



Global Macro Research – Global Economic Outlook

Q4 2024

#Global

/

#Forecasts

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#Scenarios

Is this time different?

The global economy is slowing but we forecast a soft landing. While US unemployment is rising in a manner usually consistent with recession, we think this time will be different. However, “hard landing” has replaced “no landing” as the key risk. Indeed, sustained proactive monetary easing is necessary, and we expect a series of consecutive cuts from the Fed. Japan will be the main exception to global easing; further hikes are likely and could cause volatility. China’s growth target is on a knife edge amid structural headwinds and only incremental easing.

The US and broader global economy are clearly slowing. Consumers’ savings stockpiles are almost depleted, interest rate-sensitive sectors such as manufacturing and housing are struggling, and the fiscal impulse is fading. Most concerning, the US labour market is cooling and unemployment is rising. This has triggered the “Sahm rule” (see Figure 1), usually an indicator of impending recession.

However, our baseline forecast remains for a soft landing, with US growth slowing from 2.6% in 2024 to 1.7% next year, but remaining positive, supported by material rate cuts.

That’s because the signal from rising unemployment is weaker this time around, given that it’s being partly driven by rising labour supply from immigration and higher participation. Meanwhile, corporate profitability is still robust, mortgage delinquencies are low, and measures of household net worth are close to record highs.

In addition, the moderation in sequential inflation back to target-consistent rates should support sentiment and real income growth. Trends in US rental prices suggest the sticky shelter component of inflation will continue to cool, albeit only gradually. While there are still plausible sources of upside inflation surprises, such as a sharp rise in oil prices on the back of further geopolitical shocks, we are less worried than previously about an endogenously generated, persistent inflation overshoot.

Indeed, we think that “hard landing” has replaced “no landing” as the key risk to the global cycle. While our quantitative recession risk models, which incorporate a broad range of US economic data, are not flashing red, they have been creeping up recently. This shift in the risk environment means the equity-bond correlation may start to turn negative once again.

The moderation in inflation and increasing concern about the full-employment side of the Federal Reserve’s (Fed) dual mandate means we expect it to undertake a total of 100 basis points (bps) of rate cuts this year and 125bps of cuts next year (see Figure 2). Our work on equilibrium interest rates means we expect the endpoint of this cutting cycle to be just below 3% on the fed funds rate. It is possible that wider labour market or financial market stress, or the Fed’s desire to get “ahead of the curve”, triggers more front-loaded easing.

European growth is cooling, with the German economy especially weak as it struggles with cyclical and structural headwinds. However, the European Central Bank (ECB) is still worried about underlying inflation risks, particularly the strength of wage growth. Having started cutting rates earlier than the Fed, this concern may now keep the ECB relatively more cautious in its easing cycle.

The UK economy is experiencing a cyclical upswing, which we expect to constrain the Bank of England to a quarterly pace of rate cuts this year and next. It’s too soon for the Labour government’s supply side measures to boost trend growth, so, with fiscal space very limited, the forthcoming budget will involve tax increases. It’s possible that these will become a headwind to growth and sentiment in time.

The Bank of Japan (BoJ) will remain the major exception to global easing. Although the BoJ’s previous rate hike caused large global market fallout, the significant increase in Japanese wage growth means policymakers want to continue moving interest rates up towards a more neutral stance. With financial markets seemingly doubting the BoJ’s resolve to tighten policy, this could cause another round of currency and broader market volatility.



China's real estate adjustment, which has further to run, will continue to constrain growth. A weak housing market is weighing on consumer confidence and will keep the savings rate elevated. It also hits local government finances. Achieving the 2024 growth target of around 5% is on a knife edge and we anticipate a further slowdown to 4.4% next year.

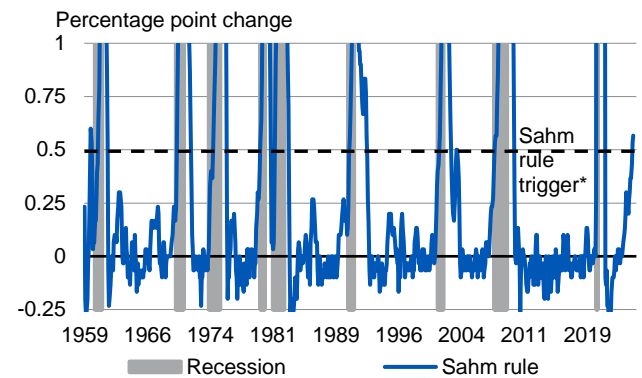
We think Chinese policy easing will remain incremental and supply-side-biased, given the balance between growth and other objectives. This may further entrench disinflationary forces in the economy, although we think policymakers would intervene more forcefully if it looked like China was heading towards "Japanification".

Broader emerging market (EM) growth appears to be robust but cooling. Headline inflation has returned to central banks' targets across a growing number of EMs, although resilient labour markets and volatility in food prices and exchange rates are now slowing the pace of disinflation in some economies. While this has caused the EM easing cycle to pause, we don't think the return to likely rate *hikes* in Brazil is a harbinger of a broader turn in EM monetary policy. EM rate cuts are likely to broaden as the Fed eases.

Finally, our forecasts are conditioned on a Kamala Harris victory in the US presidential election, given her current lead in the polls. However, the race is close to a toss-up, and Trump still has advantages on the economy and in the electoral college. A Donald Trump presidency that pursues inflationary policies such as tariffs, tax cuts, and political interference with the Fed is therefore one of our key global risk scenarios.

An oil price shock emanating from the Middle East is another source of exogenous inflation risk, while a sustained improvement in the supply capacity of the global economy, perhaps spurred on by developments in AI, remains an important upside risk.

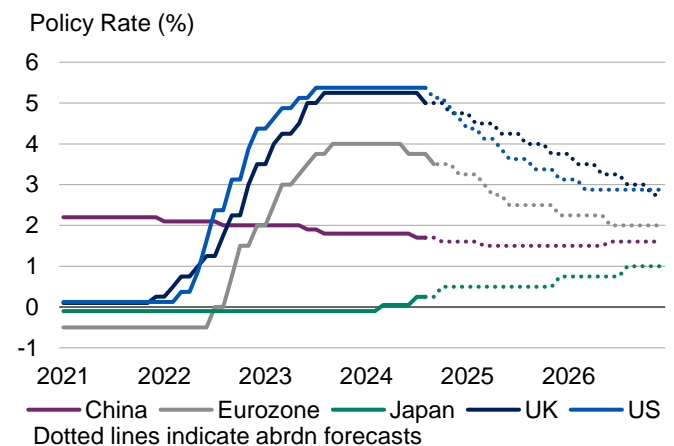
Figure 1: The Sahm rule has been triggered, but we don't think it signals certain recession this time



*The Sahm rule finds that a 0.5pp rise in the 3m moving average of the unemployment rate from its 12 month low is typically followed by a recession

Source: Haver, abrdn (September 2024)

