Global Economic Outlook

December 2023

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Introduction

A theme that's become all too familiar in KPMG's *Global Economic Outlook* is uncertainty. For many, 2023 was another year when the medicine at times felt worse than the illness. Central banks tightened their belts with tough monetary policies aimed at reigning in spiralling inflation. It appears to have paid off, but at the cost of economic stagnation for many regions and a continued squeeze on consumer spending.

KPMG's latest *Global Economic Outlook* offers a sense of what lies ahead, with the clear health warning once again that we're in deeply uncertain times, and therefore our predictions are just that – a forecast based on the few certainties that exist right now and the long-term trends that can help us piece together a complex future.

I spent the final month of 2023 in Dubai, joining delegates at COP28. The summit was focused on the climate crisis and potential solutions that could unlock a more sustainable future, but – for me – it reflected some of the wider challenges facing economies and political leaders right now. There were some positive outcomes, but many issues remained unresolved. The economic outlook is worryingly similar.

In our latest report, our economists based around the world offer their view on the economic landscape in the coming months and years. While the story varies from country to country, there are some clear universal themes. Monetary policy has had a big impact on output and growth prospects and there's growing pressure for it to ease. Whether that happens remains to be seen. Many central banks are stuck between a rock and a hard place, cautious that loosening the screws could simply lead to an inflationary rebound.

There are also fears that an increasingly protectionist, de-globalization approach in politics is impacting supply chains and the traditional trade flows that have sustained many economies. An interesting side effect – and something to watch in 2024 – is some of the beneficiaries like Mexico and Vietnam, who are embracing the opportunities to fill the space left by shifting trade relationships.

While we're anticipating no significant change to employment figures, 2024 could be a year to monitor the impact of tight economic conditions for the corporate world. A wave of debt refinancing in a particularly challenging period could put real pressure on business leaders searching for an end to the prolonged pain of recent months. Combined with ongoing geopolitical uncertainty, the coming year could be crippling for many.

While the latest KPMG *Global Economic Outlook* is unquestionably skewed toward a negative forecast, there are always glimmers of hope and optimism. Since the outbreak of the pandemic, we've had several years of uncertainty and business leaders have demonstrated a real sense of resilience and agility. With the right strategies in place and an ability to flex to an ever-changing world, the most innovative and focused should eventually start to see some light at the end of the long tunnel.

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The global outlook: Limited upside in the short term

Deceleration in growth in some of the world's largest economies, coupled with little impetus elsewhere, could see global GDP growth easing slightly in 2024.

Weaker momentum should help push down inflation, with average world inflation expected to halve by 2025.

Monetary tightening cycle is reaching its end, but there could be an increasing divergence in the timing and the extent of easing by central banks.

Weaker economic momentum has helped ease supply chain pressures and reduce broader cost pressures, with energy prices dropping significantly from their 2022 peak when Russia invaded Ukraine. Median CPI inflation for the G20 countries fell to 3.9% in October 2023 after peaking at 7.7% in July 2022, and we expect further deceleration in coming months. Our forecasts see world inflation averaging 5.0% in 2024 and 3.9% in 2025, down from an estimated 6.5% in 2023 and 8.0% in 2022. Risks are on the upside, however, as any further shocks to energy prices – or a more persistent domestic inflation in some countries – could derail the relatively smooth return to central banks' inflation targets next year.

Monetary policy has largely reached the height of the current tightening cycle. However, many central banks are likely to hold on before starting to ease again. The big question at the moment is when interest rates will start falling and how far down they will go. While central banks such as the National Bank of Poland and Banco Central do Brasil have already begun to cut rates, our view is that most central banks – including the U.S. Fed and the Bank of England – would not start acting until well into 2024, with rates settling at a significantly higher level in the medium term than during the decade prior to the Covid pandemic.

Higher interest rates are hurting the commercial property market and slowing the pace of housing transactions. A large concern in the U.S. is also the large portion of corporate debt which requires refinancing in 2024 at higher rates. Record-high household debt in Canada also remains a significant risk to the local outlook.

Global trade has plateaued in recent years, partly due to rising protectionist measures and geopolitical tensions. Geoeconomic fragmentation could lead to large output losses over the longer term. So far there is limited evidence of relocation of production on a grand scale, but countries like Mexico are benefiting from a boost to economic growth, as foreign direct investment flows are becoming more concentrated among close trading partners. At the same time, supply chains are becoming longer in an effort to avoid trade barriers, with countries like Vietnam acting as one of the destinations for manufacturing diversification.

Uncertainty triggered by rising geopolitical tensions is exacerbated by policy uncertainty for countries including the U.S., the UK, India as well as Austria, where 2024 is an important election year. This could see relatively weak business investment in the short term, while there is little room for governments to pick up the slack as public finances have worsened significantly in recent years. Nevertheless, we expect unemployment to remain relatively low – at just below 6% on average globally – providing some support for consumer spending despite the various headwinds. This could see global growth slowing slightly to 2.2% in 2024 before rising to 2.6% in 2025, similar to our estimate of global growth for 2023 (see the Appendix on p.54 for our full set of forecasts for the next two years).

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Global trade and value chains: Shaken not stirred

World trade and production have plateaued in recent years, hinting at a potential shift in the global economic paradigm.

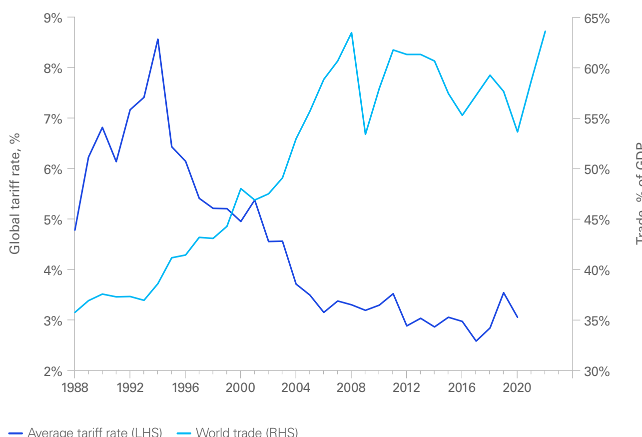
The potential for output losses and increased vulnerability to shocks highlight the complex trade-offs in reshaping supply chains.

Increased potential for inflationary episodes may exert upward pressure on future interest rates, as central banks recognize the risks associated with fragmentation.

Trade openness increased sharply after the Second World War. World trade as a share of GDP increased from 33% in 1975 to a peak of 64% in 2008, where it remains today (see Chart 1). Trade related to global value chains (GVCs), measured as intermediate inputs share in gross production, has risen from 47% in the mid-1990s to a peak of 52% in 2014, before flatlining since. However, flows have stabilized in recent years, leading some to speculate that globalization may be turning.

The main concern relates to the idea that structural tailwinds, which supported global integration during the period of trade liberalization, have been broadly exhausted. The average global tariff rate has fallen from nearly 9% in 1994 to around 3% today. The technological advancements in transportation and communication during the ICT revolution facilitated greater specialization of production and led to offshoring of manufacturing to emerging markets at a low cost. At the same time, operations of multinational corporations have become more service heavy and less dependent on investment in physical assets, which has limited the expansion in goods trade.

Chart 1: The exhaustion of global trade tailwinds has led to a slowdown



Source: World Bank, KPMG analysis.

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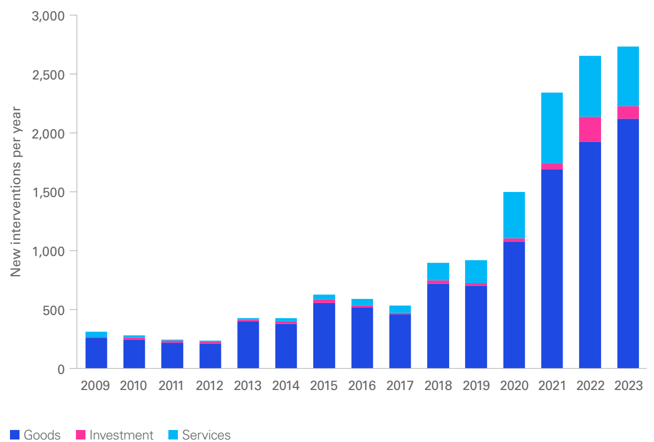
While the low-hanging fruit in trade liberalization has been picked, headwinds have also risen. Rising geopolitical tensions have led to a greater focus on political and national security goals in international trade. Trade restrictions – including tariff and non-tariff barriers – have increased sharply since 2018, with a discernible rise in measures targeting services (see Chart 2). A stark example is the bilateral trade relationship between the U.S. and China. The average U.S. tariff rate vis-a-vis China increased from around 3% to 19% since 2018, with a corresponding rise from 8% to 21% on the part of China. Other recent policies – such as the recent EU Carbon Border Adjustment Mechanism – seek to reshore production which was previously lost due to manufacturing offshoring to avoid domestic carbon taxes (also known as 'carbon leakage').

There has also been a surge in government subsidies. For example, the U.S. Inflation Reduction Act, worth an estimated USD 369 billion, aims to incentivize firms to manufacture green energy components domestically or in countries which have a free-trade agreement with the U.S. The U.S. Creating Helpful Incentives to Produce Semiconductors and Science (CHIPS) Act, worth USD 280 billion, aims to boost domestic semiconductor manufacturing capacity through a wide range of subsidies and tax incentives. This sparked a response from the European Union in the form of the European Chips Act (worth USD 47 billion), while similar packages were introduced by China, South Korea, Japan, and Taiwan to support their respective domestic semiconductor industries.

Despite a fall in trade policy uncertainty, recent supply chain disruptions have led to an increased interest in reshoring (bringing production stages back to the home country), nearshoring (moving them geographically closer) and friendshoring (restricting or reorienting production to economic and political allies) (see Chart 3). However, reorganizing supply chains is easier said than done. Given the capital in place, the cost of searching for alternatives, and factors such as wage differentials across countries, this process is likely to be slow. A good example is the largely abandoned effort to switch from just-in-time to just-in-case inventory levels. In many cases, higher interest rates have made the cost of carrying excess inventory prohibitive.

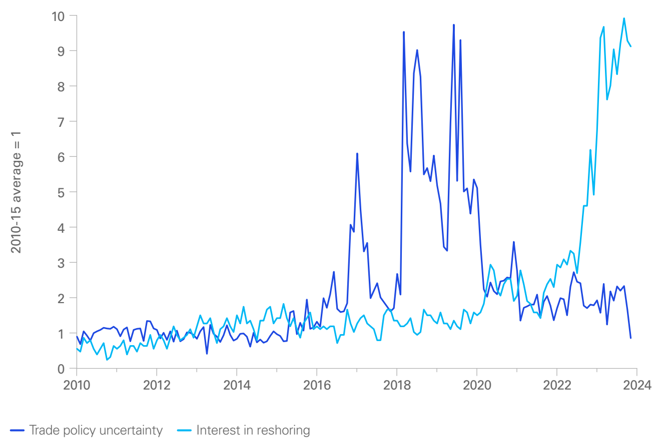
Recent evidence supports the idea that companies are making an effort to reorganize their production. KPMG has seen an increase in clients who are considering changes to their logistics in order to mitigate risks, but movement has been slow. For example, a large manufacturer has moved production of some laptops and phones from China to India and Malaysia. While that is an example of diversifying the manufacturing base, it shouldn't be confused with nearshoring: the finished goods are still moving vast distances because they're high value and relatively cheap to transport. Creating an entirely new production base is costly both in terms of capacity building and the skills base of the labor force in the new location.

Chart 2: Number of new trade barriers by commercial flow



Source: Global Trade Alert, KPMG analysis.

Chart 3: Growing interest in making supply chains less vulnerable to uncertainty



Source: Caldara et al (2020), Google Trends, KPMG analysis. The dark blue line measures media attention to news related to trade policy uncertainty. The light blue line shows the number of Google searches for 'nearshoring', 'reshoring' and 'friendshoring'.

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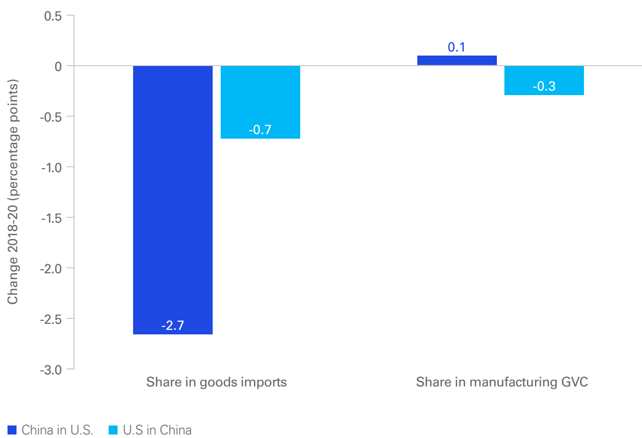
The U.S. is ahead of its peers in this regard. There have been at least 32 projects announced in the U.S. of over USD 1 billion in investment toward batteries and electric vehicles since the passing of the Inflation Reduction Act. The value of construction in computer, electronic and electrical manufacturing facilities has shot up by over USD 100 billion since 2020. U.S. trade has realigned to key partners such as Mexico and Canada via the USMCA trade agreement – one of the strongest examples of friendshoring to date.

Evidence for brute force relocations of production is limited. Trade in value added statistics are only available until 2020, but recent forecasts which combine production and trade statistics suggest that GVCs have remained stable since.[1] That being said, the cracks are starting to show. Foreign direct investment has shown dramatic swings in recent quarters, with investment being concentrated among close trading partners. That could translate to realignments in the longer run. There have also been reconfigurations in trade relations on a balance-of-payments basis. For example, China's share of U.S. goods imports fell by nearly 3 percentage points between 2018 and 2020, even as its value-added share of U.S. consumption actually increased over the same period (see Chart 4).

Chart 4: GVC shares have been steady despite a drop in bilateral trade



Source: Haver, OECD, KPMG analysis.

These shifts do not necessarily mean that we are seeing less global trade. In the short run, trade barriers and reorganizing supply chains combined are likely to lead to a lengthening of supply chains and so-called 'triangular trade', where countries divert their products to avoid trade barriers, potentially leaving the networks more susceptible to supply chain shocks. In the example above, goods could be flowing from China to the U.S. via other countries, leading to the discrepancy between the trade data and the value-added data. Indeed, the share of U.S. goods imports from Vietnam,

Chart 5: Estimates of geoeconomic decoupling can be large

Source: Various sources.

Malaysia and Taiwan has risen by 6 percentage points over the period considered, all of which have strong trade ties with China. A similar pattern could be observed over the past year between Russia and its trading partners.

Empirical estimates point to potentially large output losses from geoeconomic fragmentation (see Chart 5). They suggest that the global economy could be up to 5% smaller in the long run, depending on the exact nature of the shock. Fragmentation in commodities markets is expected to have a relatively modest effect given the offsetting effects across producing and consuming countries. Set against that, a decoupling of global technology hubs, or restricting foreign direct investment flows, could result in greater losses, owing to impaired diffusion of knowledge and intellectual capital. A less efficient allocation of resources would also lead to higher prices, especially if it requires labor to be sourced from a more expensive domestic or friendly pool.

Increasing fragmentation in trade, along with geopolitical shifts, could lead to more supply chain disruptions by constraining the availability of possible substitutes in the face of logistical breakdowns. The inherent risk is that those disruptions are inflationary. Recognizing that risk, central banks around the world have begun to focus on supply chains as an area which will increase the likelihood of inflationary episodes. This could put upward pressure on interest rates going forward.

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1 Knutsson et al (2023), '*Nowcasting trade in value added indicators*', VoxEU, September 26.

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United States: The economy endures headwinds

> The once beleaguered U.S. consumer emerged as an Atlas, supporting growth at home and abroad.

> Mortgage applications have plummeted, while housing affordability dropped to its lowest levels since the mid-1980s in the fall of 2023.

> Uncertainty around the 2024 election could act as its own tax on the economy as it prompts individuals and firms to hesitate in their decisions about the future.

The U.S. economy is poised to stall but not collapse in 2024. The path to a soft landing looks possible and even probable, but the journey is far from complete.

The U.S. economy stood out among its counterparts in much of the developed world, accelerating and exceeding its pre-pandemic trend on growth in 2023. More stunning is that those gains came on the heels of the most aggressive credit tightening cycle by the U.S. Federal Reserve since the 1980s (see Chart 6). The pandemic, and the stimulus that accompanied it, accelerated balance sheet healing in both the household and corporate sectors. Households paid down their debt, locked into long-term fixed-rate mortgages and banked the savings, which is now earning interest. The once beleaguered U.S. consumer emerged as an Atlas, supporting growth at home and abroad. Atlas is a tale of endurance rather than strength alone. The two are related but not the same.

Endurance is more about overcoming the challenges ahead than reflecting on how far we have come. Sectors that once drove employment gains started to falter as the Fed raised interest rates. What was a surprise is the extent to which sectors that once lagged were able to pick up the slack.

As the economy rounded the curve in 2023, employment gains became more concentrated in three sectors: leisure and hospitality, healthcare and government, largely public education. Those sectors are the least sensitive to interest rate hikes and suffered acute staff shortages in 2023. The concentration of employment gains makes the labor market more vulnerable to external shocks.

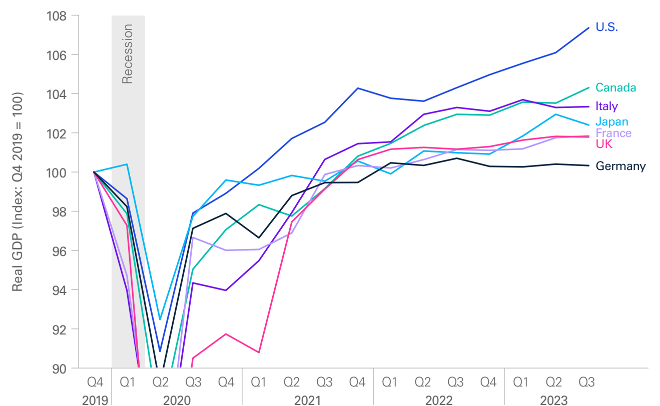
Table 1: KPMG forecasts for the U.S.

