EDITORIAL

GLOBAL ECONOMY: ARE WE STILL ON TRACK FOR A SOFT LANDING?

Much has happened since Q4 Outlooks published in September cheeringly predicted, as a matter of consensus, that the global economy was heading for a soft landing after the sharpest inflation surge and most abrupt monetary tightening in decades. On the economic front, more data have been released, helpfully adding pixels to the growth, labour market and inflation pictures. On the politics and policy fronts, China unveiled a large stimulus package, the US voted in a new President and Congress, the UK released a radical 2025 budget, and France and Germany limped into new governing arrangements. Taking stock of all these developments, is a soft landing still the central scenario for the global economy and most of its parts? In a nutshell, yes, but uncertainty bands on both sides have increased (mostly upside for the US and downside for the rest of the world).

Beginning with the US economy, the latest data affirm the soft-landing scenario. Despite a low payrolls print in October, the labour market remains in robust health judging by the jobless claims below expectations, and the unemployment still near historical lows at 4.1%. Business activity expanded at the fastest pace since 2022 according to PMIs data, led by services, but with the outlook for manufacturing at its highest in 2.5 years. CPI inflation is showing some stickiness but is declining nonetheless with headline down to 2.6% y/y in October and signs from last Friday's PMI were encouraging in terms of price pressures in the pipeline. This week's PCE data will be keenly watched to predict the Fed's next move.

Will it last? We still do not know how much of his campaign pledges Donald Trump's administration will implement, nor when. They include pro-growth measures (tax cuts, deregulation) and anti-growth, inflation-boosting ones (tariffs and tighter immigration policy). The first economic team nominations—Scott Bessent at Treasury and Harold Lutnick at Commerce—suggest both sides of the agenda will be pursued in parallel. A similar dynamic was at play during the first Trump administration. The US economy didn't break nor fly off the rails. But this time could be very different, because public debt and deficits, inflation, interest rates, and the ouput gap are all higher, as are stock market valuations. Pushing with equal strength on a string or a coiled string will give different results. Still, most measures will take time to enact, and the administration will want to avoid roiling markets. The most likely 2025 scenario might be described as "no landing", with growth and inflation not decelerating much, if at all, and the Fed keeping policy more restrictive than earlier expected. But a boom-bust scenario is plausible too.

China, for its part, has enacted stimulus measures that are beginning to show results. Domestic demand has been picking up, with only the construction sector remaining depressed. And exports have remained strong. As such, 2024 GDP growth is likely to be very close to the 5% target; 2025 will likely be lower as the impact of the stimulus wears off; but whatever the magnitude of the shock inflicted to the economy by US tariffs, the authorities have policy space and levers to cushion growth and, there too, deliver a soft landing.

In Europe, the latest data have been more challenging. Germany's economy is stagnating, with manufacturing in deep recession and services now contracting too; business activity in France is slowly but steadily deteriorating across both services and manufacturing according to November PMIs (flash estimates). The rest of Europe and notably its Southern flank is doing much better but in aggregate the latest PMIs suggest a mild contraction of business activity, with the latest composite PMI sliding to a 10-month low of 48.5. Meanwhile, wage inflation remains quite strong, with negotiated wages accelerating in Q3 to 5.4% y/y, the highest pace since the 1990s. That said, this is a backward-looking indicator largely driven by Germany and more contemporaneous ones suggest a slowing pace. Headline inflation has fallen below 2% y/y across the Eurozone, and members of the ECB's Governing Council speak of being "very confident" that inflation will sustainably revert to target next year. As such, we can expect the ECB to keep cutting interest rates at a good clip until it reaches a neutral stance, and to go beyond should headwinds to growth prove stronger.

The reacceleration in activity implied in the Eurozone soft-landing scenario has been elusive so far, but it can still be achieved, contingent on a rebound in business investment and consumer demand. Business sentiment is maybe beginning to turn around in the German manufacturing sector according to the latest PMIs, possibly explained by the combination of the economic rebound observed in China and the near-term prospect of a new government that will be more business-friendly and more willing to boost public investment. On the consumer side, the key is an inversion in the rise in the savings rate observed since the pandemic, a long expected and increasingly plausible development: falling interest rates should enhance the relative appeal of consumption vs savings, and several quarters of positive real wage growth will have allowed even the least well-off households to rebuild some financial buffers. Consumer confidence needs to hold up however, and after 3 consecutive months of improvement the latest reading was down.

Admittedly, new US tariffs, or even the uncertainty created by the threat of them, might dampen growth. But the EU is not helpless in facing it. Indeed, former Italian Prime Ministers Draghi and Letta have given EU Leaders a blueprint of the structural reforms they need to implement (irrespective of US tariffs). ECB President Lagarde and other Eurozone Central Bank Governors have been increasingly vocal in urging them to do so. According to the IMF, reducing internal obstacles by 10% could add 7% to growth[1]. This far exceeds any estimate of the impact of potential US tariffs.

Lastly, the UK is perhaps where the soft-landing narrative has been most challenged by recent data, looking more like a stagflation scenario. Both PMIs and hard data (GDP, retail sales, construction) suggest activity has been contracting recently, whereas inflation has been reaccelerating. Forward-looking sentiment indicators are also quite negative. That said, the negative mood impact of the 2025 budget should soon be offset by the positive impact of the fiscal impulse embedded in it, and the Bank of England so far has remained confident it can carry on easing policy, albeit at a gradual and prudent pace, accepting a somewhat delayed return to the 2% target for inflation. So, the soft landing remains in sight and entirely deliverable. The leeway to respond to negative shocks, notably stag-flationnary ones like tariffs, is quite limited, however.

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1 Source: A common call for a Franco-German revival | Banque de France