2024 US Economic Outlook

Between a soft landing and a mild recession

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The US economy greatly beats expectations in 2023 as the aggressive policy rate hikes have not curbed the expansion of household consumption, business capex and government spending. However, the economy may slow down in 2024 due to continuous credit tightening, weakening employment, a falling fiscal deficit ratio, and exhaustion of excess savings. Real estate and durables have already contracted since last year, while service may soften next year. The unsynchronized downturn across various sectors and a strong balance sheet of the real sector tend to reduce the risk of an economic recession. Inflation is expected to further decline thanks to moderating rents, wage growth and commodity prices. The Fed may start a cycle of interest rate cuts in May or June next year, which could lead to a moderate decline in the US dollar index.

- The US economy could come between a soft landing and a mild recession with nominal and real GDP growth respectively down from 6.2% and 2.3% in 2023 to 3.1% and 0.8% (market consensus at 3.6% and 1%) in 2024. It may see a slight QoQ decline in 1H24.
- Real growth of household consumption may slow from 2% in 2023 to 0.8% (market consensus at 1%) in 2024 because of a cooling job market, rising savings rate, excess savings depletion and consumer credit tightening.
- Housing sales dropped while supply shortage prevented price declines. Housing sales may modestly improve in 2024 due to falling interest rates and supply improvements, but it is unlikely to enter a new boom cycle. Commercial real estate market especially office buildings may continue to face pressure.
- Business investment especially in manufacturing construction has been strong in 2023 as the government has tried to revitalize manufacturing with subsidies. Due to credit tightening, high-cost pressure, softening aggregate demand and diminishing effects of policy stimulus, however, business investment growth is likely to moderate from 3.3% in 2023 to 1.8% in 2024.
- Export growth is expected to decrease from 2.8% in 2023 to 1.1% (market consensus at 0.5%) in 2024 while import growth is estimated to increase from -1.9% in 2023 to 1.4% (market consensus at 0.4%) in 2024. The base effect, ending of the inventory destocking cycle, industrial price recovery and improvement in China & Europe economies should support a pick-up in global trade in 2024.
- The disinflation should continue with PCE and core PCE inflation respectively down from 3.8% and 4.2% in 2023 to 2.3% and 2.4% (market consensus at 2.6% and 2.7%) in 2024. Major contribution is from the base effect, rent inflation decline, labor market cooling and low commodity prices.
- Government spending growth is projected to fall from 3.4% in 2023 to 1.3% in 2024 with federal deficit ratio down from 6% in 2023 to 5.8% in 2024 due to the base effect and Congressional constraint on a further rise of federal deficit ratio.
- The Fed may cut rates by 150bps (market consensus at 90-100bps) in 2024. The 10-year Treasury yield is expected to decline from 4.5% at end-2023 to 3.9% (market consensus 3.74) at end-2024. As the US-EU growth gap may narrow with potential easing of the Russia-Ukraine conflict, the US dollar index is expected to fall 5% from 103 at end-2023 to 97.8% at end-2024.

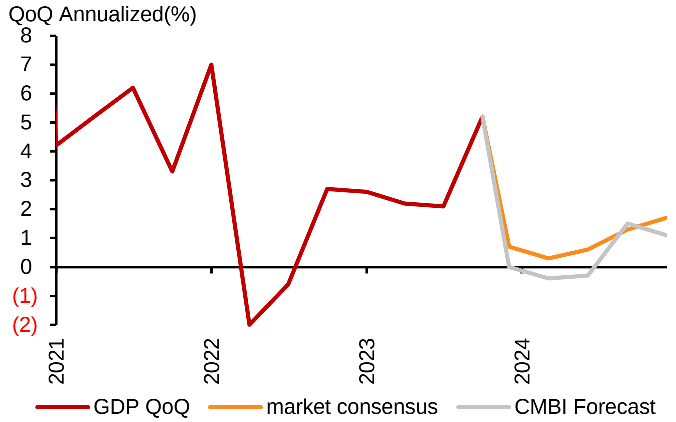
Figure 1: US Economic Forecast

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD	Decade Average	Bloomberg Median 2023F	2024F	2025F	CMBI Forecast 2023F	2024F	2025F
Nominal GDP (US$trn)	16.9	17.6	18.3	18.8	19.6	20.7	21.5	21.3	23.6	25.7	27.2	-	27.3	28.3	29.4	27.3	28.2	29.4
GDP per Capita (US$th)	53.2	55.1	56.8	57.9	60.0	62.8	65.1	64.3	71.0	77.2	81.1	-	81.6	84.2	87.0	81.6	83.7	86.8
Real GDP (YoY %)	2.1	2.5	3.0	1.8	2.5	3.0	2.5	-2.2	5.9	2.0	2.3	**2.3**	2.3	1.0	1.8	2.3	0.8	2.2
Consumer Spending (YoY %)	1.7	2.8	3.4	2.5	2.6	2.7	2.0	-2.5	8.6	2.6	2.1	**2.6**	2.2	1.0	1.8	2.0	0.8	2.2
Private Investment (YoY %)	7.4	6.5	6.3	-0.1	4.4	5.8	3.1	-4.7	9.1	5.0	-2.2	**4.3**	-1.9	1.0	3.0	-1.8	0.9	3.6
Residential	12.8	4.3	10.6	7.1	4.3	-0.7	-0.9	7.2	11.3	-9.0	-13.8	**4.7**	-	-	-	-13.5	-3.5	5.0
Non-residential	4.7	8.1	3.3	1.8	4.6	6.9	3.7	-4.7	6.0	5.2	4.3	**4.0**	-	-	-	3.3	1.8	3.2
Exports (YoY %)	3.0	3.9	0.3	0.5	4.1	2.9	0.5	-13.1	7.1	7.0	3.1	**1.6**	2.3	0.5	3.0	2.8	1.1	2.0
Imports (YoY %)	1.2	5.2	5.2	1.5	4.7	4.0	1.2	-9.0	15.2	8.7	-2.1	**3.8**	-2.3	0.4	3.0	-1.9	1.4	2.6
Government spending (YoY %)	-2.4	-0.9	2.0	2.0	0.6	2.0	3.9	3.2	-0.3	-0.9	3.8	**0.9**	3.3	1.3	0.9	3.4	1.3	1.0
Federal Deficit Ratio (%)	4.1	2.8	2.4	3.2	3.5	3.8	4.6	14.9	12.3	5.5	4.7	**5.7**	6.1	5.8	6.0	6.0	5.8	6.1
PCE (YoY %)	1.3	1.4	0.2	1.0	1.7	2.0	1.4	1.1	4.2	6.5	4.1	**2.1**	3.8	2.6	2.1	3.8	2.3	2.0
Core PCE (YoY %)	1.5	1.5	1.2	1.6	1.6	1.9	1.6	1.3	3.6	5.2	4.5	**2.1**	4.2	2.7	2.2	4.2	2.4	2.1
Unemployment rate (%)	6.7	5.6	5.0	4.7	4.1	3.9	3.6	6.7	3.9	3.5	3.9	**4.8**	3.7	4.3	4.2	4.0	4.7	4.2
Federal Fund Rate (YoY %)	0.1	0.1	0.2	0.6	1.3	2.4	1.6	0.1	0.1	4.3	5.3	**1.07**	5.33	4.33	3.33	5.33	3.83	3.33
10-Year Note (%)	3.0	2.2	2.3	2.5	2.4	2.7	1.9	0.9	1.5	3.9	4.4	**2.33**	4.52	3.74	3.60	4.50	3.90	3.55
US$ Index	80.2	90.3	98.7	102.4	92.3	96.1	96.4	90.0	96.0	103.5	103.8	**94.6**	105.7	100.2	96.8	103.0	97.8	96.4

Source: Wind, Bloomberg, CMBIGM estimates

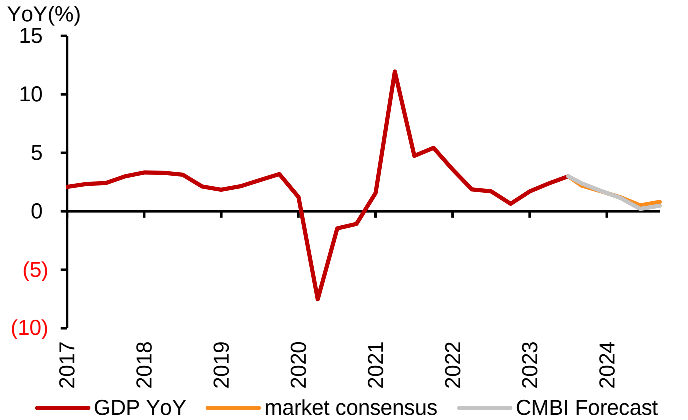
Note: Consumption, investment, exports, imports and government spending are in real-term growth rates.

