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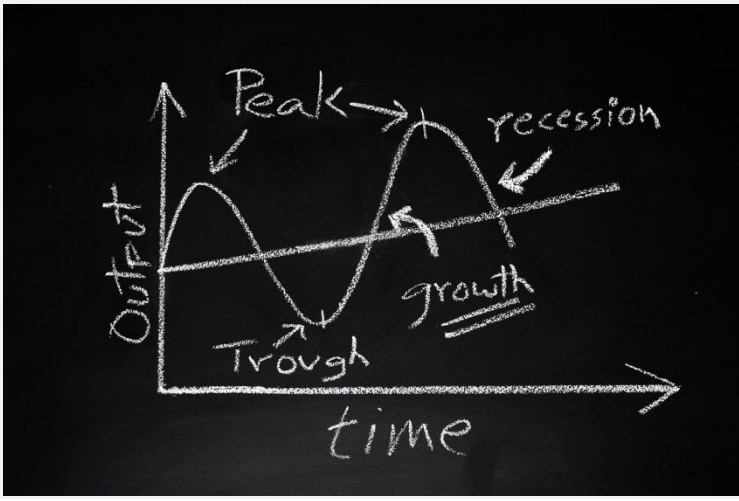
CREDITREFORM ECONOMIC BRIEFS

Inching towards a turning monetary policy cycle

March 2024



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Key Take-Aways

1. We have revised down our forecast for the **euro area's real GDP to 0.6% in 2024,** on the back of lowered growth expectations mainly for Germany amid a delayed gradual recovery. Private consumption should start to recover in the course of the year, supported by labor market and wage developments as well as by lower inflation. The expected turning monetary policy cycle should enable further revitalizing of domestic demand next year. We project euro area economic output to **increase by 1.4%, in 2025**.
2. Both euro area headline inflation as well as core inflation remain on a downward trend, although core inflation has been somewhat stickier; we now expect **a first cut in the ECB's key policy rates this June** and anticipate the **main refinancing rate to stand at 3.75% at the end of 2024**.
3. Notwithstanding progress, **fiscal consolidation in the EU continues to face headwinds** by higher financing costs, climate policies and in part by a greater extent of political fragmentation. A **reformed EU fiscal governance framework** is in the advanced stages of the EU legislative process. The provisions aim to maintain incentives for fiscal discipline while taking into account the individual fiscal positions of the EU members to a larger extent. They are envisaged to take effect this year and to be applied to the 2025 budget planning.
4. We have **markedly cut our German real GDP forecast for 2024 to 0.1%,** thus near-stagnation, in light of protracted economic weakness in the winter half year 2023/2024. Amid a pushed-back recovery, we expect **real GDP to grow by 1.2% in 2025**, supported by recovering private consumption. While construction investment likely remains severely hampered in 2024, easing monetary policy could bring some improvement in 2025, also with a view to net exports. The **number of German business defaults looks set to rise further** in the near term, while pressure should start to ease next year.
5. Fading inflationary pressure in the **UK** will likely translate into an **easing monetary policy stance this year**, supporting a gradual recovery in domestic demand, which could also benefit from recently announced additional relief for private households. We expect **the UK GDP to increase only slightly by 0.3% in 2024,** representing a lowering of previous forecasts, and to **accelerate to 1.4% in 2025**. We now assume a **cut in the Bank of England's policy rate by 75bp by the end of the year, starting from June**. Whilst the housing market is continuing to cool, we think that the anticipated turning monetary policy tide will limit the downturn. A conceivable change in government following the upcoming parliamentary election impairs visibility of the UK's medium-term fiscal course.
6. **US** inflation continues to trend downwards, and real **economic activity has by and large expanded solidly** with robust employment, maintaining expectations for a soft landing. The Fed has paused its hiking cycle since September. Our main scenario foresees a **first cut in the Federal fund rate to take place this June.**

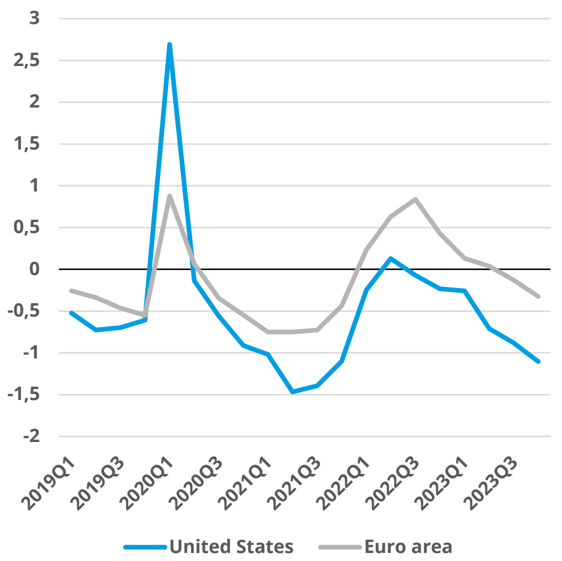
1. World

Broader-based geopolitical tensions pose risks to the disinflationary process

The global economy remains caught between uncertainty linked to geopolitical risks and the prospect of a shift in monetary policy by major central banks in the course of the year. The disinflationary progress is making headway on a broader basis, but remains subject to some noise. On a positive note, monetary policy rate cut expectations and associated increased demand of riskier assets have spurred an easing of financial conditions (see Figure **1**).

