THE WORLD BANK
Development Economics | Prospects Group

Global Monthly

March 2023

Overview

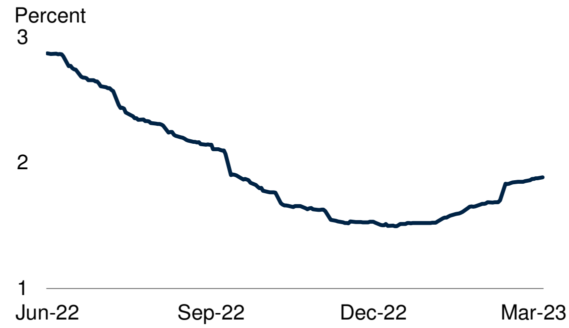
- The short-term outlook for the global economy is stabilizing, supported by services sector activity.
- Inflation remains high, with core inflation showing few signs of turning decisively lower.
- Financial conditions tightened materially on the developments in U.S. and European banking.

Table of Contents

Chart of the Month

- Consensus forecasts for global growth this year have edged up in recent months.
- Projections for 2023 growth have been upgraded for a number of economies, particularly for China and the United States.
- The upgrade for China reflects the faster-than-expected economic reopening, while stronger sentiment and labor market resilience are under-pinning improved prospects in the United States.

Global GDP growth forecast for 2023



Sources: Consensus economics; World Bank.
Note: Figure shows average GDP growth forecast for 2023, based on 59 economies for which data of consensus forecasts are available, weighted by GDP in constant 2010-19 U.S. dollars. Growth is computed each business day on a replacement basis. Last observation is March 6, 2023.

Special Focus: Spillovers of rising U.S. interest rates to EMDEs

- In 2022, the U.S. Federal Reserve embarked on its steepest and fastest hiking cycle in four decades.
- U.S. interest rate increases in 2022 are primarily driven by a perceived shift in the Federal Reserve's reaction function—"reaction" shock—as it pivots toward more aggressive action to rein in inflation.
- These reaction shocks are particularly injurious to emerging and developing economies, as they lead to adverse financial and economic impacts.

The *Global Monthly* is a publication of the Prospects Group. This edition was prepared by Samuel Hill, and Nikita Perevalov under the supervision of Carlos Arteta, based on contributions from Prospects Group staff. The special focus was prepared by Franz Ulrich Ruch. This *Global Monthly* reflects data available up to March 21, 2023. For more information, visit: www.worldbank.org/prospects. Back issues of this report are available since 2008.

Monthly Highlights

Global activity: stabilizing. Following widespread deceleration during 2022, global activity had stabilized and was showing signs of improvement in early 2023 before the emergence of global financial stress. The global composite PMI crossed the threshold of 50 to reach 52 in February 2023, pushed higher by the services component (52.6 in February, figure 1.A). Global manufacturing continued to lag, with the manufacturing PMI, at 50, signaling flat activity in February—an improvement after five straight months in contraction territory. Going forward, the service-centered reopening in China is likely to support the global services sector, with weaker positive spillovers for manufacturing.

Global trade: continued weakness amid lower supply chain pressures. Global goods trade contracted by 2 percent (q/q) in Q4 2022, as weak demand in advanced economies weighed on exports of emerging market and developing economies (EMDEs). Recent data indicate continued weakness in global trade, particularly for goods. PMI readings in February 2023 showed that new export orders for manufacturing remained in contraction territory at 48.3, while for services it improved to a neutral level of almost 50. Along with weak goods demand and the normalization of shipping conditions, global supply chain pressures and suppliers' delivery times returned to pre-pandemic levels in February 2023 (figure 1.B).