	2023	2024	2025
GDP	2.4	1.6	1.6
Inflation	4.1	2.7	2.0
Unemployment rate	3.6	4.1	4.3

Source: KPMG Economics, Bureau of Economic Analysis, Bureau of Labor Statistics.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Chart 6: The U.S. outperforms its peers



Source: KPMG Economics, Bbk, ONS, INSEE, CAO, ISTAT, StatCan, BEA.

Note: 'Real' denotes inflation-adjusted figures.

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The blow dealt to employment during the height of worker strikes in October 2023 is a case in point. Payroll growth slowed to its lowest level since January 2021, before vaccines were widely available and the economy fully reopened, while wages cooled and the ranks of the unemployed moved higher. Those out on strike surged, while the ranks of those displaced by work stoppages hit the highest level since the massive strike in the vehicle sector in 1997. The ranks of those forced to take part-time instead of full-time work to make ends meet were even greater.

Much of the drag from monetary tightening is still ahead of us. Credit card and vehicle loan delinquencies rose above their pre-pandemic levels in the second half of 2023 and started to pass through the economy. Delinquencies in the third quintile of households, which are upper middle-income households, added to the stress already seen among subprime borrowers. Defaults remain low but are expected to move higher with a rise in unemployment.

Student loan repayments surged two months ahead of the end of COVID-era forbearance; those who could, attempted to get ahead of interest accruing on those loans. A shift to income-based repayment schedules and some loan forgiveness will ease the burden of those loans for low-income households. Student borrowers have a year before delinquencies on their loans show up on their credit reports. This could mean another setback in the access to credit for student loan borrowers in the fourth quarter of 2024.

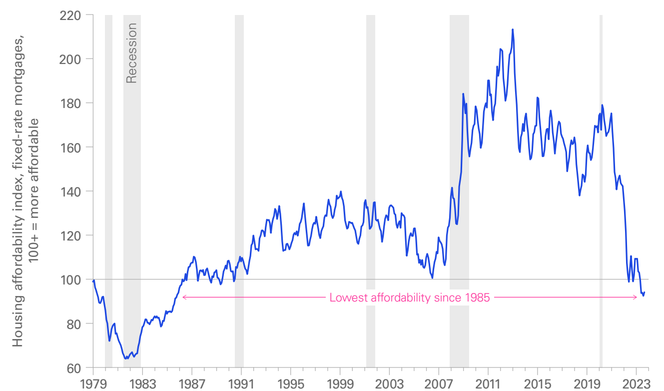
Banks held lending standards in recession territory over the summer. A set of special questions by the Federal Reserve revealed that a fair amount of credit tightening is still in the pipeline. Credit for individuals with a credit score of 680 or less will be significantly harder to get; that captures nearly half of all borrowers as we move into 2024.

Commercial real estate will suffer another setback, along with commercial and industrial loans. Both are used to fund large infrastructure projects and cover the cost of inventories. That is before banks deal with the losses in the office leasing market, which will further tighten credit conditions.

A larger portion of credit is affected by shifts in the U.S. Treasury bond market. Everything from mortgage rates to corporate and municipal bond yields is linked to Treasury bond yields. We have yet to feel the full effects of the move up in bond yields in the late summer and early fall. Those shifts dumped a bucket of ice on the housing market. Mortgage applications plummeted, while housing affordability dropped to its lowest levels since the mid-1980s this fall (see Chart 7).

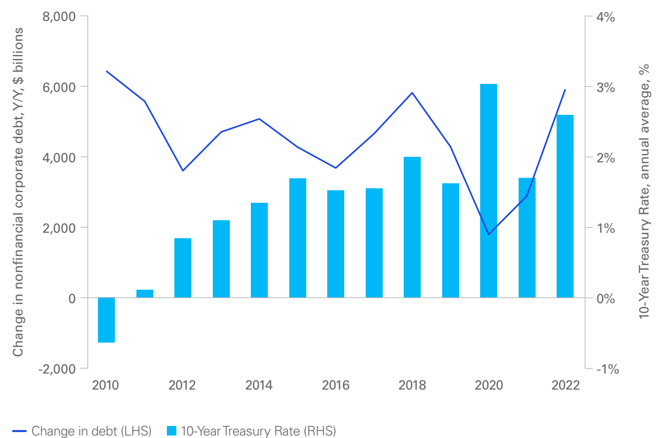
A larger concern is the surge in corporate debt as rates plummeted in 2021 and early 2022. Inflation-adjusted rates dipped into negative territory in 2021 and early 2022, before the Federal Reserve embarked on its rate hiking cycle in March 2022; that was like being paid to borrow. A portion of that debt is scheduled to reset in 2024, which will crimp profit margins along with the leveling up of wages and inability to raise prices. The result is expected to take a toll on employment and push the unemployment rate higher. Interest expense remains low on corporate balance sheets; this is an area that warrants watching as it could be a hurdle to further cooling the broader economy (see Chart 8).

Chart 7: Housing affordability plummets



Source: KPMG Economics, National Association of Realtors.

Chart 8: Surge in corporate debt due to reprice



Source: KPMG Economics, Federal Reserve Board, Haver Analytics.

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Fed shifts to wait-and-see mode

Chair Powell has made clear his intent. He believes we need "growth to slow below potential", which is fed speak for the gradual rise in unemployment. That would qualify as a "soft landing", as long as the economy avoids the requisite two quarters of contraction needed to declare the economy in a recession. He now sees the risks of overshooting and undershooting on rate hikes as roughly in balance, but the bias is to raise interest rates again.

Powell has pushed against the tendency by financial markets to front-run the Fed on rate cuts, as that could undo the progress made on inflation and force the Fed to tighten policy further. The Fed will not cut rates until inflation has convincingly dipped below 3%, which is not expected to occur until mid-2024. The 2% target is now more of a floor than a ceiling for inflation.

The descent on interest rates is expected to be much slower than the ascent. The Fed now has much more latitude to cut rates than it did in the past. The era of free money has come to an end, barring another major financial crisis.

Turning to risks to the outlook, everything from the political dysfunction in Washington to escalating government debt to geopolitical tensions could shock the economy. A more consequential spike in both Treasury bond yields and oil prices cannot be ruled out. The fact that 2024 is an election year will only add to uncertainty, which acts as its own tax on the economy as it prompts individuals and firms to hesitate in their decisions about the future.

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Canada: Economy continues to chill

20-year-high interest rates will suppress growth in the near term, as consumers cut back on spending and save towards rising mortgage payments. Record-high household debt to remain a top risk to the outlook.

Inflation to cool to the Bank of Canada's target range in 2024, providing ground for the central bank to begin slowly cutting interest rates mid-year.

A recession can be averted in the face of slowing global growth due to the soft landing in the U.S. and strong domestic labor force growth in the near term.

Canada is expected to narrowly skirt a recession but our forecasts point to a second consecutive year of sluggish growth in 2024. A soft landing in the U.S., coupled with expansionary domestic fiscal policy, will help Canada eke out growth of 0.6% next year. Lower interest rates and higher federal government spending will boost growth in 2025. However, growth will be limited due to stagnating productivity and record high household debt levels.

The Bank of Canada (BoC) has matched the rapid pace of interest rate increases to the U.S. Federal Reserve bank, with the policy rate hitting a peak of 5% in July 2023, the highest since 2001. Monetary policy has a faster transmission mechanism to the overall economy than in the U.S., as mortgage loans renew much earlier. Around a third of all households have a fixed-rate mortgage, most of which expire after five years.

Table 2: KPMG forecasts for Canada

	2023	2024	2025
GDP	1.0	0.6	1.4
Inflation	3.8	2.4	1.9
Unemployment rate	5.4	6.2	6.2

Source: KPMG Economics, Statistics Canada.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

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Households have amassed excess savings estimated to be CAD 464 billion in the second quarter of 2023, according to KPMG estimates. Canadian households are more likely than their U.S. counterparts to use their savings to blunt the blow of higher mortgage rates. This could lead to sluggish demand for goods and slowing demand for services, as the Canadian consumer accounts for 60% of the overall economy.

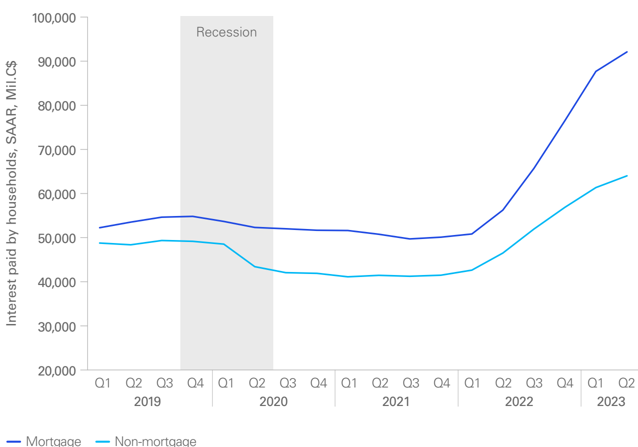
Household debt levels have risen since the pandemic and remain near 170% of disposable income and 107% of GDP. This makes Canadian households some of the most indebted among the developed economies. Interest payments on both mortgage and non-mortgage debt have soared since 2022 (see Chart 9). Delinquencies on auto loans, credit cards and lines of credit have begun to creep up in response to the burden of that debt.

Interest rate shock is one of the largest risks to economic growth in the near term. The Canadian Mortgage and Housing Corporation (CMHC) estimates that 2.2 million mortgages outstanding, or about CAD 675 billion, will reset by 2025.

Canada is benefiting from investments in clean energy and the regionalization of manufacturing activity via the U.S.-Mexico-Canada free trade agreement (USMCA), which was ratified in July 2020. Canada has already seen the trade balance in goods jump by 12% compared to a decline in the 2010s (see Chart 10).

Core annual inflation (excluding food and energy prices) has cooled notably from its 5.5% peak in July 2022 to 3.3% by the fall of 2023. The BoC's target for inflation is a range of 1-3%. A reacceleration in shelter costs over the summer was a reminder that the battle against inflation is not easily won, with rents still rising.

Chart 9: Interest payments surge in 2023



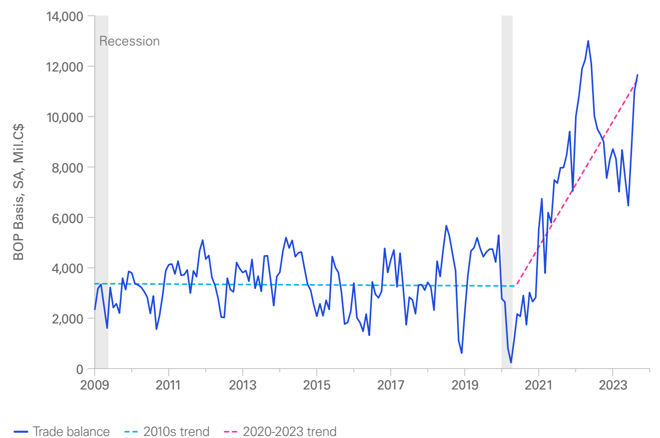
Source: Statistics Canada, KPMG Economics.

Rising costs have eroded households' purchasing power over the past few years. Food, energy and shelter costs make up over half of the consumer price index (CPI), which is projected to average 3.8% over 2023. Compared to February 2020, prices will remain 15% higher by year-end, with food 22% higher and shelter 19% higher. All have outpaced wage and salary gains by a significant margin. In response, consumer confidence fell to pandemic lows in recent months despite some cooling of inflation.

Payrolls surpassed the level hit prior to the pandemic in early 2022 and could end 2023 around 2.5% higher than the year prior. Service-providing industries are expected to continue to lead payroll growth; three-quarters of the labor force works in the services sector, compared to just 15% in the goods sector.

The unemployment rate is expected to hit a peak of 6.2% in 2024, up from 5.4% in 2023. Recent increases in the unemployment rate have been due to a rise in the ranks of those looking for work, which was buoyed by the surge in immigration rather than an increase in layoffs. Slower hiring is expected to drive unemployment up in 2024.

Chart 10: Merchandise trade balance with U.S.



Source: Statistics Canada, KPMG Economics.

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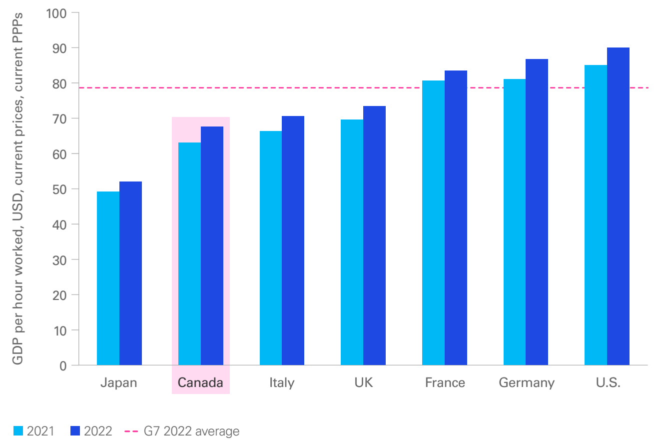
Chart 11: Canadian productivity lags most G7 counterparts



Source: OECD, KPMG Economics.

Canada has seen the fastest population growth in the G7 over the recent years. A surge of newcomers is boosting participation in the prime-age (25-54) labor force.

Declining productivity has pushed GDP per capita to decline on a quarterly basis since the second half of 2022. GDP per capita is back to 2017 levels after recovering from the pandemic-era slide. Canada lags most of its G7 counterparts in productivity measures (see Chart 11).

We do not expect productivity to be a driver of growth without significant investments. Statistics Canada estimates that population growth could slow dramatically by 2031. Absent a shift in investment, the country's potential to grow will be diminished.

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Brazil: More rate cuts to come

The Banco Central do Brasil has already begun to cut rates as inflation approaches its target.

The agricultural sector supported above-expectation growth in 2023, but El Niño in 2024 may hit crop yields.

Growth is moderating, but is set to be supported by a normalization in monetary policy.

Growth has moderated following the first half of 2023 which has largely exceeded expectations. Domestic demand has withstood the headwinds of continued tight monetary policy, with advances in both domestic consumption and imports. 2024 is likely to see a moderation from the summer of 2023, but still a strong year.

The labor market is still fairly tight, with unemployment standing at the lowest levels since 2015. While the unemployment rate could tick up as the labor market unwinds, an increase in not part of our central forecast.

Inflation was on the upswing from June to September, but there was a reversal of that trend in October 2023. That put inflation back in the right direction towards the Banco Central do Brasil's (BCB) implicit target of 3-4%. Additionally, service sector inflation has remained better anchored than in other regions.

Table 3: KPMG forecasts for Brazil

	2023	2024	2025
GDP	2.8	2.0	2.8
Inflation	4.5	3.7	3.3
Unemployment rate	8.0	7.9	7.7

Source: KPMG Economics, Instituto Brasieiro de Geografia e Estatistica.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

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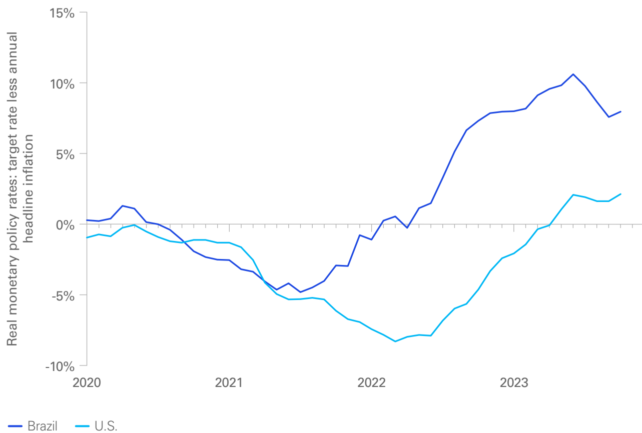
Chart 12: Brazil interest rates in restrictive territory since spring 2022



Source: KPMG Economics, Banco Central do Brasil, Instituto Brasileiro de Geografia e Estatistica, Federal Reserve Board, U.S. Bureau of Labor Statistics.

Brazil has benefitted from early rate hikes by avoiding the inflationary effects of currency depreciation. The LA5 (Brazil, Chile, Colombia, Mexico and Peru) led the charge to get inflation under control among global central banks. They raised rates aggressively ahead of the U.S. Federal Reserve and other central banks, getting to positive real interest rates more than a year ahead of Asia, the U.S. and the Eurozone (see Chart 12). That means that the BCB will have more room to cut rates and stimulate the economy in 2024. It cut the key interest rate, the Selic rate, at four consecutive meetings in 2023. We expect cuts to continue, but the BCB will be proceeding with some caution so as not to reignite inflation. We expect the interest rate cycle to be much longer on the way down than it was on the way up.

Government spending is normalizing, which should support solvency and the cost of debt on the government side. The government debt-to-GDP ratio fell below 2019 levels as of 2022; so did the budget deficit.

Exports are benefitting from agricultural products and advantageous weather, favorable commodity prices for exports, and very little depreciation in the Brazilian real. Demand for manufacturing exports has also improved. 2024 will be an El Niño year. Depending on the strength of the season, El Niño tends to hit agricultural yields – particularly soybeans – harder in Brazil. That could suppress agricultural output from the banner 2023 harvest season.

The BCB has already begun to cut rates and seen more volatility in prices. The largest risk is in rate cuts that are either premature or too rapid, which could reignite inflation in an already slowing economy. That would leave the central bank with the choice of whether to let inflation pick up, or to restrict demand more than it already has. Although that is not the baseline, its probability has risen with the beginning of a normalization in monetary policy.

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Mexico: Reaping benefits from nearshoring

The USMCA and supply chain realignments have been a boost to growth.

Mexico overtook China as the top exporter to the U.S. in 2023.

Manufacturing capacity could limit growth in certain industries.

Mexico's economic growth is expected to be flat through 2024, but still better than that of the broader region. The push for nearshoring and/or friendshoring as a result of geopolitical risk and cost pressures, as well as the U.S.-Mexico-Canada Agreement (USMCA), have provided a boost to manufacturing and spurred employment growth.

Mexico was part of the wave of Latin American central banks that started raising interest rates at the first signs of inflation, and ahead of the U.S. Federal Reserve, the European Central Bank and the Bank of England. The policy rate of the Banco de Mexico (Banxico) is still sitting at its peak of 11.25%. Inflation has reacted just as the central bank would like and is forecast to continue its downward path through 2024. Banxico is expected to start cutting rates in early 2024 as the inflation rate reaches the bank's 3% inflation target.

