2024 Macro Outlook

Business cycle & mega trends

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Ideas you will find in this presentation:

- What makes this business cycle special? Balance sheets & the breadth of the mega trends we face.
- What economic indicators say about the strength of US and eurozone GDP and inflation prospects.
- How ADA Economics thinks and includes digitalisation in our macroeconomic and political analysis.

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The macroeconomic implications of digitalisation

- What is digitalisation? AI, cloud, robotics, quantum computing, Machine Learning, IoT, virtual reality, blockchain.
- It is faster, bigger and it interferes with how people gain knowledge and their decision making.
- From a macroeconomic perspective, it directly influences investment (high depreciation, polarising impact, hard for policy makers to keep up) and productivity.
- It is THE mega trend. It is an enabling technology for the green and energy transitions, as well as underpinning another wave of financial deepening ahead via blockchain.
- Digitalisation is not the only mega trend we face: friend shoring, negative demographics (in Europe) and rising defence spending are also very important in this business cycle.
- Implementing all these changes requires labour! That is why the labour market is so tight.
- Responding to climate change requires significant upfront investment to 2030, which introduces an element of urgency for society and policy makers, which is a dimension that previous business cycles did not have.

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….in brief what we face is:

- We want to do more, with fewer people.
- Big investment cycles create inflation and, in the past, have worsened the public sector credit rating.
- These changes are very complex, polarizing society and financial balance sheets at a time when this technology requires more creativity, a happier society to nourish collaborative solutions and genuine competition.
- The political and geopolitical landscape becomes more important for financial markets than before.
- Technology by itself will not generate the productivity we expect. It requires a fairly profound adaptation of some institutions: their funding, their approach and their flexibility (or lack of it). This is the key bottleneck I see as most relevant today that will shape the new business cycle that is due to start shortly.

Inflation has returned to target – 2025 GDP outlook is highly uncertain

In the US and in the EU, we are in the last phase of the business cycle right now: economic activity is decelerating, inflation is compatible with the target, but interest rates remain very high. We see a cumulative of 175-200bp of easing in both US and eurozone over 2024-2025..

The key drivers of inflation over the “short term horizon” (1-18 months) are energy, food, housing and demand pressures. We have made extensive progress on all these fronts.

The key drivers of inflation in the “medium to long term” (2-5 years) are productivity and the design/effectiveness and underpinning ideas of public institutions that influence inflation and productivity. On this front, we have made modest steps forward.

Notwithstanding lower measured inflation, the majority perceives and acts as if inflation did not slowdown as much as it did. This creates an unusually strong trend of portfolio reallocation of savings into higher yielding assets, like equities.

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GDP: differences between US and eurozone

Investment: In the US it improved in H223, while in the eurozone it contracted last year and does not appear to be improving right now.

Household spending: It is expanding by more than what the labour market would imply, helped by credit access, while in the eurozone it is still contracting and below what the labour market would imply.

Why is that? Look at balance sheets of households: European families are too exposed to cash, US households have increased exposure to equities to unprecedented levels.

Fiscal policy in the US has stayed loose, while it was tentatively consolidating the euro area since 2023.

US real GDP growth currently estimated at 2.5% by the Atlanta FED nowcasting model as of the 1st week of March. Eurozone is likely to be stagnating in the foreseeable future, Q1 could underperform expectations.

