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2023 Global Macroeconomic Outlook: Q3 Update

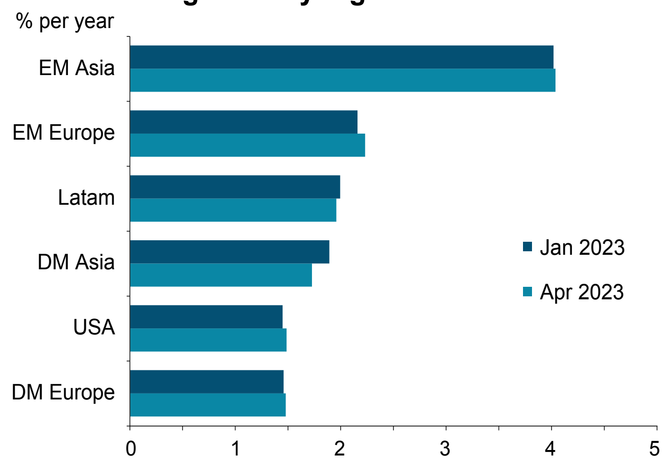
Key Macro Trends

The resilience of the global economy continues but the peak impacts of the rapid tightening of monetary policy are yet to materialize. We expect that the near-term strength, supported by services, will subside and 2024 will rank amongst the weakest in recent decades. Enduring strength in labor markets globally has been key in keeping core inflation elevated above central banks' targets. But with unemployment forecast to rise, as central banks successfully tighten financial conditions, we could see further weakness in housing markets.

Strong Services Growth Improves 2023 Outlook

Although world GDP growth is likely to have slowed in the middle of the year, near-term indicators still point to solid growth underpinned by the resilient performance of the services sector. As such, we have upgraded our 2023 world GDP growth forecast from 2.0% in April to 2.4% in anticipation of a stronger end to the year than previously anticipated. Both advanced economies (AE) and emerging markets (EM) alike saw uplifts of 0.4% to their current year forecast. While we still expect the US to enter a technical recession in Q4, the peak-to-trough GDP decline will likely be limited. And the catalysts of the recession – the cumulative effects of past rate hikes by the Fed and banks dialling back on lending – remain unchanged. Elsewhere, we have raised H2 growth forecast in China in response to recent policy loosening and waning destocking pressures. But the eurozone is an exception, where momentum indicators have recently weakened leading us to lower our 2023 GDP growth forecast to 0.6% from 0.8% in April. And manufacturing-exposed economies, such as Germany, will likely underperform the eurozone average over the remainder of the year.

World: GDP growth by region 2022-2027



Source: Oxford Economics - Regions weighted by MSCI index weights

Lagged Monetary Policy Transmission to Prolong Lackluster Global Growth

The resilience of activity data along with high services inflation and strong wage growth have heightened central bankers' concerns that second-round inflation effects are building. In response to the more hawkish tone from central banks, we have revised our expectations of policy rate paths upwards either via the terminal rate for this hiking cycle or the number of rate cuts during 2024. We think the Fed has reached its terminal fed funds rate target range of 5.25%-5.5% at their July 26th meeting. However, there is risk of additional increases in H2 if the resilient labor market data continue to defy policymakers' expectations. Throughout next year we forecast that the Fed will implement 150bps of rate cuts, down from an assumed 275bps in April. Elsewhere, after cooling its hiking pace to 25bps in its last three meetings, we now believe the ECB will reach a terminal rate of

4% in September, 25bps higher than before. Reflecting the enduring strength of core inflation in the UK, which we expect to average 7.7% this year, we have revised our expectations for the BoE terminal rate to 5.75%, from 4.5% previously. One key reason why this policy tightening is yet to have had a significant impact on the economy is that the impact on broader financial conditions has not been especially stark so far. However, it takes time for monetary policy to influence activity and inflation – because of this lag in transmission, we believe the peak impact of past policy tightening is still to be felt. Against this backdrop, we expect world GDP growth in 2024 to slow to 2%, down from 2.2% in April. This would represent the weakest calendar year growth rate since the global financial crisis, excluding 2020, and would mark a second consecutive year of lacklustre global GDP growth.

Housing Stabilization at Risk

Although fears of contagion from the market turmoil earlier this year have subsided, we see falling house prices as a key risk to the banking sector. We expect the stabilization in global house prices to prove short-lived given the factors that prompted it – such as a fallback in mortgage rates and an easing in the pace of bank credit restrictions – are wearing off. Meanwhile, other drivers such as valuations, the resetting of fixed-rate mortgages, and higher unemployment rate forecasts all suggest further declines. With some housing markets beginning to edge lower, we expect real house prices in the G7 to fall 6% this year and a further 3% in 2024.

