ABN·AMRO

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Global Monthly

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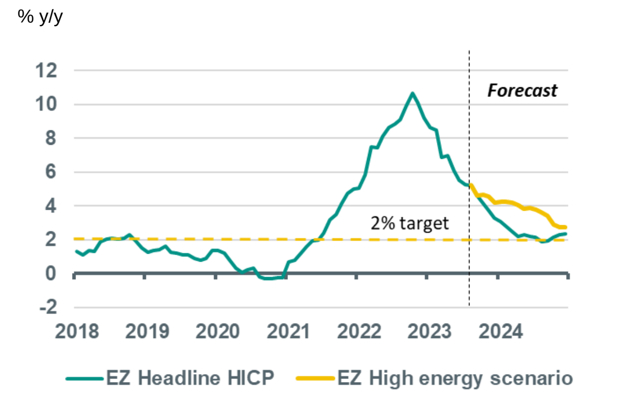
The inflation comeback?

- **Rising oil prices and a bottoming out in good prices are expected to drive a rebound in inflation in the US over the coming months, and to slow the path back to 2% in the eurozone**
- **While this apparent setback warrants vigilance, we think the turnaround in labour markets and the slowdown in wage growth is likely to keep the broad disinflation trend in tact**
- **We continue to expect inflation in the US and eurozone to be back near 2% by the end of 2024**
- **Also this month: We update our recession heatmap to reflect the latest macro developments**
- **Regional updates: We think interest rates have peaked in the *eurozone*, while in *the Netherlands,* the 'prinsjesdag' consumption boost is not enough for us to raise our growth forecast**
- **In the *US*, growth looks set for a sharp slowdown in Q4, even without a government shutdown**
- ***China's* economy is stabilising, but policy support for property is yet to have a convincing impact**

Global View: Inflation is poised for a rebound, but softening labour markets will prove more important

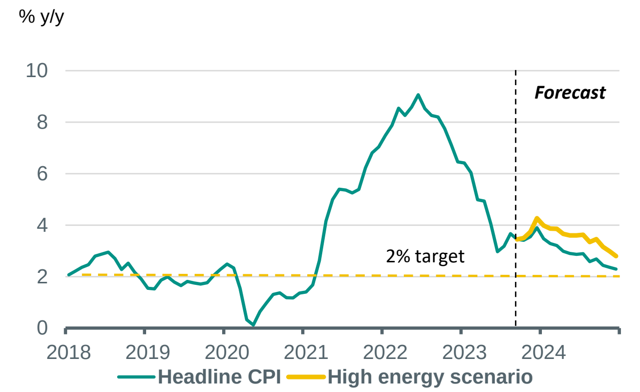
The inflation genie – which looked like it might be put back in the bottle after all – now seems poised to spring one last fright on financial markets over the coming months. The recent rally in oil prices, combined with a bottoming out in a number of other key disinflationary trends, is expected to drive a near-term rebound in inflation in the US, and a slowing in the decline in eurozone inflation compared to recent months. Does this mean we are going to be stuck with persistently above target inflation? Will central banks have to do even more to get rid of it? In this month's *Global View*, we explore the drivers of the unfolding inflation comeback, and we also lay out a more negative alternative scenario to see how bad it could get. Our conclusion is that any rebound in inflation is likely to be much more shallow than the 2021-22 inflation surge – more *dead-cat-bounce* rather than *back-to-square-one*. Core to this view is the clear turnaround in labour markets we have seen over the past year. The exceptional tightness in labour markets of the post-pandemic period is now rapidly easing, and unemployment is already rising in some countries. This weakening in worker bargaining power is likely to limit second round effects on wage growth, meaning that any inflation rebound is unlikely to last very long.

EZ: Rising oil prices could slow the disinflation trend



Source: Refinitiv, ABN AMRO Group Economics

US: Inflation rebound is likely to be short-lived



Source: Refinitiv, ABN AMRO Group Economics

What is going on with oil prices, and how does this impact the inflation outlook?

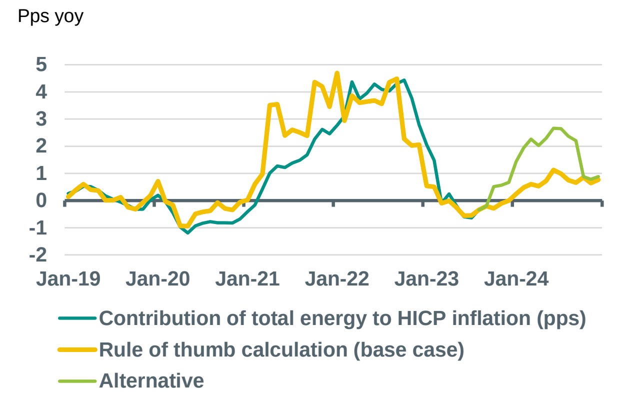
Oil prices have rallied over the past few weeks, driven by a number of factors. In particular, the announcement by Saudi Arabia and Russia pledging to extend voluntary reductions in output until the end of 2023 have put upward pressure on prices, with WTI crude hitting 90 USD, a 10 month high. The Saudi/Russian supply cuts helped offset increases in production in Iran on the back of a relaxation in the enforcement of some US sanctions, and Nigerian output rose following the restart of its Forcados terminal. Brent has already reached $95 per barrel, but we think that the price will average $90 for Q4 of 2023, driven by the expected slowdown in the US economy and the normalization of China demand which has already taken place (post-reopening). For 2024, we expect the price to average 95 as resurgent Chinese consumption, along with record low global inventories and the aforementioned supply shortfalls are expected to tighten the market further.

Higher oil prices feed rapidly through to petrol pump prices in both the eurozone and the US, and for this reason we have upgraded our near-term inflation forecasts, as described below. However, the medium-term impact is more uncertain and depends on other factors. On the one hand, higher oil prices could raise consumer inflation expectations, which as we saw during the energy crisis in Europe, could cause wage earners to demand 'inflation correcting' pay rises. But with labour markets now softening and with the direct impact of the oil price rise set to be much smaller than the surge in natural gas prices last year, we think there will be less scope this time around for second round effects on wage growth. If anything, by raising the cost of essentials and eating into disposable income, higher petrol prices could curb spending in other areas, leading to more disinflationary pressure in other inflation categories such as in discretionary goods and services.

