

The Macroscope 2024.

December 2024

CANDRIAM 
A NEW YORK LIFE INVESTMENTS COMPANY

Marketing communication for Professional & Qualified Investors

09/12/2024





1 Global economy

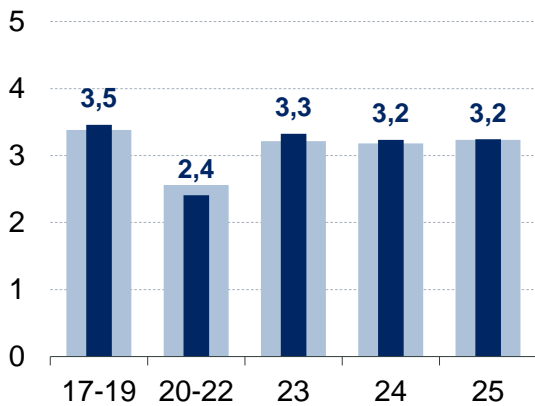
Steady growth



The IMF expects world growth to stay slightly above 3%... with the US decelerating and the euro area accelerating

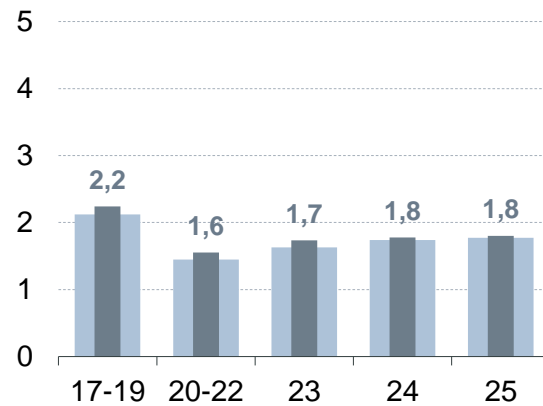
October 2024 IMF GDP forecasts (% annual average)

World

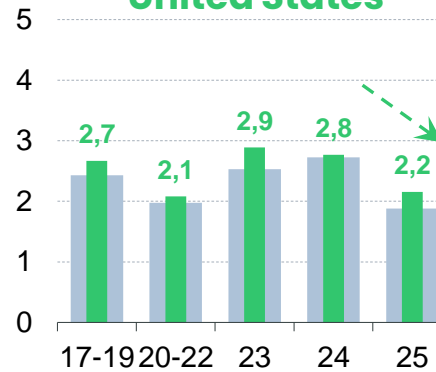


■ April 2024
■ October 2024

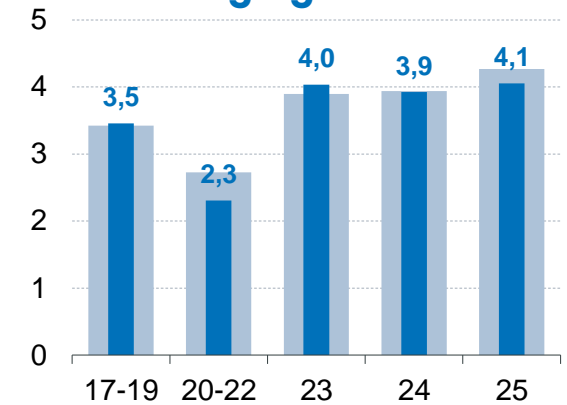
Advanced



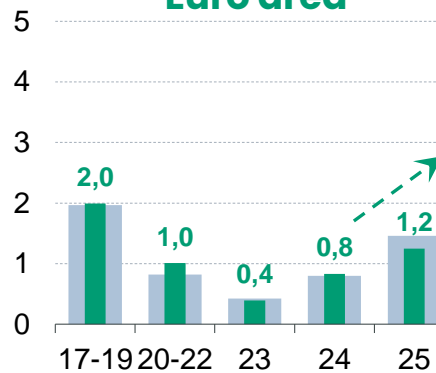
United States



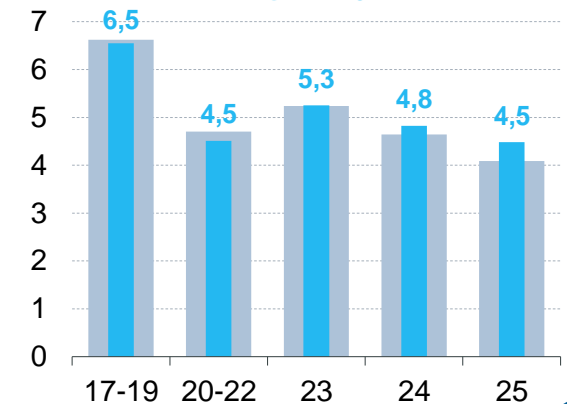
Emerging ex China



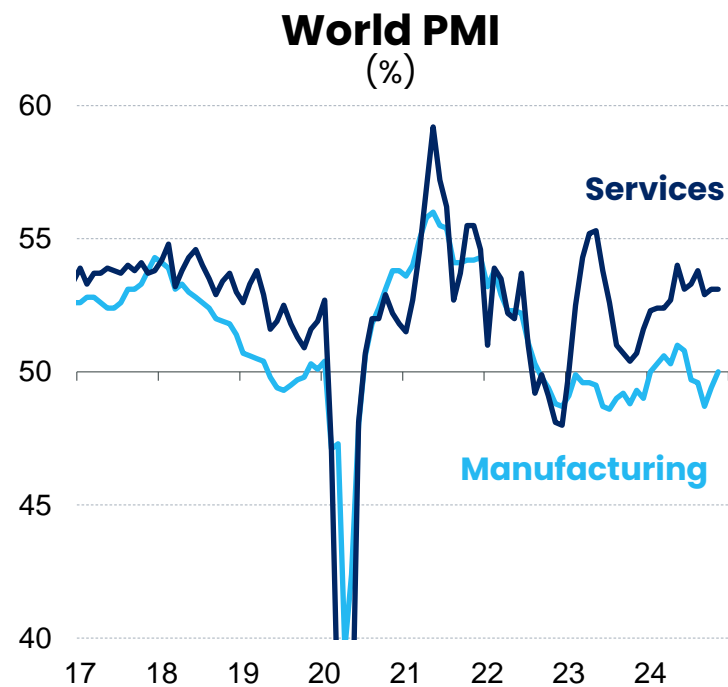
Euro area



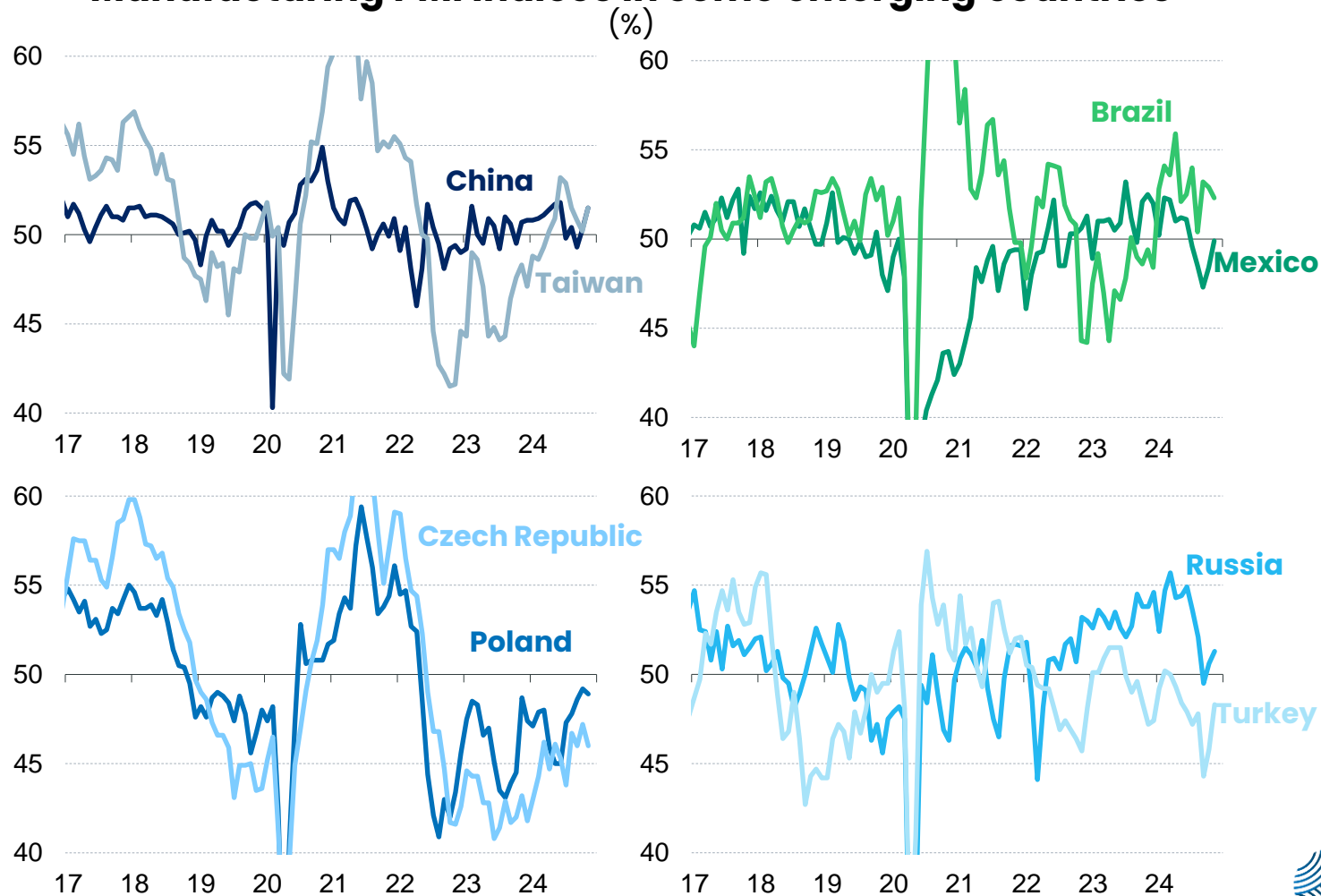
China



Activity is holding in services, but remains weak in the manufacturing sector

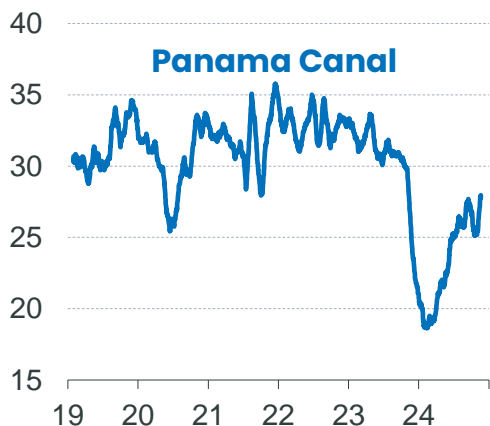
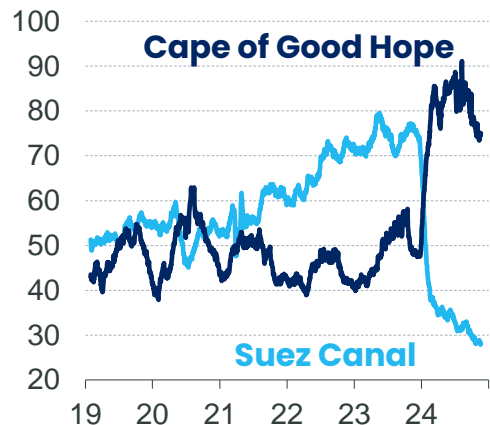


Manufacturing PMI indices in some emerging countries



Despite higher freight costs, there has been no supply chain disruptions so far

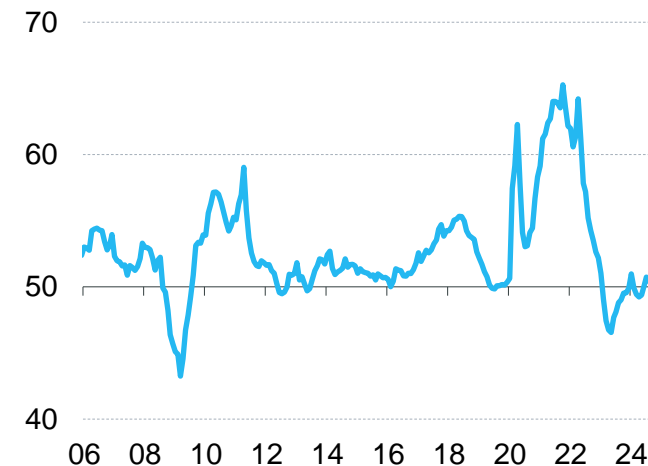
Number of vessels per day
(30 days moving average)



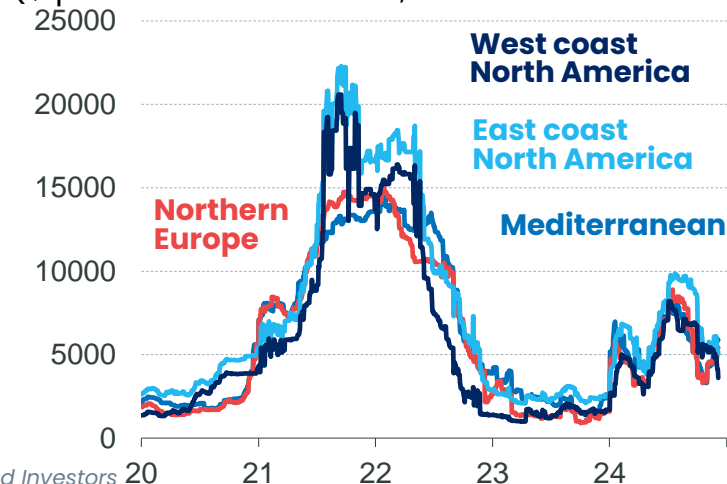
Harper shipping index
(January 2019 = 100)



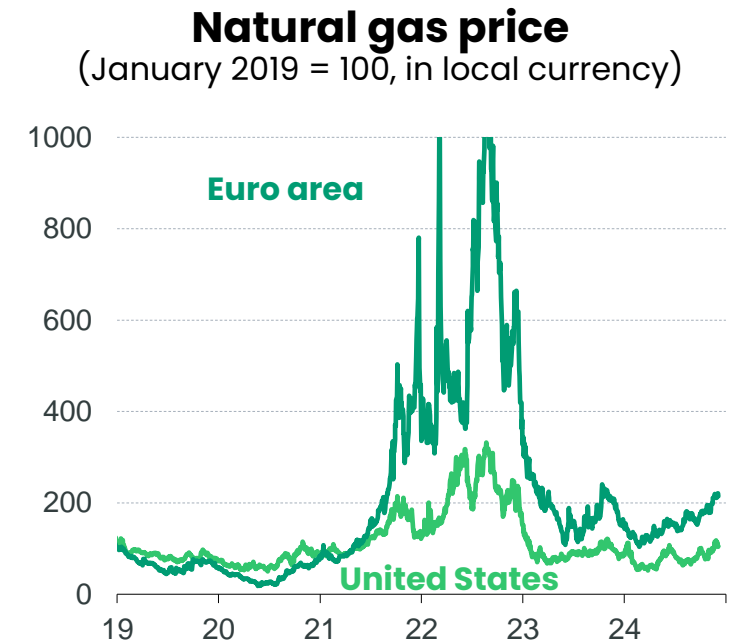
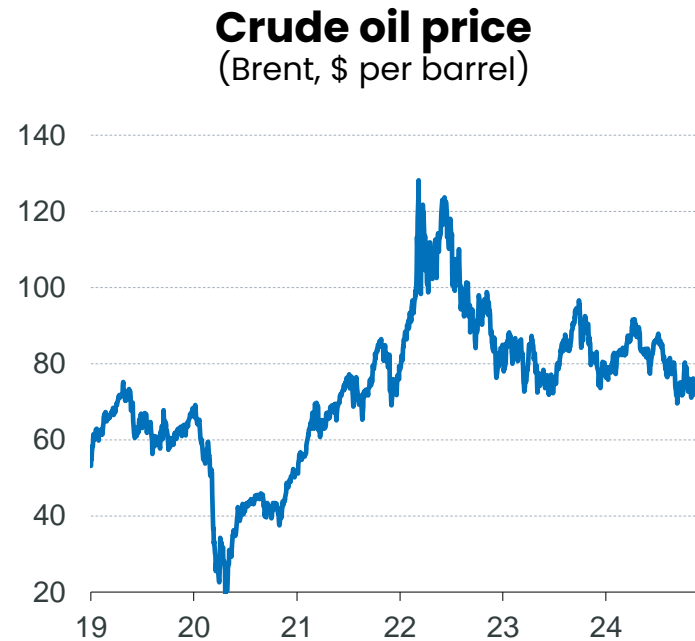
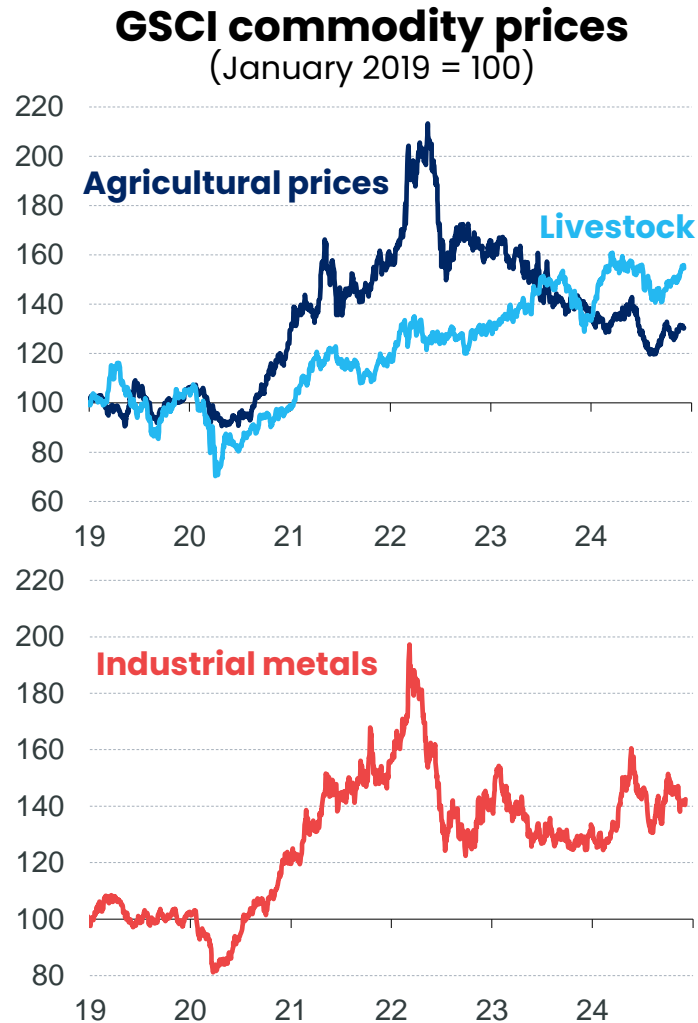
Global suppliers' delivery time
(manufacturing PMIs, %)



Freight costs
(\$ per 40-foot container, from China & East Asia to...)

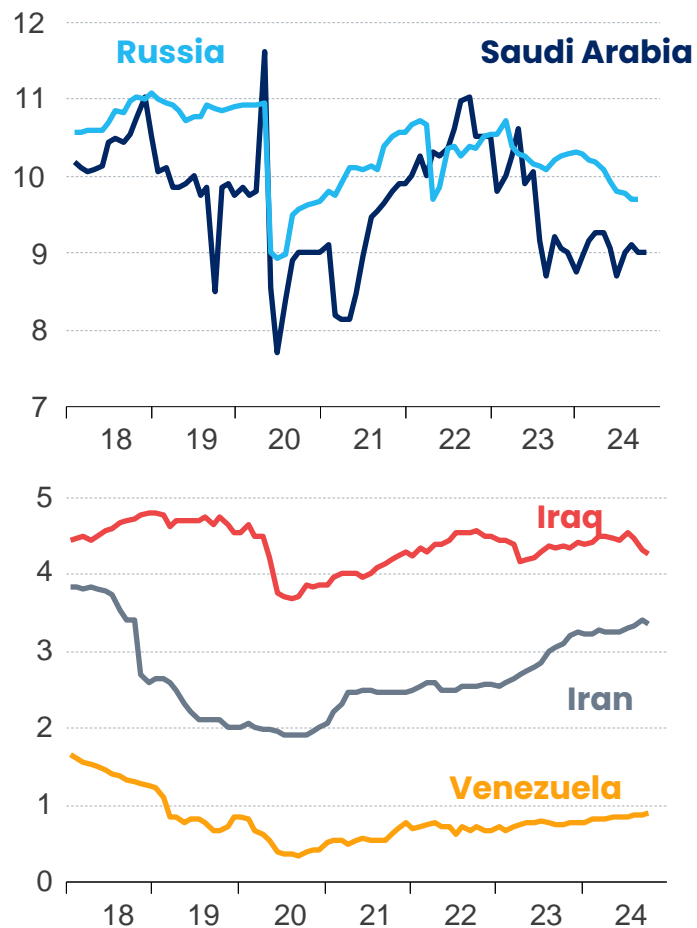


Up to now, commodity prices have been relatively stable

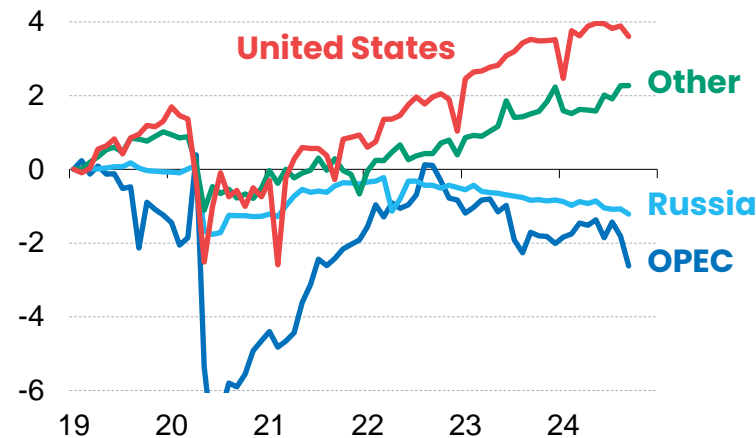


Despite rising tensions in the Middle East, ample supply has kept oil prices on the soft side

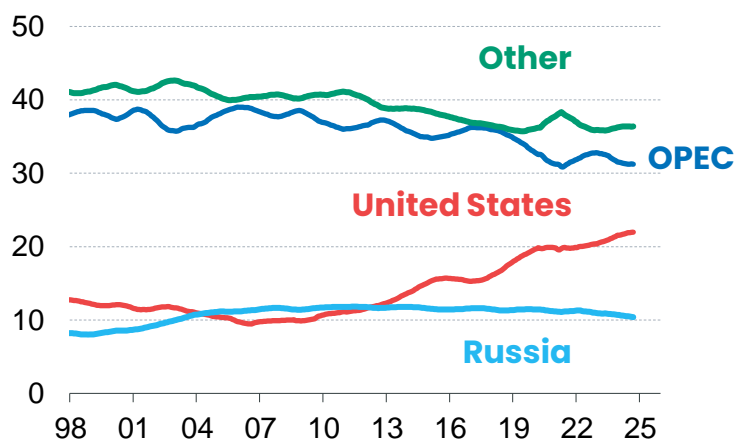
OPEC+ crude oil production
(million barrels per day)



Cumulated change in oil supply
(million barrels per day, since January 2019)



Share in oil supply
(% of world oil supply)



OPEC spare capacity
(million barrels per day)



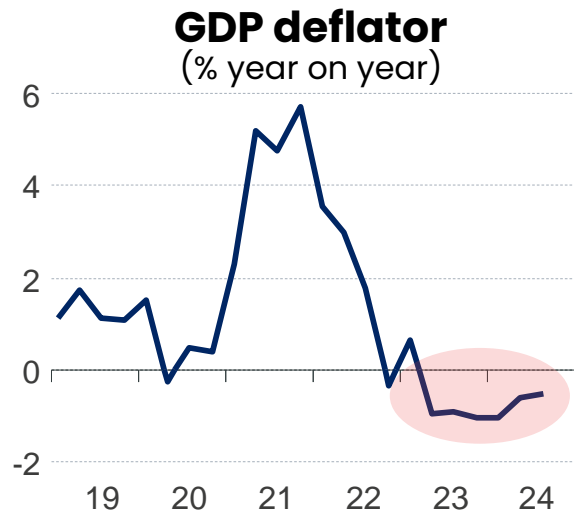
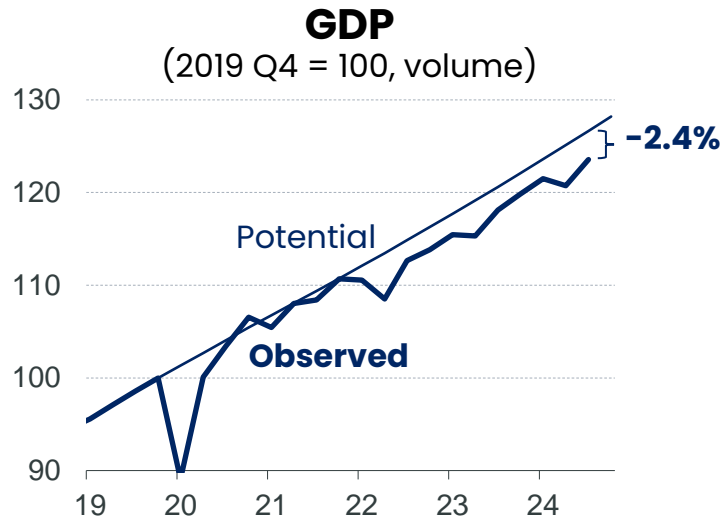


2 China

A new round of support measures... but no new policy!

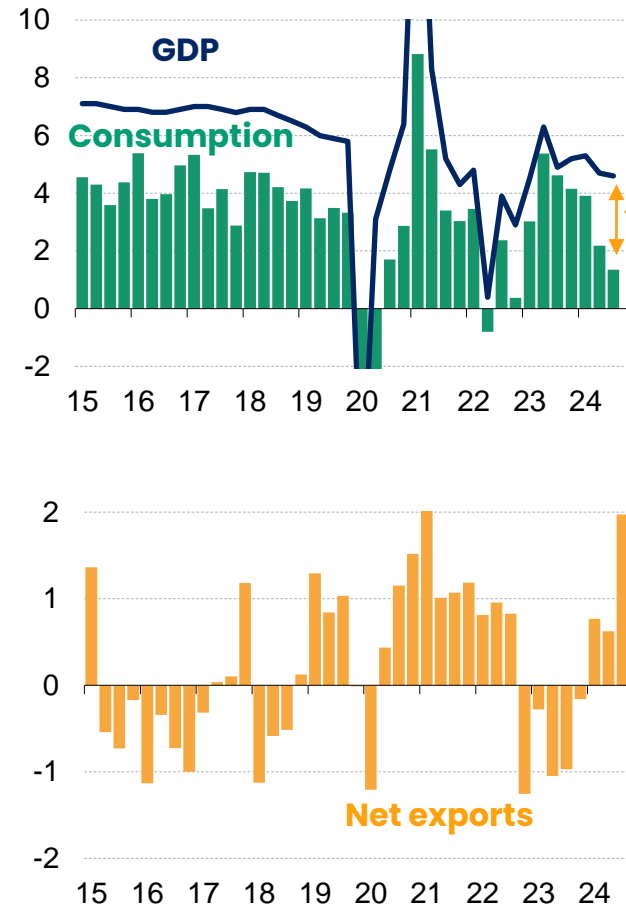


Despite the recent rebound, deflationary forces are still weighing on activity



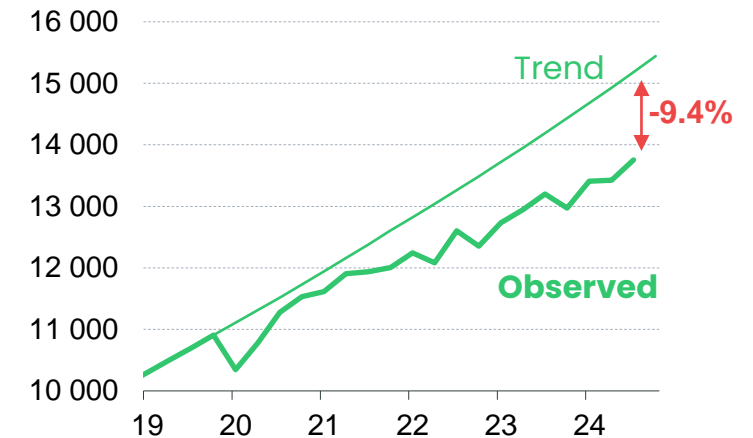
Contributions to GDP growth

(% year on year)



Urban per capita disposable income

(Yuan, quarterly rate)



Youth unemployment has kept increasing, and consumer confidence remains depressed

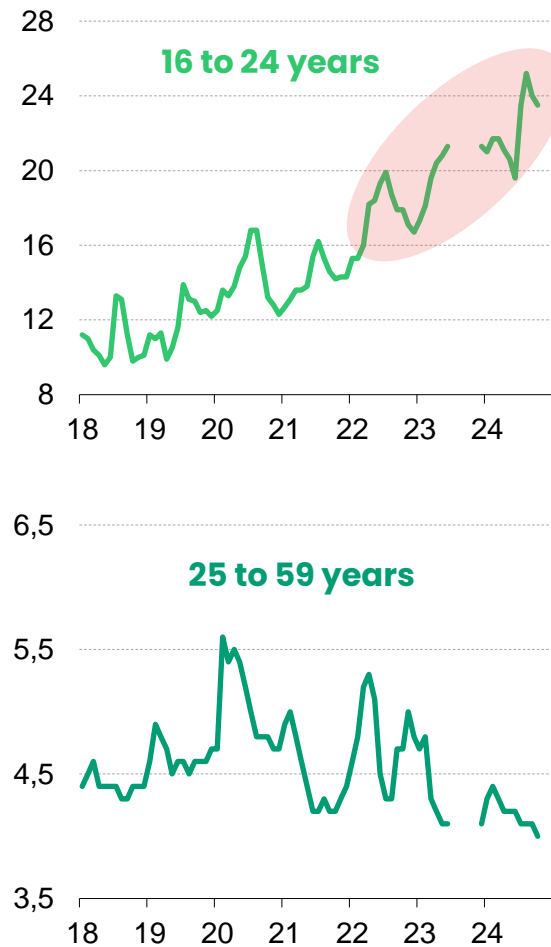
Saving rate

(% of disposable income, urban households)



Unemployment rates

(%)

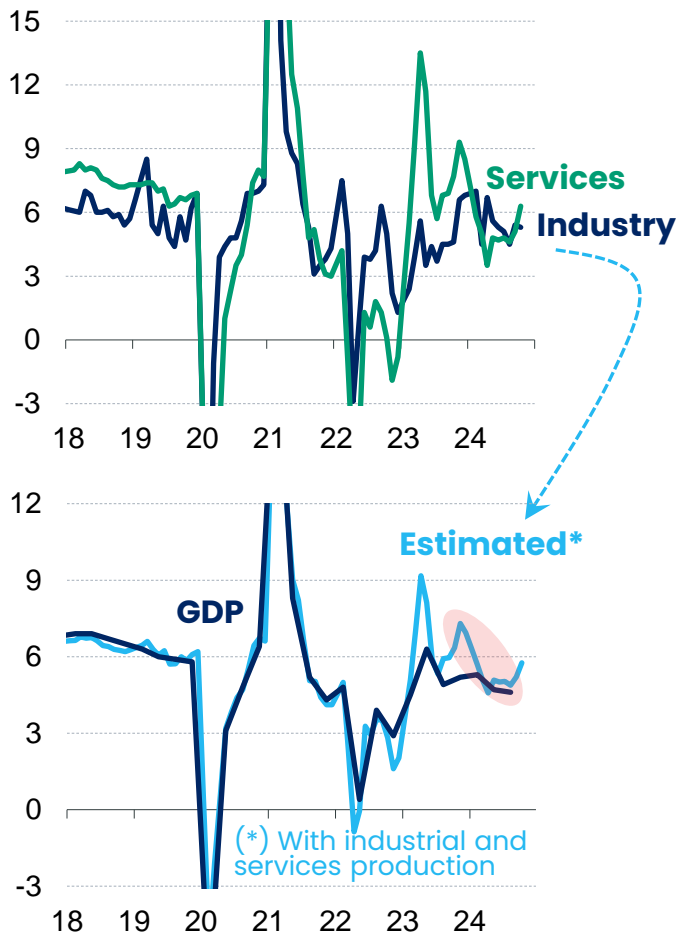


Consumer confidence

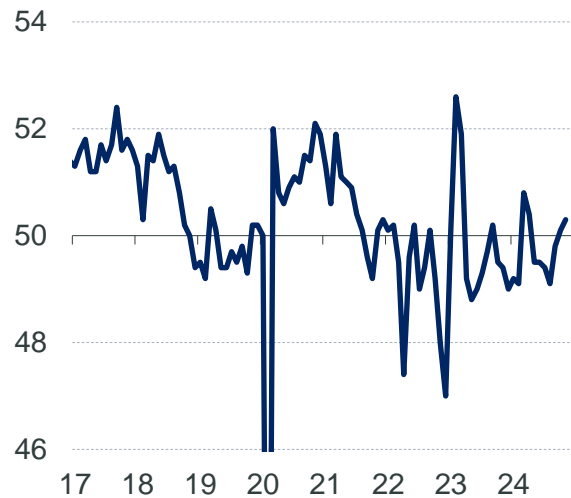


In October, the PMI index improved slightly in the manufacturing sector... but not in services

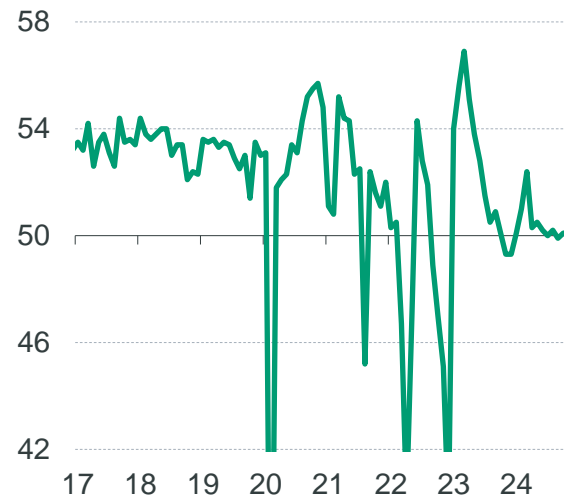
Monthly output and GDP
(% year on year)



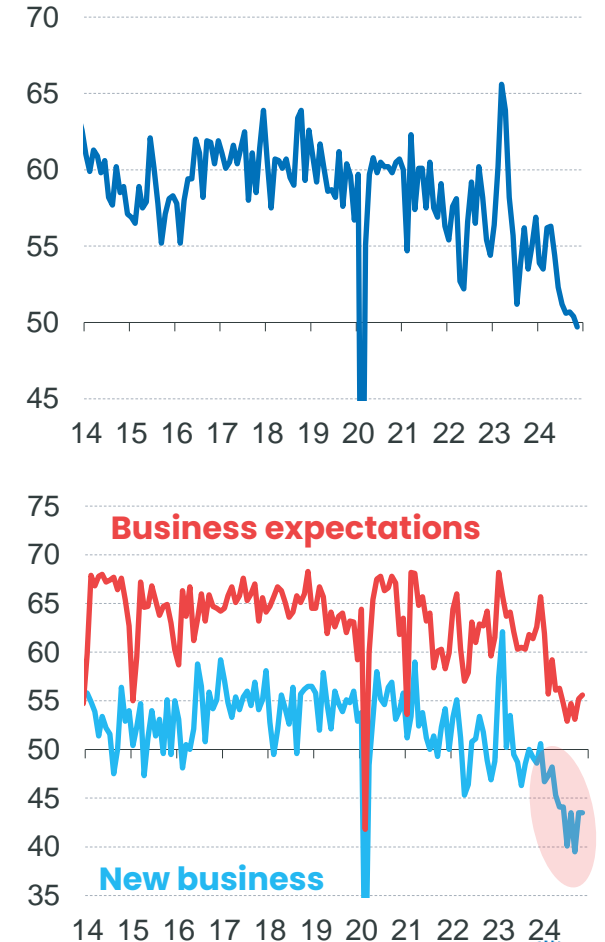
Manufacturing PMI
(NBS)



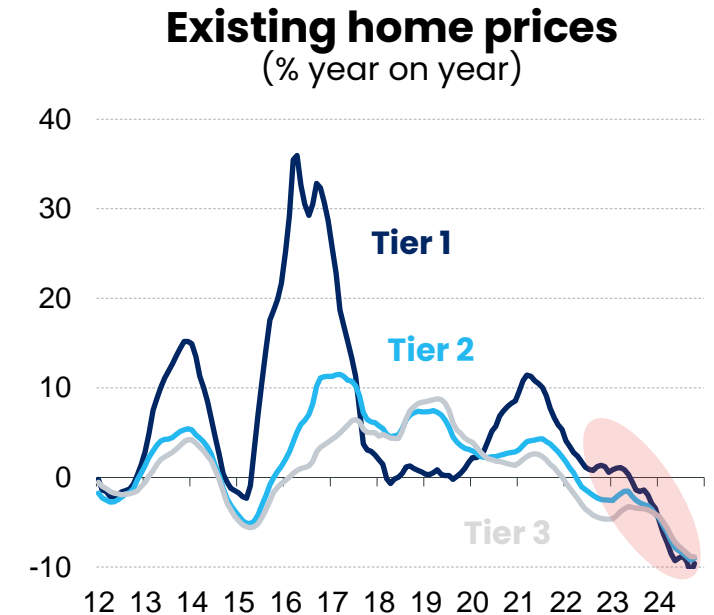
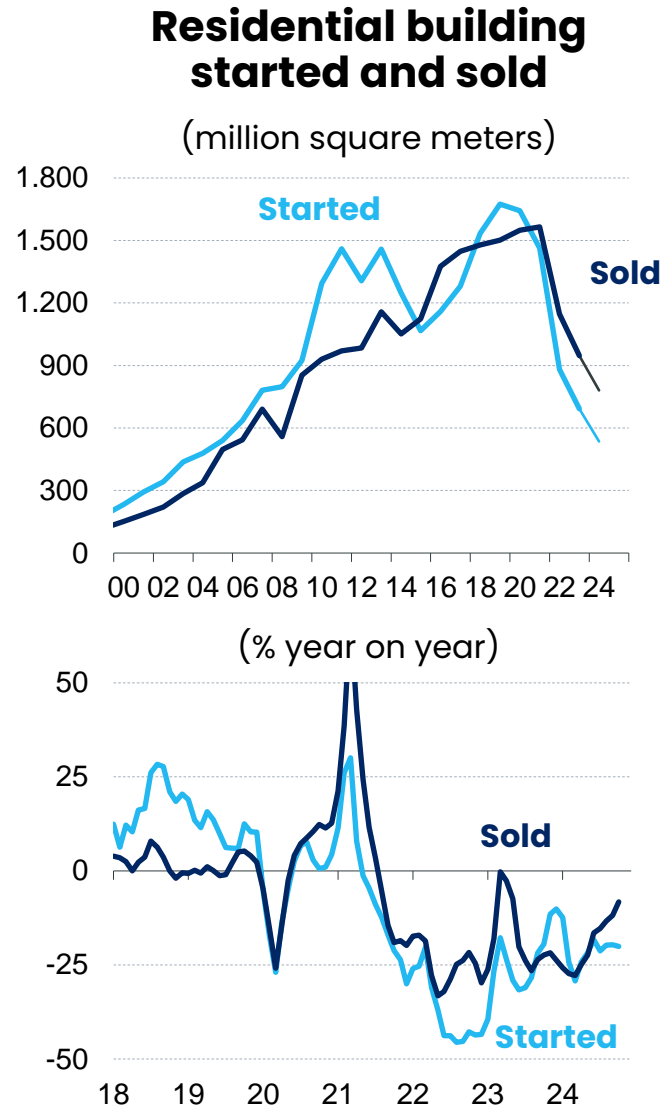
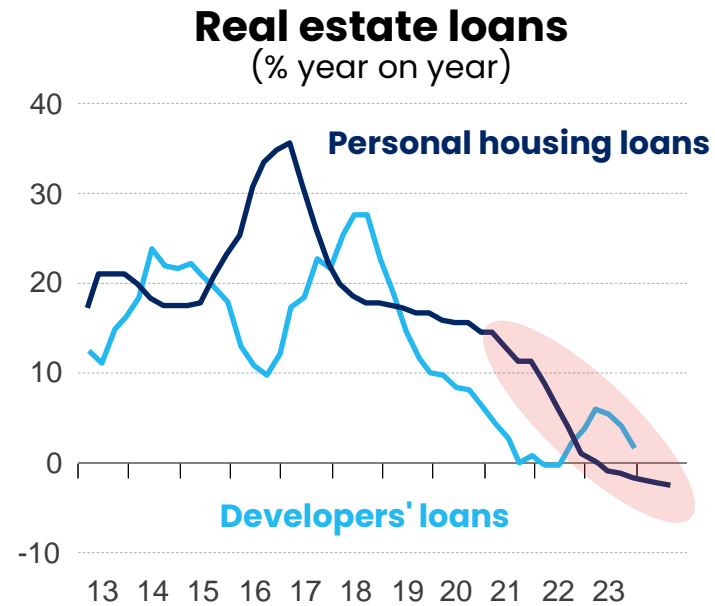
Services PMI
(NBS)



Construction PMI
(NBS)

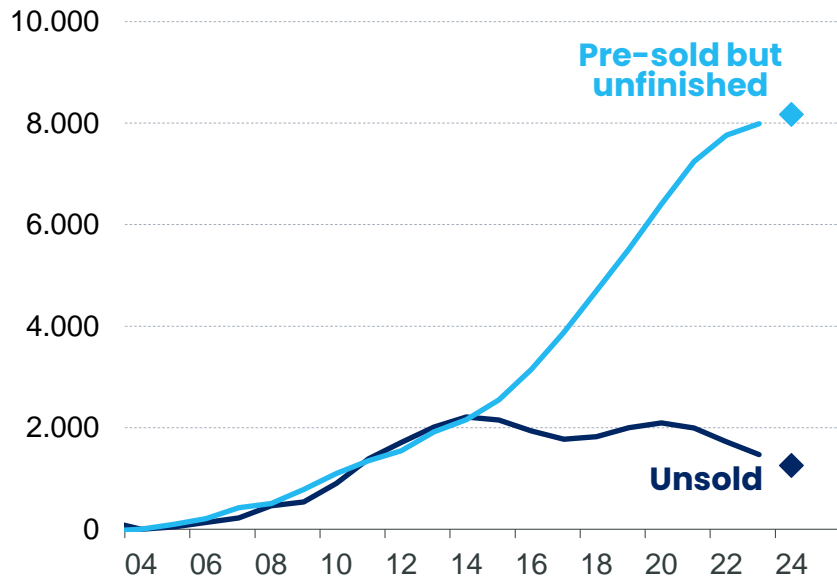


Real estate investment is the main drag on activity...

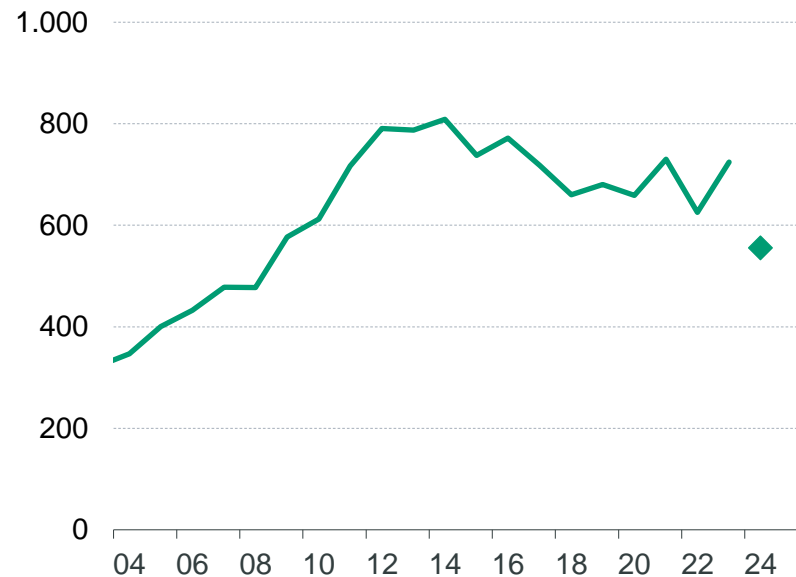


... and will remain so for the foreseeable future

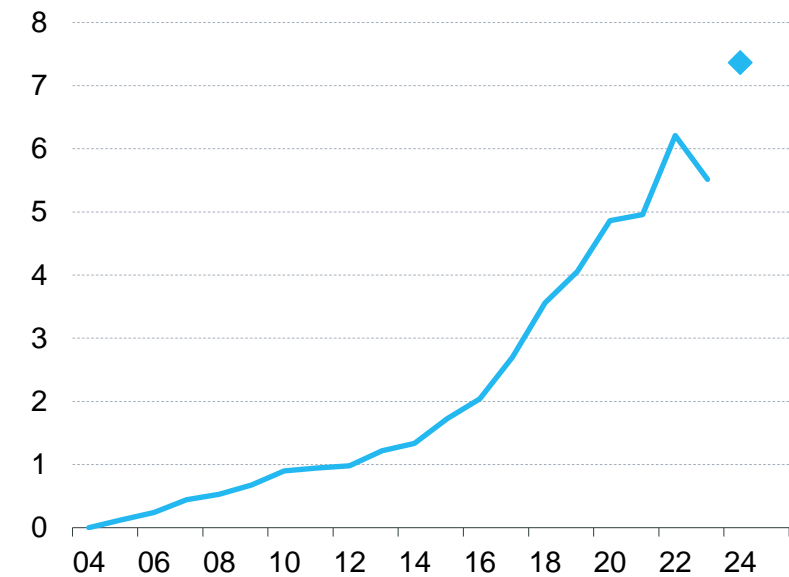
Residential construction
(millions of square meters)



Pace of completion
(millions of square meters per year)



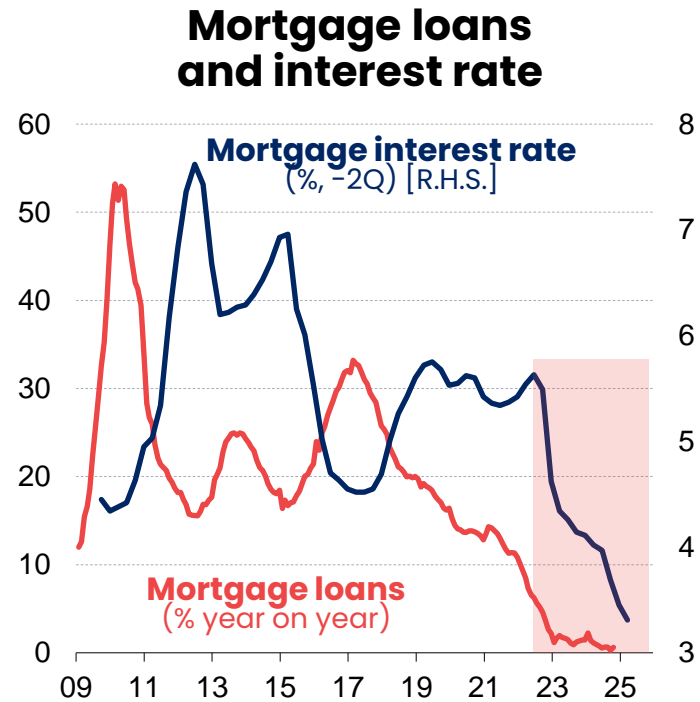
Time needed to complete pre-sold but unfinished homes*
(in years)



(*) Assuming that unfinished homes are halfway advanced and the pace of completion remains at current levels.

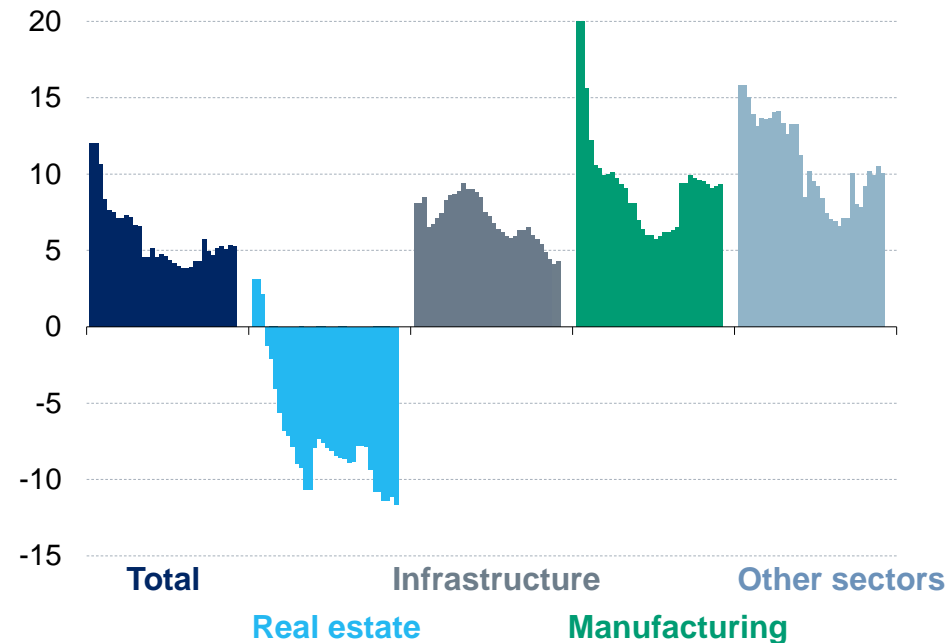


Monetary policy has stopped having traction on mortgage borrowing making deflationary pressures difficult to counter



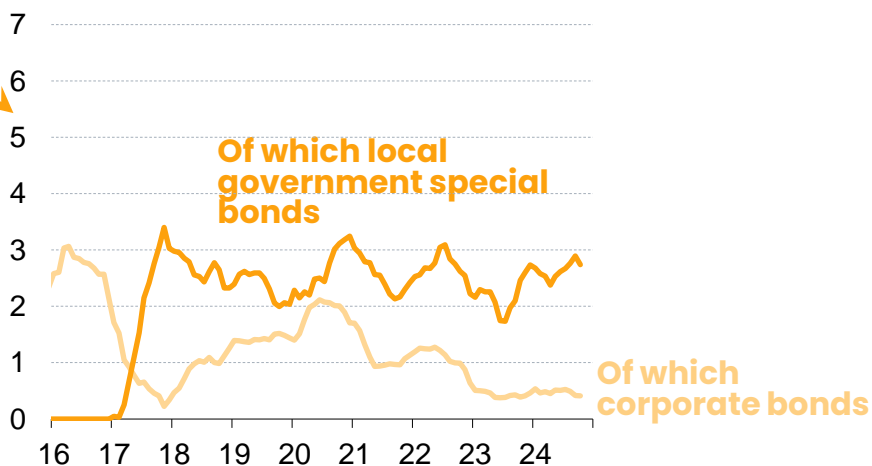
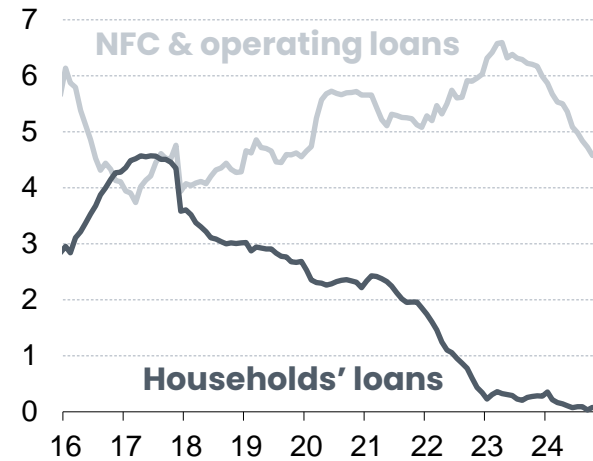
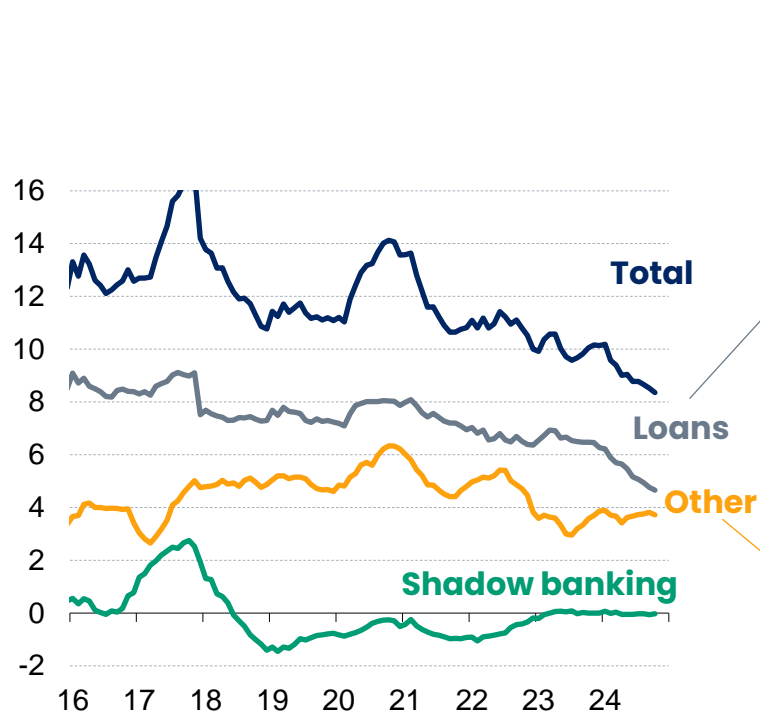
Fixed asset investment by industry

(% year on year cumulated growth, January 2022 – October 2024)

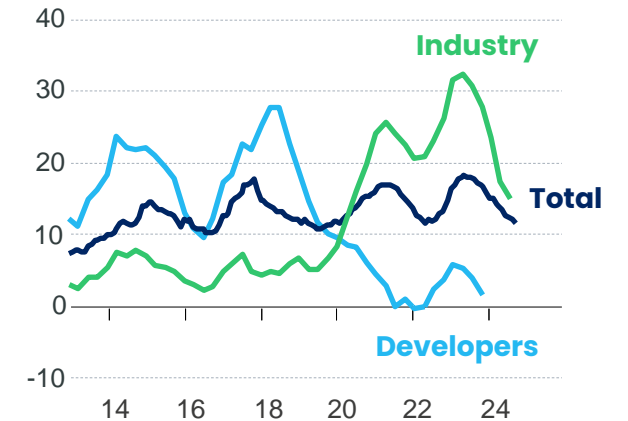


The flow of credit has continued to weaken

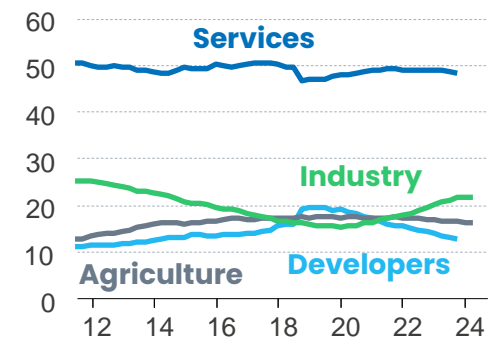
Total social financing
(% year on year, contributions)



Medium- and long-term loans to NFC
(% year on year)



Memo:
% share in M & LT loans to NFC



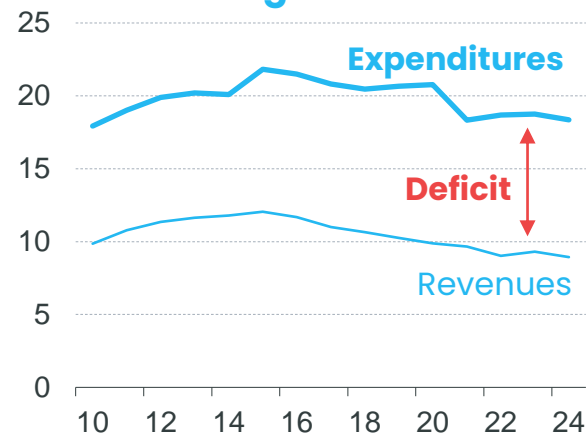
With faltering land sales, local governments need more central government transfers

General Budget (% of GDP)

Central government

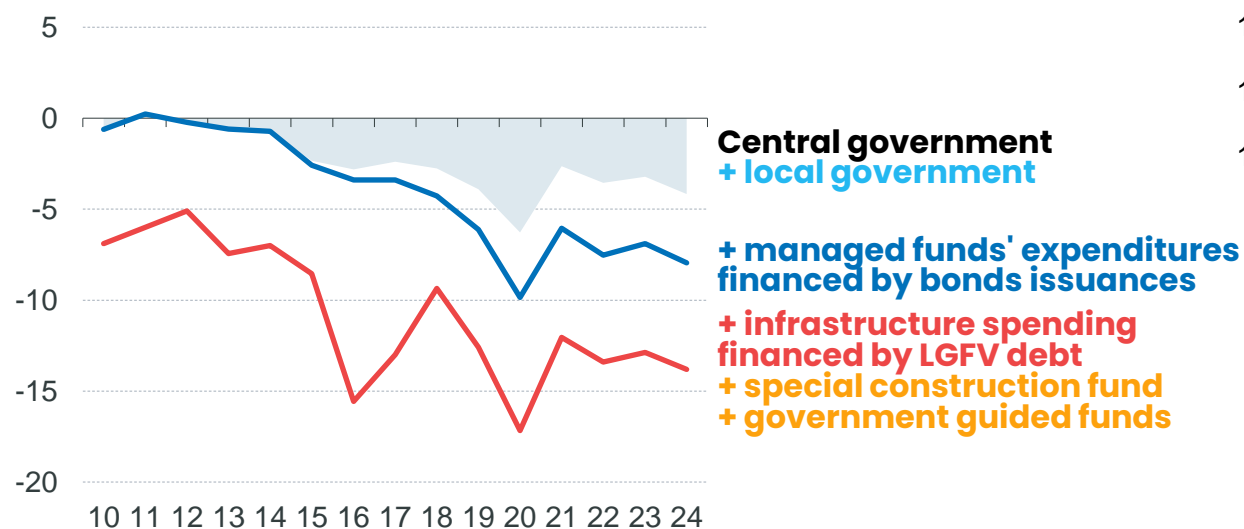


Local government

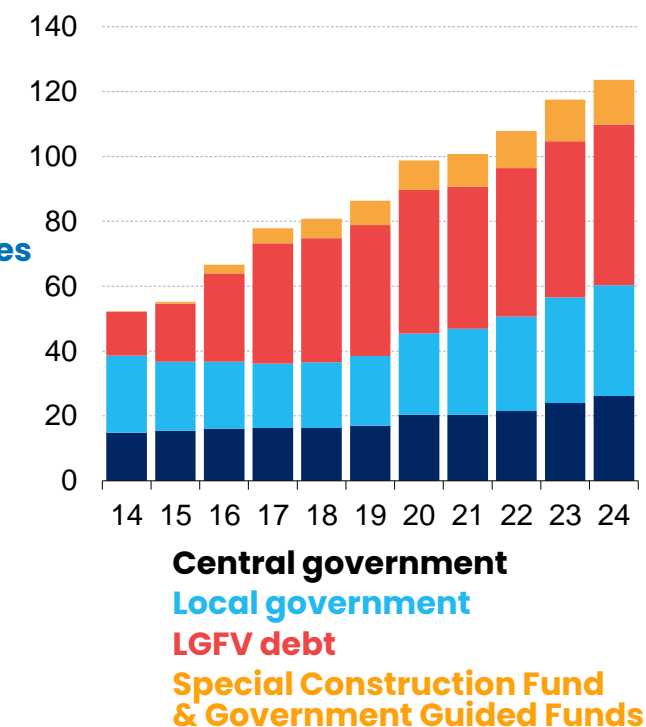


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Government net lending (+) or borrowing (-) (% of GDP)



Gross government debt (% of GDP)



The “bazooka-like” measures recently announced by the Politburo convey a sense of urgency in supporting the economy... and the financial system

September counter-cyclical announcements :

• **Monetary policy:**

- 50bp RRR cut (RMB1tn of liquidity released) with possibly more to come
- Rate cuts: 20bp OMO, 30bp MLF
- 25bp cut to 5-year LPR (mortgage interest rate benchmark) and deposit rate

• **Real estate market:**

- Downpayment ratio for 2nd home buyer cut from 25% to 15% (same downpayment ratio than for 1st-time home buyers).
- 50 bp cut in existing mortgage rate (RMB150bn savings for 50 million households or 150 million people), i.e. 0.1% of GDP.
- Allow the RMB300bn relending facility to support 100% of the principal of eligible loans, which is used by banks to support local govts in their purchases of unsold but completed homes. Previously, only 60% of principal was supported.
- Existing policy measures on commercial property loans (allow developers use bank loans backed by their operating commercial properties to repay other existing loans and bonds) and the 16-point financial measures for the property financing support will remain effective by end-2026, as it was extended from end-2024.

