Fitch Solutions

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Global Macro Themes For 2023

Inflation Fears Give Way To Growth Concerns

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Executive Summary

After a year in which rising inflation and central bank tightening dominated the economic agenda, **attention in 2023 will focus on slowing growth**. While economic outcomes in recent years have been shaped by global-level crises (the Covid-19 pandemic, the Russia-Ukraine war), we at Fitch Solutions believe that 2023 will be characterised by a larger number of smaller issues in specific countries.

This will create more **idiosyncratic problems for the global economy**. Such risks include the greater presence of smaller-scale domestic and geopolitical security risks or hidden pockets of leverage within the financial sector which could become exposed by elevated interest rates and weakening economic fundamentals. Rising geopolitical risk is likely to prove an increasing cause for concern. Despite the war in Ukraine - which we expect will continue in 2023 - relations between the US and Mainland China will remain important for global geopolitics. There are increasing signs of tension between Washington and Beijing. In the absence of any improvement, this will make it more difficult to find common ground on a range of pressing issues, such as global trade.

On the economic front, the weakness of growth will top the agenda, with global **growth slowing to 2.0%**. Risks are tilted to the downside. We expect that the Western European economy will fall into recession over the winter of 2022-2023 and that the US will experience a mild recession in H223. While our core view is that the removal of Covid-19 restrictions will push Chinese growth to 5.0%, risks to this forecast are weighted to the downside since the re-opening process may not run smoothly.

One potential bright spot is that **inflation will ease during 2023** as the energy price spike in the early months of 2022 drops out of the annual calculations. This does not mean that central banks will unwind the monetary tightening introduced in 2022. Interest rates in developed markets (DMs) will remain on hold throughout 2023 as policymakers remain vigilant for signs that second-round inflation effects are taking hold. Downward pressure on real wages across Europe and the US, and the response of trade unions in pushing to restore them, will continue to be a concern for central banks, which will worry about inflationary pressures becoming entrenched. Tight policy in DMs will force most central banks in emerging markets (EMs) to keep their rates on hold. Even so, a few Latin American markets, including Chile and Brazil - where policymakers started their hiking cycles earlier than elsewhere in the EM world - will cut key policy rates in 2023.

Economic conditions in Europe will remain contingent upon developments in the Russia-Ukraine war. DMs will be hard hit by the combined effect of high energy prices and central bank tightening; we expect that the eurozone economy will contract by 0.6% and the UK by 0.8%. Growth in European EMs will be somewhat stronger, but several important markets - including the Czech Republic, Hungary and Poland - will experience technical recessions. Difficulties may subsequently arise if a lack of Russian gas imports throughout 2023 results in Europe entering winter 2023-2024 with smaller than usual gas reserves. This would prevent a V-shaped recovery and cause the region to experience a prolonged stagnation lasting into 2024. A further concern is that if Western European countries use their considerable financial strength to secure domestic energy supplies rather than focusing on pan-European solutions, political strains will intensify and could place the EU under severe pressure.

In Asia, the removal of Covid-19 restrictions in Mainland China will provide a growth boost to the domestic economy as well as benefit the wider region as outward tourist flows recover. Having put in place measures to support the economy in the face of the pandemic and the 2022 cost-of-living problems, rising debt levels are increasingly a concern. An economic recovery will facilitate fiscal consolidation efforts in 2023 as inflationary pressures ease and borrowing costs rise. Geopolitical issues will be heightened by rising tensions between the US and China. A more hawkish US Congress will press for closer US relations with Taipei. Trade and technology transfers between the US and China will slow in 2023 as the US introduces further restrictions on high-tech goods exports. While we expect Beijing to steer clear of outright retaliation, there will likely be a heightening of rhetoric which will increase geopolitical tensions.

We expect that growth will slow particularly sharply in Latin America, which will underperform all other EM regions with the exception of Emerging Europe. We forecast that real GDP growth will slow from 3.4% in 2022 to just 1.2% in 2023. This is a consequence of tight monetary policy, elevated inflation and softer external demand, particularly from the US. While left-leaning governments will be in power in almost all of Latin America's major economies at the beginning of 2023, we expect that they will face legislative resistance and fiscal constraints which will limit their ability to shift policy in a market-unfriendly direction.

The **Middle East and North Africa** (MENA) region was one of the economic bright spots in 2022, but **growth is set to slow from an elevated 6.1% in 2022 to 5.5% in 2023**. This is a result of high inflation, tight monetary conditions, slower hydrocarbon production growth and spillovers from economic weakness in DMs. Political unrest remains an obstacle to economic and political stability, and we see a significant chance of protests, particularly in Egypt, Iran, Iraq, Israel, Morocco and Tunisia. Most of these countries have long-standing structural issues that will be exacerbated by cost-of-living issues and weak economic growth. The region will also remain characterised by a fragile geopolitical equilibrium in 2023. A delay or even failure to return to the 2015 Iran Nuclear Deal would increase geopolitical tensions and lead to renewed violence in proxy conflicts across the region which would prompt a worsening economic outlook in Lebanon, Iraq, and Yemen.

The 2023 outlook for Sub-Saharan Africa (SSA) is mixed. Although we expect an overall moderate pick-up in economic momentum, the regional powerhouses of South Africa and Nigeria will continue to underperform. With inflation remaining above historical levels, we believe that governments will seek to keep subsidies and social support measures in place. However, elevated interest rates will increase debt servicing costs, which will raise fiscal dilemmas and could force some governments to remove or phase out support arrangements. Almost half of Sub-Saharan African markets are due to hold presidential, legislative or local elections during 2023. Many of them are likely to be very closely fought, and some cases will present potential stability risks given lack of public faith in state institutions. In particular, rising levels of Islamist insurgency in the Sahel states will continue to weigh on sub-regional stability.

Global Macro Outlook

Global Macro Key Themes

We have identified eight major economic and political themes that will shape 2023. As we have seen over the past two years, the outlook can change rapidly given unforeseen and volatile events. We believe that we are moving from a period in which one or two major risks dominate (such as the Covid-19 pandemic or Russia's invasion of Ukraine) to a period in which there will be a multiplicity of smaller-scale risks. This creates more idiosyncratic problems for the global economy as well as individual economies. These, for example, could include the greater presence of smaller-scale domestic and geopolitical security risks as well as hidden pockets of leverage within the financial sector (such as with crypto exchanges or asset managers) which could become exposed by elevated interest rates and weakening economic fundamentals. In this article, we outline some of the major themes. We have not included the Russia-Ukraine war as a theme in itself because we anticipate that the conflict will continue throughout 2023, with neither side achieving a decisive victory.

KEY GLOBAL MACRO THEMES FOR 2023

Theme	Thoughts
Sharp Slowdown In Global Growth, But Nuances Exist	We expect a sharp slowdown in global growth from 3.1% in 2022 to 2.0% in 2023. Excluding the Covid-19 pandemic, this would mark the slowest growth since the global financial crisis (GFC). That said, Mainland China will buck this trend.
Inflation Will Ease Slowly, Leading To Still-Tight Monetary Policy	We believe that inflation will slow in 2023 but take a while to reach central bank targets. This means that central banks will maintain a hawkish bent, with only a few economies likely to cut interest rates in 2023.
Fiscal Policy Will Tighten	We expect that fiscal policy in most major economies will tighten in 2023 due to governments rolling back emergency spending plans launched in 2022, higher bond yields and greater pressure by market forces, and a greater focus on fiscal consolidation by policymakers.
US Dollar Not A One-Way Bet Anymore	As interest rates near their peak, the US dollar will likely weaken, particularly given a slight overvaluation of the greenback as well as lopsided investor positioning.
Fragmented Parliaments Will Stymie Policymaking	Increasing risks of protests and rising divisions between executives and legislatures will make policymaking more difficult globally over 2023. Several governments have already lost their majorities in parliament in 2022, a trend we expect will continue.
Tensions Between The US And Mainland China Increase	We anticipate that tensions between Washington and Beijing will increase in 2023 as the newly Republican-controlled House of Representatives raises pressure on the Biden administration to adopt tougher stances on China, and the latter responds accordingly.
Global Property Markets Come Under Pressure	House prices and property transactions are beginning to turn down in many markets as tighter monetary policy start to bite. This will raise the burden on consumers and increase the headwinds to activity in 2023.
Unemployment Rates Increase, But less Than In Previous Cycles	We anticipate that labour markets will weaken in 2023 as economic activity softens, reversing a tightening trend that started in late-2020. That said, given supply-side issues, we believe that unemployment rates will not rise as much as they would have in past economic cycles

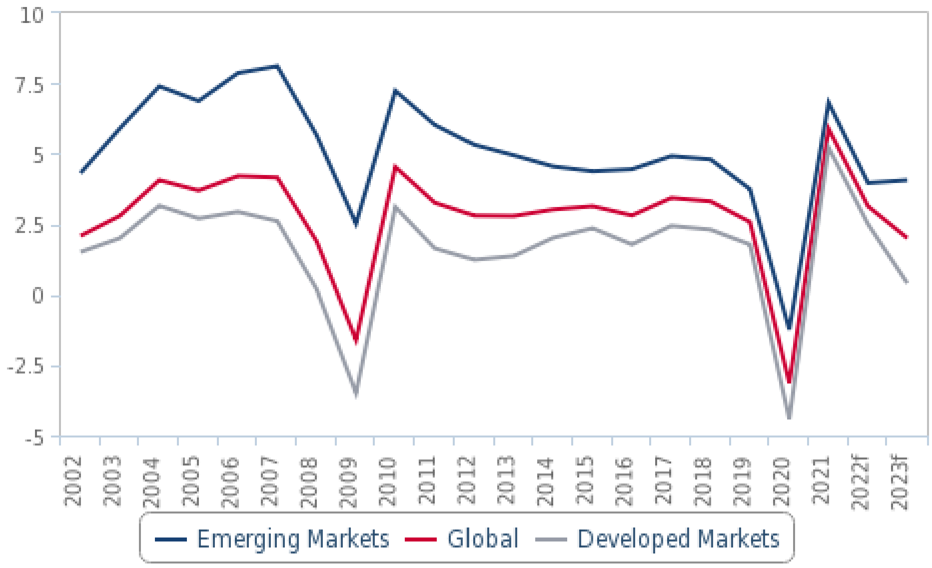
Source: Fitch Solutions

Theme 1: Sharp Slowdown In Global Growth, But Nuances Exist

We expect that global real GDP growth will slow from 3.1% in 2022 to 2.0% in 2023. Other than the pandemic in 2020, this would mark the slowest pace of growth since the GFC. Developed markets (DMs) will be hit hard, with a painful recession in the eurozone as well as a light and short recession in the US. Europe will be the region that suffers the most, contracting by 0.6% in 2023 (eurozone will contract 0.5%) given rising interest rates, the ongoing energy shock, and a sharp decline in business and consumer confidence. A contraction in output in developed Europe, combined with elevated inflation elsewhere, will also weigh on emerging Europe, where we expect that output will contract by 1.1% in 2023. We forecast that the US economy will slow to 0.3% over 2023 as a whole and will see two consecutive contractions in output in the latter part of 2023 as well as a rise in the unemployment rate.

Global Growth To Slow Sharply

Global - Real GDP Growth, % (2002-2023)

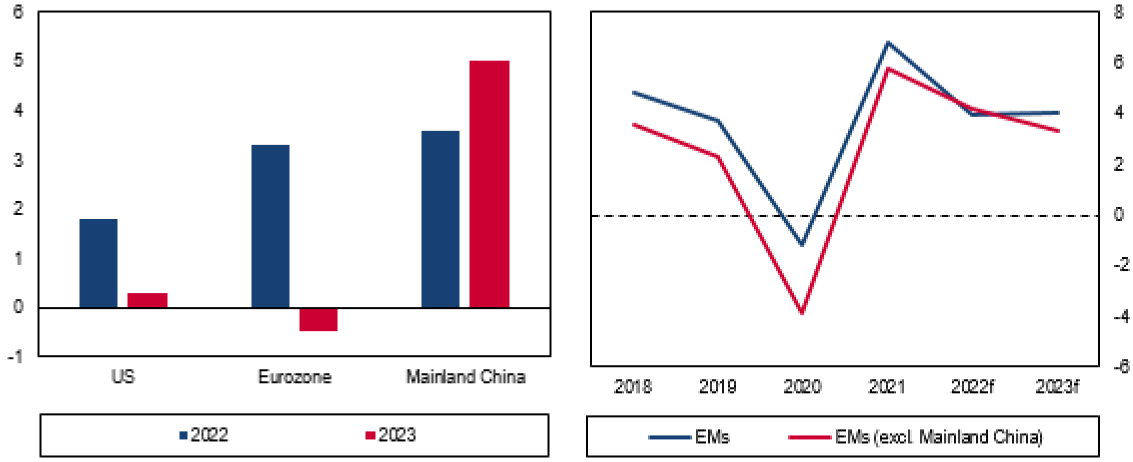


f = forecast. Source: Fitch Solutions

We think that the Chinese economy will buck the trend and is on track to see growth accelerate from 3.6% in 2022 to 5.0% in 2023. While the zero-Covid policy and the weak property sector pose downside risks to these forecasts, Beijing has provided significant policy support in recent months, including a slight easing of Covid-19 restrictions as well as a 16-point plan to support the real estate sector. While Chinese growth will lift the emerging market (EM) average, if China is excluded from the calculation, EMs will actually see growth slow from 4.2% in 2022 to 3.3% in 2023.

Growth To Slow, But Mainland China Bucks Trend

Global - Real GDP Growth, %



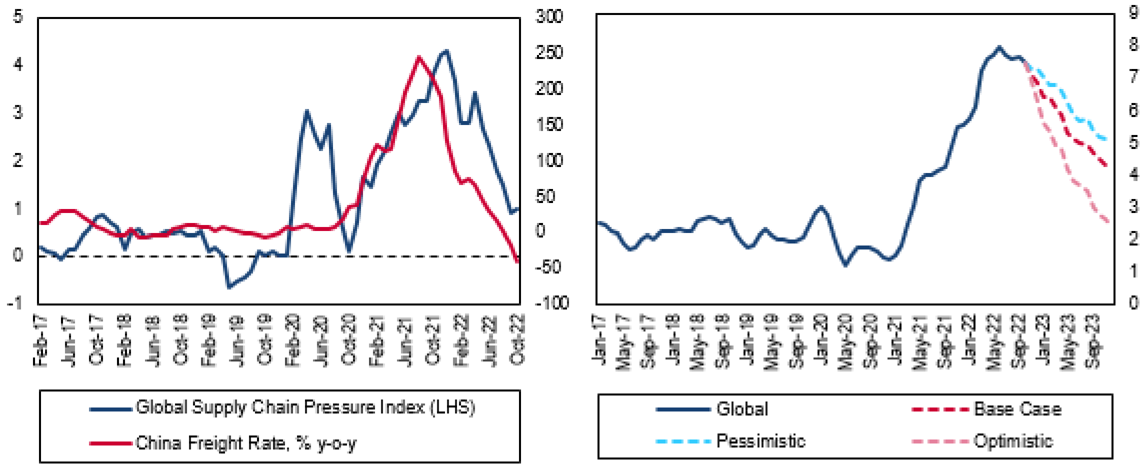
Source: Fitch Solutions

Theme 2: Inflation Will Ease Slowly, Leading To Still-Tight Monetary Policy

While leading indicators such as commodity prices, shipping rates and inflation expectations all point to weaker price growth, we believe that it will take a while for headline inflation to reach central bank targets. While inflation will trend lower over 2023, it is unlikely to hit central bank targets over the next nine-to-12 months in most economies. Inflation will remain sticky in those economies that have been hit by large supply shocks, such as European economies and, in particular, emerging European economies that depend on a high level of imported energy, food and staples. The pickup in growth in China could see commodity prices surprise to the upside in 2023, which could further slow the decline in inflation rates.

Inflation Coming Down, But How Quickly?

Supply Chain Metrics & Global Inflation, % y-o-y



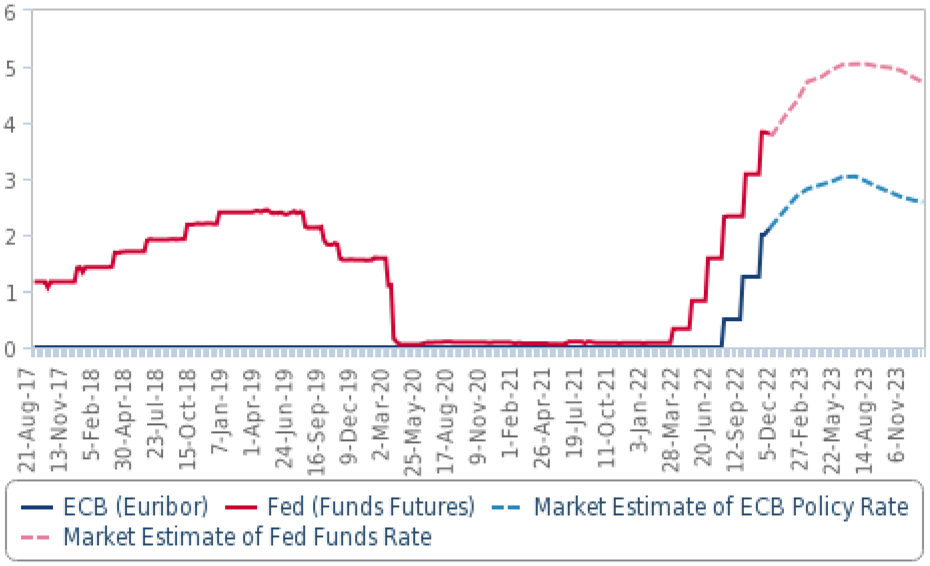
Source: Macrobond, Bloomberg, Fitch Solutions

This slow pace of disinflation towards central bank targets will have three broad implications. First, it means that policymakers will maintain a relatively hawkish bent and will be reluctant to cut interest rates quickly. We do not expect major central banks such as the US Federal Reserve (Fed) or the European Central Bank (ECB) to cut interest rates in 2023 despite a sharp slowdown in growth and easing inflationary pressures. We believe that the recent memory of high inflation might also prevent central banks from cutting aggressively and to the lower bound as they did in pre-pandemic years. Second, we continue to argue that monetary policy may still become even more unconventional whereby central banks keep interest rates elevated but are forced to inject liquidity into the market by expanding their balance sheets. We have already seen this to a degree, with the ECB's transmission protection instrument as well as the Bank of England's liquidity injection following the sharp rise in bond yields in October 2022.

Third, even as inflation comes down, 2023 might feel more 'stagflationary' than 2022 did. Despite elevated inflation in 2022, the labour market was robust and growth was reasonably strong across the global economy. As we head into 2023, elevated inflation will combine with weaker growth - and recession in certain economies - as well as a softening labour market and rising unemployment in many markets.

Central Banks Will Remain Hawkish

Policy Interest Rates & Futures Market, %



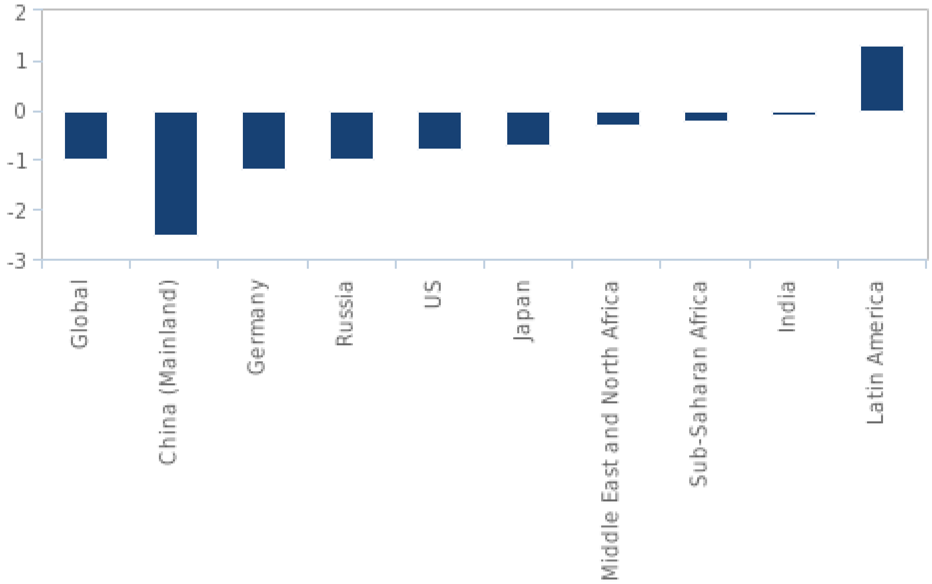
Source: Macrobond, Fitch Solutions

Theme 3: Fiscal Policy Will Tighten

We expect that fiscal policy in most major economies will tighten in 2023 due to three main reasons: 1) governments rolling back emergency spending plans launched in 2022 (Germany, China), 2) higher bond yields and greater pressure by market forces (UK, Italy), and 3) a greater focus on fiscal consolidation by legislators (US). In aggregate terms, we expect that government spending will fall by 1.0% of global GDP (*see chart below*). Among major economies, we expect the most tightening in China (where 2023 spending was frontloaded into 2022), Germany (where spending temporarily surged in 2022 due to economic support measures), Russia (where the economy will continue to contract) and the US (where the fiscally hawkish Republicans now control the lower house).

Policy Will Tighten Almost Everywhere

Global – Fiscal Expenditure, 2023 vs 2022, pp of GDP

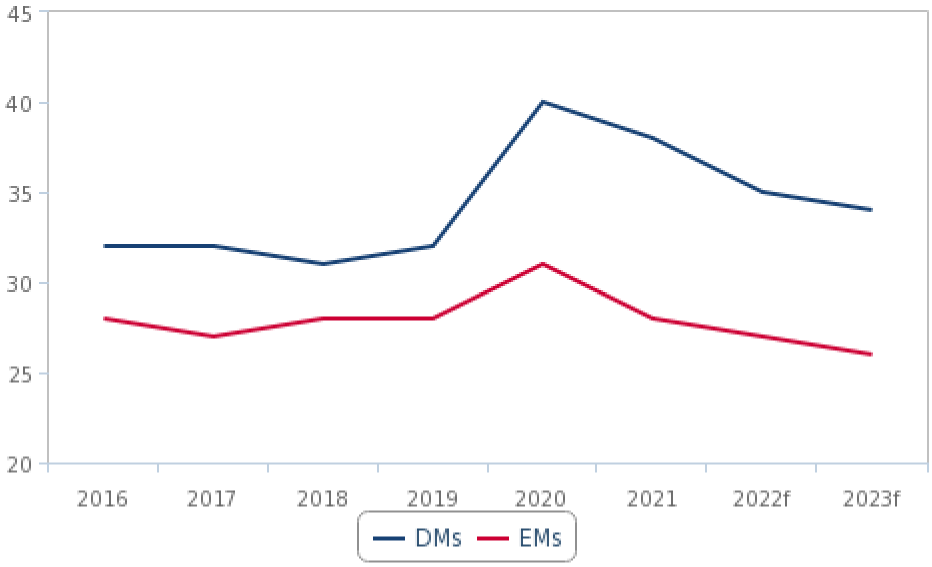


Source: Fitch Solutions

A few economies will buck this trend. Many of the biggest exceptions are in Latin America. The largest will be Brazil, where we think that newly elected President Luis Inácio 'Lula' da Silva will loosen fiscal policy in an effort to support the economy. We also expect that spending will rise in Colombia, which in 2022 elected a more leftist president (the country's first). Both presidents will, however, be constrained by divided legislatures and are unlikely to push through the sort of transformative spending plans that Lula managed in his first two terms (2003-2010).

Fiscal Expenditure To Ease Further

Global - Fiscal Expenditure, % of GDP (2016-2023)



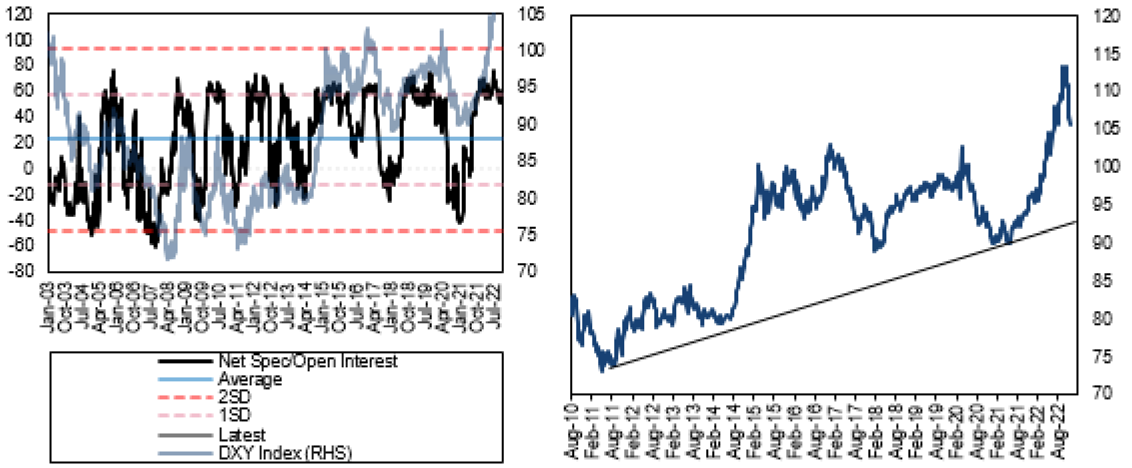
f = forecast. Source: Fitch Solutions

Theme 4: US Dollar Not A One-Way Bet Anymore

A combination of factors saw the US Dollar Index appreciate by 11.0% over 2022. While we believe that many of these factors will remain in play over the coming months, we think that the US dollar will struggle to maintain its uptrend over 2023 and instead will likely peak, if it has not already. The major driver of the US dollar in 2022 was an increasingly hawkish Fed as well as rising geopolitical risk, particularly Russia's invasion of Ukraine. However, there are several reasons why we believe that the US dollar will not be able to repeat its performance in 2023.

Dollar Coming Back To Trend?

US Dollar Index & Several Metrics



Source: Bloomberg, Fitch Solutions

First, we are nearing peak interest rates in the US, with the Fed's terminal rate (likely to be between 4.50% and 5.00%) approaching in Q123. Hence, a pause in the hiking cycle will remove a major pillar of support for the US dollar. Second, the US dollar remains overvalued on a real effective exchange rate basis, which could limit upside for the unit, while speculative positioning remains lopsided to the long side. Third, many other central banks are hiking interest rates more aggressively and are increasingly looking to manage the pace of weakening in their currencies. The Bank of Japan and the People's Bank of China have intervened in the foreign exchange market to reduce downside pressure on their currencies.

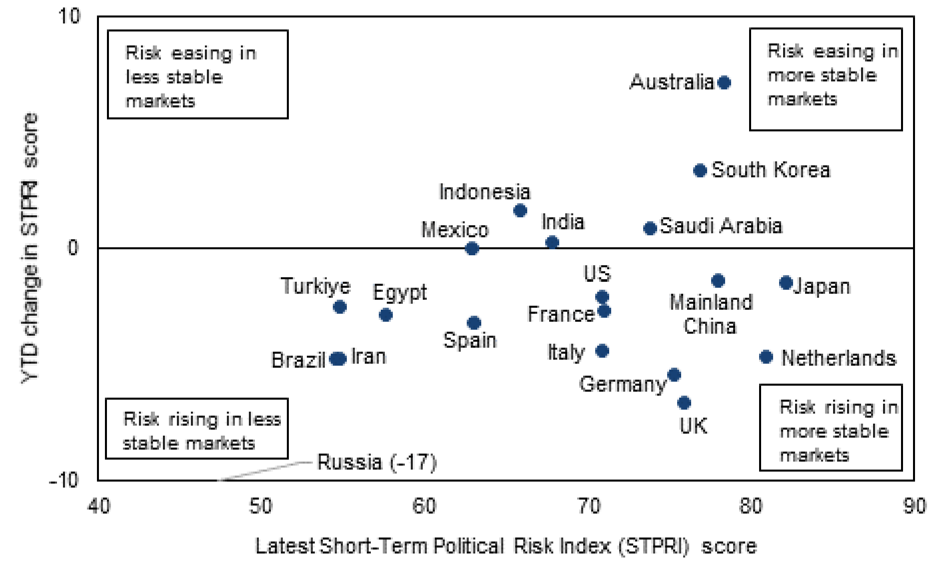
Theme 5: Fragmented Parliaments Will Stymie Policymaking

In 2023, increasing risks of protests and rising divisions between executives and legislatures will make policymaking more difficult. A combination of dissatisfaction with economic conditions and busy election cycles have already cost several governments their majorities in parliament in 2022, including in the US and France. Elsewhere, other internal tensions have led to major legislation being delayed, such as Germany's new, modestly more generous social welfare system. In terms of EMs, despite winning the presidential race in Brazil, President Luiz Inácio Lula da Silva's party does not have a majority in congress, and the November 19 2022 election in Malaysia resulted in a hung parliament.

These difficulties are reflected in our proprietary Short-Term Political Risk Index (STPRI), which continues to trend downwards across all regions on a GDP-weighted basis. Among large markets, this has weighed on European and Latin American markets in particular, the majority of which have experienced large negative revisions to their STPRI scores *(see chart below)*.

Most Large Markets Face Higher Political Risks Ahead

Selected Markets - Short-Term Political Risk Index



Note: Scores are out of 100; higher score = lower risk. Source: Fitch Solutions

We expect divisions over policy to grow in 2023 as inflation and slowing growth exacerbate fiscal and monetary policy dilemmas. This will pose downside risks to the implementation of well-balanced austerity policies, which could threaten to delay access to IMF funds in some EMs and undermine investor confidence, thus raising borrowing costs. Aside from resulting in slower policymaking, this will further raise the risk that policy missteps or other decisions trigger major protests, such as the riots in Kazakhstan in January 2022 and South Africa in July 2021, with ramifications for capital spending and growth.

