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Economic Adviser

Macro Research

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Finanzgruppe

Contents

Foreword: Outlook for 2024 hardly upbeat – Hopes of inflation downturn and interest rate cuts

Analyst: Christian Lips, Chief Economist

Risks and stress factors to continue dampening global economic growth in 2024

As expected, 2023 saw a merely moderate pace of global economic growth. The diversity of stress factors, such as the war in Ukraine, geopolitical tensions and, at least in the first half of the year, extremely high inflation, left little possibility for a global economic growth figure above a range of 2.5 to 3.0 percent – a baseline scenario with which we started into the year.

The situation in the euro area remains particularly challenging from an economic point of view, mainly owing to the structural deterioration in energy prices compared to the period before the outbreak of the Ukraine conflict. Add to that the effects of more restrictive monetary policy. The interest rate turnaround made for significantly tighter financing conditions, and these are increasingly impacting the real economy, especially in interest-sensitive sectors such as that of construction.

The global economy will remain on a flat growth path in 2024 in as well. There is again a certain risk in Europe and Germany of a technical recession in winter and, despite a slight recovery over the course of the year, the growth rate in 2024 will likely be in the region of just 0.5 percent. After an unexpectedly strong performance over the past twelve months, we expect the US economy to cool in 2024. And in China, which in any case has to adjust to slower rates of growth, GDP expansion in the New Year (of the Dragon) will – despite monetary and fiscal stimuli – likely fall short of the 5-percent threshold. All things considered, we expect merely moderate global GDP growth of around 2.5 percent in 2024.

Inflation already defeated? Reshuffling of cards between hawks and doves in 2024

The recent sharp downtick in inflation has given rise to pronounced market expectations of interest rate cuts and, as a result thereof, triggered a rally in both the stock markets and bond markets. That said, the interest rate expectations for 2024 are in the meantime of a highly aggressive nature, so there is also a certain potential for disappointment. Experience from previous phases of high inflation shows that central banks ought not to make the mistake of prematurely stopping the fight against inflation and easing their monetary policy. At the current margin, too, there are upside risks to inflation owing to geopolitics or excessive wage increases, against which background it is understandable that the central banks are biding their time for the moment and not looking to initiate a turnaround from the interest rate turnaround straight away. However, there is also a risk that the central banks will be late again – as they were at the beginning of their tightening cycle. Nevertheless, it looks a virtual certainty that the major central banks will be cutting interest rates in the course of 2024.

Comeback of consumption – forecast uncertainty remains high

A lot of hope in 2024 rests on the comeback of consumption, seeing as real income will be picking up again in the wake of lower inflation. The degree of forecast uncertainty remains high, however. In particular the geopolitical situation is set to remain extremely fragile. That said, there is also the possibility of an excessively severe slowdown through the restrictive impact of monetary and fiscal policy. And we can all rest assured that the US presidential election (5th Nov.) will certainly not be a particular point of focus among the US voters alone!

We would like to thank you for the confidence you placed in us this year and wish you a good read and, above all, good ideas and suggestions from our annual Outlook issue, a Merry Christmas and a good start into to a healthy, successful and hopefully more peaceful year 2024!

Sincerely,

Your NORD/LB Research Team

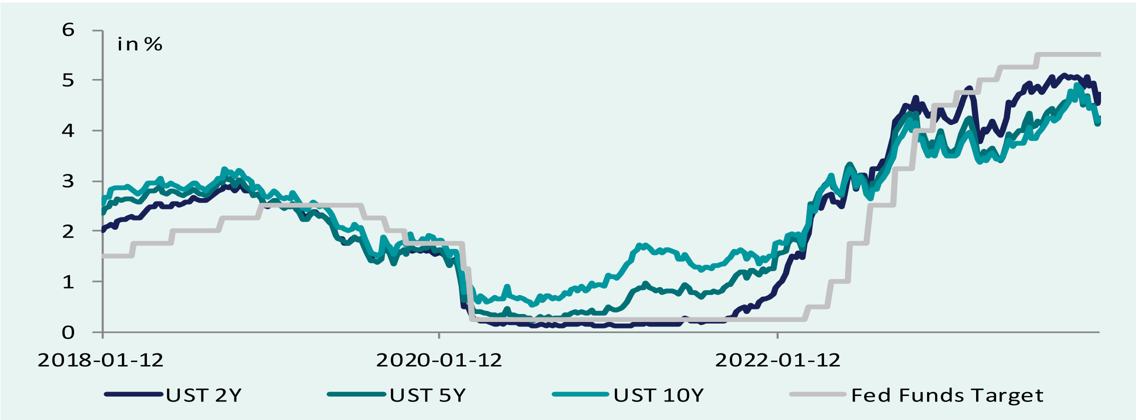
USA: A rather bleak outlook

Analysts: Tobias Basse // Constantin Lüer

A look back at really positive US economic data

The economy of the United States has given a remarkably robust showing to date in 2023. The rising interest rates – which could actually be expected to have a disruptive effect on the North American economy in various sectors – have until now had no such impact. Various indicators present an ongoingly positive picture of the economic situation in the United States, as reflected, for example, by the (still) preliminary data to the effect that the unemployment rate for November stands at just 3.7 percent; the US economy created 199,000 new jobs in the same month, with the health sector and government agencies accounting for a large proportion thereof. 150,000 of these new positions were generated in the private sector and a total of 49,000 in the public sector. This means that about 25 percent of the new jobs created in November were in state institutions – a fact that attracted critical comments from some observers shortly after the data were published. That said, it should be noted that the recent figures reported from the US labour market have clearly surprised the majority of forecasters on the upside. The same applies to the GDP data for Q3. Indeed, having been revised upwards, the annualized growth rate for this period now stands at a truly impressive level of 5.2 percent. Though the adjusted time series data for consumption are not quite as impressive as the original figures suggested, the fact is that the US economy is currently in really excellent shape. This situation will likely change in the months ahead, however. Indeed, we expect to see a marked slowdown in growth in the USA. In 2024 we can at any rate expect to be reading the "R word" a lot more frequently in America's business press!

Chart: Interest rate trend in the USA



Sources: Macrobond, NORD/LB Macro Research

A rather bleak outlook

It now certainly looks like the surge in interest rates in recent times is finally about to have consequences for the development of the US economy. Indeed, these negative effects are already quite clearly manifesting themselves in the country's real estate market. For example, the NAHB sentiment index, a really well-suited early warning indicator for the development of house prices in the USA, fell to just 34 points in November as month under review – thus sending out a clearly negative signal in terms of the situation in the US real estate market. The importance of this sector for the further development of the US economy is certainly not to be underestimated; in good times, construction companies are in a position to sustainably improve the employment situation in the land of unlimited opportunity. This supportive effect is becoming increasingly less evident. It goes without saying that the significant upward movement in interest rates is also negatively impacting other segments of the US economy. Private consumers are a case in point in this context, now seemingly "juggling" with their various credit cards in an effort to somehow make ends meet financially after the recent surge in inflation. Against this background, we expect to see a sustained deterioration in the economic situation in the United States in the very near term. Indeed, the scenario of a mild recession does not look unlikely as things currently stand. In this context, market participants will need to keep a very close eye on what the National Bureau of Economic Research has to say about the situation. As is known, this institution is responsible for the "proclamation" of recessions in the USA. The phenomenon of the technical recession could also become relevant – ultimately depending on whether GDP growth registers a black or a red zero in the first quarter of 2024.

Fed will likely prefer to hold back for the time being

In this rather challenging environment, however, we would nonetheless like to warn against expecting near-term interest rate cuts by the Fed. There is, for example, the fact that the acute manpower shortage in evidence in the U.S. economy ought to ensure that the situation in the labour market is not likely to remain protractedly unfavourable. In our view, therefore, the US central bankers will likely prefer to hold back for the time being, so cuts to the Fed funds target rate are probably not to reckoned with before the second half of 2024. Given the current inflationary environment, the FOMC would presumably not want to see the US interest rate levels falling too quickly. Nevertheless, the issue of interest rate cuts will certainly become an item on the agenda of the central bank in Washington in 2024. In this context, we would not want to overestimate the unexpectedly dovish signals sent out by the US monetary policymakers at the recent FOMC meeting – caution and moderation therefore remain called for. At first glance, this environment is rather unhelpful for the currency of the United States. The ECB must not be lost sight of either in this context, as the European central bankers, too, will likely find themselves under pressure to take action in 2024. Consequently, we expect little movement in the EUR/USD exchange rate. In this regard, it is important to note that the international financial markets are now pricing in quite ambitious expectations of interest rate cuts by the Fed. We expect a little more caution from the FOMC at this point. Despite that, we expect US capital market interest rates to fall significantly in the future. Indeed the downward movement can potentially be described as quite dynamic at times. A close eye will also need to be kept on the presidential election in the land of unlimited opportunity in this context; quite conceivable scenarios could well lead to significant turbulences, which in turn would certainly make for movement in the global stock market in particular.

Fundamental forecasts, USA

	2022	2023	2024
GDP	1.9	2.3	1.4
Private consumption	2.5	2.5	1.4
Govt. consumption	-0.9	1.5	0.5
Fixed investment	0.9	0.5	2.0
Exports	7.0	0.5	3.0
Imports	8.6	2.0	3.0
Inflation	8.0	4.1	2.8
Unemployment rate[1]	3.6	3.6	4.2
Budget balance[2]	-4.0	-5.9	-5.6
Current acct. balance[2]	-3.8	-3.3	-3.1

Change vs previous year as percentage; [1] as percentage of the labour force; [2] as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Quarterly forecasts, USA

	I/23	II/23	III/23	IV/23	I/24
GDP qoq ann.	7.0	2.1	5.2	-0.4	0.0
GDP yoy	1.7	2.4	3.0	2.2	1.6
Inflation yoy	5.8	4.0	3.5	3.1	3.1

Change as percentage

Sources: Feri, NORD/LB Macro Research

Interest and exchange rates, USA

	14.12.	3M	6M	12M
Fed funds target rate	5.50	5.50	5.50	5.00
3M rate	5.38	5.30	5.20	4.70
10Y Treasuries	3.92	4.10	3.90	3.50
Spread 10Y Bund	180	190	180	110
EUR in USD	1.10	1.08	1.08	1.09

Sources: Bloomberg, NORD/LB Macro Research

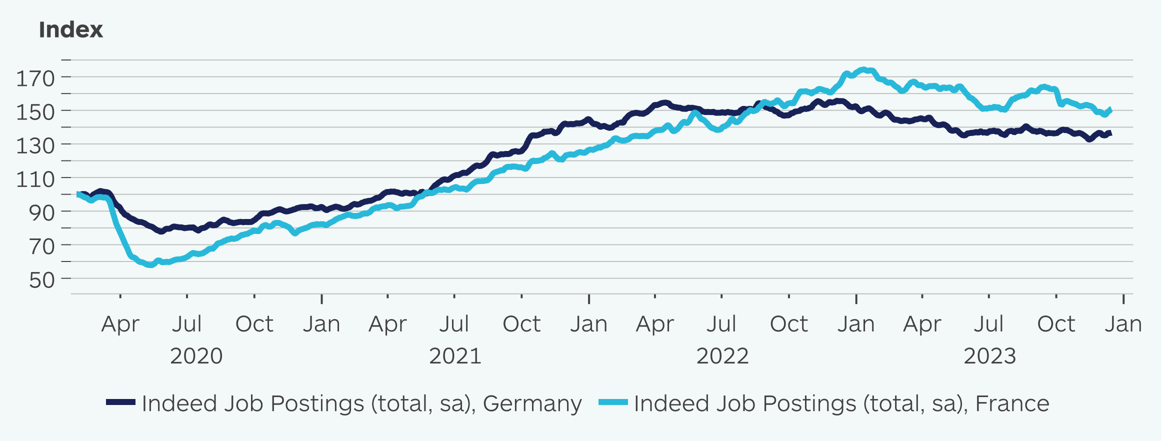
Euroland: Economic weakness and receding inflation pave the way for ECB rate cuts in 2024