Figure 2: GDP QoQ Growth Rate



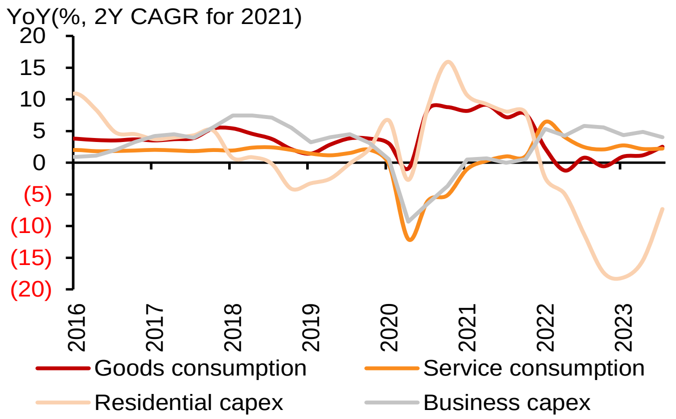
Source: Bloomberg, Wind, CMBIGM estimates

Figure 3: GDP YoY Growth Rate



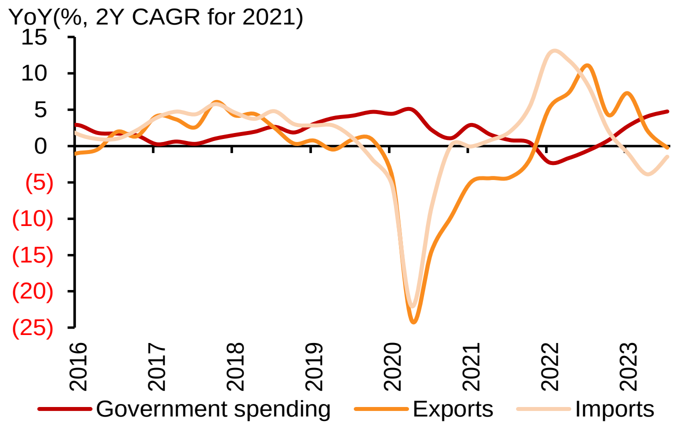
Source: Bloomberg, Wind, CMBIGM estimates

Figure 4: Consumption and Investment Growth



Source: Bloomberg, Wind, CMBIGM estimates

Figure 5: Government Spending & Export Growth



Source: Bloomberg, Wind, CMBIGM estimates

The Resilience and Hidden Concerns of Consumption

The robust growth of household consumption has been a key driver for US economic outperformance in 2023. Consumer spending at constant price rose 2.1% YoY (all on a YoY basis unless specified) in 9M23, down from 2.6% in 2022 yet higher than 2% in 2019. Goods consumption picked up 1.6% in 9M23 after rising 0.3% in 2022, down from the average growth of 8.2% in 2020-2021 with hot stay-at-home economy. Auto consumption surged by 5.7% thanks to supply chain restoration and demand upgrading towards new energy & intelligent vehicles, while furniture and home appliance purchases rebounded by rising 0.6% amid inventory normalization and mild housing market recovery. Entertainment goods consumption maintained a robust growth rate of 6%. However, spending on computers and consumer electronics weakened by declining 1.2%. Apparel consumption saw a modest increase of 0.5% and expenditure on energy products picked up 1.3% stimulated by falling energy prices. Service consumption continued to expand 2.4% in 9M23, down from 3.8% in 2022 yet well above the growth in 2020-2022. Household services, entertainment, accommodation & food services and medical care respectively rose 2.8%, 4%, 4% and 5.5%, significantly surpassing the average growth rates in 2017-2019.

Five factors contributed household consumption resilience in 2023, in our view.

1) The strength in employment and rapid wage growth. The job vacancy-to-unemployment ratio reached 150% at end-3Q23, above the average level of 110% in 2017-2019. Nominal wage growth decreased from 4.9% in 2022 to 4.5% in 9M23, but real growth rose from 0.6% to 1.8% as inflation receded more significantly. Labor supply-demand gap has remained. Labor demand was supported by rising share of labor-intensive service sector in the economy and labor hoarding by some enterprises. Labor supply remained below the pre-pandemic trend as some old workers may have opted for early retirement due to the pandemic, large-scale fiscal subsidies, and the asset boom cycle. In addition, Trump-era immigration policies and the pandemic led to a decline of immigrant labor inflow in 2018-2021 as foreign-born workers accounted for over 15% in labor supply.

2) The release of excess savings. Households accumulated over US$2trn in excess savings in 2020-2021 due to the large scale of fiscal stimulus at 25% of GDP and impaired offline consumption during the pandemic. Consumers started to use those excess savings in 2022-2023, providing strong support to consumption performance.

3) The wealth effect of the asset price boom. Super-loose policies in 2020-2021 drove significant increases in stock price, housing price and pension asset value. Household wealth hit a new high of US$154.3trn by mid-year, 32.2% higher than the value at end-2019.

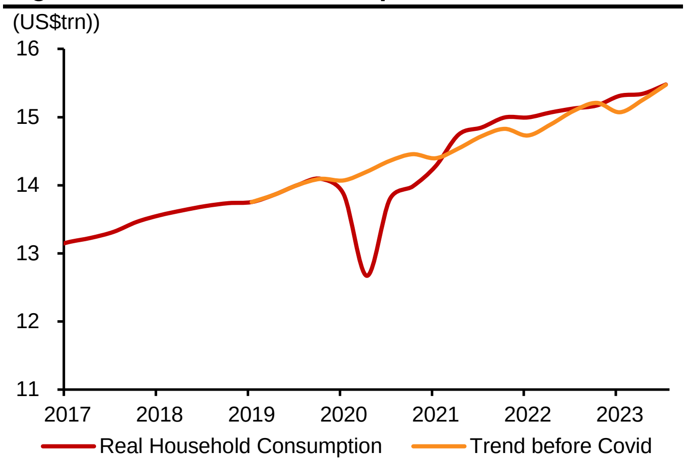
4) Most households were locked in low-fixed-rate mortgages as their debt burden only increased mildly after the aggressive policy rate hikes. While interest rates of 30-year fixed-rate mortgage loans rose from 3.08% in 4Q21 to over 7% in 3Q23, average interest rates on existing mortgage loans only climbed from 3.4% to 3.7%. Many households refinanced their mortgages with fixed-rate contracts during the low interest rate period in 2009-2021. Nearly 90% of mortgage applications in that period were fixed-rate loans. Household debt service ratio only slightly rose from 8.3% in 1Q21 to 9.8% in 2Q23.

5) Strong consumer confidence. The savings rate was at 3.8% in 3Q23, significantly lower than 11.1% in 2021 and 7.4% in 2019.

Household consumption is expected to slow in 2024 due to tightening credit conditions, rising financial pressure, a cooling labor market and softening income growth. The annualized QoQ growth of consumer loans dropped from 15.9% in March 2022 to 1.1% in

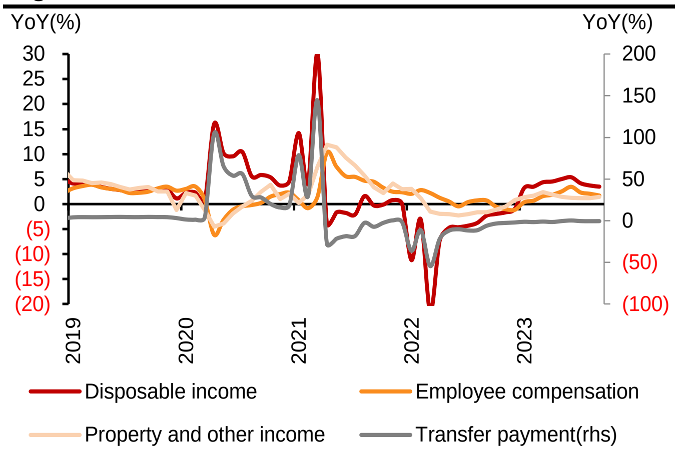
July 2023, before a modest rebound at 3.9% between August and October. Households with refinancing needs will face significantly higher financing costs as each percentage point increase in existing mortgage rates would raise household debt service ratio by 0.6ppt. Labor demand may soften as businesses faces credit tightening, cost pressure and demand uncertainty, while labor supply may gradually resume as labor participation and immigration inflow recovers. The excess savings are nearly exhausted while the savings rate may rise moderately as employment and income uncertainty increases. Overall, household financial conditions are likely to deteriorate, causing downward pressure on consumption growth.

