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Global Monthly

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Will wage growth fall back in time for summer rate cuts?

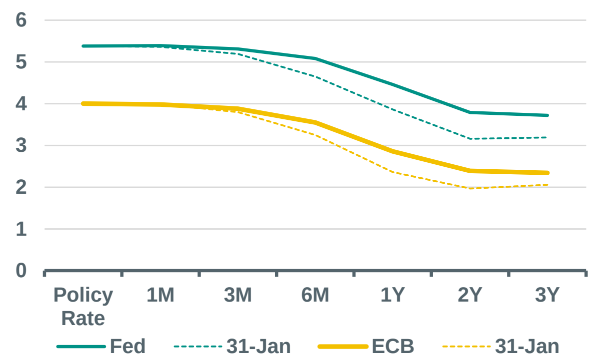
- **Continued economic resilience has driven a significant paring back in market expectations for Fed & ECB rate cuts. Market expectations are now consistent with our own call for a June start to rate cuts**
- **But what if wage growth – the current obsession of central banks – proves more persistent?**
- **While central banks are likely to gain more confidence in the wage and inflation outlook by June, we think they will need to take a leap of faith in order to avoid the risk of being too late with rate cuts**
- **Regional updates: Economic stagnation is leaving its mark on the *eurozone labour market,* while in *the Netherlands*, the period of technical recession has come to an end**
- **In *the US*, signs of rising financial stress suggest there will still be some slowdown in growth**
- **The Lunar New Year is bringing some green shoots in *China*, amid ongoing piecemeal stimulus**

Global View: June rate cuts will require confidence – rather than certainty – on wages

Bond markets now expect significantly less rate cuts by central banks than they did only a month ago. On the eve of the blockbuster US non-farm payrolls release early this month, markets were still out of kilter with our expectation for a June start to rate cuts, seeing a significant probability of a move in March. Now, markets are even beginning to cast doubt on June: at the time of publication, a June cut by the Fed is around 80% priced (for the ECB, a June cut is still fully priced – just about). This has driven a sharp rebound in bond yields, with the 10y German bund yield rising 25bp, and the 10y US Treasury yield rising 40bp over the past month. What has happened on the macro front to cause such a shift? First, the US employment report suggested an even more resilient economy than the already benign expectations of most forecasters. Second, while the eurozone remains weak, it has also continued to outperform expectations for even greater weakness. At the same time, while disinflation has broadly continued in advanced economies, a hot CPI and wage growth reading in the US reminded investors that we may not be quite out of the inflationary woods. For now, while markets have moved in our direction over the past month, we think the pricing out of rate cuts is likely to run out of steam. As we lay out in this month's *Global View*, while advanced economies are proving resilient, we continue to think central banks will gain sufficient confidence in wage (and therefore inflation) developments to start lowering rates this coming June.

Markets have dialled back rate cut expectations…

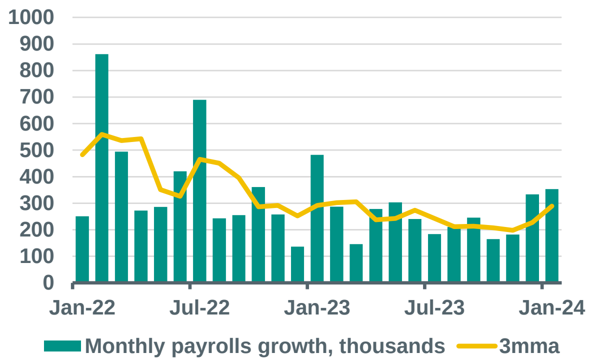
Expected path for interest rates by financial markets, %



As of 26 February. Source: Bloomberg, ABN AMRO Group Economics

…driven by more resilient macro data

US non-farm payrolls, monthly change, thousands



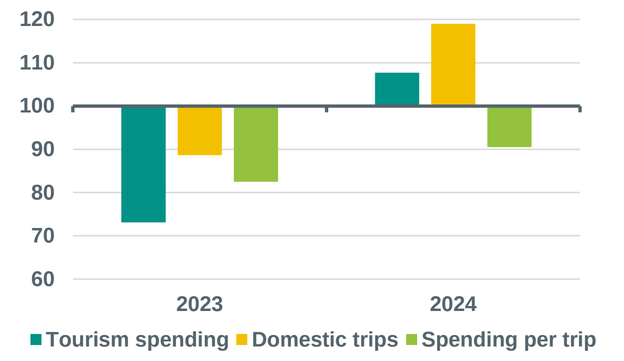
Source: LSEG, ABN AMRO Group Economics

Growth is looking a little better than expected, but driven mostly by the US

To some extent, the later start to rate cuts now expected by financial markets has been driven by commentary from Fed and ECB officials, who have sought to downplay expectations for an imminent move on rates. For the most part, however, the data has spoken for itself: growth indicators have largely come in on the stronger side, particularly in the US, but we are also seeing some green shoots in the more sluggish eurozone and China. In the US, the more resilient labour market suggests the unfolding slowdown is likely to be even shallower than we previously thought, leading us to raise our 2024 growth forecast from an already above-consensus 1.8% to 2.1%. We have made no such changes to our eurozone and China growth forecasts, but in these regions, too, there has been some cause for optimism. The eurozone economy has stagnated rather than contracted, with Q4 GDP posting a flat reading – above our expectation for a 0.2% q/q decline – meaning the region might just dodge a technical recession after all (provided there are no downward revisions). In China, the Lunar New Year holiday suggests consumers might be beginning to shake off the post-reopening gloom, with tourism spending and the number of trips taken during the holiday finally surpassing the pre-covid peak – with trips some 20% higher. While the data is likely flattered by the extra day of holiday this year, we still see it as a sign that growth in China has bottomed out.

