



Global Economic Outlook

December 2023

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Introduction



A theme that's become all too familiar in KPMG's *Global Economic Outlook* is uncertainty. For many, 2023 was another year when the medicine at times felt worse than the illness. Central banks tightened their belts with tough monetary policies aimed at reigning in spiralling inflation. It appears to have paid off, but at the cost of economic stagnation for many regions and a continued squeeze on consumer spending.

KPMG's latest *Global Economic Outlook* offers a sense of what lies ahead, with the clear health warning once again that we're in deeply uncertain times, and therefore our predictions are just that – a forecast based on the few certainties that exist right now and the long-term trends that can help us piece together a complex future.

I spent the final month of 2023 in Dubai, joining delegates at COP28. The summit was focused on the climate crisis and potential solutions that could unlock a more sustainable future, but – for me – it reflected some of the wider challenges facing economies and political leaders right now. There were some positive outcomes, but many issues remained unresolved. The economic outlook is worryingly similar.

In our latest report, our economists based around the world offer their view on the economic landscape in the coming months and years. While the story varies from country to country, there are some clear universal themes. Monetary policy has had a big impact on output and growth prospects and there's growing pressure for it to ease. Whether that happens remains to be seen. Many central banks are stuck between a rock and a hard place, cautious that loosening the screws could simply lead to an inflationary rebound.

There are also fears that an increasingly protectionist, de-globalization approach in politics is impacting supply chains and the traditional trade flows that have sustained

many economies. An interesting side effect – and something to watch in 2024 – is some of the beneficiaries like Mexico and Vietnam, who are embracing the opportunities to fill the space left by shifting trade relationships.

While we're anticipating no significant change to employment figures, 2024 could be a year to monitor the impact of tight economic conditions for the corporate world. A wave of debt refinancing in a particularly challenging period could put real pressure on business leaders searching for an end to the prolonged pain of recent months. Combined with ongoing geopolitical uncertainty, the coming year could be crippling for many.

While the latest KPMG *Global Economic Outlook* is unquestionably skewed toward a negative forecast, there are always glimmers of hope and optimism. Since the outbreak of the pandemic, we've had several years of uncertainty and business leaders have demonstrated a real sense of resilience and agility. With the right strategies in place and an ability to flex to an ever-changing world, the most innovative and focused should eventually start to see some light at the end of the long tunnel.

Regina Mayor
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Contents

The global outlook: Limited upside in the short term	4
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Global trade and value chains: Shaken not stirred	5
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Countries and regions in focus:

• United States: The economy endures headwinds	8
• Canada: Economy continues to chill	11
• Brazil: More rate cuts to come	14
• Mexico: Reaping benefits from nearshoring	16
• China: Policy stimulus is vital to economic growth	18
• Vietnam: A burgeoning manufacturing destination	21
• Japan: Yen’s depreciation complicates outlook	23
• India: Increasingly important economically and diplomatically	25
• Germany: Europe’s largest economy in a recession	27
• Austria: Higher prices and their implications	29
• Switzerland: Resilient but not fully immune to shocks	32
• Spain: Lower growth for 2024 but gaining traction throughout the year	34
• The Netherlands: Technical recession drags on for third consecutive quarter	36
• Ireland: Recent strong growth moderating to typical levels	38
• UK: Limping with a sprained ankle	40
• Czech Republic: Gradual recovery ahead	43
• Poland: Growth picking up on a bumpy path	45
• Romania: Weakening growth but economic revival in sight	47
• South Africa: In search of fiscal consolidation	49
• Nigeria: A challenging macroeconomy amid major market reforms	52

Appendix: KPMG country forecasts	54
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The global outlook: Limited upside in the short term

Deceleration in growth in some of the world's largest economies, coupled with little impetus elsewhere, could see global GDP growth easing slightly in 2024.

Weaker momentum should help push down inflation, with average world inflation expected to halve by 2025.

Monetary tightening cycle is reaching its end, but there could be an increasing divergence in the timing and the extent of easing by central banks.



Weaker economic momentum has helped ease supply chain pressures and reduce broader cost pressures, with energy prices dropping significantly from their 2022 peak when Russia invaded Ukraine. Median CPI inflation for the G20 countries fell to 3.9% in October 2023 after peaking at 7.7% in July 2022, and we expect further deceleration in coming months. Our forecasts see world inflation averaging 5.0% in 2024 and 3.9% in 2025, down from an estimated 6.5% in 2023 and 8.0% in 2022. Risks are on the upside, however, as any further shocks to energy prices – or a more persistent domestic inflation in some countries – could derail the relatively smooth return to central banks' inflation targets next year.

Monetary policy has largely reached the height of the current tightening cycle. However, many central banks are likely to hold on before starting to ease again. The big question at the moment is when interest rates will start falling and how far down they will go. While central banks such as the National Bank of Poland and Banco Central do Brasil have already begun to cut rates, our view is that most central banks – including the U.S. Fed and the Bank of England – would not start acting until well into 2024, with rates settling at a significantly higher level in the medium term than during the decade prior to the Covid pandemic.

Higher interest rates are hurting the commercial property market and slowing the pace of housing transactions. A large concern in the U.S. is also the large portion of corporate debt which requires refinancing in 2024 at higher rates. Record-high household debt in Canada also remains a significant risk to the local outlook.

Global trade has plateaued in recent years, partly due to rising protectionist measures and geopolitical tensions. Geoeconomic fragmentation could lead to large output losses over the longer term. So far there is limited evidence of relocation of production on a grand scale, but countries like Mexico are benefiting from a boost to economic growth, as foreign direct investment flows are becoming more concentrated among close trading partners. At the same time, supply chains are becoming longer in an effort to avoid trade barriers, with countries like Vietnam acting as one of the destinations for manufacturing diversification.

Uncertainty triggered by rising geopolitical tensions is exacerbated by policy uncertainty for countries including the U.S., the UK, India as well as Austria, where 2024 is an important election year. This could see relatively weak business investment in the short term, while there is little room for governments to pick up the slack as public finances have worsened significantly in recent years. Nevertheless, we expect unemployment to remain relatively low – at just below 6% on average globally – providing some support for consumer spending despite the various headwinds. This could see global growth slowing slightly to 2.2% in 2024 before rising to 2.6% in 2025, similar to our estimate of global growth for 2023 (see the Appendix on p.54 for our full set of forecasts for the next two years).

Yael Selfin
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Global trade and value chains: Shaken not stirred

World trade and production have plateaued in recent years, hinting at a potential shift in the global economic paradigm.

The potential for output losses and increased vulnerability to shocks highlight the complex trade-offs in reshaping supply chains.

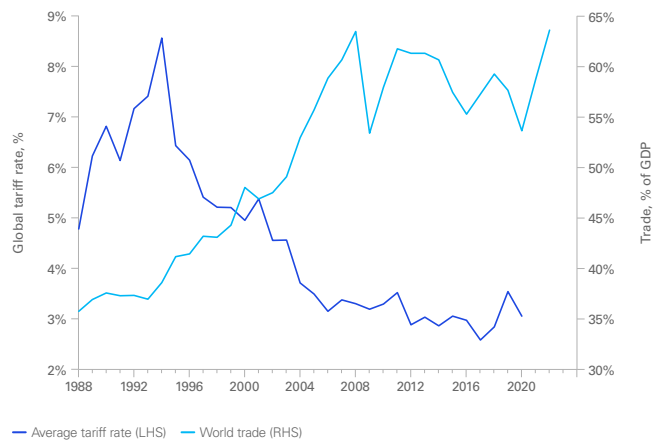
Increased potential for inflationary episodes may exert upward pressure on future interest rates, as central banks recognize the risks associated with fragmentation.



Trade openness increased sharply after the Second World War. World trade as a share of GDP increased from 33% in 1975 to a peak of 64% in 2008, where it remains today (see [Chart 1](#)). Trade related to global value chains (GVCs), measured as intermediate inputs share in gross production, has risen from 47% in the mid-1990s to a peak of 52% in 2014, before flatlining since. However, flows have stabilized in recent years, leading some to speculate that globalization may be turning.

The main concern relates to the idea that structural tailwinds, which supported global integration during the period of trade liberalization, have been broadly exhausted. The average global tariff rate has fallen from nearly 9% in 1994 to around 3% today. The technological advancements in transportation and communication during the ICT revolution facilitated greater specialization of production and led to offshoring of manufacturing to emerging markets at a low cost. At the same time, operations of multinational corporations have become more service heavy and less dependent on investment in physical assets, which has limited the expansion in goods trade.

Chart 1: The exhaustion of global trade tailwinds has led to a slowdown



Source: World Bank, KPMG analysis.