The exchange rate has appreciated roughly 15% against the U.S. dollar since 2022, making the export growth experienced toward the U.S. even more impressive. In mid-2022, Mexico (and Canada) surpassed China in their shares of exports to the U.S.

Exports are expected to be the largest contributor to real output growth in early 2024, while investment is dragged down by the high interest rate environment. Consumption, which makes up more than 70% of output, is expected to slow as interest rates and still-high inflation continue to affect consumers' purchasing power.

Geopolitical risks and competitive tariffs are not the only reasons why firms are moving to Mexico. The country boasts the Organization for Economic Co-operation and Development's lowest cost of labor, further bolstering its place as a premier near/friendshoring destination.

Table 4: KPMG forecasts for Mexico

	2023	2024	2025
GDP	3.3	2.4	1.8
Inflation	5.6	4.1	3.3
Unemployment rate	2.8	2.9	3.3

Source: KPMG Economics, Instituto Nacional de Estadística Geografía e Informatica.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

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Automobile and auto part production relocated to Mexico from Asia as part of a trend to take advantage of the USMCA agreement. One positive externality to this move is the shortening of supply lines, which not only decreases supply chain risk but also carbon emissions. On the other side of the "reason for moving" spectrum is industrial and heavy machinery, which has moved to Mexico for geopolitical reasons.

However, with an unemployment rate in the 2-3% range, the labor market is tight as real manufacturing earnings per hour have risen by nearly 25% since 2018. This can also be seen in the percentage of manufacturing firms having difficulties hiring (see Chart 13).

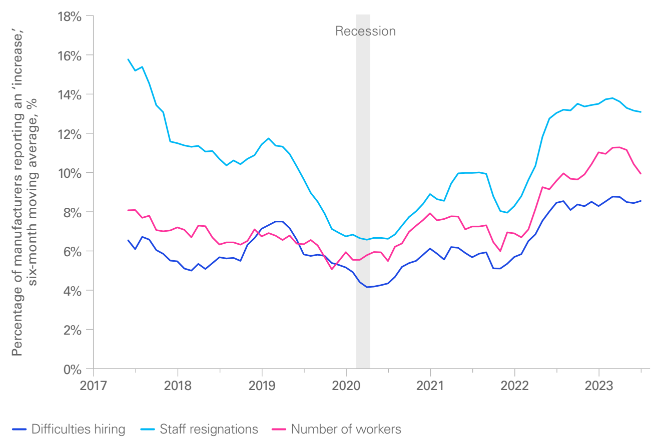
Manufacturing capacity is running short in several key industries that have experienced sizable amounts of supply chain diversification, including electricity and electrical appliances, computing and other equipment, machinery and equipment, and transportation (see Chart 14). Normal levels of utilization usually hover around 80%, consistent with the latest reading for the whole economy. However, these select industries which have seen an inflow of attention due to nearshoring have posted utilization rates of between 85% and 95%.

Activity in the construction industry is increasing to create new capacity, but that could take years to come online. Set against that, high interest rates are expected to hinder investment to create new capacity.

The tight labor market may also start to cause issues if sufficient labor is not available for more complex manufacturing, or the cost of labor continues its rapid rise. Lastly, the president of Mexico is set to leave office in 2024, creating political turnover.

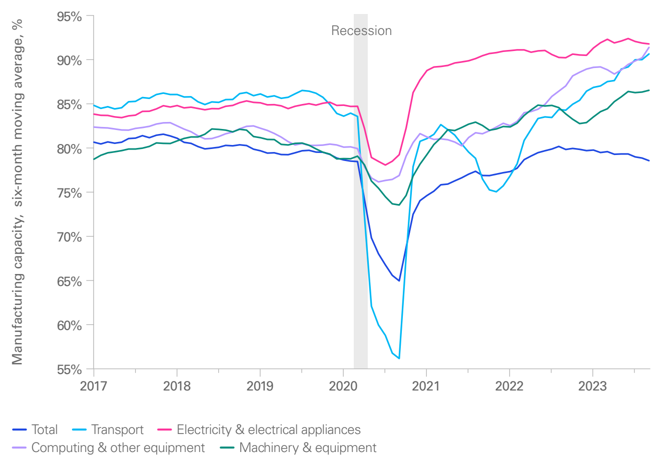
Ben Shoesmith
Senior Economist, KPMG in the U.S.

Chart 13: Companies seeing difficulties hiring



Source: KPMG Economics, Banco de Mexico, Haver.

Chart 14: Manufacturing utilization ticking higher



Source: KPMG Economics, INEGI, Haver.

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China: Policy stimulus is vital to economic growth

More policy stimulus to be released to support growth.

Consumption should recover to become China's key engine, with increasing income growth.

Technology upgrading and green transformation will support high quality development.

China's GDP grew 5.2% year-over-year by the end of September 2023, above its annual growth target of 'around 5%' set in March. This better-than-expected growth was mainly driven by the boost from consumption of services following the post-pandemic reopening, improved industrial activities and solid growth in manufacturing and infrastructure investments.

As consumer and business activity continues to rebound, supported by government stimulus measures, the drag on the property sector is expected to lessen, and we forecast China's GDP to grow at 5.2% in 2023 and 4.5% in 2024.

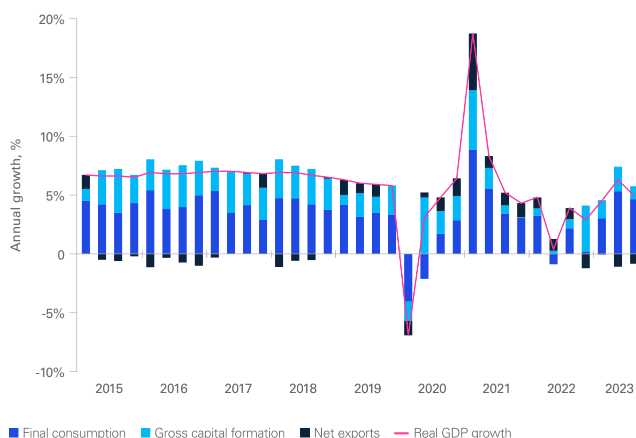
Economic activity underwent a recovery in Q3 as demand and prices continued to improve. Growth in industrial production grew by 4.5% in September and the manufacturing purchasing manager index (PMI) – a leading indicator – returned to expansionary territory after five months of contraction. Meanwhile, producer price inflation rebounded to -2.5% in September, up from its eight-year low of -5.4% in June, consistent with improving business sentiment.

Table 5: KPMG forecasts for China

	2023	2024	2025
GDP	5.2	4.5	4.5
Inflation	0.4	1.3	2.0
Unemployment rate	5.3	5.3	5.2

Source: Wind, KPMG forecasts. Average % change on previous calendar year except for the unemployment rate, which is the average annual rate. Inflation measure used is the CPI, and the unemployment measure is the surveyed unemployment rate.

Chart 15: Contributions to China's real GDP growth by sector, %



Source: China's National Bureau of Statistics, Wind, KPMG analysis.

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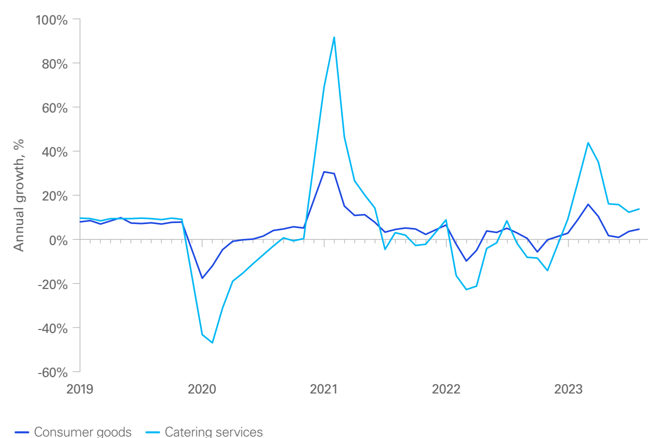
Thanks to the boost from increased services demand and the release of excess savings, consumption recovery has been stronger than expected. Growth in the retail sector rebounded to 5.5% in September from 3.1% in June, and growth in catering services reached 13.8% (see Chart 16). Tourism revenue from the recent Chinese National Holiday week increased by 129.5% from the same period in 2022, and 1.5% above the pre-pandemic level in 2019, reflecting the normalization of economic activity.

Household expectations for job security and income growth are important drivers in restoring market confidence and consumer spending. The government has taken various measures to keep the job market stable, and the urban surveyed unemployment rate dropped to 5.0% in September, the lowest since 2022. We expect the unemployment rate to average 5.3% in both 2023 and 2024. In addition, income growth reached 5.9% in the first three quarters of 2023, surpassing GDP growth. Income sentiment and consumer confidence have likely improved in Q4, which could support a recovery in consumption in 2024.

Chart 16: Growth of consumer goods and catering service, %



Source: China's National Bureau of Statistics, Wind, KPMG forecast.

On the capital side, we expect technology upgrading and green transformation to support manufacturing investment. Infrastructure investment should remain solid in order to facilitate economic growth in 2024. The government has approved RMB 1 trillion additional Central Government bonds in October to fund infrastructure projects. Outlays towards water conservancy, transportation and urban renovation have seen fast growth.

Meanwhile, real estate investment is expected to stabilize and become a lesser burden on overall growth in 2024. The government has taken action to stabilize the property market. Although liquidity is still a key challenge for developers, the declining rate of funding for real estate developers has narrowed. The latest round of property easing measures on the demand side – such as removing mortgage records for first-home buyers, cuts in mortgage down payment ratios and mortgage rates, projects in public housing and urban village renovation – may provide a boost to new home sales in larger cities. Although the property market is facing considerable headwinds, China's increasing urbanization and households' growing demand for quality homes should support the market in the long run.

While China's exports slumped over the past year amid a subdued global economy and a higher base effect, it has nonetheless outperformed other major exporters. China's share of global exports reached 14.6% in Q2 2023, up from 13.7% in Q1 2023. Despite the slowdown, the product mix of China's exports is changing, with increasing high-end manufacturing. Exports of "new three" products, including solar cells, new energy vehicles and lithium batteries, grew by 41.7% overall by the end of September 2023, becoming the main driver of China's exports.

Meanwhile, despite slowing exports to advanced economies, China's trade with emerging markets continued to rise in 2023. As the growth of exports continues to improve, we expect China's exports to remain resilient in 2024.

China is expected to maintain an accommodative policy stance to restore business confidence and boost economic growth. After announcing a set of supportive measures to help private business in mid-July, the government has approved RMB 1 trillion additional Central Government bonds to support local government spending, and will raise the fiscal deficit ratio from 3.0% to 3.8% in 2023. Fiscal support will be stepped up and be more effective in 2024.

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On the monetary side, the People's Bank of China (PBOC) has reduced the reserve requirement ratio (RRR) and policy rate twice this year to date, lowering funding costs for businesses and households. We expect China to continue to adopt supportive monetary policy, particularly in targeted areas. For example, the PBOC is expected to cut the RRR to provide liquidity on government bond issuance and cut policy rates. It is also expected to apply special relending facilities to increase financial support to SMEs, green investment, technology, and elderly care.

Inflation has remained low in China compared to many parts of the world, but it may see some upward movement in 2024. Food accounts for nearly 30% of China's consumer price inflation and the cyclicality of pork prices is an important factor behind inflation fluctuations. Driven by the recent decrease in pork prices, CPI inflation declined by 0.2% in October. Excluding food and energy, core CPI inflation remains stable at 0.6%, with the support of services consumption.

The Hong Kong (SAR) economy is also expected to recover in 2024. An expected strong rebound of tourism from the Chinese Mainland should support an acceleration of services consumption. The labor market continues to improve, aligned with the revival of domestic activities and inbound tourism. However, weak global demand is expected to weigh on exports. Meanwhile, Hong Kong is accelerating its economic integration with the Mainland, and the development of the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) continues to gain traction.

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Vietnam: A burgeoning manufacturing destination

Vietnam continues to be a destination for supply chain diversification.

Tight labor markets and increasing wage growth could hamper attractiveness.

The central bank is cutting policy rates as inflation decelerates.

Vietnam is forecast to close 2023 with strong growth that is expected to slow during the latter half of 2024. Even with the weakness, Vietnam's real output growth will remain healthily above the global average. Geopolitical risk and cost concerns have led firms to relocate manufacturing operations to the country. This makes Vietnam one of the largest beneficiaries of supply chain diversification as companies seek new locations to decrease dependence on concentrated geographic areas.

Consumer electronics, textiles, automobiles and auto parts manufacturers have found the country to be an ideal destination (see Chart 17). In addition, as part of the announcement of the comprehensive strategic partnership (CSP) with the U.S., several firms in the technology sector – including AI and semiconductor firms – have signed agreements to produce or partner with Vietnamese companies. With a relatively young population of around 100 million, Vietnam has a large talent pool and a tight labor market, with the unemployment rate hovering around 2% through 2024.

Vietnam's long and extensive coastline makes it an ideal place for manufacturing and exporting, as any production facility is never more than 300 miles from the coast or a potential ports. However, while exports are booming, aided by a weakened exchange rate over the last year, imports nearly cancel out any positive contribution to real output.

Being a single-party state gives Vietnam relative political stability that can be seen as an attractive attribute to many businesses. The strong growth Vietnam has experienced over the last decade – averaging around 6% per year, including during Covid – has allowed the Vietnamese government more authority over which industries and companies can move their operations to the country. This effectively allows for controlled growth rate that avoids runaway growth that could spur inflation.

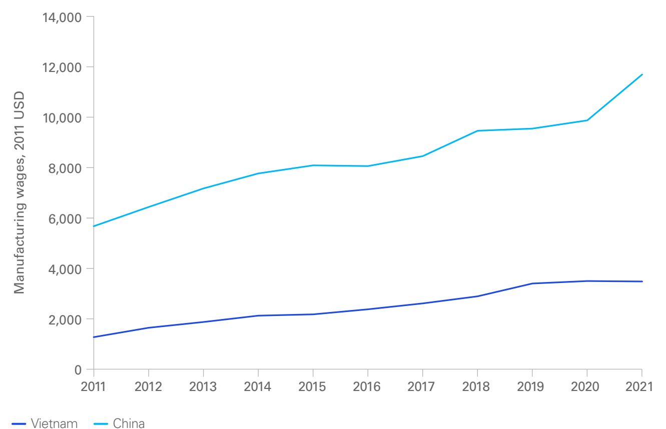
Table 6: KPMG forecasts for Vietnam

	2023	2024	2025
GDP	4.6	5.7	5.6
Inflation	3.2	3.3	2.6
Unemployment rate	2.1	2.0	2.0

Source: KPMG Economics.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Chart 17: Vietnam is a low labor cost manufacturing option



Source: KPMG Economics, Wall Street Journal, General Statistics Office of Vietnam, China National Bureau of Statistics, China Ministry of Labor and Social Security, Haver Analytics.

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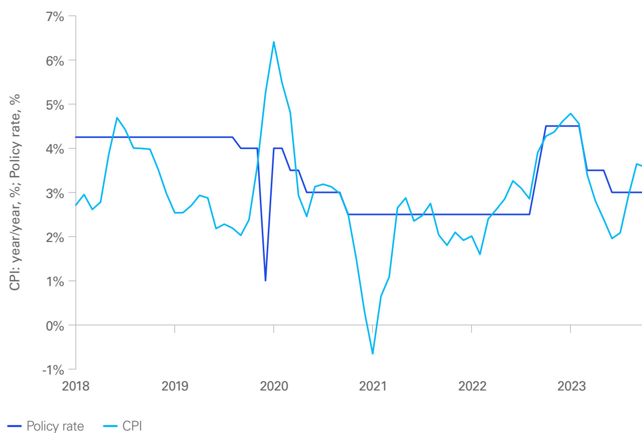
Vietnam has also been focusing on international relations by seeking additional countries to partner with for its highest level of diplomatic relations – comprehensive strategic partnerships. The U.S. has been elevated to this highest rung in Vietnam's diplomatic hierarchy, a title held – until now – by only China, India, Japan, Russia, and South Korea. Other countries currently being considered for CSPs include Australia, Indonesia and Singapore.

To combat inflation, the State Bank of Vietnam increased its monetary policy rate in mid-2022, but has since been cutting rates as inflation has moderated (see Chart 18). Current inflation has been mostly limited to energy, housing, material construction, and food. When stripping out volatile food and energy prices, core inflation has returned to the 3% range, still slightly elevated from the historical norm.

Chart 18: The State Bank of Vietnam is coralling inflation



Source: KPMG Economics, State Bank of Vietnam, General Statistics Office of Vietnam.

Part of the rise in food prices stems from the Indian government passing export controls on non-basmati white rice. Following this decision, countries across the ASEAN region experienced increases in food inflation – including Vietnam's, which jumped from 8% (quarter-over-quarter annualized rate) in July (when the export controls were announced) to 51% in August.

The tight labor market and increasingly complex manufacturing that is making its way to Vietnam is expected to increase real wages by around 7% through 2024. However, starting from the low wage base does not mean wages are rising substantially in absolute terms. In order to support potential growth, additional infrastructure is needed to capitalize on the positive momentum being experienced by the manufacturing sector.

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Japan: Yen's depreciation complicates outlook

The Bank of Japan is the only major central bank that has not raised interest rates to curb inflation.

The wage negotiations have not been enough to boost real wages.

Inflation is accelerating while the yen is depreciating, raising the probability of central bank intervention.

We see Japan's economy heading for a "slowcession" in 2024 after a sharp miss on GDP growth in the third quarter of 2023. Consumption is sluggish, inflation is climbing and investment and trade are becoming a drag on growth. Exports have been expanding following a weakening yen, but that has not been enough to support the economy. The unemployment rate is rising and will likely settle above its 2019 level as the labor market conditions unwind.

Inflation is stickier than the Bank of Japan (BOJ) had anticipated. The bank has not raised interest rates in part because inflation in Japan has picked up later, and has been concentrated in goods rather than services. Inflation excluding food and energy only rose above the 2% target in October 2022; for context, U.S. core inflation rose above 2% in March 2021. Wages are not necessarily feeding inflation, as real wage growth remains negative; workers will need to wait until Spring wage negotiations to see any gains. Nevertheless, core inflation is elevated above the bank's 2% target. Recent yen depreciation could keep inflation persistent as Japan imports inflation from abroad. That puts more pressure on the BOJ to intervene.

