Schroders

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Economic and Strategy Viewpoint

November 2023

Q4 2023

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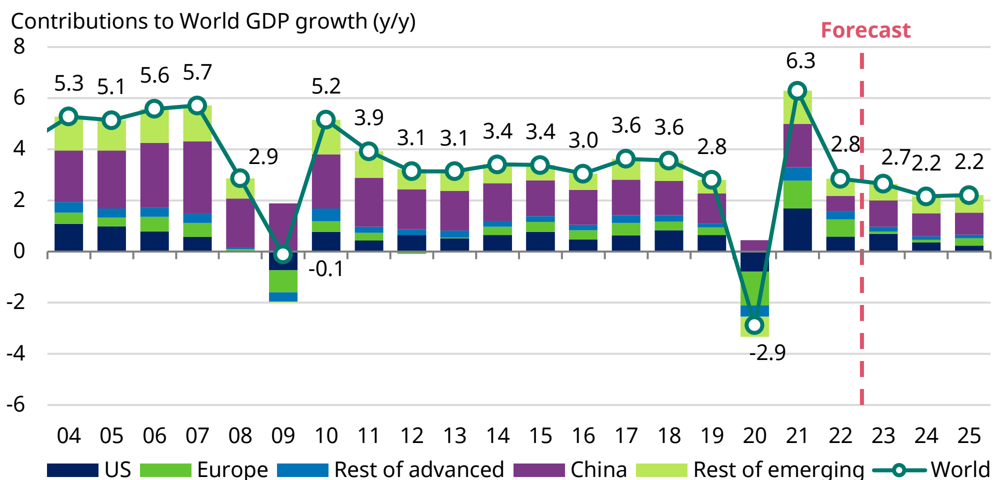
Who really will be higher for longer?

- The global economy is set to trundle along at fairly sluggish rates of growth of about 2.2% over the next two years as it continues to disinflate. But while the headline figures may be uninspiring, less synchronised global activity means that the diverging fortunes of the world's major economies is likely to have important implications for policymaking and financial markets.
- The US economy has continued to defy gravity as consumers keep spending against a backdrop of buoyant labour market conditions and excess household savings. Question marks over how the budget deficit will be funded have further tightened financial conditions through the bond market, and we do expect growth to slow as higher rates feed through to activity. However, an outright recession remains unlikely and we expect the economy to largely stagnate in 2024.
- The growth outlook in other parts of the world is not rosy. While fading activity has helped to bring down inflation, the European economy is likely to have fallen into recession before the end of 2023. Meanwhile, following a long period of stagnation, the UK economy will probably follow suit in the first half of 2024.
- Monetary policy in advanced economies is probably at peak restrictiveness, but the divergence in economic fortunes is likely to determine whether interest rates really will remain "higher for longer". The case for keeping interest rates elevated in Europe is not obvious and the European Central Bank (ECB) could deliver a first rate cut fairly early in 2024. Deteriorating fundamentals also suggest that the Bank of England (BoE) may not be far behind. But despite early signs of softening, we have pushed back our expectations for US monetary policy and now think the Federal Reserve (Fed) will not start easing until the second half of 2024 as policymakers fret about a second wave of inflation.
- Continued US exceptionalism is likely to keep the dollar supported in the near term, before gaping twin deficits eventually start to weigh on the currency. Meanwhile, delayed rates cuts, along with question marks over who will fund the larger fiscal deficit, suggests that Treasury yields will remain relatively high.
- Elsewhere, despite recent signs of stabilisation, the ongoing bust in China's housing market continues to hang over the economy. The authorities in China have been in loosening mode for some time and further easing is likely as Beijing attempts to manage the end of its housing-led economic model. And with fractious US elections on the horizon, policymakers will be keen to ward-off any further threats from trade sanctions and the break-up of supply chains.

Chart: Global growth forecast



Source: Schroders Economics Group. 21 November 2023. Please note the forecast warning at the back of the document.

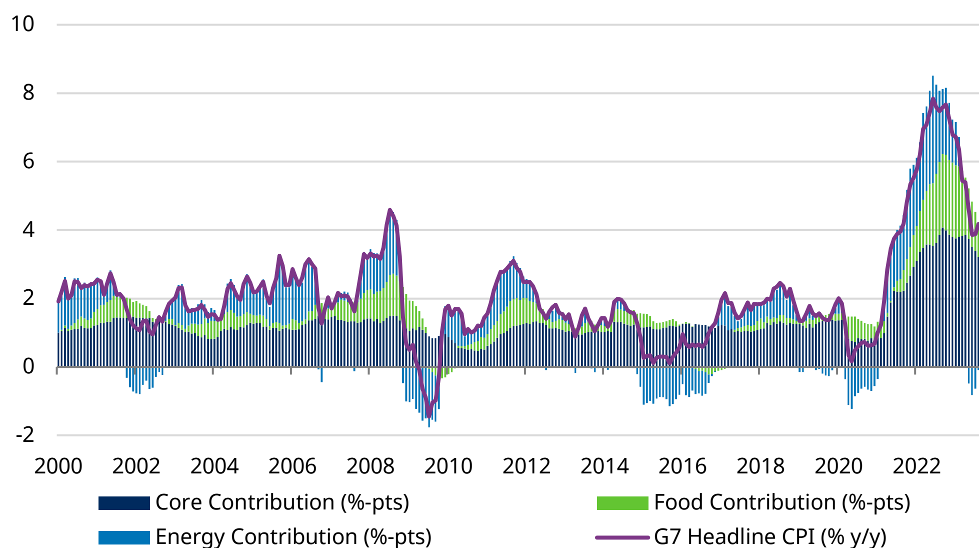
Who really will be higher for longer?

Attention is now turning to when developed market rates will be cut in 2024

Global financial markets have remained highly volatile as investors continue to fret about the outlook for inflation and the damage that past interest rate increases will have on future economic activity.

Following an aggressive repricing in global bond markets during October as investors worried about the risk of additional tightening, further evidence of disinflation has gone some way to sooth those concerns. Viewed from a high level, average inflation across the G7 group of major economies declined to 4% year-on-year (y/y) in September, from a peak of almost 8% in 2022. The contribution from energy turned slightly negative, while food fell further and there was also some decline in core inflation (see chart 1). At the country level, while inflation remains above target in the US, UK and eurozone, further declines have relieved some of the pressure on central banks in line with our belief that policy interest rates have peaked.

