Atradius

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Tightening weighing in

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Executive summary

The global economy has proven more resilient than was expected six months ago, but past monetary tightening is weighing on the outlook. Global growth in 2023 was revised upwards mainly due to strong US consumer spending and the recovery of services after the pandemic. While inflation and monetary policy rates have mostly peaked, the brunt of the impact on consumer and business demand will be felt in 2024. We think that GDP growth will weaken in 2024 as the impact of these factors wanes and monetary tightening weighs in. Mild monetary easing will help support tepid growth in 2025.

Key points

- **The 2023 GDP forecast is better than was expected six months ago.** Global GDP growth is estimated to be 2.6% in 2023, an upward revision of 0.4% compared to the July Economic Outlook. Growth is likely to dip to 2.1% in 2024. The resilience of spending by the US consumer has reached its limits and the post-pandemic recovery of services, especially of tourism and international travel, is almost complete. Moreover, the full impact of monetary policy tightening is yet to be felt. For 2025, we foresee growth to recover to 2.6%, as monetary policy starts to ease and inflation has further declined. Growth, will however, remain weak by historical standards.

- **Inflation has clearly moved past its peak, with all major inflation components in decline.** The energy component has contributed negatively to headline inflation in the US and eurozone in recent months. Moreover, the other inflation components - food, services and goods – are also clearly losing momentum. But core inflation, which excludes energy and food, is persistent, especially in the US. Still, as monetary tightening weighs on demand, headline and core inflation are expected to come down. With the lower persistence of inflation, the eurozone will be ahead with monetary easing.

- **We forecast global trade growth to slow to 0.8% in 2023, from 3.0% in 2022.** Trade growth in 2023 is lower than previously expected as the ending of the zero Covid-19 policy in China did not generate the hoped-for boost to exports, and the manufacturing sector is in recession, especially in Europe. For 2024 we predict a recovery of trade growth to 2.5% as these factors wane. Our forecast is in line with the observation that the relationship between trade growth and GDP growth has settled down to 1:1. Trade growth is constrained by rising protectionism and geopolitical uncertainty.

- **We estimate GDP growth across advanced markets to be 1.6% in 2023.** The impact of past monetary policy rate hikes is increasingly taking its toll, with consumer and business senti ment low and a slowdown in demand expected. Growth in 2024 is forecast to remain very restrained at 0.9%. For 2025, the growth picture looks slightly better. Falling inflation will improve consumer purchasing power. Mild monetary easing will support growth as well.

- **GDP growth in emerging market economies (EMEs) is expected to stay in a lower gear at 4.2% in 2023 and 3.6% in 2024.** This is due to weak external demand and tightening global financing conditions. Beneath the headline figures lies substantial heterogeneity. Emerging Asia is set to lead other regions again, with India and China being the growth motors. Latin America, struggling with structural weaknesses and political uncertainty, will lag other regions. The growth outlook for 2025 is only slightly better across EMEs (3.9%).

- **In our baseline scenario, inflation is expected to come down as monetary tightening is able to remove the persistence in core inflation and there is no new energy price shock.** In our alternative scenario, things turn out worse. Inflation is more persistent than expected, for example because consumers continue spending or there is a new energy price rise. This will trigger further tightening (instead of mild easing) by central banks. That will lead to a fall in demand from firms and households across both advanced markets and EMEs, with significant negative effects on global growth.

Global Outlook

1.1 More resilience, for now

Weak resilience. Moving away from recession. That was the picture of the global economy we depicted in our July Economic Outlook. It was shaped by three factors. First, and most prominently, expectations were related to the reopening of China after the sudden reversal of the zero tolerance policy early in the year. Second, Europe had weathered the energy price shock and the impact of sanctions related to the war in Ukraine rather well, aided by government support. Firms proved flexible in adjusting production processes, dampening the impact of the energy price rise. A mild winter helped as well. Third, monetary policy tightening in the US did not bite as hard as feared. With unemployment staying at a record low, the US consumer continued to spend from higher wages and accumulated pandemic savings. This was despite inflation levels not seen for decades.

But recessionary forces lingered. In response to the inflation shock, monetary tightening had been very aggressive and rapid, especially in the US. It was considered unlikely that the full impact had been felt. This feeling was underscored by the default of Silicon Valley Bank in March. The shockwave through the financial system could only be contained by massive intervention by the Fed and the US government. Moreover, as inflation proved stickier than initially envisaged, the question was when the series of rate hikes would peak. These effects reverberated in borrowing costs for firms and households, which continued to rise. Now, as we approach the end of 2023 and take stock of the global economy again, we can report more resilience. Two elements stand out. First and foremost economic activity in the US held up better than expected. Again. In Q3 of this year the economy grew by no less than 5.2 q-o-q. It appeared monetary tightening has not really started to bite. Demand has held up. Consumers continued to spend, as pandemic savings were not almost exhausted, as previously thought. Many firms had issued long term debt when rates were low, providing protection against the (much) higher current interest rates. Second, in 2023 the recovery of services across the globe, so badly affected during the pandemic as a result of lockdowns and infection fears, further gained force. This process is now almost complete. Tourism especially in Southern European countries, as well as France and Mexico, has recovered to pre-pandemic levels, or even above. International travel, particularly related to tourism, is buoyant, with airlines reporting strong performance during 2023.

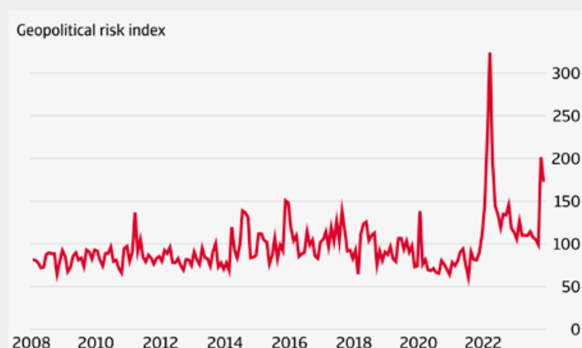
The US consumer and the services recovery have dominated a global economy, which has otherwise performed more or less as we expected. China's growth, after a strong reopening start, slowed as weakness in the real estate sector mounted, with homes not completed and investment remaining low as confidence continued to decline. This, as well as elevated labour market uncertainty, with youth unemployment reaching more than 20% this autumn, held back strong consumption growth. Europe's growth was positively affected by the continued revival of tourism flows. But its manufacturing sector, especially in Germany, soured. Still grappling with higher energy costs, it increasingly faces the impact of higher borrowing costs and tighter credit conditions that come with monetary tightening by the ECB.

The upshot is that the global economy is in now in somewhat better shape compared to July. Will this better-than-expected scenario last? We think not. And we have good reason to believe so. First and foremost, the resilience of the spending by the US consumer has its limits. The bottom of the deep pockets with accumulated savings from the pandemic stimulus by the US government is coming into sight. Moreover, and even more importantly, the lagged impact of monetary tightening is expected to kick in. That weighs on the housing sector, putting a brake on prices, creating negative wealth effects and constraining consumer spending. Tightening hits firms as well, especially those who have not locked in long term funding, thus facing higher borrowing costs. That has an effect on investment and will also lead to more bankruptcies, which is already visible now. As a result, the tight US labour market will inevitably ease, as will income growth for workers. These will then be even less inclined to go on a spending spree.

Second, as mentioned, the post pandemic recovery of services, especially of tourism and international travel, is almost complete. Services will return to a more normal growth path; its boost to GDP is running out. Meanwhile manufacturing is not able to take over the growth baton yet. With borrowing costs that have run up as a result of tightening, and demand from consumers weaker, firms are hesitant to pace up production, let alone invest in new production capacity.

Third, whereas households and firms are not likely to lead in pushing up growth, significant policy easing cannot be

Figure 1.1: Another spike in geopolitical risk



Source: Economic Policy Uncetainty, Macrobond

expected either. After a period of high inflation and core inflation showing persistence, major central banks such as the Fed and ECB are not in the mood to change track. As some easing can be expected, the overall picture will be 'higher interest rates for longer'. Precisely this is another factor that will restrain governments from stepping in. In any case, fiscal consolidation is required after the pandemic and the subsequent cost-of-living support programmes. Indeed, public finances have weakened to levels where even without significantly higher interest costs, spending restraint would be needed.

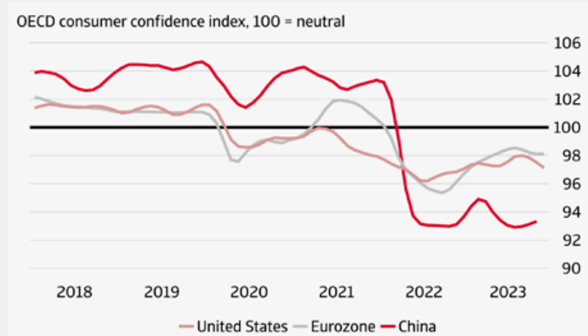
Fourth, geopolitical concerns are mounting (figure 1.1). The souring of the China - US relationship under the Trump administration was only a start. After that Russia started its war in Ukraine. China showed its military muscle to Taiwan to emphasise that the island should not get used to the idea of independence. Most recently, the long lasting Israeli-Palestinian conflict saw another eruption with the potential for proliferation, at least regionally. These conflicts add to uncertainty in the global economy. Geopolitics have quickly become a matter of concern for the global economy. In short, we could be surprised on the upside again by GDP growth, but for now we do not see where that would come from.

1.2 Slow, the best we can get

This picture of a US consumer who is running out of firepower, a post-pandemic services recovery almost ended, manufacturing firms unable to boost growth in the face of high borrowing costs and governments pushed back to get their house in order does not bode well for GDP growth. Tightening is weighing in. Slow growth is the best that we can get. That is indeed what we expect over the forecast horizon. More precisely, whilst in 2023 global growth has shown some persistence, it will slow in 2024. In 2025 a mild acceleration can be expected, on the back of some monetary policy easing and the impact of previous tightening waning. Sentiment indicators offer support for this subdued view.

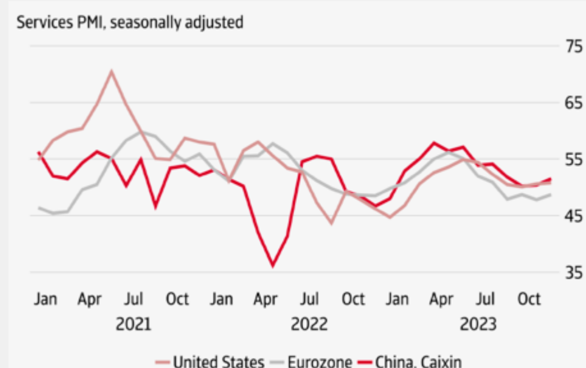
The positive trend in consumer confidence that we observed in July is reversing, or at least has peaked. In the US, the eurozone and China, we see no longer improvements in the index (figure 1.2). Moreover, the indices are all moving below 100, the level that indicates spending restraints over the next 12 months. For both the US and eurozone the 'higher for longer of interest rates' are weighing in. That feeds back into consumer sentiment, directly via interest costs for borrowers such as those buying a house, and indirectly via wealth effects for homeowners as well as asset portfolio holders. This is insufficiently compensated by the lower level of inflation, now that nominal income growth is diminishing and accumulated pandemic savings are running out. For the eurozone the persistently higher than pre-pandemic energy cost, especially for gas, is another force at play. In China, interest rates are still low, as is inflation, but the crisis in the real estate sector has stamped its mark on confidence. Homes paid for by future owners are not completed, as property developers such as Country Garden are in financial difficulties. Moreover, the labour market, especially its younger segment, faces high unemployment figures and uncertainty about future job and income prospects. No wonder the indicator for China, which plunged after a strong recovery following the reopening, is so low now.

Figure 1.2: Wobbly consumer confidence



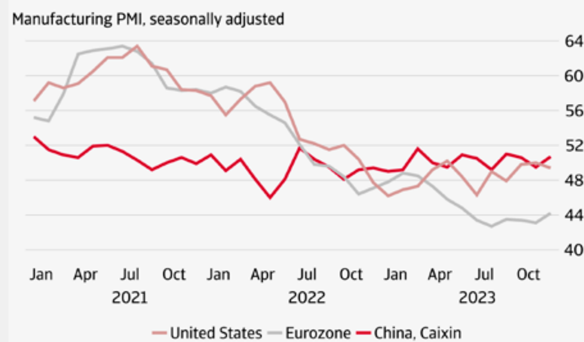
Source: OECD, Macrobond

Figure 1.3: Waning services confidence



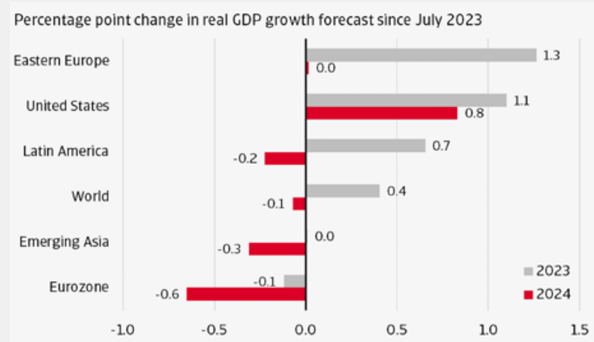
Source: S&P Global, Macrobond

Figure 1.4: Slump in manufacturing confidence continues



Source: S&P Global, Macrobond

Figure 1.5: Upward forecast adjustments



Source: Oxford Economics, Atradius

Business sentiment indicators are slightly more positive, but are sliding as well. Services PMIs have declined for all regions since the summer, and for the eurozone are even below the level of 50 that signals growth (figure 1.3). The slide partly reflects the return to normal after the pandemic recovery. The consumer's appetite for services after the pandemic, particularly for tourism and travel is waning. That weak demand drags down demand for services, reducing the services PMI in that region, much more markedly than in the US and China. Moreover, demand in the manufacturing sector remains weak, especially in the eurozone. US manufacturing PMI has fluctuated around the 50 level since the beginning of the year, without clear direction. The Chinese manufacturing PMI has gone up since the summer and has now reached a neutral level (figure 1.4).