Eurozone: Headline inflation to take somewhat longer to fall back to target

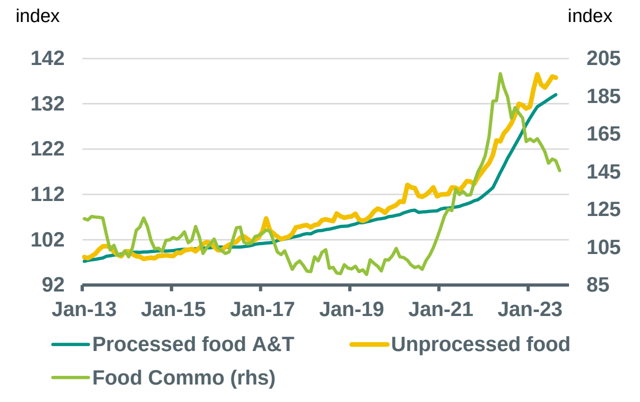
We have upgraded our forecasts for eurozone headline inflation for the rest of this year and the first months of 2024, but have kept our outlook for core inflation roughly unchanged. The upgrade to our year-end forecast for Brent crude means there will now be less of a negative contribution from overall energy inflation (of which a large part is natural gas prices). Assuming year-ahead TTF gas prices of EUR 55-60 per MWh over the coming year, and Brent at USD 90-95 per barrel, the contribution of energy to total HICP inflation is now forecast to be close to zero for the rest of the year (our previous forecast assumed a -0.5pp contribution on average). This contribution is likely to turn positive again in the first months of 2024, gradually rising to around a 0.6-0.7pp contribution in the second half of next year. In a more negative scenario, where oil and gas prices were significantly higher (TTF at EUR 110 per MWh in 2023, EUR 150 in 2024, and Brent at USD 110 per barrel in 2023-24), the energy contribution would rise to around 2.5pp by the middle of 2024. Even this more negative scenario would still see headline inflation overall continuing to decline, however.

EZ energy price inflation



Source: Bloomberg, ABN AMRO Group Economics

EZ HICP food price index and food commodity prices



Source: Refinitiv, ABN AMRO Group Economics

Another key driver of our forecast upgrade is food inflation (see also Box 1). Previously, we expected food price inflation to become negative in the final quarter of this year and to remain negative in the first half of 2024. While we still expect food price inflation to decline markedly, we now expect it to stay slightly positive. Recent extreme weather as well as geopolitical factors (such as uncertainty surrounding the Ukrainian grain deal) are expected to keep food prices relatively elevated. Although some food commodity prices have fallen in recent months, we think the high degree of uncertainty over future food commodity prices will likely make producers reluctant to pass on these declines for fear of getting caught out by any renewed spikes in prices. Indeed, the drop in the food commodity price index since the spring of 2022 (by around 25%) has so far not resulted in any monthly declines in the seasonally adjusted HICP food price index. Taking both food and energy together, we have raised our headline inflation forecasts by 0.5pp for 2023 to 5.7%, and by 0.1pp for 2024 to 2.3%.

Box 1: El Niño in the winter of 23/24 is almost certain but it's impact on food prices is not (Jan-Paul van de Kerke)

El Niño, a century old three to five year climate cycle, is almost certainly going to occur in the winter of 23/24 according to the current models of the Climate Prediction Center. Warmer, unusual and more volatile weather triggered by El Niño has implications for agriculture, commodity and food prices just as food inflation is receding from previous peaks.

During an El Niño, sea surface temperatures in the Pacific (particularly between Australia and South America) rise, which influences weather patterns and increases temperatures globally. El Niño peaks in December, with its impact on weather patterns lasting half a year around the peak (23Q4 and 24Q1). The impact varies for different regions. Droughts are more likely in the Tropics, Southeast Asia and Australia and more rain is expected in the Southern US states, Brazil as well as in China. Europe, due to its location, is less affected by El Niño. Therefore, its impact on Europe is much smaller than in other regions: more rain in Spain and Portugal and also more rain in spring in North-West Europe.

As the impact of El Niño on regions varies, its expected impact on food production and prices differs as well. Still, in principle the impact could be large as some of the largest food producing countries such as Brazil, China and the US are directly affected. Primarily prices of crops produced in affected regions are most at risk. That means that the direct impact in Europe although uncertain is limited. Europe is affected indirectly via exposure to world food markets and imports. All in all, El Niño happening is almost certain, its potential impact on food prices is not..

Despite the slower pace of disinflation we now expect in headline inflation, our forecast for core inflation – a much more important driver of the interest rate outlook – is essentially unchanged. We still expect core inflation to move gradually lower over the coming year, and to be close to 2% by mid-2024, for two reasons. First is the ongoing economic weakness. We expect eurozone GDP to contract moderately or be close to stagnant for the next few quarters, which should also result in a rise in unemployment and lower wage growth. The services sector, which grew robustly in the first half of this year and has trailed the contraction in industry, is now clearly slowing. This should limit wage growth in the sector, and strengthens our conviction that services inflation will slow. Next, both goods and services inflation should decline further as the impact of last year's energy crisis continues to peter out, and weak demand will prevent companies from passing on the renewed rise in energy costs to consumers. Taken together, our forecast for core inflation remains at 5.0% in 2023 and 2.2% in 2024.

US: Headline inflation to rebound temporarily, but underlying disinflation to continue

Higher oil prices have also led us to upgrade our US inflation forecasts, by 0.1pp to 4.2% in 2023, and by 0.2pp to 2.8% in 2024. Unlike in the eurozone, we expect the jump in oil prices to trigger an outright rise in inflation over the coming months – not merely a slowing in the disinflation process. This is because headline inflation had already fallen to relatively low levels in the US in recent months, with a recent trough of 3% in June. Inflation has since picked up to 3.7% in August, and we expect a further pickup to 3.9% by December. Aside from a higher contribution from energy, we also expect the disinflation in core goods to ease in the coming months, with for instance the declines in wholesale used car prices having come to an end. We also expect the negative drag from medical services inflation of the past year – which was driven by a statistical quirk related to the pandemic and the way this category is calculated – to normalise, meaning medical services will once again contribute positively to inflation. It is important here to note that, for the Fed's preferred inflation measure – PCE inflation – medical services is calculated in a different manner to the CPI, and so has not been subject to this same distortion. As a result, the pickup in PCE inflation is expected to be more moderate than that in the CPI, with a peak of 3.5% expected by December, vs 3.9% for the CPI measure.

