

## Quarterly Macro Report – 4th Quarter 2023

The European economy continues to slow down, raising concerns about an impending recession while the Chinese economy faces ongoing challenges in its recovery efforts. In contrast, the US economy remains resilient, even surpassing its long-term growth path.

Last summer, our quarterly macro report highlighted the challenging outlook for the global economy. Our evaluation was based on two fundamental observations. Firstly, there were notable imbalances emerging in the aftermath of the Covid-19 pandemic. The economic recovery from the pandemic was exceptionally strong and rapid, fueled by extensive fiscal and monetary policy measures. For instance, American households' goods consumption temporarily surged, surpassing the current trend level by almost 20 percent.

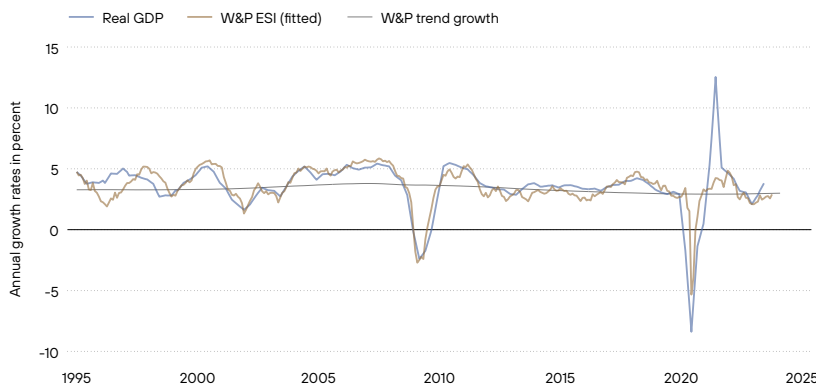
This overstimulation provoked a rapid surge in inflation. It was clear that central banks, though hesitant at the time, would need to implement substantial interest rate hikes to rectify these imbalances. The second observation focused on the sentiment of both businesses and consumers, which gradually soured amidst unsustainable economic growth and escalating inflation.

### Economic slowdown becomes evident

Reflecting on the past year, interest rates have significantly increased, business sentiment has further declined, and consumer confidence has improved somewhat but remains low. Moreover, recent months have revealed tangible signs of an economic downturn in Europe, evident in reduced consumer spending and decreased corporate investments. Consequently, the eurozone finds itself on the brink of a recession. In Germany and Switzerland, economic indicators strongly suggest that the downturn has already taken hold.

However, the US economy continues with positive momentum, even in the face of subdued confidence indicators. Economic growth is expected to stay above its long-term trend in the third quarter, reflecting its performance in the second quarter of this year. The only area of concern appears to be the gradual weakening of the labor market.

**Fig. 1: Leading indicators at trend levels**



The global economy has recently grown slightly above trend, thanks to strong growth in the USA and several emerging markets. However, leading indicators suggest that growth will return to trend levels in the coming months.

Source: Refinitiv, Wellershoff & Partners

### Effect of positive real interest rates

A crucial factor contributing to the American economy's resilience and the postponed economic downturn in Europe is the cautious approach to monetary policy. Western central banks responded to the escalating inflation rates belatedly and indecisively, keeping interest rates considerably below core inflation levels for an extended period. Negative real interest rates typically bolster demand, making spending more attractive than saving.

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Additionally, the expansive fiscal policies implemented by the US government play a crucial role in propping up the economy. A significant fiscal deficit of 2 trillion US dollars is expected for

this year. A substantial portion of these additional expenditures is allocated to programs designed to alleviate the impact of inflation on the public. Nonetheless, a slowdown in the American economy appears to have been merely postponed, not avoided. Otherwise, a looming risk of inflation persistently surpassing the target range set by the Federal Reserve (Fed) remains. However, the Fed has recently emphasized its determination to prevent this scenario from unfolding.

### China continues to face recession

There is little anticipation of any positive impulse for Western industrialized nations from China. The world's second-largest economy continues to grapple with a recession. While the economic decline hasn't worsened in recent months, a sustainable recovery isn't on the horizon either. Domestic consumption remains lackluster, and challenges persist in China's vital real estate sector. On a positive note, the threat of an imminent deflationary phase hasn't manifested. Core inflation, although exceptionally low at +0.8 percent, still remains far from a persistently negative value.