Figure 1.5 reflects the forecast revisions for 2023 and 2024 since the July Outlook. For 2023 the stronger resilience is reflected in an overall upward revision of 0.4 percentage points (ppt). The far stronger US economy shows up in the 1.1 ppt upward revision. The other upward revision is for Eastern Europe (1.3 ppt), where the Russian and Turkish economies perform better than previously expected. Latin America also performs better (0.7 ppt), with Mexico benefitting from the stronger US economy. The eurozone figure is more or less in line with our expectations in July (-0.1 ppt). These figures are not expected to hold up for 2024, and the global economy is forecast to grow 0.1 ppt less than forecast in July. The US economy is now expected to grow 0.8 ppt faster. The eurozone faces a significant downward forecast adjustment, by 0.6 ppt. Emerging Asia is reduced downward as well, by 0.3 ppt, largely reflecting the impact of lower growth in China (0.3 ppt). All the same, over the two year revision period, these adjustments imply an overall improvement for the global economy, and the US in particular.

Whereas the revisions are slightly upward, they are insufficient to be jubilant about the growth numbers. The picture of sluggishness persists. Overall GDP growth of 2.6% for 2023 and 2.1% for 2024 underscore that. Eurozone growth, in particular, remains very weak at around 0.6%. Weakness also holds for the US, especially in 2024 as the full impact of tightening is felt and fiscal consolidation kicks in. Meanwhile, the cart horse of the global economy of the past decade, Emerging Asia, is showing some weakening now that China's growth is under pressure. A growth figure of 4.5% for both 2023 and 2024 is relatively weak, considering that the 2010-2019 average amounted to 7.2%. Some support for the global economy comes from Eastern Europe, where growth is expected to be at around 2.2%. For 2025 the picture is somewhat better, especially for the eurozone when the impact of monetary tightening will have worked its way through the economy and some easing starts to benefit activity.

Table 1.1: Slow growth in numbers

	2022	2023e	2024f	2025f
Eurozone	3.4	0.5	0.6	1.8
United States	1.9	2.4	1.2	1.3
Emerging Asia	3.8	5.4	4.5	4.5
Latin America	3.8	2.0	0.8	2.5
Eastern Europe	1.8	2.7	2.2	2.4
World	**3.1**	**2.6**	**2.1**	**2.6**

Source: Oxford Economics, Atradius

1.3 The slow growth assumptions

Our slow growth forecast hinges on a number of assumptions. These are changing only gradually, implying the attentive reader may recognise quite a few of them from the July Economic Outlook.

First, the pandemic is history. It was formally declared over earlier in the year by the World Health Organisation (WHO). China's 'zero Covid tolerance' policy is long gone. Supply chain tensions have abated, as have price pressure on transport and related highs in goods prices. They will not return. A resurgence of the virus, or any other, will not lead to lockdowns or a repeat of the impact on society.

Second, restrictions on spending on services during the pandemic, combined with government support, especially in the US, have led to excess savings. These were in the range of 5.1% to 9.2% of GDP for the advanced economies by the end of 2022[1]. For the US, 4% of GDP of USD 1 trillion, is still left[2]. For the eurozone a similar amount is available[3]. We assume that there is only very mild remaining spending from these excess savings. This is because the bulk of the savings are in the higher income groups, saving is currently being stimulated by higher interest rates, and uncertainty triggers precautionary buffers.

Third, pandemic support programmes by governments will have all ended by the end of this year. As some support programmes to alleviate the cost-of-living crisis were put in place, fiscal consolidation was slowed. But given the pressure on public finances, including government debt ratios that the pandemic support generated, fiscal consolidation is inevitable. Remaining support programmes will be scaled back as energy prices have come down. The higher interest rates provide an additional stimulus for that. Nevertheless, as compared to the previous decade, we expect governments to play a more active role in supporting the economy. More particularly, governments are expected to be pro-active in the energy transition, as exemplified by large initiatives such as the Inflation Reduction Act in the US and the Green deal in the EU.

Fourth, as the sources of inflation, such as supply chain tensions, rising energy and food prices and excess demand as a result of government support programmes during the pandemic have evaporated, inflation will inevitably come down. This is reinforced by the rigorous tightening of monetary policy by the Fed, the ECB and other central banks to bring back inflation to the 2% target. We also see no vicious wage price spiral developing now that wage rises are contained, helped by the inflation expectations that have remained around the central bank target. Reaching the inflation target is expected well into 2024 or perhaps later and varies per country.

Fifth, central banks have shown a strong commitment towards bringing inflation back to target and are expected to continue to do so. Given that inflation has peaked amid the current relatively high level of interest rates, there will be very limited rate hikes in store. The question is when easing of monetary policy can be expected. We think that will be over the course of 2024, when the impact of past tightening is really felt and, especially the US and eurozone economies, slow significantly. Meanwhile, the gradual reduction of the balance sheets of central banks, through redemption of bonds purchased during the crisis, will continue.

Sixth, we assume geopolitical tensions remain contained, but the negative impact will largely persist. China is expected to occasionally bark but not bite Taiwan, in the sense that it will not invade the island. An invasion would further complicate the relationship with the US, in particular in trade. The Israeli-Palestinian conflict is thought unlikely to spread into a regional conflict, or even worse. The economic damage will therefore be largely for the parties involved, with limited global economic implications[4]. The military conflict in Ukraine seems to be turning into a stalemate on the battlefield. But a ceasefire, let alone a peace deal seems far off. Similarly, a reduction of the tensions between the US, UK and EU and Russia is not on the cards. Sanctions will remain in place, even well beyond any conclusion of the conflict. Therefore upward pressure on energy and food prices is expected to last. But not to the extent that prices spike. Gas rationing in Europe is off the cards as the tanks are well filled and there is sufficient LNG capacity.

Seventh, with the geopolitical tensions, the risk of deglobalisation has gone up. US-China tensions have not eased, and the EU has also shown a more realistic approach towards China. The Russian war has effectively cut off Russia from normal relationships with the advanced economies. Apart from that de facto piece of deglobalisation we don't envisage a break-down, rather a slowing or stabilisation of that process. The Trump-administration era trade tariffs between China and the US are still in place, but no additions have been made and we do not expect that to happen over the forecast period. Still, the US has become far more reluctant, as has the EU, to share technological expertise with China, especially when it relates to security. This erosion of globalisation is expected to last, amounting to a picture where trade is continuing, albeit with impediments, and decoupling in technology sharing.

1 See Oxford Economics. Excess savings can still deliver an upside surprise, May 10 2023.

2 See The Economist. Interest rates and the world economy, November 4th-10th 2023.

3 See Oxford Economics. Eurozone: Why excess savings are unlikely to fund a spending spree, May 3 2023.

4 Such as a significant decline in the number of flights to and from the Middle East.

1.4 Creeping trade growth

In our previous Outlook we argued that global trade growth for 2023 warranted an upward revision, citing the economic environment that proved less weak than expected[5]. Indeed, we upgraded the forecast slightly from 1.5% to 1.9% for 2023 and kept it at 2.5% for 2024. This was not only in line with other forecasts, such as that of the WTO, but was also corroborated by the new export order momentum index. The latter had edged up markedly. Trade momentum itself was also improving. The forecast was also brought in line with what we believe to be the relationship between GDP growth and trade, 1:1. In brief, slightly better GDP growth was to be reflected in slightly better trade growth.

About six months on, it appears we cannot maintain this forecast. With trade growth coming in y-o-y at -1.7% in September 2023 and a momentum that became negative again after a short revival during the summer, achieving 1.9% growth is not realistic. More likely we end up at 0.8%, which is our forecast for 2023. This implies a marked slowdown compared to 2022 (3.0%). We take into account that the second half of 2022, which is the basis for calculating the second half of 2023, was very weak. This implies we can rely on the second half of 2023 being relatively strong. An upward turn in trade momentum in Q3 as well as a recovery into positive territory for new export orders corroborates this view (see figure 1.6).

For 2023 the revision is downward; we keep the trade growth figure for 2024 at the same level as in the July Outlook[6], 2.5%. This downward revision for 2023 seems relatively mild. But it is more pronounced if one takes into account that we have upgraded the 2023 GDP forecast by 0.4 ppt to 2.6%. The result is that the 1:1 relationship between GDP growth and trade growth breaks down in 2023. That is temporary: we expect it to recover in 2024 and onwards.

Why is global trade so weak at the moment? Several factors are at play. Firstly, the situation in China, as already described above. The expectation, or perhaps hope, was that the end of the zero tolerance versus Covid-19 would provide a boost to exports, and also imports. That is not exactly what we are seeing. Chinese confidence indicators are lacklustre; especially consumer confidence is very low compared to the US and the eurozone. Given the uncertainty in the real estate market and the high unemployment rate, especially for youth, Chinese consumers have remained very reluctant to accelerate spending. Due to weak external demand, export growth is also limited. Secondly, and this relates to the relatively low export demand from China, manufacturing is in recession, especially in Europe. This is, as we have already mentioned, hitting German exports in particular. Global GDP growth is led by services growth. Services are far less trade intensive, and by nature not included in goods trade figures anyway. In other words, if we want to stick to the context of the 1:1 relationship between trade growth and GDP growth, GDP growth is perhaps inflated. Thirdly, monetary tightening plays a role, and arguably has a larger impact than initially expected. It impacts trade via several channels. The first is via investments and related international capital goods trade. Financing has quickly become more expensive and more difficult to obtain, cutting off investments that were previously profitable. That affects trade negatively. Not only financing of investments, but also trade finance (credit, insurance, guarantees) has become more expensive. Moreover, its availability, on which 80% to 90% of global trade relies, is on a downward trend, dropping at an

Figure 1.6: Trade momentum improving modestly

Source: CPB, IHS Markit, Atradius

Figure 1.7: Trade growth reverts to GDP growth

Source: CPB, Oxford Economics, Atradius, Macrobond

5 We discuss global merchandise trade, unless otherwise indicated.

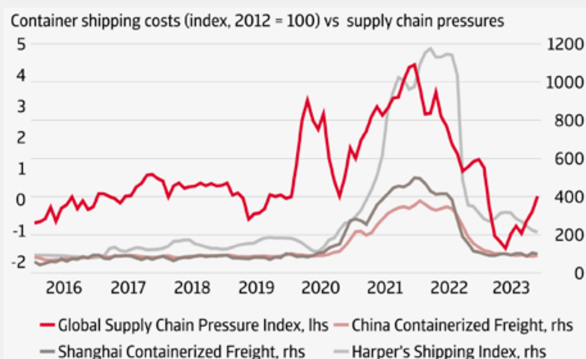
6 Of course, this implies a lower level of trade in 2024 as well, due to the current lower growth (and thus lower trade level) in 2023.

annual pace of 4%. That is starting to weigh in now that the availability of finance in general is tightening. The other impact of tightening runs via the US dollar, which is used as an invoice currency in the majority of trade transactions. Because of the high interest on the US dollar, the currency has appreciated. That makes it more expensive in local currency terms, putting a brake on demand.

These factors, plus the China slowdown, the recession in manufacturing and monetary tightening weigh heavily on current trade. This is the case even more than envisaged in the last part of 2022 and in 2023 so far. But these factors will fade, albeit gradually. Chinese consumer demand will improve; manufacturing will recover; and monetary policy will be eased over the forecast horizon, though only mildly. Then other, more positive, underlying developments in global trade can manifest themselves, justifying the more positive outlook for 2024 and onwards.

The most obvious drop is the decline in trade costs (figure 1.8). Supply-chain stress that dominated the pandemic has almost faded, with the supply chain pressure index having reverted to normal levels. This index consists of two elements: the delivery time for a good and the cost of transport. Both have come down dramatically. The Harper shipping cost index is almost at its 2019 level after a peak that was 12 times higher. The other positive development is the recovery in the semi-conductor and auto industries. The sharp downturn in the semi-conductor industry, a key factor in Asian trade weakness, seems to have bottomed out. Auto exports have finally regained their pre-pandemic levels now that shortages of components have eased. Even aerospace exports have started to recover, although they are still 10% below 2019 levels.

Figure 1.8: Supply chain pressures back to normal



Source: Macrobond, Atradius

Looking longer term, there are clear limitations for trade growth. Firstly, geopolitical, developments such as the Russian war in Ukraine and the US-China tensions have led to a drive to more regional trade relationships. This comes on top of the impact of the pandemic which has triggered awareness at firms that clustering of the supply chain is valuable in view of security of delivery. That reduces trade, and takes away the benefit of producing in a country that is economically most attractive. Second, protectionism is clearly back. As the IMF reports in its Economic Outlook, in 2022 countries added almost 3,000 new trade restrictions, up from 1,000 in 2019. This is done by way of tariffs, such as those still in place between the US and China. Moreover, following the US with the Inflation Reduction Act of USD 1 trillion, the EU and others have drafted extensive subsidies programmes, especially to induce chip makers to produce at home and drive the energy transition. These factors will clearly limit the potential of global trade.

1.5 Fossil fuel prices slide part two

In our July Outlook we wrote that the slide in fossil fuel prices was about to halt. Fossil fuel prices had declined after peaking following the Russian invasion in Ukraine in 2022 and then declined fairly rapidly. Subsequently some stability was indeed observed. We now forecast that will be short lived and the price decline will resume and continue in 2024 and 2025, be it more gradually. Part two of the (gradual) slide of oil, natural gas and coal prices will then start. Despite that, prices will remain relatively high over the forecast horizon. This puts a brake on the contribution of energy prices to the disinflation process (see below).

After the oil price peaked at USD 130 per barrel Brent in 2022 it moved towards the low end of the USD 70 to USD 90 range in the early summer of 2023. Russian oil kept flowing to the markets despite sanctions. Prices were predominantly driven by expectations about economic growth. Then there was an unexpected announcement by OPEC+ of a production cut in June, after which prices started to rise again[7]. That is not expected to last. Higher production, within and outside OPEC+, and ongoing weak demand as the global economy weakens will lead to resumption of the weakening of the price.

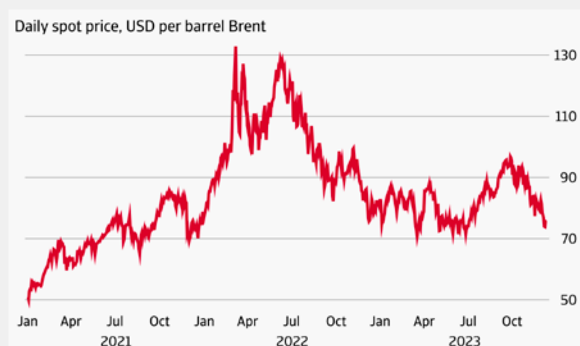
As to natural gas prices, the most prominent development was in the European variant, which plunged in 2023 after the August 2022 peak of USD 70 per million btu, to below USD 10 in the early summer of this year. That reflected market rebalancing after the termination of the delivery of Russian gas to Europe. This autumn, the price edged up again after the shutdown of a gas field off the Israeli coast, an explosion of an interconnector in the Baltic Sea and concerns about escalation of the Israeli-Palestinian conflict. As the European gas tanks are 90% filled and assuming a relatively mild winter as well as no supply disruptions, prices are expected to resume their downward trend. For the Asian benchmark, which tracks the European price with less volatility, a similar picture is envisaged. The US Henry Hub, in 2023 rather volatile, will increase as export demand rises. Coal prices are expected to decline. Demand is expected to weaken as coal continues to be replaced in power generation and industrialisation, also because alternative sources such as natural gas are cheaper. Let us now look at these developments in more detail[8].

