Quarterly Macro Report – 1st Quarter 2024

The global economy is at a critical turning point: China is facing ongoing challenges, growth is stagnating in Europe, and the United States is witnessing a significant slowdown. Encouragingly, there has been notable progress in the fight against inflation.

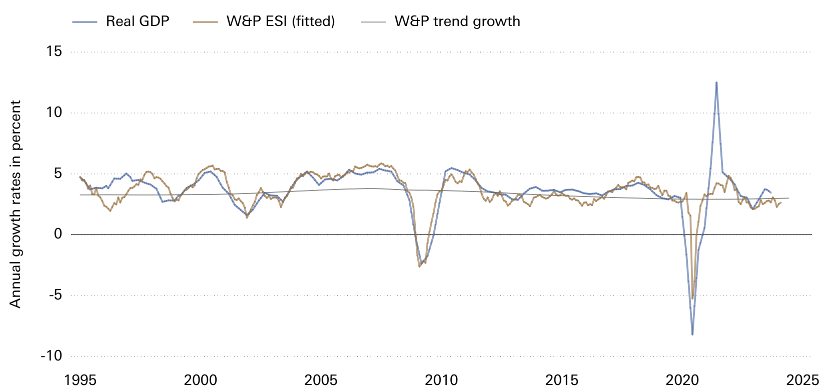
Even if the darkest predictions of the past year, such as a potential shortage of gas and electricity in Europe or an uncontrolled surge in inflation, never materialized, the backdrop for the world economy remains challenging in the new year. Economic momentum is still declining or remains at low levels across most countries.

These challenges are particularly evident in China, which is still struggling with recession and even gaining momentum. In recent months, sentiment indicators in both the services and the industrial sectors have shown minimal improvement and remain at low levels. Furthermore, the crisis in the real estate sector continues, and foreign trade figures remain well below the level of 2022. There is a risk that the inflation rate, currently standing at -0.5 percent, may continue to fall if this bleak scenario persists. Additionally, the poor numbers in China's external sector and the subdued price development are clear indicators that global demand for goods remains low or may decline even further.

Europe is close to a recession

The weak goods cycle also weighs heavily on Europe. The substantial decline in both exported goods and imports of intermediate goods vividly illustrates the weak international demand for European products. Against this backdrop, the growth of Europe's economy has come to a complete standstill throughout 2023. The low point, however, may still be on the horizon. In the fourth quarter of last year, economic momentum in Italy and France significantly slowed down. There is therefore the threat of the entire European economy gradually converging with that of Germany, which remains in recession and is not yet showing any signs of recovery.

Fig. 1: Leading indicators pointing towards a cooldown



Source: LSEG, Wellershoff & Partners

Thanks to the resilience of the United States and the strong performance of major emerging market economies like India, the world economy has grown above its trend levels over the past year. However, leading indicators suggest a slowdown in the coming six months with momentum expected to decline, particularly in industrialized economies.

So far, only a few emerging markets, like India or Indonesia, along with the United States have managed to escape the prevailing global economic downturn. Nevertheless, the US economy noticeably lost momentum in the fourth quarter. Industrial production, capacity utilization and foreign trade are declining in real terms. Moreover, there are early indications of a gradual slowdown in American consumer spending. While private incomes continue to grow robustly, consumer expenditures are falling below this positive trend. The default rate on credit card loans has also recently reached a new high compared to the last 10 years.

"The economic challenges have had a positive impact by notably slowing down inflation rates since the summer of last year."

Progress in inflation mitigation

The economic challenges have had a positive impact by notably slowing down inflation rates since the summer of last year. The core rate in the US fell from 4.7 percent in July to 3.9 percent in December. In the eurozone, it decreased from 5.3 to 3.4 percent in the same period. In addition to the economic downturn, the substantial depreciation of the Renminbi is also likely to have played a role in mitigating inflation. This devaluation has enabled many Western companies to procure their intermediate goods at lower costs, thus reducing price pressure.

Still, it would be premature to declare victory over inflation at this point. Further progress in curbing inflation is likely to be difficult. Currently, wage growth in both the US and Europe exceeds 5 percent, well above the prevailing inflation rate. This considerable increase in real income is expected to boost household consumption in the upcoming months, keeping overall economic demand at a high level. The recent marginal decline of only 0.2 percent in the core inflation rate in the United States from September 2023 to December 2023 should be seen as an early warning signal.

