Hedge Clippings: Risks & Issues in 2025 – Part 1

6 December, 2024

The global backdrop for the Australian economy is described by the International Monetary Fund (IMF) as "underwhelming". And the risks, as always lie to the downside. President Trump 2.0 adds to uncertainty. But no credible forecaster is projecting a recession.

The global backdrop favours an ongoing slowing in inflation rates. And an ongoing series of rate cuts by the major central banks.

The consensus is that the Australian economy will turn in a better economic performance in 2025. But a performance that remains sub trend. And an outcome dependent on some significant shifts in growth drivers. In particular, consumers need to open their wallets. And the RBA needs to overcome its reluctance to cut interest rates.

Rear View

It looks like the 2024 economy will meet the definition of a "curate's egg" – that is, partly good and partly bad. When the line is finally ruled under the economic data for the year, the Australian economy should show:

- GDP growth running at around 1½%pa. This outcome was *lower* than expected at the start of the year (Chart 1). And it's also below most estimates of Australia's potential GDP growth (of 2½%pa). Very strong population growth meant that the "per-capita recession" continued during 2024.
- A resilient labour market. Expectations of a cooling job market proved too pessimistic. Employment growth was better than expected. And an unemployment rate around 4¼% remains not far off the 50-year lows that have characterised the past few years (Chart 2).
- An inflation rate that remains too high. Underlying inflation looks set to print around 3½%pa at year end. Inflation around that sort of pace would be a little higher than expectations at the start of 2024 (Chart 2). And it would remain well above the 2½% midpoint of the RBA's 2-3% inflation target.

The global economic backdrop was relatively neutral from an Australian perspective. Growth in Australia's major trading partners (MTP) ran at 3¼% in 2024, in line

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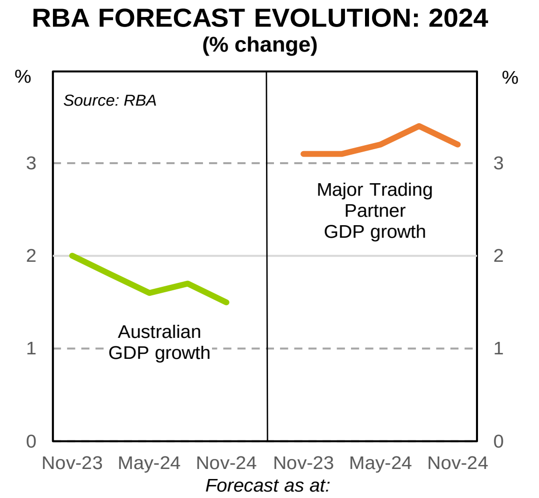

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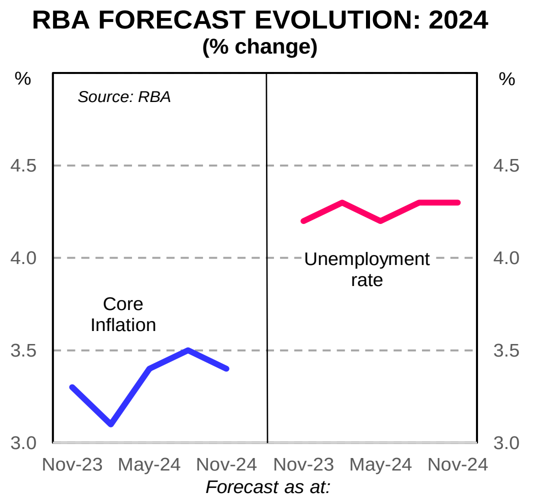

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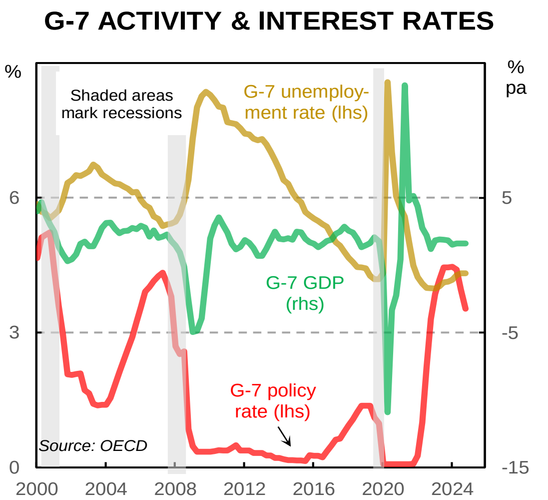

with expectations at the start of the year. MTP growth remained below the decade average (Chart 2).

