Global Economic Outlook: Balanced Economic Risks

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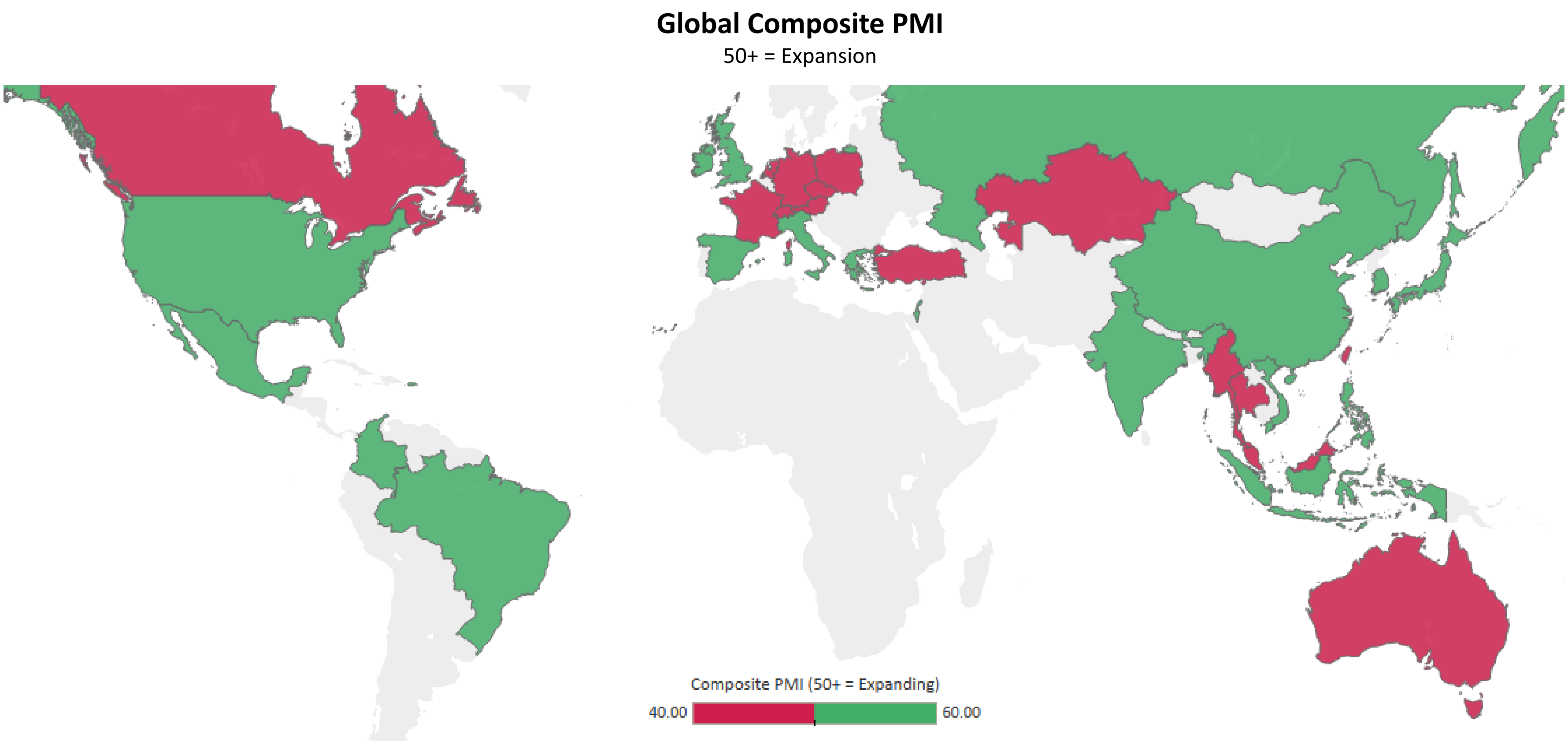
MACROPOLICY PERSPECTIVES

Global Backdrop

- The U.S. has had the strongest and most dynamic recovery with the lowest inflation within the OECD.
- Within the EU, Germany is taking the brunt of geopolitical events and has had the weakest outlook with growth declining in the second half of 2023. It is possible the ECB moves ahead of the Federal Reserve given the outlook across the core of the EU.
- All emerging markets are not equal:
  - China is fading in terms of economic significance as it can no longer grow at spectacular speed
  - Brazil and India have the greatest growth potential in 2024
  - Latin America also has the potential to surprise on the upside
- Downside risks come from geopolitics, a large number of global elections, asynchronous growth, potentially divergent central bank policy, and the lagged effects of higher rates yet to hit the global economy.
- Upside risk could come from a continuation of the productivity burst that emerged in Q3 2023, and individual country success stories which could emerge in 2024.

Global growth is mixed but there is more green on the screen



Russia's manufacturing engine is driven by military spending while India is driven by government spending. Latin America is improving.

Source: MacroPolicy Perspectives/S&P Global/Haver Analytics

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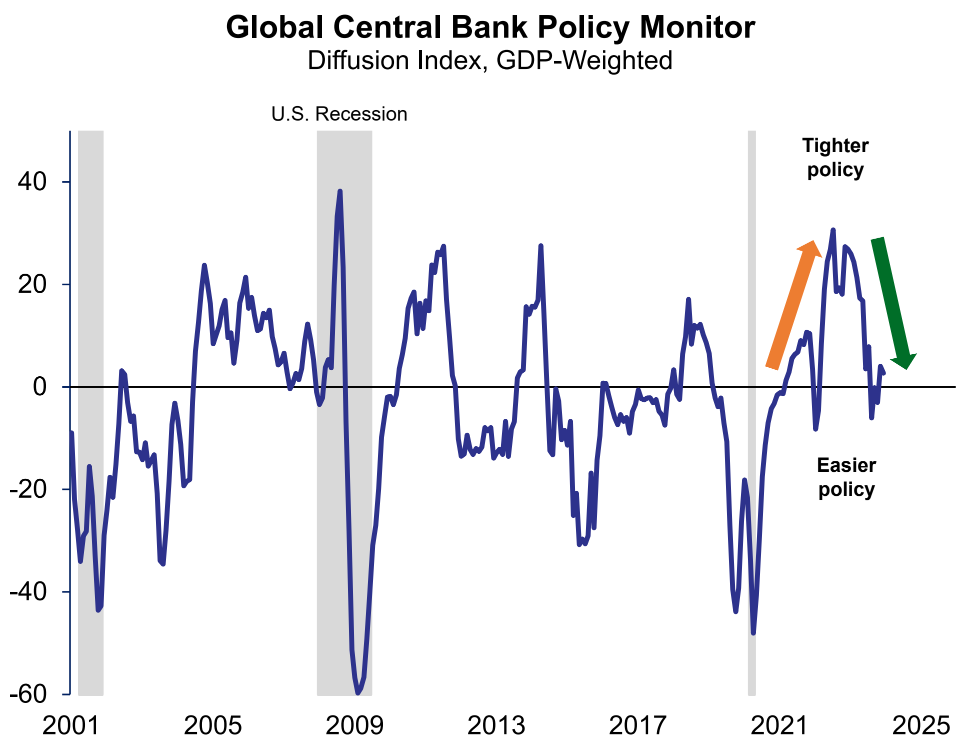
The lags of tight policy remain despite world moving to an easing stance



OECD 2024 Economic Forecasts

	GDP (Y/Y%)	Core CPI (Y/Y%)	Unemployment 2024 Rate (*Chg.*)
World	3.1	-	-
OECD	1.4	5.3	5.1 (*+0.3*)
US	1.5	2.7	4.1 (*+0.5*)
EU (17)	0.9	3.1	6.6 (*+0.1*)
Japan	1.0	2.3	2.5 (*-0.1*)
China	4.7	-	-
India	6.1	-	-
Emerging Mkts	3.9	-	-

The OECD expects global growth and inflation to both slow in 2024 while unemployment is only expected to see moderate increases

Diffusion Index: % CB reporting increases less % CB reporting decreases, 3mma
Source: MacroPolicy Perspectives/OECD/National Central Banks/Haver Analytics

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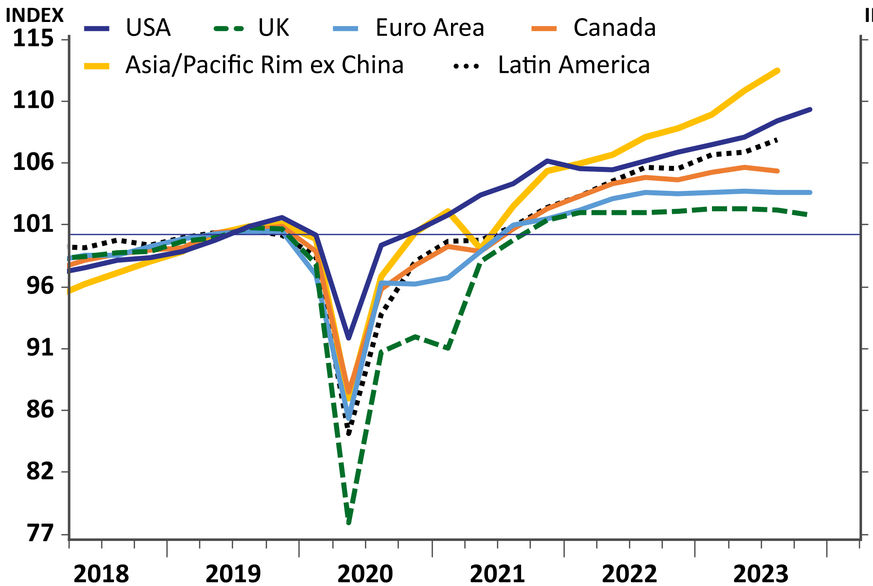
The US economy continues to outperform, global inflation cooling