Chart 1: Inflation has continued to trend downwards in recent months



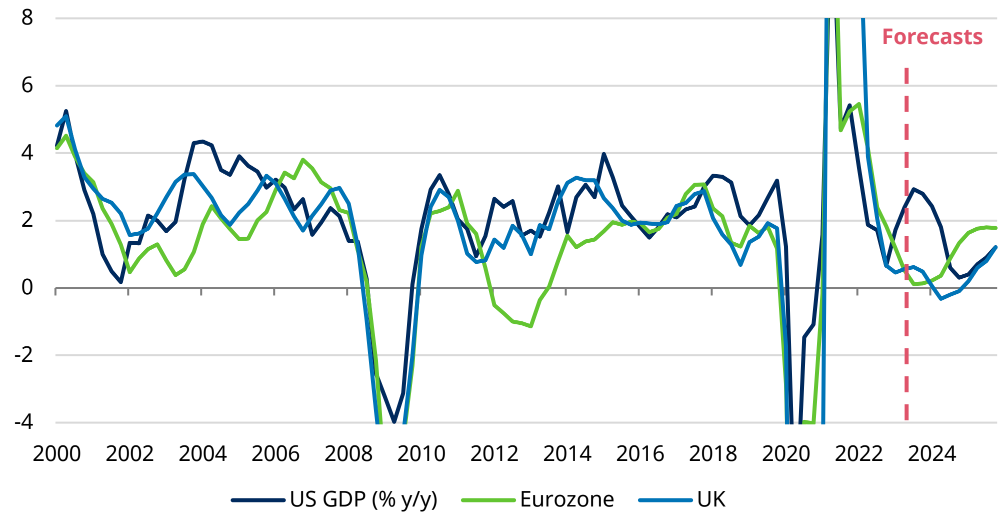
Source: Refinitiv, Schroders Economics Group. 17 November 2023.

Policymakers have been trying to signal that they expect interest rates to be "higher for longer", in an attempt to prevent a rapid loosening of financial conditions now that peak rates have been reached. Even so, with monetary policy now at restrictive levels markets are already pricing significant easing in the US, Europe and UK during 2024 and 2025.

Less synchronised growth will determine the sequencing of easing cycles

However, as we previously argued, disinflation up until this point has in large part been due to fading commodity price effects (which may start to reverse in 2024) rather than a significant easing in underlying, core price pressures. The hard yards in getting inflation down to target are still to come, and the debate about policy rates being higher for longer is further complicated by the fact that the global economy has become less synchronised. The different economic and health responses of countries to the Covid-19 pandemic and fall-out from geopolitical events have caused economies to go their own way. This will have important implications for the sequencing in central bank pivots and the performance of financial markets (chart 2). The large, structural changes that form the basis of the "3D Reset" (deglobalisation, demographics and decarbonisation) mean that these divergences will persist in the long run.

Chart 2: The global economy has been less synchronised post-Covid

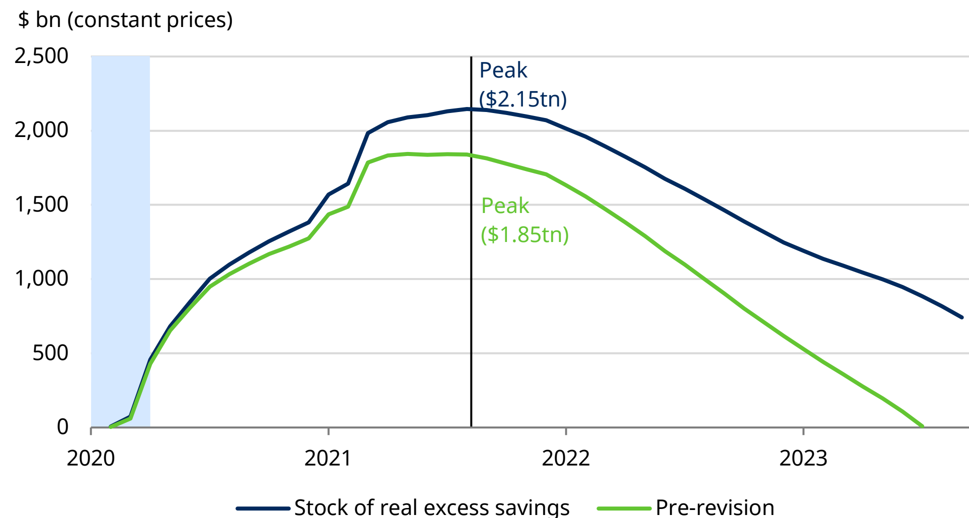


Source: Refinitiv, Schroders Economics Group. 17 November 2023. Please note the forecast warning at the back of the document.

US growth may remain resilient in the near term…

In the very near term, there are reasons to think that activity in the US will remain relatively healthy. While most of the impulse from running down cash balances has now happened, households can still fall back on some excess savings to support consumption. Indeed, data revisions suggest that in aggregate US households are still sitting on excess savings equivalent to around 3% of GDP (chart 3). And despite some moderation, labour market conditions remain relatively buoyant with decent job growth meaning that the unemployment rate is still below most estimates of the NAIRU, or the non-accelerating inflation rate of unemployment. As a result, wages are still growing at a decent pace at a time when disinflation is relieving some of the pressure on real incomes.

Chart 3: US households have more savings left than previously assumed



Source: Refinitiv, Schroders Economics Group. 17 November 2023.

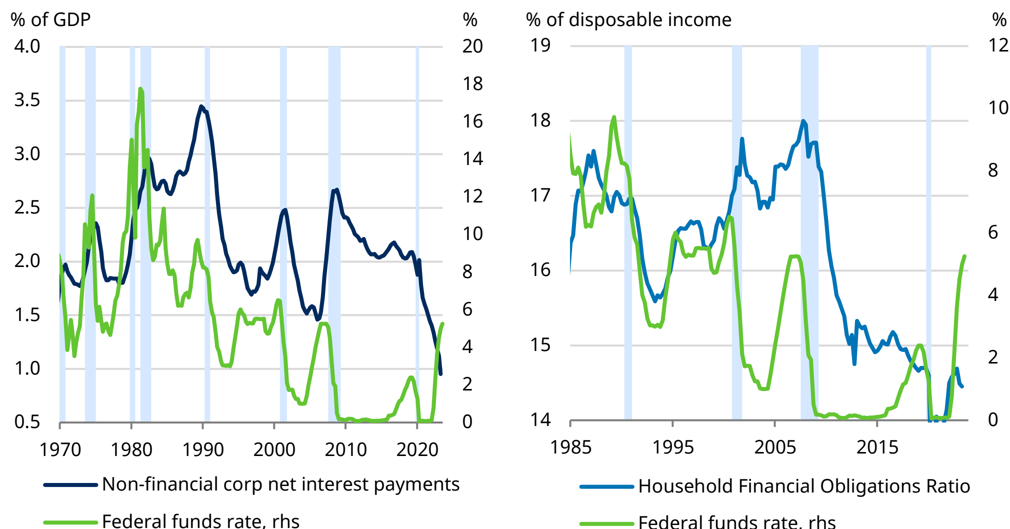
…but higher rates will increasingly weigh on growth in 2024

It would be naïve to think that the US economy will defy gravity forever, and we expect the aggressive hike in interest rates to increasingly weigh on activity during the course of 2024. After all, most estimates indicate that financial conditions have now moved into restrictive territory, while fiscal support will start to roll off and cracks in the labour market look set to widen.

Our base case is for a soft landing in the US

That being said, monetary policy appears to have become less effective in the US. When viewed in aggregate, corporate and household debt servicing costs remain remarkably low in spite of the sharp increase in policy rates (see charts 4 & 5). Higher interest rates are affecting activity at the margin and debt servicing costs will rise over time. In the absence of the sort of gaping imbalances that are usually the prelude to economic downturns, however, our baseline forecast assumes that the economy will stagnate in 2024 rather than fall into outright recession. Policymakers will also look to sustain growth in an election year.

