OUTLOOK

Economic outlook: Global growth dependent on a resilient U.S.

Rob Lovelace, Jared Franz and John Queen

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KEY TAKEAWAYS

- U.S. economy is benefiting from a strong labor market and easing inflation.
- Europe and some emerging markets are struggling to boost growth.
- Monetary easing around the world is providing a favorable backdrop for stocks and bonds.

Feedback

Economic outlook: Global growth dependent on a resilient U.S.

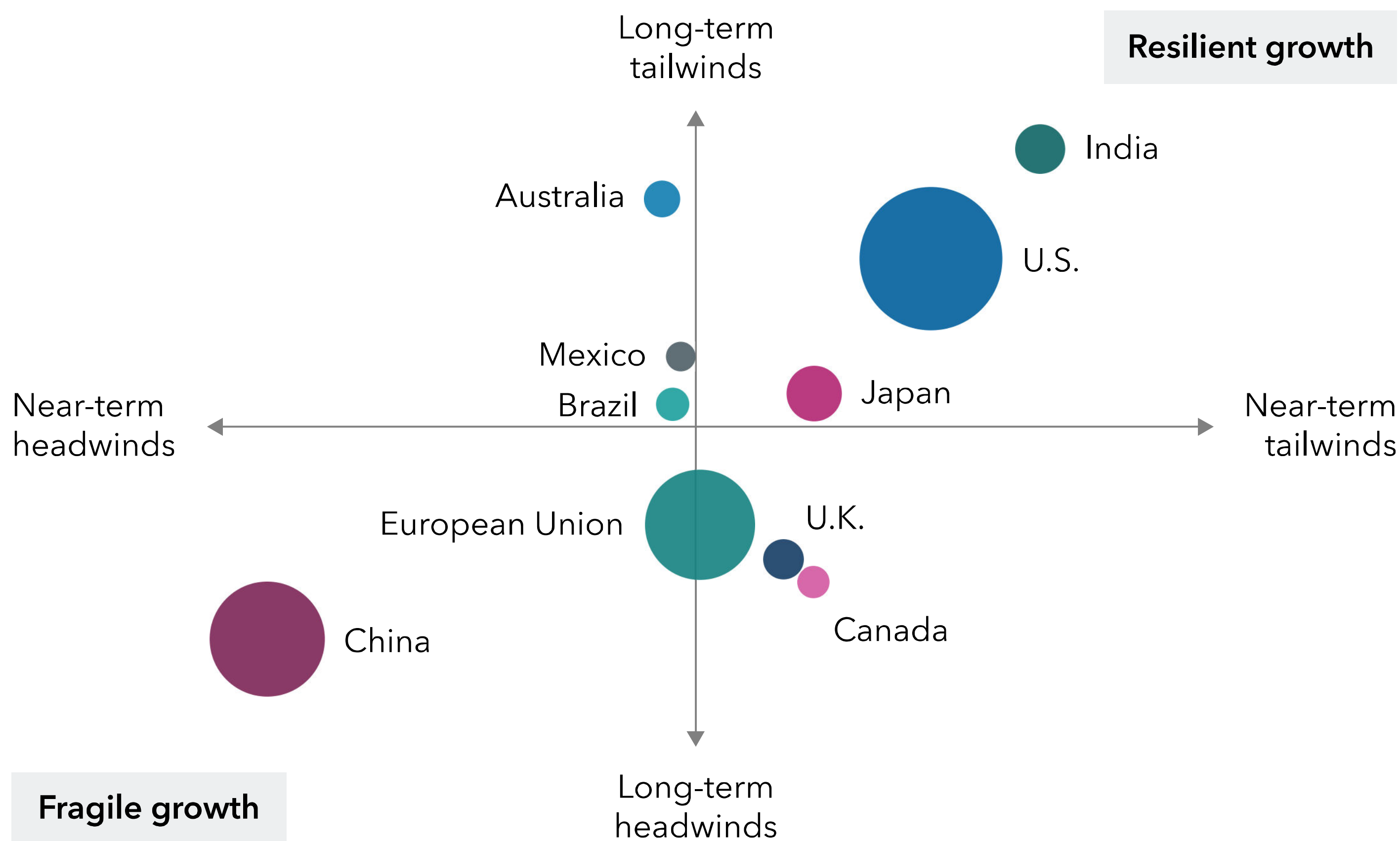
As inflation eases and central banks around the world cut interest rates, the outlook for the global economy remains decidedly mixed heading into the new year. Much like the past few years, the United States and India continue to lead the way, driving global economic activity, while weaker economies in Europe and China seek to stimulate growth.

