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INTERNATIONAL ECONOMICS

# Modest Growth—with Downside Risk

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**1750 Massachusetts Avenue, NW | Washington, DC 20036 | [www.piie.com](http://www.piie.com)**

# Demand and output have been more resilient than anticipated

To date, economic data have shown **continued forward momentum in most countries**:

- The United States has seen only scattered signs of slowdown

- Europe appears to have dodged a recession this winter

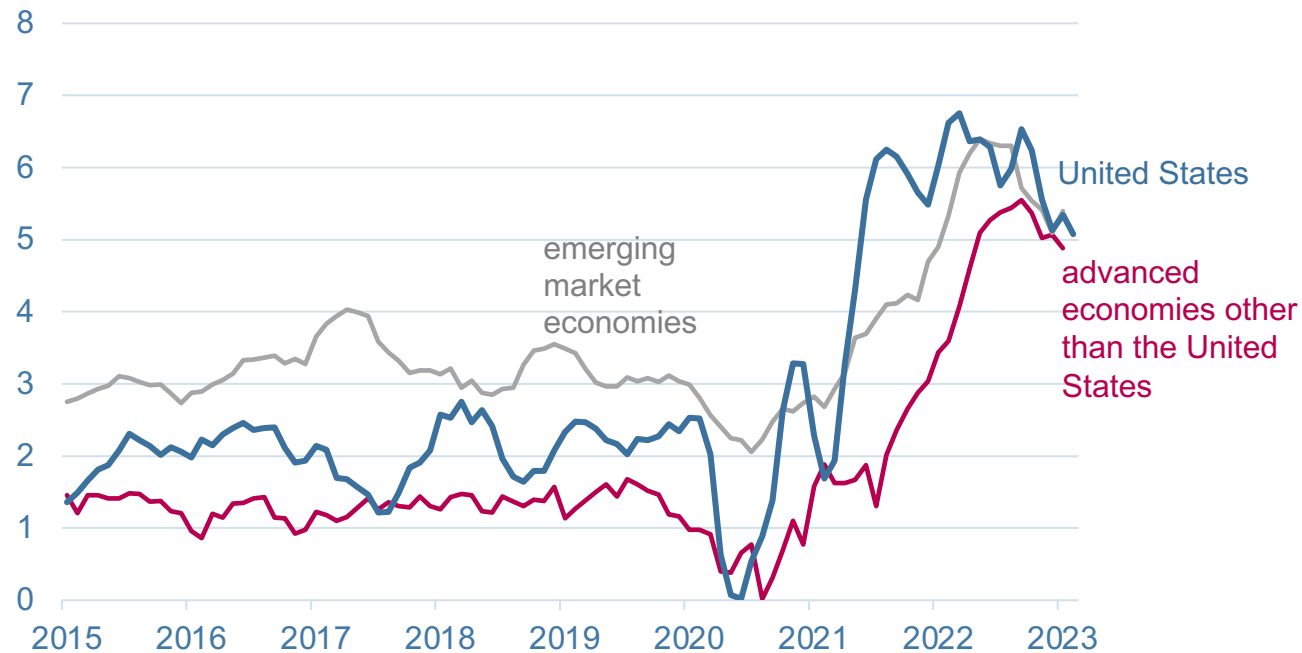
- Economic growth has picked up notably in China

- Generally, economic activity will be supported by lower energy prices

# Inflation looks to have peaked in many countries but is still high

## Core Consumer Price Index Inflation

Percent change from six months earlier (annualized)



The high level of inflation presages continued restraint from monetary policy

Note: Last data point January 2023 for non-US, and February 2023 for the United States.  
Sources: Federal Reserve Bank of Dallas and US Bureau of Labor Statistics via FRED.

# The bank panic significantly increases uncertainty about the economic outlook

The past few weeks have seen **failures, forced sales, and strains at multiple banks**, with vigorous responses by regulators in the United States and Europe

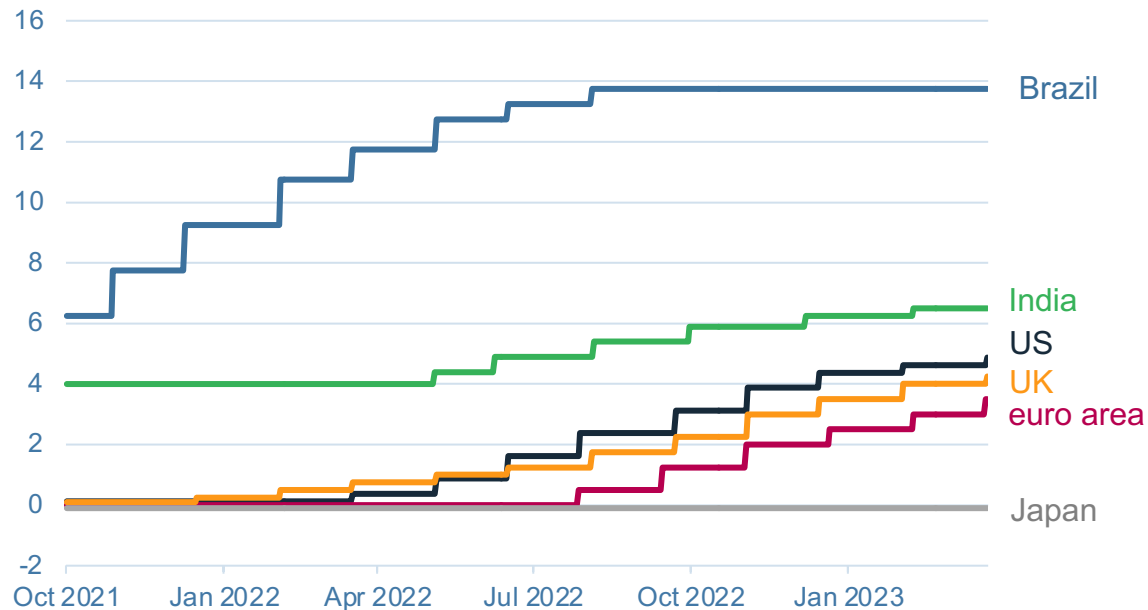
The disruptions to the banking system are **tightening credit conditions** for any given policy interest rate—although the extent of such tightening is difficult to measure and predict

The potential for further turmoil in the financial system increases **negative tail risk for economic activity**

