ZITA PLUS

GLOBAL ECONOMIC INSIGHTS

2025

TRENDS,CHALLENGES, AND OUTLOOKS

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Global Economic Insights 2025

Trends, Challenges, and Outlooks

The global economic outlook remains positive, with the slowdown in U.S. economic activity unlikely to lead to a recession. Global price pressures are expected to ease further. Although U.S. policy changes present some upside risks, the priority remains controlling inflation.

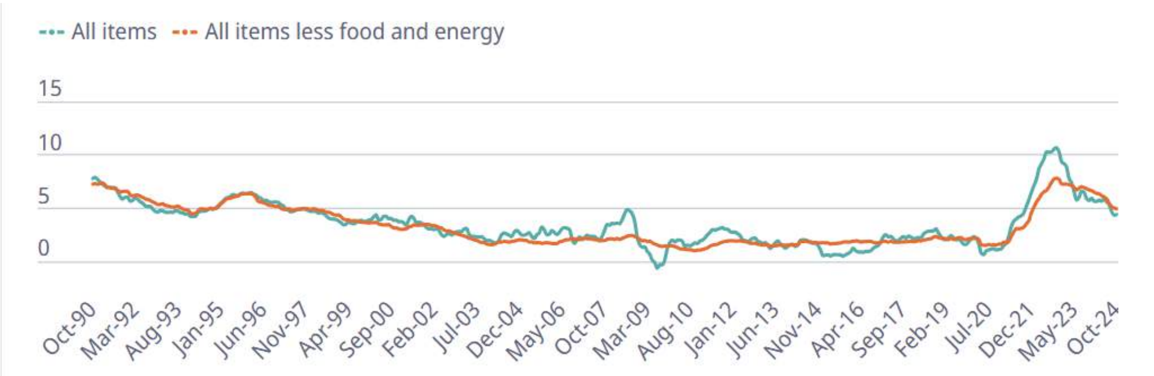

Table: Inflation Since the 1990s: All items and all items less food and energy
Source: OECD

However, there are a few key considerations. While many developed economies are easing monetary policy, rates are unlikely to reach pre-pandemic lows.

Market volatility, though increasing, doesn't fully reflect growing economic uncertainty. This is partly due to positive shifts in key economies like the U.S. and India. Central banks may need to respond more aggressively to stabilize inflation expectations.

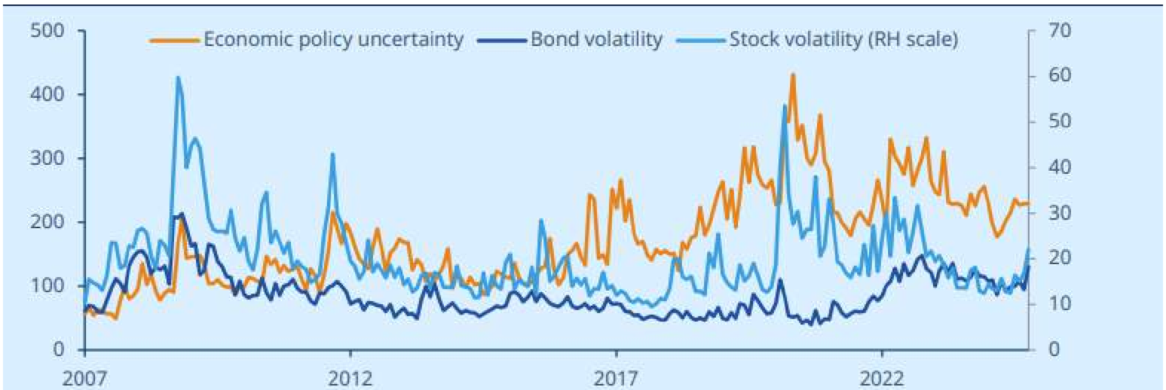

Table: Correlation between economic uncertainty and market volatility
Source: Amundi Investment Institute, Bloomberg

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Anomalies like low equity volatility in a year of high uncertainty or the resilient U.S. consumer during a rapid tightening cycle may not persist. A reversal could boost demand for fixed income, inflation-linked debt, and gold.

Political decisions may also drive demand for safe havens like gold. While 2024 is a pivotal election year, elected leaders will need to address long-deferred issues to avoid more serious problems later in the decade. For example, U.S. President-elect Trump will face record debt levels, significant structural deficits, and rising interest payments, with pre-election pledges contributing to continued debt accumulation. As long as the U.S. economy grows, investors are likely to maintain confidence in Treasuries, although the fiscal outlook suggests higher volatility in fixed-income markets. Market fluctuations may be amplified, as the demand for U.S. debt is shifting, with the Federal Reserve, commercial banks, and investors in China and Japan absorbing a smaller proportion of new debt issuance.