• **Bank recapitalization:**

- China is considering injecting more than 1tn yuan of capital into its biggest state banks to increase their capacity to offer loans.

• **Liquidity support for equity markets:**

- RMB500bn swap facility for securities firms, funds and insurance companies to tap liquidity from the PBoC to buy stocks.
- RMB300bn relending facility for banks to support listed companies and major shareholders to buy back shares and raise holdings.

• **Local governments debt swap:**

- Beijing raised local gov't debt ceiling for hidden debt swap by RMB6000bn yuan and confirmed a 5-year plan to set aside RMB800bn each year from Local Gov't Special Bond (LGSB) quota for hidden debt swap. However, LGSBs used to be almost entirely for infrastructure investment and *the newly planned portion for debt swap is not incremental to the annual quota and would eat into infrastructure financing.*

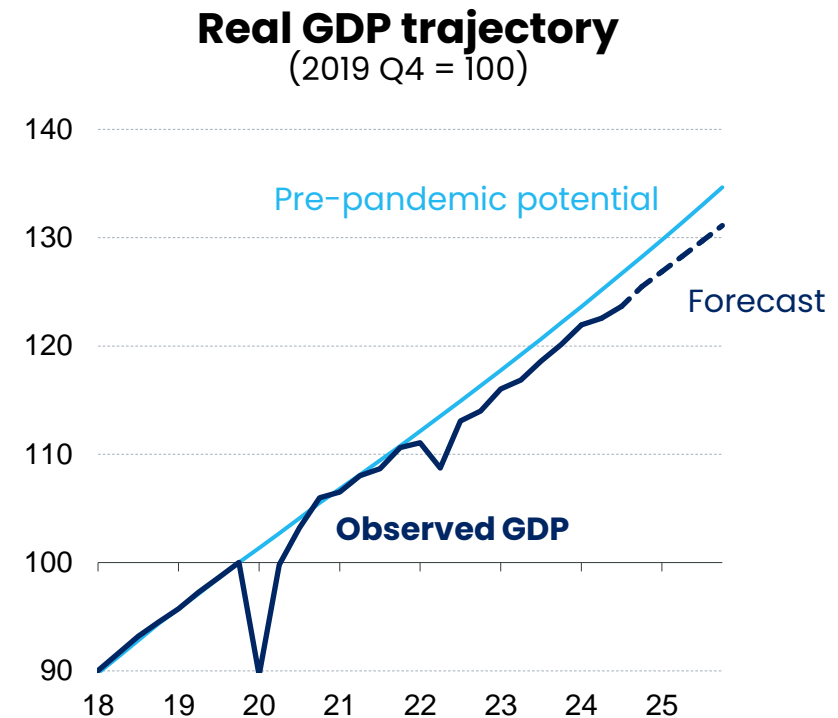
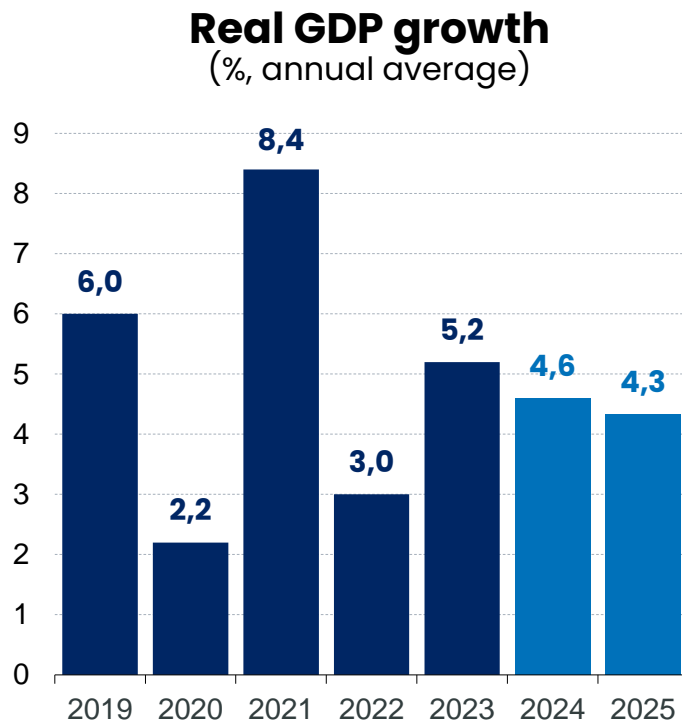
• **Fiscal measures under discussion:**

- RMB150bn of vouchers for low-income people, i.e. 0.1% of GDP
- Other support mentioned but no specifics were offered on the size of fiscal spending.
- RMB800 per month (8% of median income) per child for households with 2 or more children (excluding the first child), i.e. RMB 830 billions (~0.65% of GDP).

➔ **Estimated fiscal stimulus: ~1% of GDP**



This will give a short-term boost to activity but is unlikely to durably offset deflationary forces... especially if D. Trump implements its tariff policy*



(*) A back of the envelope calculation points to a 60% tariff increase possibly subtracting 1.5%-2% to China GDP in 2025.





3 United States

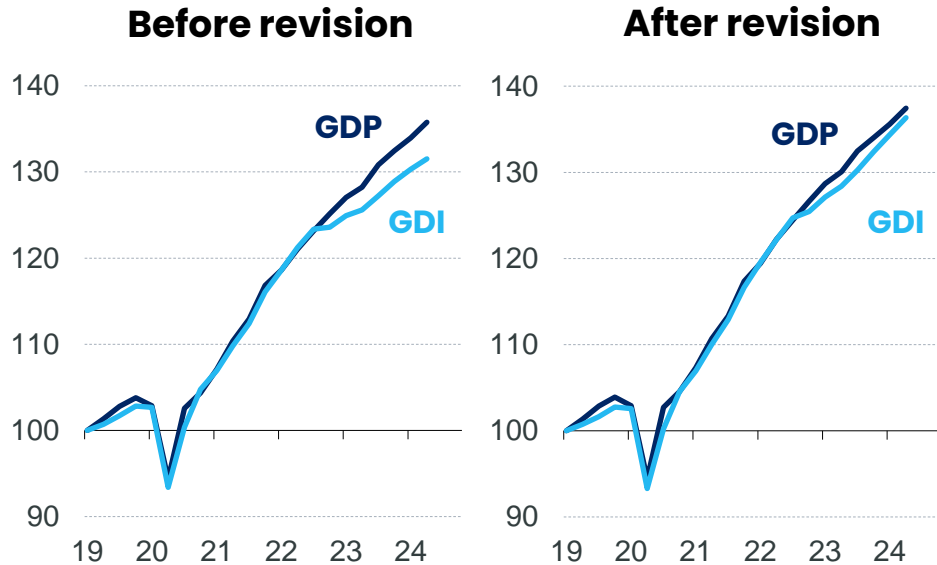
Lower uncertainty... but higher unpredictability!



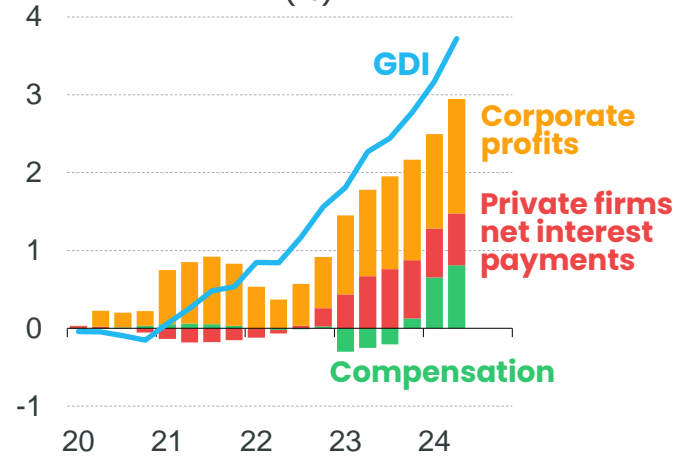
After the annual NIPA revisions, the past looks brighter: GDP, the saving rate and trend productivity are higher!

Revisions to Gross Domestic Income

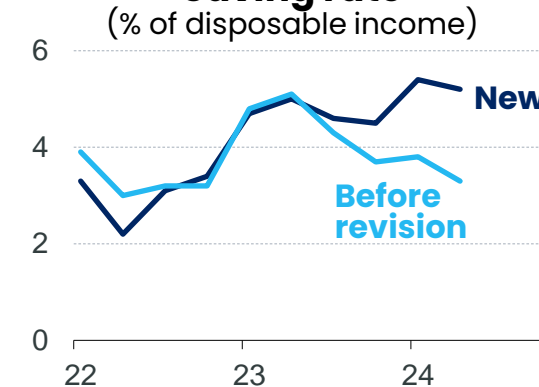
GDI versus GDP
(2019 Q1 = 100)



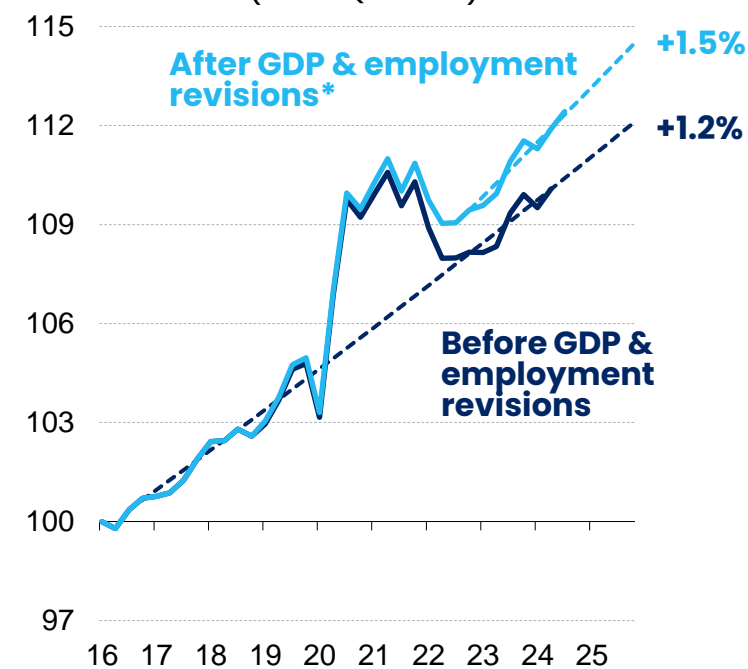
Cumulated revision in GDI
(%)



Saving rate



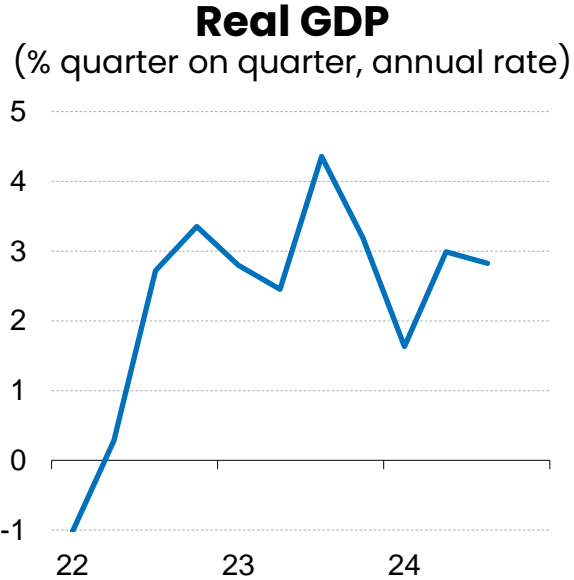
GDP per employment
(2016 Q1 = 100)



(*) The preliminary estimate of the benchmark revision indicates an adjustment to March 2024 total nonfarm employment of -818000 (-0.5%). The revision rests on data from the QCEW which is based on state unemployment insurance tax records. This means that these data likely do not pick up part of unauthorized migrant workers. Latest data point to a final revision closer to -500000 (-0.3%).

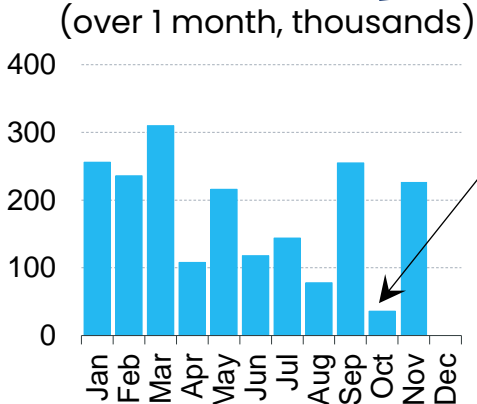
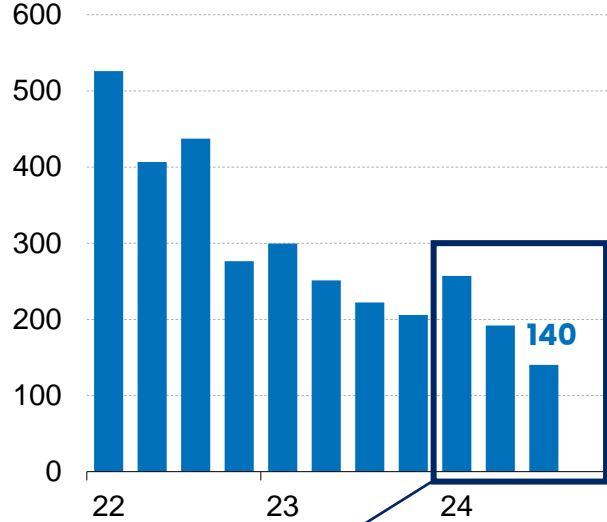


Still, the recent deceleration in job creations may not be sufficient to meet the labor supply constraint



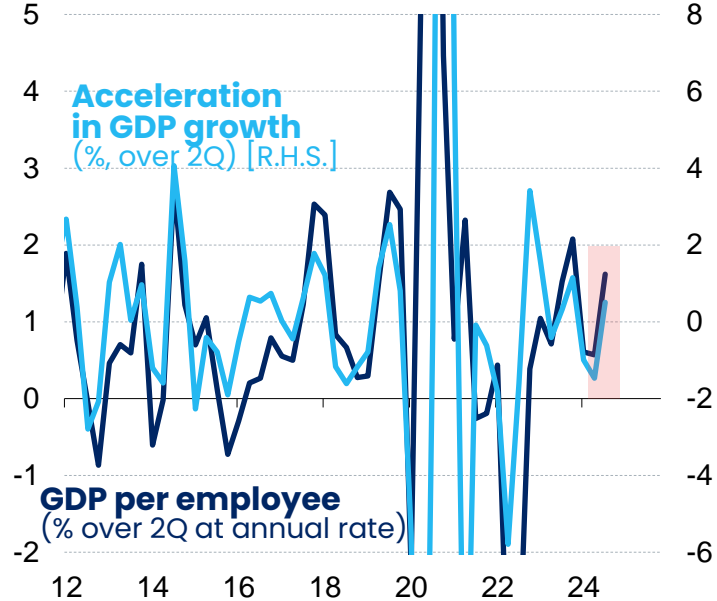
Change in employment

(over 1 quarter, monthly rate, thousands)



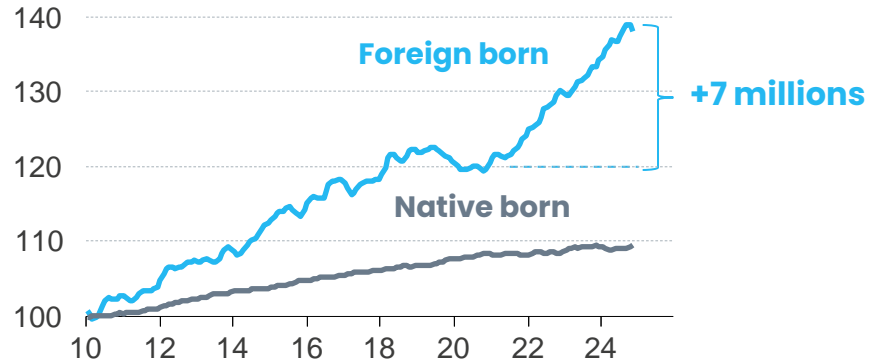
“It is likely that payroll employment estimates in some industries were affected by the hurricanes; however, it is not possible to quantify the net effect on the over-the-month change in national employment”. BLS Manufacturing payrolls employment fell 46,000, the biggest drop since April 2020 and largely reflecting strikes notably by 33,000 Boeing workers.

Cyclical behavior of productivity

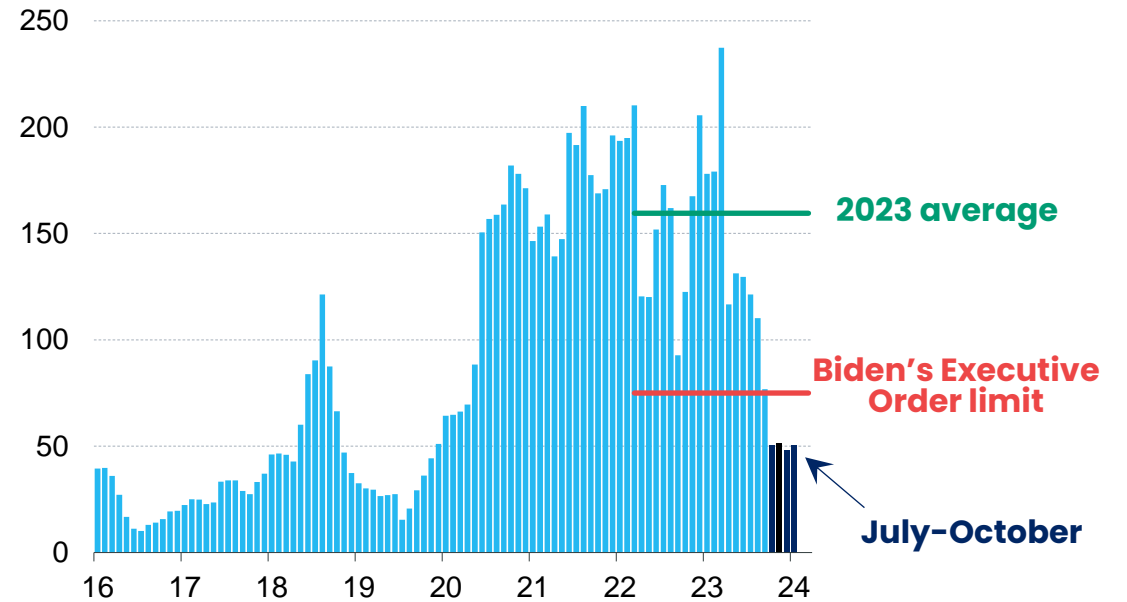


Immigration, that allowed the workforce to grow faster, has recently been curbed

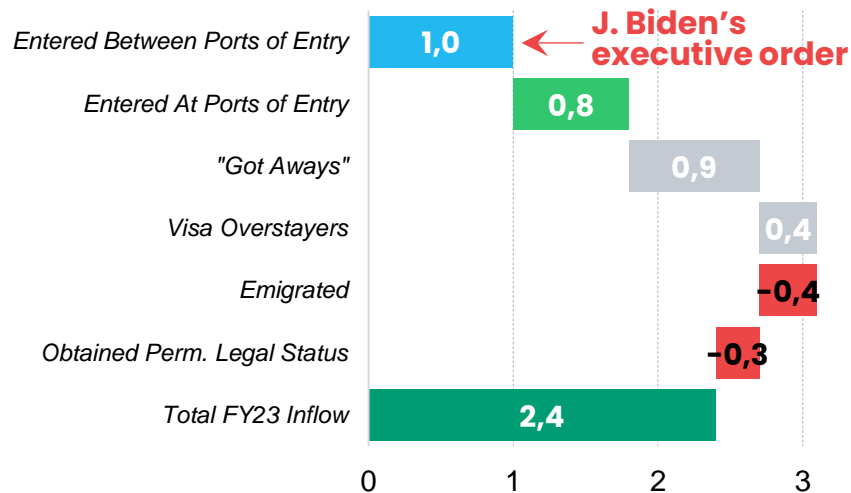
Foreign- and native-born population
(aged 16 and over, January 2010 = 100)



Southwest land border encounters between ports of entry
(thousands per month, adults only)

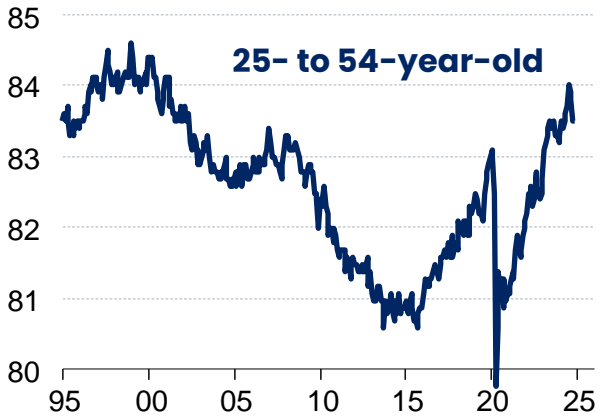


Nonlegal / Pending Status immigrants
(2023, millions)

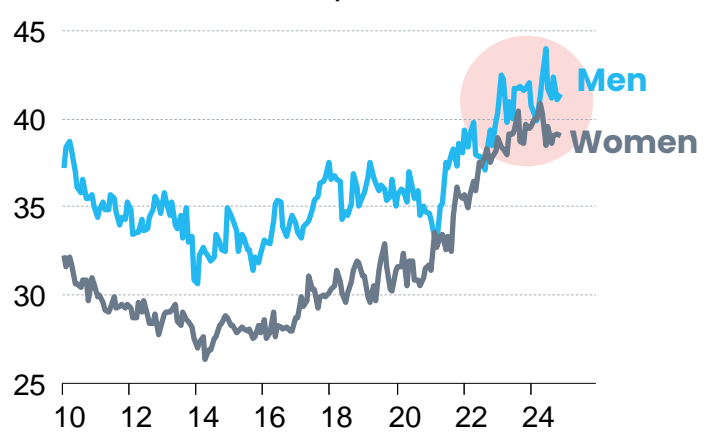


Given the tightness in the labor market, job creations are supposed to stabilize around 110 000 / month in our baseline scenario

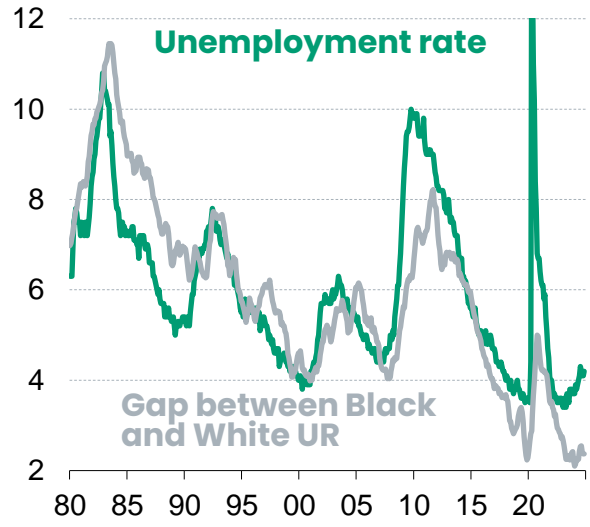
Prime age participation rate (%)



Disabled participation rate (% 16- to 64-year-old)



Unemployment rate (%)



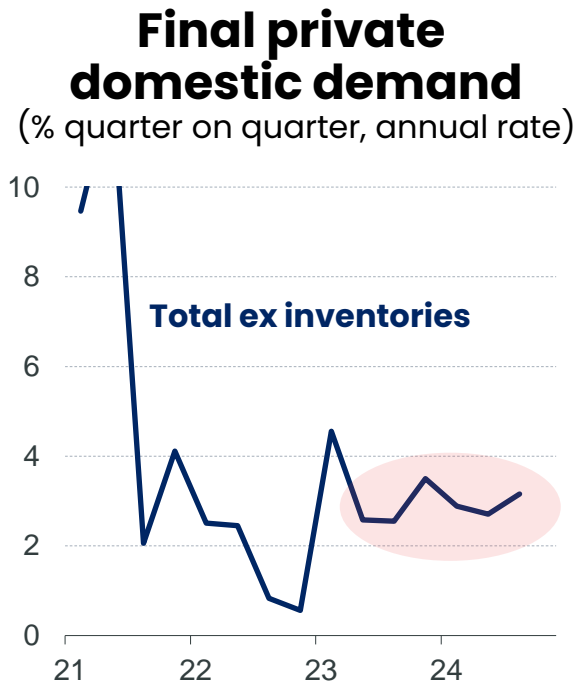
Labor force growth rate

	2025
Natural working age population	50 000 / month
Immigration	130 000 / month
Working age population	180 000 / month (+0.8%)
Participation rate	Unchanged
Labor force growth	110 000 / month (+0.8%)

→ Even assuming increased trend productivity, growth in our baseline scenario has to slow down to 2.3% (0.8% + 1.5%) to prevent a tightening in the labor market.

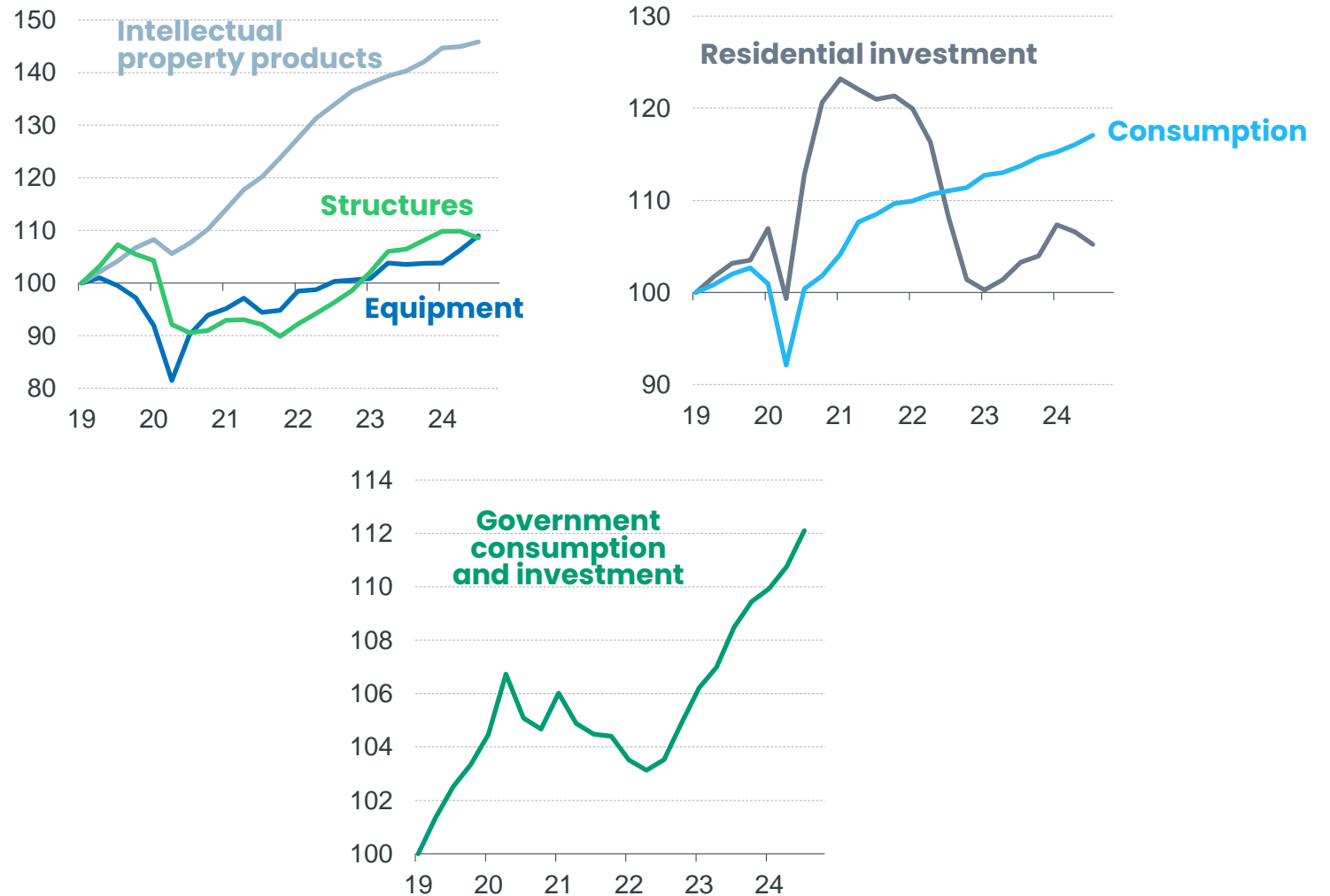


Up to now, domestic demand has remained strong... but some slowing down factors are at work



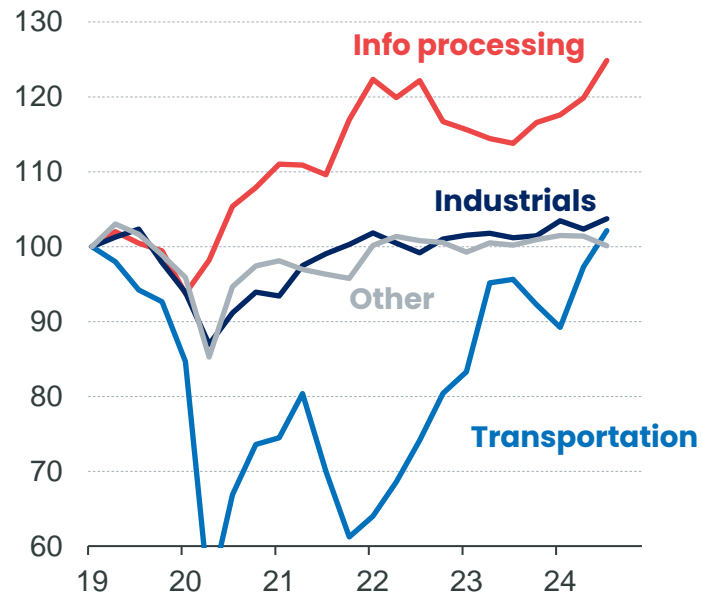
Final domestic demand components

(2019 Q1 = 100)

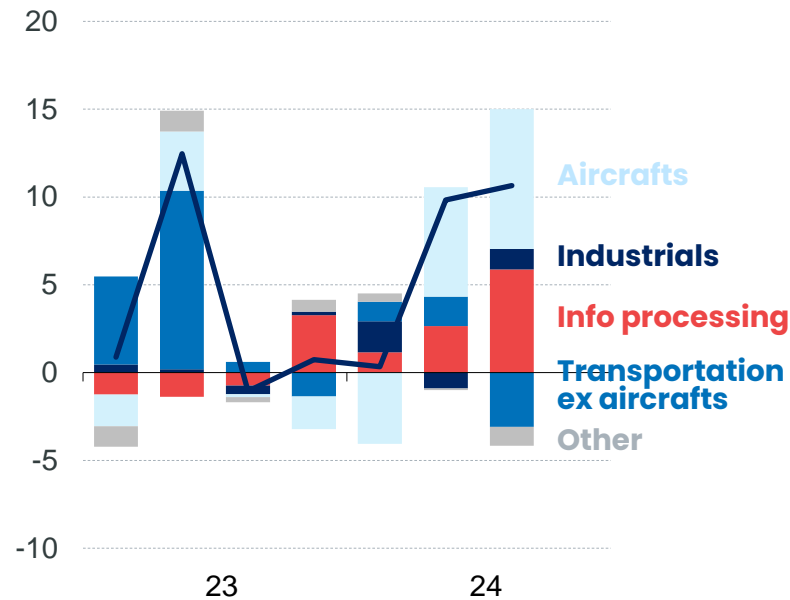


The surge in equipment investment has been exaggerated by booming nondefense aircraft transportation items

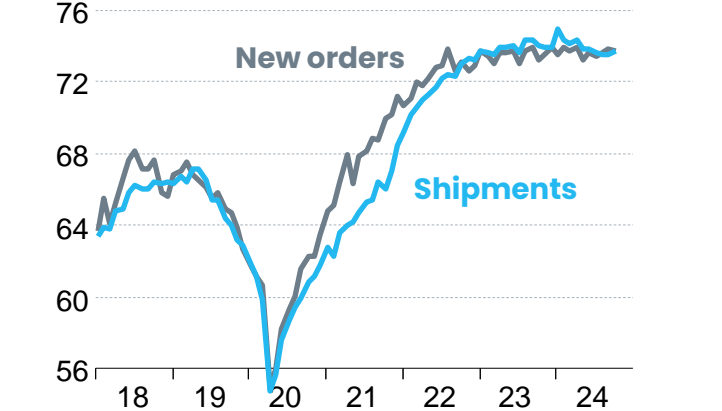
Equipment investment by type
(2019 Q1 = 100)



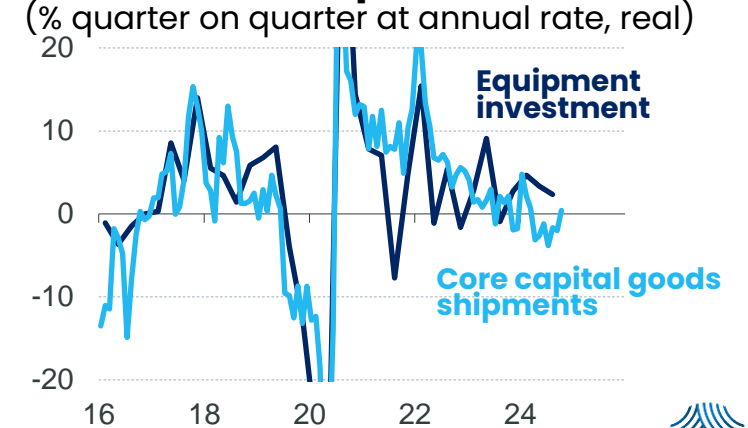
Contributions to equipment investment growth
(% quarter on quarter at annual rate)



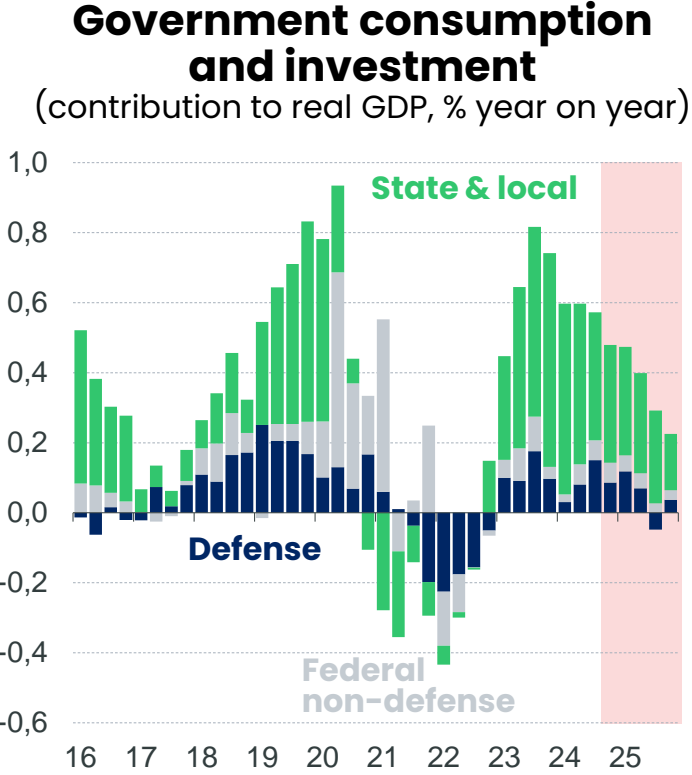
Core capital goods shipments and orders
(billions of dollars, nondefense ex aircraft)



Equipment investment and shipments
(% quarter on quarter at annual rate, real)

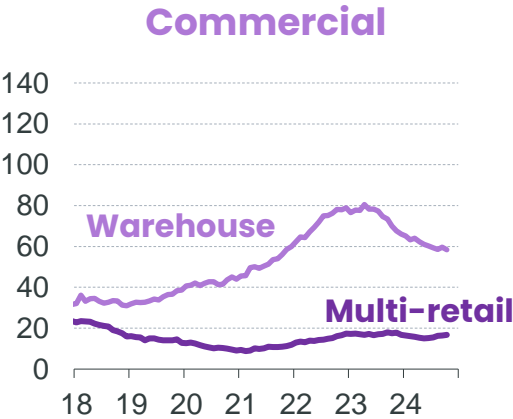
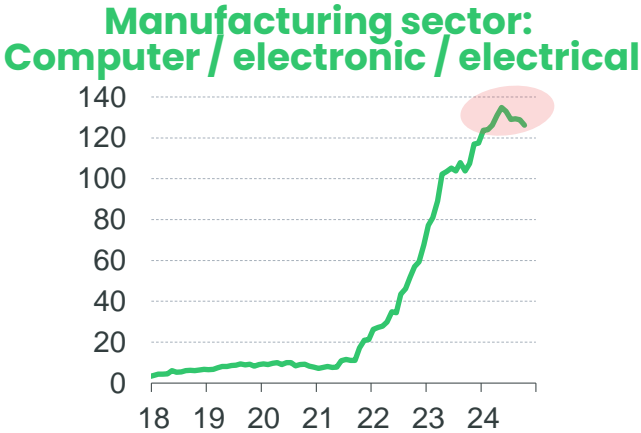
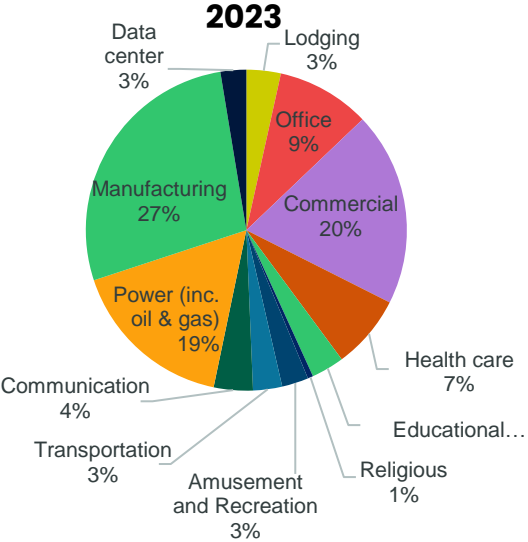
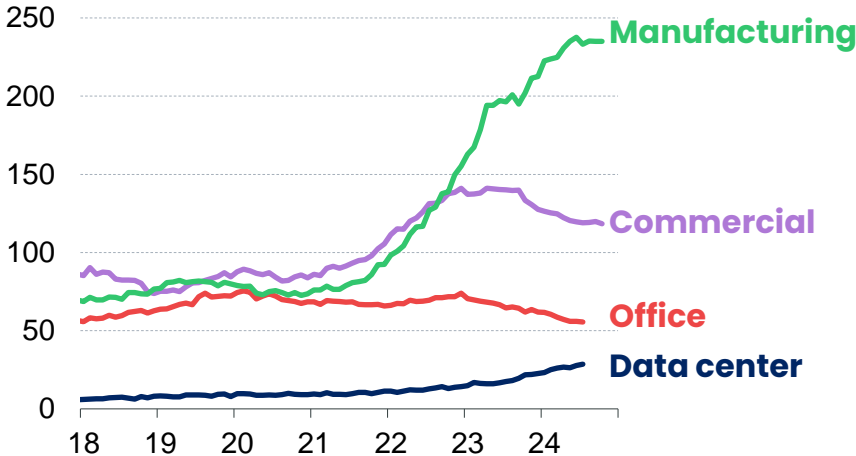


The support provided by government spending and firms' structures investment will weaken



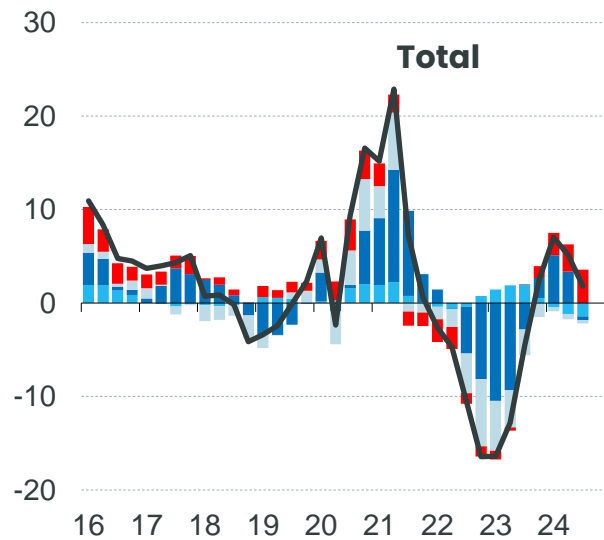
Private investment in non-residential structures

(\$ billion, current prices, annual rate)

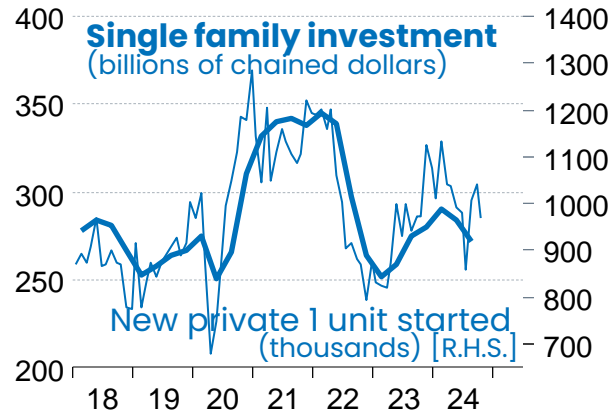


Housing is unlikely to significantly boost activity... (I)

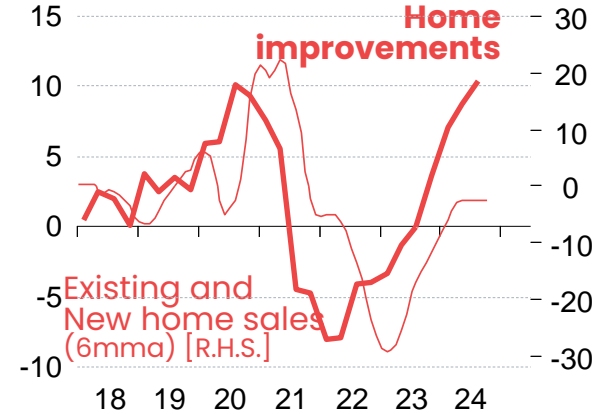
Residential investment
(% year on year contributions)



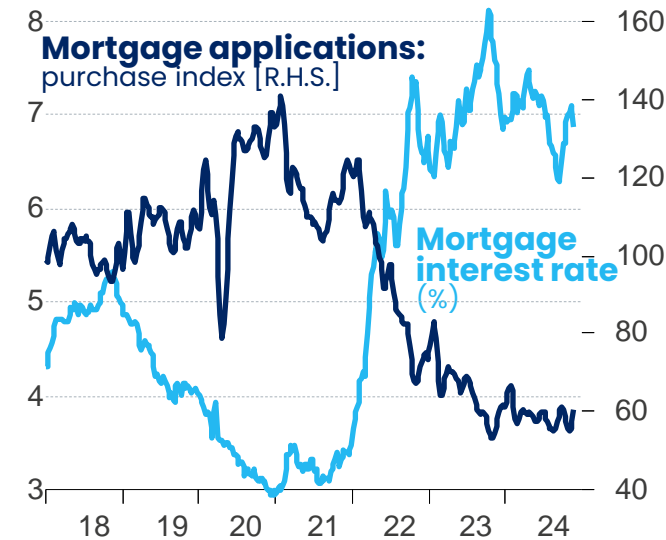
Single family investment
(annual rate)



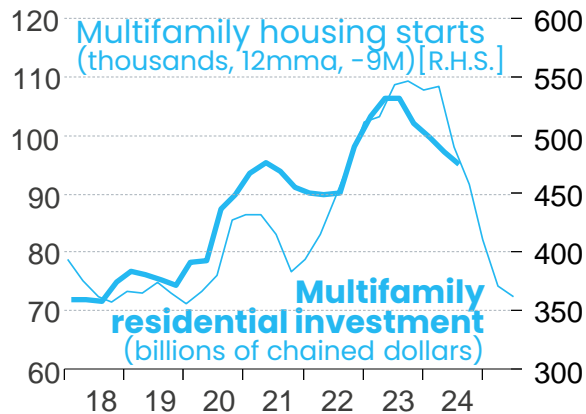
Home improvements
(% year on year, volume)



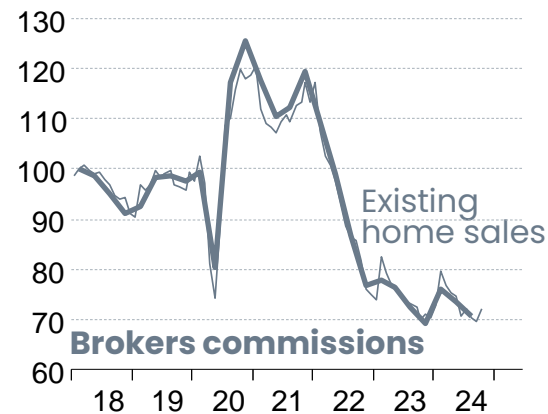
Interest rates and mortgage applications



Multifamily investment
(volume, annual rate)



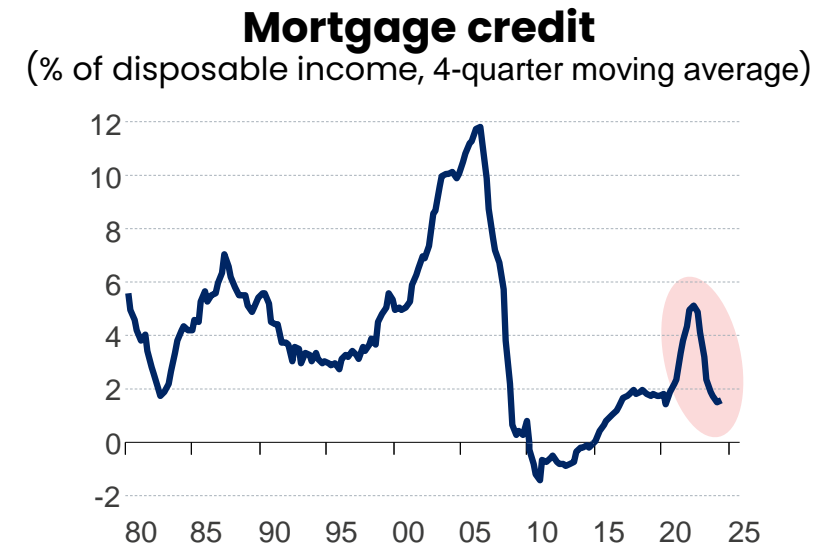
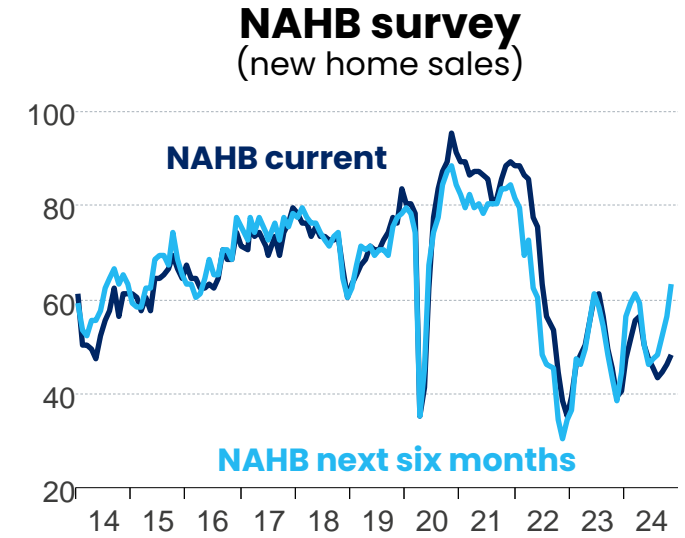
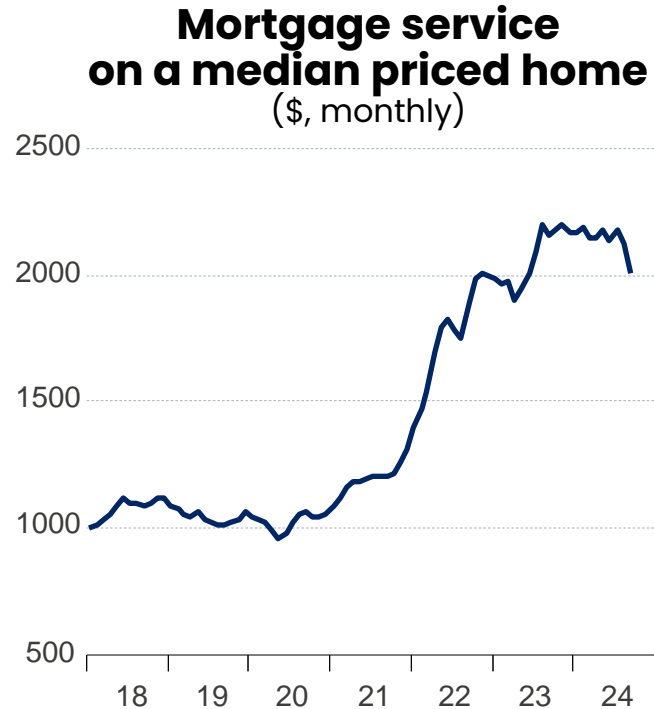
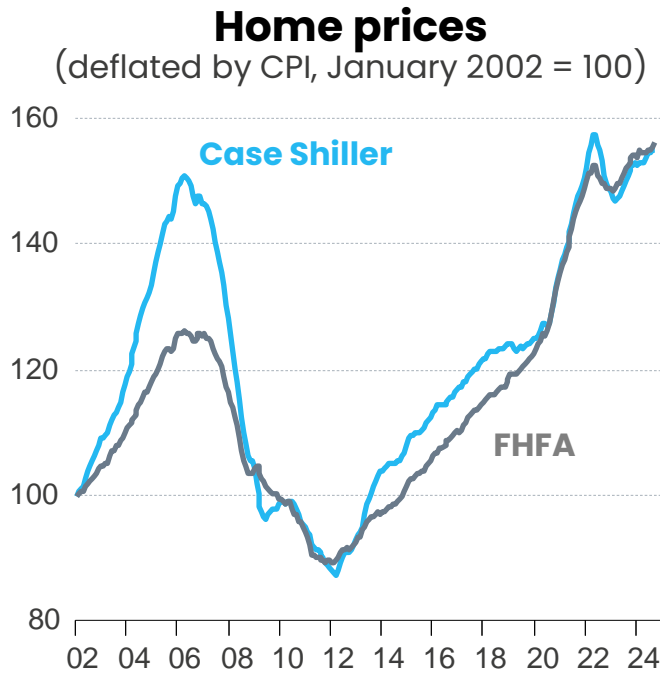
Brokers commissions
(January 2018 = 100)



- Multifamily
- Single family
- Brokers' commissions
- Improvements

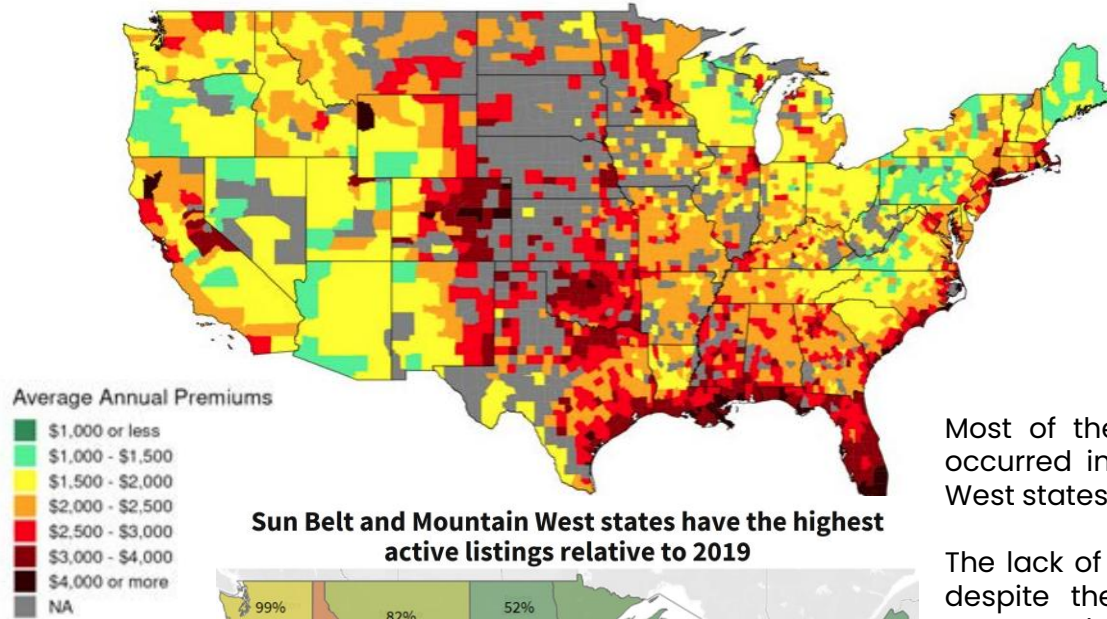


Housing is unlikely to significantly boost activity.. (II)

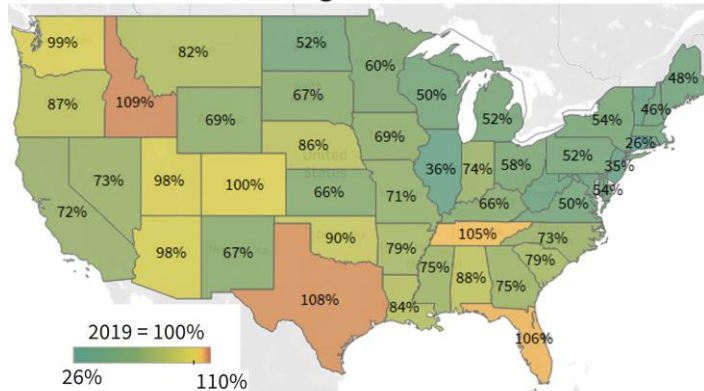


... and households are concerned about the availability and the cost of insurance

Average annual insurance premiums by county (2023 HI)



Sun Belt and Mountain West states have the highest active listings relative to 2019



Most of the rise in homes for sale have occurred in Sun Belt and a few Mountain West states.

The lack of a sales pick up in these states, despite the increase in for-sale listings, means there are no longer enough borrowers able or willing to transact at current price and mortgage rates, whether **because affordability is now binding** for the marginal buyer, **because new home sales are more attractive**, or other reasons, such as **concern about availability and cost of insurance**.

