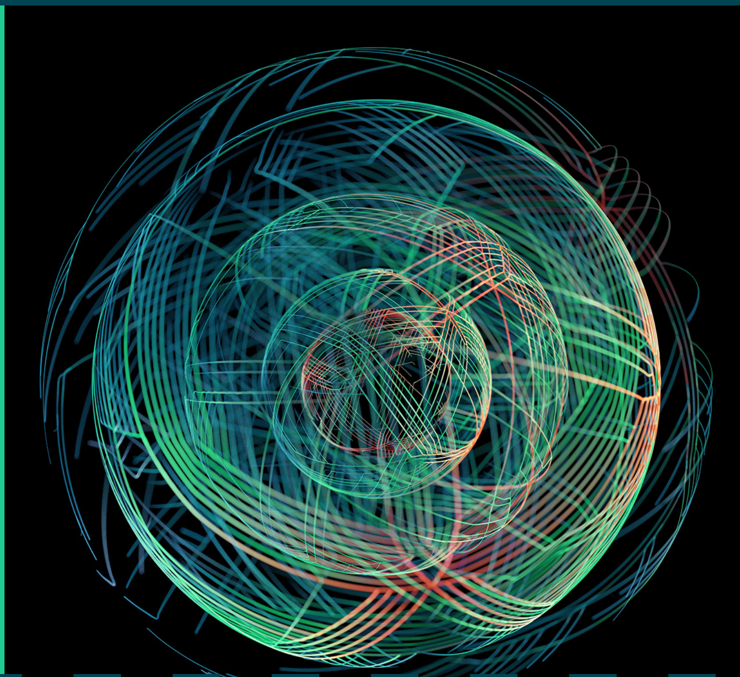
2024 Global Economic Outlook



Global growth has been more resilient than anticipated in 2023, with inflation falling in most major economies. In 2024 we expect some economies to pull off a soft economic landing, but recession risks remain. We anticipate central banks will retain tight policy settings until inflation moves sustainably toward their targets before easing. How would these factors impact investors in 2024? IFM's economic team shares their views.

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Soft or hard landing dependent on the labour market and inflation

Global economies ended more resilient in 2023 than many expected when the year began. Whether this can continue is the key question for 2024. We think the answer probably lies in the labour market and how inflation will fare in the coming year. The outlook for both factors will define the timing and scope of monetary policy easing that is to come.

Economic activity thus far has been supported by the persistence of extremely low unemployment rates. This has helped households with cost-of-living pressures that have not been seen in generations. Furthermore, many borrowers have yet to experience the impact of interest rate increases.

Inflation has been the biggest driver of economic growth in the past year, and it will be the key to watch in the year ahead. As the progress of disinflation continues around the globe, driven mainly by decelerating goods inflation, the services side remains uncertain.

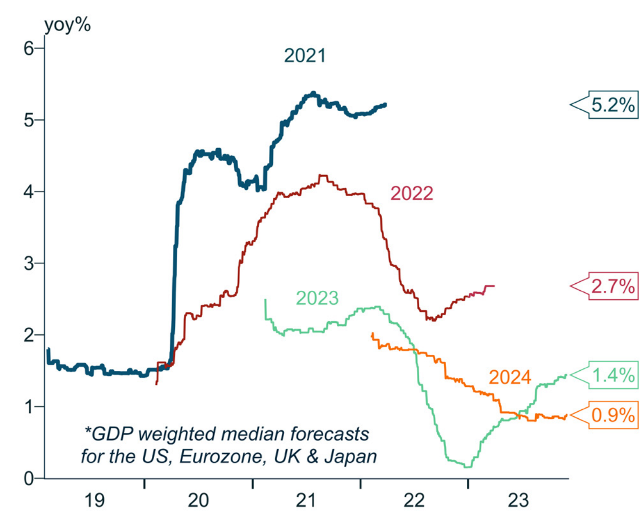
Broadly, we expect that central banks will be on hold well into 2024 to be sure inflation is sustainably anchored at respective targets before discussions shift to rate cutting. The central case, therefore, is a policy plateau where rates stay elevated for some time into 2024 before a 'slow and steady' rate cutting cycle to minimise risks of a secondary inflation outbreak (which would be particularly humbling for policymakers).

Downside surprises on inflation and/or upside surprises on unemployment may alter this view. Isolated downside inflation surprises speak to the soft-landing narrative, like what has occurred in the US through 2023. However, it is still likely that central banks would ease cautiously in this case. Upside surprises on unemployment are likely to be far more economically destructive and risk a hard landing. In this case central banks could be expected to ease policy more aggressively.

