RBC Global Asset Management

Economic outlook

SPRING 2024

Spotlight on a soft landing

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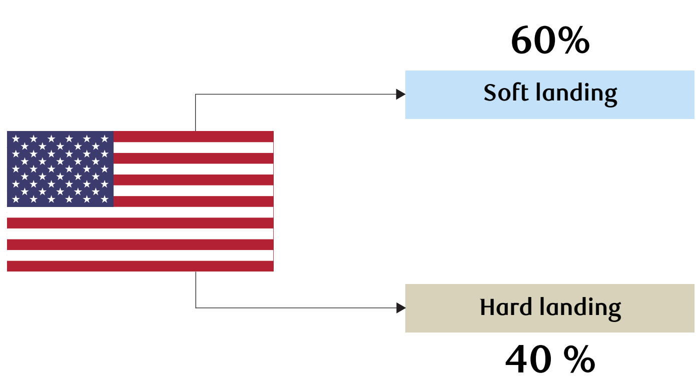
The likelihood of a soft landing – of the economy continuing to grow in the face of adversity – continues to mount, now constituting a 60% probability for the U.S. (Exhibit 1). This scenario has now become more likely than a recession. Inspiring this pivot, economic data has remained resilient – exceeding expectations, and a number of historically compelling recession signals have begun to reverse.

However, we must not make too much of this newfound optimism.

First, the transformation is more incremental than it looks. There have long been, and continue to be, multiple vying economic scenarios. The odds of a soft landing were already considerable last quarter, and the probability of a hard landing – while diminishing – still leaves a very real 40% chance of a recession. A variety of classic recession signals continue to point in that direction, though they constitute a shrinking fraction of the total (Exhibit 2).

Exhibit 1: Two vying macro scenarios for 2024



Source: RBC GAM

Exhibit 2: Recession signals significant but declining

Signal	Predicting U.S. recession?
2yr-10yr curve inverts	Yes
3m-10yr curve inverts	Yes
Fed short-term curve inverts	Yes
Inflation spike	Yes
Volume of global trade falls	Yes
Monetary tightening cycle	Likely
RBC GAM recession model	Likely
Google "recession" news trend	Maybe
Duncan leading indicator falls	Maybe
Unemployment increase	Maybe
Jobless claims jump	No
Lending standards tighten	No
Oil price spike	No

Note: As at 02/07/2024. Analysis for U.S. economy. Source: RBC GAM

Second, the divide between a soft landing and a hard landing, while significant, is smaller than it first appears. We expect only modest to moderate economic growth in the soft-landing scenario, versus just a mild decline in the hard-landing scenario. The risk of a deep recession is now small.

The prognosis for other developed markets has also improved but remains less promising than for the U.S., with a recession probability in the realm of 50% over the coming year.

From a financial-market perspective, these developments have not triggered a major asset-allocation rethink. While greater economic optimism argues, all else equal, for more risk taking, market valuations already assume a positive outcome, and leave little room for a negative scenario. Furthermore, fixed income continues to offer more attractive valuations than most risk assets.

Soft-landing odds rising

Several developments have motivated the upgrade to a 60% probability of a soft landing for the U.S. economy.

First, U.S. economic growth has continued to defy expectations for a slowdown (Exhibit 3). The rate of growth over the past two quarters was outright remarkable and has been good for 18 months. While economic theory makes clear that a sharp increase in interest rates is supposed to hurt growth, the reality has been only minor damage. When the economic data deviates from theory for a quarter or two, the best practice is arguably to stick to one's forecast. But when the data exceeds expectations over and over – and with no particular evidence of an imminent deceleration – the best practice is instead to recognize that the economy possesses a buoyancy that, while poorly understood, is entirely real.

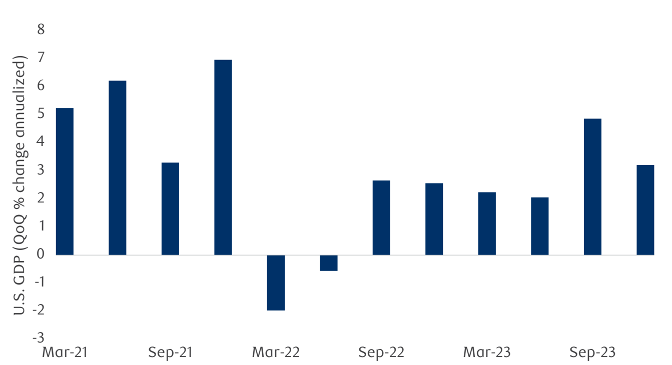
Second, inflation has retreated from the extraordinary highs of 2022, greatly reducing its corrosive effect on the economy. It is difficult for businesses, households and governments to plan for the future and operate efficiently when prices are rising rapidly, but that problem has now mostly faded.

Third, the U.S. Federal Reserve (Fed) and other central banks have stopped rate hikes and are now talking about reversing course at a pace that supports growth without fanning inflation. Monetary policy should become somewhat less restrictive over the coming year, nibbling away at the central argument for a hard landing (Exhibit 4).

Fourth, a number of recession signals have unwound, reducing the likelihood of a recession:

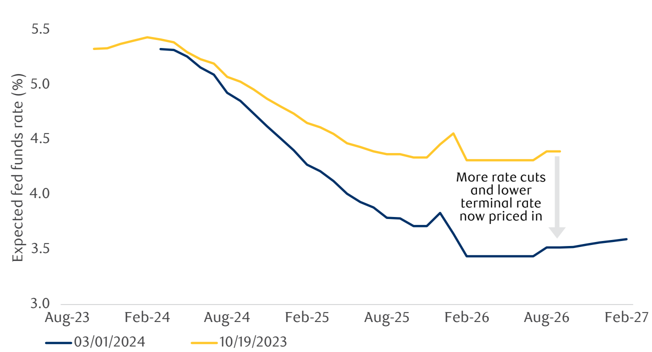
- A recession occurred the prior four times that the U.S. Senior Loan Officer Survey tightened as much as it did in 2023. However, lending conditions are now starting to loosen, arguing that a recession may be avoided this time (Exhibit 5).
- A recession happened the last five times U.S. households sharply scaled back their intentions to purchase durable household goods. But these intentions are now rising again, arguing that the moment of maximum recession risk is behind us (Exhibit 6).

