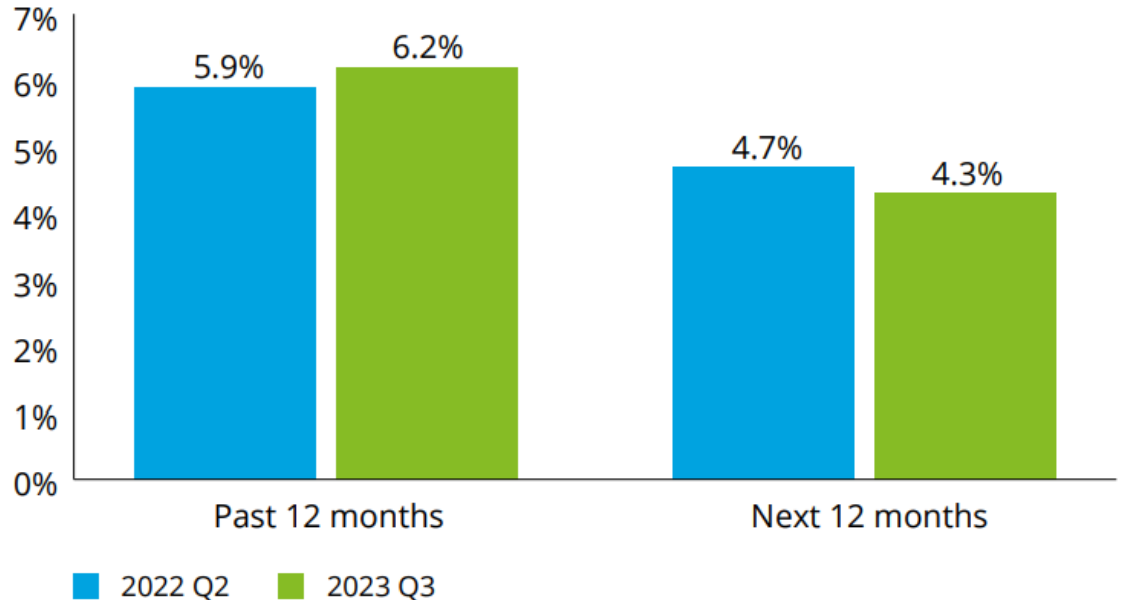


Chart 12. Wage expectations

CFOs' median reported increase in average wages in their business over the past 12 months and their expectation for the next 12 months



All these pressures are pushing corporates to be more defensive

Even if the UK does not enter a recession, most corporates feel and behave as if they are in one

Corporates are scaling back investment and retrenching...

