*Anima***Research**

OUTLOOK H2 2024

Soft landing

ANIMA

Soft landing

Overview

In November 2023, we wrote that: "2023 was not the year of change, but rather the year in which we paved the way for it". Changes in the macroeconomic scenario in the first half of 2024 indeed provided the conditions for the start of the cycle of rate cuts on both sides of the Atlantic.

In the Euro Area in particular, the conditions to allow the European Central Bank (ECB) to ease monetary tightening have already materialised: despite growth data in the first half of the year being better than expected, economic momentum remained well below potential on the whole, with the manufacturing sector only recently showing signs of moderate recovery. The outlook for consumption is constructive, but there will be no overheating: European households will continue to benefit from the gradual increase in purchasing power deriving from the slowdown in inflation and the savings rate will normalise, given the reconstitution of wealth and monetary easing. On the price dynamics front, inflation is losing momentum in line with the ECB's estimates, net of a persistent stickiness in the component of services prices, which should have run its course by the end of summer. This allowed the central bank to begin cutting rates: we expect that the script will repeat in the second half of the year, at a pace of one cut per quarter.

In the United States, the conditions for easing tightening are gaining ground, but at a slower rate. US growth continued to prove decisively resilient in the first half of 2024, but we remain convinced that it is heading towards a process of gradual slowdown, as shown by the quarterly Gross Domestic Product data, which, as much as it is above potential, is losing momentum quarter after quarter. On the one hand, the labour market, albeit resilient, continues to regain balance, as recognised by Jerome Powell, Chair of the Federal Reserve (Fed). On the other hand, household consumption, while still robust in terms of level, shows a deterioration in the "quality" of spending. In terms of prices, progress in the disinflation process has been unsatisfactory in the first half of the year, due to an acceleration in the prices of services and a recovery in the prices of core goods, which forced the Fed to keep the rates where they were and to await further confirmation of the sustainability of the disinflationary trend. We remain optimistic about this point for several reasons: (1) the inflation expectations remain stable and close to the targets of the central banks; (2) the rebalancing on the labour market continues; (3) the moderation in consumption will exert downward pressure on the prices of services and core goods. The easing in pressures on core inflation will allow the Fed to begin reducing rates after summer, at the pace of one cut per quarter, similar to the ECB.

Lastly, in China, our central scenario is unchanged: we remain convinced that the Chinese economy has entered a structural transition phase, in which only one of the two drivers of growth before COVID (exports and construction sector) is still active (export), while the construction sector is going through a transformation

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process that will no longer allow it to contribute to the growth as before. Similar to 2023, in 2024 the Chinese GDP will also expand at a rate close to the "new" potential of 5%, supported by exports, but slowed by the transition in domestic demand: private consumption is not yet ready to take up the mantle of construction.

In this context, our central scenario for 2024 remains broadly aligned with the one described in late 2023, including in terms of risk. Developments in growth and inflation remain crucial, especially in the United States, where the turning point is maturing and has not yet arrived. If for any reason the progress made in inflation did not manifest or growth did not continue in the weakening, the Fed could remain reluctant to cut rates throughout the entire second half of the year, and the turning point would be delayed for the second year in a row.

GLOBAL GROWTH

A long cycle-end

In 2024, global growth could take a surprising turn upward for the second year in a row: we expect that global real GDP will expand at a rate close to 3%, after 3.2% in 2023 (a figure over one and a half percentage points higher than the estimates made by economists in late 2022). The United States will indeed continue to grow above potential, albeit with less momentum than in 2023, in which is already a long cycle-end, whereas in the Euro Area the weakness recorded in the second half of 2023 seems to be forgotten and the economy is getting ready to take off again, aided by the support from monetary easing. Lastly, in the emerging markets, growth should slow from 4.5% in 2023 to 4% in 2024: a rate of expansion that is nevertheless higher than the world average, including China.

REAL GDP GROWTH BASELINE

Growth in US, Euro Area and China

	USA	EA	China
	Q/Q %, SAAR	*Q/Q %*	*Y/Y %*
Q4 23	3.4	-0.1	5.2
2023	**2.5**	**0.6**	**5.2**
Q1 24	1.4	0.3	5.3
Q2 24	1.8	0.2	4.8
Q3 24	1.4	0.3	5.2
Q4 24	1.4	0.4	5.2
2024	**2.3**	**0.7**	**5.1**

Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

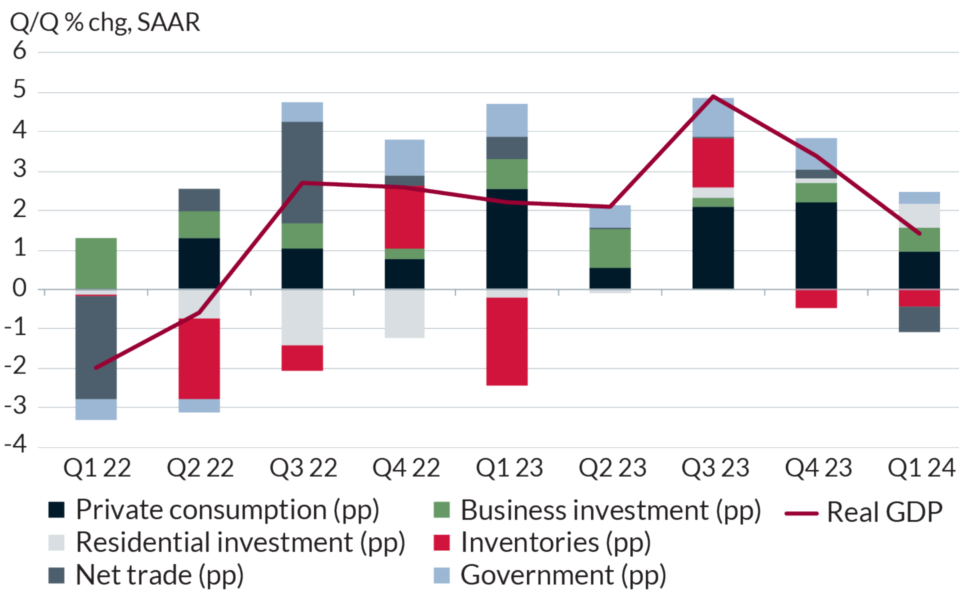
United States – Growth slowing but still above potential

The most recent inflow of data suggests that the information arriving in April had probably overestimated the deterioration of the growth fundamentals: the US economy is still heading towards a path of moderate slowdown. This picture is coherent with our baseline scenario, which does not foresee overheating for growth, but slow weakening.

The GDP report in the first quarter in particular, showed a loss in momentum compared to the fourth quarter of 2023 (**Figure 1**). Private domestic demand – excluding trade, investments in inventories and government spending – grew at a less sustained pace than expected, and below the two previous quarters. An acceleration in fixed investments, driven by the residential and non-residential components, offset the unexpected moderation in private spending for consumption, while the volatile categories, such as inventories and net exports, offered negative contributions.

FIGURE 1

Q1-24 GDP details showed a rather marked decline in consumer demand



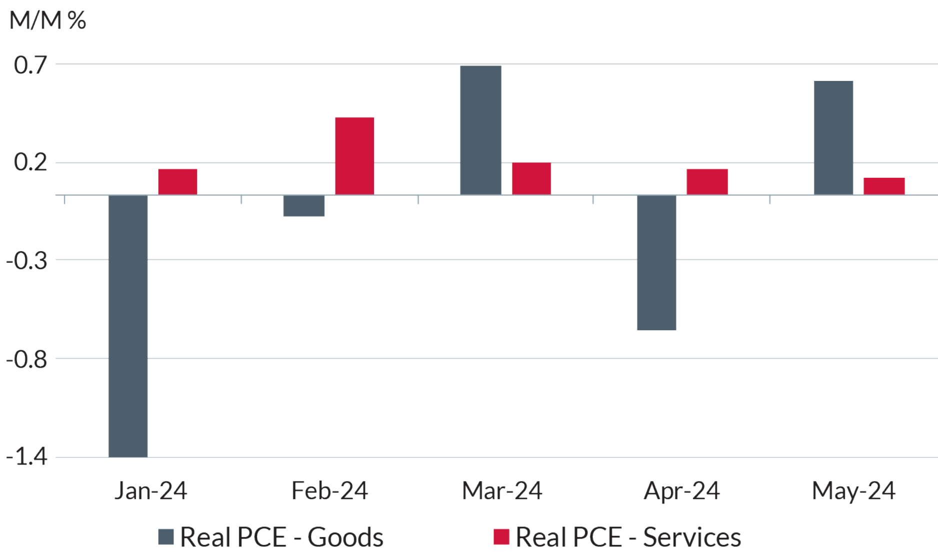
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

The data from the second quarter published to date indicate that domestic demand should have slowed further, but it did not collapse. The monthly consumption data were weaker than expected in April and May, with a clear loss in momentum in services (**Figure 2**). The ISM indices in April and May reported a moderate contraction in the manufacturing and services segments. Lastly, the data on the labour market remain positive and continue to indicate a gradual rebalancing, driven by labour supply developments; the creation of new jobs is indeed in line with a scenario of mild

economic slowdown and the JOLTS estimates (*Job Openings and Labor Turnover Summary*), while tempered, remain reassuring, with turnover rates around pre-pandemic levels (**Figures 3a and 3b**).