Despite the clear risks of the lags of monetary policy fostering a hard landing scenario, we remain in the soft landing camp, but it is a broad church. This is predicated on our expectation that every step inflation takes towards central bank targets brings greater freedom to address growth concerns by easing policy, should they arise.

Geopolitical risks remain a wildcard
What may put a spanner in the works are heightened geopolitical risks. Outright conflicts will continue with the Russia-Ukraine conflict and now the Israel-Hamas conflict, both potentially imparting further shocks to the global economy, particularly via the energy complex. Slow-moving but tectonic shifts in geopolitical and economic alignments will continue to shape trade and capital flows. US-China tensions are notable, but also the broader BRICs-plus bloc against advanced economies threatens to be destabilising. Political polarisation and populism also threaten to be disruptive. Clearly, the US Presidential election is at the forefront of these concerns, with the contest, which may again be Biden versus Trump, having domestic and global implications. There are also elections in India, Mexico and Taiwan that will be closely watched.

GRAPH 01 **2024 TO BE THE LOWEST GROWTH SINCE 2021**



Source: IFM Investors, Bloomberg, IMF, Macrobond

> **We believe how the global economy will actually land is key as long-duration investors look to potentially rotate back to growth assets.**

2024 risks bringing the lowest growth of this cycle
Overall, we expect growth to be somewhat weaker in 2024 than in 2023. This is particularly true in the US, which has experienced the most robust growth of major advanced economies and will probably slow, coming from a relatively high base. The Eurozone and the UK are already stagnating. Growth through 2024 will be likely to remain weak, not too dissimilar to 2023. Recession risks in these economies remain the most acute. The UK will probably be a touch weaker than the Eurozone, with potentially more persistent inflation. Japan's growth will likely moderate after a better-than-expected 2023, with the Japanese economy being an exception to the global increase in policy rates. And then there's China —risks abound— yet policy support will likely stabilise growth.

Investment implications
It seems that 2024 is a year in which to be cautious as an investor. There is a strong view of where we are in the rates cycle, and this lends itself to asset allocations that favour fixed income over equities despite some relatively surprising, though inconsistent, equity market performance in 2023. Nonetheless, the 60/40 fund model was again under pressure in 2023 as bonds had not yet delivered, and equity returns were highly dependent on jurisdiction and sector.

Risk-averse investors and those experiencing a 'denominator effect' have shied away from private markets in 2023, especially unlisted infrastructure. This is despite very solid returns through both 2022 and 2023. The turbulent economic years exiting the pandemic may have made it difficult to allocate to private markets, but those already exposed have observed true 'mid-risk' performance through this unusual cycle and we believe the asset class is well positioned heading into 2024.

Overall, we believe how the global economy will actually land is key as long-duration investors look to potentially rotate back to growth assets. A soft landing would facilitate this at the expense of returns in fixed income assets. Conversely, a hard landing would deter any rotation given the expectation of poor economic conditions and questions of how far rates might fall. Whatever the easing cycle, central banks will once again be looking to get a feel for the neutral rate, particularly in a soft landing scenario. While labour supply, better productivity and fiscal largesse may all support the notion of a higher neutral rate, we remain unconvinced that this could be sustained in a higher debt world.

IFM Investors

US: Recessionary risks fade, soft landing expected
We expect the US economy to slow in 2024, with consensus looking for 1.0% growth over the year as a number of headwinds build and tailwinds abate. Recessionary risks continue to fade, and a "soft landing" looks increasingly likely, but we are not out of the woods yet. There remains considerable uncertainty around how long and variable the lags in monetary policy are, and how long it will take underlying inflation to get sustainably back to target.

Inflation progress has been tracking well, and expectations are for further progress this year (consensus headline inflation of 2.7% in 2024). This should facilitate the US Federal Reserve (Fed) easing cautiously late in the year to facilitate a soft landing rather than any more dramatic cuts that would be in response to a recession.

We believe fiscal policy will be a drag in 2024 compared to 2023, where the stimulatory impulse of the CHIPS and Inflation Reduction Act was sizeable. Though the 2024 deficit will probably still be large, the growth impulse is set to be negative as the deficit will likely be smaller than 2023. Continued tight bank lending standards will also hamper output.

We expect households, which were key growth support through 2023, to be under pressure this year. The continued rundown of excess savings through 2023 was a tailwind, but most of the income distribution looks to have drawn down this buffer, so further growth support from households may be limited.

