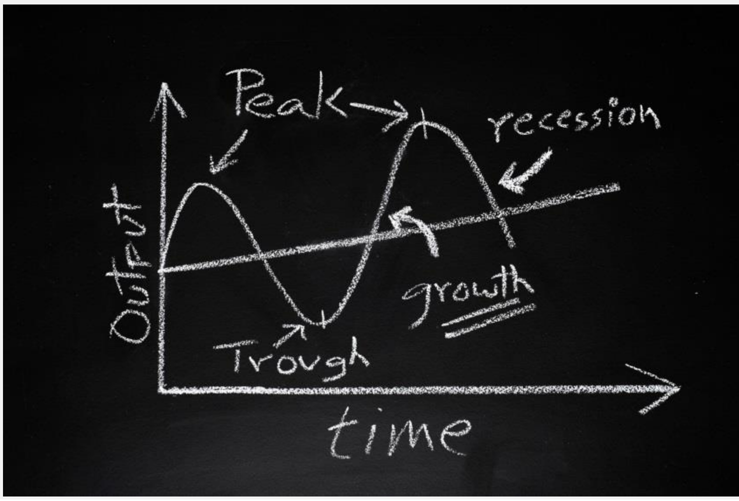
Creditreform Rating

CREDITREFORM ECONOMIC BRIEFS

Polycrisis drags on growth recovery



November 2023

Contents

KEY TAKE-AWAYS

1. We expect the **euro area GDP growth to decelerate to 0.5% this year**, corresponding to a downward revision compared with our previous Economic Briefs. A likely weak final quarter of 2023 and **additional uncertainty** about the international economic developments in light of the tensions in the Middle East **curb growth expectations for 2024**. We project a **moderate acceleration to 1.2%**, supported by an expected pick-up in private consumption on the back of lower inflation rates, as well as by impulses from non-construction investment, aided by EU funds related to the Recovery and Resilience Facility.
2. The inflation rate has decreased markedly in the euro area, but remains some way off the 2% target. Core inflation is lagging behind and is proving to be rather sticky. We expect the **ECB's monetary policy rates to remain at their current levels until the second half of 2024**. By the **end of 2024**, we forecast the **main refinancing rate to be at 4.0%**, compared with 4.5% currently.
3. While public debt ratios have generally declined following the global pandemic, the debt-to-GDP ratio has not yet returned to pre-pandemic levels in most euro area countries. Significantly higher capital market borrowing costs, shifting energy supplies and the costly green transformation, as well as geopolitical tensions, pose a **challenging environment in which to pursue fiscal consolidation**.
4. **Germany's economy** continues to **underperform** other major euro area economies, burdened by the ongoing structural changes in its energy supply. After a likely negative growth rate in 2023 (-0.1%), we expect **a feeble recovery in 2024**. With private consumption as the main driver next year, we think **GDP growth will only reach 0.8%,** a **downward revision** of our previous forecast for 2024. The construction sector remains significantly hampered, while investment in machinery and equipment should contribute positively to GDP growth this year and next. Meanwhile, the number of corporate defaults is on the rise.
5. Although it has **avoided a technical recession**, the **UK economy continues to be weak**. **UK inflation**, which remains the **highest in the G7**, has come down more markedly of late. We now believe that the **Bank of England will not lift the bank rate above the current level of 5.25%,** whilst we maintain our view that a **rate cut will not come before the second half of 2024**. The Bank of England's tightening cycle has left its mark on the housing market, with transaction numbers decreasing and the house price index dropping on an annual basis for the first time since 2012.
6. The **US economy** remains on track for a soft landing, while the pace of job creation is slowing further. The Fed pauses its hiking cycle, but maintains a tightening bias. Our updated baseline scenario now assumes that the **Fed funds rate has peaked at 5.25-5.50%** and that a **first rate cut will not take place until the second half of 2024**.

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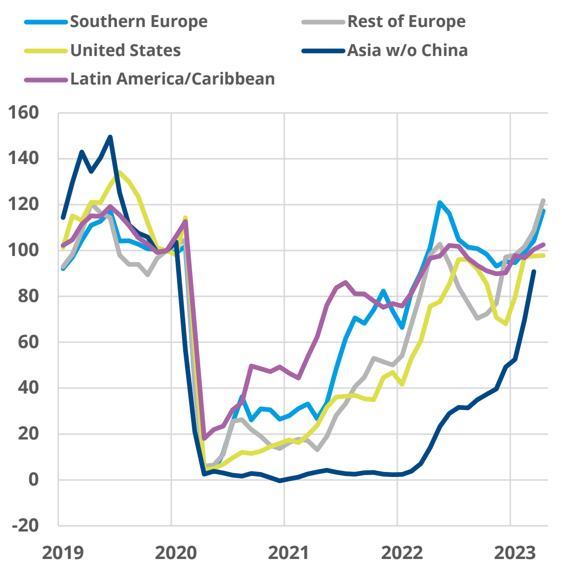
1. World

Global GDP growth squeezed by multiple factors

The global economy remains under the impression of geopolitical crises, with the recent escalation of the conflict in the Middle East adding to still high economic uncertainty. Amid comparatively aggressive monetary policy tightening cycles, central bank policy rates in major advanced economies have plateaued - and likely peaked - although core inflation rates in particular have some way to go to settle at around 2%. To be sure, the risk of a hard landing as central banks have entered fine-tuning mode is not off the table. While the tightening monetary policy has translated into diminishing inflation rates, financing conditions have become increasingly unfavorable, adversely affecting fixed investment and housing activity and slowing global economic activity. On the other hand, the services sector has left the pandemic behind by now, and the demand for services is a supportive pillar to global growth (see Figure **1**).

Figure 1: Tourism industry is back to normal, with prime tourism economies benefiting strongly

Monthly foreign tourist arrivals, index (Dec.19=100)

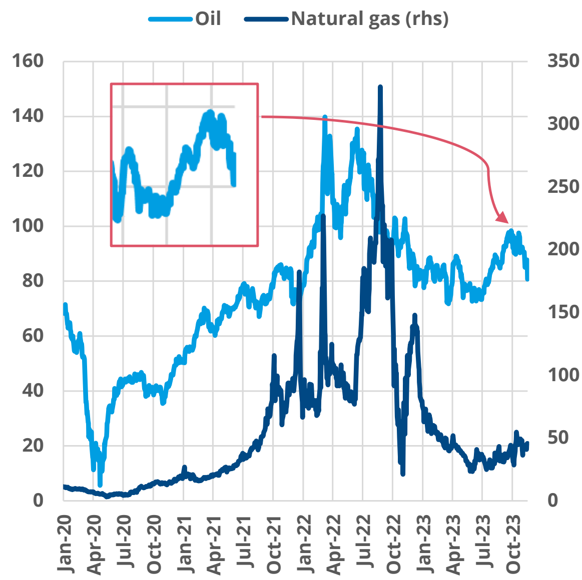


Sources: IMF, Creditreform Rating

Lower energy prices, the fading reopening boost in the aftermath of the coronavirus pandemic, and partly expiring government support measures have all contributed to reducing headline inflation rates. However, they remain at elevated levels. In addition, there are risks of renewed energy price spikes in connection with the tense situation in the Middle East, which could push inflation rates up again (see Figure **2**).

