

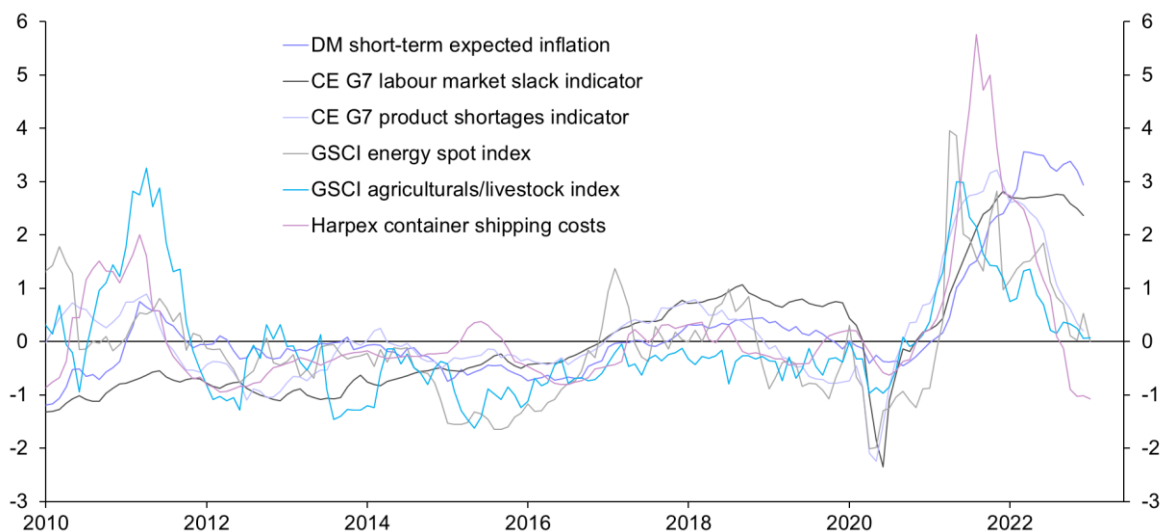


# GLOBAL ECONOMICS CHART BOOK

## Recent good news doesn't preclude DM recessions

- The past month has brought a string of positive developments on the activity and inflation side. The biggest news has been China's decision to throw in the towel on its zero-COVID policy, which brightened the prospects for the world's largest economy (in PPP terms) in 2023. We had thought that disruption from the re-opening wave of infections would weigh heavily on activity well into Q1. But high-frequency data suggest that a rebound there is already underway. What's more, in Europe, GDP looks less likely to have contracted in Q4 than it did a month ago in the likes of the UK and Germany and, at the margin, the slump in natural gas prices could lend a hand to activity in the quarters ahead. In the US, the payroll and JOLTS data suggested that its labour market remained resilient at the back end of 2022. Meanwhile, many of the latest CPI prints and numerous timely indicators (see Chart 1) point to inflation having embarked on a sustained downward trend. While we have revised up our 2023 global growth forecast, we still think that most of the effects of policy tightening are yet to be felt and that major DMs will fall into recession in the first half of this year.
- **Product shortages** have continued to ease, and China's reopening doesn't pose a big threat to supply chains.
- **Output & activity** probably contracted at the global level in Q4, with major DMs heading into recession.
- **Business surveys** were consistent with recessions taking hold in major DMs, most notably in the US.
- **Consumer spending** on goods in November continued to flatline or fall in DMs and fell sharply in China.
- **External trade** fell in most of the world in October, and timelier data point to further weakness ahead.
- **Labour markets** are showing some signs of weakening, even as unemployment rates stay stubbornly low.
- **Inflation** fell in most economies in November, and has now clearly embarked on a downward trend.
- **Financial markets** have experienced a relief rally in the past few weeks, partly driven by China's re-opening.

**Chart 1: Inflation Indicators (Z-Scores)**



Sources: Refinitiv, Bank of Japan, S&P Global, ONS, INSEE, Capital Economics

**Jennifer McKeown**, Chief Global Economist, +44 (0)207 811 3910, [jennifer.mckeown@capitaleconomics.com](mailto:jennifer.mckeown@capitaleconomics.com)  
**Simon MacAdam**, Senior Global Economist, +44 (0)207 808 4983, [simon.macadam@capitaleconomics.com](mailto:simon.macadam@capitaleconomics.com)  
**Ariane Curtis**, Global Economist, +44 (0)208 158 8107, [ariane.curtis@capitaleconomics.com](mailto:ariane.curtis@capitaleconomics.com)  
**Leah Fahy**, Assistant Economist, +44 (0)207 808 4694, [leah.fahy@capitaleconomics.com](mailto:leah.fahy@capitaleconomics.com)  
**Anna Padt**, Research Assistant, +44 (0)207 811 3901, [anna.padt@capitaleconomics.com](mailto:anna.padt@capitaleconomics.com)



# Product shortages

- The continued weakening of global demand has allowed product shortages to ease further. Our [G7 product shortages indicator](#) fell again in December, reaching its lowest level since October 2020 (2). Supply conditions continue to improve rapidly across G7 economies, most notably in the US where shortages continued to fall below their long-run average (3).
- Various indicators point to further alleviation of supply chain problems. For example, the order backlogs component of the global manufacturing PMI stayed below the 50 mark for the sixth consecutive month, suggesting that backlogs are falling. What’s more, delivery times have improved with the PMI component at its highest since January 2020 (4). And inventories have been recovering. Excluding autos, the euro-zone retail stocks-to-sales ratio has risen further above its long-run average (5). Admittedly, US retail inventories fell in October, but wholesale and manufacturing stocks rose that month, and timely data show they did so again in November, and surveys suggest there was a further build in finished goods inventories in December.
- Following the abrupt end to China’s zero-COVID policy, there are signs that the near-term disruption to global supply chains will be smaller than previously feared. China PMIs for December imply that the virus wave hit activity in the (largely domestic) services sector more than in manufacturing (6). And since then, China’s re-opening wave seems to have abated very quickly, limiting the scope for there to be a prolonged hit to the manufacturing labour supply. Even if there were greater disruption to production than now seems likely, finished product inventories are elevated relative to sales, allowing factories to fulfil orders (7).

