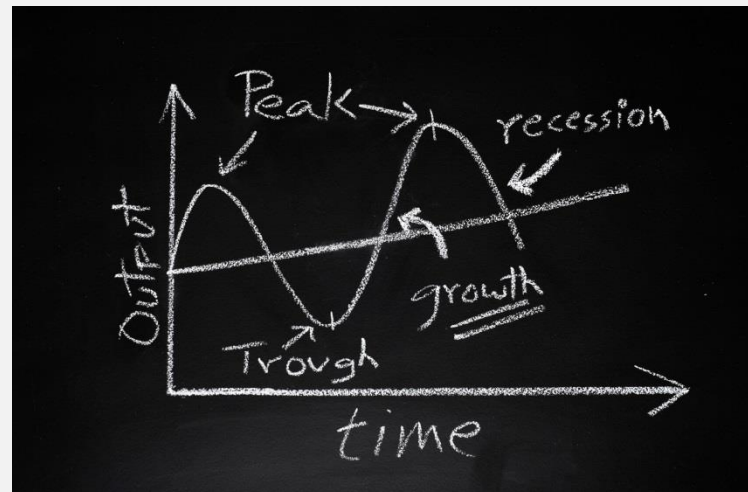


Creditreform Rating

CREDITREFORM ECONOMIC BRIEFS

Have central banks pulled off a soft landing?

September 2024



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KEY TAKE-AWAYS

- 1.** We have revised our **euro area GDP growth forecast upward to 0.8% for 2024**, mainly due to expectations for stronger GDP growth in Spain and France this year, whereas Germany's economic output will likely more or less stagnate in 2024. Spain has continued to outperform the other three major euro area economies in terms of growth lately. The French GDP could experience some boost from the Paris Olympics in Q3-2024.
- 2.** For **2025**, we continue to expect an **acceleration of euro area annual GDP growth, to 1.3%**, backed by continued gradual monetary policy easing and the associated improvement in domestic demand.
- 3.** Following its first rate cut this June, we expect the **ECB** to pursue a gradual easing path, with the **main refinancing rate expected to stand at 2.90% and the deposit rate at 2.75% by the middle of 2025**. The respective rates currently stand at 4.25% and 3.75%, and the spread between the main refinancing rate and the deposit rate is to be narrowed from currently 0.50 to 0.15 percentage points in September 2024.
- 4.** With the **focus shifting back to fiscal discipline amid the new EU fiscal governance framework** in force since April 2024, eight EU members are currently in an excessive deficit procedure under the new governance framework, including France and Italy.
- 5.** We continue to forecast **Germany's real GDP to stay largely flat this year, increasing by just 0.1%** compared with 2023, with expectations of a recovery pushed back yet again. Recent business and consumer surveys point to a deteriorating near-term outlook, while there seems to be some light at the end of the tunnel for the construction sector.
- 6.** For 2025, we expect Germany's economic output to increase by 1.1%, slightly less than previously forecast, amid further interest rate cuts and some impulses from foreign demand, with downside risks currently prevailing. **Corporate defaults remain on the up, while pressure on businesses should moderate in the course of next year amid a more positive growth environment.**
- 7.** The **UK's** economic recovery in the first half of 2024 was stronger than we had expected, leading us to **lift our GDP growth forecast for 2024 to 1.1%**. In **2025**, we expect a slightly higher growth rate of **1.5%**, partly on the back of robust private consumption. We think that the **Bank of England** will cut its policy rate further, but at a somewhat slower than pace than previously assumed, with the **Bank rate** likely to stand at **4.25% in summer 2025**. Following its landslide victory in July's snap election, the Labour party is governing with a comfortable majority. Stepping up efforts towards fiscal consolidation is likely to remain high on the agenda, as will efforts towards close cooperation with the EU in major areas of common interest.
- 8.** The **US** economy stays on course for a soft landing, with the labor market showing more signs of cooling lately. Following an expected **first rate cut in September**, somewhat later than previously assumed amid sticky inflation, we think the **Fed funds rate will stand at 4.00-4.25% by the middle of 2025**.

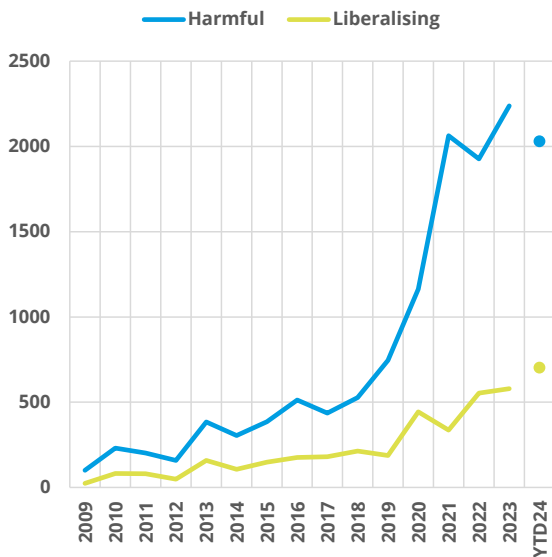
1. World

Persistent obstacles to significant growth acceleration

As the year 2024 progresses, geopolitical fragmentation remains high on the list of risks to the global economy. In addition to persisting uncertainty linked to the ongoing wars in Ukraine and the Middle East, including the risk of renewed commodity price spikes and/or disruptions to key international transportation routes, protectionist tendencies could exert downward pressure on global economic growth (see [Figure 1](#)). Partly judging by the rhetoric in the current US election campaign, as well as developments in e-mobility in China and the EU, these dynamics could change for the worse going forward.

Figure 1: Beggar-thy-neighbor policies remain on a high level

Total number of implemented interventions, adjusted, as of 29 August 2024



Sources: Global Trade Alert, Creditreform Rating

Ratcheting up of defense spending in light of resurging aggression looks set to weigh on fiscal policy for the foreseeable future. Meanwhile, with the pace of disinflation slowing, expectations with regard to interest rate cuts by major central banks have been

scaled back in recent months, whilst a measured cycle of rate cuts remains the most likely scenario over the next 12 months, thus adding a more constructive element to the global growth outlook.

