Economist's Weekly Market View

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Soft Landing in Sight

2023 was a challenging year for the global economy as it contended with rising interest rates, cost-of-living pressures and slower growth. However, it was not without some bright spots. Employment continued to expand, with unemployment rates remaining very low in all the main economies. Inflation fell sharply over the course of the year, with the headline CPI rates declining to 2.4% in the Eurozone and 3% in the US towards the end of 2023. The US economy proved the star performer, with GDP growth actually accelerating to around 2.5% from 2.1% in 2022. Europe, though, largely stagnated. Meanwhile, stock markets had a strong year, while currency markets were generally range-bound with the notable exception of the marked decline in the value of the yen.

It should be noted, though, that the global economy performed largely in line with expectations last year. Subdued growth had been anticipated for 2023 and that is what mainly transpired. The impact of tighter monetary policy on activity became increasingly visible as the year progressed, while business and consumer confidence turned down. There were very little changes to the growth forecasts published by leading economic institutions, such as the IMF and OECD, during the course of last year. The latest estimate from the IMF is that the world economy grew by 3.0% in 2023. At the start of last year, it had projected the growth rate would be 2.9%, virtually the same. However, this is a weak rate of growth for the world economy by the standards of recent decades.

Forecasters remain cautious about the prospects for the world economy in the year ahead. The latest projections from the OECD and IMF are that global growth will be slightly below 3% in 2024. Growth in advanced economies is set to remain particularly weak at around 1.5% amid continuing headwinds. The hikes in interest rates over the past two years have yet to fully impact on economies. Furthermore, although rate cuts look to be on the cards this year, the average level of interest rates will still be relatively high in 2024. Meanwhile, despite falling inflation, households and business are still facing ongoing cost-of-living pressures.

The OECD also note that increasing geo-economic fragmentation, and growing protectionism with rising trade barriers, is contributing to a slowdown in international trade that is impacting negatively

on global growth prospects. Governments are also faced with growing budgetary pressures from rising debt burdens and ageing populations. Geo-political tensions are likely to remain elevated as well. Elections are due in many countries in the coming year, which will increase uncertainty. It all adds up to a continuing challenging macro-economic environment.

That said, central banks may be on the verge of pulling off a soft landing for the world economy in 2024. The surge in inflation over the past three years, with CPI rates rising to around 10%, and the aggressive tightening of monetary policy in 2022-23 which has seen interest rate hikes totalling 450-500bps in many countries, would normally be a recipe for recession. It will be unusual if economies come through this period without a downturn in activity and significant rise in unemployment.

Based on the forecasts for the coming year, although growth will remain weak, especially in Europe, a recession is not foreseen and economies are expected to remain close to full employment. The return of inflation to its 2% target is also coming into sight. Central banks are being cautious and warn it is still too early to conclude that the battle to restore price stability has been won or that a recession will be avoided. Their view remains that the balance of risks to the economic outlook are tilted to the downside.

Markets, though, have turned much more optimistic in recent months. The far quicker than anticipated decline in inflation has convinced traders that rates will be cut aggressively in the coming year. Futures contracts are pricing in that rates will be lowered by over 150bps in the Eurozone and US and 140bps in the UK by the end of 2024, with further cuts in store for 2025. Stock markets made big gains in the final two months of 2023 on the back of these rate cut expectations and the resulting improving prospects for global growth.

Economic activity should pick up momentum in 2025 on the back of a significant easing of monetary policy and financial conditions, combined with rising real incomes as inflation falls back to 2%. The challenge ahead of this, is to get through the coming year without a significant downturn in activity. It is important in this regard, that further shocks are avoided.

Over the past three years, the world economy has had to cope with the COVID-19 global pandemic, a war in Europe, cost-of-living crises and the most severe tightening of monetary policy in decades. These shocks have left it in a weakened state. It is unlikely that economies would come through another major shock in 2024, without being hit by a recession. Thus, fingers crossed that we do indeed get a soft landing in 2024. It would be a cruel twist of fate if it turns out to be otherwise, just as the landing strip for such an outcome was coming into view. Let us hope, then, that the economic forecasts for modest growth for the global economy in 2024 prove accurate again.

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