THE WORLD BANK
Development Economics | Prospects Group

Global Monthly

September 2023

Overview

- In advanced economies, resilient activity in the United States has been accompanied by weakness in the euro area.
- Activity in China remains weak, with consumption subdued amid continued strains in the property sector.
- Prices of some commodities have rebounded, with crude oil prices supported by the announced production cuts.

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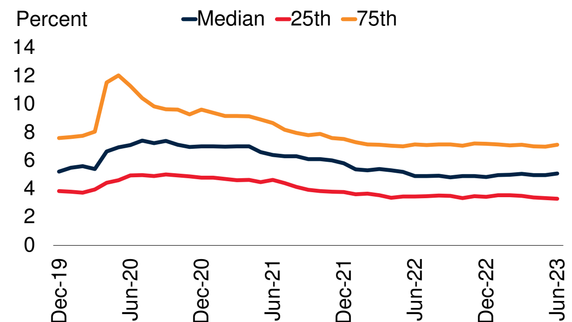
Chart of the Month

- Labor markets remain tight and unemployment rates have fallen to record lows, particularly in advanced economies.
- However, the pace of job increases has begun to slow recently, with unemployment starting to edge up in some economies.
- Going forward, unemployment is likely to rise in line with slowing activity and as more job seekers enter the labor force.

Evolution of global unemployment



Sources: Haver Analytics; World Bank.
Note: Lines show the median, 25th and 75th percentile of the distribution of unemployment rates monthly. Last observation June 2023. The panel includes up to 65 countries.

Special Focus: U.S. Monetary Spillovers and Emerging Market Vulnerabilities

- The steepest and fastest hiking cycle in four decades poses notable challenges for emerging market and developing economies (EMDEs).
- Vulnerable EMDEs have seen greater spillovers due to a more hawkish-perceived Fed.
- EMDEs that run "twin" current account and fiscal deficits exhibit greater vulnerability to higher U.S. interest rates.

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

September 2023

Monthly Highlights

Global activity: resilience. Global activity has surprised on the upside in recent months, with EMDEs excluding China and some advanced economies, mainly the United States, growing faster than expected. This is reflected in global industrial production (excluding China), which picked up toward the end of 2023Q2 (figure 1.A). Global composite PMI (excluding China), which reached 50.4 in August, suggests that growth has likely persisted through the summer. However, the pace of expansion has slowed from its peak in April as activity in the services sector lost momentum. In contrast, the global manufacturing PMI has remained in contractionary territory.

Global trade: weak goods, easing services. Global goods trade weakened further, with trade volumes declining by 3.2 percent y/y in July (figure 1.B). PMI readings for manufacturing new export orders remained in contractionary territory in August. Amid weak goods demand and slowing activity in some large economies, global suppliers' delivery times remained at historic lows. In contrast, services trade continued to expand in August, albeit at a slower pace compared to May. International tourist arrivals strengthened further between January and July, 43 percent more than the same period in 2022, and remain on track to reach up to 95 percent of pre-pandemic levels by the end of the year.

Commodity markets: rising energy prices. The commodity price index increased by 4.6 percent in August (m/m), mainly driven by a surge in energy prices (7.8 percent). The Brent crude oil price reached US$95/bbl by mid-September for the first time in 2023 after Saudi Arabia and Russia announced an extension to supply cuts to the end of 2023 (by one mb/d and 300,000 bpd, respectively). Oil prices have also been supported by lower-than-expected U.S. crude inventories. Meanwhile, natural gas prices in Europe surged 17 percent in August (m/m). This upward trajectory continued into early September reflecting labor strikes at two liquified natural gas facilities in Australia. While European gas inventories currently maintain levels above 90 percent capacity, these strikes could potentially disrupt operations, impacting approximately 1 million tonnes of global LNG supply. Agriculture prices dropped 1.5 percent in August led by declines in oil and meal prices and, to a lesser degree, a decrease in grain prices amid favorable weather conditions. Rice prices, however, surged in response to India's export ban that went into effect in July

