THE WORLD BANK
Development Economics | Prospects Group

Global Monthly

June 2023

Overview

- Global growth is set to slow substantially in the second half of 2023 amid tight monetary policy to rein in inflation pressures.
- Inflation, particularly core, has been persistent, but is projected to decline gradually as demand weakens and commodity prices moderate.
- Global financial tightening has weighed particularly heavily on countries with greater vulnerabilities.

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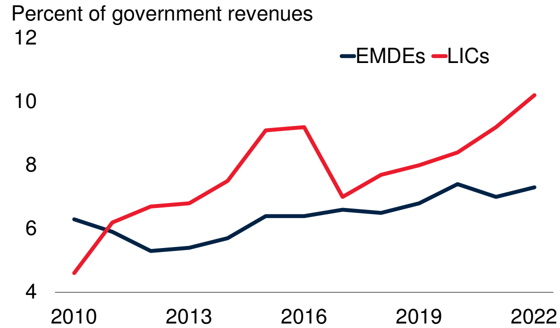
Chart of the Month

- Tighter financing conditions, slowing growth, and elevated debt levels create significant fiscal challenges for EMDEs.
- The rising cost of servicing debt is increasing the risk of debt distress among EMDEs, particularly LICs.
- Measures to improve fiscal space without unduly dampening economic activity need to be prioritized.

Government net interest payments



Sources: Kose et al. (2022); World Bank.
Note: EMDEs = emerging market and developing economies; LICs = low-income countries. Aggregates computed with government revenues in U.S. dollars as weights, based on 150 EMDEs, including 27 LICs.

Special Focus: Regional dimensions of potential growth

- Potential growth weakened in all EMDE regions (except South Asia) in the period of 2011-21, compared to 2000-10.
- Over 2022-30, potential growth is expected to be strongest in South Asia (6 percent) and weakest in Latin America and the Caribbean (2.2 percent).
- Potential growth is expected to decline overall in EMDEs, and in four of the six regions. Policies to boost human capital, trade and investment, and labor force growth could help avoid the overall slowdown.

The *Global Monthly* is a publication of the Prospects Group. This edition was prepared by Patrick Kirby and Nikita Perevalov under the supervision of Carlos Arteta, based on contributions from Prospects Group staff. The special focus was prepared by Philip Kenworthy. For more information, visit: www.worldbank.org/prospects. Back issues of this report are available since 2008.

Monthly Highlights

Global activity: set to slow. The resilience that global economic activity exhibited earlier this year is expected to fade. Global growth is projected to slow from 3.1 to 2.1 percent in 2023, with a particularly pronounced deceleration in advanced economies (figure 1.A). The slowdown in growth is explained by the effects of past monetary tightening, more restrictive credit conditions, and softer labor markets. The drag on growth from the ongoing monetary tightening to restore price stability is expected to peak in 2023 in many major economies.

Global inflation: persistently elevated. Inflation remains above target in almost all inflation-targeting economies. Median headline global inflation stood at 7.2 percent year-on-year in April, down from a peak of 9.4 percent in July 2022. This deceleration largely reflects favorable base effects from commodity prices falling below their 2022 peaks, along with abating supply chain pressures. Global inflation is expected to remain further above its 2015-19 average than was expected in January, and for a longer period (figure 1.B). With supply chain pressures easing and energy prices declining, excess demand appears to be a key driver of continuing high inflation in advanced economies, though lingering impairments to supply capacity may also still play a role.

Global trade: firming for services, weakening for goods. Global trade growth is slowing as demand gradually returns to its pre-pandemic composition, toward less trade-intensive services and away from tradable goods. Services trade continued to firm following the easing of pandemic-induced mobility restrictions, and international tourist arrivals are expected to approach 95 percent of 2019 levels in 2023. By contrast, global goods trade growth slowed in the first half of 2023 in tandem with weakening global industrial production, easing pressures on global supply chains. As a result, global trade growth is forecast to decelerate from 6 percent in 2022 to 1.7 percent in 2023 and 2.8 percent in 2024 (figure 1.C).

