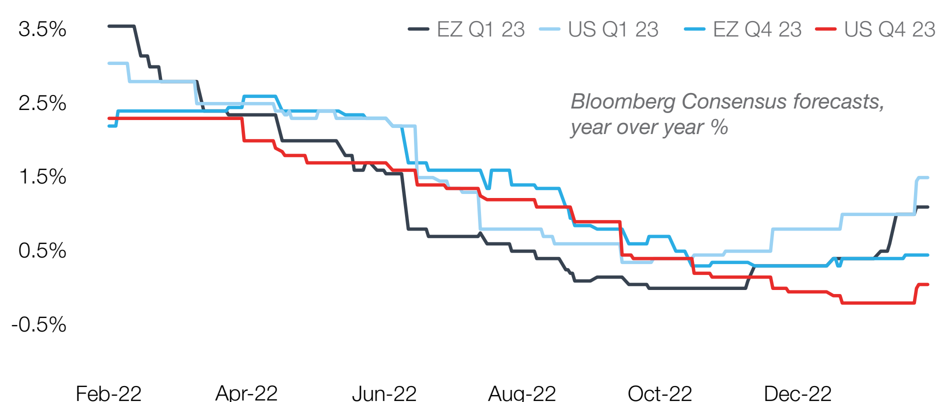
Accuracy

A GLANCE AT 2023

April 2023

In this edition of the Economic Brief, we will analyse economists' forecasts for economic growth in 2023. Comparing visions for quarter 1 with those for quarter 4, we will consider how growth profiles for Western economies will evolve over the course of the year and look into reasons for any particular developments. We will also consider the priorities of the central banks, notably the Federal Reserve, and the actions it may take for the year.

Growth in the US and eurozone: better today but not so much tomorrow...



Sources: Accuracy & Bloomberg

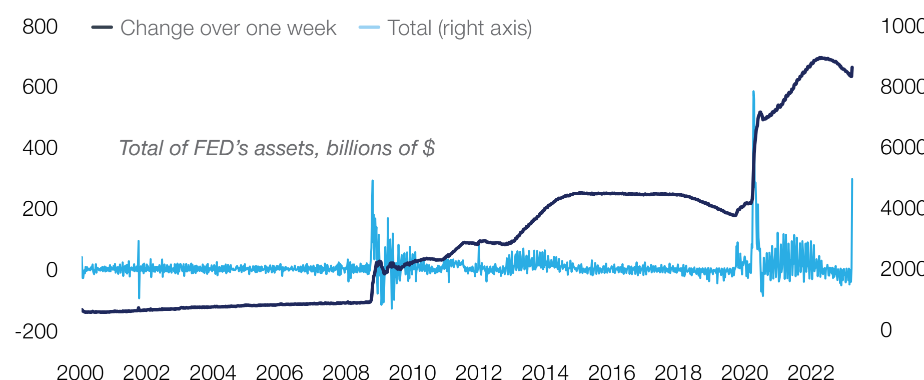
The Bloomberg Consensus on GDP growth, as illustrated in the chart opposite, reflects economists' views that quarter 1 2023 will be positive. However, when we compare that with considerations for quarter 4 2023, we see that the reversal of fortunes at the beginning of the year is not projected to last. But why might that be the case?

After all, normally, we would expect forecasts for quarter 4 to take into account the figures and trends for quarter 1 – in this case, growth – and build on them. Instead, here we see that the quarter 4 figures actually require a correction to the quarter 1 figures – Q4 performance in the eurozone is stagnating, and in the United States, it is falling.

One reason for such a correction might be seasonality. Indeed, the past winter has been rather mild. This means that certain activities that might usually slow down or even come to a halt in winter, for example, construction or public works, were not as severely affected as they might have been. This mild winter may have led to better activity and therefore better economic figures – including GDP – than usual. As a result, it may be best not to extrapolate these figures.

With this state of affairs in mind, let us look at what the priorities of the major central banks are for the year ahead, with a focus in particular on the Federal Reserve. The reappearance of banking woes in the United States has obliged the Fed to reconsider regulations. It appears that the softening of banking regulations, desired by the Trump administration in 2018, equated to the unfounded acceptance of an increase in banking risk. This was an error. The Fed is making no mistakes this time and taking another look at the dossier.

United States: the central bank manoeuvring again

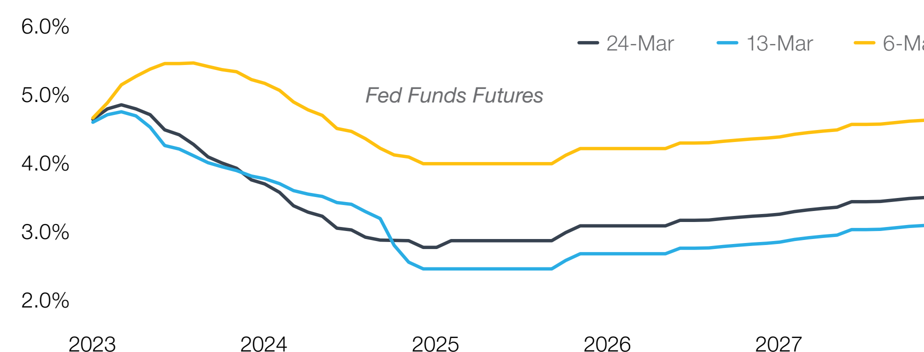


Sources: Accuracy & Bloomberg

Another issue for the central bank to grapple with is how to resolve the trilemma of fighting against inflation, maintaining low unemployment and ensuring financial stability. At first glance, the three objectives appear mutually incompatible. It is therefore probably worth returning to the classic rule of one tool for one objective.

Let us start with ensuring financial stability. The Fed is using the might of its balance sheet to this end. As illustrated in the graph above, in March 2023, the Fed increased liquidity in the market, acquiring numerous assets in order to battle against the uncertainty generated by the downfall of Silicon Valley Bank and others in the region. This battle is ongoing but appears to be somewhat in hand for now.

United States: thinking about the federal funds rate



Sources: Accuracy & Bloomberg

The Fed's tool for battling inflation is the federal funds rate. The central bank has been raising interest rates significantly for the past year and this trend is likely to continue. Indeed, a recent Reuters poll of economists indicates a return to the target inflation rate of 2% not before 2025.

Due to the recent turmoil in the banking sector, the market considered that the Fed would put its policy of hiking interest rates on hold until the difficulties were over. This is illustrated by the graph above, showing the development of Fed Funds Futures and the lowering expectations as the month of March progressed. However, at the end of March, the Fed considered its battle with inflation to be more pressing than the challenges facing the banking sector and chose to raise interest rates a further 25 basis points.

With that, we have seen two tools for two objectives: the use of the central bank's balance sheet for financial stability and the use of the central interest rate for inflation. But what about the last part of the trilemma, maintaining low unemployment? It remains unclear what tool the Fed will implement to support the labour market.