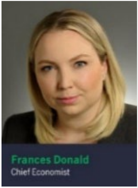
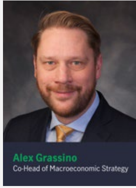
Manulife Investment Management

2024 Outlook Series: A new economy rising

Dec 2023





In this 2024 Annual Outlook, Frances Donald, Global Chief Economist and Strategist, and Alex Grassino, Head of Macroeconomic Strategy, dive into the five major forces that will drive global economies and markets in 2024.

Five macroeconomic themes for 2024

1. Darkest before dawn: Peak growth in this cycle is behind us.

A challenging year for growth

Technical recessions or not, 2024 will be a much more challenging year for growth globally compared with 2023. That economic hardship won't be felt equally across income groups or countries, with the United States more likely to withstand the tightening in the system relative to many other major economies as the country's domestic focus, strong employment profile, and relative consumer health should all provide support.

Conversely, countries that are heavily exposed to international trade and constrained by their ability to borrow are likely to face significant headwinds during the first half of the year, with gradual improvement as central banks begin easing financial conditions. Indeed, 2024 won't feel anything close to the Roaring Twenties thesis that ran rampant from 2021 to 2023. While no cycles are equal, this environment prescribes late-cycle investing strategies, especially in the first half of the year. That said, for many economies, it's often darkest before dawn, and sometime in 2024, it will be time to think about the beginning of the next cycle. Jumping too prematurely on this eventual rebound, however, is dangerous, as troubled waters are still yet to be crossed.

Drivers of successful economies in 2024

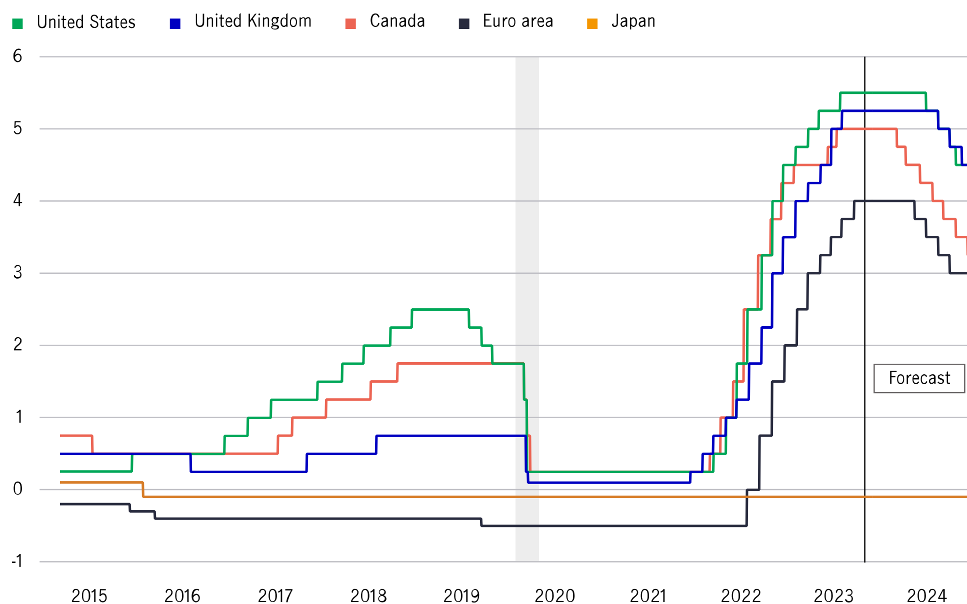
- **Lower debt sensitivities—**Countries with debt profiles (at the government, corporate, and consumer levels) that are either relatively unlevered or that have longer maturity profiles are likely to feel the pain of higher interest rates less acutely.
- **More fiscal room—**Countries that have the scope to add in government stimulus as a countercyclical measure are likely going to be able to better mitigate the full effect of slowdowns than those that don't.
- **Less manufacturing export sensitive—**We're in an environment where key drivers of the business cycle have become desynchronized. Coming out of the pandemic, the focus has shifted from a goods-driven to a services-driven economy, with the manufacturing sector weakening materially. Consequently, economies that are dependent on manufacturing and the export of goods are likely to feel the brunt of a manufacturing slowdown more acutely.
- **Exports geared toward essential commodities—**While the manufacturing impulse might have slowed materially, supply chain disruptions have left demand for core commodities at high levels. For example, climate and supply chain issues have left key crop prices high and have been a boon to exporters in those commodities.