Growth in the major-seven economies printed at pretty much the same pace as recorded between the end of the global financial crisis (2008) and the onset of COVID (2020).

Unemployment in the same major economies edged higher in 2024. But unemployment remains at the bottom end of the range of the past 25 years (Chart 3).

A sharp disinflation, or slowing inflation rates, was a defining characteristic of 2024. The global inflation rate has subsided to something close to its pre-COVID norms (Chart 4).

A normalisation in inflation rates allowed many central banks to change course towards rate cuts in 2024 (Chart 3). At year end some 77% of top global central banks had cut policy rates. The main exceptions were the BoJ – which raised rates for the first time in 17 years! And the RBA – which sat on its collective hands during 2024.

Parts of the global story were less "normal" in 2024. Geopolitics was front and centre with the ongoing Russia-Ukraine war and the escalation of conflict in the Middle East.

And the swathe of elections through 2024 added to the geopolitical backdrop. As the Financial Times noted, the incumbents in 10 major countries tracked by the ParlGov global research project lost voter share in their national elections. This is the first time this has ever happened in almost 120 years of records.

The global backdrop

There are several global themes in play as we approach the end of 2024 that will do much to drive economic and market direction in 2025.

Some of these themes have proved persistent. Some are new.

One persistent theme in the post-COVID period is the idea that a recession is imminent. Recession risks are endlessly debated in global forums. The major forecasting agencies spend much of their regular economic outlook pieces discussing the *downside* risks.

But the major forecasters, like the IMF and OECD, have never put a recession as the central forecast.

The same is true when we look at projections for 2025 (Table 1).

Global growth is expected to run at 3¼%pa in 2025. The IMF describes this projection as "underwhelming". But it is not a recession.

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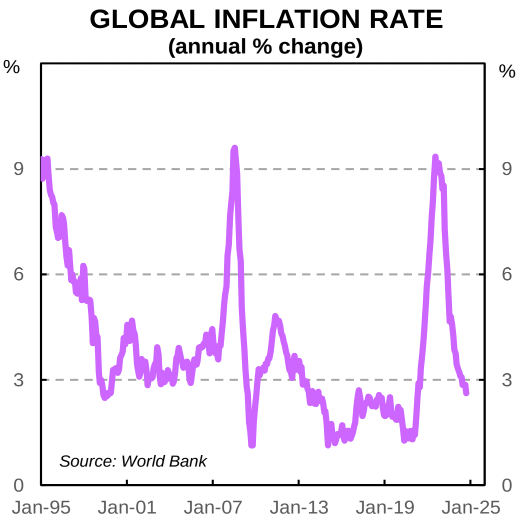

Table 1: Key Global Forecasts

	2023 *(a)*	2024 *(f)*	2025 *(f)*
GDP			
World	3.3	3.2	3.2
United States	2.9	2.8	2.2
Adv economies	1.7	1.8	1.8
EMDE	4.4	4.2	4.2
China	5.2	4.8	4.5
Australia: Major Trading Partners	3.7	3.2	3.5
Inflation			
Adv Economy CPI	6.7	5.8	4.3
Labour Market			
Unemployment	4.4	4.6	4.7

Source: IMF / RBA

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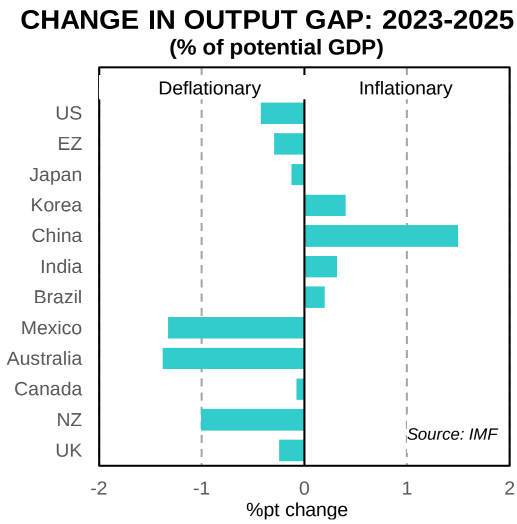