# Policy rates have increased, and longer rates are still high by pandemic standards

Central Bank Policy Interest Rates

Percent

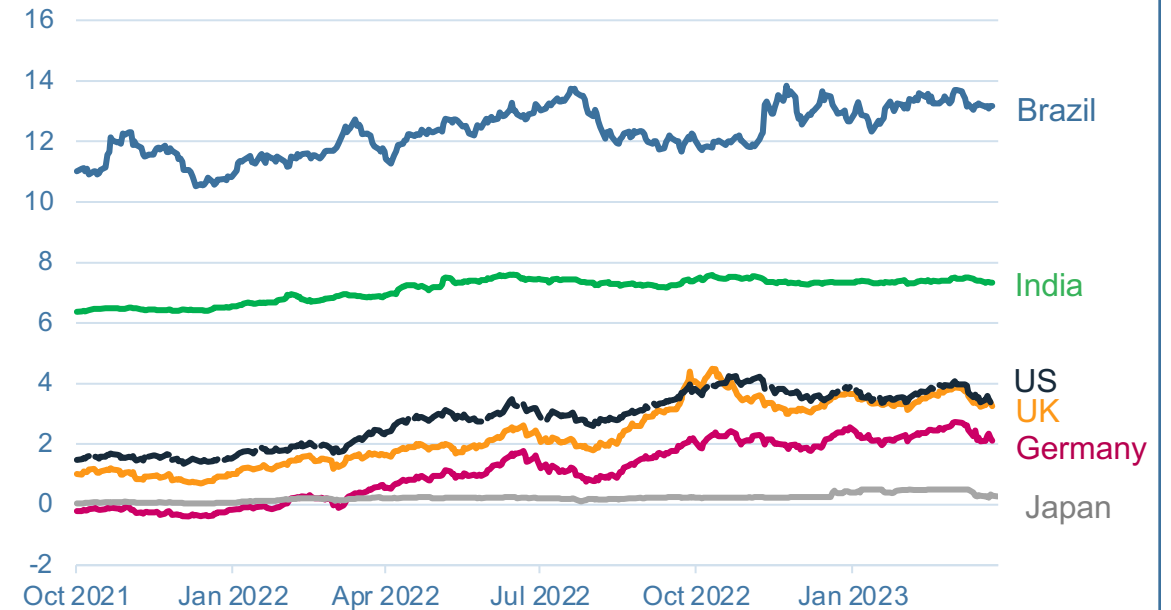


Note: last observation for March 23, 2023.

Sources: Central Bank of Brazil; Bank of England; Bank of Japan; European Central Bank via FRED; Reserve Bank of India via Macrobond; US Board of Governors of the Federal Reserve System via FRED.

Interest Rates on Long-term Government Securities

Percent



Note: last observation for March 23, 2023 for the United States, March 27, 2023 for Japan, and March 24, 2023 for the rest.

Sources: US Board of Governors of the Federal Reserve System via FRED; Macrobond Financial AB via Macrobond.

# Financial markets have responded to heightened risk

## US Corporate Baa Spread

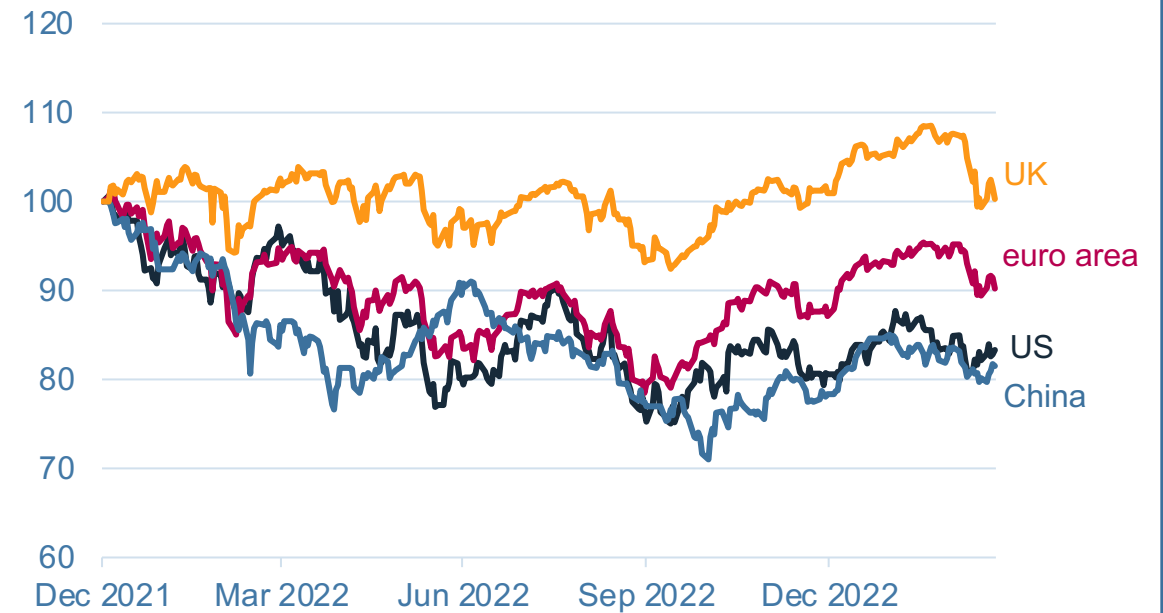
Percentage points



Notes: Relative to 10-year Treasury securities; last observation for March 22, 2023.  
Source: Moody's, and US Board of Governors of the Federal Reserve System via FRED.

## Global Stock Market Indexes

Index (December 31, 2021=100)

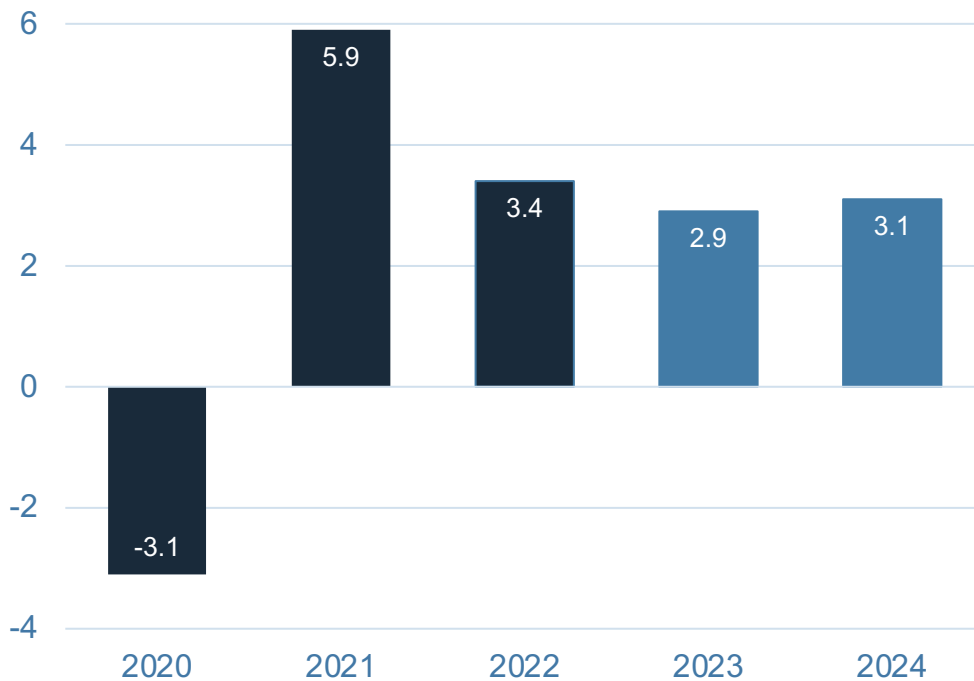


Notes: S&P 500 for US, STOXX 600 for Europe, CSI 300 for China, and FTSE 100 for UK; last observation for March 24, 2023.  
Source: S&P 500 Global, STOXX, China Securities Index Company Limited, and FTSE via Macrobond.

