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World Economic Outlook in Autumn 2023: The Economy is Holding out Against Rising Interest Rates

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- Global growth is expected to slow to 3.0% in 2023, down from 3.5% in 2022. This is primarily due to the tightening of monetary policy to cut inflation. In 2024, the world economy should grow at the same pace (3.0%) which will still be below its pre-COVID average, as the continuing slowdown in advanced countries is being offset by more robust growth in certain emerging ones.

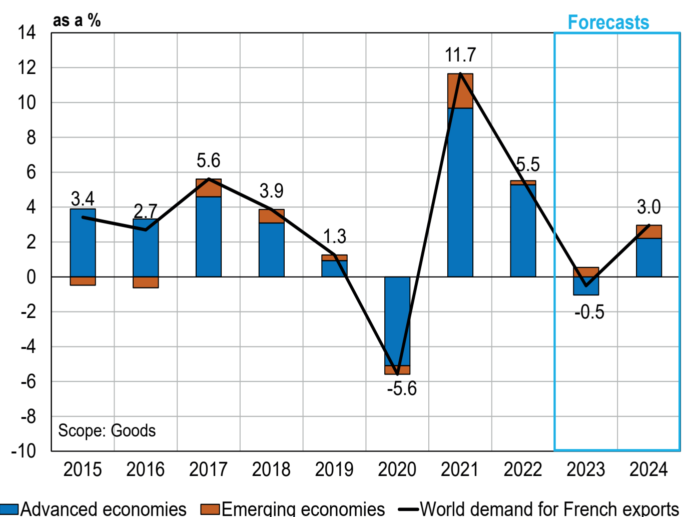
- In advanced economies, economic activity held up better than projected during the first half of 2023. In Europe, the supply of energy this winter has been secured and the supply-chain problems facing businesses have eased. The slowdown in growth in 2023 and 2024 is chiefly the result of monetary tightening and its effect on investment. Each country's growth path is also contingent on its residual catch-up capabilities following the COVID-19 pandemic, especially as regards consumption, which are greater in the euro area than in the United States, and on the extent of its exposure to world trade which is putting a drag on Germany in particular.

- In emerging economies, growth is set to remain vibrant overall in 2023 but could show the first signs that it is running out of steam. As an example, China should experience a more limited recovery (+5.0%) than first forecast, due to the weak upturn in consumption and little support from the authorities against the backdrop of the real estate crisis. In 2024, it is estimated that most emerging economies will benefit from a reduction in inflationary pressure and the relaxing of monetary policies.

- It is projected that world trade will slow significantly in 2023 in the wake of the severe contraction in trade during winter 2022-2023, before returning to normal levels in 2024. World demand for French exports (see Chart) should fall slightly in 2023 due to lower imports in advanced countries before bouncing back in 2024, driven by faster growth in the euro area.

- The main risks to this scenario are changes to inflation and the effect of monetary policy on economic activity and on the financial sector.

Annual growth in world demand for French exports



Source: DG Trésor.

1. The scenario's assumptions: high interest rates and oil prices

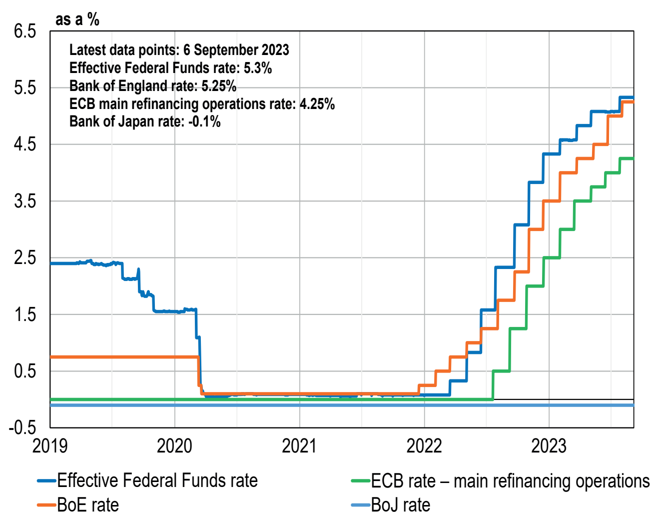
The international forecasts put forward in this paper are based on assumptions about future financial conditions, commodity prices and fiscal policy, with a cut-off date of 21 August 2023.

The central banks of the major advanced economies continued with their monetary tightening during the first half of 2023 albeit at a slower pace than for the previous six months. Quantitative tightening,[1] i.e. the reduction of central banks' balance sheets, also slowed following the banking turmoil in the United States – requiring Fed intervention – but sped up in the euro area. The forecasts include the start of cuts to key rates at the end of 2023 for the Fed and in early 2024 for the Bank of England (BoE), in line with market expectations. The European Central Bank's (ECB) rate is expected to fall slightly in 2024.[2] The situation varies in the emerging economies: China introduced a series of easing measures starting in January 2023 and Brazil should do the same during the second half-year. Conversely, rate increases have been limited in India but more prominent in Turkey where they should continue to rise owing to inflation (see Box 3).

