A soft landing beckons but is not assured

Karen Dynan
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Global growth continues to moderate

Amid restrictive financial conditions, the global recovery from COVID recessions has slowed and is likely to slow a bit further next year.

Global Real GDP Growth

Percent change from previous year

Annual-average-over-annual-average growth rates. PPP weights.
Sources: Consensus Forecasts for 2021-2022; author's forecast for 2023-2024.
Inflation is subsiding but has some distance to go to settle at target levels

**Headline CPI Inflation**

Percent change from 12 months earlier

- United States
- Other advanced economies
- Emerging market economies

**Core CPI Inflation**

Percent change from 12 months earlier

- United States
- Other advanced economies
- Emerging market economies

Shaded area corresponds to recession.
Last data point: August 2023 for the US and July 2023 for other series.
Major central banks are reaching the end of their tightening cycles

Central Bank Policy Interest Rates

Data source: Bank of International Settlements.
Last data point: September 19, 2023.
Financial conditions are tight and will remain so, as widespread rate cuts are unlikely soon.

Data source: Federal Reserve Bank of Dallas and Federal Reserve Board (via FRED).
Shaded area corresponds to recession.
Last data point: September 2023 for the US and August 2023 for other series.
Advanced economies are likely to experience subdued growth to different degrees

Real GDP Growth
Percent change from previous year

**US**
High interest rates are damping US growth momentum

**Euro area**
The European recovery is still weak and fragile

**Japan**
Japan is seeing demand pick up after delayed reopening

**UK**
A mild UK recession appears to be taking hold

Annual-average-over-annual-average growth rates, PPP weights. Sources: Consensus Forecasts for 2021-2022; author’s forecasts for 2023-2024.
Prospects for emerging market economies also vary

Real GDP Growth
Percent change from previous year

China

<table>
<thead>
<tr>
<th>Year</th>
<th>Chinese stimulus is small relative to sources of drag</th>
</tr>
</thead>
<tbody>
<tr>
<td>'21</td>
<td>8.1%</td>
</tr>
<tr>
<td>'22</td>
<td>3.0%</td>
</tr>
<tr>
<td>'23</td>
<td>5.1%</td>
</tr>
<tr>
<td>'24</td>
<td>4.5%</td>
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</tbody>
</table>

India

<table>
<thead>
<tr>
<th>Year</th>
<th>India is slowing on lower exports and higher oil prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>'21</td>
<td>9.1%</td>
</tr>
<tr>
<td>'22</td>
<td>7.2%</td>
</tr>
<tr>
<td>'23</td>
<td>6.3%</td>
</tr>
<tr>
<td>'24</td>
<td>6.0%</td>
</tr>
</tbody>
</table>

Russia

<table>
<thead>
<tr>
<th>Year</th>
<th>Russia continues to be held back by fallout from war</th>
</tr>
</thead>
<tbody>
<tr>
<td>'21</td>
<td>-2.1%</td>
</tr>
<tr>
<td>'22</td>
<td>1.4%</td>
</tr>
<tr>
<td>'23</td>
<td>1.2%</td>
</tr>
<tr>
<td>'24</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

Brazil

<table>
<thead>
<tr>
<th>Year</th>
<th>Structural issues will hamper Brazil even with lower policy rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>'21</td>
<td>5.0%</td>
</tr>
<tr>
<td>'22</td>
<td>2.9%</td>
</tr>
<tr>
<td>'23</td>
<td>2.6%</td>
</tr>
<tr>
<td>'24</td>
<td>1.3%</td>
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</table>

Annual-average-over-annual-average growth rates. PPP weights.
Sources: Consensus Forecasts for 2021-2022; author’s forecasts for 2023-2024.
### Summary of the outlook for large economies