Exhibit 3: U.S. economy has been stubbornly resilient



Note: As of Q4 2023. Source: Bureau of Economic Analysis, Macrobond, RBC GAM

Exhibit 4: Market now expects significant rate cutting



Note: As of 03/01/2024. Source: Bloomberg, RBC GAM

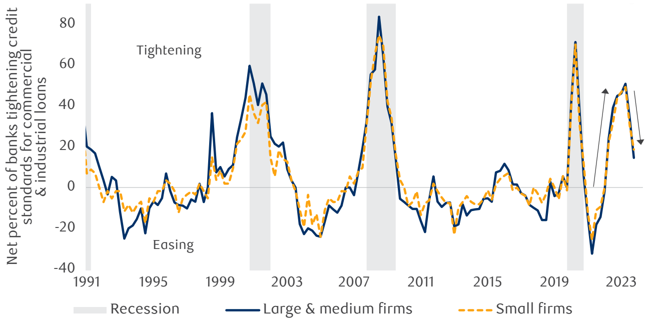
- A recession happened the last four times S&P 500 Index profit margins tumbled significantly. Profit margins again fell sharply over the past few years, but they have now begun to tentatively revive without the arrival of a recession (Exhibit 7).
- While the ISM Manufacturing Index and its new-orders component never quite descended to levels consistent with a recession, they did fall well below normal, to levels consistent with a contracting manufacturing sector. But, in recent months, the trend has begun to tentatively reverse (Exhibit 8).

Upgraded growth forecasts

With a soft landing now probable, our base case growth forecasts have increased. Instead of a recession in the first half of 2024, we now expect modest growth.

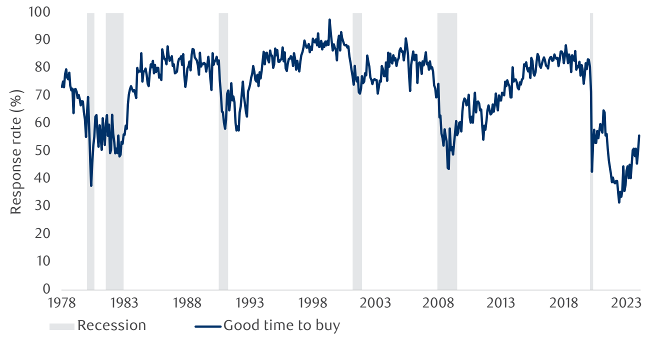
Across the developed world, our upgrades to the 2024 GDP growth forecast range from 0.7 percentage point for the eurozone and UK to a whopping 2.1 percentage points for the U.S., where an exceptionally strong handoff from 2023 and fast start to 2024 have further boosted the forecast. (Japan is an exception to these upgrades, with a roughly unchanged forecast after an improved outlook for the first half of 2024 was neutralized by a poor handoff from 2023).

Exhibit 5: U.S. business-lending standards have become less tight



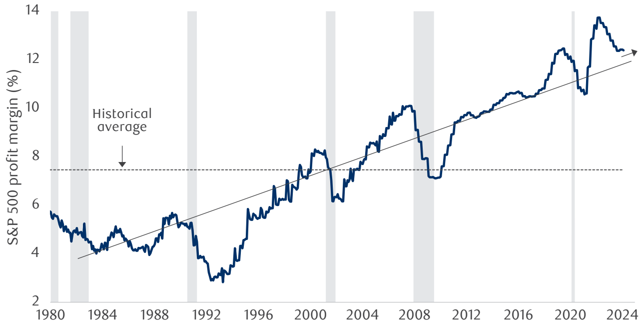
Note: January 2024 Senior Loan Officer Opinion Survey on Bank Lending Practices. Source: Federal Reserve Board, Macrobond, RBC GAM

Exhibit 6: More consumers think it's a good time to buy large durable household goods



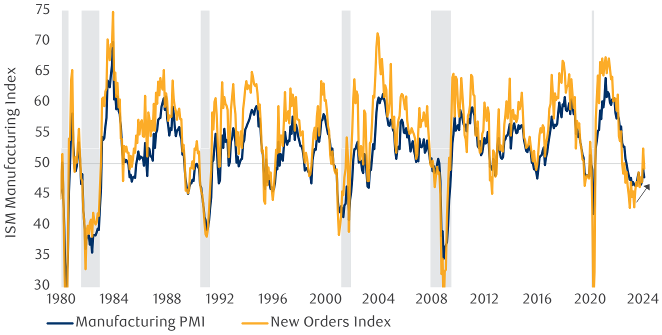
Note: As of Jan 2024. Source: University of Michigan, Macrobond, RBC GAM

Exhibit 7: S&P 500 profit margins stabilize



Note: As of Feb 2024. Shaded area represents recession. Source: RBC Capital Markets, Bloomberg, RBC GAM

Exhibit 8: U.S. manufacturing activity has bounced off floor



Note: As of Feb 2024. Shaded area represents recession. Source: ISM, Haver Analytics, RBC GAM

The upgraded 2024 growth forecasts mean we are now roughly in line with the consensus outlook for most countries, and even slightly above the consensus for the U.S. and Canada (Exhibit 9). We forecast 2.4% GDP growth for the U.S. in 2024, which is well ahead of Canada at 0.9%, and small growth forecasts for Japan, the eurozone and the UK.

The 2025 outlook presumes further moderate growth, with economies managing a slight acceleration as central-bank rates decline.

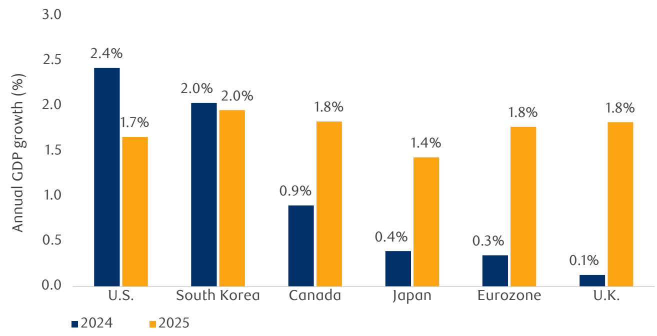
Emerging-market growth forecasts have also been raised modestly, primarily reflecting spillover effects from healthier developed-world economies (Exhibit 10).

Hard landing still in play

The soft-landing scenario merits most of our attention, but it falls short of a guaranteed outcome. A recession remains possible, with a 40% likelihood.

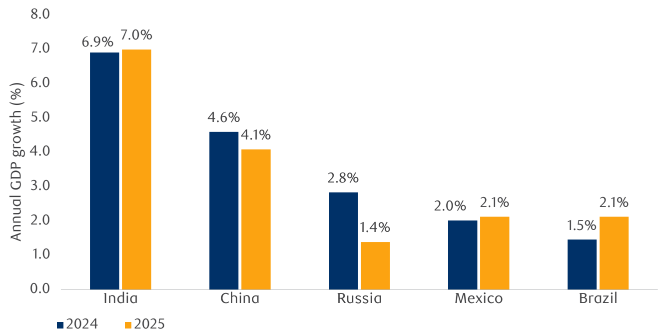
Interest rates have increased massively over the past several years, theoretically imparting a profound economic drag (Exhibit 11). This drag usually peaks a few years after rate hikes begin, making 2024 a year worth watching especially closely (Exhibit 12).