Lunar New Year travel is finally above pre-covid peak

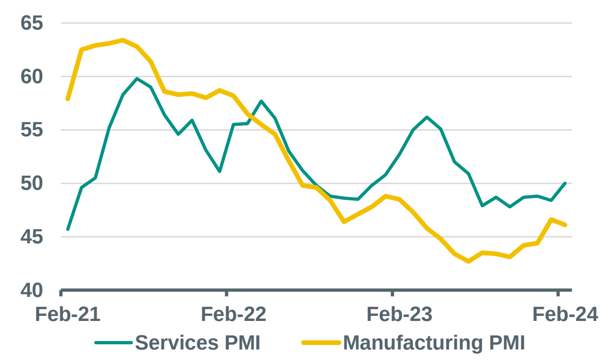
% change in travel & spending in China compared to 2019 (LNY period)



Source: China Ministry of Culture and Tourism, ABN AMRO Group Economics

EZ services PMI picks up, but manufacturing still

PMI, <50 = falling activity, >50 = rising activity



Source: LSEG, ABN AMRO Group Economics

Looking ahead, we still expect Q1 to be a relatively weak quarter. Growth in the US already slowed notably in Q4, albeit to rates that are still above trend, and the January activity data (particularly the fall in retail sales) suggests the economy is slowing further moving into 2024. In the eurozone, we expect growth to remain weighed by high rates and the rollback of fiscal support amid the easing energy crisis. Indeed, while the flash services PMI for February improved notably, likely helped by growth in real incomes as inflation abates, industry still seems to be in the doldrums, with the manufacturing PMI staying well below the neutral 50 mark. Beyond the near term, we expect a modest pickup in growth as we move into the second half of 2024, driven by falling interest rates in advanced economies, and as the cumulative impact of China's piecemeal, targeted stimulus efforts bears fruit. The recovery is likely to be constrained by the still-restrictive level of interest rates. But as the green shoots in China and the eurozone suggest, a recovery is coming, even if it is likely to be shallow.

What if rate cuts don't go according to plan?

As we describe above, the expected fall in interest rates is a key driver of our modest growth expectations for the second half of 2024. But what if the Fed and ECB are unable to start lowering rates from June, as we expect? What are the chances that inflation proves more persistent, causing rate cuts to be delayed to later in 2024 (or beyond)?

In our January Monthly, we focused on the risks to the inflation outlook from the Red Sea shipping disturbances. Since then, shipping freight tariffs have already begun to subside, and we continue to think the ultimate impact on inflation will be limited. If anything, we see evidence[1] that any upward pressure is still likely to be overwhelmed by the pass-through of prior falls in shipping and commodity prices. This leaves the main upside risk to the inflation outlook coming from wage growth. Throughout the previous high inflation period, the biggest fear of central banks was that the run-up in prices would trigger unsustainably large wage rises, which in turn would feed back into price growth, keeping inflation above 2%. As we argue below, we think central banks will have more convincing evidence that wages are normalising come June, but that they will still likely need to take a leap of faith in order to balance the risk of cutting rates too early (which could lead to inflation persisting) against cutting rates too late (which could keep the economy unnecessarily weak – or worse, cause a recession).

[1] See for instance **here**.

Wage growth needs to fall to between 3.3-4% in the US, and 2.7-3% in the eurozone

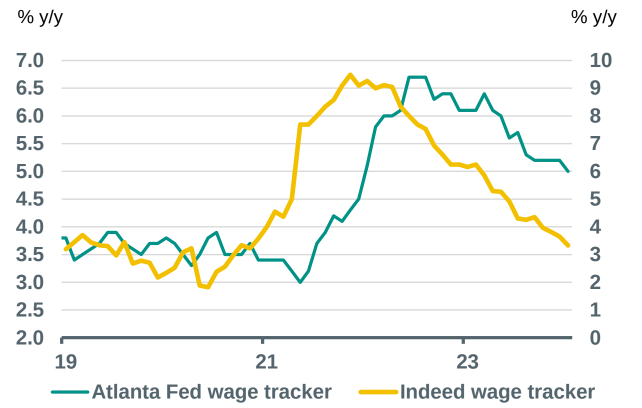
Before we look at future developments, we need to first define the level of wage growth central bank need to see to be confident inflation falls back to – and stays at – 2%. Broadly, wage growth needs to be at a level equivalent to the inflation target of 2%, plus long-run productivity growth.

Productivity growth is notoriously volatile and difficult to predict, and so central banks typically look at long term trends to inform their assumptions. Short-run (2014-19) productivity growth just prior to the pandemic was relatively weak: 1.3% in the US, and 0.7% in the eurozone. Over the longer run (2000-19)[2], productivity was much stronger, at 2.0% in the US and 1.0% in the eurozone. Adding these ranges to the 2% inflation target, we get a wage growth target of 3.3-4.0% in the US, and a narrower 2.7-3.0% range in the eurozone. Notably, these ranges are higher than average wage growth levels just before the pandemic. Indeed before the pandemic, central banks faced the opposite problem of *too low* inflation (HICP inflation averaged just 1.2% in the eurozone, and PCE inflation 1.6%). This analysis suggests that central banks will not want to see wage growth falling back to pre-pandemic levels, but rather to levels that are a little above those before the pandemic.

