中国银行 BANK OF CHINA BOC Research Institute

Global Economic and Financial Outlook

2024Q2 (Issue 58) **Issue Date: May 9, 2024**

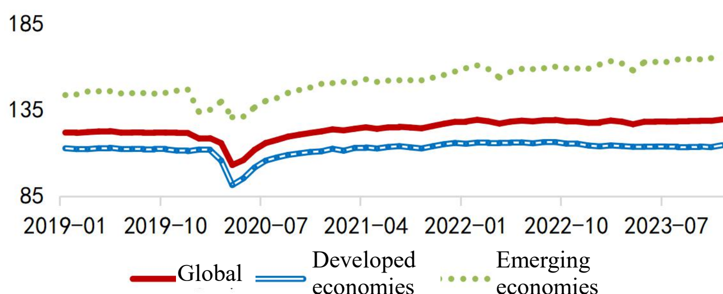
Highlights

●In 2024Q1, the growth momentum of global economy became weaker. In developed economies, the growth of consumption moderated, investment was sluggish, and government spending tended to be tighter. But manufacturing recovered from earlier weakness, services maintained good performance, and global trade recovered slowly. Driven by improved supply and sliding demand, inflation declined worldwide. Major economies tightened fiscal policies, and came to a turning point in monetary policies. Globally, foreign exchanges fluctuated more drastically, financing rates remained high, and stock prices continued to climb.

●In 2024Q2, the growth of global economy is expected to decline slightly. Shrinking demand will become a major drag on the economy, while global production is likely to extend the trend of steady recovery. Inflationary pressure will be further eased worldwide. Global supply of liquidity will be generally stable, stock investment will shift directions gradually, and commodity prices will be relatively stable.

●The following hot issues deserve particular attention: the latest adjustment of industrial chain policies in Japan and its impact on China, and the structural vulnerability and potential risks of the US money market funds.

Changes of the Global Industrial Production Index (2010=100)



Source: Netherlands Bureau for Economic Policy Analysis (CPB), BOC Research Institute

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Growth Momentum of Global Economy Strained; Monetary Policies Embrace a Turning Point

— Global Economic and Financial Outlook (2024Q2)

In 2024Q1, global economy remained strained, mainly dragged by the weak demand. In developed economies, the growth of consumption moderated; investment was still sluggish; government spending tended to be tighter; and trade picked up slowly. Global manufacturing recovered from earlier weakness, and services maintained good performance. Driven by improved supply and sliding demand, inflation declined worldwide. Among developed economies, the economic growth was moderate in the US, generally sluggish in the euro area, recovered weakly in Japan, and bottomed out in the UK. Among major emerging economies, exporters of manufactured goods, such as South Korea, Mexico, and Southeast Asian countries, generally experienced a pickup in the growth momentum; exporters of commodities, including Saudi Arabia, Brazil and Russia, saw the exports of some commodities hampered; India's economy maintained the strong momentum of growth, and countries like Egypt were stuck in trouble. Major economies came to a turning point in monetary policies, and Japan's central bank ended the "negative interest rates". FDI varied across regions, and securities investments diverged. Globally, foreign exchanges fluctuated more drastically, financing rates remained high, stock prices continued to climb, and gold prices hit a new high.

In 2024Q2, the growth of global economy is expected to decline slightly. Major developed economies will see a more pronounced momentum of moderating consumption and tightening fiscal spending. The growth of global trade will recover, increasingly closer to the historical average. Global production is likely to extend the trend of steady recovery, and supply chain disruptions will have a weaker impact on inflation, further easing the inflationary pressure worldwide. The US and European

central banks are expected to enter the interest rate cut cycle around Q2. Global supply of liquidity will be generally stable, and cross-border capital flows will slow down. In the foreign exchange market, the US dollar will be stronger than European currencies. JPY exchange rates will be on the track of appreciation. Global stock investment will shift directions as Asian and European stock markets become more appealing. Commodity prices will be relatively stable, and gold prices will remain slightly strong. This report provides a special analysis on the following hot issues: the latest adjustment of industrial chain policies in Japan and its impact on China, and the structural vulnerability and potential risks of the US money market funds.

I. Global Economic Review and Outlook

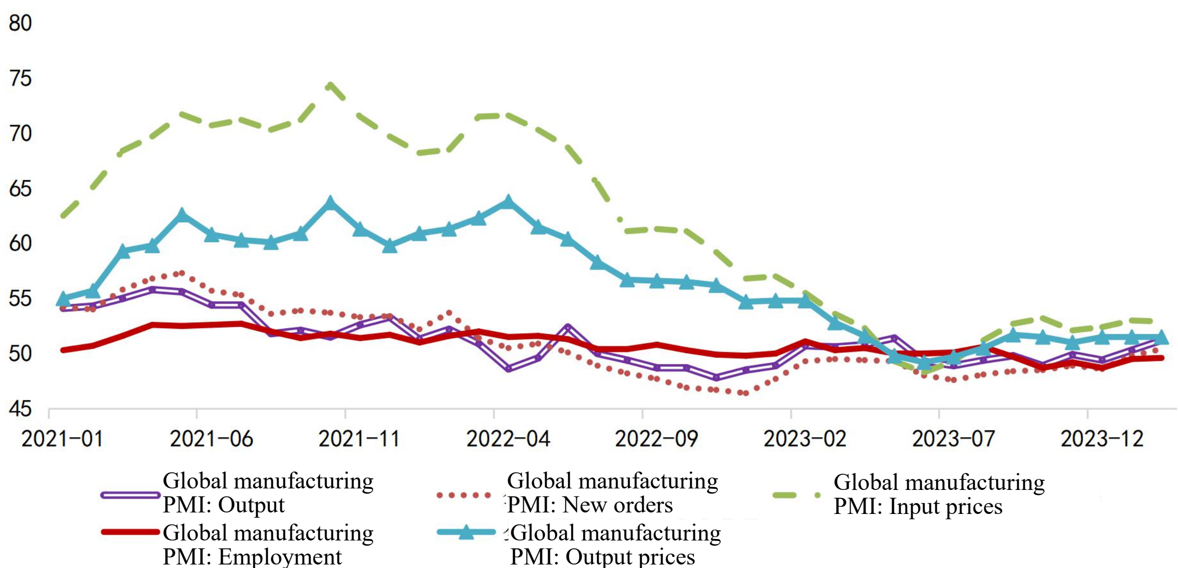
I.1 The growth momentum of global economy weakened, with downward risks building up

