Soft landing in times of political uncertainty

Following the sudden shift in monetary policy expectations since the second week of November last year, which led to one of the sharpest rallies in the value of financial assets in recent decades (+9% in fixed-income securities in the last two months of 2023, a bi-monthly peak since 1990), it is necessary to adjust the economic outlook scenario and assess whether investors have gone too far by anticipating an overly idyllic scenario, in which the resilience of the business cycle to the recent monetary tightening will be accompanied by a rapid return of inflation to 2%. Right now, the consensus of forecasts has clearly shifted towards a soft landing of the world economy in 2024, anticipating average growth similar to that of 2023 and a continuation of the divergences between sectors and economic regions. However, 2024 is expected to have a completely different profile to last year, with a first half characterised by significant economic weakness that will give way to an improvement in the second half of the year, as the effects of both the drop in inflation and the easing of financial conditions materialise. The intensity of these two processes under way will determine when potential growth rates can be recovered, currently weighed down by a succession of negative supply shocks in recent years, pending the positive effects of investments in the energy transition as well as the boost to productivity promised by the latest generation of innovations (AI, etc.).

The December employment data in the US (+216,000 jobs created, giving a total of 2.7 million in 2023), as well as the oil price remaining below 80 dollars a barrel in the first sessions of the year, reflect the fact that two of the main factors behind the resilience of the business cycle in the last year remain in force. Specifically, labour markets continue to show strength and the tensions in energy prices remain contained, in what is a rather unfavourable context marked by the monetary tightening accumulated in the last two years and the heightened geopolitical tensions in the Middle East. In this regard, the onset of winter in Europe is subject to much less uncertainty this year, taking into account gas prices and the levels of reserves compared to those of a year ago. That said, the recent weakness in economic activity will continue over the coming months, considering the ongoing sluggishness in economic agents' expectations, the negative inertia in the industrial and retail data, and the effects of the expected turnaround in fiscal policy.

However, it is on the inflation front that the outlook remains more open, despite the positive surprises of the last half-year. December's inflation figure in Europe was in line with forecasts and anticipates some of the trends we can expect to see in the short term: moderation in the base effects of energy, mixed dynamics in food inflation (better performance in processed foods than in unprocessed foods) and differing behaviour in the main categories of the core index, with relatively rapid normalisation in industrial goods (excluding energy) and greater downward resistance in the case of services. For this reason, although the measures of short-term patterns in underlying component prices (momentum) are offering positive signals, there are still some doubts (and risks) regarding the price dynamics that will unfold in the coming months. These doubts extend, therefore, to when inflation can be expected to stabilise again at around 2%. In that regard, the messages of the central banks at their December meetings appear to be quite coherent, trying not to deflate expectations of declines in interest rates, on the one hand, while highlighting the dependence of their decisions on the data that will emerge over the coming months, on the other. It is in this context that inconsistencies emerge between the new interest rate expectations anticipated by the markets and the soft landing scenarios. After all, without further and significant weakening of economic activity, with the direct implications this would have for inflation, it is hard to believe that the central banks will feel any urgent need to cut interest rates as early as Q1. This is especially the case considering the effects that the challenging electoral calendar that awaits us in 2024 will have on geopolitical risk and the tone of global fiscal policy, beginning with the elections in Taiwan on 13 January and ending with the US presidential elections on 5 November. After the experience of recent years, we know all too well how political risk can alter the behaviour of key hypotheses in economic forecasting scenarios.

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