FIGURE 2

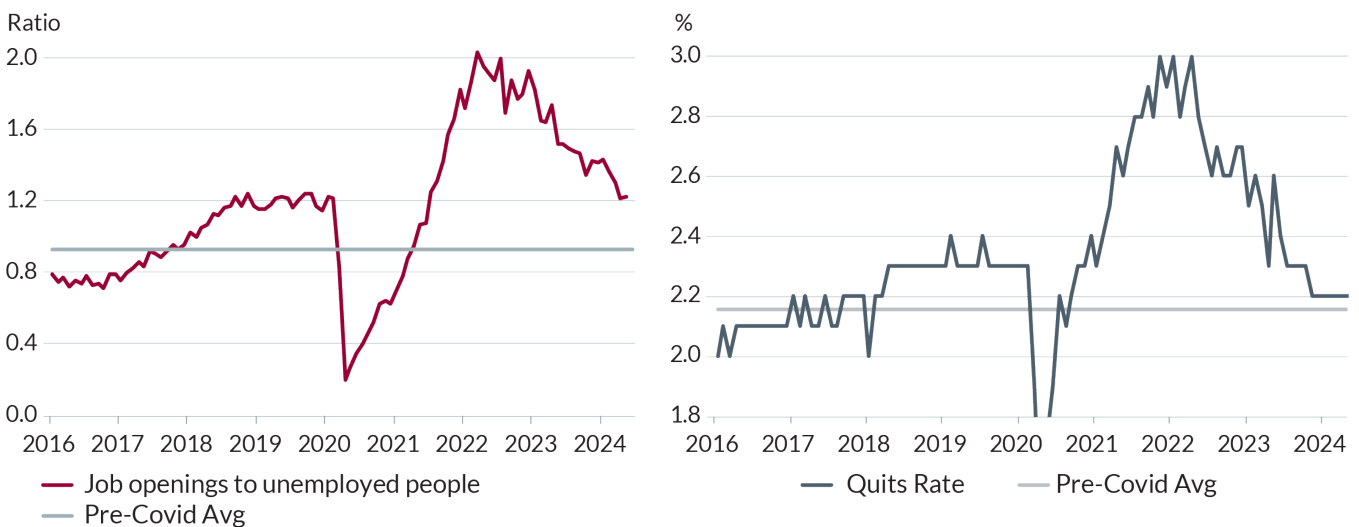
Momentum in real services spending is softening



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

FIGURES 3A AND 3B

Supply-driven labor market rebalance continues



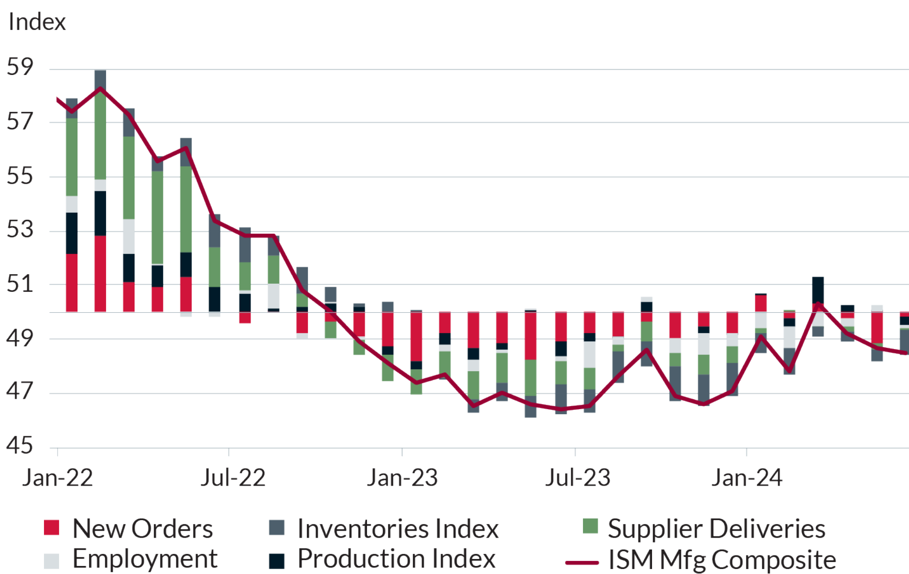
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

Looking forward, we have kept our central scenario unchanged, which hypothesises US growth above potential, but slower than in 2023: the rate of expansion of the GDP on a quarterly basis will be moderate from the second quarter, before entering the final stretch of the post-pandemic economic cycle and dropping below potential in 2025. There are multiple reasons for this:

1. The unsurprising process of rebalancing on the labour market is continuing, driven by supply, and supports a soft-landing scenario.
2. The manufacturing sector is ending the phase of momentum that began at the start of the second half of 2023 and is veering towards progressive slowdown, though not towards collapse (**Figure 4**).

FIGURE 4

The tradable sector remains in disarray



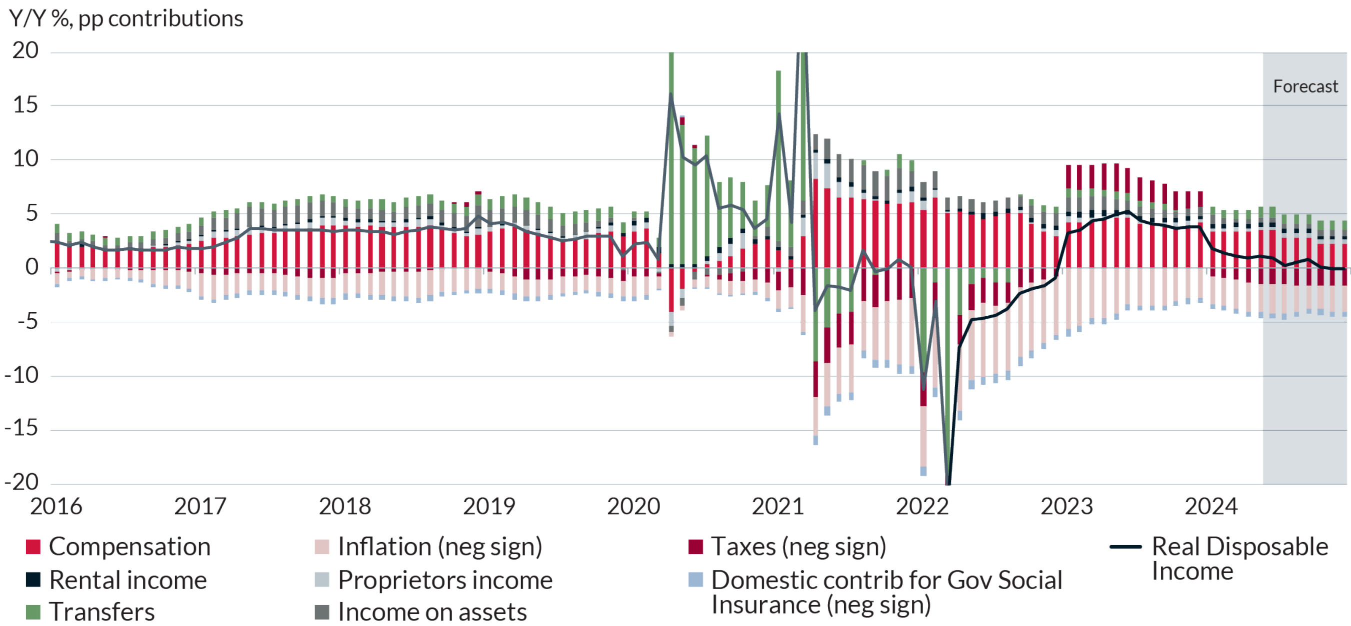
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

3. In line with our baseline scenario, which foresees a slowdown in wage growth and inflationary pressures on the one hand, and that non-withheld taxes[1] will remain positive in 2024 on the other, following the collapse of 2023, we predict that the real disposable income this year will remain favourable, albeit at significantly lower levels than the previous year (**Figure 5**).

[1] These are taxes that a taxpayer must pay directly to the tax authority, without being withheld at source by an employer or by another paying party.

FIGURE 5

Support from real income is fading

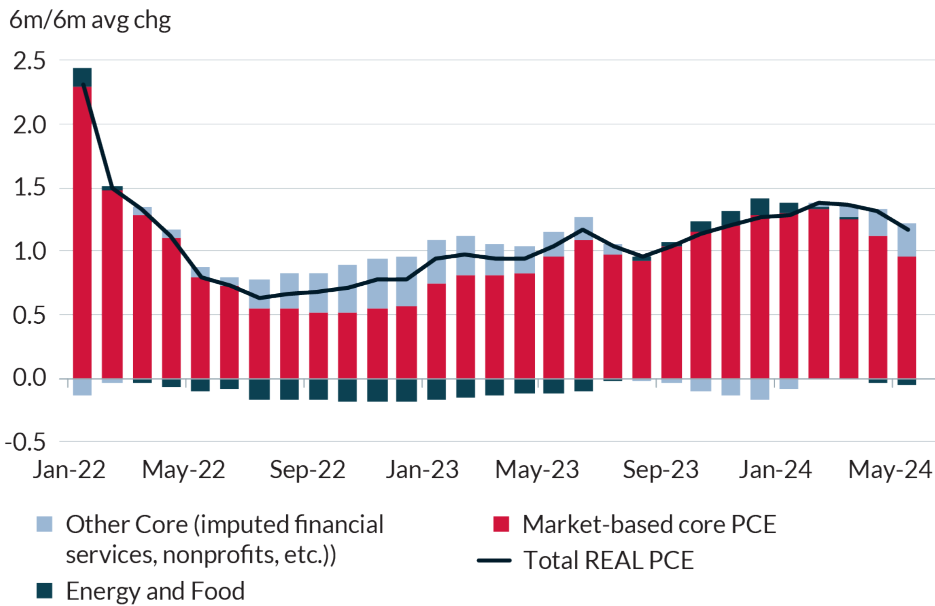


Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

4. The quality of private consumption is still robust but deteriorating. Since the second half of 2022, consumption has been driven by household spending, but we are now seeing a growing contribution from so-called "imputed" spending categories, which record fictitious and not real spending, i.e. without corresponding actual transactions (for example, expenses for bank interest or financial services – **Figure 6**). In addition, the support offered by real spending for core goods, including foodstuffs (another stronghold of growth in consumption after the pandemic), has notably weakened.