Analysts: Christian Lips, Chief Economist // Christian Reuter

Energy price shock with continued impact, weak global economic environment

Economic growth in the eurozone slowed significantly over the course of the year. Q3 saw real seasonally adjusted GDP drop by 0.1 percent compared to the previous three months. The weakness is broad-based and by no means attributable to Germany alone. Of the five largest economies, only Italy and Spain registered positive growth (0.1 percent and 0.3 percent respectively). Spain is particularly less affected by the pronounced industrial recession exacerbated in Europe by the energy price shock. Even though the phase of acute energy shortages is over, the industrial sector is still in adjustment mode, as can be seen from the development of production output among energy-intensive industries. On the other hand, the rising long term government bond yields are increasingly becoming a focus of attention. Though output levels in the construction sector have held up unexpectedly well so far, there has been a dramatic downturn in incoming orders, so that further burdening factors are to be reckoned with in the coming year. Of late, the weakness has also spread to the service sector, which had until then been a pillar of the economy. This is likely attributable in part to the fact that the catch-up processes in the wake of the COVID crisis have largely come to an end and fewer orders are coming from industry.

Chart: Job postings according to Indeed



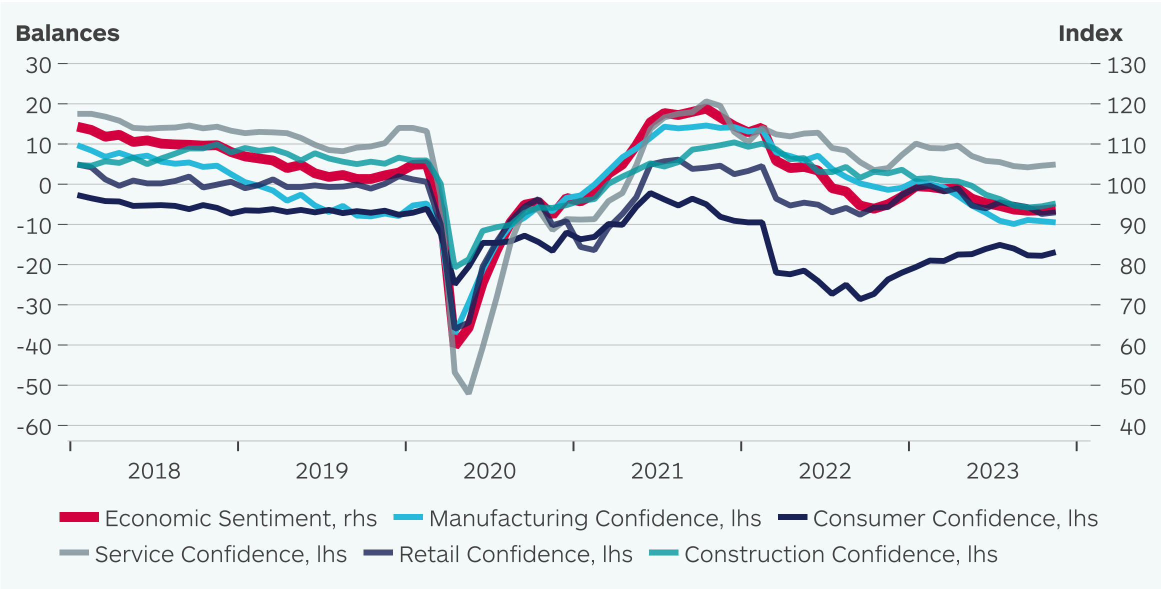
Sources: Macrobond, Indeed, NORD/LB Macro Research

Labour market hardly hit by the weak economy so far

The labour market has proven extremely robust in 2023, and is increasingly being shaped by demographic change. The lack of manpower is no longer evident among skilled workers alone; there are in the meantime frequently insufficient applicants for non-skilled jobs as well. At the latest when the COVID crisis ended, many companies made the experience that once employees have been laid off it is not easy or is more expensive to re-hire them.

Even with the economy currently in upward mode, therefore, companies are in the meantime exercising caution when making adjustments to their workforces. This is reflected in the fact that the unemployment figures have fallen more or less throughout Europe to date, despite the slowing in economic momentum that has been in progress for some time now. The unemployment rate in the eurozone has remained quite stable since March 2023, at a historic low of 6.5 percent. Nevertheless, there has been a slight downward trend of late, and the low point in this cycle might well have been reached. Anyway, the unemployment rate rose slightly in October in Germany, France and Italy, among others. Indeed, there are reports of layoffs in individual sectors, for example the construction industry. The number of job postings is also decreasing (see chart). Since we are not expecting a severe recession, the labour market ought to remain relatively robust as well, despite signs of a slight weakening. We anticipate no more than a minor increase in the average unemployment rate for the year.

Chart: Deterioration in business and consumer confidence



Sources: Macrobond, EU Commission, NORD/LB Macro Research

Outlook: Risk of a technical recession in the winter half-year, then gradual recovery

The economic sentiment indicator for the euro area climbed marginally in November, albeit from a low level. Germany, Italy and Spain once again registered slight downward movement, while the recent trend in business and consumer confidence in France and the Netherlands was more positive. Consumers, service providers, the construction industry and retailers were more optimistic, while the mood in industry deteriorated slightly. The expectations among financial market experts have brightened of late, due mainly to the hopes of falling interest rates.

A lot of hope for 2024 is being placed on private consumption. The robust labour market, together with the foreseeable nominal-wage increases and a further decline in inflation, will make for an upturn in real disposable income. This will create more leeway for consumers' spending and purchases, though consumer sentiment would have to improve even further as well.

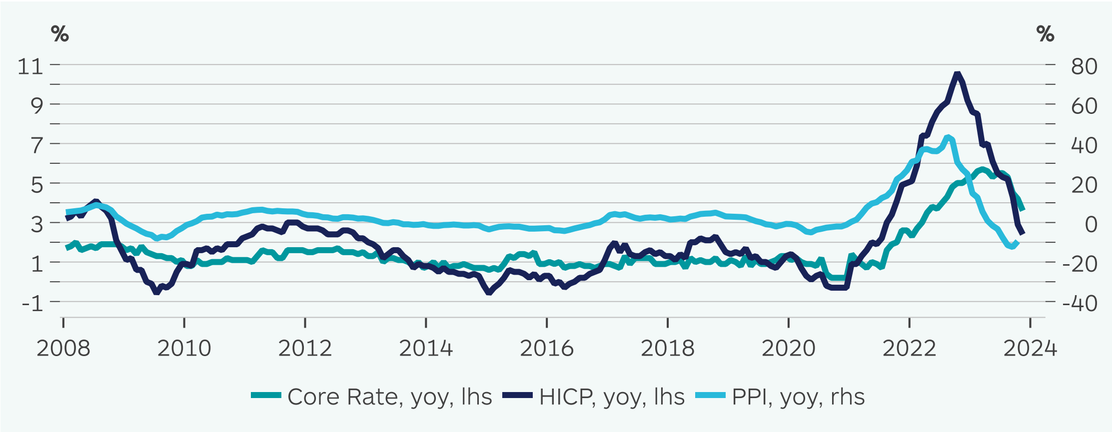
Nevertheless, considerable risks remain. The economy has yet to feel the full effect of the ECB's unprecedented tightening strategy. A period of weak economic momentum can be reckoned with for the time being, and GDP will again grow by just 0.5 percent, year on year, in 2024.

Inflation on the retreat, but not yet definitively defeated

Inflation in the eurozone has receded faster than expected over the course of the year, and surprised on the upside since September. Indeed, November saw the inflation rate fall to 2.4 percent yoy, due primarily to lower energy prices that were down by 11.5 percent in year-on-year comparison. The core rate fell to 3.6 percent yoy in the same period. Price developments at the upstream price levels are positive, as reflected, for example, in the fact that producer prices in the eurozone have fallen, year on year, since May 2023 and dropped by 9.4 percent in October.

Nevertheless, the inflation rate in the euro area is still above the ECB's tolerance threshold, especially since a slight rebound is to be expected in the short term due to base effects. Since the favourable base effects in the sphere of energy are gradually coming to an end and a further decline in energy prices is unlikely, inflation now increasingly needs to be reduced via the core rate. It is not least the developments in wages and salaries that are playing a key role in terms of this domestic price pressure. We do not expect to see a wage-price spiral, which could potentially reignite inflation. In 2024, too, however, the core rate will only decrease with a time lag as compared with overall inflation, and will thus remain above the ECB's inflation target for the time being.