Chart 2: CE G7 Product Shortages Indicator (Z-Score)

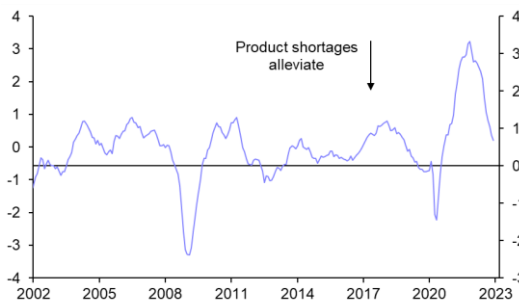


Chart 3: CE Product Shortages Indicators (Z-Scores)

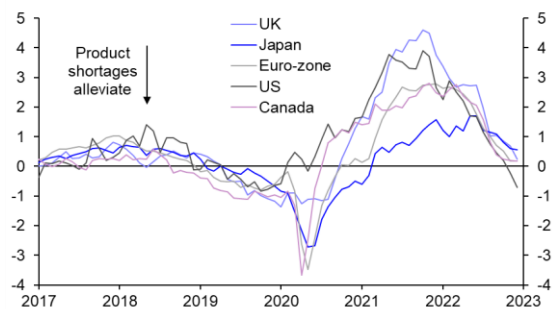


Chart 4: Global Manufacturing PMI: Suppliers' Delivery Times & Backlogs of Work

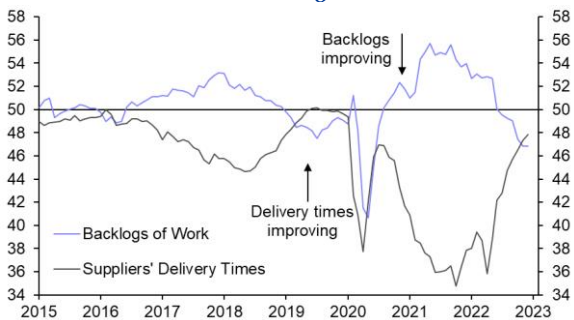


Chart 5: Euro-zone and US Retail Inventory-to-Sales Ratios (Z-Scores)

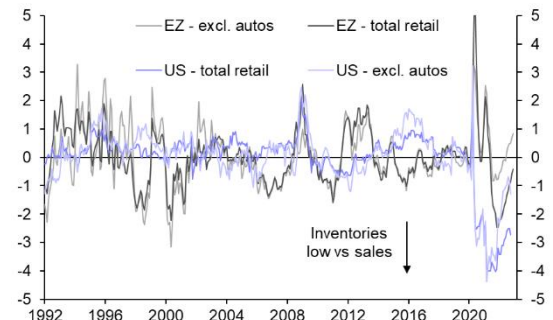


Chart 6: Caixin PMI: Manufacturing and Services Output

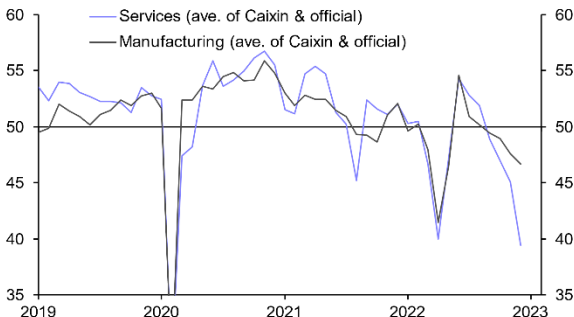


Chart 7: Finished goods inventories (days of sales, SA)



Sources: Refinitiv, S&P Global, Capital Economics



# Output and Activity

- World GDP probably fell in Q4, and while the aggregate will be boosted by the effects of reopening in China in the months ahead, the advanced economies are still heading into recession. After rising by 1.4% q/q in Q3, our estimates for the major economies point to an outright contraction in the fourth quarter. Before the onset of the pandemic, it was highly unusual for world GDP to fall outright **(8)**.
- In the advanced economies, data from Europe have surprised to the upside, implying that the euro-zone and UK economies might not have fallen into recession in Q4 as we forecast **(9)**. The US economy probably grew a bit in Q4, but we think that a recession will begin in Q1 as policy tightening takes effect. Our composite models show that the odds of the US being in recession in six months' time are above 90% **(10)**.
- Chinese activity appears to have slumped in Q4 **(11)**, first reflecting widespread lockdowns and later a surge in infections as the zero-COVID policy was dropped. Mobility data now suggest that activity is already rebounding rapidly **(12)**, which has caused us to bring forward the recovery in China and push up our forecast for growth in underlying activity there this year from 2.0% to 5.5%. This means that world GDP growth will be stronger than our previous forecast of 1.5% in 2023, but still below the 2.5% threshold at which the IMF has previously defined global recessions **(13)**.

