Box A: QB 4 – December 2024

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The International Economic Outlook

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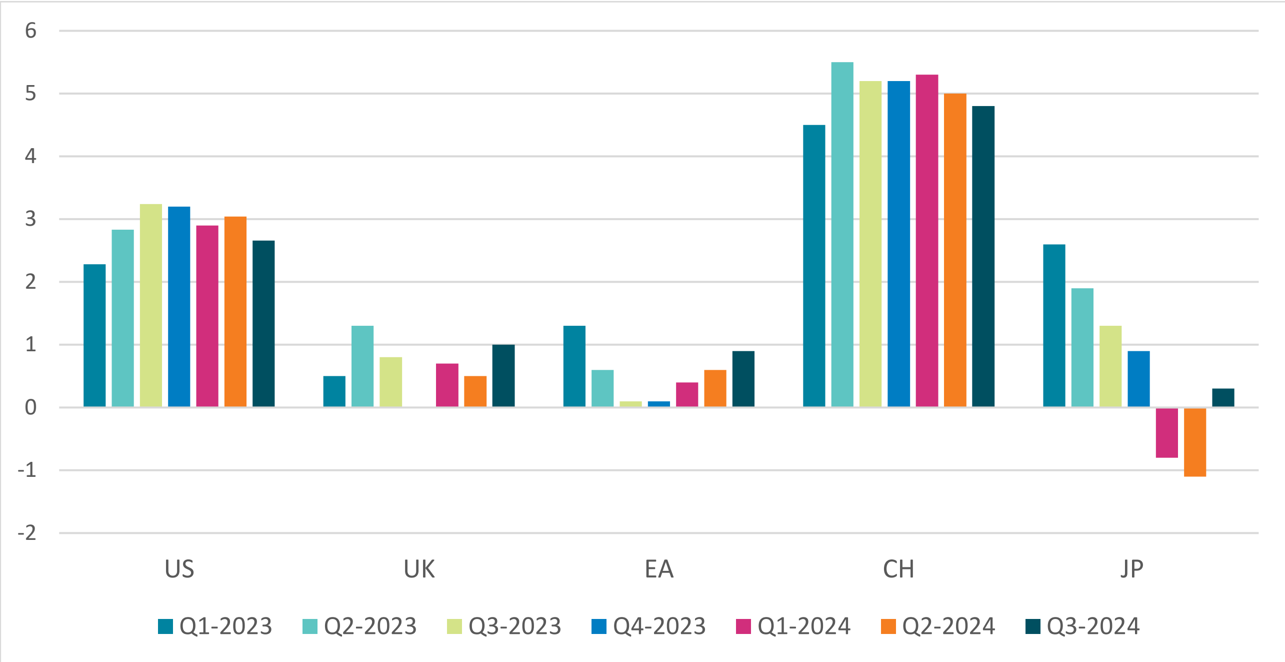
Across the world, inflation is easing and supply shocks are dissipating. Overall, global economic growth remains steady (with the IMF expecting growth of 3.2 per cent in 2024) but is becoming more and more dependent on the US, China and other emerging markets as the source of that growth. Geoeconomic fragmentation and trade barriers risk damping future growth.