Long-term rates rose suddenly with the fast tracking of monetary tightening during summer 2022,[3] in response to increased expectations surrounding inflation and central banks' announcements of future increases. Sovereign rates subsequently levelled off between Q4 2022 and Q2 2023, and forecast levels should remain similar to current ones.[4]

In Europe, fiscal policy is expected to be characterised by the continued phasing out of support measures introduced to counter the energy crisis. However, government investments should still be sustained with rollout of the national recovery and resilience plans (NRRPs). In the United States, fiscal policy is set to focus on the major investment plans introduced by the Biden administration, such as the Inflation Reduction Act (IRA), with disbursements rising in 2024. Fiscal policy in the United Kingdom should tighten in 2023 with a corporation tax hike and a cut in business investment support measures. In China, production support policies (relief from and deferral of charges) are expected to be maintained in 2023. In Brazil, the increase in welfare benefits (*Bolsa Familia*), which was decided on in early 2023, should also be maintained and this should buttress consumption.

Chart 1: Level of main key rates



Source: Fed, Bank of England, European Central Bank, Bank of Japan.

Forecasts for the price of a barrel of Brent (European benchmark) are based on unchanged oil prices. The price used is $86.1 (€78.7), which represents the average from 2 to 21 August 2023. The euro exchange rate has also been frozen at $1.09 over the same reference period.

(1) The Fed began to reduce its balance sheet in June 2022 and the ECB in November of the same year. Overall, the Fed cut its balance sheet by $579bn (i.e. almost 2.5% of 2022 GDP) between April 2022 (date of its highest level) and June 2023, on a balance sheet that accounted for around 35% of GDP. The ECB shrank its balance sheet by €1,212bn (i.e. 9% of 2022 euro area GDP) between June 2022 and June 2023, on a balance sheet that accounted for around 66% of GDP.

(2) As a quarterly average, the Fed's key rate is expected to peak at 5.4% in Q4 2023 before falling to 4.2% in Q4 2024. That of the BoE should peak at 5.9% in Q1 2024 before falling to 5.5% at the year end. It is projected that the ECB's deposit facility rate (the interest banks receive for depositing money with the central bank overnight) will reach 4.0% in Q1 2024 before falling to 3.4% at the year end.

(3) The ECB and the Fed carried out respective rate hikes of 50 basis points and 75 basis points in July, with the BoE carrying out a 50-basis-point increase in August

(4) On average in Q2 2023, 10-year rates were 2.3% for Germany, 3.9% for the United Kingdom and 3.6% for the United States.

2. A slowdown in global growth compared to 2022

Table 1: World growth forecasts

	2015-2019 average	2020	2021	2022[a]	2023	2024	Cumulative since 2019[b]		
					(forecasts, working-day ajusted)		2022	2023	2024
World growth	**3.4**	**–2.8**	**6.3**	**3.5**	**3.0**	**3.0**	**6.9**	**10.2**	**13.5**
Advanced economies[c]	**2.1**	**–4.2**	**5.5**	**2.7**	**1.7**	**1.3**	**3.7**	**5.4**	**6.8**
Euro area[d]	2.0	–6.2	5.4	3.4	0.9	1.3	2.2	3.1	4.5
Germany	*1.7*	*–4.2*	3.1	*1.9*	*–0.1*	*1.1*	*0.7*	*0.6*	*1.6*
Spain	*2.8*	*–11.3*	5.5	*5.5*	*2.4*	*1.5*	*–1.3*	*1.0*	*2.5*
Italy	*1.0*	*–9.0*	7.0	*3.8*	*1.0*	*0.7*	*1.0*	*2.0*	*2.7*
United Kingdom	2.1	–11.0	7.6	4.1	0.5	0.8	–0.3	0.1	1.0
United States	2.4	–2.8	5.9	2.1	2.1	0.8	5.1	7.3	8.1
Japan	0.9	–4.3	2.3	1.0	2.3	1.2	–1.1	1.2	2.4
Emerging economies[c]	**4.3**	**–1.8**	**6.8**	**4.0**	**4.0**	**4.2**	**9.1**	**13.4**	**18.2**
Brazil	–0.5	–3.3	5.0	2.9	2.3	1.3	4.5	6.9	8.3
China	6.7	2.2	8.4	3.0	5.0	4.5	14.1	19.8	25.2
India[e]	6.7	–5.8	9.1	7.2	6.2	6.5	10.1	16.9	24.5
Turkey	4.1	1.9	11.4	5.6	3.8	3.6	19.8	24.4	28.9
World trade in goods[f]	2.9	–4.7	12.6	4.1	0.3	3.6	11.7	12.0	16.1
World demand for French exports	3.4	–5.6	11.7	5.5	–0.5	3.0	11.3	10.7	13.9