In 2024Q1, the growth momentum of global economy was strained, with diverging performance on supply and demand sides. **On the supply side, global manufacturing gradually recovered from earlier weakness caused by the pandemic, and services maintained good performance.** In February 2024, the global manufacturing PMI regained above 50% after one year and a half, recording growths in two consecutive months; the global services PMI rose for four months in a row. **On the demand side, in major economies, residential consumption moderated, private investment remained sluggish, and government spending was tighter.** First, as more enterprises failed and US and European households gradually depleted the excess savings they accumulated since the pandemic, the growth of private spending in developed economies lacked the momentum. Second, the tightening monetary policies in major economies continued to curb private investment. Third, under debt pressure, governments in major economies gradually normalized their fiscal policies.

In 2024Q2, global economic growth will decline slightly. On the supply side,

manufacturing has shown signs of stabilizing. Among several PMI sub-indicators for manufacturing, output, new orders and employment picked up sharply, and input prices dipped slightly (Fig. 1). Global services will maintain the good momentum of recovery after the pandemic, with business activities growing and in-person services like transport, tourism, catering and entertainment recording steadily growing output. **On the demand side,** the moderation of residential consumption in major economies will be more pronounced; global investment in fixed assets will be struggling to grow in the short term due to tightening monetary policies; fiscal spending in major economies will still be in a tight equilibrium. It's estimated that the actual year-on-year GDP growth in 2024Q2 will be 2.4%, 0.1 percentage point lower from Q1, and the full-year actual GDP growth around 2.5%, 0.2 percentage point lower from 2023.

Fig. 1: Changes of the Sub-indicators of Global Manufacturing PMI (%)



Source: Wind, BOC Research Institute

I.2 Commodity supply and demand continued to improve, and global inflation maintained its downward trend

In 2024Q1, global inflation declined on the whole, but the rebounding prices of energy and traded goods pushed the inflation in some economies up again.

Global supply continued to improve, and the monetary environment was generally tight, bringing down the growth of global CPI. Geopolitical conflicts caused international energy prices to rise, and some emerging economies in Middle East and Africa saw a pickup in CPI growth. **In 2024Q2, global inflationary pressure will be further mitigated.** Global supply and demand will further improve, with commodity supply expanding and demand contracting due to increasing enterprise failures and slowing wage growth in developed economies. The slightly tight financial environment will curb consumption and investment, and the inflation in the US and European countries is poised for further decline.

Table 1: Year-on-Year CPI Changes in G20 Economies (%)

	2023	2024			2023	2024	
	December	January	February		December	January	February
China	-0.3	-0.8	0.7	**France**	3.7	3.1	2.9
Italy	0.6	0.8	0.8	**UK**	4.0	4.0	3.4
Saudi Arabia	1.5	1.6	1.8	**Australia**	3.4	3.4	N.a
Japan	2.6	2.2	2.8	**Brazil**	4.6	4.5	4.5
Indonesia	2.6	2.6	2.8	**Mexico**	4.9	4.9	4.4
South Korea	3.2	2.8	3.1	**India**	5.7	5.1	5.1
Canada	3.4	2.9	2.8	**South Africa**	5.2	5.3	5.6
Germany	3.7	2.9	2.5	**Russia**	7.4	7.4	7.7
US	3.4	3.1	3.2	**Turkey**	64.8	64.9	67.1
EU	3.4	3.1	2.8	**Argentina**	210.1	249.9	277.1

Source: Wind，BOC Research Institute

I.3 Global trade was struggling to recover, with service trade becoming a major driver

Since the start of 2024, global trade has shown signs of pickup. The Goods Trade Barometer index recovered to 100.6, mainly driven by growing export orders and expanding trade of air cargo and raw materials. Major economies generally reported improved trade data. Global trade of services, represented by transport and tourism, showed a good momentum of recovery. **In 2024Q2, the growth of global trade will continue to recover and get closer to the historical average.** The slowing decline

of global inflation will offer support for the prices of traded goods. The declining cost of major currencies used in trade, such as USD and euro, and improved liquidity will facilitate trade financing. Amid the fading impact of the pandemic, the recovery of transport and tourism and development of digital economy will prop up the fast growth of global trade in services.

I.4 Global fiscal policies tightened, and US and European central banks maintained high interest rates

Fiscal policies: Developed economies will slow spending, while developing countries will strengthen tax governance. In 2023, developed economies and middle-income emerging economies maintained the momentum of fiscal expansion, with the total deficit ratio rising by 1.9 and 0.5 percentage points respectively from 2022. In less developed economies, total deficit ratios declined, but were still above the pre-pandemic levels. **In 2024, challenged by fiscal sustainability, returning to normalization will be the major trend of fiscal policies.** Developed economies including the US, European countries and Japan will focus on cutting fiscal spending, while developing countries will highlight efforts to intensify tax governance.

Monetary policies: The US and European Central banks maintained high interest rates, and may usher into the year of interest rate reduction. At the start of 2024, the US Federal Reserve, European Central Bank and Bank of England kept benchmark rates unchanged. On March 19, the Bank of Japan hiked the short-term benchmark rate to 0-0.1%, ending the global era of negative interest rates. **In 2024Q2, the US and European central banks will postpone the expectation for rate cuts, while the Bank of England will begin to define the room for rate cuts.** As the US presidential election is approaching, economic growth will maintain certain resilience, which, combined with sticky inflation, will postpone the expectation for rate cuts. It is unlikely that the European Central Bank will reduce interest rates before its meeting scheduled for June 6. In the UK, the year-on-year growth of CPI decreased, creating conditions for interest rate cuts.