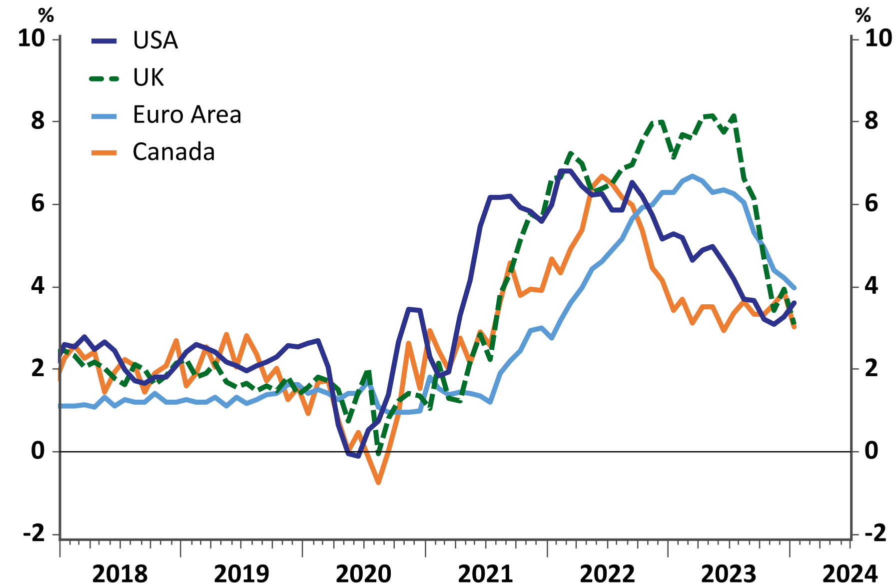
Asia ex-China is outperforming the US due to India

Real GDP (Index 2019=100)



Inflation's story is a global story

Core Consumer Price Indexes Harmonized for Cross Country Comparison (% 6m saar)



Inflation's moderation globally should give the Fed some comfort that prices are continuing their march to the 2% target

Source: MacroPolicy Perspectives/BEA/BLS/EuroStat/National Statistics Agencies/Haver Analytics

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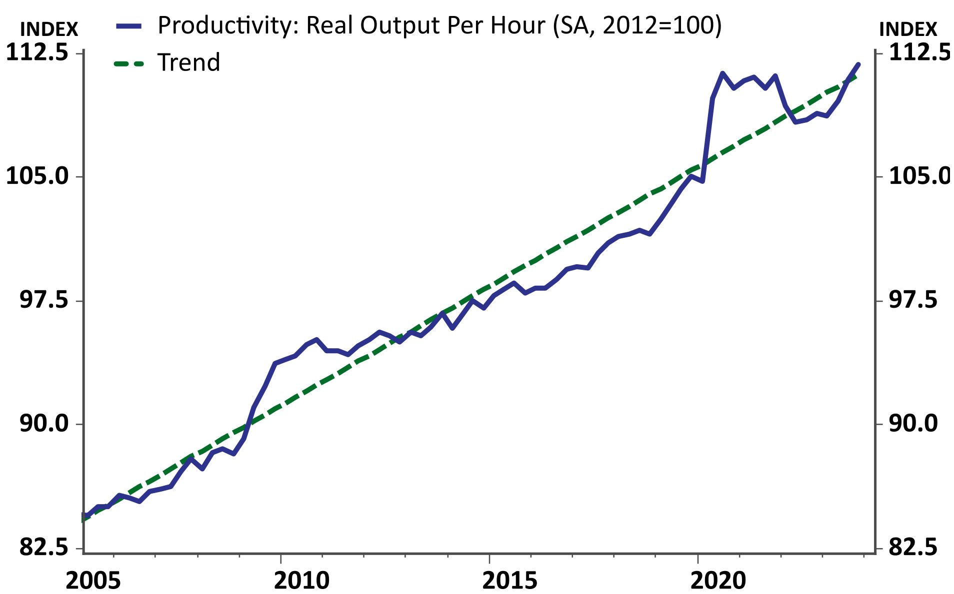
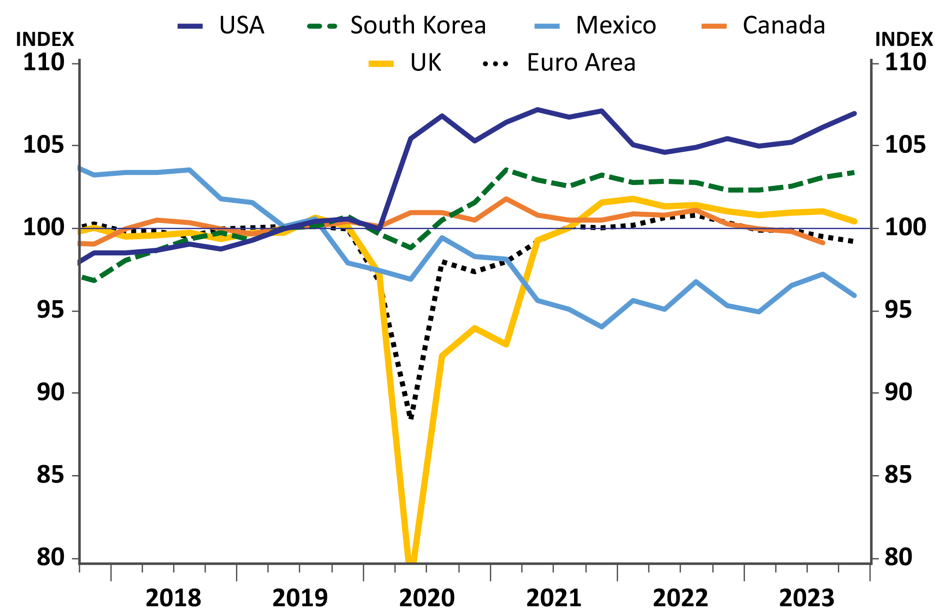
U.S. growth found new momentum in 2023 due to productivity

Productivity is Inching Above Trend



Total Economy Productivity Index (2019 = 100)



US productivity mirrored labor market volatility however now that the labor market has normalized, productivity logged 2.7% in 2023

Source: MacroPolicy Perspectives/Bureau of Labor Statistics/EuroStat/National Statistics Agencies/Haver Analytics

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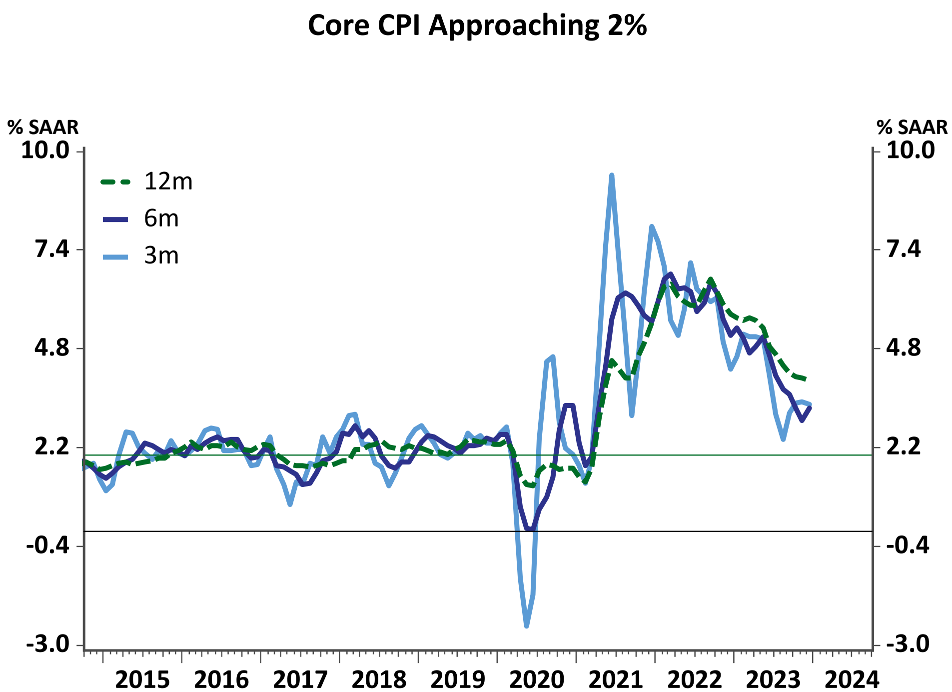
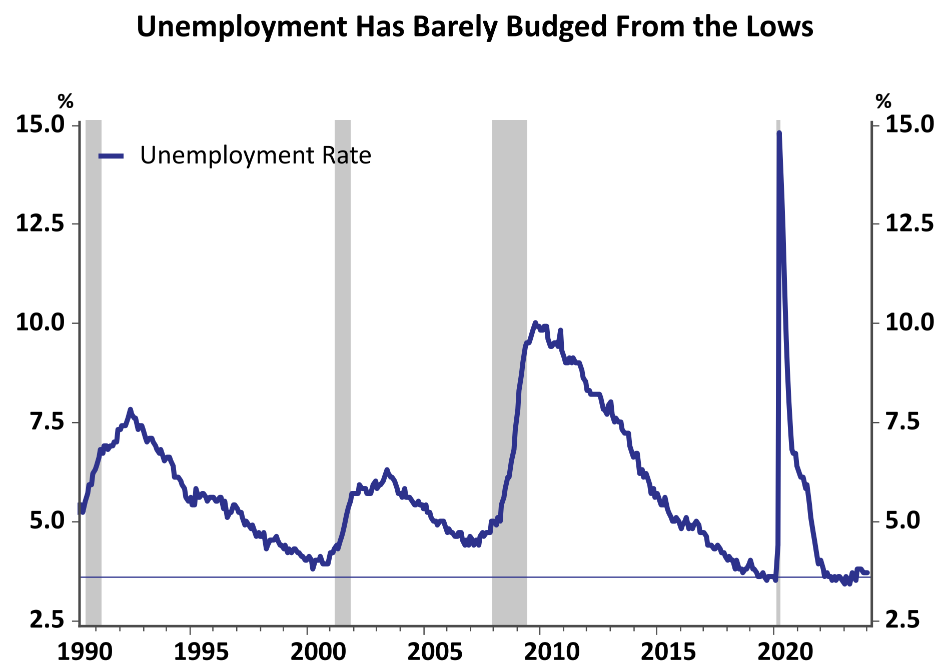
The pace of inflation has slowed while unemployment remains low