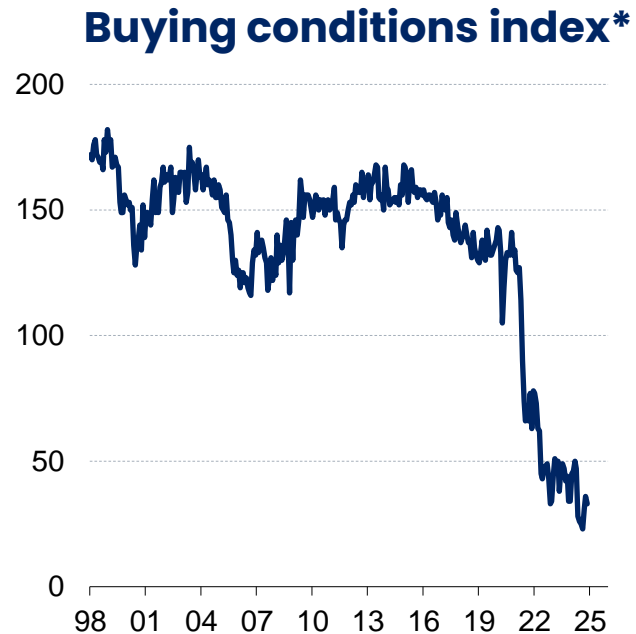
Economic Developments – Sept. 2024, Fannie Mae.

Average annual homeowners' insurance premiums (dollars)

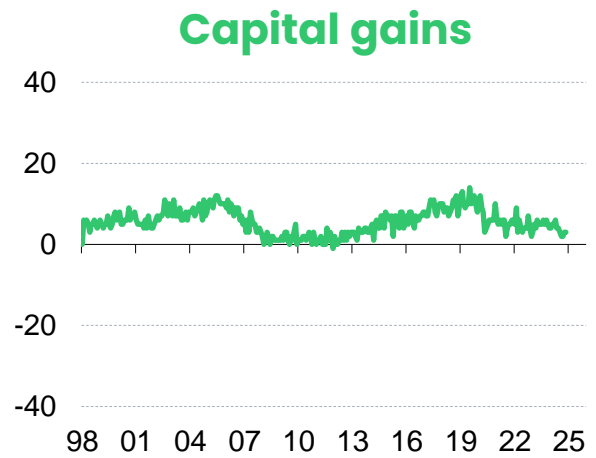
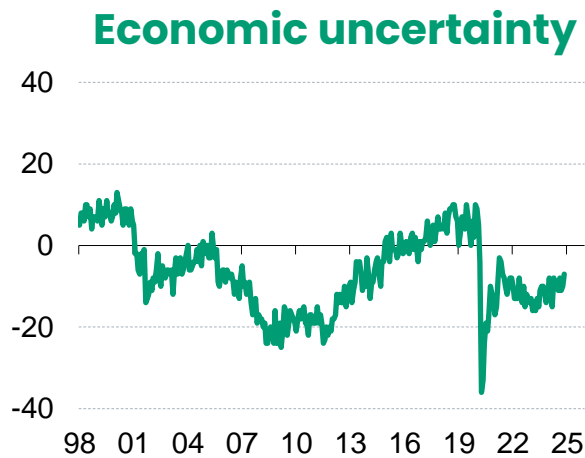
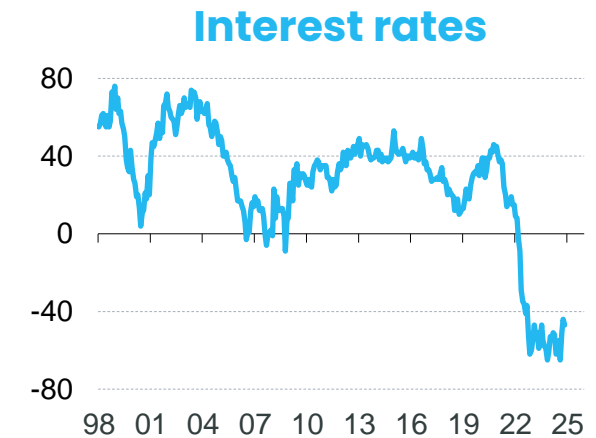


Memo. Households believe it's not a good time to buy a home

Buying conditions for houses by selected reasons (Michigan survey)

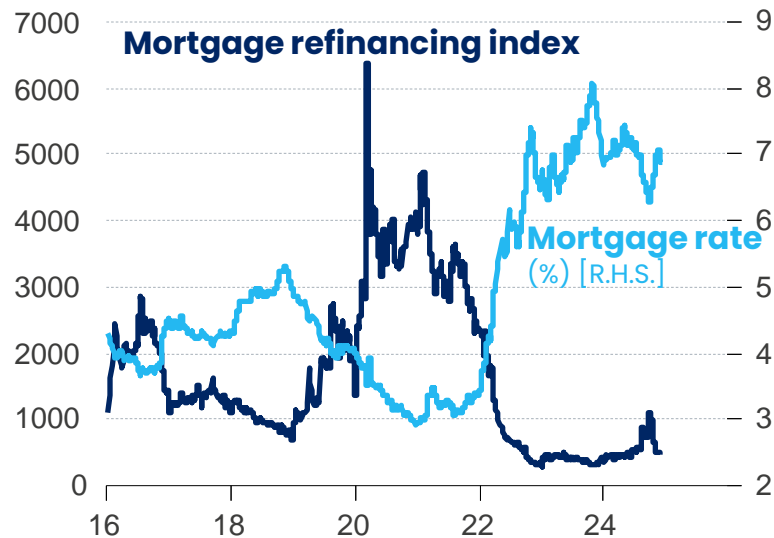


(*) Generally speaking, do you think now is a good time or a bad time to buy a house?

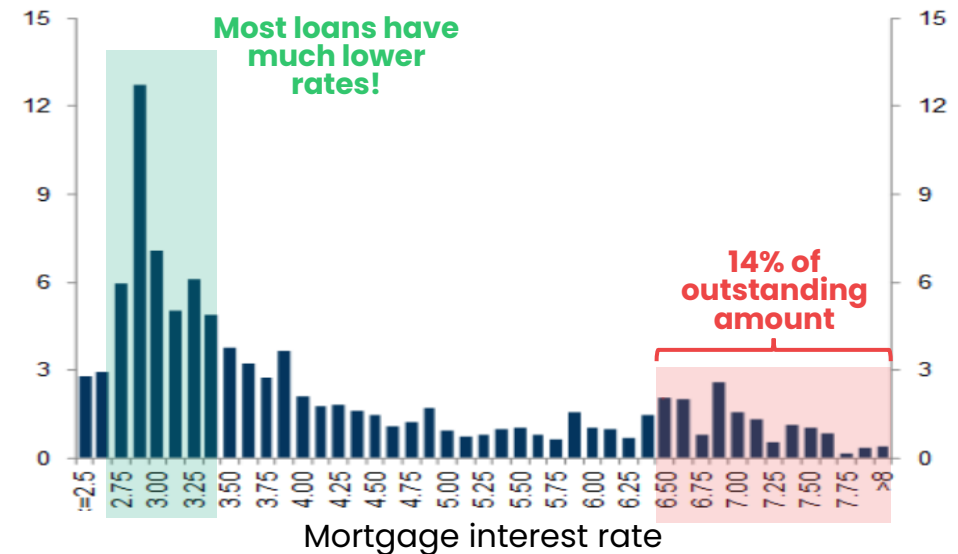


Even if mortgage rates fall to 6%, refinancing is unlikely to significantly boost activity

Refinancing applications and mortgage rate

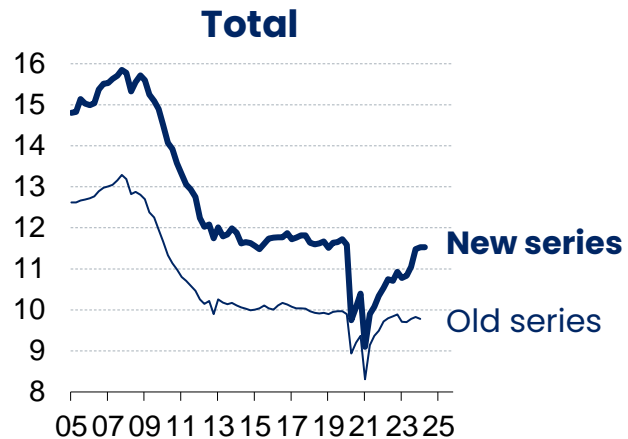


Distribution of outstanding 30-year conforming mortgages by interest rate levels (%)

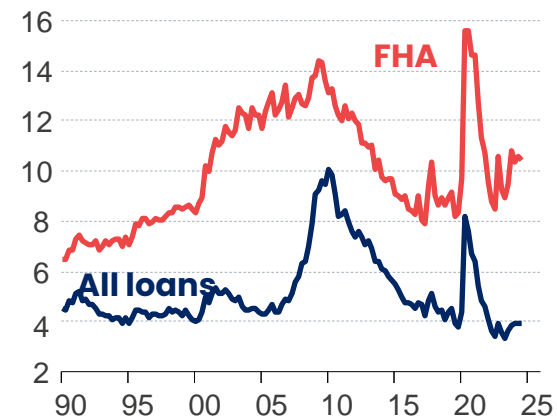


While mortgage delinquencies remain low, they have significantly increased for consumer credit

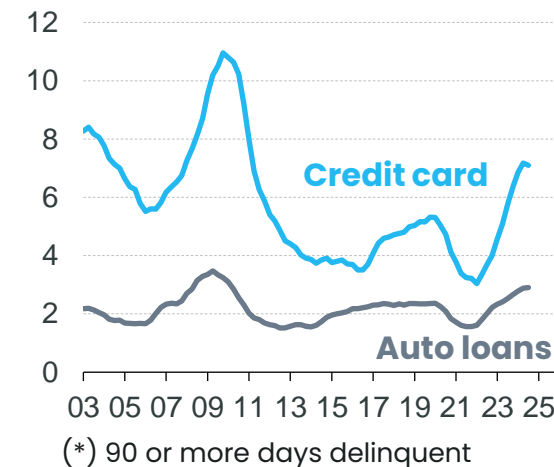
Household debt service payments
(% of disposable income)



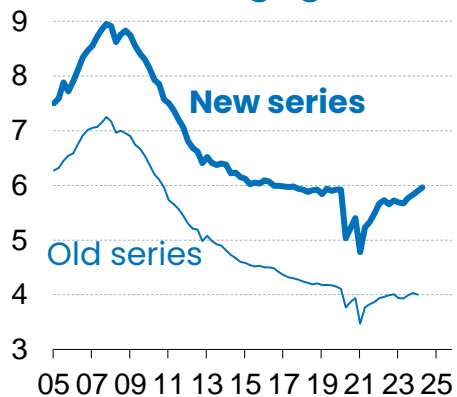
Residential mortgage delinquency rates
(% of outstanding loans)



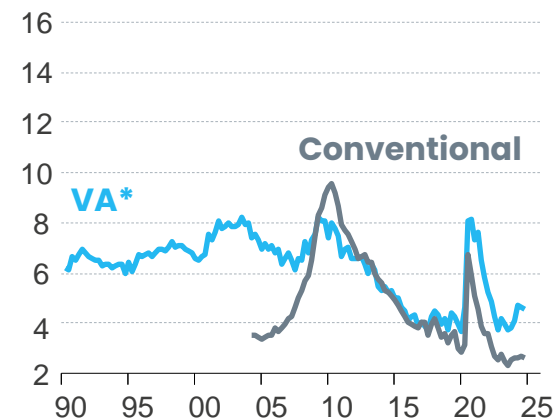
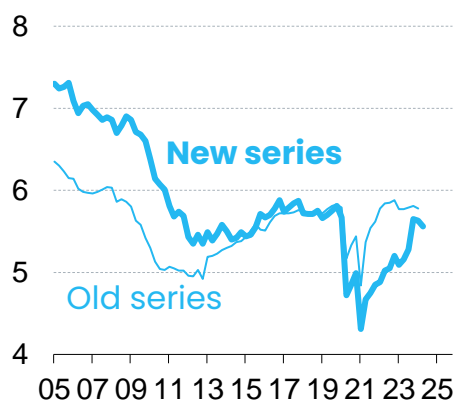
New seriously delinquent balances*
(% of outstanding loans)



Mortgage



Consumer credit

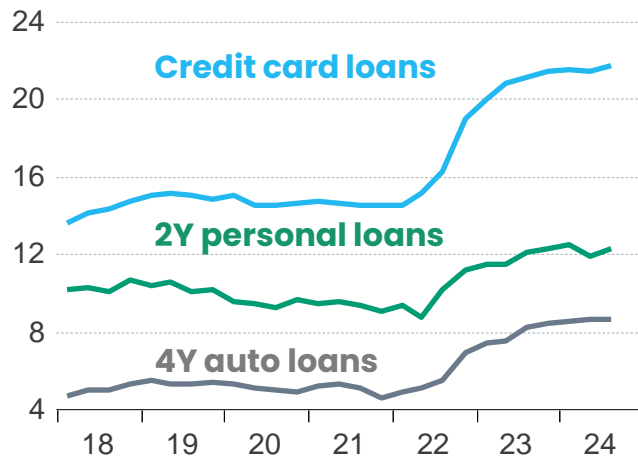


(*) Veteran Administration

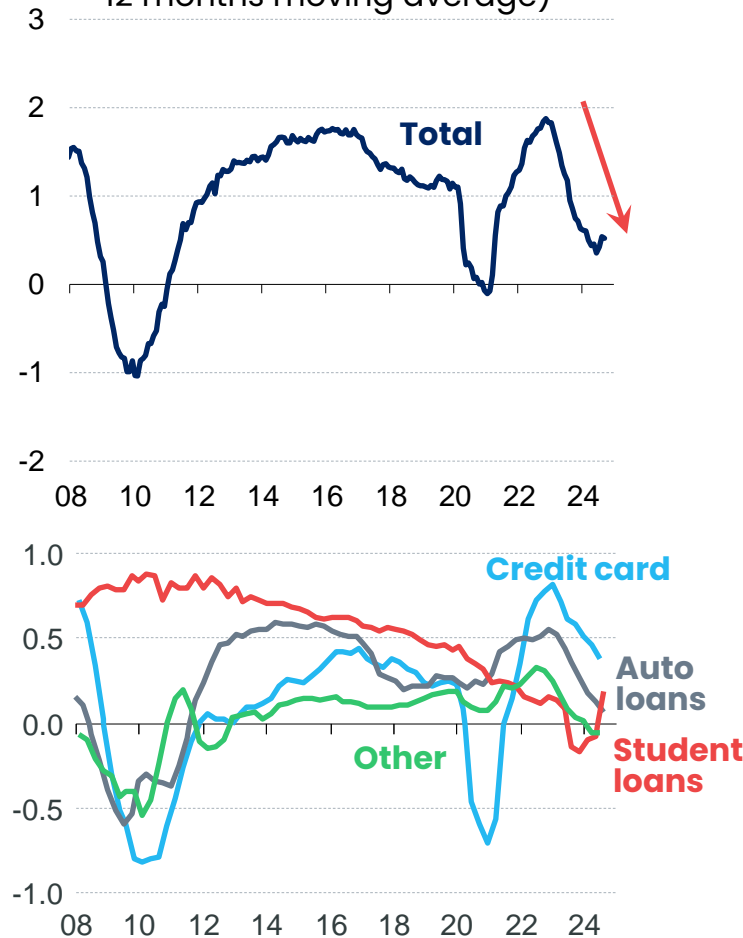


High interest rates will continue to curb consumer credit

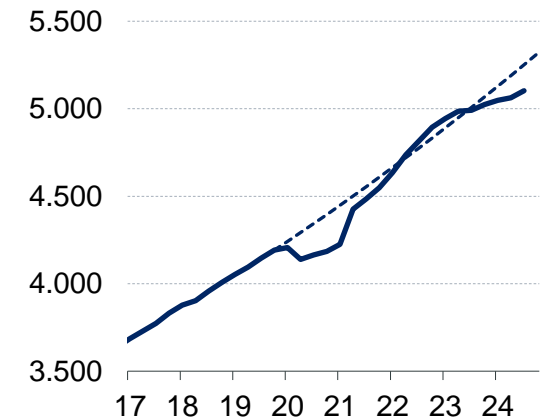
Interest rate on consumer credit (%)



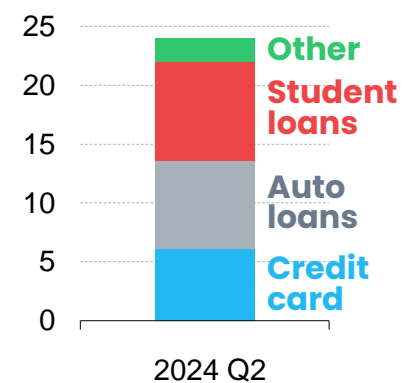
Consumer credit
(% of disposable income, 12 months moving average)



Outstanding amount of consumer credit
(\$ billion)



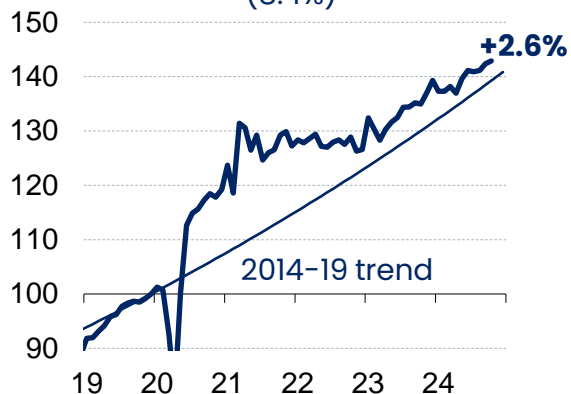
(% of disposable income)



Memo. Services consumption has already more than caught up with its past trend!

Household consumption (December 2019 = 100, volume)

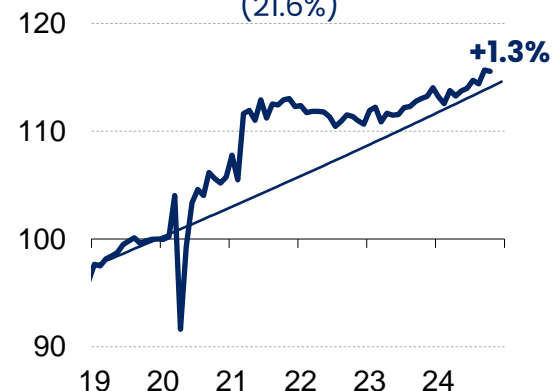
Durable goods ex autos (8.4%)



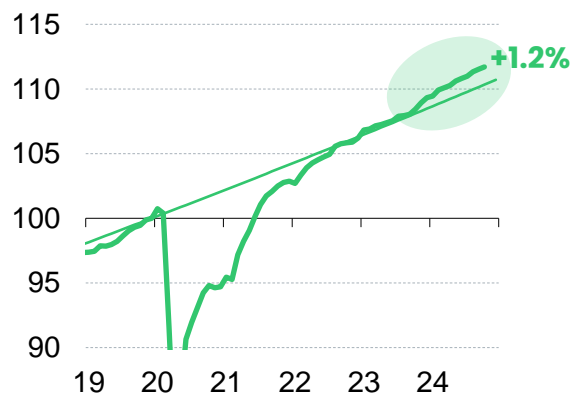
Autos (4.2%)



Nondurable goods (21.6%)

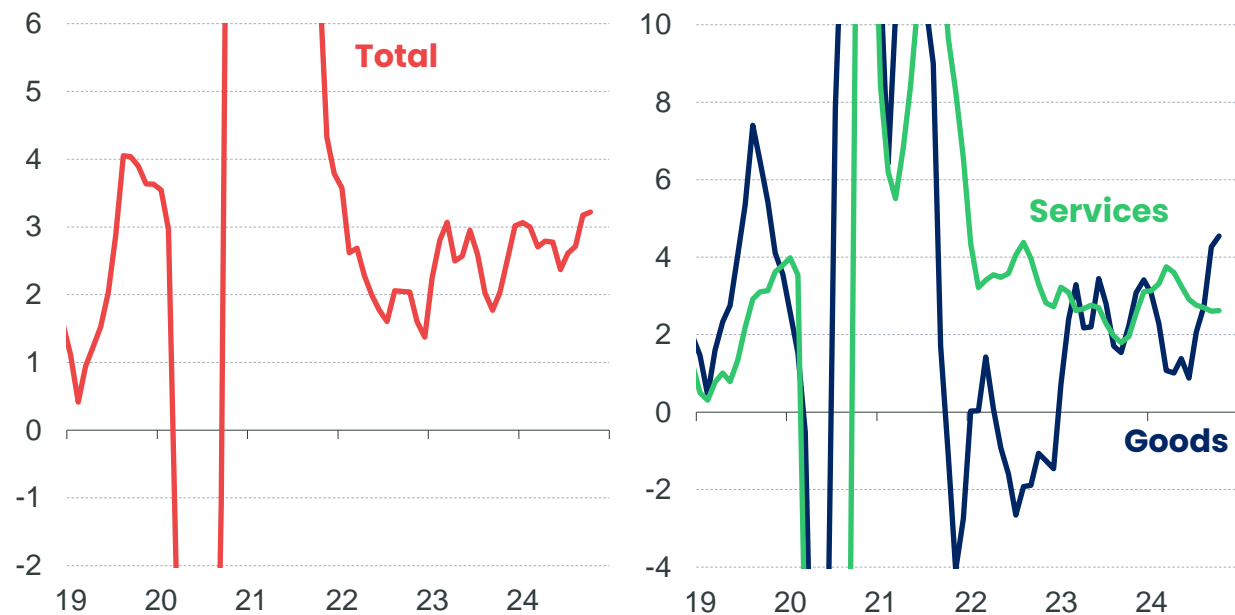


Services (65.8%)



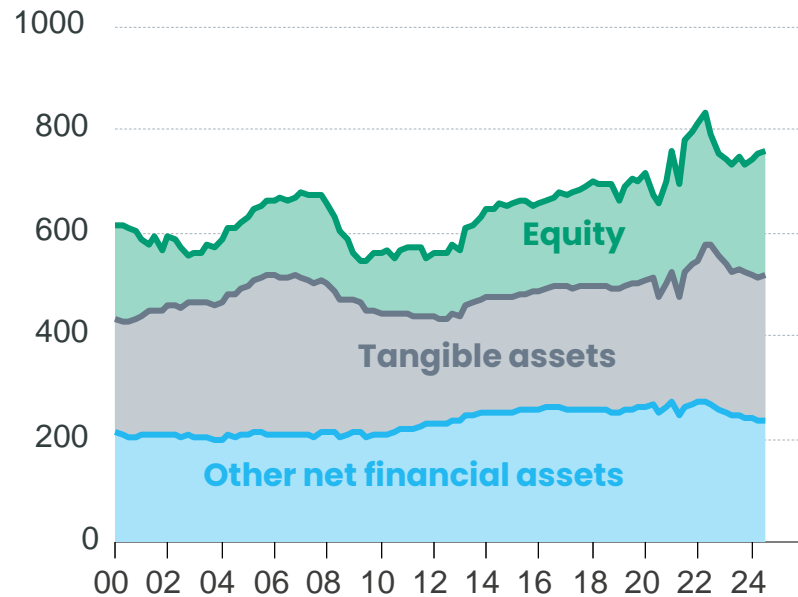
Consumption

(%, 6-month change at annual rate, 3 months moving average, volume)



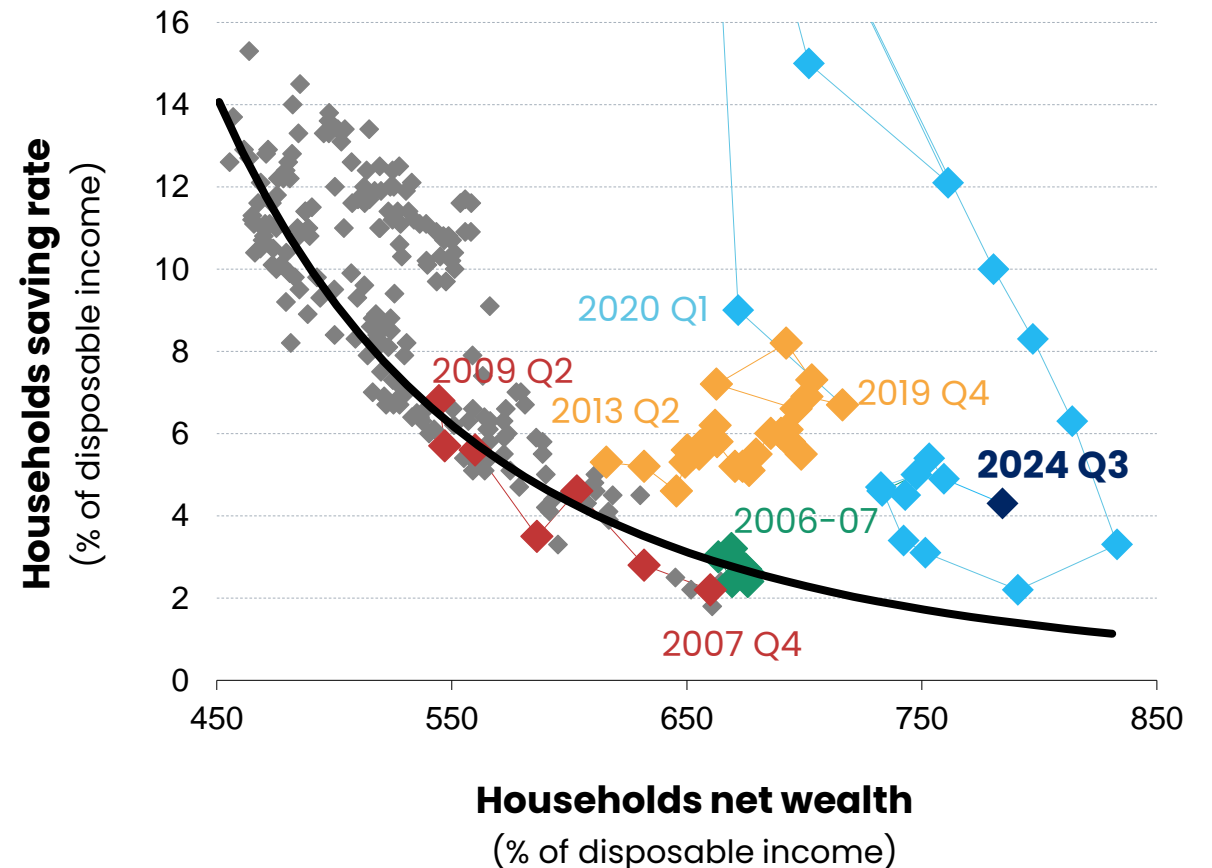
Given the rise in wealth over the last couple of years, the saving rate is not that low!

Households' net wealth
(% of disposable income)

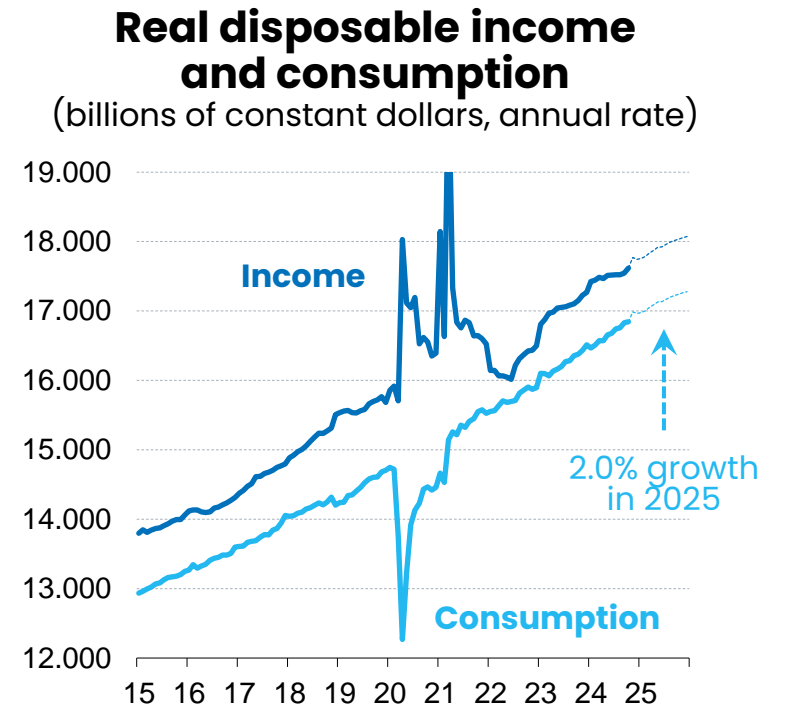
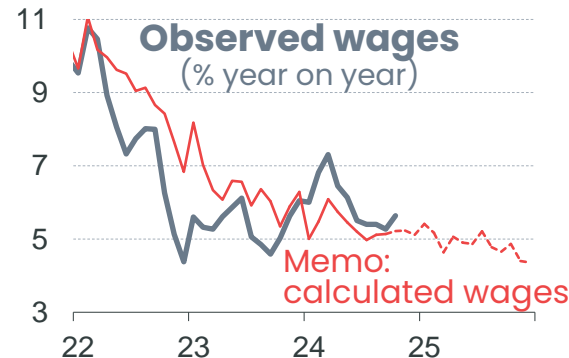
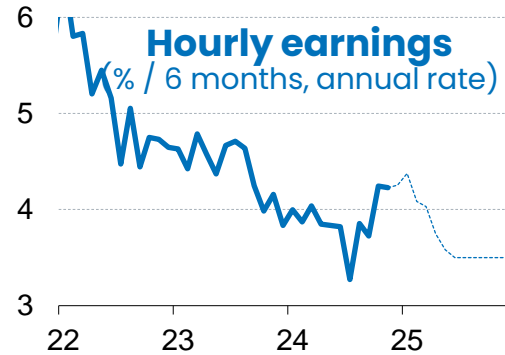
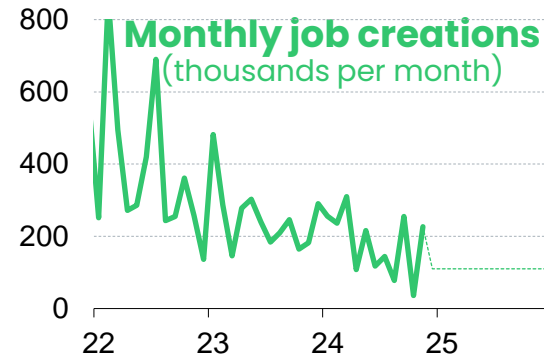
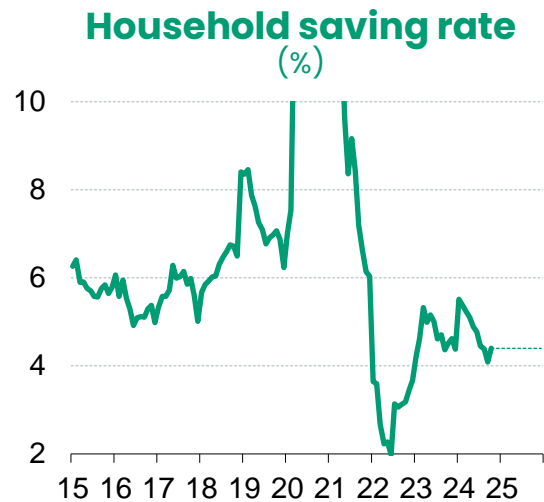


From 2019 Q4 to 2024 Q2, household net wealth has increased by close to 80 points of disposable income.

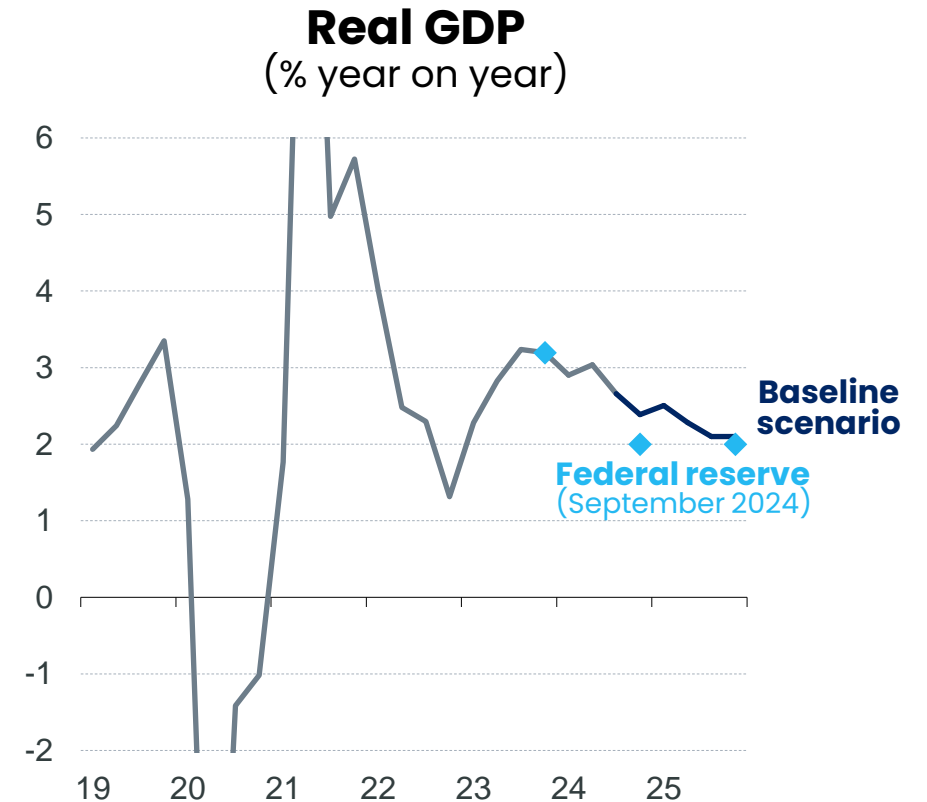
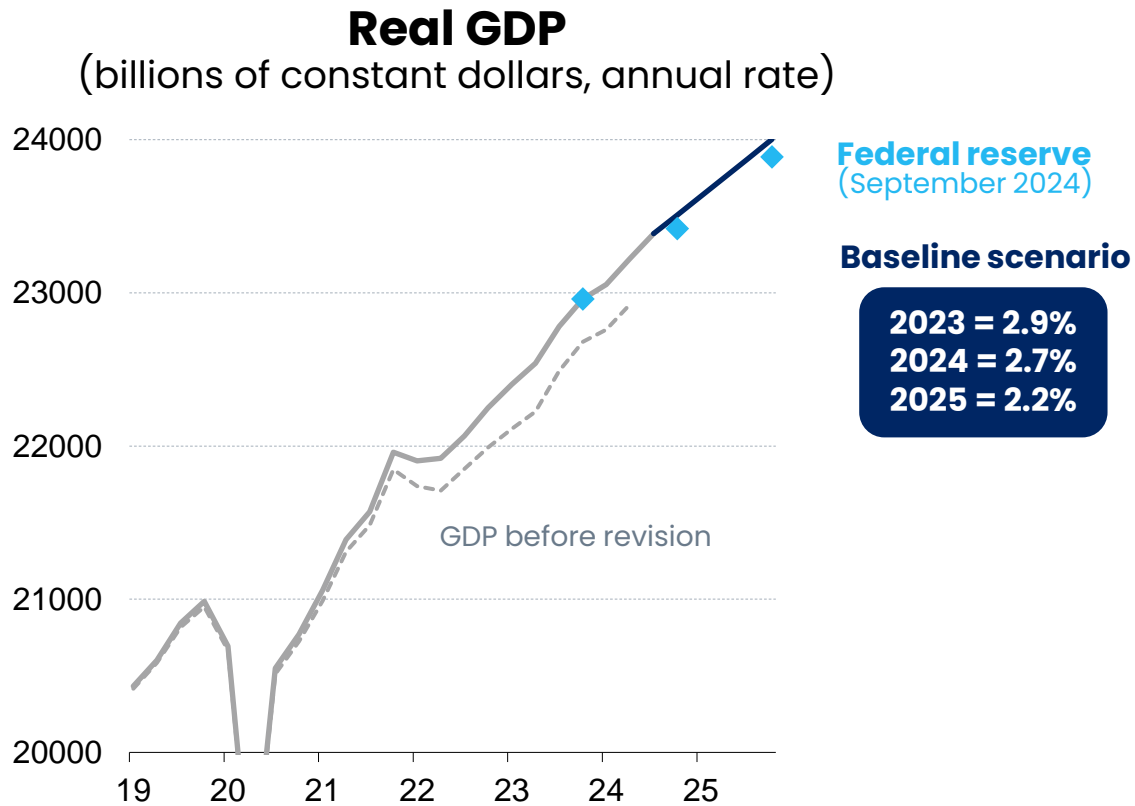
Households' net wealth and saving rate
(1959-2024)



Even with decelerating compensation, consumption can keep growing at a decent pace in real terms

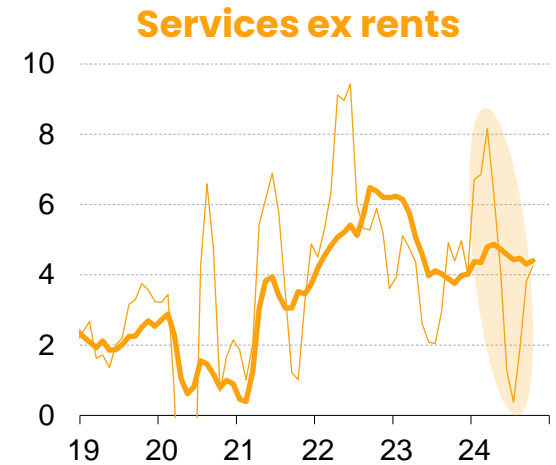
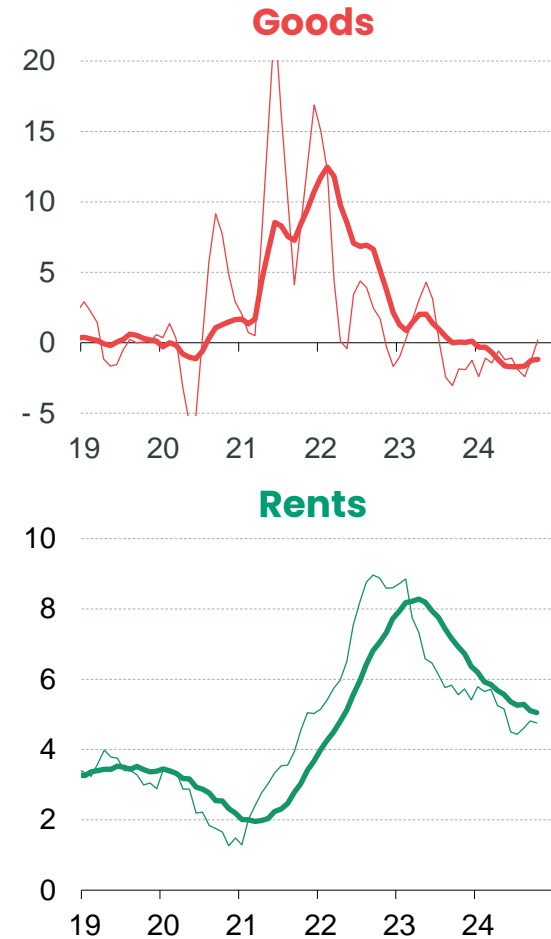
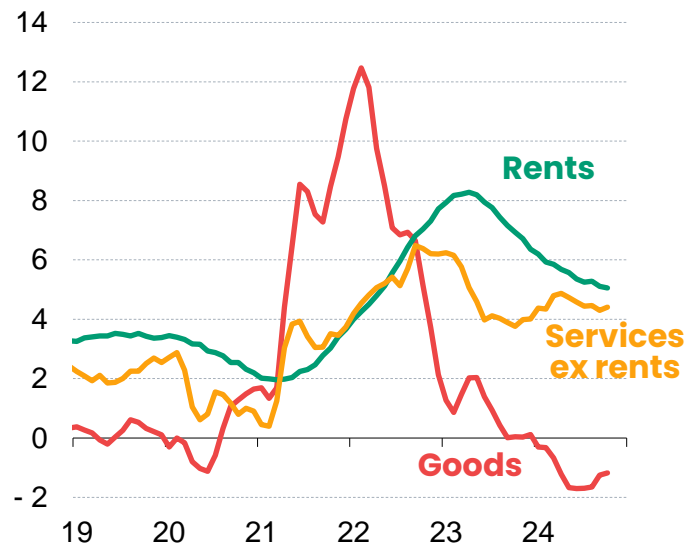


Before the election, our baseline scenario was for GDP growth to decelerate to slightly above 2% in 2025



While the disinflation trend is clear, core services prices are still growing at around 4%

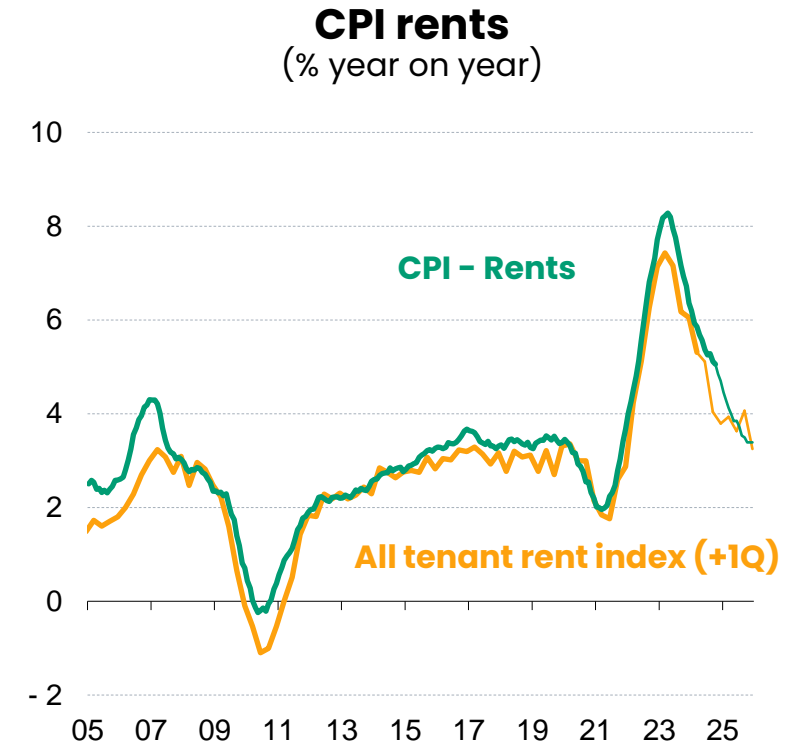
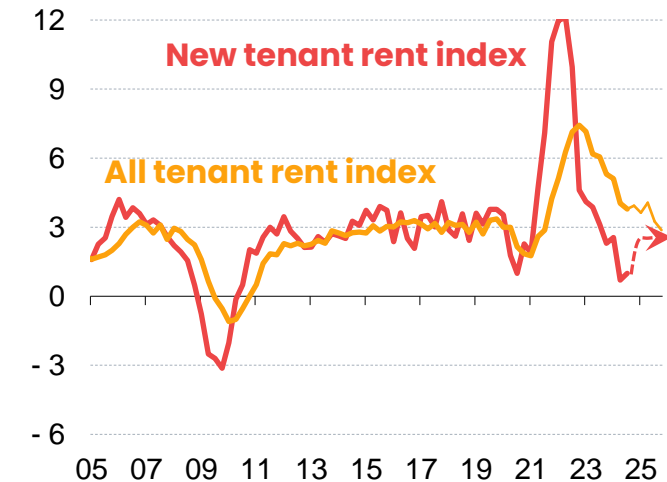
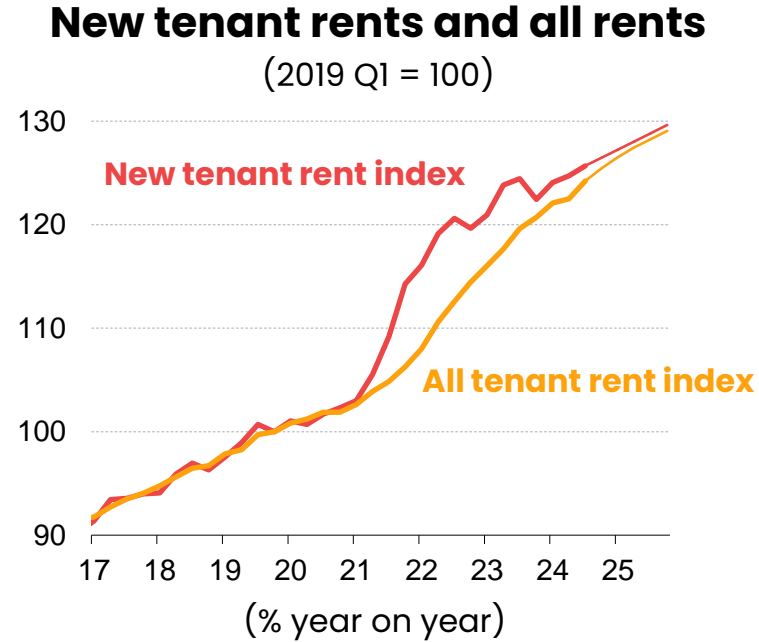
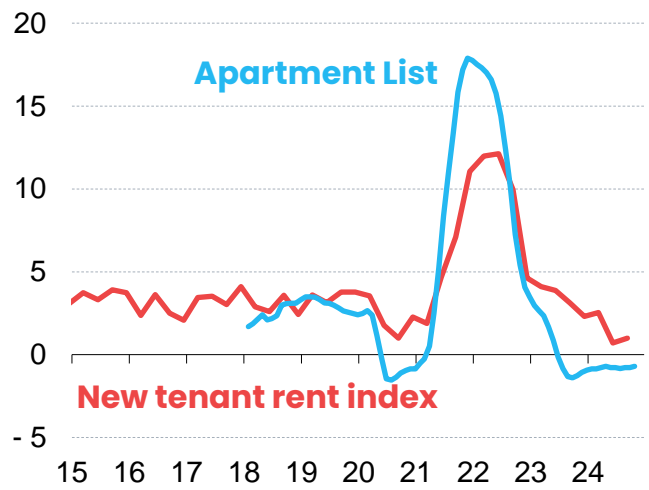
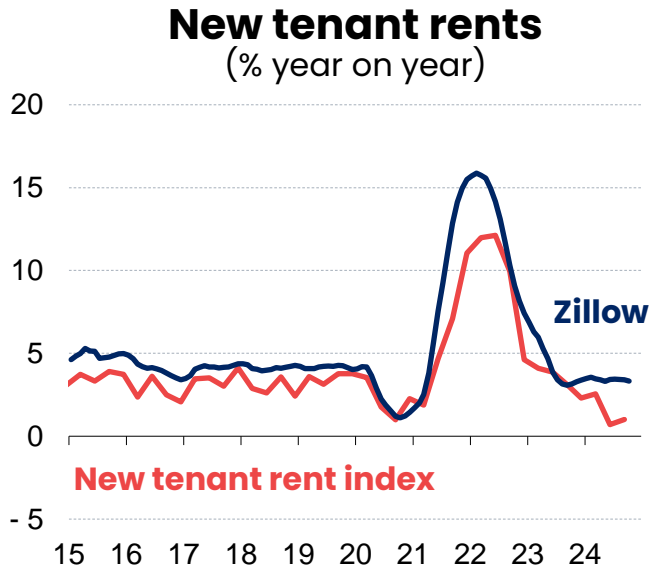
Core CPI inflation



— year on year
 — over 3 months, annual rate



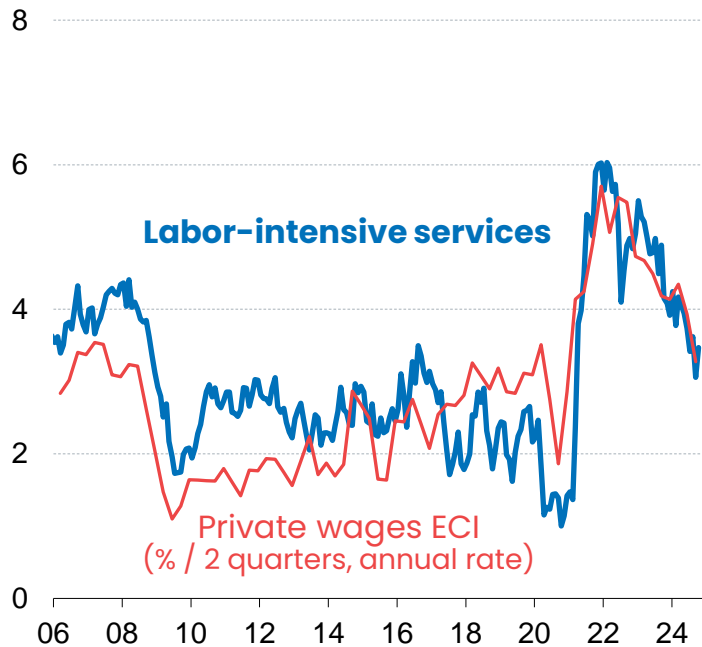
Rents are on track to decelerate further



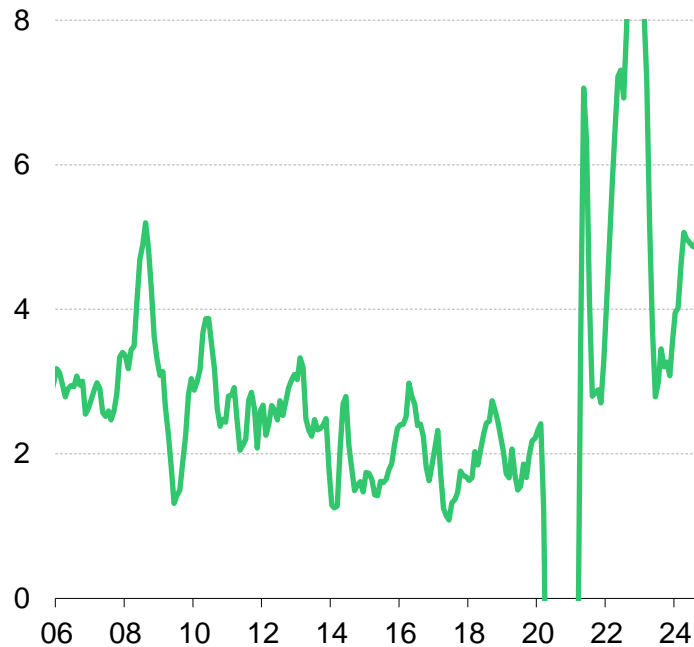
Inflation in labor intensive services is gradually falling back to pre-covid levels

Labor-intensive vs non-labor-intensive services CPI (% year on year)

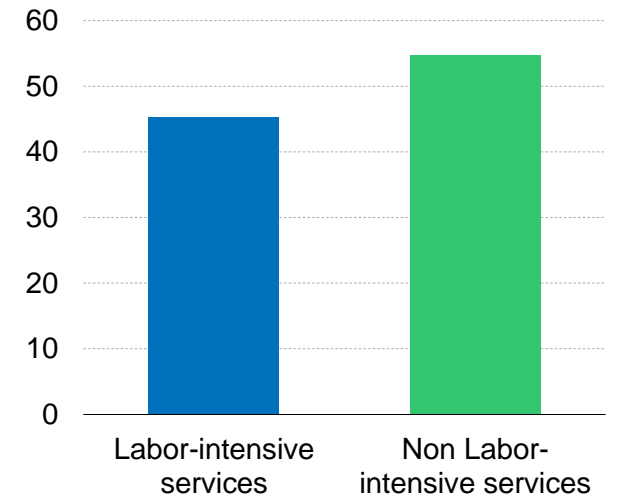
Labor-intensive



Non-labor-intensive

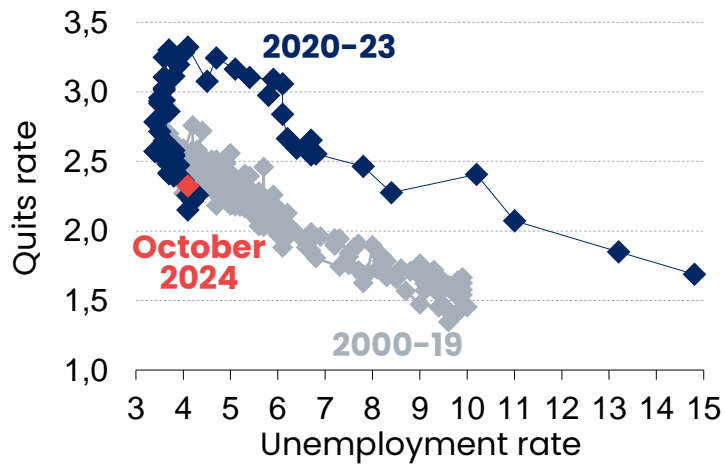


Share in core services ex rents (%)

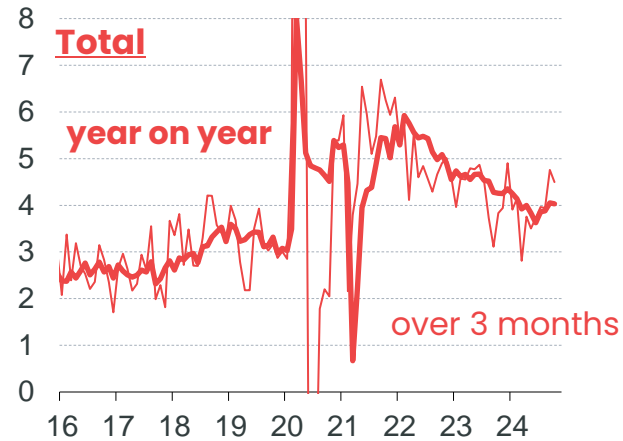


The fading of post-covid labor market tensions has allowed most wage growth measures to recede

Quits and unemployment rate
(%)



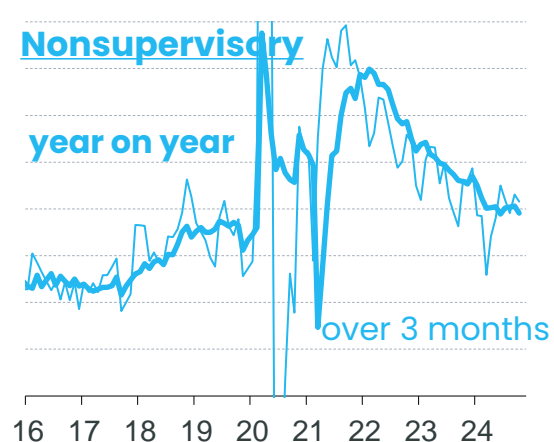
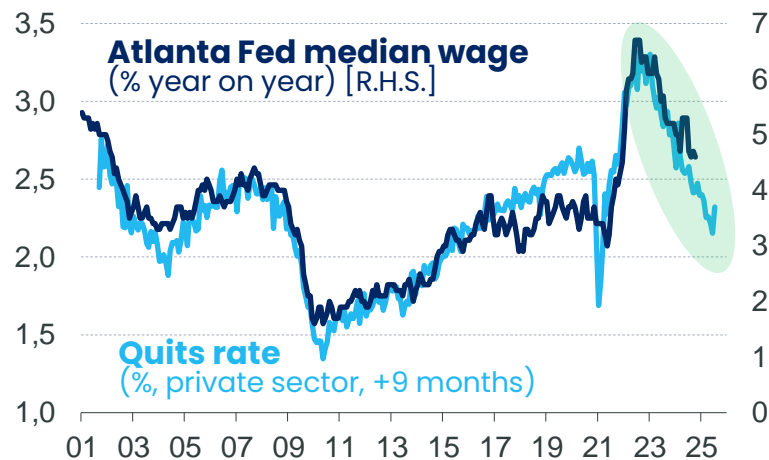
Hourly earnings
(% change, annual rate)



ECI wages
(% annual rate)



Atlanta Fed wages and quits rate

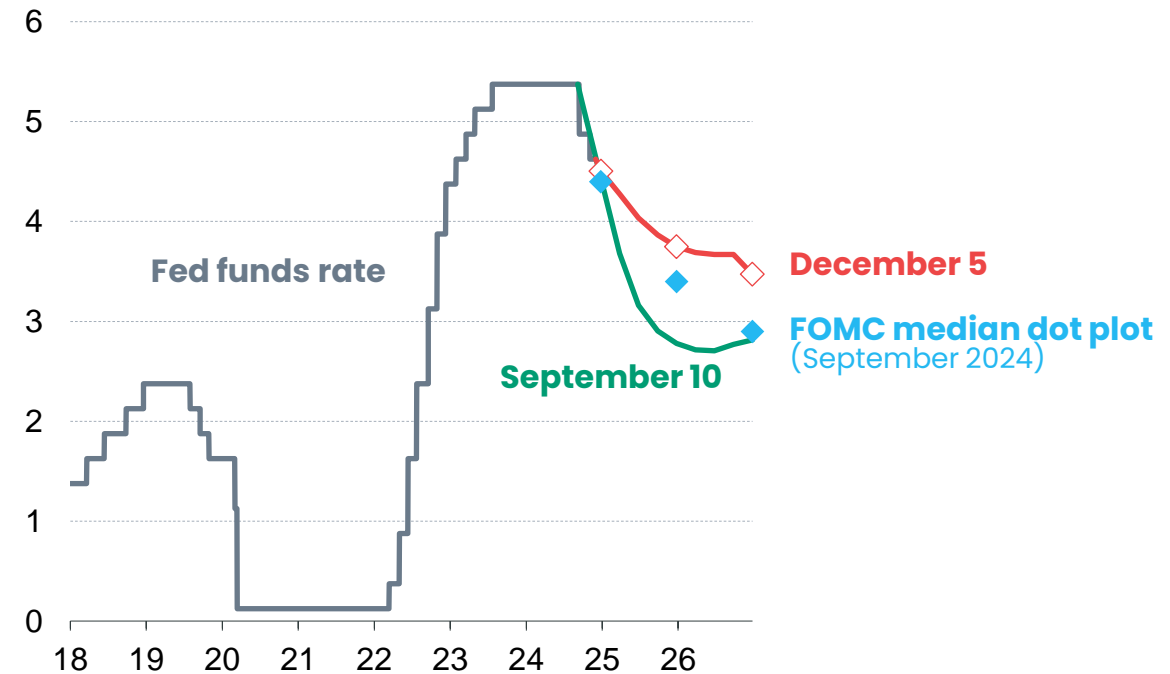


In our baseline scenario, the Fed would go on easing... cautiously!

