Global Economic Weekly

In the supply side we trust

01 March 2024

Economics
Global

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Global Letter: In the supply side we trust

We have upgraded our growth forecast for the US and we are now above consensus for growth. We now expect faster growth in 2024 while slightly lower in 2025 vs our previous forecast, and mildly stronger inflation. We now see a smaller uptick in unemployment and lower recession risks amid a resilient economy and labor market.

United States: The engine that could

We forecast faster growth in 2024 (2.1% 4Q/4Q) and slower growth in 2025 (1.7%). We expect the unemployment rate to peak at 4.1% in 4Q 2025, compared to 4.2% in 4Q 2024 previously. We still expect the Fed to start a gradual cutting cycle in June, cutting the funds rate by 75bp this year and 100bp next year, for a target range of 3.5-3.75% at end-2025.

Euro Area: ECB preview – almost there

We expect unchanged ECB guidance in the press release, but soft guidance that cuts are coming very soon at the press conference. ECB forecasts are likely to show 2.0% core in late 2026. Confidence will be the missing ingredient, the next few months' data crucial. We stick to our call that quarterly cuts are likely to start in June and speed up in 2025.

UK: Budget preview – a bit more headroom

We expect the government to stretch the somewhat higher headroom with new measures, supporting our view of a patient BoE. The Gilt issuance maturity split should mean fewer long and index-linked, more short and (quite a lot more) medium Gilts. GBP: Spring Budget could be the trigger for further cyclical outperformance.

AU & NZ: Dovish news everywhere

The RBNZ kept the OCR steady at 5.5% as we expected. Guidance was dovish and the next move is down. Timing depends on CPI. AU monthly CPI was unchanged at 3.4% in Jan, below the 4.1% official rate. Instantaneous inflation fell below 2%.

Emerging EMEA: South Africa – fiscal improvement

A largely unchanged fiscal framework relative to expectations of deterioration boosts fiscal short term. Spending risks from wages, debt service and SOE transfers. All in deficit including Eskom to improve to 5.4% in 2024 (6% in 2023).

Latin America: Costa Rica – Jaguar economy and spillovers from export-led growth

Costa Rica is showing strong growth and deflation, an apparent puzzle. Our hypothesis is that export-led growth is behind it. Like the East Asian "tiger" economies, there are important macro spillovers for Costa Rica's "jaguar" economy

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Global Letter

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In the supply side we trust

We have upgraded our growth forecast for the US and we are now above consensus. In 4Q/4Q terms, we now expect faster growth in 2024 while slightly lower growth in 2025 relative to our previous forecast. We expect lower unemployment and slightly firmer inflation. Recession risks are lower as the economy remains resilient driven by a strong labor market.

Faster US growth in 2024

Our US Economics team upgraded their growth forecasts. In 4Q/4Q terms, they now expect the US economy to growth faster in 2024 (2.1% vs 1.2%) and slightly slower in 2025 (1.8% vs 2%). However, in average terms, they expect 2024 and 2025 growth to reach 2.7% and 1.9% respectively (1pp and 0.1pp higher, respectively). In average terms, the economy will be growing faster in 2024 than in 2023 (2.4%). Sequentially, the economy will be growing faster at close-to-trend level in every quarter of 2024 relative to the previous forecast and slowing down slightly in 2H25.

The main driver of the change in the call is the supply side of the economy, as the labor market remains supported by the increase in labor force participation and net international migration, although the catch-up effect in hiring is expected to be much softer in 2024 than in 2023. The US Economics team expects lower and later peak unemployment at 4.1% in 4Q25 and labor force participation to stabilize around 62.6-62.7% with monthly private payrolls at 150k (vs 107k before).

On the demand side of the economy, the US team expects private non-residential investment to moderate more slowly than previously anticipated, due to more crowding-in of private investment from the IRA and CHIPs Act, which helps explain the stronger growth profile in 2024. Both bills are also boosting the impact of fiscal policy on the economy via state and local spending.

Slightly higher PCE inflation and no change in Fed call

Our US Economics team now expect core PCE at 2.6% and 2.3% 4Q/4Q in 2024 and 2025, slightly up vs the previous forecast. With disinflation mostly driven by falling goods prices and service inflation sticky, the outlook for inflation remains tricky. Disinflation will likely continue, but a tight labor market can put upward pressure on services inflation and the pace of good price declines should slow in the coming months.

The composition of inflation matters for monetary policy decisions and the recent dynamics help explain why the Fed might not be in a rush to start the easing cycle. Despite the higher growth forecast, our US team keeps the Fed call unchanged, as they expect 3 cuts this year starting in June, in line with market pricing. They also maintain the view that the Fed will taper its balance sheet runoff beginning in May and end balance sheet runoff around year-end.

United States

Michael Gapen
BofAS

The engine that could

- We forecast faster growth in 2024 (2.1% 4Q/4Q) and slower growth in 2025 (1.7%).
- We expect the unemployment rate to peak at 4.1% in 4Q 2025, compared to 4.2% in 4Q 2024 previously.
- We still expect the Fed to start a gradual cutting cycle in June, cutting the funds rate by 75bp this year and 100bp next year, for a target range of 3.5-3.75% at end-2025.

This is an abbreviated version of our recent forecast change. For more details, see: US Economic Viewpoint: US outlook: Supply-side resilience

The rundown

We have made revisions in our economic outlook, anticipating faster growth, lower unemployment, and slightly firmer inflation (Exhibit 1). Rather than growth slipping below potential this year and rebounding next year, we front-load growth into 2024. This is supported by improvement in supply-side factors, especially the labor force rebound. We maintain our view that any slowing in the US economy is likely to come mainly from non-consumer components. We just assume they moderate more slowly than we previously assumed.

Exhibit 1: Summary of forecast changes
Compared to our previous forecasts, we expect stronger growth this year and slower growth next year

	2024	2025
GDP (4Q/4Q)		
New	2.1	1.7
Old	1.2	2.0
Unemployment rate (4Q)		
New	3.9	4.1
Old	4.2	4.1
Headline PCE inflation (4Q/4Q)		
New	2.5	2
Old	2.3	2.0
Core PCE inflation (4Q/4Q)		
New	2.6	2.3
Old	2.5	2.2
Fed funds rate (midpoint, end of period)		
New	4.625	3.625
Old	4.625	3.625

Source: BofA Global research

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Exhibit 2: The labor force now exceeds the pre-pandemic forecast of the Congressional Budget Office
The labor force exceeds the CBO's pre-pandemic forecast by 677,000

Source: CBO, Census Bureau, Haver Analytics, BofA Global Research

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1. **Growth frontloaded in 2024.** We now expect real GDP growth of 2.5% saar in 1Q 2024 and 2.0% saar growth in the remaining three quarters of the year, for a 4Q/4Q change of 2.1%. The latter is 0.9pp higher than we had previously. Growth slows to 1.7% in 2025.
2. **More employment.** With stronger final sales, we have nudged up our outlook for employment, with private payrolls rising 150k per month in 2024, versus 107k per month previously. In 2025, we expect monthly growth in employment of 100k, down from 125k previously.
3. **Lower - and later - peak unemployment**. Alongside our expectation for a stable participation rate of 62.6-62.7% across the forecast horizon and assumptions about population growth, we now have the peak unemployment rate at 4.1% in 4Q 2025. Previously our peak unemployment rate was 4.2% reached in 4Q 24 through 2Q 25.

4. **Slightly firmer inflation.** Finally, based on recent incoming data on inflation which points to somewhat more stickiness in services inflation than we had expected, we now look for 4Q/4Q core PCE inflation to fall to 2.6% and 2.3% in 2024 and 2025.

5. **No change in monetary policy.** We still expect the Fed to start a gradual cutting cycle in June, cutting the funds rate by 75bp this year and 100bp next year, for a target range of 3.5-3.75% at end-2025. Tapering of runoff should begin in May, with quantitative tightening (QT) ceasing at year-end.

The rebound in labor supply allows momentum to persist

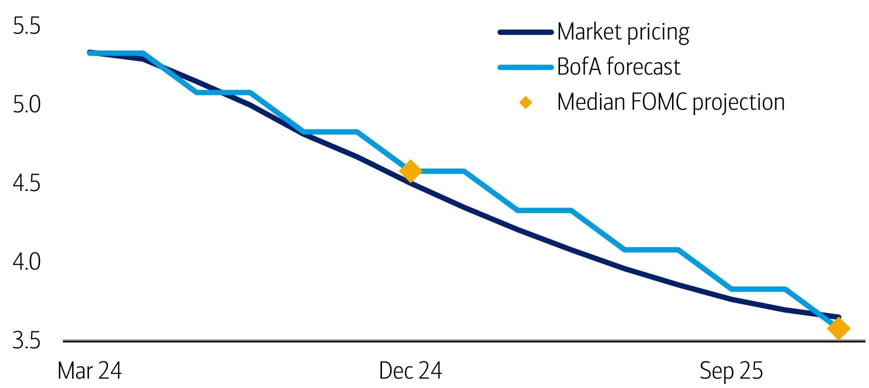
The major factor behind our upward revision to 2024 growth is the rebound in the labor force, supported by stronger participation rates and a rapid increase in net migration. The civilian labor force, at 167.8mn in 4Q 2023, is 677,000 above what the CBO (Congressional Budget Office) projected for the end-2023 labor force in their January 2020 outlook (Exhibit 2). The rebound in net international migration over the las two years has been a key driver of growth in the labor force.

This surge in labor supply has allowed strong labor demand to persist without overheating the economy. Labor demand should cool relative to last year, but the strong hiring in the laggard industries should persist. That is, we expect job growth to remain elevated owing to strong hiring in leisure and hospitality, and education and healthcare which will support consumption.

Progress on the inflation front

Stronger growth this year is only likely to cause modest upward pressure on inflation. We now expect headline and core PCE inflation to fall to 2.6% 4Q/4Q in 2024 and 2.3% in 2025. Both figures are one-tenth higher than in our prior outlook. The reason we do not expect more upward pressure on inflation is because we believe trend growth has increased temporarily. We estimate that the rebound in the labor force and, in turn, total hours worked, has increased trend growth from 1.7% pre-COVID to around 2.2% presently. Therefore, the economy is not overheating in our revised forecast.

Exhibit 3: BofA and market pricing of Fed cuts
Markets expect 75bp rate cuts this year from June, in line with our forecast.



Source: Bloomberg, BofA Global Research

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The Fed can still ease

Given our expectation for disinflation to continue, albeit more gradually, we maintain our outlook for Federal Reserve policy. We still expect the Fed to cut rates by 75bp this year— 25bp in June, September, and December— and a 100bp next. This would leave the policy rate at 3.625% by year end 2025.

Better economic activity will allow the Fed to be patient in adjusting its policy stance. That said, further declines in inflation are enough for the Fed to embark on a gradual and modest cutting cycle beginning in June. The market has also come around to this view (Exhibit 3).

