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Economic and Strategy Viewpoint

Q1 2024

The immaculate disinflation



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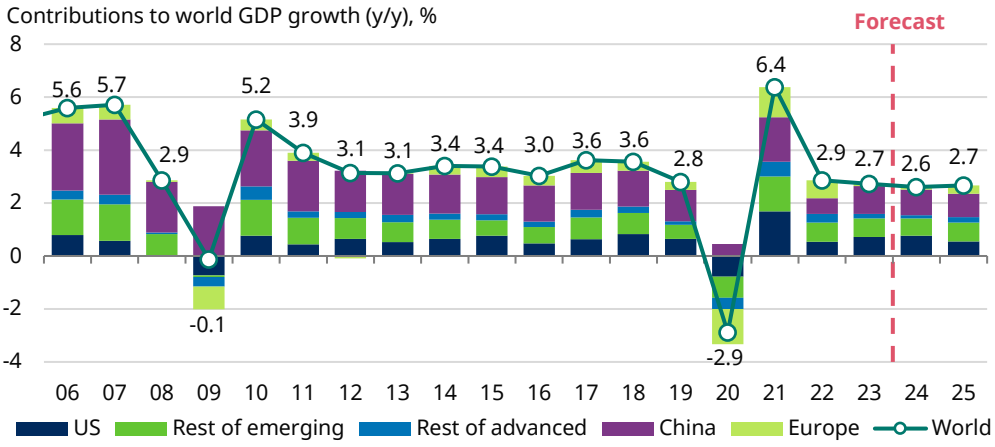
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- Investors and economists alike had thought that policy makers needed to engineer mild recessions to reduce inflation pressures. And yet, inflation has fallen sharply over the past year and is almost back to target for the major central banks. This has occurred while economies have outperformed expectations, against a backdrop of interest rates rising by more than had been expected a year ago. An immaculate disinflation, whereby inflation moderates while economic activity continues to grow, and unemployment remains low, appears now to be playing out.
- As inflation continues to fall, central banks have started to change the tone of their communication. References to upside risks for interest rates have largely been removed, while discussions of downside risks have remained. Expectations are building that interest rates will be lowered as we progress through this year, but there are still questions over how much easing will follow.
- The outlook for the global economy is looking brighter. Global GDP growth in the new Schroders forecast has been revised up from 2.2% to 2.6% for 2024 and from 2.2% to 2.7% for 2025. Meanwhile, global inflation is forecast to slow from 4.4% in 2023 to 2.9% in 2024 (unrevised) and to 2.5% in 2025 (revised down from 3%).
- In the US, the economy has proven to be far more resilient, all whilst inflation has continued to moderate. Job creation is easing but is set to remain healthy, supporting consumer spending which is also benefitting from improving real income growth as inflation continues to fade. Falling inflation should allow the Federal Reserve (Fed) to start cutting the fed funds rate this summer. However, the Schroders baseline forecast only has 100 basis points (bps) of cuts between now and the end of 2025 – materially above market expectations.
- The eurozone has managed to avoid a technical recession, but manufacturing heavy countries such as Germany are struggling. Growth has been revised marginally higher, mostly on the back of a better external outlook, although domestic demand is also expected to recover through 2024. Falling inflation, and interest rates from the spring should support a recovery in household spending.
- The recession-marred UK economy is likely to see a sluggish recovery through 2024, largely owing to more sticky inflation and structural supply problems. Pre-election fiscal giveaways will help growth at the margin, although will also contribute to inflation pressures that could limit interest rate cuts this year and next.
- China is seeing a near-term improvement in the external outlook, but underwhelming support from fiscal policy is likely to mean weak household demand will come to the fore as government spending fades. Meanwhile, overcapacity is leading to steep discounting and weaker commodity prices, particularly in foods. We have cut our inflation forecast and assume the current bout of deflation pressures will prove to be temporary.
- New risk scenarios have been introduced to better capture growing political risk. Overall, the balance of risks are skewed towards higher growth and inflation – the first time since the third quarter of 2020.

Chart: Global growth forecast



Source: Schroders Economics Group. 23 February 2024. Please note the forecast warning at the back of the document.

The immaculate disinflation

The term 'immaculate disinflation' was coined by economists last year to describe a risk scenario where inflation moderates while economic activity continues to grow, and unemployment remains low. This scenario now appears to be playing out in reality.

The outlook for the world economy is looking brighter. The narrative over the past year was that inflation was far too high, and central banks needed to engineer mild recessions to allow demand and supply to rebalance, and in-turn, to reduce inflation pressures. And yet, inflation has fallen sharply over the past year and is almost back to target for the major central banks. This has occurred while economies have outperformed expectations.

Is this too good to be true? Should investors really stop thinking about 'hard and soft landings', and instead think about 'no-landing' or reflation as their central investment thesis?

Honey, I shrunk the inflation

It sometimes amazes us the different attitudes towards inflation. In the US, headline inflation based on the consumer price index (CPI) fell to 3.1% year-on-year (y/y) in January, down from 6.4% a year earlier. Nevertheless, the current pace of price increases is still considered a 'problem' by consumers, the media and policymakers alike. By contrast, inflation in the UK is higher at 4%, yet leading politicians have been celebrating the 'halving of inflation' as a key objective being met. The fact that UK inflation is still double the Bank of England's (BoE) target seems to have been drowned out by the sounds of celebratory high-fives.

While most of the major central banks still have some work to do, it's fair to say that the worst of the high inflation pressures appear to have subsided (chart 1). Energy, and in particular gas prices have fallen back substantially, while food price inflation is set to follow suit after wholesale prices have dropped.

Chart 1: Headline CPI inflation

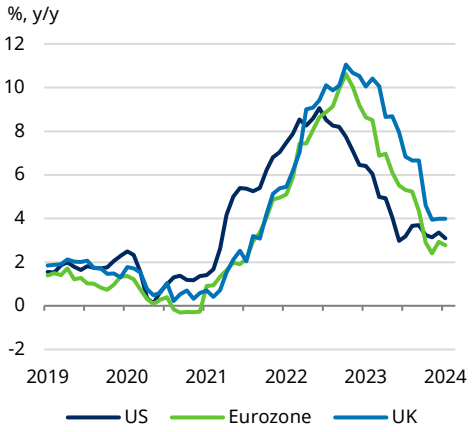
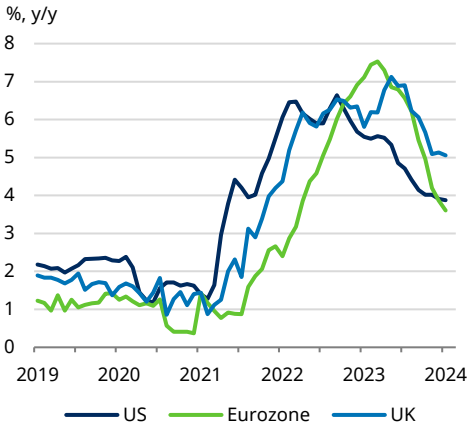


Chart 2: Core CPI inflation



Source: LSEG, Schroders Economics Group. 23 February 2024.

Inflation fell substantially in 2023, but it has further to go

However, core inflation (headline inflation excluding food and energy) remains elevated (chart 2). Core inflation is often seen as a better measure of underlying price pressures, and so it is important to see this measure fall further before investors can be confident that inflation is back under control.

