Quarterly Macro Report – 2nd Quarter 2023

The global economy faces headwinds as inflation persists, interest rates increase, and the industrial sector slows down. However, the high level of household savings accumulated during the Covid pandemic and catch-up effects in the services sector keep growth in positive territory.

The global economy seems to be cooling gradually but steadily. In the US and Europe, the industrial sector, as measured by production, capacity utilization, and new orders, is showing signs of decline. Despite these challenges, economic activity remains at an exceptional level, considering the impact of high inflation, loss of consumer purchasing power, and tighter monetary conditions.

Savings from pandemic period support consumption

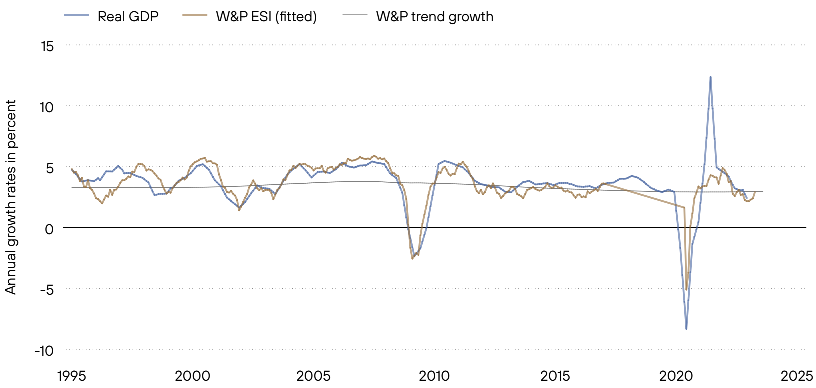
A key reason for the world economy's continued resilience is the high level of household savings that were accumulated during the Covid-19 pandemic. In the US, where saving rates were already high due to limited consumption opportunities during the pandemic, an additional fiscal stimulus program further stimulated savings. Designed to encourage consumption, the American government provided private households with so-called "cheques". With the increase in disposable income, however, private households focused on boosting their savings rather than just consumption. Thanks to these additional reserves, many consumers can now partially compensate for their loss of purchasing power and maintain consumption at a high level.

The resilience of the global economy is particularly evident in the services sector, which is benefitting from catch-up effects from the pandemic and is trending upwards. Sentiment among service providers has improved significantly in recent months. There is also an upswing in consumer sentiment, but general confidence remains low.

Inflation remains biggest challenge

The gradual slowdown in economic activity comes at a price. Due to continued high consumption

Fig. 1: Leading indicators have improved



Economic activity has continued to decline. However, economic sentiment has improved in recent months. Consumers and producers are more confident about the future, which may help to stem the negative economic trend.

Source: Refinitiv, Wellershoff & Partners

and a labor market with full employment, inflation has persisted. While headline inflation has declined due to lower energy prices with rates of 6.0 percent in the US, 6.9 percent in the Eurozone, and 10.4 percent in the UK, core inflation continues to rise in the Eurozone and the UK. Despite the tightening of monetary conditions, price dynamics have not yet been curbed. Further steps by central banks, who played a big role in fostering inflation by expanding the money supply at the beginning of the Covid-19 pandemic, will be necessary. Historically, interest rates needed to be higher than core inflation to combat inflation.

However, recent incidents in the financial system are likely to compel central banks to reassess their approach to monetary policy. The increase in interest rates has resulted in substantial losses in asset values, leading to significant reductions in banks' equity. This issue was brought to the forefront with the collapse of two American banks, which created great uncertainty in the financial system and ultimately contributed to the downfall of Credit Suisse, one of Europe's largest banks. In this context, central banks will be forced to prioritize financial stability over price stability and to adjust their monetary policy accordingly. While the recent decline in capital market interest rates may alleviate some tensions, there is a risk that central banks may refrain from further interest rate adjustments, leading to entrenched inflation.

China's powerful recovery?

China's economy, which had plummeted into a deeper recession towards the end of last year due to the sudden lifting of the zero-Covid policy, appears to be slowly recovering. While there is no clear evidence of a significant upswing in real economic data, there is a marked improvement in sentiment among producers and consumers. Service providers are more optimistic about the future than they have been in over a decade. There is thus potential for a strong economic recovery in China similar Western economies driven by catch-up effects from the Covid pandemic. However, the extent of this recovery will also depend on how the global decline in demand for goods will impact China's exports in the coming months.