The BOJ, while remaining committed to accommodative interest rates, has tweaked its monetary rules in an effort to decelerate core inflation, which should near 2% later into 2024. The policy interest rate has been at -0.1% since 2016. The bank is more worried about overshooting than undershooting; it remains the only central bank among major advanced economies that has not raised interest rates. The changes to the yield curve controls included changing the language around the 1% cap on the 10-year yield to be less rigid, which has raised the cost of borrowing without raising rates.

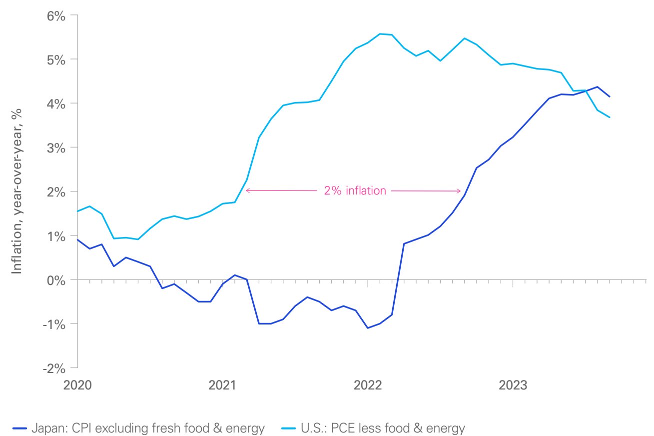
Table 7: KPMG forecasts for Japan

	2023	2024	2025
GDP	1.9	0.1	1.1
Inflation	3.2	2.2	0.5
Unemployment rate	2.6	2.6	2.5

Source: KPMG Economics, Cabinet office of Japan, Ministry of Internal Affairs and Communications, Statistics Bureau.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Chart 19: Inflation arrives later



Source: KPMG Economics, U.S. Bureau of Economic Analysis, Japan Ministry of Internal Affairs and Communications, Statistics Bureau

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The U.S. consumer shift from goods to services will weigh on the external sector for Japan in the near term. However, foreign visitors have been returning and approaching pre-pandemic flows, which has helped services exports. The easing of supply chain bottlenecks has also improved efficiency for exporters.

While we expect fiscal policy to remain supportive, with government debt to GDP ratio hovering around 250%, lower interest rates will keep interest expense low as a percentage of total output.

The largest risk to the forecast comes from the challenges posed by persistent inflation and currency depreciation from the accommodative policy of the BOJ. With the currency close to 150 yen per U.S. dollar (the level that last prompted a foreign exchange intervention in October 2022), the probability of a bank intervention to support the yen has risen. That would restrict money supply and further tighten financial and credit conditions. It is probable that the bank could raise interest rates following the wage negotiation in 2024, further strengthening the yen. That could buy time until other central banks cut rates.

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India: Increasingly important economically and diplomatically

The G20 Summit was a testament to India's diplomatic strength.

Supply chain reorganizations are making India a go-to destination for firms.

Semiconductor fabrication is heading to the world's most populous country.

India's economy is expected to slow in 2024 after this year's blistering pace, which is forecast to equal pre-pandemic growth – a rarity, as growth has generally slowed globally. The year 2023 proved to be valuable for Indian diplomacy, as the country displayed its ability to work with the world's largest economies at the G20 Summit.

Economic growth is driven by consumption and investment; there are no real drags looking forward. India's weaker 2024 growth is forecast to be a part of the global slowdown that is affecting all regions, including Asia, which is home to most of India's key trading partners. Consumers and investors are bullish on the economy, meaning there is room to expand in both the near and medium term.

Inflation has been a challenge for a couple of years, but it is heading back toward manageable levels. To fight inflation, the Reserve Bank of India raised its policy rate during 2022 and early 2023 from 4% to 6.5%. The rate is expected to stay elevated through 2025 and cause a pullback in investment as financing costs remain high.

India has been one of the largest beneficiaries of supply chain diversification. Being a low-cost manufacturer that dodges the faults of negative geopolitics has made the country very appealing. Automobile and auto part manufacturing as well as consumer electronics have migrated to the world's most populous country. Trade with key partners has increased, including a staggering 36% increase in exports to the U.S. between 2019 and 2022, according to the U.S. Census Bureau.

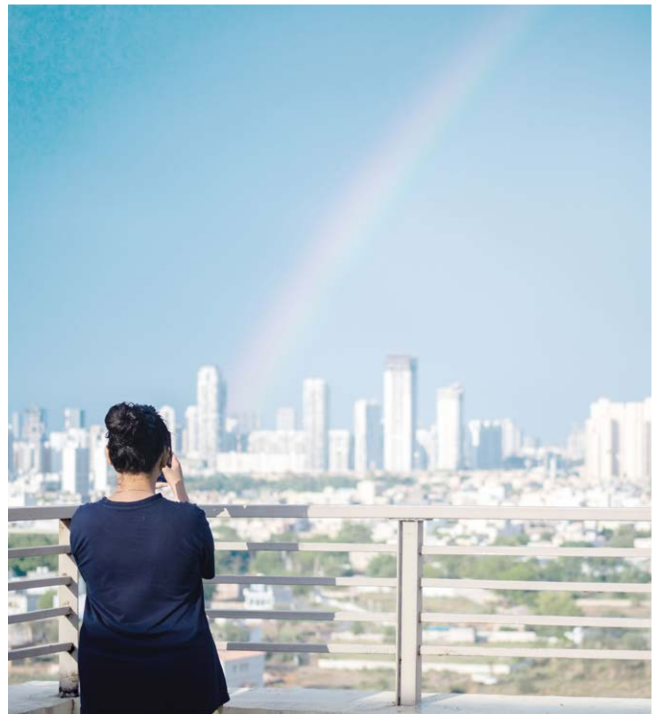
Another sector experiencing growth is semiconductors. Chip fabrication chains are on the move, with India attracting a lot of attention due to its young, vast labor market, and one million engineers graduating from universities annually. India does not produce the most cutting-edge chips, but those that are five to ten years off the frontier.

Table 8: KPMG forecasts for India

	2023	2024	2025
GDP	7.2	6.0	5.3
Inflation	5.5	5.1	4.7
Unemployment rate	6.9	7.3	7.3

Source: KPMG Economics, General Statistics Office.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.



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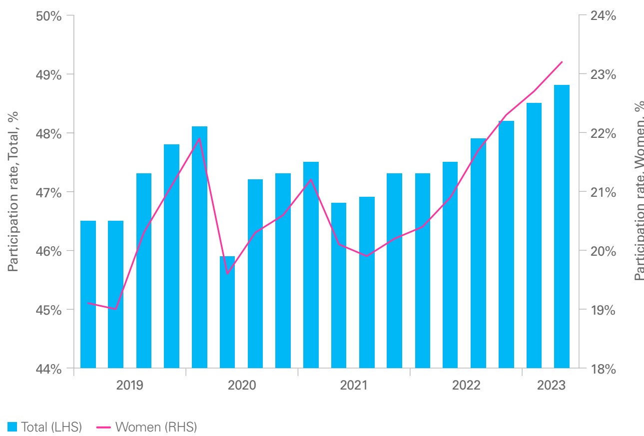
Real disposable income is expected to grow around 4% per year, providing additional spending power to India's increasingly interconnected society. The cell phone penetration rate is rapidly improving, which is giving access to digital payments and other new services.

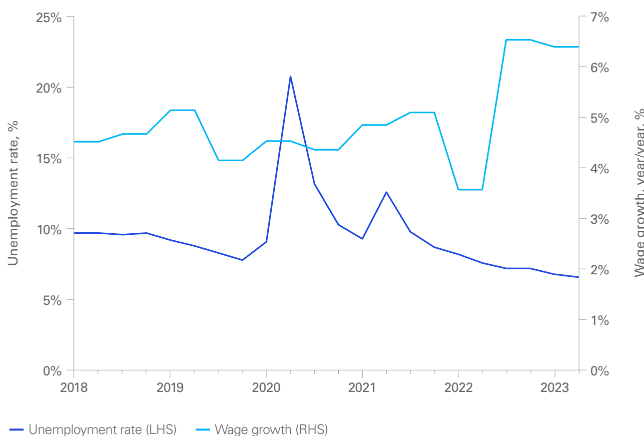
To handle the pickup in manufacturing, infrastructure is being created. Despite developing road and port access, the country is still underequipped to accommodate the influx of companies seeking alternative manufacturing destinations. Manufacturing capacity utilization is still at healthy levels and is not at risk of running short.

Chart 20: Labor force participation is improving



Source: KPMG Economics, MOSPI.

Chart 21: Tight labor market leads to increasing wages



Source: KPMG Economics, India Labor Bureau.

A benefit of the manufacturing inflow is job creation. While the population is large, women have historically not been major players in the formal workforce. The last couple of years have seen signs of improvement, however, as women have singlehandedly improved the labor force participation rate (see Chart 20).

Despite the geopolitical uncertainty, India is proving to be a diplomacy juggernaut. Walking a fine line across relationships with countries in the West and Global South, India has managed to improve its standing among partners. The G20 Summit was the best example of this as Delhi hosted the 2023 edition.

While India has portions of its workforce that are well educated, it also has a literacy rate of 78%, per the National Survey of India, which is lower than the UNESCO estimated global literacy rate of 87%. This could prove to be a headwind as the economy continues to develop, new firms enter the market, and skilled labor becomes more vital.

Following a 21% unemployment rate in 2020, the current level is near historical averages during expansionary periods. The tightening market has produced upward pressure on wages since 2022 and that is expected to continue into 2024 (see Chart 21).

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Germany: Europe's largest economy in a recession

German economy expected to slowly recover from 2024 onward.

Inflation to continue to ease, with energy prices being a key factor.

Labor market proves robust despite weakening economy and persistent shortage of skilled workers.

The persistently high inflation level, geopolitical uncertainties, high interest rates and a weak global economy continue to weigh on the German economy. In particular, the sharp rise in energy costs is impacting Germany's energy-intensive industries, which contribute a large proportion of gross value added. The global tightening of monetary policy and the slow recovery of important foreign markets for German products are also negatively affecting the export oriented German economy. As a result, output is expected to shrink in 2023.

Although sentiment in the German economy remains at a low level, there are positive signals as well. Business sentiment increased slightly in October and in November 2023, with the ifo Business Climate Index rising to 87.3 points in November, up from 85.8 points in September. Companies are more satisfied with their current business and less pessimistic about the coming months.

In 2024, the German economy is likely to register slight growth and potentially grow faster than some other G7 countries. Rising wages, falling energy prices and the ability of exporters to pass on costs to foreign customers could gradually restore domestic purchasing power in the coming year. The absence of further interest rate increases – and possibly even a fall in interest rates over the course of the year – could also help the German economy to continue its upswing.

A particularly long phase of inflationary pressure in Germany is slowly coming to an end. However, even though inflation is easing, it remains well above the ECB's target of 2%. As a result of the sharp rise in the general price level over the past two years, consumers have become much more reluctant to spend and the savings rate remains high.

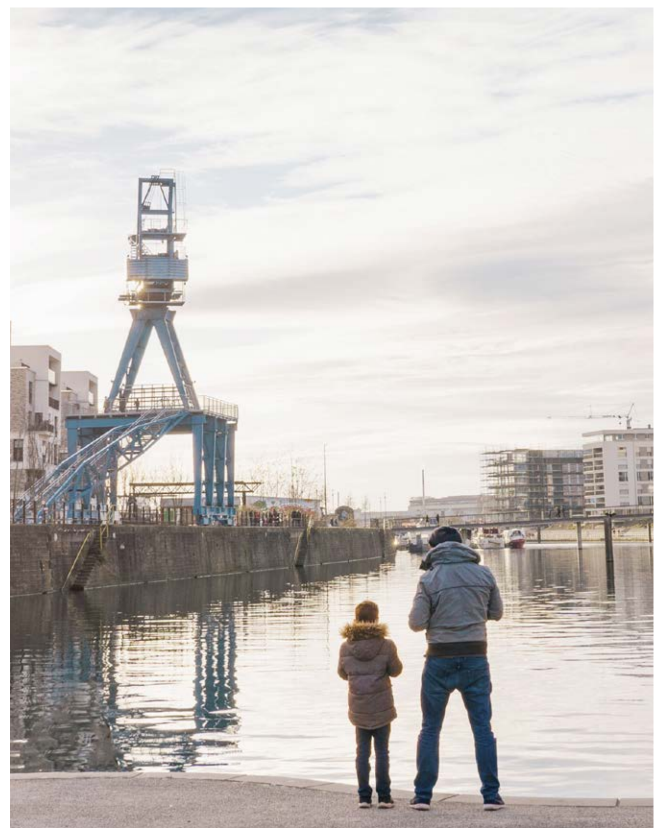
While rising interest rates are intended to dampen inflation, they are also detrimental to capital spending and thus contributed to a slowing in economic recovery. There is currently great uncertainty among consumers, companies, and investors, with many refraining from large projects due to high borrowing costs.

Table 9: KPMG forecasts for Germany

	2023	2024	2025
GDP	-0.2	0.6	1.6
Inflation	6.1	2.9	2.1
Unemployment rate	5.6	5.7	5.7

Source: Destatis, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the CPI.



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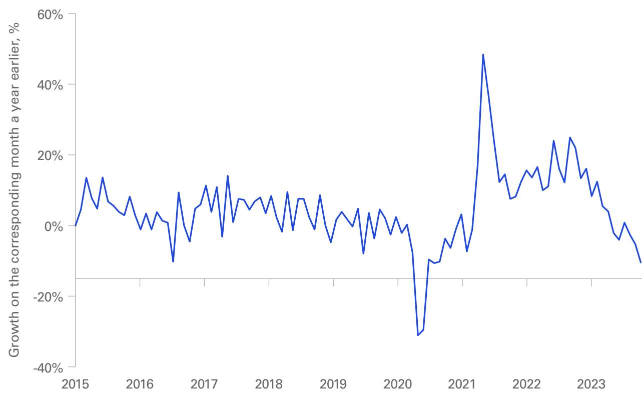
Positive signs are coming from the upstream stages of value chains. Significant declines in import, producer and wholesale prices are expected to be gradually passed on to consumers. However, the recent rise in oil and gas prices is again a cause for concern, since it could rekindle overall inflation.

The shortage of skilled workers in many sectors in Germany does not only put pressure on the workforce, but also has a negative impact on general public services, the economy, and overall growth.

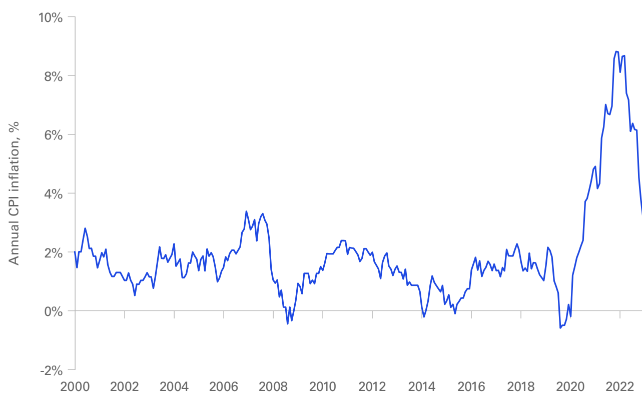
One of the main causes of this shortage is demographic change. Germany is in a phase in which the population is ageing and the ratio of working to retired people is shifting.

Chart 22: Growth in export volumes



Source: Statistisches Bundesamt (Destatis)

Chart 23: Annual CPI inflation



Source: Statistisches Bundesamt (Destatis)

Another factor is the education gap. Although Germany is known for high quality education, there is still a mismatch between the skills learned and the requirements of the labor market. Immigration of qualified skilled workers, flexible work-life models, and further qualification of the existing and potential workforce could counteract the problem. The use of new technologies, such as artificial intelligence, could also at least partially alleviate the skills shortages.

Despite the challenges, the German labor market is proving to be resistant to crisis. Although the ongoing economic weakness is gradually making itself felt, the labor market is still holding up well in view of the economic data. Demand for labor remains high, with the number of people in employment at a record level. Households' purchasing power is also picking up, which in turn should support private consumption and thus the economy.

Germany has developed a high level of resilience to crises, primarily thanks to its economic strength. For example, the country's low national debt compared to other countries has facilitated billions in aid packages to be made available to companies to overcome crises.

Despite the decline in economic growth this year, we expect the economy to recover and grow slightly across 2024 and 2025. However, external factors – such as the evolution of global demand and geopolitical tensions – may have an unpredictable impact on the overall extent of growth.

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Austria: Higher prices and their implications

Stagnation in 2023 due to price pressures and reduced export volumes.

Return to positive growth in 2024 on the back of private consumption recovery.

Inflation above European peers should moderate in 2024 and 2025.

In 2023 the Austrian economy is in a mild recession due to a variety of exogenous shocks, such as price increases caused by the pandemic, energy price shocks caused by the war in Ukraine, and a series of interest hikes by the ECB. As a consequence, Austria experienced a substantial reduction in investment and exports, alongside weak private consumption.

From mid-2023, real wages started to rise due to softening inflation. Expected wage increases could stabilize real income further and create positive economic impulses. Private consumption is set to remain a vital pillar of the Austrian economy in 2024 and 2025, although growth in spending is expected to be lower than that of real wages. The reason is a higher risk of job losses associated with the economic downturn, which negatively impacts the propensity to consume.

Table 10: KPMG forecasts for Austria

	2023	2024	2025
GDP	-0.4	0.6	1.5
Inflation	8.0	3.2	2.3
Unemployment rate	5.1	5.2	5.1

Source: Bloomberg, Statistik Austria, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

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Nevertheless, activity is expected to pick up in 2024 and stabilize in 2025, mainly driven by a boost from real wages to private consumption and an expected recovery in exports. However, weak investment, especially in the construction sector due to increased financing cost, is set to weigh on economic growth.

Due to the delayed impact of energy price reductions on Austrian retail energy prices, prices remained high at the beginning of 2023. The gradual pass-through of wholesale price decreases started to lower inflation from Q3 2023, a process which is expected to continue further (see Chart 24). In addition, a deceleration of corporate profits due to higher unit labor costs is expected to contribute to a further decrease in headline inflation. Due to the importance of the services (especially tourism-related) sector in Austria, significant wage growth is set to drive the prices of services higher.

