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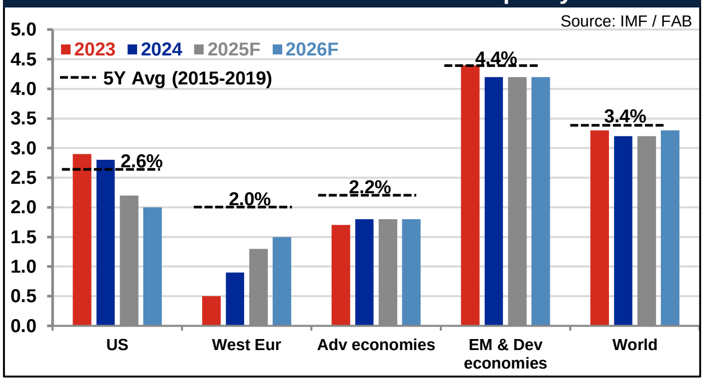
Global Macro Outlook 2025
On the Lookout for the 'Black Swan'

Global growth remained resilient throughout much of 2024 as robust job creation and solid household finances continued to drive consumer spending. Yes, there have been some setbacks in the global macro narrative recently such as the net disappointing U.S. nonfarm payrolls report for October, even after adjusting for hurricanes and strikes as well as the poorly received UK budget all of which has been drag on sentiment. Furthermore, market mood is being consistently tested by Japan's fragile political situation and ever-changing coalitions. And in China, we remind investors that the reflation path is proving to be anything but smooth.

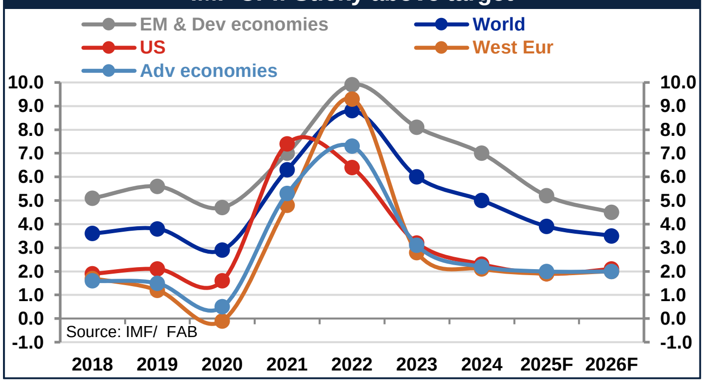
Critically, though, the global economy has avoided slipping into recession during the disinflationary process and a veil of optimism continues to shroud our outlook going into 2025. A key reason for such optimism on global growth is the dramatic inflation decline that has now been seen over the past two years and which will surely support real income, with price inflation having fallen quicker than wage inflation. And at the same time we would conjecture that disinflation is also a stimulant for aggregate demand in that it encourages central banks to normalize monetary policy and thereby ease financial conditions.

However, under the constraints of what we perceived to be persistently elevated interest rates above the so called 'neutral rate', which have been imposed over the past two years to address those surging price pressures and the post-pandemic inflation, leaving monetary conditions in net restrictive territory, macro and socioeconomic cracks are starting to emerge.

