# 4Q2023 Global Economic Outlook

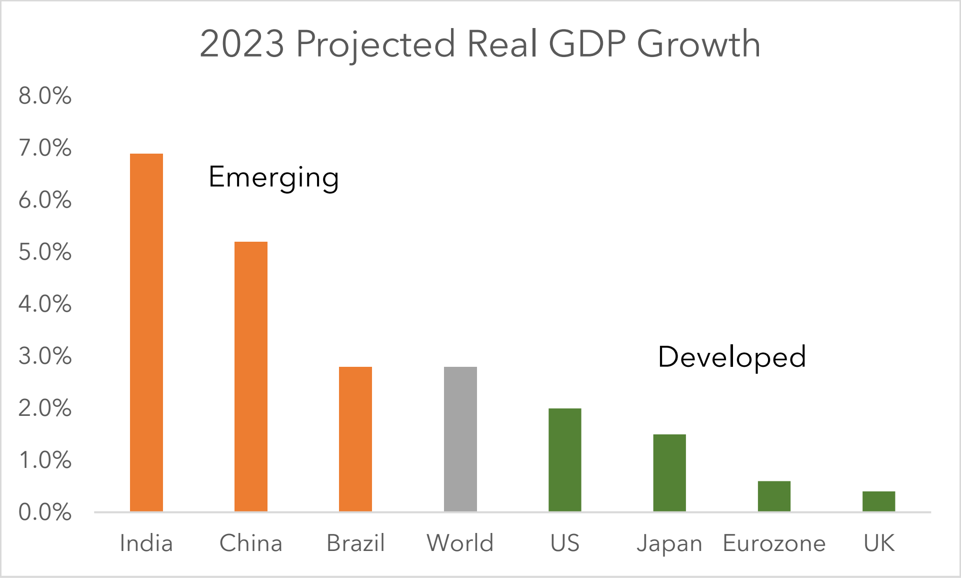
## Highlights

- Global GDP growth set to slow
- Fiscal stimulus slightly downshifting
- Inflation slowing, but inconsistently
- Potential for rate cuts improves in 2024
- CRE slowly nearing turning point

The global economic narrative for 2023 tells a tale of two halves. After a robust first half, during which economic growth proved resilient and consistent, the global economy is slowing as we head into the latter stages of the year. This slowdown is occurring across regions, and some could face a contraction this year or next. But the global economy proves resilient to regional slowdowns. In the last 45 years, the modern era of global economic integration, the global economy has contracted only twice: during the 2008-2009 global financial crisis (GFC) and during the pandemic, both highly idiosyncratic, global events. We see no such analogue this cycle. Moreover, we expect any slowdown to prove relatively short and shallow, in contrast to the prior two slowdowns.

## GDP

Defying expectations of a slowdown, the global economy grew at a consistent pace in the first half of the year. Although we anticipate a slowdown in the latter half of the year, we still foresee economic growth ultimately registering 2.5%-3.0% for the calendar year. To no small extent, resilience in the U.S. economy supported global economic growth. But generally, the developed economies of the world are lagging emerging economies. While Japan presented a bit of a bright spot in the first half of 2023, growth in the Eurozone and the UK proved lackluster, with both flirting with recession this year. Furthermore, growth in the US, the UK, the Eurozone, and Japan is set to slow over the balance of 2023 and into 2024. Meanwhile, although emerging economies typically grow faster than their developed peers, the rift has widened in recent periods. Major emerging economies such as China, India, and Brazil should all drive global economic growth over the balance of 2023.




Sources: Oxford Economics, BGO Research

Heading into 2024, that difference in growth rates should persist and widen. While both developed and emerging economies should slow in 2024, the divergence between the two should further widen. Why? First, major economy central banks will likely keep interest rates higher for longer periods to ensure that inflation returns to target in a relatively quick manner. That will more greatly restrain the economic activity of developed economies since they typically operate with much lower interest rates than their emerging-market peers. Second, fiscal stimulus has become somewhat less accommodative relative to the spending that occurred during the pandemic, including indirect impacts like excess savings which have already become exhausted in several countries. Thankfully, global growth prospects look brighter in the latter half of 2024 into 2025 as central banks seem likely to begin cutting rates by that time.