Commodity markets: subdued demand. Commodity prices have returned to the levels seen prior to the invasion of Ukraine, although they remain historically high (figure 2.A). Energy prices have eased considerably since their peak in the third quarter of 2022, as warmer-than-expected weather reduced natural gas and electricity consumption, especially in Europe. Metal prices increased in early 2023, reflecting signs of a stronger-than-anticipated recovery in China, but

FIGURE 1.A Contributions to global growth

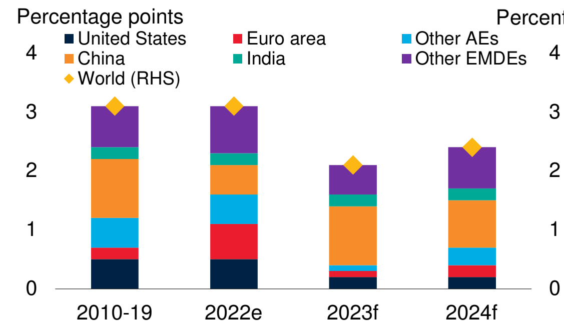


FIGURE 1.B Model-based global CPI inflation projections

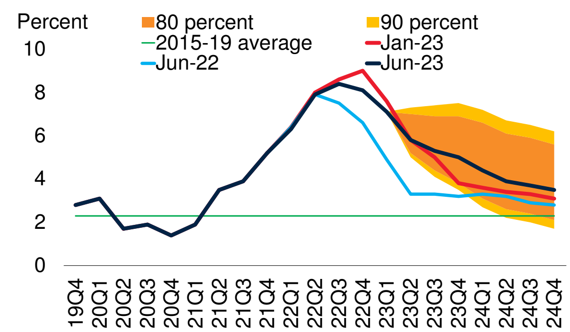
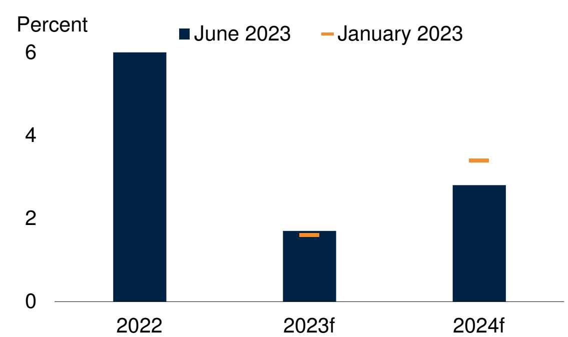


FIGURE 1.C Global trade forecast



Sources: Consensus Economics; Oxford Economics; World Bank.

A. AEs = advanced economies; EMDEs = emerging market and developing economies. Aggregate growth rates calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. Data for 2023-24 are forecasts.

B. Model-based GDP-weighted projections of year-on-year country-level CPI inflation using Oxford Economics' Global Economic Model. Uncertainty bands constructed from the distribution of forecast errors for total CPI from Consensus Economics for an unbalanced panel of 18 economies.

C. Trade is measured as the average of export and import volumes. "June 2023" and "January 2023" refer to the forecasts presented in the respective editions of the Global Economic Prospects report.

subsequently retraced those gains. Agricultural prices have eased in light of good production prospects for most crops. Prices of energy, metals, and agriculture are expected to decline in 2023 and 2024, largely reflecting subdued global demand amid mixed supply developments.

Global financial conditions: strains in vulnerable EMDEs. Global financial conditions have tightened as a result of policy rate hikes and, to a lesser extent, recent bouts of financial instability. Many banks experienced substantial unrealized losses due to the sharp rise in policy interest rates. Concerns about the balance sheets of some banks led to depositor flight and market volatility in the United States and Europe earlier in the year, which were stemmed by a swift and extensive policy response. Financial markets remain sensitive to evolving expectations about the future path of interest rates of major central banks. Spillovers from banking turmoil in advanced economies to EMDEs have so far been limited. However, countries with more pronounced macroeconomic policy vulnerabilities, as reflected by lower credit ratings, have experienced slower growth and greater financial stress, including large currency depreciations and a sharp widening of sovereign spreads (figure 2.B). Projections for 2023 growth in these economies have fallen by more than half over the past year (figure 2.C).

