

Recent developments in the global economy

Our economists take a look at recent developments in the US, Asia and Europe, as well as in FX, commodities, central banks and rates



United States

Recent business surveys suggest that the clean election outcome has led companies that delayed investment and hiring due to election/regulatory uncertainty to start putting money to work. Confirmation of an ongoing low taxation environment should also support growth.

However, there are risks too from President-elect Trump's policy proposals. Significant immigration controls could create labour shortages that constrain growth and push up wages in some areas of the economy. Then there is the uncertainty over trade tariffs. While they should boost the competitiveness of domestically orientated manufacturers, those that rely on international supply chains will face disruption while exporters will be vulnerable to retaliatory measures. It will also inevitably mean higher costs for US consumers, which will erode spending power and keep inflation more elevated. The threat of lingering inflation led the Federal Reserve to signal it will slow the pace of interest rate cuts this year.

A key risk is ongoing sharp increases in Treasury yields with Trump's policies expected to worsen the government's fiscal position. Debt sustainability concerns in an environment of elevated

inflation mean we see the US 10Y yield breaking above 5%. This will push borrowing costs higher for consumers and businesses and act as a brake on growth over the medium to longer term.

Eurozone

Eurozone indicators continue to show weakness. The composite PMI remained below the boom-or-bust level in December, although the services sector exhibited some growth. Loan growth to the private sector decelerated in November, with only a 1% annual increase in loans to non-financial companies.

While the new German government might introduce some fiscal stimulus, it is not expected to have any impact before the second half of 2025. Additionally, several countries are under excessive deficit procedures, forcing them to maintain tighter budgets. We anticipate stagnation over the winter months, followed by a modest recovery, resulting in only 0.7% GDP growth in 2025.

HICP inflation increased for the third consecutive month in December to 2.4%, while core inflation remained steady at 2.7%. Services price inflation rose to 4%, and the disinflationary impact of energy prices is diminishing. With higher energy prices, we expect headline inflation to increase further in the first quarter.

Meanwhile, long-term consumer inflation expectations have risen to 2.4%. Given that ECB monetary policy remains restrictive, the ECB can continue to cut rates in response to the weak growth environment. However, do not expect the bank to accelerate its easing pace.

China

Last month's main developments were centred on the policy outlook. The Politburo meeting and Central Economic Work Conference signalled a "more proactive" fiscal policy with a higher priority placed on stabilising consumption, and the budget deficit target is reportedly set to be raised from 3.5% to 4% of GDP.

For monetary policy, key meetings signalled a "moderately loose" monetary policy stance for 2025, the first major change in tone since 2011. The People's Bank of China (PBoC) signalled further rate and RRR cuts at an "appropriate timing" at its end-of-year monetary policy committee meeting.

We saw the government loosen its grip on CGB yields in December after repeated interventions to keep yields above 2% earlier in the year. Lower yields will reduce borrowing costs amid the anticipated increase in bond issuance for 2025, but have also weakened the CNY.

Given the lull after September's monetary easing flurry, markets understandably remain cautious, but signs are that policymakers stand ready to respond to potential shocks in 2025.

Rest of Asia

South Korea has been in the news a lot lately. The political turmoil triggered by President Yoon Suk Yeo's declaration of martial law on 3 December and the tragic plane crash on 29 December have significantly dampened consumer and business confidence. We expect the domestic economy to remain weak until political normalcy returns, yet strong global demand for semiconductors and transportation equipment should lead to solid export growth.

The macro policy will play an important role in restoring sentiment and stabilising financial markets. With inflation still below 2%, the Bank of Korea (BoK) is expected to frontload rate cuts in the first quarter of the year to maximise policy impact (25bp cuts in both January and February). The weakening KRW should be a concern for the BoK, by cutting policy rates faster than Fed, but the BoK's priority will be to support growth. Meanwhile, the government will also promote stability and recovery through prompt fiscal spending. We expect a sizable supplementary budget in the first quarter.



South Korea's Yoon Suk Yeol, who was recently impeached as president

CEE

Despite last year's underwhelming economic performance, weaker-than-expected inflation, and general European weakness, central banks in Central and Eastern Europe are taking a hawkish pause in the cutting cycle, which might ultimately mark the end of the cycle. We are far from that scenario for now, but further rate cuts will only be cautious across the region. We expect the economy to recover this year, but we see weaker-than-consensus growth in most places in the region and continue to expect downside surprises. At the same time, higher food and energy prices may push up inflation, making further rate cuts by central banks more difficult.