Baseline scenario

	2023	2024	2025
GDP	2.9	2.7	2.2
Inflation	4.1	2.9	2.3
Fed funds rate	5.5	4.5	3.5

Fed funds rate and expectations (%)



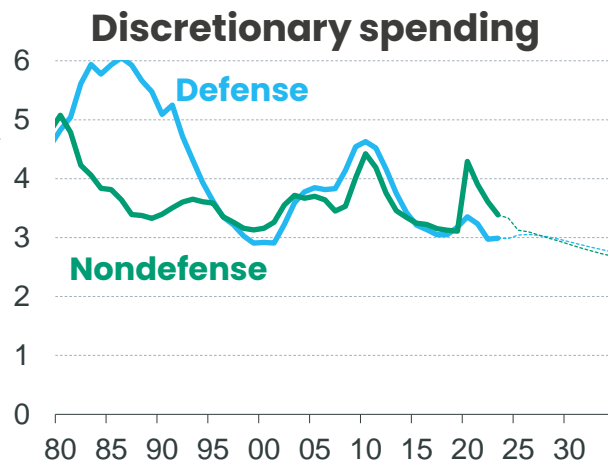
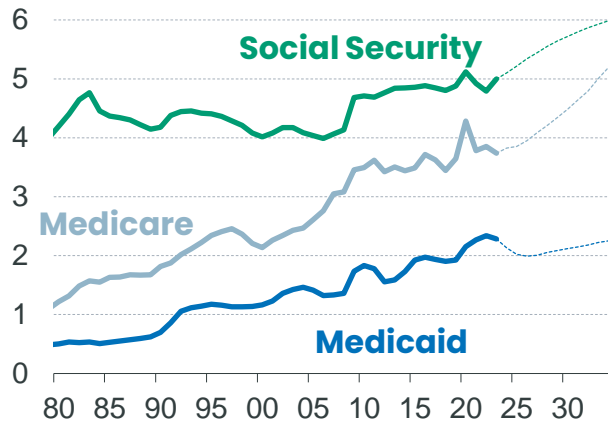
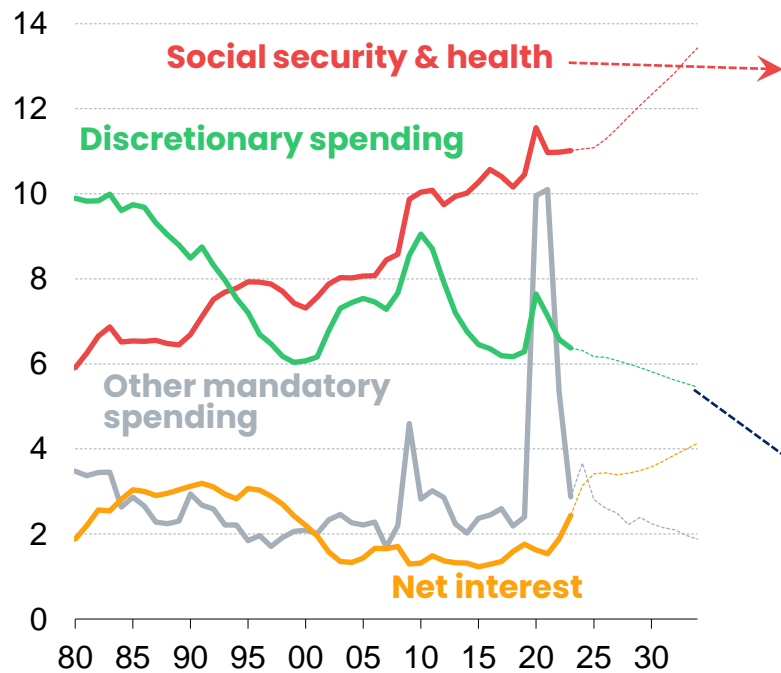
Monetary developments in 2025 will largely depend on the path of the economy... and hence on how much the economy will depart from this baseline given the outcome of the elections!



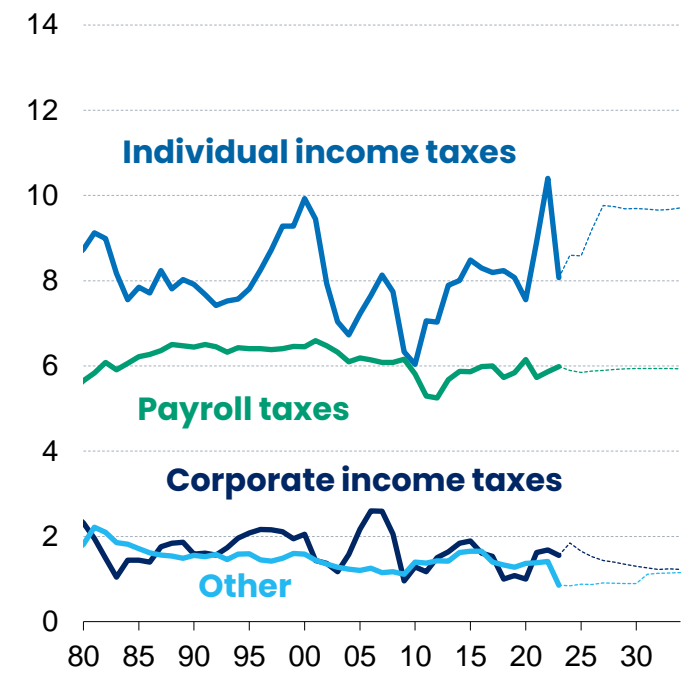
Memo. Federal government spending and revenues

Federal government spending and revenues (% of GDP, CBO forecasts)

Spending



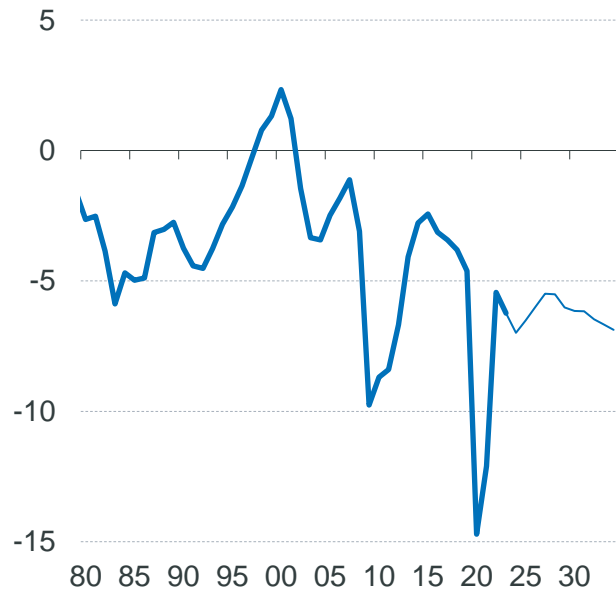
Revenues



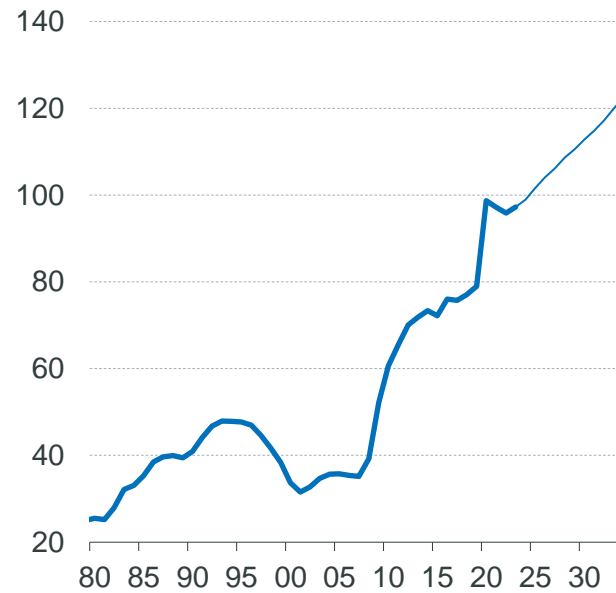
Memo. Federal government balance and debt

Federal government balance and debt (% of GDP, CBO June 2024 forecasts)

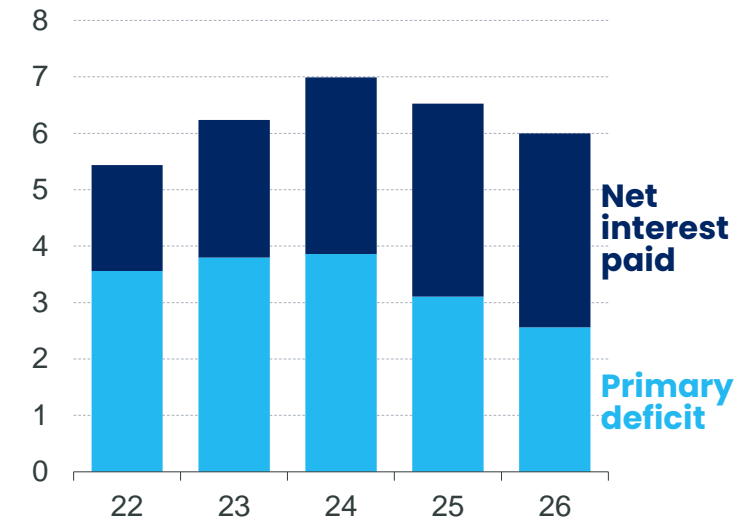
Federal balance



Federal debt



Memo: federal deficit (% of GDP)

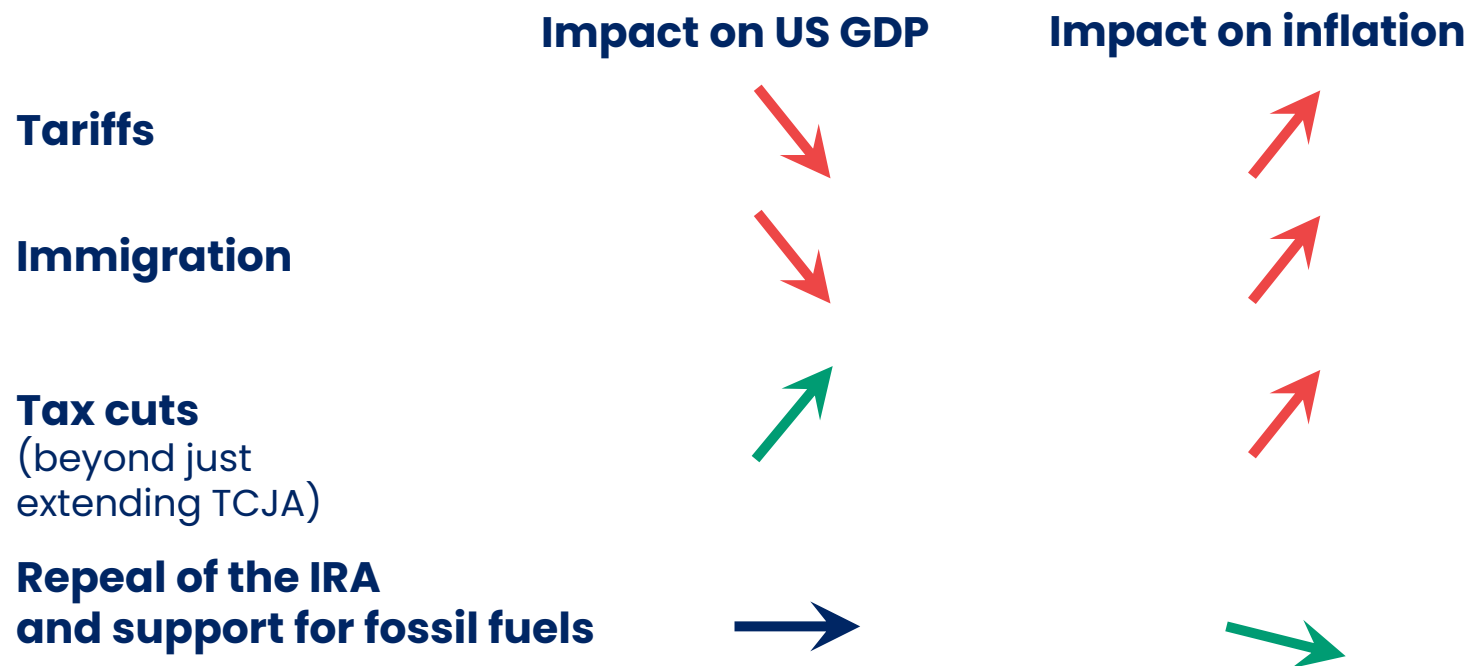




How the economy will fare in 2025 under D. Trump?



The headlines of D. Trump's economic program have been well advertised



The sequencing of the measures and their calibration will determine by how much and how quickly the economy departs from the baseline.



Tariffs are clearly Donald Trump’s preferred policy tool to correct trade imbalances... and also the one he can most freely use

Donald Trump’s preferred path on trade *“I’m a big believer in tariffs”*

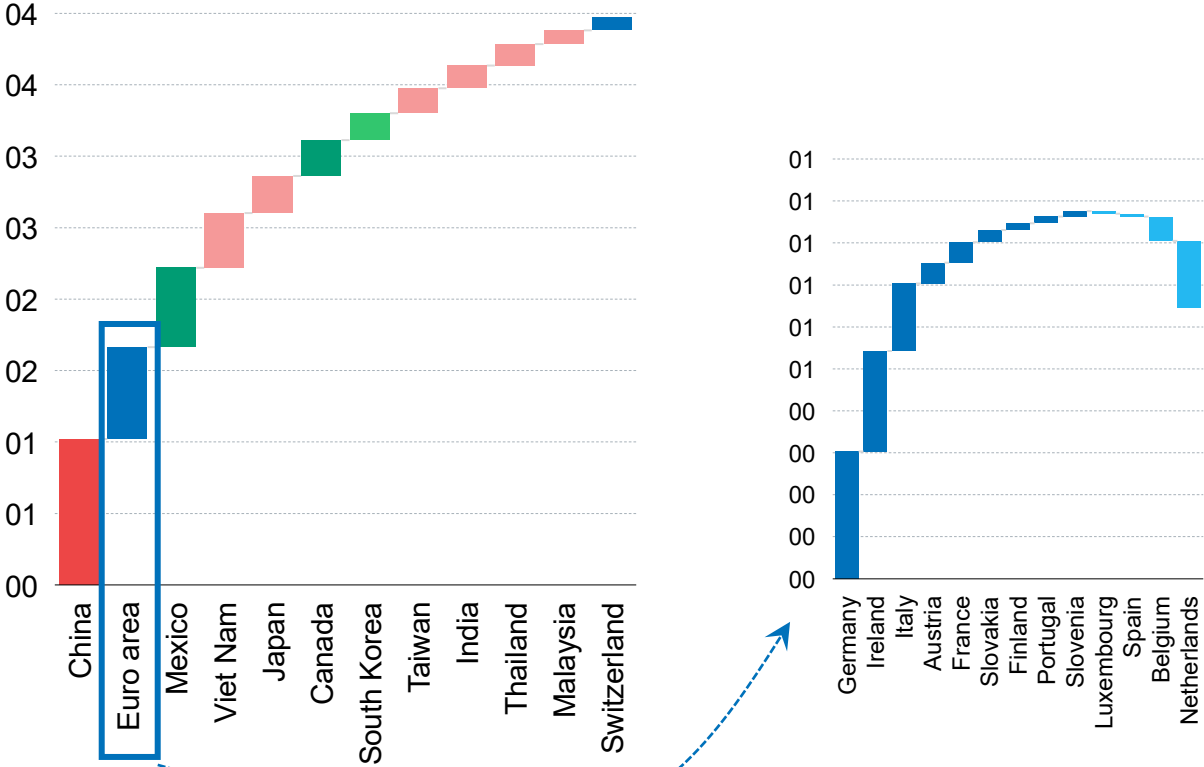
“Under Joe Biden, our trade deficits, also known as losses, have hit record highs. Since 2000, the U.S. has racked up \$17 trillion in cumulative trade deficits with the world. Only a fool or a fanatic would dismiss these facts as irrelevant.

These gigantic sums of exported wealth are being used to build up our enemies’ military strength and transfer permanent ownership of American companies, intellectual property, real estate, and other assets to foreign nations. Foreigners now own \$16.75 trillion more of our economy than we own of theirs. Our country is being plundered.

The best way to stop this hemorrhaging of America’s lifeblood is a simple but powerful tariff on most foreign products, like the kind that was the primary source of government revenue through most of American history, and which built this country into the manufacturing powerhouse of the world.”

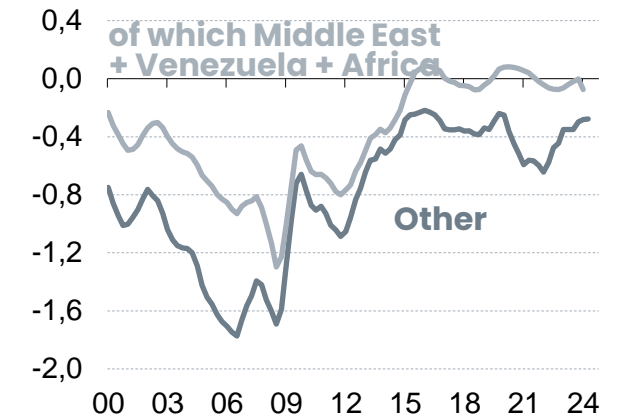
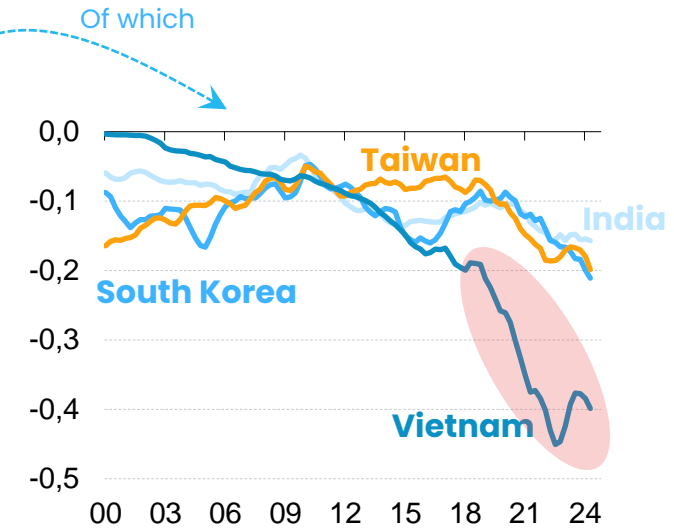
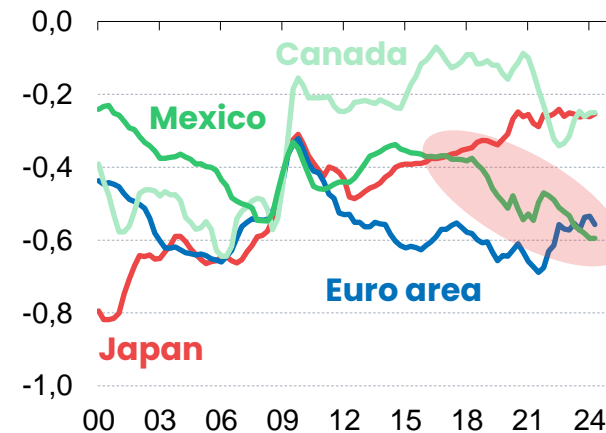
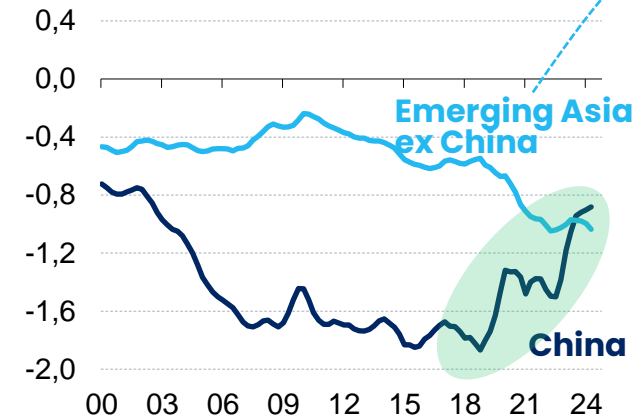
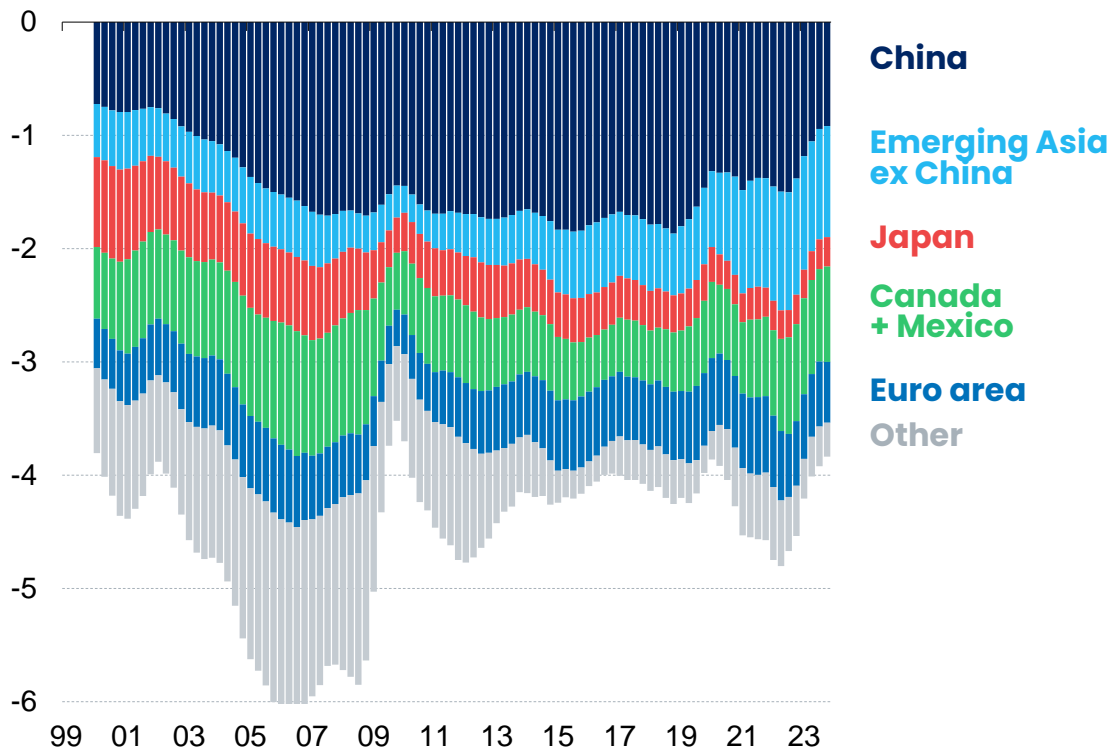
Donald Trump, “My Tariff Policies Were a Success”, Wall Street Journal.

US trade balance deficit by country or regions
(% of US GDP, 2023)



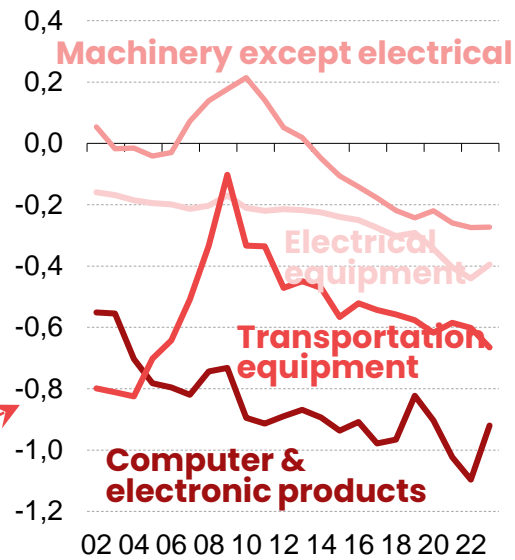
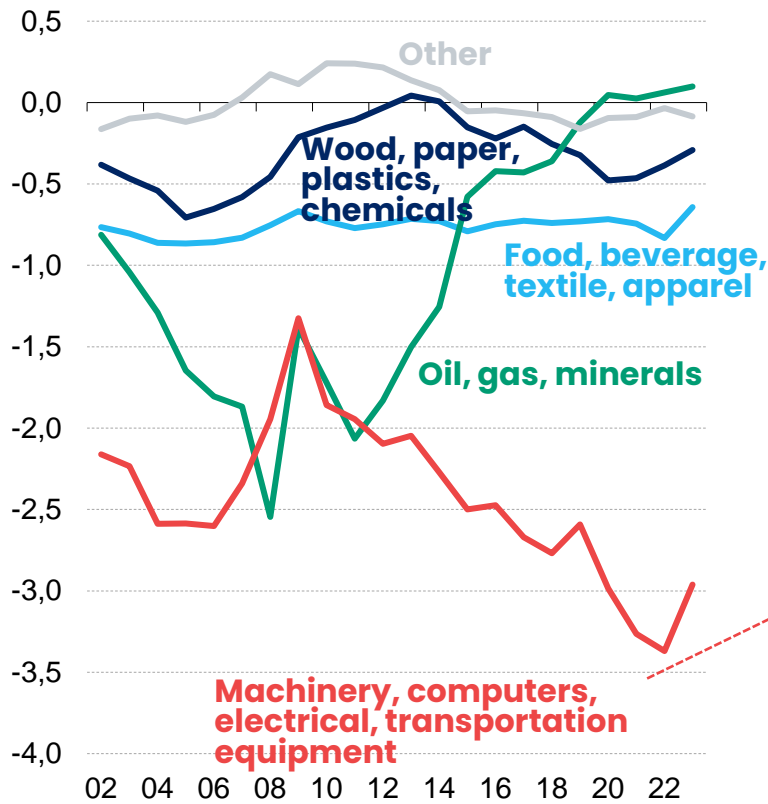
The geography of the US trade deficit has changed during the last years...

US trade balance by country or regions (% of US GDP)

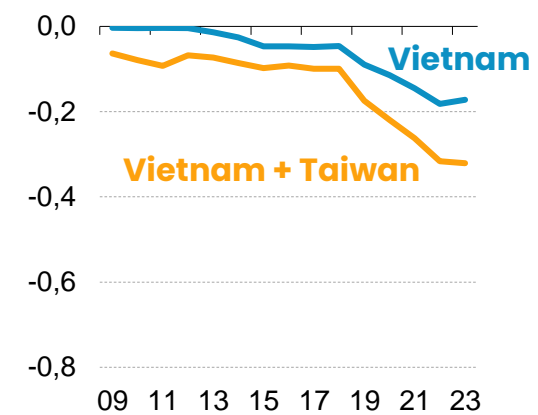
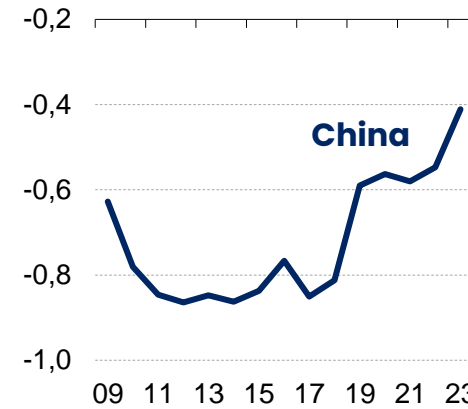


... so has its sectoral composition

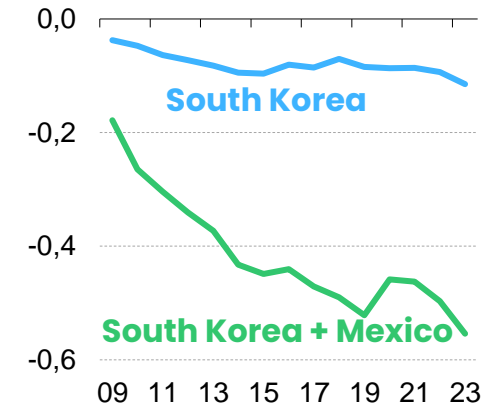
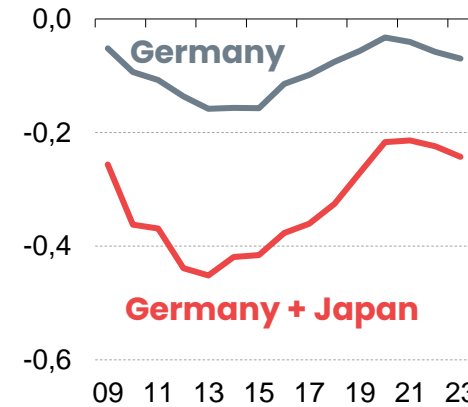
US trade balance by product (% of GDP)



Computer & electronics, by country



Transportation equipment, by country



Still there are a lot of uncertainties on what D. Trump's effective tariff policy will be

D. Trump has not explained **whether he envisions the universal tariff as a new floor or an add-on to existing ones**. For example, if an imported product was now taxed at 5 percent, would that rate rise to 10 percent or to 15 percent?

Nor has D. Trump said **whether the new tariff would apply to imports from the nearly two dozen countries with which the US has free trade deals** (in Mandate for leadership, P. Navarro targets only non-FTA countries).

The authority of the President to implement across the board new tariffs on “non free trade agreement” countries is not clear.

The Supreme Court may not go along with the president setting a new tariff rate on the pretext that all foreign trade is unfair. Placing a new 10 percent tariff against all products from all sources might even attract a judicial stay to prevent implementation as challenges are considered by the courts.

On the opposite, R. Lighthizer said that given the size of the U.S. trade deficit and its impact on the American economy, a president would have “clear authority” under two laws — the International Emergency Economic Powers Act and Section 338 of the Tariff Act of 1930 — to impose tariffs unilaterally. Still, he said, depending on political conditions, D. Trump might instead choose to ask Congress to enact new legislation so that a successor would not be able to easily revoke it. “He has the legal authority to do it and he’s got two routes”.

On China, the Supreme Court could find that it is the prerogative of the Congress to set tariffs at rates amounting to an embargo outside of war, assuming there were no grounds for invoking laws protecting national security.



The United States–Mexico–Canada Agreement (USMCA) could be used as a bargaining tool by D. Trump

The USMCA review clause (article 34.7)

In summary, USMCA will terminate 16 years after the date of its entry into force (i.e., by 1 July 2036), unless each party confirms that it wishes to continue the agreement for a new 16-year term.

The parties are to confirm their ongoing support for USMCA at a “**joint review**”. The first joint review will take place on July 1, 2026. Should the parties confirm that they want to continue, then the agreement will be extended for another 16 years.

If the parties do not extend the agreement in 2026, then the Commission is to conduct a joint review each year until 2036. During these joint reviews, the parties can confirm their wish to extend the agreement for another 16 years. **Failure to extend the agreement will lead to USMCA termination on July 1, 2036.**

Article 34.6: Withdrawal

A Party may withdraw from this Agreement by providing written notice to the other Parties. A withdrawal shall take effect six months after a Party provides written notice. If a Party withdraws, this Agreement shall remain in force for the remaining Parties.

Withdrawal from the Treaty could be done by the President unilaterally. But this raises the question of the **USCMA Implementation Act** which can normally only be terminated by Congress. If the USCMA Implementation Act remains in effect, other provisions of federal law may grant the President authority to restrict trade with Canada or Mexico. But such actions would likely be subject to judicial review on various grounds.



Fully implementing D. Trump's proposed tariffs' increases could deal a heavy blow to the world economy

Average US tariff rate since 1929
(%, import weighted)



Higher tariffs could easily shave off 1% from US growth in 2025 while increasing the consumer price level by more than 1%*

Effects of tariffs on the economy

Negative impacts on output

Aggregate income channel

By increasing the price of consumer and capital goods, higher tariffs lower the purchasing power of U.S. consumers and businesses.



Higher inflation, lower consumption and investment

Confidence channel

Businesses' uncertainty about future barriers to trade increases and so does the perception of investment's risk.



Businesses delay or forgo new investments (or make expensive changes to their supply chains).

Export Channel

Retaliatory tariffs by US trading partners reduce US exports



Less US exports

Mitigating factors

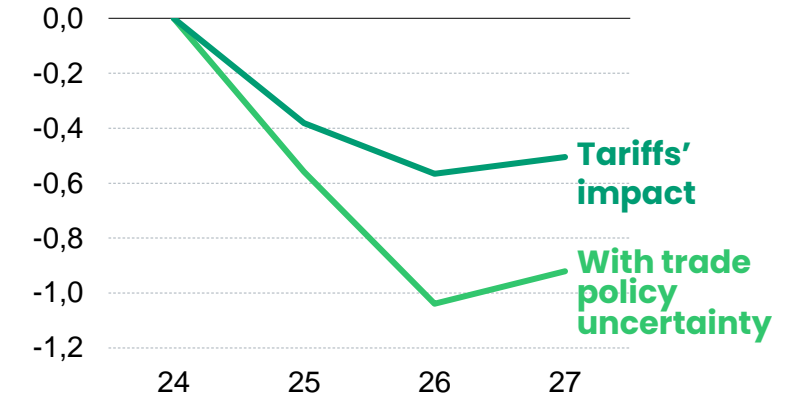
Expenditure switching channel

Higher prices for imported goods induce consumers and firms to switch to domestically produced goods, increasing domestic demand and reducing imports.

More fiscal receipts

The public deficit will be reduced.

Impact on US GDP of 10% universal tariff + retaliation (% against baseline, IMF October 2024 WEO)



CBO estimated that previously enacted substantially smaller tariffs (2% of the value of goods and services purchased by US consumers) have reduced US output by 0.1 to 0.3%.

Other recent studies

10% universal + retaliation

- 2.1% (ECB)
- 1.1% (E. York, Tax Foundation)
- 1.0% (CRFB)

10% universal + 60% on China

- 1.5% (Capital economics)
- 1.4% (Institute Der Deutschen Wirtschaft)

(*) Assuming 2/3 of the "10% +60%" duty on \$3000 billions of goods imports are passed through to the consumer.



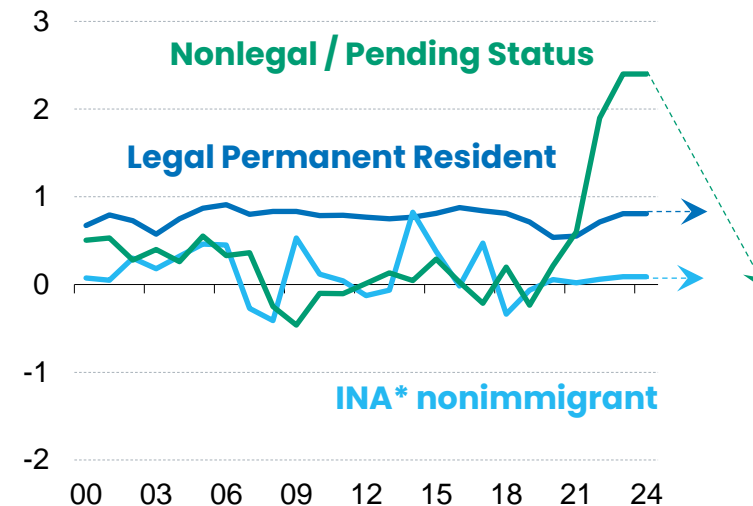
The President could also stop the inflow of migrants by executive orders but would need Congress support to deport a significant number

Immigration

- If illegal immigration is just “stopped” in 2025, the net inflow of nonlegal adult migrants falls back to zero: this would reduce the rise in working age population by 60 000 per month and the labor force by 40 000 per month. Instead of growing by +0.8% per year, the labor force will only grow by +0.5%.
- Although deporting many millions of persons in 2025 looks practically impossible*, deportations of just 1.2 million illegal migrants next year would bring labor force growth close to 0%.

(*) Although officials claimed the Eisenhower summer operation led to 1.3 million apprehensions, scholars including Lytle Hernández have challenged that figure — saying that those statistics include arrests from previous years. According to Lytle Hernández, the number of apprehensions for fiscal year 1955 was about 250,000.

Net immigration by category
(year on year, millions)



(*) Immigration and Nationality Act



Implementing the promised fiscal measures will require the approval of Congress

Tax cuts for individuals and corporates

Extend the TCJA individual tax cuts set to expire on Dec. 31, 2025.

Eliminate federal taxes on tips, overtime pay and Social Security benefits, as well as restore the deductibility of state and local taxes, which was limited by his tax cuts package.

Reduce the corporate tax rate to 15% for companies that make their products in the US.

Reinstate immediate expensing for capital expenditures.

“With a vision I’m outlining today, not only will we stop our businesses from leaving for foreign lands, but under my leadership, we’re going to take other countries’ jobs” D. Trump said.

Repeal of the IRA

Support repeal of massive spending bills like the Infrastructure Investment and Jobs Act (IIJA) and Inflation Reduction Act (IRA).

“This ridiculous Green New Deal crusade is causing car prices to skyrocket while setting the stage for the destruction of American auto production.” D. Trump.

Repeal of Obamacare

Repeal “harmful health policies enacted under the Obama and Biden Administrations” (D. Trump.).



Even if Congress approves D. Trump's "costly" fiscal package, it would only provide a "one-off" stimulus in 2025

Cost of D. Trump's fiscal plan for the Budget (billions of dollars over 10 years)

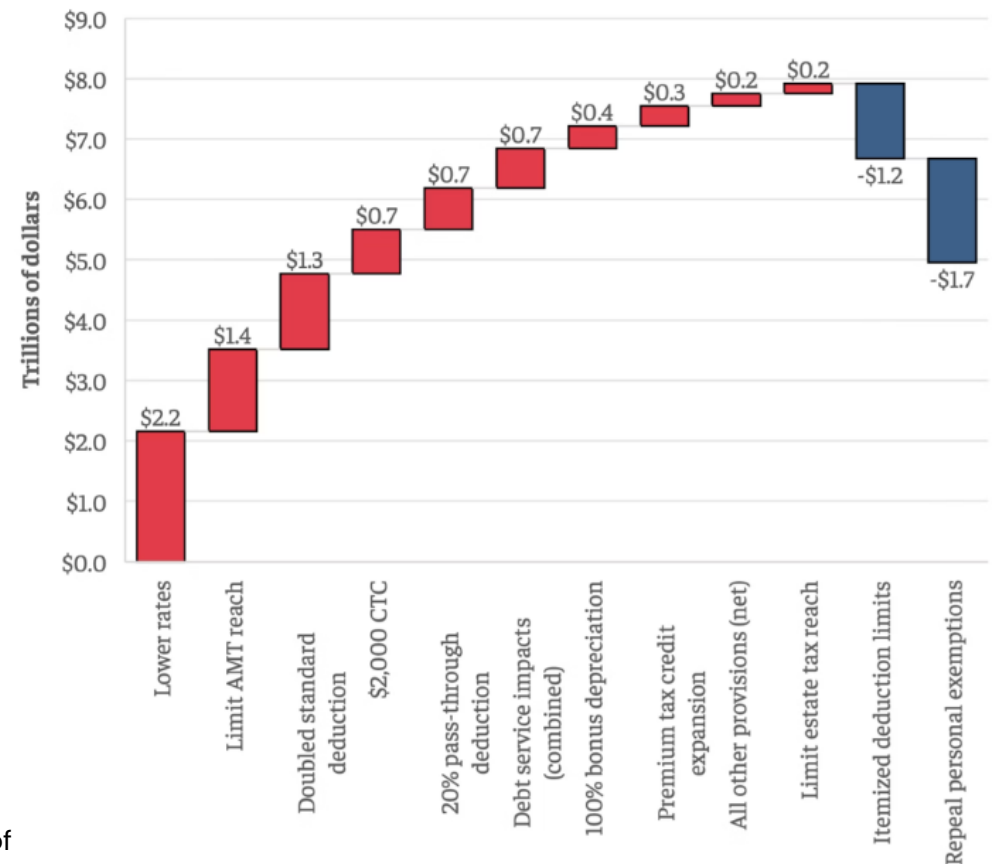
Extend TCJA	5350
Exempt overtime income*	700
End taxation of social security benefits	1300
Exempt tip income from taxes	300
Lower corporate tax rate to 15% for domestic manufacturers	200
Enact and expand other tax breaks	200
Total tax cuts	8050
Reverse current energy / environment policies and expend production	700
Total revenue increases	700
Direct impact on deficit	7350

If voted by Summer, this package could reduce taxes paid by the private sector in 2025 by **\$100 billions to \$200 billions** and **would stimulate GDP by 0.5% to 1.0%**.

(*) FLSA-qualified overtime pay among tax filers will total \$335 billion in 2025 (about 3% of total wages reported on tax returns). This income will face an average effective income tax rate of 19% in 2025. (cf. Fair Labor Standards Act)

Cost/Savings From Extending Various Expiring Tax Provisions, FY2025-2034

Source: Congressional Budget Office



Taken together, the proposed measures could have a rather contrasted impact on inflation... and on monetary policy!

Effects on the economy in 2025 compared to our baseline scenario (%)

		Soft Trump			Hard Trump			
		GDP	Unemployment rate	Inflation	GDP	Unemployment rate	Inflation	
Tariffs	Bringing tariffs at 60% on China and 10% on RoW ex FTA countries	-0.6	+0.6	+1.0	Additional 60% on China and 10% on RoW	-1.2	+1.2	+2.0
Immigration	Illegal immigration is stopped	-0.1	-0.2	+0.1	Deportation of 1.2 mln illegal migrants	-0.2	-0.7	+0.4
Tax policy	Moderate support	+0.5	-0.5		Exempt overtime, end taxation of social security benefits...	+1.0	-1.0	
Total		-0.2	-0.1	+1.1*		-0.4	-0.5	+2.4*

The Fed will tolerate the rise in inflation, viewing it as temporary.

Rising inflation coupled with a tight labor market forces the Fed to raise rates and take the risk of triggering a recession!

(*) Inflation could be slightly dampened by deregulation in the energy sector.



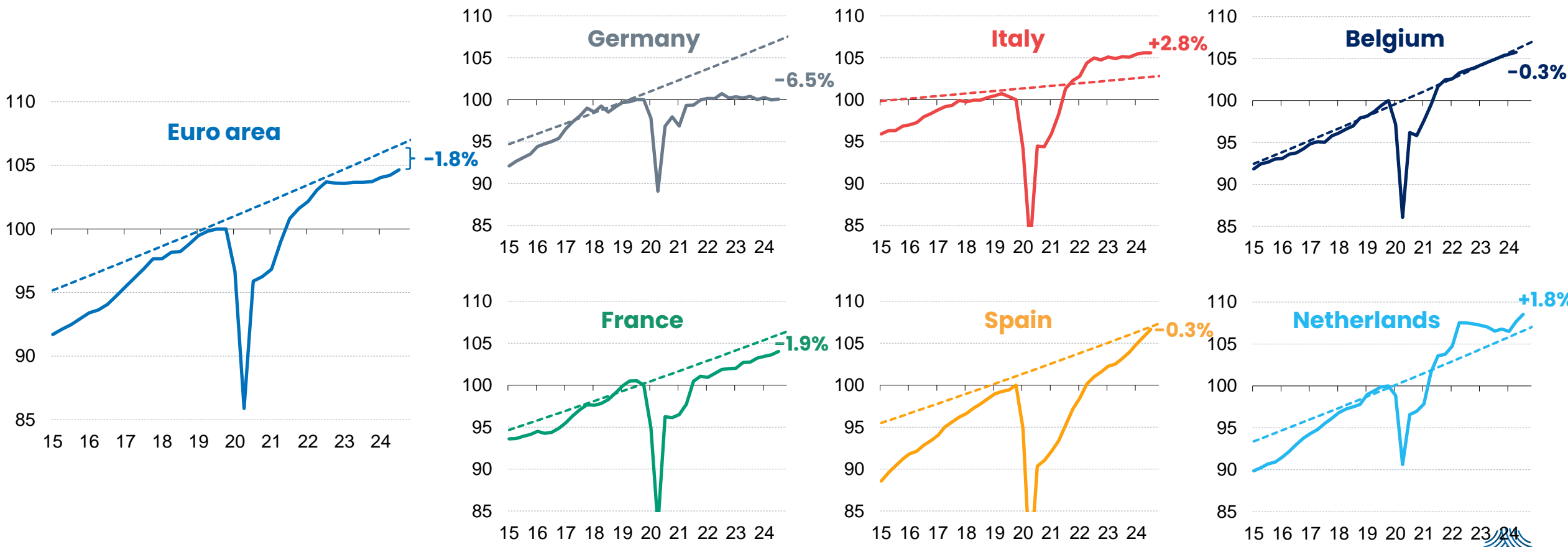
3 Euro area Facing new risks...



Euro area activity is still not back on trend... mainly because German GDP is stuck at its pre-Covid level

Real GDP

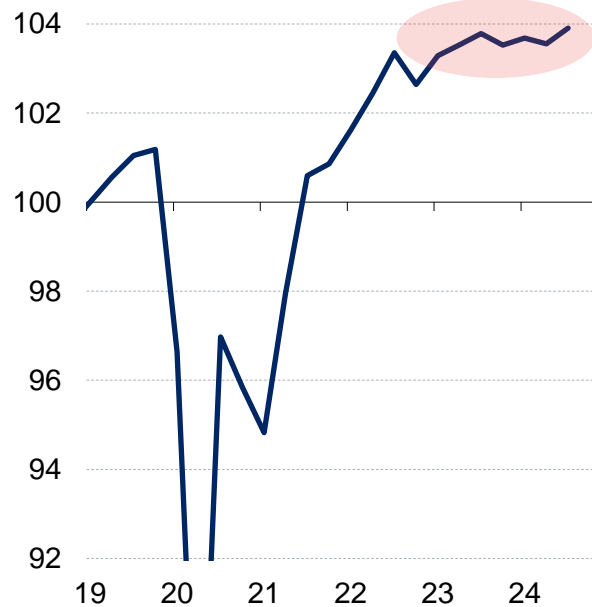
(compared to 2004-2019 trend, 2019 Q4 = 100)



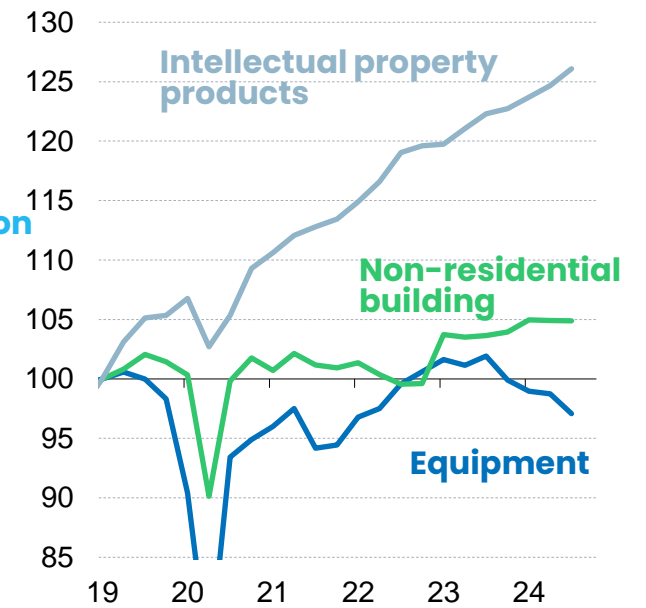
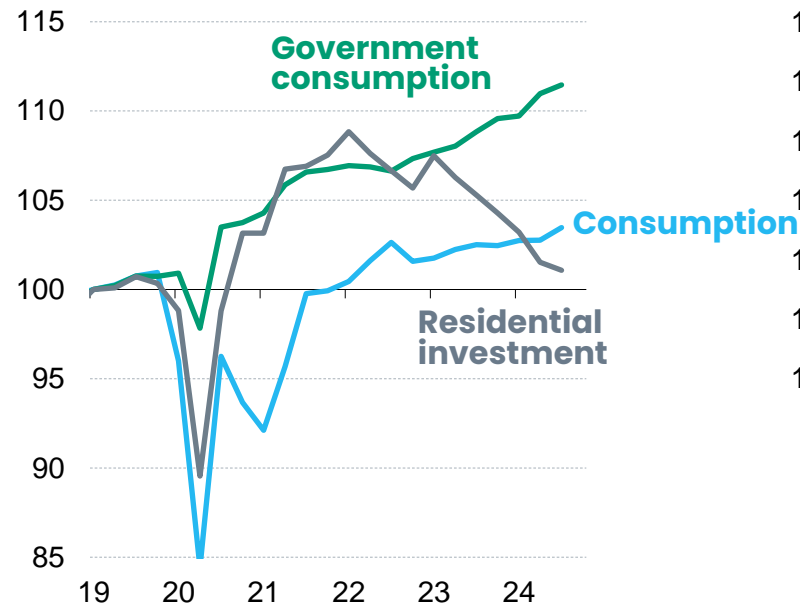
Domestic demand remains sluggish

Domestic demand in the euro area ex Ireland

Domestic demand
(2019 Q1 = 100, ex inventories
and ex public consumption, volume)



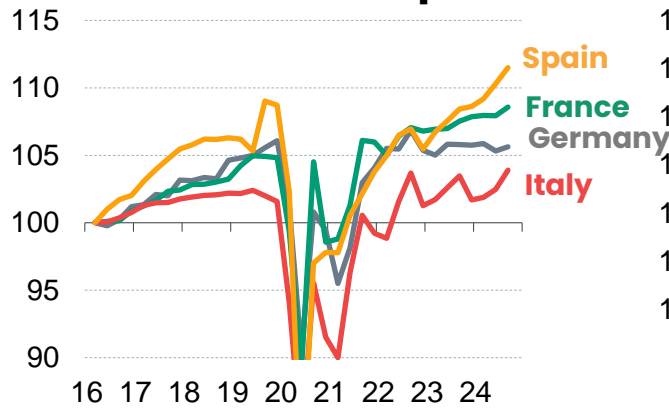
Domestic demand components
(2019 Q1 = 100, volume)



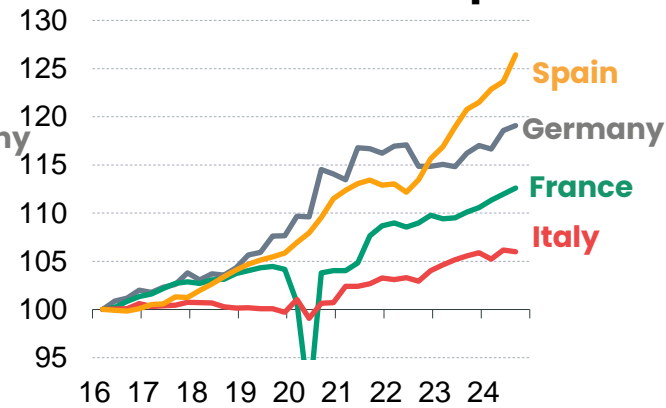
While the support provided by investment in Italy is now fading, consumption remained dynamic in Spain until Q3

(2016 Q1 = 100, volume)

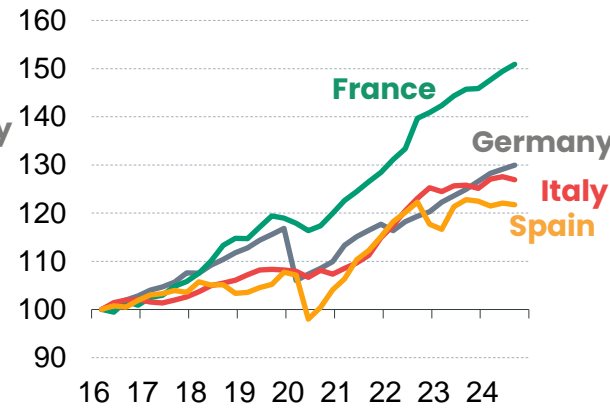
Private consumption



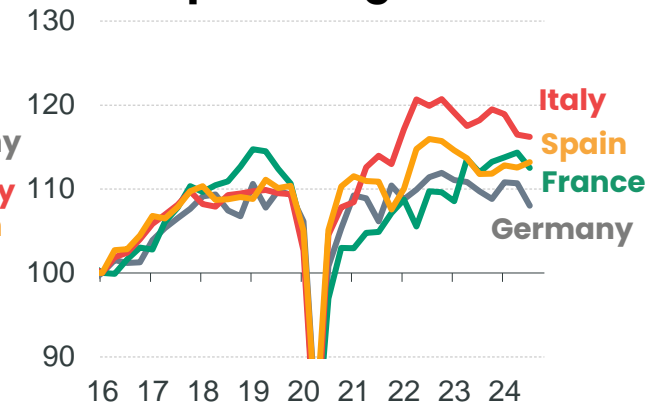
Government consumption



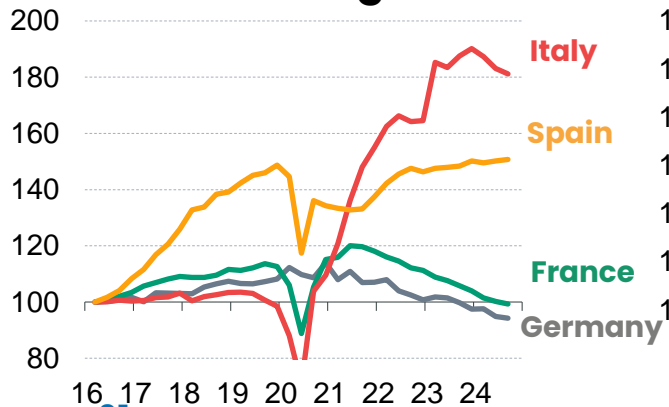
IPP investment



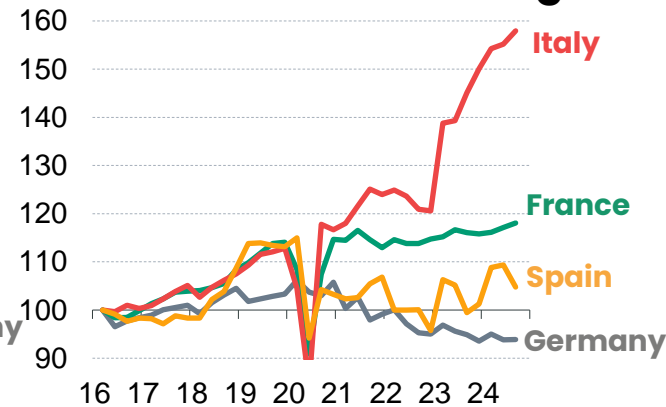
Exports of goods



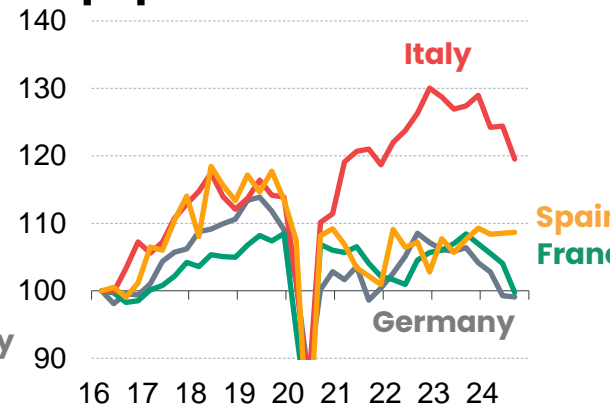
Dwellings



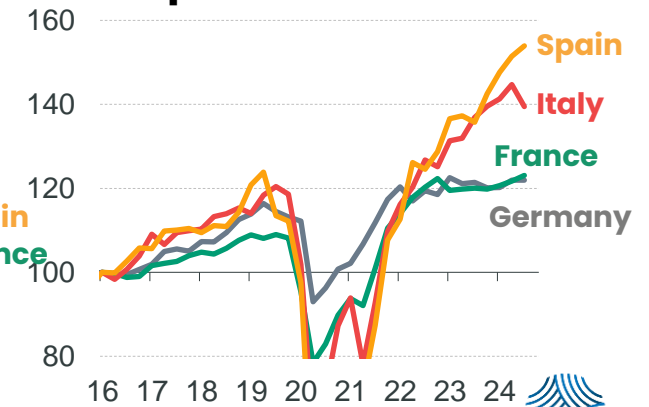
Non-residential building



Equipment investment

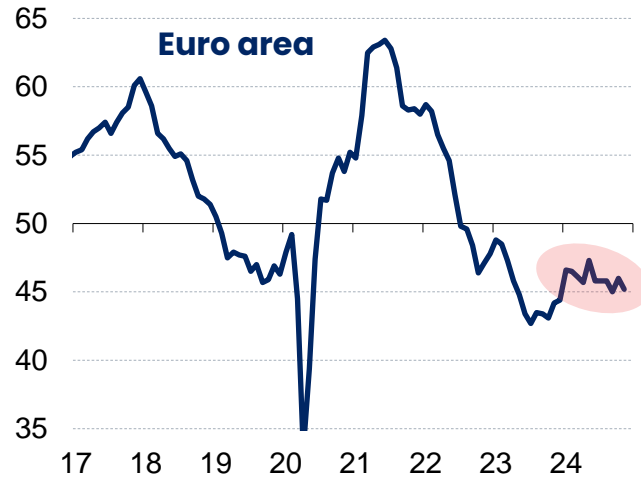


Exports of services

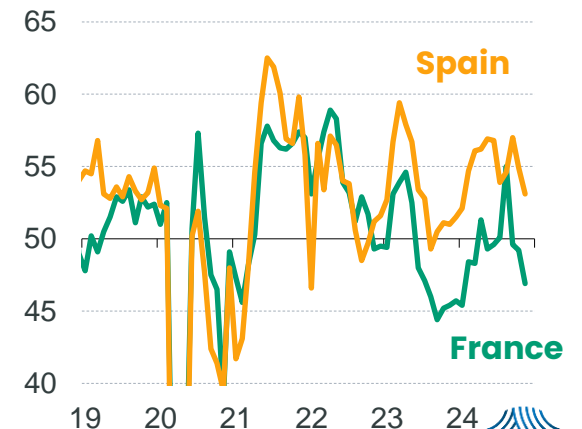
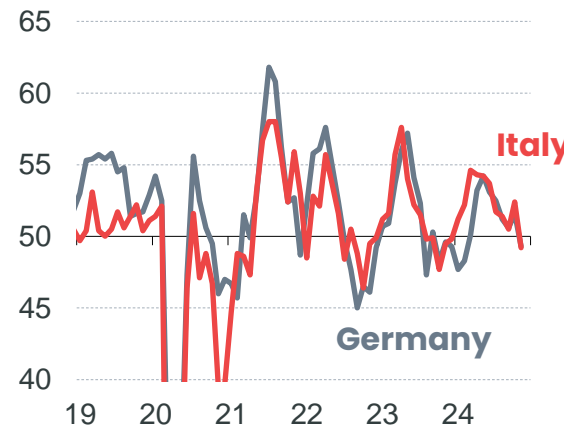
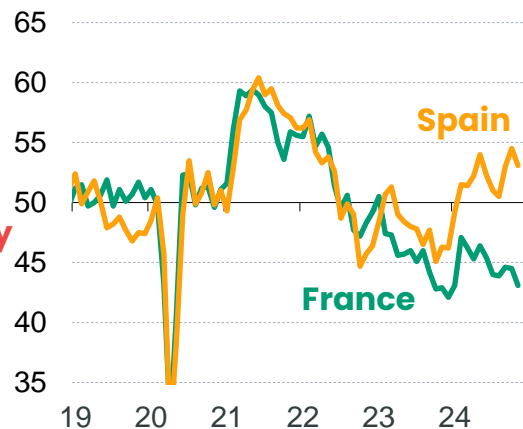
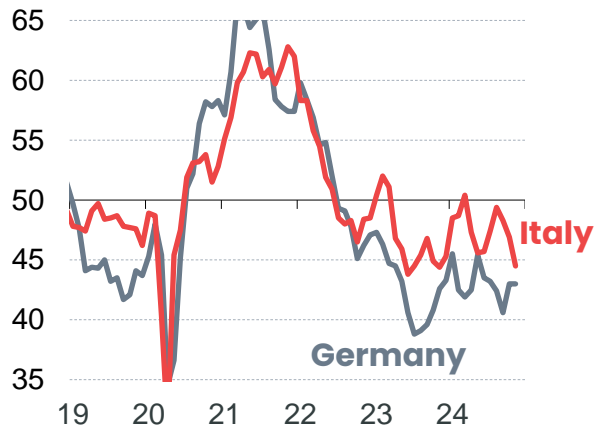
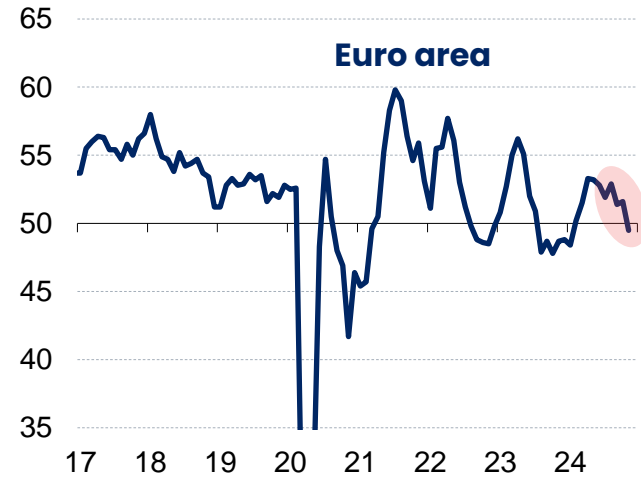