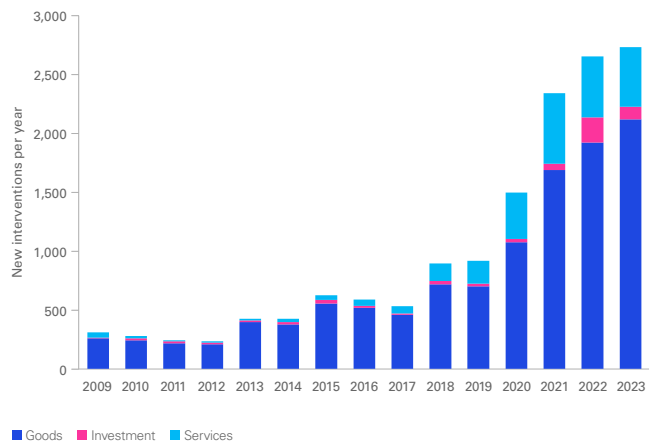
While the low-hanging fruit in trade liberalization has been picked, headwinds have also risen. Rising geopolitical tensions have led to a greater focus on political and national security goals in international trade. Trade restrictions – including tariff and non-tariff barriers – have increased sharply since 2018, with a discernible rise in measures targeting services (see [Chart 2](#)). A stark example is the bilateral trade relationship between the U.S. and China. The average U.S. tariff rate vis-a-vis China increased from around 3% to 19% since 2018, with a corresponding rise from 8% to 21% on the part of China. Other recent policies – such as the recent EU Carbon Border Adjustment Mechanism – seek to reshore production which was previously lost due to manufacturing offshoring to avoid domestic carbon taxes (also known as ‘carbon leakage’).

There has also been a surge in government subsidies. For example, the U.S. Inflation Reduction Act, worth an estimated USD 369 billion, aims to incentivize firms to manufacture green energy components domestically or in countries which have a free-trade agreement with the U.S. The U.S. Creating Helpful Incentives to Produce Semiconductors and Science (CHIPS) Act, worth USD 280 billion, aims to boost domestic semiconductor manufacturing capacity through a wide range of subsidies and tax incentives. This sparked a response from the European Union in the form of the European Chips Act (worth USD 47 billion), while similar packages were introduced by China, South Korea, Japan, and Taiwan to support their respective domestic semiconductor industries.

Despite a fall in trade policy uncertainty, recent supply chain disruptions have led to an increased interest in reshoring (bringing production stages back to the home country), nearshoring (moving them geographically closer) and friendshoring (restricting or reorienting production to economic and political allies) (see [Chart 3](#)). However, reorganizing supply chains is easier said than done. Given the capital in place, the cost of searching for alternatives, and factors such as wage differentials across countries, this process is likely to be slow. A good example is the largely abandoned effort to switch from just-in-time to just-in-case inventory levels. In many cases, higher interest rates have made the cost of carrying excess inventory prohibitive.

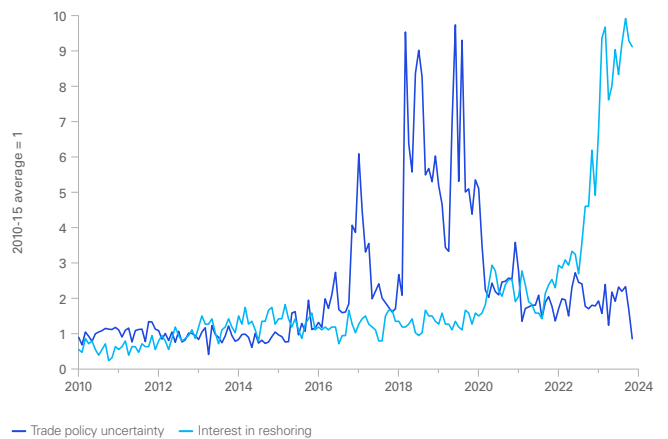
Recent evidence supports the idea that companies are making an effort to reorganize their production. KPMG has seen an increase in clients who are considering changes to their logistics in order to mitigate risks, but movement has been slow. For example, a large manufacturer has moved production of some laptops and phones from China to India and Malaysia. While that is an example of diversifying the manufacturing base, it shouldn’t be confused with nearshoring: the finished goods are still moving vast distances because they’re high value and relatively cheap to transport. Creating an entirely new production base is costly both in terms of capacity building and the skills base of the labor force in the new location.

Chart 2: Number of new trade barriers by commercial flow



Source: Global Trade Alert, KPMG analysis.

Chart 3: Growing interest in making supply chains less vulnerable to uncertainty

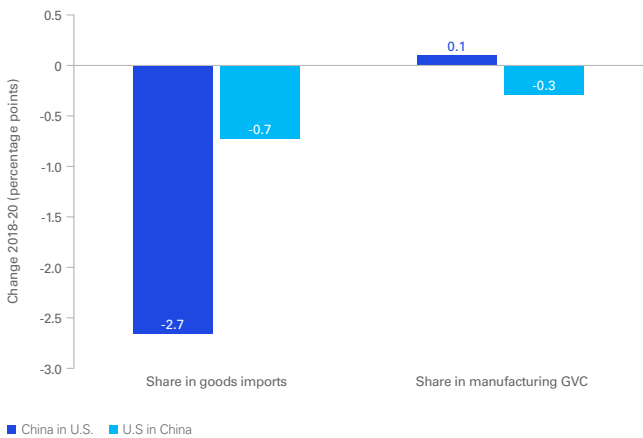


Source: Caldara et al (2020), Google Trends, KPMG analysis. The dark blue line measures media attention to news related to trade policy uncertainty. The light blue line shows the number of Google searches for ‘nearshoring’, ‘reshoring’ and ‘friendshoring’.

The U.S. is ahead of its peers in this regard. There have been at least 32 projects announced in the U.S. of over USD 1 billion in investment toward batteries and electric vehicles since the passing of the Inflation Reduction Act. The value of construction in computer, electronic and electrical manufacturing facilities has shot up by over USD 100 billion since 2020. U.S. trade has realigned to key partners such as Mexico and Canada via the USMCA trade agreement – one of the strongest examples of friendshoring to date.

Evidence for brute force relocations of production is limited. Trade in value added statistics are only available until 2020, but recent forecasts which combine production and trade statistics suggest that GVCs have remained stable since.¹ That being said, the cracks are starting to show. Foreign direct investment has shown dramatic swings in recent quarters, with investment being concentrated among close trading partners. That could translate to realignments in the longer run. There have also been reconfigurations in trade relations on a balance-of-payments basis. For example, China’s share of U.S. goods imports fell by nearly 3 percentage points between 2018 and 2020, even as its value-added share of U.S. consumption actually increased over the same period (see [Chart 4](#)).

Chart 4: GVC shares have been steady despite a drop in bilateral trade



Source: Haver, OECD, KPMG analysis.

These shifts do not necessarily mean that we are seeing less global trade. In the short run, trade barriers and reorganizing supply chains combined are likely to lead to a lengthening of supply chains and so-called ‘triangular trade’, where countries divert their products to avoid trade barriers, potentially leaving the networks more susceptible to supply chain shocks. In the example above, goods could be flowing from China to the U.S. via other countries, leading to the discrepancy between the trade data and the value-added data. Indeed, the share of U.S. goods imports from Vietnam,

1 Knutsson et al (2023), ‘Nowcasting trade in value added indicators’, VoxEU, September 26.

Chart 5: Estimates of geoeconomic decoupling can be large



Source: Various sources.

Malaysia and Taiwan has risen by 6 percentage points over the period considered, all of which have strong trade ties with China. A similar pattern could be observed over the past year between Russia and its trading partners.

Empirical estimates point to potentially large output losses from geoeconomic fragmentation (see [Chart 5](#)). They suggest that the global economy could be up to 5% smaller in the long run, depending on the exact nature of the shock. Fragmentation in commodities markets is expected to have a relatively modest effect given the offsetting effects across producing and consuming countries. Set against that, a decoupling of global technology hubs, or restricting foreign direct investment flows, could result in greater losses, owing to impaired diffusion of knowledge and intellectual capital. A less efficient allocation of resources would also lead to higher prices, especially if it requires labor to be sourced from a more expensive domestic or friendly pool.

Increasing fragmentation in trade, along with geopolitical shifts, could lead to more supply chain disruptions by constraining the availability of possible substitutes in the face of logistical breakdowns. The inherent risk is that those disruptions are inflationary. Recognizing that risk, central banks around the world have begun to focus on supply chains as an area which will increase the likelihood of inflationary episodes. This could put upward pressure on interest rates going forward.

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United States: The economy endures headwinds

The once beleaguered U.S. consumer emerged as an Atlas, supporting growth at home and abroad.

Mortgage applications have plummeted, while housing affordability dropped to its lowest levels since the mid-1980s in the fall of 2023.