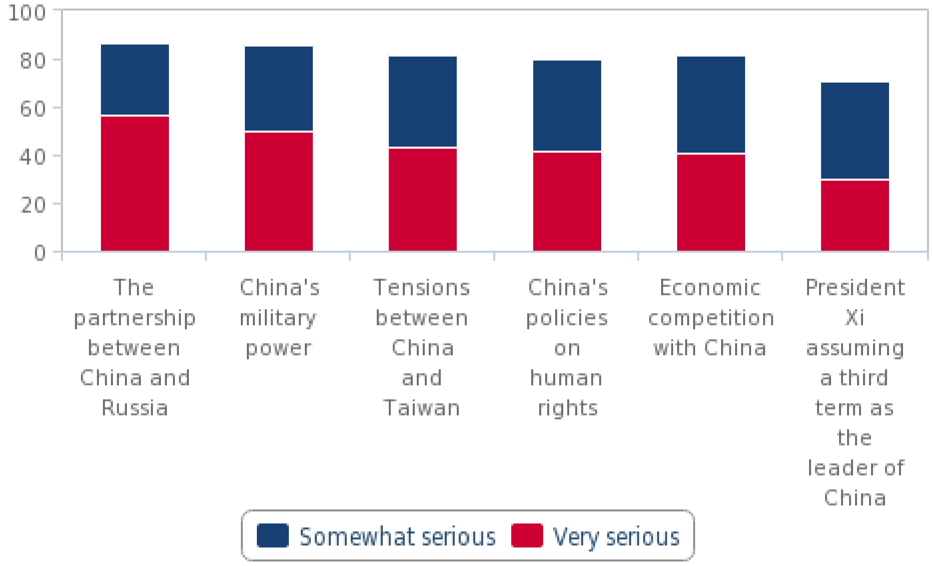
Theme 6: Tensions Between The US And Mainland China Increase

We anticipate that tensions between the US and China will increase in 2023 as the newly Republican-controlled House of Representatives raises pressure on the Biden administration to adopt tougher stances on Beijing, and the latter responds accordingly. First, we believe that Congress will press for greater US support for Taiwan, China by means of the proposed Taiwan Policy Act of 2022 (which aims to provide greater security assistance for the market) and the US-Taiwan Initiative on 21st Century Trade (which aims to increase two-way trade and investment). Second, the Biden administration is likely to strengthen its alliances with Japan, South Korea, the Philippines and Australia to counterbalance Beijing's influence in the Indo-Pacific region. This will complement initiatives such as the new Indo-Pacific Economic Framework for Prosperity, which includes 12 Asian markets.

Third, the US is likely to introduce further restrictions on high-tech goods exports to China the competition between the two markets over semiconductors and next-generation technologies increases. Fourth, the Republican party is likely to raise the rhetoric against China, which, even if does not immediately affect policy, is likely to create a more negative atmosphere in bilateral relations. Beijing is likely to respond by periodically increasing military activity and exercises around Taiwan and by strengthening ties (or at least maintaining cordial ties) with closely aligned states, such as Russia, Iran and North Korea, among others.

US Population Has Multiple Concerns About Mainland China

Percentage Who Say Each Of The Following Is A Problem For The US



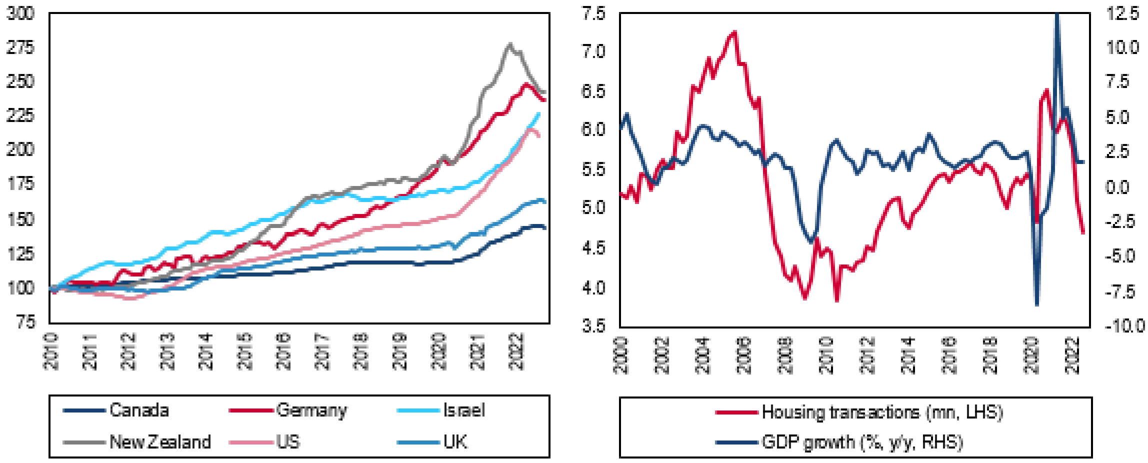
Note: The Pew Research Center Survey of US Adults was conducted over October 10-16 2022. The questions cited are as phrased by Pew. Source: Pew Research Center, Fitch Solutions

Theme 7: Global Property Markets Come Under Pressure

After a decade of rapidly rising residential property prices in most DMs, there are indications that the global housing market is losing momentum. This is the result of monetary tightening, which is raising the costs of servicing mortgages and, which will in turn squeeze the budgets of consumers who are already suffering from falling real wages. To the extent that a buoyant property market acts as a means of supporting the economy, a downturn will add to the macroeconomic headwinds.

Housing Market To Slow After A Sharp Rally

House Price Trends In Selected DMs, Jan 2010 = 100, (LHS) & US Housing Transactions Versus GDP (RHS)

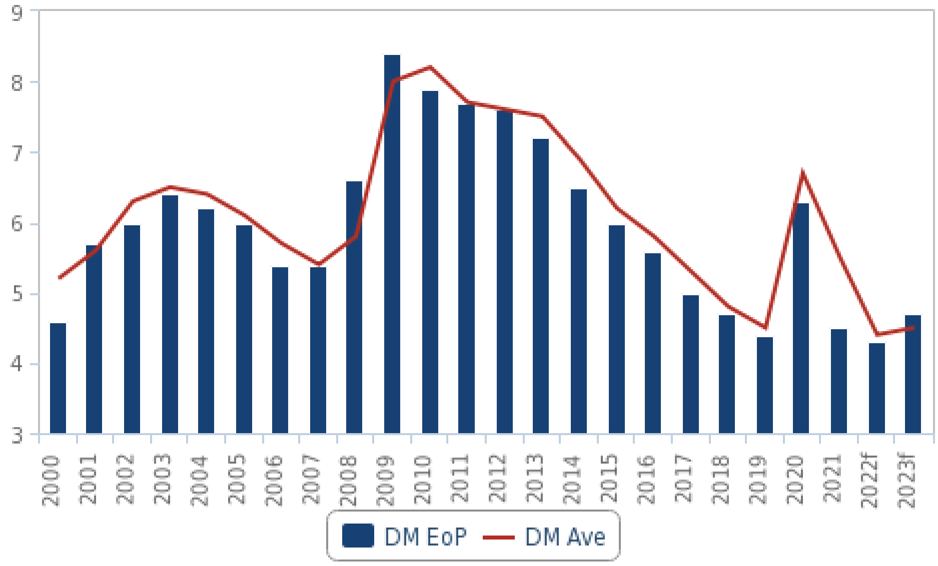


Source: Macrobond, Fitch Solutions

Housing market activity matters for the wider economy for a number of reasons. First, housing market turnover supports associated activity such as outlays on household goods. Second, in many DMs, consumers are able to borrow against the rising value of their property, which supports consumption (so-called mortgage equity withdrawal). A third issue is that falling house prices have a particularly adverse effect on consumers the more highly leveraged they are, particularly in an environment where households are subject to variable mortgage rates or where mortgages are fixed for relatively short periods. This is a particular problem for markets such as Australia and Canada. Finally, weak housing activity discourages residential investment, which has a direct impact on GDP growth. For all these reasons, a softening in housing market activity and prices will pose downside risks to DMs in 2023.

Labour Markets Will Remain Relatively Tight In 2023

DMs – Weighted Average Unemployment, % (2000-2023)



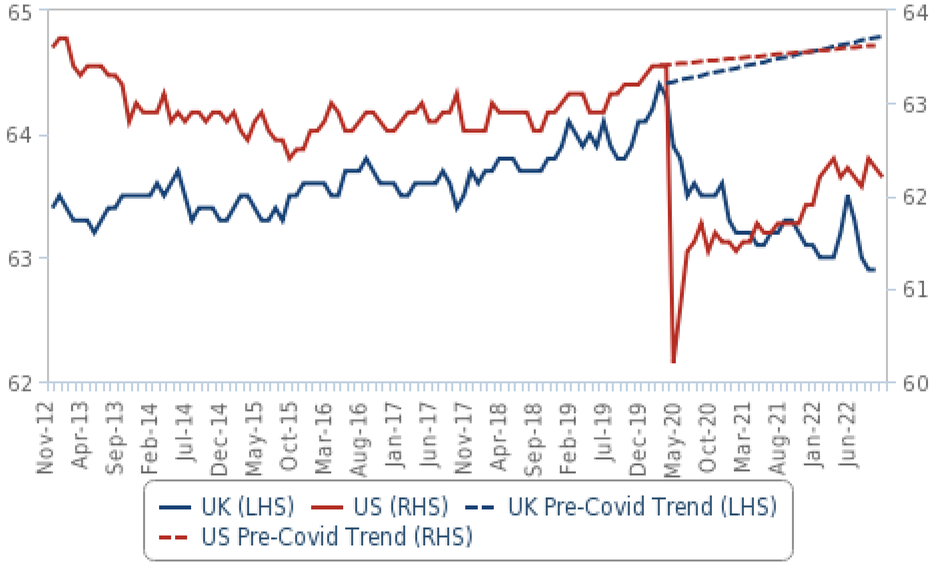
f = Fitch Solutions forecast. Source: Local sources, Fitch Solutions

Theme 8: Unemployment Rates Increase, But less Than In Previous Cycles

We anticipate that labour markets will weaken in 2023 as economic activity softens, reversing a tightening trend that started in late 2020 *(see chart above)*. That said, we believe that unemployment rates will not rise as much as they have in past economic cycles, going some way towards mitigating the impact of a weaker global economy on households and businesses. For example, we forecast a 0.7 percentage points (pp) rise in the US unemployment rate to 4.5% by the end of 2023, which would be a significantly lower increase than in past recessionary cycles. Looking at the last two (pre-pandemic) recessions, the US unemployment rate rose by 1.8pp to 5.7% between 2000 and 2001 and by 2.6pp to 9.9% between 2008 and 2009.

Labour Force Participation Still Below Pre-Pandemic Levels

US & UK – Labour Force Participation Rates, %



Source: Bloomberg, Fitch Solutions

We believe that below-normal labour force participation rates in the US and the UK have been a key contributing factor to tight labour markets and a lowering of unemployment rates over the past two years *(see chart above)*. US labour force participation rate dropped from 63.4% in early 2020 to a low of 60.2% in April 2020 before rising gradually to reach 62.2% as of October 2022. Likewise, in the UK the participation rate dropped from 64.4% in February 2020 to 62.9% as of September 2022. Still-generous spending by governments could also help to prevent a larger weakening of the labour market, particularly if direct transfers similar to those seen during the pandemic are provided to businesses.

Emerging Market Key Themes For 2023: Brace For Turbulence

At Fitch Solutions, we have identified six key themes that we think will characterise economic conditions across emerging markets (EMs) in 2023. You can read about these themes below, or watch our webinar here.

1. Most EMs Headed For Sharp Slowdown

2. Commodity Prices Have Peaked

3. Inflation Will Ease, But Lasting Problems In Emerging Europe

4. EM Rate Hiking Cycle Coming To An End

5. Industrial Policy Is Back

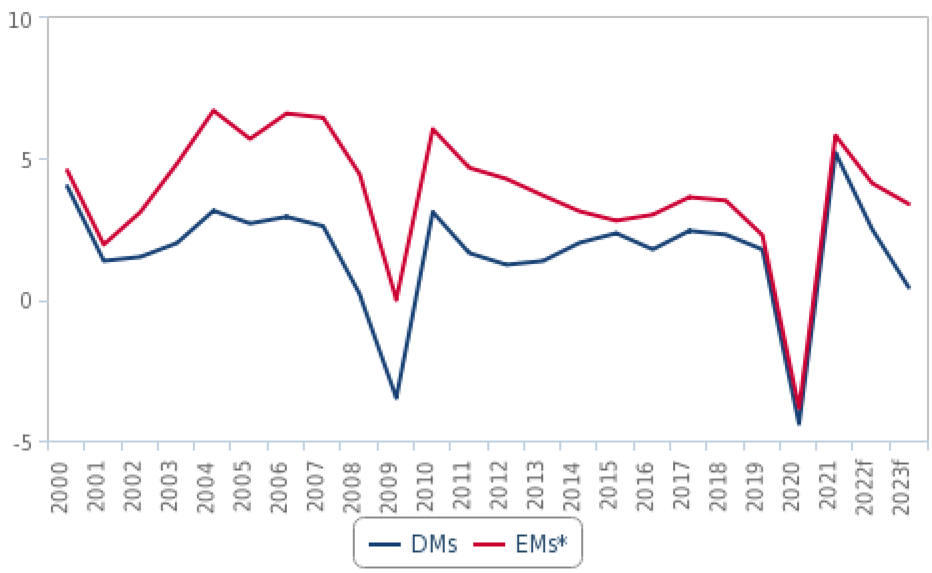
6. No Return To EM Golden Age

1. Most EMs Headed For Sharp Slowdown

At Fitch Solutions, we expect that the vast majority of EMs will experience slower growth in 2023 than they did in 2022. Excluding Mainland China, we expect that EM growth will slip from 4.1% in 2022 to 3.4% in 2023 *(see chart below).*

Deceleration Will Continue

Global – Real GDP, % (2000-2023)

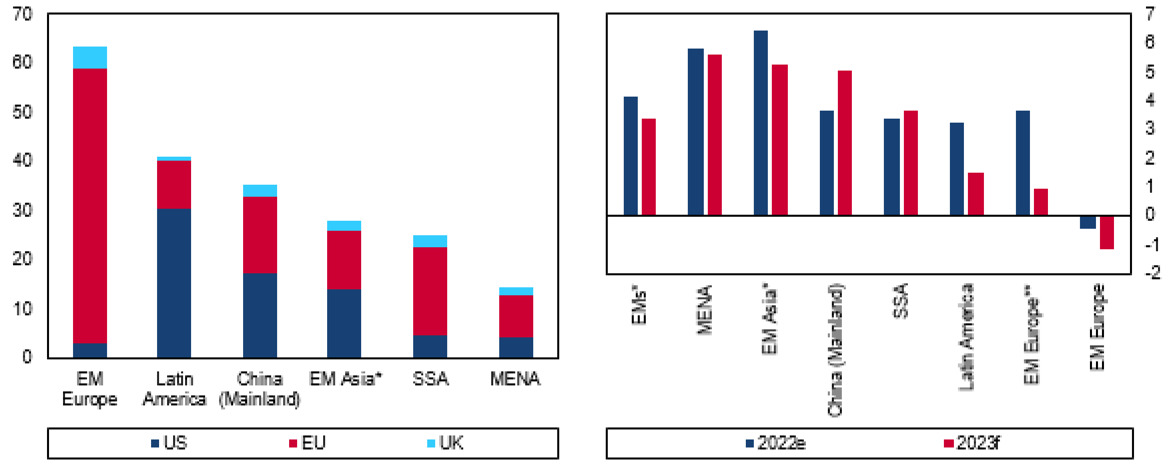


**Excludes Mainland China. f = forecast. Source: Fitch Solutions*

This deceleration will be driven by a variety of factors, including falling commodity prices *(see Theme 2)*, **inflationary pressures** *(see Theme 3)* **and increased trade barriers** *(see Theme 5)*. The key headwind for many EMs will be the sharper slowdown in growth in developed markets (DMs). The very poor performance of DMs will be driven by tighter fiscal and monetary policy as well as an energy price shock in Europe. We expect that growth in DMs will slip from 2.5% in 2022 to just 0.4% in 2023. This would be the fourth worst performance so far this century, with DMs only performing worse during the global financial crisis and the Covid-19 shock *(see chart above)*. Latin America and emerging Europe are more exposed than other EM regions *(see chart below, left)* and we think that they will perform worse than other EM regions *(see chart below, right)*.

Most Will Slow, Emerging Europe & Latin America Will Fare The Worst

EMs - Exports To DMs, % of total (LHC) & Real GDP Growth, % (RHC)



**EMs & Emerging Asia exclude Mainland China. **EM Europe excludes Russia and Ukraine. e/f = estimate/forecast. Source: Fitch Solutions*

China and Sub-Saharan Africa (SSA) will be the key exceptions, with both experiencing faster growth in 2023 than in 2022. In SSA, we expect a very small acceleration (from 3.4% in 2022 to 3.6% in 2023) as a result of faster growth in South Africa. In China, we think that the loosening of Covid-19 restrictions and policy support aimed at the property sector will boost activity. Growth in the country will remain weak by historical standards (just 5.0%) but will pick up from the very poor showing in 2022 (3.6%). Risks to our forecast for China are weighted to the downside.

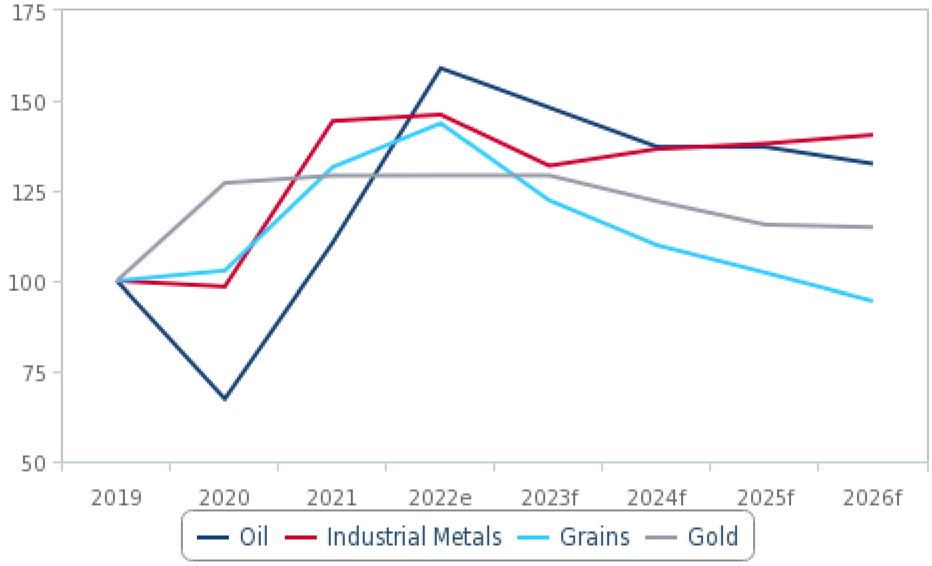
2. Commodity Prices Have Peaked

While the pace of the decline will vary, we expect that the price of almost all commodities will fall in 2023. While this will boost the terms of trade of manufacturing-heavy EMs in Asia and help reduce inflation *(See Theme 3)*, it will create headwinds for commodity exporters in the Middle East and North Africa (MENA), SSA and Latin America.

We are particularly bearish about food prices, which will continue to normalise following the shock caused by the Russian invasion of Ukraine. We expect that grain prices will average 14.9% lower in 2023 than they did in 2022, while industrial metal prices will fall by 6.7% and oil prices will dip by 6.9% *(see chart below)*.

Heading Down

Global – Commodity Price Indices, 100 = 2019 Average (2019-2026)



e/f = estimate/forecast. Source: Fitch Solutions

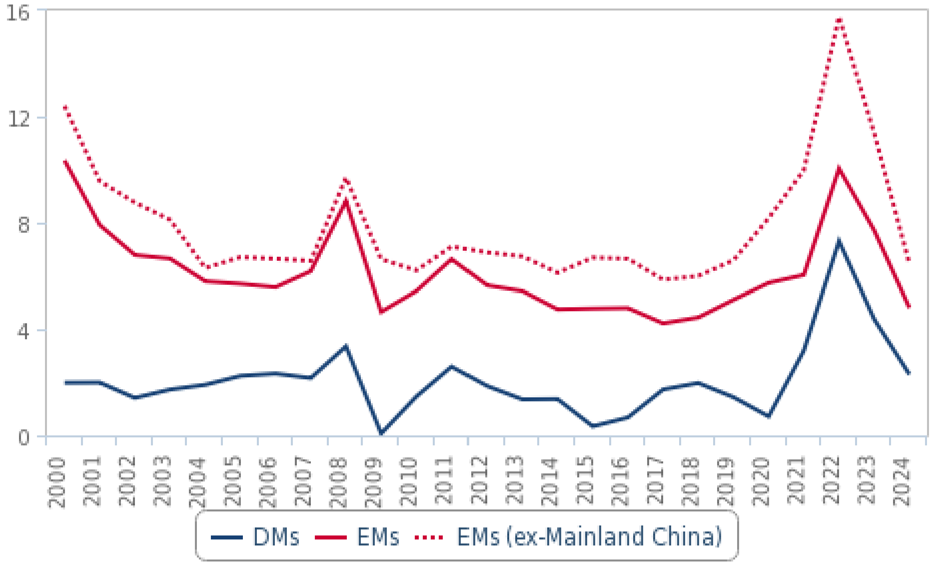
Slower global growth will weigh on demand for both energy and industrial metals in 2023. While we think that oil prices will continue to weaken over the coming years as demand growth fades, we are more optimistic about industrial metal prices. We expect that these will be supported by continued stimulus in China. There is also a risk that energy prices surprise to the upside in the event of additional supply side issues in energy-exporting economies.

3. Inflation Will Ease, But Lasting Problems In Emerging Europe

At Fitch Solutions, we expect that EM inflation will slow in 2023, with inflation easing from a GDP-weighted average of 10.0% in 2022 to a GDP-weighted average of 7.8% in 2023. If we exclude China - where price controls prevented an inflationary spike in 2021 and 2022 - then the deceleration will be even sharper, with average price growth slowing from 15.8% to 11.4% *(see chart below)*.

Inflationary Pressures Will Fade

Global – Annual Average Inflation, % (2000-2024)



Source: Fitch Solutions

Disinflation across EMs will be driven by four key factors: weaker demand *(see Theme 1),* lower commodity prices *(see Theme 2),* tighter monetary policy *(see Theme 4)* and a weaker US dollar. We expect that the US dollar will weaken in 2023, which will boost EM currencies and reduce imported inflation *(see chart below).*

Greenback Will Weaken

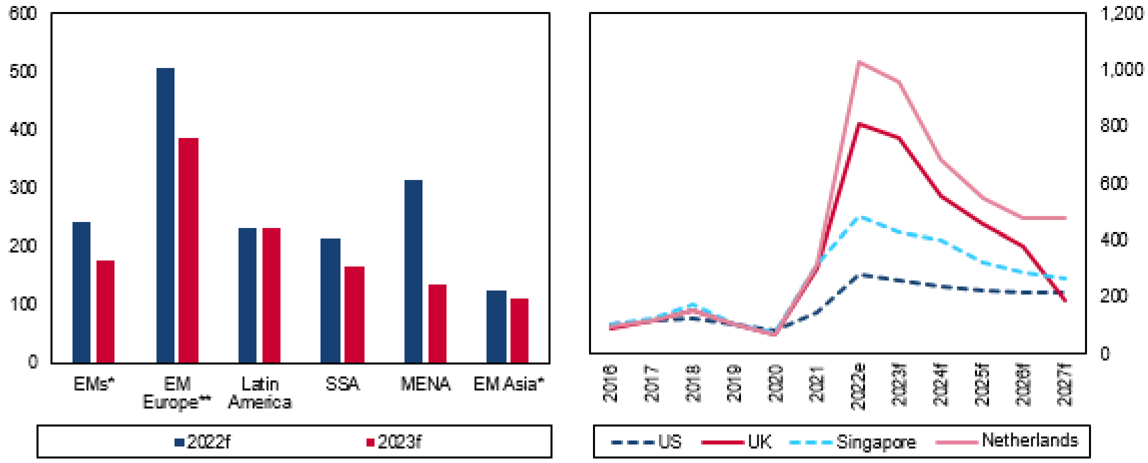
USD - DXY Index (2005-2023)

Source: Fitch Solutions

While inflation across most EMs will ease from the decade highs seen in 2022, price growth will remain elevated by recent standards. Inflation will be particularly sticky in emerging Europe, where we expect that it will average 10.6% (almost four times its pre-crisis rate) (*see chart below, left*). This is mostly because we expect that ongoing tensions with Russia will keep energy prices in Europe elevated for longer in than in other regions *(see chart below, right).* While we think that risks around an energy crisis in the winter of 2022-2023 have dissipated, the region will face a difficult situation in 2023.

Europe Faces Sharper, Longer-Lasting Shock

EMs - Annual Average Inflation (100 = 2015-2019 Average) (LHC) & Natural Gas Price Index (100 = 2019 Average) (RHC)



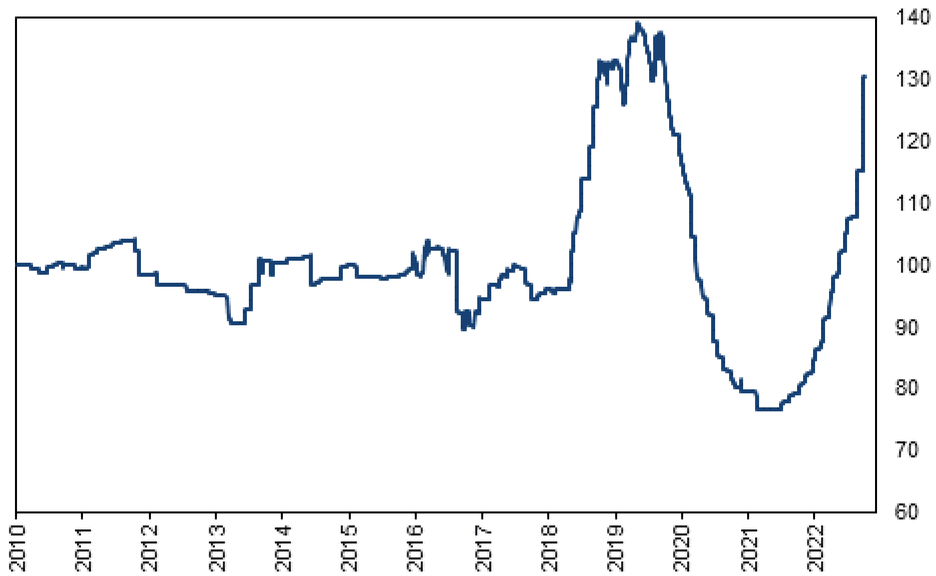
f = forecast. Source: Fitch Solutions

4. EM Rate Hiking Cycle Almost Over

With inflation set to ease, we expect that most EM central banks' interest rate hiking cycle will end in 2022 and that a few banks will begin to loosen policy. EM central banks loosened policy aggressively in 2020 in response to the Covid-19 crisis, but they shifted to a tightening policy in 2021. This tightening cycle accelerated in 2022 in response to interest rate hikes in the US and other DMs, which has taken EM rates almost back to their pre-crisis level *(see chart below)*.

EM Rates Almost Back To Pre-Crisis Peak

EM Interest Rate Index, 100 = 2010 (2010-2022)



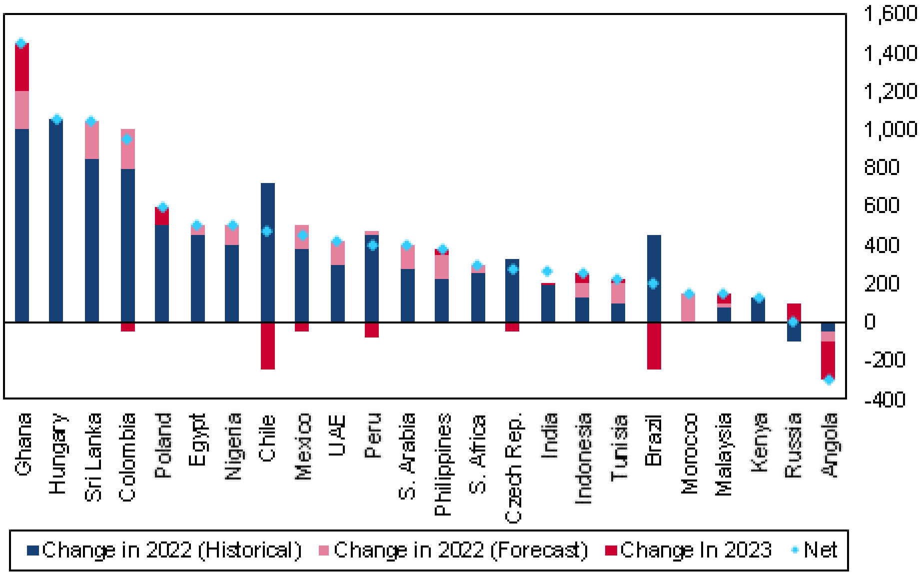
Source: Macrobond, Fitch Solutions

Over the coming months, however, we expect that the DM hiking cycle will end. The US Federal Reserve, for instance, will take its key rate to 4.50% by the end of 2022 but then leave it on hold in 2023, although there are upside risks to this forecast. At the same time, we expect another 100 basis points (bps) of hikes by the European Central Bank.

Ghana and Poland are the only EMs where we expect that policy rates will continue to rise in 2023. Elsewhere, rates will remain on hold. In Latin America - where policymakers started their hiking cycles earlier than elsewhere in the EM world - we expect that central banks will begin to cut their key policy rates in 2023. In Chile and Brazil, we expect 250bps of rate cuts in 2023. Outside of Latin America, we also expect some policy loosening in the Czech Republic and Angola *(see chart below).*

Hiking Cycle Mostly Over

EMs – Change In Policy Rate Since January 1 2022, bps



Source: Fitch Solutions

5. Industrial Policy Is Back

At Fitch Solutions, we expect that DM policymakers' concerns about dependence on imports will result in an increased use of industrial policy to shape economic outcomes in 2023. DM governments will increase the use of taxes, tariffs and subsidies in order to reduce their dependence on 'unfriendly' economies and to shift production of crucial economic processes back home. We expect that these efforts will be concentrated in the energy and high-tech sectors.