Wage growth is tantalisingly close to target levels in the US; still a way to go in the eurozone

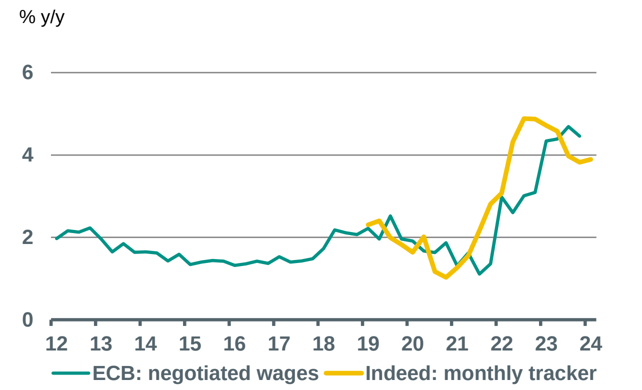
On most official measures, our estimates above suggest that wage growth still has a significant way to fall in both the US and the eurozone. The Atlanta Fed's wage tracker is – at 5% as of January – still 1-1.5pp higher than it ideally should be. However, although this measure is probably the most accurate read on wage growth in the US, it is also very lagging. The Indeed wage tracker – which uses posted salary data for new vacancies – has proven to be a strong leading indicator since its launch in 2019, suggests that wage growth is already almost back near 2019 levels. Based on the previous relationship between the two indicators, we think the Atlanta Fed's tracker will likely hit a level consistent with 2% inflation most likely in the second half of this year. In the eurozone, official measures of wage growth and the Indeed tracker are still well above 2019 levels, and well above even the most generous estimates of where wage needs to be for inflation to stay at 2%. The ECB's negotiated wages measure is, at 4.5% as of Q4, around 1.5-2pp higher than it needs to be. But even the more timely Indeed tracker is around 1.8pp above 2019 levels, or around 1pp above the level that would be consistent with 2% inflation.

US: Official data is lagging the Indeed tracker



Source: LSEG, Indeed.com, ABN AMRO Group Economics

Eurozone: Wage growth is looking stickier



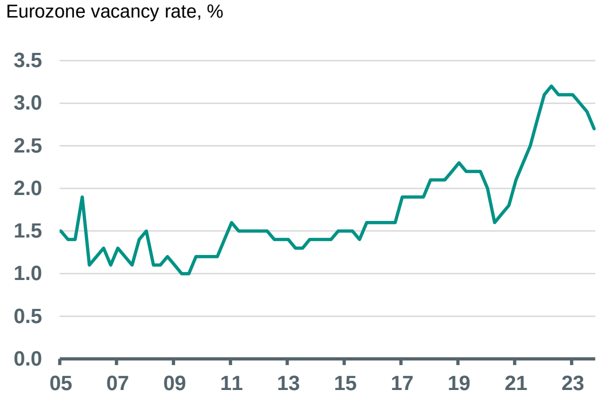
Source: Indeed.com, ABN AMRO Group Economics

Eurozone: Saved by the weak economy?

While the eurozone is facing a bigger overshoot in wage growth than in the US, the weaker macro-economic environment in Europe is driving a significant shift in the bargaining power of workers, which is likely to put more meaningful downward pressure on wages over time. Indeed, while the unemployment rate has been stable at historically low levels over the past year, the job vacancy rate has fallen sharply, from a peak of 3.2% in Q2 22 to 2.7% as of Q4 23 – 0.5pp above the pre-pandemic peak of 2.2%. In other words, around half of the increase in labour market tightness since the pandemic has already unwound. With the economy expected to stay weak in the near-term, this softening in labour demand is likely to progress further over the coming months, pushing unemployment modestly higher. This easing in labour market tightness should help drive a further decline in wage growth by June, with that likely to be most readily evident in the Indeed tracker.

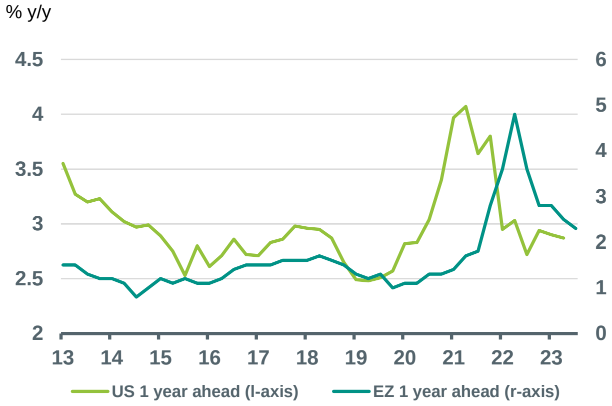
[2] We use averages from two time periods: 1) 2014-19: a relatively short period that avoids large cyclical distortions such as the eurozone debt crisis or global financial crisis; 2) 2000-19: a longer period that, alongside cyclical downturns, includes investment-fuelled bursts in productivity growth such as in the early 2000s (and which could be indicative of what an AI-fuelled upturn in productivity could look like)

Eurozone labour market tightness is unwinding



Source: LSEG, ABN AMRO Group Economics

Inflation expectations have normalised



Source: LSEG, ABN AMRO Group Economics

The other factor supporting declining wage growth is inflation expectations. As described in our January Monthly, much of the jump in wage growth has been driven by workers attempting to make up for lost purchasing power due to the energy crisis, and we now see evidence that inflation is being less frequently cited in collective wage bargaining negotiations. This is corroborated by measures of inflation expectations, which have largely normalised. If workers do not expect a repeat of the inflation surge of the past two years, the case for wage demands to persist at the current elevated rates is weakened.

What about those workers who have yet to be fully compensated for the inflation spike? Our analysis suggests that, in aggregate, eurozone wages have still not fully made up the shortfall created by the energy crisis[3]. However, profit margins in the eurozone are also elevated. This means that businesses likely have the space to accommodate some further increase in wages – at least for a time – above what would be sustainable in the long-run[4].

Ultimately, the ECB will have to take a gamble when it does decide to cut rates. By the June Governing Council meeting, we think there will have been enough of a cooling in the leading indicators for wage growth to give the Governing Council the confidence that wage growth is on its way back to levels consistent with 2% inflation. Monetary policy works with 'long and variable lags', and to wait until wage growth has fully fallen back runs the risk of rates staying high for too long, and risking recession.

