The UniCredit Macro & Markets 2024-25 Outlook

Macro Research
Strategy Research

23 November 2023

“Central banks' pivot set to support market sentiment”

- **Macro:** Global growth will likely slow further next year as past monetary tightening bites and China's economy struggles. With inflation in the US and the eurozone heading towards 2% by end-2024 and below target in 2025, the Fed and the ECB will likely be busy cutting rates from mid-2024. Growth will probably pick up somewhat in 2025.
- **FI:** We expect curves to bull-steepen and we target 4.15% for the 10Y UST yield and 2.40% for the 10Y Bund yield (10Y swap rate at 2.80%) by end-2024, with a further decline in 2025. We are constructive on BTPs.
- **FX:** A mildly weaker USD will likely push EUR-USD to 1.13 by end-2024 and to 1.15 by end-2025. USD-JPY could slip towards 140 once the BoJ starts policy normalization. A GBP fall and a USD-CNY drop below 7.00 are likely to be two stories for 2025. In CEE, the PLN strength is likely to fade, the CZK may become more stable in 2024 and the HUF is set to underperform. Monetary tightening at home is likely to curb the fall of the TRY and the RUB.
- **Equities:** Eurozone equity prices have the potential to rise by about 10% in 2024. The potential is even greater in the US as technology stocks have a higher sensitivity to interest rates.
- **Credit:** Corporate credit will likely deliver positive total returns in 2024. We expect European banks' credit to outperform non-financials due to better profitability outlook and lower supply pressure. From a risk-reward perspective, we favor IG over HY non-financial bonds as the latter face higher refinancing needs.
- **ESG:** We expect greeniums to remain positive in 2024, although lower on average than in 2023, due to modestly tighter investment-grade spreads and more selective investor behavior.

Link to webcast **Link to presentation**

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Contents

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Executive Summary

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- Global growth is likely to slow further in 2024, from 3% to 2.7%, as past rate hikes work their way through the economy while important support factors fade. Household savings buffers have largely been exhausted in the eurozone and the UK, while they have become much thinner in the US. Fiscal policy is likely to turn less supportive. In China, weakness will probably continue amid a deflating housing market, low sentiment and deteriorating demographics. From a fundamental perspective, the risk of the global economy experiencing a hard landing appears contained. Private sector balance sheets remain generally healthy, the expected increase in unemployment will be milder than in previous downturns and we see early signs of a potential bottoming-out of global trade. However, risks to our growth forecast are tilted to the downside. Geopolitics is a major concern, while it remains unclear how much of the impact of the aggressive monetary tightening of the last year and a half is still in the pipeline. High rates also bring more risks to financial stability.
- A material slowdown in US growth is arguably the key call of our outlook, given its implications for the disinflation process, the Fed's monetary policy and financial markets. Private consumption has been the main driver of the upside surprise to US growth this year, but this is likely to change in 2024. The remaining excess savings are in the hands of the wealthiest part of the population and are unlikely to boost consumption much further. The savings rate, which is currently less than half its pre-pandemic level, is likely to rise as the labor market softens and households become more cautious. We forecast a broadly flat trajectory for quarterly GDP growth next year. In yearly terms, we expect the US economy to expand by 1% in both 2024 and 2025, down from 2.4% this year.
- In the euro area, headwinds will remain strong in 2024 as the transmission of ECB rate hikes continues to unfold, challenging the resilience of the labor market. However, two factors should support growth: disinflation and a tentative recovery in global trade from current, very weak, levels. In yearly terms, we see GDP growing by 0.5% in 2024, the same pace as this year, and by 1.2% in 2025. The German economy is likely to resume expansion next year, albeit slowly (0.4%), while France (0.8%) and Italy (0.6%) should continue to grow moderately.
- Disinflation is on track. Headline inflation in the US and the eurozone is set to approach 2% in a year's time and fall slightly below central bank targets in 2025. Both the Fed and the ECB will likely pivot next year and start cutting rates, probably in June. We expect the federal funds rate to end 2024 at 4.25% and 2025 at 3.25%. In the eurozone, we forecast the deposit rate will be cut to 3.25% by end-2024 and to 2.25% by end-2025. The BoJ is likely to buck the trend, exiting yield-curve control and negative rates next year.
- CEE countries that are members of the EU (EU-CEE) are likely to grow by 3.0% in both 2024 and 2025, from only 0.6% this year. We forecast a rebound in domestic demand, helped by falling inflation, faster growth in real wages and looser financial conditions. Foreign demand might not contribute to growth until 2025. Turkish GDP might expand by 3.0% next year and accelerate to almost 4% in 2025 if lower inflation allows monetary conditions to loosen. Russia might grow by 1.3% in both 2024 and 2025. Most countries will likely miss their inflation targets and we forecast cautious rate cuts ahead.
- In this environment, we expect core bond yields to decline, particularly at the short end of the curve, with the 2-10Y spread turning positive before end-2024. Ample supply, quantitative tightening and uncertainty regarding term premiums should limit the downside for long-term yields. Our end-2024 target is 4.15% for the 10Y UST yield and 2.40% for the 10Y Bund yield, with yields declining further in 2025. We are constructive on BTPs and expect the 10Y BTP-Bund spread to reach 150bp by end-2025. Investors are likely to become more selective towards credit where carry remains high but fundamental developments warrant some caution. Equities seem better able to benefit from the improvement in risk appetite fueled by disinflation and rate cuts, offering a potential upside of about 10% by end-2024. We project a moderately lower US dollar, with EUR-USD rising to 1.13 by end-2024 and to 1.15 by end-2025.

Global

Crawling then walking

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- We expect global growth to slow next year as monetary tightening bites, while China slows structurally. Growth should pick up somewhat in 2025.
- With inflation in advanced economies expected to be close to target by the end of next year, major central banks (excluding the BoJ) are likely to cut rates in mid-2024.

Slowdown next year, moderate recovery in 2025

We expect global GDP growth to slow to 2.7% in 2024, from 3.0% in 2023, before a modest pick-up to 3.0% in 2025. Growth is slowing due to the lagged impact of past monetary tightening, reduced buffers and a structural slowdown in China. Still, healthy balance sheets and labor hoarding should avert a recession. In the US, we expect quarterly growth to be broadly flat through next year. In the euro area, we see only modest growth in 2024, supported by a pick-up in real income. In China, growth will likely slow due to deteriorating demographics, a bloated housing market and low sentiment. Other emerging markets will likely be relatively resilient, as central banks are cutting or are about to cut rates, but refinancing risks remain. Global growth should pick up in 2025 but to below historical averages amid still-restrictive monetary policy (Chart 1). The risks to growth are skewed to the downside, from geopolitics, China's property sector, greater-than-expected sensitivity to higher interest rates, and risks to financial stability.

Swift disinflation to pave way for central bank cuts

Disinflation is likely to continue thanks to lower-to-stable commodity prices, the pass-through of lower input price pressure and softening labor markets. In our base case, headline inflation falls to around 2% yoy in the US and the euro area by the end of next year, with core inflation falling too, but slightly more gradually than headline inflation. Geopolitical tensions pose upside risks for the inflation outlook. In this environment, central banks in advanced economies have likely finished raising rates, except for the BoJ, which will probably exit its yield-curve-control and negative-rates policies next year. We see the Fed and ECB starting to cut rates from mid-2024, with the BoE following shortly afterwards. The PBoC will likely continue to ease policy gradually.

Key judgements

1. "Excess savings" largely depleted

Households accumulated substantial "excess savings" during the pandemic, which have supported consumption over the last year or so, particularly in the US. There is uncertainty as to how much of a savings buffer remains and whether it will be spent. Our analysis of real net worth and real liquid assets suggests the savings buffer has been exhausted in the eurozone and the UK, while some buffer remains in the US (Chart 2). However, the US buffer lies with the top 20% of earners, who have a low marginal propensity to spend it.

CHART 1: SLOWDOWN NEXT YEAR

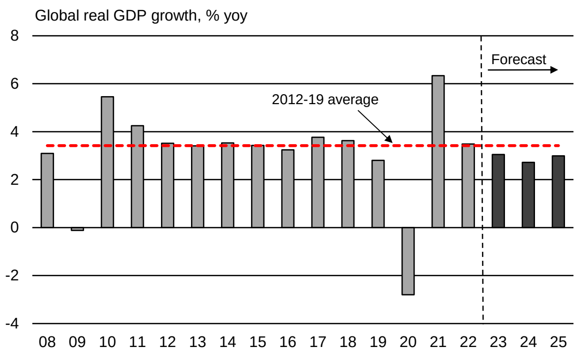
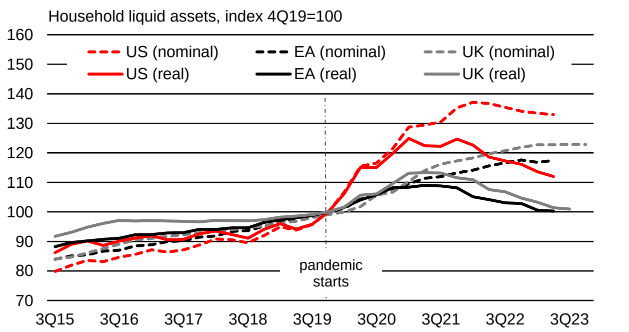


CHART 2: REDUCED SAVINGS BUFFERS



Note: liquid assets are the sum of currency; checkable, time, and savings deposits; and US money market funds. The real series is the nominal series deflated by the all-item consumer price index.

Source: BEA, BLS, Eurostat, IMF, ONS, UniCredit Research

2. Monetary transmission to build

We judge that much of the impact of higher rates on the level of GDP has yet to materialize. A central rule of thumb is that the maximum impact occurs around a year after a rate rise, although significant uncertainty surrounds this. The Fed and ECB only recently stopped raising rates, and real rates did not turn clearly positive until 1Q23. Housing investment has fallen, business investment is weak and lending to households and corporates has slowed. The impact of monetary tightening will build as debt is refinanced at higher rates (Chart 3) and the eurozone is more exposed than the US due to its shorter debt maturity. Lower house prices could also weigh on consumption via collateral and wealth effects, although price declines so far have been limited. How restrictive monetary policy is depends on the neutral interest rate. We judge that the nominal neutral rate has risen slightly, to around 3% in the US and 2% in the euro area, due to higher public debt and investment needs, de-globalization, quantitative tightening and a smaller "global savings glut", but this is highly uncertain.

3. Real labor income growth to be flat-to-modest

With "excess savings" largely depleted and credit conditions tightening, consumption growth is likely to become better aligned with real income growth. Here the health of the labor market will be key. Given that labor markets remain tight and considering the difficulty firms have had in finding workers over the last few years, we assume that labor hoarding will be strong and the rise in unemployment will be much more contained than in past downturns. We expect modest growth in real labor income next year in the eurozone (as average inflation next year will be well below this year's average), and broadly flat growth in the US (due to a softer labor market).

4. Services fading, manufacturing and trade bottoming out

Pent-up demand for services over the summer is now fading, with developed markets' PMI services orders in contractionary territory. Meanwhile, leading indicators for manufacturing, such as the orders-to-inventories ratio, have bottomed out (Chart 4) and our Global Leading Indicator for trade in goods is pointing upwards. This likely reflects the impact of lower energy prices and easing supply-chain constraints. We assume manufacturing and trade will gradually recover, supporting economies with large manufacturing sectors, but the recovery is likely to be subdued amid still-tight monetary policy, high uncertainty and fragmentation.

5. Fiscal policy less supportive

Fiscal policy is set to tighten moderately next year in the US and euro area (when the general "escape clause" is deactivated). China's government is likely to stick to its piecemeal approach to stimulus, since large-scale stimulus in 2009 and 2015 led to overleverage.

6. Geopolitical risks

We assume the conflict in the Middle East will remain localized, the Russia-Ukraine conflict will be a war of attrition and tensions between the US and China neither ease nor intensify. The risks are skewed to the downside, particularly if Donald Trump wins the US presidential election on 5 November. If geopolitical tensions were to flare up, this would push up commodity prices, disrupt trade and raise uncertainty. Inflation would rise in the short term, while the effects on output would be clearly negative, complicating the job of central banks.

CHART 3: PASS-THROUGH OF HIGHER RATES TO BUILD

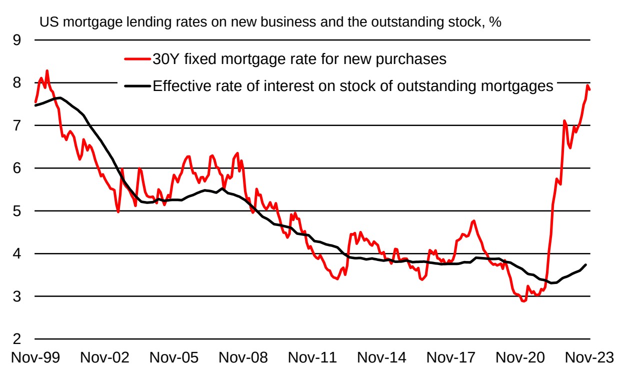
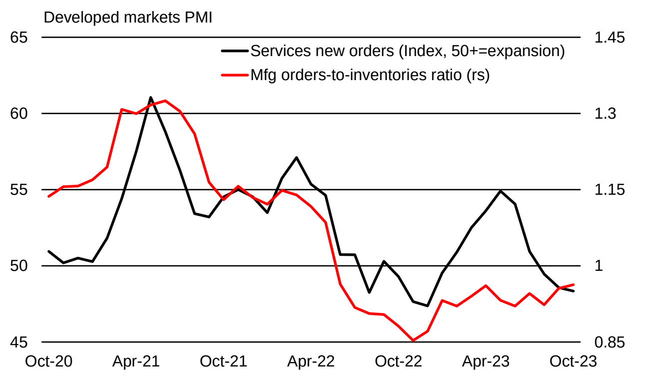


CHART 4: SERVICES FADING, MANUFACTURING BOTTOMING OUT



Source: Bankrate, BEA, Fed, S&P Global, UniCredit Research

US

A softish landing with downside risks

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- We expect quarterly GDP growth to be broadly flat next year, followed by positive but below-trend growth in 2025. Inflation is set to hit 2% by end-2024.
- The Fed's next move will likely be a rate cut in mid-2024. We expect the target range for the federal funds rate to end 2024 at 4-4.25% and to end 2025 at 3-3.25%.

Flat quarterly growth next year…

We expect GDP growth of 1.0% both next year and in 2025, after growth of 2.4% in 2023. On a quarterly basis, we see growth being broadly flat next year before picking up in 2025 but remaining below trend. The slowdown next year is likely to reflect the lagged effects of tighter financial and credit conditions, less-supportive fiscal policy, and reduced buffers from savings and labor market tightness.

…driven by a slowdown in personal consumption

In the near term, the economy has more momentum than we previously expected, largely reflecting the rundown of household savings buffers and support from fiscal policy. However, growth in consumption, which accounts for almost 70% of GDP, is highly likely to slow after the very strong growth in recent quarters. We estimate that only the top income quintile still has a savings buffer (Chart 3), but this is unlikely to be fully spent. The savings rate, at 3.4%, is less than half its pre-pandemic rate and is likely to rise as the labor market softens further and precautionary saving rises. Consumer credit growth has slowed and is likely to continue to do so amid the significant tightening of credit conditions. Credit card delinquencies have risen to above pre-pandemic levels. Meanwhile the labor market is softening, and real income growth is likely to be broadly flat next year, despite lower inflation. Still, the data does not suggest an impending collapse of personal consumption. Household balance sheets are still in decent shape. The labor market is still tight, and while unemployment is likely to rise, the increase is likely to be contained as many firms have found it difficult to find qualified and available workers in the past few years and are likely to hoard labor. Business surveys have softened, but the ISM non-manufacturing index remains above 50.

Other expenditure components of GDP to remain weak

Residential investment is likely to fall next year as high mortgage rates put downward pressure on housing demand and prices. Investment in structures has seen rapid growth over the last year but the fillip from the 2022 Inflation Reduction Act and the Chips Act appears to have already faded in 3Q23. Tight credit conditions and heightened economic uncertainty are expected to weigh on business investment next year, despite structural investment needs related to the green transition and digitalization.

CHART 1: BROAD STAGNATION NEXT YEAR

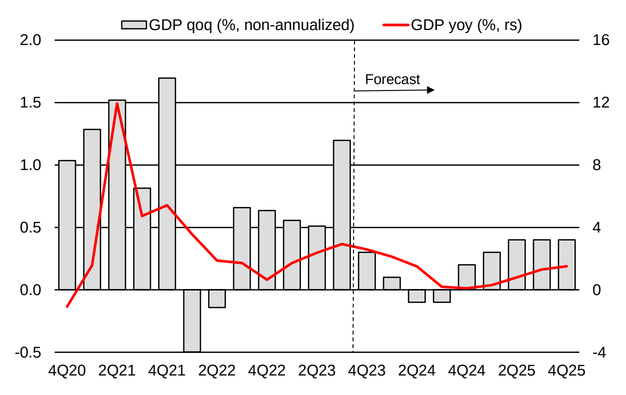
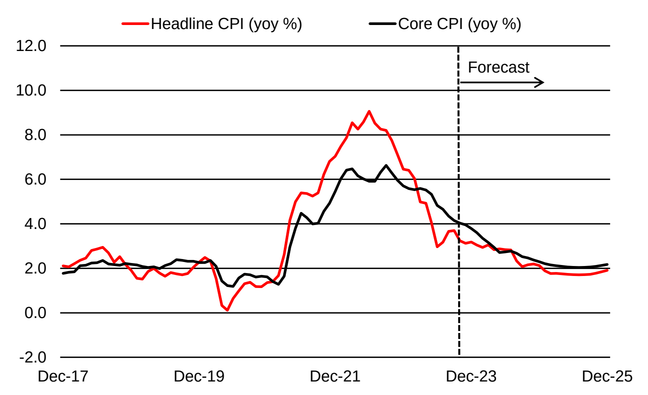


CHART 2: INFLATION MOVING DOWN TO 2%



Source: BEA, BLS, UniCredit Research

Fiscal policy a drag next year

On 15 November, US Congress passed a bipartisan stopgap spending bill to avert a government shutdown. The bill extends funding at current levels to some parts of the government until 19 January and others until 2 February. Failure to pass all annual spending bills by early January will trigger automatic spending cuts of 1%, which was part of the 3 June agreement to suspend the debt limit until 1 January 2025. House Republicans, led by Speaker Mike Johnson, are demanding spending cuts. We have penciled in a net fiscal tightening of 1% of GDP next year, compared to a net loosening of around 2% of GDP this year. Fiscal policy in 2025 will depend on the outcome of the elections on 5 November (please see next page).

Inflation to fall to 2% within a year

CPI inflation is likely to fall to around 2% by the end of 2024, with core CPI inflation following one or two quarters later. Further progress on disinflation is likely to come from housing (where private surveys of new rents point to significant disinflation in official average rents ahead) and non-housing services inflation. The latter is due to the softening labor market and lower short-term inflation expectations. The easing in labor demand so far has taken the form of lower average hours worked and job openings, with layoffs remaining low. But we expect layoffs to rise and the unemployment rate to end 2024 at 4.5%.

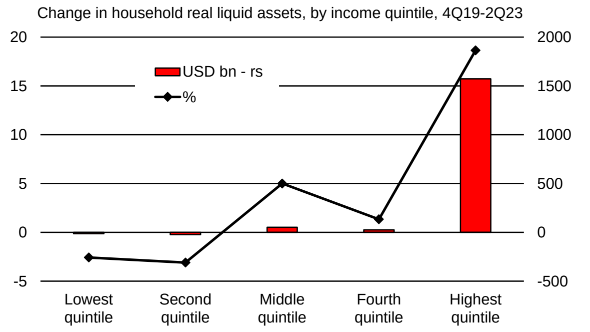
Fed to cut by 125bp in 2024 and 100bp in 2025

The next Fed move will likely be a rate cut, but given the recent resilience of economic activity, we do not expect the first cut until June 2024. The Fed will likely need to see a six-month string of core inflation prints averaging 0.2% mom, a period of below-potential growth and some further labor market softening before cutting rates. Ordinarily, lags in the effects of monetary policy mean the Fed should move well ahead of inflation hitting 2%, but it has said it will put more weight on data than forward-looking models. We expect one 25bp rate cut per meeting from June through December 2024, followed by a cut every other meeting through 2025. This would mean the target range for the federal funds rate ending 2025 at 3-3.25%, slightly above our estimate of the longer-run neutral rate.

Quantitative tightening to end by mid-2025

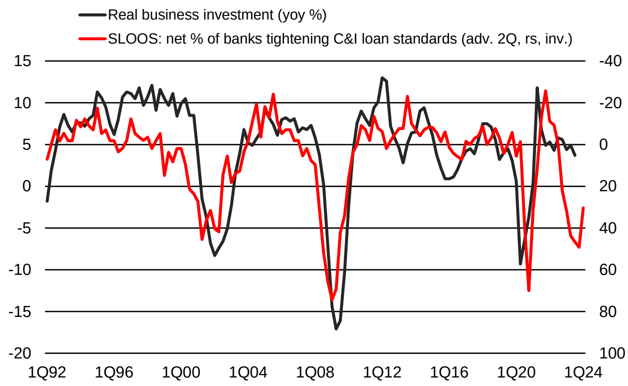
The Fed is currently reducing the size of its balance sheet by allowing its asset holdings to mature up to monthly caps of USD 60bn for Treasuries and USD 35bn for mortgage-backed securities. It intends to slow and then stop the decline when banks' reserve balances are somewhat above the level it judges to be consistent with "ample reserves" (i.e. when the supply of reserves is at least enough to meet banks' demand for reserves for liquidity and regulatory reasons). Reserves currently stand at 12% of nominal GDP, well above the 7% pre-pandemic level, leaving scope for quantitative tightening (QT) to continue (the USD 1.4tn parked at the Fed in reverse repo agreements is likely to decline, increasing the supply of reserves). We have penciled in tapering of QT to start in September 2024 and end in mid-2025. While cutting rates from restrictive to less-restrictive territory would not be working at cross purposes to QT, the same is unlikely to be true once rates get close to neutral.

CHART 3: SAVINGS BUFFER GONE EXCEPT FOR THE RICH



Note: liquid assets are the sum of deposits and money market funds. Nominal values are deflated using the all-item consumer price index and expressed in 4Q19 prices.

CHART 4: TIGHT CREDIT CONDITIONS TO HIT INVESTMENT



Source: BEA, Fed, UniCredit Research

2024 elections: A tight race

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The next US presidential election will take place on 5 November 2024, along with the full renewal of the House of Representatives and the election of 33 Senators out of 100. While the Democratic Party supports the incumbent, President Joe Biden, to be its nominee, the Republican Party will hold its primary elections between January and June. Barring any sort of legal impediment due to ongoing legal trials, former US President Donald Trump is likely to be the Republican Party's nominee.

Although it is too early to call, Mr. Trump is well-positioned

It is too early to call the election. Nominees have not been decided yet. Political platforms are still extremely vague, and a lot could change over the next 12 months, not least the economic situation. With these caveats, the national opinion polls currently suggest Mr. Trump narrowly leads Mr. Biden. Mr. Biden's popularity is at its lowest level since the beginning of his presidency (Chart 5), when his approval rating was almost 55%. Now, it has dropped to around 40%, despite him managing to pass a significant amount of legislation, from covid-related stimulus to the CHIPS and Science Act and the Inflation Reduction Act. Crucially, polls simulating an electoral contest between Mr. Biden and Mr. Trump indicate a small lead for the latter in the key battleground states of Arizona, Georgia, Michigan, Nevada and Pennsylvania.

Possible congressional flips

A high degree of uncertainty surrounds the congressional election, which will determine how much of the new president's agenda can be realized. Currently, the Democrats hold a 51-49 majority in the Senate, while the House of Representatives is narrowly controlled by the Republicans. Recent opinion polls suggest a high probability of a split Congress, possibly with the Senate flipping to Republicans and the House being turned over to Democrats.

Biden vs. Trump: the platforms

There are few publicly-available details about the presidential programs of candidates. Mr. Biden is unlikely to announce anything major on the fiscal front if he wins – as fiscal space is drastically reduced, and the risk of reigniting inflationary pressures is too high. On the foreign-policy front, we think he will likely stick to his hawkish China approach, to a made-in-America strategy and to his democratic vs. authoritarian rhetoric. If Mr. Trump wins, foreign policy would likely become more unpredictable and unconventional. There likely would be ongoing strategic rivalry with China, the protection of domestic manufacturing and the domestic development of strategic technologies. His climate-change commitments will be far less bold, as he promises to eliminate the Green New Deal and to end US compliance with the 2015 Paris climate agreement, while his energy dominance agenda is focused on natural gas and oil.

CHART 5: MR. BIDEN'S LOW APPROVAL RATING

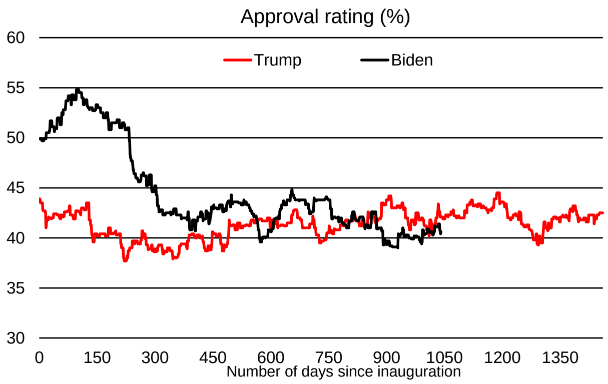
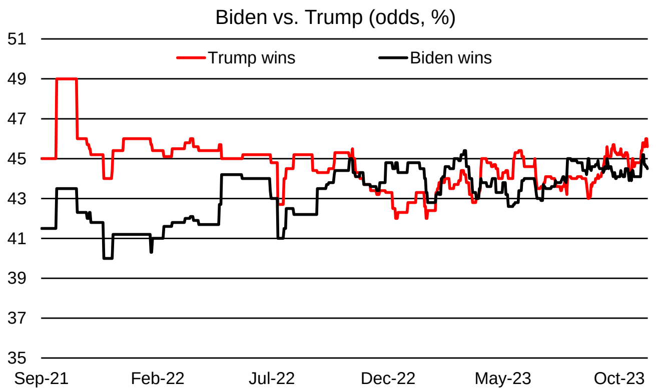


CHART 6: MR. TRUMP HAS A NARROW LEAD



Source: Real Clear Politics, UniCredit Research

Eurozone

Weak growth and disinflation pave the way for ECB cuts

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- We forecast GDP will expand by 0.5% in 2024 as restrictive monetary policy, a tighter fiscal stance and fading labor-market resilience restrain the impulse from disinflation and an expected bottoming out in global trade.
- Headline inflation is likely to approach 2% by the end of 2024 and to decline below this level in 2025, allowing the ECB to start cutting rates next June at a pace of 25bp per quarter. We think that PEPP reinvestments will continue in full until the end of 2024.

We forecast 0.5% GDP growth in 2024, in line with 2023

We expect the eurozone economy to grow by 0.5% in 2024, the same pace as this year. Survey indicators suggest that GDP will either stagnate or contract moderately in 4Q23. Headwinds will remain strong in 2024, as the transmission of the ECB's aggressive rate hikes continues to unfold at a time when households' savings buffers have largely been depleted, fiscal policy becomes tighter and the resilience of the labor market starts fading. However, disinflation and a tentative recovery in global trade are likely to provide support. We forecast that sequential growth will turn positive in early 2024 and reaccelerate slowly over the forecast horizon, reaching potential over the course of 2025. For 2025, we have penciled in average GDP growth of 1.2%.

Transmission of ECB policy is in full swing

The transmission of tighter financing conditions to the real economy is in full swing and is clearly visible in the downturn of the credit cycle and intense pressure on interest-rate-sensitive sectors of the economy. Monetary policy is set to exert a heavy drag on the economy also in 2024, as loans and bonds that come due are refinanced at much higher rates. This will increase firms' interest spending, thereby contributing to dampening their profitability amid ongoing weakness in demand. In turn, this is likely to affect the outlook for fixed investment and challenge the resilience of firms' hiring plans, putting upward pressure on the unemployment rate and downward pressure on wage growth.

How much support from disinflation?

In our baseline scenario, we make the key assumption that the positive effects of disinflation will offset the expected slowdown in nominal disposable income of households, bringing some relief to private consumption. However, risks are probably tilted to the downside here. The unimpressive rise in consumer confidence that has occurred over the last year, despite a collapse in inflation from its peak, and deteriorating sentiment among retailers might signal that households are being held back by a broader sense of uncertainty that goes beyond the effects of high inflation. If this proves true, the eurozone economy might fail to grow in 2024.

CHART 1: GROWTH TO REMAIN WEAK

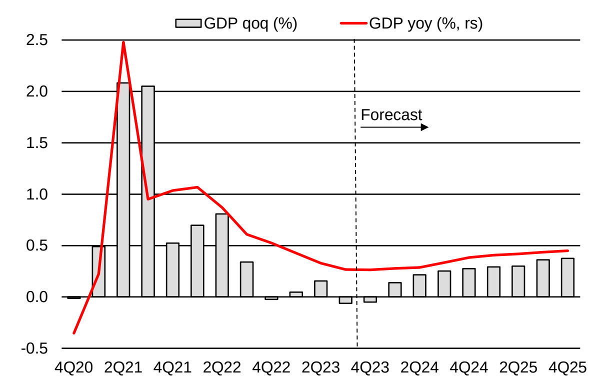
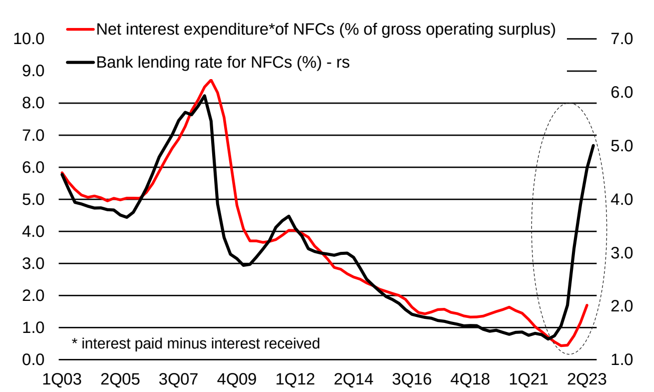


CHART 2: TRANSMISSION OF ECB HIKES HAS FURTHER TO RUN



Source: ECB, Eurostat, UniCredit Research

Inflation to approach 2% by end-2024 and to decline below it in 2025

Eurozone inflation declined massively from a peak of 10.6% yoy in October 2022 to 2.9% in October 2023, mainly reflecting the impulse of lower energy prices. However, disinflation has broadened in recent months, with pipeline price pressure easing in all sectors. Prices for core goods and food items are providing the strongest impulse to the slowdown in ex-energy inflation, and this trend is set to continue. Service prices are also moving in the right direction, although they will remain stickier due to the larger impact of wage increases on the cost bases of firms in this sector. We forecast that headline inflation will approach the ECB's 2% target by the end of 2024 and will decline below it in 2025. Core inflation will adjust downwards more slowly, closing 2024 in the 2.5% area and 2025 at or just below 2%.