IMF GDP: The cost of restrictive policy

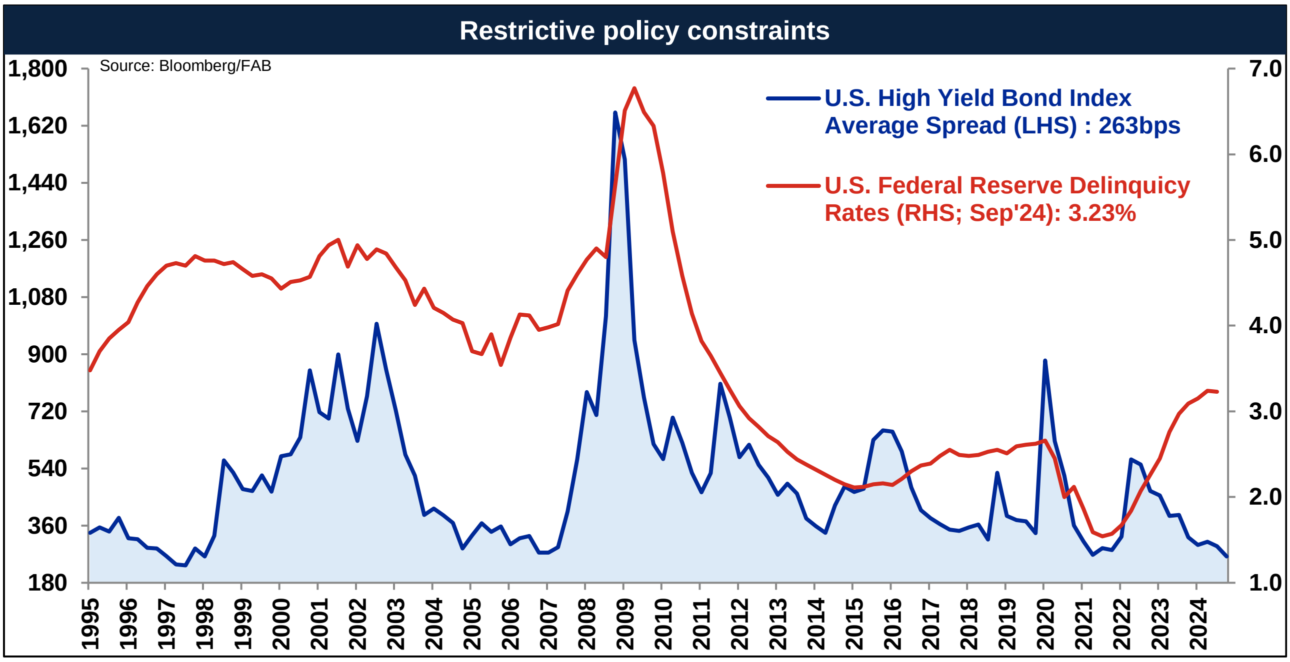


IMF CPI: Sticky above target



As a result of the latter, major central banks (the Federal Reserve, the European Central Bank, the Bank of England) began a tentative reduction of policy rates in the latter stages of 2024. This process will have further to run this year in 2025, but with inflationary pressures still sticky to the upside and likely to be aggravated by the policy initiatives of the new Trump administration in the U.S., global rates seem set to remain tight for a while longer. As a result, we forecast a slowdown in global generic economic growth conditions as we head through 2025 predominantly driven by a cooling labour market and the consequences of high interest rates; a view that is also shared by the likes of the EIU.

Indeed, the restrictive nature of monetary policy is already beginning to manifest itself and show itself in delinquency rates. A simple regression analysis of the U.S. high yield corporate bond index and U.S. (banks' credit cards) delinquency rate shows the cost of leaving interest rates too high – and in economically-restrictive territory – for too long. Faced with the aforementioned stickiness to price pressures though and the prospect of the inflationary aspect of Trump's threatened trade tariffs and promised tax cuts, the Fed and other central banks will need to tread a very careful monetary path over the course of the coming 12 months.

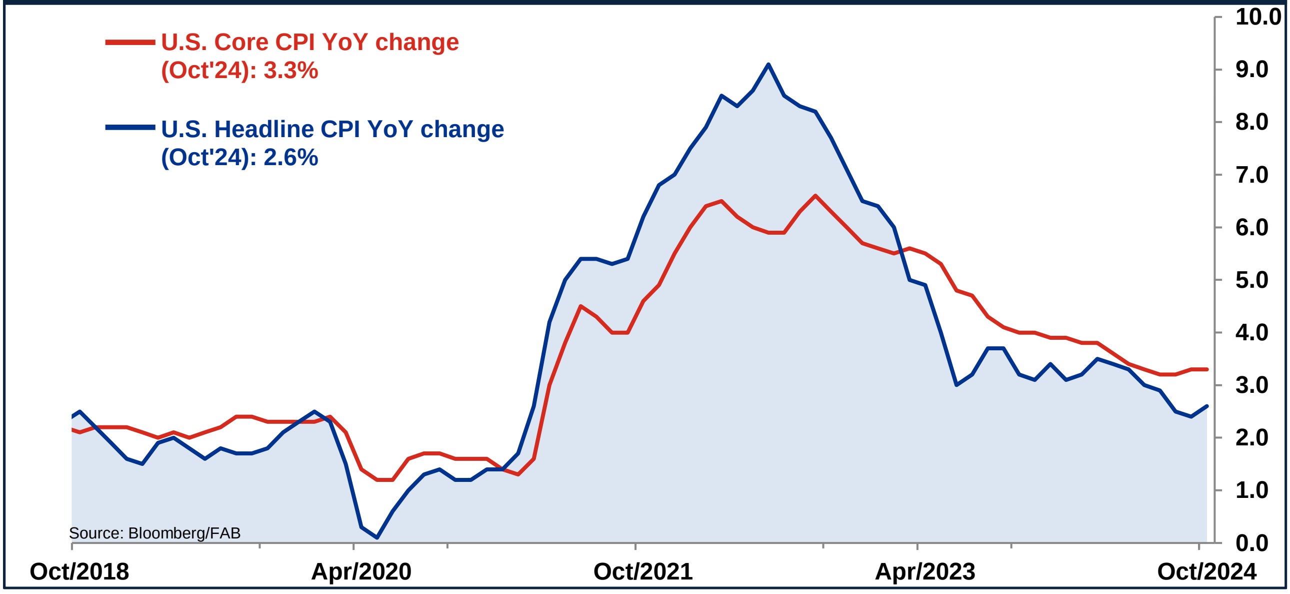


According to the latest (October 22, 2024) edition of the International Monetary Fund's World Economic Outlook publication, the IMF expects global growth to remain stable yet underwhelming. We would wholeheartedly concur. Moreover, in line with our own FAB house views, the IMF suggests that as disinflation continues, a smooth landing should be within reach of (the Federal Reserve and U.S.) policymakers.

As alluded to above, global price pressures do remain elevated, but in the bigger scheme of things we would conjecture that the global battle against inflation over recent years has now largely been won. That said, the threatened trade tariffs and tax cutting initiatives of the new Trump administration will keep the inflation flames burning over this course of this year, if introduced as per his election campaign and manifesto.