FIGURE 1.A Global industrial production

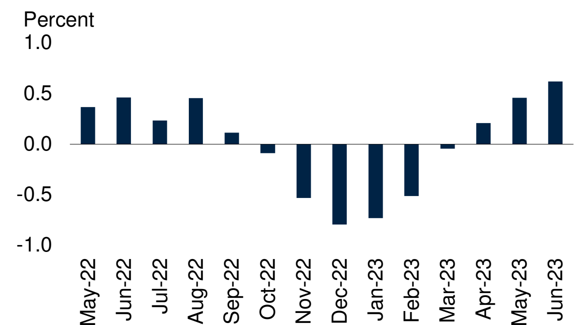


FIGURE 1.B International trade

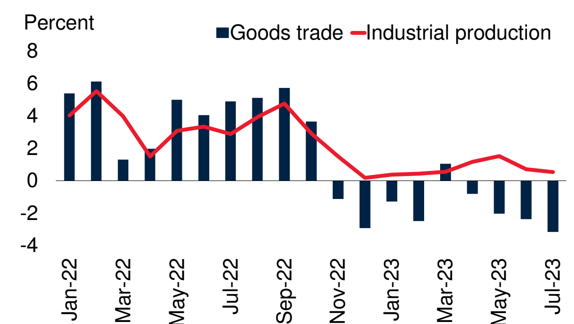
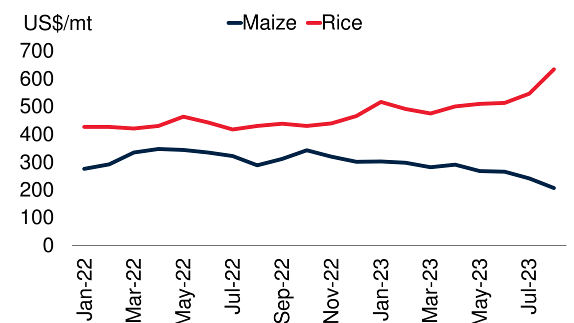


FIGURE 1.C Commodities prices



Sources: Haver Analytics; Netherlands Bureau of Economic Analysis; World Bank.

A. Figure shows percent change in 3-month average industrial production, excluding China. Last observation June 2023. Sample includes up to 60 countries.

B. Figure shows percent change in goods trade and industrial production relative to same period in previous year.

C. Lines show monthly prices for maize and rice. Last observation is August 2023.

(figure 1.C). Metal prices declined by 1.6 percent in August due to weaker demand from China given the continued weakness in its property sector.

Global financial conditions: further tightening; challenges in China. Global financial conditions tightened further in September. Long-term government bond yields rose to levels not seen since 2007 in the United States, and since 2011 in Germany. Equity volatility also picked up, with equity prices declining in both advanced economies and EMDEs. The U.S. dollar has strengthened notably since July, as market pricing has shifted to discount the likelihood of U.S. policy rate cuts this year, and economic data has weakened somewhat in other large economies. In EMDEs, the dollar's gain has been mirrored by broad local currency depreciations, with larger declines among countries with weak credit ratings (figure 2.A). In China, subdued growth and financial stress in the real estate sector have sapped investor confidence, pushing the renminbi to its lowest levels (in dollar terms) since the global financial crisis. Credit spreads on high-yield dollar-denominated Chinese corporate bonds indicate a substantial likelihood of further defaults (figure 2.B).

United States: consumer resilience. Growth again surpassed expectations, amid a spate of positive data surprises, which led to notable upgrades to consensus growth forecasts for this year. Growth in 2023Q2 came in at a stronger-than-expected 2.1 percent (saar), driven mainly by robust nonresidential investment and resilient consumption. Most recent indicators suggest that the momentum continued into Q3, with a sharp increase in real consumption spending in July (0.6 percent m/m) and a tight labor market that has shown only tentative signs of moderating over the summer (figure 2.C). In contrast, ISM's manufacturing PMI remained in the sub-50 region for the tenth consecutive month in August, a more pessimistic assessment of manufacturing activity compared to industrial production, which has been relatively flat this year through July.