# The global economy is likely to expand more slowly this year than last

## Global Real GDP Growth

Percent change from previous year



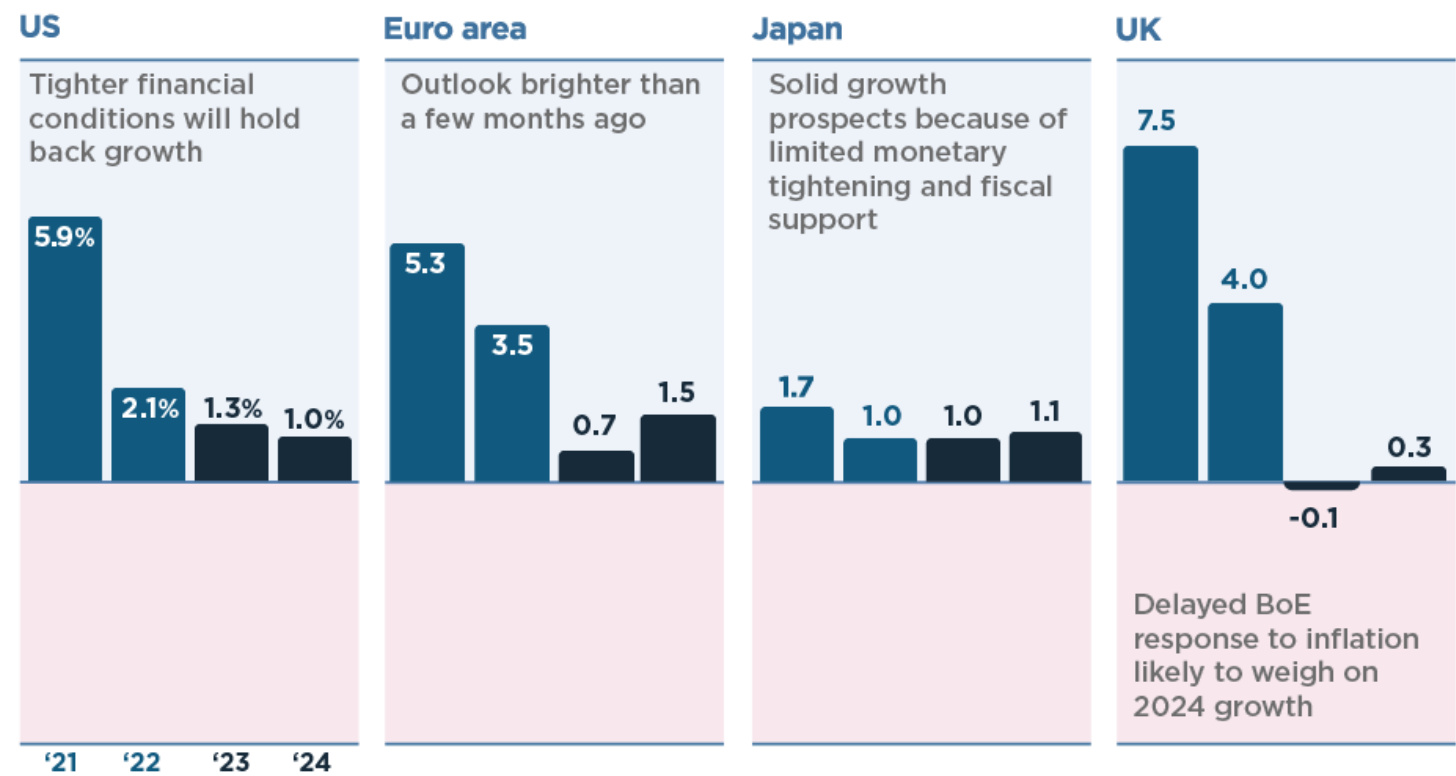
Note: Purchasing power parity weights used to calculate global GDP.

Sources: Consensus forecasts for 2020-2022; author's forecasts for 2023-2024.

Tight financial conditions will constrain economic growth this year and next

Growth next year is likely to pick up a bit but remain below trend in many economies

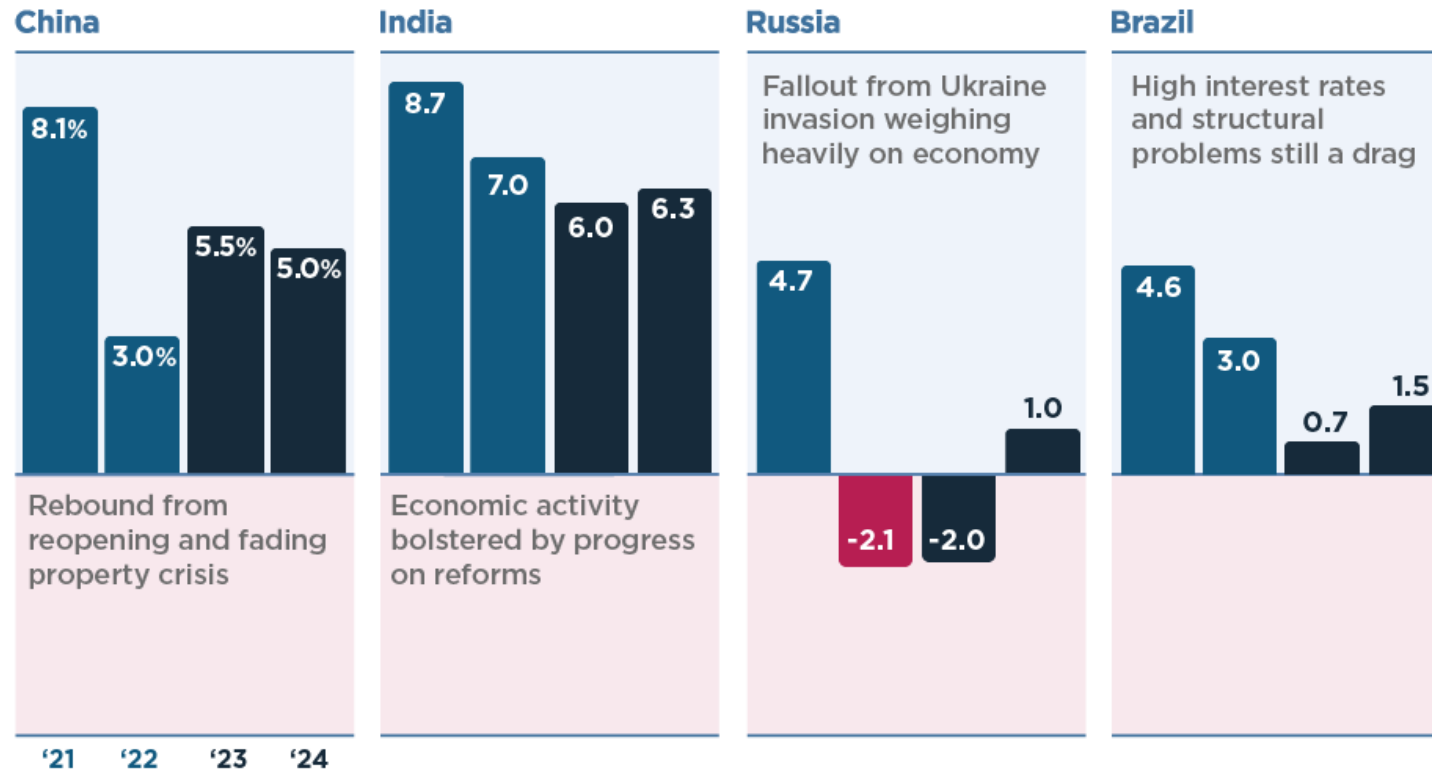
# Most advanced economies will grow modestly this year and next



Note: Annual-average-over-annual average growth rates. PPP weights.  
Sources: Consensus forecasts for 2021-2022; author's forecasts for 2023-2024.



# Growth prospects diverge for the major emerging economies



Note: Annual-average-over-annual average growth rates. PPP weights.  
Sources: Consensus forecasts for 2021-2022; author's forecasts for 2023-2024.