With U.S. labor markets healthy, profit growth solid and business investment picking up, the International Monetary Fund (IMF) recently raised its forecast for U.S. economic growth in 2025 to 2.2%. That prediction offsets downward revisions for other advanced countries, including the largest economies in Europe. China, meanwhile, continues to struggle with a real estate downturn

and worries about a broadening trade war following U.S. President-elect Donald Trump's victory on November 5.

"I tend to think about the world in terms of tailwinds and headwinds," says Rob Lovelace, principal investment officer of New Perspective Fund®. "The U.S. has plenty of tailwinds at the economic level, the industry level and the company level. Japan is picking up some tailwinds. And I think both Europe and China are dealing with some real headwinds at the moment."

Healthy U.S. economy remains a cornerstone of global growth



Sources: Capital Group. Country positions are forward-looking estimates by Capital Group economists as of November 2024 and include a mix of quantitative and qualitative characteristics (in USD). Long-term tailwind and headwinds are based on structural factors such as debt, demographics and innovation. Near-term tailwinds and headwinds are based on cyclical factors such as labor, housing, spending, investment and financial stability. Circles represent individual economies. Circle sizes approximate the relative value of each economy and are used for illustrative purposes only.

Feedback

Welcome to the Benjamin Button economy

Can U.S. strength lift up the global economy and financial markets along with it? The world's largest economy is striving to do just that.

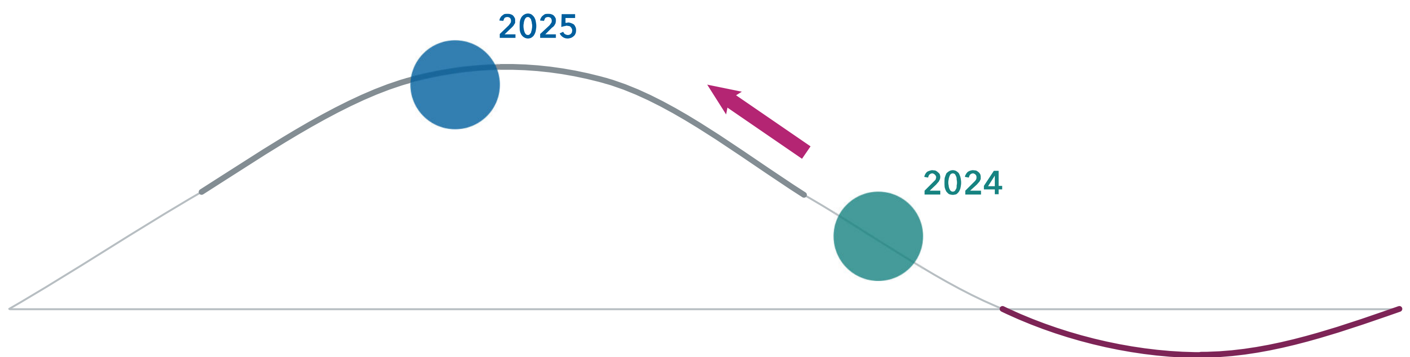
Odd as it may sound, the U.S. economy appears to be taking a page straight out of the 2008 movie *The Curious Case of Benjamin Button*. Film buffs will remember that the title character, played by Brad Pitt, ages in reverse, from old man to young child.

“The U.S. economy is going through a similar transition,” says Capital Group economist Jared Franz. “Instead of moving through the typical four-stage business cycle that has defined the post-World War II era, the economy appears to be shifting from late-cycle back to mid-cycle, conveniently avoiding a recession.”

A mid-cycle economy is generally characterized by rising corporate profits, accelerating credit demand, softening cost pressures and a shift toward neutral monetary policy. “We’ve seen all four of those in 2024,” Franz notes. “Going forward, I believe the U.S. is headed for a multi-year expansion period, perhaps fending off a recession until 2028.”

The U.S. business cycle appears to be aging in reverse

Tracking the U.S. economy



Annualized total returns of U.S. stocks by stage of business cycle

14.8%	14.0%	8.9%	-9.4%
Early	**Mid**	**Late**	**Recession**
Economic activity accelerates	Profit margins peak	Labor markets tighten	Economic activity declines
Hours worked rise	Employment improves	Profit margins contract	Credit contracts
Central bank eases	Credit demand picks up	Central bank tightens	Unemployment ris

Sources: Capital Group, MSCI. Positions within the business cycle are forward-looking estimates by Capital Group economists as of December 2023 (2024 bubble) and September 2024 (2025 bubble). The views of individual portfolio managers and analysts may differ. Returns data is monthly from December 1973 to August 2024. Data is Datastream U.S. Total Market Index from December 31, 1973 through December 31, 1994, and MSCI USA Index data thereafter. Returns data reflects all completed cycle stages through October 31, 2024.