Chart Strong disinflation trend of late

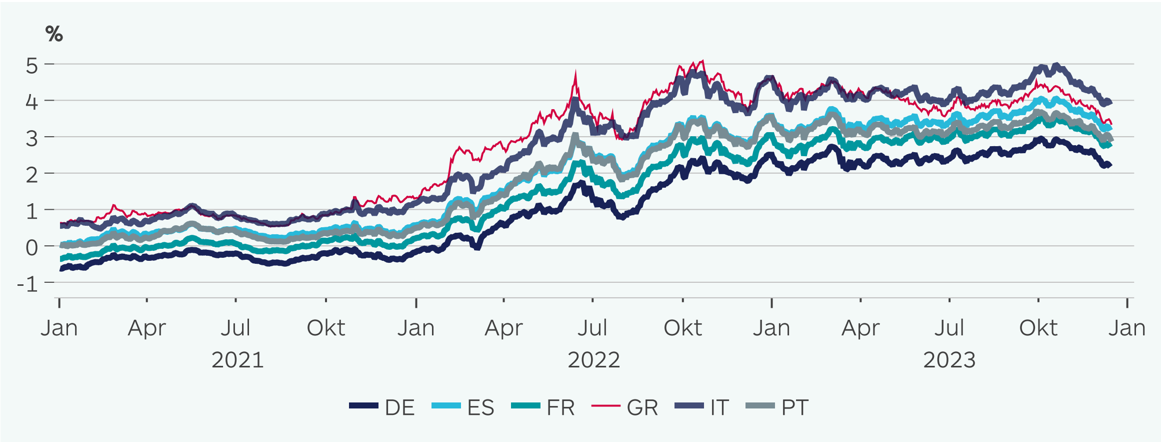


Sources: Macrobond, Eurostat, NORD/LB Macro Research

ECB: Rate tightening cycle ended, but respect for the "last mile" in the fight against inflation
October saw the European Central Bank (ECB) take a hiatus from interest rate adjustments after a series of ten consecutive hikes. The significant tightening of financing conditions is meanwhile slowing down the eurozone's economic momentum and played a role in curbing inflation. Given an in the meantime shrinking M3 money supply and a marked decline in credit dynamics, however, the question arises as to whether the ECB's monetary policy is now overly restrictive and whether easing it might be an appropriate move.
In terms of monetary policy, the trend in nominal wages in particular is still a double-edged sword, harbouring the possibility, for example, of inflation remaining at an elevated level for a longer period of time, especially in the service sector, due to excessive wage increases. The central bankers have a great deal of respect for the "last mile" in the fight against inflation. The expected temporary rebound in the inflation rate as well as the still unchecked upside risks to inflation due to geopolitical tensions provide the ECB with arguments for maintaining its rate-adjustment hiatus for at least a few more months.
Against this background, the ECB accordingly held its key rates unchanged at its last regular meeting in 2023. The key deposit facility rate thus remains at its record high of 4.00 percent. That the central bankers would vote to continue the rate-adjustment hiatus in December had been generally anticipated, so the focus was on the topics of macroeconomic projections, PEPP reinvestment policy and interest rate outlook.
With the presentation of its new projections in December, the ECB has moderately adjusted its expectations for the economy, but in some cases significantly downwards where inflation is concerned. Nevertheless, the new growth projections of 0.6 percent for 2023, 0.8 percent for 2024 and 1.5 percent for 2025 and 2026 are in our view still a bit too high. At the same time, inflation fell more sharply in the autumn than previously expected, as was also the case with the core rate. We can therefore expect to see the ECB adjusting its projections for the upcoming update in March as well. These could then definitively pave the way for an initial slight easing in the key interest rates.
At the same time, the Governing Council decided on a more rapid reduction of the PEPP bond portfolio, with tapering from mid-2024 by a monthly average of EUR 7.5bn. Reinvestments are to be completely discontinued from 2025 onwards. The clarification of this hitherto unresolved issue already in 2023 opens the door for rate cuts in the course of 2024. A later (restrictive) adjustment of the reinvestment policy during an ongoing rate-cuts cycle would have been difficult to communicate and justify. That

said, the reduction of the PEPP bond portfolio is intended as a normalizing rather than restrictive measure.

Chart: Long Term Government Bond Yields reflect growing rate-cut expectations in the euro area



Sources: Macrobond, NORD/LB Macro Research

Outlook: Interest rate cuts from spring onwards – capital market already pricing in massive rate cuts

The most recent trend in long term government bond yields reflects the expectations of near-term key-rate cuts. It should however be said that the markets' expectations for 2024 have in the meantime become rather bold, with, for example, rate cuts of a good 150 basis points in 2024 alone recently priced in on the money market – this would equate to at least six interest rate hikes of 25 basis points each. Overly aggressive rate-cut expectations bring with them the threat of financing conditions being eased too early and too far. This would jeopardize the prospects of success in the fight against inflation, which would then in turn mean that the expectations could not be met (a case of self-defeating prophecy).

Already now, the yield on 10-year Bunds has dropped from around 3.00 percent to just over 2.00 percent in the period between early October and mid-December. This is in our view quite exaggerated, just like bets on interest rate cuts already taking place in the first quarter. Together with the nearer-term reduction of the PEPP portfolio, this therefore makes for a certain potential for correction in the short term, especially since the next inflation data will likely also dampen the expectations somewhat as well.

ECB President Christine Lagarde dismisses market speculations on extremely near-term rate cuts. Indeed, a member of the ECB's Governing Council had recently referred to corresponding market expectations for Q1/2024 as "science fiction". Lagarde stressed that the central bankers had not discussed rate cuts at all at their meeting in December. The ECB rightly draws attention to ongoing upside risks, especially to domestic inflation, stressing the need to wait for the next rounds of wage negotiations before deciding on the further course of action. There will be more clarity in this context from the spring and, in the best-case scenario, the way would then be clear for an early easing of the ECB's restrictive monetary policy.

Having also learned from past experience, the ECB has no intention of announcing its success in the fight against inflation prematurely. Nevertheless, they could also slip behind the curve if they hesitate too long. That would not be the first time: the ECB was too late in starting its rate-hike cycle, and probably too late in taking its rate-hike hiatus, and could now also be too late in initiating its descent from the high-rate plateau. We expect a significant adjustment to the central bank's communication in March, and then the start of a moderate rate-cut cycle in June. However, the exact timing will very much depend on the relevant data.

In the absence of a recession, long term government bond yields (Bunds, 10Y) are unlikely to fall significantly below the mark of 2 percent over any great length of time since that would require significantly lower medium-term interest rate expectations. That said, larger movements are to be expected in 2024 at the short end of the yield curve, which means that the unnaturally long phase with an inverse yield structure will be coming to an end in 2024. Towards the turn of the year 2024/25 – and provided the economy picks up and deflationary tendencies fail to materialize – the long term government bond yields will likely trend slightly upwards again, also against the background of the ECB's continued reduction of its bond holdings.

Fundamental forecasts, Euroland

	2022	**2023**	**2024**
GDP	3.4	0.5	0.5
Private consumption	4.2	0.6	1.3
Govt. consumption	1.6	0.1	0.8
Fixed investment	2.8	0.7	-0.1
Net exports[1]	0.0	0.2	-0.3
Inflation	8.4	5.4	2.4
Unemployment rate[2]	6.7	6.6	6.8
Budget balance[3]	-3.6	-3.4	-2.7
Current account balance[3]	-0.6	1.7	1.5

Change vs previous year as percentage, [1] as contribution to GDP growth; [2] as percentage of the labour force; [3] as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Quarterly forecasts, Euroland

	I/23	**II/23**	**III/23**	**IV/23**	**I/24**
GDP sa qoq	0.1	0.1	-0.1	0.0	0.1
GDP sa yoy	1.3	0.6	0.0	0.1	0.2
Inflation yoy	8.0	6.2	5.0	2.8	2.5

Change as percentage

Sources: Feri, NORD/LB Macro Research

Interest rates, Euroland

	14.12.	**3M**	**6M**	**12M**
Repo rate ECB	4.50	4.50	4.25	3.25
3M rate	3.93	3.80	3.60	2.70
10Y Bund	2.12	2.20	2.10	2.40

Sources: Bloomberg, NORD/LB Macro Research

Germany: Stagnation at pre-pandemic level

Analysts: Christian Lips, Chief Economist // Valentin Jansen

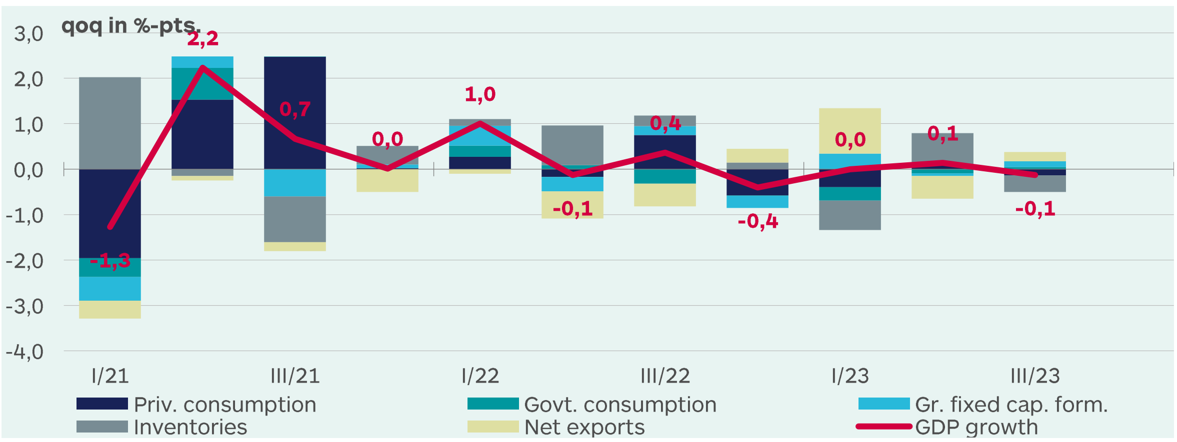
Crises and stress factors make for a downturn in economic output in 2023

The German economy is trapped in stagnation. 2023 had actually begun on a note of relief; the feared gas shortage had failed to materialize, what were for a while extremely high energy prices rapidly receded, as a result of which the massive inflationary pressure gradually subsided as well. Already early in the year, however, the air of relief gave way to one of disappointment in light of the economic developments. Although, according to current data, Germany narrowly avoided a technical recession in the last winter half-year, the country's economy has been more or less in a state of stagnation since Q1/2022 – and thus at pre-pandemic levels (see chart).

This also quickly explains one of the main reasons. Since the onset of the conflict in Ukraine, the German economy has been confronted with considerable burdening factors and the need for adjustments. This was only ostensibly a matter of scaling back dependencies on Russia, especially in the area of energy. The fundamentally changed geopolitical situation and growing tensions pose major challenges to a very open economy like that of Germany. The current weakness in world trade, which is due not only to cyclical causes, is having a very marked impact on foreign orders and exports, especially in Germany. Moreover, the structurally higher energy prices have made for pressure on the price competitiveness of companies in energy-intensive sectors of the economy. This is reflected in the fact that such companies are, as consequence, still finding themselves compelled to restrict their production significantly. Output in those sectors currently stands only slightly above 80 percent of the pre-conflict levels.

In the first three quarters of the year, for which data are currently available, real GDP contracted by 0.4 percent as against the same period last year. After the slight decline in economic output in the summer, we do not expect any recovery in the closing quarter either. On the contrary, the hard economic indicators available so far point to a stagnation or indeed a further downtick in real GDP in Q4, with the result that in 2023 as a whole, real GDP likely shrank by -0.4 percent, year on year. Our forecast at year-end 2022 of -0.3 percent has thus proved quite accurate. As expected, price-adjusted private consumption registered a particularly marked decline, with high inflation and recently growing economic concerns having substantially dampened the consumer climate. However, 2023 also saw a contraction in real terms of exports, imports and construction investments while, despite the switch to higher interest rates, companies unexpectedly upped their investments in plant and equipment.