US: Even the Fed will have to take a gamble, albeit of a different sort

On the surface, wage dynamics in the US already look much more benign than in the eurozone, suggesting the Fed will be making less of a gamble by cutting rates in June. However, the Fed faces a different risk to the ECB, reflecting the different growth environment. So far, US outperformance has been accommodated by an improved supply side. As in the eurozone, although unemployment has held at historically low levels, measures of tightness – such as the job vacancy to unemployed ratio – have eased significantly. But with the economy defying expectations for a sharper slowdown, and evidence that the jobs slowdown is bottoming out, there is a non-negligible (perhaps 20%) chance the US sees a resurgence in wage pressures. The solid anchoring of inflation expectations, and the broad normalisation in the labour market means we would not have this scenario as our base case. But it does suggest that the Fed will also have to place its own bets come June.

We will soon publish a comprehensive Macro Watch on wage developments.

[3] Note that this does not include the effects of government support measures, which to some extent compensated households for their loss of real income. These measures were largely one-off and so did not permanently raise incomes.
[4] As indicated by the ECB's Klaas Knot: "there's still space in profit margins to pay higher salaries without a drastic second round for price hikes" See **here**.

Eurozone: Economy continues to flatline

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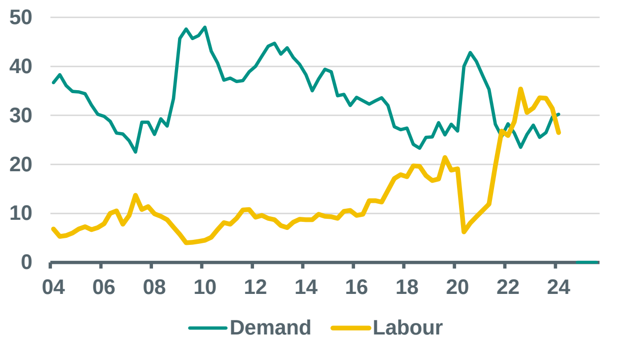
- **GDP was flat in 2023Q4, whereas a moderate contraction was expected**
- **The roughly 1.5 years of economic stagnation is leaving its mark on the labour market**
- **The ECB is expected to start cutting rates in June**

Eurozone GDP stagnated in 23Q4, which was slightly better than the consensus and our own expectation of a moderate contraction. That said, growth has been close to zero now during five consecutive quarters, and the expectation is for another stagnation in 24Q1. Subsequently, GDP should expand moderately during the rest of the year. Growth will be supported by rising real wages and easing financial conditions in anticipation of the first rate cuts by the main central banks. However, fiscal policy tightening and the still high level of interest rates will prevent a sharp rebound. The ongoing weakness in production and demand has already left its mark on the labour market, and we expect conditions to remain weak in the coming quarters. Indeed, the number of job vacancies declined significantly in the second half of 2023, and surveys gauging demand for labour have indicated sharp contraction in employment in industry. Also, when asked by the EC what factors were limiting the level of activity in the services sector, more participants to the survey mentioned lack of demand than lack of employees in 23Q4 (see graph below). The deterioration of labour market conditions that has resulted from the ongoing economic stagnation is expected to have a downward impact on wage growth this year (also see this month's *Global View*).

Disinflation has continued moving into 2024. Headline inflation declined to 2.8% in January, down from 2.9% in December and core inflation decreased to 3.3% from 3.4%. A major driver behind the decline in core inflation since its peak of 5.7% in March 2023, has been the waning impact of higher energy prices on the inflation rate of energy-intensive goods and services, which is well advanced but has somewhat further to go. Also, the weakness in the global industrial sector and the sharp contraction in eurozone industrial production during the past year, should further dampen non-energy industrial goods price inflation. Services inflation has been more sticky than goods inflation in recent months, but should decline during the rest of the year. Weak (services) consumption growth is limiting the room for companies to raise prices and labour market conditions are deteriorating, which will limit wage growth. All in all, we expect headline and core inflation to continue to decline in the coming months, approaching the ECB's 2% target around the middle of 2024.

Services: Weak demand worse than labour shortage

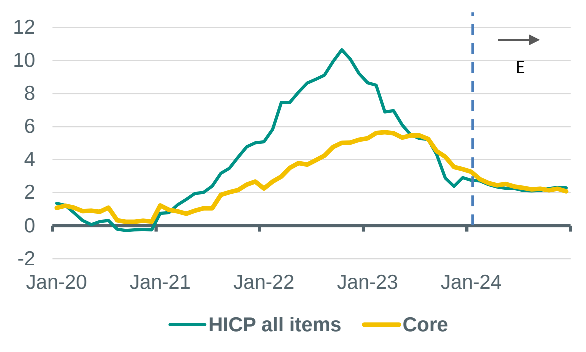
%, factors limiting the business in the services sector



Source: European Commission, ABN AMRO Group Economics

Core and headline inflation on downward trajectory

% yoy



Source: LSEG, ABN AMRO Group Economics

We expect the ECB to start cutting interest rates in June of this year. The view that the central bank is moving towards rate cuts, but not imminently, was also signalled by the policy statement and the account of the January meeting, which stated *"the current levels of the policy interest rates would make a substantial contribution to reaching the 2% inflation target if maintained for a sufficiently long duration"* and that *"further progress needed to be made in the disinflationary process before the Governing Council could be sufficiently confident that inflation was set to hit the ECB's target in a timely manner and in a sustainable way."* We think the deposit rate will eventually be reduced to 1.5% in the course of 2025.