> «The banking crisis puts central banks in a tight spot»

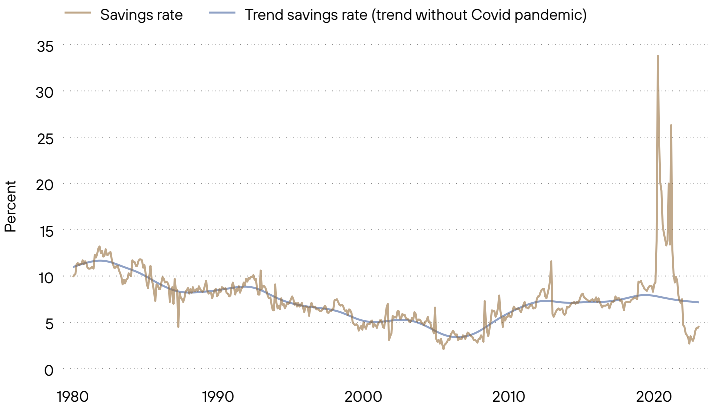
Table 1: Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2023*E*	2024*E*	2023*E*	2024*E*	Q2 2023	y/y 04/2023
USA	1.6	1.0	1.2	4.5	4.0	5.0	-5.8
Eurozone	1.0	0.4	1.4	5.0	4.0	3.0	-2.2
UK	1.7	0.0	1.0	5.5	5.5	4.25	0.0
Switzerland	1.4	0.6	1.2	3.0	2.5	1.5	-6.7
Japan	1.1	1.4	1.0	3.0	2.0	-0.1	4.3
China	4.5	4.0	4.0	2.2	2.2	4.35	5.8
Brazil	1.2	1.2	1.4	4.2	4.0	13.75	–1.7
India	5.0	6.0	6.5	5.0	5.0	6.5	9.9
Russia	1.0	0.0	1.0	10.0	4.0	7.5	22.5
World	2.9	2.5	3.0	5.5	4.0	–	–

Source: Refinitiv, Wellershoff & Partners

Fig. 2: Saving rates in the US have surged during the Covid pandemic

Average saving rates of US households

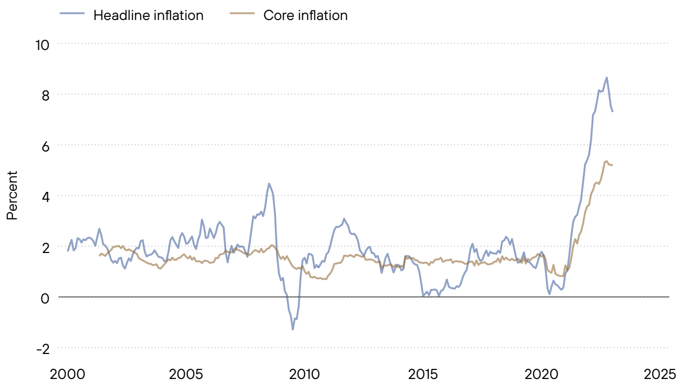


The household savings rate, measured as the ratio of savings to disposable income, has surged to over 30 percent during the Covid-19 pandemic. The accumulation of savings is presently aiding many consumers in offsetting the decline in purchasing power and sustaining consumption levels at a high rate.

Source: Refinitiv, Wellershoff & Partners

Fig. 3: Core inflation rates remain stubborn in advanced economies

Consumer price inflation in advanced economies

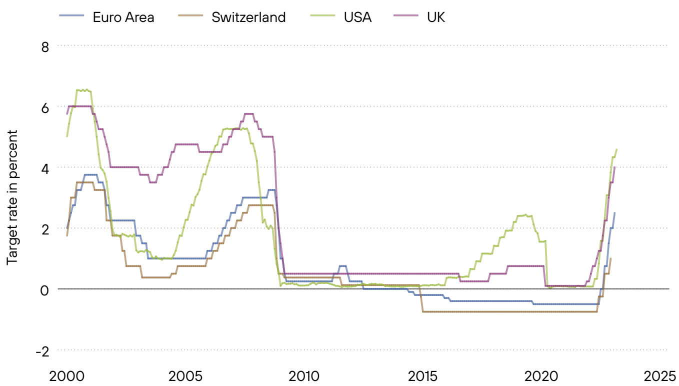


Headline Inflation rates have eased in recent months due to a fall in energy prices. Nevertheless, core inflation (which excludes volatile energy and food prices) has shown persistent resilience and has only slightly decreased. In some economies as the Eurozone and United Kingdom, core inflation rates are still increasing.

Source: Refinitiv, Wellershoff & Partners

Fig. 4: Central banks are fighting inflation

Policy interest rates of the major central banks



In recent months, the central banks of Western economies have significantly increased interest rates. However, in most economic areas, interest rates continue to remain below inflation rates. Historically, a successful fight against inflation required interest rates to be higher than the inflation rates.

