



Quarterly Macroeconomic Outlook Update

April 20, 2023

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- **“Bent But Not Broken” Characterization in January Still Appropriate**
 - Subpar ~2.5% global growth expected in ‘23 and ‘24¹
 - Headline inflation declining from recent peak but core sticky...
 - Far above central bank targets /continuing restrictive policies required
- **Some Positive Surprises and Banking Tremors in Q1**
 - Recent economic data better-than-expected
 - China’s reopening resilience surpassing expectations
 - Banking tremors seemingly contained² but, at minimum, will be headwind for GDP growth, particularly for DMs
- **Macro Fundamentals Support Baseline Outlook But Identifiable Risks Remain...**
 - Banking stress, geopolitical and central bank uncertainties ,US debt ceiling negotiations ..
 - Road ahead could be bumpy

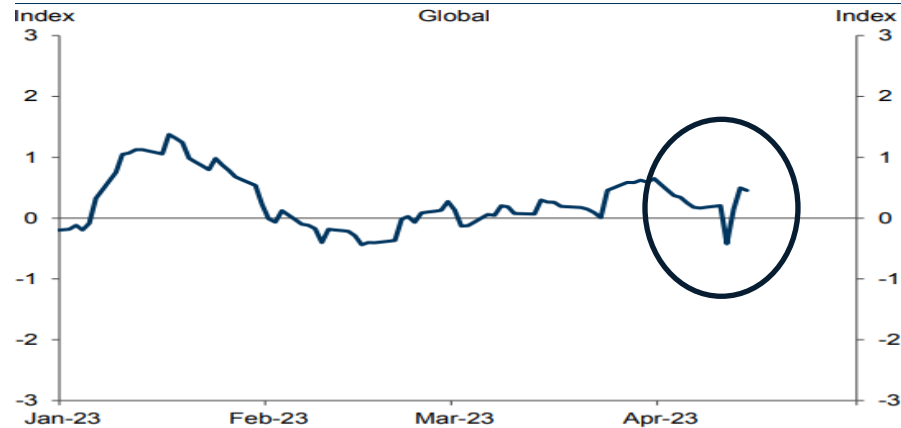
Expected Real GDP Growth			
	Global	DMs	EMs
2022	3.3%	2.7%	3.7%
2023	2.2% 2.4%	0.7%	3.4% 3.9%
2024	2.6%	1.0%	4.0%

1. ~1%-point below pre-pandemic (2015-2019) average global GDP growth of 3.5%

2. Deposit flight and loans to US banks have slowed in the US and no notable institutions have failed in the US since the SVB weekend and the Credit Suisse / UBS merger in Europe.

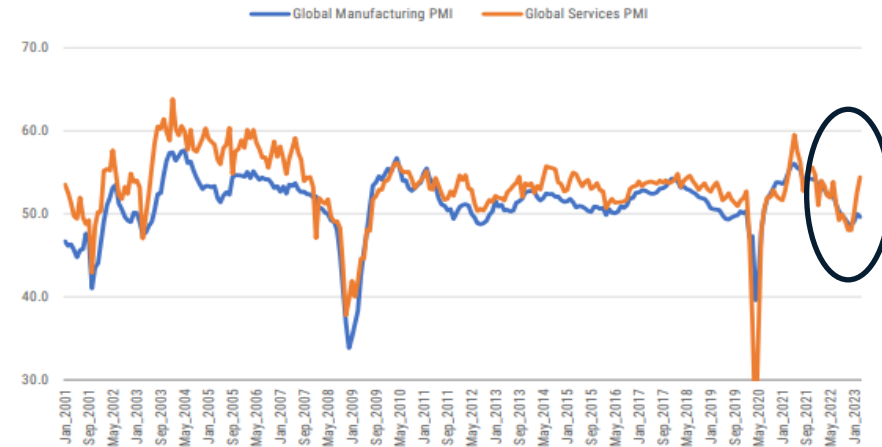
Q1 Data Exceeded Expectations: PMIs /China / Consumer Spending