The bounce in headline inflation is likely to prove short-lived, however. After peaking in December, we expect inflation to resume its downtrend, as the expected stabilisation in oil prices coincides with further disinflationary dynamics in services inflation. The biggest driver of this is likely to come from housing rents, or shelter as it is referred to in the CPI. Shelter has a very large weight in the US CPI at around 1/3 of the total basket (the equivalent for the eurozone is just 6% of the HICP basket). With the jump in housing rents during the pandemic, shelter has been one of the more durable drivers of the post-pandemic inflation wave. Due to the way this component is calculated, the response to actual changes in rents for new leases is with a very long lag. As such, there is significant disinflation from the past year still to come through to the CPI and PCE data, even though recent new lease rents are starting to pick up again. We expect this disinflation to continue as we move into 2024, which should help overall inflation to continue to trend lower. All told, we expect CPI inflation to fall back to 2.3% by December 2024, and PCE inflation to fall back to 2.1% – essentially returning to the Fed's 2% target.

What could a more negative scenario for inflation look like? Assuming a further pickup in oil prices, such that WTI crude averages $105 per barrel in 2024, and less pronounced disinflation in housing rents (for instance if the recent pickup in new lease rents is sustained), this could see inflation peaking higher at 4.3% in December, with a return to the Fed's 2% target not taking place before 2025. As with the eurozone, even this more negative scenario would still see the disinflation trend broadly continuing, just at a slower pace than in our base case.

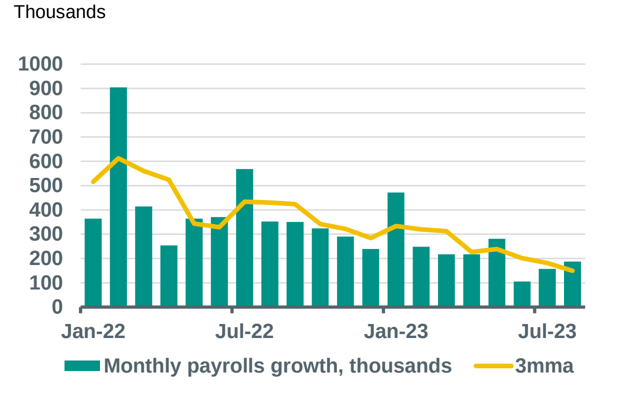
Softening labour markets are ultimately key to inflation falling back to 2%

Central banks typically 'look through' inflation upturns driven by oil (and other commodity) prices, and for good reason: most of the time, these episodes are short-lived and do not lead to sustained rises in inflation. The recent past is likely to make central banks tread more carefully this time around, given the risk that above-target inflation becomes more persistent. With that said, we think central banks are likely to draw greater comfort from the recent softening in labour markets. The reason the post-pandemic inflation wave proved to be more persistent than expected was that it came against a backdrop of very tight labour markets, which gave workers the confidence to bargain for pay rises that corrected for the inflation surge. These pay rises then fed through to services inflation, which is now the dominant driver of above-target inflation in most advanced economies.

US job vacancies have fallen by more than 3 million…

Source: Refinitiv, ABN AMRO Group Economics

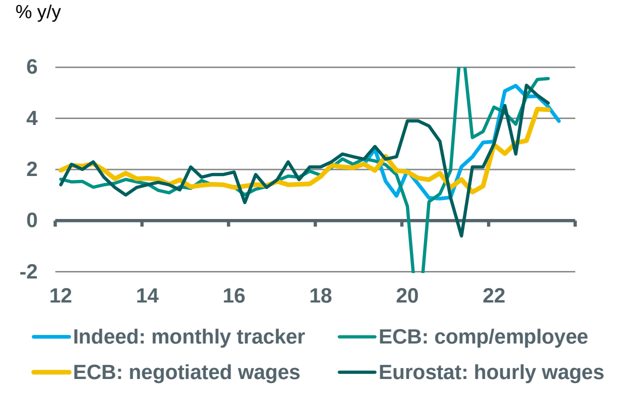
…while monthly jobs growth has slowed significantly



Source: Refinitiv, ABN AMRO Group Economics

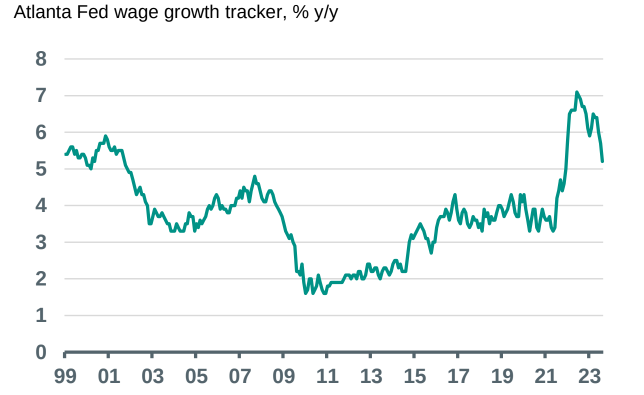
However, this backdrop is now quickly changing. Economic growth has slowed sharply in the eurozone (see Box 2), and in some countries – notably Germany – this is already driving a rise in the unemployment rate. In response, wage growth looks to have peaked, and it cooled sharply in Q2. In the US, although economic growth has been more resilient, there has been a turnaround in the labour market, with job vacancies plummeting over the past year, jobs growth slowing sharply, and wage growth that is now running very near the pre-pandemic pace. We judge that these softening labour market dynamics will have a bigger influence over the medium term inflation outlook than the rise in oil prices. While the inflation comeback certainly warrants vigilance, it is unlikely to alter the broad disinflationary trend. (Bill Diviney, Aline Schuiling, Moutaz Altaghlibi, Jan-Paul van de Kerke, Aggie van Huisseling)

EZ wage growth has peaked



Source: Refinitiv, ABN AMRO Group Economics

US wage growth is back near the pre-pandemic pace



Source: Bloomberg, ABN AMRO Group Economics

Recession Watch: Updated heatmap consistent with continued economic weakness in the eurozone, and a looming US slowdown

Part of our expectation for a further softening in labour markets – and in turn reduced inflationary pressure – hinges on a continuation of the economic weakness we have seen in the eurozone this year, and on growth slowing sharply in the US. In our May Global Monthly, we took stock of the mixed signals economies were sending at the time by constructing a recession heatmap. Since then, we dropped our expectation for a US recession, and part of the reason for this is that we started to see parts of the economy starting to recover (such as housing), before the expected slowdown in other sectors (such as in services). This dynamic has come to be called a 'rolling recession' – the idea that different sectors are going into recession at different points in time, but that these sectoral downturns are not sufficiently synchronised for the entire economy to be in a recession. This is evident in our updated recession heatmap below. While the eurozone is clearly flashing red in many categories, in the US, some categories have shown signs of recovery (housing and business investment). In the case of credit conditions, the recession signal turned out to be not as strong as first thought. Overall, the updated heatmap is consistent with our expectation for continued economic weakness in the eurozone, and a sharp slowdown in the US.