The US political landscape remains a key uncertainty with the November presidential election. Expectations are for the contest between current President Biden and former President Trump. But neither is guaranteed to get to the starting line. The outcome could have sizeable geopolitical and economic implications. A Biden victory will see continued US global engagement and support of multilateral institutions. In contrast, a Trump victory will likely see an inward turn and more focus on narrow domestic concerns. Both will be likely to mean expansionary fiscal policy but with vastly different priorities.

Overall, while we believe the chance of recession has reduced, we expect output to expand at a below-trend pace and growth headwinds to persist in 2024. A soft landing remains our base case despite the lack of historical precedent.

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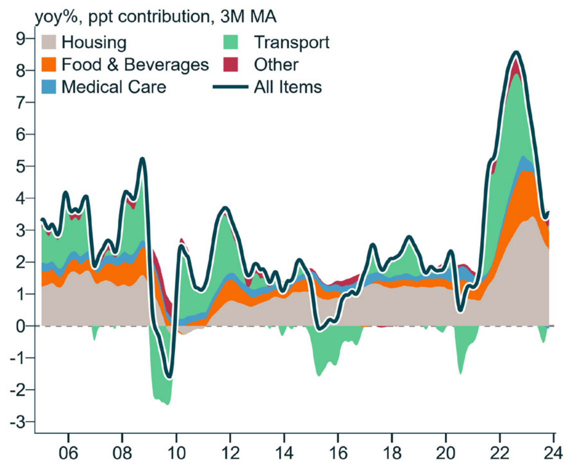
GRAPH 02 **US - BROAD-BASED DISINFLATION PROGRESS**



Source: IFM Investors, BLS, Macrobond

UK: Another uncomfortable year as households to support the economy
The outlook for the UK economy is subdued, with both structural and cyclical factors weighing. Following flatlining output in the latest GDP figures, we will probably see only a modest recovery in 2024, with consensus expectations of growth of around 0.4%, similar to 2023. Despite pressure on households, we expect their spending will be the main growth support in the first half of 2024 – there will be further growth in real disposable incomes as nominal wage growth continues to comfortably outstrip inflation in the coming months. But this effect looks set to fade through the year's second half.

Given the wide range of expectations around where nominal earnings growth will settle, there is also considerable uncertainty around how real incomes would play out. Similarly, how fast underlying inflation will dissipate and how wage-price dynamics evolve would play a part. On balance, inflation will likely prove relatively sticky in the heavily services-exposed UK economy, given that pricing momentum in services is persistent and more heavily determined by wages growth.

Expectations are that UK inflation will prove relatively persistent (consensus of 3.1% in 2024), and this will likely force the Bank of England (BoE) to maintain tighter policy through late 2024. Mortgage channel impacts will also drag as the effective mortgage rate increases via the rolling-over of fixed rate mortgages. Fiscal policy will also likely be a drag, with the Chancellor's stimulatory Autumn Statement insufficient to offset unwinding energy and COVID support measures.

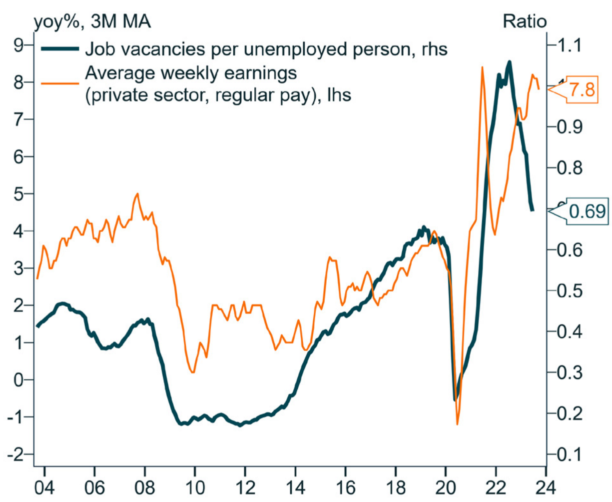
Risks to the outlook remain elevated and depend crucially on the labour market response. There has already been a sizeable labour adjustment to slowing growth, most clearly visible in the falling vacancies-unemployment ratio and rising unemployment. But if further adjustment takes place through an even more material rise in the unemployment rate, that could be sufficient to tip the economy into a recession via contracting household consumption.

In politics, the UK will hold a general election sometime in 2024 (January 2025 at the latest). The outcome of the election is more important for the 2025 outlook, though the policy ambitions of the victor will probably be constrained by structural headwinds and limited fiscal headroom. Unlike the US, the UK election is predominantly an issue of domestic concern and has negligible implications for the global economic landscape.

Overall, we expect 2024 to be another year of uncomfortable adjustment for the UK economy, with pain for households, sluggish growth, and recession risks that are materially higher than other advanced economies.