The more interesting growth story lies below the surface:

- The US is expected to outperform other advanced economies, especially in Europe.
- Growth in most Emerging Market & Developing Economies (EMDE) is hindered by commodity disruption (especially oil), conflict and civil unrest.
- The exception is Emerging Asia which benefits from the AI boom.
- Chinese growth rates are likely to slow further. IMF forecasts suggest China will fall short of its 5% growth target (Table 1). The weight from a contracting property sector continues. And the authorities seem reluctant to unleash the bazooka-type policy response that followed previous slowdowns.

The overall growth mix should help keep the global unemployment rate low.

The closing gap between demand and supply in many countries – or a narrowing output gap – should mean a further slowing in inflation rates (Chart 5).

And that disinflation trend means central banks should keep cutting interest rates. Financial markets have priced in about 150bpts worth of rate cuts for the Fed, BoE and ECB over next two years (Chart 6).

So no recession in 2025 remains the baseline. But the long list of potential downsides to that baseline also remains.

Some idea of the prevalence of “risk” is provided by a risk count through recent IMF outlook publications. These were released in late October. This count is simply the number of times the word “risk” is used in those publications (Chart 7).

“Risk” gets its usual workout in the World Economic Outlook. And “risk” is fairly uniformly scattered throughout the Regional Economic Outlooks. Many of these risks stem from the financial system (Global Financial Stability Report) and fiscal settings (Fiscal Monitor).

The main risks to financial stability come from the Chinese property sector and commercial real estate in other economies.

A downturn in residential construction activity continues to weigh on Chinese economic growth.

In something of a vicious circle, the severe funding constraints facing property developers is slowing the completion of pre-sold homes. Home buyer confidence is under pressure, prolonging the falls in real estate prices. In turn, declining real estate activity

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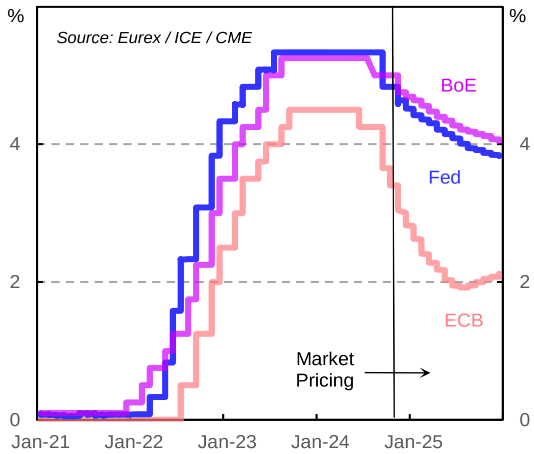
KEY CENTRAL BANK PRICING
(derived from futures markets)



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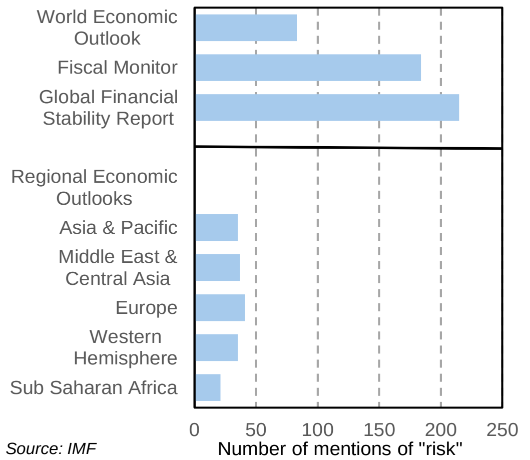
RISK COUNT
(mention of "risk" in selected IMF publications)



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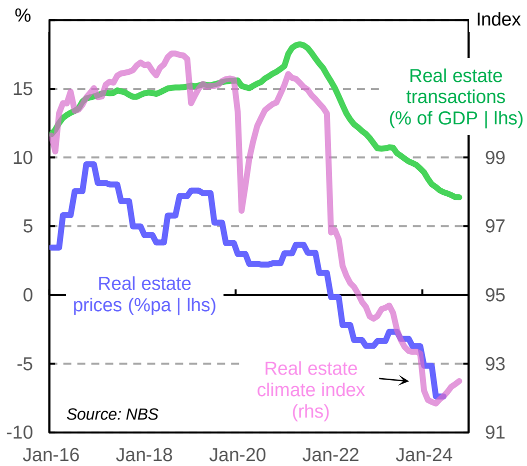
CHINA CONSTRUCTION INDICATORS



is hurting local government finances. The problems in real estate are weighing on business confidence and capex (Chart 8).