Figure 6: Household Consumption at Constant Price



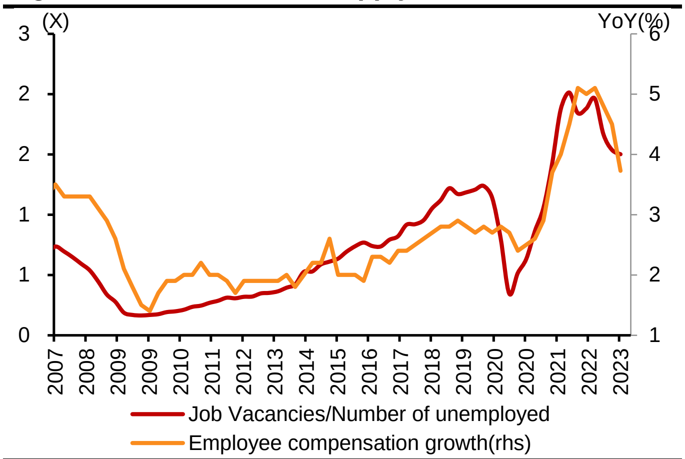
Source: Bloomberg, Wind, CMBIGM estimates

Figure 7: Real Growth of Household Incomes



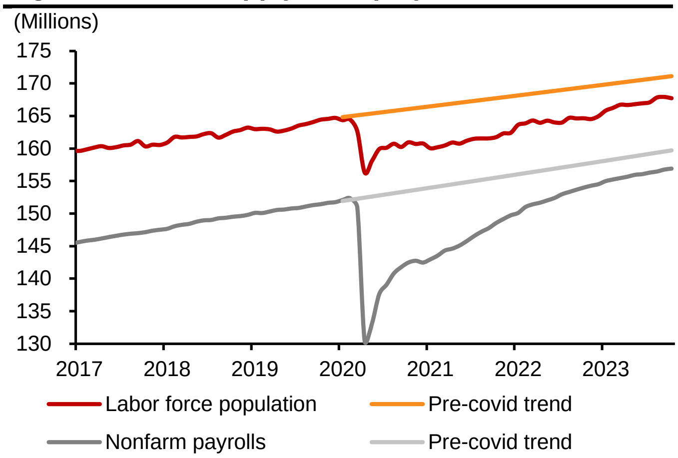
Source: Bloomberg, Wind, CMBIGM estimates

Figure 8: Labor Demand-Supply Ratio



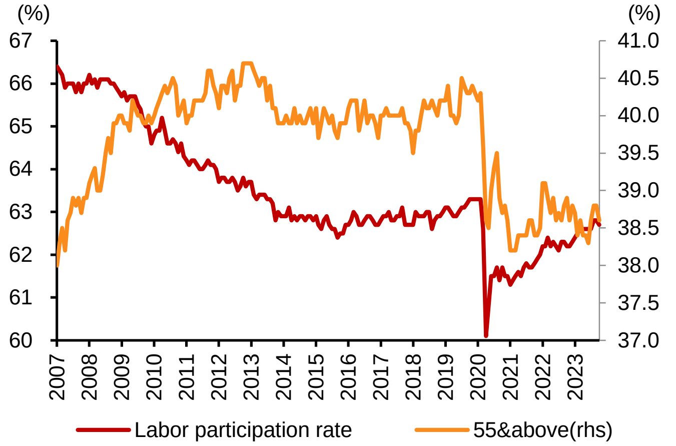
Source: Bloomberg, Wind, CMBIGM estimates

Figure 9: Labor Supply & Employment



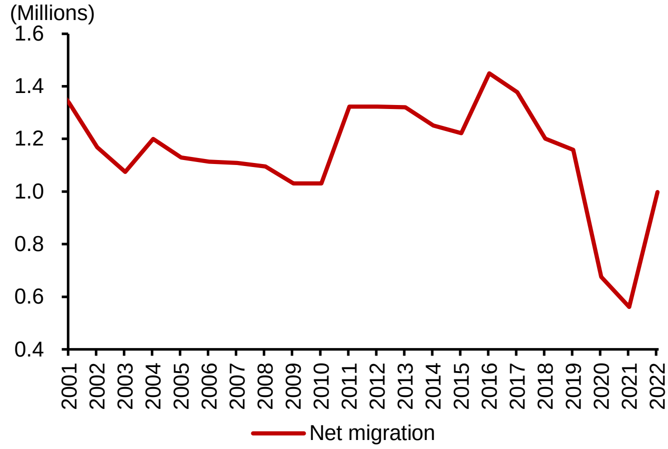
Source: Bloomberg, Wind, CMBIGM estimates

Figure 10: Labor Participation Rate



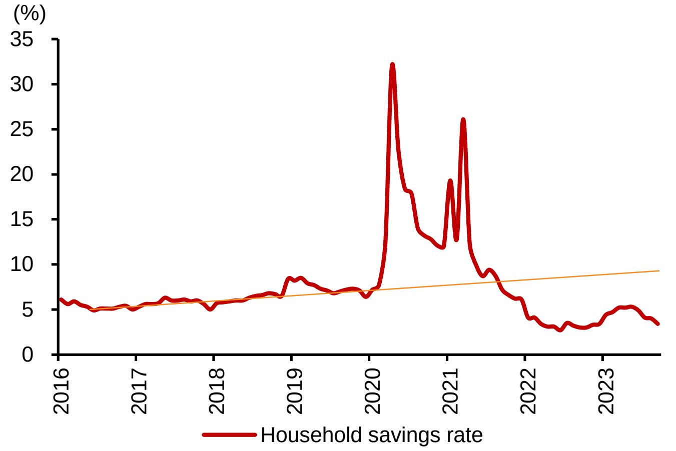
Source: Bloomberg, Wind, CMBIGM estimates

Figure 11: Number of Net Immigration Inflow



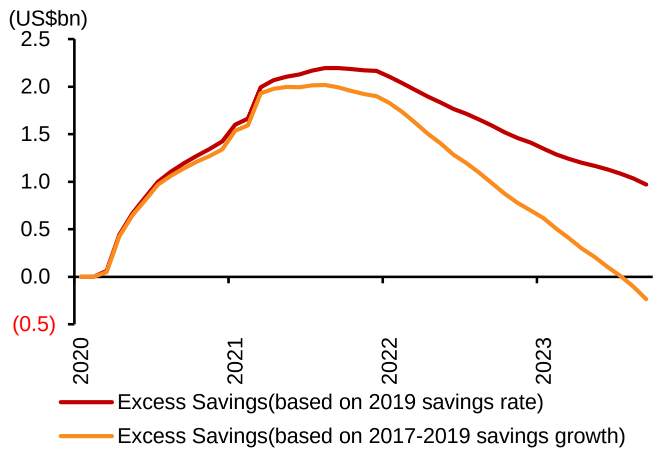
Source: Bloomberg, Wind, CMBIGM estimates

Figure 12: Household Savings Rate



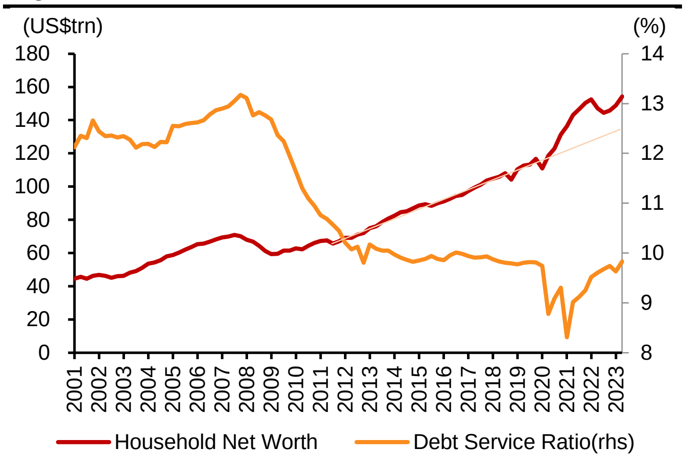
Source: Bloomberg, Wind, CMBIGM estimates

Figure 13: Cumulative Excess Savings



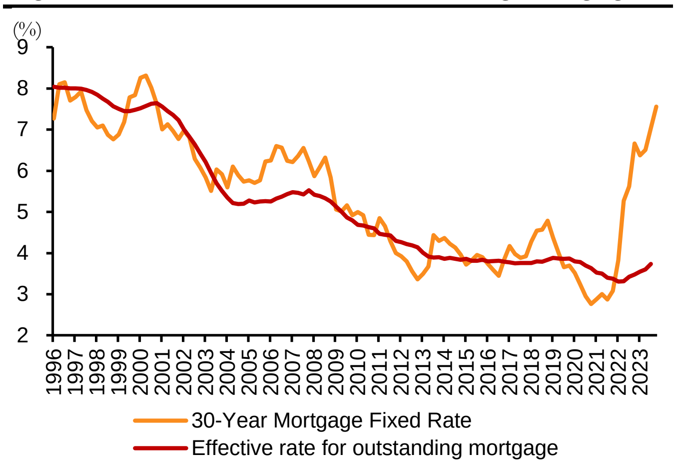
Source: Bloomberg, Wind, CMBIGM estimates

Figure 14: Household Wealth and Debt Service Ratio



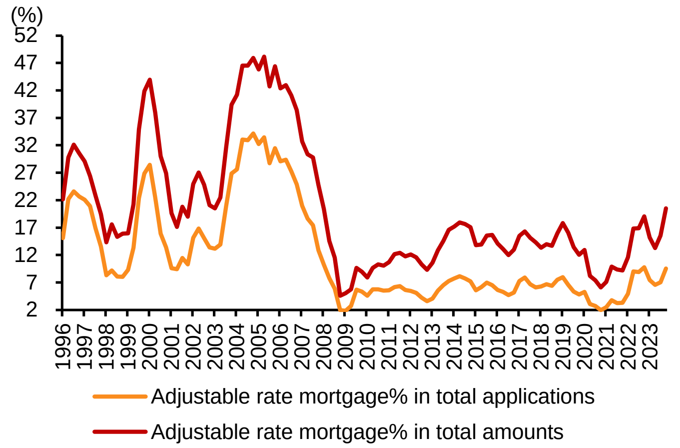
Source: Bloomberg, Wind, CMBIGM estimates