Exhibit 9: RBC GAM GDP forecast for developed markets



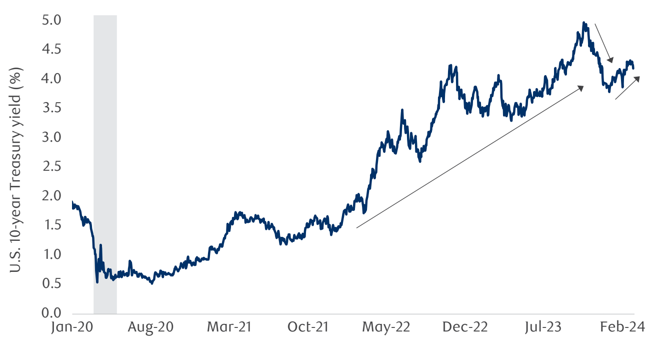
Note: As of 02/23/2024. Source: RBC GAM

Exhibit 10: RBC GAM GDP forecast for emerging markets



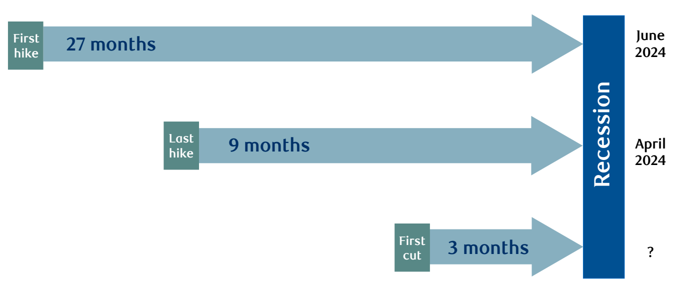
Note: As of 02/23/2024. Source: RBC GAM

Exhibit 11: Bond yields fell on rate cut bets, but now rising on strong economic data



Note: As of 03/01/2024. Shaded area represents recession. Source: U.S. Treasury, Macrobond, RBC GAM

Exhibit 12: Historical U.S. monetary cycles argue recession window is still open



Note: As at 02/09/2024. Analysis for U.S. economy. Source: RBC GAM

The pain of higher interest rates may be minimal thus far in the U.S, but it is clearly being felt elsewhere in the developed world. As an example, eurozone economic data remains materially weaker than the U.S. (Exhibit 13).

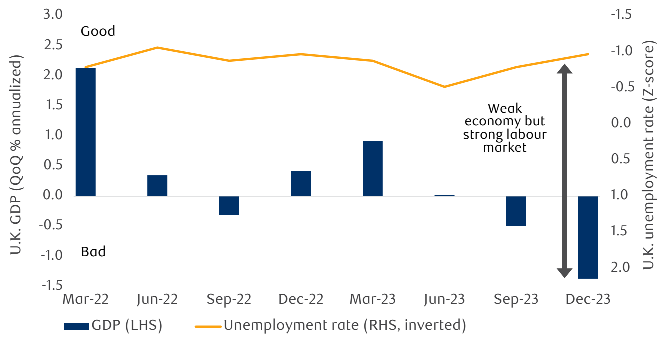
The British, German and Japanese economies have all just registered two consecutive quarters of declining GDP (Exhibit 14). This is conventionally called a "technical recession." We would argue that a proper recession also requires labour-market weakness, which has yet to happen in those markets. It is more accurate to say that developed economies aside from the U.S. are struggling but not collapsing. While the risk of a recession is higher outside the U.S., the U.S. cannot expect to be completely immune to the effect of higher interest rates when other countries have so clearly succumbed to its gravitational pull.

In the U.S., two of the factors that drove the economy in 2023 were enthusiastic consumers and fiscal spending. These may become less helpful over the coming year. Some households are beginning to struggle under the weight of higher interest rates (Exhibit 15). The IMF and OECD both project a fiscal drag for the U.S. in 2024 (Exhibit 16), though election-year considerations could induce additional fiscal support.

Exhibit 13: Economic growth gap between eurozone and U.S.

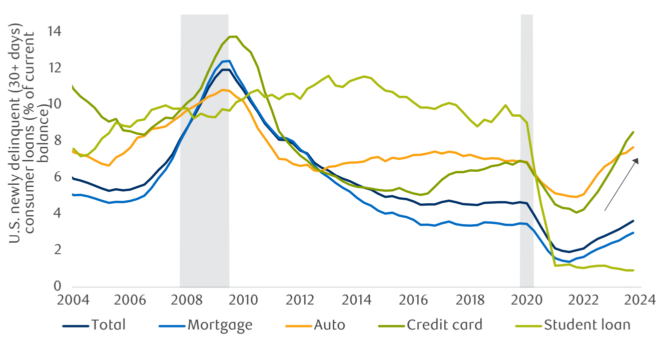
Note: As of 03/01/2024. Source: Citigroup, Bloomberg, RBC GAM

Exhibit 14: UK economy-employment disconnect



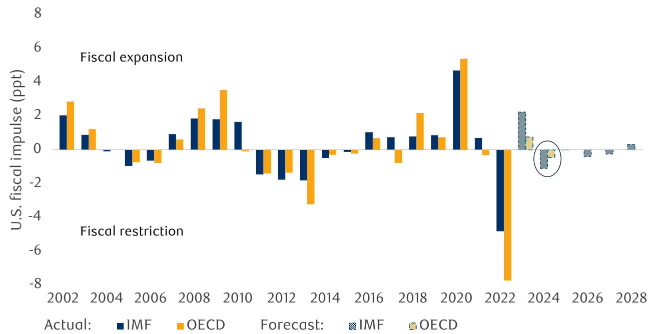
Note: GDP as of Q4 2023, unemployment as of Nov 2023. Unemployment rate normalized over the last decade and plotted on an inverted axis to display good economic data in the same direction. Source: U.K. ONS, Macronond, RBC GAM

Exhibit 15: U.S. consumer-loan delinquencies are now rising



Note: As of Q4 2023. Shaded area represents recession. Source: FRBNY, Macrobond, RBC GAM

Exhibit 16: U.S. fiscal policy to become a drag on growth in 2024

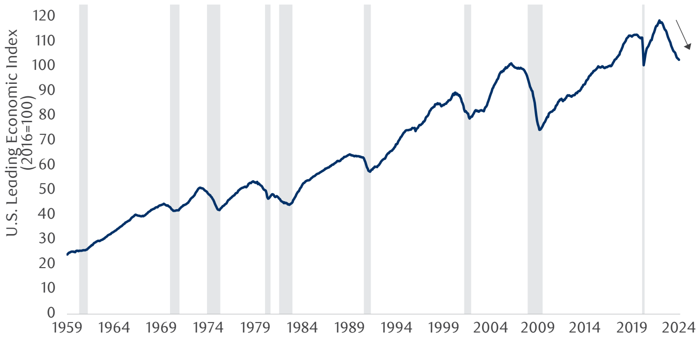


Note: Fiscal impulse is defined as the change in general government structural balance as percentage of potential GDP from the previous year multiplied by minus one. Source: IMF WEO October 2023, OECD Global Economic Outlook, November 2023, Macrobond, RBC GAM