Inflation's moderation is due as much to supply factors as demand factors while unemployment remains low due economic dynamism

Source: MacroPolicy Perspectives/Bureau of Labor Statistics/CBO/Haver Analytics

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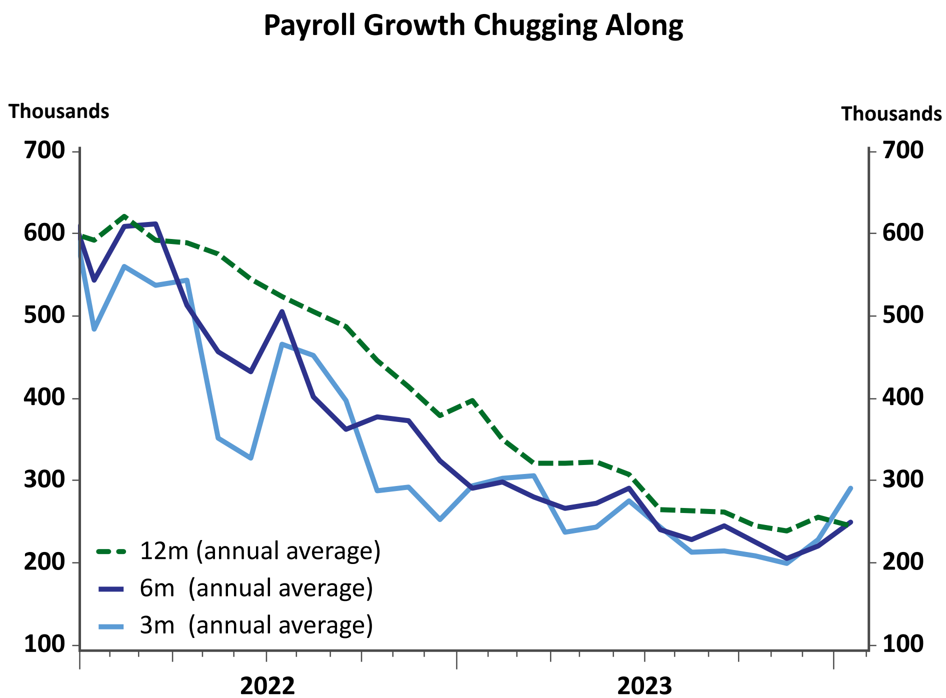
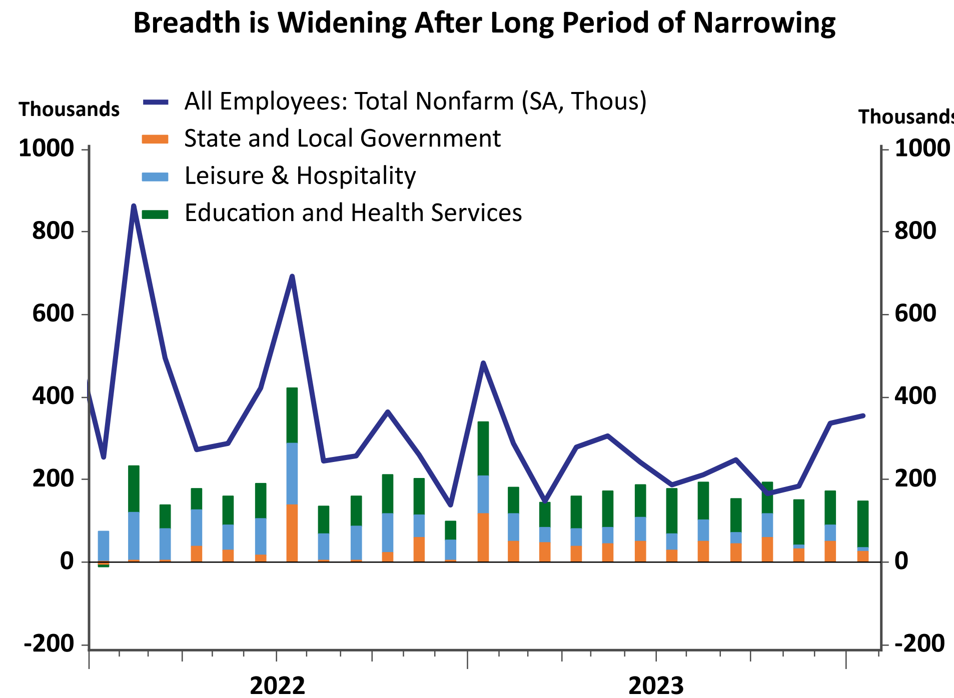
Jobs growth is showing remarkable resilience as payrolls chug along





Fed officials have indicated they are looking at a more balanced view, meaning that labor market data will influence policy timing

Source: MacroPolicy Perspectives/Bureau of Labor Statistics/CBO/Haver Analytics

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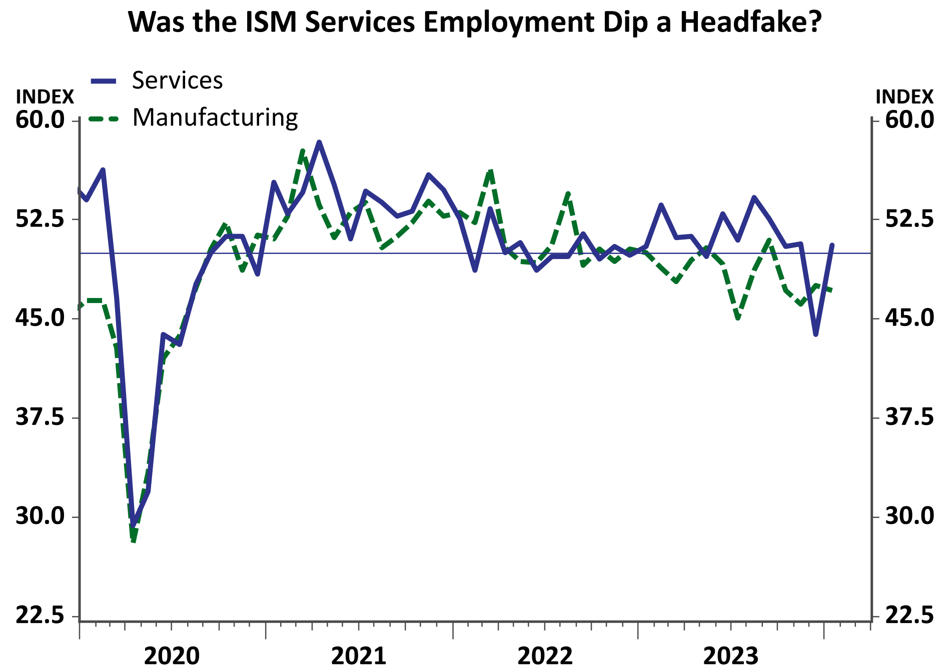
Jobs data while strong, is a coincident indicator and may be lagging



As is often the case during turning points, data can be noisy, the differing signals between jobs data and other sources warrants caution

Source: MacroPolicy Perspectives/AlphaSense/Institute for Supply Management/Haver Analytics