> **We expect 2024 to be another year of uncomfortable adjustment for the UK economy.**

GRAPH 03 **UK - REBALANCING LABOUR MARKET, EARNINGS TURNING**



Source: IFM Investors, ONS, Macrobond

EUROZONE: Recession risk on the table

Conditions look set to improve over the year relative to end-2023 on improving real incomes and a turnaround in manufacturing activity. Expectations put 2024 growth somewhere between the US and the UK, with the consensus forecast at 0.7% for the year. The manufacturing slowdown seems to have tentatively bottomed, and output should recover through 2024, helped by higher demand and as inventory levels normalise. Structurally higher energy prices and a more modest growth outlook for China will remain a headwind, and industrial activity is unlikely to return to a pre-COVID trend.

Real incomes are set to grow on continued robust nominal wages growth and ongoing disinflation. The importance of union-negotiated wages is relatively more important in the Eurozone than in the UK/US and contributes to earnings growth that is relatively less responsive to labour market conditions. Inflation is also a key determinant of negotiated wages, such that the recent exceptional inflation environment leaves additional room for a continued upward adjustment in negotiated wages growth. On balance, this should see wages growth peak over 2024 but remain above rates consistent with the inflation target. The European Central Bank (ECB) will want to see clear evidence of a moderation in wages growth to ease policy.

In the fiscal space, policy will be a drag, in line with the continued normalisation of post-pandemic fiscal support and the ending of energy subsidies. Risks to the outlook are skewed to the downside. Similar to last year, energy prices are the main risk to the first half of 2024. Escalating geopolitical tensions or a cold winter could increase energy prices substantially, which would weigh on real household incomes and growth. This risk is less acute than last year given high gas storage levels, higher LNG imports, and substitution away from gas over the last year or so. Another risk to look out for in the Eurozone relates to how long policy must stay tight: if yields have to stay higher for longer, Italian sovereign spreads may widen materially, and the question of Italian debt sustainability might become more urgent.

AUSTRALIA: Hardest of soft landings

While technical recession (two consecutive quarters of negative growth) in Australia is unlikely given population growth, there is a risk that GDP per capita extends its run of negative growth and further weighs on living standards/national income, which are already under pressure as the terms of trade fall.

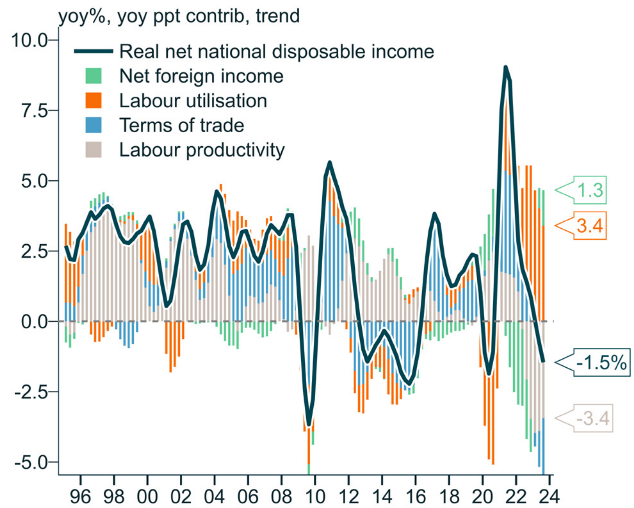
We expect real GDP growth at around 1½%, but this is lazy growth. The more important question is whether poor productivity performance can improve, adding to the growth and taking pressure off inflation. This will have to come from businesses under pressure from higher rates (headcount or hours reductions while producing the same output) or importing better productivity outcomes from other advanced economies. It seems unlikely that any government will move the needle in the near term.

Population growth is also a risk to the labour market because if labour demand falters, a strong labour supply risks increasing unemployment. Only a fall in participation could prevent this. A rise in the unemployment rate risks unravelling consumer spending, a key downside to growth.

Additionally, disinflation in Australia is running behind other advanced economies. Goods disinflation is in train but may be slower to come down than elsewhere as population growth will underpin demand, so businesses don't need to lower prices as readily. Inflation will also be supported by fiscal policy with Stage Three tax cuts due mid-year.

Services inflation may also prove more 'sticky' in Australia due to energy prices, rents and other services where cost increases are passed through. Inflation risks remaining above the Reserve Bank of Australia's (RBA) upper bound of 3%, and its mid-point of 2.5% year-on-year is unlikely to be realised until 2025 at the earliest. Given this outlook we don't expect the RBA to shift to an outright easing bias until very late in the year unless there's a material downside surprise on inflation or an upside surprise to unemployment (or both). This will probably leave the RBA one of the last, if not the last, advanced economy central banks to ease policy.