	Credit conditions	Business confidence	Corporate profits	Bankruptcies	Housing	Commercial real estate	Manufacturing / Trade	Services	Retail sales	Investment	Consumer sentiment	Labour market	Fiscal stance
US	→	↗	→	↘	↗	↘	→	→	→	↗	→	↘	↘
Eurozone	↘	↘	↘	↘	→	↘	↘	→	→	→	↘	→	↘
Netherlands	↘	↘	↘	↘	→	↘	↘	→	↘	↘	→	↘	↘
China	→	↘	→	↘	↘	→	↗	↘	→	→	↘	→	↗

= Consistent with expansion = Mixed signals = Consistent with recession

↗ = Improving trend → = Stable trend ↘ = worsening trend

In this box we review the changes compared to our last Recession Watch, which was published last May.

Credit conditions: Similar to our observations in the May monthly, both lending standards and loan demand are pointing to declines in credit flows in the eurozone. The Fed's quarterly Senior Loan Officer Opinion Survey also showed a further tightening in lending standards, but banks' assessment of the *level* of lending standards turned out to be not particularly tight, historically speaking (see also here).

Business confidence: Germany's manufacturing PMI and Ifo business climate in manufacturing remained deep in contraction territory in August and September. For the US, NFIB small business and conference board CEO survey for the US are still weak but less gloomy than at the time of our May monthly.

Corporate profits: Following the post-pandemic surge, profits in the US and eurozone continue to fall year-over-year.

Bankruptcies: For both the eurozone and the US, there is still a relatively low level of bankruptcies. We see this as an after effect of the massive support that governments provided to businesses during the pandemic. Bankruptcies are now on the rise from historically extremely low levels, but are normalizing rather than soaring.

Housing: Housing investment in the US remains weak, after contracting for eight consecutive quarters, but house price prices are creeping higher again. In the eurozone, housing investment is also affected by higher interest rates and house prices are still on the decline. Germany's Ifo sub-index for construction is at its lowest level since early 2009.

Commercial real estate: As an interest rate sensitive sector, commercial real estate has experienced sharper price declines and tight lending standards. The post-pandemic shift to work-from-home is also weighing on office demand.

Manufacturing / Trade: World trade volumes have been on a downward trend since September 2022, and the global manufacturing PMI has persistently pointed to contracting output. Manufacturing has been exceptionally weak in the eurozone, but is still holding up somewhat in the US. The UAW strikes are a near-term headwind in the US. We do expect a bottoming out in global manufacturing, but we do not foresee a strong recovery until sufficiently low inflation enables central banks to cut rates back to neutral levels – likely in 2025.

Services: Eurozone growth has benefited from the post-pandemic recovery in services, but we think the unprecedented sharp interest rate rises by the ECB will continue to feed through to the economy and dampen services output. In the US, activity has continued to expand.

Retail sales: In the eurozone, goods consumption remained stagnant moving into the third quarter. In the US, retail sales have remained solid, and this has been a key driver of economic resilience in 2023. A rising savings rate and slower jobs growth are likely to weigh on retail sales going forward.

Investment: Given the weakness in global trade and manufacturing as well as the higher financing costs due to Fed rate hikes, the rebound in fixed business investment in the US has come as a surprise. While the Inflation Reduction Act is likely providing some stimulus to investment, we expect tighter credit conditions to become a bigger drag on investment in the coming quarters. In the eurozone we see a clear slowing in fixed business investment following the post-pandemic rebound.

Consumer sentiment: Consumer confidence readings have been weak. The details of the EC consumer sentiment report indicates that confidence in the labour market has deteriorated in recent months. Weakness in US consumer confidence is largely due to high inflation, and the link between confidence indicators and consumption has been very weak in the post-pandemic period.

Labour market: Labour market tightness is easing in both the eurozone and the US. In the US, this is consistent with 'soft landing' expectations, as we have seen a sharp fall in vacancies with little rise in the unemployment rate so far. We expect a modest rise in unemployment going forward. In the eurozone, surveys signal a decline in employment in industry and sharp slowdown in labour demand in services and construction. We expect employment growth to stagnate or turn slightly negative.

Fiscal stance: Government spending is still strong. In the eurozone, although the fall in energy prices has rendered some energy crisis-related support measures obsolete, and others are being gradually phased out, EU recovery funds will likely prevent the fiscal stance from becoming too contractionary. In the US, the IRA is providing some stimulus to investment, but its direct impact is small as the funding is being disbursed on a multi-year horizon. The restart of student loan repayments is likely to weigh on consumption from Q4 onwards.