Chart 8: Global GDP (% q/q)

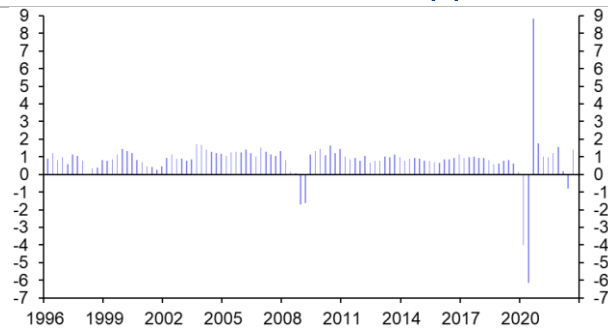


Chart 9: Euro-zone Monthly Activity Indicators & GDP

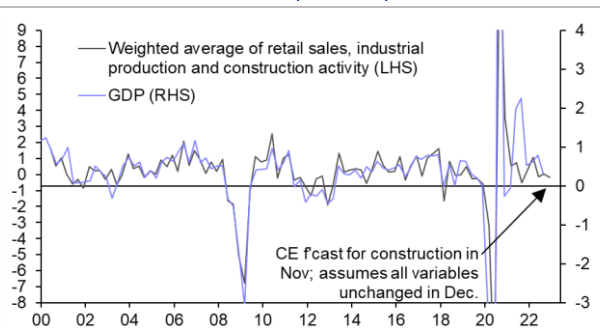


Chart 10: CE Composite Model US Recession Probability

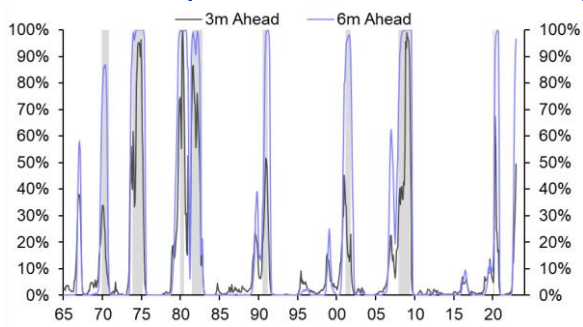


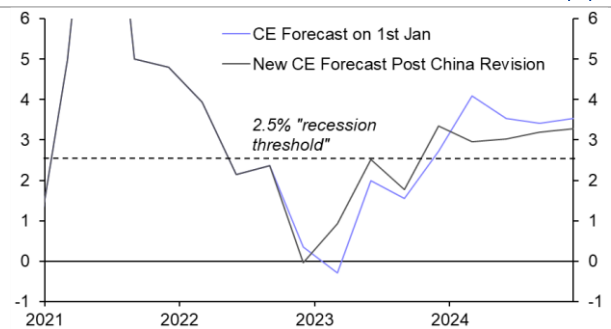
Chart 11: China Official GDP & CE Activity Proxy (% y/y)



Chart 12: Chinese Mobility (Dec. 2019 = 100)



Chart 13: World GDP Pre & Post China Revision (% y/y)

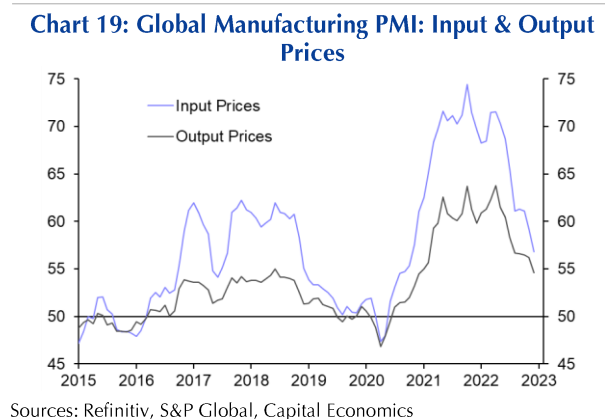
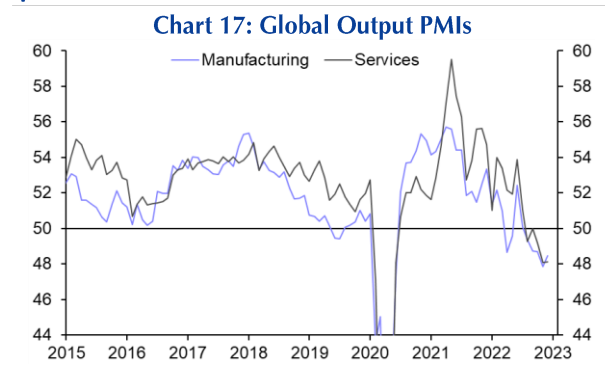
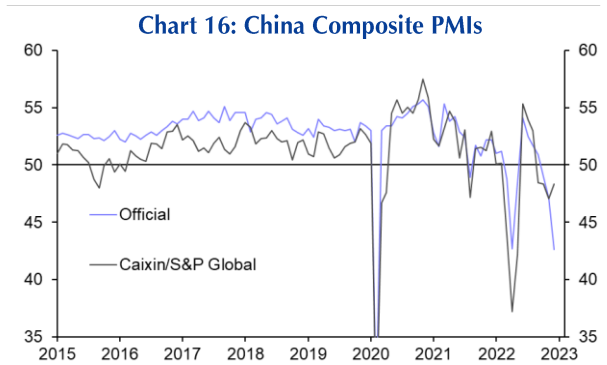
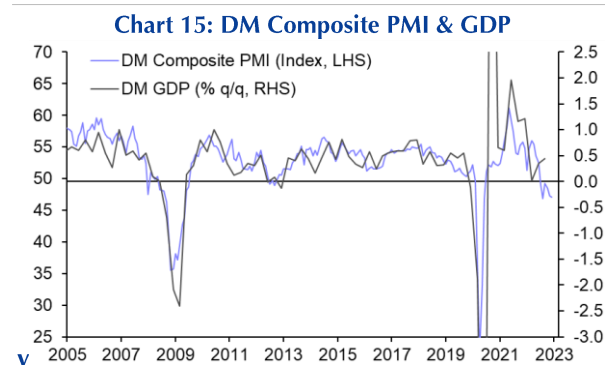
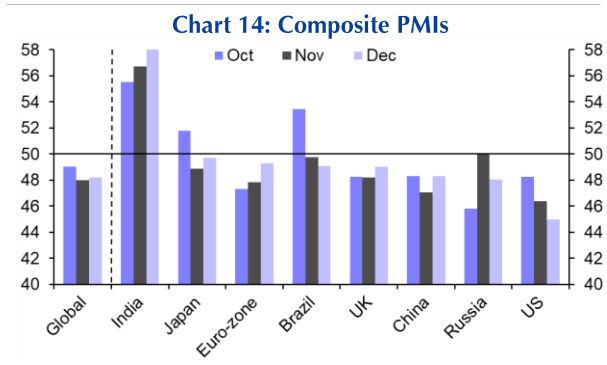