2. Critical concessions: Central banks reluctantly move past peak rates.

The fight against inflation continues

A material and global disinflation took hold in 2023, but 2024 will likely show that the last leg of the inflation battle is more difficult—not just because year-over-year price growth will struggle to return to the post-global financial crisis/pre-COVID norm, but because central banks will, in our view, ultimately begin easing before inflation definitively returns to target, thereby risking a reacceleration in demand and a possible re-emergence of inflationary pressure.

Global rates are expected to fall in 2024 (%)



Source: National central banks, Macrobond, Manulife Investment Management, as of November 30, 2023. The gray area represents recession.

Central banks are faced with an uncomfortable predicament: Do they ease in the face of deteriorating growth despite the likelihood that inflation is still materially above target (and, in price level-terms, sizably higher than pre-COVID)? We expect that, ultimately, they'll either directly or indirectly concede that their blunt tools aren't the right ones to definitively address the current inflationary environment.

This realization will likely be driven by the very nature of present-day inflation: Central bank tools are designed to cool demand-driven inflationary pressure but are less effective against supply shocks, regardless of whether these shocks are caused by enhanced pandemic-related protocols, climate change, or geopolitical tensions. Certain central bankers have already conceded the point, outlining their constrained ability to countermand external shocks.

The consequence of this dynamic is that provided inflationary pressures aren't an acute point of concern, policymakers are likely to relent in the face of weaker growth and choose to reduce restrictive policies in order to counterbalance a softening economy.

This trend will be especially true for central banks with dual mandates, such as in the United States or New Zealand, or in economies that, because of high amounts of leverage, are particularly sensitive to higher rates; Canada, with its levered consumer and expensive home prices, would be one such example.

However, it's important to note that there's a difference between normalizing policy toward more neutral levels (which would imply that monetary policy is neither restrictive nor stimulative) and switching to easing mode (which would create an environment in which low interest rates actually stimulated the economy). In this environment, we view this latter development as unlikely, especially with inflation still running above most central banks' target.

Within this context, in which the limits of central bank policy become evident, we expect a growing dialogue around new non-traditional central banking tools such as central bank digital currencies and the use of targeted tools, such as those available during times of financial system stress. We also anticipate more focus on core central banking assumptions—from the appropriate neutral rate of respective economies to the concept of a 2% inflation target, which is used in many developed-market economies.

Key questions confronting central banks this year

Inflation targets: Is 2% the right target?

As economies slow at a faster pace than inflation normalizes, the pressure to ease current monetary policy stances will intensify. If the last leg down in inflation back toward traditional targets proves difficult to achieve, a growing chorus of voices could potentially call for lowering the bar to cuts by raising the inflation target.

Terminal rates: The post-COVID economy looks different: have we moved to a persistently higher interest-rate environment?

We suspect the answer to this question is yes, but admittedly, the bar to being in a higher-rate environment is extremely low, given that central banks kept policy rates at essentially zero for the better part of a decade, which we wouldn't expect to see again for some time, barring an acute crisis.

New tools: Are quantitative easing and tightening things of the past?

We doubt it. Quantitative tightening is still ongoing in many economies, including the United States. We tend to think of policies like this as akin to putting more tools in the toolbox, to be used as the situation warrants. That said, just because they're available doesn't mean they'd need to be used.

3. The big shift: From a demand-driven to a supply-driven world.

- The drivers of our global economies (and the market implications of such) are shifting away from traditional demand-side factors and toward the supply-side influences of the world: Because of a shifting geopolitical environment, globalization has been replaced with friend-shoring/onshoring, climate events have translated into supply chain disruptions for key commodities, and post-pandemic policies have resulted in meaningful delays across supply chains. While the supply-side driver conversation has focused on inflation for much of the post-COVID period, it's bleeding across a wide range of core economic narratives, including labor markets and productivity, and will continue to do so in 2024 and beyond. We don't necessarily view a more supply-dominant world as a one-way trade (although it's certainly structurally supportive of real assets), but rather that the relative importance of many indicators, economies, and politics will shift. Importantly, this will require careful assessment of traditional forecasting tools. It will also likely open up new investment opportunities: On a regional basis, any friend-shoring/onshoring efforts that would occur from strategic supply chain realignments could prove interesting, as could thematic investments that are more closely tied to strategic government priorities, such as green investment or defense spending.

Data that needs more focus in a supply-driven world

Labor shortages—An aging workforce could continue to affect employment dynamics in two ways: First, as the 55+ cohort approaches retirement the pool of available labor is affected; Second, the departure of more experienced workers could leave institutions with knowledge gaps.