Oil

In June, OPEC+ announced that voluntary production cuts, initially due to expire by year end, would be extended until December 2024. This was reconfirmed in November. Moreover, a number of OPEC+ countries, including Saudi Arabia and Russia, volunteered an additional cut of 2.2 million barrels per day in July. The implication is that OPEC+ now holds spare capacity of more than 5% of global demand.

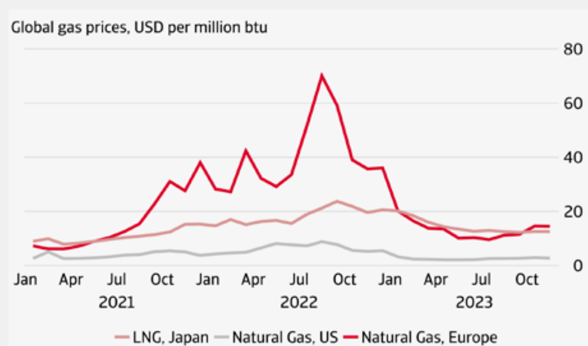
Oil demand increased by 2.3 million barrels per day in Q1-Q3 of 2023, predominantly driven by China. Demand from that country rose by 12% y-o-y despite the real estate constraints. Chinese demand is driven by transportation activity, which has continued to recover after the reopening. Oil consumption in India also rose - by 4% - while demand in the advanced economies was flat. Declines in Europe originated in the weak manufacturing sector in particular. Demand from the US, where economic activity, especially transport, was strong, remained resilient. As to supply, Iran increased its production to 3 million barrels per day, its highest level since early 2019. Production and exports from Russia have been relatively stable. But exports have shifted. Between 2021 and 2023 they increased by 40% to China, India and Turkey, partially offsetting the 53% decrease to the EU, US, UK and advanced Asian countries. The price cap of USD 60 per barrel introduced in late 2022 to limit Russian war funding capacity has not created significant disruptions. Russia is able to trade outside the cap by using a 'shadow fleet' of tankers.

Figure 1.9: Oil price slides



Source: Macrobond

Figure 1.10: Natural gas prices on a plateau



Source: IMF, Macrobond

7 OPEC+ contains the original OPEC countries plus Russia.

8 This part and the next lean on World Bank (2023) Commodity Markets Outlook: Under the Shadow of Geopolitical Risks.

Indeed, the Ural benchmark for Russian oil has been trading at around USD 80 per barrel recently. The US, the world largest producer, increased supply by 1.4 million barrels per day until Q3 2023 y-o-y. About half of the increase went to Europe and China. This occurred despite a decline in the rig count. Ramping up production further quickly will meet with supply constraints, such as cost rises. Meanwhile oil inventories, while they decreased late in the summer, remained adequate. In particular, commercial inventories surged in early autumn. Governments' stockpiles have yet to be replenished after the sales in reaction to the price rises following the Russian invasion. At the current price levels, this is a slow process.

Our outlook of slowly sliding prices assumes a demand of about 102 million barrels per day for 2023 and a very mild growth afterwards, by about 0.9 mb/d. This growth is expected to come from Asia excluding China. Demand from the latter is expected to moderate as the economy slows and moves towards consumption-led growth. In the advanced economies, demand will slide somewhat in 2024 and ease upwards as the economy gathers pace in 2025. The outlook for production assumes no escalation of the conflict in the Middle East. Production growth to meet higher demand is likely to come from non OPEC+ predominantly: the US as well as, to a lesser extent, Brazil, Canada and Guyana. OPEC+ production is expected to grow mildly, as we assume Saudi Arabia will not extend its voluntary production cut beyond year end 2023, while Russian production as well as production from other OPEC+ members is expected to remain stable. The consequence is that the oil market will come into a surplus situation somewhere in 2024, leading to a rise in (commercial) inventories.

Natural gas

Lower natural gas prices led to some bounce-back in industrial gas consumption in the first months of 2023 in Europe. Nevertheless, it was 9% y-o-y lower due to lower consumption in the power sector, fuel switching, efficiency gains and production cut-backs in the industrial sector. The EU Gas Demand Reduction Plan provided support as well[9]. In Asia- Pacific demand went up as China's industrial and power sectors increased demand; in India consumption was higher, helped by lower gas prices. The power sector in the US drove the mild increase in North America consumption. On the supply side, Russia's lower production and deliveries were offset by increases in most other regions, notably the US where production rose by 5% y-o-y. Russian production is estimated to shrink by 8% in 2023, after a 12% decline in 2022. The pipeline exports drop to Europe was insufficiently compensated by higher exports to China and Central Asia. China increased production as part of the strategy to increase energy security. The Middle East followed suit as part of a strategy to gain market share in LNG.

Meanwhile, trade patterns have fundamentally changed since the Russian invasion. There is more reliance on LNG and also more price volatility. Japan imported a lot less (-13% in H1 2023), China a similar figure more (in the first nine months), and Europe 2.7% more. Exports from the US rose by 8%. With lower prices and plenty of supply, stocks are high. In Europe 90% of the tanks were already filled in August; in the US, levels were 5% higher than on average in September and in Japan and Korea even 30% higher. Floating storage, in vessels around the globe, is increasingly used.

The forecast assumes that demand for natural gas will increase only mildly in 2024 and 2025, meaning below 2%. In North America demand will decline by about 1%, whereas in Europe it is expected to remain stable at 2023 levels. With lower prices, industrial sector demand is expected to recover, just like residential demand, which will offset lower demand from the power sector as renewable employment goes on. Demand growth comes from China as well as the Middle East and Africa. Production increases are foreseen in Russia and the Middle East, while the US will continue expanding. LNG trade is set grow further, helped by new US export capacity coming on stream. East Asia and China will absorb much of the increase. China's imports are expected to double until 2026 (versus 2022).

Coal

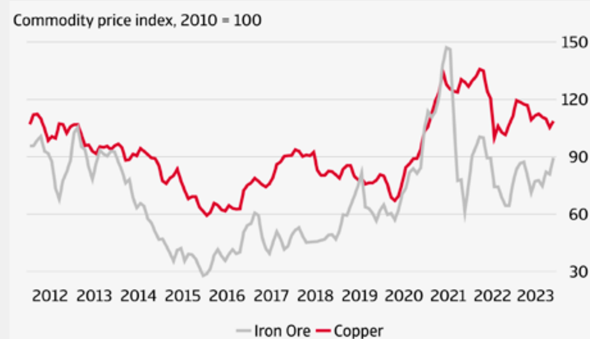
Coal demand and consumption growth are decelerating quickly after a record 2022, and to very mild levels (1.5% in H1 2023). Coal is substituted by gas in power generation and storage levels are high. Consumption is still rising in China and India, but falling in the US and EU. Production increased in China and India, as well as in Indonesia. This picture is expected to continue over the forecast horizon. As a result, global consumption will plateau during that period. India, China and Indonesia are expected to extend their position as global production leaders.

1.6 Further easing commodity prices

The underlying downward pressure on commodity prices we reported in the July Outlook, largely normalisation following the shock of the Russian invasion, has not further imposed itself since. Prices of base metals, such as copper and iron ore, have broadly moved sidewards as the economy turned out more resilient and ample supply was available. As we have seen in this Outlook, economic resilience is not expected to last. It implies that prices are forecast to weaken over the forecast horizon, despite the additional demand coming from the energy transition for some metals, such as copper. For food prices there is an underlying downward trend as well, based on rapidly growing crop yields and increased trading of production. Barring new shocks, this will become manifest in 2024 and 2025.

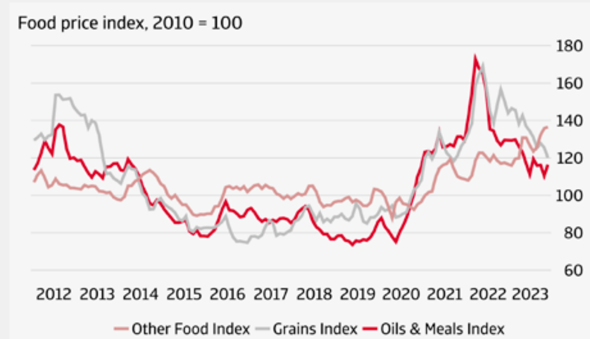
9 The plan for best practices and guidance by the EU is set to reduce gas consumption by 15% from August 2022 to March 2024.

Figure 1.11: Easing basic metal prices



Source: Macrobond

Figure 1.12: Some relief for food prices



Source: Macrobond

Metals

Weak demand for metals and steel predominantly originated in China, which consumes about 60% of the global supply. Chinese growth sputtered over the summer with the property and construction sectors in particular remaining weak. Measures by the authorities such as easing monetary policy and less stringent home purchasing restrictions should provide support in the remainder of the year and onwards. But demand in the country will remain subdued. High borrowing costs as a result of monetary tightening as well as ongoing weakness in the manufacturing sector will do the same for demand in the rest of the world. Moreover, supply of metals is increasing.

As steel demand in China rose after the summer, so did demand for its major input, iron ore. Iron prices rose in Q3 2023, be it mildly. This impetus will fade in Q4 as steel demand will face a seasonal fall, reinforced by government measures to improve air quality. The weak property and construction sectors play a prominent role. Meanwhile ore exports from Australia, Brazil and India and China are rising, partly substituting Chinese production. The rising cost of steel scrap comes into play here as well, creating additional demand for iron ore and thus providing some price support. This does not fundamentally change the picture of weak demand. China will continue to steer away from construction and property sector led growth. Add supply expansion, as new mines in Africa, Australia and Brazil come in operation and the expected picture of falling prices in 2024 and 2025 is clear.

The copper price is partly driven by the same factors as those for steel and iron ore. The weakness in the Chinese property and real estate sectors plays an important role. This is similar to the manufacturing slump in the rest of the world. But in contrast to other metals, copper is a major beneficiary from the rising demand for clean technologies, including the development of charging capacity for electric vehicles. This reins in the price decline. In 2023 so far there was additional support from outages in Chile, China and Indonesia as well. It resulted in prices that broadly moved sidewards. That will not last, as the outages are temporary and new capacity is to come on stream, later in 2023 and in 2024, in Chile, the Democratic Republic of Congo, Indonesia, Peru, Russia and Uzbekistan. Prices are therefore set to fall in 2024. As the energy transition gathers pace and economic weakness fades, in 2025, prices are expected to recover.

Food

The Grains Index significantly eased over the summer, although it remains 20% higher than the 2015-2019 average. Russia's withdrawal from the Black Sea Grain Initiative did not prevent an impact of improved supply. Ukraine had a good harvest this year. Shipments via the Danube River continued to flow, despite Russian attacks. The Oils and Meals index slid as well, driven by higher-than-expected production in Russia and Ukraine and low demand from the livestock sector. The Other Food Price Index, which includes sugar, meat and fruits was volatile at the pre-summer level. Several factors played a role, including lower chicken and beef prices due to falling grain and transport costs. Over the forecast horizon, all food indices are expected to fall, though only mildly, especially for the Other Foods Index. This is predicated on good harvest conditions, such as in Argentina, Brazil and the US for grains outweighing the impact of El Nino and India's export restrictions on sugar. That dependency highlights the level of uncertainty of food price forecasting.

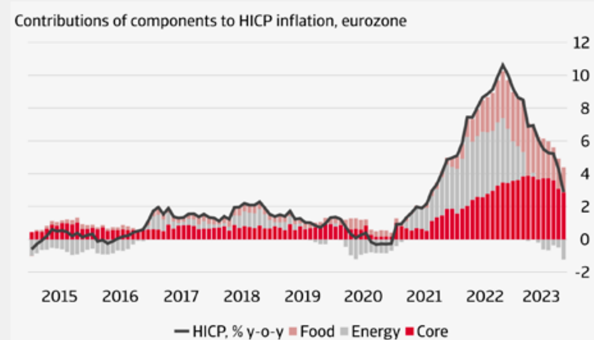
1.7 Disinflation continues

The weak growth picture, high financing costs and the downward trend in prices of energy, commodities and food, suggest downward pressure on inflation. That is indeed what we are seeing and will continue to see in the remainder of the year and beyond. It is a worldwide trend, but the speed of the process differs per economy. That divergence hinges not so much on the drivers of inflation, which are broadly similar, but rather on the impact of these drivers. These differ. We will elaborate on that point below, after taking stock of the developments since our July Outlook. In the latter context, we see the following picture. We focus on the US and the eurozone; the emerging economies will be discussed in Chapter 2.

Inflation in the US peaked in June 2022 at 9.1%. Since then it embarked on a downward trajectory, reaching a low of 3% in June this year. After that it started to rise mildly and then moved downwards again, to 3.1% in November. Core inflation, which strips out energy and food from the headline, peaked in September 2023 at 6.6% and moved on a downward trend as well, to 4% in November. Core inflation is therefore higher than headline inflation. This is because energy prices have been declining since March this year, now even reaching energy deflation (price decline of 5.4% in November) which disinflates the headline figure. Food inflation declined as well but remained positive, falling from 10.6% in November 2022 to 2.9% now.

For the eurozone the picture is somewhat different. Inflation peaked higher, at 10.6% in October 2022 but also came down more quickly than in the US. In November 2023, the figure stood at 2.4%, below the US. Core inflation has climbed more slowly than in the US, reaching a lower peak at 5.7% in 2023 as well. Declining energy inflation plays a prominent role in this difference between headline and core inflation, and even far more markedly than in the US. Both energy and food inflation have declined rapidly in the eurozone since the start of the year.