Figure 2: The cutting cycle will be sustained until interest rates get to more neutral levels



Source: Haver, abrdn (September 2024)

Figure 3: Global economic forecasts

	GDP (%)				CPI (%)				Policy Rate (% , year end)			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
US	2.5	2.6	1.7	1.9	4.1	2.8	2.0	2.2	5.375	4.375	3.125	2.875
UK	0.1	1.1	1.3	1.1	7.3	2.6	2.0	2.0	5.25	4.75	3.75	2.75
Japan	1.7	0.0	1.2	1.0	3.3	2.4	1.6	1.6	-0.10	0.50	0.75	1.00
Eurozone	0.5	0.7	1.2	1.4	5.4	2.3	2.0	1.9	4.00	3.25	2.25	2.00
Brazil	2.9	3.0	1.9	1.8	4.6	4.2	3.5	3.7	11.75	11.00	9.75	9.75
India	7.8	6.4	6.0	5.7	5.7	4.6	4.1	4.9	6.50	6.50	6.00	6.00
China	5.3	4.8	4.4	4.3	0.3	0.4	1.0	1.6	1.80	1.60	1.50	1.60
Global	3.2	3.1	3.2	3.1	6.9	5.8	4.3	3.7				

Source: abrdn, September 2024



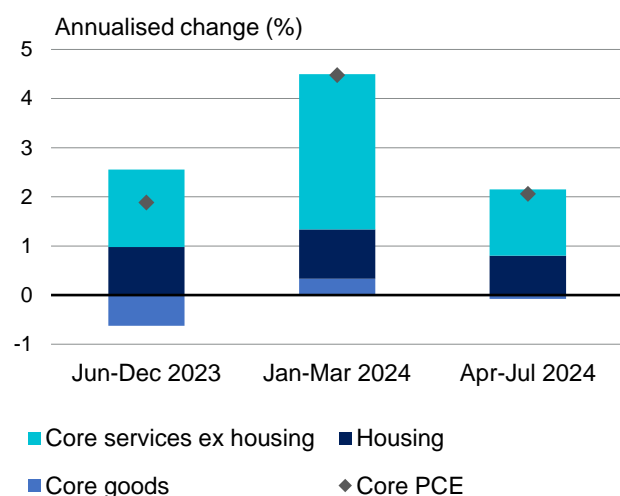
US

Activity: The US economy is clearly slowing, raising fears that it might be heading towards a hard landing after all. We expect a further deceleration in GDP growth to run rates below 2% annualised in H2 as consumer spending slows in line with muted household income growth. However, we still expect a soft landing, helped by strong consumer and corporate balance sheets, slowing price pressures, and an ongoing easing in financial conditions. But the risk of recession has increased, especially as there are signs of a concerning loss of momentum in the labour market.

Inflation: Underlying inflation pressure continues to cool, even if this process has been bumpy this year (see Figure 4). We expect further progress amid ongoing declines in core goods prices and labour costs, and a long-awaited easing in shelter inflation. This should keep sequential core PCE inflation prints around the Fed's target, but annual inflation rates will not fall closer to 2% until early 2025 given unhelpful base effects. The outlook for price growth further ahead is clouded by an uncertain policy backdrop, with former President Donald Trump running on an inflationary policy platform.

Policy: Given the fall in sequential inflation, the Fed is now able to focus on securing a soft landing. Indeed, Chair Jerome Powell has made clear that the Fed would not welcome any further deterioration in the labour market. This implies a relatively rapid return towards neutral interest rates, where policy would no longer weigh on activity. We expect policy easing in every meeting until the middle of next year, when the pace may slow slightly. Even more rapid easing is likely if the data disappoint. Markets have also started to price a lower equilibrium interest rate, consistent with our view.

Figure 4: US inflation continues to move in the right direction allowing the Fed to focus on employment



Source: Haver, abrdrn, September 2024

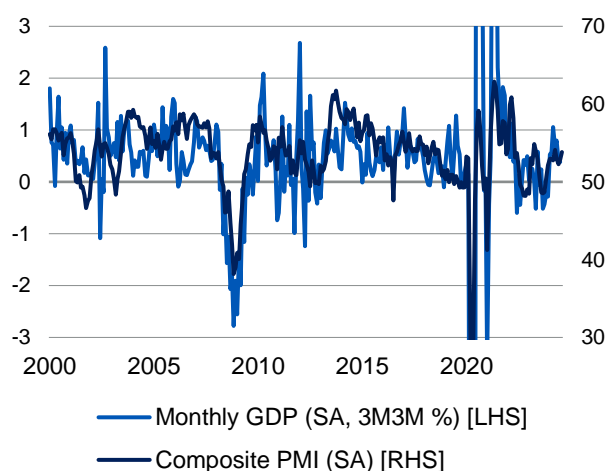
UK

Activity: The UK economy is enjoying a cyclical sweet spot compared to other DM economies. Growth was well above trend over H1 and, while a slowdown is likely, surveys are consistent with solid growth (see Figure 5). Monetary policy remains restrictive, but the housing market looks to be slowly recovering. The budget is likely to contain material fiscal tightening as the government faces a large fiscal "blackhole" over the medium term. Tweaks to the way Bank of England (BoE) losses are treated can create some fiscal space but tax increases are likely. This could weigh on activity and investor sentiment.

Inflation: Having fallen back to target in Q2, headline inflation is likely to drift higher for much of the rest of the year as energy bills rise and favourable base effects pass. Underlying inflation pressures are elevated but fading, with wage growth slowly moving back towards a more target-consistent pace. However, there is some tentative evidence that labour market cooling has stalled on the back of stronger activity growth. Given the methodological uncertainty around unemployment data, and the weakness of other labour market indicators, policymakers may discount this signal for now. But, crucially, the UK still faces endogenous inflation risks.

Policy: The UK's cyclical strength and ongoing endogenous inflation risks mean the BoE is likely to be relatively cautious in its easing cycle. We expect the next rate cut in November, with the Bank continuing with a quarterly pace of cuts through 2025. With interest rates still well above equilibrium, there is significant space to cut rates before policy becomes a tailwind to growth. Indeed, should the economy slow sharply in response to fiscal tightening, weaker sentiment, and other headwinds, the pace of rate cuts could speed up, especially from the second half of next year.