In its recently updated World Economic Outlook (July 2024), the IMF maintained its forecast for global GDP growth in 2024 at 3.2% year-on-year. For 2025, the forecast was lifted slightly, by 0.1 percentage points, to 3.3%, still representing moderate growth rates compared to the longer-term average.

US on course for soft landing, despite recent recession fears

US GDP growth continued at a higher pace in the second quarter of 2024, posting at 0.7% quarter-on-quarter, driven by domestic demand. Sentiment indicators such as the Purchasing Manager Indices (PMIs) would support expectations of a moderation in economic activity going forward, as in particular the PMI for the manufacturing sector fell relatively sharply, to 46.8 points in July. With that, it added to emerging recession fears on financial markets alongside weaker labor market data. At the same time, the PMI for the service sector returned to expansionary territory in July.

While consumer confidence has ticked up in the same month, the labor market showed signs of a more pronounced cooling. Compared with June, non-farm payrolls rose by 114,000 persons, well below the average of 209,000 per month registered since August 2023 (see [Figure 2](#)). Concurrently, the unemployment rate, while still low, climbed to 4.3%. Moreover, preliminary results related to an annual revision of the employment data suggest that the number of net newly created employment up until March 2023 was lower than previously reported.

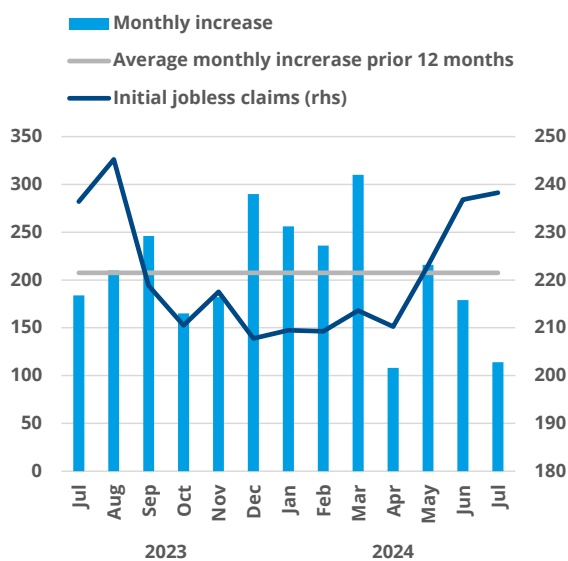
Recent IMF forecasts for the US economy suggest a robust GDP growth rate of 2.6% for the current year as a whole, following an expansion of 2.5% in 2023. For 2025, the IMF expects a deceleration to 1.9%.

The US CPI inflation rate moderated to 2.9% in July 2024, while the CPI excluding food and energy remained at an even higher level, decreasing to 3.2%. Whilst the Federal Open Market Committee (FOMC)

unanimously kept the federal funds rate stable at 5.25-5.50% at its latest meeting ending on 31 July, Fed Chairman Powell hinted at a rate cut in September, a view he seemed to reinforce in his speech at the annual Jackson Hole Policy Symposium in August.

Figure 2: Clearer signs of a slowing US labor market

Monthly increases in non-farm payrolls and initial jobless claims (rhs), thousand persons



Sources: FRED, Creditreform Rating

The FOMC’s most recent inflation projections (June 2024) were slightly upgraded for 2024 and 2025 compared to the March 2024 projections, reflecting the assumption that inflation will trend downwards and average around its 2% target by 2026. While FOMC members discussed a rate cut at the July meeting, the statement accompanying July’s policy rate decision reiterated the need for greater confidence that inflation will move toward the target rate on a sustained basis, underscoring data dependency of any decision. Labor market data and the pace of any further weakening thereof are likely to play a major role.

Our main scenario, in the absence of any major commodity price shocks and major adverse geopolitical

developments, is now that the Fed will lower its policy rate by a total of 50 basis points by the end of the year and a further 75 basis points by mid-2025. The federal funds rate should thus stand at 4.00-4.25% at the end of June 2025.

Depending on the outcome of the US presidential election on 5 November, for which current polls suggest a tight race between the Republican and the Democratic candidates, potentially intensifying protectionist policies such as (further) increases in import tariffs could exert an inflationary effect, which may slow down the pace of monetary policy easing. Similarly, policies involving higher government spending could, ceteris paribus, fuel inflationary tendencies, as could cutting taxes or extending tax relief.

China: Strengthening domestic demand high on the agenda

The Chinese economy remains broadly on track to meet the official GDP growth target of ‘around 5%’ for the current year, with the real estate sector continuing to pose downside risks to economic development. Following growth of 5.3% year-on-year in Q1-2024, the annual rate slowed to 4.7% in the second quarter.

In its July 2024 update of its World Economic Outlook, the IMF raised its forecast for China’s GDP growth in 2024 to 5.0%, on the back of increasing private consumption and exports at the beginning of the year. For 2025, the IMF now expects an output expansion of 4.5% for 2025.

Monetary policy was further loosened this July, with key short-term and longer-term interest rates being cut, in a bid to strengthen domestic demand. In part, the latter also featured among key messages conveyed by the Third Plenum held by the Central Committee of the Communist Party in July, which is held about every five years and usually focuses on longer-term economic and social strategies.

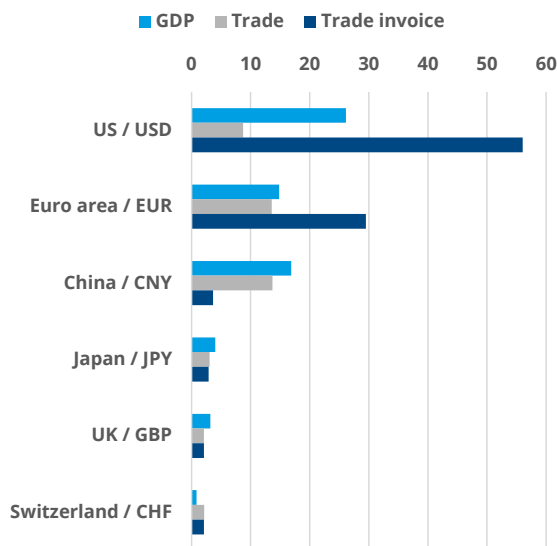
The communique accompanying the conclusion of the Third Plenum broadly seems to reflect China’s ambitions for modernization, and the balancing of

these ambitions with the desire for control and regulation, among other things touching on nurturing the science and technology ecosystem, fostering integrated rural-urban developments, the role of local governments and the balance between the public and private sectors.