Commodity markets: moderating prices. Commodity prices eased in February, led by energy prices, which declined 7 percent (m/m) as warmer-than-usual weather reduced overall demand for energy for heating (figure 1.C). In particular, European natural gas and coal prices have declined by 76 percent and 52 percent, respectively from their record-high levels in August/September 2022. The price of Brent crude oil dropped to US$75/bbl in mid-March, amid concerns about slower global growth and financial market disruptions in the United States. Metal prices declined by around 2 percent in February (m/m), reflecting concerns of weaker demand associated with China's reopening.

Financial conditions: stress in the banking sector. Global financial conditions tightened materially in the month to mid-March. Early in the month, markets priced a "higher-for-longer" path for advanced-economy policy rates, with U.S. and German 2-year yields reaching their highest levels since 2007 and 2008, respectively. Shortly after, liquidity concerns at

FIGURE 1.A Global PMI

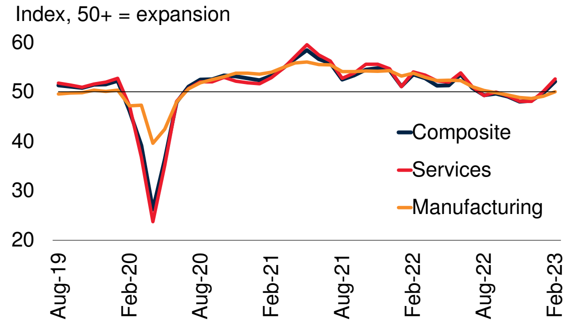


FIGURE 1.B New export orders and suppliers' delivery times

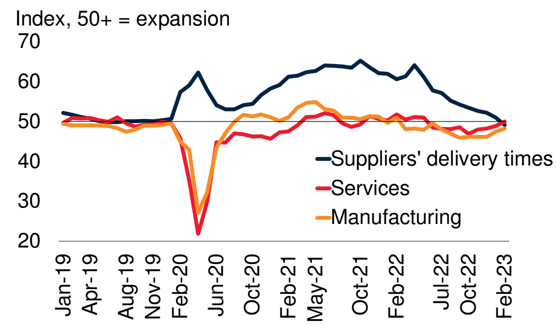
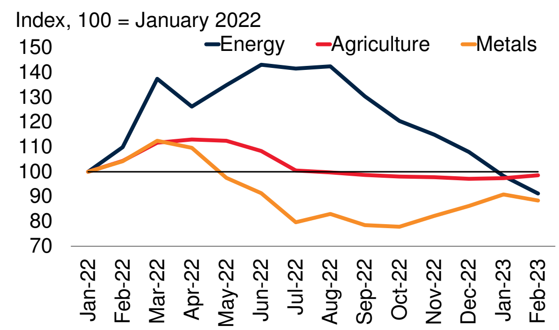


FIGURE 1.C Commodity prices



Sources: Haver Analytics; World Bank.
Note: PMI = Purchasing Managers' Index.
A. PMI readings above (below) 50 indicate expansion (contraction). Last observation is February 2023.
B. Figure shows manufacturing PMI subcomponents. PMI data for delivery times are inverted by subtracting data from 100; therefore, increasing (decreasing) PMI data indicate faster (slower) delivery times. Last observation is February 2023.
C. Monthly data, last observation is February 2023.

several U.S. mid-size banks escalated into full bank runs, leading to two failures. Spillovers to confidence in the broader sector prompted the Federal Reserve to institute a new liquidity facility and the FDIC to guarantee all deposits in the failed banks. Markets revised interest rate expectations back down, with the U.S. 2-year yield briefly falling below 4 percent, from 5.1 percent a week earlier (figure 2.A). Banking systems across advanced economies came under pressure in subsequent days. Credit Suisse, a large and systemically important European bank, which has struggled with risk management failures and large losses over recent years, became subject to an emergency takeover by UBS, after emergency liquidity support from the Swiss central bank did not avert withdrawals. Early in March, EMDE risk assets proved generally resilient to higher U.S. interest rate expectations and a somewhat stronger dollar. In mid-March, however, risk aversion picked up. Credit default swap premia rose notably across EMDEs with weaker credit profiles, while those of investment grade EMDEs remained comparatively unaffected (figure 2.B).

