Overview

- Activity in major economies was generally resilient in 2023Q1.
- Persistent weakness in global manufacturing is weighing on global trade and commodity prices.
- Financial markets have shown few signs of stress notwithstanding concerns about advanced-economy banking sectors and the continued tightening of credit conditions.

Chart of the Month

- There is a growing divergence between firming global services activity and persistent weakness in manufacturing.
- The gap between the global manufacturing and services Purchasing Manager Indexes (PMIs) is at its widest level since January 2009.
- Subdued manufacturing activity likely reflects its greater sensitivity to rising borrowing costs.

Special Focus: The impact of adverse shocks on potential growth

- Financial crises, recessions, and epidemics usually leave lasting scars on potential growth and its underlying drivers—investment, employment, and productivity.
- National recessions were associated with 1.4 percentage point slower potential growth, on average, even after five years. Banking crises, which are particularly damaging to investment, were associated with initially larger falls in potential growth.
- Epidemics had a larger negative long-term effect on potential growth in EMDEs than in advanced economies.
Global activity: strengthening services. The global composite PMI picked up to 54.2 in April, up from 53.4 the previous month, with robust services activity driving the increase. Global manufacturing output, at 50.8 in April, indicated essentially flat activity, as global monetary policy tightening continues to weigh on capital-intensive sectors. Sentiment indicators suggest that current economic conditions remain stable while expectations are being downgraded (figure 1.A).

Global trade: continued decline in goods trade. The volume of global merchandise trade has trended down since September, and was down by 2.6 percent in February (y/y). The weakness is broad-based, with imports declining across all major economies (figure 1.B). PMI readings for April signaled continued weakness in goods trade as new export orders in manufacturing remained in contraction territory for a 14th consecutive month. In contrast, services trade has strengthened for a second consecutive month, with the new export orders PMI in services reaching 52.2 in April—the highest level in the eight years the series has been recorded. Supplier delivery times sped up for a third consecutive month as global supply chain pressures returned to their 2008 levels.

Commodity markets: reversal of recent price increases. Most commodity prices rose in April; however, in many cases, this increase is being reversed in May. The price of Brent crude oil surged to around US$80/bbl in April following an OPEC+ announcement of a 1.66 mb/d production cut but declined soon thereafter, falling below US$70/bbl for part of May. The fall in oil prices reflected concerns about slowing global demand and financial market stress. Similarly, many metals prices rose earlier in the year on optimism about slowing global demand and financial market stress. One exception is gold, whose price has risen, in part as a hedge against uncertainty. Gold’s nominal price reached all-time highs in April and May, and is at elevated levels even in real terms (figure 1.C). Agricultural commodity prices gained 2.2 percent in April (m/m), led by beverages and food prices, but have generally been trending down in May.

Financial conditions: limited spillovers from U.S. bank failures. Stress in the U.S. banking sector resurfaced in late April, as First Republic Bank revealed larger-than-expected deposit outflows, resulting in a regulator-brokered acquisition
of the bank announced on May 1st. Stock price indexes for U.S. regional banks have fallen more than 30 percent year-to-date, reflecting concerns about deposit outflows, weakening U.S. growth, and lenders’ exposure to potentially stressed real estate assets. U.S. bank lending standards have become sharply more restrictive over recent quarters. Alongside, deposit balances at small banks declined 4.5 percent from January to April, the largest sustained decline since 1985 (figure 2.A). Separately, concerns about the U.S. debt ceiling intensified in May, after the U.S. Treasury indicated it could run out of cash as soon as June 1st. So far, concerns about banking stress and the debt ceiling appear to have had only limited negative effects on broader financial markets. U.S. and emerging market equity indices have been broadly flat, while risk spreads for EMDE corporates have remained contained, except among companies with highly speculative credit ratings, whose borrowing costs have risen substantially during the recent period of banking stress (figure 2.B).

United States: weak first quarter. Growth slowed from 2.6 percent (q/q saar) in 2022Q4 to 1.1 percent in 2023Q1, reflecting a large drag from inventories offsetting robust consumption growth (figure 2.C). Industrial activity remained weak, as the ISM manufacturing PMI remained in contractionary territory for the sixth consecutive month in April—the longest spell since 2008-09. Meanwhile, inflation remained elevated, partly reflecting ongoing wage pressures, as increases in the employment cost index recorded a 5 percent (y/y) increase in 2023Q1. Consumer prices rose 4.9 percent (y/y) in April, slightly below market expectations, but core inflation remained high at 5.5 percent. On May 3rd, the Federal Reserve raised its policy rate by 25 basis points amid a high level of uncertainty surrounding the effect of recent banking sector strains on credit conditions.