Eurozone: ECB probably has done enough

Aline Schuiling – Senior Economist | aline.schuiling@nl.abnamro.com

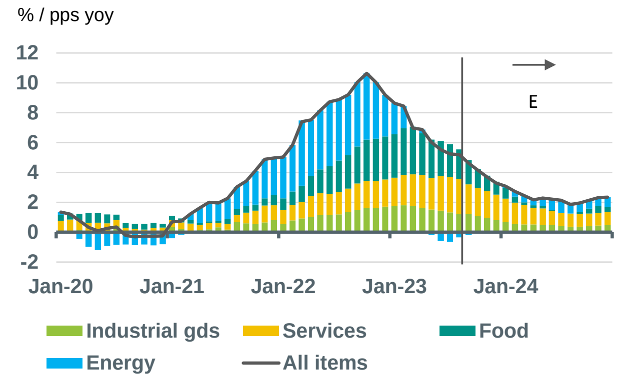
- **GDP essentially stagnated through 2022Q4-2023Q2, and weakness is expected to continue**
- **Headline inflation came in above our expectations in recent months, largely because energy and food price inflation turned out higher. We have raised our forecasts for headline inflation**
- **The ECB raised policy rates in September, whereas we had expected no change. We continue to expect rate cuts to start in March 2024**

Eurozone 2023Q2 GDP was revised lower to 0.1% qoq, down from the first estimate of 0.3% qoq. This means that GDP was roughly stagnant during 2022Q4-2023Q2. During these three quarters, private consumption contracted (-0.7% in total), government consumption was broadly unchanged and fixed investment grew moderately (0.4%). A large positive contribution from net exports (0.8 pps, mainly thanks to a drop in imports), prevented GDP from contracting during this period. Looking ahead, we expect the weakness in the eurozone economy to continue for the time being, with GDP probably contracting moderately or remaining close to stagnant during H2 2023-H1 2024. Data and surveys published in recent weeks have supported this view. The September PMIs remained in contraction territory (i.e. below 50). Although the Services PMI increased somewhat and came in higher than expected (at 48.4), its forward looking expectations component dropped lower, signalling declines in the headline PMI in the coming months.

Meanwhile, we have seen early signs of the labour market turning. Employment growth in persons has slowed down from 0.5% qoq in Q1 to 0.2% in Q2 and employment growth in hours worked from 0.9% to 0.2%. Surveys, such as the PMI and the EC's Economic Sentiment reports have signalled a decline in employment in industry and a slowdown in job growth in services. Based on the changes in economic activity in recent quarters, we expect employment growth to also stagnate or turn slightly negative in the next few quarters, implying that the unemployment rate will start moving higher.

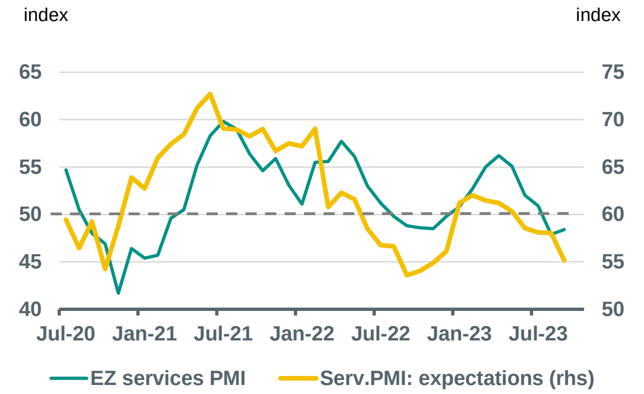
As described in this month's Global View, we have revised our forecasts for headline inflation higher, mainly due to higher energy and food inflation. Nevertheless, we expect disinflation to continue for the rest of this year. Base effects will continue to reduce food inflation. Meanwhile, core inflation should also ease, as demand for goods and services is expected to weaken and wage growth is expected to slow, which will also reduce inflation in labour intensive services.

Inflation and contribution from main components



Source: Revinitiv, ABN AMRO Group Economics

Further slowdown in services activity on the cards



Source: Refinitiv, ABN AMRO Group Economics

The ECB raised the deposit rate by 25bp in September (to 4.0%), which was against our expectation for no change. Although the central bank will remain data dependent going forward, it did hint that based on the existing outlook, it may have done enough and that the rate hike cycle may be over now. The ECB lowered its forecasts for GDP growth in 2023 and 2024 significantly, but still seems too optimistic on growth. We continue to expect macro outcomes (both growth and inflation) to come in below ECB expectations. Our base line is that the peak in the deposit rate has now been reached. We still expect a rate cut cycle to begin in March 2024. We now see the deposit rate at 2.25% by the end of 2024 (was 2.0%).

The Netherlands: Redistributive policies to support consumption next year

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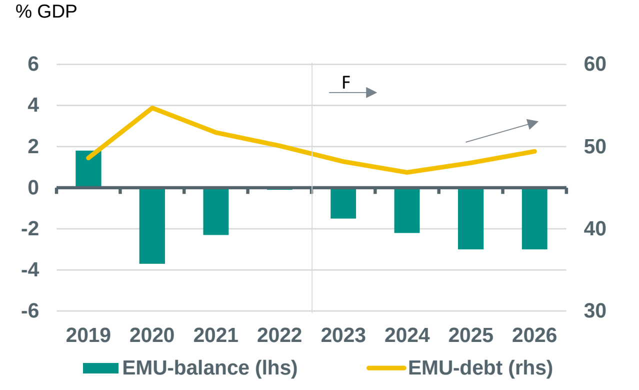
- **The caretaker government presented a policy light budget with a focus on fighting poverty**
- **The budget led to a slight upgrade to our private consumption forecast for 2024…**
- **…but we keep our GDP growth forecast at 0.5% in 2023 and 1.1% in 2024**
- **Inflation is declining but underlying pressures remain firm. Inflation to average 4.8% in 2023 and 3.5% in 2024**

At the annual 'Prinsjesdag' last Tuesday, the Dutch government presented its 2024 budget. Because of the caretaker status of the government – the Rutte IV coalition fell in July – the budget was light on policy substance. A small package of measures to prevent low-income households dropping below the poverty line were announced, involving extra spending of EUR 2bn (0.2% of GDP). This package is partly financed by raising taxation on higher incomes and raising levies on alcohol and tobacco. During the budgetary debates, larger packages were announced to sway voters running up to the November 22nd snap elections. Additional measures amounting to EUR 4bn (0.4% of GDP) found broad support, such as a minimum wage rise, postponing a scheduled petrol-levy increase by one year, and other smaller redistributive policies.

Most of the additional spending is funded, i.e. it does not result in a significantly larger deficit than the currently expected deficit of 2.2%. Compared to many other eurozone countries, Dutch government finances are solid. Still, government finances are expected to deteriorate in the medium term, as successive deficits of the Rutte IV government push up the debt-to-GDP ratio. The influential Dutch Budgetary Committee took aim at this worsening trajectory and advised the incoming government to balance spending and revenue given the longer term challenges of the Dutch economy: aging, the energy transition, and climate-related spending.