The latest PMI surveys are hardly reassuring

Manufacturing PMIs

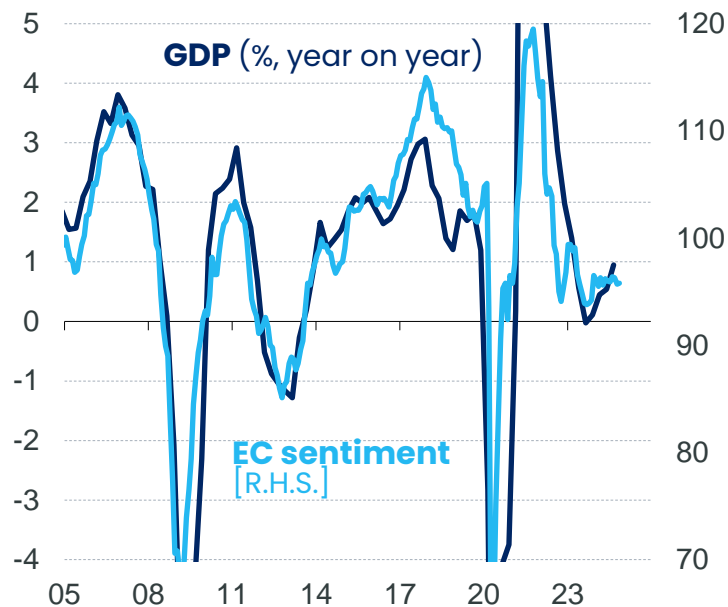


Services PMIs



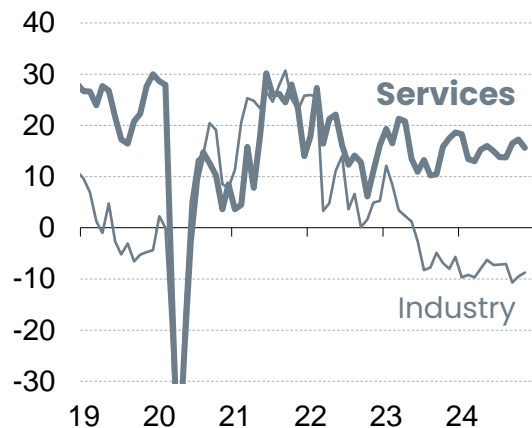
The EC economic sentiment index is a bit less worrying

EC sentiment and GDP growth

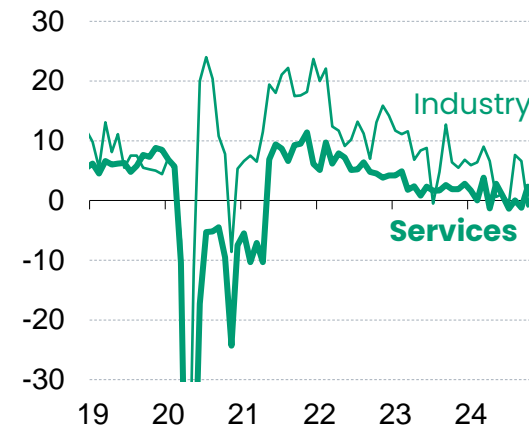


EC Survey – demand next quarter

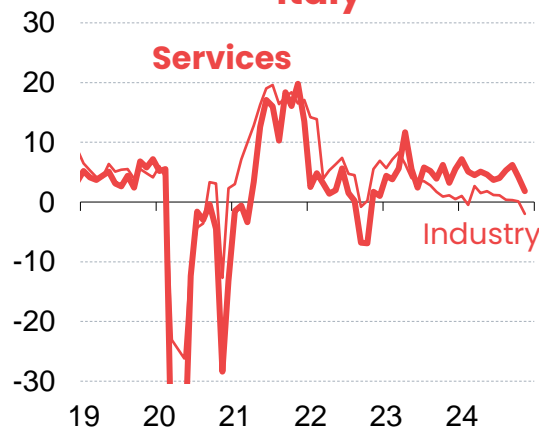
Germany



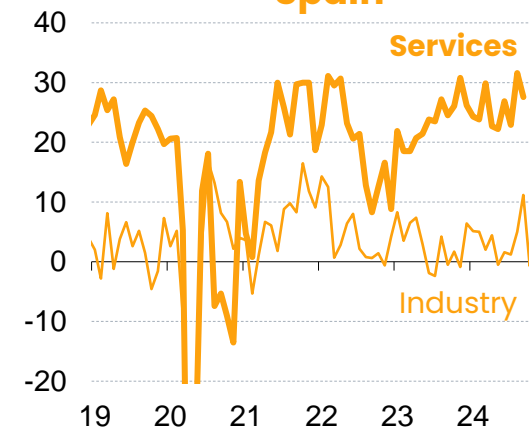
France



Italy



Spain



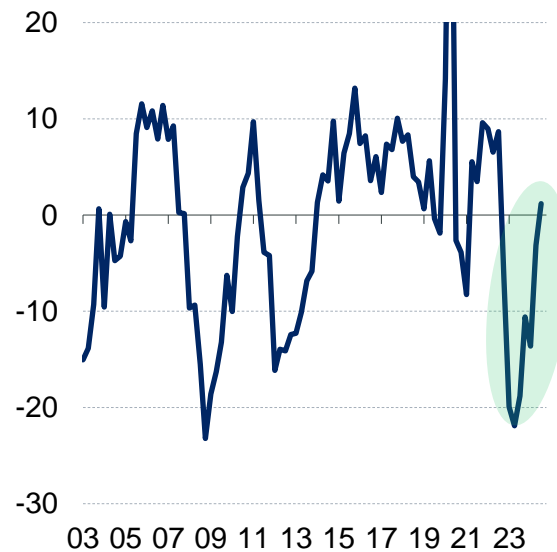
Credit conditions for firms have stopped tightening...

Changes in credit standards to enterprises and demand for loans

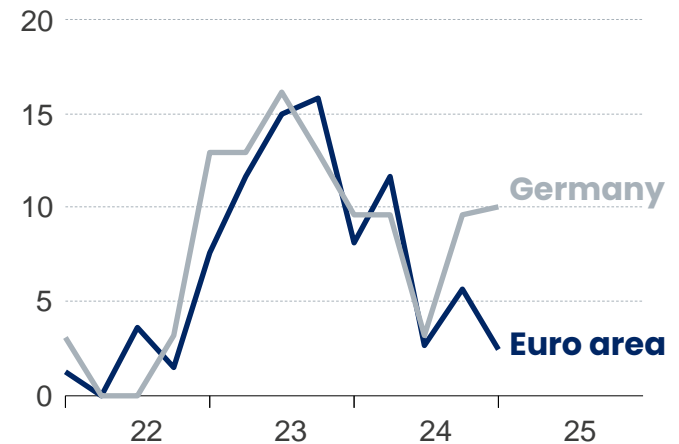
Net % of banks reporting a tightening of credit standards



Net % of banks reporting an increase in demand



Changes in the share of rejected loan applications for enterprises
(net % of banks reporting an increase)



The further increase in the share of rejected loan applications was mainly driven by developments in Germany.

The net increase in the share of rejected loan applications was larger for loans to SMEs than for loans to large firms.

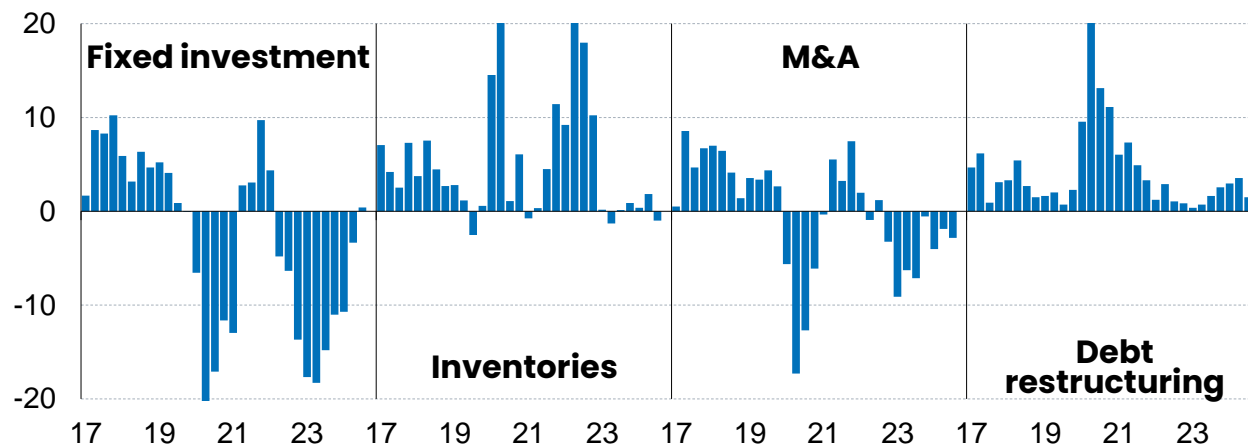


... but loans to NFC are barely growing and loan demand for fixed investment is muted

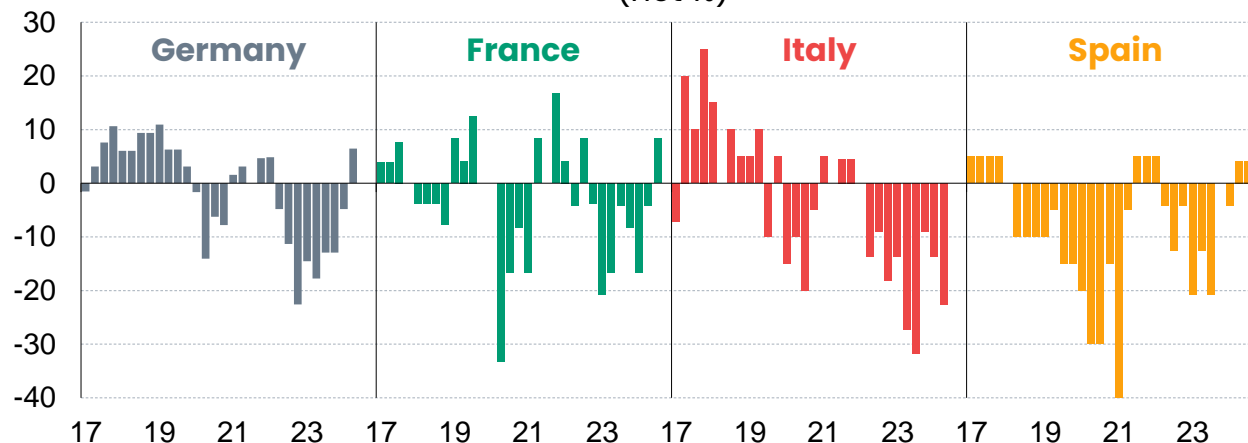
Loans to non-financial corporations
(%, annual rate)



Factors contributing to changes in demand for loans to enterprises
(net % of banks reporting an increase in demand, and contributing factors)

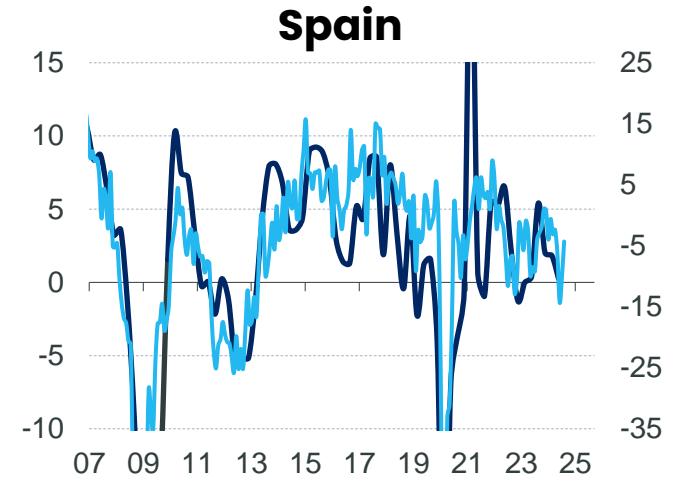
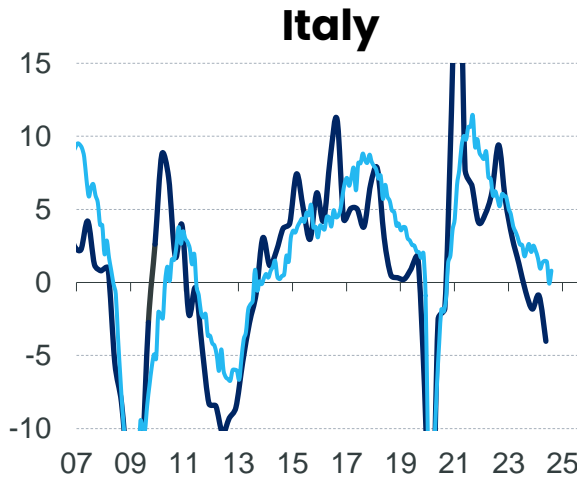
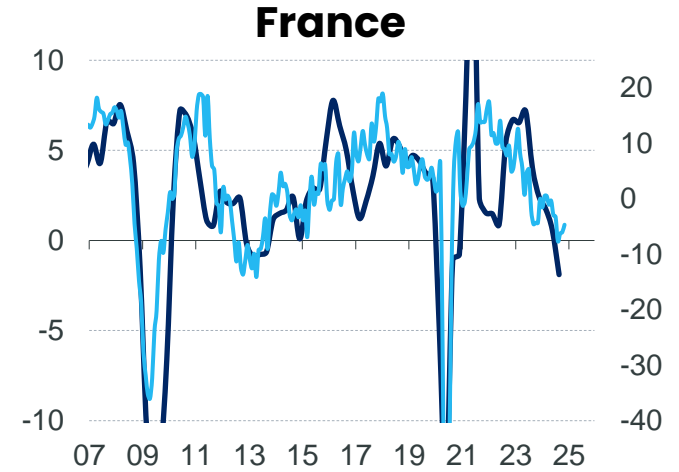
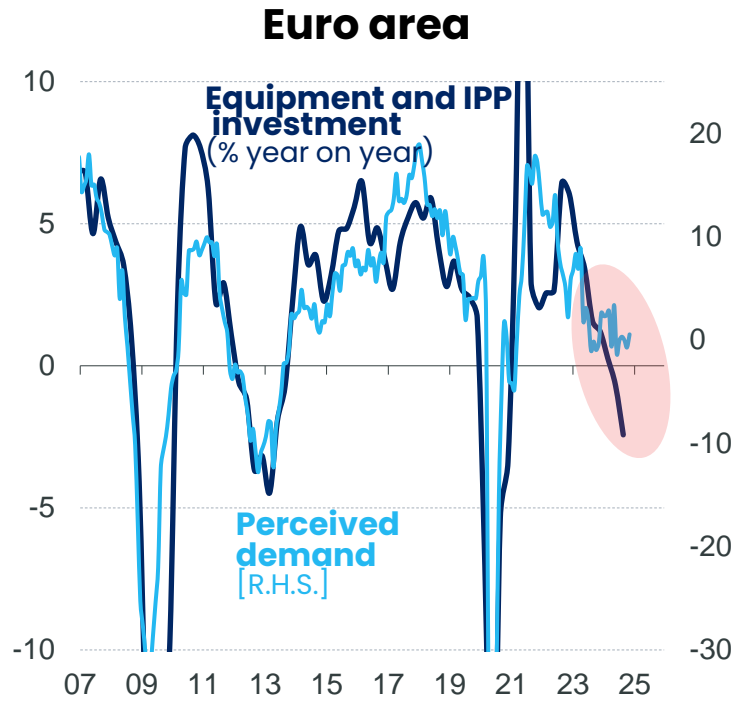


Firms' demand for loans – Fixed investment by country
(net %)



With perceived demand remaining weak, there is no reason for business investment to pick up

Equipment and IPP investment versus perceived demand



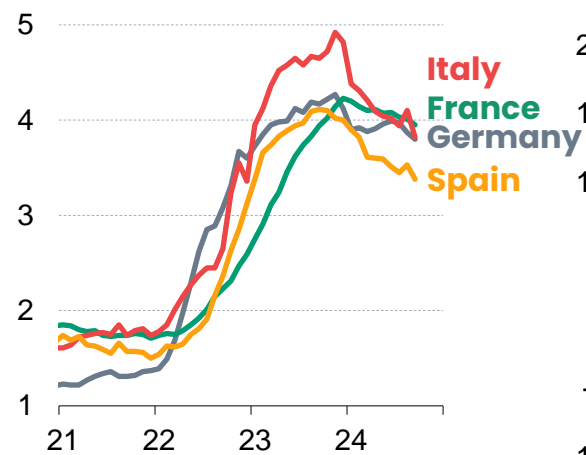
— Equipment and IPP investment (% year on year)

— Perceived demand [R.H.S.]

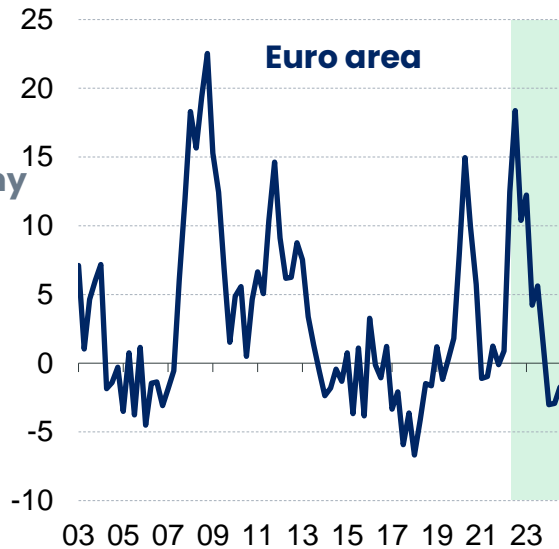


Credit conditions for mortgage loans have started to improve and loan demand by households is recovering...

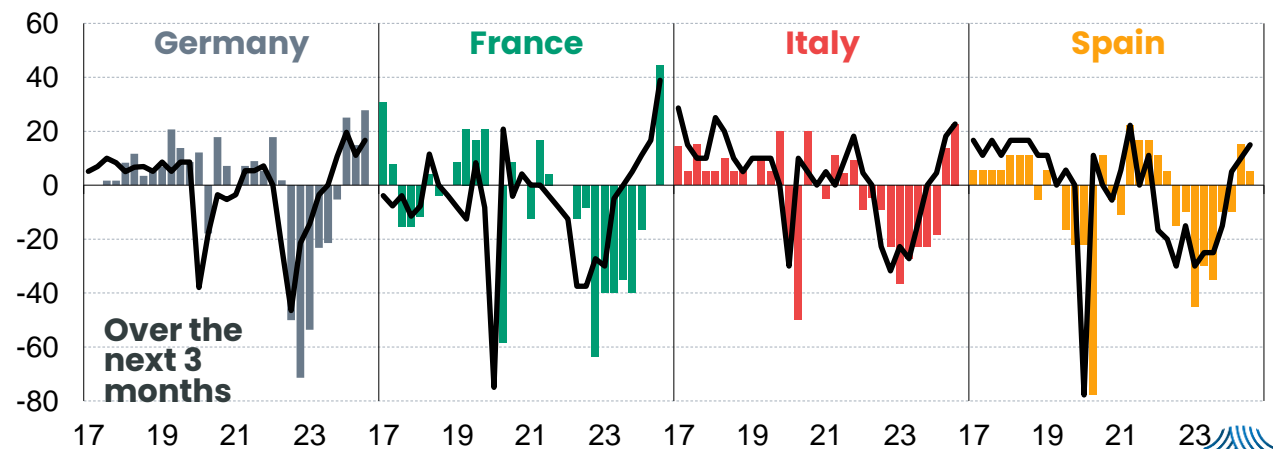
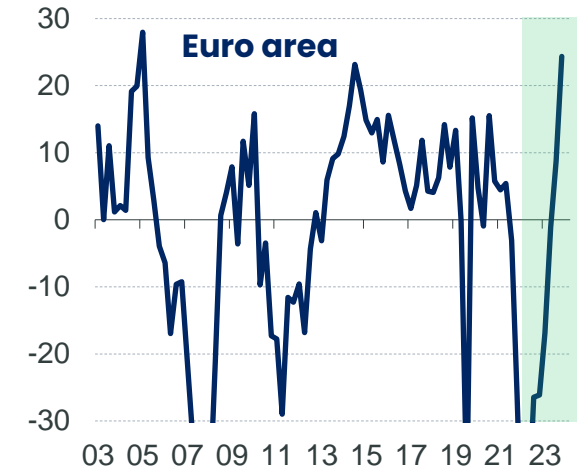
Mortgage interest rates
(%, new business)



Changes in credit standards for house purchase loans
(net % of banks reporting a tightening of credit standards)

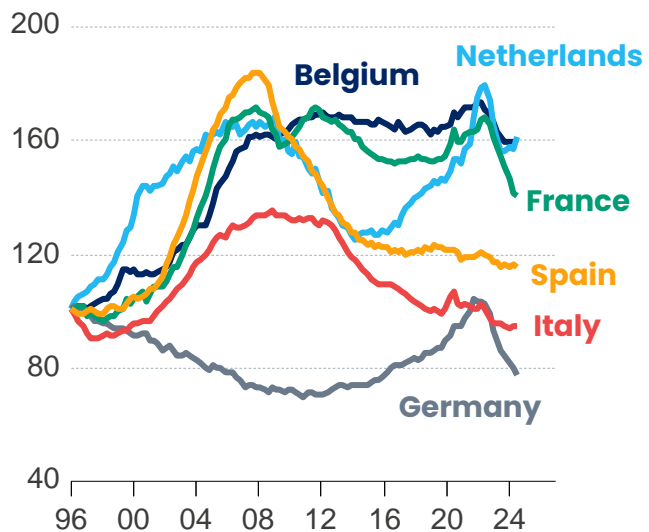


House purchase loans demand
(net %)

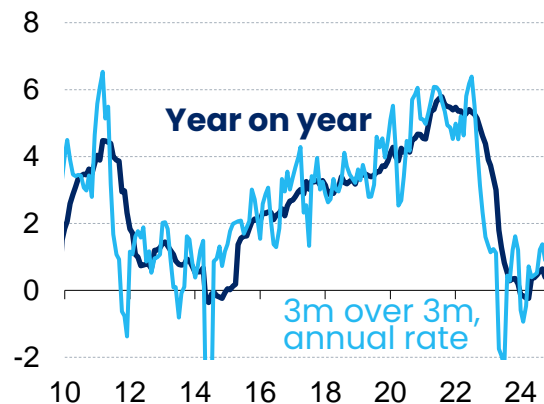


... but impaired affordability should moderate the recovery in residential investment

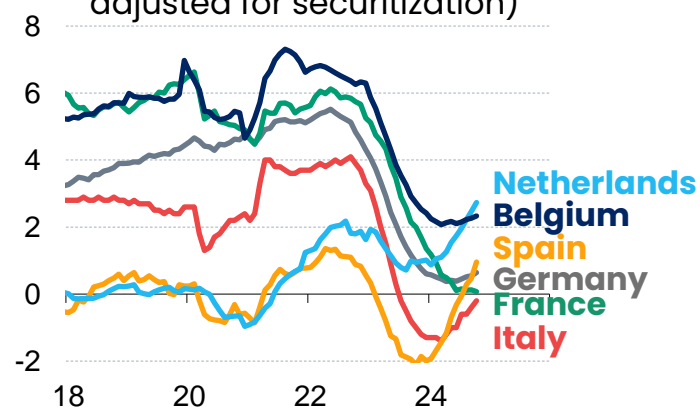
Home prices to income ratio
(1996 Q1 = 100)



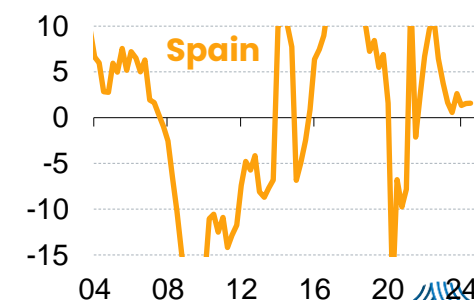
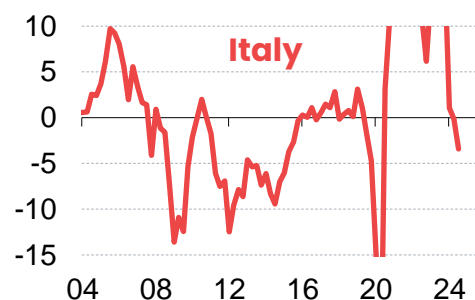
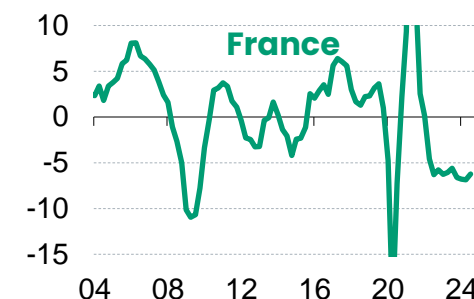
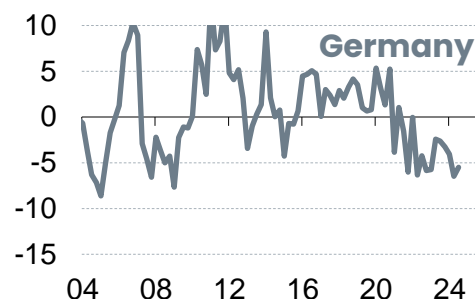
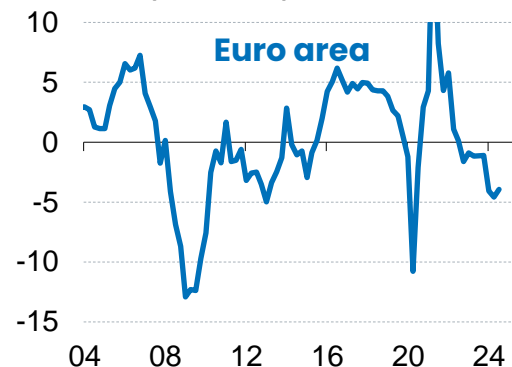
Loans for house purchase
(%)



Total loans to households
(% year on year, adjusted for securitization)

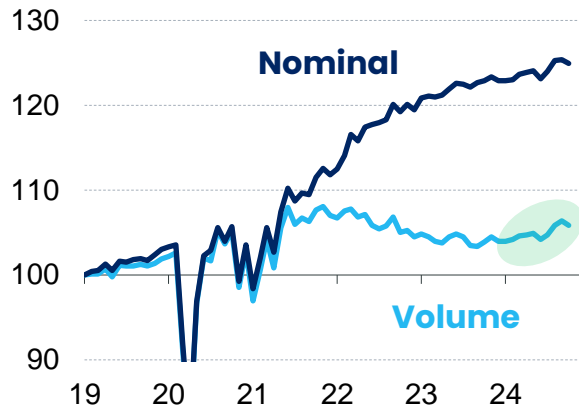


Residential investment
(% year on year, volume)

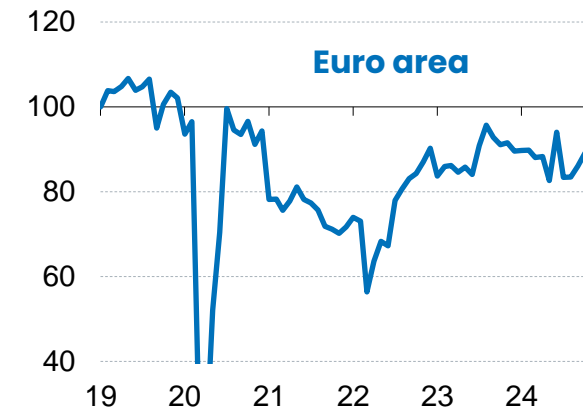


While retail sales have picked up recently...

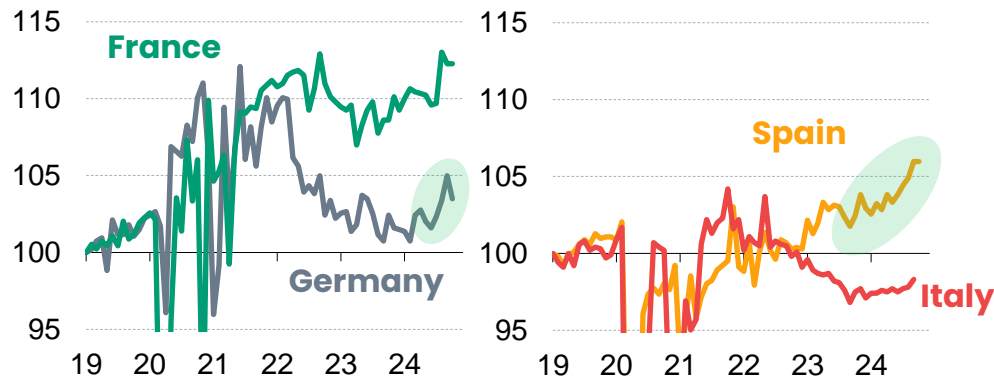
Euro area retail sales
(January 2019 = 100, ex motor vehicles)



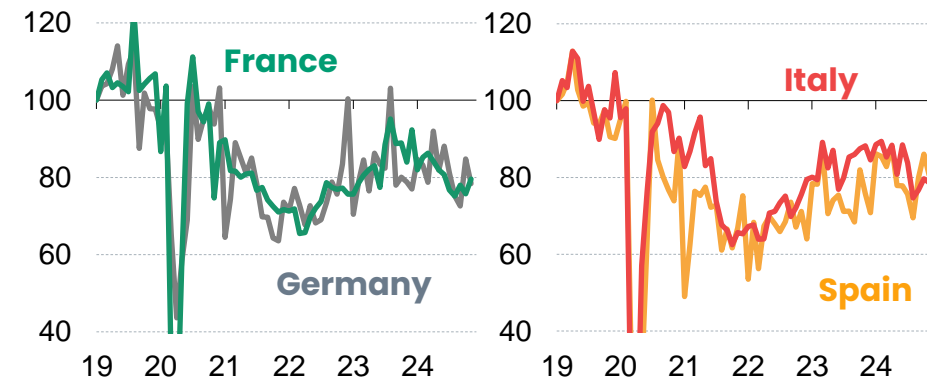
New car registrations
(January 2019 = 100)



By country
(volume)



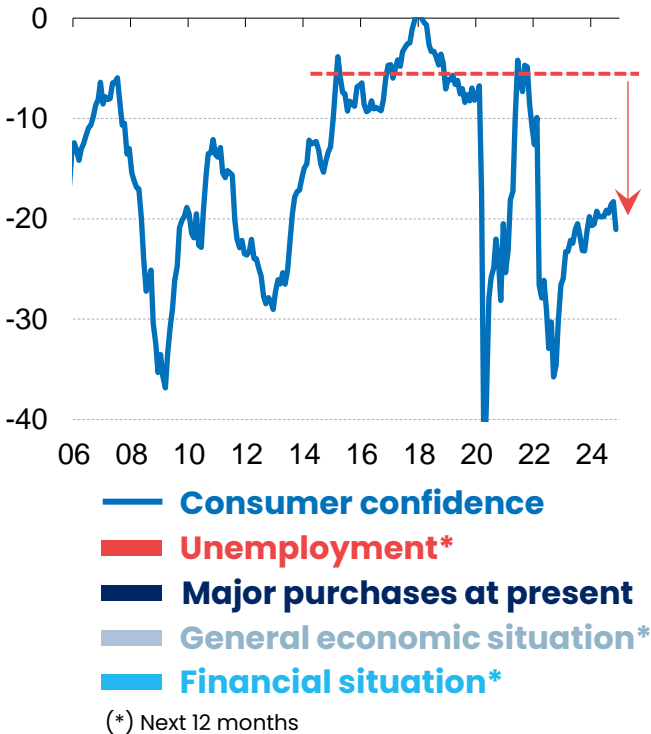
By country



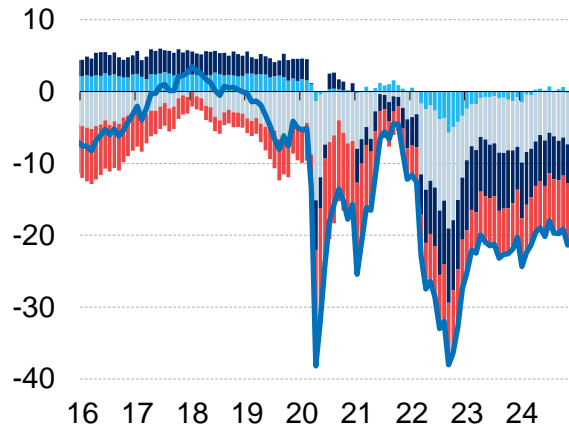
... consumer confidence remains well below its pre-covid levels

Consumer confidence by country

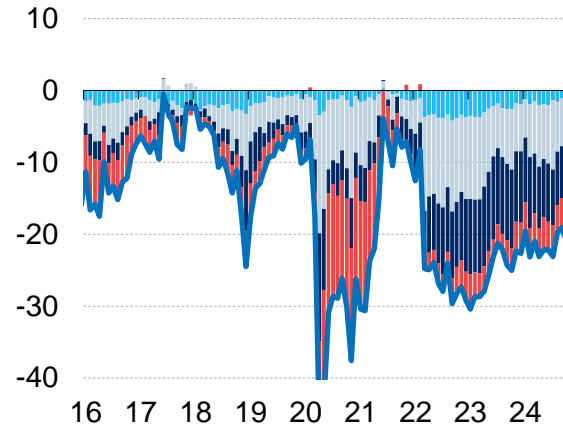
Consumer confidence in the Euro area



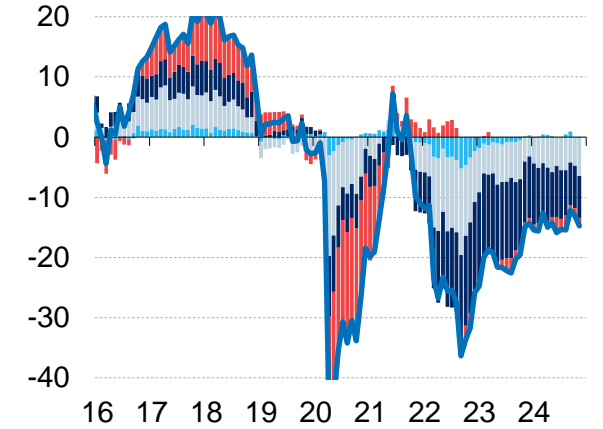
Germany



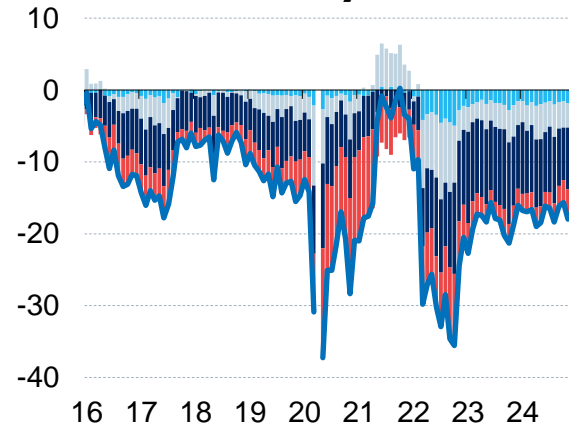
France



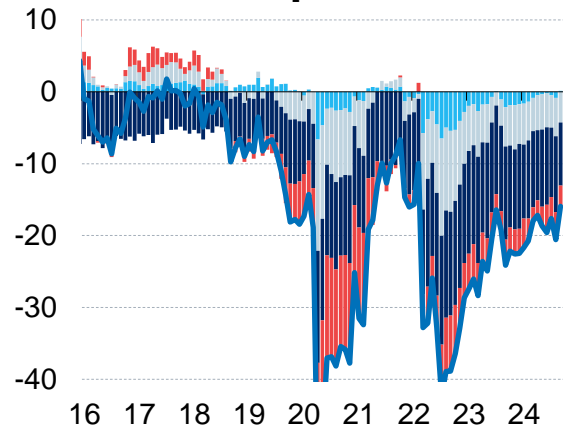
Netherlands



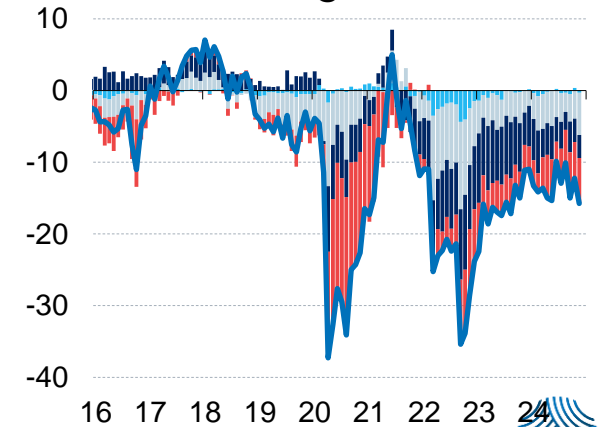
Italy



Spain

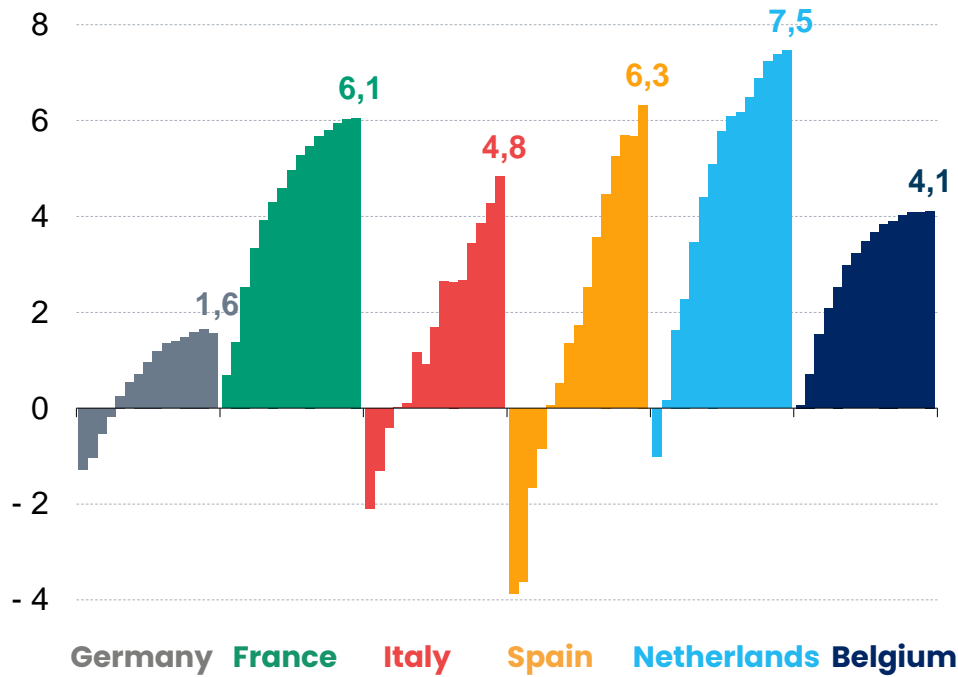


Belgium

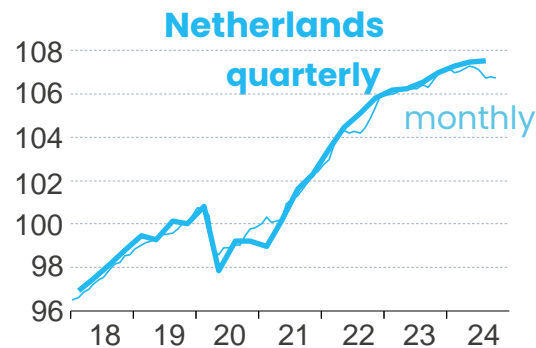
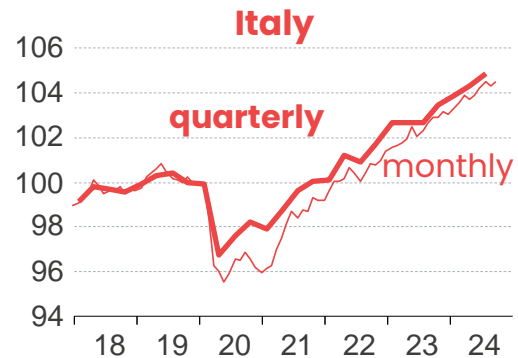
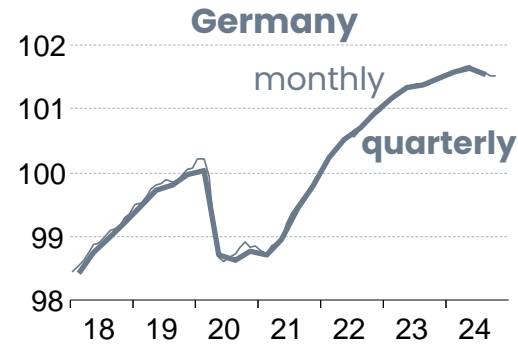


Employment is levelling off

Cumulated employment growth since Q4 2019
(%, 2021 Q1 – 2024 Q3)



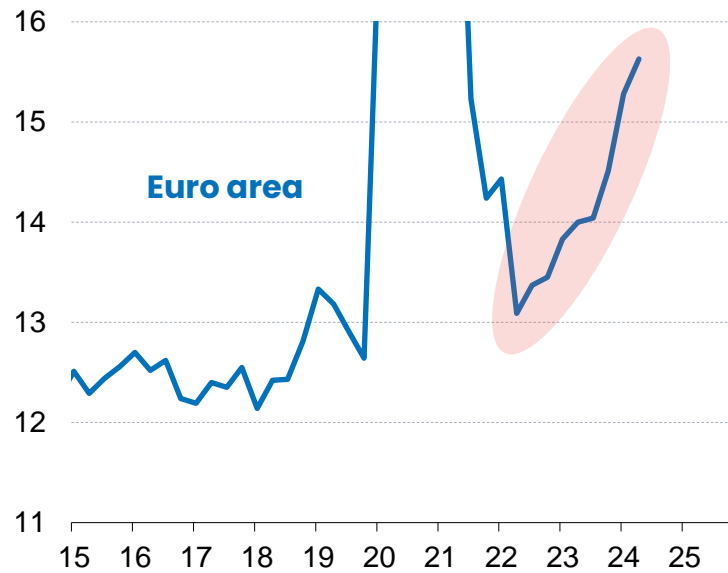
Employment
(end of 2019 = 100)



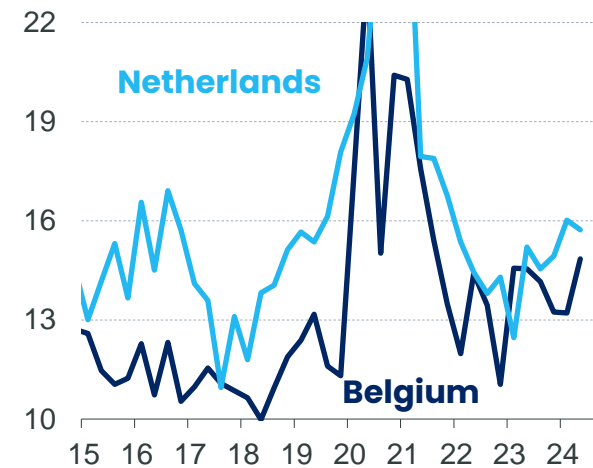
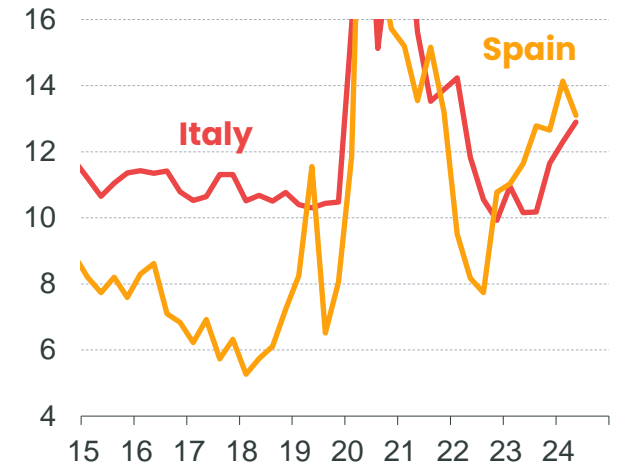
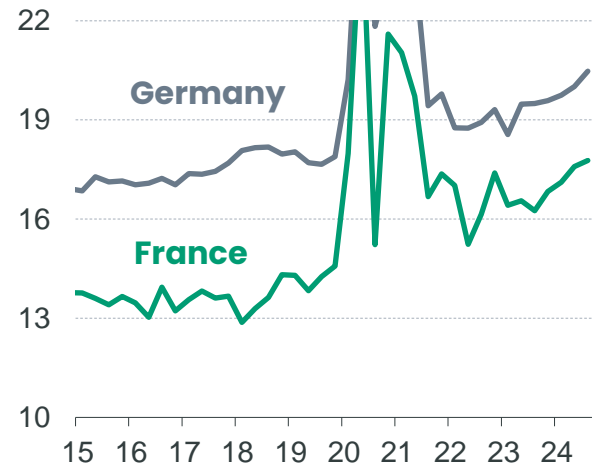
Employment and firms' expectations



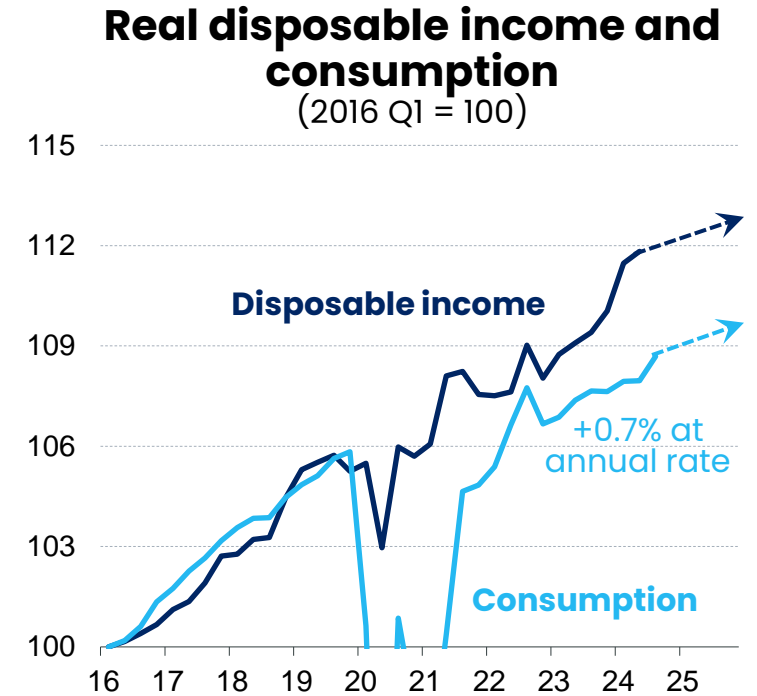
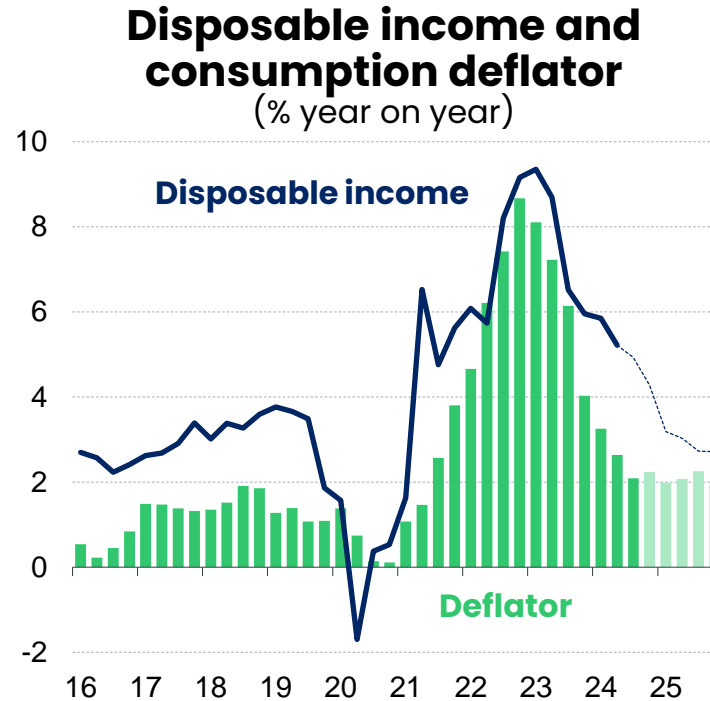
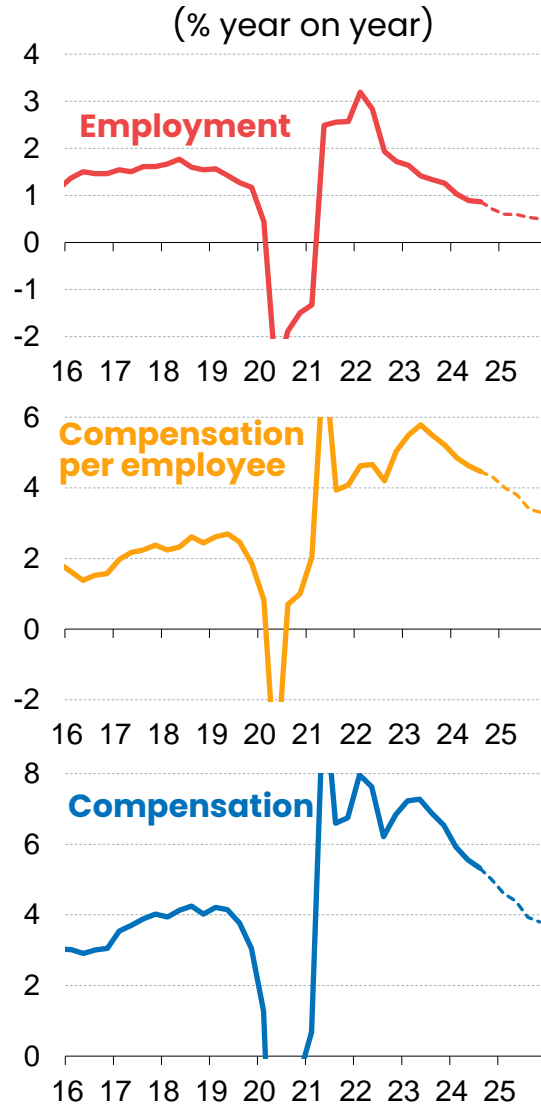
With still low consumer confidence and slowing job creations, the saving rate has little reason to fall back to pre-covid levels



Saving rates (%)

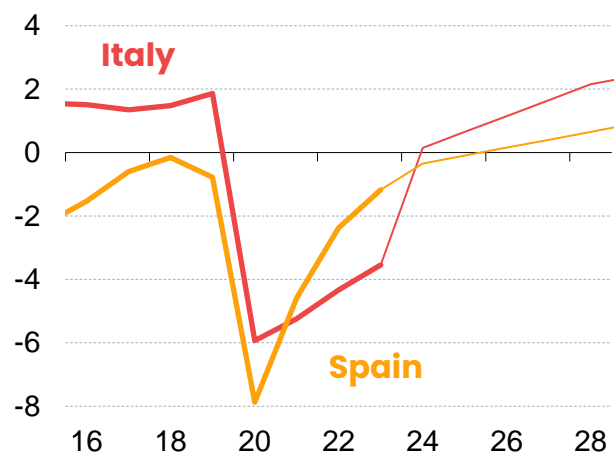
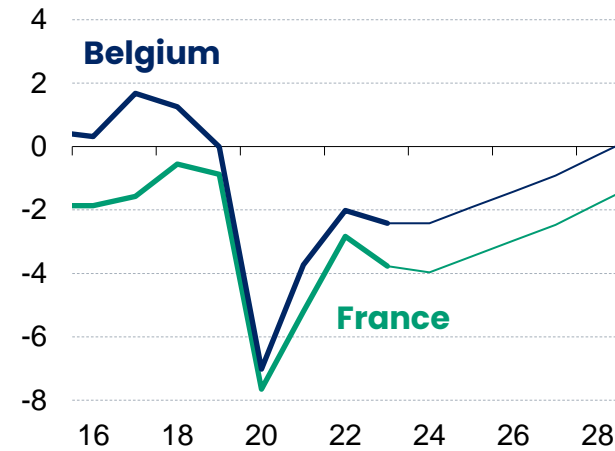
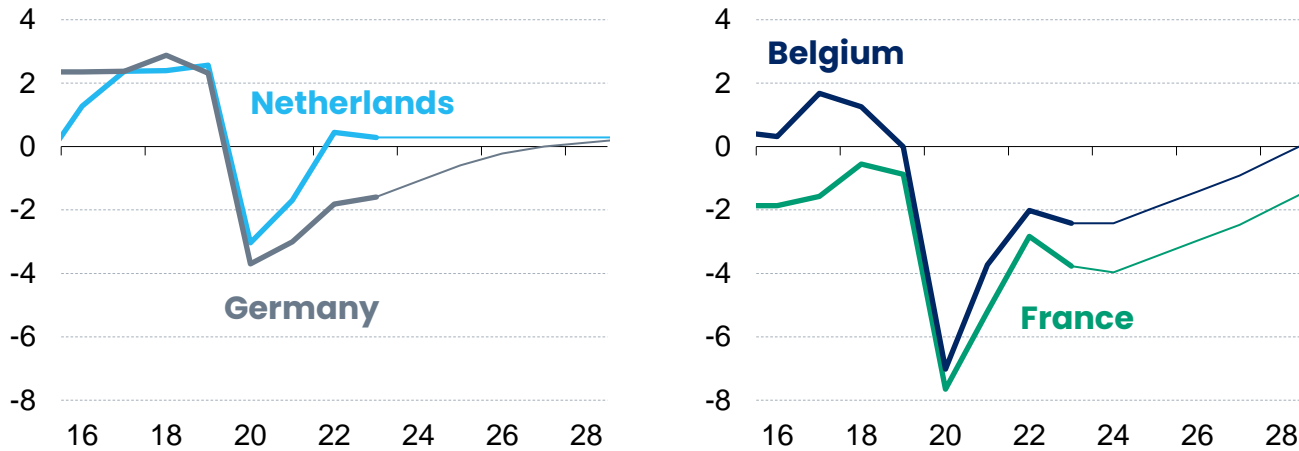


Still, steady growth in real disposable income should allow for some growth in consumption

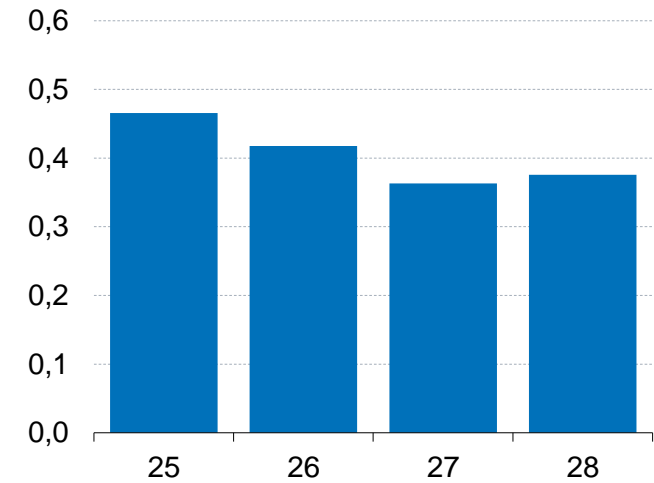


Given some coming fiscal tightening...

