Quarterly Outlook

First cuts underway – will we avoid recession?

September 2024

Market developments and other events

Growth is moderating and inflationary pressures eased in major economies, although core inflation remains sticky for most regions. Most major central banks implemented their first-rate cuts in Q3. The US Fed cut interest rates by 50bps in September succeeding earlier rate cuts by the ECB and BoE. In addition, the US Fed voiced more confidence on the sustainability of disinflation and the wish to not cool labor markets further. Other major central banks shared similar messages suggesting further rate cuts down the road.

The Bank of Japan hiked rates, triggering significant market turbulence and strengthening of the yen in August. BoJ signaled to remain committed to its long-term plan to raise rates given existing inflationary pressures, while accounting for the volatility of the yen and its effect on inflation.

Despite early bursts of volatility reflecting concerns about slowing but growing economic dynamics, global equities and corporate credits performed well amid strengthening beliefs of further monetary easing. Emerging equities outperformed other regions as China unveiled a broad stimulus package to boost its economy. Key measures include fiscal stimulus, increasing bank liquidity, reducing interest rates, and providing mortgage relief to support the ailing property market.

Outlook for growth, inflation, and interest rates

Some signs point towards a soft-landing scenario as inflation gradually declines and growth in developed economies converges to moderate levels. Global labor markets are showing signs of cooling from historically tight levels but remain relatively robust, suggesting that the damage from the extraordinary spike in global inflation remains contained.

Short-term growth prospects in developed economies remain moderate amid cooling labor markets and above-trend interest rates. Still, growth prospects are expected to slightly improve as the global economy moves on past the peak of monetary tightening and into easing financial conditions.

Against the background of normalizing economic conditions, inflation is slowly trending down. Although unanticipated, further negative economic momentum owing to deteriorating labor market conditions, could cause inflation to decline more sharply in the short run. Nevertheless, medium-term inflation is expected to stabilize somewhat above central bank targets, amongst others, owing to anticipated upward fiscal spending pressures associated with the energy transition and elevated geopolitical risks. Additionally, supply side factors such as lower global trade integration, ageing populations, and the energy transition could translate to ongoing upward inflationary pressure in the medium term.

In the coming years, long rates are expected to move around their recent levels or somewhat decline for most developed markets. This reflects higher for longer dynamics as inflation is anticipated to slowly converge to target. Short-term interest rates are expected to decline, consistent with continued forward guidance on prospective monetary easing.

Outlook for financial assets

The current economic cycle deteriorates as lower interest rates were counterbalanced by increased capital market volatility. Nevertheless, the outlook remains stable as economic conditions are normalizing with inflation slowly trending down.

Compared to the first quarter, the short-term equity outlook improves due to anticipated further monetary easing. Accordingly, equity returns remain positive over the next twelve months, despite somewhat stretched equity valuations.

The government bond and corporate credits return outlook weakens due to declining yields amid continued progress on disinflation.

The outlook for financial assets remains clouded by elevated volatility and downside risk due to above-trend interest rates and elevated geopolitical tensions. For example, further escalation of the conflict in the Middle East, potentially turning into a full-scale regional war, presents significant downside risks to the outlook.

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