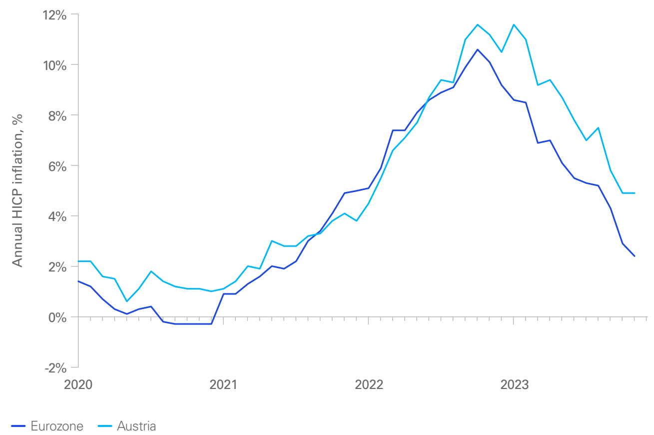
Austrian inflation has been a lot higher than its European peers, leading to stronger government response in the form of energy price compensations, stimulating inflation further (see Chart 25). Therefore, inflation is going to stay well above the central bank's target, although gradually decreasing after 2023, with 2025 expectation still well above 2%. This is mainly due to core inflation (excluding energy and food) projected to stay high as a result of strong wage growth developments.

The labor market is expected to remain resilient despite the economic downturn starting in Q3 2023. We expect employment growth of 0.6% in 2023. Continued employment growth is also expected for 2024 and 2025, if initiatives to increase participation of older workers and women pay off as intended. As labor scarcity and demographic issues prevail, the increase in labor participation will not lead to an increase in unemployment, despite stagnation in 2023 and a weak outlook for 2024 (see Chart 26). Nominal compensation of employees per head is expected to moderate from 8.3% in 2023 to 7.1% in 2024 and 3.9% in 2025, driven by inflation developments and the tight labor market.

Chart 24: Wholesale natural gas price

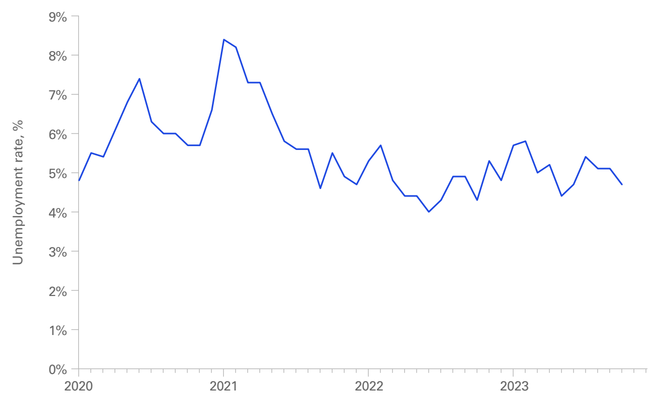
Source: Bloomberg.

Chart 25: Annual inflation in Austria and the Eurozone



Source: Eurostat.

Chart 26: Unemployment rate in Austria



Source: Eurostat.

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The general government deficit is expected to decrease from 3.5% of GDP in 2022 to 2.6% in 2023. The phasing out of Covid support measures, as well as energy price compensation, are set to contribute to this consolidation. The planned consolidation path will extend to 2024 and 2025, bringing the deficit further down. Nevertheless, public debt-to-GDP ratio is still at elevated levels, with a projected 76.3% in 2023, and 74.8% in 2025.

Due to the strong dependency on Russian gas supply, a further escalation of the war in Ukraine – causing gas shortages to industry and private households – remains a major downside risk to the Austrian economy.

Considering firm's behavior, there is a significant downside risk for investment activity in 2024, especially in the manufacturing and construction sector. Retail demand has undergone a severe decrease, mainly due to higher financing cost, lower real income, as well as macroprudential restrictions on loan accessibility. The dynamics will remain limited throughout 2024 and beyond. In addition, the cost of labor hoarding by firms during the downturn could outweigh the cost of recruiting, implying financial pressure for corporations.

Although there might be additional stimulus by the introduction of new fiscal measures in the light of the 2024 upcoming parliamentary elections, this could also spark further inflation, prolonging the price-related problems in the economy.

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Switzerland: Resilient but not fully immune to shocks

Reduced investment growth a major factor behind the 2023 weakness.

Consumption set to stabilize and bring the Swiss economy back on a growth path.

Exports to recover, with risks from global activity and energy prices.

The Swiss economy started off well in 2023, but lost momentum from the second quarter on, as foreign demand and domestic final demand did not continue to rise (see Chart 27). The decreasing final demand is mainly attributable to Swiss companies reducing spending on equipment investment. This was only partly compensated by private consumption, with a high willingness to spend in the services sector, and a boost from immigration to the Swiss labor market.

Consumption is set to be the main driver of Swiss economic activity in 2024. Although we don't expect positive real wage growth that year, labor demand should lead to a further increase in employment, with further boost of qualified labor immigration.

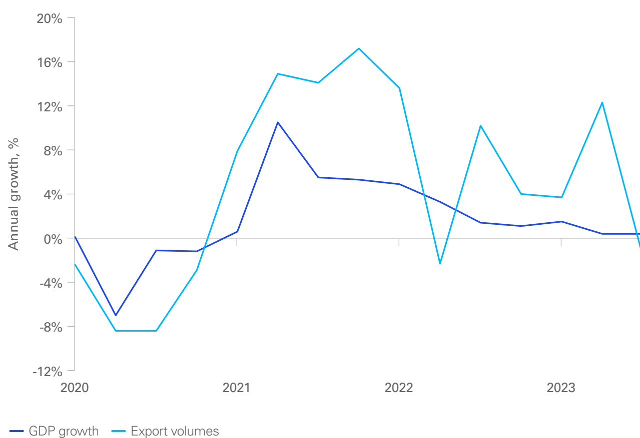
Table 11: KPMG forecasts for Switzerland

	2023	2024	2025
GDP	0.8	1.1	1.6
Inflation	2.2	1.7	1.4
Unemployment rate	2.2	2.4	2.4

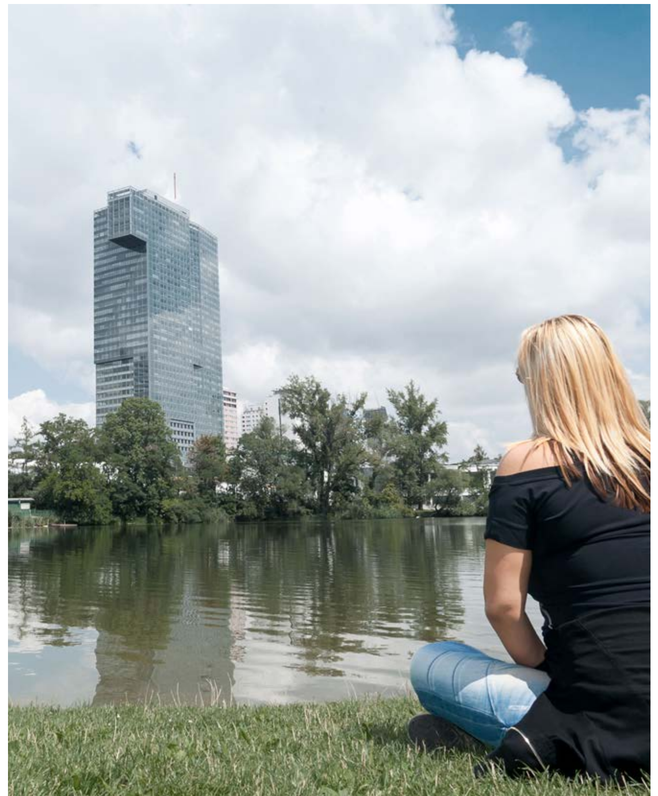
Source: Eurostat, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

Chart 27: GDP and exports growth in Switzerland



Source: Bloomberg.



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On the corporate side, efficiency-led investment could become worthwhile due to high cost pressures. Therefore, we expect equipment investment to rebound in 2024. Stabilization can also be expected from the construction sector, led by a recovery from the recent downturn. Furthermore, a rebound in western Europe should support exports growth, which is backed by a solid foundation of non-cyclical products, such as pharmaceuticals. Additional stabilizers include tourism, transport and consulting sectors.

Given the strength of the Swiss franc versus the main currencies (euro and the U.S. dollar), the Swiss economy still manages to be rather resilient, with the expectation of only limited reduction in export activity in 2023 and 2024 (see Chart 28). According to our forecast, a decline in goods exports is set to end in 2024 and to pick up again in 2025.

Chart 28: Swiss franc exchange rates

Source: Bloomberg.

The Swiss labor market is expected to cool slightly, with only a marginal rise in employment over 2024 and 2025, of around 1 %. The unemployment rate is also expected to increase, albeit remain low by historical standards. This is mainly due to the dampening in cyclical areas of manufacturing and wholesale industry, with the possibility to spill over to other industries in the private sector.

There are substantial risks to the outlook. Inflation could prove more persistent globally and necessitate more restrictive monetary policies. This would further slow down global demand, limiting export dynamics in Switzerland. Moreover, there could be an increase in existing risks associated with global debt, the risk of property and financial market corrections, as well as risks in the banking sector. In addition, the transmission of monetary tightening to the real economy could turn out to be stronger than currently assumed.

In the near term, an energy shortage in the winter of 2023-24 still poses the risk of an economic downturn, both in Europe and in Switzerland. While this would likely result in a recession combined with high price pressure, we see this as a low probability scenario.

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Spain: Lower growth for 2024 but gaining traction throughout the year

Post-pandemic rebound, Next Generation EU funds, and moderation in salaries behind strong growth in 2023.

Salaries expected to grow faster than inflation in 2024, slowing down job creation but strengthening internal demand.

Impact of monetary policy set to ease in the second half of 2024.

The Spanish economy showed a better-than-expected performance in 2023. Growth is projected to be around 2.5%, well above the Eurozone and Spain's main trade partners. This strong performance can be explained by three different factors. First, in 2023, the Spanish economy still had a GDP gap to fill from the pandemic: the contraction in 2020 (-11.2%) was larger than in other advanced economies, and, although the recovery was strong in 2021 and 2022 (with growth of 6.4% and 5.8%, respectively), it still lagged other European economies. GDP did not reach 2019 level until end-2022.

The second reason behind the resilience was a marked acceleration in the level of investment and of the Next Generation EU funds committed, compared to the slow start in 2021 and 2022.

The final, and probably most important, factor behind strong growth is that, throughout the recovery, nominal unit labor costs have grown slower than the prices set by Spanish companies. In other words, internal prices have grown faster than salaries. Although this reduction in real wages has somewhat eroded the real disposable income of certain households, it has also helped to support job creation and maintain or even improve external competitiveness.

At the same time, the impact of monetary tightening by the ECB has potentially had a more limited effect than initially thought on consumers' disposable income, real estate prices, and gross capital formation. But this does not mean that the interest hike has not taken its toll. Growth has been progressively decelerating in 2023.

Table 12: KPMG forecasts for Spain

	2023	2024	2025
GDP	2.5	1.5	1.8
Inflation	3.6	3.4	2.3
Unemployment rate	12.2	11.6	11.3

Source: Instituto Nacional de Estadística, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the CPI.

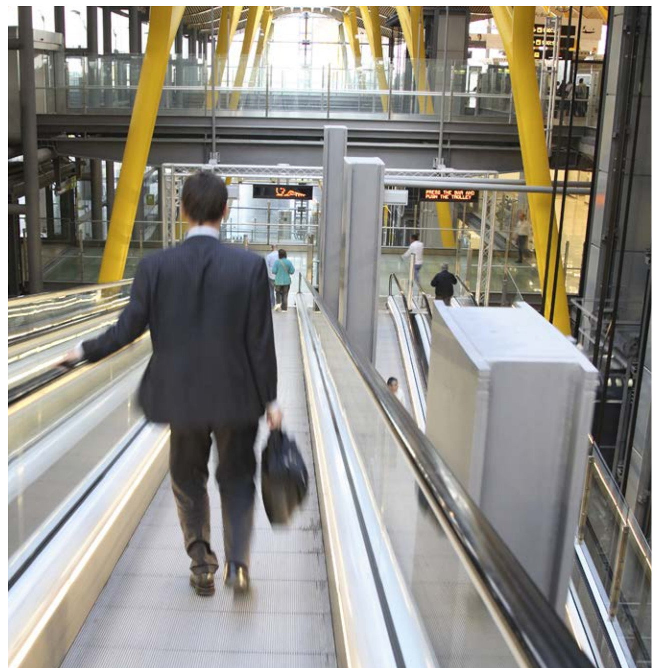

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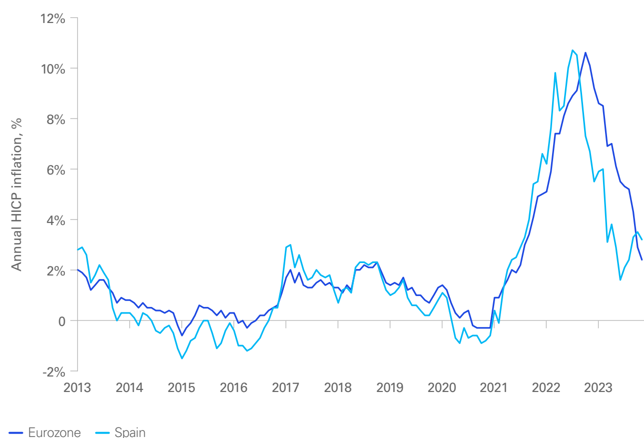
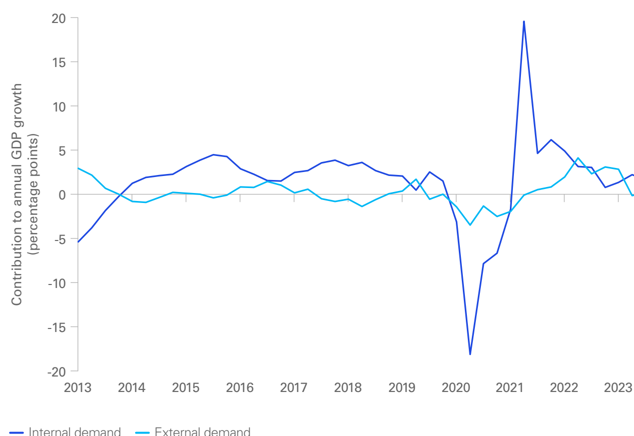
Chart 29: Annual inflation in Spain and the Eurozone



Source: Eurostat.

Chart 30: Contributions to GDP growth from internal and external demand



Source: Instituto Nacional de Estadística.

With annual CPI inflation of 3.2% in November 2023, and an expected average inflation of 3.6% for the whole year, Spain is placed towards the lower end for OECD countries. Spanish inflation is very sensitive to oil prices; this explains both the sharp rise in 2022 and the abrupt decline in 2023. Core inflation is also falling, but at a much slower pace. A warning signal to pay attention to, however, is that for the first time since 2022, Spanish inflation was higher than in the Eurozone in October and November (see Chart 29).

Employment growth is strong, at around 3%, and the unemployment rate is expected to decrease to 12% in 2023. Contained salary growth explains this performance of the labor market, as well as the resilience of private consumption, as the limited erosion of the real wages was more than compensated by job creation. Correlated with slower GDP growth as the year progressed, there are also signals of some weakening in the Spanish labor market in the second half of 2023.

A much weaker growth can be expected for 2024. Our forecast is for growth of 1.5%. But if growth in 2023 was losing steam throughout the year, we expect activity to gain traction throughout 2024. The impact of monetary tightening could reach its maximum towards the end of 2023 and the beginning of 2024. But the constant decrease in headline and core inflation in the Eurozone points at stable – or even more relaxed – monetary conditions as we advance into next year.

Next year we also expect salaries to grow faster than inflation, slowing down job creation but also strengthening internal demand through private consumption. Although Spain is set to maintain a healthy surplus in its external accounts, external demand is not expected to contribute to growth in 2024 (see Chart 30). Consequently, the unemployment rate is forecast to continue decreasing, but at a much slower pace than in 2022 and 2023.

Regarding prices, we expect a further reduction in average headline inflation to 3.4%. One of the key issues to impact inflation in 2024 is the extent to which the expected phasing out of government measures implemented to mitigate the impact of high energy and food prices will be. If this is not complete, the final inflation figure could be a little lower, but the trade-off will be in a small increase in the public deficit.

Turning to the fiscal position, we expect the deficit of around 4% of GDP in 2023, with the public debt-to-GDP ratio falling to 108% from 120% in 2020. However, most of the expected reduction in public deficit and debt is explained by the economic cycle and by the increase in nominal GDP. To continue this trend and to achieve the objective of a deficit of 3% of GDP in 2024, the Government would have to phase out most of the fiscal measures implemented to counteract the impact of high inflation. This is probably the most important challenge that the recently elected Spanish government will face on the economic front in the short term.

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The Netherlands: Technical recession drags on for third consecutive quarter

Economy set to gradually recover following a shallow recession.

Energy prices weigh on inflation; core inflation set to decrease more gradually.

Talks to form a coalition are set to soon begin following the general election.

The technical recession in the Dutch economy has not ended yet, after registering a quarter-on-quarter contraction of 0.2% in Q3 2023, marking the third consecutive decline (-0.5% in Q1 and -0.4% in Q2). Growth was also negative on an annual basis (see Chart 31). The contraction in Q3 was primarily driven by inventory depletion and reduced investment, notably in the energy supply and recreation & culture sectors. While public spending showed positive growth, private consumption remained weak due to the ongoing impact of higher inflation on households. However, the drop in activity has not amounted to be a full-blown recession (or less so a crisis) as the job market remains tight, vacancy rates remain high, and the number of corporate bankruptcies remain low by historical standards. The fast rebound following the pandemic came to an end early this year, and the economy is now undergoing a slowdown.

We forecast Dutch GDP to grow at 0.5% in 2023 and average 1.2% during 2024-25, remaining below its average historical growth. The recovery from this shallow recession is anticipated to be gradual, compounded by a persistently tight labor market. In 2024 and 2025, growth is set to be supported by lower inflation and improvement in households' real purchasing power. We expect export volumes to pick up as demand from significant trading partners stabilizes. Additionally, growth could be bolstered by increased public expenditure and a gradual rebound in private investment. The balance of risks is currently neutral, with potential downside risks linked to the impact of tighter financial conditions and persistent structural labor shortages.