Nevertheless, major central banks have progressively shifted the tone of their communications away from the hawkish signals from last year. Most have dropped

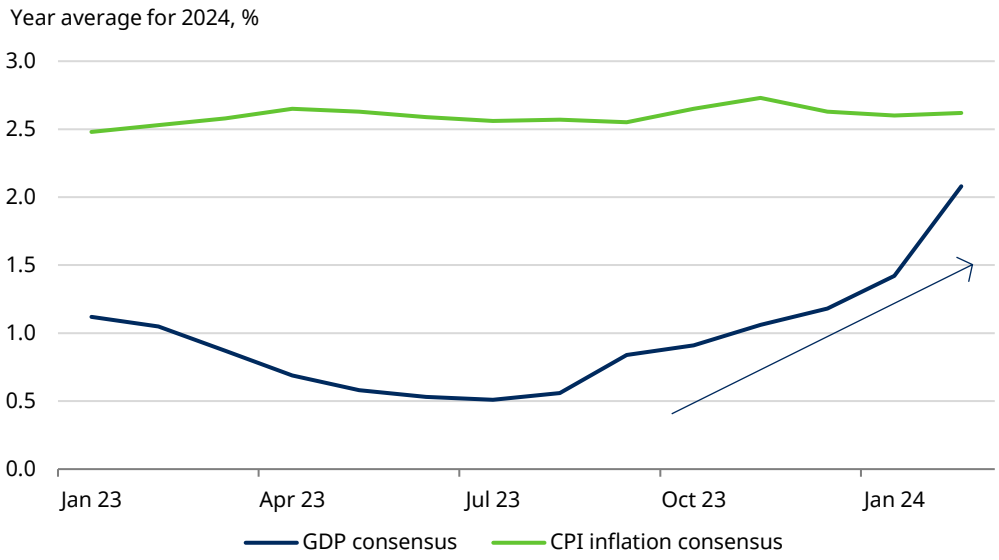
language that warns of excessive demand and upside risks to the inflation (and consequently interest rate) outlook. Instead, there has been a greater emphasis on downside risks to growth. This is a clear signal that monetary policy has turned, and that the direction for interest rates is likely to be lower.

Recession? What recession?

The fall in inflation, particularly in the US has largely been in-line with expectations. Consensus forecasts for CPI inflation for 2024 (calendar-year average) have been consistently near 2.5% since the start of last year (chart 3). The remarkable development in the past 12 months has been the fall in inflation while the US economy has remained resilient.

Expectations have shifted from a 'hard landing' to a 'soft landing', but should we be looking at 'no landing'?

Chart 3: From 'hard landing' to 'no landing'?



Source: LSEG, Schroders Economics Group. 21 February 2024.

Consensus forecasts for 2024 US GDP growth fell to 0.5% in the middle of last year, effectively forecasting a recession. There had been some softening of activity including the pace of hiring. There were concerns over the impact from the failure of Silicon Valley Bank (SVB), and fears that the wider banking system, particularly of uninsured smaller institutions, could pose a systemic risk for the US economy.

Those fears eventually abated and as we headed into the autumn, activity data continued to surprise to the upside, prompting forecast upgrades. There was some softening to activity data, especially in the labour market. Recruitment difficulties continued to ease as wage inflation moderated.

2023 ended on a strong note as the US economy grew by a 3.3% annualised rate in the fourth quarter. This was significantly more than consensus expectations of 2% and spurred further optimism for the outlook ahead. It seemed that the trade-off between growth and inflation had improved, and that a 'no-landing' scenario was possible. Consensus forecasts have since risen to 2.1% for 2024 GDP growth, which may still be an underestimate.

Don’t fight the Fed

Volatility in interest rate and bond markets has been elevated in recent months, which in hindsight is unsurprising given the swings in growth expectations. Chart 4 shows how investors’ expectations for the fed funds rate has evolved.

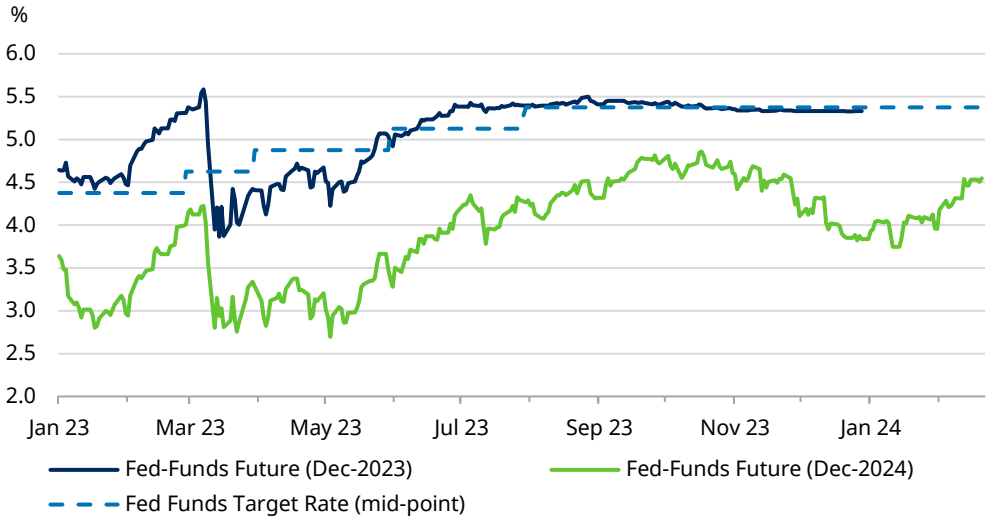
The Fed spent most of 2023 pushing the ‘higher for longer’ message regarding rates...

At the start of 2023, money markets had priced the fed funds rate to reach just over 4.5% for December 2023, and then fall about 100 bps by December 2024. Those expectations rose as the Fed raised rates in February, and repeated its ‘higher for longer mantra’.

Pricing by the end of March had risen 100 bps, which also resulted in a sharp rise in Treasury bond yields. These large shifts caught some investors off guard, and in particular SVB’s management, which contributed to its downfall. In the end, concerns over the stability of the banking system required policymakers to intervene to support markets and confidence.

Following SVB’s collapse, pessimism set in, as money markets began to price interest rate cuts by the end of last year – a 150 bps swing in pricing. But the Fed stuck to its mantra, arguing that high inflation had to be tamed, and further interest rate hikes followed in the subsequent two policy meetings. It was not until mid-June that markets/investors begin to price in further tightening again for last year, ending with rates rising one final time in July.

Chart 4: US interest rate expectations vs. policy



Source: LSEG, Schroders Economics Group. 23 February 2024.

...and it doesn’t seem that the market is listening again

Following the December Federal Open Market Committee’s (FOMC) meeting, the Fed suggested that it was preparing to think about easing policy, but was still suggesting a ‘higher for longer’ approach given the resilience of the economy. This pushed market pricing for rates lower, resulting in 150 bps of cuts being priced over the next 12 months. This is despite the (median) projection from the FOMC ‘dot plot’ suggesting only half of this easing.