FIGURE 6

Quality of spending keeps deteriorating



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

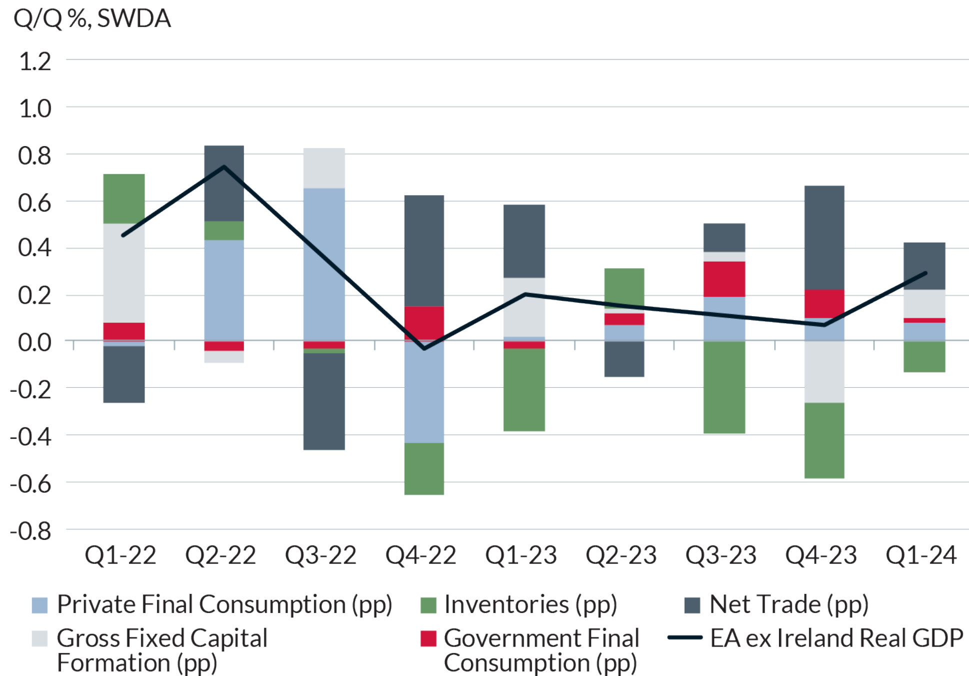
In this context, we remain convinced that US growth in 2024 will be higher on average than potential, but below 2.5% in 2023. In sequential terms, we expect annualised quarterly growth rates of 1.8%, 1.4% and 1.4% respectively in the second, third and fourth quarters (2.3% for 2024).

Euro Area – Mild ongoing recovery

In the Euro Area, the final GDP figures for the first quarter were better than expected: after a long phase of stagnation, quarterly growth was 0.3%. If we look at the aggregate picture, expansion was mainly driven by net exports, which are notoriously volatile; however, excluding the distortions linked to Ireland's contribution, signs of greater solidity are emerging (**Figure 7**). Irish data have indeed shown a strong drop in fixed investments due to the collapse in intellectual property licences; however, by focusing on our preferred underlying growth indicator (real domestic demand net of intellectual property rights), we see a genuine recovery, driven by private consumption, spending in construction (partly favoured by favourable weather conditions) and by fixed investments.

FIGURE 7

Excluding Ireland, the composition of the GDP proved robust



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

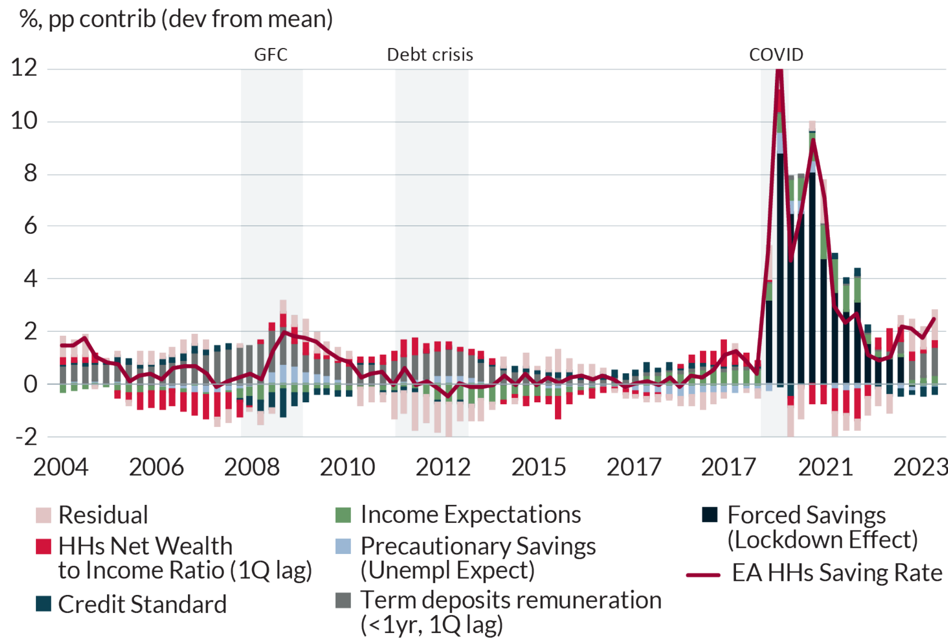
The more robust expansion of private consumption than expected and the constructive trends in the confidence data published to date for the second quarter suggest that the strength of the first quarter may not have been a flash in the pan: with the ECB beginning to cut the rates and the impact of the energy shock continuing to be reabsorbed, we expect a prolonged momentum in the upcoming quarters.

Various considerations support this theory:

1. Growth in real income has room to support consumption. To date, the increase in the savings rate has slowed the increase in spending, but our analyses suggest that the caution shown by households especially reflected lower real wealth, the appeal of historically high deposit rates and the general climate of economic uncertainty (**Figure 8**). However, in the upcoming quarters it is fair to expect a normalisation in the savings rate, given the reconstitution of real wealth and the monetary easing; furthermore, the recovery in real income generated by the drop in inflation should support consumer confidence (**Figures 9a and 9b**).

FIGURE 8

The historical drivers of the household saving rate

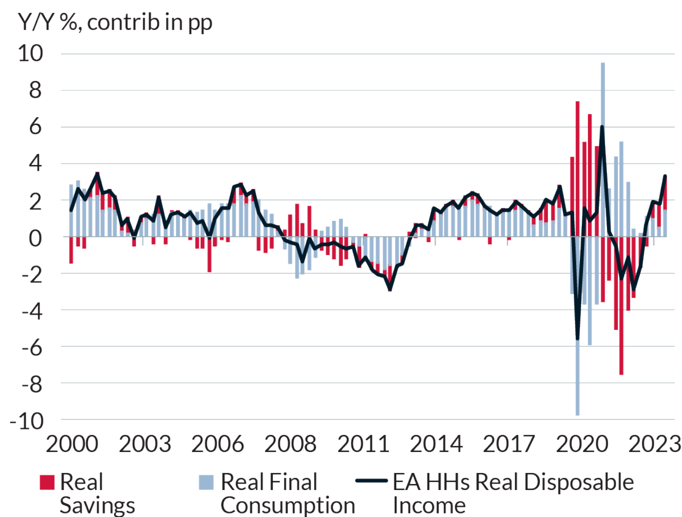


Our empirical approach to modelling the key drivers of household savings, motivated by Slacalek and Sommer (2012), links the saving rate to its lagged value, the 'wealth gap' (HHs net worth to income ratio expressed as the difference of the polynomial trend), financial/income conditions (as measured by HHs financial situation by EC survey), unemployment risk (proxied with HHs unemployment expectations by EC survey), as well as lagged deposit interest rates (with maturity of <= 1 Year) and credit conditions. However, with the distortions brought by COVID-19, we also allow the saving rate to depend on governments' containment policies during the pandemic (as captured by the Oxford University's lockdown stringency index and a Dummy variable). The model with the addition of controls for the pandemic period is in spirit similar to one developed by the ECB: see Maarten Dossche and Stylianos Zlatanos.