# Summary of the outlook for large economies

Real GDP Growth (Y/Y)	2021	2022	2023	2024
<b>Global Growth</b>	<b>5.9</b>	<b>3.4</b>	<b>2.9</b>	<b>3.1</b>
<b>United States</b>	5.9	2.1	1.3	1.0
<b>Euro Area</b>	5.3	3.5	0.7	1.5
<b>Japan</b>	1.7	1.0	1.0	1.1
<b>United Kingdom</b>	7.5	4.0	-0.1	0.3
<b>China</b>	8.1	3.0	5.5	5.0
<b>India</b>	8.7	7.0	6.0	6.3
<b>Russia</b>	4.7	-2.1	-2.0	1.0
<b>Brazil</b>	4.6	3.0	0.7	1.5

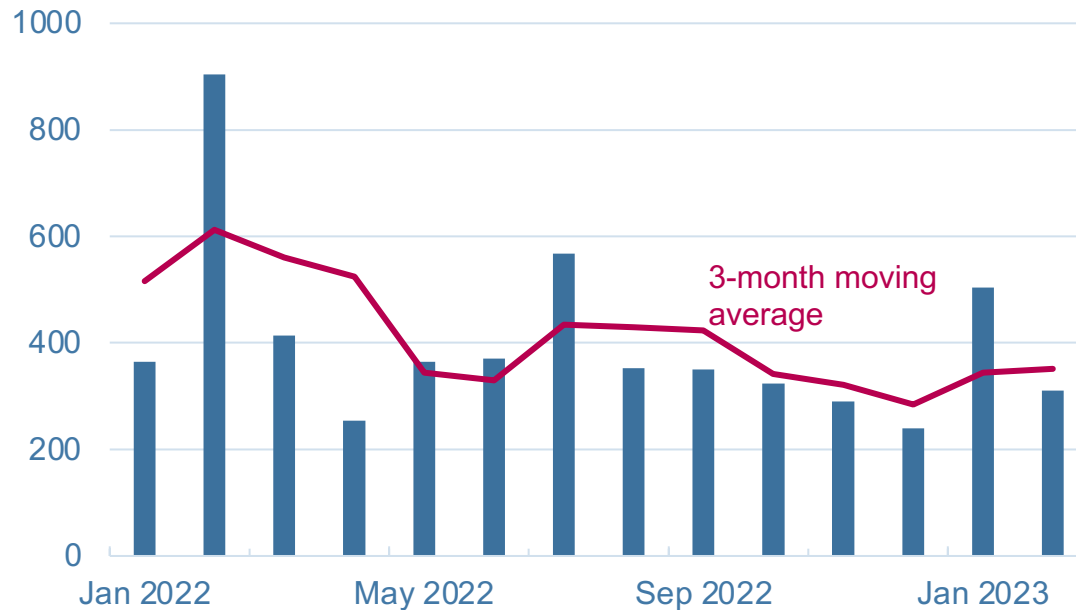
Note: Annual-average-over-annual-average growth rates. PPP weights.

Sources: Consensus forecasts for 2021-2022; author's forecasts for 2023-2024.

# In the US, economic activity has been better than expected

## Nonfarm Payroll Employment

Change from previous month (thousands)



Note: Last data point February 2023.

Source: US Bureau of Labor Statistics via FRED.

## Core Retail Sales

Three-month moving average of percent change



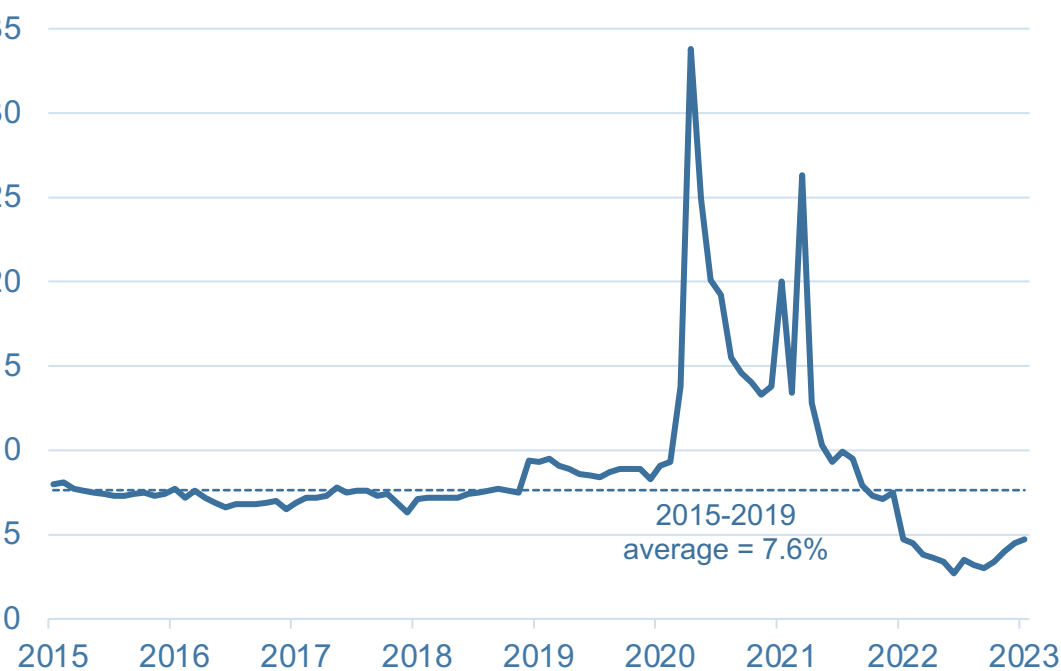
Notes: Core is defined as retail sales minus autos, building materials, and gasoline; last data point February 2023.

Source: US Census Bureau via FRED.

# Consumers still have pent-up demand and (in the aggregate) the wherewithal to finance it

## Personal Saving Rate

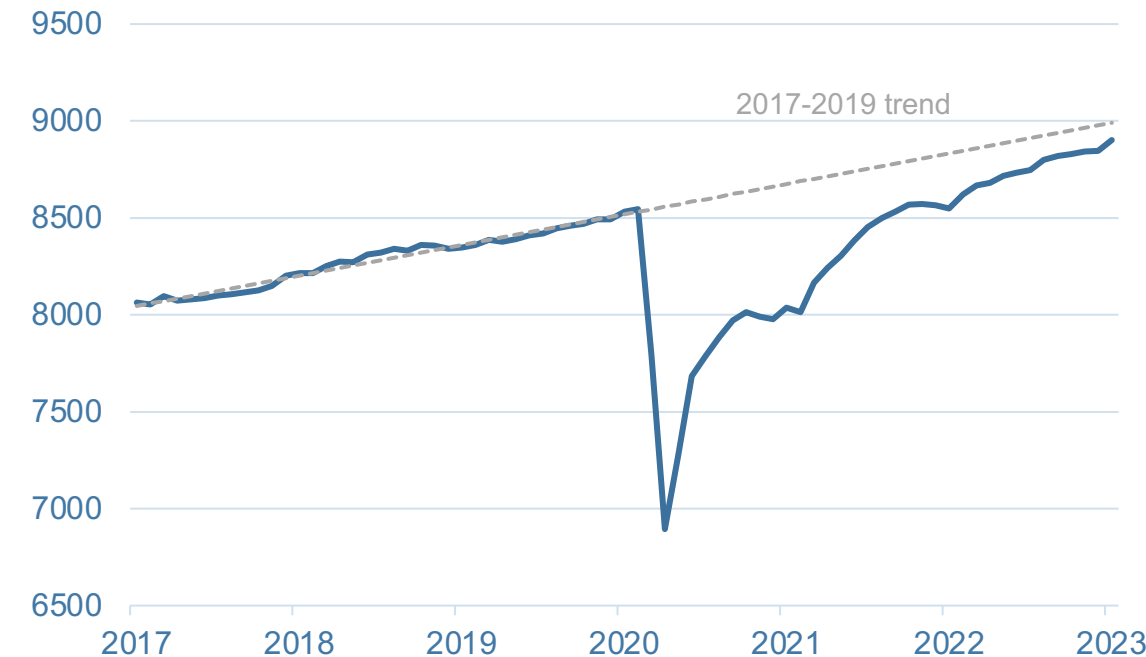
Percent of disposable personal income



Note: Last data point January 2023.  
Source: US Bureau of Economic Analysis via FRED; author's calculations.

