ABN·AMRO

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# Global Monthly

Macro Research Team abn.amro.group.economics@nl.abnamro.com

## Will the Red Sea disturbances throw disinflation off track?

- **Despite the continued transatlantic growth divergence, disinflation has made further progress in both eurozone and the US. On some measures, inflation is already back at central bank 2% targets**
- **The Red Sea and Panama Canal disturbances remind us of the risk of unexpected supply shocks…**
- **…but our take is that the they are unlikely to meaningfully disrupt the normalisation in inflation**
- **Also this month: We flag the key events and themes that are likely to shape the outlook in 2024**
- **Spotlight: We explore the implications of the new EU fiscal rules for the path of debt and bond yields**
- **Regional updates: Incoming data suggest GDP contracted in Q4 in the *eurozone*, while in *the Netherlands*, we expect a weak 2024 recovery after revisions suggest an even deeper 2023 recession**
- **In *the US*, the economy is slowing, but the economy continues to outperform expectations**
- **More stimulus in *China* will support sequential growth, but annual growth expected to slow below 5%**

### Global View: Red Sea shipping disruptions are likely to only marginally impact inflation

Since our Global Outlook 2024 publication in early December, the US economy has clearly slowed, the eurozone is stabilising at weak levels, and China's growth momentum continues to be weighed by the stumbling property sector. The broad trend has been in line with expectations. However, the US economy has continued to defy expectations for an even sharper slowdown, while the incoming data suggests the risks to eurozone GDP – in the very near-term – if anything look a little tilted to the downside. What about going forward? The core drivers of activity continue to suggest a transatlantic convergence in growth patterns. The fading impulse from excess savings and a cooling labour market are likely to weigh on consumption in the US. In the eurozone, the recovery in real incomes following the easing of the energy crisis and the catch-up in wages is expected to drive a modest recovery as the year progresses. In China, while the authorities are continuing to roll out targeted stimulus and piecemeal easing, the need to deleverage holds them back from administering a bigger jolt to growth. The subdued global growth outlook makes it all the more vital that central banks make a timely pivot to rate cuts. Could the Red Sea disturbances scupper that? As things stand, we think not. But a major escalation in the Middle East could change matters.

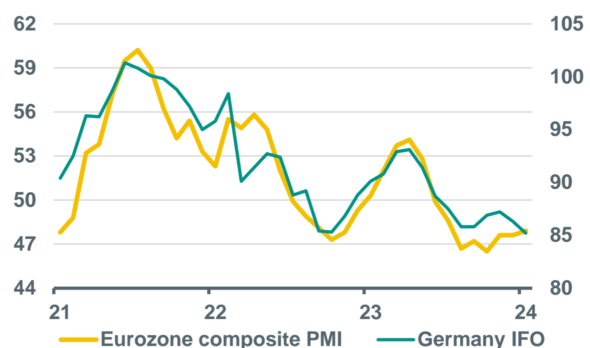
**Red Sea disruptions driving a surge in freight tariffs**

Container freight tariffs, per 40ft container, in USD

Source: Bloomberg, ABN AMRO Group Economics

**Confidence indices still point to weak eurozone**

PMI, index <50 = contraction | Germany IFO business climate

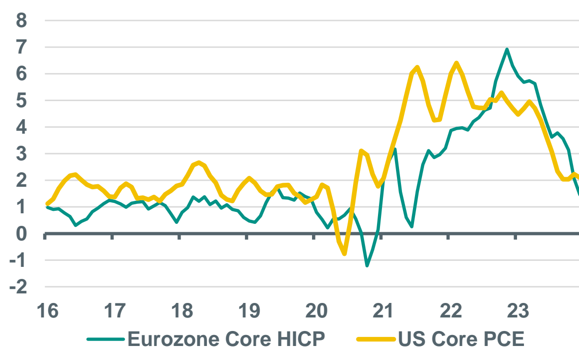



Source: Bloomberg, ABN AMRO Group Economics

## Disinflation continues apace, but sticky wage growth in Europe bears close watching

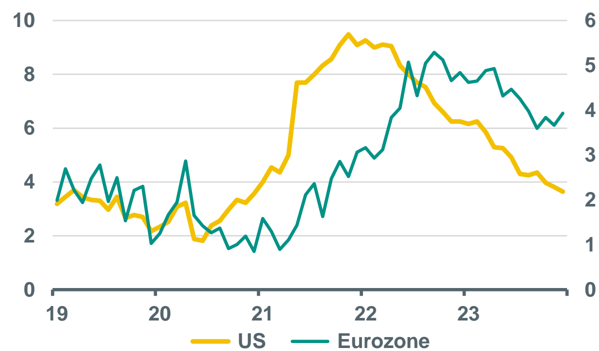
For the time being, disinflation has continued in advanced economies. On a 3m/3m annualised basis, the Fed's preferred measure – PCE inflation – is within striking distance of the 2% target, while in the eurozone, core HICP inflation is even somewhat below 2%. It is true that the main drivers of disinflation so far – goods and energy – are starting to fade. But we already see the beginnings of a decline in services inflation. For instance, annual growth in housing rents – a major driver of inflation in the US – clearly peaked back in March 2023, at 8.3% y/y, and more timely new lease data suggest that this component will continue rapidly normalising over the coming months. In the eurozone, core disinflation has been mostly concentrated in energy-intensive components so far, but given the weak demand environment, we expect this to spread increasingly to labour-intensive services.

**Core inflation back at 2% on 3m/3m basis**




Source: LSEG, ABN AMRO Group Economics

**Eurozone wage growth decline is lagging the US**




Source: Indeed.com, ABN AMRO Group Economics

Key to this is going to be a timely normalisation of wage growth. In the US, some measures of wage growth have already fully normalised: average hourly earnings are growing at around 4% on a 3m/3m annualised basis, similar to before the pandemic, and unit labour cost growth was just 1.6% y/y as of Q3. The Atlanta Fed's wage growth tracker is admittedly on the higher side, but it has also fallen sharply over the past year, and one of the Fed's favourite measures – the Employment Cost Index – is also on a clear normalising path. Given the cooling in the labour market, we see little reason to worry that these normalising trends will reverse.

