Navigating
the Economic Storm
Your Indispensable Guide Through The Global Recession

Global virtual conference session notes

The risk of another global recession is growing larger by the day. While it may not be possible to avoid an economic downturn in some economies at this point, governments and businesses can adopt strategies to moderate the impact. The Conference Board held a global virtual conference on November 29 that explored the global economic outlook, the path forward for policymakers, and the strategies that businesses can implement to help weather the storm. Here are the key insights from these sessions.

Insights for What's Ahead

- **The global economy is expected to slow further as we move into 2023.** Mild recessions are expected in the US due to aggressive monetary policy tightening and in Europe due to the energy crisis. China's recovery in 2023 will be constrained by a weakening external environment and subdued domestic demand.
- **Monetary policy remains focused on bringing inflation down.** The current tightening cycle is expected to end only if medium-term inflationexpectations by firms, households, and financial markets shift downward. The key policy tools in the US and Europe are short-term policy rates, while in China the emphasis is more on structural tools.
- **Fiscal policy should be geared toward improving the productive capacity of the economy.** For example, in China this mainly concerns policies to increase domestic consumption and tackle low fertility rates. At the same time, debt levels are elevated, particularly in Europe and the US, raising the need for a more durable and sustainable fiscal policy over the medium term (the next three to five years).
- **Disruptions to doing business over the last two years have led to a renewed focus on employee engagement.** On the employee side, this is driven by pandemic disruptions, changes in the workplace (e.g., telework), and an overall increased need for a sense of safety and purpose. On the employer side, it is driven by increased difficulty in

recruiting and retaining talent.

- **CEO confidence in the economy is low, especially in Europe, but executives still see plenty of opportunities.** Innovation and leveraging of new digital technologies have accelerated. Furthermore, in response to challenges, many businesses have structured their organizations more efficiently and with enhanced agility. Finally, companies are doubling down on precrisis trends such as focusing on the multistakeholder environment or the overall transition to a more sustainable economy.

The Global Economic Slowdown

Headwinds to the global economy are intensifying. High inflation is proving persistent and growth is losing momentum as confidence weakens and uncertainty remains elevated. Central banks have responded to above-target inflation with rapid tightening in monetary policy. This is raising borrowing costs and weighing on interest-sensitive spending while adding to the pressures many emerging-market economies face. Labor markets are also tight, with low unemployment rates giving way to labor shortages. A shrinking working-age population is exacerbating these shortages.

The Conference Board expects global GDP growth of 3.3 percent in 2022, down from 6.1 percent growth in 2021 during the rebound from the pandemic. We expect further weakening in global growth in 2023 to 2.1 percent. Growth will largely be driven by emerging economies, particularly those in Asia. This reflects a number of factors, including a delayed exit from lockdowns and the associated later rebounding of these economies, generally lower inflation, and faster underlying trend growth rates. We expect shallow but nonetheless broad-based recessions to occur in the US and the Euro Area around the beginning of 2023. The US recession is likely to be induced by aggressive monetary policy tightening in response to persistently high inflation, and the recession in the Euro Area likely will reflect surging energy prices and corresponding reductions in production and demand. China may escape an outright recession. Nonetheless, China's economy will register weak growth in 2022 due to repeated lockdowns, a housing correction, and weakening external growth. Economic growth is likely to recover only modestly in 2023.

CHINA

Policy solutions

Enabling high-quality rather than rapid growth: Besides the many economic headwinds facing China, the country is undergoing a complex restructuring process due to a series of economic imbalances generated by its previous investment-led and credit-fueled model of growth. The Chinese government understands this is a critical moment for China, which is why it has shifted its focus from pursuing rapid growth to enabling high-quality growth. Certainly, given

mounting headwinds, authorities are using monetary and fiscal policy to support economic activity, but their focus on achieving high-quality growth remains as shown by the work report delivered at the 20th National Congress of the Communist Party of China.

More support for households: Looking forward into 2023, it is unlikely that domestic consumption will drive China's economic growth given ongoing imposition of COVID controls, weak consumer sentiment, and a permanent deceleration in income growth. A key downside risk is the slowdown of external demand. As a result, growth is likely to come from new investment, especially in real estate—though authorities have no intention of bailing out developers; rather, they want stalled projects to be finished. In terms of policy solutions, over the short term the advice is for neutral fiscal policy but with a shift in the composition, with more support for households—including, for example, more social insurance provisions and payroll tax cuts. This would have high multipliers for the economy and boost demand. On monetary policy, greater emphasis on interest rates and less on structural tools would help finance investment.

Reducing the need for precautionary savings: Over the long term, boosting household consumption is also important. But this will not be easy to achieve. Despite impressive consumption growth over the last decades, China's household consumption share of GDP remains one of the lowest in the world. One reason is the need for household precautionary savings. Boosting consumption in the long term requires policies aimed at reducing this need (e.g., with better social security such as pensions), tax policies to boost disposable income, and further developing the services sector.

