J. Safra Sarasin
Cross-Asset Weekly

09 June 2023

Staying defensive

Economic activity in the past few months has surprised on the upside, while core inflation rates have remained stubbornly high. Still, some of the tailwinds that have supported global growth appear to be fading. Fundamentally, we stick to our view that the most aggressive rate hike cycle in decades will weigh on activity, albeit recognising that this might take more time than usual. As a result, we have pushed out our call for a US recession to 4Q23. Revisions to past data suggest that the euro area is already in a downturn, as we had anticipated, though spending on travelling means growth should pick up somewhat over the summer months. We think that policy rates are close to their peak in the US and Europe, and that the BoJ will start adjusting YCC later this year. The deteriorating economic backdrop is generally favourable for high quality fixed income instruments, with the prospect of lower bond yields over the next 6 to 12 months. We retain our positive view on Emerging Markets local currency debt. We have become more positive on the US dollar, in particular against the euro and the pound sterling. We remain positive on the Japanese yen and Swiss franc. In equities, we stick to our defensive preference and have upgraded the real estate sector to 'most preferred'.

The Fed and the ECB meet next week. Both probably need to tighten policy a bit more, though the Fed is likely to take a step back in June and favour a July hike. The ECB will most likely increase rates by 25bp at its next meeting, but will increasingly take into account forward-looking indicators in order to calibrate its eventual policy stance.

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Monthly macro and strategy forecast update

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Economic growth surprised positively in 1H23, reflecting falling energy prices, generous fiscal support in Europe and China's reopening. These forces, however, appear to be petering out. While spending on travelling should boost activity over the summer months, tightening lending standards and weaker demand for credit are likely to depress growth as we move into 2024. We expect the US and UK to slide into recession in 4Q23 and the euro area barely to expand. Nonetheless, services inflation will take time to drop to more normal levels, reinforcing our view that policy rates will remain elevated through the end of the year. Still, peak central bank rates are in sight and policymakers in several Emerging Markets economies are likely to loosen policy later this year. In China, our unchanged baseline forecasts hinge on a stabilisation in housing activity in the second half of the year but we note that downside risks to this assumption have increased. If our macro scenario turns out to be right, bond yields should fall over the next 6-12 months and high quality bonds should perform relatively well. In the near term, the US dollar is set to grind higher, particularly against the euro and sterling. Finally, we continue to favour defensive equity sectors and we particularly like euro area real estate. We have downgraded our year-end target for Chinese equities but still believe they have room to catch up with the macro data.

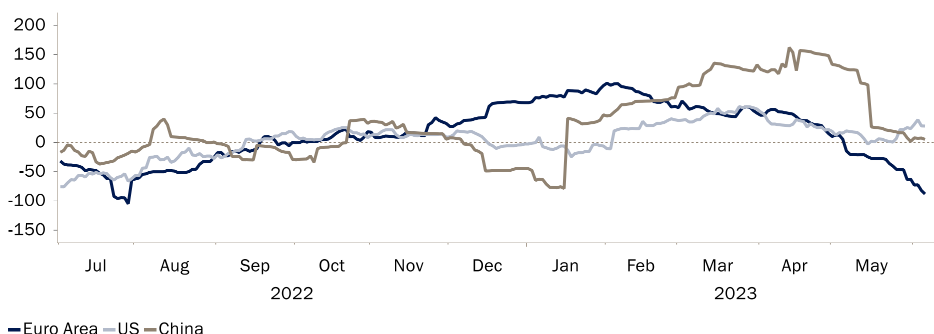
Global macro

This month's forecast changes reflect short-term dynamics rather than a fundamental shift of views

Our view remains fundamentally unchanged. We continue to expect tight monetary policy in the US and Europe to depress activity and eventually inflation, while China's services-led recovery should have limited spill-overs to the rest of the world. We think that the Consensus is too optimistic with regard to central banks' ability to soft land the economy, i.e. to bring down inflation to target while maintaining the unemployment rate at very low levels. This scenario is not impossible – this cycle is very different to previous ones, and ongoing structural changes could force businesses and households to behave in unexpected ways – but simply not the most likely one, in our view. One additional layer of complexity is that sectors and regions appear to be unusually dis-synchronised, again largely a reflection of the pandemic and its associated but heterogeneous policy responses (Exhibit 1). In short, this month's forecast update largely results from changes to the near-term outlook, rather than any major shift in viewpoint.

Exhibit 1: Activity surprises are diverging again

Citi Economic Surprise Index



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

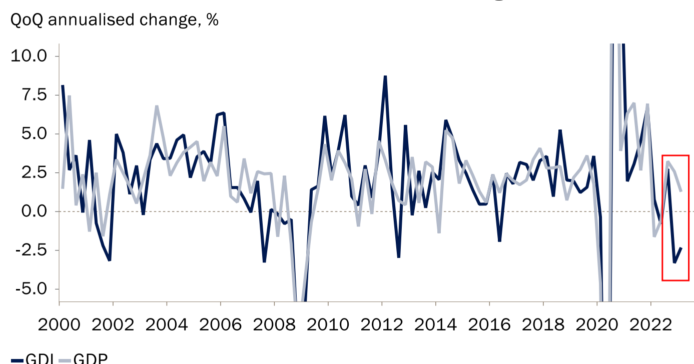
We have pushed out our US recession call by one quarter to 4Q23

Recent activity data releases in the US indicate that the economy is more resilient than previously expected (Please refer to "Getting ready for a summer hike" – *Cross-Asset Weekly*, 02.06.2023). The job market remains hot, consumers continue to spend at a descent clip and the Fed's beige book points to moderate growth in most districts. Still, other releases depict a less rosy outlook. Both the S&P Global PMI and ISM surveys suggest that the economy has come to a standstill, leading indicators continue to point south, and gross domestic income (which, as GDP, measures national output but from the income side) is already contracting (Exhibit 2). In addition, while stress in the regional banking sector appears to have abated, the profitability of the sector and its ability to extend new loans should remain under pressure. As a result, we continue to forecast a mild US recession later this year, with the unemployment rate eventually moving up by around 2 percentage points (the consensus expects only a 1pp rise). Yet the downturn is likely to take more time to materialise than we previously anticipated, and we have pushed out our call by one quarter to 4Q23. We have therefore revised up our 2023 GDP growth forecast to 1.4%, from 0.7%, but revised down our 2024 forecast to -0.8%, from -0.5%.

