MINERVA
INVESTMENT MANAGEMENT SOCIETY

MIMS – Research Area

Macro Research Team

Report – November 2023

Global macroeconomic outlook

The past years were marked by an unprecedented series of shocks: the Covid-19 pandemic and the energy crisis triggered by Russia-Ukraine conflict. Surge of inflation and the new geopolitical realities are actively redesigning macroeconomic policy. The balance of power is shifting and the old unipolar world is giving way to a multipolar one with its new powerful players. With our November report, we are aiming to give a brief review of the current macroeconomic trends in major economies, outlining their main drivers. The report covers the unexpected growth in the U.S., a case of potential stagflation in the UK, Eurozone recession fears, growth slowdown in China, a turn of Latin America towards the multipolar world, and, finally, escalation of the Israeli-Palestinian conflict.

Head of Research Area
Alessandro Archetti: +39 3386622475

Head of Macro Research
Giacomo de Michieli: +39 3403507919

Co-Head of Macro Research
Polina Mednikova: +39 3473450462

Macro Research Analysts
Matias Bonfanti: +39 3455040144
Alessandro Bosco: +39 3802453040
Francesco Casapenta: +39 3457341197
Ada Egilmez: +39 3515795201
Alessandro Pagan: +39 3505014672

The United States

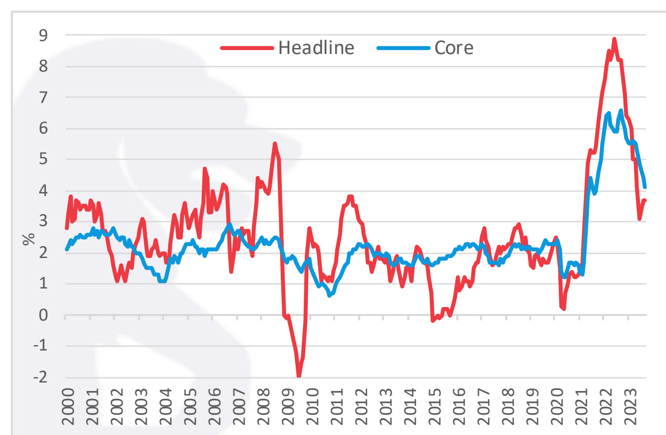
2023 has witnessed an ongoing conversation about the anticipated recession in the U.S. Several measures of the yield spread (i.e., the short minus long rates, classical predictor of the upcoming downturn), have been very low or negative since late 2022. The nominal yield spread in October predicted a 46.11% probability of a recession in 12 months, still quite high for a false positive (the probability in July 2023 was 66%).

Despite the recession anticipation, this summer the U.S. economy grew at the fastest pace since 2021. GDP grew at the annual rate of 4.9% in the third quarter of 2023, compared to 2.1% in the second quarter and surpassing market expectations of 4.3%. The growth was primarily driven by consumer spending with a substantial rise of 4% (compared to 0.8% in Q2). Strong labor market as well as the savings accumulated during the pandemic period were the main factors behind the rise in spending.

While the level of annual inflation remains elevated, with CPI increase of 3.2% in October (3.7% in September), and core CPI increase of 4.0% (4.1% in September), the Federal Reserve emphasizes that long-term inflation expectations remain anchored (Figure 1).

Figure 1

US Consumer Price Index inflation



Source: Federal Reserve Bank of St. Louis

"Higher for longer"

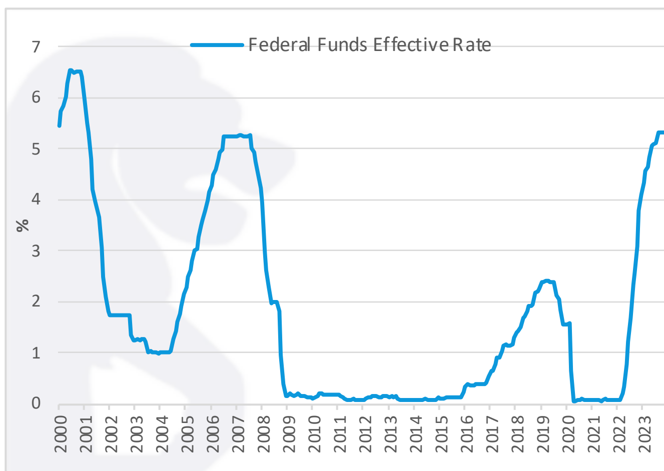
In its latest meeting on November 1st, the Fed has decided to keep interest rates steady, at a 22-year high level of 5.25-5.50% (Figure 2), so to reassess inflation data to determine future adjustment, underlying the importance of carefully considering the timing and extent of future monetary tightening.

Indeed, apart from the problem of inflation, Powell acknowledged the pressing issue of the United States' mounting debt levels ($33 trillion) in his speech on October 19th, stating that while the overall level of U.S. debt may not pose an immediate problem, it places the nation on an "unsustainable fiscal path". The nation's worsening fiscal position was also addressed in the Moody's latest rating, requiring a change in the outlook from "stable" to "negative".