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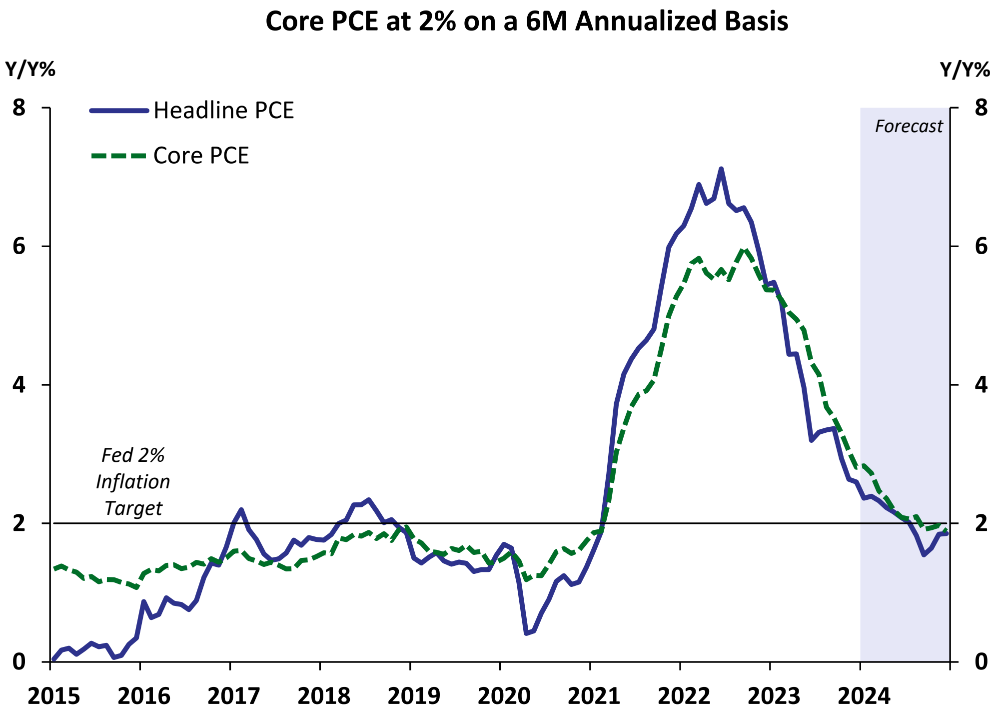
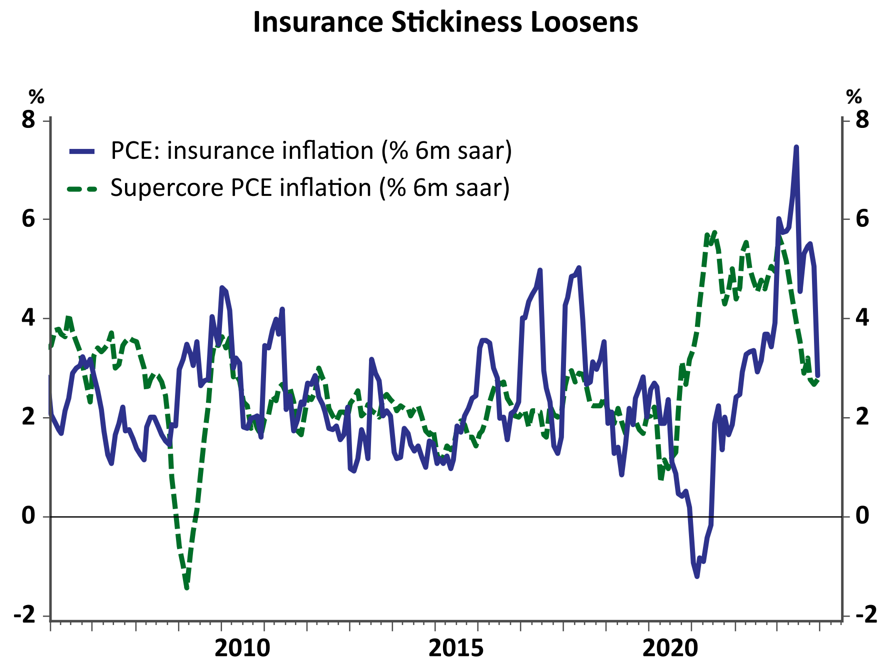
Inflation is slowing faster than the Fed forecast, but caution is the word





The previous stickiness of Super Core* is moderating which also supports a near-term rate cut to ensure a soft landing for the economy

Note: Super Core is Core Services excluding housing and comprises just over 50% of the PCE index
Source: MacroPolicy Perspectives/Bureau of Economic Analysis/Haver Analytics

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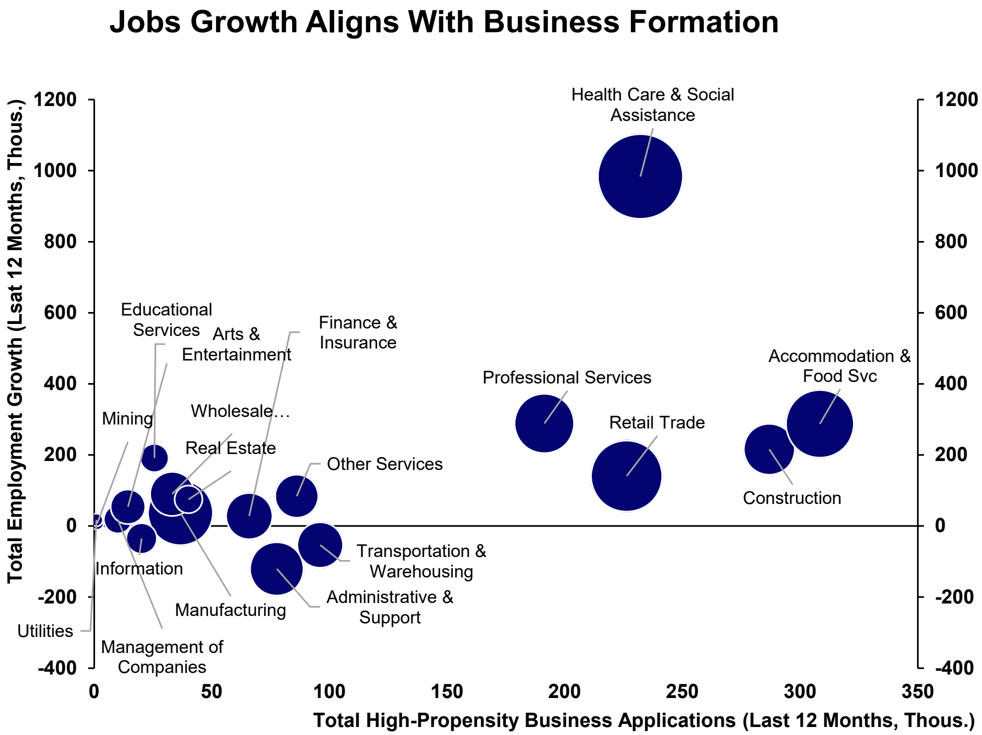
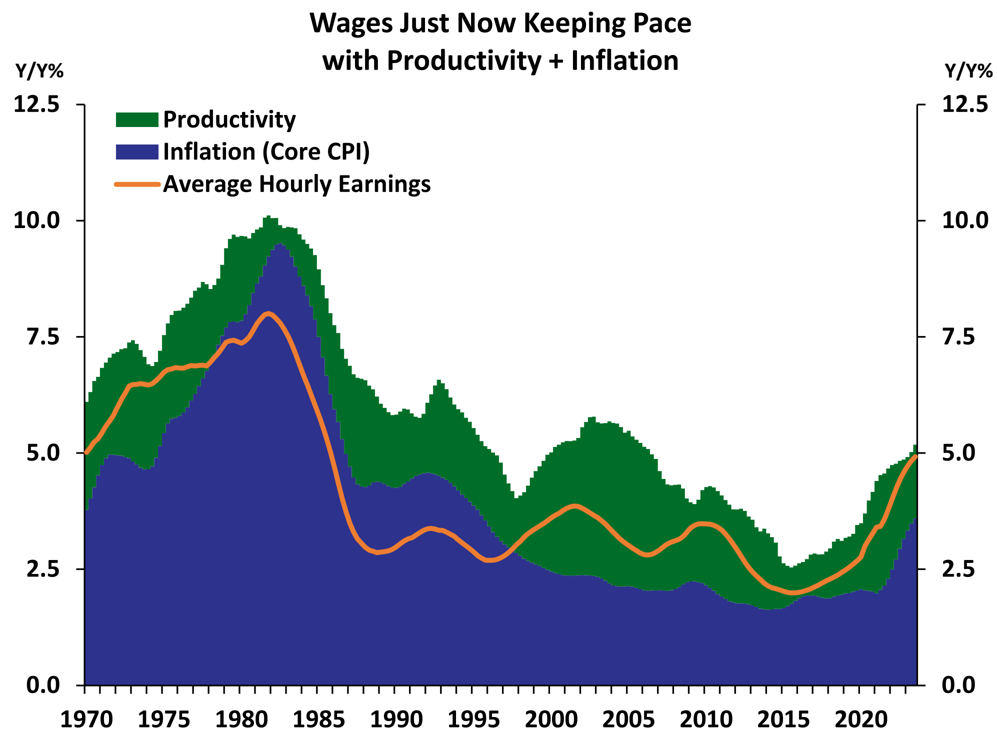
The dynamism of the U.S. economy got a boost from Covid