Heterogeneous growth dynamics

Figure 1
GDP Growth rates (%) previous s quarters



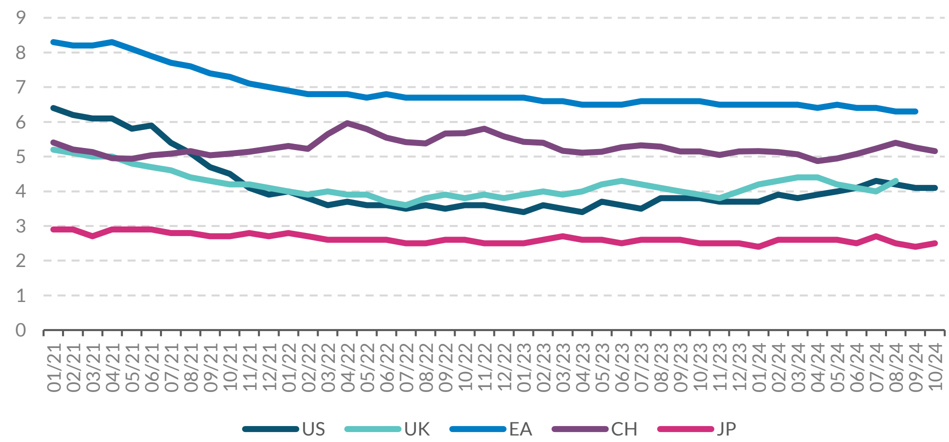
Source: National Statistics Agencies

The US and China are growing at a relatively fast pace (Figure 1), but for different reasons. In the US, GDP growth (2.7 per cent year-on-year in Q3) is being driven by exceptionally strong consumer demand and large deficit-driven government spending. China, despite seeing challenges in its real estate sector and weak consumer demand, is seeing Q3 year-on-year growth of 4.6 per cent due to increased industrial output and greater fixed investment enabled by government bond issuances. This growth rate is, however, below the government's target of 5 per cent and marks a slowdown from the exceptional growth seen up until the pandemic.

The euro area and the UK are experiencing more subdued growth (0.9 per cent and 1 per cent annually in Q3, respectively) while Japanese output growth has fluctuated over the past year (currently at 0.3 per cent year-on-year). In the euro area, net exports are the primary driver of growth with private and government consumption also contributing positively, while investment continues to wane. Growth in the UK during 2024 was primarily driven by government expenditure, while business investment and domestic demand are only adding marginally to output. Somewhat differently, Japanese growth appears to be picking up due to a resurgence in private consumption but remains low compared to the other economies.

Little movement in unemployment despite monetary policy conditions

Figure 2
Unemployment rates over the past three years.



Source: National Statistics Agencies

There has been little change in unemployment rates in any of the aforementioned economies. In the euro area, the unemployment rate is at record lows (averaging 6.45 per cent in the past 12 months) despite interest rates remaining high. Labour hoarding, job creation and labour force growth (driven by immigration) are maintaining such a positive outlook but it remains to be seen how long this will continue.

Outlook

Forecast output growth (Table 1) across the world is moderate and subject to uncertainty, with considerable heterogeneity arising across economies.

China and the US are expected to continue growing at a rapid pace with the former outpacing much of the world in 2024, 2025 and 2026. In the US, growth is expected to be supported by strong consumer and government spending with investment in technology and manufacturing also contributing positively. China's investment and export-led model should continue to contribute positively to economic growth but there are signs that returns on investment are diminishing. Additionally, it is uncertain what may happen to Chinese exports should economic fragmentation continue to worsen.

Future global growth steady but low by recent standards; China and advanced economies except US suffering from weak domestic demand

Table 1
Forecast GDP growth rates (%)

Region	2023	2024f	2025f	2026f
Global	3.3	3.2	3.2	3.3
Euro area	0.4	0.8	1.2	1.4
US	2.9	2.8	2.2	2
UK	0.3	1.1	1.5	1.5
Japan	1.7	0.3	1.1	0.8
China	5.2	4.8	4.5	4.1
Emerging Economies	4.4	4.2	4.2	4

Source: ECB for euro area and IMF for others

In the euro area, the United Kingdom and Japan forecasted growth is moderate. Similar dynamics are playing out in all three economies whereby each are relying on a consumption-led recovery driven by rising real incomes, falling inflation and monetary easing. Moreover, the euro area, the UK and Japan face many of the same structural issues: falling working age population, low productivity growth and a reversal of globalisation trends.

