NORTHERN TRUST

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# WEEKLY ECONOMIC COMMENTARY

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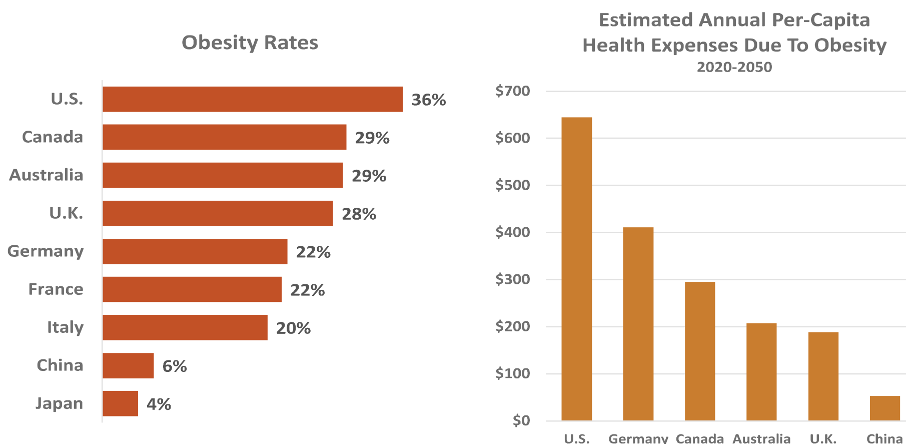
2024 is upon us. We hope that the old year concluded well, and that you are all excited about the possibilities offered by the new one.

January witnesses a seasonal surge in gym memberships. The trend is founded on new year's resolutions and the guilt of holiday binges. According to Statista, exercising more, eating in a healthier manner and losing weight are three of the top five goals that people establish as the calendar turns over.

But I am wondering whether I will see the same crowds on the treadmills this year, and in the years ahead. The advance of the new generation of appetite suppressors has become a game changer for many who struggle with their weight. The economic consequences of the new drugs could be profound.

A number of countries around the world struggle with high rates of obesity. The condition is associated with greater risk of heart disease, strokes, diabetes and some cancers. The consequences for those afflicted can be severe; the consequences for societies are high medical costs, reduced labor force participation and less-than-optimal allocations of capital. A 2020 study from the Milken Institute estimated that the costs of obesity in the United States run close to 7% of gross domestic product.




*Sources: WHO, OECD, Statista*

Obesity has a series of causes, which range from biological to behavioral. Remedies have typically focused on the latter: people have been encouraged to follow strict diets and to get regular exercise. Unfortunately, many communities do not have access to fresh groceries or fitness facilities. Results of lifestyle changes are inconsistent, and the benefits of these strategies are often fleeting. According to Johns Hopkins, most people who succeed in losing significant amounts of weight regain it within two or three years.

While some attribute that outcome to a lack of willpower, scientists have shown that evolutionary biology shoulders much of the blame. Our bodies reduce metabolism in response to reduced caloric intake, and continue to generate impulses to consume.

It is that impulse that has been the subject of the new generation of medications. Known as GLP-1 agonists, products like Ozempic, Wegovy and Mounjaro regulate chemicals in our systems that trigger feelings of hunger. They slow the rate at which our stomachs empty and may also increase energy expenditure. Originally approved for the management of diabetes, studies show that these products produce lasting weight loss and reduced risk of related conditions like hypertension.

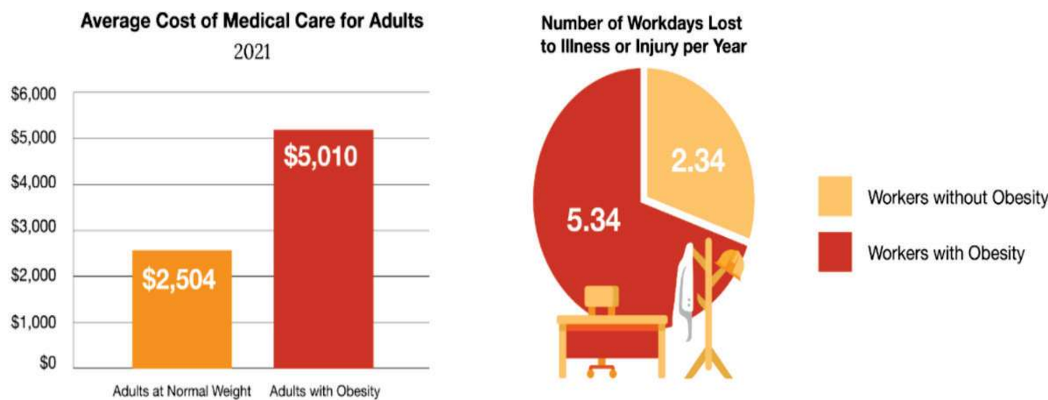
**The new class of weight management drugs will have profound economic impacts.**

The benefits to many individuals are clear. In the aggregate, GLP-1 drugs are poised to produce a demographic benefit. Improved health and longevity should enhance labor force participation and productivity. The data also show that reduced obesity increases fertility. For societies that are aging, these would be welcome developments.