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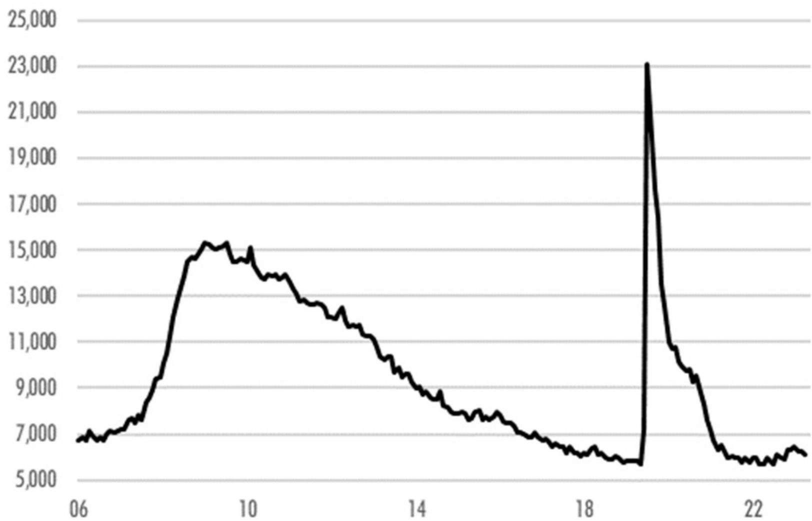
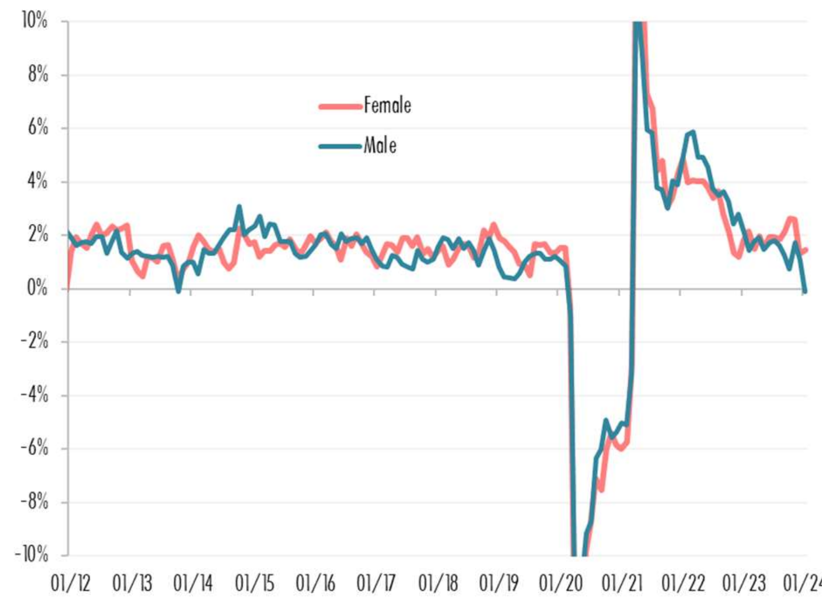
US labour market: conflicting messages but not as strong as it may look

1. Number of unemployed, mn



2. Employment by gender, yoy



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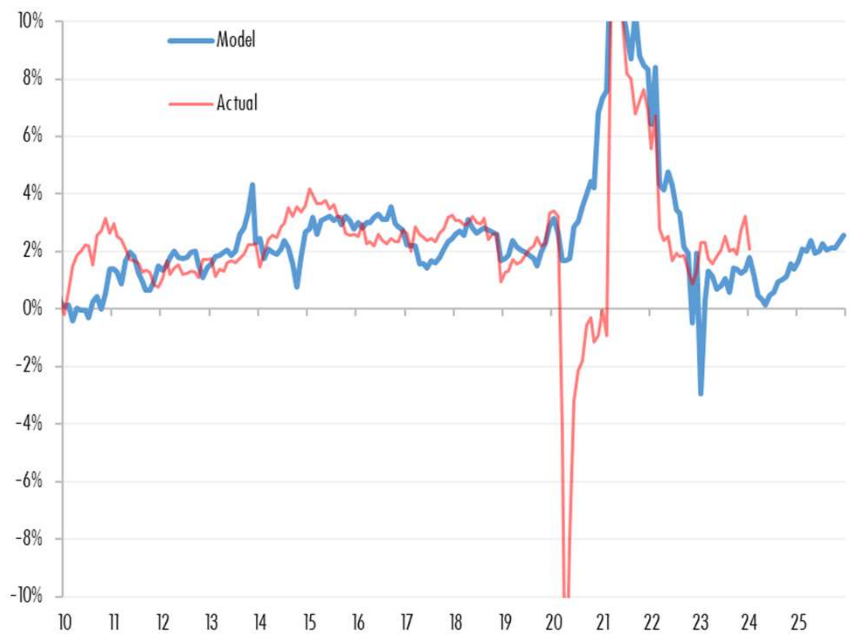
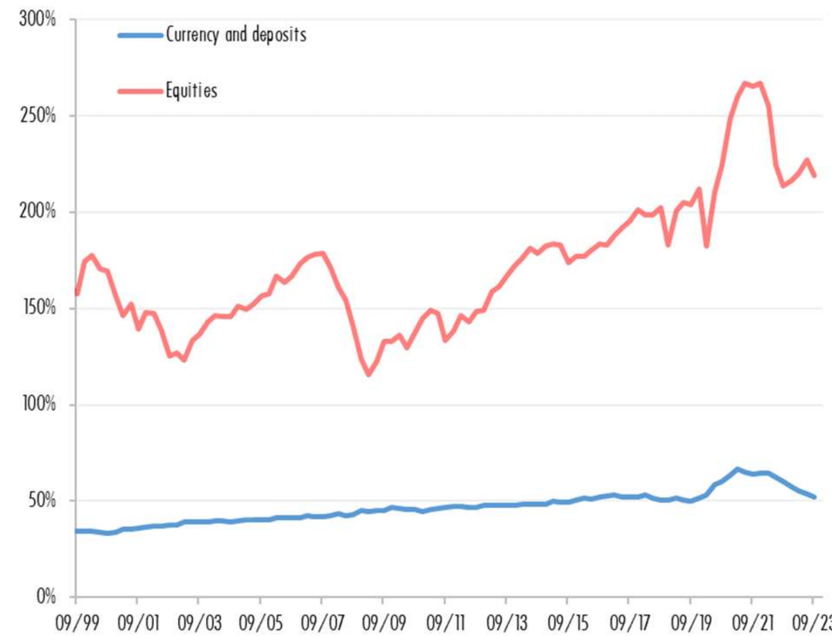
US retail spending: credit, confidence and some wealth effects