After peaking at 9.4% YoY in 3Q2022, we expect headline global inflation (CPI) to now reach 3.5% by the end of this year. Such a result would be well below the average level of 3.6% between 2000 and 2019, according to IMF data. Meanwhile, we expect global economic growth to come in at around 3.2% this year, a similar rate of expansion as seen last year in 2024. The IMF reduced its for forecast for global growth this year to 3.2% from its earlier forecast of 3.3% growth. Within this status quo for 2025 though, several low-income developing countries, have seen sizable downward revisions to their growth outlooks, while other (developed market) economies, namely the U.S., have seen their economic growth outlooks expanded for 2025 and 2026.

Opening the rate cut door, but only marginally



Source: Bloomberg/FAB

That said, we maintain a cautious stance with respect to the balance of risks, which we believe remains tilted to the downside. Such risks must include geopolitical tensions that could flare up at any moment, potential financial market volatility and the persistent spectre of renewed tightening of financial conditions, as well as the ongoing problems that are afflicting China's property sector and the government's aspirations of transitioning from an investment-based economy to a consumption driven one. Elsewhere we remain cognizant of the threat to global macro conditions from the headwinds buffeting global trade as well as those stemming from rising protectionism and (as the IMF would phrase it) continued geoeconomic fragmentation.

Meanwhile, in Europe our broad view for this year (2025) remains one of euro weakness from an interest rate differential and trade tensions perspective. In this context we anticipate further monetary policy easing by both the European Central Bank (ECB) and the Bank of England (BOE) over the coming quarters. However, whether the ECB stops easing once it gets to 2.5%, or whether it pushes down toward 2.0% as is currently being priced by the futures market, will depend on the internal debate in Frankfurt over the level of the real neutral rate with inflation stable at 2%.

Any meaningful disruptions to the disinflation process would clearly test central banks' ability to pursue their monetary easing bias, in turn creating challenges to fiscal policy and financial stability. We agree with the IMF that *'amid numerous threats, it is time for a policy pivot. With monetary policy easing, shifting gears on fiscal policy to ensure sustainable debt dynamics and rebuilding of buffers is appropriate. Advancing structural reforms to boost long-term growth and accelerating the green transition remains as necessary as ever'*.

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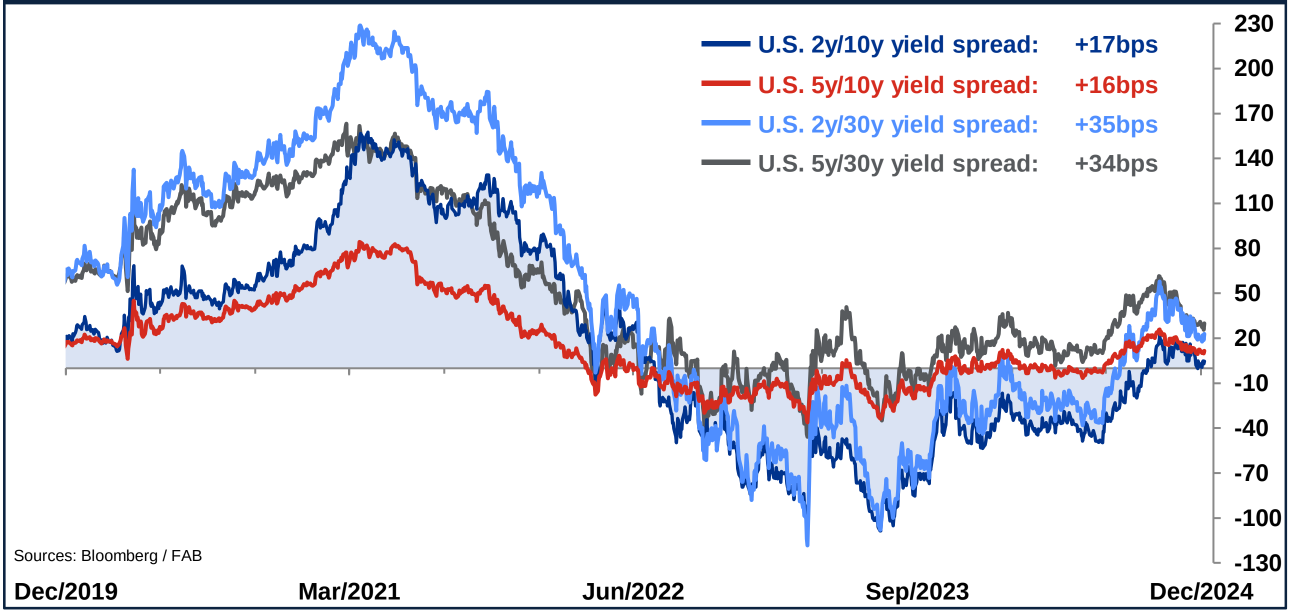
U.S. Macro / Rates Outlook

While the U.S. economy is starting 2025 on a relatively firm footing, with the two elements of the Federal Reserve's dual mandate – low inflation and a robust labor market – looking healthy, the transition to the new (second time) Trump administration is casting a veil of uncertainty over the outlook. Indeed, the US economy continues to look resilient as it has in recent quarters with the latest GDP growth rate trending close to 3% and the unemployment rate at a respectable 4.1% as we enter 2025.