Standing in opposition to the earlier list of recession signals that have now reversed course are several that remain steadfast in their gloominess:

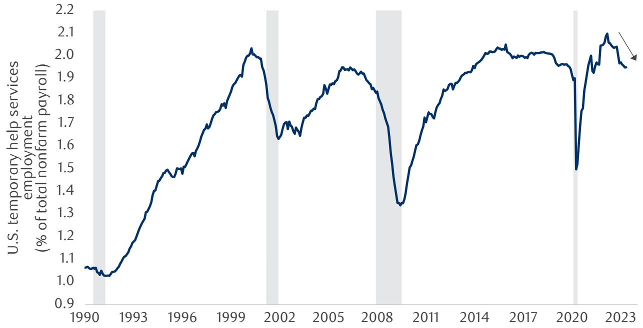
- The yield curve remains inverted – a classic recession precursor, if one that has now been crying wolf for an unusually long time.
- The U.S. Conference Board's leading economic indicator continues to fall – historically, a failsafe recession signal (Exhibit 17).
- Global trade on an inflation-adjusted basis continues to decline – this has been a reliable recession indicator. However, trade may be starting to stabilize.
- Temporary employment in the U.S. is falling, a historically reliable precursor to recession (Exhibit 18). That said, the signal may be flawed this time as companies aren't so much getting rid of temporary workers as converting them into full-time staff in a tight labour market.
- Finally, although Sahm's Law (a 0.5 percentage point increase in the 3-month moving average of the U.S. unemployment rate) has not yet delivered its definitive recession signal, the U.S. unemployment rate appears to have bottomed, and has tentatively increased off that bottom. Historically, such reversals have been closely followed by a rising unemployment rate and recession (Exhibit 19).

Exhibit 17: U.S. leading economic indicator continues to fall



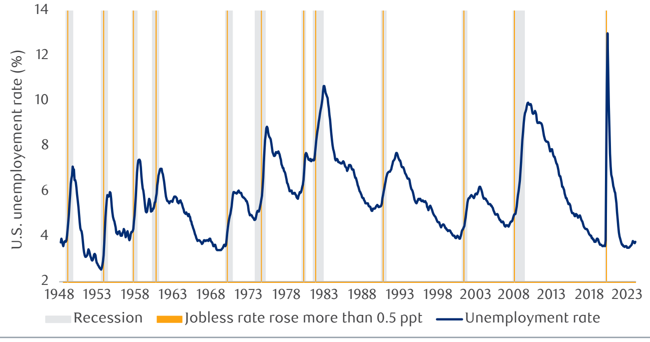
Note: As of Jan 2024. Shaded area represents recession. Source: The Conference Board, Macrobond, RBC GAM

Exhibit 18: Falling U.S. temporary employment usually leads recession



Note: As of Jan 2024. Shaded area represents recession. Source: BLS, Macrobond, RBC GAM

Exhibit 19: Not much room for cooling the economy without triggering a recession



Note: As of Feb 2024. Unemployment rate is 3-month moving average. Source: Bureau of Labor Statistics, NBER, Macrobond, RBC GAM

The evident problem is that there are compelling arguments on both sides of the soft landing-hard landing debate. Our business-cycle scorecard embodies this confusion (Exhibit 20). While the majority of the inputs still favour the view that the business cycle is old and thus vulnerable to a downturn, a significant and rising share now claim this is the start of a new cycle.

Inflation falls less reliably

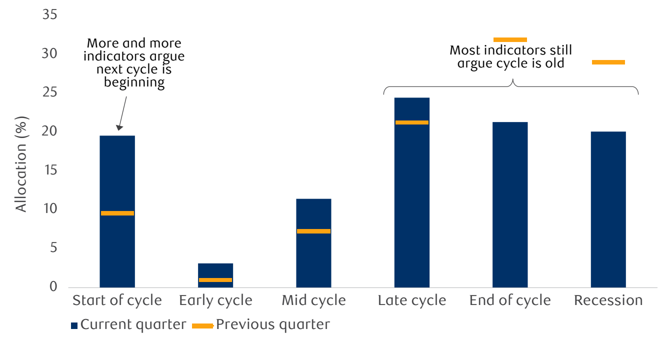
Inflation has fallen significantly from its 2022 apex (Exhibit 21). Three of the four main contributors to ultra-high inflation have been vanquished. The commodity shock has faded, supply chains have resolved their pandemic-era problems and central banks have removed their extraordinary stimulus. The one inflation driver that has not yet fully reversed is fiscal policy: some governments – the U.S. prominently among them – are still running large deficits that do not aid the pursuit of lower inflation.

> "The journey for inflation from the present range of 2.75%—3.50% down to the 2.00% target will be more difficult: slower, bumpier and ultimately less certain."

The improvement in the rate of inflation has slowed and been much choppier over the past few quarters. In the U.S., some of this relates to the economy's resilience – a complication that will persist if the soft-landing scenario continues to play out. Conversely, a recession would neatly – if painfully – arrest wage growth and undermine corporate pricing power in a way that would more swiftly tame the remaining inflation demons.

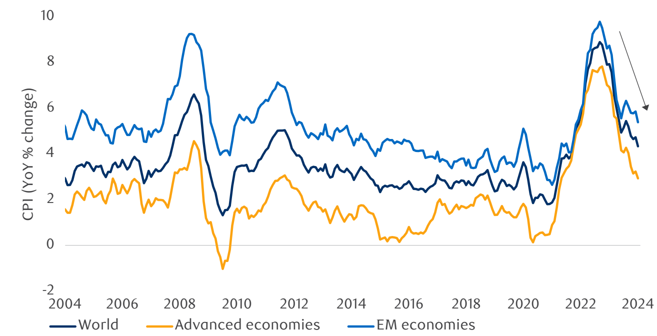
Given that our base case forecast no longer incorporates a recession, we have increased our inflation forecasts relative to a quarter ago, and these forecasts are no longer reliably below the consensus (Exhibit 22). The journey for inflation from the present range of 2.75%-3.50% down to the 2.00% target will be more difficult: slower, bumpier and ultimately less certain.