United States: slowdown expected. In the United States, growth is expected to average 1.1 percent in 2023, with the early resilience giving way to a considerable slowdown due to tighter monetary conditions. The weakness should persist into 2024, decelerating to 0.8 percent. Activity is expected to pick up toward the end of next year, as inflation eases and the effects of monetary policy tightening fade. Model-based estimates show that the peak impact on growth from this tightening is likely to be in 2023 (figure 3.A). In addition, recent bank failures have contributed to a slowdown in credit creation. Tighter credit will also weigh on near-term activity. Consumption has been resilient but is expected to weaken substantially. Higher borrowing costs and tighter financial conditions will weigh on household spending as the large stock of savings accumulated during the pandemic is depleted and unusually tight labor markets begin to rebalance.

Other advanced economies: persistent inflation. In the euro area, energy price pressures have been fading, but core inflation remains elevated, reflecting the strength of the labor market,

FIGURE 2.A Commodity price indexes

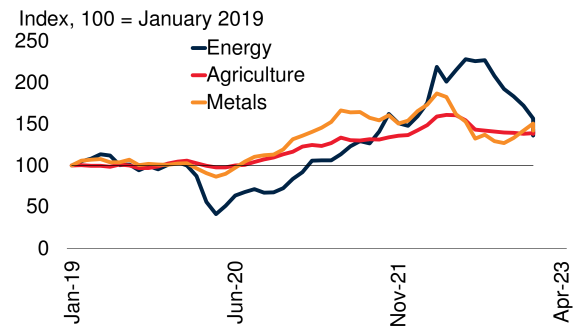


FIGURE 2.B Change in EMDE borrowing costs since February 2022, by credit rating

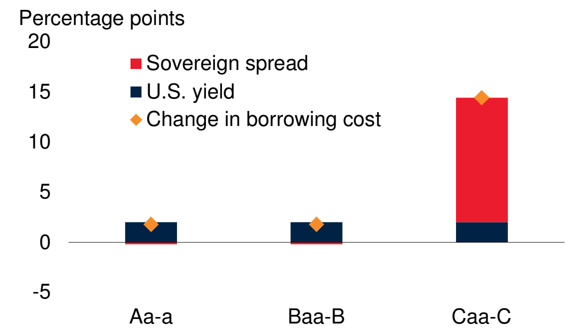
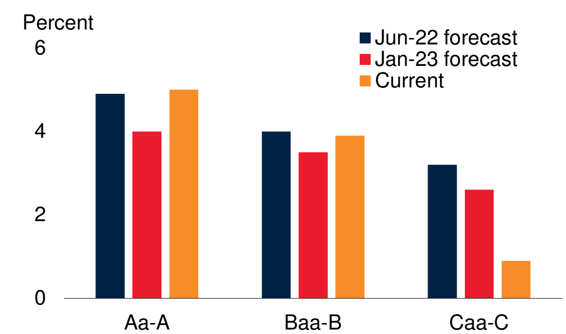


FIGURE 2.C 2023 EMDE growth, by credit rating



Sources: J.P. Morgan; Moody's Analytics; World Bank.
Note: EMDEs = emerging market and developing economies.
A. Monthly data, last observation is April 2023.
B. U.S. yield is the 5-year Treasury yield. Sovereign spread is the spread over U.S. yields for EMDE dollar-denominated sovereign debt. Changes are since February 2022 for 45 EMDEs.
C. Comparison of GDP-weighted growth across editions of the Global Economic Prospects report, by credit ratings. Sample includes 9 Aa-A, 62 Baa-B, and 25 Caa-C EMDEs.

robust wage growth, lagged effects from high gas and electricity prices, and broadening price pressures. Growth is forecast to slow to 0.4 percent in 2023, owing mainly to the lagged effects of monetary policy tightening. In Japan, growth is expected to slow to 0.8 percent in 2023, as the lagged effects of synchronized monetary policy tightening in major advanced economies weigh on external demand.

China: re-opening growth impulse beginning to fade. Economic activity in China bounced back in early 2023, spurred by the earlier-than-expected economic reopening, which bolstered consumer spending, including on services-related activity (figure 3.B). The property sector began to emerge from a protracted slump, supported by wide-ranging policies. Meanwhile, goods trade remained subdued. Growth is projected to rebound to 5.6 percent in 2023, as the economic reopening drives consumer spending, particularly on domestic services. With the reopening boost fading in the second half of the year, growth will slow to 4.6 percent in 2024, amid moderating consumption. More recent indicators showed a faster-than-expected cooling in activity and prompted the People's Bank of China (PBOC) to cut lending rates in support of growth.