The A Team - We love it when a plan comes



Our constructive view on U.S. economic growth prospects for the year ahead are also founded on our expectation that U.S. productivity growth should remain significantly stronger than in other developed economies. As a result, we would also expect to see a widening U.S./Euro area interest rate differential, fuelled by differing evolutions in regional labour productivity. For example, labor productivity in the U.S. has increased at a 1.7% annualised rate since late 2019, in a clear acceleration from the pre-pandemic trend of 1.3%. By contrast, labor productivity in the euro area has grown at only 0.2% annualized over the same period, in a marked deterioration from the +0.7% pace of productivity growth before the pandemic.

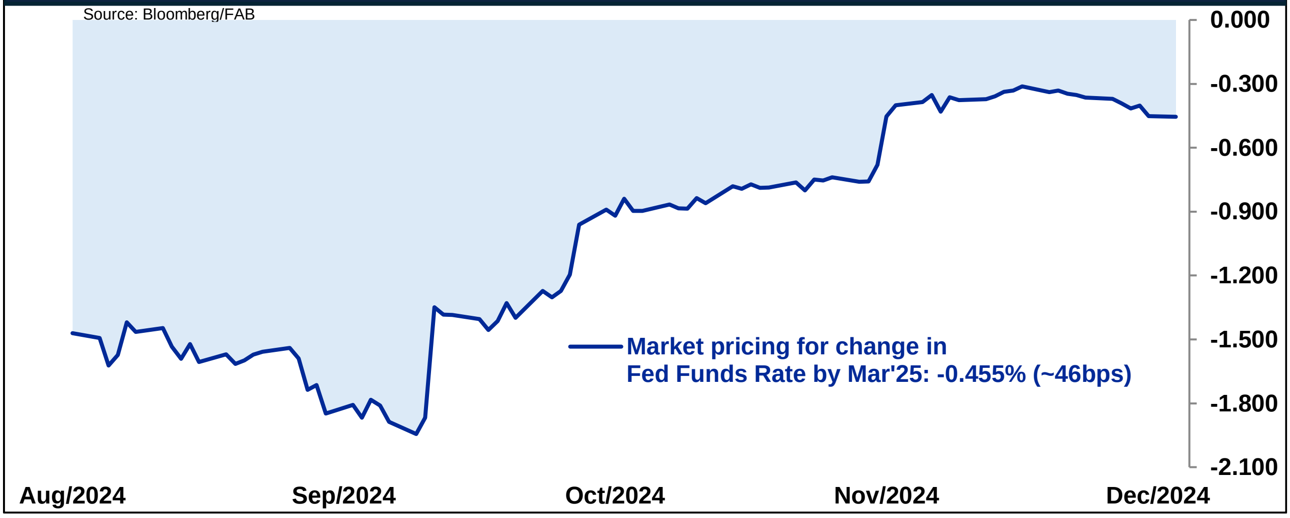
The Federal Open Market Committee (FOMC) kicked off the U.S. rate reduction process last September with a 50bp rate cut and a further 25bp reduction in early November, but then 'paused' and left the fed funds target rate unchanged at the December 17-18 FOMC meeting. In the context of President Trump's promised – or should that be threatened? – trade tariffs, the December pause was definitely the right thing to do, in our opinion.

And looking ahead through these early months of 2025, the landscape will now likely be characterised by the Federal Reserve being in 'wait and see' mode. Waiting for confirmation as to whether Trump's fiscal and trade initiatives will be as aggressive as he suggested during his election campaign. Waiting to see how much of a hawkish inflation impact his fiscal and trade policies might have and in turn what negative effect that could have on the outlook for GDP.

Our back-of-an-envelope calculations suggest that Trump's proposed trade tariffs could reduce U.S. GDP by as much as 0.3% this year (2025) and by far more in 2026 if more onerous tariffs are implanted. The flip side to this scenario of course is that the impact could be less severe if all the associated tariff revenues are fully recycled into fiscal easing (tax cut) measures.

From a Fed rates perspective, that leaves us with the broad expectation that the FOMC could now leave rates unchanged until at least March. Moreover we anticipate a maximum of 75bps of cuts by the end of the year (2025) and that the eventual implied 'neutral rate' for fed funds will be no lower than 3.50% by late 2026. This means no more than an aggregate of 1.25% of easing – five 25bps rate reductions – over the coming 24 months. A far cry from what the doves were demanding this time last year!

Pushing back expectations



Back to Mr Trump though and given what we know from his first term in office, when he favoured lower interest rates to bolster the domestic U.S. economy, we would expect him to be similarly biased this time around. Certainly, we would conjecture that with (albeit only fragile) control of both the House and the Senate, we should be braced for an extension of his first term tax cuts. In this respect though, the market reacted positively back in November – as we believe it was right to do – to the news of Scott Bessent's nomination as President Trump's Treasury Secretary.