Exhibit 20: U.S. business cycle score



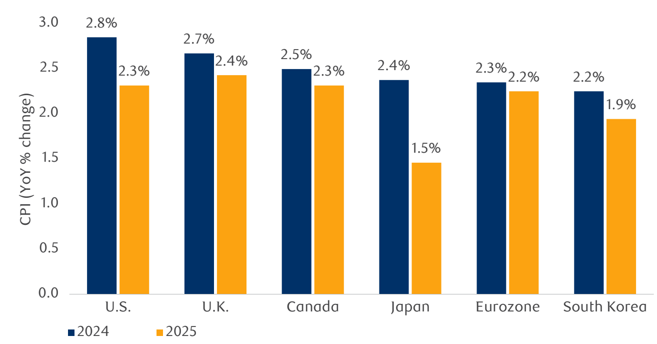
Note: As at 02/02/2024. Calculated via scorecard technique by RBC GAM. Source: RBC GAM

Exhibit 21: Global inflation has declined but remains elevated



Note: As of Jan 2024. Source: Haver Analytics, Macrobond, RBC GAM

Exhibit 22: RBC GAM CPI forecast for developed markets

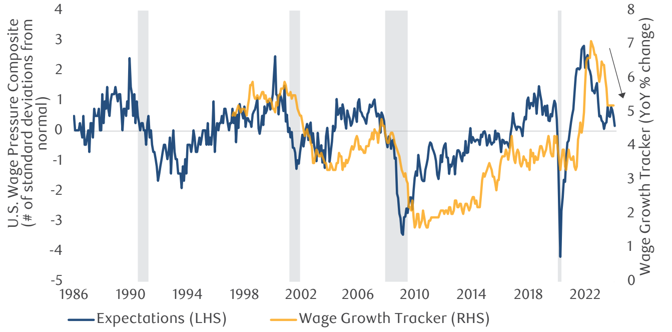


Note: As of 02/23/2024. Source: RBC GAM

But we still believe inflation is more likely to fall than rise from here. Wage pressures are gradually abating despite low unemployment (Exhibit 23).

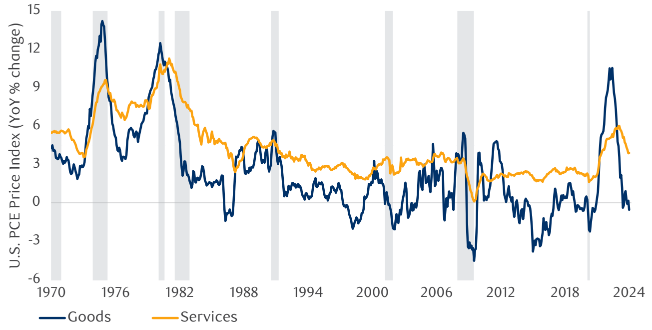
Goods inflation has already vanished. While service inflation remains too high, it is also clearly declining (Exhibit 24). The largest driver of high inflation today comes from shelter costs (Exhibit 25). But these should decline, too. In the U.S., the cost of rent has already slowed importantly, and recent improvements will appear in the CPI index with a lag. The breadth of high inflation is also now narrowing helpfully, clarifying that it is not merely big components such as gasoline and new-car prices that have ceased their rapid ascent, but a spectrum of smaller components (Exhibit 26).

Exhibit 23: Wage pressure in U.S. has eased



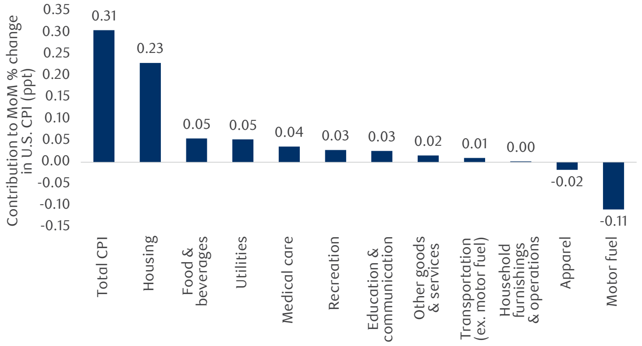
Note: Atlanta Fed Wage Growth Tracker as of Jan 2024, wage expectations as of Feb 2024. Wage Pressure Composite constructed using business intentions to raise wages. Shaded area represents recession. Source: Macrobond, RBC GAM

Exhibit 24: Both goods and services inflation are now falling



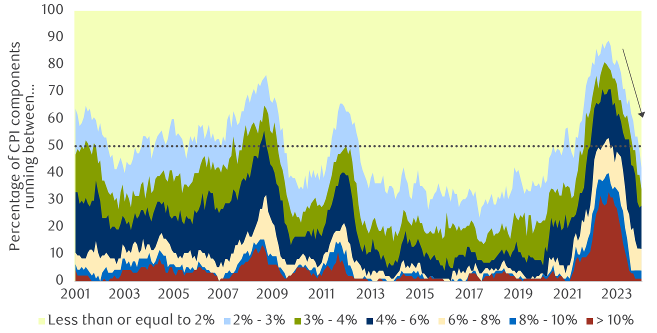
Note: As of Jan 2024. Shaded area represents recession. Source: BEA, Macrobond, RBC GAM

Exhibit 25: Contribution to latest U.S. monthly inflation rate



Note: As of Jan 2024. Source: U.S. BLS, Macrobond, RBC GAM

Exhibit 26: High inflation in the U.S. is no longer broad



Note: As of Jan 2024. Share of CPI components with year-over-year % change falling within the ranges specified. Source: Haver Analytics, RBC GAM

Central banks pivot

The era of central-bank rate hikes came to an end last year, with a small but growing number of central banks now beginning the process of removing that restraint (Exhibit 27). So far, rates have fallen exclusively in emerging markets – countries where inflation, exchange rates and capital flows tend to be more volatile. But the trend is worth watching as it was emerging-market central banks that led the way upward during the period of monetary tightening.

Major developed-world central banks are now signaling rate cuts in 2024. Their motivation is derived from three things. First, inflation has dropped significantly, and can reasonably be expected to fall somewhat further. Second, most of these countries have recorded uncomfortably slow growth over the past year, and so are looking to stabilize their economies. Third, policy rates are unquestionably restrictive and so there is a natural inclination toward lower rates over time.

The U.S. is the distinct exception on the economic front, with an economy that has continued to perform admirably over the past year, in part due to lower interest-rate sensitivity and in part because of particularly strong consumer spending and fiscal support. While the Fed should therefore be less inclined to cut rates, the U.S. central bank has actually communicated its intention to decrease rates more forcefully than many of its peers. Some of this can be chalked up to a more transparent communications strategy, and some presumably reflects the fact that high rates have begun to impose pain even on the U.S. economy, as evidenced by rising consumer-loan delinquency rates, commercial real estate worries and patches of distress among banks.

If the soft-landing scenario continues to play out, rate cuts may take longer to arrive and be more incremental in their magnitude than the market imagines. We budget for five 25-basis-point rate cuts in the U.S. over the next year. Of course, if a recession arrives, central banks are capable of moving much more aggressively, with several hundred percentage points of easing possible.