Other advanced economies: improving sentiment driven by services. In the euro area, GDP expanded 0.3 percent (q/q saar) in 2023Q1, after a 0.2 percent contraction in the previous quarter. Weakness was concentrated in Germany, where the economy contracted for a second straight quarter, declining 1.3 percent (q/q saar) as private consumption was weighed down by persistently high inflation and the effects of monetary policy tightening. Business sentiment across the euro area improved in April, as the composite PMI rose further to an 11-month high of 54.1 from 53.7, mostly driven by the services sector. Core HICP inflation edged down to 5.6
percent in April from 5.7 percent (y/y) in March—the first decline since June 2022—while lending standards continued to tighten (figure 3.A). The European Central Bank slowed the pace of rate hikes to 25 basis points at its latest monetary policy announcement on May 4th. Economic activity in Japan also continued to improve, led by services, with GDP increased 1.6 percent (q/q saar) in 2023Q1. The Bank of Japan kept its policy rate unchanged close to zero at its April meeting.

China: moderating activity. Growth rebounded strongly in 2023Q1 as the economy re-opened. More recently, however, activity appears to be moderating. The official manufacturing PMI fell to 49.2 in April from 51.9 in March, with the production sub-index essentially flat (50.2) and the new exports orders sub-index slipping into contractionary territory (to 47.6). However, the non-manufacturing PMI declined but remained elevated at 56.4 amid signs of continued strength in domestic tourism and retail sales. Inflation remained subdued in April, with the consumer price index rising only 0.1 percent (y/y) while the producer price index fell 3.6 percent (figure 3.B). In late April, the authorities reiterated the need for continued policy support but stopped short of announcing any significant new measures.

Other EMDEs: broadly resilient. The EMDE composite PMI increased slightly from 54.6 to 54.9 in April, driven by widespread strength in services. The services PMI reached its highest level in more than a decade in India and increased at the fastest pace in nine months in Brazil. Manufacturing PMIs have been more uneven: they expanded further above 50 in India, Indonesia, Saudi Arabia’s non-oil sector, Türkiye, and Thailand. The increase in Türkiye was particularly robust as the country recovered from the major earthquakes in February, while Thailand’s manufacturing PMI reached a record high as tourism recovered. In contrast, manufacturing PMIs fell further below 50 in Brazil, Poland, and Vietnam. Weakness in the manufacturing sector is also reflected in slowing input prices and decreasing output prices in EMDEs. Both price indexes reached their lowest level since the mid-2020 (figure 3.C). Headline inflation in April declined in many EMDEs—including Brazil, Mexico, Colombia, Türkiye, and Thailand—primarily due to base effects and falling energy prices. Core inflation remained above pre-pandemic levels in many countries, but showed signs of easing in India, Mexico, Russia, Thailand, and Türkiye.
Special Focus: The impact of adverse shocks on potential growth

Potential growth: a new database. The World Bank has launched a new comprehensive database of the nine most commonly used estimates of potential output growth for the largest available country sample of up to 173 economies (37 advanced economies and 136 EMDEs) over 1981-2021. These estimates are based on multiple methodologies. The book also examines prospects for potential growth based on projections of its structural drivers—growth of physical and human capital, growth of labor supply, and growth of TFP. Using the new database, the damage to potential growth from the many adverse shocks to the global economy during the past decade can be assessed.

Adverse shocks to the global economy: recessions, banking crises, epidemics. These events include financial crises, global recessions, bouts of inflation, health crises such as epidemics and COVID-19, climate-related disasters, and conflicts of varying severity. Between 1980 and 2020, advanced economies collectively experienced 124 recessions and emerging market and developing economies (EMDEs) had 351 recessions. Almost half of the country-level recessions occurred during global recession years (1975, 1982, 1991, 2009, 2020; figure 4.A). Recessions at the country level, on average, lasted 1.5 years and were associated with an average peak-to-trough contraction in output of 4 percent. Advanced economies and EMDEs have also faced 25 and 41 banking crises, respectively, since the 1990s and many of them were accompanied by recessions (figure 4.B). In addition to the pandemic, nearly 100 economies have also been affected by epidemics over the same period. Almost all of these shocks weakened potential growth.