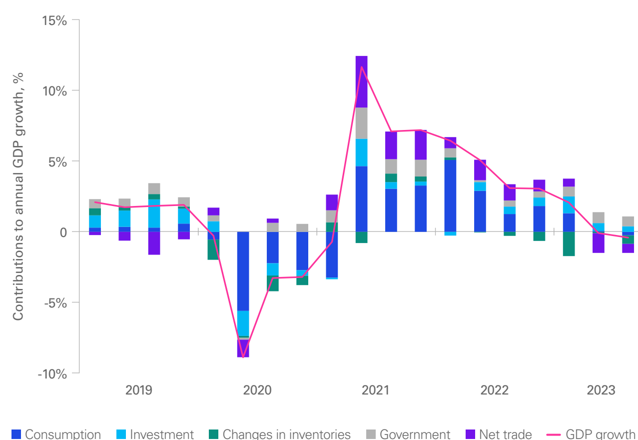
Table 13: KPMG forecasts for the Netherlands

	2023	2024	2025
GDP	0.5	0.8	1.6
Inflation	4.6	2.9	2.4
Unemployment rate	3.6	3.8	3.8

Source: Eurostat, KPMG forecasts.

Note: Average % change on previous calendar year expect for unemployment rate, which is average annual rate. Inflation rate measure is CPI.

Chart 31: Economic growth by demand components



Source: Statistics Netherlands, KPMG analysis.

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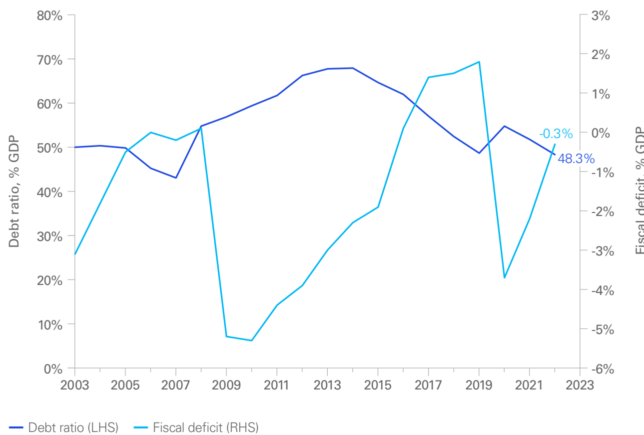
On the prices front, annual headline inflation has moderated below 2% since September on the back of lower energy prices and base effects. We anticipate inflation to remain below 3% throughout 2024-25. Meanwhile, inflation excluding energy and fuels is predicted to decrease more gradually, mainly due to higher persistence of food and services prices. Nominal wages are expected to grow above 4% over the forecast horizon, driven by labor shortages; however there are early signs suggesting a softening in labor demand. House prices fell during the first part of 2023, but the correction appears to be over as housing transactions continue to gradually increase and overbidding returns.

Chart 32: Dutch government debt and fiscal deficit



Source: Statistics Netherlands, DNB, KPMG analysis.
Note: 2023 values are forecasts.

The Freedom party (PVV) won the Dutch parliamentary elections on November 22, and a coalition is yet to be formed. The future policy direction is contingent upon the coalition's decisions. However, the proposed economic measures appear to carry significant costs, suggesting a potential widening of the fiscal deficit.

While the PVV is likely to cut spending on climate and energy transition initiatives, they have also pledged substantial additional expenditures on healthcare and free public transportation for senior citizens. Few measures aimed at bolstering household purchasing power are expected to persist into 2024, owing to diminishing inflationary pressures. There is ambiguity surrounding the costs linked to the approved pension fund reform initiated in June 2023 (transitioning from a defined benefit to a defined contribution scheme), particularly with the PVV's declared intent to overturn the legislation.

The projected deficit outlined in the Dutch spring budget for 2024 is expected to exceed 3%, surpassing the threshold permitted by Brussels. This deviation is attributed to multiple amendments in bills. The budget anticipates a deficit below 3% in 2025, followed by an escalation to 3.6% in the subsequent year. The debt to GDP ratio is expected to remain below 50% in 2024-2025 as a consequence of higher nominal GDP, mainly driven by the price component (see Chart 32).

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Ireland: Recent strong growth moderating to typical levels

Strong multi-year economic growth arrested in the latter half of 2023.

Exchequer revenue boom slowing as corporation tax take moderates.

Demand-led economy generating opportunities and challenges.

Following on from a strong bounce-back after the Covid pandemic, Ireland's economic growth evolved in 2023, with the domestic economy becoming the predominant driver of growth. GDP performance slowed in 2023, ending with a fall of -0.5-1.0%, while the domestic economy was relatively flat over the year (0.0-0.5%).

A key issue for Ireland remains that dual economy challenge. In 2023, the slowdown in global demand triggered marked reductions in export volumes, adding to the post-pandemic contraction in exports of pharmaceutical and medical products. Other factors, such as a renewed surge in commodity prices, an intensification of conflicts, and tighter-than-expected global financial conditions, all weigh heavily on the domestic economy. As the Multinational Enterprise (MNE) sector has accounted for more than 50% of Irish GDP since 2020, global shifts can have large local impacts. In 2023, Modified Domestic Demand (MDD, a measure of the domestic economy) continued to grow, albeit at a more moderate pace in the context of high inflation that is curbing spending by households and businesses.

Over the coming years, Ireland is expected to see more nominalized and moderate growth rates, as consumption recovers with rising real wages, subsiding price pressures, and a strengthening in investment and exports as external demand picks up. Most forecasters are anticipating GDP growth in 2024 and 2025 in the range of 3%-3.5%, and slightly lower growth in MDD, at 2%-2.5% over the same period.

Against this backdrop, unemployment is expected to remain at low levels over the forecast horizon (4%-4.5%), with net migration and employment growth driving higher job numbers overall. These tight labor market conditions could see an intensification of the upward pressure on wages, potentially leading to nominal wage growth of 5%-5.5% in 2023 and 2024, reflecting a catch-up following the hits to real incomes in 2022 and 2023.

Table 14: KPMG forecasts for Ireland

	2023	2024	2025
GDP	-0.5	3.0	3.5
Inflation	5.5	3.0	2.0
Unemployment rate	4.2	4.3	4.4

Source: CBI, CSO, DOF, EC, ESRI, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

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Inflation remained elevated throughout 2023, but gradually fell over the course of the year. Although energy prices fell earlier in 2023, these were not passed on to consumers until several quarters later. While the central outlook is for a gradual easing in energy prices and a restoration of real incomes to pre-2022 levels, retail energy prices are likely to stay elevated and will remain vulnerable to further volatility in the energy market. Despite ongoing government support, arrears in retail energy markets indicate that a cohort of consumers are facing difficulties with meeting higher costs.

In addition, inflation is now being driven by higher housing costs and food costs, which are in turn dragging on domestic consumption. Overall, it appears that the ECB's tighter monetary policy since 2022 will bear fruit, but slowly.

Other factors at play in Ireland's economic outlook are its property market and the Government's finances. Ireland's residential property market grew strongly over the past several years, buoyed by strong economic growth, low unemployment, and high levels of foreign direct investment. Although households showed resilience in 2022-2023 and benefited from robust income growth, some are facing repayment challenges, with the full extent of higher interest rates and monetary policy pass-through still to come. The market remains broadly balanced, with competing forces of a continued lack of supply and increasingly stretched affordability leading to the leveling off in growth.

Higher ECB interest rates are expected to weaken mortgage demand, with negative implications for house prices. However, a major threat to the housing market is the lack of housing supply, which could drive more aggressive price gains over the next one to two years. After a marked increase in housing completions in 2022, and weathering of supply pressures in 2023, there is an indication of further growth in 2024.

A key indicator for the medium-term outlook is the strength of the public finances. Most forecasters were anticipating that the long period of high levels of corporation tax receipts would end in 2023, but receipts summing to a peak of 27% of total income were collected nonetheless. 2024 will provide clarity around the overall trend and potential risks to central government spending plans.

Taken together, there are reasons to be pragmatic about Ireland's economic outlook in 2024 and beyond. While positive growth is expected, this would be more modest than in the past. The period of high corporation tax receipts is passing, meaning more cautious budgetary policy, while significant levels of investment are needed to meet demand and investment in infrastructure, housing, healthcare, and renewables. While open economies typically face greater challenges during global downturns, they are also best placed to take advantage of underlying global growth potential during recoveries.

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UK: Limping with a sprained ankle

Activity has outperformed expectations, but the outlook remains weak and vulnerable to shocks.

Although the peak in inflation is behind us, a large part of the impact from monetary policy is still to come, continuing to depress growth.

Risks to the outlook are skewed to the downside, and stem from a more persistent inflation, delayed impact of monetary policy, and structural weakness of labor supply.

The UK economy has performed better than expected this year. At the start of 2023, market consensus for GDP growth for that year was consistent with a 1% fall (see Chart 33). The latest expectation – matching our own forecast – is for growth of 0.5% in 2023. On a year-to-date basis, business investment grew by 6.3% in Q3 2023, while household consumption – the main engine of growth in normal times – was up by 0.3%, although the latter is still some way below its pre-pandemic level, largely as a result of successive negative shocks to real incomes.

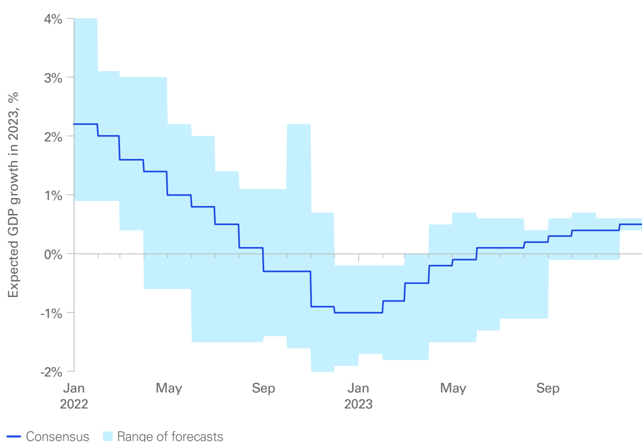
Table 15: KPMG forecasts for the UK

	2023	2024	2025
GDP	0.5	0.5	1.0
Inflation	7.5	2.8	2.1
Unemployment rate	4.1	4.7	4.9

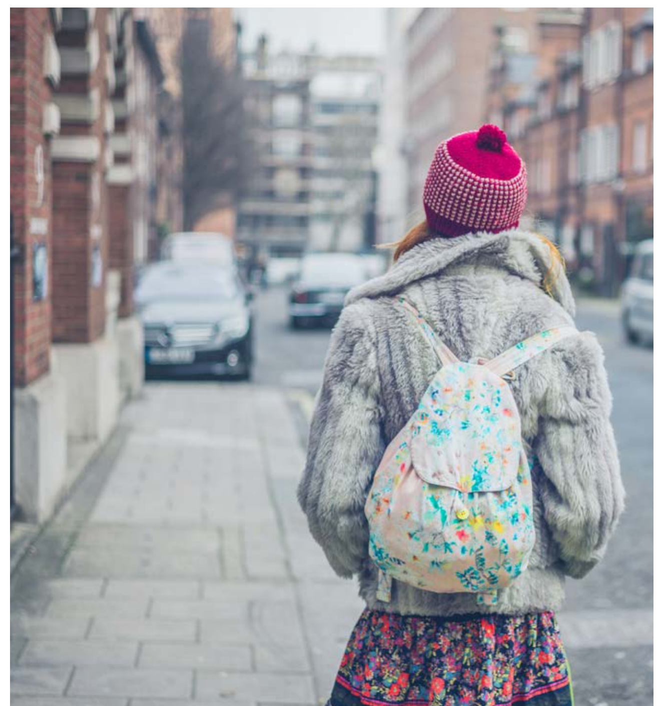
Source: ONS, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the CPI and the unemployment measure is LFS.

Chart 33: Successive market forecasts for UK GDP growth in 2023



Source: Consensus Economics, KPMG analysis.



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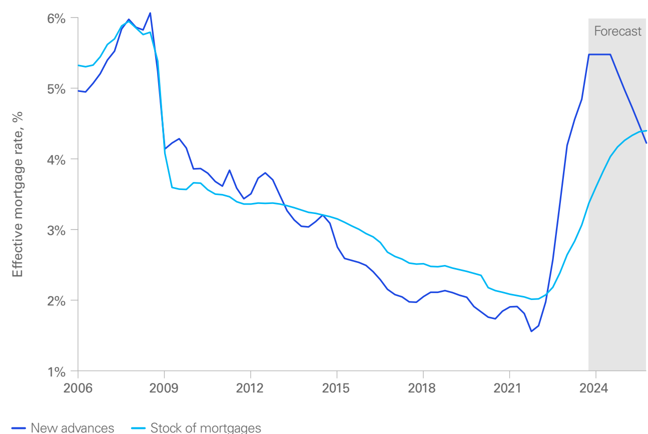
There are a number of reasons why growth has been relatively resilient. Energy prices have fallen, driving down headline inflation. Set against that, a tight labor market has put further upward pressure on nominal pay growth, laying foundations for a recovery in real purchasing power. Furthermore, the use of households' excess savings accumulated during the pandemic has likely provided support to consumption, although this is not expected to last for much longer, and further spending may need to be financed through an increase in consumer credit.

More recent data signal positive but subdued momentum as we head into the new year. Purchasing managers' indices – leading indicators for activity – are consistent with broad-based weakness across sectors, with a tentative pickup in services amid a more widespread caution among clients. Consumer confidence has recovered around a half of the drop experienced at the height of the cost of living crisis, while retail sales volumes have been on a downtrend. Housing activity has also slowed notably, with a drop in property transactions and a 30% drop in mortgage approvals compared to pre-pandemic levels.

We expect GDP to continue to grow at a modest pace of 0.5% in 2024, and only to pick up towards its steady-state rate of around 1% in 2025. Around 1.5 million fixed-rate mortgages are set to expire in 2024, compared to 1.6 million in 2023 and 1.2 million in 2022. Corporate insolvencies have also increased since the withdrawal of government support, although the rate seems to have peaked recently. One of the key questions for 2024 is whether firms seek to continue raising prices further in order to repair margins, or cut back on staff if demand is projected to remain weak in some sectors. The potential for both scenarios to unfold concurrently could result in a double blow to household real incomes.

The impact of higher interest rates is passing only gradually through the economy. Mortgage rates on new loans have risen by 370 basis points since the end of 2021, reflecting higher policy rates. However, the effective rate on the stock of mortgages has only increased by around 120 basis points, as a large share of mortgages with repayments fixed up to five years has been insulated from the immediate impact of higher rates (see Chart 34). Using data on the distribution of mortgages, we have projected the path of mortgage rates going forward, with the effective rate on the stock expected to peak at around 4.4% in late-2025. This implies that around a half of the direct impact of monetary policy on mortgage holders is still to come, which would put downward pressure on housing activity and consumption.

Chart 34: The stock of mortgages is yet to catch up to higher rates



Source: Bank of England, KPMG analysis.

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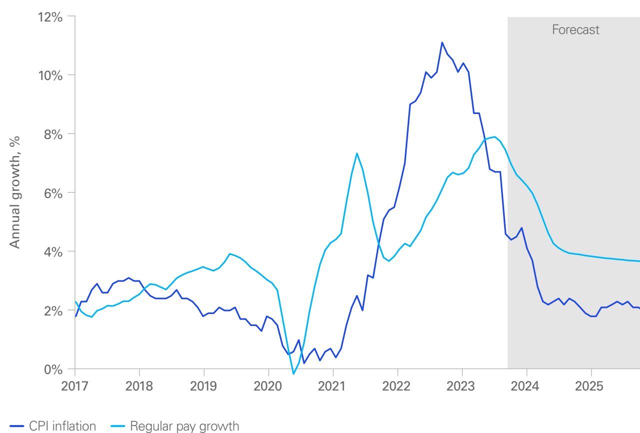
Headline CPI inflation dropped to 4.6% in October on the back of lower energy prices, which means that the UK is no longer an outlier when compared to other major economies. However, domestic influences continue to keep core inflation elevated, including tightness in the labor market, strong services price inflation, and firms passing on higher costs onto consumers. Inflation is also disproportionately affecting essential goods and services, with food prices growing at double digits and rental prices at 6-8%. One bright spot relates to a recovery in real pay growth, which we expect to continue in the near term (see Chart 35).

Despite some loosening over the past year, the labor market is still fundamentally tight at its core. The vacancy rate remains at 4% or above in sectors such as hospitality and healthcare, while nominal pay growth was over 7% in October, albeit moderating (see Chart 35). The unemployment rate sat at just 4.2% in October, although recent issues related to data quality add more uncertainty around the current state and near-term trajectory of the labor market. With 2.6 million people out of work due to long-term sickness, the government is looking at ways in which it can assist more people with health conditions to join the labor force. While boosting labor market participation would help the country economically, more could be done to assist that process, including further reforms of childcare support and an increase in the state pension age.

Chart 35: Pay growth is expected to outstrip inflation



Source: ONS, KPMG projections.

The overall policy stance is restrictive. The current level of interest rates (at 5.25%) remains above our estimate of the equilibrium rate of around 3%. We expect the Bank of England to only normalize policy as soon as it is confident that inflation is firmly on target in the medium term, which is unlikely to happen before the latter part of 2024. Fiscal policy is also set to provide a negative impulse to growth. Despite the measures announced in the Autumn Statement, which factor in a net fiscal loosening of GBP 17 billion a year on average, the cumulative impact of past policy decisions implies a narrowing in the structural budget balance (excluding interest payments) of 1.6% of GDP in 2024-25 and 0.4% in 2025-26.

Michal Stelmach
Senior Economist, KPMG in the UK

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Czech Republic: Gradual recovery ahead

Economic activity expected to only pick up gradually following stagnation in 2023.

The decline in inflation in 2024 is likely to boost consumer confidence and capital spending in 2025.

The phasing out of mitigating measures against energy prices and planned fiscal consolidation are set to provide negative momentum to GDP growth.