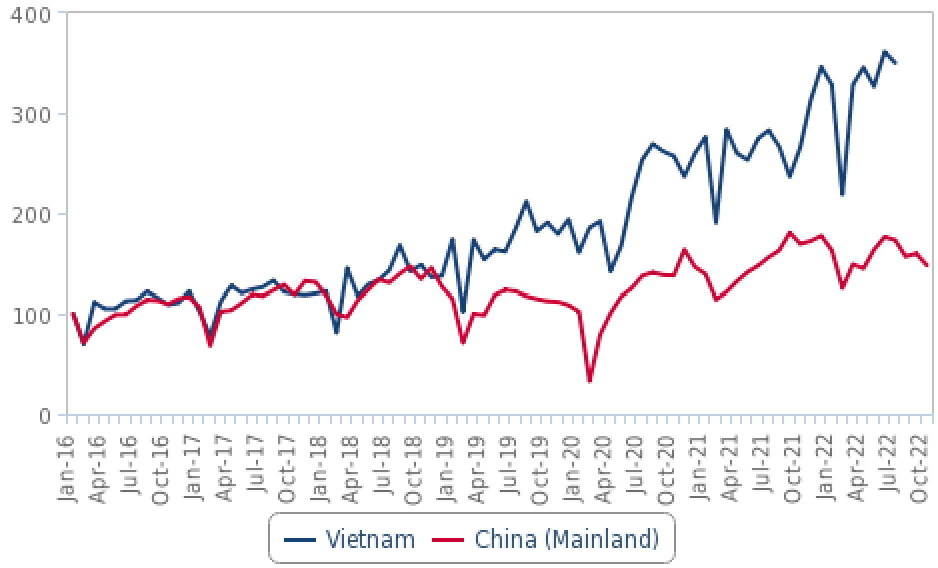
The largest energy transition will be in Europe, where we expect that the EU will work to end its dependence on Russian energy. Germany, for example, has invested heavily in floating LNG platforms to allow the country to import gas from the US, the Gulf Cooperation Council (GCC) and elsewhere. When it comes to high-tech sectors, the key actor will be the US. Washington is working to reduce US firms' dependence on Chinese input products and to prevent Chinese firms from accessing US technology.

This increased effort to shift economic outcomes to meet political aims will be painful for the economies targeted by DM policy. We expect that Russia's economic contraction will deepen to 5.0% in 2023, while the economy of China will grow by just 5.0%.

Elsewhere, the effect will be mixed. Alternate suppliers will benefit as DMs seek new sources of energy and manufactures goods. For example, increased trade tensions between the US and China during the Trump administration proved a boon for Vietnam, which replaced China as a source of many goods imported by the US *(see chart below).*

A Boon For Vietnam

EMs – Index Of Exports To US, January 2016 = 100



Source: Macrobond, Fitch Solutions

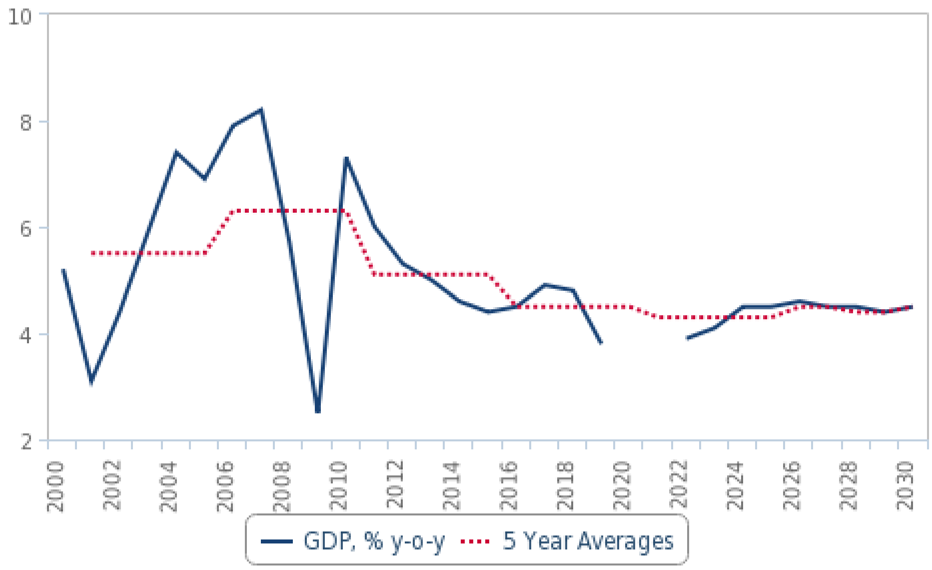
When it comes to energy, potential EM winners include Azerbaijan, the GCC economies and African hydrocarbon exporters like Nigeria, Angola and Mozambique. All stand to benefit from increased European demand for energy. Other EMs, however, will lose out from this transition. Increased European demand for ship-born LNG will push up prices for EMs like Turkey and India that rely on this market to meet their own energy demands.

6. No Return To EM Golden Age

While several one-off shocks will depress growth in 2023, we think that 2023 should also be seen in the context of an inexorable, long-term slowing of EM growth. EM growth will pick up a touch in 2024 as the economic performance of key DMs improves. However, growth will remain slower than the relatively slow performance recorded between 2015 and 2019, and far below the rates seen in the 2000s and 2010s *(see chart below).*

EM World Will Slow

EMs - Real GDP Growth, y-o-y (2000-2030)

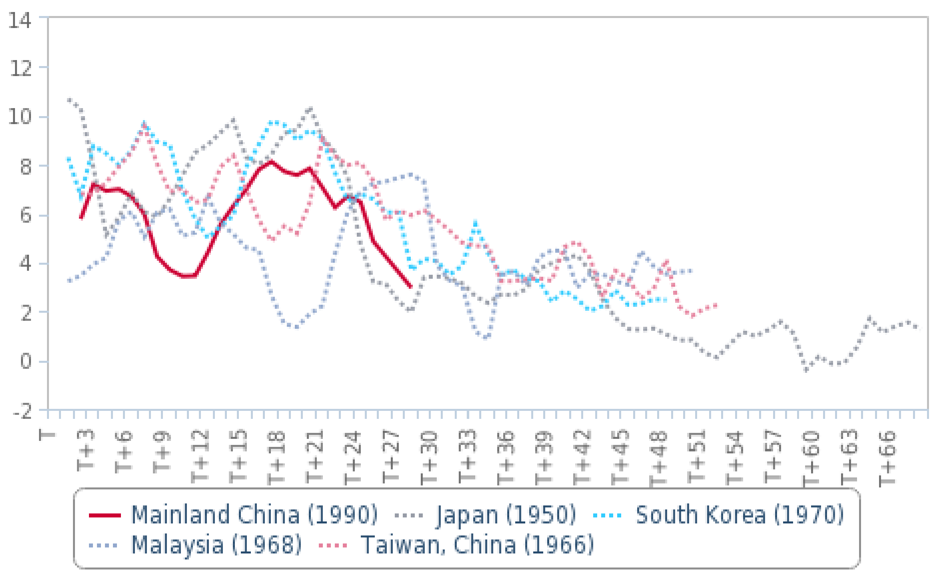


Note: 2020 and 2021 omitted for scale. Source: Fitch Solutions

Several factors will drive the continued easing of EM growth. One is the gradual slowing of economic growth in China. Like other EMs before it, the world's largest EM is set for a continued slowing of economic growth as its income levels rise and it completes the fastest pace of its industrialisation. Per capita GDP growth in China already slowed from around 8.0% in the early 2000s to just over 3.0% before the Covid-19 crisis. Based on the experience of Taiwan, China and of Japan - two economies that have followed an investment-heavy economic development path in recent decades - per capita growth in China will probably converge towards 1.0-2.0% over the coming decade *(see chart below).*

Best Years Behind Them?

EMs – Real GDP per Capita, % y-o-y, five-year rolling average



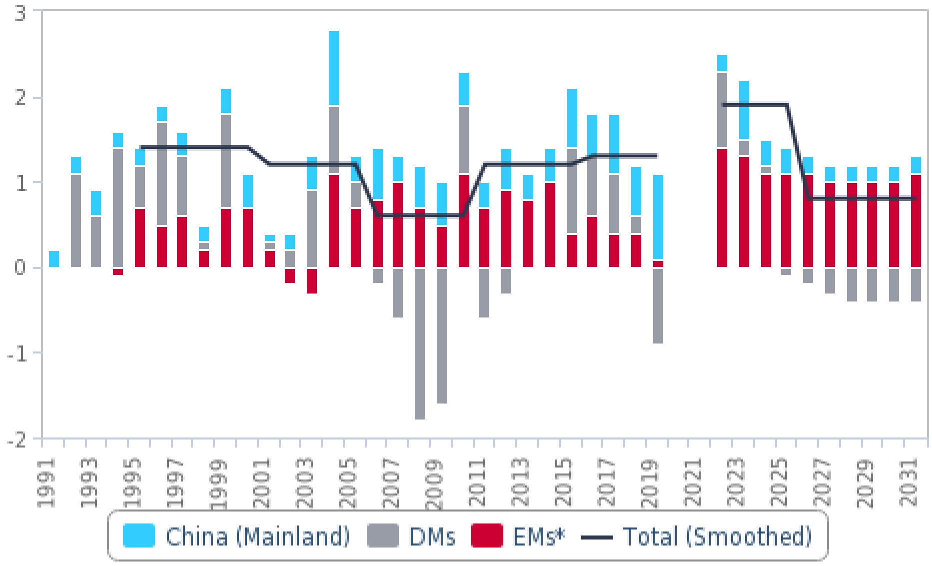
Note: May include territories, special administrative region, provinces and autonomous regions. Series begin when GDP per capita reaches approximately USD3,000; series end in 2018. Source: Angus Maddison , Fitch Solutions

China probably faces larger headwinds than its predecessors did. While Tokyo and Taipei have friendly ties with Washington, Beijing faces increasingly difficult economic and trade policies from the US, which will dent its export-heavy economic model.

Slower growth in China will spill over to other EMs through a variety of channels, notably as a headwind to further commodity demand. Given slower growth in China and an accelerating shift towards alternative energy sources, we expect that growth in oil demand will slow sharply over the coming years *(see chart below)*.

Oil Transition Will Be Painful For Many EMs

Global - Change In Oil Consumption, mn b/d (1991-2031)

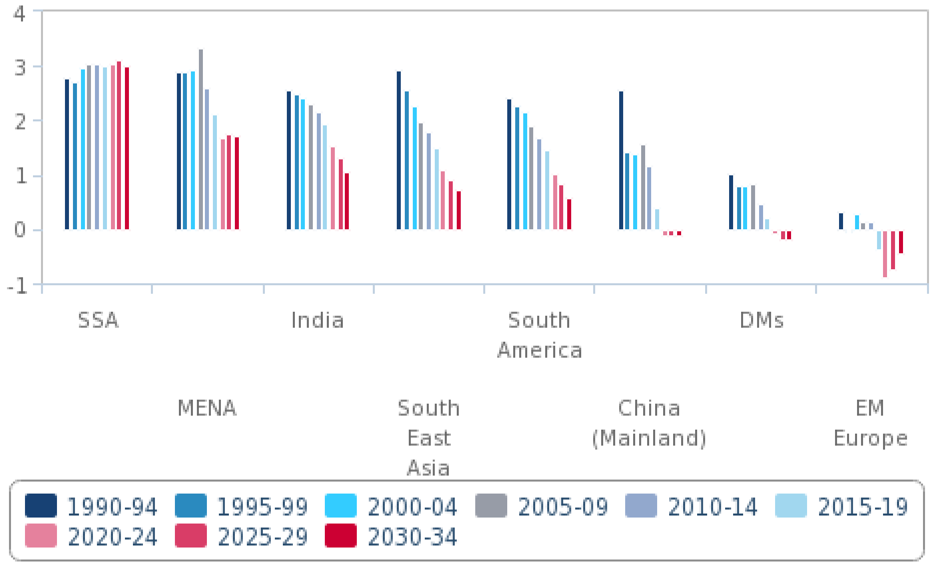


*Note: *Excludes Mainland China. 2020 and 2021 omitted for scale. Source: Fitch Solutions*

Demographic headwinds will also weigh on EM growth. Whereas labour forces in almost all EMs rose rapidly in the 1990s and 2000s, the pace of population growth slowed everywhere but in SSA. The UN estimates that the working-age populations of China and emerging Europe will be falling by 2025. The situation in emerging Europe, where the working-age population began to decline in the late 2010s, is particularly severe *(see chart below)*.

From Tailwind To Headwind

Global - Working-Age Population, % y-o-y



Note: Figures cover population aged 20-70 years. Source: UN Population Report

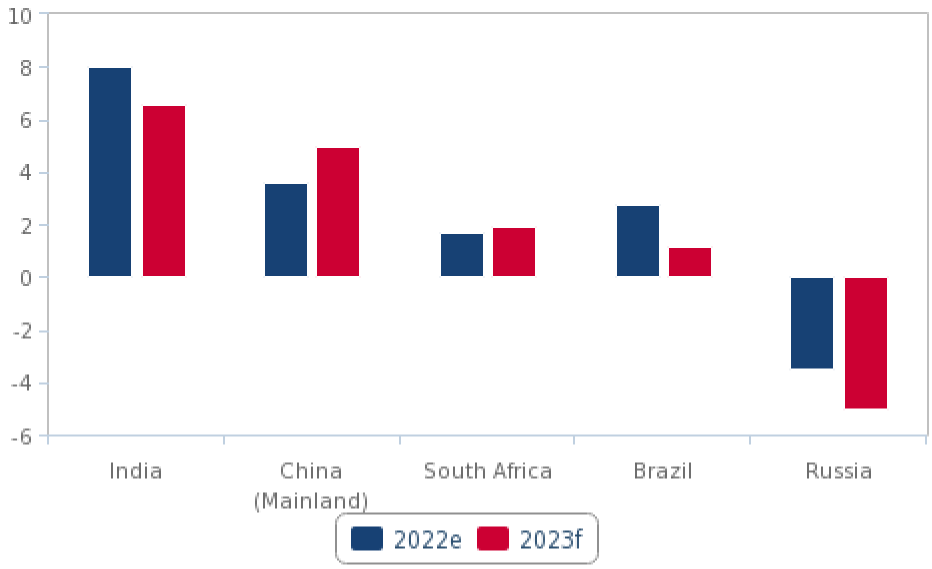
BRICS Outlook

Brazil: Lula Set For Difficult Third Term

Brazil avoided a political crisis after the outgoing president Jair Bolsonaro conceded defeat after the October 2022 election, but Latin America's largest economy still faces a difficult 2023. We expect that President Luiz Inácio 'Lula' da Silva will not be able to prevent growth in the country from slowing from 2.7% in 2022 to just 1.1% in 2023. This would make Brazil the worst-performing BRICS economy other than Russia *(see chart below)*.

Brazil, Russia Falling Behind

BRICS – Real GDP, %



Note: Indian forecasts reflect fiscal years; 2022 = 2022/23. e/f = estimate/forecast. Source: Fitch Solutions

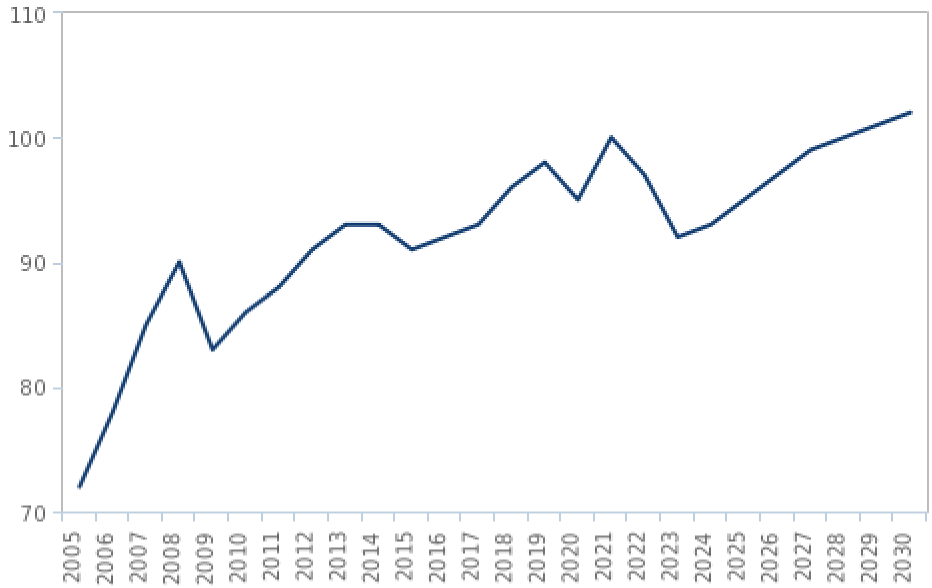
The economy will suffer as a result of lower commodity prices, slower growth in the US and China, and the expiry of stimulus measures. We expect a sharply divided congress and an election campaign fought as a moderate to prevent a significant leftward shift by Lula, though he will probably halt the privitisation drive that accelerated under Bolsonaro.

Russia: Contraction Will Deepen

At Fitch Solutions, we expect that the contraction of Russia's economy will worsen from a fall of 3.5% in 2022 to a decline of 5.0% in 2023. We think that the war in Ukraine will continue over the duration of 2023 and that a combination of tighter Western sanctions, lower oil prices and the depletion of Russia's store of stockpiled input goods will all weigh on activity. While we expect that the economy will grow by 1.5% in 2024, it will be anaemic *(see chart below).*

A Long Way Back

Russia - Real GDP Index, 100 = 2021 (2005-2030)



Source: Fitch Solutions

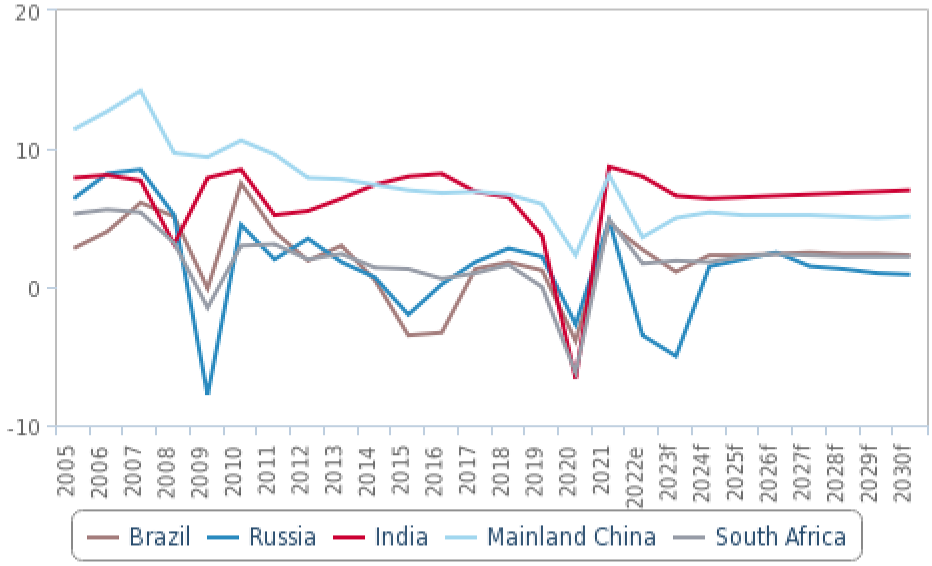
We think that Russia's lasting disconnection from Western markets will limit the availability of goods and technology, which means that the economy will not recover to its pre-war level of output until 2028 *(see chart above).*

India: Recovery Will Lose Steam But Still Outperform Peers

We expect that economic growth in India will slow from 8.0% in 2022/23 to 6.6% in 2023/24 as a result of weak global demand, elevated inflation and policy tightening. A series of state elections in 2023 will encourage populist policymaking and keep reform momentum slow. We also expect that the Reserve Bank of India will continue to tighten monetary policy in an effort to counter elevated inflation.

India Takes The Lead

BRICS - Real GDP Growth, % (2005-2030)



Source: Fitch Solutions

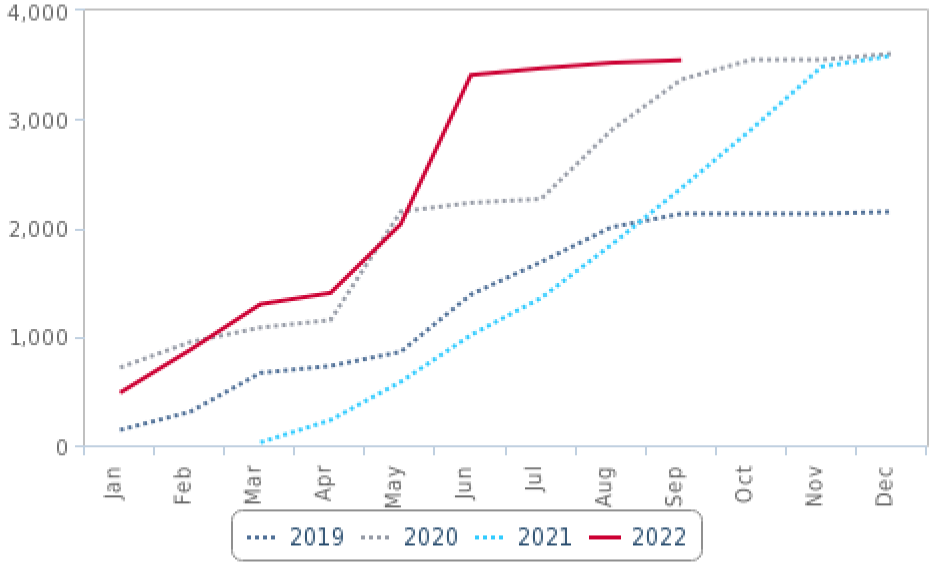
Despite this deceleration, trend growth in India is now significantly faster than in the other BRICS economies. The country is the last of its BRICS peers to have a rapidly growing population and also benefits from significant public and private investment. We expect that India will outperform key peers over the duration of our forecast period *(see chart above).*

Mainland China: Stimulus Will Boost Growth, But No Return To Pre-Crisis Pace

We expect that growth in China will accelerate from 3.6% in 2021 to 5.0% in 2023 as a result of significant government stimulus. While external demand will weaken, we think that the central government will succeed in boosting headline growth by easing some Covid-19 restrictions, providing support to the struggling real estate sector and increasing infrastructure spending. The issuance of local bonds - which fund infrastructure projects - reached the 2021 total in September 2022 (*see chart below*).

Bond Issuance Will Boost Infrastructure Spending

China (Mainland) - Year-To-Date Issuance Of Special Local Government Bonds, CNYbn



Source: Macrobond, Fitch Solutions

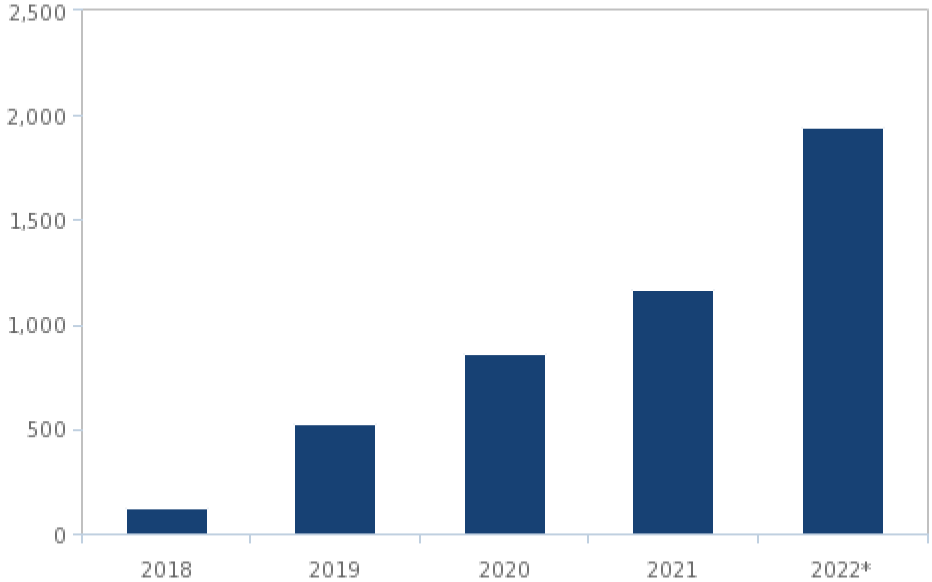
This short-term boost will not, however, address the significant structural headwinds that China is facing. We expect that growth, which averaged 6.7% between 2015 and 2019, will slip to just 5.2% between 2023 and 2027, and we see downside risks to this view.

South Africa: Slight Acceleration In 2023

At Fitch Solutions, we expect that real GDP growth in South Africa will pick up from 1.7% in 2022 to 1.9% in 2023. Elevated inflation and weak consumer sentiment will probably keep private consumption weak in 2023. However, we expect that a long-awaited telecom spectrum auction and further emergency measures to support the state-owned power firm will boost gross fixed capital formation. This will help to stabilise the power situation, which has been under significant strain. South Africa's power grid experienced almost twice as many hours of outages in the first half of 2022 than it did in all of 2021 *(see chart below)*.

Lights Going Out

South Africa – Hours of Load Shedding (2018-2022)



*Figures cover January-June. Source: CSIR, Fitch Solutions

Even so, we expect that growth will remain weak by EM standards. A lack of major reforms and large investments to restructure large parts of the economy means that the country is not to likely boost output.

Regional Key Themes

Latin America Key Themes

LATIN AMERICA KEY THEMES FOR 2023

Theme	View
Growth In Latin America Will Slow Sharply, Underperforming Other Emerging Market (EM) Regions	Economic headwinds will cause growth to ease significantly in 2023, bringing Latin America's growth rate below every other EM region, except emerging Europe.
Latin America's Central Banks To Lead World Into Rate Cutting Cycle	As inflationary pressures cool in the year ahead, the the region's central banks will start cutting interest rates in order to prevent a more pronounced economic slowdown.
Leftist Leaders Will Face Growing Policy Constraints	Despite holding power in most of the region's major markets, fiscal constraints and pressure from opposition forces will limit leftist leaders' ability to shift policy in a market-unfriendly direction.
Political Risks To Continue Driving Relative Currency Underperformance	Concerns regarding structural changes such as pensions reforms, tax hikes and constitutional rewrites will continue to drive exchange rate volatility and weakness across the region.
Venezuela Coming In From The Cold But Unlikely To See An Economic Boom	Increasing acceptance of Maduro's government by regional left-leaning leaders will lead to improving diplomatic ties between Venezuela and some of its neighbors, however, US sanctions will continue to substantially hamper Venezuelan growth.

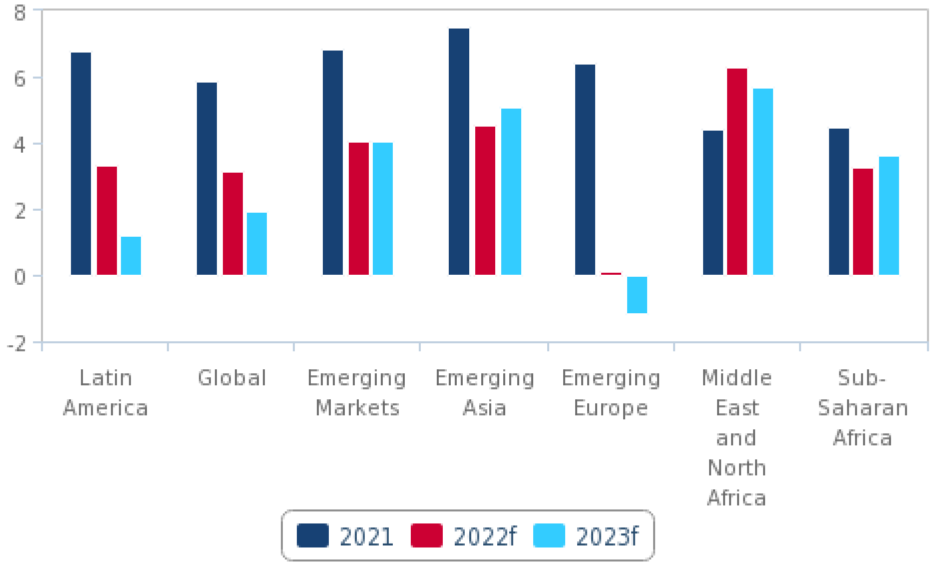
Source: Fitch Solutions

Theme 1: Growth In Latin America Will Slow Sharply, Underperforming Other EM Regions

We expect real GDP growth to slow significantly in Latin America in 2023, cooling from an estimated 3.4% in 2022 to 1.2% in 2023. This will make the region one of the weakest performers among EMs, well behind overall EM growth of 4.0% and slower than every other EM region with the exception of emerging Europe (which will be dragged down by Russia and Ukraine).

