2024: A CRITICAL YEAR

2023 closed on a note of hope, with expectations of rate cuts and signs of stabilising, perhaps even improving confidence surveys. This hope has not dissipated in the early weeks of 2024. In the absence of a new shock, inflation seems to be on course for a return to the 2% target. This opens the way to the first steps in monetary easing, expected in the second quarter. These twin falls, in inflation and interest rates, and the encouraging pattern in the bulk of the economic data, fuel the expectations of a soft-landing scenario. But this is not to say that there are no risks or points worthy of continued attention. Geopolitical tensions remain high and capable of disrupting this scenario, most notably through their inflationary effects. The rise in company failures and the difficulties of the real estate sector also create downside risks for growth. In 2024, fiscal policy and consolidation efforts are likely to return to the forefront. Politics will also play an important role, given that there are several major elections on the horizon.

Often, if not always, a new year is portrayed as a crucial juncture. 2024 is no exception. In many aspects, indeed, it can be seen as a critical year. On the climate and ecological front this goes without saying, such is the urgency of stepping up efforts to decarbonise in the face of accelerating signs of warming[1]. The same is true of the geopolitical situation, with the continuation of the war in Ukraine – with no end in sight yet – and the ongoing conflict in the Middle East, where there are risks of a regional escalation, with the resulting impact on oil prices coming on top of disruption to shipping in the Red Sea and the associated increase in shipping costs. Politics will also feature large this year, with several important elections ahead, chief amongst them the European elections on 6 and 9 June and the US Presidential election on 5 November. Although these votes are unlikely to have a direct impact on the economy this year, their outcomes could shape prospects over the longer term.

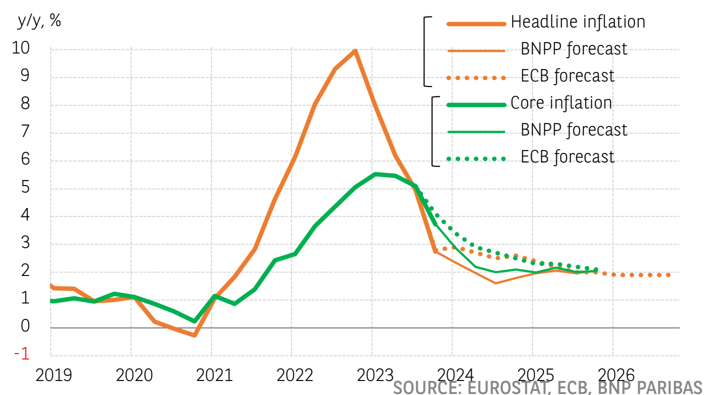
WILL THERE BE A SOFT LANDING?

2024 is also a key year for inflation and growth. Will inflation hit the 2% target this year? Will there be a soft landing for growth? A soft landing will depend in part on the speed at which disinflation continues and the scale, firstly, of the expected support of this lower inflation on confidence, household purchasing power and company margins and secondly, of the number of interest rate cuts allowed by falling inflation.

As far as inflation's return to its target is concerned, our forecasts suggest this will come fairly quickly and, notably, more quickly than the ECB currently expects (chart 1). Our inflation forecasts for the USA are also slightly more favourable (with the target met at the end of the year) than those of the Federal Reserve (expected inflation of 2.4% y/y in Q4 2024). Wages will be a key factor: whilst their enduring upward momentum means that wages have a positive effect on household disposable income and thus consumption, they also hamper inflation reduction, thus reducing expected gains in purchasing power and the support to consumption.

The significant improvement in consumer confidence on both sides of the Atlantic (since mid-2022 in the USA according to the University of Michigan survey, and since the autumn of 2022 for the European Commission survey), albeit from a very low base, is a good illustration of the positive role played by the easing of inflation and forms one of the encouraging signs of a soft landing. The same can be said for the stabilisation of the business climate in the Eurozone and the return of the US Composite PMI above the 50 threshold in January. The continued relatively robust health of the labour market is another source of optimism.

INFLATION IN THE EUROZONE AND FORECASTS



SOURCE: EUROSTAT, ECB, BNP PARIBAS

CHART 1

In the USA, the positive signal from improved household confidence has been backed up by their consumption, which remains strong. Still in the US, a major recessionary signal – the inversion of the yield curve – has eased somewhat (chart 2). These various developments seem to put meat on the bones of what one might consider the self-fulfilling prophecy of a soft landing: the expectation of such an event creates the conditions for it to occur, particularly as it fuels investors' risk appetite and reduces the financing cost for companies looking to issue debt.

Turning to the Eurozone, another characteristic of the expected soft landing and soft recovery is the passing of the baton between companies and consumers. In other words, we expect a slight increase in the strength of household consumption (as consumers take advantage of lower inflation to draw more heavily on their savings cushions) and a loss of dynamism in business investment. In the USA, household consumption is likely to run out of steam as a driving force, with consumers finding it harder to draw from excess savings built up during the Covid-19 crisis, but widely used in 2023. On both continents, the trend in the unemployment rate will have the final say. By definition there can only be a soft landing if the increase in unemployment remains limited. This could well be the case, notably due to persistent hiring difficulties (although these have become less intense and widespread), which encourage labour hoarding. Our assumption is also that the adjustment in the labour market, particularly in the USA, will come more from a reduction in the number of vacancies and less from redundancies, something we are already observing today.