Due to the ongoing decline in real household income and an increase in precautionary savings, private consumption has flatlined, leading to a stagnation in 2023 (see Chart 36). We expect real GDP growth to return to positive growth territory in 2024, as consumer confidence and spending improve due to lower inflation and a significant increase in real wages. This, coupled with lower interest rates and a more optimistic sentiment, could boost consumer demand and outweigh the effects of the fiscal consolidation package. The positive dynamics in consumption is forecast to stabilize, before accelerating in 2025.

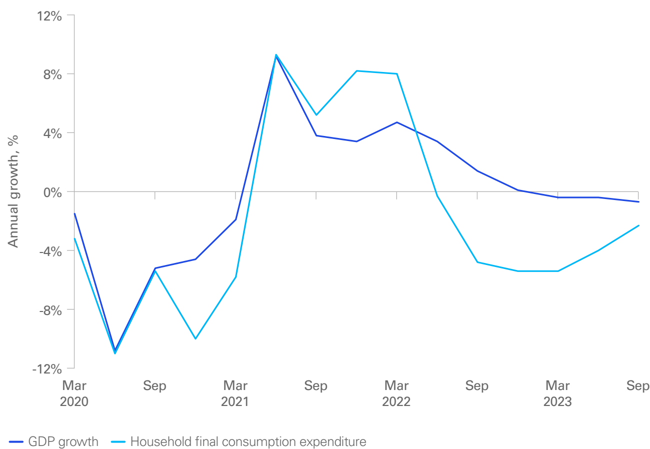
Table 16: KPMG forecasts for the Czech Republic

	2023	2024	2025
GDP	-0.5	1.9	2.7
Inflation	10.8	3.3	2.2
Unemployment rate	2.7	2.8	2.9

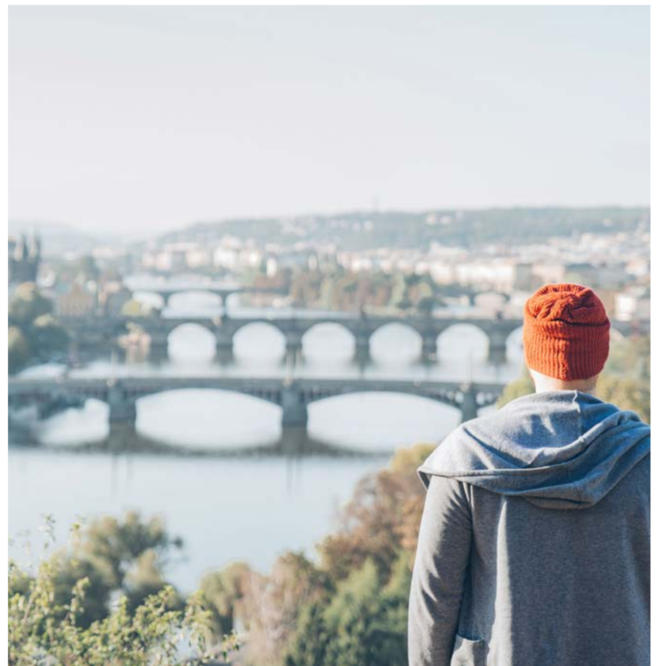
Source: Eurostat, Ministry of Finance of the Czech Republic, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

Chart 36: GDP and consumption growth in the Czech Republic



Source: Bloomberg.



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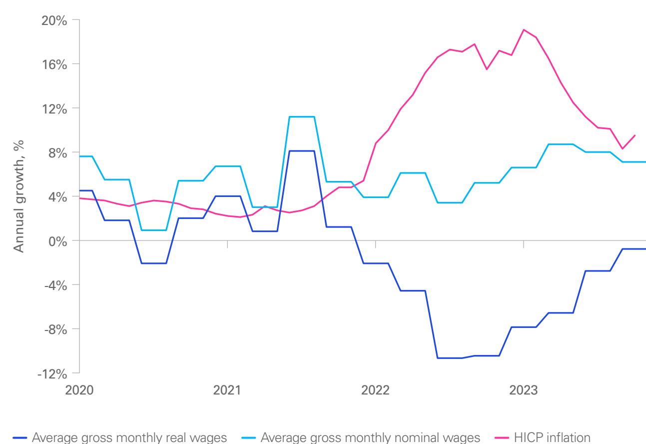
On the corporate side, as the end of the EU structural funds cycle looms, investment is set to grow only moderately in 2024. That said, Czech companies remain financially well positioned, which is manifested by increasing profit margins. Given the support from financial conditions and stronger economic activity, a return to more robust investment outlook seems feasible. Sentiment is expected to increase as well, leading to a stronger pickup in investment activity in 2025. Following a weak performance in 2023, recovering external demand should also help exports grow in 2024 and 2025.

The labor market remains tight. While the economic slowdown in 2023 is likely to lead to a small increase in the unemployment rate, it is forecast to remain broadly stable and still at a very low level through 2024 and 2025. Total employment has been increasing since 2022, supported by inward migration from Ukraine, and we expect this increase to continue in 2024, albeit at a slower pace. The driver of short-term growth in employment has been a rising number of entrepreneurs. Although unemployment is expected to rise marginally, it would remain low by historical standards.

We expect wage growth to remain elevated due to high corporate profitability, an increase in the minimum wage, as well as high bargaining power of employees in wage negotiations (see Chart 37). Shortages of skilled workers are set to persist. After a temporary decline in real wages in 2022 and 2023, a recovery is expected over 2024 and 2025, as growth in net income outpaces inflation.

Chart 37: Wage growth and inflation in the Czech Republic



Source: Bloomberg, Eurostat.

Following a peak of 18% in headline inflation at the beginning of 2023, the rate has declined significantly. This was mainly driven by energy and food prices, which are expected to drag on headline inflation further down, mainly due to base effects. As fiscal measures against energy costs expire, the negative effect from energy prices on inflation is expected to decline from the beginning of 2024. Inflation is then forecast to moderate further, gradually returning to the 2% inflation target by 2025.

The budget deficit is set to rise to 3.6% of GDP in 2023. Public investment is expected to peak in 2023, partly due to the completion of EU financed projects. The deficit is then forecast to drop to 2.2% of GDP in 2024 as measures to mitigate the impact of high energy prices expire, while the government implements a consolidation package which aims to further decrease expenditure and raise revenue. Public debt is still low compared to the EU average, however: the public debt-to-GDP ratio is forecast to rise from 44.2% in 2022, to 46.5% in 2025.

Risks remain to the downside given the strong foreign dependence of exports and the high energy intensity, with possible adverse impact from extended global growth weakness, as well as a renewed rise in energy prices.

Turning to structural challenges, labor and skills shortages are a major obstacle to long-term growth. Increasing labor force participation among the older population, women with children and greater support for short-term employment would support a more sustained growth outlook. Furthermore, attracting and retaining additional skilled foreign labor would ease skills shortages and spur growth.

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Poland: Growth picking up on a bumpy path

After a slowdown in 2023, growth is set to pick up in 2024 and 2025, supported by a rebound in private consumption.

Inflation is set to recede from 2023 onwards, but risks remain from the phasing out of anti-inflation measures and strong wage growth.

Public expenditure to remain high due to planned investments in defense and social spending.

Following weakness in the first half of 2023, the Polish economy has stabilized in the third quarter and is expected to stagnate over 2023. The main reasons for the reduced dynamics are falling private consumption and a negative contribution from inventories. Household spending is constrained by strong increases in consumer prices and a low level of consumer confidence. The strong negative impulse from inventories is also due to base effects, following large increases in 2022 as a result of normalization in supply chains. Net exports contribute positively to growth, due in part to a significant fall in imports. Although the underlying growth is weak, investment growth has been supportive amid continued high profitability of companies and a significant boost from the EU funding programs.

GDP growth is expected to return to positive territory in 2024, although dynamics will be limited. Private consumption is expected to be the main driver of growth, reinforced by rising real incomes as a consequence of nominal wage growth and fading inflation (see Chart 38). Additional fiscal support could further strengthen consumption. In 2025, economic growth is expected to accelerate further, with even stronger contribution from private consumption and investment, partly due to EU financing activities. Dynamics in exports should support growth as well.

Table 17: KPMG forecasts for Poland

	2023	2024	2025
GDP	0.4	2.6	3.3
Inflation	11.6	5.6	3.8
Unemployment rate	5.2	5.1	5.0

Source: Eurostat, GUS, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the HICP.

Chart 38: Inflation and gross wage growth in Poland

Source: Eurostat, Bloomberg.

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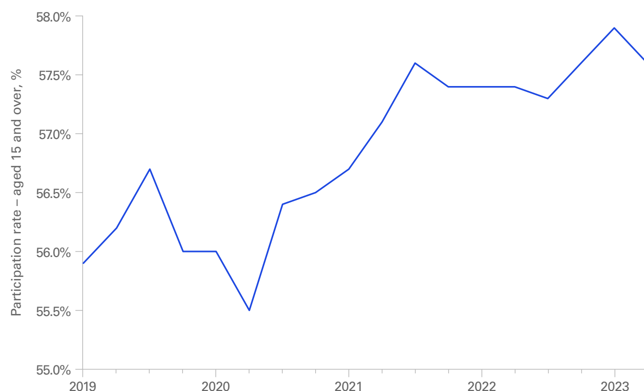
Employment is expected to slightly decrease, owing to a decrease in working age population and a slowdown in growth in 2023. The lags between activity and the labor market can be attributed to labor hoarding. Strong demographic changes are expected to drive a decrease in overall labor force participation (see Chart 39). Thus, although the number of people in employment will decrease, we expect the rise in unemployment to be contained. The registered unemployment rate at the end of Q3 2023 was 5%.

Nominal wage growth is set to decline and move away from double-digit levels due to falling inflation. Wage pressure is expected to be dampened by a greater influx of migrants from Ukraine and other countries into the labor market. That said, staff shortages and the announced increase in the minimum wage are set to pose an upside risk to wages. Real wage growth is expected to be positive in 2024, with a pace similar to that of labor productivity.

HICP inflation reached its peak in the first half of 2023 and is set to average around 11% in 2023. In 2024, inflation is expected to decline significantly. Due to the expiration of energy support measures and of the zero VAT rate for some food items at the end of 2023, as well as strong wage growth, there are upside risks to the inflation outlook. Furthermore, strong wage growth is set to keep price pressures elevated in services. In 2025, inflation is projected to be close to the central bank's target.

Chart 39: Labor force participation in Poland



Source: Eurostat.

The general government deficit is estimated to increase to 5.8% of GDP in 2023, up from 3.7% in 2022. This includes increased spending on defense, higher salaries in the public sector, healthcare, as well as subsidies to farmers. Social benefits increase as well due to the indexation of pensions. At the same time, lower economic growth is set to put a cap on revenues from indirect taxes. Although the deficit is forecast to narrow to 4.6% in 2024 and 3.9% in 2025, public sector debt is predicted to reach 56.2% of GDP in 2025.

The outlook is subject to several risks, including from a more persistent inflation. This could be caused by the easing of monetary policy, as well as foreign inflationary pressures which could stem from a rebound in energy prices. Further risks might arise from uncertainty about future fiscal policy. Investment growth is also subject to risks, including from a slower start of EU funded investments, as well as delays in the implementation of the Recovery and Resilience Plan.

Close attention shall be paid to the fiscal measures following the parliamentary elections. Nevertheless, the influx of EU-funds from 2025 (2021-2027 financial framework) is set to support public investments, and therefore longer-term growth dynamics.

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Romania: Weakening growth but economic revival in sight

Fiscal policy would require skilful steering to achieve stated objectives without harming growth.

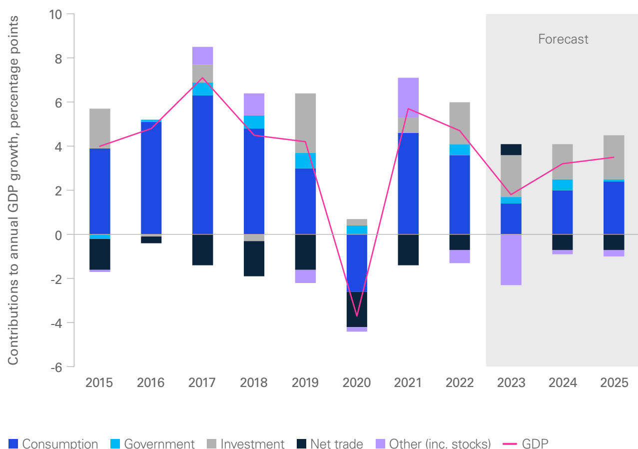
Investment and consumption expected to power the economy forward over the next two years.

Falling inflation and strong advances in nominal wages set to restore consumers' purchasing power.

Following a strong 5% growth in the first three quarters of 2022, the Romanian economy decelerated sharply, advancing by a meagre 1.4% during the same period in 2023. High inflation has been eroding households' purchasing power, eventually slowing down private consumption, which has been the main engine of growth in recent years. However, consumption is still expected to remain an important contributor to economic growth going forward, picking up gradually in 2024 and 2025, driven by double-digit increases in wages and pensions (see Chart 40).

Investment growth has been strong in 2023 and is expected to remain so over the next couple of years. Romania stands to benefit from a vast amount of financing via the EU's Recovery and Resilience Facility (RRF), amounting to a cumulative 12% of GDP by 2026. Over the coming years, EU-funded investment projects are expected to lead to an increase in the public sector investment's share in GDP.

Chart 40: Annual GDP growth in Romania



Source: National Institute of Statistics, National Bank of Romania, KPMG forecasts.

Table 18: KPMG forecasts for Romania

	2023	2024	2025
GDP	1.8	2.5	3.4
Inflation	10.7	6.9	3.7
Unemployment rate	5.5	5.4	5.2

Source: KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the CPI.

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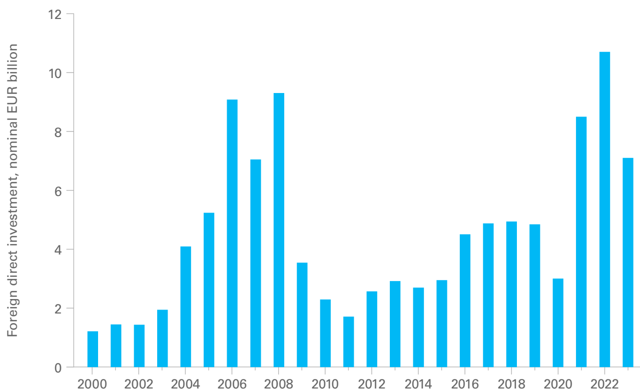
Foreign direct investment (FDI) into Romania reached a record EUR 10.7 billion in 2022 (see Chart 41). It rose by over 12% year-on-year, bucking the international trend, which saw a contraction. Industry, trade and financial intermediation sectors were the main recipients of FDI. However, FDI is expected to drop by a third in 2023 overall, as the slowdown in domestic economic activity dampens private sector's investment appetite.

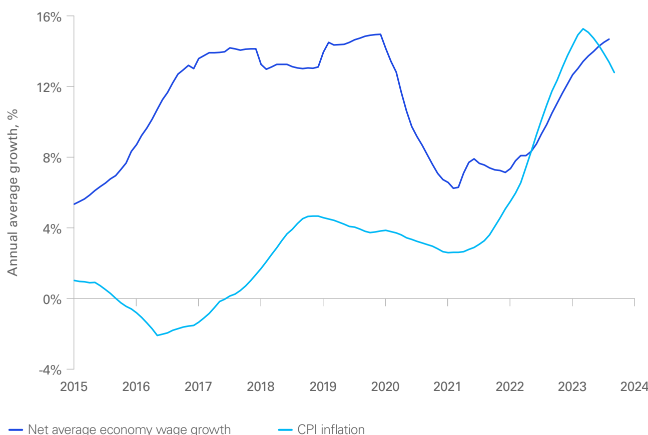
Inflation continued to fall in 2023, albeit from a relatively elevated level. At 8.3%, Romania registered the third-highest annual inflation rate in the EU in October 2023. The National Bank of Romania (NBR) kept its benchmark interest rate at 7% throughout 2023, following an aggressive monetary policy cycle that has been in place since the end of 2021. Inflation is expected to fall further in 2024, led by lower power, gas and food prices as well as subdued demand. Given this anticipated fall, real interest rates could turn positive towards the end of the first semester next year which, in turn, could fuel expectations of a potential interest rate cut, especially if the economy performs below expectations.

Chart 41: Foreign direct investment flows to Romania



Source: National Bank of Romania.
Note: 2023 is KPMG forecast.

Chart 42: Inflation and wage growth in Romania



Source: National Institute of Statistics.

Notwithstanding the deceleration in the rate of economic growth, the labor market is expected to remain tight. Unemployment is forecast to fall only marginally to 5.4% in 2024 from 5.5% in 2023. As a consequence, upward wage pressures will continue, supported partially by planned increases to the minimum wage. Historically, net wages advanced strongly, showing double digit growth, at a rate above average inflation. The gap between nominal net wage and inflation growth shrank – and even reversed – following the Covid pandemic. More recently, however, average net wage growth picked up again, reaching 14.7% in August (see Chart 42). Real wage growth has turned positive and is projected to be high throughout 2024 and 2025.

Looking ahead, the economic outlook is clouded by the uncertainty surrounding the correction paths for both the budget and current account deficits. While the latter has been falling to an estimated -7.1% of GDP in 2023 and is projected to remain around this level for the next couple of years, the budget deficit situation is more worrisome. As it stands, the budget deficit is forecast to reach -6.3% of GDP in 2023, far above the target of -4.7%. To correct this, the authorities approved a fiscal consolidation package, amounting to 1.2% of GDP, which would come into force at the beginning of 2024. Three quarters of this adjustment rely on tax increases, including for corporate taxes, the elimination of preferential wage-related tax regimes in agriculture and construction, as well as the removal of reduced VAT tax rates for some goods and services.

However, the fiscal consolidation efforts are seriously undermined by the planned increase in pensions. These are expected to go up twice in 2024, by 13.8% from January, following the yearly indexation with a coefficient which accounts for inflation and productivity, and by an average of 40% from September, following the approval of the overdue pension reform law. The additional cost of these increases to the 2024 budget alone is estimated at RON 30.2 billion, around 1.9% of nominal GDP, surpassing any gains achieved through the fiscal consolidation package.

