Economy in Focus #8

2024 outlook: What to expect and prepare for

Intrum's Economy in Focus aims to provide brief, concise and comprehensive coverage of ongoing macroeconomic trends, featuring expert commentary from our Senior Economist Anna Zabrodzka-Averianov.

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History seldom repeats itself, but it often rhymes. 2024 will likely mark the start of a gradual recovery. But to what extent?

Against the odds, Europe managed to avoid a recession in 2023 narrowly. After years of generous governmental support measures to parry the effect of the pandemic and a potential economic downturn, the hangover eventually arrived.

Technically, Europe is not currently in a recession by the textbook definition of the term (as we have yet to see a decline in real GDP in two successive quarters). However, in practice, we find ourselves in a recession-like environment, as Europe is beset by economic uncertainty and stagnation.

History gives us a good indication of the future. Or rather, a number of potential outcomes whose probability varies depending on a number of aspects. And for every crisis comes a new phenomenon. The last few years have shown us that anomalies can quickly become normal. Negative interest rate policies, deflation, and mortgage interest rates around one percent almost felt axiomatic.

Fast forward a few years, and unprecedentedly high policy rates, elevated inflation, and soaring mortgage interest rates, conditions that are completely novel for many younger people, look like they are here to stay.

Slowdowns, or recessions, can be both forceful and pressing – but more importantly – short. Usually, they last for less than a year. History thus tells us that 2024 will (in all likelihood) be a turnaround year that marks the start of a recovery and subsequent expansion of the economy.

The big question, though, is: to what extent?

Anna Zabrodzka-Averianov,
Senior Economist at Intrum

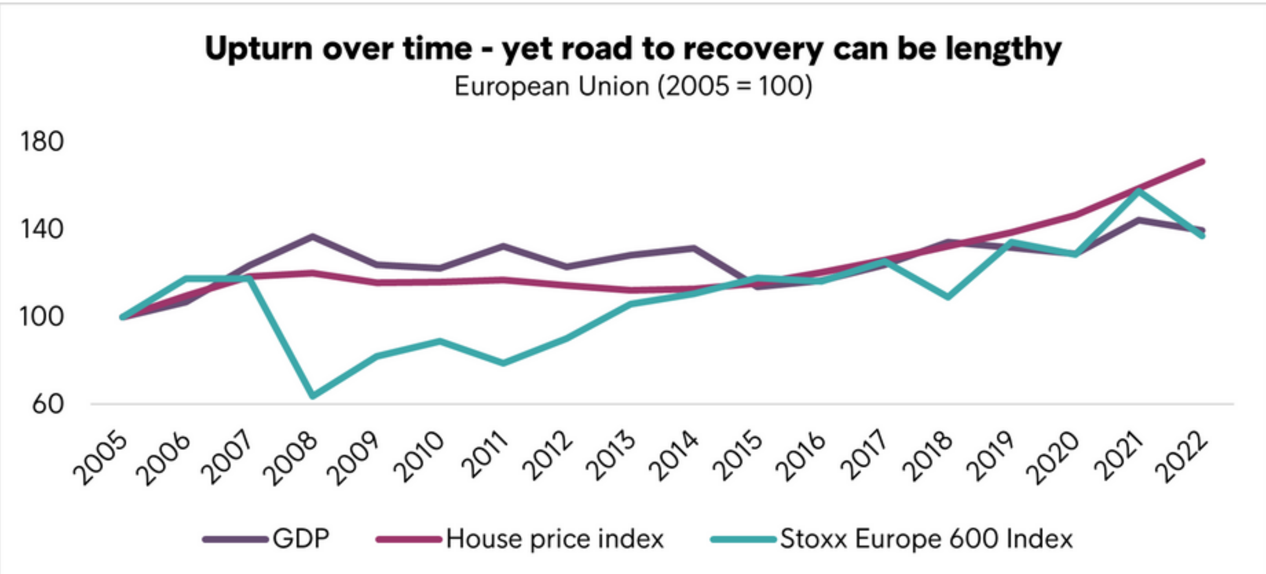
A look back, to better understand (and predict) the future

The base scenario for an economy is a positive development. It is a premise that permeates the capitalist economy, which itself is based on and influenced by productivity as well as speculation. Resource efficiency and technological advancements drive the economy forward – as is the belief in continued growth. On the other hand, crises, recessions, and even depressions, are notches in the curve, at least from a long-term perspective.