Global Economic Surprise Index



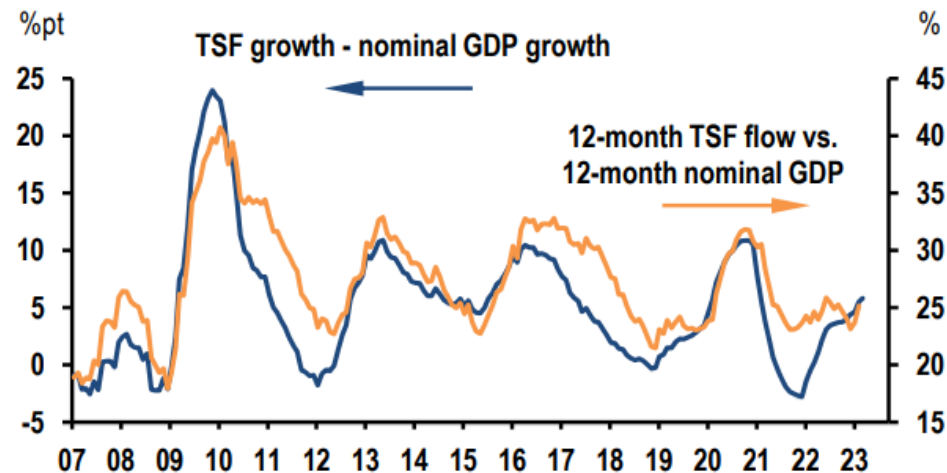
Source: GS

Global PMI Strength Led by Services



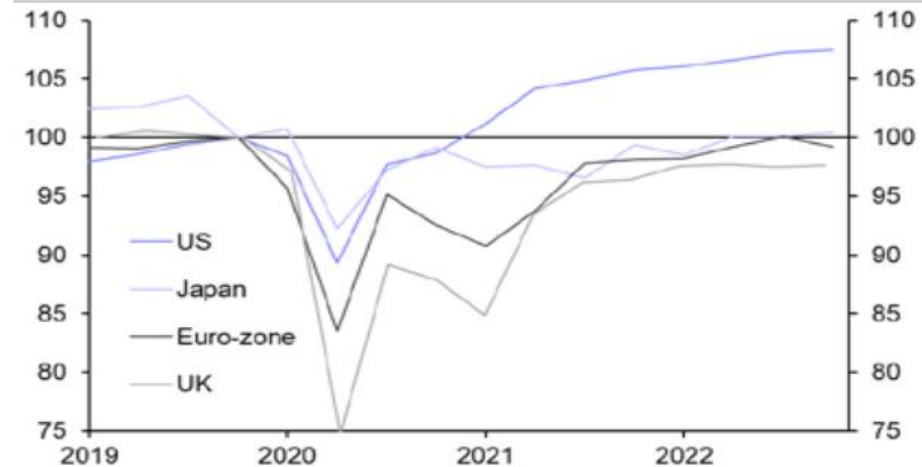
Source: Markit, Haver, MS

China's Resilient Reopening¹



Source: PBOC, JPM

Major DMs: Real Consumer Spending²

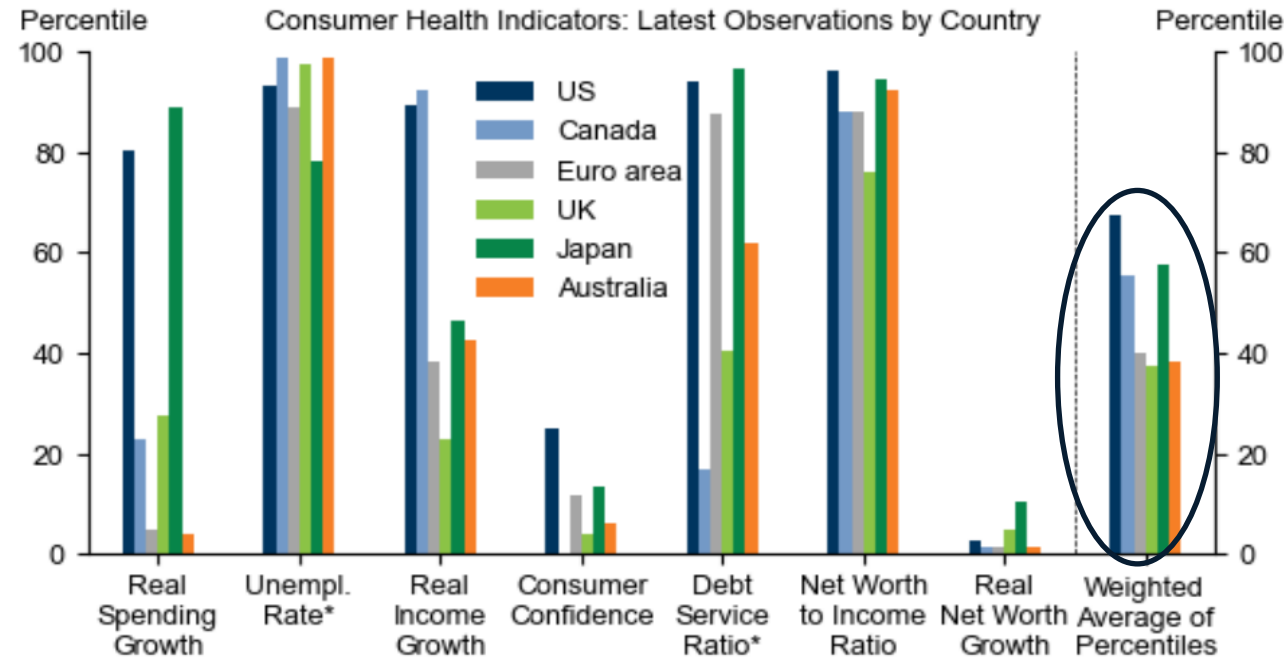


Source: Refinitiv, CE

1. TSF (Total social financing) up 10% in March. Credit impulse (gap between TSF growth and nominal GDP growth) 5.8% in February. China's economy in Q1+4.5% yoy / 11.9% q/q @ saar.
 2. Q4 2019 = 100