The Netherlands: Domestic demand drives growth

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- **The Dutch economy expanded by 0.3% qoq in Q4, bringing an end to three consecutive quarters of contractions**
- **We raised our GDP growth forecasts to 0.7% in 2024 (was 0.5%) and 1.2% in 2025 (was 1.1%)**
- **Labour market tightness remains, but we expect the unemployment rate to marginally rise to 4.0% in 2024**
- **Inflation (HICP) continues trending downward and will likely average 2.8% this year, down from 4.1% in 2023**
- **Coalition talks have stalled, delaying the formation of a new government and adding to policy uncertainty**

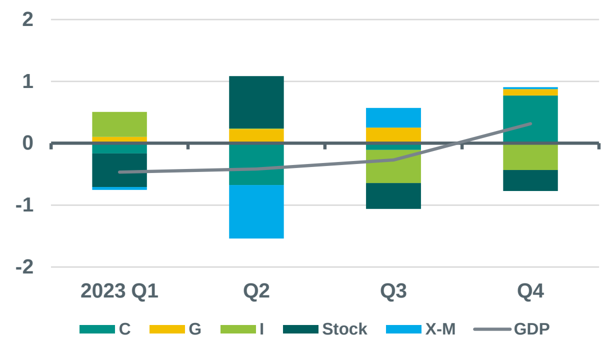
The Dutch economy expanded by 0.3% qoq in Q4, which brings the 2023 growth figure to 0.1% yoy, in line with our forecasts. After three consecutive quarters of negative qoq GDP growth (Q1: -0.5%, Q2:-0.4%, Q3: -0.3% qoq), the Dutch economy returned to growth in the final quarter of 2023. It outperformed the eurozone total, which remained stagnant in Q4, and main trading partner Germany which contracted by 0.3% qoq. The expansion was primarily driven by private consumption (+1.8% qoq). Declining inflation and high wage growth has lifted real incomes and raised purchasing power. The increase was however large by historical standards and thus risks being revised down. Government consumption also contributed positively to the GDP figure (+0.4% qoq). Despite the caretaker status of the government, fiscal policy has continued to support growth.

Looking at the other main components of GDP, external demand is showing signs of bottoming out after contracting in the first half of 2023. Since both exports and imports expanded by 0.3% qoq, the contribution of net exports was marginal. Additionally, as expected, investment continued to contract (-2.1%) on the back of restrictive financing conditions and weak growth prospects for the Netherlands and the eurozone.

Over the course of 2024, growth will stay positive but sluggish. The growth composition will be mixed. On the one hand, domestic demand will drive growth, supported by government and private consumption, as purchasing power recovers further. Indeed, the CPB recently raised its purchasing power forecasts for 2024, to 2.7% from 1.8%. On the other hand, external demand is expected to be muted and not contribute to growth until later on in the year when eurozone growth recovers and Germany has bottomed out. All in all, we expect growth to average 0.7% in 2024 (was 0.5%) and 1.2% in 2025 (was 1.1%), up from 0.1% in 2023.

Recovery mostly driven by consumption

% contribution to qoq GDP.



Source: CBS, ABN AMRO Group Economics

Hours worked per person declining

Index, 2019Q4 = 100.

Source: CBS, ABN AMRO Group Economics

The labour market remains tight and we see only modest signs of easing. For instance, the number of open vacancies per unemployed person held steady at 1.14 in Q4. Employment increased steadily over 2023 and rose to a net participation record of 73.4% of the population. At the margin we do see some signs of easing in labour market tightness. Jobs at temporary employment agencies are receding and people are working fewer hours. As bankruptcies are normalising from pandemic lows, labour mobility is also likely to increase going forward. Despite this, we do not expect a sharp rise in unemployment, as both private and public sector labour demand remains high going forward. The unemployment rate will increase to 4.0% in 2024 and 4.2% in 2025, up from 3.6% in 2023.

The caretaker status of the current government looks to have been extended as the first round of formation talks for a new government came to a halt. The New Social Contract (NSC) party pulled out after an intense seven weeks of negotiations (read more). Because of this, policy uncertainty remains high in the coming period, particularly in the areas of pension reforms, climate policy and other necessary reforms. The starting date for a new government remains elusive.

US: Stronger growth unlikely to derail Fed rate cuts

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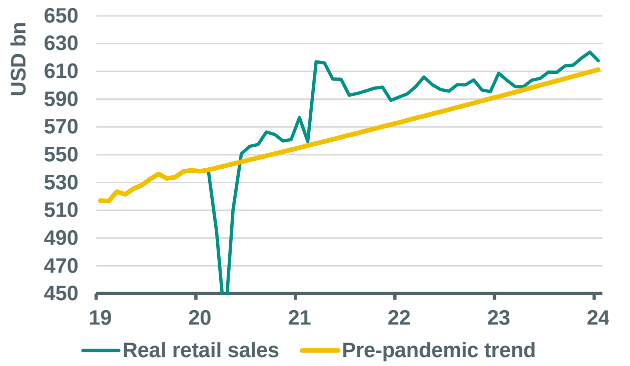
- **We have raised our 2024 growth forecast on the back of the more resilient labour market**
- **Still, we expect some slowdown in growth, given evidence of rising financial stress from high rates**
- **Despite stronger growth, we still expect inflation to fall sustainably back to 2% by mid-2024…**
- **…keeping the Fed on course to begin lowering rates at the June FOMC meeting**

In contrast to the strong labour market data for January released earlier in the month, January activity data covering the consumption and production side of the economy came in on the weak side. Nominal retail sales fell 0.8% m/m, following a downwardly-revised 0.4% rise in December. Industrial production fell -0.1% following a downwardly revised flat reading for December, likely impacted by poor weather conditions over the period. The weakness in retail sales followed a strong run in the data over the second half of last year, and in our view represents an overdue correction given that goods consumption remains above trend in the US. As such, the decline is consistent with our expectation for a slowing in activity in 2024, rather than being a cause for concern over the outlook. Indeed, despite the weak tone to the January retail sales data, we are actually raising our 2024 growth forecast by 0.3pp to 2.1%, and for 2025 we are lowering our forecast by 0.1pp to 1.9%, reflecting the higher base of 2024. We were already above consensus in our growth forecast for 2024, at 1.8% vs 1.6%, and this change takes us further above the consensus forecast.