Historically speaking, mid-cycle periods have provided a favorable backdrop for U.S. equities, generating returns averaging 14% a year. That’s based on a Capital Group analysis of economic cycles and returns dating back to 1973.

As always, it’s important to acknowledge that past results are not predictive of results in future periods. “But if the U.S. economy continues to grow at a healthy rate,” Franz says, “that could

provide a healthy tailwind for markets."

Franz's estimate for U.S. economic growth is more optimistic than the IMF forecast. He expects the U.S. economy to grow at an annualized rate of 2.5% to 3% in 2025, potentially higher if Trump is able to quickly cut taxes and slash government regulations, as he promised during his presidential campaign. Trump's election, combined with a Republican sweep of the House and Senate, will likely translate into generally higher economic growth, Franz notes, but also higher inflation and higher interest rates than previously expected.

Outlook is mixed outside the U.S.

In markets outside the United States, there is more divergence. Some bright spots, including India, are expected to lead the world, generating some of the fastest growth rates. India's economy should enjoy 6.5% growth in 2025, according to IMF estimates, driven by a young and growing workforce. India also is benefiting from a post-pandemic shift in global supply chains, adding to its manufacturing base in mobile phones, home appliances and pharmaceuticals, among other products.

Europe's economy continues to ride the edge between expansion and contraction, with expected growth around 1%, weighed down by the war in Ukraine, high energy prices and close ties to China's sluggish economy. In response, the European Central Bank (ECB) started cutting interest rates this year ahead of the U.S. Federal Reserve, hoping to kickstart the eurozone economy.

In China, meanwhile, the government has launched a massive stimulus program designed to reverse chronic weakness in the country's real estate market and slowing industrial production. China's growth-oriented policies include interest rate cuts, mortgage rate reductions, and a recently announced $1.4 trillion aid package to help local governments deal with growing debt burdens. Looking ahead, a cloud hangs over China's role in international trade as the incoming Trump administration has vowed to raise tariffs on Chinese imports.

Feedback

2025 Outlook webinar

Thursday, December 12 | 11 AM PT/2 PM ET

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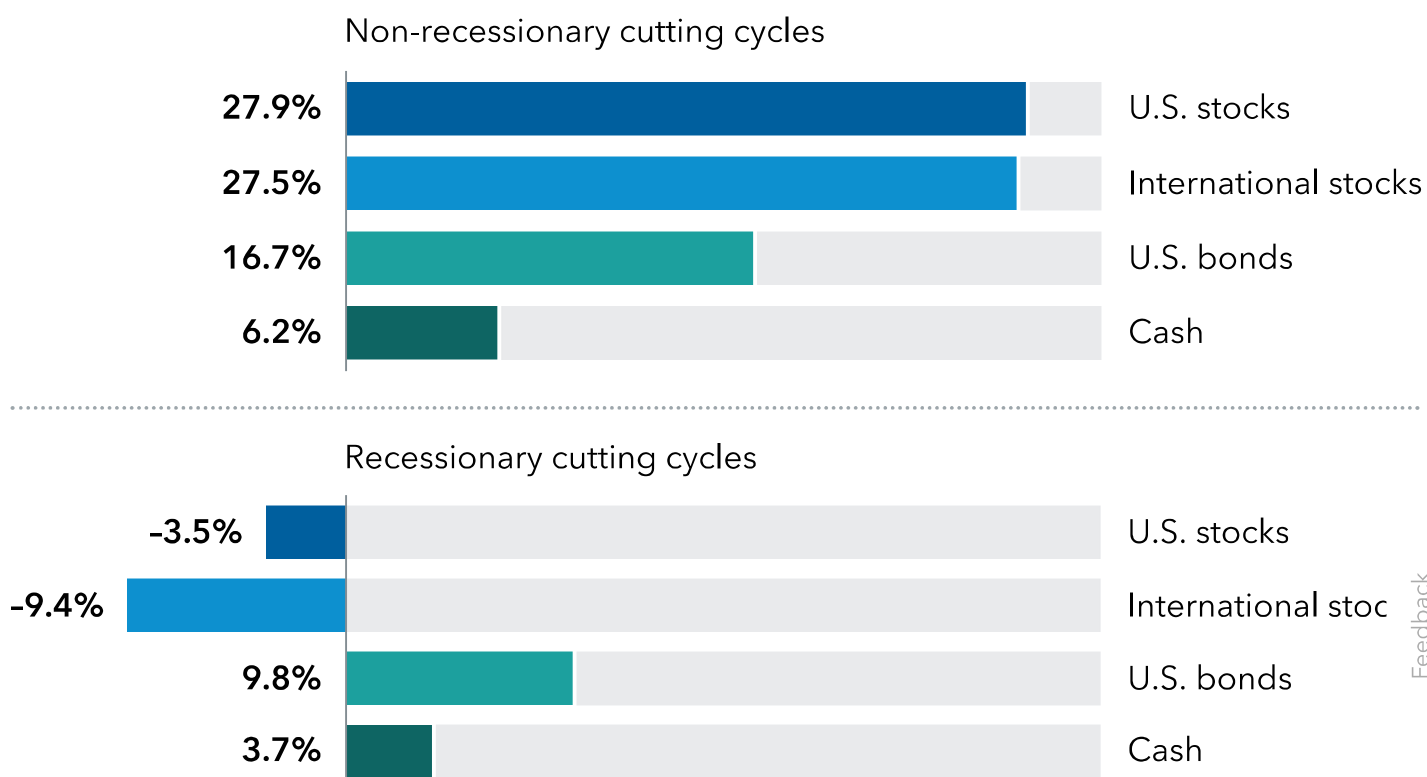
Where to invest in a rate-cutting cycle