Uncertainty around the 2024 election could act as its own tax on the economy as it prompts individuals and firms to hesitate in their decisions about the future.

The U.S. economy is poised to stall but not collapse in 2024. The path to a soft landing looks possible and even probable, but the journey is far from complete.

The U.S. economy stood out among its counterparts in much of the developed world, accelerating and exceeding its pre-pandemic trend on growth in 2023. More stunning is that those gains came on the heels of the most aggressive credit tightening cycle by the U.S. Federal Reserve since the 1980s (see [Chart 6](#)). The pandemic, and the stimulus that accompanied it, accelerated balance sheet healing in both the household and corporate sectors. Households paid down their debt, locked into long-term fixed-rate mortgages and banked the savings, which is now earning interest. The once beleaguered U.S. consumer emerged as an Atlas, supporting growth at home and abroad. Atlas is a tale of endurance rather than strength alone. The two are related but not the same.

Endurance is more about overcoming the challenges ahead than reflecting on how far we have come. Sectors that once drove employment gains started to falter as the Fed raised interest rates. What was a surprise is the extent to which sectors that once lagged were able to pick up the slack.

As the economy rounded the curve in 2023, employment gains became more concentrated in three sectors: leisure and hospitality, healthcare and government, largely public education. Those sectors are the least sensitive to interest rate hikes and suffered acute staff shortages in 2023. The concentration of employment gains makes the labor market more vulnerable to external shocks.

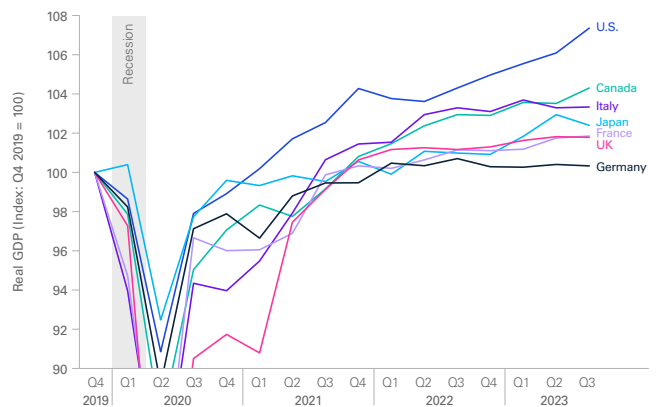
Table 1: KPMG forecasts for the U.S.

	2023	2024	2025
GDP	2.4	1.6	1.6
Inflation	4.1	2.7	2.0
Unemployment rate	3.6	4.1	4.3

Source: KPMG Economics, Bureau of Economic Analysis, Bureau of Labor Statistics.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Chart 6: The U.S. outperforms its peers



Source: KPMG Economics, Bbk, ONS, INSEE, CAO, ISTAT, StatCan, BEA.

Note: 'Real' denotes inflation-adjusted figures.

The blow dealt to employment during the height of worker strikes in October 2023 is a case in point. Payroll growth slowed to its lowest level since January 2021, before vaccines were widely available and the economy fully reopened, while wages cooled and the ranks of the unemployed moved higher. Those out on strike surged, while the ranks of those displaced by work stoppages hit the highest level since the massive strike in the vehicle sector in 1997. The ranks of those forced to take part-time instead of full-time work to make ends meet were even greater.

Much of the drag from monetary tightening is still ahead of us. Credit card and vehicle loan delinquencies rose above their pre-pandemic levels in the second half of 2023 and started to pass through the economy. Delinquencies in the third quintile of households, which are upper middle-income households, added to the stress already seen among subprime borrowers. Defaults remain low but are expected to move higher with a rise in unemployment.

Student loan repayments surged two months ahead of the end of COVID-era forbearance; those who could, attempted to get ahead of interest accruing on those loans. A shift to income-based repayment schedules and some loan forgiveness will ease the burden of those loans for low-income households. Student borrowers have a year before delinquencies on their loans show up on their credit reports. This could mean another setback in the access to credit for student loan borrowers in the fourth quarter of 2024.

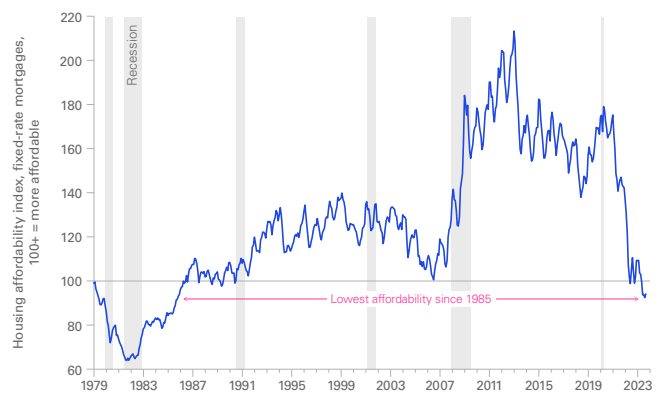
Banks held lending standards in recession territory over the summer. A set of special questions by the Federal Reserve revealed that a fair amount of credit tightening is still in the pipeline. Credit for individuals with a credit score of 680 or less will be significantly harder to get; that captures nearly half of all borrowers as we move into 2024.

Commercial real estate will suffer another setback, along with commercial and industrial loans. Both are used to fund large infrastructure projects and cover the cost of inventories. That is before banks deal with the losses in the office leasing market, which will further tighten credit conditions.

A larger portion of credit is affected by shifts in the U.S. Treasury bond market. Everything from mortgage rates to corporate and municipal bond yields is linked to Treasury bond yields. We have yet to feel the full effects of the move up in bond yields in the late summer and early fall. Those shifts dumped a bucket of ice on the housing market. Mortgage applications plummeted, while housing affordability dropped to its lowest levels since the mid-1980s this fall (see [Chart 7](#)).

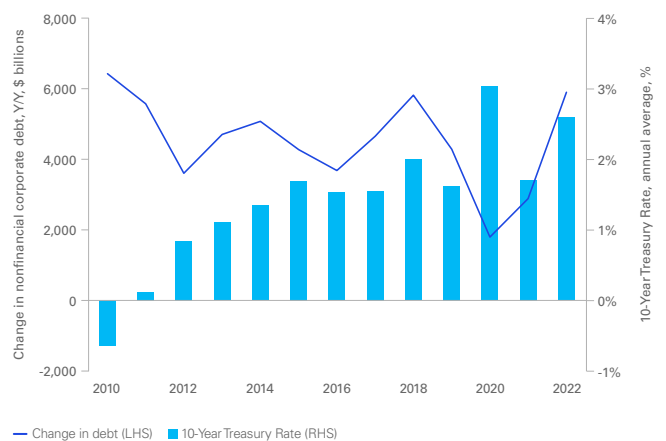
A larger concern is the surge in corporate debt as rates plummeted in 2021 and early 2022. Inflation-adjusted rates dipped into negative territory in 2021 and early 2022, before the Federal Reserve embarked on its rate hiking cycle in March 2022; that was like being paid to borrow. A portion of that debt is scheduled to reset in 2024, which will crimp profit margins along with the leveling up of wages and inability to raise prices. The result is expected to take a toll on employment and push the unemployment rate higher. Interest expense remains low on corporate balance sheets; this is an area that warrants watching as it could be a hurdle to further cooling the broader economy (see [Chart 8](#)).

Chart 7: Housing affordability plummets



Source: KPMG Economics, National Association of Realtors.

Chart 8: Surge in corporate debt due to reprice



Source: KPMG Economics, Federal Reserve Board, Haver Analytics.



Fed shifts to wait-and-see mode

Chair Powell has made clear his intent. He believes we need “growth to slow below potential”, which is fed speak for the gradual rise in unemployment. That would qualify as a “soft landing”, as long as the economy avoids the requisite two quarters of contraction needed to declare the economy in a recession. He now sees the risks of overshooting and undershooting on rate hikes as roughly in balance, but the bias is to raise interest rates again.

Powell has pushed against the tendency by financial markets to front-run the Fed on rate cuts, as that could undo the progress made on inflation and force the Fed to tighten policy further. The Fed will not cut rates until inflation has convincingly dipped below 3%, which is not expected to occur until mid-2024. The 2% target is now more of a floor than a ceiling for inflation.

The descent on interest rates is expected to be much slower than the ascent. The Fed now has much more latitude to cut rates than it did in the past. The era of free money has come to an end, barring another major financial crisis.

Turning to risks to the outlook, everything from the political dysfunction in Washington to escalating government debt to geopolitical tensions could shock the economy. A more consequential spike in both Treasury bond yields and oil prices cannot be ruled out. The fact that 2024 is an election year will only add to uncertainty, which acts as its own tax on the economy as it prompts individuals and firms to hesitate in their decisions about the future.