Charts 4 and 5: Debt servicing costs in the US are still remarkably low

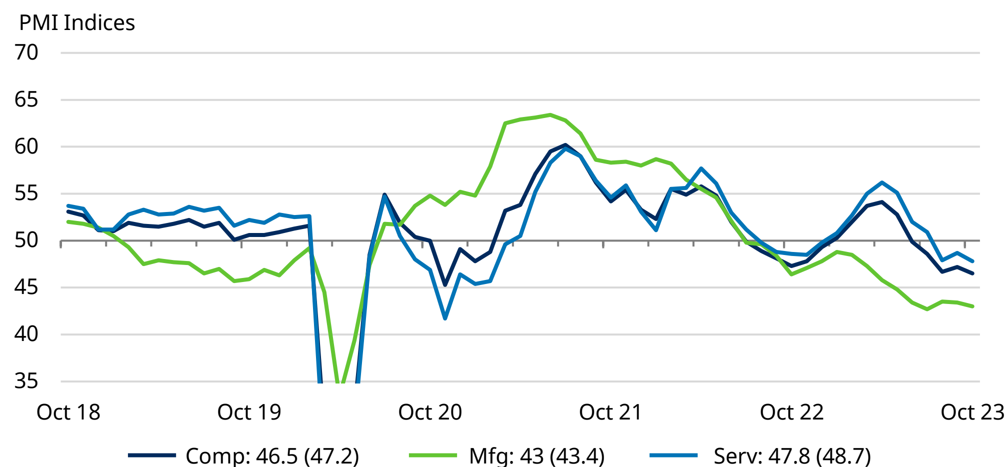


Source: Refinitiv, Schroders Economics Group. 17 November 2023.

The eurozone may already be in recession...

By contrast, the odds of imminent recession are much higher in Europe and the UK. Eurozone data have weakened at the aggregate level and the economy contracted slightly by 0.1% quarter-on-quarter (q/q) in the third quarter. Most member states are reporting recessionary levels of activity in manufacturing, but services have held up better thanks to the reopening wave (chart 6). However, even services activity has started to decline, as high inflation, and rising rates have reduced the disposable income of households. Germany, being more reliant on manufacturing has struggled significantly. Real GDP growth is down 0.4% y/y in the latest quarter, with the level of GDP being lower than at the start of 2022. By contrast, France, which has a less cyclical and a more service-based economy, has achieved 1.6% growth since the start of 2022.

Chart 6: Eurozone PMIs are already contractionary



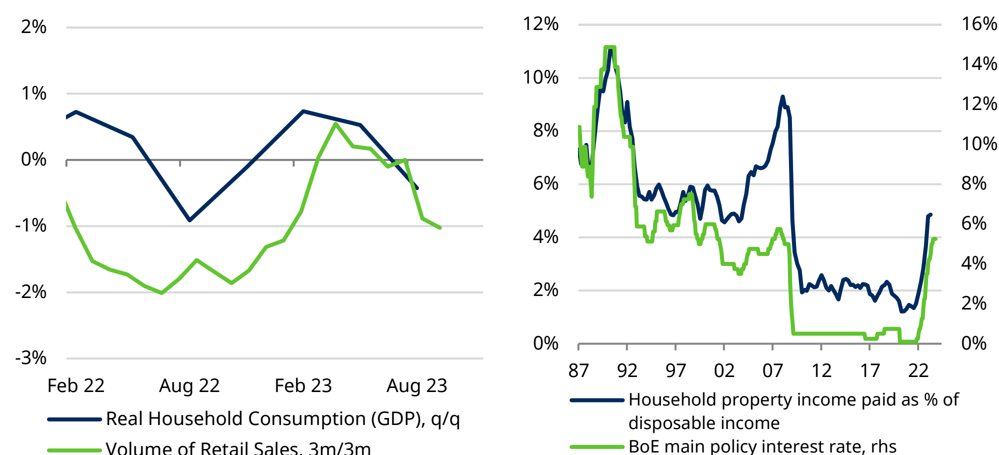
Source: Refinitiv, Schroders Economics Group. 17 November 2023.

Eurozone manufacturers will be hoping that global trade can rebound. Tentative signs of a recovery in Asia's manufacturing cycle are appearing, but it does not seem strong enough to drive an immediate recovery in European industry. As such, we think that output will contract again in q/q terms in Q4, already fulfilling the basic definition of a technical (albeit very shallow) recession before the year is over.

... and the UK is probably not far behind

The UK has so far skirted recession by the thinnest of margins as the impact of various bank holidays during the past year have distorted the incoming data. However, the bigger picture is that the economy, which has suffered severe supply side disruptions, has been stuck in stagflation. With higher interest rates increasingly feeding through to the housing market and causing consumers to retrench (charts 7 and 8), we forecast a mild recession in the first half of 2024, before a sluggish rebound ensues.

Charts 7 and 8: UK consumption is slowing as rate hikes bite



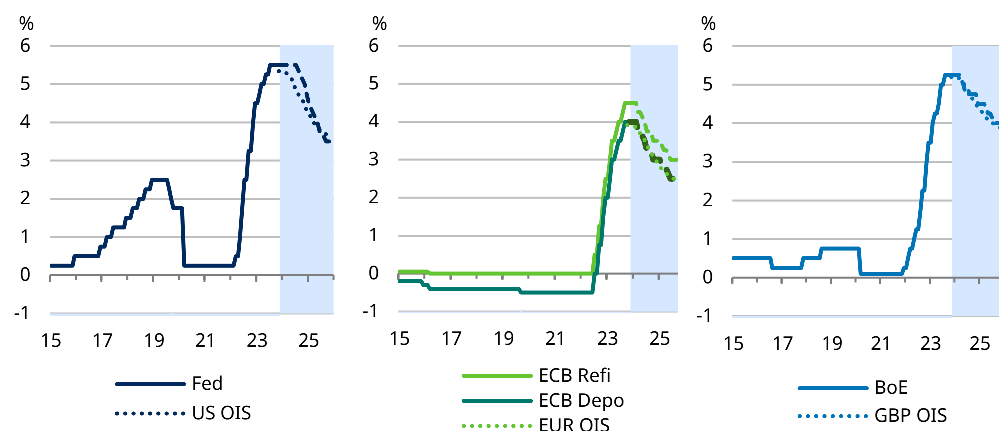
Source: Refinitiv, ONS, Schroders Economics Group. 17 November 2023.

These diverging growth trends are likely to have implications for the inflation outlook across the advanced economies and the sequencing of any pivots in monetary policy.

Recessions should ease price pressures more quickly in Europe and the UK, allowing rate cuts in the first half of 2024

Eurozone inflation is on track to return to the ECB's 2% target in the first half of 2024. Weak growth in the bloc ought to snuff out any lingering core price pressures and this is likely to ensure that the ECB will be the first major developed market central bank to start cutting rates. We have pencilled in a total of 150 basis points (bps) of rate cuts, starting in Q1 2024, taking the deposit rate down to 2.5% by the middle of 2025 (charts 9–11).