Newer companies tend to be more productive adopting new technology at a faster pace, this helps drive tech diffusion economy-wide

Source: MacroPolicy Perspectives/Bureau of Labor Statistics/Haver Analytics

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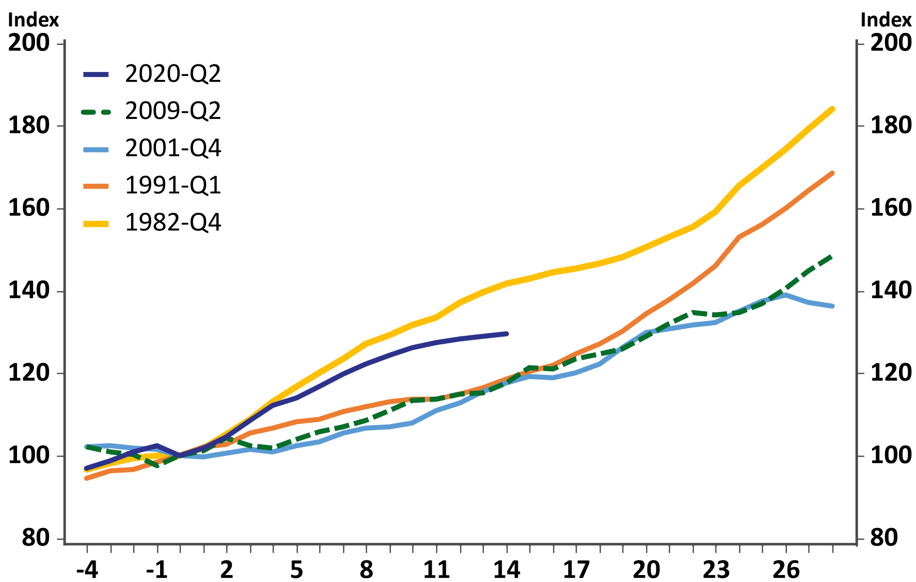
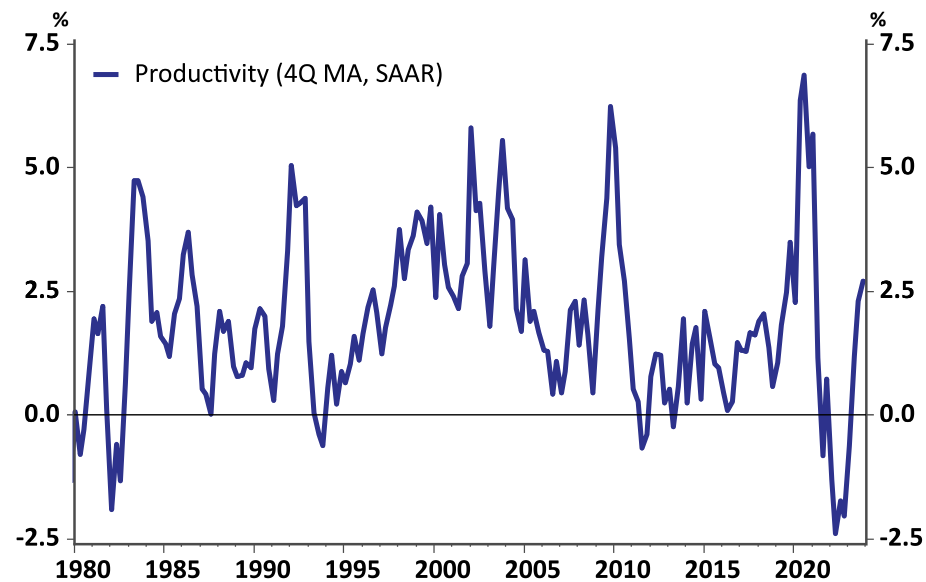
Productivity is a growth accelerant that will give the Fed policy space

Investment Presages Productivity



Can the Productivity Boost Continue in 2024?



The combination of higher investment, higher new business formation, and a new general-purpose technology gives productivity legs

Source: MacroPolicy Perspectives/Bureau of Economic Analysis/CBO/Haver Analytics

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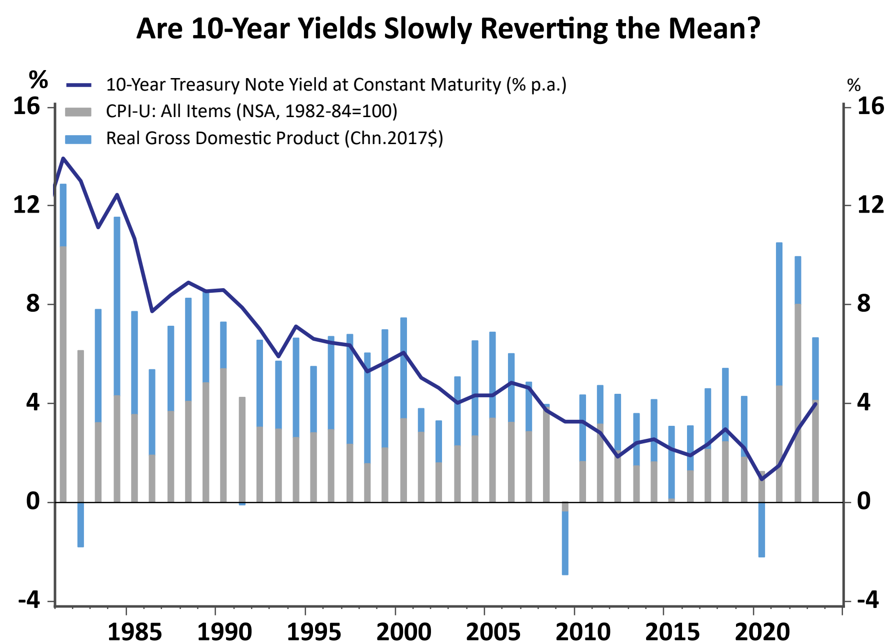
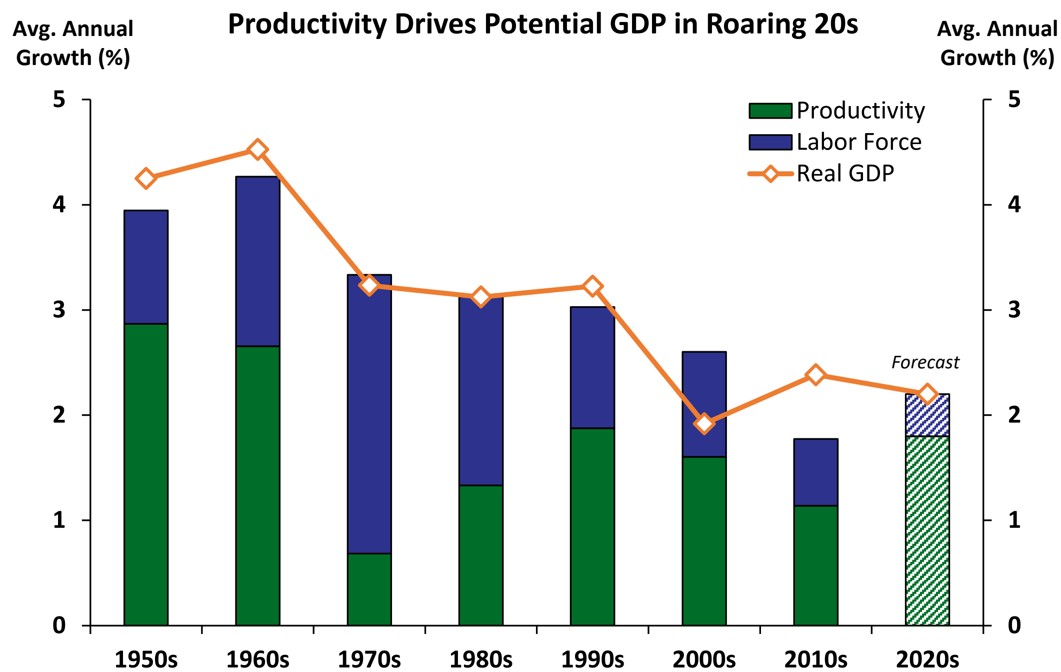
Higher productivity means higher rates, lower inflation and a strong economy





Combining greater productivity and increased legal immigration could raise potential GDP from 1.8% to 2.2%, raising rates as well

Source: MacroPolicy Perspectives/FRB/BLS/Bureau of Economic Analysis/CBO/Haver Analytics