Adding fuel to economic growth expectations, the world's major central banks — the Fed, the ECB, the Bank of England and The People's Bank of China — have all committed to monetary easing in the closing months of 2024.

The Fed, often considered the central bank to the world, has cut rates twice since September, setting the stage for what could be a favorable environment for financial markets in 2025. Rate cuts when the economy is growing have been a boon for investors in both stocks and bonds.

Of the Fed's seven easing cycles since 1984, three occurred outside a recession. During those non-recessionary cycles, the S&P 500 Index averaged a 27.9% return from the first cut to the last, with most sectors posting double-digit gains.

Rate cuts have boosted stocks and bonds in a healthy economy



Sources: Capital Group, Bloomberg Index Services Ltd., Morningstar, Standard & Poor's. Return calculations reflect annualized total returns over periods in which the U.S. Federal Reserve had stopped raising rates and began to actively cut rates, measured from the peak federal funds rate target to the lowest federal funds rate target for each cycle. Specific easing cycles included: August 1984 to August 1986 (non-recessionary), May 1989 to September 1992 (recessionary), February 1995 to January 1996 (non-recessionary), March 1997 to November 1998 (non-recessionary), May 2000 to June 2003 (recessionary), June 2006 to December 2008 (recessionary), and December 2018 to March 2020 (recessionary). Benchmarks used are the S&P 500 Index (U.S. stocks), MSCI World ex USA Index (international stocks), Bloomberg U.S. Aggregate Index (U.S. bonds) and the average investment rate of 3-month U.S. Treasury Bills (cash). As of September 30, 2024.

During times when rate-cutting cycles have preceded a recession, stocks have not fared well. But U.S. bond returns have been strong in both non-recessionary and recessionary cutting cycles, significantly outpacing cash equivalent investments in non-recessionary periods.

John Queen, portfolio manager for CGCP – Capital Group Core Plus Income ETF, believes the economy will continue to improve heading into the new year and thinks the Fed is simply looking to normalize interest rates, reducing them to a level where they are no longer restrictive. That was the base case before the U.S. election, and it is even more so now.

"The Fed is cutting rates because it wants to," Queen says, "not because it has to."
Read important disclosures

Rob Lovelace *is an equity portfolio manager and chair of Capital International, Inc. He has 38 years of investment industry experience (as of 12/31/2023). He holds a bachelor's degree in mineral economics from Princeton. He also holds the Chartered Financial Analyst® designation.*

Jared Franz *is an economist with 18 years of investment industry experience (as of 12/31/2023). He holds a PhD in economics from the University of Illinois at Chicago and a bachelor's degree in mathematics from Northwestern University.*

John Queen *is a fixed income portfolio manager with 34 years of investment industry experien (as of 12/31/2023). He holds a bachelor's degree in industrial management from Purdue.*

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Past results are not predictive of results in future periods.

Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in the prospectus. These risks may be heightened in connection with investments in developing countries.

Bloomberg U.S. Aggregate Index represents the U.S. investment-grade fixed-rate bond market.

Datastream U.S. Total Market Index measures the results of the U.S. equity market, including large-, mid- and small-capitalization stocks.

MSCI USA Index is a free float-adjusted, market capitalization-weighted index designed to measure the U.S. portion of the world market.

MSCI World ex USA Index is a free float-adjusted, market capitalization-weighted that captures large- and mid-cap representations across 22 of 23 developed market countries, excluding the U.S. The index consists of more than 40 developed and emerging market country indexes.

S&P 500 Index is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks.

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