Bessent, the CEO/CIO and founder of macro hedge fund Key Square, is a safe pair of hands on the Treasury wheel, in our opinion. While Bessent will surely back Trump's tariff and tax cut plans, we believe that his financial markets background will lead him to adhere to policies that favour sensible economic targets and (financial) market stability. We see him as market-savvy and likely to be sympathetic to market direction and sentiment and conscious of the potentially damaging impact of headline-driven volatility. We do not see him as an individual that will be out to score disruptive political points. This being the case, we would expect concerns over future inflationary pressures, worsening trade tensions and generic market volatility to generally recede (at least a little) over the coming months.

Conversely though, we are cognisant that unified Republican control will not necessarily be conducive to a model of policy restraint. Caveat emptor, therefore, the one, key, risk that we believe global markets are currently turning a blind eye to are the hawkish implications of higher-than-expected US trade tariffs. If the latter surprise strongly to the upside the resultant spike in inflationary pressures could result in the Federal Reserve needing to tighten monetary policy again - with an increase in interest rates - before the end of this year. This is not (yet) our base case forecast, but it is a clear and present danger.

Let's not lose sight of the fact that the weighted-average tariff on all U.S. imports is currently only 2%, but that this could rise ominously as high as 17%, under the plan outlined by Mr Trump on the pre-election campaign trail. Moreover, a more aggressive and penal trade tariff structure would certainly hit real (inflation adjusted) disposable personal income via inflation and higher consumer prices. At the same time, any increased uncertainty and speculation of deepening trade tensions would only be a net negative influence on business investment.

At the same time, we recognise that a strategy driven by the inflationary combination of fiscal easing and trade tariffs will be diametrically-opposed to any call for lower interest rates, as alluded to above. In this respect we recall President Trump's first term in office when he was calling for lower – even negative – interest rates to support U.S. industry and the broader domestic economy. As such, if President Trump is forced to dial back his rhetoric a little, once he recognises this paradox, it could be that his bark will have proved to be more aggressive than his bite.

From a Fed rates perspective therefore, we now expect Chair Powell to remain in the aforementioned 'wait and see' mode until there is better transparency and confirmation over what policies this new Trump administration will implement. Only then might the Fed feel comfortable committing to a future interest rate direction, once it has a clearer insight into President Trump's policies and these can be modelled for the months and quarters ahead.

From an asset allocation perspective, this outlook suggests to us that as far as Treasuries are concerned, the sector looks reasonably well priced, albeit not cheap. In the context of a robust US growth outlook, coupled with the prospect of higher government debt issuance this year (2025), as well as rapidly rising deficits, if all the tax cuts from 2017 are extended by President Trump, we may see some renewed downside pressure on prices in the coming months.

The bottom line for our U.S. macro take on 2025 therefore is that if the threatened trade war does not escalate further, the more positive derivatives from tax cuts, a friendlier regulatory environment, and improved pro-business attitudes should create a positive environment for risk asset performance as the year evolves and as we look further ahead to 2026. This suggests to us that, barring a more aggressive - and fully delivered - trade tariff and tax cut strategy from President Trump - which could trigger a broader global trade war, his eventual actions are unlikely to change the broad contours of our cautiously optimistic global economic views. But we are cognisant that it is exactly these potential 'black swans', or at the very least 'grey birds' hidden within 'Trumponomics', that we must remain mindful of.

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European Macro / Rates Outlook

While the European Central Bank (ECB) and Bank of England (BOE) are both sat on the monetary easing locomotive, importantly both European institutions' seats currently appear to be in a carriage well in front of the Federal Reserve. Given the relative health of the three economies, we believe that the ECB (and to a lesser extent the BOE) should move much more quickly than the Fed in the rate easing process, bringing the ECB's deposit rate to 2% by the middle of this year (2025). Such a rate differential outlook should help to underpin generic USD strength in year ahead relative to both European currencies.

Growth dynamics have shifted significantly across the Euro area in recent quarters, to the extent that in 2025 we potentially need to rethink conventional wisdom as to where the engine of Eurozone economic activity realty sits. At the very least the picture of Euro area economic growth is now far more uneven than it has been in recent years with the implied engine of growth moving from the so called 'core' to the 'periphery with the likes of Spain continuing to surprise on the upside, while Germany, in technical recession, will have all its work cut out this year to avoid a more painful economic contraction.

And as far as the impact of the U.S. is concerned, even if China is the main focal point and target of President Trump's new trade tariffs, Europe is unlikely to escape unscathed. We would also expect European growth to be affected by Trump's policies, if only as a result of the greater uncertainty that his tariff's will create.

In terms of the Euro area growth outlook, we expect real GDP growth for 2025 to register at around an anaemic 0.7%. Admittedly, there has been some recent improvement in spending data, which have been encouraging, but we would say that signs of any meaningful pick up in domestic demand and consumption remain fragile. On the back of this we expect headline Euro area inflation to average around 2% (or slightly lower) in 2025, the 'core' measure of price pressures should recede from the recent elevated levels of around 2.7% to settle closer to the 2.2% mark by the latter half of the year.