Over time, values – of economies, real estate assets and stock markets – move in an upward direction (see graph below). However, despite a shift of trend, the recovery back to the level of the former peak can be lengthy. Let's take the global financial crisis and its aftermath as an example. Peak-to-peak, European house prices and stock markets needed eight years to fully recover. Looking at the GDP of the EU, a whopping 13-year run was needed to surpass the former peak.

The 7-year cycle: Long and steady rises, followed by fast and steep falls
While the financial crisis was a severe crisis, with long-lasting, fundamental regulatory changes affecting the structure and dynamics of financial markets and the economy at large – it teaches us an important lesson: the business cycle is characterised by fast and steep falls, followed by long and steady rises. Some are more aggressive, others less so.

Overall, the pattern is clear. About every seventh year, a recession emerges. After a long and strong economic development, an adjustment, or rectification, is needed for the economy to regain its long-term balance and stability. Our most recent crisis, in 2020, deviated slightly from this maxim as the economy saw a very rapid and deep recession followed by an equally rapid recovery. This "seesaw" effect was somewhat unique in that it was caused by the stopping of economic activity due to the lockdowns, followed by the swift effects of the economic reopening.



Source: World Bank: GDP (current US$) – European Union (USD trillion), OECD: National and Regional House Price Indices, Statista: Annual development of the Stoxx Europe 600 Index

On average, recessions last for about 10 months. However, as always, there are exceptions to the rule of thumb. The European Sovereign Debt Crisis began in 2008 with the collapse of Iceland's banking system and ended in 2012. This recession included several European countries – Italy and Greece in particular – whose GDP figures are still below 2008 levels and who still to this day feel the aftershocks of the crisis.

Looking at the upturns of the economy, the average expansion lasts for 58 months. But even here, we see distinctive exceptions. The European Union witnessed a positive development in real GDP between 1995 and 2002, corresponding to 93 consecutive quarters (the EU was a smaller grouping of only 15 nations at that time, and there were no CEE members). Looking beyond Europe, the US experienced a 128-month-long expansion after the financial crisis, ending in 2020, with the COVID-19 outbreak.

"Europe, as opposed to large economies like the US or China, is an economy consisting of several different yet interlinked economies. The state in one country or region can be vastly different from another. Therefore, the aggregated numbers for Europe are a result of several parallel developments – from the Scandinavian Mountains in the north to the Mediterranean Sea in the south. Perhaps, the numbers behind the (EU) number are more descriptive. Thus, looking into 2024, we should expect a number of different pathways, but all in the same direction – upwards. The questions are: How fast? And how much?."

Anna Zabrodzka-Averianov,
Senior Economist at Intrum

Definitions

Expansion
Economic growth. Positive real GDP development in two consecutive quarters (or more). Lasts for 58 months on average.

Slowdown
A period of slower economic growth, typically characterised by a decrease in the rate of growth of real GDP.

Recession
Decelerating growth. Negative real GDP development in two consecutive quarters (or more). Lasts for 10 months on average.

Depression
A drop in annual GDP of 10 percent or more. Europe as a whole has not been in depression since the 1930s. However, nation-specific examples include: Albania, Czechia, and Romania (1991), Ukraine (1994), Bulgaria (1997), Estonia, Latvia, and Lithuania (2009) Greece (2011).