3. Real spending (goods and services) inc wealth effects



4. Households financial assets: cash, equities, total % GDP



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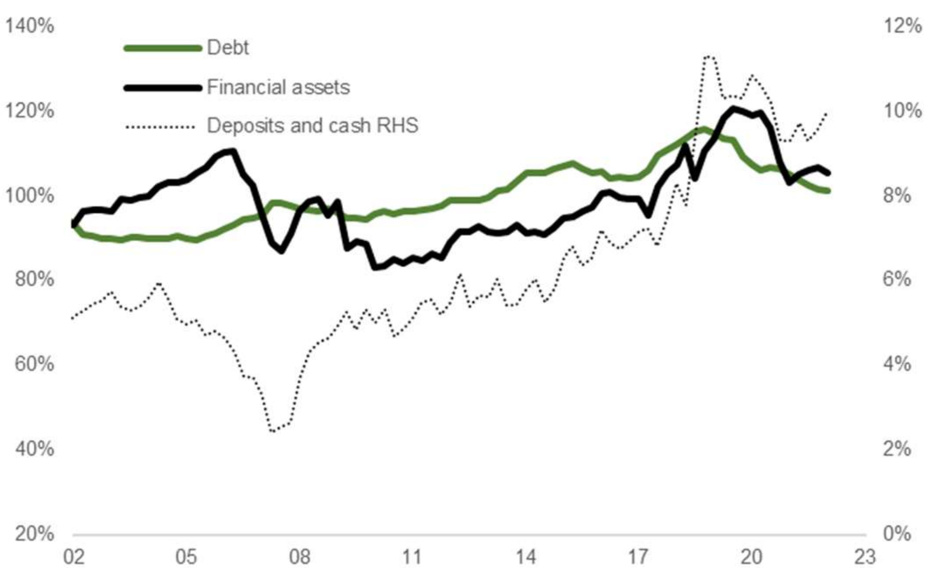
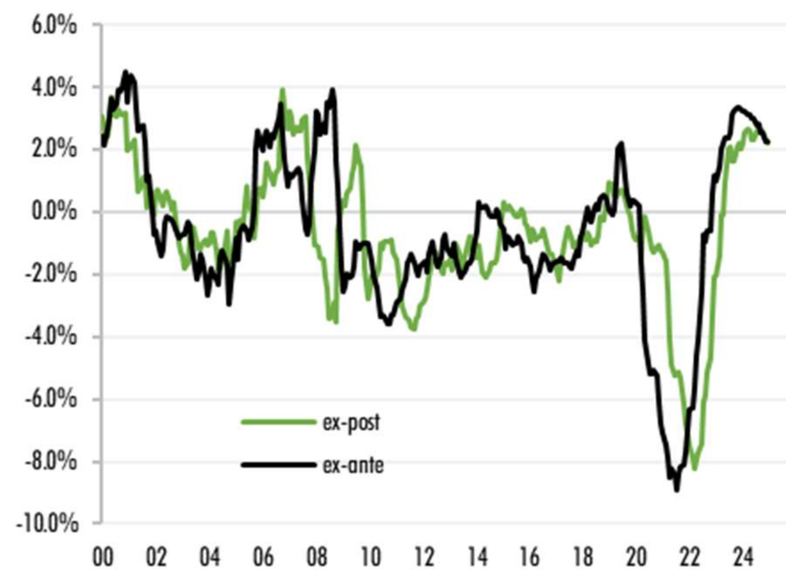
US non financial corporate business balance sheets: strong, but not unusually so