DM Consumers: Employment & Finances Sound/ Confidence Weak¹

Consumer Health Measures



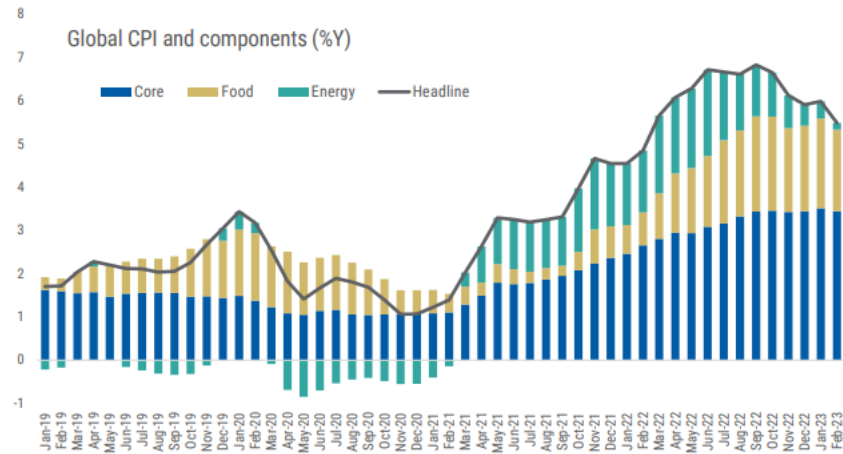
Source: Haver Analytics, GS

- Composite consumer-health readings for major DMs in the ~60th to ~40th historical percentile range in April
- Employment and net worth (nominal terms) near historical highs, confidence near lows
- Real spending and income growth mixed²

1. Unemployment rate (*) and debt service ratio (*) are inverted scales. Percentiles cover monthly observations over 20+ years for US since 1980; other countries data since 2000.
 2. Selected percentile readings for latest real consumer spending growth: US ~80th, UK ~25th, Euro area ~20th. Income real percentiles: US ~85th, UK <~20th, Euro area ~35th.

Headline Inflation Below Recent Peak / DM Wages & Core Inflation Too High SECOR | ASSET MANAGEMENT

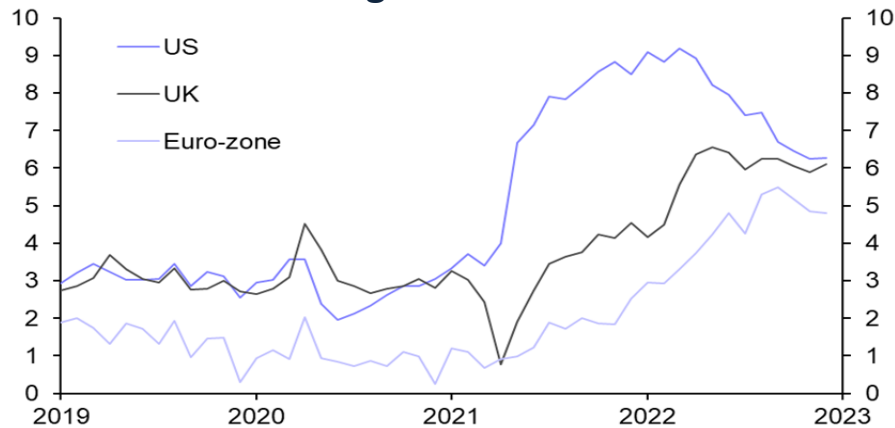
Global Inflation¹



- Global inflation 5.5% yoy in February, ~1%-pt. below 2022 peak
- Slowdown mostly driven by energy prices
- Global supply chains healing
- Long-term inflation expectations still contained²