I.5 Economic outlook for major countries/regions

1. US: The economy will maintain moderate growth, but the potential downward risks can't be ignored

In 2024Q1, the US economic growth slowed down, the contribution of private consumption and government spending to economic growth declined, and the widening trade deficit dragged down economic growth. The balance sheets of US households gradually worsened, with private spending contributing less to economic growth. The federal government decelerated spending, and reduced subsidies for enterprises. The trade deficits widened. The inflation situation has been repeated, and the risk of "secondary inflation" has risen. In March 2024, the US CPI increased by 3.5% year-on-year, an increase of 0.1 percentage point from the end of 2023. **In 2024Q2, the US economic growth will further slow down, and inflation will dip slightly.** The growth of private spending will further slow down. Elevated actual rates, falling corporate profits[1] and increasing bankruptcies will curb investment. Expectation for interest rate cuts is very likely to drive a wavy recovery of the US dollar index. Rising import costs may push total imports slightly up, and the slowing economic growth of major trade partners may dampen exports, possibly further widening trade deficits. It is expected that the US quarter-on-quarter annualized GDP growth will be about 1.5% in 2024Q2, 0.1 percentage point down from the previous quarter, and the annual economic growth 2.0%, 0.5 percentage point lower from 2023. The year-on-year growth of CPI may fall to 3.1% in 2024Q2, and around 2.8% for the full year.

2. Euro area: The economy will recover slowly and weakly, with inflation on the track of decline

In 2024Q1, the euro area saw a pickup in economic performance. Recovering private spending, investment and net exports propelled economic growth, but major

[1] In 2023, US listed companies recorded a profit growth of 8%, attributed mainly to seven tech companies, and would see profits decline by 1.6% if the major tech companies were excluded.

economies faced tightening budgets as EU's new fiscal policy cut the fiscal spending of member states. **Inflation declined on the whole.** In February, harmonized CPI (HCPI) rose by 2.6% year-on-year, 0.2 percentage point down from January, mainly a result of the declining energy prices and slowing growth of food prices. **In 2024Q2, euro area will see GDP further upward and inflation further downward.** The labor market will stay active, and falling inflation will boost residential purchasing power, leading to further recovery of private spending. The probability that European Central Bank will cut interest rates the first time in June 2024 will grow, spurring growth in investment. As global trade picks up, net exports from the euro area will continue to expand. It is expected that the euro area's quarter-on-quarter GDP growth will be 0.2% in 2024Q2, and the full-year GDP growth 0.8%, 0.4 percentage point up from 2023. The year-on-year CPI growth will drop to 2.4% in Q2, and around 2.3% for the full year.

Germany's economy lacks the momentum of growth, dragging economic recovery across the euro area. Since the start of 2024, Germany's manufacturing industry has remained weak, dampening economic vitality. Fluctuating energy prices pushed up industrial production costs, while insufficient market demand resulted in the weak performance of manufacturing. **In 2024Q2, Germany's economic growth is likely to pick up slightly.** Growing expectation for interest rate cuts by the European Central Bank will spur growth in both investment and consumption across Germany. However, Germany's energy consumption highly relies on imports. thus its industrial production, imports and exports will be still under pressure due to the persistent disturbance of the Russia-Ukraine conflict to energy supply and the impact of the Red Sea crisis on the shipping between Europe and Asia. It is expected that Germany's GDP growth will be zero in 2024Q2, and full-year GDP growth 0.2%, 0.5 percentage point up from 2023.

3. UK: The economy will bottom out, with inflation poised for decline

In 2024Q1, the UK economy somewhat recovered, with private spending and

investment rising, while government spending and net exports slightly falling. The labor market stayed vibrant, and wage grew faster than inflation, leading to improved private spending. Moderating inflationary pressure and growing expectation for interest rate cuts by the central bank boosted investor confidence, resulting in signs of recovery in investment. But shrinking fiscal spending and net exports became a drag on the economy. **Inflation continued to decline.** In February 2024, CPI grew by 3.4% year-on-year, 0.6 percentage point down from January, mainly due to falling energy prices. **In 2024Q2, the UK economy will maintain growth, with inflation to decline further.** Recovering consumer confidence will drive private spending. Expanding financial services are likely to propel investment and widen the surplus of trade in services. Fiscal policies like reducing taxes, increasing public services and promoting investment will facilitate economic development. It is expected that UK's quarter-on-quarter GDP growth will be 0.1% in 2024Q2, flat with the previous quarter, and full-year GDP growth 0.6%, 0.5 percentage point up from 2023. The year-on-year CPI growth will drop to 3.3% in Q2, and around 3.2% for the full year.

4. Japan: Economic growth will fluctuate, and recovering domestic demand will support moderate economic growth

In 2024Q1, Japan's economy recovered weakly. Improved consumer expectation somewhat boosted the earlier sluggish consumer market. Investment and industrial production showed a momentum of rebound. Foreign demand still played a positive role, with net exports offering a support for Japan's economy. **Inflation hit a historical high.** In February, CPI rose by 2.8%, 0.8 percentage point up from January, and core CPI exceeded the central bank's target of 2% for 22 straight months, boosted mainly by rising service prices. **In 2024Q2, Japan's economy will grow moderately, and inflationary expectation is likely to be bolstered.** The positive cycle of "wage-commodity price" took initial shape, helping drive up actual residential wage and improve the consumer market. Corporate investment is very

likely to maintain fast growth. It is expected that Japan's quarter-on-quarter annualized GDP growth will be around 1.5% in 2024Q2, 1 percentage point up from Q1, and full-year GDP growth 0.9%, 1 percentage point down from 2023. The year-on-year CPI growth will be around 2.6% in Q2, and around 2.5% for the full year.