a. 2022 figures are estimates using data available on the forecast cut-off date (21 August 2023).This means that they do not include changes to the United Kingdom's Blue Book released on 1 September 2023.
b. This is the cumulative change to GDP between 2019 and each of the years from 2022 to 2024.
c. Aggregate forecast figures for advanced economies and emerging economies are estimated based on IMF projections from July 2023 with past figures adjusted using the last available quarterly national accounts (Q2 2023 in most cases) and forecast figures adjusted using DG Trésor projections for the countries in the table above. The forecast for world demand for French exports no longer includes a forecast for the Russian economy due to the collapse of bilateral flows following the trade sanctions taken against that country.
d. The euro area aggregate derives from quarterly accounts with past figures. Forecast figures are estimated on the basis of OECD projections for June 2023 adjusted by those of DG Trésor for Germany, France, Italy and Spain.
e. India's growth is for the fiscal year which runs from April of year n to March of year n+1.
f. World trade is calculated as the total imports of 40 countries, accounting for 85% of global imports.

Sources: IMF, World Economic Outlook Update, July 2023; OECD, Economic Outlook, June 2023; calculations and forecasts by DG Trésor.

2.1 Tempered global growth

In 2023, global growth is expected to slow to 3.0% (see Table 1), a figure which is less than both that of 2022 (3.5%) and the pre-COVID average[5] (3.4%). This slowdown is especially due to the increase in financing costs and stricter conditions for granting loans in the majority of major economies caused by the tightening of monetary policies. Nevertheless, this growth should be higher than that projected by DG Trésor in the springtime,[6] bearing witness to better performance levels than expected in most advanced countries during the first half-year. The gap in growth between advanced economies and emerging ones is set to widen in 2023 with economic activity remaining strong in emerging countries (4.0%), with sustained growth in India and the recovery in China following the phasing out of the zero-COVID policy, even if this is more limited than expected. On the other hand, economic activity could slow significantly in advanced countries (+1.7%, after +2.7%), with growth being particularly flat in the United Kingdom and Germany.

In 2024, the world economy is expected to grow at the same pace as in 2023 (3.0%). Overall, economic

(5) Calculated for the period 2015-2019.
(6) See B. Alvarez et al. (2023), "World Economic Outlook in Spring 2023: The Economy Reaches Its Trough", *Trésor-Economics* No. 325.

activity should continue to slow in the advanced economies (+1.3%), with different scenarios depending on the zone. It is anticipated that it will fall back considerably in the United States, where household consumption will be hampered by the depletion of the excess savings accumulated during the COVID-19 pandemic and by more limited access to consumer loans. Conversely, in the euro area, consumption and economic activity will be underpinned by the decline in inflation and the increase in real wages. Growth in emerging and developing countries will rise slightly (4.2%), with the slowdown in Asia being offset by the recovery in other regions (Latin America excluding Brazil, Middle East, Central Asia and Sub-Saharan Africa).

World trade in goods is set to fall very substantially in 2023 (+0.3% vs +4.1% in 2022), before recovering next year (+3.6%). In 2023, the near-stagnation of world trade has been due to the sharp fall in trade in Q4 2022 and Q1 2023 owing to the new wave of COVID-19 in China in late 2022, the slowing of manufacturing output and the reduction of stocks built up at times of extreme supply-chain problems. These factors have faded during 2023 leading to a gradual recovery of trade which is still, however, reined in by lacklustre global activity. Growth in world trade should be driven by the emerging countries whereas the advanced economies' contribution is projected to be negative. In 2024, the growth in global trade is expected to reach 3.6% which is higher than its pre-COVID level, and this will be mainly due to the subsiding of the base effects having caused the substantial slowdown in trade in 2023.

World demand for French exports will likely contract in 2023 (-0.5%), before bouncing back in 2024 (+3.0%). French exports, which are highly dependent on European countries,[7] should be especially held back by the drop in demand from Germany, Italy and the United Kingdom in 2023. In 2024, it is estimated that world demand for French exports will bounce back in the wake of world trade, and be buoyed up, inter alia, by improved euro area growth.

Box 1: Security of the gas supply in the European Union in the run-up to winter 2023-2024

Gas accounts for a substantial proportion of the energy mix (23% of gross available energy[a] in 2021) of the European Union (EU), especially for electricity generation, heating buildings and industrial activity. As the EU's gas production covers less than 20% of consumption, it is strongly reliant on imports via pipelines and, to a lesser extent, by sea transport in the form of liquefied natural gas (LNG).[b]

In 2022, the reduction in deliveries from Russia via the Nord Stream and Yamal pipelines[c] caused serious concerns about the supply of gas for winter 2022-2023. The EU ultimately managed to get through the winter without a break in supply due to: (i) use of other sources of supply and, in particular, a sharp increase in LNG imports from non-EU countries, allowing for gas stocks to be filled to 95% on 1 November 2022 (vs 77% in 2021), at the expense of restocking at a very high cost in summer 2022; and (ii) a substantial reduction in European demand (−16% between April 2022 and March 2023 in relation to the previous five years), owing to a rise in electricity generation by renewable energies and coal, a mild winter and efforts to save energy from all the economy's stakeholders, in particular industry (see Chart 3).