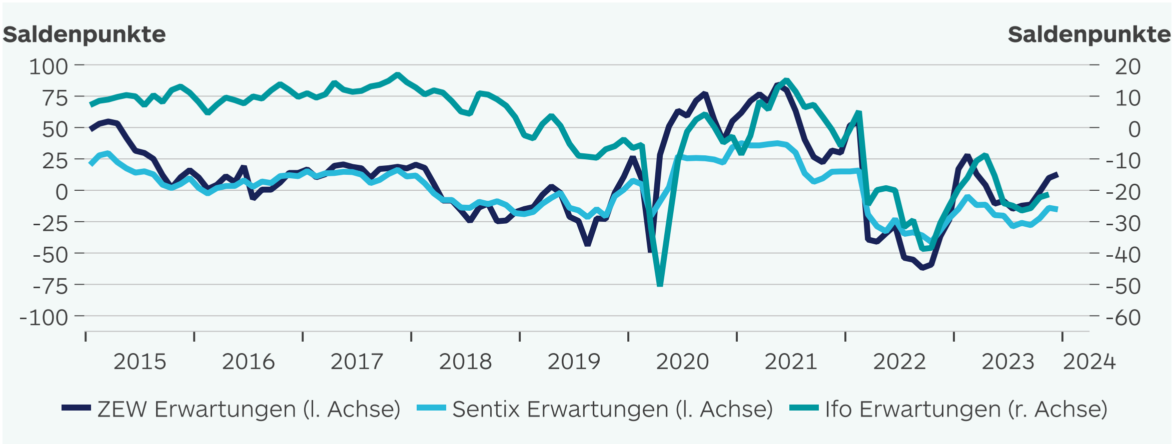
Chart: Contributions to real GDP growth



Sources: Feri, Destatis, NORD/LB Macro Research

Economic expectations depend primarily on hopes of near-term rate cuts
In the course of 2023, the mood among companies, financial market experts and consumers was massively influenced by the geopolitical developments, the rising interest rates, interim market turbulences and the inflation trend. The picture for the German economy had initially brightened at the start of 2023, with the easing in the energy markets being a particular source of relief after concerns as to a potential gas shortage in the winter had led to a considerably depressed mood. The Federal Government's relief packages undoubtedly contributed to stabilizing expectations in the meantime.
The survey results in the second half of the year point to a gradual economic bottoming out against the backdrop of steadily declining inflation and the end of the interest rate hiking cycle.
The ZEW economic expectations rose again slightly to a level of 12.8 balance points in December after having returned to positive territory in November for the first time since the May survey. The sentix economic index for Germany has improved three times in a row at the current margin, although the expectation component had slightly deteriorated in December.
The ifo Business Climate also underwent a trend reversal in October. With two consecutive increases, business sentiment also appears to be stabilizing, if at a low level. Nevertheless, the results so far point to persistently weak economic momentum. Along with the geopolitical risk situation, a particular close eye needs to be kept on budgetary developments in the months ahead. Most recently, the unexpectedly sharp drop in inflation and the associated hopes among many market participants of near-term interest rate cuts apparently overshadowed the risks to the economy and growth.

Chart: Economic expectations: Hopes of near-term interest rate cuts provided a boost of late



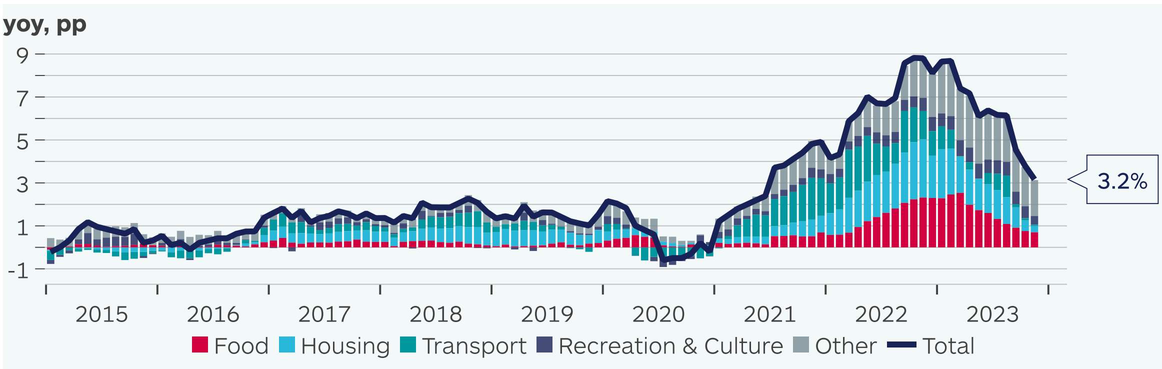
Sources: Macrobond, ZEW, sentix, ifo, NORD/LB Macro Research

Federal Constitutional Court's budget ruling with far-reaching consequences
The Federal Constitutional Court's ruling on 15 November put paid to parts of the government's previous budgetary planning and cancelled a volume of EUR 60 billion in unused loan authorizations off the Climate and Transformation Fund (KTF), which had been planned to comprise a total of EUR 211.8 billion over four years until 2027. The debt brake had been suspended in 2021 owing to the pandemic. By means of a second supplementary budget law for 2021, loan authorizations that had not yet been called up were to be transferred to what was then the Energy and Climate Fund (today's KTF). In the form of a special fund separate from the general budget, those resources were intended to be available for future budget years without being factored into the debt brake calculation.
The court ruling has strengthened the debt brake on several points. First, the Karlsruhe judges criticized the government's inadequate rationale as to how the COVID crisis as justification for taking out loans in what at the time was an emergency situation is related to the climate change mitigation investments within the framework of today's KTF. Second, the constitutional principles of "annuality" and "budget accuracy" specify that, loan authorizations created in emergency situations cannot simply be decoupled from the year in which the state of emergency was declared and transferred to other fiscal

years. And third, the transfer did not take place until February 2022 – i.e. retroactively – for the completed 2021 financial year, which violates the principle of prior approval.

Fiscal policy unintentionally restrictive – achieved compromise only of help in the short term
The German government has agreed short-term fiscal policy adjustments. For example, the supplementary budget provides for declaring an emergency situation once again for 2023 in order to attain a suspension of the constitutional debt limit. On the other hand, the debt brake is to be adhered to again for the 2024 budget. Negotiations have taken place on spending cuts, for example in the Climate and Transformation Fund, as well as a strengthening of the revenue side via higher CO_2 levies from 2024 onwards. The price signal is also intended to strengthen incentives for climate change mitigation investments, since on the other hand fewer incentives in the form of direct government funding and subsidies are now being set on the other side.
In the short term, the achieved budgetary compromise leads to a more pronounced contractive fiscal stimulus. In addition to unanswered questions, it also provides no answer as to how the necessary public investments and measures towards mobilizing private investments for climate change mitigation are to be financed in the medium term. As a result of this uncertainty, companies and consumers lose planning certainty, which tends to lead to a postponement of investments.
The constitutional debt rule in its current form has been tightened by the Federal Constitutional Court's ruling. However, this is not a rejection of meaningful adjustments that better take account of the strict investment and transformation requirements – without jeopardizing fiscal stability. The debt rule could be adjusted, for example, by privileging public investment expenditure or through a moderate raising of the annual structural borrowing limit (currently 0.35 percent of GDP at the federal level), e.g. analogous to European fiscal rules. Assuming nominal growth averaging 2.4 percent, the debt ratio would converge towards the mark of 42 percent of GDP over the long term, even if the structural borrowing limit were to be raised to 1.0 percent of GDP at the national level.
Be that as it may, there are no signs as yet of a broad political consensus that this requires – and the struggle for a reform of the European fiscal rules would in any case likely stand in the way of that. Until then, the restrictive fiscal stimulus ensuing from the budget adjustments and the lack of planning certainty for investments will dominate as a result of the budget judgement, with a correspondingly dampening effect on the already moderate economic momentum.

Chart: Inflation momentum (CPI) slowing faster than expected – rebound expected in December

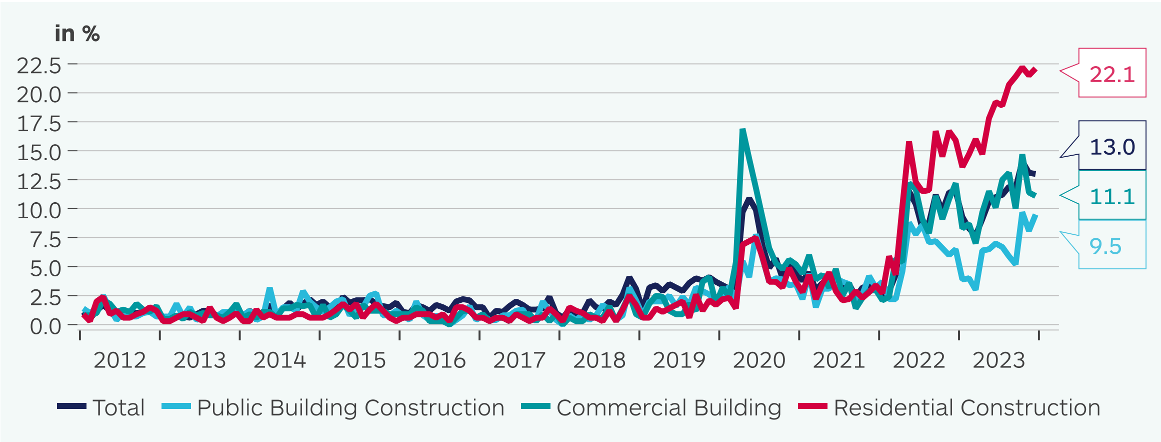


Sources: Macrobond, Destatis, NORD/LB Macro Research

Rapidly falling inflation – temporary rebound expected due to base effects
Inflation in Germany has receded significantly from the highs at year-end 2022. Especially since September, the disinflationary trend has been more pronounced than expected. By November, the inflation rate in the national consumer price index (CPI) had fallen to 3.2 percent yoy (see chart). Indeed, in the European harmonized consumer price index (HICP), the inflation rate actually fell from 3.0 percent yoy to just 2.3 percent yoy, and thus only marginally above the ECB's stability target.

This decline is largely attributable to favourable base effects, such as with food, the prices of which have increased by just 5.5 percent yoy of late. Energy prices fell by 4.5 percent year-on-year, but this was mainly due to the most recent downward movement in energy prices with, for example, the price of Brent crude falling by almost 9 percent in November as against October. The momentum of the core rate (ex food, energy, alcohol, tobacco), too, has slowed markedly, to a current level of 3.8 percent yoy. Base effects will likely make for a strong rebound in December, however, especially where Germany's inflation is concerned. At year-end 2022, the government's one-time payment of December's monthly gas and district heating bills had considerably reduced household energy costs.
In the new year, too, the rate of inflation rate will likely remain at a slightly elevated level for some time before receding further. On average for the year, we expect 2024 to see inflation slightly above the mark of 2 percent again. Given this background, it is still too early to give an all-clear in the fight against inflation. However, the decline in price pressure so far will likely help to get private consumption back on its feet in the coming year. Real wages already rose again in Q3/2023, by 0.6 percent yoy, since nominal wages developed more dynamically than the consumer prices. This trend will pick up momentum.

Chart: Rising interest rates cause wave of cancellations in the construction sector



Sources: Macrobond, ifo, NORD/LB Macro Research

Forecast 2024: We expect the German economy to remain trapped in stagnation for the time being

2023 was a year of weak economic momentum, and there are no signs of a tailwind for the coming months either. While sentiment indicators had registered a slight upward trend in recent months, this represents no more than a bottoming out so far. The uncertainties, burdens and stresses caused by geopolitics, high energy prices and the interest rate reversal are simply too substantial.
Thanks to lower inflation, the signs are that private consumption will pick up in the new year; on the other hand, we expect weak growth on the investment front. Monetary and fiscal policy will have a restrictive effect in 2024, in particular the long-term implications of the Federal Constitutional Court's ruling are not yet foreseeable – an additional source of uncertainty for companies and a factor that will weigh on the investment and consumption climate. Construction investment will likely decline further, owing to the prevailing restrictive monetary policy. Companies in the sector are finding themselves confronted with a veritable wave of cancellations, especially in housing construction (see chart). Almost every second construction business is currently complaining of a lack of new orders. Against this background, our GDP forecast for Germany of 0.3 percent for 2024 is correspondingly cautious. We expect the labour market to cloud a bit further but, given structural manpower bottlenecks, unemployment will likely rise merely slightly and only temporarily. On a slightly more positive note, we expect to see signs of a gradual easing in terms of monetary policy and interest rate levels in the course of 2024 (see the Euroland analysis).