Other advanced economies: euro area weakness. In the euro area, growth was downwardly revised to 0.1 percent (q/q sa) in 2023Q2. Output shrank in nearly one-third of the bloc's economies, while activity in Germany—the euro area's largest economy—was flat after two consecutive quarters of contraction (figure 3.A). Survey data indicate that activity has further deteriorated in 2023Q3, with the services PMI sliding below 50 in August for the first time since December, while

FIGURE 2.A Change in currency values versus U.S. dollar since July, by credit rating

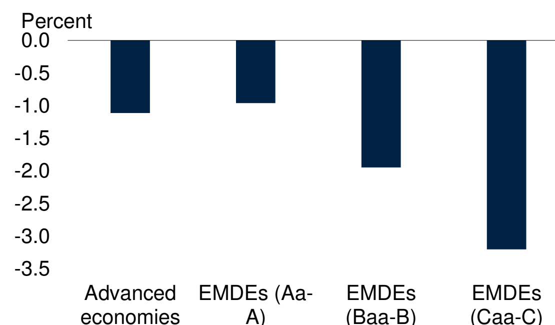


FIGURE 2.B Credit spreads on high-yield Chinese corporate bonds

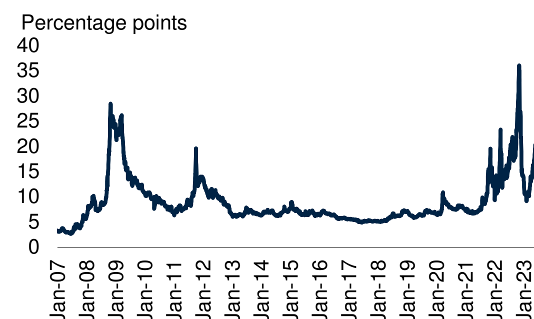
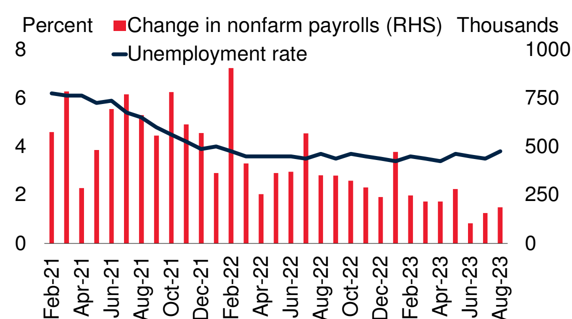


FIGURE 2.C U.S. labor market indicators



Sources: J.P. Morgan; World Bank.
Note: EMDEs = emerging market and developing economies.
3mma = 3-month moving average.
A. Average change in currency values, expressed in terms of U.S. dollar values, since the start of August 2023. Composite currency indices are constructed by compounding the simple average of daily changes (against the U.S. dollar) for currencies in each category.
B. Credit spread on an index of Chinese dollar-denominated high-yield corporate bonds.
C. The chart shows monthly data for the unemployment rate and the change in the U.S. nonfarm payrolls. Latest datapoint is August 2023.

the manufacturing PMI remained firmly in contractionary territory. In Japan, August manufacturing PMI remained below 50 since October 2022, with the exception of May. In contrast, growth in 2023Q2 soared to 4.8 percent quarterly annualized, led by a fall in imports and a rebound in exports.

China: protracted weakness. Incoming data points to persistent broad-based weakness in China. Investment continues to be hobbled by the property sector downturn, with property prices experiencing renewed downward pressure (figure 3.B). In August, retail sales remained subdued rising 4.6 percent (y/y). Inflationary pressures also remained subdued in August, with consumer prices broadly unchanged in year-on-year terms amid declining food prices, while producer prices fell 3 percent (y/y). The official manufacturing PMI increased marginally, to 49.7 in August from 49.3 in July, while the non-manufacturing PMI declined to 51. The People's Bank of China continued to ease monetary policy, cutting the reserve requirement ratio by 25 basis points in September. This followed a ten basis points cut in the one-year loan primate rate in late August, and other measures to support property sector demand, including the reduction of downpayment requirements for mortgages. To lower borrowing costs, the central bank has also encouraged banks to refinance existing loans.

Other EMDEs: resilience in larger economies. Amid better-than-expected growth in advanced economies, GDP growth in some major EMDEs surprised on the upside in 2023Q2 (Brazil, India, Mexico, Russia, South Africa, Türkiye). The output PMI for EMDEs excluding China remained in expansionary territory, at 54.8 in August, unchanged from July. At the same time, smaller economies in Eastern Europe continued to face headwinds, with GDP in Hungary and Poland contracting in Q2 amid weakness in Germany. Similarly, growth in several Asian economies (Malaysia, the Philippines, Thailand) moderated in Q2 due to weak goods exports. Several EMDE central banks further hiked policy rates in response to sticky core inflation, while others started cutting rates to support their economies (figure 3.C).