United States: resilient consumption. U.S. consumption momentum revived in early 2023, underpinned by the continued strength in the labor market and unseasonably warm weather. In January, real personal consumption increased sharply, by 1.1 percent (m/m), driven by both goods and services spending (figure 2.C). Data for February showed expanding services activity with the ISM services index at 55.1, with its new orders subindex rising to a 15-month high of 62.6. The new orders component of the ISM manufacturing PMI jumped to 47.0 in February from 42.5 in February. Likely reflecting resilient consumption, strong services activity and stabilizing U.S. manufacturing, new orders for nondefense capital goods excluding aircraft (core) rebounded 0.8 percent (m/m) in January. Despite the financial stress in the banking sector, high inflation prompted the Federal Reserve to raise its policy rate by 25 basis points on March 22nd.

Other advanced economies: strong services, weak manufacturing. In the euro area, incoming survey data continued to show a recovery in sentiment, especially in the service sector. In February, the services PMI rose further from 50.8 to an 8-month high of 52.7, with an improvement in forward-looking sub-indices. Meanwhile, manufacturing activity remains weak, with the manufacturing PMI edging down to 48.5 (figure 3.A). Furthermore, the retail sales

FIGURE 2.A U.S. and German 2-year yields

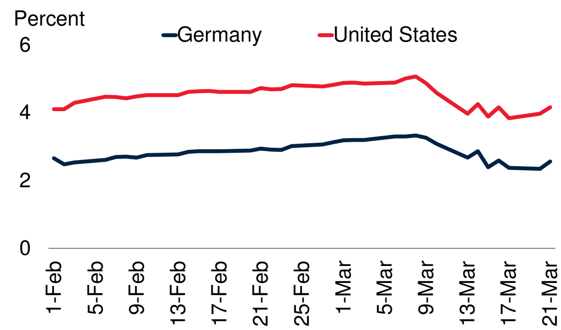


FIGURE 2.B Change in EMDE CDS premia between March 21 and March 8

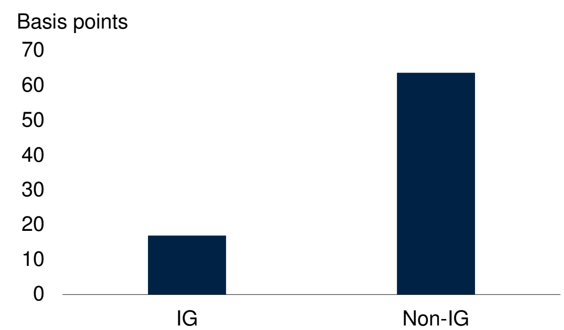
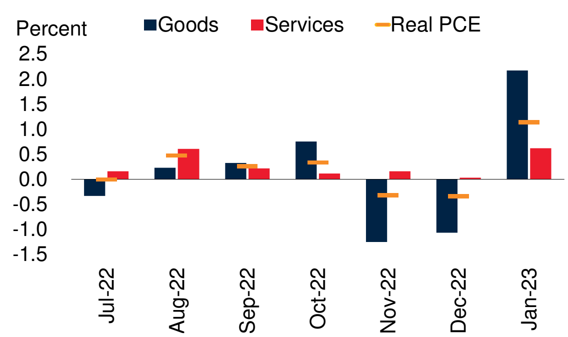


FIGURE 2.C Real personal consumption expenditures in the United States



Sources: Bloomberg; Federal Reserve Economic Data; Moody's; World Bank.
Note: EMDEs = emerging market and developing economies; SVB = Silicon Valley Bank.
A. Figure shows the 2-year government bond yield for the United States and Germany. Last observation is March 21, 2023.
B. IG = investment grade. Figure shows median change between March 8 and March 21, 2023, in 5-year U.S. dollar-denominated credit default swaps for a sample of 49 EMDEs (20 IG; 29 non-IG).
C. Figure shows year-on-year change in real personal consumption expenditures (real PCE). Last observation is January 2023.