5. Key balance sheet items, % of GDP, of NFCs



6. FED policy rate deflated by CPI



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Our view is that the FED will cut by 100bps in 2024E, real GDP growth will be 2%

Inflation slowed to 3.1%yoy in January, we see it below 2% in Q4 and at target in 2025E.

Ideally the FED should cut from the June meeting, that would allow the economy to decelerate without generating unemployment.

There is growing risk that the FED will delay the cuts because GDP growth is strong, which probably means that the unemployment rate will edge up by year end and next year will likely underperform consensus expectations

We anticipate a strong dollar vs euro, at 1.03 later this year

ECB to cut by 100bp from June, real GDP stagnates

Preliminary inflation at 2.6%yoy in February, hovering above 2% this year and below target in 2025E.

Business surveys show now improvement in the manufacturing sector, orders are stagnant

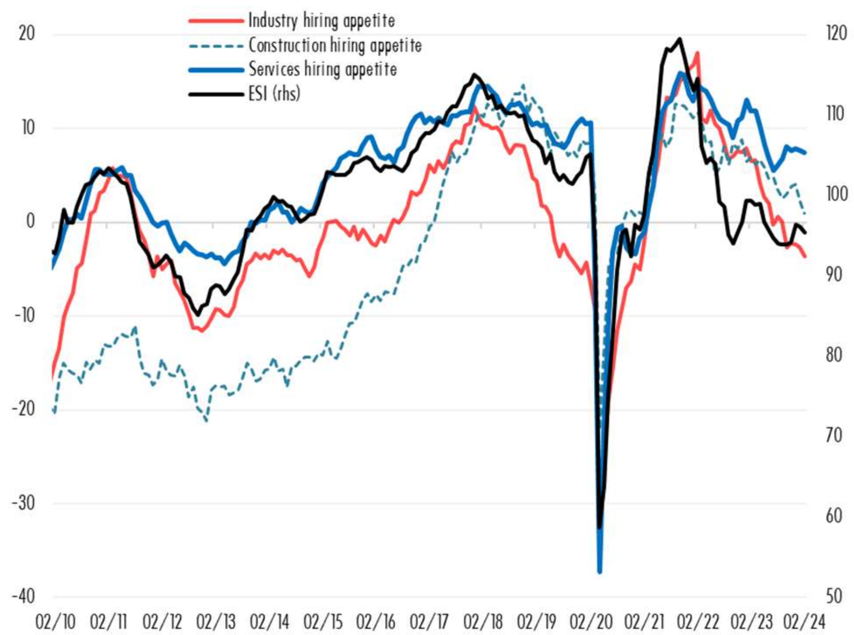
European leaders have made legislative progress on the framework for the green, digital, energy, friendshoring and defence transitions. But policy communication is weak into the June EU parliamentary elections and that compounds uncertainty and weighs on investment.