Fed is likely to hike once more to 5.50%

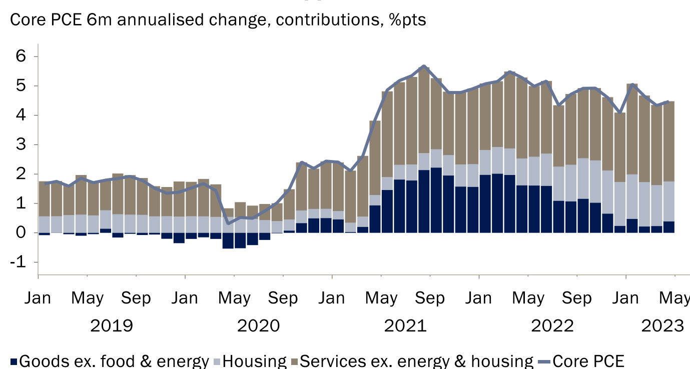
The combination of strong demand and a tight labour market is contributing to the persistence of inflation and is likely to force the Fed to tighten policy somewhat more than we previously thought (Exhibit 3). We now forecast one additional hike in July, which would push the upper band of the Fed funds rate to 5.50%.

Exhibit 2: Gross domestic income is contracting



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 3: US core inflation appears to be stuck between 4-5%



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Euro area GDP is set to grow at 0.5% this year. We have also made some small adjustments to our inflation forecasts on the back of lower energy prices

Moving to the euro area, we have revised down our GDP growth forecast for 2023 to 0.5% from 0.6% (yesterday's downward revision to Q1 GDP by Eurostat means that the risk to our annual forecast is skewed to the downside). And at 0.7%, our 2024 forecast remains far below consensus. More importantly, it seems that the rebound in economic activity, in part driven by the drop in energy prices in early spring, is already fading. Higher interest rates are depressing credit growth and will continue to do so in the coming months. Still, excess savings, labour shortages and pent-up demand for services, in particular travelling, should prevent a broader slowdown of private consumption over the summer. We have also lowered our inflation forecasts for this year, reflecting lower energy prices. We note though that we remain significantly less optimistic than the ECB with respect to the outlook for core inflation. In our view, stickier core prices will prevent any policy rate cuts this year, and force the ECB to keep the policy rate somewhat above the neutral rate in 2024.

We continue to expect inflation in Switzerland to move back to target in 2024

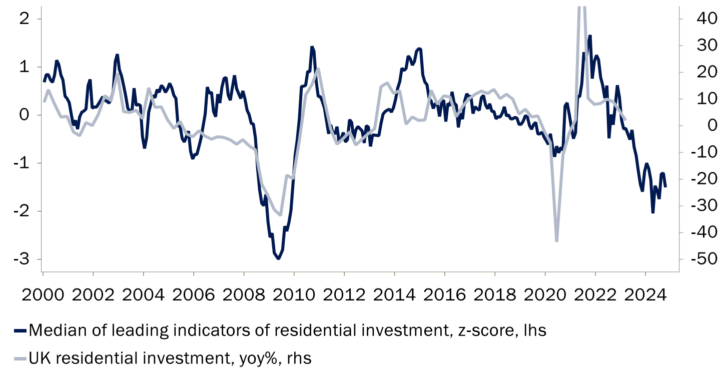
The Swiss economy is slowing down too, led by the manufacturing sector. But so far, the services sector remains resilient. We have reshuffled our inflation forecasts, lowering them to 2.3% from 2.4% for this year but increasing them to 2% from 1.9% for next year

when the VAT is set to increase. Rents – that are linked to mortgage rates – might also be increased overtime, slightly adding to inflationary pressures. In general though, second-round effects are benign and a stronger Swiss franc is lowering import prices. We believe that the SNB will only need to hike its policy rate once more by 25bp to reach a terminal level of 1.75% at the end of June.

UK economy to fall into recession towards year-end. We now expect the BoE to hike its policy rate to 5.0%

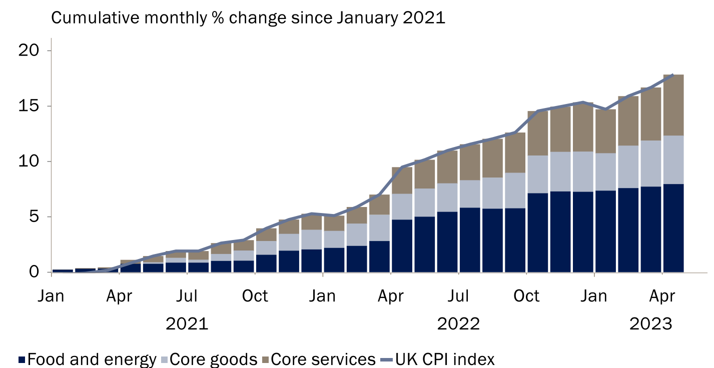
UK economic growth has also been stronger than expected, in large part reflecting lower energy prices and a tight labour market. While the pace of consumer spending has trended down over the past few quarters, it has remained in positive territory. The outlook, however, remains rather bleak. Elevated interest rates will continue to push up households' debt servicing costs, and weigh on fixed investment, both residential and non-residential (Exhibit 4). As such, we have delayed our recession call to the end of the year and we now expect GDP to expand by 0.2% in 2023 (rather than to contract by -0.4), but to contract by 0.4% in 2024 (vs. 0.6% previously). Inflation has surprised on the upside too, with both March and April figures coming way above expectations, on the back of higher core and food inflation (Exhibit 5). We have therefore increased our 2023 CPI forecast to 7.9% (from 7.4%) and our 2024 forecast to 2.9% (from 2.7%). While the Bank of England (BoE) remains worried about overshooting, it is also concerned that elevated inflation could lead to second-round effects and an un-anchoring of inflation expectations. In our view, the BoE will have to hike in June (as previously expected) and once more in August, pushing the Bank terminal rate to 5.0% (vs. 4.75%).