The mentioned prevention and control of trade risks may indicate that the Chinese leadership expects protectionist trade policies to continue. Given the China's weight in global trade, which is not reflected in its currency's share in trade invoices due to its limited convertibility, this could have negative implications in the medium term (see [Figure 3](#)). Moreover, the authorities' emphasis on the importance of national security on the modernization path will likely have to be read in the context of currently heightened geopolitical tensions and important ramifications for China's Taiwan policy.

Figure 3: China exhibits a very low currency share regarding trade invoices

Economy and respective currency shares in global GDP/global trade/global trade invoice, in %



Sources: BIS, Creditreform Rating

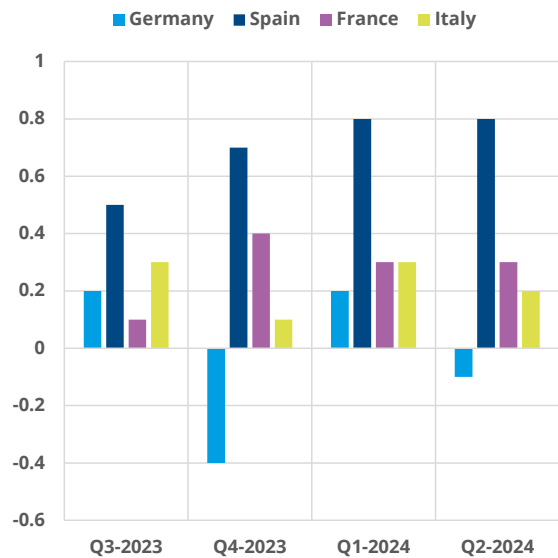
2. Euro area

Economic recovery without Germany

Having stagnated in the second half of 2023, the euro area GDP resumed growth in 2024, posting a quarter-on-quarter expansion of 0.3% both in Q1 and Q2-2024. Looking at the four largest euro area economies, Spain's economic performance remains significantly stronger than that of its peers, boasting q-o-q growth rates of 0.8% in Q1 and Q2, respectively (see [Figure 4](#)). Germany continued to underperform versus the other three major economies, posting another GDP contraction in the second quarter, on the heels of a feeble expansion in Q1.

Figure 4: Spain in a league of its own

Real GDP q-o-q growth in %



Sources: Eurostat, Creditreform Rating

Survey data such as the euro area PMIs continue to point to a two-speed economy, with the services sector outperforming the manufacturing sector. In August, the Composite PMI climbed to a three-month high of 51.2 points, driven by stronger growth in services, with the French services PMI gaining markedly, possibly pushed by the Olympics.

Even though the Olympic event in Paris may have led to some crowding-out effects, the French GDP could still receive a boost in Q3. As suggested by the French statistical institute INSEE, the 2024 Olympics may have lifted quarter-on-quarter French GDP growth by about 0.3 percentage points in Q3, with e.g. ticket sales, broadcasting rights, but also transport services, likely constituting important drivers.

Spain upgraded to "A" from "A-"

[We have raised Spain's long-term sovereign rating to "A" from "A-".](#) The rating upgrade is firstly a result of Spain's robust growth trajectory following the pandemic recovery, as well as its continued outperformance of euro area growth lately (see [Figure 4](#)), partly boosted by tourism and other services exports. We expect Spanish GDP growth to continue to exceed the economic expansion rate in the euro area this year and next. Second, we view a positive medium-term growth outlook as buttressed by ongoing tangible improvements in the labor market, and strengthening economic resilience on the back of recent and ongoing initiatives related to the Spanish Recovery, Transformation and Resilience Plan, which draws on significant EU funding, as well as by diminishing external vulnerabilities. Third, based on the above, prospects for a strengthening government revenue base and a continued favorable debt trend after the recent stronger-than-expected decline in the public debt ratio have improved – notwithstanding weakening debt affordability.

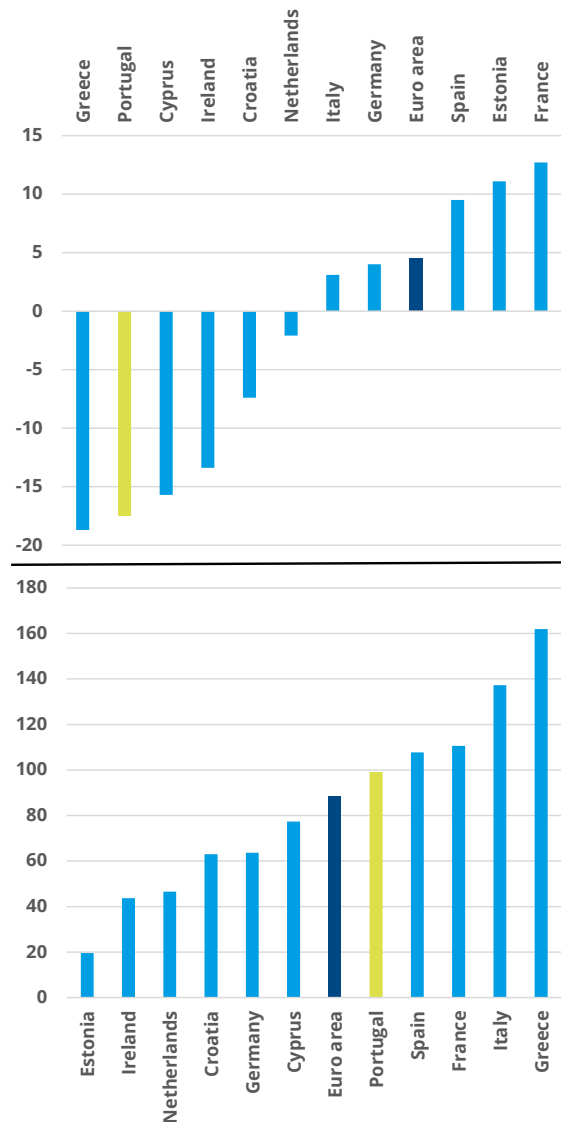
Favorable macroeconomic and fiscal outlook exerts upward pressure on Portugal's rating