Latin American Growth To Underperform Its Peers In 2023

Global - Real GDP Growth By Region, % (2021-2023)

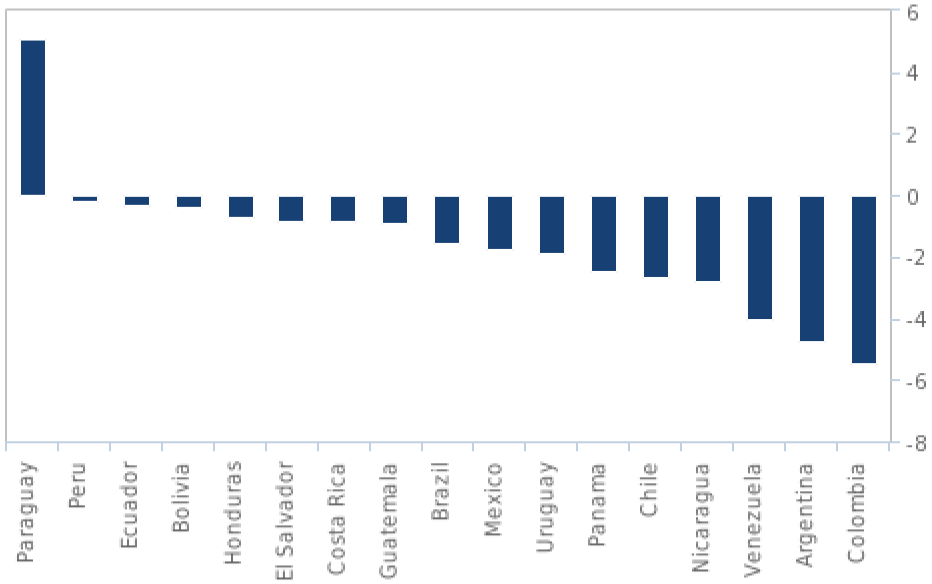


Note: May include territories, special administrative regions, provinces and autonomous regions. f = forecast. Source: Fitch Solutions

Growth will be held back by extremely high interest rates, still elevated inflation and softer external demand, particularly from the US. Concerns about policy direction will also hold back investment in many markets, most notably Brazil, Chile and Colombia. We expect that every market in Latin America will see slower growth in 2023 than in 2022 (*see chart below*), with the exception of Paraguay, where headline growth will benefit from a normalisation of weather conditions after drought devastated the 2022 harvest.

Growth To Slow In Almost Every Market

Latin America - Change In Real GDP Growth, pp (2022 to 2023)

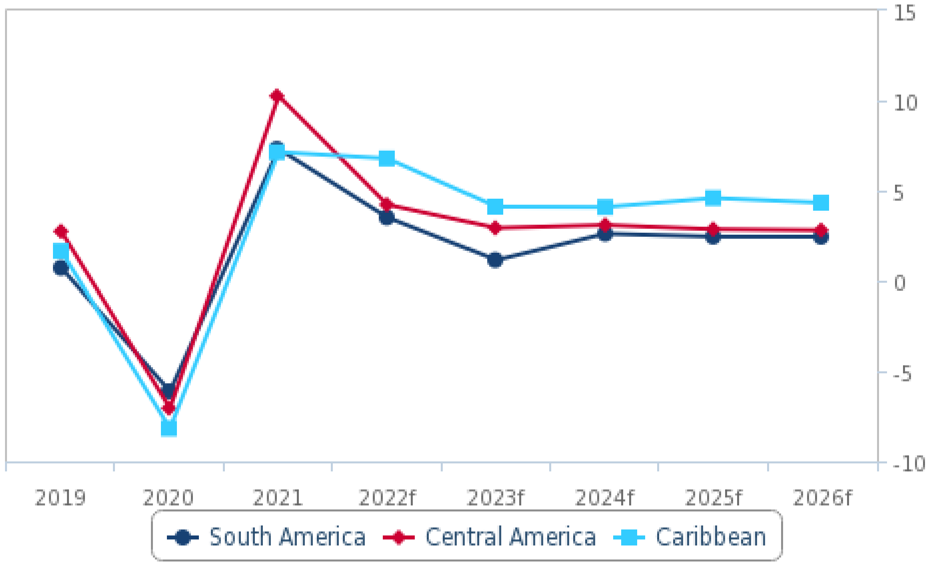


Source: Fitch Solutions

We expect Central America and the Caribbean to be particularly exposed to the US slowdown as they are reliant on the US for export demand, remittances and tourism. While these regions will grow faster than South America - which we forecast to see growth of only 1.2% in 2023 - both will undergo notable slowdowns compared with 2021 and 2022 (*see chart below*), and Central America's 2.9% growth will underperform the 4.1% average over 2010-2019.

Growth To Slow Across All Three Sub-Regions

Latin America & Caribbean - Real GDP Growth By Sub-Region, % y-o-y (2019-2026)



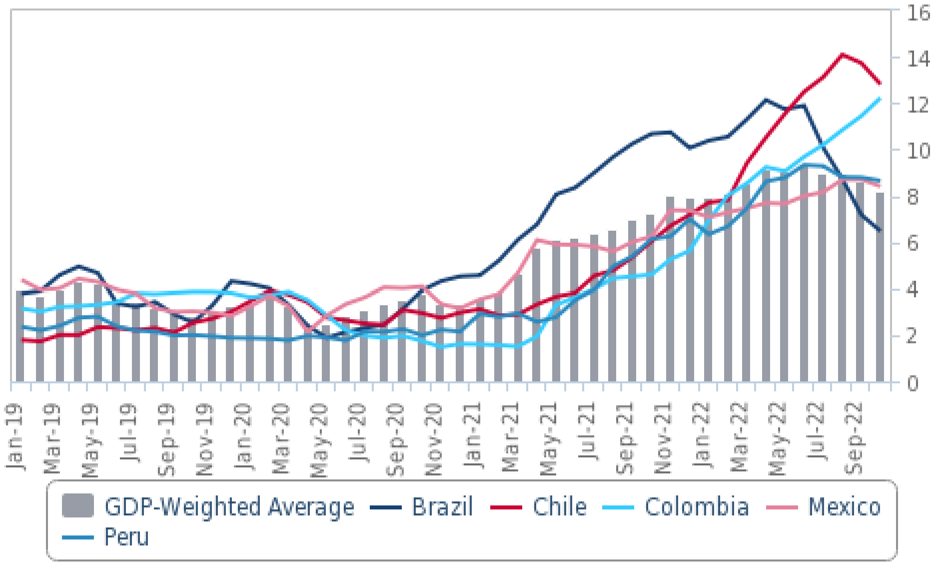
f = forecast. Source: Fitch Solutions

Theme 2: Latin America's Central Banks To Lead The World Into Rate Cutting Cycle

We expect that inflation will cool in Latin America in 2023, allowing the region's central banks - which embarked on some of the earliest and most aggressive rate hiking cycles globally beginning in early 2021 - to begin to make interest rate cuts. We believe that inflation has peaked in the region, with a GDP-weighted average of price growth in the largest markets already showing a deceleration (*see chart below*).

Inflationary Pressures Have Begun To Moderate

Latin America (Selected) – Monthly Consumer Price Inflation, % y-o-y

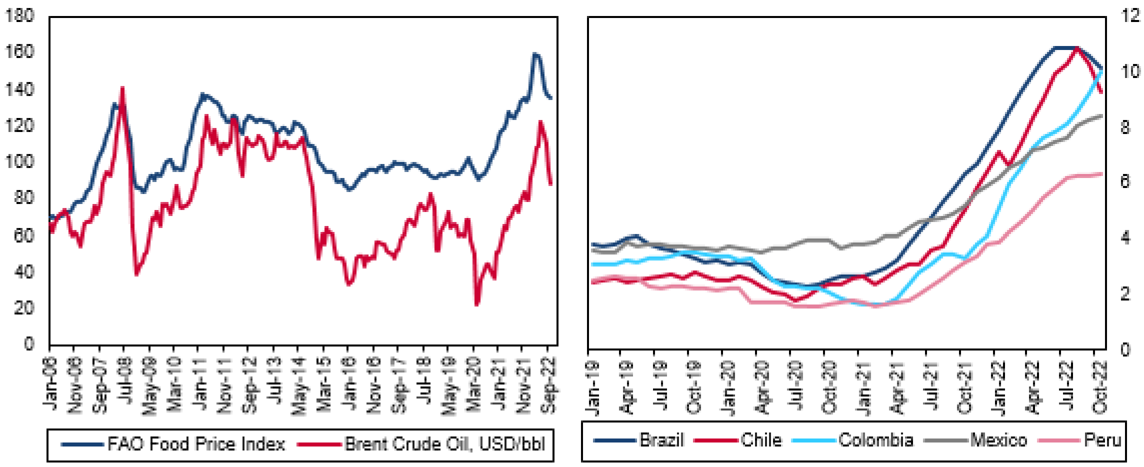


Source: Macrobond, Fitch Solutions

This trend will likely continue, based on various indicators such as moderating global food and fuel prices (*see chart below*), improving supply chains and inflation expectations, and government intervention to contain prices.

Lower Food And Fuel Prices, But Core Inflation Remains High

Global – UN FAO Food Price Index & Brent Crude Oil Price (LHC); Core Inflation, % y-o-y (RHC)



Source: Macrobond, Fitch Solutions

While still elevated core inflation (*see chart above*) suggests that this process will be gradual, with prices remaining above central bank targets throughout 2023, the region's weak growth outlook and the magnitude of rate hikes thus far suggest that the door will be open to rate cuts in the region's largest markets. Chile is likely to begin cutting first as inflation in the market has begun to ease from a peak of 14.1% y-o-y in August 2022 to 12.8% in October 2022 and its economy has begun to fall into contraction.

Aggressive Hiking Cycle Nearing Its End

Latin America (Selected) – Benchmark Interest Rate, %

Source: Macrobond, Fitch Solutions

However, we expect the pace of easing to be slow, with the regional GDP-weighted average interest rate only falling from 11.7% in 2022 to 10.1% in 2023. First, most other global central banks are likely to remain hawkish, with the US Federal Reserve unlikely to cut rates in 2023, raising the risk of capital outflows and currency weakness if Latin America's central banks cut too quickly. Second, inflation could prove stickier than we expect, for example if the pickup in Mainland Chinese growth leads to higher commodity prices. Third, idiosyncratic political risk - such as concerns about the impact of fiscal policy on inflation in Brazil, and politics-driven currency volatility in Chile and Colombia - could complicate the path for policymakers.

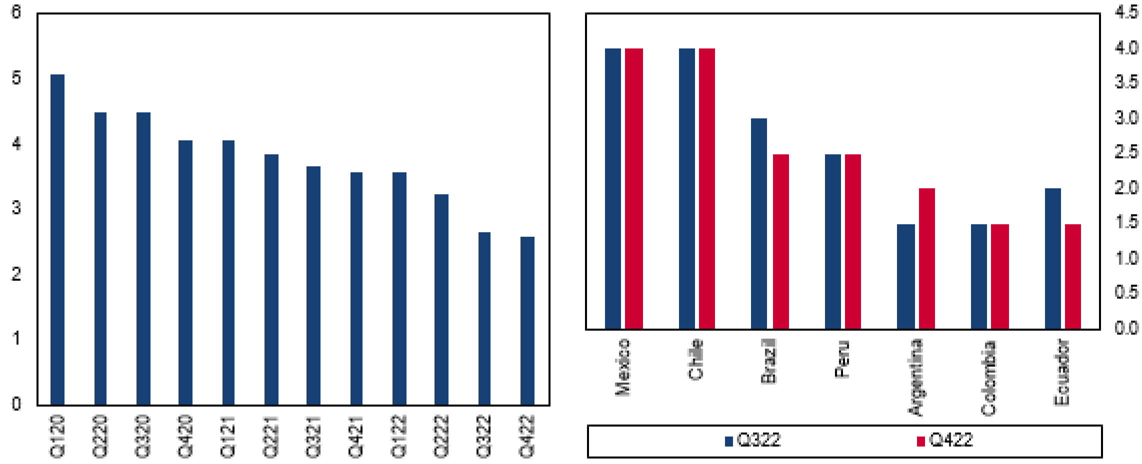
Theme 3: Leftist Leaders Will Face Growing Policy Constraints

While leftist leaders will be in power in almost all of Latin America's major economies at the beginning of 2023, we expect them to face legislative resistance and fiscal constraints in the coming year, limiting their ability to shift policy in a market-unfriendly direction. In line with our view in our Key Themes for 2022, strong anti-incumbent sentiment has brought a wave of left-leaning leaders to power, with Gustavo Petro in Colombia and Luiz Inácio Lula da Silva (Lula) in Brazil being the most recent.

However, these leaders will be constrained by highly polarised electorates and a lack of legislative majorities, forcing them to moderate proposed reforms and negotiate with centrist and right-wing parties to pass legislation. This process was on display with Colombia's tax reform as the total amount to be raised was steadily reduced due to talks with centrist parties and business leaders. While we do not expect these leaders to pursue business-friendly reforms - reflected in the region's score in our Reform Tracker falling to 2.6 out of 10 in Q422 (*see chart below*), an all-time low - we also do not expect that they will be able to fully enact their agendas.

Latin America's Reform Score Continues To Decline

Latin America (Selected) - Average Regional Reform Tracker Score (LHC) & Score By Country (RHC)

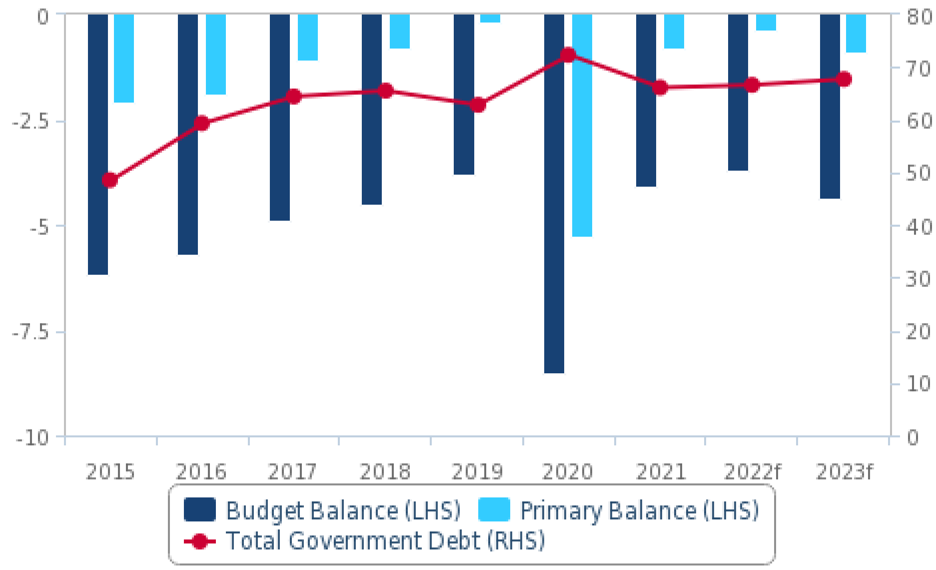


Note: Scores out of 10; higher score = stronger reform progress. Source: Fitch Solutions

In this vein, while we forecast an expansion of the average budget deficit across the region from 3.7% of GDP in 2022 to 4.4% in 2023, this will be predominantly driven by the rise in Brazil's fiscal deficit from 4.2% to 6.1%. Moreover, the region's overall average deficit will be narrower than the 5.0% averaged from 2015-2019 before the pandemic. We expect that in addition to resistance within legislatures, Latin American governments will face increasing financing constraints given elevated global interest rates and sharply higher debt burdens following the Covid-19 pandemic, preventing the implementation of transformative spending plans. For example, yields on Brazilian bonds rose sharply after Lula's election, underlining our view that market pressure will limit spending increases.

Fiscal Balance To Deteriorate In 2023, But Not Massively

Latin America - Regional Budget Balance & Government Debt, % of GDP (2015-2023)



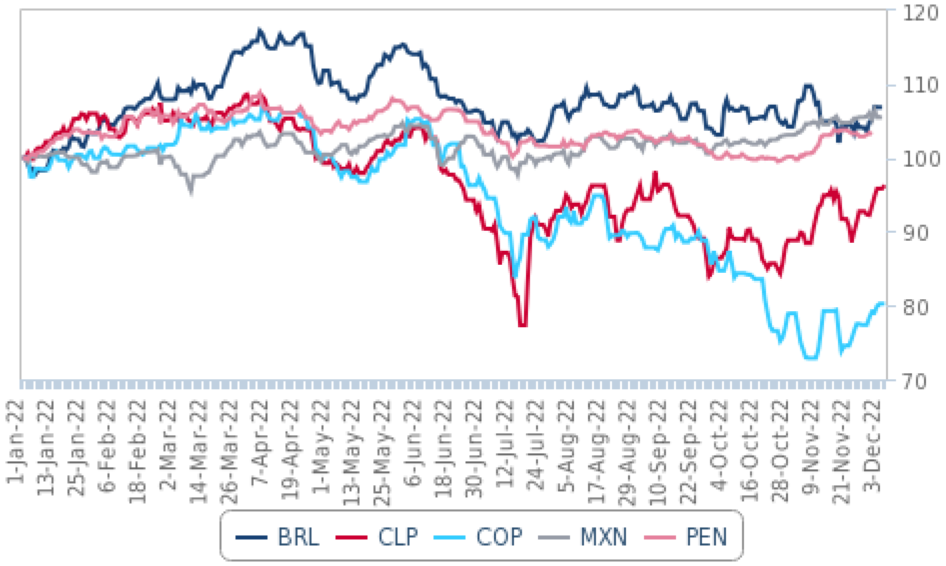
Note: Weighted by nominal GDP. f = forecast. Source: Fitch Solutions

Theme 4: Political Risks To Continue Driving Relative Currency Underperformance

We expect that, as seen in the second half of 2022, idiosyncratic political risks will drive a risk premium on regional currencies in 2023, which could result in relative underperformance. We expect the region's basket of currencies to depreciate modestly as a whole in 2023 as moderating commodity prices and narrowing real interest rate differentials weigh on the currencies despite a slightly weaker US dollar.

Political Risks Driving COP, CLP Underperformance In The Year To Date

Exchange Rate (daily, rebased to January 1 2022 = 100)



Source: Macrobond, Fitch Solutions

However, we expect political risk to remain an outsized driver of currency returns, particularly in Brazil (where Lula is attempting to pass notable increases in fiscal spending), Colombia (where Petro is seeking a number of reforms to pensions and agrarian land, among other areas) and Chile (where the country is likely to pursue a new constitutional reform process). Thus far in 2022, the Colombian and Chilean pesos have seen notable depreciation (*see chart above*), driven largely by concerns about the political outlook, with both hitting all-time lows earlier in 2022, while the Brazilian *real* has been volatile since Lula's election victory in October.

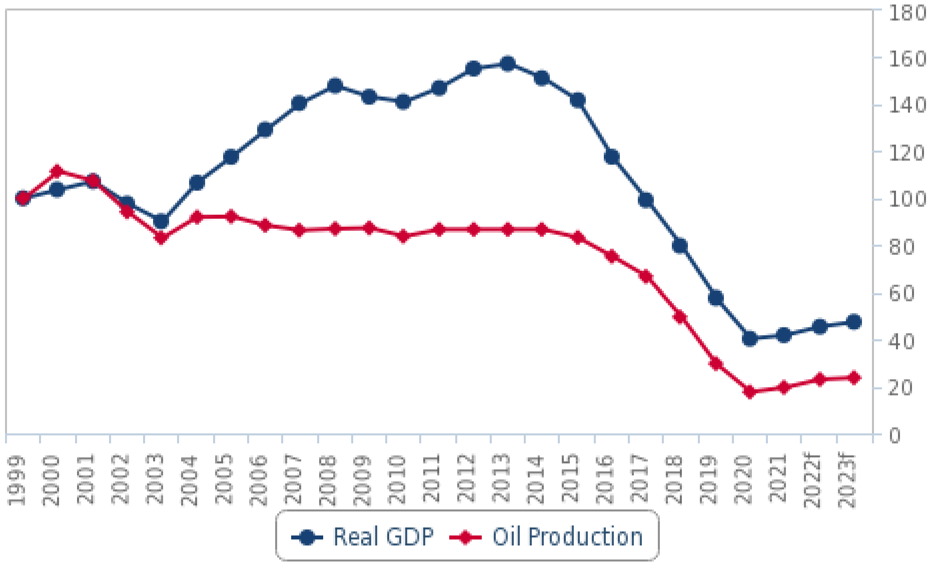
By contrast, the Mexican peso and Peruvian sol are likely to continue holding up well - despite ongoing attempts to impeach President Pedro Castillo in Peru - given greater investor confidence in the stability of their economic policies, among other factors. Finally, we expect the Argentine peso to continue to weaken, falling from ARS170.0/USD at the end of 2022 to ARS320.0/USD at the end of 2023 amid extremely high inflation.

Theme 5: Venezuela Coming In From The Cold But Unlikely To See An Economic Boom

We expect that governments throughout the western hemisphere will take an increasingly accommodative stance on Venezuela's current government, led by President Nicolás Maduro, in 2023. Over recent years many of these countries have participated in a broad front aimed at pressuring Maduro to leave power via sanctions and switching their recognition to opposition leader Juan Guaidó. However, this front has collapsed as Maduro has tightened his hold on power within the country and as left-leaning leaders, ideologically closer towards Maduro, have come to office. Colombia has resumed diplomatic relations with Venezuela, and the US eased sanctions on Venezuela's oil sector after the Maduro government and opposition restarted negotiations in Mexico City.

Looser Sanctions Needed For A Sustained Increase In Oil Production, GDP Growth

Venezuela - Total Oil Production & Real GDP, 1999 = 100 (1999-2023)



Note: Hugo Chavez took power in 1999. f = Fitch Solutions forecast. Source: EIA, OPEC, UN, Fitch Solutions

We expect that this process of 'coming in from the cold' will continue through the coming months, with Lula likely to recognise Maduro when he takes office in January 2023 and the US likely to continue loosening sanctions as talks between the government and the opposition progress. However, we do not expect that reduced sanctions will lead to an immediate rebound in growth in 2023. We forecast growth in Venezuela to slow from 8.6% in 2022 to 4.5% in 2023 as inflation increases and the re-opening of the oil sector takes time to pay dividends. The sector's infrastructure is in dire shape, confidence in policy under Maduro's United Socialist Party of Venezuela is low and US sanctions are likely to remain partially in place throughout 2023, among other structural headwinds to growth. While the re-entry of foreign firms into the oil sector will benefit production in the long term, this process is likely to require billions of dollars of investment and take several years to play out.

Europe Key Themes

We at Fitch Solutions expect that European economies will continue feeling the effects of the Russia-Ukraine war in 2023, and the energy crisis provoked by this will continue to leave its mark. Economic recession is forecast for most countries in the EU, and this could weaken unity in the region on matters such as fiscal policy coordination, energy policy and support for Russian sanctions. The continuation of the war will also reorient geopolitical ties at the outer edges of the region, with countries in the Commonwealth of Independent States looking for new strategic partners for security and economic support.

EUROPE KEY THEMES FOR 2023

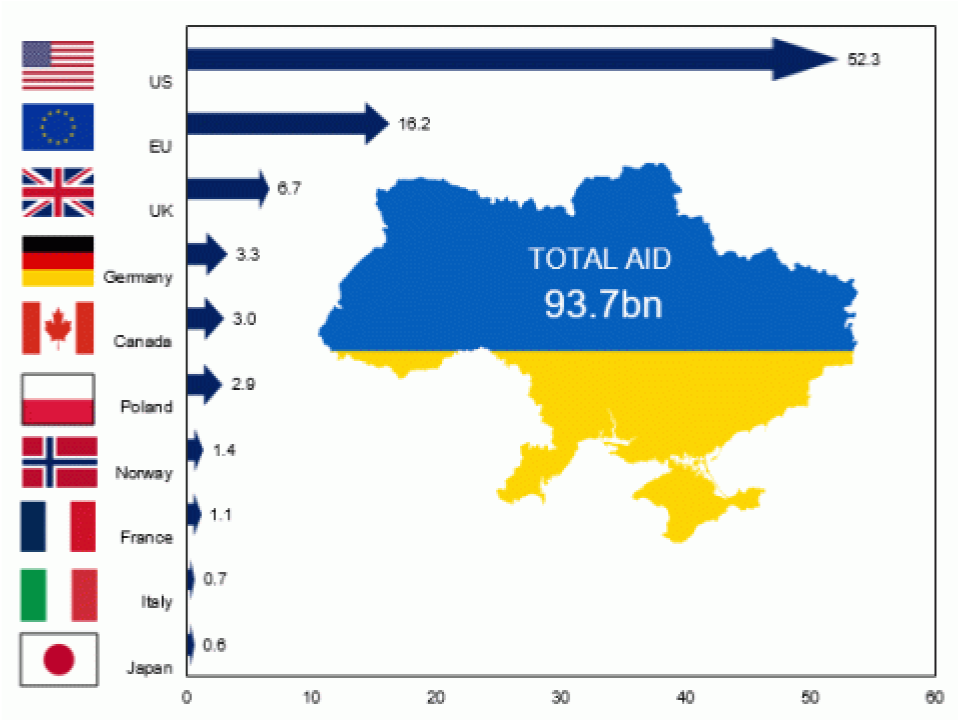
Theme	View
Russia-Ukraine War Will Persist, But Neither Side Will Achieve Their Objectives Fully	Even though resource constraints will intensify on both sides, we do not expect commitment to the conflict to weaken on either side.
Europe Will Fall Into A Recession Which Will Be Followed By An Uninspiring Rebound	We believe that the energy crisis caused by the Russia-Ukraine conflict could worsen in 2023, thereby exacerbating growth weakness and weighing on hopes of a resilient recovery.
Fiscal Policy In Europe Will Diverge From Monetary Policy	Fiscal and monetary policy divergence will likely prove costly as governments are faced with expensive debt burdens to service beyond 2023.
EU Unity To Come Under Pressure	We see cracks emerging both with regard to the commitment of member states to supporting Ukraine and sanctions against Russia, as well as in terms of domestic policy actions to offset the negative impact of the war.
Tensions Between The EU And the US To Rise	The EU's and the US's geopolitical goals will be less aligned, especially on trade and industrial policy.
Russia's Sphere Of Influence In The Commonwealth of Independent States (CIS) To Continue Receding	Countries like Kazakhstan and Turkiye will likely grow their influence in former Soviet countries as Russia's ability to provide security and economic partnerships abates.

Source: Fitch Solutions

Theme 1: Russia-Ukraine War Will Persist, But Neither Side Will Achieve Their Objectives Fully

We remain of the view that the Russia-Ukraine war will continue for most of 2023. While we previously expected the conflict to enter into a *de facto* frozen conflict stalemate by the end of 2022, we now think that fighting will continue at a more intense pitch throughout 2023. Both sides remain committed to achieving their objectives, although this will prove difficult as neither side possesses sufficient personnel, weaponry or financing to fulfil them. On the Ukrainian side, fulfilling its war aims refers to the restoration of the country's 1991 borders. On the Russian side, this refers to the complete occupation of the annexed regions of Kherson, Zaporizhzhia, Donetsk and Luhansk. Ukraine is faced with increasing financing constraints, and heavy sanctions against Russia will make it increasingly hard for it to replenish its military resources. For Ukraine, we see the IMF stepping in as a major provider of its financing needs. On October 12 2022, IMF Managing Director Kristalina Georgieva pledged to work with the Ukrainian authorities to establish an appropriate forum to facilitate Program Monitoring with Board Involvement (PMB). Georgieva confirmed that the PMB would pave the way to an 'upper credit tranche arrangement', hinting at a fully fledged IMF programme.

Huge Inflows Of Financial, Military and Humanitarian Aid To Continue
Ukraine - Aid By Donor Country & In Total Up To October 3 2022, EURbn



Source: Kiel Institute For The World Economy, Fitch Solutions

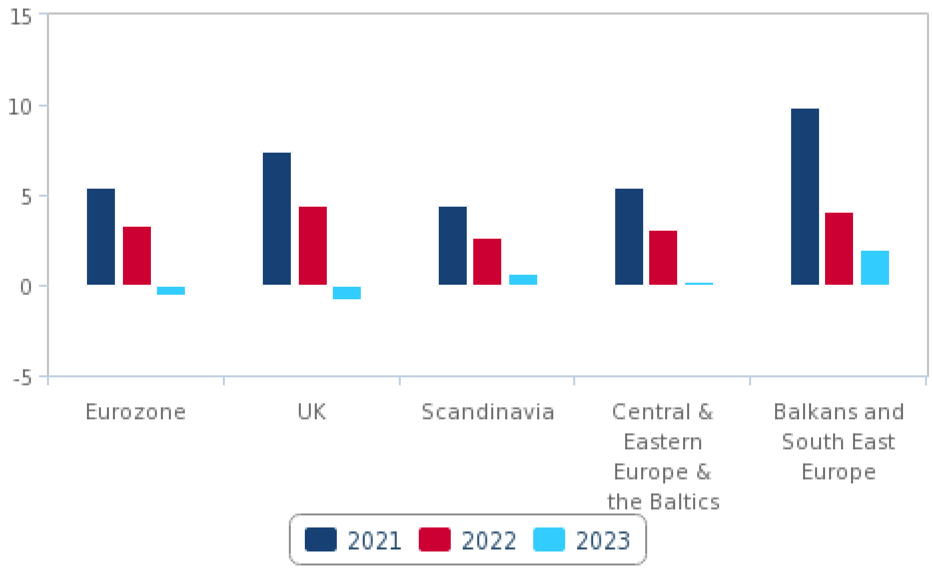
For Russia, we expect the Kremlin to seek ways of increasing the number of troops stationed in Ukraine without necessarily calling for a full-scale mobilisation of its armed forces. While a full mobilisation remains a possibility, we think the Kremlin's apparent reluctance to depart from the definition of 'Special Military Operation' for its activities in Ukraine suggests that this remains a last resort. Regarding financing, bumper hydrocarbon revenues from the first three quarters of 2022 will help sustain defence spending in 2023. Russia's 2023 fiscal budget commits roughly a third of expenditures to defence and domestic security, totalling RUB9.4trn (USD15.0bn) at the cost of public amenities like healthcare, education and civil infrastructure. The Kremlin will finance a 2.0% budget deficit via borrowing on the domestic market, having held its largest ever OFZ bond auction in November 2022, selling government securities worth RUB823bn (USD13.7bn). In our view, Russia's ability to finance the war without compromising stability at home will diminish as time goes on. We think that any potential territorial gains in south and eastern Ukraine are unlikely to compensate for deteriorating living standards at home in the minds of ordinary Russians.

Theme 2: Europe Will Fall Into A Recession Which Will Be Followed By An Uninspiring Rebound

Europe's post-pandemic rebound will come to a halt in 2023, with the economy (excluding Russia and Ukraine) seeing in its third worst performance since 2000. Growth will be the weakest in developed markets, with the eurozone and the UK set to contract by 0.6% and 0.8% respectively. We forecast full-year growth at a somewhat stronger 0.2% in Central and Eastern Europe and the Baltics and 2.0% in the Balkans and South East Europe. However, we anticipate that several important markets - including the Czech Republic, Hungary and Poland - will enter technical recessions in the coming quarters.