## Real PCE Services

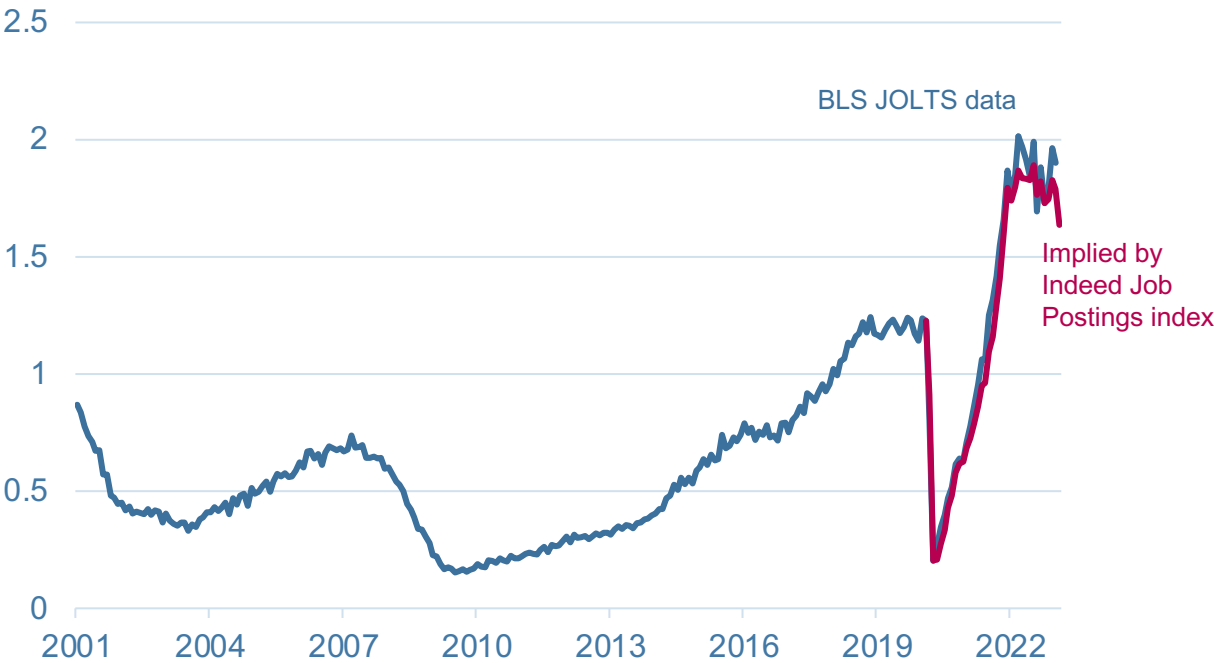
Chained 2012 dollars (billions)



Note: Last data point January 2023.  
Source: US Bureau of Economic Analysis via FRED.

# Labor markets have eased but only slightly

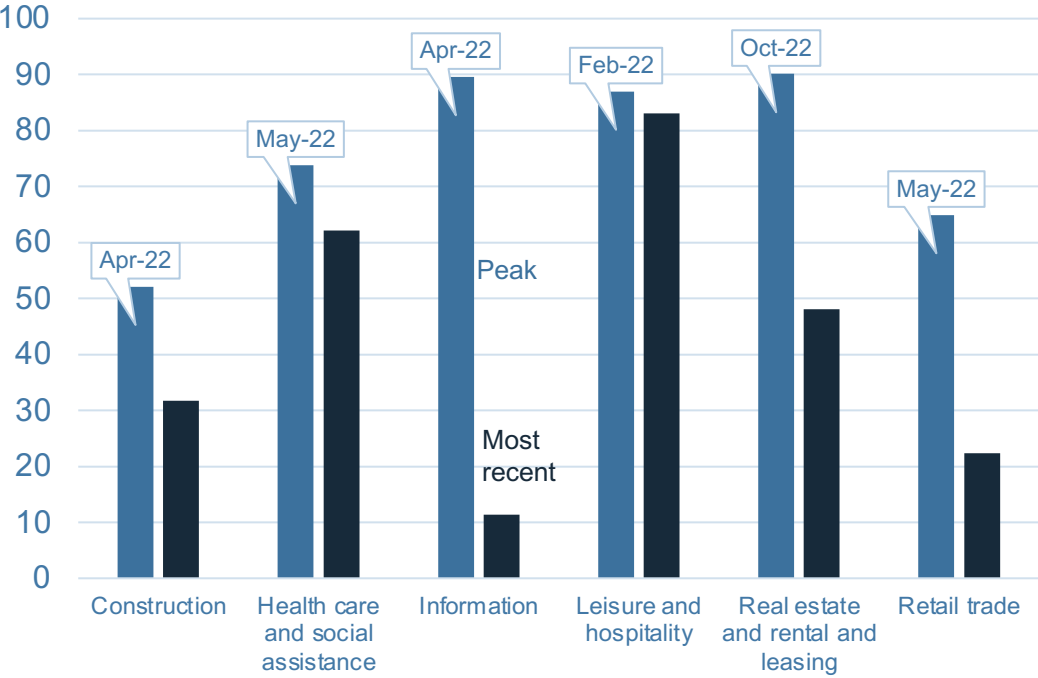
## Job Openings per Unemployed Worker



Notes: Last data point January 2023 for BLS data, and February 2023 for Indeed implied series.  
Sources: US Bureau of Labor Statistics, Indeed, and author's calculations.

## Sectoral Job Openings

Percent changes from January 2020

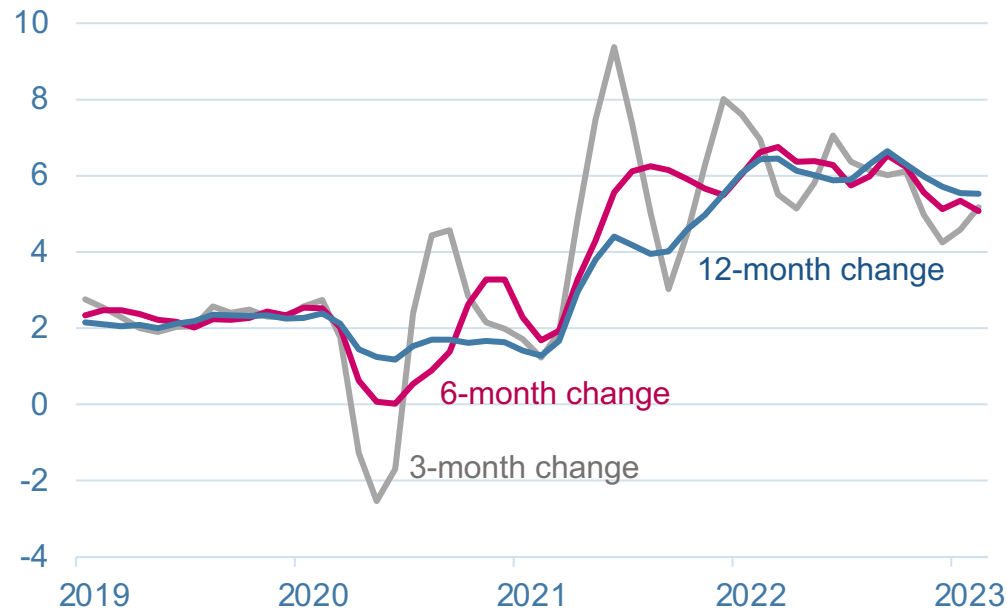


Notes: Most recent data point January 2023; percent changes calculated on 3-month moving averages.  
Sources: US Bureau of Labor Statistics and author's calculations.