Diane Swonk

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Canada: Economy continues to chill

20-year-high interest rates will suppress growth in the near term, as consumers cut back on spending and save towards rising mortgage payments. Record-high household debt to remain a top risk to the outlook.

Inflation to cool to the Bank of Canada’s target range in 2024, providing ground for the central bank to begin slowly cutting interest rates mid-year.

A recession can be averted in the face of slowing global growth due to the soft landing in the U.S. and strong domestic labor force growth in the near term.



Canada is expected to narrowly skirt a recession but our forecasts point to a second consecutive year of sluggish growth in 2024. A soft landing in the U.S., coupled with expansionary domestic fiscal policy, will help Canada eke out growth of 0.6% next year. Lower interest rates and higher federal government spending will boost growth in 2025. However, growth will be limited due to stagnating productivity and record high household debt levels.

The Bank of Canada (BoC) has matched the rapid pace of interest rate increases to the U.S. Federal Reserve bank, with the policy rate hitting a peak of 5% in July 2023, the highest since 2001. Monetary policy has a faster transmission mechanism to the overall economy than in the U.S., as mortgage loans renew much earlier. Around a third of all households have a fixed-rate mortgage, most of which expire after five years.

Table 2: KPMG forecasts for Canada

	2023	2024	2025
GDP	1.0	0.6	1.4
Inflation	3.8	2.4	1.9
Unemployment rate	5.4	6.2	6.2

Source: KPMG Economics, Statistics Canada.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Households have amassed excess savings estimated to be CAD 464 billion in the second quarter of 2023, according to KPMG estimates. Canadian households are more likely than their U.S. counterparts to use their savings to blunt the blow of higher mortgage rates. This could lead to sluggish demand for goods and slowing demand for services, as the Canadian consumer accounts for 60% of the overall economy.

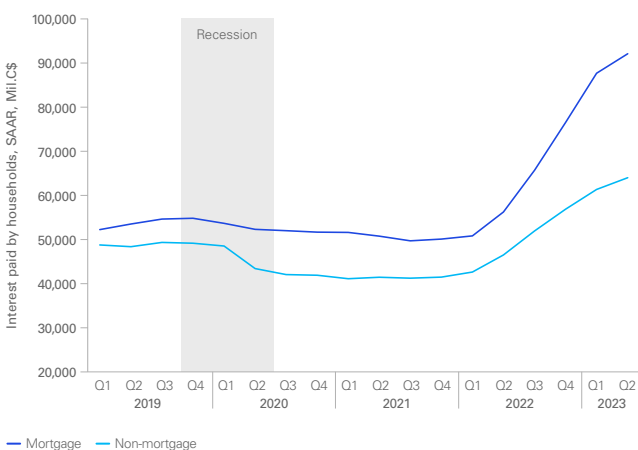
Household debt levels have risen since the pandemic and remain near 170% of disposable income and 107% of GDP. This makes Canadian households some of the most indebted among the developed economies. Interest payments on both mortgage and non-mortgage debt have soared since 2022 (see [Chart 9](#)). Delinquencies on auto loans, credit cards and lines of credit have begun to creep up in response to the burden of that debt.

Interest rate shock is one of the largest risks to economic growth in the near term. The Canadian Mortgage and Housing Corporation (CMHC) estimates that 2.2 million mortgages outstanding, or about CAD 675 billion, will reset by 2025.

Canada is benefiting from investments in clean energy and the regionalization of manufacturing activity via the U.S.-Mexico-Canada free trade agreement (USMCA), which was ratified in July 2020. Canada has already seen the trade balance in goods jump by 12% compared to a decline in the 2010s (see [Chart 10](#)).

Core annual inflation (excluding food and energy prices) has cooled notably from its 5.5% peak in July 2022 to 3.3% by the fall of 2023. The BoC’s target for inflation is a range of 1-3%. A reacceleration in shelter costs over the summer was a reminder that the battle against inflation is not easily won, with rents still rising.

Chart 9: Interest payments surge in 2023



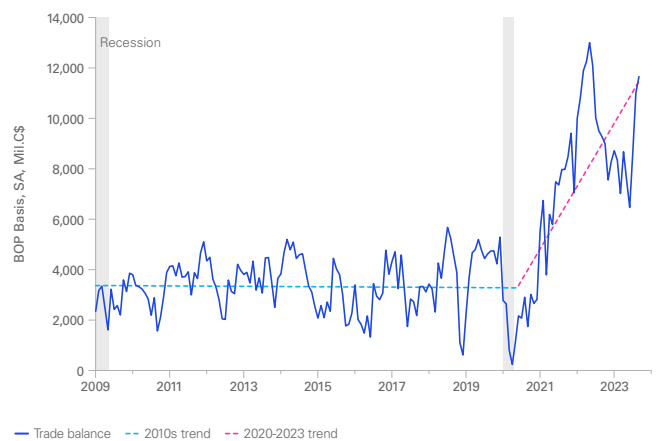
Source: Statistics Canada, KPMG Economics.

Rising costs have eroded households’ purchasing power over the past few years. Food, energy and shelter costs make up over half of the consumer price index (CPI), which is projected to average 3.8% over 2023. Compared to February 2020, prices will remain 15% higher by year-end, with food 22% higher and shelter 19% higher. All have outpaced wage and salary gains by a significant margin. In response, consumer confidence fell to pandemic lows in recent months despite some cooling of inflation.

Payrolls surpassed the level hit prior to the pandemic in early 2022 and could end 2023 around 2.5% higher than the year prior. Service-providing industries are expected to continue to lead payroll growth; three-quarters of the labor force works in the services sector, compared to just 15% in the goods sector.

The unemployment rate is expected to hit a peak of 6.2% in 2024, up from 5.4% in 2023. Recent increases in the unemployment rate have been due to a rise in the ranks of those looking for work, which was buoyed by the surge in immigration rather than an increase in layoffs. Slower hiring is expected to drive unemployment up in 2024.

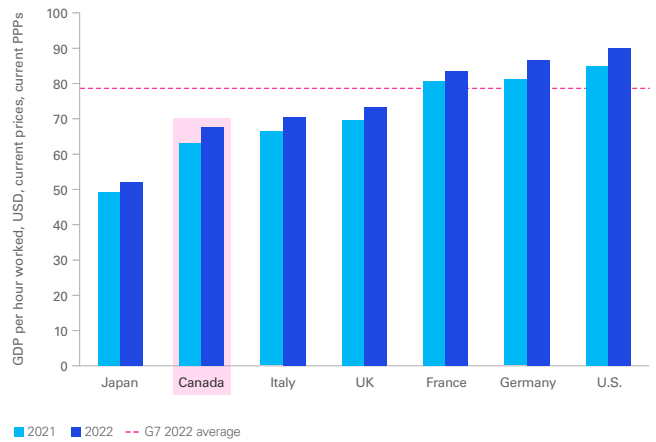
Chart 10: Merchandise trade balance with U.S.



Source: Statistics Canada, KPMG Economics.



Chart 11: Canadian productivity lags most G7 counterparts



Source: OECD, KPMG Economics.

Canada has seen the fastest population growth in the G7 over the recent years. A surge of newcomers is boosting participation in the prime-age (25-54) labor force.

Declining productivity has pushed GDP per capita to decline on a quarterly basis since the second half of 2022. GDP per capita is back to 2017 levels after recovering from the pandemic-era slide. Canada lags most of its G7 counterparts in productivity measures (see [Chart 11](#)).

We do not expect productivity to be a driver of growth without significant investments. Statistics Canada estimates that population growth could slow dramatically by 2031. Absent a shift in investment, the country’s potential to grow will be diminished.

Yelena Maleyev

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Brazil: More rate cuts to come

The Banco Central do Brasil has already begun to cut rates as inflation approaches its target.

The agricultural sector supported above-expectation growth in 2023, but El Niño in 2024 may hit crop yields.

Growth is moderating, but is set to be supported by a normalization in monetary policy.

Growth has moderated following the first half of 2023 which has largely exceeded expectations. Domestic demand has withstood the headwinds of continued tight monetary policy, with advances in both domestic consumption and imports. 2024 is likely to see a moderation from the summer of 2023, but still a strong year.

The labor market is still fairly tight, with unemployment standing at the lowest levels since 2015. While the unemployment rate could tick up as the labor market unwinds, an increase is not part of our central forecast.

Inflation was on the upswing from June to September, but there was a reversal of that trend in October 2023. That put inflation back in the right direction towards the Banco Central do Brasil’s (BCB) implicit target of 3-4%. Additionally, service sector inflation has remained better anchored than in other regions.