Eurozone labour market: tight, but not forever

7. Employment (LHS)

	16-64yrs old			25-54yrs old		
	2008	2023	difference	2008	2023	difference
EU27	191,648.7	199,661.8	8,013.1	149,516.7	142,949.6	-6,567.1
EZ20	147,286.3	155,172.5	7,886.2	114,794.7	109,169.0	-5,625.7
Belgium	4,430.4	4,974.4	544.	3,617.5	3,699.9	82.4
Bulgaria	3,360.3	2,851.9	-508.4	2,621.1	2,108.1	-513.
Czechia	4,947.4	4,903.9	-43.5	3,868.4	3,716.9	-151.5
Germany	38,330.1	41,400.0	3,069.9	28,694.3	27,323.9	-1,370.4
Estonia	637.4	652.3	14.9	471.6	472.2	0.6
Ireland	2,163.2	2,542.1	378.9	1,534.3	1,808.0	273.7
Greece	4,550.9	4,140.0	-410.9	3,705.6	3,134.6	-571.
Spain	20,399.5	20,933.5	534.	16,228.3	15,510.0	-718.3
France	25,973.8	28,092.8	2,119.	20,588.3	20,164.0	-424.3
Croatia	1,789.2	1,570.4	-218.8	1,418.7	1,190.4	-228.3
Italy	22,805.6	22,850.9	45.3	18,819.8	16,440.4	-2,379.4
Hungary	3,857.6	4,617.7	760.1	3,194.1	3,537.8	343.7
Netherlands	8,289.0	9,402.4	1,113.4	5,932.0	5,895.9	-36.1
Austria	3,972.6	4,443.7	471.1	3,048.2	3,161.4	113.2
Poland	15,749.8	16,448.5	698.7	12,764.1	12,889.9	125.8
Portugal	4,783.6	4,795.1	11.5	3,733.0	3,493.9	-239.1
Romania	9,101.2	7,649.4	-1,451.8	7,164.9	6,062.2	-1,102.7
Slovenia	999.1	971.4	-27.7	799.4	731.5	-67.9
Slovakia	2,461.9	2,556.8	94.9	1,997.4	1,981.7	-15.7

8. Economic sentiment surveys & hiring appetite



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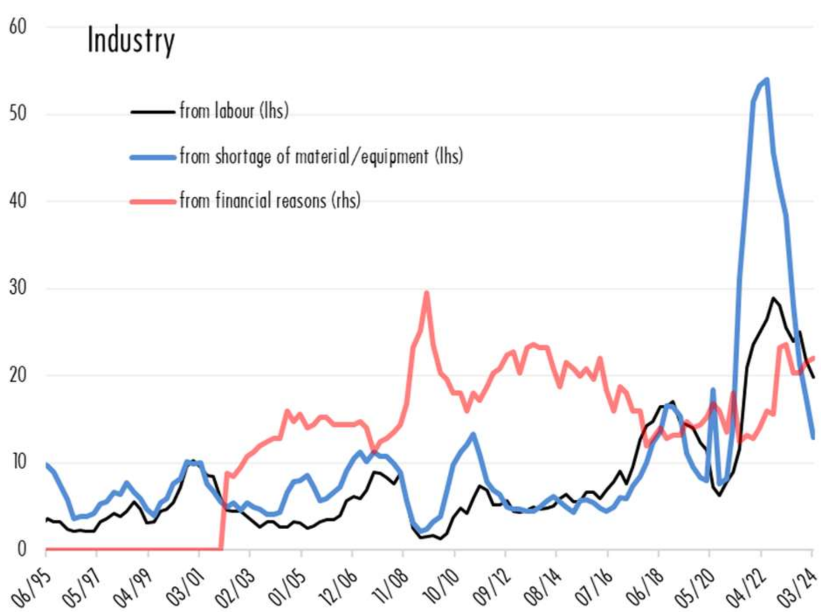
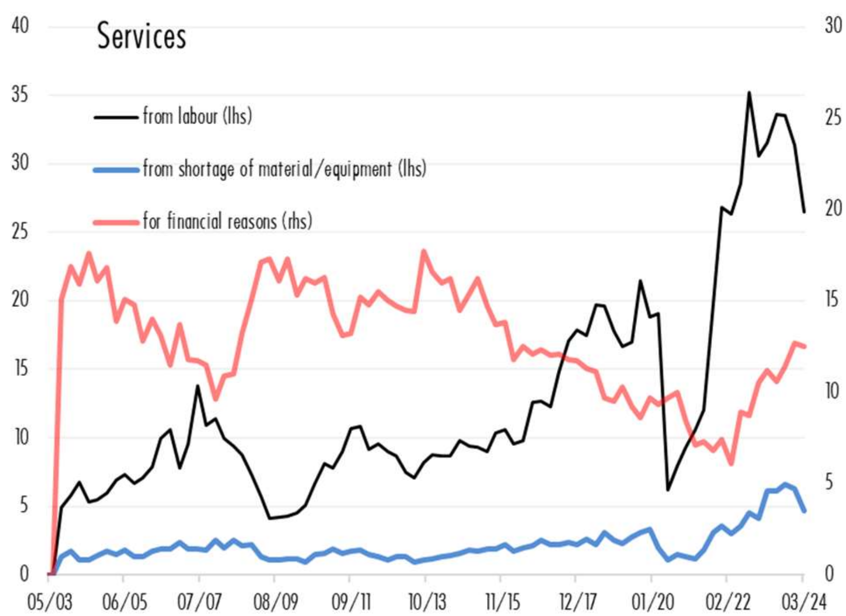
Eurozone labour market: tight, but not forever