Other EMDEs: slowing growth this year. Excluding China, EMDE growth is set to decline to 2.9 percent this year, from 4.1 percent last year. The resilience in activity in early 2023 is expected to weaken through this year due to the drag from slowing external demand, high inflation, and the associated monetary tightening—both domestically and via monetary policy spillovers from advanced economies. China's recovery, being services oriented, rather than trade-intensive, is likely to provide only a modest boost to other EMDEs. Over the first half of the 2020s (2020-24), growth in EMDEs is expected to be unusually weak, averaging just 3.4 percent. This can be largely attributed to the overlapping adverse shocks of recent years—the COVID-19 pandemic, the repercussions from Russia's invasion of Ukraine, and the ongoing global monetary policy tightening cycle. However, a longer-term perspective suggests that a fundamental structural slowdown is also at work, which is likely to persist throughout the remainder of the decade (figure 3.C). This involves a reduction in the prospects for potential output, resulting from a slowing in all the major underlying drivers of growth: labor force growth (associated with aging populations); capital accumulation; and improvement in total factor productivity.

FIGURE 3.A Estimated impact of latest Federal Reserve tightening cycle on annual U.S. growth

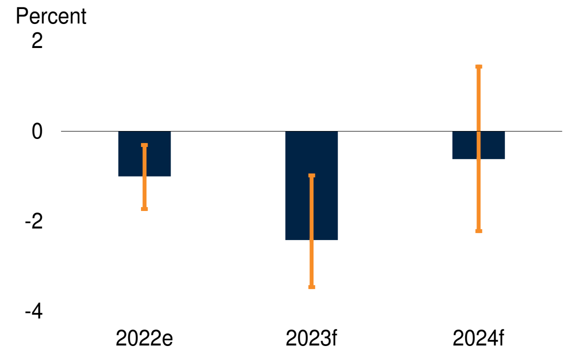


FIGURE 3.B PMIs in China

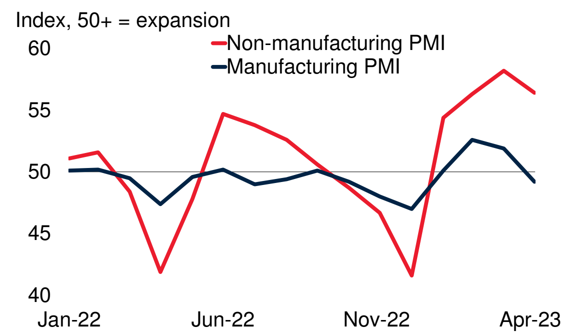
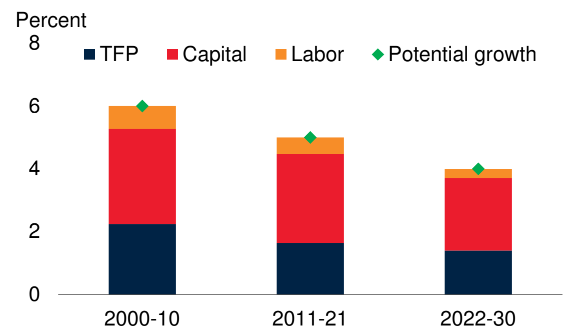


FIGURE 3.C Potential growth in EMDEs



Sources: Anderson et al. (2013); Blagrave et al. (2020); Brayton, Laubach, and Reifschneider (2014); Haver Analytics; Oxford Economics; World Bank.

Note: EMDEs = emerging market and developing economies.

A. Estimated impact on U.S. GDP growth of the rise in the U.S. policy rate from 0.25 to 5.25 percent, between 2022Q1 and 2023Q4, according to several major published global projection models. Bars indicate simple averages; orange whiskers indicate minimum-maximum values.

B. Figure shows official manufacturing and non-manufacturing Purchasing Managers' Index (PMI). PMI readings above (below) 50 indicate expansion (contraction) in economic activity. Last observation is April 2023.

