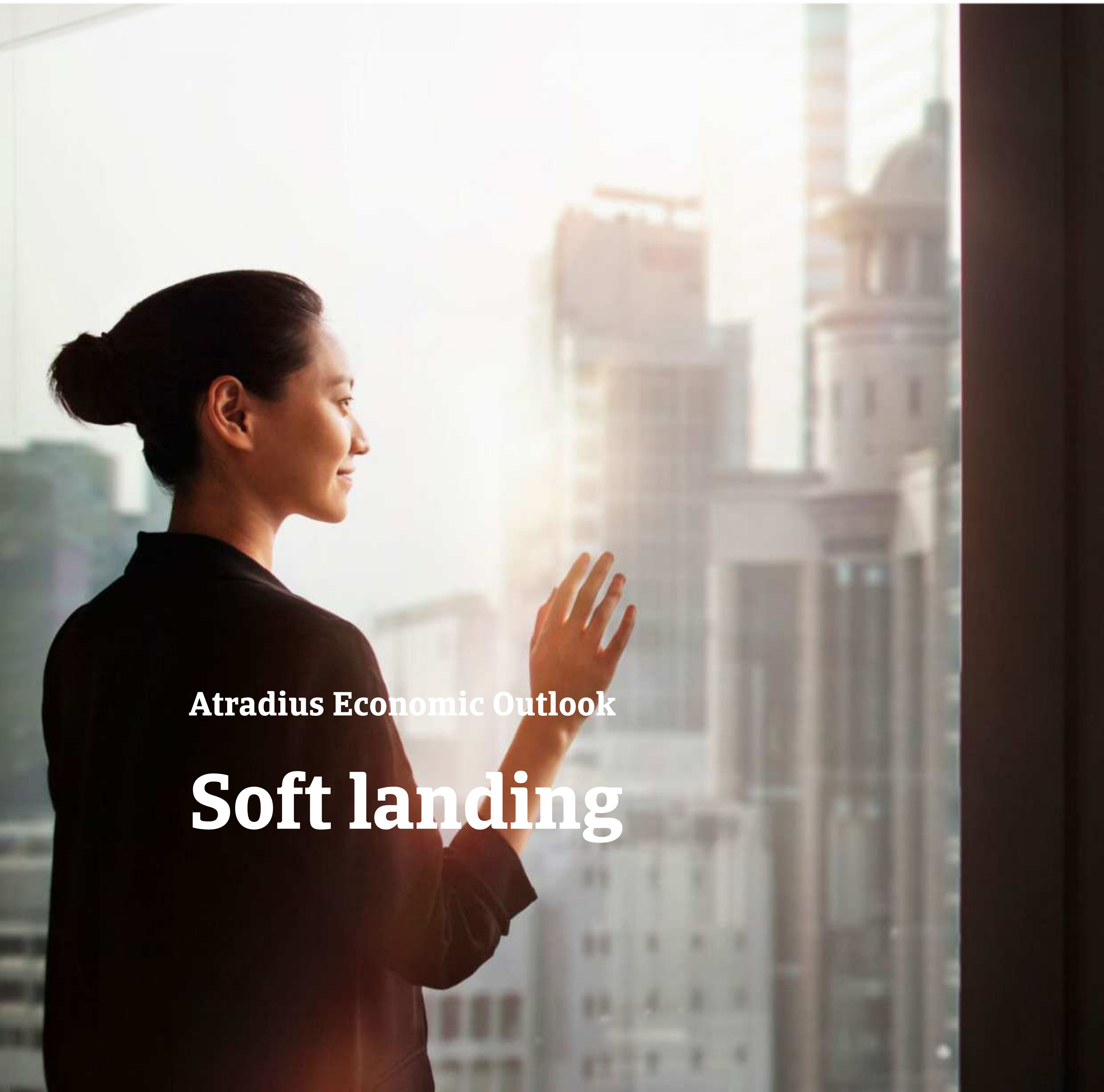
Atradius
Managing risk, enabling trade

July 2024



Atradius Economic Outlook

Soft landing

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Executive Summary

The global economy seems on track for a soft landing, as inflation is coming down while a recession can be avoided. Global GDP projections for 2024 have been revised upwards due to a surprisingly resilient US economy, while the effects of monetary tightening are less severe than expected. For 2025 the outlook is also slightly better, mostly due to upward revisions for the US.

Key points:

- **Global growth is estimated to be 2.6% in 2024, an upward revision of 0.5% compared to the December Economic Outlook.** The US economy stands out in its resilience due to a stronger demand outlook and higher immigration. Growth is likely to improve slightly in 2025, to 2.8%, with improvements in purchasing power as inflation continues to decline.
- **Inflation has been coming down in the past two years and is now closing in on central bank targets.** At the same time there are signs that the last mile of disinflation could be a challenge, especially in the US where inflation appears stickier. Eurozone inflation, by comparison, is on a clearer downward trajectory and can be expected to fall below 2% in 2024.
- **We forecast global trade growth to improve to 2.5% in 2024 and 3% in 2025, in line with GDP growth.** This comes after a rather downbeat 2023, when trade shrank by 1.2%. Eurozone trade was hit hard in 2023 as high energy prices hit the manufacturing and demand from China was relatively weak. Trade growth in 2024-2025 does remain slow, however, by historical perspective. While the Red Sea crisis does weigh on the trade outlook, we think the risk is relatively contained at the moment.
- **Advanced economies are expected to grow by 1.6% in 2024, an upward revision.** The US economy is displaying resilience, due to lower inflation driving consumers' purchasing power and higher immigration driving up labour supply. The delayed effects of monetary policy tightening can be felt, but less vigorously than previously expected. For 2025 we predict a growth rate more or less on par with this year.
- **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 3.9% this year and 4.0% in 2025. Many EMEs continue to face spending pressures related to ongoing geopolitical tensions (defence spending) and fiscal support to address negative effects from disruptions to international trade.
- We have also looked at an alternative scenario that rests on higher geopolitical tensions. Rising tensions could lead to increased shipping costs and higher oil prices, which then pushes up inflation. This will trigger further tightening by central banks, leading to lower demand from firms and households, and lower GDP growth.

Global macroeconomic environment

1.1 A soft landing

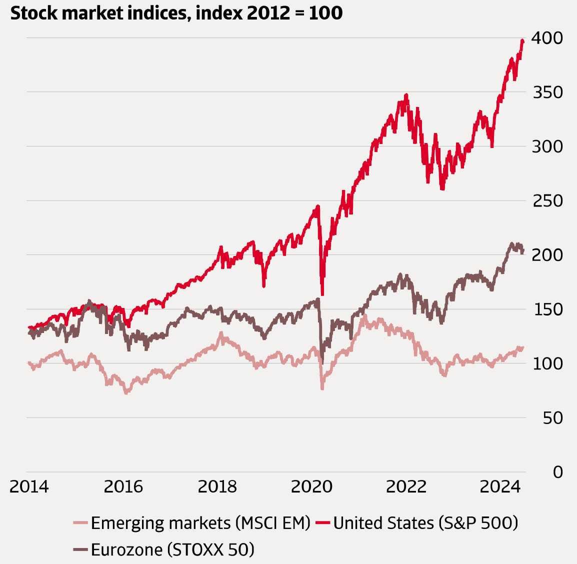
In our December Economic Outlook, we were somewhat sceptical about the persistence of the remarkable resilience of the global economy. The resilience was supported by economic activity in the US that held up unexpectedly. This was due to the exuberance of the US consumer and the recovery of services, especially tourism in Southern European countries.

This was not supposed to hold. First, the coffers of US consumers, especially the accumulated pandemic savings, were finite and lagged effects of the rapid past monetary tightening to fight the inflation surge were expected kick in. That would weigh on consumption, with pressure on housing prices creating negative wealth effects. Investment would then come under pressure and more bankruptcies follow. The tight labour market would ease, with lower income growth for workers. That would reinforce pressure on consumption. Second, the recovery in services, especially international travel, was almost complete. Manufacturing would be unable to take over the growth baton, facing high borrowing costs and weaker demand. Third, significant policy easing was also not in the cards. Governments had run out of money after all the pandemic and energy-crisis support programmes. Central banks were not in the mood for easing either, determined to root out inflationary pressures that had initially been so badly misjudged according to some.[1] Fourth and finally, the eruption of the Israeli-Palestinian conflict in October added to the list of major geopolitical concerns that already included Russia-Ukraine and China-Taiwan, to name few. The result was a surge of uncertainty in the global economy, holding back consumption and - especially - investment.

In view of this we thought it premature to subscribe to the soft-landing scenario for the global economy, in which inflation is brought under control without causing a recession. Six months on, it seems we were a touch too sceptical at the time. The global economy is indeed on track for a soft landing. What explains this persistent resilience? Two of the above factors that made us cautious turned out differently.[2]

First, consumption has held up further, especially in the US. Both supply and demand factors play a role here. On the supply side, a factor arguably ignored so far, and often the subject of heated debate in the politically arena, started to impose itself: immigration, especially in the advanced economies. This was enhanced by higher participation of local workers, including elderly. The picture emerged of a larger workforce with more spending power. On the demand side, lower inflation in combination with higher wages led to higher real wages, supporting consumption. This was further underpinned by the wealth effect of rising asset prices, especially equities, since the autumn of last year, as the (future) easing of monetary policy started to be priced in (figure 1.1).

Figure 1.1 Monetary easing priced in equity prices



Source: Macrobond

Second, while financial markets started to bet on monetary easing, lagged effects of the ongoing tight monetary stance had not kicked in as vigorously as expected. When inflation expectations started to rise it took some time before nominal interest rates went up, effectively lowering the real rates. That supported economic activity, especially investment, in most of the advanced world, with the notable exception of Europe. Moreover, households in the advanced economies were more protected against the interest rate rise due to the (low) fixed rates they had locked in. This is another reason why consumption has held up.

The other factors, the rather restrictive policy stance and geopolitical uncertainty, have not changed much as compared to our last outlook, or at least had limited impact on the global economy (such as attacks on ships in the Red Sea, to be discussed be low). It is really the labour market situation and the still relatively muted impact of monetary tightening that have driven the soft landing. These effects are having a lasting effect on the forecast. The labour supply will not change quickly, as immigrants are not expected to leave and participation rates are likely to remain up. Moreover, with

[1] Such as former US Treasury Secretary Laurence Summers. See https://time.com/6157535/the-fed-must-do-much-more-to-fight-inflation-and-fast/

[2] See also World Economic Outlook, April 2024.

inflation (almost) under control, first steps towards monetary easing can be expected. That would imply that for longer term debts with a fixed rate of a sufficient maturity, by households or firms, the impact of tightening will largely pass by. The result of all this is that a soft landing is indeed the most likely current scenario at this juncture.

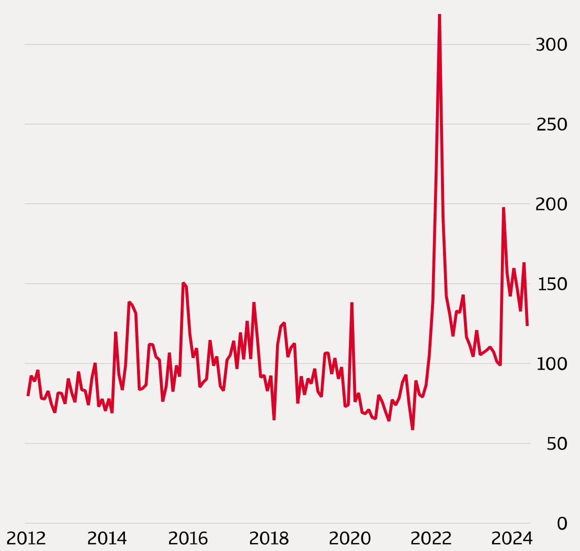
1.2 Solid but unspectacular growth

This picture of a soft landing for the global economy has now been given more concrete shape. The result is higher than previously expected consumption and investment growth. This all bodes well for global GDP growth. It is indeed revving up as we will elaborate below.

But make no mistake. Growth levels, though more robust, are to remain relatively subdued as compared to those seen during the first two decades of the millennium. This is due to policy support from the government becoming restrictive, with only mild easing coming from the monetary side. On top of that, a revival of flagging productivity growth within firms is at least highly uncertain, despite promising developments in areas such as artificial intelligence (AI). Geopolitical developments that affect the global economy via increased uncertainty and fragmentation are also not helpful (figure 1.2).

Figure 1.2 Elevated geopolitical risk

Geopolitical risk index

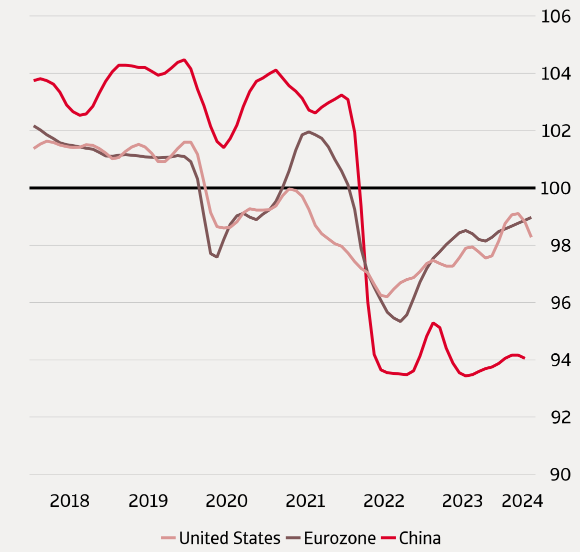


Source: Economic Policy Uncertainty, Macrobond

Having said that, the more robust growth picture is reflected in confidence indicators. Starting with consumer confidence (figure 1.3), compared to the December Outlook, where we characterised consumer confidence as wobbly, the picture has quite significantly changed. Confidence is clearly on the rise in the US and eurozone and is approaching levels indicative of expansion. Higher wages, lower inflation, as well as increased employment opportunities strengthen this. Protection via fixed rate mortgages as well as the observation that there will be some loosening are also supportive. As opposed to this, confidence levels in China, low but at least no longer declining, largely reflect the crisis in the construction and real estate sector where home buyers are confronted with negative wealth effects due to price pressures. The deflationary environment as well as high unemployment, especially among the youth, is likewise not triggering an increase in spending plans there.

Figure 1.3 Consumer confidence continues to improve

OECD consumer confidence index, 100 = neutral

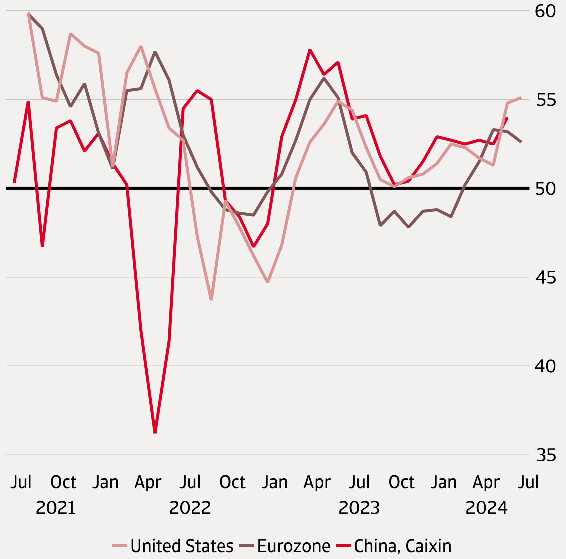


Source: OECD, Macrobond

The difference in services and manufacturing confidence indicators that we signalled in the previous Outlook is still there (figures 1.4 and 1.5). Services PMIs are in expansionary territory in the US and China and even showing an upward tendency. The news is that the eurozone has turned a corner and moved above 50, thus into expansionary territory as well. The latter is not the case for eurozone manufacturing, but it has at least moved on an upward trend since July 2023. This highlights the fact that the crisis in eurozone manufacturing, especially in Germany, is not over yet. Relatively high interest rates and faltering demand in export markets such as China are causing this. The PMI in the US, during the autumn below 50 without a clear direction, has shifted into positive territory as well, suggesting expansion. The Chinese manufacturing PMI, that fluctuated around 50 for most of 2023, is now distinctively in expansionary territory.