The update is driven by two main factors. The first is backward-looking – though the economy is slowing significantly, activity (particularly consumption) held up better than expected in the last months of 2023, and this 'carry-over' effect by itself lifts our 2024 forecast. The second driver of the change is the strength in the labour market. While we do not take too much signal from the blockbuster January payrolls data, given that it is based on a relatively low survey response, the significant upward revisions to employment in Q4 2023 suggest a bottoming out in the jobs slowdown. Given this, we expect only a marginal rise in unemployment (to around 4% from the current 3.7%). While higher credit card delinquencies and a reduced savings buffer still point to some consumption slowdown, the slowdown is shallower than we previously forecast.

Retail sales see an overdue correction in January

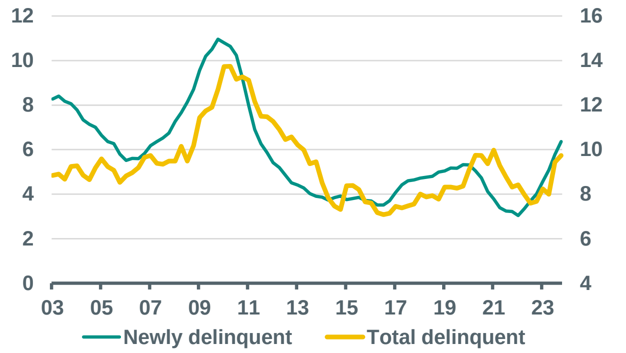
Real retail sales volumes, USD bn



January is our estimate. Source: LSEG, ABN AMRO Group Economics

Rising financial stress still likely to slow consumption

% share of credit card borrowers overdue with repayments by >45 days



Source: LSEG, ABN AMRO Group Economics

Despite this more resilient growth picture, we still expect the Fed to start cutting rates from June. As Chair Powell stated at the January FOMC press conference, 'we don't look at stronger growth as a problem'. This is because much of the strength in growth has been driven by a significant improvement in the supply side, particularly the labour market. Indeed, although unemployment has held at historically low levels, this masks a major easing in labour market tightness below the surface. Specifically, the job vacancy to unemployed ratio has fallen from a peak of 2.0 in July 2022, to 1.4 as of December – only a little above the pre-pandemic level of 1.2. This has been driven by both improved labour force participation *and* cooling labour demand. As we describe in this month's *Global View*, this has helped wage growth fall back to levels already close to what is necessary to meet the 2% inflation target sustainably. We expect PCE inflation to hit the Fed's 2% target on a sustainable basis already by April, giving the Fed ample reason to start lowering interest rates at the June FOMC meeting.

China: Year of the Dragon kicks off with some green shoots

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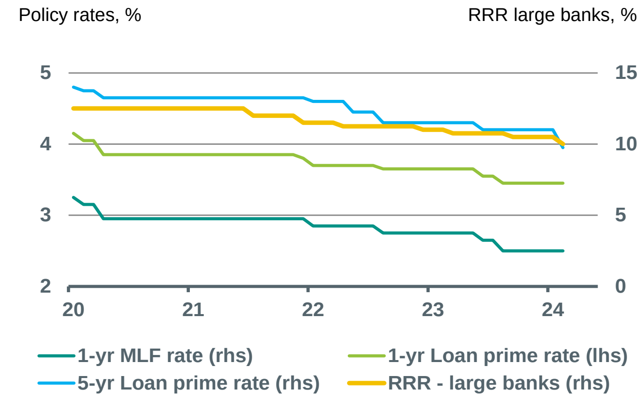
- **Deflationary pressures stronger, but Lunar New Year holiday data bring some green shoots**
- **PBoC continues with small policy rate cuts, while targeted lending drives balance sheet expansion**
- **Quarterly growth to pick up compared to Q4-2023; risks to our forecasts are balanced**

On 10 February, the Year of the Dragon kicked off, followed by the usual one-week public holiday. Due to the different timings of the LNY break each year, monthly activity data in Q1 can show distortions, and fewer monthly data are published. Recent data still paint the picture of an uneven recovery – with ongoing headwinds from property, and the supply side still stronger than the demand side – but there are some green shoots. Meanwhile, in line with our expectations, Beijing continues with measures to safeguard growth, stabilise real estate and restore confidence. We still think this will help qoq growth to pick up a bit compared to Q4-23, with risks to our forecasts balanced. Further policy guidance will be given at the annual NPC starting on 4 March, when the 2024 growth target will be set: a target of 'around 5%' is likely.

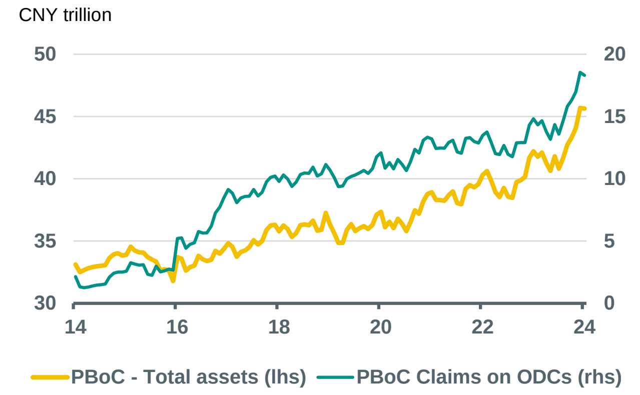
Deflationary pressures stronger in January; LNY holiday data bring some green shoots
January PMIs showed a modest improvement, with the official composite PMI rising to a four month high of 50.7, and Caixin's composite PMI stable around 52.5 (see our comment here). That said, the manufacturing components of both surveys show the supply side is still stronger than the demand side. This is also reflected in the latest inflation data. CPI inflation for January came in at -0.8% yoy, the weakest annual number since 2009. While this is strongly impacted by food prices, core CPI fell to a three-year low of 0.4% yoy, showing weak demand is also weighing on underlying inflation. We still expect deflationary pressures to ebb in the course of 2024, but have cut our average CPI forecast for 2024 further to 1.0% (from 1.5%). Turning to growth indicators, monthly lending volumes came in at record highs in January, reflecting seasonal effects and government support, but remained subdued in annual growth terms. By contrast, LNY holiday related data brought some green shoots – with e.g. tourism spending and trips up by 8% and 19% compared to pre-pandemic levels, although the 2024 break was one day longer, and spending per trip was 9.5% lower than in 2019 (also see global theme).