C. Based on the production function approach as described in Kose and Ohnsorge (2023a). Sample includes 53 EMDEs.

Special Focus: Regional dimensions of potential growth

EMDE potential growth is slowing. Potential growth is the rate of increase in potential output, defined as the level of output an economy would sustain at full capacity utilization and full employment, and is critical to macroeconomic and development outcomes. Recent estimates indicate that across EMDEs, potential growth averaged 5 percent per year in 2011-21, a 1-percentage-point reduction from the 2000-10 average (figure 4.A). The slowdown in EMDE potential growth raises concerns about the prospects for per capita income growth, poverty reduction, and convergence of per capita incomes with advanced economies. It could also erode the ability of many economies to meet rising debt service costs.

Potential growth slowed in almost every EMDE region. The Middle East and North Africa (MNA) experienced the steepest decline in potential growth between 2000-10 and 2011-21, by 2.4 percentage points a year (figure 4.B). Capital accumulation plunged due to the sharp drop in oil prices from 2014 to 2016, policy uncertainty increased in parts of the region, and capital was destroyed by conflicts in some countries. In East Asia and the Pacific (EAP), potential growth fell almost 1.4 percentage points a year in 2011-21 compared to 2000-10 (figure 4.C). However, at around 6.2 percent a year, it remained higher than in most other regions. The slowdown in EAP was largely due to developments in China—the rebalancing away from investment, together with slower total factor productivity (TFP) and working-age population growth.

Some regions experienced more moderate declines. In Europe and Central Asia (ECA), Latin America and the Caribbean (LAC), and Sub-Saharan Africa (SSA), potential growth declined more modestly in 2011-21, but from lower rates in 2000-10 than EAP or MNA (figure 5.A). The deceleration in ECA averaged 0.6 percentage point, reflecting diminishing productivity catch-up with Western Europe and population aging. Potential growth in LAC declined by 0.5 percentage point a year amid slowing labor force growth and a continued decline in TFP growth. In SSA, potential growth edged down by 0.2 percentage point a year, as a sharp slowdown in TFP growth offset buoyant labor force growth and a rising contribution from capital accumulation.

Potential in South Asia (SAR) will remain robust. In contrast to other regions, potential growth in SAR was virtually unchanged in 2011-21 and, together with EAP, the strongest

FIGURE 4.A Potential GDP growth

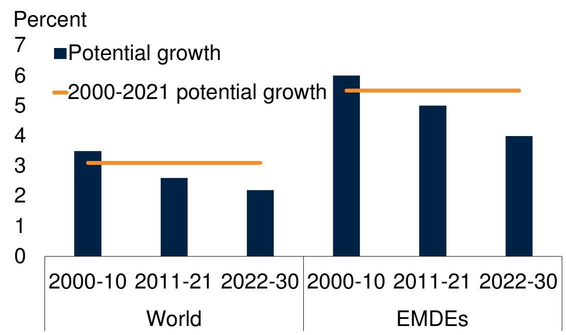


FIGURE 4.B Contributions to regional potential growth

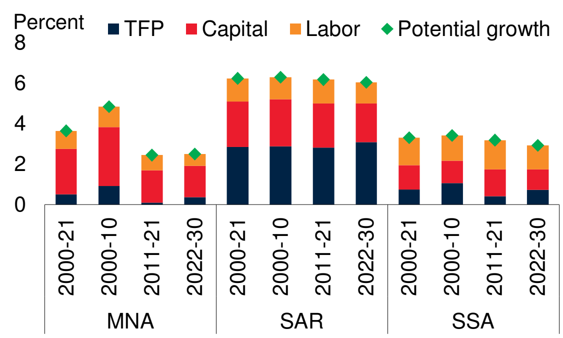
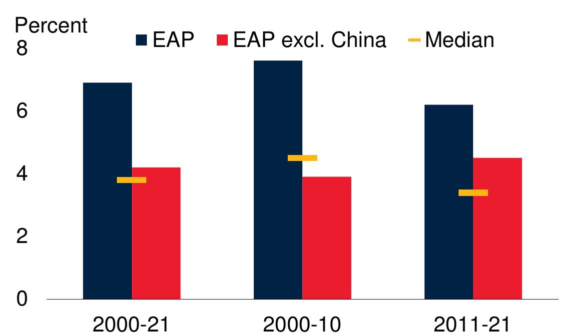