Figure 5: UK surveys suggest GDP growth will remain robust



Source: Haver, abrdrn, September 2024



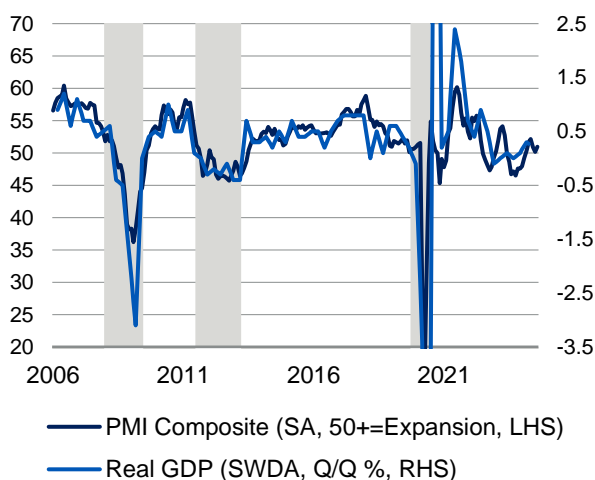
Eurozone

Activity: The Eurozone's recovery is faltering. Q2 GDP growth was revised down from 0.3% to 0.2% at the latest estimate, and survey data suggest the economy has carried this weakness into Q3 (see Figure 6). We have accordingly revised our near-term forecasts for growth down. However, the labour market remains tight, real wage growth strong, and the European Central Bank (ECB)'s gradual easing cycle should eventually support demand. Therefore, the economy should avoid recession and post stronger growth in 2025. Germany's growth prospects are limited by structural headwinds, while strongly negative fiscal impulses could see France and Italy underperform.

Inflation: Helpful base effects and lower commodity prices have driven the Eurozone's headline rate of inflation down to 2.2%. We think that the headline rate will now bounce around the ECB's 2% target as long as the economy avoids large exogenous shocks. Unhelpful base effects could drive the headline rate up to 2.5% by December, but we expect this increase to be reversed in early 2025 even if some components will remain sticky. Indeed, we think that consensus forecasts and the ECB underestimate the stickiness of core and especially services inflation, which we expect to decline only slowly.

Policy: The ECB cut its deposit rate by 0.25% in September, but its rhetoric remained cautious. We think a combination of weak growth and stable inflation should see the ECB continue gradually reducing rates. However, the pace of cuts is likely to remain slow unless recession risks rise meaningfully. As such, October is likely too soon for the ECB to cut again. Instead, we expect the ECB to next cut in December, before reducing rates by 1ppt over 2025. Importantly, we think the ECB will stick to its cautious approach, even if the Fed pursues more aggressive cuts.

Figure 6: Eurozone survey data are soft, but not recessionary



Source: Haver, abrdn, September 2024

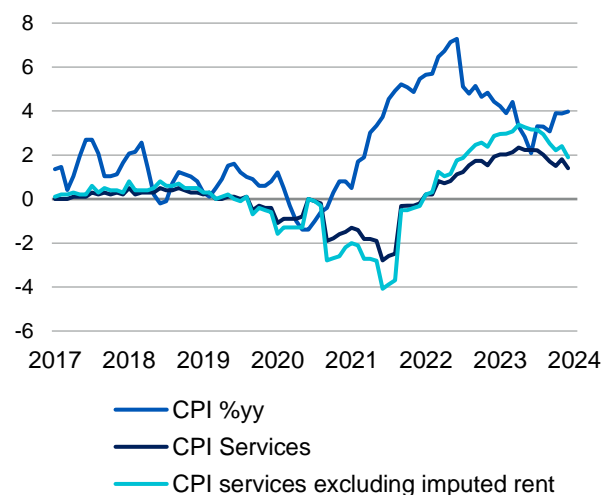
Japan

Activity: Following four consecutive quarters of contraction, Japanese consumption finally rebounded in Q2 amid positive real income growth. This trend must continue for consumers to leave behind the previous “deflation mindset” and shift the economy toward a virtuous cycle of wage and price growth. The combination of stronger real incomes, a one-off tax cut for households, and the temporary return of electricity and gas subsidies, should see the economy continue to recover modestly over the coming quarters. That said, weak external demand will continue to be a drag.

Inflation: There are finally signs of the strong Shunto wage round feeding into higher realised earnings, with base pay measures rising meaningfully over the past quarter. If this trend continues, services inflation could stabilise, and the Bank of Japan (BoJ) would have greater impetus to continue with its gradual policy normalisation. However, wage growth feeds into inflation with a lag, and Japan's headline inflation looks set to continue heading lower in the near term. Core national inflation excluding fresh food and energy and services inflation excluding rents continue to decelerate, suggesting domestically generated inflation pressure are fading (see Figure 7).

Policy: The BoJ's decision to raise rates and reduce the pace of bond purchases contributed to a sudden unwind of the yen carry trade in early August. The Ministry of Finance and BoJ continue to view the yen as undervalued despite the rally, and so policymakers would like to tighten monetary policy further to help sustainably support the currency. As such, we expect further rate hikes, including a 25bps increase in October. The BoJ will not want to surprise investors and precipitate another round of volatility so is unlikely to hike in October if it is not priced.

Figure 7: Stronger Japanese wage growth needed to support domestically generated inflation



Source: Haver, abrdn, September 2024



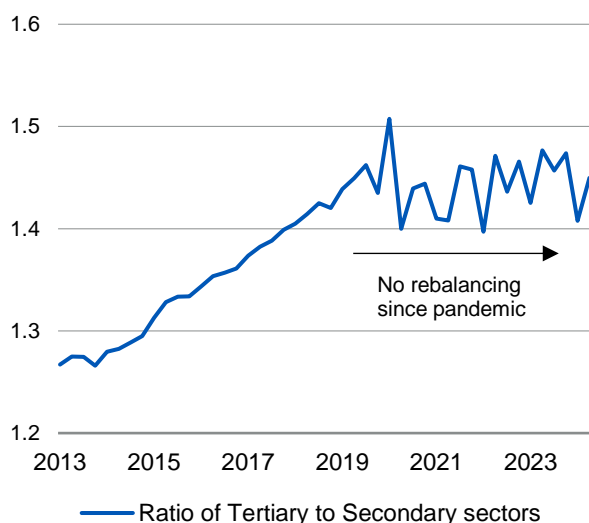
China

Activity: China's growth target of "around 5%" is on a knife edge. A weak Q2 GDP print and modest start to Q3 have pushed our 2024 forecast down to 4.8%. Policymakers have signalled support to boost domestic demand is on the way, but an incremental approach to easing risks falling short of what is needed to spur the economy. Indeed, with house prices continuing to fall and income expectations damaged, household saving is likely to remain a headwind to growth. Should a trade war unfold under a second Trump presidency, 2025 GDP growth would fall below our 4.4% forecast.

Inflation: Even if activity data is not weak enough to spur an aggressive policy reaction, questions remain as to whether China is sleepwalking into 'low-flation'. Headline CPI inflation was positive for the seventh month in a row in August, but it is still advancing at a tepid pace of only 0.6% year over year. The incremental and supply-side biased policy mix, which favours investment in strategic industries over consumption, implies 'low-flation' will be hard to shake (see Figure 8). Fears of 'Japanification' may be overstated, but we expect annual CPI growth of just 1% next year, below consensus expectations of 1.5%.