Figure 1: IMF financial conditions indices, based on a set of 10 financial indicators, raise hopes for a soft landing

Standard deviations from the mean; negative values: easing financial conditions; Q4-23: proxy value;



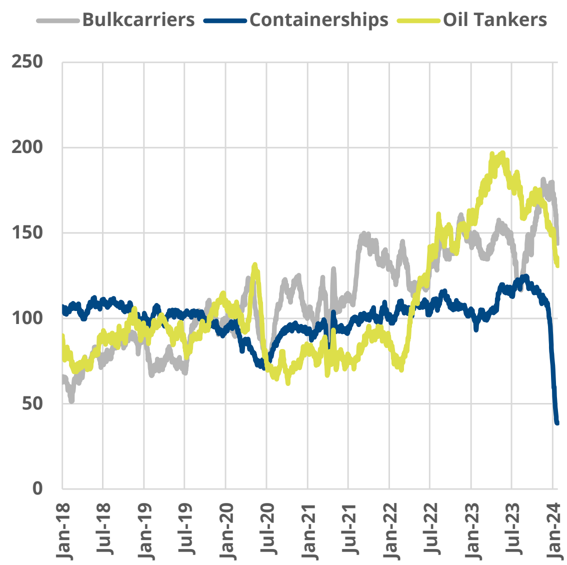
Sources: IMF World Economic Outlook Update, January 2024, Creditreform Rating

The IMF slightly increased its 2024 global GDP growth forecasts in the January 2024 update of its World Economic Outlook, now expecting 3.1% for 2024 and 3.2% for 2025, after an estimated 3.1% for 2023. Nevertheless, expected growth rates remain rather moderate compared to the longer-term average.

Apart from potential further escalation of the wars in Ukraine and the Middle East, rebel attacks on ships in the Red Sea, a vital global transport route, highlight global vulnerabilities to disruption of trade flows, causing longer delivery times and underscoring risks for renewed price spikes. Roughly 12% of global trade passes through the Red Sea and the Suez Canal (see Figure **2**). Commodity prices, in particular prices for energy commodities, remain vulnerable to risks linked to the tensions in the Middle East.

Figure 2: Forced to re-route

Daily transits through the Suez Canal, 28-day rolling average, index, average = 100



Sources: UNCTAD, Creditreform Rating

Several elections in 2024 could additionally bring different spins into challenging geo-economic circumstances. The result of the US election later this year could further complicate the delicate situation of international political relations and put additional pressure on European public finances. There are already signs that the US may drastically cut financial support to Ukraine, increasing the pressure on Europe to further step up defense spending.

In the context of joint defense, the European Commission has put forward initial steps of a proposal for a European defense industrial strategy, with dedicated funding in the amount of EUR 1.5bn over the period 2025-2027. Targets set out by the strategy would include that EU members should buy at least 40% of the defense equipment by working together and spend at least half of their defense procurement budget on products made in Europe.

Chinese economy resilient at face value, and likely to see growth rates edge down

The slightly upgraded global GDP growth expectation expressed by the IMF for 2024 also reflects an increase regarding China's assumed GDP expansion this year, now projected to come to 4.6% in 2024 and 4.1% in 2025, following an official expansion of 5.2% in 2023, which slightly surpassed the government's target for last year. In the fourth quarter of 2023, real GDP had reportedly risen by 1.0% q-o-q, showing robustness, following upward-revised economic growth in Q3-2023. The new growth target for 2024, presented at the National People's Congress held from 5 March, is set at 'around 5%'. Moreover, the defense budget is to be increased by 7.2%.

This February, the People's Bank of China cut its benchmark five-year loan prime rate (LPR) by 0.25 percentage points to 3.95%, the largest reduction since its introduction in 2019, flanking targeted government measures to support the property sector. While government expenditure and partly looser monetary policy should act as stabilizing factors to domestic demand, downside risks to the economic development from China's real estate sector are likely to persist. Tensions with Taiwan will have to be monitored as well, not least since Taiwan's newly elected president advocates a course geared towards differentiation from China.

US central bank in no hurry to cut policy rates

US GDP growth has remained solid, with the quarter-on-quarter increase moderating somewhat to 0.8% in the final quarter of 2023, after an annualized expansion of 1.2% in Q3-2023. In 2023 as a whole, total economic output thus rose by 2.5%. With sentiment indicators such as the Purchasing Manager Indices (PMI) and consumer confidence partly showing brightening tendencies, and the labor market holding up well, the Federal Reserve may not be in a hurry to lower its policy rate, although the US inflation rate remains on a declining trend. In January, CPI inflation reached 3.1%, with the core rate (excluding food and energy) continuing to move on a slightly higher level, posting at 3.9% in January.

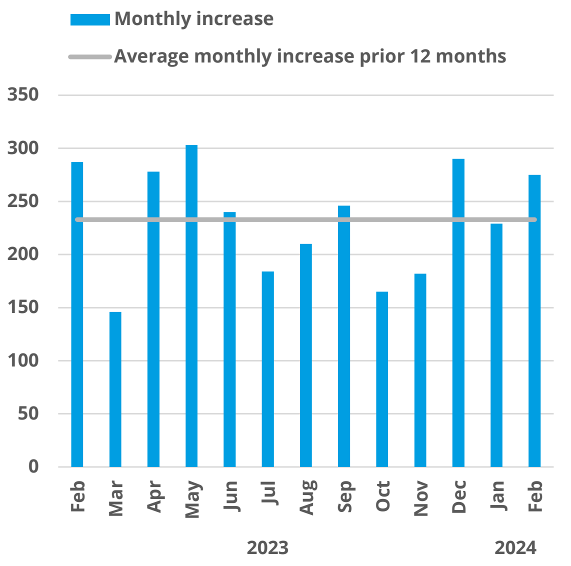
The Purchasing Manager Index (PMI) for the manufacturing sector remains below the 50-point threshold indicating a decline in economic activity. At 47.8 points this February, it decreased again after a two-point increase to 49.1 in January. The respective indicator for the service sector decreased to 52.6 points in February, hinting at overall solid growth at the beginning of the year 2024.

On the US labor market, job creation has shown an accelerating tendency around the turn of the year 2023/2024, with total nonfarm payroll employment rising by 275,000 persons in February (Jan: 229,000), compared to an average monthly increase of 233,000 in the 12 months to February 2024 (see Figure **3**). The unemployment rate increased to a still low 3.9% in February. Drawing on recent IMF forecasts, the US economy could see growth moderating to 2.1% this year and 1.7% in 2025.

