

## Quarterly Macro Report – 3rd Quarter 2023

The momentum of industrialized economies continues to decelerate, as both the industrial and service sectors adopt a more cautious outlook. A slowdown in the economy would be welcomed by concerned central banks since inflation rates prove to be stubborn.

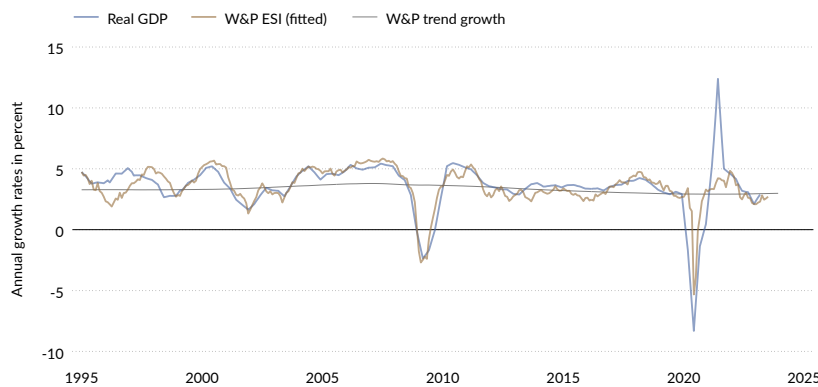
Inflation dynamics in industrialized countries reaffirm the challenge of containing the genie once it's out of the bottle. Although overall inflation rates have declined due to lower energy prices, core inflation excluding volatile price components remains persistently high. In the United States and the eurozone, core rates hover above 5 percent, just a few basis points below their respective peaks. In the United Kingdom, the core rate even continues to rise.

The persistence of price increases emphasizes that inflation dynamics have entered a new phase. Inflation was initially driven by the rapid recovery from the Covid-19 pandemic, facilitated by unprecedentedly expansive monetary and fiscal policies that boosted demand and raised prices for goods. The second phase saw additional price increases due to the impact on energy costs because of Russian aggression against Ukraine. Now, inflation

has settled at a high level. Employees have been demanding higher wages to compensate for increased prices, and market participants have adjusted their inflation expectations upward. Hence, price increases now encompass not only goods but also services to a significant extent.

The continuity of inflation is sustained by the prevailing economic conditions. Despite a notable slowdown in economic growth across industrialized nations this year, a deep recession has not yet materialized. The resilience is remarkable considering the challenges posed by rising interest rates, tightening credit conditions, and dwindling purchasing power of consumers. The robust economic development is closely tied to strong labor market conditions, with exceptionally low unemployment rates empowering workers during wage negotiations and enabling them to maintain their high levels of consumption.

**Fig. 1: Leading indicators below trend**



The leading indicators suggest a global economic development slightly below trend. However, there is a significant disparity among different economic areas. While the indicators in advanced economies are significantly lower, the prospects for emerging market economies are notably more positive.

Source: Refinitiv, Wellershoff & Partners

## Something has to give

However, if the current economic momentum continues, a rapid decline in inflation rates appears unlikely, which raises concerns among central banks. This cautious outlook may lead to further interest rate hikes by the end of the year. Nonetheless, signs of a global economic slowdown are becoming more evident. Industrial companies have been reporting weakening business conditions for months, and now the services sector in Europe and the United States is gradually losing momentum as well. Additionally, there is a slowdown in wage growth, particularly in the lower income bracket, in the United States.

A continued weakness in the services sector and slower wage growth could positively impact inflation, relieving central banks and reducing the need for further interest rate hikes. However, a further decline in demand for services and consumer purchasing power would undoubtedly push industrialized nations into a recession. Hence, it is clear that something has to give. Either the economy weakens, or interest rates must continue to rise.

## China's slow recovery

Even looking east for a silver lining proves to be somewhat disappointing. The world's sec-

ond-largest economy is struggling to meet the high expectations of its economic recovery. While sentiment data for services and retail sales leave no doubt about the general trend of China's recovery, weak figures for industrial production and foreign trade numbers suggest that the upturn may not be very strong. The same can be deduced from the development in the real estate market. In

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response, the Chinese central bank has recently begun to loosen its monetary policy to stimulate domestic consumption. On a more positive note, other emerging market economies, such as India and Indonesia, have exceeded growth expectations in the first quarter of this year by a significant margin. However, these encouraging developments are unlikely to offset the impending downturn in industrialized economies.

