Helaba

Markets and Trends 2024

Global economy in a transition game

Research & Advisory, November 2023

Values with impact.

Inhaltsverzeichnis

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The Editorial for 2024

Every year, Helaba Research & Advisory's annual outlook is based on a theme. But it is not simply chosen at random: our goal is to convey, in a metaphoric sense, the broad circumstances that will affect the economy and the markets in the new year. In 2024, with Germany hosting the European Championship, there is no escaping the fact that football will be even more prominent than usual. Interestingly, football has more in common with economics than you might think. That is because, ultimately, the factors determining a team's competitiveness and success are long-term strategies combined with short-term tactics. In this context, many people here are wondering: is our economy in good enough shape to finally return to growth in 2024 or is Germany destined for elimination at the group stage again?

Long-term strategies for success

In football, it is vital to identify and develop young talent early on. Economists call this human capital. Training is a key ingredient but, on its own, is not enough. The capacity to innovate is also a factor for success in both economics and football, whether it be the use of artificial intelligence to support education or for companies and the state; or innovations in formation and training techniques. Managing resources also has a critical role to play. In football, this means lining up the best players and allocating budgets; in the wider economy, it is about workers, capital and other resources. Therefore, the focus is on a more effective use of resources to achieve a higher output. Innovations are the key to a country's success – not least given the challenges posed by climate change.

Infrastructure a crucial factor

If a team trains and plays on a farmer's field, what use is the best formation? Neither a football team nor a country can achieve lasting success without proper and modern infrastructure. Both digital and transport infrastructure are crucial for a successful economy.

Creating incentives and cutting red tape

However, in football as in the economy, it is vital to have effective incentive systems. Tough competition and an arduous selection process mean that only a handful make it to the top. What is more, rigorous training, the risk of injury and setbacks call for determination, discipline and resilience. The ones who persevere and, as a result, propel the team to victory should be rewarded for their efforts. High tax rates and bureaucratic obstacles are not conducive to ensuring the best players stay in the country and drive local innovation.

Diversification and a capacity to adapt

A team made up only of strikers has no future and a similar logic applies to an economy. In order to be successful in the long run, a diversified economic structure is critical. Recent external shocks such as Russia's invasion of Ukraine have exposed Germany's vulnerability. That is why flexibility and a capacity to adapt are decisive factors in both football and the economy.

Tactical adjustment

To win, a team has to be able to adjust its tactics depending on the score and each player's individual skills. Coaches and teams must have the ability to react. This requires players to be mentally and technically strong. There must be effective communication and coordination within the team.

Football defines our scenarios

All of this sets the tone for our annual outlook for 2024. Although next year will be challenging, it will also present opportunities. The prevailing opinion in Germany, especially, is that the country is heading for **group stage knock-out** in 2024 – in other words, a severe recession. We have assigned a probability of 20 % to this negative scenario.

> *"There's only one possibility: win, draw or lose"*
> *Franz Beckenbauer*

It seems hard to imagine spectacular wizardry with the ball, flawless passing skills, masterful dribbling against multiple opponents, followed by a goal scored from a seemingly hopeless position. In football, virtuoso performances like this are more the exception than the rule. That is partly down to the fact that so many factors have to come together perfectly and every player on the team must be at the top of their game. Likewise, successful economic policy requires team spirit, a dash of ingenuity and a measure of luck. A rare but not impossible task. At 10 %, our positive scenario **beautiful game** has a lower probability than our negative one. In short, not only must every policymaker, or at least many of them, be at the very top of their game – they also have to put the success of the team above anything else.

Baseline scenario: Transition game

In football, when one side loses or gains possession of the ball, the transition game of both sides is tested. Similarly, with the macroeconomic and geopolitical environment changing fast, a new strategy is called for. Following the pandemic, in 2021/2022, monetary and fiscal policymakers did not manage the transition very well. We look for better results in 2024. That is why, with a probability of 70 %, a **transition game** is our baseline scenario.

Probabilities of our scenarios for the economy and financial markets

Source: Helaba Research & Advisory

The key players on the pitch will be the **central banks** in 2024 as well. Following belated but then drastic monetary tightening in 2022/2023, the Fed and the ECB have reached the peak of their interest rate hiking cycles. One of the pivotal questions in 2024 will be whether, in the heat of the moment, the playmakers in central banks have already advanced too far from the halfway line by **over-tightening**.

Agile dribbling will also be required when it comes to geopolitics. A fragmentation of the global economy into two technology and trading blocs is becoming a risk. In industrialised countries, protectionism and interventionist industrial policies are gaining ground. The **US election campaign**, among other things, should mean these issues will remain in the headlines in 2024.

Meanwhile, not least in Germany, the downsides to rampant state intervention are becoming increasingly evident, particularly in terms of **out-of-control regulation**. It is much easier to limit political resistance to the transition to net-zero if the economic side effects of new policies, which are often foreseeable, are taken into account and **market forces** are harnessed rather than supressed. This is one policy area that would benefit from a smarter transition game in many places in 2024.

So, come and join us on the football pitch, the setting for this year's "Markets & Trends". Strategies and tactics, as well as a measure of luck, will decide whether we will delight in a match full of the back and forth of a successful transition game or a spectacular and beautiful game. Or are we facing a group stage knock-out, which will not just be a cause for disappointment among the fans but also for your investment decisions.

In this spirit, I wish you a successful transition game in 2024.

Yours,

Dr. Gertrud R. Traud
Chief Economist/Managing Director

Baseline scenario: Transition game (70 %)

If circumstances suddenly change, a rapid response becomes necessary. In football, when one side loses or gains possession of the ball, the transition game of both sides is tested. Similarly, with the macroeconomic and geopolitical environment changing fast, a new strategy is called for. Following the pandemic, in 2021/2022, monetary and fiscal policymakers did not manage the transition very well. Will this work better in 2024?

The key players on the pitch will be the **central banks** in 2024 as well. Following belated but then drastic monetary tightening in 2022/2023, the Fed and the ECB have reached the peak of their interest rate hiking cycles. Astonishingly, despite the sharp rise in key rates within a short space of time, the economies of the United States and the euro area appear to have gotten off lightly, avoiding a severe recession. On both sides of the pond, the labour market remains exceptionally tight. Is this likely to change in 2024? Together with the path of inflation, this will be the key question facing monetary policymakers over the next twelve months.

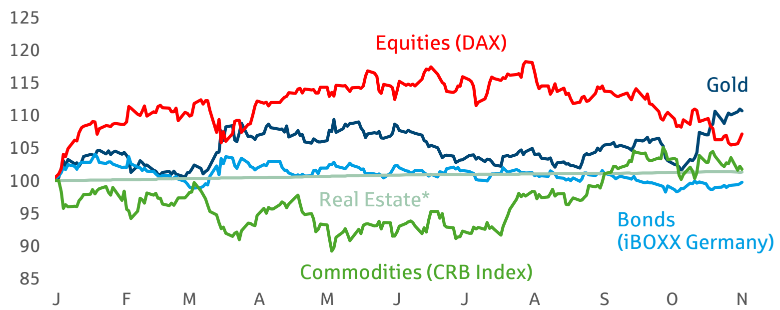
One of the pivotal issues for 2024 will be whether, in the heat of the moment, the playmakers in **central banks** have already advanced too far from the halfway line by **over-tightening**. Yet, they will only have the scope to loosen policy, as financial markets expect, if they have actually **done enough** to curb inflation. At present, though not entirely conclusive, this seems most likely the case from our perspective.

Becoming the "most valuable player" no easy feat

That is why **considerable flexibility** is essential for monetary policy. We expect this to prompt an initial correction over the course of 2024 to what is currently a very restrictive monetary environment. In our baseline scenario, however, this will not be the usual frantic reversal (“we've overstepped the mark!”) of previous interest rate cycles – at least not for the ECB and the Fed. Rather, our forecast looks for a somewhat more **tentative reduction** of key interest rates, as central banks feel their way forward, reflecting their fears of not having fought inflation for long enough. An exception to this are Central and Eastern European countries, where key rates have already been cut.

Equities lose role as favourites

Indexed, 31.12.2022 = 100, total yield in euro



*Helaba index for German open-ended real estate funds
Sources: Refinitiv, Helaba Research & Advisory

From a monetary policy perspective, however, the economic environment will continue to be fairly challenging in 2024. The major blocs will see an **economic recovery**, which would normally be an argument against interest rate cuts. However, the rebound is likely to be muted and that will limit any rise in the economy's capacity utilisation. At the same time, **inflation** will continue to fall.

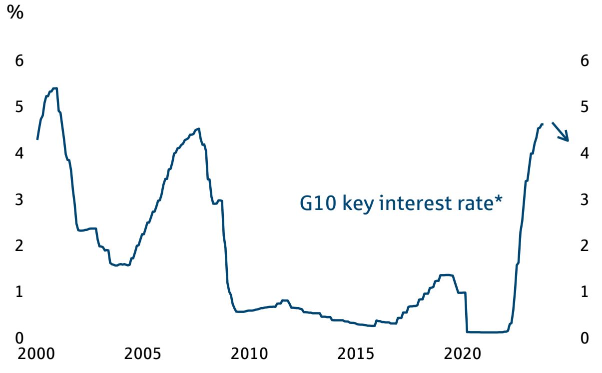
On the one hand, that means central banks will move closer to their goals. Given the long lags with which monetary policy works, though, they cannot simply maintain the same degree of restriction until they reach their targets. On the other hand, declining inflation expectations will **lead to higher real interest rates** if there is no change in nominal rates. We expect the major central banks to, at the very least, limit this rise and to reduce their key rates gradually as the year unfolds.

Tough matches for politics – at home and away

Agile dribbling will also be required when it comes to geopolitics. A fragmentation of the global economy into two technology and trading blocs is becoming a risk. In industrialised countries, protectionism and interventionist industrial policies are gaining ground, which is ultimately a zero-sum game in which taxpayer's money is channelled to private companies. **The US election campaign**, among other things, should mean these issues will remain in the headlines in 2024.

The ongoing discussion about future relations with China – to which we owe the annoying but almost ubiquitous term “**de-risking”** – will not only demand adept ball control but also sound tactics that are as well coordinated as possible. In this regard, there is bewilderment in the industrialised world at how many poorer countries have geopolitically aligned themselves more closely with Russia or China. Efforts to establish parallel global structures without "Western-dominated" institutions have clearly accelerated. In an environment such as this, expectations for **global trade** are **not exactly rosy**: even a largely stable or only slightly higher volume of trade would be a satisfactory outcome in 2024.

Central banks transitioning



* G10: USA, EZ, J, UK, CH, N, S, CDN, AUS, NZ; GDP weights
Sources: Macrobond, Helaba Research & Advisory

Politicians will also confront major **domestic economic policy** challenges. Faced with **spiralling levels of public debt**, an end to the free spending culture of previous years, when governments simply threw public money at every problem, is overdue. To some extent, the significant rise in bond yields over recent years probably reflects growing dissatisfaction among investors with the reckless fiscal policies of many countries. Having provided a modest boost in 2023, current plans suggest that global fiscal policy will indeed tend to have a restrictive influence in 2024.

> *“The cards have been rolled”*
> *Oliver Kahn*

Meanwhile, not least in Germany, the downsides to rampant state intervention are becoming increasingly evident, particularly in terms of **out-of-control regulation**. By tweaking rules on many fronts simultaneously, governments are not only imposing additional direct costs on businesses but are also fuelling greater uncertainty. It is much easier to limit political resistance to the transition to net-zero if the economic side effects of new policies, which are often foreseeable, are taken into account and **market forces** are harnessed rather than supressed. This is one policy area that would benefit from a smarter transition game in many places in 2024.

Overview of forecasts in the baseline scenario

Global economic **growth** in 2024 will be roughly on a par with the previous year, measured by annual averages. Following 2.3 % growth in 2023, the US economy likely will even slow to 1.3 %. However, these average figures mask an acceleration in momentum over the course of the year in key markets, including China. 2024 is set to see a cyclical recovery. We forecast the German economy to grow by 1.3 %.

Inflation will continue to ebb on both sides of the Atlantic. We do not anticipate any repeat of the relief that lower energy prices provided in 2023. Nevertheless, a steady decline in core inflation should have a noticeably dampening effect on headline inflation. Though the inflation targets of central banks will come within striking distance, they will not be fully achieved.

Selected forecasts for 2024

Euro area

GDP growth, %	1.3			
Inflation, %	3.0			
Q1 - Q4				
Refinancing rate, %	4.50	4.50	4.25	4.00
USD / Euro	1.05	1.10	1.10	1.10
EURO STOXX 50, index value	4,500	4,600	4,700	4,800

Germany

GDP growth, %	1.3			
Inflation, %	3.0			
Q1 - Q4				
3M Euribor, %	4.00	3.80	3.50	3.30
10y Bunds, %	2.70	2.70	2.50	2.30
DAX, index value	16,400	16,800	17,200	17,500

USA

GDP growth, %	1.3			
Inflation, %	2.7			
Q1 - Q4				
Federal Funds Rate (mid-point), %	5.38	5.38	5.13	4.88
10y Treasuries, %	4.40	4.30	4.20	4.00
S&P 500, index value	4,580	4,650	4,730	4,800

Sources: Helaba Research & Advisory

Most **central banks** will transition from attack to defence in 2024. The Fed and ECB will take the first steps towards a less restrictive monetary policy in the summer. By year-end, we expect key rates to be 50 basis points lower than current levels.

Pressure on **bonds** will ease in the course of the year. Positive momentum for the 2024 season will flow from lower inflation and a turnaround in key interest rates. Despite this, with central banks reducing their bond portfolios and relatively high levels of government bond issuance, there will only be limited potential for price gains.

Funding costs for **corporates** will have peaked in 2024. Given the urgency to invest in new supply chains and sustainable business processes, companies will be more active on bond markets. For **banks**' core business, higher interest rates represent a return to normality. We expect to see a renewed high volume of senior unsecured issuance by banks, particularly due to substantial maturities.

Covered bonds will continue to benefit from their status as safe haven assets. The quality of cover assets, high overcollateralisation ratios and banks' solid credit ratings are compelling arguments in favour of this asset class. Despite this, it is likely that new business will decline somewhat and that the issuance volume will be slightly lower.

On **equity markets**, high interest rates, tepid growth and adverse geopolitical developments have already been adequately priced. With moderate to cheap valuations, economic sentiment having already reached very low levels and cautious positioning among a broad cross-section of investors, the stage is set for prices to rise significantly once again. At the end of 2024, the DAX should be trading at around 17,500 points.

> *"The riskiest thing you can do in football is not take any risks"*
> *Pep Guardiola*

Thanks to a sustained high level of demand and a sharp fall in construction activity on the German **real estate market**, the downward trend in residential property prices should bottom out. Following years of decline, prices of retail properties will stabilise, whereas those of office real estate can be expected to contract further.

Gold may benefit from diminishing opportunity costs. As soon as signs of an improvement in real yields emerge, which should occur no later than the second half of the year, the precious metal will exceed the level of 2,000 US dollars per troy ounce.

In the context of an incipient interest rate cutting environment, the **US dollar** will generally trend weaker. Additionally, the growth gap between the US and the euro area will narrow. However, given the Fed's hesitancy, there is only limited potential for the relatively strong US dollar to lose ground. The euro-dollar exchange rate is likely to be around 1.10 at the end of 2024.

Patrick Franke

Monetary policy: Rate cuts in the second half

Easing inflationary pressure will provide central banks with latitude for monetary policy action. The Fed and the ECB are likely to start reducing interest rates in the second half of 2024.

While the ECB's **monetary policy tightening cycle** has been significantly more restrictive than previously anticipated in most quarters, it may possibly shorten the timeline before the first phase of loosening begins. The refinancing rate has reached a level that has tangibly limited the financial headroom for consumers, companies and governments. **Risks to economic growth, financial market stability and euro bond spreads** have risen. Should inflation move closer towards the ECB's 2 % target, with the prospect of this being achieved in 2025, the Governing Council is unlikely to hesitate in adopting a strategy of tentative **interest rate cuts**. By the end of 2024, a main refinancing rate of **4.0 %** and a deposit rate of **3.5 %** would seem a plausible outcome.