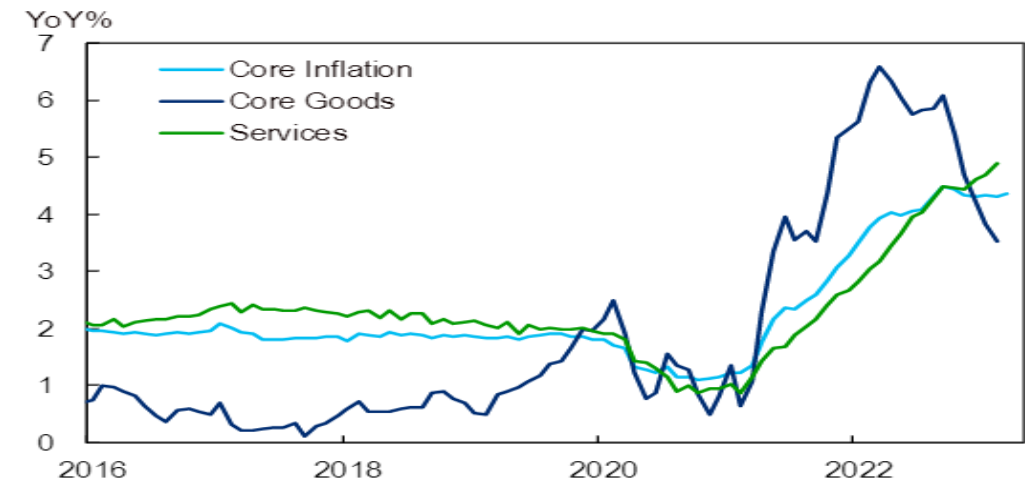
Source: Haver Analytics, MS

Wage Trackers³



Source: Indeed, CE

Global Core Inflation



Source: Haver, Citi

1. Global inflation excludes, Russia, Ukraine, Turkey and Argentina
 2. Long-run inflation expectations 2.1% in February-source: Cleveland Fed
 3. US hourly earnings 4.2% yoy in March vs. 5.8% a year ago. Euro area: estimated negotiated pay index ~3% (2022), ~4% (2023), ~3% (2024) — JPM. UK: tightness in labor market easing, inflation moderating — wages expected to slow — GS.

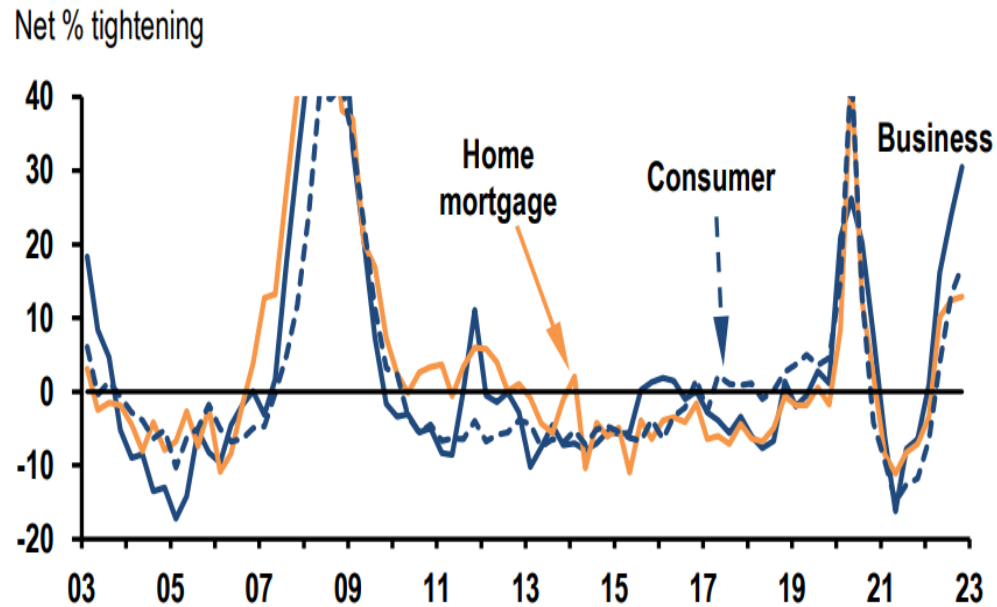
- **Tremors Sparked by Failures of Silicon Valley and Signature Banks**
 - Quickly spread to Credit Suisse and threatened Republic Bank
- **Too Early to Declare Victory But Tremors Seemingly Contained by**
 - Prompt and decisive responses of Treasury, Fed, FDIC and ...
 - Private banks in US and Swiss National Bank in Europe
- **Initial Assessment of Likely Impact on Growth and Policy Rates**
 - Tightening in lending standards will slow growth in major DMs¹:
 - Estimated hit to GDP-growth in major DMs in ~ 0.4% - 0.8%-pt range
 - Central banks focusing on price and financial stability
 - Expected terminal policy rates lower than pre-crisis
- **Recession Risks Increased but Lehman-Like Event Unlikely**
 - Risks of further bank failures, smaller US banks appear to be particularly vulnerable
 - Challenges for real estate investors and central bankers exacerbated
 - Post-GFC changes limiting possibility of Lehman-like event²

1. GS and JPM forecast hit to 2023-24 GDP growth in ~ 0.4% pt – 0.8% pts range. IMF hit to US GDP growth this year 0.44% pt.

2. Post GFC changes / differences include major banks better capitalized, financial market more robust — large share of interbank transactions centrally cleared, leveraged excesses and widespread use of opaque financial instruments not evident currently