9. Bottlenecks to production from labour, equipment and financial reasons since 1995





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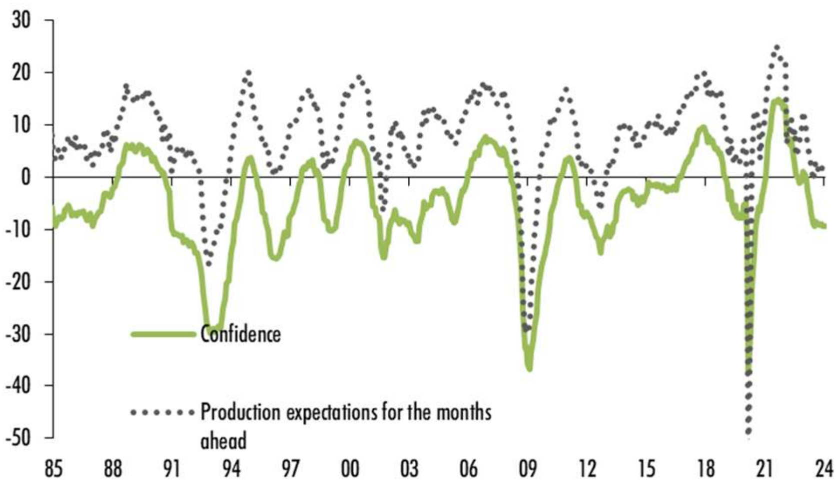
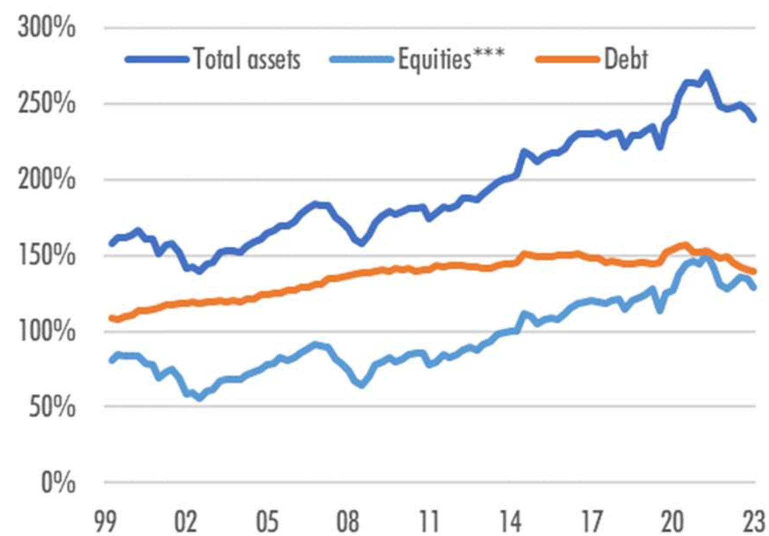
10. Industrial sector sentiment is not improving



11. . . .but NFCs balance sheets have (and have more cash at hand)