volumes in January rose just 0.3 percent (m/m), following a sharp 1.7 percent fall in December. Although headline inflation edged down in February, core inflation accelerated from 5.3 percent (y/y) to a new record high of 5.6 percent, prompting the European Central Bank to proceed with a 50 basis points rate hike in March. Sectoral divergence is also evident in Japan, where the manufacturing PMI slipped further into the contractionary territory to 47.7 in February, while the services index rose to 54.

China: strengthening domestic activity, weak external demand. Following a weak end to 2022, domestic activity in China continues to strengthen this year. After a rebound in January, the official manufacturing and non-manufacturing PMI rose further in February, to 52.6 and 56.3 respectively. The non-official manufacturing and services PMI also improved in February. In contrast, trade remained weak, with both goods exports and imports declining by 6.8 percent (y/y) and 10.2 percent, respectively, on average in January and February (Figure 3.B). In its Government Work Report delivered in early March, the authorities signaled prioritizing macroeconomic stability and set a GDP growth target of “around 5 percent” for this year, the lowest in over three decades. In mid-March, the People’s Bank of China announced a 25 basis points cut to the required reserve ratio for banks.

Other EMDEs: signs of stabilization following widespread weakness. Economic activity deteriorated in several large EMDEs towards the end of 2022. In Brazil, Poland and Thailand, GDP fell in Q4, by 0.2, 2.4, and 1.5 percent (q/q) respectively, reflecting tighter financial conditions, weak external demand weighing on exports, weak consumption and high inflation (figure 3.C). In February, the manufacturing PMI edged up in Brazil and Poland, albeit to levels just below 50. The economy also contracted in South Africa, by 1.3 percent (q/q), reflecting severe power outages. More recently, stronger exports appear to have offset the negative impact of continued power disruptions and the composite PMI in South Africa improved to 50.5 in February from a 13-month low the month before. In India, growth declined from 6.3 percent (y/y) in Q3 to 4.4 percent in Q4. However, leading indicators in India point to improvement, with the services PMI increasing from 57.2 in January to 59.4 in February.

FIGURE 3.A Euro area PMIs

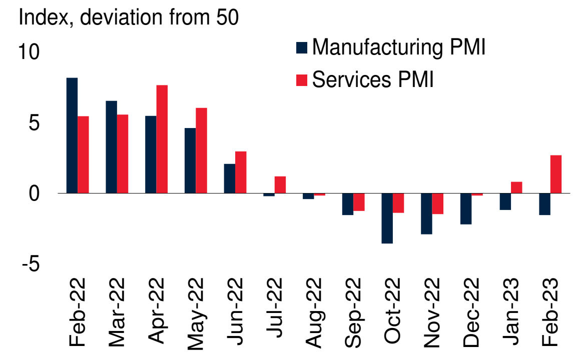


FIGURE 3.B China exports and imports

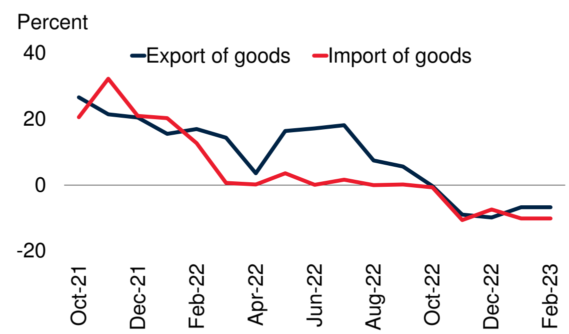
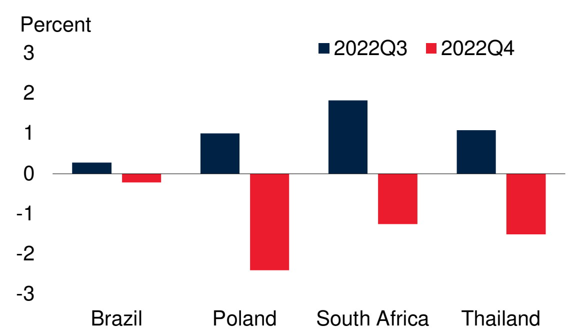


FIGURE 3.C Growth in selected EMDEs



Sources: Haver Analytics; S&P global; World Bank.

