

WEEKLY ANALYSIS

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THE BEARISH SCENARIO NEEDS TO BE REVISED

Energy and commodity prices are finally declining. Inflation may have peaked. Recession risks outweigh inflation fears. The bearish scenario is widely shared. Markets likely to rebound in Q3.

Key points



- Recession risks intensify
- Consumption and production are adjusting
- Inflation persists but will decline in the second half
- The recent fall in commodity prices is reducing inflationary pressures
- Central banks are forced to tread carefully in raising interest rates
- The worst may be over in the short-term capital markets
- A window of opportunity is ready to open in the financial markets
- The bearish scenario is widely shared

Recession risks intensify

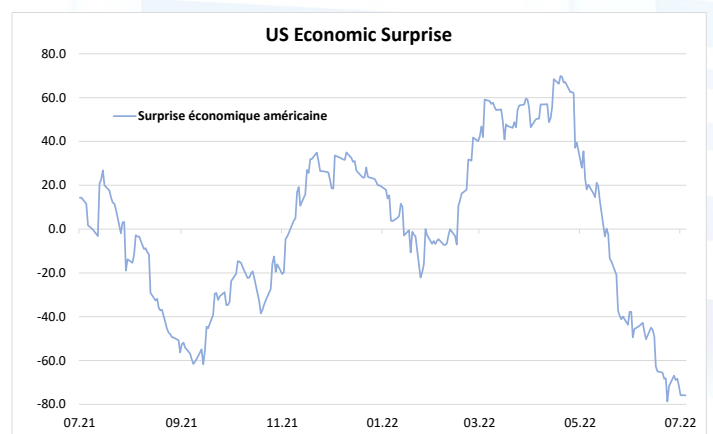
The risks of recession are undoubtedly intensifying, mainly due to the loss of confidence of households and their growing difficulties in maintaining their level of consumption in the particularly penalizing context of the rise in energy, transport and food prices in recent months. The purchasing power of American and European households has already been severely impacted by the explosion in the costs of several important items of their consumption. In the United States, the rise in nominal wages is notable, but it only very partially offsets inflation and households no longer have savings reserves that have been largely used since 2020 to cope with it. The expected decline in household consumption is likely and will also have consequences for investment and production.

Leading indicators have already been weakening for several months in both the industrial and service sectors, logically reflecting this likely development. The rise in financing costs, which is less related to the rise in key rates than to the sudden adjustment of the yield curves, is having a negative impact on all economic agents.

The major adjustment of mortgage rates (30 years) from 2.8% to 5%, now at the highest level of the decade, will not be without effect on the capacity of households to acquire real estate, especially as the level of prices is still close to its highest levels.

The Federal Reserve is reassuring that the US economy is sufficiently dynamic to withstand the rate hikes that the institution is preparing to implement to fight inflation. The US economy, like others, is already reacting to rising inflationary shocks from external factors by adjusting consumption and production without waiting for central banks to act to try to prevent future price slippages.

The markets are therefore already aware of this new paradigm and are adjusting quickly. Therefore, the real question is again whether the Fed's restrictive action is justified. It could be excessive and reinforce the adjustment mechanisms already at work at the risk of greatly increasing the likelihood of recession. The economic surprises have been rather negative for several months, as shown by the Citigroup's index has been declining sharply since May. The publication of the Atlanta Fed's GDPNow indicator also surprised by indicating a sharp drop in a few days in the US GDP estimates for Q2 of +0.5 estimates for Q2 from +0.72% on 28 June to -2.07% on 1 July. The US economy would therefore have already entered a recession by 30 June according to this indicator, thus upsetting current expectations of +0.9% growth and a risk of recession later in the year.



Source: Bloomberg, BBGI Group SA