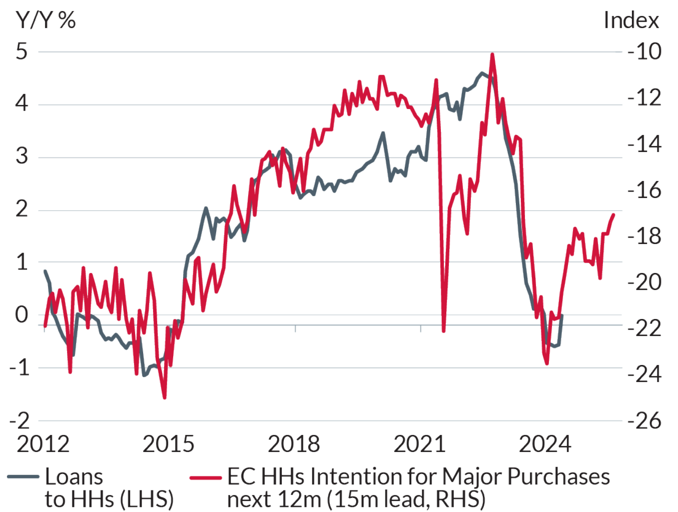
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

FIGURES 9A AND 9B

Real income has room to support consumption



Lower rates should support spending

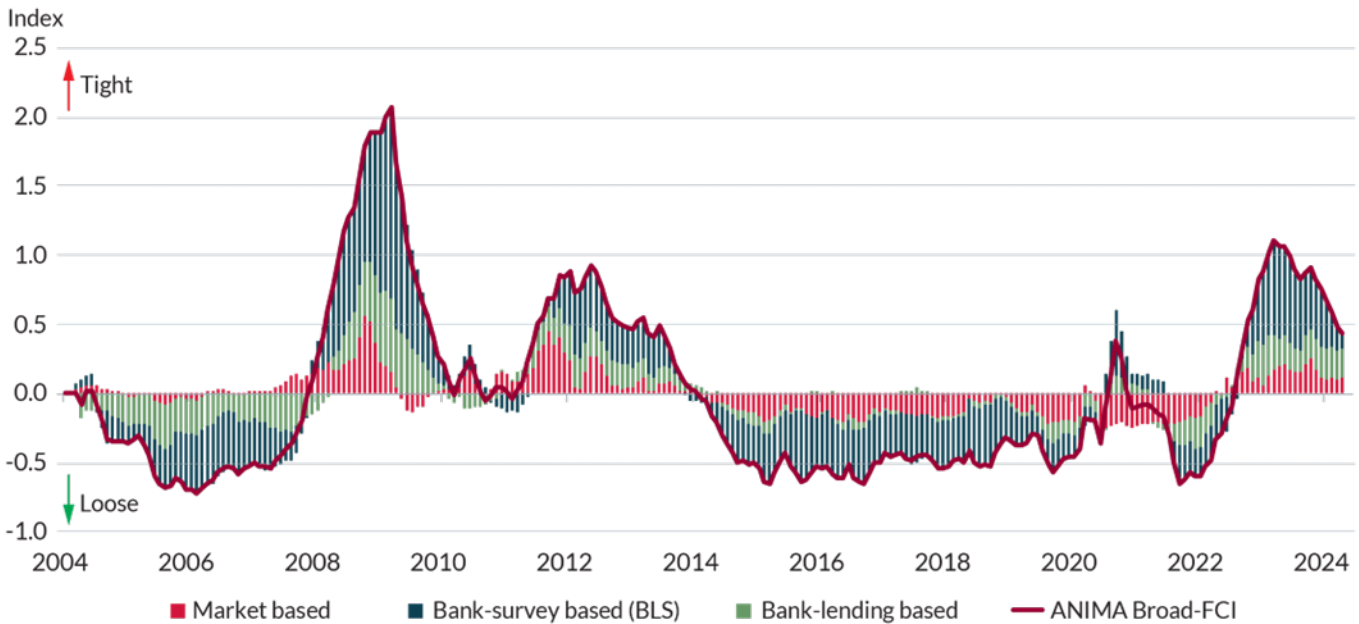


Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

2. Drag from past monetary tightening is fading. Despite the tightening of financial conditions (**Figure 10**), we note that the corporate sector has surprisingly managed to remain in comfortable territory, aided mainly by decent profitability, solid debt servicing capacity and healthy leverage levels (**Figure 11**).

FIGURE 10

Drag from past monetary tightening is fading

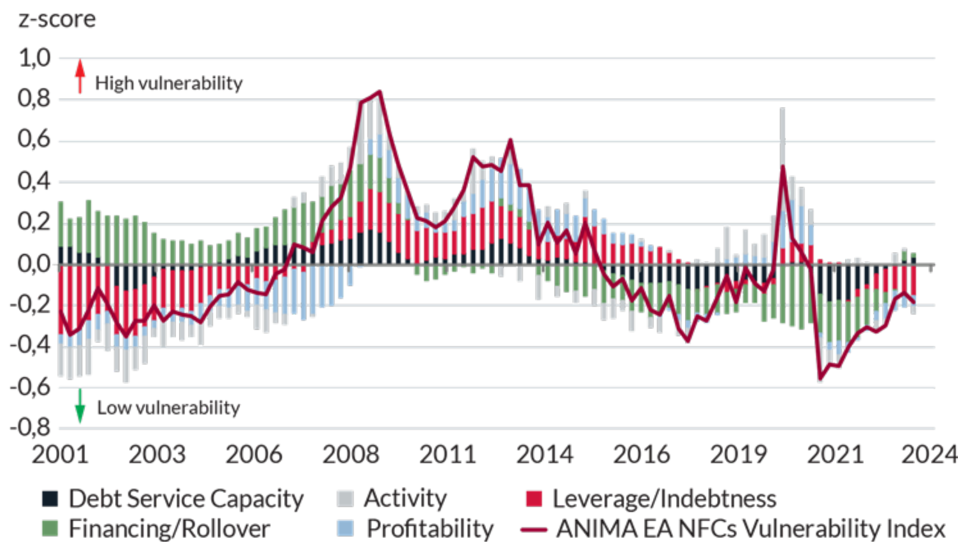


Note: For our Financial Conditions Index (FCI), we identify a broad set of economic variables referring to: 1) market-based financing conditions (e.g. sovereign yields, government spreads and swap rates); 2) bank credit-based financing conditions (e.g. credit impulse, lending volumes to the real economy - HHs and NFCs); 3) We also rely on data based on the ECB's Bank Lending Survey (BLS), available quarterly. Variables are selected on the basis of their correlation with AE GDP. We follow a methodology similar to that of Angelopoulou et al. (2013) published in an ECB Working Paper Series.

Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

FIGURE 11

The corporate balance sheets remained solid



**NFCs = non-financial corporations.*

Note: The composite measure is based on a broad set of indicators along five dimensions: debt service capacity (measured by the interest coverage ratio, corporate savings and revenue generation), leverage/indebtedness (debt-to-equity, net debt-to-EBIT and gross debt-to-income ratios), financing/rollover ((short-term debt-to-long-term debt ratio, quick ratio (defined as current financial assets/current liabilities), overall cost of debt financing and credit impulse (defined as the change in new credit issued as a percentage of GDP)), profitability (return on assets, profit margin and market-to-book value ratio) and activity (sales growth, trade creditors ratio and change in accounts receivable turnover). Except for the overall cost of debt financing and GDP, all indicators are based on data from the ECB's quarterly sector accounts. The overall cost of debt financing indicator is calculated as a weighted average of the costs of bank borrowing and market-based debt, based on their respective amounts outstanding.

Based on ECB methodology presented in "Assessing corporate vulnerabilities in the euro area". See here.

Data as of 2 July 2024. Source: Haver Analytics, Bloomberg, ANIMA Research

3. Manufacturing activity has room to improve, albeit gradually. Industrial activity has underperformed notably over the last two years, reflecting high energy prices, weak foreign demand and higher interest rates. We believe that industrial production is likely to rise from here; as the headwind from high energy prices recedes, global growth improves and financial conditions ease.

4. **Foreign demand towards a gradual improvement**. There are several signs that global demand is strengthening (**Figure 12**). Consumption goods exports in the EA have started to recovery, while exports to China might be showing signs of life. All in all, the external sector is likely to continue to support EA growth going forward, but the impact of net trade should be far from the magnitude we have seen in Q1 2024 – not least because improving domestic demand should push up imports, as is often the case during a revival in manufacturing and business investment.

FIGURE 12

Global trade is recovering

Note: We built a proxy of global demand by computing a GDP weighted average of PMI new export orders (26 countries included).

Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

In this context, we expect a 0.7% expansion in the EA GDP in 2024, compared to 0.9% estimated by the ECB. In sequential terms, the quarterly growth will come to 0.2% q/q in the second quarter, 0.3% in the third quarter, and 0.4% in the fourth.

China – 5% growth is the new standard

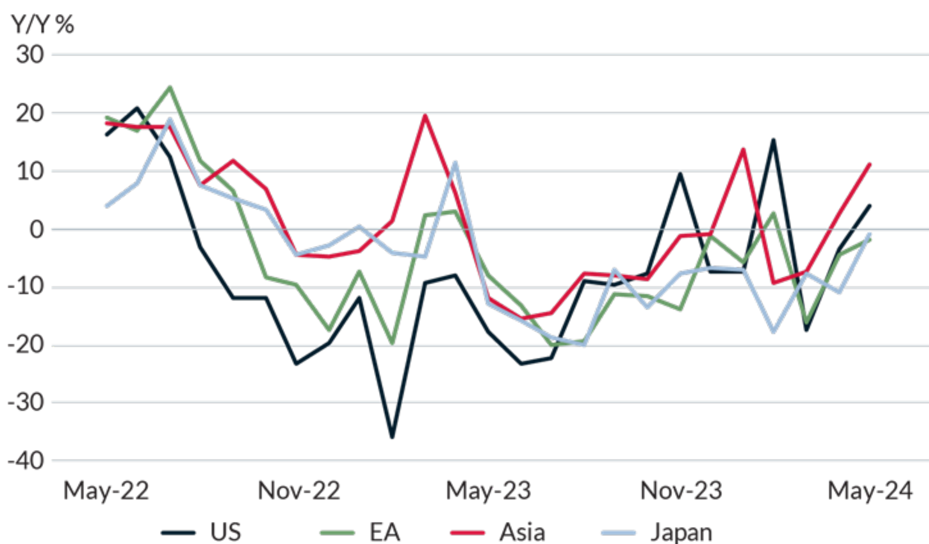
We are expecting the Chinese economy to continue to expand at a rate close to the current potential, equal to 5% year-on-year: a level that since 2022 seems to be deemed adequate by the Chinese Communist Party. On the one hand, this is sufficient to achieve the broader strategic and geopolitical objectives of the Asian giant; on the other, it reflects a more realistic opinion of the drop in the Chinese growth potential at the end of the first decade of the third millennium compared to the 1980-2010 period.