Increasing investments: From a macroeconomic perspective, the key to ensuring long-term, sustainable growth is boosting total factor productivity growth rather than consumption. This can only be done by increasing investments, but capital needs to be allocated wisely to improve efficiency: struggling firms must be allowed to sink and new ones to rise.

Incentivizing fertility: Finally, a key challenge to longer-term growth in China is demographics, as fertility rates are at such low levels that the working-age population is shrinking. Policymakers have to come up with new ways of providing opportunities and incentives for people to both work and raise children.

Business solutions

The past years have brought great change to China's business landscape. Multinational companies (MNCs) have had to deal with the disruption of their operations by COVID-19 and related controls; weaker economic growth and subdued domestic demand; the increasing "rhythm mismatch" between their China and global operations; and global risk events such as the war between Russia and Ukraine and the volatility this is causing in international commodity and energy prices. New security risks are also emerging due to increasing digitalization of the economy (e.g., hacking, cybercrimes, etc.).

Like businesses worldwide, MNCs in China must also address an internal, bottoms-up demand for change from their employees. This has become very clear over the past two years, given the effect the pandemic and its disruption of the workplace had on the mental and physical health of employees. Businesses are now being pressured to rethink their culture and principles, as well as the way they go about recruiting and retaining talent.

All this has brought to light how critical it is for MNCs to be agile, ensuring the resilience of their operations. Indeed, MNCs that have successfully managed through these past years of rising headwinds have:

- **Continuously adjusted their value propositions**—irrespective of the sectors in which they operate—to face changing consumption trends, new security risks, changing policy priorities, and the impact of global risk events such as war and climate change.
- **Advanced innovation and leveraged new digital technologies**. The acceleration of "digital first" due to the impact of the pandemic has enabled companies to offset some of the disruptions in recent years, such as the need to work remotely. It has also helped increase their addressable markets and improve the way they communicate with customers.
- **Structured their business to be prepared to respond efficiently and rapidly** to any changes, whether driven by policies or by the impact of an external macro driver.
- **Maintained constant communication with global colleagues** to, among other things: share lessons learned, improve coordination on implementing global and regional strategies, and keep global HQs abreast of any changes in China that might affect global operations and vice versa.
- **Built an inclusive internal environment that respects differences** and is aimed at addressing employees' concerns, increased the value employees derive from working in their companies, and provided development opportunities.

EUROPE

Policy solutions

Continued monetary tightening: It's not easy to conduct effective monetary policy in an environment of persistent and well-above-target inflation while the economy may be moving into recession. Central banks in Europe are laser focused on inflation but need to take into account a weakening growth environment as well. The initial surge in inflation was largely driven by supply shocks associated with energy and commodity prices. But recently these price increases have become more embedded into firms' and households' pricing decisions. This explains why, for example, the Bank of England is likely to continue tightening its policy, first and foremost using short-term interest rates. A durable shift downward in medium-term inflation expectations by

firms, workers, and financial markets could signal an end to the hiking cycle.

In the interim, however, the risk of overtightening increases as multiple central banks around the world tighten policy, amplifying the overall effect through international trade and capital flows. While central banks are communicating their actions to the best of their ability, overall coordination will be difficult as central banks face different domestic challenges.

Continued high spending in the short term: While borrowing costs are increasing due to rising interest rates, there is at the same time increased pressure on European governments to continue high levels of spending. Initially this was driven by the need to keep the economy afloat during the worst part of the pandemic in 2020; currently more government spending is redirected to shield households and firms from extremely elevated energy prices.

Spending cuts and higher business taxes over the longer term: More public expenditure is needed to finance the energy transition and overall greening of the economy, while defense expenditures are also rising as a result of increased security threats since the start of the war in Ukraine. It's unclear how these expenditures will be financed. For now, governments use debt financing, but this is not a durable solution and is also not recommended by the European Union. Increased taxation is also not a good solution, as taxation ratios in Europe are already among the highest in the world, in the range of 35-40 percent for most countries, compared to 25 percent in the US. The result is likely going to be a mix of expenditure cuts and a shift in taxation away from labor income and more toward business income. In the short term, this includes windfall taxes on energy firms (the so-called solidarity charge), while in the longer term this includes a move toward a global minimum corporate tax rate of 15 percent.

Business solutions

Confidence among CEOs in the economic outlook is depressed, according to our own poll conducted together with ERT. CEOs are especially pessimistic about the European outlook, and they expect the European economy to trail the recovery seen in the US and Asia. Energy-intensive industries such as chemicals and materials face especially challenging times, though the expectation that this will lead to an overall acceleration in deindustrialization appears overblown. European industry will eventually recover from the current shock, which includes not just energy but also an overall shortage of inputs, but the question is during which time frame.

C-suites in Europe are likewise focused on the multiple challenges ahead: labor and material shortages, rising energy costs, geopolitical uncertainties, and constrained consumer budgets. At the same time, they realize that a crisis brings opportunities for a wholesale shift to sustainability strategies (or even a sustainability revolution) and increased incentives for innovations more broadly.