> *“Monetary policy is like a football match: central bankers try and keep the ball in play but sometimes their kicks go astray and there are unpredictable fouls”*
> *A football analogy generated by AI on current monetary policy*

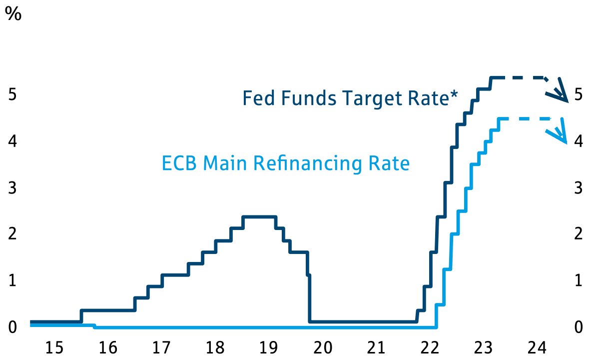
Since 1954, when Germany won its first World Cup, the country has seen **twelve interest rate peaks and troughs** under the auspices of the Bundesbank and the ECB. The average period without any change in monetary policy has been around **nine months**, although the spectrum was very broad and ranges from two to twenty-seven months.

We expect the ECB to shrink its **balance sheet**, the volume of which has fallen by almost 20 % over the past year, by a relatively modest degree in 2024. The **monetary aggregates** have also decreased substantially and the **interest burdens** are mounting. This suggests that the doves on the ECB's Governing Council would oppose any accelerated reduction in its bond portfolio, which most recently amounted to around 20 billion euro a month.

Fed: Room for easing in the course of the year

The **US Federal Reserve** has raised its key rate from essentially zero in the spring of 2022 to almost 5.5 %. It has simultaneously been slashing its bond portfolio, which had been bloated since the pandemic, by almost 100 billion US dollars a month. While rates have likely peaked, there is no consensus on what the effective floor for the Fed's **balance sheet** is. However, it seems unlikely that it will be reached in 2024. Thus, our forecast is for the Fed to continue its balance sheet run-off. Consequently, the money supply will also likely decline further – which would be entirely justifiable given its explosion in 2020/2021.

Rate cuts will not wait until additional time



*middle of target range
Sources: Refinitiv, Helaba Research & Advisory

A more intriguing question is **how long** the Fed intends to maintain the Fed Funds Rate at its current, rather **restrictive level**. Even if no new problems in the financial system, like in March 2023, pop up, falling inflation expectations mean the real interest rate will rise if the nominal rate stays the same.

In our baseline scenario, the Fed will start to consider such a "passive" tightening of monetary policy undesirable at some point during the course of the year. It is therefore likely to **pivot towards gradually cutting interest rates** in the summer in order to **avoid a policy overshoot**, i.e. to limit the negative impact on economic growth. However, the pace and scale of this change will not be comparable to previous interest rate cycles. By the end of 2024, we expect the target range for the Fed Funds Rate to modestly decline by 50 basis points to 4.75 % to 5.00 %.

%	Q1/24	Q2/24	Q3/24	Q4/24
3M Euribor	4.00	3.80	3.50	3.30
ECB Refinancing Rate	4.50	4.50	4.25	4.00
Fed Funds Target Rate	5.38	5.38	5.13	4.88

Source: Helaba Research & Advisory

Ulf Krauss, Patrick Franke

Government bonds: Hopes pinned on central banks as playmakers

Having been promoted to a higher-yield division, the signs are pointing to consolidation. Declining inflation and interest rate turnaround should be the key drivers for the 2024 season.

It is looking as if hopes will be dashed that bonds will at least put in a satisfactory performance in 2023 following two years of, in some cases, considerable price declines. As expected, **inflation rates** have fallen sharply, but lingering doubts over how it will develop going forward have **unsettled** both investors and central banks alike. Most recently, the **US bond market** was the main source of negative signals, with the yield on 10-year US Treasuries soaring at times to as much as 5 % **–** more than one percentage point above its level at the end of 2022. At just under 3 %, 10-year German bund yields were only around 0.4 percentage points higher, but at least provide a **more favourable entry level** for new investments.

Will fiscal policy spoil the game?

A certain amount of volatility can be expected on bond markets in 2024, too. Caution is the order of the day, given that central banks will be **running off their portfolios of securities** at the same time as a relatively high level of **sovereign issuance**. In the wake of rising government debt and interest payments, an upward trend in credit default swaps has emerged, and not only since the US was downgraded. Rates on US Treasuries have reached their highest level for more than ten years and, though only half as steep, those on German bunds are on the rise as well. Risk premiums have also risen again in the euro area.

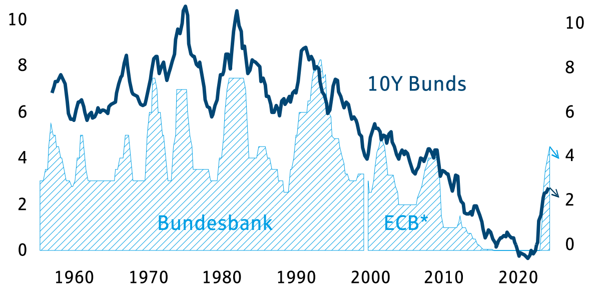
Negative effects could also arise from long-term **inflation expectations** in 2024, with the respective eurozone futures rising to more than 2.6 % at times and marking a new all-time high. The upward trend remains undiminished and reflects the uncertainty associated with shifting **structural factors** such as demographics, climate change and geopolitical conflicts.

Central banks to assume role of playmakers

For 2024, bondholders' and debtors' hopes will primarily be resting on the role of **central banks** which, although unlikely to achieve their inflation targets of 2 %, are nonetheless set to **reverse their monetary policy stance** in the second half of the year. Experience has shown that phases such as these create propitious conditions for price gains. Since the 1950s, in twelve comparable scenarios on the German bond market, bund **yields have fallen** in eleven of them. Analysis of the US bond market reveals a similar pattern, where yield spikes have frequently occurred prior to a peak or at the beginning of a plateauing in key interest rates. Seen from this vantage point, the most recent peak in yields on US Treasuries and German bunds could very well mark a **cyclical high**. It is also worth noting that, in the past, an inverted yield curve in the US was a reliable indicator that yields would at least remain on the same level but would be more likely to trend downwards again.

Key interest rate peaks – potential for bonds

Key interest rate and yield, %



*main refinancing rate

Sources: Refinitiv, Helaba Research & Advisory

%	Q1/24	Q2/24	Q3/24	Q4/24
10y Bunds	2.70	2.70	2.50	2.30
10y Treasuries	4.40	4.30	4.20	4.00

Source: Helaba Research & Advisory

The **yield on 10-year German bunds** should close out 2024 at **2.3 %**, although this level is likely to be at the lower end of the spectrum over the course of the year. The US bond market can be expected to have a supportive effect. 10-year **US Treasury** yields should return to **the 4 % mark.**

Ulf Krauss

Covered Bonds: Popularity among issuers and investors to remain high in 2024

Covered bonds continue to benefit from their safe haven status. The quality of both, underlying cover pools and high levels of over-collateralisation make a strong case for this asset class.

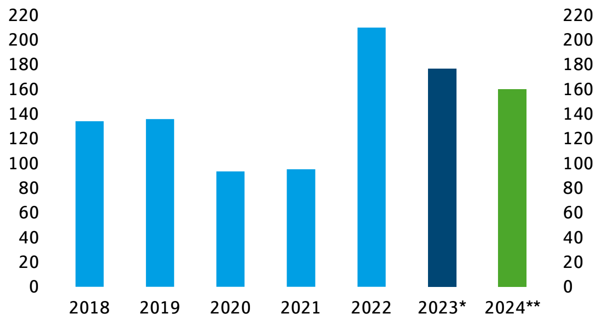
Having previously set a **new issuance record** in 2022, the primary market for covered bonds achieved another all-time high in 2023, despite turmoil in the US and Swiss banking sectors leading to a significant, albeit temporary, slowdown in activity in March. The segment rapidly put this weak phase behind it, with the focus turning to the imminent **termination of the TLTRO programme** and, in turn, the need to replace the ECB's declining liquidity provision to some extent with capital market refinancing. In addition, given the ECB's decision to phase out its asset purchase programme, many issues were brought forward to the first half of the year.

> *“Central bank exit gives covered bonds new lease of life”*
> *Global Capital*

We anticipate a reduced but still robust level of issuance for 2024 of 160 billion euro. The absence of the extraordinary TLTRO effects as well as a lower volume of maturing bonds of 121 billion euro (2022: 136 billion euro) will contribute to this. This will be compounded by a declining amount of new lending by banks due to higher interest rates, which has already been noticeable in 2023. This will reduce the volume of assets eligible for refinancing. In spite of this, we believe that issuers will continue to make greater use of covered bonds as a **comparatively inexpensive refinancing instrument** in an environment of relatively high interest rates. One reason for this is that the relative appeal of covereds is likely to rise owing to an emerging tendency towards a widening of spreads between covered and uncovered bonds. In terms of maturities, the focus in 2024 is once again likely to be on the **short to medium-term segment** given the fact that the interest curve is still inverted. At best, there will only be isolated long-term issues: After all, with the ECB withdrawing from the market as a major investor, placement risks have significantly increased and compensating for higher yield spreads is expensive.

New issuance to decline slightly in 2024

Billion euro



*as of 19 October 2023, **estimated volume for 2024
Sources: Bloomberg, Helaba DCM, Helaba Research & Advisory

Covered bonds to remain sought after as safe haven assets

Demand is therefore set to remain high. Ultimately, covered bonds benefit from their **status as safe haven investments**. On the one hand, this asset class is distinguished by top-quality underlying asset pools and high overcollateralisation ratios, notwithstanding falling real estate prices in many locations. On the other hand, the majority of credit institutions enjoy solid credit ratings that have a supportive impact on these papers. Our analysis indicates that most financial institutions are in a considerably stronger position than they were at the time of the global financial crisis. They are reaping the rewards of rising interest rates in the form of higher earnings and exhibit robust asset quality metrics. Furthermore, covered bonds issued in the European Union have secured preferential regulatory treatment following the final implementation of the **EU Covered Bond Directive** and the establishment of the European Covered Bond (Premium) label.

Despite strong investor interest, all signs continue to point towards a "**buyer's market**", which we expect will generate net new issuance (total issuance minus maturing debt) of around 39 billion euro. As has recently been the case, investors have the power to extract a lucrative initial offer from issuers. At the same time, we assume that relatively high interest rates and the fact that there is currently no evidence of a reversal in the ongoing trend towards a widening of spreads will serve to **further enhance the appeal of covered bonds**. It is possible that other groups of investors, such as those from Asia, will flock back to this asset class.

Christian Schmidt

Credit: In calmer waters

The corporate bond market is being fuelled by ongoing demand for investment and more stable issuance costs. Banks are preparing to defend their recent stellar profits.

Thanks to lower volatility and receding upward pressure on funding costs, the **primary market for euro-denominated corporate bonds** has performed considerably better this year than in 2022. In particular, a stabilisation in swap rates has made planning capital market transactions more reliable and appears to be prompting some issuers to bring forward deals they had previously put off. Additionally, higher capital market yields are generating strong demand among investors. Consequently, we expect a placement volume in 2023 as a whole of more than 350 billion euro.

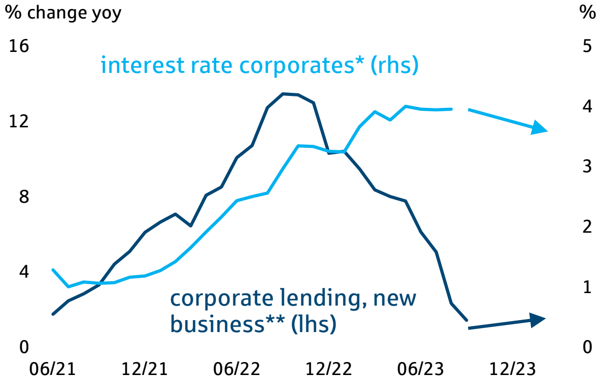
Looking to 2024, corporate refinancing rates will probably not rise any further; in fact, they are more likely to decline from current levels. At the same time, given the ECB is still pursuing a cautious monetary policy, any return to the cheap rates of the past would appear out of the question in 2024. The corporate bond market has recently seen **quite a stable trend in yields** and this will probably remain the case into next year. In our view, this bodes well for strong issuance activity over the course of the year.

Considering the **investments required** in diversifying supply chains, digitalisation and sustainable manufacturing processes, it is hardly likely that the challenges facing many companies will become any less pressing. What is more, the internal financing capacity of many firms is coming under pressure due to the recent weakness in the economy and rising production costs. As some banks have tightened their lending policies, many corporates are essentially limited to raising funds on the capital markets. For this reason, we anticipate that **issuance volumes** on the euro-denominated corporate bond market are set to remain at least **on a par with 2023**.

Banks in a strong position

Thanks to the turnaround in interest rates, **profits have surged** in the banking sector since at least the middle of 2022, boosted by a sharp rise in net interest income, mainly from customer deposits and liquidity reserves. Yet, **competition for customer deposits** is intensifying and banks are under growing pressure to pass on higher interest rates to them. Meanwhile, lending activities have been adversely affected by tighter monetary conditions. Although ratios of non-performing loans have so far held steady at historically low levels, the current sluggish economic environment may drive them up in 2024. On a positive note, however, the sector enjoys healthy risk buffers, among other things in the form of additional top-level adjustments created during the pandemic that was not drawn down. Furthermore, capital ratios have reached such high levels due to regulatory reforms over the last ten years and the suspension of dividend payments during the pandemic that institutions are now able to resume payouts to equity holders and launching share buyback programmes.

Corporate lending on the decline



*new business > 1 million euros, > 5 years; Germany
**adjusted for securitisations and other products; Germany
Sources: Refinitiv, ECB, Helaba Research & Advisory

Most recently, bond issuance has been on course for a bumper year. The volume of new issuance of senior unsecured euro-denominated benchmark bank bonds, which amounted to a record level of around 190 billion euro in 2022, could reach a new all-time high by the end of 2023. For 2024, we expect another year of strong issuance, even though there will be no repeat of the TLTRO refinancing transactions seen in 2023. Activity will primarily be driven by a continued large volume of maturities and the aforementioned decline in customer deposits.

Ulrich Kirschner, CFA, Dr. Susanne Knips

Equities: The next game is always the hardest

With the multitude of looming challenges, it would be easy to fall into pessimism. But equities have already priced in a lot of negative factors and the DAX and the DAX is attractively valued.

From the standpoint of equity investors, 2023 has been a **good to very good year** for the most part. The majority of global indexes have recorded gains, in some cases in the double digits, making up for or at least going some way to reversing the heavy losses they suffered in the previous year. Technology stocks – the laggards of 2022 – have turned out to be the leading lights of this year's bull market. A cumulation of negative factors in the late summer led to a correction on most indexes.

A rocky road for equities

Equity markets are confronted by a long **list of challenges**, which include purely economic factors as well as geopolitical conflicts. Is inflation going to come down fast enough to give central banks room to cut interest rates? Will China act as a drag on the global economy or will it be able to jump-start its engine of growth again? Has the global industrial cycle reached a trough and is it now set to pick up speed again? Will geopolitical tensions intensify, such as those with China? How is the war in the Middle East going to play out? More questions than answers!

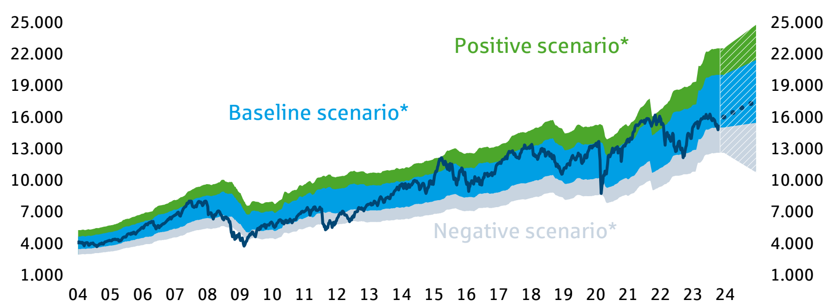
> *"We mustn't bury the sand in our heads now"*
> *Lothar Matthäus*

One particularly salient issues that currently preoccupies investors is **monetary policy**. The impact of central banks' blistering pace of interest rate hikes on the real economy is obvious and its ripple effects have been felt on capital markets, too. For one thing, key interest rates were ratcheted up within a virtually unprecedented space of time; for another, central banks have embarked on running off their balance sheets. The fact that equities held their ground for a long time despite mounting competition from fixed-income products is a good sign, as share purchases were evidently based on fundamental convictions and were not the result of a lack of alternative options. Meanwhile, though, it seems that the markets have finally hit a pain threshold. After all, investors are able to generate respectable yields with apparently safe fixed-income investments at the short end as well as, in some cases, at the long end of the yield curve. Even so, as the rate hiking cycle draws to a close, the relative valuation is likely to tilt back in favour of equities; although it is important to note that the extent to which an index is an attractive proposition for investing in depends on its specific valuation.