In the eurozone, the wages story is lagging the US given the later surge in inflation, and because the rise in wage growth was driven more by workers seeking compensation for the shock to their real incomes rather than being driven by a particularly tight labour market[1]. Wage growth is still well above pre-pandemic levels, even according to the most timely measures such as the Indeed monthly tracker. However, the peak looks to have been set in the Autumn of 2022, and since then the Indeed tracker has been on a downtrend. Other, more lagging measures of wage growth remain elevated but look also to have peaked. With the economy much weaker than in the US, and the main driver of the jump in wage growth (the energy crisis) now resolved, we expect a much more rapid normalisation in wage growth over the coming months, thereby giving the ECB the confidence to start lowering rates in June.

## Will the Houthis and the Panama drought throw disinflation into reverse? We think not

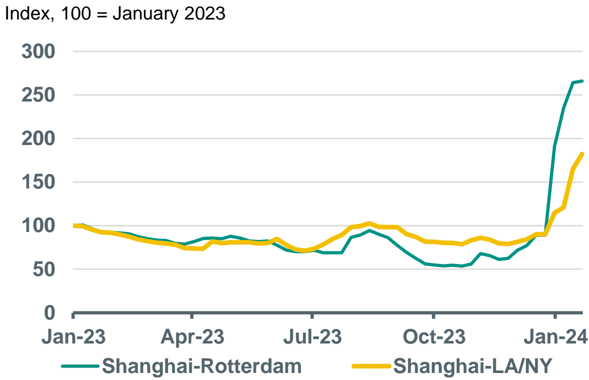
While we await clarity on wage developments, a new inflation risk has emerged: the Houthi attacks on commercial ships passing through the Red Sea. This has led to a quadrupling in shipping freight tariffs from their recent lows between China and Europe, and the potential for supply disruptions due to the diversion of ships around the much longer Cape of Good Hope route. This comes on top of the disruptions in another crucial global trade artery, particularly for the movement of goods to the US from Asia – the drought in the Panama Canal. Taken together, the disruptions have led to a quadrupling in shipping tariffs from Asia to Europe, and a doubling in tariff rates to the US. Just as we seem to have got over the pandemic and energy crisis supply shocks, is inflation now set for another supply shock-induced surge?

[1] Of course, there were pockets of labour market tightness eg. in Germany and the Netherlands, but not at the eurozone aggregate level

We think not, for three reasons. First, shipping costs make up a relatively small share of the cost of goods imports: according to an **ECB paper** from 2021[2], international shipping costs make up less than 1% of the final cost of manufactured goods. Goods themselves make up 26% of eurozone and 20% of US inflation baskets. Even then, a significant share of this is unaffected by international shipping costs. For instance, in the US, nearly half of the good in the inflation basket is cars (new and used), and medicines, which are largely domestically sourced. Moreover, shipping freight tariffs collapsed by nearly 90% in 2022, but partly due to fears of potential future disruptions or price rises (see **here**), this was likely not passed on to consumers. Taken together, goods importers therefore probably have enough margin to absorb the recent tariff rises, which is itself still an order of magnitude smaller than in 2021.

**Shipping tariffs to Europe have risen more steeply**

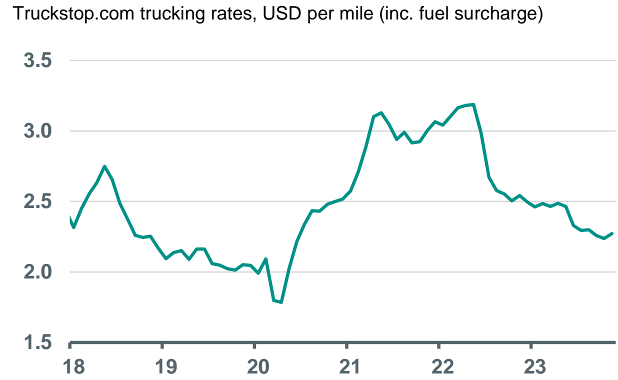
Index, 100 = January 2023




Source: Bloomberg, ABN AMRO Group Economics

**US trucking rates still well off their pandemic highs**

Truckstop.com trucking rates, USD per mile (inc. fuel surcharge)



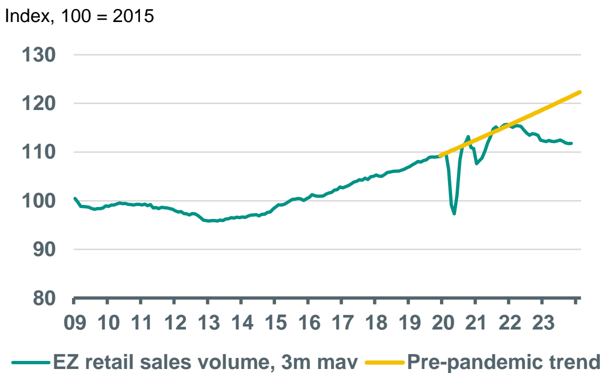

Source: Bloomberg, ABN AMRO Group Economics

A second and related reason not to expect an inflation surge is that, unlike the 2021-22 period, this shock is not being accompanied by other supply shocks. Back then, it was not just shipping freight tariffs that rose: freight tariffs across transport modes (including domestic routes, such as road haulage) also jumped, and shortages of key components (such as semiconductors) led to surging prices of other input costs. These cost pressures are no longer present. Indeed, on the contrary, prices of many inputs are seeing falling prices: in Europe specifically, a massive offsetting factor is the collapse in energy prices, which is still yet to fully feed through to goods prices.

Third, even for those businesses where margins are tighter as a result of shipping tariff rises, the weaker demand environment at present means that it will be much harder for costs to be passed on. Eurozone retail volumes have been on a persistent downtrend since the end of 2021, and remain some 4% below their end-2021 peak. We are therefore sceptical that European importers will be able to pass on any extra costs. In the US, where consumer demand has been more resilient, the rise in shipping costs – and the potential for disruption – is much smaller given that the disruptions to the Panama Canal are less severe than the Red Sea/Suez Canal.