Euro Area

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ECB preview – almost there

- We expect unchanged ECB guidance in the press release, but soft guidance that cuts are coming very soon at the press conference.
- ECB forecasts are likely to show 2.0% core in late 2026. Confidence will be the missing ingredient, the next few months' data crucial.
- We stick to our call that cuts are likely to start in June. Markets still focus too much on 2024, while pricing too little for 2025, we think.

Complete report: Europe Economic Weekly: Coming, just not right now 01 March 2024

Not yet ready to firmly pre-commit

We expect unchanged guidance from the ECB in the press release. Soft guidance during the press conference that we are almost there when it comes to ECB cuts is likely though. This could come in the form of a suggestion that, as long as wages and underlying inflation near-term confirm expectations, the conditions will be there to start a cutting cycle. If something along on those lines were to be included in the press release, it would send a stronger signal, but it's not our base case. We would also expect Lagarde to acknowledge they have started to discuss the right conditions for the beginning of the cutting cycle.

A few weeks ago we were contemplating – on the back of forecasts that would likely show the job is pretty much done – a strong signal in the March meeting that a cutting cycle could start in the following two meetings. We were even slightly open to an April cut after Banque de France's Villeroy's interview in Les Echos.

We still think the signal from forecasts will be there (see below for a discussion on ECB forecasts). But recent data printing hawkish on the margin has probably reduced the likelihood that the Governing Council is ready to move partially away from data dependence to some sort of date dependence.

The need for more confidence is a key theme across central banks these days, and the ECB is no exception. We don't think the ECB is ready yet to confidently signal that a cutting cycle is about to start.

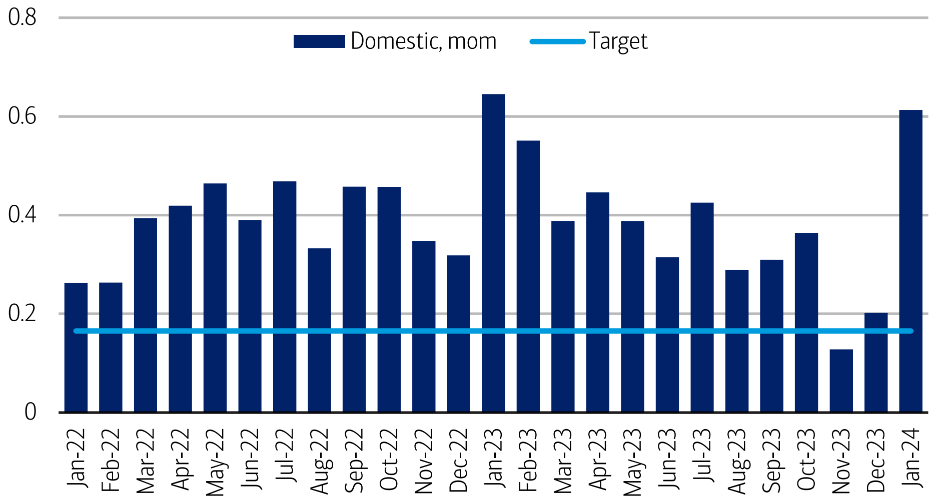
We think it's too early to get details on the operational framework review, but we could get news on an announcement coming soon. In line with recent reports, we would expect the ECB to move to a demand-driven framework, with a narrower corridor, a new lending facility with, hopefully, longer maturity than one week, and a small structural portfolio of assets. We work on the assumption of no changes to minimum reserve requirements, but small (one-off) changes can´t be ruled out.

A few reasons to be cautious

As we argued last week, details of the January inflation print, growing signs of an accelerating economy, and the first signals from wages for 1Q, probably do not create a sense of urgency for the ECB to cut before June. We would add that some of the data probably even created more resistance to signal anything too firm next week. This is particularly the case for domestic inflation, a key focus these days. Even in sequential terms the January print is likely to cause some additional caution (Exhibit 4).

As a reminder, we still expect the first (25bp) cut from the ECB in June this year. We have 75bp of cuts in 2024E and 125bp in 2025E (one per quarter in 2024, accelerating to one per meeting in December). By June, we expect data to sufficiently comfort the ECB that disinflation has legs. Data will eventually push the ECB to speed up the cutting cycle by more than they currently expect. Hence, our call for the ECB depo to be at 2% by mid-2025. And we have been flagging the risk of earlier acceleration of the cutting cycle than we expect now (by September). But that implies at most 100bp of cuts in 2024 and a lot more than is priced in for 2025.

Exhibit 4: Euro area, domestic inflation, mom%
The January print gives a reason to wait



Source: Eurostat, BofA Global Research

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April or June?

While our base case is June, we would not expect any clear pushback from ECB President Lagarde on an April cut. Rather, we would expect her to reiterate what she said in the last ECB meeting, emphasising data dependence rather than date dependence. We would not be surprised if she stands by her words in Davos earlier this year when asked about the timing of cuts, without providing specifics.

In our view, absent any major surprises on the very little data we (and they) will have between the March and April meetings, we doubt they can build consensus for an April cut if they are not ready to provide firmer guidance next week.

ECB projections: the price of confidence

In December, the ECB surprised with a very hawkish set of inflation forecasts, with core inflation, in particular, still at 2.1% on average in 2026E. Three months later, it will be tough to avoid cuts to the whole inflation trajectory, given the almost 10% decline in the (weighted) average of gas and oil prices over the forecast horizon. The ECB's own sensitivity analysis in the June 2023 forecast would suggest c 20-30bp of headline inflation at risk in 2024/25 and c 10bp in 2026 via energy prices alone. Food prices should compensate partly, but a mild downward revision even in 2025/26 is likely.

The ramifications for core inflation are not so obvious. Lower headline inflation and looser financing conditions (the 10y government bond yield moved down c 40bp between the forecast cut-off dates) will probably bring better growth forecasts once the 2023/24 winter lull is passed. A cut to 2024 growth by 20-30bp to 0.5-0.6% is likely, followed by upward revisions of 10-20bp per year in 2025/26.

Compensation per employee growth may have ended 2023 a tad weaker than the ECB initially expected, but paired with weaker growth in the short term, unit labour cost pressures remain (at least) as expected.

All combined, we expect only marginal changes to core inflation forecasts. The path in 2024-25 might be 10bp lower (at most 20bp), and we think there is a possibility of the ECB adjusting the back-end to the 2026 core inflation forecast by 10bp to 2%. It is unclear if that would be enough to push the 2026 average to 2%, but it strikes us as unlikely that the ECB will forecast an undershoot in this round.

Why not normalise rates when the target is reached in the relevant monetary policy horizon? The argument would be that reaching 2% is still so far off that the option value of waiting for further confirmation of the disinflation process is low (whether we subscribe to that argument is a different matter).

Exhibit 5: ECB projections – GDP and inflation
Path to target is created, confidence in it is missing

	Dec-23				Mar-24 (exp)			
	2023	2024	2025	2026	2023	2024	2025	2026
Real GDP	0.6	0.8	1.5	1.5	0.5	0.5-0.6	1.6-1.7	1.5-1.6
HICP	5.4	2.7	2.1	1.9	8.4	2.3-2.4	2.0-2.1	1.8-1.9
ex food & energy	5	2.7	2.3	2..1	5	2.6-2.7	2.1-2.2	2.0-2.1

Source: BofA Global Research, ECB staff projections

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Exhibit 6: ECB projections – technical assumptions
Gas and oil prices are on average almost 10% below Dec forecasts

	Dec-23				Mar-24 (exp)			
	2023	2024	2025	2026	2023	2024	2025	2026
Oil (USD/barrel)	84	80.1	76.5	73.6	82.5	79.2	74.8	72.1
Gas (EUR/MWh)	42	47	44	37	41.4	29.4	30.8	28.6
USD/EUR	1.08	1.08	1.08	1.08	1.08	1.08	1.08	1.08
NEER (1999Q1=100)	121.9	123.5	123.5	123.5	122.3	123.1	123.1	123.1

Source: BofA Global Research, ECB staff projections

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Getting there on the new operational framework

A story from an ECB source out this week suggested consensus is slowly building on the new operational framework. A demand-driven framework seems to be the choice, with liquidity operations set, eventually, at market prices within a smaller corridor and, perhaps, a structural bond portfolio. The story lacks details on whether a new liquidity facility would be created and its potential maturity. It also suggests some national central banks are still pushing the idea of a higher minimum reserve requirement.

We don't think the ECB will be ready to unveil such a framework next week: key details are yet to be determined, according to the story, and those won't be easy to settle. We work on the assumption that there will be a new facility, hopefully with a maturity all the way to one year. That would facilitate a smooth transition from the current situation to one in which demand for liquidity for regulatory reasons can be met without heightened uncertainty. We also work on the assumption that the corridor will eventually (not necessarily immediately) be narrowed to 25bp. That would reduce the stigma of such a new facility.

Finally, as we have been flagging, changes to the minimum reserve requirement, if any (we don't have a strong view), would be likely to be small and one-offs, although we work on the assumption of no change.

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Budget preview: a bit more headroom

- We expect the government to stretch the somewhat higher headroom with new measures, supporting our view of a patient BoE.
- The Gilt issuance maturity split should mean fewer long and index-linked, more short and (quite a lot more) medium Gilts.
- GBP: Spring Budget could be the trigger for further cyclical outperformance.

Some more headroom in the new forecasts

New forecasts in next week's Budget will in our view show some more headroom relative to the Autumn statement before new measures are factored in. We would expect somewhere around £15-20bn headroom (probably closer to the upper bound), potentially enough to cancel the fuel duty rise and implement additional small tax cuts. We work on the assumption that 1p off the basic rate of Income Tax is one of those cuts. Borrowing is likely to be marginally lower for '24-25 before potential new measures are factored in.

Some tailwinds, but not large ones

We would expect the nominal GDP profile to be moved marginally lower (Exhibit 1). We think there will be some reduction in the OBR's GDP growth forecasts near term, too, since growth has surprised to the downside. We also expect inflation forecasts to be revised down (mostly through less imported inflation). On the other hand, debt interest cost should move lower, but by less than we would have anticipated a few weeks back given the repricing of the Bank of England cutting cycle (Exhibit 2). Finally, we would expect a smaller indexation cost only in the current fiscal year to add to the headroom.

Broadly unchanged borrowing pre-measures

Given the discussion above, and with the current fiscal year going broadly to plan, changes in borrowing will be mostly down to Budget measures. We would expect the government to stretch the headroom with new measures, but remain agnostic on their size and composition.

A non-event?

Stretching the headroom now with the hope – perhaps not politically feasible – that real expenditure cuts in the future take the debt profile lower comes with risks. But this has been the norm for quite some time and largely anticipated for this budget. As long as any announcement stays within the margins of what we discuss above, we would not expect a large reaction from markets.