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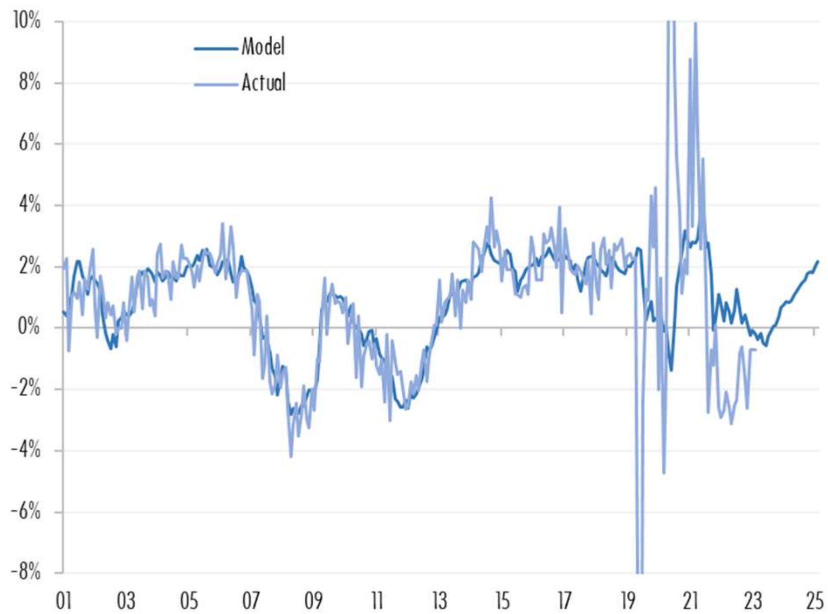
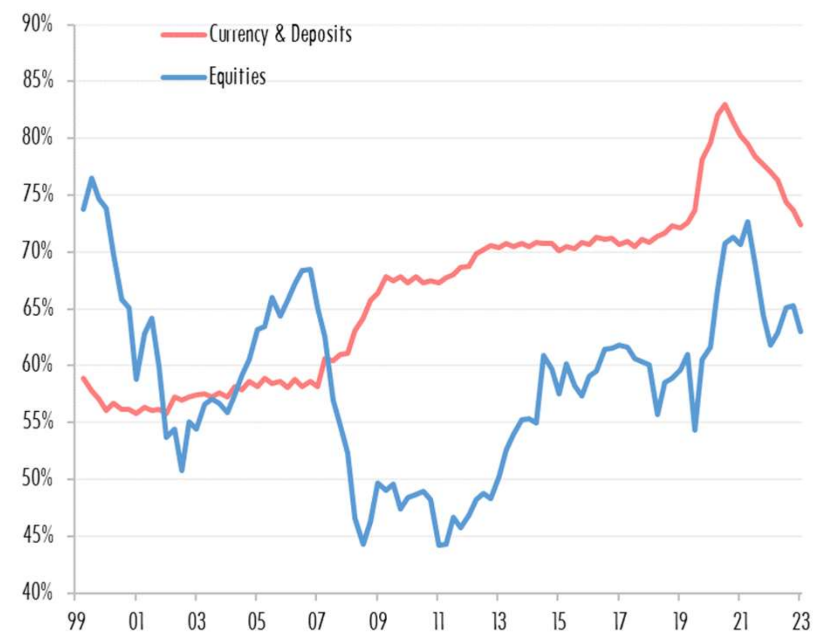
Eurozone retail spending: actual spending vastly underperforms the labour market

12. Retail model unadjusted



13. Households financial assets: cash, equities, total % GDP



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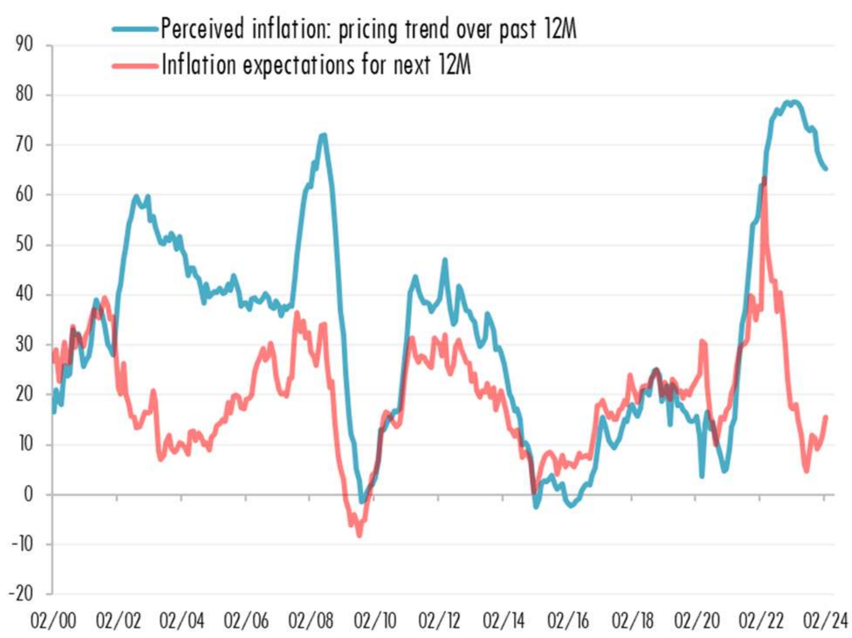
The problem with monetary policy going forward