**Eurozone consumer demand remains weak**

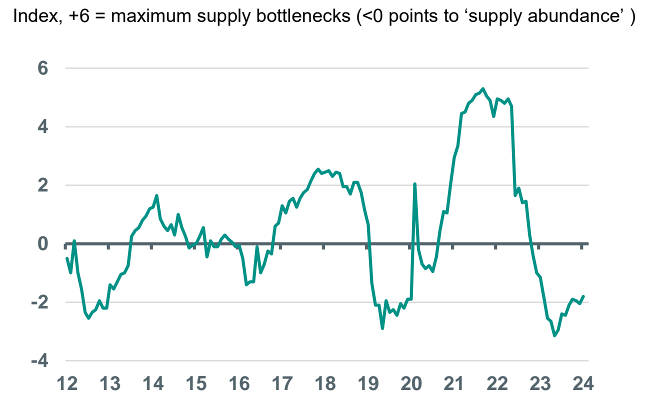
Index, 100 = 2015




Source: LSEG, ABN AMRO Group Economics

**Our bottlenecks index still suggests abundant supply**

Index, +6 = maximum supply bottlenecks (<0 points to 'supply abundance' )



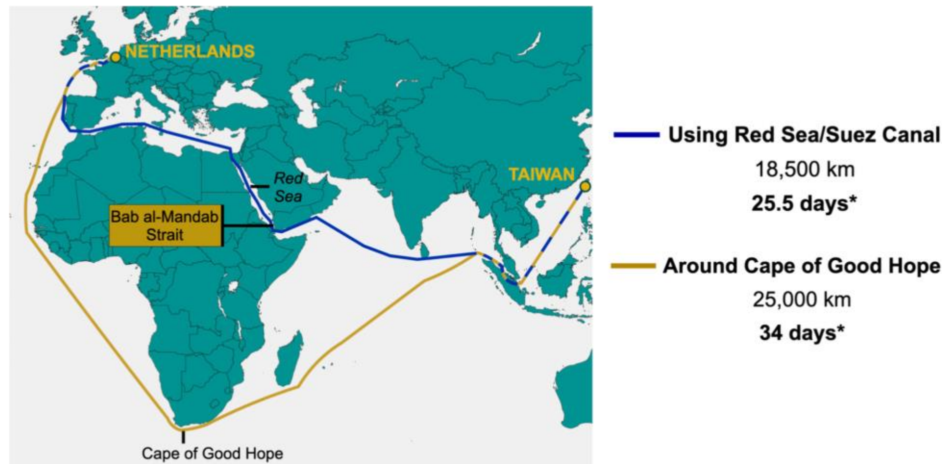

Source: ABN AMRO Group Economics, Bloomberg, LSEG

[2] When shipping freight tariffs also surged – by a much larger magnitude.

Even under the most generous assumptions, we estimate the rise in shipping tariffs – if they are sustained and fully passed on – may raise eurozone goods inflation by c1pp. This would raise overall inflation by only 0.3pp. Given the powerful offsetting factors, such as the collapse in energy prices and the downward pressure on goods prices from overcapacity in global manufacturing, this would marginally slow the disinflation trend, but it would not come close to derailing it. In the US, the impact is expected to be even smaller, given the proportionally smaller rise in shipping costs.

## What about supply disruptions?

With shipping from Asia to Europe taking around 9 days longer via the Cape of Good Hope than via the Red Sea, another concern has been the potential for supply disruptions resulted from delays to parts deliveries impacting supply chains.




Source: BBC News, ABN AMRO Group Economics

So far, there is limited evidence of this. Some auto makers announced production pauses for 3-10 days, although the same companies have also faced weak consumer demand, and so the Red Sea disturbances could be convenient cover for a pause. In the eurozone flash PMIs for January, the sub-index for delivery times suggests some lengthening, although the commentary that accompanied the release added the caveat:

*"…various industry reports indicate that businesses are not caught off guard like they have been previously, having learned from past disruptions. Many have proactively diversified their suppliers across geographical regions and enterprises, mitigating the potential fallout from such unforeseen challenges."*

Also noteworthy is that the Houthis have said they would not target Chinese ships in their attacks (reflecting China's neutral stance in the Middle East). This is crucial given that much of the trade that could be impacted originates from China. Indeed, the latest data suggests that around half of the traffic that typically passes through the Red Sea is proceeding as normal.

With regards the Panama Canal, while drought-related disruptions have pushed shipping costs higher, physical disruptions have been limited. Monthly transits through the canal are down by around 25%, but most of this decline has been due to dry bulk shipments diverting to lower cost routes, as canal passage fees rose. Container ships – those containing finished consumer goods – have been less affected. Where there has been an impact on container shipments, shipping companies are adapting, for instance by moving some cargo over land adjacent to the Panama canal and reloading back onto ships at the other end. This raises costs, but the risk of physical disruptions is minimised.

## What if the conflict in the Middle East escalates?

At present, the main channel of impact from the conflict in the Middle East is via shipping, which – as we have argued – is unlikely to really move the needle on inflation. Another channel, which drew attention back in October when the conflict between Israel and Hamas broke out, is oil prices. While oil prices initially rose in the early stage of the conflict, this proved short-lived, and oil prices are now around 15% below where they were on the eve of the conflict in late September. But with the US and UK militaries becoming involved, the risk of a further escalation – potentially drawing Iran directly into the conflict – has risen. Should such a material escalation occur, a much steeper and more sustained rise in oil prices could occur.

Were oil to rise 35-40% above current levels – to average $110-120 per barrel in 2024 (and potentially a much higher peak) – we estimate this would add around 0.7pp to US inflation, and 0.9pp to eurozone inflation. Given the risks this would pose to inflation expectations, such an escalation could have more meaningful consequences by potentially postponing the start of interest rate cuts, which would negatively impact the growth outlook. As things stand, this remains a risk scenario, and our base case for inflation assumes only a modest rise in oil prices this year (to $90 per barrel by end-2024 for Brent crude).