5. Major exporters of manufactured goods: The growth momentum will recover on the whole

South Korea: Export data will continue to expand, indicating better global trade situations and boosting confidence in economic development. In March 2024, South Korea's exports grew by 3.1% year-on-year, with the exports of semiconductors and computer respectively expanding by 35.8% and 24.5%. Exports became the major support for the country's economic growth, while also driving the improvement of trade across Asia Pacific. **In 2024Q2, South Korea will see export recovery powered by a stronger momentum than domestic demand, propping up economic growth.** As the global semiconductor industry continues to recover, the country strategically focuses on the exports of semiconductors and several other commodities to key markets, likely to further expand the growth of exports. It is expected that South Korea's year-on-year GDP growth will be 2.4% in 2024Q2, flat with the previous quarter, and full-year GDP growth 2.2%, 0.8 percentage point up from 2023.

Southeast Asia: Major economies are expected to experience a further increase in exports, which will drive economic recovery and serve as a significant force in stabilizing global economic growth. As international trade recovered, the exports of Southeast Asian countries rebounded first. Amid the fast integration of Asia's economy, expanding exports by China, Japan and South Korea spilled over into Southeast Asia. Growing export orders drove private investment in Southeast Asian countries. **In 2024Q2, relevant situations will continue to improve.** China and South Korea will see accelerated economic recovery, benefiting the exports of

Southeast Asia and regional industrial chains. Due to restructuring global industry chains, FDI, securities investment and cross-border bank credit flowing into Southeast Asia will grow. It is expected that Southeast Asia's year-on-year GDP growth will be 4.5% in 2024Q2, 0.2 percentage point up from Q1, and full-year GDP growth 4.5%, 0.5 percentage point up from 2023.

Mexico: Economic growth will somewhat decline, but manufacturing will continue to benefit from the transfer of global industry chains. In 2024Q1, with the slowdown of the US economy and the export substitution formed due to improved trade situation in Asia Pacific, Mexico experienced a weaker momentum of export expansion, leading to declining economic growth. But thanks to the Mexican government's increased efforts to attract foreign investment, investment extended the trend of growth. **In 2024Q2, Mexico's economic growth will continue to decline.** Its export to the US may further shrink, widening trade deficits and dragging down economic growth. The diverging attitude between the two parties of the US Congress towards Mexico in terms of "friend-shoring" may become a potential risk. It's expected that Mexico's year-on-year GDP growth will be 2.6% in 2024Q2, and full-year GDP growth 2.4%.

6. Major exporters of commodities: Economic growth will have a less dependence on commodity exports, with domestic investment and consumption becoming major drivers

Saudi Arabia: The drag from the cuts in crude oil production will be eased, and investment in non-oil and gas sectors will become a major driver of growth. In 2024Q1, international oil prices steadily recovered[1], supporting the country's exports and weakening the negative impact of the reduction of oil production[2]. Saudi Arabia continued to advance the transformation of its economic structure, with the

[1] The average price of Saudi Arabia's light crude was USD73.7 per barrel, USD76.6 per barrel and USD80.0 per barrel in January, February and March ended 22, 2024.

[2] In April 2024, Middle East countries including Saudi Arabia announced voluntary cuts in crude oil production from May to the end of 2023 as a preventative measure to stabilize the oil market. In July 2023, Saudi Arabia increased the scale of voluntary production cuts to an average of 1 million barrels per day. It announced the extension of the production cut policy to 2024Q1 in November 2023, and to the end of June 2024 in March 2024.

contribution of non-oil sectors to GDP further climbing. **In 2024Q2,** oil prices will be propped up, expected to mitigate the negative impact of the cuts in oil production. Driven by expansive fiscal policies, non-oil sectors will continue to inject impetus to economic growth. It's expected that Saudi Arabia's year-on-year GDP growth will be 1.8% in 2024Q2, and full-year GDP growth 4.0%.

Russia: The economy will appear resilient under extreme pressures. In 2024Q1, Russia's economic structure was transformed at a faster pace, while foreign trade remained sluggish. The government scaled up fiscal spending to boost domestic demand, with investment in national defense and military industries still robust. In March 2024, Vladimir Putin won the presidential election, which will help stabilize the country's economic and diplomatic policies. **In 2024Q2, Russia will remain under huge pressure in terms of economic growth and transformation.** Amid the ongoing economic transformation, the growth model for the "wartime economy" will not be sustainable. It's expected that Russia's quarter-on-quarter GDP growth will be 0.4% in 2024Q2, and full-year GDP growth around 2%.

Brazil: Commodity exports will face uncertainty, and private investment is likely to become a major driver of growth. In 2024Q1, thanks to elevated commodity prices[1], Brazil recorded a year-on-year export growth of 3.2%, maintaining a good momentum of economic growth. **In 2024Q2, the growth momentum of Brazil's economy will weaken.** Agricultural and animal husbandry production and commodity markets will be challenged by more uncertainties[2], weakening the support from net exports. Brazil is very likely to expediate the cuts in interest rates[3], with private investment expected to become a new driver of growth and the auto industry to be a key area of investment[4]. It's expected that Brazil's

[1] In February 2024, Brazil's composite commodity index, agricultural commodity index and metal commodity index went up by 17.42, 28.01 and 4.80 points from December 2023, respectively.
[2] According to a report released by FAO in October 2023, the EI Nino phenomenon will last till the first half of 2024, possibly resulting in abnormal rainfall and thus severer droughts in wider areas of Brazil.
[3] The Central Bank of Brazil cut interest rates by 50 bps successively in August 2023, September 2023, November 2023, December 2023, February 2024 and March 2024.
[4] Since the start of 2024, major auto makers including GM, VW, HYUNDAI, Toyota and BYD have all announced the plan to ramp up investment in Brazil.

year-on-year GDP growth will be around 1.5% in 2024Q2, and full-year GDP growth 1.7%.

7. Other emerging markets worth attention: India will maintain the momentum of growth; Egypt and some others will be stuck in crisis.