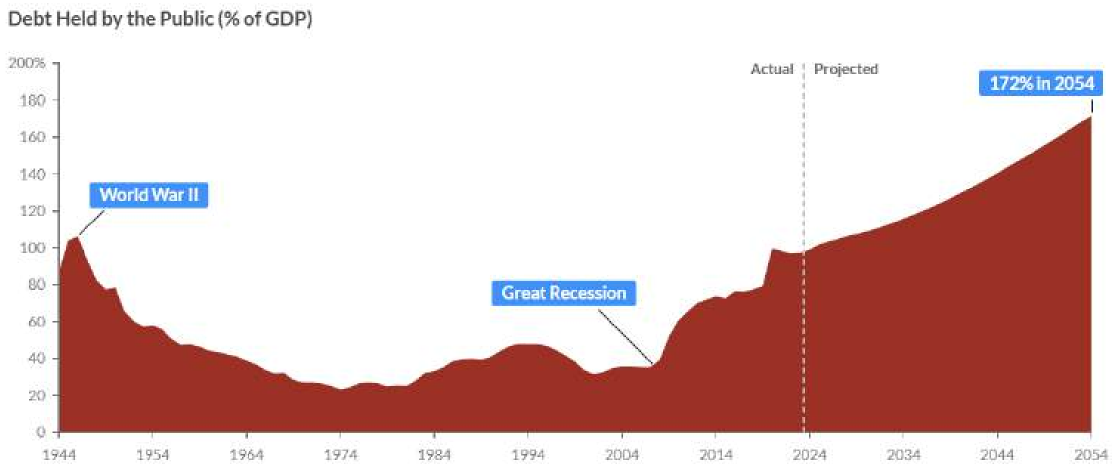


Table: U.S. Government Debt

Source: Congressional Budget Office, Office of Management and Budget

Washington is expected to prioritize geostrategic competition, focusing on technological leadership in AI, quantum computing, and semiconductors. Certain manufacturing activities will be deemed matters of national security, leading to a more inward-looking U.S.

This shift will encourage European politicians to focus on strategic autonomy and address the productivity and investment gap with the U.S. While Draghi's report offers a roadmap, stronger political commitment is needed. Ideas like issuing common EU debt could be the key significant change.

Other regions, however, do not face such constraints. Chinese policymakers have room to implement additional fiscal stimulus. The effectiveness of this will depend on its scale, timing, and focus. Gulf states are increasing infrastructure investments, potentially boosting demand for commodities.

U.S. DOLLAR

The U.S. economy is slowing due to weakening domestic demand and labor market conditions. Disinflation continues, but inflation risks remain, possibly prompting Federal Reserve policy adjustments.

Real GDP is projected to grow 1.8% in Q4, with 2024 annual growth at 2.3%. Consumer spending, accounting for 78% of GDP growth in the first three quarters, rose 3.0% in Q3, up from 2.7% in Q2, supported by real after-tax income gains. High-income households led spending growth, while others remained cautious.

Real wage growth will sustain consumer spending, though its contribution to overall growth may decline. U.S. elections could influence Fed policy.