ECB to start cutting rates next June

Weak growth and broadening disinflation make it very likely that the ECB's policy rates have peaked. The central bank will probably start cutting rates next June, when it should be clear that wage growth has embarked on a downward trend consistent with its 2% inflation goal. In this regard, we note that both ECB President Lagarde and chief economist Lane have signaled that wage/compensation data for 1Q24 will be key inputs informing the assessment of the Governing Council (GC). Therefore, when one takes into consideration publication lags and assumes that the economy does not take a turn for the worse, June seems to be the earliest possible time for the ECB to start reversing course. We think that the easing cycle will proceed gradually, given the high uncertainty surrounding the level of rates that is consistent with a broadly neutral stance. We have penciled in cuts of 25bp per quarter, which would take the deposit rate to 3.25% at end-2024 and to 2.25% at end-2025. We assume that the landing point will be 2% in early 2026, a level that the majority of the GC might consider neutral.

Risks of early PEPP run-off outweigh benefits

We expect reduction of the APP portfolio to continue at a pace of EUR 30bn per month, while the outlook for PEPP reinvestments is more uncertain. In our view, costs and risks of early run-off outweigh possible benefits. Stopping full reinvestments sometime next year is unlikely to lead to a meaningful reduction in excess liquidity, while it would increase the risk of unwarranted tightening of financing conditions. The ECB's reaction function would become more blurred if markets perceived that early disinvestments do not primarily reflect monetary-policy considerations. Therefore, we assume that PEPP reinvestments will continue in full in 2024, followed by a slow run-off in 2025. The GC might decide to reduce excess liquidity through an increase in minimum reserve requirements. Any changes here would probably come after a review of the ECB's operational framework is completed, likely sometime next spring.

A revamped operational framework

As a result of this review, we think the ECB will rely on two tools to achieve the appropriate level of reserves in the system: a structural bond portfolio and collateralized liquidity provision to banks through both short-term and longer-term refinancing operations.

CHART 3: DISINFLATION BROADENS

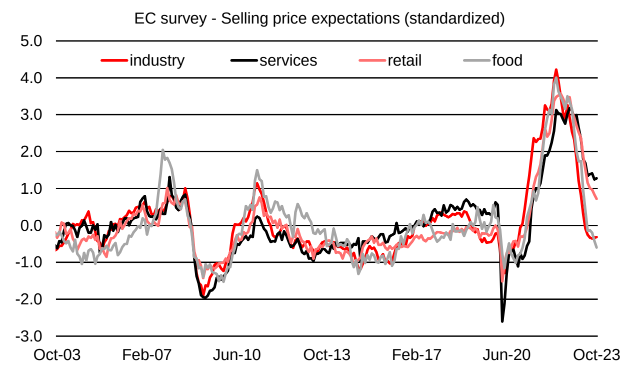
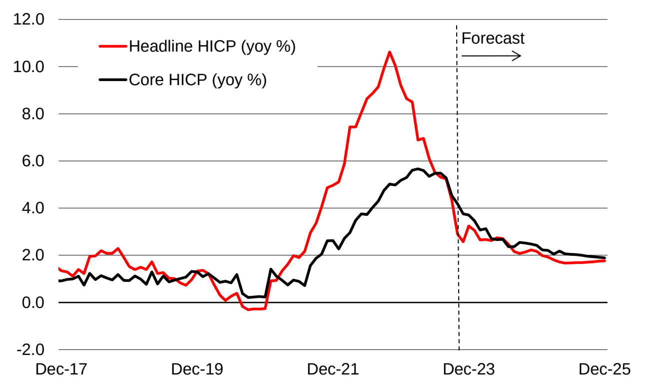


CHART 4: HEADLINE INFLATION TO DECLINE BELOW 2% IN 2025



Source: EC, Eurostat, UniCredit Research

Macroeconomic effects of a new energy-price shock

Key assumptions

We have performed a scenario analysis to estimate the impact on eurozone growth and inflation of an intensification of tensions in the Middle East. In this scenario, we assume that the conflict between Israel and Hamas spreads to Iran and sea transportation across the Strait of Hormuz is severely disrupted. In such a scenario, Brent prices might reach USD 150/bbl, while supply shortages in the global market for LNG might push European gas prices (TTF) towards the cap level of EUR 180/MWh. For the sake of simplicity, we assume that the shock materializes in full by the end of this year. Compared to our end-2023 forecast, Brent and TTF prices would be USD 60/bbl and EUR 130/MWh higher, respectively. We then hold oil and gas prices constant throughout 1H24 and pencil in a gradual decline towards current levels over the course of 2025. We also assume that fiscal policy will once again come to the rescue, cushioning the real economy with targeted support measures. Finally, we do not include in our estimates the effect of any potential policy response by the ECB, the direction of which is uncertain due to a challenging trade-off between resurgent inflation and quickly deteriorating growth.

The shock to GDP growth would be about 2pp

The increase in energy prices and a negative effect on confidence among firms, households and investors would be the main transmission channels of the shock. When it comes to the pass-through of the spike in energy prices to inflation, we use elasticities that are somewhat above historical averages, but below those recorded directly after the pandemic (which were particularly high). The key assumption here is that largely exhausted savings buffers of households and restrictive monetary policy would reduce the pricing power of firms, which would have to absorb a large share of the cost increases through an erosion of profits. In turn, this would dampen the outlook for fixed investment and the labor market. As for the confidence effect in financial markets, we model it broadly along the lines of the shock recorded after Russia's invasion of Ukraine. We assume a two-standard-deviation increase in implied equity volatility (from current low levels) and a 50bp widening in BBB rated corporate spreads. The outcome of our exercise in shown in the two charts below. The largest impact on growth is felt in 2024, when the economy might contract by almost 1%. In 2025, the pace of recovery would more than halve compared to our current forecast. In cumulative terms, the shock to GDP growth would be about 2pp. Headline inflation would be about 2pp higher in 2024, while a large base effect would push it towards 2% in 2025. Core inflation would remain above our forecast throughout the two-year horizon.

ECB policy response

The ECB would be in a very uncomfortable position. While short-term inflation expectations would almost certainly surge, the direction of the policy response, if any, would likely be dictated by developments in inflation expectations at medium-to-longer horizons. If they increase measurably, the central bank would very likely hike rates further. This would act as a further drag on sentiment, adding to the downward pressure on economic activity and reducing the size of the inflation shock in 2025 as the output-gap effect works its way through the economy.

CHART 5: IMPACT ON GROWTH…

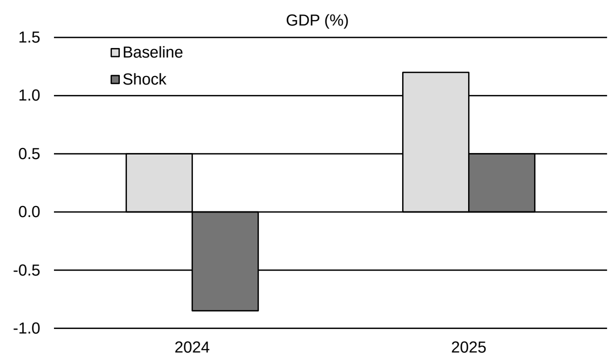
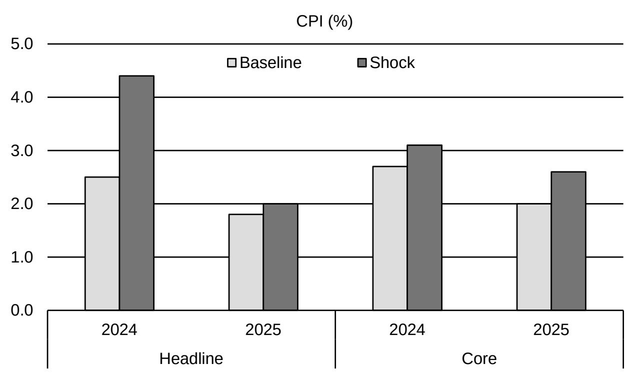


CHART 6: …AND INFLATION



Source: UniCredit Research

Setting out the path to new economic governance

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Fiscal tightening is a key theme of the eurozone outlook as we expect it to weigh on the pace of recovery in the next two years. It is also likely to represent a key challenge to medium-to-longer-term growth prospects at a time when the long-debated reform of the European economic governance is likely to be adopted and enter in full force by 2025.

Fiscal adjustment in 2024 is likely to be softer than expected earlier this year

The fiscal adjustment that started in 2023 is likely to continue through our forecast horizon. In our calculation, next year's average adjustment for the euro area, measured in terms of the change in structural budget balance (one of the metrics on which the European Commission's recommendations are based) is likely to be lower than what member states envisaged in spring, close to but below 0.5% of GDP. This is largely due to some member states slowing the phase-out of fiscal measures introduced to address the energy shock. Among the larger eurozone countries, this is likely to be the case, for example, for the Netherlands, Ireland and Austria. In contrast, Italy and Spain committed in October to pursuing stronger fiscal adjustment than what announced in spring.

Fiscal consolidation will be stepped up in 2025

After a relatively moderate fiscal adjustment in 2024, member states are likely to accelerate fiscal consolidation in 2025, when the new economic governance framework will likely be in full force. By end-2024, public-debt-to-GDP ratios in most eurozone countries are likely to be still much higher than in 2019. We expect the 2025 fiscal adjustment to be no less than 0.5% of GDP, i.e. the mid-point of the "minimum fiscal adjustment" range that the European Commission (EC) recommends on the basis of member states' debt-sustainability positions.

2024 will be a transition year from the current to the new economic governance framework

As we write, it appears increasingly likely that full implementation of the new economic governance framework will be postponed to 2025. We therefore expect 2024 to be a transition year in which the recommended pace of adjustment will be calibrated based on a combination of new and old fiscal criteria (i.e. debt-sustainability analysis but also the gap to medium-term budgetary objectives, MTO), not dissimilar to the 2024 fiscal guidance provided by the EC this spring. This combination of criteria is also likely to form the basis of any decision by the Commission next spring on the excessive deficit procedure (EDP), which will be reinstated after a four-year suspension. Member states' compliance will be assessed on the basis of outturn data for 2023 and targets for 2024. Any decision on this will probably be postponed till after June to avoid interfering with the elections of the European Parliament.

Discussion on the new fiscal framework is being wrapped: what we think

Policymakers are close to reaching agreement on the main elements of the new economic governance framework. The latest developments in the reform debate support our view that the (welcome) differentiation of fiscal targets on the basis of country specificities is unlikely to mitigate the significant adjustment that member states with larger public-debt challenges will have to carry out. The recently proposed multiplication of requirements (safeguards and numerical benchmarks) that member states must comply with risks imposing a greater adjustment than justified to assure that the debt trajectory is on a plausibly downward path or stays at prudent levels. This overlap of requirements to define the appropriate adjustment is negative for at least two reasons. First, it runs counter to the goal of promoting national ownership as it makes the logic behind the required adjustment unclear. Second, it risks undermining the incentive to keep money flowing into EU-level strategic priorities once Next Generation EU expires as it does not offer incentives for investment beyond what is already financed by the EU's Recovery and Resilience Facility (which only extends through 2026). Importantly, green investments would by no means be exempt from the assessment of compliance with fiscal requirements.

While we hope that some of the drawbacks of the proposed reform will be amended before adoption, we stick to our view that a defined set of fiscal rules must be complemented by European central fiscal capacity. This would allow common investments in strategic areas (such as research, infrastructure, digitization) and, in this way, strengthen European sustainable growth and hence sovereignty against external pressure.

European elections

Grand coalition still in the lead, but margin is narrowing

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The political balance that will emerge in Europe following elections for the European Parliament (EP) on 6-9 June 2024 will be key to shaping European policy in the second half of the decade amid growing geopolitical and environmental challenges.

The latest opinion polls point to a decline in support for the liberal-centrist grand coalition formed by the European People's Party (EPP), the Socialists and Democrats (S&D) and Renew Europe (RE) in favor of the European Conservatives and Reformists group (ECR) and, to a lesser extent, the far-right Identity and Democracy party (ID). Polls indicate that the grand coalition still commands a majority, but its margin has almost halved compared to 2019. The Greens/European Free Alliance party (Greens/EFA) has lost the largest share of the vote but not enough to lose its attractiveness for RE – liberals are still flirting with the idea of broadening the current coalition to include them.

The grand coalition appears likely to hold…

These trends have given rise to speculation that, after the elections, EPP, which is likely to remain the most popular party, may decide to break with its traditional alliance with S&D and form a new right-wing coalition with ECR. This would be unprecedented in the history of the EP. However, the creation of a formal coalition between EPP and ECR appears unlikely for two main reasons, in our view. First, significant ideological differences remain between the two groups despite recent rapprochement between some of their affiliated parties. Some EPP members are likely to oppose any cooperation with, for instance, the Polish Law and Justice party (PiS) and the Finns party, which sit in the ECR, because they are seen as either having a lack of respect for the rule of law (PiS) or holding Eurosceptic views (Finns). Second, even if these differences could be overcome, the two groups are unlikely to gather enough votes to form a majority coalition, according to the latest polls. This implies that they would have to broaden the coalition to include either ID or RE, and this seems unlikely from an ideological perspective.

…but this leaves open the possibility of collaboration with other parties

Nevertheless, a particular practice of coalitions within the EP leaves open a scenario in which, for example, some ECR-affiliated parties that lean to the center-right would decide to engage with the EPP, possibly also supported by the right wing of RE and some parties affiliated with ID. We think this could happen in regard to issues on which the EPP's stance diverges from that of its center-left allies, such as on immigration.

A confirmation of a trend reversal in voter turnout would benefit the EP

An increase in voter turnout in 2019 was interpreted as an indication that a renewed interest by EU citizens in the opportunities that the EU offers was taking hold, after a clearly downward trend over the last two decades. Confirmation of this trend reversal would be good news.

CHART 1: CONSERVATIVES ARE GAINING GROUND

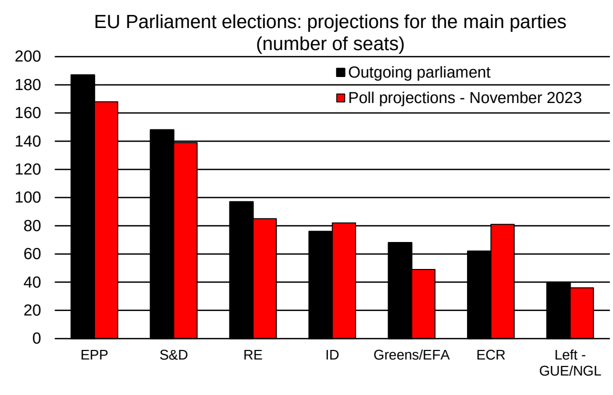
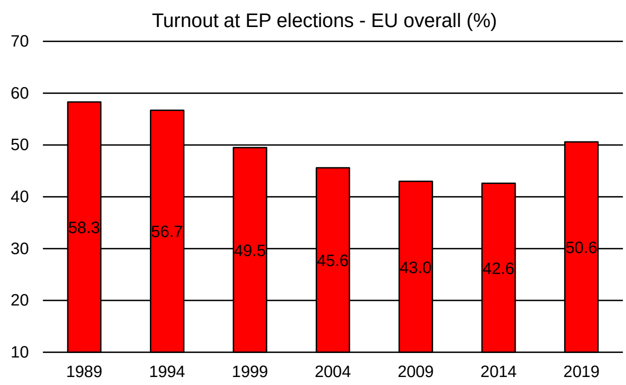


CHART 2: VOTER TURNOUT PICKED UP IN 2019



Source: European Parliament, Politico, UniCredit Research

Germany

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After a decline of probably 0.4% in 2023, we expect real GDP to rise 0.4% in 2023 and to grow 1.3% in 2025 (each on a non-working-day adjusted basis). Given substantial uncertainties in key macro and geopolitical drivers, in particular in regard to German fiscal policy, the forecast risks point to the downside, especially for 2024.

Slight recovery

Economic activity is likely to shrink again in 4Q23 by 0.2% qoq (3Q23: -0.1%; on 24 November, the GDP components for 3Q23 will be released which could also include a revision of the headline figure) before growing moderately from 1Q24 onwards (+0.1 qoq; 2Q-4Q24: +0.3% qoq). There are three key triggers for this slight recovery. First, global trade is expected to resume moderate growth after posting marked declines in 2023. Second, there are signs that the reduction of goods inventories is coming to an end, as signaled by surveys of manufacturers and retailers (see Chart 1). Third, further declining inflation is likely to support the purchasing power of households, at least slightly. At the same time, weaker job creation and (somewhat) less-pronounced wage hikes will limit the potential of any consumer-spending recovery. Note that the fiscal policy stance in 2024 is also likely to weigh on the economy (see next page).

Disinflation to continue

We expect the current disinflationary trend to continue in 2024 and 2025, with consumer price increases of 2.9% yoy in 2024 and 1.7% in 2025 (2023: 6.1%; 4Q23: 4.1%). Probably from 2Q25 onwards, inflation rates will fall below 2% yoy (4Q24: 2½%). Besides lower energy and food prices, the broadening of disinflation across spending categories is likely to continue. This is signaled by indicators at an earlier stage of the price formation process such as producer and import prices. However, in the next few months, we expect headline inflation readings to be bumpy due to the reversal of cuts in the VAT rate for natural gas and restaurants (at the start of January 2024) and the end of price brakes on gas and electricity (at the end of March 2024). Furthermore, stickier service-price inflation is still likely to keep the core rate above the headline figure throughout 2024 and for large parts of 2025 (2024: 3.3% yoy; 2025: 1.9%).

Wage growth to soften

We expect hikes in tariff wages (including special payments) to slow only slightly to about 4% in 2024 after rising to probably 4½% in 2023. A more-pronounced slowdown is likely to occur in effective wages, which surged by about 6% yoy in 1H23 (latest available data) due to strong rises in the statutory minimum wage (see Chart 2). At the time of writing, bargaining agreements in the retail, wholesale & export and public sectors are still pending where unions demand hikes in the double-digit range. In 2024, collective bargaining rounds are to take place in major industrial sectors, such as construction, chemicals and metal and electro.

CHART 1: INVENTORY CYCLE LIKELY TO HAVE PEAKED

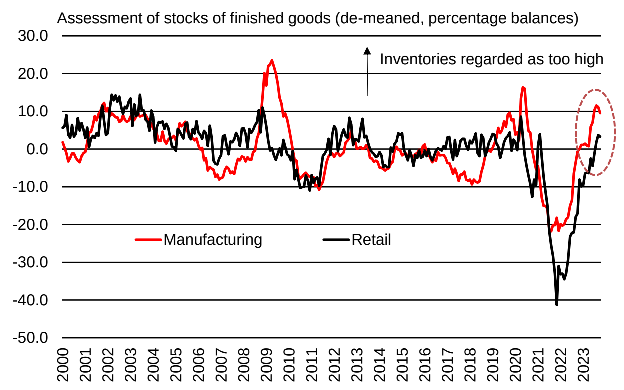
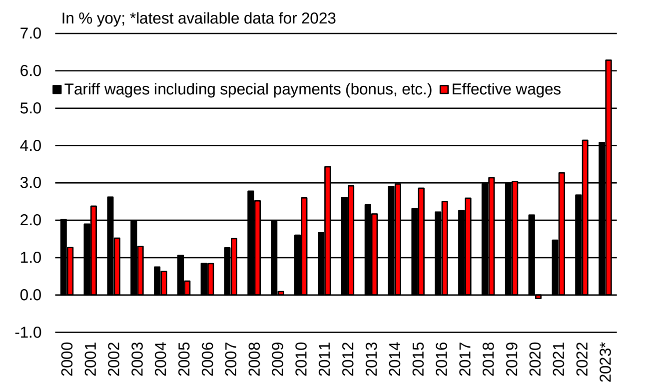


CHART 2: EFFECTIVE WAGE INCREASE TO SLOW



Source: European Commission, Bundesbank, UniCredit Research

Fiscal policy in 2024: restrictive stance, high uncertainty

In restrictive territory

It is likely that the overall fiscal policy stance, including off-balance-sheet funds, will become restrictive in 2024 after supporting the economy in 2023. The key reason behind this change will likely be that some fiscal expenditures, such as those associated with price brakes on natural gas and electricity for households, will end in 2024 (see Chart 3).

Downside risks

After the recent ruling by the German Constitutional Court (GCC), the risks of fiscal policy becoming even more restrictive have increased, as uncertainty about the use of off-balance-sheet funds and, as a result, the federal budget has emerged. The GCC said that the reallocation of unused funds of EUR 60bn, or about 1½% of GDP, to the climate and transformation fund has to be reversed. This ruling could also lead to the reversal of allocated funds in the Economic Stabilization Fund, another shadow budget. Without phasing out again the debt brake in 2024, policymakers could be forced to cut expenditures further and/or hike taxes.

First tentative signs of de-risking from China

Strong dependencies on the import side

With regard to dependencies on China, the focus is often on German exports, although the export share is still comparatively low. From 1Q-3Q23, about 6¼% of German exports were shipped to China, with car producers and the machinery sector being more, but not massively, dependent (9½% and 13¾ in terms of sector exports, respectively). Instead, the German economy is likely to be more vulnerable in terms of imports, especially when it comes to intermediate goods, such as batteries, electronics, and optical equipment. Since the start of the Russia-Ukraine war, these dependencies have temporarily increased even further to an import share of about 16% (see Chart 4). The reason behind this pattern was a surge in imports of petrochemicals from China in order to replace the imports from Russia.

Some structural change is underway

The latest edition of the Bundesbank Online Panel, a survey of German companies, even suggests that these import shares grossly underestimate the extent of dependencies. Accordingly, about 50% of manufacturers reported that they rely on Chinese intermediate goods for production processes that are largely “difficult” or even “very difficult” to replace.[1] On a positive note, the Bundesbank survey also shows the substantial efforts by companies to address this. About 40% of manufacturers, which rely heavily on China, reported that they have started to take measures to reduce their dependence, primarily by trying to import more intermediate goods from the EU.

CHART 3: FISCAL POLICY TO BECOME RESTRICTIVE IN 2024

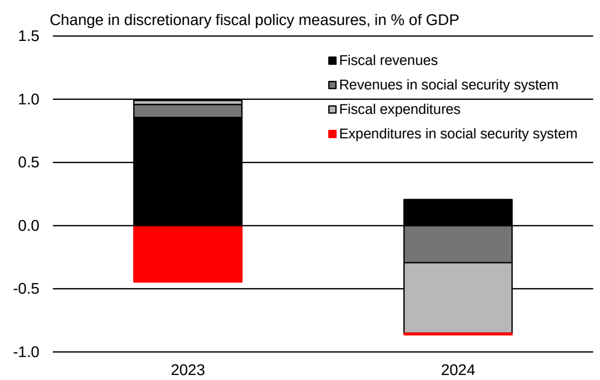
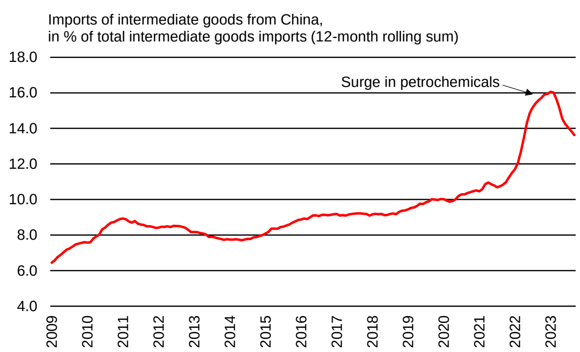


CHART 4: STILL HIGH IMPORT DEPENDENCE ON CHINA



Source: German Council of Economic Exports. federal government, destatis, UniCredit Research

[1] Deutsche Bundesbank, Germany as a business location: selected aspects of current dependencies and medium-term challenges, Monthly Report, September 2023

France

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Easing growth in services to weigh on GDP growth

We expect French GDP to rise by 0.9% in 2023, by 0.8% in 2024 and by 1.1% in 2025. Economic activity is likely to remain subdued through the first half of next year amid easing growth in services and protracted weakness in manufacturing. This is likely to reflect fading pent-up demand for contact-intensive services and the broadening of the negative impact of higher interest rates to less-capital-intensive sectors, while weakness in global trade weighs on manufacturing activity. The subsequent recovery will be mainly driven by a stabilization/mild pick up in global trade, and, as a result, it will probably be shallow. GDP growth is likely to regain momentum in 2025, although sequential growth might not return to trend growth before the end of that year.

Private consumption is likely to hold up as gross disposable-income growth exceeds consumer inflation

In the short term, the resilience of private consumption is likely to partially offset the negative impact on final domestic demand from a slowdown in gross fixed-capital formation, as weakness, which has so far been concentrated within household investment, extends to non-financial corporates. Household spending will be supported by gross disposable-income growth exceeding consumer inflation, as a result of a combination of robust (albeit slowing) growth in wages and social benefits, which, with inflation falling, will more than offset the impact of a broad stagnation in the number of people employed on labor income. Liquidity buffers accumulated by households during the pandemic could also offer some support to spending. French households have not exhausted their buffers, although these are unevenly distributed among the population.

Disinflationary pressure will continue to broaden

Consumer inflation is likely to slow from 4.9% in 2023 to 2.4% in 2023 and to 1.7% in 2025. In 2024, this deceleration is likely to be driven by a decline, amplified by large base effects, in energy prices and, to a lesser extent, easing inflation for food and manufactured goods. Services inflation is likely to prove stickier due to second-round effects. Our baseline scenario assumes that gas prices will converge only very gradually towards theoretical regulated sale prices (calculated according to wholesale futures prices), following the removal of a government-sponsored price shield in August.

Unambitious fiscal adjustment in 2024

The draft budget foresees a reduction in the deficit-to-GDP ratio to 4.4% in 2024 from 4.9% expected for this year. Most of the announced reduction in public expenditure (EUR 16bn) is to stem from a reduction in energy-related support measures that were put in place in 2022 to mitigate the impact of surging energy prices on households and, to a lesser extent, firms. The remaining cuts will involve tax exemptions and fiscal loopholes. We think that social discontent and difficult political relations with opposition parties explain why the government has not been more ambitious in reducing the deficit. However, in our view, this simply postpones tougher decisions to next year, when a revised EU fiscal framework will force the government to confront the challenging situation facing public finances.

CHART 1: MANUFACTURING WEAKNESS HAS SPILLED INTO SERVICES

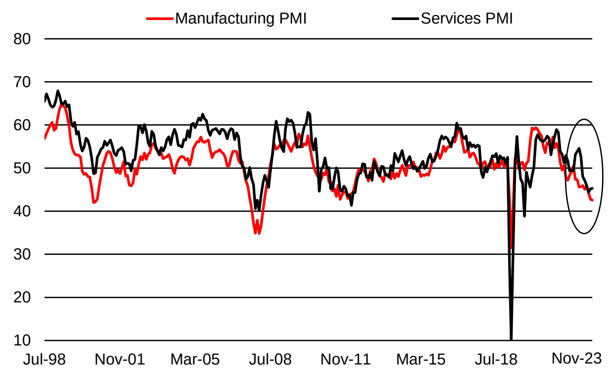
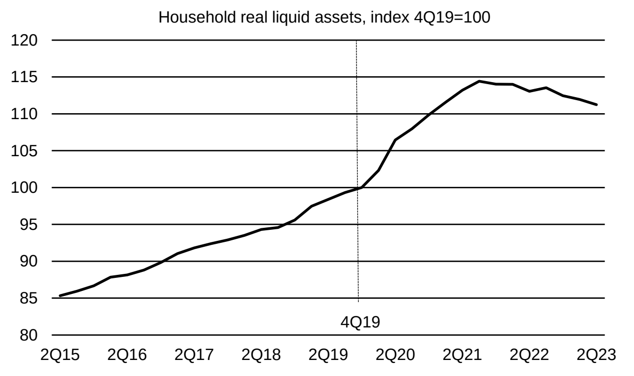


CHART 2: LIQUIDITY BUFFERS CAN STILL PROVIDE SOME SUPPORT



Source: ECB, S&P Global, UniCredit Research

Macron's search for a new narrative

Macron confronts the second-term curse

Finance Minister Bruno Le Maire's recent call for greater visibility regarding the major reforms that the Elysée wants to implement before the expiration of President Emmanuel Macron's second five-year mandate (due in 2027) is indicative of two main features of the current political debate in France: **1.** the increasing difficulty for the president to follow through on his transformation narrative, as his relative majority and the increasing polarization of the political landscape oblige him to walk a fine line; **2.** that the race to succeed Mr. Macron has already begun among his own allies – including Mr. Le Maire, Minister of the Interior Gérald Darmanin, Mayor of Le Havre (and former prime minister) Edouard Philippe and Education Minister Gabriel Attal – who have begun to compete with each other to propose ideas to keep France "in motion", at the risk of fracturing a fragile governing coalition.

