Five lessons from 2024

By Jesper Rangvid

2024 witnessed soaring stock markets, falling but persistent inflation, easing of monetary policy, and large fiscal deficits and an awakening of bond vigilantes in some countries. In this review of the past year, I reflect on five key lessons we learned about economic and financial trends in the US and Europe.

Lesson 1. The US debt crisis: Heading toward troubled waters

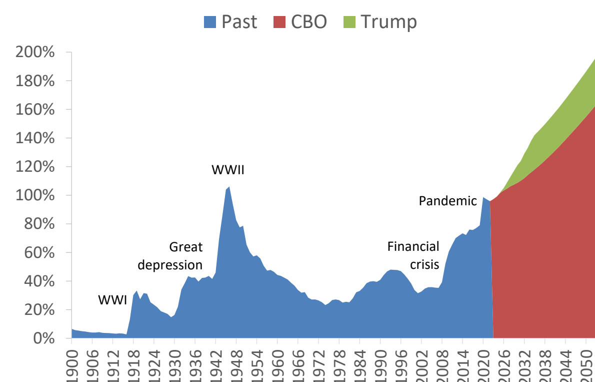
The worsening US fiscal policy situation has been a well-known issue for years. However, 2024 saw a US presidential election in which none of the candidates meaningfully addressed this challenged. In fact, as I discussed (link), both presidential candidates proposed policies that would further widen the deficit, with Trump's campaign promises being the costliest.

Trump was ultimately elected. Now, there is speculation that he might not implement all the expensive policies he promised during the campaign. Perhaps. Yet, I have not heard the incoming president retract these proposals. He might do so—or he might not. The reality is that we have absolutely no clarity on how the US plans to tackle its mounting fiscal challenges.

If the US fails—or proves unable—to address its large and persistent fiscal deficits, the consequences will include higher interest rates and inflation. Moreover, these effects are likely to spill over into other countries, making this not just an American problem but a global one.

To provide an update on the challenges facing the US, and how they hinge on whether Trump follows through with his campaign promises, I have used projections from the Congressional Budget Office (CBO) in Figure 1, incorporating the potential effects of Trump's commitments. In my analysis of the presidential candidates (link), I looked at projections up until 2034. In Figure 1, I—to make things simple—add the CBO's projected debt growth rates for 2034 to 2054 to those that incorporate Trump's plans but end in 2034.

Figure 1. *US federal debt held by the public in percentage of US GDP: historical (blue), projected by the CBO (red), and including additional debt due to Trump's campaign promises (green). 1900-2054. Source: Congressional Budget Office and J. Rangvid.*



According to its baseline projection, the CBO estimates that the US debt-to-GDP ratio will rise to 163% by 2054. Factoring in the effects of Trump's campaign promises in the simple way I do here, this ratio would climb to 200% by 2054—a level of debt that would most likely be unsustainable.

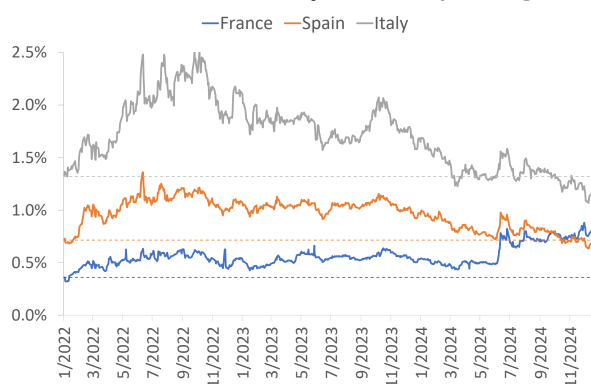
Are these debt projections realistic? Regrettably, unless Trump signals a reversal of policies, and until American politicians present clear and well-articulated plans to improve the budget, I am inclined to believe they are.

I argued that the massive expansion of debt in the US since the financial crisis of 2008 has contributed to its economic growth, helping to explain the growth disparity between the US and Europe. While Europe faces severe growth challenges, it is nevertheless worth noting that the US has relied far more heavily on borrowing.