DAX in great shape from a valuation perspective

DAX offers attractive risk-reward profile

Index, weekly values



*bands: Fair value consisting of earnings, dividends, cash flow and book value
Sources: Refinitiv, Helaba Research & Advisory

Due to the enormous significance of manufacturing industry in Germany, it is especially dependent on the global industrial economy. While the ifo business sentiment index had rebounded up until the spring of 2023, it fell again amid a global downturn in manufacturing. This also had a negative impact on the DAX. Thanks to **solid corporate earnings**, however, weakness in the real economy was not translated one-to-one into falling share prices but resulted instead in a valuation compression. The upshot of this is that the **valuation** of German dividend stocks is **decidedly modest** based on the most relevant quantitative benchmarks (price/earnings, price/dividend, price/cash flow and price/book value ratios).

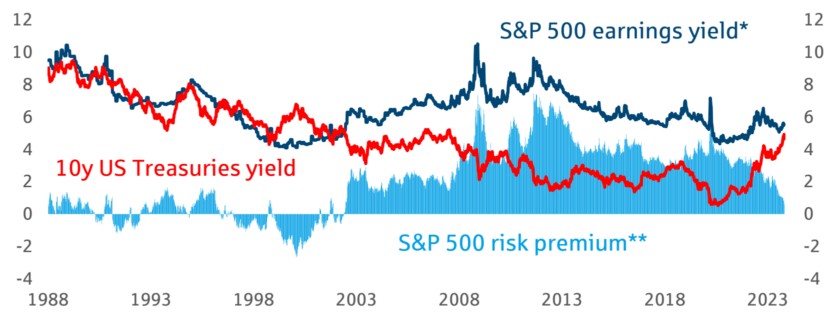
Helaba's valuation indicator for the DAX is currently slightly below its long-term range. At the same time, economic expectations in Germany are likely to be gradually reaching their nadir. Sentiment among investors has also been marked by scepticism with respect to equities for much of 2023. By way of a contrarian indication, the Helaba BEST indicator (which reflects valuation, expectation, sentiment and technical factors) recently **generated a buy signal**. By the end of 2024, the DAX should touch 17,500 points, which would represent its current fair value. So, for it to hit this level, corporate profits would not even have to rise – the assumption of a normalisation in its valuation would be sufficient.

US market valuation overly optimistic

The picture on the **US stock market** in terms of valuations is less favourable. Based on the most common valuation ratios, the S&P 500 is already **quite expensive** – unlike the DAX. Even the market's relative valuation against US Treasuries, whose yields are close to 5 %, poses a problem: the S&P 500 would then only offer a risk premium of one percentage point. However, looking back over a longer period of time reveals that low or even negative risk premiums were not an uncommon occurrence. For much of the 1990s, they fluctuated in a range of between -2 and +2 percentage points. The high relative attractiveness of equities versus bonds in the last 20 years was mainly due to the (abnormally) low interest rate level. This mispricing of the bond market has been corrected in recent months.

US Treasuries giving S&P 500 a run for its money

% or %-points, weekly



** earnings/price ratio; **earnings yield minus yield on 10-year US Treasuries
Sources: Refinitiv, Helaba Research & Advisory

There is little doubt that, to some extent, conservative investors will be drawn to government bonds by the higher yields they offer. That said, the reallocation process is arguably already far advanced. In addition, as the Fed reaches the end of its rate hiking cycle, the long end is also likely to settle down again somewhat, reducing headwinds for US equities. Given an expected recovery in the US economy over the course of 2024, the **odds that equity prices will rise** are not bad. We expect the S&P 500 to close out 2024 at 4,800 points.

Equities enter 2024 as favourites

We assume that the **corrective phase will soon be over** and that equities will resume their bullish run. Hence why our advice is to take advantage of weak periods to buy. Due to their much more attractive valuations, German and euro stocks are our favourites.

> *“I had a good feeling in terms of how I felt”*
> *Andreas Möller*

Granted, it is not easy to muster the courage to invest in equities amid the current news cycle dominated by crises. After all, history shows that equities can fall below their fair value for longer periods of time. But accepting higher risks is the only way to achieve above-average returns. In the past, **investing in undervalued markets has usually paid off** in the long run. For this reason, and because emotions are often deceptive, investments should be made based on fundamental factors.

Index value	Q1/24	Q2/24	Q3/24	Q4/24
DAX	16,400	16,800	17,200	17,500
Euro Stoxx 50	4,500	4,600	4,700	4,800
S&P 500	4,580	4,650	4,730	4,800

Source: Helaba Research & Advisory

Markus Reinwand, CFA

Gold: Back on the interest rate offensive in 2024

Monetary policy has gone into extra time, with the turnaround in interest rates adjourned. The deadlock for gold should be over with the first interest rate cuts from the ECB and the Fed.

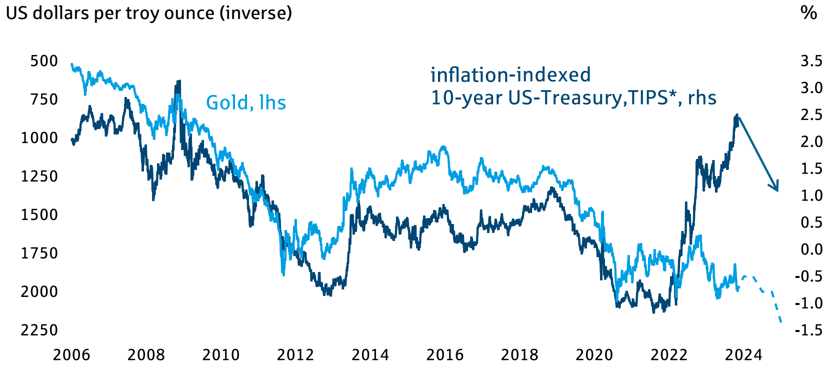
For gold, 2023 was a volatile and nail-biting year that only ended on a positive note thanks to a shift to safe haven assets. While the precious metal was leading for large swathes of the year, rising by more than 10 % (in US dollars and euros), these gains were almost wiped out when expectations for monetary policy were disappointed. The **most important factor** determining the price of gold, which fluctuated between 1,811 and 2,051 US dollars per troy ounce, were investors' **hopes of an interest rate cut**. Consequently, gold peaked at 2,051 $/oz when initial speculation of an autumn 2023 interest rate cut by the Fed was most intense – and tumbled again when these hopes were dashed.

> *"Gold is money. Everything else is credit"*
> *J. P. Morgan*

Non-interest-bearing gold highly dependent on real yields

Given the pace and magnitude of monetary policy tightening, especially in the United States, gold actually put in a respectable performance in 2023. After all, the hawkish stance of both the Fed and the ECB drove up interest rates on the capital markets to levels not seen in 15 years.

Ambitious real yields: Correction will boost gold



*TIPS=Treasury inflation-protected securities as a proxy for real yields
Sources: Macrobond, Bloomberg, Helaba Research & Advisory

Now, after more than a decade, non-interest-bearing gold is once again competing with safe government bonds, which are enticing investors with attractive yields. This could be an argument for reassessing the value of gold, as the **rationale for buying it as an alternative investment has lost its appeal**. The counter-argument is that it remains a safe haven investment which justifies paying a higher price in the form of a risk premium.

Falling real yields will provide a boost to gold

Nominal yields are less important in pricing gold than **real yields**. At the same time, it remains to be seen if the markets consider the most recent surge in yields as a sustainable and long-term phenomenon. If 2024 sees a reversal in real yields in 2024 and they settle on a lower level, as we expect, that would open up an opportunity for gold. The latest jump in real yields (as expressed in TIPS) to 3 % drove down gold to 1,815 $/oz. The last time they hit this level was as far back as 2009. However, it was steadily downhill from there, even into negative territory, with the price of gold breaking one record after another.

Though there is no prospect of a return to negative yields, a U-turn on key rates by both the Fed and the ECB is on the cards for 2024. Record levels of global sovereign debt, ongoing pressure to invest in transforming economies as well as existing geopolitical risks are more likely to put central banks on the defensive. That means yields have probably peaked and that, as a result, real yields should move towards 1 %. For that reason, gold will **benefit from clear signs of an interest rate turnaround** in the second half of 2024 at the latest, which will enable the precious metal to exceed the 2,000 $/oz level.

Price / ounce	Q1/24	Q2/24	Q3/24	Q4/24
Euro	1,810	1,818	1,818	2,000
USD	1,900	2,000	2,000	2,200

Source: Helaba Research & Advisory

Claudia Windt

Real estate: Relegated from Premier League this season

German property markets have already undergone a significant correction and the odds are good that investors have weathered the worst of the storm. Despite this, risks still remain high.

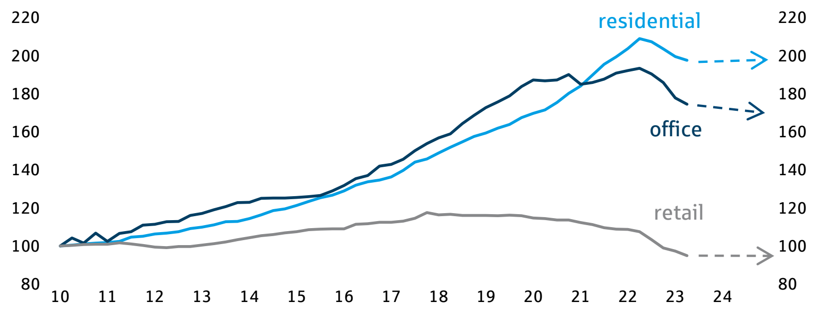
After an extended period of expansion lasting many years, German real estate is in the grip of a **correction**. Prices have been declining since the middle of 2022, having practically doubled in key segments since 2010. The prices of retail properties, which have been falling since as early as 2018, largely as a result of mounting competition from e-commerce, are an exception in this regard. It was not oversupply or weak demand that finally **put an end to the boom**; in fact, the primary trigger was the **steep rise in interest rates** on capital markets, which led to a dramatic and rapid surge in financing costs.

Correction on housing market largely run its course

So far, prices on the German residential property market have fallen by between 5 % (vdp index) and 10 % (German Federal Statistical Office) on average, with both indices most recently pointing to an **easing in the downward trend**. As a general rule, prices of properties that do not meet increasingly strict energy efficiency requirements have declined most precipitously. Meanwhile, a number of factors suggest that the downturn will steadily bottom out over the next few quarters and that there is **likely to be at least a modest increase in house prices** in the new year.

Turning point reached – at least on housing market

vdp Property Price Index Germany, capital value, Q1 2010 = 100



Sources: vdp, Helaba Research & Advisory

It is worth noting that the bulk of the previous rise in prices was **fundamentally justified,** given the fact that demand continues to rise due to high net migration to Germany while the housing stock remains limited. For many years now, the number of **completed dwellings** has been considerably lower than the estimated annual requirement of approximately 400,000. The sharp fall in building permits issued as well as shrinking order books in the construction sector suggest that this figure will decline even further to as little as **around 200,000** in 2024.

Affordability of owner-occupied housing set to improve to some extent

There are at least some signs that home ownership should become more affordable in the new year. Following the ECB's previous policy rate hike in mid-September, capital market rates are likely to have **reached a peak** and the upward trend in mortgage rates had already stagnated for the most part some months ago. Should market **expectations of an interest rate cut** by the central bank gain traction in the foreseeable future, this is likely to provide a certain degree of relief to mortgage rates. Other factors that affect the affordability of housing also point to an easing in the situation, with housing prices declining and **real wages set to climb again** in view of strong pay increases and falling inflation rates. Another aspect supporting house prices and helping to stabilise them is the ongoing **growth in rental prices**.

In 2024, a **package of measures by the German federal government** will provide additional support for the housing market, including the option to use an accelerated depreciation of 6 % for new properties, suspending the introduction of a new energy efficiency standard, an increase in the construction of new public housing and raising the maximum income thresholds to qualify for subsidised loans. However, it is not possible to enact some of these changes in the short term as they are subject to approval by the German federal states. When it comes to other measures, it will take some time before their impact filters through to the housebuilding sector.

Taken together, these developments mean investors can expect to see a turning point in house prices in 2024. However, **risks will remain** high for property developers and construction firms and it will take longer for a recovery to set in for these players. For the time being, it is likely that the rate of insolvencies will stay high and that, given significantly higher interest rates compared to the initial mortgage term, refinancing will pose a challenge for many borrowers.

Considerable uncertainty for offices, retail properties to bottom out

Prices for office buildings have fallen more steeply than those in the residential segment, although the rate of decline has been slowing of late and increasing rents in prime locations are having a stabilising effect. However, it is likely that prices will remain **under pressure** and vacancy rates will increase slightly from a moderate level in 2024 due to the lingering uncertainty over how the trend towards working from home will evolve and recent above-average completions. We neither anticipate any widespread 'return to the office' nor any greater proliferation in remote work. Overall, the trend towards hybrid working arrangements will result in a modest fall in demand for office space. This will be a gradual process, though, and one that will be accompanied by more subdued construction activity, which will ensure its impact is limited.

> *“Forcing staff to return to the office is not an option either”*
> *Jean-Victor Alipour, ifo Schnelldienst (10/2023)*

Rents for **retail properties** appear to have recently formed a trough. Considering that the price correction in this segment has been underway since around 2018 and is already far advanced, it would be reasonable to expect property values to stabilise on a low level in 2024.

% yoy	2020	2021	2022	2023f	2024f
Open-ended fund index*	1,5	2,0	2,3	1,5	1,8
Residential real estate**	6,8	10,3	7,2	-4,0	2,0
Commercial real estate**	3,1	-0,8	-0,4	-8,5	-1,0

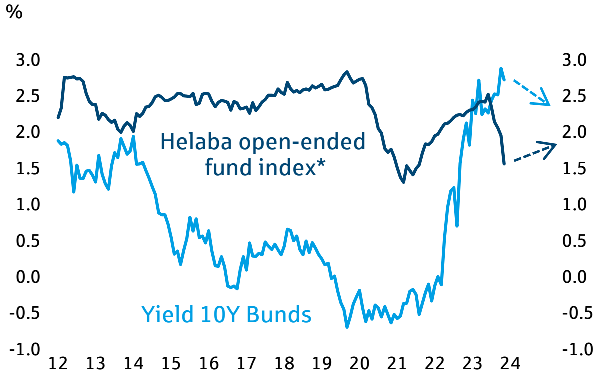
* Helaba index für German open-ended funds (annual total return); **vdp price indices Germany (annual average), f=forecast; Sources: vdp, Refinitiv, Helaba Research & Advisory

Open-ended real estate funds: Declining returns

Returns on open-ended real estate funds in Germany have been on a downward trajectory for several months now. As measured by the "Helaba open-ended fund index", their **performance** recently slipped **below the 2 %-mark**. This index tracks the average performance of nine major funds from four leading providers. This decline, which was the result of the depreciation of properties in some portfolios, will continue for a few more months.

This view is also corroborated by the most recent performance data in key markets outside Germany, such as France, the United Kingdom and the United States, in which around a tenth of fund assets are invested respectively. Since portfolio properties are subject to special appraisals by surveyors, there is a time lag before their valuations are reflected in a fund's shares. The average performance of open-ended funds is **unlikely to stabilise until later in 2024** and, in all probability, will still be below 2 % at the end of the year.

Performance remains low



*total return, average of nine major German open-ended real estate funds
Sources: Refinitiv, Helaba Research & Advisory

Net inflows into open-ended funds have been trending downwards for at least three years. Considering that the attractiveness of these funds relative to fixed-income securities has significantly fallen, with returns expected to remain below the yield on 10-year German government bonds, they are **more likely to see net outflows** than inflows in 2024. Nevertheless, due to minimum holding and notice periods introduced in 2013, these are not expected to reach levels seen in 2005/2006 or 2008, even though there is still a large stock of legacy assets that were acquired before the new regulation was put in place.

Dr. Stefan Mitropoulos

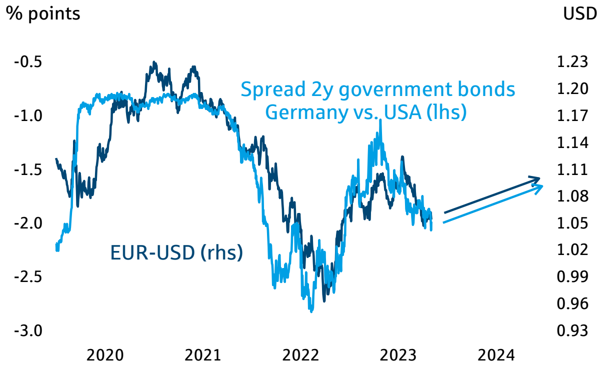
Currencies: US dollar's winning streak draws to a close

The US dollar cannot always be the winner and tailwinds from the economy and monetary policy will fade in 2024. That is likely to drive up the euro-dollar rate, albeit to a limited extent.