Figure 1.14: Eurozone energy inflation negative



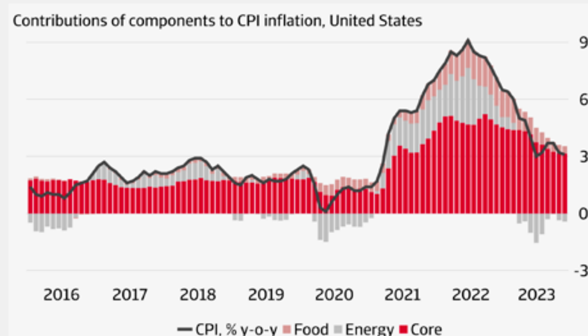
Source: Macrobond

In brief, headline inflation rose later in the eurozone, peaked higher and is coming down more quickly. Core inflation in the eurozone even rose a lot later, peaked markedly lower and is now already coming down as well. What is this?

To understand this situation better, we first identify four factors that have driven inflation generally over the past 2021-2023 period. Firstly, there were lockdowns and shutdowns of production facilities during the pandemic amid strong consumer demand for goods. This was due to services, such as travel and hospitality, not being available during the lockdowns. This global supply-demand imbalance caused supply-chain strains, reflected in stretched delivery times and mounting transport costs for durable goods such as cars and electronics. That in turn pushed up goods inflation.

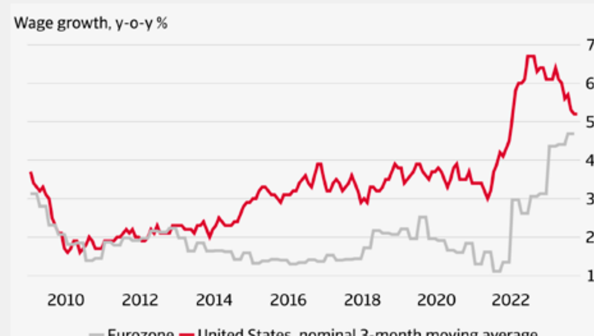
Secondly, the Russian invasion of Ukraine triggered energy, commodity and food price spikes, generating another push to inflation. The effect was direct, simply because energy and food prices are components of headline inflation.

Figure 1.13: Persistent core inflation in the US



Source: US BLS, Atradius, Macrobond

Figure 1.15: Wage growth contained



Source: Federal Reserve, ECB

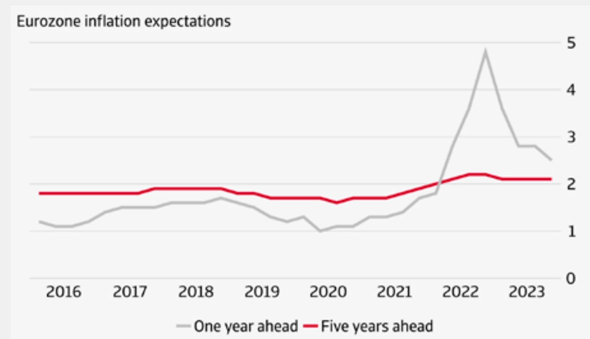
Moreover, a spillover effect occurred to core inflation. This effect runs via increased input costs for sectors that are sensitive to energy prices, such as travel and hospitality (e.g. hotels and restaurants). These, supported by strong demand after the pandemic, have passed on higher input costs to consumers. That pushes up core inflation[10]. Thirdly, and this is perhaps a less well known factor, local supply-demand imbalances were given an additional boost by government support during the pandemic. This created excess savings that were gradually being unwound after the pandemic. This additional demand met constrained supply, also because in countries such as the US, labour market participation had declined. The resulting tight labour market pushed up wages as firms struggled to find staff, reflected in a vacancy rate (vacancies as percentage of employment) far above average. Higher wages were also passed on to clients - a variant of inflation called wage inflation. This factor played a predominant role in the US (figure 1.15). Fourthly, whereas inflation expectations remained well anchored to the 2% central bank targets, they did edge up somewhat, especially in the short run. This has most likely driven up inflation as well, although perhaps only mildly (figures 1.16 and 1.17).

Now, with this in mind we can take the next step. What does this analysis tell us about the disinflation process over the forecast period? The global supply-demand imbalance is no longer playing a significant role and can be disregarded. This does not hold for the stronger local supply demand imbalance in the US. That is more persistent than in the eurozone. This means it will take more time (and effort by the Fed) for inflation, especially core inflation, to come down. In the eurozone, inflation is coming down because energy and commodity price are declining, or are at least stable. The impact is soon felt directly on inflation and with a certain lag indirectly via core inflation. In short, inflation can be expected to come down, towards the mandate levels of 2%. But it will take more time and effect in the US. We are not there yet (figure 1.18).

Figure 1.16: Inflation expectations in the US edged up

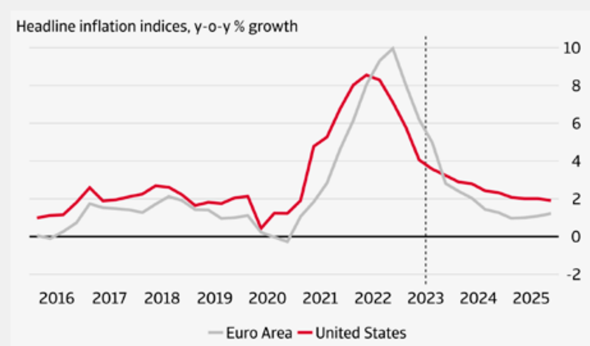
Source: Federal Reserve Bank of Cleveland, Macrobond

Figure 1.17: Inflation expectations in the eurozone contained



Source: ECB, Macrobond

Figure 1.18: Disinflation ends in 2024



Source: Oxford Economics, Macrobond

10 Oxford Economics estimates that this direct effect has added 1ppt to core inflation in the eurozone in the first part of 2023, with persistence in the remainder of the year. See Oxford Economics, Lower inflation will allow rates to fall faster in EA than US/UK, November 14 2023.

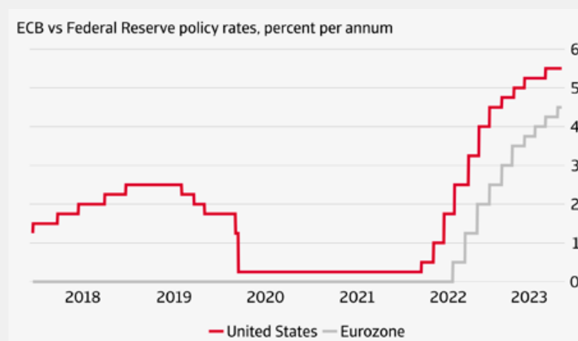
1.8 Mild easing

The picture sketched in this Outlook so far is one of a weak global economy, where disinflation is ongoing with some persistency in core inflation, especially in the US. It raises the question how we view the current - and future - monetary policy stance. Is current monetary tightening accurate? Or should we expect more tightening? When does easing come into play? Answers to these question are invariably economy-specific. We focus on the US and the eurozone. Details on the emerging economies policy are provided in chapter 3.

Let us first take stock of the developments since the July Outlook. It is clear that aggressive monetary tightening, in the form of accelerated rate hikes, has stopped. The Fed had raised its policy rate from 0.25% in March 2022 to 5.5% in August 2023. That is 5.25 ppt in period of just under a year and a half. No further hikes, and also no clear forward guidance of the financial market as to a next one. Unless one considers the message that every option is open. Any further step depends on incoming data regarding variables such as inflation, core inflation and the labour market. The ECB started hiking later, in July 2022. Its approach was also aggressive, though slightly less so compared to the Fed. The official rate went up from 0 to 4.0% a year later. After that, two other steps followed, to 4.5%, with the latest taken in September. In October, the ECB kept its policy rates unchanged. As to any further steps, like the Fed, the ECB has also indicated that this is data dependent, and has given no forward guidance either.

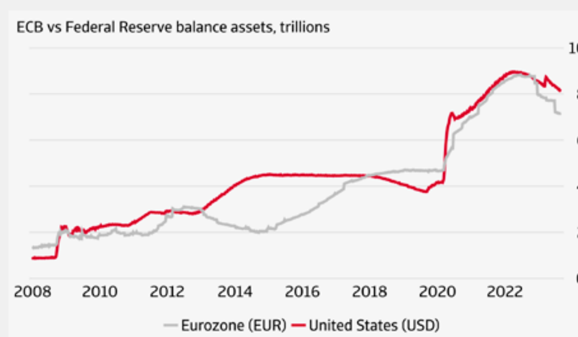
The other leg of tightening, reduction of the balance sheet inflated during the pandemic, i.e. quantitative tightening (QT), is continuing. The Fed is taking a passive stance here, by not reinvesting any portion of maturing assets. This is to avoid liquidity issues in a system that has been awash with liquidity for more than a decade. The balance sheet has shrunk from a peak of USD 8.95 trillion in late spring 2022 to USD 8.14 trillion in October this year. The ECB is acting more quickly here, as it has fewer concerns about liquidity in the system. It has brought back the balance sheet from EUR 8.6 trillion to EUR 7.2 trillion since the summer of 2022. Banks paid back amounts under the long term financing operations (LTROs), and reinvestment under the Asset Purchase Program was ended. Flexibility is being maintained though, by partially reinvesting under the Pandemic Emergency Purchase Program until the end of 2024 as well as staying with the Transmission Protection Programme[11].

Figure 1.19: What steep hiking looks like



Source: Macrobond

Figure 1.20: Quantitative tightening pushed on



Source: Macrobond

In brief, both the Fed and ECB have tightened their policy, the Fed arguably slightly more aggressively and ending up at a higher level of interest rates. This means both central banks are now in a contractionary policy stance. Both the Fed and the ECB are currently restricting demand and therefore economic growth - the ECB even more so[12]. This is taking place against the background of higher growth in the US, and inflation, particularly core inflation, that is more persistent. That suggests that, looking at the forecast horizon, further steps in tightening are more likely in the US than in the eurozone. The flipside of this is that easing of monetary policy is likely to happen earlier in the eurozone. Eurozone growth is much slower and the development of inflation as well as core inflation seem to be on track to allow it.

11 The latter programme can be used in the case of what is considered (by the ECB) to be unjustified market fragmentation, such as a sudden rise in the yields of Italian government bonds, for example.

12 One comes to this view by calculating the real interest rate, which is the actual policy rate minus (one year) inflation expectation and comparing this to the so-called natural rate of interest. The latter was discussed in Box 1 of the July Outlook. We calculate the US real interest rate 2.7% against a natural rate on interest of 1%, suggesting a restrictive monetary policy stance. For the eurozone this figure is 2.5% against 0% natural rate (an estimate based on Germany and France), thus even more restrictive.

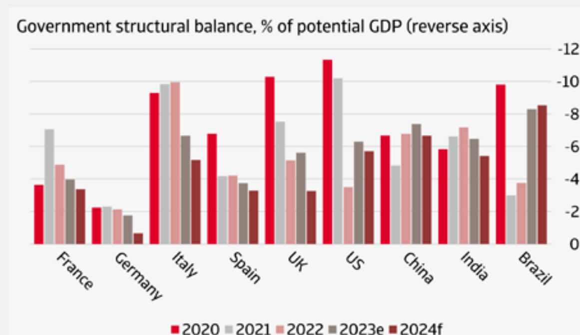
While this conclusion seems to provide a clear view on policy, this is not the case. There are several reasons for this. First, there is a high level of uncertainty surrounding the disinflation process as such. For example, it is uncertain when and to what extent the indirect effects of lower energy and commodity prices will manifest themselves in lower core inflation in the eurozone. Second, lagged effects of past tightening may not have worked their way through the economy. Moreover, the impact may be different for the US and eurozone. If the impact is greater in the US, it may offset or even outweigh the seemingly more easy stance of the Fed[13]. Third, and very importantly, central banks' credibility is at stake. When inflation rose, they arguably acted rather late with their hikes and QT. With this high level of uncertainty, they now want to avoid erring again. Or at least to be seen to err. The policy seems to be to hold off with further action until the data provide more certainty as to what course to take. The implication of this is that we can expect interest rates to remain elevated, and that the steps towards easing, in the case of the US, potentially after another hike, will be small.

1.9 A new reality for governments

The picture sketched so far is one of low growth, declining inflation and interest rates that remain higher for longer. This raises the question whether governments can use fiscal policy, to help support the slow economy. The overall picture that we elaborate on below is that it can be done and is being done. But the days of big spending are over. Governments are facing a new reality.

Let us start with the advanced economies. The significant support packages in reaction to the pandemic, especially in the US, helped push up inflation as we have seen. The energy and commodity price rises provided further impetus, triggering the second round of government support, especially in the eurozone and the UK. This support pales compared to that provided during the pandemic. But it is sizeable nevertheless, costing an estimated 0.8% of GDP in the median OECD economy and 2% of GDP in several European countries, such as Poland and Germany[14]. This support, started in 2022, will be largely phased out during this year and 2024 as energy and commodity, especially food, prices come down. After that, government support packages will therefore no longer push up inflation, or constrain the disinflation process

Figure 1.21: Government stimulus still there



Source: Oxford Economics, Macrobond

This does not mean governments will stop supporting the economy. To evaluate this, we consider the government structural balance as a percentage of potential GDP[15 16]. With the exception of Germany that economic variable was negative before the pandemic and the Russian war shock[17]. This means the economy was already being stimulated by the government's fiscal policy. Particularly in the US, the level of stimulus was high with a structural deficit of above 5%. The two shocks brought the impetus to another level, roughly doubling it in the US and France, and even higher in countries such as Italy, Spain and the UK.

Now, with the support packages related to the shocks expiring, the stimulus will be reduced as well over the forecast period. But to what level? That is very relevant because GDP growth is rather weak. Then, what we forecast here is not a return to the normality of the years before the pandemic, but a rather somewhat more expansionary government structural balance. This holds for Italy, the UK and, to a lesser extent, for the US. The latter country will indeed return from an extremely expansionary, to an expansionary fiscal policy. Even Germany will reverse its contractionary policy and move, albeit very carefully (and thus at a very low level), to an expansionary stance. France and Spain will return to what is more or less normal for these countries. The necessary support for the economies, therefore, will continue over the forecast horizon (figure 1.21).

13 Reasons to believe that this impact in the US is greater are not spurious. We refer in this context to the argument made in the July Outlook that the banking turmoil in the US of March this year and the restrictive stance in lending of US banks may indeed have had such an effect.