Sources: Refinitiv, CEIC, Capital Economics



# Business Surveys

- The latest business surveys suggest that the global economy was already contracting towards the end of last year, and that activity will probably stay weak at the start of 2023. The PMIs remained below the 50 no-change mark in nearly all major economies in December (14). In advanced economies, the average PMI was consistent with GDP falling outright in Q4 (15). And in China, although the slight rise in the Caixin PMI was at odds with the very sharp fall in the official PMI, both surveys still imply that activity contracted in the fourth quarter amid the latest COVID outbreak (16).
- Globally, the weakness in activity appears to have been broad-based across sectors. Both the manufacturing and services output PMIs remained below 50 in December (17). Meanwhile, the forward-looking components of the manufacturing PMI point to further falls in output at the start of the year. Although the future output index ticked up further, both the new orders and export orders indices fell to their weakest levels since the initial COVID outbreak (18).
- The good news is that the ongoing weakness in demand has allowed capacity constraints to ease further, which has contributed to a marked easing in goods price pressures. According to the PMIs, both input and output prices of manufactured goods rose at their slowest pace in around two years (19).



Sources: Refinitiv, S&P Global, Capital Economics



# Consumer Spending

- Retail sales remained soft across advanced economies in November, suggesting that high inflation and interest rates are continuing to take a toll on household spending. Retail sales fell across the US, UK and Japan and the 0.8% m/m rise in the euro-zone reversed only half its fall in October (20). Sales of interest-sensitive household goods have also generally fallen across DMs since the beginning of 2022 – the recent increase in the UK in November still leaves them well below their pre-pandemic level (21).
- More forward-looking indicators suggest that the outlook for consumption remains bleak. Despite upticks in recent months, consumer confidence levels in the US and UK are still lower than their pandemic troughs and remain far below their long-run average in Japan and the euro-zone (22). What’s more, in DMs real household disposable incomes remain below pre-pandemic levels (23) and household savings have fallen steadily since early 2021 (24), leaving little scope for a rebound in household spending in the near-term.
- The limited data we have so far from emerging markets suggest that retail sales fell on average in November. This is largely due to a sharp fall in China where the contraction in retail sales deepened from -0.5% y/y in October to -5.9% in November as a result of disruptions from COVID outbreaks (25). Following the sudden easing of virus restrictions in mid-December, we expect the reopening infection waves to have caused consumer spending to fall further in December, but a recovery could be underway as early as January.

Chart 20: DM Real Retail Sales (Dec. 2019 = 100)

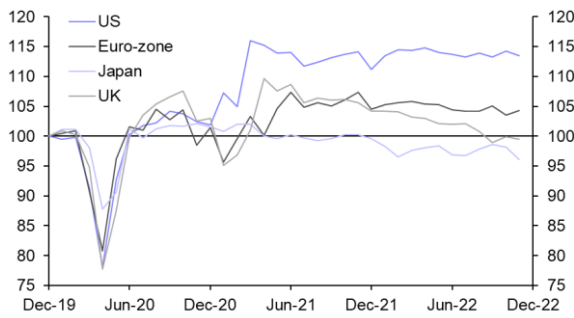


Chart 21: Household Goods Sales (Dec. 2019 = 100)

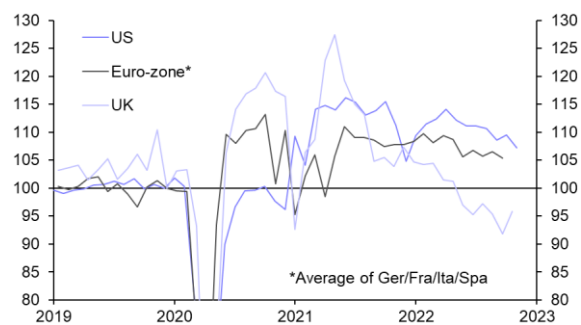


Chart 22: Consumer Confidence (Z-Scores)

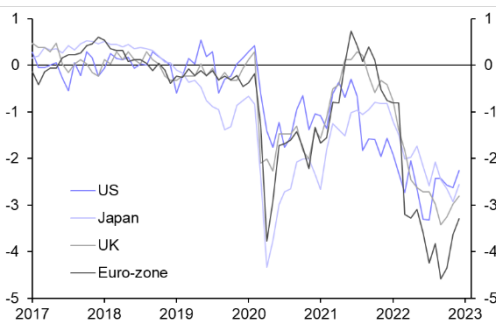


Chart 23: Real H'Hold Disp. Incomes (Q4 2019 = 100)

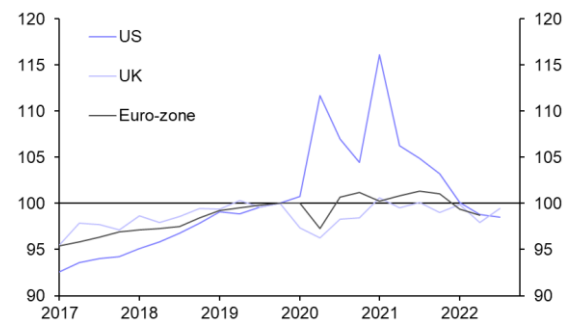


Chart 24: Household Saving Rate (%-point difference from 2015-19 average)