In sequential terms, we foresee a transitional slowdown in the second quarter caused by weakening in the supply and demand conditions, which should be followed by a recovery in the second half of the year; our growth forecasts for the months either side of summer were therefore revised downward, in line with a flow of data that suggests a temporary loss in vigour of economic activity.

After the leap in the first quarter and the current weakness, domestic demand should stabilise. The confidence indexes show a generalised moderation of economic momentum in the manufacturing, services and construction sectors, despite levels remaining in expansion territory. At the same time, overseas trade continues to surprise upward: exports have been stronger than expected in the first half of the year thanks to the constructive dynamic of exports to the G3 countries (United States, Euro Area, Japan – **Figure 13**) and to a favourable base effect, while imports slowed due to the lower influx of key raw materials. Overall, overseas trade should maintain a stable momentum in the coming months, offering a positive contribution to growth.

FIGURE 13

Foreign trade continues to surprise on the upside

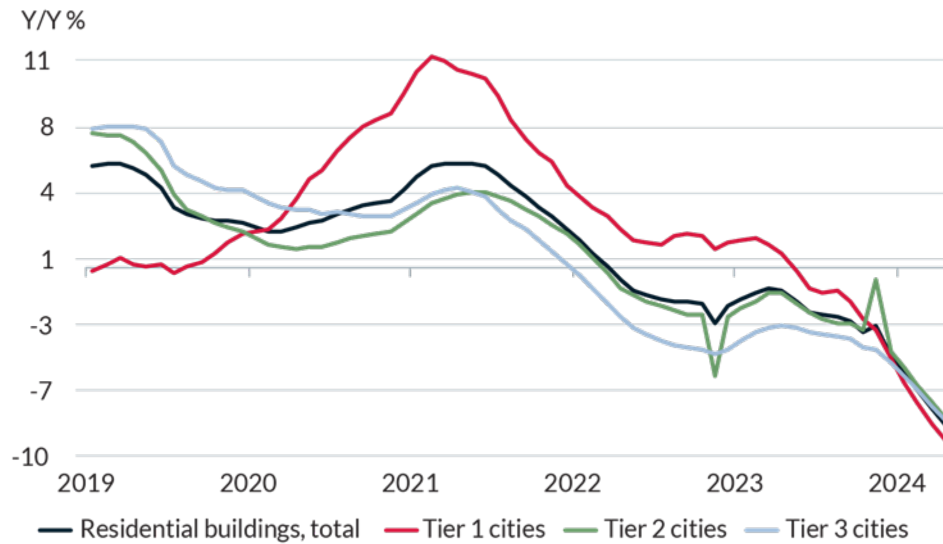


Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

As for the real estate market, there are no structural developments, and we are still of the idea that sector stabilisation will take time (**Figure 14**). Yet another housing policy easing package announced May 17 includes a further accommodationist revision of mortgage regulations and the creation of a new refinancing tool worth 300 billion yuan by the People's Bank of China to support the purchase of unsold houses to be converted into social housing. Though this is a step in the right direction, it will take time to significantly reduce the real estate inventory and to raise house prices back up, which have been constantly falling since mid-2021. Therefore, we maintain a cautious approach.

FIGURE 14

Stabilisation of the housing market will take time



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

Overall, our baseline scenario has not changed. The Chinese economy should continue to expand at a quarterly rate of approximately 5% and growth in 2024 should reach a new potential level: a 5-6% more modest compared to the approximate 9% recorded between 1990 and 2018.

GLOBAL INFLATION

Nearing the target

Crossing over from 2023 to 2024, the last milestone in the process to contain inflation was bumpy for all developed markets, with the only relevant exception being Japan. At core inflation level, the prices of core goods were back in line with pre-pandemic levels, while inflation from services stayed stable on both sides of the Atlantic. In the second half of 2024, we expect that prices of services will resume their gradual process of deceleration. This process will be aided by lapsing wage pressures, profit margins that continue to absorb the increase of unit labour costs and domestic demand for which overheating is no longer envisaged. Even the emerging markets will see a widespread slowdown in inflation in the largest geographical areas in 2024, with a more pronounced drop in Asia, while in Latin America the levels of prices have already plateaued, given that the disinflationary process had already started before other geographic areas. Overall, therefore, we expect that the global fall in prices will continue for the rest of the year, to bring global inflation towards 3% from 3.6% in late 2023.

INFLATION BASELINE

	CPI Core US	PCE Core US	HICP Core EA	CPI Headline China
	y/y %	*y/y %*	*y/y %*	*y/y %*
Q4 23	4	3.2	3.7	-0.3
2023	**4.8**	**4.1**	**4.9**	**0.2**
Q1 24	3.8	2.9	3.1	0
Q2 24	3.5	2.7	2.7	0.3
Q3 24	3.4	2.6	2.7	0.7
Q4 24	3.3	2.6	2.5	1.2
2024	**3.5**	**2.7**	**2.7**	**0.6**

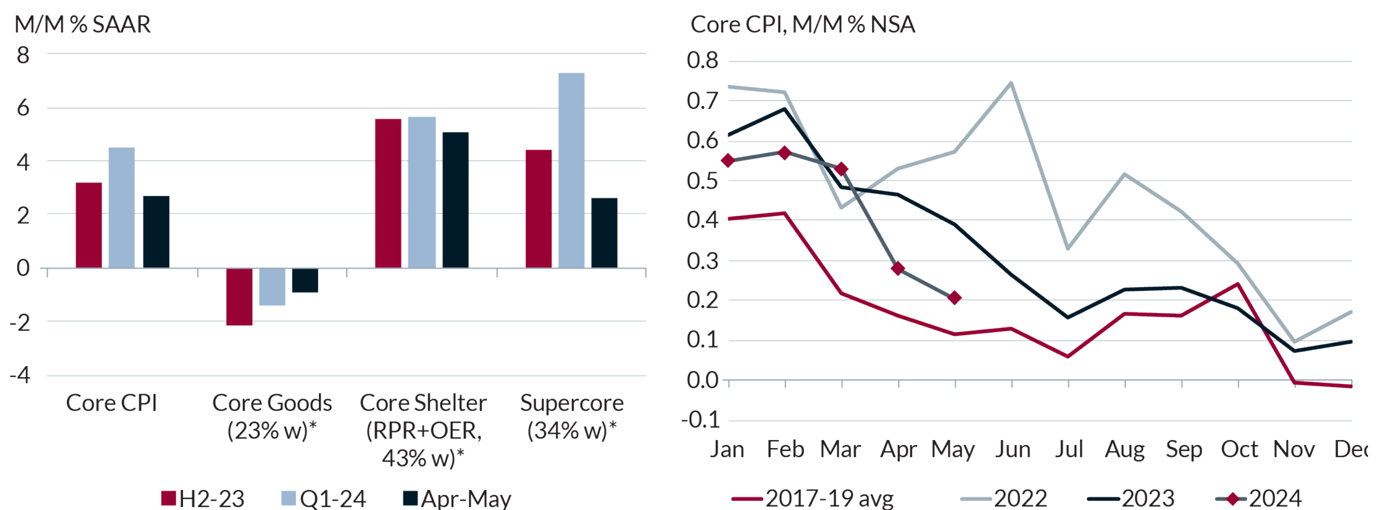
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

United States – Gradual slowdown

After a rapid easing of pressures in the final quarter of 2023, the progress in the disinflation process was limited at the start of 2024, largely due to a reacceleration in core services inflation and a recovery in the prices of core goods. Nevertheless, data from April and May backed our opinion that the dynamics recorded in the first quarter were an aberration (**Figures 15a and 15b**), largely attributable to technical and seasonal effects. The acceleration of inflation in the first months of the year largely reflected the increases in prices in several regulated categories (in particular maintenance services and hospital services), the effect of residual seasonality and a rather anomalous increase in the OER (Owners' Equivalent Rent – 34% weight relative to the core CPI index basket) in January, which then fell within its range.

FIGURES 15A AND 15B

April and May figures were encouraging compared to the Q1 bad surprises



Note on Figure 15A: Percents in parentheses denote the weight in core CPI. RPR+OER = Rent of Primary Residence + Owners Equivalent Rent.