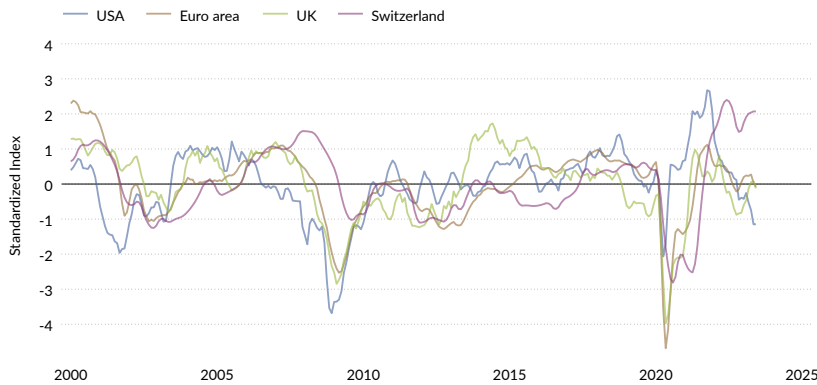
**Table 1: Macroeconomic estimates (in %)**

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2023E	2024E	2023E	2024E	Q3 2023	y/y 07/2023
<b>USA</b>	1.6	1.3	1.2	4.5	4.0	5.25	-9.8
<b>Eurozone</b>	1.1	0.6	1.4	5.0	4.0	3.50	-6.2
<b>UK</b>	1.7	0.2	1.0	6.5	5.0	5.00	-4.4
<b>Switzerland</b>	1.3	0.8	1.2	2.5	2.2	1.75	-12.2
<b>Japan</b>	1.1	1.3	1.0	3.0	2.0	-0.1	4.4
<b>China</b>	4.5	4.5	4.5	1.5	2.0	4.35	4.7
<b>Brazil</b>	1.4	1.5	1.4	5.0	4.0	13.75	-4.4
<b>India</b>	5.0	6.0	6.5	5.0	4.5	6.5	7.8
<b>Russia</b>	1.0	-1.0	0.0	6.0	5.0	7.5	36.9
<b>World</b>	3.0	2.5	2.8	5.0	4.0	-	-

Source: Refinitiv, Wellershoff & Partners

### Fig. 2: Services companies become more cautious

Sentiment among service companies in industrialized economies since 2000

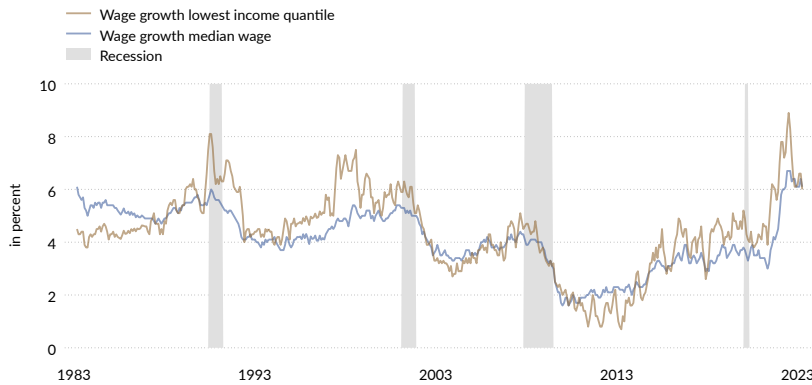


Source: Refinitiv, Wellershoff & Partners

While industrial companies have been pessimistic about the future for months, service companies are gradually becoming more cautious as well. In the US, eurozone, and UK, sentiment among service providers is below average. However, Switzerland stands out with exceptionally high levels of sentiment.

### Fig. 3: Wage growth in the US slows down

Wage development in annual growth rates in the United States since 1983

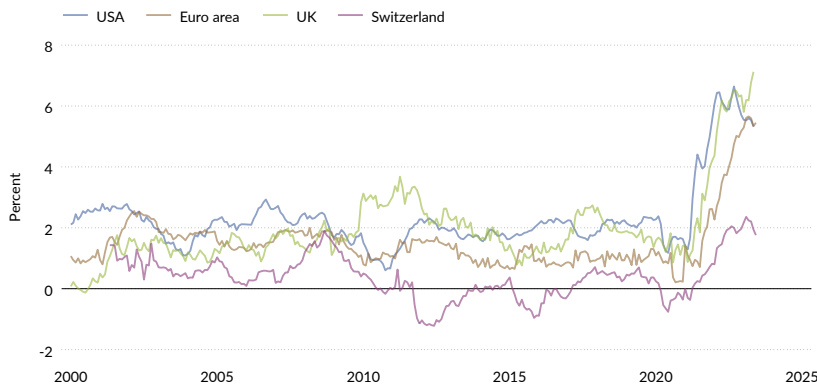


Source: Federal Reserve Bank of Atlanta, Wellershoff & Partners

The strong labor market has resulted in a substantial rise in wages in the United States over the past two years. However, there is now a clear decline in wage growth, particularly in the lower income bracket. Historically, this trend has often coincided with the onset of a recession.