Caught between the extremes, the president is struggling to maintain his narrative

Mr. Macron's decision not to participate in a cross-party march against antisemitism recently organized in Paris is just the latest example of the difficult situation the president faces. After much hesitation, Mr. Macron finally decided not to participate in the march to avoid lending credence to the normalization strategy of Marine Le Pen's populist National Rally party (RN), which had announced in advance that it would participate, despite its founder's antisemitic legacy. In the past, mainstream parties would have agreed to apply a "cordon sanitaire" around RN to prevent the party from participating in such a march. However, this is no longer a viable strategy. On the one hand, RN, with a solid delegation of MPs (88) in the National Assembly, is now part of France's political establishment more than it ever was before. On the other hand, the increasingly "disobedient" stance of the far-left France Unbowed coalition (LFI), which, on this specific occasion, refused to condemn the 7 October attack by Hamas on Israel, makes it impossible for the governing majority to invite political parties to close ranks against RN. Therefore, if the president attacks one extreme of the political spectrum, he may end up strengthening the other, and vice versa. This risks putting him in a difficult spot politically and making his narrative elusive, even to those close to him.

Le Pen remains the main adversary

While the president's strategy to free himself from the grip of the increasing polarization in the political landscape is in flux, in the eyes of Mr. Macron's allies, Ms. Le Pen remains the main adversary. The public image of Ms. Le Pen has been shown to have improved across most social groups, particularly among retirees (who traditionally do not vote for far-right parties), and she is considered the politician most likely to win the next presidential election, according to opinion polls. Some members from Mr. Macron's Renaissance party recently went so far as to say that they wish RN would neither vote in favor nor abstain from voting on a prominent immigration bill (the main reform bill under discussion in parliament since the passage of pension reform) as this would contribute to making RN appear mainstream. However, for the government, minimizing this risk would come at the price of passing the bill by using special constitutional powers, exposing itself to the risk of a vote of no confidence and possible new elections. Incidentally, the conservative The Republicans party, whose constituents would have an interest in passing the law, is still in disarray and without leadership seen as capable of gathering consensus to vote in favor.

The way out

To break the impasse, we think that once the immigration law is passed Mr. Macron should refocus on economic reforms, as these could offer more-fertile ground for his narrative. Mr. Le Maire suggested that the president could focus on a package of measures to attain full employment, a milestone of Mr. Macron's second term and a topic that is likely to again garner a lot of attention, as the current slowdown in economic activity is set to increasingly weigh on job creation. The president has undertaken several labor-market reforms since he was first elected, but not all of them have produced the results that were expected. Policy measures aimed at removing lingering geographic and educational disparities in accessing employment would be critical to addressing a reported feeling of being left behind among France's lower-income population – a feeling that is seen as fueling support for populist parties. This priority would require more effective professional training and initial education to support stronger and more inclusive productivity growth. These reforms typically take time to bear fruit, but they would allow Mr. Macron's to breathe new life into a vision that first compelled the French people to vote for him.

Italy

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We expect GDP to expand by 0.6% in 2024 and by 1.1% in 2025. Economic activity has been stagnating on a quarterly basis over the last year, and annual GDP growth has declined from 2.6% in 3Q22 to zero. Both private consumption and fixed investment have slowed visibly. We expect Italy to return to moderate quarterly growth over the next year and the recovery to consolidate in 2025. High uncertainty surrounds global economic prospects at a time when resuming global demand and lower prices and costs are key drivers of our recovery story.

GDP growth mainly driven by private consumption amid lower inflation

Recovery in private consumption will play a key role in cementing Italy's return to quarterly growth. Significantly lower inflation will support households' real income after it moved deep into negative territory. While we expect employment growth to slow, its impact on income and spending will be mitigated by a still-decent increase in compensation per employee (following wage acceleration), especially when one considers its meager growth over the last decade. Moreover, although fiscal policy will remain a drag next year, as the country is called upon to consolidate its fiscal position, the measures targeted within the 2024 budget law will lead to a moderation of the tax burden for low-and-middle-income households. Still, private-consumption (and thus GDP) growth will remain moderate next year (at just above 0.5% yoy), as we expect to see an increase in the propensity of Italian households to save, after these have reduced their flow of savings and faced a decline in the availability of liquid assets this year.

Fixed-investment growth will gradually strengthen

The negative impact from an increase in borrowing costs will continue to be felt in economic activity over the coming quarters. Should government-bond yields have surpassed their peak (as we expect), this negative impact should start to moderate from 2H24, supporting a recovery in private-sector investment. The latter would initially be underpinned by a gradual recovery in global demand, and thus in firms' exports, given the competitiveness of Italian products, as reflected, for example, by the country's broadly stable export share. The ongoing curb in tax credits for building renovation will slow construction investment, but we project an acceleration in public investment next year (almost double its increase in 2023), given progress made in the implementation of the recovery and resilience plan (RRP) since June.

Inflation to hover around 2%

We expect CPI inflation to average around 2% yoy in 2024 and 2025. Inflation declined by 10pp, to 1.7%, in exactly one year, as energy inflation moved from +71% to -20% yoy. Consistent with our oil and gas-price scenario, we expect energy inflation to remain in negative territory for most of our forecast horizon and headline inflation to stay well below core inflation. We acknowledge that high uncertainty surrounds the speed of energy inflation adjustment, as around 60% of retail gas and electricity prices are set on the free market. Core inflation is projected to move from slightly above 4% to 2% by end-2025, as services inflation has probably just passed its peak (vs. February for core goods inflation) and is likely to gradually decline.

CHART 1: HOUSEHOLDS LIKELY TO RESTORE SAVINGS

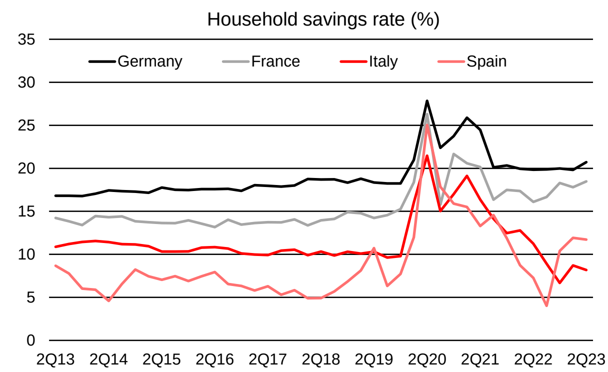
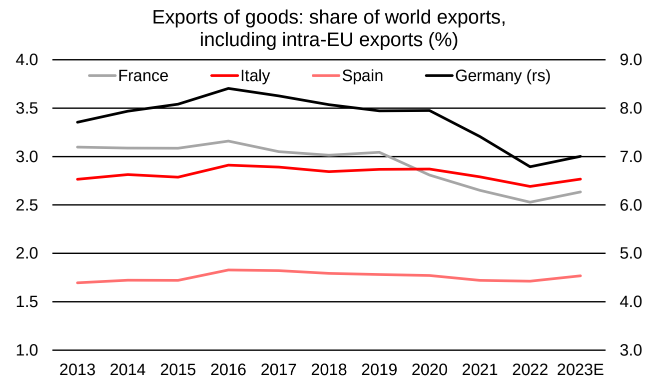


CHART 2: EXPORTS SET TO IMPROVE WITH GLOBAL DEMAND



Source: AMECO database, Eurostat, UniCredit Research

We are constructive while acknowledging key challenges

Italy's high public debt still poses a challenge

Managing high public debt will remain one of the main challenges Italy faces. Most of the good news for the debt dynamic is behind us as nominal GDP growth will continue to slow (from around 5% yoy this year) and as interest expenditure will gradually exceed 4% of GDP, reflecting the rapid increase in interest rates. On top of this, the legacy of tax credits for building renovation will push up the public-debt-to-GDP ratio by around 1pp each year starting in 2024. Although it has declined by 14pp since 2020, the public-debt-to-GDP ratio, at around 141%, will remain above its 2019 level and above that of Italy's main EU peers. A prudent fiscal strategy will be needed to keep the ratio on a broadly stable/downward trend and to preserve the confidence of investors and rating agencies, especially if downside risks to the global growth outlook intensify. This strategy hinges on two key achievements, which we assume when defining our fiscal outlook based on the commitment Italy has shown so far to the EU.

We expect to see improvement in the primary balance…

First, continued adjustment in the primary balance (headline and structural). The government is committed to moving the country's primary balance towards zero next year and to a surplus of at least 1.5% of GDP by 2026. Sticking to this goal will be crucial, in our view. The adjustment in the structural primary balance still envisages a deficit of around 0.6% of GDP next year. Given the high probability that a new EU's economic governance framework will be in place in 2025, we think that efforts will need to be made to achieve a balance close to zero by then, in order to mitigate the adjustment required in the medium to long term to put the debt trajectory on a plausibly downward path. In the 2024 budget law, the government targets a (temporary) cut of the tax wedge for low-and-middle-income employees and further tax relief worth 0.7% of GDP. As it is reasonable to assume that the government will aim to prolong such a decline in the household tax burden, it will have to make a greater effort to review public spending and improve tax compliance to find adequate offsetting measures. Lastly, while the risk of a reassessment of the 2021-23 accounting of tax credits for building renovation might create uncertainty regarding future budget-deficit development, we expect a constructive approach to prevail, given the government's commitment to reducing the scope of the building bonus starting from 2024.

…and progress in the disbursement and use of EU funds

Second, economic growth is increasingly supported by the RRP. Given the sizeable revision of the plan approved by the government in August and good cooperation with the European Commission (EC), we expect the main obstacles to its implementation to be removed, allowing for the achievement of milestones and targets in line with future deadlines. Italy is about to receive a fourth payment from the EC (bringing the disbursement from the EU to 53% of EUR 191.5bn) and is currently working to meet the conditions to request a fifth payment by spring. Hence, we expect to see a pick-up in the use of EU funds starting from next year. The initial version of the RRP was expected to support (through higher spending) a cumulative increase in real GDP by around 2.5% by 2026, compared to a scenario without a plan. While the reallocation of some infrastructure projects financed with EU loans might mitigate growth impulse from the RRP, we regard it as positive that critical factors and weaknesses have been recognized, and this might increase the chances that the RRP will be fully implemented.

Political stability might be tested

On the political side, the two key events to watch will be the EP elections in June and the approval in parliament of constitutional reform. The latter would increase the prime minister's power by proposing their direct election and a majority bonus to the coalition supporting them. This would thus partially change the prerogatives of the president of the republic. Regarding the EP elections, in our view, it could be crucial if it further strengthens the relationship between Italy and Europe. This will require a balance to be struck between a will to increase the role of conservative and nationalist policy in the EU and a need to further strengthen European integration at a time of high geopolitical fragmentation. Parliamentary approval of the constitutional reform in Italy will probably move to center stage in 2H24, after the first round of voting in both chambers of parliament. A referendum could be held in 2025 if a qualified majority is not reached during the second round of voting. This might be an important test for the governing coalition.

Spain

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Headwinds to GDP growth

After expanding by about 2.4% in 2023, we expect GDP growth to decelerate to 1.3% in 2024 and to average 1.5% in 2025. The slowdown in economic activity is likely to continue through the first half of next year, reflecting the delayed effects of monetary policy tightening, the impact of fading pent-up demand for contact-intensive services, weak growth prospects among Spain's main trading partners, and less-supportive fiscal policy. GDP growth should then re-accelerate slowly in 2H24 amid a broad stabilization/mild pick up in global trade. In the near term, we expect tourism to continue to support export growth, mitigating the impact of weak demand for goods. However, as tourism has already recovered towards its pre-pandemic level, its contribution to GDP growth is likely to be smaller than in 2022. The mobilization of RRF funds should contribute to sustaining investment throughout the forecast horizon, notably in non-residential construction.

Domestic demand is set to slow down

The recovery in domestic demand is likely to lose momentum in the coming quarters due to higher interest costs and sluggish exports weighing on firms' profitability and, consequently, investment plans, as well as a slowdown in private consumption growth, which has been fairly healthy so far. The unwinding in early 2024 of fiscal measures introduced in 2022 to limit the increase in energy prices for consumers will act as a drag on household disposable income growth via temporarily higher inflation, largely offsetting the impact on labor income of robust (albeit decelerating) growth in wages. Easing employment growth and rising mortgage rates will also weigh on disposable-income growth.

Consumer inflation unlikely to ease significantly due to pick up in energy inflation

After averaging 3.6% this year, we expect HICP inflation to ease to 3.4% in 2024 and 2.0% in 2025. A reacceleration of energy inflation is likely to prevent headline inflation from falling below 2% before next summer or autumn. This is likely to occur even though the slowdown in manufactured goods and food inflation should accelerate, with the latter also supported by the extension of a lower VAT rate on some food products to 1H24.

Deal with Catalan separatists secured Pedro Sanchez a second term

Four months after the general election, Socialist leader Pedro Sánchez secured another term as Spain's prime minister thanks to a controversial amnesty deal with Catalan separatists, which saw thousands of people take to the streets in protest. Mr. Sánchez has formed a minority government with the far-left Sumar coalition, whose leader, Yolanda Díaz, served as second deputy prime minister in the previous government. Smaller parties, including the Catalan separatist Junts party, agreed to provide external support. The significant ideological differences among parties that back Mr. Sánchez's cabinet imply that it might be difficult for the new government to pass major legislation, while the excessive influence of pro-independence parties may further polarize the country.

CHART 1: LOSS OF GDP MOMENTUM

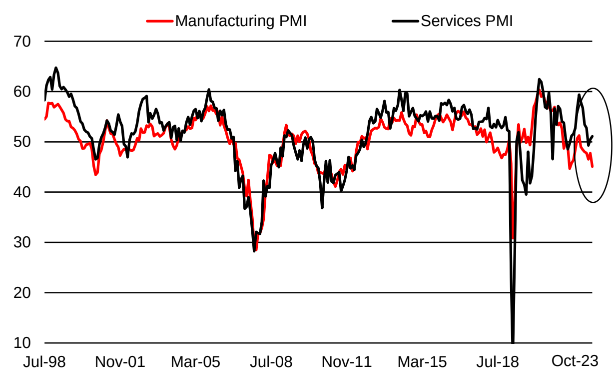
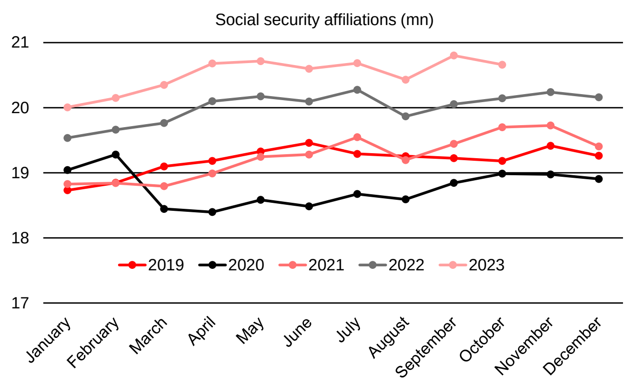


CHART 2: EMPLOYMENT GROWTH HAS BEEN ROBUST SO FAR



Source: S&P Global, INE, UniCredit Research

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The recession that began in the spring is likely to lead to a 0.5% decline in GDP in 2023. We expect a moderate recovery, supported by a further slowdown in inflation, to begin in 2024, with a slight increase in GDP of 0.3%, which should accelerate to around 1.5% in 2025.

Subdued recovery expected

Initial signs that the economy is slowly bottoming out point to an end to the recession towards the end of 2023. Rising real wage growth as a result of falling inflation should trigger a moderate recovery via consumption in early 2024. The turnaround in the inventory cycle should also provide growth impetus. In contrast, restrictive monetary policy will continue to pose a major challenge to investment activity in 2024. While the service sector is expected to lead the recovery, supported by the rising purchasing power of households, the situations in the construction sector, particularly in building construction, and in industry will remain tense. However, a gradual recovery by the global economy should increasingly support export-oriented sectors.

Increase in unemployment

The situation in the labor market is likely to continue to deteriorate gradually, particularly due to weakness in industry and construction. After the unemployment rate increased to an average of 6.4% in 2023, we expect it to rise to 6.7% in 2024. Stronger GDP growth should allow it to fall to 6.5% in 2025.

Decline in inflation slows

After reaching a double-digit peak at the beginning of the year, we expect inflation to slow to less than 5% yoy at the end of 2023, mainly due to lower energy and commodity prices. Inflation is falling much more slowly than the eurozone average. This is due to noticeable second-round effects, such as those related to indexed rents. However, after it reached an annual average of 7.8% in 2023, we expect inflation to slow to 3.6% in 2024 and to 2.3% in 2025.

Consolidation of the budget halts

The general government budget deficit is likely to fall to below 3% of GDP in 2023. We expect a further decline in 2024, supported by the expiration of numerous measures to cushion inflation, such as an electricity-price cap. In addition, the decline in inflation (which will lead to real wage increases), combined with the recently introduced indexation of social benefits and income tax brackets, and strong pension increases should support consumer spending and boost VAT revenues. However, these factors will also lead to higher expenditure. Overall, however, we expect the budget deficit to fall to 2.5% of GDP in 2024, although higher debt service costs will present an additional burden. We anticipate debt service costs to amount to at least EUR 10bn. As parliamentary elections are expected to take place in fall 2024, there is a risk of the budget deficit increasing, and this would support the economy but also fuel inflation.

CHART 1: MODEST RECOVERY EXPECTED FROM 2024

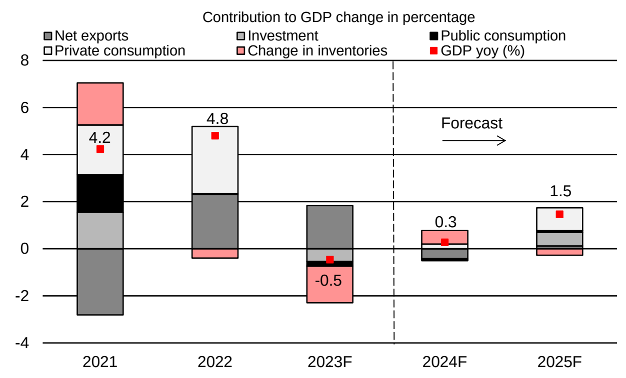
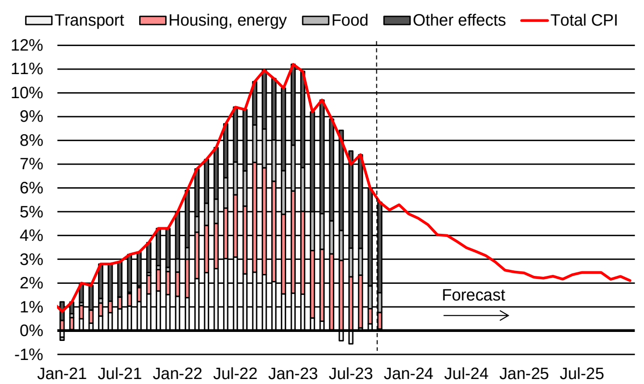


CHART 2: INFLATION SHOULD CONTINUE TO SLOW



Source: Statistik Austria, UniCredit Research

CEE

Years of crucial decisions

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- We expect the economies in EU-CEE2 to grow by around 3.0% in 2024 and 2025, helped by stronger domestic demand. We expect GDP to grow by 3.0% in 2024 and by 3.9% in 2025 in Turkey and by 1.3% in 2024-25 in Russia.
- We forecast that inflation targets will be missed, except in Serbia and Russia in 2024-25 and in Czechia in 2025. We expect cautious interest-rate cuts in 2024-25 across CEE.
- In our view, the main risks for CEE will be **1.** weak foreign demand, **2.** spillovers from the attrition war in Ukraine, **3.** a potential oil shock and **4.** a premature dissolution of the Polish government. The main opportunities for CEE will come from **1.** Poland heading a stronger EU-CEE front in European politics, **2.** Bulgaria's accession to the eurozone and **3.** gradual eastward broadening of the European customs union.

Economic growth is expected to accelerate in 2024-25

We expect domestic demand to rebound in 2024 throughout CEE, helping GDP in EU-CEE grow by 3.0%, in the Western Balkans by 2.8%, in Turkey by 3.0% and in Russia by 1.3% (Chart 1). Base effects will help in EU-CEE, where private consumption and investment were weak in 2023. Precautionary savings accumulated by CEE households and companies since the start of the COVID-19 pandemic were largely exhausted by mid-2023, while real wages only started growing by late summer in Central Europe. As inflation slows further, financial conditions ease and capex resumes, we expect demand to accelerate in the private sector in 2025, compared to 2024 (Chart 2). Fiscal tightening could offset stronger private-sector demand, keeping GDP growth stable in 2025 in EU-CEE (3.0%) and in Russia (1.3%), while we expect economic growth to accelerate in the Western Balkans (3.1%) and in Turkey (3.9%).

We do not expect exports to contribute to growth in 2024…

Exports could contribute little to growth in 2024, as we expect foreign demand from both developed and emerging markets to remain weak. In 2023, manufacturing and exports were resilient, while CEE companies worked through a backlog of orders accumulated since 2020. These have been exhausted. Export orders (as measured by PMIs) seem to have troughed in 3Q23, but they remained very weak in 4Q23., whereas inventories fell to two-year lows. From now on, industrial output will be far more sensitive to shifts in economic activity in the eurozone, which is expected to be subdued in 2024 and to recover gradually in 2025.

…but increased foreign demand and capex are forecast for 2025

Postponed FDI projects could finally start in 2024 if demand rebounds in the eurozone. Otherwise, they might be further postponed to 2025, especially in electric mobility and energy-intensive manufacturing.

CHART 1: STRONG CONSUMPTION GROWTH IN 2024

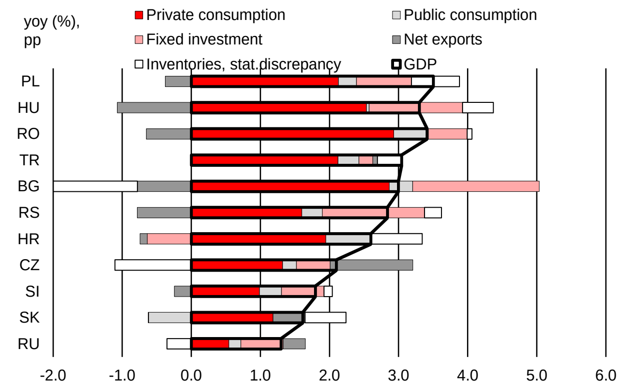
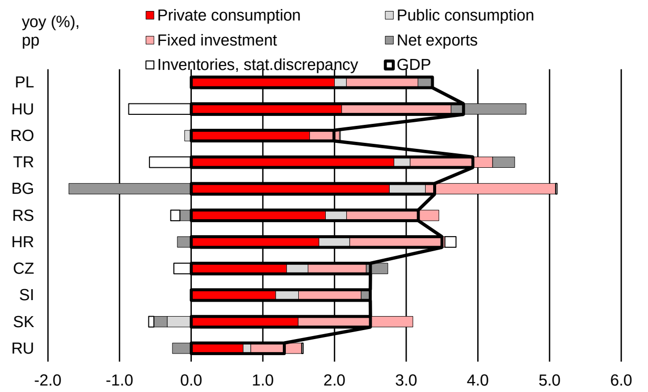


CHART 2: INVESTMENT IS EXPECTED TO ACCELERATE IN 2025



Source: Central banks, National statistical offices, World Bank, UniCredit Research

[2] EU-CEE refers to CEE countries that are members of the EU: Bulgaria, Croatia, Czechia, Hungary, Poland, Romania, Slovakia and Slovenia.

Terms-of-trade improvement and private-sector net savings rebalanced current accounts

Lower energy imports will help trade balances, as CEE enters the 2023-24 winter with full gas storage, and the weather is expected to be mild and wet[3]. In addition, scarring and the rapid adoption of solar panels for household heating and electricity will probably prevent energy demand from returning to levels seen before Russia's invasion of Ukraine.

From a structural point of view, current-account deficits fell in 2023 as the terms-of-trade shock that resulted from high energy prices was partly reversed and as the private sector swung to net savings in most CEE countries. High interest rates and tight financial conditions led to the postponement of investment, with FDI being dominated by reinvested profits and debt flows amid borrowing costs that were lower in the eurozone than in CEE. Carry trades fueled large liquidity surpluses on interbank markets in 1H23. Enjoying abundant liquidity, CEE governments postponed fiscal adjustment, thereby accepting that they would have to pay higher yields and, in some cases, reduce debt duration.

Small fiscal adjustment expected in 2024, more in 2025

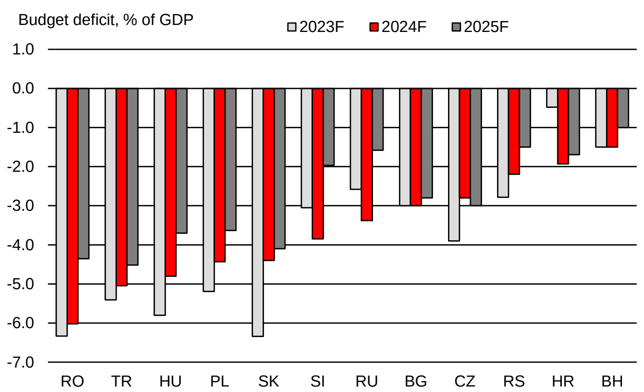
Thus, as 2024 starts, there will be limited scope for policy action in CEE. In 2024, the fiscal impulse should be negative in all CEE countries but Bulgaria and Croatia, while in 2025, it should be negative everywhere. Risks, however, remain skewed towards a slower adjustment CEE prepares for a busy election schedule in 2024-25 (Table 1). Budget deficits are expected to fall below 3% of GDP in Bosnia-Herzegovina, Serbia, Croatia and Czechia. At the other extreme, Bulgaria, Hungary, Poland, Romania, Slovakia and Turkey will continue to run budget deficits of more than 4% of GDP in 2024, with limited scope to reduce them to close to 3% of GDP in 2025 (Chart 3). In Russia, budget deficits will stem from the country's war effort and limited tax receipts from exports, rather than from electoral concerns.

Most CEE governments have yet to remove support given to households following the pan-demic and 2022's energy shock. These subsidies, combined with rising pensions and borrowing costs, will further squeeze non-discretionary public spending. If most EU-CEE countries face excessive deficit procedures in 2024, we expect governments to push for limited fiscal tightening in 2025 with a combination of smaller subsidies for households (especially in Hungary and Poland), higher taxes (Romania) and lower public spending (Czechia, Romania, Slovakia). Markets could force CEE countries to reduce budget deficits as global sovereign-bond issuance (net of central-bank purchases) will be the highest on record in 2024. This is why we expect 2024 to be more of a carry story than one of capital gains and converging borrowing costs in CEE. Government spending on interest will continue to rise in 2024, especially in countries with high borrowing needs and short debt duration, such as Hungary and Turkey.

TABLE 1: BUSY ELECTION SCHEDULE AHEAD

	Election type
Bosnia-H	**2024:** local (Nov)
Croatia	**2024:** EU parliament (9 Jun), parliament (<22 Jul), president (Dec)
Czechia	**2024:** EU parliament (5-9 Jun); **2025:** parliament (<Oct)
Hungary	**2024:** EU parliament and local (9 Jun)
Poland	**2024:** EU parliament (9 Jun), local (Oct-Nov); **2025:** president (<Aug)
Romania	**2024:** EU parliament (9 Jun), local (<22 Sep), president (Nov-Dec), parliament (>6 Dec)
Serbia	**2023:** parliament, local (17 Dec)
Turkey	**2024:** local (31 Mar)

CHART 3: SLOW FISCAL ADJUSTMENT EXPECTED IN 2024



Source: Electoral commissions, Electoral laws, National statistical offices, EC, UniCredit Research

[3] Seasonal forecasts | Copernicus. We think this would be a fortunate combination for CEE, as it would require limited depletion of gas stores and as precipitation would support hydro and nuclear power generation.

Romania, Croatia and Poland will lead in terms of EU-fund absorption

Transfers from the EU should bridge part of governments' non-discretionary spending gaps in EU-CEE related to funding their green transition, the development of digital infrastructure, fostering energy independence from Russia and further integration into European transport networks. However, take-up of the Recovery and Resilience Facility (RRF) and RePowerEU remains underwhelming, with Romania and Croatia accounting for two thirds of disbursements made so far. We expect these two countries and Poland to receive more funds in 2024-25.

Positive EBB in all countries but Bosnia-Herzegovina, Romania and Turkey

An opposition-led government in Warsaw could unlock RRF funding in 2H24 if President Andrzej Duda and the courts do not oppose legislative changes pertaining to human rights, judicial independence and the primacy of EU law. In contrast, Hungary will not unfreeze RRF funding in 2024, in our view, as it will likely be found to have made insufficient progress towards implementing and monitoring legislation adopted following recommendations made by the European Commission (EC). The appeal of RRF funding will decline as the end of the scheme approaches (2026). We expect the Hungarian government to unlock most of its EUR 13bn in structural and cohesion funds by delivering needed reforms. Absorption is unlikely to be smooth if the EC is not satisfied with the pace of reform.

FDI, currency depreciation and/or industrial policies needed to improve trade balances

Extended basic balances (EBB, C/A + FDI + EU transfers) will improve further, likely being negative by 2025 only in Bosnia-Herzegovina, Romania and Turkey. However, trade balances will continue to be affected by scarring in energy-intensive manufacturing (mainly that involving metals, chemicals, food, construction materials) and real currency appreciation amid a fast rise in input and labor costs. Thus, trade balances should improve in countries where the pipeline of new FDI projects is significant (Hungary, Poland), where currencies depreciate to improve price competitiveness and/or where governments implement industrial policies to protect sectors affected by the energy shock and deemed strategic.

We forecast that disinflation will slow in 2024-25…

We expect much slower disinflation in 2024 compared to 2023. Negative producer-price inflation (mostly imported) and falling food prices will help reduce headline inflation. At the same time, we forecast that service prices will remain sticky and that non-food prices will rise at a faster pace in 2024 than in 2H23 as consumer demand rebounds. Finally, we expect some post-pandemic support to be withdrawn or reduced, such as VAT cuts in Poland, energy and utility caps in Hungary, Slovakia and Turkey and food-price caps in Romania. All these measures would accelerate inflation in 2024 and even in 2025 if governments wait for the new election cycle to return to flexible pricing.