Since the start of this year, the stronger data mentioned earlier has again shifted expectations and market prices, with the latest now showing only 100 bps of cuts expected for December 2024. Investor Marty Zweig coined the famous phrase: ‘Don’t fight the Fed’ back in 1970, yet those lessons are still being learned.

Forecast update: diverting to 'no landing'

Overall, the new Schroders baseline forecast has seen a significant upgrade to global growth, with the forecast for inflation being reduced towards the end of the forecast horizon.

The new Schroders forecast has seen significant upgrades to global growth...

Global GDP growth has been revised higher this year from 2.2% to 2.6%. Most regions have seen some upgrades, but the biggest contributor came from the US economy. The global forecast for 2025 has also been revised up, from 2.2% to 2.7%, again, mostly on the back of upgrades to the US outlook.

Meanwhile, the global inflation forecast for 2024 remains unchanged. Inflation is projected to moderate further from 4.4% in 2023 to 2.9% for this year. However, a lack of change masks a reduction to the emerging markets (EM) forecast, which has been offset with a small upward revision for advanced economies.

Inflation is forecast fall further to 2.5% in 2025, a reduction from the previous forecast of 3%. Although a number of regions have had their respective inflation forecasts downgraded, the negative contribution is mainly coming from the EM.

US forecast update: big upgrade

...most of which has been driven by upgrades to the US growth forecast...

Given the above analysis, this is where there has been the largest shift in the new baseline forecast. US GDP growth for 2024 has been upgraded from 1.3% to 2.7%, which is considerably higher than the 2.1% consensus expectation discussed earlier. Growth is then expected to slow to 1.9% over 2025, but this is also a significant upgrade compared to the previous forecast of 0.8%.

The US economy was previously assumed to remain relatively healthy in the near-term, with households still using their pandemic excess savings to fall back on. However, the peak of the impact from aggressive interest rate hikes was expected to hit activity in the middle of this year, just as fiscal support was waning. These two factors were expected to slow the economy to sub-trend growth rates, resulting in the unemployment rate rising to 4.8% by the end of 2024 and 5.5% by the end of 2025.

But, the economy has proven to be far more resilient, all whilst inflation has continued to moderate. Job creation is easing but is set to remain healthy, supporting consumer spending which is also benefitting from improving real income growth as inflation continues to fade.

...on the back of falling inflation, and a more resilient economy.

US CPI inflation is forecast to slow from 4.1% in 2023 to 2.7% this year, before averaging 2.1% in 2025. Rent of shelter has been a prominent contributor to the headline rate of inflation over the past year (chart 5), but faster moving surveys of private rent suggest that much of the inflation pressures have now subsided. For example, the Zillow rent index suggests that rental inflation has already returned to pre-pandemic rates, which should feed into the CPI component over the course of this year (chart 6).

Chart 5: US CPI inflation contributions

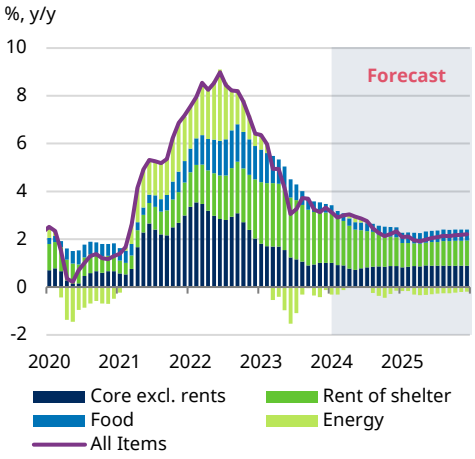
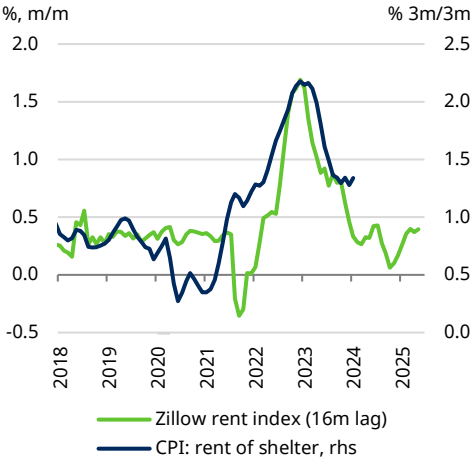


Chart 6: Rents inflation set to fall



Source: Macrobond, Zillow, Schroders Economics Group. 22 February 2024. Please note the forecast warning at the back of the document.

The Fed is likely to cut rates from June...

The Fed's preferred measure of inflation using the personal consumption expenditure deflator (PCE) has recently run half a percentage point below CPI inflation. Meaning that its target of 2% PCE inflation translates to about 2.5% CPI inflation. This may not strictly hold but is a reasonable guide in the near-term.

Indeed, over the final six months of 2023, the annualised run-rate of PCE inflation has already fallen back to the Fed's target. Does that mean monetary policy is about to be eased? Not quite yet. At the January FOMC press conference, Chair Powell set out the conditions for the easing of policy. He stated that: *"The lower inflation readings over the second half of last year are welcome. But we will need to see continuing evidence to build confidence that inflation is moving down sustainably toward our goal."*

When asked *"whether its premature to think that rate cuts are right around the corner"*, Powell replied: *"... I don't think it's likely that the Committee will reach a level of confidence by the time of the March meeting to identify March as the time to do that."*

...but long-run market rate expectations may be too low

The continued decline in inflation should enable the Fed to start carefully and methodically cutting rates from June. The baseline forecast has a total of three 25bps cuts this year, and one further cut in March 2025. By then, not only will inflation be close to target, but demand in the economy will be showing signs of re-acceleration. Goods price disinflation will likely come to an end, leading the Fed to conclude that the neutral interest rate is somewhat higher than currently implied by its longer-run estimate of the fed funds rate (2.5%).

Of course, the election at the end of this year will receive a great deal of attention. At this point, the contest is incredibly close and too difficult to predict. For the purpose of the forecast, it is assumed that President Joe Biden will be returned to office. However, where we do have more confidence is on the margin of the victory. We assume that there will be a narrow majority in Congress, constraining the ability of the President to enact any sweeping reforms to domestic policy. However, with the use of executive orders, there is clearly more scope to more active policymaking on the international front.

Europe: recovery in 2024

Europe has seen a slight upgrade to its growth forecast

The baseline forecast for Europe has only had minor revisions at face value, but beneath the surface, there is more movement. Starting with the eurozone aggregate, the GDP growth is forecast to rise slightly from 0.5% in 2023 to 0.7% in 2024, before

returning to above trend growth in 2025, achieving 1.8% for the year as a whole. This is half a percentage point higher than consensus forecasts.

Within this profile, heavy manufacturers led by Germany are struggling. The German economy contracted by 0.1% last year, and is probably in recession now. It is forecast to only eek out 0.2% growth this year (downgraded from 0.7%), although a broader recovery is expected to emerge in 2025, with growth averaging 1.7%.

With Germany so weak, that means other member states are doing the heavy lifting this year. France, Spain and Italy are all forecast to outperform Germany, mostly thanks to a greater share of services activity in their respective economies, but also looser fiscal policy. Both Spain and Italy have enjoyed larger injections of support from the European Union's Next Gen funds. In contrast, Germany's coalition government has been forced to reverse some of its public investment plans following a ruling from the German Constitutional Court that the use of funds set aside to help with the pandemic was deemed to break fiscal rules.