Exhibit 4: UK residential investment is likely to contract



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 5: Food and core prices are keeping UK inflation elevated



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

We have increased our inflation forecasts for Japan for 2023 and 2024

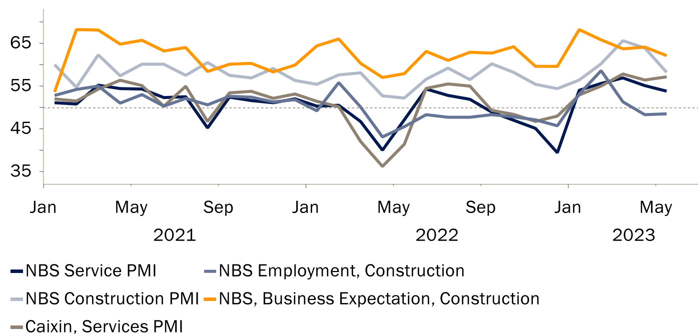
Finally, we have not made any change to our annual growth forecast for the Japanese economy (though yesterday's upward revision to Q1 GDP implies that the risk is skewed to the upside), but increased our 2023 inflation forecast to 3.0%, from 2.6%, and our 2024 forecast by 0.1 percentage point to 1.8%. These changes largely reflect higher-than-expected inflation rates at the start of the year. The case for the Bank of Japan (BoJ) to gradually ease its Yield Curve Control (YCC) policy remains strong.

The uneven recovery in China continues

In China, we note the growing divergence between the services and industrial sectors (Exhibits 6-7). After the reopening boost to the housing sector earlier in the year, activity appears to have fizzled out. Sluggish housing activity implies weak demand for industrial goods such as steel and other construction-related materials. It also adds more uncertainties to the labour market recovery which, in our view, is required for a sustained consumption recovery through the rest of the year. Our (unchanged) baseline forecasts hinge on a stabilisation in housing activity in H2 but we note that downside risks to this assumption have increased. Given poor sentiment and still rising youth unemployment, we also expect the government to come up with more measures to support growth.

Exhibit 6: Services sector remains robust

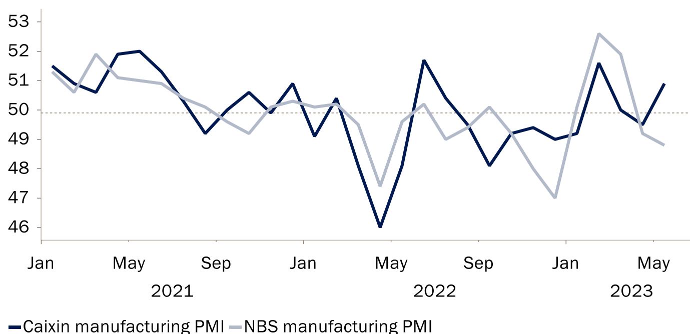
China, Non-Manufacturing PMIs, SA, Index



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 7: Weak demand is weighing on manufacturing activity

China, Manufacturing PMIs, SA, Index



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

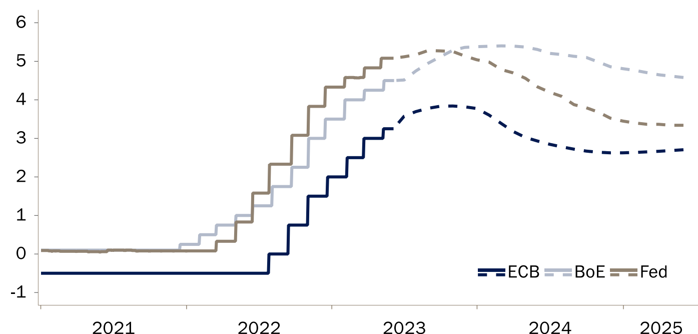
Fixed income

Market-implied policy rate expectations for 2024 are probably too hawkish

Both the US and the euro area economies have held up, so far, surprisingly given that this rate hike cycle has been the steepest over the past four decades. Still, we continue to think that market-implied policy rate expectations for late 2024 are probably too hawkish. Longer-term rate expectations appear to be too far above most estimates of the neutral policy rate, in particular for the euro area and the UK. Core inflation in these two economies has shown few signs of easing, or has even re-accelerated, putting the ECB and BoE under pressure to do some more additional tightening than the Fed (Exhibits 8-9). But the odds, in our view, will increasingly shift towards a retracement in rate expectations once uncertainty with regards to the peak rate diminishes and markets start to focus on how long central banks will keep rates unchanged.

Exhibit 8: Policy rate expectations are probably too high

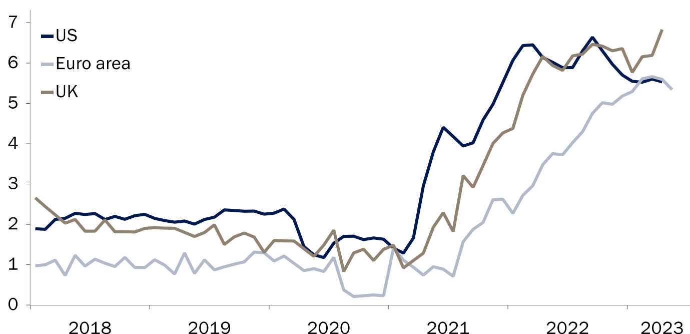
Market-implied policy rate expectations in %



Source: Bloomberg, Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 9: Eventually, EA and UK inflation cycles should follow the US

Core CPI, % yoy



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Backdrop for fixed income remains positive

The current economic backdrop continues to be positive for high-quality fixed income instruments. Inflation is set to move lower, even if it takes time, and economic growth will likely slow further, which will ultimately force central banks to loosen their policy stance. Therefore, the path is set for lower yields over the next 6-12 months. We continue to have a preference for Investment Grade over High Yield.