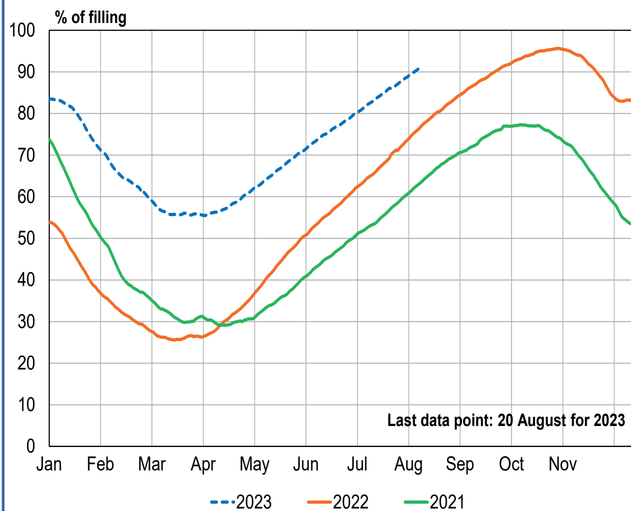
Since April 2023, European gas stocks have been replenishing very rapidly. On 20 August 2023, the EU's stocks were filled to 91% of capacity, a very high level compared to past figures (see Chart 2). Owing to the risks weighing on the security of the gas supply in the EU, the Commission requires the Member States to have a minimum gas storage filling level of 90% of capacities on 1 November 2023. With the current rate of filling, EU stocks could be almost replenished at the end of September. These stocks would allow coverage for around two months of winter consumption, or three months if the same energy savings efforts as last year are again implemented.

a. Gross available energy is the overall energy supply for all sectors of the economy.
b. Gas is transported by LNG tankers in liquified form to reduce its volume. It is then regasified in LNG terminals before being injected into the European transmission network.
c. The Yamal pipeline connects the Russian gas fields in the Yamal Peninsula with Germany, via Belarus and Poland. The Nord Stream pipeline connects Russia to Germany via the Baltic Sea.

(7) In 2022, 68% of French exports were destined for the European market.

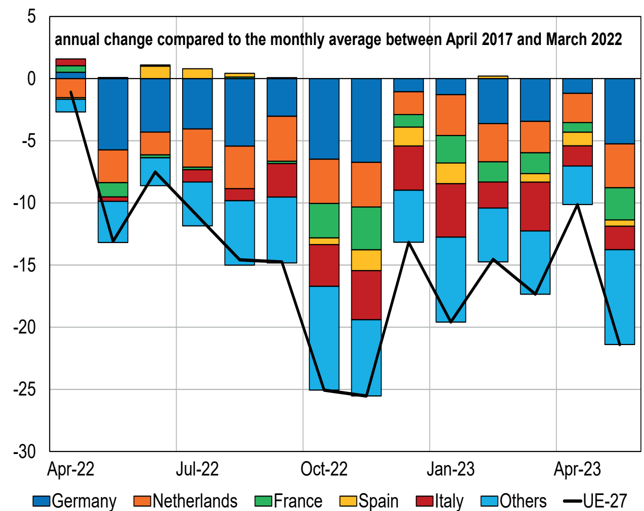
In addition, to ensure energy security for winter 2023-2024, the EU could boost its supplies during the winter months, in particular supplies of LNG. Global LNG supply should increase this winter: the United States should significantly bolster its exports to meet European and Asian demand, with the latter being dictated by the extent of the recovery of growth in China.

Chart 2: Level of gas storage filling in the EU



Source: GIE (Gas Infrastructure Europe).

Chart 3: Breakdown of changes to gas consumption in the EU by country, compared to the monthly average between April 2017 and March 2022



Sources: Eurostat, DG Trésor calculations.

2.2. Faltering growth in the advanced economies

Growth in the major advanced economies is set to slow substantially in 2023 and to a lesser extent in 2024 without, however, these countries entering a recession, with the telling exception of Germany in 2023. The continuing tightening of monetary policy is expected to have an adverse effect on business and household investment, whilst a recovery in household consumption due to lower inflation should gradually pick up the baton to support growth in the majority of economies. Some countries, such as Spain and Germany, will likely profit from substantial post-COIVID catch-up effects in their domestic demand.