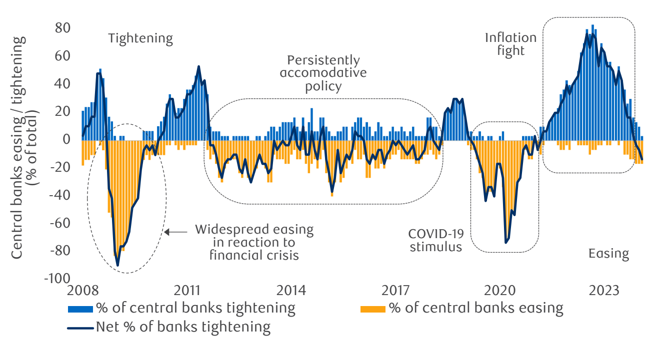
Key risks

A variety of risks bracket the base case outlook. As a starting point, there is more uncertainty than usual across a range of variables, including the trajectory for the economy, inflation, interest rates, geopolitics and the rate of technological progress (Exhibit 28).

The geopolitical environment remains complex and challenging. The war in Ukraine continues, with Russia managing incremental gains and international support for Ukraine wavering. This is potentially consequential for the European economy and the global price of energy.

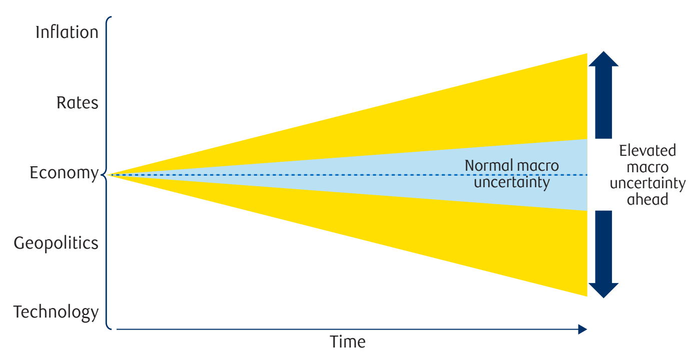
The Middle East remains in a state of turmoil, with ongoing fighting in Gaza and bursts of violence in Israel, the West Bank, Lebanon, Syria, Jordan, Iraq, Iran, Yemen and even extending to an air strike directed by Iran into Pakistan. From a narrow economic perspective, the conflict has the potential to interact with the global economy in two main ways – via the price of oil and the capacity to ship goods through the

Exhibit 27: Central banks are pivoting to rate cuts



Note: As of 02/29/2024. Based on policy rates for 30 countries. Source: Haver Analytics, RBC GAM

Exhibit 28: Still fairly high macro uncertainty



Note: As at 03/04/2024. Source: RBC GAM

region. Oil prices have so far not been greatly affected, but supply chains have been tangled by missile strikes on ships attempting to transit the Red Sea via the Suez Canal, with shipping costs rising and European inflation in particular slightly boosted (Exhibit 29).

U.S.-China relations are still frosty, and while they have lately been slightly more harmonious than in recent years, a significant easing of friction is unlikely. As a result, downside risks on this front abound, including the possibility of large additional tariffs levied on China in the event of a Trump presidency, or if China more actively pursued its claims over Taiwan.

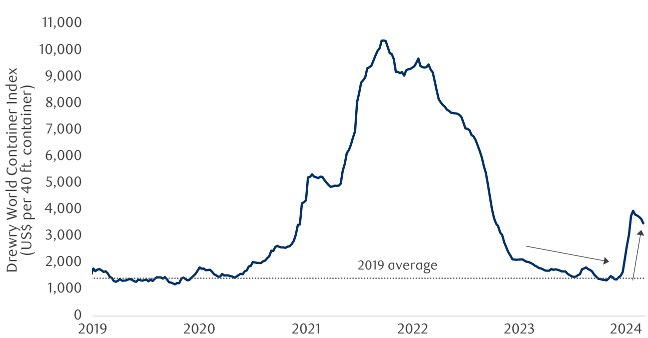
There is also considerable uncertainty in the context of the U.S. election in November. At this juncture, it seems that the vote will be a reprise of 2020, with President Biden pitted against former President Trump. Polls and betting markets suggest it will be a close contest, with Trump slightly favoured (Exhibit 30). While both candidates have no qualms about running deficits and share an aversion toward China, there are also major differences in their platforms. Biden is the more environmentally friendly of the two, while Trump is friendlier toward business, with proposals for corporate-tax cuts and deregulation that are likely to be embraced by markets. Conversely, Trump's tariff proposals and desire to pare immigration constitute economic negatives. His isolationist tendencies are likely to reduce global stability while creating winners and losers internationally. Above all, political uncertainty rises with a Trump presidency.

Perhaps the one major source of macroeconomic uncertainty for which the risks tilt profoundly in a positive direction is technological change. This is a time of particularly impressive progress, with generative artificial intelligence (AI) set to continue making great leaps forward, alongside advances in computer sensing and robotics, and a variety of innovations in health care. These developments should boost capital investment in the short run and productivity over the medium and long run. We have budgeted for a moderate acceleration in productivity growth, but there is an upside scenario in which AI constitutes the world's next general-purpose technology and comes to affect practically every facet of everyday life. The implication is that productivity growth could accelerate more profoundly than we have assumed and remain elevated over a period of a decade or longer. This would have massively positive ramifications for economic prosperity and the stock market, and potentially push inflation lower and inflation-adjusted bond yields higher.

Challenged China

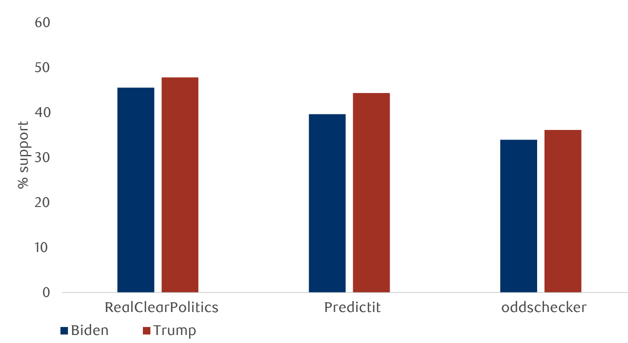
China's economy remains constrained by housing-market weakness. The combination of falling home sales, declining prices and insolvent builders has broad ramifications for the country's economy given that home building constitutes a remarkable one-quarter of GDP. Local-government finances

Exhibit 29: Shipping costs rose on tensions in Red Sea



Note: As of the week ending 03/03/2024. Source: Drewry Supply Chain Advisors, Macrobond, RBC GAM

Exhibit 30: 2024 U.S. presidential election: Biden vs. Trump



Note: RealClearPolitics (RCP) (03/03/2024) poll averages for Biden vs. Trump matchups only. Others acknowledge possibility of other candidates contesting the election. Predictit (03/04/2024) probability of winning derived from prediction markets data. oddschecker (03/04/2024) probability of winning derived from median daily betting odds. Source: oddschecker, Predictit, RCP, Macrobond, RBC GAM

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are also adversely affected due to their reliance on land sales to plug revenue gaps, the large amount of local government debt at risk, and the detrimental effect that weak home prices have on retail sales given that the bulk of Chinese household wealth is stored in real estate. These is a risk that these issues will lead to financial instability, though it is not our base case expectation.