# Inflation appears to have peaked but remains well above the Federal Reserve's target

## Core CPI Inflation

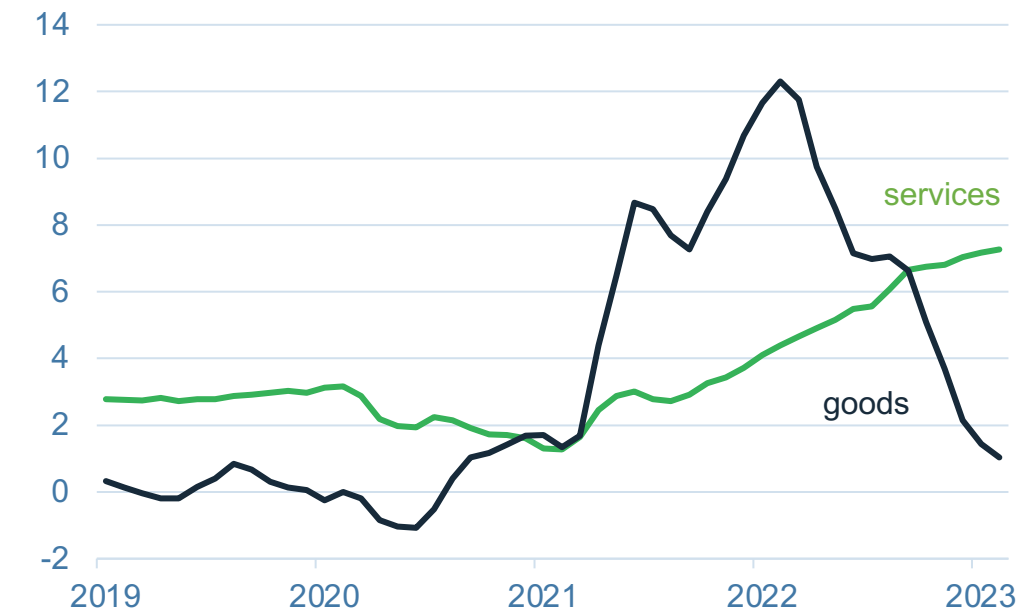
Percent change (annualized)



Notes: Last data point February 2023.  
Sources: US Bureau of Labor Statistics via FRED.

## Breakdown of Core CPI Inflation

Percent change from 12 months earlier

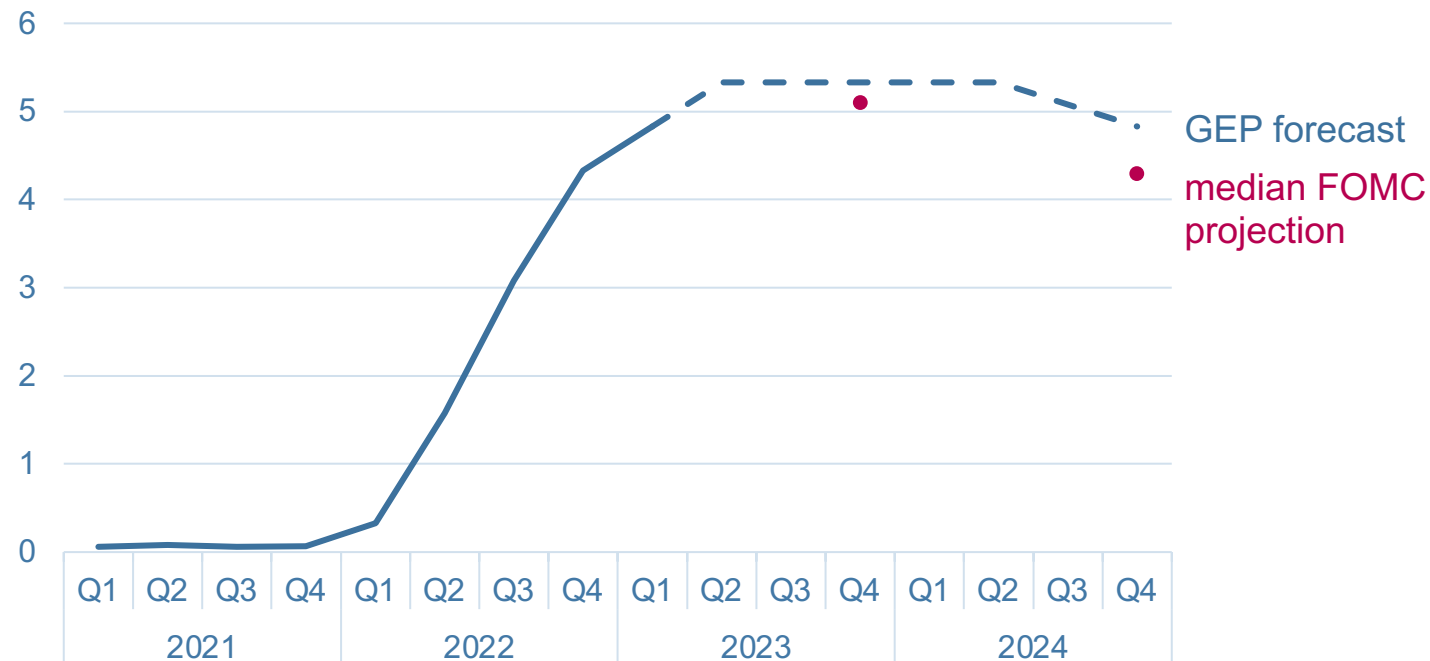


Notes: Last data point February 2023.  
Sources: US Bureau of Labor Statistics via FRED.