Table 3: KPMG forecasts for Brazil

	2023	2024	2025
GDP	2.8	2.0	2.8
Inflation	4.5	3.7	3.3
Unemployment rate	8.0	7.9	7.7

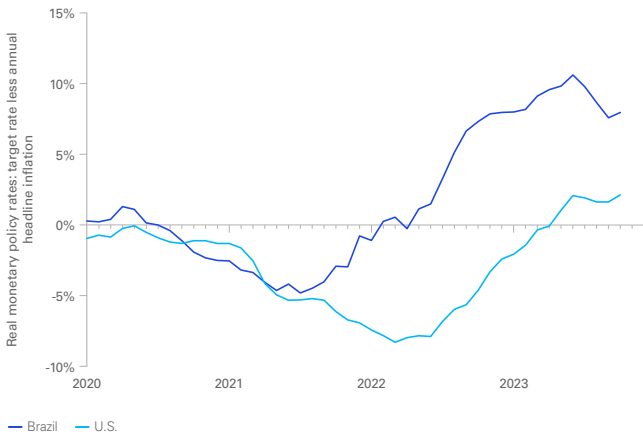
Source: KPMG Economics, Instituto Brasileiro de Geografia e Estatística.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.





Chart 12: Brazil interest rates in restrictive territory since spring 2022



Source: KPMG Economics, Banco Central do Brasil, Instituto Brasileiro de Geografia e Estatística, Federal Reserve Board, U.S. Bureau of Labor Statistics.

Brazil has benefitted from early rate hikes by avoiding the inflationary effects of currency depreciation. The LA5 (Brazil, Chile, Colombia, Mexico and Peru) led the charge to get inflation under control among global central banks. They raised rates aggressively ahead of the U.S. Federal Reserve and other central banks, getting to positive real interest rates more than a year ahead of Asia, the U.S. and the Eurozone (see [Chart 12](#)). That means that the BCB will have more room to cut rates and stimulate the economy in 2024. It cut the key interest rate, the Selic rate, at four consecutive meetings in 2023. We expect cuts to continue, but the BCB will be proceeding with some caution so as not to reignite inflation. We expect the interest rate cycle to be much longer on the way down than it was on the way up.

Government spending is normalizing, which should support solvency and the cost of debt on the government side. The government debt-to-GDP ratio fell below 2019 levels as of 2022; so did the budget deficit.

Exports are benefitting from agricultural products and advantageous weather, favorable commodity prices for exports, and very little depreciation in the Brazilian real. Demand for manufacturing exports has also improved. 2024 will be an El Niño year. Depending on the strength of the season, El Niño tends to hit agricultural yields – particularly soybeans – harder in Brazil. That could suppress agricultural output from the banner 2023 harvest season.

The BCB has already begun to cut rates and seen more volatility in prices. The largest risk is in rate cuts that are either premature or too rapid, which could reignite inflation in an already slowing economy. That would leave the central bank with the choice of whether to let inflation pick up, or to restrict demand more than it already has. Although that is not the baseline, its probability has risen with the beginning of a normalization in monetary policy.

Meagan Schoenberger
Senior Economist, KPMG in the U.S.

Mexico: Reaping benefits from nearshoring

The USMCA and supply chain realignments have been a boost to growth.

Mexico overtook China as the top exporter to the U.S. in 2023.

Manufacturing capacity could limit growth in certain industries.

Mexico’s economic growth is expected to be flat through 2024, but still better than that of the broader region. The push for nearshoring and/or friend-shoring as a result of geopolitical risk and cost pressures, as well as the U.S.-Mexico-Canada Agreement (USMCA), have provided a boost to manufacturing and spurred employment growth.

Mexico was part of the wave of Latin American central banks that started raising interest rates at the first signs of inflation, and ahead of the U.S. Federal Reserve, the European Central Bank and the Bank of England. The policy rate of the Banco de Mexico (Banxico) is still sitting at its peak of 11.25%. Inflation has reacted just as the central bank would like and is forecast to continue its downward path through 2024. Banxico is expected to start cutting rates in early 2024 as the inflation rate reaches the bank’s 3% inflation target.

The exchange rate has appreciated roughly 15% against the U.S. dollar since 2022, making the export growth experienced toward the U.S. even more impressive. In mid-2022, Mexico (and Canada) surpassed China in their shares of exports to the U.S.

Exports are expected to be the largest contributor to real output growth in early 2024, while investment is dragged down by the high interest rate environment. Consumption, which makes up more than 70% of output, is expected to slow as interest rates and still-high inflation continue to affect consumers’ purchasing power.

Geopolitical risks and competitive tariffs are not the only reasons why firms are moving to Mexico. The country boasts the Organization for Economic Co-operation and Development’s lowest cost of labor, further bolstering its place as a premier near/friend-shoring destination.

Table 4: KPMG forecasts for Mexico

	2023	2024	2025
GDP	3.3	2.4	1.8
Inflation	5.6	4.1	3.3
Unemployment rate	2.8	2.9	3.3

Source: KPMG Economics, Instituto Nacional de Estadística Geografía e Informática.
 Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.





Automobile and auto part production relocated to Mexico from Asia as part of a trend to take advantage of the USMCA agreement. One positive externality to this move is the shortening of supply lines, which not only decreases supply chain risk but also carbon emissions. On the other side of the “reason for moving” spectrum is industrial and heavy machinery, which has moved to Mexico for geopolitical reasons.

However, with an unemployment rate in the 2-3% range, the labor market is tight as real manufacturing earnings per hour have risen by nearly 25% since 2018. This can also be seen in the percentage of manufacturing firms having difficulties hiring (see [Chart 13](#)).

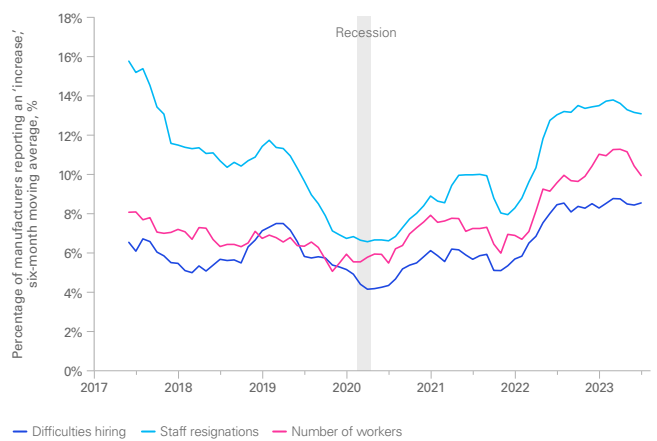
Manufacturing capacity is running short in several key industries that have experienced sizable amounts of supply chain diversification, including electricity and electrical appliances, computing and other equipment, machinery and equipment, and transportation (see [Chart 14](#)). Normal levels of utilization usually hover around 80%, consistent with the latest reading for the whole economy. However, these select industries which have seen an inflow of attention due to nearshoring have posted utilization rates of between 85% and 95%.

Activity in the construction industry is increasing to create new capacity, but that could take years to come online. Set against that, high interest rates are expected to hinder investment to create new capacity.

The tight labor market may also start to cause issues if sufficient labor is not available for more complex manufacturing, or the cost of labor continues its rapid rise. Lastly, the president of Mexico is set to leave office in 2024, creating political turnover.

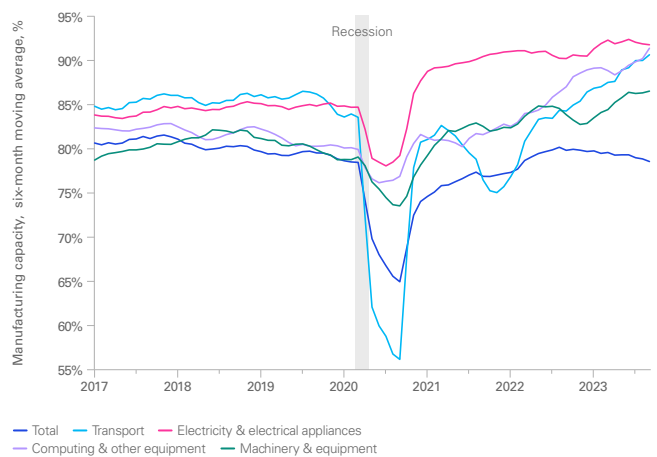
Ben Shoemith
Senior Economist, KPMG in the U.S.

Chart 13: Companies seeing difficulties hiring



Source: KPMG Economics, Banco de Mexico, Haver.

Chart 14: Manufacturing utilization ticking higher



Source: KPMG Economics, INEGI, Haver.

China: Policy stimulus is vital to economic growth

More policy stimulus to be released to support growth.

Consumption should recover to become China’s key engine, with increasing income growth.

Technology upgrading and green transformation will support high quality development.

China’s GDP grew 5.2% year-over-year by the end of September 2023, above its annual growth target of ‘around 5%’ set in March. This better-than-expected growth was mainly driven by the boost from consumption of services following the post-pandemic reopening, improved industrial activities and solid growth in manufacturing and infrastructure investments.

