Press Release
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Invesco releases 2025 Investment Outlook "After the Landing"

- ***Base case.*** *Expect significant monetary policy easing to foster an attractive environment for risk assets as central banks achieve a "soft landing" of lowering inflation without a recession.*
- ***Downside scenario.*** *Risk of a policy mistake that causes global growth to undershoot but central banks may enact more rate cuts to counteract it.*
- ***Upside scenario.*** *Potential for global growth to be stronger than expected. Falling inflation and rate cuts could help drive a "Goldilocks" environment across most economies.*

London, 20 November 2024 – Invesco today released its 2025 Investment Outlook with insights on the expectations for global markets in 2025, along with asset implications across key economies.

New and old challenges remain, including geopolitical tensions and a new administration in the United States (US), which introduce uncertainties in the path ahead. The question remains whether central banks can steer the world's major economies toward moderate growth while keeping inflation in check. The 2025 Outlook expects significant monetary policy easing to push global growth to re-accelerate, fostering an attractive environment for risk assets as central banks achieve a "soft landing" of lowering inflation without a recession.

Kristina Hooper, Chief Global Market Strategist at Invesco, commented: "After a steep climb to restrictive rates to curtail rapidly rising prices, central banks have all but declared victory over inflation. Yet many of the world's major economies have been showing signs of slowing, with areas of weakness including slipping Eurozone Purchasing Managers' Indexes, rising unemployment rates and faltering consumer confidence pushing central banks to cut interest rates in the latter half of the year. 2025 is likely to be framed by the push-and-pull between pockets of slowing economic activity due to accumulated rate hikes and the supportive effect of the rate cutting cycle."

<u>Base Case: Trend growth then reacceleration</u>

It is expected that the **US economy** will continue to grow near its potential rate. A modest slowdown in growth to potential rates will continue in the near term, given the restrictive monetary policy environment that has persisted for several quarters and continues to this day, irrespective of recent policy changes. However, the resilient labor market and strong overall household balance sheets should help spending and the broader economy continue to grow. This, coupled with continued easing in financial conditions and continued real wage growth should help the US economy re-accelerate in 2025.

The Base Case believes the Federal Reserve (Fed) will lower its policy rate toward neutral in 2025, reducing the downward pressure of higher interest rates on growth. The Fed also has additional room for further policy easing, laying a positive backdrop for economic momentum through 2025.

In **Canada**, the economy has faced headwinds and has not fared as well as the US economy. However, now that the Bank of Canada has begun easing, the Canadian economy is likely to follow in the footsteps of other major developed economies and re-accelerate next year. The economy will likely be helped by improving real wages, particularly if an accelerating global economy leads to higher commodity prices.

Ms. Hooper noted: "Since mid-2024, views about the trajectory of US economic growth have been rotating between pessimism and optimism in fits and starts. We continue to expect the US to deliver higher growth than other developed economies, largely due to the combination of its favorable demographics and immigration, its business dynamism, and its healthy rate of productivity growth."

In the **eurozone**, recovery appears to have lost momentum in key economies like France and Germany, particularly in the manufacturing sector. The Eurozone continues to be weighed down by structural challenges and demographic issues, which suggest continued economic divergence from the US. Fiscal consolidation in France, Germany and Italy, as well as smaller eurozone economies, may also exert downward pressure on growth, investment, and consumption. The European Central Bank's (ECB) interest rate cuts through 2025 should begin to reverse growth slowdown.
Ms. Hooper added: "As we move through 2025, we anticipate that further rate cuts should help push economic growth up toward potential rates, supported by moderate real wage growth. The ECB currently seems to favor a gradual rate-cutting cycle, which, though positive for the economic picture, may delay growth improvement. Upside surprises elsewhere in the world, such as in China, would likely boost eurozone growth as a surplus economy."

The Outlook is cautiously optimistic on the **United Kingdom (UK)** economy since it has shown surprising resilience in recent quarters after years of slow growth. The UK's fiscal overhang remains a hurdle, and its relatively more stubborn inflation outlook suggests the Bank of England will need to keep rates relatively high. Nevertheless, rate cuts should help the UK consumer and lift housing market activity, delivering decent growth as inflation continues to trend lower and real wages rise.

With inflation and wage growth seeing a revival, **Japan** appears to have broken out of its long-running low-inflation regime. In contrast with many central banks, the Bank of Japan (BOJ) moved into a tightening stance in 2024 as inflation accelerated. However, its recent policy tightening has meant significant currency volatility, complicating Japanese export-focused business. Yet, Japanese equity valuations remain attractive relative to some markets such as the US.

