CAPITAL ECONOMICS

INDEPENDENT ANALYSIS, FORECASTS AND CONSULTANCY

Global Economics Chart Pack

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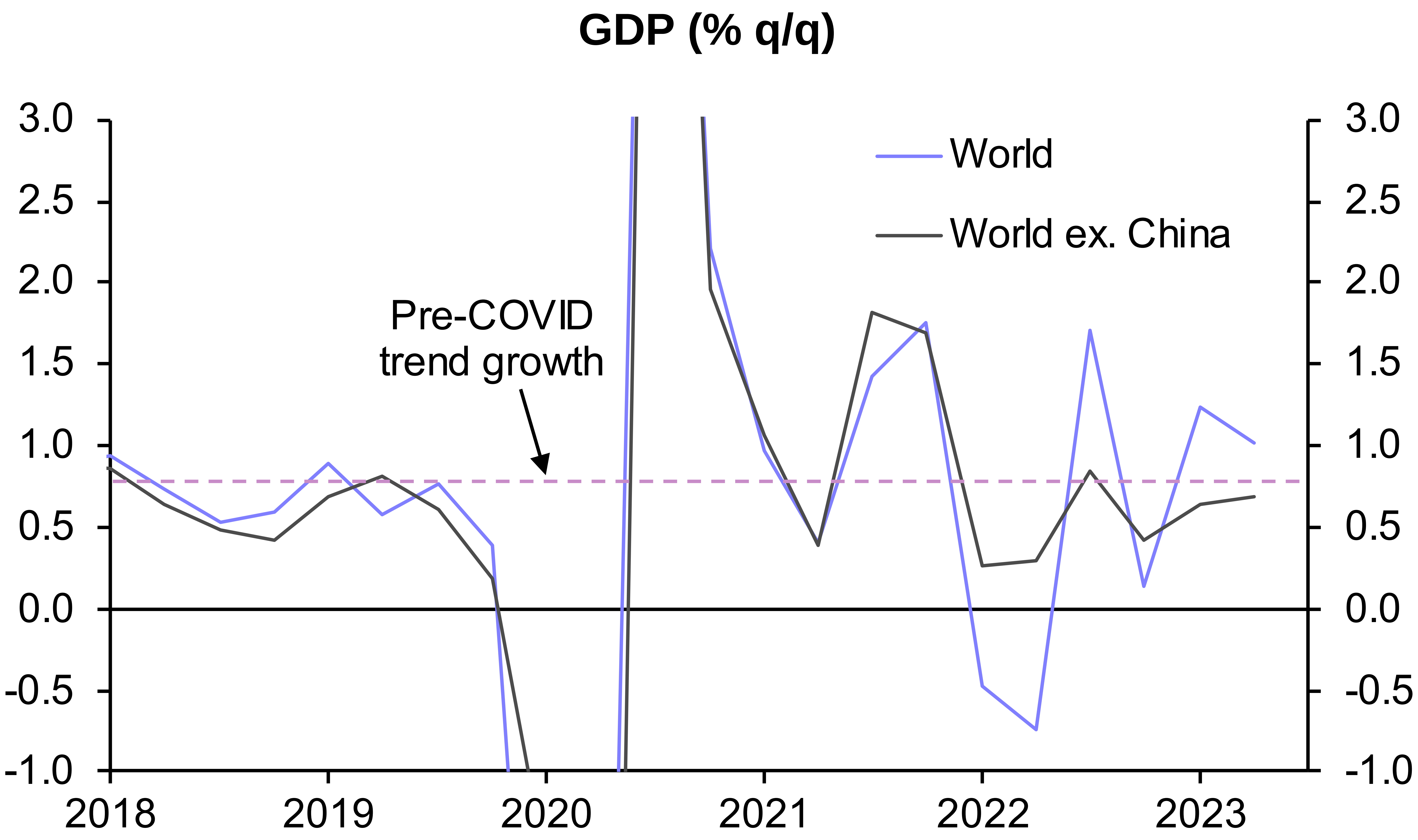
Our View: The latest activity and survey data have provided even more evidence that the resilience in activity in advanced economies over the first half of 2023 is now fading. High interest rates are clearly weighing on credit growth, and a further rise in debt servicing costs in the coming months should contribute to a period of economic weakness in most DMs. Headline inflation is already falling sharply, and the combination of weaker activity and a gradual loosening in the labour market should exert downward pressure on core rates too. Accordingly, we doubt that the recent ‘higher for longer’ rhetoric from policymakers will last, and we expect central banks to start cutting rates next year. On the other hand, a step-up in policy support looks set to deliver a modest cyclical recovery in China, but the revival will not be strong or sustained.

- **Activity**: The latest activity and survey data point to a slowdown in growth in most advanced economies in Q3. On the other hand, the recent step-up in policy support in China has led to a pick-up in activity there.
- **Labour Markets**: Although employment growth remains robust, there have been more signs elsewhere that labour market conditions are cooling, especially in the US. However, wage growth in Europe is still uncomfortably high.
- **Inflation**: The recent rise in fuel prices will not be enough to derail the ongoing decline in global headline inflation. Core inflation should fall sharply too, although core rates will take longer to return to targets in Europe than in the US.
- **Policy**: Despite the recent ‘higher for longer’ rhetoric from policymakers, we think that policy rates have now reached their peak in most DMs. Central banks will turn to rate cuts next year, starting with the US Fed.

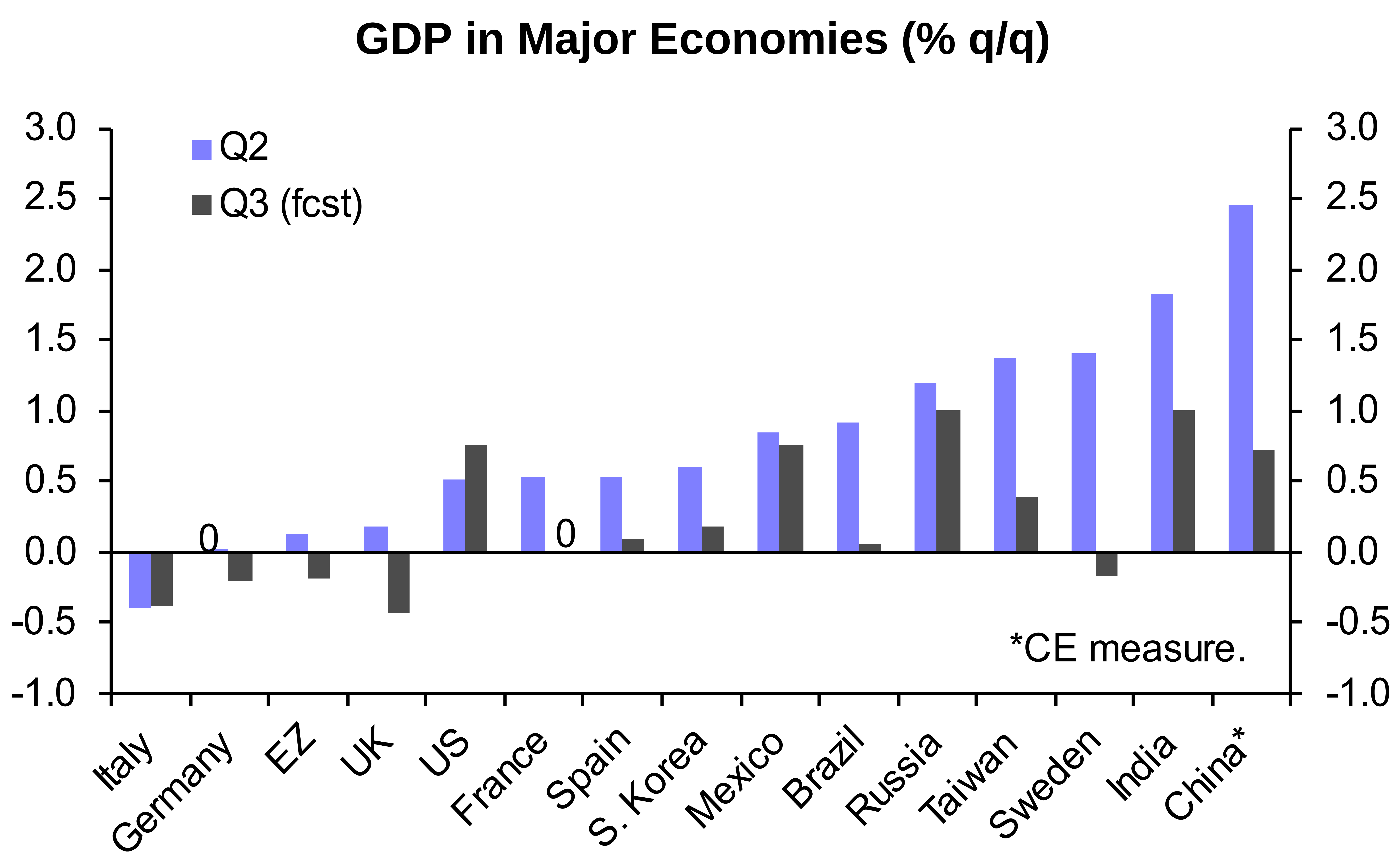
To see all our analysis on the global economy and details of our forecasts, visit our landing page.

Global GDP grew by 1% q/q in Q2. Weakness in China pulled down global GDP growth vs Q1, though growth outside China also remained below trend.



Sources: Refinitiv, Capital Economics

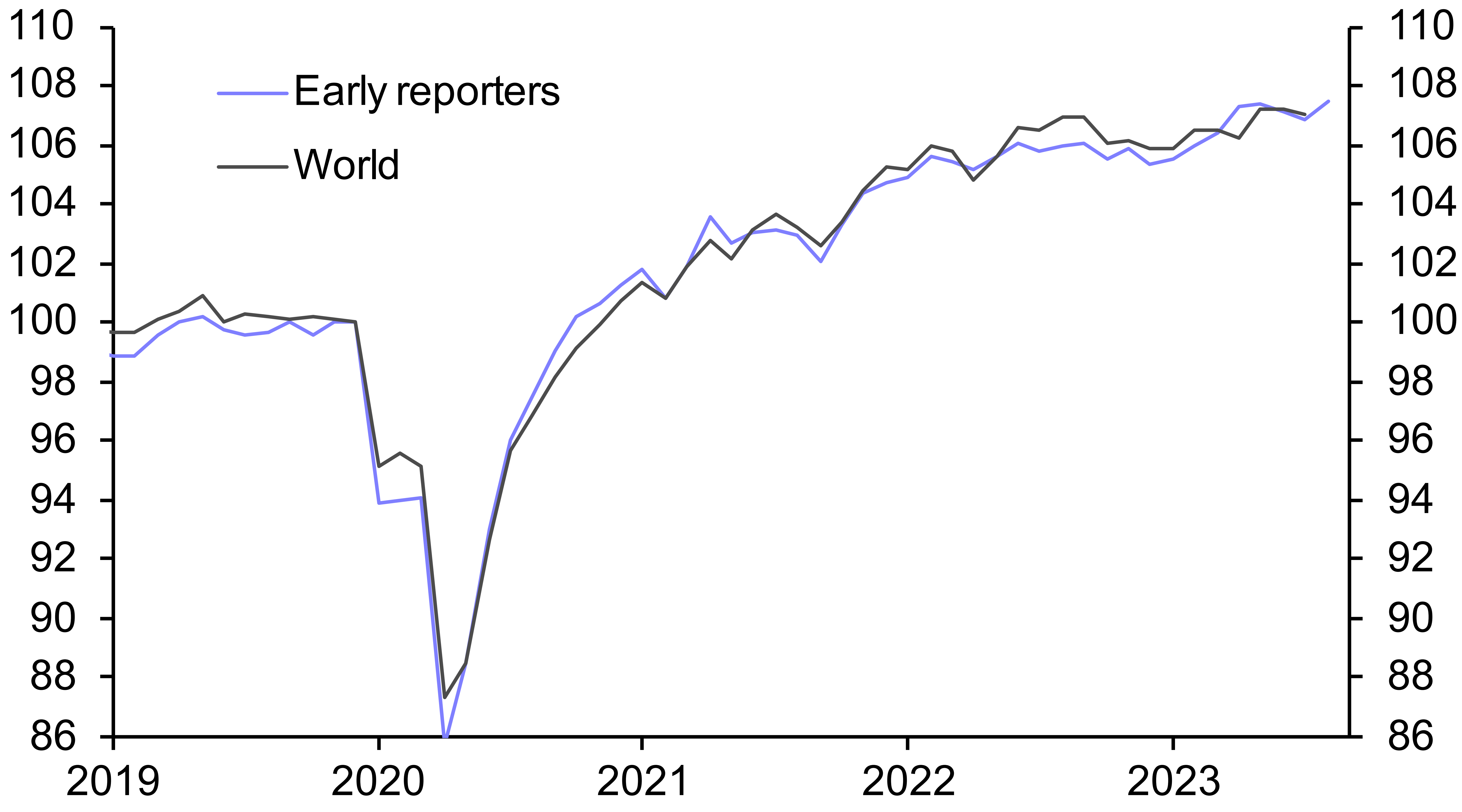
Most major economies avoided contractions in Q2 but the latest survey and activity data point to falls in output in several DMs in Q3.



Sources: Refinitiv, Capital Economics

World industrial production probably ticked up in August having stagnated in June and July.