Fundamental forecasts, Germany

	2022	2023	2024
GDP	1.8	-0.4	0.3
Private consumption	3.9	-1.1	1.6
Govt. consumption	1.5	-2.2	0.3
Fixed investment	0.1	0.9	-0.7
Exports	3.3	-1.4	1.2
Imports	6.6	-2.5	2.0
Net exports[1]	-1.2	0.4	-0.3
Inflation[2]	8.7	6.0	2.6
Unemployment rate[3]	5.3	5.7	6.0
Budget balance[4]	-2.5	-2.2	-1.3
Current account balance[4]	4.4	6.8	6.6

Change vs previous year as percentage, [1]as contribution to GDP growth; [2]HICP; [3]as percentage of the civil labour force (Federal Employment Office definition); [4] as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Quarterly forecasts, Germany

	I/23	II/23	III/23	IV/23	I/24
GDP sa qoq	0.0	0.1	-0.1	-0.1	0.1
GDP nsa yoy	0.2	-0.4	-0.8	-0.5	-0.7
Inflation yoy	8.7	6.9	5.7	3.0	3.3

Change as percentage

Sources: Feri, NORD/LB Macro Research

Switzerland: Inflation in check, SNB acts with a steady hand

Analysts: Christian Reuter // Christian Lips, Chief Economist

Slowdown on the consumer front – cooling in growth continues

The Swiss economy has cooled appreciably in the course of 2023. Q3 saw GDP – adjusted for major sporting events – grow by +0.3 percent, quarter on quarter, after a slight qoq decline of -0.1 percent in the summer. The challenging international environment is having a marked impact on the industrial sector in particular, with less new orders coming in and the order backlog shrinking. The service sector, on the other hand, once again played a supportive role, though the post-COVID boom in the hospitality industry has now finally come to an end.

Up to now, the hopes for a revival of the economy rested on the consumers. However, consumer sentiment has deteriorated unexpectedly sharply of late. The KOF economic barometer fell from -27 to -40 points, which is slightly lower than at the outbreak of the COVID crisis, but still above the "absolute" historic low of -47 points a year ago. Consumers are again more pessimistic about the economy's development; what is particularly striking is the fact that they rate their personal financial situation as getting progressively worse. This could well be due to the fact that they have been compensating for real wage losses for some time by tapping into their savings. The coming year will also see them faced with rising health insurance contributions and rents, as well as higher expenses for electricity. Despite a fairly robust labour market, wages have been unable to keep up with inflation, and no real advances are to be reckoned with in this context until the course of 2024. When that happens, we can expect to see not only the foreign trade environment improve again, but also the lower inflation rates making for an upturn in real incomes, in addition to which positive stimuli can likely be expected from investments in plant and equipment again.

Switzerland has, via immigration, benefited for several years from an expansion of its potential in terms of output – a trend that has continued in 2023. There were apparently no difficulties in integrating the newcomers into the labour market. At any rate, registered unemployment rose just slightly from 1.9 to 2.1 percent in November.

Overall, we expect the Swiss economy to remain sluggish in 2024. Widely followed leading and sentiment indicators, such as the KOF business barometer or the industry PMI, suggest a weak start into the year.

Inflation remains under control

November 2023 saw the rate of inflation fall unexpectedly sharply again, from 1.7 to 1.4 percent yoy – the lowest level in two years. The core rate (excluding fresh produce, seasonal items, energy and fuels) likewise dropped again, to 1.4 percent yoy. There was also a downward trend in the prices in the hotel sector and of package holidays, and particularly so as regards fuels and heating oil. Rent prices, on the other hand, continued to rise. The latter is attributable to the fact that in Switzerland, a mortgage reference rate is incorporated into the rent index collected nationwide, which – due to increased long term government bond yields – was raised in June 2023; a further increase is scheduled for the beginning of 2024. Moreover, the electricity prices and VAT are set to rise in January. On average across all households, electricity will be 18 percent more expensive. Due to the base effect, these increases will stretch throughout the entire year. We expect the inflation rate to initially rise above the 2-percent mark in early 2024, and later fluctuate around a level of 1.8 percent yoy.

SNB restores its steady-hand policy, no interest rate changes for the time being

The Swiss National Bank (SNB) last raised the key rate in June, to 1.75 percent, leaving it unchanged since then. The central bankers have gradually lowered their conditional inflation forecast over the course of the year, and have in fact seen inflation back inside their targeted corridor of 0 to 2 percent yoy since June and likewise the core rate since as far back as May 2023.

That said, the SNB is clearly having difficulty defending its strict course of action. The central bankers are particularly concerned about the effects of the price increases set to take effect at the beginning of 2024, against which background a near-term interest rate cut is hardly likely. The downside cyclical risks for Switzerland, too, have grown, however. There will leeway for moderate key-rate cuts from mid-year onwards.

As in the past, the SNB can and will intervene on the forex market to neutralize unwanted exchange rate developments that could potentially have a destabilizing impact on the Swiss economy. When announcing their last interest rate decision on 14 December, the central bankers gave no indication as to the direction in which this is to go. Foreign exchange sales had been in the foreground up to now, by which means the SNB aimed not only to normalize its balance sheet but also to prevent a depreciation of the franc and an import of inflation. The latter is increasingly losing importance, especially since the Swiss franc has already appreciated significantly and is now having an almost excessively disinflationary effect. Against this backdrop, the SNB will also have to take account of the trend in interest rate differentials, in particular with regard to the euro area, when calibrating its interest rate and foreign exchange policy in 2024.

Fundamental forecasts*, Switzerland

	2022	2023	2024
GDP	2.4	1.2	1.0
Inflation (CPI)	2.8	2.1	1.8
Unemployment rate[1]	2.2	2.0	2.2
Budget balance[2]	1.2	0.4	0.6
Current account balance[2]	9.7	9.0	8.6

Interest and exchange rates, Switzerland

	14.12.	3M	6M	12M
SNB policy rate	1.75	1.75	1.50	1.00
3M rate	1.68	1.60	1.40	0.90
10Y	0.62	0.60	0.60	0.80
Spread 10Y Bund	-150	-160	-150	-160
EUR in CHF	0.95	0.96	0.96	0.97

* Change vs previous year as percentage; [1] as percentage of the labour force, [2] as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Japan: The new BoJ governor will have to take action

Analysts: Tobias Basse // Bernd Krampen

Inflation will put pressure on the central bank to take action

As opposed to many other countries, Japan has not had any really big inflation problem to contend with in recent times. That said, the wind is now slowly changing direction, so to speak; this current development will likely "blow away" the deflation concerns among the economic policymakers in Tokyo. Long considered unattainable, the Bank of Japan's inflation target is suddenly no longer any great problem. However, the yen's devaluation tendencies, which have of course played a significant role in this development, are now causing certain concerns. This is especially the case in the Japanese Ministry of Finance, where it is feared that the weakness of the domestic currency could negatively impact private household consumption. These concerns are by no means unfounded. The central bankers in Tokyo are now under growing pressure to take action.

Japan: The new BoJ governor will have to take action

The new BoJ governor, Kazuo Ueda, will therefore have to make a move. The Bank of Japan has already made significant operational adjustments to the *mode d'emploi* of its yield curve control strategy. The central bank's once extremely direct control of capital market rates has thus been increasingly flexibilized. The "allowed" fluctuation range around the yields on 10-year Japanese government bonds has, figuratively speaking, turned what was formerly an anchor chain into just a fairly stretchable rubber band. This, consequently, made for rising capital market rates in the Land of the Rising Sun. These recent developments come as no great surprise. In the course of 2024, however, the central bankers will have to undertake increases to the "traditional" policy interest rate. In the absence of any major inflation shock, however, the BoJ would be well advised to try and wait for the review of its monetary policy strategy to be completed before implementing corresponding monetary policy measures. No later than summer 2024, however, there will need to be highly intensive discussions on higher key rates!

Yen's weakness ought to subside in the near term

This means that once again, the central bank in Tokyo is not marching in lockstep with monetary policy makers in other major currency areas. The prospective hikes of the traditional policy rate by the Bank of Japan ought – even if the central bankers will likely only be looking to act with extreme caution – to be of help to the yen. Against this background, we expect the weakness of the Japanese currency to now slowly subside. A look at the respective chart already provides initial indications in this direction. That said, it would be overly optimistic to already have hopes of a really sustainably strong yen.

Fundamental forecasts*, Japan

	2022	2023	2024
GDP	1.0	2.0	0.9
Inflation	2.5	3.3	2.1
Unemployment rate[1]	2.6	2.6	2.5
Budget balance[2]	-5.8	-5.6	-4.1
Current account bal.[2]	1.8	3.2	3.4

* Change vs previous year as percentage;

[1] as percentage of the labour force; [2] as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, Japan

	14.12.	3M	6M	12M
Key rate	-0.10	-0.10	0.00	0.10
3M rate	0.08	0.05	0.10	0.20
10Y	0.66	0.80	1.00	1.10
Spread 10Y Bund	-145	-140	-110	-130
EUR in JPY	156	151	146	140
USD in JPY	142	140	135	128

China: Stabilization in 2024 likely to remain turbulent

Analyst: Valentin Jansen

Economic problems cast long shadows

The end of Beijing's zero-COVID strategy had raised expectations of a lively recovery of the Chinese economy in the first half of 2023 which would also hold out the prospect of a global economic boost. However, those hopes were quickly dashed by the smouldering problems on the real estate market, weakening consumption, and clear warning signs from the industrial sector. This is reflected in the Caixin Manufacturing PMI, a key sentiment indicator for the Chinese industry, which has been fluctuating around the expansion threshold of 50 points for months now. Subdued foreign demand is another brake on output and exports, and this in turn is having an impact on the employment situation. At a record 21.3 percent, the youth unemployment rate was particularly alarming in June, since which time the National Bureau of Statistics (NBS) has provided no further data in this context. And other specific problems continue to play a role in the overall situation. The crisis in the real estate market is certainly not helping to replace demand from abroad – as hoped for by the government in Beijing – with domestic consumption. On a positive note, November's summit in the USA at least made for fresh impetus amid the highly strained relations between Washington and Beijing. Despite low expectations, the mutual will to improve trade relations was unambiguously formulated. This message was also communicated in the recent talks between Australia and China. A displeasing trend for the Chinese economy: after the experiences from the COVID crisis, a steadily growing number of North American and European companies appear to looking for additional business partners outside of China.

Fiscal and monetary stimuli primarily become apparent in 2024

Beijing's intervention at both the fiscal and monetary levels is primarily aimed at bolstering the construction sector and ultimately regaining stability. China's weakening domestic consumption would likewise benefit from this. The effectiveness of the latest stimulus measures – including an additional fiscal deficit of one trillion yuan, interest rate cuts and reductions in the minimum reserve rates by the PBOC – will probably not fully show until next year, owing to the customary time-lag before such measures fully kick in; readjustments are by no means ruled out!