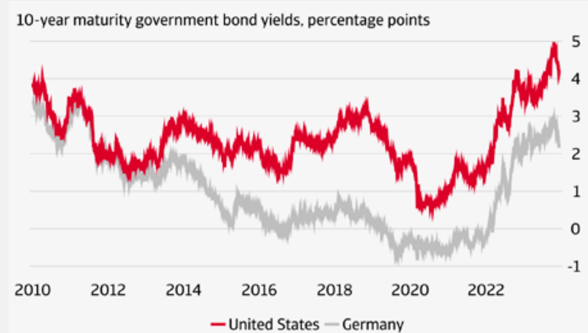
14 See 'Fiscal support needs to be refocused' OECD Economic Outlook, June 2023.

15 This effectively means that the government balance as well as GDP are adjusted for the business cycle and temporary revenues or expenditures. For example, in 2013 Greece reported a 3.5% surplus of the adjusted government balance as a share of potential GDP (i.e. GDP at full capacity), meaning that the country's fiscal stance was restrictive. See https://www.oecd-ilibrary.org/docserver/gov_glance-2015-9-en.pdf?expires=1701183355&id=id&accname=guest&checksum=A60A7E2A07CE0D9243AF057BF0CD7471

16 Note the difference with the reported government balance as a percentage of GDP. For the example of Greece in the previous note we see that the deficit was 12.3% as a share of GDP. That is due to one-off factors related to the Greek bail-out in 2013 and the significant economic recession. In other words, due to temporary factors, the government balance was much more negative, and GDP much lower than the respective structural balance and potential GDP.

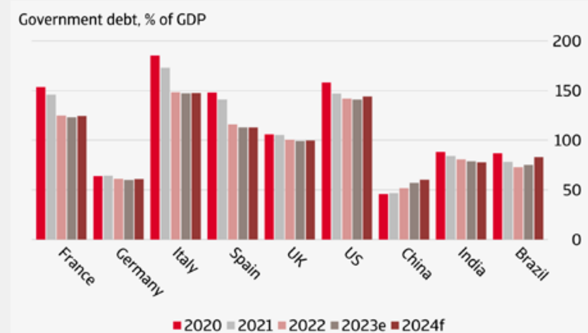
17 Germany had structural surpluses of around 1% before the pandemic.

Figure 1.22: No ultralow interest rates anymore



Source: Macrobond

Figure 1.23: Government debt remains high



Source: Oxford Economics, Macrobond

This support will be a balancing act because, as is the case for households and firms, the resources available to the government are not infinite. There are several factors underpinning this new government reality. First and foremost, as we argue above, the era of ultralow interest rates, debt for free, is over, at least for the foreseeable future. Whereas during the pandemic governments were able to write cheques for free or even at a positive yield, since then, yields have sprung up (figure 1.22). Gradually, this is going to weigh on government spending, as refinancing of existing loans and bonds rise.

Secondly, as it is declining, inflation is no longer coming to the rescue of governments. It did so in several ways. Government debt exploded during the pandemic, but was eroded afterwards as inflation pushed up nominal GDP and thus lowered the debt-to-GDP ratio[18]. The government deficit in turn was positively affected because tax revenues rose with nominal GDP and expenditure was largely fixed. But now that inflation is fading, so are these positive effects for government finances. Worse, expenditure, such as public sector wages, is on the rise in reaction to past inflation.

Thirdly, and closely related to the first two points, government debt-to-GDP ratios, though lower than their peak, are generally higher than prior to the pandemic. And they remain high and will even move up mildly in major economies over the forecast horizon (figure 1.23). For advanced economies, 90% is considered a benchmark. Above that level, debt sustainability issues may kick in, especially if interest rates remain high. These reasons, higher for longer interest rates, the fading of inflation benefits and the debt-to-GDP level, press home the message of a new, harsher, reality for governments.

18 Debt remained constant so that the debt to GDP ratio declined.

1.10 An alternative scenario: higher for longer

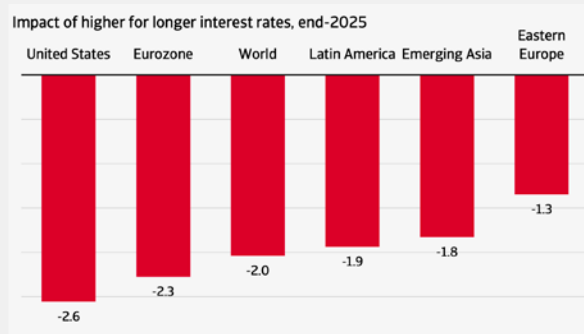
In the baseline scenario that we have described above, we see inflation coming down towards the mandate values of the central banks over the course of the forecast horizon. Energy prices drop, or remain around current levels, preventing an impetus to inflation revival. Underlying such a world is that monetary tightening is able to remove the supply-demand tensions especially in the US that keep core inflation at a high level. Moreover, the conflict in the Middle East is assumed not to escalate, meaning that energy prices will continue to slide, or at least remain volatile around current levels. In that scenario, central banks will be allowed to provide support to the economy, albeit very mild. As a result, borrowing costs will not rise further, the number of non-performing loans at banks remains contained and equity prices will recover further. Growth will get some stimulus from monetary policy, especially in 2025 in our view.

Such a scenario is, of course based on assumptions - to which we accord the highest probability. What if inflation remains more persistent, fed by even more persistent core inflation, in the US predominantly? That situation could arise if the impact of the current high interest rate is overestimated. Consumers continue spending, from their income or from the remaining excess savings accumulated during the pandemic. Or energy prices may rise again as result of renewed or potential escalation of the Israeli-Palestinian conflict, in which case inflation will be directly and indirectly (via higher core inflation) pushed upwards.

This will fundamentally affect our scenario in the sense that tightening is expected to weigh in even more heavily and over a longer period. This is because central banks will be obliged to raise interest rates further to fight the new inflation rise. It is not too difficult to envisage what will happen in that situation. Borrowing costs will not come down over the forecast period. Banks will come under renewed pressure, with non-performing loans in sectors such as (residential) property rising quickly. Their reluctance to finance firms and households will be reinforced, credit conditions will tighten further. Equity markets will fall, causing financing costs for firms to rise higher and households to face negative wealth effects from their investments.

The ultimate result is a fall in demand from firms and households. Sentiment, especially that of households, worsens and saving instead of spending occurs. Governments will be constrained in their attempts to stimulate the economy. They will be even more constrained as GDP is lower, as are tax revenues, as social spending rises and the debt to GDP ratio is worse than expected. The result is a protracted period of sub-par growth, with global GDP only accruing at a pace of 1.5% in both 2024 and 2025. By the end of that latter year, the world will be 2 ppt worse off (figure 1.24).

Figure 1.24: Hit to growth in Higher for Longer scenario



Source: Oxford Economics, Atradius

Advanced economies grappling with tight conditions

Activity across advanced economies is expected to slow significantly from 2.6% in 2022, to 1.6% in 2023 and to 0.9% in 2024 as the impact of past interest rate increases takes its toll. Consumer resilience has brought 2023 estimated growth 0.6 percentage points higher than expected in July, led by the upward revision for the US where we no longer expect to see a recession. Consumer and business sentiment across advanced economies is low and we anticipate the slowdown in consumption in demand in 2024 to sufficiently bring down inflation in the second half of the year. This should allow for central banks to commence mild easing and support growth prospects for 2025 to a meagre 1.7%.

Table 2.1: Real GDP growth (%) – advanced economies

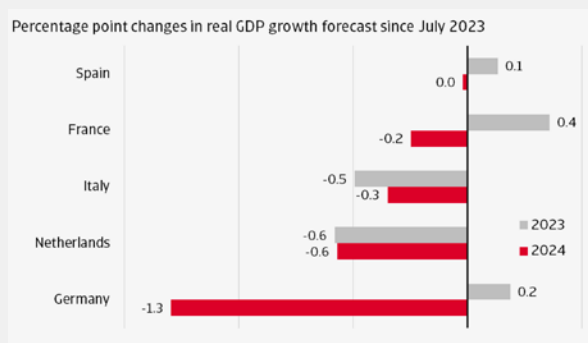
	2022	2023e	2024f	2025f
Eurozone	3.4	0.5	0.6	1.8
United States	1.9	2.4	1.2	1.3
United Kingdom	4.3	0.6	0.5	1.5
Japan	0.9	1.7	0.7	0.8
Australia	3.8	2.0	1.2	2.6
New Zealand	2.3	1.7	2.1	2.8
Advanced economies	**2.6**	**1.6**	**0.9**	**1.7**

Source: Oxford Economics, Atradius

2.1 Eurozone: sluggish growth

The outlook for the eurozone economy continues to be weak. The manufacturing sector struggles with subdued foreign demand and tighter financial conditions that are increasingly weighing on investment and consumer spending. The services sector is also weakening further. This is mainly because weaker industrial activity is spilling over to other sectors, the growth boost from the reopening after the pandemic is fading and the impact of higher interest rates is broadening. Our latest forecast is for GDP to expand by 0.5% in 2023, 0.1 percentage points lower than six months ago. The eurozone growth forecast for 2024 was also revised downwards, with GDP growth expected to come in at 0.6%, 0.6 percentage points below our expectation six months ago. Growth was revised down for all the major economies in 2024 (figure 2.1), most notably in Germany.

Figure 2.1: Negative growth revisions for 2024



Source: Oxford Economics, Atradius

Table 2.2: Real GDP growth (%) – eurozone

	2022	2023e	2024f	2025f
Austria	4.8	-0.7	0.3	2.0
Belgium	3.0	1.4	0.7	1.4
France	2.5	0.8	0.6	2.0
Germany	1.9	-0.2	-0.1	1.5
Greece	5.7	2.1	1.4	2.5
Ireland	9.5	-2.1	1.8	4.5
Italy	3.9	0.7	0.5	1.2
Netherlands	4.4	0.1	0.8	2.3
Portugal	6.8	2.2	1.3	2.1
Spain	5.8	2.4	1.3	1.7
Eurozone	**3.4**	**0.5**	**0.6**	**1.8**

Source: Oxford Economics, Atradius

Recent data confirm that the eurozone economy has stagnated since Q4 of 2022. Eurozone GDP decreased by 0.1% in Q3 of 2023 according to the flash estimate. This followed on a 0.2% quarter-on-quarter growth in Q2 and stagnation in Q1. In Q3 2023 there was growth in, for example, Belgium (0.5%), Spain (0.3%) and France (0.1%). However, in several other eurozone economies there was a decline of economic activity in Q3, such as Germany (-0.1%), the Netherlands (-0.2%) and Austria (-0.6%). In Italy, there was a stagnation of economic activity in Q3.

Sentiment indicators draw a picture of continued economic weakness in the near term. The European Sentiment Indicator (ESI) improved slightly to 93.8 in November, from 93.5 in October. The ESI has been below the neutral level of 100 for 1.5 years now. The purchasing managers index (PMI) improved slightly in November to 47.6, but remains below the neutral level of 50. There remains a clear distinction in the level of PMI between the services sector (48.7) and manufacturing (44.2). The manufacturing PMI is in clear recessionary territory, with new orders falling at an accelerated pace and an ongoing depletion of order backlogs. Weak manufacturing in the eurozone can be expected to last well into 2024. Eurozone manufacturers, in particular Germany, are facing high borrowing costs and low external demand (including from China). Moreover, they are also still grappling with higher energy costs.

The services PMI performed well in the earlier months of 2023, but went into reverse after that. In part, this reflects a cooling of the spending on travel and recreation.

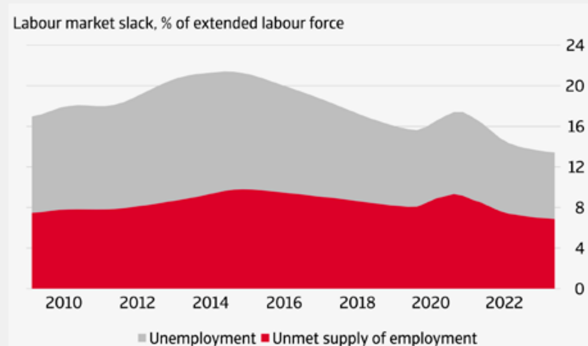
Net trade and investment contribute little to growth
Exports declined in 2023 and the outlook for 2024 is that export growth will remain low. The contribution of net trade to GDP growth is expected to be very limited. Global GDP growth slowed in the course of 2023, as the excess savings accumulated during the pandemic began to decline, the initial growth stimulus from the reopening of the services sector diminished, and a sustained slowdown in manufacturing occurred. Business investment growth remains low due to monetary tightening, but it still continues to increase. Strong corporate balance sheets are helping businesses to make the transformation in the context of energy-saving and lower emission production. Easing supply chain bottlenecks are also foreseen to support investment. Infrastructure investment has also benefited from public spending and not least by EU funding packages such as REPowerEU. Housing investment is doing less well as monetary tightening and high input costs are weighing on this sector. Housing is expected to remain a drag on overall investment growth, but this will gradually abate. This is a pattern that is visible in all the major eurozone economies.

Consumption picks up again
We expect private consumption growth to pick up again in 2024 and 2025, after meagre growth in 2023. Private consumption remained stagnant in Q2 of 2023, after a small increase in Q1. Unlike during the post-pandemic reopening, consumption has not been a solid growth driver in 2023. We expect a 0.5% consumption growth in the full year 2023. Much of the consumption outlook hinges on the resilience of the labour market. Even though the employment indicator of ESI declined through 2023, it remains in positive territory. Nevertheless, consumption is set to remain the key growth driver. Higher wages, continuing employment growth and further slowing of inflation are expected to result in positive real gross disposable income growth in 2024 and 2025. Therefore, we expect a more favourable consumption growth figure in 2024 (0.9%) and 2025 (2.1%) compared to 2023.

The labour market remains tight, despite some recent cooling. The latest unemployment figure (6.5% in October) is still very low. Labour market slack, which comprises all people who have an unmet need for employment was at a new low of 13.2% of the extended labour force in Q2 of 2023. The latest information from surveys points to some cooling of the labour market. In November, the Employment Expectations Indicator declined compared to October, but remained above its long-term average. Wage growth picked up in 2023 as employees were trying to make up for lost purchasing power. Negotiated wage growth increased through 2023 to 4.7% in Q3, which is considerably higher compared to Q4 2022 (3.1%). Wage growth is still negative when adjusted for inflation (-0.2% in Q3 of 2023), much less so than at the start of the year. Real wage growth may very well turn positive in Q4 2023. We expect wage demands to moderate in 2024 and 2025 as domestic demand and inflation are easing.