What Bayern Munich is for the Bundesliga, so the US dollar is to forex markets. It is dominant and usually wins – but is not universally loved. 2023 saw the **dollar** recover from a period of weakness and **brim with renewed strength**. Will the greenback remain the perennial champion in the future as well or will it give other currencies a shot at the crown for once?

One source of strength for the dollar is the **US economy's resilience**. So far, it has not suffered all that much from the increase in energy prices and interest rates, unlike other currencies, such as the euro, which have come under greater pressure. This has enabled the Fed to raise its key rate – or at least keep it high – which has in turn rendered the currency more attractive. In the meantime, though, interest rates have also crept up in other places, including the euro area, which has diminished the US dollar's yield advantage.

Yield advantage providing less support to dollar



Sources: Macrobond, Helaba Research & Advisory

Fed setting the pace for the dollar

Among global central banks, it is the Fed that generally sets the pace and an interest rate hiking cycle is, by definition, followed by an interest rate cutting one at some point. Even if the US avoids a recession, the US central bank is likely to usher in a **turnaround in monetary policy in the second half of 2024**. In the past, reductions in interest rates were normally accompanied by a weaker US dollar, unless the latter was used as a safe haven in times of crisis. Consequently, the US yield advantage versus the euro and other currencies should diminish. But the probability that the Fed will only moderately relax its policy suggests there will not be any vigorous movement in the exchange rate.

Structural risks for the US currency

To a certain degree, the United States' economic outperformance ca be attributed to its fiscal policies, which were more accommodative in 2023 than, for example, in the euro area. As a result, the US is running a considerably higher budget deficit that it is unlikely to reduce significantly in the next few years. Combined with a persistent deficit in the current account, this has created a **sizeable "twin deficit"**. Incidentally, not only do the euro countries have much smaller budget deficits but they also returned to a substantial current account surplus after the downturn in the wake of the energy crisis. Historically, US deficits of this magnitude were usually followed, sooner or later, by a weaker dollar. At the moment, this does not appear to be an issue on currency markets nor is there any certainty that it will become one in the future. However, it does at least suggest caution is warranted. A similar picture emerges in terms of the dollar's valuation based on purchasing power parities or real exchange rate indices, which indicate that, although not at record levels any longer, the **dollar is still quite expensive**.

> *„It is fast impossible zu verbessern"*
> *Pep Guardiola*

In 2024, the US' advantages in terms of both yield and GDP growth are likely to decline. Eventually, the **economy in the euro area is expected to improve** and this should shore up the euro. Consequently, the tendency will be for the US dollar to lag behind – even though it could benefit now and again if the market gets nervous or if any geopolitical tensions flare up. The **euro-dollar exchange rate should therefore be trading at a level of 1.10 by the end of 2024.** Well, even Bayern Munich loses occasionally. Despite that, there is no doubt that the dollar will continue to be the dominant force on currency markets for the foreseeable future.

A bumpy ride for the pound sterling

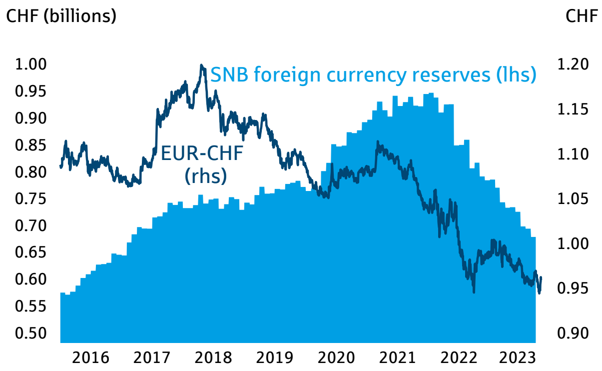
2023 saw the **pound sterling** bounce back from its previous phase of weakness; although this recovery stalled in the middle of the year. Having initially surprised on the upside, the economic environment has meanwhile deteriorated. With the Bank of England set to end its interest rate hiking cycle before the end of 2023, sterling will gradually lose support. However, since other major central banks have adopted a similar stance, this suggests a certain degree of stability for exchange rates. Higher British economic growth in 2024 should also have a positive effect on the pound. As 2024 progresses, though, the Bank will be looking further down the road. After initially remaining elevated, inflation should come down further, giving the **Bank of England more room to change course**. The first interest rate cuts in the second half of 2024 and the prospect of additional loosening in 2025 could weigh on sterling. Nevertheless, the potential for losses will be limited. By the end of 2024, the euro-pound exchange rate is likely to stand at 0.88; the pound-dollar exchange rate at 1.25.

Swiss franc not always the best performer

In 2023, the **Swiss franc** was one of the strongest performers on foreign exchange markets. The Swiss National Bank (SNB) raised its key interest rate to 1.75 %, which probably marks the end its hiking cycle. After all, inflation has fallen well below the 2 % mark and will stay there in 2024. The country should achieve GDP growth of 1.5 % next year. Fundamentally, the lower rate of inflation relative to the euro area justifies the appreciation of the Swiss franc. In terms of purchasing power parities, though, it is still rather overvalued.

The Swiss franc occasionally benefits from its status as a safe haven as risk aversion grows; but this will not provide it with any lasting support in 2024 any longer. The SNB has been considerably less aggressive in hiking rates than the ECB and the Fed, which **pushed the Swiss franc's yield disadvantage to levels not seen in years**. That said, the SNB intervened on currency markets to prop it up. However, with inflationary risks receding, it is likely to loosen its policy. In that case, the Swiss currency should depreciate and the euro-franc rate should rise slightly above parity.

SNB reduces reserves to support the franc



Sources: Macrobond, Helaba Research & Advisory

Japanese yen: Potential for recovery

The **Japanese yen** has emerged as one of the big losers of 2023, just as it did in the previous year, despite a strong temporary surge. Monetary policy was the principal reason for this, as the Bank of Japan has not jumped on the global bandwagon of rate hikes. As a result, the **yen exhibits a marked yield disadvantage** against the euro and the dollar. That said, this is already more than adequately reflected in the exchange rates and interest rate spreads are likely to narrow again in 2024. On the one hand, capital market yields in the United States and the euro area should fall; on the other hand, the Bank of Japan is set to relax or abandon its policy of yield curve control, which should lead to a slight increase in Japanese yields. In the medium term, this should benefit the yen. In the shorter term, the central bank may intervene to support the currency.

vs. Euro	Q1/24	Q2/24	Q3/24	Q4/24
US dollar	1.05	1.10	1.10	1.10
Japanese Yen	155	153	150	148
British Pound	0.86	0.86	0.87	0.88
Swiss franc	0.97	0.98	1.00	1.01

Source: Helaba Research & Advisory

In the longer run, the yen is by far the most undervalued of the world's major currencies based on purchasing power parities or real exchange rate indices. Hence why Japan's current account surplus is slowly approaching previous records again. For this reason, the **prospects for the Japanese currency are indeed positive**. The dollar-yen exchange rate is likely to fall to 135 and the euro-yen rate to 148.

Christian Apelt, CFA

Germany: Renewed appetite for consumption

Thanks to consumers, Germany is set to return to growth in 2024. While industry should recover, the construction sector will remain in crisis. Structural reforms could boost momentum.

Currently, Germany is not in contention for the top spots in the economic league table. Output has stagnated for the last six quarters, while the euro area as a whole is estimated to have grown by 0.5 % in 2023. **Globally**, though, **manufacturing industry** is likely to **regain its footing**. As Germany has an above-average share of industry, it should benefit from this. Still, with GDP growth of **1.3 % in 2024**, the German economy will be on a par with the euro area average.

	2023e	2024f	2025f
GDP real, % yoy	-0.2	1.3	1.0
GDP real, % yoy, working day adjusted	0.0	1.3	1.1
Private consumption, % yoy	-0.7	1.3	1.3
Government spending, % yoy	-1.5	1.5	1.0
Gross fixed capital formation, % yoy	0.6	0.6	0.8
Investment in equipment, % yoy	4.0	2.0	2.0
Construction, % yoy	-1.5	-1.0	0.0
Exports, % yoy	0.0	3.5	4.0
Imports, % yoy	-1.0	3.0	4.0
Consumer prices, % yoy	6.0	3.0	2.5
Unemployment rate, %	5.7	5.6	5.2
Unemployed, thousands	2,600	2,550	2,350
Budget balance, % of GDP	-2.0	-1.5	-1.0
Current account balance, % of GDP	5.9	6.0	6.1

Sources: Macobond, Helaba Research & Advisory

Structural constraints will prevent even stronger growth. Although the country's gas supplies have been successfully restructured, **gas prices** are **higher than before** and than in other countries. What is more, electricity is expensive in Germany and is hobbling the growth of many sectors, especially energy-intensive ones. Additional structural factors, such as **high taxes** and **bureaucracy** as well as the **weak trend in productivity**, have been plaguing the country for some time and should be addressed by policymakers. In addition, another reason why the economy is lagging behind other euro states is that countries like Italy and Spain are the main beneficiaries of EU funds. The significance of these effects should gradually subside.

Falling inflation rates to stimulate consumer spending

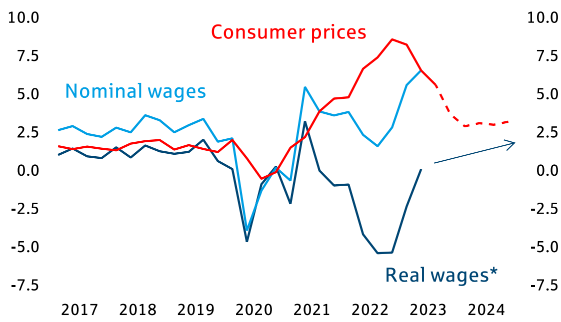
Since as far back as the summer of 2021, the dominant issue has been the increasingly steep rise in consumer prices, which has left households struggling. There have been periods when real wages fell significantly and the real disposable incomes of private households are likely to have declined slightly for the third year in a row in 2023. Since the savings rate has returned to pre-crisis levels and has recently hardly changed, consumer spending is estimated to have shrunk by 0.7 % in 2023, too.

Only bold structural reforms will raise the productive capacity of the economy

But a recovery is on the horizon: In **2024**, **inflation** is set to come down significantly from 6 % to around 3 **%**. Despite the recent cyclical downturn, employment in Germany has been growing steadily and this is likely to continue as the economy picks up again. Unemployment should only see a temporary spike around the turn of the year and is not expected to have any substantially negative impact on consumer spending next year. At the same time, **net wages and salaries** will rise noticeably. This is partly because, in addition to generous wage settlements in some sectors, the standard income tax brackets will be adjusted and employers will be able to pay tax-free inflation bonuses until 2024. Furthermore, **higher pensions**, an **increase in the "citizen's basic income"** and a **sharp rise in immigration** will result in higher monetary social benefits. In contrast, corporate earnings and investment income are unlikely to see any substantial growth. Taken together, the **disposable income** of private households should rise by **around 4 ¼ %**. Assuming an almost unchanged savings rate, this would translate into an **increase in private consumption of 1.3 %**.

Real wages set to rise in 2024

Quarterly values, % change yoy



*gross monthly earnings including one-off payments
Sources: Macrobond, Helaba Research & Advisory

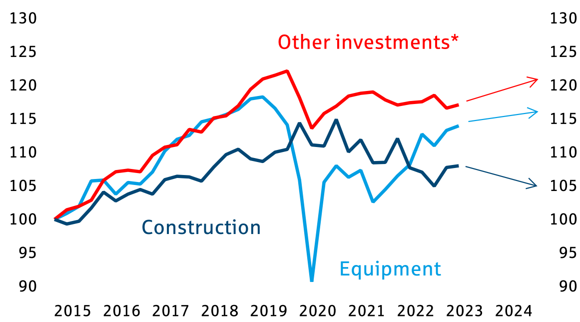
Consumption by the public sector also had a dampening effect on growth in 2023, mainly owing to the absence of spending to mitigate the impact of COVID. This will not be a factor in 2024. Public sector consumption, which accounts for just over a fifth of GDP, is likely to rise again from a lower level due to higher wages and salaries for public servants and increased spending on health, social care and education.

Uneven development in capital expenditure

While investment in equipment has been resilient in 2023, rising by 4 %, construction spending has fallen for the third year running (-1.5 %) and this dichotomy will be repeated in 2024. The sharp rise in interest rates has so far only had a limited impact on equipment investments. Businesses invested in their vehicle fleets, particularly as subsidies for electric vehicles expired in August 2023. As a result, investments like these are now likely to make a smaller contribution to growth. In addition, demand for capital goods in Germany is weak, but the anticipated rebound in manufacturing should have a positive effect here in 2024. The government's special fund for investment in the German armed forces of 100 billion euro will also provide an increasing boost from 2024 onwards. Taking these factors into account, overall **investment in equipment** is expected to grow **by approximately 2 %** in 2024.

Crisis in construction sector not over yet

Real fixed capital formation, index: Q1 2015 = 100



* including research & development, software, databases, copyrights
Sources: Macrobond, Helaba Research & Advisory

Further contraction in construction sector

Construction activity will decline by a further 1 % in 2024, with new housing shrinking at an above-average rate. The increased cost of building and high interest rates will weigh on homebuilders' budget calculations. In many cases, it is only possible to build new houses at prices the market cannot afford. On a positive note, new orders have recently stabilised after having fallen sharply. In 2023, the number of building permits issued has fallen by almost 30 % and completions are expected to decline to a level of only around 200,000 in 2024.

Due to the difficult situation, the German government put forward a **comprehensive package of measures** in September 2023 which, in addition to the option to use a declining-balance method of depreciation of 6 % for new residential properties, also includes an increase in the maximum income thresholds to qualify for subsidised loans. These measures should gradually have a positive effect in the course of 2024. It is also worth noting that the share of new housing as a proportion of total residential construction activity is only around 30 %. The outlook for renovation work on existing properties looks less bleak. In 2024, a combination of high energy prices, statutory requirements and subsidies is likely to generate increased demand for energy-efficiency retrofits, including new heating systems.

New orders for non-residential construction have been more stable. Investments by Deutsche Bahn gave a strong boost to the **commercial construction sector**. Many private companies, however, are unlikely to consider placing more orders until there are clear signs of an economic upturn. In contrast, **public sector budget** planning suggests spending will remain high. In 2024, the cost of building is also likely to come down, increasing the odds of even real term growth.

German **exports** have not made any headway in 2023, with the economic slump in China and the euro area putting the brakes on them. Falling real **imports**, however, have slightly lifted net exports. As the global economy improves in 2024, German exporters should gradually benefit from greater opportunities again. However, as a result of more buoyant consumer spending, imports will also rise. On balance, therefore, the **contribution of foreign trade to GDP growth** will be limited.

Dr. Stefan Mütze

France: Progress with reforms

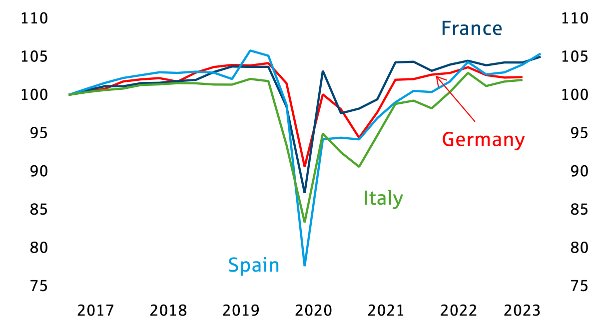
Having managed to stave off a recession, the French economy should grow by 1.5 % in 2024. Policies adopted by Macron's governments since 2017 have boosted the country's competitiveness.

The impact of elevated inflation, sluggish global trade and declining industrial output has also been felt in France – albeit less severely than in Germany, for instance. The country has been **successful in avoiding a recession in 2023** and reforms enacted in recent years are meanwhile paying dividends.

"Macronisme" a factor in France's resurgence

French consumers holding back

Real consumer spending, index: Q1 2017 = 100



Sources: Macrobond, Helaba Research & Advisory

Taking its inspiration from Germany's Hartz reforms, the French **labour market has been overhauled** since 2017. This involved making it more flexible, reducing the length of time people receive unemployment benefit and developing vocational training schemes. On top of that, the French government **cut corporate taxes** and was even able to pass highly controversial **reforms to the pension system**. The Macron administration has combined three supply-side initiatives with the **characteristic French approach to industrial policy** that aims to reindustrialise the country. To achieve this, the government launched its "France 2030" investment plan with a total volume of 50 billion euro. What is more, the cost of electricity for industry is relatively low. While these policies give little priority to the national debt, they help to attract foreign direct investment.