Lending Standards Tightening / Estimated Drag on GDP Growth

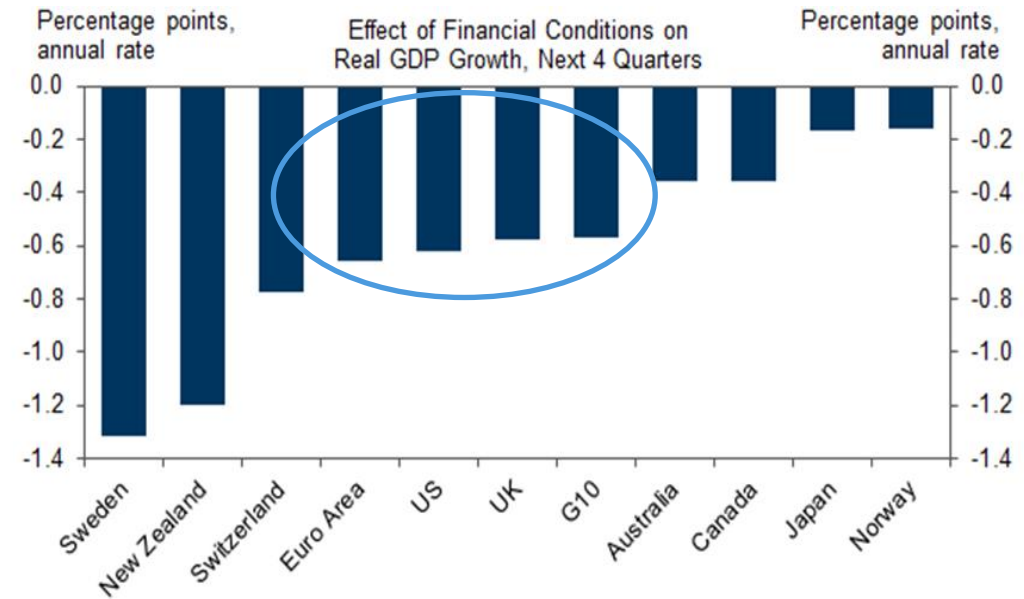
G4 Lending Standards



Source: Fed, ECB, BoE, BoJ

- Concerns about financial fragility prompting banks to...
- Tighten lending standards

Effects of Financial Conditions on GDP



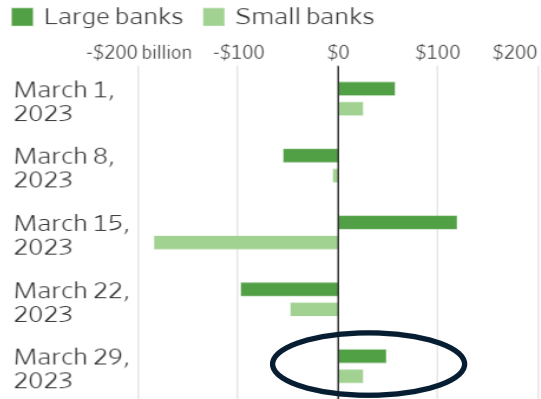
Source: GS

- GS economists expect tightening financial conditions to...
- Subtract ~0.5%-pt, from G10 growth in 2023