There are an estimated 700 million people worldwide who are challenged with obesity, so the potential market for GLP-1 drugs is massive. Morgan Stanley estimates that nearly 7% of Americans will be using these products over the next decade.

The new class of obesity drugs are not for everyone. Apart from the side effects that can appear in some patients, the medications are very expensive. Reuters estimated the cost of Ozempic at $1,000 per month.

A number of insurance companies are limiting coverage, and even those with good insurance plans will find themselves bearing significant out-of-pocket costs. GLP-1 drugs prescribed for weight loss are not currently covered by Medicare in the U.S.; most European national healthcare programs also exclude them. Economically disadvantaged communities, which have a disproportionate incidence of obesity, may struggle to access and afford the treatments.




*Source: Premise Health*

Overall and over time, however, the new medications have the potential to reduce health care outlays. Governments bear the responsibility for providing care to many of their citizens, and the bill for doing so is an important component of national budgets. Aging and infirm populations threaten to make this an expensive proposition; GLP-1 drugs may bend this cost curve and help keep national debts sustainable.

The impact of GLP-1 medications is being mentioned more and more frequently in corporate earnings calls. On one side are the pharmaceutical companies: makers of the drugs have seen

their share prices skyrocket. On the other side are a whole host of companies whose business models are based on people's cravings and their efforts to break free from them. Curbed appetites will limit demand for snacks, fast food and diet products, and traditional weight loss programs may lose popularity. Insurance companies will have some hard work ahead to reprice health, disability, and life policies.

**ChatGPT gets a lot of attention, but GLP-1 drugs could also be transformational.**

Based on data from his pharmacy and grocery sections, the U.S. Chief Executive Officer of Wal-Mart reported that people taking Ozempic are buying less food. Share prices of food and beverage companies have slumped, even as the overall market has rallied. Makers of medical products that deal with the consequences of obesity have also seen their market values decline.

Some of this may be an overreaction, an emphasis on potential over the present. Advancing acceptance and application of GLP-1 drugs will be a long process that could encounter any number of twists and turns. But while artificial intelligence is getting the lion's share of attention as a major economic innovation, the new weight loss drugs also have the potential to be transformational.

Selfishly, I will be happy if GLP-1 treatments reach their full promise. My fitness center is pretty crowded at the moment, and I often have to wait to access my favorite machines. It would be nice to get a workout completed in less than two hours.

## One Size Doesn't Fit All

Maastricht is the birthplace of the European Union (EU). The treaty forming the Union was negotiated and signed there, following years of debate on increasing economic cooperation across the continent. In the more than three decades of the treaty's existence, the bloc has grown in size and scope. However, the treaty's fiscal limits—deficits of no more than 3% of gross domestic product (GDP) and government debt not exceeding 60% of GDP—had remained unchanged.

Government debts and deficits in Europe have soared in the aftermath of the pandemic and the Ukraine war. Members are facing rising borrowing costs due to higher interest rates and increased spending needs in areas like defense, digitalization, the green transition and old age support.

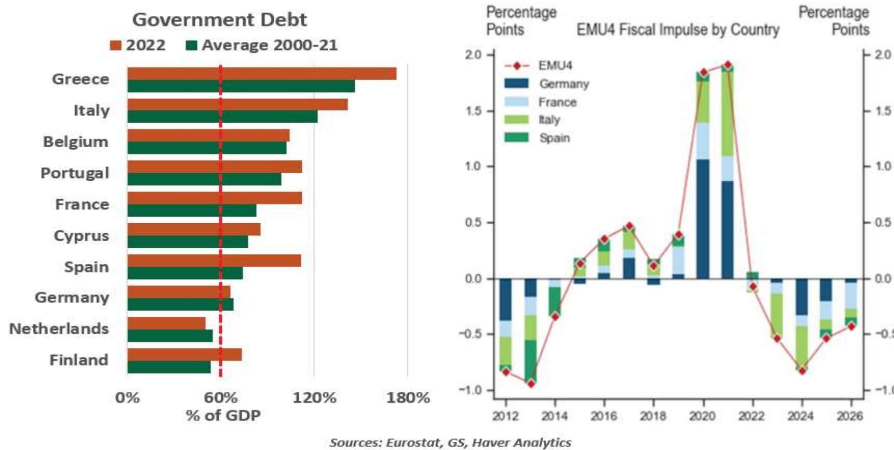
Debt in the common currency region remains elevated at around 90% of GDP, and in excess of 100% in Greece, Italy, France, Spain, Portugal and Belgium. Only nine of the 20 eurozone states have consistently had debt levels below 60% of GDP since the year 2000.

Reconsidering the bloc's fiscal rules has been on the agenda for several years. But the persistent North-South divide within Europe hindered progress.