Charts 9–11: Interest rates are likely to fall in Europe and the UK before the US



Source: Refinitiv, Schroders Economics Group. 17 November 2023. Please note the forecast warning at the back of the document.

Stagflation, plus an uncertain reaction function at the BoE, makes it hard to judge the future path of UK rates. But it seems more likely than not that the hiking cycle is over. And, despite talk of an extended period of holding rates at 5.25%, we expect policymakers to pivot relatively quickly once inflation subsides and the economy enters recession. Headline inflation is likely to return to the upper end of the Monetary Policy Committee's target band from Q2 onwards and we think this will be enough to convince it to start cutting rates as we head towards the middle of 2024. Aggressive easing is unlikely given upward pressures on structural inflation from supply chain disruption and labour shortages. We have pencilled in 125 bps of cuts to 4% by mid-2025. Like in Europe, though, rates are then likely to remain restrictive to contain structurally higher inflation pressures on the supply side of the economy.

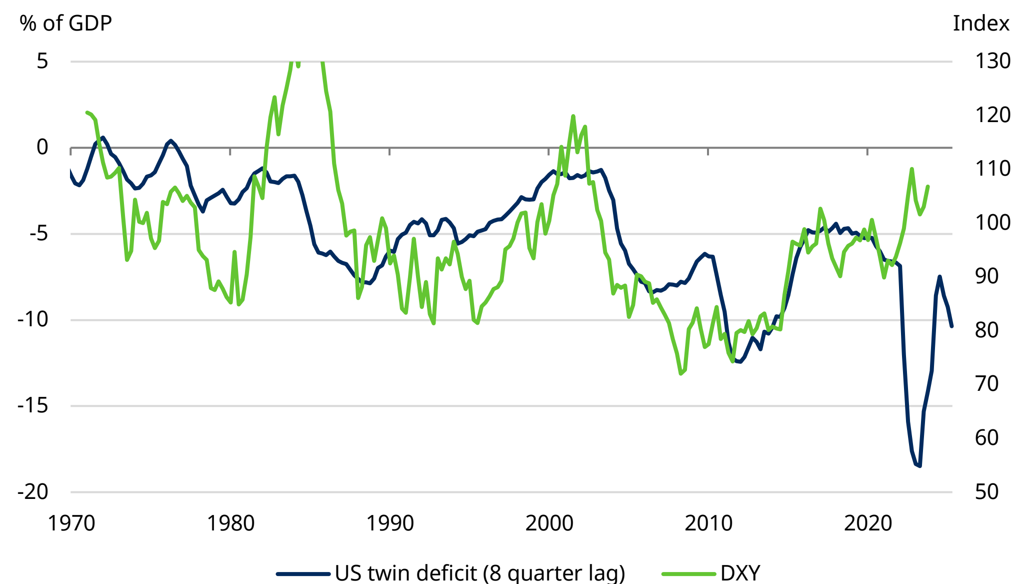
Fed unlikely to pivot until the second half of 2024

By contrast, we think the Fed will be the last to cut rates. We expect headline inflation to continue to trend down over the course of 2024, narrowing in on the 2% target in mid-2024. However, core inflation is likely to take a bit longer to decline as the US economy goes through a period of sub-trend growth rather than outright recession. Lingering risks from resilient demand and employment conditions are likely to ensure that the Fed will be patient before easing in order to ward-off the threat of a second wave of inflation. Indeed, we have pushed back our expectations for the Fed pivot and now expect a first cut in September 2024, with rates then eventually falling by 200 bps to 3.5% in 2025 – a bit later than the market currently expects.

US exceptionalism will remain major factor for markets

Further US exceptionalism will be a key influence over financial markets. While most of the gains are surely behind us, the relative outlook for growth and monetary policy suggests that a major reversal in the performance of the dollar will take time to come through. For the time being the dollar remains a useful hedge for risky assets and is likely to remain well supported in the near term, before large twin budget and current account deficits, along with narrowing rate differentials, eventually start to assert downward pressure on the currency (chart 12). While likely to decline, bond yields seem set to remain relatively high versus other advanced economies.

Chart 12: Twin deficits in the US should eventually weigh on the dollar



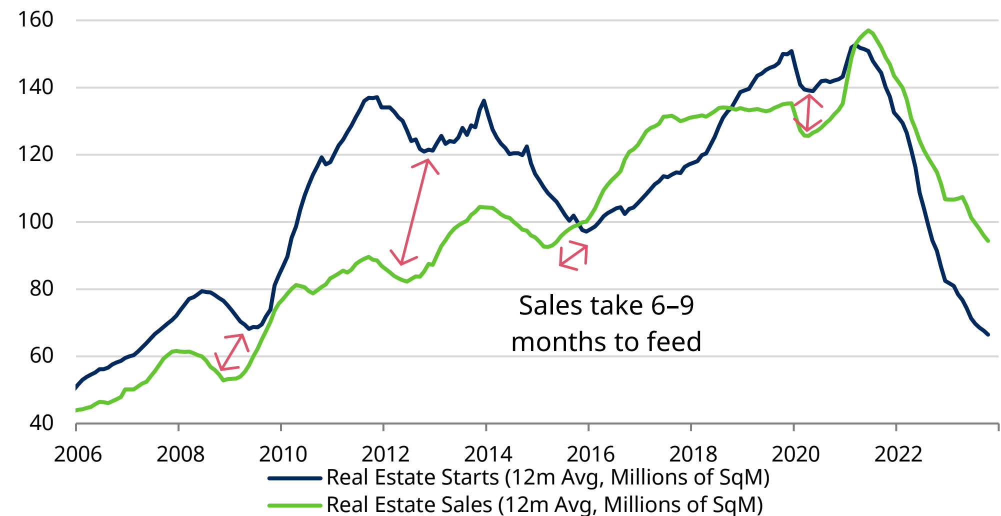
Source: Refinitiv, Schroders Economics Group. 17 November 2023.

China has shown signs of stabilisation

Elsewhere, economic data from China showed some welcome signs of stabilisation in the second half of 2023 to soothe fears of a hard landing. As a result, GDP growth in 2023 should ultimately exceed the government's 5% target.

However, the domestic picture remains fragile as the economy continues to contend with the end of housing-led growth. Measures aimed at supporting housing transactions in higher tier cities, along with support to ensure the completion of outstanding projects, will help the sector to some degree. But the bigger picture is that housing transactions are still falling and with speculative demand for property set to be much weaker going forward, real estate will contribute much less to overall GDP growth (chart 13). Meanwhile, concerns over the housing market will continue to weigh on consumer confidence for a while longer.

Chart 13: Housing transactions continue to tumble in China



Source: Refinitiv, Schroders Economics Group. 17 November 2023.

End of housing-led growth to drive trend slowdown in growth

Looser economic policy, along with near-term support from manufactured exports, may lead to some cyclical improvement in underlying growth in the months ahead. However, with soft global growth likely to weigh on demand for exports, that is unlikely to be enough to offset the drag from property. As a result, we expect the trend slowdown in GDP to continue and forecast growth of 4.5% and 4.3% in 2024 and 2025 respectively.