14. Is inflation as low as we measure it? Maybe not…



- What is imperfectly measured in current CPI: depreciation, complex pricing, shifting basic needs towards services rather than goods, withdrawal of state core services pushes people to more expensive private services.
- We are very good at calibrating monetary policy when there is a demand problem, but we are not very good at calibrating the monetary stance when there is an investment supercycle. Maturity mismatch, productivity barriers and insufficiently accurate measure of inflation are all very real implementation difficulties.
- When the distribution representing financial strength becomes too polarised, the mean does not represent enough and higher interest rates would be needed for the top 20% of the distribution.

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The macroeconomic implications of digitalisation

- It is faster, bigger and it interferes with how people gain knowledge and their decision making.
- It is an enabling technology for the green and energy transitions, as well as underpinning another wave of financial deepening ahead via blockchain.
- The business case for broadening digital tools for education and healthcare is clear. The productivity gains however as things stand will be negligible at the country level in many cases.
- Digitalisation gains should be easier and bolder for some emerging markets with young population and an acceptable level of freedom of speech & action.
- The financial consequences of breaking public trust, especially where a global reserve currency is in place, could be very severe and should be taken more seriously.

Notes and sources on the charts and tables in this report

1. The number of unemployed in the US in millions of persons, is historically a leading indicator of a turning point in the business cycle. The primary data source is Bureau of Labour (BLS), we sourced it from CEIC, which is a data aggregator.

2. The year on year change in employment of male and females, the chart shows an abrupt slowdown of male employment, which we see it as a further signal that the labour market is weakening. The primary source of the data is BLS, we sourced it from CEIC.

3. Real spending year on year changes reflects the real personal consumption quarterly series produced by the Bureau of Economic Analysis (BEA) and the model showing in the chart was created by us and attempts to explain and project PCE using the following variables: households assets, oil prices, housing prices, oil price, interest rates, USD and government spending.

4. US households financial accounts provided by the Federal Reserves in % of US GDP.

5. Non financial corporations reflect the nonfinancial corporate sector in the financial accounts for the US, in % of US GDP. The primary source of the data is the Federal Reserve.

6. The Federal Reserve effective policy nominal rate deflated by the current inflation rate (ex post series) and by our inflation rate projection in 12 months' time (ex-ante series). The time series comes from CEIC.

7. Employment in the EU for the 16-64 years segment and the 25-54yrs old segment (the most productive). The primary source of the data is Eurostat.

8. Economic sentiment surveys represent the perception of consumers and the key business sectors: industry, construction, services, retail. The hiring appetite index is part of the survey on economic conditions. These surveys are produced monthly by the European Commission.

9. Bottlenecks to production surveys are released by the European Commission on a monthly basis for construction and quarterly for the industrial sector.

10. Industrial sentiment indices for the eurozone, released by the European commission.

11. Non financial corporations financial accounts for the eurozone are released by Eurostat on a quarterly basis.

12. Retail sales in volume terms for households in the eurozone and our model aims to explain the pattern in year on year change in retail sales, using the following variables: ECB assets, eur-usd, consumer confidence, Stoxx index, interest rates and oil prices.

13. Households financial accounts for the eurozone are released by Eurostat.

14. Eurozone households' inflation survey produced by the European commission, the chart shows an index that reflects the level of concern of households with regards to inflation in the coming year and their perception of how high inflation was in the last twelve months.

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