<table>
<thead>
<tr>
<th>Real GDP Growth (Y/Y)</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Growth</td>
<td>5.9</td>
<td>3.4</td>
<td>3.0</td>
<td>2.8</td>
</tr>
<tr>
<td>United States</td>
<td>5.9</td>
<td>2.1</td>
<td>2.2</td>
<td>1.6</td>
</tr>
<tr>
<td>Euro Area</td>
<td>5.6</td>
<td>3.4</td>
<td>0.6</td>
<td>1.0</td>
</tr>
<tr>
<td>Japan</td>
<td>2.2</td>
<td>1.0</td>
<td>1.8</td>
<td>1.3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8.7</td>
<td>4.1</td>
<td>-0.3</td>
<td>-0.2</td>
</tr>
<tr>
<td>China</td>
<td>8.1</td>
<td>3.0</td>
<td>5.1</td>
<td>4.5</td>
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<td>India</td>
<td>9.1</td>
<td>7.2</td>
<td>6.3</td>
<td>6.0</td>
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<td>5.6</td>
<td>-2.1</td>
<td>1.4</td>
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<td>2.6</td>
<td>1.3</td>
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</table>
US output will stay slightly below potential

Incoming data suggest robust growth in 2023:Q3

But 2023:Q4 is likely to see a lull in growth owing to:

the UAW strike
restart of student loan payments
probable government shutdown

Dashed line is author’s forecast.
Other data sources: Bureau of Economic Analysis and Congressional Budget Office (via FRED). Shaded area corresponds to recession.
The US labor market is rebalancing

Labor Force Participation Rate, Ages 25-54

Change in Nonfarm Payrolls


Slack in the US labor market is increasing—without much increase in unemployment

Job Openings per Unemployed Worker


Beveridge Curve

US wage growth and broader compensation growth are gradually slowing

**Average Hourly Earnings Growth**

- Percent (annualized)

**Employment Cost Index Growth**

- Percent (annualized)

Last data point: August 2023.

Last data point: June 2023.
US core inflation is falling

PCE Core Goods Inflation
Percent (annualized)

PCE Core Housing Services Inflation
Percent (annualized)

PCE Supercore Inflation
Percent (annualized)

Data source: Bureau of Economic Analysis. Shaded region corresponds to recession.
Last data point: July 2023.

Inflation for core PCE services excluding housing.
Data source: Bureau of Economic Analysis and author's calculation.
Shaded region corresponds to recession.
Last data point: July 2023.
Households' expectations of inflation are subsiding; market expectations are fairly low.

**Median Expected Inflation: Household Survey**

- Percent
- Shaded area corresponds to recession.
- Last data point: August 2023.

**Median Expected Inflation: Market-Based**

- Percent
- Data source: Federal Reserve Bank of Cleveland (via FRED).
- Shaded area corresponds to recession.
The Fed will start cuts next fall, as 12-month US core PCE inflation slips below 3 percent

<table>
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<th>Core 12-Month PCE Inflation and Fed Funds Rate</th>
</tr>
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<tbody>
<tr>
<td>Percent</td>
</tr>
</tbody>
</table>

- **Core PCE inflation (Q4/Q4)**
  - 2023: 3.3
  - 2024: 2.6

- **PCE inflation (Q4/Q4)**
  - 2023: 3.3
  - 2024: 2.6

- **Core PCE inflation (Q4/Q4)**
  - 2023: 3.8
  - 2024: 2.8

- **Unemployment rate**
  - 2023: 3.8
  - 2024: 4.2

Data source: Bureau of Economic Analysis and Federal Reserve Board (via FRED); author's forecasts. Shaded area corresponds to recession.
But bringing inflation all the way back to target is likely to take some time.
Risk scenario 1: Sustained overheating

Underlying demand may be stronger than the current consensus:

- Excess saving may still be large
- Pent-up demand lingers
- Strong labor markets supporting income

The Fed may need to tighten further, which increases the chance of a hard landing.

Data source: Bureau of Economic Analysis (via FRED).
Shaded area corresponds to recession.
Last data point: July 2023.
Risk scenario 2: Global malaise

Demand may be dragged down by incipient weakness:

- European recession
- Weakening Chinese economy
- Spillovers to the rest of Asia
- Troubled US banking sector

The Fed may not be able to cut rates quickly enough to avoid recession

*Commercial and industrial loans to large and middle-sized firms.
**Commercial real estate loans secured by nonresidential properties.

Risk scenario 3: Further inflationary supply shocks

Inflation could materially reaccelerate if developments in global commodity markets push up energy and food prices or there is a significant disruption to supply chains.

This scenario would be especially challenging for the Fed and other central banks—with more tightening amid economic conditions already weakened by the shocks.

A soft landing beckons but are not assured

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