Policy: An accelerated pace of government bond issuance and further small rate cuts by the People's Bank of China (PBoC) should reduce the risk that growth falls well below target. That said, the emergence of financial stability concerns, which motivated an intervention to stem the rally in long-dated bonds, suggests a cautious approach to easing. The Third Plenum also revealed little indication that the authorities are considering a more forceful stimulus, asserting that security remains the 'foundation' for China's technology-focused modernisation. This implies that resilience is being prized above growth, which will continue to amplify tensions with the West.

Figure 8: China's rebalancing has stalled and its supply-side biased policy is set to continue



Source: Haver, abrdn, September 2024

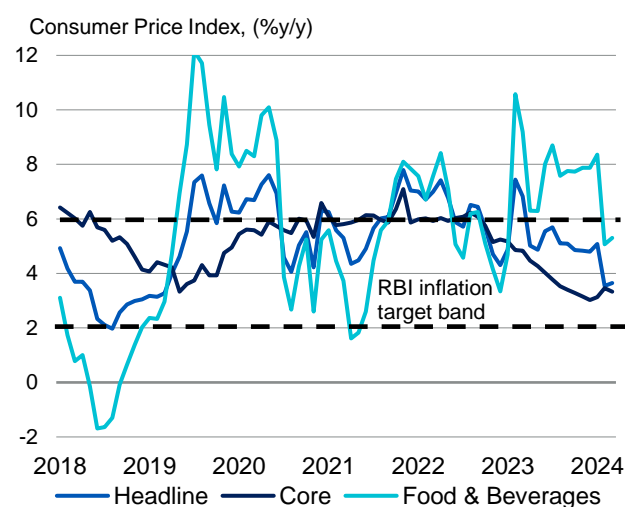
India

Activity: We think Indian economic growth will slow over coming quarters, albeit continuing to outperform global growth. While the economy slowed more sharply than expected in Q2, the breakdown revealed a still healthy domestic private sector. Tailwinds from public infrastructure spending and exports will ease in the coming quarters, and there will be a greater onus on the private sector to drive growth. However, much will depend on the pace of reform to spur investment and job creation in more productive sectors. Still, risks are skewed to the upside, especially as a strong harvest could boost rural demand.

Inflation: Inflation continues to be driven by rising food prices, stalling the broader disinflation process in India. While core inflation has been well anchored, food prices have been spiking due to adverse weather conditions (see Figure 9). The progress of the remainder of the monsoon season will be crucial, with initial signs pointing to a good harvest. A strong harvest should cool, or at least stabilise, food prices, helping to slow the month-over-month increases in headline inflation. Coupled with lower oil prices, this should bring inflation closer to the Reserve Bank of India (RBI)'s 4% inflation target mid-point.

Policy: The RBI has held its policy rate at 6.5% since February 2023, highlighting the importance policymakers are putting on food prices and the risks of higher inflation expectations. Indeed, we forecast the RBI to maintain its current policy stance over the rest of the year until the outlook for food inflation improves. We expect policymakers to tolerate some slowing of activity in the near term and look past the Fed's easing cycle. As food price risks recede, we expect a modest easing cycle to ensue in early 2025.

Figure 9: Volatile food prices in India are hindering RBI easing



Source: Haver, abrdn, September 2024



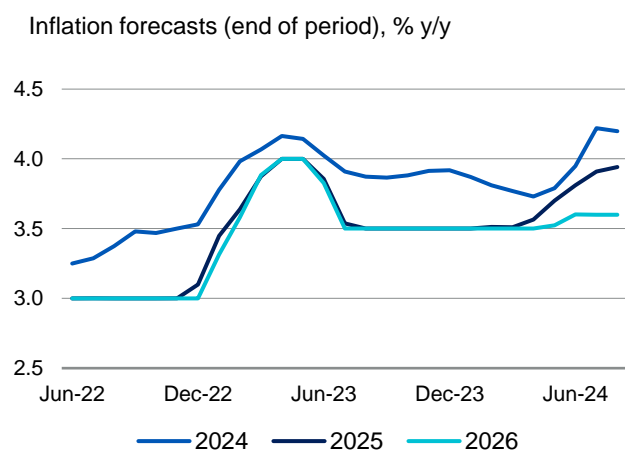
Brazil

Activity: Brazil's economy grew above trend through the first half of the year, averaging 1.2% quarter over quarter. This has in part been due to recovering real incomes and supportive fiscal policy, which has buoyed domestic demand and strengthened the labour market. However, with the economy running hot, markets are pressuring policymakers to tighten policy. As such, we expect modest fiscal consolidation and tighter financial conditions through the remainder of the year and the first half of 2025. This should slow growth from 3% this year to around 1.9% by 2025.

Inflation: The 'last mile' of disinflation is proving tricky in Brazil. Headline inflation has remained near the upper end of the Banco Central do Brasil (BCB)'s target range of 3% +/-1.5ppt, and inflation expectations have been shifting further away from the 3% target mid-point (see Figure 10). Strong domestic activity, particularly in the services sector, has kept underlying inflation elevated, while there are also some upside pressures from rebounding producer prices. That said, we expect tighter fiscal and monetary policies to cool the economy and ultimately bring inflation lower through 2025.

Policy: We expect the BCB to hike 50bps before year-end, taking the Selic rate to 11% given concerns over rising inflation expectations and the path of fiscal policy. Despite an upcoming change in the BCB governor at the turn of the year, we expect rates to remain at 11% until around mid-year. Cuts will only begin once inflation has shown sufficient signs of cooling. As such, were fiscal policy to remain looser than we are expecting or the economy to prove more resilient, then the BCB may have to tighten monetary conditions even further to bring inflation back to target.

Figure 10: Increased Brazilian inflation expectations are a concern for the BCB



Source: BCB Focus Survey, Haver, abrdrn, September 2024

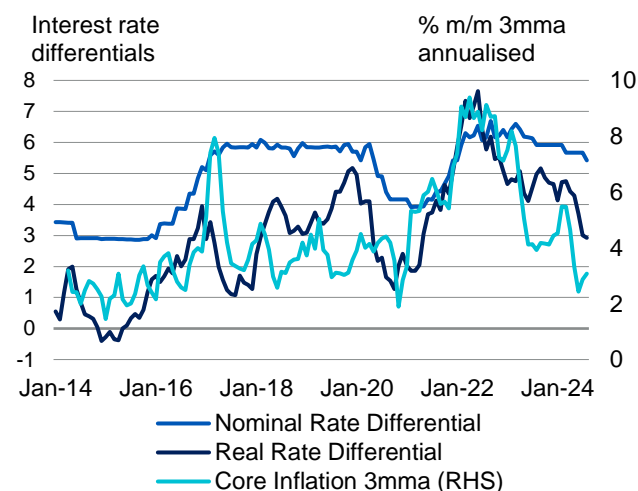
Mexico

Activity: The Mexican economy's momentum has faltered in recent quarters. Indeed, Banxico's latest forecast project annual growth of just 1.5% in 2024 and 1.2% in 2025 (down from 2.4% and 1.5% previously). However, low unemployment, the gradual normalisation of inflation and supportive fiscal policy will buoy domestic demand over the coming quarters. A more material slowdown in the US would be a significant headwind for the Mexican economy, while greater protectionism under a Trump presidency could hurt trade and investment.