But with some risks

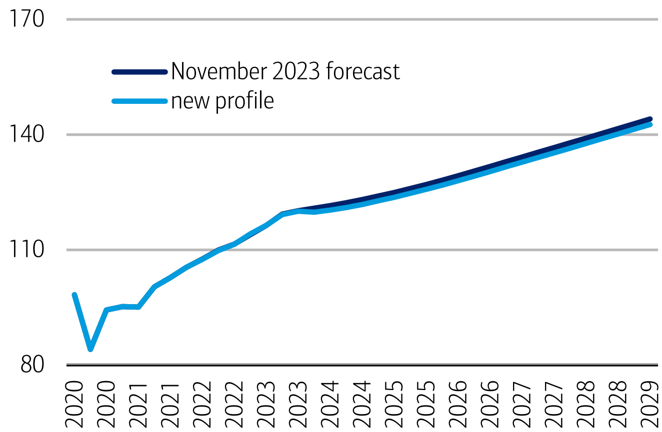
But given recent press reports we are concerned about potential announcements that deliver more ambitious tax cuts now on the back of backloaded and very politically challenging real expenditure cuts in the future. The government has already pencilled in a 1% annual real terms spending increase for all departments. But in light of existing commitments for some (NHS, defence, foreign aid or childcare), that means more than a 2% drop in real spending for all other departments from April 2025. Going further in that direction ahead of an election could clearly question credibility.

Likely to feed a cautious BoE

Given our expectation of additional measures we think the Budget will be mildly inflationary, adding another reason for the Bank of England to be patient and cautious when starting a cutting cycle. We think the budget next week should reinforce our view that a slow cutting cycle is unlikely to start before August this year.

Exhibit 7: Nominal GDP profile

Nominal GDP profile likely to be slightly lower



Source: OBR, BofA Global Research

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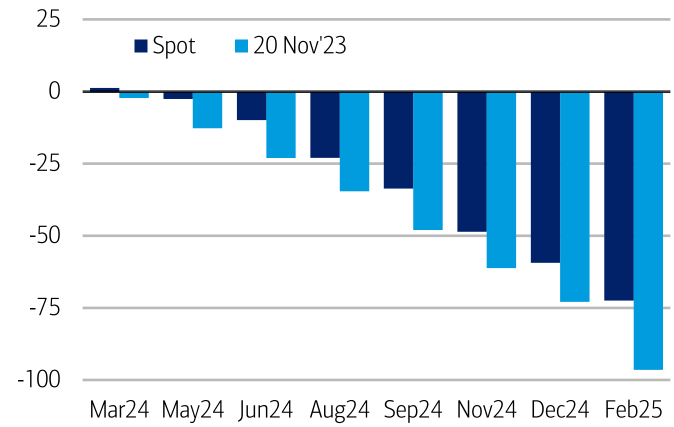
Exhibit 8: Market pricing of BoE cuts

Clear repricing since November



Source: Bloomberg, BofA Global Research

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Rates: Nothing to nudge the Budget

Our working assumption is that the Debt Management Office (DMO) will aim to meet any upside in the financing need via net T-bill issuance and National Savings and Investment (NS&I), minimising the need for material Gilt Remit changes. This would not be unprecedented; the net contribution of T-bills has been quite variable in recent years, with the DMO pencilling as much as £40bn in September 2022 (Exhibit 9).

We expect the Gilt issuance maturity split to mean fewer long and index-linked, more short and (quite a lot more) medium Gilts. Assuming the remaining unallocated portion of current Remit is used for the last linker syndication, this year's split will be 36% shorts, 29% mediums, 22% longs and 12% linkers.

For 2024/25, we pencil in 5% for unallocated, the same share as at the start of the current fiscal year. In line with late feedback from Gilt Edged Market Makers (GEMMs) and investors, we expect the shares of longs and linkers to be reduced to 17% and 10%, from 21.1% and 10.9% in March 2023, respectively. This allows shorts and mediums' weightings to be lifted to 37% and 31%, respectively (Exhibit 10 and Exhibit 11). A skew shorter *within* the long and linker buckets is also likely, meaning that the effective skew shorter will be greater than the simple bucket weights show.

Exhibit 9: Total net contribution of T-bills for debt financing, £bn

Big variation in net contribution of T-bills for debt financing in recent years

	2020/21	2021/22	2022/23	2023/24
March Remit	0	1.8	23.2	5
April revision	6	1.8	30.2	5
Sep'22 update			40.2	
Autumn Statement	-2	-23.2	33.2	-5
Outturn	-2	-23.2	33.2	

Source: BofA Global Research, Debt Management Office

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Exhibit 10: 2023/24 and 2024/25 Gilt Remit splits per "bucket", %

We expect 5% unalloc, 37% shorts, 31% mediums, 17% longs and 10% ILBs

	23/24	23/24	23/24	23/24	24/25 (f)
	Mar'23	Apr'23	Nov'23	Outturn (f)	Mar'24
Short	36.0%	35.6%	36.5%	36.5%	37.0%
Medium	27.1%	27.5%	28.8%	28.8%	31.0%
Long	21.1%	20.9%	21.6%	22.3%	17.0%
ILB	10.9%	11.0%	12.1%	12.4%	10.0%
Unalloc	5.0%	5.0%	1.1%	0.0%	5.0%

Source: BofA Global Research, Bloomberg

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Exhibit 11: UK DMO Remit for fiscal years 2023/24 and 2024/25 including BofA projections, £bn

We expect the DMO to aim to keep Gilt sales broadly unchanged

	FY 2023/24 (DMO - Apr'23)		FY 2023/24 DMO - Nov'23		FY 2024/25 (BofA - Feb'24)	
CGNCR	159.5		150.5		145.0	
Redemptions	117.0		117.0		139.9	
Adj. from prev. FY	-24.6		-24.6		0.0	
Gross Financing Req. (GFR)	251.9		242.9		284.9	
Less:						
NS&I	7.5		7.5		15.0	
Other financing	1.5		3.0		0.0	
Net Financing Req. (NFR)	242.9		232.4		269.9	
To be financed through:						
Gilt sales, through:	237.8		237.3		240.0	
Short	*84.6*	*36%*	*86.6*	*36%*	*88.8*	*37%*
Medium	*65.3*	*27%*	*68.3*	*29%*	*74.4*	*31%*
Long	*49.7*	*21%*	*51.3*	*22%*	*40.8*	*17%*
Index-linked	*26.2*	*11%*	*28.6*	*12%*	*24.0*	*10%*
Unallocated	*12.0*	*5%*	*2.5*	*1%*	*12.0*	*5%*
Net T-bill sales	5.0		-5.0		29.9	
Total financing	242.8		232.3		269.9	
DMO net cash position	2.3		2.3		2.3	

Source: DMO, BofA Global Research

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GBP: Fiscal Tailwinds

We think that the Spring Budget could be the trigger for further cyclical outperformance in GBP. At the start of the year, markets were concerned that the March Budget could precipitate the kind of market response similar to September 2022, as the UK Government stretched public finances to cut taxes ahead of the UK general election. However, as discussed about, the fiscal headspace has assuaged these concerns and with the rates market recalibrating the timing of the first BoE rate cut, fiscal stimulus could add further upward pressure to UK rates. As in September 2022, GBP is likely to take its cue from the reaction in rates market but on the assumption that UK yields rise for the right reasons rather than the wrong ones, this should be supportive for GBP in a market where carry remains a major driver for FX and against the backdrop of a weak vol environment.

Options Market Sanguine Ahead of the Event

Markets remain relaxed that there will not be a “fiscal mistake”. At the time of writing, both GBP/USD and EUR/USD 1wk implied volatility remains well anchored towards the lows for the year. Unsurprisingly, some premium has been placed into the curve given some residual concerns about the outcome, but this is relatively small. Whilst this would indicate that the event does not hold the market focus that it did at the start of the year, we continue to believe that should the Government deliver the kind of package discussed above, that this will add further weight to the evidence that UK growth pessimism has now passed the trough. Of course, the asymmetry is obvious: should the government surprise with a package that tests the markets resolve. However, a focus on the consumer, against the backdrop of rising real incomes and full employment will be GBP supportive and raises further questions over the timing of the first UK rate cut.

Au & NZ

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Merrill Lynch (Australia)

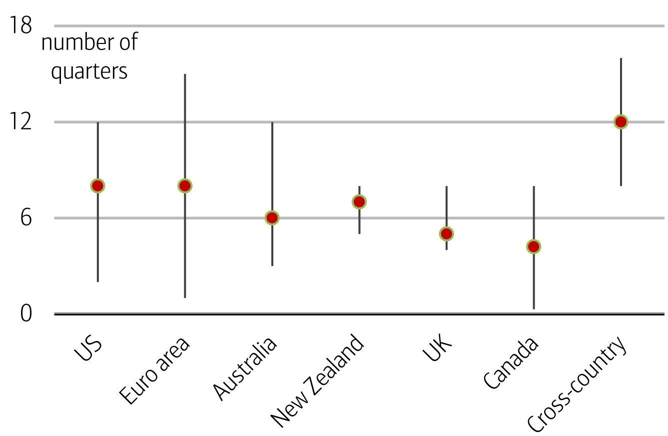
Dovish news everywhere

The RBNZ has kept rates unchanged and suggested the next move is likely down, as we expected. Given weak economic momentum we think easing could start from May. Of course, risk is for a later start if inflation surprises to the upside or unemployment does not rise further. See: New Zealand Economic Watch: RBNZ preview: all about the time to target 22 February 2024.

At this meeting there was a clear evolution in guidance towards a more dovish stance. The RBNZ removed the sentence "***If inflationary pressures were to be stronger than anticipated, the OCR would likely need to increase further***". The latter suggests the Official cash rate (OCR) has clearly peaked. Not surprising, Governor Orr reinforced the view that "*The OCR needs to remain at a restrictive level for a sustained period of time to ensure this [the return to the CPI target} occurs"*. Indeed, he said rates will likely remain unchanged over 2024. Despite this, we think economic data has become too weak and argues for earlier easing, but the stickiness of inflation justifies the cautious approach to easing.

New Zealand inflation remains well above the 2% midpoint of the target at 4.7%yoy and new data for 1Q 2024 will not be available until April 17, after the next RBNZ meeting on April 10. The RBNZ assumption is for CPI to ease to 3.8%yoy. Traction from a sustained period of higher rates will continue to dampen activity and prices given based on the RBNZ's analysis, the economy has not yet felt the full impact of the hiking cycle (peak at around 9 quarters) (Exhibit 12). In addition, economic data has continued to surprise to the downside (Exhibit 13). Hence, May will be the first "live meeting", in our view.