As consumer and business activity continues to rebound, supported by government stimulus measures, the drag on the property sector is expected to lessen, and we forecast China’s GDP to grow at 5.2% in 2023 and 4.5% in 2024.

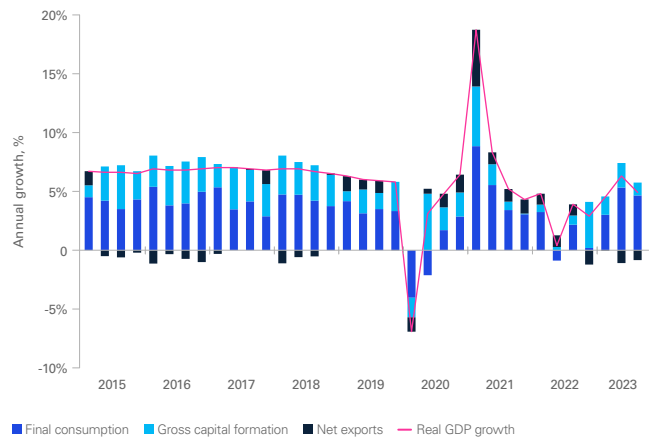
Economic activity underwent a recovery in Q3 as demand and prices continued to improve. Growth in industrial production grew by 4.5% in September and the manufacturing purchasing manager index (PMI) – a leading indicator – returned to expansionary territory after five months of contraction. Meanwhile, producer price inflation rebounded to -2.5% in September, up from its eight-year low of -5.4% in June, consistent with improving business sentiment.

Table 5: KPMG forecasts for China

	2023	2024	2025
GDP	5.2	4.5	4.5
Inflation	0.4	1.3	2.0
Unemployment rate	5.3	5.3	5.2

Source: Wind, KPMG forecasts. Average % change on previous calendar year except for the unemployment rate, which is the average annual rate. Inflation measure used is the CPI, and the unemployment measure is the surveyed unemployment rate.

Chart 15: Contributions to China’s real GDP growth by sector, %

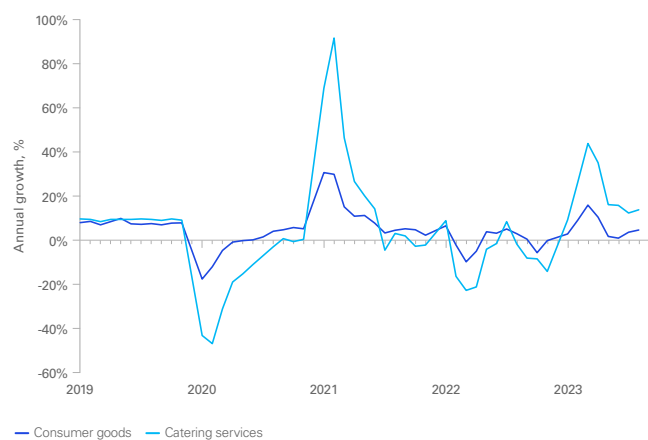


Source: China’s National Bureau of Statistics, Wind, KPMG analysis.

Thanks to the boost from increased services demand and the release of excess savings, consumption recovery has been stronger than expected. Growth in the retail sector rebounded to 5.5% in September from 3.1% in June, and growth in catering services reached 13.8% (see [Chart 16](#)). Tourism revenue from the recent Chinese National Holiday week increased by 129.5% from the same period in 2022, and 1.5% above the pre-pandemic level in 2019, reflecting the normalization of economic activity.

Household expectations for job security and income growth are important drivers in restoring market confidence and consumer spending. The government has taken various measures to keep the job market stable, and the urban surveyed unemployment rate dropped to 5.0% in September, the lowest since 2022. We expect the unemployment rate to average 5.3% in both 2023 and 2024. In addition, income growth reached 5.9% in the first three quarters of 2023, surpassing GDP growth. Income sentiment and consumer confidence have likely improved in Q4, which could support a recovery in consumption in 2024.

Chart 16: Growth of consumer goods and catering service, %



Source: China's National Bureau of Statistics, Wind, KPMG forecast.

On the capital side, we expect technology upgrading and green transformation to support manufacturing investment. Infrastructure investment should remain solid in order to facilitate economic growth in 2024. The government has approved RMB 1 trillion additional Central Government bonds in October to fund infrastructure projects. Outlays towards water conservancy, transportation and urban renovation have seen fast growth.

Meanwhile, real estate investment is expected to stabilize and become a lesser burden on overall growth in 2024. The government has taken action to stabilize the property market. Although liquidity is still a key challenge for developers, the declining rate of funding for real estate developers has narrowed. The latest round of property easing measures on the demand side – such as removing mortgage records for first-home buyers, cuts in mortgage down payment ratios and mortgage rates, projects in public housing and urban village renovation – may provide a boost to new home sales in larger cities. Although the property market is facing considerable headwinds, China's increasing urbanization and households' growing demand for quality homes should support the market in the long run.

While China's exports slumped over the past year amid a subdued global economy and a higher base effect, it has nonetheless outperformed other major exporters. China's share of global exports reached 14.6% in Q2 2023, up from 13.7% in Q1 2023. Despite the slowdown, the product mix of China's exports is changing, with increasing high-end manufacturing. Exports of "new three" products, including solar cells, new energy vehicles and lithium batteries, grew by 41.7% overall by the end of September 2023, becoming the main driver of China's exports.

Meanwhile, despite slowing exports to advanced economies, China's trade with emerging markets continued to rise in 2023. As the growth of exports continues to improve, we expect China's exports to remain resilient in 2024.

China is expected to maintain an accommodative policy stance to restore business confidence and boost economic growth. After announcing a set of supportive measures to help private business in mid-July, the government has approved RMB 1 trillion additional Central Government bonds to support local government spending, and will raise the fiscal deficit ratio from 3.0% to 3.8% in 2023. Fiscal support will be stepped up and be more effective in 2024.



On the monetary side, the People’s Bank of China (PBOC) has reduced the reserve requirement ratio (RRR) and policy rate twice this year to date, lowering funding costs for businesses and households. We expect China to continue to adopt supportive monetary policy, particularly in targeted areas. For example, the PBOC is expected to cut the RRR to provide liquidity on government bond issuance and cut policy rates. It is also expected to apply special relending facilities to increase financial support to SMEs, green investment, technology, and elderly care.

Inflation has remained low in China compared to many parts of the world, but it may see some upward movement in 2024. Food accounts for nearly 30% of China’s consumer price inflation and the cyclical nature of pork prices is an important factor behind inflation fluctuations. Driven by the recent decrease in pork prices, CPI inflation declined by 0.2% in October. Excluding food and energy, core CPI inflation remains stable at 0.6%, with the support of services consumption.

The Hong Kong (SAR) economy is also expected to recover in 2024. An expected strong rebound of tourism from the Chinese Mainland should support an acceleration of services consumption. The labor market continues to improve, aligned with the revival of domestic activities and inbound tourism. However, weak global demand is expected to weigh on exports. Meanwhile, Hong Kong is accelerating its economic integration with the Mainland, and the development of the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) continues to gain traction.

Gary Cai
Chief Strategy Officer, KPMG China

Vietnam: A burgeoning manufacturing destination

Vietnam continues to be a destination for supply chain diversification.

Tight labor markets and increasing wage growth could hamper attractiveness.

The central bank is cutting policy rates as inflation decelerates.

Vietnam is forecast to close 2023 with strong growth that is expected to slow during the latter half of 2024. Even with the weakness, Vietnam’s real output growth will remain healthily above the global average. Geopolitical risk and cost concerns have led firms to relocate manufacturing operations to the country. This makes Vietnam one of the largest beneficiaries of supply chain diversification as companies seek new locations to decrease dependence on concentrated geographic areas.

Consumer electronics, textiles, automobiles and auto parts manufacturers have found the country to be an ideal destination (see [Chart 17](#)). In addition, as part of the announcement of the comprehensive strategic partnership (CSP) with the U.S., several firms in the technology sector – including AI and semiconductor firms – have signed agreements to produce or partner with Vietnamese companies. With a relatively young population of around 100 million, Vietnam has a large talent pool and a tight labor market, with the unemployment rate hovering around 2% through 2024.

Vietnam’s long and extensive coastline makes it an ideal place for manufacturing and exporting, as any production facility is never more than 300 miles from the coast or a potential ports. However, while exports are booming, aided by a weakened exchange rate over the last year, imports nearly cancel out any positive contribution to real output.

Being a single-party state gives Vietnam relative political stability that can be seen as an attractive attribute to many businesses. The strong growth Vietnam has experienced over the last decade – averaging around 6% per year, including during Covid – has allowed the Vietnamese government more authority over which industries and companies can move their operations to the country. This effectively allows for controlled growth rate that avoids runaway growth that could spur inflation.