A. Figure represents the Purchasing Managers’ Index (PMI) in the euro area. PMI readings above (below) 50 indicate expansion (contraction) in economic activity. Last observations is February 2023.

B. Figure shows the year-on-year percentage change of goods imports and exports in China with January and February 2023 observations averaged. Last observation is February 2023.

C. Figure shows percent change, quarter-on-quarter for selected EMDEs.

Special Focus: Spillovers of rising U.S. interest rates to EMDEs

Rapid and steep U.S. monetary policy hiking cycle. Rapid increases in consumer inflation led the U.S. Federal Reserve to embark in 2022 on its steepest and fastest hiking cycle in four decades. In the space of a year, between March 2022 and February 2023, the Federal Reserve increased its policy rate by 450 basis points (figure 4.A). By comparison, the hiking cycle that started in 2015 was about half the size but took almost four times as long, while the 2004 hiking cycle was about equal in size but twice in length.

Different nature of the current hiking cycle. The current hiking cycle is not only different in its speed and steepness but also its underlying drivers. Accordingly, the nature of the accompanying increase in two-year interest rates is also different. In general, interest rates may rise for different reasons: expectations of improving economic conditions, expectations of higher inflation, or expectations of changes in the central bank's reaction function to achieve its goals. Increases in interest rates during the 2004 and 2015 hiking cycles were prominently a response to expectations of better economic activity. Increases in interest rates during the current hiking cycle, however, are mainly driven by a perceived shift in the Federal Reserve's reaction function—also known as "reaction" shocks—as it pivots toward more aggressive action to rein in inflation (figure 4.B).

Channels of spillovers of rising U.S. interest rates to emerging market and developing economies (EMDEs). Spillovers from rising U.S. interest rates occur through several channels. First, through an exchange rate channel, increases in U.S. interest rates can lead to EMDE currency depreciation as investors shift funds toward higher-yielding U.S. dollar assets. Second, through a financing channel, rising U.S. interest rates increase the cost of foreign currency borrowing and reprice existing foreign-currency debt. Third, through a risk channel, increases in U.S. interest rates can change perceptions of risk toward EMDEs, leading to a flight to safety. Lastly, through a trade channel, slowing U.S. activity induced by higher interest rates may lower demand for EMDE exports.

Impact on EMDE financial conditions. When periods of rising U.S. interest rates are dominated by changes in investors' assessments that the Federal Reserve's reaction function has become more hawkish—reaction shocks—the impacts on

FIGURE 4.A Inflation and policy

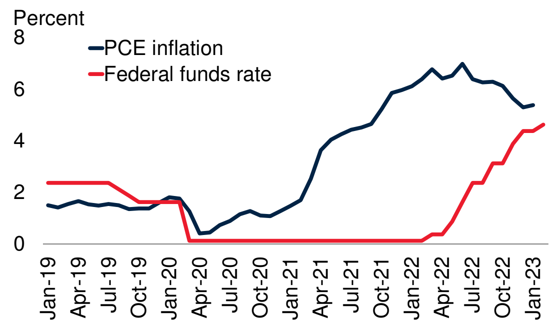


FIGURE 4.B Underlying drivers of the increase in 2-year U.S. interest rate yields