An improved outlook for France, Italy and Spain has offset the weakness in Germany

Despite the above, growth data has at the margin surprised to the upside. Additionally, with the US economy now expected to avoid a significant slowdown this year, there is the prospect for a recovery in net exports – exports have been a key source of weakness, especially for Germany.

Having peaked at 10.6% in October 2022, eurozone HICP inflation has been steadily falling back, averaging 5.4% in 2023. The latest reading from January showed inflation down to 2.8% y/y and is forecast to fall below the European Central Bank's (ECB) central 2% target in the next few months. This should prompt the ECB to start to cut interest rates as soon as March by 25 bps, with a further three cuts to follow this year.

Consumer confidence has already started to recover, largely thanks to inflation falling, and real disposable incomes recovering. The eurozone unemployment rate is still at a record low, while wage inflation remains elevated. Combined with falling interest rates, households should start to reduce their precautionary savings to boost spending and domestic demand.

Improved domestic demand is likely to cause inflation pressures to build once again in the latter part of the forecast. Inflation is forecast to rise from 2.1% in 2024 to 2.8% in 2025, which, while within the ECB's 1% upper band, will be uncomfortable for policymakers. The governing council is expected to cut rates twice more in the first half of 2025, before pausing – taking the refinancing rate to 3%, with the deposit rate at 2.5%.

UK: sticky inflation to limit recovery

Recession hit UK has been downgraded in the near-term

Another major economy that has had its growth forecast downgraded was the UK, as recent official data showed that the economy had entered a technical recession in the second half of last year. The recession was expected, though the size of the contraction in activity was a little worse than expected. For this reason, the near-term prospects have been downgraded, and the economy is expected to remain in recession until the second quarter of this year. However, with the worst of the forecast recession unfolding sooner, the prospects of a faster rebound have improved at the margin. Sequential growth in the forecast has been raised from the second half of this year onwards, leading to GDP growth for this year being lowered by 0.1 percentage points to -0.2%, but raised from 0.7% to 1% for 2025.

One of the features of the UK economy are the structural supply side problems, exacerbated by Brexit in recent years. Impediments to trade and labour shortages are partly to blame for the sticky inflation seen which is likely to persist. CPI inflation is forecast to briefly fall below the BoE 2% target in the first half of this year, before heading back towards 3% over the rest of the forecast horizon.

Pre-election fiscal giveaways will help at the margin, but may also limit interest rate cuts

The government is likely to announce fresh fiscal stimulus ahead of the expected general election this autumn. The BoE already expects inflation to rise in the second half of this year, even before accounting for any new stimulus, which suggests that interest rate cuts are likely to be limited.

The first cut in UK interest rates is forecast for May (25 bps), followed by another in June. However, due to the expectation that inflation will then rise, interest rates are then only lowered by another 50 bps over the rest of the forecast, ending the forecast at 4.25%.

The general election is highly likely to result in a change in government. The left-wing Labour party has a strong lead in popular opinion polls, which tends to prefer a more interventionist set of policies, with higher taxes and higher public spending. However, Labour's leadership have not made many pre-election pledges yet, and those that were made have recently been abandoned, owing to costs.

Emerging markets: external boost

Stronger growth in developed markets, in particular the US, are likely to have some positive spill over to the EMs and we have nudged up our projections for activity. We now expect EM GDP growth of 4% both this year and next, up from 3.9% and 3.8% respectively. Aggregate inflation is set to be lower. But this is in large part due to China, whereas inflation elsewhere is likely to be a bit higher than previously assumed. This, coupled with a higher rates environment in developed markets, means that EM interest rates are unlikely to fall quite as quickly as previously assumed.

China: Structural slowdown with cycles

We entered this year expecting China to enjoy a slight cyclical improvement in growth in the first half of 2024 on the back of looser policy and an acceleration in manufactured exports. Exports have picked up, notably in volume-terms that is important for real GDP growth, and our continued expectation for a recovery in the global manufacturing cycle implies that manufacturing will continue to fare relatively well.

At the same time, with government bond issuance set to drive the credit impulse higher for a while longer, looser policy is likely to support growth for a bit longer than we previously assumed. After all, movements in the credit impulse typically lead growth by about nine months.

China's underwhelming fiscal stimulus means domestic demand is likely to soften into 2025

However, given that fiscal stimulus remains relatively small, weak domestic demand conditions are likely to come to the fore again as the boost from public spending fades into 2025. Despite some tentative signs of stabilisation in higher tier cities, the housing market remains extremely fragile and any significant turnaround seems unlikely in the foreseeable future. That, along with soft labour market conditions, will probably continue to weigh on confidence for some time.

China's fragile domestic economy means that deflation remains a concern. The headline CPI rate has turned negative on the back of commodity price effects and deflation in some goods amid signs of overcapacity in industry. Meanwhile core inflation has remained positive on the back of services prices. While we have significantly lowered our projections for inflation, our baseline forecast assumes that the current bout of deflation will prove temporary with headline inflation averaging 0.2% in 2024 and 0.7% in 2025 (down from 1% and 1.2% respectively).

There is a clear risk, however, that services inflation will roll over in the months ahead, not least because several of the categories that are holding up pertain to the weak housing sector. Evidence of outright deflation would probably be a necessary

condition for the authorities to significantly adjust their policy mix, something that we have begun tracking in our 'China stimulus' scenario.

Outperformance of India's economy to continue

Fading inflation in India should allow the RBI to cut interest rates, and support robust growth

With President Modi seemingly on track to comfortably win this year's general election, the government delivered a reassuringly restrained budget in February. Rather than deliver a splurge of pre-election giveaways to shore up support, spending is set to remain restrained in a bid to reduce the fiscal deficit and make space for private sector investment to take up the baton from government capital expenditure (capex).

Some slowdown in growth still seems likely in the first half of 2024. But fading inflation pressures should eventually allow the Reserve Bank of India (RBI) to lower interest rates later this year. And this, along with the solid policymaking environment, is likely to support activity further down the line and ensure that India remains the faster growing major EM economy. We expect GDP growth in the region of 6.5-7% through the next 18-months.