Primary balance
(% of GDP)



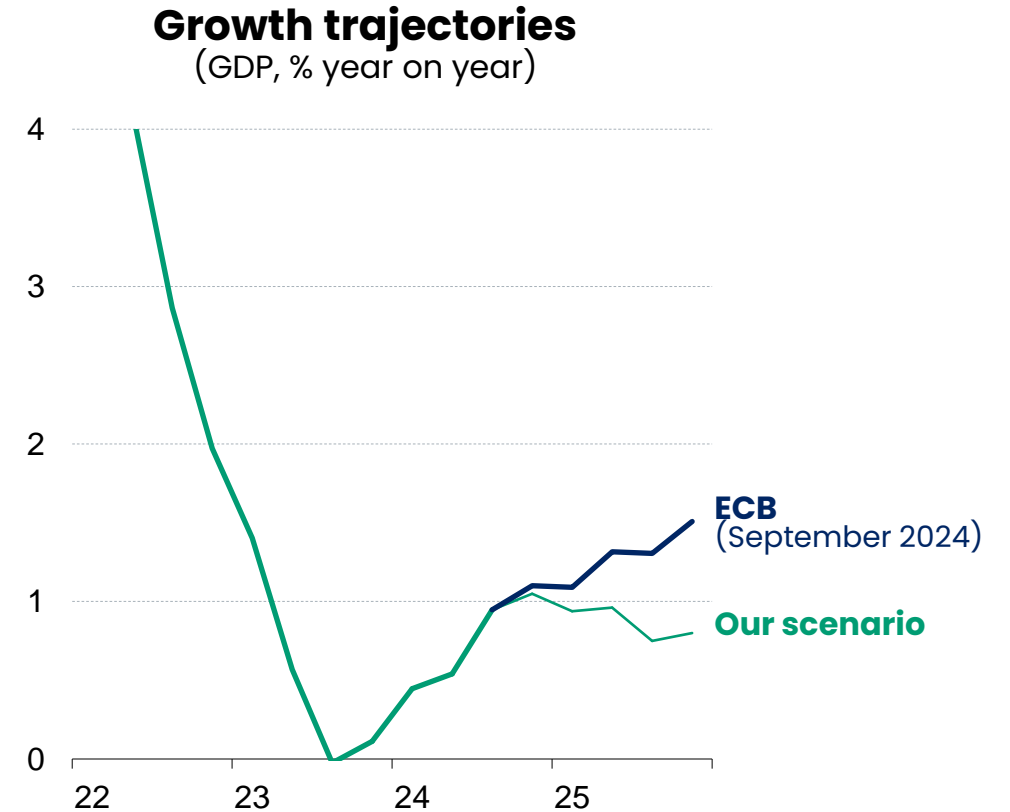
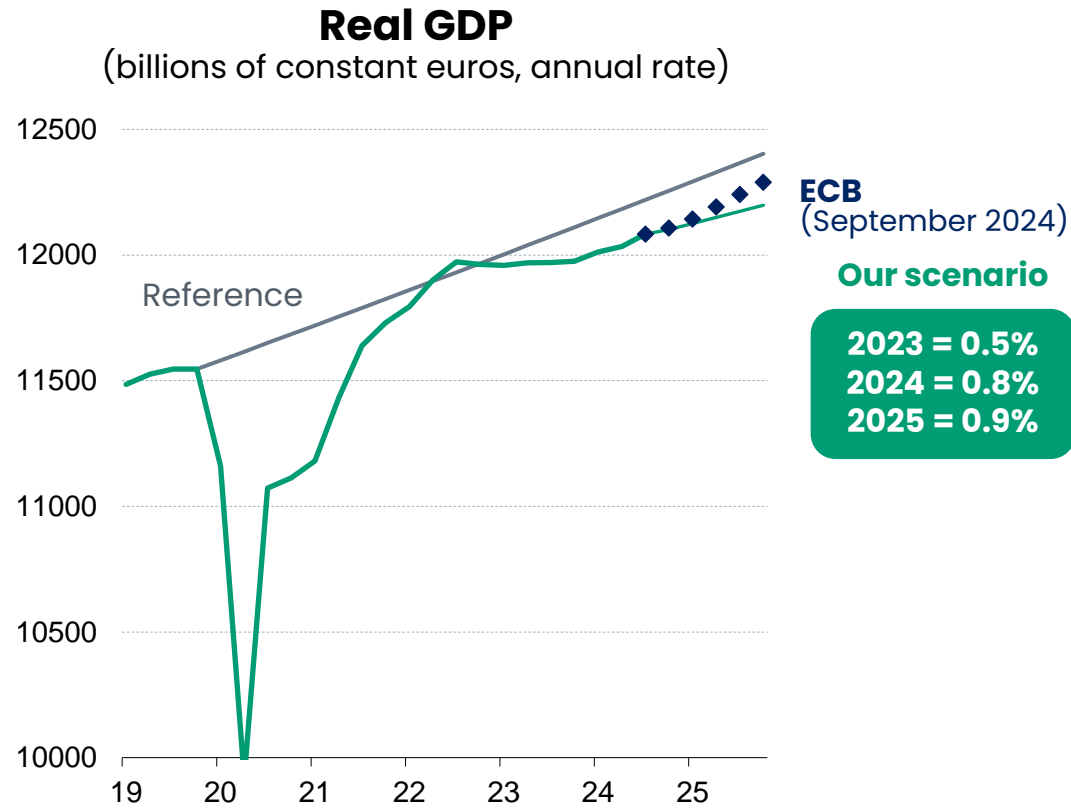
Euro area* fiscal rebalancing effort
(% of GDP)



(*) Germany, France, Italy, Spain, Belgium

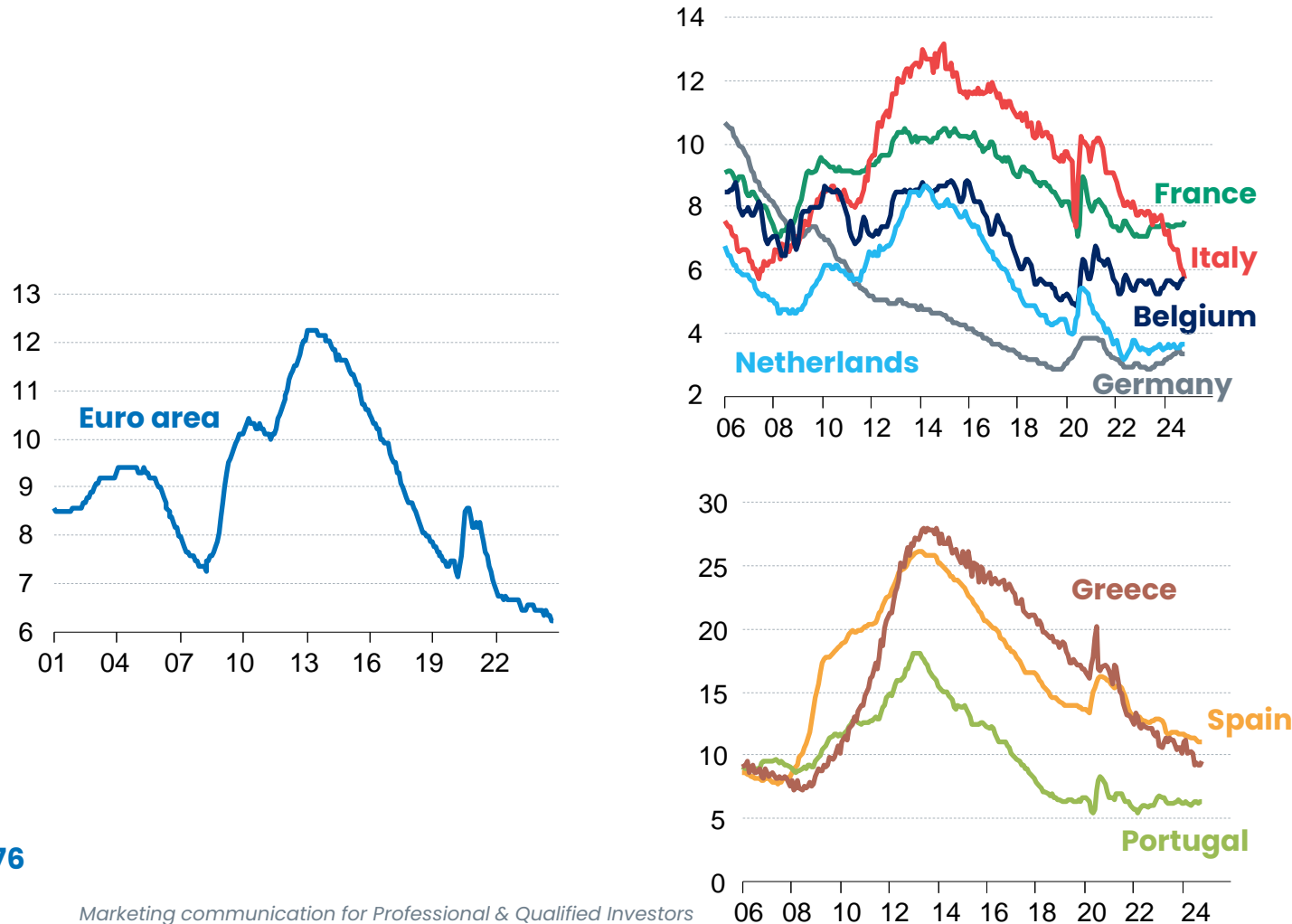


... our baseline scenario is for growth to remain below 1% in 2025

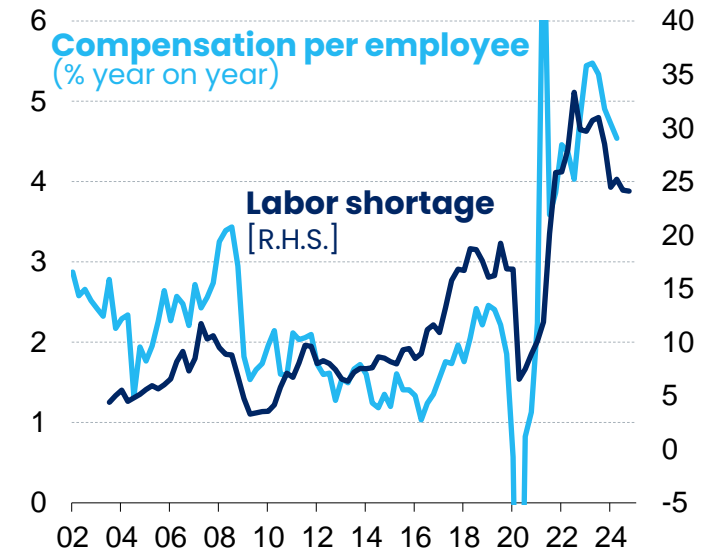


While the labor market is still tight...

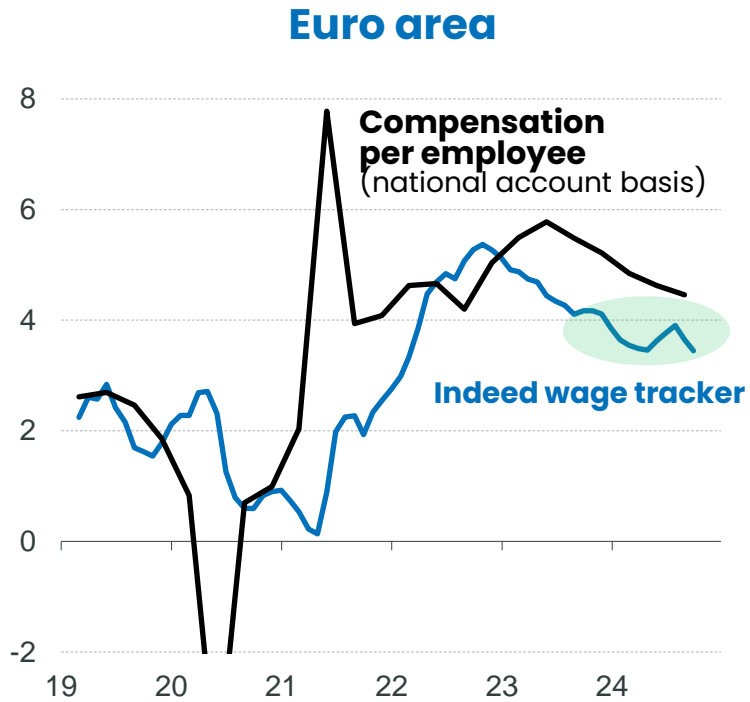
Unemployment rate in the euro area (%)



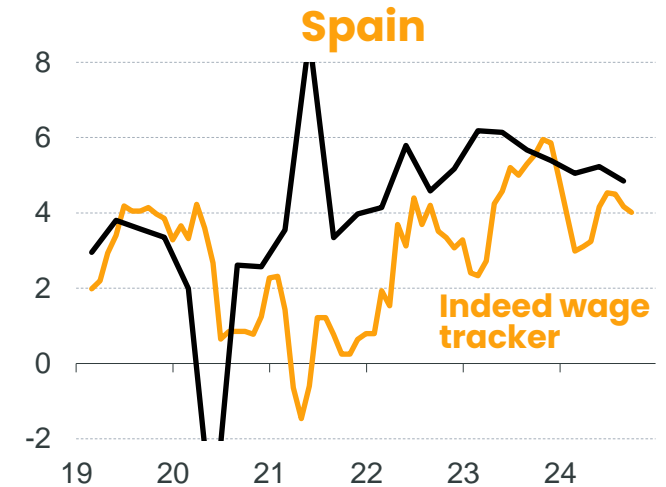
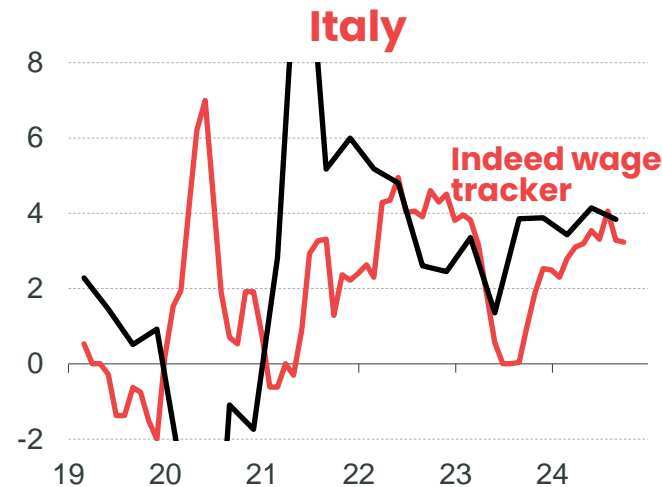
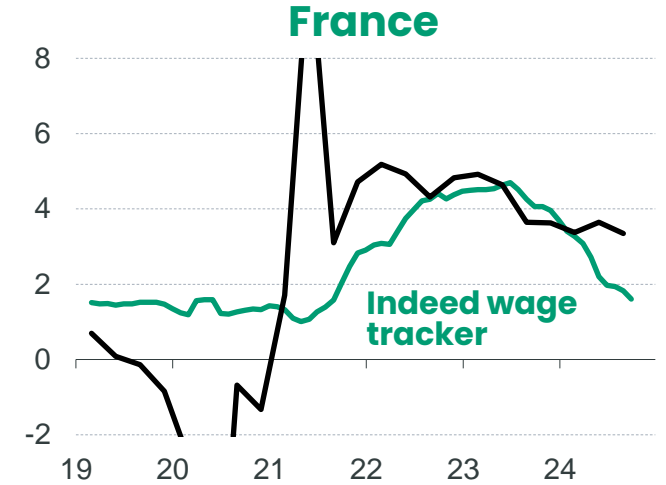
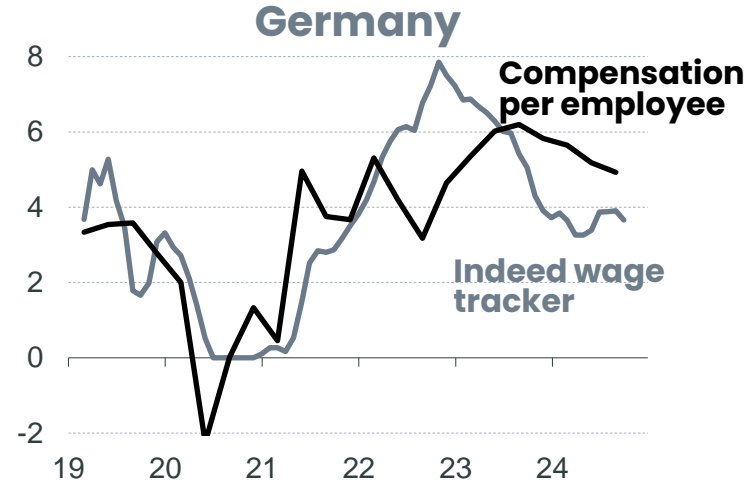
Labor shortage and compensation per employee



... wage pressures have started to ease

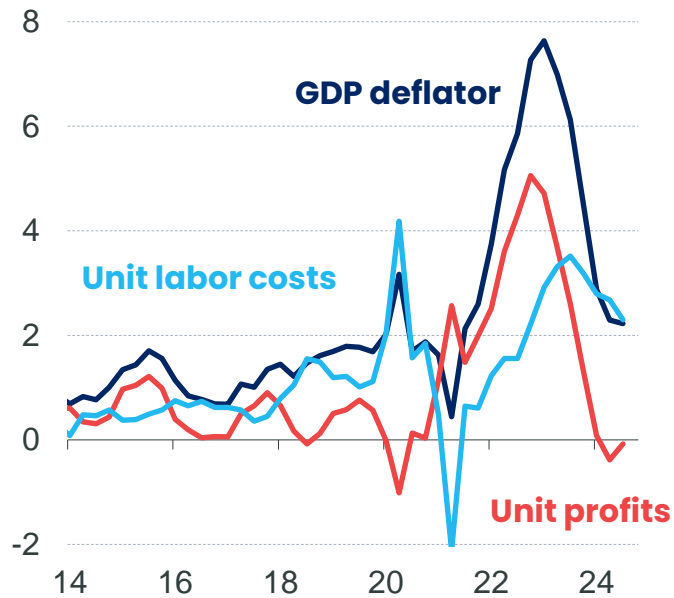


Compensation per employee (% year on year)

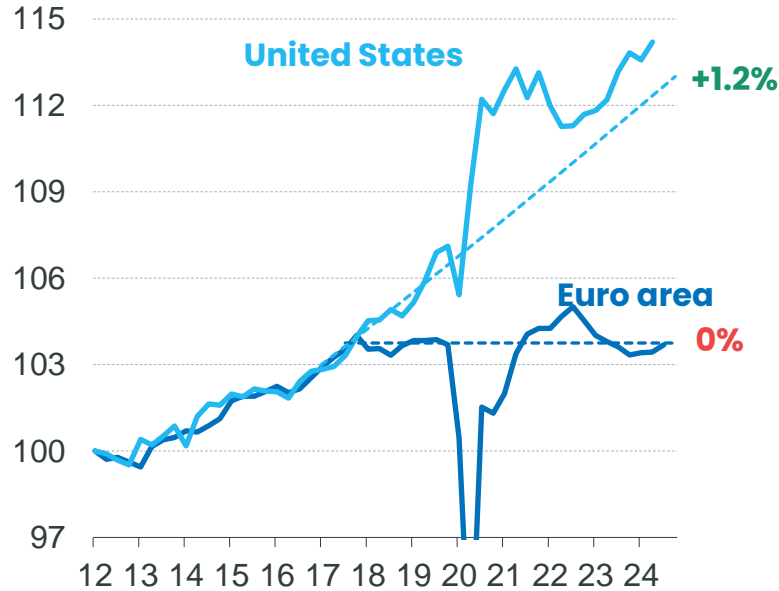


The deceleration of unit labor costs could however take some time

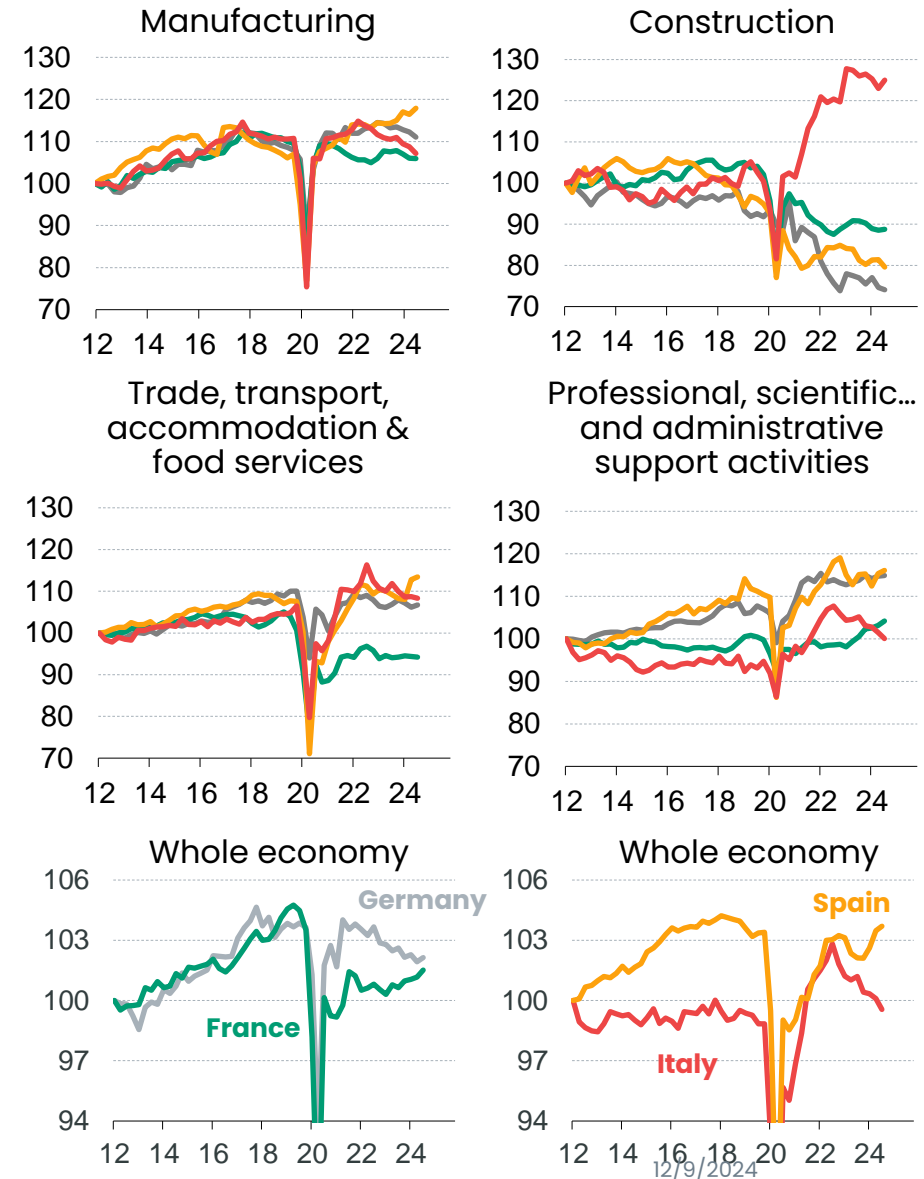
Contribution to the GDP deflator
(% year on year)



Real GDP per employee
(2012 Q1 = 100)



Real GDP per employee
(2012 Q1 = 100)

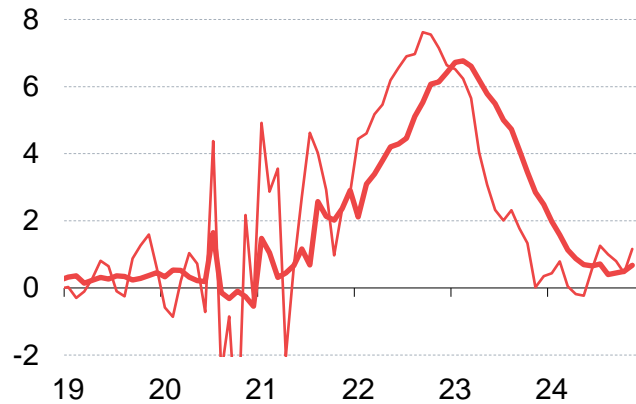


Still, as long as inflation keeps on receding...

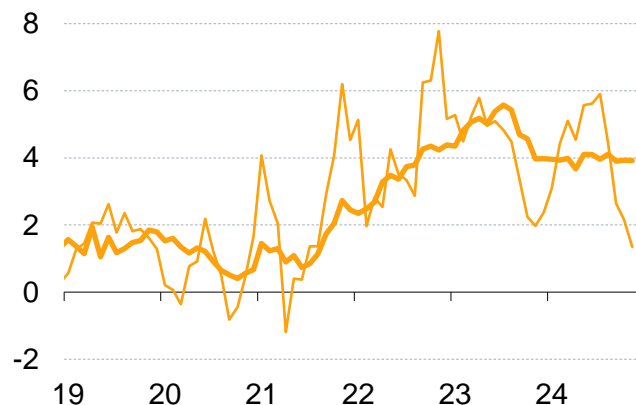
Core CPI inflation
(% annual rate)



Core goods



Core services

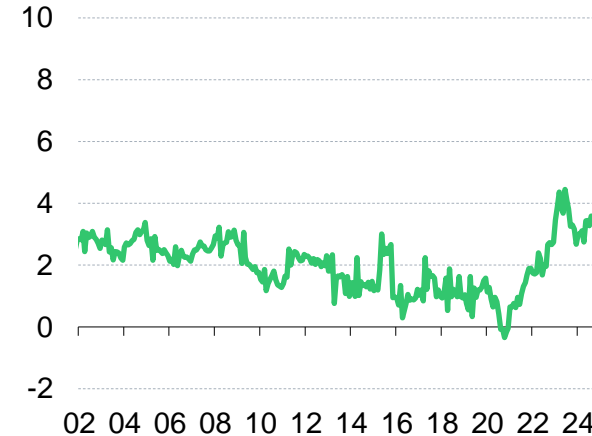


Core services CPI
(% year on year)

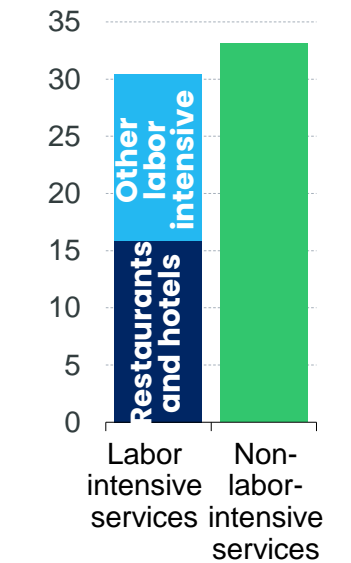
Labor intensive services



Non-labor-intensive services

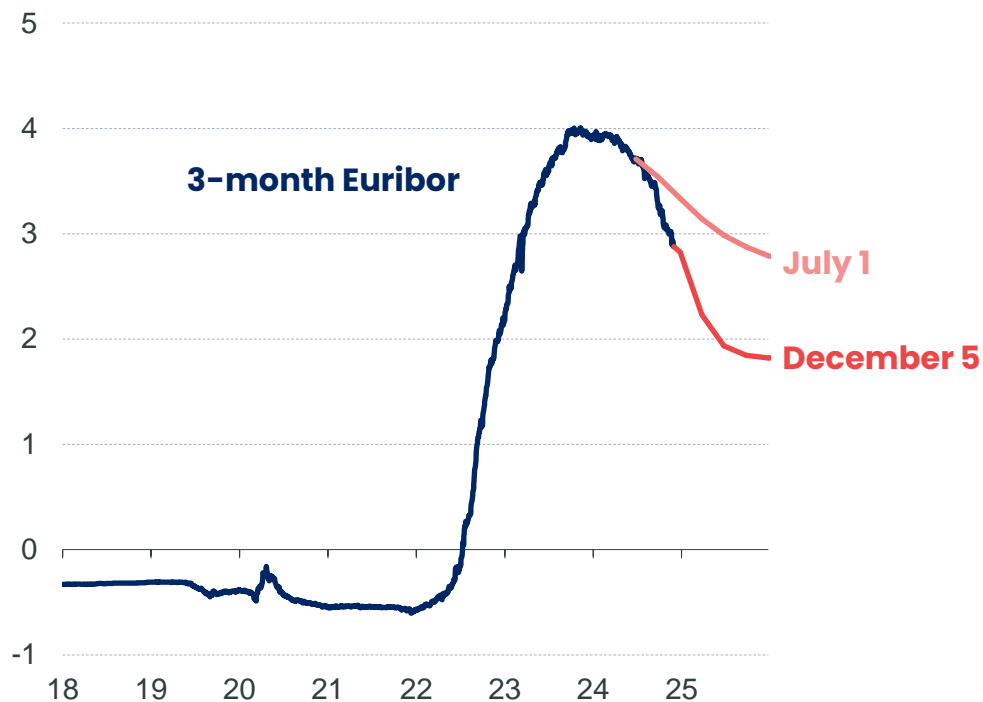


(% share in core CPI)



... the ECB will be “forward looking” and continue to ease its monetary policy

ECB interest rate expectations (%)



“If you look past the monthly ups and downs, you can see that price stability is not far off, but the last stretch of the road still has to be covered.”

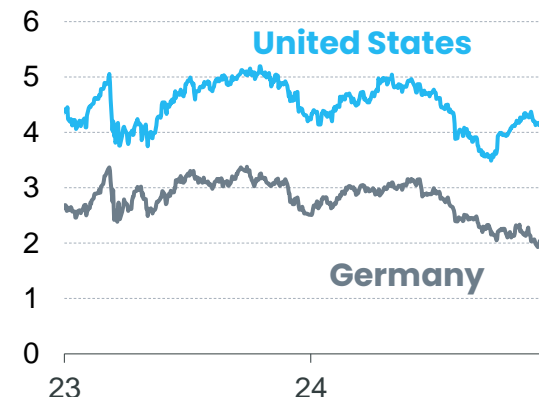
Joachim Nagel, October 30 2024

“When victory against inflation is in sight, monetary policy shouldn’t inflict excessive or prolonged restraint to activity and employment, and hence to our fellow citizens.”

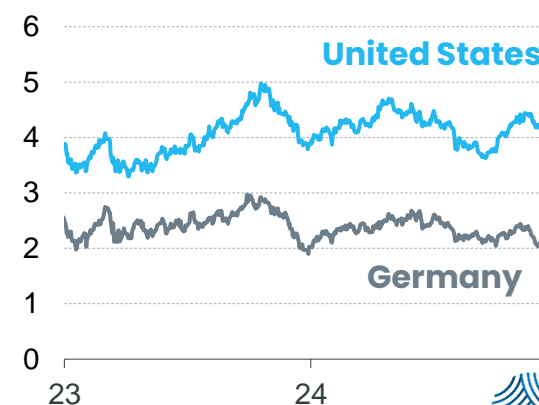
François Villeroy de Galhau, October 22 2024

German and United States sovereign rates (%)

2-year rate

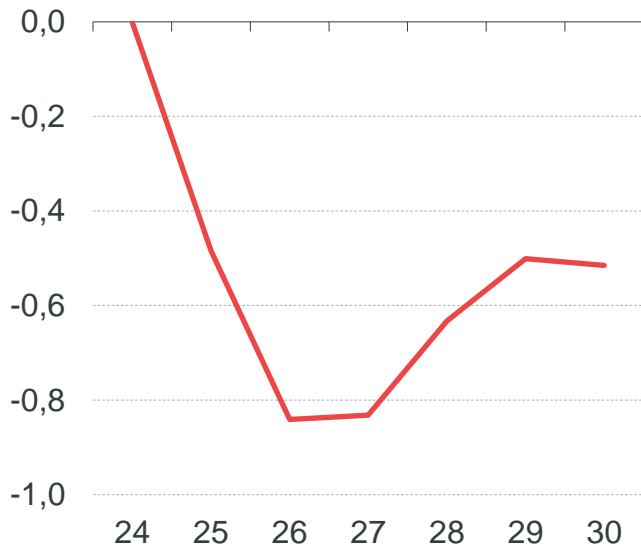


10-year rate

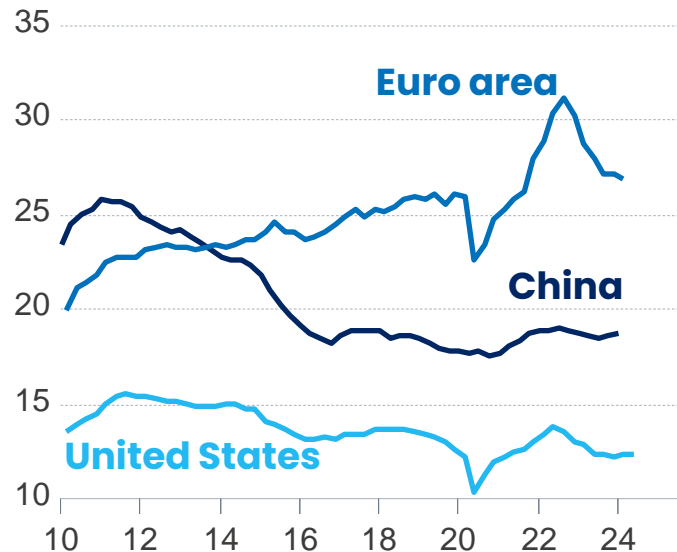


The more so since the downside risks from a looming trade war have increased

Effect on world growth of a "full Trump" scenario
(% deviation from IMF baseline)



Trade openness*
(% of GDP, 4Q moving average)



(*). Measured as the half sum of exports and imports to GDP

Impact of 1% lower world growth using our macro model
(%)

Euro area	DE	FR	IT	ES
-0.7	-0.9	-0.4	-0.6	-0.4

1% lower world growth would weaken growth in the euro area by 0.7%.

This would likely push the euro area in recession territory.

The ECB would cut rates more than in our baseline and the euro would weaken against the dollar.



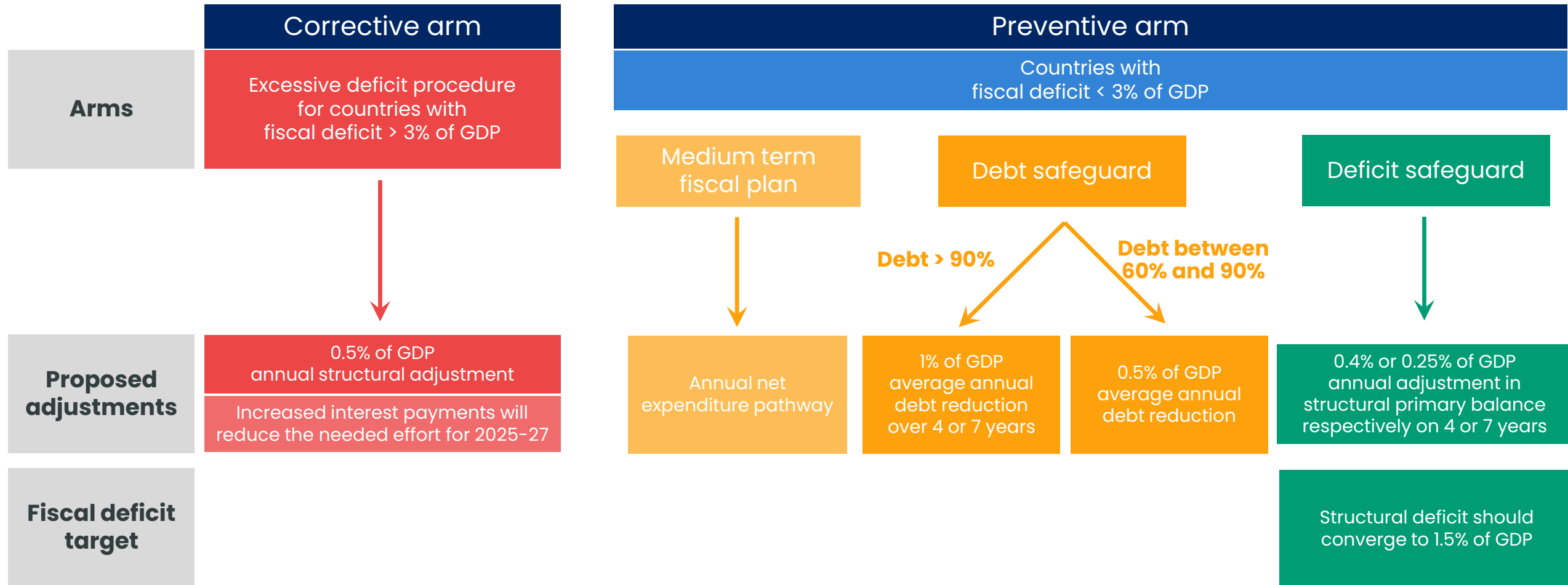


4 Annex

Public debt trajectories

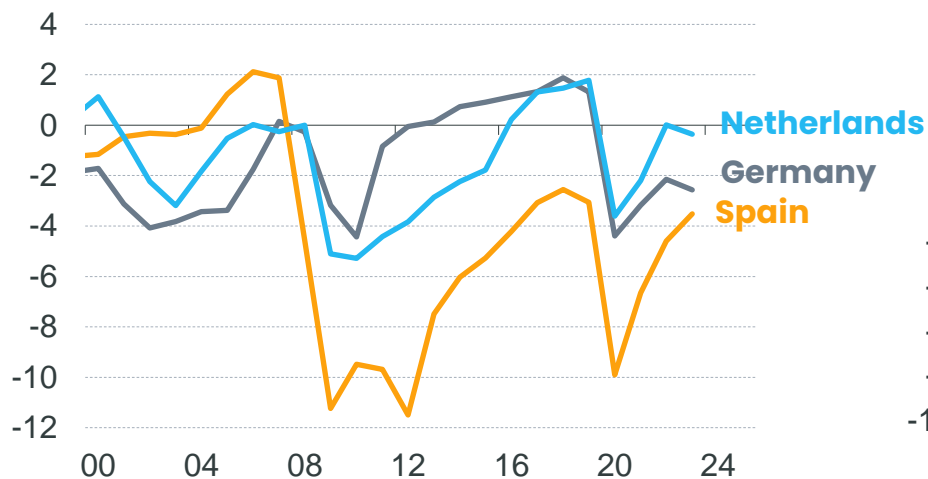


Summary of the new EU fiscal rules

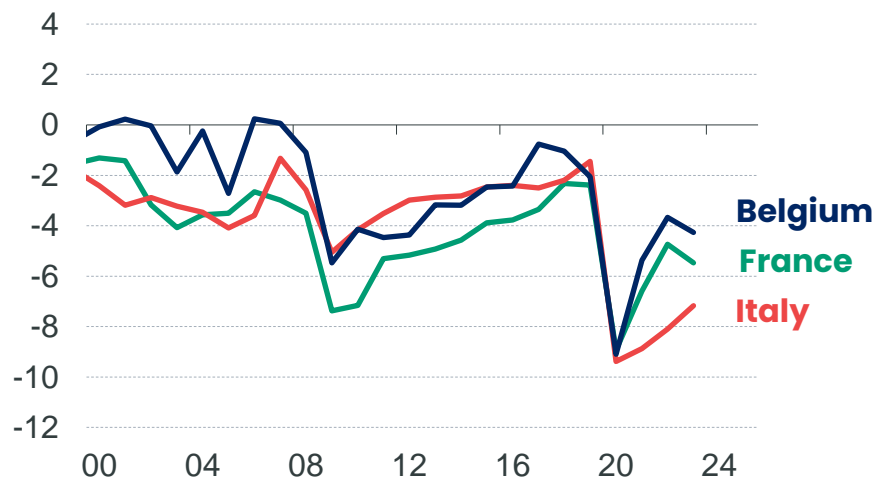
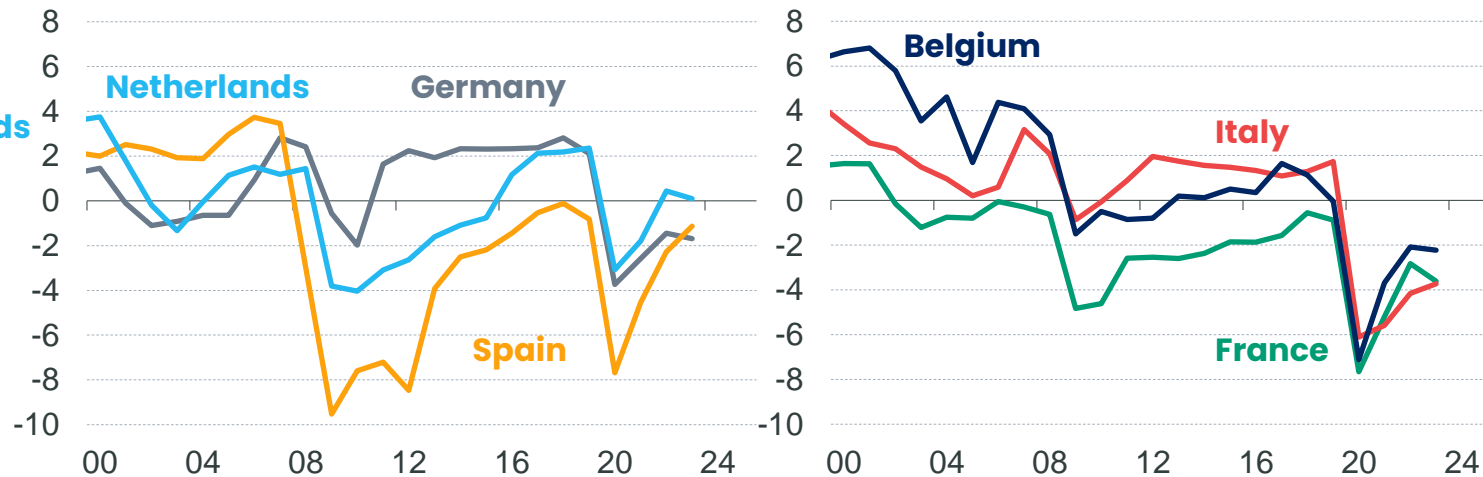


With a deficit above 3% of GDP in 2024, Belgium, France and Italy have been placed under an excessive deficit procedure

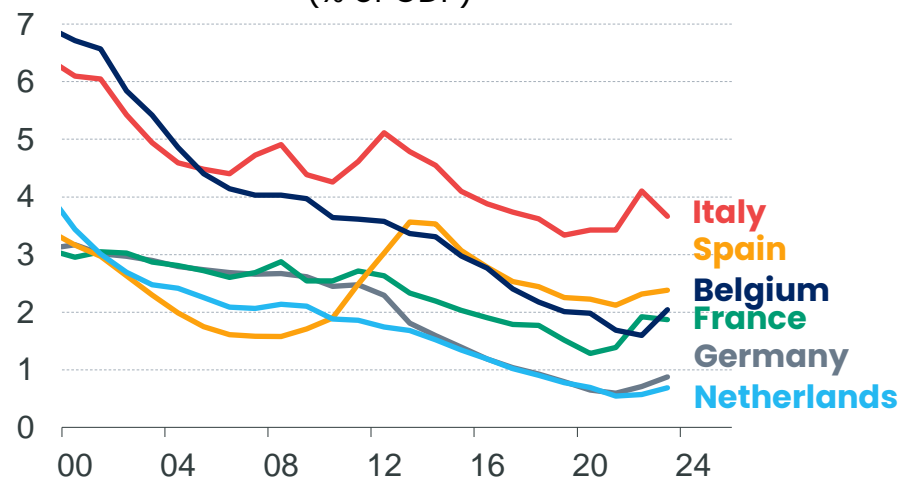
Government balance
(% of GDP)



Government primary balance
(% of GDP)



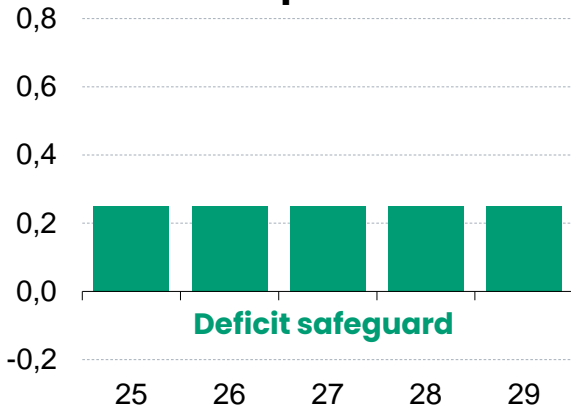
Interest payments
(% of GDP)



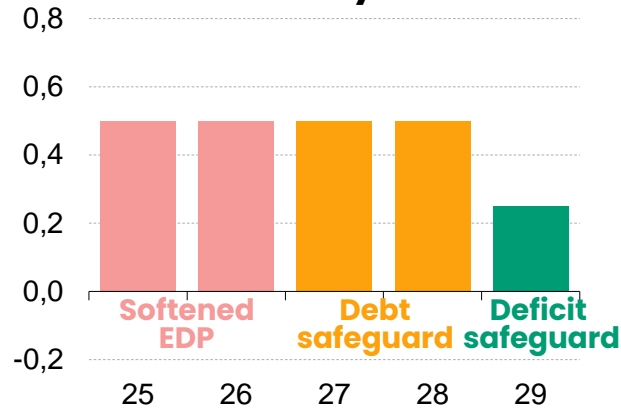
In EDP countries, the new fiscal rules call for a sustained rebalancing effort of 0.5% of GDP

Fiscal rebalancing effort* (% of GDP)

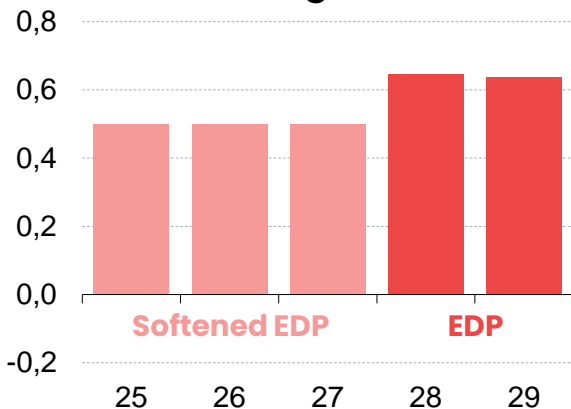
Spain



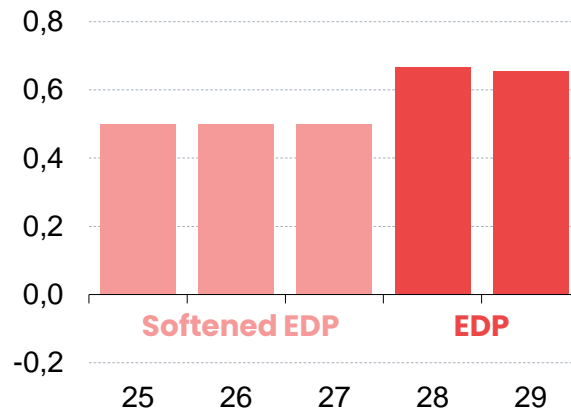
Italy



Belgium



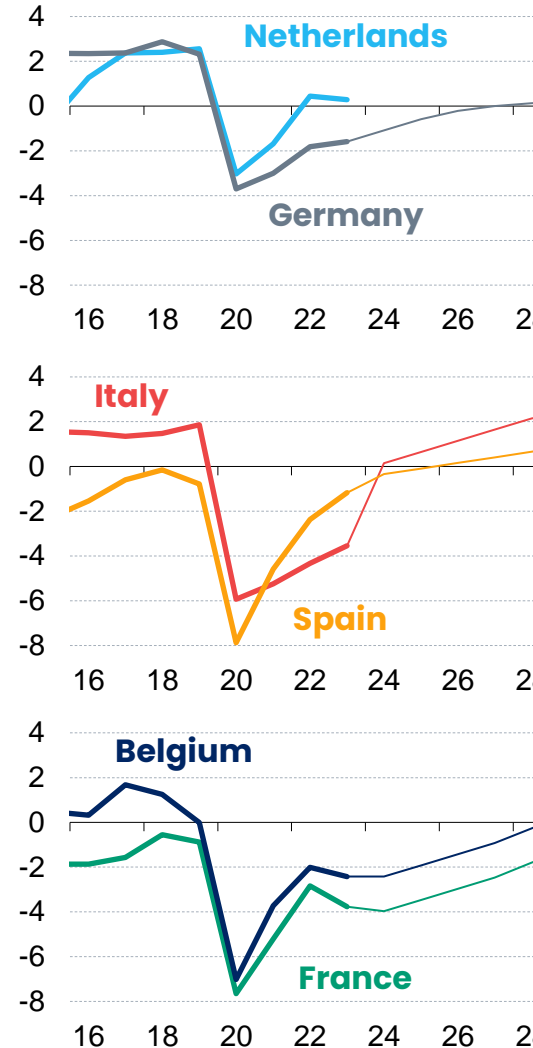
France



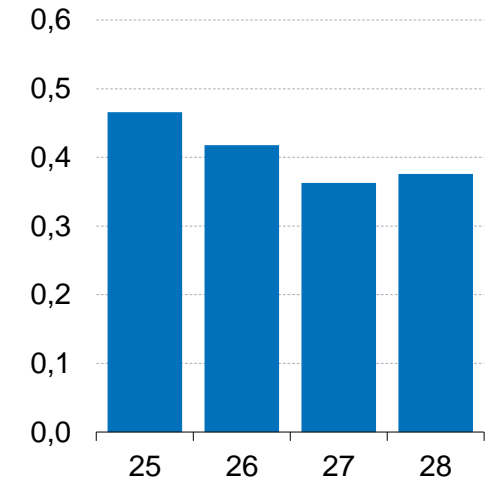
85

(*) Change in primary balance

Primary balance (% of GDP)



Euro area* fiscal rebalancing effort (% of GDP)

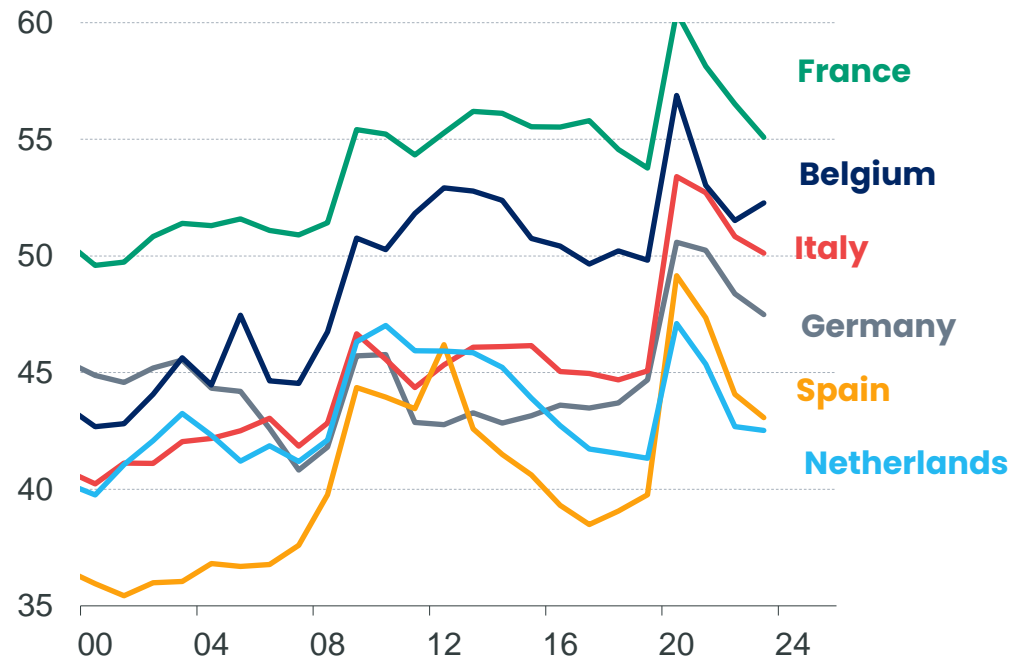


(*) Germany, France, Italy, Spain, Belgium

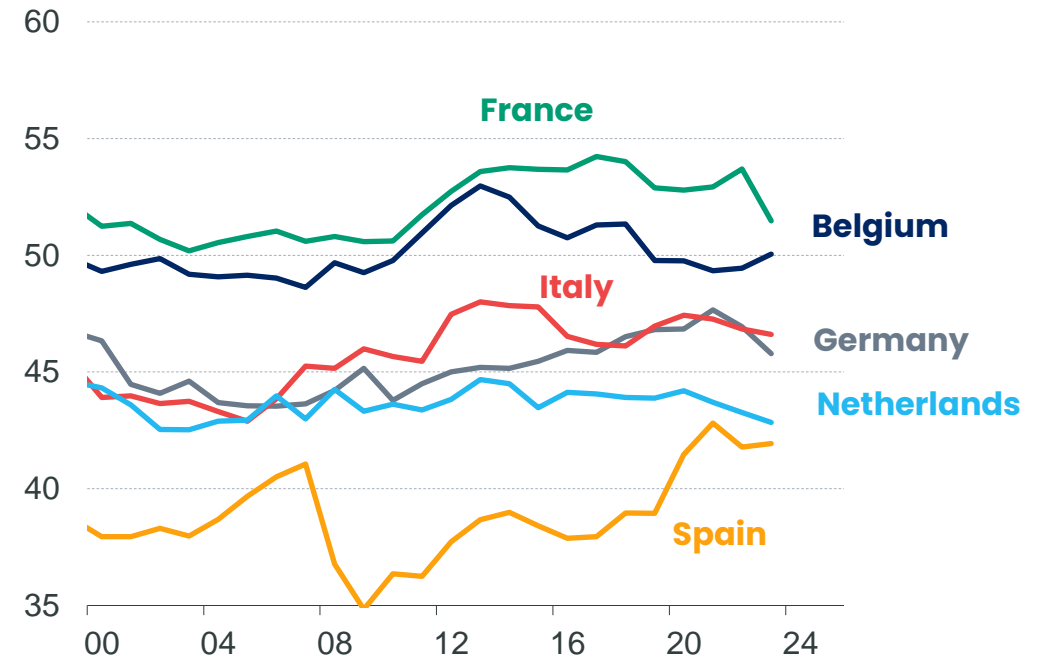


Since 2019, the ratio to GDP of government expenditures has increased in Italy while it has fallen for revenues in France

General government expenditures
(% of GDP, ex interest paid)