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**Key events & themes 2024:** To supplement our ***Global Outlook 2024***, below we flag some key events that could impact the outlook in our coverage space. Below this, we describe some broader themes that are likely to dominate the news cycle.

| Key dates to watch | What to expect |
| --- | --- |
| **5 March** | • **China** will announce its 2024 growth target at the **National People's Congress** (our forecast is for a slowdown in growth to 4.7% from 5.2% in 2023) |
| **6 June** | • **ECB's first 25bp rate cut expected** |
| **9 June** | • **European Parliament elections** will be closely watched for an expected slight shift to the right. According to current polls the Green Deal is safe, but there is a risk that climate policy gets watered down in a national level and that there is weaker implementation of the Green Deal at the European level.<br>• **German municipal elections** will be held on the same day, with the right-wing AfD party expected to make significant gains |
| **12 June** | • **Fed's first 25bp rate cut expected** |
| **July** | • **European Commission's China EV probe outcome:** the earliest tariffs could come is July, but the full investigation might take until November |
| **September** | • **German state elections** held in Saxony and Thuringia on 1 September, and in Brandenburg on 22 September. AfD is again expected to make large gains |
| **Autumn** | • **UK general election:** Date is not yet fixed. Polling suggests the opposition Labour party is likely to win, after 14 years of Conservative Party rule |
| **5 November** | • **US presidential election:** Highly likely to be a rematch between former president Trump and incumbent president Biden. Current opinion polling suggests a roughly even 50:50 chance of either candidate winning. A second Trump presidency could herald sweeping new import tariffs, posing downside risks to global trade, and upside risks to US inflation and interest rates. See here for more |
| **Themes to watch** | **What to expect** |
| **Political events** | • **Trump faces a host of court trials,** with 4 March an important date to watch<br>• **Dutch coalition talks** look likely to lead to a right-wing coalition taking office<br>• **Taiwan presidential inauguration (May)** could elicit military posturing and/or sanctions by China<br>• **Elections (not mentioned above) in** India, Belgium, Austria, South Africa, Mexico, Indonesia |
| **Russia-Ukraine war** | • **Key potential flashpoints include:** Nato drills (February), Russia presidential election (March), new Nato head (November). US presidential election also probably pivotal for the direction of the conflict, as Trump is openly less supportive of Ukraine |
| **Israel-Hamas conflict** | • **A wider escalation of the conflict** (eg. Iran directly entering the fray) could trigger a surge in oil prices, sending disinflation into reverse. The current **Red Sea disturbances** are not expected by themselves to materially impact inflation |
| **AI adoption** | • **AI will continue to proliferate**, but measurable productivity gains are unlikely to be visible this year. Meanwhile, 'deepfakes' might increasingly dominate election cycles |
| **Sporting events** | • **EURO 2024 Germany (June-July), Paris Olympics (August)** |

# Eurozone: Entering a moderate recession

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

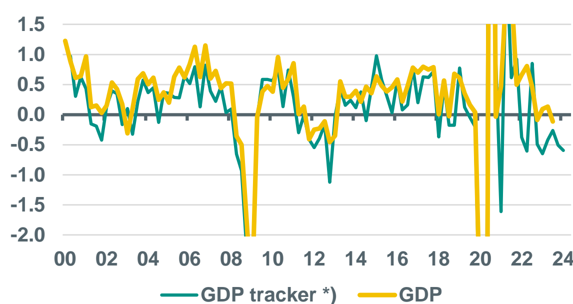
- **Incoming economic data for October-November suggests GDP contracted in Q4**
- **Core inflation is on a clear downward trajectory, which should continue in the coming months**
- **The ECB is expected to start cutting rates in June, with ECB officials trying to bring down market expectations of an earlier cut**

Economic data for October-November suggests that GDP contracted in Q4 (number will be published on 30 January). We have pencilled in -0.2% qoq, but our monthly GDP tracker (graph below) indicates that the risks to this forecast are tilted to the downside. Indeed, the volume of retail sales fell by 0.3% 3mo3m in November and industrial production by 1.6%. Services output is not covered by our tracker, but the level of the services PMI (48.8 in December) suggests the sector is shrinking moderately. As GDP shrank in Q3, another contraction in Q4 would put the EZ in technical recession. We expect GDP to roughly stabilise in 2024Q1 and to grow well below the trend rate during the rest of 2024. Growth will continue to be dampened by the high level of interest rates. Moreover, fiscal policy will be restrictive, as governments' energy-support measures for households and companies will be unwound. That said, the upcoming start of interest rate cuts by the main central banks has resulted in some easing of financial conditions and has also lifted sentiment amongst consumers and producers, which should support domestic demand moving into 2024. No sharp rebound is expected, however.

Disinflation is ongoing. Headline inflation reached 2.4% in November, the lowest point since July 2021. It rebounded somewhat to 2.9% in December, but this was totally due to base in effects in energy price inflation. All other main components of HICP inflation (food, industrial goods and services) have remained on a downward trajectory. Core inflation has fallen from a peak of 5.7% in March 2023, to 3.4% in December, with a major driver being the waning impact of the jump in in energy prices on the inflation rate of energy-intensive goods and services (see graph below), which has further to go. Also, downward base effects should dampen food price inflation in the coming months. More fundamentally, underlying inflationary pressures are also easing. Weak consumption growth is limiting the room for companies to raise prices and labour market conditions are deteriorating, which will limit wage growth (more on this in the first chapter of this report). All in all, we expect headline and core inflation to continue to decline, reaching the  ECB's 2% target around the middle of 2024.

**GDP and monthly tracker**

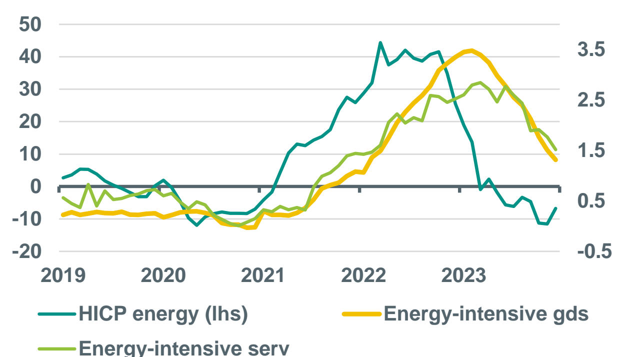
% qoq / 3mo3m




*) weighted avg. of ind. production, car sales and retail sales
Source: LSEG, ABN AMRO Group Economics

**Core inflation falls on waning energy-impact**

% yoy




Source: LSEG, ABN AMRO Group Economics

We expect the ECB to start cutting interest rates in June of this year. Recent comments by a string of ECB officials have also pointed in this direction. The comments have been clearly designed – as well as co-ordinated - to bring down market expectations of early cuts in policy rates. Markets continued to price in a significant probability of a rate cut in April. At the time of writing, around 20bp was priced, though that is down from 40bp at the start of this year. Given this, we think that some further correction is likely as the bar in terms of data (much weaker activity and inflation) to trigger an April rate cut is high. Looking further out, we think that once the rate cut cycle starts, it is likely to be more extensive than markets currently price, with the deposit rate eventually being reduced to 1.5% in the course of 2025.