Figure 2: Inflation strongly influenced by energy prices, which remain highly volatile

Brent oil, daily spot prices in USD, Dutch TTF daily natural gas spot price in EUR



Sources: Refinitiv, Creditreform Rating

Concerning the global economy, the IMF by and large maintained its global GDP growth forecasts in its October 2023 World Economic Outlook, expecting 3.0% for 2023 and 2.9% for 2024.

Risks remain manifold

In view of financial stability risks associated with a possibly extended period of high interest rates, macroprudential policies and related supervision have come to the forefront. Various measures are either already in place or currently under consideration to ensure banks prepare for a growing number of ailing loans as more companies and households may struggle to service their debt. Bankruptcies have risen substantially in the euro area and the US throughout the year, albeit from historically low levels.

In terms of geopolitics, the 2024 US election could make the fragile international situation more complicated. If protectionist trade policies become more prevalent and political bloc-building intensifies going forward, this could have significant adverse consequences for the global economy. The relationship between the Chinese government and the US administration should be monitored vigilantly in this regard.

Throwing climate risk into the equation, more frequent extreme weather events and related hazards, along with efforts to shift to renewable energy, will likely act as price-driving forces in the background. At the same time, providing funds to tackle or prevent damage related to climate change looks set to be a more constant factor weighing on public finances.

Chinese economy still facing headwinds regarding its real estate sector

Despite recent signs that the slowdown in the Chinese economy is bottoming out after the rebound, market fears of a sharper downturn have not yet been completely dissipated. Particularly the real estate sector remains under strain. Over recent months, Chinese authorities have implemented measures to support the economy, along with some monetary policy easing. This year's third quarter GDP growth was reported to have accelerated to 1.2% q-o-q, up from 0.5% in the second quarter.

However, China's real estate sector continues to pose downside risks to the economy. Property developers continue to struggle to secure sufficient financing, leading to an increase in the number of pre-sold dwellings that are not completed, which in turn weighs on consumer confidence. Inflation rates have been floating around zero over recent months, continuing to point to different challenges for the central bank compared to central banks in the advanced economies. The IMF lowered its GDP forecast for China slightly for both 2023 and 2024, to 5.0% and 4.2% respectively. As regards 2023, a GDP expansion by 5% would correspond to the Chinese leadership's growth target.

Federal Reserve pauses, but maintains tightening bias amid resilient growth and slowing inflation

In terms of economic growth, the US has fared well in the first three quarters of the current year, with the pace of economic expansion picking up in Q3. That said, more recent high-frequency indicators point to a slowdown in the final quarter of 2023. The Purchasing Manager Index (PMI) for October saw a larger drop to 46.7 points, well below the 50-point threshold that indicates expanding economic activity, but the negative result may have been exacerbated by strikes in the car industry. The corresponding index for the services sector continues to point at growth, although it decreased in October, too.

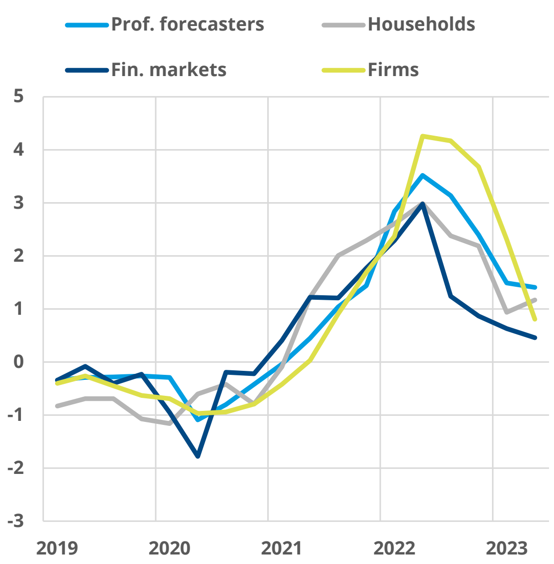
On the US labor market, job creation has moderated, while the unemployment rate remains very low. More specifically, total (nonfarm) payroll employment increased by 150,000 persons in October, well below the average monthly increase of 258,000 persons over the prior 12 months, but also weighed down by strike action in the manufacturing sector. The monthly US unemployment rate edged up to a still very low 3.9% in October.

In the meantime, the US inflation rate has hovered around 3.5% in the last few months, recording 3.2% in October 2023 (Jun-22: 9.1%). Whilst trending down, core inflation has been running above that level, posting at 4.0% in October. Against this backdrop, the Federal Open Market Committee (FOMC) remains wary regarding inflation risks, but held the federal funds rate steady at 5.25-5.50% in a unanimous decision at its latest meeting on 1 November. Nevertheless, the door for additional policy firming remains open. The FOMC's most recent GDP growth projections were 2.1% for 2023 and 1.5% for 2024 (median forecast).

Whilst we would not entirely rule out another rate hike, our base scenario now is that the policy rate has reached its peak. That said, the FOMC may well maintain its policy rate at the current level for an extended period of time, before a first rate cut takes place in the second half of 2024 (see Figure 3).

