

The Long View 2023: Big, foundational issues will dominate the global business leader agenda.

December 8, 2022

Topline: The world is in a macro moment.

- Uncertainty about the world's **macroeconomic** state—most importantly inflation—will be the predominant theme of the global narrative. The persistency of inflation will determine interest rates, access to capital, investment levels, consumer and market sentiment, and growth. Another macro uncertainty will be the health of China's economy and its significance for business there and around the world.
- **Macropolitical** dynamics will override micro policy issues. Key concerns include the political dynamics in China, Europe, and the US, and the futures of Ukraine, Russia, and Iran. Small and medium-sized economies will struggle for visibility and influence in a world dominated by two Cold War blocs.
- **Macro transformation** will take precedence over micro-optimization. Sustainability, digitalization, and value chain reengineering require ambitious efforts, not fiddling.
- **What this means for business leadership: Operating at two levels.** Success will not only require keeping the enterprise going but also navigating big uncertainties and shifts in the macro field of play.

Four geopolitical drivers will shape the business context.

Two immediate drivers: Pandemic fallout and the war in Ukraine.



- **Pandemic fallout** will continue disrupting the economic narrative. The disruptions will manifest in the unwinding of extraordinary monetary policies and market volatility; supply chain problems and weak consumer sentiment in China; and labor and social upheavals.
- **The war in Ukraine** is reshaping the contours of Europe and transatlantic relations. It is calling out dependencies on China and Taiwan—most notably in technology. And it has accelerated the redivision of the world into Cold War blocs, the reengineering of energy supply chains, and the push for sustainability. ►

Two long-term drivers: Technology competition and nationalism.



- **Technology competition:** The Fourth Industrial Revolution has driven globalization, and the dominance of large American tech platforms (including the foundations of the internet) has driven standardization. Now, other countries and companies are rising and challenging US-led tech dominance, and geostrategic competition has spread to many lines of business.
- **Nationalism** has become a worldwide political reaction to economic and cultural integration and the societal pressures of labor arbitrage, the Fourth Industrial Revolution, and migration. In the business world, nationalism manifests in governments' efforts to impose controls on data, technology, capital flows, Covid, and people's identities.

Going deeper: Six business leadership issues that will unfold.

1. Economic swings and extremes will complicate business strategy.

The issue: Economic fundamentals have confounded the experts.

- **Inflation** greatly exceeded expectations and dominated the economic narrative in 2022, but the cost of key producer inputs started falling as the year progressed.
- **Global growth** slowed sharply in 2H22, and China, India, and the US significantly underperformed expectations set earlier in the year. But growth in Europe exceeded expectations despite surging energy prices.
- **US equity markets** fell into bear territory, but **corporate profits** surprised on the upside. Strong job creation and consumer spending defied expectations.
- **Turmoil in the UK** this fall highlighted economic and political risks in an era of rapid inflation, slow growth, tight liquidity, and the unwinding of large central bank balance sheets.

Signposts to watch:

- **Has the inflation fever broken?** Experts' disagreements will persist into early 2023 over central banks' imperatives to beat down economic activity and prices via rate hikes. The China slowdown will also have deflationary effects.
- **Uneven performances:** The UK, Germany, and Italy are expected to tip into recession in 2023, but the US may see a narrow escape and a soft landing. Growth in Asian economies is expected to be varied but solid. ►

Bloomberg Commodity Index



Financial Times, December 7, 2022.

- Sluggish global growth will push producer prices down in 2023 and **dim the prospects for many industries** that had been flying high: oil and gas, metals, logistics, property, luxury goods, and semiconductors. Agriculture will likely face falling prices and droughts.
- **Debt-driven policies and deals** that made sense in the past will need to be reevaluated and perhaps unwound. M&A and IPOs will remain spotty in 2023, while credit risks, insolvencies, and restructurings will increase.

2. Businesses will face unprecedented uncertainty in China.

For 30 years, China delivered exceptional, reliable growth for global firms. That has ended.

- China's growth in 2022 is expected to be **3.0%–3.5%**—significantly below the 4.7% growth rate required to attain the regime's long-term social prosperity target.
- In 2023, the IMF expects growth to recover to **4.4%**, but the forecast is based on questionable assumptions that an easing of Covid restrictions and traditional stimulus measures will overcome the many headwinds the economy faces.