The Outlook anticipates that Japan will reaccelerate in 2025 as wage growth helps push up consumption. As the BOJ continues its very modest tightening cycle and other central banks ease, the yen may strengthen.

The property sector will likely continue constraining strength in **China's** consumption and investment activities in 2025 to a certain degree. The high growth of exports strongly supported overall economic growth in 2024, but continued trade frictions could cause a slight deceleration in that growth. The Outlook suggests that policy stimulus measures could mitigate downward pressures, with economic growth likely to decelerate modestly in 2025. There is also the potential that stimulative policy measures may lead to upside surprise, with growth higher than expected.

US rate cuts, global monetary easing, China's stimulus, and moderate US dollar softening should all be broadly supportive of other **emerging market** growth and performance. Commodity prices should trend higher – especially if China stimulus gains traction. Fed rate cuts should pave the way for emerging market rate cuts, especially where rates are still very high, and inflation is coming down – potentially parts of Latin America, Central Europe, Asia, and South Africa.

The Outlook believes that **India** in particular stands out among emerging economies as growth in investment and consumption is running strong with inflation under control. **Latin America** will probably continue to offer both opportunities and risks. **Central Europe** has continued to bring down rates with successful disinflation, and further ECB easing should point to further rate cuts.

<u>Investment Implications</u>

Given the positive macro backdrop, the Outlook favors an overweight to risky assets while remaining cognizant of the high valuations for some assets.

Within **equities**, cyclicals and smaller caps are favored given lower valuations and greater sensitivity to the economic cycle, as well as developed ex-US – especially UK and Japanese equities – and emerging market equities for those same reasons.

Bonds offer attractive opportunities despite tight spreads, especially for longer holdings periods. Strong fundamentals underpin many fixed income assets, helping to explain extremely tight credit spreads in both investment grade and high yield credit. To take advantage of the resilient and improving growth backdrop, some credit risk such as higher quality high yield is favored. The diversification properties of bank loans are also attractive given the near-zero duration; and expectation to be relatively immune to interest rate volatility. Strong performance from emerging market local currency bonds is also anticipated.

Opportunities are increasing in **real estate**, as there could be meaningful upside potential as the environment improves and rates ease. Among **commodities**, base metals are favored given their sensitivity to the economic cycle. Within **currencies**, the US Dollar should begin to weaken this year as the Fed continues to cut rates, which would favor currencies such as the Japanese yen and the British pound.

<u>Alternate Scenarios</u>

There is the potential that the Base Case is not realised hence the Outlook contemplates alternate scenarios.

In a **downside scenario**, there is a risk that a policy mistake could cause global growth to undershoot, which could presage a sustained growth deceleration in key economies, including the US. However, if activity falters, central banks will likely enact more rate cuts to counteract a growth slowdown, resulting in below-trend performance in the first half of the year, followed by a pick-up towards trend in the latter half of the year. In this scenario, a defensive positioning favoring US stocks, longer duration Treasuries, gold and 'safe haven' currencies such as the US dollar and Japanese yen are preferred.

Conversely, an **upside scenario** could occur where falling inflation and rate cuts help accomplish a 'Goldilocks' environment, leading to a period of growth above potential and across most major economies while inflation remains near target rates. In this scenario, a more 'risk on' positioning favoring emerging market equities, including Chinese equities, bank loans, industrial commodities and energy, and 'commodity currencies' such as the Canadian dollar and the Australian dollar are preferred.

Swing Factors

The Outlook remains watchful for additional factors that can impact expectations for the path ahead.

Policy uncertainty on tariffs and immigration has increased and there is the potential for higher market volatility that could cause disruptions to the global economy. These policy shifts have the potential to amplify growth – and inflation – which could in turn impact the trajectory of Fed policy.

A pick-up in Chinese policy stimulus could raise upside potential, which could have positive spillovers to the global economy and equities. The Outlook remains watchful for further shifts in investor sentiment sparked by recent policy momentum.

Inflation while falling, could return and spark sea-change in the current outlook and recalibrate expectations around policy easing and the resulting boost to the economy. Trump administration policies on trade and immigration as well as pro-growth policies could also create inflationary forces.

Recent above-potential growth in key economies was driven in part by large-scale fiscal spending. Now, despite a more normal macro environment compared to the pandemic era, the fiscal taps remain largely open. If governments **curtail government spending** to rein in deeply expansionary fiscal policy, it may cause growth headwinds to build which would limit the degree of reacceleration expected in 2025.

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