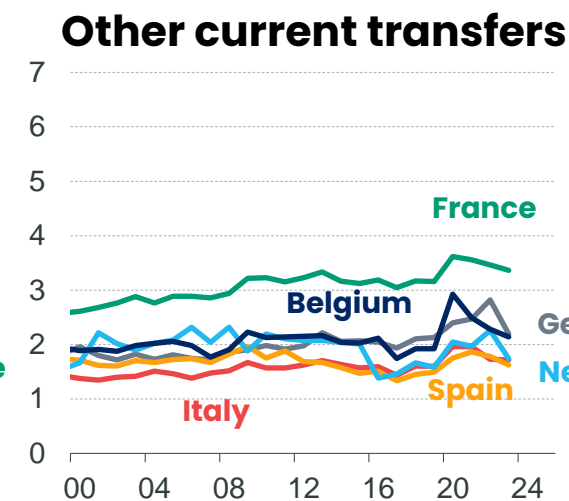
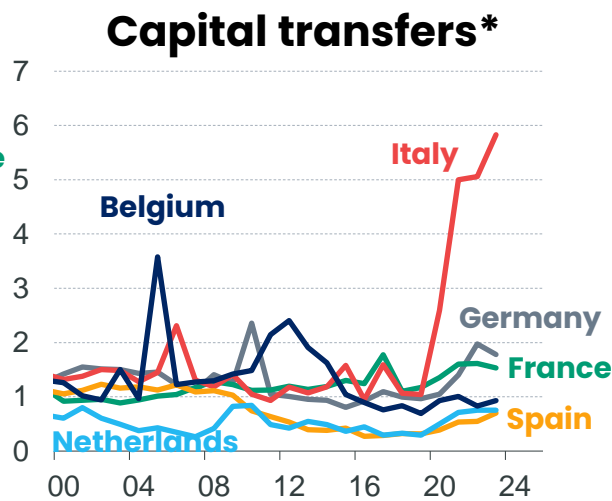
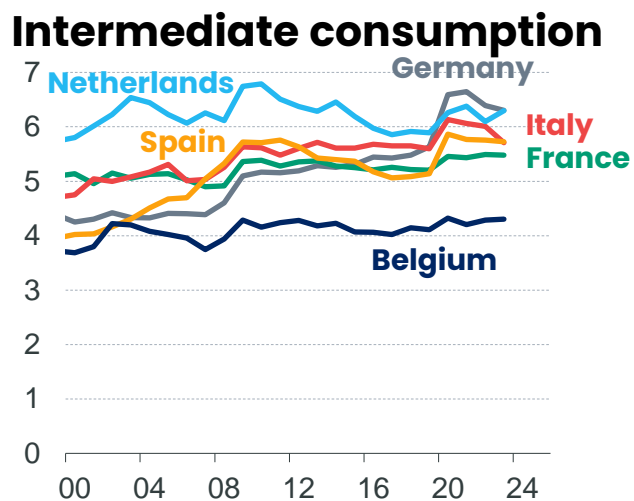
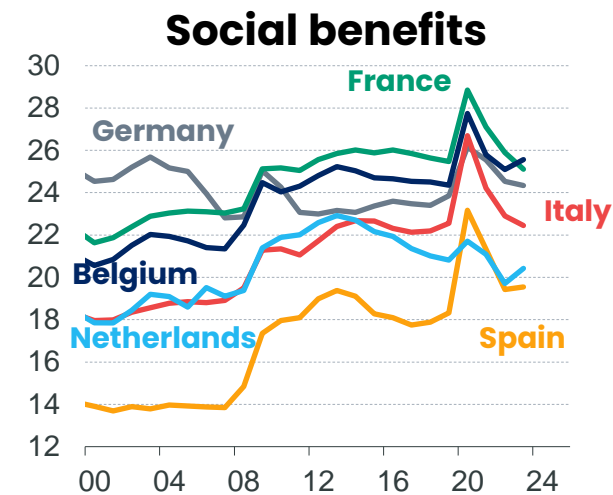
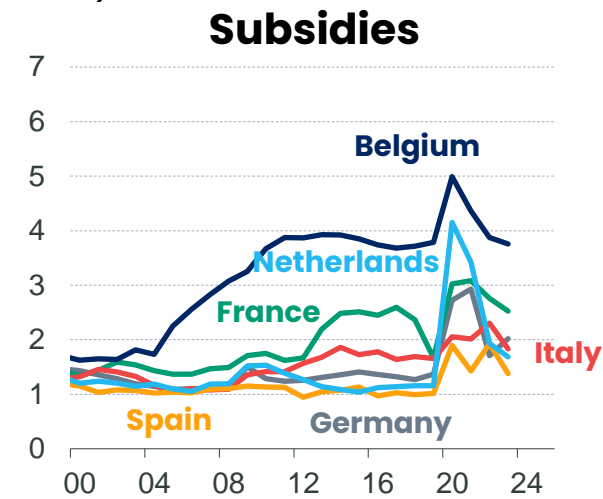
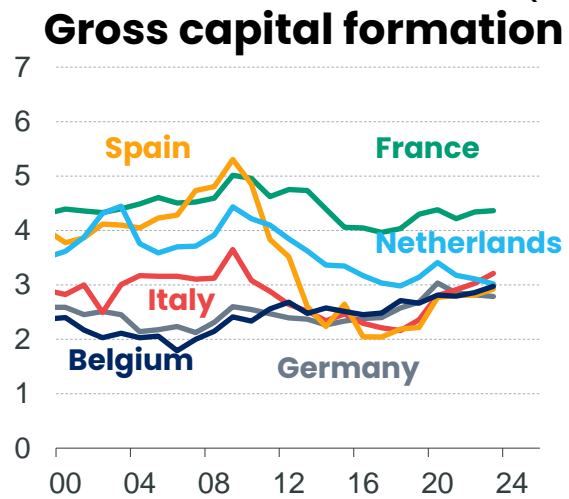
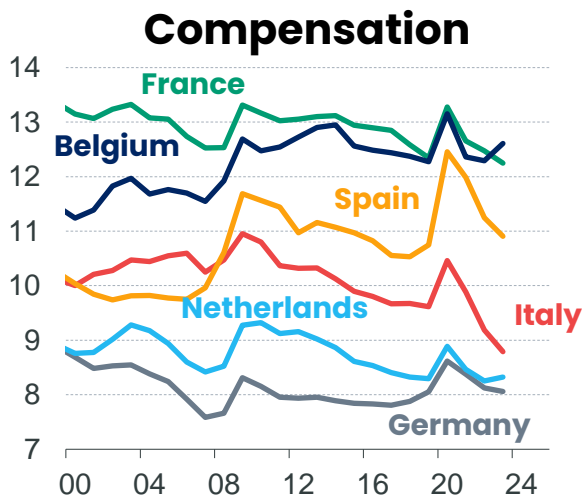


General government revenues
(% of GDP)



Capital transfers account for most of the rise in Italy's expenditures to GDP ratio

Government expenditures by type (% of GDP)

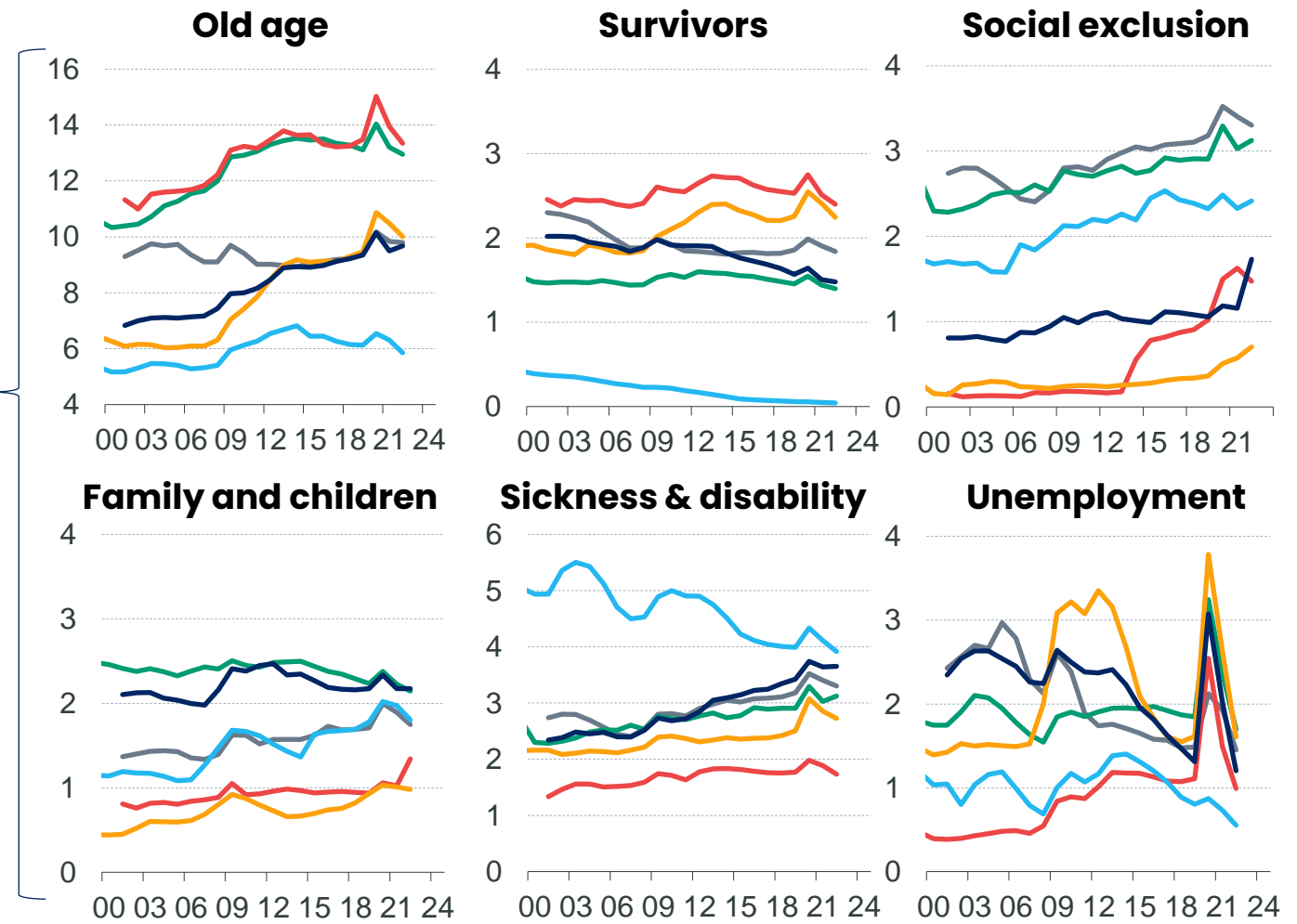
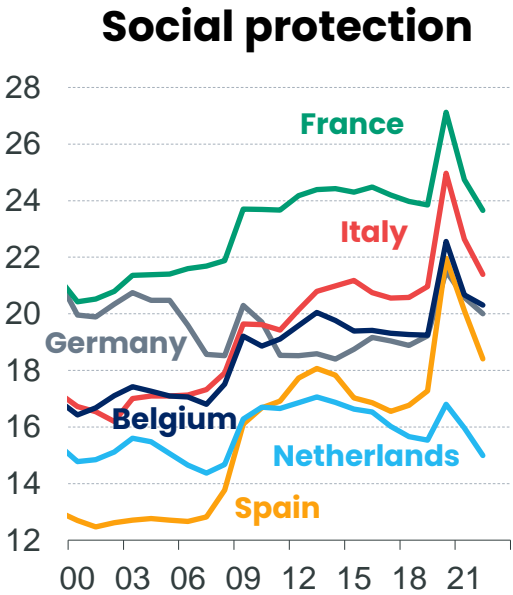
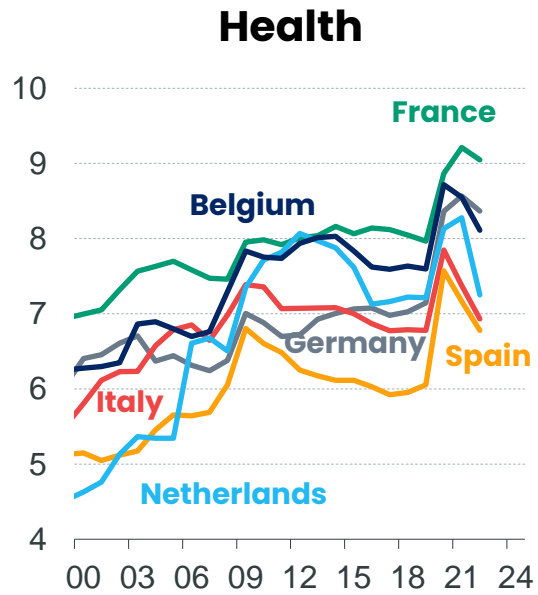


(*) Capital transfers and investment grants



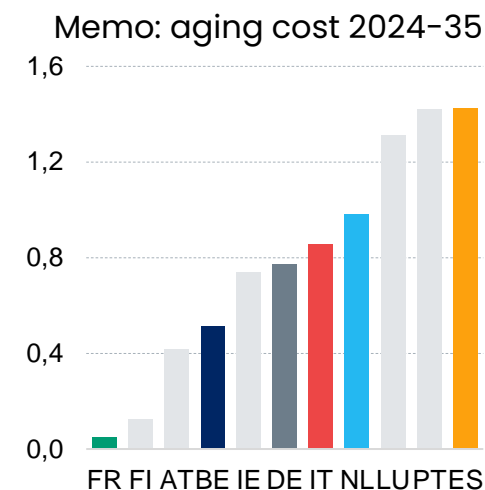
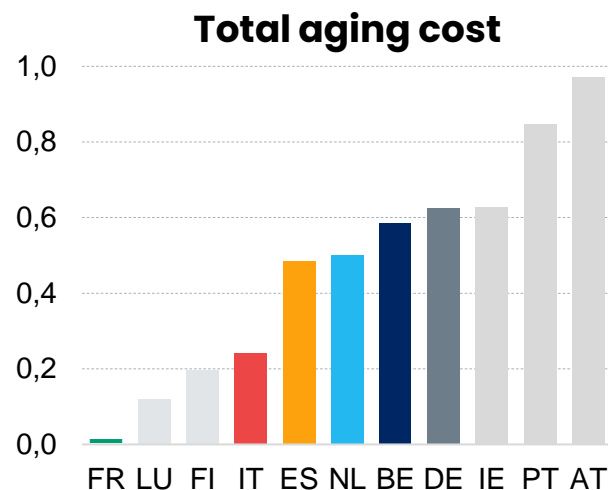
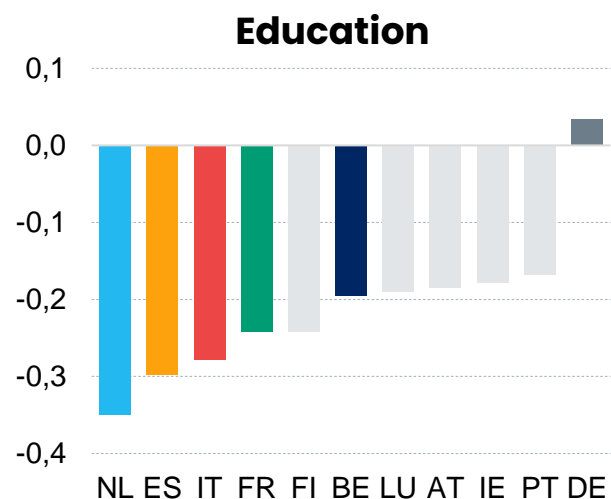
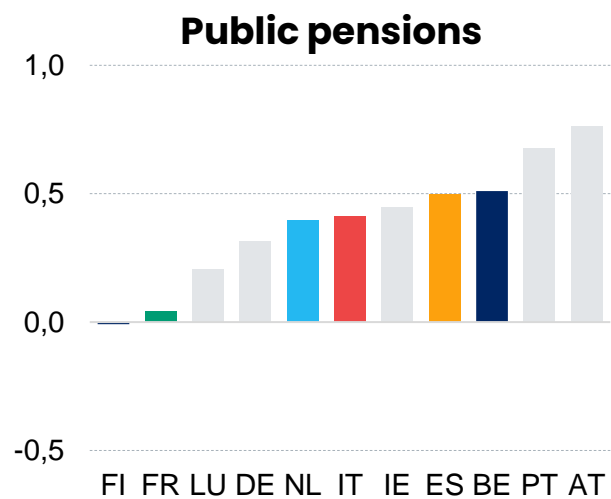
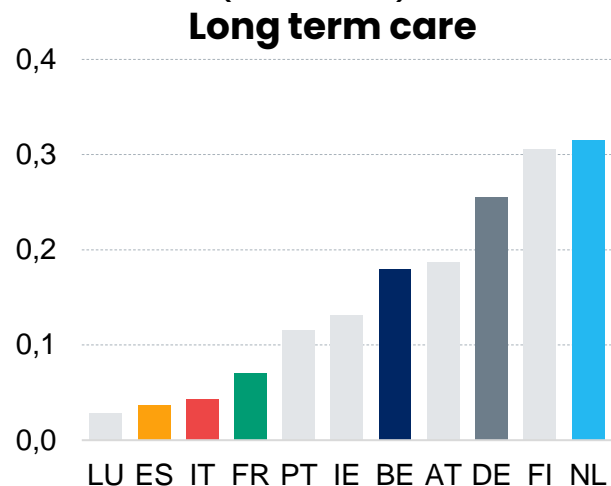
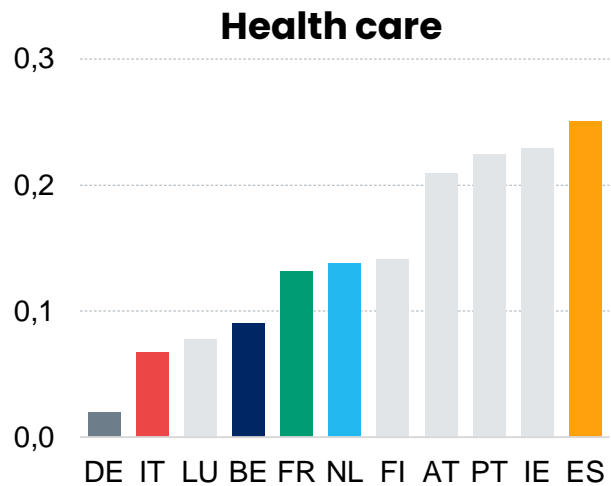
Memo. Covid pushed health spending upwards in most countries

Government expenditures by function (% of GDP)



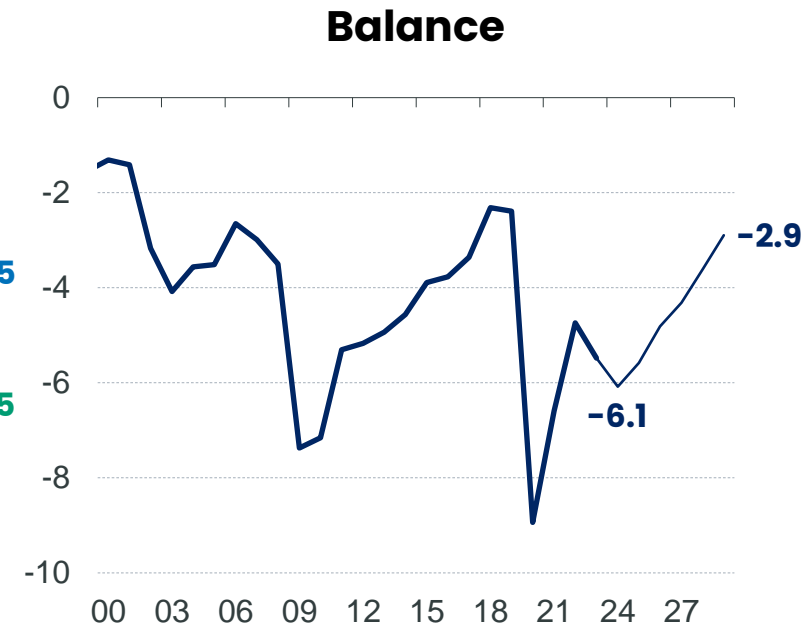
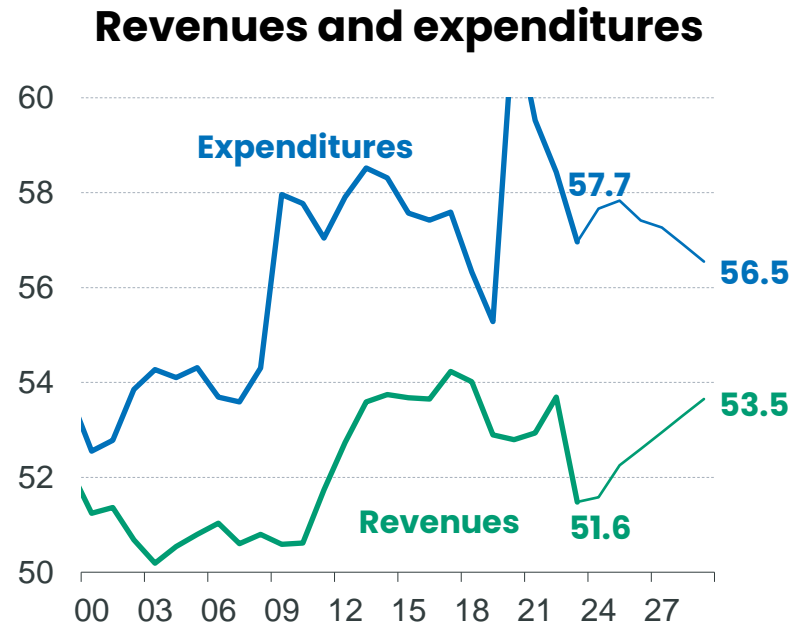
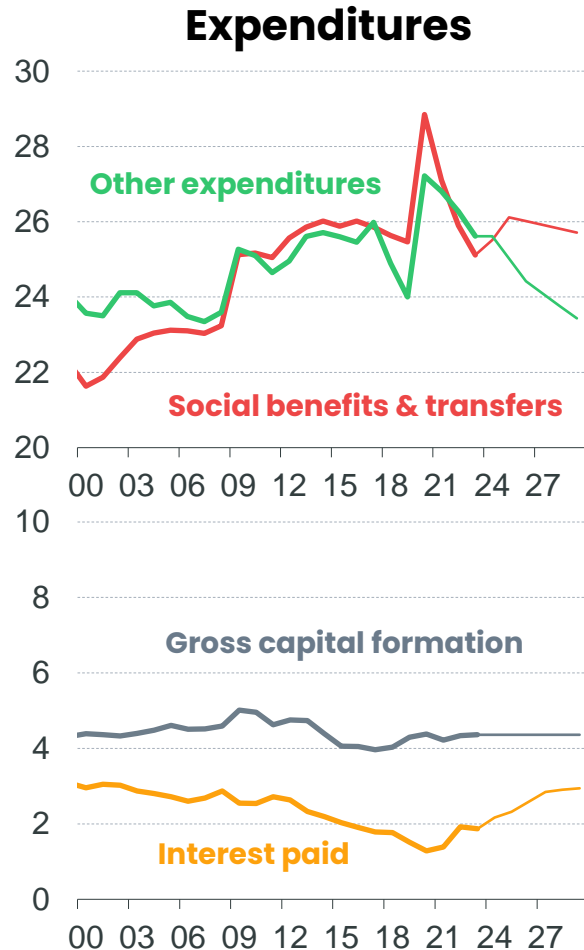
For most countries, the cost of aging is going to add to public debt in the coming years... except in France!

Cost of aging: increase over 2024–2029 (% of GDP)



The French fiscal rebalancing effort is nevertheless important... and even if expenditures are curbed, an increase in revenues is required

General government revenues, expenditures and balance in France (% of GDP)



Assumptions

Social benefits & transfers:

Pension expenditures increase by 0.5 GDP point over 2024-25 and remain stable thereafter.

Health expenditures increase by 0.5 GDP point over 2024-24 and gradually fall back thereafter.

Other expenditures:

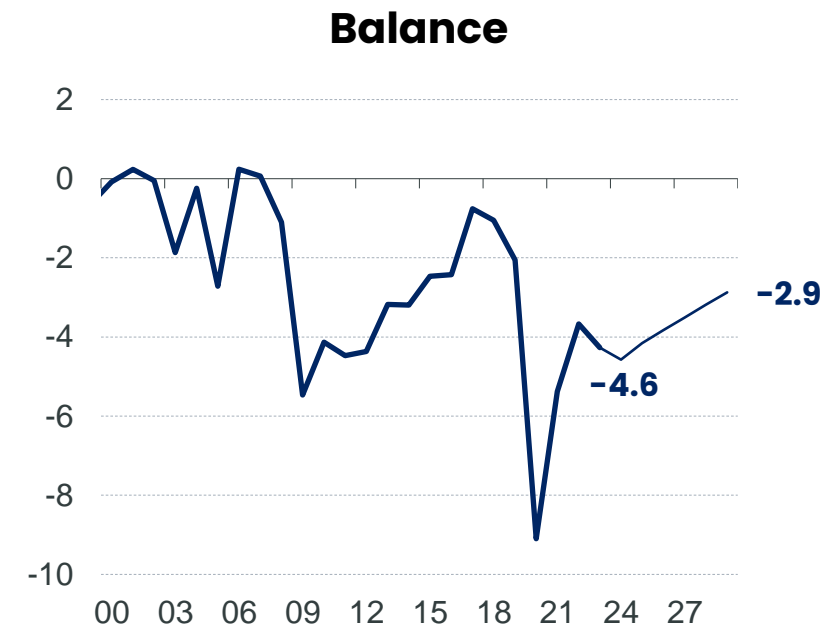
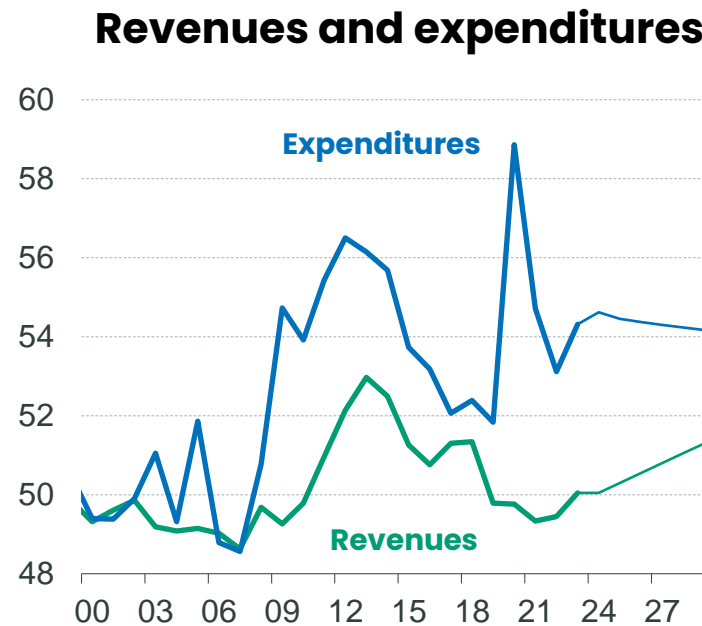
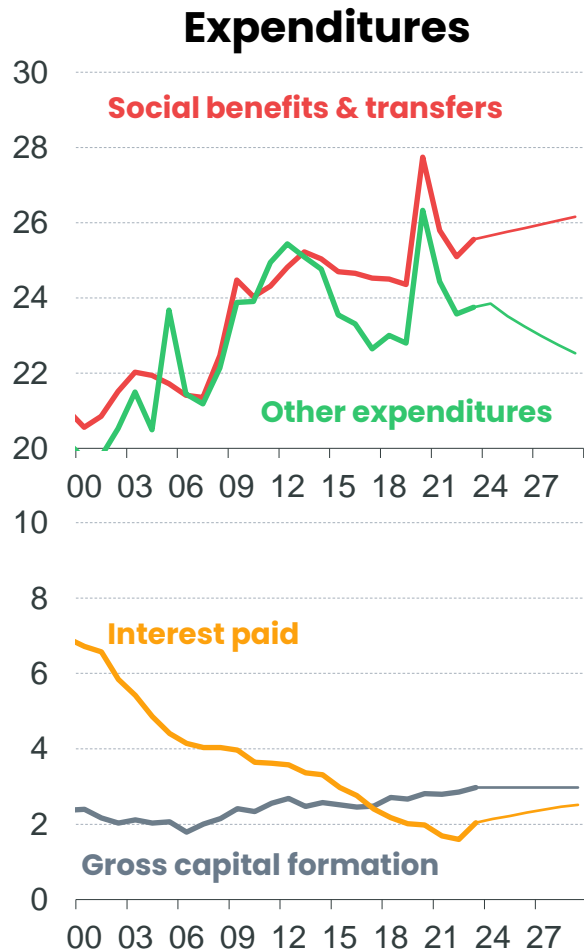
1 GDP point reduction over 2025-26 resulting from the end of energy subsidies; increase 0.5% less than inflation afterwards.

→ To reach the 3% target by 2029, revenues have to increase by €20 billion in 2025, and by an additional €12 billion from 2026 on (i.e. 0.35% of GDP)



In Belgium, an increase in revenues is also needed to reach the 3% target by 2029

General government revenues, expenditures and balance in Belgium (% of GDP)



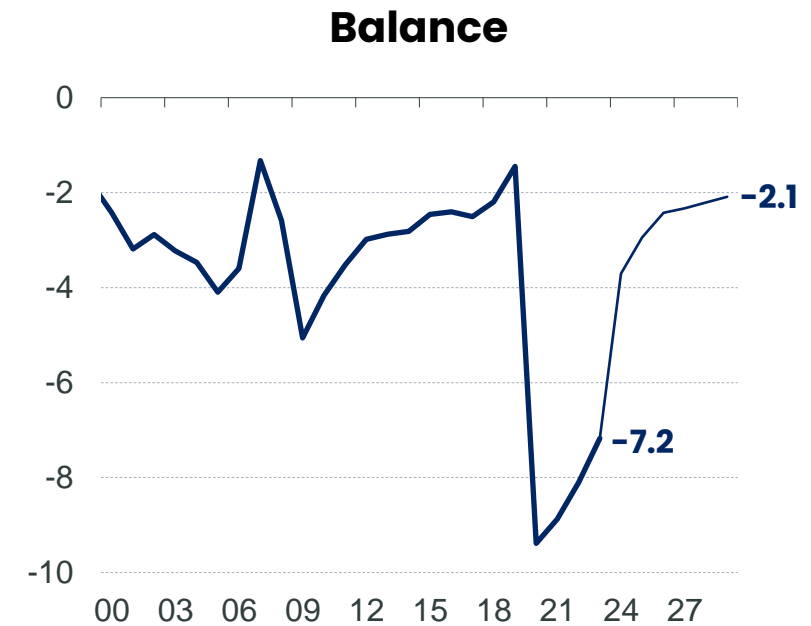
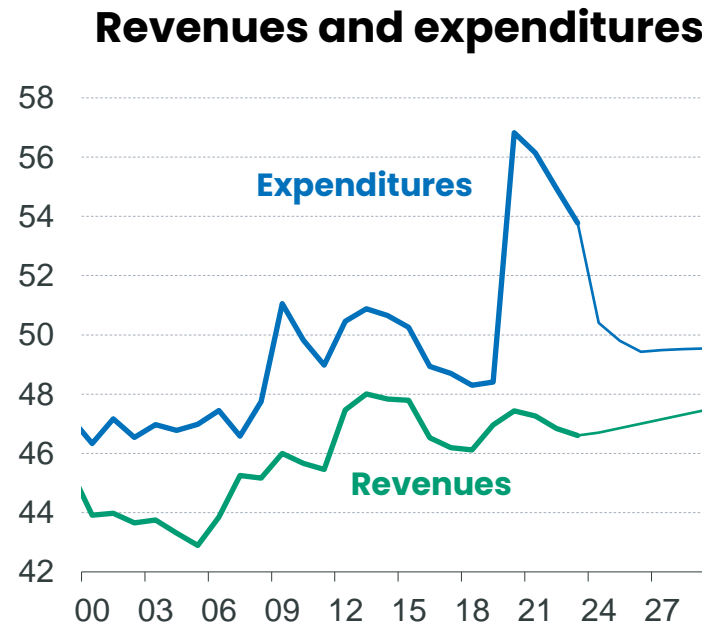
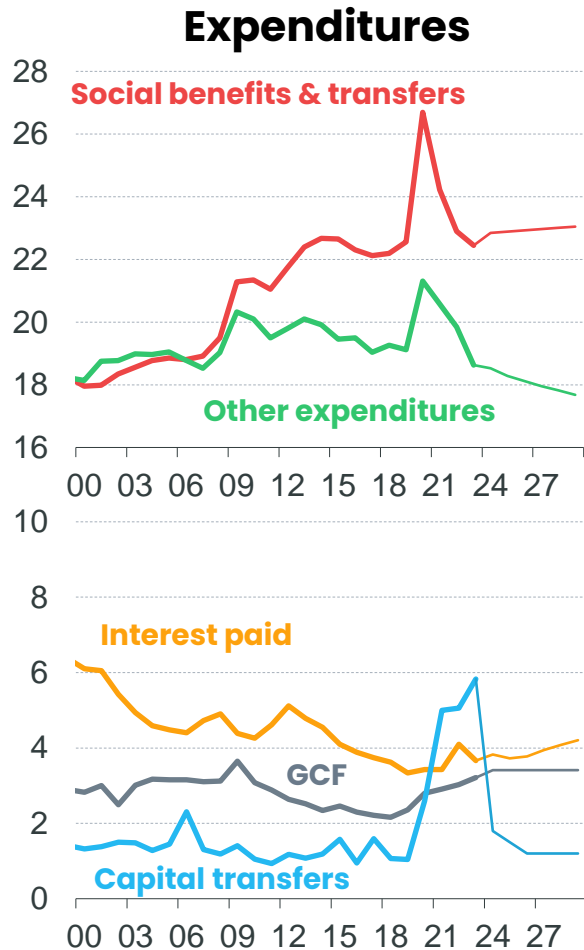
Assumptions
Other expenditures:
Increase as inflation.

→ To reach the 3% target by 2029, revenues have to increase by €1.7 billion from 2025 on (i.e. 0.25% of GDP)



Italy seems in a slightly more favorable position

General government revenues, expenditures and balance in Italy (% of GDP)



Assumptions
Capital transfers:
 End of the "superbonus"

Other expenditures:
 Increase 0.5% less than inflation from 2025 on.

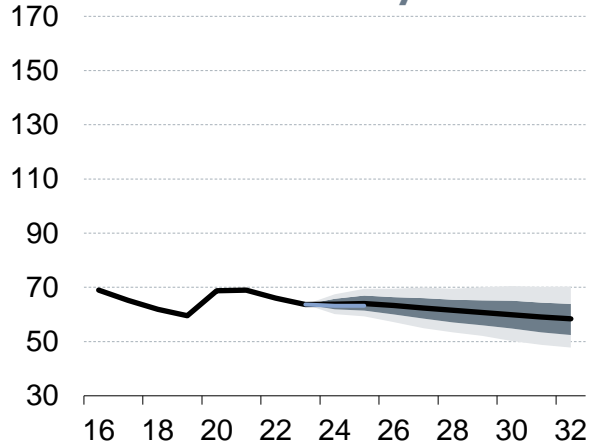
→ To reach the 3% target by 2029, revenues have to increase by €3.5 billion from 2025 on (i.e. 0.15% of GDP)



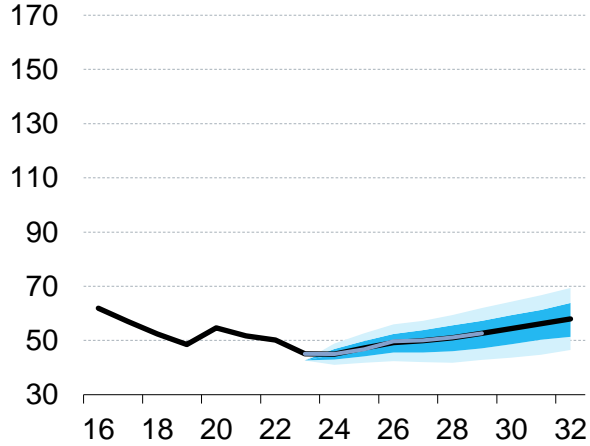
Memo. Public debt trajectories for euro area countries

Public debt (% of GDP)

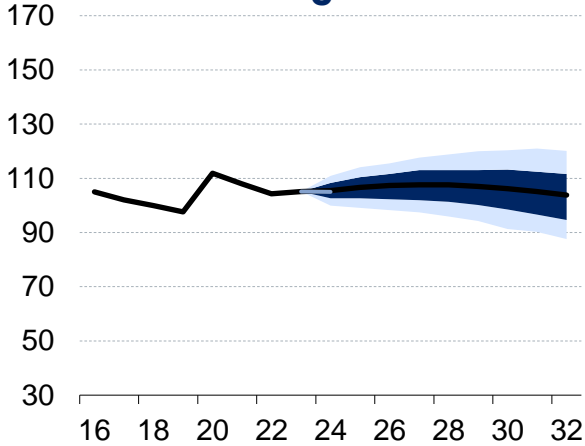
Germany



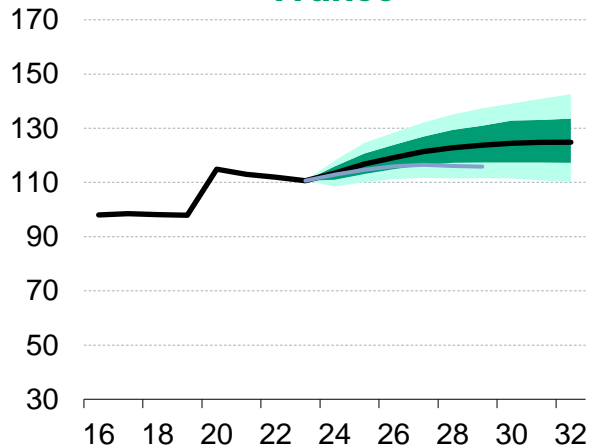
Netherlands



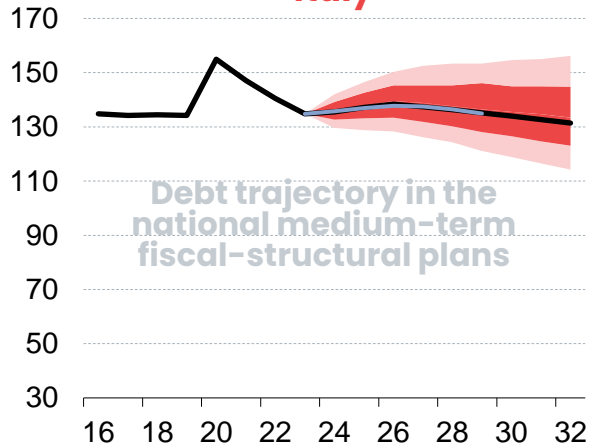
Belgium



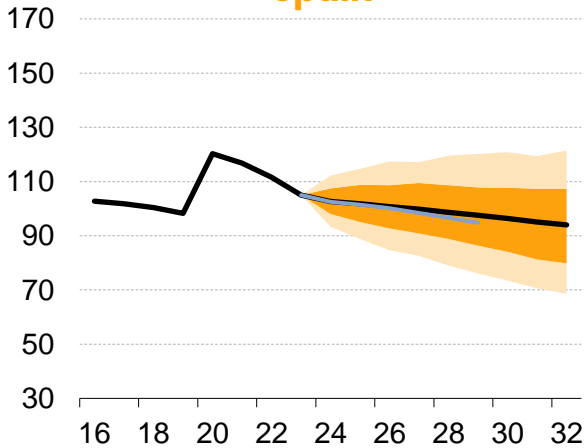
France



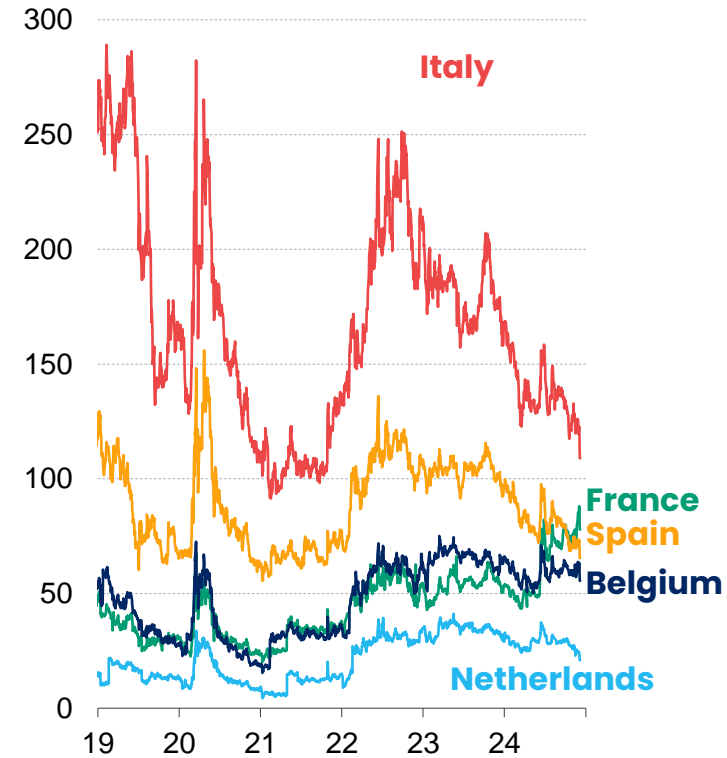
Italy



Spain



10-year-sovereign spreads to Germany (basis points)

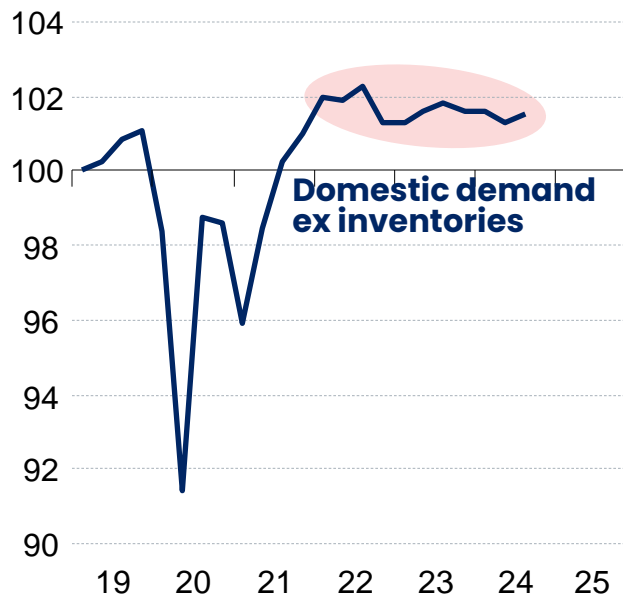


5 Annex

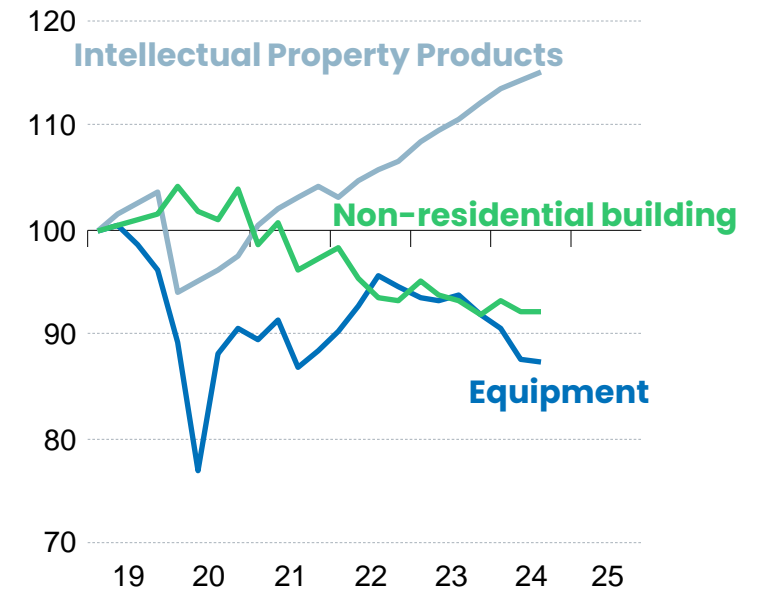
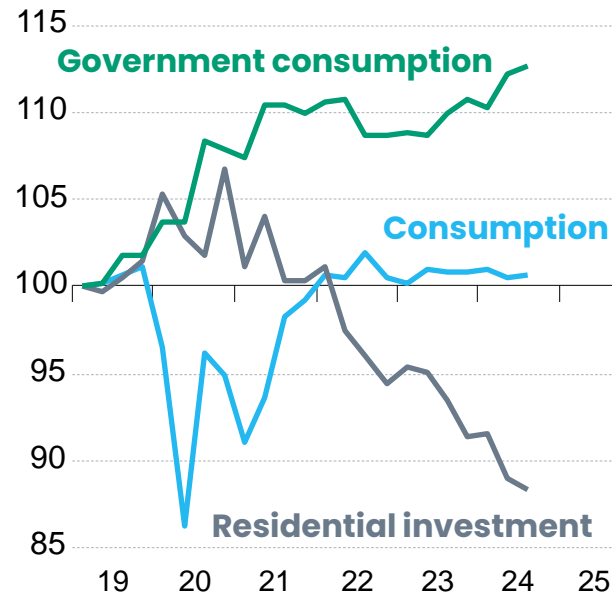
Germany... in trouble!



Since 2022, domestic demand has been stagnating

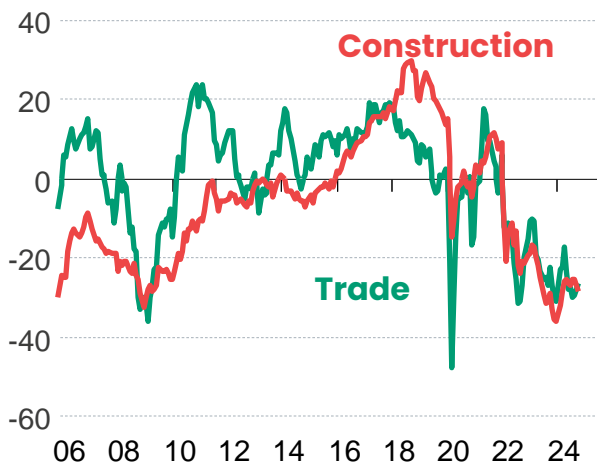
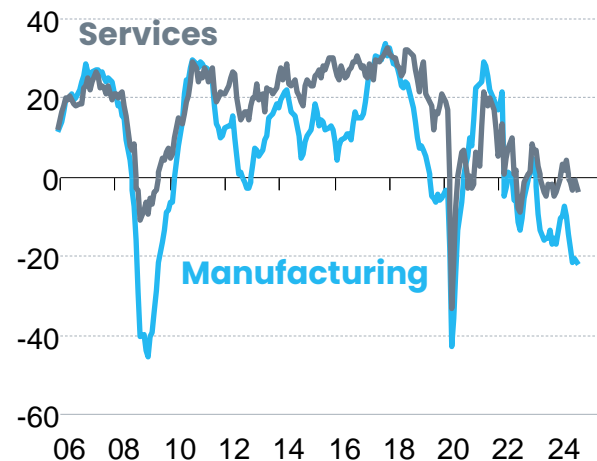


Domestic demand components
(2019 Q1 = 100, volume)

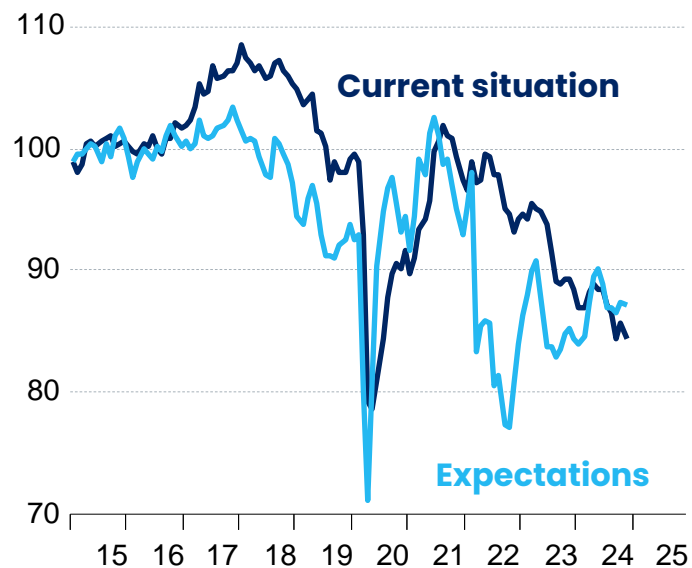


IFO is pointing to more softness ahead

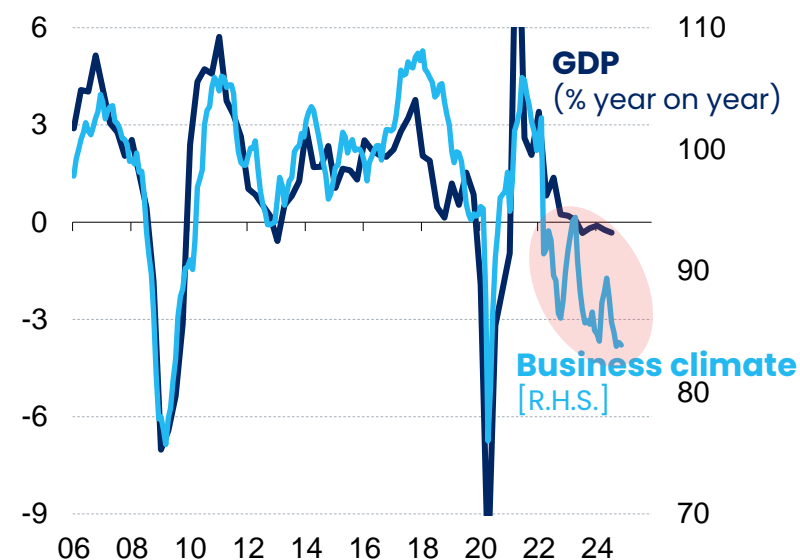
IFO business climate by sector



IFO business climate

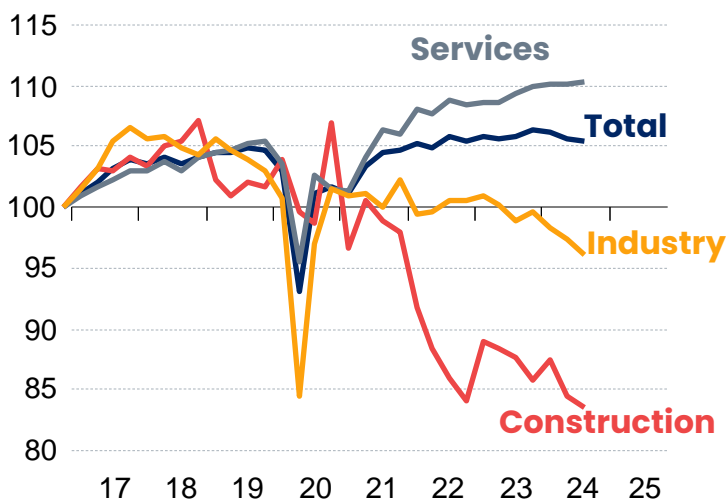


IFO business climate and GDP growth

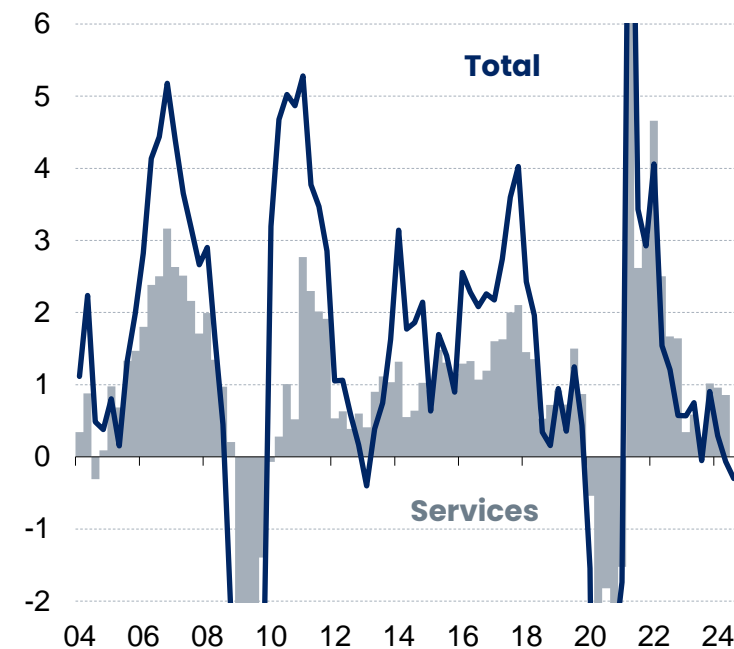
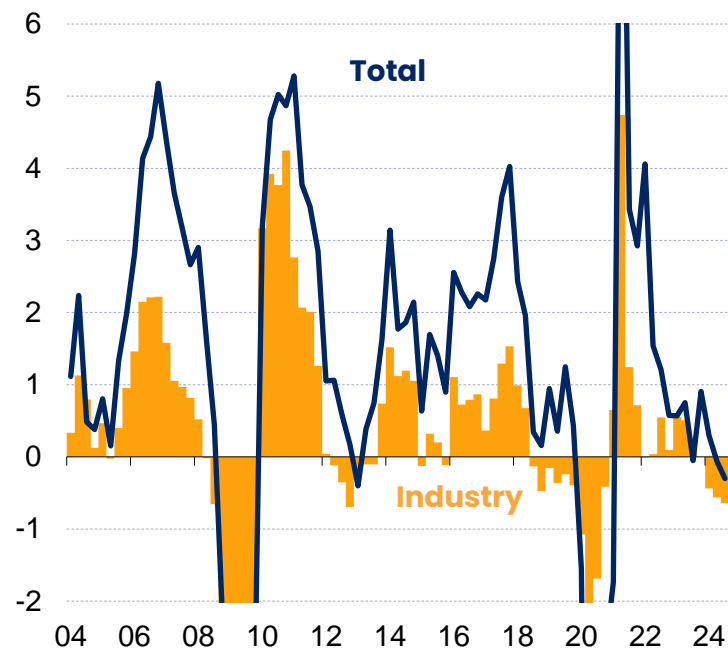


After having been for years a pillar of German growth, the manufacturing sector is now a drag!