In the United States, growth in 2023 is projected to be unchanged from 2022 at 2.1%. Economic activity was more robust than expected during the first half-year and was underpinned by household consumption. However, it is estimated that it will slow significantly in 2024 (+0.8%). Starting in the second half of 2023, household consumption is expected to be less robust owing to the increase in the cost of borrowing and the fact that the excess savings accumulated during the COVID-19 pandemic have now been mostly depleted. It is likely that household spending will also be reined in by the slowdown in the labour market and the resumption of student loan repayments which have been frozen since the pandemic.[8] Business and household investment is set to fall slightly due to restrictive borrowing terms. Consumption and, to a lesser extent, investment, should only recover at the end of the period thanks to increased purchasing power and the major investment plans introduced by the Biden administration.

Germany's GDP is set to fall very slightly in 2023 (−0.1%) before reverting to positive growth in 2024 (1.1%). In 2023, the economy is expected to be penalised by its dependency on sluggish world trade and be dragged down by energy-intensive industries facing the drop in Russian gas supplies. The increase in the ECB's key rates and the prevailing uncertainty

(8) In March 2020, the Trump administration paused student loan repayments and the arrangement was extended by the Biden administration, which even wrote off part of this debt before the Supreme Court blocked the measure in June 2023. To mitigate the resumption of repayments for borrowers, the Biden administration introduced the Saving on a Valuable Education (SAVE) plan. Repayments of student loans will start up again in October 2023 more than three years after they were frozen.

should weigh on investment, in particular in the residential housing construction sector. Household consumption, which is the main growth driver, is projected to recover gradually over the forecast period thanks to savings rate normalisation and wage momentum, in a labour market under strain.

It is estimated that growth in the United Kingdom[9] will slow sharply in 2023 (0.5%) before recovering slightly in 2024 (0.8%). The 2023 slowdown is due, inter alia, to the decline in investment starting in the second half of the year in the wake of the tightening of borrowing terms, the phasing out of the accelerated depreciation policy, known as the "super-deduction", and the increase in corporation tax. Despite higher inflation than in the main advanced economies, household consumption should hold out in 2023 and become stronger in 2024, buttressed by the gradual fall in inflation and wage hikes.

Italy is expected to experience a significant slowdown in growth in 2023 (1.0%) and 2024 (0.7%), after having over-performed compared to its European neighbours in the wake of the COVID-19 pandemic. Over the forecast period, economic activity (at quarterly rates) will be principally driven by private consumption on the back of higher real income. Private investment, which was strongly underpinned by energy retrofitting support measures in 2021 and 2022, is set to slow sharply after their partial phasing out as from Q2 2023, and due to the rise in borrowing costs. Government investments should continue to be spurred by the European recovery plan (see Box 2).

In Spain, after two strong years following the COVID-19 pandemic, growth will likely fall off in 2023 (2.4%) and 2024 (1.5%), while remaining above the euro area average. Household consumption, which was still 3.4 points below its pre-COVID level in Q2 2023, should be boosted until the end of 2024 by catch-up effects and lower inflation, that are already among the lowest in the euro area. It is projected that investment, hampered by monetary tightening, will continue to be buttressed by the European recovery plan.

In Japan, growth is expected to continue being driven by the post-COVID catch-up effect in 2023 (2.3%) and 2024 (1.2%). It is estimated that household consumption will rise slightly thanks to use of the excess savings accumulated during the pandemic and falling inflation. In addition, the increases agreed upon in April during the annual wage negotiations (*Shunto)* point towards higher nominal wages in 2023, which should help support both household income and consumption. Investment is set to be strong and should gradually revert to its pre-COVID level due, primarily, to public and private investment projects in the green transition and digitalisation.

Box 2: The outlook for investment against the backdrop of high rates

In the face of high inflation, central banks in the main advanced economies began a monetary tightening cycle with varying timelines and scope depending on the monetary zone. The BoE was the first to raise its key rates (by 515 basis points since December 2021), followed by the Fed (by 525 basis points since March 2022) and the ECB (by 425 basis points since July 2022).

The rise in key rates has led to stricter terms for granting loans and an increase in borrowing costs. Since tightening began, interest rates for new mortgages have jumped sharply in the United States (from 4% to 7%) and in the euro area (from 2% to 4%). As mentioned by the OECD,[a] lending rates for firms have increased faster than for households. The increase for businesses is also higher in the euro area (bank lending rates up three points for non-financial corporations) than in the United States (corporate bond yields up two points).[b]

a. OECD Economic Outlook, Volume 2023 Issue 1 of 7 June 2023, Box 1.1, "Monetary policy pass-through to household and corporate credit financing conditions: a preliminary assessment".

b. American firms seek financing more on the bond market than the bank market. In Q1 2023, companies' outstanding debt comprised 60% of debt securities, 89% of which were corporate bonds. To gauge businesses' financing costs, we are using Moody's Seasoned Baa Corporate Bond Yield covering corporate bonds subject to moderate credit risk.

(9) As the cut-off date for the forecasts was 21 August 2023, these figures do not factor in the statistical changes to the Blue Book (from 1997 to 2021) on 1 September 2023, which increased the level of the UK's GDP by around 2%.