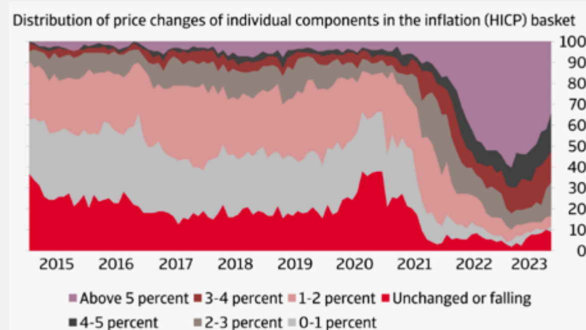
Inflation continues to drop
Inflation in the eurozone continued to decline through 2023, primarily due to falling energy inflation and falling food inflation. Inflation eased to 2.4% year-on-year in November, a 0.5 percentage point decline compared to previous month. Core inflation went down by 0.6 percentage points to 3.6%. The energy and food components of inflation are declining rapidly thanks to favourable base effects, as the large price increases from last year are starting to drop out of annual inflation numbers. But the components of core inflation – non-energy industrial goods and services – likewise started to decline in recent months. Total (CPI) inflation is projected to continue trending down. The average inflation rate in 2023 is projected to be 5.4%, followed by 1.8% in 2024.

Figure 2.2: Eurozone labour market slack at new low



Source: Macrobond

Figure 2.3: Ongoing disinflation across inflation components



Source: Macrobond

Whether victory over inflation can be declared remains to be seen. As one ECB board member recently remarked, initial rapid declines of headline inflation after a period of high inflation, often leads to "premature celebrations"[19]. IMF research[20] has shown that in about 90% of unresolved inflation episodes, inflation declined materially within the first three years after the initial shock, but then either plateaued at an elevated level or accelerated again. One reason is that base effects often turn from being a source of disinflation to becoming a renewed headwind, as they operate in both directions. Another reason is that underlying price pressures can prove much stickier than the more volatile components of inflation.

Monetary tightening is paused

The ECB governing council expects that interest rates have reached levels that, if maintained long enough, will return inflation to target. Following a 25 bps policy interest hike in September, the ECB kept its policy rates unchanged in October. Since July 2022, it had increased its key policy rates by 450 bps. The main refinancing rate currently stands at 4.5%. This means the terminal rate has been reached and that rates will remain stable at the ECB's upcoming meetings. October's inflation figure seems to confirm the ECB's view that a pause in interest rate increases is justified. Furthermore, the size of the ECB balance sheet has continued to shrink.

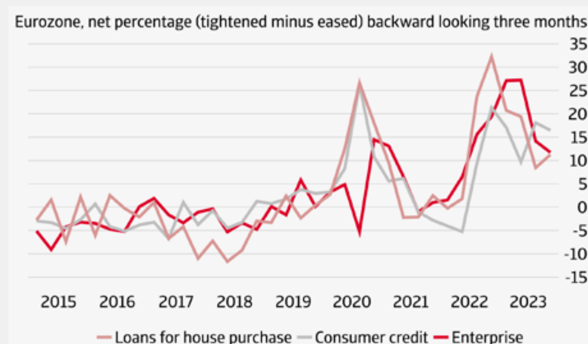
Recent data show monetary tightening is having an effect on credit availability. The ECB's Q4 bank lending survey again pointed to a tightening of credit standards on business loans (with the net percentage of banks reporting a tightening standing at 12%). Banks also reported a further tightening of their credit standards for consumer credit and mortgage lending (net percentages of banks at 16% and 11% respectively). Banks' heightened risk perceptions and lower risk tolerance continued to have the largest tightening impact. Bank lending data are also weak, with bank lending growth slowing to -0.3% for non-financial corporations and 0.6% for households in October 2023.

Fiscal policy remains expansive

Fiscal policy expansionary, though budget deficits are forecast to decline in 2024 and 2025. Adjusted for the business cycle, the government deficit declined from 4.1% in 2022 to 3.9% in 2023. This was underpinned by the phasing out of pandemic-related fiscal measures. On the other hand, there were still costs related to fiscal measures to mitigate the energy crisis and the humanitarian crisis following Russia's invasion of Ukraine. The structural deficit is projected to decline further to 2.2% in 2024 and 2.0% in 2025.

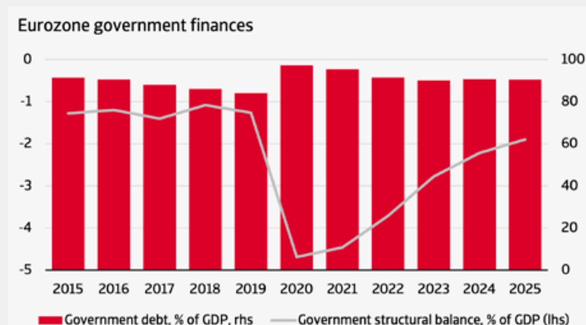
The eurozone debt-to-GDP ratio declined slightly to 90% in 2023 and is forecast to remain roughly at this level in 2024 and 2025. At the same time, there are several member states with significantly higher debt, such as Italy (148%), France (123%) and Greece (207%). Germany is the exception, with a 60% debt-to-GDP ratio. Although short-term debt sustainability risks are limited, several member states with high government debt cannot afford to do nothing about their budgetary policies in the long term. The 10 year yields on government bonds have increased by some 3 percentage points in the major eurozone economies since July 2021. This is going to lead to higher interest payments in the medium term. Inflation expectations do not explain the jump in nominal yields. This could mean that either equilibrium real interest rates have risen or financial markets are counting on monetary policy to remain tight.

Figure 2.4: Credit standards are tightening



Source: ECB, Macrobond

Figure 2.5: Eurozone deficit and debt remain high



Source: Oxford Economics, Atradius

19 Keynote speech by Isabel Schnabel, Member of the Executive Board of the ECB, at the annual Homer Jones Memorial Lecture, St. Louis, 2 November 2023.

20 Ari, A. et al. (2023), "One Hundred Inflation Shocks: Seven Stylized Facts", IMF Working Papers, No 2023/190, IMF, 15 September.

2.2 US economic resilience won't last

The pace of economic growth in the US this year is unsustainable but a recession is no longer on the cards. We expect the US economy to have grown 2.4% this year, 1.1 percentage points higher than forecast in July due to ongoing consumer resilience. But the fates are turning: past monetary policy tightening and a cooling labour market are catching up with an increasingly cash-strapped consumer while the government's fiscal stance turns restrictive. We now expect GDP growth to slow sharply to 1.0% in 2024 and remain weak with 1.3% growth in 2025.

The US economy far exceeded expectations in 2023, driven by continued consumer resilience. In July, we expected the business cycle to turn downwards in H2 2023, but growth has proven resilient – even in the face of lingering inflation and lower consumer sentiment. With firm job creation and the unemployment rate now 3.7%, consumer spending rose by 3.6% in Q3 compared to Q3 2022. This resilience is attributable to the tight labour market, residual pandemic-era support and the USD 2.1 trillion of excess savings accumulated during the pandemic.

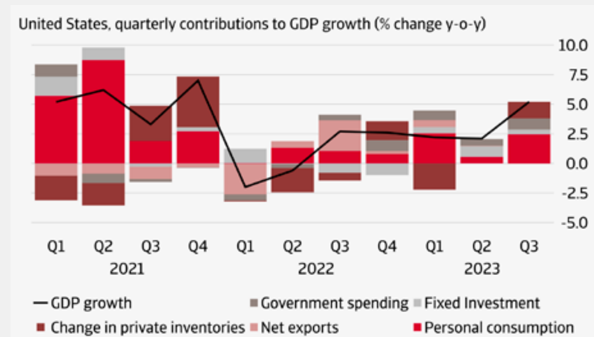
Historical data revisions released end-September from the US Bureau of Economic Analysis (BEA) show that the stock of excess savings has been drawn down more gradually than previously estimated[21]. At the same time, US households have been spending more of their disposable income than previously thought. Consumers have also been taking on more debt than ever before, with household debt reaching an all-time high of USD 17.1 trillion in Q2 2023 – over USD 1 trillion of which is in credit card debt.

Fixed investment on the other hand rose 1.3%, a sharp downward shift from previous quarters. This is a sign that the economy is beginning to feel the impact of tighter monetary policy. Government spending is also boosting economic growth with its contribution expanding in Q3 especially due to increases in defence spending. Inventories also provided a surprise positive contribution to growth in Q3 but we expect this to be revised down.

The tide will turn for the US consumer in 2024

US consumers have spent more than anticipated time and time again in part thanks to substantial excess savings accumulated during the pandemic. The BEA estimates that the USD 430 billion of excess savings still in the economy will be depleted in the first half of 2024. This means the buffers that households have had to withstand higher interest rates are dwindling. On top of this, the Covid-19 grace period for student loans just ended which means households may need to cut back on spending to resume those payments. Credit card debt has expanded rapidly, up 17% y-o-y in H1 2023, showing consumers are increasingly dependent on credit to keep up spending in the face of higher prices. But overall, demand for most other forms of credit have also slowed which may further strain consumer finances in 2024.

Figure 2.6: Explosive Q3 growth unsustainable



Source: Macrobond

Healthy household balance sheets should ensure a soft landing though. Total household debt, while standing at all-time highs in nominal terms, is steady around 75% of GDP as of Q2, compared to over 100% on the eve of the financial crisis in 2008. The share of delinquent household debt across nearly all categories remains relatively low. That is especially the case for mortgages, home equity and student loans. While delinquencies are beginning to tick up, it is from historically low levels.

In addition, the labour market is showing signs of softening but from very tight conditions. The unemployment rate is ticking up but remains near all-time lows. The pace of job creation has disappointed, in part due to major strike disruptions, but it continues at historically robust rates. Average hourly earnings rose 4.1% in October, down from almost 6% in early 2022 but remained above inflation. While these indicators are moving in a challenging direction, they remain far from recessionary territory. Combined with stronger household finances, this should all ensure the American consumer on aggregate can withstand tighter economic conditions more sustainably than in the past.

The consumer outlook for the economy is still turning gloomier amid higher prices. Despite the stronger position of US households, consumer sentiment is turning downward. Worsening consumer confidence mirrors an uptick in consumer inflation expectations. Expectations for one-year ahead increased from 3.4% over the summer to 4% most recently. This comes despite the fact that overall inflation declined to 3.2% in October, from its 9% peak in June 2022. While prices may no longer be rising as much,

21 Data Revisions and Pandemic-Era Excess Savings | San Francisco Fed (frbsf.org)

consumers are clearly concerned with the fact that average consumer prices are 20% higher than they were at end-2019.

We expect the Federal Reserve to continue to look beyond this sort of 'noise' and keep rates on hold. The Fed kept its target policy rate unchanged between 5.25% and 5.5% in its November meeting to give more time for the cumulative 525 basis point increase in interest rates to feed through to the economy. There are signs that restrictive policy is starting to be felt by the economy: credit quality for households is deteriorating, investment and hiring plans are softening and bank lending standards continue to tighten. These effects should increase through 2024 as households and corporates need to re-set fixed-rate debts. Bond yields have begun decreasing as markets begin to anticipate rate cuts, but the Fed is clear that it will not consider cutting rates before the slowdown is more entrenched. Thus we expect the Fed to maintain a hawkish tone in the coming months to prevent undesired financial easing and not make the first cut until Q3 2024.

Fiscal tightening is a major factor behind slowing economic momentum

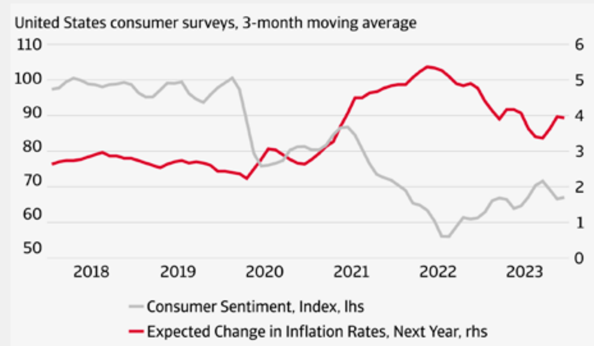
Federal spending will remain elevated as some new investment programmes in infrastructure, climate change mitigation and semiconductor manufacturing come into effect. This can be seen in the still-elevated structural deficit of the US in figure 1.21 but overall the fiscal stance will tighten in 2024. This is partially due to the fading or reversal of several one-off spending boosts from the last fiscal years related to the pandemic recovery. It's also a result of spending cuts agreed in the appropriations bill for fiscal-year 2024. While this tightening isn't so significant to spur a recession, it's another lever that will not help economic growth. A downside risk remains that the Fiscal Responsibility Act could be triggered at the start of 2024, unleashing automatic spending cuts of 1% in Q2. With a split House and elections coming up in November 2024, political gridlock will prevent the capacity to respond to any significant slowdowns.

Wide fiscal deficits, declining debt affordability and ongoing political uncertainty are also dragging on US creditworthiness. The United States lost its AAA-credit rating from Fitch in August; and Moody's, the last major rating agency to assign the US the highest AAA-rating lowered its outlook to negative in October. While the federal government remains capable of meeting its debt obligations, political uncertainty remains high and the cost of borrowing will increase further in 2024.

2.3 UK growth to remain sluggish

The UK's economic outlook remains weaker than other major economies given its overreliance on private consumption and the hit to export competitiveness from Brexit. The economy has avoided contracting as we had expected six months ago, but the lagged impact of tighter monetary policy and restrictive fiscal policy is keeping growth sluggish at only 0.6% in 2023 and 0.4% in 2024.

Figure 2.7: Rising consumer inflation expectations despite relief



Source: University of Michigan, Macrobond

Figure 2.8: UK real wage growth finally back in black

Source: UK ONS, Macrobond

The cost-of-living crisis has taken its toll on the UK economy

Britons have faced exceptional cost-of-living challenges over the past years. Average weekly pay contracted for 18 consecutive months starting in December 2021. Wage growth fell at record rates in 2022 as inflation reached an all-time high above 11%. As inflation has finally begun its steady decline downward, there has been some relief for consumers in H2 2023 as real income growth has crossed back into the black.

Underneath the steady deceleration in price growth though is sticky core inflation. The drop in energy prices in particular has helped rein in inflation to 4.6% in October, compared to 11.1% in October 2022. This offers some relief for consumers and monetary policymakers but the underlying picture is not sufficient for the Bank of England (BoE) to begin considering lowering rates from the current 5.25%. The pace of disinflation is slower than in other advanced economies, as the UK, like the US, has a very tight labour market and, like the eurozone, higher vulnerability to energy prices. Core inflation, stripping out volatile items like housing and energy, was still 5.7% in October, compared to 6.5% one year before.