In August, [we have raised the outlook on Portugal to positive from stable and affirmed the long-term sovereign rating of "A-".](#) The outlook revision reflects the recent sharp reduction in the general government debt-to-GDP ratio (see [Figure 5](#)), accompanied by budgetary outperformance, and our expectation of a continued decline in the public debt ratio. These developments are flanked by a strengthened resilience of the banking sector, contributing to diminishing risks to fiscal sustainability. The positive outlook also reflects our expectation that favorable prospects for the solid economic growth trend persist,

bolstered by progressing implementation of Portugal's Recovery and Resilience Plan, as well as steps towards structural improvements regarding the labor market. Moreover, private debt ratios have decreased, which should add to economic resilience, alongside some reduced vulnerability with regard to external risks.

Figure 5: Portuguese debt-to-GDP ratio approaching euro area level

Above: percentage point change in general government debt 2023 vs. 2019, below: general government debt in % of GDP in 2023



Sources: Eurostat, Creditreform Rating

Outlook for Estonia revised to 'negative'

[We have lowered the outlook on Estonia to negative from stable and affirmed the long-term sovereign rating of "AA-".](#) The main reason for the downward revision of the outlook is the prolonged adverse impact of geopolitical tensions on the Estonian economy, which has extended a phase of real GDP contraction and dampened expectations for a timely resumption of the currently interrupted convergence process towards EU income levels. In this context, ongoing pressure on export competitiveness and weakening productivity contribute to clouding medium-term economic growth prospects. The negative outlook also reflects our expectation of an ongoing adverse debt trend, albeit from a low level, on the back of protracted economic slack and persistent spending pressures.

GDP growth rate in 2024 held back by the largest economy, higher growth rate expected for 2025

Lower inflation and the overall robust labor market should lend support to households' purchasing power, strengthening private consumption in the euro area this year. The unemployment rate stood at 6.5% in June 2024, in line with the previous year's average rate. Labor shortages continue to represent a factor limiting economic activity, although easing somewhat from recent peaks. Partly related to skill shortages, we observe that labor hoarding is a more widespread phenomenon across sectors than it was immediately before the outbreak of the pandemic (see [Figure 6](#)).

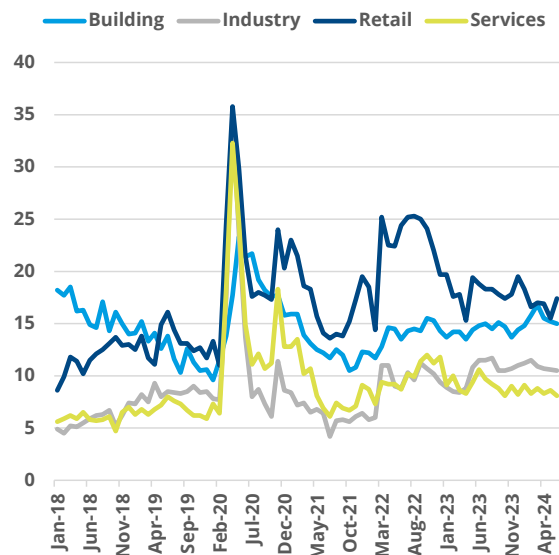
Although the ECB has started to ease monetary policy in June, the lagged effect of the previous aggressive hiking cycle is still weighing on private investment in the current year. Public investment, on the other hand, remains supported by the funds provided via the EU's Recovery and Resilience Facility, contingent on the fulfillment of reforms and investments under the respective national Recovery and Resilience Plans.

Net external trade could exert a slightly negative impact on euro area real GDP growth in 2024 as a whole, as higher private spending is set to increase

import demand, while foreign demand remains subdued. That said, given the expected prospective impetus to foreign demand from lower monetary policy rates in the US and elsewhere, the ground should be prepared for a more positive contribution to growth from foreign demand next year.

Figure 6: Labor hoarding still more pronounced than in the months leading up to the pandemic

Percentage of firms expecting output to decrease, but employment to increase or remain the same



Sources: European Commission, Creditreform Rating

Overall, we forecast only moderate euro area GDP growth of 0.8% in 2024, dragged down by Germany. However, this represents a slight upward revision compared to the [last edition of our Economic Briefs](#) (March 2024), partly driven by the recent outperformance of the Spanish economy. For 2025, we expect real GDP growth in the euro area to accelerate to 1.3%, supported by some relief via the monetary policy channel and the associated strengthening of domestic demand. Downside risks to these forecasts continue to arise from the wars in Ukraine and the Middle East.

With the new EU fiscal governance rules in force since the end of April 2024, the focus is shifting to

fiscal consolidation and sound public finances following the exceptional period of the past few years shaped by the global pandemic and the energy price shock. Eight EU countries are currently undergoing an 'excessive deficit procedure' under these new rules, monitored by the European Commission, including Italy and France. Their respective budget deficits are exceeding the 3% of GDP reference value, which the European Commission does not expect to be temporary and not due to exceptional economic circumstances.

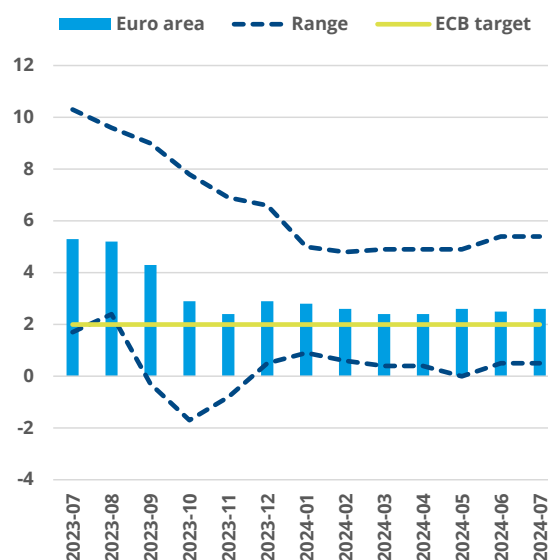
Inflation moving down slowly

HICP Inflation in the euro area as a whole has proved somewhat sticky of late, posting at 2.6% in July 2024, after hovering around 2.5% between February and June 2024. The core rate remains even higher at 2.9% in July. Different approaches among the EU countries as regards measures to mitigate high energy prices had led to a relatively wide range among the national HICPs over the last two years, but as these measures are largely being wound down now, this spread has narrowed (see [Figure 7](#)). At 5.4%, Belgium's inflation rate was the highest in July, where significant base effects linked to energy prices were at play, whilst Finland stood at the bottom of the range with an inflation rate of only 0.5%. At 2.6%, Germany's HICP inflation was in line with the overall euro area inflation rate in July.