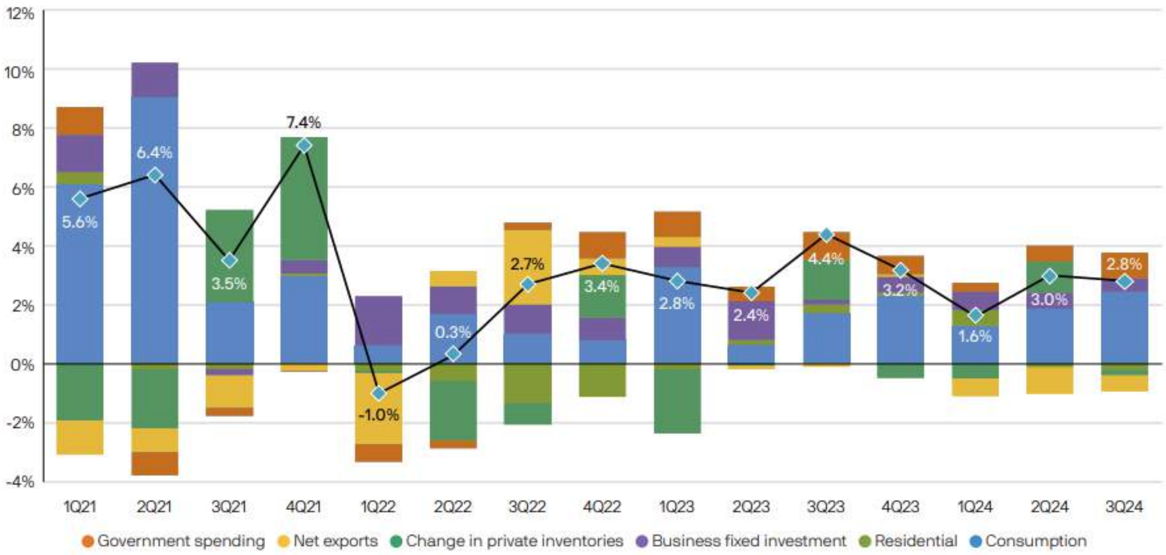


Table: Contributors to real GDP growth, q/q change, annualized rate

Source: JP Morgan

Market expectations for the Federal Reserve halting rate cuts have risen sharply, particularly for the October 2025 FOMC meeting. Forward pricing of the Fed funds rate increased by 100 basis points in two months, from 2.9% to 3.9%, driven by concerns over inflationary pressures from tariffs, tax cuts, and labor supply constraints. In contrast, expectations for other central banks have remained stable, with the Fed-ECB rate gap exceeding 200 basis points, more than doubling during the same period.

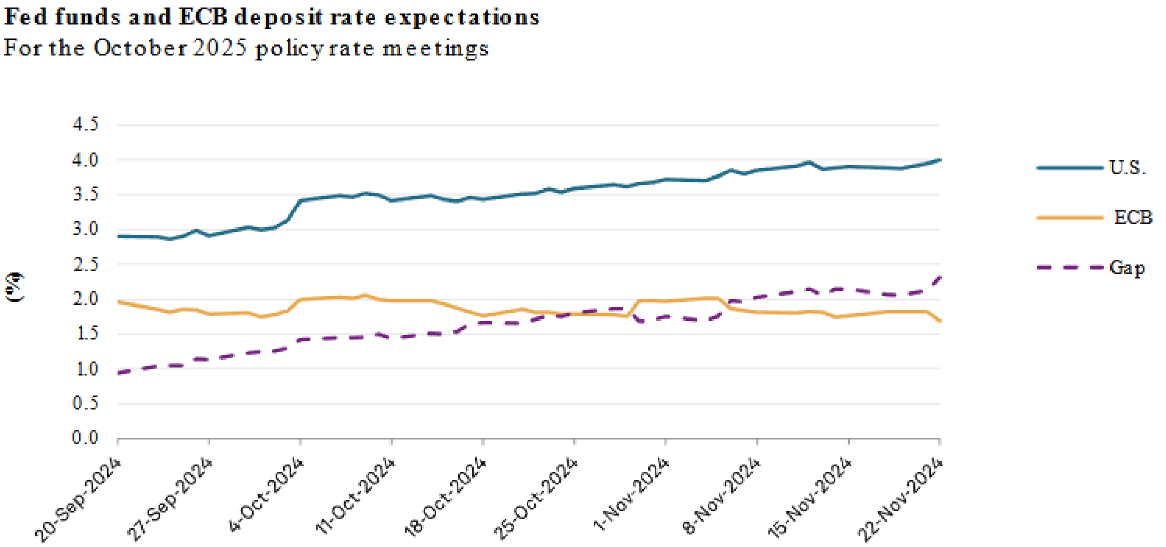


Table: Fed funds and ECB deposit expectations
Source: ECB, CME

The U.S. economy's unconventional cycle, triggered by the Covid-19 pandemic, was marked by fiscal and monetary measures that stimulated activity and tightened the labor market. This caused a surge in inflation in 2021-2022, driven by supply chain disruptions, the war in Europe, and domestic policies like the Inflation Reduction Act. To combat entrenched inflation, the Fed raised interest rates to levels last seen in the late 1970s, prompting mild recession fears, particularly during the banking crisis. However, high household wealth, fiscal stimulus, and the Fed's swift actions mitigated impacts, allowing growth to resume. Disinflation set in, with inflation rates dropping and expectations stabilizing. A soft landing is expected, with slower growth over the next 18–24 months due to cooling domestic demand.

Key factors to monitor that could influence the U.S. economic cycle include:

1. **Labor Market**: Labor supply will be influenced by factors like turnover, wage growth, layoffs, and immigration policies. A gradual cooling of the labor market, without sharp increases in layoffs, aligns with the central scenario.
2. **Inflation**: Core inflation in services, especially shelter, and goods will shape Fed policy. Tariffs could raise goods inflation, offsetting disinflation trends depending on their scope and timing. Core disinflation, driven by normalizing supply chains and cooling demand, is evident in goods and moderating shelter inflation. This trend is expected to persist if domestic demand slows, barring energy or supply chain disruptions.