Inflation: After accelerating from 4.4% year over year in February to 5.6% in July, Mexico's headline inflation rate slowed to 5.0% in August. The prior rise was largely due to rising food prices, which will continue to hinder disinflation in the coming months. However, core inflation has maintained a downtrend since early 2023, with our preferred measure marginally above Banxico's 3% target. Softening domestic growth should further contain core domestic price pressures. However, peso depreciation could exacerbate import price growth, keeping inflation expectations stubbornly high.

Policy: Banxico's easing cycle this year has been cautious, with two 25bps cuts in March and August. In the future, the Fed's easing cycle will provide room for Banxico to cut further without sharply widening its real rate differential with the US. However, with concerns regarding the new government's strengthened legislative powers, its fiscal stance, and US election uncertainty weighing on the peso (see Figure 11), Banxico will take a more cautious path in cutting than the Fed over the near term unless investor sentiment materially improves.

Figure 11: Banxico will lower rates further, but peso's slide will keep policymakers cautious

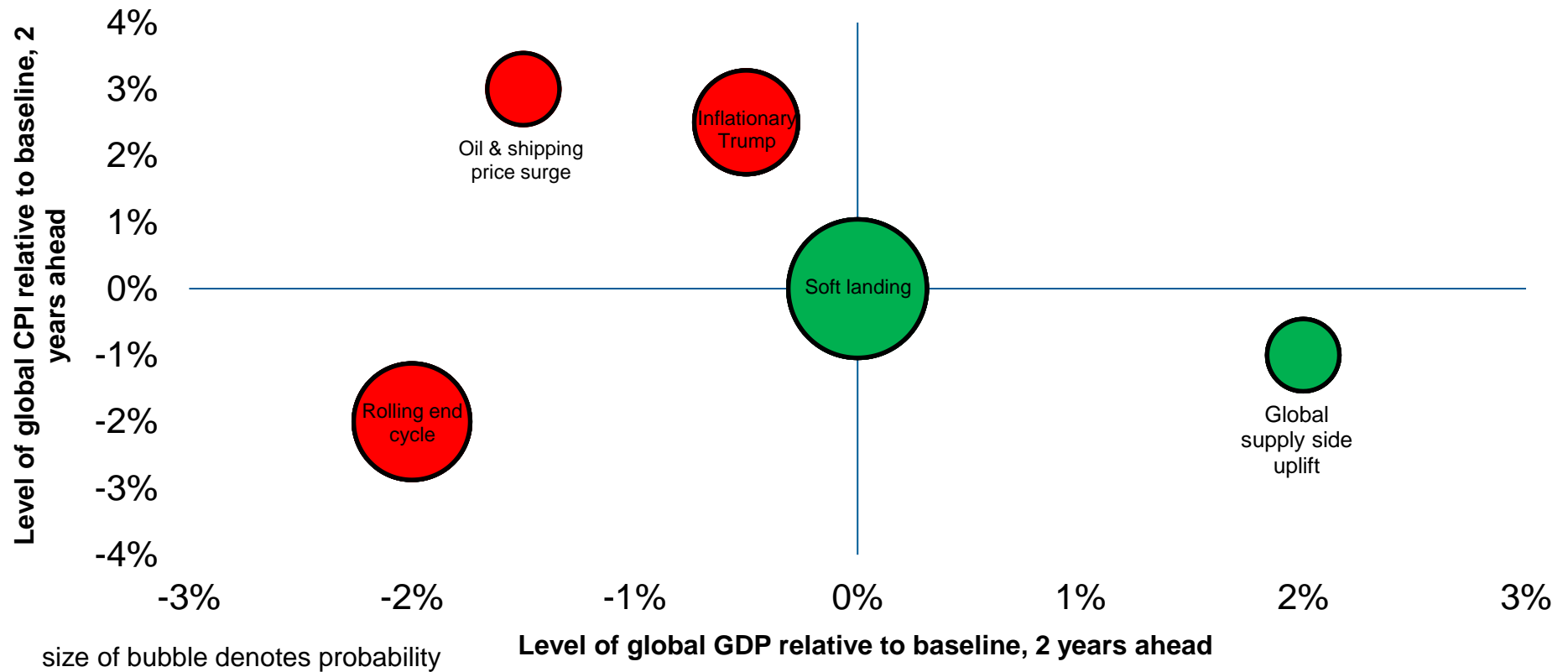


Source: Haver, abrdrn, September 2024



Global scenarios overview

Figure 12: Global activity and price level in key alternative scenarios, relative to baseline, 2 years ahead



Source: abrdn, September 2024



Soft landing: 35%

Both US and Chinese growth slows, but the US avoids a recession. Sequential inflation stays around target, allowing more central banks to lower rates.

US growth remains positive, even while the labour market cools further. Positive real income growth allows European economies to continue to slowly expand. In China, the push-and-pull of policy easing and real estate headwinds mean the government's growth target is on a knife edge.

Sequential inflation in most economies stays around target-consistent rates, but underlying inflation pressures remain, and headline rates may stay elevated for longer. Wage growth slows as labour markets cool.

The Fed and other major central banks ease policy interest rates back to neutral. The Bank of Japan slowly increases interest rates further.

Waymarks

US economic growth slows from the rapid pace of last year as temporary supports from excess savings, strong immigration, and fiscal policy fade. However, despite the triggering of the Sahm rule, the economy avoids a recession as the normal feedback loops around job destruction are less present this time.

The Eurozone remains sluggish, with positive real income growth helping to offset the severe headwinds in Germany and the industrial sector more broadly.

Globally, nominal wage growth cools and unit labour cost growth fall toward inflation-target consistent rates. Sequential core inflation moves essentially back to target in many economies.

Inflation expectations stay well-anchored, with medium term expectations around long-term averages.

The Fed joins the European Central Bank and the Bank of England in cutting interest rates, with the Fed moving rapidly to return policy to a more neutral stance. Underlying inflation concerns may see slightly more policy caution in the UK and Eurozone.

The Bank of Japan gradually increases interest rates, with another hike this year.

Chinese policy remains moderately accommodative but falls short of 'big bang' easing given a desire to hold the line on de-risking and with an eye on other policy objectives.