The increase in rates has led to a decline in demand for new loans, putting a drag on household (residential real estate) and business investment. As the tightening is more robust and began earlier, the impact has already been substantial in the United States, where investment in residential real estate has plummeted since Q2 2022. In the euro area, the consequences for business investment were partially offset in 2022 and 2023 as (i) the relaxing of supply-chain problems enabled the number of back orders to be brought down from mid-2022; (ii) higher business profits meant that part of the financing requirement was able to be soaked up; and (iii) some support programmes stimulated investment, especially in Italy, where it was 20 points above its pre-pandemic level in Q1 2023, thanks to incentive schemes for energy renovation (Superbonus) and the modernisation of businesses' production processes (both included in NRRP funding), which were nevertheless partly phased out starting in 2023.

The consequences of monetary tightening are set to heighten over the forecast period as the transmission of monetary policy to real activity takes time. This transmission time also differs across countries,[c] depending on the organisation of domestic financial markets, the distribution of household income and debt structure.[d]

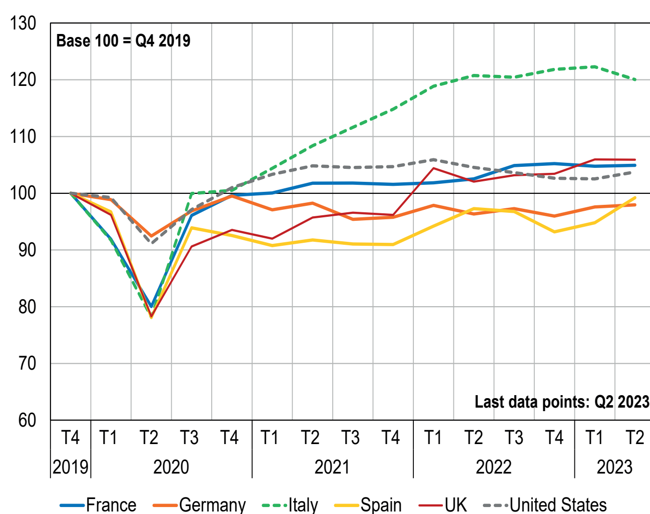
The impact of monetary tightening should be mitigated by fiscal support for public and private investment in the euro area and the United States:

- In southern European countries, the NRRPs, financed by European funds, support investment. These plans are set to ramp up over the forecast period with budgeted amounts of 2.1% and 2.4% of GDP in Italy in 2023 and 2024, and 2.6% of GDP in Spain in 2023.[e] While initiatives were mainly focused on private investment in Italy up to 2023, they will shift more towards public infrastructure in 2024.
- In Germany, where the NRRP does not have a comparable scope, investment is expected to be supported by the Climate and Transformation Fund (KTF), which is earmarking expenditure of 0.9% of GDP in 2023 and 1.5% in 2024.
- In the United States, several investment plans, including the Inflation Reduction Act (IRA) were adopted in 2021 and 2022,[f] with budgeted amounts accounting for 0.4% of GDP in 2023 and 0.5% in 2024.

The scale of these positive factors depends on each country's ability to absorb the funds. This especially applies to Spain and Italy, where the rollout of programmes is already behind schedule and where there are likely to be continuing problems with disbursing the funds due, among other things, to rising input costs, hiring difficulties, and, in Spain, the lack of political stability.

Conversely, in the United Kingdom, support for private investment has weakened: the super-deduction for business investments was phased out at the end of March 2023[g] and corporation tax increased from 19% to 25% on the same date.

Chart 4: Total investment (private in the United States) in the main advanced economies



Source: National statistics institutes.

c. Empirical works flag up long and highly uncertain transmission times: it is estimated that changes to monetary policy take between 18 and 24 months to filter through to prices.

d. See Box 1.2. in Chapter 2 of the IMF's World Economic Outlook report from April 2023.

e. The amount for 2024 is not yet known and will be contingent on (i) actual disbursement figures for 2023 and (ii) the breakdown of the total budgeted amounts for the period 2024-2026 (the government plans to use more than an additional 7% of GDP).

f. The Infrastructure Investment and Jobs Act (IIJA), a 10-year plan for investment in infrastructure (promulgated in November 2021); the CHIPS and Science Act, aimed at bolstering the competitiveness of American industry by grants to semi-conductor industries and investments in public R&D (promulgated on 9 August 2022); the Inflation Reduction Act (IRA), which has the primary objective of increasing energy security and furthering the green transition (promulgated on 16 August 2022).

g. The super-deduction was a 130% first-year capital allowance granted to businesses investing in plant and machinery assets. The measure took effect in 2021 and was phased out at the end of March 2023. The "full expensing" scheme which has replaced it will run from April 2023 until 2026.