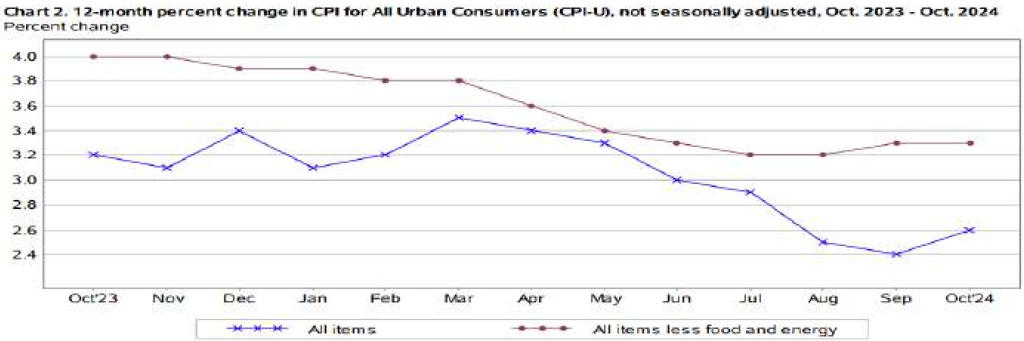


Table: 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, Oct. 2023 - Oct. 2024
Source: U.S. Bureau of Labor Statistics

3. **Fiscal Policy**: Bold fiscal stimulus could impact growth and inflation but may tighten financial conditions if seen as unsustainable.
4. **Monetary Policy**: With a softer labor market and improving inflation, interest rates could gradually drop, potentially reaching 3.5% by mid-2025. However, post-election policy shifts and increased government debt could make the rate path less predictable.

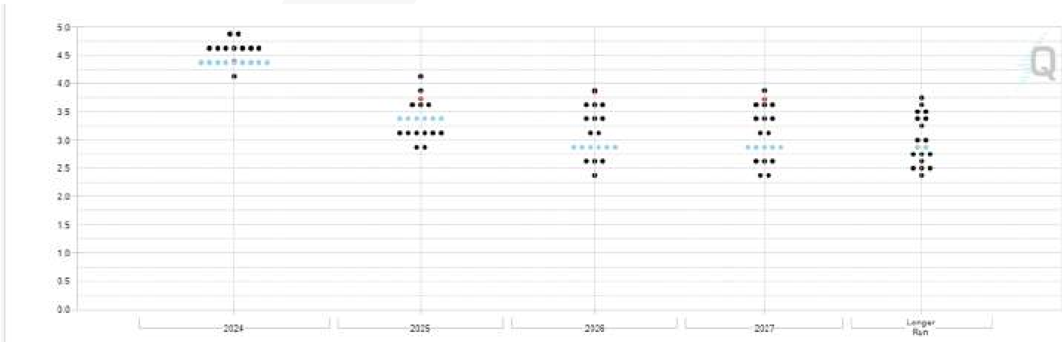


Table: FOMC participants assessments of appropriate monetary policy: "Dot – Plot"
Source: CME

Europe

Europe is set for a modest recovery next year, driven by disinflation and accommodative ECB policies, though fiscal support remains constrained by EU rules. Consumption and domestic demand are expected to rise with lower interest rates and increasing real incomes. Investment should rebound, supported by delayed projects, green transitions, and technological advancements, though long-term investments and strategic policies are critical for competitiveness. External trade risks have grown post-U.S. elections.

Growth will vary across the Eurozone, with Germany lagging, France and Italy seeing moderate growth, and Spain expected to outperform.

Europe's growth next year depends on disinflation and flexible ECB policies, with fiscal support limited by EU guidelines. External trade's contribution will decline amid rising protectionism. Easing ECB policies and higher real incomes should boost consumption and credit growth, with potential growth of 1% by 2025. Inflation is expected to align with ECB targets by mid-2025, supported by high savings rates.