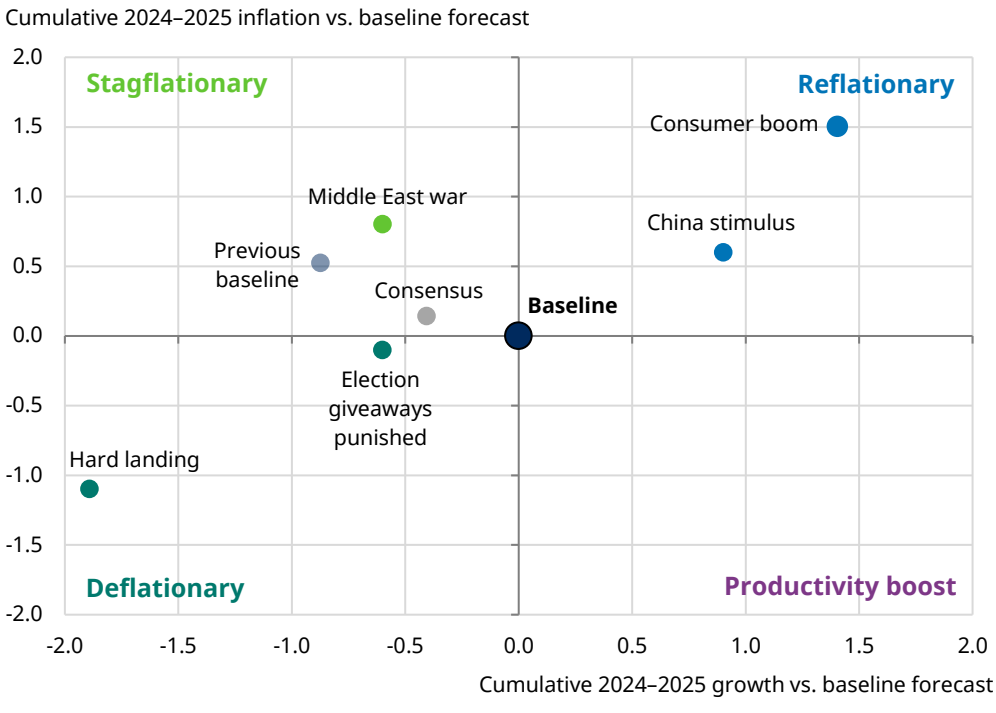
Risk scenario analysis: rising geopolitical risk

In addition to the baseline forecast, the Schroders Economics Group produces a set of risk scenarios designed to examine the impact of potential events and risks around some of the underlying assumptions made in the forecast. The criteria for inclusion is that the risk must be expected to at least become a concern to investors, and therefore is reflected in financial markets in the next six months.

New scenarios introduced to capture the rise in geopolitical risk

The scenarios are summarised in Chart 7 below, where the cumulative difference in GDP growth between now and the end of the forecast horizon is shown for each scenario along the horizontal axis, and the cumulative difference in CPI inflation is shown on the vertical axis. Therefore, scenarios in the top right quadrant are classified as reflationary versus the baseline forecast owing to higher growth and inflation, whereas scenarios in the bottom left quadrant are deflationary, and so on.

Chart 7: Scenarios grid – growth and inflation deviations from baseline



Source: Schroders Economics Group. 23 February 2024. Please note the forecast warning at the back of the document.

In this quarter's update, we have attempted to capture the growing concerns over geopolitical risk.

Previously, the stagflationary '**geopolitical crises**' scenario attempted to model several potential flair-ups, including an escalation of the conflict in the Middle East as well as rising tensions between the West and China. This scenario has been replaced with one that exclusively focuses on the former, and two more that target other concerns.

A 'Middle East war' scenario includes oil prices rising to $100 per barrel

The new '**Middle East war**' scenario assumes that the localised fighting in Israel spreads across the region, which also drags Western nations into the conflict. The war is assumed to not only disrupt key shipping channels but also the supply of oil, causing wholesale prices to spoke towards $150 per barrel. The macroeconomic impact is likely to be stagflationary for the global economy. Higher inflation caused by the shock to commodity prices is likely to meet a severe shock to corporate confidence, which will likely reduce capex at a time of great uncertainty.

With 59% of democratic populations going to the polls this year, representing 43% of world GDP, the political risk brought about by elections is also high on the list of concerns. The most important of all will be the US election this November, where a return of former president Donald Trump is expected by many investors to lead to renewed fiscal stimulus.

The US's large fiscal deficit would probably make this difficult, but what if the two candidates throw caution to the wind and engage in an ever-escalating bidding war of fiscal giveaways? To explore this, we have introduced the '**elections giveaways punished**' scenario, where the current administration finds a way to increase spending just before the next election (temporarily boosting growth), but further promises of giveaways from both sides scare investors over the increase in future indebtedness. Bond vigilantes return in force worldwide, punishing profligate governments, and those that had been vulnerable in the past. Yields rise sharply, causing future borrowing costs to explode.

'Election giveaways punished' sees the return of bond vigilantes, and market induced austerity

In response, the next US president (whomever it is) is forced to not only U-turn on election giveaway pledges, but also to introduce harsh austerity measures in an attempt to win back investors' confidence. This results in a deflationary outcome relative to the baseline forecast in 2025.

Other impacted countries act sooner, introducing emergency austerity from the third quarter of this year, and also seeing deflationary results.

The third government driven scenario is more positive for investors over the forecast which is the new '**China stimulus**' scenario. Weaker activity data at the start of this year coupled China's annual rate of inflation falling below zero prompts authorities to inject substantial fiscal stimulus in order to boost demand. The proceeds of large government bond issuance are used to fund infrastructure projects, investments in green technology and high-tech manufacturing along with some support for consumers. Beijing also delivers some measures to stabilise the housing market but resists the temptation to restart mass real estate construction.

'China stimulus' could follow if the nation falls into deflation...

Higher growth in the region follows, although the spillover to advanced economies is limited. Commodity prices rise in response to stronger demand, contributing to higher global inflation. Overall, a reflationary scenario.

The remaining two scenarios focus more on uncertainties around the impact of monetary policy, and the behaviour of households. The '**hard landing scenario**' has been retained, and reflects the risk that monetary policy typically works with long and variable lags. The cumulative effect of tighter monetary policy has a larger impact in this scenario compared to the baseline, prompting households and firms to cut back

spending aggressively, tipping many economies into recession (and deepening those already in one). Spare capacity opens-up pulling inflation down more quickly, making this a deflationary scenario.

...while uncertainty over consumers is reflected by the 'hard-landing' and 'consumer boom' scenarios

The final scenario is an update of our previous 'consumer resilience' scenario, where households continue to use excess savings built-up during the pandemic to grow their spending. Despite the upgrade to the baseline forecast, we feel there is still room for household consumption to surprise to the upside, especially in Europe where those pandemic savings are mostly still intact. Therefore, to better reflect the status and risk to the baseline, we have renamed the scenario '**consumer boom**'. Even stronger household consumption drives up growth and investment, pushing wages higher and re-inforcing demand. Inflation is naturally higher as labour markets tighten even further, and monetary policy in this scenario remains at current levels or restrictiveness, or additional tightening is required (for example in Europe).

Balance of risks

Compared to the end of 2023, the new Schroders forecast for the world economy has moved in the direction of the productivity boost quadrant, meaning growth revised higher and inflation lower. In comparison to our peers, the consensus average is more stagflationary, with lower growth and higher inflation.

In thinking about the likelihood of each of the risk scenarios, the '**consumer boom**' is seen as the most likely outside of the baseline forecast (chart 8). '**China stimulus**' and '**hard landing**' receive equal probabilities and are joint second and third in the order, followed by '**Middle East war**' with '**Election giveaways punished**' seen as the least likely.