PBoC continues with mini cuts in policy rates and RRRs



Source: Bloomberg, ABN AMRO Group Economics

Targeted lending contributes to PBoC balance sheet



Source: Bloomberg, ABN AMRO Group Economics

PBoC continues with piecemeal rate cuts; targeted lending facilities contribute to PBoC balance sheet expansion
In line with our expectations, Beijing continues with piecemeal monetary easing and targeted support, in an attempt to safeguard growth and break the negative feedback loop in the property sector. Following the 50bp cut in bank RRRs announced in January, in mid-February the 5-year loan prime rate (a benchmark in mortgage lending) was cut by a record 25bp, to 3.95%, while other policy rates were left unchanged. We expect further mini policy rate cuts throughout 2024. What is more, as we flagged in earlier publications, the PBoC continues with a quasi-fiscal, targeted lending tool (the Pledged Supplementary Lending facility) – which totals around CNY 500 bn so far. The PSL enables certain policy banks to provide low-cost funding to the so-called 'three major projects' (urban village renovation, affordable housing, emergency infrastructure). This sort of 'China-style QE' is also visible in the PBoC's balance sheet, with claims on ODCs (other depository corporations) rising at the fastest pace since 2016 (see chart). Meanwhile, Beijing's latest attempts to stabilise the stock market – including amongst other things a sharp tightening of (short) selling restrictions –seem to have contributed to the CSI-300 index regaining around 10% over the past weeks, following a decline of 45% in the preceding three years.

Key views on a page

The global economy is likely to grow at a subdued pace in the near term, as high rates continue to bear down on demand in advanced economies, while China continues to face both cyclical and structural headwinds. Global trade and industry looks to be bottoming out, but a sharp rebound is unlikely while rates remain restrictive. On the positive side, inflation has fallen significantly and is now within touching distance of central bank targets. The Red Sea disturbances are unlikely to meaningfully impact inflation, but a major escalation in the Middle East could change matters. Further falls in inflation will enable central banks to pivot to rate cuts by mid-2024, and financial conditions are already easing in anticipation of this. Still, monetary policy will remain relatively tight for some time yet, and this will keep a lid on the recovery.

Macro	Central Banks & Markets
Eurozone – GDP stagnated in 23Q4. Growth has been close to zero now during five consecutive quarters, and the expectation is for another stagnation in 24Q1. GDP should expand moderately during the rest of the year, among other things because fiscal policy will be tightened. Labour market conditions have deteriorated, which will limit wage growth going forward and reduce underlying inflationary pressures. Headline and core inflation have remained on a downward trajectory moving into 2024. We expect headline and core inflation to be close to the ECB's 2% target around the middle of this year.	**ECB** – The ECB kept policy rates unchanged in January. Although it struck a more optimistic tone on inflation, we still expect the rate cut cycle to begin in June. Indeed, the account of the January meeting mentions that 'it was affirmed that further progress needed to be made in the disinflationary process before the Governing Council could be sufficiently confident that inflation was set to hit the ECB's target in a timely manner and in a sustainable way'. Therefore we still expect a first cut in June. We think the deposit rate will eventually be reduced to 1.5% in the course of 2025.
The Netherlands – The Dutch economy expanded by 0.3% qoq in Q4, bringing an end to three consecutive quarters of contractions. We raised our GDP forecasts to 0.7% in 2024 (was 0.5%) and 1.2% in 2025 (was 1.1%). Labour market tightness remains, but the unemployment rate will marginally rise to 4.0% in 2024. Inflation (HICP) continues trending downward to average 2.8% this year, down from 4.1% in 2023. Formation talks recently stalling, which delays the forming of a new government and adds to policy uncertainty.	**Fed** – The FOMC has kept rates on hold since its last rate hike in July. We expect the Fed to start cutting rates from June, with the risk somewhat tilted to earlier cuts. Even with rate cuts starting next year, monetary policy is expected to remain restrictive throughout 2024 and even into 2025. We expect the upper bound of the fed funds rate to reach 4.25% by end-2024, and 3% by mid-2025. The Fed also looks set to wind down its quantitative tightening somewhat sooner than previously expected, though this will be well telegraphed and gradual.
UK – Disinflation has continued, providing some relief to the Bank of England, but upside inflation risks remain significant given that wage growth is still elevated and well above levels consistent with the 2% target. At the same time, unemployment has started rising, and we expect a softening in demand to dampen wage growth over time. The economy is expected to broadly stagnate over the coming year or so, weighed by tight monetary policy.	**Bank of England** – The MPC kept policy on hold at the September and November meetings. We now think Bank Rate has peaked at 5.25%. However, we would not rule out one last rate hike if inflation springs another upside surprise. The BoE is in full data-dependent mode, and UK macro data has been erratic over the past year. We do not expect rate cuts until next August, and there is a risk that rate cuts get delayed even further, if inflation proves to be more persistent.
US – Growth slowed in Q4 following an exceptionally strong Q3, but remained well above trend. The recent strength in inventory build makes the economy vulnerable to a sharp slowdown in coming quarters. We also expect a slowdown in consumption given the cooling labour market and a reduced tailwind from excess savings. We expect weak growth in the next few quarters, before easing financial conditions set the stage for a recovery later in 2024. Wage growth has peaked, and inflation is moving in line with expectations back to the 2% target. A recovery next year hinges on a timely pivot to rate cuts by the Fed in response to falling inflation.	**Bond yields –** Following recent macroeconomic data releases (particularly in the US) and central bank officials' speeches, the financial market started to retrieve gradually from its extensive policy rate cuts for 2024. The market priced out as much as 60bp of cuts for the ECB and about 75bp for the Fed by the end of this year. Indeed, the market has now delayed its first rate cut to June, which is in line with our rates forecast. Indeed, as we expected, the pricing out of extensive rate cuts occurred which means that we expect bond yields to soon start their way down again. We expect the declining trend to be the steepest as we approach the month of June and to keep this trend for the rest of the year across all maturities.
China – Recent data still paint the picture of an uneven recovery – with ongoing headwinds from property, and with the supply side still stronger than the demand side. CPI inflation turned deeper into the red in January, but LNY holiday data showed some green shoots. In line with our expectations, Beijing continues with piecemeal easing and targeted support. The PBoC cut banks' RRR and the 5-yr LPR this month; we expect more mini rate cuts to follow. Meanwhile, the expansion of the PBoC's balance sheet is partly a result of the use of a targeted lending facility.	**FX** – For this year we expect expectations for Fed/ECB policy to continue to drive the direction in EUR/USD. The market expects both the Fed and the ECB to start its easing cycle in April/May and rates to be reduced to 4% for the Fed and 2.5% for the ECB by the end of 2024. We expect the easing cycles to start later, in June, and the Fed to arrive at 4.25% and the ECB at 2.75% at the end of the year. So, both for the Fed and the ECB we are somewhat less dovish than the market and the difference with the market is roughly the same. Therefore we expect EUR/USD to stay around 1.10 for the time being.