Exhibit 12: The RBNZ estimates full impact of hikes around 9Q
Some pain is yet to be felt



Source: RBNZ

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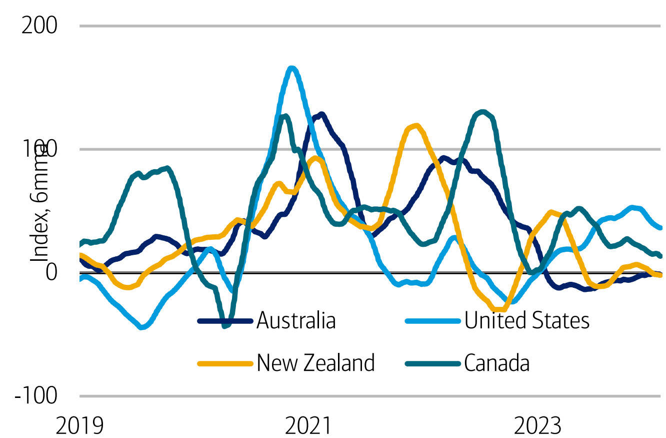
Exhibit 13: Economic surprise
NZ data has surprised to the downside



Source: Citi, Macrobond

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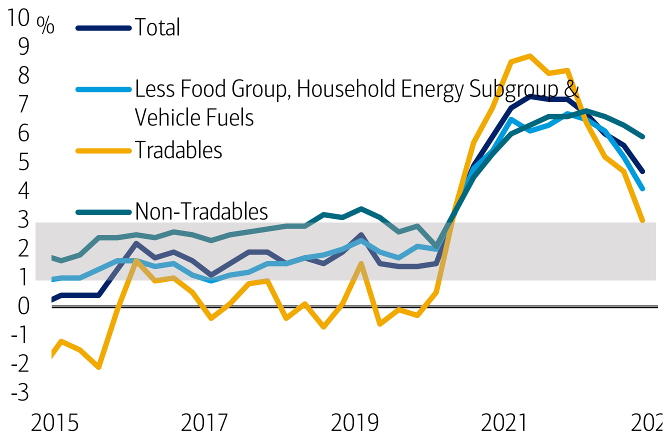
Nonetheless, the OCR track reflects a peak for the cash rate at 5.6% from 5.69% as inflation printed softer than anticipated in 4Q and is expected to fall below the 3% top of the target in Sep-2024, unchanged from November. These changes suggest (1) Unless there is a significant upside surprise to inflation, the OCR has clearly peaked, (2) the next move is down and likely earlier than anticipated in November as economic data disappointed. The Bank sees potential easing from 1H 2025 vs 2H 2024 back in November while we think easing could start as soon as 2Q 2024. See: New Zealand Watch: RBNZ review: Dovish turn in sight 28 February 2024. Inflation has continued to trend lower with tradables leading the way while non-tradables are lagging. Yet, with ongoing weak demand, particularly consumer spending (Exhibit 15) we think upside risk to demand-driven inflation is very limited.

Exhibit 14: Progress towards target is evident
But driven by tradables



Source: StatsNZ, Macrobond

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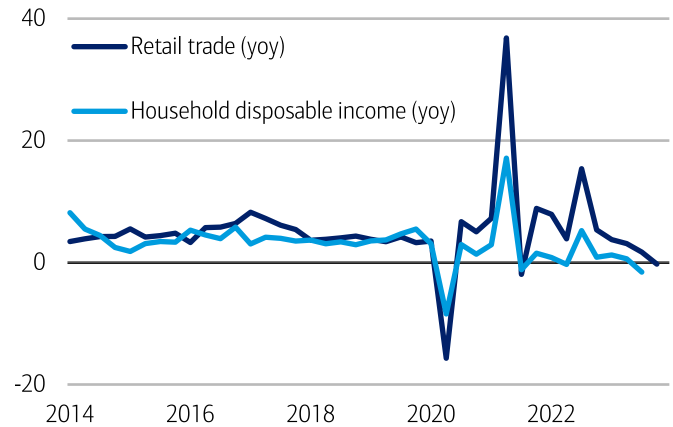
Exhibit 15: Retail spending is very weak
As is disposable income



Source: StatsNz, Macrobond

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AU: Instantaneous inflation prints softer

Australian monthly inflation printed unchanged at 3.4%yoy in January, well below the 4.1%yoy official rate. (see: Australia Watch: Monthly CPI steady at 3.4% 28 February 2024. The gap between the official quarterly CPI measure currently at 4.1%yoy versus monthly inflation at 3.4% in January increases difficulties for the Reserve Bank of Australia (RBA) to assess current inflation pressures. Recent data for Australia showed CPI continues to ease at a faster pace than the RBA forecasts. With base effects pushing inflation lower and weight updates, we think instantaneous inflation may be a better reflection of current inflation pressures. While volatile, instantaneous inflation has fallen below 2% in January, the lowest since Mar-21 (Exhibit 16).

Indeed, annual inflation considers observations from the past, with base effects contributing to the easing of annual inflation since its peak (7.8%yoy) in late 2022. We think a measure of instantaneous inflations provides a better gauge as it captures fast changes in prices and places more weight on recent observations. While monthly inflation showed CPI steady at 3.5%yoy, the instantaneous measure eased to 1.8%yoy. This is the first-time instantaneous inflation falls below 2% since March 2021.

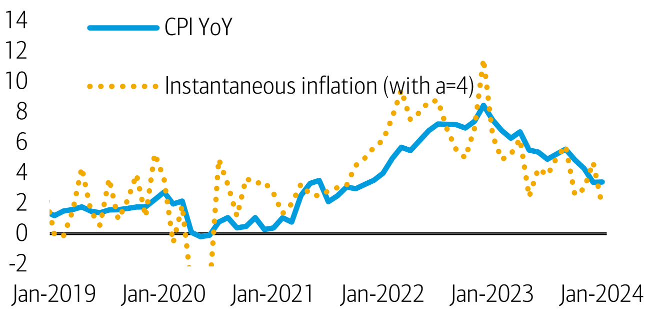
GDP data will show demand is slowing

Inflation is now more narrow-based (Exhibit 18) so focus will shift to aggregate demand. GDP data for the December 2024 quarter will be released on Wednesday March 6 and we expect a modest 0.3%qoq rise that will push growth down to 1.5%yoy from 2.1%.

While our household consumption Tracker suggests consumption improved since 3Q on the back of black Friday sales and services spending, the level of consumption remains weak. Partial data for construction work done showed a 1.1% decline in building work offset by a 2.7% rise in engineering work while private capital expenditure indicated business investment grew in the mining and non-mining industries in the December quarter.

Mining rose 1.1% and non-mining was up 0.6%. These outcomes imply a positive contribution from public sector spending and private final demand. However, we expect a detraction from net exports on the back of rises in services imports and slower export volumes. Company profits are expected to be flat while compensation to employees should reflect higher wages in the quarter (see: Australia Economic Watch: Positive real wage growth to end 2023 21 February 2024

Exhibit 16: Instantaneous inflation is consistent with monthly CPI
Suggesting inflation continues to slow



Source: Macrobond calculation based on Instantaneous inflation paper from UPF Barcelona, July 2023. Kernel density estimation with bandwidth parameter a=4 vs traditional inflation a=0.

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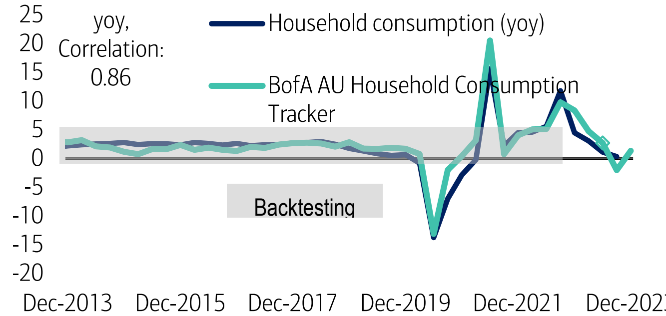
Exhibit 17: Modest rebound in spending in 4Q
Driven by heavy discounting



Source: BofA Global Research, Macrobond, CoreLogic, ABS. This performance is back-tested and does not represent the actual performance of any account or fund. Back-tested performance depicts the theoretical (not actual) performance of a particular strategy over the time period indicated. No representation is being made that any actual portfolio is likely to have achieved returns similar to those shown herein. The Tracker is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This Tracker] was not created to act as a benchmark BofA GLOBAL RESEARCH

Exhibit 18: Inflation heatmap
Inflation pressure is becoming more narrow-based

	Old Weights	New weights Jan-2024	Jan-24	Dec-23	Nov-23	Oct-23	Sep-23	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23
Total	100	100	3.4	3.4	4.3	4.9	5.6	5.2	4.9	5.4	5.5	6.7	6.3
Food & Non-Alcoholic Beverages	17.04	17.15	4.4	4	4.6	5.3	4.7	4.4	5.6	7	7.9	7.9	8.1
Meat & Seafoods	2.27	2.12	-2	-1.9	0.2	1.8	1.7	2.6	2.4	2.7	3.8	4.4	4.3
Fruit & Vegetables	2.2	1.99	1.6	-2.2	0.7	1	-5.4	-8.3	-5.4	1	2.7	3.5	5.9
Alcoholic Beverages & Tobacco	7.74	6.98	6.7	6.8	6.4	6.6	5.8	4.4	4.5	4.6	4.7	4.8	4.9
Alcoholic beverages	5.04	4.8	4.5	4.6	4.2	4.5	5	4.7	5	5.1	5	5.1	5.4
Tobacco	2.7	2.18	10.7	10.8	10.5	10.4	7.5	3.7	3.6	3.8	4.1	4.3	3.9
Clothing & Footwear	3.22	3.4	0.4	-0.8	-0.9	-1.5	-0.1	1.5	1.5	-0.7	-0.4	2	3.2
Housing	22.18	21.74	4.6	5.2	6.6	6.1	7.2	6.6	7.3	7.4	8.3	8.8	9.4
Rents	5.76	6.03	7.4	7.4	7.1	6.6	7.6	7.8	7.6	7.3	6.3	6.1	5.3
New Dwelling Purchase by Owner-Occupiers	8.52	8.07	4.8	5.1	5.5	4.7	4.9	4.8	5.9	6.6	8.3	9.2	11.1
Furniture, Furnishings & Household Equipment & Services	8.77	8.43	0.3	-0.3	-0.3	0.4	2.3	4	4.3	6.3	6	6.3	7.2
Health	6.22	6.43	3.9	4.7	5.2	6.3	5.4	5.2	5.2	5.2	4.7	4.7	5.4
Transport	10.69	11.42	3	3.6	3.6	5.9	9.4	7.4	0.3	-0.9	0.8	7.1	0.8
Automotive Fuel	3.46	3.73	3.1	5.3	2.3	8.6	19.7	13.9	-7.6	-10.6	-8	9.5	-8.2
Communication	2.18	2.14	2	2	2.4	1.8	1.2	1.6	0.3	0.6	1.1	0.2	1.2
Recreation	11.87	12.55	-1.7	-2.4	1.2	2.7	3.5	3.9	4.1	6.8	3.5	6.4	6.1
Travel & Accommodation	5.38	6.02	-7.1	-9.1	-0.3	1.3	1.9	6.6	5.3	12.9	7.3	11.9	13.9
Education	4.43	4.34	4.7	4.7	4.8	4.8	4.8	5.5	5.2	5.2	5.5	5.5	5.5
Finance & Insurance	5.66	5.43	8.2	8.2	8.8	8.6	8.6	8.8	8.5	8.5	7.8	6.7	6.6

Source: ABS, Macrobond

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Emerging EMEA

Tatonga Rusike
MLI (UK)

South Africa: Spending grip + SARB profits transfer champion short-term boost for Budget

Fiscal framework unchanged – a short-term positive

With no real new tax measures, the National Treasury largely maintained its call for a grip on spending. It cited nominal reductions in non-interest spending, no new allocations to state-owned enterprises and slower growth in debt service costs, helping to keep fiscal forecasts more constructive than our base case. Non-interest spending is set to grow 4-5% per year, while interest spending should increase by less than 10%.