By late 2024 or 2025, inflation rates in CEE could diverge again due to differing degrees of price liberalization. Hungary and Serbia would have to increase household tariffs by up to 40%, and Turkey would have to triple prices to align them with wholesale natural-gas prices. On the other hand, retail tariffs are fully aligned with market prices in Bulgaria, Czechia, Poland and Romania. Subsidies for electricity prices are highest in Hungary, Serbia, Croatia and Turkey.

…with only Serbia, Russia and Czechia expected to meet targets

For 2024, we forecast that inflation will return inside the target range only in Serbia (Chart 4). Inflation might fall back to target in Russia only if fiscal pressure on consumption taxes and the RUB is alleviated. We expect year-end inflation to be almost flat compared to 2023 in Hungary if the government decides to reduce subsidies, and to remain outside target ranges in Poland, Romania and Turkey amid election-related stimulus. In 2025, we expect the inflation target to be met also in Czechia, but another year of missed targets is in the cards elsewhere.

We expect there to be gradual rate cuts in 2024-25 throughout CEE

In 2023, central banks reacted differently to price shocks. The NBP decided to focus on good news before parliamentary elections but reconsidered inflationary risks once the opposition won. Based on our inflation forecast, we see scope for limited cuts to 5% by the end of 2024, with the policy rate at 4% a year later (Chart 5). In Czechia, we think a cautious CNB might cut the policy rate to 6.75% in December 2023 amid the lowest core-inflation momentum in CEE. We expect the policy rate to be lowered to 4.5% in 2024 and 3.5% in 2025.

We think the NBH will realign its policy rate with those of its regional peers in 2024, taking it to around 7% by the end of the year. Another target miss in 2025 might prevent further narrowing of spreads to Czechia and Poland, and we expect the repo rate to be at 5%.

The NBR signaled it might cut the policy rate cautiously in 2H24 if fiscal policy is tightened. A large fiscal package will keep the budget deficit close to 6% of GDP in 2024. As a result, we expect the NBR to cut to 6% in 2024 and to 4% in 2025 if the budget deficit is reduced. The NBS could cut the policy rate to 6.0% in 2024 and to 4.5% in 2025, with limited impact on domestic financial conditions, as 80% of mortgage and corporate loans are FX-indexed.

We think the CBR could cut the policy rate next year to 10.5% and to 7.0% in 2025. Financial conditions might remain tight due to capital controls, and a structural lack of foreign currency amid sanctions and limited RUB acceptance in international trade. The CBRT will probably keep its policy rate flat next year, with capital flows likely to resume after local elections. The CBRT could cut the policy rate to 25% in 2025, helped by lower inflation.

The main risks in 2024-25…

In our view, the main economic and geopolitical risks for CEE in 2024-25 are:

1. Low global growth, especially in Europe, could postpone a CEE recovery.

2. A war of attrition in Ukraine and less support from Europe and the US could further affect the Ukrainian state and economy, with negative repercussions for CEE.

3. An oil shock (if the war in the Middle East escalates) would affect CEE economies asymmetrically, with larger importers (landlocked Central Europe, the Balkans) being affected more than Romania, Croatia or, to some extent, Poland.

4. A majority formed by the former Polish parliamentary opposition might not last long if the three coalitions do not agree on economic and social priorities. The risk of early elections will probably be higher in 2025 than in 2024.

…and the main opportunities in CEE

In our opinion, the main opportunities for CEE in 2024-25 are:

1. The European Parliament that will be elected in 2024 will have to drive further EU integration if the EU were to improve its economic and geopolitical standing. EU-CEE could play a more important role under Polish coordination, although Hungary and Slovakia risk being marginalized if their governments keep their current stance.

2. Bulgaria should finally join the eurozone in 2025 or in 2026 at the latest, with progress being made in terms of adopting necessary legislation.

3. Negotiations between the EU and the Western Balkans, Ukraine and Moldova to grant access to the customs union could speed up due to geopolitical threats and a perceived further decline in globalization. In economic terms, we think this would be the most important achievement for candidate countries.

CHART 4: MOST COUNTRIES WILL MISS INFLATION TARGETS

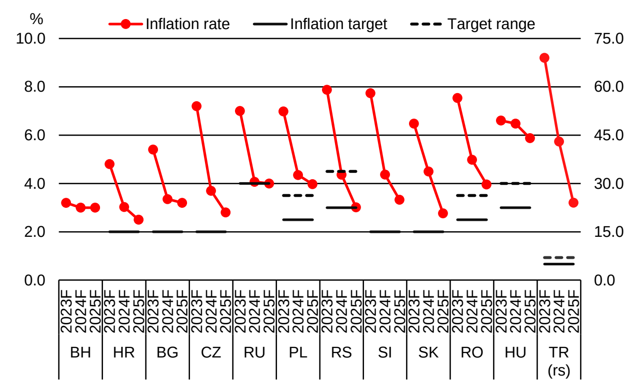
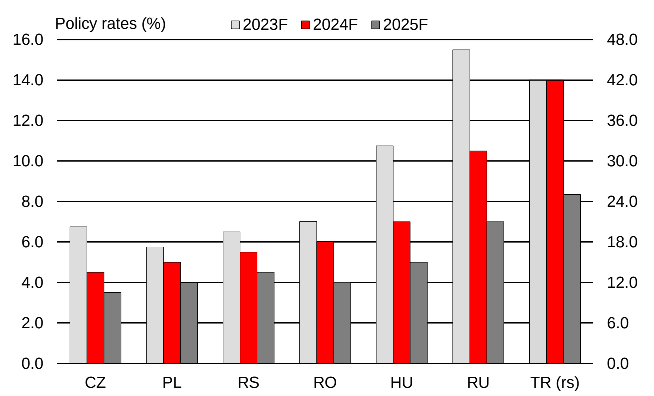


CHART 5: WE EXPECT GRADUAL RATE CUTS IN CEE



Source: National statistical offices, Central banks, UniCredit Research

UK

Mild recession looms

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- We expect the UK economy to enter a technical recession next year due to the lagged effects of monetary tightening, fiscal tightening and a lack of savings buffers. Opinion polls for the next general election point to a win for the main opposition center-left Labour party.

- The BoE will likely wait until 3Q24 before cutting rates due to high wage growth, but they are likely to cut more rapidly than markets expect once they start.

Mild recession next year

We expect UK GDP to contract by 0.3% next year, mostly due to the lagged impact of monetary tightening, before posting a modest recovery of 0.8% in 2025. The quarterly trajectory includes a peak-to-trough fall in output of 0.5% between 4Q23 and 3Q24 (Chart 1). Much of the effect of the 515bp rise in the bank rate since December 2021 has yet to work its way through the economy. Around 1.5mn mortgage holders will have to refinance at significantly higher rates before the end of next year. This mortgage cash-flow channel, while slower than it used to be due to the higher proportion of fixed-rate mortgages, is more forceful in the UK than in the US and euro area, where longer fixed-rate periods are common. Job vacancies have continued to fall, payroll growth has slowed and unemployment has risen (notwithstanding uncertainty stemming from the ONS suspending publication of the Labor Force Survey due to low response). Consistent with this, the latest NMG/BoE survey reported households expect to save more in the next six months than in the past six months. Lower inflation next year will support real income growth, but we judge that higher interest payments, slower employment growth, lower pay growth and fiscal tightening will leave real disposable income growth broadly flat at best. Meanwhile, the household “excess savings” buffer accumulated during the pandemic has been exhausted in real terms by high inflation (Chart 2).

Business surveys have weakened

The starting point is weak. Quarterly GDP was flat in 3Q23 and probably would have been negative if it were not for the base effect from an extra bank holiday in May and fewer industrial strike days in 3Q23 compared to 2Q23. Household consumption fell 0.4% qoq, which was the weakest reading in a year. Business surveys suggest the weakness persisted into 4Q23, with PMI manufacturing output and PMI services new business remaining in contractionary territory in November. We expect another flat reading for GDP growth in 4Q23 as an underlying slowdown is offset by a pick-up in public sector output due to fewer industrial strike days.

CHART 1: A MILD RECESSION NEXT YEAR

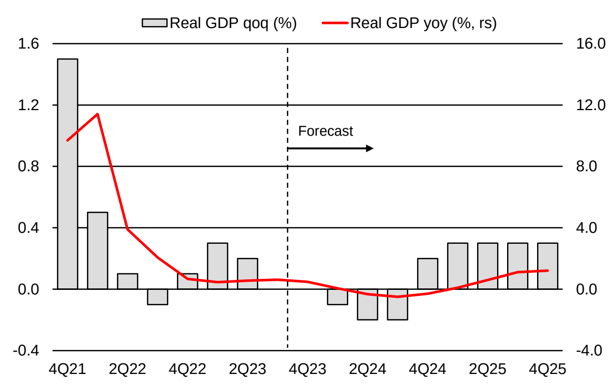
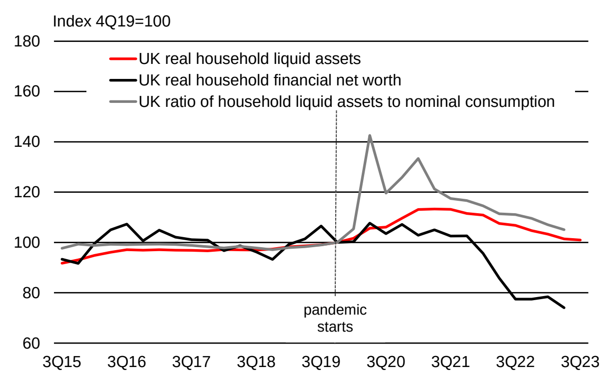


CHART 2: THE SAVINGS BUFFER HAS GONE



Source: ONS, UniCredit Research

Inflation moving down to 2% by early 2025

Headline CPI inflation fell sharply to 4.6% yoy in October from 6.7% in the prior month, with core inflation easing to 5.7% from 6.1%. The fall in the headline figure was due to a base effect and a decline in Ofgem-regulated electricity and gas prices. Most of the downward effect from energy prices is now over, with energy bills set to rise slightly in 1Q24 before gradually falling from 2Q24, according to gas futures prices. Food-price and core-goods-price inflation has eased and has further to run judging by the fall in producer input prices. The bulk of current inflation is now from services prices, and here we expect a gradual easing throughout next year. This will be driven by lower wage growth, as the labor market continues to soften and short-term inflation expectations ease. Regular pay growth in the private sector eased slightly to a still-high 7.8% yoy in the three months to September, while the 3M/3M annualized rate has eased more sharply to 5.8%. The BoE's Decision Maker Panel survey points to pay growth of around 5% over the next year. Given still high, but falling, wage growth and the related stickiness of service-price inflation, we do not expect headline CPI inflation to hit 2% until early 2025, slightly later than in the US and the euro area. We expect inflation to fall below 2% in 2H25.

Tighter fiscal policy ahead of the next general election

The Autumn Statement on 22 November included tax cuts for firms and workers, but fiscal policy will still be tighter next year than this year. The Office for Budget Responsibility forecasts a 1.6% of GDP increase in the cyclically-adjusted primary balance (the discretionary part of the budget) next year, from a deficit of 1.3% of GDP in 2023/24 to a surplus of 0.3% in 2024/25. This is a faster pace of consolidation than the 0.8% of GDP tightening between this year and last year. What happens to fiscal policy in 2025 will depend on the result of the next general election, which must be held no later than January 2025. Opinion polls put the main opposition Labour party ahead of the incumbent Conservative party by around 20pp, which would likely be enough to win a majority of seats in the first-past-the-post electoral system. Under their leader Keir Starmer, the Labour Party has shifted to the center ground, pledging to be pro-business and to cut regulation, and has ruled out wealth taxes and nationalization.

BoE to cut rates from 3Q24 and faster than markets expect

The BoE left the bank rate unchanged at 5.25% at its 2 November meeting and is likely done raising rates. The MPC minutes stated that policy would need to be restrictive for "an extended period of time". BoE Governor Bailey said on 20 November that it was "far too early" to be thinking about rate cuts. Key BoE officials have spoken of their preference for a "Table Mountain" approach to monetary policy, rather than a sharp up and down for interest rates. This approach, along with still-high wage growth and the stickiness of service-price inflation means the MPC is likely to wait until 3Q24 before cutting rates, a quarter later than the Fed and ECB. Once they start cutting, we expect a faster pace of rate cuts than markets currently expect, with a 25bp cut per meeting through 3Q25 and the bank rate ending 2025 at 2.75%.

CHART 3: WEAK BUSINESS SURVEYS

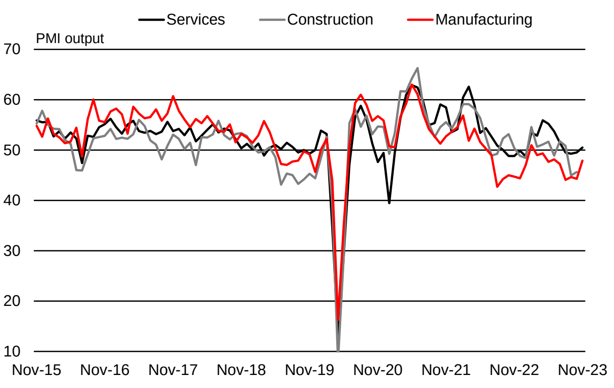
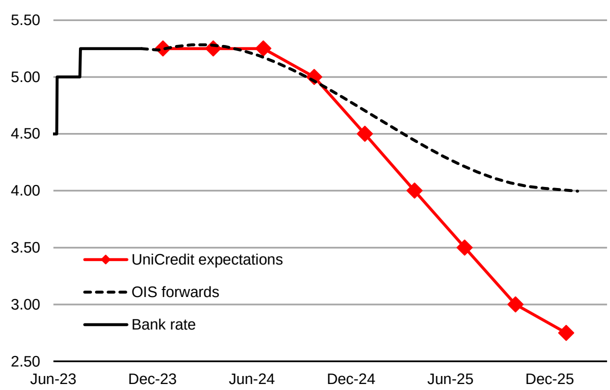


CHART 4: BOE TO CUT FASTER THAN MARKETS EXPECT



Source: Bloomberg, S&P Global, UniCredit Research

Sweden & Norway

Looking for tailwinds from the easing of monetary policy

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Monetary-policy tightening is impacting Sweden's and Norway's economies as well as those of their most important trading partners. This will likely result in subdued GDP in 2024-25 and rising unemployment, as households and businesses are forced to adjust spending decisions to higher interest rates. Domestic demand is the main weak spot, while exports might start bottoming out from very weak levels. Disinflation has started, but the price outlook is still uncertain and Nordics central banks remain hawkish. We think interest-rate cuts will be on the table from 2H24 on.

Sweden: GDP to grow by 0.3% in 2024 and 1.6% in 2025

After a likely contraction of 0.5% in 2023, the Swedish economy is likely to recover by a muted 0.3% in 2024. We expect domestic demand will deteriorate amid tightening financial conditions, the cooling of the labor market and a decline in housing construction. By contrast, innovative projects in manufacturing should support investment in equipment and information technology. Thanks to strong competitiveness of Swedish firms and a gradual improvement in demand from the eurozone, the contribution of net exports is likely to be positive in 2024. In 2025, GDP is projected to post a moderate recovery of 1.6%, thanks to a pickup in household consumption which will benefit from higher real disposable income resulting from the inflation deceleration.

Slowing domestic demand will contribute to easing underlying price pressure. This, together with decreasing energy prices and base effects, is expected to bring inflation down steadily to below 2% in 2025.

Riksbank to cut to 2.25% by end-2025

With the key policy rate at 4.00%, the Riksbank (RB) is done tightening, in our view, and we expect it to start a gradual easing cycle in June 2024. We expect it to undertake a 25bp cut per quarter, which would take the policy rate to 3.25% at end-2024 and to 2.25% at end-2025.

Norway: mainland GDP to grow by 0.6% in 2024 and by 1.0% in 2025

Norway's mainland GDP growth is likely to slow to 0.6% in 2024 (from 1.3% this year) and to accelerate somewhat to 1.0% in 2025. Overall GDP (i.e. including the petroleum-based offshore sector) is expected to follow a similar pattern. The growth outlook in Norway is similar to that in Sweden, except that investment in Norway is mainly in the petroleum-sector, while in Sweden investment in equipment and information technology plays a larger role.

Norges bank to tighten to 4.50% by end-2023 and cut to 2.75% by end-2025

Persistently high core inflation, volatility in energy prices and NOK depreciation, which could fuel inflationary pressure, are likely to lead Norges Bank (NB) to hike the policy rate by 25bp, to 4.50%, in December. After taking a break, the NB will probably cut its policy rate by a cumulative 175bp, delivering a 25bp cut in each quarter starting in June 2024. At the end of 2025, the policy rate will likely be brought down to a less restrictive 2.75%.

CHART 1: DISINFLATION HAS STARTED

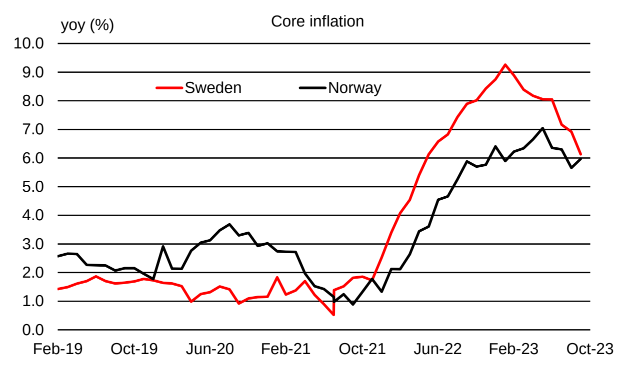
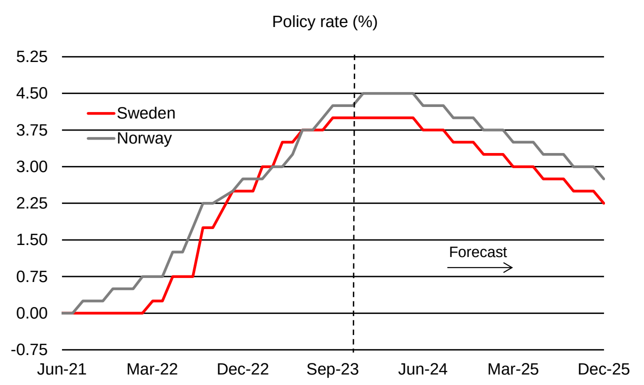


CHART 2: EXPECTATIONS OF POLICY RATE CUTS



Source: Norges Bank, Riksbank, Statistics Norway, Statistics Sweden, UniCredit Research

Switzerland

SNB to cut rates gradually

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We forecast real GDP to rise by 0.7% in 2023, by 1.2% in 2024 and by 1.6% in 2025. Note that the 2024 figure is likely to be inflated by license income, probably by nearly 0.5pp, which will stem from major international sporting events, such as the Summer Olympic Games. Our forecast risks are skewed to the downside, given geopolitical and macroeconomic uncertainty.

Solid rise in exports and domestic demand

Both exports and domestic demand are likely to support the economy slightly in 2024 and 2025. The anticipated moderate recovery in global trade will lead to a slight acceleration in Swiss export growth. Furthermore, private consumer expenditures will probably increase solidly due to a slowdown in inflation, anticipated wage growth of about 2% (in 2024) and continued job creation. However, after strong employment growth of probably about 2½% in 2023, the fastest increase in more than 10 years (Chart 1), leading indicators such as vacancies point to a cooldown. While the signs of a slowdown in the construction sector are obvious due to the rise in interest rates and construction cost, neither business surveys among construction companies nor lending data point to a hard landing.

Bumpy road to further disinflation

Overall, we expect the disinflation trend to continue. After an increase of 2.2% yoy in 2023 (2022: 2.8%), inflation rates are likely to slow to 1.5% in 2024 and to 1.0% in 2025. Further easing in inflationary pressure has been signaled by both surveys and hard data, such as import and wholesale prices. However, in the short term, the road to disinflation will likely become bumpy due to hikes in administered prices at the start of 2024, such as for electricity. Furthermore, the VAT rate will be increased slightly in January 2024, to 8.1% from 7.7%. As a result, we expect headline inflation rates to temporarily increase to about 2% before decreasing again to 1¼-1½% during the remainder of 2024 and slow to below 1% in 2H25.

SNB to cut rates gradually

We continue to expect the SNB not to hike key rates further and to remain in wait-and-see mode for large parts of 2024. The key reason is that the depo rate is still rather low at 1.75%, in contrast to 4.0% in the eurozone, and that policymakers will want to see actual inflation rates remain persistently below 2%. We expect the SNB to start cutting rates by 25bp in 4Q24, followed by two additional rate cuts of 25bp each in 1Q25 and 2Q25. The forthcoming administered price increases at the beginning of 2024 are unlikely to trigger a further tightening of monetary policy, as second- and third-round effects will probably remain contained. Recent SNB statements also suggest that, if tighter monetary policy is needed, further FX currency sales to strengthen the Swiss franc could be considered rather than hiking interest rates further. The SNB has already used FX sales to a greater extent to decrease its balance sheet (Chart 2).

CHART 1: EMPLOYMENT GROWTH PROBABLY PEAKED

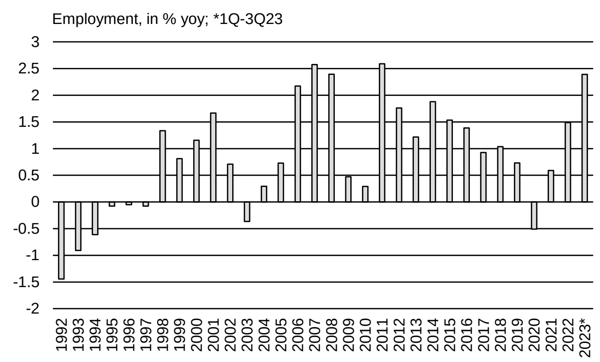
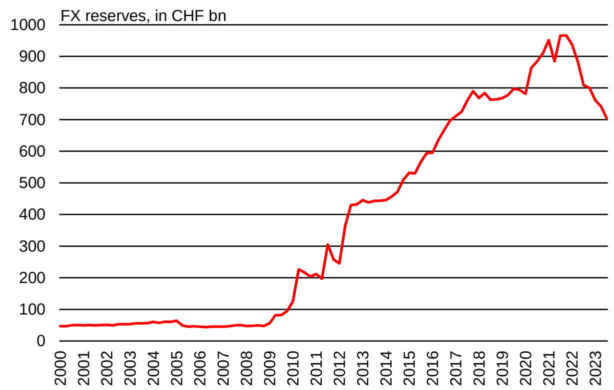


CHART 2: DECLINING FX RESERVES



Source: Bloomberg UniCredit Research

China

A crisis of confidence

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We expect GDP growth to decelerate to 4.5% in 2024 and to 4.3% in 2025 (Bloomberg consensus 4.5% and 4.4% respectively), down from around 5.2% this year. After a rebound in economic activity in 1Q23 that followed the sudden lifting of all COVID-19-related restrictions, the Chinese economy has surprised to the downside. Part of this disappointment has had to do with timid Chinese consumers, whose confidence is reportedly at its lowest since 1991 (Chart 1). In our view, consumption weakness is likely to persist throughout 2024.

Factors weighing on consumption

There are at least four factors weighing on consumption. **1.** The Chinese government has not announced any all-out fiscal stimulus, resorting to a piecemeal approach at a time of stagnating wages. **2.** Around 70% of household wealth in China is tied up in property. Consequently, declining property values are creating negative wealth effects and dragging down consumer spending. **3.** The effects of regulatory tightening on real estate, education and tech, which used to be a major employment-driver, is affecting confidence. **4.** The youth unemployment rate is at historically high levels, and younger generations have a high propensity to spend.

There is no major fiscal stimulus in the pipeline and the real estate sector is unlikely to recover

We think that a rebound in private consumption is unlikely to occur next year for a number of reasons. First, the government is likely to somewhat revitalize consumer confidence in the short term only through fiscal incentives tied to the purchase of specific goods or services. But no major fiscal stimulus appears to be in the pipeline. Second, the probability that a large bailout package will be agreed for the real-estate sector is low. We think that Beijing is likely to continue to intervene as needed, easing liquidity conditions for developers and mitigating potential contagion risks. Despite falling mortgage rates, property sales have not rebounded, while both property prices in the largest 100 cities and residential investment are declining (Chart 2). Some developers have resorted to cutting home prices to clear unsold inventory. Yet, this strategy is backfiring, as potential buyers end up delaying purchases in hopes that there will be further price reductions. Thus, pre-sales, which represent a significant percentage of developers' sources of funding, have declined. Third, today's crisis of confidence is partly due to structural factors, such as a poorly developed social safety net and pension system. Any successful structural reform, if implemented, would take time to bear fruit.

The PBoC is to remain supportive

Weak domestic demand should contribute to keeping CPI inflation around 1.5% next year, with sizable downside risks to the forecast. However, a deflationary spiral appears unlikely. In order to support demand and prices, monetary-policy easing is likely to continue. The PBoC is likely to further reduce minimum reserve requirements, to activate targeted lending facilities and to cut further its one-year medium-term lending facility rate.

CHART 1: LOSING CONFIDENCE

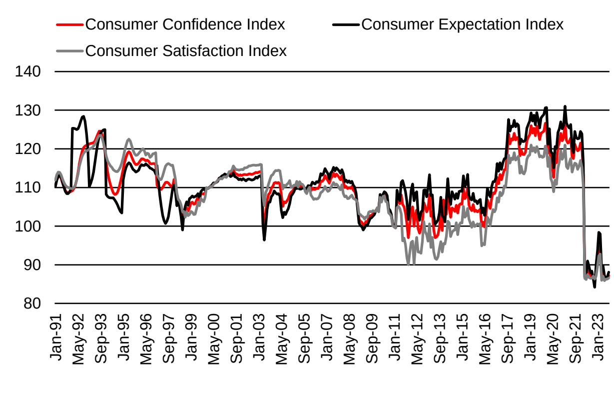
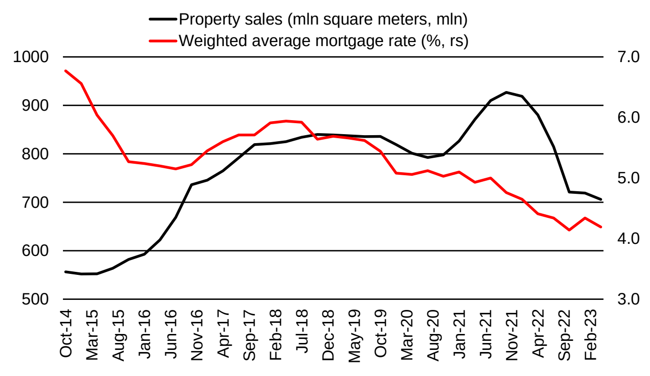


CHART 2: REAL ESTATE IS NOT PICKING UP



Source: NBS, UniCredit Research

Oil

Towards a more balanced market

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Brent prices have been on a rollercoaster throughout 2023, under the pressure of speculative short-selling, rising geopolitical risk and tighter OPEC+ production. We see Brent prices to stabilize slightly above USD 90/bbl in 1H24 as OPEC+ is likely to adopt a hawkish rhetoric at its next annual meeting in late November, contemplating further collective production cuts for 1Q24 in order to lift prices at a time of speculative short-selling pressure and weak demand. We see Saudi Arabia unwinding its voluntary production cuts next spring (and no longer in early 2024), when demand is supposed to reaccelerate, thus gradually improving demand-supply balance (Chart 1). Then, prices will likely decline towards USD 85/bbl in 2H24. Overall, for 2024, we expect an average Brent price of USD 89/bbl and for 2025 of USD 82/bbl.

Artificially low supply

Since the beginning of 2023, OPEC+ has removed around 2.5mn b/d of supply from the market. At the moment, however, the gap between demand and supply amounts to around 1.5mn b/d, and it is expected to remain at that level until the end of the year. But spare sustainable capacity among OPEC+ members amounts to around 5.6mn b/d (Chart 2), or four times the level of the current shortage. Saudi Arabia is leading the group, with supply of more than 3mn b/d that can be activated in less than 90 days. This supply shortage would be larger if the US and Brazil had not surprised the market by pumping more than expected.

Global demand remains resilient

Global oil demand is on track to hit 102mn b/d in 2023 – almost 2% higher than before the pandemic. Despite the current headwinds faced by the Chinese economy, oil demand in China seems to be unaffected. It reached a historic monthly high of 16.7mn b/d in July. This resilience has much to do with the expansion of the country's petrochemical activity, where China is crowding out international suppliers of feedstocks and polymers. However, global demand will likely increase by around 1mn b/d in 2024.

Global inventories are low

Given current undersupply, global inventories are at historically low levels, but in OECD countries, they keep increasing. This diverging path is due to weak demand in advanced economies, while demand in Asia is rather strong. Global inventories will start to be replenished when the supply-demand balance improves in 1H24.

Limited impact of the Israel-Hamas conflict

We expect the conflict between Israel and Hamas to remain localized and, as such, to have no major repercussions on the oil market. If the conflict were to broaden and involve other regional actors (Iran in particular), we would expect Brent prices to jump to USD 150/bbl. In such a scenario, the main risks would be represented by military strikes on oil facilities and infrastructure in Saudi Arabia as well as a partial or total blockade of the Strait of Hormuz, through which almost 20% of seaborne crude passes.