Against this backdrop, the Federal Open Market Committee (FOMC) kept the federal funds rate stable at 5.25-5.50% in a unanimous decision at its latest meeting ending on 31 January. Contrary to the meeting in December 2023, when it expressed preparedness to tighten policy further if appropriate, it now hints at the next step being a reduction. However, the Committee wishes to gain greater confidence that inflation is moving sustainably toward the 2% target. The FOMC's most recent inflation projections (personal consumption expenditure inflation, median forecast, December 2023) were 2.4% for 2024, 2.2% for 2025 and 2.0% for 2026, with the forecasts for 2024 and 2025 slightly lower than before.

Figure 3: US labor market showing resilience

Monthly increases in non-farm payrolls, thousand persons



Sources: BLS, Creditreform Rating

Our baseline scenario remains that the policy rate has peaked. In the absence of any major commodity price shocks and major adverse developments on the geopolitical stage, we think it likely that a first cut will occur around the middle of the year. With a possible first reduction of the monetary policy rate in June 2024, we expect the Fed funds rate to be lowered by 75 basis points by the end of the year.

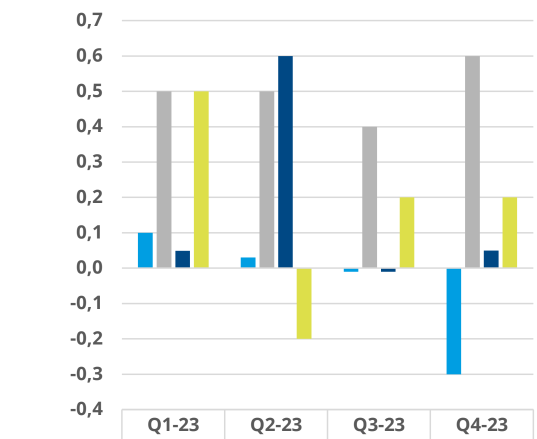
2. **Euro area**

Lackluster start into 2024

Real economic activity in the euro area has remained largely stagnant in the course of 2023. The real GDP growth rate for the whole year (0.4%) was mainly a result of a positive carry-over effect from the previous year. In fact, the GDP only stagnated in Q4-2023, following a slight decline of -0.1% q-o-q in last year's third quarter. Among the four largest euro area economies the Spanish economy continues to stick out positively, with robust positive quarterly growth all throughout last year. By contrast, Germany's weak economic performance posed a drag to the euro area GDP outcome, whilst France's total economic output exhibited stagnation or near-stagnation in three of the four quarters last year. Italy posted modest quarterly growth in the second half of 2023, with its GDP expanding by 0.2% q-o-q in Q3 and Q4-2023 (see Figure **4**).

Figure 4: Diversity in practice

Real GDP q-o-q growth in percent



	Q1-23	Q2-23	Q3-23	Q4-23
Germany	0,1	0,0	0,0	-0,3
Spain	0,5	0,5	0,4	0,6
France	0,0	0,6	0,0	0,1
Italy	0,5	-0,2	0,2	0,2

Sources: Eurostat, Creditreform Rating

Pointing to a less gloomy near-term outlook, the euro area Composite PMI improved further to 49.2 points in February, marking an eight-month high. While the composite indicator thus remained below the 50-point threshold associated with economic growth, the PMI for the service sector climbed to 50.2 points. The European Commission's Economic Sentiment Indicators broadly mirror an ongoing performance gap between the service sector and manufacturing. They also illustrate a downbeat mood in the retail sector as well as among consumers.

Expected pick-up in the later year, pushed back yet again

That said, with inflation rates retreating and labor markets showing relative stability, private consumption should pick up in the course of the year. Strong wage growth and remaining fiscal support at least over the first few months of the year support positive prospects as well. The monthly unemployment rate in the euro area as a whole stood at a low 6.4% in January 2024. Employment growth has displayed some slowdown, but still posted at a healthy 1.2% y-o-y in the fourth quarter of 2023.

EU financing or co-financing of investment through the Recovery and Resilience Facility (RRF), which is linked to the implementation of reforms and measures included in the national Recovery and Resilience Plans (RRP) of the EU members, remains a supportive pillar to gross fixed capital formation (see Figure **5**).

Figure 5: Southern European countries making good use of the EU Recovery and Resilience Facility

Number of disbursements of RRF grants by EU country, as of 27 February 2024

4th payment	IT, PT
3rd payment	EL, ES, HR, SK
2nd payment	FR, SI, RO
1st payment	AT, BG, CY, CZ, DE, DK, EE, LT, LU, LV, MT
Pre-financing only	BE, FI, HU, PL
No disbursement	IE, NL, SE

Sources: European Commission, Creditreform Rating

With regard to net exports, we anticipate a slightly negative impact on GDP growth for the current year, not least as private consumption should pick up and bolster import demand. The complex geopolitical situation and related uncertainty looks set to remain a downside risk to export growth of the euro area. On the other hand, as 2024 progresses, foreign demand could start to set some impulses amid the assumed beginning of monetary policy loosening in the euro area and in the US.

Overall, we forecast euro area real GDP to experience lackluster growth of 0.6% in 2024. Compared to our forecasts in the previous issue of the Economic Briefs (November 2023), we revised our projection for 2024 downwards, chiefly on account of weaker expectations for the German economic output, but also for the French economy. Euro area GDP growth should pick up to 1.4% in 2025, as domestic demand should benefit from lower inflation rates and the assumed monetary policy easing. Net exports could exert a moderately positive effect as well.