Impact of recessions: persistent. National recessions, even five years later, were associated, on average, with a decline of about 1.4 percentage points in potential growth (figure 4.C). While the magnitude of the estimated decline in potential growth five years after a recession differed depending on the estimation methodology used, it was always statistically significantly negative; and similar whether national recessions are defined as periods of negative growth or as periods where growth is both negative and at least one standard deviation below its long-term average. The effect was somewhat stronger in EMDEs than in advanced economies: in EMDEs, potential growth was still, on average, 1.6 percentage points lower five years after the recession, whereas in advanced economies, it was only 1.3 percentage points lower.
Impact of banking crises, epidemics: somewhat less persistent. Like recessions, both banking crises and epidemics have reduced potential growth, but the timing of their effects differed from those of recessions (figure 5.A). Banking crises tended to have larger short-term impacts than recessions but somewhat smaller long-term effects on potential growth. Using estimates based on the production function approach, potential growth slowed more steeply in the first 1-2 years after banking crises than after recessions, but the initial decline in potential growth after banking crises was subsequently partly reversed, whereas the slowing effect of recessions strengthened over time. Epidemics had somewhat more modest, but still statistically significant, negative long-term effects on potential growth than did recessions—larger in EMDEs than in advanced economies (figure 5.B). Potential growth five years after an epidemic was 0.9 percentage point lower than it would otherwise have been.

Impact of recessions on potential growth: multiple channels. In a recession, unemployment generally rises significantly and remained elevated for a prolonged period. Gross fixed investment typically falls more sharply in response to recessions than other components of GDP, as investors may reassess long-term growth prospects, lose access to finance, or both. The collapse in investment also indirectly slows the adoption of productivity-enhancing embodied technologies and the reallocation of resources toward more productive uses. Workers losing their jobs during recessions may permanently enter lower-skilled employment paths. Skills mismatches between job market entrants and job requirements are larger during recessions than expansions and tend to be long-lasting, suggesting persistent productivity losses.

Impact of recessions on potential growth: adverse impacts on investment, employment, and productivity. Empirically, all these channels of transmission were at work in past recessions. Four to five years after an average recession, potential growth and its underlying drivers—investment, employment, and productivity—remained significantly lower than in “normal” years (figure 5.C). Investment growth was 3 percentage points lower while employment and total factor productivity growth were both 0.7 percentage point lower. This contrasts with banking crises, which tended to be associated mostly with lasting losses of productivity growth, and epidemics, which were mainly associated with lasting employment losses, possibly reflecting economic shifts caused by behavioral responses to epidemics.

Note: Recessions are defined as the period from the peak preceding a business cycle trough to the trough, with a trough defined as a year in which output growth is both negative and at least one standard deviation below its long-term average. EMDEs = emerging market and developing economies. Bars are coefficient estimates from local projections model. Orange whiskers indicate 90 percent confidence interval. Sample includes unbalanced panel of 32 advanced economies and 97 EMDEs for 1981-2020. Banking crises are identified as in Laeven and Valencia (2012, 2018, 2020). Epidemics include SARS (2003), swine flu (2009), MERS (2012), Ebola (2014), and Zika (2016). A. Sample includes unbalanced panel of 32 advanced economies and 97 EMDEs for 1981-2020.
### Recent Prospects Group Publications

- Global Economic Prospects - Forthcoming, June 2023
- Commodity Markets Outlook—April 2023
- 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
- Commodity Markets: Evolution, Challenges, and Policies

### Recent World Bank Working Papers

- Measuring Global Economic Activity Using Air Pollution
- The Impact of Tax Blacklisting
- Commodity Price Cycles: Commonalities, Heterogeneities, and Drivers
- Potential Growth Prospects: Risks, Rewards, and Policies
- Trade as an Engine of Growth: Sputtering but Fixable

### Recent World Bank Reports

- World Development Report 2023
- Europe and Central Asia Economic Update, Spring 2023: Weak Growth, High Inflation, and a Cost-of-Living Crisis
- Expanding Opportunities: Toward Inclusive Growth
- Africa’s Pulse: Leveraging Resource Wealth During the Low Carbon Transition
- The Promise of Integration: Opportunities in a Changing Global Economy
- Middle East and North Africa Economic Update: Altered Destinies

### TABLE: Major Data Releases

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