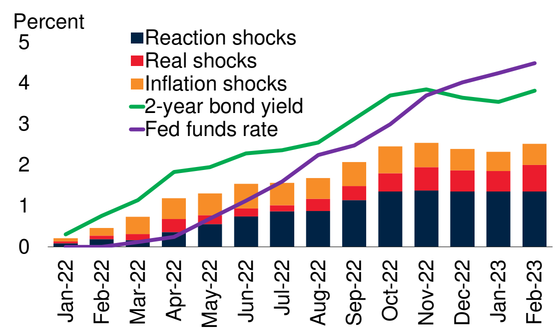
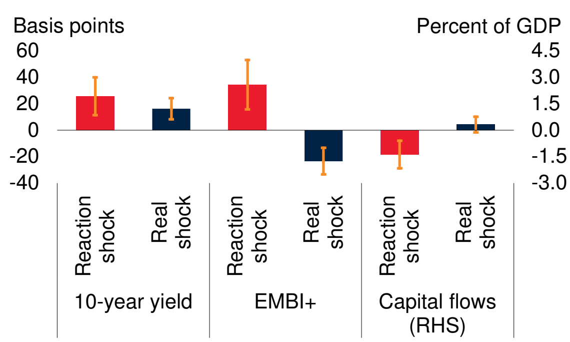


FIGURE 4.C Impact of a 25-basis point U.S. interest rate shock on EMDE financial markets



Sources: Arteta, Kamin, Ruch (2022); Haver Analytics; World Bank.
Note: EMBI = emerging markets bond index; EMDEs = emerging market and developing economies.
A. PCE = personal consumption expenditure.
B. Shocks are estimated from a sign-restricted Bayesian vector autoregression (VAR) model with stochastic volatility. Figure shows cumulative change in underlying shocks and yields since January 2022. Inflation shocks are prompted by rising expectations of U.S. inflation. Reaction shocks are prompted by investors' assessments that the Federal Reserve has shifted toward a more hawkish stance. Real shocks are prompted by anticipation of improving U.S. economic activity.
C. Figure shows impulse responses after one quarter from panel local projection models with fixed effects and robust standard errors, to reaction-function shocks and real shocks. Positive "capital flow" values reflect an increase in net liabilities of portfolio and other investments for EMDEs. Orange whiskers reflect 90 percent confidence intervals. EMBI+ spread is a proxy for sovereign risk.

EMDEs are particularly detrimental to financial markets. In particular, reaction shocks boost 10-year EMDE local-currency bond yields, widen EMBI+ sovereign risk spreads, and dampen EMDE capital flows (figure 4.C). They also depreciate currencies and depress equity prices. In contrast, when rising U.S. rates are mainly due to expectations of firming activity in the United States—real shocks—they tend to be followed by more benign movements in EMDE financial markets, likely because such shocks are associated with positive prospects for U.S. activity and imports.

Impact on EMDE economic conditions. The different impacts of U.S. interest rate shocks extend to their effects on EMDE economic activity. Reaction shocks are associated with a significant decline in EMDE investment and private consumption (figure 5.A). In contrast, real shocks are associated with higher real exports, as the benefits to EMDEs through trade channels dampen some of the negative effects of tighter global financing conditions.

Impact on EMDE fiscal outcomes. Reaction shocks to U.S. interest rates are followed by an increase in EMDE primary balances (smaller deficit or larger surplus; figure 5.B). This increase almost entirely reflects a sharp decline in government expenditure, most likely prompted by a tightening of the cost and availability of credit. In contrast, while real shocks are also associated with a significant increase in the primary balance, this reflects a rise in government revenues in addition to lower spending. Moreover, the decline in government spending due to real shocks appears to be markedly smaller than that due to reaction shocks, indicating that the latter leads to more pronounced austerity.

More vulnerable EMDEs at greater risk. The impact of U.S. interest rate increases also differs based on the underlying vulnerabilities of EMDEs, with countries with poor credit ratings experiencing much larger financial spillovers (figure 5.C). In response to a 25-basis point hike in U.S. interest rates driven by a reaction shock, non-investment grade EMDEs face larger increases in local currency 10-year bond yields and sovereign risk spreads than investment grade EMDEs.