In the absence of structural reforms to boost other areas of domestic demand, in particular consumption, macroeconomic policy will need to remain loose in order to manage to slowdown in trend growth. The central government balance sheet remains in good health and could increasingly be used to deliver future stimulus. But a deterioration in the overall public sector debt dynamics means that fiscal support is likely to remain small and targeted, making large stimulus packages unlikely.

In this environment, monetary policy will remain loose. High debt levels, along with pressure on the financial sector to provide ongoing support to developers, means that there are likely to be further cuts in reserve requirements and interest rates. All of this is also likely to have implications for exchange rate policy. While we continue to expect some recovery in exports to support appreciation of the renminbi, unfavourable interest rate differentials and a desire to maintain external competitiveness suggest that the upside will be capped at around CNY6.80/$.

Elsewhere in the emerging world, the focus remains on lowering interest rates as inflation subsides. Brazil has been at the forefront of the emerging markets (EM) easing cycle, having begun to cut rates in August. While bumper agricultural output supported better-than-expected GDP growth in 2023, underlying growth is expected to continue slowing as the lagged effects of tighter financial conditions continue to pass through into the economy. As such, we expect the benchmark Selic rate to fall further, perhaps 8.50% in late-2024, which should support some pick-up in GDP growth in 2025.

India heads into election year with relatively fast headline GDP growth, but some signs in underlying data that higher interest rates and inflation have sapped demand. The inflation outlook remains uncertain given that food accounts for about half of the consumer prices index (CPI) basket, and remains vulnerable to weather-related shocks such as climate change and El Niño that have already affected rice and sugar prices. On balance, though, we expect inflation to trend low to make some room for the Reserve Bank of India to lower interest rates, perhaps cutting the repo rate by 50 bps to 6% in 2024. That, along with the potential for increases in foreign investment as firms look to diversify supply chains away from China, should ensure that India remains the fastest growing major EM for some time.

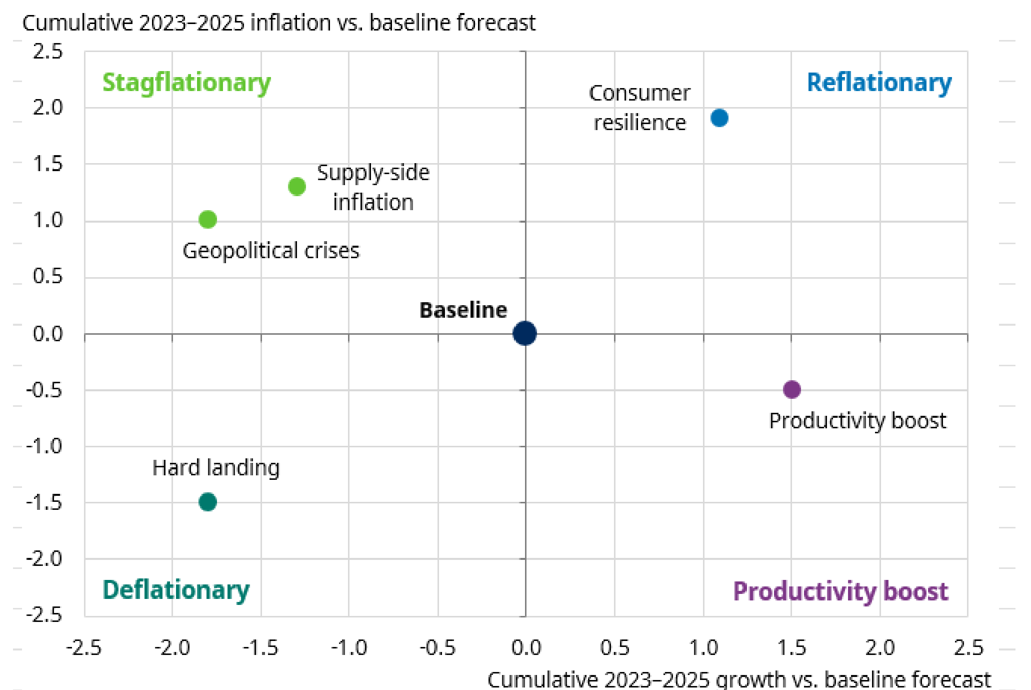
Scenario analysis

The balance of risks is still skewed in a stagflationary direction

The uncertain global backdrop and less synchronised economic growth mean that the risks around our baseline forecast remain high.

As shown by recent resilient spending data, there is a risk that monetary policy has become less effective and that consumption will remain buoyant, preventing a smooth decline in inflation and even forcing interest rates higher. As the grid in chart 14 shows, our analysis suggests that while this consumer resilience scenario could add a cumulative 1.3 percentage points (pp) of additional growth to our global forecast, it would also add 1.3 pp to inflation and delay reductions in interest rates. Indeed, resurgent demand and inflation could force a further tightening of monetary policy. At the same time, though, there is also a clear risk that the long and variable lags in policy transmission come to the fore more quickly than anticipated, leading to a hard landing in the global economy.

Chart 14: Scenario grid – growth and inflation deviations from baseline



Source: Schroder Economics Group. 21 November 2023. Please note the forecast warning at the back of the document.

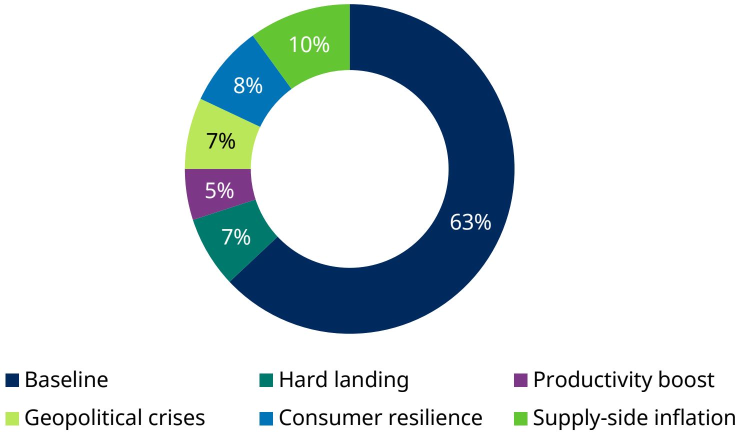
However, there also remains a lot of uncertainty about the supply side of the global economy. Euphoria about new technologies such as artificial intelligence (AI) could translate more quickly into an investment boom that results in a **productivity boost** that supports a softer landing than we assume in our baseline forecast. Equally, though, there is a risk that negative supply shocks move the global economy in a

more stagflationary direction as tracked by a **supply side inflation** scenario. Recent signs of moderation in labour markets such as the US could prove to be a false dawn and persistently elevated wage growth may cause higher rates of inflation to become ingrained. Finally, **geopolitical crises** could disrupt commodity supplies – particularly of oil – hinder international trade and investment and lead to resurgent inflation. Both scenarios would leave central banks in advanced economies with little or no room to cut interest rates.

As chart 15 shows, our long-running supply side inflation scenario continues to be assigned a relatively high probability of 10%. This, along with the 7% assigned to the geopolitical crises scenario, means that stagflationary outcomes remain the biggest risk to our baseline forecast.