The Fed's final meeting of the year is scheduled for December 13, and due to data showing cooling inflation, the policy rate is likely to remain unchanged.

Figure 2

Federal Funds Effective Rate



Source: Federal Reserve Bank of St. Louis

Hiring slowdown

Hiring in the U.S. experienced a slowdown in the past month. The October jobs report displayed a softening of the labor market characterized by an increase in nonfarm payroll of 150,000 (lower than the expected 170,000 and half the September's gain), unemployment rate rising from 3.8% to 3.9%, and average hourly earnings increasing by 0.2% from the previous month (against an expected 0.3%.). September's report was also revised, lowering estimates of jobs created to 297,000 instead of 336,000 as previously reported.

The slowdown in the payroll growth can be partly attributed to the United Auto Workers strike against Detroit's "Big Three" car companies (General Motors, Stellantis (formerly Chrysler), and Ford Motor Company) that reduced manufacturers' wages.

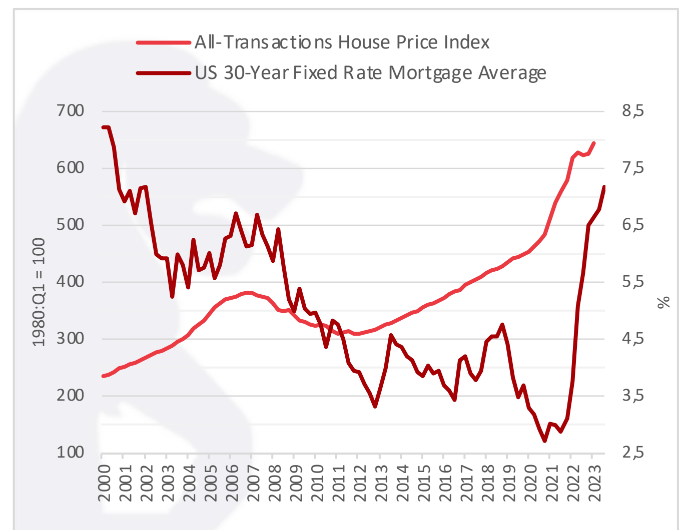
Stock markets reacted positively following the jobs data, reporting the best week in a year. The yields on Treasury notes dipped (10-year treasury yield dropped below 4.5%, to a three-week low). All of it because the October labor market data supported the anticipation of the Fed stopping with the rate hikes for now.

Decline in housing affordability

The Fed's hiking rates policy has been significantly affecting the cost of borrowing. The average 30-year fixed mortgage rate has spiked to 8%, a level unseen since the early 2000s (Figure 3). The price-to-income ratio, a significant measure of houses affordability, is at its worst since the 1980s. Housing has become less affordable: according to a recent report by Redfin, a real estate firm, homebuyers must earn $114,627 to afford a median-priced house in the U.S. At the same time the median U.S. household income was reported at a level of $75,000 in 2022.

Figure 3

US House Price Index and average 30-year fixed mortgage rate



Source: Federal Reserve Bank of St. Louis

Analysts hold contrasting views on future mortgage rates. Pessimistic forecasts (e.g., Zillow, an American real-estate marketplace), project a 2.1% increase in home prices over the next year. The main argument is that as many homeowners are locked in mortgages with interest rates below 4%, rising rates will make them less likely to sell. This means that fewer homes will go on the market, but the demand will still be high enough to increase prices.

Conversely, more optimistic outlooks like the Mortgage Bankers Association and Morgan Stanley, anticipate mortgage rates to decline to 7.2% and 5% respectively. These varying perspectives highlight the dynamic and uncertain nature of the housing market.

Canada

Economic activity in Canada slowed toward mid-2023 as businesses and households continued to adjust to higher borrowing costs. Real GDP was essentially unchanged in

Q2 2023 after expanding 0.6% in Q1. The estimations signal that the economy flatlined for the third quarter, in stark contrast to the U.S. economy, which grew at full potential.

The rising level of household debt in Canada (4.2% growth in Q2 2023 compared to Q2 2022) makes the economy more sensitive to higher interest rates than, for instance, the U.S. The latest interest rate hikes in June and July, up to 5%, should have slowed down borrowings in the second half of the year as households repay debt and try to save more.

According to Benjamin Reitzes, managing director of Canadian rates and macro strategist at Bank of Montreal, the recent economic data on Canada's growth can be taken as a "yet one more crystal-clear sign that the Bank of Canada should be done hiking,".

The inflation rate declined to 3.8% in September from 4% in the previous month, below market expectations of 4% (with core inflation at 3.2%). Such information supported Bank of Canada's decision to refrain from further rate hikes in October, waiting for the last-year meeting on the 6th of December, with policymakers paying attention to the risks of early cuts.

Rising unemployment

The unemployment rate rose to 5.7% in October from 5.5% in September, marking the fourth monthly increase in the past six months. This data is the highest since January 2022 and above market expectations of 5.6%.