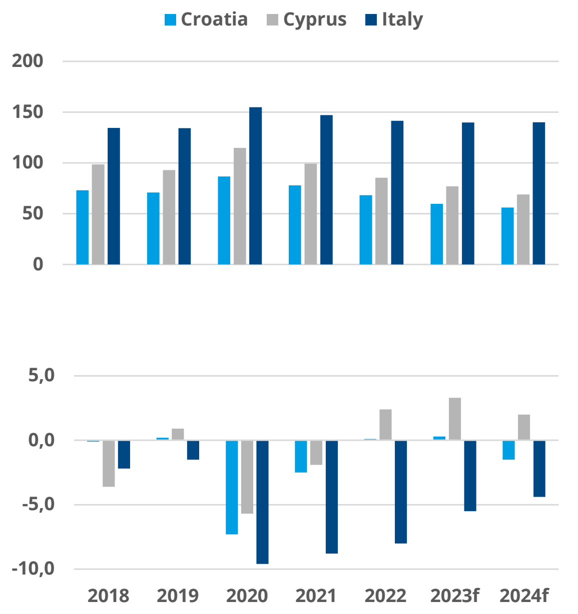
Recent rating activities: Positive rating actions regarding Italy, Cyprus and Croatia

Since our last Economic Briefs, we have, among other things, raised the outlook on Italy to "positive" from "stable" this January, whilst affirming the unsolicited long-term sovereign rating of "BBB-". Reasons for the improved outlook include our firming expectation of a more constructive medium-term growth outlook on the back of the recent acceleration in RRP disbursements and significant progress in terms of diversification of energy import sources. The positive outlook also reflects our perception of a relatively stable political constellation at present, which we assume to be conducive to fiscal planning and further reform implementation. Based on the above and amid increasing resilience of the banking sector, the revised outlook is also supported by strengthening confidence regarding a more benign debt trend beyond the short term.

In February, we have raised Cyprus' unsolicited long-term sovereign rating to "BBB+" from "BBB" and lifted its outlook to "positive". Among others, the rating upgrade reflects marked outperformance of fiscal expectations which have contributed to a rapid reduction of the debt-to-GDP ratio (see Figure **6**), as well as further progress in reducing vulnerabilities in the banking sector and the impression of strengthening economic resilience, reflected in recent stronger-than-expected economic growth performance. Reasons for a more positive outlook include expectations for a solid medium-term growth outlook, favorable prospects regarding a further significant decrease in debt-to-GDP and ongoing reduction of vulnerabilities in the banking sector.

Figure 6: Partly moderating fiscal risks contributing to recent rating actions in our "BBB" basket

Above: General government debt in % of GDP, below: General government balance in % of GDP; values for 2023 and 2024: Creditreform Rating forecast



Sources: Eurostat, Creditreform Rating

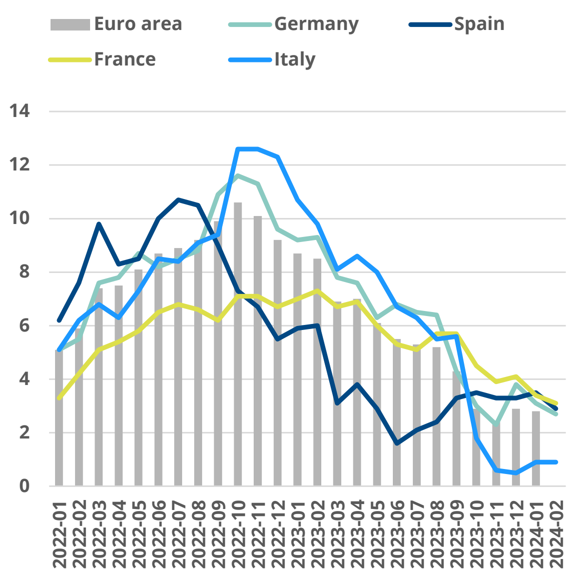
We have also [upgraded Croatia's unsolicited long-term sovereign rating to "BBB+" from "BBB", as well as raised the outlook to "positive"](). Croatia's rating upgrade came on the back of its robust economic recovery and outperformance of growth expectations, which has led to a significant increase in its per capita income. Further reasons include its progress in terms of RRP implementation and related disbursements of EU funds, as well as its repeated outperformance of public finance targets, which supported a faster-than-expected decline of its debt-to-GDP ratio. The outlook revision to "positive" is due to favorable prospects for medium-term growth on the back of EU funds and tourism, which should foster the convergence process towards EU income levels, the expected strengthening of the institutional framework amid progressing RRP implementation and the expected continued downward trajectory of its debt-to-GDP ratio

Inflation rates on a bumpy downward trend

The euro area inflation rate, meanwhile, has trended downwards to 2.6% as of February (preliminary), with recent volatility partly owing to base effects from expiring VAT relief and other policy support measures. Lower energy prices remain the major source for retreating inflation rates, while service price inflation proves stickier. Nevertheless, the core inflation rate, i.e. excluding energy, food, alcohol and tobacco, has slowed to 3.1% as of February (see Figure **7**).

Figure 7: Heterogeneous inflation picture, but trending downwards following peak in 2022

HICP inflation rates, in %



Sources: Eurostat, Creditreform Rating

The March 2024 macroeconomic projections published with the ECB Governing Council's decision to maintain the policy rates at their current level display a slightly lower inflation profile than in December 2023, with the HICP inflation rate expected to average 2.3% in 2024, 2.0% in 2025 and 1.9% in 2026.

What is more, core inflation projections were lowered to 2.6% in 2024, 2.1% for 2025 and 2.0% for 2026.

First ECB rate cut in the middle of the year

Whilst the ECB's most recent inflation projections thus suggest a drifting of the inflation rate towards the desired territory, and despite single ECB Governing Council members making a case for immediate rate cuts, the Council as a whole continues to put emphasis on "sufficiently restrictive levels for as long as necessary" regarding its policy rates. While the lowered inflation projections seem to lay a foundation for an approaching first interest rate cut, the ECB still stressed high domestic price pressure, partly boosted by wage growth, which could suggest that at least April may be seen as too early for a first interest rate reduction.

We think that a first rate cut around the middle of 2024 is a more likely scenario, also given some inflation volatility lately. From its current level of 4.50%, we expect the main refinancing rate to be lowered in June 2024 for the first time, by 25 basis points. At the end of 2024, we anticipate the respective rate to stand at 3.75%. Meanwhile, the unwinding of the APP portfolio continues to proceed as planned, and the ECB intends to discontinue reinvestments under the PEPP at the end of 2024.