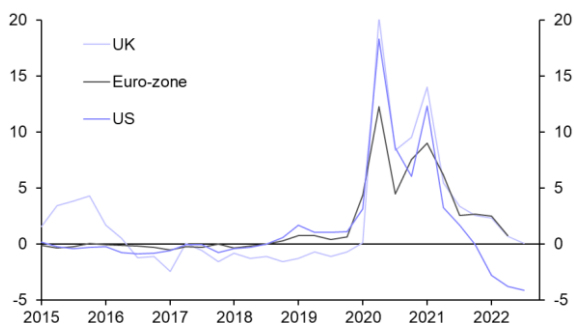
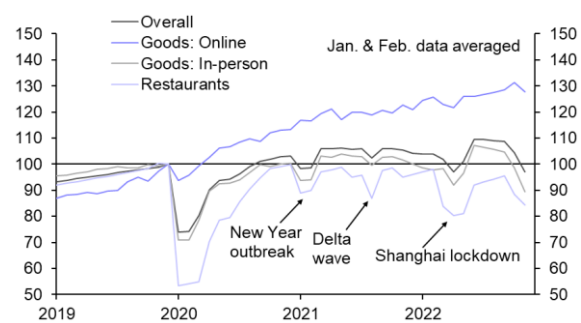


Chart 25: China Real Retail Sales (Dec. 2019 = 100)



Sources: Refinitiv, CEIC, WIND, Capital Economics





# External trade

- Real world goods trade fell by 1.6% m/m in October, down from +0.1% in September, reflecting weakening global demand (26). Real goods exports fell across most economies – while they dropped in both the Asian Tigers and China, the greatest fall was in other Asian countries, where exports fell by 7.3%. The only increases were in the Russia-dominated Commonwealth of Independent States and Japan – but the notable 4.4% spike in the former was not enough to fully reverse the greater 6% fall in its exports in September (27).
- Meanwhile, timelier data for November suggest that this downturn will continue. Real goods trade fell across all early-reporting Asian economies, plunging by an aggregate 3.5% (28). And Chinese exports fell by 6.2%, with shipments of electronics dropping sharply back down to levels seen in early 2020 in a sign that the pandemic-induced shift in global goods demand has largely reversed (29). What’s more, the new export orders index of the global manufacturing PMI fell further below the 50-no change mark (30).
- **Shipping costs** have also plummeted since early last year, with spot freight rates on China outbound routes down 85% from their January 2022 peak, indicating that weak demand is weighing on world trade (31). Alongside high interest rates, which will continue to bear down on credit-sensitive goods demand, this all suggests that world goods trade should fall further in the coming months.

Chart 26: Real World Goods Trade (Dec-19 = 100)

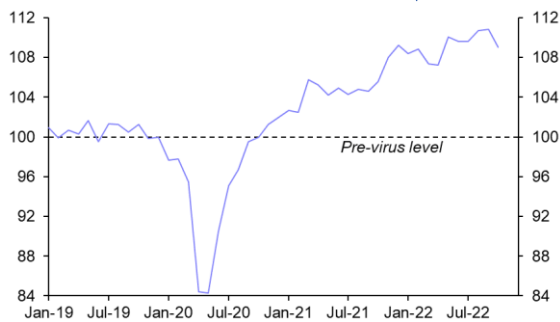


Chart 27: Real Good Exports by Region (Oct., % m/m)

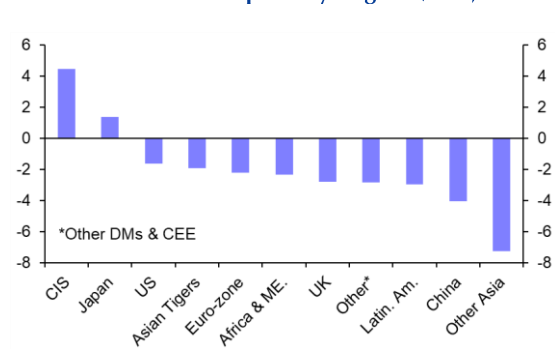


Chart 28: Real Goods Trade of Early Reporting Asian Economies (US\$ bn)

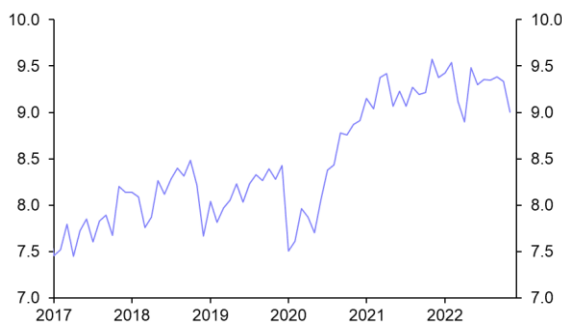


Chart 29: China Exports By Good (US\$, Dec-19=100, seasonally adjusted)

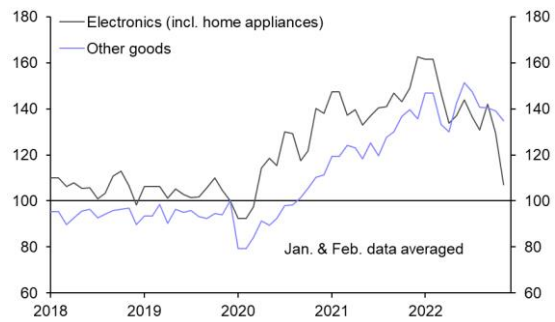


Chart 30: Global Mfg. PMI Export Orders & Real Trade

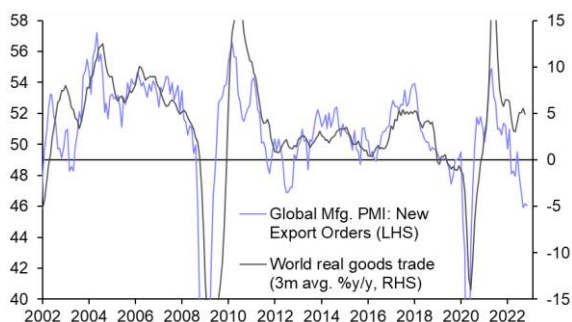
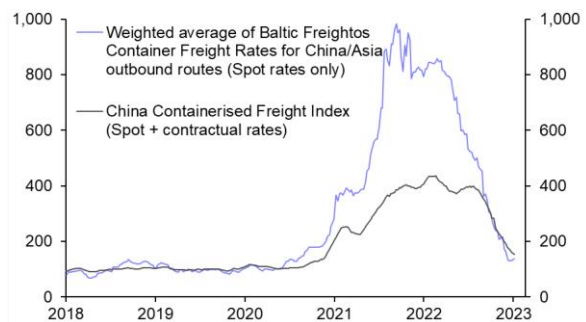