Figure 15: Golden Handcuffs in Existing Mortgage



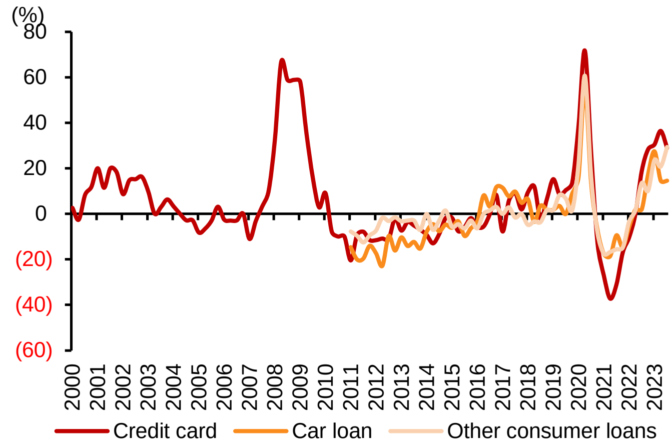
Source: Bloomberg, Wind, CMBIGM estimates

Figure 16: Proportion of ARM in Mortgage Application



Source: Bloomberg, Wind, CMBIGM estimates

Figure 17: Net % of Banks Tightening Loan Standard



Source: Bloomberg, Wind, CMBIGM estimates

Narrowing Decline in Real Estate

The property sector is sensitive to interest rates due to its high leverage. Property sales have shrunk after the aggressive interest rate hikes. New home sales, housing start approvals and existing home sales respectively fell by 17.2%, 4.2% and 17.1% in 2022. While new home sales rebounded by 5.3%, housing start approvals and existing home sales further decreased by 16.3% and 21.9% in 9M23. The commercial real estate market experienced even sharper declines as its transaction volume dropped by half in 2022-2023.

Housing price has softened yet a shortage of supply especially in existing homes has prevented a sharp correction of housing prices. Monthly average inventory of existing homes dropped from 1.74 million units in 2019 to 1.1 million units in 2022 and 1.06 million units in 9M23. The average period of supply available for sale dropped from 3.9 months in 2019 to 2.7 months in 2022 and 3 months in 9M23. The shortage of existing homes has constricted sales, pushed up prices and shifted more housing demand to the rental market, which supported rent inflation. The Fannie Mae House Price Index significantly increased 31.6% from end-2019 to end-2021, followed by a rise of 6.5% in 1H22 and a decline of 1.6% in 2H22. However, it rose again by 5.8% in 9M23. The Zillow Market Rent Index increased by an average of 7.8% MoM in 2022 and 2.6% MoM in 10M23.

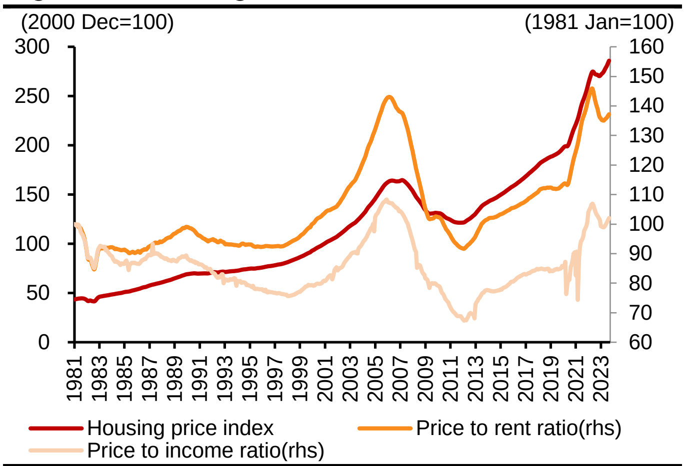
The supply shortage of existing homes is primarily due to the 'golden handcuffs' effect in existing mortgage loans. Many homeowners have been locked in low-fixed-rate mortgages as they are unwilling to sell their homes to buy a new one with new mortgage rates up to over 7%. As of September 2023, the average interest rate for existing mortgage loans was at 3.74% while the interest rate for 30-year new mortgage loans was at over 7%. According to a Zillow survey, lowering mortgage rates to 5% could double homeowners' willingness to sell. According to John Burns Research & Consulting, 71% of potential homebuyers with a mortgage application plan believe that rates above 5.5% are unacceptable. It seems that 5%-5.5% is a critical threshold for mortgage rates, but it will take time for new home mortgage rates to fall to 5%-5.5% or existing mortgage loan rates to rise to the critical level.

The housing market may mildly improve in 2024, but it is unlikely to see a new boom cycle. Housing sales would benefit from likely moderate cuts in the policy rate and a gradual improvement of housing supply. However, mortgage rates may remain at restrictive levels and household financial conditions may deteriorate in 2024. As new home inventory has been high in 2023, housing starts may continue to decline in 2024. Multi-family housing may face oversupply pressure as private multi-family housing construction value grew

22.1% YoY in 9M23 and there were nearly 1 million apartments under construction in September. The matured amount of multi-family housing loans will rise from US$185bn in 2023 to an annual average of US$250bn in 2024-2025, with an increase of refinancing cost pressure in future.

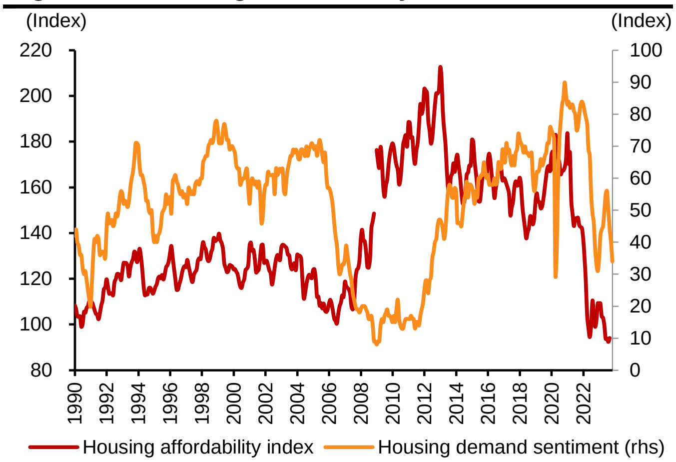
The commercial real estate market may continue to be under pressure in 2024, with office buildings likely to see the most significant strain. The pandemic has popularized remote working and reduced demand for office spaces. However, construction and supply have continued to grow. In 9M23, private office building construction value increased 7.4% YoY. The vacancy rate for U.S. office buildings reached 17.8% in October 2023. Commercial real estate prices had cumulatively fallen by over 15% since peaking in March 2022. According to a Bloomberg survey, over 70% of institutional investors believed commercial real estate prices may not see the bottom until 2H24 or later. As of the end of October 2023, outstanding commercial real estate loans was nearly US$3trn, with an annual maturing volume of US$600bn over the next two years. The weakness in commercial real estate market has a greater drag on small banks than large banks, with large banks and small banks having commercial real estate loan balances of US$0.9trn and US$2trn, respectively, as of October 2023.

Figure 18: Housing Price and Bubble Index



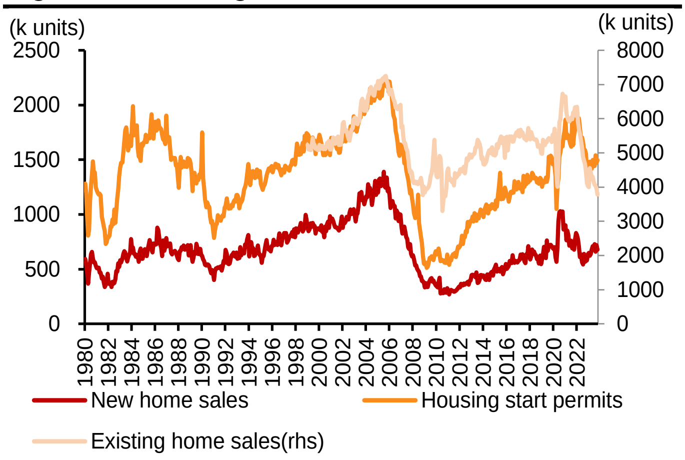
Source: Bloomberg, Wind, CMBIGM estimates

Figure 19: Housing Affordability and Demand



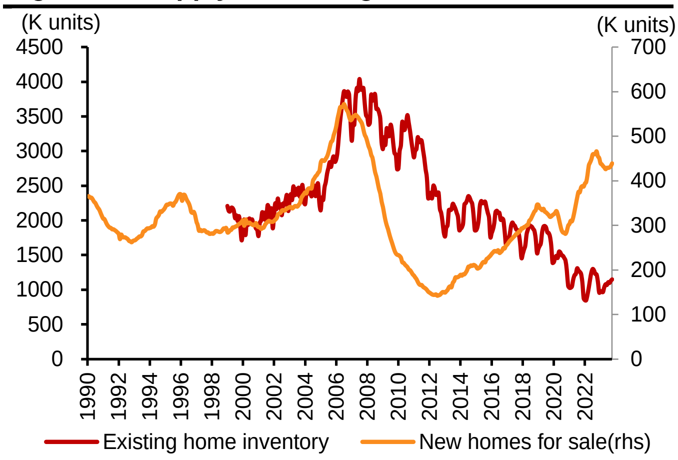
Source: Bloomberg, Wind, CMBIGM estimates