Looking at the ECB's most recent Bank Lending Survey (BLS), referring to Q4-2023, credit standards for loans to firms tightened moderately further, mainly due to banks' higher risk perceptions, and more tightening is expected in Q1-2024. Loan demand declined again markedly on the back of high interest rates, lower financing needs for fixed investment by firms, subdued consumer confidence and weaker housing markets. Additionally weighing on the abovementioned expected weakness in construction investment, the survey also hints at a particularly strong tightening of bank lending conditions in real estate and in the construction sector.

We remain vigilant to developments as regards the private sector's ability to service its debt, including corporate insolvencies and housing market developments. Since our last Economic Briefs, macroprudential measures were intensified again to bolster shock-absorbing capacities particularly in the banking sectors.

Fiscal consolidation in the EU: New governance framework to address emerging challenges

The process of debt consolidation after the corona pandemic remains challenging in view of financing needs arising from the complex geopolitical developments, climate policies and the impression of a higher degree of domestic political fragmentation, with the above issues partly adding to difficulties regarding the formation of stable government coalitions in many European countries.

In December 2023, a political agreement on the legislative package to reform economic governance, including fiscal rules, was reached among the EU finance ministers. As a main new feature under the reform, a differentiated approach is to be taken towards each member state to take account of the heterogeneity of fiscal positions, public debt and economic challenges across the EU. The new framework thus is to allow multi-annual country-specific fiscal trajectories for each member state.

The agreement also includes safeguards linked to benchmark thresholds for all countries, to ensure an effective average annual reduction of one percentage point in the public debt ratio for countries with debt above 90% and 0.5 percentage points for countries with debt ratios between 60% and 90%. In a bid to protect investment capacity, the rules also provide for a transitional regime until 2027, intended to soften the impact of the higher interest burden amid tighter capital market conditions.

The trilogue negotiations on a coordinated draft law between the Council of the European Union, the European Parliament and the European Commission are under way, with the aim of adopting the legislative package at the end of April 2024. According to plans, the legislative package would thus enter into force in 2024, with effect from the 2025 budget planning.

3. Germany

Recovery further delayed

Germany's economy remained in recessionary territory at the end of last year, with a 0.3% q-o-q decline in economic output in the fourth quarter, on the heels of stagnation in Q2 and Q3-2023. A series of strike actions in various sectors is likely to have further hampered the economic output in 2023 to some extent. Germany's overall real GDP fell by 0.3% last year, representing the weakest outcome among the four largest euro area economies.

Private consumption fell by 0.8% in 2023, in light of high inflation rates. Amid expiring pandemic spending, government consumption also posted a decline last year. Mainly dragged down by falling construction investment, gross fixed capital formation likewise recorded a decline, by 0.3%. An expansion of investment in machinery and equipment of 3.0%, partly driven by the automotive sector, in turn boosted by temporary incentives in place until August 2023, was ultimately not sufficient to compensate for the declines in other investment categories. Due to the weakness in domestic demand, which was also reflected in a stronger decline in imports compared to the decline in exports, the growth contribution of net exports was positive (0.6 percentage points) (see Figure **8**).

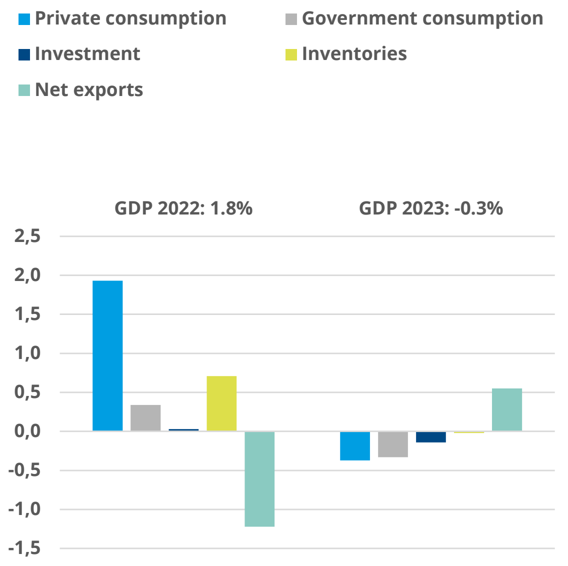
Optimism in short supply at the beginning of 2024

Sentiment indicators for the current quarter point to a continuation of the weak streak, and repeated strike action in a number of industries does little to change estimates of another feeble GDP outcome in Q1-2024. Following two consecutive declines, the ifo business climate has slightly improved in February, with the sub-indicator capturing companies' expectations for the next six months rising and the sub-indicator gauging their assessment of the current situation remaining stable.

The breakdown of the business climate indicator by sectors displays a picture of ongoing gloom in the construction industry, while pessimism among companies in the trade sector also remains pronounced, having increased in each of the three months to February. Pessimism among companies in the manufacturing sector seems less widespread compared to the above two sectors, while business sentiment in the service sector remains markedly more upbeat overall.

Figure 8: Broad-based weakness in domestic demand in 2023

Contribution to annual German GDP growth by main expenditure components, in percentage points