Still, in the context of relentless pessimism about China's economy and its near-term prospects, it must be said that the country is hardly collapsing. Industrial production is advancing at a reasonable clip and China is managing to partially offset declining trade with the U.S. by deepening its ties with developing nations. Ultimately Chinese GDP is on track to grow by a respectable 4.6% in 2024 (Exhibit 31).

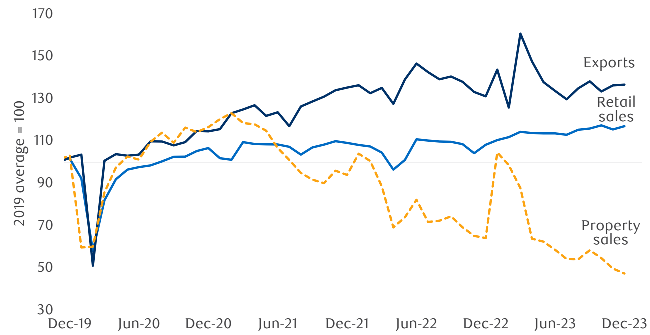
To be sure, China's housing market is unlikely to stage a rapid revival given structural problems, and nor can the country's geopolitical frictions with the West be discounted. China's shrinking population is a challenge, as are decisions that have prioritized the state over the private sector. We budget for 3%-4% real GDP growth once the country has completed its pandemic recovery, materially less than the 6%-plus growth regularly achieved in the 2010s. But even in this diminished state, China should comfortably remain the single most important driver of global economic growth. Incidentally, India is set to claim second place on the list, ahead of the U.S. Emerging-market countries should collectively generate more than 80% of the world's economic growth over the next five years.

Canadian quandaries

Thus far, the Canadian economy has underperformed the U.S. while managing to slightly outperform the UK and the eurozone. Genuine economic weakness is visible both in several quarters of stagnant GDP and in weak business expectations (Exhibit 32).

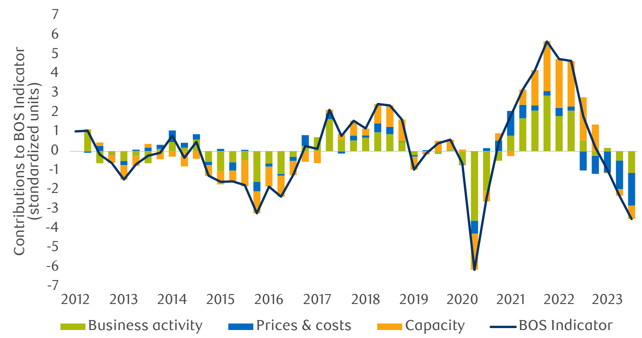
Several Canada-specific issues are worth examining. The country has a high sensitivity to interest rates due to elevated household debt and poor housing affordability. When paired with higher interest rates, this materially explains Canada's recent economic struggles. We anticipate that home prices will remain roughly flat over the next few years as fixed-rate mortgages continue to roll into higher rates (Exhibit 33).

Exhibit 31: Monthly economic indicators for China point to mediocre growth



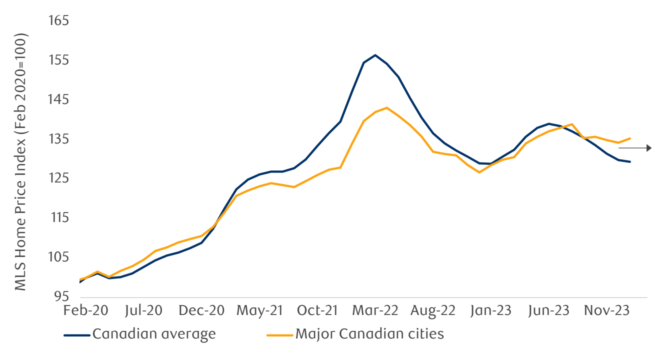
Note: As of Dec 2023. Average of 2019 levels indexed to 100. Source: Haver Analytics, RBC GAM

Exhibit 32: Canadian Business Outlook Survey Indicator falling further



Note: As of Q4 2023. Source: Bank of Canada Business Outlook Survey, Macrobond, RBC GAM

Exhibit 33: Canadian home prices to remain soft



Note: As of Jan 2024. Source: CREA, Macrobond, RBC GAM

Canada's rate of population growth has led the developed world in recent years, with more than 1.25 million residents added in 2023 alone (Exhibit 34). The underlying drivers of the rapid immigration have probably peaked now that the government is cracking down on temporary visas, with the result that population growth should be rapid but slowing in 2024 and then merely robust thereafter. This expansion of the population base has added to Canada's overall economic growth rate via increased demand, but with adverse consequences that include diminished productivity and a housing shortage.

Conversely, Canadian productivity has been atrocious, declining outright over the past year and now pitifully resting at the same level as eight years ago – a remarkable failure given that productivity normally rises over time (Exhibit 35). The blame extends in several directions: the immigration surge, lingering post-pandemic distortions, inadequate business investment, insufficient inducements for entrepreneurs and excessive red tape. The first few of these problems should fade with time, but the country has been on a relatively slow productivity train for decades. Canada's failure to address its productivity problem threatens the country's prosperity and corporate profits.

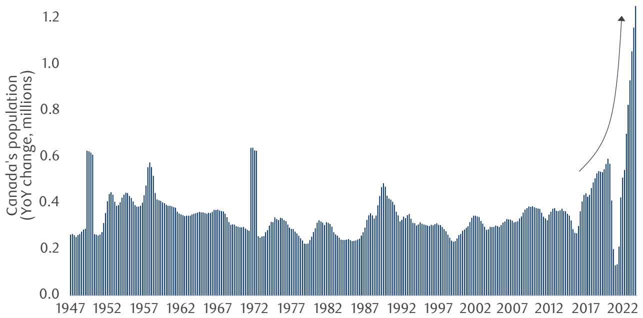
Canada's inferior economic performance would normally prompt the Bank of Canada (BOC) to cut rates well before the U.S., but the poor productivity growth alongside sticky rent and mortgage-interest costs have limited progress on inflation. Ultimately, the Fed and BOC could follow a fairly similar trajectory downward on rates.

Longer-term themes

Several longer-term themes merit mention because they will play important roles in the medium- and long-run economic and inflation outlooks. The role of potentially accelerating technological change has already been addressed, with the possibility of faster economic growth and lower inflation. Others include deteriorating demographics (negative for growth, negative for inflation) and the effects of climate change (negative for growth, positive for inflation).