Global economic forecasts

Growth: 2024 3.1%, 2025 3.2%, 2026: 3.1%

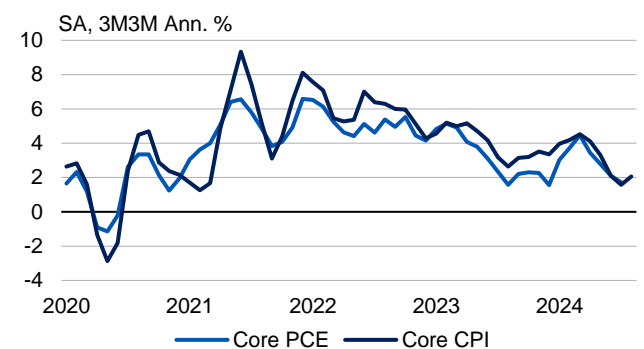
Inflation: 2024 5.8%, 2025 4.3%, 2026 3.7%

Figure 13: Services PMIs remain in expansionary territory even as manufacturing continues to struggle



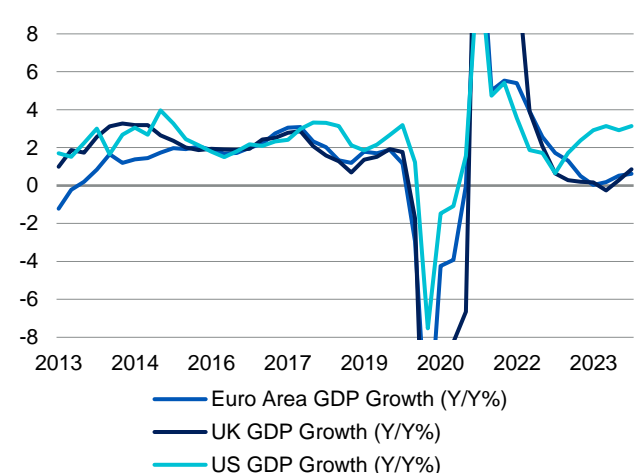
Sources: Haver, abrdrn, September 2024

Figure 14: The moderation in underlying inflation brings headline rates back to central banks' targets



Sources: Haver, abrdrn, September 2024

Figure 15: US growth exceptionalism fades



Sources: Haver, abrdrn, September 2024



Rolling end cycle: 25%

The US falls into recession, with cracks in the labour market spreading across the rest of the economy. The Fed cuts rapidly. Chinese activity slows sharply.

The triggering of the Sahm rule once again presages the start of a US recession. Cracks in the labour market spread across the economy, with job destruction picking up amid much weaker income growth and spending.

Monetary policymakers are perceived to have fallen behind the curve when dealing with deteriorating growth, with easing seen as reactive rather than proactive. Linger concerns about underlying inflation pressures may explain why some central banks are slower to start easing than would be optimal, especially in Europe.

In China, real estate vulnerabilities combined with an insufficient policy response lead to a sharp slowing in growth. Cyclical and structural headwinds mean the economy continues to struggle with deflation.

The Eurozone and UK economies face headwinds, including the spillovers from a weaker US and China.

Waymarks

US unemployment rises further. The weakness in manufacturing and housing spreads to services and consumption activity. Credit conditions start to tighten again, household excess savings are exhausted, and the fiscal impulse turns negative. Recent supply-side improvements reverse.

The US economy formally tips into recession before the end of the year. The Eurozone's slowdown accelerates and UK activity data turn down again.

There is a new bout of weakness in Chinese activity indicators including manufacturing and services surveys. Consumer confidence remains weak and housing market activity struggles. Corporate defaults rise, local government finances come under pressure, but there is little sign from policymakers that further stimulus and bail-outs will be put in place

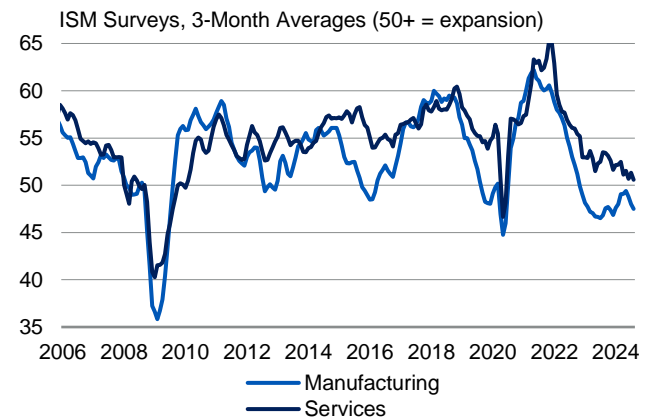
Globally, interest rates are cut significantly. But policymakers are seen as being behind the curve, easing too little too late. For example, European policy makers continue to reference inflation concerns when justifying only gradually cutting rates. This sluggish pace of easing means that cuts do not support risk assets and financial conditions may even tighten despite falling interest rates. Rates are ultimately cut well below the neutral rate.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: -2.0%

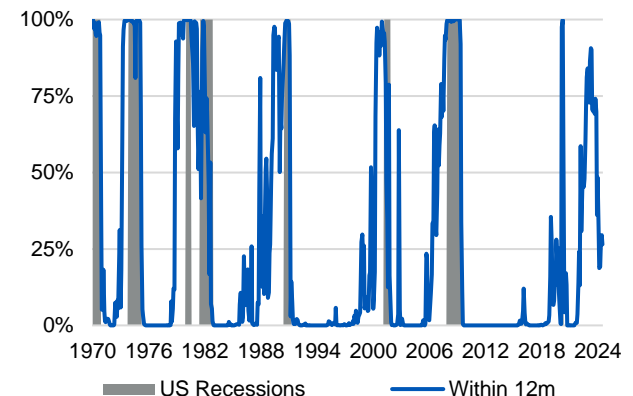
Price level: -2.0%

Figure 16: The US services business surveys “catch down” to the already weak manufacturing surveys



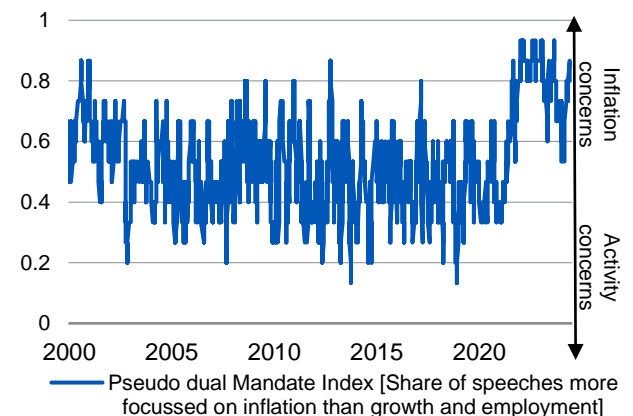
Sources: Haver, abrdn, September 2024

Figure 17: Our recession risk models increase in probability as weakness spreads across the economy



Sources: Haver, abrdn (September 2024)

Figure 18: Policymakers remain overly focussed on inflation worries and fall behind the curve



Sources: Haver, abrdn, September 2024



Inflationary Trump: 20%

Trump is elected and prioritises tariffs, immigration restrictions, and easier fiscal policy. This is a big inflationary shock, complicated by interference with the Fed.

There is considerable uncertainty about the policy agenda a second Trump term could pursue, turning on both the governing style of Trump and the composition of Congress.

In this scenario, the inflationary aspects of Trump's policy agenda take centre stage. This includes increasing tariffs on Chinese goods targeted during Trump's first term to 60%, and imposing tariffs on certain other countries with large surplus with the US. We also assume a large fall in immigration.