Figure 1.4 Services confidence signals further expansion

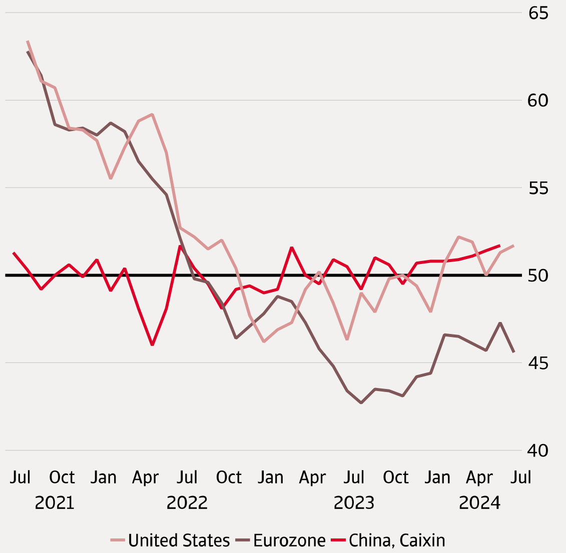
Services PMI, seasonally adjusted



Source: S&P Global, Macrobond

Figure 1.5 Upward trend in manufacturing confidence

Manufacturing PMI, seasonally adjusted

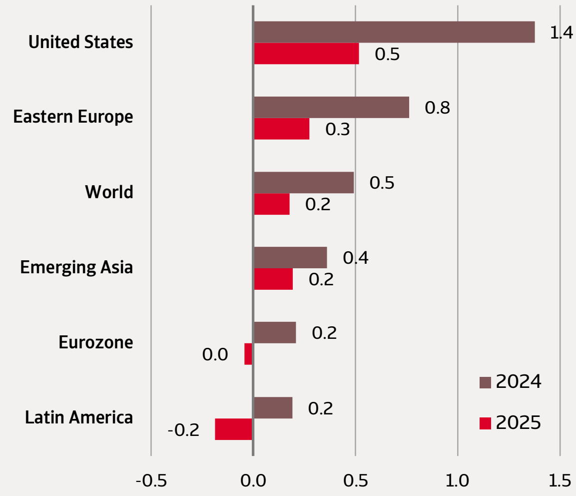


Source: S&P Global, Macrobond

All this culminates in a relatively strong upward forecast adjustment as compared to our December Outlook, especially for 2024 (figure 1.6).

Figure 1.6 Strong upward forecast adjustments

Percentage point change in real GDP growth forecast since December 2023



Source: Oxford Economics, Atradius

The US adjustments stand out markedly. The global outlook has improved by 0.5 ppt in 2024, with a strong contribution from the US: plus 1.4 ppt. Eastern Europe improves a lot as well, by 0.9 ppt, supported by strong upward revisions for Russia and Turkey. Emerging Asia is higher by 0.4 ppt, helped by more favourable developments in China and India. The upward adjustments for the eurozone and Latin America are minor. For 2025 the adjustments are generally a lot less soft, with the - upward - global adjustment falling back to only 0.2ppt. Again, the highest adjustment is for the US at 0.6ppt, followed by Eastern Europe at 0.5ppt. For the latter region, adjustments for Turkey and Russia are marginal. For the remaining regions, there is little, or indeed no adjustment, as in the case of the eurozone.

The significant upward adjustments naturally push up forecasted GDP growth levels. As already indicated, these growth numbers remain below historical averages (table 1.1). A soft landing it really is. Global growth is now at 2.6% in 2024. This is precisely the expected GDP growth level for the US as well. Above and below that global (and US) figure are the usual suspects. The cart horse of the millennium so far, Emerging Asia (which includes China), is above the global average at 4.9%. The eurozone is anticipated to remain stuck at 0.8%, with Latin America only a touch higher. Eastern Europe growth this year is above the global average. In 2025, growth paces up a bit, to 2.8%. Especially the eurozone and Latin America show higher growth levels, though still below the global average. Such will also be the case for the US which falls back to 1.9%. Growth above average is then again seen in Emerging Asia, although again somewhat lower compared to 2024, and, though marginally, Eastern Europe.

Table 1.1 Real GDP growth – global regions

Regions	2023	2024*	2025*
Eurozone	0.5	0.8	1.8
United States	2.5	2.6	1.9
Emerging Asia	5.5	4.9	4.7
Latin America	1.9	1.0	2.3
Eastern Europe	3.0	3.0	2.7
World	**2.7**	**2.6**	**2.8**

Source: Oxford Economics, Atradius (* forecast)

1.3 Assumptions for solid growth

The above picture of solid but unspectacular GDP growth is built on several assumptions. As this changes only gradually, the reader may recognise a few of them from the December Outlook. We will discuss these in more detail here.

First, an elevated level of geopolitical uncertainty is here to stay, at least over the forecast horizon. We do not envisage an end to the Ukraine war. Even a ceasefire, let alone a peace deal, is far off. The related tensions between the NATO countries and Russia thus remain. As do the sanctions imposed on Russia. Tensions between China and Taiwan continue as well. They will regularly flare up. But a full invasion by China of Taiwan is not in our baseline scenario. Such an act would further complicate the already complex relationship between the US and China. Nor is an escalation of the conflict in the Middle East between Israel and Hamas expected. It remains contained to the parties involved, as does the economic damage.

Second, US-China relations remain broadly where they are. The US views China as an economic rival, whose progress in strategic sectors, including those related to the energy transition, needs to be checked. Moreover, the US has put an industrial policy in place not only to protect but to develop sectors as well. This means that access to US technology is restricted and tariffs on certain types of traded goods, such as recently on electronic vehicles, will be imposed if felt needed. China will then retaliate with trade measures as well. But it will not lead to a full-blown trade war, as both the US and China still have an interest in bilateral trade. The EU is cautiously developing similar views in relation to China and the need for its own industrial policy. It is a world of increasing trade restrictions and globalisation that erodes but persists.

Third, inflation came down significantly during 2023 and is moving to targets that the various central banks have put in place. This is a process, though with a clear downward trend, that varies per country or region. We expect EU inflation to be brought down faster than the US, as the source of inflation is much different. Services inflation is more sticky than other inflation components, such as energy. Wage growth is expected to remain relatively high as compared to current inflation to make up for past real income losses. This effect will die out over time, helped by robust inflation expectations at central bank targets. Moreover, immigration and increased participation will support this. Central banks will keep a very close eye on inflation to avoid a repeat of the surprise inflation seen after the pandemic.

Fourth, we expect some mild monetary easing to start during 2024. This is because inflation is close to being under control by central banks. Moreover, as is the case for the Eurozone, the economic activity is such that a resumption of inflation caused by excess demand is not likely. For the Fed the matter is slightly different, with more persistency of inflation due to the very presence of such a surplus. As that will wane, so will inflationary pressures, and easing will come into play. Easing will be mild and will consist of some rate cuts, while the shrinking of the balance sheet, which is in fact monetary tightening, will continue. Moving back to the pre-pandemic period of ultra-low interest rates and ample monetary easing is not on the cards. Central banks will want to remain potent in being able to react by raising or lowering rates if inflation runs too far above or below target.

Fifth, the role of the government in the economy is expected to grow further. It is not only that governments will be willing to step in in the case of an economic crisis, but at other times too, as we saw during the pandemic and the energy crisis following the Russian invasion. Perhaps more importantly, policies aimed at developing and protecting sectors that are considered vital to the economy or even to security, will be implemented, particularly in the advanced economies. The US is leading this process. It means that fiscal prudence is a lesser priority. Therefore, budget deficits will be wider than initially envisaged, with less fiscal consolidation. The latter is needed, especially in the US, given the debt that was increasing at a fast pace during the pandemic and the energy crisis. This more prominent role that government takes on implies that central banks are more restricted in designing their policies.[3]

[3] A clear example was the expansionary US government fiscal policy during and after the pandemic. This had an inflationary impact, prompting the Fed to hike interest rates more aggressively.

1.4 Trade out of the doldrums

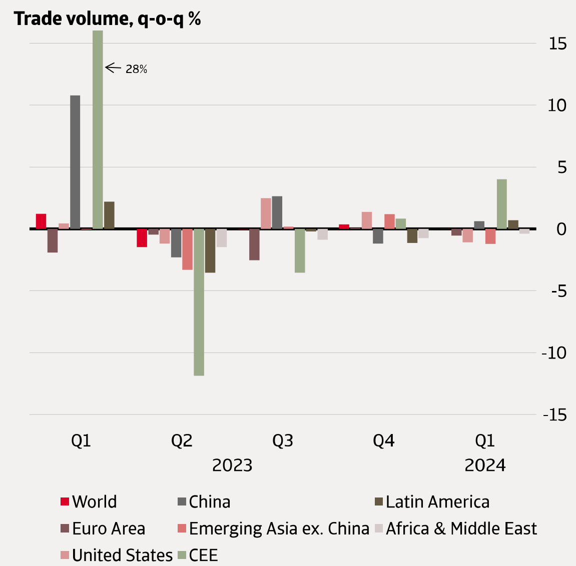
In our December Outlook we halved the global trade growth forecast for 2023 to 0.8% from 1.9% while keeping the 2024 forecast at 2.5%.[4] This was in line with other forecasters, such as the WTO, that also had noticed the global trade shrinkage of 1.7% up to September. We were relatively optimistic because of a base effect: the second half of the preceding year had been weak[5] and there were clear signs of recovery from confidence indicators. Despite the forecasted recovery later in the year, our overall forecast for 2023 turned out too optimistic. The year ended with a trade shrinkage of 1.2%. This is way out of line with GDP growth of 2.7%.

Figure 1.7 Reinforced export orders

Source: CPB, IHS Markit, Atradius

We think this is very unlikely to last. Our forecast for 2024 is that trade will grow by 2.5%, followed by 3% in 2025, in line with GDP growth. The reader may notice that, whilst the trade growth figure is unchanged, we are now much more cautious regarding global trade than in December. Indeed, the 2.5% increase we forecast now for 2024 is to be applied to a lower base (of 2023) than we envisaged earlier. Apart from this 'mean reversion argument' the forecast is supported by forward indicators such as the reinforced exports orders index (figure 1.7). Also, quarter-on-quarter trade growth expanded in Q4 2023 and Q1 2024, albeit marginally (figure 1.8). Clear signs trade will emerge from the doldrums in 2024.

Figure 1.8 Global trade modestly expands in Q1



Source: CPB, Macrobond

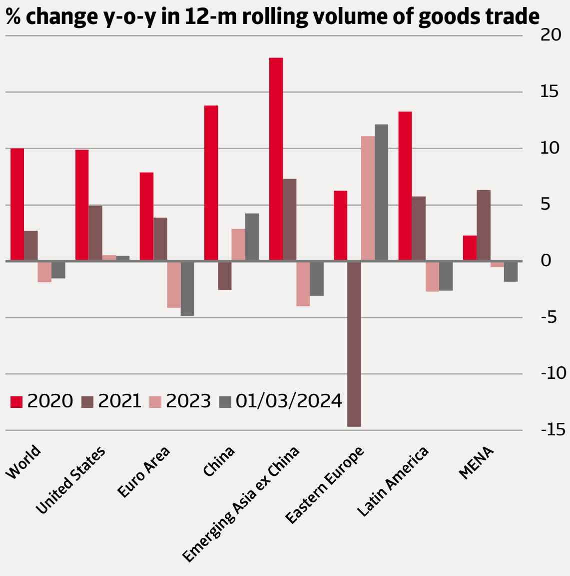
We can appreciate that, with the rather large difference between forecasted trade growth and the ultimate outcome for 2023, the reader may want some more substance for the 2024 forecast.

Let's start with the picture of trade growth in 2023 (figure 1.9). What we observe is an across-the-board weakness of global trade, except for China (5% growth) and Eastern Europe (16.5% growth). The latter, relatively small region in trade terms, should be viewed in perspective: following the Russian invasion of Ukraine, trade had shrunk by almost 15%. US trade growth remained stagnant, with Latin America and MENA having relatively low weights in global trade. This leaves us with the Euro Area as the main drag on global trade growth. With 4% shrinkage and 30% weight in global trade, it seems this region is the main culprit.

[4] As usual, the figures here cover global trade in goods in volume terms. Services trade amounts to 42% of the value of global trade, according to the WTO.

[5] A weak second half of 2022 implied that the trade level in the second half of 2023 would have to be relatively low to show growth for that period. It did show growth, but that was insufficient to make up for the growth decline in the first half of 2023.

Figure 1.9 China and Eastern Europe exceptions in meagre year



Source: CPB, Atradius

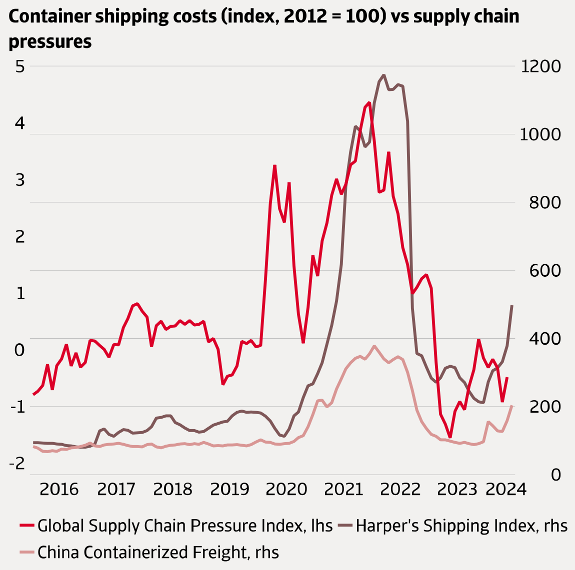
What happened there that made trade so weak? First, the eurozone was hit hard by the rise in energy prices, in particular the gas price, following the Russian invasion. That impacted European manufacturing severely, driving up input costs. This was reinforced by the relatively weak demand from China, where the economy is in lower gear, reducing demand. Eurozone growth was low, particularly in manufacturing. Precisely manufacturing goods, rather than services, are trade intensive. Second, investment in manufacturing was weak. This comes as no surprise. Who wants to invest in a sector that is stagnant at best? Arguably even more important, is the high borrowing cost that firms are facing after the hiking of interest rates by central banks. This clearly hits demand for capital goods, or investments. Production and sales of capital goods are trade intensive as well. Third, inflation. During 2023 inflation was declining but remained relatively high. At the same time, wage growth was catching up, but this lagged inflation and remained short of full compensation. This meant that real disposable income for households was under pressure. It made households cautious about spending, especially on durable consumer goods, such as vehicles and household appliances. This cautiousness was reinforced by the high borrowing costs. Durables are often bought on credit. One can then guess: durables are relatively trade intensive as well, and low purchases depress trade.

For Europe, therefore, all important signs in support of trade growth were red. To some extent, these factors played a role in the rest of the world as well. But their impact was lower. In the US, the other economy with a large weight in global trade, the impact of energy prices was much lower. This, combined with strong government support for the economy, supported manufacturing. The US consumer kept up spending, including on durables, from accumulated pandemic savings. Chinese growth was underpinned by exports, especially of goods related to the energy transition. The pressure from borrowing costs did not play a role for investment growth, they remained low. In short, GDP growth in the main region for trade was low and driven by services. Other regions did not make up for this.

This situation of factors all pointing the wrong way is unlikely to last in 2024. In the eurozone, GDP growth will pick up and become less services driven. Manufacturing is recovering as we have already seen earlier, helped by lower (though still relatively high) energy costs, and adjustments to make production more energy efficient. China's demand is recovering. In such an environment, investments will gradually pick up. Disposable income for consumers benefits from the benign coincidence of lower inflation and wage growth that is still catching up. Moreover, as monetary easing comes in, credit will become less expensive. This all points to more spending on durables, and increased trade.

We do not think that the attacks on shipping in the Red Sea pose a major risk for this view. True, they have caused the average daily number of vessels to decline by 51% in the first quarter of the year. Rerouting of ships via the Cape of Good Hope pushes up journey times between Asia and North Europe by 30%. But it only affects 9% of the world's maritime fleet. Moreover, despite shipping costs having gone up significantly, at 60% higher in the first quarter compared to 2023, there are no signs of pandemic-era supply chain constraints that may break the decline of inflation (figure 1.10). Limited global demand for goods and additions to the container fleet support this.

Figure 1.10 No signs of pandemic-era supply chain pressures



Source: CPB, IHS Markit, Atradius

This all sounds bullish for global trade. But make no mistake: trade growth will be slow for the longer term, fluctuating slightly above 3%. This is far below the 4.9% average of the first decades of the millennium. Whilst a slowdown from such a high level was bound to happen anyway,[6] the situation has deteriorated as geopolitical issues have increasingly impacted trade. Research by the IMF shows that trade is increasingly taking place within politically friendly blocs, such as the US, the EU and other OECD countries on the one side and Russia and China on the other. Since the start of the Russian war in Ukraine, trade between blocs has declined by 2.4 ppt more than within these blocs. This effect is even more pronounced in strategic sectors such as machinery and chemicals where the additional slowdown was 4 ppts. More specifically, trade between the US and China is under pressure (See box for the impact of a new Trump presidency). China's share of US imports has fallen by almost 8ppts since tariffs were put in place in 2017. While some reallocation of trade has taken place towards Vietnam and Mexico, this has only lengthened supply chains. On top of this development, we observe a wider increase in (often bilateral) trade restrictions. Pre pandemic, the level was 1000 per annum; in 2022 and 2023 this level tripled (3200 and 3000 respectively). The economic impact of this surge in fragmentation, bilaterally and between blocs, is a loss of benefit of international trade. Trade is diverted and less trade created. It results in less specialisation, smaller economies of scale and less competition. This will weigh on trade.

1.5 Fossil fuel prices trending down

In our December Outlook we unfolded our view that fossil fuel prices, after the spikes caused by the Russian invasion and subsequent sharp decline would stabilise at an above-invasion level. After that stabilisation, the energy transition would start to impose itself, causing a downward trend in prices. That said, the volatility characteristic for the fossil fuel (especially oil) market would remain. With the energy transition ongoing, we see no reason to change that view.