Chart 15: Supply side inflation has the highest probability assigned to it

Scenario probabilities



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Schroders Economics Group: Views at a glance

Macro summary – Q4 2023

Key points

Baseline

– **US:** Resilient incoming data mean that we have nudged up our near-term forecasts for US GDP growth, to 2.5% in 2023 and 1.3% in 2024. But restrictive financial conditions are increasingly weighing on activity meaning that, while a soft landing remains our base case, the economy is likely to largely stagnate in 2024. Inflation will take longer to descend to target in the absence of an outright recession, meaning that while we expect to deliver a cumulate 200 bps of easing to 3.50% by 2025, we have pushed back the first rate cut until the second half of 2024.

– **Eurozone:** Activity in the eurozone has deteriorated rapidly meaning that the economy was already flirting with recession in the second half of 2023. Fading demand pressures, coupled with an unwinding of the past energy price shock, are likely to ensure that headline inflation will return to the ECB's 2% target in the first half of 2024 clearing the way for interest rate cuts. We expect the ECB to deliver 150 bps of easing, to lower the main refinancing and deposit rates to 3% and 2.5% respectively in 2025. That should underpin some recovery in GDP growth to 1.7% in 2025 from 0.7% in 2024.

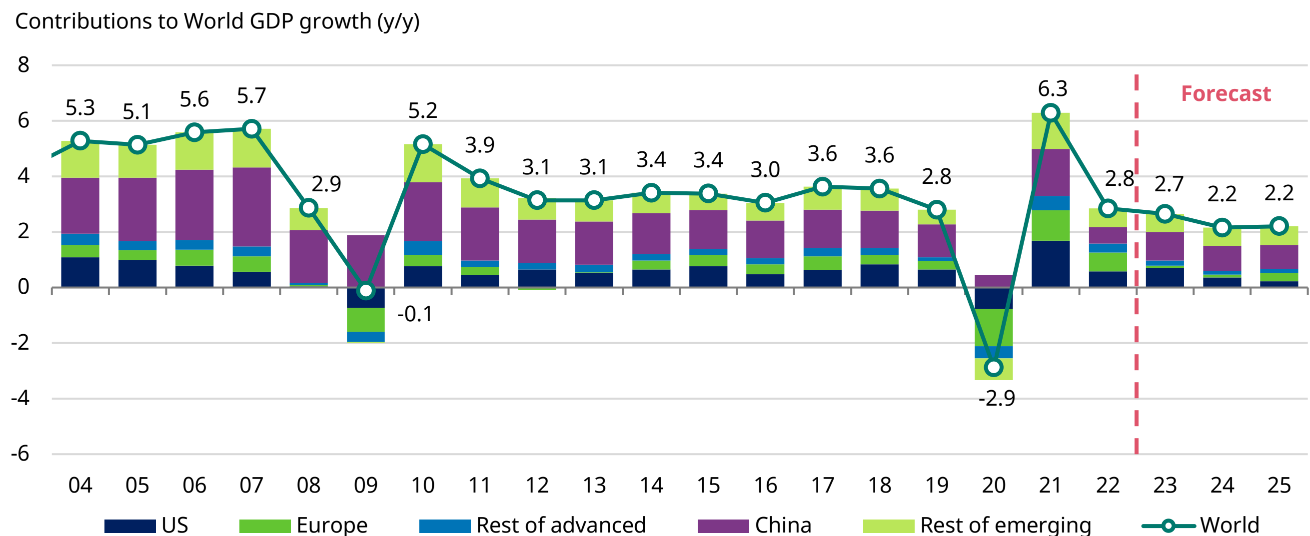
– **UK:** The UK faces recession in the first half of 2024 as higher inflation and interest rate hikes increasingly squeeze consumers and homeowners and we expect the economy to contract by 0.1% in 2024 as a whole. Weak activity and fading pressures from food and energy inflation should return headline inflation to the upper end of the BoE's target range in 2024, making space for 125 bps of interest rate cuts to 4% by 2025. But monetary policy will remain restrictive in order to counteract inflationary forces on the supply side of the economy.

– **Emerging Markets:** Ongoing weakness in China's property sector means that, despite some near-term recovery in manufacturing exports, the trend slowdown in economic growth is set to continue. We project GDP growth of 4.5% and 4.3% in 2024 and 2025 respectively. The story in rest of EM is generally one of falling inflation and interest rates. Following some softening in activity during 2024, further rate cuts should eventually give rise to some recovery in GDP growth in 2025.

Risks

We still see the balance of risks as being tilted towards stagflation. Three of our five risk scenarios are predicated on weaker output and two assume inflation will be higher. We continue to assign of high probability to our supply side inflation scenario. We still are concerned about consumer resilience, but see similar negative risks from geopolitical crises and a hard landing. A productivity boost from new technology would be a welcome, but less likely outcome.

Chart: World GDP forecast



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Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2022	2023		Prev.	Consensus	2024		Prev.	Consensus	2025
World	100	2.8	2.7	↑	(2.5)	2.6	2.2	↑	(2.1)	2.1	2.2
Advanced*	59.6	2.6	1.6	↑	(1.5)	1.6	1.0		(1.0)	0.9	1.1
US	28.3	2.1	2.5	↑	(2.3)	2.4	1.3	↑	(1.1)	1.1	0.8
Eurozone	15.6	3.5	0.5	↓	(0.6)	0.5	0.7	↓	(1.0)	0.6	1.7
Germany	4.5	1.8	-0.1	↑	(-0.2)	-0.4	0.7	↓	(0.8)	0.5	1.6
UK	3.4	4.0	0.5	↓	(0.6)	0.4	-0.1	↓	(0.3)	0.2	0.7
Total Emerging**	40.4	3.1	4.2	↑	(3.9)	4.1	3.9	↑	(3.7)	3.8	3.8
BRICs	28.3	3.0	4.9	↑	(4.6)	4.9	4.3	↑	(4.1)	4.3	4.2
China	19.9	3.0	5.2	↑	(4.8)	5.2	4.5		(4.5)	4.5	4.3

Inflation CPI

y/y%	Wt (%)	2022	2023		Prev.	Consensus	2024		Prev.	Consensus	2025
World	100	7.2	4.4		(4.4)	4.5	2.9	↓	(3.1)	3.2	3.0
Advanced*	59.6	7.5	4.7		(4.7)	4.7	2.4	↓	(2.6)	2.7	2.5
US	28.3	8.0	4.1	↓	(4.2)	4.2	2.3	↓	(2.8)	2.7	2.2
Eurozone	15.6	8.4	5.5	↑	(5.4)	5.5	2.0	↓	(2.1)	2.6	2.7
Germany	4.5	8.7	6.2	↑	(5.9)	6.0	2.3		(2.3)	2.7	2.6
UK	3.4	9.1	7.3		(7.3)	7.4	2.6	↓	(3.1)	3.1	3.0
Total Emerging**	40.4	6.7	4.1		(4.1)	4.2	3.7	↓	(3.9)	3.9	3.8
BRICs	28.3	4.1	1.9	↓	(2.0)	2.0	2.2	↓	(2.9)	2.5	2.3
China	19.9	1.9	0.4	↓	(0.5)	0.5	1.0	↓	(1.8)	1.6	1.2