# Spotlight: The implications of the new EU fiscal rules

Sonia Renoult – Rates Strategist | sonia.renoult@nl.abnamro.com
Aline Schuiling – Senior Eurozone Economist | aline.schuiling@nl.abnamro.com

- **The EU finally managed to agree on a new set of fiscal rules in late 2023**
- **Although the path to meeting the new criteria is less restrictive and countries are allowed to adjust more gradually, it will still imply significant fiscal effort for the most indebted countries**
- **The strongest incentive to stick to the rules lies in the ECB's TPI instrument, as only countries that comply to the EU fiscal rules will be eligible for asset purchases in future**
- **Thus, this could have an impact on bond yields of countries that would fail to meet those rules**
- **In the meantime, we expect country spreads to slightly tighten in 2024, as we expect the central bank rate-cut cycle to be the dominant driver**

Finally, the EU member states have reached an agreement on a new set of fiscal rules. A compromise was found between fiscal tightening and investment needs. The new rules will bring fiscal tightening back to the table although less strict than under the previous rules. Fiscal effort will be required, though, and weigh on the economies of the most indebted countries. Our calculation show that within the group of big-6 eurozone countries France, Italy and Belgium are expected to be in conflict with the EU fiscal rules. This means they will have to implement significant austerity measures during the adjustment period in order for their government debt ratio's to decline at the required pace. This adjustment is aggravated by the fact that interest payments will take up a rising part of government expenditure in the coming years.

We think that the most disciplinary element of the new fiscal rules probably is that only countries that adhere to these rules will be eligible for asset purchases under the ECB's Transmission Protection Instrument (TPI). Indeed the TPI (see here) states that only countries that comply with the EU fiscal framework are eligible for asset purchases by the Eurosystem. This means that the sovereign bond spreads of countries that are not in compliance with these rules would probably surge higher in case of a financial or economic crisis that would affect the entire eurozone. This is one of the main reasons why we expect fiscal tightening to materialise this time, although at a very slow pace.

Most EU governments already plan to cut spending this year. However, this is mainly due to the unwinding of the financial support provided during the pandemic and the energy crisis. Thus, the more structural fiscal tightening is still yet to come. In our view, the start of the ECB interest rate cut cycle, which we expect in June, (see eurozone), will be the dominant narrative in the bond market this year. Based on our forecasts for growth and inflation, we think the interest rate cut cycle will have a narrowing effect on country spreads. As such, we forecast country spreads to tighten slightly toward the end of the year.

In our publication of 23 January (see here) we discuss the key takeaways from the new fiscal rules and what they mean for government finances and the economies of the big-6 eurozone countries. We also shed some light on this rule's impact on sovereign bond spreads and the forecast for the year 2024.

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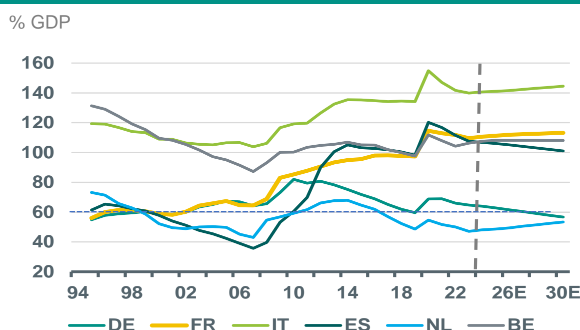
**Old base scenario for debt ratios**




Source: EC, ABN AMRO Group Economics

**Annual austerity needed to meet the new rules**

Source: EC, ABN AMRO Group Economics

## The Netherlands: Growth to resume but stay weak in 2024

Jan-Paul van de Kerke – Economist | jan-paul.van.de.kerke@nl.abnamro.com
Aggie van Huisseling – Economist | aggie.van.huisseling@nl.abnamro.com

- **Growth positive but weak during 2024; external demand to bottom out, with growth driven by domestic demand**
- **GDP revisions showed Dutch technical recession to be slightly deeper, caused by lower consumption**
- **We lowered our HICP forecasts on the back of stronger than expected goods and services disinflation**
- **Bankruptcies have been low since the pandemic, but the December data shows that trend to have turned**

At the start of 2024, the growth outlook of the Dutch economy is still meagre. Backward looking revisions to GDP which were published late December, showed the Q3 2024 contraction was deeper than reported earlier at -0.3% qoq (was -0.2% qoq). Particularly private consumption – which contracted instead of stagnated – and investment were adjusted downwards. These revisions slightly pushed down our annual GDP forecasts for 2023 (0.1%, was 0.2%) and 2024 (0.5%, was 0.6%). Growth is expected to cautiously resume in the final quarter of 2023, for which data is released later in February. Recent figures such as activity trackers and export volume indicators point towards some improvement in economic momentum. All in all, the final quarter of 2024 is expected to show a slight expansion (+0.1% q/q), partly caused by a bounce back from the -0.3% qoq contraction in Q3. Risks however are clearly to the downside, with the broader eurozone – and Germany in particular – showing signs of weakness and associated contractions in GDP (see here).

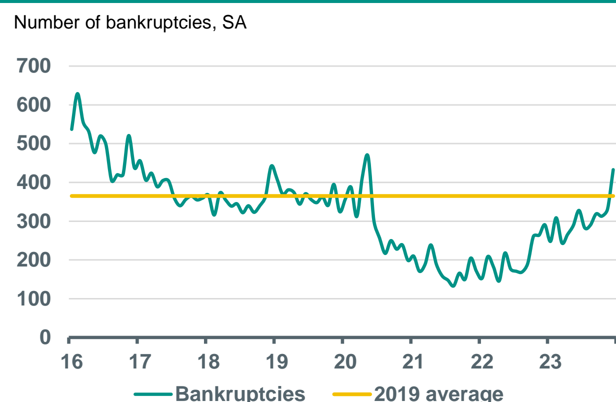
Over the course of 2024 growth is set to continue but stay weak. We expect the weakness in external demand to bottom out as growth in the eurozone returns to positive territory. The main driver of Dutch growth this year will be domestic demand by the government and households. The government will contribute to growth via expansive fiscal policy. For consumers, declining inflation and strong wage growth has lifted real incomes, which is expected to continue during 2024, raising purchasing power and supporting household spending. The resilient labour market is another supportive factor for consumption. Despite a weak macroeconomic environment, employment has increased steadily over the year culminating in a labour force participation record of 76% in December 2023. More generally, on the back of rate cut expectations financial conditions have eased a bit, which already provides some support for businesses.

