WEEKLY ANALYSIS

M. Alain Freymond—Partner & CIO

ATTRACTIVE DISCOUNT FOR UK EQUITIES

Recession likely in 2nd half. Leading indicators fall. Household confidence erodes. Inflation finally falls. End of rate hike cycle. Real estate consolidates. Attractive valuation of equities.

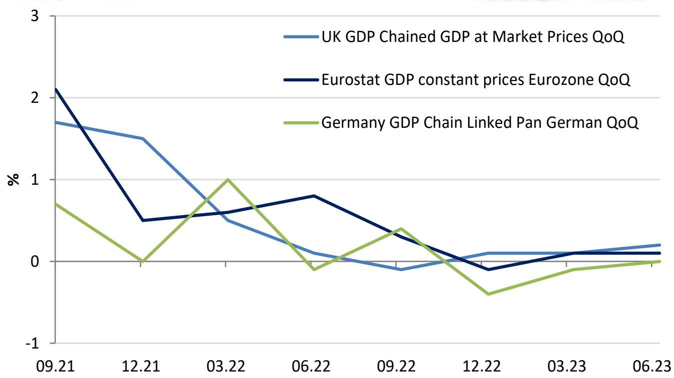
Key points

- Resurgence of risks to the British economy
- Recession in the 2nd half
- Further worrying declines in leading indicators
- Significant downturns in the job market
- Household confidence and questioning
- Inflation finally coming down
- The Bank of England sees the end of the interest rate hike cycle in sight
- New highs for interest rates?
- Sterling could benefit from more attractive yields
- Real estate continues to consolidate
- Discount still attractive for equities

Resurgence of risks to the British economy

For several quarters now, the British economy has been resisting economists' forecasts of a likely recession. In Q2, it seems once again to have surprised forecasters, posting another slight increase of +0.2%, ahead of the forecast of stagnant growth (0%). This follows a small rise of +0.1% in Q1, but is the strongest increase for a year. However, the British economy remains threatened by a complicated situation in the labor market, real estate, foreign trade, industrial production, inflation and, finally, domestic demand. This positive result once again enables us to avoid a recession at the end of June, and to avert the immediate spectre of two consecutive quarters of decline. At the end of June, inflation still out of control, a restrictive monetary policy and rising financing costs had not yet had the effects logically expected, as they had not weighed sufficiently on momentum to push the economy into decline. Naturally, the outlook does not seem any better to us today, particularly in view of the persistence of inflation and the need for the BoE to pursue its policy of rate hikes in an attempt to bend the trajectory of price rises. The economy's overall resilience is essentially due to a domestic dynamic that remains surprisingly resilient, underpinned by a +0.7% rise in private consumption and a marked +3.1% rise in public spending over the quarter. At the end of June, therefore, the British economy was in a very weak state of growth and, in our view, temporarily in a state of suspended animation, as the forces at play should eventually bite back more sharply on consumption and investment, which were stable over the period. On an annual basis, GDP growth was still +0.4%. We do not believe that this result is a sign of recovery, but rather that the third quarter should begin to show real weakness in the economy, which should then be less supported by these two domestic components.

Quarterly GDP growth-United Kingdom



Sources: Bloomberg, BBGI Group SA

Recession in the 2nd half

Household resilience is likely to flag a little as government spending also stabilizes. As a result, a real slowdown should finally occur in Q3, and certainly continue towards the end of the year. The recent publication of GDP figures for July already seems to confirm this forecast of a decline in UK activity. The British economy recorded a net decline of -0.5% in July, the sharpest fall for seven months.