Chart 31: Container Freight Rates on China Outbound Routes (2018-19 Average = 100)



Sources: Refinitiv, CPB, WIND, S&P Global, Capital Economics



# Labour Markets

- Low unemployment rates and resilient employment growth imply that labour markets remain very tight across advanced economies, but other indicators point to labour markets losing some momentum. Unemployment rates fell in December in the US and Canada amid strong employment growth, and remained at a record low in November in the euro-zone (32). In the US, both the household and payrolls employment measures came in stronger than expected. And the very large 717,000 rise in the household measure meant that the discrepancy between the two has narrowed, but it remains unusually wide (33).
- In contrast, other indicators suggest that as economic activity has slowed, demand for labour has weakened, causing labour market conditions to come off the boil in some advanced economies. For one thing, the details of the US payroll report offered hints of weaker labour demand that was not obvious in the headline number. Meanwhile, although job vacancy rates are still historically high, they have fallen from their peaks in the US and UK (34). And average hours worked fell in December in both the US and Canada (35).
- These slightly looser labour markets already seem to have had some impact on wage pressures in these economies. Although average earnings growth remains well above levels consistent with central bank inflation targets in most DMs, it has started to come down in the US and Canada (36). And surveys of firms' pay plans point to wage pressures moderating somewhat, especially in the UK (37). On the other hand, euro-zone firms continue to report acute labour shortages, and we expect wage growth to rise a bit further.

Chart 32: Percentage-Point Difference in Unemployment Rate From December 2019 Level\*

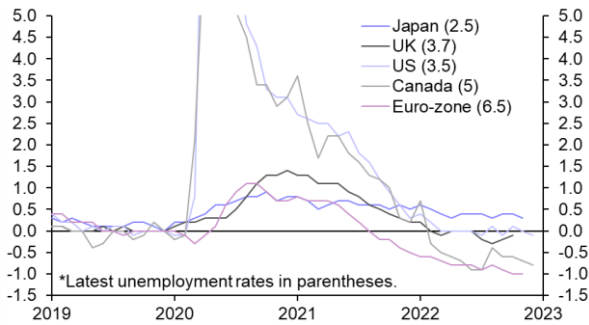


Chart 33: US Employment (Dec. 2019 = 100)

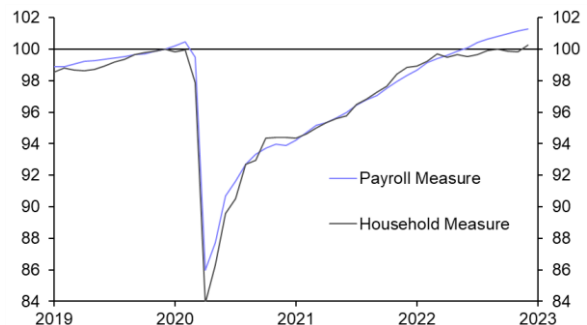


Chart 34: Job Vacancy Rates (Z-Scores)

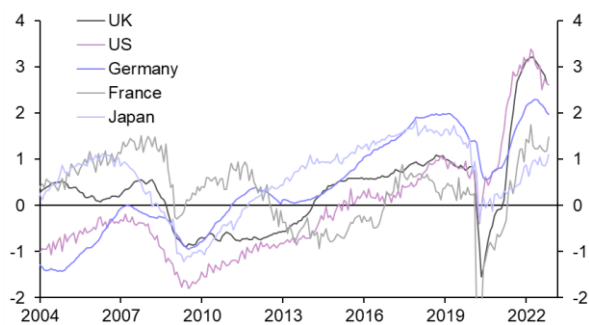


Chart 35: Average Hours Worked Per Week

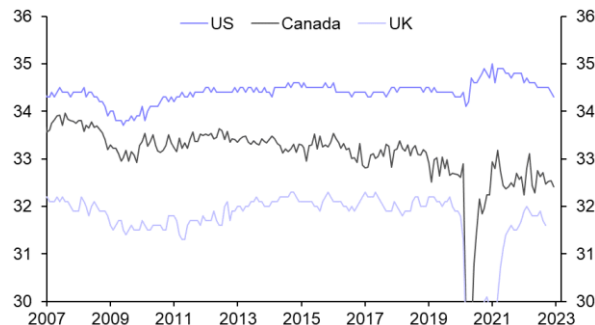


Chart 36: Headline Average Earnings (% y/y)

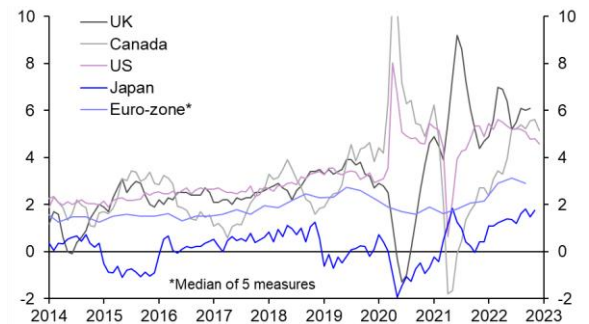
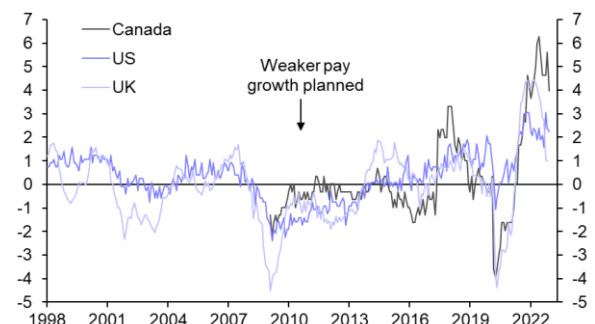