As to oil prices, volatility, rather than a clear direction, is precisely what we have seen since December (figure 1.11). In late autumn the market was unnerved by the escalation of the conflict in the Middle East. Soft demand and record US output dominated. The oil price continued downwards. Even the announcement of OPEC+[7] of a production cut of 2.2 mb/d initially failed to arrest the trend. It all changed with the attacks on the ships in the Red Sea already discussed. These were the catalysts. Even US and UK military operations to safeguard shipping did not prevent longer journey times and higher shipping costs, precipitating a rise in the oil price. Besides that, deeper concerns about the resolution of the conflict came to the fore. The Brent crude oil price consequently moved to above USD 90 per barrel. Meanwhile prices have calmed down again, moving to around USD 80.

Figure 1.11 Oil prices lack clear direction

Daily spot price, USD per barrel Brent

Source: Macrobond

In contrast to oil prices, natural gas and coal prices did move in a clear direction: downward (figure 1.12). This was especially true of gas prices in Europe and the US. In contrast, the Asian price is edging up slightly. The explanations vary. The US Henry Hub fell relatively sharply in Q1 on the back of strong domestic production and a relatively mild winter. In Europe, the decline was even more pronounced as demand tumbled amid high inventories. Since then, European prices, determined by LNG prices, have edged up somewhat as tensions, particularly those related to the Middle East, flared up. Asian natural gas prices were slightly higher as the LNG contracts reflected lagged effects of higher oil prices and increased demand in the region, especially from China.

Coal prices fell markedly, with Australian coal 47% lower y-o-y, due to robust supply and substitution away from coal in the power sector. This is bound to continue, although the pace of the decline is slowing. We discuss underlying market developments below.[8]

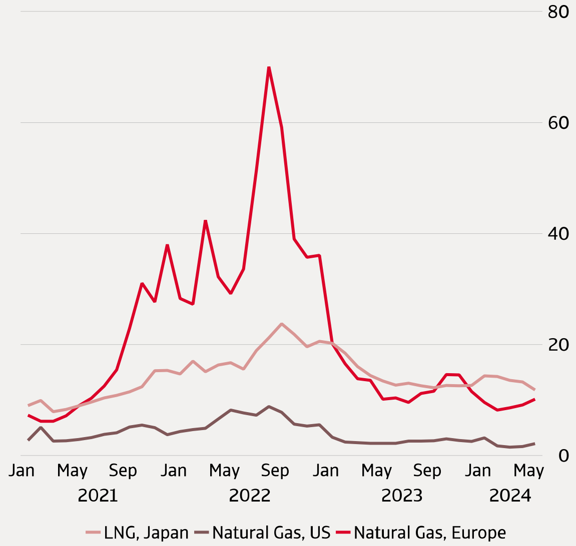
[6] These high growth levels were largely driven by the reopening of China and Eastern Europe. That effect has now waned.

[7] OPEC+ contains the original OPEC countries plus Russia.

8 Substantial use is made of the World Bank Commodity Markets Outlook, April 2024, when forecasts are involved.

Figure 1.12 Natural gas prices move downward

Global gas prices, USD per million btu



Source: IMF, Macrobond

Oil

Demand for oil grew by 2.3 mb/d in 2023, to 101.7 mb/d, surpassing 2019 levels for the first time. Demand in China, representing 15% of global demand, is largely behind this. That surge was triggered by the scrapping of the 'zero Covid policy' in late 2022. Indeed, China accounts for 78% of the global increase in demand.[9] Recently, demand growth slowed. The expansion fell from 2.8 mb/d in Q3 2023 to 1.9 mb/d in Q4 and 1.6 mb/d in Q1 24. Ongoing weakness in the manufacturing and industrial sector, particularly in Europe, plays an important role. The energy transition is also a factor, with tighter efficiency standards and an expanding electric vehicle fleet. Support from demand related to the normalisation of Covid policy is now fading as well. Therefore, for the full year 2024 growth of oil demand is expected to almost halve to 1.2 mb/d and 1.1 mb/d in 2025. This reduced demand growth will be led by non-OECD countries, China, Indonesia, India, Brazil and Saudi Arabia in particular. Demand growth in OECD countries is forecast to decline mildly.

Supply growth in 2023 came from the United States, Brazil, and Guyana as well as Iran. In the US, drilling efficiencies and high well productivity in the shale sector drove production to exceed 20mb/d in September, defying expectations of a slowdown due to cost inflation and capacity constraints. Altogether, the US accounted for two thirds of the non-OPEC expansion. By contrast, OPEC+ posted a decline of 400kb/d, driving its market share down to 51%. Iranian production reached a five year high. Meeting the developments on the demand side, global production growth started to slow as well, to 1 mb/d in Q3 2023 (q-o-q), followed by more than a reversal in Q1 2024. This latter largest supply reduction since the pandemic was due to ongoing OPEC+ production cuts,[10] reductions in global biofuel supply (included in the oil supply), and weather-related disruptions in North America. The change in OPEC + production was small, with Russian production largely maintained, exports to China and India continuing in spite of sanctions from the US, the EU and other countries. These trends are forecast to continue, with the supply increase from non-OPEC to grow by 1.6 mb/d in 2024 and 1.4 mb/d in 2025 against a further fall for OPEC+ to meet the demand increase. US production is to grow even further – by around 500 kb/d per annum.

Meanwhile inventories (held by industry as well as governments), which act as a buffer for market disruptions, provide a mixed picture. For OECD countries they are now able to cover 90 days of consumption. This is down from 110 pre pandemic. The figure includes the so called 'oil on water', which is at its highest level in 15 months. It is due to rerouting of tankers in view of the geopolitical tensions in the Middle East and the drought in the Panama Canal. The refilling of the US Strategic Reserve, used after the Russian invasion to contain price rises, is progressing slowly. They are now at just 14% of the pre-invasion level.

Natural gas

Global gas demand stagnated in 2023. To be precise, it increased by a mere 0.5% or 22 billion bcm (y-o-y), only partly reversing the fall the year before. The increase was dominated by Asia Pacific with 24bcm, due to demand from power and industrial sectors in China and India. North American consumption increased marginally; Europe declined by 36bcm, the lowest level since 1996. This was caused by lower electricity consumption, efficiency gains, policies, and a mild winter. But this picture of stagnation is not forecast to last. Global demand will rise by 100bcm in 2024 and another 80bcm in 2025. Demand is driven by China, but not only there. In the other regions lower gas prices will increase demand in the industrial and power sector as well. This is for 2024; in 2025 the demand increase is forecast to be driven by emerging economies.

Global supply changes were rather limited in 2023. Higher LNG production continued to compensate for the lower Russian pipeline exports. US production rose by 40bcm in 2023 - another record. European supply was 15bcm lower as demand declined amid high storage levels. Russian production declined

9 See https://www.iea.org/reports/oil-market-report-december-2023.

10 On June 2 OPEC + agreed to an extension of production cuts agreed in late 2022, some of them extending until the end of 2025. Three sets of cuts were involved. First, an OPEC + wide cut of 2 mb/d was extended for 12 months. Then there are 1.66mb/d voluntary cuts by Russia, Saudi Arabia and the UAE, expiring by the end of 2025. Lastly, another 2.2 mb/d is to be prolonged until September and then gradually unwound over a period of a year. With these cuts, about 6% of global oil supply is hanging over the market.

by 32 bcm, mitigated by LNG exports not affected by sanctions. To make up for lost Russian supply, Europe absorbed 70% of US LNG exports. Chinese LNG imports rose as well, by 12bcm, with China regaining its position as the largest LNG importer. The US has now become the largest LNG exporter, before Australia and Qatar. Together, these countries account for more than 60% of LNG supply.

Meanwhile, storage levels are high. This is especially the case in the EU, where they are above pre-pandemic levels, as demand is weak and LNG imports ample. They are also elevated in the US and Asia (Japan as well). In 2024 and 2025 storage levels are not expected to change much, as production is forecast to stay close to demand levels. As demand rises, so does supply, in all regions. Even in Russia a rebound can be expected, from a relatively low level. The US will benefit from new pipelines and wet gas production.[11]

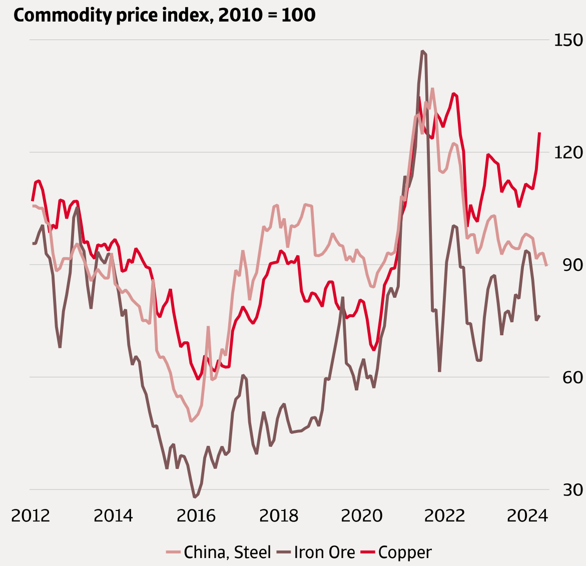
Coal

Coal demand reached an all-time high in 2023, although demand has since slowed with softer economic activity, increased penetration of renewables-generated electricity and lower gas prices. Production rose in India and to a lesser extent in China, while production in the US and EU declined. Demand is expected to fall over the forecast horizon, especially in the US and EU and to some extent in China. In India demand continues to grow, albeit more slowly. In line with lower demand, production falls are expected in the US, China and Indonesia.

More bullish on metals prices

In the December Outlook we argued that the rather weak economic outlook would be an important factor in a further easing of commodity prices. Like fossil fuel prices, these had spiked after the Russian invasion. As prices remained relatively high the reversal set in was likely to continue, reinforced by the growth. Two factors warrant a challenge to this view. The first is that the economic outlook is firming as we have seen. Second, it is becoming increasingly clear that the energy transition needs commodities, including base metals such as steel, iron ore and - particularly - copper. This provides an upward underlying trend in commodity prices – as opposed to fossil fuel prices. It is then not surprising that we have seen a slightly upward movement in prices of these commodities since our December Outlook (figure 1.13).

Figure 1.13 Metals prices on an upward trend



Source: Macrobond

As to the steel market, China is the dominant force, accounting for over 50% of global steel consumption as well as production. In 2023 steel consumption grew marginally in China, by just 0.5%, dragged by low demand from the vital construction sector.[12] India, Russia and Turkey showed demand growth, but it was weak elsewhere, especially in Europe. Global consumption shrank marginally, by 0.3%. With a rebound of the global economy, consumption growth of about 2% per annum is forecast. The Chinese construction sector woes will continue to put a lid on global demand, while US and EU demand will grow. On the supply side, price support will come from the capacity reduction in China, which will continue over the forecast horizon. The result is a slight upward edge in prices, particularly in 2025.

Iron ore is used as an input for steel making and is therefore closely linked to steel demand. The market nevertheless showed a different dynamic due to the supply side developments. As opposed to steelmaking, where capacity shrinks, in iron ore it expands. Especially in Australia and Brazil iron ore production is likely to increase over the forecast horizon, along with projects elsewhere. This will put downward pressure on prices. An inkling of this was given in Q1 when prices dropped as increased seaborn supply from these countries resulted in higher stocks in Chinese ports. Therefore, the impact on prices from steel demand gaining traction is likely to remain limited.

Copper prices are driven by the same factors as steel and iron ore: global manufacturing growth, and construction in China. The forecast recovery of the manufacturing sector will provide

[11] Wet gas is gas with some liquid.

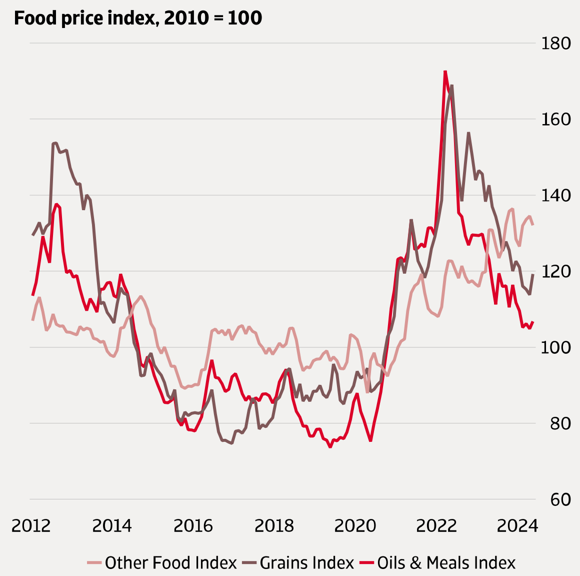
[12] To provide some, perspective, in 2023 new home starts fell 20%.

price support. More fundamentally, copper demand has a strong additional driver: the energy transition. It is vital in the electricity grid infrastructure, EVs and solar panels. This has helped to mute the price decline after the spike of the Russian invasion and will continue to provide support. Demand for copper is set increase by 3-4% per annum. Supply is scheduled to expand, especially in China, India, the US, Uzbekistan, and Indonesia. In Europe, copper has been included as 'strategic material' in the proposed Critical Raw Materials Act, which will underpin further expansion of capacity. However, over the forecast horizon, production will closely track demand, or even fall short of it. Upward price pressures will be the result.

Food prices slide continues

As opposed to metals prices, we see no reason to change our view that food prices will further slide from the peak after the Russian invasion. Compared to the commodities just discussed, demand is a lot less sensitive, if at all, to cyclical factors, let alone the energy transition.[13] It is predominantly supply-side dynamics that determine prices. In that context, the additional production triggered by the price spikes after the Russian invasion is now complemented by robust recovery of exports from the Black Sea region. After the collapse of the Black Sea Grain Initiative, Ukraine has found ways to transport by sea or land. Against this backdrop, the Oils and Meals Price Index further declined, by 5% in Q1 2024. The Grains Index fell even more, by 8%. The Other Food Price Index, encompassing sugar, meat, and fruits, stayed at a relatively high level, without a clear direction (figure 1.14).

Figure 1.14 Food prices continue downward track



Source: Macrobond

This picture will not change much over the rest of the 2024-2025 period. The slide in the Oil and Meals Price Index is determined by a large fall in soybean prices, reflecting favourable production forecasts and very high stocks. For the Grains Price Index, which is also set to decline further, it is the expected higher grain supplies that play a prominent role. In contrast with this, the Other Food Price Index will lack clear direction. While El Ni*ń*o is expected to weaken, and accordingly its negative impact on harvests, supply constraints in India and Thailand provide an opposite force. Similarly, the ongoing drought conditions in Spain.

1.6 Sticky US inflation not indefinite

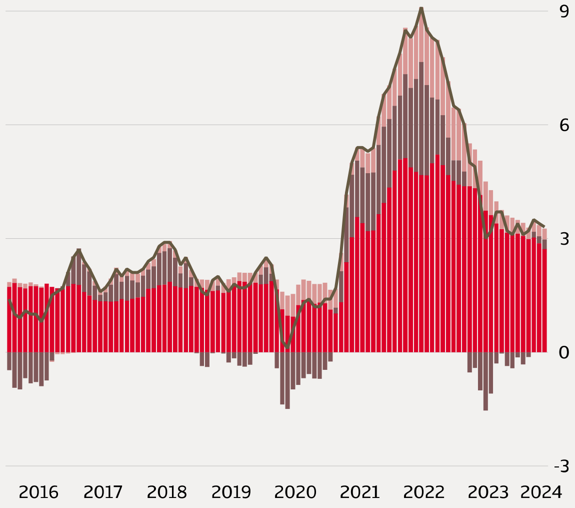
The process of disinflation that we have seen over the past two years or so should now have run its course, or at least we should be close to it. This means that inflation should be back to its central bank target level – in the advanced economies often at, or approaching, 2%. Is that the case? Yes, inflation has further come down since the December Outlook. But there are also signs that the reaching of those targets is being somewhat hampered and can face a delay, especially in the US. Let us now first take stock of the developments and outlook, focusing on the US and the eurozone.

Whereas the US headline inflation peak of June 2022 at 9.1% is far behind us, the decline of inflation, or disinflation, seems to have stalled since our December Outlook and has become volatile, slightly above 3% (figure 1.15). The most recent May inflation figure comes out at 3.3% y-o-y, marginally lower than the 3.4% in April but still higher than the 3.2% in February. Core inflation, which excludes food and energy, has continued its downward trajectory, and is now at 3.4%. This means the picture we observed in December of core inflation above headline has almost vanished. At the time we had energy deflation. That has now turned into inflation: 3.7% in May I. Food inflation is at a moderate 2.1%. Our forecast for 2024 reflects the slowdown in headline disinflation in 2024: we expect the headline figure for 2024 to come in at 3.3% (4.1% in 2023) and 2.5% in 2025.

[13] Climate change is of course a factor that plays a role.