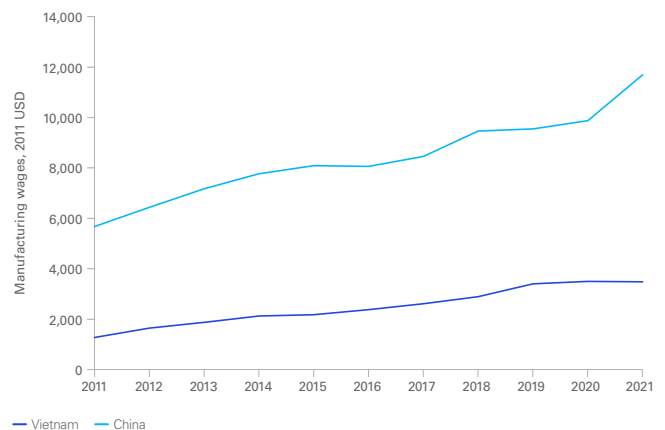
Table 6: KPMG forecasts for Vietnam

	2023	2024	2025
GDP	4.6	5.7	5.6
Inflation	3.2	3.3	2.6
Unemployment rate	2.1	2.0	2.0

Source: KPMG Economics.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Chart 17: Vietnam is a low labor cost manufacturing option



Source: KPMG Economics, Wall Street Journal, General Statistics Office of Vietnam, China National Bureau of Statistics, China Ministry of Labor and Social Security, Haver Analytics.



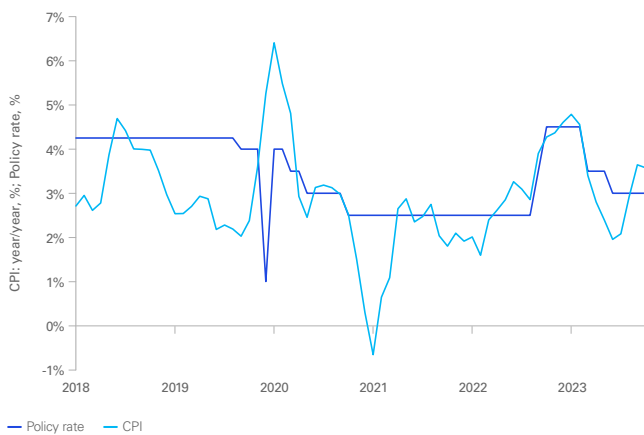
Vietnam has also been focusing on international relations by seeking additional countries to partner with for its highest level of diplomatic relations – comprehensive strategic partnerships. The U.S. has been elevated to this highest rung in Vietnam’s diplomatic hierarchy, a title held – until now – by only China, India, Japan, Russia, and South Korea. Other countries currently being considered for CSPs include Australia, Indonesia and Singapore.

To combat inflation, the State Bank of Vietnam increased its monetary policy rate in mid-2022, but has since been cutting rates as inflation has moderated (see [Chart 18](#)). Current inflation has been mostly limited to energy, housing, material construction, and food. When stripping out volatile food and energy prices, core inflation has returned to the 3% range, still slightly elevated from the historical norm.

Part of the rise in food prices stems from the Indian government passing export controls on non-basmati white rice. Following this decision, countries across the ASEAN region experienced increases in food inflation – including Vietnam’s, which jumped from 8% (quarter-over-quarter annualized rate) in July (when the export controls were announced) to 51% in August.

The tight labor market and increasingly complex manufacturing that is making its way to Vietnam is expected to increase real wages by around 7% through 2024. However, starting from the low wage base does not mean wages are rising substantially in absolute terms. In order to support potential growth, additional infrastructure is needed to capitalize on the positive momentum being experienced by the manufacturing sector.

Chart 18: The State Bank of Vietnam is coralling inflation



Source: KPMG Economics, State Bank of Vietnam, General Statistics Office of Vietnam.

Ben Shoemith

Senior Economist, KPMG in the U.S.

Japan: Yen's depreciation complicates outlook

The Bank of Japan is the only major central bank that has not raised interest rates to curb inflation.

The wage negotiations have not been enough to boost real wages.

Inflation is accelerating while the yen is depreciating, raising the probability of central bank intervention.

We see Japan's economy heading for a "slowcession" in 2024 after a sharp miss on GDP growth in the third quarter of 2023. Consumption is sluggish, inflation is climbing and investment and trade are becoming a drag on growth. Exports have been expanding following a weakening yen, but that has not been enough to support the economy. The unemployment rate is rising and will likely settle above its 2019 level as the labor market conditions unwind.

Inflation is stickier than the Bank of Japan (BOJ) had anticipated. The bank has not raised interest rates in part because inflation in Japan has picked up later, and has been concentrated in goods rather than services. Inflation excluding food and energy only rose above the 2% target in October 2022; for context, U.S. core inflation rose above 2% in March 2021. Wages are not necessarily feeding inflation, as real wage growth remains negative; workers will need to wait until Spring wage negotiations to see any gains. Nevertheless, core inflation is elevated above the bank's 2% target. Recent yen depreciation could keep inflation persistent as Japan imports inflation from abroad. That puts more pressure on the BOJ to intervene.

The BOJ, while remaining committed to accommodative interest rates, has tweaked its monetary rules in an effort to decelerate core inflation, which should near 2% later into 2024. The policy interest rate has been at -0.1% since 2016. The bank is more worried about overshooting than undershooting; it remains the only central bank among major advanced economies that has not raised interest rates. The changes to the yield curve controls included changing the language around the 1% cap on the 10-year yield to be less rigid, which has raised the cost of borrowing without raising rates.

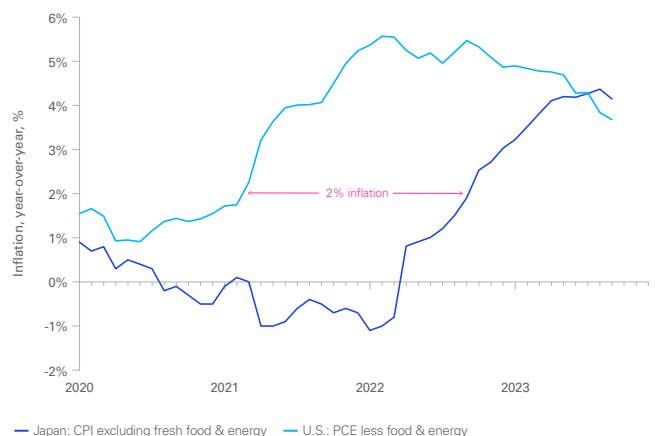
Table 7: KPMG forecasts for Japan

	2023	2024	2025
GDP	1.9	0.1	1.1
Inflation	3.2	2.2	0.5
Unemployment rate	2.6	2.6	2.5

Source: KPMG Economics, Cabinet office of Japan, Ministry of Internal Affairs and Communications, Statistics Bureau.

Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.

Chart 19: Inflation arrives later



Source: KPMG Economics, U.S. Bureau of Economic Analysis, Japan Ministry of Internal Affairs and Communications, Statistics Bureau



The U.S. consumer shift from goods to services will weigh on the external sector for Japan in the near term. However, foreign visitors have been returning and approaching pre-pandemic flows, which has helped services exports. The easing of supply chain bottlenecks has also improved efficiency for exporters.

While we expect fiscal policy to remain supportive, with government debt to GDP ratio hovering around 250%, lower interest rates will keep interest expense low as a percentage of total output.

The largest risk to the forecast comes from the challenges posed by persistent inflation and currency depreciation from the accommodative policy of the BOJ. With the currency close to 150 yen per U.S. dollar (the level that last prompted a foreign exchange intervention in October 2022), the probability of a bank intervention to support the yen has risen. That would restrict money supply and further tighten financial and credit conditions. It is probable that the bank could raise interest rates following the wage negotiation in 2024, further strengthening the yen. That could buy time until other central banks cut rates.

Meagan Schoenberger

Senior Economist, KPMG in the U.S.

India: Increasingly important economically and diplomatically

The G20 Summit was a testament to India’s diplomatic strength.

Supply chain reorganizations are making India a go-to destination for firms.

Semiconductor fabrication is heading to the world’s most populous country.

India’s economy is expected to slow in 2024 after this year’s blistering pace, which is forecast to equal pre-pandemic growth – a rarity, as growth has generally slowed globally. The year 2023 proved to be valuable for Indian diplomacy, as the country displayed its ability to work with the world’s largest economies at the G20 Summit.

Economic growth is driven by consumption and investment; there are no real drags looking forward. India’s weaker 2024 growth is forecast to be a part of the global slowdown that is affecting all regions, including Asia, which is home to most of India’s key trading partners. Consumers and investors are bullish on the economy, meaning there is room to expand in both the near and medium term.