Main economic & financial market forecasts

	GDP				Inflation				Policy rate			
	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025
Eurozone	3.4	0.5	0.4	1.6	8.4	5.5	2.3	2.1	2.00	4.00	2.75	1.50
Netherlands	4.4	0.1	0.7	1.2	11.6	4.1	2.8	2.4				
UK	4.3	0.1	0.1	1.1	9.1	7.4	2.4	2.9	3.50	5.25	4.75	3.50
US	1.9	2.5	2.1	1.9	6.5	3.7	2.0	1.8	4.50	5.50	4.25	3.00
China	3.0	5.2	4.7	4.6	1.9	0.2	1.0	1.8	3.65	3.45	3.25	3.25

	2023	23/02/2024	Q1 24	2024	2025	Energy	2023	23/02/2024	Q1 24	2024	2025
US Treasury	3.88	4.26	4.05	3.60	3.55						
German Bund	2.02	2.36	2.30	1.90	2.10	Brent - USD/bbl*	77.04	81.62	80	90	80-85
EUR/USD	1.05	1.08	1.10	1.10	1.10	WTI - USD/bbl*	71.65	76.49	75	85	75-80
USD/CNY	7.10	7.20	7.20	7.00	6.80	TTF Gas - EUR/MWh*	35.25	27.35	25	35	35-40
GBP/USD	1.23	1.27	1.27	1.3	1.30						

* Brent, WTI: active month contract; TTF: next calender year

	2023				2024				2025			
GDP (qoq)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	0.1	0.1	-0.1	-0.2	0.1	0.2	0.2	0.4	0.4	0.5	0.6	0.5
Netherlands	-0.5	-0.4	-0.3	0.3	0.0	0.4	0.5	0.5	0.2	0.2	0.1	0.4
US (saar)	2.2	2.1	4.9	3.3	1.5	1.0	1.5	1.5	2.0	2.0	2.5	2.5
UK	0.2	0.0	-0.1	-0.3	0.2	0.1	0.2	0.3	0.3	0.3	0.3	0.4
China (yoy)	4.5	6.3	4.9	5.2	4.4	5.0	4.7	4.8	4.7	4.6	4.5	4.5
Inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	8.0	6.2	4.9	2.7	2.6	2.1	2.0	2.3	2.1	2.1	2.1	2.2
Netherlands	7.3	6.3	2.8	1.0	3.4	3.3	3.2	2.9	2.8	2.7	2.7	2.4
US (PCE)	5.0	3.9	3.3	2.7	2.2	2.0	1.8	2.1	1.9	1.8	1.8	1.7
UK	10.2	8.4	6.7	4.2	3.7	1.6	1.9	2.4	2.7	3.3	3.0	2.8
China	1.3	0.1	-0.1	-0.3	-0.4	0.6	1.5	2.2	2.1	1.9	1.7	1.6
Unemployment	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	6.6	6.5	6.5	6.5	6.7	7.0	7.2	7.3	7.3	7.1	6.9	6.9
Netherlands	3.5	3.5	3.6	3.7	4.0	4.2	4.2	4.1	4.0	4.0	4.0	4.0
US	3.5	3.6	3.7	3.8	3.8	4.0	4.1	4.0	3.9	3.8	3.7	3.6
Policy rate	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	3.00	3.50	4.00	4.00	4.00	3.75	3.25	2.75				1.50
US	5.00	5.25	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	3.00	3.00
UK	4.25	5.00	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50
China	3.65	3.55	3.45	3.45	3.35	3.35	3.30	3.25	3.25	3.25	3.25	3.25

Source: LSEG, Bloomberg, ABN AMRO Group Economics

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