Figure 1.15 Persistent core inflation in the US

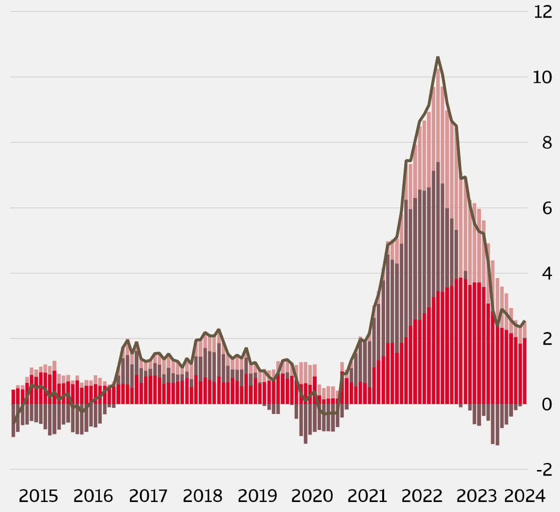
United States: Contributions to inflation



Source: US BLS, Atradius, Macrobond

Figure 1.16 Eurozone energy inflation is negative

Contributions of components to HICP inflation, eurozone



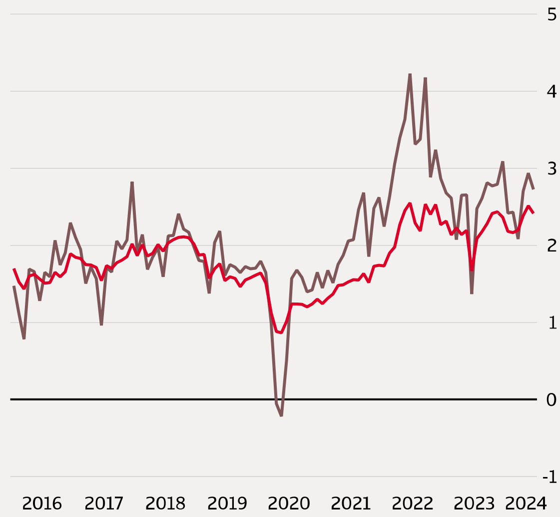
Source: Macrobond

The picture of eurozone inflation dynamics is somewhat different than that of the US (figure 1.16). Largely driven by energy inflation it went up more quickly after the Russian invasion. Inflation peaked higher at 10.6% in late 2022, and then also declined more rapidly - and to lower levels. Headline inflation briefly went up in January this year and then continued its downward trajectory, edging up to 2.6% in May. Moreover, core inflation has been and is still significantly lower than in the US. It is currently running at 2.9%. The decline of the energy prices since May last year has now stopped: energy inflation is currently around zero. Food inflation has come down considerably, from 13.7% last May to 2.0% now. We expect headline inflation for the eurozone to continue falling, even below 2% for 2024, implying an average of 2.2% that year. For 2025 we see a further decline of inflation, to 1.3%.

The overall picture of headline inflation is now as follows: Eurozone inflation was below that in the US for a considerable number of years before the pandemic. It peaked briefly above US inflation due to energy inflation and is now relatively quickly reverting to pre-pandemic levels. US inflation is set to be higher for longer, moving towards a level above the 2% target. The latter is the real change since the December Outlook. It is also reflected in inflation expectations (figures 1.17 and 1.18).

Figure 1.17 US inflation expectations signal some stickiness

United States CPI inflation expectations



Source: Federal Reserve Bank of Cleveland, Macrobond

Figure 1.18 Eurozone inflation expectations back to target

Source: ECB, Macrobond

What is behind this picture? Several factors, partly overlapping those that were discussed in the December Outlook, play a role. Let us look at these factors and then argue how they relate to the current view.

First, energy inflation. Europe was particularly hard hit by it. It showed up in headline inflation directly via the energy component. Then, after some time it filtered through in input cost in sectors selling to consumers that are energy sensitive, such as travel and hospitality. This was subsequently passed on in higher prices, especially services prices, marking an indirect effect of inflation. Second, as prices for consumers went up, from this direct and indirect source, so did demands for higher wages. These further pushed up input cost, particularly for labour intensive sectors. For sectors such as travel and hospitality this is high, as was the subsequent passing on to consumer prices, reflected in core inflation. Third, consumer prices also directly rose as food prices went up. Fourth, in the manufacturing sector, another source of input cost to sectors, energy and wages costs also rose. This was also the case for a number of commodity prices. This was again passed on to producer prices, ending up as inputs for sectors selling to consumers. Again, a source of inflation. Fifth, whereas the above factors are supply driven, the demand side also plays a role. During the pandemic, demand for services was all but blocked and all demand power switched to goods and then, after the pandemic, switched back to services. This allowed for services prices to be raised in response to the input prices. Sixth, post-pandemic demand was also reinforced by government support programs that helped firms and households cope with the pandemic and later the energy prices. The former in particular generated accumulated savings that were spent post pandemic. Seventh, recent government programs in support of the energy transition such as the Inflation Reduction Act in the US have fired up demand, now from firms, as well. Stringent monetary policy (see below) has only partially able to offset this.

How do these factors relate to the current inflation forecast? On the supply side, energy inflation has come down, with the direct and indirect effects on prices fading. The effect is largest where the energy inflation was greatest, i.e., in the eurozone. Moreover, the underlying trend for energy prices is downward, as we have argued above.[14] We also see no further wage increase rises, let alone a wage price spiral that was feared (figure 1.19). Food price inflation has come down as well and will slide as we have argued. Given the dying out of energy price rises and wage rises, producer price inflation can likewise be expected to come out lower. From that source, no further upward pressure on prices can be expected either. The demand side is a different ball game. True, the post-pandemic switch back from goods to services demand has ended, taking away the possibility to raise prices for services firms. But more importantly, rather large, accumulated pandemic savings, government support programs and an increasing labour force still underpin strong demand, especially in the US. This points at persistency of inflation. Recent IMF research on the so-called output gap supports this:[15] it is positive for the United States and negative for the eurozone.[16] Indeed, US inflation can be expected to come down only if the economy slows down. We expect that happening in 2025. Inflation persistency will erode accordingly (see figure 1.20).

[14] This is confirmed by IMF research. See World Economic Outlook, April 2024, p4.

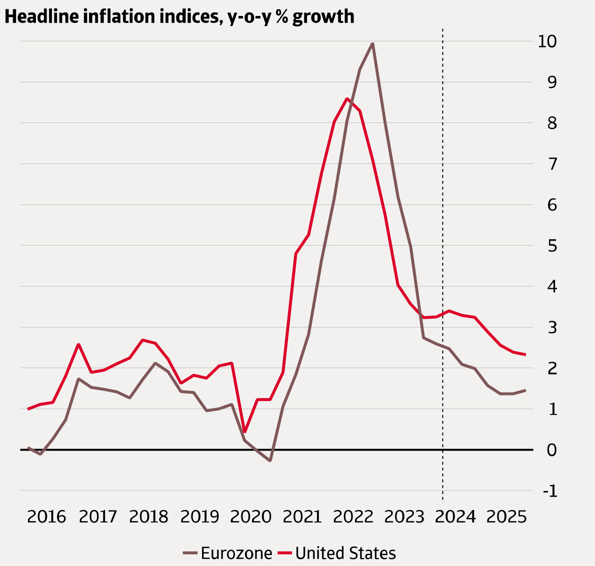
[15] The output gap is the difference between actual and potential output level. Potential output is a theoretical construct, where all production factors, labour and capital are fully employed.

[16] See World Economic Outlook, April 2024, p5.

Figure 1.19 The end of wage growth rises

Source: Federal Reserve, ECB

Figure 1.20 US inflation to come down in 2025

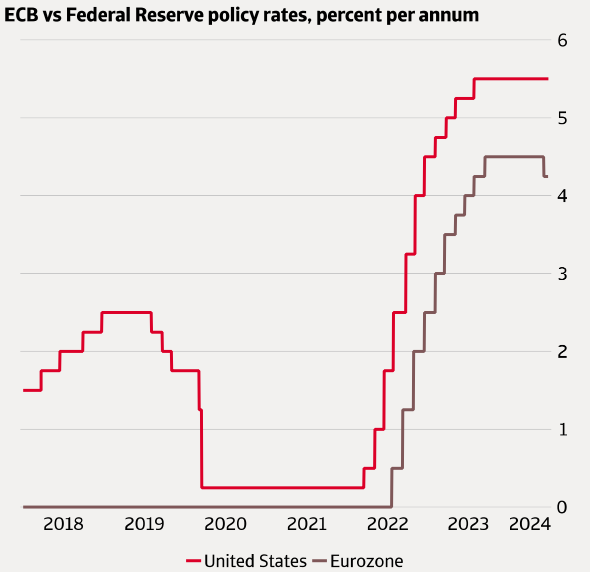


Source: Oxford Economics, Macrobond

1.7 High policy rates unsustainable

With inflation on a clear downward trend and growth solid but unspectacular, one would expect the aggressive tightening of monetary policy of the Fed and ECB to be eased rather soon. In the December Outlook we argued this may be a misconception. This was because of uncertainty about the continuation of the disinflation process, lagged effects of tightening still working their way through the economy, creating uncertainty about the impact of easing, and central bank credibility erosion in the case of premature easing. Therefore, monetary policy was to remain rather tight, with only very cautious steps towards easing.

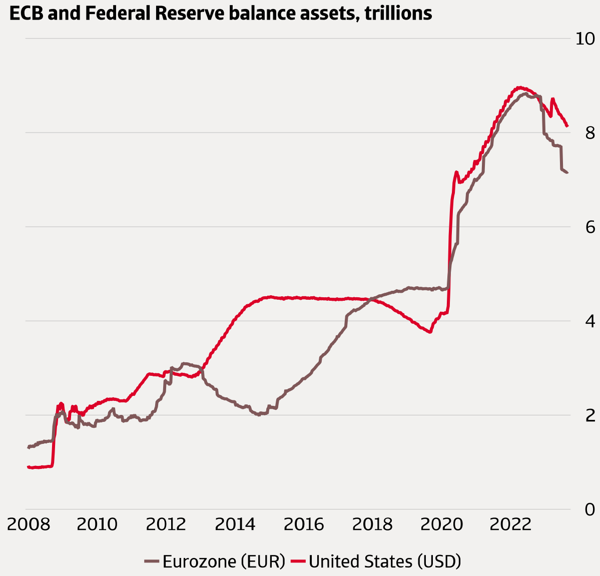
Figure 1.21 First sign of monetary easing



Source: ECB, Federal Reserve, Macrobond

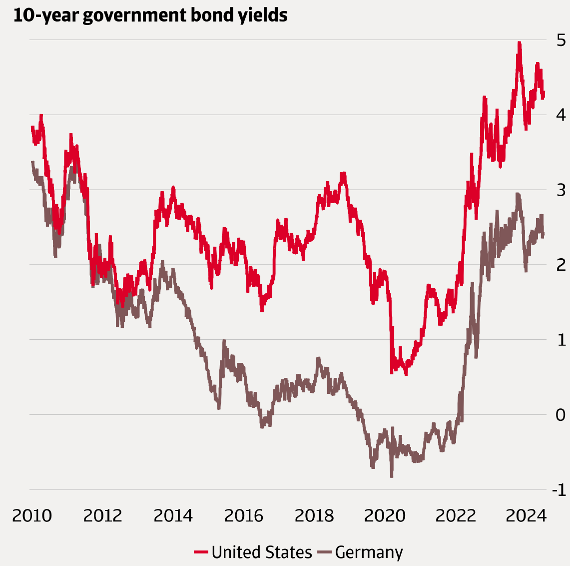
What have we seen since then? Only one step by the ECB, in June when the policy rate was lowered by 0.25 ppt to 4.25% (figure 1.21). Guidance was given to the financial markets that further steps will be taken based on incoming data about inflation. The Fed has left the policy rate unchanged and is also very careful not to create expectations about the timing of future rate cuts. As for the ECB, these will depend on data on inflation and the labour market coming in. This looks like a picture of mild easing, but it is not. The reason is that the shrinking of the balance sheet by the Fed and ECB, blown up by the pandemic support, has continued. Since December both balance sheets have further declined by USD 500 billion, to around USD 7.3 trillion and USD 6.5 trillion for the Fed and ECB respectively (figure 1.22).

Figure 1.22 Shrinking central bank balance sheets goes on



Source: Macrobond

Figure 1.23 Long-term borrowing costs up for US



Source: Macrobond

This process, quantitative tightening (QT), works as a reinforcement of the other, better known, leg of monetary policy, interest rates policy.[17] Therefore, barring this mini rate cut by the ECB, the monetary stance has arguably tightened, rather than eased, since December. This has kept long-term borrowing costs high and even slightly upward in the case of the US (see below).

One can then question whether this is sustainable. We think the answer is negative. With the inflation target coming closer to being reached it will not be necessary, or even desirable, to keep the monetary stance as restrictive as it is. We will now explain why.

First consider why the current policy is restrictive. Let us focus on the interest rate leg, in particular the real interest rate. The real rate is the nominal rate minus inflation. This interest rate is in the range of 2% for the US and 2.5% for the eurozone. To assess these levels one should consider that what is called the neutral interest rate, the (real) interest rate that neither stimulates nor constrains the economy is below these actual real rates: 1.5% for the US and -0.25% for the ECB.[18] With QT ongoing as well, both the Fed and ECB are therefore currently putting a brake on economic growth. But we should be aware that this policy stance is only justified when inflation is above target. Now that inflation is moving to target over the forecast horizon until 2025, such justification will gradually vanish. Accordingly, the current restrictive monetary stance will no longer be necessary. More to the point, easing will become all but inevitable.[19] Inevitable because if the central banks fail to ease monetary policy, inflation is likely to trend below 2% and deflation will loom. That would be in violation of their mandates.

To give a hint about the extent of easing one can estimate the policy rate that is in accordance with a neutral monetary policy for the inflation target of 2%. We arrive at 3.5% for the US and 1.75% for the Eurozone.[20] Compare these with the current policy rates of 5.5% and 4.25% respectively, and it is obvious

[17] It is done via only partly reinvesting maturing bonds held on the balance sheet as well as non-renewal of special bank funding operations such as LTROs in the Eurozone.

[18] We have calculated the neutral rate by taking the midpoint of the estimates of Figure 1.23 of the OECD Economic Outlook, May 2024.

[19] The proviso to be made here is that the neutral rates are difficult to estimate. Accordingly, the extent of easing will remain a judgement call by the central bank.

[20] Calculated by taking the neutral real interest rate plus 2% inflation target: 1.5% + 2% = 3.5% for the US and -0.25% + 2% = 1.75%.

that there is quite some room for easing of monetary policy.[21] Clearly, this only holds if inflation comes down to target. Given uncertainty related to that trajectory, the Fed and the ECB will tread carefully with easing, as we mentioned. But the direction is clear. This will lower borrowing costs for firms and households.

1.8 Government stimulus under stress

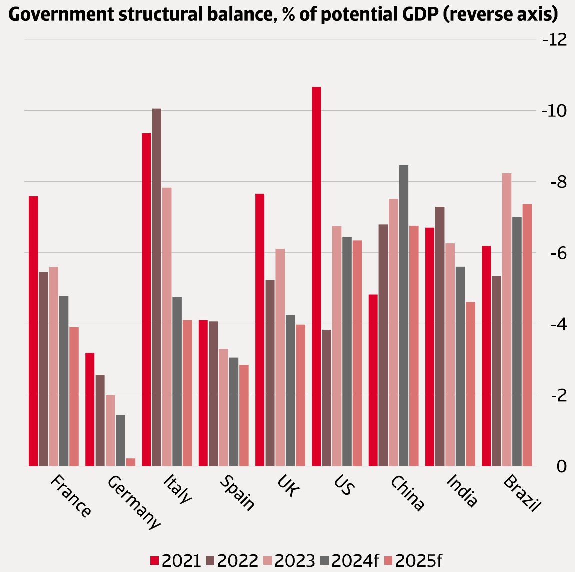
During the pandemic and the energy crisis we saw a host of government policies designed to keep the economy afloat and mitigate the impact of the crisis on certain groups. This considerable government intervention pushed up fiscal deficits and debt levels.

The subsequent period of high inflation has helped mitigate the stress on public finances somewhat. Inflation drove up nominal incomes. Via the so-called creeping effect[22], 'in real terms', government revenues increased. Nominal expenditures remained largely flat, or only grew with inflation. With parts of government debt locked in at fixed interest rates, this resulted in improved, but still high, fiscal deficits. Debt levels were positively affected as well because the - unexpected – rise in inflation mitigated public debt-to-GDP ratios.[23]

But this inflation impact is not sufficient. Governments should reduce expenditure as well, to bring public finances onto a sustainable path. That would also support central bank policies in their 'last mile against inflation', especially in the US. Having said that, we are somewhat sceptical as to whether governments will indeed embark on such a fiscal consolidation track. We expect only limited fiscal tightening, albeit with exceptions.

First, consider the advanced economies, starting with the US. Prior to the pandemic our preferred measure of fiscal stimulus – the government structural balance (deficit) as a percentage of potential GDP[24] – stood at 6%. It doubled during the pandemic, subsequently fell, and then rose again to almost 7% in 2023 (figure 1.24). This level is not expected to change a lot over the forecast horizon.

Figure 1.24 Elevated government stimulus is here to stay



Source: Oxford Economics, Macrobond

This has several consequences. First, such a level of fiscal stimulus in an economy that is already operating at full capacity continues to exacerbate inflation. Indeed, IMF research shows that the contribution to core inflation is about 0.5%.[25] Second, as we have already observed, the interest rate at the long end of the yield curve, or term premium, has gone up. This reflects the perceived risk of persistent inflation, uncertainty about the path of monetary policy, and the US Treasury plans to sell more bonds while the Fed continues with QT. Third, the higher interest rates, of course, do have an impact on financing costs for the US government which had already run up due to Fed policy and inflation. Fourth, higher interest rates in the US spill over to other advanced economies as well as emerging economies almost on a 1:1 basis, meaning that a 1% increase in US long term yields leads to a 1% increase in yields elsewhere.