On fiscal policy, expiring personal tax cuts are extended along with additional tax cuts for higher earners, and a reduction in the corporate tax rate to 15%. There is a rollback of environmental regulation, and budget cuts for other regulatory agencies.

These policies represent a highly inflationary mix, pushing down on aggregate supply and up on demand. Inflation would be higher, while the net growth impacts are somewhat ambiguous.

Ordinarily, the Fed would tighten monetary policy in response to such a shock, but Trump may put political pressure on the Fed to avoid this.

The scenario is therefore likely to involve significant market volatility as investors struggle to price oftentimes contradictory aspects of the policy agenda. The risk premium across asset classes is likely to spike higher.

Waymarks

Trump imposes 60% tariffs on Chinese goods targeted in his first term, resulting in an effective average bilateral tariff on Chinese goods of 40% and selective tariffs on some other sectors and countries.

Comprehensive reform is passed to limit illegal and legal forms of immigration. Deportations increase.

There is a second major tax-cutting bill. Sunset clauses in TCJA are removed and the corporation tax is reduced to 15%. The deficit rises.

The economy is hit by a significant inflationary shock, while the impact on growth would depend on risk sentiment and the monetary policy response.

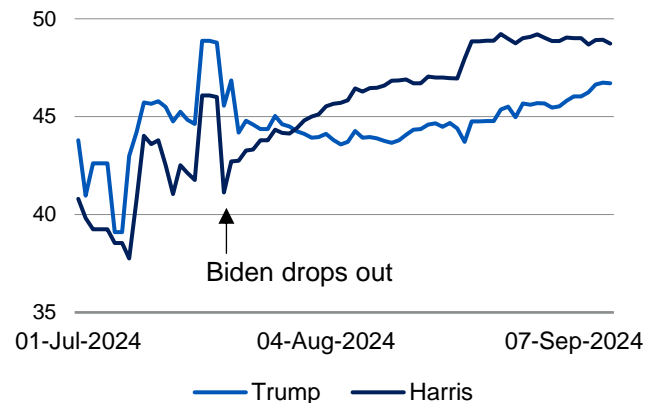
Trump attempts to pressure the Fed to not deliver the degree of monetary tightening that might be normally associated with this kind of shock.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: -0.5%

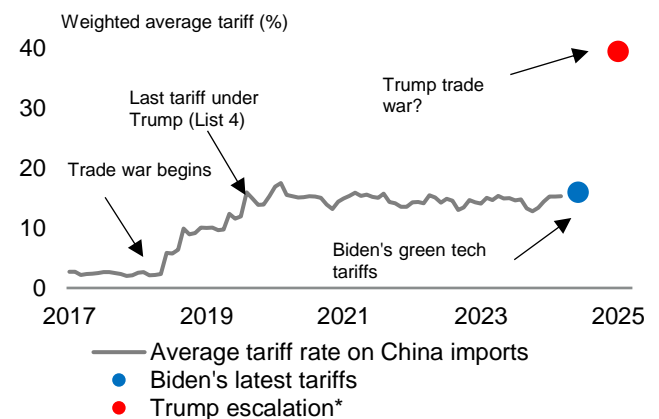
Price level: +2.5%

Figure 19: Trump wins the election, and alongside a Republican congress, pursues inflationary policies



Sources: Haver, abrdn, September 2024

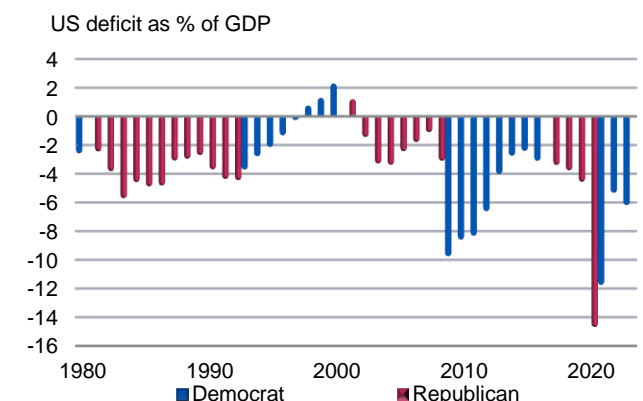
Figure 20: Tariffs on Chinese goods are increased with an average weighted tariff rate of around 40%



*Scenario assumes 60% tariffs applied to Lists 1-4

Sources: Haver, abrdn, September 2024

Figure 21: The already-large US fiscal deficit increases further, raising concerns about fiscal sustainability



Sources: Haver, abrdn, September 2024



Oil and shipping price surge: 10%

Conflict in the Middle East escalates, causing a surge in oil prices and disruption to global supply chains. Inflation jumps. Central banks start tightening policy again.

Escalation by Iran and proxies results in a more significant conflict across the whole Middle East, bringing Israel, Iran, and a variety of non-state actors into open and larger scale conflict. The US struggles to stay out of the conflict.

Shipping costs rise further, and global supply chains disruptions become more meaningful. Oil prices jump, with Brent prices well above \$100 per barrel.

This large increase in energy prices represents a significant negative supply shock to the global economy, pushing inflation higher and growth lower. This causes renewed downturns in the Eurozone and UK, while the US economy also weakens.

The recent experience of high inflation means that inflation expectations are less well anchored than normal, so central banks do not feel comfortable “looking through” this shock. Monetary policy is tightened despite the weaker growth environment and increased financial stress, which pushes down further on growth.

Waymarks

Direct confrontation between Israel and Iran intensifies and broadens. Attacks on shipping increase, with oil tankers and oil infrastructure becoming targets, including in the Indian Ocean. Attacks on US military assets and bases across Syria and Iraq intensify.

There is a significant increase in energy and maritime freight prices, with large spillovers to the global economy through higher inflation and lower growth. Shipping costs revisit pandemic-era highs, and oil prices increase well above \$100.

Inflation expectations start to move higher as households lose confidence in inflation returning to target.

Interest rate hiking cycles start again, with central banks needing to signal inflation credibility in response to higher inflation expectations. Longer maturity rates could settle higher if an increased inflation risk premia and higher policy rates dominate, or lower if weaker growth and flight to quality prove more important.

