New scenario: international economy and market outlook

After performing better than expected in the first half of 2023, global economic activity has experienced a slowdown in Q3 as a result of differing dynamics among the major economies. Below, we take a look at the outlook for the international economic environment.

Starting point: uneven slowdown

Global economic activity has felt the effects of the loss of steam in China, where the initial revival of Q1 2023 gradually gave way to indicators that fell consistently short of expectations, in addition to the persistent difficulties in the real estate sector. Among advanced economies, the weakness exhibited by industry since the end of 2022 has begun to dampen the performance of the services sector, albeit to differing degrees from region to region. Specifically, in the US the indicators have reflected a gentle slowdown in economic activity, with growth of around 0.5% quarter-on-quarter and consumption holding up remarkably well, while the weakness has been concentrated in residential investment and in modest contributions from the foreign sector. In contrast, euro area GDP has been sluggish, registering growth rates of around 0.1% quarter-on-quarter, reflecting the weakness of consumption, investment and foreign demand. All these dynamics are clearly reflected in the data and expectations comparison set out in the second chart.

Key assumptions: disinflation, disinflation and disinflation

To understand the outlook for the slowdown in economies such as the US and, especially, the euro area, we must reiterate that both of them are emerging from a period of unusually pronounced distortions in demand and production capacity, first at the hand of the COVID-19 pandemic[1] and then with the war in Ukraine. Distortions on this scale take time to digest. Moreover, they have coexisted with transient tailwinds, such as the support from fiscal policy, the fading of the bottlenecks, a degree of a cyclical boost from services (with their definitive post-pandemic normalisation) and the savings buffers accumulated following COVID-19.

Inflation is the metric in which this digestion has become the most visible, suffering a rebound in the US as early as 2021 and accelerating a little later in the euro area. This rebound is taking place in three phases, beginning with the initial impacts (such as the bottlenecks associated with the pandemic or the energy crisis due to the war in Ukraine) and continuing with the resulting indirect effects (the rise in the price of goods and services which, although not directly impacted by the initial shock, are driven up by production costs and relative price adjustments). As the third chart shows, we are beginning to leave these two phases behind us and the most up-to-date indicators, such as momentum, reflect sharp disinflation relative to the most tense moments of 2022. However, there is a third phase which still lies ahead before we can celebrate the normalisation of inflation: that of second-round effects (i.e. the feedback loop

1. Not only did the pandemic freeze supply and demand, but it also led to major readjustments in the economy, such as in consumption patterns or in the decisive response from fiscal and monetary policies.

Forecasts for international economies and markets
Annual change (%), unless stated otherwise

	2022	2023	2024
Global GDP	3.5	3.0 (2.8)	2.9 (3.0)
US GDP	2.1	2.0 (1.7)	0.8 (0.5)
US inflation	8.0	4.2 (4.0)	2.4 (2.1)
Fed - fed funds rate *(year end)*	4.50	5.75	4.25
Euro area GDP	3.5	0.5 (0.7)	0.7 (1.0)
Euro area inflation	8.4	5.6 (5.3)	3.1 (2.7)
ECB - depo rate *(year end)*	2.00	4.00	3.50
12-month Euribor *(average)*	1.1	3.9	3.6
Chinese GDP	3.0	5.2 (5.7)	4.6 (4.9)
Brent oil *(€/barrel, average)*	94	76.3 (72.5)	73.9 (68.6)
Natural gas (TTF) *(€/MWh, average)*	132	43.1 (43.9)	50.4

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

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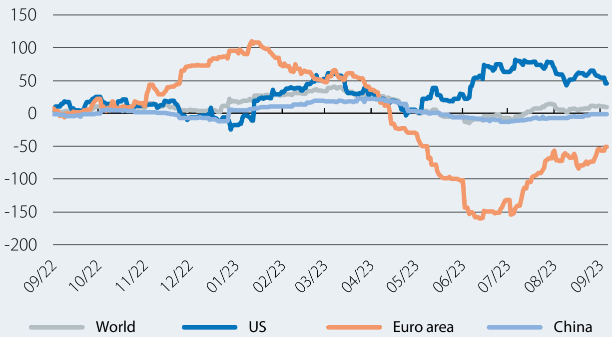


Note: *Positive (negative) figures reflect that the indicators were better (worse) than expected by the consensus of analysts.*
Source: *CaixaBank Research, based on data from Citi and from Bloomberg.*

between prices, business margins and wages in response to the initial rise in prices themselves). This phase tends to give inflation inertia and could delay the final decline towards the target rate, but it is key that the process of disinflation proceeds as expected so that the central banks do not need to further weaken demand.