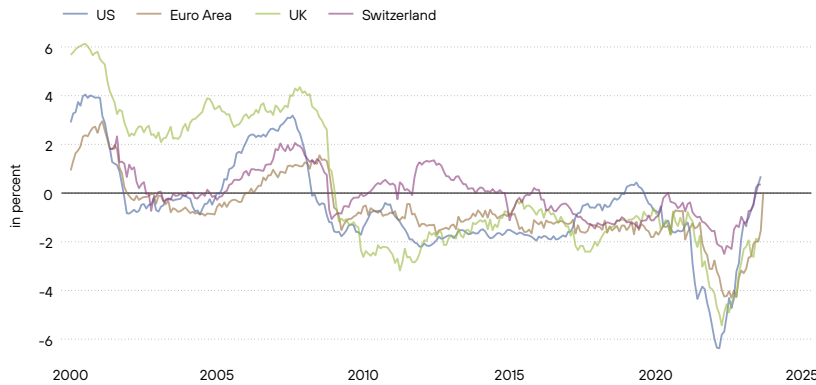
**Table 1: Macroeconomic estimates (in %)**

|                    | GDP Growth |       |       | Inflation |       | Interest Rates | Money Growth M1 |
|--------------------|------------|-------|-------|-----------|-------|----------------|-----------------|
|                    | Trend      | 2023E | 2024E | 2023E     | 2024E | Q4 2023        | y/y 10/2023     |
| <b>USA</b>         | 1.6        | 2.2   | 1.2   | 4.0       | 3.6   | 5.50           | -10.5           |
| <b>Eurozone</b>    | 1.1        | 0.4   | 1.1   | 5.5       | 3.5   | 4.00           | -10.4           |
| <b>UK</b>          | 1.7        | 0.2   | 1.0   | 7.5       | 3.5   | 5.25           | -8.7            |
| <b>Switzerland</b> | 1.3        | 0.7   | 1.2   | 2.0       | 2.2   | 1.75           | -17.8           |
| <b>Japan</b>       | 1.1        | 1.8   | 1.0   | 3.0       | 2.0   | -0.10          | 4.2             |
| <b>China</b>       | 4.5        | 4.5   | 4.5   | 0.5       | 1.5   | 4.35           | 2.3             |
| <b>Brazil</b>      | 1.4        | 3.2   | 1.7   | 5.0       | 4.0   | 12.75          | 0.0             |
| <b>India</b>       | 5.0        | 6.3   | 6.5   | 5.3       | 4.5   | 6.50           | 7.2             |
| <b>Russia</b>      | 1.0        | 0.8   | 0.9   | 5.2       | 5.0   | 13.00          | 27.4            |
| <b>World</b>       | 3.0        | 2.9   | 2.7   | 6.0       | 4.8   | –              | –               |

Source: Refinitiv, Wellershoff & Partners

**Fig. 2: Real interest rates gradually return to positive territory**

Inflation adjusted (= real) interest rates in industrialized countries since 2000

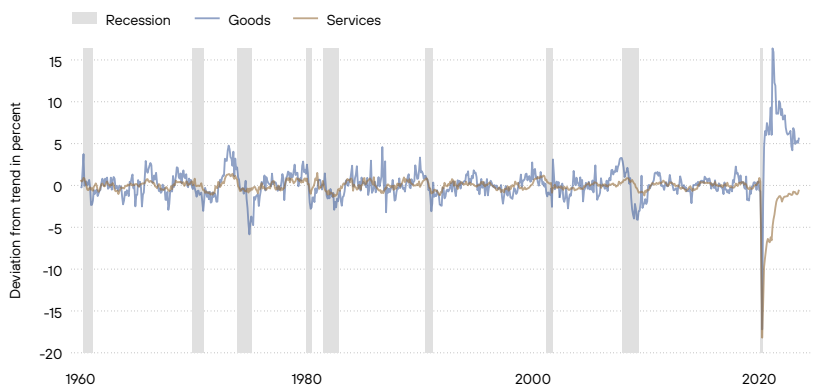


Source: Refinitiv, Wellershoff & Partners

Central banks of industrialized nations have had real interest rates (interest rates adjusted for core inflation) significantly below zero over the past two years. Only gradually, through further interest rate hikes and the decline in inflation, are real interest rates moving back towards positive territory.

**Fig. 3: US goods consumption remains at exceptionally high levels**

Inflation adjusted (= real) US consumption compared to its trend level since 1960

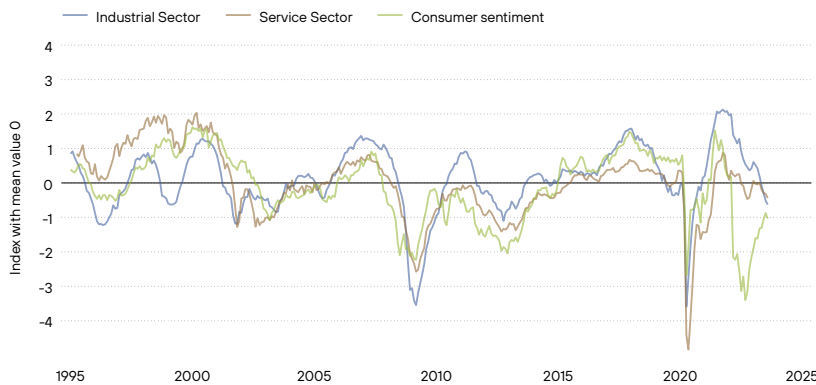


Source: Refinitiv, Wellershoff & Partners

The consumption patterns of American households have significantly shifted amid the Covid-19 pandemic. There was a notable increase in the consumption of goods, while services experienced a decline. Although service consumption has since normalized, the consumption of goods continues to remain significantly above its long-term trend level.