Similarly, we anticipate that UK growth should register at close to 1% in 2025 (possibly just over 1% if it's lucky). We see only limited growth benefits from last October's fiscal event in the form of the new Labour government's expansive tax-and-spend budget. Combining the Eurozone and UK macro outlooks, we would suggest that the region's recent track record of lacklustre, albeit positive... just… economic growth should persist through the coming year.

As far as ECB and BOE interest rates are concerned, we maintain that they should pursue a more dovish path than the Federal Reserve over the coming quarters. Unfortunately, the ECB is not in the habit of offering much in the way of guidance on future policy decisions, but multiple speakers have opined in recent months that monetary policy remains restrictive, thereby suggesting that the Bank (ECB) has room to cut interest rates further before the 'neutral rate' is reached.

We now expect the ECB to cut policy rates by 25bp at every meeting until June. That would take the ECB deposit rate to 2.0% from 3.25% currently. More importantly though, we expect to see further ECB easing during 2H2025, when the euro area neutral rate is likely to be viewed as being lower than the ECB's 2-2.5% estimate. This being the case, global markets should be braced for the ECB's deposit rate to fall toward 1.50% territory during the latter half of the year.

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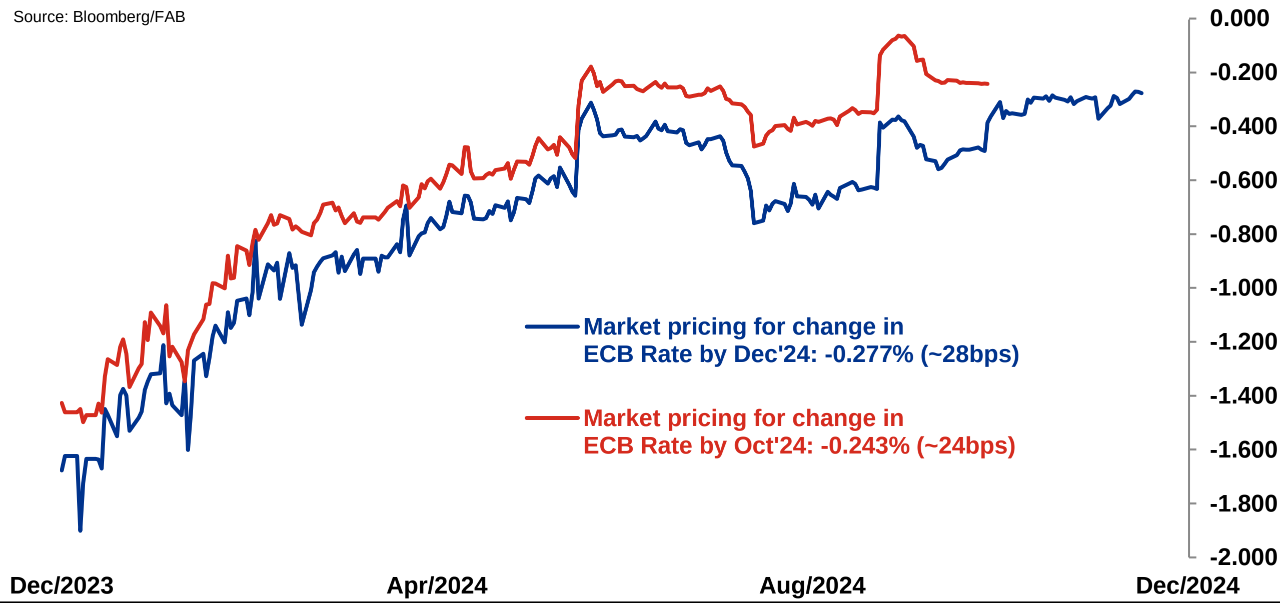
Market pricing in -25bps this week, but ECB could justify -50bps



Across the Channel, while the Bank of England kicked off its rate reduction cycle back in August (2024), with Bank Rate currently at 4.75%, and with further easing justified given the macro situation in the country, that might be easier said than done for the BOE. We believe that the aforementioned fiscal event of the UK government's budget last October will create a solid headwind against BOE easing aspirations. Unsurprisingly the BOE now recognises the associated monetary and fiscal uncertainty, which means that its forecast still leaves headline inflation above 2% over the coming two-year period. We believe that the Bank will now follow a slower pace of monetary easing – likely structured around quarterly (25bp) cuts until May (2025), and then sequentially thereafter until September 2025, which should result in Bank Rate finding a floor close to 3.5% territory.