Outlook

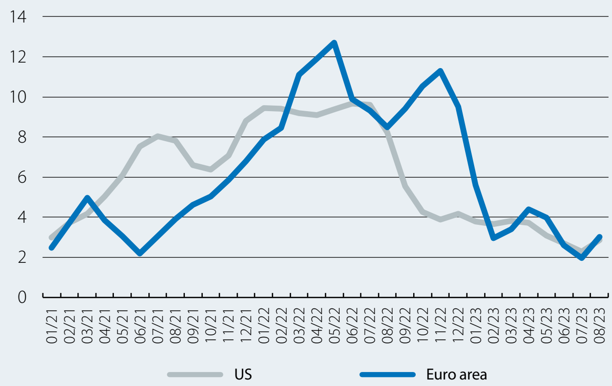
In this context, and after more than a year of sharp interest rate rises, recently the Fed, the ECB and most of the world's central banks have reorientated their monetary policy strategy. Specifically, they have hinted at the end of the cycle of rate hikes, but at the same time they are also indicating their intention to keep rates around their current levels, which they consider sufficiently restrictive, for an extended period of time. Therefore, although they have not shut the door to the possibility of further adjustments, official interest rates may have reached the top of a plateau where, according to expectations implicit in the financial markets, they will remain for at least a large part of 2024.[2]

Given the persistence of the restrictive monetary conditions, and in an environment of weak foreign demand, we can expect economies such as the US and the euro area to show limited buoyancy over the coming quarters. In fact, the transmission of the tighter monetary policy is gradually seeping through to the wider economy and it is already visible in the weakness of the demand for credit and in the tightening of credit standards, two dynamics which explain the deterioration of so-called «credit impulse» (see fifth chart).[3]

However, there are some buffers in the forecast scenario, such as the strength shown by the labour market, and these should help the cooling of economic activity to materialise in the form of sluggishness rather than contraction.[4] Thus, after a few quarters of relative stagnation, we expect the world economy to be reinvigorated in 2024, spurred on by a recovery in household purchasing power (thanks to the fall in inflation and the rise in wages).[5]

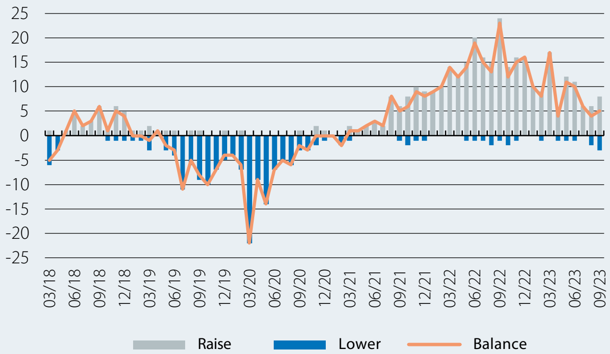
2. The ECB will have reached this plateau in September, when it placed the depo and refi rates at 4.00% and 4.50%, respectively, while the Fed could do so in November, when we expect it to set its target rate within the 5.50%-5.75% range.
3. Historically, this indicator has identified a close association between credit dynamics and GDP growth. See the Focus «Is monetary policy managing to cool economic activity? A first assessment» in the MR06/2023.
4. For example, our forecast scenario for the euro area projects quarter-on-quarter GDP growth rates of around 0.0-0.1% through to Q1 2024.
5. The economy could also benefit from weaker headwinds, such as the inventory over-accumulation crisis that has weighed down industry in recent quarters.

Headline inflation: momentum *
(%)



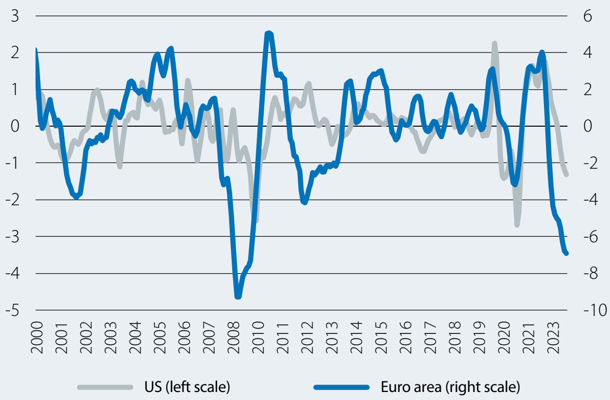
Note: ** Momentum is defined as the annualised and seasonally adjusted change in the three-month average CPI compared to the previous three months.*
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics and the ECB.*

Central banks that raise or lower rates in a given month
Number



Note: *The sample consists of 35 central banks from North America, South America, Europe, Africa, Asia and Oceania.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Credit impulse
Year-on-year change (%) *Year-on-year change (%)*



Notes: *Credit impulse is calculated as the change in the balance of outstanding credit minus its change in the previous year (as a percentage of nominal GDP). The changes used are three-month cumulative changes and the credit impulse plotted on the chart is smoothed out using a moving average.*
Source: *CaixaBank Research, based on data from the ECB and the Fed.*