Source: Refinitiv, Wellershoff & Partners

Foreign Exchange

Currency markets witnessed significant volatility in the first quarter of the year. The different sentiments and perceptions in the financial markets about the future of interest rates, inflation and growth resulted in diverging capital flows and corresponding changes in the major exchange rates.

The US dollar weakened at the beginning of the year, as it had done towards the end of the previous. The American currency then experienced a brief recovery before losing value again in the wake of the banking crisis. Still, the dollar remains significantly overvalued against most currencies. The biggest trading opportunities remain against the Japanese yen, which has been one of the weakest currencies in recent quarters and is clearly undervalued.

«Oil price drop takes toll on commodity currencies.»

Swiss Franc remains undervalued

The Swiss franc is another undervalued currency besides the Japanese yen, which can mainly be attributed to Switzerland›s moderate inflation rates. These rates are significantly lower than those in other industrialized nations. However, experience has shown that it can take some time for these imbalances to be resolved. As of the first quarter of this year, the Swiss franc has not yet been able to appreciate sustainably.

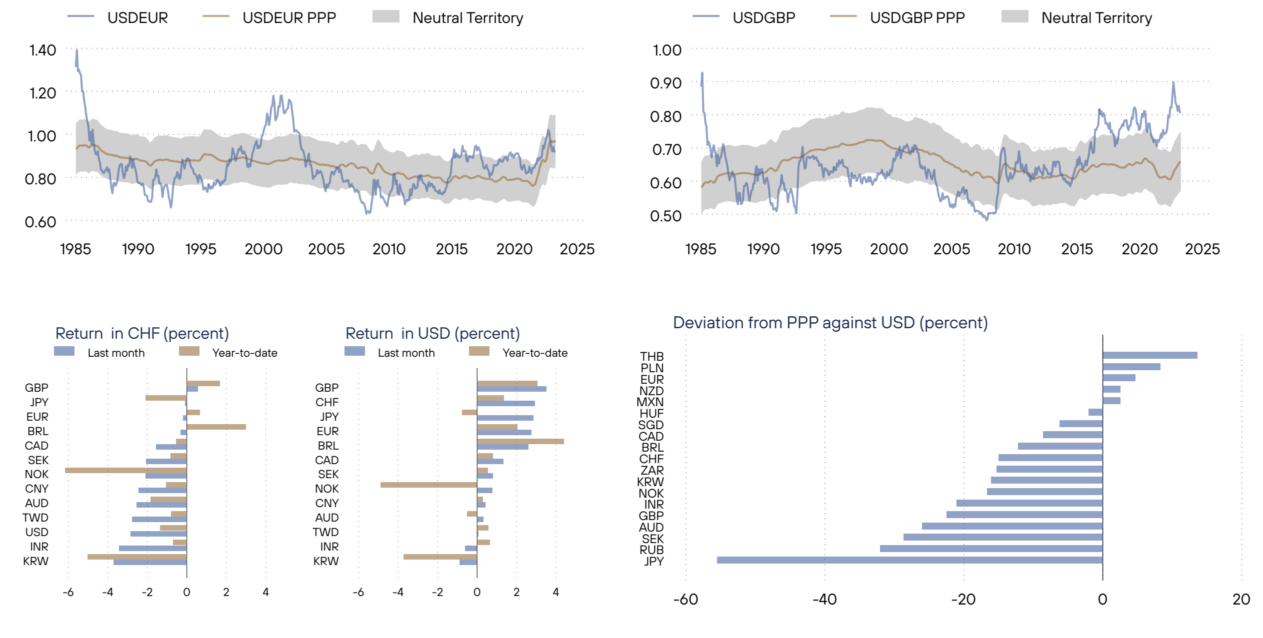
Weak commodity currencies, strong Mexican peso

Commodity currencies have weakened significantly this year due to the drop in oil prices. The Norwegian krone and the South African rand have both declined by 6 percent, while the Australian dollar has fallen by 2 percent. These currencies are all from countries whose exports, and therefore currency demand, are heavily reliant on natural resources.

The Mexican peso is among the best-performing currencies this year, having gained 7 percent against the US dollar. A major factor contributing to its strength may be the credible approach of Mexico›s central bank in addressing high inflation rates. Interest rates have been raised in 15 consecutive steps to over 11 percent, a level significantly higher than that of most other economies.

Fig. 5: FX performance and valuations

Based on W&P purchasing power parity calculations (PPP), a measure for currency valuation



Source: Refinitiv, Wellershoff & Partners

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Published by: Wellershoff & Partners Ltd., Zürich
Conception: Wellershoff & Partners Ltd., Zürich
Editorial Deadline: April 4, 2023