Chart 37: Employers' Pay Plans (Z-Scores)



Sources: Refinitiv, Capital Economics



# Inflation

- Inflation is now on a downward trend, and should fall sharply over the coming year. Our estimate of global headline CPI inflation fell for a second consecutive month in November from 7.7% to 7.3%, driven by declines in both advanced and emerging economies (38). Meanwhile, timely data for December showed that inflation fell further in both the euro-zone and the US (39).
- Lower energy inflation has been a major driver of the recent declines in headline inflation across economies (40). Energy inflation will continue to fall sharply over the coming months, driven by strong base effects and prices staying lower on average than last year. The recent fall in European gas prices should also weigh on inflation somewhat. Along with food, this should knock about 3%-pts off headline inflation in DMs by the end of the year (41). Goods price pressures have also eased, at least in the US and the UK, causing core inflation to fall there (42). On the other hand, core inflation in the euro-zone rose further in December.
- In China, inflation ticked up slightly in December but remained comfortably below the government’s 3% ceiling (43). And although the shift away from zero-COVID will put some upward pressure on inflation, the impacts from reopening will probably be smaller than was the case elsewhere. Indeed, in China, there is less scope for labour shortages to stoke wage growth and household savings to fund a consumption boom.

Chart 38: Headline CPI Inflation (%)

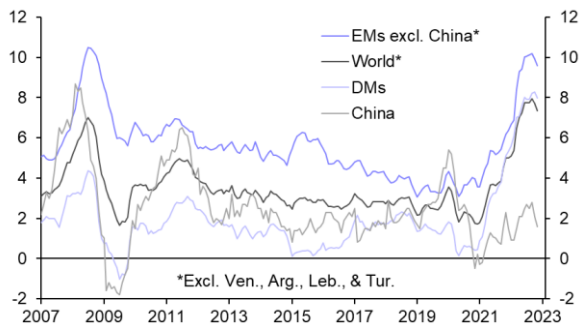


Chart 39: Headline CPI Inflation (%)

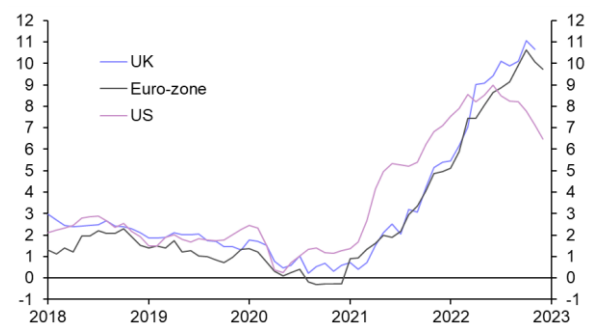


Chart 40: Energy CPI Inflation (%)

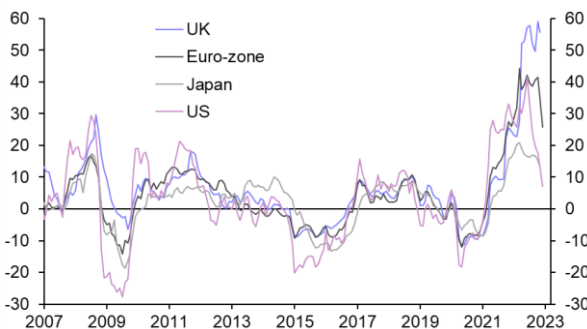


Chart 41: Cumulative %-Point Contributions of Food & Energy Inflation to DM Headline Rate From Jan. 2021

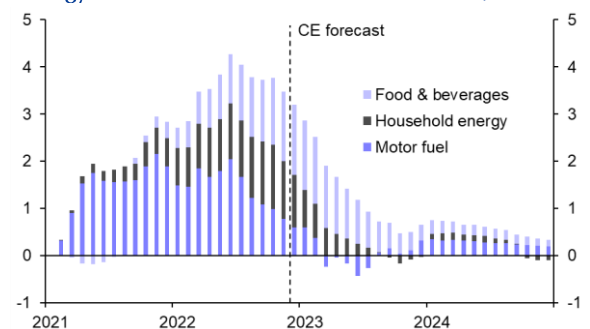


Chart 42: Core CPI Inflation (%)

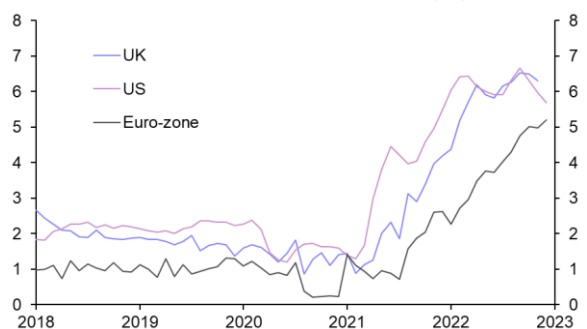
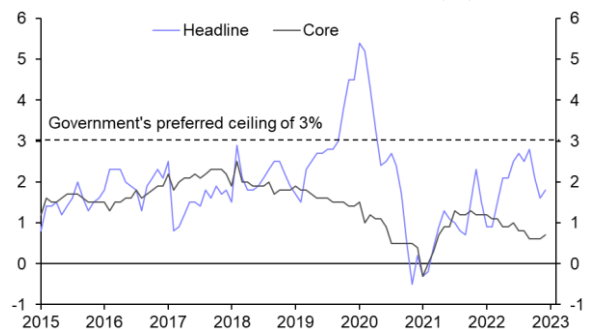


Chart 43: China CPI Inflation (%)