Investment in capital equipment has risen by about 4 % in 2023, although this rise is expected to be lower next year. The same cannot be said for **construction activity**, however, which has declined by an estimated 2 % in 2023 due to higher capital market interest rates, the increased cost of building and the fact that private households are facing a precarious income situation. Given that these underlying factors will only gradually improve, the construction sector is likely to act as a drag on economic growth in 2024 as well.

Consumers holding back

At the moment, economic growth is being hampered by weak **consumption** – an important factor in France. Private households have held back on spending and increased their consumption expenditure in 2023 slightly below average. The government responded to the energy crisis at an early stage by imposing wide-ranging caps on gas and electricity tariffs, which only temporarily limited the peak in inflation compared to the rest of Europe and stabilised consumer spending. In 2023, inflation returned approximately to the euro area level of 5.7 % and is not expected to see any significant change in 2024, when it should settle at around 3 %. Coupled with lower inflation and rising employment, a likely substantial increase in wages and salaries of around 4 ½ % will result in an estimated 1.5 % uptick in **consumption – the same as GDP growth**.

		2022	2023e	2024f	2025f
GDP, real change	% yoy	2.5	1.0	1.5	1.2
Inflation rate	% yoy	5.9	5.7	3.0	2.7
Unemployment rate	%	7.3	7.3	7.0	6.7
Budget balance	% GDP	-4.7	-5.0	-4.5	-4.0

Sources: Macrobond, Helaba Research & Advisory

Foreign trade made a net contribution to growth in 2023, with Germany, to which 13 % of goods were exported and from which 12 % of goods originated, remaining the country's most important trading partner. While exports should increase more rapidly in 2024 as the global economy picks up steam, the rebound in consumer spending is likely to stimulate imports. Consequently, foreign trade is unlikely to make a significant overall contribution to growth.

Dr. Stefan Mütze

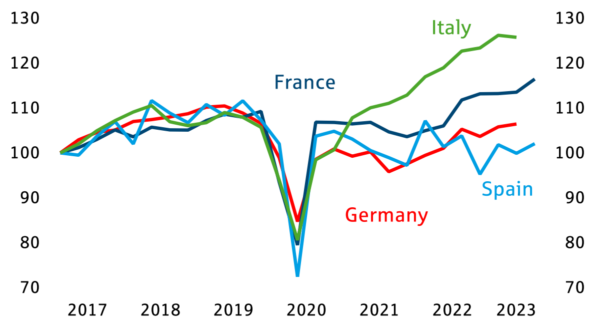
Italy: Growth based on EU aid rather than reforms

Italian GDP growth of 1.1 % will be weaker than in the euro area in 2024, despite generous financial assistance from Brussels. Reforms would be the only way to change this.

Italy's economy has outpaced that of the single currency area as a whole since 2021. For one thing, the country experienced a more pronounced COVID slump; for another, **extensive funds from the EU of nearly 70 billion euro** in the form of transfers continue to stimulate growth. Despite this, at 1.1 %, Italy will grow slower than the euro area in 2024. Capital investment has risen significantly despite the challenges the country faces in planning projects and getting them approved. Investment in **capital equipment** has grown by around 5 % in 2023, although momentum has recently eased. Despite that, Italy should manage a modest increase once again in 2024.

Italy: High dynamics in investment is weakening

Real investment, Index: Q1 2017 = 100



Sources: Macrobond, Helaba Research & Advisory

Excessive subsidies for construction sector

Whereas investment in capital equipment has risen by 19 % since the end of 2019, construction spending is as much as 31 % above pre-COVID levels. One of the principal drivers for this has been the exceptionally generous **"Superbonus 110"** refurbishment subsidy. This has enabled property owners to offset more than the entire cost of energy efficiency renovation work on a building, i.e. 110 %, against their taxes. This scheme has been widely abused and has led to enormous costs. Though restrictions have meanwhile been imposed on the programme, it continues to inflate Italy's **fiscal deficit**. The latter stands at 5.5 % in 2023 and is forecast to amount to a still high 4 % in 2024. **Investments in construction** fell by around 2 ½ % in 2023 and building permits for residential properties have recently declined. The restrictions placed on subsidies are not the only factor here: higher mortgage rates and build cost inflation continue to weigh on the sector.

Conditions for consumer spending remain unfavourable

Consumer spending grew by an estimated 1 ¼ % in 2023 and should **increase by a similar rate** in 2024. The savings rate is not expected to decline any further, as it has already dipped below its pre-COVID level. Falling inflation rates and a simultaneous modest rise in wages will provide some relief to Italian consumers. There should be further expansion in the number of people in work and a decline in the unemployment rate.

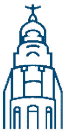
Once again, foreign trade has acted as a drag on economic growth in 2023, with exports barely increasing at all. Most recently, exports to the three principal markets of Germany, the United States and France have been falling. This should change in the course of 2024 as economic activity picks up speed. As a result, **foreign trade** should then at least **not make a negative contribution to GDP growth**, despite rising imports.

		2022	2023e	2024f	2025f
GDP, real change	% yoy	3,9	0,7	1,1	1,2
Inflation rate	% yoy	8,7	6,1	2,7	2,6
Unemployment rate	%	8,1	7,6	7,3	6,9
Budget balance	% GDP	-8,0	-5,5	-4,0	-3,5

Sources: Macrobond, Helaba Research & Advisory

If the Meloni government wants to stimulate the forces that drive growth, it needs to focus more closely on implementing reforms. For instance, the Italian civil service and judiciary are still considered to be overly lethargic. In addition, the state must invest more money in education and the Italian pension system is an expensive luxury. That comes on top of the country's commitment to achieving the goal, required by the EU Commission, of net-zero greenhouse gas emissions by 2050. For these and other reasons, despite receiving stimulus funds from Brussels, Italian **economic policy** is faced with **formidable challenges**.

Dr. Stefan Mütze



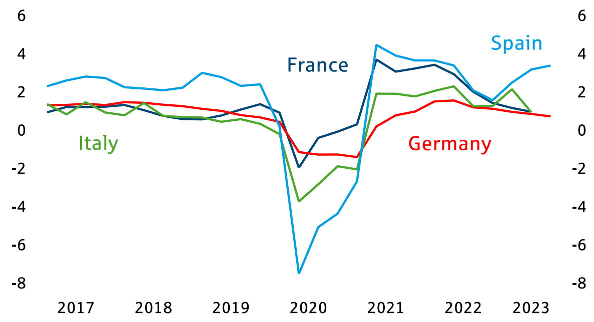
Spain: The economy is humming – for now

Spain hast high economic growth, even though a reluctance for political compromise is holding the country back. Consumption and construction activity are the driving forces.

Once again, at 2.4 %, the Spanish economy posted significantly stronger growth than the euro area as a whole (0.5 %) in 2023. That said, it also suffered the biggest pandemic-related downturn in 2020 among the major euro countries. Meanwhile, GDP has exceeded its 2019 level and momentum is slowing. This also applies to the all-important tourism sector, which has returned to pre-COVID levels. In 2024, **economic growth** is expected to **ease back slightly** to 2 %, which will still be higher than that of the euro area (1.3 %). However, on the downside, **high levels of public debt** leave the country vulnerable. The government would be **well advised to reform** the expensive pension system, for instance, while the country's productivity is considered to be rather low.

Strong growth in Spanish employment

Employment, % change yoy



Sources: Macrobond, Helaba Research & Advisory

Average consumption growth

2023 has seen Spanish **consumption** rise at the same rate as GDP. 2024 the situation for private households will brighten. Therefore, consumer spending should expand with 2.5 % at a higher percentage as the overall economy. The **inflation rate**, which has reached 3.5 % in 2023, has declined much more quickly than in other euro countries. For many Spaniards, the price they pay for electricity is pegged to the volatile wholesale price, so the most recent reductions in the latter have had a positive impact. The harmonised core rate, which excludes energy and food prices, was as much as one percentage point higher in 2023. While inflation should only fall slightly to 3.3 % in 2024, **higher levels of employment** will stimulate consumption. Despite the fact that a large number of Spanish work part time, the total number of hours worked is increasing. Wage increases will be higher than in 2023 and the government is likely to raise pensions significantly. Moreover, disposable incomes will get a boost from the higher earnings of self-employed workers.

Political uncertainty blocking investment

In addition to low-interest loans, Spain is entitled to **transfers of around 80 billion euros** from the European Recovery and Resilience Facility (RRF). However, the difficulties in forming a functioning government are delaying the approval of projects and their funding. If no new government is formed by the end of November 2023, the Spanish will go back to the polls on 14 January 2024. So far, unlike Italy, financial support from the EU has had little impact on **investment in equipment** (see chart p. 23). Having even declined somewhat in 2023, it is expected to recover in 2024 despite higher capital market interest rates. The trend in **construction activity** is more encouraging and the industry is more optimistic about its prospects for 2024. Similar to production output, the number of houses approved and under construction has risen considerably in 2023. Construction expenditure is likely to increase further in 2024, with non-residential building activity performing more positively.

		2022	2023e	2024f	2025f
GDP, real change	% yoy	5.8	2.4	2.0	1.5
Inflation rate	% yoy	8.3	3.5	3.3	2.7
Unemployment rate	%	12.9	12.0	11.5	10.9
Budget balance	% GDP	-4.8	-4.0	-3.5	-3.0

Sources: Macrobond, Helaba Research & Advisory

With exports growing more rapidly than imports, **foreign trade** has made a positive contribution to economic growth in 2023. It is only expected to generate a limited boost to GDP in 2024, as more buoyant consumer spending will lead to higher imports.

Dr. Stefan Mütze

Sweden: Troubleshooters needed on many fronts

For economic and monetary policy, the weak economic development coupled with elevated inflation rates remains a challenge. A shortage of housing is providing tentative scope for price rises.

2024 will see Sweden gradually emerge from an economic downturn. Since May of 2022, the Riksbank has raised its key rate from zero to 4 % in order to contain soaring inflation. Consequently, higher borrowing costs for businesses and consumers will initially act as a drag on demand but monetary policymakers are expected to take a more dovish stance as the year progresses. **Consumer price inflation** should fall to around 3 ½ % in 2024, considerably lower than this year.

		2022	2023e	2024p	2025p
GDP, real change*	% yoy	2.9	-0.5	0.8	2.3
Inflation rate	% yoy	8.4	8.6	3.5	2.2
Unemployment rate	%	7.5	7.6	7.7	7.3
Budget balance	% GDP	0.8	-0.3	-0.2	-0.1

*calendar adjusted; Sources: EU, Eurostat, Helaba Research & Advisory

Generous wage settlements will sustain consumer spending in 2024 and the rise in unemployment will remain modest. Investments in climate change mitigation and adaptation, some of which are co-funded by the EU, will also provide a boost to the economy. Additionally, greater global uncertainty has prompted the government to raise defence spending more quickly than originally planned. **GDP growth** in 2024 will be moderate. This, with inflation falling, should facilitate interest rate cuts in the second half of the year.

> *"The government is ready to act"*
>
> *Deputy Minister for Finance and Minister for Financial Markets, Niklas Wykman, referring to problems on the Swedish real estate market*

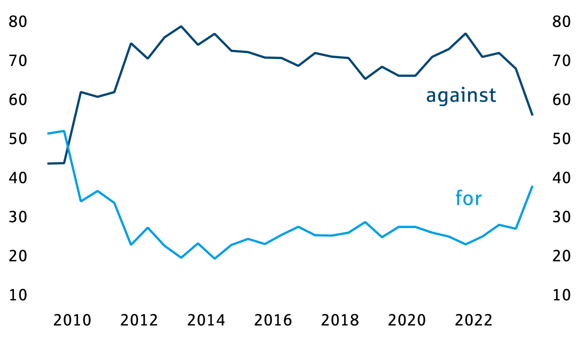
After pronounced declines in 2023, **house prices** should begin to trend higher in the course of 2024, driven by an ongoing lack of residential properties. That said, the higher cost of credit is squeezing borrowers since they often have variable-rate mortgages. That is why, although house prices will not grow at the pace seen in previous years, they could rise by 2 to 3 % as pressure from higher interest rates subsides. In the short term, the **Swedish krona** is likely to remain vulnerable. Despite this, the upside potential outweighs the downside risks as both interest rate spreads and purchasing power parities suggest it is currently undervalued. In 2024, the EUR/SEK rate should fall back towards the 11 level.

Neutral status no longer the country's overriding goal

The **minority coalition** of Moderates, Christian Democrats and Liberals is dependent on an agreement with the far-right Sweden Democrats, which gives it a wafer-thin majority. Given the wide diversity of opinion among the parties and the slim majority, it is uncertain whether the government will last a full term until autumn 2026. There will be fierce wrangling over issues such as the economy, housing, migration and domestic security. The prime minister, Ulf Kristersson, secured a key political victory with Turkey agreeing on the ratification of Sweden's **accession to NATO**, even if it has not yet been formalised and Hungary has also been repeatedly stalling the process. The precarious global geopolitical situation and the weak economy appear to be prompting a sea change in Swedish attitudes towards their membership of alliances.

Rising support for membership of euro area

Attitudes towards Economic and Monetary Union and the euro*, %



*Standard Eurobarometer 99

Sources: Macrobond, Helaba Research & Advisory

This is also true when it comes to membership of the euro area, with the latest Eurobarometer survey registering a **sharp jump in support of EMU** and the single currency in Sweden. On the specific question of switching to the euro, there was even a majority in favour. It remains to be seen as to whether this trend can be sustained as the economy picks up again.

Marion Dezenter

Poland, Czechia and Hungary: Counter-attack by central banks

The three countries' economies are gradually recovering. The central banks aim to stimulate growth with interest rate cuts. Quarrels with the EU are delaying release of recovery funds.

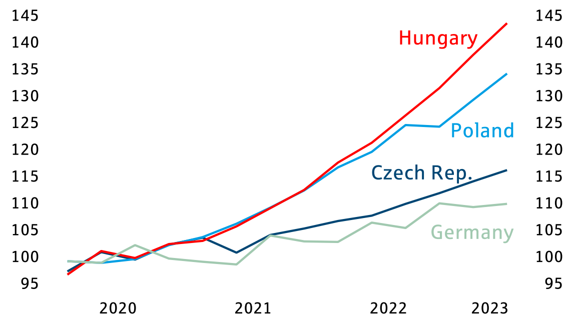
For the three Central and Eastern European (CEE) countries, all signs suggest that they will **only see a sluggish economic recovery** in 2024 and that GDP growth, although stronger than the euro area average, will not yet return to rates seen prior to the pandemic and the war in Ukraine. Consumer spending is set for a muted rebound and pay increases will only gradually make up for the previous decline in real wages. This will push up costs and force businesses to accept lower earnings or charge higher prices. It is unlikely, however, that companies will be able to completely pass on higher costs.

Improving the state of public finances will be back on the political agenda. In Czechia, for example, the government is planning to raise several taxes. This will delay progress in bringing down **inflation**, which will remain sticky to some extent in 2024. On average, though, prices will increase more slowly than in 2023, with inflation ranging between 2.7 % in Czechia and 5.3 % in Poland.

High levels of inflation have triggered **hefty wage increases**, particularly in Hungary; in Poland, parliamentary elections in October were most likely a factor in significantly hiking the minimum wage. While minimum wages in the three countries are still considerably lower than the German minimum wage, continuing rapid wage growth will erode this locational advantage. However, **generous state subsidies** in the three CEE countries continue to attract foreign direct investment, as was recently the case for a cathode material plant in Poland. Beyond that, they are able to access funds from the EU's climate change mitigation and adaptation programmes in order to further raise their competitiveness in respect of electric mobility.

Comparative labour cost advantage eroding

Business economy wages*, index, 2020 = 100



*seasonally and calendar adjusted
Sources: Macrobond, Helaba Research & Advisory

2024: Better underlying conditions for GDP growth

Over the course of 2024, higher wages and, to varying degrees, falling prices should support consumer spending in Poland, Czechia and Hungary. The downward trend in interest rates will benefit business investment. Although stronger economic activity among trading partners should provide a boost to exports, rising domestic demand will also fuel imports. Higher military spending in all three countries will stimulate economic growth. Poland is aiming to spend over 4 % of its GDP on defence – considerably more than the 2 % that NATO has called for. Overall, **GDP growth of between 2.2 % in Czechia and 3.2 % in Hungary** can be expected for 2024.

