New economic scenario: a change of outlook for international economies and markets?

The international economy in the year to date has been marked by three major dynamics. Firstly, energy price tensions have eased, with prices stabilising at much lower levels than had been feared a few months ago, although they are still above pre-pandemic levels.[1] Secondly, the economic indicators have shown resilience on the activity side, while sending mixed signals on the inflation side, with sharp declines in headline inflation but significant persistence in the more inertial components. For these reasons, and as the third key dynamic of the year, the major central banks have been driven to further tighten their monetary policy. In addition to rate hikes, financial conditions in 2023 have also been strained following the collapse of Silicon Valley Bank (SVB) in the US and its reverberations in the global financial markets.[2] Taken together, all these developments have led us to re-evaluate the outlook for the international economy and financial markets.[3]

Easing of energy prices

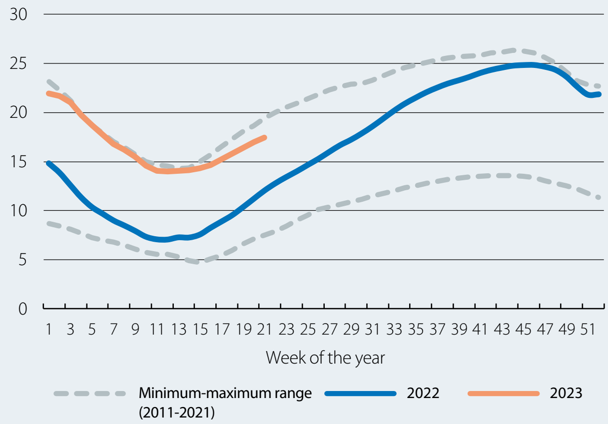
2023 began with energy prices that were much less stressed than had been initially feared, and this scenario has been confirmed over the course of the spring. In the gas market, Europe managed to get through the winter without major incidents, thanks to high levels of reserves and effective policies to contain demand and price volatility, all accompanied by a more temperate winter than usual. Thus, in May in the futures markets, the TTF gas price was trading at around €50/MWh on average for 2023 and 2024 as a whole. These levels, which are well below those anticipated at the start of the year (of over 100 euros),[4] will provide some relief for economic activity over the coming quarters.

The oil market, meanwhile, has experienced a more volatile few months, with the Brent barrel fluctuating between 70 dollars (when the market was dominated by fears of global cooling) and almost 90 dollars (when signs of a rapid revival of the Chinese economy coincided with further cuts in OPEC production). This volatility, coupled with the prospect of a second half of the year in which China's rebound could have a greater effect on commodity prices, leads us to forecast a Brent barrel price of around 85 dollars (80 euros) for 2023.

1. Gas prices are also now below their pre-Ukraine war levels (having been on the rise since Q3 2021).
2. See the Focus «Financial stability considerations amid monetary tightening» in the MR05/2023.
3. Our new macroeconomic scenario can be viewed in the forecast tables of this very *Monthly Report*.
4. Prices based on the 60-day moving average, which is the benchmark metric used for our gas price projections. In part, the lower prices also reflect the prospect of a cooling in global economic activity.

Euro area: gas storage *

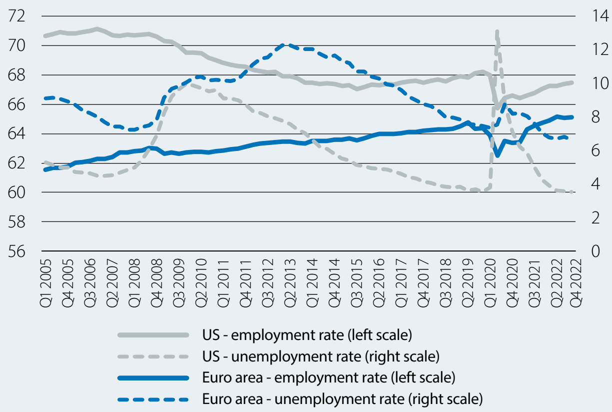
(% of consumption)



Note: ** Average for Germany, France, Italy and Spain.*
Source: *CaixaBank Research, based on data from AGSI.*