Risks to spending could influence fiscal outcomes

There are risks to spending assumptions that could impact fiscal outcomes. Historical wage agreements have resulted in settlements above the Treasury's baseline. Interest spending has grown by 15% over the past three fiscal years. Assuming an increase of less than 10% could be a risk, even if helped by reducing borrowings through central bank profits drawdowns. New spending transfers to Transnet may be delayed rather than denied, as Transnet is too big to fail.

We turn more positive once Eskom support is phased out

The government expects a main budget deficit of -4.7% of GDP in 2023/24 (BofA -4.8%) and -4.3% for the 2024 budget (BofA -4.5%). Our all-in deficit including Eskom support is above the line at -5.8% in 2023/24E and -5.4% in 2024/25E and -5.6% in 2025/26E. Our forecasts underscore our overall dim view of public finances. To be constructive on the fiscal, we wait for 2026 when Eskom support is phased out, likely resulting in a stronger primary surplus.

Central bank profits drawdown reduces borrowing

Immediate access to central bank profits (unrealised revaluation gains from central bank FX reserves in the Gold & Foreign Exchange Contingency Reserve Account (GFECRA)) reduces near-term borrowing requirements. The government is set to tap into R150 billion (about 2% of GDP) of GFECRA funds over the next three years. Net borrowings, excluding redemptions, in 2024/25 will likely decline to R385 billion, from R407 billion in 2023/24. However, due to lower GFECRA drawdowns, net borrowings could increase to R418 billion in 2025. As Eskom support is phased out, net borrowings should decline more significantly in 2026 to below R300 billion.

Leadership continuity at Treasury key post elections

As South Africa heads to elections on May 29, opinion polls suggest governing ANC could fail to win an outright majority and it may need to form a coalition to remain in government. The outcome could be uncertain and noisy. However, the budget presentation looked beyond elections and refuted suggestions of populist spending before voting: no new spending ahead of the election and no tax increases, with the aim to stabilise debt. We hope that, for continuity, the Finance Minister can stay beyond 2024 to continue implementing his fiscal framework. Leadership changes could be a further setback to structurally weak public finances.

Post-budget fiscal views

Short-term boost

The budget provided a short-term boost to the fiscal outlook – the drawdown from central bank profits cut near-term borrowing by R100 billion. However, it will be challenging to reduce fiscal deficits significantly over the next two years. Fiscal consolidation will likely rely on containing expenditure due to few tax options – VAT and PAYE are already at high rates. CIT (corporate income tax) was supposed to trend downwards but will likely stay at the current level as the government can't afford to lose more tax revenues.

New bailout packages for state-owned enterprises were temporarily contained but not eliminated. Transnet is still covered by the R47 billion guarantee and may require future transfers to support its turnaround plans. Like Eskom, Transnet is too big to fail.

Spending increases by R250 billion over the medium term are largely due to budgeting for higher wages and social protection. Budgeting for wages becomes more realistic with average growth of 4.5% compared to close to 2% in the previous framework. Social protection increases suggest the social relief of distress grant could become permanent through increases in overall social protection allocation. For the first time, there is no additional allocations for debt service over the medium term.

Primary surpluses to anchor fiscal outlook

The National Treasury is targeting consistent primary surpluses over the medium term to anchor fiscal consolidation and debt stabilisation by 2025/26 – an elusive dream over the past 10 years. We think the fiscal outlook is more positive from 2026, when Eskom financing is completed and deficits below 4% of GDP should truly support strong primary surpluses. When we include Eskom allocations in spending, primary balance remains negative until at least 2026.

Increasing tax revenues are likely to rely on higher GDP growth. We see new tax policy measures as limited – there were no increases in the major taxes in the 2024 budget, in line with our expectations. The R15 billion baseline of new tax measures is largely covered by bracket creep – not by adjusting tax brackets for inflation which provides a higher revenue base. The Treasury largely maintained its call for a grip on spending with no new allocations to state-owned enterprises and slower growth in debt service costs helped by tapping into GEFECRA. Additional spending of R58 billion should cover shortfalls in wage bill budgeting.

Fiscal revenues likely to hold up

Changes to economic growth forecasts to 0.6% in 2023 and 1.3% in 2024 are largely in line with our expectations. Tax revenues are directly affected by changes in nominal GDP growth. Headline revenue projections remain largely unchanged compared to three months ago. While revenue buoyancy in 2024 appears higher than usual (1.33 in 2024/25 vs 0.6% in 2023/24), it reflects the pick-up in economic growth that will be transmitted to revenues. We think revenue targets should be broadly achievable. Tax revenue gains over the medium largely emanate from bracket creep resulting in overall gains of R18.2 billion in 2024/25, R19.3 billion in 2025/26 and R28.2 billion in 2026/27.

Nominal spending reductions set tone for containment

Expenditure growth is assumed to increase below inflation – in nominal terms, 4% in 2024 and 5% thereafter. The 2023 fiscal year shows control over non-interest spending – down R6 billion from the original 2023 budget guidance. Over the medium term, non-interest expenditure cuts amount to R80.6 billion due to a reduction in the baseline from the February 2023 budget. Nevertheless, some expenditure increases contained in the fiscal framework relate to provisioning for wage increases, social grants inflation related adjustments, , among others. For instance, the Treasury has now factored in additional allocations for social protection until 2027– amounts similar to those for the social relief of distress grant, implying this funding may become permanent.

Higher wage increases remain a risk to fiscal outlook

The overall wage bill increase has risen to 4.5% compared to around 2% in the previous framework. Should wage negotiations result in higher increments, the government intends to offset increases within existing budget lines and, if necessary, reduce headcount. Negotiations between the PSA and the public service unions are to begin in the next fiscal year. Higher wage increases present downside risks to the fiscal framework.

Debt service costs have been among the fastest-growing spending items, rising by 15% on average in the last three fiscal years. The pace of growth is assumed to slow to less than 10% pa due to lower borrowing than suggested by headline deficits. This is largely due to drawdowns of central bank profits by the government.

Deficit and financing

Exhibit 19: Financing Outlook table for 2024

GFECRA drawdowns of R100 billion reduces borrowings more substantially.

Financing outlook	Revised 23/24	Budget 2024	BofA 2024 baseline
Main budget balance	-331.38	-321	-341
Redemptions	-145.76	-172.6	-172.6
Eskom debt relief	-78	-64.15	-64.15
GFECRA settlement		100	100
Total financing required	**-555.1**	**-457.7**	**-477.8**
Financing items			
Domestic long term	327.9	328.1	328.1
Domestic short term	88	33	53.1
External borrowing	45.16	36.7	36.7
Use of cash	92.07	59.9	59.9
Total financing	**553.13**	**457.7**	**477.8**

Source: National Treasury, BofA Global Research

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Domestic borrowing auctions largely unchanged

Domestic long-term borrowings were largely left unchanged. Treasury bills were utilised to cover short term funding gaps. Domestic auction changes were made to long term issuances, albeit mildly. The fixed rate bond amounts were reduced marginally to R3.75 billion per week from R3.9 billion, inflation linkers remained unchanged at R1 billion.

No Eurobond market access near term

Near-term external borrowing remains relatively low. The government expects to borrow $2 billion in 2024/25 fiscal year largely from concessional sources. There is no baseline for market issuance. External borrowing is likely to be scaled up in 2025 to about $9.5 billion, with Eurobond market access likely that year.

Latin America

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Jaguar economy and the spillovers from export-led growth

Full report:* *[Costa Rica Viewpoint: Jaguar economy and the spillovers from export-led growth]

Strong growth and deflation: Export-led growth explains it

Costa Rica is achieving a remarkable combination of strong growth and deflation. We believe that this apparent puzzle can be explained because Costa Rica's growth has become more export-led since the outbreak of the pandemic. We see an analogy to the East Asian "tiger" economies that developed rapidly from the 1960s by focusing on capital accumulation, export-oriented manufacturing, and human capital development.

"Jaguar" vs. East Asian "tiger" economies

The Costa Rican "jaguar" economy has some key differences with the East Asian "tiger" economies. Costa Rica is currently at a higher level of economic development than those economies were in the 1960s and its workforce boasts high education and health indicators compared to the region. In addition, Costa Rica's export mix is not restricted to manufactured goods but includes a significant share of non-tourism services.

Costa Rica's unique free trade zone policy

There is less state intervention than happened in East Asia, though Costa Rica's free trade zone policy is clearly part of the success. A unique feature of Costa Rica is that its free trade zones are not restricted to specific geographic locations. It is a differentiated tax regime that can be claimed by any qualifying business, in both goods and services. This flexibility is an important driver of the outperformance of this sector, in our view.

Three benefits from export-led growth

Export-led growth is having at least three additional desirable effects on the macroeconomy: 1) a decline in the natural unemployment rate, with favorable implications for monetary policy, 2) an improvement in balance of payments, and 3) perhaps a stronger fundamental value of the Costa Rican Colon, which can be critical to bring down the public debt ratio.

Stronger Costa Rican Colon: Balassa Samuelson effect

We have revised up our GDP growth forecasts for 2024, to 4.2% (from 3.8%), and 2025, to 3.8% (from 3.5%). Labor productivity in Costa Rica is growing 5x faster than in the US. Real wages are growing at the fastest pace in over 20 years. These are signals of something that economists call the "Balassa Samuelson effect" which makes the real exchange rate stronger. Hence, we also changed our USDCRC forecasts to 505 (year-end 2024) and 518 (year-end 2025). This is an out-of-consensus view for a stronger CRC.

Summary of investor trip: A solid case

Costa Rica is one of the very few LatAm countries, in our view, where the economy seems on track to achieve substantial and sustained progress. Some locals push back by saying crime is on the rise or criticizing the government's style of doing politics (vinegary with the press and opposition parties). Nevertheless, the broad picture looks quite positive when contrasted with the region.

The economy is growing robustly, led by exports, amid (temporary) deflation. The opposite of stagflation, one could say. The balance of payments and fiscal conditions are on an improvement trend, which we think will trigger more credit rating upgrades.

Meeting with policymakers and experts from different sectors (financial, multilaterals, independent economists), during our recent trip to San Jose, reaffirmed our conviction that Costa Rica is a solid case.

Revised up GDP growth forecasts for 2024 and 2025

We have revised up our GDP growth forecasts for 2024, to 4.2% (from 3.8%), and 2025, to 3.8% (from 3.5%). Growth in 2023 was 5.1%. Exports of goods and services (10.5%) and investment (8.6%) were particularly strong. Exports of goods and services have grown at rates above 10% for three consecutive years. December's GDP proxy showed a slowdown at the margin, but nothing that changes our opinion about the broad picture.