Core services inflation remains especially concerning at 6.6%. Moreover, house prices have fallen year-on-year for the first time in a decade, while rental costs are rising at a record pace, which will increasingly weigh on household confidence and wealth.

Lower demand to rein in inflation further in 2024, allowing the BoE to keep rates on hold. Evidence is mounting that the cost-of-living crisis and the gradual pass-through of higher interest rates is a drag on domestic demand. Household consumption fell 0.4% q-o-q in Q3 while investment contracted 2%. The labour market is also showing signs of cooling with the estimated unemployment rate standing at 4.2%, from 3.7% a year ago. We expect demand to continue weakening but there are still challenges – namely sticky core inflation and wage growth – that will prevent the BoE from cutting rates before H2 2024.

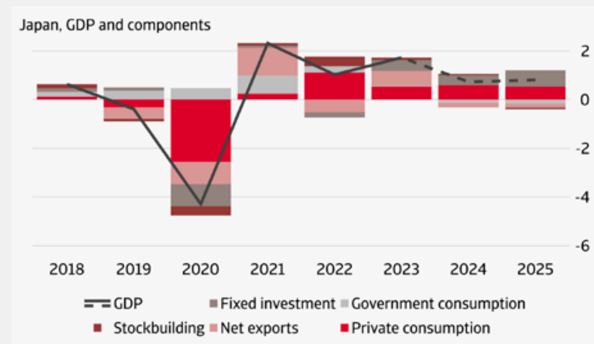
Fiscal policy to continue as drag on UK growth
Economic activity has also been strained by the end of pandemic-era and energy-related stimulus packages from the past years. Besides these temporary measures, tax increases and spending restraint have been priorities of the Sunak administration. The Office for Budget Responsibility's (OBR) updated inflation forecasts have been revised substantially up from their last estimates in March – 7 percentage points higher in Q1 2028 to be exact – which provides a boost to expected tax revenues. This has allowed the Chancellor to announce in the Autumn Statement a fiscal expansion of GBP 14.2 billion (0.5% of GDP) in 2024 to 2025. But with the net impact of past tightening events and limited scope for policy change ahead of the 2024 elections, fiscal policy is estimated to exert an overall drag of over 2% of GDP over the forecast period.

2.4 Advanced Asia outlook remains muted

The lacklustre growth experienced by Japan in recent decades will continue in the coming two years. We expect 1.7% GDP growth in 2023 followed by 0.7% in 2024. This will be supported by improving private consumption as well as government policy that supports investment in strategic industries. Inflation reached its peak in January 2023 (4.4%), before declining to 3.3% in October. Core inflation (excluding energy and fresh foods) remains elevated, but there are signs it is nearing its peak. Core CPI slowed slightly to 4.0% in October from its 4.3% peak in August, with non-fresh foods and durable goods prices easing. With moderating CPI, we expect that real income will keep recovering gradually. A dip in real incomes should be largely resolved by early 2024. Investment growth remains constrained by high input costs and a soft recovery in external demand. The labour market remains strong, with the latest unemployment figure at 2.5% (October 2023).

Export growth was lacklustre in 2023, with annual growth estimated to be 2.1%. Goods exports rose by declined by 3.0% year-on-year in October. Global capital expenditures are

Figure 2.9: Japanese economic outlook remains lacklustre



Source: Oxford Economics, Macrobond

hampered by high interest rates, and recent gains in auto shipments are unlikely to last. Despite the government's desire to restore fiscal soundness, expansionary policy will remain necessary to supplement private-sector demand. Defence spending will be stepped up in the coming years. Public expenditure targeted at the private sector will aim to incentivise businesses to promote digitalisation and to invest in research and development, particularly in important industries such as semiconductors and renewable energy. The government is also increasing social spending to support childcare and encourage greater wage growth. This is likely to lead to an elevated fiscal deficit of 5.1% of GDP in 2023, with prospects of a somewhat lower deficit in 2024 (4.3%).

Economic activity in Australia and New Zealand is also increasingly facing the impact of past monetary tightening. Australian inflation stood at 5.4% in Q3, down from a peak of 7.8% last year, but still well above the Reserve Bank of Australia's (RBA) target range of 2% to 3%. Consumer resilience and sticky services inflation prompted the RBA to resume hiking rates by 25 bps to 4.35% in November. It will likely hike rates once more in the coming months before ending the tightening cycle. With a very tight labour market, sticky core inflation and higher-for-longer rates, we expect GDP growth to slow from 1.9% in 2023 to 1.3% in 2024. Net exports will also pose a small drag on GDP growth over the forecast period due to economic challenges in China, Australia's largest overseas market.

New Zealand is a bit further than most other advanced economies in its economic cycle. Its economy toed the line of recession earlier this year as a result of tight financing conditions and the impact of Cyclone Gabrielle. Inflation eased to 5.6% in September 2023, down from a peak of 7.3% in June 2022, giving the central bank (RBNZ) room to stop its tightening cycle with the policy rate at a 15-year high of 5.5%. Policy will need to remain tight to keep inflation on a downward trajectory but growth will likely gather pace from 1.7% this year to 2.1% in 2024 and 2.8% in 2025.

Emerging market economies' outlooks diverge

The outlook for emerging market economies (EMEs) is on average stronger than that for advanced economies, but it remains weak by historical standards. We expect GDP growth to stay in a lower gear at 4.2% this year and 3.6% in 2024, due to weak external demand and tightening global financing conditions.Many EMEs continue to face spending pressures. Ongoing geopolitical tensions may lead to further increases in defence spending and fiscal support to address negative effects from disruptions to international trade. Industrial policies, including government subsidies, may also emerge to foster import substitution. As interest rates are rising globally, governments of EMEs face higher interest payments which are expected to remain higher in the medium term compared to pre-pandemic levels. Low-income countries in particular may face debt sustainability issues.

Under the headline figures lies substantial heterogeneity. Emerging Asia is set to lead other regions again in terms of GDP, though growth is subdued in a historical perspective due to external headwinds. Still, China and India are projected to contribute jointly about half of world growth in 2023 and 2024. Latin America, struggling with structural weaknesses and political uncertainty, will lag other regions, especially in 2024. Only in MENA and Sub-Saharan Africa will economic growth accelerate next year.

3.1 Emerging Asia to shift to lower gear

Growth in Emerging Asia is likely to have increased to 5.4% in 2023, before slowing to 4.5% in 2024 and 2025. The economy in China is expected to expand by 5.2% in 2023 and 4.4% in 2024. GDP growth in China was higher in 2023 than in 2022, but this was mostly the result of a first quarter consumption boost following the end of Covid containment measures. After a strong GDP growth of 2.2% q-o-q in the first quarter of 2023, GDP growth slowed significantly to 0.5% in the second, before picking up to 1.3% in the third quarter. Consumer spending proved more resilient than expected in the third quarter, despite the still-weak level of consumer confidence. In 2024 we expect private consumption growth to slow.

Table 3.1: Real GDP growth (%) – emerging market economies

	2022	2023e	2024f	2025f
Emerging Asia	3.8	5.4	4.5	4.5
Latin America	3.8	2.0	0.8	2.5
Eastern Europe	1.8	2.7	2.2	2.4
MENA	5.7	1.4	3.0	3.8
Sub-Saharan Africa	3.8	3.1	3.3	3.3
Emerging Markets	**3.7**	**4.2**	**3.6**	**3.9**

Source: Oxford Economics, Atradius

Rising global food and energy prices are having a modest impact on inflation due to the domestically administered pricing mechanism and self-sufficiency in coal and food (staple grains). Inflation moderated from 2.1% in January to -0.2% in October 2023. We do expect to see an increase in the coming months as supply-side deflationary pressures ease (i.e. normalising firms' price-cutting practices) and consumption demand broadly holds up. As food and fuel prices are expected to increase, the baseline outlook is for a gradual rise in inflation from 0.4% in 2023 to 1.5% in 2024. Whereas most other central banks hiked policy rates in response to rising inflation since 2022, the PBOC has kept its policy rate low – currently at 3.45% - in response to disinflation.

Private investments stayed in contractionary territory, pulled down mainly by real estate investments. External demand is not particularly strong either, and Chinese industry is still faced with destocking pressure. There are some bright spots emerging, however, in the three 'new economy' sectors of electric vehicles, batteries and renewables. The outlook for 2024 is that industrial activity will strengthen moderately, as destocking pressures fade and the decline in industrial profits bottoms out. The property sector remains the biggest downside risk in China, with poor housing activity indicators and a steady stream of negative headlines about distressed property developers. The Chinese central bank (PBOC) is cautious with possible easing, reflecting concerns about banking sector profitability.

In India, growth in 2023 is estimated to pick up slightly to 7.0% from 6.7% in 2022, supported by household consumption, investment, and strong services activity. Consumption growth is weakening and we expect it to continue trending down. Rural incomes have been hit by reduced crop output due to below-average monsoon rains, while government measures to lower food prices have depressed farmer earnings. Inflation cooled to 4.9% in October, with easing price pressures across the board. However, it does remain above the central bank's 4% midpoint target. We expect to see a moderation in inflation from 5.8% in 2023 to 4.8% in 2024. Inflation is still above the central bank's midpoint target (4%) and we do not expect a rate cut in India before Q2 of 2024.

High frequency indicators show signs of a loss in private investment momentum. Industrial production weakened in September, with growth falling to 5.8% year-on-year, 4.5 ppt lower than in August. Capital goods imports declined in Q3. Industry and services credit expanded further in September, but with financing conditions likely to tighten further as the lagged impact of monetary policy tightening feeds through, this is unlikely to be sustained. There are signs that economic activity is going to soften in 2024. Consumers are feeling the strain from weakening labour market conditions and subdued real income growth.

Private investment is yet to see the full effects of past monetary policy tightening materialise. Meanwhile, external demand will likely remain soft given the lacklustre global growth outlook. GDP growth in India is likely to dip in 2024 (5.7%), before increasing in 2025 (7.0%).

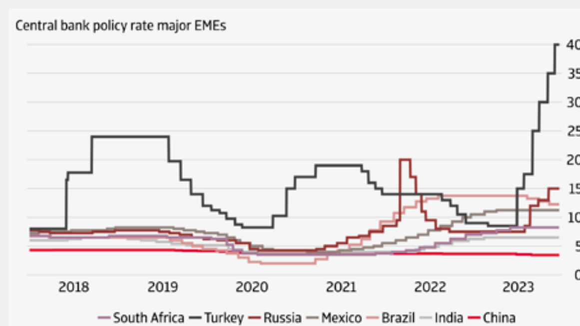
3.2 Latin America is facing the lowest regional growth prospects in 2024

We expect already-weak GDP growth in Latin America to slow from 2.0% in 2023 to 0.8% in 2024. Whereas the region continues to lag behind other EME regions in terms of GDP growth, its shock resistance has improved substantially. This is largely thanks to improvements in policymaking, visible in the region's proactive approach in monetary policy. Latin American central banks hiked interest rates earlier and further than the US Fed to stave off inflation and now the region is leading in the easing cycle.Brazil, the region's largest economy, was the first (and so far only) among the featured markets in this Economic Outlook to begin cutting its policy rate.

Brazil's GDP outlook is very weak with only 0.4% growth forecast in 2024, down from 2.9% in 2023. But there is considerable upside potential for growth, if the central bank interest rate cuts have an effect on the economy faster than expected. Inflation went down from 5.8% in January to 4.8% in October, and the expectation is that it will decline further. The current monetary stance is highly contractionary given where inflation is. Some further monetary easing can be expected in 2023 and 2024. The economic slowdown that we expect in 2024 is mostly due to the lagged impact of restrictive monetary policy. The magnitude, however, is in part due to negative base effects from the bumper harvest of H1 2023. After a record grain harvest in Q1, agricultural output levels are normalising and potentially adverse weather associated with El Niño is a downside risk. Support from higher global commodity prices will also fade over the forecast period. The fiscal deficit is likely to remain high (8.7% of GDP in 2023 and 2024), but that is due to high interest expenditure (there is a small surplus on the primary balance). The public debt burden is likely to increase on account of the high interest rate costs.

Mexico is outperforming regional peers but growth is decelerating. GDP growth is expected to hold up at 3.3% in Mexico, driven by US consumer resilience and domestic fiscal support. We expect growth to slow to 1.9% in 2024 owing to weaker external demand and fading support from government infrastructure projects. New FDI inflows slowed in Q3, mostly due to lower FDI in companies that were already located in Mexico. While the labour market is tight, supporting domestic consumption, the retail and tourism sectors are cooling. Mexico's fiscal position is likely to worsen somewhat as President Obrador (AMLO) ramps up spending ahead of the 2024 elections. This is an upside risk for growth as it could strengthen consumer resilience but it will also cause a substantial deterioration

Figure 3.1: Turkey is shifting to orthodox monetary policy



Source: National Sources, Macrobond

in public finances. The central bank is holding the policy rate constant as it remains concerned about tightness in the labour market and sticky inflation expectations. We expect some easing of the policy rate in Mexico from Q1 2024 onwards.

3.3 Eastern Europe outlook is bleak

Our growth estimate for Eastern Europe in 2023 was subject to the largest revision (+1.3 ppt) compared to July as Turkey shifted to orthodox policy and Russia skirted international sanctions. But the outlook for the region in 2024 and 2025 remains very cloudy. In Turkey, tighter monetary policy, high inflation and slower global growth weigh on economic activity. We expect GDP growth to decrease from 4.0% in 2023 to 1.0% in 2024. The long-running consumer boom is now set to come to an end, and many companies and households are likely to face difficulties in 2024. As part of the shift to a more orthodox footing, the government has started to increase taxes and interest rates, as well as limiting access to credit, with negative implications for both consumer spending and government expenditure. Inflationary pressure emerged again as the central bank allowed the lira to weaken, and higher government spending and increases in pay and pensions boosted demand. Headline inflation rose from a yearly low of 38.2% in July to 61.4% in October. The central bank started a tightening cycle in June, marking the beginning of a shift towards more orthodox polices (see figure 3.1). The central bank has hiked the policy several times since the May elections and the policy rate is now at 35%. We expect a couple of further rate hikes before the central bank will pause.

Higher domestic interest rates are bearing down on consumer loan growth, underpinning a moderation in consumption. Intensifying demand weakness, both internally and among key European trade partners, is driving the softening in business conditions. The

employment picture is deteriorating, and we expect more companies to reduce staffing. The conditions are likely to be slightly better in 2025, due to lower inflation and higher growth in Turkey's trade partners, leading to an expected 1.9% GDP growth.