The macro impact of the budget is limited. Redistributive policies do boost the purchasing power of lower income households, which will support private consumption in 2024, but is likely not enough for us to raise our GDP forecast of 1.1%. In the near term, we expect growth to remain roughly stagnant in the third quarter before it picks up slightly in the fourth quarter on the back of household spending. Sectoral confidence indicators point to a broad slowing in economic activity. Industry is the outlier and in clear recession. The return to growth will therefore be driven by private consumption, as wage growth and the one-off energy allowance – which past experience suggests will drive a short term boost in spending – will lift private consumption in the fourth quarter. In 2023, the Dutch economy is expected to grow by 0.5%.

Government finances to deteriorate in medium term



Source: Refinitiv, ABN AMRO Group Economics

Confidence indicators signal weakness to continue

Source: Refinitiv, ABN AMRO Group Economics

In August, inflation continued trend lower, falling to 3.4% (from 5.3% in July). Core inflation on the other hand remained elevated at 7.0%. Inflation is expected to come down further over the coming year and to average 4.8% in 2023, and 3.5% in 2024. With wage growth slowing but still historically elevated, and the labour market expected to remain tight, inflation is unlikely to return to 2% any time soon.

US: Headwinds are building

Bill Diviney – Senior Economist | bill.diviney@nl.abnamro.com

- **Growth looks set to slow sharply in Q4. Even without a government shutdown, the restart of student loan repayments and slowing jobs growth are likely to weigh on consumption**
- **The labour market has cooled significantly. This is helping to dampen wage growth, making it likely that disinflation will resume once the near-term inflation bounce is behind us**
- **We continue to expect rate cuts next year, but policy will stay in restrictive territory until 2025**

The cruising US economy is about to enter choppier waters. The most immediate risk is of a government shutdown. If Democrats and Republicans cannot reach a compromise to pass the president's budget by the end of September, parts of the government will suspend activity and hundreds of thousands of workers will be furloughed – something that last happened in late 2018. At the time of writing, betting markets put the odds of a shutdown at 69%, and the rule of thumb is that a shutdown would lower quarterly annualised GDP growth by around 0.2pp for each week the government is closed (the most recent shutdown lasted 5 weeks). While much of this negative impact would be unwound once a deal is struck, it would come alongside a number of headwinds which, taken together, could drive a contraction in output in Q4. One is the restart of student loan repayments, as the pandemic era moratorium comes to an end. Another is the United Auto Worker (UAW) strikes, which could hit output in the sector just as it recovers from pandemic-related supply chain disruptions. We in any case expect growth to slow sharply in the Q4, with a rising savings rate and slowing jobs growth expected to weigh on consumption. These additional headwinds could tip that into an outright decline in GDP, particularly after what is shaping up to be a strong Q3 (the Atlanta Fed's GDPNow tracker for Q3 stands at 4.9% q/q saar, partly driven by higher inventories).

Elsewhere, the economy is showing signs of slowing. Q2 GDP was revised down to 2.1% from 2.4% on the back of weaker business investment, and although jobs growth for August was broadly in line with expectations, there were significant downward revisions to previous months. All told, the pace of jobs growth has more than halved in the year to date, with the 3 month average falling from around 330k at the beginning of 2023, to just 150k as of August. Over the same time period, job vacancies have fallen by nearly 2 million, and the ratio of job vacancies to unemployed people has fallen to 1.5 – still on the high side, but now not far above the pre-pandemic level of 1.2. This broad easing in labour market tightness has helped dampen wage growth, with various wage growth measures now cooling rapidly. Given that wage growth is the main driver of the medium term inflation outlook, we expect the broad disinflation trend to resume once the near-term (oil-driven) rebound in inflation is behind us (see this month's Global View).

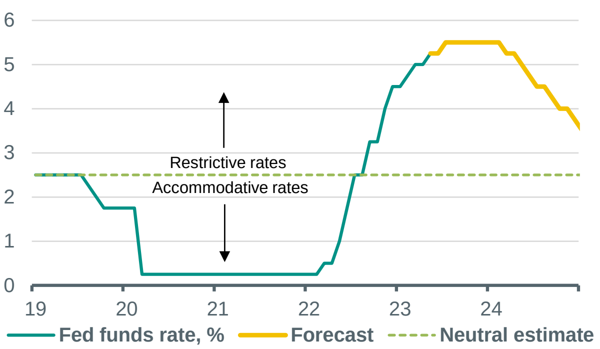
Job vacancies have tumbled over the past year

JOLTS job openings, millions

Source: Refinitiv, ABN AMRO Group Economics

Fed to cut rates in 2024, but policy will stay restrictive

Fed funds rate upper bound, %



Source: Refinitiv, ABN AMRO Group Economics

For now, the Fed continues to strike a hawkish tone given the resilience in the economy, and the fear that inflation may not fall fully back to target. We remain unconvinced that the Committee will follow through with a further rate hike, as signalled in last week's projections. Financial markets are currently split on the issue, with around a 50% probability of one last hike priced in. Once the economy more meaningfully slows, and assuming the the labour market slowdown and the broad disinflation continues, we continue to expect the FOMC to pivot to rate cuts from March. Still, rates are likely to remain well into restrictive territory throughout the coming year, with policy returning to neutral settings only in 2025.

China: More signs of stabilisation, as support starts filtering through

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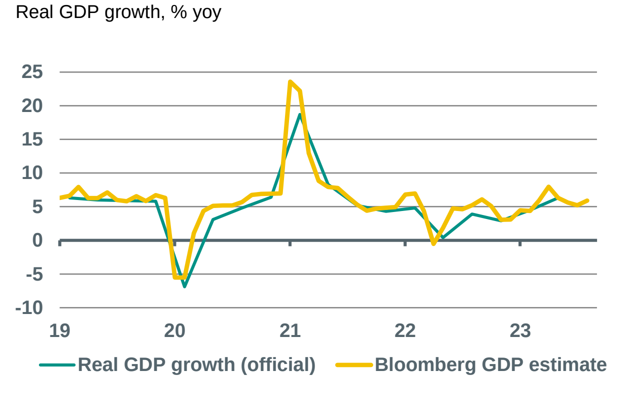
- **After weak Q2 and July data, August data point to a stabilisation of the Chinese economy**
- **This follows further piecemeal monetary easing and more targeted support, particularly for property**
- **Still, targeted support has yet to filter through more convincingly into property market data**

After a rapid reopening rebound in Q1, the Chinese economy lost steam, as headwinds from problems in the property sector and from the global growth slowdown intensified. Moreover, scarring from previous stringent policies also form drags on consumption and private investment, while renewed signs of distress in property over the summer impacted confidence and sentiment as well. Meanwhile, Beijing continues with piecemeal monetary easing and the stepping up of targeted support, particularly for the property sector, in line with our expectatinos. That seems to have started filtering through, as the August macro data are pointing to stabilisation. This lends support to our view that quarterly growth will pick up again in 2H-2023.