Banking Stress: Intense Pressures Subsiding / Ongoing Headwinds¹

Deposit Flows²

Deposits, change from a week earlier

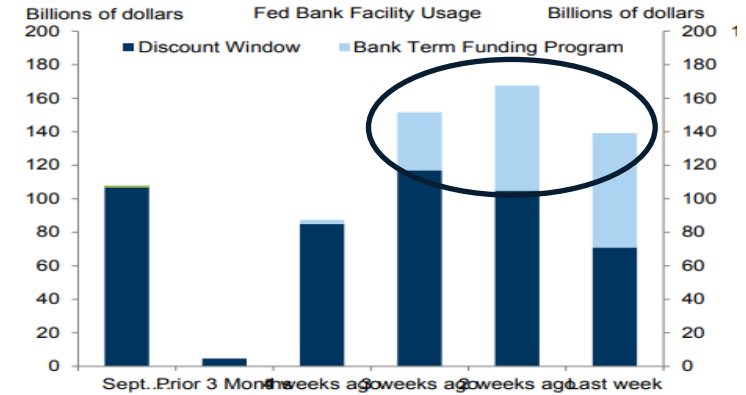


Source: Federal Reserve

Pressures Subsiding

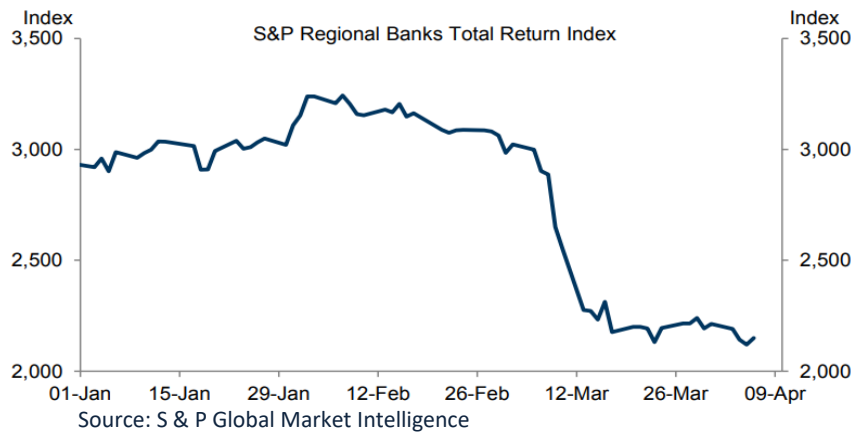


Liquidity Needs



Source: Federal, FHLB, GS

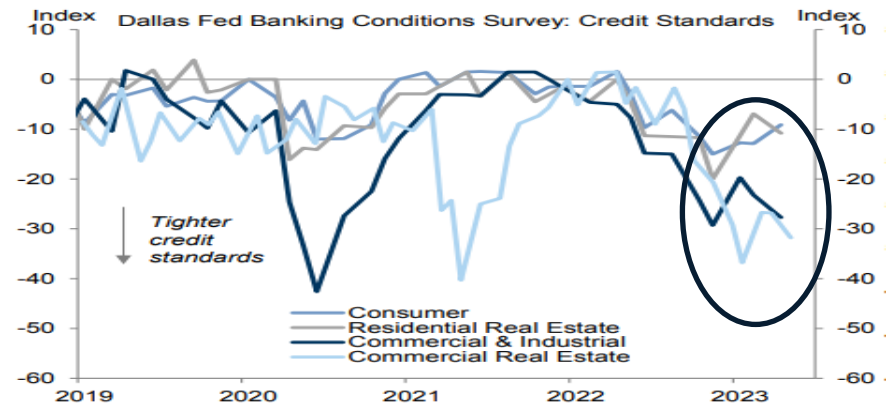
Regional Bank Stock Prices³



Ongoing Headwinds



Bank Credit Standards Survey⁴

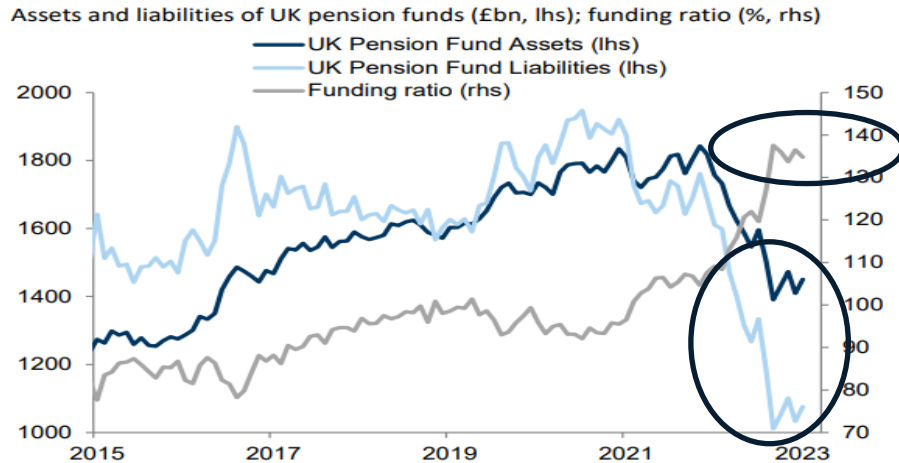


Source: Dallas Fed, National Assoc. of Credit Mgt.

- Charts ex Deposit Flows updated April 7, 2023
- Large banks top 25 ranked by domestic assets. Small banks domestically charted commercial banks not in top 25.
- IMF in recent Global Financial Stability Report: Banks' stock prices highly correlated with willingness to lend; recent weakness points to 1% decline in bank lending this year
- Dallas Fed's Banking Conditions Survey points to incremental tightening in lending standards, particularly on commercial industrial and industrial real estate, though roughly at same pace as before banking turmoil.

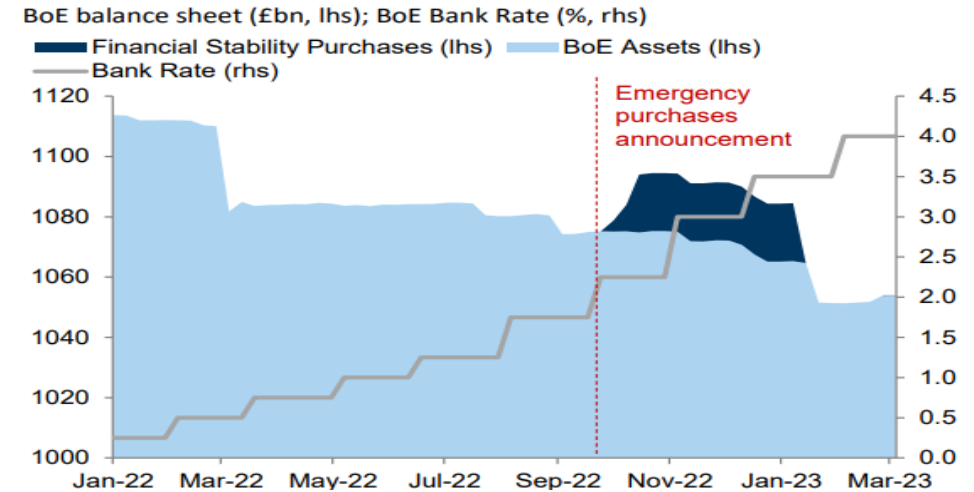
Separation Principal¹: BoE's Recent Success / Current Priority

UK's Pension Funding Ratio



Source: Haver Analytics, GS

Emergency Purchases / Ongoing Rate Increases



Source: Bank of England, GS

- **Central Bank Heads Reiterating "Separation Principle" -- Commitments to Price and Financial Stability²**
 - After latest rate hike Lagarde stressed ECB's role as ...