Figure 3: Broad agreement on inflation dynamics in the United States

Next-12-months mean inflation expectations by economic agent, z-score, standard deviations from the mean



Sources: IMF, Creditreform Rating

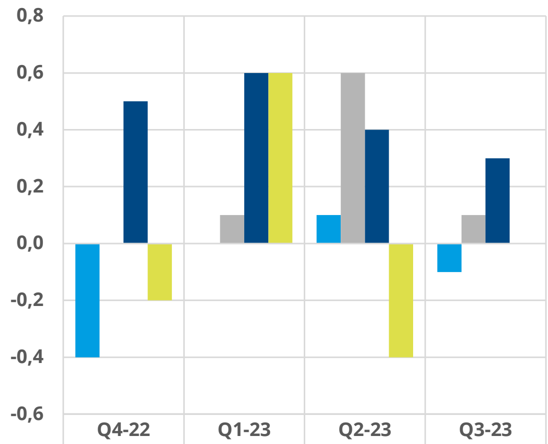
2. Euro area

Crawling over the finish line

Real economic activity in the euro area was more or less stagnant in the four quarters to the third quarter of 2023. In fact, the GDP recorded a slight decline of -0.1% q-o-q in Q3-23. The Spanish economy remains the frontrunner among the four largest euro area economies, posting solid increases in total output, although the quarterly pace of growth has moderated somewhat, to 0.3% in Q3 (see Figure 4). By contrast, Germany and Italy remain on the verge of recession, with the Italian economy experiencing considerable quarterly volatility. The French economy has proved slightly more resilient, but after a more pronounced increase in the second quarter of 2023, partly due to a one-off effect, it barely expanded in Q3.

Figure 4: Ongoing heterogeneous growth picture in the euro area

Real GDP q-o-q growth in percent



	Q4-22	Q1-23	Q2-23	Q3-23
DE	-0,4	0,0	0,1	-0,1
FR	0,0	0,1	0,6	0,1
ES	0,5	0,6	0,4	0,3
IT	-0,2	0,6	-0,4	0,0

Sources: Eurostat, Creditreform Rating

Looking at current sentiment indicators as a gauge for developments in the final quarter of 2023, the Composite PMI continued to decline in October. At a level well below the 50-point mark typically associated with economic growth, the indicator points to a feeble economic finish at the end of 2023.

Private consumption is most likely to act as a drag on euro area GDP growth this year, as still high, albeit easing, consumer price increases have eaten into disposable income. That said, a wide range of government support measures to alleviate the burden of high energy prices are still in place, and euro area labor markets have held up relatively well, generally supporting private households' income. What is more, labor markets remain tight in a number of euro area members, and shortages of skilled labor in various industries add to upward pressure on wages.

The unemployment rate in the euro area as a whole has recently stabilized at its low level, standing at 6.5% in September 2023, compared to a maximum of 8.6% (Sep-20) during the acute phase of the corona pandemic. Employment growth continues, and despite slowing momentum, total employment still increased by 1.3% y-o-y in the second quarter of 2023. Against this backdrop, we expect private consumption to gather pace as inflation rates settle at lower levels.

Tighter financing conditions hamper fixed investment, although available EU funds in connection with the implementation of measures and reforms under the national Recovery and Resilience Plans maintain a constructive outlook for public investment, with some possible spill-over effects on private investment. While construction investment will likely post moderate declines this year and next, we expect investment in machinery and equipment to continue to grow, although at a more moderate rate than in 2022.

Normalization after the post-pandemic recovery is likely to weigh somewhat on exports at this stage, alongside subdued foreign demand due to tighter monetary policy and slowing economic activity in many export destinations. Moreover, given the complicated geopolitical situation, external demand for euro area goods and services looks set to remain somewhat dampened in the near future. While we still expect net exports to make a small positive contribution to GDP growth in 2023, we anticipate a slightly negative impact for the following year, not least as private consumption should gain some traction and boost import demand.

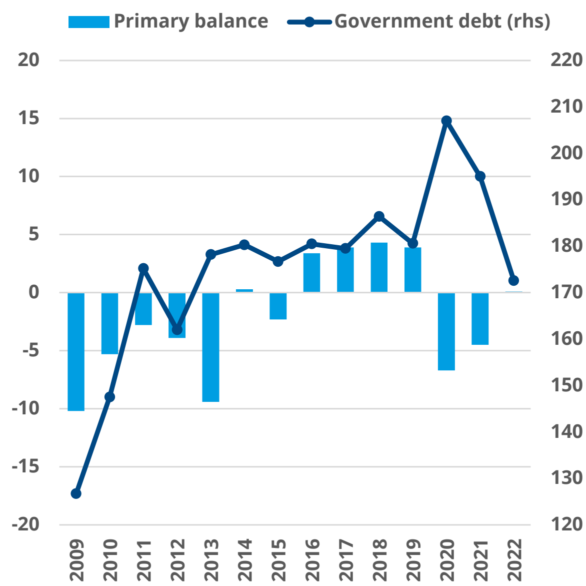
Overall, we forecast the euro area GDP to expand by 0.5% in 2023, and accelerate to 1.2% in 2024. Compared to our forecasts in the previous issue of the Economic Briefs (August 2023), we revised our projection for 2023 downward, mainly on account of an ultimately weaker quarterly growth profile in the course of the year.

Recent rating activities: Ireland and Greece subject to positive rating actions

Since our last Economic Briefs, we have raised the outlook on Greece to “positive” from “stable” in November, whilst affirming the unsolicited long-term sovereign rating of “BB+”. Reasons for the improved outlook include our belief that Greece will experience solid economic growth over the medium term, supported by tourism and investment, a resilient labor market, progress in cleaning up the bank balance sheets, and structural reforms. The positive outlook also reflects our expectation of a progressing implementation of the Greek Recovery and Resilience Plan, not least as the government enjoys an outright parliamentary majority. Moreover, the revised outlook is supported by our expectation of a declining debt trend over the medium term (see **Figure 5**).

Figure 5: Considerable decrease of Greece’s government debt ratio on a high level

In percent GDP



Sources: Eurostat, Creditreform Rating

We have also raised Ireland’s unsolicited long-term sovereign rating to “AA-“ from “A+” in September, while the outlook remains "positive". The upgrade reflects resilient and robust economic growth, underpinned by strong labor market developments, strong competitiveness, and significant private sector deleveraging in recent years. We also see a limited economic and fiscal impact on the Irish economy from Russia's war in Ukraine, as well as a substantial post-pandemic decline in government debt, and we expect an ongoing downward trend for the Ireland's debt-to-GDP ratio.

Apart from the above rating actions, we have [affirmed Slovakia's unsolicited long-term sovereign rating](#) at "A+" with a negative outlook, as well as the unsolicited long-term sovereign ratings of "A+" and a stable outlook for [Malta](#) and [Lithuania](#), respectively.