FIGURE 3.A Euro area activity

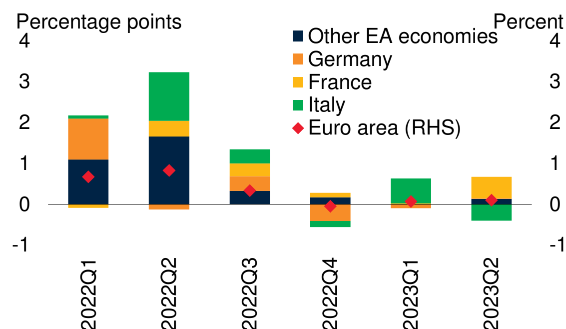


FIGURE 3.B China's property prices

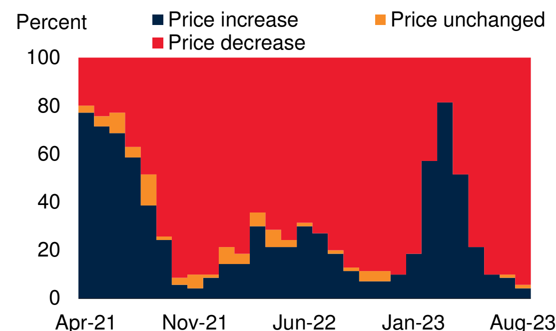
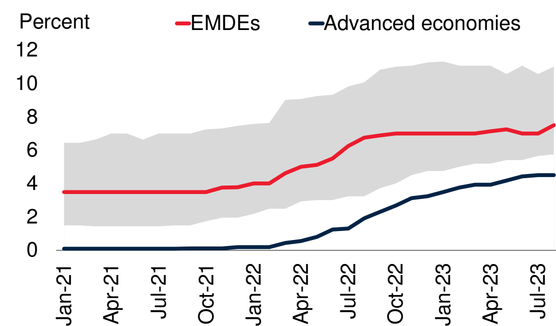


FIGURE 3.C Monetary policy rates



Sources: Eurostat; Haver Analytics; NBS; World Bank.
Note: EMDEs = emerging market and developing economies.
A. Chart shows percent change from previous quarter, of GDP at market prices, seasonally and calendar adjusted data.
B. Shares of cities with increasing, unchanged, and falling month-on-month existing residential building prices. Sample includes 70 major cities. Last observation is August 2023.
C. Lines represent median values for the official policy rates in each group. Sample includes 16 AEs (euro area is considered one observation); and up to 76 EMDEs. Grey shade refers to the interquartile range.

Special Focus: U.S. Monetary Spillovers and Emerging Market Vulnerabilities

Steepest Fed hiking cycle in four decades. The U.S. Federal Reserve started raising the Federal Funds rate in March 2022. By July 2023, the Federal Funds rate had been raised by 5¼ percentage points, the fastest pace of increase since the 1980s (figure 4.A). Two-year U.S. Treasury yields have increased markedly, reflecting this tightening. In general, U.S. interest rates can reflect three potential drivers: (1) "inflation shocks," which reflect expectations of rising U.S. inflation; (2) "reaction shocks," which reflect investors' assessments that the Federal Reserve's reaction function has become more hawkish; and (3) "real shocks," which are prompted by improved prospects for U.S. economic activity. Since early 2022, rising U.S. interest rates have been driven mainly by reaction shocks, as the Fed has pivoted toward more aggressive action to rein in inflation.

Rising U.S. interest rates and EMDEs vulnerabilities. More vulnerable economies are more likely to exhibit adverse responses to U.S. interest rate increases due to reaction shocks than more resilient economies. While indications of EMDE financial distress have been somewhat less widespread than what might have been expected given the aggressive Fed tightening, many of these economies have seen financial conditions worsen. Since the beginning of 2022, there has been an increase in the number of EMDEs with sovereign spreads exceeding 10 percentage points, a benchmark suggesting loss of market access and an elevated likelihood of default. More vulnerable EMDEs, particularly those with weak credit ratings, have also experienced larger increases in sovereign risk spreads since the start of 2022 (figure 4.B).