Developed Europe Growth To Suffer

Europe - Real GDP Growth, annual % chg (2021-2023)

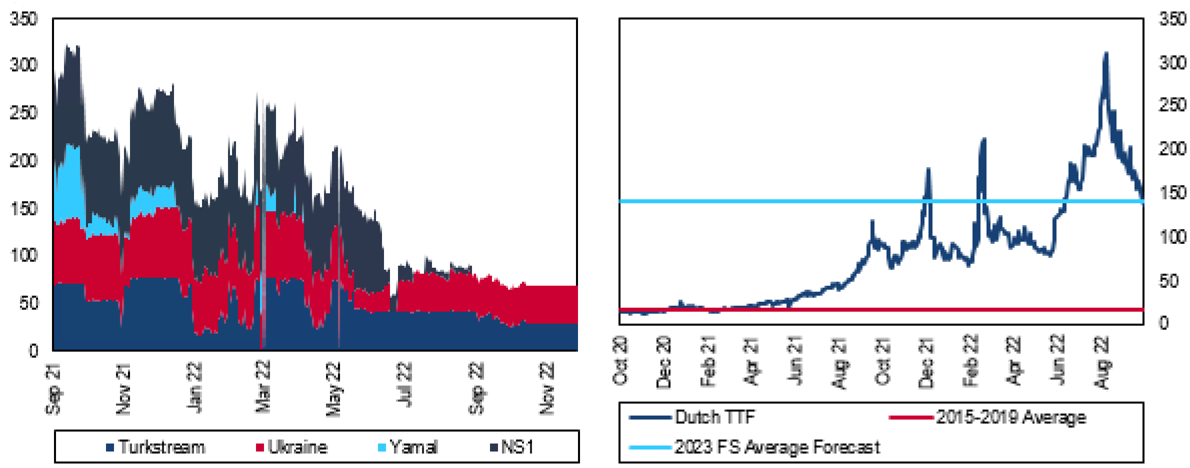


Source: Eurostat, Fitch Solutions

The European downturn will be largely linked to spillover effects from Russia's invasion of Ukraine, and in particular the ongoing energy crisis. Over 2022, Russia has meaningfully curtailed natural gas exports in an attempt to undermine Western support for Ukraine, which has pushed prices to seven times their 2015-2019 average. Governments have rolled out significant support measures in an attempt to shield the private sector from this cost of living shock, but we nonetheless expect that much of the region will plunge into recession from Q422. Those economies with larger manufacturing sectors and where natural gas accounts for a larger share of energy consumption will struggle the most in the coming months, with Germany, Italy and Central and Eastern Europe markets standing out as particularly vulnerable in developed and emerging Europe respectively.

Energy Crisis To Remain A Constraint On Growth

Eurozone - Russian Gas Exports By Pipeline, mcm per day (LHC) & Dutch TTF Month Ahead, EUR per MWh (RHC)

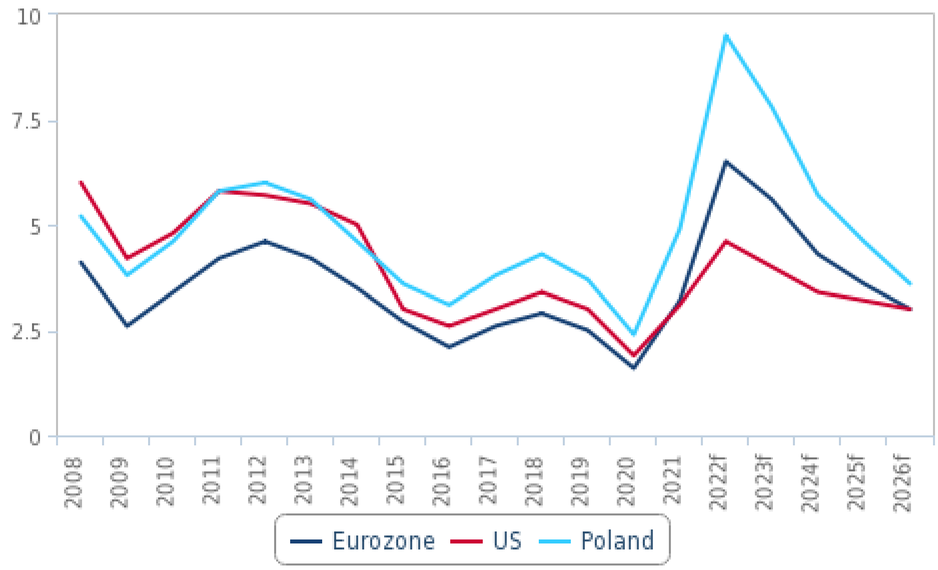


Source: Bloomberg, Fitch Solutions

Energy security will endure as a pressing matter for Europe throughout 2023, with rationing remaining a distinct possibility in the event of an unusually cold winter. Our Oil & Gas team estimates that the continent could be facing a shortfall of up to 30bn cubic metres of natural gas in 2023 (roughly 10% of expected 2022 consumption) should Russia cut exports to zero. Against this backdrop, our industry analysts see little scope for natural gas prices to meaningfully fall back from current levels, which will see energy bills remain hefty throughout 2023.

A Long Road Back To Normal In Europe

US & Europe – Oil & Gas Consumption, % of GDP (2008-2026)



Source: Fitch Solutions

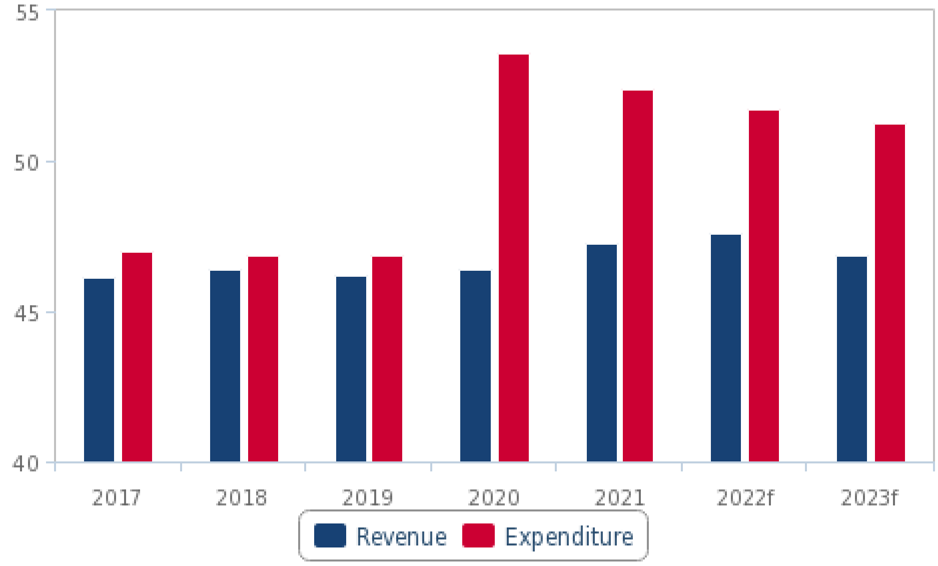
Growth will be further constrained by central banks' hawkish policy stances as tighter financial conditions hit the economy with a lag. Interest rates have effectively returned to pre-global financial crisis levels across Europe over the past several months as the persistence of elevated inflation forced central banks into action. For the most part, we believe that tightening cycles will come to an end in the early part of 2023, but with price pressures likely to remain sticky, we see little scope for central banks to begin meaningfully loosening in 2023 in response to these growth concerns.

Theme 3: Fiscal Policy In Europe Will Diverge From Monetary Policy

We believe that the pace of fiscal consolidation will markedly slow across Europe as governments manage the effects of tighter monetary policy, cost of living challenges and the Russia-Ukraine war-induced energy crisis. The improved epidemiological outlook across Europe allowed for budget deficits to narrow over 2021 and 2022. Despite inflation rising to multi-decade highs, post-pandemic demand has generally proven resilient through to Q322, thereby driving notable nominal revenue growth. However, the higher cost of living will increasingly stifle demand and revenue generation compared to 2022. Support measures that were announced in 2022 - including subsidising energy bills, price caps and transfer payments to vulnerable groups - will keep expenditure high over 2023. We project average expenditure relative to GDP across the eurozone to reach 51.3% in 2023, remaining well above the level of 46.9% of 2019 (*see chart below*), with a similar trend in non-eurozone economies.

Two Consecutive And Expensive Economic Crises

Europe - Weighted Average Revenue & Expenditure, % of GDP (2017-2023)

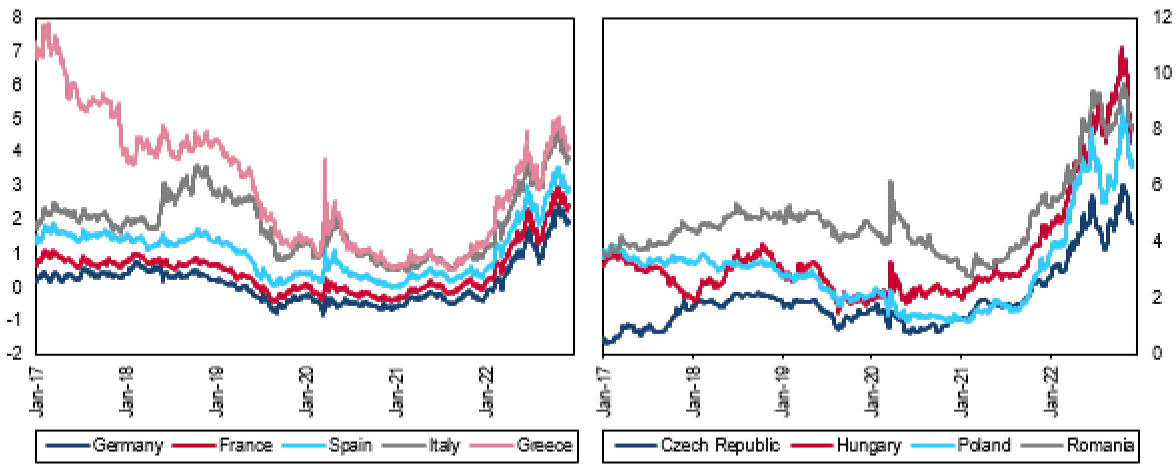


f = Fitch Solutions forecast. Source: Eurostat, Fitch Solutions

Revenue constraints and extensive support packages will lead European governments to continue borrowing significantly over 2023, and at a higher cost. Bond yields have risen sharply over 2022, owing to a combination of increased risk aversion alongside inflation which has spurred monetary tightening (*see charts below*). Still, even with higher borrowing and debt servicing costs, European governments will remain under considerable political pressure to support households and firms over the short term.

Cost Of Funding Generous Fiscal Packages Will Remain Elevated

Europe - Bond Yields For Selected EMs & DMs, %



Source: Bloomberg, Fitch Solutions

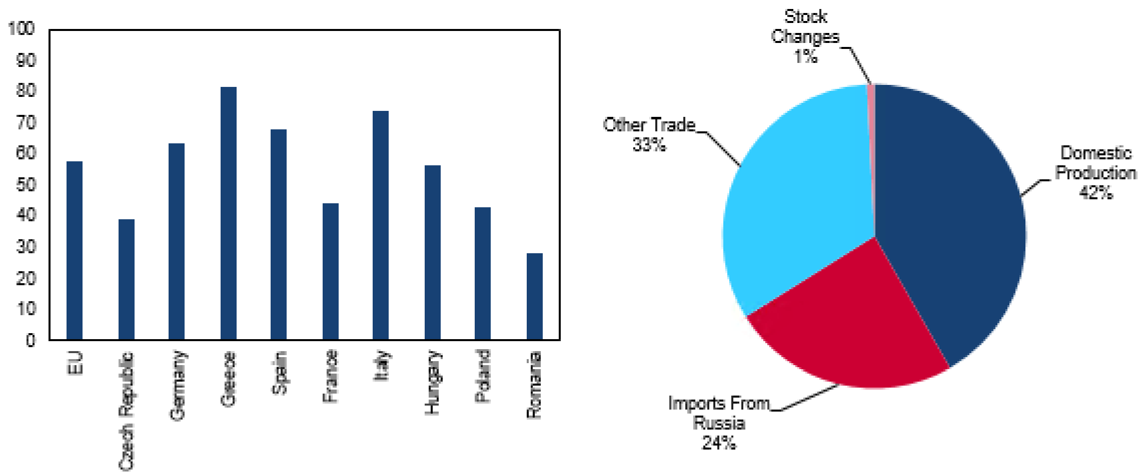
Theme 4: European Union Unity To Come Under Pressure

While the bloc managed to find consensus in 2022, maintaining a mostly united front against a tough macroeconomic backdrop, several strains have recently become evident. Even as the EU passed a swathe of sanctions on Russia, several member states undertook actions that deviated from the consensus. French President Emmanuel Macron was criticised for his early failed attempts at diplomacy with Russian President Vladimir Putin, and prior to the conflict Germany was in the process of certifying the Nord

Stream 2 pipeline (in spite of several vocal warnings from allies such as the US), which would have further entrenched Germany's dependence on Russian energy. Russian energy dependence is a theme for much of the continent's east and is the driver of red lines on sanctions laid down by governments inside the bloc, such as Hungary, or in applicant states, such as Bosnia-Herzegovina and Serbia. Beyond the conflict, lawsuits threatening bloc funding for Hungary and Poland progressed as both markets allegedly continue to break bloc laws and values - the EU initiated article 7 proceedings (which would suspend certain membership rights upon conclusion) with both states over 2017-2018. Italy and Sweden elected right-wing governments in October 2022, which will at best prevent further bloc integration and could present significant challenges in the worst case scenario.

EU Russian Energy Dependence Presents 2023 Threat To Unity

Europe - Energy Import Dependency (LHC) & Energy Availability By Source (RHC), % (2020)



Source: Eurostat, Fitch Solutions

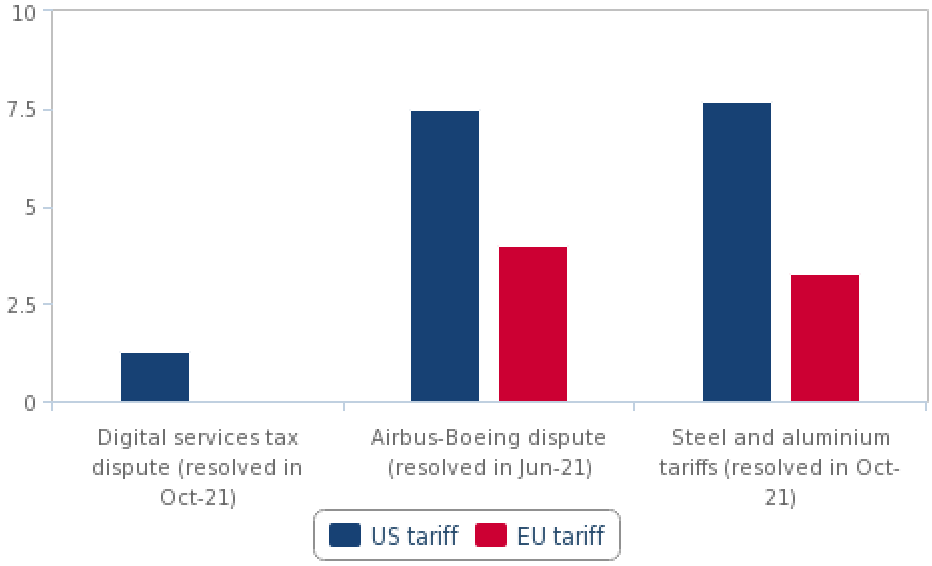
Several challenges will emerge in 2023 which will put further strain on the bloc. While the EU is in a decent position to get through winter, the gas outlook for 2023 is more uncertain, and it is unlikely that pipelines from Russia will be flowing at capacity for the 2023 refilling season. This will keep prices elevated (perhaps encouraging a less hawkish stance on the conflict in some states) and may threaten the EU's borderless gas sharing system as markets prioritise their own energy consumption. Inflation may remain elevated, which could pose a dilemma for the European Central Bank. The bank's overriding objective is price stability; however, monetary policy has a limited impact on supply side pressures whilst rising interest rates will significantly raise debt servicing costs for those member states with large debt burdens. **A showdown between the core and peripheral states within the EU over perceived fiscal laxity versus monetary tightness is a major risk in 2023.** Refugee inflows could pose another major threat, with Ukrainian migrants joining traditional flows from non-European countries. Coupled with a potential influx from Turkiye in a similar manner to 2015, this could trigger crises in several member states.

Theme 5: Competition Between The EU And The US Will Rise

We expect relations between the EU and the US to deteriorate in 2023 and remain strained beyond that. This is due to an increasing domestic focus of industrial, trade and other policies in the US and the EU. In 2023, this will manifest in several areas, such as industrial policy disputes (most visibly the US Inflation Reduction Act which is due to provide generous incentives for investment in the US). Washington will likely increasingly put pressure on EU states to follow US trade restrictions on Mainland China, which we expect will tighten further in 2023.

The EU will likely prove divided on these questions, which will at best keep disagreements unresolved and potentially exacerbate tensions with the US and within the EU. In case of industrial policy disputes, the bloc will suffer from divisions between Germany and France in particular, where Paris favours responding to US subsidies in kind (by adopting similar subsidies for EU firms), which Berlin rejects. This will impede an EU-wide response and potentially lead to some unilateral measures by individual EU governments. Even if the EU succeeds in pushing the US into making concessions on its subsidies, the risk of similar disputes will remain elevated as both sides increasingly intervene in key sectors via industrial policies.

Lifting Of US-EU Tariffs Helps, But Other Obstacles Are On The Horizon
US & EU - Trade Volume Facing Tariffs Due To Select Disputes, USDbn



Source: Fitch Solutions

In terms of the impact on Europe of US export controls against China, these have so far been primarily focused on **ASML**, the Netherlands-based manufacturer of lithography systems. In response, the Dutch government has reportedly ceased issuing certain export licences to ASML in order to align with US export controls. However, further US pressure on Europe could follow in 2023 and beyond as tensions between US and China are likely to increase. European governments will prove reluctant to impose significant additional obstacles to trade that would further weigh on the bloc's already dismal economic growth outlook for 2023, potentially adding to US-EU tensions.

As a result, we expect greater industrial policy competition between the US and the EU in 2023, leading to a higher regulatory burden as firms navigate an increasingly diverse set of incentives and obstacles to trade and investment. **While not our core view, renewed US-EU competition would raise the chances of retaliatory EU measures against US subsidies, which Brussels views as illegal, and of US secondary sanctions on European firms that are deemed to be bypassing US sanctions on China.** Such fears will be more pronounced over the medium term, particularly if the prospects of a Republican victory at the US presidential election in 2024 increase, for example due to a likely economic slowdown in the US in 2023.

Theme 6: Russia's Sphere Of Influence In The CIS To Continue Receding

In 2023, we believe that Russia's standing in Central Asia and the Caucasus will decline further as the war in Ukraine diverts resources and attention away from the country's former sphere of influence. Not only will Russia be in a weaker position to enforce its influence in the regions, Central Asian and Caucasus governments will make active efforts to reduce their reliance on Russian economic and security support. While for some of the larger, more powerful countries - like Kazakhstan - Russia's relative impotence offers an opportunity for greater independence, smaller states like Armenia might seek to replace Russia with new partners.

Turkiye's Geopolitical Role To Strengthen At Centre Of Trade Route

Europe, Middle East & Africa- Belt & Road Initiative Map

Template image: d-maps.com. Source: Asian Pacific Center, Fitch Solutions

In our view, Russia's loosening grip on the region will be visible across Russia-led institutions (like the Collective Security Treaty Organisation) and in investment projects. In this vein, we expect to see greater investment in strengthening trade routes and infrastructure that circumvent Russia as broad-based Western sanctions have significantly reduced Russian trade competitiveness. For example, on November 26 2022 officials from Georgia, Turkiye, Azerbaijan and Kazakhstan agreed to further develop the 'Middle Corridor', a trade route connecting Turiye to China. Similarly, we expect the Georgian government to revitalise the shelved Anaklia deep water port project on Georgia's Black Sea Coast. Previously, the project had been scrapped for a number of political reasons, including Kremlin opposition to the plan.

Sub-Saharan Africa Key Themes

At Fitch Solutions, we anticipate a mixed outlook for Sub-Saharan Africa (SSA) in 2023. While we assume a moderate pickup in economic momentum, reflecting accelerating growth in Mainland China and moderating (albeit still high) inflation levels, performance by the region's major markets will be mixed, with South Africa and Nigeria continuing to underperform. We expect monetary policy tightening to slow, despite still high inflation levels, and governments to face fiscal policy dilemmas. We expect social unrest and political tensions to rise across SSA and, in particular, West Africa.

SSA KEY THEMES FOR 2023

Theme	View
Economic Growth To Accelerate Despite Mixed Performance By Major Markets	Growth in East and Central Africa will strengthen as Chinese demand rebounds, but economic activity in markets including Nigeria, Ghana and South Africa will slow.
Monetary Policy Tightening To Slow Despite Still Elevated Inflation	Inflation will slow but remain well above the 2012-2021 average. However, many regional central banks have front-loaded rate rises in 2022, and the end of tightening cycles in key developed markets will also discourage further sharp rate rises.
West Africa To Become The Locus Of Political Unrest	In Nigeria, religious and ethnic tensions will increase around the February 2023 presidential election. Rising Islamist insurgency in the Sahelian states will continue to weigh on sub-regional stability.
Mixed Outlook For Currencies Despite Softening US Dollar	While a softening US dollar will bode well for emerging market (EM) exchange rates, slowing global growth will cause prices of oil and industrial metals to fall in 2023, benefitting net oil importers in the region but weighing on net commodity exporters.
Rising Interest Expenditure To Create Fiscal Policy Dilemmas	With inflation remaining above historical levels, we believe that governments will seek to keep subsidies and social support measures in place. However, pressurised fiscal accounts on the back of rising interest payments could force some governments to remove or phase out these support arrangements.
Highly Contested Elections To Take Place In Several Markets	Elections in a number of markets are likely to be very closely fought and in some cases will present potential stability risks given lack of public faith in state institutions.

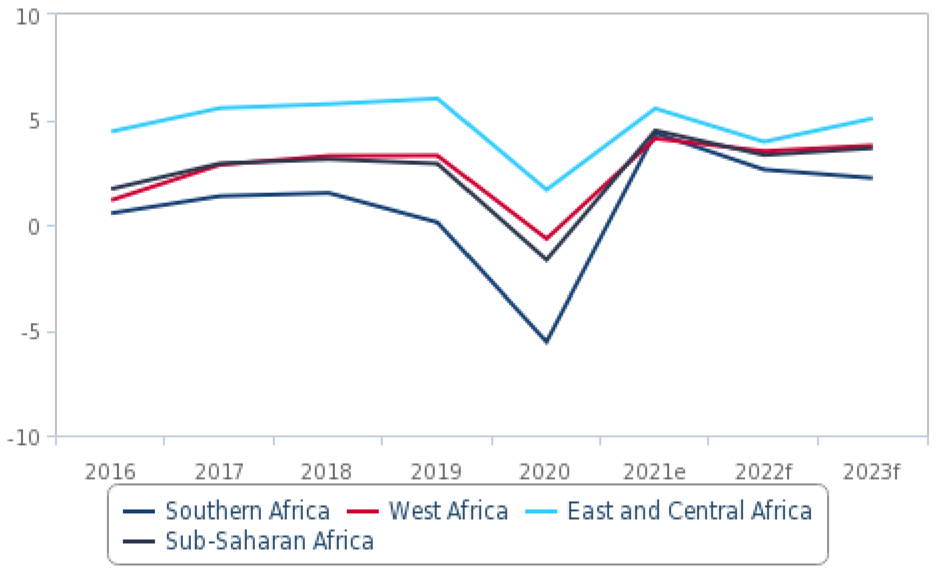
Source: Fitch Solutions

Theme 1: Economic Growth To Accelerate Despite Mixed Performance By Major Markets

At Fitch Solutions, we forecast that growth in Sub-Saharan Africa (SSA) will accelerate to 3.6% in 2023, up from 3.3% in 2022 but still below the 2010-2019 average of 4.1%.

East And Central Africa Sub-Region To Drive Growth

SSA - Real GDP Growth, % (2016-2023)

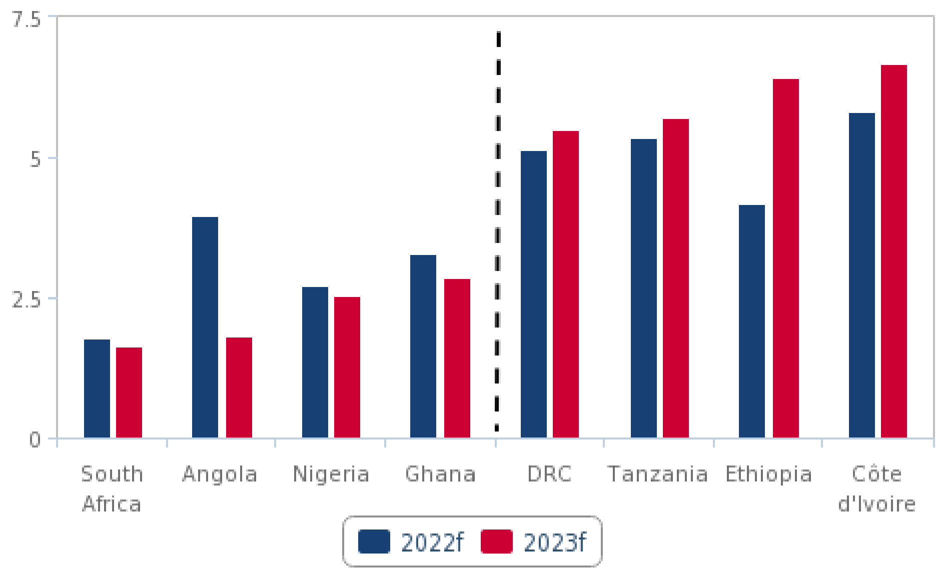


e/f = estimate/forecast. Source: Fitch Solutions

Growth will be strongest in East and Central Africa, where we expect growth to rise to 5.0%, from 3.9% in 2022 *(see chart above)*. Accelerating growth in **Mainland China** - we forecast that growth will strengthen to 5.0% in 2023, up from 3.3% in 2022 - will support demand for key mining exports in the **Democratic Republic of the Congo** (DRC) (copper accounted for 65.0% of merchandise exports in 2021). In addition, growth in **Ethiopia** and **Tanzania** will strengthen as easing inflation facilitates stronger private consumption, and robust fixed investment will support construction activity. We forecast that growth in West Africa will rise modestly to 3.7% in 2023, from 3.5% in 2022. While we expect growth in **Côte d'Ivoire** to strengthen as inflation moderates, we forecast that economic growth in **Nigeria** will slow from 2.7% in 2022 to 2.5% in 2023, based on our expectation of declining hydrocarbon output. **Ghana** will see weaker economic activity as a result of fiscal consolidation under a likely IMF programme.

Mixed Performance By Major Markets In 2023

Selected SSA Markets - Real GDP Growth, % (2022 & 2023)



f = forecast. Source: Fitch Solutions

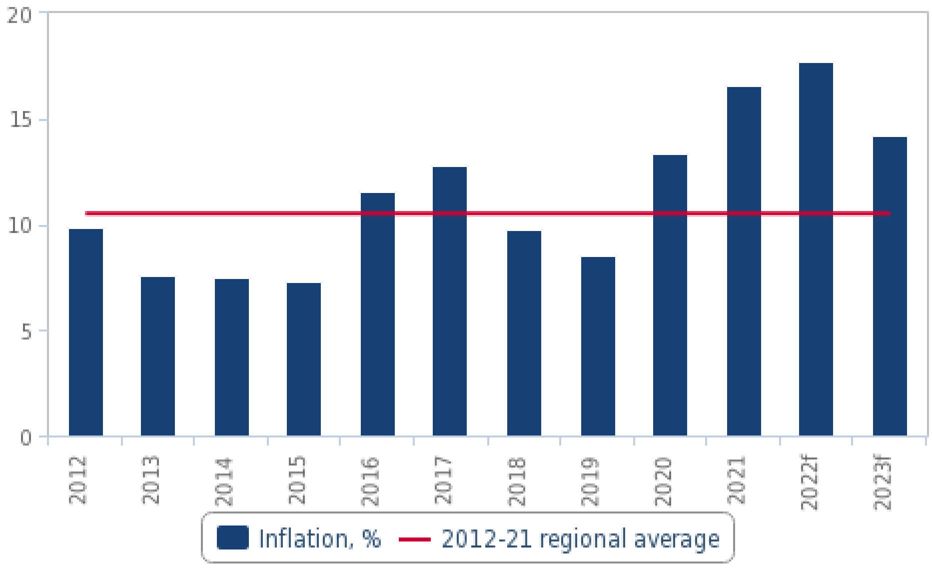
A moderate slowdown in Southern Africa - from 2.8% in 2022 to 2.2% in 2023 - will weigh on the regional average. We expect growth in **South Africa** - the largest economy in Southern Africa - will continue to trend downwards (to 1.6% in 2023, from 2.1% in 2022). This is due to sticky inflation and monetary tightening, which raises the cost of borrowing for consumers and businesses. Angola will also weigh on growth in the sub-region due to headwinds to its oil sector.

Theme 2: Monetary Policy Tightening To Slow Despite Still Elevated Inflation

We expect that inflation will remain elevated in most SSA markets in 2023. While the average annual inflation rate will ease from 17.7% in 2022 to 14.2% in 2023 - chiefly reflecting moderating global commodity prices following the sharp global price rally in 2022 - it will remain above the 2012-2021 average of 10.5% *(see chart below)*.