2.3. Vibrant emerging economies in 2023 despite a weak recovery in China

In China, growth is expected to bounce back to 5.0% in 2023 (after 3.0% in 2022). Despite the phasing out of zero-COVID measures in December 2022, the recovery of growth during the first half of 2023 was weaker than projected. Consumption has picked up less than expected, private investments were slack during the first six months and the situation in the real estate sector is continuing to worsen. Support measures for that sector,[10] manufacturing, and the easing of monetary policy have so far been limited and fairly ineffective (see Box 3). Growth is set to fall to 4.5% in 2024 as usual growth channels such as real estate and investment run out of steam, while growth in productivity contracts and the population continues to age. Due to a lack of rebalancing of domestic demand, uncertainty surrounds the sustainability of the Chinese growth model.

In Turkey, growth is projected to slow to 3.8% in 2023 (compared to 5.6% in 2022), owing to galloping inflation and persistent external imbalances (depreciation of the Turkish lira and low foreign exchange reserves). Annual growth should result essentially from the first half-year, when domestic demand was driven by pre-election support measures, monetary easing and reconstruction following the earthquakes in February. During the second half of 2023, investment and private consumption will likely be affected by the increase in the cost of borrowing caused by the central bank's restrictive U-turn. In 2024, growth is expected to fall to 3.6% due to the continuation of a restrictive monetary policy and the lack of measures to buttress demand.

In India, growth is set to fall to 6.2% in 2023/2024[11] (from 7.2% in 2022/2023) against a backdrop of declining global demand, monetary tightening and fiscal consolidation. In 2024/2025, growth should pick up again to 6.5% on the back of continued investments in infrastructure and increased household consumption, and a more accommodative monetary policy thanks to the expected drop in inflationary pressure.

In Brazil, growth is expected to be robust (2.3%) in 2023 owing to unprecedented harvests and strong agricultural exports during the first half-year (up 40% compared with the first six months of 2022), and to resilient domestic demand despite interest rates being kept high by the Central Bank of Brazil (BCB) during the first half-year (13.75%); these rates should be cut by the year end. In 2024, Brazilian growth is projected to fall to 1.3% (reflecting a major base effect), in spite of fiscal support for consumption, the continuation of monetary easing which began in 2023 and the gradual rollout of reforms in favour of investments.

(10) The Chinese authorities have encouraged commercial banks to grant fresh financing to the most serious real estate developers and to renegotiate developers' defaulted loans.
(11) The benchmark calendar is the fiscal year which starts in April of year N and ends in March of year N+1.

Box 3: Momentum of inflation and monetary policy in the major emerging economies

After having peaked at the end of 2022, inflation is expected to fall in the majority of emerging economies in 2023 and 2024. This contraction is expected to result from the decline in energy and food prices, and the monetary tightening carried out by most central banks since 2022, in particular in India and Brazil. Among the major emerging economies, the inflation rate and monetary policy strategies are set to remain divergent in 2023. According to the World Bank's June forecasts for 2023,[a] inflation should remain moderate in China (2.1%), whilst falling in India (4.8%), Brazil (5.6%) and Turkey where it is nevertheless projected to remain very high at over 40%.

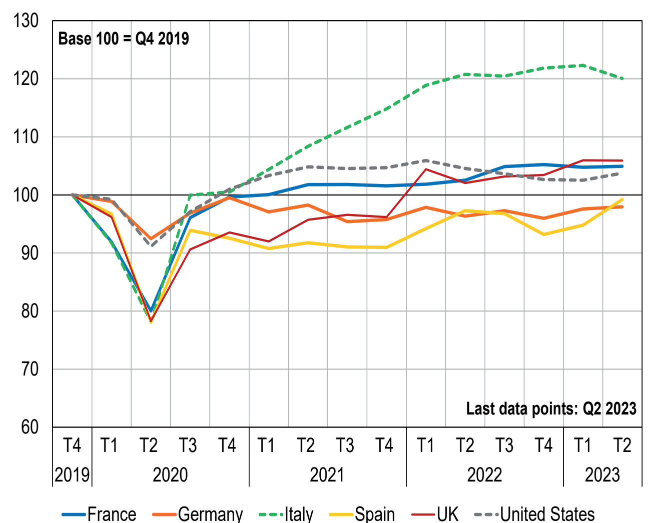
Inflation is especially low in China (0.7% for the first-half of 2023 and −0.3% year-on-year in July), due to cyclical factors (lower pork prices since October 2022, discount on electric vehicles) and structural ones (slack consumption and high levels of savings, new urban dwellers continuing to enter the labour market and accepting low wages, regulated electricity and gas prices). As the recovery of economic activity during the first six months was weaker than expected, the People's Bank of China (PBoC) continued with its easing measures by lowering its key rates in June and August 2023, but it is still reined in by the depreciation of the yuan against the dollar (−4.8% since January 2023),[b] and, above all, by the determination of households and businesses to pay down debt rather than consume or invest. In addition, public investment remains high but the rate of return is declining due to already-high capital stock, in particular in infrastructure.