Value added by sector
(2017 Q1 = 100, volume)

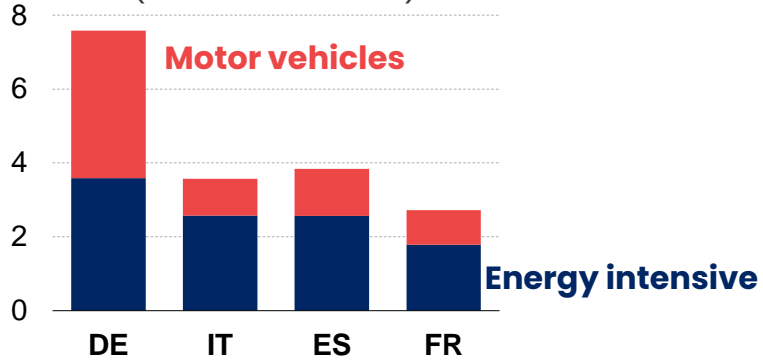


Value added by sector
(% year on year contribution to total VA, volume)

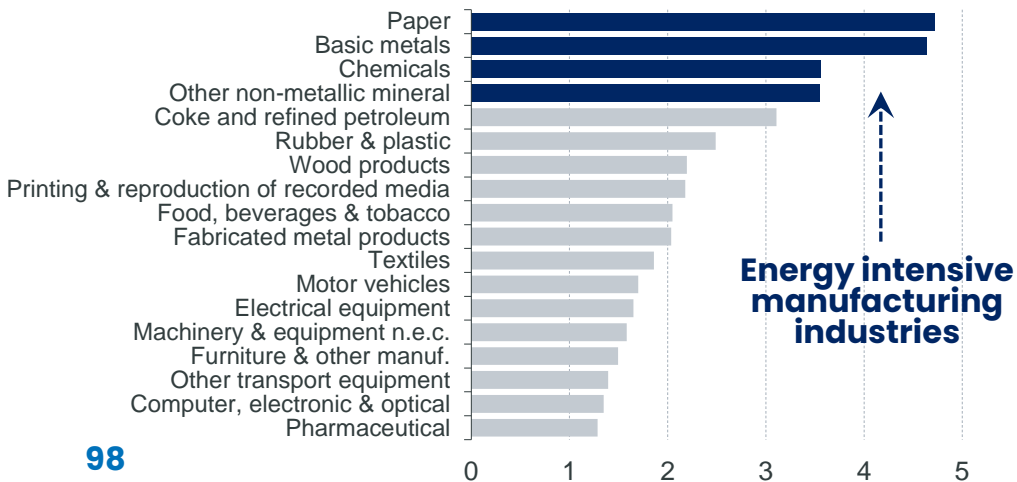


The auto sector first, then energy intensive industries were severely hit

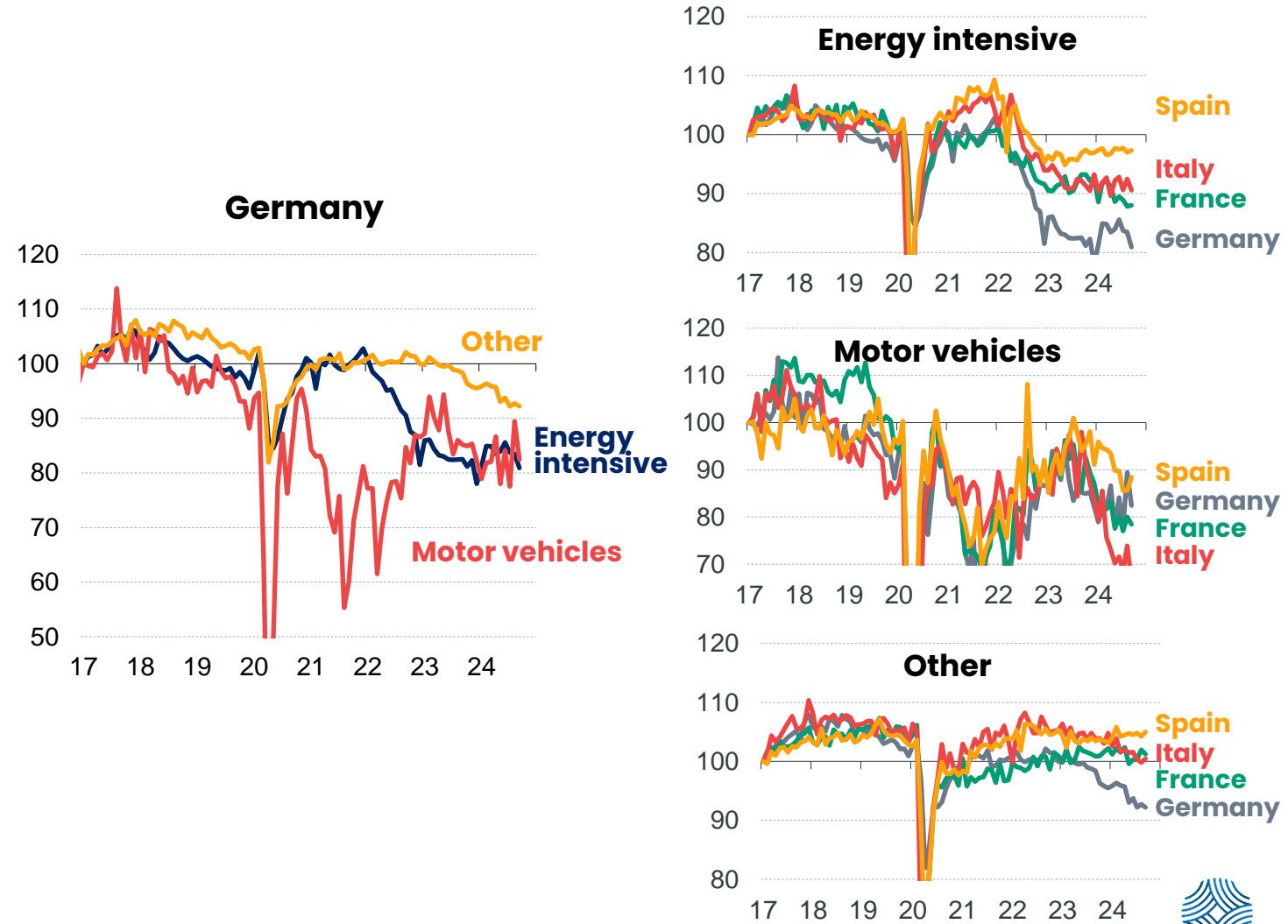
Energy intensive and motor vehicle industries
(% of value added)



Euro area industry's dependence on electricity and gas
(electricity and gas content as % of sector's output, 2014)

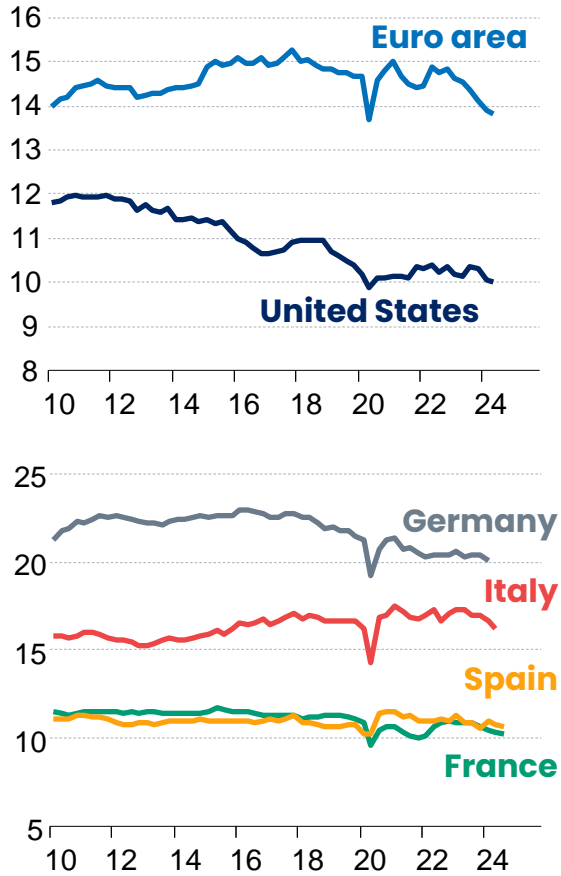


Industrial production
(January 2017 = 100)

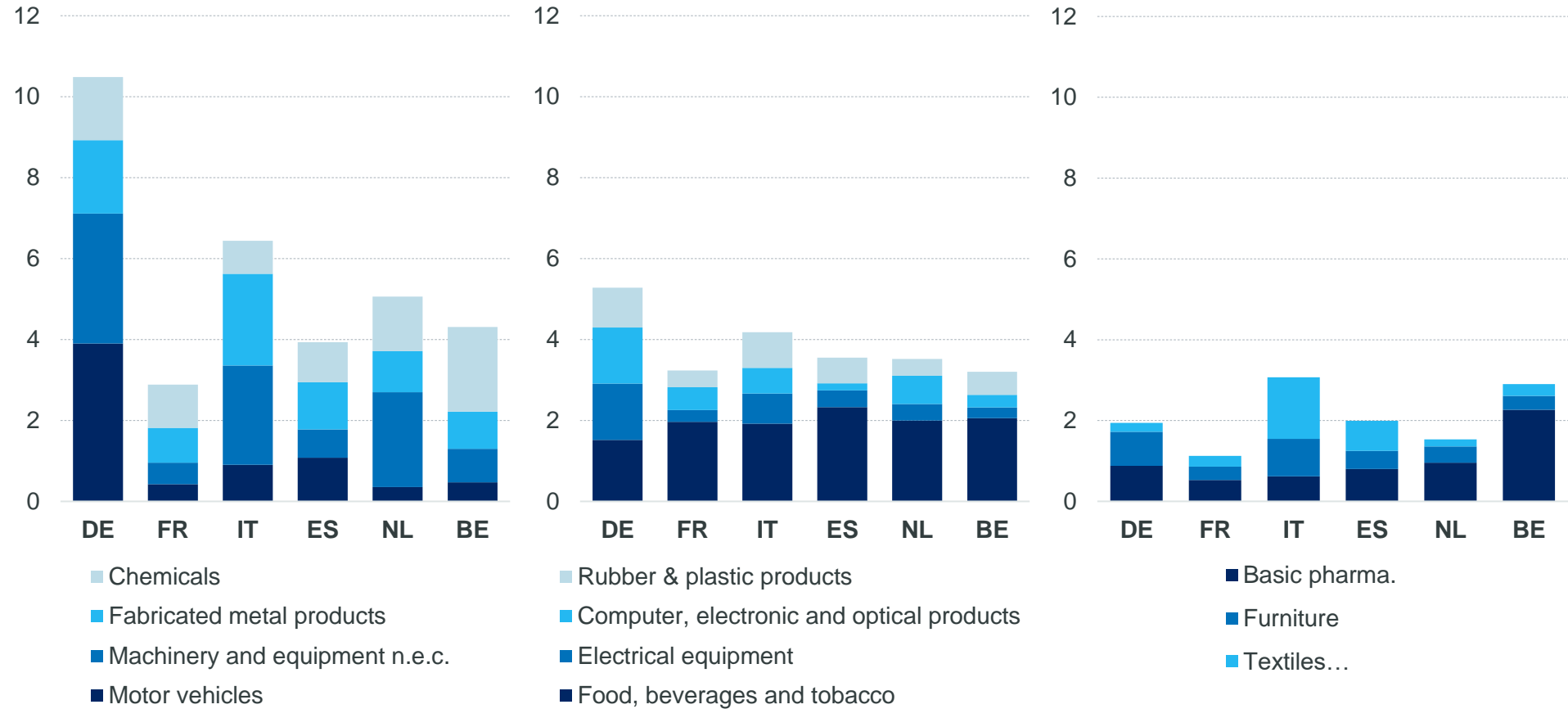


Memo. Manufacturing share in total value added

Manufacturing sector (% share in GDP)

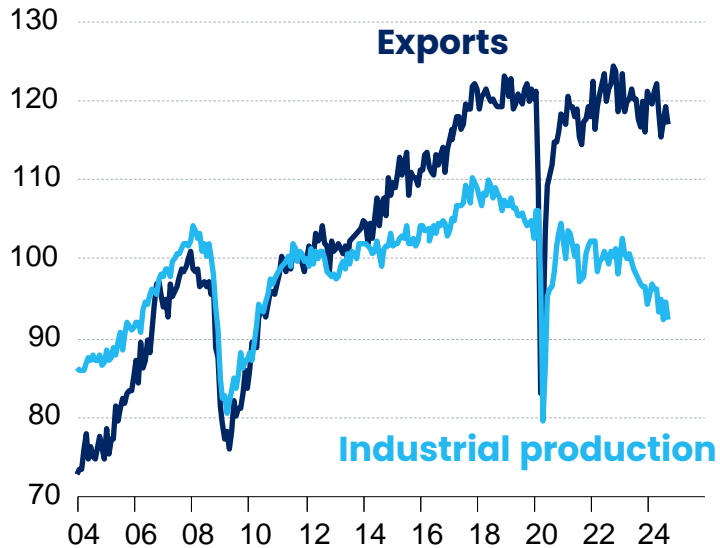


Share of manufacturing industries in total value added (%, 2021)



German exports have been stagnating since 2017

Industrial production & exports
(January 2012 = 100, volume)



100

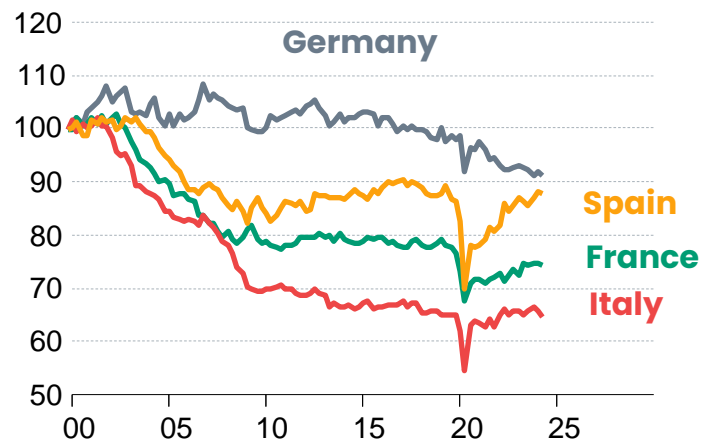
External demand

(% growth over 7 years, annual rate)

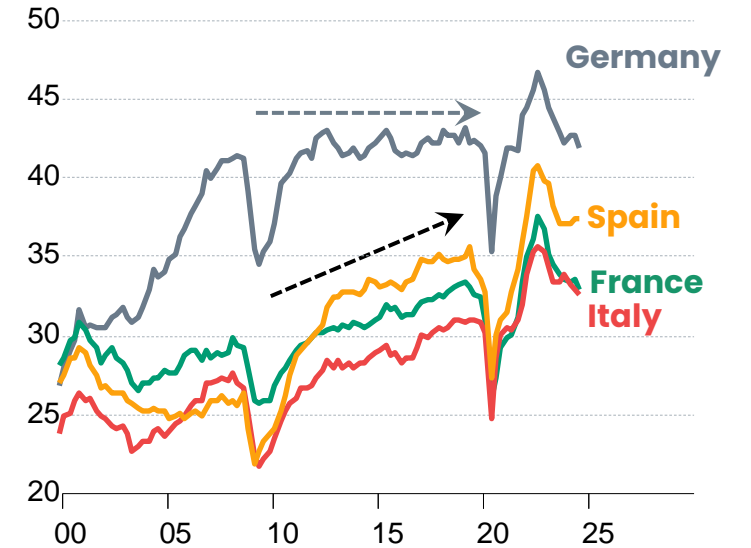


Export performance

(2000 Q1 = 100)

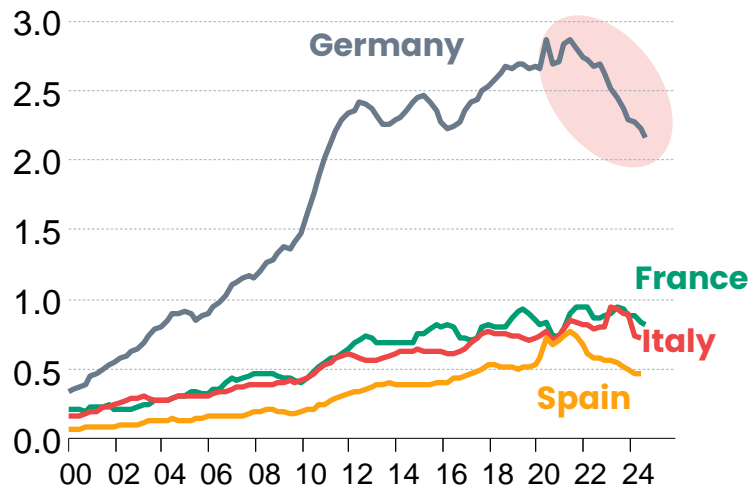


Exports
(% of GDP)

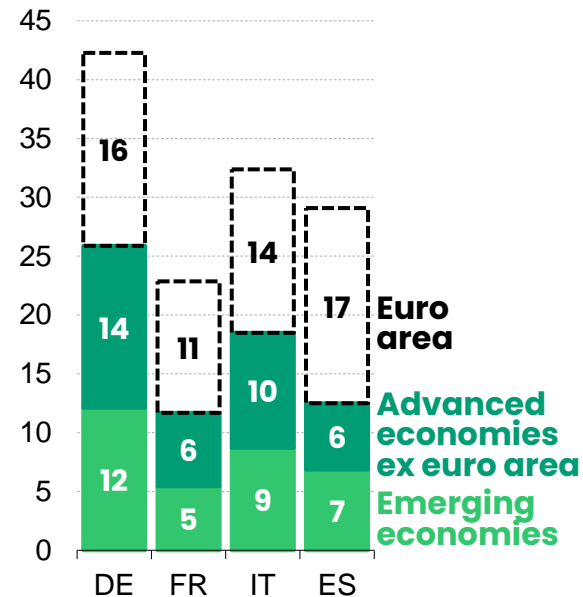


Germany has suffered from its exposure to China

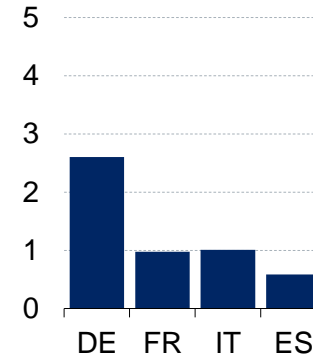
Exports to China
(% of GDP)



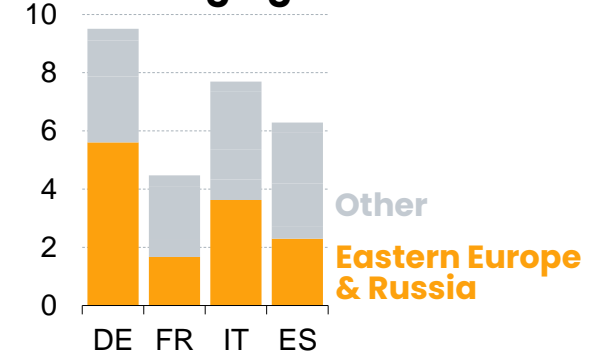
Exports of goods by region
(% of GDP, 2023)



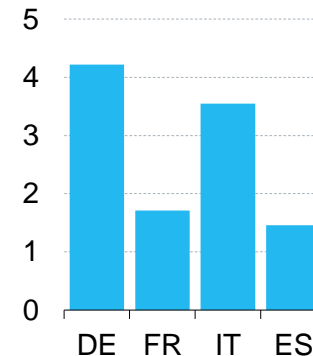
China



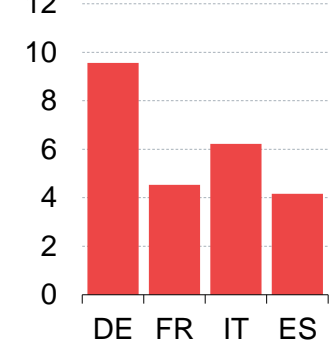
Other emerging



United States

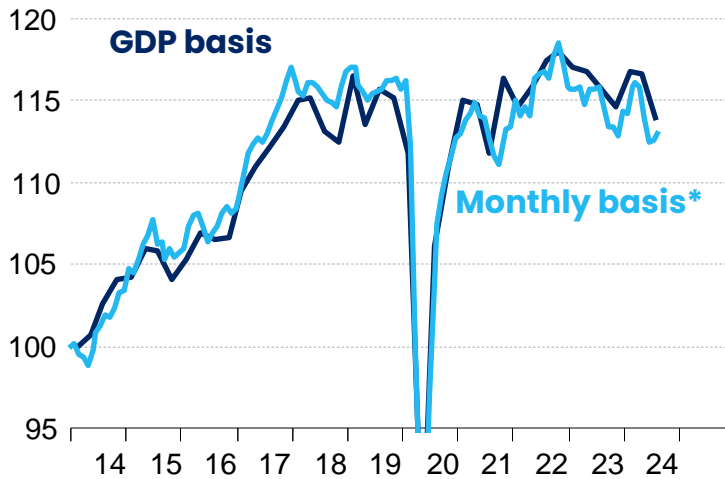


Other advanced



For the time being, there are no signs of an imminent rebound in exports

Exports of goods
(January 2014 = 100, volume)

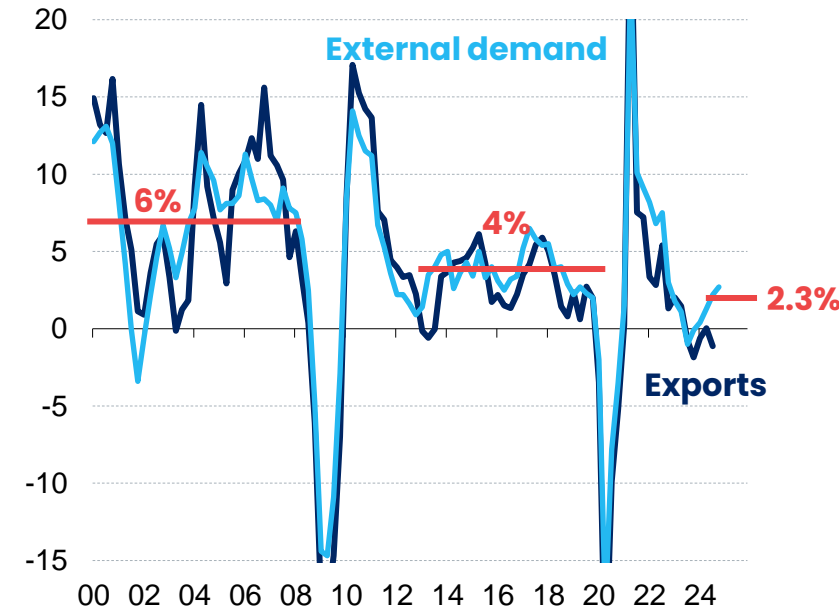


(*) 3 months moving average

IFO export orders

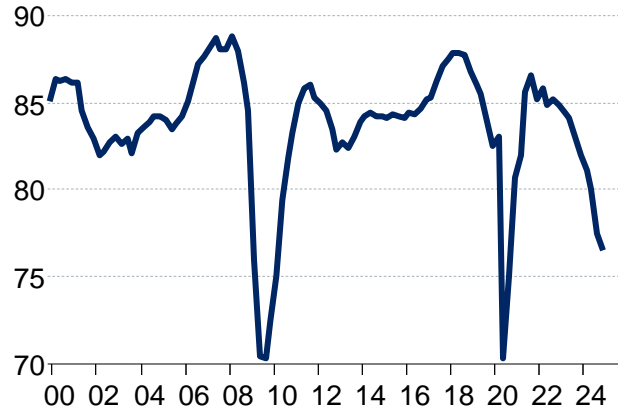


Exports and external demand
(% year on year)

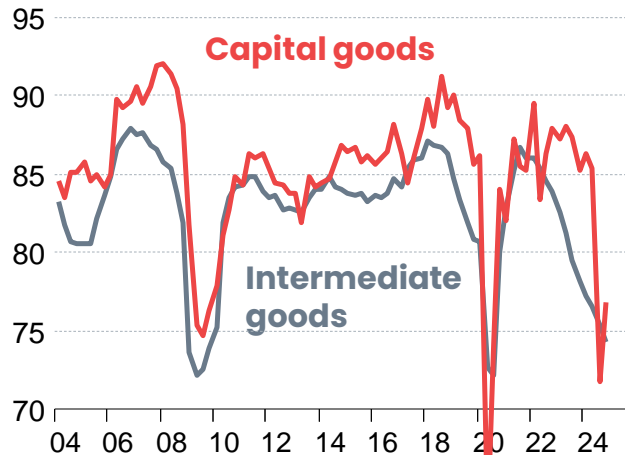


Business investment is unlikely to revive quickly either

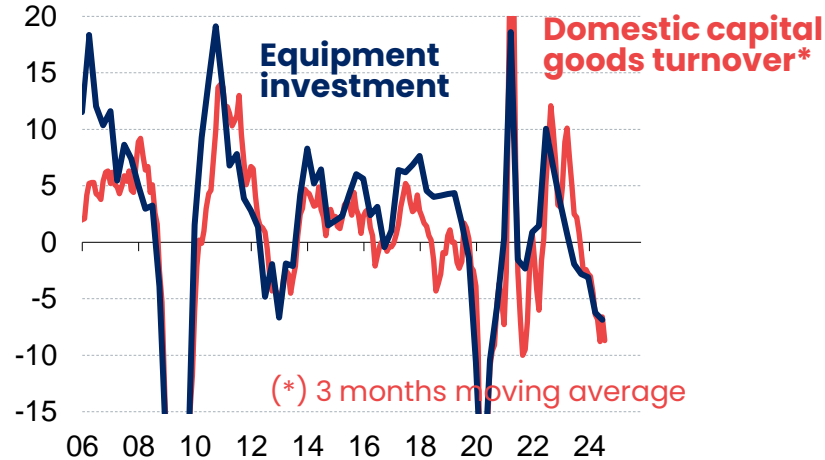
Capacity utilization rate
(%)



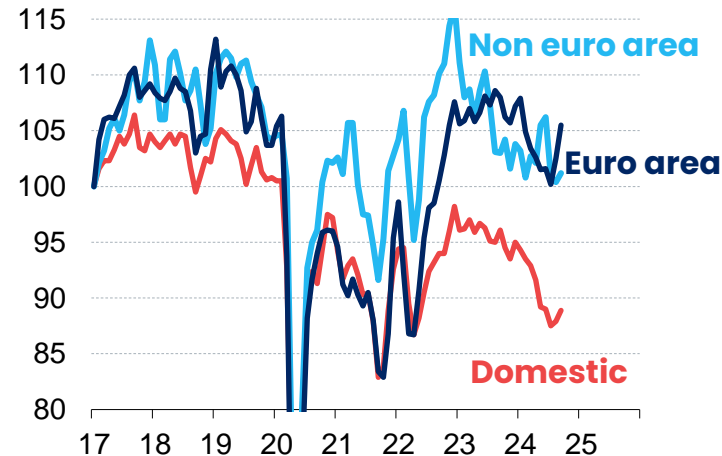
Capacity utilization rate
(%)



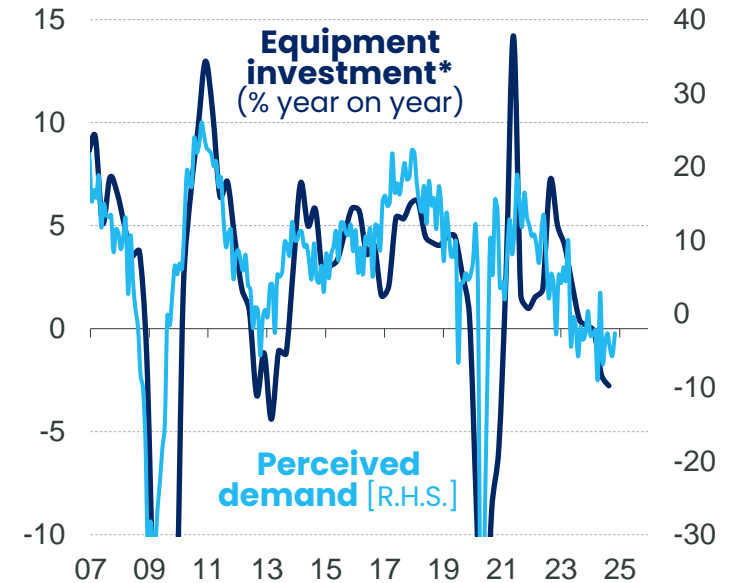
Equipment investment
(% year on year, volume)



Capital goods turnover
(January 2017 = 100)



Equipment investment and perceived demand

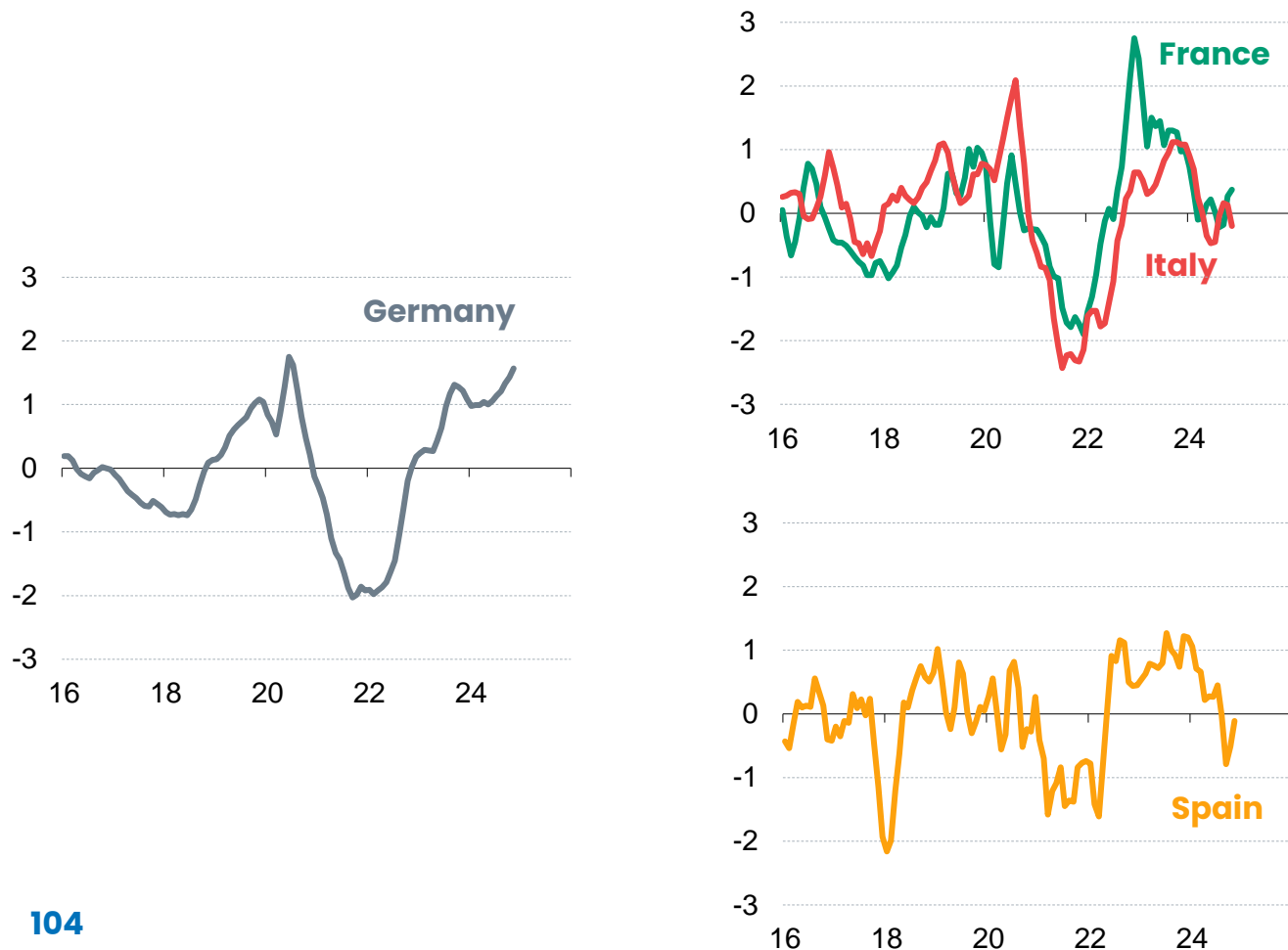


(* including IPP)



Elevated inventories are likely to weigh on growth in the coming months

Firms' assessment of inventories
(EC survey, normalized)



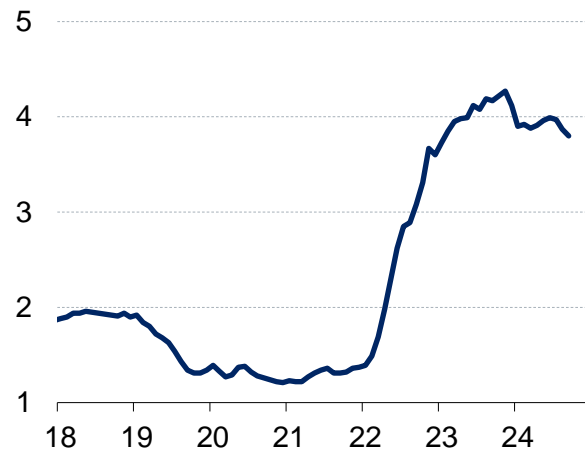
Inventories contribution to GDP
(%)



Residential investment is unlikely to pick up

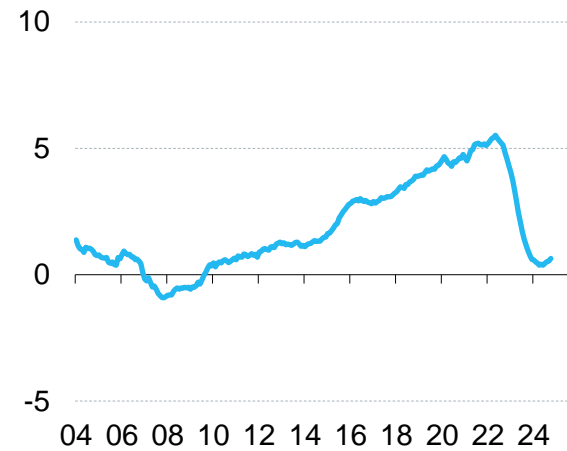
Mortgage interest rates

(%, new business)



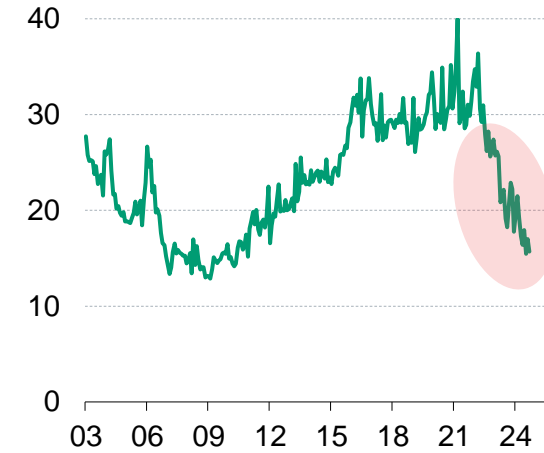
Total loans to households

(% year on year, adjusted for securitization)



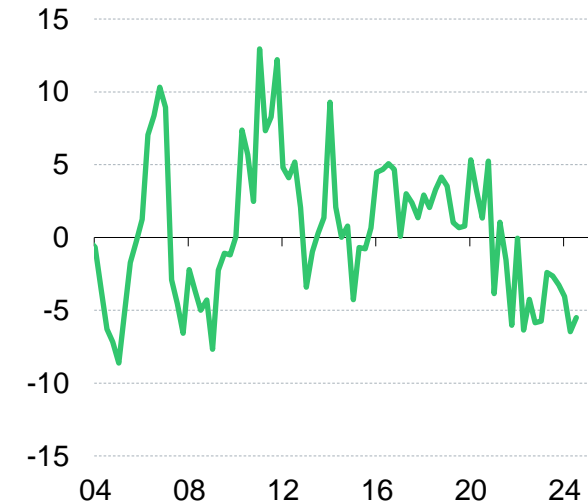
Housing permits

(thousands of dwellings)



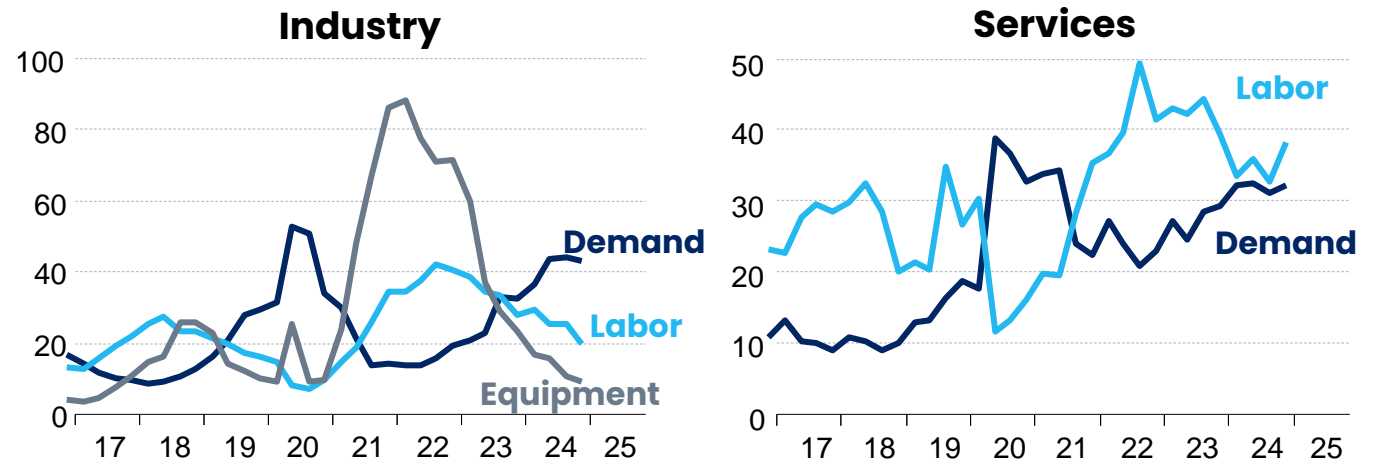
Residential investment

(% year on year, volume)

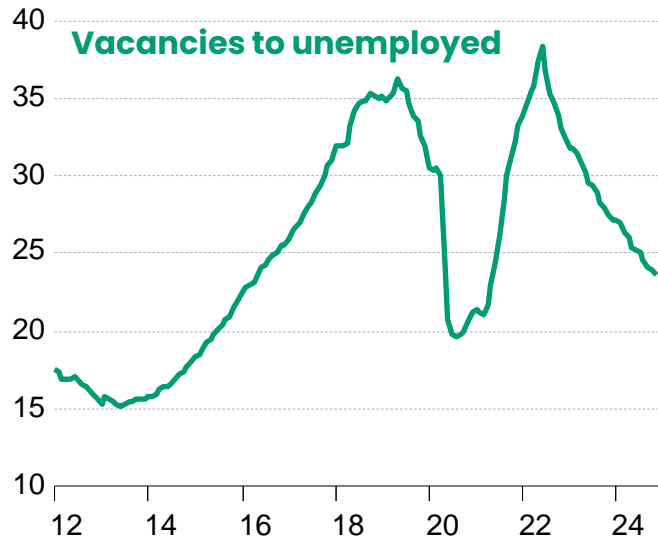


For German firms, lack of demand has now become more of an issue than labor shortages...

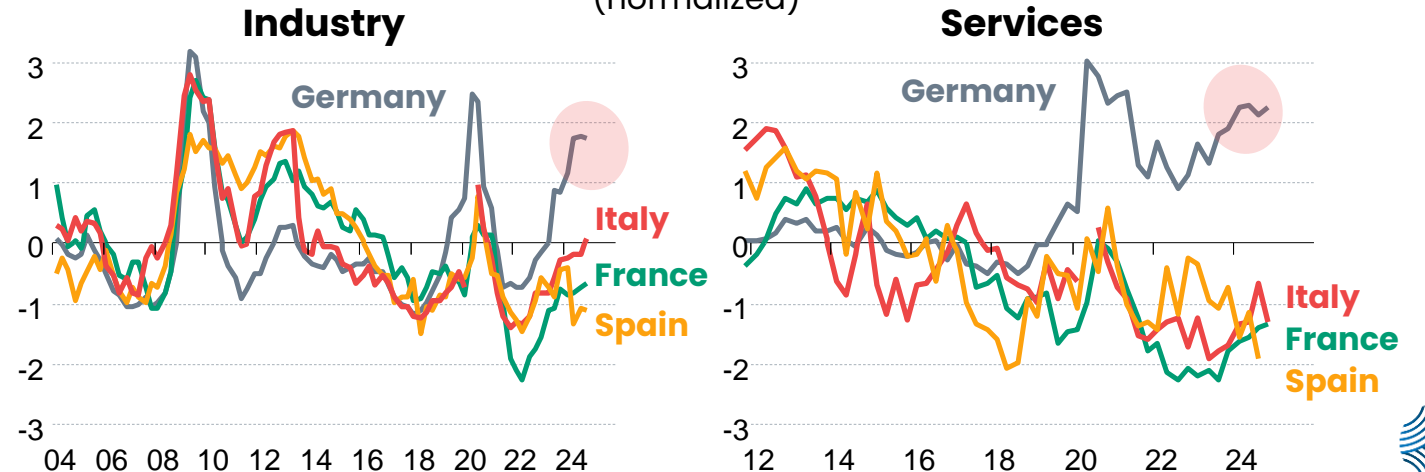
Factors limiting production in Germany
(% of firms)



Job vacancy rate
(%)



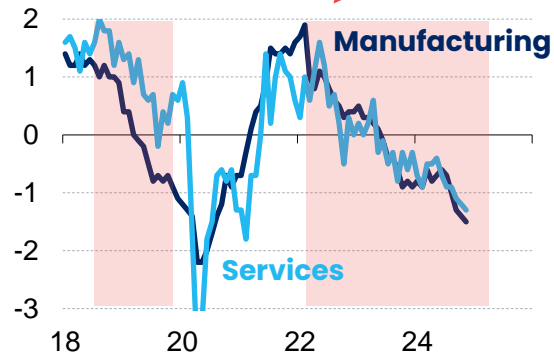
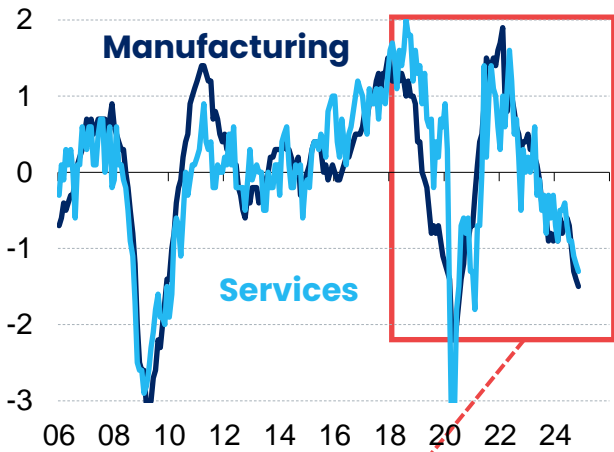
Factors limiting production in euro area countries: demand
(normalized)



... and the labor market has now started to deteriorate

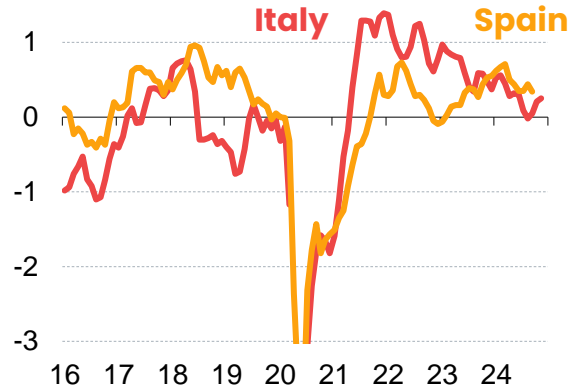
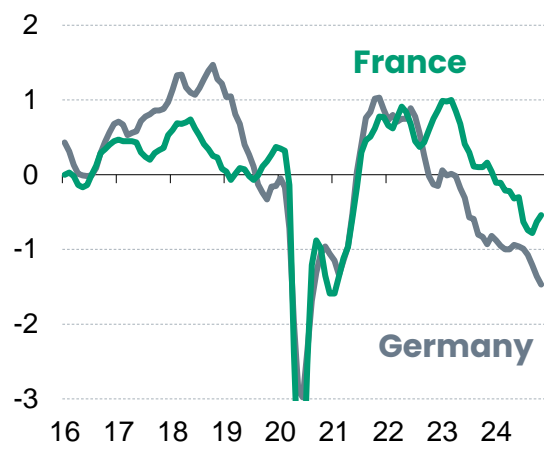
IFO employment expectations

(3-month ahead, normalized)



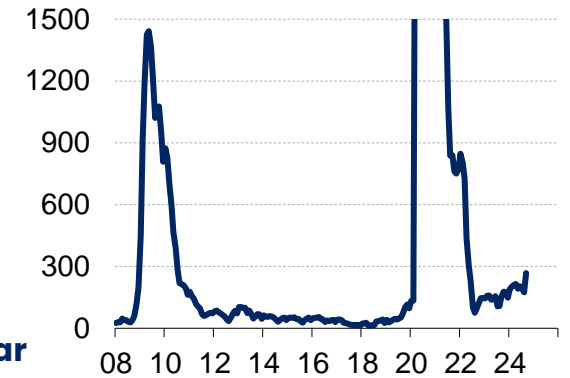
Firms' employment expectations

(EC survey, normalized)



Short-time unemployment

(thousands of employees)



Employment growth

(%, annual rate)



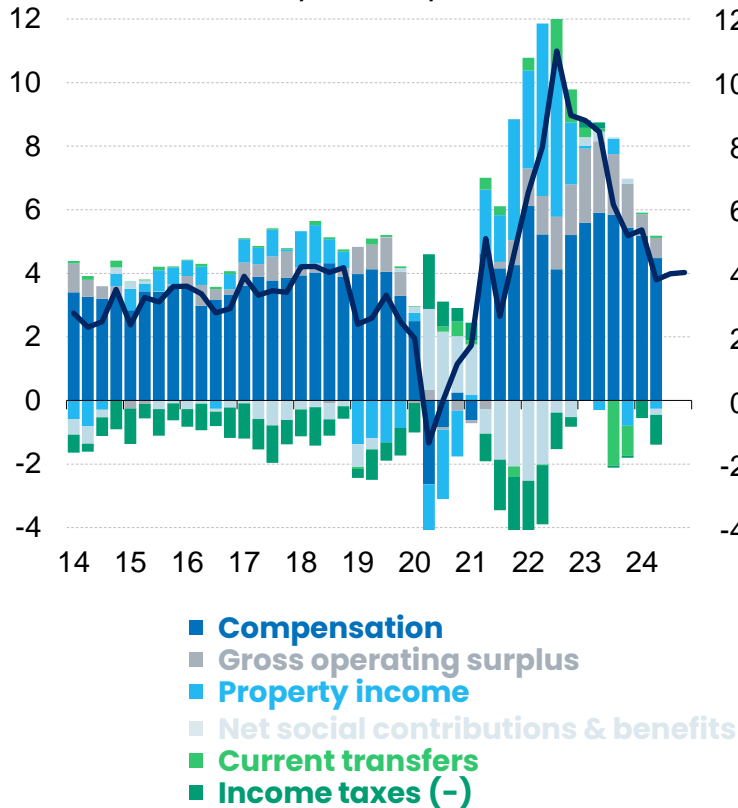
Unemployment rate

(%)

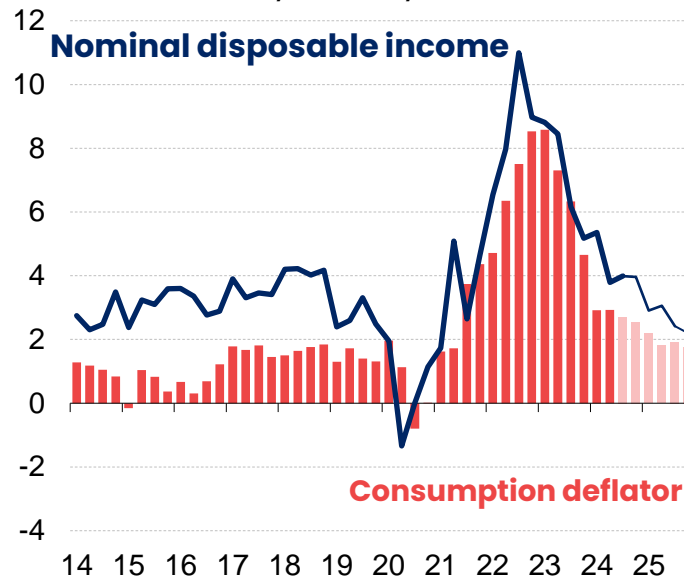


Real disposable income growth should slow down

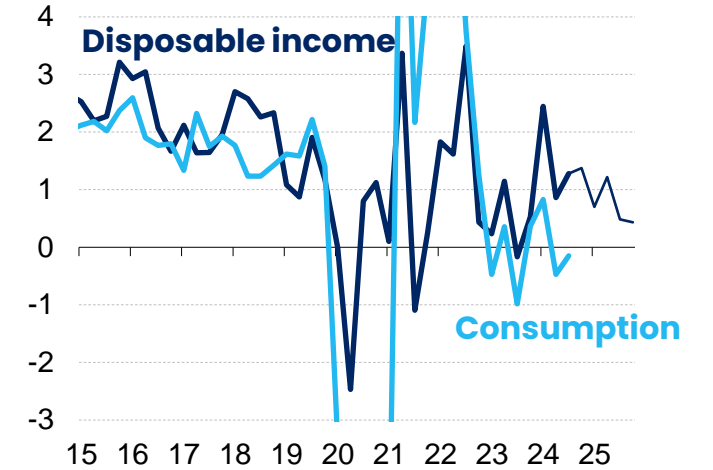
Contribution to nominal disposable income
(% year on year)



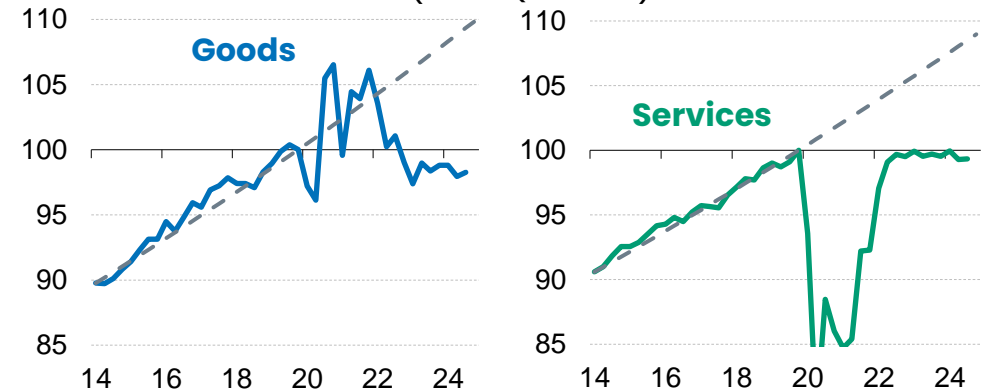
Nominal disposable income and consumption deflator
(% year on year)



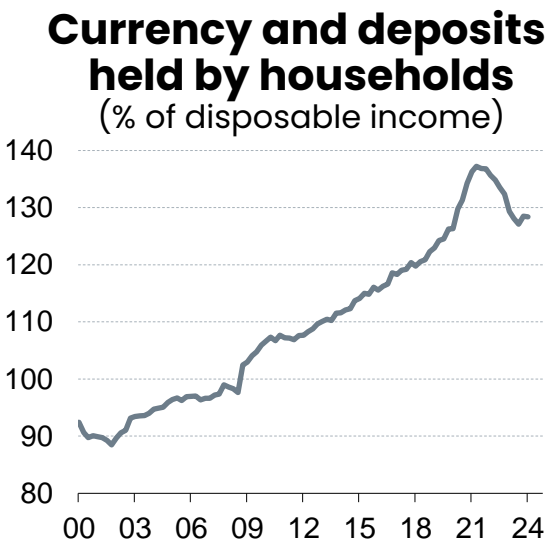
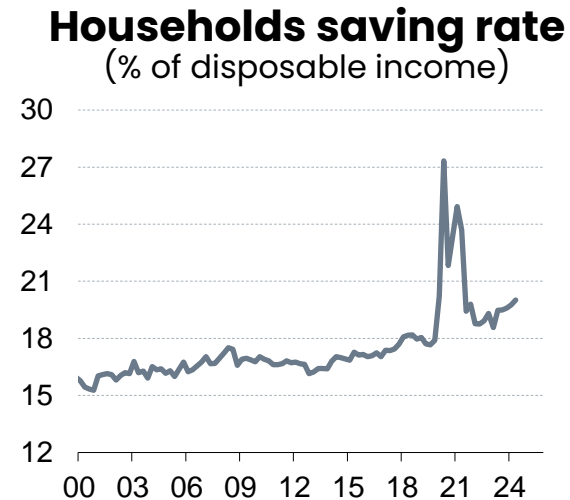
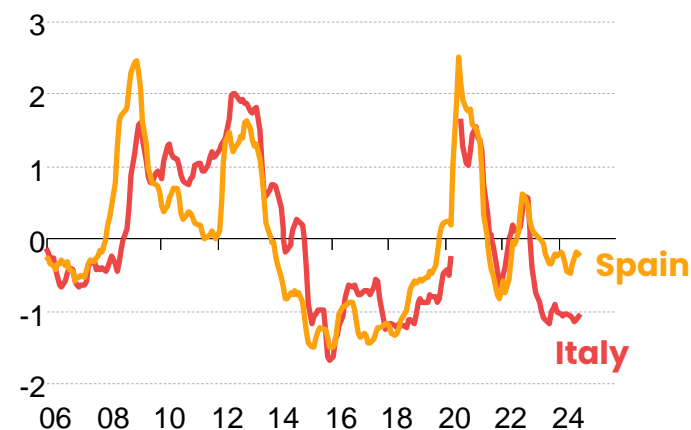
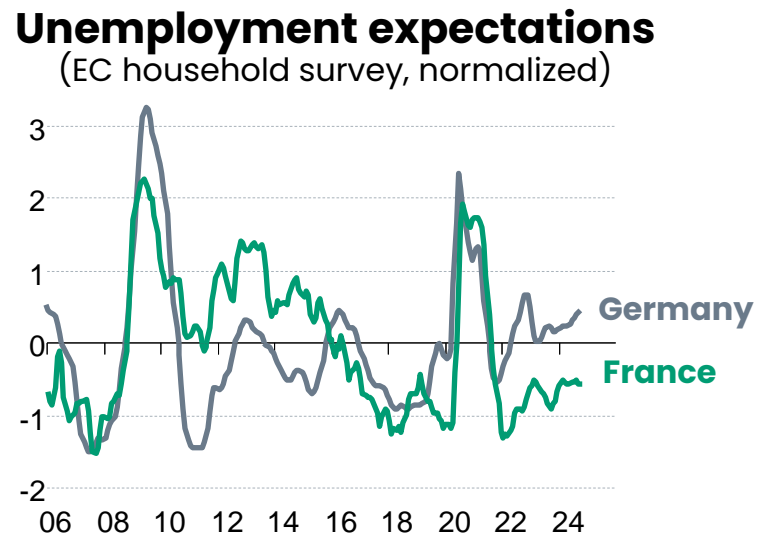
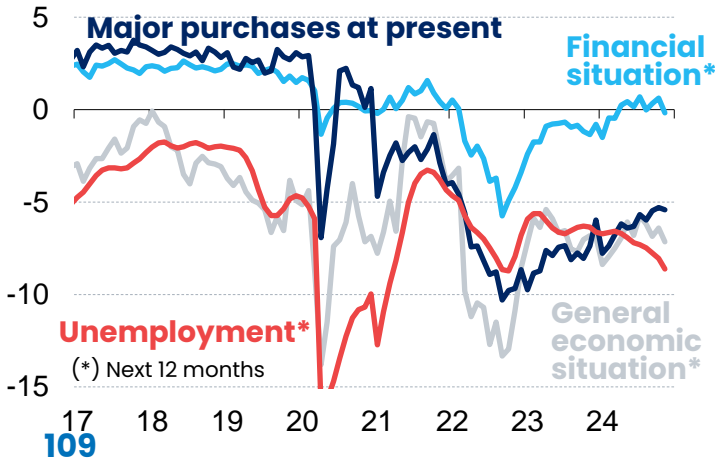
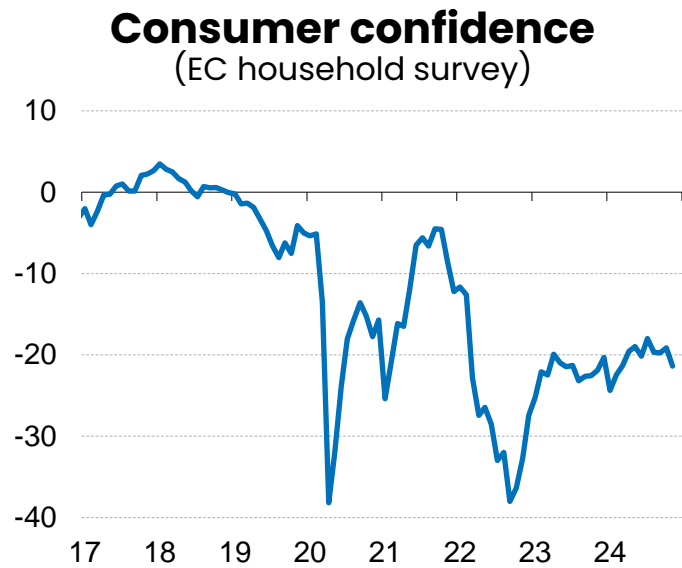
Real disposable income and consumption
(% year on year)



Consumption
(2019 Q4 = 100)

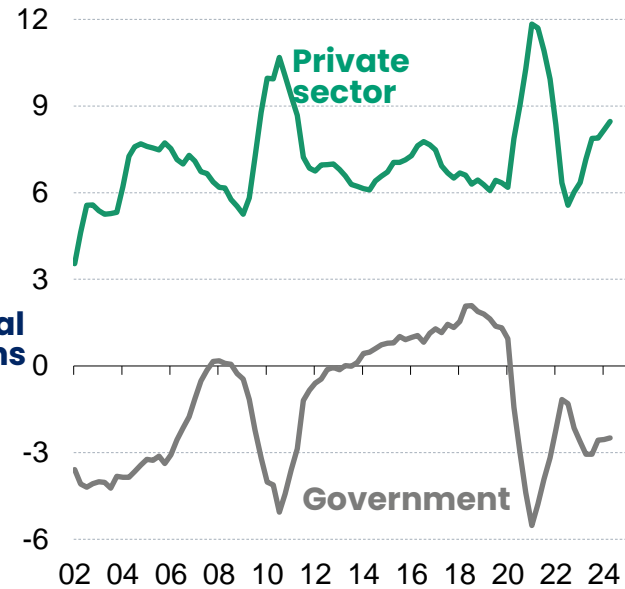
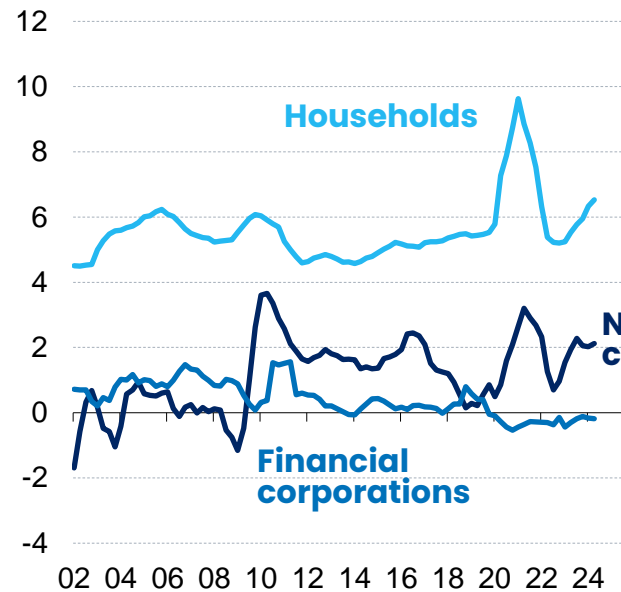


With impaired confidence and no excess cash left, there is no reason for households to save less!



For many years, Germany has preferred to export its savings... despite obvious domestic investment needs!

Net lending (+) / borrowing (-) by sector
(% of GDP)



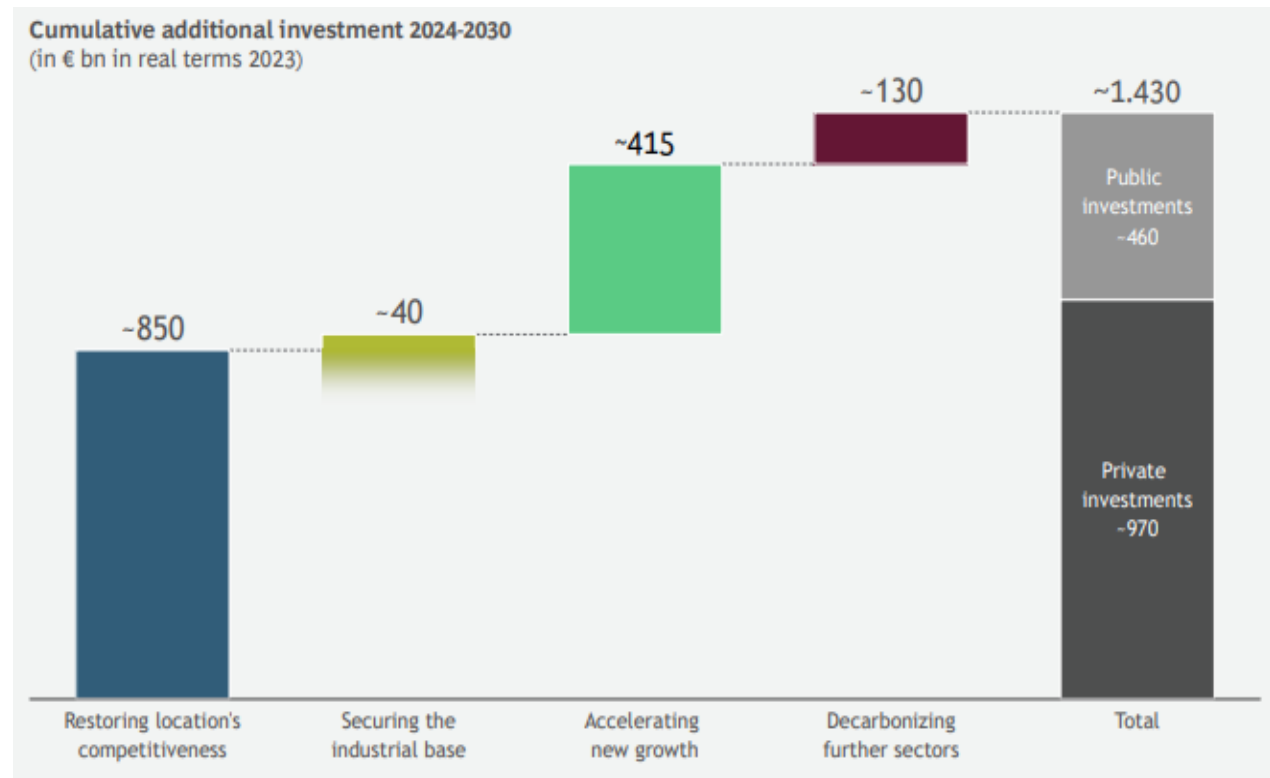
The BDI has indeed estimated that €1400 billion of investment are needed over 2025–2030 for Germany to restore its competitiveness

The Federation of German Industries (BDI) identified 15 action areas necessary for a successful transformation of the German industry.

The transformation of Germany as an industrial location will require one of the greatest transformation efforts since the postwar period – and additional investments of around €1.4 trillion (~37% of GDP) by 2030, of which €460 billion needs to be invested by the public sector.

On an annual basis, this corresponds to an additional annual investment of close to 5% of GDP (of which 1.6% of GDP for the public sector).

Additional investment required by 2030 to transform the German industry



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