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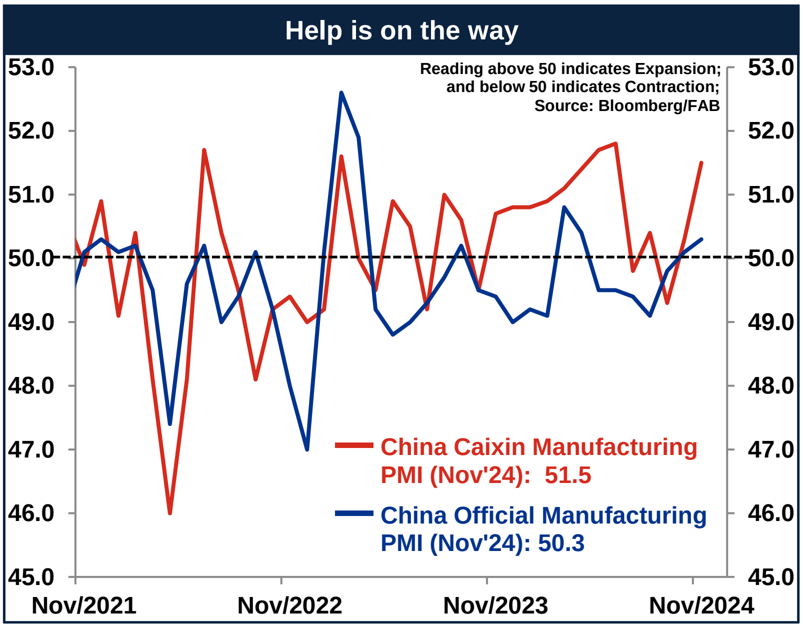
China Macro / Rates Outlook

China has made some significant strides in recent months in its efforts to shore-up the economy and aid the aspirational transition from an investment-led to a consumption-led economic model, but the success rate has been limited and much work remains to be done. Notwithstanding the efforts that have been made, domestic consumption has consistently disappointed over the past year or so and housing demand has still not stabilized. The latter sector still looks parlous. Meanwhile, the economy continues to be plagued by near-zero inflation, within which falling home prices have created a negative wealth effect. And all of this with the added negative overhang that youth unemployment remains structurally elevated.

Monetary and fiscal stimulus from the PBOC and the government alike have been sizable but focused on putting a floor under the still anaemic housing market and helping local governments, as opposed to proving a meaningful and sustainable boost to consumption. Yes, the measures have fuelled a rally (that has since stabilised) across the equity market, but investors remain wary. What the market really needs to build its confidence would be greater transparency and colour as to just how much fiscal medicine (stimulus) the authorities are prepared to prescribe – and finance – for the patient. As of yet we have seen no concrete sign of the hoped-for ‘bazooka style’ initiative.



That said, we must acknowledge the recent shift by the Politburo away from its ‘prudent’ bias to a ‘moderately loose’ strategy for monetary policy in 2025. This was, without doubt, the most aggressive shift in stimulus tone in over a decade and marks the first time in some 14 years that the stance has been ‘moderately loose’. The last time such a stance prevailed was from late 2008 until end 2010, in response to the Global Financial Crisis, when Beijing announced a bazooka stimulus package to underpin the economy at a time of global meltdown.

The Politburo also stated that it would now take a ‘more proactive’ approach to fiscal policies, with the aim of stabilizing the anaemic property sector and bolstering the stock markets, while at the same time committing to ‘forcefully lift consumption’. One might assume that this will now lead to Beijing widening the economy’s fiscal deficit from the current 3% at the annual parliamentary gathering in March.

That said, however positive these latest headlines from Beijing may appear, we will retain a degree of caution until we see the extent to which the delivery and implementation of the measures prove successful or otherwise.

We therefore remain sceptical as to what extent the government can feasibly create a sustained recovery in housing market activity as well as in consumption. These two sectors will remain critical to China’s macro outlook this year (2025) given that collectively they account for around 70% of the country’s GDP. All together, we continue to believe that the China economy will struggle to get even close to the government’s aspirational target of 5% real GDP growth and would forecast 4.1% as a more likely result over the coming 12 months as the hit from tariffs offsets (at least partially) the boost from stimulus.

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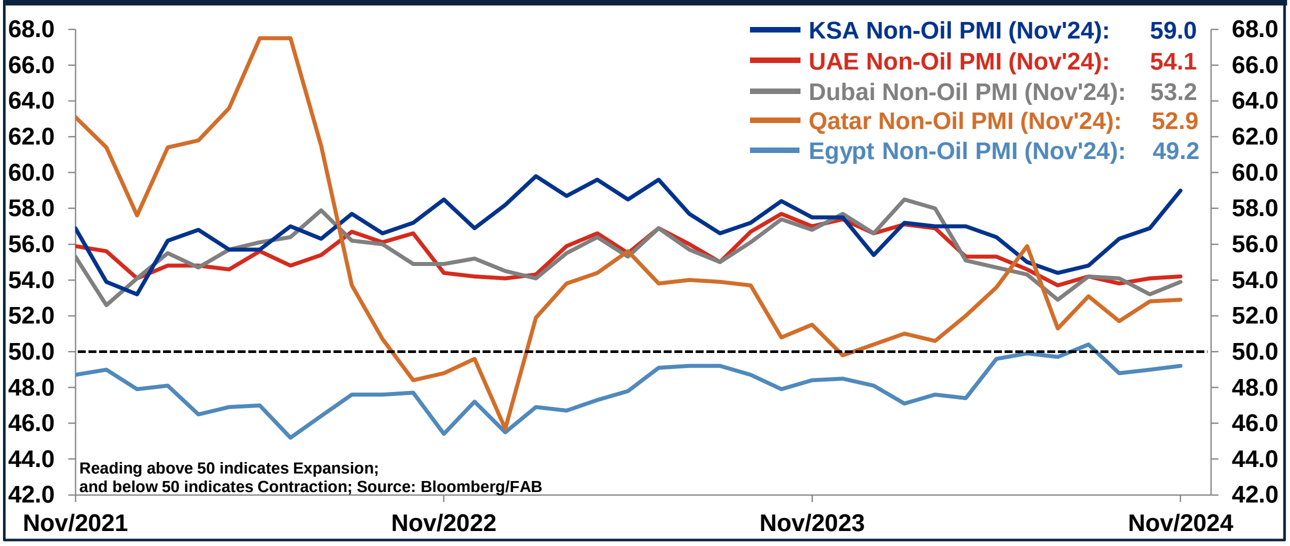
GCC Macro Rates Outlook: And now for the good news