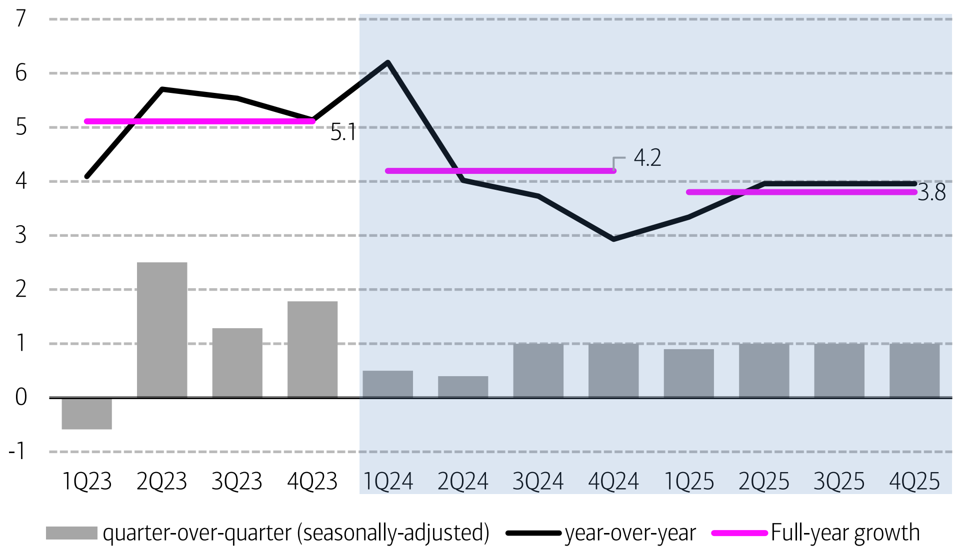
Nearshoring, luxury properties, trickle-down effects

Locals say there is tangible evidence on nearshoring of US investments to Costa Rica (Intel, Johnson & Johnson, Abbot, among others), mainly in the export-oriented free trade zones. They also highlight a boom in the construction of luxury properties along the Guanacaste coast, and trickle-down effects of robust economic growth for the population.

The Statistics Institute's (INEC) household survey estimates the poverty rate fell to 21.8% in 2023 (from 23% in 2022). More high frequency data shows real wages are growing 14% yoy (December 2023, latest data point). Conversely, some business associations complain that the appreciation of the Costa Rican Colon is eroding the cost-competitiveness of domestic producers.

Exhibit 20: GDP growth forecasts

We forecast GDP growth hovering around 4%, higher than the mean of the last fifteen years (3.3%)



Source: BofA Global Research, Central Bank (BCCR)

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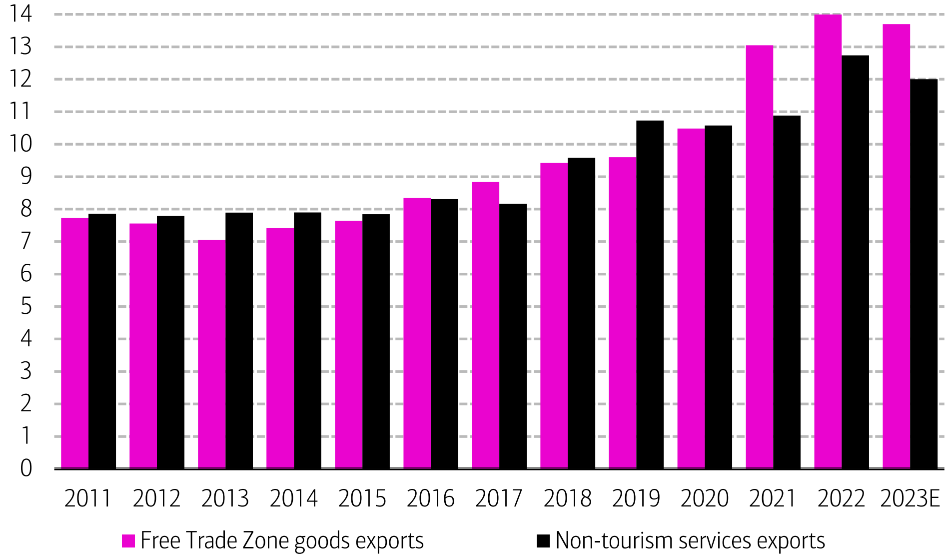
Export-led growth strengthens macroeconomic stability

GDP driven by exports is a much healthier way for an economy to grow, compared to public sector demand-led or consumption-debt expansions that are less sustainable because of their proclivity to create macro imbalances.

Moreover, in the case of Costa Rica, we will argue export-led growth is having at least three additional desirable effects in economic conditions: 1) a decline in the natural unemployment rate, with favorable implications for monetary policy, 2) an improvement in balance of payments, the easiest to observe; and 3) perhaps a stronger fundamental value of the Costa Rican Colon (more difficult to prove), which can be critical to bring down the public debt ratio.

Exhibit 21: The booming Free Trade Zone goods exports and non-tourism services exports (% of GDP)
Between 2019 (pre-pandemic) and 2023, free trade zone goods exports jumped from 9.6% to 13.7% of GDP, while non-tourism services exports rose to 12% of GDP (from 10.7%) driven by professional services



Note: Data for 2023 are rolling four quarters ended in 3Q2023 (latest data point in the balance of payments).
Source: Central Bank (BCCR), BofA Global Research

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Decline in natural unemployment rate

Unemployment rate at historical lows

Costa Rica's unemployment rate declined to 7.3% in 4Q2023 (from 11.7% in 4Q2022), the lowest on-record, well below what consensus considers to be the natural rate of unemployment (around 10%, like the historical median). Economists generally say structural unemployment in Costa Rica is high because the tax wedge on labor costs imputable to social security is twice the OECD average, among other reasons. Yet currently, with the rate at 7.3%, the economy is not exhibiting symptoms of overheating. In fact, the number of employed workers dropped 4.2% yoy in 4Q2023, which is very puzzling for an economy that grew more than 5% in 2023.

Falling participation rate is only a partial explanation

An arithmetical explanation is that the participation rate is much lower than last year (53.8% in 4Q2023 vs. 59.7% in 4Q2022). If less people are looking for jobs, then the number of unemployed individuals goes down mechanically. Locals say the falling participation rate may be attributable to i) women attending childcare responsibilities (drop is sharper in female population); ii) older cohorts rushing to retire (because of recent changes in early retirement laws); and iii) people reevaluating their life choices after the pandemic.

Export-led growth on the back of labor-intensive, formal, activities

In our interpretation, the structural decline in the unemployment rate must also be related to export-led growth. Between 2019 (pre-pandemic) and 2023, free trade zone goods exports jumped from 9.6% of GDP to 13.7% of GDP, while non-tourism services exports rose to 12% of GDP (from 10.7%) driven by professional services. These are labor-intensive activities that predominantly operate in the formal sector and pay higher wages. They are absorbing jobs from the less productive, more informal, non-tradable sectors.

Tellingly, data from the Social Security Institute (CCSS) shows the number of people affiliated to social security (proxy for formal employment) is up 3.8% yoy. Meanwhile, delving into the labor market data one can see that the category in which employment is falling the most is "household employment" (part of the informal economy).

Monetary policy: more degrees of freedom because of lower U-star

A lower natural unemployment rate (U-star) should be welcomed by the Central Bank (BCCR) because it will allow them to achieve higher economic growth and a lower unemployment rate without fanning inflation. It may help to solve the puzzle for why Costa Rica's inflation is so low now. CP inflation is running at -1.9% yoy (January 2024), and core (CPI excluding volatile food & fuels) is at -0.3% yoy.

We think deflation is driven by the exchange rate appreciation (related to Balassa-Samuelson effect), flexible regulation of fuel and food prices (international variations are quickly passed along to consumers), and a labor market than is less tight than what would assume by simply looking at the unemployment rate. Looking ahead, we expect the BCCR to cut in tandem with the US Fed in 2024 (25bp in June, September, and December) taking the policy rate to 5%. For 2025, we expect two additional 25bp cuts.

Improvement in the balance of payments

Narrowing of current account deficit will probably stick

We estimate Costa Rica's current account deficit narrowed to 1.5% of GDP in 2023, from 3.7% in 2022, much smaller than its long-term average (4%). At the outset, the deficit seems small for a year in which oil prices were relatively high (US$/bbl 80 on average), the exchange rate was supposed to be overvalued (that's what locals say), and the economy grew above 5% (exceeding the potential rate, ~3.5%-4%) putting pressure on demand for imports.

Yet that overlooks what is going on the exports part of the equation. As we mentioned above, goods exports from free trade zones and services exports have increased a lot compared to the pre-pandemic year (more than 5pp of GDP, added up together). That change is structural, we think, and should get reinforced by the ongoing nearshoring of US investments which is flowing into the free trade zones. We forecast the current account deficit at 1.7% of GDP for 2024 and 2025 (from 2.5% and 2.7% in our previous scenario, respectively).

Improvement is also visible on funding side and international reserves position

On the funding side, net FDI is strong (above 4% of GDP, almost tripling the current account deficit). Net FDI grew 19% yoy in the first three quarters of 2023. Also, Costa Rica is receiving large loans from multilateral institutions (see exhibit 4), and the government's access to markets is much better than a few years ago (Eurobonds' risk premium, measured by the EMBI, has fallen below some investment-grade countries like Colombia, Mexico, and Panama). Furthermore, international reserves are at historical highs (US$ 13.2bn, +55% yoy, 15.3% of GDP). Roughly around 140% of the IMF's recommended ARA metric.