Lesson 2: Despite US debt being more unsustainable, European countries face greater punishment from investors

Something remarkable occurred in European sovereign bond markets in 2024: yields on French bonds rose above those on Spanish bonds—the latter a country that was at the heart of the European debt crisis just a decade ago. Figure 2 provides the updated data.

Figure 2*. Yields on ten-year sovereign bonds for France, Italy, and Spain relative to German yields. Daily data, 1 January 2022 – 19 December 2024. 1 January 2022 levels indicated by dotted lines. Source: Datastream via Refinitiv and J. Rangvid.*



I wrote about French yield developments two months ago, in late October (link). Since then, Spanish and Italian yield spreads towards Germany have narrowed further, while the French yield spread has widened. The change is not dramatic, but it is moving in the wrong direction for France.

One might argue that French politics is to blame. In other words, investors are probably concerned about France's ability to address its debt challenges. This is likely to be true. However, the situation is no better in the US, where lawmakers frequently clash over the debt ceiling and how to keep the government running—the latest drama unfolding just before Christmas (link). Also, as I showed (link), the US is set to accumulate more debt than Europe. Despite this, investors seem remarkably calm about US debt and budget issues, while seizing every opportunity to scrutinise Europe. How long will this divergence continue?

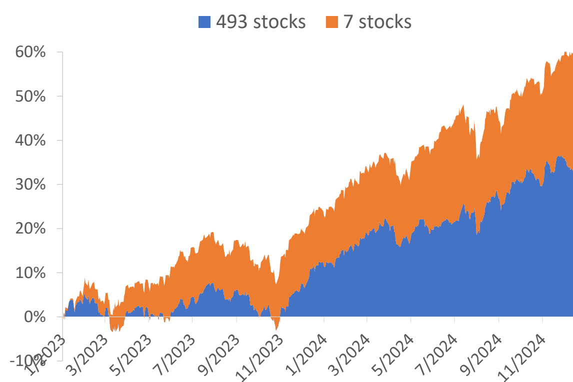
Lesson 3: The Magnificent 7 continue to drive the US stock market to unprecedented valuations

In August 2023, I showed that the "7 Magnificent" stocks had been responsible for 70% of the total value gain across all 500 stocks in the S&P 500 (link). Many, including myself, speculated on whether this impressive dominance would persist. It did. Figure 3 presents an updated version of the graph I created in 2023.

The figure illustrates that the total value of all 500 stocks in the S&P 500 has risen by 54% since 1 January 2023, increasing from USD 32 trillion to USD 50 trillion today. Remarkably, half of this value gain has been driven by just seven stocks, the "Magnificent 7."

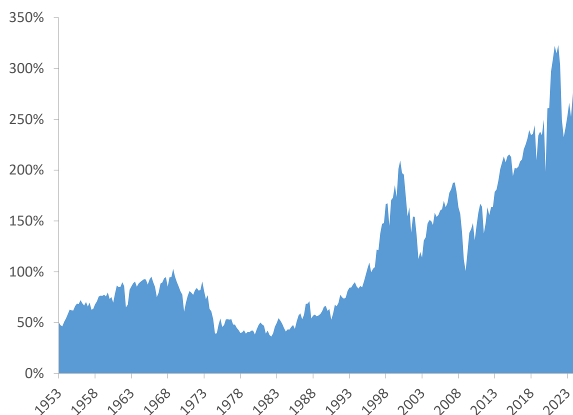
The value of the remaining 493 stocks has grown from USD 26 trillion to USD 33 trillion, representing a 28% increase over the same period. The Magnificent 7 alone have contributed a 26% boost to the total value of the S&P 500.

Figure 3. *Percentage change in total market value of all companies in the S&P 500, split between the return of the Mag7 and the remaining 493 stocks, since 1 January 2023.*
Source: Datastream via Refinitiv and J. Rangvid.



Meanwhile, the stock market has significantly outpaced the real economy, pushing the S&P 500 to one of its highest values relative to US GDP, as I also showed in 2024 (link). Figure 4 updates this analysis with the latest data.