Inflation To Remain Elevated In 2023

Sub-Saharan Africa – Inflation, % (2012-2023)

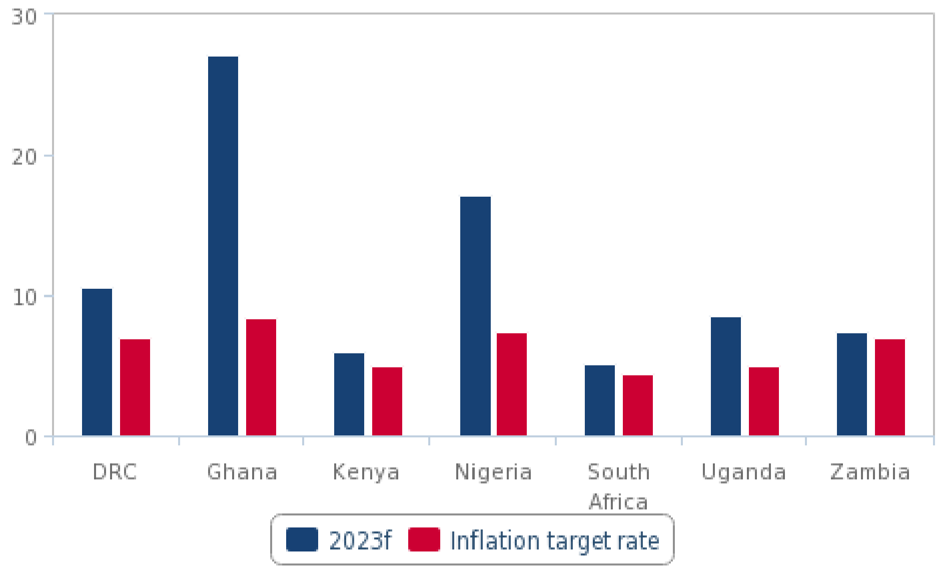


f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

In addition, in major economies such as the **DRC**, **Ghana**, **Kenya**, **Nigeria**, **South Africa**, **Uganda** and **Zambia** we expect headline inflation to remain above the mid-point of central bank target bands *(see chart below)*. All these markets are net importers of food, fuel or both and were seriously affected by global supply shocks in 2022.

Inflation To Remain Above Mid-Point Of Inflation Target Bands

Selected SSA Markets – Average Inflation & Mid-Point Of Target Band

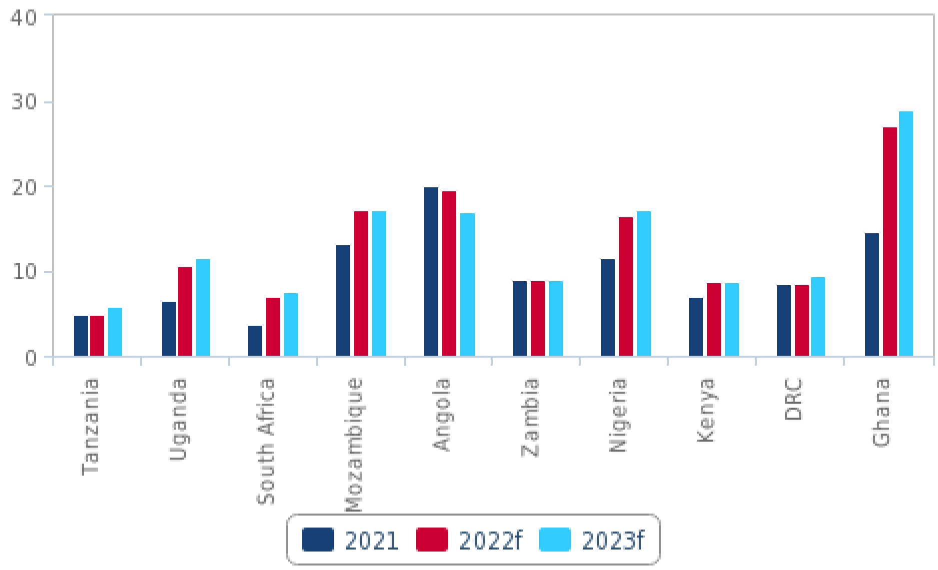


Note: DRC and Uganda do not have mid-points. f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

The reluctance of the US Federal Reserve (Fed) to cut rates rapidly - we expect the Fed to hold its funds rate at 3.50% across 2023 - will discourage rate cuts as SSA central bank policymakers will want to support interest rate differentials and thus limit downward pressure on their currencies. Given this and the slow pace of disinflation, we expect further - albeit more modest - rate hikes in the DRC, Ghana, Nigeria, South Africa and Uganda, and holds in Kenya and Zambia *(see chart below).*

Central Banks To Tighten Or Hold In 2023

Selected SSA Markets – Central Bank Policy Rate, % (2021-2023)



f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

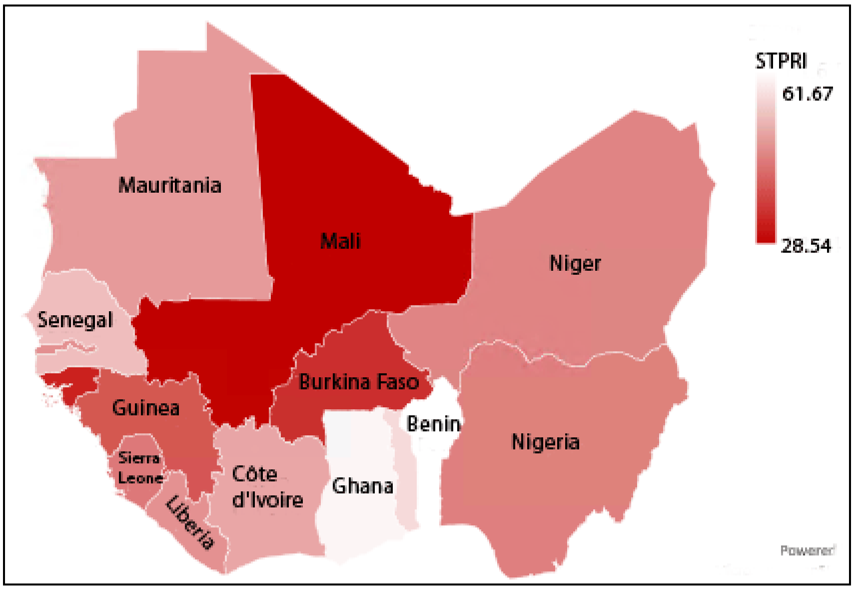
However, we expect that Angola will remain a key outlier and project a 150 basis point cut in its policy rate to 17.00% in 2023. We see inflation slowing sharply (from an average of 21.9% in 2022 to 14.0% in 2023), while muted economic growth (from 4.0% in 2022 to 1.8% in 2023) amid declining oil production will incentivise the Banco Nacional de Angola to ease its monetary policy in an effort to increase demand in the non-oil sector and offset the economic losses from the hydrocarbons sector.

Theme 3: West Africa To Become The Locus Of Political Unrest

In 2023, we expect that social unrest and political tensions will rise across SSA and, in particular, West Africa. In **Nigeria**, we expect campaigning ahead of the February 2023 presidential election to increase religious and ethnic tensions. Since 1999 there has been an informal agreement that has resulted in the presidency alternating between Northern and Southern states and between Muslim and Christian candidates. However, we expect Bola Tinubu, the candidate of the ruling All Progressives Congress, to win the election and become the second successive Muslim president. Tinubu has named a fellow Muslim, Kashim Shettima, as his running mate, which will further increase perceptions of marginalisation among Christians and likely fuel social unrest.

Risks Remain Elevated

West Africa – Short-Term Political Risk Index

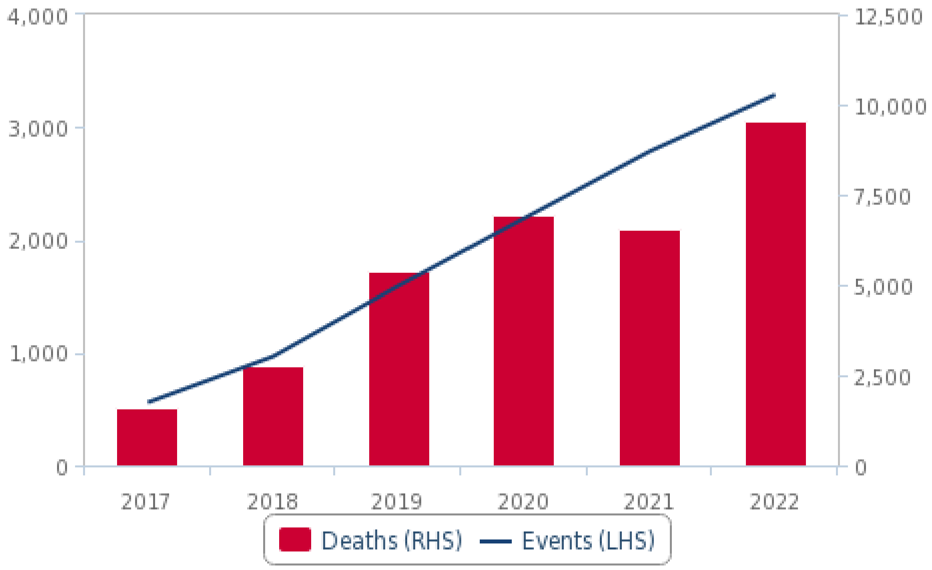


Note: Scores out of 100; higher score = lower risk. Source: Fitch Solutions

In addition, we expect that rising levels of Islamist insurgency in the Sahel will continue to weigh on regional political stability. According to the Armed Conflict Location & Event Data Project, incidents (including battles, violence against civilians and explosions) in the G5 Sahel (**Burkina Faso**, **Chad**, **Mauritania**, **Mali** and **Niger**) rose from 2,768 in 2021 to 3,287 in 2022 (up to December 1). In particular, in Mali, the absence of French forces, the expected withdrawal of other European forces and the increasing presence of the combative private military contractor, the **Wagner Group**, will lead to increased battles and weaken the governance of rural areas. This will allow insurgents to consolidate their influence in the Sahel region over the coming months. We also note the risk that insecurity could spill over into the wider region, with **Nigeria** and **Cameroon** sharing particularly porous borders with Sahel states.

Increasing Insurgency In The Sahel To Weigh On West Africa

G5 Sahel - Insurgent Incidents & Casualties



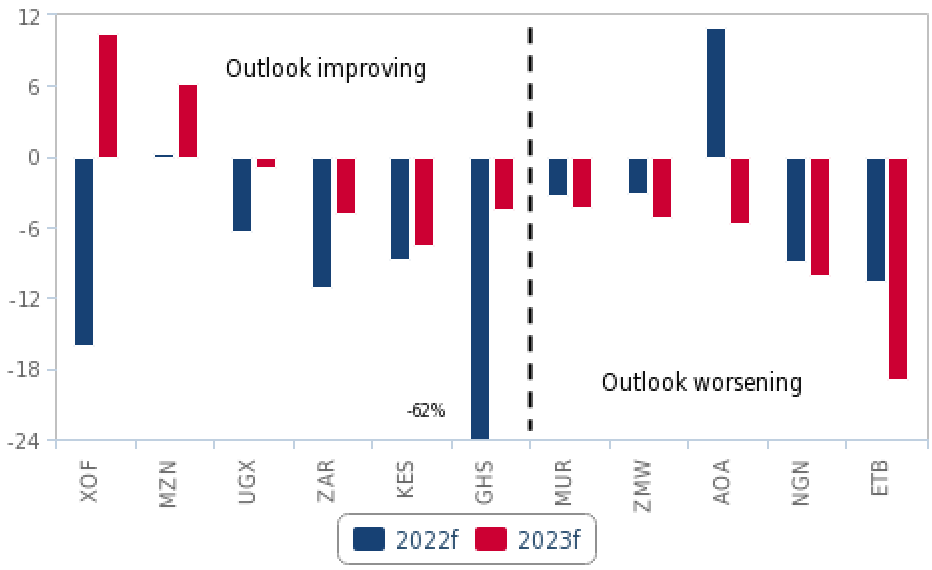
Source: Armed Conflict Location & Event Data, Fitch Solutions

The delays in a return to civilian rule in Mali and Burkina Faso pose further risks. The military coup in Mali in May 2021 (the second in less than a year) led to tough trade sanctions by the Economic Community of West African States, weighing on economic conditions. Military leaders in Mali and Burkina Faso have set out plans for a return to civilian rule in March and July 2024 respectively, but should it become apparent that either leader is unwilling to hand over power, we would expect to see a significant uptick in activism - and the imposition of tougher sanctions - in H223.

Theme 4: Mixed Outlook For Currencies Despite Softening US Dollar

At Fitch Solutions, we anticipate a mixed performance for SSA currencies over the course of 2023, with very few appreciations among the main markets *(see chart below)*. While a softening US dollar will bode well for EM exchange rates, slowing global growth will cause prices of oil and industrial metals to fall in 2023, benefitting net oil importers in the region but weighing on net commodity exporters.

Mixed Outlook For SSA Currencies
Selected SSA Markets - Exchange Rate, LCU/USD, Spot Returns, %



Note: Percentage change over the course of the year. f = forecast. Source: Fitch Solutions

Outlook Improves For Several Currencies

We expect that the Mozambican metical and West and Central African francs to outperform over 2023. The ongoing ramp-up of gas production in northern **Mozambique** will boost the country's export receipts, causing a 6.2% appreciation of the metical over 2023. The strengthening of the euro against the US dollar over 2023 will benefit the West and Central African francs - both pegged to the euro - and we see both currencies appreciating by 10.0% (end-of-period terms).

The **South African** rand is also likely to benefit from a softening dollar over 2023. However, persistent political uncertainty stemming from President Cyril Ramaphosa's weakening position will act as a depreciatory factor, and declining metals prices will depress export earnings and ensure that the rand continues to weaken, by 4.8% over 2023 as against 11.1% over 2022.

Within the East African Community, the **Kenyan** and **Ugandan** shillings will continue to weaken, by 7.5% and 0.9% respectively, but at a slower pace compared with 2022 as lower global food and fuel prices deflate both countries' import bills.

After depreciating by 61.9% over 2022, we see the **Ghanaian** cedi weakening by a smaller 4.5% over 2023 as the likely approval of an IMF programme in early 2023 eases investor concerns about the country's deteriorating fiscal metrics.

Worsening Performance For Other Currencies

Falling commodity prices will take a toll on **Nigeria**, **Angola** and **Zambia**. Our Commodities team forecasts that Brent prices will fall by 6.9% in 2023. This will compound declining oil production in both Nigeria and Angola - SSA's two largest oil producers - causing the naira and kwanza to depreciate by a respective 10.0% and 5.7%. A similar decline in copper prices will offset a forecast rebound in domestic copper output in Zambia, contributing to a weakening kwacha after a strong 2022 performance.

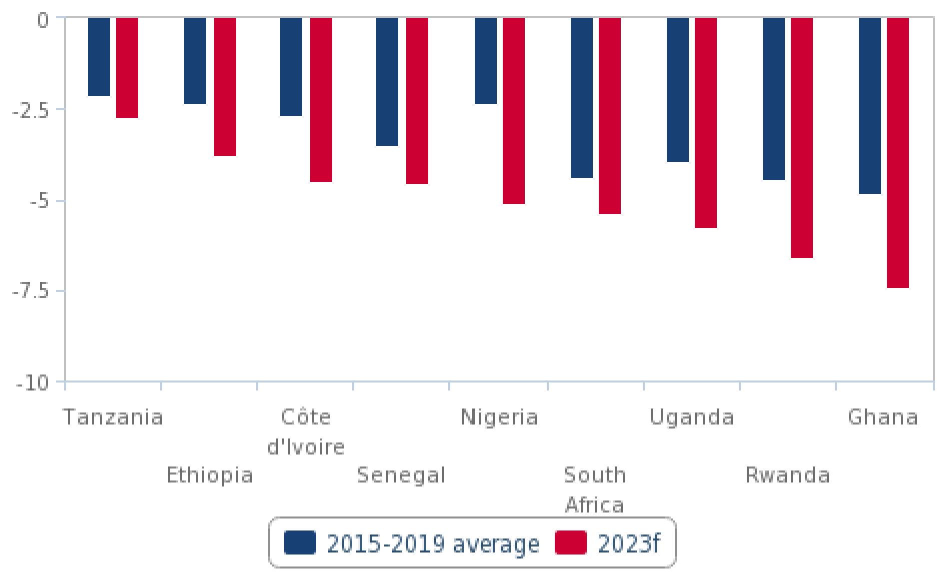
The **Ethiopian** birr will be the region's main underperformer in 2023. We expect political stability to improve following a ceasefire agreement between the federal government and the rebel Tigray People's Liberation Front. However, a decline in foreign reserves (to a forecast 0.8 months of imports at the end of 2023) will prompt the National Bank of Ethiopia to devalue the birr more aggressively.

Theme 5: Rising Interest Expenditure To Create Fiscal Policy Dilemmas

At Fitch Solutions, we believe that governments across SSA will face fiscal pressures stemming from rising debt servicing costs in 2023. In 2022, global monetary tightening and risk-off sentiment following Russia's invasion of Ukraine have increased bond yields across SSA, limiting access to the international debt market. While we expect the US Fed to refrain from tightening monetary policy further in 2023, growing recession concerns in the US and Europe will result in continued risk aversion, keeping bond yields elevated.

As a result of tight external financing conditions, many SSA governments will continue to rely on domestic borrowing in 2023, as was the case in 2022. While this is a more viable option for governments when external borrowing costs are unfavourable, it tends to come at high interest rates in SSA as banking sectors are underdeveloped and debt markets shallow by international standards. This will increase debt repayments in 2023, weakening fiscal accounts, with budget deficits in many SSA markets set to remain wide by historical standards *(see chart below)*.

Fiscal Pressures To Keep Budget Shortfalls Wide Across SSA
Selected SSA Markets - Budget Balance, % of GDP

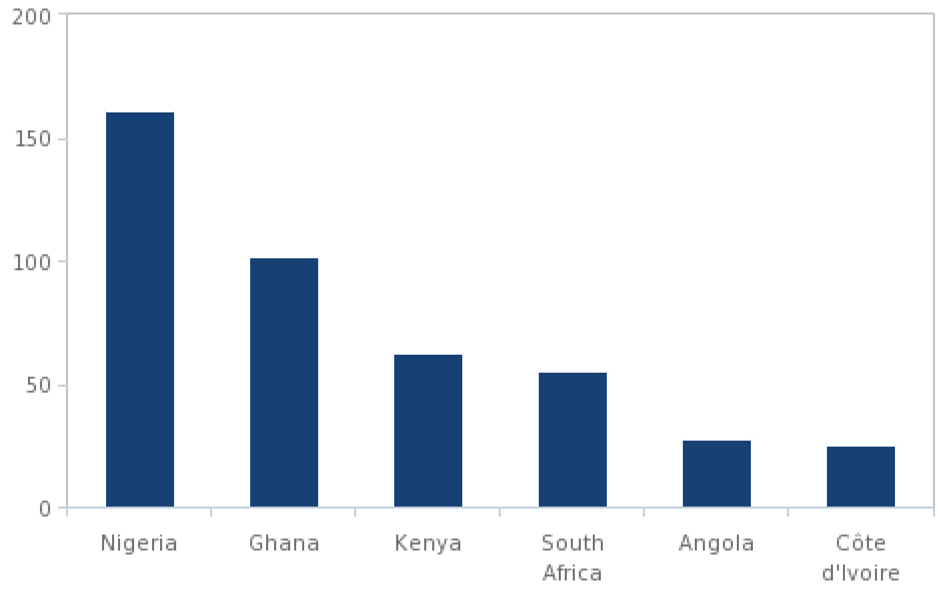


f = forecast. Source: Fitch Solutions

We believe that higher debt servicing costs will create fiscal policy dilemmas in many SSA markets in 2023. With inflation remaining above historical levels, we believe that governments will seek to keep subsidies and social support measures (some of them implemented in 2022) in place. However, pressurised fiscal accounts on the back of rising interest payments could force some governments to remove or phase out these support arrangements. Authorities in countries where debt repayments will increase significantly - including **Ghana**, **Nigeria**, **South Africa**, **Angola** and **Kenya** - will have to consider raising taxes or cutting non-interest expenditure (such as public wages and development spending) at the risk of slowing economic growth and fuelling anti-government sentiment. Ghana's 2023 budget details multiple tax reforms, including an increase in the VAT rate from 12.5% to 15.0%.

Debt Servicing To Limit Fiscal Space In 2023

Selected SSA Countries - Debt Servicing In 2023, % of total revenue



Note: 2023 revenue forecast = Fitch Solutions forecast. Source: Bloomberg, national sources, Fitch Solutions

We believe that tight external financing conditions and rising interest payments will push more SSA countries to seek support from multilateral lenders in 2023. The IMF approved financial programmes for multiple SSA countries in 2022, including Mozambique, Tanzania and Benin, and negotiations between Ghanaian authorities and the IMF are ongoing (we expect a staff-level agreement to be reached in Q123). We expect this trend to continue as rising interest payments reduce fiscal space across SSA in 2023. Notwithstanding SSA's fiscal challenges, we believe that borrowing from China will remain low compared with the previous decade as Beijing becomes increasingly cautious about lending to the region.

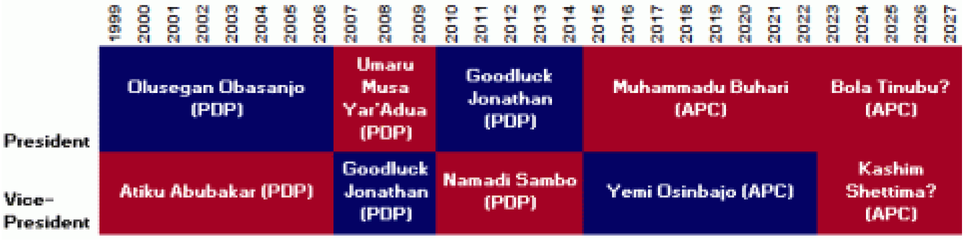
Theme 6: Highly Contested Elections To Take Place In Several Markets

Almost half of SSA markets are due to hold presidential, legislative or local elections during 2023. In states such as **Togo** and **Mozambique** (due to hold legislative and local elections respectively), the benefits of incumbency should see ruling groups secure solid majorities despite growing public discontent with the length of their tenure. In a number of markets, however, elections are likely to be more closely fought and in some cases will present potential stability risks given lack of public faith in state institutions.

In **Nigeria**, we expect that the ruling APC will secure another legislative majority in February 2023 and that its candidate, Bola Tinubu, will win the presidency. We believe that this will lead to protests and social discontent, partly because it will end the informal agreement under which Muslims and Christians alternate the presidency *(see chart below)* and partly because it will likely lead to questions over the fairness of the electoral process, particularly among supporters of the Labour Party candidate, Peter Obi. Recent polls have put Obi ahead of both Tinubu and the other main candidate, Atiku Abubakar, and while we believe this support is overstated, Obi's supporters - mostly young, urban voters - are likely to protest any defeat of their candidate.

Tinubu Win Would Break With Tradition Of Presidential Rotation

Nigeria - Presidents & Vice Presidents By Religion



Note: Blue = Christian; Red = Muslim. Source: Fitch Solutions

In the DRC, we see a tight race between incumbent Felix Tshishekedi, Martin Fayulu (who won 34.8% of the vote in the 2018 general elections, against Tshisekedi's 38.6%) - and, potentially, Joseph Kabila, who was ineligible to stand in 2018. While the handover of power in January 2019 was the first peaceful transfer of the office of the presidency since independence in 1960, it followed a deeply flawed election process that was criticised extensively both domestically and internationally. Independent observers suggest that Fayulu secured the greatest share of the vote but that he was deemed unacceptable to Kabila and his supporters. The weak institutional strength exposed by the electoral process has not materially improved since, suggesting that supporters of the losing candidates may reject the result, leading to political unrest.

General elections in **Zimbabwe** are also likely to prove challenging. The ruling Zimbabwe African National Union-Patriotic Front (ZANU-PF) has been in power since independence in 1980, and international observers have regularly highlighted flaws in the electoral process. We expect the ZANU-PF to win another majority in the parliamentary elections, reflecting the use of incumbency advantages, but believe that supporters of the main opposition Citizens Coalition for Change (CCC) will reject the result, particularly given that the CCC won 19 out of 28 National Assembly seats in by-elections in Q122. That said, we expect the ZANU-PF to retain the broad support of the military and security services, which will continue to intervene to suppress any substantial dissent.

Middle East And North Africa Key Themes

At Fitch Solutions, we foresee a weakening outlook for the Middle East and North Africa (MENA) region in 2023, but the Gulf Cooperation Council (GCC) countries will remain a bright spot. Oil prices, albeit declining, will remain high by historical standards. This will allow GCC countries to maintain healthy external and fiscal positions and robust growth, especially in the non-oil economy. At the same time, even though lower commodity prices will provide some breathing room for countries in North Africa and the Levant, most of these markets will continue to face macroeconomic and political challenges. The divergent macroeconomic trajectories that we predicted in our Key Themes for 2022 will be more prominent in 2023.

We have identified five main themes that we believe will shape MENA in 2023. Granted, these are based on a specific set of assumptions, such as a modest decline in hydrocarbon prices and a sharper fall in other commodity prices; a significant slowdown in hydrocarbon production growth; a slowdown in the US economy, a shallow recession in Europe and a pickup in Mainland Chinese growth; and the peaking of US dollar strength in early 2023. Any change to our assumptions will either accentuate or tarnish some of our five key themes

MENA KEY THEMES FOR 2023

Theme	View
Growth Will Slow, But The Gulf Cooperation Council Will Be A Bright Spot	After a strong post-pandemic recovery, economic growth in the MENA region will slow in 2023. That said, the region's growth will remain above-trend due to strong non-oil economies in GCC countries and a rebound in Iran.
Inflation Will Ease But Remain Above Historical Averages	After surging to multiyear highs in 2022, average inflation in the MENA region will slow in all countries except Egypt. Despite easing, price growth will remain above-trend.
Significant Chance Of Protests In North Africa And Levant	Elevated cost of living and structural macroeconomic weaknesses will increase the chance of protests in North Africa and Levant.
Narrower Current Account Deficits For Hydrocarbon Importers, But Financing Risks Persist	External pressures on net hydrocarbon importers will remain elevated despite narrowing current account deficits.
Fragile Geopolitical Equilibrium	The MENA region will be characterised by a fragile geopolitical equilibrium which could easily break, especially in case of a no-deal scenario between the US and Iran.

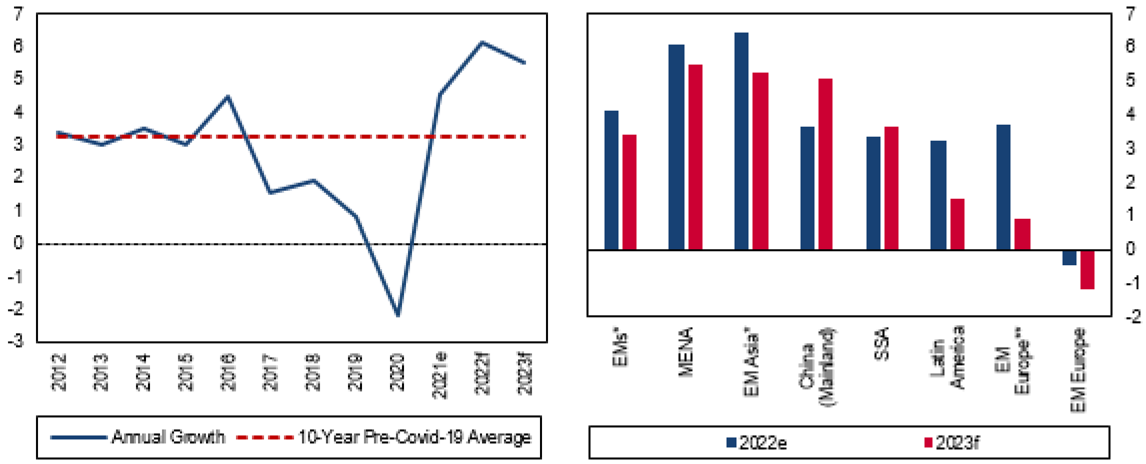
Source: Fitch Solutions

Theme 1: Growth Will Slow, But The GCC Will Be A Bright Spot

After a strong post-pandemic recovery, economic growth in the MENA region will slow in 2023. Excluding conflict countries (Libya, Syria and Yemen), we forecast MENA growth to ease from an estimated 6.1% in 2022 to 5.5% in 2023 (*see chart below left*). This is mainly due to a combination of factors, namely the high cost of living and tight monetary conditions (see Theme 2); slower hydrocarbon production growth; spillovers from the economic recession in the eurozone and the slowdown in the US; and country-specific factors.

Slower Growth In MENA In 2023 But Still Strong By Historical And Global Standards

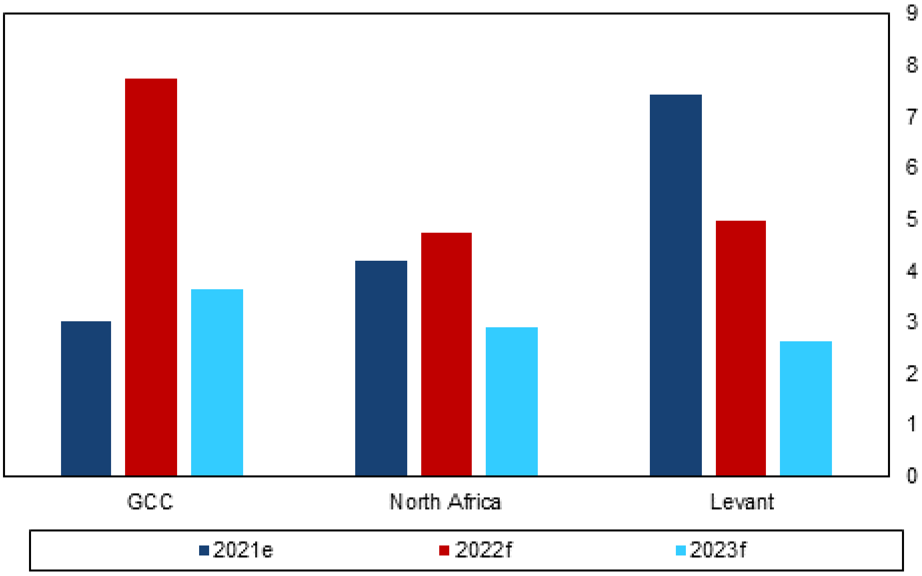
MENA (LHC) & EMs (RHC) - Real GDP Growth, %



*Note: May include territories, special administrative regions, provinces and autonomous regions. *Excludes Mainland China. **Excludes Russia and Ukraine. e/f = Fitch Solutions estimate/forecast. Source: National sources, Fitch Solutions*

Despite the slowdown, growth in MENA will remain above trend in 2023 due to a pickup in Iranian growth and robust activity in the non-oil sector in the GCC. It will also be stronger than emerging market (EM) growth and most of the EM world (*see chart above, right*). We expect that a return to the Iran nuclear deal in H123 (*see Theme 5*) will drive exports and overall improvement in activity in the country.