Estimated Terminal Policy Rate: Lowered and Advanced³

	Current	Early March	Change
Fed	5.08% in June	5.69% in Sept.	(0.61%-pt)
ECB	3.66% in Oct.	4.07% in Oct.	(0.41%-pt)
BoE	4.64% in Sept.	4.88% in Nov	(0.24%-pt)

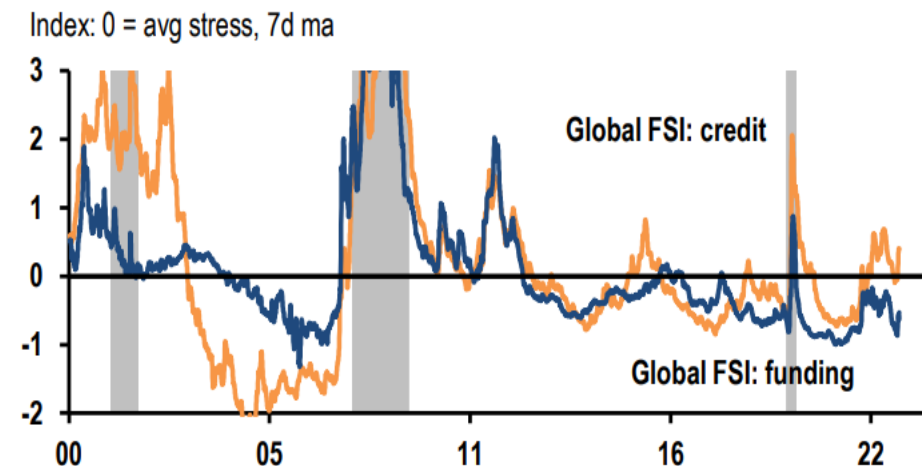
1. Separation principle: maintain commitments to financial stability —supplying liquidity institutions in need — and to raising rates if necessary to contain inflation

2. Powell's statement at press conference following March 21-22 FOMC meeting

3. Estimated terminal (peak) policy rates based on overnight index swaps: source: Bloomberg, GS. Pre crisis estimates as of 8 March / post-crisis estimate as of 14 April. All estimated terminal rates reached in 2023

Global Financial Stress Limited / Relatively Modest Hit to US GDP Expected

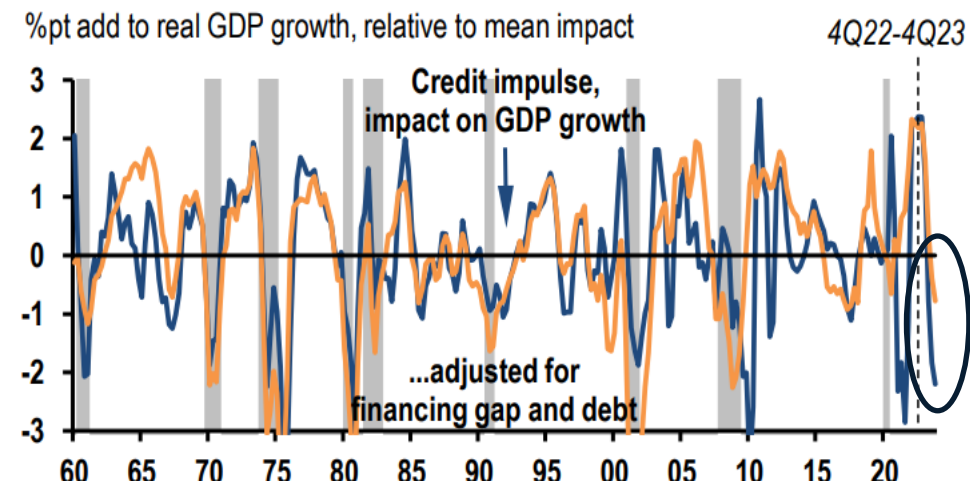
OFR Financial Stress Indicator



Source: Bloomberg, OFR, JPM

- Global financial stress appears limited currently
- Credit spreads and market volatility has increased but Treasury (OFR) measures of global credit and funding stress remain close to their average levels of the past decade

Impact of Credit Impulses on US GDP Growth



Source: JPM

- Based on JPM model estimated credit drag on GDP growth this year² ~ 2%-pts. if health of business sector is not considered (blue line)
- However, accounting for limited external financing needs of nonfinancial corporate sector estimate drag on '23 GDP growth is 0.8%-pt. (gold-line)

1. Office of Financial Research (OFR) created as part of Dodd Frank to promote financial stability
 2. JPM assumes credit cycle savings down in 2023 — e.g., bank lending declines from 12% oya in 4Q22 to just 2% this year

Country / Regional Outlooks

Major DMs	Estimated GDP Growth			Estimated CPI Increase		
	2022	2023	2024	2022	2023	2024
US	2.1%	0.8% 0.7%	1.2%	8.0%	4.0%	2.6%
Euro Area	3.5%	0.3% 0.8%	1.2%	8.4%	5.3%	2.5%
UK	4.0%	(0.7%) (0.3)%	0.6%	9.1%	6.2%	2.2%
Japan	1.0%	1.3% 1.0%	1.1%	2.5%	2.2%	1.5%
BRICs						
China	3.0%	4.8% 5.7%	5.0%	2.0%	2.5%	2.2%
India	6.8%	6.0%	6.2%	6.7%	5.0%	4.8%
Brazil	2.9%	1.0%	1.2%	9.3%	5.3%	4.5%
Russia ¹	(2.1)%	(2.0)%	1.0%	13.7%	5.0%	5.0%