Many economic indicators are flashing yellow.

- **Property investment and sales** fell sharply and home prices started declining too in 2022. Provincial and municipal governments account for 85% of public sector spending and this has been sustained by revenue from property sales and running up debt. Although Beijing is extending a lot of credit to developers, the funds don't patch local governments' \$1 trillion budget hole, so social spending will be shortchanged. ►

YoY GDP growth in China, by quarter (%)



National Bureau of Statistics of China via Trading Economics, November 18, 2022.

- **Market pessimism** has depressed share prices, and the yuan tumbled to 10-year lows in 2022. Meanwhile, talk among the entrepreneurial business class has shifted from getting along with the government to withholding investment and getting out of the country. (Top destinations: Singapore, California, and Canada)
- **Hong Kong** lost its second-place standing to Singapore as a global financial hub—thanks to Covid travel restrictions, the political clampdown, and an expat exodus that will likely continue in 2023.

Political signposts to watch:

- The October Communist Party Congress set China's leadership and policy direction for the next five years, but economic reforms and the intention to make China more attractive to foreign investors were not agenda priorities but business implications will become clear only when **the next five-year plan is released in March**.
- Policymakers face an unprecedented array of challenges at home and abroad. President Xi Jinping favored loyalty over competence when selecting his team, which will likely limit policy discussions' candor and breadth and increase missteps. The handling of the country's **worst Covid outbreak and social frustrations** will be the important near-term indicators.
- China's global influence has been tied to its economic might. How will investors, companies, and countries **adjust to a less reliable growth engine?**

3. Ukraine will reshape the political and economic contours of Europe.

The war will subside in 2023.

- Given the pace of losses on both sides, Kyiv and Moscow will be able to sustain the current pace of war for **months not years**. Ukraine's allies are also concerned about drawdowns of their weapons stocks, given production costs and bottlenecks.
- Where the **line of contact** settles in 2023 is not clear. ►

Europe's center of gravity is shifting east.

- Ukraine became a **de facto affiliate** of both NATO and the EU in 2022. Poland, Finland, and the Baltics have become more pivotal to both institutions.
- European and US leaders in 2023 will have to start helping with **rebuilding**. This will create opportunities for Western firms: Ukraine's needs are in the hundreds of billions of euros.
- Eventually, **business investments** that once flowed to Russia will be channeled to Ukraine.



Institute for the Study of War, December 7, 2022.

Geostrategic signposts to watch:

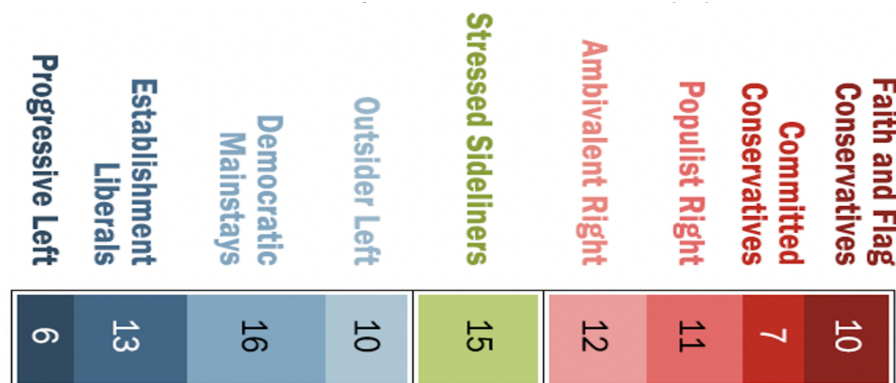
- Ukraine has been remarkably skilled in taking up Western intelligence and military support. Once the fighting ends, it will have to quickly turn its attention to embracing **governance reform and the rule of law**. (Ukraine was rated by Transparency International as the most corrupt country in Europe after Russia in 2021.)
- In 2022, Europe suffered the stunning failure of a half-century of trade engagement with Moscow. Now Ukraine is forcing **a rethink on China**. Finnish Prime Minister Sanna Marin—a rising star in European politics—summed up the situation: “We shouldn't be building strategic and critical dependencies on an authoritarian country.”
- The war has revived transatlantic military, political, and **economic ties**. Germany's exports to the US rose by nearly 50% in 2022, and the US has offset pressures on European producers from dwindling exports to China and embargoes on Russia. Europe has become a big purchaser of American LNG.