Monetary Policy

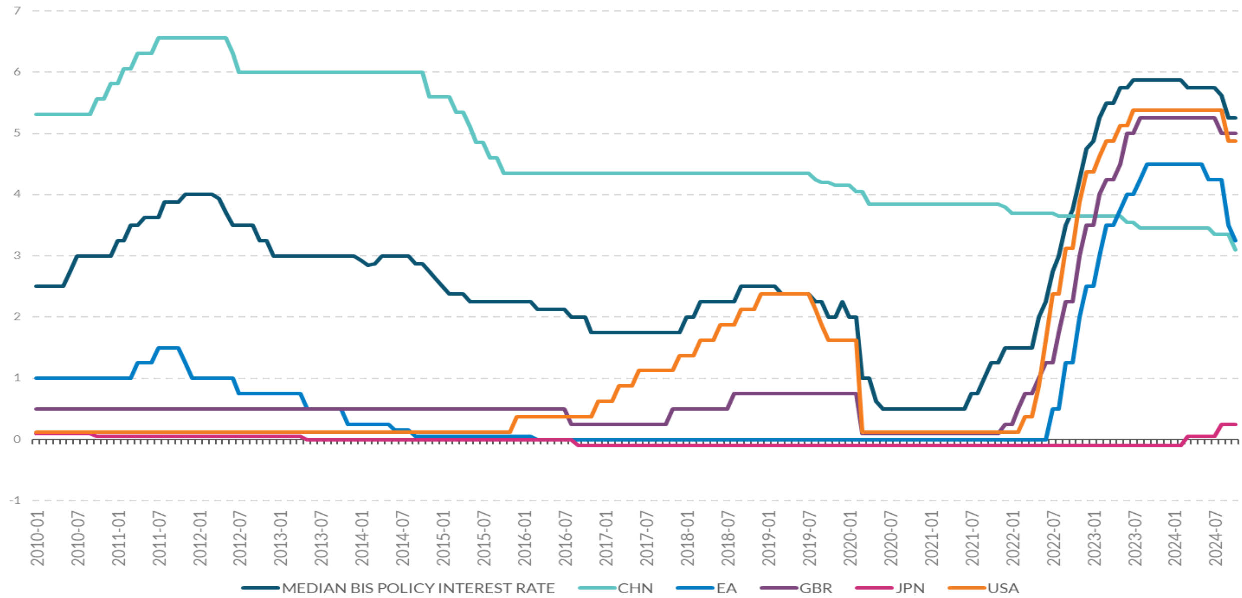
Central banks across the world are continuing to moderate their monetary policy stance as inflation converges towards national targets. By October, the median central bank had reduced interest rates by over 60 basis points since the start of the year (see Figure 3). In 2022 and 2023, the world economy had experienced a remarkably synchronised and steep monetary tightening cycle as inflation surged across the globe and most central banks responded by tightening monetary policy. Median rates were

raised during this period by over 4 per cent cumulatively (reaching 5.9 per cent at end-2023, the highest level since 2008). The current reversal of some of this policy tightening appears to be less synchronised and less steep as of yet, as inflationary risks remain non-negligible in a number of jurisdictions, prompting central banks to take a relatively cautious approach to rate reductions.

Central banks have started to reduce levels of restriction, with a few exceptions

Figure 3

Main monetary policy interest rate (%)