- **Major DMs: 2023-24 growth outlook mild or borderline recessions expected** — peak effects of monetary tightening to hit late '23 early '24
 - Inflation persistent but expected to moderate over cyclical horizon
- **Major EMs: expected cyclical growth nuanced**
 - China: resilient recovery, India still strong, Brazil moderating, Russia in recession

1. Only limited official economic data available for Russia: continuing to publish mainstay data — e.g., GDP and CPI — but narrowed scope of available data a year ago to hide impact of Western sanctions.

High Probability of DM Recession(s)¹

Concern

- Monetary tightening and banking stress have historically led to recessions
- Consensus points to high probability (65%) of US recession in the next 12 months

Possible Counterpoint

- GS economists contend recent economic resilience, unfilled jobs, initial success in containing banking stress reduce recession risk significantly (to 35%)

Further Bank Failures Similar to 1980s S&L Crisis²

Concern

- SVB's failure could cascade throughout regional banks akin to 1980s when more than 1,100 lenders collapsed

Possible Counterpoint

- Economy experienced long albeit choppy expansion in 1980s. 1990s recession largely sparked by invasion of Kuwait and subsequent oil-price shock

Systemic Lehman-Like Event/Global Recession³

Concern

- Tail risk: Banks reduce credit availability/ consumer demand and investment weaken/ accelerating economic deterioration/ precipitating defaults and deep recession ensues

Possible Counterpoint

- Not like GFC: Major banks and private sector in much stronger financial position... financial markets more robust... e.g., interbank transactions centrally cleared. China and India poised for strong growth

1. Bloomberg: Consensus US recession risk 65% over next 12 months; GS: US recession risk 35% over next 12 months and would be surprised if Euro area evades recessions. Global Views: Jan Hatzius 12 April 2023

2. "Fink raises fear of slow rolling crisis sparked by SVB failure," FT 16 March 2023. Counterpoints. "... Gauging the credit shock", JPM, 30 March 2023

3. Two recent Capital Economics articles: 'Just how big a problem are bonds for banks and the economy?'. 17 March 2023, "Banking stress raising another dilemma for central banks," 16 March 2023.

Commercial Real Estate Bruised But Not Broken¹

Possible Counterpoint

- Possible mitigants: commercial real estate accounts for only one-third of US mortgage market, bankers tightening lending standards pre-crisis...
- Fundamentals for apartment and industrial subsectors of market healthy currently. Small bank loans concentrated in less vulnerable suburban buildings, while large banks have more diversified portfolios

Concern

- Rising rates, higher vacancy rates, soft rents, exposure to floating rates concerns re commercial real estate

US Debt Ceiling Potential Impasse

Possible Counterpoint

- If impasse can't be resolved, GS economist expects some central Republican representatives will vote with Democrats at brink to lift debt limit³

Concern

- Debt ceiling expected to be reached between July and September. Current political posturing concerning². Failure to reach agreement would be destabilizing event for financial markets and economy

1. Megan Greene, "Commercial real estate is bruised but not broke" FT, 13 April 2023

2. Administration: Speaker holding full faith and credit of US hostage. McCarthy: "No Strings attached debt limit will not pass". Joe Manchin: "Biden administration is determined to pursue ideological agenda rather than confront...danger debt and deficits pose to our nation..." WSJ, March 30, 2023.

3. "More Questions Than Answers on Debt Limit", Phillips, 20 January 2023

- **Global Growth Forecasts, Particularly for DMs, Hardly Changed But...**
 - **2023 GDP Outlook** includes some significant surprises in underpinnings of forecast...
 - Better-than-expected Q1 data and tightening lending standards offsetting
 - EM outlook received lift from China's resilient reopening
 - Outside of Asia EMs tracking modest expectations/developing countries facing debt challenges¹
 - **2024 GDP Outlook's** expected growth slightly stronger via-a-vis 2023
 - Path of next year's growth, particular for DMs, expected to be...
 - Mirror image of 2023/increasing gradually over course of year²
- **Baseline Inflation Outlook Unchanged / Taming Inflation Still Work in Progress**
 - Positives cited in January remain in place³
 - Central bank commitments to price stability in wake of recent banking stress reassuring
 - Preliminary signs wage pressures starting to ease but..
 - Sticky core inflation underscores that central banks have more work ahead
 - Possible central bank miscues major known risk

1. IMF in recent (April 2023) economic outlook report noted that frontier and low-income countries face extremely challenging debt conditions, more than half (37 out of 69) are in or at high risk of debt distress

2. Slowing effects of monetary tightening expected to reach peak near turn of year

3. Headline inflation declining, long-run inflation expectations anchored, bottlenecks easing, spending patterns normalizing, wage pressures caused by prior supply shocks have not caused wage-price spirals.

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