Figure 20: Housing Sales & New Start Permits



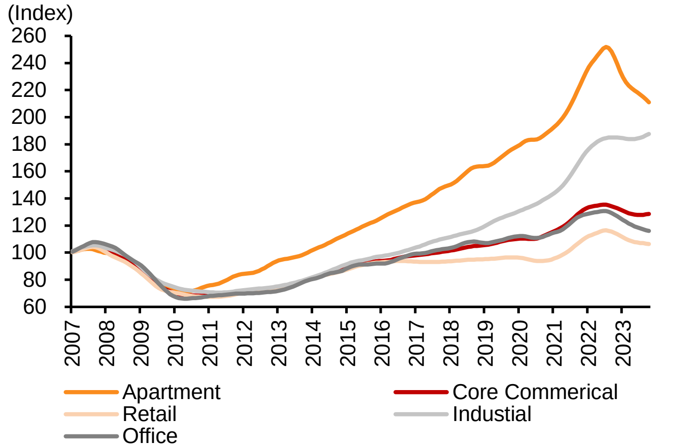
Source: Bloomberg, Wind, CMBIGM estimates

Figure 21: Supply of Existing and New Homes



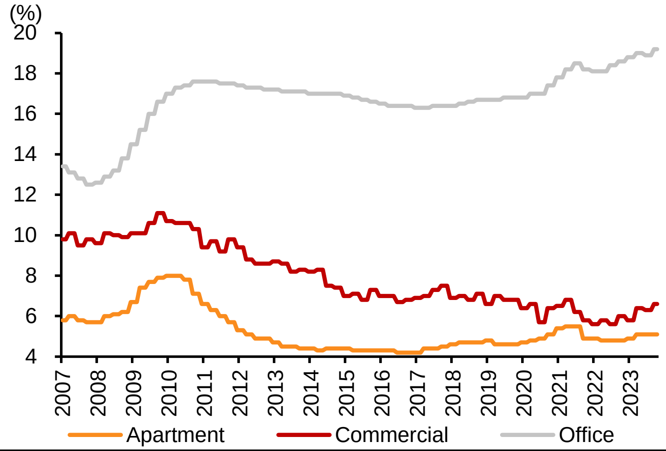
Source: Bloomberg, Wind, CMBIGM estimates

Figure 22: Commercial Real Estate Price Index



Source: Bloomberg, Wind, CMBIGM estimates

Figure 23: Vacancy Rates of Commercial Real Estate



Source: BBG, Wind, CMBIGM estimates

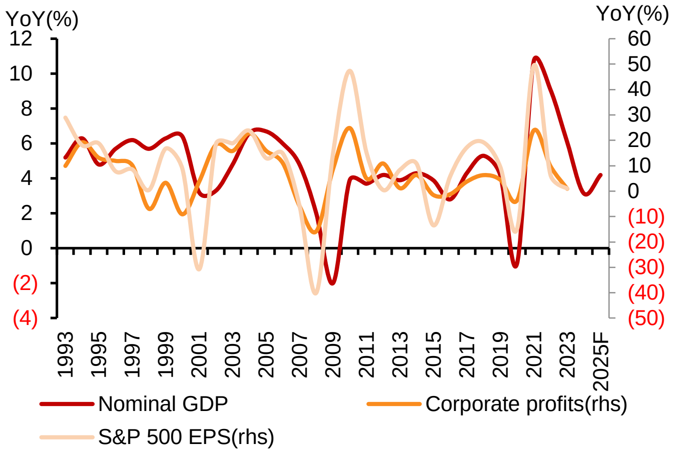
Business Investment and Inventory Cycle

Business investment maintained rapid growth in 2023, with manufacturing construction investment being a highlight. Non-residential fixed investment at constant price rose 4.3% YoY in 9M23, compared to 5.3% in 2022, 2.2% in 2020-2022 and 4.7% in 2013-2019. Despite the aggressive interest rate hikes, business investment maintained strong growth, contributing 0.6ppt to the annualized QoQ GDP growth in the first three quarters. Breaking down items, construction investment and intellectual property investment respectively grew by 11.2% and 5%, while equipment investment slightly declined by 0.1% in 9M23. Manufacturing construction investment, intellectual property and transportation equipment respectively contributed 66.2%, 28.2% and 22.8% to the business investment growth, whereas IT equipment, mining construction and industrial equipment all dragged down the investment growth. The robust growth in manufacturing construction investment was primarily driven by the computer and electronic and electrical equipment industries, with likely benefits from the Inflation Reduction Act and the CHIPS Act. The former provides US$369bn subsidy for electric vehicles, key minerals, clean energy and power generation while the latter provides US$252.7bn subsidy for investment in semiconductors, artificial intelligence and related sectors. As the PPI continued to decline, businesses continued to maintain low inventory levels. Inventory change detracted 0.3ppt from the annualized QoQ GDP growth in the first three quarters.

Business investment may moderate in 2024, due to continuous credit tightening, high-cost pressure, demand softening and stimulus effect fading. Business credit conditions continued to tighten, with the YoY growth of outstanding commercial and industrial loans sharply down from 12.7% at end-2022 to -0.3% at end-10M23. The QoQ growth slightly improved from July, but remained below 2% in annualized terms. In the past decade with low interest rates, businesses typically opted for fixed-rate borrowing, and the proportion of floating-rate bonds in bond issuance dropped from nearly 30% before the financial crisis to about 15% over the past ten years. Net interest expenses of large enterprises have remained low thanks to the rise in returns on abundant cash assets after the aggressive interest rate hikes. As low-interest debt continues to mature, however, refinancing costs may gradually rise in future. High labor costs remain a concern as corporate profits dropped 0.8% in 1H23, potentially dragging down investment activity. Consumer demand may gradually cool down in the next few quarters, adding downside pressure on business investment. In addition, the policy stimulus effect on business investment may decline in

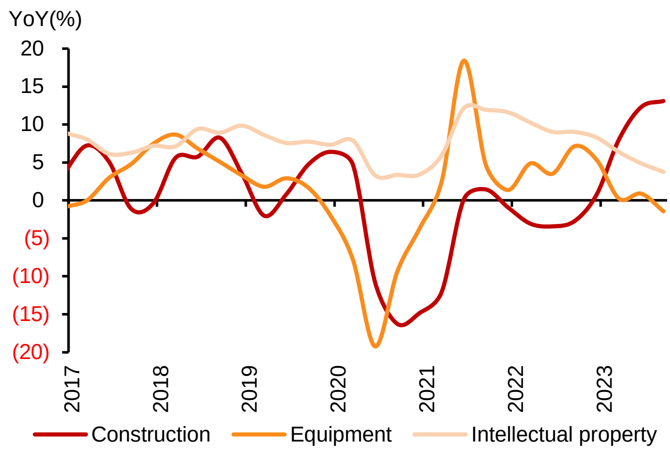
2024. The Republicans are making efforts to limit further expansion of the Biden administration's spending and corporate subsidies, and some investors are starting to worry about possible overcapacity in new energy and semiconductor industries in the medium term. The de-stocking cycle may end in 2024, but businesses may have low willingness to increase inventory if the demand prospect weakens. Business inventory investment may only see a modest increase.

Figure 24: Nominal GDP and Profit Growth



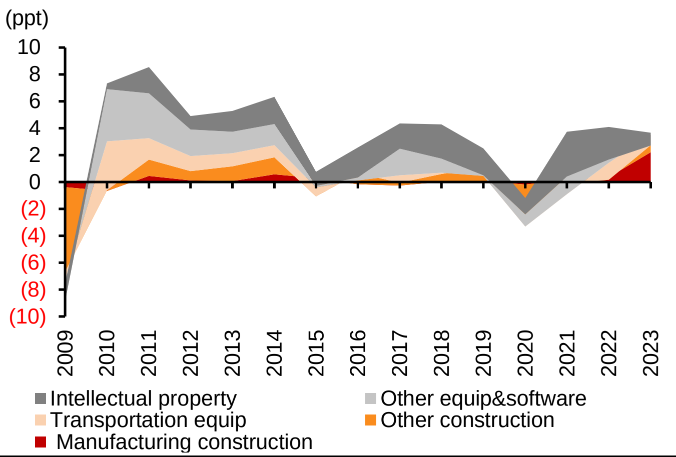
Source: Bloomberg, Wind, CMBIGM estimates