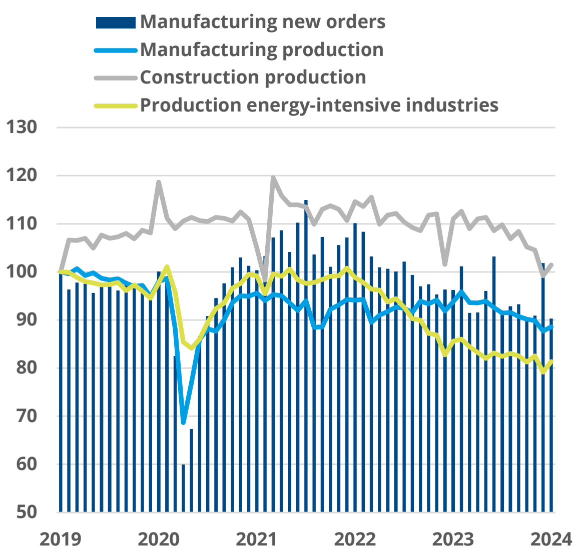
Sources: Eurostat, Creditreform Rating

Judging by the consumer confidence indicator compiled by GfK/NIM, a slightly more optimistic mood towards the end of last year has taken a hit at the beginning of 2024, although the indicator recovered partly in February. An early end to the electricity and gas price breaks for private households in a bid to put budgetary plans on sounder footing following the German Constitutional Court's decision in November, which limits the use of special-purpose funds, has likely played a role here. Moreover, the so-called environmental bonus for electric vehicles was terminated early, ending in 2023 instead of December 2024. Expectations for an imminent recovery of private consumption as inflation rates are decreasing may have to be tamed somewhat against this backdrop.

Elsewhere, the downward trend in new manufacturing orders may have come to halt recently. Looking at the three-month on three-month comparison of data available until January 2024, which smooths out pronounced volatility, new orders were 2.3% higher over November to January 2024 than in the preceding three-month period (Aug-Oct 2023). This could at least signal an approaching end of the negative trend in industrial production. Applying the respective three-month on three-month comparison to industrial production data, production declined by 1.5% in the period from November to January 2024 (see Figure **9**).

Figure 9: Energy-intensive production and construction remain a drag, but may be bottoming out

Indexed, January 2019 = 100



Sources: Destatis, Creditreform Rating

The weekly activity indicator provided by Bundesbank hints at a similarly unfavorable picture for the first quarter of 2024. The implied GDP growth rate for the 13 weeks up to 3 March compared with the preceding 13 weeks would be -0.1%, based on this metric.

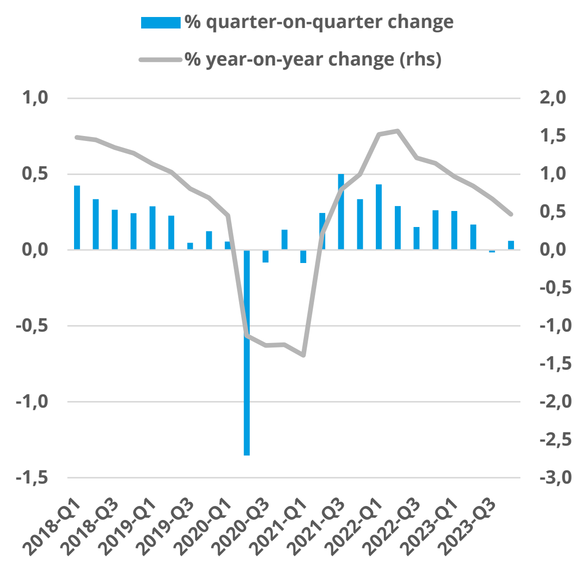
Growth forecast for 2024 revised down

Despite the setback to consumer confidence in early 2024, we continue to expect private consumption to accelerate over the course of the year, supported by lower inflation rates, strong nominal wage growth and a relatively stable labor market. In 2023 as a whole, nominal wages rose by 6.0%, while real wages were only up by 0.1% due to high inflation. However, as of Q4-2023, the increase in real wages has strengthened to 1.8% y-o-y, continuing a positive trend.

Germany's labor market has remained broadly stable, with the monthly unemployment rate standing at a very low 3.1% in January 2024. Quarter-on-quarter employment growth has slowed down in the second half of 2023. However, at 0.5% as of Q4-2023, annual employment growth was still positive (see Figure **10**). A protracted phase of economic weakness would eventually be reflected on the labor market as well.

Figure 10: Slowing employment dynamics

Total German employment, domestic concept



Sources: Eurostat, Creditreform Rating

Drawing on the ifo employment barometer, which declined in January and February, companies have become less inclined to hire lately. This also holds for the service sector, although ultimately service companies are still willing to add to staff, in particular regarding IT and consulting services. At 3.9% as of Q4-2023, despite some decrease, the vacancy rate still stood at an elevated level, also comparing high among the euro area members, suggesting that upward pressure on wages in a number of industries affected by skill shortages is likely to remain high.

Construction investment is likely to weigh on GDP growth in the near term, although expected monetary policy easing later in the year could lay the ground for more positive developments in 2025. We continue to expect equipment investment to expand moderately, with government spending on defense equipment contributing positively, taking into account increased pressure from geopolitical developments to step up defense spending.

We stick with our assumption that German real exports will see a moderate increase this year, as economic growth in the euro area and other major export destinations should pick up somewhat or remain relatively robust. Having said that, export expectations captured by the respective ifo indicator do not yet point to an acceleration. Prospects for rate cuts among key central banks in the course of the year would add to reasons for a brightening export outlook, though. Apart from that, EU funding linked to the Recovery and Resilience Facility is likely to continue to act as support to demand from EU members.

However, acting as a counterweight, risks for renewed price spikes regarding commodities and other goods remain pronounced, and have been added to by the disruptions in the Red Sea. In light of our expectations for domestic demand to pick up somewhat, impulses on GDP growth from net exports remain rather unlikely in 2024 as a whole.