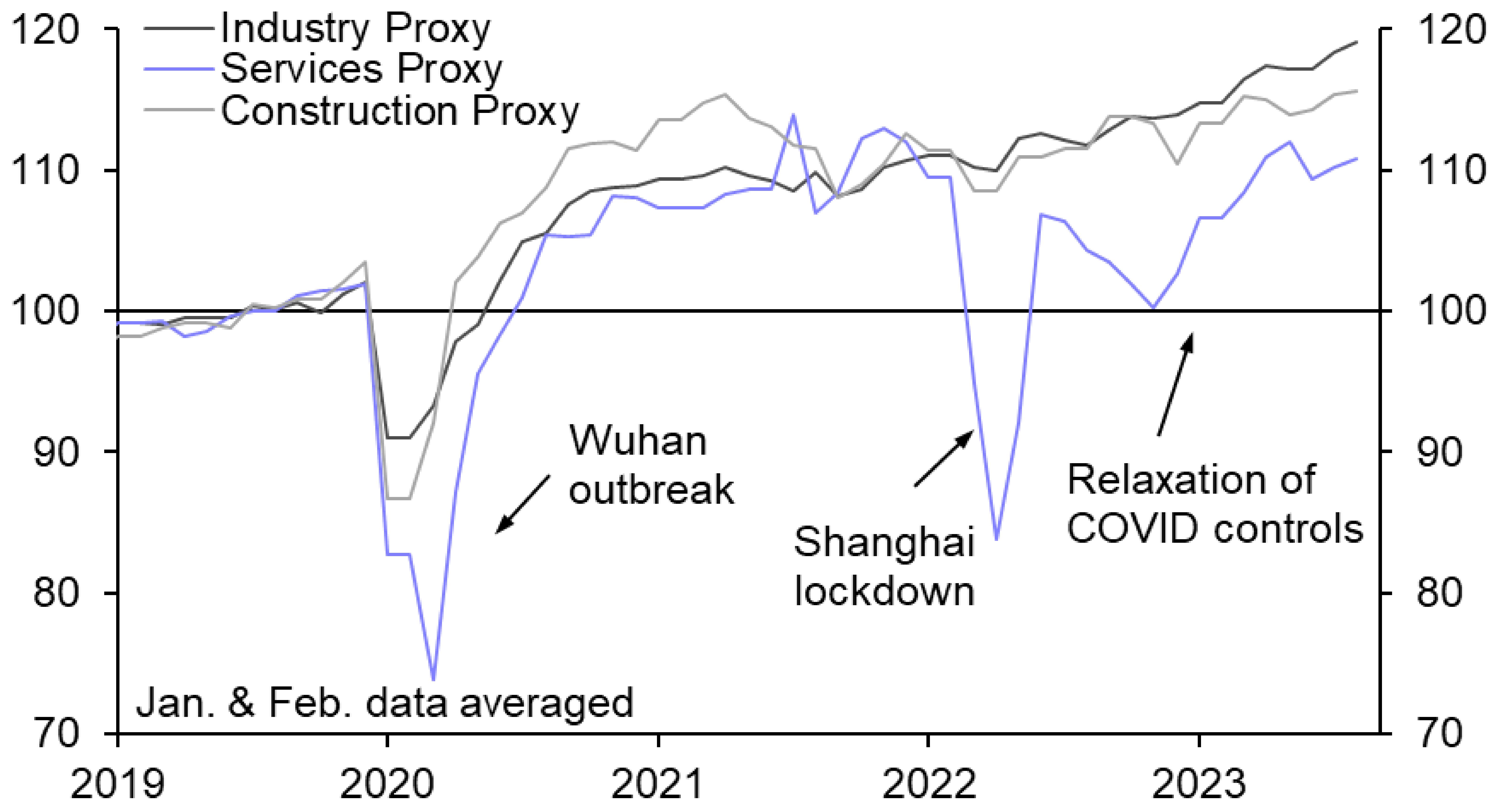
World Industrial Production (Dec. 2019 = 100)



Sources: Refinitiv, Capital Economics

This was driven in large part by an increase in industrial output in China following a step-up in policy support in recent months.

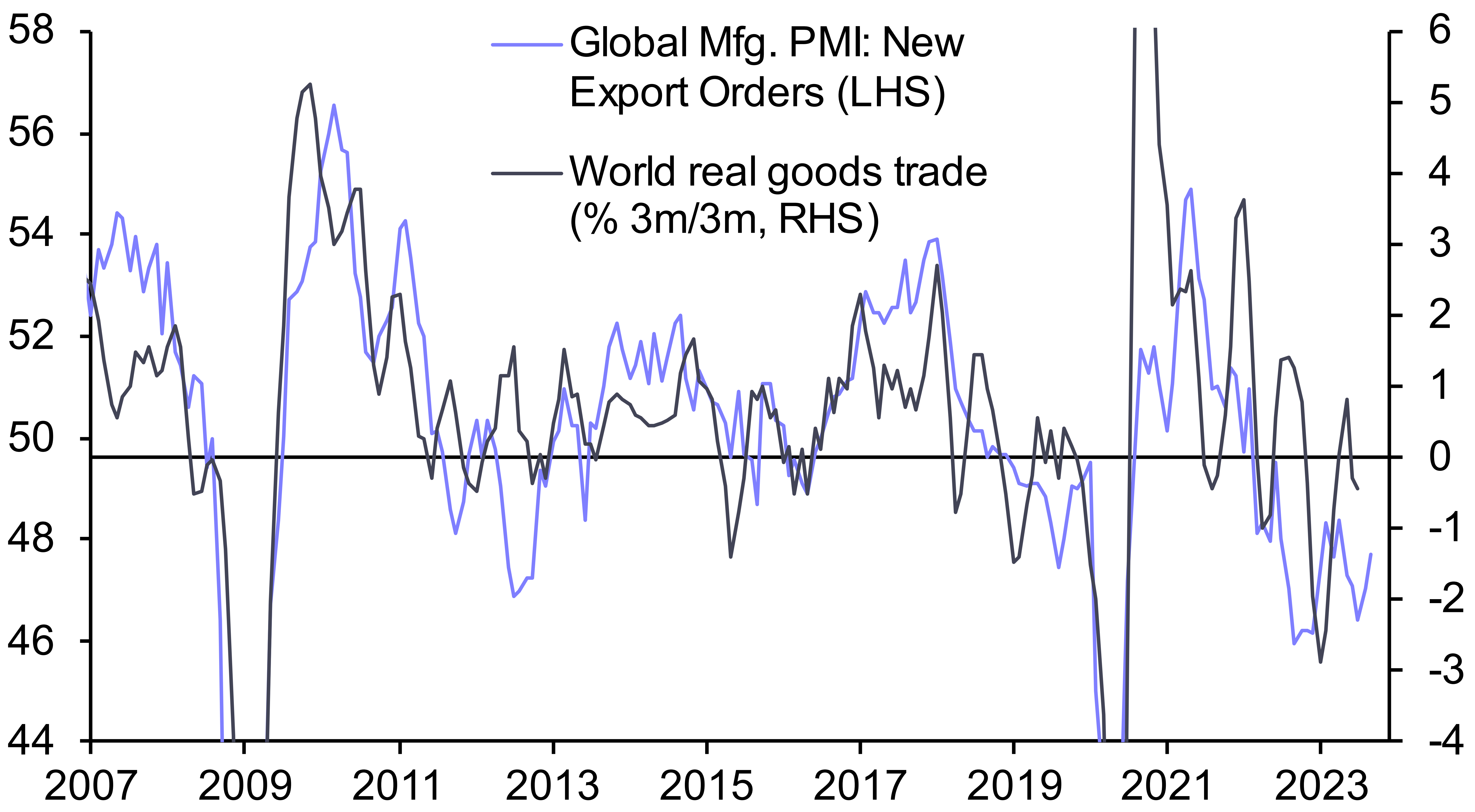
CE China Activity Proxy – Sector Proxies (2019 = 100)



Sources: CEIC, NBS, WIND, Capital Economics

Elsewhere, the latest data have been less positive. World goods trade fell again in July and manufacturing surveys point to further contractions in Q3.

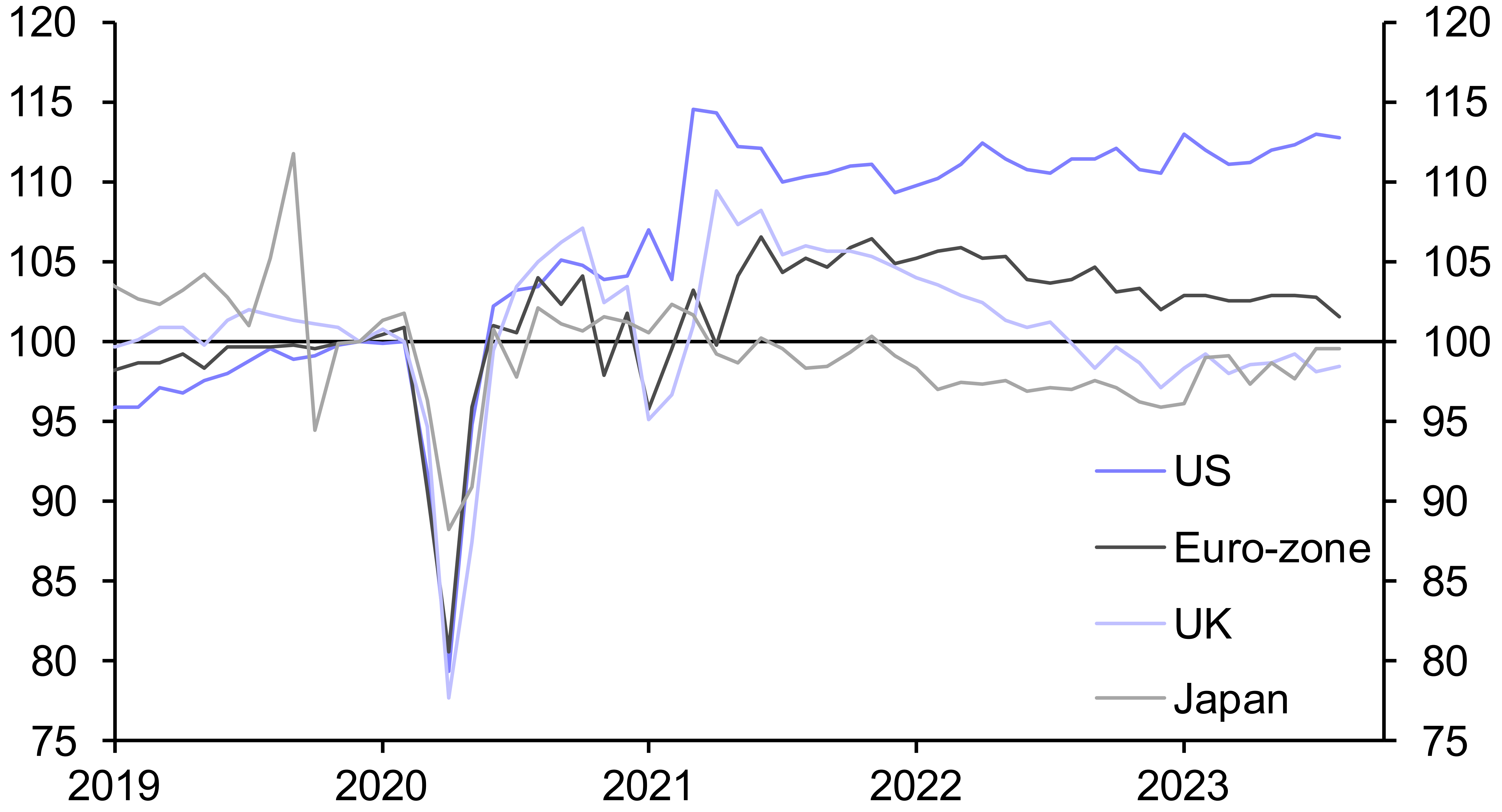
Global Manufacturing PMI New Export Orders & Real Goods Trade



Sources: Refinitiv, S&P Global, Capital Economics

Meanwhile, retail sales have been weak in most major DMs. Even in the US – where consumer spending has been more resilient – retail sales ticked down in August.

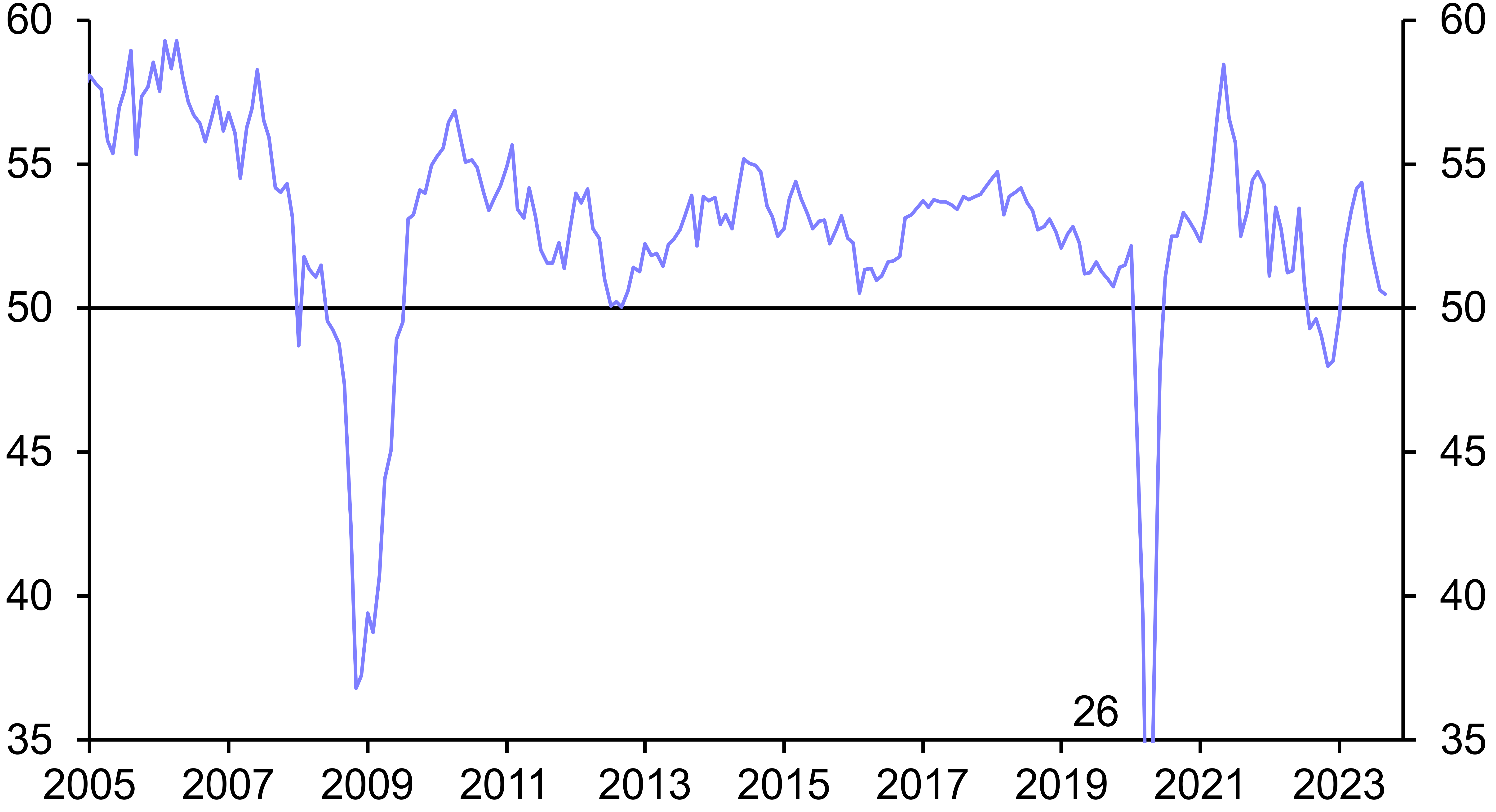
Real Retail Sales (Dec. 2019 = 100)