Inflation to come down in 2024 – three alternative scenarios possible

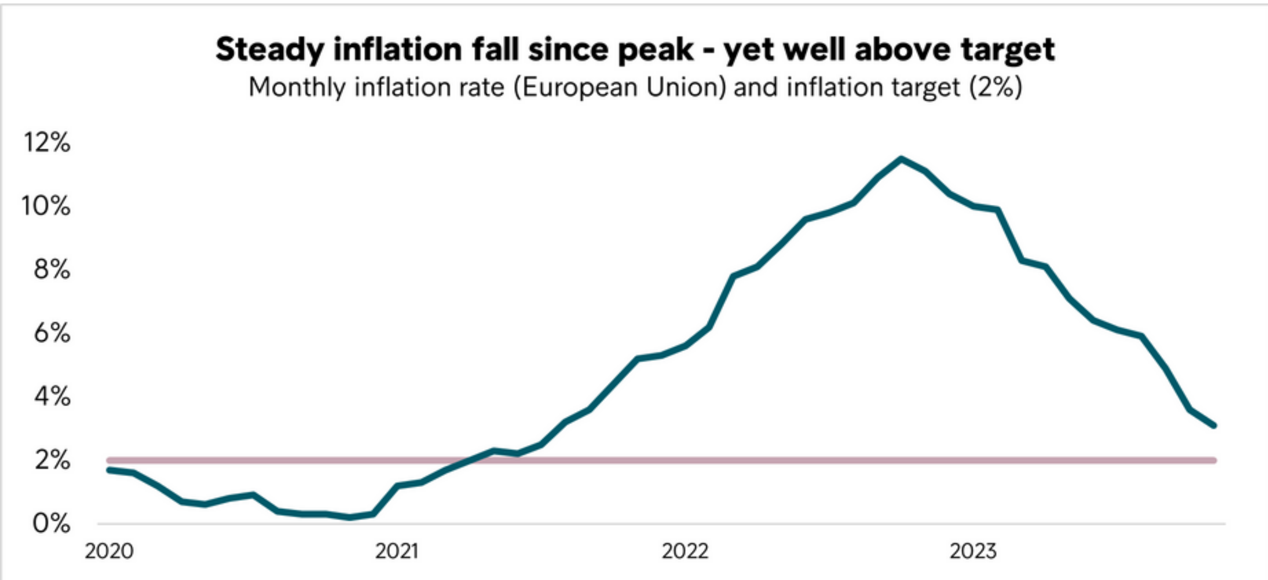
A defining aspect of recent global economic development was the rapid surge in inflation, numbers that have not been seen in several decades. Since the beginning of the year, Europe has experienced a very gradual slowdown of pricing pressures after they peaked in late 2022.

Data for the past 3 months indicate that headline inflation seems to be yielding, finally. Important to note, however, is that the sharp acceleration and subsequent deceleration in inflation has mainly been driven by energy prices, which will soon disappear from year-on-year calculations.

Therefore, while there are plenty of factors, especially in recent months, speaking in favour of a continued decrease in European inflation levels come 2024, we might still have a way to go before the two percent target is reached.

With Europe practically in a recession, the inflation outlook improves – as a slower economy generally means lower inflation. Should the bleak prospects for the year ring true, and barring any drastic exogenous shocks, we will most likely experience a further dampening of underlying inflation levels.

There are, broadly speaking, three different ways inflation can take. It can either fall precipitously, drop more gingerly (with the potential for reversions) or experience a "soft landing".



Source: Eurostat: HICP - monthly data (annual rate of change)

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Scenario 1: A precipitous return to or below the 2-percent inflation target

Some economists argue that we will see a rapid slowdown – so-called disinflation – during 2024, and possibly even reach the state of deflation. The case for this is that the central bank measures undertaken in 2022 and 2023 will reach full effect in 2024, a reasonable scenario due to the response lag of policy measures, which can take up to 18 months to reach full effect.