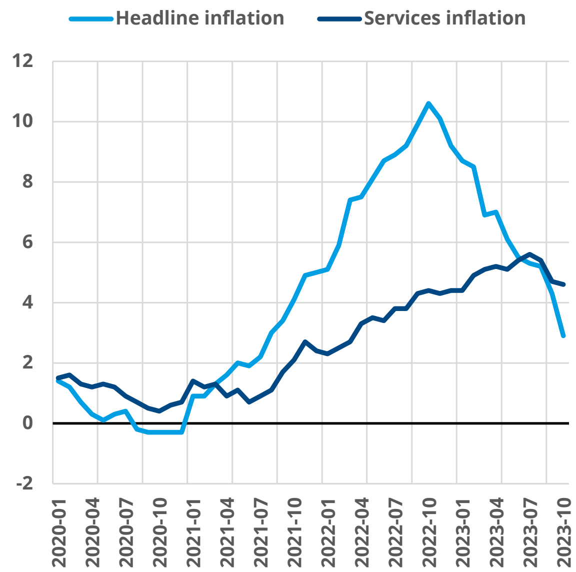
Inflation on the decline, but the road gets rockier

The European Central Bank's fight against high inflation continues. In October, inflation in the euro area dropped to 2.9%, compared to 10.9% in October 2022, mainly driven by lower energy prices, which were 11.1% lower than a year earlier. Core inflation (excluding food, energy, alcohol and tobacco) has decreased as well, but remains high at 4.2%. The ECB staff macroeconomic projections foresee a decline of the HICP inflation rate to an average of 5.6% in 2023 and 3.2% in 2024. The corresponding forecasts for the core rate were 5.1% and 2.9%.

The European Commission's latest survey of euro area consumers' inflation expectations for the coming 12 months does indeed paint a picture of significantly lower price expectations. However, over the next few months, energy prices may well rise again to some extent, against the backdrop of the tensions in the Middle East, partly expiring support measures and the start of the heating season in the Northern Hemisphere. Apart from that, about 40% of service prices saw increases in excess of 5% year-on-year in October (see Figure **6**). Similarly, in the goods sector, about 40% of the products display increases above an annual rate of 5%, pointing to a slow pace of disinflation.

Figure 6: Sticky services inflation partly explaining still high core inflation

Annual rate of change



Sources: Eurostat, Creditreform Rating

Higher ECB key policy rates for longer

Hence, the ECB Governing Council is keen to avoid a de-anchoring of inflation expectations in the later stages of the disinflation process, also due to upward pressure on wages. For these reasons, the decision-makers have hitherto refrained from suggesting that rate cuts are imminent. Instead, the ECB Governing Council emphasizes that interest rates could remain at their current high level for a protracted period.

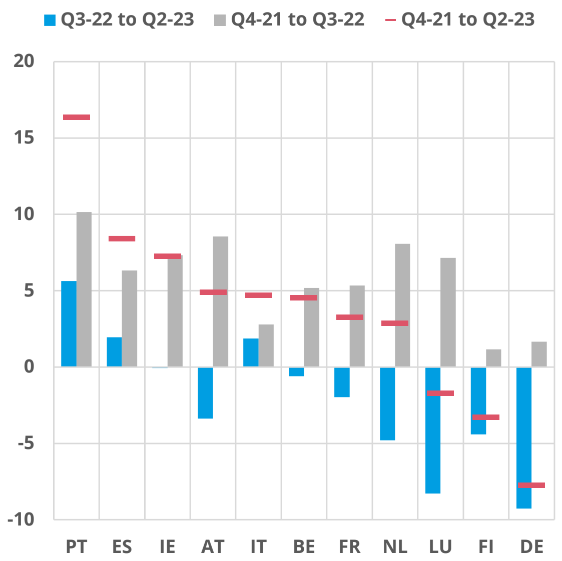
At its October monetary policy meeting, the ECB decided to keep key policy rates unchanged, having raised them by 25 basis points in September. Meanwhile, the unwinding of the APP portfolio is proceeding as planned, while maturing government bonds in the significantly smaller PEPP portfolio will be reinvested until at least the end of 2024.

We think that the ECB's interest-rate hiking cycle has indeed peaked, with the main refinancing rate standing at 4.50%, and we maintain our view that a first rate cut is unlikely to occur before the second half of 2024. At this stage, we forecast the main refinancing rate to be at 4.0% at the end of 2024.

In light of the tight monetary policy stance we are closely following the private sector's ability to service its debt and the number of corporate insolvencies, as well as the developments in housing markets (see Figure 7). For some time now, banks have been tightening their credit standards for all loan categories, as confirmed again by the latest ECB Bank Lending Survey conducted between 15 September and 2 October 2023, while loan demand from both firms and households has continued to decrease.

Figure 7: Euro area residential property prices are decelerating or reversing

House price changes in percent



Sources: Eurostat, Creditreform Rating

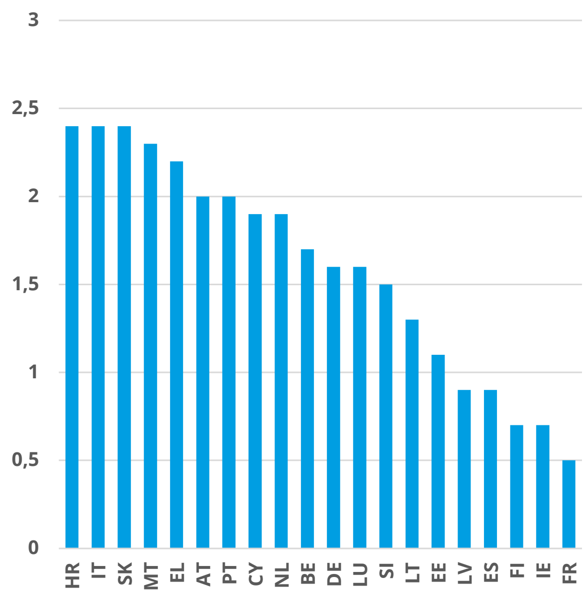
In terms of financial stability, macroprudential levers have been activated, in particular to prepare the banking sector for a potentially larger wave of loan delinquencies. Increases in the countercyclical capital buffer (CCyB) rate have become effective in 10 of the 20 euro area member states in 2023. Recent examples of tightening macroprudential policies include the National Bank of Belgium's decision to lift the CCyB from currently 0% to 0.5% with effect from April 2024 and to 1.0% with effect from October 2024.

A delicate mix of circumstances in which to manage fiscal consolidation

While the pandemic has largely been overcome, and public debt ratios have generally declined almost four years after the outbreak of the global health crisis, debt ratios in most euro area countries have not yet returned to pre-pandemic levels. However, governments now face a challenging environment in which to pursue fiscal consolidation. Capital market borrowing has become significantly more expensive, and monetary policy rates seem set to remain high for longer. At the same time, the green transformation is proving to be costly to finance, and the choices of which path to take in this pursuit is at times creating political divisions and complicating the formation of stable government coalitions, which in turn poses risks to fiscal consolidation and reform implementation going forward.