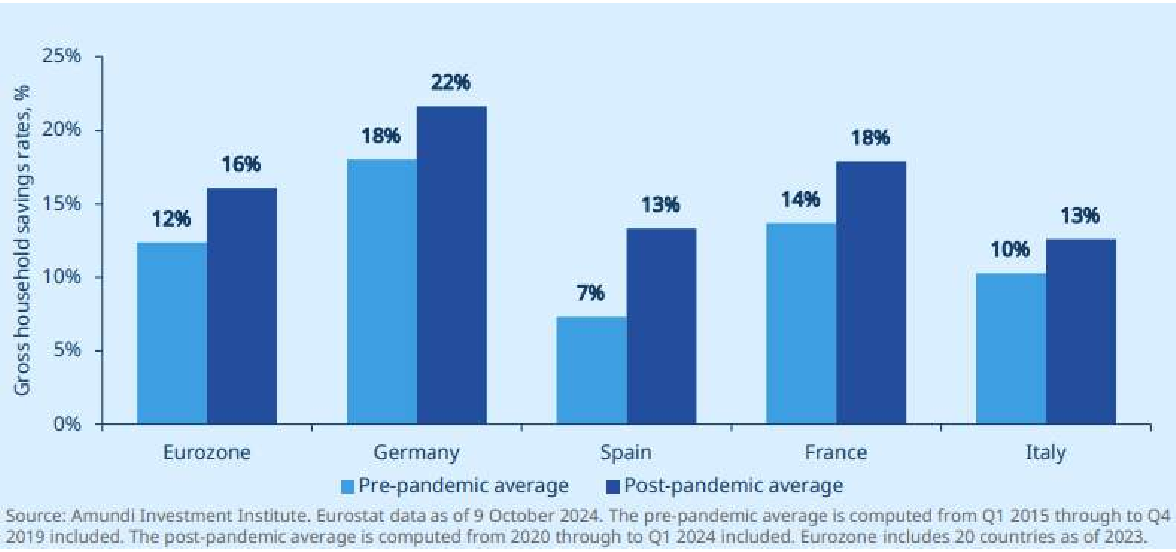


Table: Pandemic impact on household savings rates in Europe
Source: Amundi Investment Institute

Europe faces challenges in weak productivity and underinvestment, exacerbated by advances in AI, digital economies, rising protectionism, and interventionist policies. Closing the gap with the U.S. and fostering competitiveness will require substantial investments.

In the short term, Eurozone growth recovery is expected as monetary easing takes effect. Private consumption remains weak due to high savings (4% above pre-pandemic levels) and low confidence but should gradually recover with rising incomes, easing inflation, and lower ECB rates. Risks include labor market slowdowns, which could hinder growth.

Table: GDP growth rates over the previous quarter
Source: Eurostat

Investments are expected to recover in 2025, driven by delayed Next Generation EU projects, the green transition, and Industry 4.0/5.0 initiatives. Addressing higher depreciation from rapid technological advancements like AI will also be key.

Lower interest rates should boost growth across the Eurozone, though impacts will vary. Germany is projected to lag, France and Italy to see moderate growth, and Spain to outperform into 2025. Fiscal policy and deficit reduction efforts may dampen growth, particularly in Germany, France, and Italy.

Asia Markets

Emerging Asian economies are seeing strong growth, driven by dominance in the ICT supply chain and supportive fiscal and monetary policies. Asia's share of the $2 trillion ICT goods market grew from 75% in 2017 to nearly 80% by 2021, with East Asia accounting for 60%. Vietnam and Malaysia are rapidly increasing their contributions. Moderate inflation has enabled less restrictive policies, fostering robust growth.

Regional trade integration, strengthened by the RCEP, supports resilience across electronics, semiconductors, agriculture, and textiles. Intra-regional trade within emerging Asia rose to 23% of exports in H1 2024, up from 21% in 2018 and 10% at the start of the century. India and Indonesia show long-term growth potential, while China's economy stabilizes amid ongoing policy shifts.

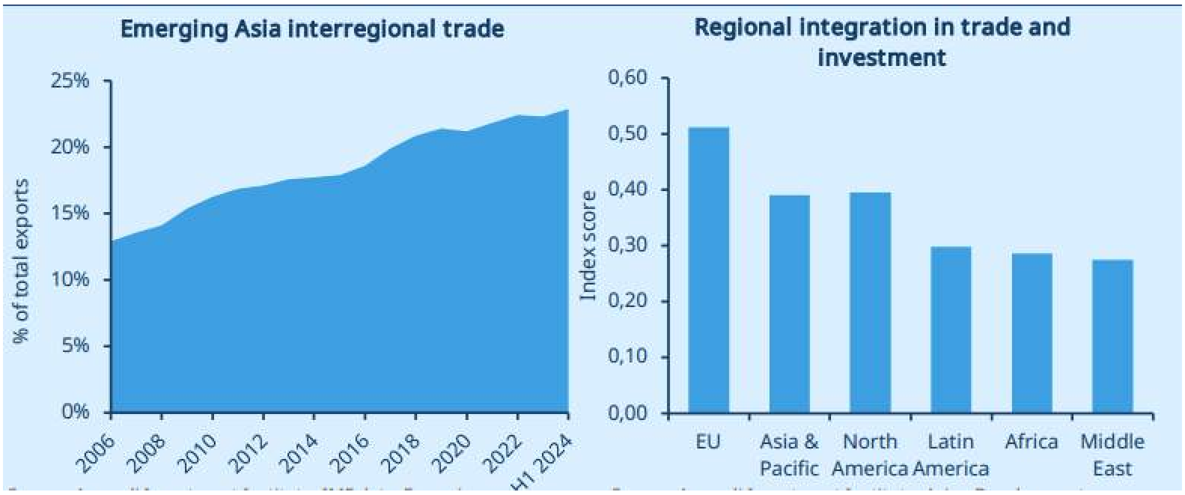


Table: Interregional Trade
Source: Amundi Investment Institute

Looking towards 2025, India is experiencing a natural slowdown after recent strong economic momentum. Weak performance in capital, infrastructure, and construction sectors points to a moderation in growth, which is expected to stabilize between 6% and 7%.