Sources: Refinitiv, Capital Economics

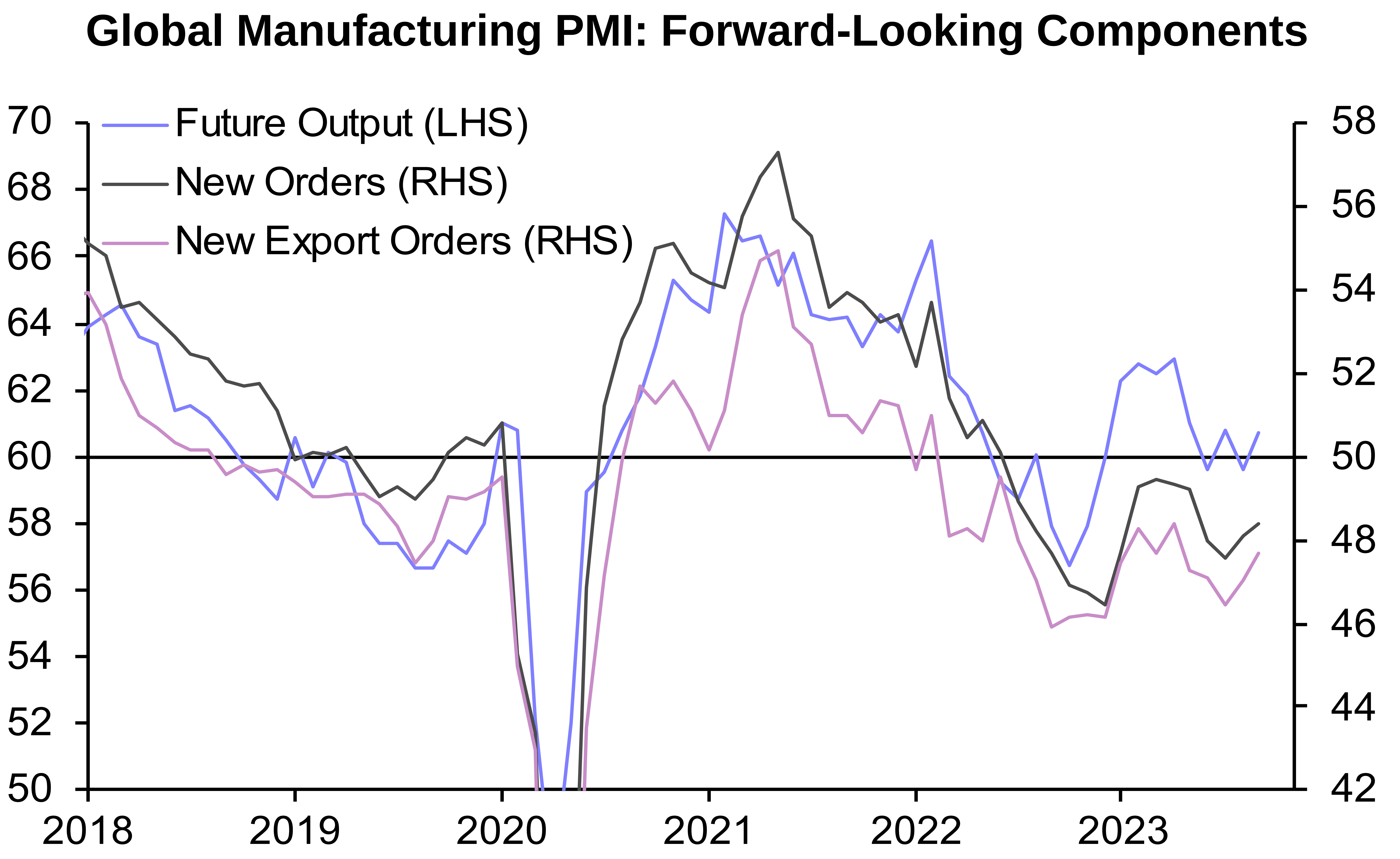
The survey data suggest that the global economy has continued to lose momentum in recent months.

Global Composite PMI



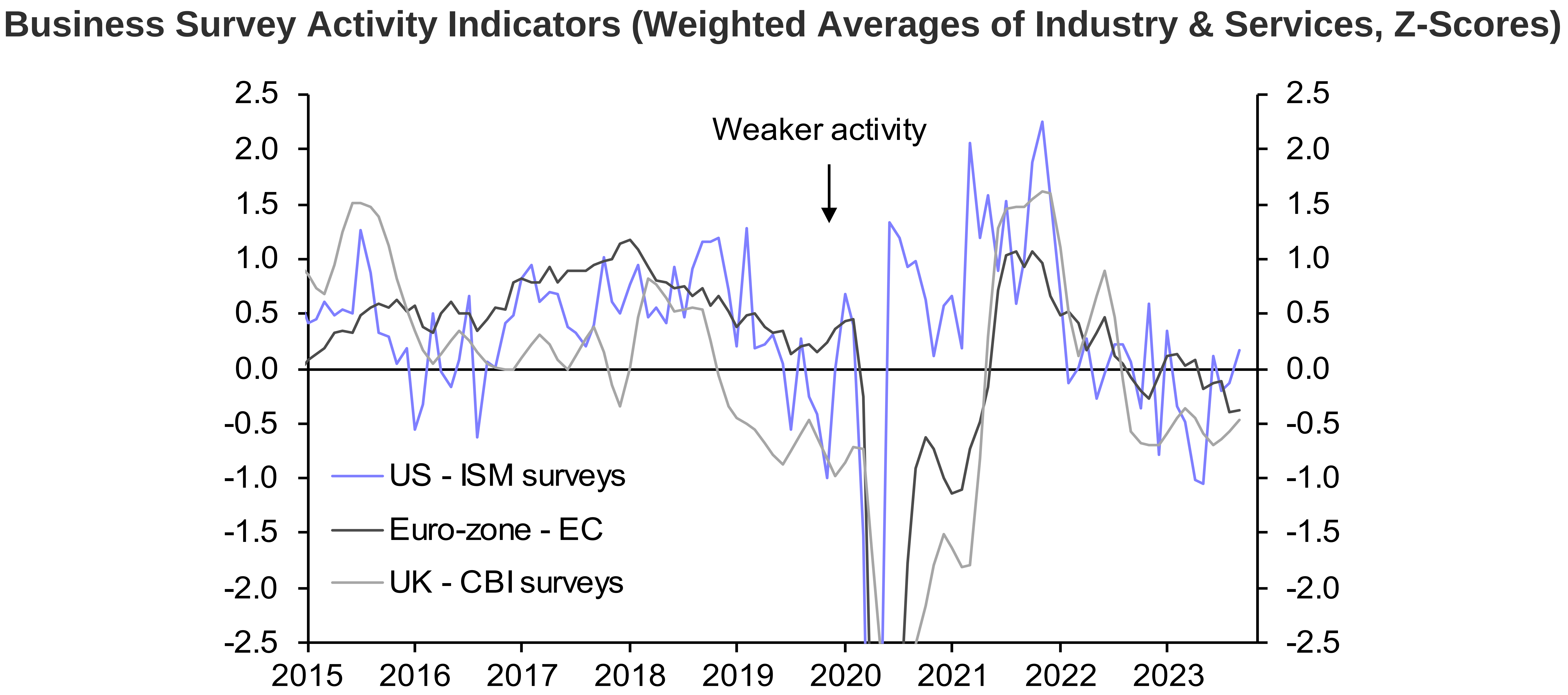
Sources: S&P Global, Capital Economics

New orders balances improved a bit in September but generally remain below the level that divides expansion from contraction.



Sources: S&P Global, Capital Economics

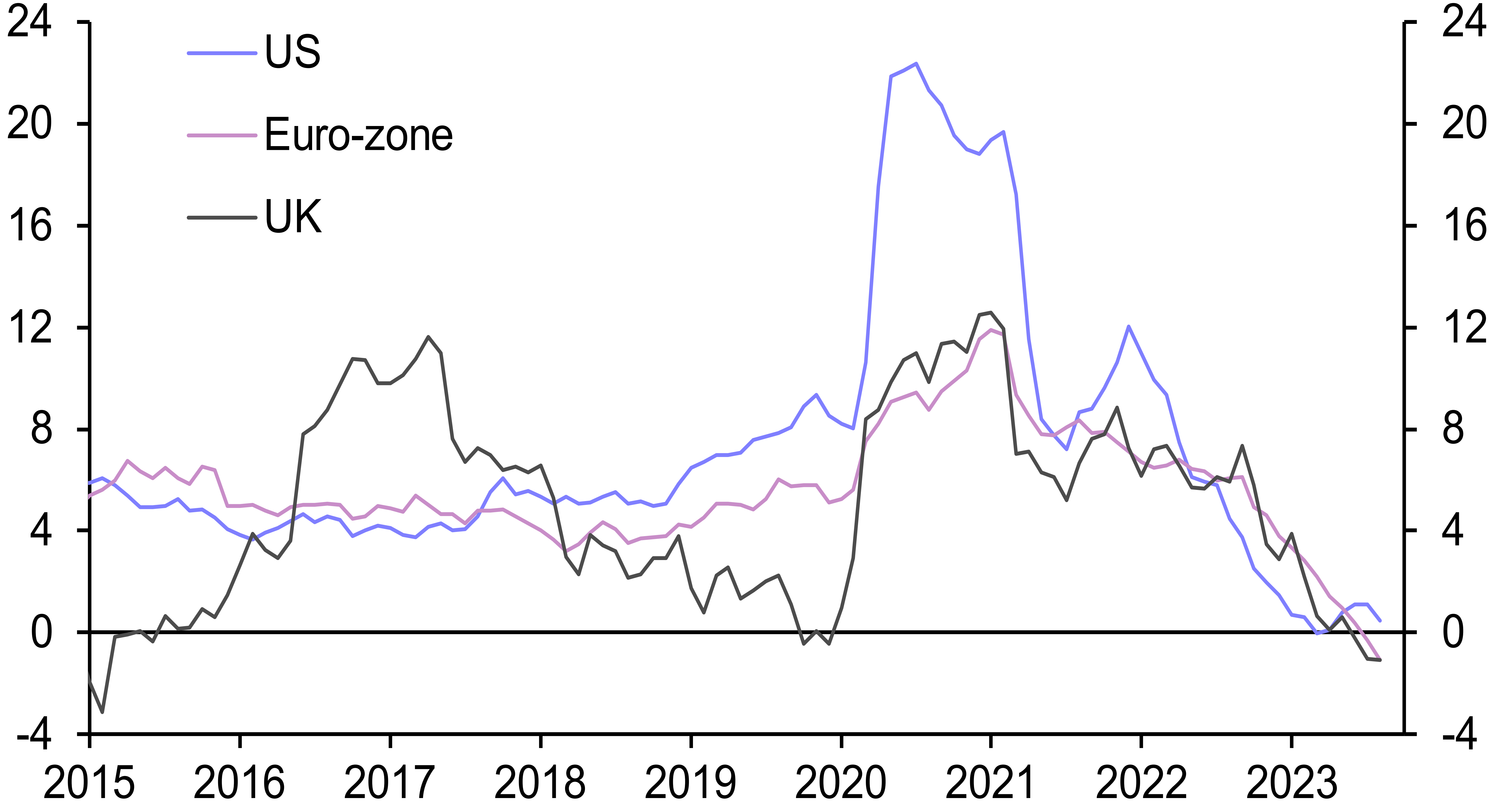
It's not just the PMIs pointing to downturns in activity. Alternative business surveys are also consistent with falling output across Europe.



Sources: Refinitiv, Capital Economics

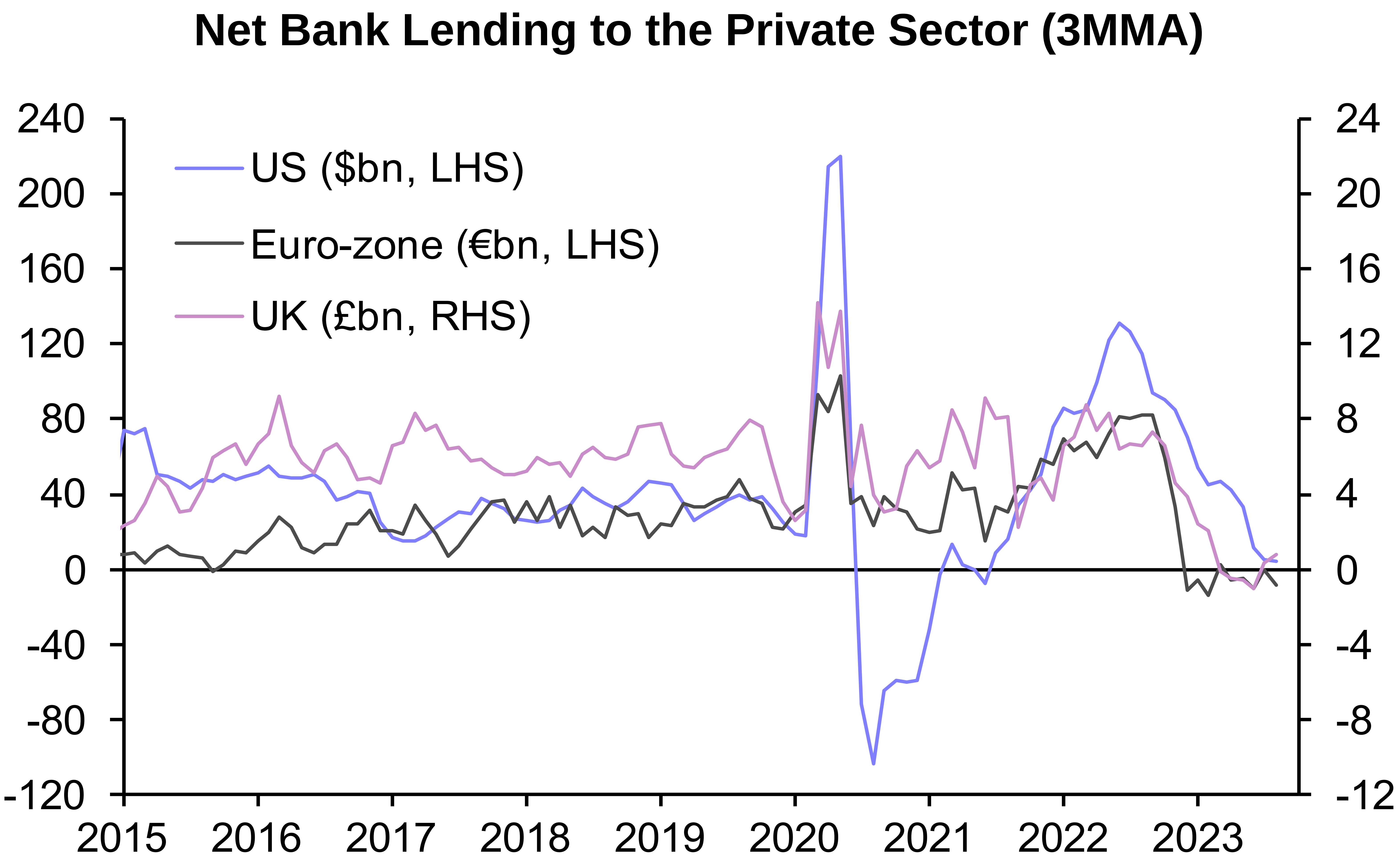
In terms of the ‘hard’ data, it’s clear that high interest rates are already weighing on money and credit activity. Broad money supplies have generally ground to a halt in DMs.