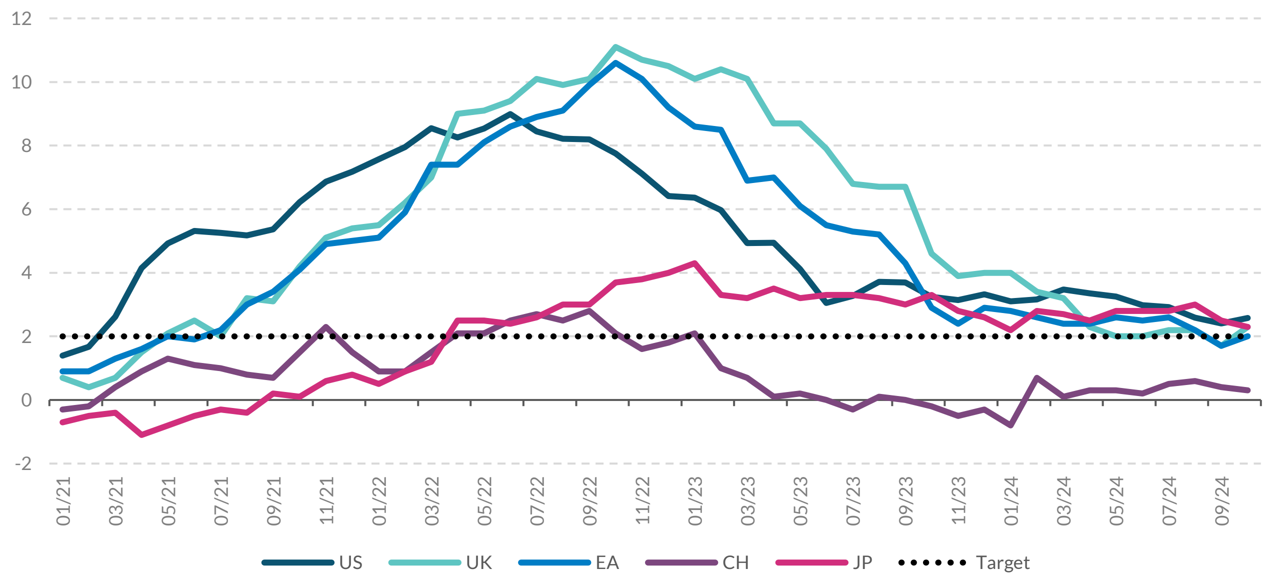
Source: Bank for International Settlements central bank policy rates statistics & authors' calculations

The Governing Council of the European Central Bank has reduced its Deposit Facility Rate by 25 basis points at each of its last three meetings in September, October and December 2024. Inflation in the euro area was 2.3 per cent, close to the ECB's target of 2 per cent, in November (see Figure 4). Due to higher but slowly declining core inflation (2.7 per cent in November), headline inflation is forecast to rise slightly in the following months before reaching the ECB's target rate of 2 per cent in the medium term (2.2 per cent next year and 1.9 per cent in 2026 according to forecasts).

Inflation is returning towards targets from 2022/23 heights in major advanced economies, while China faces deflationary risks

Figure 4

Year-on-year headline inflation rate (%)



Source: National sources. Note: US, EA, UK and Japan have a target inflation of 2% (with the US fed additionally targeting 'full employment'), while China's target is 'around 3%'.

Inflation in the US has been close to but above the Federal Reserve's 2 per cent target since mid-2023. The continuing underlying disinflationary process has allowed the FOMC to start lowering the federal funds rate, with a 50 basis point fall occurring in September, and a further decrease of 25 basis points in November, bringing the federal funds rate on a range of between 4.5 and 4.75 per cent. The medium-term outlook for inflation and growth in the US is highly uncertain due to the change in administration and a number of potential policy announcements, especially with regards to trade policy, that could have a strong impact on inflation in particular.

In November, the Bank of England noted continued progress in the disinflationary process, prompting the monetary policy committee to cut the bank rate for a second time (after lowering it to 5 per cent in August), to 4.75 per cent. The committee forecasted inflation to rise to 2.7 per cent next year, before gradually falling towards target afterwards.

The Bank of Japan has recently indicated that it intends to continue to raise the policy rate and adjust the degree of monetary accommodation. The Bank projects inflation to be 2 percent in 2025 and 2026, marking a significant turnaround from decades of 'lowflation' and allowing it to continue normalising its decades-long ultra-accommodative policy. Despite the divergence in monetary policy movements (Figure 3), the remaining very large differentials in risk-free rates between Japan and

other advanced economies have contributed to a strong depreciation of the Japanese Yen, currently exchanging for more than 150 JPY per US dollar. Relatively high risk-free returns in the US have indeed led to a strong appreciation of the dollar with respect to a large number of currencies.

Against a backdrop of subdued domestic demand and very low inflation, the People's Bank of China has further reduced its official 1-year loan prime rate to 3.10 per cent in October (down from 3.35 per cent previously), along with a number of other official rates to stimulate the economy. In light of economic headwinds, in December the Chinese government changed its stance on monetary policy to "moderately loose" and declared that they needed to "strengthen extraordinary countercyclical adjustments and . . . vigorously boost consumption, improve investment efficiency and expand domestic demand in all directions," in a sign of further upcoming stimulus.