For other advanced economies, the picture is a bit mixed. In the UK and Italy, significant stimulus was provided to the economy in 2023 with structural deficits of 6.1% and 8.2%, respectively. As opposed to the US, these countries are forecast to reduce the deficit over the forecast horizon, but levels will remain (far) above what we observed prior to the

[21] QT is the uncertain factor in the monetary policy mix. The balance sheet of the central banks will have to be further reduced. But this process will have to stop if it starts biting into the other element of monetary policy easings, interest rate cuts. At what level of QT this is, is difficult to determine. QT is a relatively new policy instrument. See OECD Economic Outlook, p 38.

[22] The creeping effect occurs if household nominal income rises and ends up in a higher tax bracket, increasing the tax burden.

[23] This is because nominal debt is unchanged and nominal GDP rises in the case of inflation.

[24] The structural balance is the government balance adjusted for swings in the business cycle taken as a share of potential GDP (i.e. GDP at full capacity). For example, in 202322013 (2023?) Greece reported a surplus of 3.5% of the adjusted government balance as a share of potential GDP, meaning that the fiscal stance was restrictive.

[25] IMF Fiscal Monitor April 2024, p 6.

pandemic. This tightening implies less stimulus by the government. Spain and – especially Germany – tightened fiscal policy in 2023 and will continue to do so over the forecast horizon. Germany is a real outlier: it is even expected to all but eliminate the deficit. France's deficit was moderately high in 2023 and is expected to be reduced only marginally.

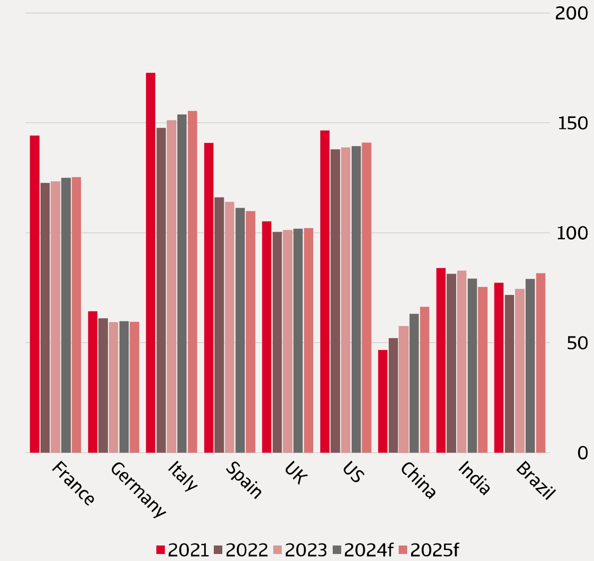
Meanwhile, debt-to-GDP levels of advanced economies, indicating the sustainability of stimulus, remain elevated (figure 1.25). EU rules consider debt levels excessive, and require reduction, if the debt is above 60% of GDP and even more if it is above 90%.[26] In this context even the German debt is excessive (61% in 2023), albeit not significantly and improving over the forecast horizon. Also, the high debt level of Spain (116%) is declining. But for France (123%) and Italy (151%) as well as the UK (101%) and the US (139%), the ratio indeed worsens.

This suggests the level of stimulus provided to the economy is not sustainable and further tightening will be needed. This will be a challenge. Government interference is called upon in relation: the energy transition, including industrial polices to avoid dependence on 'unfriendly' countries; the impact of climate change, especially environmental damage due to extreme weather conditions; and defence, given the geopolitical threats. These come on top of the already known future pressure on public finances due to ageing, such as expenditure on health care and pensions. The relief that will come from lower borrowing costs, as monetary policy is eased, will be no more than a drop in the ocean.

For the largest emerging economies, India and especially China and Brazil it strikes us that the level of government stimulus to the economy is rather high and remains so, as compared to the advanced economies, barring the US. At the same time, with debt-to-GDP levels below about 80% (India), sustainability seems less of an issue. This does not hold for China. The rapid increase of the Chinese debt ratio by 8ppt over the forecast horizon to 66% in combination with a high structural deficit (7.5% in 2023) only marginally declining, raises a red flag. More details on the emerging economies' public finances will be discussed in chapter 3.

Figure 1.25 Government debt remains high

Government debt as a % of GDP



Source: Oxford Economics, Macrobond

1.9 What if inflation rises?

The Outlook for the global economy that we have just sketched is predicated on the five major assumptions mentioned earlier in this chapter: contained geopolitical tensions, China-US relations not materially changing, inflation gradually moving to target, interest rates gradually lower and a more prominent role for the government role in the economy.

The alternative scenario that we now present rests on the biggest uncertainty the global economy is currently facing: geopolitical tensions. It is especially true of the current Israeli-Palestinian conflict, with increased shipping disruptions further pushing up producer and import prices, and oil prices that are rising amid fears of escalation of the conflict. This is essentially a cocktail of trade cost and energy price rises that we have seen before but are now exacerbated.

In such a scenario, inflation is pushed up rather than further sliding. Inflation expectations rise by about 0.25% above the benchmark. Central banks hike policy rates. The result is higher yields in the bond markets. The latter initially rise by 0.9% and end up 0.5%, on average, above the benchmark. Equity prices fall to about 10-15% below the benchmark.

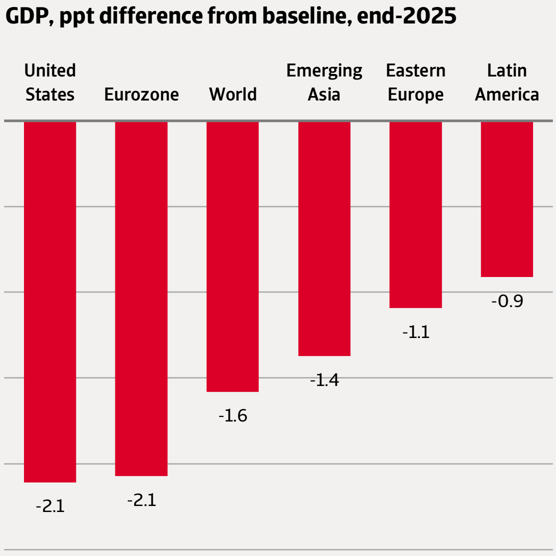
The economy is negatively affected via a number of channels. Borrowing costs for firms and households rise, rein in

[26] https://www.europarl.europa.eu/news/en/press-room/20240419IPR20583/new-eu-fiscal-rules-approved-by-meps

consumption and investment. The latter is reinforced by a fall in equity prices. This raises the costs of capital for firms, leading to investment postponement. Adverse wealth effects directly bite into consumer spending. Demand for labour declines and unemployment rises. Higher borrowing costs also lead to a fall in house prices, resulting in weakness in residential investment. Expected losses at mortgage lenders go up, potentially curtailing the credit supply. Weaker banks may get in trouble due to the higher borrowing rates that can not immediately be passed on to lenders. This will further restrain credit supply. Household confidence takes a hit.

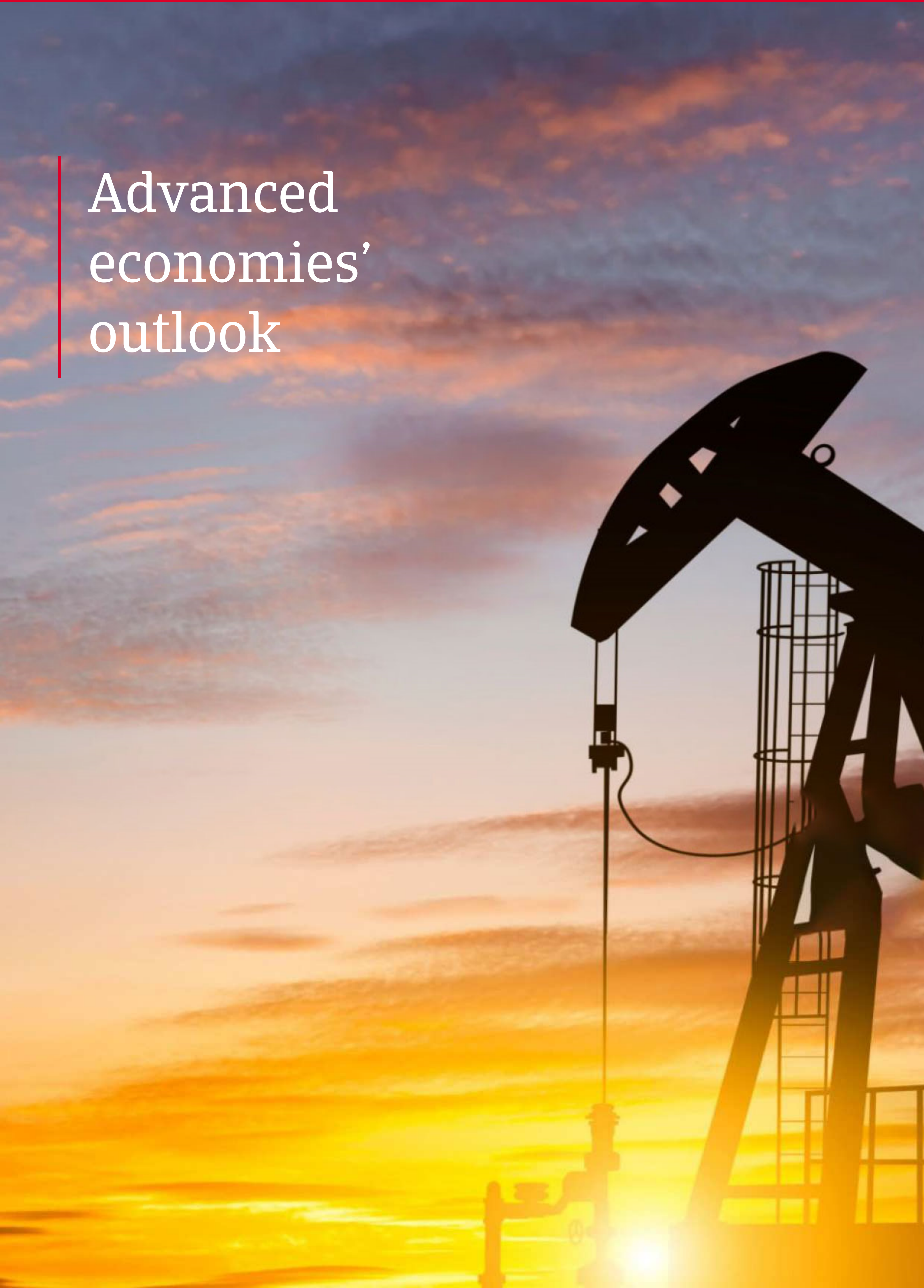
In brief, we see the reverse of the factors driving the soft landing we described earlier in this chapter. Consumer spending is depressed and the impact of monetary tightening imposes itself now that interest rates are even higher. Global GDP takes a significant hit (figure 1.26).

Figure 1.26 Hit to growth if geopolitical tensions intensify



Source: Oxford Economics, Atradius

Advanced economies' outlook



2.1 More benign inflation environment in advanced economies

Advanced economies are expected to grow by 1.6% in 2024, an upward revision. The US economy is displaying resilience, due to lower inflation driving consumers' purchasing power and higher immigration driving up labour supply. The delayed effects of monetary policy tightening can be felt, but less vigorously than previously expected. For 2025 we predict a growth rate more or less on par with this year.

Table 2.1 Real GDP growth, % - advanced economies

Regions	2023	2024*	2025*
Eurozone	0.5	0.8	1.8
United States	2.5	2.6	1.9
United Kingdom	0.1	0.9	2.0
Japan	1.9	0.5	0.9
Australia	2.1	1.3	2.7
New Zealand	0.6	1.0	3.5
Advanced economies	**1.6**	**1.6**	**1.8**

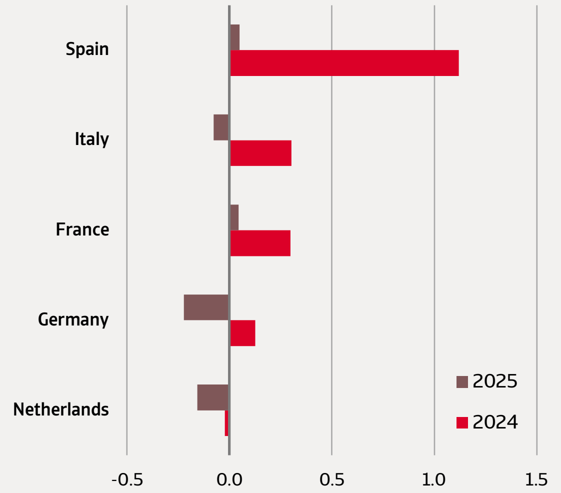
Source: Oxford Economics, Atradius

2.2 Eurozone: mild recovery in 2024 and 2025

In 2024 the eurozone economy is likely to enter a year of mild economic recovery. Our latest forecast is for GDP to expand by 0.8% in 2024, from 0.5% in 2023 and 0.2 percentage points higher than we predicted six months ago. Spain was a clear outlier with a 1.1 percentage points upward revision. The Spanish economy is benefiting from a booming tourism sector, a continued robust labour market, and fiscal support as part of the European Recovery and Resilience Facility (RRF). The revisions in the other major eurozone countries were also upwards, but smaller. Germany remains a weak spot due to its sluggish manufacturing sector. For 2025 we predict a higher GDP growth rate of 1.8% for the eurozone as a more benign inflationary environment supports consumers' purchasing power.

Figure 2.1 Positive GDP revisions in 2024 for most eurozone countries

Percentage point change in real GDP growth forecast since December 2023



Source: Oxford Economics, Atradius

Table 2.2 Real GDP growth, % - eurozone

Regions	2023	2024*	2025*
Austria	-0.7	0.3	2.2
Belgium	1.4	1.2	1.5
France	0.9	0.9	2.1
Germany	0.0	0.0	1.3
Greece	2.0	1.7	2.3
Ireland	-3.3	-0.8	4.4
Italy	1.0	0.8	1.1
Netherlands	0.2	0.8	2.1
Portugal	2.3	1.8	1.9
Spain	2.5	2.4	1.8
Eurozone	**0.5**	**0.8**	**1.8**

Source: Oxford Economics, Atradius

According to the flash estimate published by Eurostat, eurozone GDP increased by 0.3% in Q1 2024, marking the first meaningful growth figure in over a year. Among the largest member states, Spain took the lead in Q1 of 2024, growing by 0.7%, while Germany, France and Italy all grew at about the same speed (0.2-0.3%). According to preliminary information from national sources, growth in the first quarter was driven by expanding consumption and exports. Some countries' GDP figures disappointed, including the Netherlands with a 0.1% GDP decline, mainly driven by lower exports and negative inventory investment.

Recent survey data are a bit of a mixed bag. The June purchasing managers index (PMI) shows a slight decline of overall economic conditions, with the composite index declining to 50.8. However, the composite index is still above 50, which usually signals an expansion. The manufacturing index is still in recessionary territory (45.6), while the services sector is expanding (52.6). The Economic Sentiment Indicator (ESI) of the European Commission in May was 96.0, a slight improvement compared to April, but below the neutral level of 100.

Inflation closing in on central bank target

After months of uninterrupted decline, there was an uptick in inflation in May 2024. Inflation increased from 2.4% in April to 2.6% in May. Energy prices and food prices, which contributed most to the decline of inflation in the past 1.5 years, are now making a broadly neutral contribution to inflation. Services inflation has remained relatively high and there even was a slight uptick in May. Core inflation (CPI excluding food and energy) went up by 0.2 percentage points in May, to 2.9%. Despite the increase in May, total (CPI) inflation is projected to continue trending down. The average inflation rate in 2024 is projected to be 2.2%, followed by 1.3% in 2025.

As the target of 2% comes into sight, the inflation picture is also turning muddier. With GDP growing faster than expected in the first quarter, and domestic demand recovering, inflation could turn out to be more stubborn. But sentiment indicators are not convincingly pointing in one direction or the other.

Some cooling of the labour market

National data indicated that the expected consumption recovery in Q1 was unevenly distributed across countries. We expect private consumption growth to pick up in 2024 and 2025. We predict a 1.2% consumption growth in 2024, compared to 0.6% last year. Private consumption in the eurozone will benefit from stronger real disposable income this year. The resumption of real wage growth (nominal wage growth adjusted for inflation) and moderate gains in employment account for this. Recent survey results from the European Commission's Consumer Survey show continued improvement in consumer confidence, though from a level well below the long-term average, as well as a steady decline in consumers' uncertainty about their own financial situation.

The labour market remains tight, but there are signs that it is cooling somewhat. The eurozone economy created more than two million jobs in 2023. Firms still report relatively high labour shortages and vacancies are also still above their long-term average. The unemployment rate has been broadly stable in recent months, with the latest figure being 6.4% (April 2024). The indicator for broad unemployment, which besides regular unemployment also comprises people who have an unmet need for employment, was at 13.2% of the extended labour force in Q1 of 2024. While higher than regular unemployment, broad unemployment is also at its lowest level in years.