1 See. 2024: two anniversaries - and hopes for an inversion of the emissions curve, 17 January 2024

Although this soft-landing scenario looks likely, it is nevertheless surrounded by numerous uncertainties and unknowns on the downside: thus we can not rule out the risk of a recession in 2024. Negative signals and areas of concern are hardly in short supply: increase in company failures, crisis in real estate markets, negative effects from past rate hikes that have yet to feed through (for companies needing to refinance debt, for households that borrowed at adjustable rates and now face increases in their interest payments), and lastly China, which continues to suffer from a number of weaknesses.

CHANGES IN THE POLICY MIX ARE RELATIVELY WELL ADAPTED

Changes in the policy mix will be another new feature of 2024: monetary policy is likely to become less restrictive, whilst fiscal policy will turn less accommodating. This will limit, but not prevent, any recovery. On the monetary side, cuts to policy rates are one of the few 'certainties' for the year ahead, as inflation falls – while this is not an absolute certainty, it has a very high probability of occurring. The timing of the first cuts and the number of cuts over the course of the year are nonetheless uncertain. Given our inflation forecasts, we expect that the ECB will act first, as soon as April, followed by the Fed in May. When it comes to the number of cuts, the Fed is likely to be slightly ahead of the ECB, with six versus five 25-basis point cuts respectively.

On the fiscal policy front, it should be expected that high public debt ratios will once again become a topic of attention, as will the fiscal consolidation efforts needed to ensure that public finances remain on a sustainable trajectory. In an environment where the gap between growth and interest rates is less favourable, a gradual but steady reduction in primary deficits would appear necessary. In Europe, this reduction will happen within the slightly more flexible – although not necessarily less complicated – framework of the new fiscal rules, after member states finally reached agreement at the end of 2023. According to European Commission data, fiscal policy in the Eurozone will indeed be less accommodating in 2024, if we judge not only by the expected reduction in structural primary deficits but also by their lower levels (with the notable exception of France) after already two years of reductions and thus negative fiscal impulse (chart 3). This rebalancing comes after the sharp deterioration in public finances in 2020, and to a lesser extent 2021, that resulted from the Covid crisis and the measures taken to help absorb the shock.

For the Eurozone in aggregate, although the negative fiscal impulse is currently lower than during Europe's sovereign debt crisis and the ensuing rapid fiscal consolidation, the figures are nevertheless relatively close (reduction in structural primary deficit of 0.7 of a point on average between 2022 and 2024, compared to 0.9 of a point from 2011 to 2014). The major difference is that the current fiscal consolidation is coming under more favourable economic conditions, making it contra-cyclical in nature in 2022 and close to neutrality in 2023 and 2024, rather than pro-cyclical as it was between 2011 and 2014. The situation in the US is harder to assess due to the lack of comparable statistics, but it will probably be fairly similar to that in the Eurozone in 2024. In the final analysis, changes in the policy mix in 2024 seem adapted to the current context of fighting inflation: monetary policymakers can allow themselves to be less restrictive as inflation is coming down and because of the complementary action of the fiscal brake.

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US: UNEMPLOYMENT RATE AND YIELD CURVE

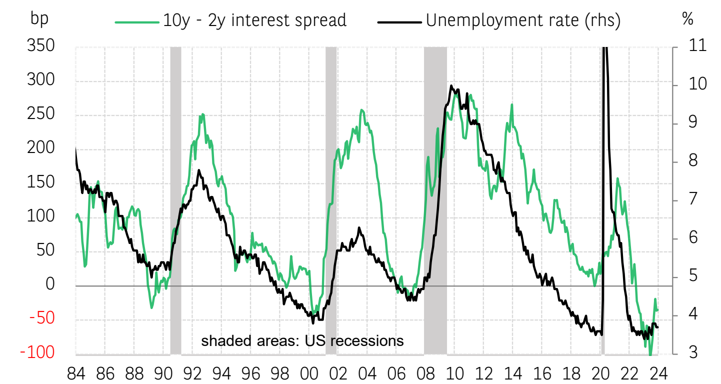

CHART 2 SOURCE: FEDERAL RESERVE, BLS, MACROBOND, BNP PARIBAS

EUROZONE: PRIMARY STRUCTURAL BALANCE (% POTENTIAL GDP)

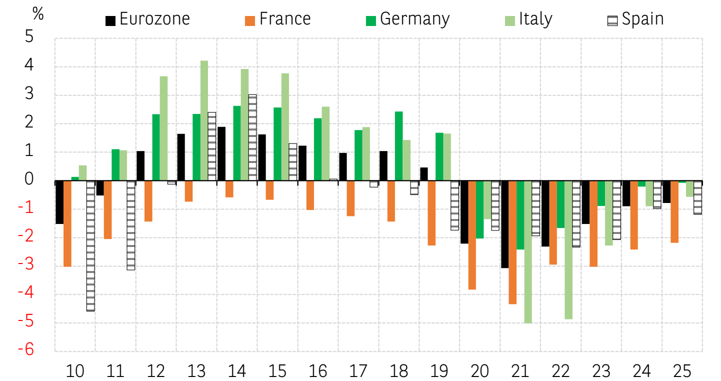

CHART 3 SOURCE: EUROPEAN COMMISSION, MACROBOND, BNP PARIBAS