Key forecasts

Exhibit 22: Economic forecasts
GDP growth, inflation and policy rate forecasts for the major economies

Economic forecasts

	2023Q1	2023Q2	2023Q3	2023Q4	2024Q1	2024Q2	2024Q3	2024Q4	2022	2023F	2024F	2025F
Global and Regional Aggregates, %												
United States												
Real GDP growth [1]	2.2	2.1	4.9	**3.2**	**2.5**	**2.0**	**2.0**	**2.0**	1.9	**2.5**	**2.7**	**1.9**
CPI inflation	5.8	4.0	3.6	**3.2**	**3.2**	**3.4**	**3.1**	**2.9**	8.0	**4.1**	**3.2**	**2.5**
Policy Rate (EoP)	4.88	5.13	5.38	**5.38**	**5.38**	**5.13**	**4.88**	**4.63**	4.38	**5.38**	**4.63**	**3.63**
Euro area												
Real GDP growth [1]	0.4	0.5	-0.5	**0.2**	**0.1**	**0.8**	**0.9**	**1.2**	3.4	**0.5**	**0.4**	**1.1**
CPI inflation	8.0	6.2	5.0	**2.7**	**2.7**	**2.5**	**2.1**	**1.9**	8.4	**5.5**	**2.3**	**1.4**
Policy Rate (EoP)	3.00	3.50	4.00	**4.00**	**4.00**	**3.75**	**3.50**	**3.25**	2.00	**4.00**	**3.25**	**2.00**
China												
Real GDP growth [2]	4.5	6.3	4.9	**5.2**	**4.3**	**5.0**	**4.8**	**5.0**	3.0	**5.2**	**4.8**	**4.6**
CPI inflation [3]	1.3	0.1	-0.1	**-0.3**	**0.1**	**0.5**	**0.9**	**1.7**	2.0	**0.4**	**0.8**	**1.7**
Policy Rate (EoP)	3.65	3.55	3.45	**3.45**	**3.45**	**3.45**	**3.30**	**3.00**	3.65	**3.45**	**3.00**	**2.90**
Japan												
Real GDP growth [1]	4.4	4.0	-3.3	**-0.4**	**-3.7**	**5.6**	**3.0**	**1.0**	1.0	**1.9**	**0.3**	**1.4**
CPI inflation	3.6	3.4	3.1	**2.9**	**2.5**	**2.5**	**2.6**	**2.2**	2.5	**3.3**	**2.5**	**1.9**
Policy Rate (EoP)	-0.10	-0.10	-0.10	**-0.10**	**0.05**	**0.05**	**0.05**	**0.25**	-0.10	**-0.10**	**0.25**	**0.5**
Global Aggregate [4]												
Real GDP growth									3.5	**3.0**	**2.9**	**3.2**
CPI inflation									6.0	**4.2**	**2.9**	**2.7**
Policy Rate (EoP)									4.5	**5.2**	**4.7**	**4.0**
Emerging Markets Aggregate [4]												
Real GDP growth									4.2	**4.1**	**4.0**	**4.3**
Real GDP growth (ex-China)									4.9	**3.5**	**3.5**	**4.2**
CPI inflation									4.8	**3.8**	**3.1**	**3.2**
Policy Rate (EoP)									5.7	**5.9**	**5.4**	**5.0**

Note: Bold values correspond to forecasted data. Notes: 1. Quarterly values are % q/q annualized | 2. Quarterly values are % y/y. | 3. Quarterly values are period averages. | 4. Due to reporting limitations, Global and EM aggregate are annual only. **Source:** BofA Global Research

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Exhibit 23: Markets forecasts
Forecasts for FX, interest rates, commodities and equities

Markets forecasts

	spot	2024Q1	2024Q2	2024Q3	2024Q4	2025Q1
Exchange Rates (EoP)						
EUR/USD	1.08	**1.07**	**1.10**	**1.12**	**1.15**	**1.16**
USD/JPY	150.0	**145**	**143**	**142**	**142**	**140**
USD/CNY	7.19	**7.45**	**7.40**	**7.10**	**6.90**	**6.90**
GBP/USD	1.26	**1.26**	**1.31**	**1.33**	**1.37**	**1.36**
Interest rates (% EoP)						
US 10yr	4.25	**4.40**	**4.30**	**4.25**	**4.25**	**NA**
Bunds 10yr	2.41	**2.45**	**2.35**	**2.25**	**2.10**	**NA**
Japan 10yr	0.71	**0.70**	**0.85**	**0.95**	**1.05**	**1.05**
Commodities [1]						
Oil - Brent ($/bbl)	83.6	**78.0**	**80.0**	**82.0**	**80.0**	**NA**
Oil - WTI ($/bbl)	78.3	**73.0**	**75.0**	**77.0**	**75.0**	**NA**
Gold ($/oz)	2043.6	**1950**	**1950**	**2000**	**2000**	**2100**
Equities (EoP)						
S&P 500	5103				**5000**	
Stoxx 600	495				**410**	

Note: Bold values correspond to forecasted data. Notes: 1. All values are EoP, except for gold forecasts, which are period averages. **Source:** BofA Global Research

BofA GLOBAL RESEARCH

Detailed forecasts

Global economic forecasts

Exhibit 24: Global Economic Forecasts

Global GDP growth expected at 2.9% in 2024

	GDP growth, %				CPI inflation*, %				Short term interest rates**, %			
	2022F	2023F	2024F	2025F	2022F	2023F	2024F	2025F	Current	2023F	2024F	2025F
Global and regional aggregates												
Global	3.5	3.0	2.9	3.2	6.0	4.2	2.9	2.7	6.08	5.20	4.66	4.02
Global ex US	3.9	3.2	2.9	3.5	5.5	4.2	2.9	2.8	6.24	5.16	4.67	4.11
Global ex China	3.7	2.4	2.4	2.8	7.0	5.2	3.5	3.0	6.80	5.71	5.15	4.36
Developed Markets	2.6	1.5	1.4	1.5	7.5	4.7	2.7	2.0	4.21	4.27	3.65	2.71
Emerging Markets	4.2	4.1	4.0	4.3	4.8	3.8	3.1	3.2	7.56	5.93	5.42	4.99
Emerging Markets ex China	4.9	3.5	3.5	4.2	6.5	5.8	4.4	4.1	10.09	7.58	7.04	6.38
Europe, Middle East and Africa (EMEA)	3.9	1.0	1.1	2.1	8.0	7.0	4.3	3.3	9.23	5.85	5.61	4.46
European Union	3.0	0.6	0.8	1.6	9.2	6.5	2.6	1.8	4.35	4.39	3.57	2.36
Emerging EMEA	4.6	2.1	2.5	4.0	7.6	9.3	7.7	6.3	18.91	9.98	10.71	9.60
Emerging Asia	4.2	5.0	4.8	4.8	3.6	2.3	1.9	2.4	4.28	4.38	3.98	3.76
ASEAN	5.8	4.2	4.7	4.9	4.6	3.6	1.5	2.7	4.89	4.92	4.39	3.86
Latin America	4.1	2.1	1.5	2.3	7.7	5.0	3.7	3.4	10.69	10.88	8.59	7.66
G6												
US	1.9	2.5	2.7	1.9	8.0	4.1	3.2	2.5	5.38	5.38	4.63	3.63
Euro area	3.4	0.5	0.4	1.1	8.4	5.5	2.3	1.4	4.00	4.00	3.25	2.00
Japan	1.0	1.9	0.3	1.4	2.5	3.3	2.5	1.9	-0.10	-0.10	0.25	0.50
UK	4.3	0.1	0.3	0.8	9.1	7.3	2.4	2.3	5.25	5.25	4.75	3.75
Canada	3.8	1.1	1.3	2.4	6.8	3.9	2.5	2.1	5.00	5.00	3.75	3.00
Australia	3.6	1.8	1.4	2.0	6.6	5.7	3.4	2.9	4.35	4.35	4.35	3.50
Euro area												
Germany	1.9	-0.1	-0.2	0.9	8.6	6.1	2.7	1.4	4.00	4.00	3.25	2.00
France	2.5	0.8	0.7	1.3	5.9	5.7	2.9	2.0	4.00	4.00	3.25	2.00
Italy	3.9	0.7	0.5	1.1	8.7	6.0	1.8	1.5	4.00	4.00	3.25	2.00
Spain	5.8	2.4	1.3	1.5	8.3	3.4	2.6	1.1	4.00	4.00	3.25	2.00
Netherlands	4.4	0.0	0.3	1.1	11.6	4.1	1.7	1.6	4.00	4.00	3.25	2.00
Belgium	3.0	1.4	0.9	1.2	10.3	2.2	1.5	1.7	4.00	4.00	3.25	2.00
Austria	4.8	-0.7	0.0	1.5	8.6	7.7	2.7	2.1	4.00	4.00	3.25	2.00
Greece	5.7	2.0	1.1	1.7	9.3	4.2	2.0	1.7	4.00	4.00	3.25	2.00
Portugal	6.8	2.2	1.0	1.4	8.1	5.4	2.5	1.1	4.00	4.00	3.25	2.00
Ireland	9.5	-1.4	2.7	2.0	8.1	5.8	2.9	1.6	4.00	4.00	3.25	2.00
Finland	1.6	-0.4	0.2	1.0	7.2	4.3	0.9	1.2	4.00	4.00	3.25	2.00
Other developed economies												
New Zealand	2.5	1.2	0.8	2.0	7.2	5.8	3.0	2.5	5.50	5.50	3.75	3.00
Switzerland	2.7	0.9	1.1	1.2	2.8	2.2	1.3	1.2	-0.75	1.75	1.25	0.50
Norway	3.7	1.1	0.4	1.2	6.2	5.3	3.7	2.8	4.50	4.50	4.00	2.75
Sweden	3.0	-0.3	-0.4	1.1	8.1	8.5	2.5	1.6	4.00	4.00	3.25	2.00
Emerging Asia												
China	3.0	5.2	4.8	4.6	2.0	0.4	0.8	1.7	3.45	3.45	3.00	2.90
India	6.7	6.5	5.7	6.0	6.7	5.6	4.7	4.3	6.50	6.75	6.50	6.25
Indonesia	5.3	5.0	5.1	5.2	4.2	3.7	2,8	2.8	6.00	6.00	5.25	4.25
Korea	2.6	1.4	2.3	2.5	5.1	3.6	2.3	2.0	3.50	3.50	3.00	2.50
Taiwan	2.6	1.4	3.2	2.3	2.9	2.5	2.0	1.5	1.88	1.88	1.88	1.88
Thailand	2.7	1.8	2.6	2.8	6.1	1.6	0.8	0.9	2.50	2.50	2.00	1.75
Malaysia	8.7	3.7	4.4	4.8	3.4	2.5	2.0	2.5	3.00	3.00	3.00	3.00
Philippines	7.6	5.6	5.4	5.5	5.8	6.0	3.3	3.1	6.50	6.50	5.50	4.50
Singapore	3.6	1.1	2.6	2.6	6.1	4.8	2.8	2.3				
Hong Kong	-3.5	3.2	2.1	2.4	1.9	2.1	2.0	1.9	4.68	5.75	5.00	4.00
Vietnam	8.0	5.0	6.2	6.8	3.2	3.4	3.8	4.1	4.50	4.50	4.50	5.00

Source: BofA Global Research

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Exhibit 25: Global Economic Forecasts (continued)