China's stabilization and rate cuts in the USA ought to help the renminbi in 2024

Weak economic activity does at least make for low inflation or, in some cases, deflation (CPI October level: -0.2 percent yoy), but this may change with the prospects of success of the recent stimulus measures. The renminbi came under significant pressure in 2023; in July, moreover, there was an unexpected change at the helm of the PBOC. Before the new governor's appointment, the CNY fell against the USD as result of weak economic news; afterwards, China's lead currency fluctuated around the mark of CNY 7.30/USD for months. A gradual stabilization of the Chinese economy and the prospects of near-term rate cuts in the US and Europe ought to keep the CNY above the level of 7.00 in 2024.

Fundamental forecasts*, China

	2022	2023	2024
GDP	3.0	5.2	4.5
Inflation	1.9	0.4	1.4
Unemployment rate[1]	5.2	5.2	5.0
Budget balance[2]	-7.5	-5.0	-4.5
Current account bal.[2]	2.2	1.5	1.2

* Change vs previous year as percentage

[1] as percentage of the labour force; [2] as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, China

	14.12.	3M	6M	12M
Deposit rate	1.50	1.50	1.50	1.50
3M SHIBOR	2.60	2.25	2.25	2.25
10Y	2.65	2.65	2.65	2.65
Spread 10Y Bund	53	45	55	25
EUR in CNY	7.82	7.72	7.67	7.68
USD in CNY	7.11	7.15	7.10	7.05

Britain: Economy to get away with just a graze?

Analyst: Constantin Lüer

2023 was a mixed bag

From an economic perspective, the past year has been a mixed bag of ups and downs for the United Kingdom. The Bank of England's Bank rate – the key interest rate in the UK – was a particularly active example in terms of upward movement. Over the course of the year it was hiked five times, rising in total by 175 basis points from 3.5 to 5.25 percent. The unemployment rate has likewise risen significantly in the course of the year, now standing above the 4-percent mark. On the positive side, the most recent data available for October as month under review indicate that the inflation rate now stands at just 4.6 percent, having literally nosedived from well above 10 percent. From a mechanistic perspective, this development is particularly attributable to the high interest rates. That said, this is also having a marked impact on GDP, which, in quarter-on-quarter terms, is virtually stagnating around the 0-percent mark. The unemployment rate is at a slightly higher level compared to other countries, with the prospect that even more people could lose their jobs. Foreign trade is stagnating, too, though this could be an aftermath of Brexit. With all this in mind, the Bank of England's Monetary Policy Committee (MPC) held the Bank rate unchanged at 5.25 percent at its last meeting in December. A further key-rate hike would have proved simply too much for the UK economy.

No change of course yet at the Bank of England

That was the reasoning behind the MPC's decision to make this non-move. The way in which the votes were cast was identical to that of the previous meeting, with six members in favour of holding the Bank rate unchanged and three – namely Catherine Mann, Megan Greene and Jonathan Haskel – again voting for a further increase of 25 basis points to 5.5 percent. The credo that price stability has top priority, under which the Bank rate is adjusted, appears to be somewhat more pronounced among the aforementioned three MPC members, seeing as its level is still high. A really sound sense of proportion is a crucial necessity in this situation.

Britain is treading a fine line

A slight recession is the more likely scenario for the UK economy at the moment. However, the forecasts go as far as to suggest that inflation will already have reached the 2-percent range as early as Q2/2024. Should the disinflation trend continue to chime with the strategy pursued by the MPC, therefore, this could potentially open a door for Bank-rate cuts. According to the MPC's projections, however, this will probably play no role before Q3/2024. Nonetheless, the committee is indicating gradual adjustments towards a target rate of 4.25 percent by year-end 2026. The UK economy has a long road ahead of it. Time will tell whether the United Kingdom will suffer a mild recession or get away with just a graze again.

Fundamental forecasts*, Britain

	2022	2023	2024
GDP	4.3	0.4	0.4
Inflation (CPI)	9.1	7.4	3.1
Unemployment rate[1]	3.7	4.1	4.7
Budget balance[2]	-4.6	-4.9	-3.5
Current account bal.[2]	-3.2	-3.3	-3.0

* Change vs previous year as percentage

[1] as percentage of the labour force as per ILO concept

[2] as percentage of GDP

Sources: Feri. Bloomberg. NORD/LB Macro Research

Interest and exchange rates, Britain

	14.12.	3M	6M	12M
Repo rate	5.25	5.25	5.25	5.00
3M rate	5.33	5.40	5.40	5.15
10Y	3.79	4.20	4.20	3.90
Spread 10Y Bund	167	200	210	150
EUR in GBP	0.86	0.87	0.88	0.88
GBP in USD	1.28	1.24	1.23	1.24

Australia: 2024 set to be a challenging year

Analysts: Constantin Lüer // Tobias Basse

Robust growth despite high interest rates – rate peak in sight

Despite high key interest rates, economic growth in Australia has been fairly robust, recording positive qoq growth rates in all four quarters of 2023. However, the trend reversal in momentum will likely become apparent in Q4 2023, against which background the GDP growth rate will likely be lower than in Q3, though still well inside the positive zone. Despite high key interest rates, Australia is a good bit away from every policymaker's nightmare, namely recession – which remains unlikely for the time being, and the fact that the outlook for 2024 is in part less favourable has no effect on this.

The eight key-rate hikes in 2022 – starting out from a level of 0.1 percent – were followed in 2023 by five further increases, after which the cash target rate currently stands at 4.35 percent. While the rate hikes were initially relatively substantial, the most recent increases were of a considerably lower magnitude, none of which exceeded 0.25 percent. Indeed, the ascent to the rate peak has recently been peppered with several breathers, so to speak.

Inflation persistent but in downward mode

2023 started with the peak of the inflation cycle, at a level of 8.3 percent, and will probably close at around 4.5 percent. An average annual inflation rate of 3.5 percent is forecast for 2024, which means that, for the time being, inflation will remain higher than what the RBA has in mind. The inflation target in Australia is defined in such a way that the rate of price increase should be between 2-3 percent, which gives it considerably more leeway than, for example, in the eurozone. Be that as it may, the goal of price stability according to Australian interpretation and definition may already be achieved again in the first half of 2024, likely without the necessity of a further key-rate hike. Australia, too, will then likely see interest rates having peaked. It goes without saying that inflation is not the only driving force behind interest rate decisions; it is the overall economic situation that matters!

Risks and opportunities for the Australian economy

The economy will continue to cool somewhat, as reflected in the employment figures. The labour market weakened somewhat in the run-up to year-end 2023, and the unemployment rate rose by 0.1-0.2 percentage points. Demand for employees has fallen even further, which will likely be reflected in higher unemployment figures at the beginning of next year. Positive effects on general demand can in turn be generated by the recently increased immigration rate, all in all balancing out the ups and downs of the economic cycle. The recent rapprochement with key trading partner China will also help improve the general framework conditions Down Under!

Fundamental forecasts*, Australia

	2022	2023	2024
GDP	3.8	1.8	1.5
Inflation	6.6	5.7	3.5
Unemployment rate[1]	3.7	3.7	4.2
Budget balance[2]	-1.8	0.5	-0.6
Current account bal.[2]	1.1	1.1	0.5

*Change versus previous year as percentage;

[1] as percentage of the labour force; [2] as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, Australia

	14.12.	3M	6M	12M
Cash target rate	4.35	4.35	4.20	4.20
3M rate	4.35	4.40	4.25	4.25
10Y	4.10	4.40	4.25	4.00
Spread 10Y Bund	199	220	215	160
EUR in AUD	1.64	1.64	1.59	1.54
USD in AUD	0.67	0.66	0.68	0.70

Stock markets: 2023 an unexpectedly positive stock market year – moderately positive development expected in 2024 as well

Analyst: Wolfgang Donie

2023 – Expected interest rate turnaround the main driver of an unexpectedly positive development

Despite the ongoing economic slowdown, the international stock markets have performed very solidly overall in 2023. The first quarter of the year initially saw a strong upward trend among the indices, especially in Germany and Europe. The reasons for this lay in the non-occurrence of horror scenarios for the past winter, such as, for instance, the feared gas shortage, and the about-face in China's COVID policy. In the second half of the quarter, however, the turbulence among US banks made for a correction. In Q2, the indices continued their upward movement in the wake of the companies having exceeded market expectations with their business figures for the first quarter, falling energy prices making for relief, and inflation having peaked on both sides of the Atlantic. The third quarter started on a note of hope, too, with company profits for Q2 once again outpacing market expectations. The DAX hit a new all-time high in late July. From then on, the markets in both Europe and the US entered a period of weakness that lasted through to late October, making for price losses in excess of 10 percent. The main reason here lay in the fears that the central banks' restrictive monetary policy could overly slow the economy. With the downward trend in inflation having surpassed market expectations of late, there has also been a turnaround in the assessment of future monetary policy. Some market participants are expecting the first rate cuts on the part of the central banks as early as March next year. Even though this expectation is likely very optimistic, the major indices have completely recovered their losses in November and the DAX actually hit several further all-time highs in early December, which means that it is currently in unchartered territory. Indeed, this trend could even continue within the context of the year-end rally. This environment prompts us to consider a further testing of the 17,000-point mark on the DAX as possible, with the index already having briefly surpassed that threshold on Thursday, 14 December. Our year-end forecast for the DAX this year accordingly stands at 17,000 points, and for the S&P500 at 4,600 points.

Outlook for 2024: Moderate stock market upturn

Diverse risks make forecasting developments for 2024 a highly challenging task as well. The news reports are dominated by a multitude of geopolitical conflicts, for example the hostilities in Ukraine or in Israel/Gaza, or the tensions between Beijing and Taiwan. The strained global situation is compounded by tense trade relations, especially between the USA and China, the budget crisis in Germany, which could potentially escalate into a government crisis, or the presidential election in the USA, where Donald Trump intends to run again. A cold winter could also raise fears of a gas shortage, and there is also the fact that the future monetary policy stance of the major central banks is anything but clear. Nevertheless, we expect a constructive, moderately upward development of the European and American stock markets for 2024 as a whole. Our forecasts for the DAX and the S&P500 stand at 17,500 and 4.750 points respectively by the end of the year. That said, a correction is likely to occur in the first quarter of 2024 if it should turn out that the currently highly optimistic expectations of interest rate cuts will have been somewhat exaggerated after all. Against such a background, there can be a very real possibility of seeing the DAX back at the 16,000-points mark again. Be that as it may, the first rate cuts later in the year will likely increase the attractiveness of the stock markets, and the large companies can then be expected to justify upward movement in share prices by registering moderate earnings growth.