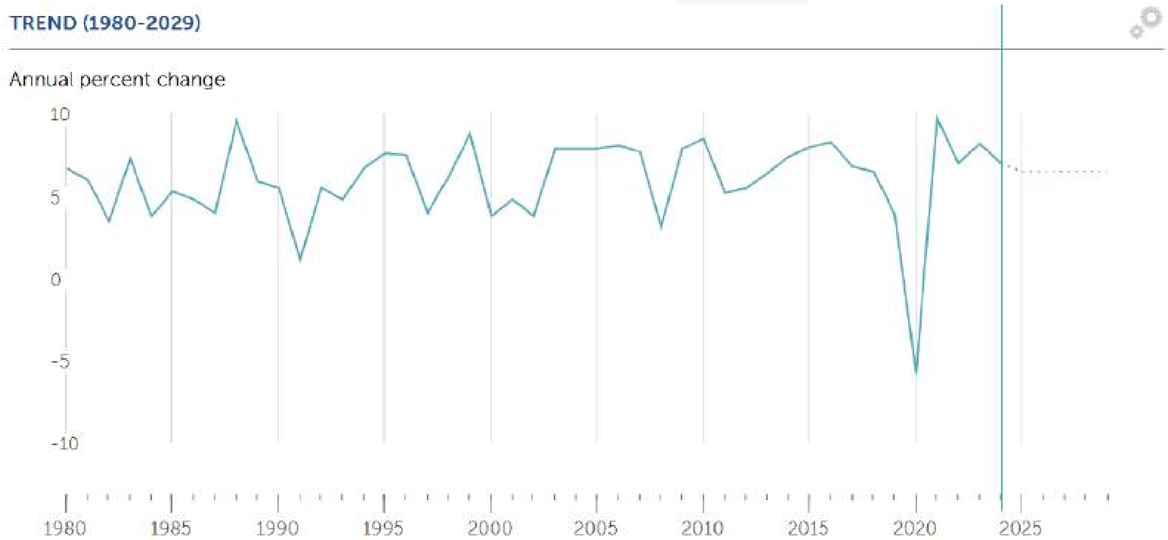


Table: India Real GDP
Source: IMF

India's current account deficit, estimated at 1% of GDP, remains manageable due to a reduced oil import bill and export growth. Inflation, particularly in food prices, is expected to stay within the RBI's target range, though living costs may rise. The RBI has limited room for monetary easing, with a potential 50-75 basis point rate cut. India is prioritizing its global value chain position and infrastructure improvements.

Gold

Gold's upward trend is supported by medium-term factors such as monetary easing (M2 supply growth), fiscal imbalances, rising U.S. debt, central bank purchases (notably from non-dollar-aligned countries), US-China tensions, geopolitical uncertainties, and slow mining sector growth.