Impact of non-investment grade status. EMDEs with weaker credit ratings and higher sovereign risk spreads tend to experience more adverse financial spillovers from U.S. reaction shocks, including larger increases in local-currency long-term bond yields and sovereign risk premiums, as well as larger declines in equity prices (figure 4.C). For any given increase in U.S. interest rates due to reaction shocks, more vulnerable economies tend to experience local-currency yield increases that are almost twice as large.

Impact of frontier market status. Compared to emerging markets, "frontier market" economies tend to have less developed financial markets and more limited access to

FIGURE 4.A Federal Reserve tightening cycles

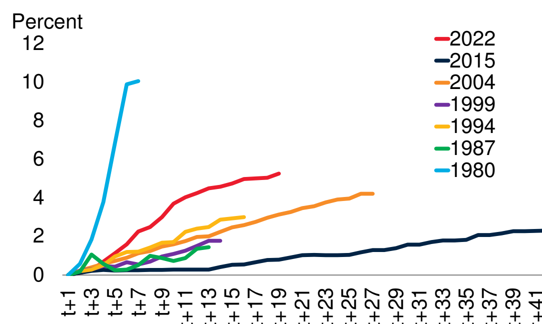


FIGURE 4.B Sovereign risk spreads since January 2022

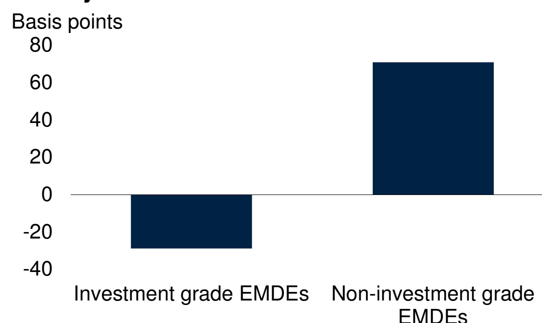
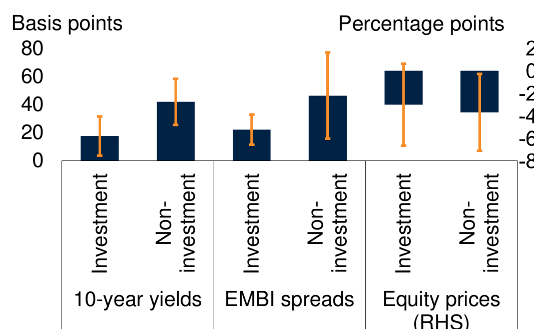


FIGURE 4.C Impact of U.S. interest rate reaction shock on EMDE financial variables, by rating



Sources: J.P. Morgan; Federal Reserve Bank of St. Louis; World Bank.
Note: EMDEs = emerging market and developing economies.
A. Based on the cumulative change in the effective Federal Funds Rate. Monthly data. Last observation is August 2023.
B. Last observation is August 2023.
C. Figure shows impulse responses after one quarter from non-linear panel local projection models with fixed effects and robust standard errors prompted by a 25-basis-point reaction shock (investors' assessments that the Federal Reserve has shifted toward a more hawkish stance). Orange whiskers reflect 90 percent confidence intervals. Models exclude observations during global financial crisis (2008Q4-2009Q4) and the COVID-19 pandemic. Based on the average foreign-currency long-term sovereign debt rating by Fitch Ratings, Moody's, and Standard and Poor's.

international financing. Following U.S. reaction shocks ten-year local currency bond yields tend to increase by 50 percent more in frontier economies, sovereign risk spreads tend to increase by more than three times, and equity prices decline by almost twice as much as in other EMDEs (figure 5.A).

Impact of twin-deficit status. Countries that run "twin" current account and fiscal deficits often depend on foreign investors to finance them, and therefore are especially exposed to U.S. interest rates. Twin-deficit EMDEs experience more adverse impacts from U.S. reaction shocks than their non-twin-deficit peers (figure 5.B). Twin-deficit EMDEs tend to see larger increases in sovereign risk spreads, larger falls in equity prices and an increase in 10-year local currency yields that is greater than the change in U.S. interest rates, a statistically different response from the non-twin-deficit peers.