Vivid wage growth and energy-related base effects are likely to prevent headline inflation from falling much further this year. However, there are tentative signs that pressures from higher labor costs are beginning to ease. Negotiated wage growth slowed to 3.6% year-on-year in Q2-2024, after increasing to 4.7% in the preceding quarter, with the latter being driven by wage agreements in Germany's wholesale, retail, chemical and construction sectors. The wage tracker compiled by Indeed Hiring Lab, reflecting wages advertised in job postings, hints at a slowing trend over the course of 2024. More recently, it pointed to stabilization, with the year-on-year percent change in wages edging up to 3.8% in July.

Figure 7: Inflation remains slightly off target as corridor narrows

HICP inflation rates, in %; 'range' refers to HICP levels among EU member states (highest/lowest)



Sources: Eurostat, Creditreform Rating

More policy rate cuts to come, but likely at a gradual pace

Given the recent slowdown in disinflation, the ECB's monetary policy stance remains highly data dependent, and the ECB continues to emphasize a meeting-by-meeting approach to its interest rate decisions, gathering evidence from economic and financial data that underpins a clearer downward trend in underlying inflation. Following its rate cut by 25 basis points this June, the first cut since halting its aggressive tightening cycle, the ECB thus left its key policy rates unchanged at its July meeting. The marginal lending facility, the main refinancing rate and the deposit rate continue to stand at 4.50%, 4.25% and 3.75%, respectively.

While not a foregone conclusion, we expect another rate cut at the upcoming September meeting, when a new set of inflation projections will also be available. According to its latest macroeconomic projections, dating from June 2024, the ECB forecasts inflation to average 2.5% in 2024 and to decline to 2.2% in 2025. The core rate is expected to be slightly

higher this year, but to average 2.2% next year as well.

As regards the further rate path, we believe that the ECB will lower interest rates two more times this year, also bearing in mind that the difference between the main refinancing rate and the deposit rate will be narrowed to 15 basis points from September 2024. More specifically, we expect the main refinancing rate to stand at 3.4% at the end of 2024. Beyond this year, we expect a similarly gradual pace of monetary policy easing at this stage, with the main refinancing rate expected to stand at 2.9% by the middle of 2025.

Meanwhile, the winding down of the Asset Purchase Portfolio proceeds as planned, with no reinvestment of principal payments from maturing securities. As part of the July meeting, the Governing Council reaffirmed its intention to also discontinue reinvestments under the PEPP at the end of this year.

With a view to credit developments in the second quarter of 2024, the July 2024 ECB bank lending survey points to mixed signals, with more tangible signs of easing financial conditions and recovering loan demand from private households. Credit standards for loans to households for house purchases saw some further net easing in Q2-2024. Moreover, net demand for housing loans registered its first increase since 2022. By contrast, credit standards for loans to businesses tightened slightly further in the second quarter of 2024, although only to a small extent, hinting at underlying easing tendencies. High interest rates and lower fixed investment continued to weigh on firms' loan demand in Q2-2024. That said, with regard to the third quarter 2024, responding banks anticipated a moderate increase in loan demand both from enterprises and private households.

Challenging government formation in France

France's legislative election, held in two rounds on 30 June and 7 July, resulted in a fragmented parliament, with no alliance obtaining a majority (289 seats), complicating government formation, as party policies and preferences seem very divided. Following

the election outcome, Prime Minister Attal submitted his resignation, but he and his administration continue to serve in a caretaker role during the transition period. The snap election was triggered by president Macron's dissolution of the National Assembly as a consequence of the far-right National Rally (RN) becoming France's strongest force in the European Parliament elections, while Macron's alliance saw significant losses.

Ultimately, the left-wing alliance New Popular Front (NFP) won the most seats in the national elections (182 seats), followed by Macron's alliance Ensemble with 168 seats and the RN with 143 seats. At the time of writing, no prime minister has been appointed, with president Macron recently refusing to appoint a prime minister from NFP. Depending on the composition of the new government, we see some fiscal risk if the recent pension reform is rolled back. Moreover, with parts of the left-wing spectrum calling for strike action, a potentially extended political deadlock could have adverse consequences on the implementation of growth-enhancing reforms and fiscal consolidation.

3. Germany

Mired in misery

The German economy continues its weak streak. Following a moderate GDP increase by 0.2% q-o-q in this year's first quarter, economic output shrank by 0.1% q-o-q in Q2, with the decline being broad-based. Apart from private consumption, investment in machinery and equipment, as well as investment in construction, contracted in the second quarter, as did exports (see [Figure 8](#)).

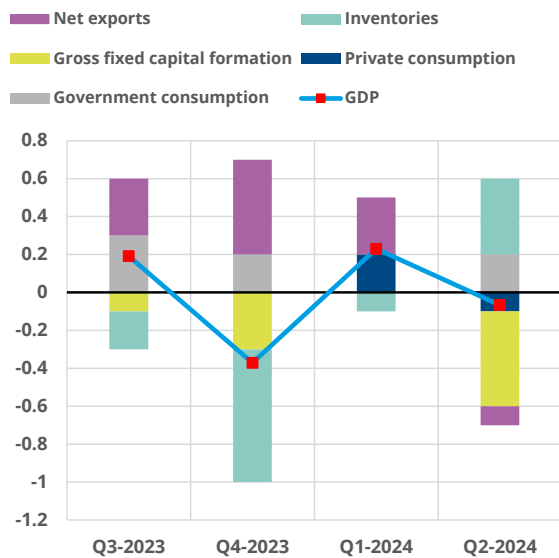
Expectations for more vivid economic activity pushed back again

Worse still, business sentiment indicators are currently not pointing to a faster economic pace. On the contrary, the ifo business climate deteriorated for a

third consecutive month in August, with the component capturing expectations for the coming six months likewise falling for the third time in a row. Even among businesses in the service sector, which had held up relatively well, optimism seems to be waning of late. The mood among companies in the construction sector remains gloomy, while the business climate in the manufacturing sector has sharply worsened over the last two months.