China's policy makers have taken steps to support the economy. The PBoC has cut some lending rates and reserve requirement ratios to help the property sector. The National People's Congress (NPC) Standing Committee announced a CNY10 trillion package to resolve local governments' off-balance-sheet debt. But commentators and markets have typically seen these measures as falling short of what is needed. It may be that Chinese policy makers are keeping some of their powder dry while they see which way the new Trump Presidency moves.

Commercial real estate has been in focus for regulators for a while now. The structural shift to working-from-home and online shopping has reduced demand for office and retail real estate. Add on higher interest rates and you have an environment where valuations are under pressure.

Commercial real estate prices have fallen by more than 20% from the peak in Europe and the US (Chart 9). Some banks with large exposures to commercial real estate – notably in the US – have suffered as a result.

Falling interest rates will help ease some of the pressures. But there is a significant refinancing task coming up. The RBA estimates that nearly US$500bn in commercial real estate debt will mature each year over the next five years. Interest rates may be on a downward trajectory. But financing rates will still be well above those prevailing at origination.

Commercial real estate prices have also fallen in Australia. But by less than elsewhere (Chart 9). Australian banks are less exposed to commercial real estate than their global peers. And they have maintained conservative lending standards.

One other persistent financial risk lies with any tightening of financial conditions associated with market volatility. Risk premia in global credit and equity markets are low. Asset prices in some markets could be hit by any disorderly adjustment, particularly if growth prospects fade.

Disappointing fiscal outcomes have also been a major risk focus for some time now. And that risk has increased over the past couple of years.

Most countries have pursued fiscal consolidation in the post-COVID period. Most countries have failed to achieve that consolidation. At the global level, for example, fiscal policy aimed to *improve* the budget bottom line by 1.3% of GDP between 2022 and 2024.

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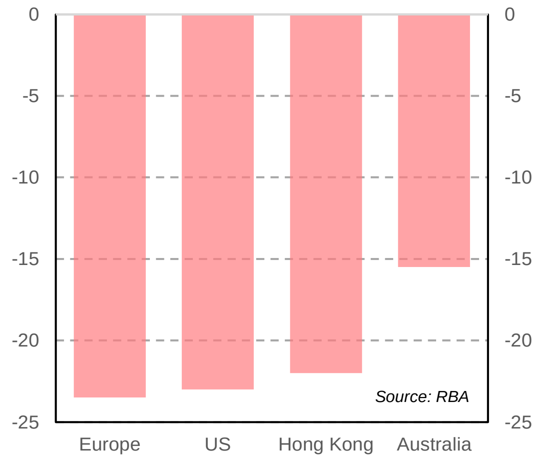
COMMERCIAL REAL ESTATE
(% change in value from peak)



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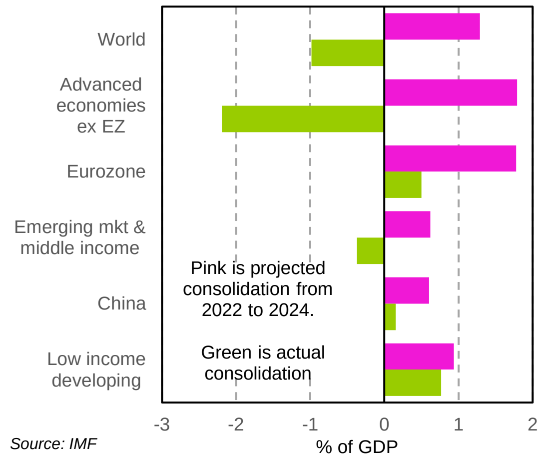
FISCAL OUTCOMES
(change between 2022 and 2024)