In summary, we expect growth to slowly return in 2024 driven by private consumption and government expenditure. External demand is bottoming out and will increase in the second half of 2024 on the back of eurozone growth resuming. Still, 2024 GDP growth remains far below the trend growth rate.

**Quick pace of disinflation lowers inflation forecasts**

Source: CBS, ABN AMRO Group Economics

**Bankruptcies surpass 2019 levels**




Source: CBS, ABN AMRO Group Economics

The Netherlands is no exception to the global disinflationary trend. In the final months of the year, the tempo of disinflation has been stronger than expected, particularly in goods and services (excluding housing). Therefore, we have made a downward adjustment to our inflation forecasts of 2024 and 2025. We now expect Dutch HICP to average 2.8% (was 3.2%) in 2024 and 2.4% (was 2.7%) in 2025. As things stand, inflation risks stemming from geopolitical turbulence in the middle-east are limited (see this month's Global View), but this hinges on no major escalation of tensions in the region.

In December, bankruptcies ticked above the pre-pandemic average in the Netherlands for the first time since 2021. Since the pandemic bankruptcy rates have been very low due to Covid support, low interest rates and ample consumer demand when lockdown measures were unwound. Up until now, the Netherlands was lagging behind other eurozone countries, where bankruptcy rates passed their pre-pandemic averages sooner. We expect bankruptcies to rise further given the weak growth environment and high interest rates which are yet to impact most businesses.

# US: Still humming along

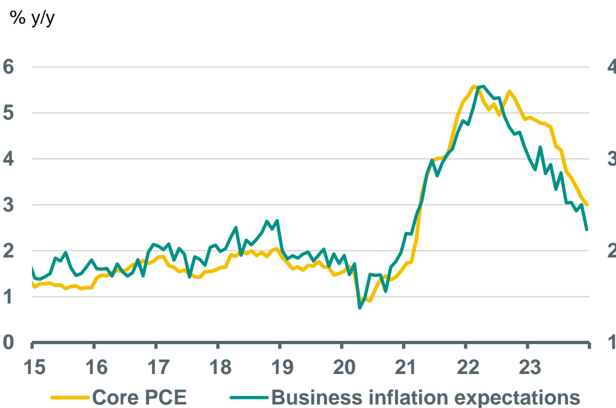
Bill Diviney – Senior Economist | bill.diviney@nl.abnamro.com

- **The economy is clearly slowing, but it also continues to outperform expectations. Meanwhile, falling business and consumer expectations suggest the disinflation trend is set to continue**
- **The drop in mortgage rates last year is already giving some stimulus to housing, but a bump in the road has materialised, with markets beginning to pare back rate cut expectations**
- **The Fed is still not *aggressively* pushing back on market rate cut expectations. We continue to expect rate cuts to start in June, leaving room for a further near-term recovery in bond yields**

Incoming data suggests the US economy clearly slowed as 2023 drew to a close, following the blockbuster Q3 growth reading. However, the economy also continues to defy expectations for a sharper slowdown. Q4 GDP came in at 3.3% q/q annualised, which was well above our expectation back in December for nearer 1% growth. The main driver was an unexpected rise in inventory build, and GDP looks vulnerable to an unwind of this in the coming quarters. However, the ever-almighty US consumer was also resilient: following above trend growth of 3.1% annualised in Q3, consumption barely paused for breath in Q4, growing at 2.8% annualised. This strength comes despite the headwinds from slowing jobs and wage growth, and continued high interest rates. Indeed, while headline payrolls growth has surprised to the upside in recent months, downward revisions to prior months have meant a clear overall slowing trend: 3 month average jobs growth fell from 221k in September to 165k in December. For the time being, consumers continue to dip into their excess savings to keep consumption humming along, but as jobs growth slows further, we expect consumers to become increasingly cautious.

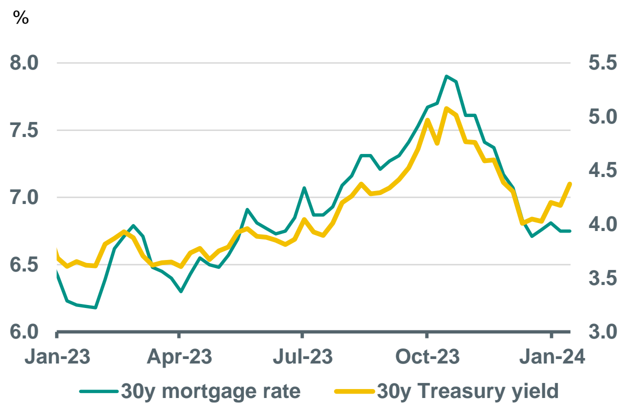
One area that may partly offset the expected slowdown in consumption is housing. Leading indicators suggest homebuyers are being brought in from the sidelines by the sharp decline in mortgage rates, which fell over 1pp from nearly 8% in October to below 7% in late December. For instance, Redfin pending home sales jumped 4.1% m/m in December – the biggest rise in over two years – while the NAHB homebuilder sentiment index rose 7 points to 44 in January. Increased housing demand is likely to drive a recovery in housing investment, although it should be noted that housing is a much smaller part of the economy than it was before the 2008-9 Great Recession, and so this will likely only provide a modest uplift to growth.