FIGURE 4.C Potential GDP growth in EAP



Source: Haver Analytics; Penn World Table; UN Population Prospects; World Bank.
Note: GDP weights are calculated using average real U.S. dollar GDP (at average 2010-19 prices and market exchange rates). Period average of annual GDP-weighted averages.
A. EMDEs = emerging market and developing economies. Data for 2022-30 are forecasts. World sample includes up to 53 EMDEs and 30 advanced economies.
B. MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa. Estimates based on the production function approach. Sample includes 5 countries in MNA, 3 in SAR, and 14 in SSA. Data for 2022 -30 are forecasts.
C. EAP = East Asia and Pacific. Markers show median of GDP-weighted averages of the six EMDE regions. Estimates based on production function approach. Sample includes 6 countries.

among EMDE regions. Demographics remained supportive, while investment weakness and lower TFP growth in India were offset by growth of investment and TFP elsewhere.

Absent reforms, potential growth in EMDEs is projected to decline further in the remainder of the 2020s. The pandemic is expected to have lingering effects on growth across EMDEs, in many cases exacerbated by the fallout from the Russian Federation's invasion of Ukraine. The adverse effects of these shocks on human capital, fixed capital formation, and supply chains will weigh on long-term prospects.

Of the six EMDE regions, EAP is expected to experience the sharpest decline in potential growth during 2022-30. The 1.6 percentage points decline is primarily due to a reduced contribution from capital accumulation and slower TFP growth, especially in China. After a decade of resilience, potential growth elsewhere in the region is also expected to moderate as labor force growth eases. In ECA and SSA, potential growth is projected to slow as a result of investment weakness and diminishing demographic dividends, partially offset by a moderate pick-up of TFP growth. The consequences of Russia's invasion of Ukraine are likely to dampen investment in ECA for several years.

In SAR, LAC, and MNA, potential growth is projected to be broadly unchanged in 2022-30. Demographic tailwinds that benefitted SAR over the past decade are expected to fade, but be offset by stronger TFP growth. Labor force growth is expected to continue declining in LAC, but this too should be counteracted by TFP growth, assuming political and social stability. In MNA, slowing working-age population growth is expected to outweigh improved TFP growth, which itself is contingent on previous adverse shocks (such as wars and commodity price plunges) not recurring.

Further weakening of potential growth in EMDEs can be avoided. Weak TFP growth in LAC, MNA, and SSA makes policy action targeting productivity especially important for these regions. Trade integration, improved access to education, investments in infrastructure, and measures to promote agricultural productivity and economic diversification could all help. In MNA and SAR, there is significant room to strengthen potential growth by increasing female labor force participation (figures 5.B and 5.C). Prospects for investment growth in LAC and SSA are particularly weak. Efforts to improve the stability of policy frameworks could generate important growth dividends, as could improvements to business climates and security.

FIGURE 5.A Contributions to regional potential growth

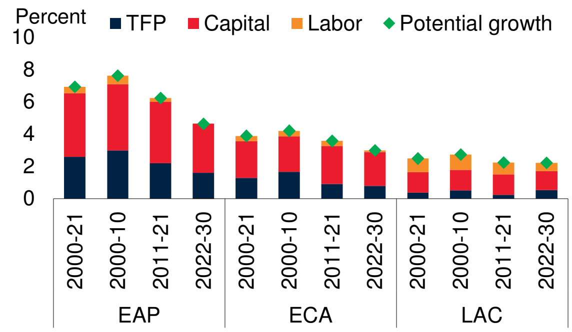


FIGURE 5.B Female labor force scenarios for MNA

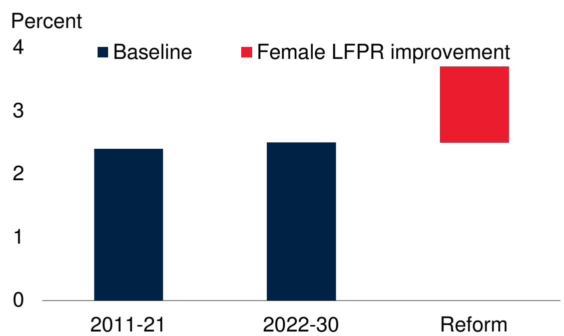
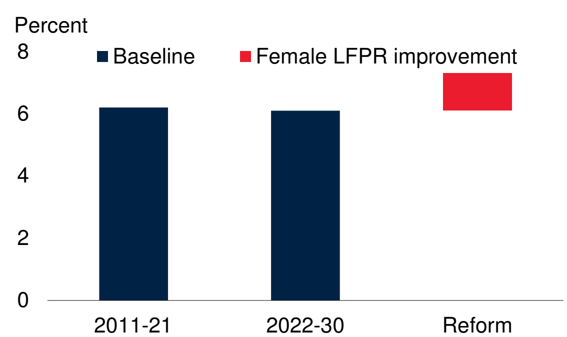


FIGURE 5.C Female labor force participation scenarios for SAR



Sources: Haver Analytics; Penn World Table; UN Population Prospects; World Bank.