Late last year, however, European finance ministers finalized the long-awaited reform of the fiscal framework. Formal backing by national governments and EU lawmakers is likely to happen later this year. The new outline aims to give member states greater independence on agreeing to debt and deficit plans with EU authorities in Brussels. The main elements of the reform include:

- The two fiscal targets remain untouched: a 3% deficit limit and a 60% public debt to GDP ratio.
- Countries with debt ratios over 90% of GDP will be required to trim them by one percentage point per year over the duration of their national spending plan. That target is halved for states with debt ratios above 60% but below 90% of GDP.
- Member states breaching deficit rules will have to set a course of reducing their deficits by 0.5% of GDP each year. However, increased interest payments will be excluded from the calculation until 2027.

- The deal requires countries to keep deficits to around 1.5% of GDP, below the mandatory 3% deficit limit, to create room to increase spending during unexpected crises without breaching the original deficit threshold. Nations with deficits above 1.5% but below 3% will have to meet schedules for reducing them.
- States will be able to extend their fiscal adjustment period from four to seven years by following through on reforms that improve growth and support debt and deficit sustainability.




*Sources: Eurostat, GS, Haver Analytics*

**The new EU fiscal rules are complicated and may be difficult to enforce.**

The flexibility offered by the new rules will limit the return of austerity, especially during tough economic times. The old rules prevented countercyclical growth-augmenting investments in areas like infrastructure, one of the key factors behind the economic under-performance of several EU members over the past decade. However, the reform falls short of the objective of simplification. Several exemptions and extensions to the pace of adjustment will make it difficult to enforce.

While the focus on budget restraint will comfort markets, it is also likely to weigh on growth at a time when the continent is fighting hard to avoid a recession. With the unwinding of energy-related support and the normalization of post-pandemic economic measures, the fiscal impulse in Europe is set to turn negative in the coming years.

The new fiscal framework agreed by the EU finance ministers is far from perfect, but still an important step forward. Pushing for the perfect might have been the enemy of the good.

## New Year's Continuing Resolution

As a team, we resolved to share a quiet week to end the year, with no publications or other requirements to work. The timing was good: economic news was sparse at the end of 2023. But we were disappointed to see that members of Congress also took a holiday reprieve. Yet another federal government shutdown is fast approaching, and a deal to avoid it seems to be nowhere in sight.

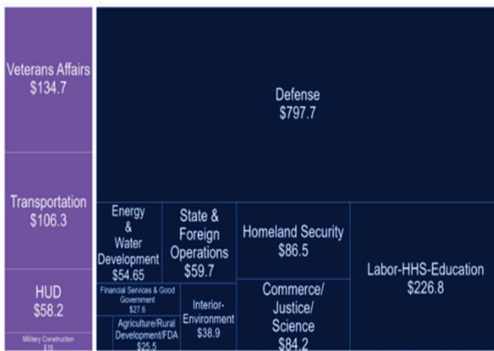
To recap: The Fiscal Responsibility Act (FRA) which ended the debt ceiling standoff last June included broad guidelines for spending in fiscal year 2024. However, the FRA was not a firm budget, and haggling ensued over details. Just before a shutdown was to begin on October 1, Congress passed a continuing resolution (CR) of the 2023 budget. That bridge only lasted seven weeks, though, and a new, staggered CR was passed carry on into the new year.

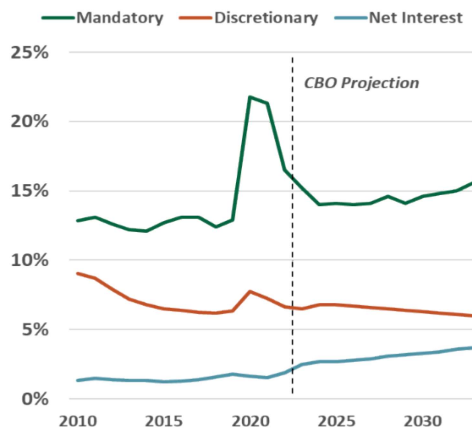
Without a new budget or another continuing resolution, the federal government will enter a partial shutdown on January 19, and a full shutdown on February 2.

Cessation of all nonessential services beginning in February would be highly disruptive, especially to hundreds of thousands of furloughed government workers. Further, the FRA stipulated that if budget negotiations were still at an impasse in April, 1% across-the-board cuts will become effective for all discretionary spending—including defense spending, an unpopular prospect.

Sticking points in current negotiations include funding for border security and support for the efforts in Ukraine and Gaza. While these are hot-button issues, the amounts under debate are minute relative to total discretionary spending of $1.7 trillion in fiscal 2023. The battle over discretionary spending misses the more worrying trajectories of costs for interest and mandatory programs.

**A U.S. government shutdown is likely as negotiations come down to the wire.**




*Sources: House Committee on Appropriations, Eurasia Group, CBO, Haver Analytics*

At least a partial shutdown looks likely: there are only eight legislative days before the January 19 deadline. Agency closures at that time will be limited and less essential; the broader closures at the beginning of February would be much more impactful. There is still room for cooler heads to prevail: shutdowns reflect poorly on both parties, an outcome to avoid in an election year. And the 1% sequester in April is a recent, self-imposed rule that Congress can revise.

We never expected the relaxation of our week away to last long. Now, it's back to the grind of following tense negotiations and last-minute dealmaking.

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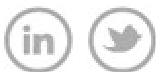

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