Figure 8: Mediterranean euro area countries' insurance against natural hazards tends to remain low in relation to projected risks

Score on the estimated protection gap against climate perils (i.e. earthquake, flood, wildfire, windstorm), from 0=no risk to 4=high risk



Sources: EIOPA, Creditreform Rating

Increasingly - and this concerns in a first instance countries particularly exposed to climate change risks due to their geographical and topological situation – financial and other resources may need to be made available to cope with extreme weather events, including insurance costs. This will put additional pressure on public finances until well-designed financing models are in place, such as charging for the external costs of polluting emissions (see Figure 8).

3. Germany

Flatlining German economy

Burdened by the ongoing structural changes to its energy supply, the German economy has continued its weak streak, with the real GDP decreasing by 0.1% q-o-q in Q3-23, after edging up by a mere 0.1% in the second quarter and stagnating in the first three months of the year. In light of high energy costs and inflation rates, private consumption has declined in three of the four quarters to Q3-23. Fixed investment in machinery and equipment contributed positively in Q3, providing some silver lining in the current challenging environment.

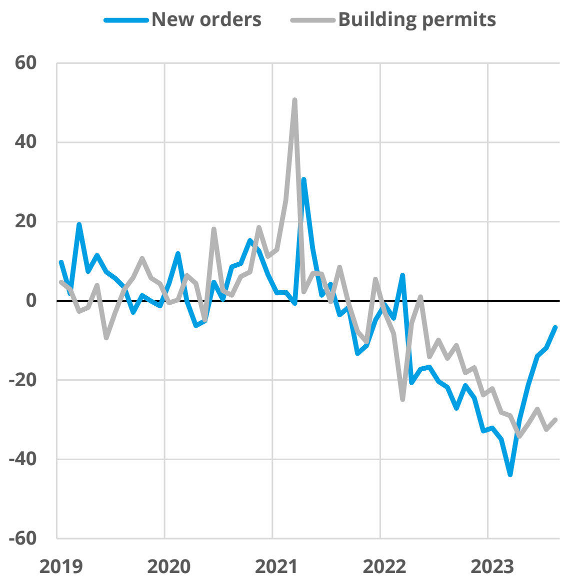
Construction sector remains under strain

Zooming in on total fixed investment over recent quarters, the downturn in the construction sector continues to stick out negatively, with both residential and non-residential investment on a downward trend. In October, 22.2% of construction firms surveyed by the German ifo institute reported on canceled projects, a new high, spurred by higher material and energy costs and tighter financing conditions, while shortages of material have eased somewhat.

The downturn in the construction industry is also reflected in fewer new orders, as the share of construction firms reporting lack of new orders has increased to 48.7% in October 2023, up from 18.7% a year earlier. In the first half of 2023, the number of building permits fell by 27% y-o-y (see Figure **9**). Tighter financing conditions and rising construction costs have also left their mark on the German residential property markets. Loan demand for house purchases is slowing, and house prices have dropped by 9.9% year-on-year as of Q2-2023 and are likely to decline further in the near term.

Figure 9: Cross-currents continue to weigh on German residential construction

Y-o-y changes in percent



Sources: Destatis, Creditreform Rating

After falling short of its coalition agreement target of 400,000 new dwellings per year, the government launched a 14-point-plan in the fall to support residential construction in light of abovementioned challenges, flanking its intention to invest more than EUR 18 billion in social housing between 2022 and 2027. The initiatives include improved conditions for KfW loans to facilitate home ownership for families from mid-October, including the introduction of a higher income threshold concerning the respective eligibility. Plans to enforce stricter building insulation standards have been suspended. Planning and approval procedures are to be accelerated. Moreover, the conversion of vacant commercial real estate space into residential real estate is to be fostered via a dedicated KfW promotional program in 2024 and 2025 with a volume of EUR 480 million.

Economic year-end rally cancelled

As regards growth expectations for the fourth quarter, evidence from various short-term indicators is somewhat mixed. On the positive side, German HICP inflation fell to 2.9% in October on the back of falling energy prices, but as in the euro area overall, the core rate remains higher, recording 4.2%. Consumer confidence as captured by the GfK/NIM indicator has deteriorated since August. The broad-based ifo business climate may have bottomed out, having increased in October after stabilizing in the preceding month. The respective expectation component has risen for a second consecutive time.

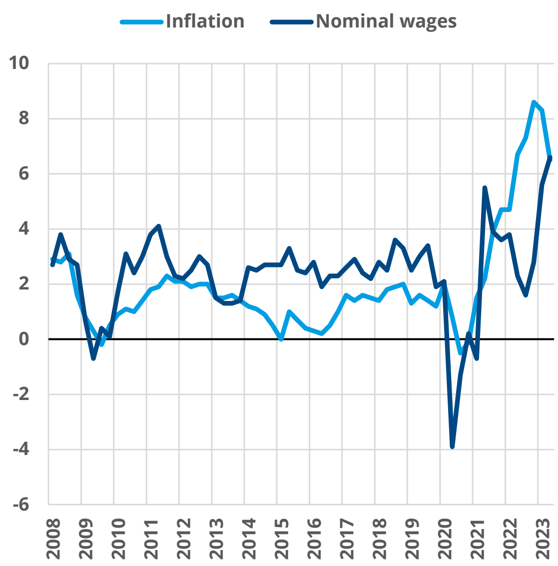
However, a closer look at the ifo sentiment by sectors reveals that pessimism has receded mainly among services firms, while the mood in trade and construction remains gloomy. Sentiment in the manufacturing sector may have troughed, but the recent slight improvements have taken place at a rather downbeat level. Order backlogs in the manufacturing sector are still at elevated levels, but have been reduced from their highs in 2022, which could slow down monthly industrial production going forward, given the downward trend in new manufacturing orders. The latter have also been very volatile over the last few months, but there are signs that the downward trend in orders may be coming to a halt.

Outlook for 2024: Hopes rest on private consumption

As the cumulative effects of monetary policy hikes weigh on domestic demand in the near term, the focus will be on further relief for private households through retreating inflation rates. Combined with a resilient labor market and strong wage increases, private consumption should add positively to GDP growth in 2024 and even turn out as the main driver. Indeed, nominal wages have risen by 6.6% y-o-y in this year's second quarter, the highest increase on Destatis records (see Figure **10**). As a corollary and arguably more importantly, real wage growth finally turned positive in Q2-2023 (+0.1%).