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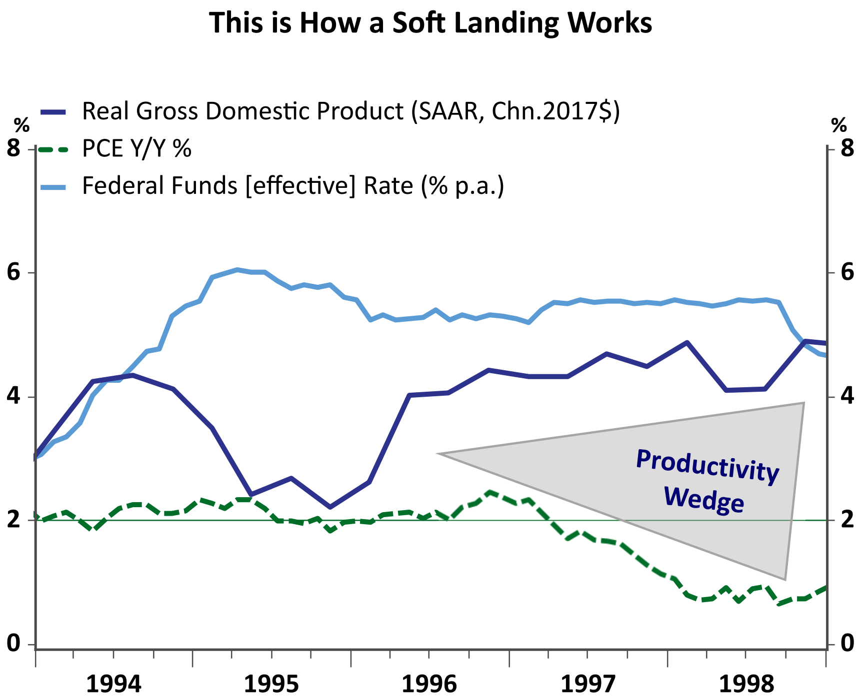
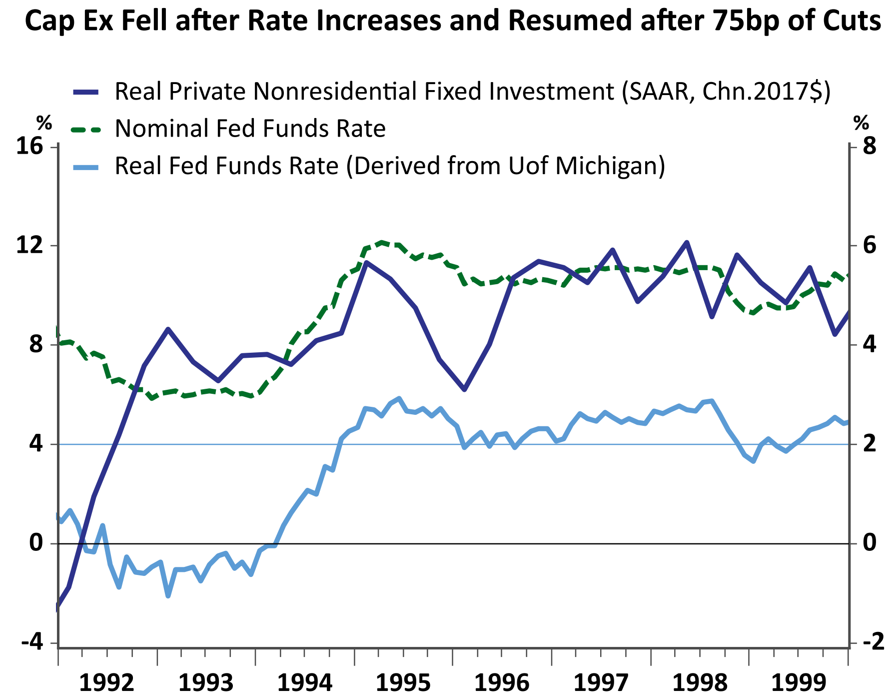
Can the Federal Reserve engineer a 1990s style soft landing?





By lowering the overnight rate to 4-4.5%, the Fed remains restrictive while also giving space for the productivity wedge to continue

Source: MacroPolicy Perspectives/Bureau of Economic Analysis/Federal Reserve Board/University of Michigan/Haver Analytics

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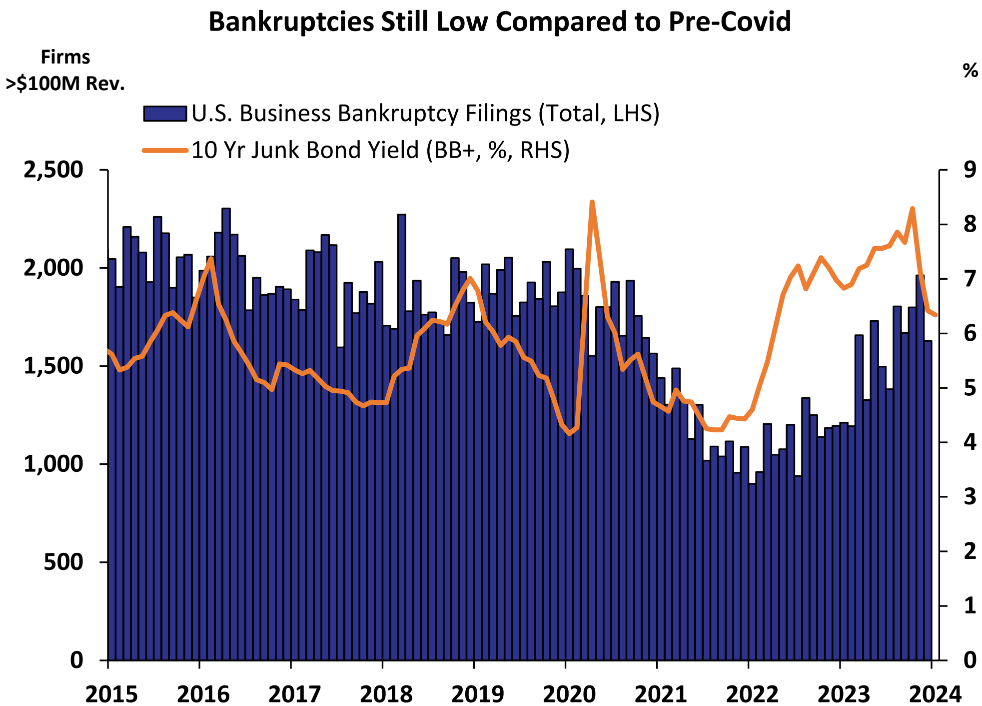
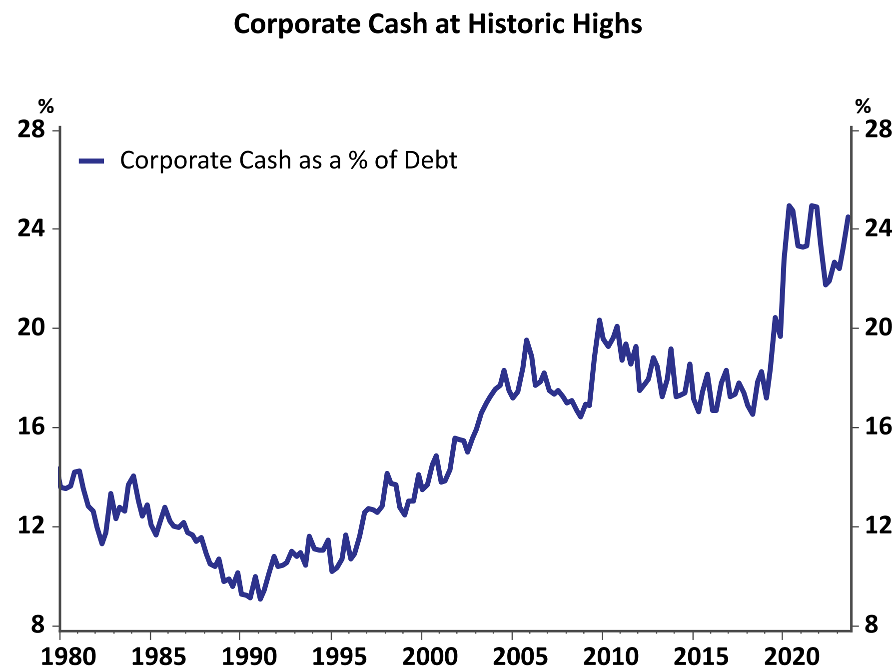
U.S. corporations are in a healthy position with low near-term risk





Although there is concern about rising bankruptcies, they are well below pre-pandemic levels and corporates' have high levels of cash

Source: MacroPolicyPerspectives/Standard & Poor's Global Fixed Income Research/Administrative Office of the U.S. Courts/Haver Analytics