GRAPH 04 **AUSTRALIA - LIVING STANDARDS ARE GOING BACKWARDS**



Source: IFM Investors, ABS, Macrobond

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CHINA: Growth requires policy support

The IMF raised its forecast for 2024 growth to 4.6% from 4.2% but noted that key risks to the outlook are ongoing weakness in the property market and restrained global demand. Looking forward, China will likely maintain its 5% growth target for 2024 with some risk of a change to a target of 4.5% annual growth. Over the past ten years, the GDP growth target has not changed by more than 50 basis points. If the growth target is maintained at 5%, we expect this will require fiscal stimulus aimed at local government, additional infrastructure spending, monetary easing, and property market support.

The property sector continues to weigh on economic growth as developers face difficult financing conditions. Developers are struggling to tap capital markets, and defaults have meant that banks are less forthcoming with loans. Over half of China's top 50 private developers have defaulted, and further defaults are likely in coming months.

Weakness in the property sector has particularly affected household consumption, and it remains unclear to what extent consumption will improve over the near term. Much of the economic recovery has been supported by household consumption, particularly in services. China recently exited a deflationary period, with recent inflation largely driven by services. Goods inflation remains weak. While spending on services has continued to improve, the savings rate is now at pre-pandemic levels, making it difficult for household consumption growth to continue to outstrip wage growth.

External conditions have been challenging for China's exporting sector, a traditional growth driver, with exports down 6.4%yoy in nominal terms in September 2023. While the improvement in the global chip cycle will likely support exports, external demand will be unlikely to drive growth over the near term.

JAPAN: Progress towards a new normal?

Despite a material budget deficit and mammoth public debt burden, Prime Minister Fumio Kishida announced a fiscal package worth ¥17 trillion or 2.8% of GDP in November 2023. The package included tax cuts, cash handouts, energy subsidies for households to ease costs of living and subsidies for businesses that increase wages. In doing so he hoped that the "increase in the income of the people will be higher than the rise in prices in the summer of 2024". It is expected that the FY24 Shunto wage negotiations should support this effort keeping the momentum with some large employers (flush with solid profitability and competing in relatively tight labour markets) already touting material increases. This growth in incomes is hoped to overcome inflation and support consumer spending (around 54% of the economy).

The absence of external shocks to energy prices and a global soft landing will be needed for a more sustained recovery in industrial sectors. Growth in 2024 is likely to return to a trend rate of around 1.0% after recording what we expect will be a 1.7% expansion in 2023.

The modest economic outlook should be matched by measured disinflation towards the Bank of Japan's (BoJ) target. This should occur over 2024, but the BoJ does not want to impart too much disinflationary momentum. Modest adjustments to the BoJ's yield curve control through 2023 were noted as more aimed at "improving its resilience" and "reducing the chance of speculative moves". This is rather than a shift in policy footing with the effects of monetary easing assessed as "sufficiently maintained". The BoJ will want to observe inflation, driven primarily by domestic sources, anchored at its target before considering formal policy normalisation. We expect the outlook for inflation and the domestic and global economies may make this an unlikely prospect in 2024.

KOREA: Exports to lead recovery

We believe 2023 was the low point in real GDP growth for the Korean economy and that growth slightly above 2% should prevail in 2024, led by exports. We expect the highly indebted household sector to remain under pressure from higher interest rates in terms of real spending. Key to this expectation will be that external headwinds from 2023, notably a weaker-than-expected Chinese economy and downturn in the tech cycle, reverse. Further, we assume that no material deterioration in geopolitics impacts either global growth or the energy space. Ongoing resilience in the US capex cycle will also be important.

As in most other developed economies, the inflation outlook will be key to domestic growth in 2024. The path of private services inflation, which has been decelerating at the end of 2023, will also be key. The measure has ticked higher as 2023 drew to a close, with some potential stickiness in prices expected through 2024, particularly in utilities. More broadly, wage pressures continued to ease, despite the tight labour market. Should this outlook for inflation pan out as expected, the Bank of Korea (BoK) should be able to move to an easing bias in the second half and be likely to deliver cuts by year's end.

One important caveat is the threat of household debt, which has risen appreciably over recent decades to a peak of 105% in 2021 (according to the BIS and notably still well short of Australia's peak at the same time of 122%). It has edged lower more recently as rates have increased and tighter credit conditions prevailed, but the BoK will need to see this ratio remain at least stable to give it comfort to ease policy. And even then, its moves are likely to be cautious, and this will probably result in some modest appreciation of the Korean won but nothing to derail the export-led recovery.

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