The war in Ukraine has unleashed deep transformation in Russia's economy. International sanctions are hurting the economy, but have not crippled it. Russia's economy expanded by 3.0% in 2023, after a 2.1% contraction in 2022. We expect the war to continue to drag on economic growth, which is likely to be low in the coming years. GDP growth is still supported by high government spending. Military spending has increased to 6% of GDP in the 2024 budget, from 3.9% in 2023. Increasing wage growth and low unemployment support private consumption, although higher interest rates will constrain consumer demand. Inflation was elevated at 6.7% in October, which is above the central bank target (4%). It is likely to remain elevated due to high import costs, labour market shortages, and supply chain disruptions. The central bank started to tighten its monetary policy again since July, by raising the policy rate from 7.5% to 15% in October.

The central bank was responding to inflationary pressure and a weakening rouble. We expect that monetary policy remains very tight in the near term and there could be some easing in Q2 2024 at the earliest.

Oil exports to some key emerging markets, such as China, India and Turkey, offer some respite on the external trade front. Urals oil is consistently trading above the EU-G7 price cap of USD 60 per barrel. The discount of Urals to European brent has narrowed to around USD 10 per barrel. There was some pressure on the rouble in October 2023, but the partial re-introduction of capital controls has reversed the downward trend of the rouble.

3.4 Weak external backdrop increases domestic challenges in Africa

We expect GDP growth in South Africa to moderate to 0.8% in 2023. There is likely to be a very limited recovery to 1.0% in 2024, helped by a mild improvement in domestic conditions, although the global backdrop will remain challenging. Inflation has been ticking up again in recent months. In October inflation rose to 5.9% from 5.4% in September, reaching the upper limit of the inflation target range of the central bank (3-6%). Food and transport prices are driving the upturn in inflation. The central bank has raised the interest rate in total by 475 basis points since November 2021 to 8.25%, the highest level since 2008. Since May 2023 the central bank has kept its monetary policy rate constant.

Increased private sector investment in electricity generation capacity is supporting the demand side, but households are experiencing strain due to elevated prices and high interest rates. The next presidential and legislative elections, scheduled for mid-2024 could dent confidence but are unlikely to be destabilising. The government's main medium-term policy challenge is to boost growth and employment by implementing the vital structural reforms needed to tackle serious power shortages and transport bottlenecks. The task will be complicated by domestic political challenges.

Appendix: Macro economic headline figures - Major markets

	GDP growth (% change p.a.)			Inflation (% change p.a.)			Budget balance (% of GDP)			Gross government debt (% of GDP)			Current account (% of GDP)			Export growth (% change p.a.)		
	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025
Australia	2.0	1.2	2.6	5.7	3.6	3.0	1.0	-1.7	-0.9	54.1	55.4	55.6	1.0	1.1	-0.8	7.0	4.4	4.1
Austria	-0.7	0.3	2.0	7.7	1.9	0.6	-2.3	-2.2	-2.0	109.0	109.4	108.1	2.9	2.3	2.5	1.7	1.3	2.2
Belgium	1.4	0.7	1.4	4.0	2.1	1.7	-3.8	-3.3	-2.8	110.0	107.7	107.0	-0.5	0.0	-0.7	-1.0	0.1	2.1
Brazil	2.9	0.4	2.3	4.6	3.7	3.7	-8.8	-9.2	-8.1	74.5	82.2	86.5	-1.1	-1.6	-2.3	8.8	-2.8	-0.1
Canada	0.9	-0.6	2.2	3.8	2.4	2.1	0.1	-2.2	-2.2	98.9	99.4	98.1	-0.7	-0.8	-1.5	4.5	-0.2	2.6
China	5.2	4.4	4.0	0.4	1.2	2.3	-7.6	-7.5	-6.6	57.1	61.1	64.3	1.5	1.4	1.4	3.2	1.7	3.4
Denmark	1.1	1.8	3.4	3.4	0.7	1.5	2.4	0.9	0.7	38.2	36.0	33.3	10.9	11.7	11.6	9.9	-0.4	1.4
Finland	-0.4	0.6	1.7	6.3	2.0	1.9	-3.4	-2.8	-1.7	74.5	76.1	75.4	-1.2	-0.1	-0.1	-0.8	2.1	3.2
France	0.8	0.6	2.0	4.9	2.0	1.0	-4.5	-4.5	-4.4	123.2	124.8	125.4	-1.1	-2.3	-1.9	1.8	1.6	4.1
Germany	-0.2	-0.1	1.5	5.9	1.0	0.4	-1.8	-1.5	-0.7	59.6	60.0	59.2	6.6	6.4	6.0	-1.3	1.2	2.7
Greece	2.1	1.4	2.5	3.4	2.3	1.0	-1.8	-1.4	-1.0	206.6	201.4	196.0	-5.6	-3.5	-3.6	2.4	3.1	4.0
Hong Kong	3.3	2.7	4.0	2.1	2.1	2.4	-2.6	-1.9	-0.6	3.6	4.4	5.1	6.5	5.4	4.3	-6.1	10.6	6.2
India	7.0	5.7	7.0	5.7	4.7	4.5	-6.4	-5.5	-5.1	79.1	76.4	74.9	-1.2	-2.0	-0.9	1.6	1.6	9.0
Ireland	-2.1	1.8	4.5	6.2	1.9	1.2	2.3	1.5	0.8	34.5	32.2	29.3	7.2	2.8	6.4	-4.3	1.4	5.1
Italy	0.7	0.5	1.2	5.7	1.7	1.6	-5.4	-4.5	-3.8	147.7	147.9	148.2	0.4	0.9	1.2	0.0	3.1	3.8
Japan	1.7	0.7	0.8	3.2	1.6	0.7	-5.1	-4.3	-3.3	238.1	240.1	240.9	3.4	2.9	2.5	2.1	1.0	1.5
Luxembourg	-1.2	1.4	3.8	3.8	2.6	1.8	-1.3	-2.1	-2.0	29.8	31.5	31.7	5.5	6.0	5.1	-1.7	3.3	4.1
Netherlands	0.1	0.8	2.3	3.8	1.6	1.8	-0.2	-2.1	-2.5	50.8	51.6	52.0	9.6	8.6	8.7	-1.0	0.8	5.0
New Zealand	1.7	2.1	2.8	5.9	3.4	1.6	-3.5	-1.5	-0.8	44.8	44.0	42.8	-6.1	-4.9	-4.0	11.6	7.3	5.8
Norway	0.1	0.2	2.6	5.6	3.2	1.6	16.6	7.8	4.8	35.1	34.1	33.0	14.1	14.3	11.2	1.0	1.3	3.5
Portugal	2.2	1.3	2.1	4.3	2.3	1.8	1.5	0.4	0.0	103.5	99.3	95.5	1.6	0.9	0.9	3.9	0.1	2.2
Russia	3.0	2.3	0.7	5.8	6.1	4.9	-1.0	-3.0	-1.5	14.2	16.4	17.7	2.8	5.4	4.8	3.0	3.0	2.3
Singapore	0.9	2.0	3.9	4.6	1.9	1.1	-0.4	0.4	0.3	168.6	158.0	152.6	19.9	17.3	13.0	1.0	1.9	6.1
Spain	2.4	1.3	1.7	3.6	2.5	1.7	-4.0	-3.7	-3.1	113.1	113.2	112.2	2.8	3.0	3.2	1.1	2.4	3.4
South Africa	0.8	1.0	1.2	5.8	5.3	5.0	-5.9	-5.0	-5.1	74.5	77.9	81.7	-1.3	-1.5	-2.1	4.6	1.4	1.7
South Korea	1.2	1.4	2.4	3.7	1.4	1.2	-1.0	-1.4	-0.1	50.1	51.3	50.1	1.7	1.4	2.9	2.1	-0.3	2.9
Sweden	-0.4	-0.1	2.1	8.5	2.8	1.7	-1.0	-0.9	-0.7	42.9	42.7	41.8	5.5	4.4	4.3	2.7	1.1	2.3
Switzerland	0.7	1.0	1.5	2.1	1.8	1.1	0.0	0.0	0.0	25.0	24.4	23.8	7.4	8.8	8.6	3.3	2.1	3.2
Turkey	4.0	1.0	1.9	54.0	53.6	24.3	-3.3	-3.2	-1.9	28.4	24.0	21.8	-4.7	-2.8	-2.6	-2.3	1.3	2.6
United Kingdom	0.6	0.5	1.5	7.4	3.2	1.6	-5.8	-3.6	-3.1	99.2	100.1	100.2	-2.7	-2.8	-2.7	-0.4	2.0	2.8
United States	2.4	1.2	1.3	4.1	2.6	2.0	-7.6	-7.1	-6.9	140.8	143.2	145.2	-3.0	-2.9	-3.3	2.7	1.8	3.6
Eurozone	0.5	0.6	1.8	5.4	1.8	1.1	-3.1	-2.8	-2.3	-	-	-	1.8	2.0	2.1	-0.6	1.5	3.6

	Private cons. (% change p.a.)			Fixed investment (% change p.a.)			Government consumption (% change p.a.)			Retail sales (% change p.a.)			Industrial prod. (% change p.a.)		
	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025
Australia	1.2	1.6	3.4	5.2	1.8	2.2	1.4	-0.2	0.9	-1.1	0.8	2.6	0.4	0.2	2.1
Austria	-0.4	0.4	2.6	-2.8	-0.4	2.5	0.3	1.0	0.8	-2.8	1.4	3.2	-0.9	-0.6	1.8
Belgium	1.3	1.8	3.7	4.8	-0.5	0.8	0.3	0.5	-0.1	-5.9	3.4	6.5	-5.9	-1.6	2.5
Brazil	3.2	-1.7	0.1	-3.1	5.1	4.1	1.4	1.6	2.3	2.0	-2.7	-0.1	-0.1	1.1	2.3
Canada	2.0	-0.2	2.9	-2.4	0.0	4.9	1.6	0.9	0.8	1.6	-0.6	2.9	0.0	-0.6	2.0
China	8.7	5.2	5.1	3.4	4.2	3.3	4.6	2.5	4.2	9.0	5.4	5.3	4.5	4.2	3.9
Denmark	1.2	2.8	2.3	-4.8	1.9	8.7	0.9	-0.2	0.5	-1.6	1.0	2.4	7.0	6.4	4.6
Finland	-0.8	0.7	2.2	-5.4	0.5	3.1	4.0	0.0	0.9	-2.9	1.4	2.5	-0.9	1.1	1.4
France	0.7	0.6	1.4	1.4	0.0	0.9	0.6	1.7	1.3	-2.0	-1.4	1.2	0.5	0.8	2.3
Germany	-0.9	1.3	3.2	0.8	0.9	4.1	-2.2	-0.2	0.2	-3.1	1.4	3.5	-1.6	-1.0	2.7
Greece	0.9	0.9	2.0	5.2	7.1	13.0	1.1	0.9	1.2	-3.1	0.0	0.6	1.3	2.3	3.9
Hong Kong	8.1	2.4	2.0	9.2	1.5	4.8	-4.7	2.0	2.8	18.0	9.6	2.0	1.7	-0.1	1.2
India	3.8	5.8	8.1	9.5	5.3	6.3	4.3	5.7	6.4	5.3	7.2	9.4	5.9	3.3	7.0
Ireland	3.3	2.0	1.9	-11.0	1.6	2.6	0.4	2.8	1.6	0.8	2.2	2.9	-8.5	4.1	5.2
Italy	1.5	0.3	0.6	0.6	1.6	1.9	-0.4	-0.3	0.0	-3.1	0.8	1.5	-2.3	1.2	3.4
Japan	0.7	0.8	1.2	1.7	1.7	2.9	0.4	-0.2	-0.7	3.1	0.9	0.3	-1.5	1.5	3.9
Luxembourg	1.5	-0.4	1.4	2.6	1.8	4.0	1.2	-2.0	-0.3	3.6	3.2	8.3	-6.9	-0.3	7.1
Netherlands	0.2	0.8	2.5	2.8	-0.1	3.4	2.7	1.1	1.1	-2.0	2.2	1.6	-6.8	-1.1	3.5
New Zealand	1.3	1.2	2.1	0.9	-0.1	3.1	-1.8	2.6	2.3	-3.8	0.9	2.1	-0.4	1.7	3.1
Norway	-1.0	0.7	2.8	-1.1	-1.2	2.4	2.7	1.5	1.0	-3.1	1.0	3.1	-9.2	5.8	2.7
Portugal	1.2	0.9	1.7	1.7	3.0	3.9	1.1	1.7	1.2	1.8	-0.6	1.2	-3.3	0.9	3.1
Russia	5.2	0.8	0.3	8.1	6.7	1.6	5.2	2.5	1.1	5.9	2.9	0.4	3.7	2.6	-0.2
Singapore	4.0	2.2	4.1	0.3	2.8	7.4	2.1	2.1	2.7	-5.7	4.5	6.2	-5.0	4.4	8.7
Spain	2.1	1.5	1.8	1.6	1.4	4.9	2.6	1.2	0.9	6.0	1.7	1.2	-1.0	0.6	2.5
South Africa	0.6	0.4	1.2	6.6	1.9	0.7	1.7	-0.7	0.1	-0.6	1.9	1.2	0.4	2.2	1.4
South Korea	1.8	1.1	1.9	1.0	0.0	4.5	1.2	0.9	2.2	-1.0	3.3	4.2	-4.2	4.0	5.2
Sweden	-2.4	0.2	2.0	-1.0	0.4	1.7	2.1	1.5	1.7	-4.6	1.2	3.3	0.1	1.7	2.7
Switzerland	2.1	1.0	1.7	-0.7	0.3	2.8	0.2	-0.8	1.1	-1.3	0.8	1.0	1.0	0.6	3.1
Turkey	11.0	-5.6	-2.5	8.7	-0.9	0.2	5.3	1.0	0.1	19.5	-5.5	-2.6	1.5	1.3	2.4
United Kingdom	0.5	0.2	1.5	2.7	-3.4	0.3	0.3	4.4	2.1	-2.6	0.5	1.8	-0.1	0.0	0.8
United States	2.2	1.5	1.3	1.8	0.9	4.3	2.6	0.8	0.4	1.3	2.0	1.8	0.4	0.4	1.5
Eurozone	0.5	0.9	2.1	0.8	0.8	2.9	0.1	0.7	0.7	-1.7	0.7	2.1	-2.5	0.0	2.8

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