The result was somewhat expected as the Bank of Canada previously warned about the notable impact of its aggressive rate hikes policy. In October, employment increased in the fields of construction, information, and culture. However, this was offset by decreases in manufacturing and wholesale.

The United Kingdom

The UK economy stagnated in the third quarter for the first time this year, avoiding a decline. The OECD forecasts UK's GDP to rise by 0.3% in 2023 and by 0.8% in 2024 (a deceleration with respect to previous 2024 growth forecast of 1.0%).

Given the context of a global economic slowdown and the delayed repercussions of fourteen consecutive increases of interest rates up to 5.25%, the British economy is going to encounter several difficulties in the latter part of the year. Also, considering the uncertainty surrounding the upcoming general election of 2024, demand strength, and the future course of interest rates, many forecasts tend to lean towards negative projections in growth.

On the latest meeting on November 2nd the Bank of England's Monetary Policy Committee (MPC) left interest rates unchanged at 5.25% for the second time in a row. Thus, analysts expect Bank of England to be likely done with policy tightening, leaving the rate at 5.25%.

Latest KPMG projections indicate that actual GDP expansion will drop from 4.3% in 2022 to a mere 0.4% in 2023 and 0.3% in 2024. Other recent projections forecast a modest 1% average growth for the UK economy in the next two years, a figure however notably lower than the 1.9% average GDP growth observed between 1990 and 2022. This projection falls within the range provided by both the OBR and the Bank of England and is primarily supported by an expected productivity growth rate of 0.9%.

Figure 4

Monthly growth of gross domestic product in the United Kingdom from January 2020 to September 2023

Source: Office for National Statistics

Inflation remains high

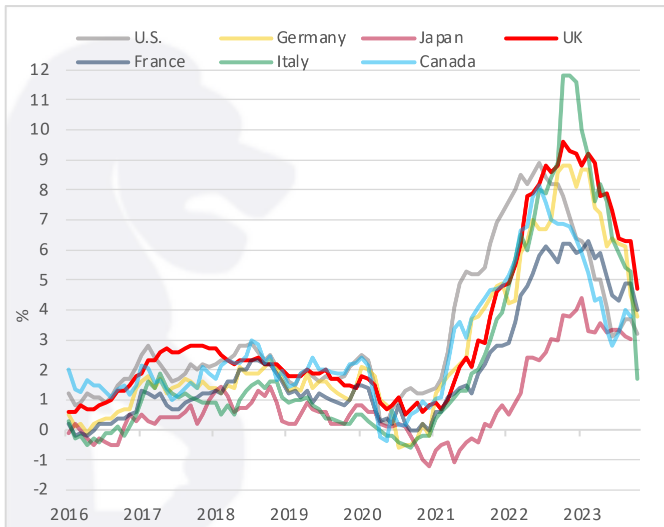
Despite the stagnation, inflation rates remained well above the target of 2%. Prices rose by 6.7% in September, which is the highest headline inflation in the G7 (Figure 5), and nearly double the rate in the U.S. Core inflation (5.9%) also remained the highest in the G7, and more than 2 pp higher than that of the U.S. Hence, the global stagflation scenario is one of the major risks for the UK. Besides, possible commodity market shocks amid intensifying conflicts in Israel and Ukraine have the potential to reaccelerate headline inflationary pressures and force the BoE to tighten its policy.

Regarding consumer spending, the forecast is quite lackluster compared to historical norms. In fact, according to recent surveys conducted by the BoE, the demand is increasingly influenced by discounts, leading to reduced expenditures on domestic vacations and

dining out. Private car registrations (an alternative economic growth indicator) have increased by 0.9% year-to-date, while they averaged 11.26% from 1991 until 2023. Retailers and the hospitality industry continue to witness sales driven by higher prices, resulting in reduced sales volumes as consumers scale due to decreased purchasing power caused by high inflation. In this scenario, most analysts anticipate a modest 0.5% increase in consumer spending for 2024.

Figure 5

CPI inflation in G7 countries, January 2016 to October 2023



Source: Federal Reserve Bank of St. Louis, Destatis, Istat, INSEE, Office for National Statistics, Statistics Canada, Ministry of internal affairs and communications of Japan

Housing market past its "peak"

The market is gradually adapting to the impact of prolonged high interest rates. In July, mortgage approvals declined by 22% compared to the previous year, while property transactions dropped by 16%. This decline can be attributed to the increase in mortgage rates that eventually leads to a heightened risk of loan defaults, which in turn imposes additional costs on lenders. According to most recent BoE projections, approximately 350,000 households in the UK are expected to experience a significant monthly mortgage payment increase of more than £500 by the end of 2023.

Regarding the supply side, the number of residential housing completions decreased notably at the beginning of the year, aligning with the weakness observed in construction output and residential PMI data. Forecasts anticipate a decline in nominal house prices of approximately 8-10% from its peak (which is roughly equivalent to half of the decline witnessed during the 2008 financial crisis).