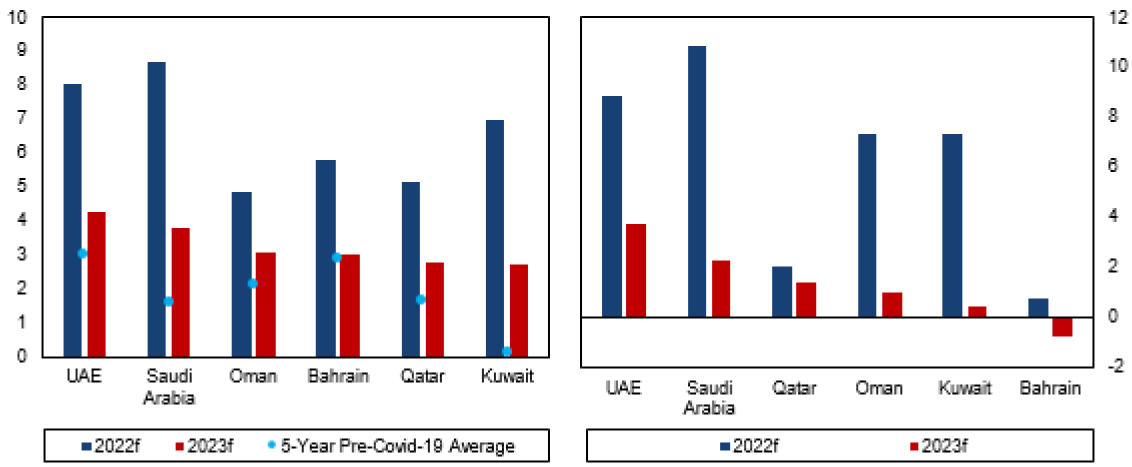
GCC Will Outperform For The Second Consecutive Year
GCC, North Africa & Levant - Real GDP Growth, %



e/f = Fitch Solutions estimate/forecast. Source: National sources, Fitch Solutions

In the GCC, while hydrocarbon production growth will slow in all countries, elevated energy prices will continue to support activity in the non-oil economy, keeping overall growth in 2023 above trend (*see charts below*) and the fastest in MENA (*see chart above*). This will be the case for four reasons. First, while our Oil & Gas team expects oil prices to decline by 6.9% in 2023, they will remain significantly above historical averages and also above the external and fiscal breakeven oil prices. This will keep sentiment elevated and allow governments and government-related entities to continue making progress on their investment plans, especially in Saudi Arabia and the UAE. Second, higher salaries in most GCC countries will support spending despite the rising cost of living. Third, ongoing momentum in the tourism recovery will continue. So far, only Qatar (because of the World Cup) and the UAE (because of the Dubai Expo and spillover from the World Cup) will see their tourism sectors recover to pre-Covid levels by the end of 2022. Fourth, sustained growth in non-hydrocarbon exports to regional markets will also add tailwinds to economic activity.

GCC Growth Still Strong Despite Slowing
GCC - Real GDP Growth, % (LHC) & Hydrocarbon Production, % chg (RHC)

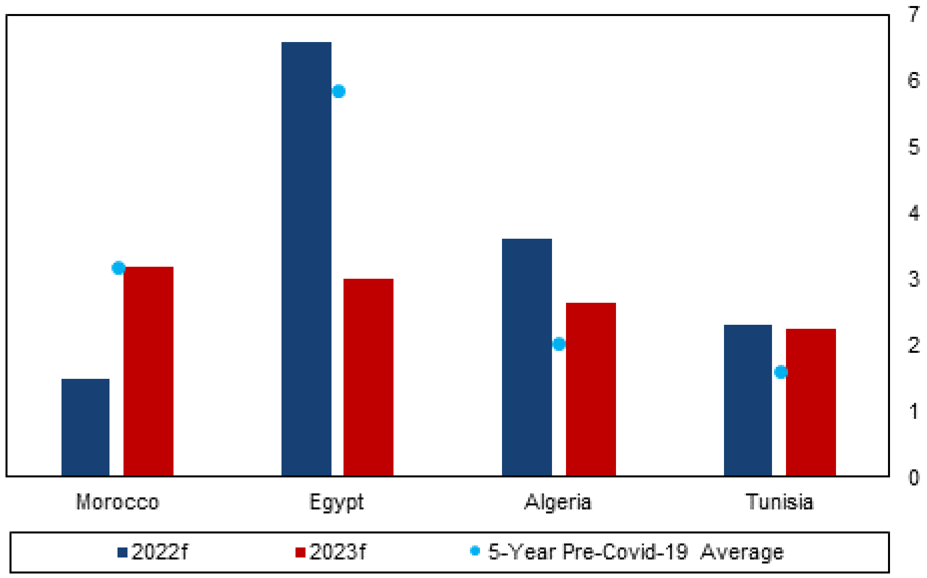


f = Fitch Solutions Forecast. Source: National sources, Fitch Solutions

By contrast, in North Africa, we expect an economic slowdown in 2023 across the board, except for in Morocco. In Egypt, we forecast growth to slow to a decade-low of 3.0% in FY2022/23 (July 2022-June 2023) amid tighter monetary policy, soaring inflation, high levels of political uncertainty and lower capital spending. These factors will add to existing grievances triggered by Russia's invasion of Ukraine which caused a major currency sell-off, shortages of US dollars and the re-emergence of a parallel market. Maghreb countries, such as Tunisia and Morocco, will be affected by the economic contraction in the eurozone, which will weigh on tourism activity, demand for goods exports and remittance inflows. While the recovery in Morocco's agricultural sector after the severe drought in 2022 will lead to faster growth in 2023, these challenges will keep growth just on par with trend.

Challenging Growth Outlook For North African Economies

North Africa - Real GDP Growth, %



f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

The growth outlook for the Levant is mixed. On the one hand, Israel and Iraq will see economic growth slowing. In Israel elevated inflation and tighter monetary policy will weigh on domestic consumption, and weak demand in key trading partners will cap export growth. In Iraq, headline real GDP growth will be brought down by a slower increase in hydrocarbon production. On the other hand, growth will accelerate in the remaining countries. For instance, Jordan's economy will be supported by strong tourism activity, and in Lebanon we expect that an IMF programme will be the starting point to address the prevailing economic and financial crises.

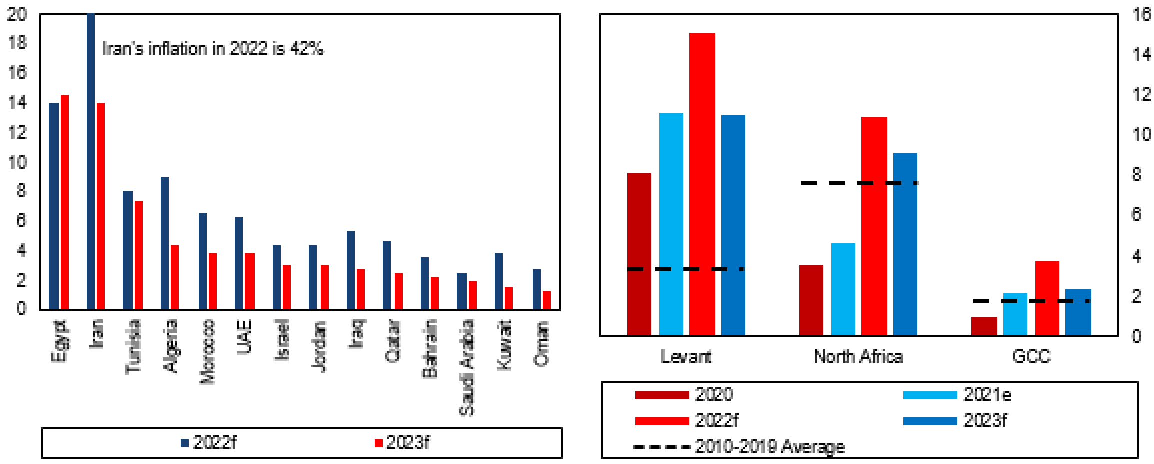
Theme 2: Inflation Will Ease But Remain Above Historical Averages

After surging from 5.9% in 2019 to 20.0% in 2022, we forecast the GDP-weighted average inflation rate in the MENA region to slow to 8.8% in 2023. Tight monetary conditions, lower commodity prices, stronger currencies and weaker demand pressure (*see Theme 1*) will reduce inflationary pressures. Country-specific factors will play a role as well. For instance, in Iran we are foreseeing lower inflation as progress on nuclear negotiations (*see Theme 5*) will ease the pressures on the Iranian rial.

In 2023, we expect average inflation to be lower in almost all MENA countries. Egypt will be the exception as a weaker Egyptian pound and subsidy reform will put inflation on a higher trajectory (*see chart below, left*). This will keep inflation in North Africa the highest in MENA in 2023 (*see chart below, right*). However, sticky prices due to the lingering effects of the 2022 inflationary shock will keep inflation above trend in most MENA countries in 2023.

Lower Inflation Across The Board Except In Egypt...

MENA - Average Inflation Per Country (LHC) & Per Sub-Region (RHC), %

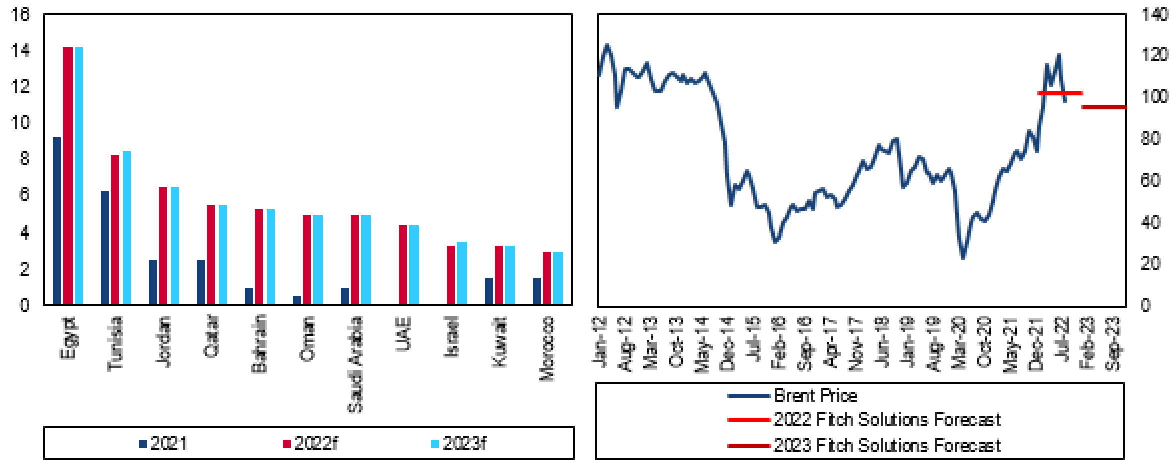


e/f = Fitch Solutions estimate/forecast. Source: National sources, Fitch Solutions

Lagged effects of a surge in interest rates in 2022, together with tight global financial conditions, will slow price growth in MENA in 2023. After hiking policy rates to multi-year highs in 2022, we expect central banks to maintain tight monetary stances throughout 2023 (*see chart below, left*). This will put inflation on a downward trend, with real rates turning positive by H223 for all countries but Morocco and Egypt.

Tight Financial Conditions, Falling Commodity Prices...

MENA - Policy Rate Per Country, % (LHC) & Brent Oil Prices, USD/bbl (RHC)

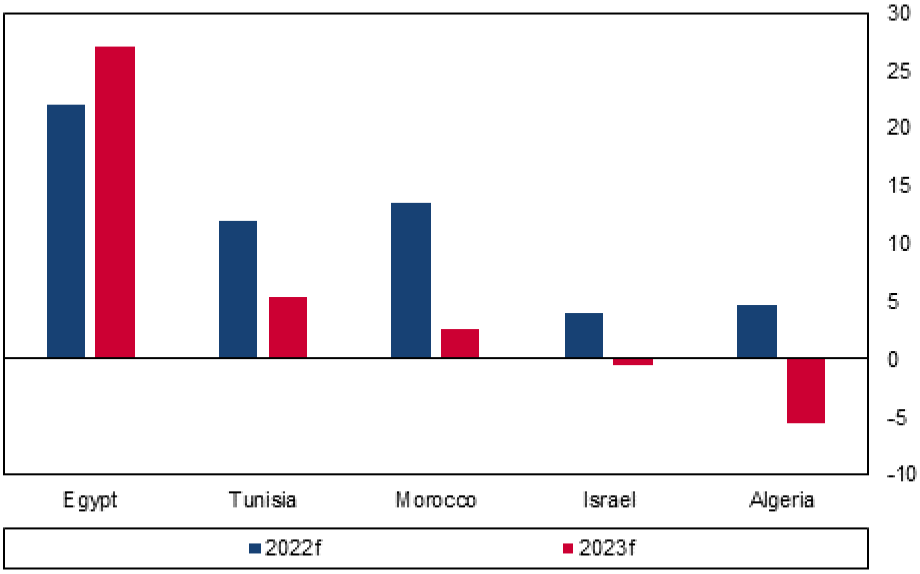


f = Fitch Solutions forecast. Source: National sources, World Bank, Fitch Solutions

Lower commodity prices due to the normalisation of supply chains and slowing global demand will lead to disinflation in some components of consumer price index baskets. North African countries will benefit the most from this as food and energy account for a significant share of their consumer price index baskets. For instance, average wheat prices will fall by 7.8% y-o-y and corn by 4.3% in 2023, while average Brent oil prices will decline by 6.9% y-o-y (*see chart above, right*). Despite these declines, the prices of key commodities will remain above their historical averages.

...And More Supportive Exchange Rate Dynamics

MENA - Exchange Rate, LCU/USD, % chg (2022 & 2023)



Note: % chg is the year-on-year change in the annual average exchange rate. Negative change means currency appreciation. f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

A weaker dollar after Q123 will provide some relief for MENA currencies, reducing imported inflation. We expect a modest weakening of the Tunisian dinar and the Moroccan dirham in 2023, while Algeria (due to market intervention) and Israel will see their currencies appreciate (*see chart above*). The Egyptian pound will be the exception as it will start 2023 from a significantly weaker level after two large devaluations in 2022.

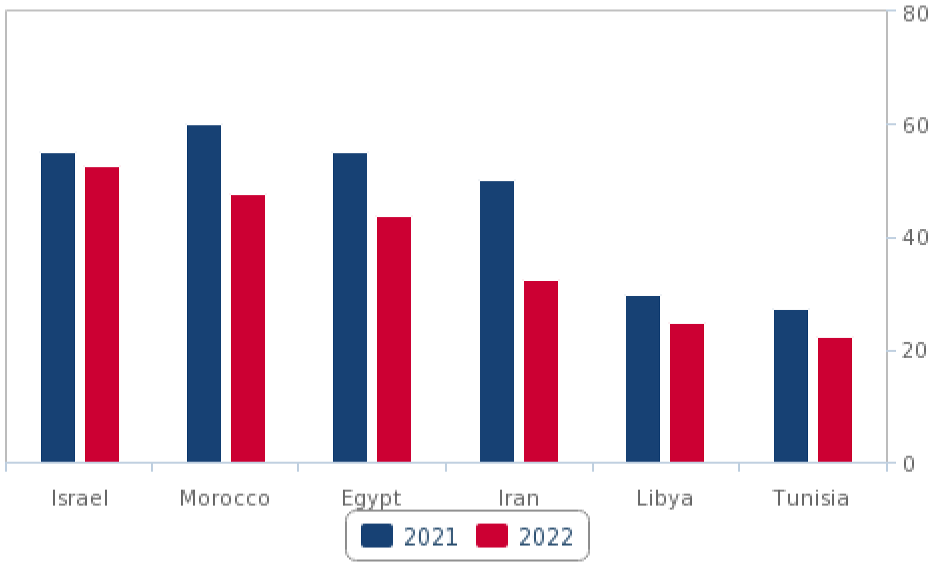
Theme 3: Significant Chance Of Protests In North Africa And Levant

In 2023, we see a significant chance of protests in North Africa and Levant, which will increase risks to macroeconomic stability in MENA. Egypt, Iran, Iraq, Israel, Morocco and Tunisia are particularly vulnerable. After being severely hit by the outbreak of Covid-19 in 2020, a short breathing space in 2021 was quickly followed by another shock in the form of Russia's invasion of Ukraine in early 2022. Most of these countries will enter 2023 with long-standing external, fiscal and labour market weaknesses that will be compounded by the rising cost of living (*see Theme 2*), weak economic growth (*see Theme 1*) and stagnating remittances due to an economic recession in the eurozone. Many of these countries have already started seeing bouts of protests in Q422.

In Israel, while a weakening macroeconomic outlook will increase discontent, the risk of social unrest will be mainly due to the elevated tensions between Arab and Jewish Israelis fuelled by the new right-wing government's harder stance on Palestine. In Iraq, underlying inter- and intra-ethnic tensions could lead to large-scale protests if the new Al-Soudani government fails to keep its promises of political and economic reforms.

Chances Of Protests Rising

Selected MENA Markets - Social Stability Score (2021 & 2022)

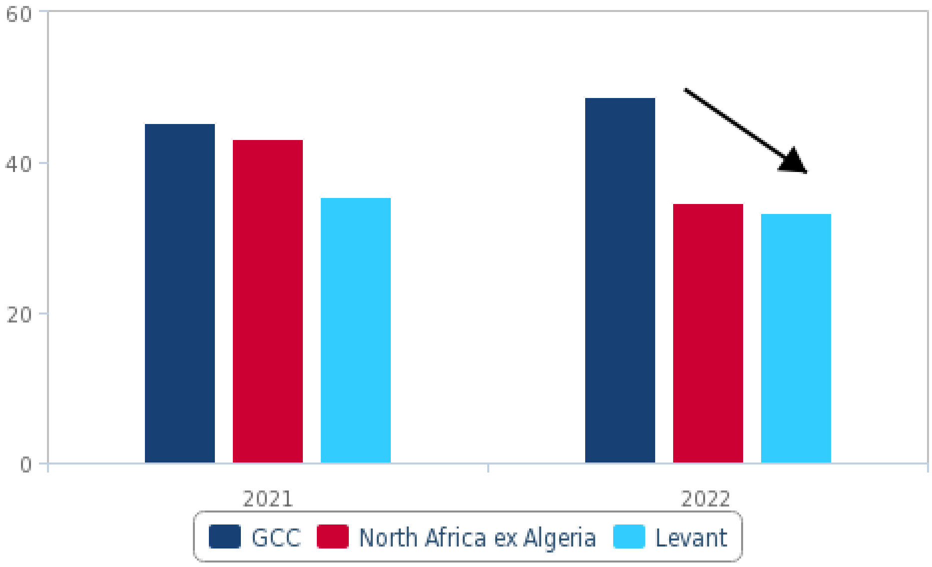


Note: Scores out of 100; higher score = lower risk. Source: Fitch Solutions

Reflecting this dimmer political outlook for the upcoming 12 months, we have revised down the 'social stability' sub-component score in our proprietary Short-Term Political Risk Index in these markets several times throughout 2022 (*see chart above*). This adds to the already high risk of social unrest in Iraq, Jordan, Lebanon, and West Bank and Gaza. Compared with the GCC and excluding Algeria - where the government will increase social spending to shore up support - the risk of protests in North Africa and Levant is significantly higher (*see chart below*).

Gap With GCC Widening

MENA - Social Stability Score (2021 & 2022)



Note: Scores out of 100; higher score = lower risk. Source: Fitch Solutions

In most of these countries, fiscal policy will provide only limited support. Not only will they enter 2023 with fragile fiscal positions, but tighter monetary policy will increase their debt servicing costs, exacerbating pressure on public finances. Egypt, Tunisia, Lebanon and Morocco are likely to adopt painful fiscal and financial measures in exchange for funding as part of IMF programmes. This will likely entail reforming government subsidies and exchange rate systems as well as cutting capital spending, among others. All of these will further weigh on economic activity and keep the cost of living elevated. In Morocco, while we anticipate the Akhannouche-led government to increase spending to support the economy, this will not be enough to ease popular frustration with high prices.

SELECTED MENA MARKETS - IMPLICATIONS AND TRIGGERS OF SOCIAL UNREST

Market	Implications Of An Outbreak Of Social Unrest In The Next 12-18 Months	Triggers Of Recent, Current And Future Unrest
Egypt	IMF-mandated market reforms could be delayed; foreign investment could be further discouraged; further currency weakening.	Lack of economic opportunity; rising cost of living; elevated unemployment; implementation of painful fiscal measures.
Israel	Protests could fuel tensions and clashes between Arab and Jewish Israelis, with consequences for the country's long-term growth and stability.	Tensions in the West Bank and Gaza; tensions between Israeli Arabs and Israeli Jews; hardline government policy towards settlements.
Iran	Extension of protests could limit incentive for US to resume Iran Nuclear Deal negotiations; loosening of socially conservative policies; reshuffling of public administration.	High inflation and unemployment; water rationing; implementation of socially conservative policy; perceived abuse of power by authorities or law enforcement officers.
Iraq	Large-scale protests could easily lead to a breakout of violence between supporters of different political leaders, discouraging investment and consumption.	High cost of living; deep interethnic tensions; easy access to weapons; perceptions of government corruption; lack of economic opportunities; perceived excessive interference of Iran into domestic affairs.
Lebanon	Large street protests could weigh significantly on economic activity, delay/derail an IMF programme and could translate into inter-ethnic violence.	High cost of living; deep inter-ethnic tensions; perceptions of government corruption; declining wealth; limited access to basic goods, including healthcare and electricity.
Libya	Protests are more likely to erupt in the West of the country, where militant groups would expand their operations in main urban centres, delaying improvements in public administration and works on infrastructure projects; protests could lead to political gridlock and blackouts in utility supplies.	Lack of government fiscal support; perception of government corruption; policy gridlock; elevated cost of living; power cuts.
Morocco	Protests will remain contained, with limited disruption to economic activity. Delays in fiscal consolidation.	Elevated cost of living; high youth unemployment.
Tunisia	Renewed protests could encourage a more permanent consolidation of power by President Kais Saied; delays in reaching IMF deal.	Escalation of tensions between President Kais Saied and Ennahda and other political parties; perceived failure to deliver on promises of economic opportunity and reform; implementation of painful fiscal measures.
West Bank and Gaza	Protests could lead to an escalation of violence with the Israeli Defense Force and could drive up the popularity of radical militias with severe disruptions to economic activity.	High unemployment; lack of economic opportunity; assertive stance of Israeli right-wing government on Palestinian settlements.

Source: Fitch Solutions

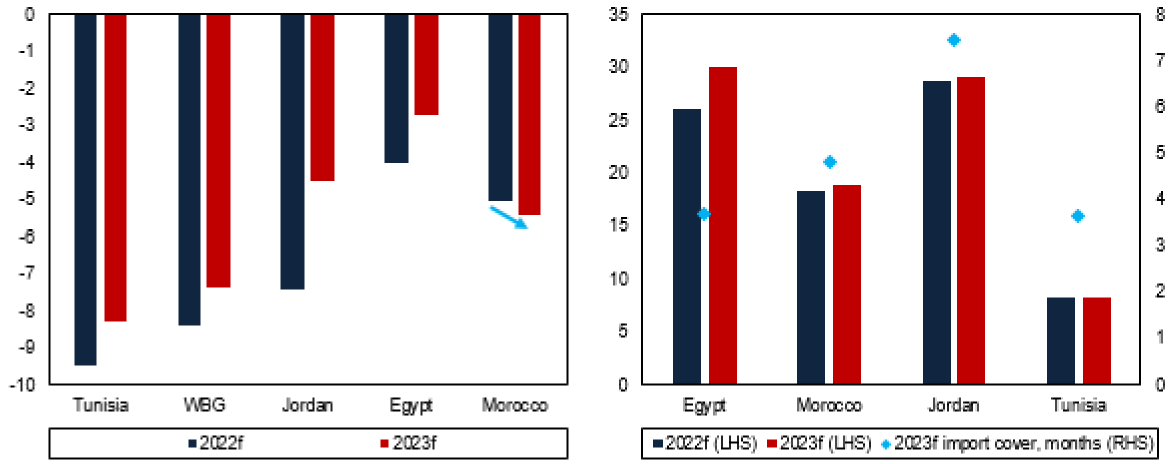
While we do not expect protests to spiral out of control in these countries due to fragmented opposition and government policing actions, we cannot rule out this possibility. A sudden controversial event could act as a trigger for large-scale protests. While social unrest might not take place at the same time, we believe that contagion risks are high. For instance, protests could derail the implementation of IMF-related measures and put much-needed funding at risk. They would also disrupt economic activity and discourage foreign investment (*see table above*).

Theme 4: Narrower Current Account Deficits For Hydrocarbon Importers, But Financing Risks Persist

We expect that the external positions of MENA hydrocarbon importers will benefit from lower global commodity prices in 2023, but pressures will persist. We forecast that the GDP-weighted average current account deficit for these countries (excluding Israel, which will post a surplus) will narrow from an estimated 4.5% of GDP (USD32.4bn) in 2022 to 3.6% of GDP (USD25.7bn) in 2023, largely owing to lower import bills. While all MENA hydrocarbon importers will post narrower deficits, except Morocco (*see chart below left*), financing risks will remain high. We expect Morocco to join Egypt, Jordan and Tunisia in seeking IMF support due to rising pressures on its foreign currency reserves, which fell to below five months of import cover for the first time since 2013 (*see chart below right*).

External Pressures Will Persist Despite Narrower Deficits

Selected MENA Hydrocarbon Importers - Current Account Balance, % of GDP (LHC) & Foreign Currency Reserves, USDbn (RHC)



f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

Financing risks will be particularly high in Egypt and Tunisia as they face large external funding needs in 2023. This will leave them reliant on timely financial support from the IMF and other sources, and in the case of Egypt also on access to international debt markets and foreign direct investment. However, the access to the much-needed funding is subject to substantial risks amid elevated public discontent in both countries as support is conditional on the implementation of reforms (*see Theme 3*). With relatively low FX reserves (*see chart above, right*) and a negative net foreign asset position in Egypt, this will further weaken the Tunisian dinar and the Egyptian pound, increasing pressures on the two countries' unfavourable debt dynamics.

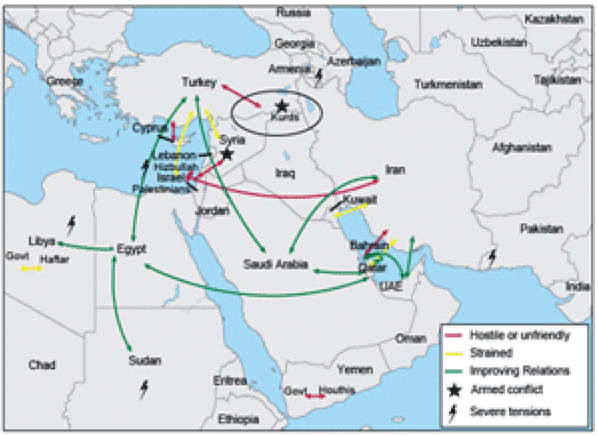
Theme 5: Fragile Geopolitical Equilibrium

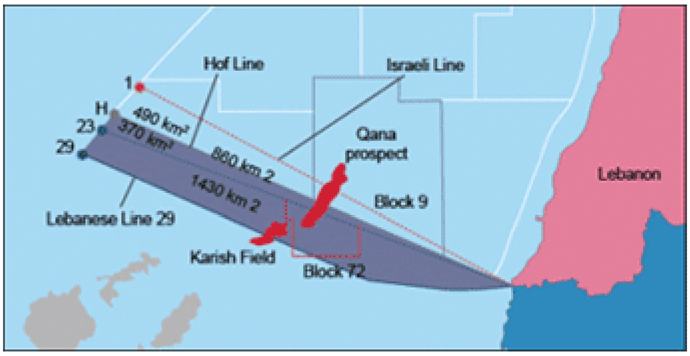
We believe that the MENA region will be characterised by a fragile geopolitical equilibrium in 2023. This follows an overall easing of tensions across the region in 2022 which are unlikely to flare up again. As predicted in our Key Themes for 2022, we have seen a wave of reconciliation between several MENA countries. Most notably, Turkey and the UAE, Saudi Arabia and Egypt, and the restoration of diplomatic ties between Iran and Kuwait as well as the UAE (*see map below, left*). We have also seen some degree of bilateral engagement between historical rivals such as Saudi Arabia with Iran and with Israel. Most recently, on October 27

2022 Israel and Lebanon signed the maritime border deal that they had reached two weeks earlier, following years of on-and-off US-mediated talks (*see map below right*).