August data generally point to some stabilisation in growth momentum; property market data still weak

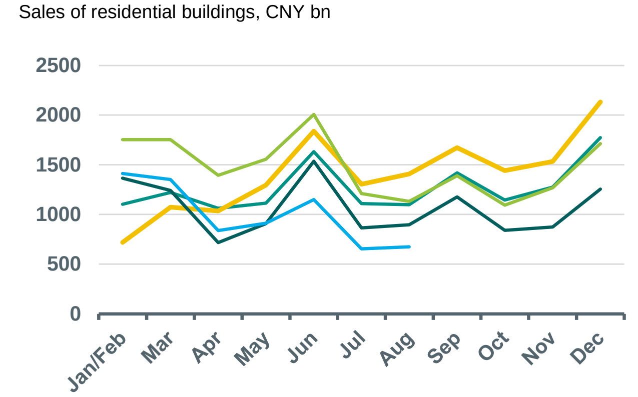
Following disappointing Q2 GDP and July activity data, the August data indicated some stabilisation. Both the official and Caixin's manufacturing PMIs improved, but the official PMI remained below the neutral mark separating expansion from contraction. Lending volumes clearly picked up compared to July. CPI inflation returned to positive territory, although still very low at 0.1% yoy (July -0.3%) , with core inflation stuck at 0.8%, and producer price deflation easing further. Imports and exports remained in contraction territory, but improved on a monthly basis. Retail sales accelerated to 4.6% yoy (July: 2.5%), helped by a pick-up in summer travel activity and related spending. Industrial production picked up to 4.5% yoy (July: 3.7%). The jobless rate fell back to 5.2% (July: 5.3%). Not all data showed improvement, though. The services PMIs came down further, with the gap between manufacturing/services PMIs closing rapidly. This reflects the fading of the reopening rebound, with services initially benefiting the most from the Zero-Covid exit. And fixed investment slowed further to 3.2% yoy ytd (Jan-July: 4.4%), with private investment still particularly subdued. Property market data also remained weak in August, showing that the recent stepping up of support for the sector (see below) is yet to filter through. All in all, Bloomberg's monthly GDP estimate for August showed the first improvement since April, rising to 5.9% yoy (July: 5.2%).

August data suggest GDP growth is bottoming out



Source: Bloomberg

Residential home sales have underperformed since Q2-2023



Source: Bloomberg, ABN AMRO Group Economics

Beijing continues with piecemeal monetary easing and targeted support, particularly for the property sector

Following a second round of mini cuts in some policy rates last month, in mid September the PBoC cut banks' reserve requirement ratios for the second time this year (by 25bp), freeing up additional liquidity and enabling banks to increase lending to local governments to help implement fiscal stimulus. Beijing also stepped up property sector support, by easing downpayment requirements for housing and enabling further reductions in mortgage rates. After these measures were announced at the central level end-August, they have been implemented in many large cities. There is some initial evidence that home sales are starting to bottom out following these measures. The government has also taken other measures in an attempt to stimulate consumption (such as expanding household tax breaks), restore confidence amongst private firms, and promote the manufacturing industry. All in all, we expect piecemeal monetary easing and targeted support to continue, but we still do not expect a 'credit bazooka' given that Beijing wants to keep leverage in check – particularly in the property sector – and given constraints regarding local government finances and shadow banking.

Key views on a page

The global economy continues to send mixed signals, with weakness in the eurozone contrasting with strength in the US, while China's post-covid rebound has disappointed. The global economy continues to expand, but the impact of monetary tightening is being increasingly felt, with manufacturing and housing in a downturn. Tightening credit conditions are weighing on bank lending, which we expect to eventually hit other sectors of the economy. Headline inflation has continued to trend lower, but higher oil prices are temporarily slowing the return to central bank targets, and tight labour markets are keeping core inflation elevated. Central bank policy rates are peaking, but even with rate cuts starting in the first half of next year, we expect monetary policy to stay restrictive throughout 2024. This will keep a lid on any post-slowdown rebound.