This scenario assumes a rapid fall in inflation that could potentially veer into deflation if we experience a much stronger pass-through of monetary policy tightening combined with a renewed deterioration of business and consumer sentiment resulting in outright recession with visibly higher unemployment.

Speaking against this are new macroeconomic and geopolitical concerns that could further prolong the inflation headache, bringing us to the second scenario.

Prerequisites: Continued economic slowdown, limited effect of new macroeconomic and geopolitical concerns and potential energy shortages.

02

Scenario 2: A gingerly drop (potentially interrupted by a slight acceleration of inflation) towards the 2-percent inflation target

On the other hand, a much slower return to normal inflation levels could also prove to be the case in 2024. If macroeconomic and geopolitical turbulence beset European and US economies, a new wave of inflationary pressures could play out. Unfortunately, there are still conflicts and wars taking place across the world, clouding the prospects of development at large and having far-reaching consequences beyond the immediate, tragic humanitarian disasters.

The impact on the local as well as the wider economy is paramount. Current conflicts have impacted the world economy in a multitude of different ways, as will most future conflicts. Inflation is most acutely impacted when said conflicts spill over and directly or indirectly affect commodity prices, such as oil and natural resources, thereby exerting price pressures on companies and consumers alike.

As such, a new energy price shock could prove to prolong the inflation challenge into 2024. However, even in this scenario, a continued decrease from the current rate of inflation of 3.6 percent (in the EU) is expected, yet at a slower pace.
A much slower disinflation, or even a temporary acceleration of inflation, caused by geopolitical tensions would require more action from central banks and could potentially push Europe into stagflation i.e., recession with elevated inflation.

Prerequisites: New macroeconomic and geopolitical concerns resulting in another spiralling energy crisis

03

Scenario 3:
A soft landing with a modest growth forecast – the most likely scenario

Perhaps the most likely scenario is somewhere in between the two extremes of the spectrum. Indeed, there are plenty of indicators that the heavy measures taken by central banks will finally bear fruit in 2024 and being mindful of the many hiccups we are still to encounter along the way, a soft landing including a gradual but stable deceleration of inflation toward the two percent target combined with slow economic expansion seems to be exceedingly likely.

This assumption of course necessitates a continuation of the geopolitical status quo, as any deterioration in global stability could lead to commodity and confidence shocks that would seriously hamper the prospects of a soft landing. At the same time, embedded into this scenario is the hope that the effect of the monetary policy tightening efforts will be enough to slowly return us to the two percent target, and not necessitate any new measures.

Prerequisites: No significant new exogenous shocks and an expected monetary-tightening effect.