Sources: Refinitiv, Capital Economics





# Financial Markets

- Financial conditions have loosened significantly over the past month due to China’s reopening and renewed downgrades to investors’ US interest rate expectations. Chinese equities rallied after the announcement in early December of an abrupt end to zero-COVID policies, bringing them almost 50% above their October trough (44). Equities across DMs and EMs have also risen, driven largely by strength in cyclical sectors on the back of optimism over China (45), and corporate bonds have similarly rallied in recent weeks.
- This rally in risky assets has been supported by falling government bond yields, with DM yields having generally fallen since November in response to easing inflation (46). Despite continued hawkish rhetoric from the Fed, markets are still expecting rate cuts in late 2023, and have priced in an extra 25bp rate cut in 2024 compared to a month ago (47). Meanwhile, in Japan, the BoJ’s unexpected decision to widen the tolerance band for 10-year JGB yield has led to a surge in the yen on speculation that yield curve control’s days are numbered. Currencies in most other markets have also appreciated against the dollar (48).
- All of these factors in tandem have led to a marked easing of financial conditions in recent months. In fact, our DM financial conditions index has now fallen to its lowest level since February 2022, almost back to its long-run average (49).

Chart 44: China MSCI Equity Index (3<sup>rd</sup> Jan. 2020 = 100)

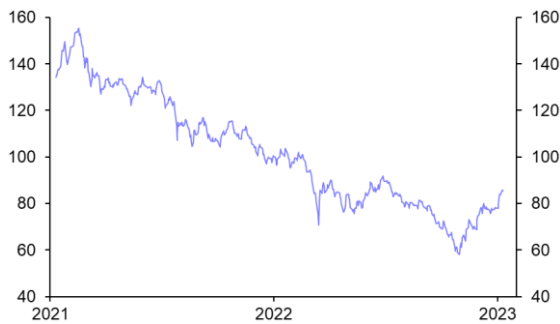


Chart 45: MSCI Equity Indices (% chg, 11<sup>th</sup> Dec. to 11<sup>th</sup> Jan., local-currency terms)

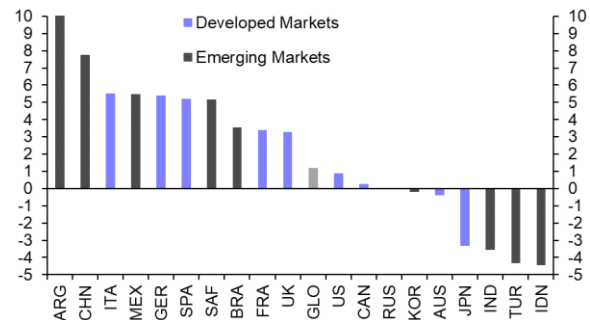
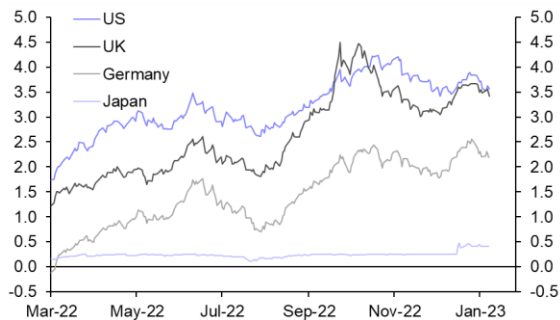


Chart 46: 10-Year Government Bond Yields (%)



Fed Funds Rate (%)

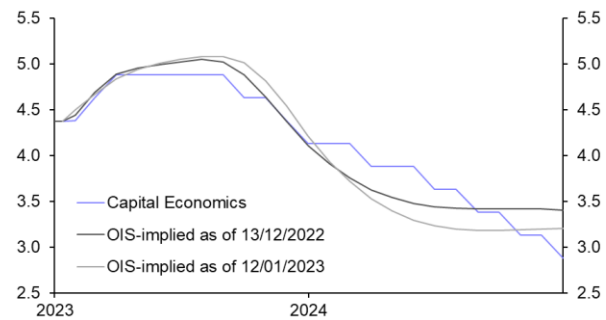


Chart 48: USD Exchange Rates (% change, 12<sup>th</sup> Dec. to 12<sup>th</sup> Jan.)

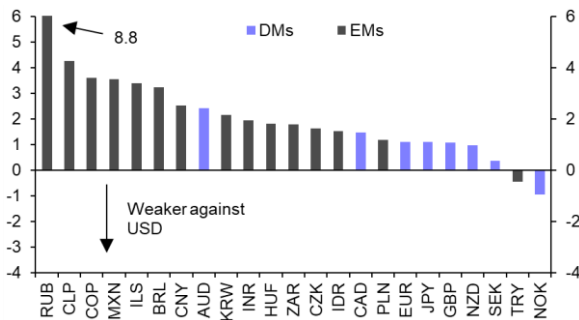
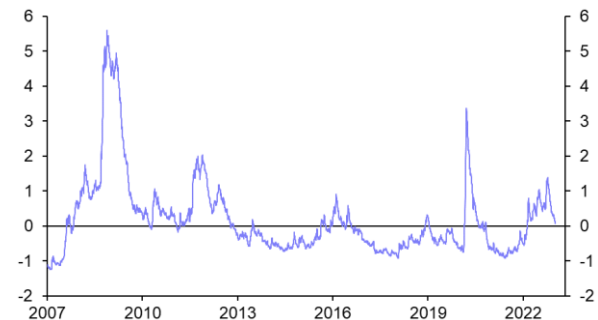


Chart 49: CE DM Financial Conditions Index (Z-Score)



Sources: Refinitiv, Capital Economics



**Disclaimer:** While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Capital Economics Limited and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or investments.

**Distribution:** Subscribers are free to make copies of our publications for their own use, and for the use of members of the subscribing team at their business location. No other form of copying or distribution of our publications is permitted without our explicit permission. This includes but is not limited to internal distribution to non-subscribing employees or teams.