**Falling expectations suggest continued disinflation**




Source: Atlanta Fed, LSEG, ABN AMRO Group Economics

**Mortgage rates look set for a rebound in the near-term**




Source: Bloomberg, ABN AMRO Group Economics

Even this boost from lower rates may be about to hit a bump in the road. The disinflation trend of the past 18 months shows no signs of letting up: the Atlanta Fed's year-ahead business inflation expectations dropped another leg lower in January to 2.2%, while the equivalent consumer measure from Michigan University fell to 2.9%. These were the lowest readings in three years. However, the aforementioned resilience in the economy is likely to keep the Fed on its guard in the near-term, and our base case continues to foresee rate cuts starting in June. Markets have to some extent priced out the probability of earlier rate cuts, but there is still some way to go: the first fully priced 25bp cut is in May, and markets still see a 50% probability of a cut in March. So far, Fed officials are not pushing back against market expectations quite as forcefully as ECB officials. But as it becomes increasingly clear that the Fed is not on the verge of cutting rates, bond yields – and therefore rates that impact the real economy, such as mortgage rates – could yet see some further upward pressure in the near-term, before rates resume their fall later in the year.

## China: How to safeguard growth while reshaping your growth model?

Arjen van Dijkhuizen – Senior Economist | arjen.van.dijkhuizen@nl.abnamro.com

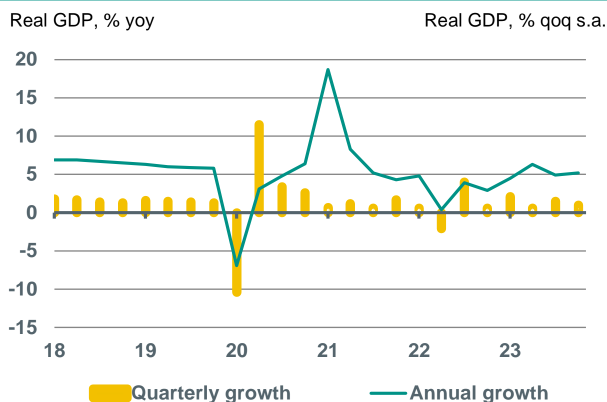
- **Growth momentum still dragged down by property sector woes and slowdown external demand**
- **We expect ongoing (targeted) support, which should underpin quarterly growth during 2024**
- **…but we still foresee annual growth dropping from 5.2% in 2023 to 4.7% in 2024 and 4.6% in 2025**

On 17 January, Q4 GDP numbers came in close to consensus expectations including ours. Annual growth accelerated to 5.2% yoy (Q3: 4.9%), driven by base effects from Q4-22, but quarterly growth slowed to 1.0% qoq s.a. (Q3: 1.5%). While the economy has recovered from the trough in Q2-23 (+0.6% qoq s.a.), there are still headwinds from the property sector and the slowdown in global demand. Full-year growth for 2023 came in at 5.2%, just above the 5% target. The focus now shifts to the annual NPC meetings in early March, when the 2024 growth target will be announced. Absent a similar reopening bonus like in 2023 and with Beijing trying to reshape China's growth model, growth in 2024 will be more reliant on effective policy support. We expect ongoing piecemeal monetary easing and additional targeted fiscal support, but still no old-school 'credit bazooka', and have kept our growth forecasts for 2024 and 2025 unchanged at 4.7% and 4.6%, respectively.

**Growth still dragged down by weakness in property sector and external demand**

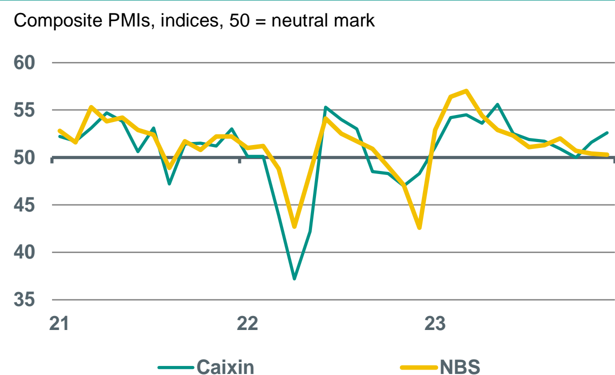
The December data were a mixed bag, showing that growth momentum is still fragile and the recovery from the dip in Q2-23 uneven. On the positive side, infrastructure investment accelerated on the back of policy stimulus, while retail sales and exports picked up in monthly terms. Caixin's PMIs were also a bright spot, with the composite PMI jumping to 52.9 (Nov: 51.5). By contrast, the official manufacturing PMI and lending volumes disappointed, while property sector data remained lacklustre. Property sales and investment fell deeper into contraction territory, and house prices keep falling. For the first time since the GFC, headline inflation was negative for three consecutive months, although overall deflationary pressures seem to be ebbing a bit. The jobless rate rose marginally to 5.1%. All in all, Bloomberg's monthly GDP estimate fell to 7.3% yoy (Nov: 7.6%). Going forward, we expect qoq growth to pick up a bit compared to Q4-23, helped by additional support (and lagged effects of past support). Bear in mind that, as usual, Q1 data will be distorted by Lunar New Year effects.

**Annual growth picks up, quarterly growth down in Q4-23**




Source: Bloomberg, ABN AMRO Group Economics

**China's PMIs are diverging again to some extent**




Source: LSEG, ABN AMRO Group Economics

**Growth will likely be more policy-dependent this year: more targeted support, still no *credit bazooka* expected**

Absent a similar reopening rebound like in 2023, with headwinds from property and global growth weakness remaining, and with Beijing aiming for a different growth model, more support is needed to get a decent growth rate this year (of – say – 4.5% to 5%; specific target to be announced at the annual NPC in early March). In the Central Economic Work Conference held in December, Beijing announced a more effective and coherent policy framework for 2024. However, the efficacy of support is being hampered by a lack of consistency, with the recent tightening of video game rules reminding investors of the internet platform crackdown and with the PBoC recently defying (modest) rate cut expectations. Although the impact of previous stimulus is still partly feeding through (with for instance the PBoC injecting CNY 350bn into policy banks in December to help finance property), we expect further piecemeal monetary easing and targeted (fiscal) support. This is confirmed by plans to issue CNY 1 trn of ultra-long sovereign bonds and the announcement of a 50bp bank RRR cut. Allegedly, Beijing is also working on a CNY 2 trn fund to stabilise stock markets. Still, although the pendulum is shifting from 'derisking' to growth stabilisation again, we do not expect an old-fashioned *credit bazooka,* as that would run counter to Beijing's longer-term goals of keeping overall leverage in check and reducing the economy's dependence on real estate.