The balance of risks to the baseline forecast is skewed towards a reflationary direction

Chart 8: Scenario probabilities

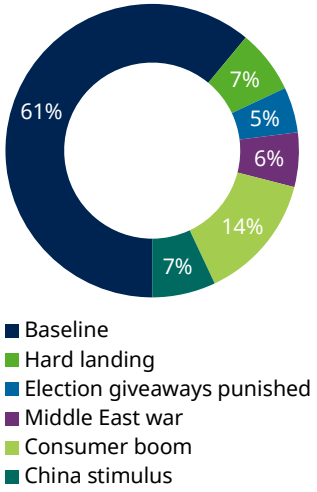
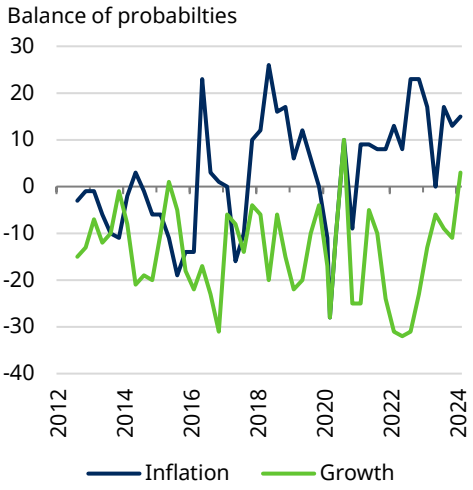


Chart 9: Growth and inflation skews



Source: Schroders Economics Group. 23 February 2024. Probabilities are mutually exclusive.

Overall, the evolution of the baseline forecast and risk scenarios means that the balance of risks for growth has flipped to being skewed to the upside, and has reached its highest level since Q3 2020 (chart 9). The risk to the inflation forecast has risen slightly, and remains skewed to the upside.

Schroders Economics Group: Views at a glance

Macro summary – Q1 2024

Key points

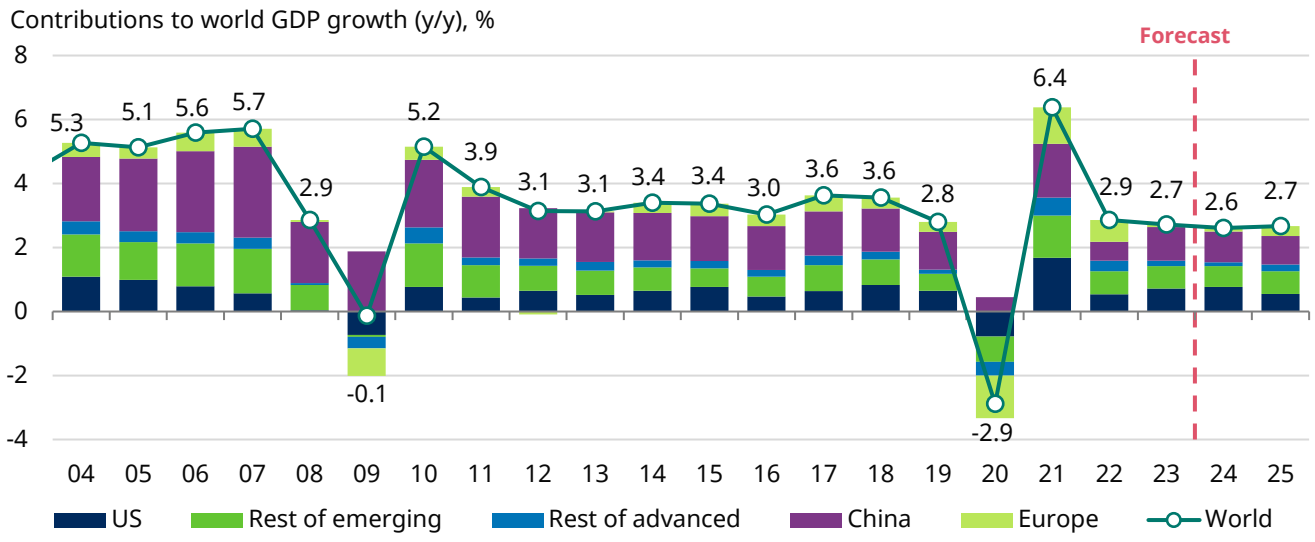
Baseline

- **US:** A strong end to 2023 combined with a solid start to 2024 mean that we now forecast GDP growth of 2.7% this year. For 2025, we expect a more modest 1.9% expansion. On the inflation front, tight labour conditions will ensure 'supercore' remains sticky. But this will be more than offset by the shelter category, such that inflation ought to return to target around the turn of the year. This should allow the FOMC to cut the federal funds rate from June in a careful and methodical manner. However, we believe there is only scope for 100 bps of easing, given that by early 2025 the committee will have achieved its dual mandate of full employment and price stability.
- **Eurozone:** Activity in the eurozone was very weak in the second half of 2023, with several economies experiencing recessions. Domestic demand has been hit by high inflation and the rise in interest rates, while external demand has been even weaker, partly due to a loss in eurozone competitiveness. The ECB is expected to begin cutting interest rates in the next quarter, delivering 100 bps of cuts this year, and another 50 bps next. Falling inflation and interest rates should underpin some recovery in GDP growth, rising to 0.7% this year and then returning to above trend in 2025.
- **UK:** The UK fell into recession in the second half of 2024, slightly sooner than we had expected. High and sticky inflation coupled with the rise in interest rates have squeezed consumers, weakening domestic demand. The economy is forecast to see a sluggish recovery in 2024 (-0.2% GDP growth), as supply side problems limit the pace of growth, and result in higher inflation. As a result, the BoE is forced to cut more slowly, with only 100 bps of cuts forecast for this year and next. The general election, likely to be held in the autumn, presents additional uncertainty for investors owing to the likely change in government.
- **Emerging Markets:** Large upgrades to global growth suggest that manufactured exports will offer some boost to China's economy in the months ahead, while looser policy should give some temporary support to the fragile domestic economy before fading later in the year. We expect GDP growth of 4.8% in 2024 and 4.5% in 2025. Despite the risk of some near-term slowdown, India is set to remain the fastest growing major EM economy over the next two years. Elsewhere, interest rates are set to fall further across many parts of EM aside from Asia. That should eventually support some pickup in domestic growth.

Risks

The balance of risks has shifted towards reflation with the new set of scenarios. Only two out of five scenarios offer higher growth risks, but the recent resilience of households has prompted a high probability being assigned of further upside risks to consumer spending. The risk of deflation in China in the very near-term also increases the likelihood of authorities injecting substantial new stimulus, which ultimately proves to be reflationary. Concerns remain over the possibility of a hard landing scenario, but geopolitical risks are also high on the agenda. New scenario capturing growing tensions in the Middle East, and risks around excessive fiscal exuberance ahead of elections capture some of the downside risks to growth.