Global GDP growth expected at 2.9% in 2024

	GDP growth, %				CPI inflation*, %				Short term interest rates**, %			
	2022F	2023F	2024F	2025F	2022F	2023F	2024F	2025F	Current	2023F	2024F	2025F
Latin America												
Brazil	2.9	3.0	2.2	2.5	9.3	4.6	3.8	3.7	11.25	11.75	9.50	9.50
Mexico	3.9	3.2	1.8	1.0	7.9	5.5	4.9	4.4	11.25	11.25	9.25	7.50
Argentina	5.2	-1.6	-3.5	3.5	72.4	133.5	283.2	152.9	100.00	100.00	60.00	55.00
Colombia	7.3	0.6	1.4	2.8	10.2	11.8	6.4	4.0	12.75	13.00	9.50	6.00
Chile	2.4	0.1	2.2	2.0	11.6	7.3	3.2	3.0	7.25	8.25	5.00	4.75
Peru	2.7	-0.6	2.5	2.9	7.9	6.3	2.3	2.5	6.25	6.75	4.00	4.00
Ecuador	6.2	2.7	1.0	2.4	3.7	1.3	1.7	2.1				
Uruguay	4.9	1.1	3.3	2.0	8.3	5.1	5.4	5.5				
Costa Rica	4.6	5.1	4.2	3.8	7.9	-1.8	2.3	3.0	5.75	6.00	5.00	5.00
Dominican Republic	4.9	2.4	5.3	5.0	7.8	3.6	4.2	4.9	7.00	7.00	6.25	6.00
Panama	10.8	6.0	2.0	3.6	2.1	1.9	1.7	1.5				
El Salvador	2.6	2.8	2.7	2.8	7.3	1.2	1.9	1.4				
Guatemala	4.1	3.5	3.5	4.0	9.2	4.2	3.9	4.3	5.00	5.00	4.25	4.25
EEMEA												
Türkiye	5.6	4.3	3.4	4.6	72.0	53.4	56.9	29.3	45.00	42.50	45.00	30.00
Nigeria	3.3	2.5	3.1	3.1	18.8	24.5	24.0	15.0	22.75	18.75	25.00	20.00
Egypt	6.7	3.8	2.5	3.8	8.5	24.4	29.0	25.0	21.75	18.25	22.25	23.25
Poland	5.5	0.0	3.0	3.5	14.3	11.6	4.1	4.8	5.75	5.75	5.75	4.75
South Africa	1.9	0.5	1.3	1.5	6.9	5.9	5.0	4.6	8.25	8.25	7.50	7.00
Romania	4.6	1.9	3.0	3.7	13.7	10.5	5.6	4.0	7.00	7.00	6.25	5.25
Czech Republic	2.4	-0.4	1.0	2.6	15.1	10.7	2.1	1.9	6.25	6.75	3.50	3.00
Israel	6.5	2.0	2.3	3.4	4.4	4.2	2.5	2.2	4.50	4.75	3.50	2.20
Hungary	4.6	-0.8	2.8	3.0	14.6	17.1	4.0	3.9	9.00	10.75	5.50	4.00
Saudi Arabia	8.7	-0.9	0.1	4.5	2.5	2.6	2.2	2.1	5.50	6.00	5.25	4.25
Ukraine	-29.1	6.3	4.5	8.0	20.0	13.4	7.0	8.0	15.00	15.00	14.00	13.00

Source: BofA Global Research

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Exhibit 26: Real GDP growth, qoq annualized %

Global GDP growth expected at 2.9% in 2024

	1Q 2023	2Q 2023	3Q 2023	4Q 2023	1Q 2024	2Q 2024	3Q 2024	4Q 2024	2023	2024	2025
Developed Markets											
United States	2.2	2.1	4.9	3.2	2.5	2.0	2.0	2.0	2.5	2.7	1.9
Euro Area	0.4	0.5	-0.5	0.2	0.1	0.8	0.9	1.2	0.5	0.4	1.1
Japan	4.4	4.0	-3.3	-0.4	-3.7	5.6	3.0	1.0	1.1	1.3	1.2
United Kingdom	0.9	0.0	-0.5	-1.4	0.6	1.0	1.4	1.2	0.1	0.3	0.8
Canada	2.6	0.6	-0.5	1.0	1.8	1.7	2.1	2.3	1.1	1.3	2.4
Australia	-	-	-	-	-	-	-	-	1.8	1.4	2.0
G6 Aggregate	1.8	1.6	1.5	1.3	0.8	1.9	1.7	1.5	1.5	1.5	1.5
Emerging Markets											
China	8.7	2.4	6.1	4.1	4.8	5.1	5.2	4.8	5.2	4.8	4.6
Indonesia	6.0	5.2	2.9	4.1	5.7	7.0	3.6	4.1	5.0	5.1	5.2
Korea, Republic Of (South)	1.3	2.5	2.4	3.0	0.4	3.2	2.7	3.1	1.4	2.3	2.5
Thailand	6.6	0.9	2.4	-2.3	3.5	4.4	7.0	3.9	1.8	2.6	2.8
Singapore	-1.4	0.3	5.3	7.0	-3.9	3.2	3.6	4.1	1.1	2.6	2.6
Hong Kong	21.5	-3.5	1.9	2.0	7.7	-1.7	2.8	4.9	3.2	2.1	2.4
Brazil	7.5	7.5	1.1	0.1	5.8	0.8	2.2	1.1	3.0	2.2	2.5
Mexico	3.3	3.4	4.3	0.3	2.4	1.4	0.8	-0.2	3.2	1.8	1.0
Colombia	9.2	-4.1	1.4	0.1	2.0	2.4	2.8	2.8	0.6	1.4	2.8
Chile	0.2	1.6	1.3	2.1	2.7	3.3	2.5	1.9	0.1	2.2	2.0
Peru	-5.2	1.3	0.6	2.1	3.6	2.4	2.8	2.8	-0.6	2.5	2.9
Türkiye	-1.0	13.9	1.1	0.0	5.7	2.8	3.0	3.0	4.3	3.4	4.6
South Africa	-1.9	0.7	0.7	0.8	1.8	1.8	2.0	2.0	0.5	1.3	1.5

Source: BofA Global Research

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Monetary policy forecasts

Exhibit 27: Key meeting dates and expected rate change (bp)
End of period

	Current	24-Jan	24-Feb	24-Mar	24-Apr	24-May	24-Jun
Developed Markets							
Fed	5.25	31st (unch)	-	20th (unch)	-	1st (unch)	12th (-25bp)
ECB	4.50	25th (unch)		7th (unch)	11th (unch)		6th (-25bp)
BoJ	-0.10	23rd (unch)		19th (unch)	26 (+10bp)		14th (unch)
BoE	5.25		1st (unch)	21st (unch)		9th (unch)	20th (unch)
BoC	5.00	24th (unch)	-	6th (unch)	10th (unch)	-	5th (-25bp)
Riksbank	4.00		1st (unch)	27th (unch)		8th (unch)	27th (-25bp)
SNB	1.75			21st (unch)			20th (unch)
Norges Bank	4.50	25th (unch)		21st (unch)		3rd (unch)	20th (unch)
RBA	4.35		5-6 (unch)	18-19 (unch)		6-7(unch)	17-18(unch)
RBNZ	5.50		28th (unch)		10th (-25bp)	22th(-25bp)	
Emerging Asia							
China (lending rate)	3.45	19th (unch)	19th (unch)	19th (unch)	19th (unch)	19th (unch)	19th (unch)
Req. res. ratio*	10.00	-	-	-	-	-	-
India**	6.75	-	8th (unch)	-	-	-	-
Repo rate	6.50	-	-	-	-	-	-
Cash res. ratio	4.50	-	-	-	-	-	-
Korea	3.50	11th (unch)	22nd (unch)	-	12th (unch)	23rd (-25bp)	-
Indonesia	6.00	Unch	Unch	Unch	Unch	Unch	-25bp
Taiwan	1.88	-	-	21st (unch)	-	-	20th (unch)
Thailand	2.50	-	7th (unch)	-	10th (unch)	-	12th (unch)
Malaysia	3.00	13th (unch)	23rd (unch)	-	12th (unch)	24th (unch)	-
Philippines	6.50	-	Unch	Unch	-	Unch	-25bp
Latin America							
Brazil	11.25	(-50bp)		20th (-50bp)		8th (-50bp)	19th (-50bp)
Chile	7.25	(-100bp)			2nd (-25bp)	23rd (-25bp)	18th (-25bp)
Colombia	12.75	(-25bp)	-	(-25bp)	(-25bp)	-	(-50bp)
Mexico	11.25	-	(unch)	21st (-25bp)	-	9th (-25bp)	27th (-25bp)
Peru	6.25	(unch)	(-25bp)	(unch)	(-25bp)	(unch)	(-25bp)
Emerging EMEA							
Czech Republic	6.25		08th (-25bp)	20th (-25bp)		02nd (-50bp)	27th (-50bp)
Hungary	9.00	(-50bp)	(-50bp)	(-50bp)	(-50bp)	(-50bp)	(-50bp)
Israel	4.50	1st(unch)	26th(unch)	-	8th(unch)	27th(-50)	-
Poland	5.75	(unch)	(unch)	(unch)	(unch)	(unch)	(unch)
Romania	7.00	(unch)	(unch)		(unch)	(-25bp)	
South Africa	8.25	25th (unch)	-	21st (unch)	-	23rd(unch)	-
Türkiye	45.00	(unch)	(unch)	(unch)	25th(+500bp)	(unch)	

Note: Bolded data are expectations in basis points. "—" denotes no meeting. TBA: MPC meeting not yet set. *Major five banks. **Reverse repo rate.
Source: BofA Global Research, Central Banks

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FX, rates and commodity forecasts

Exhibit 28: Quarterly forecasts

End of period

	Spot	23-Dec	24-Mar	24-Jun	24-Sep	24-Dec
FX forecasts						
G6						
EUR-USD	1.08	1.05	1.07	1.10	1.12	1.15
USD-JPY	150	153	145	143	142	142
EUR-JPY	162	161	155	157	159	163
GBP-USD	1.26	1.21	1.26	1.31	1.33	1.37
USD-CAD	1.36	1.36	1.35	1.34	1.32	1.30
AUD-USD	0.65	0.64	0.66	0.68	0.71	0.71
Asia						
USD-CNY	7.19	7.40	7.45	7.40	7.10	6.90
USD-INR	82.91	83.00	83.00	82.50	82.00	82.00
USD-IDR	15715	15500	15600	15500	15300	15200
USD-KRW	1331	1300	1325	1300	1265	1230
Latin America						
USD-BRL	4.97	4.85	4.90	4.88	4.80	4.75
USD-MXN	17.05	16.97	17.80	18.00	18.30	18.50
Emerging Europe						
EUR-PLN	4.32	4.34	4.30	4.25	4.23	4.20
USD-RUB	118.69	89.47	76.00	77.00	78.00	80.00
USD-TRY	31.22	29.53	32.00	35.00	37.00	40.00
USD-ZAR	19.19	18.36	19.00	19.20	18.50	18.00
Rates forecasts						
US 10-year	4.26	4.50	4.40	4.30	4.25	4.25
Germany 10-year	2.41	2.70	2.45	2.35	2.25	
Japan 10-year	0.71	0.61	0.70	0.85	0.95	1.05
UK 10-year	4.12		4.00	4.00	4.00	4.00
Canada 10-year	3.49	3.75	3.70	3.65	3.65	3.60
Commodities forecasts						
WTI Crude Oil - $/bbl	78.29	82.00	73.00	75.00	77.00	75.00
Brent Crude Oil - $/bbl	83.62	86.00	78.00	80.00	82.00	80.00
Gold $/oz	2043.48	1900.00	1950.00	1950.00	2000.00	2000.00

Notes: Spot exchange rate as of day of publishing. The left of the currency pair is the denominator of the exchange rate. Currency forecasts are for end of period

Source: BofA Global Research, Bloomberg

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