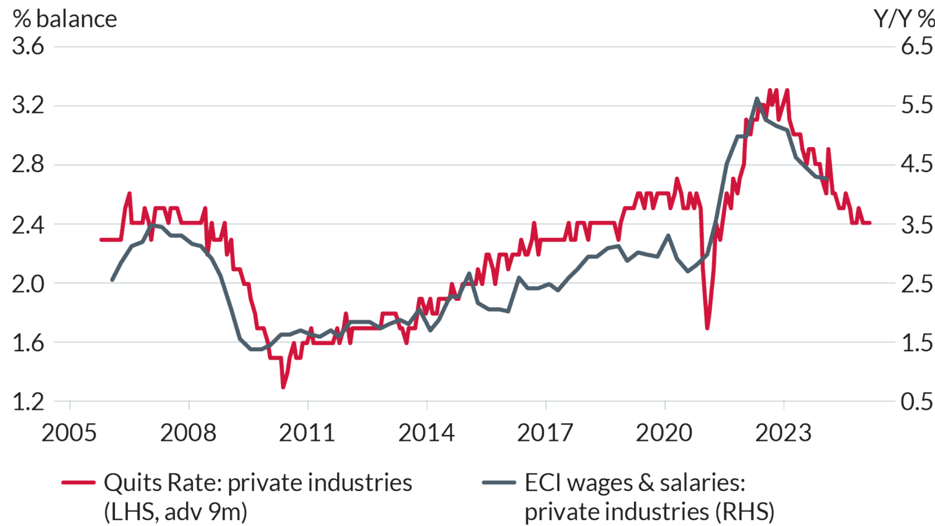
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

We remain optimistic about the consolidation of the disinflationary process, for various reasons:

1. The labour market is rebalancing and will continue to do so, contributing to limit wage pressures further (strongly correlated with core services inflation) – **Figure 16**.
2. Inflation expectations remain stable and close to central bank targets.

FIGURE 16

Wage moderation continues: leading indicators point to more easing ahead

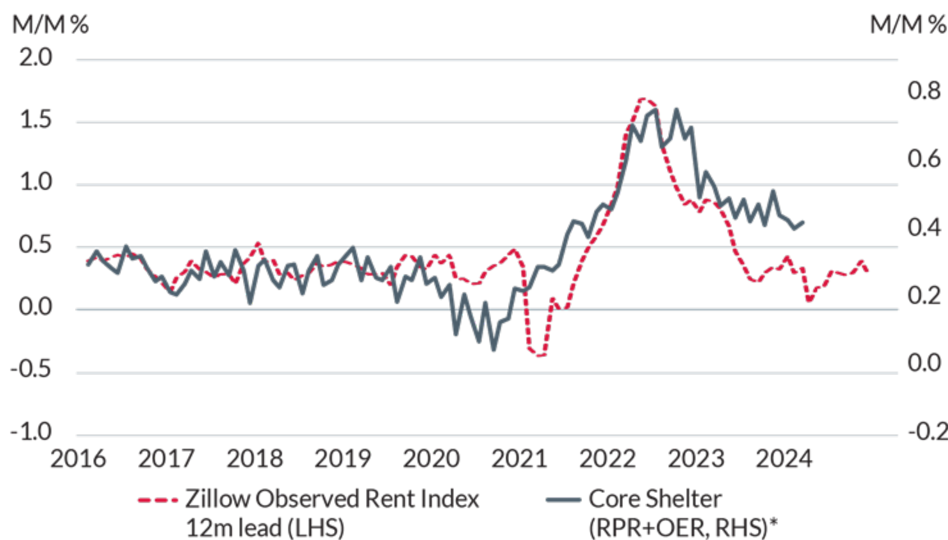


Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

3. Some of the most viscous and important components of inflation in terms of contribution to total inflation (particularly rents: i.e. shelter) should finally downshift in the second half of the year. Privately sourced data on the rents of new leases continue to show an imminent disinflationary impulse for the official series of the *Bureau of Labor Statistics (BLS)* – **Figure 17**.

FIGURE 17

Leading indicators for core shelter continue to point south



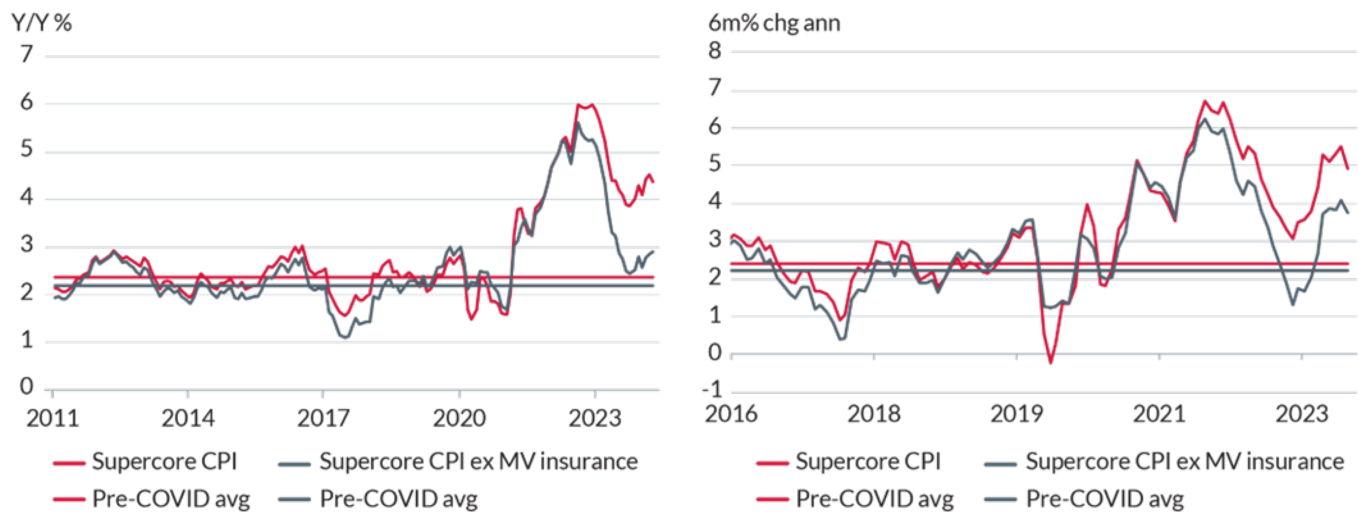
Note: Core shelter = RPR+OER = Rent of Primary Residence + Owners Equivalent Rent.

Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

4. The pressures on the prices of services net of rent (the “supercore” index, monitored very closely by the Fed), should continue to lessen, given the expected moderation in demand for private consumption (**Figures 18a and 18b**).

FIGURES 18A AND 18B

Supercore is approaching target levels



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

Overall, we expect a gradual deceleration in core inflation over 2024; the annual average should come to 3.5%, with sequential rates of 3.5% in the second quarter, 3.4% in the third quarter, and 3.3% in the fourth.

Euro Area – Volatility and disinflation coexist

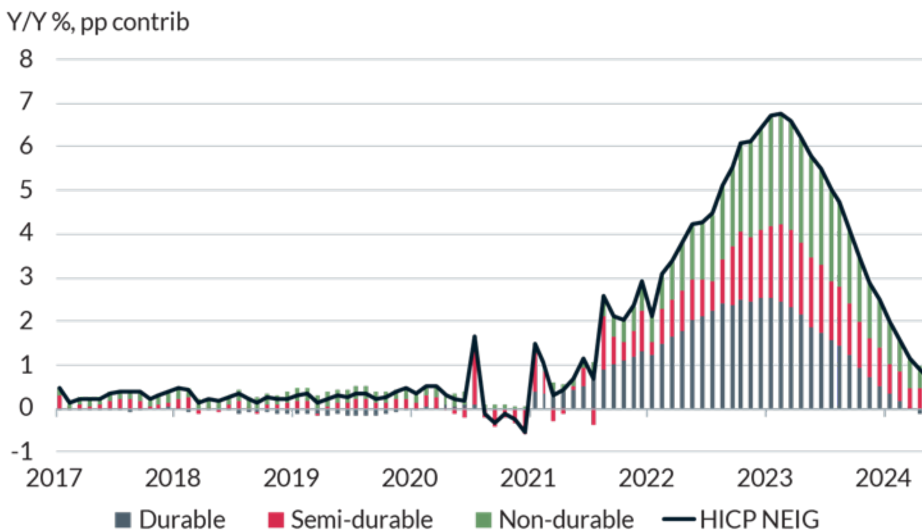
During the first two quarters of 2024, pressures on core inflation continued to become apparent. The adjustments to several categories of regulated prices in January (such as insurance and hospital services), an early Easter and a combination of unfavourable core effects contributed to a rather volatile journey for services prices, which remained at 4% year-on-year in the first quarter. Though April brought the first slowdown of the year in the prices of services, reflecting the inversion of an early Easter on the components linked to tourism, May took a surprising turn upward.

However, despite a potential high volatility on the prices of services, especially in the summer, we remain of the view that inflationary pressures have room to continue a gradual moderation during the year. For a series of reasons:

1. The prices of core goods recorded a considerable weakening, falling from a peak of 6.7% year-on-year in the first quarter of 2023 to 0.8% in the second quarter of 2024 and rapidly normalising towards the pre-pandemic average (**Figure 19**). Though a large portion of disinflation on this component is probably behind us, the early indicators point towards limited upward pressures in the coming months, given that the economic momentum remains coherent with price levels aligned to the ECB inflation target.