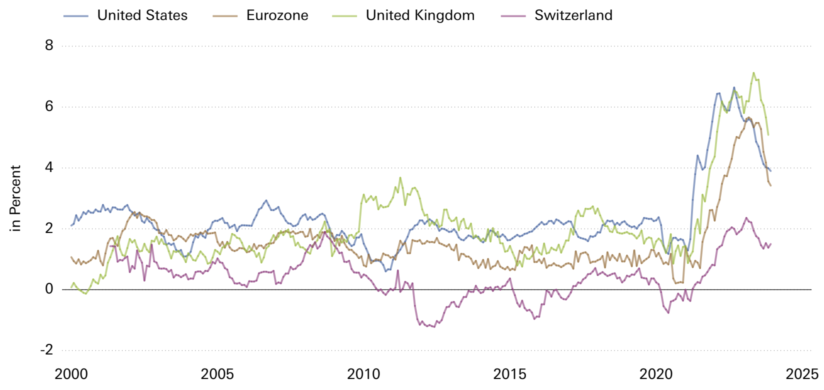
Table 1: Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2023*E*	2024*E*	2023*E*	2024*E*	Q1 2024	y/y 01/2024
USA	1.6	2.4	1.2	3.8	3.4	5.50	–9.7
Eurozone	1.1	0.2	0.8	5.5	3.5	4.50	–9.3
UK	1.7	0.2	0.8	7.0	3.5	5.25	–9.8
Switzerland	1.3	0.5	1.2	1.9	2.0	1.75	–18.7
Japan	1.1	1.8	1.0	3.0	2.0	–0.10	3.8
China	4.5	4.5	4.5	0.5	1.5	4.35	1.3
Brazil	1.5	3.0	1.7	5.0	4.0	11.75	0.5
India	5.0	6.3	6.5	5.3	4.5	6.50	7.9
Russia	1.0	0.8	0.9	5.2	5.0	16.00	15.4
World	3.0	2.9	2.7	6.0	4.8	–	–

Source: LSEG, Wellershoff & Partners

Fig. 2: Substantial progress in mitigating inflation

Core inflation rates in industrialized economies

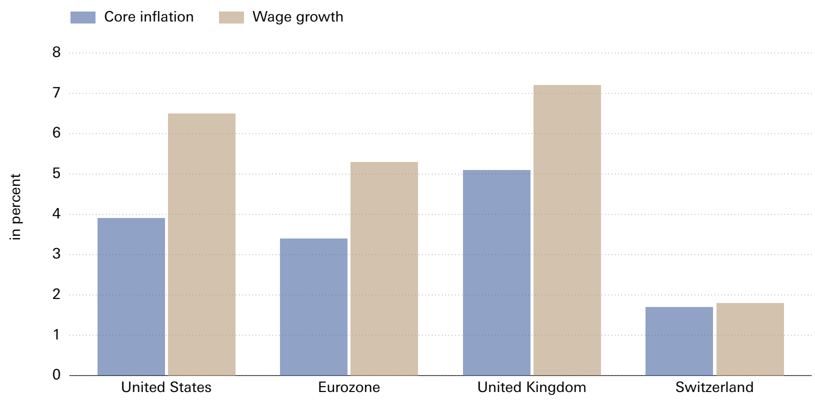


Source: LSEG, Wellershoff & Partners

Against the backdrop of weak economic momentum, core inflation rates have significantly decreased in most industrialized economies since last summer. Achieving further progress, however, is likely to be difficult.

Fig. 3: Wage growth significantly surpasses inflation

Annual growth rates of wages and inflation in industrialized economies

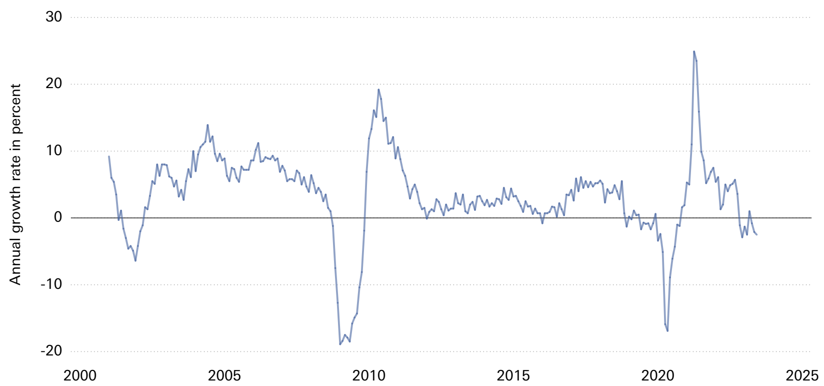


Source: LSEG, Federal Reserve Bank of Atlanta, Eurostat, BFS, Wellershoff & Partners

Wages currently grow significantly stronger than inflation. This increase amends purchasing power losses from previous years when wages failed to keep pace with inflation. The strong wage growth is expected to support consumer spending and overall economic demand.