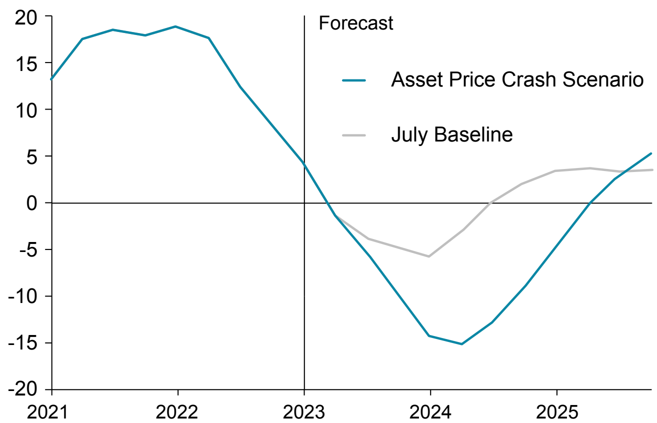
Risk Scenario: Asset Price Crash

In this scenario, core inflation slows less sharply in the near term than expected in our base case. Central banks follow up on last year's aggressive policy tightening with additional large rate hikes implemented. As a result, US policy rates lie 125bps above the level seen in our baseline forecast by the end of the year.

Higher interest rates weigh heavily on financial and housing markets, leading banking strains to spread to larger banks. Sharply lower equity prices hit business and consumer demand. House price falls exacerbate the impact, leading to a tightening of credit conditions and weaker residential investment. As a result, the global recovery grinds to a halt in the near-term, accompanied by a broad-based US dollar appreciation. Growth eventually rebounds, with the help of substantial monetary loosening including cuts to US policy rates amounting to more than 500bps. Despite the renewed policy easing, the level of world GDP of this scenario remains more than 1% below our baseline forecast at the end of 2028.

United States: GDP, real, LCU

% y/y



Source: Oxford Economics / Haver Analytics

The hardest hit are economies with overvalued housing markets that are also sensitive to the fall-out from sharply weaker stock markets. European economies generally fare badly. In the UK and eurozone, for example, GDP lies around 4% below baseline in 2025. In Asia, impacts are relatively large for China, but more muted for Japan which avoids the sharp near-term tightening of monetary policy seen elsewhere.

Market Forecasts and Private Allocation

This section offers a more granular view of our medium-term forecasts (5-year horizon) for both public and private key market segments, as well as our top-down allocation tilts across private alternatives. We also provide additional perspective into current market risks by contrasting our baseline views to those obtained within the context of a higher inflation scenario resulting in significant asset price corrections, as described in the previous section. For an overview of Ben's portfolio modeling approach, we refer to our 2022 whitepaper Geographic Diversification in Private Equity Markets and Global Macroeconomic Outlook, where we describe Ben's portfolio management framework and risk-adjusted forecasting methodology.

On the U.S. public markets front, our models suggests that real estate sector remains the most likely to outperform, in part due to recent corrections making new investments significantly more attractive, while we also expect corporate high yield segments to generate appealing medium-term returns due to a higher rate environment combined with our view that treasury yields are currently at or near their peak for 2023-2027. On the private markets front we similarly expect real estate funds to outperform, and private equity to also outperform most other sub-asset classes while falling short of generating the returns that have become the norm over the past two decades. This mild change of fortune in PE funds is in large part a consequence of the higher rate environment as well as of a more competitive alpha-generating landscape forcing GP to pay higher prices for their investments than in the past.

We expect the most meaningful impact of our risk scenario to once again be in the technology sector, which would prolong an already difficult period for many venture capital funds whose investments are often concentrated in growth technology companies. In this high inflation risk scenario, U.S. policy rates would indeed rise by an additional 125bps before the end of the current hiking cycle, making for a difficult environment for tech investments which would soon erase the gains from 2023 H1 (up ~42% as of June 30th).

On the private allocation side of our forecasts, we expect good risk/reward trade-offs in private real estate, and to a lesser extent in private equity (buyouts, growth capital) and private debt as risk aversion sentiments gradually fade and central banks successfully provide markets with a 'soft landing' through 2023-2024. In our high inflation risk scenario, market landing is anything but soft in the short-to-medium term, but we still see nice opportunities in real estate, and to a lesser extent in natural resource and infrastructure investments as these sub-asset classes (real assets) can offer good inflation protection and generally have lower downside risks during inflationary periods. Such risk scenario would see further increase in yields, both treasury and corporate spreads, which from a risk/reward perspective we expect to favour private debt over most other private sub-asset classes.

Market Forecasts

Market Segment	Baseline	Risk Scenario
Equities - Broad	4.5%	4.6%
Equities - Technology	4.7%	3.1%
Equities - Energy	5.1%	5.1%
High Yield Corp. Bonds	8.7%	10.7%
Real Estate	10.8%	10.9%
T-Bills (3 month)	3.0%	2.3%
Private Equity	10.0%	10.0%
Venture Capital	6.8%	6.0%
Private Debt	7.1%	7.7%
Private Real Estate	10.1%	10.1%
Natural Resources	8.0%	7.7%
Infrastructure	7.1%	6.7%

Analytics from Beneficient and Oxford Economics. Additional data sources: Burgiss, Preqin, Bloomberg.

Optimal Allocations (Bullish, Bearish, Neutral)

Private Allocations	Baseline	Risk Scenario
Private Equity	neutral	-neutral
Venture Capital	-1	-1
Private Debt	neutral	+1
Private Real Estate	+1	+1
Natural Resources	neutral	neutral
Infrastructure	-1	neutral

Analytics from Beneficient and Oxford Economics. Additional data sources: Burgiss, Preqin, Bloomberg.

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