India: The economy will maintain the momentum of growth, and efforts will be redoubled to attract foreign investment. In 2024Q1, India's economy continued to grow. The Indian government worked further to attract foreign investment in areas like aerospace and electric vehicles. In January, the industrial production index for capital goods grew by 4.1% year-on-year. **In 2024Q2,** India will see equally strong confidence in private spending, and the falling inflation will spur the growth of durable and service consumption. India will kick off the national presidential election in April, expected to keep the quarter-on-quarter growth of government spending above 10% in Q2. Indian policy rates will remain high, and declining inflation will push up the actual cost of lending and curb private investment. It's expected that India's quarter-on-quarter GDP growth will be 2.8% in 2024Q2, and full-year GDP growth 6.8%.

Egypt: Amid the increasingly complex geopolitical conflicts, Egypt will be challenged in economic development. In 2024Q1, Egypt's economy slid faster, with the Red Sea crisis having significant impact on its operating revenue from the Suez Canal. The PMI for non-oil sectors showed a trend of contraction. High inflation inhibited residential consumption, and social polarization became more pronounced. **In 2024Q2, Egypt will feel great pressure when driving economic growth.** In March 2024, the Central Bank of Egypt liberalized EGP exchange rates, while hiking interest rates by 600 bps, which aimed to achieve an equilibrium in the balance of payments and combat inflation, but will curb economic growth in the short run. The fund support from IMF and gulf neighbors[1] will help Egypt boost

[1] Abu Dhabi Sovereign Wealth Fund announced to invest USD35 billion in Egypt to develop the coastal tourist area in northwestern Cairo.

market confidence and improve the resilience against external impacts. It is expected that Egypt's actual year-on-year GDP growth will slide sharply in 2024Q2. With the implementation of reform policies and the release of their effects, Egypt's economy is expected to recover, with the GDP growth possibly around 1%-2% in 2024. Other emerging countries including Turkey, Nigeria and Morocco will also see economic dilemmas of varying degrees.

Table 2: Forecasts for Key Indicators of Major Economies in 2024 (%)

Region	Year / Country	GDP growth			CPI growth			Unemployment rate		
		2022	2023	2024F	2022	2023	2024F	2022	2023	2024F
Americas	U.S.	1.9	2.5	2.0	8.0	4.1	2.8	3.6	3.6	4.1
	Canada	3.8	1.1	1.6	6.8	3.6	2.4	5.3	5.5	5.4
	Mexico	3.9	3.2	2.4	7.9	5.5	4.4	3.3	2.8	3.1
	Brazil	2.9	2.9	1.7	5.8	4.6	3.9	9.3	8	8.1
	Chile	2.4	-0.2	1.9	11.6	7.7	3.4	7.9	8.6	8.3
	Argentina	5.0	-4.5	-2.0	71.4	128.6	265.4	6.8	7.4	8.5
Asia Pacific	China	3.0	5.2	5.2	2	0.2	0.2	5.6	5.2	5.1
	Japan	1.0	1.9	0.9	2.5	3.2	2.5	2.6	2.6	2.5
	Australia	4.0	2.0	1.5	6.6	5.8	4.0	3.7	3.7	4.3
	India	6.4	7.5	6.8	6.7	5.7	5.4	7.3	8	7
	South Korea	2.6	1.4	2.2	5.1	3.6	2.6	2.9	2.7	3.5
	Indonesia	5.3	5.1	5.0	4.2	3.7	2.9	5.9	5.4	5.3
Europe and Africa	Euro area	3.4	0.4	0.8	8.4	5.5	2.3	6.7	6.5	6.7
	UK	4.3	0.1	0.6	7.9	7.6	3.2	3.7	4.0	4.5
	Russia	-1.2	3.6	2.0	13.8	6.0	4.3	3.9	3.2	2.9
	Turkey	5.5	4.5	2.8	72	53.4	55.7	10.3	9.4	10.5
	Nigeria	3.3	2.6	3.2	18.8	24.5	25.6	—	—	—
	South Africa	1.9	0.6	1.2	7.0	5.9	5.0	33.5	32.4	31.8
Global		3.0	2.7	2.5	8.7	6.9	5.8	—	—	—

Note: "F" stands for forecast; global GDP growth is calculated using the market exchange rate approach.

Source: BOC Research Institute

II. Global Financial Review and Outlook

Cross-border capital flows: FDI remains sluggish, and investment in security

portfolios shows disparity. First, FDI gradually recovers despite weakness, with industrial and regional structures constantly adjusted. In 2023, global FDI appeared weak, with worldwide FDI inflows totaling USD1.4 trillion, 3% up from 2022 (Table 3). Excluding the FDI sourced from the Netherlands and Luxembourg, the "tax havens" in Europe, global FDI flows dropped by 18% from 2022. Developed economies recorded a year-on-year growth of 29% in FDI, which fell to 28% if the Netherlands and Luxembourg are stripped. In developing countries, FDI slid by 9%. FDI in the manufacturing industry increased by 38%, and FDI in the primary industry and the tertiary industry declined by 45% and 8%, respectively. **Second, global bond and stock investment diverges, with emerging markets seeing net inflows of cross-border capital.** In 2023, global monetary policies were in the tightening cycle, and the net flows of securities investment contracted to some extent. The net inflows of securities investment in developed economies decreased year-on-year. The euro zone faced big pressure of capital outflows, while Japan reported decelerated net inflows of capital. In 2024, as major central banks in the US and Europe slowed interest rate hikes, the securities portfolios in emerging markets and developing economies will be much more appealing to investors.