Figure 10: Record-high nominal wage increases and waning inflationary pressure should support German household spending

Y-o-y changes in percent



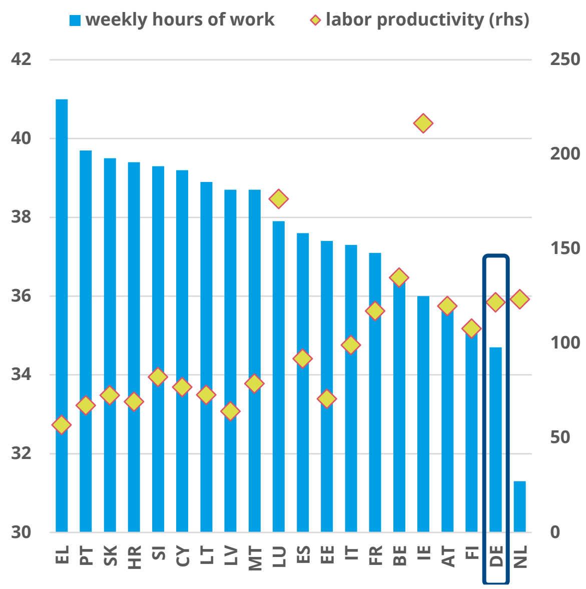
Sources: Destatis, Creditreform Rating

Government support to cushion the negative effects of high energy prices is likely to fade next year, although the government may consider extending support, possibly in a more targeted manner, in the event of renewed bouts of energy price increases. Electricity and gas price breaks for private households are currently foreseen to expire at the end of April 2024.

Taking a closer look at the labor market, Germany's unemployment rate was stable at a very low 3.0% in September 2023, less than half the 6.5% rate reported for the euro area as a whole. While employment dynamics have slowed somewhat, total employment still increased by 0.7% year-on-year in the second quarter of 2023 and Germany's labor force continues to exhibit a persistently high productivity. Recent developments concerning the labor supply seem to highlight the risk of falling behind competitors if the volume of labor is cut back without being made up for by rising productivity (see Figure **11**).

Figure 11: Until recently, high productivity compensated for fewer weekly hours of work

Average number of usual weekly hours of employed persons aged 15y and over; labor productivity per hour worked as a percentage of the EU-27 total, 2022



Source: Eurostat, Creditreform Rating

According to the latest ifo employment barometer, companies remain overall cautious when it comes to their hiring intentions. In October, the indicator increased, mainly as a result of intensified recruiting efforts in the services sector, in particular IT services and in tourism, whereas hiring plans in the manufacturing contracted markedly. The vacancy rate has edged down somewhat from its peak reached in Q2-22, but remains one of the highest in the euro area at 4.1% in Q2-23, adding to upward pressure on wages in a number of industries already facing shortages of skilled labor.

Further relief for the energy-intensive industry

Germany's export prospects should improve somewhat, as economic activity in the euro area and other major export destinations picks up amid declining inflation rates and concurrently rising household spending - despite the effects of tighter monetary policy still weighing on foreign demand. The positive effects of EU funding linked to the Recovery and Resilience Facility among the EU members should help to stabilize demand from the European trade partners.

However, despite some improvement in October, export expectations remain rather depressed at this stage, dampening any enthusiasm as regards a meaningful acceleration over the next few months. Against this backdrop, we maintain our forecast that net exports will be a drag on GDP growth next year, after a likely positive contribution in 2023. While construction investment should weigh on GDP growth next year, we expect equipment investment to expand moderately, with government spending on defense equipment contributing positively, bearing in mind the government's EUR 100bn special fund for the armed forces.

Concerned that high electricity cost could cause Germany's industry a competitive disadvantage and trigger companies to relocate to destinations with lower production costs, the government came forward with a support package for the energy-intensive industries such as the chemical, pharma, glass and metal industries this November. Among other things, the package foresees a significant reduction in the electricity tax rate for 2024 and 2025. In 2024, financial relief via this channel could amount to up to EUR 12bn in 2024, according to government estimates.

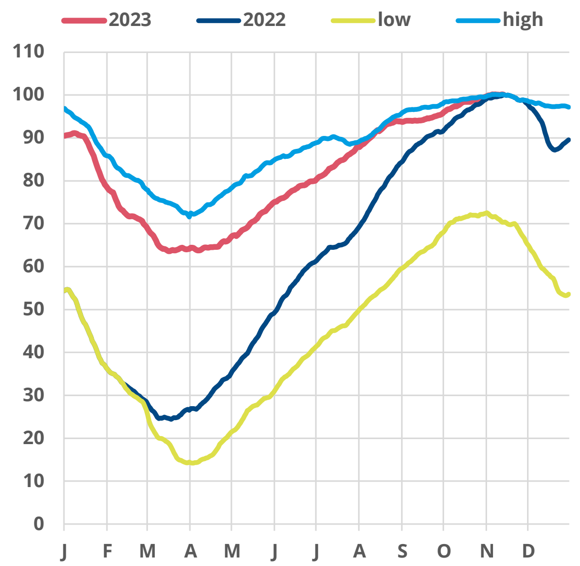
The government's fiscal plans as regards the general financing of the green and digital transformation have received a blow with a decision of the German Constitutional Court delivered in November. The Court ruled that the transfer of an authorisation to borrow EUR 60bn, granted in response to the pandemic but unused in the respective fiscal year (2021), to the special-purpose Energy and Climate Fund, to be used in subsequent fiscal years, was unconstitutional. By the same token, the constitutionality of the EUR 200bn Economic Stabilization Fund (WSF) is currently called into question. Against the backdrop of these latest developments, already high economic uncertainty among private households and businesses increases further, adding to downward risks to GDP growth in the near term.

Overall, we currently forecast GDP growth of -0.1% for Germany in 2023, unchanged compared to our latest Economic Briefs, whereas we have slightly lowered our forecast for 2024 to 0.8%, in the face of a delayed recovery.

Next year's growth is likely to be supported by an overall moderate contribution from domestic demand, mainly private consumption. Uncertainty around the forecasts remains high, with a possible further escalation of the war in Ukraine and the conflict in the Middle East unpredictable. Temporary spikes in energy prices are at least conceivable in case of an escalation involving major opposing oil producers in the Middle East, although this is not our baseline scenario. Drawing on current data on gas storage levels (see Figure **12**), Germany and the EU as a whole are heading into this winter season at high levels.