ESG is still top of mind: Firms remain committed to the overall transition to a more sustainable economy and are even doubling down on their greening efforts. In some cases, businesses even

want to move faster than governments, and this creates friction in some circumstances. CEOs also realize that leadership in crisis is leadership on steroids. That means leaders need to go out of their way to be visible in the organization and help employees see through the current period. A rapidly changing environment requires employers to spend a larger part of their time caring for their employees and providing them with a sense of safety and purpose, which can keep employees motivated over the longer term.

Communications is king: The role of the communications officer has therefore also become more important, but given the abundance of communications platforms nowadays (e.g., social media), it's important to identify the right internal and external stakeholders and speak to them in their own voices. But above all, the crisis has shown the need to engage with each other and collaborate to set goals for the company and define its future trajectory.

UNITED STATES

Policy solutions

Engineering a soft landing: The US Federal Reserve (Fed), like its counterpart in Europe, is primarily focused for the moment on bringing inflation down to a more tolerable level in the range of 2 percent, which would allow for a more smoothly functioning environment in which firms and consumers can make better spending and investment decisions. And like European central banks, the Fed's primary tool is raising the short-term policy rate—specifically, the overnight rate. The balance sheet drawdown is a second instrument, but it is not being used as extensively. The effect of these changes is initially mostly felt in interest rate–sensitive sectors of the economy such as housing, and typically the manufacturing sector slows down initially before it feeds through to the rest of the economy. The goal is to engineer a so-called soft landing, where inflation is brought down over a reasonable period without material cost to the economy like large increases in unemployment or large declines in output. The Fed prefers to do this through restoring balance in the supply and demand of labor: reducing labor demand preferably by reducing vacancies, which would limit the rise in unemployment.

Balancing supply and demand: The role of US fiscal policy in bringing down inflation is twofold. On the demand side, the goal should be to not throw more gas on the fire; that is, to avoid raising demand further when it's already elevated. On the supply side, the goal should be to expand the productive capacity of the economy. The US government is doing that through, for example, the CHIPS and Science Act and the Inflation Reduction Act, both of which are geared toward physical capital and increased investment growth. Fiscal policy can also help expand the supply side of the economy by encouraging people to work longer and increasing the labor supply. However, all of these are longer-term solutions and will not help address inflation in the short term.

Cutting the public debt: The key current issue with US fiscal policy is high debt levels. The government continues to spend more, particularly on health care programs and net interest, than

it collects in revenues. While high levels of debt are not an immediate problem for the US economy, the longer-term outlook is not encouraging as future generations will bear the brunt of current unsustainable fiscal policies. At the same time, finding solutions to stop debt from swelling further or even reducing it is extremely difficult. It requires hard decisions and political will to craft policies governing spending and curbing excesses. In the past, crises such as shutting down government or debt default moved policymakers to action, but none of these options work in the longer run. The only way to solve the problem would be through bipartisan actions.

Implementing a pro-productivity, pro-growth policy agenda: US CEOs we spoke with said rolling back some of the unnecessary regulatory burden on corporations should be a priority. Regarding labor shortages, reforming immigration policy should be part of this debate, not just by regulating the flows better but also by providing immigrants with better human capital skills. Education and workforce development should get priority, CEOs told us, and childcare credits would be better than selective stimuli. Regarding inflation and global supply chain issues, a pro-business agenda would entail reductions in the Section 301 tariffs on Chinese imports, and overall a global diplomatic effort such as we saw with the UN Black Sea Grain Initiative.

Business solutions

Agility is key: US CEOs see the current environment as a transitional period globally, with many potential paths that require them to remain flexible as they keep all possible scenarios in mind. They must continually measure risk versus reward as part of an agile and flexible strategy—for example, when trying to determine whether a soft or a hard landing will emanate from monetary policy tightening to fight inflation.

Embracing deglobalization: Like their European counterparts, US CEOs see opportunities. For example, in the current environment of deglobalization, more investments could be going to Mexico to reap the benefits of lower labor costs. Furthermore, the US as a global hub for R&D will continue to attract investments.

Continued focus on stakeholder capitalism: C-suite executives see the coming recession as structurally different from earlier ones, partly because this recession is adding a new layer of complexity to underlying trends, for example with relation to deglobalization, emphasis on sustainability, reassessment of work, and geopolitical tensions. In this environment, the need for calm leadership with a clear focus is paramount. What that focus should be differs for each industry and company, although there are a number of common denominators: 1) a continued focus on the multistakeholder environment, forging a broad agreement on the “what” and not necessarily on the “how,” 2) despite the downturn, maintaining efforts to communicate the value of ESG programs by explaining their close relationship to sound business philosophy and value. These long-term pillars and corporate purpose serve as the framework for making the right decisions now.

Increased focus on efficiency and innovation: These are prerequisites for continuing growth and strong relationships with peers and partners, as some problems can't be solved within the company and require partnerships. In some cases, this requires taking a fresh look at ROI of capital and other investments in order to align them with long-term, interim, and short-term goals that concern the shareholders.

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