Note: GDP weights are calculated using average real U.S. dollar GDP (at average 2010-19 prices and market exchange rates) for the period 2011-21. Data for 2022-30 are forecasts. Period averages of annual GDP-weighted averages. Potential growth estimates based on production function approach.

A. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean. Sample includes 6 countries in EAP, 9 in ECA, and 16 in LAC.

B. C. LFPR = labor force participation rate. Figure indicates the average annual potential growth rate for each region if female labor force participation rose to the EMDE average level over 2022-2030. Methodology as described in Kose, M. A., and F. Ohnsorge, eds. 2023. *Falling Long-Term Growth Prospects: Trends, Expectations, and Policies*. Washington, DC: World Bank.

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TABLE: Major Data Releases

(Percent change y-o-y)

Recent releases: May 28, 2023 - June 27, 2023					
Country	Date	Indicator	Period	Actual	Previous
India	5/31/23	GDP	Q1	6.1%	4.5%
Türkiye	5/31/23	GDP	Q1	4.0%	3.5%
Brazil	6/1/23	GDP	Q1	4.0%	1.9%
Switzerland	6/5/23	CPI	MAY	2.2%	2.6%
Türkiye	6/5/23	CPI	MAY	39.6%	43.7%
South Africa	6/6/23	GDP	Q1	0.2%	0.8%
Australia	6/6/23	GDP	Q1	2.3%	2.7%
Japan	6/7/23	GDP	Q1	1.3%	0.4%
Brazil	6/7/23	CPI	MAY	3.9%	4.2%
Mexico	6/8/23	CPI	MAY	5.8%	6.3%
China	6/8/23	CPI	MAY	0.2%	0.1%
United States	6/13/23	CPI	MAY	4.0%	4.9%
Germany	6/13/23	CPI	MAY	6.1%	7.2%
China	6/14/23	IP	MAY	3.5%	5.6%
United States	6/15/23	IP	MAY	0.2%	0.2%
France	6/15/23	CPI	MAY	5.1%	5.9%
Euro area	6/16/23	CPI	MAY	6.1%	7.0%
Italy	6/16/23	CPI	MAY	7.6%	8.2%
United Kingdom	6/21/23	CPI	MAY	8.7%	8.7%
South Africa	6/21/23	CPI	MAY	6.3%	6.8%
Japan	6/22/23	CPI	MAY	3.2%	3.5%

(Percent change y-o-y)

Upcoming releases: June 28, 2023 - July 28, 2023				
Country	Date	Indicator	Period	Previous
United States	6/29/23	GDP	Q2	0.9%
South Korea	6/29/23	IP	MAY	-8.9%
United Kingdom	6/30/23	GDP	Q1	0.6%
Portugal	6/30/23	IP	MAY	-7.0%
Indonesia	7/2/23	GDP	JUN	4.0%
Switzerland	7/3/23	CPI	JUN	2.2%
Türkiye	7/3/23	CPI	JUN	39.6%
South Korea	7/3/23	CPI	JUN	3.3%
Philippines	7/4/23	CPI	JUN	6.1%
Brazil	7/4/23	IP	MAY	-2.7%
France	7/5/23	IP	MAY	1.3%
Spain	7/5/23	IP	MAY	4.5%
Brazil	7/6/23	CPI	JUN	3.9%
Norway	7/7/23	IP	MAY	-4.7%
Germany	7/7/23	IP	MAY	1.6%
China	7/17/23	GDP	Q1	4.5%
New Zealand	7/18/23	CPI	Q2	6.7%
United States	7/18/23	IP	JUN	0.2%
South Korea	7/24/23	GDP	Q2	0.9%
Australia	7/26/23	CPI	Q2	7.0%
Austria	7/28/23	GDP	Q2	1.9%