# The Fed will probably make a couple of further 25 basis point hikes

## Federal Funds Rate

Percent



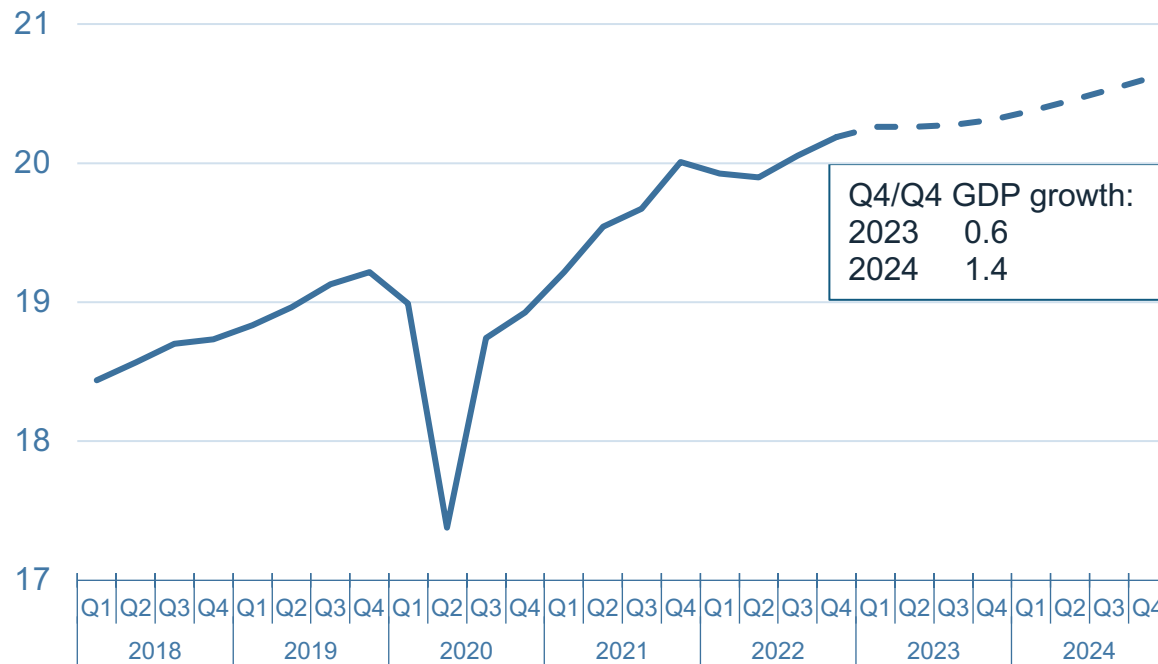
Note: Quarterly, end-of-period; dashed line corresponds to forecast.

Sources: Federal Reserve via FRED; author's forecast.

# US growth will fall short of trend, but a recession is not the most likely outcome

## US Real GDP

Chained 2012 Dollars (Trillions)



Note: dotted line is author's forecast.

Sources: US Bureau of Economic Analysis via FRED; author's forecast.

Despite the bank crisis, the strength of economic activity and some good news on inflation and its determinants mean that a recession is less likely than not

But we are in for a slog in economic growth until inflation falls closer to the Fed's target



# Inflationary supply shocks have abated, and inflation expectations are still contained

## Global Supply Chain Pressure Index

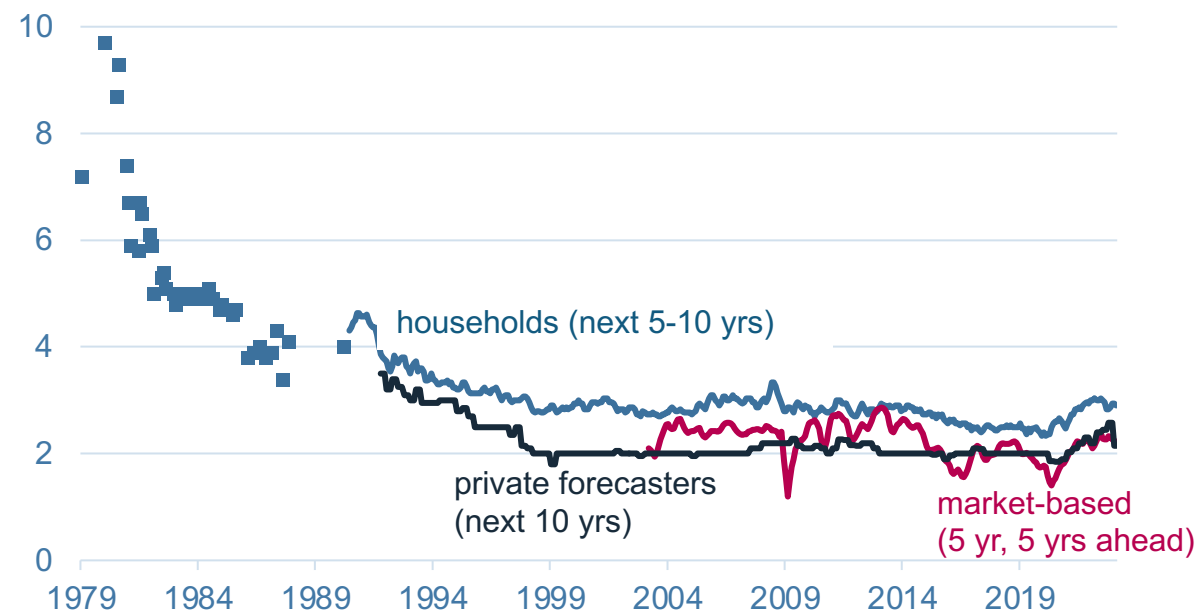
Standard deviations from average value



Note: Last data point February 2023.  
Source: Federal Reserve Bank of New York.

## Long-term Inflation Expectations

Percent

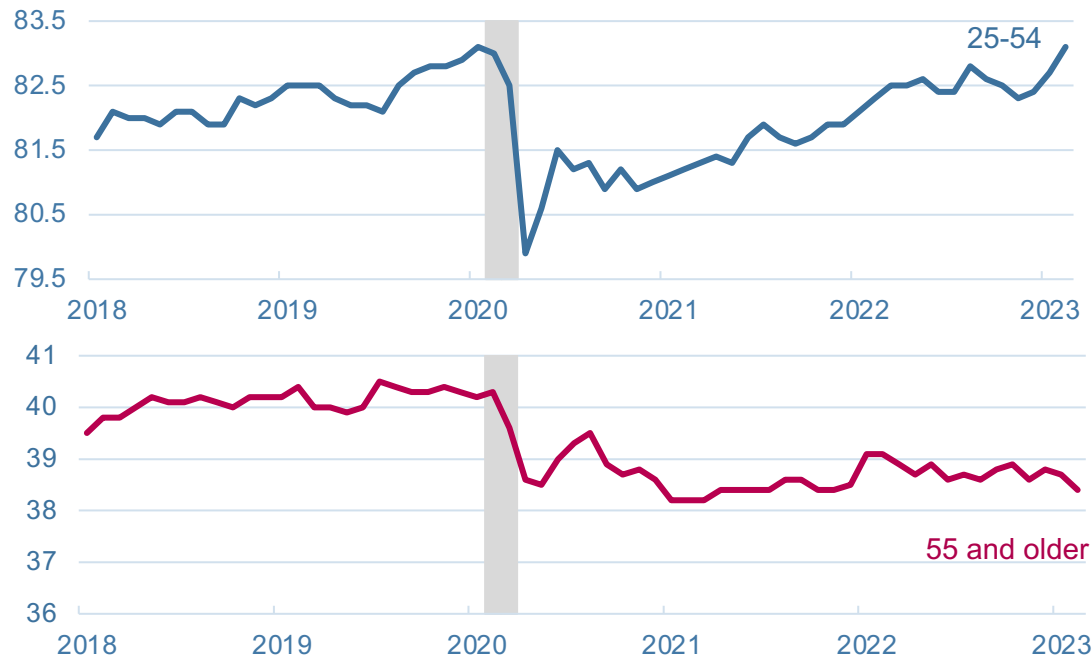


Notes: Lines are 3-month moving averages; dots are for single point in time; last data point February 2023.  
Sources: University of Michigan, Survey of Professional Forecasters, Federal Reserve Bank of St. Louis via FRED.