Macro	Central Banks & Markets
Eurozone – 2023Q2 GDP was revised lower to 0.1% qoq, down from a first estimate of 0.3%. Thus, GDP was roughly stagnant during 2022Q4-2023Q2. We expect the weakness in the EZ economy to continue for a while, with GDP probably contracting moderately or being close to stagnant during H2 2023-H1 2024. Recent economic data and surveys have supported this view. Inflation is expected to continue to decline this year and the next. Nevertheless, we have revised our forecasts for headline inflation higher, mainly due to higher energy and food inflation. Core inflation should fall to around 2% by mid-2024.	**ECB** – The ECB raised the deposit rate by 25bp in September (to 4.0%), which was against our expectation of no change. The ECB will remain data dependent going forward, but it did hint that it may have done enough and that the hike cycle may be over. The ECB cut its forecasts for GDP growth in 2023 and 2024 markedly, but still seems optimistic on growth. We also expect inflation to come in below ECB expectations. Our base line is that the peak in the deposit rate has now been reached. We still expect a rate cut cycle to begin in March 2024. We now see the deposit rate at 2.25% at the end of 2024 (was 2.0%).
The Netherlands – Dutch GDP contracted in the first two quarters of 2023 which means the Dutch economy is officially in a technical recession. As growth will resume in Q4, over 2023 Dutch GDP is expected to grow by 0.5%. We expect growth to remain sluggish in the coming quarters on the back of high rates and lower external demand. The Dutch economy remains resilient; the labour market is still tight and bankruptcies – although increasing in recent months – are still below 2019 levels. We expect inflation (HICP) to average 4.8% in 2023 and 3.5% in 2024.	**Fed** – The FOMC kept rates on hold in September, but the Committee made clear that it is open to further tightening. We think July was the last hike of the cycle, and that benign core inflation readings will give the FOMC the confidence to keep policy on hold over the coming months. We continue to expect the Fed to start cutting rates from next March. Falling inflation will push real rates higher, and Fed officials have signalled that this would be inconsistent with the FOMC's goals. Even with rate cuts starting next year, monetary policy is expected to remain restrictive throughout 2024 and even into 2025.
UK – Disinflation has continued, providing some relief to the Bank of England, but upside inflation risks remain significant given that wage growth has continued to accelerate. Demand has also shown signs of rebounding, with GDP growth surprising to the upside in Q2. 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 in September, in a knife-edge vote. 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 few months. We do not expect rate cuts until next May, and there is a risk that rate cuts get delayed even further, if inflation proves to be more persistent.
US – Growth remains resilient for now, but headwinds for the economy are building, including from a potential government shutdown, the restart of student loan repayments, and slowing jobs growth. We expect a sharp slowdown in Q4, with the risk of a contraction. While higher oil prices are boosting headline inflation, wage growth has peaked, and we judge that a slowdown and a period of below trend growth will be sufficient to return inflation back to target. Inflation falling sustainably back to target hinges on a rise in unemployment over the coming year.	**Bond yields** – Main theme priced in by the market is for rates to stay ''higher-for-longer''. Both US and Bund yields have reached a new peak as CB officials managed to convince the market that rate cuts are not on the card. The market does not price in any rate cuts before at least mid-2024. Looking at US rates, it's increasingly evident that a more dramatic shift in the Fed's narrative will be needed to generate a sustained turnaround in yields and meet our base forecast. On the Eurozone side, as the rise is mostly US driven and our economic view is gloomier, we continue to expect EU rates to decline by year-end.
China – After the reopening rebound in Q1, the recovery lost steam, as headwinds from property and the global slowdown intensified. Scarring from previous stringent policies also form drags. Renewed signs of distress in property over the summer impacted confidence and sentiment as well. Beijing has continued with piecemeal monetary easing and targeted support, particularly for the property sector. That seems to have started filtering through, as the August data are pointing to stabilisation. We assume qoq growth to pick up again in 2H-2023.	**FX** – We forecast a modest upside of the US dollar versus the euro. The technical trend of the euro has deteriorated and some of the large net-long speculative euro positions have been reduced. We expect rate cuts by the Fed and the ECB next year, but our view on the ECB deviates more from the market than the Fed. EUR/USD could test support zone 1.0500-1.0640 in the coming weeks and months. Our forecasts for EUR/USD are 1.08 (end 2023) and 1.05 end 2024.

Main economic & financial market forecasts

	GDP				Inflation				Policy rate			
	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024
Eurozone	5.4	3.4	0.4	0.6	2.6	8.4	5.7	2.3	-0.50	2.00	4.00	2.25
Netherlands	6.2	4.4	0.5	1.1	2.8	11.6	4.8	3.5				
UK	8.7	2.5	0.4	0.4	2.6	9.0	7.4	2.9	0.25	3.50	5.25	4.75
US	5.9	2.1	2.0	0.9	4.7	8.0	4.2	2.8	0.25	4.50	5.50	3.75
China	8.4	3.0	5.2	4.8	0.9	1.9	0.5	1.8	3.80	3.65	3.40	3.40

	2022	25/09/2023	Q4 23	2023	2024	Energy	2022	25/09/2023	Q4 23	2023	2024
US Treasury	3.87	4.54	3.85	3.85	3.25						
German Bund	2.57	2.79	2.40	2.40	1.90	Brent - USD/bbl*	85.91	93.29	90	90	95
EUR/USD	1.07	1.06	1.08	1.08	1.05	WTI - USD/bbl*	80.26	89.68	85	85	90
USD/CNY	6.99	7.32	7.00	7.00	6.60	TTF Gas - EUR/MWh*	88.63	51.90	55	55	60
GBP/USD	1.15	1.22	1.25	1.25	1.28						

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

	2022				2023				2024			
GDP (qoq)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	0.6	0.8	0.4	-0.1	0.1	0.1	-0.1	-0.2	0.1	0.3	0.5	0.5
Netherlands	0.5	1.8	-0.2	0.9	-0.4	-0.2	0.2	0.0	0.3	0.5	0.4	0.4
US (saar)	-1.6	-0.6	3.2	2.6	2.0	2.1	3.7	0.0	-0.4	0.9	1.4	2.0
UK	-1.2	0.1	-0.1	0.1	0.1	0.2	0.2	-0.1	0.1	0.0	0.3	0.4
China (yoy)	4.8	0.4	3.9	2.9	4.5	6.3	4.5	5.4	4.5	4.9	5.0	4.8
Inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	6.1	8.0	9.3	10.0	8.0	6.2	5.0	3.7	2.8	2.2	2.0	2.3
Netherlands	8.9	10.4	14.1	13.0	7.2	6.3	3.2	2.6	4.4	3.6	3.1	2.8
US	8.0	8.5	8.3	7.1	5.8	4.0	3.4	3.6	3.3	2.9	2.7	2.4
UK	6.2	9.2	10.0	10.8	10.2	8.4	6.7	4.4	4.0	2.2	2.5	3.0
China	1.1	2.2	2.7	1.8	1.3	0.1	0.0	0.6	1.2	1.6	2.3	2.0
Unemployment	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	6.8	6.7	6.7	6.7	6.6	6.4	6.6	7.0	7.1	7.2	7.1	7.1
Netherlands	3.4	3.3	3.7	3.6	3.5	3.5	3.7	3.9	4.0	4.1	4.0	4.0
US	3.8	3.6	3.5	3.6	3.5	3.5	3.6	3.8	3.9	4.2	4.4	4.5
UK	3.8	3.7	3.6	3.7	3.8	4.2	4.4	4.6	4.8	4.8	4.7	4.6
Policy rate	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Eurozone	-0.50	-0.50	0.75	2.00	3.00	3.50	4.00	4.00	3.75	3.25	2.75	2.25
US	0.50	1.75	3.25	4.50	5.00	5.25	5.50	5.50	5.25	4.75	4.25	3.75
UK	0.75	1.25	2.25	3.50	4.25	5.00	5.25	5.25	5.25	5.25	5.00	4.75
China	3.70	3.70	3.65	3.65	3.65	3.55	3.45	3.40	3.40	3.40	3.40	3.40

Source: Refinitiv, Bloomberg, ABN AMRO Group Economics

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