CHART 1: FROM UNDERSUPPLY TO BETTER BALANCE

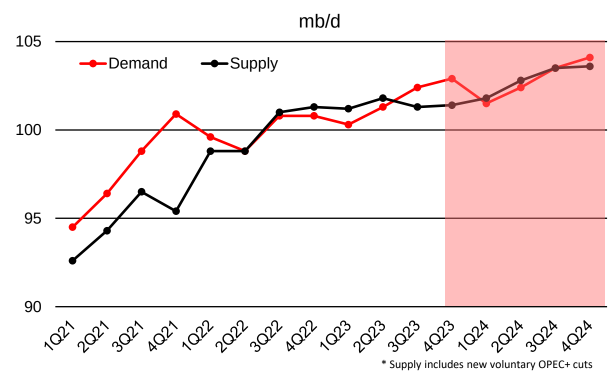
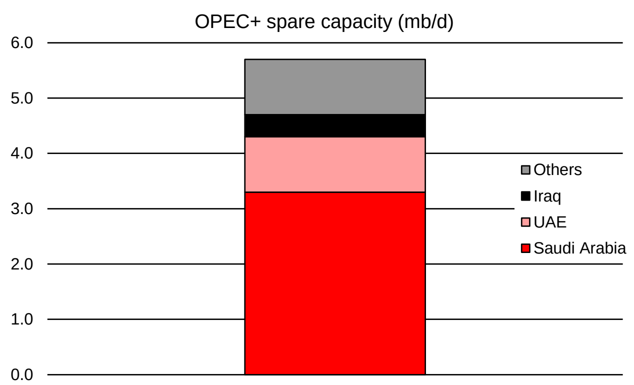


CHART 2: ABUNDANT SPARE CAPACITY TO ABSORB SHOCKS



Source: International Energy Agency, UniCredit Research

Natural Gas

Tight supply

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Over the last couple of months, price volatility of the TTF benchmark has intensified. This is the result of overlapping factors, such as extraordinary maintenance operations at gas plants in Norway; strikes at LNG terminals in Australia; the conflict between Israel and Hamas; and sabotage to a Finland-Estonia pipeline. In our view, TTF prices are likely to average EUR 45/MWh in 2024, with peaks at EUR 50/MWh in 1Q24 and 4Q24, when seasonal demand is higher due to heating. Despite all the structural improvements recorded by the European gas market since the beginning of the war in Ukraine, we see EUR 35/MWh as a new floor for the TTF going forward – that is almost three times higher than the pre-2022 historical average.

Subdued demand

The sharp decline in TTF prices since summer 2022 is primarily a demand story. Demand has not recovered due to weather anomalies and long-lasting scarring effects in energy-intensive sectors. Looking at 2024, both factors are likely to weigh on the demand outlook. According to the EU agency Copernicus, the 2023-24 winter season is predicted to be warmer and wetter than average in Europe because of the El Niño weather effect. At the same time, some production capacity in energy-intensive sectors has been permanently lost. For these reasons, we see European gas demand in 2024 to be around 410bcm – almost 20% below levels before the start of the war in Ukraine. Lasting energy-efficiency gains (the positive legacy of the energy crisis) and the rising role of renewables will also contribute to lower demand.

Tight supply

Despite a successful strategy to diversify supply, some 10% of European gas consumption is still covered by Russian gas. This is something that will not be reversed next year due to the rigidity of supply in the short term. However, even if inflows of gas into Europe remain 15-20% below pre-2022 levels, thanks to weak demand, storage is likely to hit 90% again next August. The tightness in supply will contribute to generating short-term price volatility. Despite LNG playing a greater role, global liquefaction infrastructures are able to cover only 15% of global demand (Chart 1) – meaning that piped gas remains the main source of supply.

Limited consequences of the war between Israel and Hamas

In a scenario of localized conflict between Israel and Hamas, the repercussions for the natural gas market will be limited. Israel is not a major gas producer, while Algeria and Libya, which are key suppliers for both Spain and Italy, are geographically distant from the epicenter of the war so there is no risk of attacks on pipelines. In the event of a broader conflict, the major source of vulnerability would be represented by Qatar and the UAE, which export around 25% of global seaborne LNG through the Strait of Hormuz where the risk of military skirmishes or even a blockade would be high. In addition, higher oil prices due to a regional conflict would make LNG more expensive for buyers on long-term contracts, which still underpin the majority of global LNG trade. In such a scenario, TTF prices would likely rise above EUR 100/MWh.

CHART 1: RISING BUT STILL LIMITED ROLE FOR LNG

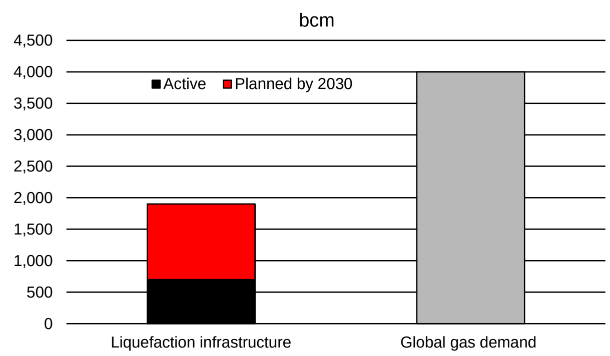
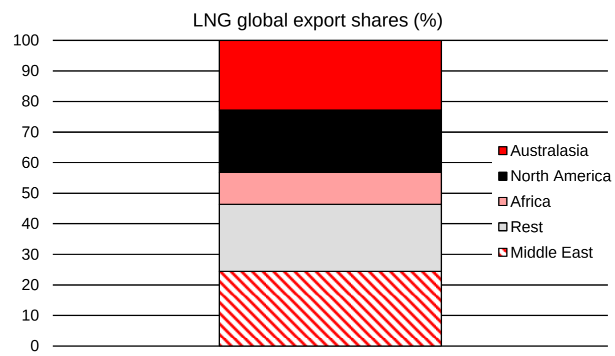


CHART 2: QATAR'S LNG EXPOSED TO REGIONAL TENSIONS



Source: Energy Aspects, UniCredit Research

Cross Asset Strategy

Improved return prospects for a diversified allocation

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- We expect positive bond- and equity-return prospects for 2024. By the end of 2024, inflation risks should be under control, ECB/Fed cuts should be well advanced and GDP growth prospects should be improving. Still, economic and geopolitical risks persist and large amounts of debt refinancing are looming.
- We expect high-rated bonds to make up an increasing share of portfolios and investors are likely to become more active on duration. Attractive risk-free yield levels and declining central-bank liquidity reduce yield-hunting pressure and call for a more selective approach on credit. Equities might be better suited to position for an improvement in risk appetite.

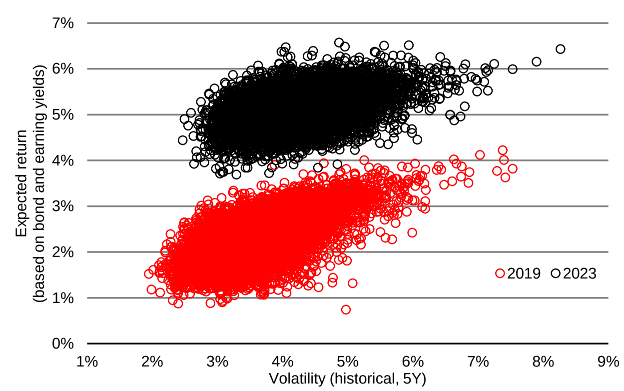
2023: despite wild swings, carry paid off, as did equities. Duration posed a drag

Following two years of negative performance, large parts of the fixed-income universe managed to deliver positive returns in 2023. Carry helped in this respect, with lower-rated bonds outperforming while short duration was the right call for bonds. Equity performance was very volatile, with drawdowns of around 10%, but most indices are closing the year with double-digit gains. EM was the main underperformer, dragged down by the sell-off in Chinese stocks, while tech names fueled the outperformance of US equities. Cyclical headwinds weighed on commodities, which lost some ground after two solid years, except for precious metals. Uncertainty regarding the peak level and future policy rates along with geopolitical tensions added to volatility, while lower commodity prices and softening global demand fueled disinflation and caused some de-correlation between bond and equity returns. As performance dispersion increased, so did diversification opportunities, while a 60/40 portfolio swung back into positive territory after the negative 2022 returns.

Improved risk-return expectations for the coming years

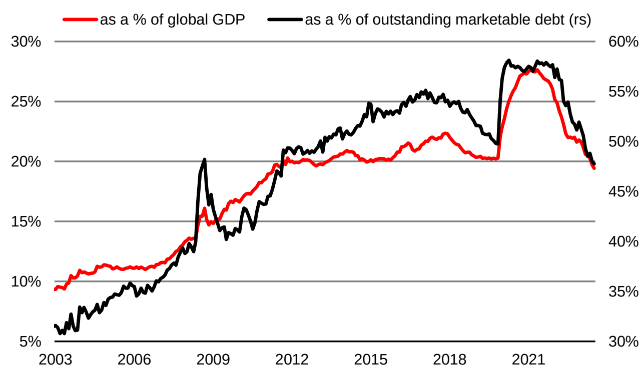
In our baseline scenario, by the end of 2024, inflation risks should be under control, ECB/Fed rate cuts should be well advanced and economic growth prospects should be improving. Thanks to the highest core bond yields in over ten years and to somewhat cheaper valuations across assets, risk-return expectations over the medium term are much improved compared to the last few years (Chart 1). Given this backdrop, both bonds and equities could perform well. Nevertheless, significant sources of risk linger. The full impact of monetary tightening is yet to be seen, while recession fears and increased refinancing risks will add to geopolitical tensions, likely keeping sentiment unstable. Although below recent peaks, interest-rate volatility will likely remain elevated given the changed inflation and monetary-policy outlook, with structural changes in the level of liquidity in the system adding to uncertainty.

CHART 1: IMPROVING RETURN PROSPECTS



10K simulated portfolios from selected global bond and equity indices. Expected medium-term returns and volatility

CHART 2: LIQUIDITY IS SHRINKING



Liquidity: Fed, SNB, ECB, BoJ balance sheets and global FX reserves. Debt: Bloomberg Multiverse index outstanding (IG, HY)

Source: Macrobond, Bloomberg, UniCredit Research

Declining central bank liquidity

The balance sheets of central banks continue to shrink, with almost USD 5tn of liquidity having been drained from the system since YE21 (20% of the total). The ECB contributed to this trend to a great extent as maturing refinancing operations added to quantitative tightening (QT). FX reserves also dropped sharply worldwide. Hence, central-bank liquidity as a share of world GDP or of the outstanding global debt has plummeted (Chart 2). Over the past decade, along with ample central-bank liquidity, depressed risk-free rates have contributed to pushing demand towards higher-yielding investments, which resulted in higher levels of duration, credit or liquidity risk in investors' portfolio. With nominal bond yields trading at attractive levels and real yields in positive territory, the need to look for yield in remote corners of the market is fading and high-rated bonds are likely to take on an increasing share of portfolios.

A more-active duration view for 2024

Disinflation will lead to more appetite for bonds, while official rate cuts are fueling bull steepening. Duration should contribute to returns in 2024, increasing the appeal of medium-to-long-term bonds, particularly when reinvestment risk is factored in. However, prospects of high supply, QT and pressure on term premiums are set to limit the downside for long-term yields. The short-end of the curve will likely continue to play a key role until the curve slope turns positive. We project total returns of 4.5% for 10Y Bunds and 7% for 10Y USTs in 2024.

A more-selective approach to low-rated credit and EM

Corporate credit has weathered the tightening cycle relatively well thanks to solid fundamentals and relatively low duration. Carry has kept up returns in 2023. Looking ahead, default rates and the risk of a deep recession are likely to remain contained, while risk-free rates are expected to fall. Hence, we expect European IG and HY NFI credit to post total returns of 6-8% in 2024. That said, refinancing risks are looming as a large share of the cheap quantitative easing (QE) era borrowing will have to be refinanced at much higher costs while the profitability outlook remains challenging, thus translating into gradually deteriorating credit fundamentals. Our expectation of lower UST yields and a weaker USD is good news for EM, while lower carry and high core yields might dent the appetite of crossover investors for EM paper. Thanks to carry, return prospects are positive but the risks should not be ignored. Lower central-bank liquidity and a more-positive view on high-grade bonds translate into de-risking and a more selective approach on credit.

Equities to gain the upper hand

Despite all headwinds, we think that portfolios should be positioned for an improvement in risk appetite, and equities might be the best pick to exploit such a trend and post double-digit returns in 2024. Given the still-uncertain outlook, we project modest earnings growth in 2024/25 and we would opt for a phased approach with a preference for rate-sensitive and non-cyclical sectors. US equities' higher valuations will look less rich as UST yields inch lower. An improvement in the global growth backdrop would call for an increasingly cyclical allocation as 2024 goes by and for a better outlook for the broad asset class.

CHART 3: FROM YIELD-FREE RISK TO RISK-FREE YIELD

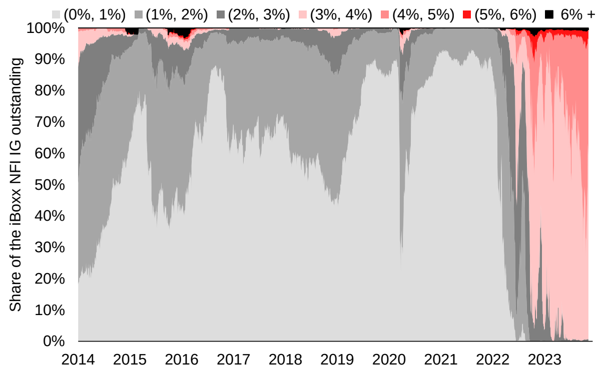
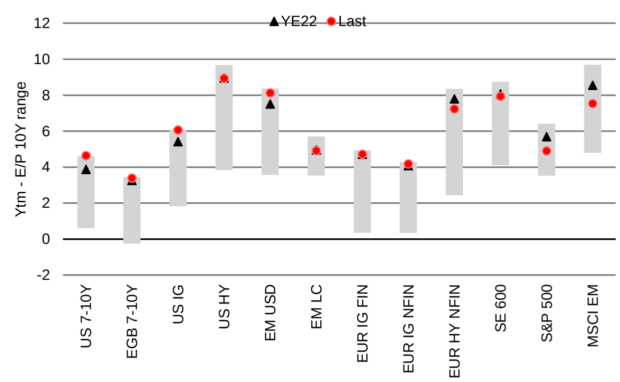


CHART 4: VALUATIONS AT A GLANCE



Source: S&P Global, Bloomberg, UniCredit Research

FI Strategy

Escaping curve inversion

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- The key trends we expect in 2024 are lower yields and bull steepening as central banks move from hiking to cutting rates. We expect the 10Y UST yield to be 4.15% and the 10Y Bund yield at 2.40% (10Y swap rate at 2.80%) by the end of 2024.
- We expect further tightening of Bunds/swaps amid lower collateral scarcity and lower yield volatility. The belly should underperform the wings 2Y and 10Y and the 10/30Y should steepen.
- We expect BTPs to come under pressure in early 2024 as supply weighs in but we are constructive overall for 2024 as a whole. We expect the 10Y BTP-Bund spread to trade at 165bp at the end of 2024 and to tighten further in 2025, possibly to 150bp.
- EU bonds continue to offer an appealing pickup to Bunds and OATs and could outperform if liquidity improves.

Fixed income has had another rough year

Major central banks have continued to tighten monetary policy in 2023 to stabilize inflation expectations. Reflecting a mix of central bank credibility and concerns about the possible impact of policy tightening on growth, the long end has been remarkably stable for most of the year. Only after summer selling pressure on 10Y USTs emerged, due to higher-for-longer rhetoric by the Fed and concerns about the high US deficit.

2024 in a nutshell: lower yields and curve disinversion

With policy rates now most likely at their peaks in major economies, fixed income securities are likely to navigate calmer waters in 2024. We expect the key trends to be lower yields and disinversion of the curve, driven by the short end, as central banks move from hikes to cuts.

Yields to decline reflecting policy easing…

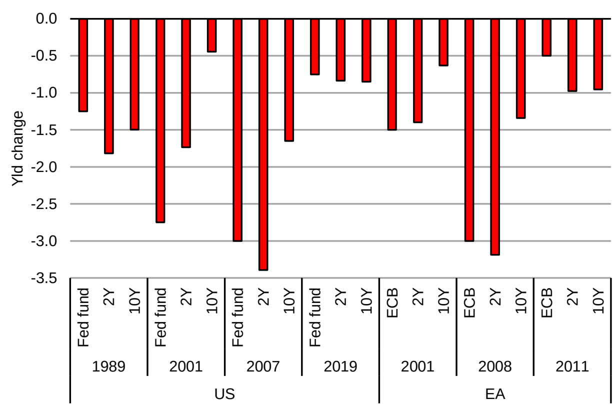
2Y yields should decline, reflecting central bank action. The move will be gradual, especially in the US, as investors will take time to converge towards our below-forwards Fed call. By the end of 2024, we expect 2Y UST yields to be 4% and the 2Y euro swap rate to be 2.60%.

With respect to the long end, while the direction of yields is to the downside, the magnitude is more difficult to assess as investors are already positioned for an easing, especially in the euro area, where the curve shape is unprecedented. This warrants some caution with respect to the potential decline in long-term yields in the coming quarters.

…but expect moderate elasticity of the long end to rate cuts…

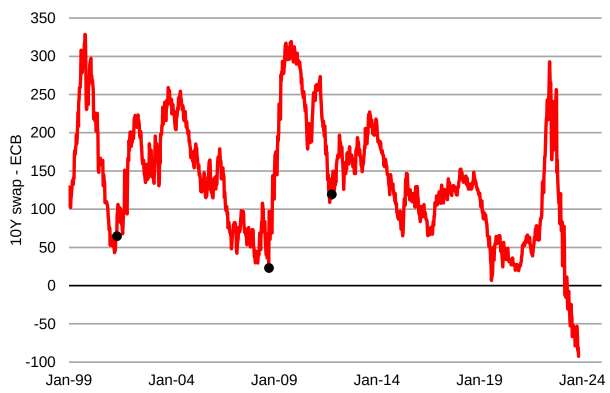
Since March 2022, the 10Y UST yield has risen by around 250bp, about half the amount that the Fed has hiked. For the 10Y euro swap rate, the ratio is just one fifth. This suggests the long end is likely to exhibit very modest elasticity once rate cuts start, especially in the eurozone.

CHART 1: YIELDS DROP WHEN EASING CYCLES START



Changes from three months before the first cut to six months afterward

CHART 2: EURO AREA CURVE INVERSION IS EXTREME



Dots indicate the date of first cut for past cycles. ECB refi or depo as appropriate

Source: Bloomberg, UniCredit Research

…and don't forget investors have jumped the gun a few times in 2023!

Investors have jumped the gun a few times in 2023 with respect to bond-market rallies. Furthermore, central banks will want to avoid excessive investor optimism leading to financial conditions easing prematurely. Expect yields to remain highly sensitive to data and central banks to lean against fixed income rallies until they become convinced that inflation is moving sustainably towards target.

What level can long-maturity yields reach?

One way of assessing an equilibrium for long-maturity yields is to divide them into three main components: inflation expectations, the natural rate (r*) and the risk premium. While elegant and conceptually solid, this approach is impractical because these components are un-observable and need to be estimated, leaving a high margin of uncertainty on any exact equilibrium level. Chart 3 illustrates this point showing that the range for these components in the past ten years has been very large, amounting to a cumulative 400bp in both the US and the eurozone. That said, Chart 3 also indicates that real yields are high relative to r* (Chart 3 shows revised data) and BE are (modestly) higher than central bank targets. This argues in favor of lower nominal yields going forward, with the risk premium remaining a wild card.

We do not expect much yield pressure from supply and QT

Supply/demand dynamics have captured investors' attention in recent months, putting pressure on the long end via higher risk premiums. In our baseline we do not expect a significant further increase in term premiums. Quantitative tightening (QT) is on autopilot and should be priced in both in the eurozone and the US. Similarly, supply needs are already known and are not a reason for concern, particularly in the eurozone.

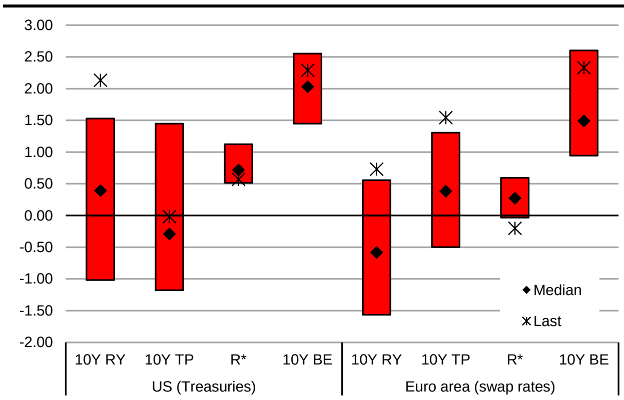
Our end-2024 targets for 10Y yields

A more practical approach is to consider that the curve should have a positive slope at the end of the easing cycle, with the 10Y trading higher than the very short end. In our baseline, the Fed and the ECB reach neutrality in late 2025/early 2026, at 2.75% and 2.00%, respectively. Accordingly, we expect that at the end of 2025, the 10Y UST yield will be trading at 3.80% and the 10Y euro swap rate will be 2.65% (10Y Bund at 2.30%). A smooth trajectory toward these targets implies end-2024 levels of 4.15% for the 10Y UST yield and 2.80% for the 10Y swap rate (10Y Bund at 2.40%) although risks are that most of the decline in yields will be front-loaded, as soon as data give enough support to policy easing. We expect the 2/10Y spread in the US and eurozone to turn positive sometime after mid-year.

Steepening to reach all the way to the 30Y

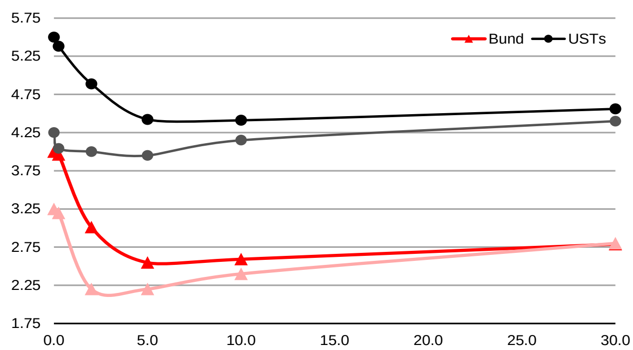
Lower yields and curve normalization are also likely to affect the extra-long end. The 10/30Y spread is historically flat both on the UST and Bund curves and is still inverted on the EUR swap curve, although much less (50bp) than at the beginning of this year. We expect 10/30Y spreads to steepen on both sides of the Atlantic in 2024. The main drivers for this move will be **1.** lower demand for IR hedging by ALM desks as policy rates start to decline, **2.** positive net bond supply at the extra-long end, coupled with QT and **3.** lower demand for convexity as yield volatility is expected to remain off peaks.

CHART 3: R*, TERM PREMIUM AND INFLATION



Red bars denote the 5%-95% range of the past ten years

CHART 4: OUR CURVE FORECASTS FOR END-2024



Dark colors show current curves, light colors our end-2024 forecasts

Source: Bloomberg, UniCredit Research

Bund-swap spread: more tightening ahead

Bund-swap spreads have been very volatile in 2023 but are finally easing. We expect more to come in 2024 as collateral scarcity is set to ease further amid the ECB's QT and German supply, volatility across rates markets should be more contained than in 2023, and ECB rate cuts should lead to steeper curves (a detailed discussion of the main drivers for Bund swaps can be found in our Rates Perspectives – Swap spreads: room for further tightening, 9 October). The 10Y Bund-swap spread is currently trading below 50bp, some 30bp tighter than it was a year ago, and we target 40bp for YE24 and 35bp for YE25.

Risks to our yield forecasts

One risk to our forecasts stems from inflation remaining sticky and delaying rate cuts. As seen in October, higher-for-longer rhetoric is tremendously negative for the long end, given its present negative carry. If consensus starts to believe the Fed or the ECB will keep rates on hold throughout 2024, the long end will most likely sell off, with 5% for 10Y USTs and 3% for 10Y Bunds being reasonable targets.

A second risk comes from a further increase in the risk premium, which could be triggered by weakening demand for USTs from foreign investors. This would make the long end even less responsive to policy easing than we project in our forecasts.

Not all the risks are to the upside, however. A final risk is that the policy tightening leads to a much more pronounced slowdown in growth compared to our baseline, and central banks cut more aggressively, not only to neutral rates but to outright easing. This would result in a more pronounced rally compared to our forecasts, especially at the short end.

We expect positive returns from govies

Risk/reward is more attractive at the short-end

After a few dismal years, especially for the long end, we expect sovereign bonds to deliver positive returns in 2024. Based on our forecasts, and assuming no big changes in yields until the end of this year, we expect returns from 2Y Bunds to be just over 3% and returns from the 10Y area to be around 4.5%. While returns at the long end are likely to be better than in 2023, especially for USTs, the short end offers a more attractive risk/reward.

BTPs set to benefit from carry

BTPs are set to outperform Bunds significantly, albeit with some intra-year volatility, as the higher carry should add to a nice roll-down at both the short end and the long end. We also expect positive returns on USTs in local currency. Hedging FX risk with forwards would cost about 1.7% leaving an attractive outperformance for USTs relative to Bunds. Our EUR-USD forecasts envisage euro appreciation similar to that priced in by forwards, so no big incentive to leave FX risk open.

ILBs to provide a positive return plus a hedge in case disinflation slows

Finally, we expect ILBs to perform roughly in line with nominal bonds in the US and the euro area. Our inflation forecast broadly match current breakevens and, if anything, we expect a modest decline in BE during 2023. That said, ILBs are a good hedge against a scenario of sticky inflation.

CHART 5: SWAP SPREADS TO TIGHTEN FURTHER

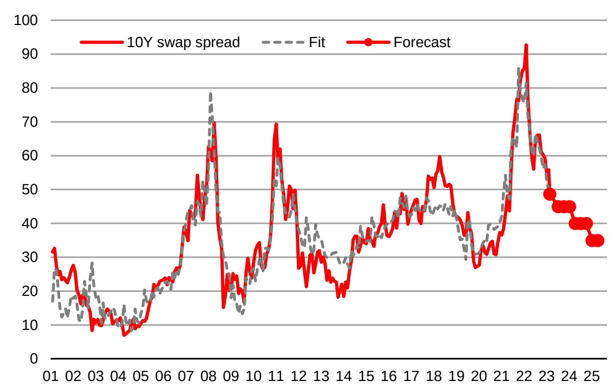
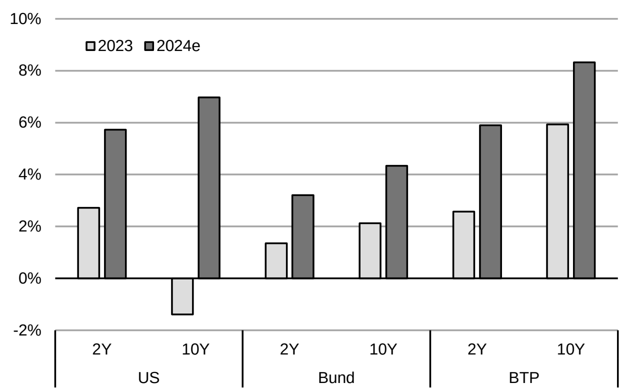


CHART 6: EXPECTED RETURNS BASED ON OUR FORECASTS



Source: Bloomberg, UniCredit Research

BTPs: robust supply ahead but carry is on their side

BTPs have been the best performing asset class among EGBs in 2023

Despite higher ECB rates, Quantitative Tightening (QT) and high supply, BTPs are set to close 2023 as the best performers among EGBs. The strong demand from retail investors has boosted confidence overall. The latest decisions by rating agencies are another supportive factor. The 10Y BTP-Bund spread is currently at around 175bp, lower than its yearly average of 182bp. BTPs are trading slightly cheaper than the YTD average versus swap. With a 50bp range through the year, spread volatility has been well below that of 2022.

Caution is warranted in the short term as supply heats up in early 2024

From a short-term perspective, heavy supply is the main risk, and we expect modest spread widening for BTPs towards 180-190bp in early 2024. Net supply adjusted for QT is projected to be EUR 140bn, the highest level since the inception of the euro and around EUR 40bn up from 2023. Risks are tilted to the upside if PEPP disinvestments start before the end of 2024 (not our baseline). We expect retail investors to remain buyers but net buying is also needed from other investors who are likely to require a premium. Foreign investors are underweight BTPs and could rebalance their exposure, especially as rating risk has now largely receded.

Key reasons why we expect a positive performance overall in 2024

High supply could lead to occasional bouts of volatility, which are likely to present buying opportunities given our constructive view on BTPs for 2024. BTPs have a much better rolldown and carry than other EGBs, which creates a disincentive to stay structurally short. If anything, there are several reasons why we would stay long: **1.** BTPs are high-beta assets and should benefit from moderately declining risk-free yields. **2.** Investors will discount the positive implications for debt cost from lower policy rates. **3.** Reduced rating risk should unlock demand by foreign investors that are still underweight BTPs compared to the pre-COVID period, by around EUR 115bn. **4.** TPI reduces the likelihood of large and persisting spread widening as long as Italy's fiscal and reform agenda remains on track. **5.** The Next Generation EU program (NGEU) should have a positive impact on growth, allowing for Italy's growth to perform broadly in line with its peers in the next few years. **6.** The ongoing political commitment to the EU project should ultimately lower credit risk in the euro area.

We expect the 10Y BTP-Bund spread to trade at 165bp at the end of 2024 and to tighten further in 2025, possibly to 150bp, with the positive backdrop from ongoing monetary policy easing to offset the negative impact from the start of PEPP disinvestments.

Key risks for the spread

The main risk factors for BTPs are: **1.** A change in the government's attitude towards the EU and/or a significant deterioration in the fiscal picture. This could easily send the spread above 200bp, and significantly so if it undermines the possibility to activate TPI. **2.** The decision to start PEPP disinvestments before the end of 2024. **3.** A significant weakening of demand from domestic retail investors.