Fig. 4: World trade in decline

Annual growth rate of world trade



Source: LSEG, Wellershoff & Partners

The ongoing decline in global goods demand is evident when looking at the significant drop in worldwide trade volume compared to the previous year. This weakened trade volume is also reflected in the decreasing foreign trade figures of many industrialized nations.

Capital Market

Last fall, long-term interest rates rose significantly. For example, the yield on 10-year US treasuries reached a high of almost 5 percent in October. However, they fell again considerably in November and December, even dipping below 4 percent. A similar trend was observed for European government bonds; the yield on 10-year German government bonds dropped from nearly 3 percent in October to 2 percent by the end of the year.

> "The downside potential in capital markets is considerable."

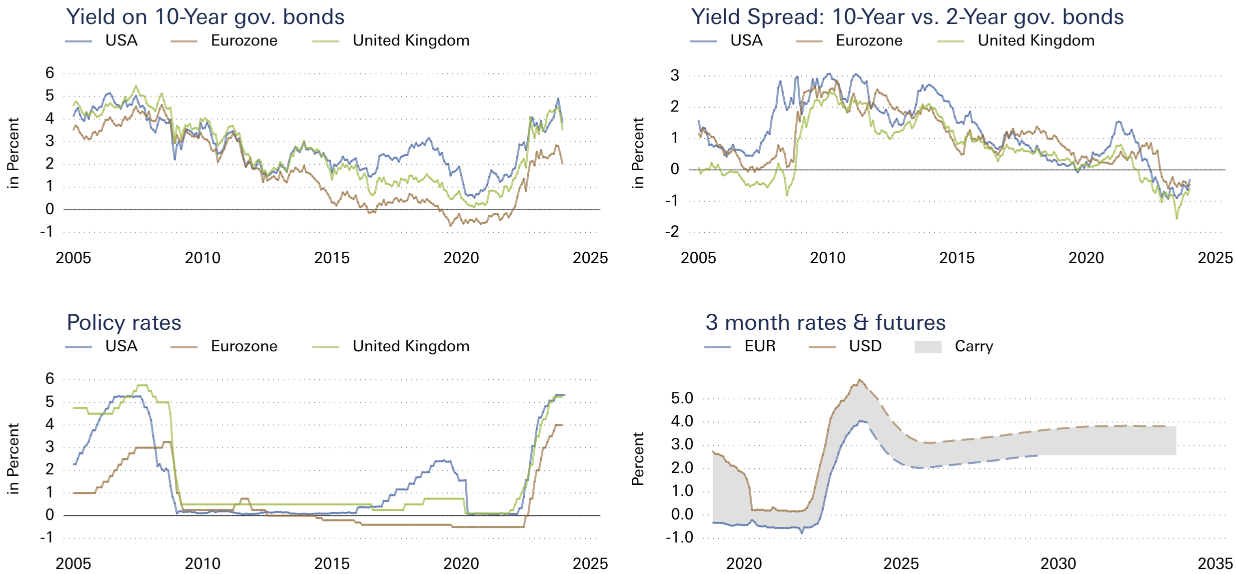
The noteworthy decline in long-term interest rates at the year's end is attributed to successful efforts in controlling inflation in 2023, surpassing most expectations. The lower rates also suggest the anticipation of significant cuts in policy rates by central banks this year. The Federal Reserve's monetary policymaking body (FOMC) gives further evidence of these expectations by stating that in its latest meeting, the majority of its members anticipated a cumulative reduction of 75 basis points in 2024. However, given the recent minimal progress in core inflation, a substantial rate cut seems unlikely in the near future.

Deepening the yield curve inversion

Nevertheless, these shifts along the longer end of the yield curve have exacerbated the unusual situation where the long-term investment horizon is notably less rewarding than the short-term. This so-called "inversion" of the yield curve has traditionally been associated with recessions. But this scenario is not consistently reflected in the financial markets. Credit spreads, i.e. the difference between the yields of risky bonds and government bonds, are still very low and cannot be compared with the levels seen in times of recession. Traditionally, these spreads widen in the event of economic turbulence,

The downside potential in capital markets is thus substantial. Both the scenario of persistently high inflation rates and the scenario of a continued sharp decline in inflation due to further economic weakening would cause significant disappointment.

Fig. 5: Money market and capital market interest rates



Source: LSEG, Wellershoff & Partners

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