Figure 2.2 Employment growth is cooling, but unemployment remains low

Source: Macrobond

For 2024, we expect a somewhat lower employment growth. In May, the Employment Expectations Indicator declined compared to April, but remained above its long-term average. Negotiated wage growth increased by 4.7% in Q1 of 2024, marking a slightly higher wage growth than in Q4 of 2023 (4.5%). Wage growth is gradually adjusting to the reality of a lower inflation rate, and we expect nominal wage growth to moderate in 2024 and 2025. Real wage growth (nominal wage growth minus inflation) turned positive in Q4 of 2023. Given the declining trend in inflation, real wage growth is likely to remain positive throughout 2024.

Better times ahead for export growth

The global economy held up better than expected in 2023, but global goods trade slowed considerably. Goods trade was held back by several factors, including the post-pandemic demand shifts, a rundown of inventories, and tighter monetary conditions that were weighing on investment spending. Towards the end of 2023 the situation improved and eurozone export growth turned positive. This normalisation of export growth is expected to continue, with limited export growth in 2024 (0.6%), followed by an acceleration of growth in 2025 (4.3%).

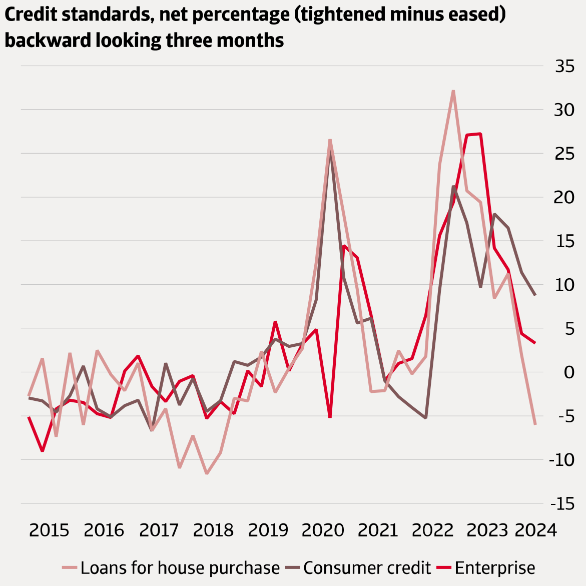
Eurozone fixed investment grew by 1.4% in 2023, driven largely by a carry-over from 2022. The construction sector, sensitive to interest rates, experienced a pronounced downturn towards the year's end. In 2024 investment activity is expected to gradually expand, supported by easing credit conditions as the ECB started to cut interest rates early June, and robust financial deleveraging. Investment growth is anticipated to accelerate in 2025, with non-residential construction investment remaining resilient, largely due to government infrastructure spending. However, housing investment is projected to continue contracting due to falling house prices and inventory build-up. The aggregate outlook varies significantly across countries.

ECB implements first rate cut, but rates will stay higher for longer

The ECB implemented a 25 bps rate cut in June. In its press statement, it highlighted the progress it had made in lowering inflation from double digits, when the ECB began to tighten policy, and the further easing in price pressures over the course of the past nine months. However, the ECB did not commit to a particular interest path, reiterating that its future policy decisions will be data dependent. We expect two more rate cuts in 2024, in September and December, and by the end of 2025 the ECB policy rate is higher than we predicted six months ago.

Since the start of the year, the ECB balance sheet has continued to downsize, mainly via repayment by commercial banks of loans and, to a lesser extent by the non-reinvestment of the proceedings of maturing securities purchased under the asset purchase programme (APP). The ECB also indicated that it wants to reduce holdings under the pandemic emergency purchase programme (PEPP) by EUR 7.5 billion per month in the second half of 2024.

Figure 2.3 Credit standards are still tightening



Source: ECB, Macrobond

Recent data show there is reason for cautious optimism about bank lending and credit standards. The 2024 Q1 bank lending survey of the ECB pointed to a net easing of credit standards on mortgage lending (net percentage of -6%), thanks to easing conditions in France. This was the first time since 2021 Q4 that credit standards on mortgages eased. Credit standards on business loans tightened slightly according to the latest bank lending survey (with the net percentage of banks reporting a tightening standing at 3%). Credit standards also tightened for consumer loans (net percentage of 9%). Bank lending data remains somewhat weak, with bank lending to households increasing 0.2% in March 2024 (compared to the same month in 2023), while bank lending to non-financial corporations grew at 0.4%.

Budget deficits to come down only gradually

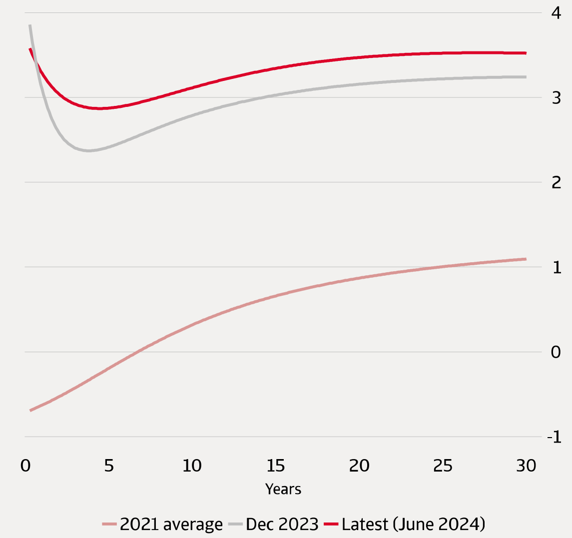
We forecast the eurozone structural budget balance to decline from 3.3% in 2023 to 2.6% in 2024 and 2.1% in 2025. For 2024-2025, expenditures are likely to decline due to lower government subsidies to private investment and the almost complete phase-out of energy-related measures.

Regarding the Recovery and Resilience Facility (RRF) expenditures, these are set to accelerate over the forecast horizon. By 2025, expenditure financed by RRF grants is expected to be above 3% of GDP in five Eurozone Member States (Latvia, Spain, Portugal, Croatia and Greece), while it is projected between 2% and 3% of GDP in four countries (Lithuania, Cyprus, Italy and Slovakia) and above 1% in four countries (Malta, France, Estonia and Slovenia).

The eurozone debt-to-GDP ratio declined slightly to 90% in 2023, driven by strong nominal GDP growth. For 2024 and 2025 we expect the debt ratio in the eurozone to stabilise due to higher costs of servicing debt and lower nominal GDP growth. There are several member states with significantly higher debt ratios than the eurozone average, such as Italy (148%), France (124%) and Greece (203%). On the other hand, there are also member states with a lower debt ratio, such as Germany (60%) and the Netherlands (50%). Although short-term debt sustainability risks are limited, the latest yield curve shows that markets have reassessed prospects of rate cuts and now expect interest rates to stay high for longer. The yield curve describes the relation between the maturity of bonds and the market-implied interest rate. The still-high interest rate in the coming years gradually translates to higher government expenditure.

Figure 2.4 The yield curve remains elevated

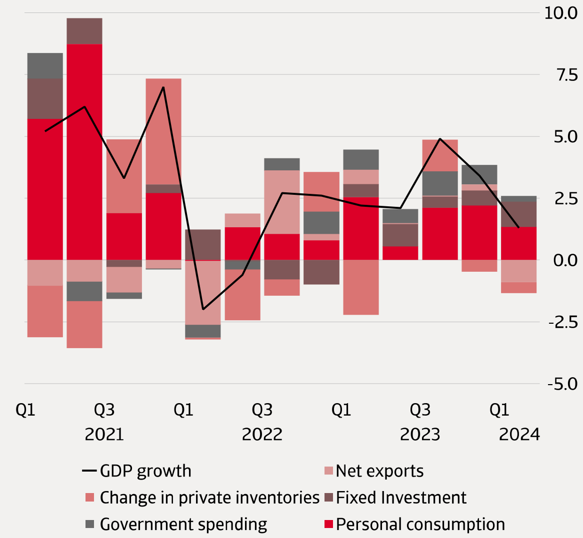
ECB yield curve eurozone, all bonds, spot rate



Source: ECB, Macrobond

Figure 2.5 US growth losing steam

US, quarterly contributions to GDP growth (% change y-o-y)



Source: US Bureau of Economic Affairs, Macrobond

2.3 US slow and steady

Despite a relatively slow start to the year, the US economic outlook for 2024 remains strong, supported by robust consumption. Disinflation should allow the Federal Reserve to continue its easing in H2, supporting a soft landing.

Weaker start doesn't threaten path to soft landing

The government estimates that the economy grew only 1.6% y-o-y in Q1, down from 3.4% in Q4. The weakness was concentrated in volatile inventories and net exports; domestic demand indicators continued to demonstrate resilience. Real personal consumption expenditure remained healthy at an annualised 2.5%, and private investment accelerated. Robust domestic demand is keeping inflation stickier than consumers and Federal Reserve officials would like. Headline CPI inflation stood at 3.4% y-o-y in April, up from 3.1% at the start of the year. Demand-led services inflation was the main driver, so the Federal Reserve is not yet confident that inflation is fully under control, delaying the first interest rate cut, previously expected in May. Jobs data have shown some signs of cooling though: unemployment ticked up to 3.9% in April and jobs growth slowed down to 175,000 jobs.

Looking forward, we expect GDP growth to pick up in Q2 and continue relatively steadily for the remainder of the year. The labour market remains tight, underpinning consumer spending, while business investment is also solid. We expect GDP growth in 2024 to maintain pace compared to last year, at 2.6%. Next year, this should slow slightly to 1.9%.

Consumer outlook remains strong, but faces more balanced risks

Resilient private consumption has kept the wind in the sails of the US economy since the recovery from the pandemic. This trend should continue over our forecast period, growing another 2.5% year-on-year in 2024. But we do expect stronger headwinds to slow consumption growth to 1.9% in 2025.

The consumer outlook is supported by (very) gradual disinflation and modest wage gains. We expect consumer price inflation to ease to 3.3% in 2024 compared to 4.1% in 2023. The pace of disinflation will remain slow due to consumer resilience on the demand side. But we're confident it will continue decreasing in H2 as high base effects drop out from the year-on-year comparison, especially for the housing component. In addition, President Biden's new tariffs on China (see figure 2.7) shouldn't have a significant impact on domestic inflation. Moderating wage growth will further help bring inflation down. At 4.7%, nominal wage growth remains solid and exceeds inflation – but the upward price pressure is less intense compared to growth rates above 6% at the start of 2023.

On the flipside, slowing jobs gains, worsening household finances and still-high interest rates will weigh on consumer spending. Slowing wage gains are accompanying an uptick in unemployment: to 4.0 % in May compared to 3.7% at the start of the year. Unemployment should stay contained though, peaking at only 4.1% in H1 2025. The labour market outlook is therefore less hot but still decent. This is positive news for households as finances remain difficult. Years of high interest rates have tightened access to credit for households and firms alike at a time that household debt continued to reach historic highs. Total household debt rose to USD 17.7 trillion in Q1, up USD 184 billion from the quarter before. As can be seen in figure 2.6, payment practices have begun deteriorating across most classes of consumer debt. Student loan delinquency remains low thanks to supportive policies from President Biden whereas all other classes have been gradually ticking up since early 2023. Loan delinquency on credit card payments has made the most striking increase, surpassing 10% of credit card loans for the first time since 2013.

Figure 2.6 Consumer loan delinquency ticking up

US consumer loan delinquency, 90 days or more late

Source: Federal Reserve Bank of New York, Macrobond

All in on industrial policy

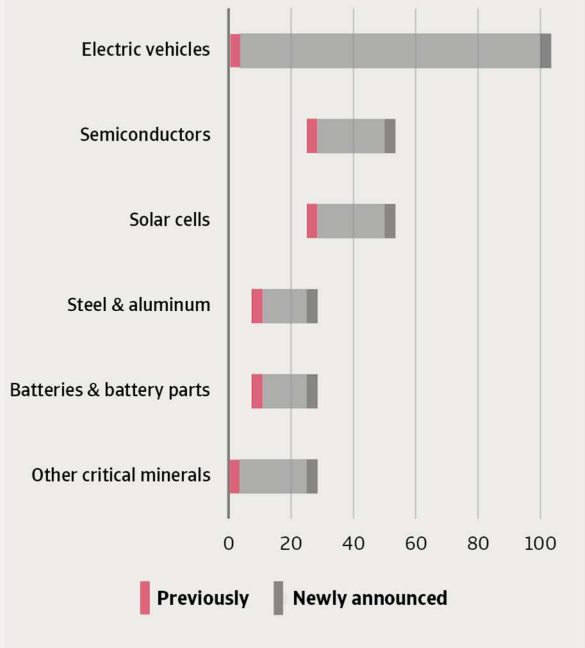
Federal policy has taken a more hands-on approach in recent years, with a broad political consensus towards measures that improve national security and shore up supply chains for defence, industrial goods and strategic minerals. Part of this has entailed historic investments and subsidies for these industries while another part has entailed protectionist measures to insulate domestic firms from foreign competition.

President Biden has continued the protectionist bent introduced by President Trump. Not only has Biden maintained the Trump-era tariffs on China, but his administration has expanded import restrictions. Biden's tariffs target only about USD 18 billion worth of imports compared to USD 350 billion under Trump, but the penalty is much higher. Moreover, the federal government has opened the tap of subsidies for US companies in strategic industries, particularly high-tech and green energy in industrial policy akin to the New Deal almost a century ago.

The White House announced an increase in tariffs on selected Chinese goods considered central for national security and the green energy transition on 14 May (see figure 2.7). Ensuring the sustainability of unprecedented investments in these strategic sectors is part of the reason for raising these tariffs. Trademark policies of the Biden administration include the Inflation Reduction Act, the Bipartisan Infrastructure Law and the CHIPS and Science Act – all of which include billions of dollars of direct investment, tax credits, grants and loans in these sectors, among others.

Figure 2.7 Higher tariffs target strategic industries

US tariff rate increases on Chinese imports



Source: The White House, Atradius

We expect this protectionist style policy to continue over the forecast period and to only increase in 2025 should former president, Donald Trump, be re-elected in November. Boosting activity in strategic sectors such as energy, critical minerals and semiconductors will remain policy priorities for the US regardless of political outcomes, and we expect the boost to the real economy through investment will be increasingly felt beyond 2025.

Sustaining public investments and wide deficits

The landmark spending bills of the Biden administration will continue to fuel public investment in 2024 and 2025. While the contribution to economic growth in our forecast period will diminish due to higher base effects, the focus of investments in physical infrastructure, high-speed internet connectivity and clean energy sectors should enhance US productivity.

Ongoing public investments will sustain high government deficits though. As shown in figure 1.23, its structural balance as a percentage of GDP will remain in excess of 6% in 2024. This indicates an expansionary fiscal policy and is the loosest among advanced economies. We expect the US fiscal stance to continue in 2025 under a Biden presidency and to widen further into stimulus territory in the case of a Trump victory. Federal debt will remain well above 100% of GDP and interest costs on that debt will also continue to rise. Political tensions will remain a cause for concern for US debt sustainability as the highly politicised debt limit will be reimposed in 2025.

2.4 UK outlook to stay dreary

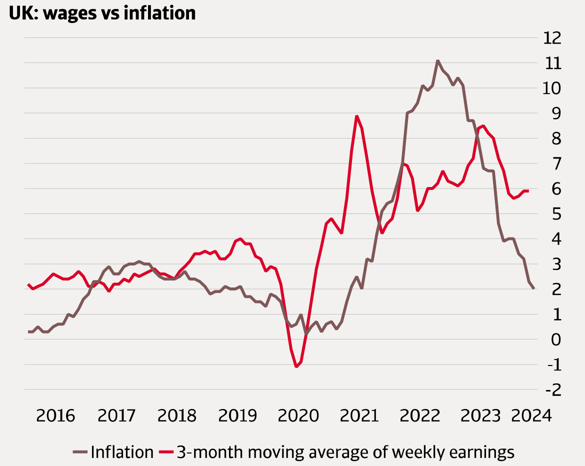
We've revised up our forecast for the UK economy to 0.9% from 0.6%, spurred by stronger-than-expected consumer spending. Growth should pick up to 1.3% in 2025 as political uncertainty eases, but remains structurally weak.

Cost-of-living relief allows for some cautious optimism

The UK economy grew more quickly than expected in Q1 and we expect that momentum to be sustained in Q2. Consumer spending is the main driver of the recovery, with significantly lower inflation boosting spending power (see figure 2.8). Headline inflation rose 2.0% year-on-year in the 12 months to May, its lowest level in three years and down from double digit inflation a year and a half ago. Household energy bills are nearly 20% below their peak. Real wage growth and improved consumer confidence are causes for optimism that consumer spending will persist in H2. In addition, the composite purchasing managers' index (PMI) remains in positive territory (51.7 in June) and the manufacturing component reached a two-year high, suggesting a firming of the economic recovery.

The economic recovery will remain weak though, as headwinds from tight fiscal policy and past interest rate hikes weigh on demand. Moreover, the most recent inflation data was not sufficiently good news: while CPI inflation reached the target rate of 2% in May, stubborn services inflation persisted. This motivated the Monetary Policy Committee to keep its policy rate on hold at 5.25% in its June meeting, postponing its first expected rate cut from June to August. We now anticipate a total of 50 basis points worth of cuts by the end of the year with a chance of a third 25 bp cut if pay and inflation data slows more quickly than expected. The BoE should be able to move sooner and cut rates a bit more quickly than the US Federal Reserve: the weaker economic situation in the UK has allowed labour market tightness to fade faster. The BoE would also be joining the ECB, Swiss National Bank and Swedish Riksbank in cutting rates before the Fed.