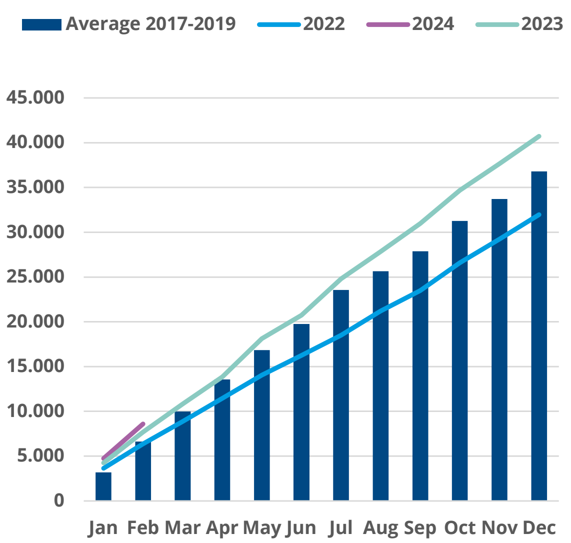
Overall, we forecast Germany's real GDP to edge up by 0.1% in 2024 as a whole, which represents a marked downward revision compared to our last Economic Briefs. For 2025, we expect total output to grow by 1.2%, as we assume an improvement regarding construction investment and a moderately positive contribution from net exports. Uncertainty around the forecasts remains high, with downside risks still dominating in our view. These continue to relate to a considerable degree to developments linked to the war in Ukraine and tensions in the wider Middle East, including potential disruptions to supply chains and possible price spikes.

Feeling the pinch: Business defaults going up

The number of German companies that have defaulted has continued to climb over 2023 (see Figure 11). We measure corporate default rates based on a Basel-compliant definition of the default event, which not only includes corporate bankruptcies but also payment delays of more than 90 days. The results are empirical default rates rather than extrapolations or estimates, due to our comprehensive database of roughly 2.5 million economically active companies, equivalent to a complete survey of the German corporate sector.

Figure 11: Defaults remain on the rise

Cumulative number of corporate defaults in Germany



Source: Eurostat, Creditreform Rating

By December 2023, a total of 40,717 companies have defaulted according to this definition, corresponding to an increase of 27.4% compared to 2022. In the years 2017-2019, hence prior to the pandemic, we recorded an annual average of 36,794 companies defaulting.

We think that defaults will continue their rising tendency this year, and likely in 2025, although the outlook should improve somewhat on the back of the expected rate-cutting cycle starting from around mid-2024. While debt servicing costs would likely remain relatively high, pressure should start to ease in the course of next year.

4. United Kingdom

UK economy may turn the corner after a technical recession in the second half of 2023

On 1 March 2024, we have affirmed the UK's sovereign rating at "AA", as well as the negative rating outlook. The latter reflects in particular elevated uncertainty over fiscal consolidation in the medium term, given still subdued economic growth prospects amid geopolitical risks, impaired visibility over policy priorities after this year's election and elevated interest outlays.

The UK economy entered a recessionary phase in the second half of 2023, falling by 0.3% q-o-q in the fourth quarter, following a decline by 0.1% in Q3-2023. Private household expenditure, government consumption and net trade all fell in last year's final quarter, whilst gross fixed capital formation registered an increase.

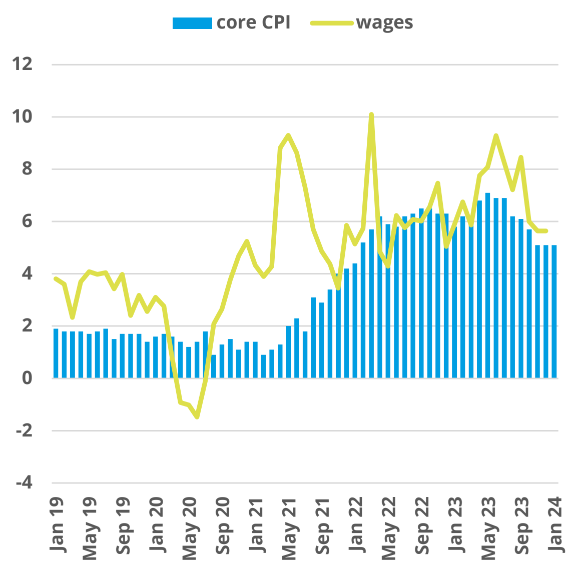
In 2023 as a whole, total output has little more than stagnated, recording an increase by 0.1%, after growing by 4.3% in 2022. Economic output in the service sector is estimated to have fallen in three consecutive quarters through the end of 2023.

Current sentiment indicators suggest that economic activity may have troughed, but we still expect some further unfolding of negative effects of the higher interest-rate environment on domestic demand in 2024. The PMI for the service sector in February continued to move well in expansionary territory, at 53.8 points. While the respective PMIs for the manufacturing sector remained in contractionary territory, it saw a slight increase in February. That said, supply chain bottlenecks linked to attacks on ships in the Red Sea pose challenges and add to production costs at the current juncture.

Likely spurred by retreating inflation rates, consumer confidence as captured by the GfK indicator climbed to its highest level in two years in January, backing expectations for a pick-up in private consumption during the course of the year. However, it dipped by two points in February. The UK CPI stood at 4.0% in January 2024, after peaking at 11.1% in October 2022, dragged down largely by lower prices for energy. The core rate remains higher than that, but has also edged down, posting at 5.1% this January (see Figure **12**).

Figure 12: Core inflation proves sticky

Core CPI inflation in %; average weekly earnings whole economy, % y-o-y



Sources: ONS, Creditreform Rating

Unemployment still very low, wage growth only slightly moderating

Despite decreasing somewhat, growth in average weekly earnings remains strong, and is likely to support household expenditure, as real incomes are starting to rise. The national living wage will be lifted significantly from April 2024. Moreover, the spring budget presented by the finance minister on 6 March came with some further relief for private households from April, mainly via another cut to national insurance contribution rates, which softens a tightening effect from previous decisions on freezing income tax thresholds.