## 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 declined by 0.1% qoq in 23Q3. We expect another moderate fall in 23Q4, but recent data indicates that the risks are tilted towards a stronger fall. We expect GDP to stabilise in 24Q1 and grow below the trend rate during the rest of the year. Headline inflation rose in December due to base effects in energy price inflation. Still, the other main components of inflation (food, industrial goods and services) have remained on a downward trajectory. Despite higher energy inflation, HICP inflation is expected to continue to decline in the coming months. Core inflation should fall to around 2% by mid-2024. | **ECB** – The ECB kept interest rates unchanged in January. In December, the ECB announced a very gradual wind down of PEPP reinvestments. Although macro data continues to point in the direction of a start of a rate cut cycle over the next few months, we think it will take the Governing Council time to form consensus and change its communication. Therefore, we expect a first rate cut in June. Recent comments by ECB officials have been clearly designed to bring down market expectations of early cuts in policy rates. We think the deposit rate will eventually reach 1.5% in the course of 2025. |
| **The Netherlands** – GDP contracted in the first three quarters of 2023 which means the Dutch economy still is in a technical recession. We expect growth to resume in the coming quarters but remain sluggish. Dutch GDP growth is expected to average 0.1% in 2023 and pick up slightly to 0.5% in 2024. The Dutch economy remains resilient; the labour market is still tight and bankruptcies creep up only slowly. We expect inflation (HICP) to average 2.8% in 2024 and 2.4% in 2024. | **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 has kept policy on hold since last August. We think Bank Rate has peaked at 5.25%. 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. The risk is tilted towards somewhat earlier cuts given the more rapid progress on inflation. However, sticky wage growth – which poses upside risks to medium-term inflation – is likely to stay the MPC's hand. |
| **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 –** Since the start of the year, Central Banks and financial market's battle on the start of the rate cut cycle is one of the main market drivers. Despite some repricing, we think that the market remains too optimistic on pricing the first rate cut in April/May. Until all rate-cuts wagers before June are priced out, we could see further upward pressure on yields. However, this upward move will be short-lived as we expect rates to come down again before the first rate cut occurs. We expect both US and EU rates to pursue this downward trend in 2025. This rates' development will lead both Treasury and Bund yield curves to dis-invert and bull-steepen throughout the year. |
| **China** – The economy has recovered from the dip in Q2-23, but headwinds from property and the slowdown in global demand remain. The focus now shifts to the annual NPC in early March, when the 2024 growth target will be announced. Absent a similar reopening bonus like in 2023 and with Beijing trying to reshape China's growth model, growth in 2024 will be more reliant on effective policy support. We expect ongoing piecemeal monetary easing and additional targeted fiscal support, but still no *credit bazooka*, and have kept our 2024 growth forecast at 4.7%. | **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 | 0.4 | 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 | 0.5 | 1.1 | 11.6 | 4.1 | 2.8 | 2.4 | | | | |
| UK | 4.3 | 0.6 | 0.4 | 1.1 | 9.1 | 7.4 | 2.8 | 2.3 | 3.50 | 5.25 | 4.75 | 3.50 |
| US | 1.9 | 2.5 | 1.8 | 2.0 | 6.5 | 3.8 | 2.0 | 1.9 | 4.50 | 5.50 | 4.25 | 3.00 |
| China | 3.0 | 5.2 | 4.7 | 4.6 | 1.9 | 0.2 | 1.5 | 2.0 | 3.65 | 3.45 | 3.35 | 3.30 |

| | 2023 | 25/01/2024 | Q1 24 | 2024 | 2025 | Energy | 2023 | 25/01/2024 | Q1 24 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| US Treasury | 3.88 | 4.13 | 4.10 | 3.60 | 3.55 | | | | | | |
| German Bund | 2.02 | 2.28 | 2.30 | 1.90 | 2.10 | Brent - USD/bbl* | 77.04 | 82.43 | 80 | 90 | 80-85 |
| EUR/USD | 1.05 | 1.08 | 1.10 | 1.10 | 1.10 | WTI - USD/bbl* | 71.65 | 77.36 | 75 | 85 | 75-80 |
| USD/CNY | 7.10 | 7.18 | 7.20 | 7.00 | 6.80 | TTF Gas - EUR/MWh* | 35.25 | 32.40 | 30 | 40 | 40-45 |
| GBP/USD | 1.23 | 1.27 | 1.24 | 1.26 | 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 | 0.2 | 0.1 | 0.3 | 0.4 | 0.4 | 0.2 | 0.1 | 0.3 | 0.2 |
| US (saar) | 2.2 | 2.1 | 4.9 | 3.3 | 0.9 | 1.1 | 1.6 | 1.6 | 2.3 | 2.3 | 2.4 | 2.4 |
| UK | 0.3 | 0.2 | 0.0 | 0.1 | 0.1 | 0.0 | 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 | 2.8 | 2.2 | 1.9 | 1.8 | 2.0 | 2.0 | 1.9 | 1.8 | 1.7 |
| UK | 10.2 | 8.4 | 6.7 | 4.2 | 4.3 | 2.0 | 2.3 | 2.7 | 2.3 | 2.6 | 2.2 | 2.0 |
| China | 1.3 | 0.1 | -0.1 | -0.3 | 0.4 | 1.2 | 1.9 | 2.3 | 2.2 | 2.1 | 1.9 | 1.8 |
| **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 | 3.9 | 3.8 | 4.0 | 4.0 | 4.0 | 3.9 | 3.8 | 3.7 |
| **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 | 3.45 | 3.40 | 3.35 | 3.35 | 3.30 | 3.30 | 3.30 | 3.30 |

Source: LSEG, Bloomberg, ABN AMRO Group Economics

## Macro Research Team

**Sandra Phlippen**, Chief Economist | sandra.phlippen@nl.abnamro.com

**Aggie van Huisseling**, Economist | aggie.van.huisseling@nl.abnamro.com

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

**Arjen van Dijkhuizen**, Senior Economist | arjen.van.dijkhuizen@nl.abnamro.com

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

**Jan-Paul van de Kerke**, Economist | jan-paul.van.de.kerke@nl.abnamro.com

**Nick Kounis**, Head of Financial Markets Research | nick.kounis@nl.abnamro.com

## FX & Rates Research

**Georgette Boele**, Senior FX & Precious Metals Strategist | georgette.boele@nl.abnamro.com

**Sonia Renoult**, Rates Strategist | Sonia.renoult@nl.abnamro.com

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