EM inflation to drop more rapidly, supporting local currency bonds

We also maintain our preference for emerging markets (EM) local currency bonds. We expect inflation rates to come down more quickly given that we have entered into a period

with high base effects, especially for food and energy inflation. Growth in many EMs, particularly in Central and Eastern Europe and Latin America, has significantly slowed. This should help dampen underlying inflation, although a few countries, such as Poland and Mexico, still have relatively tight labour markets. Many Asian EMs, which did not experience the same surge in inflation last year, are already seeing their headline inflation rates back within the target range (India, Indonesia and Thailand). Brazil's latest inflation rate is also within the tolerance band. While most EM central banks will start cutting rates early next year, we expect Brazil, Chile, Indonesia and Korea to start already later this year (and Hungary to continue its rate cut cycle).

FX

We expect a stronger US dollar and a weaker euro and pound sterling in coming months

Expectations about relative developments on the rates front are shaping our near-term FX convictions to a considerable extent. As of late, we have become more positive on the US dollar, while our view on the euro has turned more cautious (see FX Atlas June 2023 «A bumpy road ahead for the euro» for a more detailed discussion). Last month, we mentioned that the US dollar would grind higher if global recessionary forces were to strengthen. May's manufacturing PMIs support the notion that activity is slowing at a faster pace outside of the US, which has helped the dollar to recover to the levels it last reached at the beginning of the year (Exhibit 10). The relative weakness in the euro area manufacturing sector (Exhibits 11) reinforces our view that we are likely to see a retracement in euro area policy rate expectations and, as a result, a re-widening of the Fed's policy rate advantage (Exhibit 12). We also believe that the British pound is prone to a similar repricing in rate expectations. Hence we expect both the euro and sterling to grind lower versus the US dollar over the coming months.

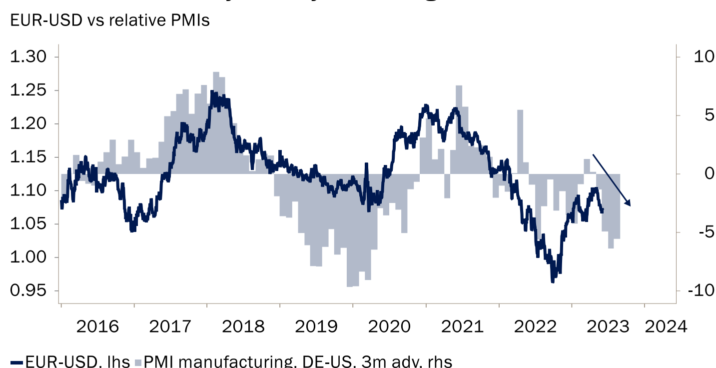
Exhibit 10: US dollar has recovered to where it started from in January

Ytd USD performance

Source: Bloomberg, Bank J. Safra Sarasin, 08.06.2023

Exhibit 11: Relative cyclical dynamics argue for a weaker euro ahead

EUR-USD vs relative PMIs



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Positive on Japanese yen and Swiss franc

We are constructive on the Swiss franc. In our view, the currency is likely to hold up well against the euro, given that the German-Swiss yield advantage should rather narrow than widen. In Japan, while we acknowledge that some more 'patience' is likely needed, we continue to expect the BoJ gradually to normalise its policy stance. Q1 GDP growth was revised strongly up, reinforcing our case that the BoJ will announce further adjustments to its YCC policy in coming months. This should push the Japanese yen higher in the second half of the year.

US dollar constitutes a near-term challenge for gold, while lower real yields should help into 2024

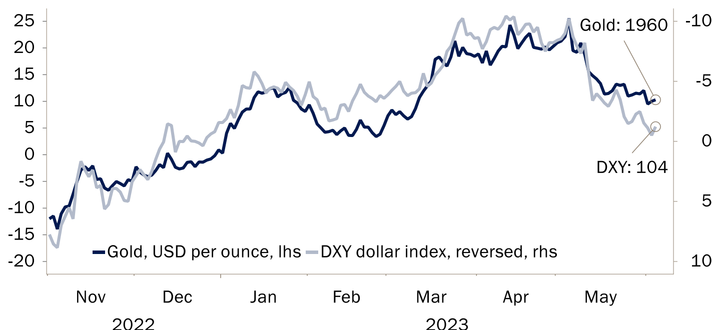
We also stick to our positive longer-term view on gold, even if the stronger US dollar should constitute a challenge for the precious metal in the near term. Over the past months, gold

has moved particularly tightly with the US dollar, indicating that some further gold retracement would be justified in the light of the dollar's recent appreciation (Exhibit 13). Given that we don't forecast any rate cate cuts this year, we shouldn't expect too much support from falling real yields over the coming months. Still, the precious metal should be better supported towards the end of the year as disinflationary forces become more evident, allowing central banks to consider loosening policy.

Exhibit 12 US-EA policy rate differential passed its narrowest point

Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 13: Stronger dollar points to near-term downside for gold



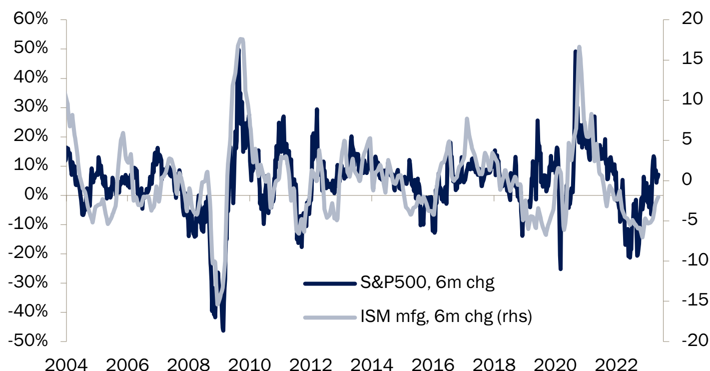
Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Equities

Macro data has seen a turning point and rates have been more stable, supporting equities

The equity market recovery since the beginning of the year has benefitted from two factors. On the one hand, even though macro data remains weak, it has troughed at low levels. Macro momentum (the 6-month change in the US ISM) has turned slightly less negative as result (Exhibit 14), marking the turning point for equity performance in Q4 2022. On the other hand, rates have stabilised, removing a key pressure point for valuations, which could re-rate and move back up to levels last seen in Q2 2022 (Exhibit 15).