4. The US will have a year of relative political stability, but businesses will have to navigate cross-cutting winds.

The political context going into 2023:

- **No consensus:** The midterms split Congress down the middle, but focusing on the two main parties obscures the bigger picture: Political sentiment is fragmented and spread relatively evenly across a wide spectrum—from the progressive left to “faith and flag” conservatives. ►

Americans' political orientations (%)



Pew Research Center, November 9, 2021.

- **Underlying tensions:** Unsurprisingly, 81% of Americans were unhappy with the country's direction in October according to Gallup—one of the lowest-ever levels of satisfaction. In this context, Americans have strong ideas about how to fix things but differ sharply on the solutions.
- **Silver lining:** In the midterms, voter turnout was high, and fears of voter intimidation, election denials, and political violence did not materialize.

Businesses will be under more pressure from both the left and right—to do more and do less.

- Business policy issues will be trumped by **politics** as party and candidate positioning intensifies in the run-up to the 2024 election. Rising stars of the Republican party have pledged to kill "woke" policies.
- Gridlock (a.k.a. policy stability) will prevail in Washington, but business leaders will have to navigate growing policy differences **at the state level**—on abortion, ESG, and regulation, for example.
- **Cold War II will intensify:** Both parties are competing to show which can be seen as more pro-American. (China's hawkish behavior will also promote distrust.) The decisive business exits from Russia in 2022 have increased expectations in some quarters that corporates should be more critical of China.
- **Choosing battles matters:** In a 2021 Edelman survey, 86% of Americans said they expect corporate leaders to publicly engage on major issues. "Societal leadership now a core business function," said the consultancy. (Workers agree.) Yet, Disney's LGBT+ kerfuffle in Florida in March has motivated many leaders to be more cautious.

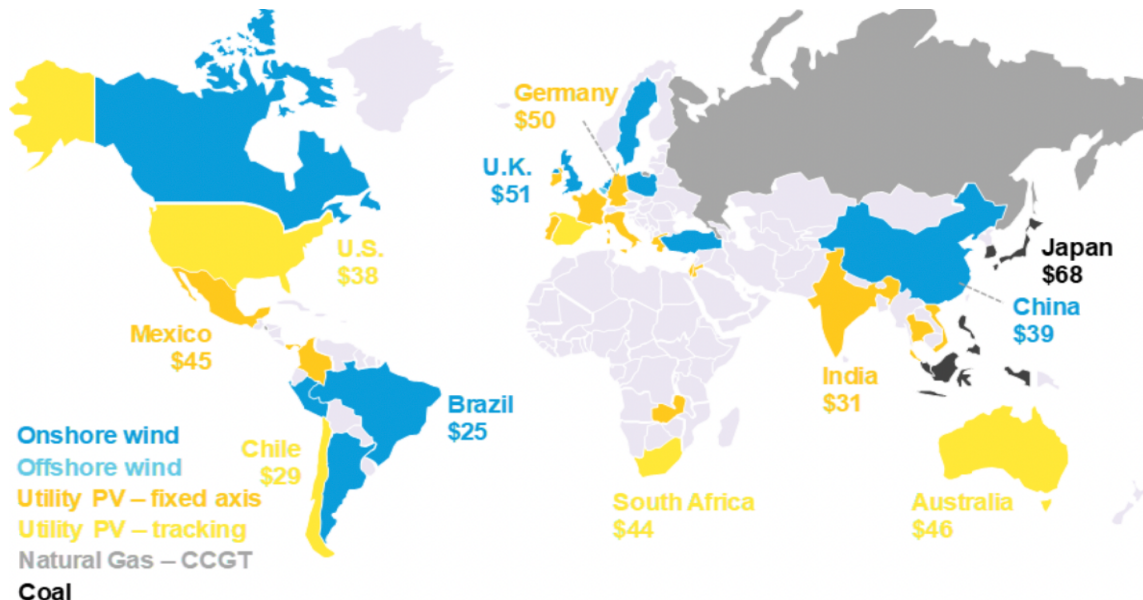
5. Energy security and the energy transition fuse with economic competitiveness and nationalism.

The energy crisis dominated headlines and pushed sustainability and the energy transition into the background in 2022. Concerns about energy prices and security thwarted an agreement at COP27 to phase down oil and gas. ►

But, but, but: The sustainability pendulum will swing back.