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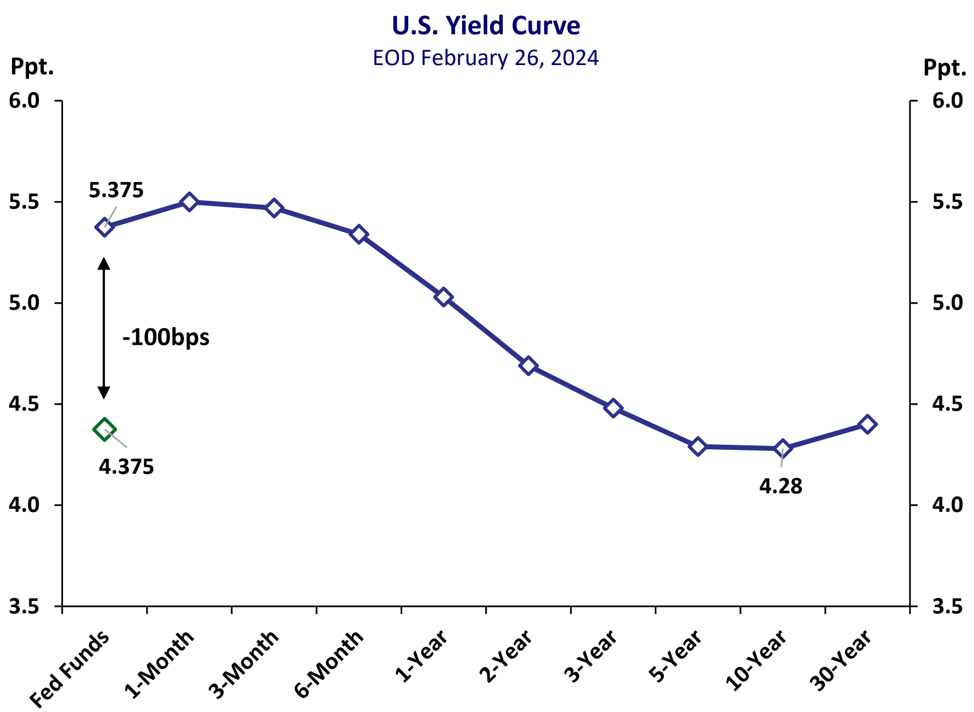
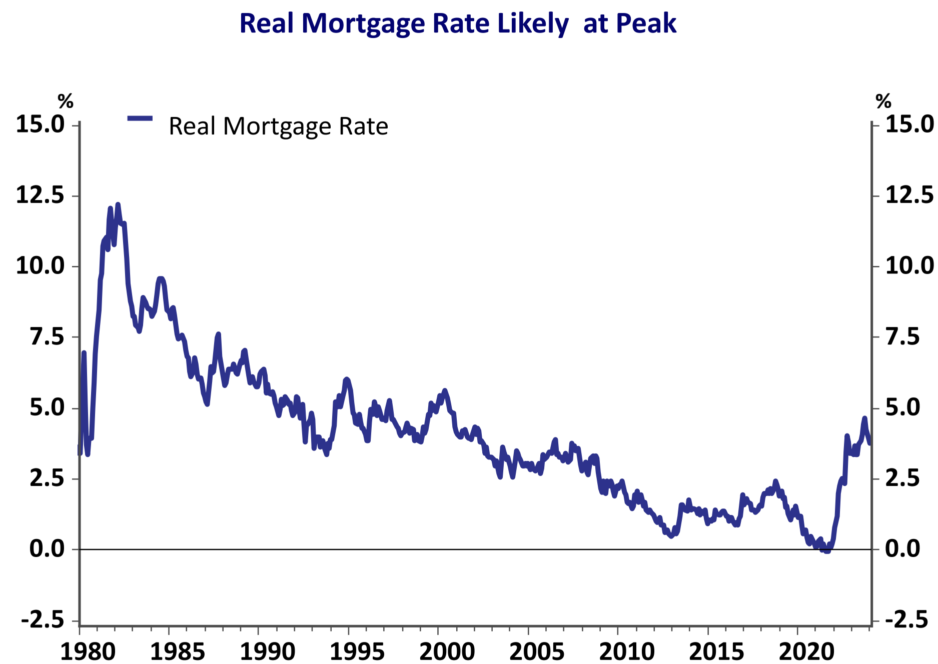
A positive sloping yield curve could have outsized impact on mortgages





The spread of mortgages over 10-yr yields is higher than normal due to the inverted curve and high pre-payment risk

Source: MacroPolicy Perspectives/Federal Reserve Board/Haver Analytics

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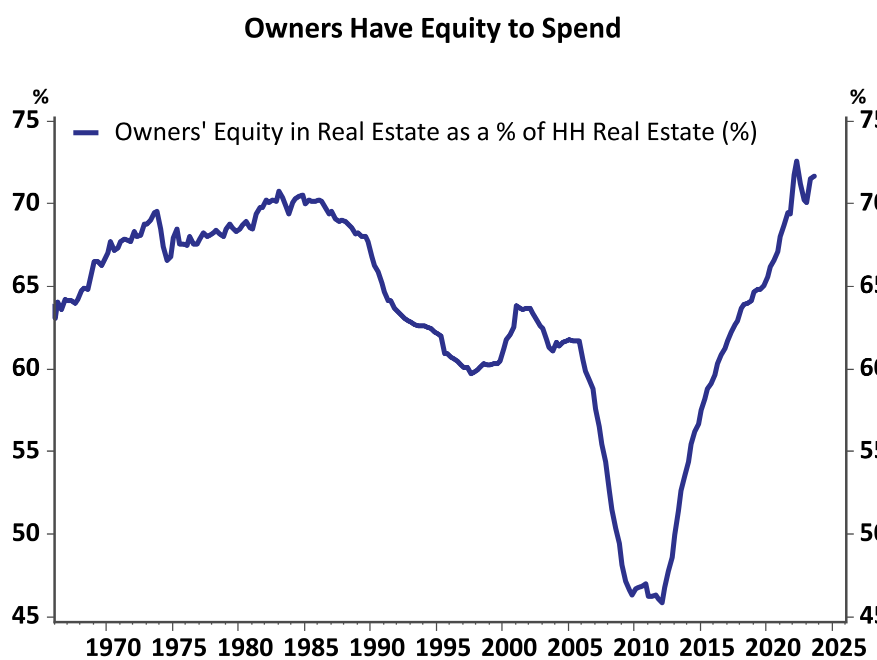
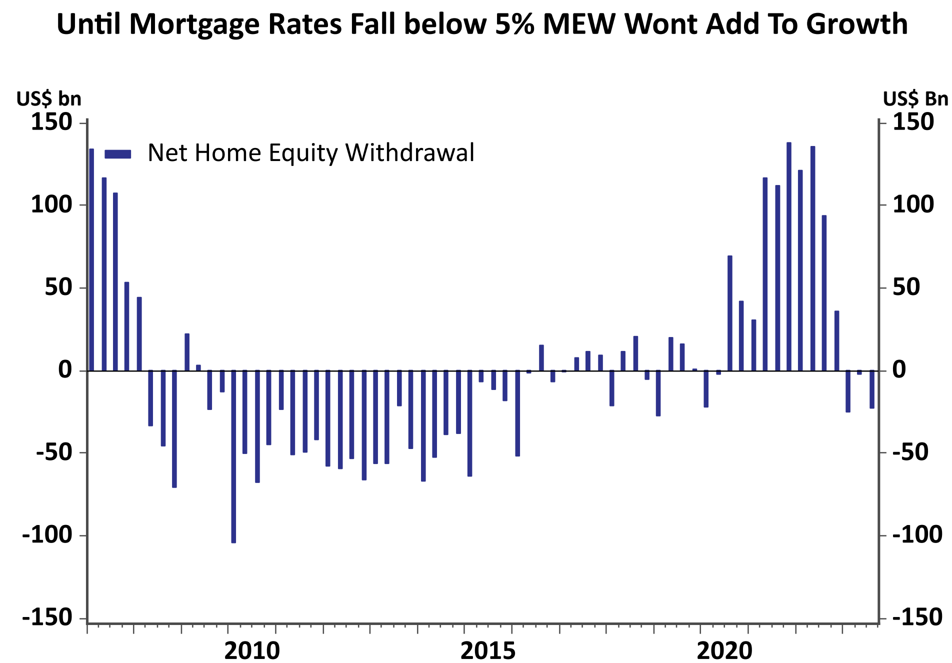
When rates fall, households will have a source of capital to spend





Homeowners have added to net home equity as real rates have risen; this is a potential source of cash when the rates fall into 2024