FIGURE 19

Core goods inflation continues to decline

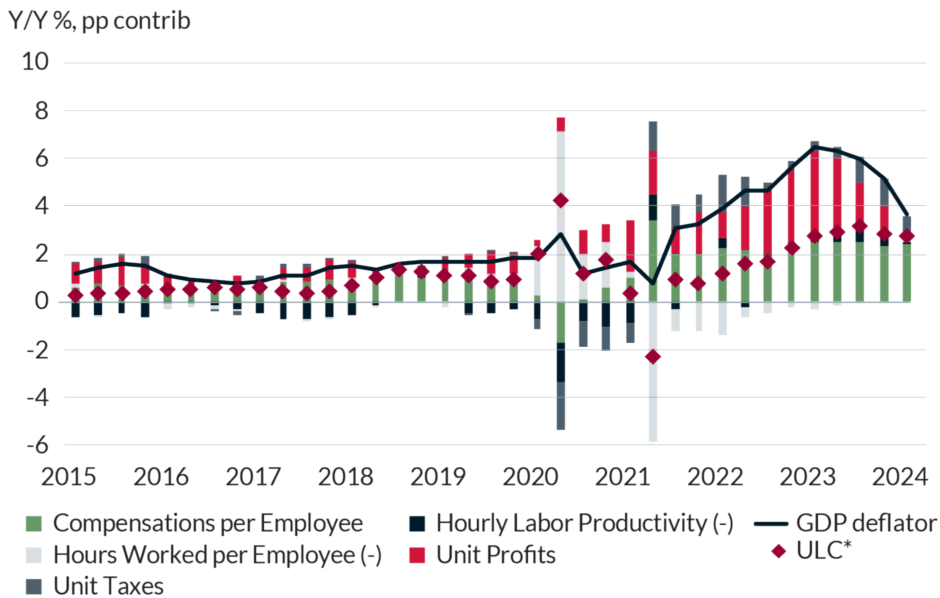


Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

2. The breakdown of the GDP deflator in the first quarter indicates that the profit margins are normalising (**Figure 20**): businesses are absorbing the increase in the unit cost of labour, after having accrued sizeable profits for two years. Though the increase in wages (in terms of compensation per employee – the measurement used by the ECB) has risen from 4.6% year-on-year in the fourth quarter of 2023 to 5.1% in the first quarter of 2024, we believe that this growth reflects a recovery in past inflation and that the risks of a wage-price spiral are low. In addition, the early indicators on wage negotiations point towards a progressive moderation during the year, which should continue to reduce downstream price pressures and make the ECB's job easier (**Figures 21a and 21b**).

FIGURE 20

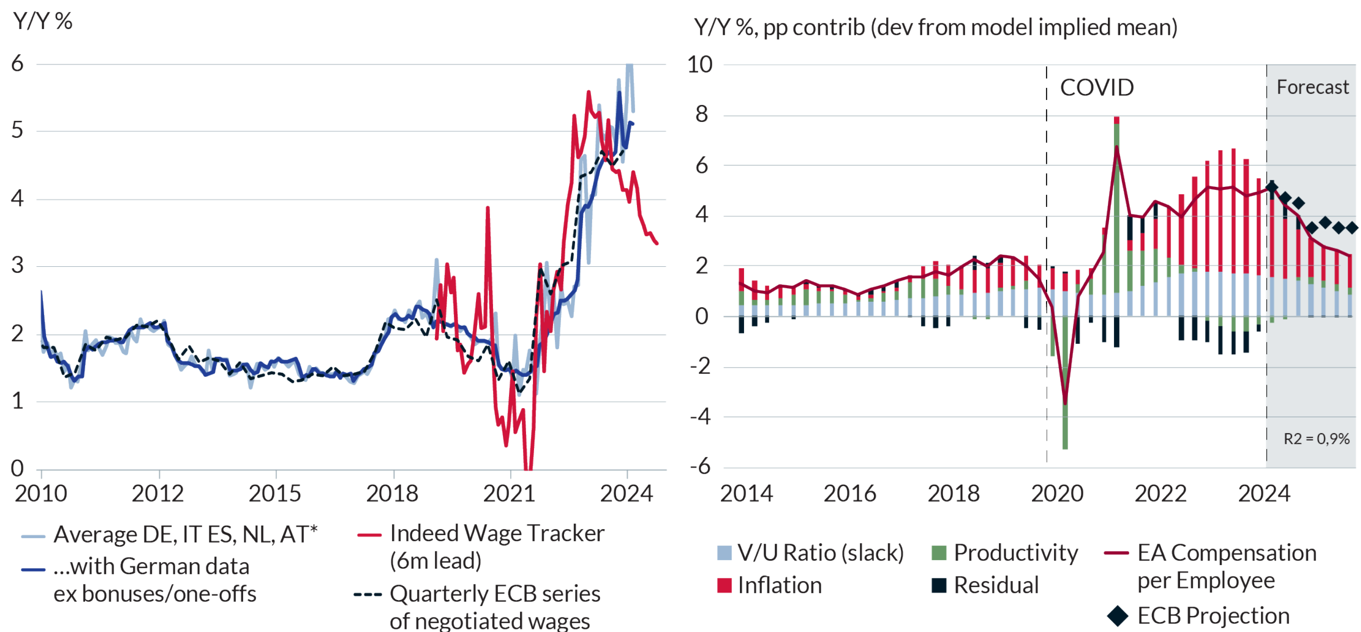
Ongoing profit margins compression



Notes: Here we further decompose ULC as ULC = compensation per employee(employee/hours)*hours/real GDP ie with hours/employee and hourly productivity having a "negative" contribution to ULC.*
Decomposition methodology in line with ECB calculations (see here).
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

FIGURES 21A AND 21B

Wages point to a gradual deceleration

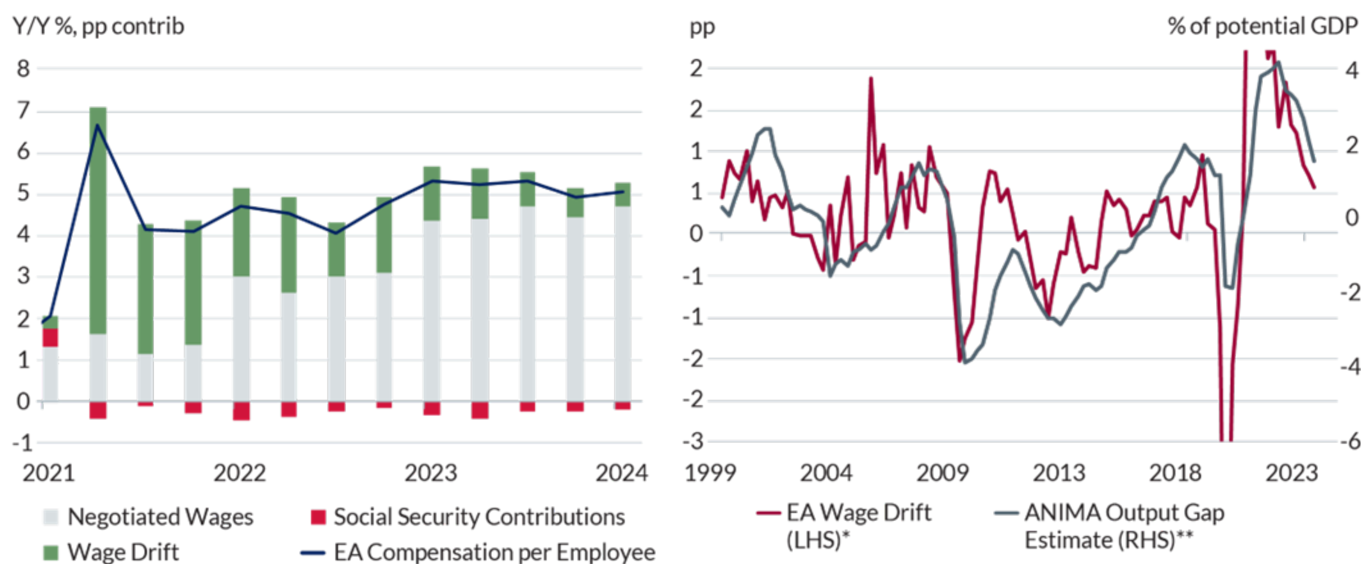


Note on Figure 21A: the average excludes France, because France only publishes wage data on a quarterly basis.
Note on Figure 21B. Model based on an augmented Phillips curve that relate sequential growth in compensation per employee to measures of labour market slack, inflation catch-up and other factors (including lagged wage growth, trend labour productivity and country-specific effects).
Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

3. In this regard, the ECB may also find comfort in the fact that the wage drift, i.e. the measurement that captures the quota of extra compensation that exceeds the negotiated salary (such as bonuses), is slowing down (**Figure 22a**). With the gradual cooling of demand for labour and the attenuation of employment imbalances, we expect that the wage drift will continue to slow down (**Figure 22b**), further contributing to reduce wage pressures.

FIGURES 22A AND 22B

The wage drift is narrowing



Note on Figure 22A: Wage drift reflects elements not agreed via collective bargaining, such as individual bonus payments or changes in overtime, and therefore it usually reacts quickly to changes in economic conditions.
Aggregate wage drift is not observable, and is here derived as the difference between growth rates of gross wages and salaries per employee and those of negotiated wages. See: ECB: Tracking euro area wages in exceptional times.