Financial crisis risks rise. In the average EMDE, the probability of facing a crisis in any one year from 1985 to 2018 was 3.5 percent. If 2-year yields in the U.S. were to increase by 25 basis points because of the Federal Reserve reaction shocks, then the estimated probability of crisis about doubles, to 6.6 percent. The risks are particularly acute for twin-deficit EMDEs facing a currency crisis. Since the Fed started its hiking cycle in March 2023 interest rates driven by these reaction shocks have increased by 116 basis points. This translates into a significant increase in the likelihood of a currency crisis in EMDEs with twin-deficits (figure 5.C). Indeed, several EMDEs experienced a full-fledged currency crisis in 2022.

Concerted policy response needed. Advanced economies' central banks can reduce the risk of disruptive spillovers by clearly communicating their intentions and calibrating policies to avoid abrupt changes in market participants' perceptions of their reaction functions. In response to tighter monetary stance in advanced economies, EMDE monetary authorities may need to also tighten policies to moderate destabilizing capital outflows, currency depreciation, and resultant increases in inflation. Critically, communicating monetary policy decisions clearly, leveraging credible monetary frameworks, and safeguarding central bank independence will help EMDEs to keep inflation expectations from becoming de-anchored and avoid disruptive capital outflows. Finally, authorities in EMDEs can mute the effects of disruptive spillovers by reducing the fundamental vulnerabilities of their economies and financial systems.

FIGURE 5.A **Impact of U.S. interest rate reaction shock on EMDE financial variables, by market**

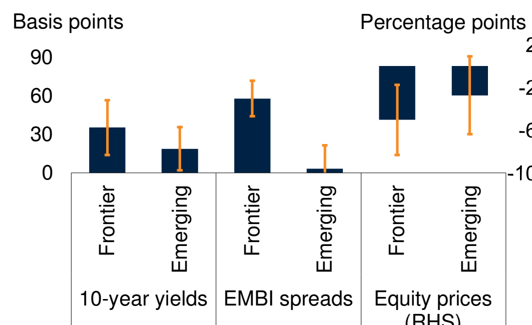


FIGURE 5.B **Impact of U.S. interest rate reaction shock on EMDE financial variables, by balances**

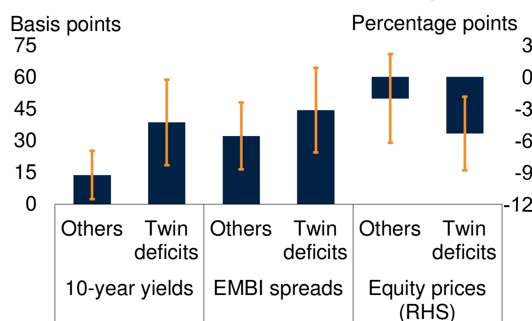
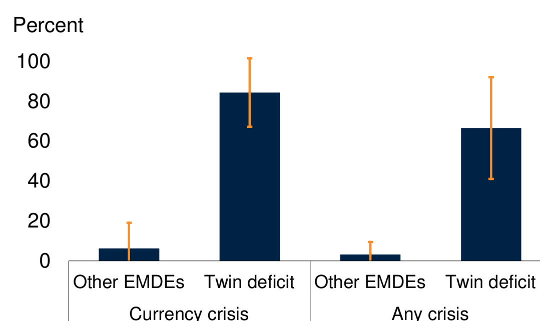


FIGURE 5.C **Probability of a financial crisis since the start of the 2022 hiking cycle**



Sources: Arteta, Kamin, and Ruch (2022).
Note: EMBI = emerging market bond index.
A-B. Figures show impulse responses after one quarter to a 25-basis-point shock prompted by investors' assessments that the Federal Reserve has shifted toward a more hawkish stance. Orange whiskers reflect 90 percent confidence intervals. For further details, see Arteta, Kamin, and Ruch (2022).
A. Based on the Morgan Stanley Capital International (MSCI) country classification in 2022. Frontier markets include up to 9 economies while emerging markets include up to 19 economies.
B. Based on economies that run twin current account and primary fiscal deficits.
C. Reflects a 1.16 percentage point increase in the 2-year U.S. Treasury yield driven by a reaction shock (the increase seen in the 12 months since the start of the U.S. Fed hiking cycle in March 2022). Orange whiskers reflect 68 percent confidence intervals. For further details see Arteta, Kamin, and Ruch (2022).