Figure 25: Real Growth of Corporate Investment



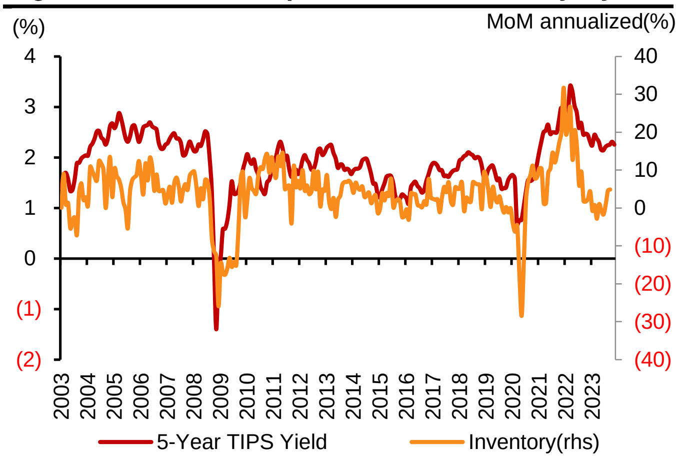
Source: Bloomberg, Wind, CMBIGM estimates

Figure 26: Contribution to Investment Growth



Source: Bloomberg, Wind, CMBIGM estimates

Figure 27: Inflation Expectations & Inventory Cycle



Source: Bloomberg, Wind, CMBIGM estimates

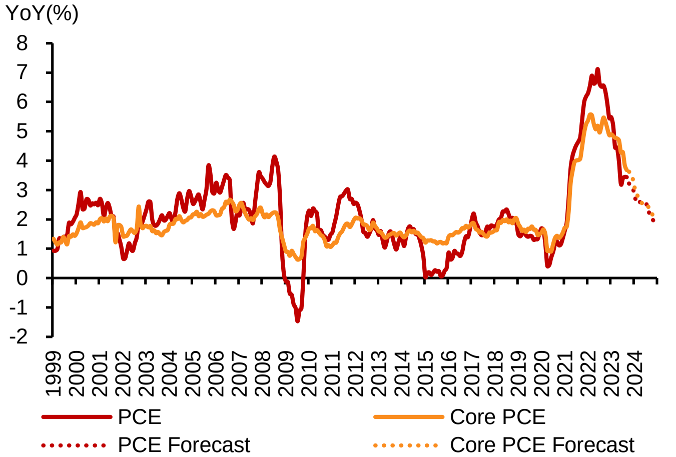
The Disinflation Goes On

Inflation receded in 2023. Energy inflation experienced the largest decline, non-energy goods and non-rent services decreased noticeably, yet rent inflation only marginally reduced. The CPI and core CPI growth respective decreased from 6.4% and 5.7% in December 2022 to 3.2% and 4% in October 2023. Specifically, the growth of energy and food prices dropped from 7.1% and 10.5% to -4.5% and 3.3%; other goods and services excluding rent decreased from 2.2% and 7.5% to 0% and 3%; and rent inflation only declined from 7.6% to 6.8%. The disinflation trend slowed in 2H23 due to resilient economy, rebounding commodity prices and the base effect. The annualized MoM growth of core CPI and food price respectively reached 2.4% and 2.8% in the past three months, while the growth of other goods declined from 4.4% to -2.4% thanks to demand softening and supply chain restoration in durables. However, the price of non-rent services picked up 5.6% in annualized MoM terms after rising 0.4% in 2Q23, as rebounds in energy price pushed up transportation service price, and strikes in the healthcare sector along with recalculations of health insurance price increased medical care inflation.

The disinflation trend should persist into 2024 with the most significant contribution from the rent component. In the CPI, rent is derived from surveys of tenants and homeowners, reflecting the prices of existing rental agreements or equivalent rents. Because adjustments to existing rental prices have a lag, and the Department of Labor samples rents of the same residential units only once every six months, CPI rent changes lag behind market rents by 12 months. The MoM growth of Zillow's Market Rent Index peaked around September 2021, and its YoY growth rate peaked around March 2022, with a significant decline in 2H22. The most recent two months have seen the YoY growth rate drop to around 3%. Therefore, the CPI rent inflation still has much room to decrease in the future. Services inflation excluding energy is closely related to labor cost increases. As the labor market weakens and wage growth decelerates, services inflation excluding energy will likely fall further.

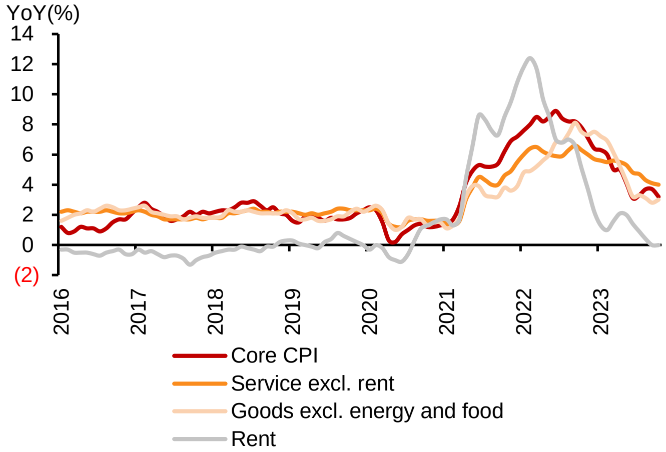
Commodity inflation may fluctuate at low levels in 2024. Bulk commodities may decline slightly while industrial product prices may bottom out. Macro factors that could boost commodity prices in 2024 include moderate easing of global monetary policies; modest improvement in demand from China and the Eurozone; and disruptions to bulk commodity supplies due to weather and geopolitical factors. Macro factors that could dampen commodity prices include possibly still-tight credit conditions and slowing demand in the US; further restoration of global commodity supply amid potential easing of the Russo-Ukrainian war and phased improvement in Sino-US relations.

Figure 28: PCE and Core PCE Growth



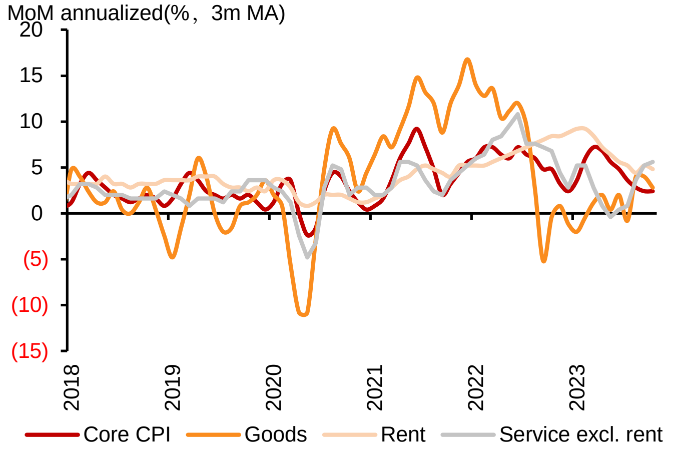
Source: Bloomberg, Wind, CMBIGM estimates

Figure 29: YoY Growth of Major Components



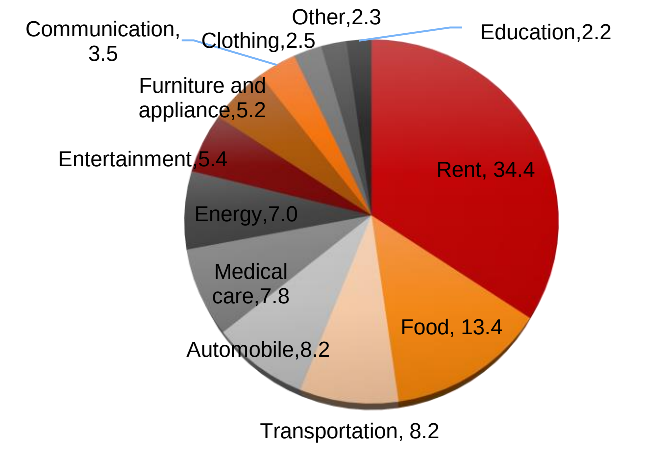
Source: Bloomberg, Wind, CMBIGM estimates

Figure 30: MoM Growth of Major CPI Components



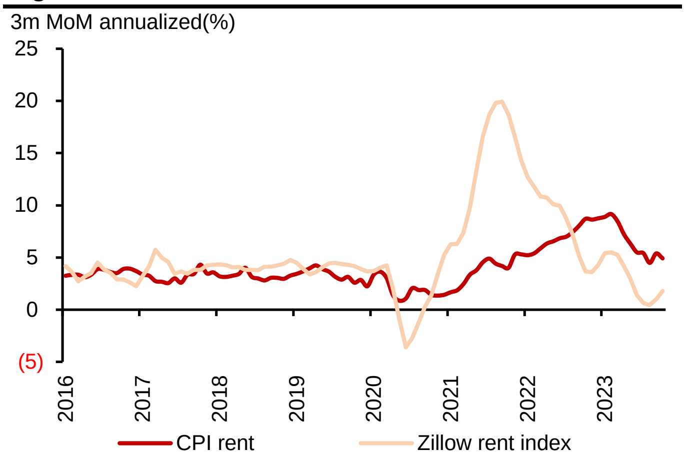
Source: Bloomberg, Wind, CMBIGM estimates