Chart: World GDP forecast



Source: Schroders Economics Group. 23 February 2024. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2023	2024		Prev.	Consensus	2025		Prev.	Consensus
World	100	2.7	2.6	↑	(2.2)	2.4	2.7	↑	(2.2)	2.5
Advanced*	59.6	1.6	1.6	↑	(1.0)	1.3	1.8	↑	(1.1)	1.5
US	28.3	2.5	2.7	↑	(1.3)	2.1	1.9	↑	(0.8)	1.7
Eurozone	15.6	0.5	0.7		(0.7)	0.5	1.8	↑	(1.7)	1.3
Germany	4.5	-0.1	0.2	↓	(0.7)	0.3	1.7	↑	(1.6)	1.2
UK	3.4	0.1	-0.2	↓	(-0.1)	0.3	1.0	↑	(0.7)	1.1
Total Emerging**	40.4	4.3	4.0	↑	(3.9)	4.0	4.0	↑	(3.8)	3.9
BRICs	28.3	5.1	4.5	↑	(4.3)	4.4	4.3	↑	(4.2)	4.1
China	19.9	5.2	4.8	↑	(4.5)	4.6	4.5	↑	(4.3)	4.3

Inflation CPI

y/y%	Wt (%)	2023	2024		Prev.	Consensus	2025		Prev.	Consensus
World	100	4.4	2.9		(2.9)	3.0	2.5	↓	(3.0)	2.5
Advanced*	59.6	4.6	2.5	↑	(2.4)	2.5	2.3	↓	(2.5)	2.1
US	28.3	4.1	2.7	↑	(2.3)	2.6	2.1	↓	(2.2)	2.2
Eurozone	15.6	5.4	2.1	↑	(2.0)	2.3	2.8	↑	(2.7)	2.0
Germany	4.5	6.0	2.4	↑	(2.3)	2.5	2.8	↑	(2.6)	2.1
UK	3.4	7.3	2.4	↓	(2.6)	2.6	2.8	↓	(3.0)	2.1
Total Emerging**	40.4	4.1	3.4	↓	(3.7)	3.7	2.8	↓	(3.8)	3.2
BRICs	28.3	1.8	1.8	↓	(2.2)	2.1	1.9	↓	(2.3)	2.4
China	19.9	0.2	0.2	↓	(1.0)	0.9	0.7	↓	(1.2)	1.6

Interest rates

% (Month of Dec)	Current	2023	2024		Prev.	Market	2025		Prev.	Market
US	5.50	5.50	4.75		(4.75)	4.51	4.50	↑	(3.50)	3.67
UK	5.25	5.25	4.50		(4.50)	4.51	4.25	↑	(4.00)	3.82
Eurozone (Refi)	4.50	4.50	3.50		(3.50)	2.91	3.00		(3.00)	2.25
Eurozone (Depo)	4.00	4.00	3.00		(3.00)		2.50		(2.50)	
China	3.45	3.45	3.35	↑	(3.30)	-	3.25	↑	(3.20)	-

Other monetary policy

(Over year or by Dec)	Current	2023	2024		Prev.	Y/Y(%)	2025		Prev.	Y/Y(%)
US QE ($Tn)	7.7	7.7	6.5	↓	(6.8)	-15.6	6.4	↑	(5.9)	-1.5
EZ QE (€Tn)	2.7	2.7	2.4		(2.4)	-11.1	1.9		(1.9)	-20.8
UK QE (£Bn)	744	744	639	↑	(627)	-14.1	499	↑	(487)	-21.9
China RRR (%)	10.50	10.50	9.50		9.50	-	9.00		9.00	-

Key variables

FX (Month of Dec)	Current	2023	2024		Prev.	Y/Y(%)	2025		Prev.	Y/Y(%)
GBP/USD	1.27	1.27	1.22	↓	(1.26)	-4.3	1.24	↓	(1.26)	1.6
EUR/USD	1.08	1.10	1.05	↓	(1.10)	-4.9	1.07	↓	(1.12)	1.9
EUR/GBP	0.85	0.87	0.86	↓	(0.87)	-0.7	0.86	↓	(0.89)	0.3
USD/RMB	7.20	7.09	7.00	↑	(6.80)	-1.3	6.80	↓	(7.20)	-2.9
Commodities (over year)										
Brent Crude	82.3	82.3	76.8	↓	(80.0)	-6.7	72.9	↓	(76.2)	-5.1

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.
Market data taken as at 20/02/2024. Previous forecast refers to November 2023
* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.
** **Emerging markets**: Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Schroders Forecast Scenarios

Scenario	Summary	Macro impact	Probability*	Cumulative 2024/25 global vs. baseline: Growth	Inflation
Baseline	Global GDP growth has been revised higher this year from 2.2% to 2.6%. Most regions have seen some upgrades, but the biggest contributor came from the US economy. The global forecast for 2025 has also been revised up, from 2.2% to 2.7%, again, mostly on the back of upgrades to the US outlook. US GDP growth for 2024 has been upgraded from 1.3% to 2.7%. Growth in the US is then expected to slow to 1.9% over 2025. Meanwhile, growth in the eurozone is forecast to rise from 0.5% in 2023 to 0.7% in 2024 and 1.8% in 2025. By comparison, UK GDP growth for this year has been lowered to -0.2% but raised from 0.7% to 1% for 2025. Stronger growth in developed markets, particularly the US, are likely to have some positive spill over to the emerging markets. We now expect EM GDP growth of 4% both this year and next, up from 3.9% and 3.8% respectively.	The global inflation forecast for 2024 remains unchanged. Inflation is projected to moderate further from 4.4% in 2023 to 2.9% for this year. The reduction to the emerging markets inflation forecast has been offset with a small upward revision for advanced economies. Inflation is forecast fall further to 2.5% in 2025 driven mainly from the emerging markets. We still expect the ECB will be the first major developed market central bank to start cutting rates as soon as March by 25bps, with a further three cuts to follow this year. Meanwhile, the first cut in UK interest rates is forecast for May followed by another in June with rates falling to 4.25% by the end of 2025. In the US, the Federal Reserve is expected to start cutting rates from June. The baseline forecast has a total of three 25bps cuts this year, and one further cut in March 2025.	61%	-	-
1. Hard landing	The long and variable lags of monetary policy finally come to the fore as the cumulative effect of past aggressive interest rate hikes hit domestic demand hard across developed markets from Q2 onwards, particularly in the US where GDP falls by a cumulative 2%. Evidence of deep recessions that will alleviate labour market and price pressures see central banks pivot quickly to easing mode, front-loading cuts in interest rates to expansionary levels. The Fed cuts to 2%, with rates in the eurozone and UK falling to 2% and 1.75% respectively, leading to some recovery towards the end of the forecast horizon. Weaker global growth snuffs out any recovery in China's manufacturing sector, adding to problems in the housing market.	**Deflationary**: Declines in domestic demand cause negative output gaps to open up, leading to some deterioration in labour markets and easing inflationary pressures. At the same time, commodity prices tumble as the outlook for demand deteriorates, with Brent crude falling to a trough of just $40/bbl in Q3 2024. As a result, headline rates of inflation fall further than in the baseline, with calendar year averages about 0.5 percentage points below target in most developed markets in 2024, while China slips into outright deflation.	7%	-1.9%	-1.1%
2. Election giveaways punished	Bond market investors take umbrage at pre-election give-aways ahead of elections in the US and UK, at a time when leading candidates fail to deliver credible plans to tackle dreadful fiscal positions further down the line. Bond yields spike in the third quarter as elections near. Tighter financial conditions, that are buttressed by central banks being forced into rate hikes to calm financial markets, deliver an immediate hit to growth in late-2023. Central banks are also forced to restart QE. Market pressures force newly-elected governments to deliver austere budgets in 2024, resulting in a significant decline in growth that eventually allows some rate cuts later in the year.	**Deflationary**: Pre-election sweeteners initially push the global economy in a reflationary direction, notably in the US. However, tighter financial conditions and austere financial conditions reverse those trends, resulting in both growth and inflation falling below our baseline projections in 2025.	5%	-0.6%	-0.1%
3. Middle East war	The outbreak of war in the Middle East where localised fighting in Israel spreads across the region, which also drags Western nations into the conflict. This causes wholesale oil prices to spike towards $150/bbl in the second half of 2024 and remain above $100/bbl until late-2025. Conflict in the region means that disruption to shipping routes through the Red Sea continues and delivers a general shock to confidence. Flight to safety causes the US-dollar to appreciate.	**Stagflationary**: The surge in oil prices passes immediately pushes inflation higher. While the squeeze on real incomes has a negative impact on growth, concerns about tight labour markets and second round effects on wages force central banks to push back the start of easing, meaning that rates end 2024 around 50bp higher than in the baseline forecast before falling more significantly in 2025. Delayed easing cycles weigh on growth in 2025.	6%	-0.6%	+0.8%
4. Consumer boom	Higher interest rates struggle to gain traction as buoyant labour market conditions and real income growth drive continued strong consumer spending. Meanwhile, the fading effects of the regional banking crisis clear the way for a credit cycle to further support demand. Booming consumption bolsters the outlook for corporate profitability, encouraging greater capex and the passing on of costs through higher prices.	**Reflationary**: Robust consumer demand ensures that growth is far stronger than in our baseline forecast, but also causes prices pressures to remain sticky and leads to higher commodity prices. As a result, inflation remains significantly above target throughout the forecast horizon, forcing central banks to abandon plans to cut interest rates in 2024 and eventually restart hiking cycles as underlying price pressures re-emerge.	14%	+1.4%	+1.5%
5. China stimulus	A weak start to 2024 that causes China to slip deeper into deflation forces the authorities to change tack and deliver a substantial fiscal stimulus in order to boost demand. The proceeds of large government bond issuance are used to fund infrastructure projects, investment in green technology and high-tech manufacturing along with some support for consumption. Beijing also delivers some measures to stabilise the housing market but resists the temptation to restart mass real estate construction.	**Reflationary**: Stimulus measures lead to significantly faster growth in China's economy, but the spill-overs to the rest of the world are fairly narrow. Expectations of stronger demand lift commodity prices, supporting those (largely emerging market) economies that export natural resources. But while other economies receive some benefit from stronger Chinese demand, higher commodity prices also cause inflation to be a bit higher than in our baseline meaning that interest rate cuts are marginally less aggressive than in the baseline.	7%	+0.9%	+0.6%
6. Other			0%	-	-