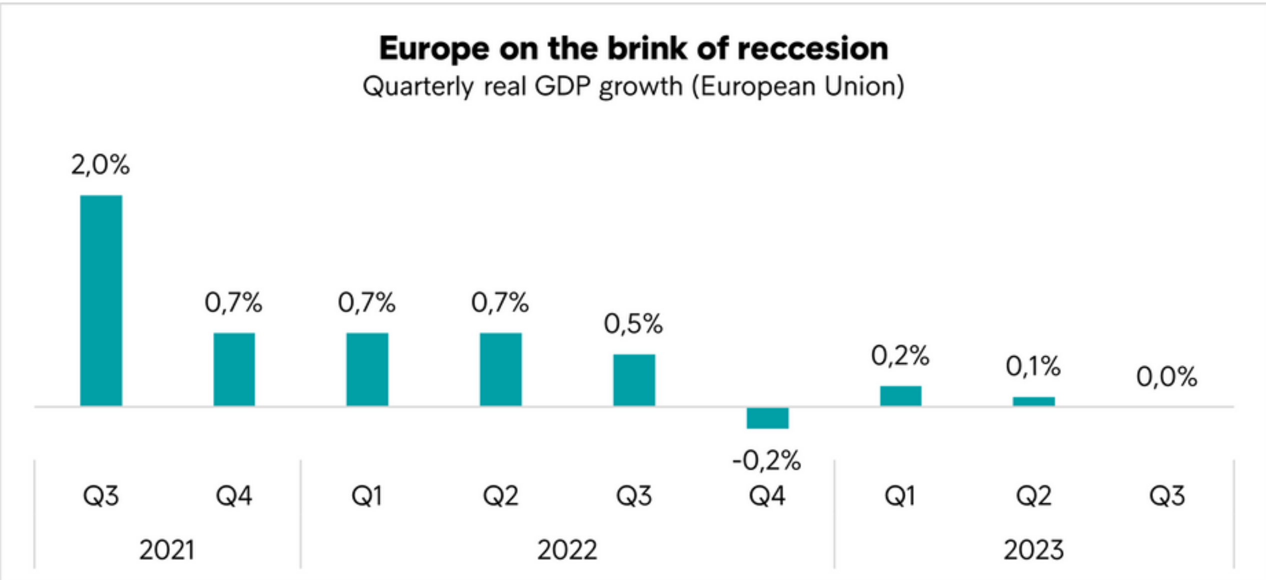
In a strict sense, Europe is yet to enter a recession. The continent has over the course of the last year been on the right side of the zero line, but only just. Practically, Europe is experiencing a recession as it struggles to grow. Consumers find themselves in a situation with limited room for manoeuvre, as inflation has outpaced wages (at least until only recently). Companies are hesitating to advance their positions as macroeconomic uncertainty remains and debt servicing costs rise sharply. Policymakers and central banks are pulling the handbrake to combat inflation.

Perhaps the most pessimistic scenarios are out of the equation. A soft landing for the economy in general appears to be the most likely scenario in 2024 – both for the global economy, including the labour market that has proved its persistence through this downturn.

On one hand, it is reassuring that a crash might not occur. On the other, it is worrisome that the growth outlook is as pale as ever - the lowest in decades.

On average, the European economy has grown at about 3.7 percent nominally or 1.5 percent in real terms every year. For the last couple of years, Europe has found itself below the 1-percent level in real terms. With low growth to remain the case going forward, the compounded effect over time becomes even smaller.

Looking at 2024, the European economy is expected to grow by about 1.2 percent, in real terms.



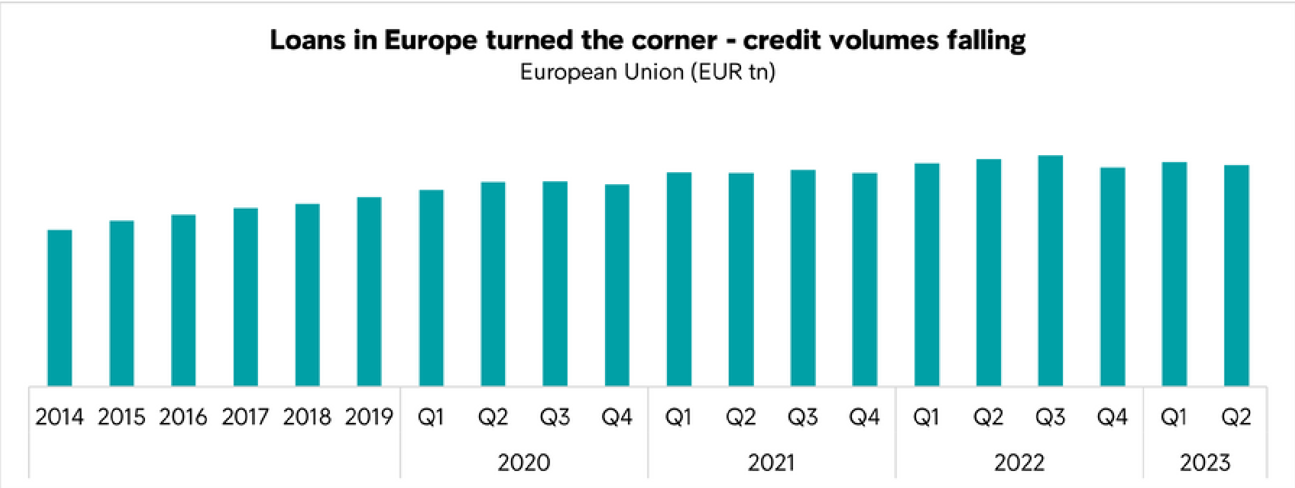
Source: OECD: Quarterly National Accounts: Quarterly real GDP growth

