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Unfavourable

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At the start of the year, the German economy is in a technical recession. In view of the adverse economic conditions, little momentum is likely to develop over the course of the year. Only private consumption offers glimmers of hope thanks to strong wage growth combined with falling inflation rates.

- 1) Little support from the global economy: Global GDP growth is likely to slow to 2.6% in 2024 after 3.0% in 2023.
- 2) Another GDP decline of 0.2% is expected in Germany in 2024, but private consumption should slowly recover.
- 3) According to our forecast, the German inflation rate will fall towards the 2% target in 2024, but will probably still average 2 ½% for the year after 5.9% in 2023.
- 4) The Fed and ECB are likely to cut interest rates significantly from the early summer / spring onwards. However, the central banks' decisions will be highly data-dependent, i.e. high forecast uncertainty. At the long end, sharp cuts in central bank interest rates are already priced in, providing some setback potential.
- 5) Significant political risks include the Middle East, US presidential elections and state elections in eastern German states.

Key messages in detail:

1. Weak growth in the global economy

Industrialized countries are likely to be in recession in the first half of the year. China lacks internal growth drivers due to the ongoing problems in the real estate sector and unsettled consumers; we therefore expect more expansionary fiscal and monetary policies (GDP growth forecast for 2024: 4.7%). The growth impetus for the German economy is likely to be lower due to the decline in trend growth and efforts toward greater economic independence. In the US, there is increasing hope that a "soft landing" could be achieved after all. However, our basic forecast remains a moderate recession in the first half of the year caused by the massive rise in interest rates (GDP forecast 2024: 0.9%). Europe is likely to initially fall into a mild recession in H1 due to the loss of purchasing power caused by high inflation, the weak US economy and the dampening effect of ECB interest rate hikes of



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450 basis points on investment and consumption. We expect GDP growth of 0.2% for the full year 2024.

2. Germany: GDP down again in 2024

Germany is hit harder by current structural changes (higher energy prices, structurally weaker global trade) due to its energy-intensive industries. This is having a particularly negative impact on cyclical demand components, exports and investments. In addition to weak global trade, exports are also affected by a deterioration in the price competitiveness of German industry, as our labor costs have risen comparatively sharply and energy costs are very high compared to the USA and China. Although investment in equipment increased by 3% in 2023, this was almost exclusively due to a sharp rise in commercial vehicle registrations, which was driven by tax breaks for electric cars available until the end of September. Investments in other machinery and equipment virtually stagnated. In view of weak demand and the subdued mood in the economy (ifo), this is unlikely to change much for the time being. Last year's rise in interest rates will probably initially further exacerbate the recession in residential construction. The ifo business climate in residential construction fell to an all-time low in December, with 22% of companies surveyed complaining of cancellations. However, our real estate expert Jochen Möbert expects that mortgage interest rates, which have fallen again in the meantime, could initiate a trend reversal towards the end of the year. On the other hand, private consumption, which has been badly hit by the explosion in consumer prices in recent years, is a source of hope. This year, strong wage increases (around 5 ½%) and the significantly falling inflation rate should lead to noticeable real income gains again for the first time, which should then be increasingly reflected in consumption. However, the labor market is causing some concern despite (or perhaps because of) the increasing labor shortage. Rising unemployment figures of just under 20 thousand per month have recently caused the unemployment rate to rise to 5.9%. This slight weakening trend could continue at least until the middle of the year.

3. Inflation towards 2%

A sharp year-on-year fall in energy prices has caused the rise in consumer prices to fall from 8.7% yoy in January 2023 to 3.7% most recently. Furthermore, price increases for food (4.6%) and goods (excluding energy) (3.9%) have slowed. In contrast, strong wage increases should lead to further price rises, particularly for services but also government fees etc., meaning that core inflation should still average around 3% this year.

4. Sharp cuts in key interest rates expected

We expect the Fed to cut its key interest rates by a total of 175 bp in the current year, starting in June. In the event of a soft landing, interest rate cuts could start as early as March, but be smaller overall. In view of the weak eurozone economy and the recent sharper-than-expected fall in inflation in the eurozone, we now expect the ECB to start cutting interest rates as early as April and to reduce them by 150 bp over the course of the year, with the first 100 bp coming relatively quickly. However, recent comments from ECB Governing Council members, which have varied considerably, show that opinion-forming is in flux and very data-dependent. In other words, the key



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interest rate forecasts are subject to a very high degree of uncertainty. Irrespective of this, ten-year bond yields have fallen by a full percentage point in the US and by $\frac{3}{4}$ percentage points in Germany since October, thus pricing in early and sharp interest rate cuts. Ten-year interest rates are therefore unlikely to fall much further in 2024. On the contrary, there could even be setbacks here (year-end: 10Y Treasuries 4.05%, 10Y Bunds 2.6%).

5. Considerable political risks

COVID and the Russian invasion of Ukraine have made us painfully aware in recent years of how modest our forecasting abilities can ultimately be. A global pandemic and a war in Europe were not completely unexpected, but they only appeared as "wildcards" in the risk listings. The "unknown unknowns" cannot be named, by definition. But this year, the "known unknowns" already call for caution. These include the tense situation in the Middle East, which could hamper global trade. Following the elections in Taiwan, the situation in the South China Sea also remains tense. Right-wing populists could succeed in the EP elections at the beginning of June and in the upcoming state elections in three eastern German states in the fall, making it much more difficult to form a government. And then there are the elections in the USA, where a particular right-wing populist could be elected as president again in November. This scenario could already cause considerable unrest on the financial markets in the second half of the year.

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