Source: MacroPolicy Perspectives/Federal Reserve Board/Haver Analytics

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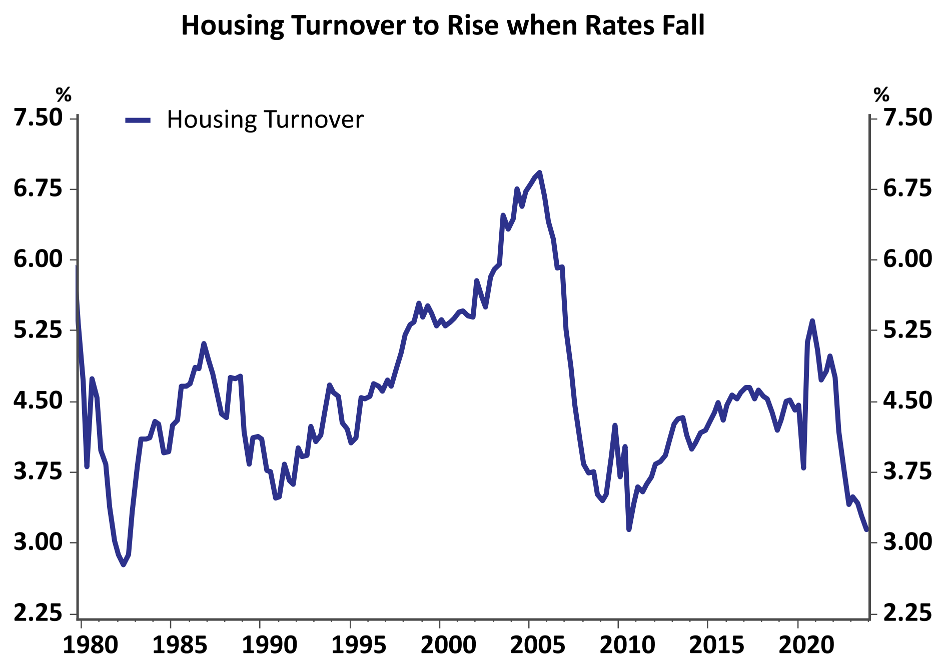
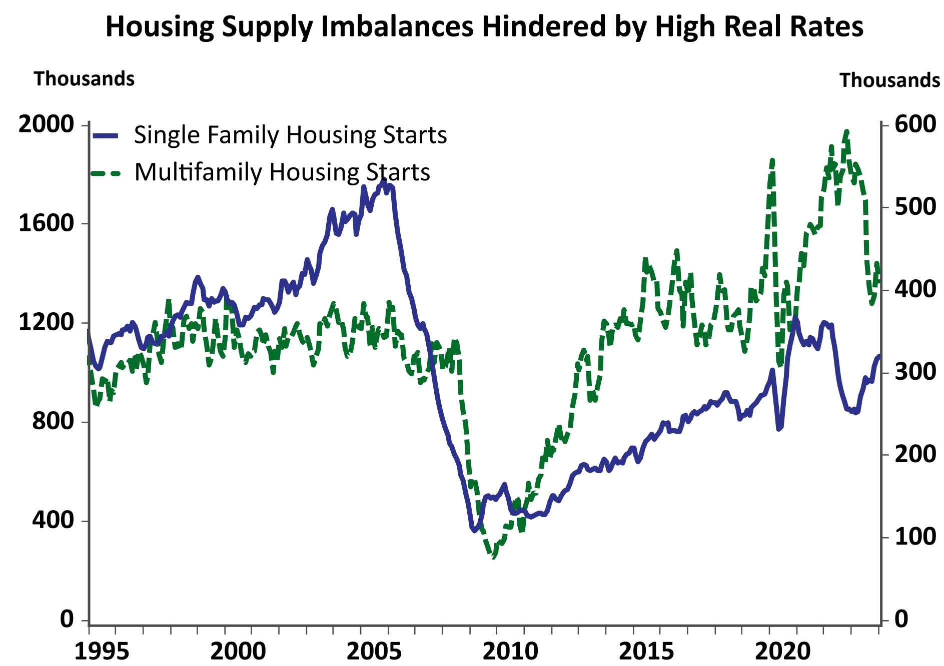
The supply of new and existing homes is also held back by high rates





Supply is one of the factors contributing to high housing prices, lower rates should loosen up supply helping to soften housing prices

Source: MacroPolicy Perspectives/Census Bureau/Haver Analytics

MACROPOLICY PERSPECTIVES

After a pause in momentum, higher growth in H2 2024

MPP US Economic Forecast Summary

	2023	2024-Q1	2024-Q2	2024-Q3	2024-Q4
Real GDP (% q/q saar)	3.1	1.6	2.0	2.1	2.5
Real PCE (% q/q saar)	2.6	1.8	2.1	2.2	2.5
Unemployment rate (%)	3.7	3.7	3.7	3.8	3.9
Labor force participation (%)	62.7	62.6	62.6	62.7	62.8
Employment (avg mthly chg)	255	211	137	150	165
PCE Price Index (% y/y)	2.7	2.4	2.2	1.8	1.8
Core PCE Price Index (% y/y)	3.2	2.7	2.2	2.0	1.9
Federal funds rate (%, eop)	5.4	5.4	5.1	4.6	4.1
Federal Reserve Balance Sheet (trn $, eop)	7.7	7.4	7.2	6.9	6.8

Source: BEA, BLS, Federal Reserve, MacroPolicy Perspectives LLC.

- We expect rate cuts to help boost consumption by Q4
- We expect some softening in payrolls while participation rises slightly. This should push up unemployment, but not to recessionary levels
- Productivity will be the key to allowing stronger growth to be maintained without igniting inflation
- We expect real rates to remain restrictive, even as the Federal Reserve cuts rates, putting continued downward pressure on prices

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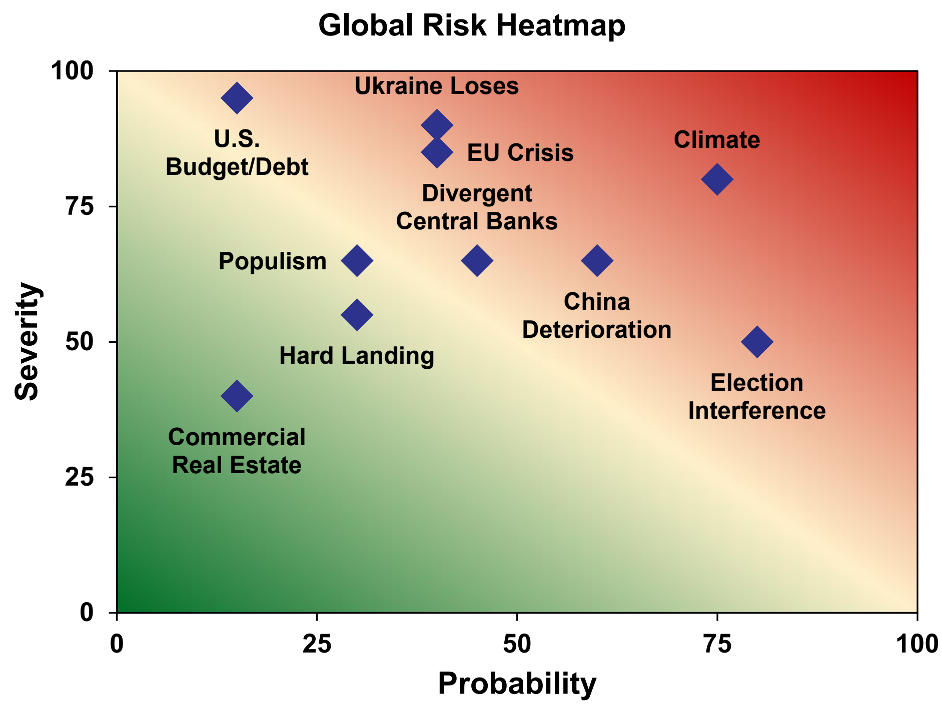
U.S. Key Takeaways

- We expect the Fed to have the confidence in price stability to cut in Q2
  - On a 6-month annualized basis, PCE and Core PCE have already hit the 2% target which is faster than Fed forecasts as indicated by the summary of economic projections. **MPP forecasts that by June, headline PCE will be at 2.1% y/y.**
  - Now that Fed speakers have highlighted balanced risks, it means they will consider inflation data in tandem with labor market data which shows a mix of resilience in the jobs data but some signs of possible weakness in hours worked and the household survey. In addition, MPP's proprietary analysis of earnings calls suggests that labor hoarding may be coming to an end which would likely mark an inflection point in jobs data.
  - The Fed has room to lower rates starting in March, even if they don't yet have the confidence to do so. Nevertheless, initiating a series of cuts in May or June will likely allow the economy to capitalize on the productivity surge underway and could allow for a repeat of the second half of the 1990s where growth accelerated, and the price level declined.
  - A delicate balance between dynamism and slowing growth will play out in 2024.
  - Global factors not withstanding, the U.S. economy is slowing moderately and the pace at which it deceleratess will be greatly influenced by the timing of the first rate cut and the magnitude of cuts the Fed signals it will make as the year progresses. In addition, slow global growth will not do the U.S. economy any favors, except perhaps in terms of softer price pressures.
  - Despite slowing growth, there is significant momentum to the dynamism that the combination of the pandemic and technology have unleashed on the economy. These trends are likely to play out over 2024 and be a source of positive surprises for a roaring 20s if geopolitics do not derail the expansion.

The top 10 risks vary in terms of likelihood and severity

- Low probability risks such as failure to raise the U.S. debt ceiling or pass a budget would have severe consequences.
- While individual properties are at high risk, there is moderate systemic risk from a commercial real estate crash given the current economic outlook. Nevertheless, it makes the top 10 list and bears watching closely as the level of intertwined holdings and contagion could materially increase this risk.
- More severe risks, such as Ukraine being defeated and Russia gaining territory, pose severe long-term risks to NATO and the West.
- Over 50% of the world's population votes in 2024 making it a year when election interference or increased populism could impact economic outcomes.
- Climate risks are increasing in terms of frequency and severity. As can be seen in slide 6, they manifest in higher insurance costs. Meanwhile, Europe has commenced the implementation phase of their Carbon Border Adjustment Mechanism that will change world trade over the next five years.



Source: MacroPolicy Perspectives

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