So far it is unclear where the required monies will come from. Romania has been under EU's Excessive Deficit Procedure (EDP) since 2019, with a reduction to the government's budget deficit a priority. Failure to do so could lead to a suspension of EU funds, on which the economy relies for growth. Finding a solution to this in the forthcoming multiannual government budget projections is paramount for future growth.

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South Africa: In search of fiscal consolidation

Economic growth slow but resilient.

Debt service cost is third highest component of budget expenditure.

Inflation set to reach the target in 2025.

South Africa's economic growth is expected to register 0.7% in 2023, according to KPMG estimates. This is to be followed by growth of 1.1% in 2024 and a marginally higher 1.6% in 2025. Growth projection over the next three years is below the average of 1.7% experienced over the ten years leading up to the Covid pandemic, and far below what is required to make a meaningful impact to economic inclusion and absorb a significant proportion of the unemployed into the labor force.

The tight monetary policy environment, coupled by the continued pressure of insufficient and inconsistent supply of electricity provided by South Africa's monopolistic state-owned energy supplier, Eskom, as well as deteriorating logistics infrastructure, created the expectation for even lower levels of GDP growth, especially for 2023 and 2024. However, larger than expected private investment into alternative energy sources following the liberalization of the energy market in Q1 2023 has created some insulation from the inconsistent availability of power and supported economic growth.

Table19: KPMG forecasts for South Africa

	2023	2024	2025
GDP	0.7	1.1	1.6
Inflation	5.9	4.9	4.5
Unemployment rate	33.0	32.8	33.4

Source: Statistics South Africa, KPMG analysis.

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The predicted rate of economic growth over the forecast period would be insufficient to reduce the high unemployment rate, leading to a continued decline in per capita GDP and increased pressure on the public finances.

Fuel price increases in September and October 2023 resulted in increases in the monthly headline inflation and we expect it to average 5.9% over 2023. Consequently, the South African policy rate remains restrictive (at 8.25%), which is more than double the lows of 3.5% experienced up to Q3 2021. Although inflationary expectations remain unanchored, the expectation is for the policy rate to remain at this level until the central bank is more certain of its sustained return to the target.

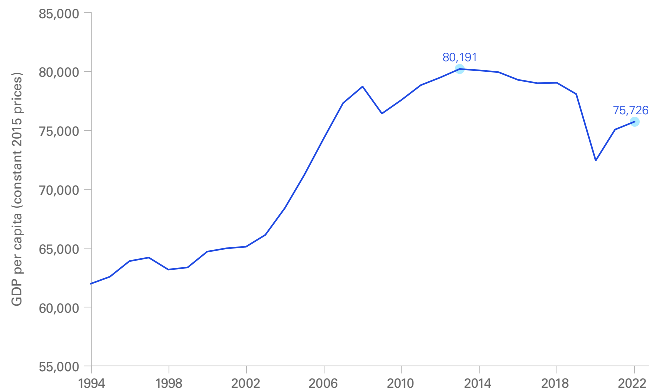
South Africa has had a dual mandate regarding its economic strategy: to support those in society who have been left behind and to grow the economy. There has always been a need to support those citizens who were excluded from participating in the economy through the social wage and social protection in particular. This was an immediate goal required to ensure a minimal level of wellbeing while at the same time striving to create sustainable long-term economic growth that could absorb excess labor and facilitate broader participation in the economy.

The first fourteen years of democracy resulted in substantial wealth improvement in South Africa, with GDP per capita increasing by 27% by 2008 when the Global Financial Crisis caused a break in that trend (see Chart 43). Over the following five years GDP per capita rose by a modest 1.9% – peaking in 2013 – and has since declined as a result of policy uncertainty, mismanagement and corruption, as well as external shocks such as the Covid-19 pandemic.

The 2023 medium term budget policy statement states that since 2008 South Africa has adopted a centrist model pushing government led economic growth. From this time onwards government spending has exceeded revenue, resulting in persistent large budget deficits, and where the higher levels of borrowing were unmatched by improvements in public services.

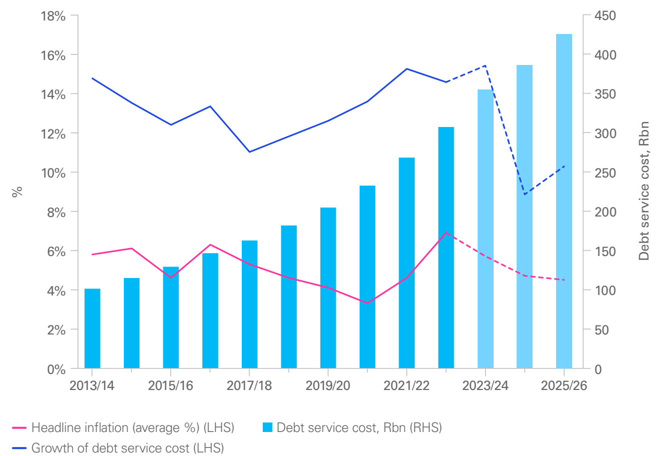
As a percentage of GDP, gross loan debt increased by 47.2 percentage points between 2008-09 and 2022-23. Borrowing costs have also increased as the country's sovereign debt rating was reduced from 3-4 stages above neutral to 2-3 levels below. Debt servicing costs have grown to become the third largest component of government expenditure and have crowded out financial resources assigned to national development objectives (see Chart 44).

Chart 43: South Africa's GDP per capita



Source: Statistics South Africa, KPMG analysis.

Chart 44: Rising cost of servicing debt



Source: National Treasury MTBPS, Statistics South Africa, KPMG analysis.

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An additional factor underlying the deteriorating fiscal situation was that the increased borrowing was not used for financial investments that supported faster job-creating growth, but rather was absorbed by a ballooning public sector wage bill and the social wage. The public sector wage bill is forecast to cost 37% of total revenue (or 29.2% of total expenditure) in 2023-24 (see Chart 45).

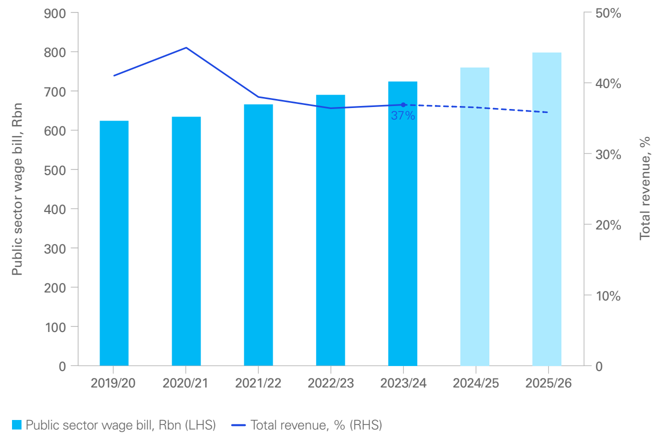
Besides improving the quality of governance, government services and adopting consistent and investor-friendly policies, South Africa needs to spend a larger proportion of its resources on maintaining and improving the growth supporting infrastructure on which its economic activity depends. Sufficient electricity supply, upgrading water and sanitation infrastructure, along with efficient transport and logistics, will allow business and the economy to grow at a pace required to achieve the development objectives. This is echoed in the medium-term budget, with expenditure on capital goods forecast to be the fastest growing component of future expenditure.

Achieving this requires consolidating the public finances, with more financial resources going to service delivery and capital expenditure and less required for servicing debt and contributing to the public sector wage bill.

South Africa will continue to experience economic growth lower than its potential until the level and quality of basic infrastructure have been brought in line with the demands of a growing economy. This investment expenditure, along with the overall quality of governance as well as efficiency gains in the public sector, will be the focus of both South African and international investors as the main determinants of the future prospects of the economy and the country.

Frank Blackmore
Lead Economist, KPMG in South Africa

Chart 45: Budget consolidation requires tempering public sector wage growth



Source: National Treasury, KPMG analysis.

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Nigeria: A challenging macroeconomy amid major market reforms

Growth to improve moderately in 2024 driven by sustained growth in the non-oil sector and the recovery of the oil sector.

Inflation to ease as base effects kick in and as the Central Bank of Nigeria (CBN) continues to pursue monetary tightening.

Unemployment to be broadly stable following the revised methodology adopted by the Nigerian National Bureau of Statistics.

Nigeria's recovery in the post-Covid era has been stalled by major domestic and international headwinds in 2023. The increasing geopolitical tensions and their impact on supply bottlenecks and high global inflation have kept the rate of GDP growth slow and fragile. That comes on top of slower global growth and the cash crunch crisis, the exchange rate unification reform, the removal of fuel subsidy, and low crude oil production.

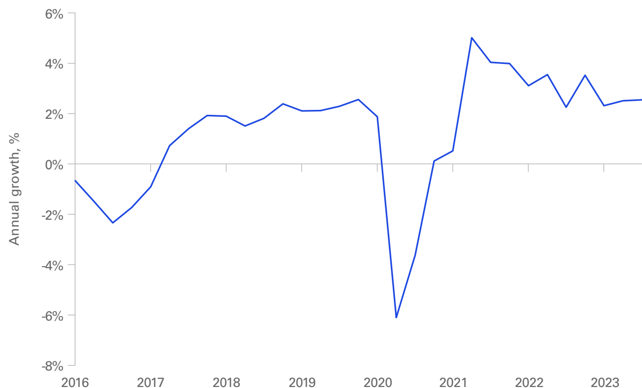
The economy grew by an average of 2.45% in the first three quarters of 2023 on a year-to-date basis, weaker than both the 2.96% recorded in the same period in 2022 and the 3.75% assumed in the 2023 budget (see Chart 46). This is in line with our estimates of a 2.6% growth in 2023.

Table 20: KPMG forecasts for Nigeria

	2023	2024	2025
GDP	2.6	3.0	3.5
Inflation	24.5	21.9	19.6
Unemployment rate	4.1	4.3	4.4

Source: KPMG forecasts.
Note: The unemployment figures are based on revised NBS estimates.

Chart 46: Real GDP growth in Nigeria



Source: National Bureau of Statistics (NBS).

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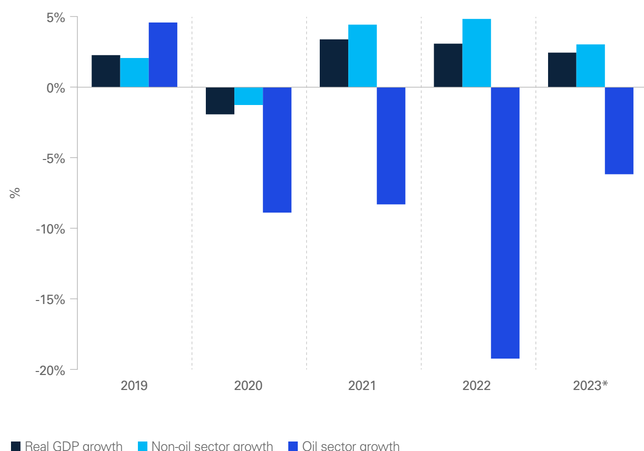
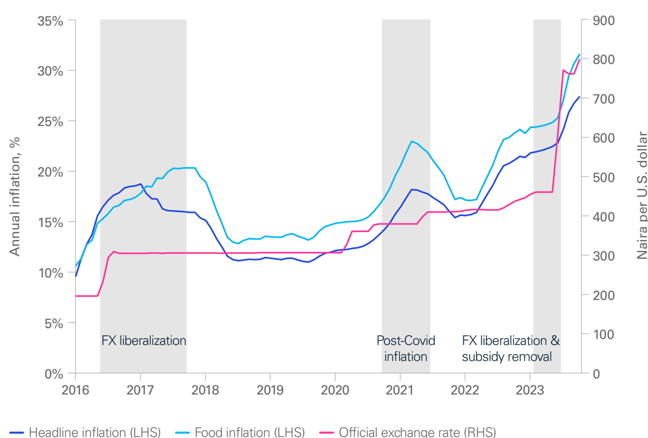
Chart 47: Oil and non-oil sector growth



Source: National Bureau of Statistics (NBS).
Note: 2023 figures show simple averages of official Q1 to Q3 2023 estimates.

Chart 48: Inflation and the exchange rate in Nigeria



Source: National Bureau of Statistics (NBS), Central Bank of Nigeria (CBN).

We expect growth to improve in 2024, driven predominantly by a sustained expansion of the non-oil sector as macroeconomic stability is returned to the Nigerian economy from the second half of the year. In addition, the recent reforms and interventions introduced to cushion their impact on households and businesses are expected to start to take effect. We also expect to see improvements in the oil sector, which we anticipate may finally exit recession by Q4 2023, following 14 quarters of protracted contraction, as oil production continues to rise due to recent successes at curtailing the oil theft and oil infrastructure vandalism (see Chart 47).

Headline inflation has been elevated throughout 2023, rising from 21.8% in January to 27.3% by the end of October 2023, and we expect this trend to continue till the end of the first quarter of 2024 (see Chart 48). A combination of significant money supply growth, persistent supply side disruption, and security and transportation cost increases have been worsened by the recent removal of fuel subsidies and various FX reforms. Many of these challenges persist and are expected to keep inflation high in 2024. Inflation is then expected to slow in the second half of 2024, largely due to base effects kicking in. However, fiscal policy is turning expansionary and – as revealed in the 2024 budget estimates – it will make it harder for the CBN to control money supply in 2024. Accordingly, we anticipate that the CBN will retain its tight monetary policy stance in 2024.

The weak transmission mechanism of monetary policy implied that despite continuous and aggressive monetary tightening by the CBN's Monetary Policy Committee, the rate of inflation continued to climb steadily. Although inflation will likely sustain its momentum into the medium term, we expect it to ease from Q2 2024, largely on account of base effect and progressively tighter monetary policy stance of the CBN.

Unemployment in Nigeria was estimated at 4.1% in Q1 2023, down from 33.3% in Q4 2020. The apparent decline in unemployment rate is attributed to the adoption of the revised methodology by the National Bureau of Statistics, and hence does not reflect a real decrease in unemployment. This is because the revised methodology classifies a large amount of the Nigerian workforce engaged in informal and subsistence work for at least an hour a week as employed.

Despite this lower estimate, the labor market remains characterized by high unemployment and underemployment levels, dominated by a large and undocumented informal sector which stood at 92.6% in Q1 2023, offering often low-productivity work for little pay to survive. Accordingly, we do not envisage significant change in the rate of informal sector employment, given that it is mostly for the purpose of subsistence and occurring in the presence of little social support systems. However, formal sector employment is likely to worsen in 2024, as businesses struggle to keep jobs on the back of higher costs and slowing consumer demand.

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Appendix: Summary of KPMG forecasts

	GDP			Inflation			Unemployment		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
World	2.6	2.2	2.6	6.5	5.0	3.9	5.8	5.9	5.9
US	2.4	1.6	1.6	4.1	2.7	2.0	3.6	4.1	4.3
Canada	1.0	0.6	1.4	3.8	2.4	1.9	5.4	6.2	6.2
Argentina	-1.8	-2.3	2.9	128.9	178.0	78.0	7.0	9.1	8.1
Brazil	2.8	2.0	2.8	4.5	3.7	3.3	8.0	7.9	7.7
Chile	0.1	2.1	2.3	7.5	3.4	3.0	8.6	8.4	7.8
Mexico	3.3	2.4	1.8	5.6	4.1	3.3	2.8	2.9	3.3
Colombia	1.3	2.1	3.1	11.7	6.9	4.1	9.9	9.5	9.0
Peru	0.3	2.4	2.8	6.4	2.6	2.1	3.8	4.2	4.1
Germany	-0.2	0.6	1.6	6.1	2.9	2.1	5.6	5.7	5.7
Austria	-0.4	0.6	1.5	8.0	3.2	2.3	5.1	5.2	5.1
France	0.8	0.8	1.5	5.0	2.4	1.7	7.3	7.6	7.7
Italy	0.7	0.3	0.6	5.7	2.0	1.5	7.8	7.9	8.2
Netherlands	0.5	0.8	1.6	4.6	2.9	2.4	3.6	3.8	3.8
Spain	2.5	1.5	1.8	3.6	3.4	2.3	12.2	11.6	11.3
Ireland	-0.5	3.0	3.5	5.5	3.0	2.0	4.2	4.3	4.4
Eurozone	0.6	0.9	1.6	5.5	2.5	1.9	6.6	6.7	6.7
Norway	0.3	0.1	1.7	5.4	2.1	1.7	3.5	3.7	3.6
Sweden	-0.4	-0.3	2.3	8.5	3.5	2.6	7.7	7.9	7.4
Switzerland	0.8	1.1	1.6	2.2	1.7	1.4	2.2	2.4	2.4
UK	0.5	0.5	1.0	7.5	2.8	2.1	4.1	4.7	4.9
Poland	0.4	2.6	3.3	11.6	5.6	3.8	5.2	5.1	5.0
Czech Republic	-0.5	1.9	2.7	10.8	3.3	2.2	2.7	2.8	2.9
Romania	1.8	2.5	3.4	10.7	6.9	3.7	5.5	5.4	5.2
Turkey	3.8	1.4	1.8	51.2	62.5	58.9	9.7	10.2	10.1
China	5.2	4.5	4.5	0.4	1.3	2.0	5.3	5.3	5.2
Japan	1.9	0.1	1.1	3.2	2.2	0.5	2.6	2.6	2.5
India	7.2	6.0	5.3	5.5	5.1	4.7	6.9	7.3	7.3
Indonesia	5.1	4.9	4.6	3.7	3.2	3.4	5.6	5.5	5.5
Malaysia	4.4	4.7	4.0	2.6	2.4	2.3	3.4	3.2	3.2
Philippines	5.4	5.4	5.7	6.0	3.2	2.7	4.6	5.1	5.1
Singapore	0.9	2.4	2.0	4.9	3.2	2.2	1.9	2.1	2.1
South Korea	1.4	2.4	2.3	3.6	2.5	2.0	2.6	2.9	3.2
Vietnam	4.6	5.7	5.6	3.2	3.3	2.6	2.1	2.0	2.0
Saudi Arabia	-0.8	1.1	5.9	2.4	1.7	2.4	5.0	5.1	5.0
Nigeria	2.6	3.0	3.5	24.5	21.9	19.6	4.1	4.3	4.4
South Africa	0.7	1.1	1.6	5.9	4.9	4.5	33.0	32.8	33.4

Source: KPMG forecast.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate.

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