Table 3: Global FDI Inflows (USD100 million)

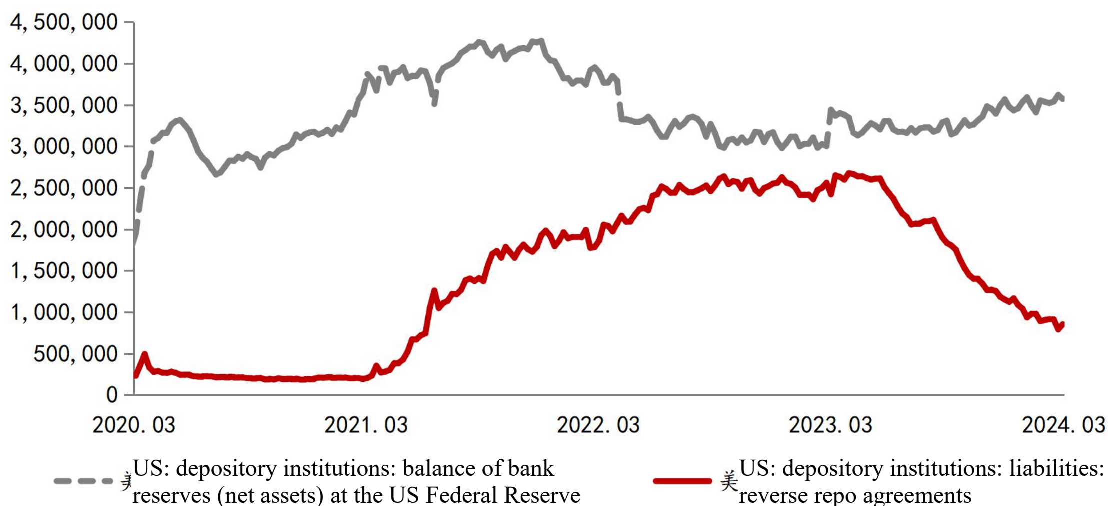
	2016	2017	2018	2019	2020	2021	2022	2023
Global	**20035**	**16449**	**13754**	**17078**	**9620**	**14781**	**12947**	**13650**
Developed countries	**13436**	**9432**	**6782**	**9987**	**3155**	**5972**	**3783**	**5240**
Europe	7532	5187	3237	6343	1325	507	-1068	700
North America	4955	3317	2409	2805	1228	4534	3377	3770
Others	949	927	1136	839	602	931	1474	770
Developing countries	**6598**	**7017**	**6972**	**7091**	**6465**	**8809**	**9164**	**8410**
Africa	462	404	442	460	392	796	449	480
Asia	4782	5044	4973	5035	5165	6621	6618	5840
Latin America and Caribbean	1344	1561	1545	1581	899	1379	2085	2090

Source: United Nations Conference on Trade and Development, BOC Research Institute

Money markets: Money market rates fluctuate at a high level, and overnight

reverse repo balance declines. First, in money markets, interest rates fluctuate at a high level, and the supply of liquidity is generally stable. European and British central banks vary with the US Federal Reserve in the pace of rate cuts, expected to cause short-term flows of capital across the border. SOFR, €STR and SONIA, among other interest rates, are very likely to fluctuate at high levels in Q2. **Second, capital flows in money markets change directions, and some non-banking institutions are under liquidity stress.** The changing expectation for rate cuts by the US Federal Reserve causes changes in the directions of capital flows in money markets. Currently, the balance of deposit reserves in US banks moderately climbs to USD3.6 trillion. By contrast, the use of overnight reverse repo, which represents the liquidity of non-banking institutions in the US, extends the trend of fast decline, falling by USD1.8 trillion from the medium-to-high level in mid-2023 to USD0.85 trillion on March 15, 2024 (Fig.2). Major central banks including the US Federal Reserve are very likely to slow or stop the reduction of the balance sheet size. Some non-banking institutions, especially the high-leverage hedging funds exposed to large-scale US bonds and active in cross-market transactions, will face liquidity pressure, which may trigger fluctuations in the money markets.

Fig. 2： Changes in the Directions of Capital Flows in the US Money Market (USD1 million)



Source: Wind, Bloomberg, BOC Research Institute

Foreign exchange markets: Basically, USD is strong while European currencies are weak, and foreign exchange rates show bigger fluctuations globally. First, in the foreign exchange markets, USD is stronger than European currencies, and JPY is on the track of appreciation. In 2024, the US Federal Reserve and the European Central Bank will begin to cut interest rates, but the pace may vary, with the European Central Bank very likely to move faster than the US Federal Reserve. It's expected that the US dollar index will fluctuate at a high level, and the exchange rate of EUR against USD will weaken. With the improving fundamentals of Japan's economy, the central bank's withdrawal from the negative freight policy, reshoring of capital and the re-valuation of JPY-denominated assets, the exchange rate of JPY will be effectively supported. **Second, currencies of emerging markets are generally under pressure, and some African and Latin American countries are stuck in the currency crisis.** Amid the fluctuations of USD at a high level, the currencies of emerging markets remain strained, with performance diverging across regions. Asian currencies depreciate slightly. Latin American, Africa and turbulent Middle East countries and regions feel bigger pressure of currency depreciation, and

face severe inflation and debt distress. USD liquidity is insufficient or even dries up, undermining market confidence, and making it hard for currency credibility and exchange value to pick up in the short run. **Third, global exchange rates fluctuate more drastically, and foreign exchange derivatives are traded more actively.** 2024Q2 will be critical for the US and European central banks to decide on a shift in their monetary policies, and changes in economic indicators like inflation and employment will have a big impact on the pace of policies and market expectation. Exchange rates will show bigger fluctuations, and the demand for speculative transactions and risk management will grow accordingly.

Bond markets: Financing rates continue to fluctuate at a high level, and the sovereign debt risk in developing countries mounts. First, the treasury bond yields of major economies fluctuate more drastically, and bond rates are high across sectors. In the US, inflation deceleration somewhat halts, the labor market remains tightly balanced, and the expectation for rate cuts by the US Federal Reserve declines. Europe's economy extends the trend of weak recovery, and the European Central Bank is expected to maintain high policy rates in the short run. Going ahead, the treasury bond yields of major economies may fluctuate at high levels, and the rates on bonds of all sectors and ratings will be relatively high in history. **Second, bond markets play a limited role in financing, and the US treasury bonds are under growing pressure of supply.** The high interest rate environment will persist globally, with financing cost kept a relatively high level, inhibiting financing through issuance of bonds. In the short term, the US Department of The Treasury will suspend the additional issuance of coupon-bearing treasury bonds as of May 2024. As the US Federal Reserve slows the reduction of the balance sheet size and turns to rate cuts, the US treasury bonds will see an improved supply and demand structure. In the middle and long term, the US treasury bonds will still see pressure on the supply side. The trend of climbing fiscal deficits will be hard to reverse, and the fluctuations in the bond market will be amplified in 2024, the year of the US

presidential election. **Third, debts continue to build up worldwide, with the risks associated with the high-yield debts of developed economies and the sovereign debts of developing countries worth attention.** In developed economies, as corporate profitability is undermined, the high-yield bond market is exposed to certain default risk. In developing economies, earlier economic recession combined with balance of payment disequilibrium adds to the pressure from sovereign debts. Turbulences in the bond markets triggered by the escalating political conflicts in Middle East, presidential elections in emerging countries and the growing sovereign debt risk in some emerging countries should be carefully monitored.