Figure 8: Sluggish domestic demand weighs on overall economic activity

Change in real GDP, quarter-on-quarter, in %, and contribution by main expenditure components in percentage points



Sources: Eurostat, Destatis, Creditreform Rating

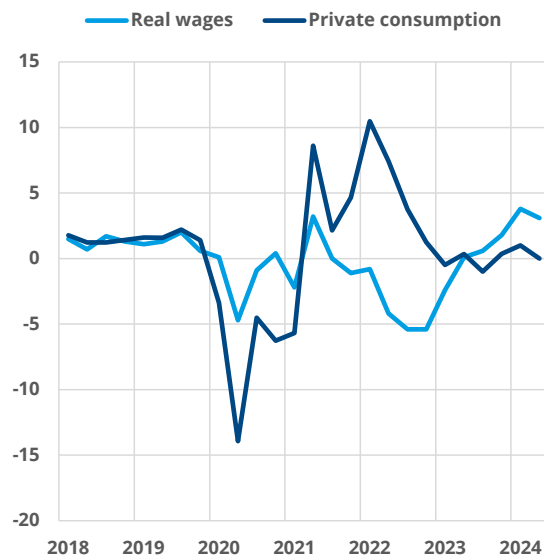
Following a brightening tendency over recent months, consumer confidence as captured by GfK/NIM reflected a souring mood in August, partly on the back of receding income expectations and willingness to buy. As a result, prospects for private consumption to post an increase this year appear to be somewhat diminished. However, the relatively stable labor market situation, with an unemployment rate close to record lows, strong wage growth, as well as significantly lower inflation rates compared with the same period last year in our view still provide fertile ground for a recovery of household

spending (see Figure 9). The German HICP inflation rate stood at 2.6% in July, compared with an average rate of 6.0% in 2023.

In Q3, private consumption may even have received a small boost from Germany's hosting of the European Football Championship this June/July. The number of overnight stays by guests from abroad rose by 15.7% to 8.7 million in June 2024, the highest June figure ever recorded for foreign guests.

Figure 9: Positive signals for household spending from rising real wages

Annual change in real wages and private consumption, quarterly data in %



Sources: Destatis, Creditreform Rating

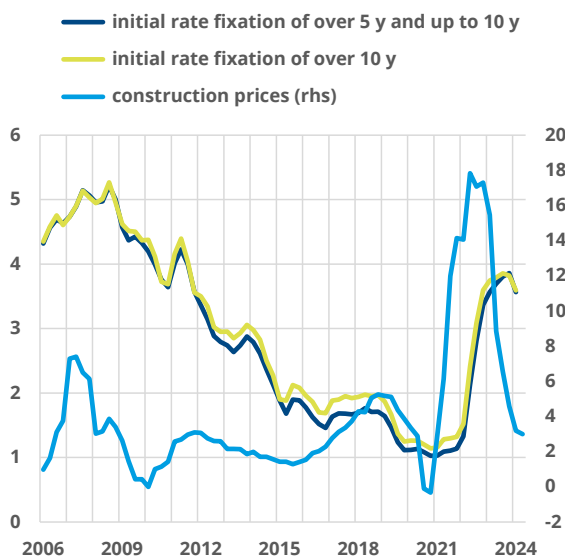
In June, Germany's unemployment rate remained stable at 3.4% (Eurostat data), compared with 6.5% in the euro area as a whole. However, employment growth has been weak over the last few quarters (Eurostat data). Willingness to hire among firms remains more muted than at the same time last year, as suggested by the ifo employment barometer in August, which fell for a third consecutive month.

Construction: Light at the end of the tunnel?

While construction investment remains impacted by the high interest rate environment and higher costs for commodities, materials and energy, light at the end of the tunnel may be coming in sight, despite the renewed decline in Q2-2024, which followed an increase in construction investment in the first quarter. With a first step of monetary easing by the ECB and expectations of more to come, albeit at a gradual pace, there are some green shoots for the construction sector. In addition, cost pressure is easing (see Figure 10). Adding to a slightly improving outlook, (price-adjusted) new orders for construction increased by 1.9% year-on-year in the first half of 2024 compared with the first half of 2023. To be sure, this was driven by civil engineering rather than building construction.

Figure 10: Some relief underway for the construction sector

Year-on-year change in construction prices in %, lending rates on housing loans in %



Sources: Deutsche Bundesbank, Eurostat, Creditreform Rating

Meanwhile, clear signals of an improving situation in the manufacturing sector remain largely absent. While new orders posted a strong month-on-month increase in June, they were 1.4% lower in Q2-2024

than in Q1-2024. Excluding big-ticket orders, which tend to distort underlying developments, new orders were 1.4% higher in Q2-2024, which may be seen as a silver lining.

Similarly, industrial production increased month-on-month in June 2024, whereas the less volatile three-month comparison showed that production in Q2-2024 was 1.3% lower than in Q1-2024. However, hinting at fading negative effects on energy-intensive branches, the respective three-month on three-month comparison for these industries, which include the chemical and metal industries, showed that production was 1.3% higher in Q2-2024.

Prospects for a growth acceleration in 2025 becoming shakier

We continue to expect investment in machinery and equipment to expand moderately this year, while construction investment is likely to post another decline, despite an assumed stabilization in the second half of 2024. Government spending on defense equipment remains set to contribute positively to investment, with the challenging geopolitical context remaining a strong driver.

Even though export expectations derived from the respective ifo survey in August dampen the near-term outlook, German real exports could see a moderate increase this year, as economic growth in the euro area and other major export destinations appears relatively robust. EU funding linked to the Recovery and Resilience Facility is likely to continue to act as support to demand from EU member states. Moreover, interest rate cuts by other major central banks lend some support to the respective local economic developments, probably more so in the coming year.