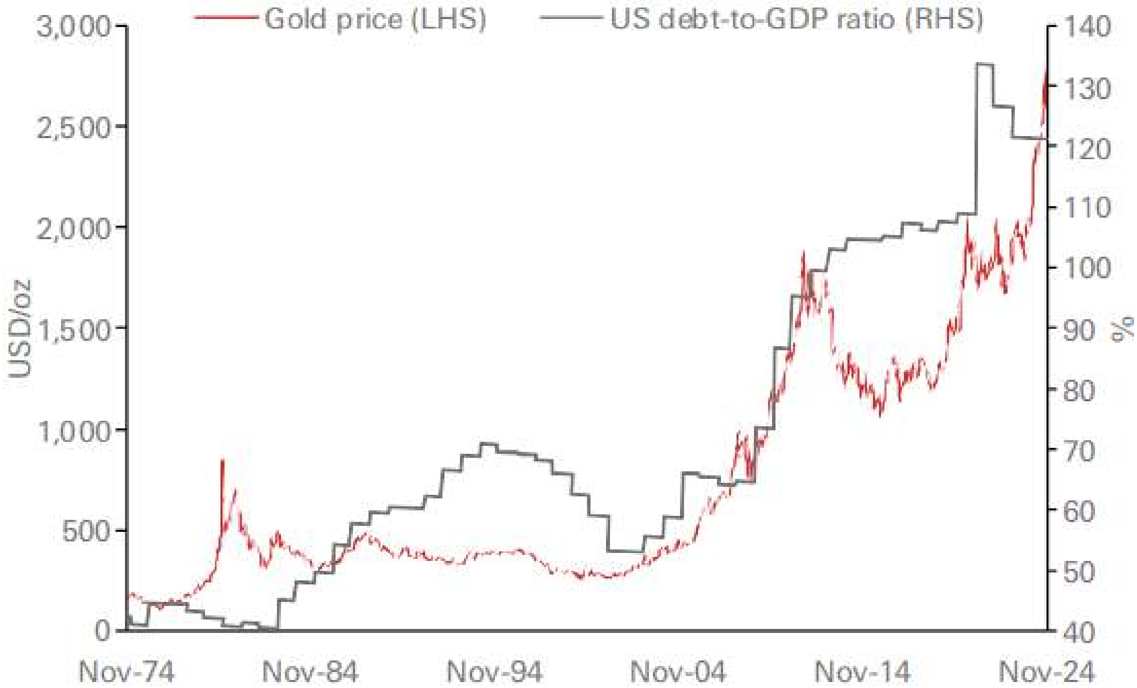


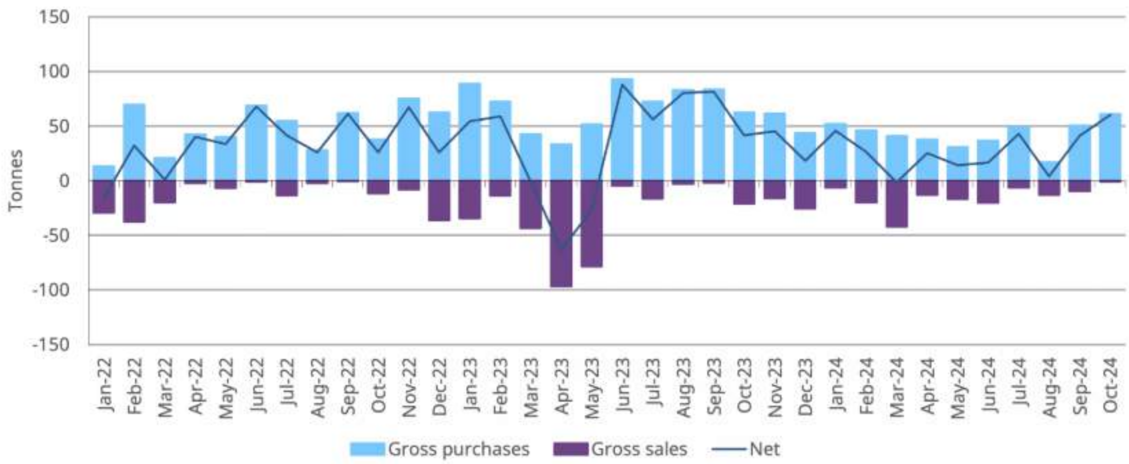
Table: US Debt vs Gold Price

Source: HSBC

Table: M2 money supply increase

Source: Federal Reserve Bank of St. Louis

Monthly reported central bank activity, tonnes*



*Data to 31 October 2024 where available. Note: chart includes only purchases/sales of 0.5t or more.
Source: IMF IFS, respective central banks, World Gold Council

Table: Monthly reported central bank activity
Source: IMF, IFS, World Gold Council

However, any upside is likely to be limited as gold continues to defy expectations. Valuations are high, long positions have become widespread, and price elasticity is beginning to dampen demand for gold jewelry.