CHART 7: A CHALLENGING SUPPLY PICTURE

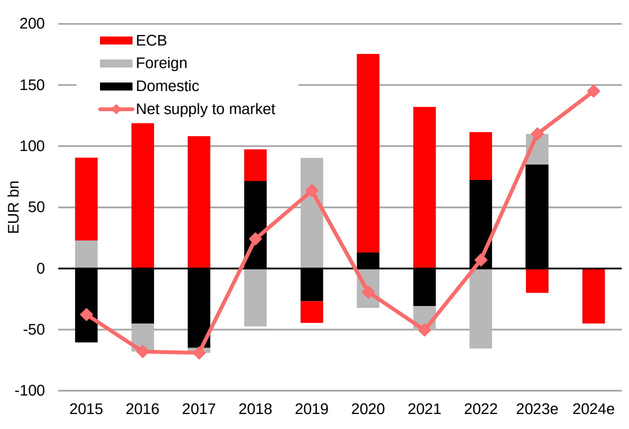
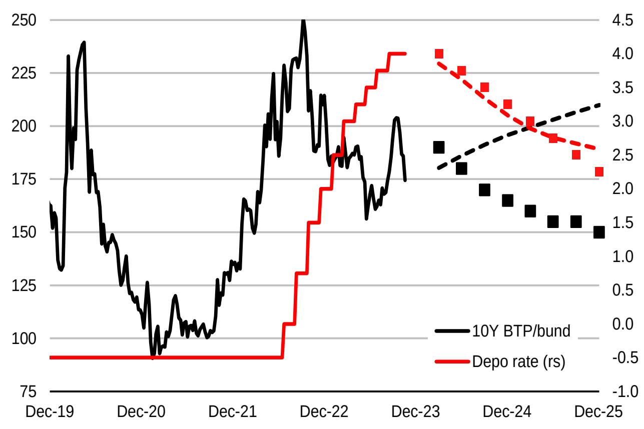


CHART 8: FORWARDS ARE TOO PESSIMISTIC ON BTPS



Dots indicate UniCredit forecasts, dotted lines indicate forwards

Source: Bank of Italy, ECB, Bloomberg, UniCredit Research

EU bonds amid heavy supply and potentially better liquidity

EU-EGB spreads are little changed from a year ago

Barring some volatility during the year, EU bond spreads to Bunds and OATs have remained relatively stable, while they have widened relative to swaps, with the 10Y spread rising from flat to 20bp this year. This underperformance is not specific to the EU and can be explained by the combination of the ECB's QT and the positive net supply of bonds.

More net supply to be absorbed next year amid ECB QT

Following a slowdown in 2H23, EU issuance activity is set to pick up next year. We expect the EU to sell EUR 150bn of bonds, more than EUR 30bn above this year's target. Net supply will be strongly positive, and higher than in 2023 (EUR 147bn, vs. EUR 115bn in 2023), and it will likely exceed that of any EGB issuer. For further information on EGB and EU issuance activity, see our Rates Perspectives - Gross EGB supply to remain at EUR 1.2tn in 2024, net to decline. EU bond redemptions will amount to EUR 3bn in 2024 and EUR 30bn in 2025. The direct impact of the ECB's QT will probably be limited next year in light of subdued redemptions, while there could be an indirect influence, as the ECB is probably using reinvestments to rebalance its portfolio from the bonds of other supranational issuers to EU.

EU-bond liquidity set to improve

Supply is also important because the EU bond market is to become sufficiently sizable so as to be as liquid as government bond markets, which the European Commission aims to accomplish. Looking at bid-ask spreads, EU bonds remain less liquid than govies, but a few steps could improve this picture next year. These include future contracts, which Eurex plans to launch in late 2024, and repo transactions. Moreover, EU bonds could be included in government bond indices. While these measures should help bridge the divide between EU bonds and more liquid government bonds, investors will probably remain cautious for the time being due to the uncertainty surrounding EU issuance activity once NGEU funding is completed in 2026.

Interesting pickup relative to Bunds and OATs

In line with govies, EU bonds are set to underperform swaps in the coming months as a result of the ECB's QT, but such widening will probably be only moderate. EU bonds still offer an appealing pickup to Bunds (70bp) and OATs (15bp) and are attractive from a buy-and-hold perspective. If liquidity conditions of EU bonds improve, we see room for EU bonds to outperform semi-core and core govies.

We see value at the 7Y area of the curve

The 7Y area of the curve is the most appealing, in our view. It is trading above the swap curve and offers the highest pickup to OATs and attractive spread to Bunds. Moreover, 7Y EU bonds are currently trading cheaper than KfW bonds of a similar tenor. Longer-dated bonds are worse-positioned given general steepening and the EU's intention to keep maturity at issuance elevated. We expect average maturity at issuance to be 13 years in 2024, in line with this year, while it will likely be around 10 years for EGBs.

CHART 9: EU BONDS VS. BUNDS, OATS AND SWAPS

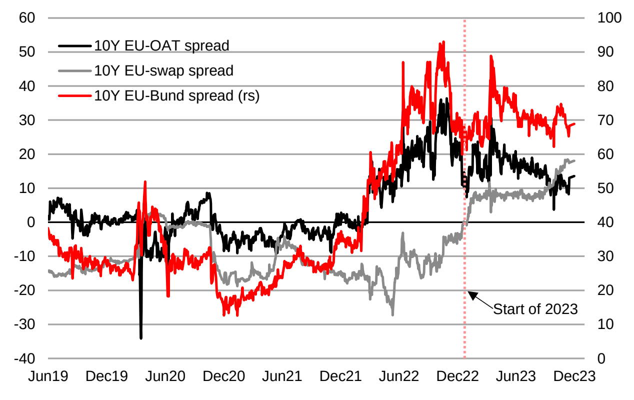
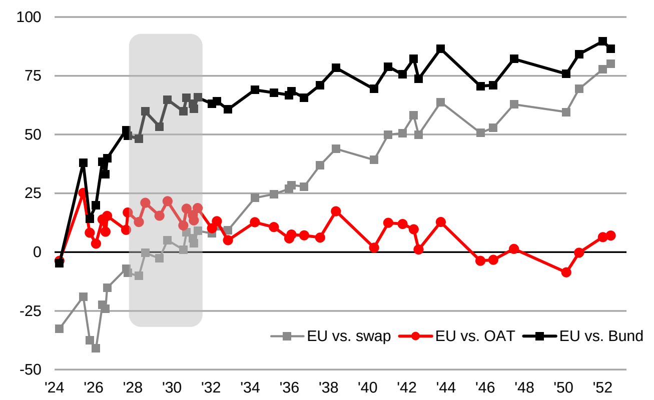


CHART 10: THE 7Y AREA OF THE EU CURVE IS APPEALING



Source: Bloomberg, UniCredit Research

FX Strategy

USD only moderately weaker even if Fed starts easing cycle

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- We expect the Fed to cut rates in 2024 and 2025. Yet, slow growth outside the US and other major central banks starting easing cycles as well will limit the USD fall. EUR-USD will likely rise to 1.13 at end-2024 and will probably hit 1.15 only in late 2025.
- USD-JPY could fall towards 140 once the BoJ kicks off policy normalization, probably next year. Sterling is likely to depreciate against both the USD and the EUR, but mostly in 2025 on the back of more intense BoE easing. A USD-CNY break below 7.00 is a story for 2025.

Limited downside potential for the USD

Chart 1 shows that this year the dollar index (DXY) has been very sensitive to the dynamics of US long-term yields and the 10Y tenor, in particular. We expect the Fed to begin an easing cycle in June 2024, cutting the fed funds rate (upper limit) to 4.25% from the current 5.50% by end-2024. Easing will continue in 2025 (but at a slower pace) down to 3.25%. However, this picture is set to be only moderately negative for the USD, as we expect weak growth also outside the US and other major central banks to start easing cycles next year as well. Geopolitical risks might affect the US unit from time to time (and probably in more of a bullish than a bearish way given the USD's safe-haven status) while the greenback might experience some volatility ahead of the US presidential election in November 2024.

EUR-USD to reach 1.13 by end-2024 and 1.15 only in late 2025

We also expect the ECB to start easing next June and the differential with the Fed policy rate, now at 150bp, is set to fall to 100bp by end-2024 (see Chart 2). Our scenario is not fully priced in by forward curves, which are implying a wider differential between the two rates over the coming quarters. However, the narrowing we expect (50bp) is too small to offer EUR-USD enough of a boost to drive it significantly above 1.10. Growth differentials between the US and the eurozone are likely to act as a brake on a much stronger EUR-USD rally as well. We expect both the Fed and the ECB to cut by 100bp in 2025 and EUR-USD to probably hit 1.15 only in late 2025. The overall rise we expect in 2024-25 is set to bring the pair to around its long-term fair value, which we estimate to be 1.14. The two main risks (to the downside) to our call are either that the Fed remains on hold for longer than we anticipate or that the ECB cuts earlier and by more than we expect. Either case would likely re-open a below-1.05 scenario.

USD-JPY to decline, but the intensity of the fall will depend on the BoJ's policy intentions

Interest rate differentials have been a key driver for USD-JPY this year, reflecting the diverging monetary policies the Fed and the BoJ have conducted until now. The Fed's easing in 2024, favoring a slightly lower USD and narrower interest rate differentials between the two countries, will likely drag USD-JPY down, but probably not much given the pair's strong resilience below 150, as

CHART 1: THE DYNAMICS OF US INTEREST RATES IS SET TO REMAIN A KEY DRIVER FOR THE DOLLAR INDEX (DXY)

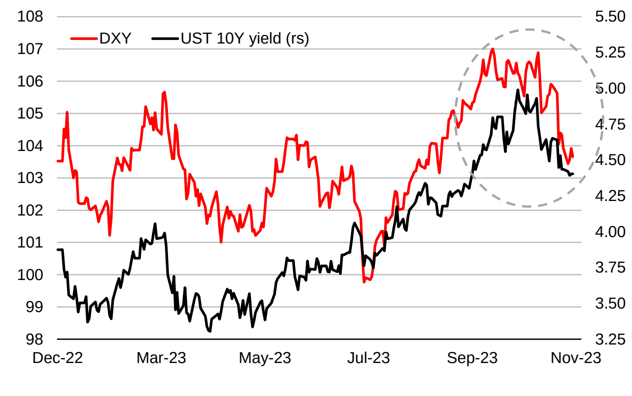
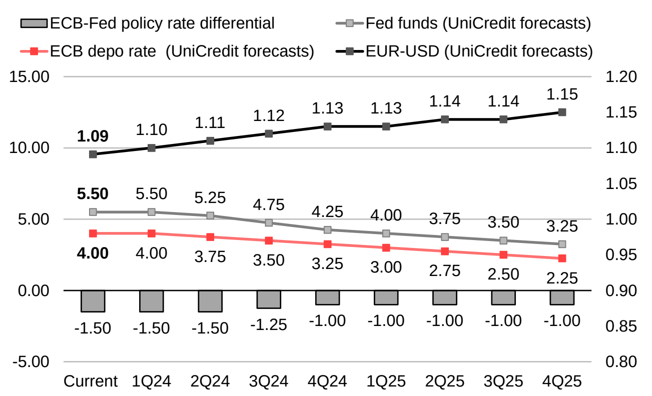


CHART 2: OUR FED AND ECB SCENARIOS POINT TO A HIGHER EUR-USD BUT STILL WITHIN 1.10-1.15 IN 2024 AND 2025



Source: Bloomberg, UniCredit Research

shown in Chart 3. A trend reversal would require a game changer, such as the BoJ starting policy normalization in 2024. This would mean ending the era of negative rates that began in early 2016. The BoJ's mild tweak to its yield curve control (YCC) policy in October, when it started considering 1% a reference for the 10Y JGB yield rather than an upper limit, disappointed investors, lifting USD-JPY to a YTD peak of 151.92. Japanese GDP falling by 2.1% in annualized terms in 3Q23 does not call for a quick turn in the bank's policy. BoJ Governor Ueda sounded prudent about a change as well, stressing that: **1**. the BoJ would not hesitate to ease further if needed; **2.** there is a lot of uncertainty regarding inflation; **3.** it is too early to set out the process of normalization and **4.** the discussion on wages might be delayed to 2024. A further note of caution stems from the fact that the BoJ might hike rates when the other major central banks start their respective easing cycles. Japanese forwards have already delayed a change in the BoJ's monetary policy until after June 2024. The Fed easing alone will probably not be enough to drag USD-JPY much lower. The BoJ starting policy normalization probably next year will likely drive the pair towards 140 by end-2024 and below 140 by end-2025. This fall would cut the USD-JPY misalignment with respect to its BEER value, which we now estimate as being close to 115. EUR-JPY is set to fall below 160.

We expect a weaker GBP, but more in 2025 than in 2024

We expect sterling to weaken, reflecting the bleak outlook for the UK economy and the BoE easing, but more in 2025 than next year. We do not expect the BoE to start cutting rates until 3Q24 and by 75bp to 4.50% (see Chart 4). This will likely limit the GBP's fall next year, leaving GBP-USD and EUR-GBP relatively stable, and not exceeding 1.28 or 0.88, respectively. Sterling will likely drop in 2025, along with the BoE accelerating its easing cycle. GBP-USD is set to slide towards 1.20 and EUR-GBP will probably rally beyond 0.90, reflecting the heavier rate cuts in the UK than in the US and the eurozone.

Our targets for the rest of G10

In the rest of G10 FX, we expect the SNB to have already ended its rate-hike cycle at 1.75% and cut rates only once in 4Q24, possibly followed by two more cuts in 2025. This will probably make it harder for EUR-CHF to exceed parity next year, also given the limited upside we see for EUR-USD. Stabilization just above parity will likely be the theme for 2025. USD-CHF will probably remain between 0.88 and 0.89. Geopolitical tensions might lift the CHF from time to time, as happened at the start of the Middle East crisis, but the impact will likely remain limited. The RBA, the RBNZ and the BoC will probably start easing late in 2024 but the AUD, the NZD and the CAD will likely benefit only modestly from the weaker USD. Rate cuts are unlikely to be strong in Sweden and Norway and probably in line with the ECB's easing. Hence, the SEK and the NOK will probably cut their still large undervaluation only partially. We estimate the EUR-SEK and EUR-NOK fair values at 10.20 and 8.30, respectively, compared to their current spot values of roughly 11.45 and 11.70.

CHART 3: USD-JPY HAS JUST FALLEN BELOW 150 DESPITE THE NARROWING IN 10Y UST VS. JGB YIELD SPREAD

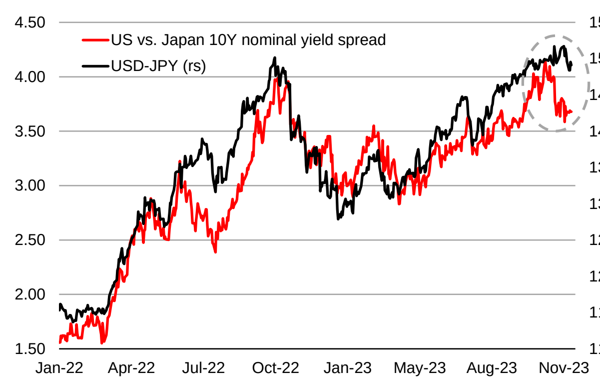
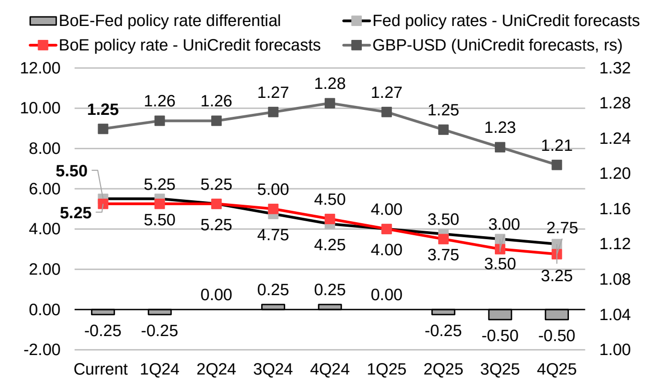


CHART 4: BOE EASING IS LIKLEY TO DRAG STERLING DOWN, BUT MOSTLY IN 2025



Source: Bloomberg, UniCredit Research

USD-CNY returning below 7.00 remains a story for 2025

Beijing has no major reason to counter the yuan weakness, considering that inflation in China remains close to zero. GDP growth for 3Q23 was better than expected at 4.9% yoy, but difficulties in the property sector remain a source of concern. The PBoC is set to further control the CNY's fall through tough action in its daily fixing operations to avoid a CNY tumble well beyond 7.35 against the USD, which might rattle Chinese financial markets. The moderately weaker USD we expect in 2024-25 might drag USD-CNY down somewhat. However, a reversal of the current yuan weakness primarily requires stronger Chinese domestic demand, reducing Beijing's reliance on a competitive currency to support exports and thus help the economy. In our view, for USD-CNY, a full break below 7.00 has probably become a story for 2025.

Appendix – FX BEER model updated

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We refreshed our FX fair-value model, BEER by UniCredit[4]. The text and the table below lay out the major changes to our estimates. Using a confidence threshold of +/-5% with respect to fair values, we estimate the following:

- **EUR-USD** looks slightly undervalued with respect to its fair value, which is around 1.14.
- **GBP** remains significantly undervalued. We see GBP-USD and EUR-GBP fair values at around 1.46 and 0.78, respectively.
- **USD-JPY** remains quite overvalued, but less than it was in 2022, as its fair level has risen to around 115, mostly due to widening interest rate differentials between the US and Japan.
- **EUR-CHF** has become even more undervalued. We now estimate its fair value well above parity, at around 1.17. Rate differentials are mostly behind this increase.
- We consider **AUD-USD** to be more undervalued than the **NZD-USD** and estimate their fair values at 0.78 and 0.64, respectively. **USD-CAD** is overvalued with respect to its fair value, at 1.26. The **NOK** is still more undervalued than the **SEK**.

FAIR VALUATION OF G10 FX ACCORDING TO BEER BY UNICREDIT

	Current	BEER by UniCredit	Misalignment	undervalued*	fairly valued*	overvalued*
EUR-USD	1.09	1.14	-4%		EUR-USD	
EUR-CHF	0.96	1.17	-17%	**EUR-CHF**		
EUR-GBP	0.87	0.78	12%			**EUR-GBP**
EUR-JPY	163	131	24%			**EUR-JPY**
EUR-NOK	11.71	8.29	41%			**EUR-NOK**
EUR-SEK	11.38	10.22	11%			**EUR-SEK**
EUR-AUD	1.66	1.45	14%			**EUR-AUD**
EUR-NZD	1.80	1.77	2%		EUR-NZD	
EUR-CAD	1.49	1.43	4%		EUR-CAD	
USD-CHF	0.88	1.03	-13.9%	**USD-CHF**		
GBP-USD	1.25	1.46	-14.5%	**GBP-USD**		
USD-JPY	149.06	114.89	29.7%			**USD-JPY**
USD-NOK	10.73	7.29	47.2%			**USD-NOK**
USD-SEK	10.43	8.99	16.0%			**USD-SEK**
AUD-USD	0.66	0.78	-16.1%	**AUD-USD**		
NZD-USD	0.61	0.64	-5.7%	**NZD-USD**		
USD-CAD	1.37	1.26	8.5%			**USD-CAD**
USD index	116.64	102.36	13.9%			**USD index**

*with respect to a threshold of +/- 5%

Source: Bloomberg, UniCredit Research

[4] The original version of our BEER model can be found in UniCredit Global Themes - Introducing BEER by UniCredit, 3 September 2013.

CEE: Fading support from interest-rate carry

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- Narrowing interest-rate premiums versus core market yields may halt the real appreciation in CEE currencies seen since 2020, as inflation and wage growth remain elevated. A weaker dollar and narrowing external deficits may help to mute depreciation pressure.
- The PLN strength is likely to fade later in the year. The CZK may become more stable in 2024, while the HUF is likely to underperform its regional peers. Monetary policy tightening is set to curb TRY and RUB depreciation amid structural FX shortages.

High interest-rate carry and narrowing structural external shortages supported massive real FX appreciation in CEE

External conditions have turned more supportive for CEE currencies this year, as headwinds from USD strength have reversed and energy prices have normalized. Core market yields remain key drivers for CEE FX, but the external headwinds have faded. As central banks in the CEE region hiked rates in 2022, widening interest-rate carry has supported massive appreciation in real effective exchange rates. In addition to lower drag from energy imports on the trade balances of energy importers, domestic demand contraction, amid tightening monetary conditions, and a sharp negative real-income shock have supported an adjustment in structural external shortfalls.

Tightening global liquidity makes us more cautious about EM FX, despite weaker USD

The global environment is unlikely to create major headwinds for CEE currencies, considering that core market yields have likely passed their peak and prospects point to a weaker dollar trend in 2024-25. A weaker USD historically tends to support EUR satellite CEE currencies, yet we think the positive impact could be offset by narrowing interest-rate premiums. Tightening global liquidity conditions as the balance sheets of major central banks start to contract make us cautious about EM currencies in general and suggest that capital inflows will be selective. Sustained weakness in foreign demand remains a potential drag in CEE, especially where export performance is closely linked to eurozone manufacturing activity. While fiscal positions will remain loose in most CEE economies, with more contribution to improving external positions in 2025 than in 2024, rising private sector savings should continue to support narrowing external deficits in 2024.

Narrowing positive carry should open the door to adjustments closer to fair values

As positive interest-rate premiums narrow, CEE currencies may unwind some of the significant real appreciation they have experienced since 2020 amid rising wages and input costs. The CZK, which was the most overvalued CEE currency in mid-2023, has already started this adjustment, which, together with the recent PLN and HUF appreciation, has narrowed valuation gaps. The PLN and the HUF may both be better aligned with fair values by the end of next year. The TRY and the RUB look cheaper on a fair-value basis as structural FX shortages have added to depreciation pressure.

CHART 5: INTEREST-RATE PREMIUMS VERSUS CORE MARKET YIELDS MAY NARROW FURTHER NEXT YEAR

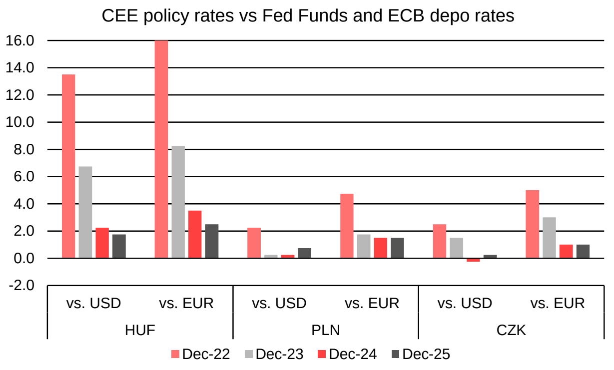
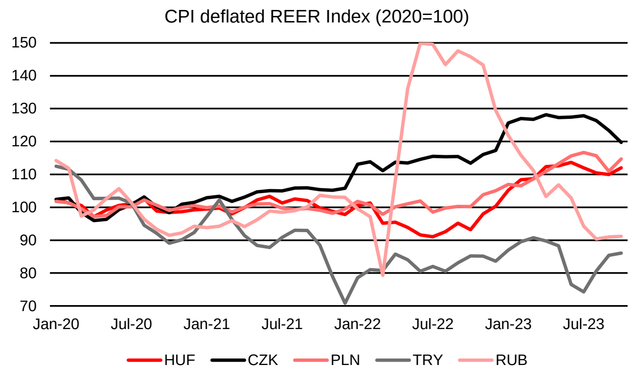


CHART 6: FUNDAMENTAL VALUATIONS MAY COME INTO SHARPER FOCUS AS INTEREST-RATE PREMIUMS NARROW



Source: Bloomberg, UniCredit Research

Political risks are key local factors to watch given the heavy election calendar ahead

Key risks to our forecast include geopolitical tensions leading to a renewed rise in energy prices, to which the HUF may be the most vulnerable given it has the largest energy-import dependence of the CEE economies. Political risks are key local risk factors for CEE currencies, considering the heavy election calendar ahead, with risks centered around fading political support for more market-friendly central bank governance in Turkey, further fiscal slippage in Hungary, Romania and Poland and the potential breakup of the new opposition coalition government in Poland, all of which point towards weaker currencies.

PLN gains, supported by capital inflows and a halt in NBP cuts, may start to be eroded from late-2024

The PLN is likely to enjoy further gains in 1H24 due to rising capital inflows and quick access to EU funds following the formation of a new government coalition. A halt in NBP rate cuts may also support EUR-PLN bottoming out around 4.25 in 1Q24. Following local elections next autumn, we expect markets to focus on the need for fiscal adjustment and concerns about political stability, reversing PLN gains and lifting EUR-PLN close to 4.40 by late-2024 and 4.50 by 4Q25.

The HUF may underperform its CEE peers

In Hungary, the lack of confirmation of positive progress on access to cohesion funds and the RRF being locked by the 27 supermilestones, combined with fiscal slippage in 2023 and 2024, point towards an increased risk of credit-rating downgrades. Deteriorating risk perception, a sticky inflation outlook and the erosion of the largest positive carry in the region may move EUR-HUF to the 395-400 range by 4Q24 and close to 410 by late-2025. Market perception of a dovish shift in NBH governance may trigger more volatility but risks of a sustained sharp HUF depreciation look set to be muted by Hungary's positive basic balance as FDI inflows are expected to pick up.

The outlook for EUR-CZK looks balanced following further adjustment above 25.0

The delay in CNB cuts may be followed by a faster decline in CZK rates in 1H24, which could lift EUR-CZK further to 25.20 as the interest-rate premium narrows. We expect the CNB to deliver fewer cuts than implied by the central bank's staff projections, maintaining 0.7-0.8% positive real rates and a 100bp spread over ECB rates throughout our forecast horizon. This, combined with a stable current account surplus and large FX reserves, may support a stabilization of EUR-CZK in 2H24, with greater uncertainty in 2025, when parliamentary elections are due.

Structural FX shortage to keep USD-RUB and the USD-TRY on a gradually rising path

Increased budget spending plans adding to RUB liquidity suggest that the recent RUB consolidation supported by capital-control measures is likely to be temporary. We expect USD-RUB to remain below the key psychological level of 100 until the presidential elections in March. The CBR's efforts to curb domestic demand by keeping real rates positive may help to ease the structural FX shortage and keep USD-RUB on a gradually rising path. In Turkey, the CBRT may allow faster FX depreciation to unwind FX-positions after the local elections in March 2024. The peak in TRY rates and more market-friendly governance might encourage some capital inflows, supporting real TRY appreciation and lowering the risk of a sharp rise in USD-TRY.

CHART 7. A WEAKER DOLLAR MAY HELP TO MUTE PRESSURE ON CEE CURRENCIES

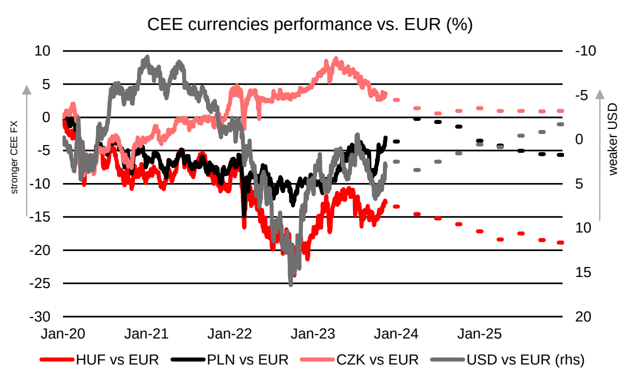
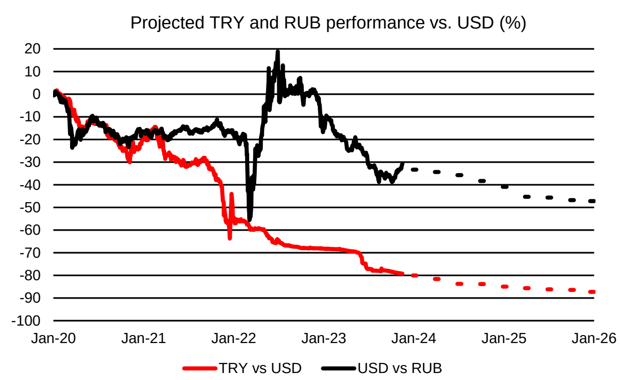


CHART 8. STURCTURAL FX SHORTAGE MIGHT KEEP TRY AND RUB ON A GRADUAL DEPRECIATING PATH



Source: Bloomberg, Macrobond, UniCredit Research

Equity Strategy

2024 – double-digit performance is in the cards

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- 2024 is likely to be a year of transition from a drag on equities due to weak growth and high interest rates to receding headwinds throughout the year, mainly due to gradually easing financial conditions.
- We think eurozone equity prices have the potential to rise by about 10% in 2024. While we see higher potential for the US due to its higher sensitivity to interest rates based on its technology-heavy sector structure.

Central bank rate cuts and lower bond yields will be the main drivers in 2024

We think the stock-market environment next year will be characterized by low growth in company earnings. The economic recovery in 2024 will be tentative and will reaccelerate slowly in 2025. The ECB will probably start cutting rates around mid-2024. We also expect subdued economic conditions in the US, with quarterly GDP growth broadly flat next year followed by below-potential growth in 2025. We also see the Fed starting rate cuts around mid-2024.

Against this background, the main driver for equities will not result from company earnings growth but rather from interest rates coming off their peaks, offering potential for valuations to rise again in 2024. While attractive bond yields continue to represent an alternative for risk-averse investors, equities should offer additional upside potential, particularly when the trend towards lower yields and signs of economic stabilization in 2025 become more visible.

We expect stock markets to rise by more than 10% in 2024

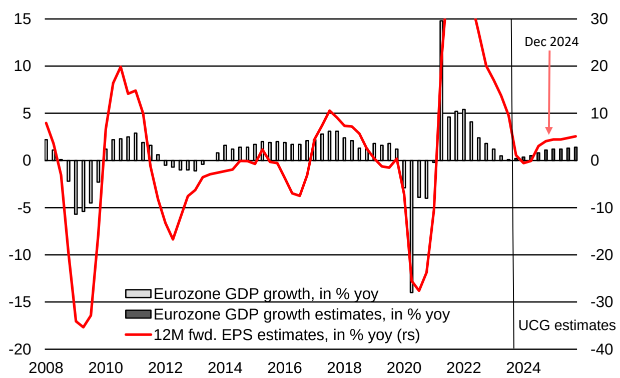
We expect eurozone equities prices have the potential to rise by about 10% in 2024, whereas we see slightly higher potential in the US due to its generally higher sensitivity to interest rates based on its technology-heavy sector structure. In contrast, Europe has a more pronounced economic sensitivity, which will still be a dampening factor compared to the US in 2024.

Our 2024 year-end index targets are as follows: STOXX Europe 600: 500, Euro STOXX 50: 4700, DAX: 17300, MSCI Italy: 82, S&P 500: 5000 and Nasdaq 100: 18000.

