MACRO STRATEGY | Economic Monthly

Global Outlook 2025

October 2024

In 2025, we believe the core question to dominate economic discussions is where the unobservable natural rate (r*, the neutral rate of interest that supports full employment and constant inflation) lies and when central banks should stop cutting.

As global inflation decelerates, all the regions respective central banks have begun a cutting cycle, except for the Bank of Japan which is normalizing from lower rates. We expect rate paths to continue down through the first half of next year with little fanfare. The second half of the year would become more challenging as central banks consider ceasing cuts.

Alongside the further normalization of inflation, we expect moderate but steady GDP growth in each region. This base case rests on avoiding significant conflict escalations, increases in geopolitical tensions, and quantitatively significant policy changes resulting from the outcome of U.S. elections.

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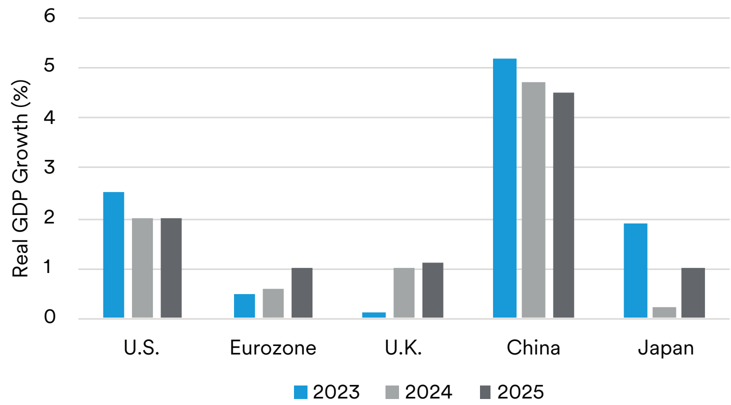
Global Growth

We expect overall global growth to continue at a moderate pace. A slowing manufacturing industry, driven by lower production, demand, and exports, has contributed to lower global growth overall. But recent data revisions show the U.S. consumer is stronger than initially thought, and we expect consumer demand in Europe to pick up moderately as the ECB further cuts interest rates. In Asia, Beijing is intervening to support the economy via monetary and fiscal policy measures. The slowdown in manufacturing has been particularly marked in China, but we expect overall growth in the region to remain stable. The Bank of Japan, for example, noted that private consumption is on a moderately increasing trend in its policy statement late last month.

Much of the uncertainty in the trajectory of global growth comes from the still unknown outcome of the U.S. elections. The election could have a significant impact on global trade relationships (increased tariffs or renegotiating trade agreements) as well as the U.S.' longer-term policy objectives (climate and defense investments). At least in the short- to medium-term, changes resulting from the election would likely have a bigger impact on other countries than directly on the U.S. itself.

Chart 1 | Global Growth Should Continue at a Moderate Pace



Source: BEA, Eurostat, ONS, Bloomberg, MIM. As of 10/7/2024.

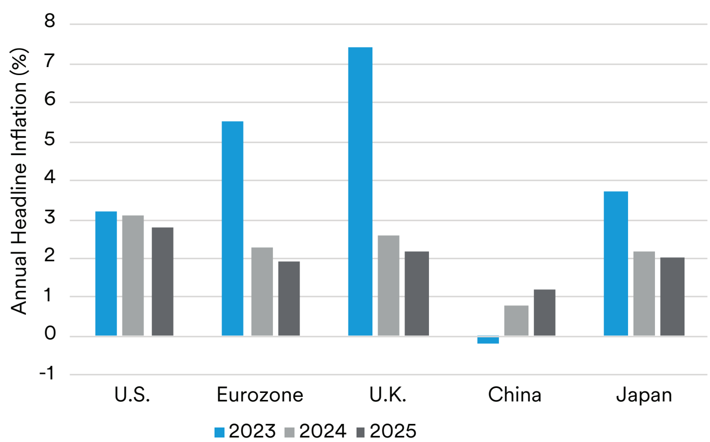
Global Inflation

Other major economies' inflation rates have normalized alongside that of the United States and should continue to do so if the U.S. is able to proceed with its rate cutting cycle as we expect. Year-over-year inflation in the UK, the EU, and Japan is expected to moderate from highs seen over the last few years, and we expect China to move away from the slight deflation seen in 2023.

The upcoming U.S. election is once again a source of risk for the global inflation outlook. If further tariffs are implemented, any price shocks will likely be one-time, and inflation should subsequently continue on trend.

Additionally, new geopolitical tensions or a further spread of the Israel/Hamas conflict could put upwards pressure on commodity prices and influence shipping/transportation costs.

Chart 2 | Inflation Expected to Continue Normalizing



Source: BEA, Eurostat, ONS, Bloomberg, MIM. As of 10/7/2024.