Credit tightening across Europe – the credit party is over (for now)

Since the global financial crisis, credit volumes have grown steadily across Europe, underpinned by falling interest rates that reached historically low levels. Today, we see reduced risk appetite from individuals and companies across the continent – leading to a subsequent fall in credit volumes. A natural response to a threefold, even fourfold, increase in interest rate costs over the last 18 months.

Despite the anticipated interest rate cuts in 2024, "higher for longer" interest rates are expected – which will put restrictions on credit growth over the next few years and at the same time we will likely see further increases in defaults as the cost of existing credit servicing increases.

We are, at last, moving towards a more sustainable and reasonable level of interest rates, which will be key in preventing a new overheating of the economy. Credit tightening is expected to permeate the economy in 2024 and beyond as households and companies are adapting to a vastly different interest-rate environment. That being said, resilience has proven to be a keyword during the economic challenges of recent years.



Source: Eurostat: HICP - monthly data (annual rate of change)

Psychology – perhaps as important as the material economic effect

While interest rates are a core part of economic science, it is also a psychological phenomenon. Individuals and companies make economic decisions based on speculation about the future.

An optimistic view of the future – across market participants – creates the necessary stability and reassurance for a potential home buyer to place the winning bid. Likewise, the company that considers entering a new market will likely make the investment – regardless of whether the interest rate is 2 percentage points higher, assuming expectations of a higher return for the risk taken.

The struggle with inflation is likewise imperilled by our unique human psychology. Findings from our latest ECPR report indicate that one in five European consumers expect the current level of price rises will be permanent, while about half of consumers claim that they will reduce the amount of money put into their savings as a result of high inflation.

This gloomy outlook and lack of confidence in policymakers and their ability to tackle these issues, which some would argue is not rooted in an accurate assessment of economic conditions, could eventually result in a self-fulfilling prophecy.

Concluding reflections

As we begin the new year, with the past year's tumultuous and rapid changes still fresh in our memories, we have yet to experience the final act of the narratives that defined 2023. Chief among these seemingly never-ending topics of discussion is inflation. Numbers from the latter months of 2023 indicated that inflation in Europe was declining. There is good reason to believe that the hard measures taken by central banks to combat inflation will yield further results in 2024, although they come with some economic effects that will prevent a faster economic expansion.

Hand in hand with declining inflation is the deterioration of economic growth in Europe. For much of the past year, the European economy's growth rate managed to just about hover above the zero percent line. As consumers continue to find themselves with limited maneuvrability and companies increasingly look to play it safe, a soft landing looks to be the likeliest outcome for the European economy in 2024. As such, although Europe will likely manage to avoid an outright recession on average in this downside cycle, the recovery also will likely be only gradual and underwhelming.

Finally, we are also beginning to see falling credit volumes across Europe, much owed to the interest rate hikes over the past year. Decreasing credit levels, which have grown steadily since the global financial crisis, will test the financial and economic resilience of consumers and companies alike as the macroeconomic conditions impose new uncertainties on them. We will also likely not return to the very cheap credit environment even after the recovery, as the time of ultralow inflation and interest rates seems to be markedly behind us, which will require adjustments in consumption and financing behaviour.

Against this backdrop, we are yet again reminded of the crucial role that Intrum plays in maintaining a healthy and functioning financial value chain, ensuring that individuals and companies are able to participate in the ecosystem to their fullest extent, and securing a sound economy for society at large.

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