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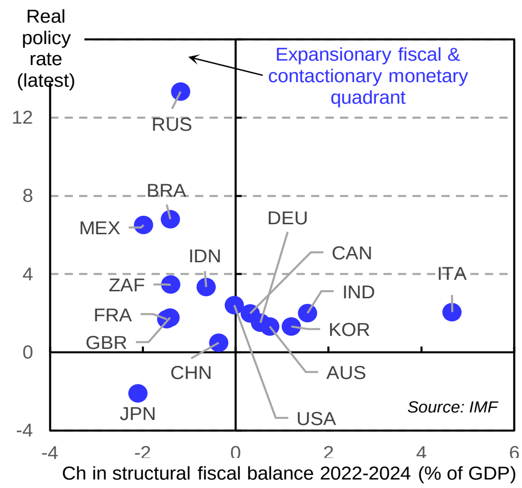
FISCAL-MONETARY POLICY MIX



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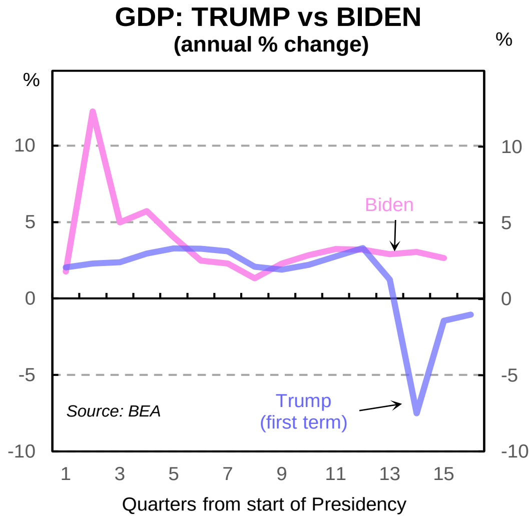

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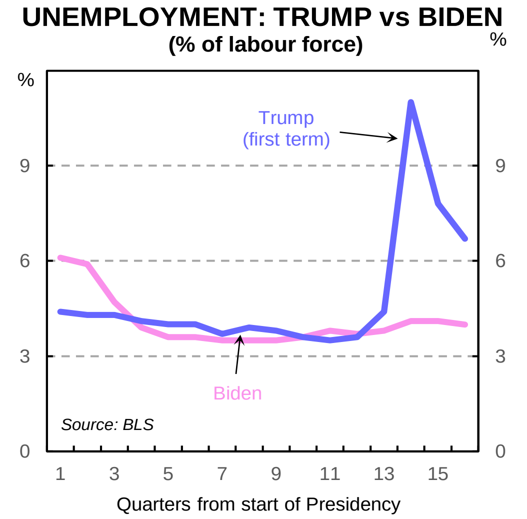

The reality was that budget balances *deteriorated* by 1.0% of GDP (Chart 10).

This policy failure has three implications:

- Fiscal cannons have not been reloaded, reducing the ability to deal with future shocks.
- Many countries have not reached a budget position that would see their government debt-to-GDP ratios stabilise. To stabilise debt-to-GDP ratios at 2023 levels would require fiscal consolidations of 1.5% of GDP in Japan, 1.8% in the UK, 2.3% in the US and 5.7% in China.
- Monetary and fiscal policies are pushing in opposite directions in some countries. Expansionary fiscal settings require tighter monetary policy than otherwise. Countries that fall into this quadrant include France, the UK and Brazil (Chart 11). Other have only just started to move out of that quadrant thanks to recent interest rate cuts.

There is one new risk to consider. That relates to the potential risks and uncertainties of a renewed Trump Presidency.

A new President brings with it the usual debate about what the change will mean for the economy and financial markets. But it is important not to overstate the primacy of politics. The underlying economic fundamentals exert a powerful influence.

We can compare the economic outcomes under Trump 1.0 with Biden's term. The broad macro picture is surprisingly similar (Charts 12 and 13). Divergences stem mainly from the Covid impact (at the end of Trump's term and the start of Biden's) and the policy response to it.