- The war in Ukraine has **accelerated** the quest for efficiency and clean energy. In the March–September period, solar and wind power output in the EU increased by a record 13% YoY, and by November, EU nations managed to curtail gas consumption by 24%.
- Carmakers have been rolling out **new EV models**, and high gasoline prices spurred demand. Globally, EV sales rose 63% YoY in 1H22.
- In most major markets, wind and solar are the **least-cost alternatives** for new power generation capacity. Commenting on the energy crisis, the International Energy Agency stated: "Higher shares of renewables were correlated with lower electricity prices."
- In the US, the Infrastructure Investment and Jobs Act and the Inflation Reduction Act are **market game changers**. Massive incentives will spur clean power R&D and deployment, including emerging technologies such as green hydrogen and industrial-scale batteries.

Lowest lifetime cost option for new power generation capacity in 1H22, by country



BloombergNEF, June 30, 2022.

Climate accountability will be a business leadership flashpoint.

- In the run-up to COP26 in 2021, net zero pledges and ESG investing were in vogue. Accenture a year later found that while more than one-third of the world's largest companies had made net zero commitments, **almost all will fail** unless the companies double their rate of carbon emissions reductions by 2030.
- Asset managers, banks, and corporates will have to **clarify and defend their climate stances**—to investors and stakeholders, including Red State attorneys general in the US. Early next year, the European securities regulator will finalize rules for the use of ESG- and sustainability-related terms in fund names.
- **Disclosures will be in focus:** New requirements are expected from the SEC, the International Sustainability Standards Board, and the European Commission in 2023. ►

6. A new global trade order built around values and friendships will emerge.




The Ukraine war accelerated the formation of three economic blocs reminiscent of the first Cold War: the West, China/Russia, and non-aligned nations, such as Singapore, India, and Saudi Arabia.

How this happened:

- Russia's invasion of Ukraine forged **unparalleled unity** among Western governments on of financial, technology, and trade sanctions. Ukraine aid has also been coordinated.
- Meanwhile, over the past two years, the US, EU, and Japan have aligned on a **Western vision of trade** that aims to counter the subsidies, non-market practices, unfair labor practices, and theft and forced transfer of IP common among Chinese firms.
- Western nations have also mustered infrastructure **project financing** to counter the Belt and Road program in Asia. And they are more frequently **rejecting Chinese investment** in industries deemed critical to national interests.

Tech is at the forefront of the global realignment, but many value chains are subject to geostrategic rethinks.

- The pandemic accentuated competition and dependencies in **pharmaceuticals** and personal protective equipment. At stake in early 2023 is the Biden administration's budget for more vaccine development and production and Beijing's refusal to embrace Western mRNA vaccines. ►

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- The war in Ukraine has forced trade workarounds involving **energy, fertilizer, and food**. And single points of failure were exposed in Europe's **specialty chemicals, metals, and automotive** supply chains.
 - First-generation tech restrictions implemented by the Trump administration curtailed access to specific products. In 2022, the Biden administration targeted the entire **semiconductor manufacturing ecosystem**, which could hobble innovation in China. In the coming year, Washington may expand controls to AI and quantum computing.
 - Government and corporate decision makers are increasingly concerned about access to **critical materials**—such as lithium, cadmium, and cobalt—that are essential for high-tech and clean-tech goods, such as semiconductors, wind turbines, batteries, and solar arrays. The US, Europe, South Korea, and Japan are spending heavily to localize and secure these value chains.

Globalization is not over. It will advance among like-minded and trusted friends.

- Beijing's lesson from the 2022 Russia sanctions regime is that it must become **less dependent on the West**, partner more with Moscow, and make friends elsewhere.
- Non-aligned nations will pursue **geostrategic balancing**. India, for example, will enjoy access to discounted Russian oil while it promotes a digital policy framework that is more amenable to Western firms.
- Institutions such as the **WTO, UN, the G20, and even the WEF** are losing their mojo as platforms for global cooperation, instead becoming forums to air disagreements and negotiate side deals.
- At the G20, Xi and Biden pledged to resume climate cooperation, but clean tech is likely to remain off-limits while both sides vie for its global leadership. The two countries could **agree to work in parallel**, for instance, by boosting green project financing and underwriting the loss and damage fund announced at COP27. ■