M3 ‘Broad’ Money Growth (% y/y)



Sources: Refinitiv, Capital Economics

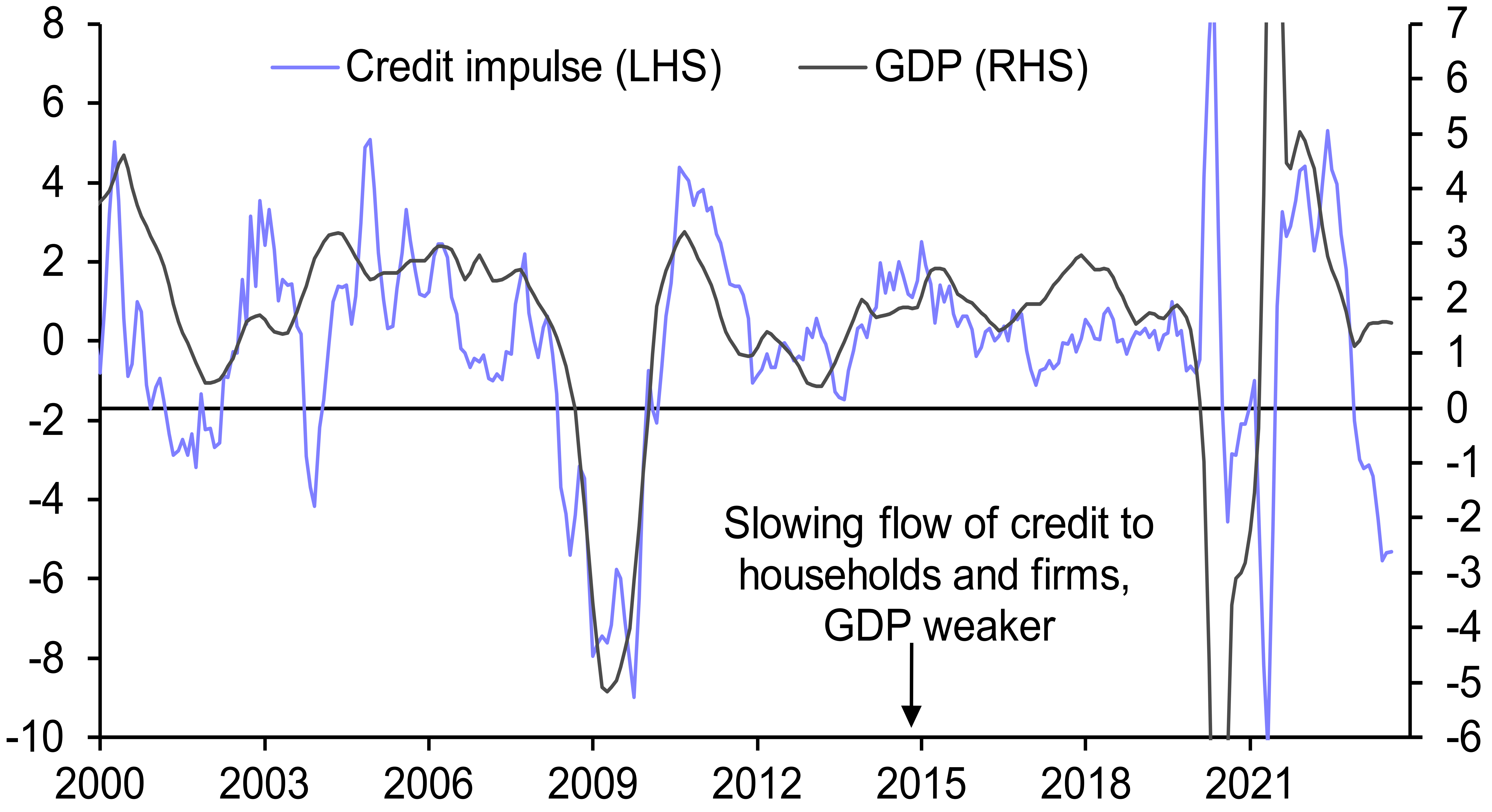
And net bank lending to the private sector has flatlined in the US and Europe.



Sources: Refinitiv, Capital Economics

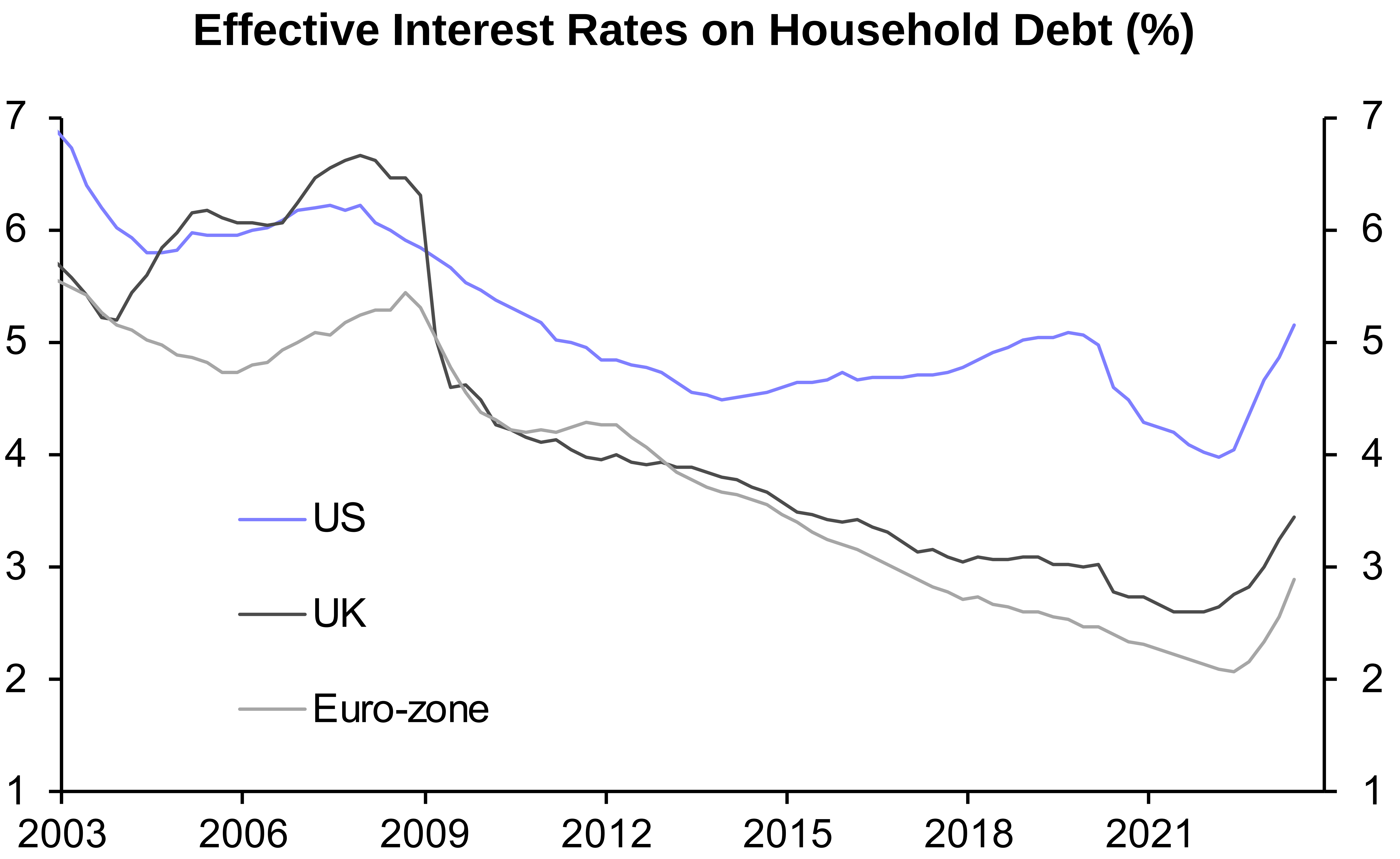
Accordingly, the change in the flow of overall credit to the private sector in major DMs (the ‘credit impulse’) is deep in recessionary territory.

Private Sector Credit Impulse & GDP in Major DMs



Sources: Refinitiv, Capital Economics

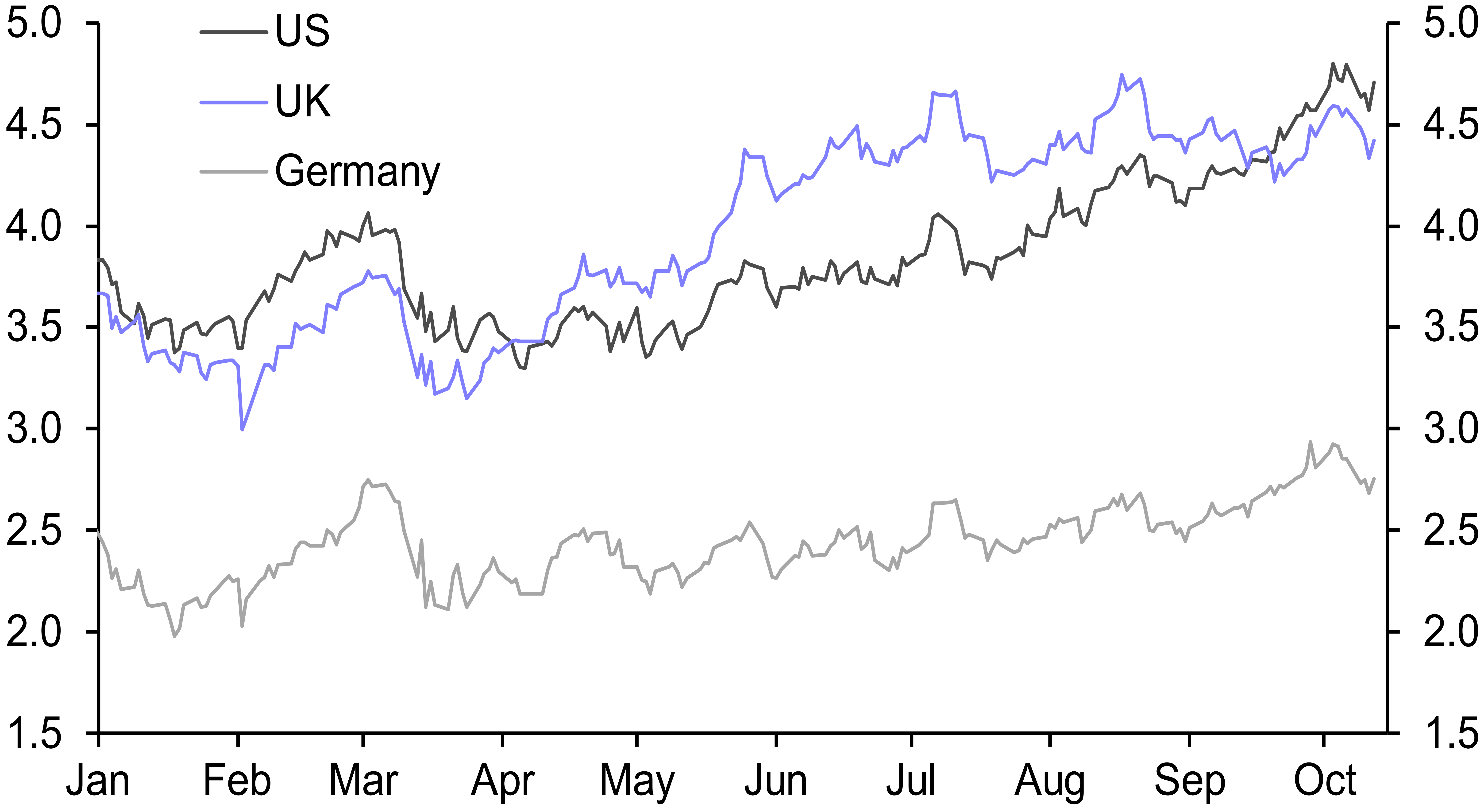
The impact of policy tightening in DMs has been limited by the greater prevalence of debt with longer maturities, meaning the rise in debt servicing costs has so far been modest.



Sources: Refinitiv, Capital Economics

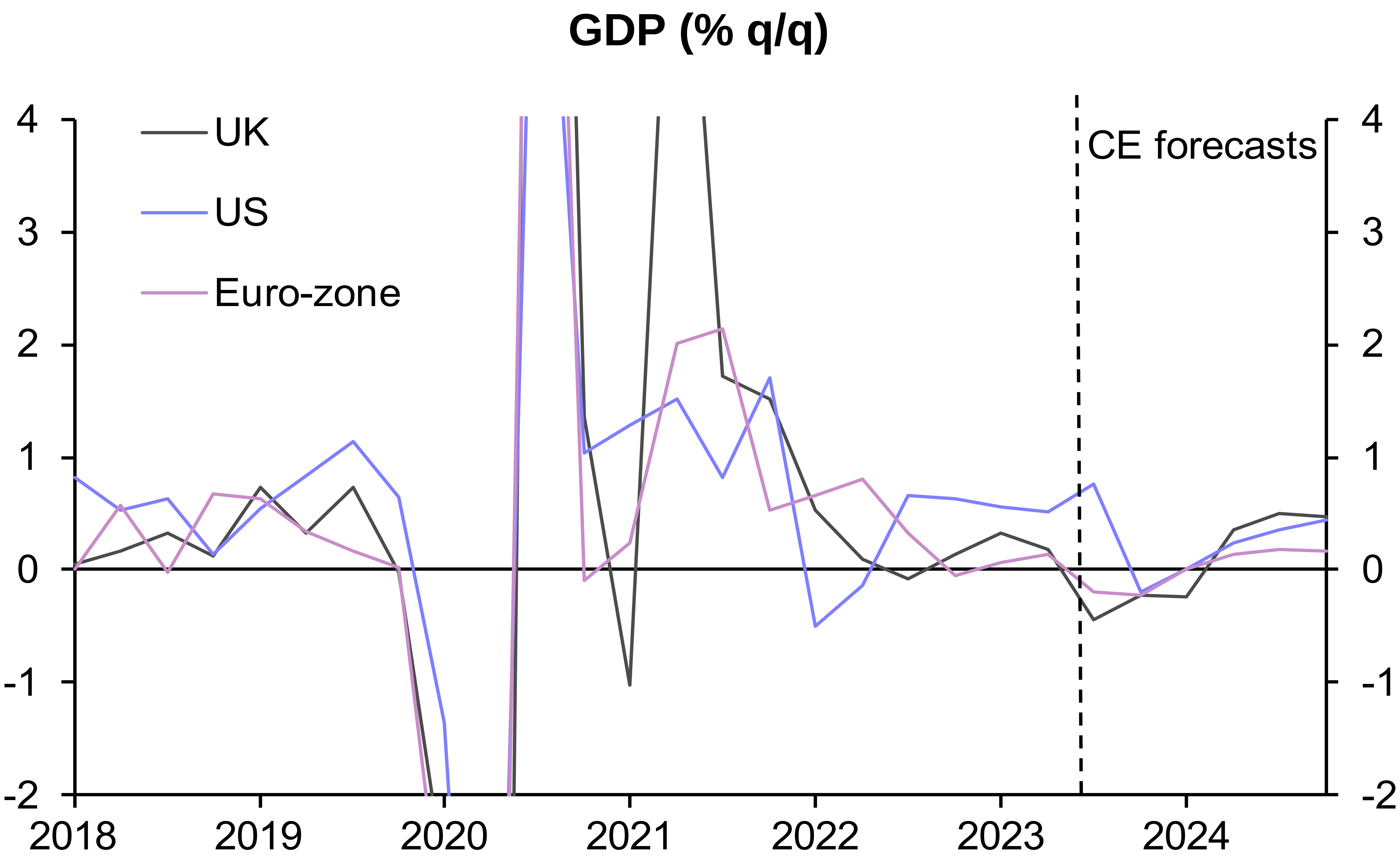
But we expect interest burdens to rise as households are forced to renew at higher rates. And if the past month's rise in bond yields is sustained, interest costs could rise by more.