Figure 4. *Market value of corporate equities in the US, all sectors, as a percentage of US GDP. Quarterly data, 1953Q1-2024Q3.*
Source: FRED of St. Louis Fed and J. Rangvid.



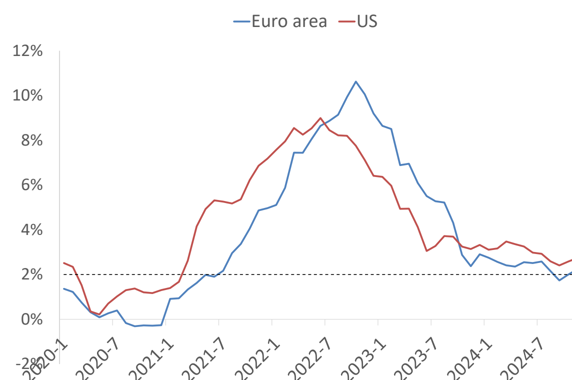
I wonder how long this elevated valuation, driven by a handful of stocks, can be sustained.

Lesson 4: Inflation appears under control in Europe, but remains a concern in the US

Over the past couple of years, inflation has been a dominant theme. However, inflation declined from the very high levels seen in 2022 and 2023—a welcome development. Consequently, the Fed and the ECB started to lower interest rates in 2024.

Still, central banks are struggling to bring inflation fully down to their 2% targets, particularly in the US, as shown in Figure 5.

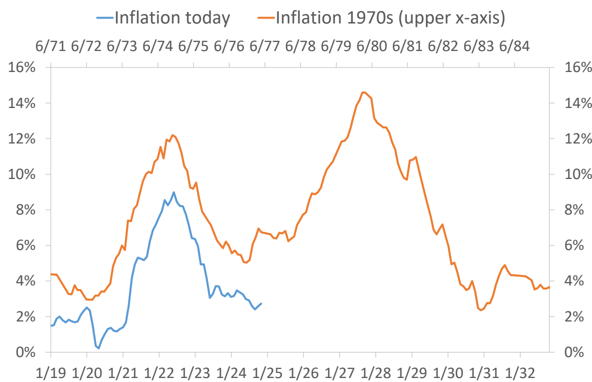
Figure 5. *Inflation (annual percentage growth in CPI) in the US and the euro area. Monthly data, January 2020—November 2024.*
Source: FRED of St. Louis Fed and J. Rangvid.



Lesson 5. Do not dismiss the risk of a second inflation spike

As mentioned earlier (link), this episode of inflation has been eerily like the one in the 1970s, which saw inflation spike for a second time. If you look closely at Figure 6, which compares inflation dynamics in the 1970s and today, you will notice that US inflation has been creeping up over the past couple of months.

Figure 6. *US inflation (annual percentage change in CPI) from June 1971 to June 1984 (dates on upper x-axis) and from January 2019 to November 2024.*
Source: St. Louis FRED and J. Rangvid.



This development is concerning, particularly given what seems to be on the horizon: a rapidly growing US economy set to encounter even more expansionary fiscal policies (see Lessons 1 and 2), along with tariffs, deportations, and other factors likely to push inflation higher. In autumn, before Trump was elected, it seemed that inflation had been brought under control, including in the US (link). After the election, this remains my primary scenario, but I am less certain now.

It will be fascinating to create Figure 6 in a year's time and see whether the recent early signs of rising inflation will result in today's inflation experience once more mirroring that of the 1970s, i.e., with a second spike of inflation.

Conclusion

2024 is ending. During the year, the incoming US president proposed policies that are likely to exacerbate already concerning US debt levels, yet investors seem largely unfazed. In contrast, investors are more attuned to France's debt challenges, even though they are less severe than those of the US. Meanwhile, the US stock market has continued its remarkable rise, driven by a handful of stocks in a highly concentrated rally, while inflation has largely been brought under control in Europe but remains a concern in the US.

All these developments mean that there is plenty to keep an eye on in 2025. I will make sure to keep you updated.

Wishing you a Happy New Year!