Stock markets: Globally, stock markets move further upward, with Asian and European stock markets driven by shifting monetary policies and low valuations coming into the spotlight. First, the upside for the US stock market is limited, while European and Asian markets offer more appealing stock valuations. In 2024, the US economy is very likely to see soft landing. Amid the adjustment of monetary policies by the US Federal Reserve, risk-free rates and financing cost will decline slightly, offering certain support for the stock market. However, given the persistent surges of US stocks, a notable bubbling trend will appear, and the upside will be limited. In Europe and Asia, stocks will be more appealing in the future as their valuations are generally low. **Second, as the vulnerability of sectors, tech in particular, is increasingly felt, stock investment will shift directions globally.** Amid geopolitical conflicts, elevated debts and high rates, the financial market will still face numerous uncertainties, and the strategy of long-term investment and investment in tech stocks will appear more vulnerable. Going forward, stock investment will have shorter terms and gradually shift to the sectors with underestimated values.

Commodity markets: Global commodity prices remain volatile at a high level, and the mismatch between supply and demand continues to improve. First, the rise of crude oil prices is limited. The reduction of oil production by OPEC+

countries have limited impact on crude oil prices, and the upside for crude oil prices will be limited amid the accelerated transition towards low-carbon energies. **Second, the demand for natural gas will pick up slightly in the future, while alternative energies will become more competitive.** The continued decline of prices will improve the competitiveness of natural gas vis-à-vis alternative energies. Global warming is expected to boost the demand for electricity, and slightly drive up the demand for gas. **Third, gold prices hit a new high in history, and will maintain the strong upward trajectory in the future.** The demand of worldwide central banks for the additional gold purchases gives the precious metal an upward impetus. Also, the ongoing geopolitical conflicts, upcoming presidential elections, and other uncertainties are intensifying investors' risk aversion, which will result in an inflow of funds into the gold market and further strengthen the strong trend of gold prices.

III. Special Research

III.1: Latest adjustment of Japan's industrial chain policies and its impact on China

1. Latest adjustment of Japan's overseas industrial chain

Outbound direct investment has been a major part of Japan's economic development strategy. In recent years, the Japanese government has rolled out a package of policies to guide outbound direct investment by Japanese enterprises and support the development of relevant industries to boost the resilience of industrial chains.

First, the Japanese government supported Japanese enterprises in diversifying production locations in ASEAN countries. Japan released the "Program for Strengthening Overseas Supply Chains", to back the enterprises' building of production bases in Southeast Asia. In response to the policy, Japanese enterprises began to expand their presence in Southeast Asia, with a particular focus on Vietnam and Thailand. This mainly involved the introduction of processing and production facilities. From May 2020 to August 2023, the program sponsored a total of 125 Japanese enterprises, of which 31.5% and 20.4% were established in Vietnam and

Thailand, respectively.

Second, the Japanese government guided the return of strategic industries back home. It released the "domestic investment promotion subsidy policy", to offer considerable subsidies to the reshoring of manufacturing enterprises. The strategic high-tech industries represented by semiconductors are key rescored industries. From May 2020 to June 2023, the policy subsidized the reshoring of four batches of enterprises, with the share of semiconductor-related enterprises respectively reaching 15.8%, 25.0%, 62.3% and 74.1%, and the combined share of enterprises related to batteries, aircrafts and wind power generation totaling 23.7%.

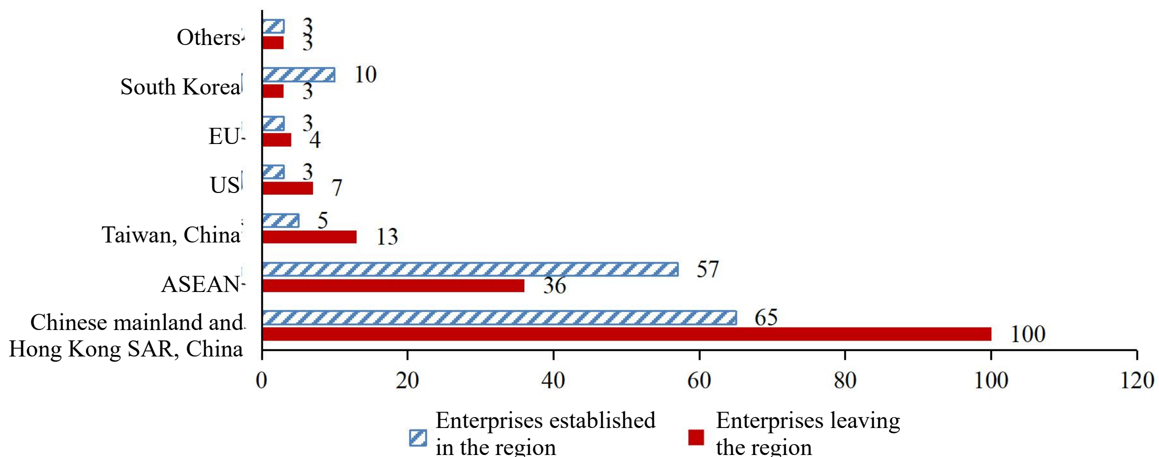
Third, the Japanese government increased international collaboration to restructure the competitiveness of key industries. In July 2023, the revised *Foreign Exchange and Foreign Trade Act* took effect, imposing restrictions on the exports of 23 pieces of equipment and materials needed in the advanced semiconductor manufacturing process. Since 2020, built on the consensus reached under the Quadrilateral Security Dialogue (QUAD), Chip 4 and Camp David Summit, Japan has strengthened supply chain cooperation with the US, Australia, India, EU and South Korea, with the focus on semiconductors, new energies, critical minerals and information communication technologies. In order to develop new energy vehicles and improve the capacity to manufacture storage batteries, it also intensified the supply chain connections with Africa, Central and South America and some other developing economies.