The Euro Area

According to the projections of the Eurosystem, annual average real GDP growth in the euro area is about to decrease from 3.4% in 2022 to 0.7% in 2023, before rebounding to 1.0% in 2024 and 1.5% in 2025. The projections have been adjusted downward compared to June estimates, reflecting a less favorable short-term outlook mostly due to tighter financing conditions. Still, the recession fears are intensifying: the Eurozone economy shrank 0.1% in Q3 compared with the previous three months (Table 1).

Table 1

GDP growth rates, EU, Euro area and U.S.

	% change, previous q.				% change, previous y.			
	2022	2023			2022	2023		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Euro area	0,0	0,0	0,2	-0,1	1,8	1,2	0,5	0,1
EU	-0,1	0,1	0,0	0,0	1,7	1,1	0,4	0,1
Germany	-0,4	0,0	0,1	-0,1	0,8	-0,2	0,1	-0,4
France	0,0	0,1	0,6	0,1	0,8	1,0	1,1	0,7
Italy	-0,2	0,6	-0,4	0,0	1,6	2,1	0,3	0,0
Spain	0,5	0,6	0,4	0,3	3,8	4,1	2,0	1,8
U.S.	0,6	0,6	0,5	1,2	0,7	1,7	2,4	2,9

Source: Eurostat

In the first half of 2023, the euro area experienced modest economic growth, despite a high backlog of manufacturing orders. The anticipated drivers of growth in 2024 are foreign demand, that will likely return to pre-pandemic levels, and an increase in real income, partly due to cooling inflation.

Germany

The German economy faced several challenges in 2022 that still have an impact in 2023, namely, the ongoing war in Ukraine, disruptions in the supply chain, and the energy crisis.

The country was hit harder by the Russia-Ukraine conflict than other major European economies due to its heavy reliance on Russian energy and significant number of energy-intensive industries. This economic strain is believed to have cost Germany approximately 2.5% of its gross economic output (around €100 billion) to this day.

Despite these hurdles, German economy managed to achieve a 1.8% GDP growth in 2022. The growth was largely attributed to robust private consumption, which expanded by 4.3%. While the economy experienced a 0.4% GDP contraction in the last quarter of 2022, the 2023 slowdown turned out to be shorter and less severe than initially feared. According to Eurostat, the German

GDP experienced near zero growth in Q1, 0.1% growth in Q2, and 0.1% decrease in Q3. The introduction of energy price control measures at the beginning of the year is likely to help preventing a recession in the end of 2023, pushing the economy towards a phase of stagnation instead (expected GDP growth of 0.1% in the final months of 2023).

Weakening labor market

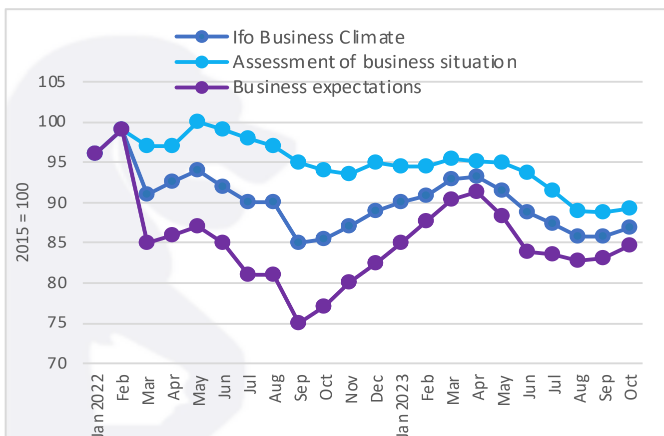
Germany is facing a persistent increase in its unemployment rate, projected to reach 5.8% in Q4. This upward trend commenced in early 2022 when it stood at 5.0%. Consequently, this rise has led to an uptick in the number of jobseekers in the largest European economy, with the total now standing at 2.61 million, reflecting an increase of 165,000 compared to 2022 figures. The arrival of over a million Ukrainian refugees so far has contributed an additional 0.4 pp to the overall unemployment rate.

Rising business sentiment

Companies are expressing optimism about the current situation and prospects (Figure 6). This positive shift can be attributed to reduced producer prices in the manufacturing sector, benefiting industries in terms of procurement costs. Moreover, the new price control measures have provided some stability and confidence to the country's energy-intensive businesses. Germany is now planning to extend the electricity and gas price caps it adopted last year until March 2024, and the European Commission is examining the feasibility of the measure.

Figure 6

Ifo Business Climate Germany



Source: ifo Business Survey

Housing market downturn

The housing market is facing a significant downturn: analysts predict a decline of over 5% in home prices for 2023, with a subsequent stagnation in 2024. This projection aligns with the constantly growing unaffordability of rents, as more potential buyers opt out of the costly housing market.