Figure 2.8 Real incomes growing for past year in UK



Source: Macrobond, UK ONS

The positive impact of monetary loosening will only be felt in 2025, though, as debt interest payments rise this year from previous tightening. We expect real GDP growth to pick up to 2.0% as the political situation settles down and monetary policy loosens. Actual GDP will continue to lag its potential due to structural limitations such as low investment, poor productivity and trade barriers created by Brexit.

Tight fiscal outlook regardless of political outcome

While the UK has had some tentatively positive economic news, PM Sunak unexpectedly called general elections for 4 July (the date of publication). They were previously expected by the end of the year when the Tories may have been able to leverage progress on inflation and possibly even additional tax cuts in the autumn budget. But with low approval ratings and limited scope for such policy successes to boost them in the coming months, the government has brought elections forward.

Markets' reactions to the surprise announcement have accordingly been limited and we do not expect the results of the election to have a significant impact on our economic outlook. The reason is that the opposition Labour Party has a significant lead in the polls. At this point, its victory appears to be all but a foregone conclusion. Public dissatisfaction with the Conservative government is high, especially due to the state of public services and recent political scandals and economic volatility. This was clear in the May local elections in which the Conservative Party had its worst performance in 40 years.

The economic policy under either party is likely to be similar in the forecast period. Following the mini-budget crisis of 2022, both parties have committed to adhering to the existing fiscal rules. The government's tight fiscal stance has slightly slipped since 2022, as public spending has hardly been adjusted in line with high inflation. Addressing this will be one of the main challenges for the incoming government. Furthermore, with highly contentious issues like Brexit and Scottish independence no longer on the ballot, the stakes are lower this election cycle. Given the well-established independence of the Bank of England and expectation of policy continuity, we believe the impact of the early elections on the near-term economic outlook will be limited.

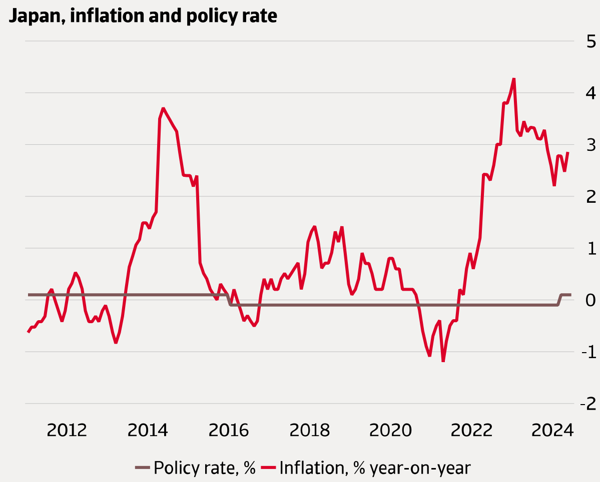
2.5 Advanced Asia facing sluggish growth in 2024

Japan's economy is slowing, as one-off factors that boosted 2023 growth fade, but robust wage growth should help shore up economic momentum by 2025. Stubborn inflationary pressures in Australia and New Zealand are keeping monetary policy there tighter for longer, threatening their path to a soft landing.

Japan: fragile recovery finding its footing

Japan's economy is steadily recovering from the pandemic, with price pressures picking up after three decades of low inflation. GDP growth exceeded expectations last year at 1.9%, finally bringing Japan's economy back to its pre-pandemic size. The recovery has been uneven though. Goods and services exports have led growth, buoyed by a weak yen, whereas the domestic demand components, private consumption and investment, are still below their 2019 peaks. We expect growth to shift back down to 0.5% this year, due to the ending of a one-off tourism boom in 2023, and to reach 0.9% in 2025. But that growth will become more broad-based. Export growth will continue to support the recovery thanks to the upturn in the semiconductor chip cycle. Private consumption should also pick up from H2 2024 on, partly driven by a whopping 5.6% pay increase agreed in the "shunto" spring wage negotiations. Rising wages reflect chronic labour shortages but will also help real wages return to growth after two years of decline. Inflation has exceeded the 2% target since April 2022 which has squeezed consumers and allowed the Bank of Japan to end its negative policy rate era which was in place since 2016. Inflation is expected to stay above 2% through the end of 2025 and the Bank of Japan will keep its policy rate at 0% at least for the rest of the year. The BoJ has a single mandate of maintaining price stability, in contrast to the Fed's dual mandate also targeting employment. But we expect it to hike rates only very gradually with an eye on preserving the momentum of the economic recovery, as that will also ensure more sustainable, demand-driven inflation.

Figure 2.9 Japan ends its negative interest rate era



Source: Macrobond, Atradius

Australia: slowing growth and persistent inflation

Australia is currently grappling with a challenging economic situation characterised by sluggish growth and still-high inflation. After nearly halving to 2.1% in 2023, GDP growth is set to slow even further to 1.3% this year. Past monetary tightening is dragging on domestic demand and sticky inflation continues to squeeze real purchasing power. Inflation surprised on the upside, ticking up to 3.6% in April, but the Reserve Bank of Australia (RBA) will keep its policy rate on hold at 4.35%, the level it's been since November. Similar to the BOJ, the RBA is attempting to avoid further tightening to preserve labour force momentum as unemployment ticked up to 3.8% in March. We expect growth to pick up to 2.7% in 2025, largely supported by a much easier fiscal stance in 2025. Fiscal subsidies aimed at relieving cost-of-living pressures will help bring down headline inflation next year but the surprisingly stimulatory budget will do little to help tame core inflation. Thus we expect rates to stay higher for longer in Australia with a first cut only coming in 2025.

New Zealand: stagnation in 2024

New Zealand's economy is expected to stagnate with 1% growth in 2024, after a weaker-than-expected end to 2023. The country entered a technical recession in Q4 2023 as output contracted slightly for the fourth time out of the last five quarters. High migration rates have led to record population growth, but households have been facing intense headwinds of high inflation and negative real wage growth. While the worst is likely behind us, consumer confidence remains at historic lows, inflation remains at 4%, and unemployment ticked up to 4.3% and is likely to rise to 5% by year's end. In this difficult environment, the Reserve Bank of New Zealand (RBNZ) is likely to keep its policy rate at a 15-year high of 5.5% until Q1 2025. Easing financial conditions should help the recovery take hold with 3.5% growth in 2025.

Emerging market economies' outlook

3.1 Diverging prospects for EMEs

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 3.9% this year and 4.0% in 2025.

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 have risen 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.

Behind the headline figures lies substantial heterogeneity. Emerging Asia is set to lead other regions again in terms of GDP, though growth is subdued historically 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.

Table 3.1 Real GDP growth, % - EME regions

Regions	2023	2024*	2025*
Emerging Asia	5.5	4.9	4.7
Latin America	1.9	1.0	2.3
Eastern Europe	3.0	3.0	2.7
MENA	1.9	2.3	4.0
Sub-Saharan Africa	3.1	3.2	3.3
Emerging Markets	**4.2**	**3.9**	**4.0**

Source: Oxford Economics, Atradius

3.2 Emerging Asia shifting to a lower gear

Emerging Asia's economic outlook has brightened compared to the start of the year, thanks to retreating inflation. But we still expect a significant slowdown to 4.9% in 2024 and 4.7% in 2025 – higher than any other global region but below Emerging Asia's historical trend – dragged down primarily by China's economic slowdown.

China: structural weaknesses ushering in slowdown

China's economy is gradually cooling off from a strong 5.2% expansion in 2023. Momentum carried into Q1 2024 due to stimulus-supported industrial activity, which rose 6.1%. The services sector also grew 5%, contributing strongly to growth as consumer demand shifts from goods to services. But we expect this momentum to lose steam in the remainder of the year. This is partially mechanical, as declining capacity utilisation rates accompanying strong production in Q1 mean that inventory destocking should weigh on GDP growth in the coming quarters. Moreover, the property sector is plagued by weak buyer demand for new homes and worsening financing difficulties affecting developers. The yuan is also depreciating, and disinflation is flirting with deflation which could cause households to defer spending. Inflation expectations are already trending downwards, as is demand for consumer credit and discretionary retail items. The People's Bank of China (PBOC) will maintain a loose monetary policy stance, accepting yuan weakness to avoid tightening domestic financing conditions.

Figure 3.1 Consumer confidence in China slowly recovering from low levels

Source: National Bureau of Statistics of China

There are some tailwinds for Chinese growth, though. Firstly, the government is supporting growth with fiscal expansion, especially targeting the manufacturing sector to expand productive capacity. On the flipside, this could put further downward pressure on prices as domestic demand wanes. Secondly, external demand for Chinese products is increasing. Despite rising tariff risks, we still expect 6.3% growth in goods exports this year. But we do not expect these trends to be sufficient for the government to reach its target growth rate of "around 5%" with total 2024 growth reaching 4.7%. In 2025, we expect a more meaningful slowdown to 4.1%.

India: somewhat cooling growth

In India, growth in 2024 is estimated to slow to 6.3% from 7.7% in 2023, but it remains the fastest growing emerging market (see table 3.2). GDP growth in India is likely increase again in 2025 to 7.2%. In the coming years, households are expected to shift their spending focus more towards services, including travel and leisure, rather than physical goods. Even with the uptick in interest rates, the credit expansion to households is projected to continue robustly through 2024 and 2025, indicative of a surge in market confidence. Inflation softened marginally in March. The headline CPI index rose by 4.9% year-on-year, down from 5.1% in February. We expect to see a moderation in inflation from 5.7% in 2023 to 4.7% in 2024 and 4.5% in 2025. Inflation is still above the central bank's midpoint target (4%). We do not expect a rate cut in India before Q3 of 2024, and we forecast a gradual normalisation in monetary policy settings.

Table 3.2 India is leading the major emerging markets in GDP growth, %

Regions	2023	2024*	2025*
China	5.2	4.7	4.1
India	7.7	6.3	7.4
Brazil	2.9	2.1	2.4
Mexico	3.2	1.9	2.1
Russia	3.6	3.6	1.6
Turkey	4.5	2.5	1.9
South Africa	0.6	0.7	1.4

Source: Oxford Economics, Atradius

Investment, the main growth engine of 2023, is set to cool given the smaller boost from public capital expenditure, while the private investment cycle will likely only revive at a gradual pace. Public spending on infrastructure was a major investment driver in recent years, but support is set to wane amid fiscal prudency pledges. Although the necessary conditions are in place for a more broad-based revival of the private investment cycle, we expect the uptick to be gradual, as financing conditions will likely remain tight for longer and the demand outlook is uncertain. The still elevated interest rates limit the recovery in private investment in 2024 and 2025. An anticipated moderation in external demand will curb goods export growth in 2024, but exports in certain segments, such as pharmaceuticals, will perform well. Overall, export growth is to increase in both 2024 and 2025.

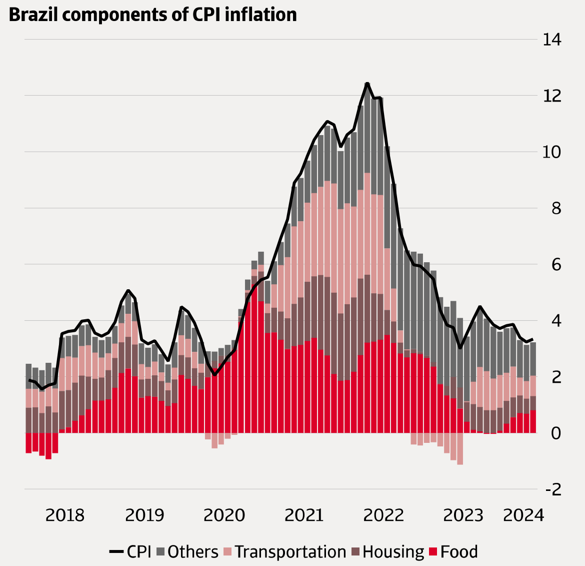
3.3 Latin America: improving resilience in the face of economic slowdown

Latin America and the Caribbean face the weakest growth prospects among EME regions but this masks the remarkable resilience the region has demonstrated through recent global volatility. Adverse weather conditions will keep growth muted at only 0.9% this year before picking back up to 2.3% in 2025.

Brazil: adverse weather events exacerbate Brazil's economic challenges

Brazil's resilient economy is facing increasing headwinds that will weigh on GDP growth in 2024 and 2025. Last year, growth surpassed expectations at 2.9%, on the back of strong household spending. Inflation has been declining steadily for the past two years from double-digit highs (see figure 3.2), and the central bank made the first step in relaxing financing conditions already in August 2023. While we expect this to help keep household spending firm, it is losing momentum over our forecast period. Devastating floods in southern Brazil will cause inflation to decline more slowly than previously expected, in turn slowing the pace of monetary easing and dragging on growth. The most impacted state, Rio Grande do Sul, is a significant producer of grains. The disruption to soybean and rice supply will push up food inflation. We now expect inflation to stay at nearly 4% by the end of 2024 and converge to the central bank's 3% mid-point target only in 2026. With inflation higher than expected, we now expect the central bank to cut its interest rate to only 9.75% by the end of this year (previously 9%) and 9% in 2025.

Figure 3.2 Inflation in Brazil is coming down gradually



Source: IBGE, Macrobond

Governability also remains a challenge for Brazil's economic outlook. President Lula is governing with a minority in Congress. We expect Congress to remain gridlocked at least until the mid-term elections coming up in October 2024. This delays much-needed reform bills into 2025. Fiscal risks are also rising as the fiscal consolidation efforts are so far insufficient to meet targets. Moreover, the government has relaxed its fiscal targets for 2025 and beyond, raising concerns of its commitment to rein in spending, and potentially bringing debt higher from 76% of GDP currently to 82% in 2025. Corruption is also an ongoing concern, following the overturning of two high-profile convictions from 'Car Wash', the landmark anti-corruption probe. This will all translate to a steady slowing in GDP growth to 2.1% in 2024, before picking up slightly to 2.4% in 2025 as political uncertainty declines and households benefit from loosening financing conditions.

Mexico shifting to a lower gear

Mexico outperformed regional peers in 2023 with 3.2% growth, but we expect momentum to ease this year to 1.9%. The strong 2023 performance as a basis for comparison partially explains the slower growth. More tangibly, growing caution among Mexican consumers and the end of key infrastructure projects are dragging on growth. Mexico's outlook is also clouded by the slowdown in the US, its primary export market and source of remittances. As US growth disappointed in Q1, so did remittances which contracted for the first time on an annual basis since the pandemic. Fiscal risks have also continued to increase, as government spending rose 20% year-on-year in Q1 ahead of the elections. Claudia Sheinbaum, a close ally of President Andrés Manuel López Obrador, won the June elections with a solid victory. This will ensure policy continuity which risks a further deterioration in government finances. The Banco de México (Banxico) made its first rate cut of 25 basis points in March that brought the policy rate to 11%. Since then though, Banxico has opted to keep rates on hold, given sticky inflation and higher-for-longer rates in the US. The monetary policy stance will remain restrictive, easing only gradually to around 10% by year-end and accelerating in 2025, should disinflation continue.

3.4 Eastern Europe outlook is bleak

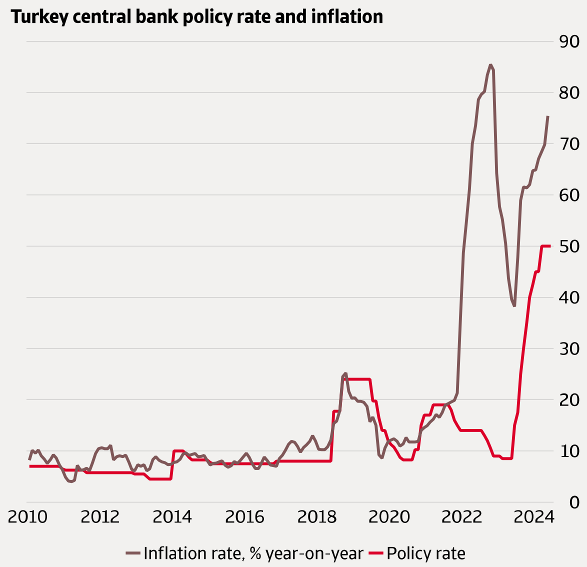
Our growth estimate for Eastern Europe in 2023 was subject to the largest revision (+1.3 ppt) compared to last July as Turkey shifted to orthodox policy and Russia skirted international sanctions. But the outlook for the region in 2024 and 2025 remains very cloudy.

Turkey: ongoing high inflation

In Turkey, Erdogan and the ruling AKP-coalition suffered significant losses to the main opposition CHP party in local elections in March 2024. Turkey's high inflation was the main factor behind the election result. We expect economic growth to slow from 4.5% in 2023 to 2.5% in 2024. The long-running consumer boom is expected to run out in 2024. The substantial salary and pension hikes announced in January 2024 will support consumer demand. However, as part of a shift to a more orthodox footing, the government has started to increase taxes and interest rates, and is limiting access to credit, which will affect consumer spending and government expenditure. Inflation is still high at 68% year-on-year in March 2024. High inflation is driven by the weakening lira, large-scale government spending and generous wage and pension increases.