US and euro area: labour market

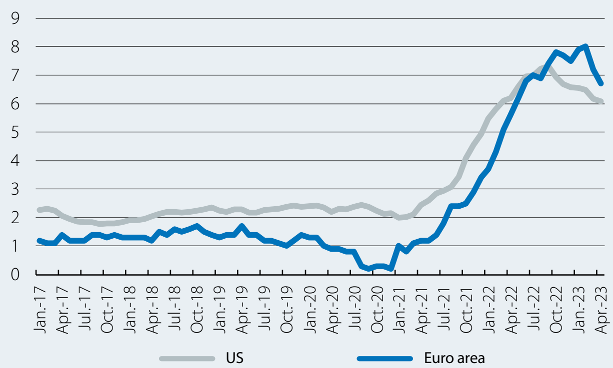
(% of population between 15 and 74 years old) *(% of labour force between 15 and 74 years old)*



Source: *CaixaBank Research, based on data from the OECD.*

CPI: 15% trimmed mean *

Year-on-year change (%)



Note: ** The trimmed-mean inflation rate is calculated based on the mean basket of goods, but where the components with the most pronounced price movements are excluded (trimmed). In this case, the 15% of components with the sharpest movements (16% for the US series) are excluded.*
Source: *CaixaBank Research, based on data from the ECB and the Federal Reserve Bank of Cleveland.*

Resilience of global activity

Not only did the economic activity indicators improve steadily over the winter and spring (e.g. the global PMI rose from a low of 48 points in November, indicating economic contraction, to above 54 points in April, well within expansionary territory), but the GDP figures for Q1 in the major economies also proved better than expected: while the forecasts were for growth of 0.1%, 2.0% and –0.2% quarter-on-quarter in the US, China and the euro area, respectively, the actual figures were 0.3%, 2.2% and 0.1%.[5] This suggests that economic activity has been less weak than expected and, almost mechanically, it leads us to raise our GDP forecasts for 2023.

However, this does not mean that the global economy is out of the woods. In reality, our new forecasts paint a picture of rather modest quarterly growth, especially in the US and for the euro area as a whole. The fact is that higher interest rates are exerting a burden on the economy that will become increasingly visible. In fact, the cooling is already visible in the sector breakdown: the strength of the PMI mentioned above is driven mainly by the services sector, while various indicators point to a contraction of industrial activity in the world's major economies in recent months.

However, the loss of momentum of economic activity will be cushioned by the strength of the labour markets, which continue to show unemployment rates at close to all-time lows in both the US and the euro area, as well as significant growth in labour activity rates.

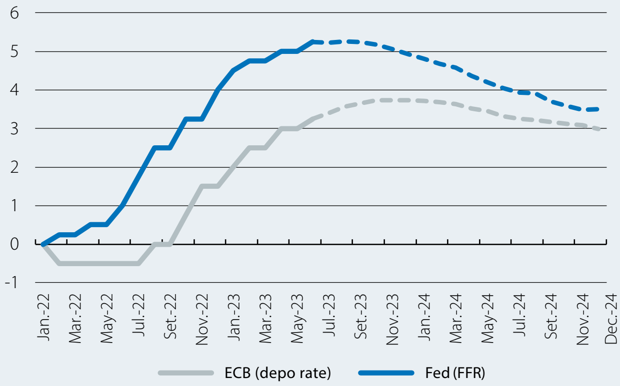
Greater inertia in underlying inflation

Headline inflation has fallen steadily since the peaks reached in 2022, and it has done so mainly thanks to energy prices, both due to their base effect and because of lower energy costs.[6] This energy effect will indirectly filter through to the rest of the price basket over the coming months, intensifying the decline in inflation. In fact, the emergence of disinflationary signals is becoming increasingly apparent in the middle stages of the price formation chain, where supply bottlenecks have normalised, producer prices are decelerating in all sectors (including food) and the surveys reflect a moderation in businesses' pricing intentions. Moreover, the US rent index, which is a key component accounting for 40% of the core inflation basket, has registered two consecutive months of moderation and will help to bring down inflation going forward.