Tensions Eased In 2022

LHC: Map Of Middle East; RHC: Lebanon & Israel Maritime Borders Map

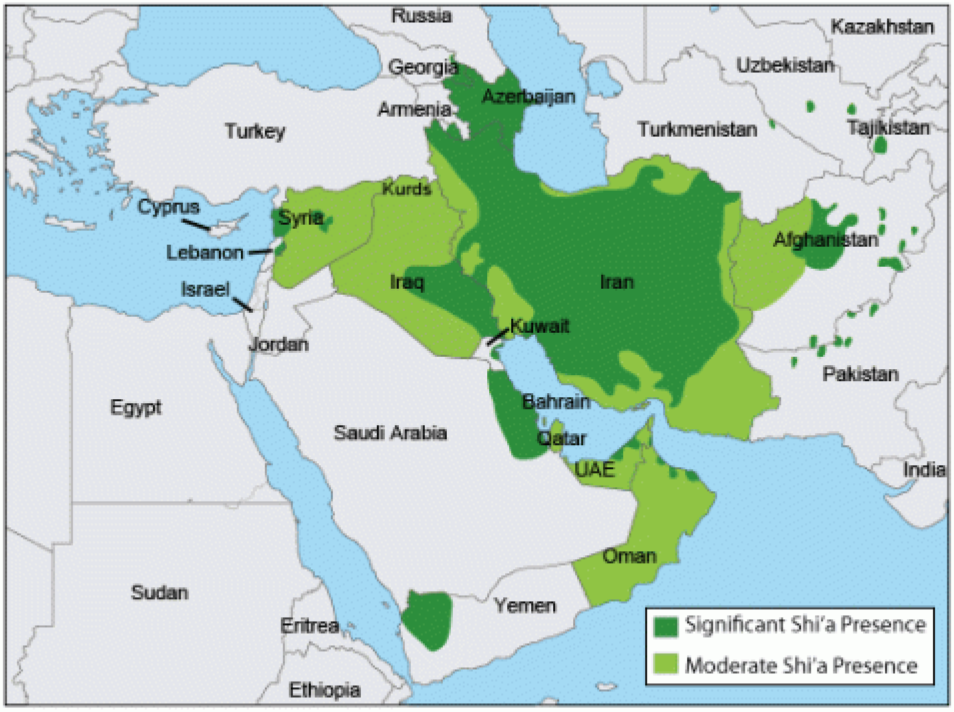




Source: L'Orient Today, Fitch Solutions

While these reconciliations have facilitated the improvement of political conditions in some countries where key MENA powers have influence, several of these countries will continue to be governed by a fragile status quo. Central to our belief that the region's equilibrium will persist is that both geopolitical and domestic risks in Iran will abate. On the foreign front, we still think that there will be a return to the Iran Nuclear Deal in H123, capping Iran's adventurist posture in the region through its proxies (*see map below*). Domestically, while we believe that recent mass protests will die down by Q123 due to the government's policing efforts, smaller-scale demonstrations will continue in the country's periphery.

Nuclear Deal Will Lower Risks In Iranian Network
Middle East - Map Of Shi'a Presence

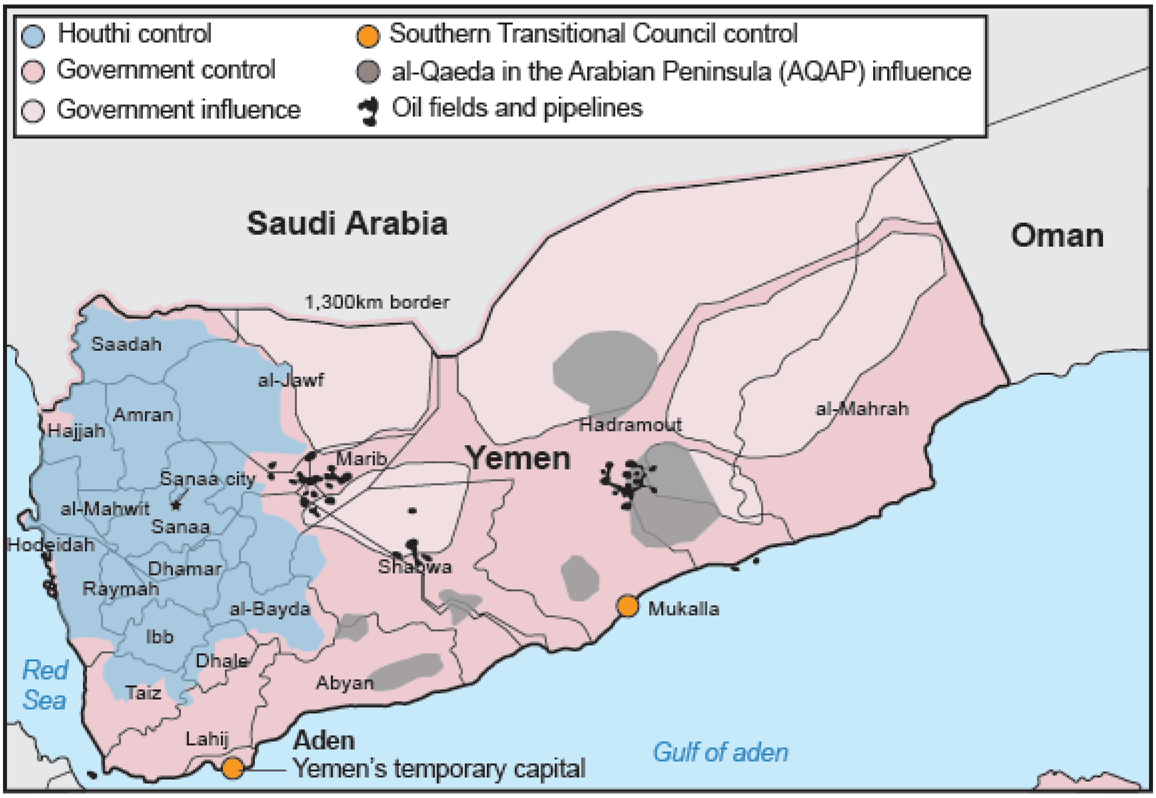


Source: Fitch Solutions

In Yemen, while the expiration of the ceasefire between the Iran-backed Houthis and the Yemeni government will cause tensions to escalate, we believe that political forces are unlikely to escalate fighting and that another truce will be reached by Q123, brokered by the international community. Nonetheless, the risk of the resumption of hostilities remains elevated. In Iraq, the quick formation of a new Iran-friendly government likely reflects a power compromise between the main political players, allowing for some stability in the country. However, deep ethnic and ideological differences could lead to a sudden eruption of violence.

Yemen Is Split Along Sectarian Grounds

Map Of Yemen

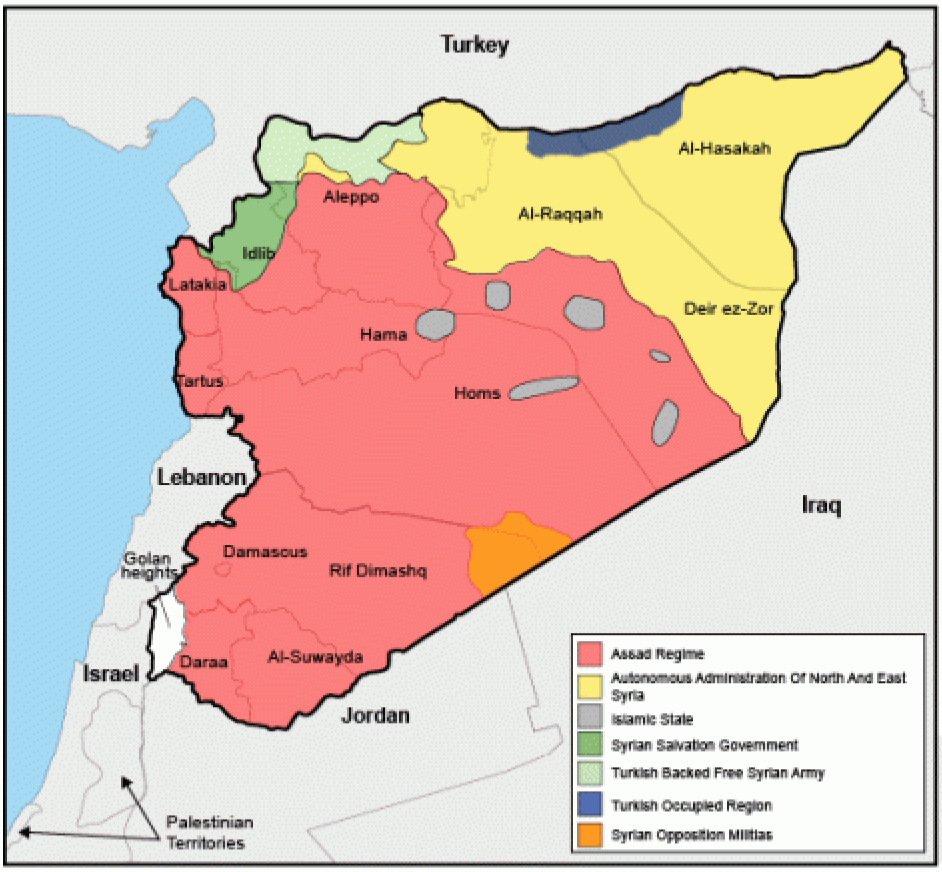


Source: Al-Jazeera, Fitch Solutions

In Lebanon, while we expect that the political forces will reach an agreement with the IMF by Q223, paving the way for the resolution of the existing crisis, entrenched ethnic divisions, vested interests and challenging macroeconomic conditions will keep popular dissatisfaction extremely elevated. In Syria, while we do not expect skirmishes between Turkiye and the Kurdish-led Syrian Democratic Forces will escalate to a full-blown conflict and prompt a Turkish ground incursion, we expect some level of fighting to continue. In Libya, tensions will remain elevated as various political players in the country's east will seek to establish themselves as the main opponent to the Tripoli-based Government of National Unity (GNU).

Syria Will Remain Divided

Map of Syria & Areas Of Military Control



Note: Areas of control as of December 5 2022. Source: Syria Live Map, Fitch Solutions

The status quo in most of these countries could break easily. The main factor that could lead to such a rupture is a delay or a failure in negotiations for the return to the 2015 Iran Nuclear Deal. For example, if the talks take longer than our core view (or break down entirely), if Iran's military support to Russia deepens or the protests in Iran last longer (*see Theme 4*) than we are currently expecting, which would make Washington unwilling to re-reengage with Tehran. This would increase geopolitical tensions and lead to renewed violence in proxy conflicts across the region. Iran would mobilise Hezbollah to increase tensions in Lebanon, the Houthis in Yemen could initiate cross-border attacks on Saudi Arabia and the UAE, and the Iraqi government could adopt an even more a more aggressive pro-Iran stance, which could lead to popular backlash by political opponents. This would likely prompt a worsening economic outlook in Lebanon, Iraq and Yemen. In Libya, different eastern-based militias could resort to fighting and oil export blockades to emerge as the leading opponent to the GNU.

Asia Key Themes

As 2022 draws to a close, we at Fitch Solutions lay out five key themes that we expect will have a major impact on the Asia-Pacific region for 2023.

ASIA KEY THEMES FOR 2023

Theme	View
Tensions Between the US And Mainland China Will Intensify	We anticipate that tensions between the US and Mainland China will continue to increase in 2023 on two fronts as the Republican-controlled US House of Representatives raises pressure on the administration under President Joe Biden to adopt tougher stances on Beijing, and the latter responds accordingly.
Foreign Direct Investment (FD) Inflows Will Slow	We think that FDI inflows stagnated in 2022 and expect a decline of 10-15% in 2023. That contraction would be somewhat sharper than the one over 2015-2016 but less severe than the decline in the aftermath of the global financial crisis
Zero-Covid To Be Lifted In Mainland China, Benefitting Regional Tourism Recovery	Asia's tourism recovery will pick up pace in 2023 due to the influx of tourists from Mainland China, who in pre-pandemic times accounted for 20-30% of total visitors in the region.
Fiscal Consolidation Will Accelerate In 2023 After A Slow Start In 2022	We expect that most governments in Asia will accelerate fiscal consolidation efforts in 2023 as pandemic-related spending is scaled back, inflationary pressures ease and borrowing costs rise.
Protest Risks Will Remain Elevated Due To Worsening Food Insecurity	Food security is likely to remain a key source of uncetainty for Asia in 2023, which could weigh on social stability and add to political risks.

Source: Fitch Solutions

Theme 1: Tensions Between the US And Mainland China Will Intensify

We anticipate that tensions between the US and Mainland China will continue to increase in 2023 on two fronts as the Republican-controlled US House of Representatives raises pressure on the administration under President Joe Biden to adopt tougher stances on Beijing, and the latter responds accordingly.

First, we expect that geopolitical rivalry and security risks between Washington and Beijing will likely intensify after the lower house of US Congress, which is now controlled by the more hawkish Republican party, passed the Taiwan Enhanced Resilience Act (TERA), which aims to provide greater security assistance to the market. In addition, the lower house is looking to push forward with the US-Taiwan Initiative on 21st Century Trade which aims to increase two-way trade and investment. At the same time, the Biden administration is likely to strengthen its alliances with Japan, South Korea, the Philippines and Australia for the purpose of counterbalancing Beijing's influence in the Indo-Pacific region. This will complement initiatives such as the new Indo-Pacific Economic Framework for Prosperity, which includes 12 Asian markets. Beijing is likely to respond by periodically increasing military activity and exercises around Taiwan, China and by strengthening ties (or at least maintaining cordial ties) with closely aligned states, such as Russia, Iran and North Korea, among others.

US To Focus More On Indo-Pacific In 2023

Indo-Pacific Region – Geopolitical Alignments

Note: May include territories, special administrative regions, provinces and autonomous regions. Template image: d-maps.com. Source: Fitch Solutions

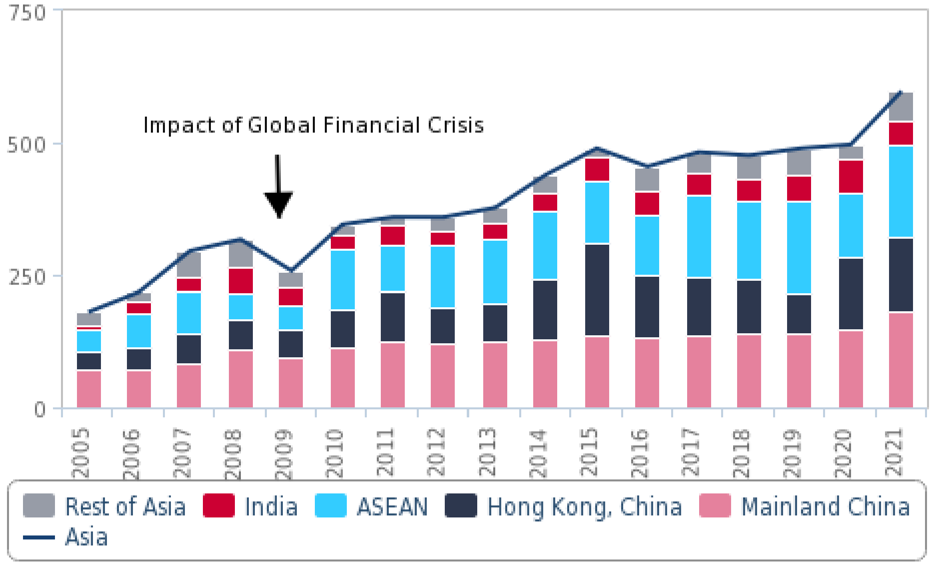
Second, on the economic front, the US is likely to introduce further restrictions on high-tech goods exports to China as competition between the two markets over semiconductors and next-generation technologies increases, leading to slower trade and technology transfers over the coming quarters. We expect that Beijing will steer clear of retaliating against the US tech sector in the near term as this would impose further difficulties on China-based companies which still rely on other technology imports which are not yet being restricted. Instead, we believe that the Chinese authorities will resort to rhetorical and largely symbolic responses, as was the case when some countries restricted China-based 5G providers from their telecommunications markets.

Theme 2: Foreign Direct Investment Inflows Will Slow

FDI inflows into Asia jumped by 20.0% to a record USD597bn in 2021, but we think that FDI inflows have stagnated in 2022 and expect a decline of 10-15% in 2023. That contraction would be somewhat sharper than the one over 2015-2016 but less severe than the decline in the aftermath of the global financial crisis (GFC).

FDI Inflows To Asia May Have Already Peaked

Asia – Foreign Direct Investment Inflows, USDbn (2005-2021)



Note: May include territories, special administrative regions, provinces and autonomous regions. Source: Macrobond, Fitch Solutions

We are forecasting that global output will grow by 1.9% in 2023, which would be nowhere as severe as the outright economic contraction in 2009 caused by the GFC. Nevertheless, we expect recessions in the US and the eurozone, which will hit corporate profits and limit foreign investment appetite. Whereas developed market central banks responded to the GFC by loosening monetary policy, which encouraged investment, we think that they will keep policy tight in 2023 in response to elevated inflation. This will keep financing costs for corporates in the US and in the eurozone elevated, which will subsequently limit the ability of firms to invest overseas.

Business attitudes to supply chain management are also very different now than they were a decade ago. In particular, multinational corporations have developed stronger preferences for reshoring as a result of the trade tensions between the US and Mainland China. This trend has accelerated since 2020 as a result of Covid-19 and Ukraine war-related disruptions highlighting the risks of cross-border operations.

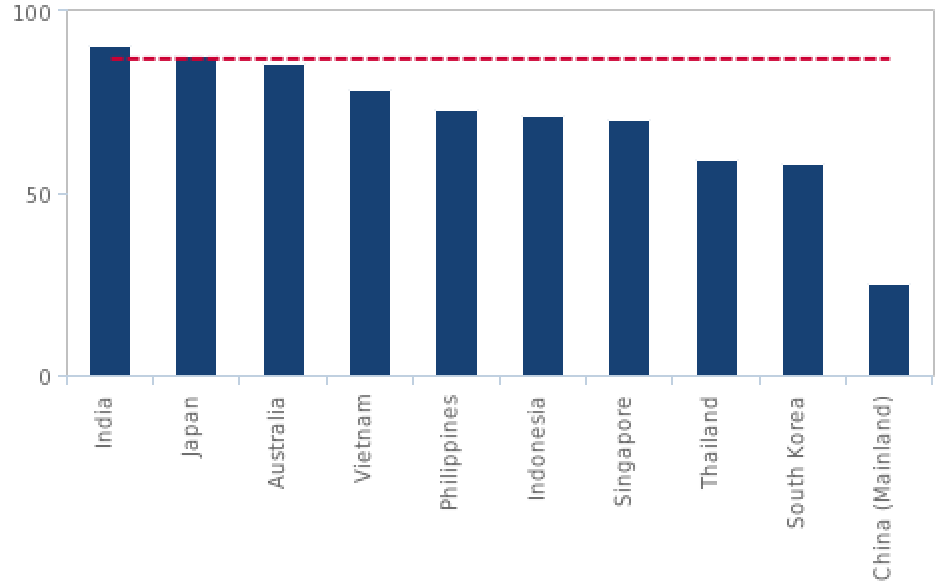
Geopolitical considerations have also been prompting governments to incentivise domestic production, which is likely to push firms to investing locally. The starkest example is the US CHIPS Act passed by Congress in 2022, which has come at a time of deteriorating China-US relations and a global race for semiconductor leadership. Among other things, the US has set aside USD52.7bn to boost domestic investment in the production of semiconductors, alongside a 25% investment tax credit for chips-related capital expenses.

Theme 3: Zero-Covid To Be Lifted In Mainland China, Benefitting Regional Tourism Recovery

The recovery in tourism will pick up pace across Asia in 2023 due to the influx of Chinese tourists. While economies across the region generally saw a rebound in their tourism sectors in H222, the recovery was held back due to the absence of Mainland Chinese travellers, who represented about 20-30% of total visitors in the pre-Covid period. This is the key reason why most Asian economies' travel recoveries have been slower than the global average (*see chart below*).

Still Below Global Average For Most

Selected Asian Markets - Active Flights, Seven-Day Average, % (Early December 2022 Versus 2019)



Note: Red dashed line = global average. Source: Airportia, Fitch Solutions

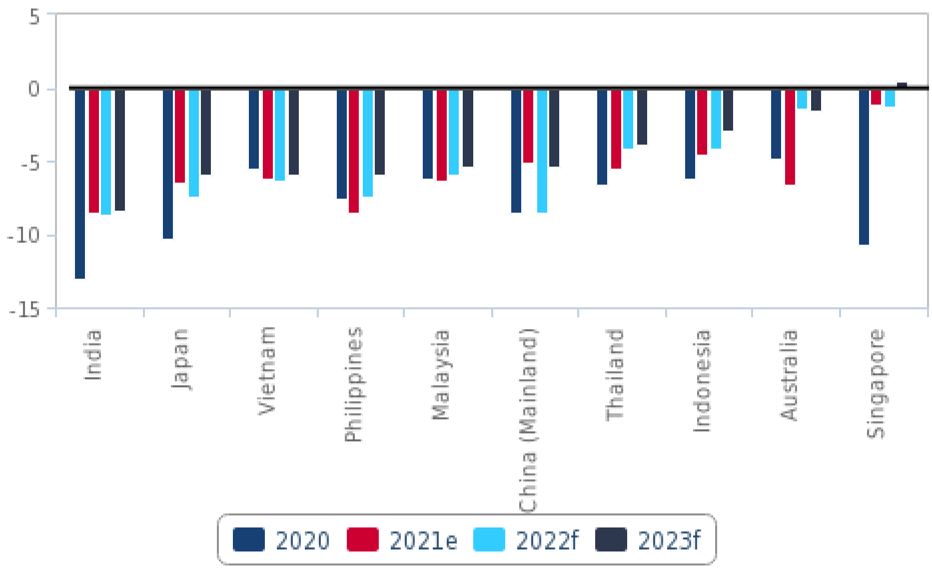
Our base case scenario is for Mainland Chinese authorities to continue to ease Covid-19 restrictions at the margin over the coming months and shift away from its zero-Covid policy in a more significant way after the annual meetings of the national legislature and the top political advisory body ('Two Sessions') in March 2023. The eventual normalisation of economic activity and lifting of border controls in China would provide a substantial boost to the region's tourism industry. Already we are seeing signs of a potential pivot in the zero-tolerance policy towards Covid-19, with the authorities lifting lockdowns and scaling back mass testing even as cases surged to a record high.

Theme 4: Fiscal Consolidation Will Accelerate In 2023 After A Slow Start In 2022

We expect that most governments in Asia will accelerate fiscal consolidation efforts in 2023 as pandemic-related spending is scaled back, inflationary pressures ease and borrowing costs rise. Against a backdrop of elevated inflation and tightening monetary conditions, policymakers across Asian markets have adopted various fiscal support measures in an attempt to help their citizens cope with the rising cost of living. Some of these policies include subsidies, tax cuts, price controls and trade protectionist measures. As a result, many authorities in the region have delayed fiscal consolidation - despite an increase in debt due to the pandemic - as well as market-friendly reforms.

Fiscal Balance Will Improve In Almost All Economies

Selected Asian Markets - Budget Balance, % of GDP (2020-2023)



e/f = Fitch Solutions estimate/forecast. Source: National sources, Fitch Solutions

In Mainland China, we expect that the budget deficit will widen to a record high of 8.6% of GDP in 2022 before narrowing sharply to 5.4% in 2023, supported by the ongoing economic recovery. In January-November 2022, the Chinese authorities have rolled out a series of tax cuts, subsidies and infrastructure spending plans to support the economy, while revenue has taken a big hit due to the ongoing weakness in the real estate sector.

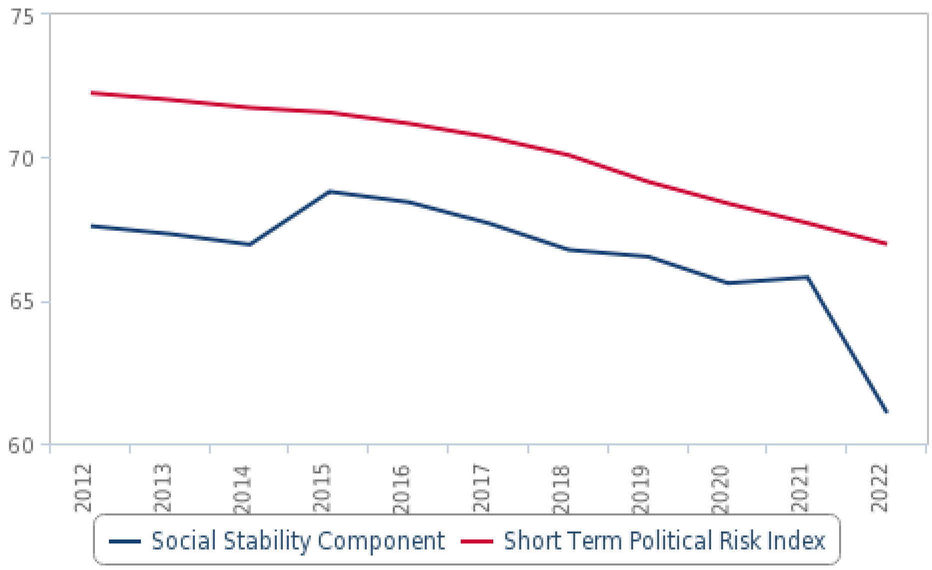
In South East Asia, we also expect fiscal deficits to narrow in Indonesia, the Philippines, and Vietnam, while we expect that the budget in Singapore to flip back into a surplus. Indonesia's government has reinstated the fiscal deficit ceiling of 3.0% of GDP for 2023 after suspending it for 2020-2022 due to the Covid-19 pandemic. Accordingly, we expect that Indonesia's budget deficit will narrow from our estimate of 4.2% of GDP in 2022 to 3.0% of GDP in 2023. We also believe that the Philippines remains on track for fiscal consolidation in 2023 due to strong revenue growth on the back of extensive tax reforms and robust economic growth, which will offset expansionary fiscal spending. The Singapore government has confirmed a raft of revenue expansion measures, including a hike in the goods and services tax from 7.0% to 8.0%, effective January 1 2023, and to 9.0% in 2024 as well as a hike in taxes on luxury cars and property. In particular, the taxes on residential properties not occupied by their owners will be increased from 10-20% to 11-27% in 2023.

Theme 5: Protest Risks Will Remain Elevated Due To Worsening Food Insecurity

Elevated food security is set to remain a persistent theme in Asia in 2023, and this could weigh on social stability across the region. According to the Food and Agriculture Organization (FAO), about 10.5% of the population in Asia faced severe food insecurity in 2021. This figure likely increased in 2022, in line with data from the World Bank highlighting that individuals suffering from acute food insecurity globally more than doubled from 135mn in 2019 to 345mn by June 2022. This comes as the economic fallout of the Covid-19 pandemic, supply chain disruptions and the Russia-Ukraine war pushed food prices to all-time highs in March 2022. While food prices - proxied by the FAO Food Price Index - have since fallen by 15.0% from the March 2022 peak, we expect that escalating geopolitical tensions and increasing climate volatility will continue to threaten the stability of global and regional food markets over the coming quarters.

Social Stability Risks Have Been Weighing On Asia's Political Outlook

Asia – Short-Term Political Risk Index & Social Stability Sub-Component Scores (2012-2022)



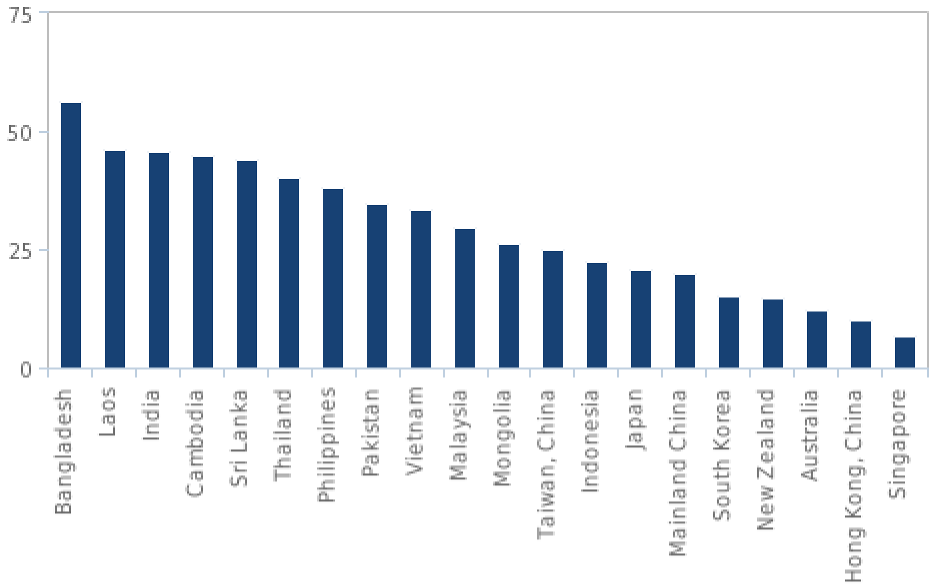
Note: May include territories, special administrative regions, provinces and autonomous regions. Scores out of 100; higher score = lower risk. Source: Fitch Solutions

We think that the war in Ukraine remains a key source of uncertainty for food prices. Russia and Ukraine together account for the largest proportion of global wheat trade (at 28%) and about 18% of global maize exports. Food and fertiliser exports from key Ukrainian ports have resumed as a result of the Russia-Ukraine Black Sea Grains Initiative. However, there is no guarantee that either party will remain committed to the agreement, and food supply chains will remain vulnerable in the meantime.

Economies that spend a significant proportion of their income on food are particularly vulnerable to the risk of renewed food price increases. Bangladesh, Laos and India stand out, and increased food prices would also be especially damaging for Sri Lanka and Pakistan, both of which are still in the middle of balance of payments crises.

Economies With Higher Food Weighting In CPI Baskets Are More Vulnerable

Selected Asian Markets - Food Weighting Within CPI Baskets



Note: May include territories, special administrative regions, provinces and autonomous regions. Source: Local Sources, IMF, Fitch Solutions

Many Pacific islands as well as South and South East Asian economies will need to navigate climate change risks, which can depress crop yield and damage key infrastructure. According to the World Bank, South Asia is one of the most vulnerable regions to extreme weather events induced by climate change. More than half of all South Asians have been affected by climate-related disasters in the past two decades. A recent example is Pakistan, which is experiencing severe flooding due to heavy monsoon rainfall. Flooding is a key reason why we expect that real GDP growth in Pakistan will slow sharply from 6.0% in FY2021/22 to 0.2% of GDP in FY2022/23 (July-June).

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