... to reduce costs, increase cashflow and deleverage

Deloitte CFO Survey: Balance sheet priorities

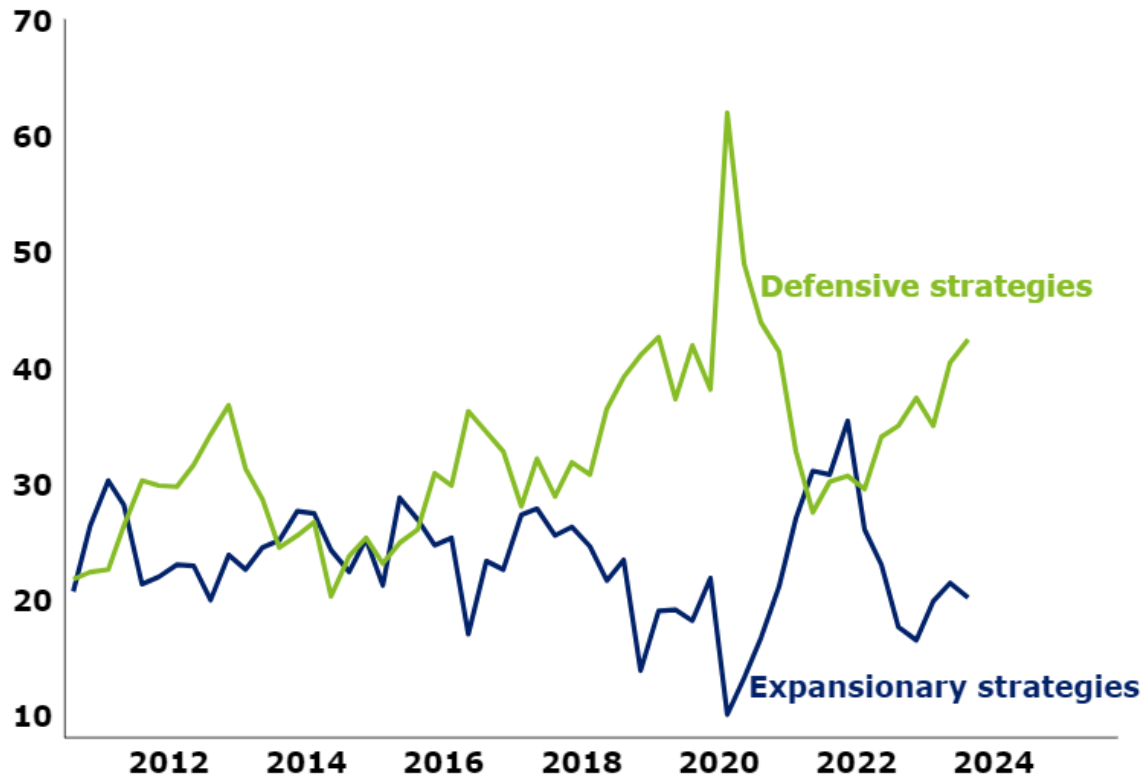
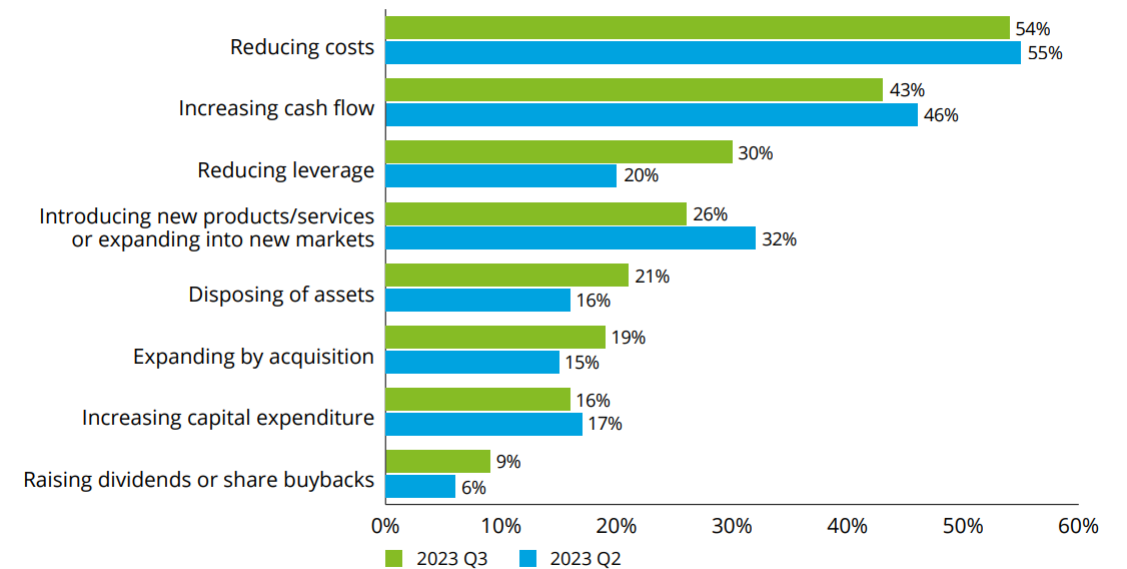


Chart 9. Corporate priorities in the next 12 months

% of CFOs who rate each of the following as a strong priority for their business in the next 12 months



Summary

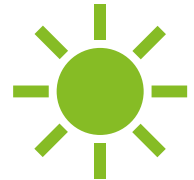
To sum up...

Key takeaways and risks to look out for



Outlook

- 1 Inflation and interest rate have peaked
- 2 Advanced economies to drag down global growth
- 3 UK to stagnate until 2025



Upside

- 1 Pandemic and energy shocks are in the past
- 2 Savings and a resilient labour market have supported consumption
- 3 Emerging markets to provide global growth



Downside

- 1 Financial stress and triggers may not over
- 2 EU and UK labour markets may change fast
- 3 China's slowdown



This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.