Figure 31: CPI Component Weights



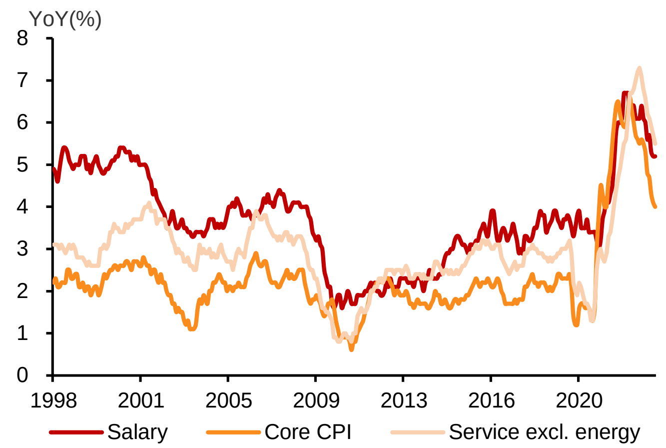
Source: Bloomberg, Wind, CMBIGM estimates

Figure 32: Growth Rate of Rent



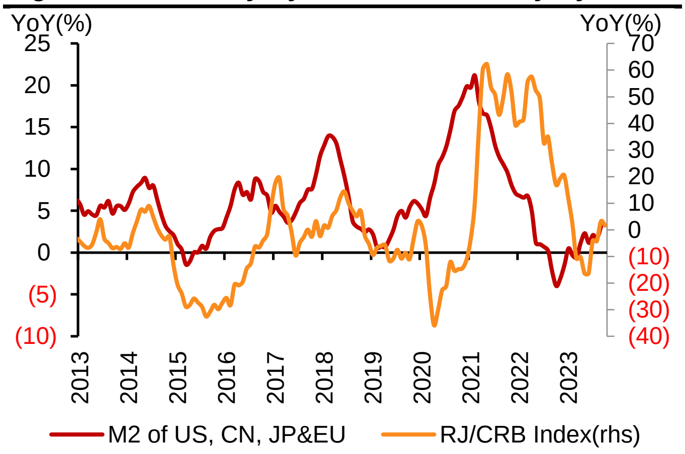
Source: Bloomberg, Wind, CMBIGM estimates

Figure 33: Wage Growth and Core Inflation



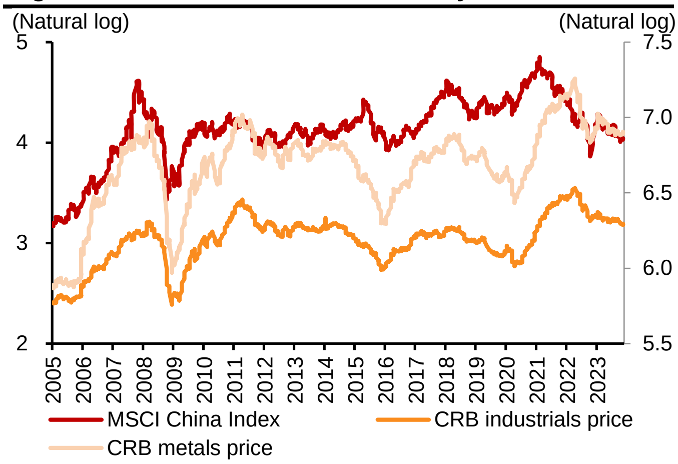
Source: Bloomberg, Wind, CMBIGM estimates

Figure 34: Monetary Cycle and Commodity Cycle



Source: Bloomberg, Wind, CMBIGM estimates

Figure 35: MSCI China & Commodity Price



Source: Bloomberg, Wind, CMBIGM estimates

Macroeconomic Policy

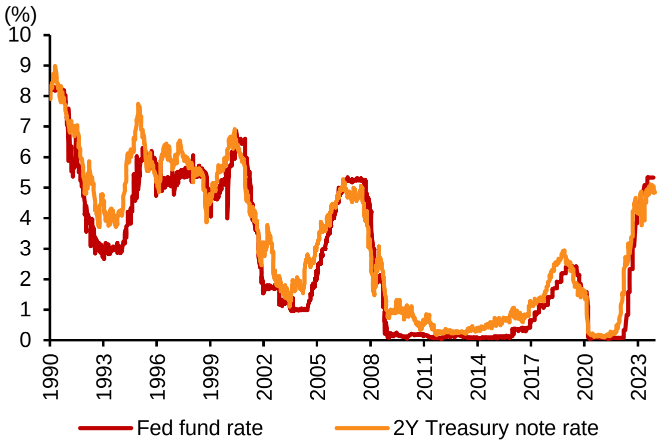
Fiscal expansion may slow in 2024. The federal deficit ratio is expected to decline from 6.1% in 2023 to 5.8% in 2024. Government spending growth may slow from 3.4% in 2023 to 1.3% in 2024 due to the halting of large emergency allocations and relief expenditures during the pandemic, the expiration of some tax credits and a June 2023 debt ceiling agreement to reduce spending by US$234bn over the next two fiscal years. Accompanying sharp interest rate hikes, the federal government's debt service burden has significantly increased. Interest expenditure reached nearly 15% of revenue in 2023 and may be above 20% in the coming years. The sustainability of federal government budget and debt has attracted heightened attention with both parties to engage in intense debates over the fiscal budget before the election. While the Biden administration desires further fiscal expansion to extend the economic boom, the Republicans are determined to impose restrictions. The Brookings Institution expects a decline of fiscal expansion may drag down the 2024 GDP growth by 0.6ppt. However, significant cuts in federal spending are challenging. Two-thirds of the expenditures are mandatory welfare spending on social security, healthcare and social relief. There is strong political resistance to cutting these outlays.

The Fed's rate-hiking cycle has peaked. As inflation receded, credit conditions tightened, financial pressure rose and employment softened, the Fed has regained confidence in controlling inflation and started to pay attention to potential risks after aggressive tightening. Most coincidental indicators such as employment, consumption and service activity have pointed to a resilient economy, but some leading indicators like the yield curve, manufacturing PMI, credit condition and consumer confidence have sent warning signals for economic downside risks. The ceasing of a policy rate hike in October-November indicates the Fed opbecame reluctant to risk financial turmoil for over tightening, opting instead to patiently await the further release of high interest rate effects.

The Fed will likely commence a rate-cutting cycle in 2024. As inflation falls markedly, real interest rates would reach high levels, potentially continuing to pressure the banking system and financial markets, with conditions for rate cuts gradually materializing. The Fed may start to cut rates around May or June, with a total reduction of about 1.5 percentage points throughout the year. As real interest rates continue to rise with tightening credit conditions, households' financial condition would worsen, putting downward pressure on consumption and housing sales. Businesses will be more cautious about capex expansion and inventory increase. Fixed rates on long-term loans are pressuring small and medium banks with turbulence risk still there. Due to the strong balance sheet of the real sector and a resilient banking system, the possibility of a banking crisis should be low.

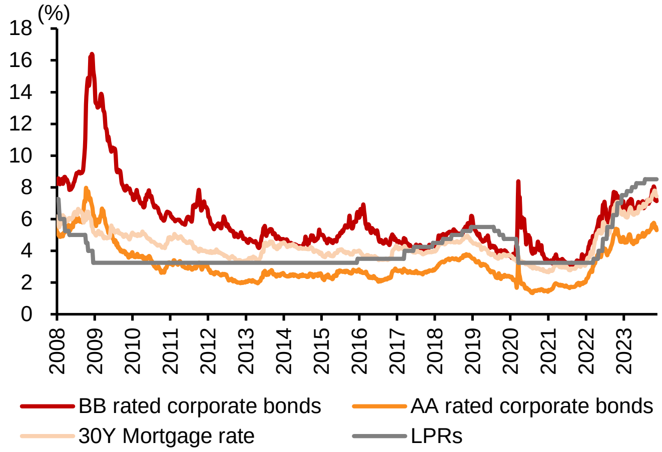
The US dollar index may undergo a cyclical decline. First, the growth differentials between the US and Europe may moderately narrow. The US economic growth, inflation and interest rates are likely to fall significantly with GDP growth potentially decreasing from 2.3% in 2023 to 0.8% in 2024, while the Eurozone's economy has already significantly slowed down in 2023 as its GDP growth may rise slightly from 0.6% in 2023 to 0.8% in 2024. Secondly, the Russo-Ukrainian War may move towards de-escalation, reducing pressure on the euro. The conflict continues to intensify the drain on both sides, and the Israeli-Palestinian conflict may further divert US attention and resources, with anti-war sentiment growing within Europe and America. Lastly, Sino-US relations may see a phased improvement, which would be positive for the euro. China seeks to improve Sino-US relations to restore market confidence and rejuvenate its economy. The US government, aiming to extend the current business expansion cycle and alleviate pressures on businesses and SMEs, is focused more on targeting China's high-tech sectors while reopening communication and cooperation in other areas. The Eurozone's dependency on the Chinese supply chain and market is higher than that of the US, so a phased improvement in Sino-US relations would benefit the euro.