Exhibit 14: Macro momentum trough marked turning point in equities



Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Exhibit 15: US yields stabilised, removing a headwind for valuations

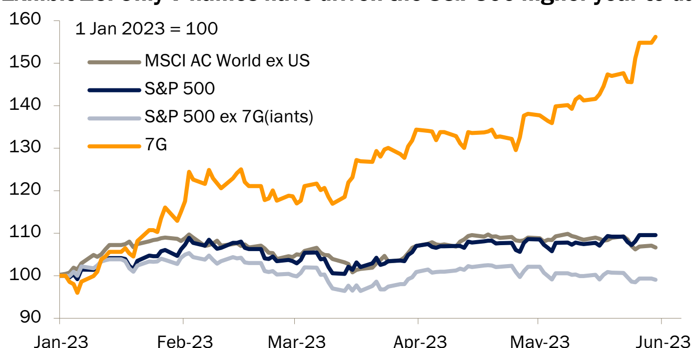
Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

US equity performance has been extremely narrow

Despite the stabilisation of those key drivers, the market's rebound has been extremely narrow. The seven largest stocks in the S&P 500 have delivered all of the performance since the beginning of the year (Exhibit 16), with less than a quarter of S&P 500 names outperforming year-to-date. Tech and tech-related names have been the dominant force driving the market higher over recent months, taking relative valuations for tech back to

the highest level since the early 2000s. The previous two times tech was similarly expensive as today (relative to the market), was in November 2007 and in December 2021 (Exhibit 4). Both times, the equity market was at the cusp of a multi-month sell-off. This does not go to say that this is about to happen this time around, but shows that the market stands on a fragile footing, with little assurance of the recent rally to continue.

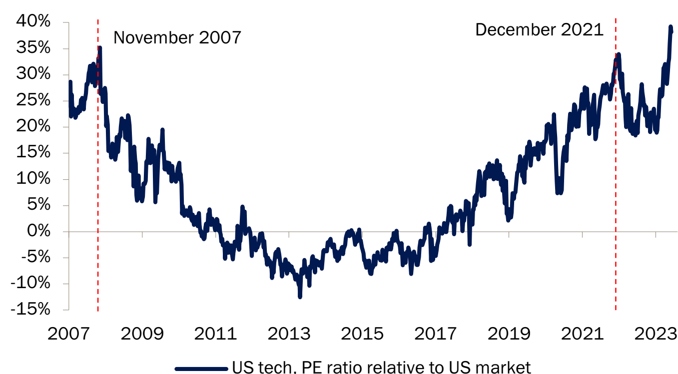
Exhibit 16: Only 7 names have driven the S&P500 higher year-to-date



*7G(iants) = Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla

Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Exhibit 17: Tech relative more expensive than in 2007 and in 2021

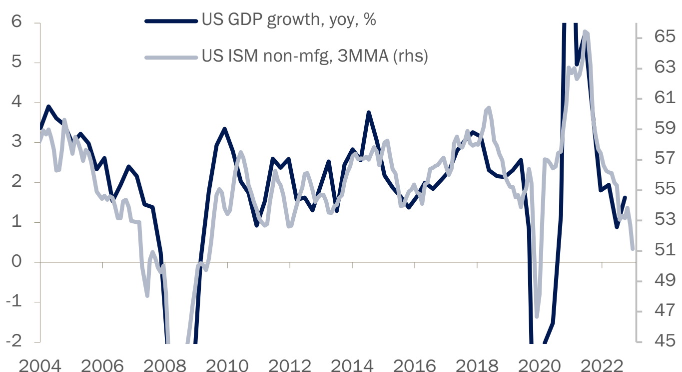


Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

We remain cautious as data in May has shown surprising signs of weakness, in particular in the services sector

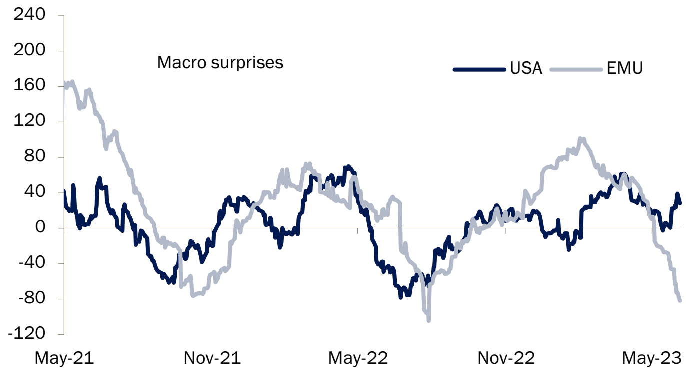
What keeps us cautious from a fundamental point of view is the renewed deterioration in US macro data in May, specifically on the services side. A pocket of strength in recent months, the US services ISM dropped sharply in May and took the 3-month moving average back to levels it has touched only during recessions (Exhibit 18). This decline is not just sending warning signals over the health of the US consumer, it also implies that US GDP growth has slowed sharply in the second quarter. Other data has held up somewhat better in the US (e.g. labour market numbers), keeping macro surprises in positive territory, while they have slumped in Europe. Euro area macro surprises have moved from the highest level in two years in January to the lowest level since mid-2022 (Exhibit 19).

Exhibit 18: Softening services data points to weaker Q2 GDP growth



Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Exhibit 19: Macro surprises in Europe have slumped



Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Euro area macro surprises have fallen sharply, implying euro area underperformance

Given that euro area equities are more cyclical and more geared towards the domestic economy than equities in any other region, they closely track euro area macro surprises. The recent slump implies a more sustained underperformance versus global equities from a tactical point-of-view (Exhibit 20).

