

Three calls for the global economy: Inflation waves and investment demands

Many central bankers have declared victory over inflation this year, projecting recent trends into 2025. We, though, are more cautious



Tourists look onto London's financial district

1 Call 1: Investment divergence

The list of investment needs in most economies is long and growing; think about reindustrialisation, AI, renewing infrastructure, green technology and defence. However, it's uncertain if next year will see a significant global investment boom. Instead, there is a high risk of investment divergence.

Although the specifics of the new US economic policies are still unclear, pressure on American companies to restore will increase, and foreign companies will feel the need to increase their US presence. And all that should boost investment.

The need for investment in the eurozone and China is also high, but fiscal constraints and new geopolitical uncertainties could hold back a spending boom. A new era of industrial policies in the US could actually cannibalise investments elsewhere, leading to investment divergence.

Call 2: Inflation will come in shorter but more frequent cycles

Many central bankers have already declared victory over inflation this year, projecting recent trends into 2025. We remain more cautious.

In the short run, cyclical disinflation should still prevail, particularly in the eurozone, as the turning of the labour market will further dampen wage growth. However, this might not be the full story for 2025. In fact, there is a high chance that inflation could come back with a vengeance.

Potential tariffs aren't the only factor that could reignite inflation throughout the year. Investment plans and initiatives could easily reintroduce supply-side constraints in many economies, creating new inflationary pressures. Initially, these investments might lead to higher inflation, with the hope that they will eventually boost productivity and reduce inflationary pressures.

Consequently, 2025 could mark the beginning of a stop-and-go inflation pattern, with shorter but more frequent cycles, potentially necessitating more active monetary policy or a prolonged, steady approach from central bankers.

3 Our bold call: Yield curve control as result of higher debt

Debt-funded investments in the Western world could easily bring back debt sustainability concerns in the eurozone and the US. With much higher inflationary pressures than in the 2010s, central banks cannot go all-in with highly accommodative monetary policies across the board. The lower bound for interest rates will be higher this time around than in the 2010s.

Still, as the longer end of the curve is critical to mortgage and corporate borrowing costs, when push comes to shove, both the Federal Reserve and the European Central Bank could be forced to tackle elevated bond yields, trying to square the need for investment with price stability. This could lead to a new discussion on yield curve controls in the US and the eurozone, eventually forcing both central banks to start buying longer-dated government debt again. The ECB already has an instrument for it: the Transmission Protection Instrument (TPI). They might have to use it earlier than they had ever thought.

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