FIGURE 5.A Impact 25-basis point U.S. interest rate shock on EMDE economic activity

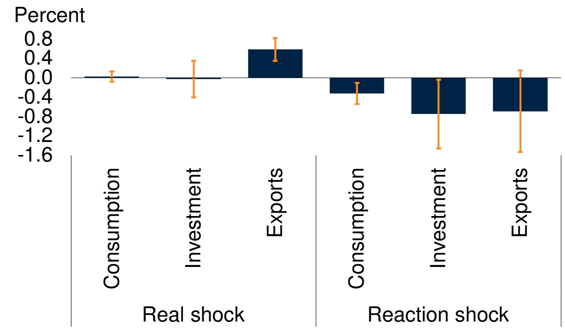


FIGURE 5.B Impact of U.S. interest rate shocks on EMDE fiscal outcomes

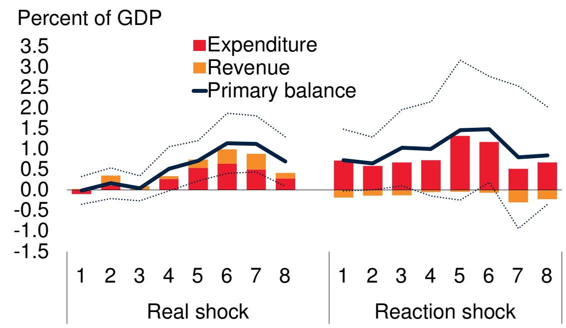
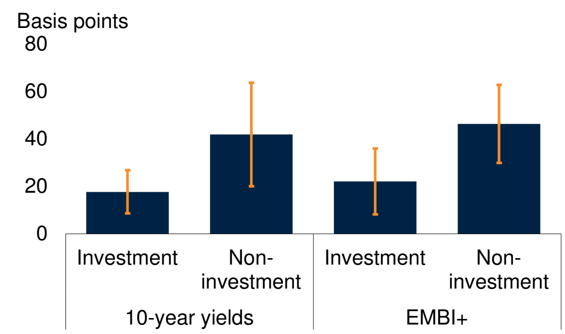


FIGURE 5.C Impact of 25-basis point U.S. reaction shocks on EMDEs, by investment



Sources: Arteta, Kamin, Ruch (2022); World Bank.

Note: EMBI = emerging market bond index; EMDEs = emerging market and developing economies.

A. Figure shows impulse responses after one quarter from panel local projection models to real shocks and reaction shocks. Orange whiskers reflect 90 percent confidence intervals. "Output" is real GDP, "Consumption" real private consumption expenditures, and "Investment" real gross fixed capital formation.

B. Figure shows impulse responses after one to eight quarters from panel local projection models with fixed effects and robust standard errors, to real shocks and reaction shocks. "Expenditure" and "Revenue" reflect the mean response of each variable to the underlying shock, come from separate models, and may not add up to the change in the primary balance. Dotted lines indicate 90 percent confidence intervals.

C. Figure shows impulse responses after one quarter from panel local projection models with fixed effects and robust standard errors to real shocks and reaction shocks. Orange whiskers reflect 90 percent confidence intervals. Based on average foreign currency long term sovereign debt ratings.