### Fig. 4: Core inflation rates remain stubborn

Core inflation rates in industrialized economies since 2000



Source: Refinitiv, Wellershoff & Partners

Core inflation, which measures inflation excluding volatile components, has passed its peak in most industrialized nations. However, the decline is occurring at a slow pace and with setbacks. In the UK, the core rate is even continuing to rise.

## Foreign Exchange

The persistence of inflation rates, expectations regarding central banks' future interest rate decisions, and the gradual economic slowdown also have an impact on currency markets.

Despite challenging conditions, the US dollar has temporarily halted its downward trend observed since last fall. Its current value, on a trade-weighted basis, is similar to the value it had at the end of March. However, considering the

## Strong Latinos

Since the beginning of the year, several Latin American currencies have experienced substantial appreciation. The Colombian peso, Mexican peso, and Brazilian real have all gained over 10 percent against the US dollar. The strong performance is likely attributed to the implementation of credible monetary policies, as their central banks have decisively combated inflation by raising interest rates to over 10 percent.

## Weak Japanese yen and Scandinavian currencies

On the other hand, the Japanese yen continues to decline. In the second quarter of this year, it lost over 10 percent against the euro and the US dollar, further deepening its existing significant undervaluation on a trade-weighted basis. The Japanese currency remains the most undervalued among G10 currencies.

The Scandinavian currencies have also displayed weakness. Both the Swedish and Norwegian krona significantly depreciated on a trade-weighted basis in the second quarter. While weak energy prices affected the Norwegian krone, concerns about financial stability due to high household debt weighed on the Swedish krona.

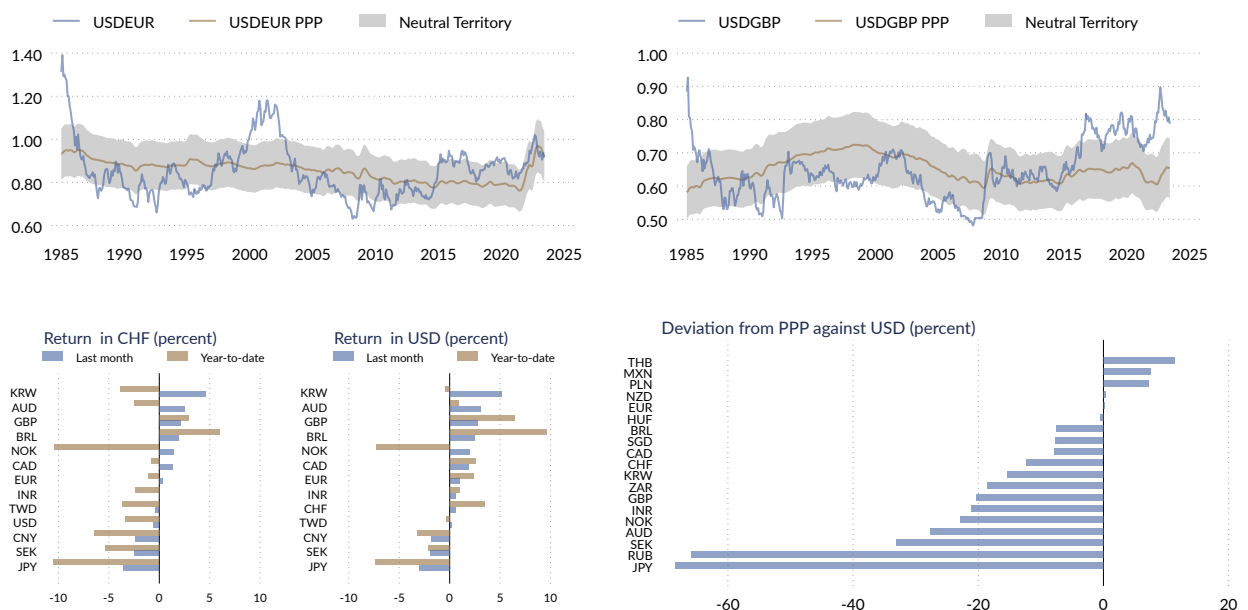
«A brief respite for the US Dollar.»

bleak economic outlook and the ongoing overvaluation of the US dollar, further depreciation would not be surprising.

Both the euro and the Swiss franc have shown stability alongside the US dollar in recent months. As a result, the Swiss currency resists the upward pressure resulting from significantly lower inflation rates compared to its trading partners and remains undervalued.

**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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