10Y Government Bond Yields (%)



Sources: Refinitiv, Capital Economics

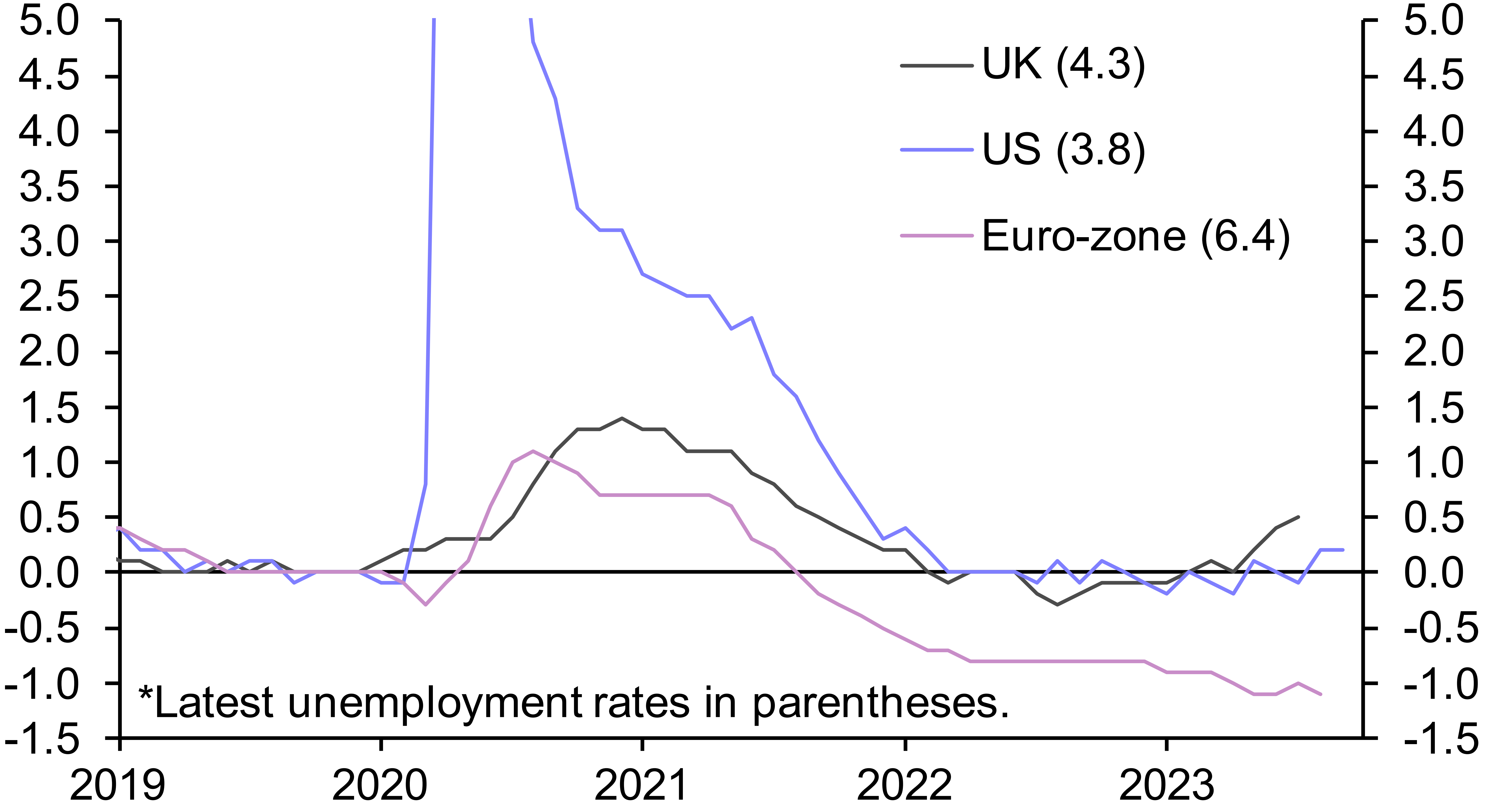
Altogether, we still expect the lagged impacts from policy tightening to push the UK and euro-zone into mild recessions later this year, while US growth will weaken too.



Sources: Refinitiv, Capital Economics

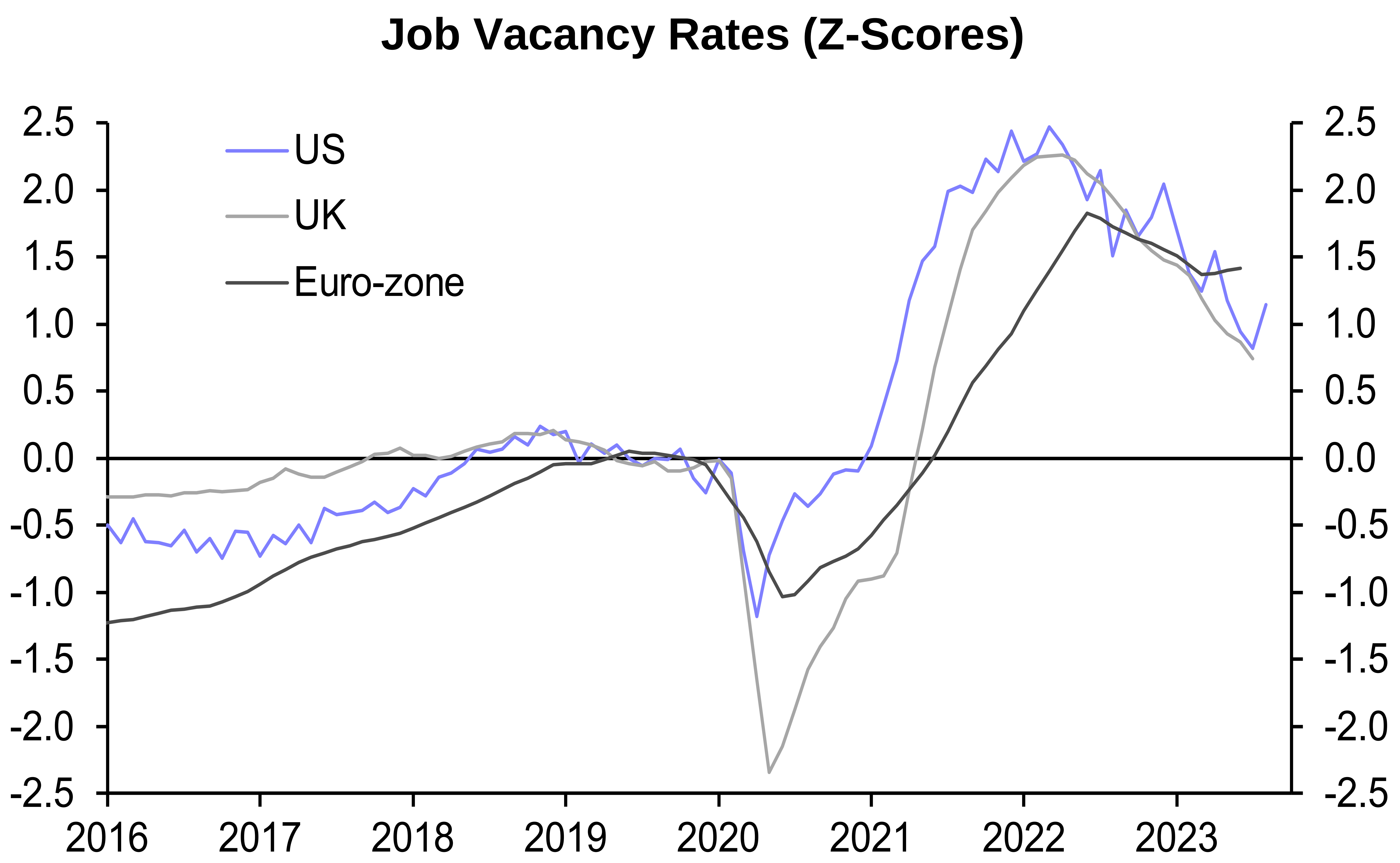
There has also been evidence that labour markets are coming off the boil in some DMs. Unemployment rates have started to inch higher in the US and UK.

Percentage Point Change in Unemployment Rates From December 2019 Level*



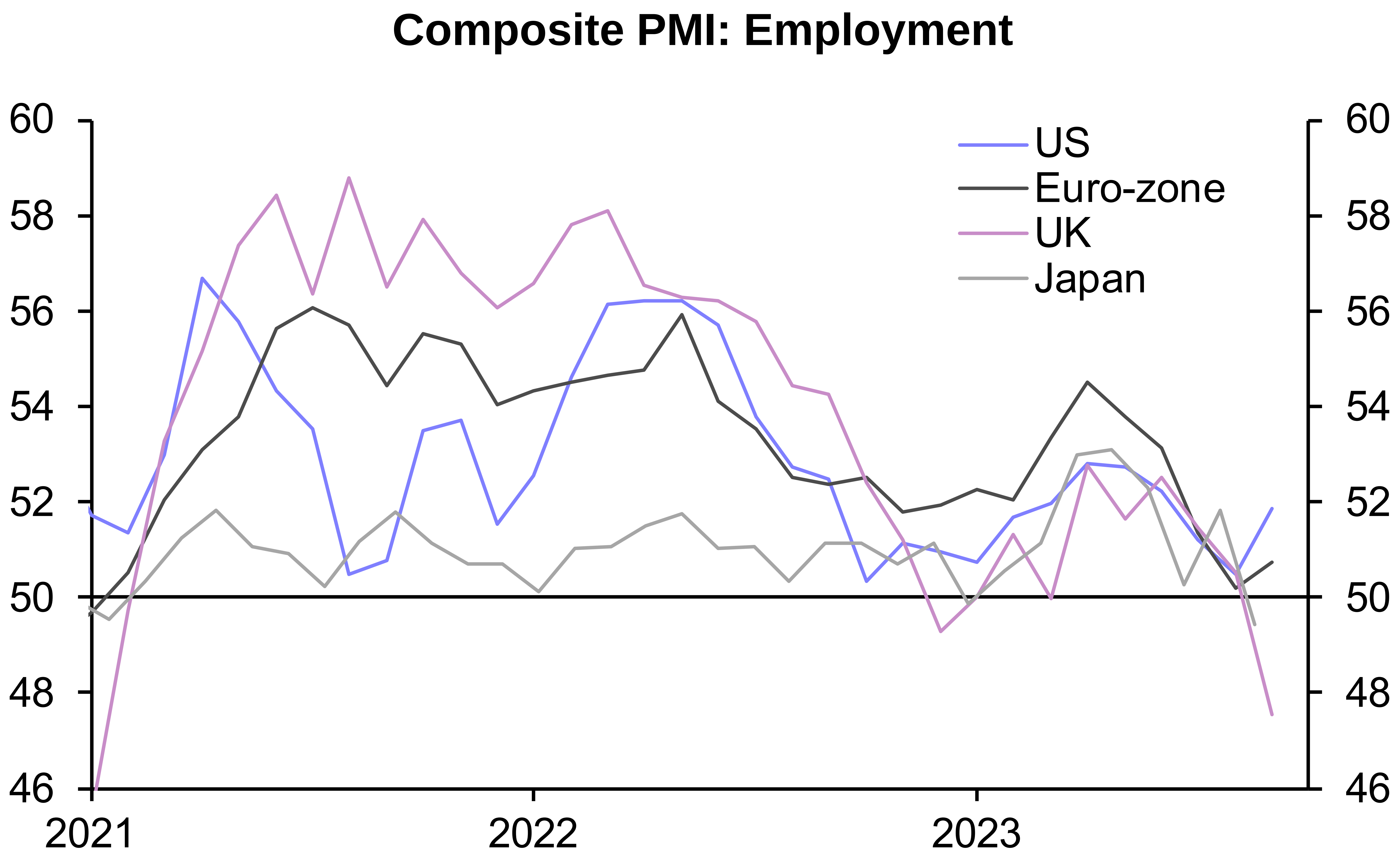
Sources: Refinitiv, Capital Economics

And vacancy rates have fallen sharply in the US and UK. Once again though, progress in the euro-zone has been slower.



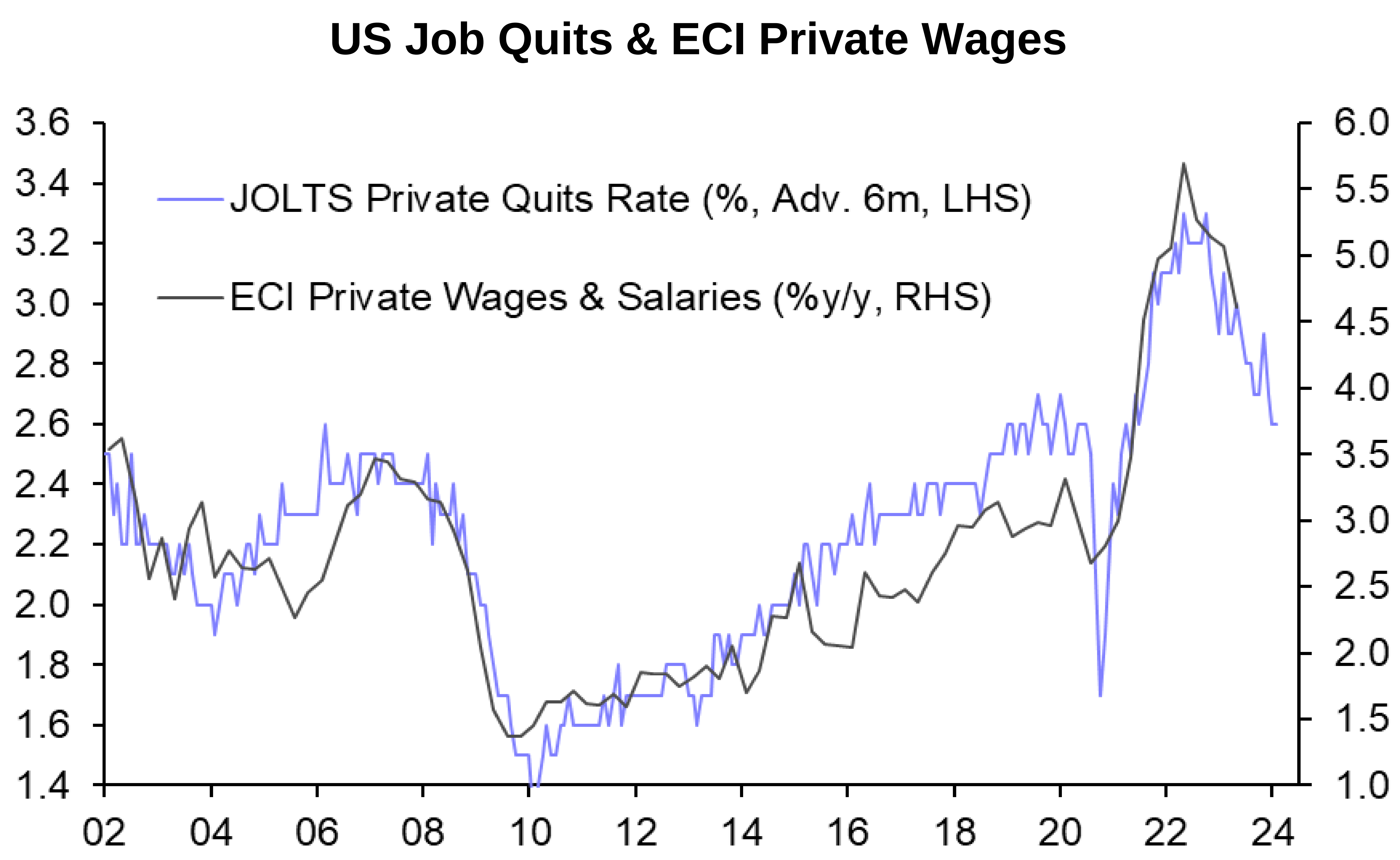
Sources: Refinitiv, Capital Economics

Although employment is still rising in many DMs, the latest survey indicators point to a slowdown in jobs growth too. In the UK, the PMI suggests that employment is now *falling*.