The first half of 2023 saw a substantial 27% drop in building permits for apartments, and many property developers have declared insolvency. According to ING Bank macro researchers, a substantial recovery in the German real estate market cannot be anticipated any time soon. Instead, there is an expectation of a slow correction, followed by a gradual upward trend in the next years. However, this won't substantially improve overall affordability. Residential prices experienced a significant 6.8% decline in the first quarter of 2023 compared to 2022, marking the most significant drop since official data began to be published over two decades ago. As we have stated, purchasing affordability of houses is not expected to improve much despite predictions of a decline in prices in the next months, and so the pressure on rental markets is likely to increase (rental prices are expected to grow). As regards forecasts for 2024 house prices are expected to stagnate, with a bit of an upgrade compared to the 2% fall predicted in May.

China

China was supposed to bounce back this year after an extremely restrictive Zero-Covid lockdown policy was lifted at the end of 2022. Despite these expectations for post-pandemic recovery, the Asian giant, is experiencing a slowdown and the recovery is nowhere in sight. Manufacturing activity is contracting, real estate market is in a downturn, consumer demand is weak, consumer prices dropped in deflation, declining export all point at a loss of momentum in the country's recovery.

The International Monetary Fund (IMF) forecasts a GDP growth rate of 5.4% in 2023, up from its previous forecast of 5%. The upward revision was based on the economy support measures as well as China's approval of a 1 trillion yuan ($137 billion) sovereign bond issue. IMF forecasts growth slowdown in 2024 with GDP expanding by 4.6% (up from a 4.2% previous forecast), due to property sector downturns and falling export.

Real estate crisis

It is difficult to overestimate the importance that the real estate sector plays in Chinese economy. In fact, the sector was the main driver behind the Chinese extraordinary growth for the past decades. Putting it into numbers, residential property sector in China contributes around 25% of GDP.

However, the housing market started cooling with the COVID-19 lockdowns and a decrease of credit to property

developers. New construction fell by 2 % in 2020, 11% in 2021, and 39% in 2022.

Moreover, the liquidity squeeze (regulations called "Three Red Lines"), initiated late in 2020 to limit speculation and excessive leverage by developers, has led to numerous defaults. More than half of the biggest 50 developers in 2020 have now gone into default. The latest case was linked to Country Garden, China's biggest private sector developer. As of now, two of China's largest developers, Evergrande and Country Garden (both defaulted on dollar bonds and have liabilities that have grown far beyond their assets), face possible liquidation.

Declining export

China's exports fell for the sixth consecutive month in October, 6.4% lower compared to year earlier. Decreasing exports reflect an uncertainty in demand from Chinese goods' importers, that are themselves experiencing growth slowdowns and rising financing costs.

Weak exports means that growth needs to be driven from the internal sources, which is far from easy considering that the main economy driver, the real estate sector, is in a crisis.

Deflation

In contrast to the advanced economies, where fighting inflation has been the top priority, in China inflation is following a different path (Figure 7). The Asian giant is facing difficulties in reviving the domestic demand and it shows in negative CPI data: CPI fell 0.2% in October, for the second time in a year since July, after staying flat in September. These numbers are far below the target rate of 3%.

Japan

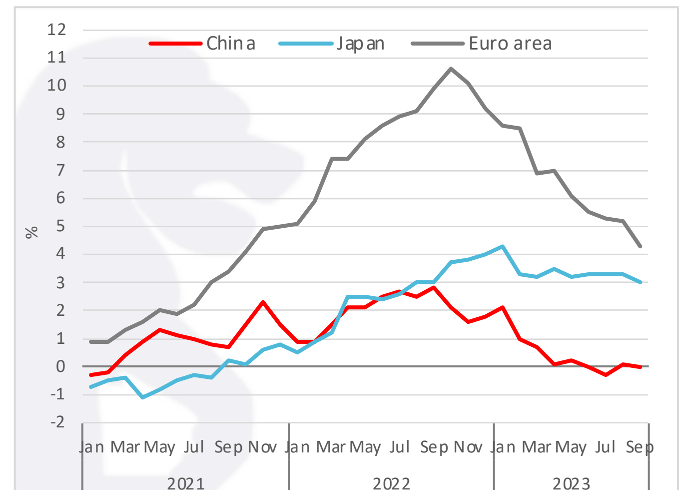
In contrast to China and the U.S., Japan's economy shrank 0.5% in Q3 (2.1% on annualized basis) after 1.1% growth in Q2 due to weak household and corporate spending following rising prices. Some economists expect the Japanese economy to bounce back in the Q4, supported by a recovery in domestic demand and the revival of foreigners visiting Japan. Others see potential risks to Japanese growth linked to China's slowdown and overall geopolitical situation.

The end of Japanification

The term Japanification refers to falling into deflationary trap with low demand that caused the Lost Decades (a period of economic stagnation in Japan from 1990s to 2010s). For nearly quarter of century Japan has been trying every way to fight deflation. However, the escape from the deflationary trap came unexpectedly with the supply-chain shocks triggered by Covid-19 pandemics and Russia-Ukraine conflict (Figure 7). Now, according to the latest data, inflation in Japan reached 3% in September (core inflation at 4.2%). On October 31st the Bank of Japan expressed its expectations of 2.8% core inflation in the fiscal year ending March 2025.