		Poland				Czech Republic				Hungary			
		2022	2023e	2024f	2025f	2022	2023e	2024f	2025f	2022	2023e	2024f	2025f
GDP, real change	% yoy	5.6	0.0	2.5	3.4	2.4	-0.2	2.2	2.8	4.6	-0.5	3.2	3.5
Inflation rate	% yoy	14.4	11.6	5.3	4.0	15.1	10.9	2.7	2.7	14.5	17.8	5.0	3.8
Unemployment rate EU	%	2.9	2.8	3.0	2.9	2.4	2.7	2.7	2.6	3.6	3.9	4.0	3.8
Budget balance	% GDP	-3.7	-4.8	-4.5	-3.8	-3.7	-3.8	-3.0	-2.5	-6.3	-5.0	-4.2	-3.3

*calendar adjusted; Sources: EU, EIU, Macrobond, Helaba Research & Advisory

Monetary policy should provide more favourable conditions for economic growth. Given weak macroeconomic indicators, the Hungarian and Polish central banks have already reduced interest rates on the back of falling inflation rates. Most likely, they were at least partly motivated by a ray of hope that the base effect would more or less automatically put the brakes on high inflation numbers. Fears of recession evidently have the upper hand. The Polish central bank was first off the mark, lowering its key interest rate in two steps by 100 basis points to 5.75 % shortly before parliamentary elections in October.

The Hungarian central bank had already been gradually reducing its overnight deposit rate since May 2023 and has now followed this up with a base rate cut as well. The Czech central bank has adopted a more cautious stance and is expected to join the other two countries in the trio with an initial loosening step in the fourth quarter of 2023. In 2024, all three central banks will **adhere to the course they have embarked upon**. As the ECB has not yet initiated an interest rate turnaround, the spread to the ECB's key rate will narrow again. At least in Poland and Hungary, potential stumbling blocks, such as inflationary pressure from a weaker currency or higher wages, are likely to take a back seat to the overriding goal of delivering stronger economic growth.

> *"Brussels is not our boss. We are an independent (…) nation"*
> *Viktor Orbán, Hungarian prime minister, 2022*

As key interest rates have already been reduced in anticipation of substantially lower inflation and are not underpinned by strong **exchange rates against the euro** in every case, there is a risk of spooking the markets. In "risk-off" mode, this could result in capital outflows that would weaken the currencies, thereby raising the cost of imports and impeding the countries' ability to reduce inflation.

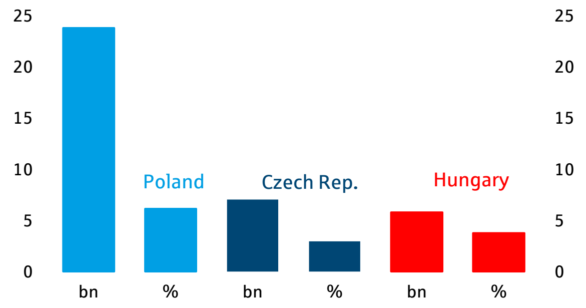
Hungary, which has the highest level of external debt, the most volatile of the three currencies and has been engaged in the most aggressive **confrontation with the EU** for many years, even in periods without elections, is likely to be most vulnerable to a scenario such as this. At the same time, given higher budget deficits and anaemic economic growth, Poland and Hungary would more than welcome the billions in EU funds, with both countries' public deficits expected to exceed the Maastricht criteria of 3 % of GDP beyond 2024.

Still no EU recovery funds for Poland and Hungary

Initial disbursements from the NextGenerationEU Recovery and Resilience Facility were made to Czechia in March 2023, while Poland and Hungary have so far been left empty-handed. The EU Commission wants to ensure the two countries **meet previously defined milestones**, particularly those concerning the rule of law, before making any payments. Moreover, these countries are at risk of losing out on cohesion funds, which have been frozen since the end of 2022 in order put pressure on their governments. There is a real danger that the Hungarian Prime Minister Orbán will succeed in his strategy of blocking EU decisions as a means of extracting payments and that this could encourage similar behaviour from other member states.

Coveted EU funding

EU Recovery and Resilience Facility, grants allocated in billions of euro and % of GDP



Sources: Recovery and Resilience Scoreboard EU, Helaba Research & Advisory

The EU's capacity to pull together is being sorely put to the test at a time when unity is more important than ever given the economic and geopolitical challenges it faces. The election **victory of the Polish opposition**, led by the former President of the European Council Donald Tusk, should bring about an improvement in relations with the EU and progress on EU funding – if it actually goes on to form the next government.

Opinion polls even suggest that confrontation with the EU would not win the governments in the three countries any votes. Last summer's **Eurobarometer survey** found that the share of respondents who had confidence in the EU was considerably greater than that of the sceptics, especially in Poland and Hungary, and was even significantly higher than the EU average. When asked about joining the euro area, Hungarians were by far the most enthusiastic, with almost three-quarters of those polled in favour of adopting the single currency and more than 40 % eager to see it introduced as soon as possible. Seen against the backdrop of Hungary's (widely criticised) presidency of the Council of the European Union in the second half of 2024, the results of the survey should give the countries' governments food for thought.

Marion Dezenter

United Kingdom: Escaping the relegation zone

The British economy has put in a respectable performance. Even though it will not excel in 2024 either, it will at least post higher GDP growth while the spectre of inflation will recede.

Chaos in the government, double-digit inflation rates, a dramatic rise in gilt yields and anxiety over a possible recession: the prospects for the UK were anything but rosy in the autumn of 2022. Seen in this light, the **country has managed to weather the year better than expected**, with the new Prime Minister Rishi Sunak bringing stability to government. While inflation is still high, it is clearly on a downward track and gilt yields have settled at an elevated level. The dreaded recession scenario did not materialise, though the economy grew by a rather modest 0.5 % – hardly something to write home about.

> *"As is so often the case, the middle lies somewhere in the truth"*
> *Rudi Völler*

The UK economy coped reasonably well with the energy price shock and consumers' energy bills will continue to fall in 2024, albeit they will still be above pre-crisis levels. In contrast, the interest rate shock is likely to be followed by nasty ripple effects. Given that a much higher proportion of homeowners are on fixed-rate mortgages than in the past, however, its impact will only gradually unfold. At the very least, it will hit construction activity and lower property prices are hardly likely to have any positive effect on consumer confidence. But it appears that house prices are set to plateau in 2024, while unemployment will probably continue to rise slightly. Despite this, the **outlook for consumer spending is definitely bright**. Declining inflation combined with persistently robust wage growth will lift real incomes.

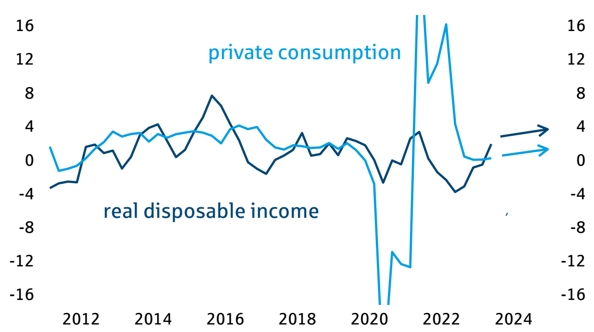
		2022	2023e	2024f	2025f
GDP, real change	% yoy	4.3	0.5	1.0	1.2
Inflation rate	% yoy	9.1	7.4	3.5	2.5
Unemployment rate	%	3.7	4.1	4.3	4.1
Budget balance	% GDP	-5.2	-5.0	-4.0	-3.5

Sources: Macrobond, Helaba Research & Advisory

Interest rate hikes should have a more noticeable impact on businesses. Following three years of quite solid growth (which, incidentally, mitigates the weakness since the Brexit referendum), **capital expenditures** are only likely to **expand slightly at best in 2024**. Despite rising exports, foreign trade will only have a limited effect on economic growth. The government does not have the financial leeway to provide any significant support. However, before the next general election is held in January 2025 at the latest, fiscal policy will not act as much of a brake on economic activity either. Taken together, **GDP growth in 2024 will amount to a somewhat more buoyant 1 %**.

Rising real incomes bolster private consumption

% yoy



Sources: Macrobond, Helaba Research & Advisory

Inflation in retreat

Despite still standing at an alarmingly high average of around 7.5 % in 2023, the rate of inflation has eased off. Besides declining energy prices, prices of other goods and services are also trending downwards. For the latter sector, in particular, **significant wage rises are limiting the disinflationary effect**. The pace of food price inflation is only gradually subsiding. As a result of the overall macroeconomic downturn and the associated lower capacity utilisation, inflation should more than halve to 3.5 % in 2024 compared to the previous year.

Is the Bank of England poised to make a U-turn?

Though the British central bank determinedly tightened monetary policy in its efforts to curb inflation, it has since lost its nerve. The rate hiking cycle will peak in 2023, after which the BoE can wait and see whether inflation falls to the desired level. It will not, however, reach its stated 2 % target in 2024. As the focus shifts more towards 2025 during the second half of the year, this would seem a **realistic window of opportunity for a first rate cut**.

Christian Apelt, CFA

United States: A perfect play by monetary policy?

As of now, it looks very much as if the US economy will manage a soft landing, despite the enormous inflation spike of 2021/2022 and subsequent drastic interest rate hikes. Should this actually succeed, the Fed would deserve credit for a performance worthy of a champion. A cyclical recovery of the economy is likely in 2024.

We expect the new year to get off to a somewhat muted start, with activity gathering steam in the further course of 2024. As inflation subsides, **real incomes** are set to climb more strongly while the most negative **impact of monetary policy tightening** is likely to have been felt in 2023. Even though the Fed Funds Rate will remain quite high, the additional adverse effects of its aggressive raising should increasingly dissipate. While the latter has only a transient impact, it is more pronounced when markets do not expect the tightening. In this respect, monetary policymakers significantly exceeded expectations by the majority of observers in 2022 and 2023. The Fed's upcoming change in course (see text on monetary policy), by comparison, is not projected to be substantial enough as to provide a major boost to economic activity as early as 2024. That is more of a scenario for 2025.

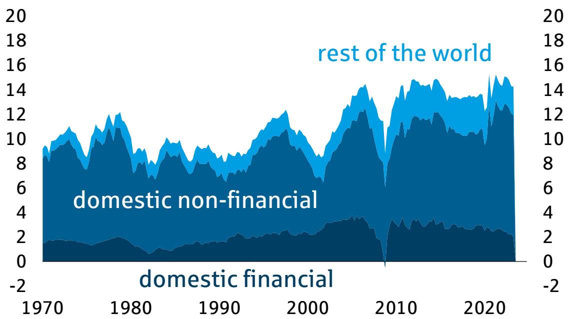
The relatively low average rate of GDP growth in 2024 of only 1.3 % (2023: 2.3 %) will primarily result from the year getting off to a weak start. As 2024 unfolds, momentum should build and, by the end of the year, our forecast is once again for the US economy to achieve quarterly growth rates of more than 2 % (on an annualised basis). An important factor here will be the **housing market**, which appears to have already put the bulk of its correction behind it. In turn, this is an encouraging sign for the banking sector, which, having undergone a phase of turmoil in the spring of 2023, has meanwhile stabilised again. Despite a marked rise in interest costs, the balance sheets of **private households** appear to be on a solid footing. The pick-up in real income growth should more than offset the effects on consumer spending of another potential slight uptick in the savings rate.

Healthy corporate profits despite strong wage pressure

A contentious point, though, is the outlook for **the business sector**. Corporate debt ratios have reached historically high levels, depending on the exact metric used. Yet so far, companies have continued to enjoy very robust earnings as a share of national income (see chart below). We look for investment to make make a significant contribution to the economic recovery.

Historically high profit share

Share of corporate profits* in national income, %



*Corporate profits with inventory valuation and capital consumption adjustments, from the national income and product accounts (NIPAs).
Sources: Macrobond, Helaba Research & Advisory

A high profit share is all the more remarkable given the fact that the **labour market** has been tighter in recent years than it has been for decades. That has forced companies to accept substantial wage rises that, on balance, have only marginally reduced the profit share, which has remained at a historically high level. The current share of income (Q2 2023) has only rarely been topped over the last fifty years.

Initially, the situation on the labour market, which remains very tight, should continue to ease. We expect the unemployment rate to rise from its recent low of 3.4 % by a few more tenths of a percentage point before hitting a peak of 4.2 %. Subsequently, as the economic recovery takes hold, there should be a modest time lag before it also has a positive impact on the labour market. This would be a **very soft landing** given the extent of the Fed's move into restrictive monetary policy territory and the size of the previous inflationary shock.

In October 2023, the consensus among economists surveyed by Bloomberg still regarded the **risk of a recession** over the next twelve months as above average (50 %). However, in every monthly survey, analysts shift the negative quarters further into the future. This made sense for 2023. However, it is becoming increasingly unlikely that a "final reckoning" will only materialise at some point later in the year 2024 – at least if the Fed's rate hiking cycle has indeed already peaked in 2023, which is meanwhile an almost universal view.

Distracting discussions about a change of coach

On the political stage, 2024 will be dominated by **election campaigns**, with both congressional and presidential elections slated for November. The two most likely candidates, Joe Biden and Donald Trump, present voters with a choice of two very different personalities and platforms – if the word "platform" makes any sense in connection with Trump. Shifting expectations over the course of the year regarding the outcome of the election are unlikely to have any direct economic impact. However, this assumes that there will be no upheaval on financial markets due to these developments. In particular, any statements by campaigning politicians on the country's **policy towards China** could easily lead to a further deterioration in Sino-US relations.

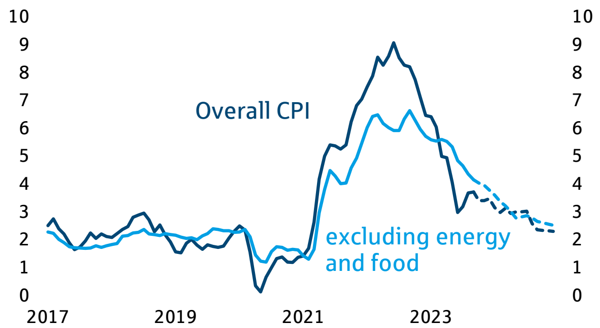
Considering the balance of power in the 118th Congress, it is unlikely that much will change in terms of **fiscal policy** in 2024. Figures from the IMF suggest that based on current legislation US fiscal policy will have a dampening effect, having provided a tailwind for the economy in 2023. In the absence of a political consensus, the potential for a government shutdown remains in play. Until the beginning of 2025, the perennial issue of the federal debt ceiling will remain off the table. But it will raise its ugly head again just when the newly elected 119th Congress and, potentially, a new president are sworn in.

> *"Boring!"*
> *Homer Simpson at his first football game*

Persistently **high budget deficits** are the price to pay for the economic tailwind that fiscal policy has provided recently. The federal deficit is expected to be at or above 6 % of GDP in both 2023 and 2024, a level that was once inconceivable in peacetime without a recession. The m**ountains of government debt** are growing, increasingly driven by the sharp rise in interest expenses. This is limiting the budgetary room for manoeuvre, precisely when a financial cushion is urgently needed in view of the demographic challenges ahead.

Inflation: Heading in the right direction

Consumer prices, % yoy*



*forecasts after October 2023.
Sources: Macrobond, Helaba Research & Advisory

Inflation to fall further, but at a slower pace

Sliding energy prices helped drive **disinflation** in 2023, but this will not be repeated in 2024. On the contrary: energy prices are set to rebound. Similarly, following notable improvements in global supply chain problems in 2022 and 2023, this factor will have a more neutral impact looking ahead.

It will thus be a **softening of core inflation**, especially in the service sector, that will have a dampening effect on overall inflation in the new year. The consumer price index should rise by an annual average of 2.7 % in 2024 and the core index by 2.9 %. That would put headline inflation at 2.3 % and core inflation at 2.5 % at the end of the year. In other words, the Fed would almost, but not quite, hit its **inflation target**. We think it is unlikely that there will be any return to an environment of "too-low" inflation.