Inflation has been a challenge for a couple of years, but it is heading back toward manageable levels. To fight inflation, the Reserve Bank of India raised its policy rate during 2022 and early 2023 from 4% to 6.5%. The rate is expected to stay elevated through 2025 and cause a pullback in investment as financing costs remain high.

India has been one of the largest beneficiaries of supply chain diversification. Being a low-cost manufacturer that dodges the faults of negative geopolitics has made the country very appealing. Automobile and auto part manufacturing as well as consumer electronics have migrated to the world’s most populous country. Trade with key partners has increased, including a staggering 36% increase in exports to the U.S. between 2019 and 2022, according to the U.S. Census Bureau.

Another sector experiencing growth is semiconductors. Chip fabrication chains are on the move, with India attracting a lot of attention due to its young, vast labor market, and one million engineers graduating from universities annually. India does not produce the most cutting-edge chips, but those that are five to ten years off the frontier.

Table 8: KPMG forecasts for India

	2023	2024	2025
GDP	7.2	6.0	5.3
Inflation	5.5	5.1	4.7
Unemployment rate	6.9	7.3	7.3

Source: KPMG Economics, General Statistics Office.

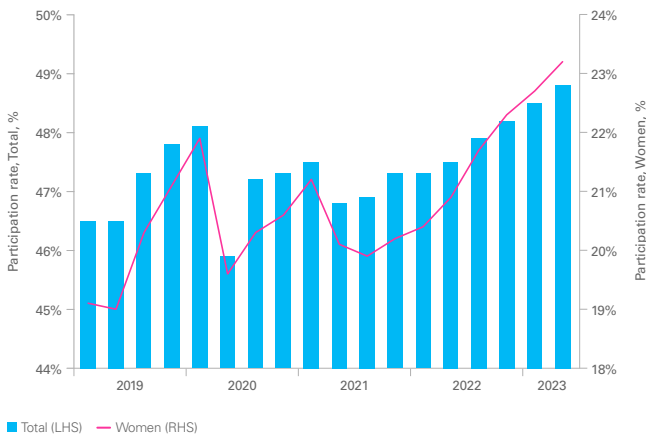
Note: Forecasts are dated as of December 12, 2023. GDP, inflation, & the unemployment growth rates are annual averages. Numbers are percentages.



Real disposable income is expected to grow around 4% per year, providing additional spending power to India’s increasingly interconnected society. The cell phone penetration rate is rapidly improving, which is giving access to digital payments and other new services.

To handle the pickup in manufacturing, infrastructure is being created. Despite developing road and port access, the country is still underequipped to accommodate the influx of companies seeking alternative manufacturing destinations. Manufacturing capacity utilization is still at healthy levels and is not at risk of running short.

Chart 20: Labor force participation is improving



Source: KPMG Economics, MOSPI.

A benefit of the manufacturing inflow is job creation. While the population is large, women have historically not been major players in the formal workforce. The last couple of years have seen signs of improvement, however, as women have singlehandedly improved the labor force participation rate (see [Chart 20](#)).

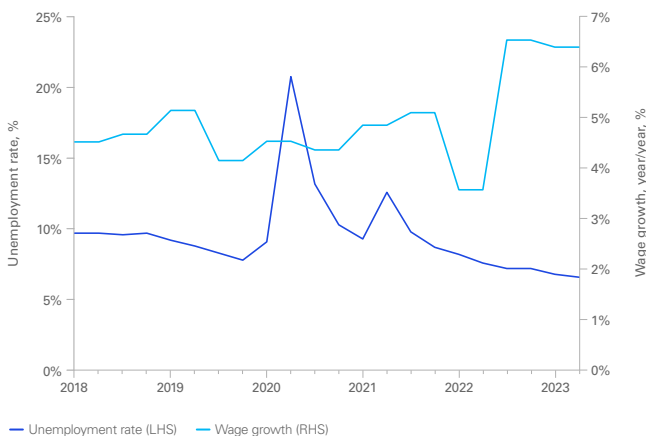
Despite the geopolitical uncertainty, India is proving to be a diplomacy juggernaut. Walking a fine line across relationships with countries in the West and Global South, India has managed to improve its standing among partners. The G20 Summit was the best example of this as Delhi hosted the 2023 edition.

While India has portions of its workforce that are well educated, it also has a literacy rate of 78%, per the National Survey of India, which is lower than the UNESCO estimated global literacy rate of 87%. This could prove to be a headwind as the economy continues to develop, new firms enter the market, and skilled labor becomes more vital.

Following a 21% unemployment rate in 2020, the current level is near historical averages during expansionary periods. The tightening market has produced upward pressure on wages since 2022 and that is expected to continue into 2024 (see [Chart 21](#)).

Ben Shoemith
Senior Economist, KPMG in the U.S.

Chart 21: Tight labor market leads to increasing wages



Source: KPMG Economics, India Labor Bureau.

Germany: Europe’s largest economy in a recession

German economy expected to slowly recover from 2024 onward.

Inflation to continue to ease, with energy prices being a key factor.

Labor market proves robust despite weakening economy and persistent shortage of skilled workers.

The persistently high inflation level, geopolitical uncertainties, high interest rates and a weak global economy continue to weigh on the German economy. In particular, the sharp rise in energy costs is impacting Germany’s energy-intensive industries, which contribute a large proportion of gross value added. The global tightening of monetary policy and the slow recovery of important foreign markets for German products are also negatively affecting the export oriented German economy. As a result, output is expected to shrink in 2023.

Although sentiment in the German economy remains at a low level, there are positive signals as well. Business sentiment increased slightly in October and in November 2023, with the ifo Business Climate Index rising to 87.3 points in November, up from 85.8 points in September. Companies are more satisfied with their current business and less pessimistic about the coming months.

In 2024, the German economy is likely to register slight growth and potentially grow faster than some other G7 countries. Rising wages, falling energy prices and the ability of exporters to pass on costs to foreign customers could gradually restore domestic purchasing power in the coming year. The absence of further interest rate increases – and possibly even a fall in interest rates over the course of the year – could also help the German economy to continue its upswing.

A particularly long phase of inflationary pressure in Germany is slowly coming to an end. However, even though inflation is easing, it remains well above the ECB’s target of 2%. As a result of the sharp rise in the general price level over the past two years, consumers have become much more reluctant to spend and the savings rate remains high.

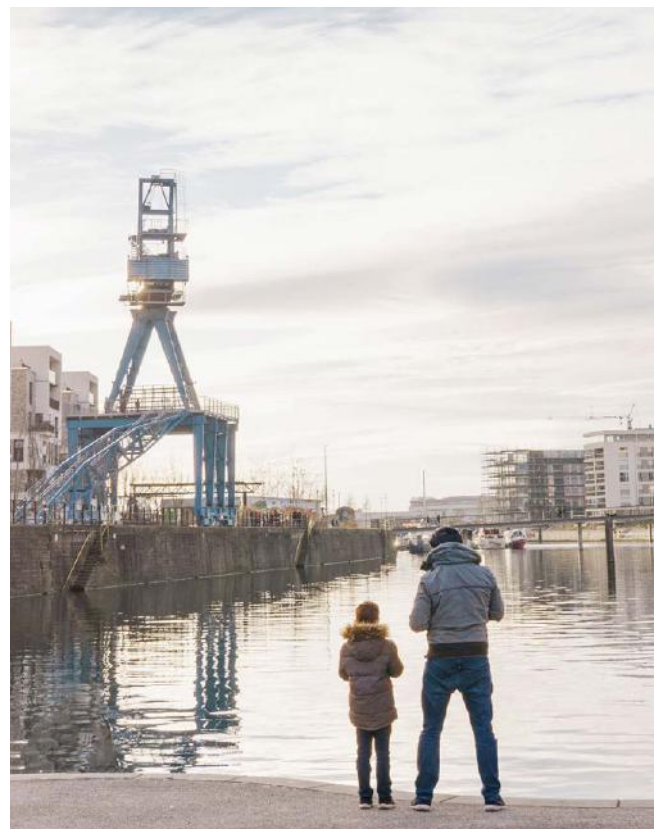
While rising interest rates are intended to dampen inflation, they are also detrimental to capital spending and thus contributed to a slowing in economic recovery. There is currently great uncertainty among consumers, companies, and investors, with many refraining from large projects due to high borrowing costs.

Table 9: KPMG forecasts for Germany

	2023	2024	2025
GDP	-0.2	0.6	1.6
Inflation	6.1	2.9	2.1
Unemployment rate	5.6	5.7	5.7

Source: Destatis, KPMG forecasts.

Note: Average % change on previous calendar year except for unemployment rate, which is average annual rate. Inflation measure used is the CPI.



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