5. Although better than expected, the euro area figure has been overshadowed by a downward revision in Germany (–0.3%, after an initial estimate of 0.0%). However, the euro area figure is also weighed down by a contraction of 2.7% in Ireland (a country which has recently been generating unusually volatile data). With these two notable exceptions, in the majority of euro area countries GDP was higher than expected in Q1.
6. In the euro area, the energy component has gone from adding around 5 pps to headline inflation in the autumn (when inflation peaked at 10.6%) to just 0.2 pps in April (when headline inflation stood at 7.0%).

Official interest rates and market expectations

(%)



Source: *CaixaBank Research, based on data from the Fed, the ECB and Bloomberg.*

However, so far this year, underlying price pressures have shown more resistance than initially anticipated.[7] While this leads us to moderately raise our inflation forecasts for 2023 as a whole (more than offsetting the downward effect of the new energy forecasts), we continue to expect a gradual slowdown in prices over the coming quarters, supported by the indirect effects mentioned above, the cooling of demand and the containment of the feedback loops between wages, margins and prices.

Interest rates, higher for longer

Given these dynamics in the energy crisis, economic activity and inflation, the central banks of the major advanced economies have been driven to continue to raise rates (with the fed funds rate at between 5.00%-5.25% in the US and the depo rate at 3.25% in Europe). On the other hand, with interest rates at clearly restrictive levels, and conscious that the macroeconomic impact of rate hikes operates with a time lag and with clear indications that the monetary policy transmission mechanisms are working,[8] the central banks have recently adopted a more cautious approach. While the Fed has not ruled out further rate hikes, and further moderate rises are still being considered by the ECB, the general strategy is now to keep rates in restrictive territory for a long time (as opposed to raising them even further) and to monitor the economic activity and inflation data before deciding on the next steps.

7. For example, core inflation began 2023 at 5.6% in the US and at 5.3% in Europe in January, while in April it remained at 5.5% in the US and at 5.6% in the euro area.
8. A viewpoint reinforced by the SVB episode. Also see the Focus «Is monetary policy managing to cool economic activity? A first assessment» in this very *Monthly Report.*

Thus, focusing on Europe, we take up the ECB's message of the need for rates to be kept «higher for longer» and our new forecasts contemplate that interest rates will reach a slightly higher peak in the coming months (depo rate at 3.75%) and that they will remain there for a little longer (the first rate cut would not occur before mid-2024).

The environment remains challenging

Behind these changes in the economic environment, a constellation of risks persists which still leave the global economy in a fragile environment. In addition to the geopolitical factors, most notably the war in Ukraine, the collapse of SVB has highlighted the fact that, in a context of sharp interest rate rises (particularly following a long period of low rates), there is a risk of a sharp tightening of financial conditions, which in turn can trigger a sudden cooling of the economy. In the same vein, the state of some real estate markets is also cause for concern, having experienced significant price increases in recent years and with signs of overvaluation and high household indebtedness, as we recently analysed.[9] In addition, if the underlying price pressures persist, the central banks may be forced to tighten monetary policy even further, accentuating the aforementioned risks.

Forecasts for international economies and markets

Annual change (%), unless otherwise stated	2022	2023	2024
Global GDP	3.4	2.8 (2.7)	3.0 (3.4)
US GDP	2.1	1.2 (0.9)	0.8 (1.4)
US inflation	8.0	4.2 (4.1)	2.2 (2.7)
Fed funds rate *(year end)*	4.50	5.00	3.75
Euro area GDP	3.5	0.9 (0.5)	1.3 (1.6)
Euro area inflation	8.4	5.5 (5.3)	2.6 (2.7)
ECB depo rate *(year end)*	2.00	3.75 (3.50)	3.00 (2.50)
12-month Euribor *(average)*	1.1	3.8 (3.4)	3.3 (2.6)
EUR/USD exchange rate *(year end)*	1.06	1.12 (1.10)	1.15
Chinese GDP	3.0	5.7 (5.2)	4.9 (5.1)
Brent oil *(€ per barrel, average)*	94	80	76
Natural gas (TTF) *(€ per MWh, average)*	132	51 (113)	55 (93)

Note: *In brackets, previous forecast (only where different).*
Source: *CaixaBank Research.*

9. See the Focus «Advanced economy housing markets in a scenario of tighter monetary policy (part I)» in the MR04/2023.