Figure 7

Monthly inflation rates (compared to the same month of the previous year)



Source: Statista

The Bank of Japan experiments

Considering the Japanese macroeconomic situation, it is worth reminding of the BoJ's monetary policy experiments. In 1999, the Japanese central bank was the first to adopt a zero-interest-rate policy. It also was the first to try quantitative easing. The goal was to ease credit conditions and encourage lending. Another notable experiment was the yield-curve-control policy. BoJ has attempted to manage the yield on 10-year Japanese government bonds (JGBs) to stimulate the economy and inflation.

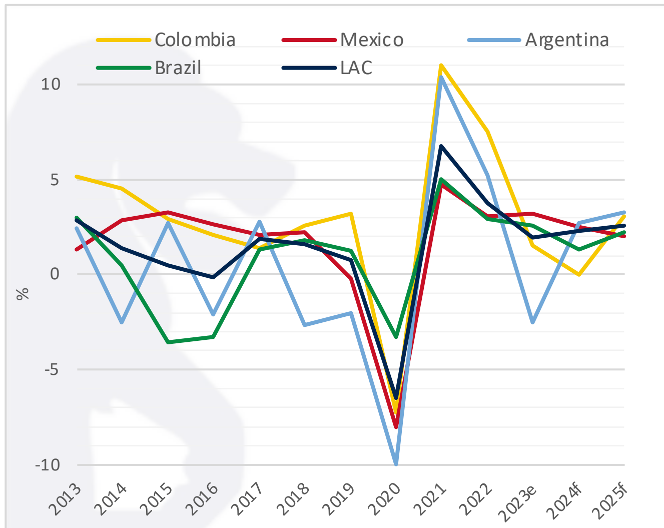
The BOJ has been the only major developed-economy central bank that has not significantly tightened policy. At its September meeting it left monetary policy unchanged: the rate remained slightly below zero and the yield curve control policy fixed the 10-year yield at zero percent.

Latin America and the Caribbean

Even though LAC's real GDP is now above pre-pandemic levels (Figure 8), it still lags behind other developing areas of the world. While South and East Asia are expected to grow 30% from 2019 to 2025, LAC trails at 11%, even below Eastern Europe's expected 15%.

Figure 8

Real GDP growth rate, LAC



Source: World Bank

These anemic growth prospects for LAC are not mainly attributable to the damages from the pandemic, but rather reflect longstanding structural issues like overreliance in commodities exports, improper protectionist industrializations and poor institutions. Addressing these issues through policy requires consensus and support, but the social fabric remains stretched as seen recently in Chile, Peru, and Argentina's political unrest. On average trust levels in LAC reached 34% in 2020, 4.4 pp lower than in 2007, and below the OECD average of 45%.

External Headwinds: China and Commodities

One of the major concerns for Latin America is the economic performance of China, an increasingly important trading partner. The assumption of a strong post-lockdown rebound in the economy of the Asian giant has been challenged by the developments in the real estate sector and disappointing economic indicators such as retail sales and industrial production.

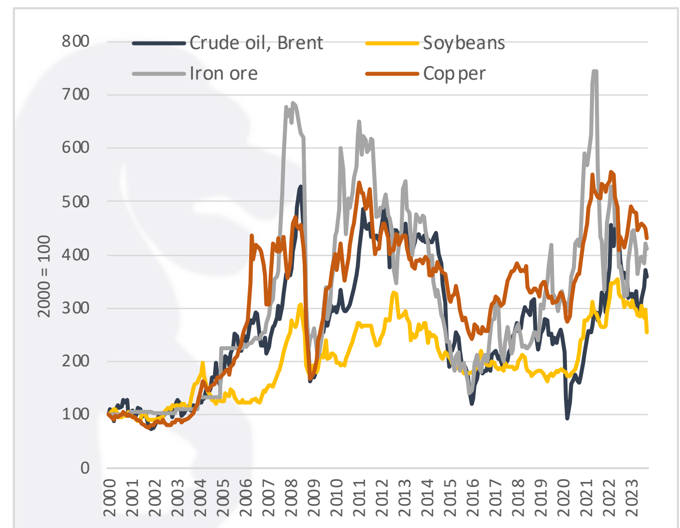
In 2000, China's share in LAC's trade was a mere 2%. By 2022 this figure had surged to 17%. In fact, excluding Mexico (which represents 71% of US-LAC trade) China is already the top trading partner. Brazil and Argentina both export 70% of their soybeans to China, while Peru and Chile export around 70% of their copper to China. China accounts for 9% of the region's total FDI and several countries have received resources to develop infrastructure through loans from Chinese banks.

This deepened economic interdependence means that reduced Chinese demand poses risks to LAC's trade exports. The implications of such a demand slump are twofold: a contraction in export volumes for LAC countries and a downward pressure on global commodity prices, which could imply further currency devaluation and current account deficits.