**Fig. 4: Sentiment in the Euro area highlight the economic challenges**

Sentiment indicators in the Euro area since 1995



Source: Refinitiv, Wellershoff & Partners

The sentiment among service and industrial companies in the euro area has further deteriorated in recent months, reflecting the challenging economic outlook. While consumer confidence has slightly improved, it remains at a low level.

## Foreign Exchange

The disparity in economic strength among industrialized nations is reflected in the currency markets. Thanks to the robustness of the US economy, the US dollar has rebounded from its extended period of weakness since the end of last year and undergone a significant appreciation in the third quarter of this year. When measured on a trade-weighted basis, the value of the American currency is now approximately 3 percentage points

depreciated by about 4 percent against the US Dollar, while the British pound experienced an even sharper decline of 5 percent.

Despite the trend of weak economic performance, the Swiss franc successfully managed to resist a downward spiral. Although the Swiss currency lost some momentum in September due to the unexpected decision by the Swiss National Bank to hold off on further interest rate hikes, its overall quarterly performance remained positive compared to most currencies.

### Japanese yen continues to decline

The Japanese yen continued to face a notable depreciation in the third quarter of this year and remains the most undervalued G-10 currency. The Bank of Japan's unwavering commitment to ultra-expansive monetary policies, despite high inflation rates, has exerted tremendous pressure on the currency. Conversely, the Chinese renminbi has stabilized. After intentionally allowing the currency to depreciate for an extended period to bolster its domestic economy, the Chinese government has implemented measures to prevent further devaluation. Since mid-August, the Chinese currency has predominantly moved sideways.

«Resilient US economy strengthens the dollar.»

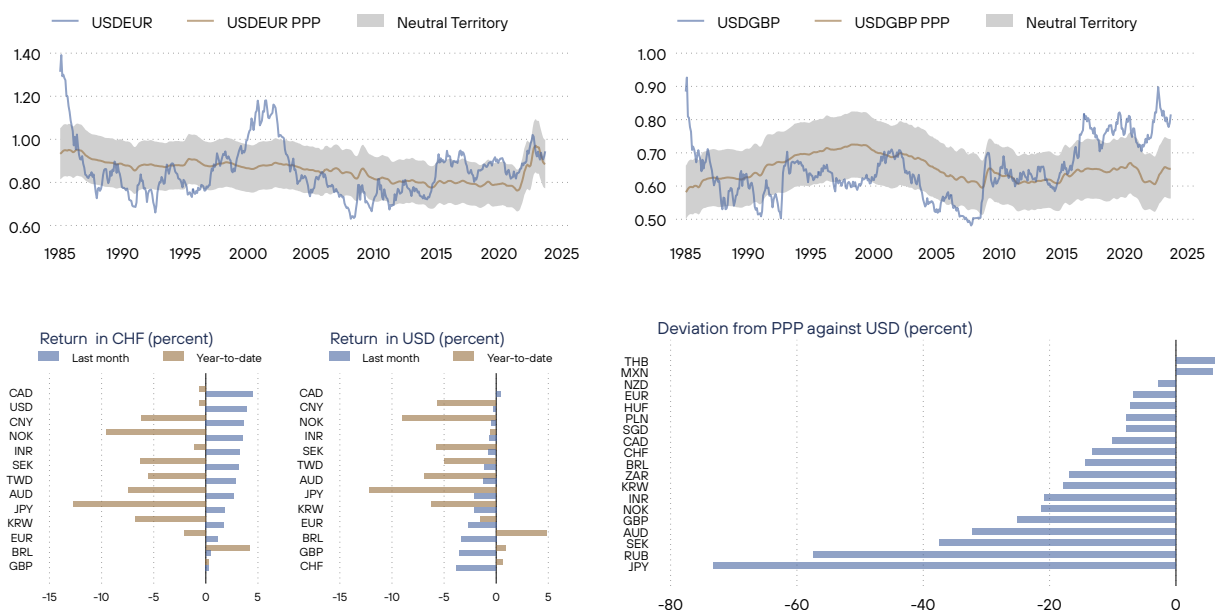
higher than at the beginning of the year. With this recent appreciation, the US dollar remains significantly overvalued against most currencies from the perspective of purchasing power parity.

### Weak euro and British pound

On the contrary, the euro and the British pound faced devaluations over the last quarter, indicating a threat of an impending recession. The euro

**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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