WEEKLY ANALYSIS

M. Alain Freymond—Partner & CIO

END OF RECESSION LIKELY IN Q3 ALREADY IN THE US

Technical recession confirmed in Q2. The Fed still does not believe in a recession. Strong rise in household credit. Inflation starts to decelerate. A recovery already in Q3. Stabilisation of interest rate markets. Stocks rebound.

Key points

- US economy contracts in Q2 for the 2nd consecutive quarter and enters recession
- Exit from recession already possible in Q3
- Leading indicators show a positive trend
- Increased credit to compensate for loss of purchasing power
- The Federal Reserve does not believe in a recession
- Inflation has finally started to decelerate
- Fixed income markets also anticipate a decline in inflation
- Equities also benefit from falling yields

The US ec onomy shrinks in Q2 for the 2nd consecutive quarter and enters recession

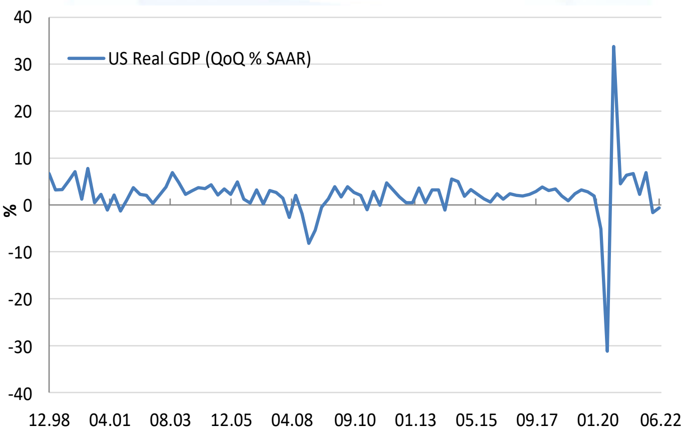
The US GDP contracted by -0.9% in the second quarter against all expectations, while investors were expecting positive growth of +0.4%. This result comes after the economic dynamic had already stalled in the first quarter, plunging by -1.6%. This is the second consecutive quarter that growth has declined, technically suggesting a recession in the US economy. Formally, the official determination of a positive or negative business cycle in the US has to be estimated and approved by a panel of experts from the National Bureau of Economic Research, which allows the Federal Reserve to not yet consider that the economy has actually entered a recession. The GDP Now index published by the Atlanta Fed at the end of June, a few weeks before the GDP announcement at the end of July, already suggested that the economy was in recession with an estimate of -2.1%.

The sharp reduction in household purchasing power in a period of historically high inflation is one of the main reasons for the economic downturn. The economy quickly lost momentum as financing conditions tightened with rising bond yields and monetary policy decisions taken in March. Personal consumption was still rather resilient (+0.7%), while residential and non-residential investment (-2.73%), housing (-2.73%), inventories (-2.01%) and government spending (-0.33%) made significant negative contributions. Spending on services increased quite significantly (+4.1%), but was offset by a decline in consumption of durable goods (-2.6%) and non-durable goods (-5.5%).

The US Federal Reserve has belatedly embarked on a fight against inflation by repeatedly raising its key interest rates. It now hopes that the rapid monetary tightening policy will ensure that the economy is resilient enough to withstand the rate hikes imposed and that it will not plunge into a deeper recession than the one already underway. The US administration also remains convinced that the strength of the labour market and a low unemployment rate provide strong support for the thesis that the economy is still growing.

The rise in key interest rates has already had a major indirect impact on credit card usage costs, car leasing rates and mortgage rates, which have almost doubled in a few weeks. It therefore seems difficult to rule out all the risks of a further weakening of the economy. It is therefore difficult to dismiss the risks of a further weakening of the US economy in the coming months in such an uncertain environment.

Quarterly GDP growth - United States



Sources: Bloomberg, BBGI Group SA