TABLE 1: GROWTH OF EARNINGS ESTIMATES (CONSENSUS AND UNICREDIT RESEARCH)

	Consensus		UniCredit	
	2024E	2025E	2024E	2025E
Growth of EPS estimates, yoy (%)				
Euro STOXX 50	5.0	9.3	3.0	6.0
DAX	6.7	10.6	3.0	7.0
S&P 500	11.3	12.4	n.a.	n.a.
Nasdaq 100	15.5	17.0	n.a.	n.a.
Earnings level compared to end-2022 = 100				
Euro STOXX 50	109	119	107	114
DAX	107	119	104	111
S&P 500	112	126	n.a.	n.a.
Nasdaq 100	127	148	n.a.	n.a.

CHART 1: EUROZONE GDP GROWTH AND EURO STOXX 50 12M FORWARD EARNINGS ESTIMATES



Source: Bloomberg, Refinitiv Datastream, UniCredit Research

Earnings growth to remain subdued in 2024

Earnings estimates for the next 12 months are still around their all-time highs. This is an unusual situation in an environment in which the European economy has already weakened significantly and we also see a high likelihood of lower growth ahead in the US. Against this background, we think that ongoing high earnings estimates may turn out to be somewhat overoptimistic. Our earnings projections for 2024 and 2025 are below consensus estimates (see Table 1), as our economic growth forecasts are below consensus, particularly for the US. This also has repercussions for European companies due to their high dependence on exports, almost one fifth of which go to the US. Due to the sluggish growth environment in 2024, we think companies will have increasing difficulty passing on price increases to customers. This will also result in a weakening of profit margins. However, an important stabilizing factor for earnings is productivity growth, which was around 2% yoy on average over the last 70 years. From a longer-term perspective beyond our forecast horizon, one factor that many sources have suggested might boost productivity is the increasing use of artificial intelligence, combined with automatization in production, potentially softening the negative impact of a more fragmented world on productivity. This will probably first become apparent in the US, although it is not clear at this stage which sectors are likely to benefit most.

Profit margins should continue to weaken somewhat in 2024

Globally, profit margins are still high for countries in the MSCI World index, at almost 10%, as Chart 2 shows (STOXX Europe 600 9%, S&P 500 10.2%). The big question is the extent to which companies can maintain high margin levels in an environment of lower overall economic demand (which we expect in the coming months) and lower price increases. In terms of potential price increases, recently plunging selling-price expectations in eurozone manufacturing send a cautious signal. If margins continue to weaken somewhat, which we expect, the percentage earnings growth is likely to remain in the low single digits in 2024, as Chart 2 suggests (the R^2 of the regression is 0.6). A decline in profit margins to around 8% should be seen as a normalization to levels seen in the past, following the distortions triggered by supply chain issues and high inflation rates. We think that the recent trend of softening earnings and sales estimates for European companies is likely to continue before a positive momentum arises again over the course of next year (see Chart 3).

CHART 2: NORMALIZATION OF PROFIT MARGINS SUGGESTS EARNINGS GROWTH WILL BE LOW BUT STABLE GLOBALLY

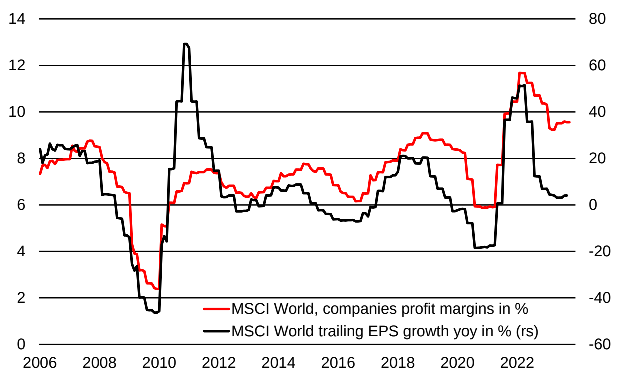
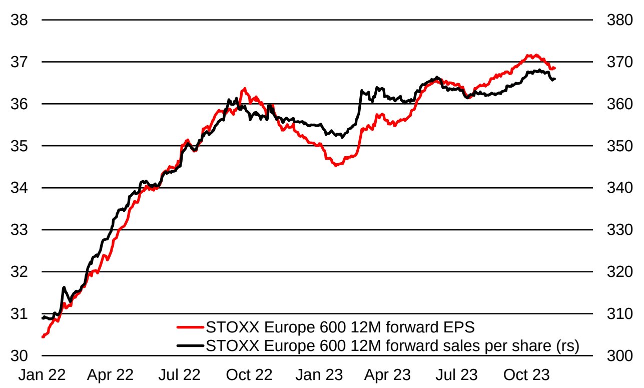


CHART 3: EARNINGS AND SALES ESTIMATES ARE LIKELY TO REMAIN UNDER PRESSURE FOR THE TIME BEING



Source: Bloomberg, UniCredit Research

Support from valuation expansion

An important factor supporting our 2024 price targets comes from an expected valuation expansion. We expect bond yields to gradually decline over the course of the year. Lower bond yields have a supportive effect on P/E valuations as future company profits are discounted at a lower rate. Chart 4 shows the inverse correlation between real interest rates and the P/E ratio, indicating that falling (real) interest rates in 2024 should lead to higher P/E ratios. We assume that P/E ratios have the potential to widen by about five to ten percent in 2024 (see Chart 5). To calculate our year-end targets for 2024, we chose a conservative approach, with a P/E valuation expansion of 5% due to the manifold uncertainties involved, such as the risk of escalating geopolitical tensions, more sticky inflation and, last but not least, the lagged effects of strong central bank tightening weighing on sentiment. A 5% increase in valuation results in a P/E ratio of 12.8 for the STOXX Europe 600 and 19.2 for the S&P 500, with the P/E ratio in Europe remaining below its long-term average and the US value failing to reach its 2023 high. However, our conservative approach also means that our 2024 year-end targets have some upside risk. If the overall environment becomes more favorable with a greater easing of financial conditions than we expect, valuations might easily increase by 10% to the long-term average of 13.4 in Europe and to 20 (the high from 2023) in the US. Given our earnings projections, a 10% increase of the European P/E ratio to the long-term average would result in a potential increase in the Euro STOXX 50 of about 16%. This exemplifies the upside risk for the other indices as well.

CHART 4: A DECLINE IN REAL INTEREST RATES OFFERS POTENTIAL FOR HIGHER P/E RATIOS

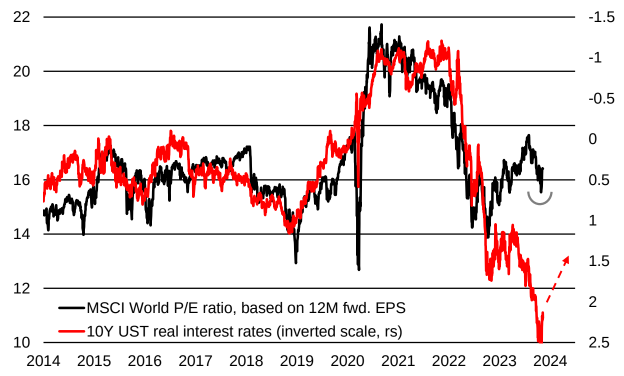
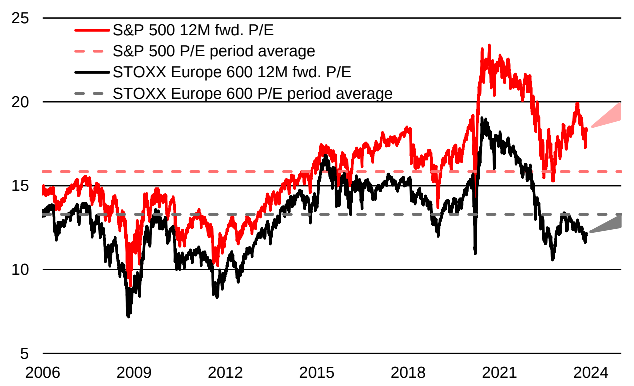


CHART 5: STOXX EUROPE 600 AND S&P 500 P/E RATIO AND P/E TARGET ZONE



Source: Bloomberg, UniCredit Research

Technology is likely to lead the stock market for much of 2024

We expect the technology sector to outperform for much of 2024, which will have the greatest positive impact in the US due to the sector's large share of the market. For the Nasdaq 100, we see a potential of about 16%, compared to 13% for the S&P 500 in our baseline scenario (see the paragraph on valuations above). An important driver will certainly be declining interest rates, which take pressure off valuations and financing costs, on which many technology companies are heavily dependent. However, in our view, the most important driver will be that the US technology sector has overcome its 2022 earnings recession, while we still expect a decline in profits for traditional or "old economy" companies. Chart 6 shows that in the last 20 years there has not been a Nasdaq 100 earnings recession like there was in 2022, which has already been overcome, with 12M forward earnings estimates strongly increasing again. As the technology sector has developed into a less cyclical sector in recent years due to the more stable and sustainable business models of its largest companies[5]. This means that earnings growth is likely to remain less affected by an expected slowdown in US GDP growth in the coming months.

Cyclicals should gain momentum throughout 2024

European cyclicals have outperformed their defensive counterparts in 2023, largely in the first half as stock markets continued to trend upwards and weak economic prospects were not yet as pronounced as they became towards the end of spring. This course also reflects the fact that cyclicals tend to outperform in upward stock-market trends or, to put it the other way around, stock markets can only rise sustainably with the help of cyclicals. Against this background, we expect cyclicals to become increasingly attractive throughout the year, when stock markets start to exploit their positive potential. The main driver of cyclical outperformance is of course the earnings development of cyclical companies. While we still see some advantage of defensive sectors at the beginning of the year due to existing manifold uncertainties, a gradual economic improvement in 2024, indicated by an increase in economic indicators, should herald increasing earnings momentum of economically sensitive

[5]Among others, software-as-a-service (SaaS), platform and subscription models, marketplace providers. Many of these business models can be typically found in technology: e-commerce, cloud computing and cloud hosting, streaming (video and audio), social networks, cybersecurity, digital advertising market, software.

cyclical companies, outpacing those of defensive companies (see Chart 7). With a lead of about three months, the eurozone manufacturing PMI is a good indicator of the relative momentum of 12M forward earnings estimates of cyclical sectors compared to their defensive counterparts.

Consumer-related sectors are likely to receive some support from a further decline in inflationary pressure and a gradual easing of financial conditions, while financials are likely to gradually lose the tailwind of high interest rates. However, banks' high dividend yield of almost 6% remains a strong supportive factor.

CHART 6: TECHNOLOGY TO SHOW AN IMPRESSIVE EARNINGS REBOUND AFTER THE DECLINE OF 2022

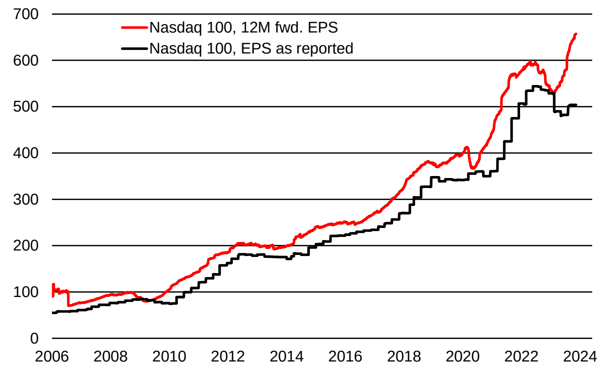
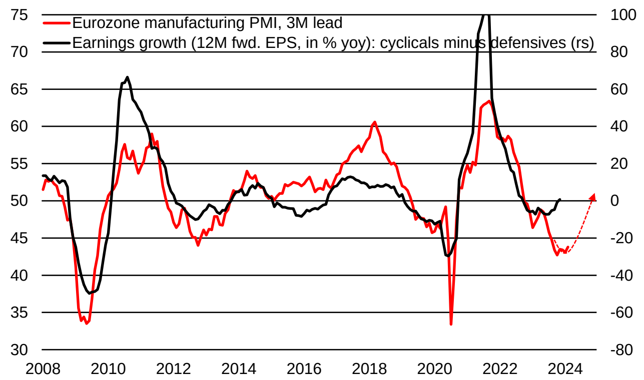


CHART 7: TURNING ECONOMIC INDICATORS SUGGEST HIGHER EARNINGS MOMENTUM FOR CYCLICALS IN 2024



Source: Bloomberg, UniCredit Research

Tensions in the Middle East harbor the biggest risk

We think the biggest risk for stock markets comes from geopolitical developments. We assume that the rise in geopolitical tensions, involving the Middle East, Russia-Ukraine, and relations between the West and China, is unlikely to dissipate any time soon. However, there is a non-negligible risk that the conflict in the Middle East could spread across the region, including the direct involvement of Iran, which would significantly increase the price of oil. The negative repercussions on stock markets through rising production costs, lower demand due to inflation rates rising again, and longer-lasting hawkish central bank policy would likely result in equity prices dropping by up to 20% in an initial reaction.

However, apart from the risk of geopolitical escalation, with the full impact of ongoing central bank tightening not yet fully understood, this could slow the economy even more than expected, including the potential risk of a hard landing. Another risk could emerge if inflation is stickier than anticipated, possibly weighing on economic prospects and the level of yields, which would likely make our expectations of rising stock market valuations invalid.

Credit Strategy

Non-Financials: Attractive carry, but downside risks loom

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- Low-but-accelerating economic growth and disinflation, allowing the ECB to ease policy in June 2024, has created a positive backdrop for credit. However, from a risk-reward perspective, we favor IG over HY non-financial bonds given high refinancing needs.
- As for sector allocation, besides Telecommunications and Health Care, we are overweight on Oil & Gas and Basic Resources and still underweight on Retail, Travel & Leisure, Automobiles & Parts and Industrial Good & Services.

It is late in the current credit cycle, but challenges are contained

We expect economic growth to be weak. This paints a negative macro backdrop for European corporate credit, due to largely exhausted savings, reduced profit tailwind and accelerating effects of monetary policy. However, we think growth will accelerate later amid continuing disinflation, which will allow the ECB to start easing next June. Lower yields should support appetite for duration. However, one should bear in mind the late stage of the current credit cycle and related challenges, and the impact of such factors will be thwarted by high funding costs and tight lending standards. This could create risk, primarily for weaker issuers' ability to refinance. On balance, however, we envision a constructive base scenario for corporate credit. We expect iBoxx investment-grade (IG) non-financial senior bonds' yield spreads to tighten by end-2024, to 70bp (from 77bp), while we expect hybrid and high-yield (HY) bonds' yield spreads to slightly widen, to 270bp (from 260bp) and to 370bp (from 330bp) respectively, by end-2024. At these levels, non-financial bond spreads will remain close to their 10Y averages.

Still-decent returns – carry

High carry is still a key source of total return (TR) in Non-Financials (NFI). Our base spread forecast places TR around 6% for IG seniors in 2024. HY non-financial bonds should return around 8% and non-financial hybrids around 7%. TR should be comparable to this year's TR and well above its long-term average. High carry also acts as a buffer against spread widening (a genuine risk, notably in HY credit, due to high funding costs and potential refinancing tensions). In such a case, we would expect the HY spread index to move towards 400bp (March's high). This would lead TR to shrink to around 5%. From a risk-reward perspective, HY credit will likely be less appealing than IG credit in 2024.

Technicals may turn negative for HY bonds…

The technical backdrop warrants caution, particularly for HY bonds. We expect corporates to place EUR 45-55bn of new HY paper. This would be the highest gross supply of such paper since 2021, and amounting to EUR 5-15bn, it could exceed net supply of such paper this year (EUR 35bn worth and EUR 5bn worth respectively YTD), mainly due to increased switching from loan to bond funding. However, aside from higher funding costs, an important negative factor is that, in some HY market segments – BB and B rated bonds in NFI, Retail, Travel & Leisure and Utilities – redemptions will amount to 30-50% of outstanding amounts over the next two years (Chart 2).

CHART 1: IBOXX NON-FINANCIALS – TOTAL RETURN*

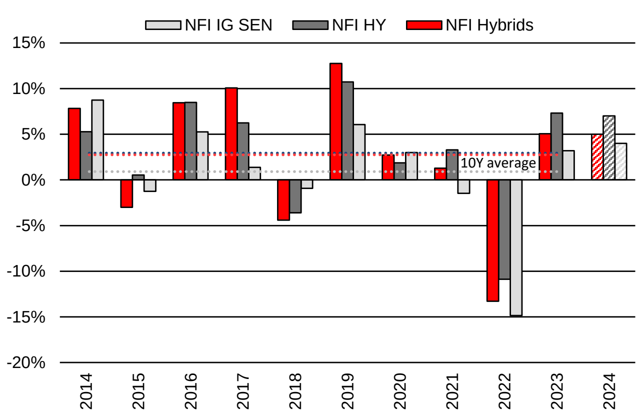
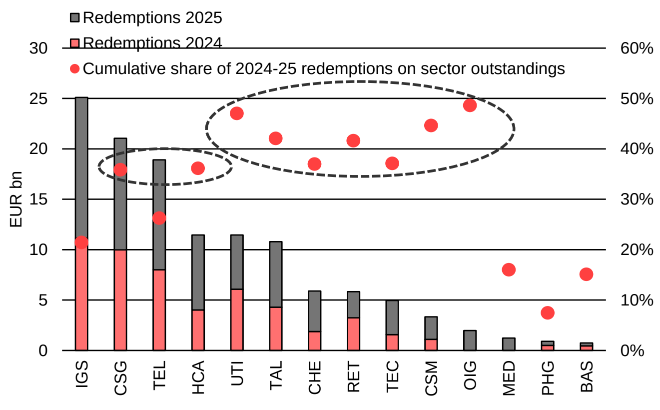


CHART 2: IBOXX HY REDEMPTIONS 2024-25 BY SECTOR



. *Total return refers to carry and credit return, while swap return has been disregarded.

Source: S&P Global, UniCredit Research

...but may remain neutral for IG and hybrids

In contrast to HY bonds, supply of new bonds from IG and hybrid corporates is expected to be neutral. IG corporates are expected to place EUR 180-200bn of senior bonds in 2024, a gross amount similar to this year, although low capex will lead to a net-supply decline to EUR 20-40bn, from EUR 70bn YTD. CSPP-adjusted net supply, at EUR 70bn, is also expected to be slightly below this year's volume. With respect to non-financial hybrid bonds, the current environment suggests there will be limited demand for hybrid funding, leaving issuance of such bonds driven mostly by refinancing of called bonds (amounting to almost EUR 19bn next year, vs. EUR 13bn in 2023). For more details, see Credit Perspectives - Moderate net supply expected from non-financials in 2024, 3 November.

Fundamentals to continue deteriorating amid higher funding costs

High funding costs, averaging 5%, are at levels not seen since 2009 in Europe. This will weigh on credit metrics, and, in our view, EBIT interest coverage has not yet reached a floor (Chart 3). However, its decline should be gradual, tempered by more-decisive cash-preserving policies (i.e. further reduction of capex and shareholder remuneration) and by debt-funded M&A. Nonetheless, as higher funding costs feed through to credit fundamentals, we expect more fallen angels next year (EUR 10bn worth) than this year (EUR 4bn worth YTD), while scope for rising stars should be limited to EUR 5bn worth (EUR 13bn worth YTD) in 2024. We also expect to see a gradual increase in speculative-grade defaults, from 2.7% currently to 4.5% by end-2024. However, this in line with market consensus. In our view, Retail, Travel & Leisure and Industrial Goods & Services are most vulnerable to fallen angels and defaults.

Preference for duration

Expected loosening of monetary policy, coupled with increasing growth expectations, should support lengthening duration. We think IG non-financial senior bonds offer a more-appealing risk-reward profile than HY credit, where the risk of even moderate spread widening will reduce reward. For the former, we recommend BBB credit, given its higher carry, and notwithstanding its slightly longer duration than A and AA credit. Within HY, we continue to favor BB paper, as its spread offers the highest reward premium within the iBoxx NFI. Given our expectations that refinancing costs and needs will be high and that lending conditions will tighten, we have an underweight recommendation on B and CCC credit, where reward credit risk seems low (Chart 4).

Our recommendations by sector

In terms of sector allocation, aside from Telecommunications and Health Care, which have some of the highest duration in the iBoxx NFI index, we also have overweight recommendations on Oil & Gas and Basic Resources. The latter two offer above-average carry and are likely to benefit from acceleration of economic growth that is expected to occur in 2H24. At the same time, they should outperform if geopolitical tensions worsen, which could cause commodity prices to go higher. We still have underweight recommendations on Retail and Travel & Leisure, which we expect to suffer from ongoing-weak consumer demand – and, in the case of Travel & Leisure, also from corporate discretionary spending. We also continue to have an underweight recommendation on Automobiles & Parts and on Industrial Goods & Services.

CHART 3: IBOXX NON-FINANCIALS – INTEREST COVERAGE VS. 12M FORWARD FUNDING COSTS

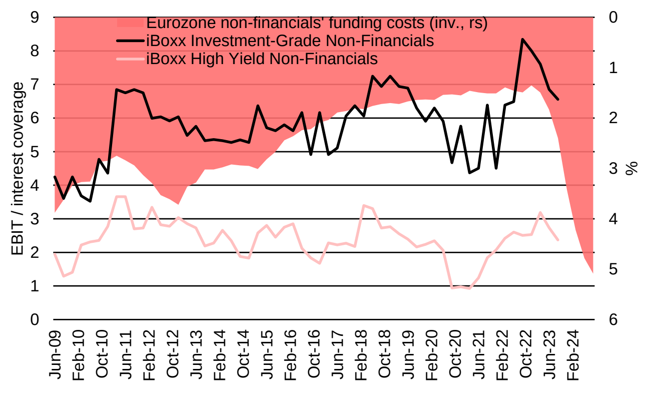
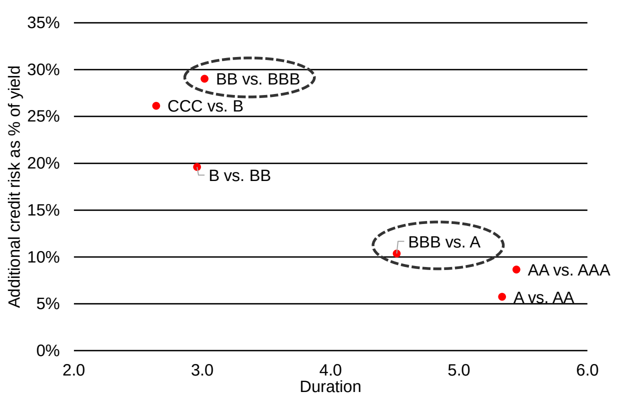


CHART 4: REWARD – CREDIT VS. CURRENT SPREAD IN IBOXX NON-FINANCIALS VS. DURATION



Source: S&P Global, ECB, UniCredit Research

Financials: Bank credit to outperform non-financials in 2024

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- We expect European banks' profitability and capitalization to remain strong. Combined with an only moderate increase in the cost of risk, this will be credit-supportive for banks.
- Carry will be the largest contributor to total returns but some spread tightening and a decline in swap rates will add to the performance. Within the capital structure, we prefer banks' AT1.

Slow reacceleration of economic growth positive for banks

Economic growth will likely be weak in 2024 but we expect continued disinflation, interest rate cuts by the ECB and a tentative recovery in global trade to provide support for growth. This environment should support bank credit, as the reduction of central-bank rates will be positive for loan growth, and also support banks' asset-quality outlook, in particular by lowering tail risks for real estate lending exposure.

Spread outlook banks

Against this backdrop we expect bank senior spreads to tightening from 104bp currently to 95bp by end-2024. Spread tightening is expected to be supported by the first interest-rate cuts by major central banks and an improved macroeconomic outlook from 2025 onwards. Regarding AT1 spreads, we expect to see spread tightening from 638bp currently to 600bp. However, for covered bonds year to date spreads have widened by 13bp to 32bp. We expect to see continued spread widening of 5bp in 2024 amid high primary-market supply and the continued reduction of the ECB's covered-bond holdings. We estimate a reduction of the ECB's covered bond portfolio by EUR 33bn for 2024. Given our estimated EUR 59bn of net covered-bond supply, this results in EUR 92bn of net supply to be absorbed by investors other than the ECB, a similar level as in 2023.

High carry provides buffers against spread widening

The carry for bank credit is high from a historical perspective but comparable to other asset classes (besides AT1). Carry will be the key source of total return in 2024 (see Chart 5). Our base-case spread forecast implies a total return of 5.4% for bank covered bonds and 6.3% for bank seniors. In the subordinated space, the total return for Tier-2s is 7.0% and for AT1s it is 13.2%. The total return levels are well above levels seen over the last five years supported by the higher current carry, expected spread tightening and the anticipated decline in swap rates, leading to additional return for bondholders. This higher carry provides a buffer against possible spread widening. If the credit spreads for AT1s were to widen by 236bp, the spread return would decline to zero (64bp for Tier-2s, 29bp for bank seniors and 7bp for covered bonds).

CHART 5: TOTAL RETURN EXPECTATIONS FOR THE BANK CAPITAL STRUCTURE

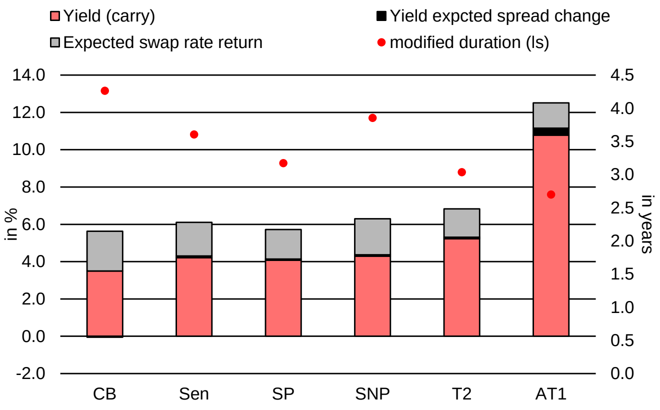
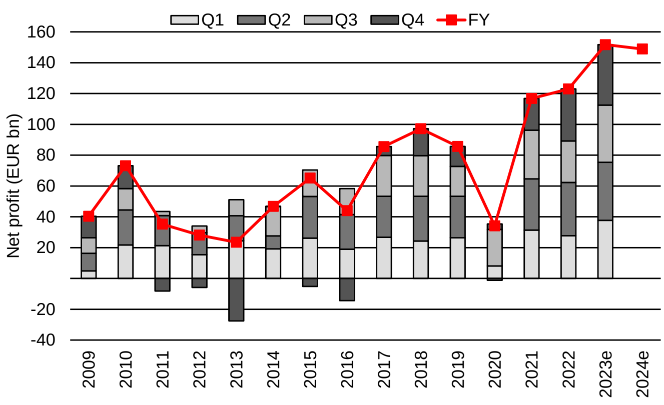


CHART 6: BANK PROFITABILITY EXPECTED TO REMAIN STRONG IN A HISTORICAL CONTEXT



CB: Covered bonds, Sen: Senior bonds, SP: senior preferred bonds, SNP senior non-preferred bonds, T2: Tier-2 bonds, AT1: AT1 bonds
Right chart: Aggregated P&L for listed banks included in the STOXX 600 Banks (Price) Index

Source: S&P Global, UniCredit Research

Net interest income will normalize, but profitability is expected to remain high

For 2024, we expect net interest income of European banks to start to decline from current very high levels owing to expected cuts in ECB policy rates, a potential increase of the minimum reserve requirements and further deposit repricing. Nevertheless, banks' profitability is expected to remain at very strong levels in 2024 with a consensus return on equity of 11% compared to an average of 4.4% from 2015-2022. The strong profitability is supported by the cost of risk being below the long-term trend, due to still available credit risk provision overlays. Tight cost control and higher bond yields for assets in banks' fixed-income portfolios are contributing factors as well. In our view, the turn in the net interest income trend is anticipated by the market and should be credit neutral as long as overall profitability remains sound, which is our base case. We therefore have a constructive view on bank credit for 2024.

Bank primary market supply to remain strong despite lower loan growth

We expect bank funding to hold up well in 2024 despite weak loan growth, with the maturity of TLTRO-III funds and a moderately declining stock of deposits being the main drivers. The expected 2024 gross EUR-denominated benchmark supply of bank covered and senior bonds is EUR 400bn (vs. EUR 410bn in 2023). The expected net EUR-denominated benchmark supply is EUR 121bn (vs. EUR 144bn in 2023). For covered bonds, we expect gross covered-bond primary-market issuance in 2024 to amount to EUR 180bn. This results from EUR 121bn of upcoming covered-bond maturities in 2024 and EUR 59bn of net supply. Expected 2024 gross supply is lower than the EUR 200bn in 2022 and 2023, as weak real-estate lending volumes will have a dampening impact. We expect EUR 220bn of gross primary senior-bond supply in 2024. This results from EUR 158bn of upcoming senior-bond maturities or calls and an expected EUR 62bn of net supply. In our view, an expected decline in deposits is one main driver of this. Moreover, we expect credit demand to recover in 2024, supported by the first expected interest-rate cuts by central banks and by a gradual improvement of the economic outlook. For further details on our new-bond-supply outlook, see our Credit Perspectives - Despite weak loan growth, we expect positive net supply for 2024 bank funding, 17 November 2023.

Preference within the capital structure

When comparing credit spreads of bank seniors to senior bonds of non-financial corporates, we see room for a further reduction in the spread pick-up, meaning that bank seniors should outperform seniors of non-financial corporates. The strong profitability of banks should be supportive compared to further profit headwinds for non-financial corporates. We regard AT1 bank bonds as attractive due to their high current yield of 10.6%. This is attractive compared to the consensus bank dividend yield of 7-8% in 2024 and 2025 for the banks included in the STOXX 600 Banks (Price) Index. Moreover, within the capital structure, the yield pickup versus Tier-2 is currently at 5.3pp, which is high compared to the 5Y average of 4.5pp. In contrast to our cautious view on HY non-financials, where we see higher refinancing risks, banks' AT1 bonds should be supported by the continued strong credit fundamentals of banks.