Interest rates

% (Month of Dec)	Current	2022	2023		Prev.	Market	2024		Prev.	Market	2025	Market
US	5.50	4.50	5.50		(5.50)	5.37	4.75	↑	(3.75)	4.46	3.50	3.69
UK	5.25	3.50	5.25	↓	(6.00)	5.22	4.50		(4.50)	4.66	4.00	4.14
Eurozone (Refi)	4.50	2.50	4.50		(4.50)	3.91	3.50	↑	(2.75)	3.09	3.00	2.57
Eurozone (Depo)	4.00	2.00	4.00		(4.00)		3.00	↑	(2.25)		2.50	
China	3.45	3.65	3.45	↑	(3.30)	-	3.30	↑	(3.20)	-	3.20	-

Other monetary policy

(Over year or by Dec)	Current	2022	2023		Prev.	Y/Y(%)	2024		Prev.	Y/Y(%)	2025
US QE ($Tn)	8.0	8.6	7.8	↓	(7.8)	-9.4%	6.9	↓	(7.1)	-11.6%	5.9
EZ QE (€Tn)	2.8	2.9	2.7		(2.7)	-6.9%	2.4		(2.4)	-11.1%	1.9
UK QE (£Bn)	757	831	732	↓	(758)	-11.9%	627	↓	(653)	-14.3%	487
China RRR (%)	10.50	11.00	10.00	↓	10.25	-	9.50	↓	10.00	-	9.00

Key variables

FX (Month of Dec)	Current	2022	2023		Prev.	Y/Y(%)	2024		Prev.	Y/Y(%)	2025	Y/Y(%)
GBP/USD	1.26	1.35	1.24	↓	(1.26)	3.1	1.26	↑	(1.22)	1.6	1.26	0.0
EUR/USD	1.09	1.14	1.08	↓	(1.10)	1.2	1.10	↓	(1.16)	1.9	1.12	1.8
USD/JPY	149.5	115.2	147	↑	(140)	11.4	130	↑	(120)	-11.6	120	-7.7
EUR/GBP	0.87	0.84	0.87	↓	(0.87)	-1.8	0.87	↓	(0.95)	0.2	0.89	1.8
USD/RMB	7.15	6.37	7.10		(7.10)	2.1	6.80	↑	(6.40)	-4.2	7.20	5.9
Commodities (over year)												
Brent Crude	80.3	70.8	83.2	↑	(82.7)	-16.0	80.0	↑	(77.5)	-3.9	76.2	-4.7

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.
Market data as at 24/11/2023
Previous forecast refers to August 2023
* **Advanced markets**: Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.
** **Emerging markets**: Argentina, Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South 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 2023-2025 global vs. baseline: Growth	Inflation
Baseline	Global GDP growth is expected to ease from 2.7% in 2023 to 2.2% in both 2024 and 2025. Among advanced economies, growth is forecast to fall from 1.6% in 2023 to 1.0% in 2024 before ticking up to 1.1% in 2025. For the time being, the US economy continues to defy gravity, but we do expect growth to slow as higher interest rates gradually feed through to activity. We also expect the eurozone to have fallen into recession before the end of 2023, with the UK economy probably following suit in the first half of 2024. Meanwhile, emerging market growth is forecast to slow from 4.2% in 2023 to 3.9% in 2024 and 3.8% in 2025. In China, the ongoing bust in the housing market continues to hang over the economy. The authorities have been in loosening mode for some time and further easing is likely as Beijing attempts to manage the end of its housing-led economic model.	We expect global CPI inflation to moderate from 4.4% in 2023 to 2.9% in 2024 before edging up to 3.0% in 2025. Even so, disinflation up until this point has in large part been due to fading commodity price effects rather than a significant easing in underlying, core price pressures. And so the hard yards in getting inflation down to target are still to come. We expect the ECB will be the first major developed market central bank to start cutting rates. We forecast 150bp of rate cuts, starting in Q1 2024, taking the deposit rate down to 2.5% by the middle of 2025. Following not far behind should be the BoE, for which we have pencilled 125bp of easing to 4% by mid-2025. By contrast, we think the Fed will be the last to cut rates. We have pushed back our expectations for the Fed pivot and now expect a first cut in September 2024, with rates eventually falling by 200bp to 3.5% in 2025.	63%	-	-
1. Hard landing	Developed market central banks continue to tighten monetary policy in order to stamp out inflation. The Fed hikes to a terminal rate of 6.50%, with the ECB and BoE reaching 5% and 5.75% respectively. But the cumulative effect of further interest rate hikes, along with the eventual lagged impact of past aggressive tightening, hit domestic demand hard. Rate cuts eventually follow, but too late to prevent all major economies from tipping into recession. Meanwhile in China, problems in the housing market go from bad to worse as a further collapse in new home sales causes more developers to default on their debt obligations, raising concerns about a financial crisis and further denting confidence. With Beijing still reluctant to deliver significant stimulus, economic growth slows markedly.	**Deflationary**: Overtightening of monetary policy and the consquential recessions cause negative output gaps to open up. At the same time, commodity prices tumble as the outlook for demand deteriorates, with Brent crude falling to a trough of below $50/bbl in mid-2024. As a result, headline rates of inflation fall further than in the baseline, with calendar year averages about 1 percentage point below target in most developed markets in 2024, while China continues to flirt with a prolonged period of deflation.	7%	-1.8%	-1.5%
2. Productivity boost	Initiatives such as the Inflation Reduction Act (IRA) and CHIPS Act by the Biden administration continue to support strong US business investment, increasingly among non-US domiciled corporates. Other countries seek to replicate this, either through co-operation agreements (e.g. Japan's critical minerals deal, the UK's Atlantic Declaration) or by funding their own incentive schemes. This proliferation of subsidies results in a sharp rise in capital expenditure that delivers immediate productivity gains. Alongside this, the adoption of artificial intelligence is more rapid and widespread than expected, resulting in significant efficiency gains across economies but without significant displacement of labour.	**Productivity boost**: Economic growth is initially bolstered by higher capital expenditure, which is then sustained as projects come onstream and new industries are created. The resulting net productivity gains enable corporates to rein in price increases, with some sectors even seeing outright deflation. This sees inflation fall back more sharply across developed and emerging, aided by a weaker USD which serves to offset modestly higher crude oil prices. Central banks are able to cut rates more aggressively and step up the pace of quantitative tightening as a consequence.	5%	+1.5%	-0.5%
3. Geopolitical crises	An escalation of the conflict in the Middle East resulting in higher oil prices as Iran initiates a blockade of the Strait of Hormuz. Brent crude oil climbs above $120/bbl and hovers around that level until the end of 2025. Meanwhile, tensions between the West and China intensify as frustration over the latter's support for Russia's war with Ukraine brings a renewed bout of trade sanctions and tariffs from the US and Europe. The impact is felt directly through higher energy prices and inflation globally and indirectly through its impact on trade and international investment. Capital spending is expected to be weaker as firms reassess supply chains in the light of a deteriorating geopolitical situation.	**Stagflationary**: The result is a more stagflationary outcome for the world economy as higher oil prices push up inflation and weigh on activity. Central banks respond by keeping rates more restrictive relative to the baseline, such that the Fed keeps rates on hold through 2024. However, China is the deflationary exception, with the imposition of trade barriers from the West weighing on growth and domestic inflation. This prompts Beijing to respond by cutting the loan prime rate and the reserve requirement ratio.	7%	-1.8%	+1.0%
4. Consumer resilience	Excess savings built up during the pandemic continue to be drawn down, such that household spending continues to grow strongly as saving rates do not normalise, real income growth turns positive and consumer credit lines are tapped. At the same time, higher rates struggle to gain traction owing to deleveraging efforts since the financial crisis and because rock bottom interest rates were locked in during previous years across long time horizons. This strong consumer backdrop in-turn bolsters the outlook for corporate profitability, encouraging greater capex and the passing on of costs through higher prices.	**Reflationary**: Robust consumer demand causes core inflation to remain stickier than in the baseline, whereas headline inflation falls back more slowly. Also, strong growth results in a further tightening of labour markets, with the US unemployment rate falling below 3%. Central banks respond by raising interest rates more aggressively. The Fed funds rate rises to a peak of 7% in Q3 2024, while the ECB main refinancing rate reaches 6%. Eventually, higher interest rates cause activity to slow, prompting central banks to start cutting rates.	8%	+1.1%	+1.9%
5. Supply-side inflation	Despite an economic downturn, companies choose to hoard workers after the hiring difficulties experienced over recent years. With the labour market remaining tight as a consequence, companies are forced to offer higher pay awards to attract and retain staff, causing wage growth to accelerate further still. These factors weigh on productivity and push up unit labour costs, which are then passed on through price rises, keeping inflation sticky at elevated levels. All the while, the mismatch between worker skills and jobs in the post-pandemic economy means the NAIRU rises and available slack is less than in the baseline.	**Stagflationary**: With companies clinging on to workers, tight labour markets ensure that price pressures endure as wages increase and productivity stagnates. These factors result in inflation proving persistent at above-target rates across much of the global economy. This forces the Fed to raise rates to 6.50%. Other central banks also step up the pace of tightening. Higher inflation, along with tighter monetary policy, chokes off demand leading to economies witnessing below-trend growth and flirting with recessions.	10%	-1.3%	+1.3%
6. Other			0%	-	-