		2022e	2023e	2024f	2025f
GDP, real change	% yoy	1.9	2.3	1.3	2.2
Inflation rate	% yoy	8.0	4.2	2.7	2.2
Unemployment rate	%	3.6	3.7	4.1	4.0
Budget balance*	% GDP	-4.3	-6.5	-6.0	-6.0

*Federal incl. Social Security
Sources: Macrobond, Helaba Research & Advisory

Patrick Franke

Japan: Back to the middle of the pack

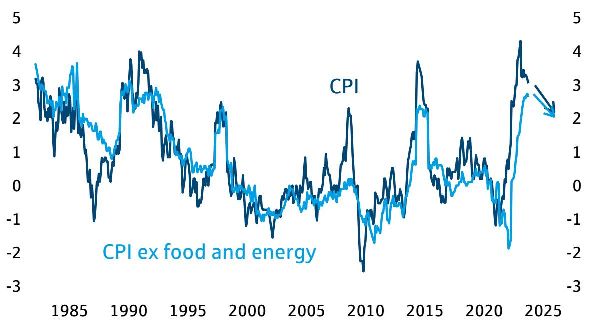
2023 saw Japan's economy post unexpectedly high growth, a feat it is unlikely to repeat in 2024. Despite some easing, inflation will settle firmly into positive territory.

In contrast to its performance on the pitch, Japan has long ceased to pose any economic threat. Overall, the Japanese economy has only experienced modest growth since the 1990s and any major upswings have typically followed sharp downturns. Hence, it has come as a surprise that the economy is expected to grow by **around 2 % in 2023**, leaving almost all other G7 countries in its wake. At least since COVID, Japan has not been lagging behind Europe anymore. The question is: will the Japanese economy manage to sustain this success in the future?

At first glance, foreign trade and investments in equipment investment appear to offer some encouragement. On closer inspection, however, a less favourable picture emerges. Net exports have primarily been fuelled by declining imports and investment activity has already slowed down again. While foreign trade and investments will probably make a smaller contribution to GDP growth in 2024, **consumer spending should prove quite resilient**. Japanese real incomes will rise, albeit the positive effects of both higher wages and disinflation will be weaker than in other countries.

Inflation reaches unusually high levels

% change yoy



Sources: Macrobond, Helaba Research & Advisory

The government will not stimulate growth to an appreciable extent. As a result, the prospects for 2024 are not particularly upbeat and, instead, would tend to suggest a return to a **normal GDP growth rate** of 1 %.

Deflation a thing of the past

Inflation has recently been reminiscent of long bygone days, peaking at more than 4 % – the highest level in over 40 years. Having averaged just over 3 % in 2023, it is likely to abate somewhat, which is also due to a number of base effects such as the cost-push from the depreciation of the yen. Despite this, elevated core inflation rates point to **broader-based price increases than in the past**. Rising wages also suggest that inflation will stabilise at a higher level. Taken together, these factors imply that inflation will remain above 2 % on average in 2024. The days of deflation are over and the Bank of Japan will even regard this as a success.

		2022	2023e	2024f	2025f
GDP, real change	% yoy	1.0	2.0	1.0	0.8
Inflation rate	% yoy	2.5	3.2	2.5	2.0
Unemployment rate	%	2.6	2.6	2.7	2.7
Budget balance	% GDP	-5.9	-5.2	-4.0	-3.5

Sources: Macrobond, Helaba Research & Advisory

Is the Bank of Japan set for a policy turnaround?

Unlike all other major central banks, the Bank of Japan has so far not tightened its monetary policy to any noticeable extent. It has merely relaxed the ranges it allows ten-year government bonds to fluctuate within as part of its yield curve control strategy. Any **conventional interest rate hikes are probably some way off for the time being**.

> *"There's got to be a U-turn. And it must be 360 degrees"*
> *Eduard Geyer*

Inflation will decline in 2024, even if a rebound cannot be ruled out in subsequent years – especially if the Bank does not tighten its policy. However, there is a distinct possibility that the BoJ will terminate its yield curve control policy or loosen it to the point where it scarcely matters any longer. That would not equal any genuine tightening, but would at least be a step towards a policy normalisation. Despite this, there will be no return to the high levels of growth and significant inflation rates of the 1980s. It is reasonable to assume, that economic growth and inflation will normalise to the extent that Japan will no longer be an outlier with a combination of stagnation and deflation.

Christian Apelt, CFA

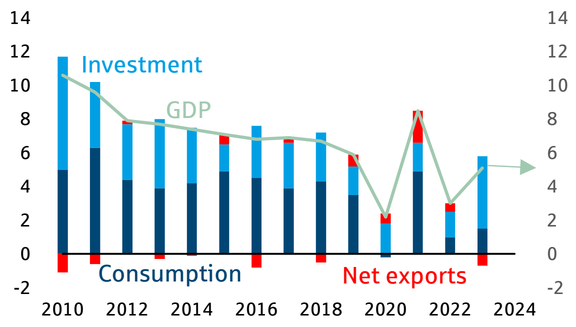
China: At risk of relegation?

Following a challenging 2023, China is poised for a better economy in 2024. However, a recovery cannot be taken for granted and policymakers have a great deal of work ahead of them.

2023 was a year of massive economic disappointment in China. The initial elation over an expected sharp and prolonged rebound after the end of the country's zero-COVID policy was short-lived. Instead, what followed was a **correction of the previous years' boom in exports** and a notable **slump in domestic demand**. The latter was fuelled, to a significant extent, by considerable turmoil in the real estate sector and the associated impact on the financial system. However, that was not all. Following up on their announced intention to squeeze China out of global supply chains in the high-tech sector, the United States and other Western countries put their money where their mouth is. On top of that, **structural problems** – particularly but not exclusively demographic ones – cast doubts over whether China will ever replace the US as the world's largest economy. For many years that had been considered a foregone conclusion.

Consumption is weak, net exports are a drag

% yoy or contribution to growth in percentage points*



*2023 based on data for the first three quarters.
Sources: Macrobond, Helaba Research & Advisory

2024: Better…

So, can things only get better in 2024? In principle: Yes – but it will **not be a cakewalk**. The most obvious risk is an escalation of the trade and technology dispute with the US in an election year in which candidates running for the White House and Congress will seek to portray themselves as "tough on China". Structural headwinds from an ageing society are also getting stronger over time.

> *“Peak China?”*
> *Headline of “The Economist”, May 2023*

Thus, the government must urgently address systemic **imbalances in the real estate sector and the financial system** beyond simply injecting more monetary and fiscal stimulus. There is little or no prospect of achieving a sustainable recovery with a housing market paralysed by enormous debts and dwindling cash flows as well as unnerved consumers and homebuyers and an ailing banking sector.

…but not exactly great

Although China’s economy enters a recovery in our baseline scenario, there is no boom in demand. The government will not abandon its current restraint regarding the amount of economic stimulus. With GDP forecast to grow by 5 % in real terms in 2024, China will more or less return to its **"normal" growth** rate. The reason why this annual average figure is slightly lower than the "problematic" previous year reflects the immense volatility associated with the shutdown in Shanghai in 2022 and the reopening of the economy at the beginning of 2023.

		2022	2023e	2024f	2025f
GDP, real change	% yoy	3.0	5.3	5.0	4.8
Inflation rate	% yoy	1.9	0.5	1.5	2.3
Unemployment rate*	%	5.6	5.2	5.0	4.9
Budget balance	% GDP	-7.5	-7.0	-7.5	-7.2

*Surveyed. Sources: Macrobond, Helaba Research & Advisory

On balance, **downside risks specific to China** will dominate in 2024 – both of a domestic economic and of a geopolitical nature. In particular, the real estate market will continue to pose a danger to stability. That is why the government is prioritising this issue. It also has more wide-ranging scope for intervention than its counterparts in the advanced economies do. However, the risk that an economically and, to some degree, politically weakened leadership will pursue a more aggressive foreign strategy will remain elevated in 2024.

Patrick Franke

Russia: Struggling to adjust to a new environment

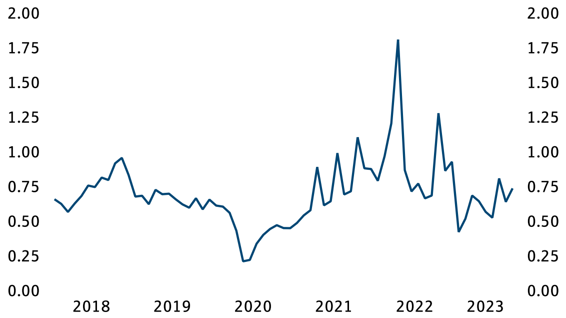
Russia has put its recession behind it and is on track to post modest economic growth in 2024. The geopolitical landscape poses the biggest risks for the country.

The Russian national football team was suspended from playing in or qualifying for international tournaments. Since then, the focus has been on playing against countries that are still more or less on friendly terms with Russia. It is the same story with the economy, with (direct) relationships to its major European trading partners being severed and, as a result, Asian countries becoming more important. However, the **Russian economy has been remarkably resilient** in the face of Western sanctions and is trying to adjust to a radically different environment as well as it can. In 2024, Russia is expected to post a slight gain in economic output of 1.8 % after two years of recession.

> *"We have withstood absolutely unprecedented external pressure"*
> *Russian President Vladimir Putin*

Oil revenues: Moderate upward trend

Monthly government revenues from oil and gas, in billions of roubles



Sources: Macrobond, Helaba Research & Advisory

Commodities are the mainstay of the economy, generating around a third of GDP, 40 % of the government's budget revenues and almost two-thirds of export earnings. At an average of 90 US dollars a barrel, the price of Brent crude is expected to be somewhat higher in 2024 than in the previous year. Although Russian oil sells at a markdown to the global market price, the 60 US dollar price cap for oil has had a negligible impact. This is because, recently, Moscow has been increasingly shifting away from using Western insurance companies to cover its crude oil shipments; by the middle of 2023, only a quarter of ships carrying Russian oil were insured by Western firms. Meanwhile, intermediaries – especially India but also China and Turkey – are facilitating its transport to Western countries.

Limited opportunities for growth beyond commodities

In the middle of 2023, the Bank of Russia began a series of substantial interest rate hikes in an attempt to stem the devaluation of the rouble, with four initial steps taking it from 7.5 % in July to 15 % in October. The key rate should be held broadly at its current level until mid-2024, as the Bank wants to avoid stifling economic growth too much. **Interest rate cuts** would be a conceivable prospect in the second half of the year. Capital expenditure will remain weak, not just because of high interest rates but also due to the fact that Western companies will continue scaling back their operations in the country.

		2022	2023e	2024p	2025p
GDP, real change	% yoy	-2.1	-1.0	1.8	2.0
Inflation rate	% yoy	13.7	7.0	5.5	3.5
Unemployment rate	%	3.9	3.2	3.0	3.2
Budget balance	% GDP	-2.1	-3.5	-3.0	-2.5

Sources: EIU, Helaba Research & Advisory

With respect to consumption, limited catch-up effects were noticeable in 2023; but 2024 will see a renewed softening as the **pace at which inflation has been declining slows down**. The average inflation rate over the year is expected to come in at 5.5 %, which is above its pre-war level. Upward pressure on prices will come from a tight labour market and the higher cost of imports.

Since the start of the war, the era of budget surpluses (excluding the COVID-dominated year of 2020) has been well and truly over, with a combination of lower revenues and **higher expenditure**, mainly **on the military**. However, as income from commodity sales improves slightly in 2024, the budget deficit, at 3 % of GDP, should be somewhat lower than in the previous year.

Patrick Heinisch

Brazil: Interventionist economic policy

President Lula is at loggerheads with Congress over implementing his agenda: Spurring economic growth with a major public works programme, flanked by monetary policy.

The challenges facing Brazil's President Luiz Inácio Lula da Silva in 2024 are to maintain fiscal consolidation and deliver on his promise of higher economic growth. His task is complicated by the fact that Congress is dominated by opposition parties on the right of the political spectrum. In the middle of 2023, Lula reshuffled his cabinet to secure the support of the Centrão bloc. Despite this, next year he will be forced to strike deals with parliamentary groups on a case-by-case basis to get his agenda passed, especially as they will be looking to stake out their positions in the run-up to **local elections in October 2024**.

> *"The state will once again be an entrepreneurial state"*
> *Brazilian President Lula da Silva*

Lula announced his **economic stimulus programme** "Aceleração do Crescimento" (Growth Acceleration Programme) in the middle of August 2023, which envisages total spending of 1.7 trillion reals (approx. 340 billion US dollar) until 2026. Only about 20 % of this, however, is expected to come directly from the central government budget: the rest is divided among state-controlled enterprises, borrowing and the private sector. The programme's goals include boosting public and private investment, expanding lending and promoting environmentally sustainable growth.

Government unlikely to meet fiscal targets

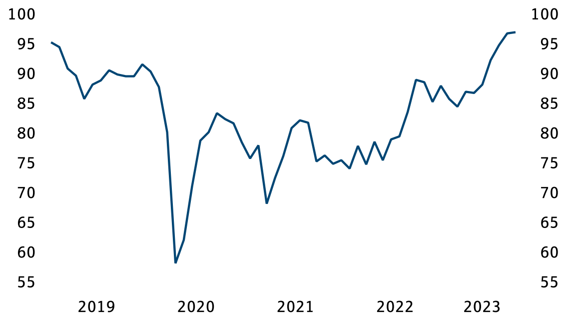
		2022	2023e	2024p	2025p
GDP, real change	% yoy	2.9	2.6	2.2	2.0
Inflation rate	% yoy	9.0	5.0	3.5	3.5
Unemployment rate	%	7.9	8.3	8.5	8.4
Budget balance	% GDP	-4.0	-7.6	-7.5	-7.0

Sources: EIU, Helaba Research & Advisory

Yet the government is in no position to afford any significant fiscal stimulus in 2024 with annual interest payments of almost 7 % of GDP straining public finances. Proposals in the 2024 draft budget aim to achieve a primary balance while reforms to simplify taxation and create a more progressive income tax regime are still in the pipeline. However, it is unlikely that Lula will be able to get his plans through Congress without any changes. For this reason, the **increase in revenues of 1.5 % of GDP** he had hoped to generate **will probably be smaller than planned**. As the stimulus programme will put pressure on spending, it is not likely that the government will achieve its aim of a primary balance next year.

Consumers in an upbeat mood

Consumer sentiment index, July 2010 = 100



Sources: Macrobond, Helaba Research & Advisory

However, **monetary policy** will support economic growth. The Central Bank of Brazil was one of the first in the world to kick off the interest rate hiking cycle in order to bring down inflation – which it has successfully managed to do. The turnaround in monetary policy was launched in early August 2023 and there are likely to be **further interest rate cuts** in 2024 as inflation approaches the Bank's 3 % target.

Monetary policy will have a positive effect on **investments** and continue to drive inflation towards its target level. This will also benefit **consumer spending**, which has already improved in 2023 in line with a consistent upward trend in the consumer sentiment index throughout the year. Notwithstanding these factors, **economic growth of 2.2 %** is likely to be slightly lower in 2024 than in the previous year. In 2023, thanks to a record soybean harvest – the country's second most important export product – agriculture made an extraordinary contribution to growth. Overall, export demand will be weaker in 2024.

Patrick Heinisch

Negative scenario: Group-stage knock-out (20 %)

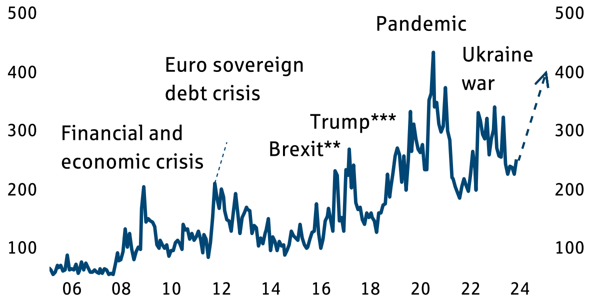
Even the best intentions and grandest plans do not always protect against early defeat. In fact, inflated ambitions and the use of a seemingly tried-and-tested but outdated approach can make it more likely. In our negative scenario, the global economy falls into recession. This is mainly the fault of playmakers in central banks, who have overshot in their eagerness to tighten monetary policy. Yet political factors also play a role: an increasingly protectionist agenda and geopolitical confrontation lead to elimination in the group stage.

With economic growth in industrialised countries having surprised on the upside in 2023, the question arises as to whether a **recession**, which seemed quite likely given sharp interest rate hikes, has been **banished or merely postponed**. So far, Germany has fared worse than its euro area peers or the United States. But even here, the economy has hitherto coped with the inflationary shock and monetary tightening better than many had previously expected.

The fact that **monetary policy** affects economic activity with **long and variable lags** is well known. It is thus hard to refute the argument that central banks have overtightened and that it is only a question of time before the real economic data reflect this. The pessimists clearly have historical evidence on their side in this regard.

Geopolitical instability poses risks to growth

Global uncertainty index*



*calculated using news reports, among other sources
**referendum ***elected as US president
Sources: Refinitiv, Helaba Research & Advisory

Recession the price to pay for defeating inflation

Hence why it is entirely plausible that 2024 could begin with a **significant cyclical contraction**. That would most likely put an end to the period of "invulnerable" labour markets – something that has been a surprise so far in many countries. **Rising unemployment** would weigh on incomes and lead to insecurity among consumers. What is more, a very cold winter could put the issue of energy shortages back on the agenda.