Artificial intelligence—Expanded use of artificial intelligence (AI) could potentially lead to a productivity miracle similar to what was seen during the earlier days of the internet, where seemingly above-trend growth and modest inflationary pressure combine.

The weather—An increasingly important part of supply chain disruptions and corresponding price shocks are climate events.

Asset classes that could receive more investor attention

Strategic commodities—Raw materials that are either nondiscretionary (e.g., agricultural assets) or strategically important will be an area of focus.

Fixed income—Our base case is that while central banks ease, they don't lower policy rates to the point where they're stimulative to the economy. This is at least partly because of incremental modest inflationary pressures caused by the realignment of supply chains. Consequently, with higher base-level yields, the return profile around fixed income is likely to be fundamentally

different relative to other asset classes than it was in a zero-rate world.

Relative beneficiaries of supply chain realignments—With onshoring and friend-shoring becoming more pervasive structural factors in supply chains, countries that are deemed more secure are likely to benefit from continued foreign investment. Similarly, companies responsible for supporting onshoring initiatives are likely to benefit.

4. Out of sync: Desynchronization expands and accelerates.

- While global desynchronization is now a well-understood macro theme, it often gets specifically viewed through the lens of U.S.-China economic decoupling or other measures of broad deglobalization forces. In 2024, we see these elements of global desynchronization accelerating but also expect to see other areas of uncoupling. For one, the global economy is still distorted by the COVID shock and the global manufacturing and services sectors are uncharacteristically disconnected: Manufacturing has experienced a period of weak or negative growth; it's already evident in export-centric countries like Germany, which is already teetering on the edge of a recession. Conversely, while demand for services is moderating, it still remains relatively healthy: Spain is a good example. That's problematic for forecasting models, but it may also present opportunities even as some areas of the global economy falter. We also expect that growth challenges in 2024 won't be distributed equally across economies or income groups, once again muddying the idea of a single, simple global economic forecast applicable to all. In 2024, we also expect to see more focus on intraregional stories. In addition to dynamics such as the European example above, the same general dynamics can be applied to the emerging markets: Certain countries are likely to feel the full impact of Mainland China's structural slowdown and/or U.S. growth challenges differently.

Better understood areas of desynchronized growth

The divergence between goods and services—The manufacturing sector has already experienced a slowdown as a shift from goods to services has occurred. This is in part due to a shift away from using discretionary income on items back toward services such as vacations and dining out.

Timing around exiting lockdowns—Countries that took longer to emerge from restrictive lockdowns are still to varying degrees enjoying that post-opening surge, while regions that exited earlier are closer to normalizing. For example, even though it ultimately proved short-lived, China's exit from lockdown conditions was the impetus for a short-term risk-on rally late in 2022 and in early 2023.

Less well-recognized areas of desynchronized growth

Long(er) and more variable lags—Market participants understand and expect that the global monetary policy tightening experienced over 2022 and 2023 should lead to a lower growth environment. What's less clear is how quickly the full impact of those moves will be felt.

Labor market dynamics—Because of recent employer trauma around scarcity of labor, it's possible that companies will go to greater lengths to retain workers even against a backdrop of slowing growth, which could in turn support the economy and extend the cycle.

What happens when policy eases? Several themes that dominated 2023, such as cash as an asset class and the bifurcation between U.S. new and existing home sales, were due to high policy rates. As central banks ease, the opportunity cost of certain decisions (refinancing a mortgage, flows into money market funds) will diminish, possibly reversing certain trends.

5. Fiscal dominance: Governments grow and become more disruptive.

- The COVID pandemic and, more recently, the rise in fiscal stimulus unlocked a surge in global government spending, some of which was likely

necessary and net positive and some of which was likely excessive and inflationary. In 2024, we expect the growing government share of spending in both individual countries and the world to become more prominent and structural. It will likely show more tangible impacts, including the disruptive nature of a significant increase in sovereign bond supply and the rising costs of large sovereign debt overhangs. Several major elections will become focal market events, decreasing visibility around key policy initiatives and increasing volatility: The Netherlands has recently undergone one such election, and the U.S. election in November 2024 is also likely to require a lot of attention. More strategically, countries with more fiscal room to support their economies through weak economic times will be advantaged, although how that government spending is dispensed (e.g., green spending versus defense spending versus direct redistribution spending) will matter.

Disclaimer

Investing involves risks, including the potential loss of principal. Financial markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. These risks are magnified for investments made in emerging markets. Currency risk is the risk that fluctuations in exchange rates may adversely affect the value of a portfolio's investments.