2. The impact of Japan's adjustment of overseas industrial chains on China

First, as Japan restructures its competitiveness in high-tech industries, China feels it more urgent to achieve technological progress in the area of high-end manufacturing. As Japan is likely to further consolidate its edges in critical technologies, China will face fiercer competition when moving up in the high-tech industrial chain, which will require faster speed and higher quality of independent

R&D. **Second, as Japanese enterprises scale up investment in Southeast Asian countries, China will be challenged in terms of export competitiveness and the completeness of industry chains.** To Japanese enterprises, ASEAN countries will substitute China as their overseas destinations of investment (Fig.27). A new manufacturing center may take shape faster in Southeast Asia, likely weakening the international competitiveness of some of China's industrial chains in the long run. Also, the completeness of China's industrial chains may be challenged, and the low-skill labor market will be impacted as well.

Fig.3 Adjustment of the Overseas Presence of Japanese Enterprises in 2022 (number of enterprises)



Source: Japan External Trade Organization, BOC Research Institute

III.2 The structural vulnerability and potential risks of the US money market funds

First, Money market funds are more vulnerable than other financial instruments due to their special structure. (i) Runs on money market funds happen more easily. The primary investors in U.S. money market funds are owners of short-term funds, whose investment objective is to balance liquidity, security and profitability. As the investors of money market funds may require the redemption of their funds at any time, particularly when the financial market is turbulent, runs

characterized by centralized redemption are more likely to occur. **(ii) The shortage of liquidity happens more easily.** Financiers in the US money market funds include financial institutions, enterprises and governments, who need longer-term and stabler funds. As media, fund management institutions actually assume the function of converting the terms of assets and liabilities, and thus need to hold the lowest possible level of liquid assets to cope with redemption. **(iii) Derivative risks are involved.** Money market funds are highly substitutable for bank deposits because both are short-term investment instruments, which means that money market funds are likely to crowd out deposits, the stable funds of banks. However, the yields on money market funds are more sensitive to interest rates. In the last four rounds of rate hikes by the US Federal Reserve, money market funds attracted huge amounts of funds due to high yields. In the ongoing rate rise cycle, money market funds tilted towards high-yield assets again, providing an average annualized yield of more than 4%. So, money market funds attract considerable funds. Moreover, as their yields are higher than those of bank deposits, their rapid growth is largely at the expense of bank deposits. This trend may threaten the fund stability of the US banking industry. **(iv) Systematic risk is more likely to be triggered.** Covering a wide range of participants, US money market funds are highly connected to other financial institutions, financial markets and the real economy, and sensitive to market turbulences. The fluctuations of, especially runs on money market funds, are more likely to spread into financial markets and the real economy.

Second, the US money market fund is not likely to see any systematic risk in the short term. (i) The impact of fund growth on bank deposits of different sizes varies. Recently, the US bank deposits have been relatively stable, with the weekly balance increasing from USD17.23 trillion in May 2023 to USD17.42 trillion in February 2024 and its ratio to the balance of bank assets kept at a safe level of around 75%. According to BIS estimates, 45% of the US money market funds flow to banks per month on average. Noteworthily, the growth of money market funds

impacts community bank deposits heavily. These banks are more challenged by changing depositor behaviors, rising financing cost and the falling values of investment in securities markets. Community banks have to raise deposit rates to compete with big banks and money market funds, while developing greater reliance on wholesale funds. This not only causes a decline in net interest margins, but also pushes up the share of uninsured deposits and adds to the vulnerability of the sources of funds. **(ii) The heavy investment of money market funds in overnight reverse repo somewhat plays a role in maintaining market liquidity.** The US Federal Reserve raised the reverse repo rate equivalent to the lower limit of the target range of the federal fund rate in mid-2021 to 5 bps higher than that, which has helped the asset attract much inflows of money market funds, which accounted for 95% of the balance of reverse repo. Historically, the market liquidity crisis that happened when the US Federal Reserve reduced the balance sheet size in September 2019 shows, the banking reserve level is critical to maintaining banking and market liquidity. This is more crucial in the ongoing process of reducing the balance sheet size due to several factors, including the larger scale and faster speed of reduction compared with the previous round, as well as the bigger increase of the issuance of treasury bonds, which attract massive working funds. **(iii) Currently, US households and corporate sectors have sufficient liquidity and cash with relatively low leverage ratios and stable corporate profitability.** Consequently, they are not under significant pressure from centralized redemption of money market funds to boost liquidity.

Third, the US regulatory reform targeting money market funds aims to improve market resilience, but whether it works is to be seen. In the aftermath of the 2008 financial crisis, the US financial regulator implemented a reform to enhance the stability of money market funds and reduce associated risks. This was done in order to prevent a recurrence of the market runs during the crisis. As part of the reform, the minimum required level of liquid assets held by money market funds was

defined. Despite these efforts, the financial market experienced turbulence during the pandemic. The ongoing regulatory reform is designed to enhance the resilience, liquidity, and transparency of money market funds, benefiting a broader range of investors, particularly at a time when the market is under pressure. So far, whether the financial reform is effective is subject to further market tests. Relevant industries and stakeholders generally expressed support for the new rules, believing that the reform is a major progress made to improve the resilience of money market funds. However, some stakeholders pointed out that although the proposed pricing method could mitigate operating risks, it may be overly complex and costly. They also expressed concern that money market funds may still be susceptible to runs under significant pressure.

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