CHART 7: CREDIT SPREADS OF BANKS VS. NON-FINANCIAL CORPORATES

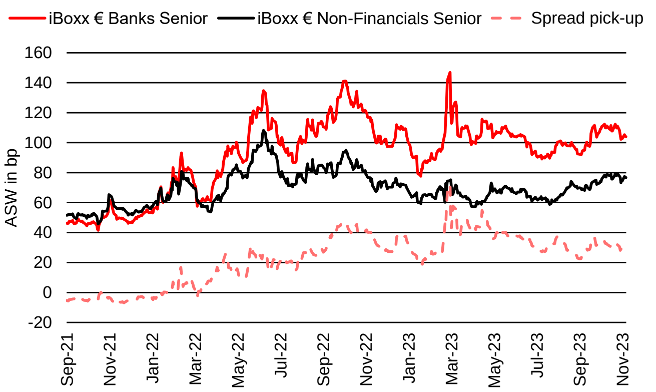
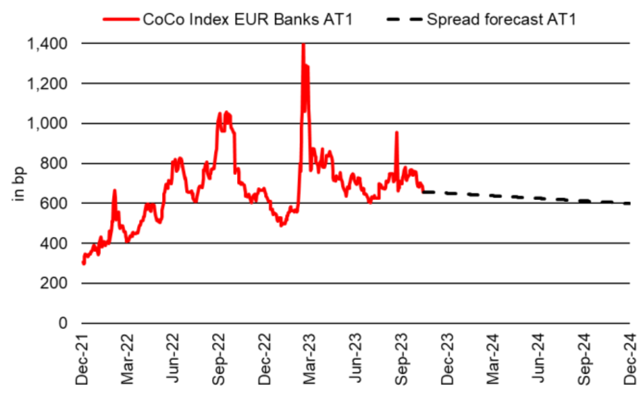


CHART 8: CREDIT SPREAD FORECAST EUR-DENOMINATED BANK AT1



Source: S&P Global, UniCredit Research

ESG: Greeniums to remain positive but face headwinds

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- After a decline in greeniums in 2H23, our forecast for a slight decline in credit spreads in 2024 should limit scope for a future rebound in the near term.
- Increasingly selective investor behavior should also prevent a sustained increase greeniums. Nevertheless, greeniums should remain positive, supported by solid investor demand for ESG investments.

Greeniums expected to stay positive but at lower levels

In 2024, we expect greeniums in most credit segments to remain positive but to stay at relatively tight levels. This implies that the valuation of ESG bonds would remain less expensive relative to standard bonds as their spreads would trade tighter to standard peers than they have during periods of greenium expansion. Greeniums have typically increased as spreads of standard bonds widen since ESG investors tend to take a longer-term orientation than standard bond investors and are less likely to sell in a market downturn. In 2024, we forecast modest spread tightening of 10bp for standard IG corporates. Tighter spreads tend to imply lower greeniums as investors should also be less willing to sacrifice spread on ESG bonds at tighter levels.

Greeniums are still present but have declined since 2H23

We believe that trend toward tighter greeniums on EGBs (Chart 9) and on corporates (Chart 10) that started in the summer is likely to persist into 2024. Investors appear to have become more selective in 2H23. As long as this more cautious approach prevails against the background of a tougher macroeconomic outlook, the valuation of ESG bonds is likely to be more closely coupled to that of standard bonds. In the corporate sector, investors' increased selectivity also appears to be linked to changes in the industry composition. Automotive and industrial companies have driven the recent high ESG issuance growth. Investors are increasingly questioning whether the green bonds and SLBs from certain issuers meet stricter environmental standards. We think that closer investor scrutiny in an environment of rising ESG bond supply will continue to contribute to an increasingly selective approach and will put some pressure on greeniums.

Greeniums likely to be supported by intact investor demand for ESG assets

Despite our expectation of sustained headwinds for greenium growth in 2024, we think that current reduced levels will also prevent any significant further decline. If greeniums were to decline meaningfully, some debut issuers might choose to forego the effort and external scrutiny associated with initiating a sustainable-bond program. Our expectation of ongoing solid investor demand for ESG assets should ultimately keep greeniums intact and provide enough of an incentive for further ESG issuance growth in 2024.

CHART 9: EGB GREENIUM AND GREEN VOLUME TRENDS

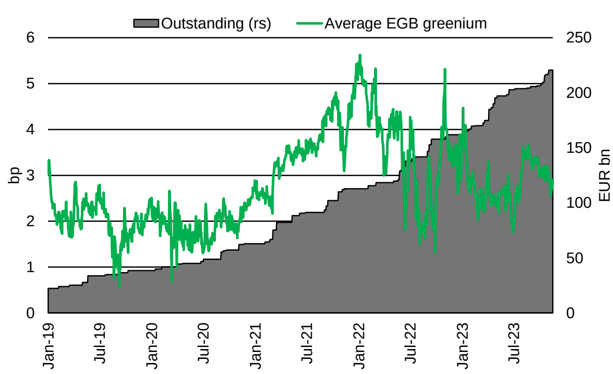
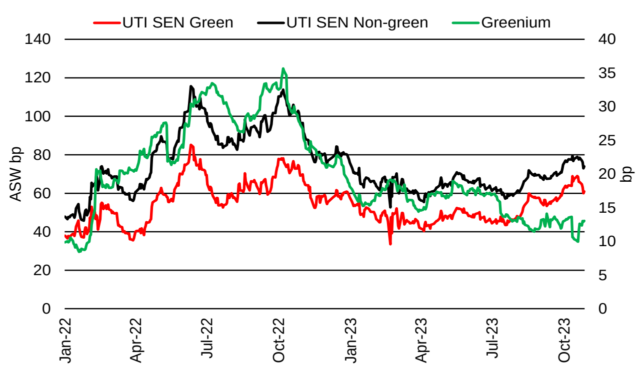


CHART 10: IBOXX BBB UTILITIES SPREAD TRENDS



Source: Eurozone debt agencies, S&P Global, UniCredit Research

Table 1: Annual macroeconomics forecasts

	GDP (%)			CPI inflation (%)*			Central Bank Rate (EoP)			Government budget balance (% GDP)			General government debt (% GDP)			Current account balance (% GDP)		
	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025
World	**3.0**	**2.7**	**3.0**	-	-		-	-	-	-	-	-	-	-	-	-	-	-
US	**2.4**	**1.0**	**1.0**	**4.1**	**2.6**	**1.8**	**5.50**	**4.25**	**3.25**	**-8.2**	**-7.4**	**-7.4**	**123.0**	**127.0**	**130.0**	**-3.0**	**-2.7**	**-2.5**
Eurozone	**0.5**	**0.5**	**1.2**	**5.5**	**2.5**	**1.8**	**4.00**	**3.25**	**2.25**	**-3.6**	**-3.2**	**-2.9**	**90.5**	**90.6**	**90.3**	**2.2**	**2.4**	**2.6**
Germany	-0.4*	0.4*	1.3	6.1	2.9	1.7	-	-	-	-2.5	-2.0	-2.0	64.8	64.6	64.7	6.5	7.0	7.5
France	0.9	0.8	1.1	4.9	2.4	1.7	-	-	-	-4.9	-4.4	-3.9	109.4	109.9	110.1	-2.3	-2.1	-1.9
Italy	0.7	0.6	1.1	5.7	2.2	1.8	-	-	-	-5.4	-4.4	-3.8	140.5	141.2	141.1	0.5	1.0	1.2
Spain	2.4	1.3	1.5	3.6	3.4	2.0	-	-	-	-4.1	-3.4	-3.0	107.2	106.6	105.9	1.8	1.4	1.3
Austria	-0.5	0.3	1.5	7.8	3.6	2.3	-	-	-	-2.8	-2.5	-2.5	76.7	76.6	76.3	1.7	1.6	2.0
Greece	2.3	1.3	1.7	3.5	2.0	1.6	-	-	-	-2.1	-1.3	-1.0	163.0	159.8	158.7	-6.9	-5.9	-4.8
Portugal	2.1	0.7	1.4	4.6	2.3	1.7	-	-	-	0.8	-0.3	-0.1	103.1	101.0	98.7	1.6	1.1	1.2
CEE																		
Poland	0.3	3.5	3.4	7.0	4.4	4.0	5.75	5.00	4.00	-5.2	-4.4	-3.6	49.4	52.0	53.6	1.0	0.6	0.5
Czechia	-0.3	2.1	2.5	7.2	3.7	2.8	6.75	4.50	3.50	-3.9	-2.8	-3.0	44.5	44.5	44.9	-0.9	0.3	0.3
Hungary	-0.7	3.3	3.8	6.6	6.5	5.9	10.75	7.00	5.00	-5.8	-4.8	-3.7	70.9	71.3	69.6	-0.3	0.5	1.8
Russia	2.5	1.3	1.3	7.3	4.1	4.0	15.50	10.50	7.00	-2.6	-3.4	-1.6	16.5	19.9	20.7	1.9	3.5	2.9
Turkey	4.2	3.0	3.9	69.0	43.0	24.0	42.00	42.00	25.00	-5.4	-5.0	-4.5	34.6	36.8	36.3	-4.6	-2.7	-2.3
Other Europe																		
UK	0.5	-0.3	0.8	7.4	3.1	1.9	5.25	4.50	2.75	-5.4	-4.5	-3.5	99.1	102.5	104.0	-3.0	-2.5	-2.7
Sweden	-0.5	0.3	1.6	6.0	2.6	1.9	4.00	3.25	2.25	-0.4	-0.6	0.2	32.3	32.6	32.2	5.3	5.4	5.2
Norway	1.3**	0.6**	1.0**	5.3	2.7	2.0	4.50	3.75	2.75	15.1	14.4	13.1	37.4	36.3	36.2	26.2	25.4	22.9
Switzerland	0.7	1.2	1.6	2.2	1.5	1.0	1.75	1.50	1.00	-0.4	0.0	0.3	41.3	41.2	40.8	8.8	9.2	9.5
Others																		
China	5.2	4.5	4.3	0.7	1.4	1.6	4.35	4.15	4.15	-7.1****	-6.9****	-6.8****	82.9	87.4	89.0	1.5	1.3	1.1
Japan	1.8	0.8	1.0	3.2	2.0	1.3	-0.10	0.00	0.00	-5.5	-4.5	-3.5	255	254	250	3.1	3.0	3.0

Source: UniCredit Research

*Annual averages, except for CEE countries, for which end-of-period numbers are used. **Non-wda figures. Adjusted for working days: -0.2% (2023), 0.4% (2024) and 1.4% (2025). ***Mainland economy figures. Overall GDP: 1.4% (2023), 0.7% (2024), 1.2% (2025). ****Official budgetary balances are adjusted according to IMF methodology to include government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

Table 2: Quarterly GDP and CPI forecasts

REAL GDP (% QOQ, SA)

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
US (non-annualized)	**1.2**	**0.3**	**0.1**	**-0.1**	**-0.1**	**0.2**	**0.3**	**0.4**	**0.4**	**0.4**
Eurozone	**-0.1**	**-0.1**	**0.1**	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.4**	**0.4**
Germany	-0.1	-0.2	0.1	0.3	0.3	0.3	0.4	0.4	0.4	0.4
France	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.4
Italy	0.0	0.0	0.1	0.3	0.3	0.2	0.3	0.3	0.3	0.3
Spain	0.3	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.5	0.5
Austria	-0.6	0.0	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4
CEE										
Poland (% yoy)	0.7	2.2	5.5	4.0	2.8	2.0	3.7	3.3	3.0	3.5
Czechia	-0.2	0.5	0.8	0.7	0.7	0.7	0.6	0.5	0.6	0.6
Hungary (% yoy)	-0.4	0.9	2.0	3.9	5.3	1.9	5.2	3.8	3.5	2.9
Russia (% yoy)	4.3	4.4	3.3	2.1	0.4	-0.5	0.1	0.9	1.8	2.6
Turkey (% yoy)	5.4	3.6	4.9	1.8	2.2	3.2	2.7	3.7	4.3	4.6
Other Europe										
UK	0.0	0.0	-0.1	-0.2	-0.2	0.2	0.3	0.3	0.3	0.3
Sweden	0.0	-0.3	0.2	0.3	0.3	0.3	0.3	0.5	0.5	0.5
Norway (mainland)	0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Switzerland	0.0	0.1	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4

CPI INFLATION (% YOY)

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
US	3.5	3.2	3.0	2.9	2.4	2.2	**1.9**	**1.7**	**1.7**	**1.8**
Eurozone	**5.0**	**2.9**	**2.8**	**2.7**	**2.2**	**2.2**	**1.9**	**1.7**	**1.7**	**1.7**
Germany	5.6	4.1	3.4	3.0	2.8	2.6	2.2	1.7	1.4	1.3
France	4.7	3.8	3.0	2.5	2.2	1.9	1.8	1.7	1.7	1.7
Italy	5.6	1.4	2.0	2.2	2.4	2.3	2.0	1.9	1.7	1.7
Spain (HICP)	2.6	4.0	4.0	3.9	2.8	2.8	2.4	2.1	1.8	1.8
Austria	6.8	5.3	4.7	3.9	3.3	2.6	2.3	2.3	2.4	2.2
CEE*										
Poland	8.2	7.0	4.4	4.2	5.4	4.4	3.1	3.5	3.9	4.0
Czechia	6.9	7.2	3.4	3.7	3.6	3.7	3.0	3.1	3.0	2.8
Hungary	12.2	6.6	6.4	7.6	6.0	6.5	5.2	6.0	5.8	5.9
Russia	6.0	7.3	7.3	6.8	5.0	4.1	3.9	3.8	3.9	4.0
Turkey	61.5	69.0	68.3	75.0	48.9	43.0	37.1	31.1	27.1	24.0
Other Europe										
UK	6.7	4.5	4.3	2.7	2.9	2.6	2.0	1.8	1.7	1.9
Sweden	5.0	3.6	2.9	2.8	2.4	2.3	2.1	1.8	1.8	1.8
Norway	4.5	3.9	3.0	2.9	2.5	2.4	2.0	1.9	1.9	2.0
Switzerland	1.6	1.8	1.6	1.3	1.5	1.6	1.2	1.2	0.9	0.6

*CEE CPI figures are end-of-period.

Source: UniCredit Research

Table 3: Oil forecasts

	Current	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
Brent (USD/bbl, average)	81	93	90	88	85	85	83	80	80

Source: Bloomberg, UniCredit Research

Table 4: Comparison of annual GDP and CPI forecasts

GDP (%)

	UniCredit			IMF (Oct-23)			European Commission (Nov-23)			OECD (Jun/Sep-23)***		
	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025
World	**3.0**	**2.7**	**3.0**	**3.0**	**2.9**	**3.2**	**3.1**	**2.9**	**3.2**	**3.0**	**2.7**	**-**
US	**2.4**	**1.0**	**1.0**	**2.1**	**1.5**	**1.8**	**2.4**	**1.4**	**1.8**	**2.2**	**1.3**	**-**
Eurozone	**0.5**	**0.5**	**1.2**	**0.7**	**1.2**	**1.8**	**0.6**	**1.2**	**1.6**	**0.6**	**1.1**	**-**
Germany	-0.4*	0.4*	1.3	-0.5	0.9	2.0	-0.3	0.8	1.2	-0.2	0.9	-
France	0.9	0.8	1.1	1.0	1.3	1.8	1.0	1.2	1.4	1.0	1.2	-
Italy	0.7	0.6	1.1	0.7	0.7	1.0	0.7	0.9	1.2	0.8	0.8	-
Spain	2.4	1.3	1.5	2.5	1.7	2.1	2.4	1.7	2.0	2.3	1.9	-
Austria	-0.5	0.3	1.5	0.1	0.8	1.7	-0.5	1.0	1.3	0.2	1.6	-
Greece	2.3	1.3	1.7	2.5	2.0	1.4	2.4	2.3	2.2	2.2	1.9	-
Portugal	2.1	0.7	1.4	2.3	1.5	2.2	2.2	1.3	1.8	2.5	1.5	-
CEE												
Poland	0.3	3.5	3.4	0.6	2.3	3.4	0.4	2.7	3.2	0.9	2.1	-
Czechia	-0.3	2.1	2.5	0.2	2.3	2.9	-0.4	1.4	3.0	0.3	2.4	-
Hungary	-0.7	3.3	3.8	-0.3	3.1	3.3	-0.7	2.4	3.6	0.0	2.5	-
Russia	2.5	1.3	1.3	2.2	1.1	1.0	2.0	1.6	1.6	0.8	0.9	-
Turkey	4.2	3.0	3.9	4.0	3.0	3.2	4.2	3.5	4.0	4.3	2.6	-
Other Europe												
UK	0.5	-0.3	0.8	0.5	0.6	2.0	0.6	0.5	1.3	0.3	0.8	-
Sweden	-0.5	0.3	1.6	-0.7	0.6	2.4	-0.5	-0.2	1.3	-0.3	1.4	-
Norway	1.3**	0.6**	1.0**	2.3	1.5	1.2	1.4	1.5	1.7	1.5	1.5	-
Switzerland	0.7	1.2	1.6	0.9	1.8	1.2	1.0	1.4	1.7	0.6	1.2	-
Others												
China	5.2	4.5	4.3	5.0	4.2	4.1	5.2	4.6	4.6	5.1	4.6	-
Japan	1.8	0.8	1.0	2.0	1.0	0.7	1.9	0.8	0.6	1.8	1.0	-

CPI INFLATION (%)****

	UniCredit			IMF (Oct-23)			European Commission (Nov-23)			OECD (Jun/Sep-23)		
	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025
US	**4.1**	**2.6**	**1.8**	**4.1**	**2.8**	**2.4**	**4.2**	**3.0**	**2.2**	**3.8**	**2.6**	**-**
Eurozone	**5.5**	**2.5**	**1.8**	**5.6**	**3.3**	**2.2**	**5.6**	**3.2**	**2.2**	**5.5**	**3.0**	**-**
Germany	6.1	2.9	1.7	6.3	3.5	2.2	6.2	3.1	2.2	6.1	3.0	-
France	4.9	2.4	1.7	5.6	2.5	2.0	5.8	3.0	2.0	5.8	2.9	-
Italy	5.7	2.2	1.8	6.0	2.6	2.2	6.1	2.7	2.3	6.1	2.5	-
Spain	3.6	3.4	2.0	3.5	3.9	2.1	3.6	3.4	2.1	3.5	3.5	-
Austria	7.8	3.6	2.3	7.8	3.7	2.5	7.7	4.1	3.0	8.0	3.9	-
Greece	3.5	2.0	1.6	4.1	2.8	2.2	4.3	2.8	2.1	3.9	3.2	-
Portugal	4.6	2.3	1.7	5.3	3.4	2.4	5.5	3.2	2.4	5.7	3.3	-
CEE												
Poland	7.0	4.4	4.0	12.0	6.4	4.5	11.1	6.2	3.8	12.4	4.8	-
Czechia	7.2	3.7	2.8	10.9	4.6	2.1	12.2	3.2	2.4	12.2	3.4	-
Hungary	6.6	6.5	5.9	17.7	6.6	4.3	17.2	5.2	4.1	19.2	5.4	-
Russia	7.3	4.1	4.0	5.3	6.3	4.0	6.0	4.6	4.0	5.3	5.2	-
Turkey	69.0	43.0	24.0	51.2	62.5	52.5	55.4	53.6	22.9	52.1	39.2	-
Other Europe												
UK	7.4	3.1	1.9	7.7	3.7	2.1	7.3	3.6	2.5	7.2	2.9	-
Sweden	6.0	2.6	1.9	6.9	3.6	2.7	5.7	1.8	2.2	7.9	2.4	-
Norway	5.3	2.7	2.0	5.8	3.7	2.6	5.6	4.5	2.9	5.4	3.5	-
Switzerland	2.2	1.5	1.0	2.2	2.0	1.7	2.2	1.7	2.0	2.4	1.2	-
Others												-
China	0.7	1.4	1.6	0.7	1.7	2.2	-	-	-	0.5	1.3	-
Japan	3.2	2.0	1.3	3.2	2.9	1.9	3.3	2.7	2.2	3.1	2.1	-

*Non-wda figures. Adjusted for working days: -0.2% (2023), 0.4% (2024) and 1.4% (2025). **Mainland economy figures. Overall GDP: 1.4% (2023), 0.7% (2024), 1.2% (2025).
***Economic Outlook (June 2023) and Interim Economic Outlook (September 2023); ****Annual averages, except for CEE countries, for which end-of-period numbers are used.
Source: IMF, European Commission, OECD, UniCredit Research

Table 5: FI forecasts

INTEREST RATE AND YIELD FORECASTS (%)

	Current	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
EMU									
Refi rate	4.50	4.50	4.25	4.00	3.75	3.50	3.25	3.00	2.75
Depo rate	4.00	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.25
3M Euribor	3.96	3.95	3.70	3.45	**3.20**	2.95	2.70	2.45	**2.20**
Euribor future		3.85	3.62	3.34	3.08	2.89	2.76	2.67	2.59
2Y Schatz	3.02	2.85	2.60	2.40	**2.20**	2.05	1.90	1.80	**1.70**
fwd		2.74	2.54	2.38	2.26	2.22	2.17	2.13	2.11
5Y Obl	2.55	2.60	2.45	2.30	2.20	2.10	2.05	2.00	1.95
10Y Bund	2.57	2.65	2.55	2.45	**2.40**	2.35	2.30	2.30	**2.30**
fwd		2.55	2.53	2.52	2.52	2.54	2.56	2.57	2.59
30Y Bund	2.75	2.80	2.80	2.80	2.80	2.85	2.85	2.85	2.90
2/10	-46	-20	-5	5	20	30	40	50	60
2/5/10	-50	-30	-25	-25	-20	-20	-10	-10	-10
10/30	18	15	25	35	40	50	55	55	60
2Y EUR swap	3.53	3.30	3.05	2.85	2.60	2.45	2.30	2.20	2.10
5Y EUR swap	3.08	3.05	2.90	2.75	2.60	2.50	2.45	2.40	2.35
10Y EUR swap	3.06	3.10	3.00	2.90	2.80	2.75	2.70	2.65	2.65
10Y BTP	4.33	4.55	4.35	4.15	4.05	3.95	3.85	3.85	3.80
US									
Fed fund	5.50	5.50	5.25	4.75	4.25	4.00	3.75	3.50	3.25
3M OIS SOFR	5.38	5.25	4.93	4.39	**4.04**	3.81	3.55	3.30	**3.04**
fwd		5.35	5.13	4.85	4.34	4.12	3.98	3.84	3.70
2Y UST	4.90	4.90	4.60	4.30	**4.00**	3.80	3.60	3.40	**3.20**
fwd		4.62	4.47	4.36	4.27	4.22	4.17	4.12	4.09
5Y UST	4.43	4.55	4.35	4.15	3.95	3.80	3.65	3.55	3.45
10Y UST	4.40	4.55	4.40	4.25	**4.15**	4.00	3.90	3.85	**3.80**
fwd		4.39	4.38	4.38	4.39	4.40	4.41	4.43	4.45
30Y UST	4.54	4.70	4.60	4.50	4.40	4.30	4.25	4.20	4.20
2/10	-50	-35	-20	-5	15	20	30	45	60
2/5/10	-44	-35	-30	-25	-25	-20	-20	-15	-10
10/30	13	15	20	25	25	30	35	35	40
2Y USD swap	4.71	4.85	4.55	4.25	3.95	3.75	3.55	3.35	3.15
10Y USD swap	4.06	4.35	4.20	4.05	3.95	3.80	3.70	3.65	3.60
UK									
Key rate	5.25	5.25	5.25	5.00	**4.50**	4.00	3.50	3.00	**2.75**

Spreads	Current	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
10Y UST-Bund	184	190	185	180	175	165	160	155	150
10Y BTP-Bund	176	190	180	170	165	160	155	155	150
10Y EUR swap-Bund	49	45	45	45	40	40	40	35	35
10Y USD swap-UST	-34	-20	-20	-20	-20	-20	-20	-20	-20

Source: Bloomberg, UniCredit Research

Table 6: FX forecasts

EUR	Current	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	*3M*	*6M*	12M
G10												
EUR-USD	1.09	1.10	1.11	1.12	**1.13**	1.13	1.14	1.14	**1.15**	1.10	1.11	1.13
EUR-CHF	0.96	0.97	0.98	0.99	**1.00**	1.00	1.01	1.01	**1.02**	0.97	0.98	1.00
EUR-GBP	0.87	0.87	0.88	0.88	**0.88**	0.89	0.91	0.93	**0.95**	0.87	0.88	0.88
EUR-JPY	163	163	162	162	**162**	160	160	158	**158**	163	162	162
EUR-NOK	11.71	11.65	11.60	11.60	**11.55**	11.55	11.50	11.50	**11.45**	11.67	11.62	11.57
EUR-SEK	11.38	11.35	11.30	11.30	**11.25**	11.25	11.20	11.20	**11.15**	11.36	11.32	11.27
EUR-AUD	1.66	1.67	1.66	1.65	**1.64**	1.61	1.61	1.58	**1.60**	1.66	1.66	1.64
EUR-NZD	1.80	1.80	1.79	1.78	**1.77**	1.74	1.73	1.70	**1.69**	1.80	1.79	1.77
EUR-CAD	1.49	1.50	1.50	1.50	**1.50**	1.49	1.49	1.48	**1.47**	1.50	1.50	1.50
EUR TWI	97.2	97.6	98.1	98.5	**100.1**	100.0	101.0	101.0	**101.9**	97.5	97.9	99.5
CEEMEA & CHINA												
EUR-PLN	4.36	4.25	4.27	4.30	4.40	4.42	4.47	4.48	**4.50**	4.29	4.26	4.37
EUR-HUF	380	385	388	392	398	404	402	406	**410**	383	387	396
EUR-CZK	24.44	25.00	25.20	25.10	25.00	25.00	25.00	25.00	**25.00**	24.81	25.13	25.03
EUR-TRY	31.55	35.42	40.52	41.10	44.64	46.90	49.02	49.59	**52.90**	34.10	38.82	43.46
EUR-RUB	96.41	103	107	112	119	127	130	131	**133**	101	106	116
EUR-CNY	7.79	7.88	7.91	7.95	7.97	7.91	7.98	7.92	**7.94**	7.85	7.90	7.96

USD	Current	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	3M	6M	12M
G10												
EUR-USD	1.09	1.10	1.11	1.12	**1.13**	1.13	1.14	1.14	**1.15**	1.10	1.11	1.13
USD-CHF	0.88	0.88	0.88	0.88	**0.88**	0.88	0.89	0.89	**0.89**	0.88	0.88	0.88
GBP-USD	1.25	1.26	1.26	1.27	**1.28**	1.27	1.25	1.23	**1.21**	1.26	1.26	1.28
USD-JPY	149	148	146	145	**143**	142	140	139	**137**	148	147	144
USD-NOK	10.73	10.59	10.45	10.36	**10.22**	10.22	10.09	10.09	**9.96**	10.64	10.50	10.27
USD-SEK	10.43	10.32	10.18	10.09	**9.96**	9.96	9.82	9.82	**9.70**	10.36	10.23	10.00
AUD-USD	0.66	0.66	0.67	0.68	**0.69**	0.70	0.71	0.72	**0.72**	0.66	0.67	0.69
NZD-USD	0.61	0.61	0.62	0.63	**0.64**	0.65	0.66	0.67	**0.68**	0.61	0.62	0.64
USD-CAD	1.37	1.36	1.35	1.34	**1.33**	1.32	1.31	1.30	**1.28**	1.36	1.35	1.33
USTW$	90.8	97.1	96.3	95.6	**94.7**	94.5	93.9	93.7	**93.0**	95.0	96.6	95.0
DXY	103.7	103.1	102.2	101.4	**100.4**	100.3	99.7	99.7	**99.0**	103.3	102.5	100.7
CEEMEA & CHINA												
USD-PLN	4.00	3.86	3.85	3.84	**3.89**	3.91	3.92	3.93	**3.91**	3.91	3.85	3.87
USD-HUF	349	350	350	350	**352**	358	353	356	**357**	350	350	351
USD-CZK	22.40	22.70	22.70	22.40	**22.10**	22.10	21.90	21.90	**21.70**	22.60	22.70	22.20
USD-TRY	28.86	32.20	36.50	36.70	**39.50**	41.50	43.00	43.50	**46.00**	31.09	35.07	38.57
USD-RUB	88.49	94.00	96.00	100.00	**105.00**	112.50	114.00	115.00	**116.00**	92.16	95.33	103.33
USD-CNY	7.14	7.16	7.13	7.10	**7.05**	7.00	7.00	6.95	**6.90**	7.15	7.14	7.07

Forecasts are end of period.

Source: Bloomberg, UniCredit Research

Table 7: Risky assets forecasts

EQUITY AND CREDIT FORECASTS

	Current	Mid-2024	End-2024
Equities			
Euro STOXX 50	4,352	4450	4700
STOXX Europe 600	457	470	500
DAX	15,957	16300	17300
MSCI Italy	75.3	78	82
S&P 500	4,556	4700	5000
Nasdaq 100	16001	16500	18000
Credit			
iBoxx Non-Financials Sen	77	80	70
iBoxx Banks Sen	104	100	95
iBoxx High Yield NFI	331	400	370

Source: Bloomberg, IHS Markit, UniCredit Research

EQUITY SECTOR ALLOCATION WESTERN EUROPE

STOXX Europe 600 Sector	Portfolio weight over/underweight – (% points)	Portfolio position (%)	Strength of over/underweight in % of sector weight
Automobiles & Parts	0	2.6	0
Banks	0	9.3	0
Basic Resources	0.5	2.9	21
Chemicals	0.5	3.2	18
Construction & Materials	-0.5	3.4	-13
Consumer Products & Services	1	8.0	14
Energy	-1.5	3.6	-29
Financial Services	0	3.8	0
Food, Beverage & Tobacco	0	6.4	0
Health Care	0	16.1	0
Industrial Goods & Services	1	14.6	7
Insurance	0.5	6.2	9
Media	0	1.6	0
Personal Care, Drug & Grocery Stores	0.5	2.8	22
Real Estate	-0.5	0.9	-36
Retail	0.5	1.4	55
Technology	1	7.8	15
Telecommunications	-1	1.8	-36
Travel & Leisure	-0.5	0.7	-40
Utilities	-1.5	2.7	-36

Source: STOXX Ltd., UniCredit Research

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E 20/1

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M/S 23/4

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