Figure 12: German gas storage well filled

Gas storage filling level by month, in percent, historical high/low since 2011



Sources: AGSI, Creditreform Rating

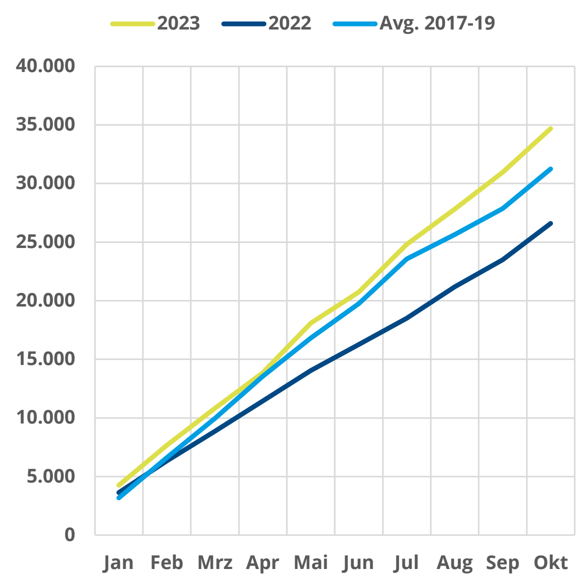
Business default rates trend upward in a challenging economic environment

The number of German companies that have defaulted remains on the rise, following expiration of exceptional rules during the acute pandemic phase and in light of the challenging economic circumstances caused by the war in Ukraine (see Figure **13**).

We measure corporate default rates based on a Basel-compliant definition of the default event, which not only includes corporate bankruptcies but also payment delays of more than 90 days. The results are empirical default rates rather than extrapolations or estimates, due to our comprehensive database of more than 2.5 million economically active companies, equivalent to a complete survey of the German corporate sector.

Figure 13: Defaults continue to rise significantly

Cumulative number of corporate defaults in Germany



Sources: Creditreform Rating

By October 2023, a total of 34,683 companies have defaulted this year as compared to 26.609 in the same period in 2022 and an average of 31.255 in the respective periods of the pre-pandemic years 2017-2019. From 1.17% at the end of 2022, the pre-pandemic default rate of 1.36% (2019) is likely to be exceeded this year, and we also believe that defaults are set to trend further upwards, given remaining challenges related to higher debt servicing costs and higher financing costs.

4. United Kingdom

Economic activity broadly stagnating in the second half of the year

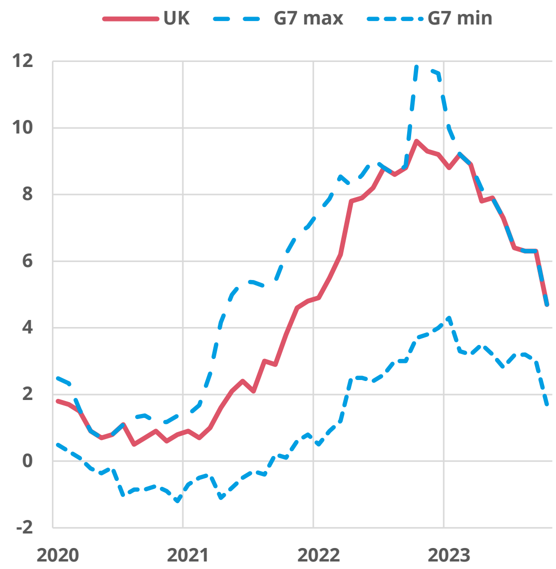
Compared to the German economy, the UK economy fared much better in the first half of the year, recording q-o-q GDP growth rates of 0.3% and 0.2% in Q1 and Q2, respectively. However, according to preliminary data, total economic output only stagnated in the third quarter, as a positive contribution from net exports was offset by combined declines in business investment, private consumption and government spending.

Using the production approach, output declines in real estate, transportation and storage were significant drags on the services sector. Falling activity in the real estate sector reflect the negative impact of significantly tighter financing conditions on the back of a restrictive monetary policy stance, as the Bank of England continues to face inflation rates still well above desired levels and constituting the highest among the G7 countries (see Figure **14**). That said, the consumer price inflation (CPI) rate has decreased more markedly to 4.6% in the year to October. At the same time, the core rate, i.e. excluding energy, food, alcohol and tobacco, was down to 5.7%. The largest downward pressures on consumer prices in October stemmed from housing and household services.

Based on its short-term GDP tracker, the National Institute of Economic and Social Research (NIESR) suggests that total output could post very modest growth of 0.1% in the final quarter of 2023. Business sentiment as captured by the monthly PMI indicators improved slightly in October in the manufacturing and construction sectors, although from low levels associated with contracting activity. The respective gauge for the services sector remained at a higher level, but close to the threshold usually associated with shrinking output. Consumer confidence has taken a hit in October, dropping to a three-month low.

Figure 14: UK inflation remains higher than that of G7 peers

Monthly inflation rates (CPI), y-o-y change in percent



Sources: OECD, Creditreform Rating

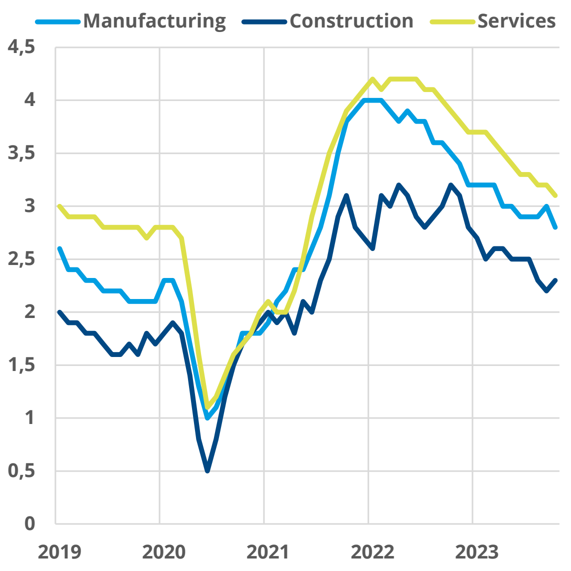
Against this backdrop, private consumption is likely to remain subdued until there is a more significant decline in inflation. Continued strong wage growth, however, is already pushing up real wages, providing scope for a rebound in household spending, while the employment situation looks set to remain broadly supportive, despite further signs of cooling. Looking at the economy as a whole, average weekly regular earnings grew by 7.7% in the three months to September 2023, and by 7.8% in the private sector, representing a slight deceleration over the last few months.