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

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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

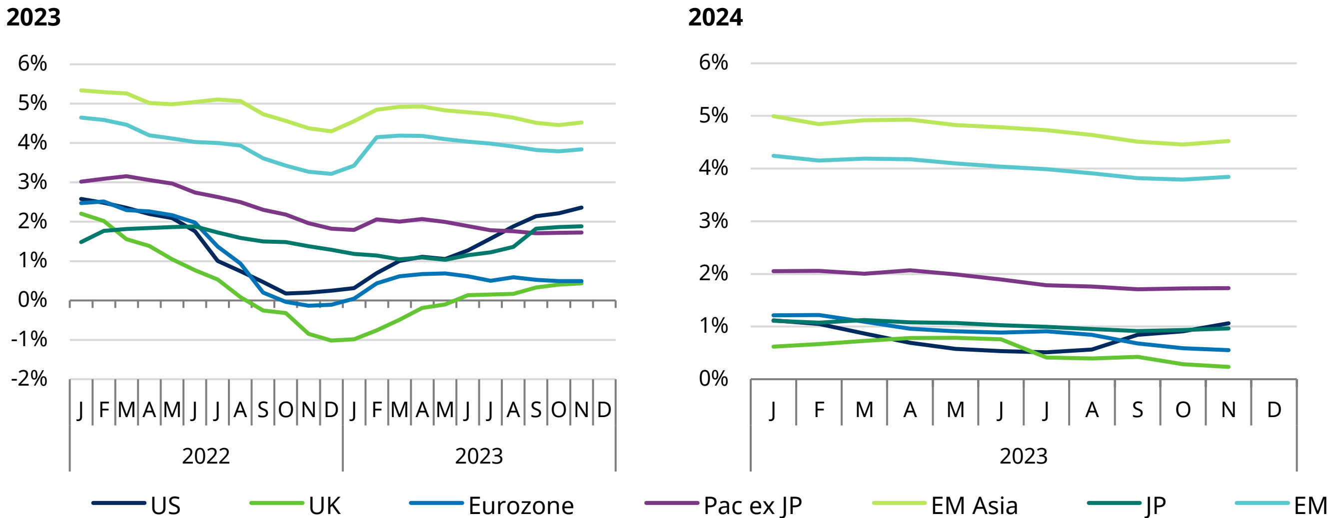
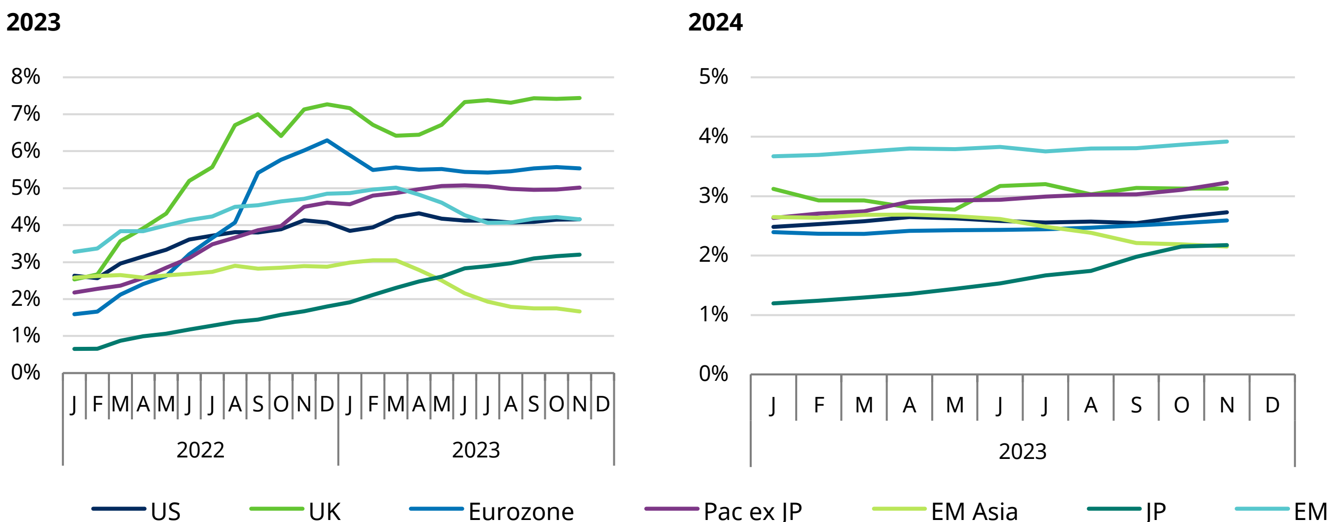


Chart B: Inflation consensus forecasts



Source: Consensus Economics (November 2023), 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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