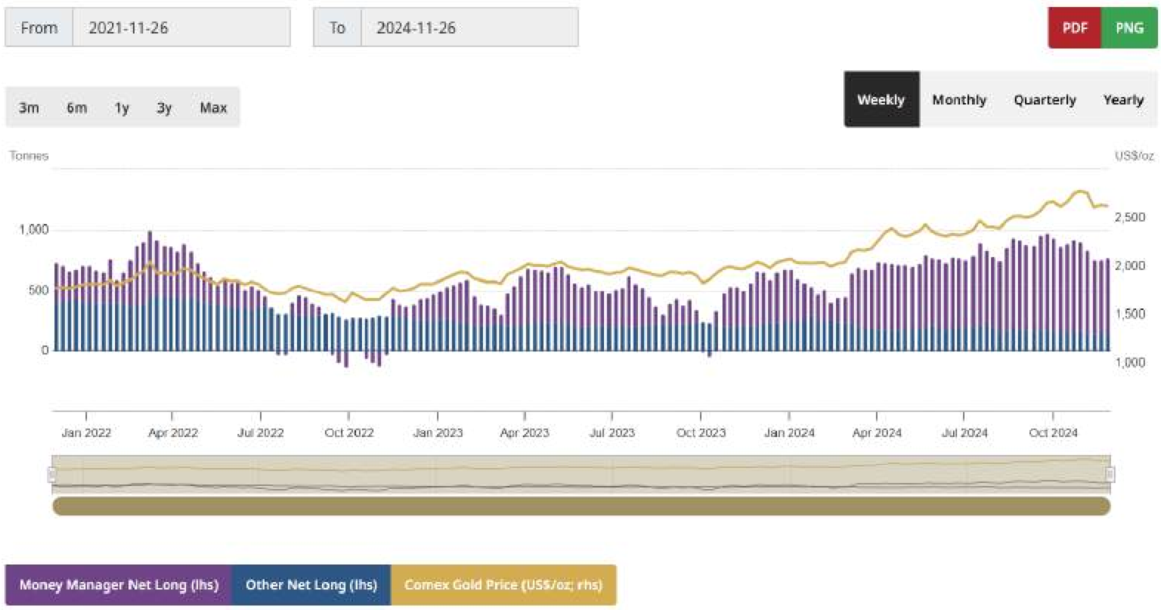


Table: Gold net long positions
Source: IMF, World Gold Council, COMEX

Base Metals

China's debt reduction and the energy transition are key factors in the metals market. While China's stimulus reduces systemic risks, it won't reverse long-term trends in the property sector. Global growth stabilization and monetary easing are expected to boost metal demand, driven by the energy transition and electric vehicles. Medium-term metals investment remains attractive.

Fixed Income

As inflation trends toward long-term averages, central banks are expected to shift to neutral policies, reducing recession risks and emphasizing bonds' income potential with higher yields. Investment opportunities include investment-grade and short-term high-yield credit, leveraged loans, emerging market bonds, and private debt.

With inflation returning to mid-1990s–2019 levels, restrictive policies are no longer needed. By mid-2025, rates from the Fed and ECB are expected to reach neutral levels, with U.S. Treasuries leading bond performance. Bonds will play a key role in portfolio diversification, offering solid income and higher yields amid low recession risks.

After two years of benefiting from central bank rate hikes, money markets are expected to pivot to fixed income investments in 2025 as rates decline. Bond investors should monitor three key trends:

1. Curve Movements: As rate cuts continue in Europe and the U.S., we anticipate 2-year yields will decline, causing the gap between 2-year and 10-year yields to widen.

Table: 10-2 Year Treasury Yield Spread
Source: Y Charts

2. Income as the Primary Driver: Income will drive performance, with investment-grade credit outperforming government bonds due to lower volatility. High-yield bonds may gain from strong corporate cash flows but face interest rate volatility. Emerging market bonds will benefit from high yields and falling rates.

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3. Regional Opportunities: U.S. bonds are expected to lead, with Treasuries potentially achieving their best performance since 2023. Europe may see solid returns, while Japanese Government Bonds are likely to underperform in 2025.

With yields higher than in the past decade and modest capital gains potential, 2025 is expected to be another strong year for fixed income investments.

Region Specific Outlook

- United States: A soft landing is expected with slower growth, falling inflation, and reduced imbalances.
- Europe: Moderate growth and inflation returning to target levels, supported by green investments and fiscal sustainability.
- Japan: Improved fundamentals with inflation expectations anchored despite global spillovers.
- China: Policy support aims to reverse structural slowdown and drive transformation.
- India: Strong growth persists, aligning with a 6.5% potential by 2026, driven by demand and investments.
- Emerging Markets: Robust growth continues, with Asia as the key driver of global expansion.

Market Recap

Geopolitical tensions and global economic fragmentation, driven by rising protectionism and sanctions, are reshaping trade and supply chains. The Ukraine conflict persists with a potential ceasefire, while Middle East negotiations and conflicts continue. U.S.-China relations are deteriorating, and U.S.-Europe tensions remain strained.

Disinflation is expected to continue, but inflation risks persist. Developed market central banks aim for neutral rates by 2025, while many emerging markets are nearing peak rates. Fiscal policies diverge: the U.S. faces scrutiny with a possible Trump presidency, the EU focuses on consolidation, and China maintains expansionary measures.

Climate change hampers growth and fuels stagflationary trends. China dominates critical mineral supply chains, while the U.S. works to narrow the gap.

Growth trends are shifting, with Europe seeing modest recovery, the U.S. slowing but retaining strong potential, and emerging markets, especially India, showing upward revisions.

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