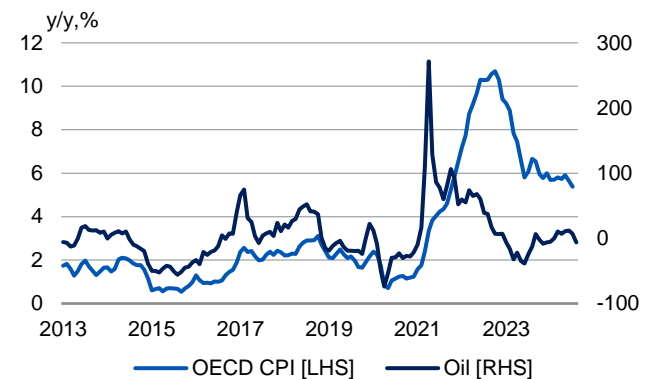
There is a pronounced fall in activity indicators in response to higher energy prices, tighter policy, and increased financial stress.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: -1.5%

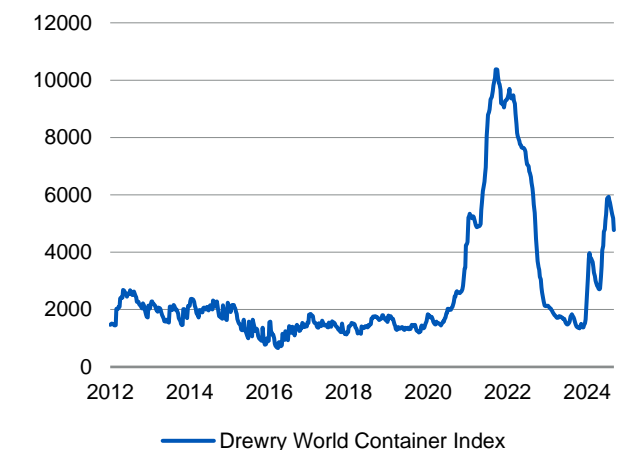
Price level: 3.0%

Figure 22: Headline and core inflation increase, which central banks are unable to “look through”



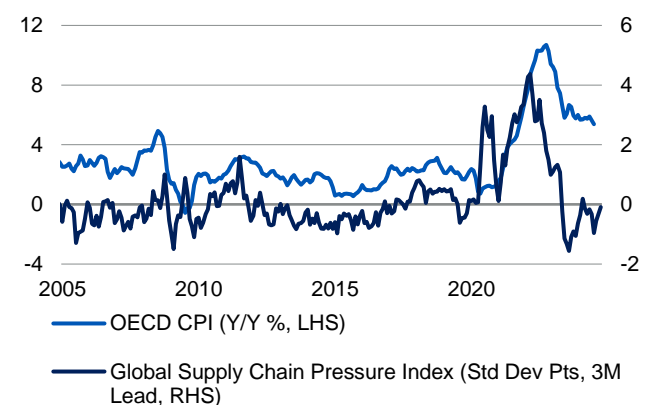
Sources: Haver, abrdn, September 2024

Figure 23: Global shipping container rates rise further alongside much higher oil prices



Sources: Haver, abrdn, September 2024

Figure 24: Supply chain disruptions increase back towards pandemic-era highs



Sources: Haver, abrdn, September 2024



Global supply side uplift: 10%

Robust supply growth means activity picks up without inflationary pressures. Central banks ease, but higher potential growth means higher equilibrium rates.

The global economy benefits from a positive supply-side boost, driven by a further rise in labour force participation, improved productivity, and a more efficient labour market. The productivity gains from AI are realised sooner and more comprehensively than in the base case. Meanwhile, recent global supply chain disruptions emanating from events in the Middle East fizzle out, and global shipping rates fall.

Stronger productivity growth means that the sustainable rate of wage growth increases, with subdued unit labour cost growth despite strong nominal earnings growth.

The Fed and other central banks slowly cut interest rates. However, stronger potential growth means that assessments of the equilibrium rate of interest are revised higher, limiting the extent of rate cuts and keeping longer maturity interest rates elevated.

Waymarks

US productivity growth remains very strong and this strength spreads globally, supported by elevated R&D spending and realising the gains from AI. Labour force participation moves higher, and the Beveridge curve remains around the pre-pandemic norm.

Wage growth remains resilient, but stronger productivity growth means this can be absorbed without inflationary increases in unit labour costs.

Activity growth remains above previous estimates of potential growth, but underlying inflation remains subdued. Robust labour income growth means consumption growth easily weathers the impact of depleted pandemic savings, while investment remains solid in anticipation of higher future productivity despite tight credit conditions.

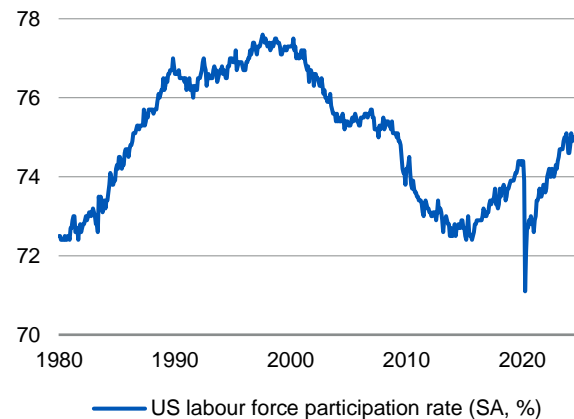
Policy makers become optimistic about the economy's new supply potential, and more confident that inflation can return to target while growth remains robust. Interest rates are cut only modestly, while the Fed's estimate of the long-run interest rate is revised higher. The market moves to price in a permanently higher rates structure.

Global economic forecasts relative to baseline, 2 years ahead:

Activity: 2.0%

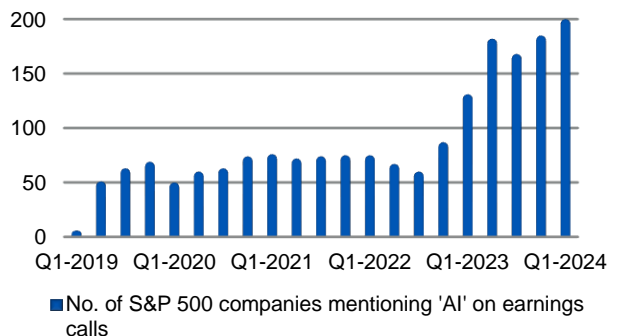
Price level: -1.0%

Figure 25: US labour force participation picks up further, boosted by strong wage



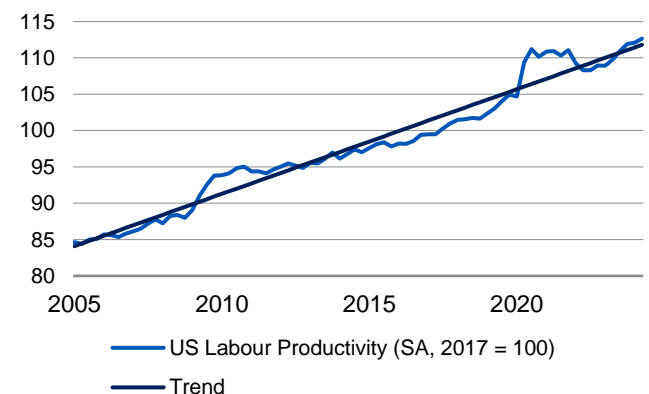
Sources: Haver, abrdn, September 2024

Figure 26: The roll-out of AI use case accelerates, delivering material productivity benefits



Sources: Factset, abrdn, September 2024

Figure 27: Productivity growth moves above its medium-term trend



Sources: Haver, abrdn, September 2024



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