International economy: the outlook improves as the year draws to a close

As we approach the end of a year characterised by uncertainty and volatility in the economic and financial variables, the sensation is that the global economy is capable of absorbing the effects of the supply shocks, the increase in geopolitical risk and the rising interest rates much better than had been anticipated at the end of the summer. Having confirmed that there was positive growth in Q3 in most major economies (with the exception of Japan and the United Kingdom), the cooling of economic activity in recent weeks is appreciable but less pronounced than anticipated. In particular, the strength of the services sector is managing to offset both the widespread weakening of industry and the initial effects of the interest rate rises on the housing markets with the greatest imbalances. Meanwhile, the decline in agents' expectations also seems to have slowed at a level which, while consistent with a significant cooling in economic activity, does not indicate a widespread recession that would affect employment.

The steady improvement in the bottlenecks since the summer (inventories have recovered) and the moderation in energy prices (both oil and gas) have offered the first respite in a long time in these supply-side constraints, which have been holding back the international economy for the last two years. All this, combined with the continued encouraging tone in the labour market and the safety buffer still provided by the household savings accumulated during the pandemic (1.5 trillion in the US alone), is allowing the slowdown in economic activity to remain contained in the closing weeks of the year. These dynamics are also reducing the risk of stagflation, especially if prices begin to come back down from the peaks reached in the autumn, as seems to be the case, with the incipient correction of the imbalances between global supply and demand.

Such a scenario would allow the central banks to take a break after their December meetings in order to assess what effect the sharpest tightening of financial conditions in recent decades has had on economic activity, financial stability and the pattern of inflation. The monetary authorities have used much of the arsenal of tools at their disposal, yet they do not yet know whether what they have done will be sufficient to achieve their objectives, not least because of the time lag of monetary policy. This pause could lead to a more surgical convergence on the terminal rate, which could be below that expected by the markets. That said, we cannot yet rule out the potential need for a new phase of rate hikes if the inflationary pressures intensify once again or if inflation expectations need to be kept in check. For the time being, it is also worth point out that, with much of the work done, the monetary normalisation process is taking place without major financial accidents (except for the British mini-crisis), even in emerging markets, despite high global debt levels.

The good news, therefore, is that the central forecast scenarios laid out after the summer look increasingly likely to materialise, most of which anticipated a stagnation in economic activity over the winter but not a recession with job destruction linked to energy rationing in northern Europe. A large part of these scenarios envisaged higher oil or gas prices at this point in the year compared to where they stand today, which means there is some leeway in the forecasts for potential negative surprises. In this regard, although winter still lies ahead and it is too early to declare victory on the energy front, the risk profile also seems to be shifting as more attention is being focused on the effects of China's zero-COVID policy being brought to an end, without forgetting possible complications in the final stages of the monetary normalisation process. Most importantly, after what has been a very difficult year, it seems we will end it in better shape than could have been expected just a few months ago, with the supply-side shocks beginning to weaken. Let us hope that will be the tone throughout 2023.

José Ramón Díez
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