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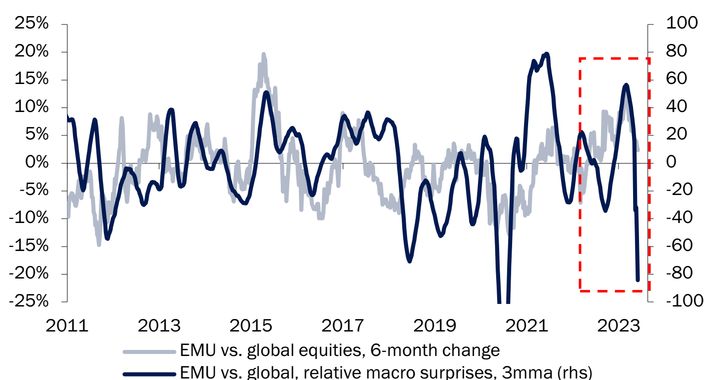
Preference for euro area real estate

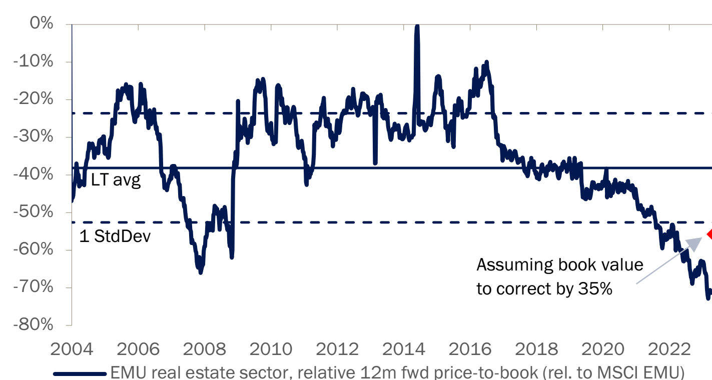
While we have euro area equities at the bottom end of our preference list, we think there's value in the euro area real estate equity sector. We have moved the sector to "most preferred" given that it is already priced for a slump in house prices, which yet has to materialise. Even if house prices and book values of the sector were to correct by 35%, it would still look attractive (Exhibit 21). Furthermore, the sector tends to benefit from falling rates more than any other sector in the euro area market. Given our base case which projects yields in the US and Europe to drop over the coming 12 months, real estate equities stand to benefit.

Exhibit 20: Drop in macro surprises suggests weaker EMU equities



Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Exhibit 21: EMU real estate priced for a sharp house price correction

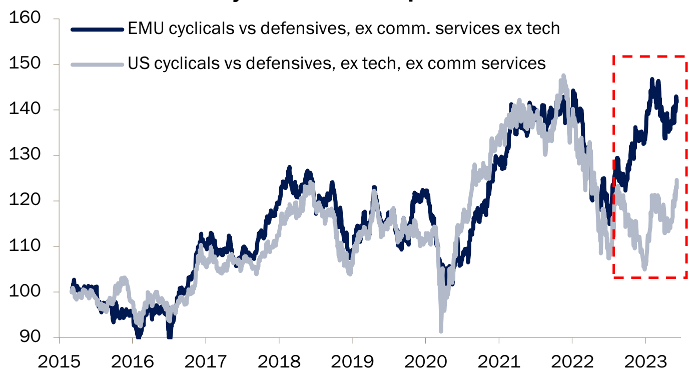


Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Euro area cyclicals are looking exhausted

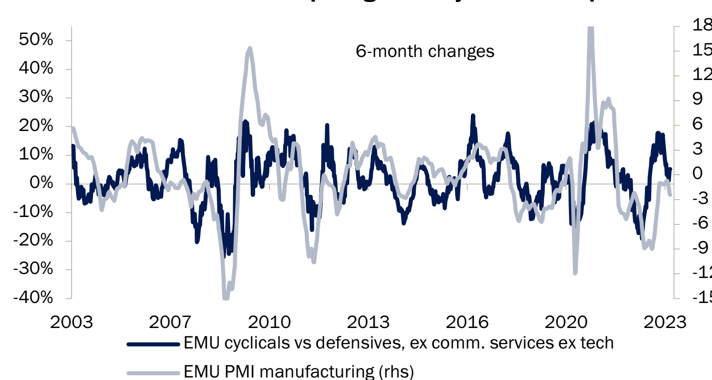
Staying with European equites, we believe there is a strong case for euro area defensives to outperform euro area cyclicals (ex tech sectors) as macro data has started to weaken once again, implying some more sustained weakness in cyclicals (Exhibits 22-23).

Exhibit 22: Euro area cyclicals have outperformed



Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

Exhibit 23: Soft PMIs in Europe argue for cyclical underperformance



Source: Refinitiv, Bank J. Safra Sarasin, 08.06.2023

We have downgraded our year-end target for Chinese equities but still believe they have room to catch up with the macro data

Lastly, we have downgraded our year-end target for Chinese equities, yet believe they still have room to catch up with fundamentals. Political risks have been a headwind in recent months and continue to loom large for the market. While we would not expect a significant escalation of tensions between the US and China, they still justify a cautious approach when adding China exposure.

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Exhibit 24: BJSS forecast overview

Breakdown per Asset Class

Equities Countries / Regions	
USA	→
Eurozone	↓
Switzerland	↑
United Kingdom	↓
Japan	↓
Emerging Markets	→
China	↑

Equity Sectors	
Energy	→
Materials	↓
Industrials	↓
Consumer Discretionary	→
Consumer Staples	↑
Health Care	↑
Banks	→
Insurance	→
Information Technology	→
Communication Services	→
Real Estate	↑
Utilities	↑

Fixed Income Performance	
US Treasuries	→
German Bunds	→
UK Gilts	→
Swiss Eidgenossen	→
IG Credit	→
HY Credit	↓
EM USD Government Bonds	↓

↑ **Overweight** → **Neutral** ↓ **Underweight**

Asset class views (overweight, neutral, underweight) express a tactical recommendation with a 3-month horizon. Tactical views might diverge from year-end stock index targets, which are based on our long-term economic and interest rate forecasts.