Recent Prospects Group Publications

Falling Long-Term Growth Prospects: Trends, Expectations, and Policies
Global Economic Prospects January 2023
How Do Rising U.S. Interest Rates Affect Emerging and Developing Economies? It Depends
Is a Global Recession Imminent?
Commodity Markets: Evolution, Challenges, and Policies
Commodity Markets Outlook—October 2022
Implications of the War in Ukraine for the Global Economy
What Has Been the Impact of COVID-19 on Debt? Turning a Wave into a Tsunami

Recent World Bank Working Papers

Investment in Emerging Market and Developing Economy Regions: Trends, Prospects, and Policy Options
The Past and Future of Regional Potential Growth: Hopes, Fears, and Realities
The Macroeconomic Implications of a Transition to Zero Net Emissions: A Modeling Framework
The Global Investment Slowdown: Challenges and Policies
Unlocking SME Finance in Fragile and Conflict Affected Situations

Recent World Bank Reports

Climate and Development: An Agenda for Action
Digital Africa: Technological Transformation for Jobs
Poverty and Shared Prosperity 2022
Women, Business and the Law 2023
Social Sustainability in Development: Meeting the Challenges of the 21st Century
Off the Books: Understanding and Mitigating the Fiscal Risks of Infrastructure

TABLE: Major Data Releases

(Percent change y-o-y)

Recent releases: February 22, 2023 - March 21, 2023					
Country	**Date**	**Indicator**	**Period**	**Actual**	**Previous**
Mexico	2/24/23	GDP	Q4	3.6%	4.4%
Australia	2/28/23	GDP	Q4	2.7%	5.9%
France	2/28/23	GDP	Q4	0.5%	1.0%
Indonesia	2/28/23	CPI	FEB	5.5%	5.3%
Türkiye	2/28/23	GDP	Q4	3.5%	4.0%
India	3/1/23	GDP	Q4	4.4%	6.3%
Brazil	3/2/23	GDP	Q4	1.9%	3.6%
South Korea	3/6/23	GDP	Q4	1.3%	3.1%
South Africa	3/7/23	GDP	Q4	0.9%	4.2%
Argentina	3/8/23	IP	JAN	6.3%	-2.7%
China	3/8/23	CPI	FEB	1.1%	2.2%
Japan	3/8/23	GDP	Q4	0.4%	1.5%
Saudi Arabia	3/8/23	GDP	Q4	5.5%	8.7%
Germany	3/10/23	CPI	FEB	8.7%	8.7%
Russian Federation	3/10/23	CPI	FEB	11.0%	11.8%
United Kingdom	3/10/23	IP	JAN	-4.3%	-4.1%
India	3/13/23	CPI	FEB	6.4%	6.5%
Mexico	3/13/23	IP	JAN	2.8%	3.0%
United States	3/14/23	CPI	FEB	6.0%	6.3%
Euro area	3/17/23	CPI	FEB	8.6%	8.7%
Canada	3/21/23	CPI	FEB	5.3%	5.9%

(Percent change y-o-y)

Upcoming releases: March 22, 2023 - April 30, 2023				
Country	**Date**	**Indicator**	**Period**	**Previous**
South Africa	3/22/23	CPI	FEB	7.2%
United Kingdom	3/22/23	CPI	FEB	8.8%
Japan	3/23/23	CPI	FEB	4.4%
Netherlands	3/24/23	GDP	Q4	3.3%
Spain	3/24/23	GDP	Q4	2.7%
Brazil	3/30/23	IP	FEB	0.9%
South Korea	3/30/23	IP	FEB	-3.7%
United Kingdom	3/31/23	GDP	Q4	0.4%
Russian Federation	4/7/23	GDP	Q1	-3.7%
China	4/11/23	CPI	Q1	1.1%
China	4/17/23	GDP	Q1	2.9%
South Korea	4/17/23	GDP	Q1	1.3%
New Zealand	4/19/23	CPI	Q1	7.2%
Australia	4/25/23	CPI	Q1	7.8%
United States	4/27/23	GDP	Q4	0.9%
Belgium	4/28/23	GDP	Q1	1.4%
Euro area	4/28/23	GDP	Q1	1.8%
France	4/28/23	GDP	Q1	0.5%
Germany	4/28/23	GDP	Q1	0.9%
Italy	4/28/23	GDP	Q1	1.4%
Mexico	4/28/23	GDP	Q1	3.6%