The information provided does not take into account the suitability, investment objectives, financial situation, or particular needs of any specific person. You should consider the suitability of any type of investment for your circumstances and, if necessary, seek professional advice.

This material is intended for the exclusive use of recipients in jurisdictions who are allowed to receive the material under their applicable law. The opinions expressed are those of the author(s) and are subject to change without notice. Our investment teams may hold different views and make different investment decisions. These opinions may not necessarily reflect the views of Manulife Investment Management or its affiliates. The information and/or analysis contained in this material has been compiled or arrived at from sources believed to be reliable, but Manulife Investment Management does not make any representation as to their accuracy, correctness, usefulness, or completeness and does not accept liability for any loss arising from the use of the information and/or analysis contained. The information in this material may contain projections or other forward-looking statements regarding future events, targets, management discipline, or other expectations, and is only current as of the date indicated. The information in this document, including statements concerning financial market trends, are based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. Manulife Investment Management disclaims any responsibility to update such information.

Neither Manulife Investment Management or its affiliates, nor any of their directors, officers or employees shall assume any liability or responsibility for any direct or indirect loss or damage or any other consequence of any person acting or not acting in reliance on the information contained here. All overviews and commentary are intended to be general in nature and for current interest. While helpful, these overviews are no substitute for professional tax, investment or legal advice. Clients should seek professional advice for their particular situation. Neither Manulife, Manulife Investment Management, nor any of their affiliates or representatives is providing tax, investment or legal advice. This material was prepared solely for informational purposes, does not constitute a recommendation, professional advice, an offer or an invitation by or on behalf of Manulife Investment Management to any person to buy or sell any security or adopt any investment strategy, and is no indication of trading intent in any fund or account managed by Manulife Investment Management. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Diversification or asset allocation does not guarantee a profit or protect against the risk of loss in any market. Unless otherwise specified, all data is sourced from Manulife Investment Management. Past performance does not guarantee future results.

Manulife Investment Management

Manulife Investment Management is the global wealth and asset management segment of Manulife Financial Corporation. We draw on more than a century of financial stewardship to partner with clients across our institutional, retail, and retirement businesses globally. Our specialist approach to money management includes the highly differentiated strategies of our fixed-income, specialized equity, multi-asset solutions, and private markets teams—along with access to specialized, unaffiliated asset managers from around the world through our multimanager model.

This material has not been reviewed by, is not registered with any securities or other regulatory authority, and may, where appropriate, be distributed by the following Manulife entities in their respective

jurisdictions. Additional information about Manulife Investment Management may be found at manulifeim.com/institutional

Australia: Manulife Investment Management Timberland and Agriculture (Australasia) Pty Ltd, Manulife Investment Management (Hong Kong) Limited. **Canada:** Manulife Investment Management Limited, Manulife Investment Management Distributors Inc., Manulife Investment Management (North America) Limited, Manulife Investment Management Private Markets (Canada) Corp. **Mainland China**: Manulife Overseas Investment Fund Management (Shanghai) Limited Company. **European Economic Area** Manulife Investment Management (Ireland) Ltd. which is authorised and regulated by the Central Bank of Ireland **Hong Kong:** Manulife Investment Management (Hong Kong) Limited. **Indonesia:** PT Manulife Aset Manajemen Indonesia. **Japan:** Manulife Investment Management (Japan) Limited. **Malaysia:** Manulife Investment Management (M) Berhad 200801033087 (834424-U) **Philippines**: Manulife Investment Management and Trust Corporation. **Singapore:** Manulife Investment Management (Singapore) Pte. Ltd. (Company Registration No. 200709952G) **South Korea:** Manulife Investment Management (Hong Kong) Limited. **Switzerland:** Manulife IM (Switzerland) LLC. **Taiwan:** Manulife Investment Management (Taiwan) Co. Ltd. **United Kingdom:** Manulife Investment Management (Europe) Ltd. which is authorised and regulated by the Financial Conduct Authority **United States:** John Hancock Investment Management LLC, Manulife Investment Management (US) LLC, Manulife Investment Management Private Markets (US) LLC and Manulife Investment Management Timberland and Agriculture Inc. **Vietnam:** Manulife Investment Fund Management (Vietnam) Company Limited.

Manulife, Manulife Investment Management, Stylized M Design, and Manulife Investment Management & Stylized M Design are trademarks of The Manufacturers Life Insurance Company and are used by it, and by its affiliates under license.