Stock Index Price Targets

	06.06.	2Q23	4Q23	4Q24
S&P 500	4'284	4'073	4'000	4'600
MSCI UK	2'183	2'125	2'000	2'300
DJ Euro Stoxx 50	4'295	4'200	4'300	4'600
DAX	15'992	15'686	15'800	16'800
SMI	11'468	11'337	11'800	12'600
MSCI Japan	1'375	1'212	1'200	1'300
MSCI EM	988	980	1'000	1'050
MSCI China	62	62	65	70

Key Policy Rates in %

	06.06.	2Q23	4Q23	4Q24
US Fed Funds	5.25	5.25	5.50	2.00
EUR Depo Rate	3.25	3.75	3.75	2.00
CHF Saron	1.44	1.75	1.75	1.00
BoE Base Rate	4.50	4.75	5.00	2.00
JP O/N Call Rate	-0.06	-0.10	0.15	0.15

Bond Yields (10yr Benchmark)

	06.06.	2Q23	4Q23	4Q24
USA	3.69	3.70	3.30	3.00
Germany	2.37	2.55	2.15	1.75
Switzerland	0.89	1.30	1.20	1.00
United Kingdom	4.21	3.50	3.30	3.00
Japan	0.43	0.50	0.75	0.75

FX-Forecasts

	06.06.	2Q23	4Q23	4Q24
EUR-CHF	0.97	0.97	0.96	0.95
EUR-USD	1.07	1.07	1.05	1.10
EUR-GBP	0.86	0.86	0.87	0.87
GBP-USD	1.24	1.24	1.21	1.26
USD-JPY	140	140	125	118
USD-CHF	0.91	0.91	0.91	0.86
USD-CNY	7.12	7.12	6.80	6.80
Gold, USD per ounce	1'959	1'957	2'000	2'050

Macro Forecasts

		2022	2023	2024
US	GDP	2.1	1.4	-0.8
	CPI	8.0	4.0	2.0
Euroland	GDP	3.4	0.5	0.7
	CPI	8.4	5.2	2.6
Switzerland	GDP	2.1	0.6	1.1
	CPI	2.8	2.3	2.0
UK	GDP	4.1	0.2	-0.4
	CPI	9.1	7.9	2.9
Japan	GDP	1.0	1.3	1.0
	CPI	2.5	3.0	1.8
China	GDP	3.0	5.9	4.7
	CPI	2.0	2.0	2.4

J. Safra Sarasin
Cross-Asset Weekly

09 June 2023

Fed preview

Skipping June

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Investors' expectations about the Fed's next move have swung over the past weeks, but appear for now to have settled on a June skip in favour of a July hike. We agree with this view. The data points to a more resilient economy and more persistent inflation than previously expected, but is confusing enough to justify a pause. The new dot plot is likely to shift upward, pointing to a terminal rate of 5.5%. New projections for the unemployment rate for year-end will most likely have to come down, while those for inflation to move up. Projections for 2023 GDP might have to be revised up too if Fed officials want to flag that the economy is unlikely to fall into recession this year.

The Fed to keep rates unchanged next week but flag a high likelihood of a July hike

Fed officials will meet next week to discuss how to adapt (or not) the policy stance. A hawkish skip might be how investors read Chair Powell's message following the press conference. By this we mean that officials will keep rates unchanged but flag a high likelihood of a July hike if data continues to print on the strong side. This assumes the CPI report published ahead of the meeting doesn't show a nasty pick-up in prices in May.

The labour market remains very tight and inflation sticky

Labour market and inflation data published since the Fed's last meeting, as well as lower banking stress and the resolution of the debt ceiling, should call for some "additional policy firming". The number of unfilled positions per unemployed worker jumped back up to 1.8 in April, and payrolls were strong. Savings accumulated during the pandemic remain elevated, core inflation appears to be stuck in the 4-5% range, and there is still upside risk to consumer spending on services, and hence on services sector inflation.

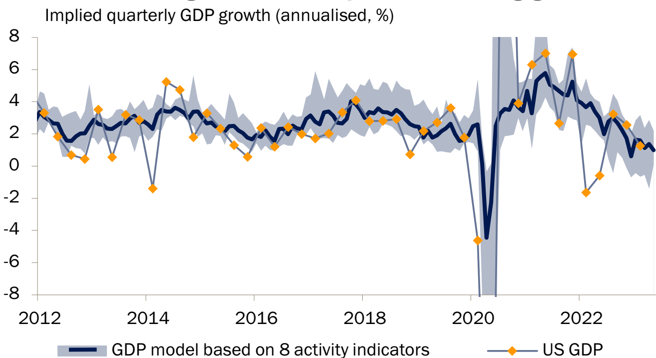
Surveys have come on the weaker side

So why skip June? Well, not everything is pointing in the same direction. The ISM services index fell to 50.3 in May, the second lowest reading since the pandemic, and all sub-components point to sub-par growth. Our GDP 'nowcast' index, which aggregates both soft and hard data, suggests that economic activity is growing at a rate of about 1%, half the pace implied by the Atlanta Fed GDPNow index (Exhibit 1). Other surveys, such as the NFIB, also point to waning corporate pricing power (Exhibit 2).

The new dot plot is likely to point to one additional rate hike this year

Still, new projections will have to take into account the stronger-than-expected start of the year, and probably indicate that unemployment is set to increase by less than previously anticipated, but also that core inflation is likely to be stickier. Year-end GDP growth could also be raised. The new median dot is likely to shift up by 25bp.

Exhibit 1: Our GDP growth tracker points to slowing growth



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 2: Corporate pricing power is weakening

Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

ECB Preview

There is still more ground to cover

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We expect the ECB to hike by 25bp and to leave the door wide open for another hike in July. The ECB is likely to stress its data-dependent approach and three criteria for its future policy decisions, rather than indicating what the likely terminal rate will be. Additionally, it will be crucial for the coming policy decisions how smoothly markets react to the huge liquidity withdrawal at the end of June when banks have to repay a TLTRO tranche of EUR 477 bl. We expect the updated quarterly macro projections to show small downward revisions to the GDP and inflation forecasts.