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Recent Prospects Group Publications

Global Economic Prospects—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

Policy Uncertainty and Aggregate Fluctuations : Evidence from Emerging and Developed Economies
Trade Elasticities in Aggregate Models: Estimates for 191 Countries
Considering Labor Informality in Forecasting Poverty and Inequality: A Microsimulation Model for Latin American and Caribbean Countries
The Impact of the Transition and EU Membership on the Returns to Schooling in Europe
The Economic Effects of Market Integration in the Western Balkans
Measuring Total Carbon Pricing
External Debt, Fiscal Consolidation, and Government Expenditure on Education

Recent World Bank Reports

World Development Report 2023
Climate and Equity: A Framework to Guide Policy Action
Learning Recovery to Acceleration: A Global Update on Country Efforts to Improve Learning and Reduce Inequalities
Striving for Clean Air: Air Pollution and Public Health in South Asia
Exports to Improve Labor Markets in the Middle East and North Africa

TABLE: Major Data Releases

(Percent change y-o-y)

Recent releases: August 25, 2023 - September 24, 2023					
Country	Date	Indicator	Period	Actual	Previous
Germany	8/25/23	GDP	Q2	-0.1%	-0.3%
Nigeria	8/25/23	GDP	Q2	2.6%	2.4%
Mexico	8/30/23	GDP	Q2	3.6%	3.8%
United States	8/30/23	GDP	Q2	2.5%	1.8%
France	8/31/23	GDP	Q2	1.0%	0.8%
India	8/31/23	GDP	Q2	7.8%	6.1%
Indonesia	8/31/23	CPI	AUG	3.3%	3.1%
Türkiye	8/31/23	GDP	Q2	3.8%	3.9%
Brazil	9/1/23	GDP	Q2	3.4%	4.0%
Canada	9/1/23	GDP	Q2	1.1%	2.1%
Italy	9/1/23	GDP	Q2	0.4%	2.0%
South Korea	9/4/23	GDP	Q2	0.9%	0.9%
Australia	9/5/23	GDP	Q2	2.1%	2.4%
South Africa	9/5/23	GDP	Q2	1.6%	0.2%
Euro area	9/7/23	GDP	Q2	0.5%	1.1%
Japan	9/7/23	GDP	Q2	1.7%	1.8%
Saudi Arabia	9/7/23	GDP	Q2	1.2%	3.8%
China	9/8/23	CPI	AUG	0.2%	-0.2%
Argentina	9/13/23	CPI	AUG	124.4%	113.4%
Argentina	9/19/23	GDP	Q2	-4.9%	1.4%
United Kingdom	9/20/23	CPI	AUG	6.3%	6.4%

(Percent change y-o-y)

Upcoming releases: September 25, 2023 - October 31, 2023				
Country	Date	Indicator	Period	Previous
United States	9/28/23	GDP	Q2	1.8%
France	9/29/23	CPI	SEP	4.6%
United Kingdom	9/29/23	GDP	Q2	0.2%
Indonesia	10/1/23	CPI	SEP	3.3%
China	10/9/23	CPI	SEP	0.2%
India	10/12/23	IP	AUG	5.7%
Mexico	10/12/23	IP	AUG	4.8%
United States	10/12/23	CPI	SEP	3.7%
Euro area	10/13/23	IP	AUG	-2.0%
China	10/16/23	GDP	Q3	6.3%
Canada	10/17/23	CPI	SEP	3.9%
United States	10/17/23	IP	SEP	0.2%
South Africa	10/18/23	CPI	SEP	4.8%
Japan	10/19/23	CPI	SEP	3.1%
Australia	10/24/23	CPI	Q3	6.1%
South Korea	10/25/23	GDP	Q3	0.9%
Spain	10/27/23	GDP	Q3	2.2%
Euro area	10/31/23	GDP	Q3	0.5%
Germany	10/31/23	GDP	Q3	-0.1%
Italy	10/31/23	GDP	Q3	0.4%
Mexico	10/31/23	GDP	Q3	3.6%