Though prices of commodities exports have been moderated in the past two years, they have done so from a relatively high base and are still elevated in historical terms (Figure 9). High commodity prices have caused an increase in export value, while the volumes remained stable. The impact of these trends varies depending on the composition of each country's trade portfolio. Commodity exporters like Argentina, Brazil, Chile, Colombia, and Peru have experienced more advantageous trade terms compared to their pre-2020 status. Conversely, those countries without energy independence (petroleum importers), notably Costa Rica, Guatemala, and Uruguay have not seen such favorable developments in their trade conditions.

Figure 9

Indexed commodity prices



Source: World Bank

Inflationary Pressures and Interest rates

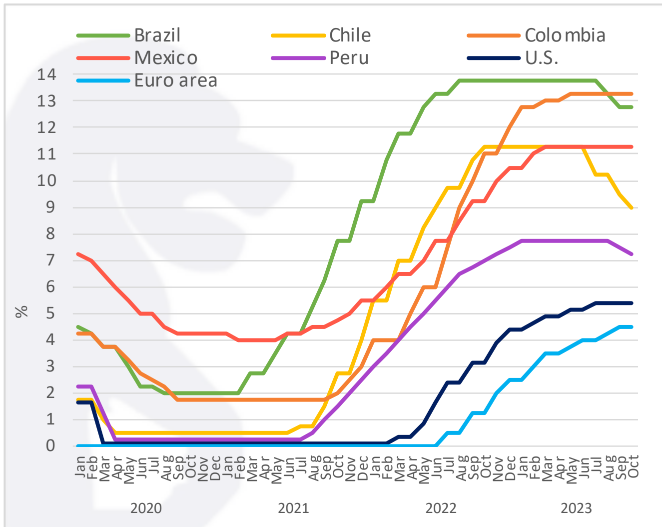
Recent decreases in global food prices, although still high by historical standards, have moderated inflation. LAC's central banks have been particularly proactive in responding to inflationary pressures, undertaking earlier and more aggressive interest rate hikes compared to their counterparts in advanced economies (Figure 10).

Brazil's monetary authority led the assertive approach taken in the region, having raised its benchmark rate from 2% in February 2021 to 13.75% in June 2022, starting a full year ahead of the Fed's tightening cycle in the U.S. This pre-emptive stance is a testament to the independence and competency of some of LAC's central banks. It has also allowed them to stabilize inflation expectations more effectively and quickly. They have managed to halt their

interest rate increases sooner than those in advanced economies, with most now beginning to cut rates, potentially providing economic stimulus. Brazil, for example, has already cut rates three times by 150 bps total.

Figure 10

Nominal Central Bank's Policy Rates

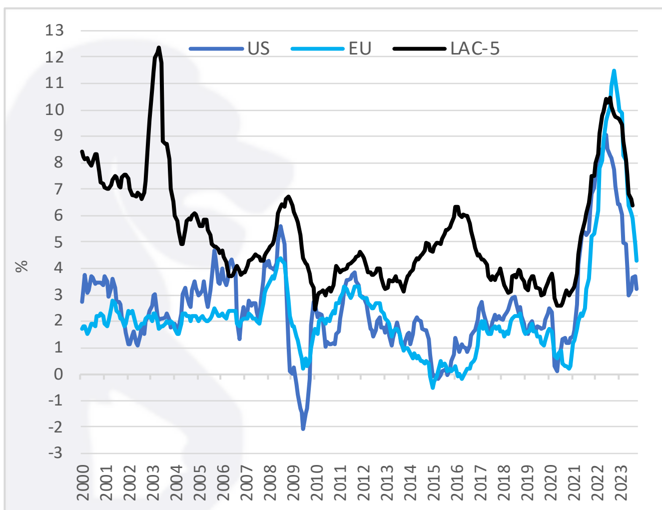


Source: Bank for International Settlements

Nearing the end of 2023, inflation in the region remains only slightly above that of the US and EU (Figure 11). It is relevant to note that the LAC region has had inflation run significantly above developed countries in the 20 years prior. Despite the early interventions, inflation in the LAC region persists above target levels and is expected to reach them in 2024 (targets vary from country to country but are in the range of 3-4%).

Figure 11

CPI inflation in the U.S., EU, and LAC-5 (GDP-weighted average of Brazil, Chile, Peru, Colombia, and Mexico)



Source: Federal Reserve Bank of St. Louis

The notable exception is Argentina, where the government's monetary financing of the fiscal deficit has led to rapidly escalating 143% inflation rate (October 2023), capital controls and a situation of negative net international reserves.

Middle East

The IMF predicts a 2% economic growth in 2023 for the Middle East and North Africa (MENA) region, a slowdown compared to 5.6% in 2022, followed by a rebound to 3.4% in 2024. This decline in 2023 growth rate is attributed to reduced oil production and tighter policy conditions in the region. It is important to note that the IMF projections were made before the conflict between Israel and Hamas erupted on October 7th. For example, JPMorgan has revised its GDP forecast for Israel in Q4 2023, anticipating an 11% decline (on annualized basis), a substantial revision from the prior estimate of -1.5%.