While the U.S., European and China economies will face myriad varied monetary and fiscal challenges over the course of 2025, as discussed above, the GCC macro landscape is again expected to be a picture of economic resilience and growth outperformance. For the GCC region as a whole, we currently expect GDP growth to double from 2.1% in the past year to 4.2% in 2025. Such a rebound will be founded on another year of solid economic diversification and resilient economic activity and growth performance by the non-oil sectors of the economy.

Indeed, a clear reflection of domestic economic activity and business optimism, particularly across the non-oil sectors of the economy, is evident in the recent performance of the region's Purchasing Managers Indexes – the so-called PMIs. With '50' on the indices representing the breakeven between economic contraction (<50) and economic expansion (>50), the majority of the GCC region's country PMIs have now been in 50+ territory since late 2020.

An oasis of value



Such readings underscore the robust nature of domestic activity, consumption and private investment. The PMIs also reflect the depth and ongoing success of economic diversification strategies across the region, encapsulating key sectors such as tech, healthcare, education, tourism, finance, renewable energy and AI.

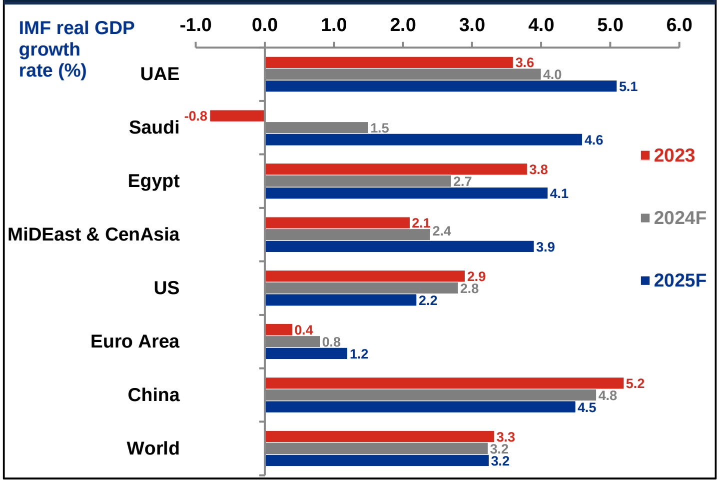
Our constructive outlook on the GCC macroeconomic landscape in 2025 was also bolstered and corroborated by Mody's upgrade of Saudi Arabia's sovereign credit rating. On November 23, 2024, the rating agency upgraded its sovereign credit rating for KSA – and associated GREs – to Aa3 from A1. At the same time, the rating outlook was – unsurprisingly – revised to stable from positive, indicating balanced risks to the new, higher rating.

Moody's stated that the upgrade was in reflection of the success of the country's economic diversification efforts and the reduction in KSA's exposure to oil market developments and long-term carbon transition. Moreover, in the rating report, Moody's stated that the new (Aa3) rating was also based on the expectation that KSA's diversification momentum will be sustained going forward. This was the first rating upgrade of KSA by Moody's since the initial assessment in 2016.

The relative allure of the GCC region is perhaps no better highlighted than by comparison with the Eurozone manufacturing PMI that continues to languish sub-50. This maturing picture across the GCC's non-oil economy, coupled with an anticipated easing of OPEC+ oil production quotas over the coming months should help to further bolster the economic outlook and outsized growth potential for the region during FY2025.

In this respect we note that the Central Bank of the United Arab Emirates (CBUAE) recently opined that the country's strong foreign trade performance should continue in 2024 and 2025; a view that we wholeheartedly concur with. Even more constructively, while the CBUAE estimates that UAE economic growth in 2024 should prove to have registered at just sub 4% (3.9%), we believe that the economy will have expanded by 4.5% YoY in 2024. Moreover, we then forecast a further pickup in the pace of economic expansion to 5.6% over the year ahead (2025), with the CBUAE hopeful for growth of up to 6.2%.

UAE to become one of the fastest growing economies



From a rates perspective across the GCC territories, we would expect sovereign interest rates to move (lower) in line with U.S. interest rates over the coming quarters. This of course will be a consequence of the U.S. dollar-pegged currencies; and we see no threat to the pegs over the foreseeable time frame. With the Fed now seen leaving the fed funds rate target on hold until perhaps March, followed by modest easing thereafter, we would expect GCC rates to move in a similar direction and to a similar magnitude this year. Like the Fed, this would mean no more than an aggregate of 1.25% of easing – five 25bps rate reductions – over the coming 24 months.

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