The central bank has been pursuing a tightening monetary policy since June 2023 (see figure 3.3). In March 2024, the policy rate was increased by 500 basis points to 50%. We expect that the policy rate will be kept at this level into 2025. In the long term, this will probably contribute to cooling inflation, although inflation will remain above the official target of 5% in the coming years. Furthermore, the central bank is expected to continue winding down its interventions in the FX market, and unpicking the many regulations that it has imposed on banks to deter the use of foreign currency and control the level and direction of credit.

Figure 3.3 Turkish rates to stay high as inflation persists



Source: Macrobond

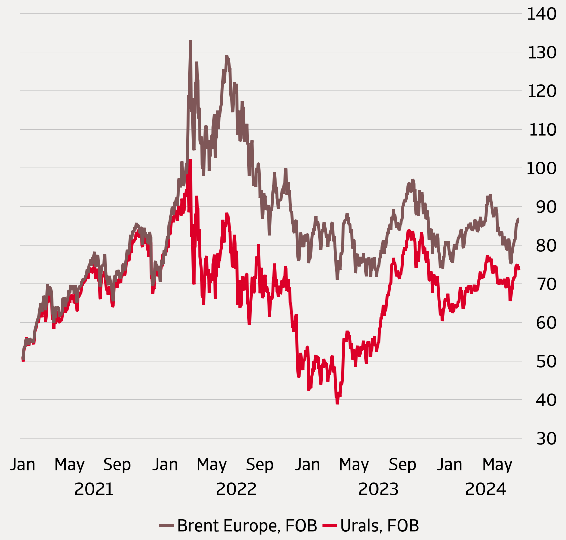
The anticipated slowdown in domestic demand will bear down on import growth in the coming months, helping the external balance. Meanwhile, a still-strong tourism sector and a recovery in external demand will support trade and services exports. This contributes to a narrowing of the current account deficit to 2.1% in 2024. But it remains a challenge to attract sufficient capital inflows to cover the remaining deficit and service foreign debt without drawdowns of FX reserves.

Russia's economy performs above expectations

Russia's economy continues to perform above expectations, with 3.6% growth in 2023 and an expected 3.2% growth in 2024. Ukraine's Western allies expect Russia to launch a new large-scale offensive this summer. The army is trying to avoid new mobilisation at all costs and is instead relying on conscription and expansion of the contractual army. This is causing the labour market to tighten further, driving up labour shortages and fuelling nominal wage growth. Frontloaded fiscal spending and rapidly growing wages are contributing to strong domestic demand. Along with rising hydrocarbon and non-hydrocarbon revenues, reflecting demand strength and Russia's adaptation to Western sanctions targeting its oil sector, this supports GDP growth. Urals oil is consistently trading above the EU-G7 price cap of USD 60 per barrel. The discount of Urals to European brent has stabilised to around USD 10 per barrel (see figure 3.4).

Figure 3.4 Spread between Brent oil and Urals blend has narrowed to USD 10

Price of Brent vs. Urals blend in USD



Source: Macrobond

Headline inflation remained sticky at 7.7% in March. It is likely to increase further in the coming months to 8%, where we think it will peak. The Russian Central Bank has signalled that it will keep its policy rate at 16% in the near term. We don't expect a policy rate cut before Q3 2024 and possibly later if labour market tightness persists. The central bank intervened to stem the fall of the rouble at the start of 2024, and further interventions in foreign-exchange markets are likely. The risk of capital controls will rise with persistent rouble weakness.

Russia's fiscal capacity will be stretched in 2024. The high costs of the war and sanctions on the economy will put pressure on the federal budget. Military spending has been hiked to 6% of the 2024 budget, up from 3.9% in 2023. Defense spending is one third of the total government expenditure for the year, as Russia prepares for a protracted war, and reconstruction in the annexed territories.

3.5 Sub-Saharan Africa

South Africa: elections deliver the worst result for the ANC in 30 years

We expect GDP growth in South Africa in 2024 to remain on par with 2023 (0.7%). The prospect for 2025 is slightly better with an expected 1.4% GDP growth. South Africa's election on May 29th has delivered a major shock to the African National Congress, which has been in power for 30 years, after its vote shared plummeted to 40.2%. The ANC has agreed to form a coalition with the centrist, pro-business Democratic Alliance. On the policy front, the new government will remain focused on structural reforms to alleviate growth-inhibiting electricity shortages and transport bottlenecks, in partnership with the private sector.

South Africa's economy has performed poorly since the pandemic, while inflation continues to erode South Africans' purchasing power. The inflation picture is improving, however, with April's inflation figure at 5.1%. Factors keeping a lid on inflation include tight monetary policy, spare industrial capacity, a persistent output gap and strong retail competition. Rising electricity tariffs will remain a major inflation driver. Although inflation is moving in the right direction, it remains above the midpoint of the target range (4.5%). The central bank is reluctant to cut interest rates too soon and has kept the policy rate unchanged at 8.25% after May's meeting. We think the first rate cuts will not be delivered before Q4 of 2024.

The latest sentiment indicators show somewhat improving business confidence, albeit from low levels. The current account is likely to remain in deficit in 2024 (1.9% of GDP), but the shortfall is relatively small. The persistence of an overall current-account deficit in 2024-2025, will leave South Africa to some extent reliant on financial inflows to plug the gap. But a business-friendly government could unlock fresh investment to give the economy some legs to run in H2 2024. The coming years economic growth is forecast to remain positive, but still constrained given the problems with state-owned enterprises, including Eskom (power) and Transnet (rail and ports).

Appendix: macroeconomic tables

	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	1.3	2.9	5.6	3.3	2.9	0.7	-0.5	-1.3	54.4	54.1	54.7	0.3	0.0	-1.4	6.6	2.9	4.8
Austria	-0.7	0.3	2.2	7.8	3.0	1.2	-2.6	-2.6	-2.4	109.4	108.8	107.9	2.7	2.3	2.0	0.2	1.9	2.1
Belgium	1.4	1.2	1.5	4.0	3.5	1.9	-4.4	-5.3	-3.2	113.9	113.7	112.2	-1.0	1.7	1.5	-3.3	-1.4	4.5
Brazil	2.9	2.1	2.4	4.6	4.1	4.0	-8.2	-7.3	-7.1	74.4	79.0	81.7	-1.4	-2.1	-1.8	9.1	1.2	-2.5
Canada	1.2	0.2	1.9	3.9	2.6	2.2	0.0	-1.6	-2.2	103.4	103.1	101.5	-0.7	-0.5	-0.7	5.4	2.7	3.1
China	5.2	4.7	4.1	0.2	0.4	1.5	-7.7	-8.5	-6.8	57.6	63.2	66.3	1.4	1.6	0.4	4.1	9.3	-4.3
Denmark	1.9	1.5	3.1	3.3	1.5	1.9	3.2	2.1	1.9	34.0	31.9	29.2	10.9	10.5	11.0	13.4	3.5	1.7
Finland	-1.0	-0.2	2.1	6.3	2.0	1.9	-2.5	-2.5	-1.6	75.9	78.8	78.9	-1.4	-1.2	0.0	-1.7	-4.9	6.1
France	0.9	0.9	2.1	4.9	2.3	1.7	-5.4	-5.1	-4.1	123.4	125.0	125.4	-0.8	0.2	-0.2	2.5	3.0	3.1
Germany	0.0	0.0	1.3	5.9	1.8	0.9	-2.4	-2.3	-1.2	59.3	59.9	59.5	6.1	6.9	6.1	-0.2	0.5	2.1
Greece	2.0	1.7	2.3	3.5	2.4	1.7	-1.6	-1.4	-1.0	209.1	201.8	194.7	-6.5	-5.9	-4.8	3.7	-3.4	6.1
Hong Kong	3.3	3.6	4.1	2.1	2.2	2.4	-1.8	-1.9	-0.6	0.3	0.2	0.2	9.1	6.4	6.1	-6.6	4.5	4.8
India	7.7	6.8	7.0	5.7	4.7	4.5	-6.0	-5.6	-4.6	82.8	79.2	75.3	-0.9	-0.9	-1.4	3.5	10.1	1.5
Ireland	-3.3	-0.8	4.4	6.3	2.2	1.6	1.7	1.1	0.4	37.5	36.1	33.3	9.8	10.4	8.2	-4.9	4.2	3.1
Italy	1.0	0.8	1.1	5.6	1.1	1.6	-7.2	-4.5	-3.8	151.2	153.9	155.4	0.5	1.9	1.5	0.5	2.6	3.4
Japan	1.9	0.5	0.9	3.3	2.2	1.5	-4.1	-3.7	-3.5	233.0	231.0	231.8	3.6	4.2	3.7	3.2	0.3	2.2
Luxembourg	-1.1	1.1	3.9	3.7	2.4	2.0	-1.2	-1.4	-1.1	25.6	26.3	25.6	6.7	4.5	4.9	-1.4	1.7	4.5
Netherlands	0.2	0.8	2.1	3.8	2.7	1.9	-0.3	-1.4	-2.0	51.3	50.0	50.1	10.1	9.1	9.1	-1.4	-0.2	5.3
New Zealand	0.6	1.0	3.5	5.7	3.2	1.9	-2.2	-1.5	-0.8	45.7	46.9	45.1	-6.9	-5.0	-4.2	9.6	8.0	6.1
Norway	0.7	1.2	1.3	5.5	3.6	2.2	16.2	12.3	8.5	41.0	40.8	35.4	17.8	15.5	12.7	1.7	3.2	1.0
Portugal	2.3	1.8	1.9	4.3	2.5	1.7	1.2	0.1	-0.4	105.8	99.9	96.8	1.3	1.8	1.2	4.1	2.8	1.5
Russia	3.6	3.6	1.6	5.9	7.6	6.0	-2.3	-2.0	-2.4	14.6	13.6	15.6	2.5	5.2	6.3	2.7	1.2	1.2
Singapore	1.1	2.2	2.8	4.8	2.2	1.4	-1.6	-0.1	0.3	170.8	161.3	157.3	19.8	23.1	17.9	2.4	3.3	3.3
Spain	2.5	2.4	1.8	3.5	3.3	2.1	-3.6	-3.1	-2.8	114.1	111.3	109.9	2.6	3.1	3.4	2.3	3.5	2.7
South Africa	0.6	0.7	1.4	5.9	5.2	4.9	-5.9	-4.3	-5.1	73.4	75.2	77.4	-1.6	-1.9	-2.4	3.7	1.0	1.7
South Korea	1.3	2.4	2.2	3.6	2.6	1.5	-1.7	-1.7	-0.8	53.1	55.4	54.9	2.1	2.4	3.3	2.9	6.3	3.3
Sweden	0.1	1.1	2.1	8.5	3.2	1.7	-0.6	-0.8	-0.5	41.8	41.0	40.0	6.5	5.9	4.5	3.6	1.6	1.8
Switzerland	0.7	1.5	1.5	2.1	1.4	0.9	0.0	0.0	0.0	25.1	24.3	23.8	6.8	7.1	7.7	2.0	3.6	3.5
Turkey	4.5	2.5	1.9	53.9	59.3	26.4	-5.1	-4.2	-2.1	25.6	23.8	23.0	-4.3	-2.1	-2.1	-2.7	3.4	2.6
United Kingdom	0.1	0.9	2.0	7.3	2.5	2.5	-5.9	-4.5	-4.0	101.3	101.9	102.1	-3.3	-2.7	-3.1	-0.5	-1.2	2.5
United States	2.5	2.6	1.9	4.1	3.3	2.5	-7.9	-7.2	-7.2	138.9	139.4	141.0	-3.0	-3.0	-3.1	2.6	2.5	3.8
Eurozone	0.5	0.8	1.8	5.4	2.3	1.4	-3.6	-3.2	-2.6	-	-	-	1.6	2.3	2.0	-0.6	1.4	3.2

	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	2.1	1.2	3.1	5.4	1.4	2.3	1.7	2.9	0.3	-1.0	0.0	2.0	0.5	1.0	1.8
Austria	-0.1	1.2	2.3	-1.2	-1.9	2.8	-0.1	-0.8	1.2	-3.3	0.2	3.7	0.1	-2.4	2.8
Belgium	1.4	1.8	3.5	3.6	1.4	2.5	1.6	0.6	-1.8	-6.8	-3.0	6.0	-7.3	-1.8	0.4
Brazil	3.1	1.0	-0.4	-3.0	3.6	2.8	1.7	1.8	2.1	1.8	1.4	-0.3	0.3	2.0	1.8
Canada	1.7	1.4	1.9	-3.2	0.5	5.0	1.6	1.6	1.4	1.8	0.7	1.9	-0.7	-0.3	2.3
China	9.2	6.1	3.4	5.3	2.3	5.4	4.1	8.8	2.2	9.6	6.2	3.7	4.8	5.0	3.4
Denmark	1.0	0.8	3.9	-5.0	1.8	5.8	0.1	1.1	-0.5	-1.3	1.3	1.8	8.9	9.3	4.9
Finland	0.6	1.0	0.7	-4.2	-3.4	3.0	4.5	1.2	0.2	-3.8	-0.2	2.1	-2.2	-0.2	2.4
France	0.9	1.0	1.6	0.7	-1.3	1.3	0.8	0.6	-0.1	-1.9	0.6	1.7	0.4	0.4	3.0
Germany	-0.6	0.8	3.0	-0.2	-0.1	4.0	-1.0	0.7	0.1	-3.2	0.1	3.7	-1.7	-1.2	3.1
Greece	1.6	1.7	0.8	4.0	6.8	14.1	1.4	-0.8	2.4	-3.3	-1.2	1.4	2.3	4.1	4.0
Hong Kong	7.7	0.2	2.9	11.2	0.7	4.7	-4.2	-0.7	2.5	13.8	5.4	2.9	3.8	-2.1	1.2
India	3.4	5.7	8.1	8.3	4.9	10.4	6.2	3.3	6.5	4.8	7.1	9.4	5.8	4.6	6.4
Ireland	3.2	1.9	2.1	2.9	-13.4	4.1	1.7	3.0	2.3	1.1	2.0	2.9	-7.0	-4.1	7.8
Italy	1.2	0.2	0.9	4.9	3.3	0.8	1.2	0.8	0.6	-2.4	-0.3	1.5	-2.1	-1.4	5.1
Japan	0.6	-0.2	1.7	2.0	1.9	2.9	0.5	0.0	-0.7	2.6	0.5	1.3	-1.4	-1.4	4.9
Luxembourg	4.0	1.6	2.1	-0.9	-2.1	8.4	2.8	2.6	0.7	7.2	10.2	3.4	-5.6	-0.9	5.2
Netherlands	0.4	2.3	1.7	1.9	-2.0	3.9	3.6	2.5	1.1	-1.6	2.1	2.8	-1.1	-1.7	3.3
New Zealand	0.3	-0.3	2.1	-1.0	-4.5	3.0	-1.1	2.7	1.7	-3.8	-1.1	2.2	-2.1	6.8	3.1
Norway	-0.6	0.2	3.3	0.0	-5.4	2.1	3.4	3.1	1.8	-2.8	0.4	2.9	0.0	4.4	0.7
Portugal	1.6	1.8	1.8	2.6	3.3	3.9	1.0	1.6	1.4	1.1	1.3	1.5	-3.2	3.6	1.5
Russia	6.5	4.1	0.6	8.8	4.5	1.7	7.0	2.2	2.3	5.3	8.3	0.9	3.1	3.4	1.5
Singapore	3.8	3.0	2.8	-0.2	-1.3	5.8	2.6	3.2	0.3	0.6	0.4	5.1	-4.3	3.4	8.9
Spain	1.8	1.8	1.7	0.8	2.6	5.0	3.8	1.9	1.1	2.5	0.9	1.4	-1.2	1.2	3.3
South Africa	0.7	0.1	1.2	3.9	-1.7	3.7	1.9	-0.3	-0.3	-1.0	1.1	2.3	-0.4	0.4	2.7
South Korea	1.8	1.5	1.4	1.2	1.2	3.5	1.3	1.4	1.6	-1.5	3.1	5.0	-2.5	3.6	3.6
Sweden	-2.2	0.8	2.0	-1.0	0.4	2.1	1.3	1.2	1.9	-5.2	1.3	3.6	0.2	1.5	2.2
Switzerland	2.1	1.2	1.6	-1.4	0.3	3.5	-2.0	0.3	0.4	-1.5	0.7	0.9	0.8	1.1	3.5
Turkey	12.8	0.0	-6.1	8.9	3.4	-1.4	5.2	0.5	0.8	23.6	2.9	-6.2	1.6	3.4	1.7
United Kingdom	0.2	0.7	2.6	2.2	-0.5	0.8	0.5	3.4	2.8	-2.7	0.5	2.5	-0.4	0.1	0.9
United States	2.2	2.4	2.0	2.1	4.5	3.7	2.7	1.3	0.5	1.7	1.7	1.9	0.2	0.0	1.8
Eurozone	0.6	1.1	2.0	1.5	-0.1	3.0	1.0	1.0	0.4	-2.0	0.5	2.6	-2.1	-1.0	3.7

Source: Oxford Economic, Atradius

Atradius economic research

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