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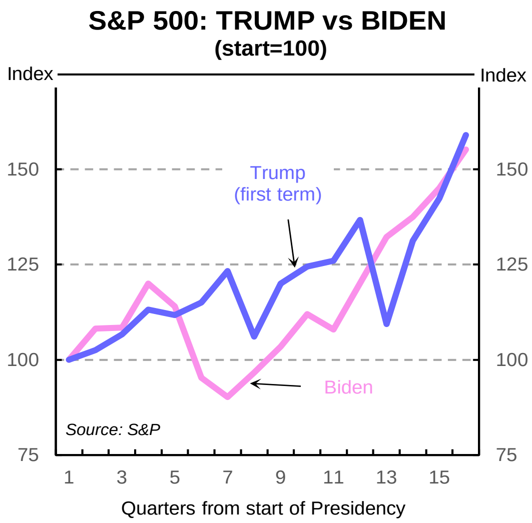

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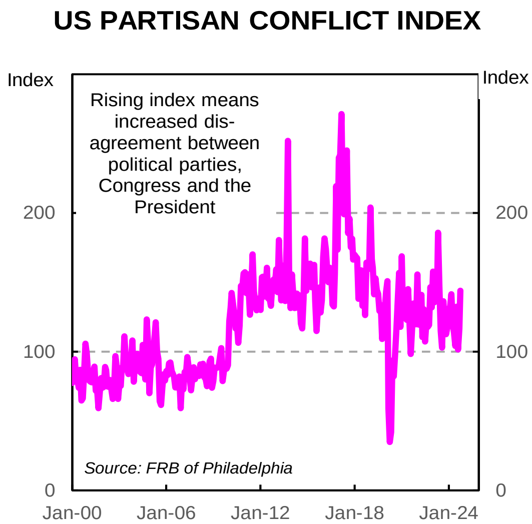

The equity market trajectory differs between Trump and Biden. But the end point after 4 years looks very similar (Chart 14).

Interest rates (Fed funds and bond yields) were generally higher during Biden's term as the Fed responded to rising inflation pressures. The USD was stronger during the Biden Presidency.

Consumers and businesses were generally more positive during the Trump Presidency.

Biden faced a more difficult geopolitical environment (Russian invasion of Ukraine, Middle East) than Trump. Trump faced a more fractious Congress for much of the period than Biden (Chart 15). And this fractiousness probably moderated some of the Trump agenda during his first term.

Of course, in those famous words that economists like to trot out: "this time is different". It seems the second Trump Presidency will have control of the House of Representatives and the Senate. And President Trump himself won the popular vote. This combination means Trump has a mandate and the ability to use it. And the Trump agenda is more likley to proceed.

The broad sweep of the Trump 2.0 agenda is known. But there is not much in the way of detail. This lack means its hard to be too prescriptive about what the agenda will mean for the economy and markets.

The policy mix will involve tariffs – "the most beautiful word in the dictionary is tariff" according to the President (Chart 16). The mix will include tax cuts.

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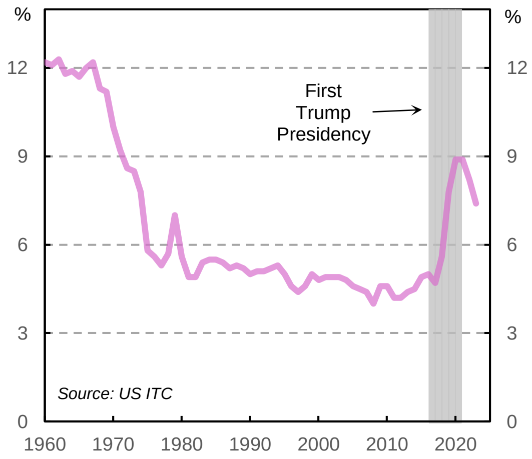
US TARIFF RATE
(duties paid as % of dutiable imports)



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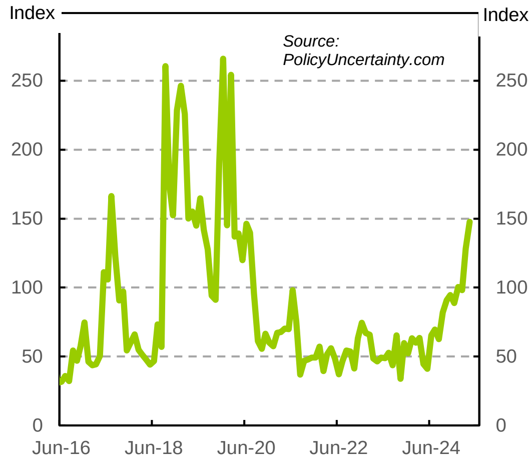
US TRADE POLICY UNCERTAINTY
(rising index means more uncertainty)