In India, due to rising inflation (6.7% as an annual average over 2022 and 7.4% year-on-year in July 2023), the Central Bank raised its key rates to 6.5% (i.e. up 250 basis points since May 2022). It is not expected to lower these rates until 2024 so as to anchor expectations, especially as much uncertainty surrounds inflation forecasts. Indeed, climate-related factors, such as the monsoon and El Niño, could have an adverse effect on harvests and provoke fresh food price rises. In the short-term, household consumption will likely be held back by continuing high prices and the increase in key rates since more than one year ago (half of household loans are indexed to the key rates).

In Brazil, the monetary tightening introduced by the Central Bank of Brazil (BCB) to counter inflation has enabled it to reduce inflation which is projected to level out at an average of 5.6% for 2023 according to the World Bank. This is a significant drop compared to its April 2022 peak of 12.1% but is above the inflation target of 3.0% set by the National Monetary Council in June. The BCB has kept an extremely high key rate of 13.75% since August 2022 and this has put a drag on consumption and investment. Following several months of tension between the new Brazilian government and the BCB, the latter announced that there would be a reduction of the rate of up to 2.25 points by the end of 2023. This was materialised by an initial 0.5 point cut in August bringing the key rate down to 13.25%.

Since summer 2021, the Central Bank of the Republic of Turkey (TCMB) has been conducting a monetary easing policy aimed at supporting growth rather than ensuring price stability. The policy has caused significant depreciation of the Turkish lira, very high inflation (72.3% as an annual average in 2022 after 19.6% in 2021), which has been intensified by commodity price hikes, and the depletion of foreign exchange reserves. There has been severe monetary tightening since the general election in May with three successive increases of the key rate which rose from 8.5% to 25% at the end of August 2023. Despite this monetary tightening, inflationary pressure is expected to remain prevalent with the TCMB predicting inflation of 58% at the end of 2023.

Chart 5: Inflation (year-on-year, %)



Source: National statistics offices.

a. Global Economic Prospects, June 2023. For most economies, and in particular for China, the World Bank's forecasts do not include Q2 data.

b. At 11 August 2023.

3. Monetary tightening and its impact are the main risks to our scenario

Whilst the risks relating to this international scenario are still declining, they seem to be more balanced than during the spring 2023 forecasts as a number of downside risks have faded away. In Europe, the risk to the gas supply during winter 2023-2024 seems limited due to high storage levels, efforts to save energy and the successful diversification of sources of supply (see Box 1). The collapse of American banks in March 2023 did not cause widespread contagion thanks to the responsiveness of the Fed which doled out emergency loans to banks. While there were major concerns about the potential of a temporary US government default in May, these were assuaged by the suspension of the debt ceiling until 2025. Pressure on agricultural prices, exacerbated by Russia's unilateral withdrawal from the grain deal on 18 July 2023 and Russian strikes against Ukrainian Black Sea ports, has been contained at present.

How monetary policy will change and the effect of the cycle of rate hikes on economic activity are the main risks to the international scenario. This change will be determined by the trajectory of inflation – especially core inflation which is closely monitored by the central banks – and also by its transmission times to the economy, and the extent of its impact on borrowing terms and the prices of assets with both upside and downside risks. The increases in key rates decided on by the central banks of the major advanced economies are unprecedentedly high which means that their effects on economic activity are especially uncertain. Businesses could further tap into their margins to maintain investment levels or, conversely, find that their financing is severely restricted by the tightening of terms for granting loans. The rise in rates also generates risks on the financial markets with a possible fall in the prices of assets which would generate tension in the financial sector.

The change in commodity prices is a major determinant for the forecast, in particular, that of oil prices which are still volatile and high despite being lower than in 2022. To a lesser extent, the price of European natural gas was rather volatile during summer 2023: the increase in imports of LNG since the Russian invasion of Ukraine means that the European gas market is exposed to fluctuations on global spot markets. Downward or upward price adjustments could have a medium-term impact on core inflation.

Uncertainty surrounds the development of the geopolitical situation. An escalation of tensions, against the backdrop of the Russian invasion or in the China Sea, could disrupt global value chains. Conversely, a ceasefire or even peace between Ukraine and Russia could reassure both the financial and energy markets.

Changes to trade policies will broadly determine the momentum of world trade. If the increase in trade restrictions, which were introduced in the context of the COVID-19 pandemic, the war in Ukraine and the Sino-American conflict, were to continue, world trade could be held back even further. On the other hand, the recent changeover of the United States' position vis-à-vis China to a de-risking strategy by diversifying trading partners, rather than total decoupling, could be beneficial to world trade over the forecast period. The development of global trade could also be affected by the scope of the Chinese economic recovery in 2023 and, especially consumption which appears to be focused, at present, essentially on services.

Lastly, global warming is a structural risk which is likely to put a drag on growth in the event of extreme weather events, including in the short term.

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