Crude oil: OPEC+ vs. (geo)politics and weak demand

Analyst: Thomas Wybierek

Oil price surge and correction influenced by geopolitics

There was a high degree of volatility in oil prices in 2023. The opening quarter saw initial fluctuation around a level of USD 85/b, followed by a rather weak showing in Q2 before the price of North Sea Brent moved towards the mark of USD 100/b in Q3/2023. There were a number of reasons for this surge. On the one hand, Saudi Arabia voluntarily reduced its oil production by 1 million barrels from July, and Russia cut its oil exports in the summer by 500,000 b/d, which tightened supply. On the other hand, market participants still reported open short positions that had to be covered. The important US economy proved more robust than expected, and thus had bolstered the demand side in parallel. The strength in prices didn't last long, however, and there followed an initial correction from September onwards. The downward trend was then brought to a halt in October by the Hamas assault on Israel and the ensuing fears of an escalating conflict in the Middle East. There was then a surge in prices in the wake of speculation about Iran's involvement as well as the horror scenario of a blockade of the Strait of Hormuz – which is of key importance as a sea passage for oil transportation. Indeed, around one third of the approximately 60 million barrels transported by tankers per day on the world's oceans pass through this channel between the Persian Gulf and the Gulf of Oman. A blockage of this transport artery would lead to a far-reaching collapse of the global economy. However, the neighbouring countries, all of which are dependent on oil and gas exports, are well aware of this. Accordingly, attempts were made in other areas to stabilize oil prices. In late November, the cartel and its allies announced fresh, additional output cutbacks to take effect from January 2024. The crux of the matter, however, is that these are once again voluntary measures. All told (including the continuing measures on the part of Saudi Arabia and Russia), the output cutbacks will then amount to approx. 2.2 million b/d and, for the time being, are planned to remain in place until March 2024. In the past, however, the member states of the OPEC+ alliance were not exactly known for being particularly disciplined in terms of their production. Either high prices were exploited or allocated quotas could not be met on account of ailing infrastructure. Accordingly, oil prices fell again just shortly after the last OPEC meeting in late November. Moreover, the US oil producers could throw a spanner in the works, once again. Their aggregate output in the second half of the year rose again to a level of around 13 million b/d. This was a rather unexpected development, seeing as a decline in the number of drilling rigs had been expected to lead to a downward production trend. At any rate, the US oil industry had evidently been able to respond to lower oil prices with ramped-up efficiency, drilling in more promising locations and also successfully tapping into lower-lying deposits. Similarly high output figures had not been seen since before the onset of the COVID-19 pandemic.

Weak economy as brake on demand

The global economy failed to pick up any real momentum in 2023. The major central banks found themselves having to react to the prevailingly high inflation resulting, mainly, from the soaring energy prices, with the Ukraine conflict and the sanctions imposed on Russia having made energy more expensive. The multiple rate hikes by the Fed and the ECB in 2023 are proving to be a tremendous burden on the economies affected thereby. Moreover, the development of the Chinese economy fell short of expectations. The real estate crisis there is a particular source of concern, since the construction sector accounts for around a quarter of China's GDP. While the Middle Kingdom undoubtedly benefited from the availability of comparatively cheap oil from Russia, it is suspected that a large portion of the oil purchases were used to ramp up reserves. Another factor believed to contribute to the decrease in China's crude oil consumption is seen in the normalization of travel patterns. There were, admittedly, catch-up effects in the wake of the government's abandonment of its zero-COVID strategy, but these faded again in the second half of 2023.

Growth in global oil demand in 2024 as well
The cutbacks in output planned by the OPEC+ alliance for Q1/2024 illustrate rather subdued expectations as regards global economic development and the resulting demand. This chimes with the latest IMF outlook, which assumes a slight downturn in global economic growth compared to 2023. The IEA (International Energy Agency), on the other hand, is somewhat more optimistic as to the prospects for 2024, raising its forecast for the growth to be expected in global oil demand from 880,000 to 930,000 b/d. As regards In the current year, the IEA expects an oil demand figure of approx. 102 million b/d (as at November).

New CO2 emission surcharges from January 2024 onwards to make for rising prices and a heavier burden on consumers
By means of the Fuel Emissions Trading Act, the prices per metric ton of CO2 were determined for the years 2021 - 2025 in Germany. An annually staggered increase of the CO2 tax had originally been provided for, but the Ukraine conflict and significant increases in energy prices led to a suspension of the tax hikes in 2023. From January 2024 onwards, however, the price surcharge will again apply, now set at EUR 40/mt. A levy of 35 EUR/mt was originally planned; indeed, there were fears of a leap to 45 EUR/mt in order to make up for the shortfall expected in 2023. A level of 65 EUR/mt can be reckoned with from 2026 onwards. Raising the CO2 emissions price is intended to make the consumption of fossil fuels progressively more expensive and thus facilitate the transition to low-carbon or carbon-free technology. In practice, however, the only effect this mainly has for the time being is the artificial inflation of diesel/heating oil, gasoline and gas prices. The proceeds are intended to go into the Climate Transformation Fund (KTF), with the help of which the transformation process is to be financed. The fact is, however, that the burdens and benefits are out of all proportion – against which background a stable trend in oil prices in 2024 would be the preferred situation. Given the complex global situation (ongoing crises, inconsistent doings among the members of the OPEC+ alliance), we consider this a distinct possibility.

Gas: Winter developments and consumption in focus

Analyst: Thomas Wybierek

LNG – ramp-up of supply still "in-line"
The cessation of pipeline gas supplies from Russian sources made for an urgent near-term need to switch to alternatives in 2022. In spite of resistance, the LNG supply for Germany was ramped up in a fast-track process, and a total of three LNG terminals (Wilhelmshaven, Brunsbüttel and Lubmin) were already put into operation in 2023. At approx. 7 percent (the figure as of the beginning of December), the proportion of Germany's gas imports accounted for by LNG remained relatively low in 2023, however.
Norway and the Netherlands remained Germany's principal gas suppliers in 2023, though 1 October 2023 saw the definitive closure of the Netherlands' Groningen gas field, which was the largest in Europe. The decision to do so had already been taken before the onset of the Ukraine conflict, since the region had been increasingly hit by gas extraction-induced earthquakes and subsidence. However, a total of eleven boreholes will be kept operational as a sort of emergency reserve for another year. Germany's main gas supplier is now Norway, accounting for over 40 percent of its gas imports since the

beginning of the year. By comparison, the Netherlands accounted for a good quarter of imports. Belgium followed, with a share of about 22 percent. However, it should be noted that Belgium itself has no natural gas reserves, but is instead an important transit country. Moreover, some of the gas likely comes from the port of Zeebrugge's LNG tanks. Belgium is one of the few ports capable of handling ice-class tankers, which are used in the far north, for which reason gas shipments from Norway, but also from Russia, find their way into Europe's gas networks via this port. In Q3/2023, Russia was the EU's second-largest LNG supplier, behind the US, despite a ban on imports of fossil raw materials, the reason for this being that natural gas is not subject to the embargo. Data from the IEEFA (US Institute of Energy Economics and Financial Analysis) indicate that approximately 18 billion cbm of natural gas was shipped from Russia to the EU in the first nine months of 2023.

Full gas storage as backup

The gas storage filling targets were already reached considerably earlier than planned, with that of 95 percent set for 1 November 2023 already having been achieved in late September and the mark of 100 percent actually exceeded – this being technically possible – by early November. It was thus possible to cushion the impact of winter's onset at the beginning of December, in spite of which the filling levels in the storage facilities remain above the average mark recorded for the years 2017-2021 and which the Federal Network Agency uses as benchmark data for comparative purposes. Moreover, the current weather forecasts beyond the turn of the year also suggest a mild 2023/24 winter, at least in Central Europe. However, the reserve also benefits from relatively low consumption owing to the weak economy, and appeals to save on energy consumption, in combination with prices above pre-crisis levels for the end user, are also having an effect in this context. Bottlenecks will become increasingly unlikely if the European gas supply can be maintained without disruptions. Be that as it may, the fact is that companies and private consumers will also have to reconcile themselves with volatile prices and generally higher costs in the future as well. The era of cheap energy from Russia thanks to contractually secured pipeline gas supplies is over. The planned ramp-up of "green" hydrogen production, the continuation of the legally mandated transformation processes ("heat transition") as well as dependencies on world market prices (LNG) will make for a multitude of additional costs which, however, it will not be possible to adequately offset by means of government action packages in the foreseeable future. The dispute over the so-called industrial electricity price has clearly reflected this. The price of gas traded on the commodity exchanges will continue trending sideways in 2024, due to the ongoingly weak state of the global economy. This will only be the case in the absence of any fresh geopolitical crises, however.

Market data *Spot; **Day Ahead; ***Front Month Future	Prices 14.12.23	12-month high on daily basis		12-month low on daily basis		NORD/LB forecast 1 month	6 months	12 months
Brent crude (USD/barrel)*	76.57	94.51	18.09.23	71.86	03.05.23	83	84	81
WTI crude (USD/barrel)*	71.58	93.68	27.09.23	66.74	17.03.23	79	81	78
Electricity price (EUR/MWh)**	74.20	282.10	19.12.22	72.62	01.06.23	98	105	110
CO2 certificates (EUR/metric ton)**	66.79	97.08	21.02.23	66.79	14.12.22	85	100	105
Natural gas TTF (EUR/MWh)**	33.90	133.49	16.12.22	22.58	01.06.23	50	45	55
Coal Rotterdam (USD/metric ton)***	117.75	240.60	16.12.22	93.00	30.05.23	125	115	110

Sources: Macrobond, NORD/LB Research

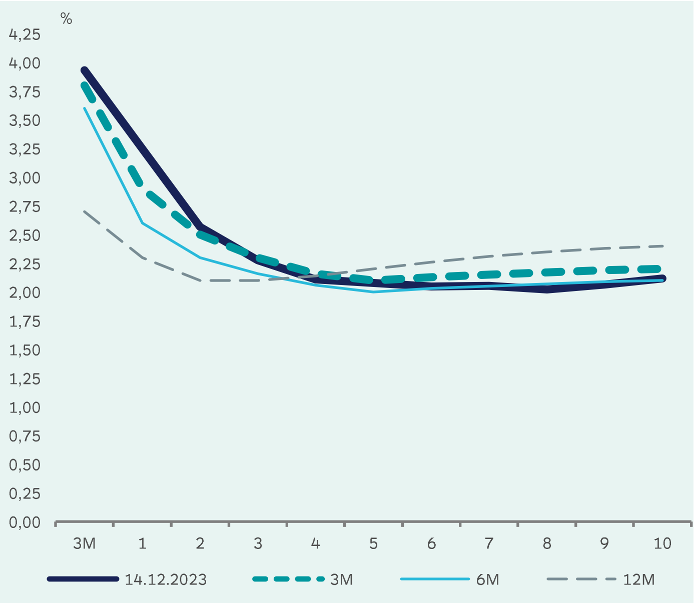
Portfolio strategies
Yield curve, Euroland

Yields and forecasts (Bunds/Swap)

Yields (in %)		NORD/LB forecasts for the horizons		
	Current	**3M**	**6M**	**12M**
3M	3.93	3.80	3.60	2.70
1Y	3.25	2.90	2.60	2.30
2Y	2.57	2.50	2.30	2.10
3Y	2.28	2.30	2.16	2.10
4Y	2.11	2.16	2.06	2.14
5Y	2.08	2.10	2.00	2.20
6Y	2.05	2.13	2.03	2.26
7Y	2.05	2.15	2.05	2.31
8Y	2.02	2.17	2.07	2.35
9Y	2.07	2.19	2.09	2.38
10Y	2.12	2.20	2.10	2.40
2Y (Swap)	2.99	3.00	2.80	2.60
5Y (Swap)	2.57	2.65	2.55	2.75
10Y (Swap)	2.59	2.70	2.60	2.90

Sources: Bloomberg, NORD/LB Macro Research

Yield curve forecasts (Bunds)