*Scenario probabilities are based on mutually exclusive scenarios. Please note the forecast warning at the back of the document.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

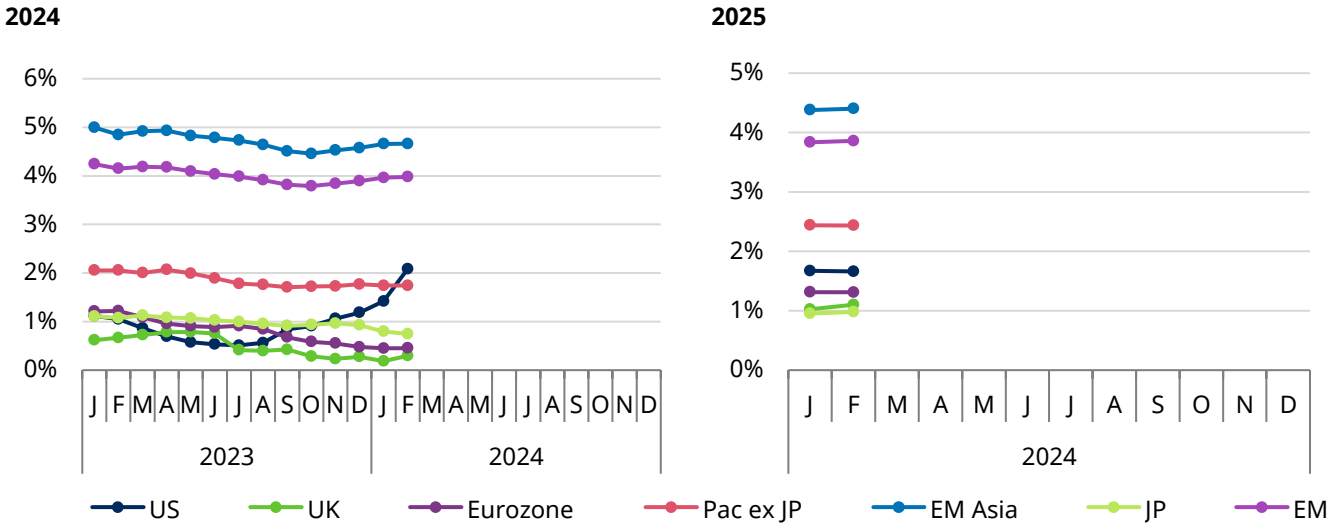
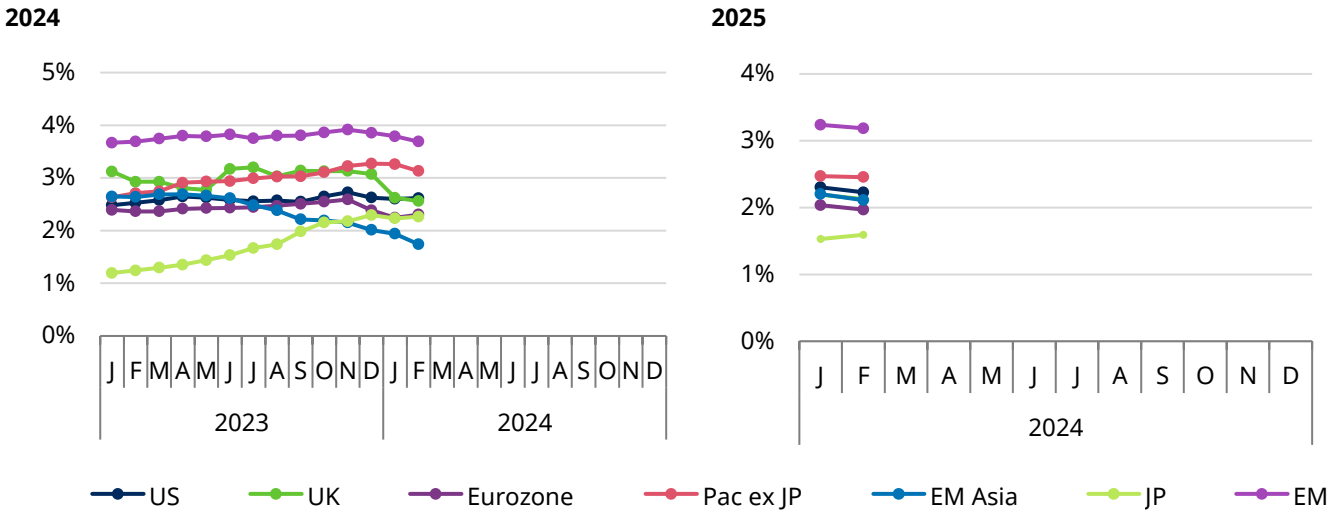


Chart B: Inflation consensus forecasts



Source: Consensus Economics (February 2024), Schroders.
Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore.
Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand.
Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

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