2023: Key risks on the horizon

While the new year is still young, we take this opportunity to highlight some of the key risks to the global economy, to air transportation, and to our forecasts. Although broad, the list is not intended to be exhaustive.

Source: IATA Economics. NB: The chart above utilizes the standard framework to illustrates the likelihood and potential impact of key risks facing the air transport industry in 2023. The impact is assessed with reference to our baseline expectations for the year ahead.

- **War:** The war in Ukraine will likely have caused a contraction in that economy by around 30% in 2022, and in Russia's economy of approximately 10%, and is a major reason behind the global economic slowdown from 6% GDP growth in 2021 to close to 3% in 2022. It would take an end to the war for any material upside in the outlook to materialize. While predicting when this conflict might end is nigh impossible, we assume that it will dominate the global picture also in 2023. Further looming risks of military conflict clearly include that of some form of nuclear weapon being deployed, and the already observed tensions surrounding North Korea, Taiwan, and Iran, though we regard the likelihood of any such escalation as low.
- **Global recession:** The war in Ukraine and the risk factors detailed below heighten the risks of a global recession. However, global recessions are rare, though since the Great Depression we have had two in rapid succession: the 2008 Global Financial Crisis and the 2020 COVID-related recession. Pronounced recessions are unlikely when unemployment rates are at or near record lows. Labor markets are still red hot, exemplified by the US having added 223,000 new jobs in December, lowering the unemployment rate to 3.5%. With the US, China, and the EU economies slowing simultaneously, global GDP will likely decelerate further in 2023, while remaining positive.

- **Inflation:** Most of the global surge in inflation in 2022 is related to the war in Ukraine and its effect on energy and food prices. At the global level, inflation likely reached around 9% in 2022, up from some 5% in 2021. Barring unexpected events, simply the base effect will bring inflation lower in 2023. This does nevertheless imply that the price level with remain high.

- **Oil:** Oil prices swung wildly in 2022, peaking at USD 133.2 on 8 March, but gaining only around 10% over the full year. As for the price of jet fuel, it averaged USD 139.1 per barrel in 2022 and ended the year up nearly 42% from January 2022. Further oil price volatility is to be expected in 2023, notably as a result of the US having prohibited EU vessels from transporting Russian crude oil (from 5 December 2022) and petroleum products (from 5 February 2023) to third countries. Moreover, limited refining capacity will in all likelihood mean that the historically elevated crack spread between crude and jet fuel prices will be a feature of the market also in 2023. Nevertheless, the slowing global economy should have a dampening effect on average oil prices.

- **Exchange rates:** In response to the surge in inflation, central banks have lifted policy rates around the globe. The US Federal Reserve’s policy rate now stands at 4.5%, having started 2022 at 0.25%, and will likely peak in 2023 in the vicinity of 5%. This has made the US dollar more attractive to investors and coupled with the safe-haven status of the dollar in uncertain times, including the war in Ukraine, it has brought about an appreciation of just over 8% against a basket of currencies. The cost of any US dollar denominated transactions, such as energy purchases and debt service, have risen for all who do not earn revenue in dollars, over and above the price inflation. An end to the war in Ukraine, or a recession in the US, would be catalysts for a weaker US dollar.

- **COVID:** The virus has reemerged as a risk to the 2023 outlook as it spreads through China and will most probably dampen GDP growth in that country as a result. However, the lifting of lockdowns and travel restrictions will, on the other hand, support economic activity in the economy and in air transportation. GDP growth in China in 2022 likely dropped to 4.4% according to President Xi Jinping, the lowest rate since 1990. It is uncertain whether the pandemic situation this year will allow for a higher figure in 2023.

- **Travel restrictions:** The re-introduction of travel restrictions by a number of countries around the globe in response to the COVID outbreak in China is damaging to all forms of economic activity and bring no scientifically certified benefits in terms of limiting the spread of the virus. In the EU, France, Germany, Greece, Italy, Spain and Sweden have so far tightened rules on travelers from China. Regrettably too is that in the EU and beyond, countries have failed to agree on a coordinated approach - a fundamental departure from the level playing field that the signatories of Chicago Convention (all UN member states) deemed necessary for global civil aviation. Outside of the EU, Australia, Canada, India, Israel, Malaysia, Morocco, Qatar, South Korea, Taiwan and the USA have all introduced additional COVID measures for arrivals from China.

- **The US debt ceiling:** The US has a fiscal rule which limits the amount of debt that the country can issue. Once that limit has been reached, the government can still function for a period of time thanks to cash on hand and extraordinary measures. However, when the money runs out, the government risks defaulting on its debt obligations unless the debt ceiling is lifted. While there is a degree of habitual drama around this issue on an annual basis, it led to important crises in 2011 and 2013. The risk of another crisis in 2023 is greater than usual given the sharply divided Congress. The risk of an outright default, however, is still low, though were it to occur it would have cataclysmic consequences for the US and for global financial markets.
• **Climate change:** Extreme weather events pose an ongoing risk to all infrastructure and will likely continue to disrupt air travel at some airports and flight routes. The costs associated with such events can be expected to increase, as can the costs relating to any policy response to climate change, ranging from carbon pricing to taxes and consumer protection.

• **Trade wars:** There are similarities in the current economic and political environment to that during the inter-war period. One significant event in 1930 was the US’ Smoot-Hawley Tariff Act which prompted global retaliation, causing global trade to decline by 65% and adding significantly to the depth and duration of the Great Depression. Today, US industrial policy, which focuses on subsidies, export controls, and trade barriers, is met with an urge in China, Europe, and other major economies to respond in kind. However, even in a worst-case scenario, the impact will be far less than in the 1930s given the much lower average tariffs in the world of today.

• **Demand and supply imbalances:** The sudden shutting down and opening up of the world economy in response to the pandemic has shown with utmost clarity that this cannot be done as easily as turning the lights off and back on again. Lingering market disequilibria will likely continue to keep prices high, including that of labor. China’s reopening will likely come with its set of challenges, but as the global economy slows bottlenecks will wane, and unemployment will begin to rise again.

• **Elections:** Many countries around the globe will hold elections in 2023. Among them, Nigeria, Türkiye, and Argentina which countries will hold presidential elections in February, June, and October, respectively. These will be important given the challenges those countries are already facing, but the global impact if any local political turmoil ought to be limited.

• **Blocked funds:** Record global debt levels across sovereigns, corporates, and households pose a particular threat to fragile emerging economies where run-away inflation and pronounced currency depreciations invite capital controls as a means to combat balance-of-payment crises. Foreign entities including airlines face a growing inability to repatriate earnings in many such instances. The current total blocked funds amount to around USD 2 billion, a quarter of which pertain to Nigeria.

• **In sum:** Most of the headwinds from 2022 are likely to remain with us also in 2023, though on the whole they may be unlikely to intensify. This nevertheless implies that airlines will face elevated costs on virtually all fronts, arguably putting a floor under ticket prices. Passenger price sensitivity has been low so far since travel has again been possible, though this can be expected to rise as economies slow and unemployment rates climb again. The upside potential in our forecasts therefore looks capped, and the balance of risks remains tilted to the downside. The main positive surprises which could produce significant upside in economic activity and air transportation would be an end to the war in Ukraine, and an end to all travel restrictions.

IATA Economics

economics@iata.org

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