## Fiscal Policy

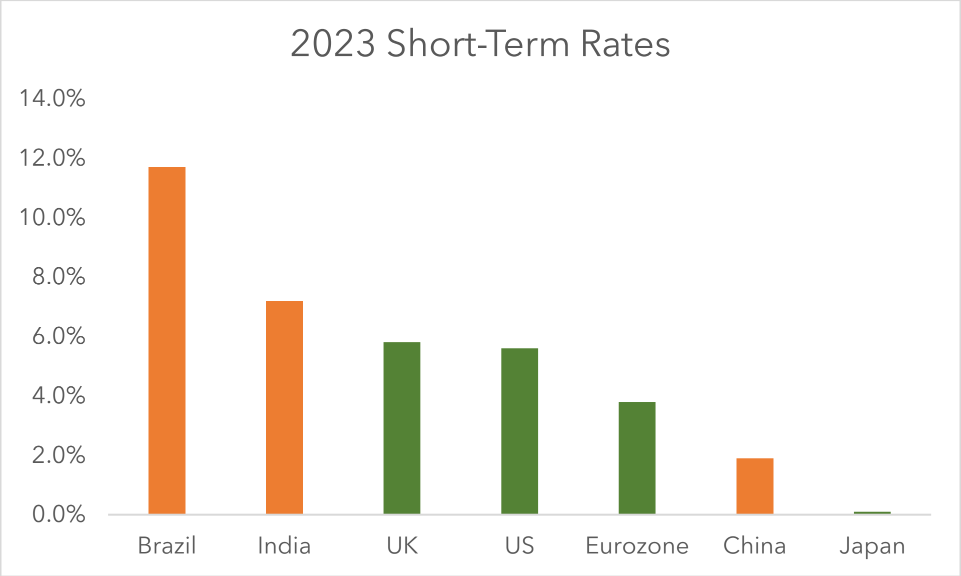
As mentioned above, fiscal policy remains broadly accommodative, but its impact has lessened over time. In major developed economies, purely stimulative fiscal stimulus largely ended by 2021. However, its impact continues to linger because not all funds approved by legislatures got spent immediately and, in several countries like the US, consumers retained excess savings which has helped them continue to spend money. Yet we expect to see greater impact from fiscal tightening over the balance of this year and into 2024.

Yet if growth slows, as we largely expect, several countries could consider greater spending to boost aggregate demand. China presents an interesting exception. Despite recent economic troubles, the government has not implemented significant stimulus measures to offset weak domestic demand relative to past instances of fiscal stimulus. Nonetheless, it should provide a marginal boost to growth which should help both nationally and globally. And if the slowdown worsens, the government could implement further stimulus, which would provide a boost to global growth.

## Inflation And Monetary Policy

Inflation around the world has notably decelerated as it evolved largely over three phases. In the first phase disrupted global supply, coupled with resurgent demand due to fiscal stimulus and reopening of economies as vaccination spread, produced a notable acceleration in inflation. As the global economy began to move past that phase, the war in Ukraine pushed up energy prices in the second phase causing inflation to hit multi-decade highs around the world. As those forces have largely abated, inflation has decelerated around the world. That brings us to the third phase, where central banks now focus on tight labor markets, which they believe are preventing inflation from slowing more rapidly. We expect inflation to slow across almost all major developed and emerging economies over the next 12-24 months. But it should prove bumpy and inconsistent on the way down. Energy markets, labor markets, and housing markets all remain supply-constrained (in many cases artificially or because of bad policy) which should make the return to target rates a tougher slog than otherwise.

Thankfully, with inflation slowing, most major central banks have already implemented the majority of their tightening for this cycle. Recently, the Federal Reserve, the European Central Bank, and the Bank of England have all communicated something similar. But they have also suggested that rates will likely remain higher for longer. Historically, high inflation at the beginning of a cutting cycle has resulted in relatively slow pace of loosening. Based on recent guidance, that will likely occur again unless growth contracts more meaningfully than expected. In our base case, we do not foresee major central bank loosening until around the middle of next year. Central banks will need more confidence that inflation is moving back to target rates than they currently possess. They likely will not need to see inflation at target before cutting interest rates, or at least halting rate hikes, but they will need to see more sustained deceleration, getting closer to target, than currently. Year-over-year inflation will likely have to fall within 100 basis points of target rates before central bankers feel more secure about cutting rates.



Sources: Federal Reserve, BGO Research

## CRE And The Economy

Of all the relevant macro factors, interest rates remain the focus for commercial real estate (CRE) investment. That seems a bit of an oversimplification but given the significant increases in central bank policy rates around the world the important of space-market fundamentals has become diminished. Asset pricing has adjusted downward around the world, in some locations potentially too much, and the cost of capital makes borrowing infeasible for many investments. Yet, that presents excellent opportunities for those funds capable of capitalizing on such an environment. Our proprietary research demonstrates that when central banks cease raising rates, CRE returns tend to improve quickly and in some cases dramatically. Even if the cause of a change in monetary policy is a slowdown in macroeconomies, any potential negative impact on space market fundamentals, that would dampen net operating income (NOI), would likely get more than offset by a decrease in interest rates. And the substantial rate increases of the last 18 months give central banks more runway to cut rates than they have had in roughly 15 years. The outlook is slowly turning positive, but a few more bumpy quarters likely lie ahead.

## Closing Thoughts

The main source of optimism is also the main source of risk – monetary policy. If central banks around the world leave rates higher for longer than expected, that will cause CRE to remain in a holding pattern with relatively little transaction volume and lending activity. Such an environment would not last forever, certainly, but extending this period could prove painful for some investors that are banking on a decrease in rates before they must refinance or bring a property to market. That could also present tremendous investment opportunity. A silver lining? Perhaps, but despite the uncertainty of timing the winds of change are starting to blow. And we must also not forget the potential impact that geopolitical risk can have on the global economy. Geopolitical risk is higher than at any time since the end of the Cold War and it keeps going up every year, not down.

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