Labor market becoming less tight

Meanwhile, the UK unemployment rate has drifted slightly upward, but remains comparatively low at 4.3% in the three months to September 2023. At the same time, total employment has continued to grow, with preliminary data showing an increase of 0.6% y-o-y as of September 2023. Notably, vacancy rates have decreased further in the months to October, and difficulties in recruiting are reported to have lessened (see **Figure 15**), suggesting some easing in the labor market. That said, shortages of labor persist in several sectors.

Figure 15: Vacancy rates are on the retreat

Vacancies per 100 employee jobs



Sources: ONS, Creditreform Rating

The near-term outlook for investment remains cautious, as the interest rate hikes work their way through the economy, and as the higher corporate tax rate effective from April 2023 will have to be digested. However, there are signs that cash-rich companies remain inclined to invest, and capital spending on cutting-edge technologies such as AI in order to boost productivity in some industries may well lend some support. Foreign demand is likely to be subdued in the near term, as tighter monetary policy in a significant share of the UK's export destinations will also weigh on local consumption and investment plans.

Modest impulses from the Autumn Statement for growth in 2024

Overall, we expect the UK GDP to grow by 0.6% in 2023 as a whole. In an attempt to boost the lackluster economic development, the Chancellor announced a two percentage point cut to the main national insurance rate from January 2024, an increase to the National Living Wage and pensions, and some tax relief for businesses in his November's Autumn Statement. The measures could entail some upside risks to our currently anticipated, equally moderate, growth rate of 0.6% for 2024, as they will likely coincide with decreasing inflation, providing some impetus for domestic demand. The Autumn Statement also includes stricter rules on requirements to look for work while receiving certain benefits, as well as an a five-year extension of the investment zones program.

The relief measures announced with the statement partly comes on the back of likely higher-than-expected tax revenue this year. Moreover, the next parliamentary election will have to be held by January 2025, and the leading Conservatives are under enormous pressure, judging by the considerable polling gap versus the leading Labour party as regards current election polls. With the inflation rate having been more than halved compared to its double-digit rate earlier in 2023, representing a declared goal by the prime minister, the inclination to offer some tax relief may have been higher after all.

Monetary policy: A (weaker) tightening bias remains in place

The Bank of England has raised the Bank Rate 14 times since December 2021, with the latest hike in August 2023, and has maintained its policy rate at 5.25% since then. To be sure, there remains a minority of members with a preference for further hikes. At the latest meeting in November 2023, the vote in favor of a stable policy rate was 6:3, with the three dissenting members preferring to raise the Bank Rate by another 25 basis points. The Bank of England's updated projections in November, as usual conditioned on the market-implied path for Bank Rate, suggest that the inflation rate will return to the

2% target by the end of 2025, while highlighting the risk that it could take longer, not least due to the unpredictable situation in the Middle East.

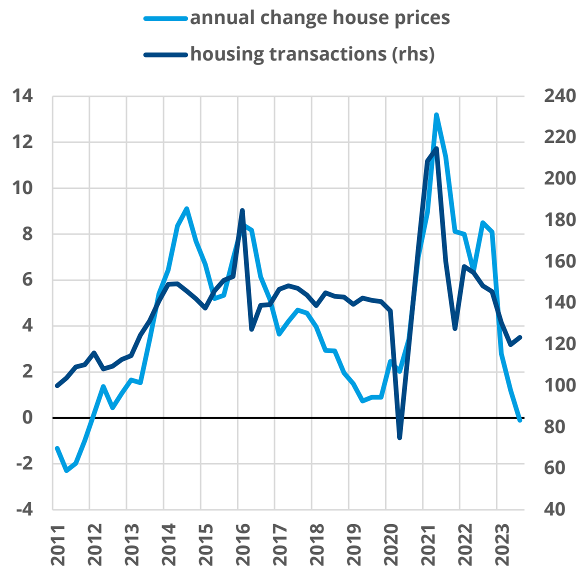
In our most recent Economic Briefs (August 2023), we forecast that the Bank Rate would peak at 5.75% in 2023. By now, we consider it much more likely that the policy rate has reached its cycle high at 5.25% after all, while we maintain our view that a rate cut will not come before the second half of 2024.

Negative annual change in house prices for the first time in over ten years

UK house prices have continued to diminish in recent months, as housing activity has slowed under the burden of higher borrowing and material costs. At -0.1% in September 2023, the annual price change recorded by the HM Land Registry's house price index was negative for the first time since April 2012 (see Figure **16**). Transactions statistics confirm that transactions of residential properties valued at GBP 40,000 and above fell by 17% y-o-y. We think that the downward trend in both activity and prices will continue in the near term. A turning point in house prices may be reached once market expectations of imminent interest rate cuts firm, prospectively in the course of the second half of 2024.

Figure 16: Housing under pressure

Housing transaction index (Q1-2011=100), y-o-y change in house prices in percent



Sources: ONS, Creditreform Rating

Figure 17: We have revised down our forecasts for 2023

In percent, IMF forecasts for World, China, US

	2010-19	2020	2021	2022	2023e	2024e
World	3,7	-2,8	6,3	3,5	3,0	2,9
Euro area	1,4	-6,1	5,9	3,4	0,5	1,2
Germany	2,0	-3,8	3,2	1,8	-0,1	0,8
France	1,4	-7,5	6,4	2,5	1,0	1,2
Italy	0,3	-9,0	8,3	3,7	0,7	0,8
Spain	1,1	-11,2	6,4	5,8	2,4	1,8
UK	2,0	-10,4	8,7	4,3	0,6	0,6
US	2,3	-2,8	5,9	2,1	2,1	1,5
China	7,7	2,2	8,5	3,0	5,0	4,2

Sources: Creditreform Rating, IMF

Related Credit Ratings

Rating Action 22 September 2023: Creditreform Rating upgrades the Republic of Ireland's rating to 'AA-' from 'A+', the outlook remains positive

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Rating Action, 10 October 2023: Creditreform Rating raises the outlook on the Hellenic Republic to 'positive' from 'stable' and affirms the rating at 'BB+'

Rating Action 20 October 2023: Republic of Malta's credit ratings affirmed at 'A+', outlook stable

Rating Action 20 October 2023: Republic of Lithuania's credit ratings affirmed at 'A+', outlook stable

Rating Action 10 November 2023: Creditreform Rating revises Outlook on the Hellenic Republic to positive, while affirming its credit ratings at 'BB+'

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