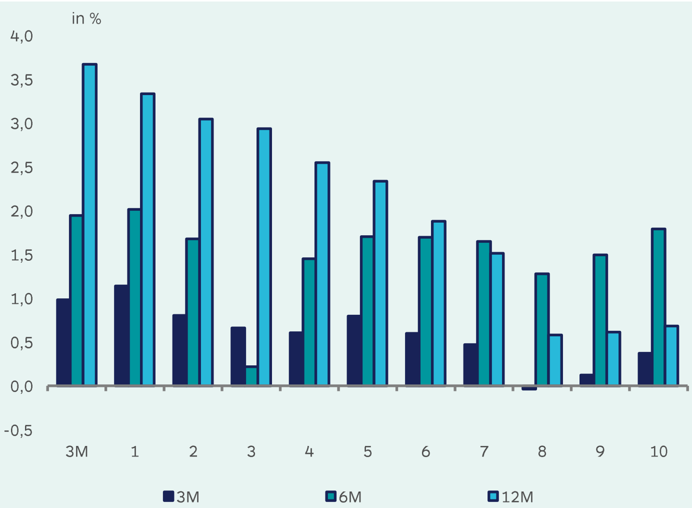
Sources: Bloomberg, NORD/LB Macro Research

Forecasts and total returns

	Total returns (in %) for horizons...		
	3M	**6M**	**12M**
3M	0.98	1.94	3.67
1Y	1.14	2.01	3.33
2Y	0.80	1.68	3.04
3Y	0.66	0.22	2.93
4Y	0.61	1.45	2.55
5Y	0.79	1.70	2.34
6Y	0.60	1.69	1.88
7Y	0.47	1.65	1.51
8Y	-0.04	1.28	0.58
9Y	0.12	1.49	0.61
10Y	0.37	1.79	0.68

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns



Sources: Bloomberg, NORD/LB Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve change.

Portfolio strategies International yield curve: 3-month & 12-month horizons

3-month horizon

Expected total returns (as percentage) in euro

	EUR	USD	GBP	JPY	CHF
1Y	1.1	3.0	0.1	3.3	-0.3
2Y	0.8	2.5	-1.1	3.4	-0.5
3Y	0.7	2.3	-2.5	3.4	-0.3
4Y	0.6	2.3	-4.0	3.4	-0.3
5Y	0.8	2.4	-4.1	3.5	-0.2
6Y	0.6	2.9	-5.5	3.2	-0.4
7Y	0.5	2.6	-6.0	3.3	-0.4
8Y	0.0	2.5	-5.4	3.2	-0.4
9Y	0.1	2.5	-4.9	3.1	-0.3
10Y	0.4	2.4	-4.1	2.8	-0.4

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies

	USD	GBP	JPY	CHF
1Y	1.2	1.2	0.0	0.4
2Y	0.7	-0.1	0.0	0.3
3Y	0.5	-1.5	0.0	0.3
4Y	0.5	-3.0	0.1	0.3
5Y	0.6	-3.2	0.2	0.4
6Y	1.1	-4.5	-0.1	0.3
7Y	0.8	-5.0	-0.1	0.3
8Y	0.7	-4.4	-0.1	0.2
9Y	0.7	-3.9	-0.2	0.4
10Y	0.6	-3.1	-0.5	0.3

Sources: Bloomberg, NORD/LB Macro Research

12-month horizon

Expected total returns (as percentage) in euro

	EUR	USD	GBP	YPY	CHF
1Y	3.3	5.9	2.7	11.4	-0.3
2Y	3.0	5.6	1.6	11.5	-0.5
3Y	2.9	6.2	0.3	11.5	-0.6
4Y	2.5	6.6	-1.1	11.7	-0.8
5Y	2.3	7.0	-1.1	11.8	-1.0
6Y	1.9	7.7	-2.2	11.5	-1.5
7Y	1.5	7.3	-2.6	10.9	-1.7
8Y	0.6	7.5	-1.9	11.3	-1.9
9Y	0.6	8.0	-1.5	11.1	-2.1
10Y	0.7	8.6	-0.6	10.3	-2.3

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies

	USD	GBP	JPY	CHF
1Y	5.0	5.0	0.0	1.4
2Y	4.7	3.8	0.1	1.2
3Y	5.3	2.5	0.1	1.2
4Y	5.7	1.1	0.3	0.9
5Y	6.1	1.0	0.3	0.7
6Y	6.8	-0.1	0.1	0.2
7Y	6.4	-0.5	-0.4	0.0
8Y	6.6	0.2	-0.2	-0.2
9Y	7.1	0.7	-0.3	-0.5
10Y	7.7	1.6	-1.0	-0.6

Sources: Bloomberg, NORD/LB Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve and exchange rate change.

Portfolio strategies
Stock market strategy; 3-month, 6-month & 12-month horizon

Levels and performance

Index	Level as at 14.12.2023	Status Prev. month	Status Start of year	Performance since Prev. month	Performance since Start of year
DAX	16,752.23	16,215.43	13,923.59	3.31%	20.32%
MDAX	27,198.24	26,183.42	25,117.57	3.88%	8.28%
EuroSTOXX50	4,539.16	4,382.47	3,793.62	3.58%	19.65%
STOXX50	4,071.85	3,982.61	3,651.83	2.24%	11.50%
STOXX600	476.57	461.61	424.89	3.24%	12.16%
Dow Jones	37,248.35	35,950.89	33,147.25	3.17%	11.90%
S&P 500	4,719.55	4,567.80	3,839.50	3.05%	22.60%
Nikkei	32,686.25	33,486.89	26,094.50	-2.39%	25.26%

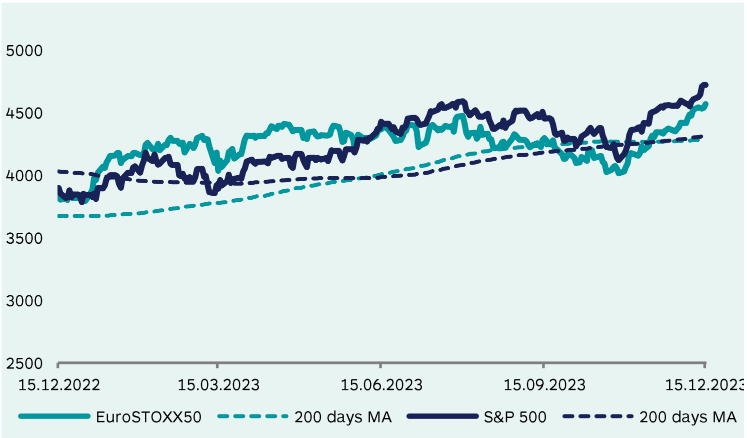
Sources: Bloomberg, NORD/LB Macro Research

Index forecasts

Index	NORD/LB forecast for the horizons ... 3M	6M	12M
DAX	16,000	16,800	17,500
MDAX	25,400	26,600	28,000
EuroSTOXX50	4,300	4,500	4,650
STOXX50	3,950	4,000	4,300
STOXX600	450	480	490
Dow Jones	35,500	36,000	37,000
S&P 500	4,550	4,650	4,750
Nikkei	33,000	33,500	34,000

Sources: Bloomberg, NORD/LB Macro Research

EuroSTOXX50 and S&P500



Sources: Bloomberg, NORD/LB Macro Research

Date of going to press for data, forecasts and texts was **Friday, 15 December 2023**.
The next English issue of Economic Adviser will be appearing on **29 January 2024**.

Overview of forecasts

Fundamental forecasts

in %	GDP growth			Rate of inflation			Unemployment rate[1]			Budgetary balance[2]		
	2022	2023	2024	2022	2023	2024	2022	2023	2024	2022	2023	2024
USA	1.9	2.3	1.4	8.0	4.1	2.8	3.6	3.6	4.2	-4.0	-5.9	-5.6
Euroland	3.4	0.5	0.5	8.4	5.4	2.4	6.7	6.6	6.8	-3.6	-3.4	-2.7
Germany	1.8	-0.4	0.3	8.7	6.0	2.6	5.3	5.7	6.0	-2.5	-2.2	-1.3
Japan	1.0	2.0	0.9	2.5	3.3	2.1	2.6	2.6	2.5	-5.8	-5.6	-4.1
Britain	4.3	0.4	0.4	9.1	7.4	3.1	3.7	4.1	4.7	-4.6	-4.9	-3.5
Switzerland	2.4	1.2	1.0	2.8	2.1	1.8	2.2	2.0	2.2	1.2	0.4	0.6
China	3.0	5.2	4.5	1.9	0.4	1.4	4.0	5.2	5.0	-7.5	-5.0	-4.5

Change vs previous year as percentage; [1] as percentage of the labour force (Germany: as per Federal Employment Office definition); [2] as percentage of GDP
Sources: Feri, NORD/LB Macro Research

Key interest rates

In %	14.12.23	3M	6M	12M
USD	5.50	5.50	5.50	5.00
EUR	4.50	4.50	4.25	3.25
JPY	-0.10	-0.10	0.00	0.10
GBP	5.25	5.25	5.25	5.00
CHF	1.75	1.75	1.50	1.00
CNY	1.50	1.50	1.50	1.50

Sources: Bloomberg, NORD/LB Macro Research

Exchange rates

EUR in...	14.12.23	3M	6M	12M
USD	1.10	1.08	1.08	1.09
JPY	156	151	146	140
GBP	0.86	0.87	0.88	0.88
CHF	0.95	0.96	0.96	0.97
CNY	7.82	7.72	7.67	7.68

Interest rates (government bonds)

	3M rates				Yields 2Y				Yields 5Y				Yields 10Y			
	14.12.	3M	6M	12M	14.12.	3M	6M	12M	14.12.	3M	6M	12M	14.12.	3M	6M	12M
USD	5.38	5.30	5.20	4.70	4.39	4.60	4.25	3.60	3.90	4.10	3.85	3.50	3.92	4.10	3.90	3.50
EUR	3.93	3.80	3.60	2.70	2.57	2.50	2.30	2.10	2.08	2.10	2.00	2.20	2.12	2.20	2.10	2.40
JPY	0.08	0.05	0.10	0.20	0.04	0.05	0.07	0.10	0.25	0.30	0.38	0.40	0.66	0.80	1.00	1.10
GBP	5.33	5.40	5.40	5.15	4.36	5.03	5.02	4.80	3.82	4.80	4.80	4.50	3.79	4.20	4.20	3.90
CHF	1.68	1.60	1.40	0.90	1.00	0.90	0.70	0.70	0.68	0.60	0.60	0.70	0.62	0.60	0.60	0.80

Sources: Bloomberg, NORD/LB Macro Research

Spreads (bp)

	3M EURIBOR				2J Bund				5J Bund				10J Bund			
	14.12.	3M	6M	12M	14.12.	3M	6M	12M	14.12.	3M	6M	12M	14.12.	3M	6M	12M
USD	145	150	160	200	182	210	195	150	183	200	185	130	180	190	180	110
JPY	-385	-375	-350	-250	-253	-245	-223	-200	-182	-180	-163	-180	-145	-140	-110	-130
GBP	140	160	180	245	180	253	272	270	174	270	280	230	167	200	210	150
CHF	-225	-220	-220	-180	-157	-160	-160	-140	-140	-150	-140	-150	-150	-160	-150	-160

Sources: Bloomberg, NORD/LB Macro Research

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