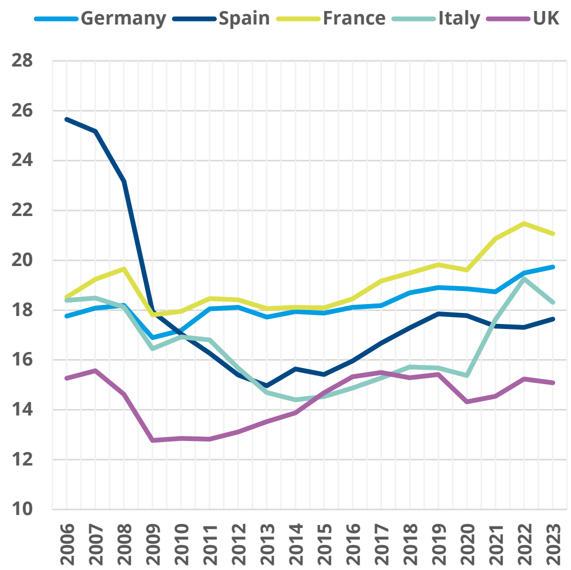
The labor market remains tight overall. The unemployment rate has decreased in recent months, posting at 3.8% on average in the three months to December 2023. Hinting at persisting challenges to finding suitable staff, the number of vacancies remains relatively high. The UK's labor market activity rate remains below its pre-pandemic level, posting at 78.1% (Oct-Dec 2023), with evidence pointing towards a higher level of long-term sickness as one key factor behind this. Apart from health-related issues, Brexit has likely reduced labor supply in the lower-skilled sector to some extent.

Efforts are underway to address the higher level of labor market inactivity as compared to the pre-pandemic years. In this context, it is also worth highlighting recent developments in net migration. According to the Migration Observatory, total net migration in the year to Jun-23 was markedly above pre-pandemic (2019) levels, mainly driven by non-EU migrants. International students and skilled workers - particularly in the health and care sector - were among the main drivers, apart from non-EU migrants coming to the UK via humanitarian routes.

High financing costs and economic uncertainty look set to weigh on gross fixed capital formation over the coming months. However, given our expectation for monetary policy rate cuts from the middle of the year, prospects for business and housing investment should gradually improve. Drawing on the latest Decision Maker Panel published in Feb-24, average expected annual capital expenditure over the next year is positive. Some initially temporary incentives to bring forward investment have been made permanent, potentially supporting the investment outlook beyond this year (see Figure **13**).

Figure 13: Private investment continues to show scope to catch up

Private sector investment to GDP, in %



Sources: AMECO, Creditreform Rating

We do not expect significant growth contributions via net external trade this year, in light of the weakness in foreign demand, in particular with regard to main European trading partners. Risks linked to the war in Ukraine and the conflict in the Middle East are flanked by disruptions to shipping in the Red Sea, affecting global trade and entailing potential knock-on effects on commodity prices if tensions escalate or continue for a prolonged period.

On the whole, we forecast real GDP growth to increase only slightly to 0.3% in 2024 and to accelerate to 1.4% in 2025. The disinflationary process and the expected easing of monetary policy rates later this year should support a moderate recovery of domestic demand, with the additional relief for the private sector announced with the spring budget in March firming expectations for a pick-up of the economic pace. Downside risks to these projections remain the possibility of renewed spikes in commodity prices and a disruption in trade flows in light of the geopolitical tensions.

Monetary policy: Rate cuts inching closer

The Bank of England has maintained its policy rate at 5.25% since September 2023. At the January meeting, preferences deviated to a higher extent, with two members of the nine-member committee favoring a 25 basis point increase, and one member opting for a rate reduction by 25 basis points. The Bank of England's updated projections in February 2024, as usual conditioned on the market-implied path for Bank Rate, suggest that the CPI inflation rate could be around 2¾% by the end of 2024, at about 2.3% in two years' time and 1.9% in three years. We now expect a first cut in the Bank rate for this June, with an overall reduction by 75bp by the end of the year.

House prices continue to decline in an annual comparison

Tight financing conditions on the back of the monetary hiking cycle have left their mark on the UK housing market, with signs of cooling somewhat more pronounced by now. House prices continue to decline year-on-year, as suggested by the HM Land Treasury's UK index for all types of property, which registered an annual fall by 1.4% in December 2023. Lending dynamics to the private sector have slowed as well, also illustrated by lower mortgage approvals and a two-digit percentage decline in residential property transactions in Q4-23. We expect the housing market to continue to soften over the coming months, with the expected turning of the monetary policy cycle likely to limit a downturn.

Labour maintains sizeable lead over the ruling Conservatives ahead of the parliamentary election

Judging by recent polls, the Labour party opposition remains in the lead regarding the upcoming election, which will have to be held by January 2025, although a date later this year is becoming more likely. Longstanding challenges around the National Health Service (NHS) are likely to remain an important issue both for the incumbent and the main opposition party in the election campaign, and climate policies may feature more prominently as well. Incentives for more economic stimulus in view of the approaching election, and possible further adverse effects linked to the challenging geopolitical environment, are likely to pose headwinds to commitment to fiscal consolidation in the medium term.

Figure 14: We have revised down our forecasts for 2024

In percent, IMF forecasts for World, China, US

	2010-19	2021	2022	2023	2024e	2025e
World	3,7	6,3	3,5	3,1	3,1	3,2
Euro area	1,4	5,9	3,4	0,4	0,6	1,4
Germany	2,0	3,2	1,8	-0,3	0,1	1,2
France	1,4	6,4	2,5	0,7	0,7	1,4
Italy	0,3	8,3	4,0	0,9	0,8	1,2
Spain	1,1	6,4	5,8	2,5	1,6	1,8
UK	2,0	8,7	4,3	0,1	0,3	1,4
US	2,3	5,9	1,9	2,5	2,1	1,7
China	7,7	8,5	3,0	5,2	4,6	4,1

Sources: Creditreform Rating, IMF

Related Credit Ratings

Rating Action 19 January 2024: Creditreform Rating raises the outlook on the Italian Republic to 'positive' from 'stable' and affirms the rating at 'BBB-'
Rating Action 09 February 2024: Creditreform Rating upgrades the Republic of Croatia's rating to 'BBB+' from 'BBB' and lifts the outlook to 'positive' from 'stable'
Rating Action, 09 February 2024: Creditreform Rating upgrades the Republic of Cyprus' ratings to 'BBB+' from 'BBB' and revises the outlook to 'positive' from 'stable'
Rating Action, 01 March 2024: Creditreform Rating affirms the United Kingdom's ratings of 'AA' and the negative outlook

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