Recessions invariably damage **financial stability**. Rising default rates on loans would coincide with falling interest rates, albeit not to the record lows before or during the pandemic. Instead, what should emerge is a **"new normal"** in which neither key interest rates are cut to or below zero nor central banks launch vast asset purchase programmes any longer. In this scenario, although the Fed for example would no doubt take bold action in reducing rates, they would likely only go down to around 2 %.

> *“At first we had no luck and then we also had bad luck”*
> *Jürgen Wegmann*

Assuming interest rates do not probe the lows of the past zero-rate-period again, the **real estate sector** would also remain under pressure. Mortgages would still be more expensive than in 2020/2021, despite a weak economy. Project developers and construction firms would face higher refinancing costs. The correction in property prices would therefore likely continue.

Geopolitics and trade policy: The wrong tactics

Geopolitical tensions are running high in many parts of the world, the most recent example being the crisis in the Middle East. This is having an adverse impact on sentiment, creating uncertainty and leading to restraint, particularly with regard to investment. It is conceivable that, in the fields of geopolitics and trade policy, some spectacular own goals could be scored in 2024. This is where the right tactics matter, since there is a lot that can go wrong between **China** and the West – on both sides. In the process, the danger is that missteps could lead to **collateral damage** in other areas.

For instance, if the EU were to impose punitive tariffs on Chinese electric cars, this would hamper the shift away from internal combustion engine vehicles. Billions spent on subsidies for chip producers and other corporations may be needed for other purposes, particularly in a weak cyclical environment. State-directed **industrial policy** can result in overcapacity, inefficiency and higher prices that not only slow down the transition to a net-zero carbon economy but also **stifle productivity gains** – which are becoming ever more important in view of demographic trends.

The focus is once again turning to **emerging countries**, whose sovereign debt had risen steeply due to the pandemic and the commodity price shock when the war in Ukraine began. For poorer countries, the issue of restructuring external debt has become even more pressing than in the past.

Overview of forecasts in the negative scenario

From a cyclical perspective, 2024 is a year marked by **recession** followed by a shallow recovery in the second half of the year. In Germany, GDP contracts by around 2 % and the US economy shrinks by 0.5 %.

There is a discernible fall in **inflation**, primarily on the back of much lower oil prices. Experience shows that this effect is more pronounced in the US than in Europe, where in addition natural gas prices jump up again in the 2023/2024 winter season. Although core inflation rates also fall, they do so from a high level. Consequently, a 2 % core rate is not reached until the autumn in the US, for instance.

In our negative scenario, **central banks** perform a rapid monetary policy volte-face and rapidly make sharp cuts to interest rates in the time-tried manner. Yet, key rates do not reach the depths of the pandemic era. The Fed lowers the Fed Funds target rate to 2 %, the ECB its refinancing rate to 1.5 %.

On the **bond market**, the decisive pivot by central banks leads to a marked decline in yields. This is supported by a flight into perceived safe haven assets and falling long-term inflation expectations. In this scenario, the yield on 10-year German Bunds is around 1.5 % at the end of 2024.

In view of the adverse situation in the real economy, **corporate** default rates increase and cause spreads to widen significantly. In turn, the **banking sector** grapples with mounting NPL ratios. As high-quality assets, **covered bonds** benefit from their status as a safe haven amidst an environment of growing risk aversion. Declining interest rates exert downward pressure on spreads.

Current negative factors persist and even intensify, resulting in considerably lower corporate profits. Risk aversion among investors worsens and precipitates an additional contraction in valuations. **Equities** slip into bear market territory. The DAX temporarily falls below 11,000 points.

> *“In this game, there were two or three players who were weak like an empty bottle!”*
> *Giovanni Trapattoni*

Prices on the German **real estate market** begin to plummet again. As there is still a huge shortage of housing, the decline in residential property prices remains limited; but the value of offices and retail properties falls sharply. Not even the lower financing costs make any difference to this.

As a crisis-proof investment, demand for **gold** rises dramatically. The precious metal easily surpasses its previous record high of 2,075 US dollar per troy ounce and heads towards the 2,500 US dollars mark.

As a safe haven currency, the **US dollar** is also increasingly sought after – not just because of geopolitical uncertainty. After all, the recession hits Europe harder. The euro-dollar exchange rate falls as low as 0.90.

Patrick Franke

Positive scenario: The beautiful game (10 %)

Spectacular wizardry with the ball, flawless passing skills, masterful dribbling against multiple opponents, followed by a goal scored from a seemingly hopeless position: in football, this is more the exception than the rule. That is partly due to the fact that many factors have to come together perfectly and every player on the team must be at the top of their game. Likewise, economic policy requires team spirit, a dash of ingenuity and a measure of luck to achieve the same success. A rare but not impossible task.

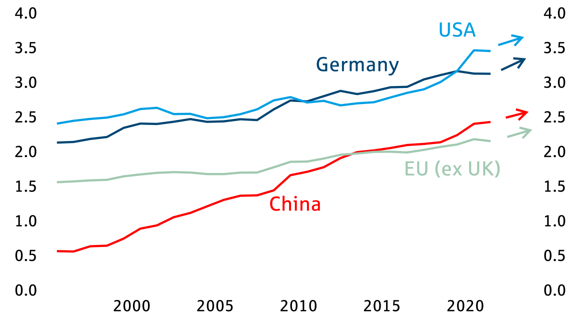
This year, we have assigned a **lower probability** to our positive scenario than to our negative one. In short, more has to go right for the former to happen than to go wrong for the latter to occur. Not only must every policymaker, or at least most of them, be at the very top of their game – they also have to put the success of the team above anything else.

This is especially the case in respect of two major sources of recent uncertainty and disruption, namely the widespread **drift away from globalisation** in favour of narrowly defined "national" interests and, by extension, the rise in **geopolitical conflict**. A key aspect of our positive scenario is **a decrease in these tensions**. When it comes to the war in Ukraine, this seems hard to imagine now. However, as for the West's relationship with China, a diplomatic path that focuses more on shared interests, such as climate change, and less on conflicting goals is entirely feasible for both sides. Closer global cooperation in trade and environmental policy and less subsidy competition to the detriment of poorer countries would also have a positive impact. It would not be easy – but no less implausible than a goal scored with an overhead kick.

In addition to these political factors, there are also intrinsic reasons why the economy could improve. While also playing a role in our baseline scenario, they may well turn out to be stronger than expected. For instance, the **global industrial cycle** is likely nearing a trough and pent-up demand will accelerate the recovery. In this respect, there is quite a bit of catch-up potential, especially in Germany, where 2023 has been a particularly weak year. **Structural problems are not an obstacle to a cyclical recovery.**

Greater innovation drives economic growth

Spending on research and development, % of GDP



Sources: Macrobond, Helaba Research & Advisory

A surge in demand and supply

A crucial feature of our positive scenario is that the recovery does not just involve a boom in demand, but a simultaneous **positive supply shock** that would prevent core inflation going through the roof, as it did in 2021. This would most likely entail a combination of technological progress and an increased use of fixed capital – in other words, entrepreneurial investment. The potential offered by innovations such as AI or green technologies is self-evident.

> *"If things go well, they go well"*
> *Manfred Schwabl*

That is why **inflation** is only slightly higher than in our baseline scenario and is primarily driven by an increase in oil prices. As a result, central banks would not have to do much more than in the base case. Although further interest rates rises of around 50 basis points are likely in the short term, i.e. at the start of 2024, the economy would be able to absorb them without much difficulty. This is because, thanks to the pace of investment, trend growth and the "neutral" interest rate would be significantly higher than in our baseline scenario.

With tax revenues soaring and fewer social transfers due to robust economic growth, governments would be able to bring the **national debt** under control, even if interest rates are slightly higher. In times of rapid growth, politicians are more inclined to cut public spending and tighten fiscal policy a little.

Overview of forecasts in the positive scenario

Global **economic growth** picks up. We expect Germany's real GDP to grow by more than 2 % – much faster than in our baseline scenario. However, since this would not be entirely driven by demand-side factors, the added **inflationary pressure** would be manageable and mainly the result of higher energy prices. Inflation on both sides of the Atlantic decreases over the course of the year in our positive scenario, just more slowly than in the baseline scenario.

The upshot of this is that interest rate cuts are off the table for **central banks** in 2024. Instead, they would probably raise them slightly in the short term from current levels. The Fed increases the Fed Funds Target Rate to around 6 %; the ECB hikes its key rate to 5 %.

As a result of rising key interest rates and significantly higher inflation expectations on both sides of the pond, **bond markets** come under pressure. The yield on 10-year German bunds climbs to more than 4 % by the end of 2024. However, risk premiums on government bonds trend lower thanks to abating concerns over fiscal policy.

With profits and cash flows climbing, corporate default rates decline. As a consequence, there is a marked fall in risk premiums on **corporate** debt.

As for the **banking sector**, this scenario sees NPL ratios remaining at their recent historically low levels while there is a surge in new lending activity. Thanks to their very good earnings position, banks are able to increase their capital resources, which they at least partly distribute to shareholders in the form of share buyback programmes and dividends.

> *“As we are not focused on losing, we are focused on winning”*
> *Berti Vogts*

Yields on **covered bonds** rise in the short term as central banks tighten the screws again on interest rates. But with investors' risk aversion fading, the safe haven status of covered bonds is no longer a key investment consideration.

The economic recovery leads to substantial growth in revenues for companies. With margins remaining high, corporate profits jump at double-digit rates and appetite for risk increases sharply. Investors consider **equities** to be a significantly more attractive asset class and the DAX breaches the 20,000 point mark by the end of 2024.

German **Real estate** benefits from the improved economic environment, which more than offsets the negative impact of a renewed increase in financing costs. There is a revival in the residential price boom, while prices for office buildings at least stabilise and retail properties perform somewhat better after having suffered a protracted slump.

Rising opportunity costs due to sustained higher levels of real interest rates exert downward pressure on **gold**. Furthermore, the precious metal is no longer in demand as a crisis currency. It plunges towards a level of 1,500 US dollars per troy ounce.

Sentiment on foreign exchange markets is also lifted by the upturn in the economy and an easing in geopolitical tensions. Demand for the **US dollar** as a safe haven falls. Growth rates in the euro area, in particular, surprise on the upside. This leads to an erosion in the US dollar's yield advantage over the euro and the euro-dollar exchange rate rises to as much as 1.25.

Patrick Franke

Gross domestic product and inflation

	Gross domestic product Real change, % yoy				Consumer prices Change, % yoy			
	2022	2023e	2024f	2025f	2022	2023e	2024f	2025f
Euro area	3.4	0.5	1.3	1.2	8.4	5.5	3.0	2.5
Germany	1.9	0.0	1.3	1.1	6.9	6.0	3.0	2.5
France	2.5	1.0	1.5	1.2	5.9	5.7	3.0	2.7
Italy	3.9	0.7	1.1	1.2	8.7	6.1	2.7	2.6
Spain	5.8	2.4	2.0	1.5	8.3	3.5	3.3	2.7
Netherlands	4.5	0.5	1.2	1.5	11.6	6.0	4.0	2.3
Austria	4.8	-0.3	1.0	1.7	8.6	7.9	3.7	2.6
Sweden	2.9	-0.5	0.8	2.3	8.4	8.6	3.5	2.2
Poland	5.6	0.0	2.5	3.4	14.4	11.6	5.3	4.0
Czech Republic	2.4	-0.2	2.2	2.8	15.1	10.9	2.7	2.7
Hungary	4.6	-0.5	3.2	3.5	14.5	17.8	5.0	3.8
United Kingdom	4.3	0.5	1.0	1.2	9.1	7.4	3.5	2.5
Switzerland	2.4	1.3	1.5	1.4	2.8	2.2	1.5	1.5
USA	1.9	2.3	1.3	2.2	8.0	4.2	2.7	2.2
Japan	1.0	2.0	1.0	0.8	2.5	3.2	2.5	2.0
Asia ex Japan	3.7	4.7	4.7	4.6	3.7	2.4	2.5	2.5
China	3.0	5.3	5.0	4.8	1.9	0.5	1.5	2.3
India*	7.2	6.5	6.0	5.9	6.7	5.7	4.5	4.0
Russia	-2.1	-1.0	1.8	2.0	13.7	7.0	5.5	3.5
Turkey	5.6	3.0	2.8	3.7	72.4	37.0	20.0	11.2
Latin America**	3.7	1.7	2.3	2.4	14.9	16.7	13.0	8.6
Brazil	2.9	2.6	2.2	2.0	9.0	5.0	3.5	3.5
World	3.0	2.8	2.9	3.1	7.0	5.1	3.7	3.0

*India: Financial Year; ** Latin America ex Venezuela due to hyperinflation; f=forecast, e=estimate; GDP growth working-day adjusted if available

Sources: Macrobond, Refinitiv, Helaba Research & Advisory

Financial markets forecasts

	Change from end of year	latest*	Helaba forecast for end of period... Q1/2024	Q2/2024	Q3/2024	Q4/2024
Interest rates	basis points	%				
ECB refinancing rate	200	4.50	4.50	4.50	4.25	4.00
ECB deposit rate	200	4.00	4.00	4.00	3.75	3.50
Overnight rate €STR	201	3.90	4.00	4.00	3.75	3.50
3M Euribor	184	3.97	4.00	3.80	3.50	3.30
6M Euribor	138	4.07	4.05	3.85	3.55	3.35
2y Bunds	25	3.01	3.10	2.90	2.50	2.30
5y Bunds	2	2.60	2.75	2.75	2.50	2.30
10y Bunds	15	2.72	2.70	2.70	2.50	2.30
2y swap rate	14	3.53	3.70	3.50	3.00	2.80
5y swap rate	-8	3.16	3.35	3.35	3.10	2.90
10y swap rate	3	3.23	3.30	3.30	3.10	2.90
20y swap rate	32	3.25	3.00	3.05	2.90	2.70
30y swap rate	49	3.02	3.00	3.05	2.90	2.70
Fed funds target rate	100	5.38	5.38	5.38	5.13	4.88
10y Treasuries	78	4.66	4.40	4.30	4.20	4.00
Equities	in local currency, %	index				
DAX	8.8	15,144	16,400	16,800	17,200	17,500
Euro Stoxx 50	9.9	4,170	4,500	4,600	4,700	4,800
Dow Jones	2.1	33,839	36,200	36,800	37,400	38,000
S&P 500	12.5	4,318	4,580	4,650	4,730	4,800
Nikkei 225	21.1	31,602	35,200	35,800	36,400	37,000
Gold / crude oil	%					
Gold €/oz	9.7	1,869	1,810	1,818	1,818	2,000
Gold $/oz	8.9	1,986	1,900	2,000	2,000	2,200
Brent crude $/barrel	1.1	87	89	89	90	91
Currencies	vs. euro, %	exchange rate				
US dollar	0.8	1.06	1.05	1.10	1.10	1.10
Japanese yen	-12.1	160	155	153	150	148
British pound	1.7	0.87	0.86	0.86	0.87	0.88
Swiss franc	2.8	0.96	0.97	0.98	1.00	1.01

*02/11/2023

Sources: Bloomberg, Helaba Research & Advisory

We are here for you:

Function	Authors	Phone +49 69/9132-
Chief Economist / Head of Research & Advisory	Dr. Gertrud R. Traud	20 24
Bond Strategy	Ulf Krauss	47 28
Equity Strategy	Markus Reinwand, CFA	47 23
Currency Strategy, UK, Japan	Christian Apelt, CFA	47 26
Gold	Claudia Windt	25 00
Real Estate	Dr. Stefan Mitropoulos	46 19
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Corporate Bonds	Ulrich Kirschner, CFA	28 39
Bank Bonds	Dr. Susanne Knips	32 11
Germany, Euro area	Dr. Stefan Mütze	38 50
USA, China, Scenarios	Patrick Franke	47 38
Central and Northern Europe	Marion Dezenter	28 41
Emerging Markets	Patrick Heinisch	74 27

Publisher and editors

Helaba Research & Advisory

Editors:
Dr. Stefan Mitropoulos
Susanne Eulenkamp

Production:
Saskia Lethaus

Publisher:
Dr. Gertrud R. Traud
Chief Economist/
Head of Research & Advisory

Neue Mainzer Str. 52-58
60311 Frankfurt am Main
Phone +49 69/91 32-20 24
Internet: http://www.helaba.de

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https://news.helaba.de/research/

Translation

Christopher Hanna

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