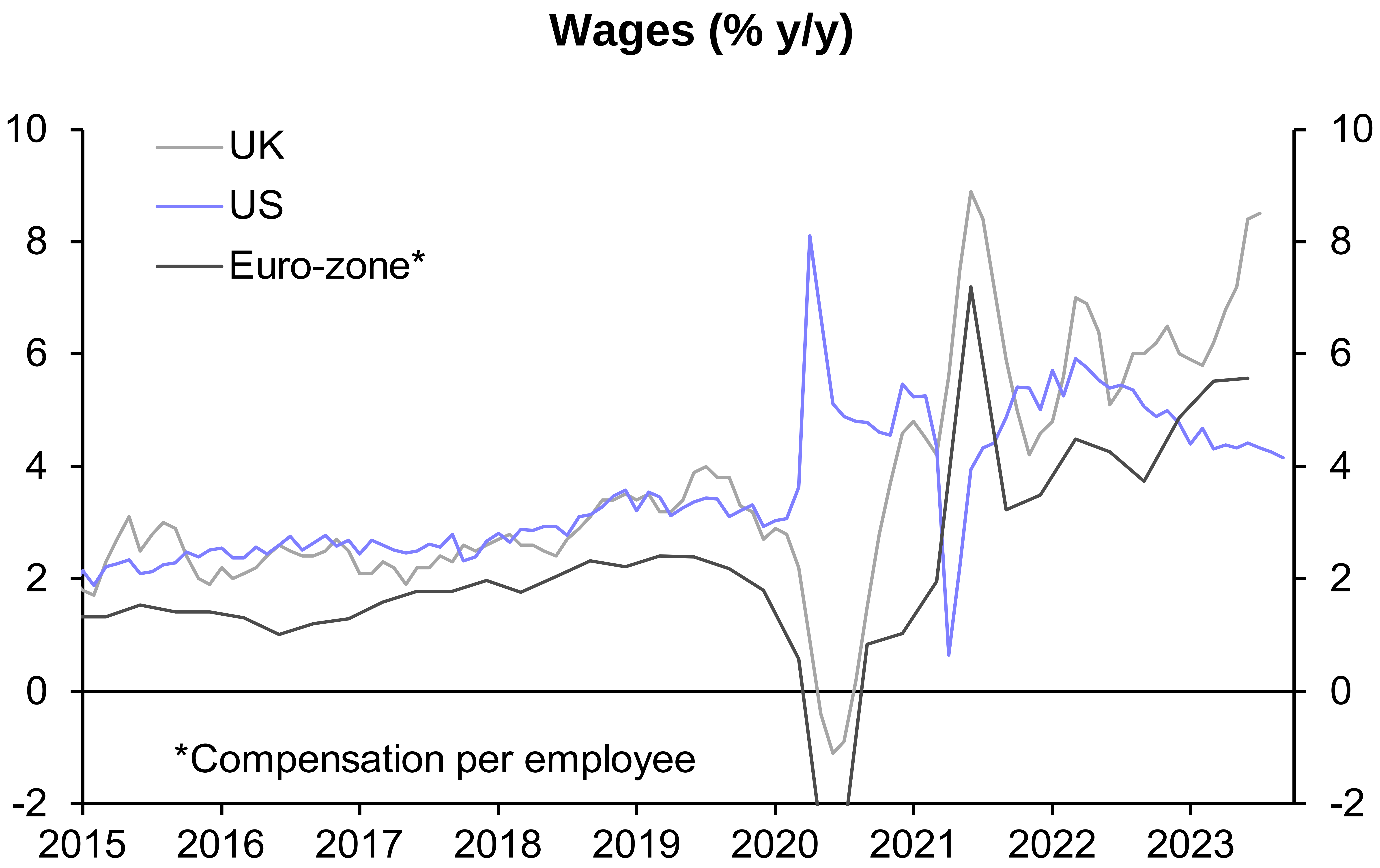
Sources: S&P Global, Capital Economics

The loosening in labour market conditions has been most notable in the US. Indeed, the private quits rate now points to wage growth moderating to just above 3.5%.



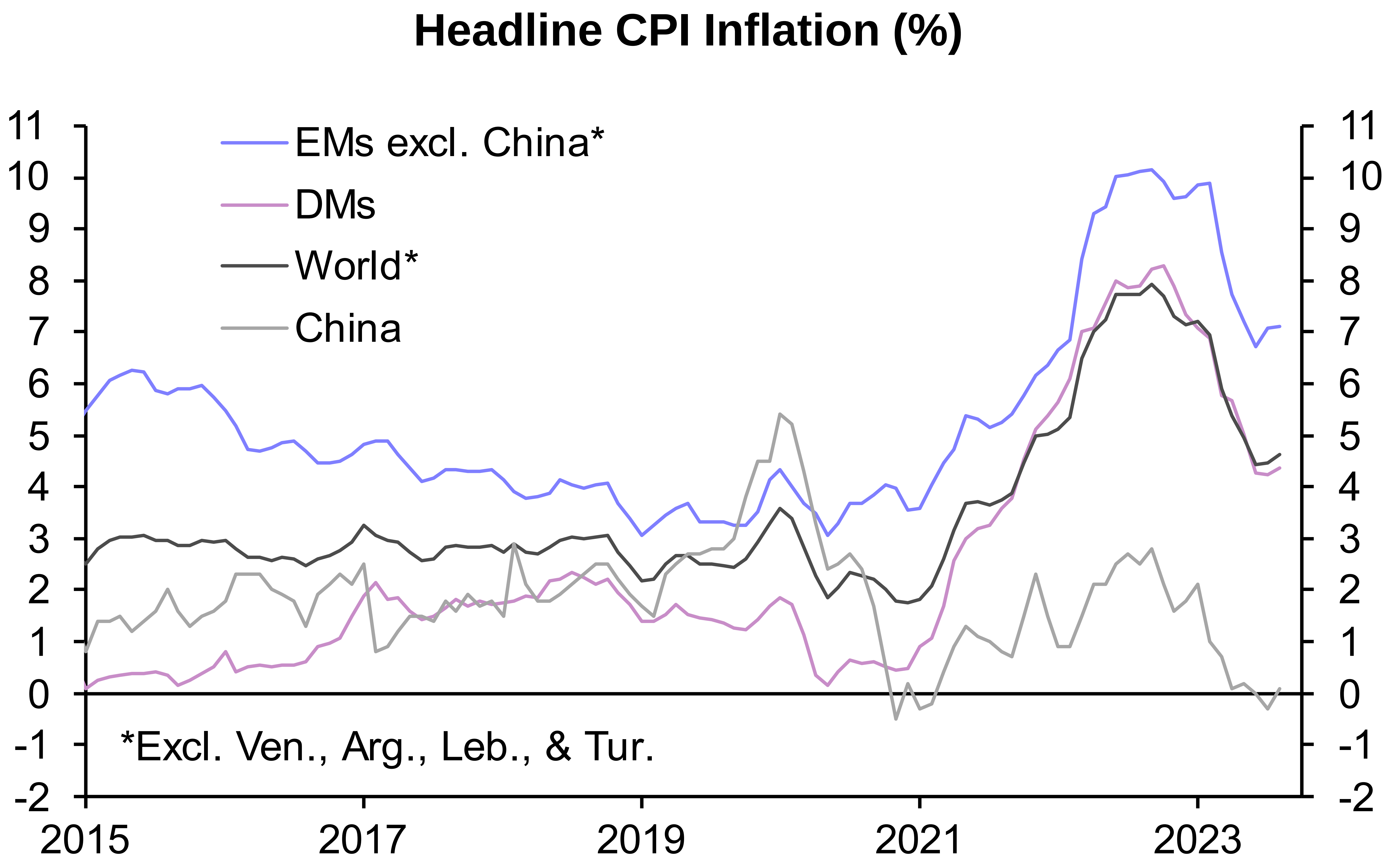
Sources: Refinitiv, Capital Economics

But outside of the US – where wage growth has been gradually falling for the past year – wage growth remains uncomfortably high for central banks and is still *rising*.



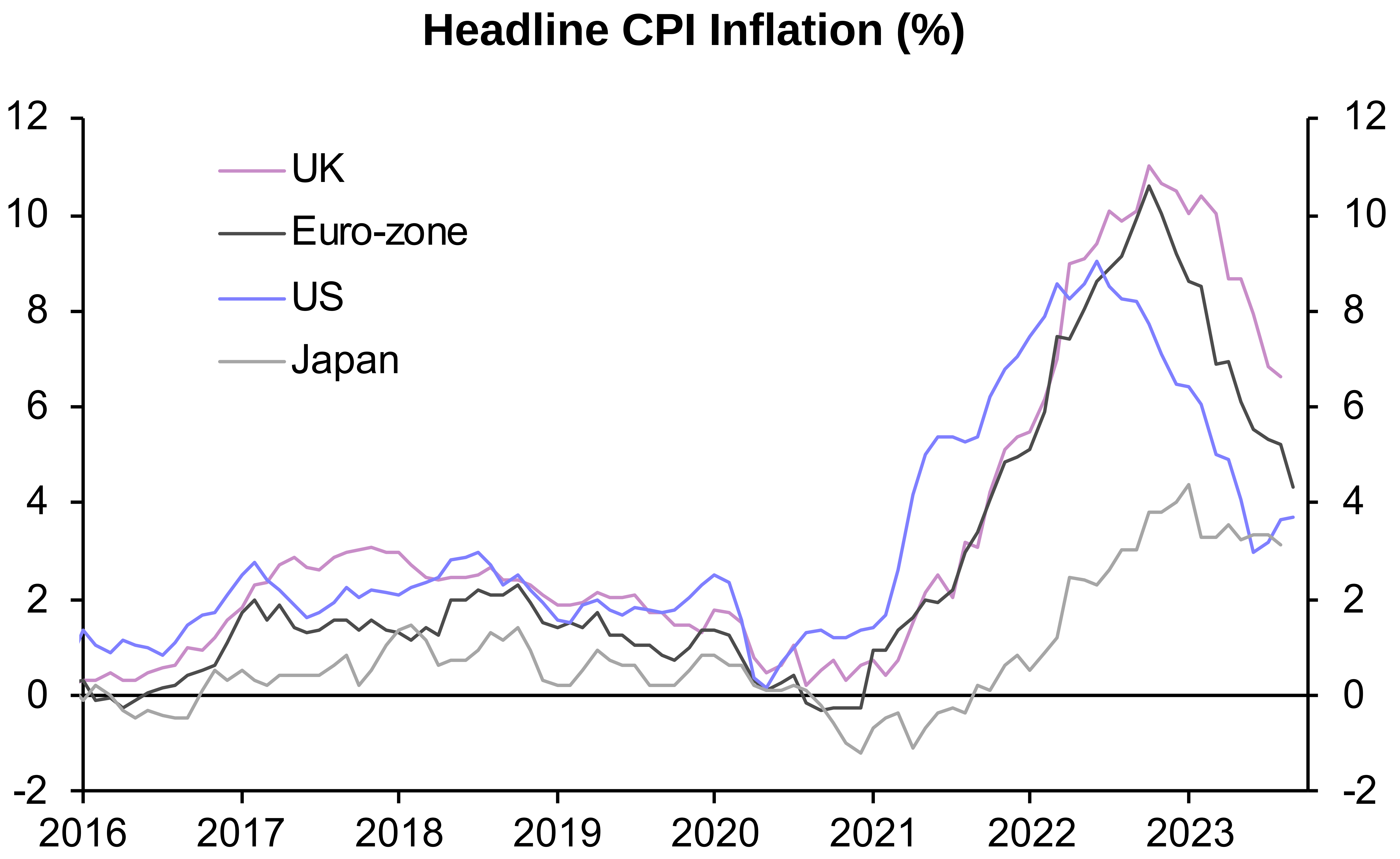
Sources: Refinitiv, Capital Economics

Although a rebound in fuel prices caused headline inflation to rise slightly in August, global inflation has still fallen by about 2.5%-pts since the start of this year.