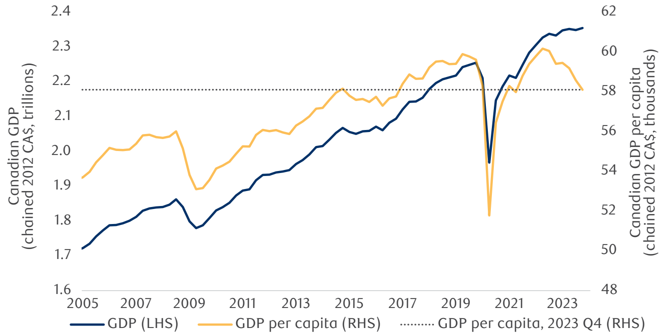
Deglobalization is also now underway, in part as frictions mount between global powers such as the U.S., Russia and China, and more generally as trade barriers rise around the world (Exhibit 36). The resulting deglobalization will be fairly

Exhibit 34: Canada's record population growth fueled by immigration



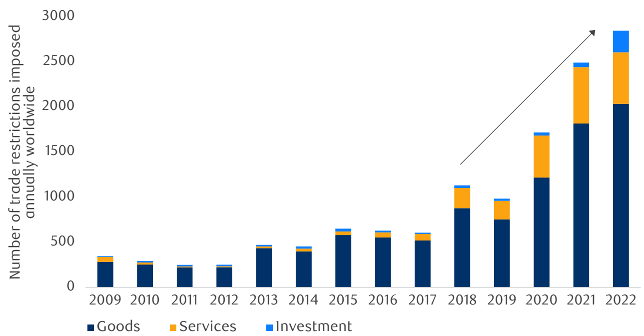
Note: As of Q4 2023. Source: Statistics Canada, Macrobond, RBC GAM

Exhibit 35: Canadian GDP per capita has been shrinking



Note: As of Q4 2023. Source: Statistics Canada, Macrobond, RBC GAM

Exhibit 36: Global trade restrictions ballooned in recent years



Note: As of 2022. Source: Global Trade Alert, IMF, fDi Intelligence, RBC GAM modest, but nevertheless constitute a reversal of a previously favourable trend. We believe that deglobalization will, over time, subtract slightly from global economic growth and add slightly to inflation.

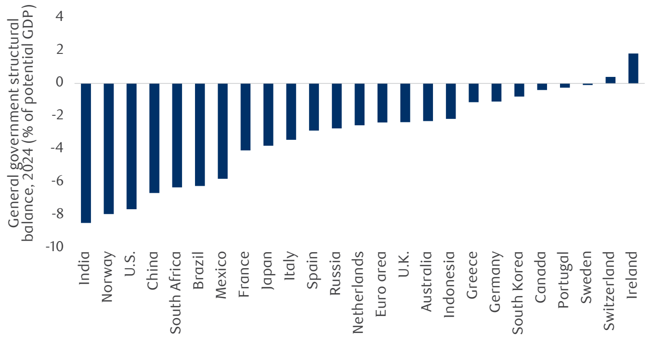
A final thematic consideration is the substantial fiscal deficits that continue to be run across a sizeable fraction of world's major economies (Exhibit 37). Such overspending may have been affordable when interest rates were very low. But the financial burden is mounting as borrowing costs rise, and the bond market is likely to rebel should a measure of fiscal austerity not be delivered within the next few years. This threatens to suppress economic growth over that time frame.

Bottom line

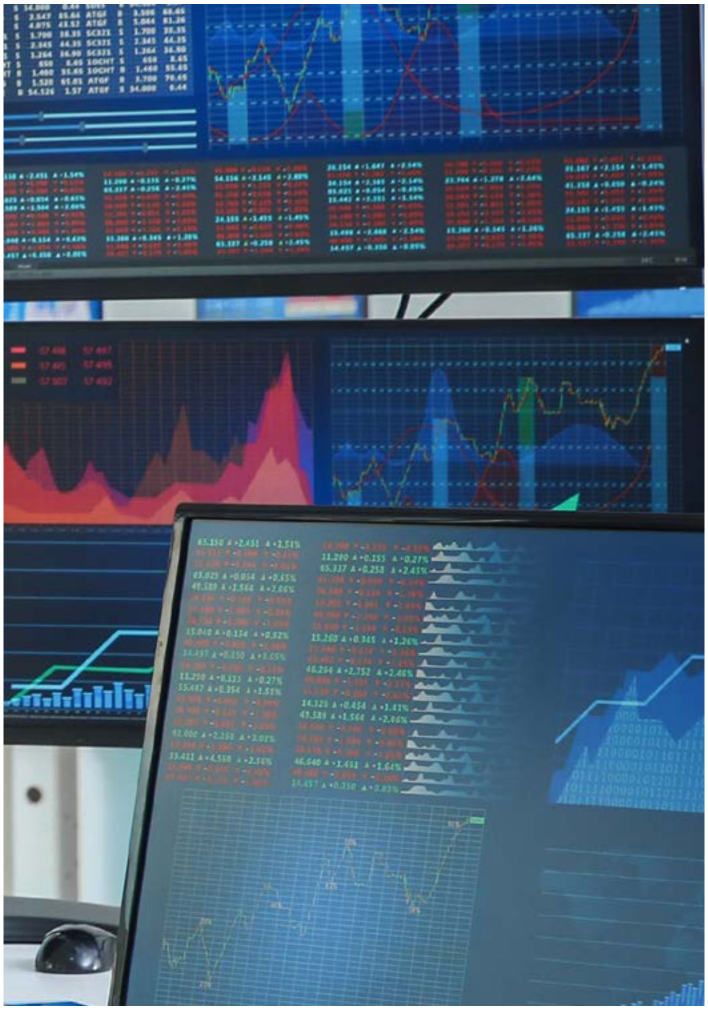
The main macroeconomic takeaway is that the odds of a soft landing have been materially upgraded, now amounting to a 60% likelihood. This shift is welcome news and supports risk assets. However, faster-than-expect growth also complicates the inflation-normalization process and slows the clip at which central banks can remove monetary restraints. We still believe that inflation can fall further and that central banks will be able to cut rates later this year, but in a soft-landing scenario progress may be more fitful.

At the same time, it is important to appreciate that the risk of a recession has not vanished. Many recession indicators continue to blink red, even as others have turned to amber or green, and geopolitics risks abound. Conversely, technological change could prove more helpful than many imagine. But above all, it remains a time of elevated uncertainty, which contributes to our decision to maintain a roughly neutral asset allocation.

Exhibit 37: Significant structural fiscal deficits persist



Note: IMF projections for year 2024. Source: IMF WEO, October 2023, Macrobond, RBC GAM



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