While there is little reason to expect more than broad stagnation of Germany's real GDP in 2024, given the weak first half of the current year, we stick with our expectation for stronger growth dynamics in 2025. Having said that, prospects for a growth acceleration in 2025 are becoming more uncertain, and a protracted weak streak in the second half of 2024 would lead to a more marked downward revision to

our current GDP growth forecast for 2025. With monetary policy easing likely to continue and the broadly stable labor market situation, we still expect more impulses from domestic demand next year, alongside rising exports. At this stage, we forecast real GDP to increase by 0.1% in 2024 and by 1.1% in 2025.

Notwithstanding further adjustment to geopolitical challenges, unpredictable developments linked to the wars in Ukraine and the Middle East continue to pose downside risks, including renewed commodity price spikes and possible disruptions to important international transport routes.

Corporate defaults remain on the up

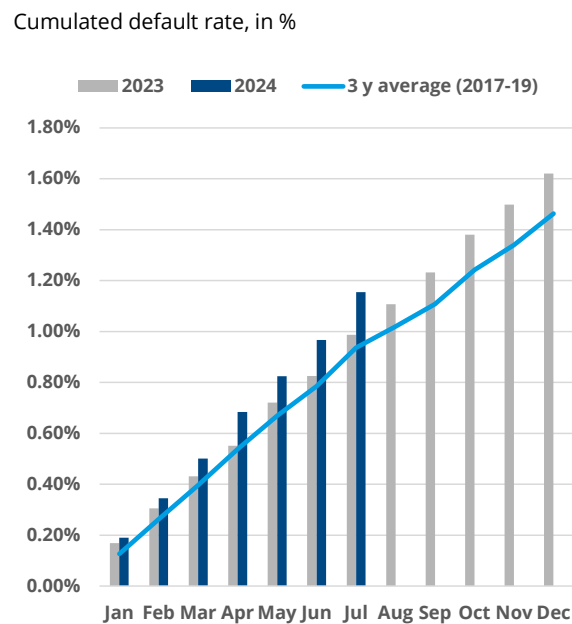
Our expectations of an increasing number of defaults this year have so far materialized. Applying a Basel-compliant definition of a corporate default, which not only includes corporate bankruptcies but also payment arrears of more than 90 days, defaults among German enterprises have continued to rise in the first half of 2024 (see Figure 11). The results are empirical default rates rather than extrapolations or estimates, due to our comprehensive database of roughly 2.5 million economically active companies, equivalent to a complete survey of the German corporate sector.

By July 2024, a total of 28,773 firms has defaulted according to the above definition, corresponding to an increase of 15.9% compared to the first seven months of 2023. With that, the number of cumulative defaults remains markedly higher than the average for the same periods in the years 2017-2019, a phase that initially saw relatively strong economic growth and was not characterized by severe global shocks. Compared with this average, defaults from January to July 2024 are up by 22.1%.

Drawing on this year’s cumulative default rate up until July 2024, the construction sector remains among the hardest-hit sectors, exhibiting a default rate of 1.55% as of July 2024. This compares with the sector’s average default rate of 1.21% through July in 2017-2019, and 1.15% across all sectors.

We maintain our view that defaults will continue their unfavorable trend this year and likely so in 2025. However, the expected further monetary policy easing should gradually be conducive to an improvement, with pressure on businesses likely moderating more visibly over the course of next year.

Figure 11: Corporate sector remains under pressure



Source: Creditreform Rating

4. United Kingdom

Economic rebound in the first half of 2024

After a technical recession in the second half of 2023, UK economic activity recovered in the first half of 2024, recording stronger quarter-on-quarter growth rates than we had expected at the time of our last Economic Briefs. On the heels of a quarterly expansion of 0.7% in Q1-2024, preliminary estimates point to quarterly GDP growth of 0.6% in the second quarter, chiefly driven by domestic demand, whereas net trade posed a drag.

Focusing on the production side, services recorded a broad-based increase in Q2-2024, with 11 out of 14

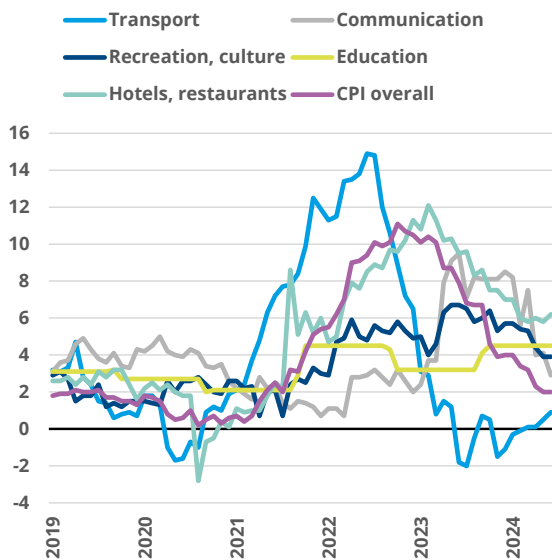
sub-sectors adding positively, according to the Office for National Statistics (ONS). Production and construction both decreased by 0.1% in the second quarter. While construction output fell for a third consecutive quarter, the decline was less pronounced than in the preceding two quarters.

Positive signals for GDP growth ahead

Drawing on the monthly GDP Tracker by the National Institute of Economic and Social Research, quarter-on-quarter GDP growth could be in the vicinity of 0.4% in Q3-2024. Sentiment indicators gauging the mood among businesses and consumers back expectations for ongoing growth in the second half of 2024. With tailwind from new orders, the flash PMI for the manufacturing sector rose to 52.5 in August, its highest level in 26 months. The service PMI moves at a similar level, while the respective indicator for the construction sector hints at an accelerating economic pace.