# Immigration is boosting labor supply, but participation may have peaked

## Labor Force Participation Rate

Percent of population in age group

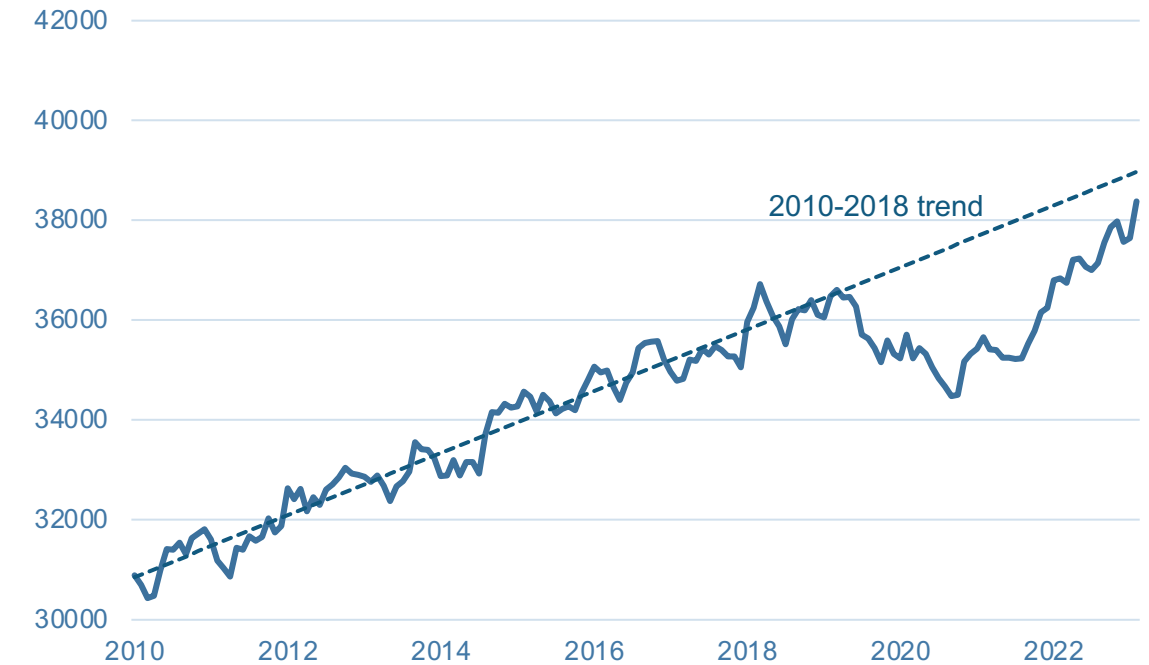


Note: Last data point February 2023.

Source: US Bureau of Labor Statistics via FRED.

## Foreign Born Population, Age 16-64

Thousands



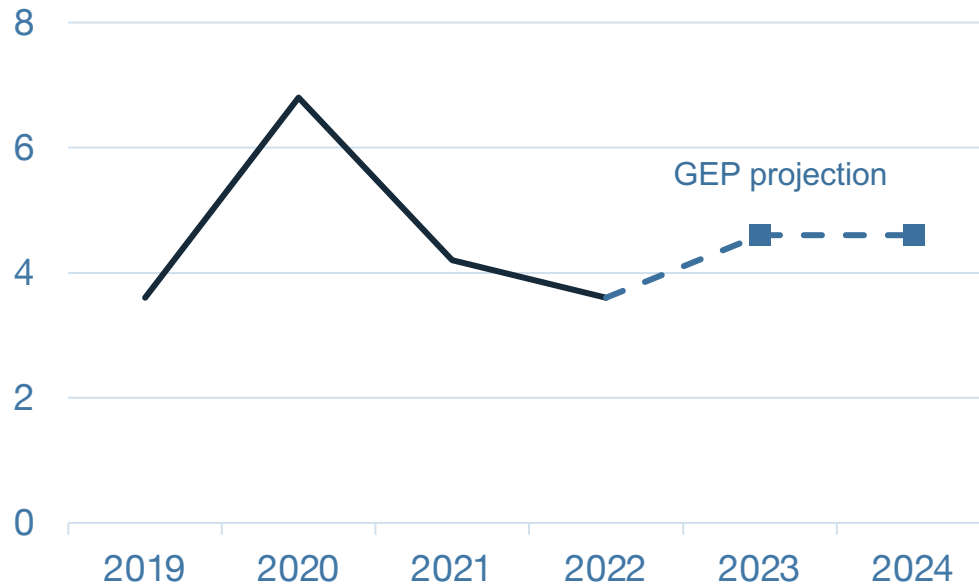
Note: Last data point February 2023.

Source: US Bureau of Labor Statistics.

# The unemployment rate will probably rise and inflation will gradually slow

## US Unemployment Rate

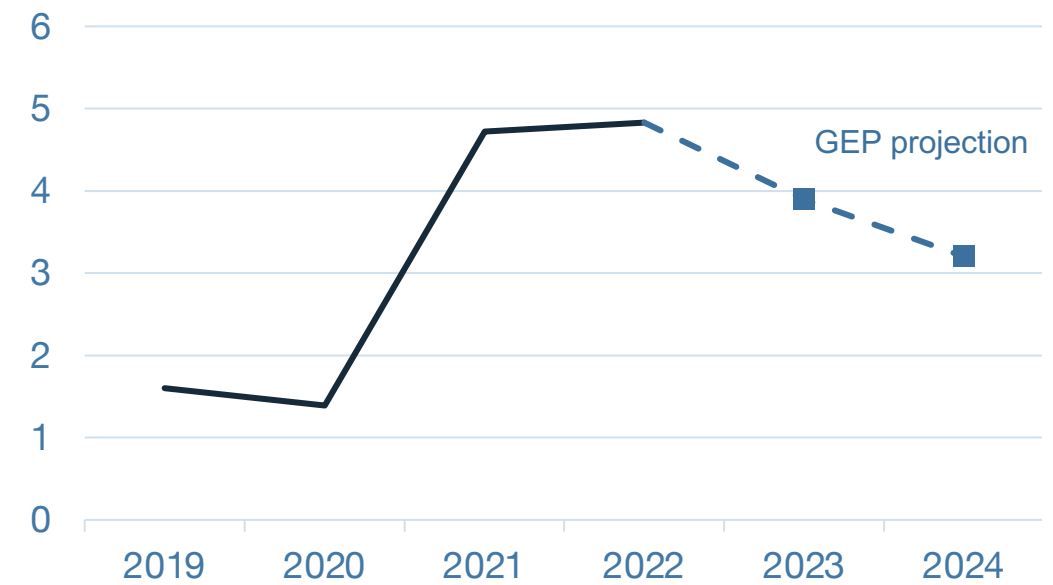
Q4 level



Sources: Bureau of Labor Statistics via FRED; author's forecast.

## Projection of Core US Inflation

Percent change in core PCE deflator from Q4 to Q4



Sources: Bureau of Economic Analysis via FRED; author's forecast.

# Risks tilt to the downside

The troubled banks were especially vulnerable to current economic conditions, and the vigorous response from policymakers **will probably limit contagion** to other financial institutions

But ... similar sentiments were offered following previous financial disruptions that **later worsened considerably** (e.g., August 2007)

Moreover, **the intrinsic difficulties of achieving a soft landing remain**—including the transmission lags of monetary policy and the possibility of unforeseen shocks



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