Figure 36: Policy Rate and 2Y T-bond Yield



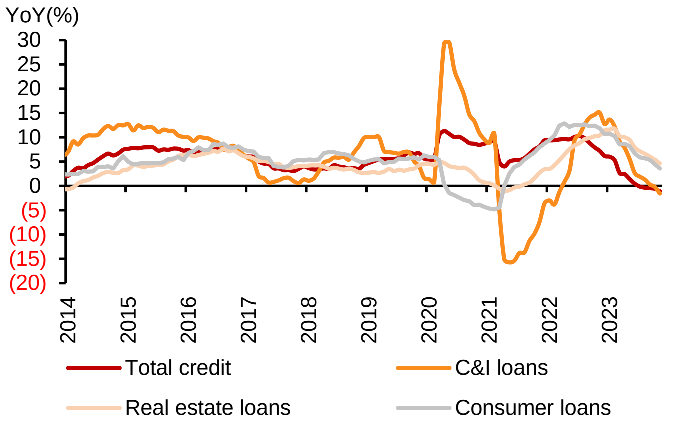
Source: Bloomberg, Wind, CMBIGM estimates

Figure 37: Financing Cost



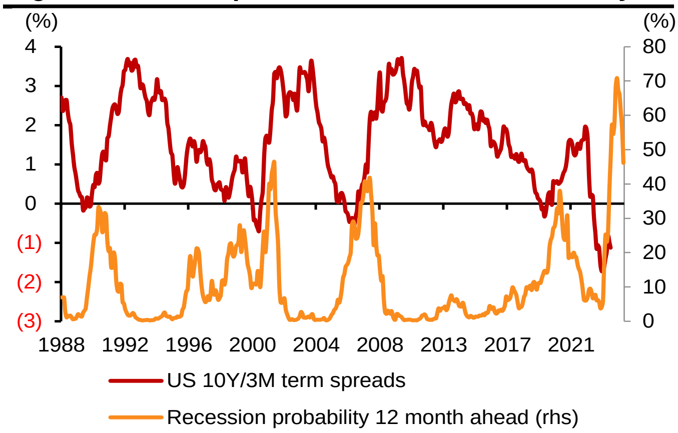
Source: Bloomberg, Wind, CMBIGM estimates

Figure 38: Credit Growth



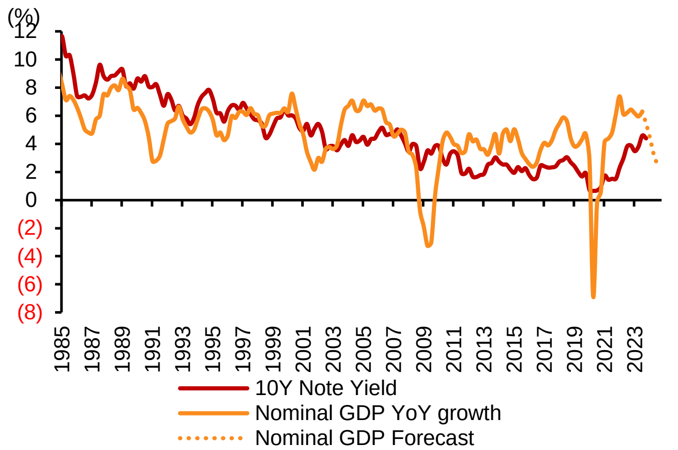
Source: Bloomberg, Wind, CMBIGM estimates

Figure 39: Term Spreads & Recession Probability



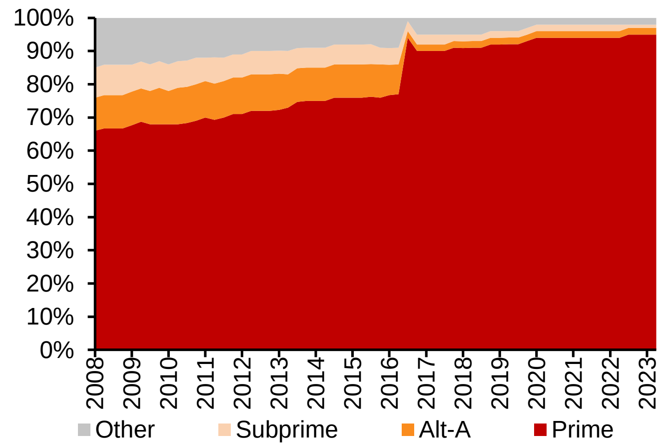
Source: Bloomberg, Wind, CMBIGM estimates

Figure 40: 10Y T-bond Yield & Nominal GDP Growth



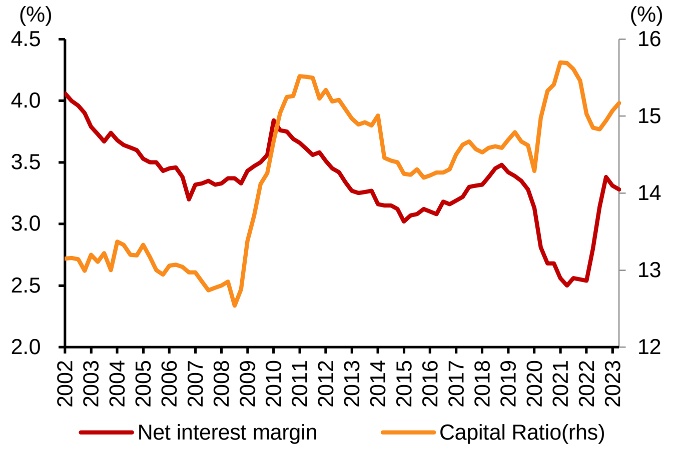
Source: Bloomberg, Wind, CMBIGM estimates

Figure 41: Existing Mortgage Structure by Quality



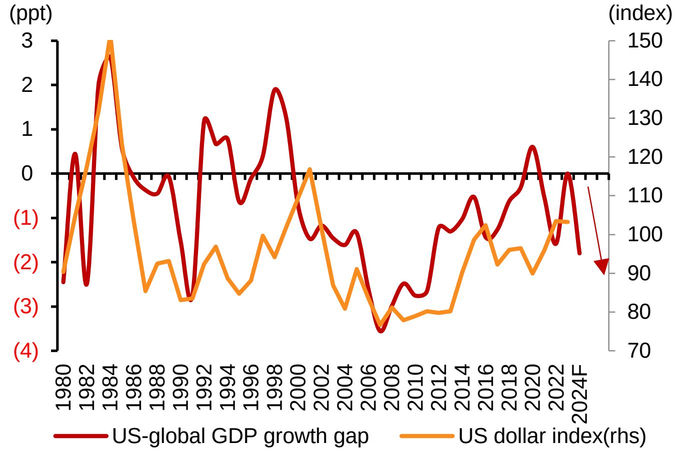
Source: Bloomberg, Wind, CMBIGM estimates

Figure 42: Banks' NIMs & Capital Ratio



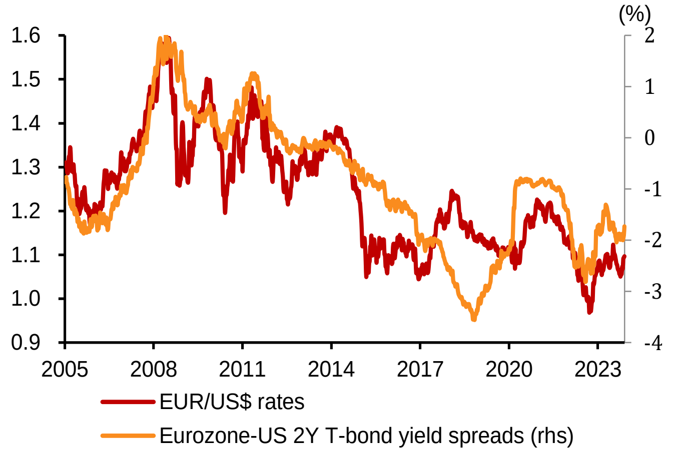
Source: Bloomberg, Wind, CMBIGM estimates

Figure 43: US Dollar Index & US Economy Strength



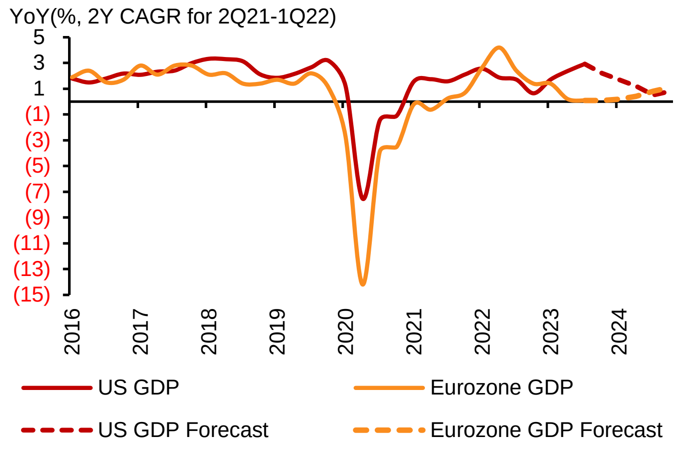
Source: Bloomberg, Wind, CMBIGM estimates

Figure 44: Euro/US Dollar Rates & Interest Spreads



Source: Bloomberg, Wind, CMBIGM estimates

Figure 45: US-Eurozone Growth Differentials



Source: Bloomberg, Wind, CMBIGM estimates

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