Despite cooling inflation, certain economies still face extremely high CPI growth rates, contributing to food insecurity. Jihad Azour, the IMF's director for the Middle East and Central Asia, characterizes 2023 as a year of transition for the region. The average inflation rate in MENA region is expected to peak at 17.5% this year before decreasing to 15% in 2024, with significant variation among different countries.

Potential Global impact of the Gaza-Israel conflict

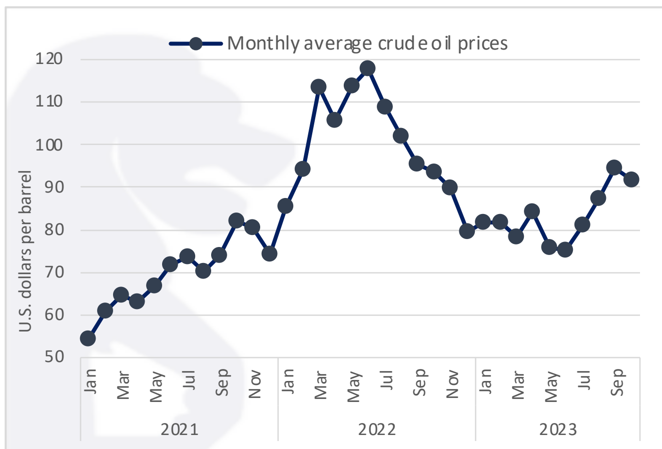
The impact of the conflict on global commodity markets has been limited thus far, with a mere 6% increase in oil prices after the conflict's onset, and minimal fluctuations in agricultural and metal prices. The situation is highly dynamic, and it is important to consider the intricate geopolitical landscape that extends beyond the immediate parties involved. For instance, the attack appears to have disrupted U.S.-mediated talks concerning Saudi-Israel relations. Additionally, tensions seem to be increasing between Israeli forces and Hezbollah militants supported by Iran along the Lebanon border, raising questions about potential Iranian involvement. To assess potential impacts, we need to look at two key scenarios: if the conflict is contained or if it escalates.

In a contained situation, neither party in the conflict significantly impacts the oil industry, with Brent crude oil prices rising but remaining below summer highs. The limited movement reflects the balance between global oil supply and demand. Unlike Russia's invasion of Ukraine, where disrupted supply led to significant price increases, today's oil markets can likely handle a

moderate disruption, like stricter U.S. enforcement of sanctions on Iranian oil. Iran contributes about 4% of the world's oil supply, and improved U.S.-Iran relations have led to less stringent enforcement, allowing some Iranian oil to reach the market. Currently, oil prices are lower than peak levels observed during the summer.

Figure 12

Monthly average crude oil prices of the OPEC basket



Source: Statista

A broader conflict poses significant risks, reminiscent of the 1973 Yom Kippur War, causing a 300% surge in oil prices, inflation, economic downturn, and a stock market decline. Although no similar actions have occurred, an escalation involving Iran could disrupt vital shipping routes, like the Strait of Hormuz, responsible for 20% of global oil consumption. Other producers, supported by the U.S. increasing oil production, may mitigate the impact. The U.S., now more energy-efficient, requires over 70% less oil to generate one unit of GDP compared to the early 1970s.

Russia

According to the World Bank, IMF, and OECD, 2022 and 2023 were years of negative growth of the Russian economy. It is estimated that in 2022, Russia's GDP dropped by 2.1% and Russia's economy may continue to shrink significantly in 2023. Its GDP is forecasted to decline by 2.5% in the worst-case scenario (OECD) or by 0.2% according to the World Bank. The IMF expects modest growth in 2023 (0.7%). The forecasts presented by Vladimir Putin in his speech on November 17th are much more optimistic, anticipating a more than 3% growth in 2023.

Since Russia's invasion of Ukraine in February 2022, the major factor impeding its growth were the extensive sanction packages. The European Council has adopted 11 packages of sanctions against Russia and Belarus , while the U.S. has imposed more than 3,126 sanctions. These sanctions target individuals, entities, and economic activity.

Despite these extensive restrictions, public sector support measures have helped the Russian economy recover much faster than expected from the initial post-invasion shock and GDP fall in spring 2022. Wars inevitably raise government spending, and in Russia's case, direct costs of warfare increase domestic economic activity. Most military procurements go to domestic suppliers, forcing firms serving the military to compete for the limited pool of workers by offering attractive wage and benefit packages. Salaries and other compensation paid to mobilized reservists and their families are also considerably higher than average earnings during peacetime. War pay has been a boon to retail sales and demand for services, especially in Russia's poorer regions. Government interest subsidies have also accelerated growth in the bank lending stock, especially in mortgages. An ever-larger share of economic growth is dependent on direct and indirect government support.

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