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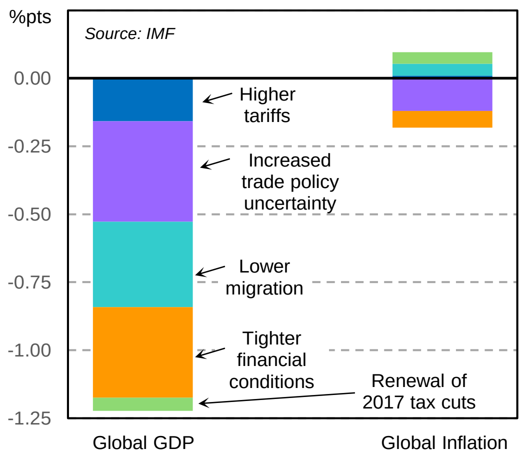
IMPACT OF TRUMP AGENDA
(indicative scenario | %pt impact in 2026)



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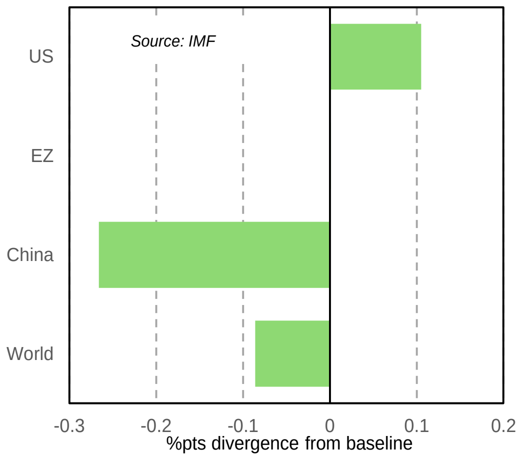
INFLATION IMPACT OF TRUMP AGENDA
(indicative scenario | %pt impact in 2026)



There will be curbs on migration. And a winding back on climate change policies (Chart 20).

The IMF has modelled a scenario that broadly replicates the Trump agenda. It assumes:

- The US imposes a 10% tariff, leading to similar retaliation by other countries.
- The "trade war" generates a lift in trade policy uncertainty (Chart 17).
- The impact on the world economy, trade, interest rates and uncertainty tightens global financial conditions.
- Tax cuts are proxied by assuming that Trump's 2017 Tax Cuts and Jobs Act (TCJA) is extended rather than allowed to expire.
- Migration changes are assumed to reduce the size of the US labour force by 1%.

The net effect of this scenario is to *decrease* the level of global GDP by 1.3% by 2026, relative to the baseline (Chart 18). This outcome would be a substantial hit to the global economy in 2026 where the baseline has growth running at a modest 3.3%.

The impact on global inflation is muted, due to some offsetting forces. Inflation outcomes do, however, vary by country. The US would see some *upward* pressure on their inflation rate, for example (Chart 19).

Part 2 of Risks & Issues in 2025 will consider the implications of this global backdrop for Australia as well as some home-grown influences.

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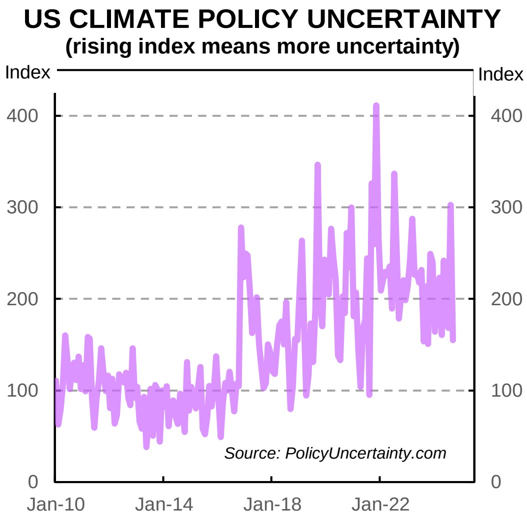

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