Figure 12: Service inflation finally on the decline

Consumer price inflation, annual rates in %, 2015 = 100



Sources: ONS, Creditreform Rating

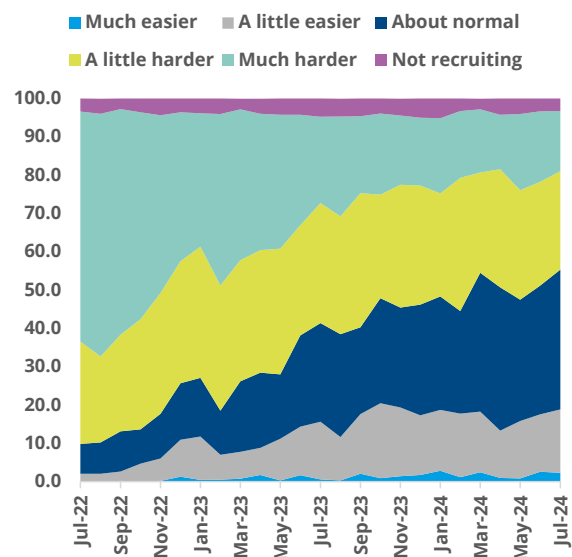
Consumer sentiment, as captured by the respective GfK indicator, has also improved, partly reflecting easing inflationary pressures. Overall CPI inflation

stood at 2.0% in June, with service inflation by and large retreating as well by now, although it remains generally higher than the headline CPI inflation rate, in part to due wage pressures (see Figure 12). We expect rising real incomes on the back of fading inflation and sustained pay growth to support household spending.

That said, the labor market appears less tight by now. To be sure, the unemployment rate remains relatively low, standing at 4.2% in the three months to June 2024. However, the number of vacancies remains on the decline, and finding suitable candidates to fill vacancies appears to have become less difficult (see Figure 13). At the same time, the August Report on Jobs by KPMG and REC showed that the number of permanent staff appointments declined in July. The report also highlighted that permanent salaries had risen again. Overall, though, growth in average weekly earnings slowed down significantly in June.

Figure 13: Recruiting appears to become an easier job

Level of difficulty associated with recruiting new employees, % of respondents



Sources: Bank of England, Creditreform Rating

Notwithstanding the turning tide in monetary policy, gross fixed capital formation is unlikely to provide a

significant boost to economic growth this year. Business investment remains adversely affected by tight financing conditions, although it should gradually gain momentum, as we expect more rate cuts to follow. Housing investment should likewise benefit over time from loosening monetary policy. According to the monthly Decision Maker Panel, average annual growth in capital expenditure could be positive over the next year. Subdued foreign demand should continue to pose a drag on net exports this year.

We now forecast UK real GDP to expand by 1.1% in 2024, marking a pronounced upward revision compared to our last Economic Briefs, primarily due to the better-than-expected first half of the year. Assuming further monetary policy rate cuts, also among important trade partners, the effects of which should be increasingly felt next year, we continue to forecast UK GDP growth to be around 1.5% next year. Uncertainty pertaining to these forecasts remains high, not least due to geopolitical tensions in Ukraine and the Middle East. With the new government currently hinting at possible fiscal measures to step up consolidation efforts, we see some potentially offsetting effect to the expected relief from interest rate cuts via the fiscal channel.

First rate cut since early 2020

Given that the CPI inflation rate had decreased to the 2% target in May and June, the Bank of England's Monetary Policy Committee (MPC) decided to cut the Bank rate by 0.25 percentage points at its July meeting, although in a narrow vote. Five members advocated a rate cut by 25 basis points, while four members opted for maintaining the rate at 5.25%.

Nevertheless, the MPC expects inflation to rise again to around 2.75% in the second half of the year, due to fading favorable base effects related to energy prices. Although the MPC anticipates domestic inflationary pressures to abate gradually going forward, second-round effects continue to pose a risk over the medium term. We expect the MPC to tread carefully in this environment, and the key policy rate only to be lowered one more time this year, to 4.75% at the end of 2024. We expect the Bank rate to be at 4.25% by the middle of 2025.

The portfolio size of the Asset Purchase Facility is to be reduced further to GBP 658bn in September. A vote concerning the intended reduction of the gilt stock over the 12-month period from October 2024 to September 2025 will take place at the Bank of England's September meeting.

In light of the turnaround in monetary policy, the housing market may also have turned the corner, with risks of a major correction on the housing market appearing diminished. That said, the assumed gradual approach to monetary policy easing does not entirely remove the risks via the housing market. Following a limited phase of house price declines, the HM Land Registry's UK house price index for all types of property has risen recently, with the annual rate of change standing at 2.2% in May 2024. Residential property transactions rose by 11.3% y-o-y in Q2-2024.

Labour secures a comfortable majority

The UK parliamentary snap election held in July saw a landslide victory for the opposition Labour Party, bringing it to power for the first time since the 2005 general election. Led by Keir Starmer, Labour obtained a comfortable majority of 412 out of 650 seats, which should facilitate the implementation of government policies.

Looking at domestic policies, Labour had expressed its commitment to fiscal consolidation efforts during the electoral campaign. While the Prime Minister reaffirmed his commitment not to raise income tax or national insurance contributions in a speech delivered in August, he seemed to hint at possible fiscal decisions nevertheless affecting the private sector in the upcoming Autumn Budget. According to the new government, there is an estimated GBP 22bn shortfall in public finances with regard to the fiscal year 2024-2025.

Looking at the relation with the EU in the aftermath of Brexit, we expect further rapprochement and strengthening cooperation, which could tend to strengthen underlying GDP growth in the UK over the coming years, e.g. via closer collaboration regarding R&D.

Figure 14: We have revised our forecasts for the euro area excluding Germany upward for 2024

In percent, IMF forecasts for World, China, US

	2010-19	2021	2022	2023	2024e	2025e
World	3.7	6.5	3.5	3.3	3.2	3.3
Euro area	1.4	6.1	3.5	0.4	0.8	1.3
Germany	2.0	3.2	1.8	-0.2	0.1	1.1
France	1.4	6.9	2.6	0.9	1.2	1.3
Italy	0.3	8.3	4.0	0.9	0.9	1.1
Spain	1.1	6.4	5.8	2.5	2.7	1.9
UK	2.0	8.7	4.3	0.1	1.1	1.5
US	2.4	5.8	1.9	2.5	2.6	1.9
China	7.7	8.5	3.0	5.2	5.0	4.5

Sources: Creditreform Rating, IMF

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