At the same time, the new year means new fiscal plans and political challenges. Although all four countries in the CEE region are promising lower public deficits than last year, we see upside risks because of several elections this year and the start of election campaigns. Even so, the supply of government bonds will grow year-on-year in most places in the baseline scenario, highlighting another risk for this year with the difficult global conditions and falling demand indicated last year.

Central Banks

Federal Reserve

Donald Trump's policy thrusts are extended and expanded tax cuts, trade tariffs and immigration controls, which should keep the growth story supported in the near term. However, there is concern from the Fed about the inflation implications of trade protectionism and labour supply

constraints. There will be fewer and more gradual rate cuts in 2025 versus the second half of 2024.

We forecast 25bp cuts in each of the first three quarters of 2025 versus the market and the Fed favouring two in total for 2025. The cooling jobs market remains an important story while the sharp move higher in longer-dated Treasury yields will push up consumer and corporate borrowing costs. The dollar has risen to a 2Y high on a trade-weighted basis and this too may act as a brake on the economy. As such, the Fed may feel compelled to try and mitigate these factors and cut interest rates a little more than the market is currently pricing.

European Central Bank

If anything, macro data since the ECB's December rate cut have returned the spectre of stagflation – a scenario that could get worse if trade tensions escalate. This is a complication for the ECB which could further widen the current divergence between hawks and doves.

But will higher inflation in December and potentially also in January stop the central bank from further cutting rates? Not really. At 3%, the deposit interest rate is still restrictive and definitely too restrictive for the current weak state of the eurozone economy. Even if some argue that there is very little monetary policy can do to solve structural issues, political instability and uncertainty in many countries will force the ECB to continue doing the heavy lifting.

Also, as long as the current inflationary pressure is anticipated to diminish over the year, the ECB is likely to overlook the present inflation resurgence. While the experience of being slow to address rising inflation will deter the ECB from adopting ultra-low rates, the desire to stay ahead of the curve remains a compelling reason to return interest rates to neutral as swiftly as possible.

FX

The dollar has started the year largely holding onto the substantial gains made in the final quarter of 2024. The narrative of US exceptionalism is alive and well in FX markets, where investors are now hyper-sensitive to incoming headlines about Trump policy. On an inflation-adjusted, trade-weighted basis, the dollar is now close to levels seen in 1985 – levels which prompted the Plaza Accord. As yet, there have been little or no complaints about these dollar levels from the incoming administration, but that is the risk.

Dollar strength is causing some problems, especially for Japan, China and many emerging markets. USD/JPY is now close to the 158/160 area, where Japanese authorities sold \$35bn in July last year. Chinese authorities continue to resist renminbi depreciation, and in Brazil, the local bank has been drawn into a heavy bout of FX intervention too. Unless US trading partners are prepared to offer some sizable fiscal stimulus to support domestic demand as an offset to a more difficult export environment, expect non-USD currencies to remain under pressure this year.

Rates

As we progress through 2025, our vision is for the US 10yr Treasury yield to head toward the 5-5.5% range. Today a 4% SOFR rate coincides with a 4.5% 10yr Treasury yield (50bp spread vs SOFR), and 4.5% was the average Treasury yield seen during the Noughties. We find this relevant as during this decade, US inflation averaged 2.5% and the Fed funds rate averaged 3%, which smacks of an equilibrium (on average).

The Euribor 10Y swap rate should start settling closer to its long-term fair value as the ECB

normalises monetary policy. Based on our outlook on nominal growth, we think that 2.7% as the fair value of the 10Y Bund yield is justified. Our baseline scenario sees the ECB settle at 1.75% and the 10Y Bund yield rise to 2.7% by year-end. US to eurozone spreads are liable to remain wide as a theme through 2025, with, if anything, a bias to widen further.

Commodities

The oil market had a strong end to 2024 and a strong start to 2025 with ICE Brent trading above \$76/bbl in early January. In early December, [OPEC+ agreed to a further extension to its supply cuts](#), leaving the market with a smaller-than-expected surplus for 2025. In addition, broader sanctions against Iran and Russia have seen Asian buyers looking for other Middle Eastern oil grades, leading to a stronger Middle East physical market. There is also uncertainty over the Iranian oil supply once Trump enters office later this month.

The European natural gas market has also strengthened with TTF briefly trading above EUR50/MWh. Gazprom's transit deal with Ukraine expired at the end of 2024 and as a result, Europe has lost around 15bcm of annual gas supply. However, this should be widely priced in, given that Ukraine made it clear for over a year that it did not intend to extend the transit deal. Forecasts for colder weather in early January mean that gas storage could fall at a quicker pace, leaving storage to fall further below the five-year average. EU storage is 70% full, down from 85% last year and below the five-year average of 76%.

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