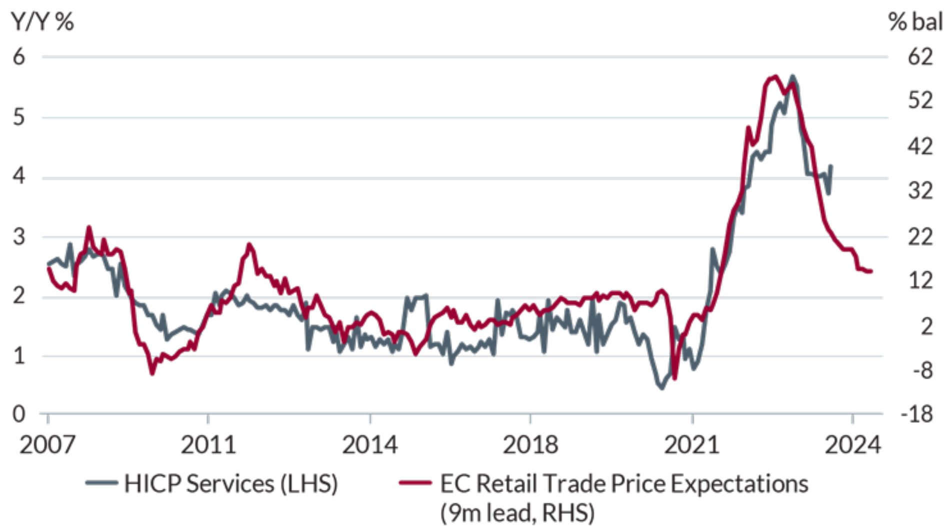
*** Note on Figure 22B: The output gap is unobservable in real time and can be estimated only with a high degree of uncertainty. That said, indicators of short-term economic slack, such as capacity utilization, the unemployment rate and labor as a factor limiting production, can provide some real-time signal around economic slack. We estimate a survey-based measure of economic slack through an unobserved component model that maps survey data (such as factors limiting production for industry, construction and services - weighted by GVA shares) and the unemployment rate to GDP dynamics. See here.*

Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

4. Though during summer, the momentum on the prices of services could remain volatile, including due to the UEFA European Football Championship in Germany and the Olympics in France, the trend will remain on a downward trajectory, in line with the signs shown by many early indicators (**Figure 23**).

FIGURE 23

Leading indicators point to more disinflation ahead



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

Overall, we expect that core inflation will come to 2.7% in 2024 and will follow a process of progressive moderation: 2.7% year-on-year in the second quarter, 2.6% in the third quarter and 2.5% in the fourth.

China – End of deflation in sight

Inflation remained close to zero in the first quarter, before showing shy signs of life from April/May. The driver of this growing inflationary dynamic, though weak, is the turning point in the cycle of prices of pork meat, which reached minimum levels in late 2023, is regaining ground and should continue to increase at least until the end of the summer, supporting the general level of prices of foodstuffs. Even production prices continue to experience reflation and in May recorded the first positive month-on-month change since the end of 2022. In this context, we believe that the deflationary condition that China experienced from January 2023 onwards is slowly dissipating, with the driving force of food prices, which have the greatest weighting in Chinese trolleys. Nevertheless, in 2024 the wide imbalances between supply and demand will continue to put the brakes on consumer prices.

In relation to core inflation, the trend in the first half of the year remained all but unchanged at around 0.6% (the same level recorded since mid-2023), in the wake of an inflation from services that have showed weak dynamics since the flare in late 2023 (**Figure 24**). Inflation originating from the prices of manufacturing products remains equally feeble, also due to the downward pressures exerted by the excess in domestic production on output prices (**Figure 25**). The latter should maintain an upward trend in the coming months, at least due to the contribution of the base effects.

FIGURE 24

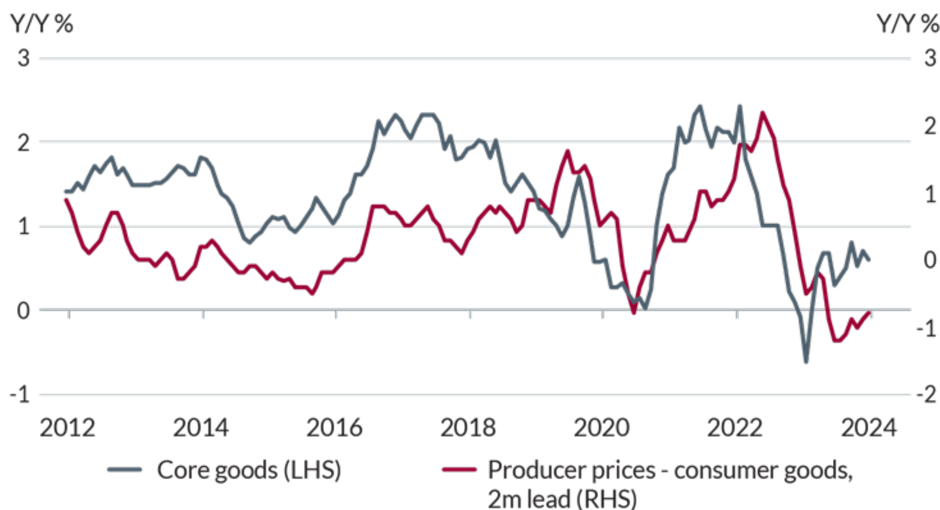
Services inflation weakened after the flare-up at the end of 2023

Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

The recovery of prices, however, will not be widespread: we remain of the idea that China is experiencing a prolonged phase of low inflation due to structural changes imposed on the national economic system by authorities. In the second half of the year, with the balance between supply and demand still imbalanced in favour of the former, pressures on prices will increase gradually. Nonetheless, inflation will remain much lower than the 3% target set by the central bank for 2024.

FIGURE 25

Producer prices underwent a strong downward correction



Data as of 2 July 2024. Source: Haver Analytics, ANIMA Research

CENTRAL BANKS

Federal Reserve – Towards the first rate cut

Inflation data for the first quarter published in the United States showed the disinflation process coming to a halt, making the Fed more cautious about the timing of the first rate cut and more hawkish in its rhetoric. At the June meeting, the members of the FOMC upwardly revised their expectations on inflation in 2024 (from 2.4% to 2.6% for headline PCE inflation, from 2.6% to 2.8% for core PCE inflation) and the number of cuts expected in 2024 fell from three to just one.

However, we are still convinced that there will be two cuts this year, for 25 basis points each, at the meetings in September and December. There are multiple reasons for this:

1. The last two reports on the price dynamics were encouraging: the momentum of supercore inflation slowed significantly across all components. In the upcoming months, a certain volatility could return in several categories of prices, but we believe that the disinflation process will continue to progress.
2. In our view, in light of the fact that the US economy is entering the final phase of the post-pandemic economic cycle, our reading of the most recent data on consumption is more cautious than that of the Fed.
3. Supply and demand on the labour market continue their rebalancing towards pre-pandemic levels.
4. The rhetoric of Chair Powell remains more accommodating than that suggested by the macroeconomic estimates or by the valuations of the FOMC members reported in the dot plot.

As for the budget policy, the Fed announced a slowdown in quantitative tightening as early as June: the maximum amount of treasuries that could mature without being reinvested fell from 60 to 25 billion dollars per month. We expect that the programme will conclude in the first quarter of 2025, leaving a high stock of treasuries in the budget (at the moment, the Fed holds around 16% of the tradable government debt of the United States).

European Central Bank – A gradual approach to the next cuts

At the June meeting, the European Central Bank cut the rates by 25 basis points, without providing additional indications on future interventions. The rhetoric of the various members of the Council remains overall very cautious, centred around the mantra that the pace and extent of the cuts will depend on the flow of data. The approach will remain cautious and gradual. In addition, President Lagarde indicated that the level of the rates would remain restrictive, even in the case of further monetary easing.

We expect another two cuts of 25 basis points each in 2024, one fewer than the estimates at the beginning of the year, for various reasons:

1. The growth forecasts for the Euro Area in 2024 have been revised slightly upward, after the GDP report in the first quarter showing a more marked resilience in the economy than expected.
2. Pressures on prices will continue to slow in the coming months, but the inflation of services could remain volatile during summer, pushing the ECB to maintain a moderately hawkish rhetoric.
3. The probability that the Fed will cut the rates before September is very low and this also reduces the margin for manoeuvre for the ECB. In recent history, the ECB has almost always cut or raised the rates after the Fed: an aggressive intervention before the American central bank would have an impact that was difficult to quantity and seems less likely for this reason.

China – Authorities will continue to support the economy, but looking to the future

The tug of war in China between the “organic” reacceleration of the economy and the “inorganic” support from political authorities is not set to ease off any time soon. In the second quarter, policy-makers approved new measures to begin to dispose of at least a small part of the stock of properties built and unsold accrued by the private sector. The real estate segment continues to face difficulties. This measure supports our theory that the authorities aim to support growth with ad hoc measures only if and when necessary to achieve the objective of GDP expansion of 5%, which we believe will be the new standard of growth for the foreseeable future.

As a matter of fact, faced with the risk of a slowdown in economic activity, at the Politburo meeting in late April, the intervention policies were swiftly adjusted, increasing net issues of SGBs (Special Government Bonds). In addition, the State Council requested to ease the implementation of the measures already approved to favour property sales and promised to explore new policies to further reduce the stock of unsold properties. At the Politburo in July, we expect that the focus will shift to progress and technological supremacy, which will be the new strategic objective in which China will invest massive resources.

With reference to the monetary policy, the context is largely unchanged compared to the start of the year: we expect that the PBoC will cut the required reserve coefficient by 50 basis points and the benchmark monetary rate by 10 basis points by the end of the year. The risks remain oriented towards a sharper development in the stimuli, once the Fed has launched the expansive cycle.

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