Sources: Refinitiv, Capital Economics

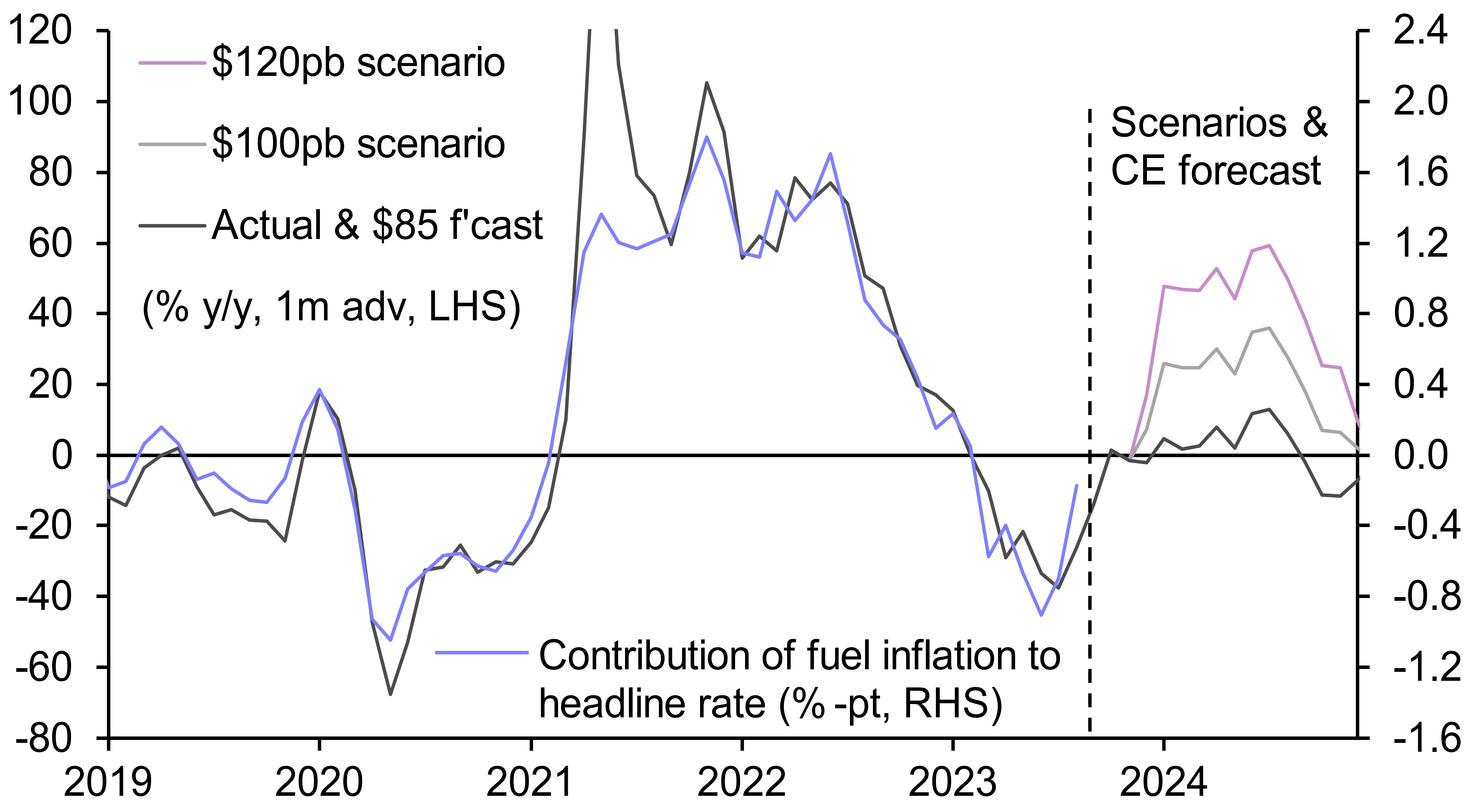
Meanwhile, available data for September showed that headline inflation fell sharply to 4.3% in the euro-zone, whereas in the US it was unchanged at 3.7%.



Sources: Refinitiv, Capital Economics

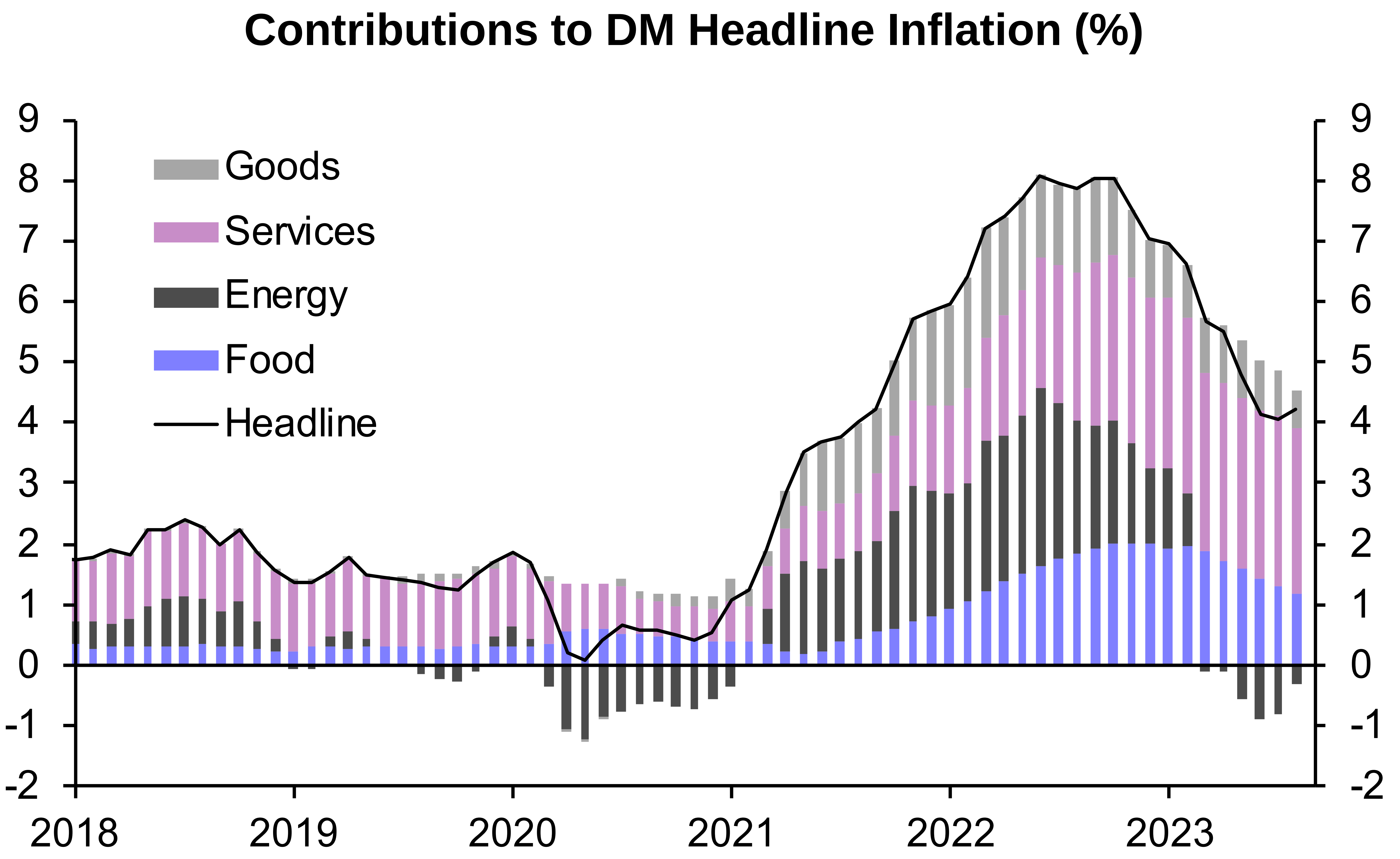
Higher oil prices should add about 0.5%-pts to DM inflation in the next year. But if a bigger rise in oil prices was sustained it would be more concerning for central banks.

Oil Price & Average DM Contribution of Fuel Inflation to Headline Rate



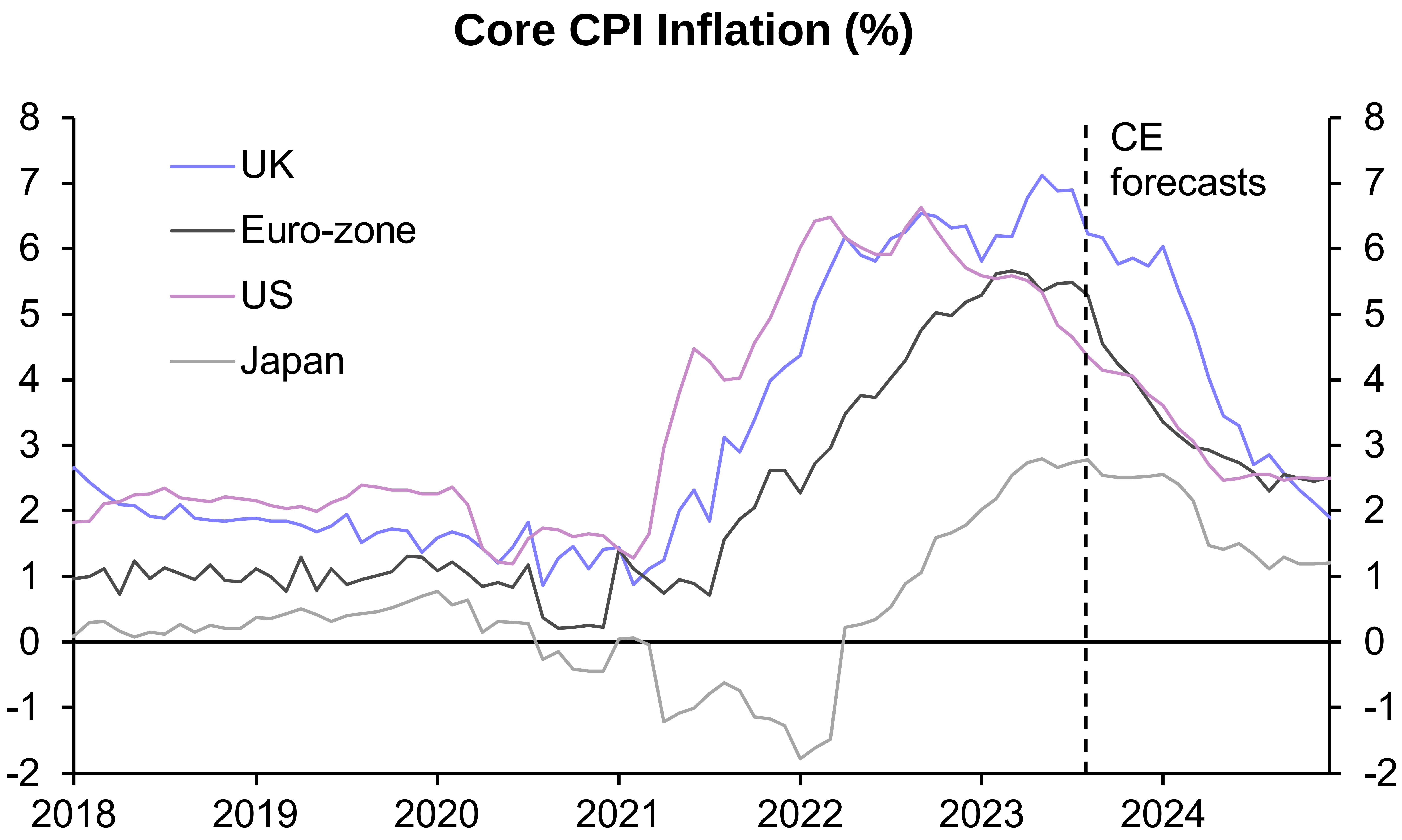
Sources: Refinitiv, Capital Economics

Despite a rebound in energy inflation, falls in food and goods inflation should continue to exert downwards pressure on DM inflation.



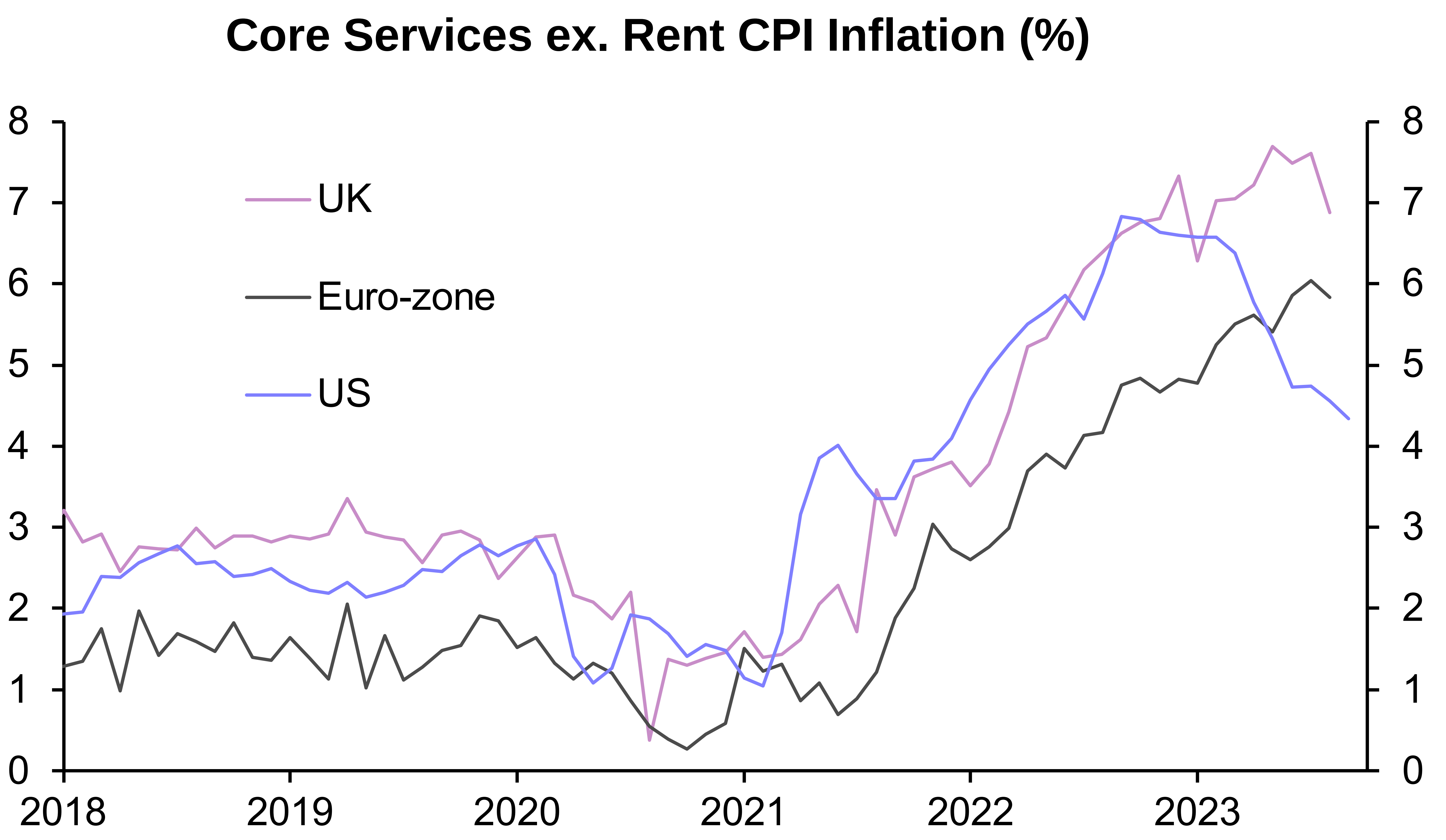
Sources: Refinitiv, S&P Global, Capital Economics

Core inflation is now falling as well and should be back around targets by 2025.