Global Central Banks

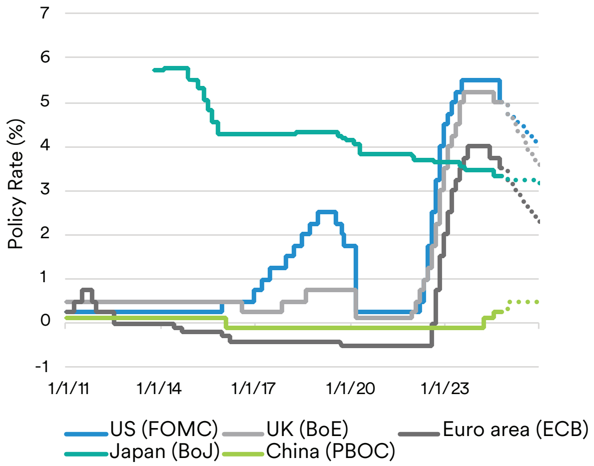
The Federal Reserve, European Central Bank (ECB), the Bank of England (BoE), and the People's Bank of China (PBOC) are all on a rate cutting path, while the Bank of Japan is normalizing from below.

Central bank uncertainty has abated, with the main question being the speed of cuts rather than whether there will be cuts. We expect this greater certainty to persist into the second half of 2025 as the FOMC, ECB and BoE each have quite a way to go before achieving equilibrium neutral rates. Except for the PBOC's cuts in China, none of these cuts are expected to be stimulative: we don't expect policy rates to fall below neutral rates.

However, this raises the question of where the true neutral rate is. Although unobservable, it is possible to estimate. For both the U.S. and the U.K., we agree with consensus that nominal neutral rates are higher, at around 3%, while for the ECB, estimates are between 1.5-2.5%.

Toward the second half of 2025, the most pressing question will likely be where the central banks will stop cutting. This will likely be accompanied by a pick up in uncertainty.

Chart 3 | Central Banks are Normalizing Rates



Source: Federal Reserve, BoE, BoJ, ECB, PBoC, Macrobond, MIM. As of 10/10/2024.

	Growth (%y/y)			Policy rate (YE, %)			Inflation (Dec, %y/y)			10-year yields (YE,%)		
	2023*	2024	2025	2023*	2024	2025	2023*	2024	2025	2023*	2024	2025
U.S.	2.5	2.0	2.0	5.50	4.75	4.00	3.2	3.1	2.8	3.88	4.25	4.00
Eurozone	0.4	0.6	1.0	4.00	3.25	2.25	2.9	2.3	1.9	2.02	2.30	2.10
U.K.	0.1	1.0	1.1	5.25	4.50	3.25	3.9	2.6	2.2	3.53	3.80	3.65
China	5.2	4.7	4.5	3.45	3.25	3.15	0.3	0.8	1.2	2.56	2.20	2.20
Japan	1.8	0.2	1.0	-0.10	0.50	0.50	3.7	2.2	2.0	0.61	1.00	1.10

U.S. Outlook Summary

We continue to expect growth in 2024 and 2025 to be softer than 2023 but remain at or above long-term trend growth with no recession.

Uncertainty around U.S. elections remains, dampening company investment and hiring until there is more clarity on potential policy changes.

However, we do have more clarity on Federal Reserve policy compared to last month, and Chair Powell hinted at two more cuts for the remainder of the year (bringing the total to 100bps) if the economy performs in-line with expectations.

U.S.	2023*	2024	2025
GDP	2.5	2.0	2.0
CPI	3.2	3.1	2.8
10 Year	3.88	4.25	4.00
Policy rates (upper bound)	5.50	4.75	4.00
Unemployment	3.7	4.4	4.3

*Actual; other data are forecast.

Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management. As of October 2024.

We continue to expect the Fed to cut rates by an additional 25 bps by year-end. While the labor market has weakened, September data was positive. Furthermore, the BEA's recent annual NIPA revisions show consumers are stronger than initially thought. Finally, corporate profits remain robust. All of these will provide a bulwark against recession and potentially reduce the number of cuts implemented.

Risks

Our recession probability for 2025 is ~30%. The Fed is likely to remain cautious in adjusting rates lower in the face of mixed data and may wind up behind the curve and unable to prevent a recession. However, our base case is that they succeed in cutting rates sufficiently to underpin growth.

The labor market is in a precarious place, but may be helped by the Fed, resilient profit margins, and wealthier consumers.

Re-emergence of inflation remains a risk, although this is currently overshadowed by labor market risks. Election and geopolitical uncertainty are significant drivers of inflation risk, as tariffs and other policy changes could shift price levels and an escalation or spread of the conflict between Hamas and Israel has the potential to impact commodity, shipping, and transportation costs.

Perhaps most consequentially for the U.S. economy, uncertainty around the U.S. elections has increased relative to summer and many businesses are holding off decision making because of it. Polling has settled down somewhat following a volatile summer. While Harris has been slightly ahead in recent polls, the Presidential race remains extremely tight.

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