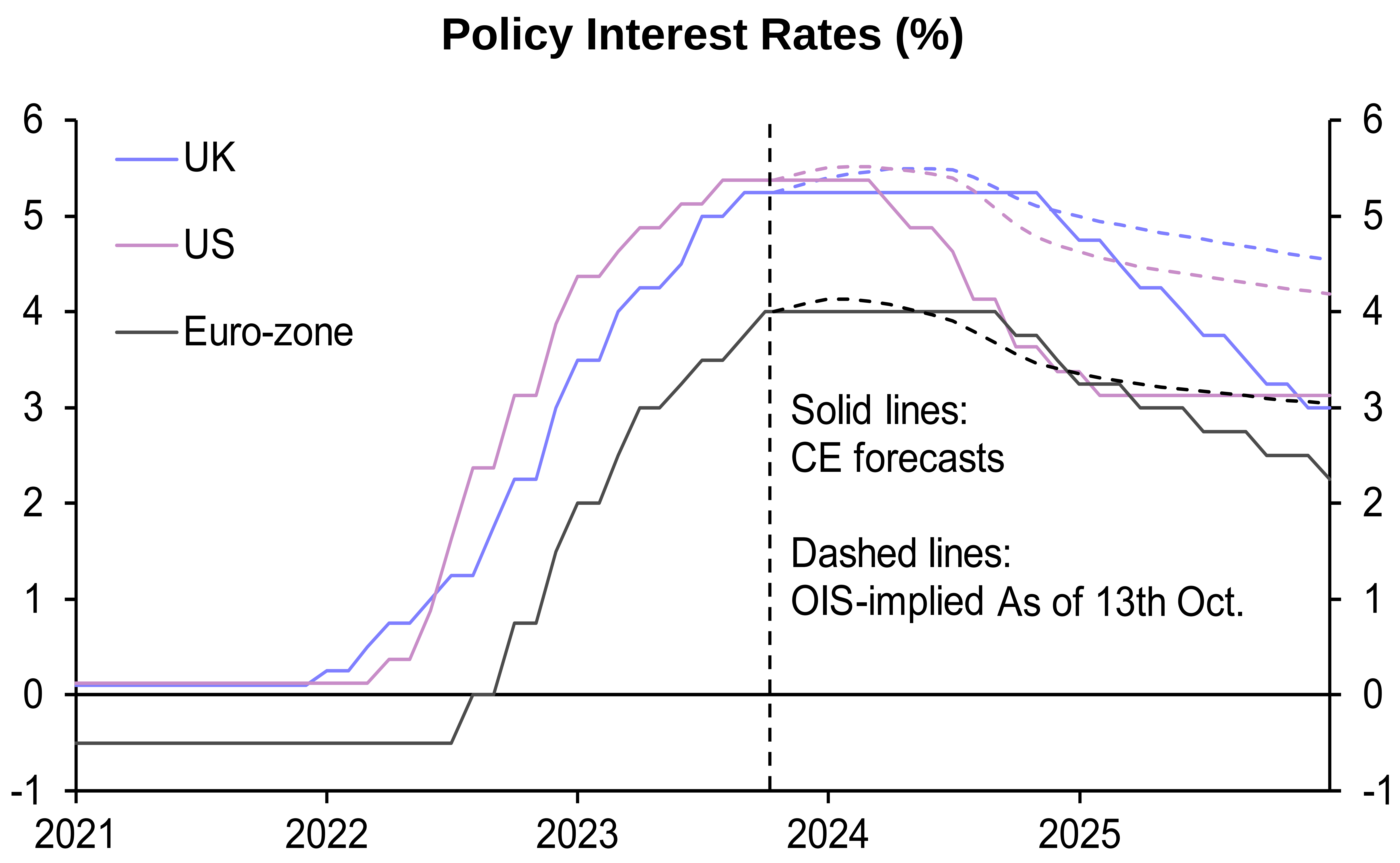
Sources: Refinitiv, Capital Economics

But tight labour markets in Europe mean that core services inflation will fall more slowly than in the US.



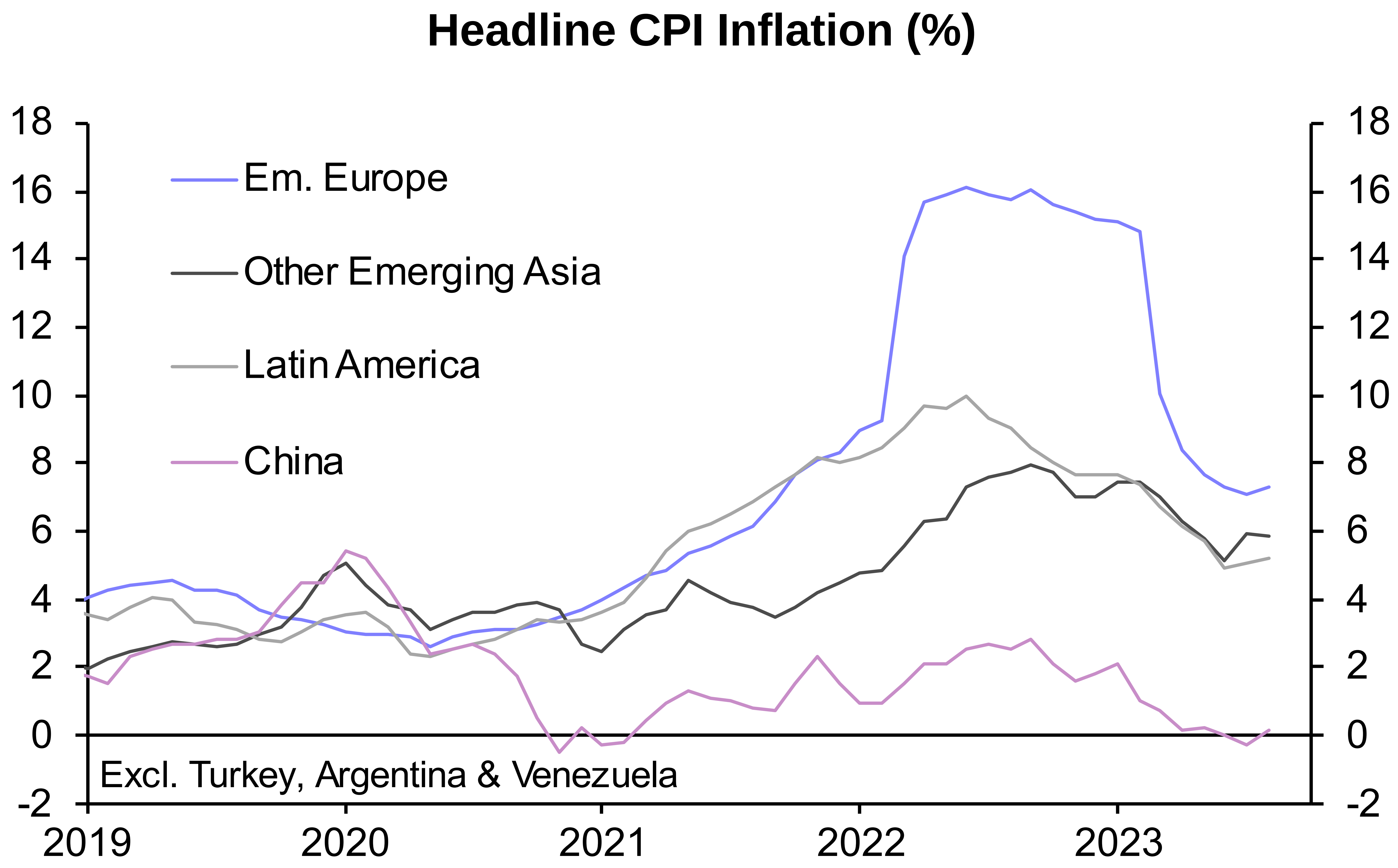
Sources: Refinitiv, S&P Global, Capital Economics

Sticky services inflation means rates will stay at their peaks for a little longer in Europe, but when cuts do come, we think they will be more aggressive than investors expect.



Sources: Refinitiv, Capital Economics

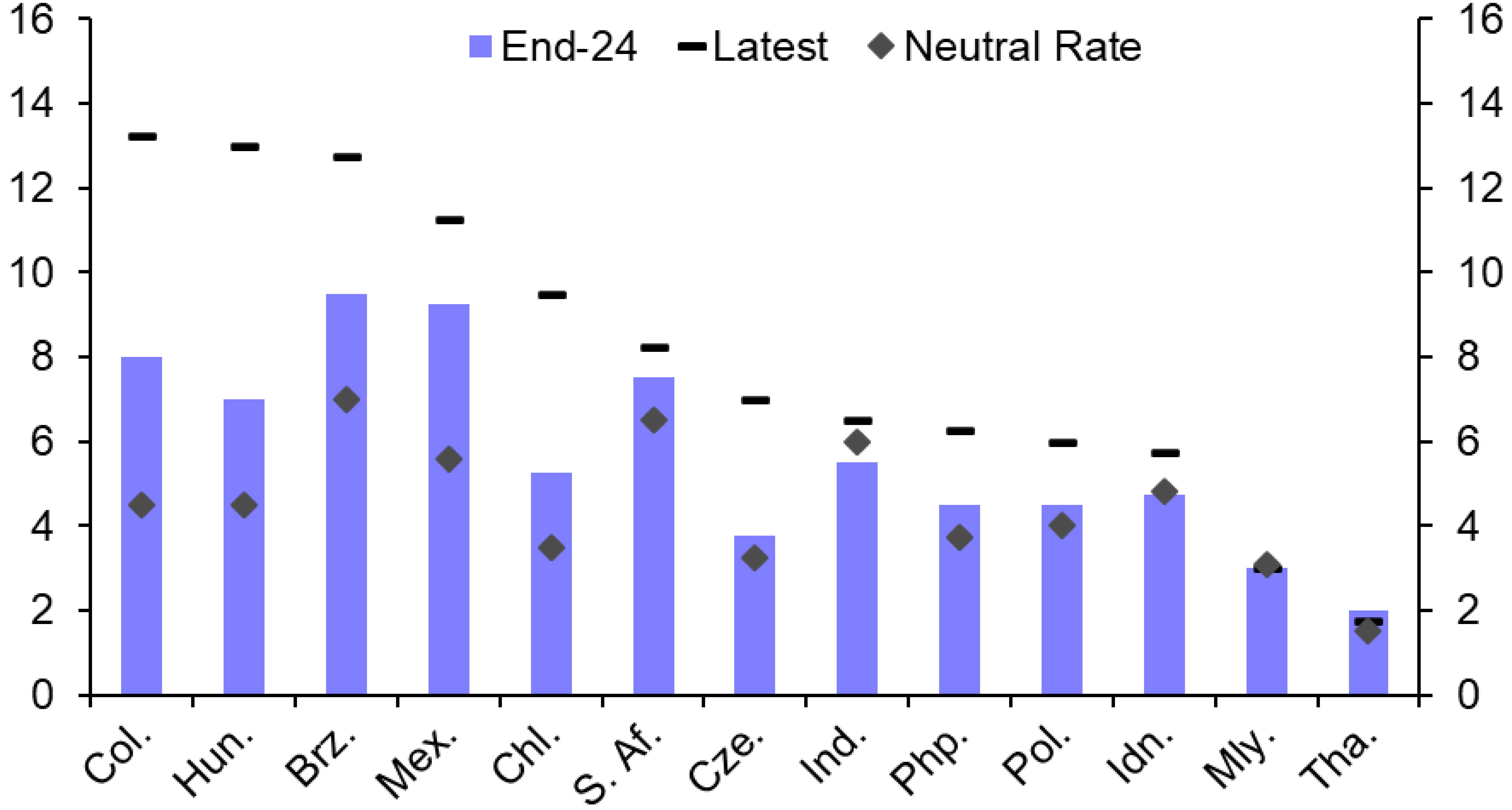
In emerging markets, inflation has also fallen a long way from its peak. But the recent rise in food and fuel inflation has caused headline inflation to rebound.



Sources: Refinitiv, Capital Economics

We expect EMs to remain at the forefront of policy easing. But high food inflation in Asia means those central banks will probably cut rates later and by less than their EM peers.

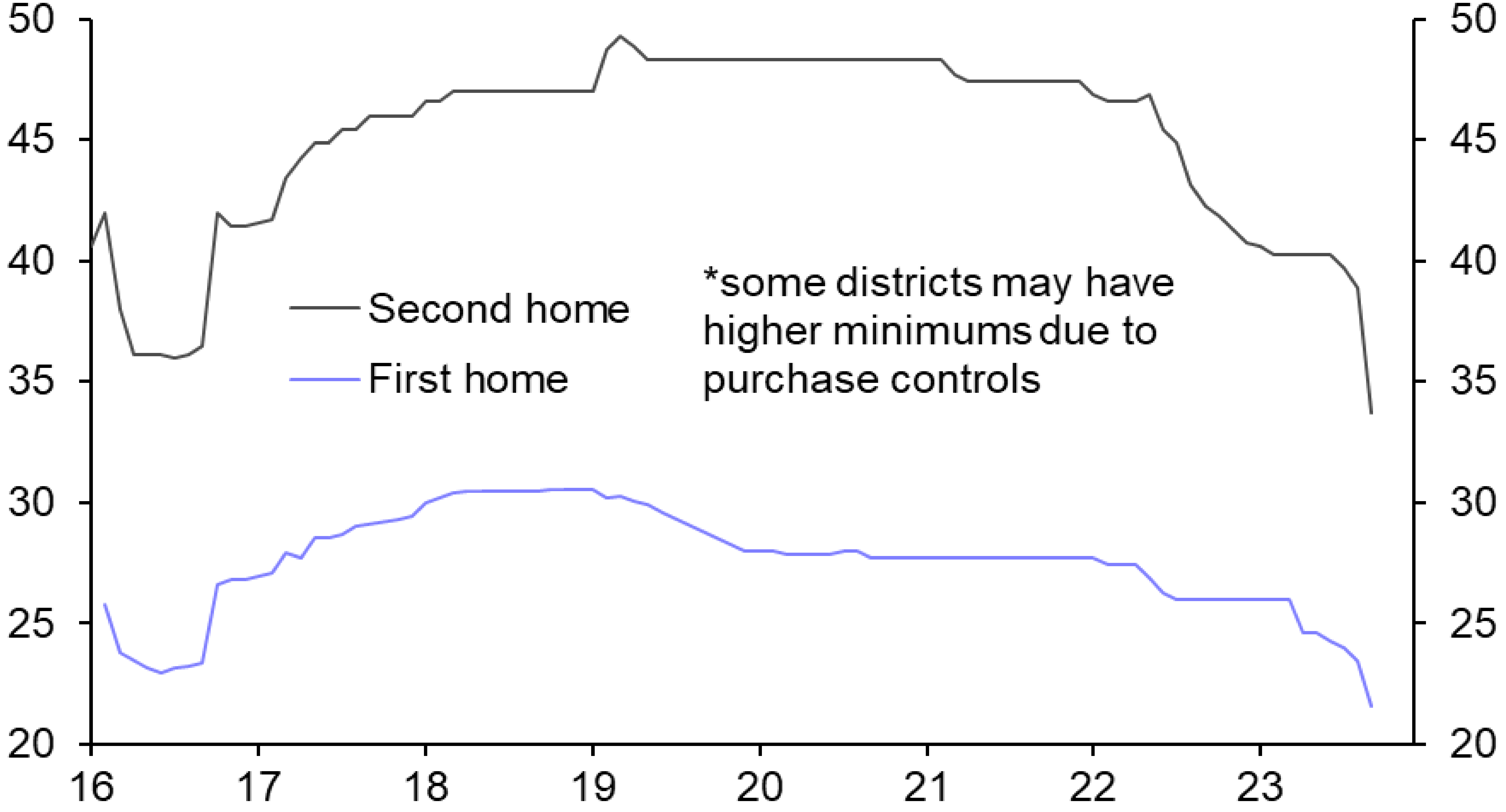
EM Policy Interest Rates (%)



Sources: Refinitiv, Capital Economics

And in China, policy stimulus has been stepped up in the form of rate cuts and greater support for the struggling property sector, paving the way for a modest cyclical recovery.

Minimum Downpayment Required in China (35 City average, %)



Sources: CEIC, WIND, Capital Economics

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