Three criteria that the ECB is watching:
(i) inflation outlook in light of incoming data;
(ii) underlying inflation dynamics;
(iii) the strength of monetary transmission.

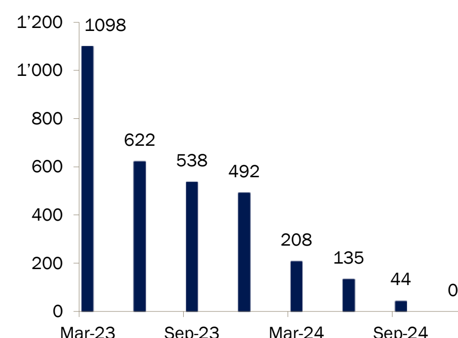
In our view, the ECB will conclude that its three criteria for its policy decisions argue for another rate hike next week. The new ECB macro projections should show small downward revisions for GDP and inflation as the growth dynamic seems to slow and energy prices have been falling (Exhibit 1). However, underlying inflation remains too strong as high wage settlements are likely to lead to some second-round effects. Regarding the policy transmission process, we note that monetary aggregates and credit growth are coming down, which suggests that tight monetary policy is weighing on the economy already. Periphery spreads have not widened so far, signalling that the ECB can continue hiking rates if needed. Beyond June, future ECB decisions will likely depend on how banks could cope with the liquidity withdrawal that originates from the TLTRO repayments and the coming redemptions of the APP-that will not be reinvested from July on. We expect the ECB to hike for the last time for this cycle in July to 3.75%, and to hold that rate constant until early next year as core inflation remains too high in our view.

Exhibit 1: Staff forecasts – March 2023 forecasts and our most recent assessment

	2023		2024		2025	
Macro projections in % yoy	ECB March 23	JSS forecast	ECB March 23	JSS forecast	ECB March 23	JSS forecast
GDP	1.0	0.5	1.6	0.7	1.6	1.0
Headline Inflation	5.3	5.2	2.9	2.6	2.1	2.4
Core inflation	4.6	5.1	2.5	3.5	2.2	2.7
Technical assumptions						
Oil price in USD	82.6		77.8		73.9	
Natural gas price	58		61		51	
Non-energy commodity prices in % yoy	-6.4		0.3		1.2	
EUR-USD	1.08	1.08	1.08	1.10	1.08	1.10

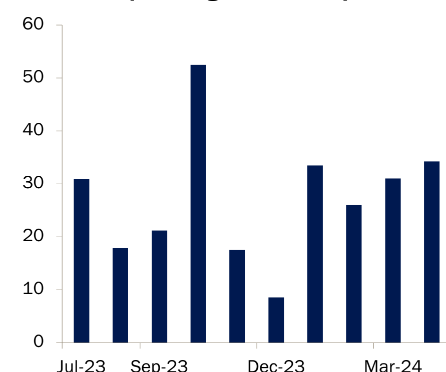
Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 2: Outstanding TLTROs to fall



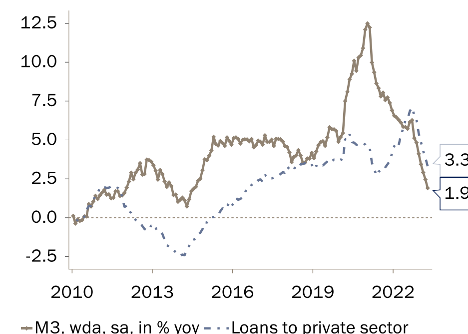
Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 3: Upcoming APP redemptions



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

Exhibit 4: Declining monetary aggregates



Source: Macrobond, Bank J. Safra Sarasin, 08.06.2023

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Economic Calendar

Week of 12/06 – 16/06/2023

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 12.06.2023						
JP	1:50	PPI	May	mom		0.2%
	1:50	PPI	May	yoy		5.8%
	8:00	Machine Tool Orders	May	yoy		-14.4%
CN		Aggregate Financing	May	CNY bn	1'900	1'220
		Money Supply M2	May	yoy	12.0%	12.4%
Tuesday, 13.06.2023						
DE	8:00	CPI	May F	mom	--	-0.1%
	8:00	CPI	May F	yoy	--	6.1%
	11:00	ZEW expectations	Jun	Index		-10.7
	11:00	ZEW current situation	Jun	Index		-34.8
US	14:30	CPI	May	mom	0.2%	0.4%
	14:30	CPI ex food and energy	May	mom	0.4%	0.4%
	14:30	CPI	May	yoy	4.1%	4.9%
	14:30	CPI ex food and energy	May	yoy	5.2%	5.5%
Wednesday, 14.06.2023						
EMU	11:00	Industrial Production	Apr	mom	--	-4.1%
US	13:00	Mortgage Applications	Jun	wow	--	-1.4%
	14:30	PPI	May	mom	-0.1%	0.2%
	14:30	PPI ex food and energy	May	mom	0.2%	0.2%
	14:30	PPI	May	yoy	1.5%	2.3%
	14:30	PPI ex food and energy	May	yoy	--	3.2%
Thursday, 15.06.2023						
JP	1:50	Core Machine Orders	Apr	mom	--	-3.9%
CN	4:00	Industrial Production	May	yoy	3.8%	5.6%
	4:00	Retail Sales	May	yoy	13.9%	18.4%
	4:00	Fixed Asset ex Rural YTD	May	yoy	4.4%	4.7%
	4:00	Property Investment YTD	May	yoy	-6.7%	-6.2%
EMU	14:15	ECB Main Refinancing Rate				3.75%
US	14:30	Retail Sales	May	mom	0.0%	0.4%
	14:30	Empire Manufacturing	Jun	Index	-16.0	-31.8
	14:30	Philly Fed Business Outlook	Jun	Index	-12.5	-10.4
	15:15	Industrial Production	May	mom	0.1%	0.5%
Friday, 16.06.2023						
EMU	10:00	CPI	May	mom	--	0.0%
	10:00	CPI	May	yoy	--	6.1%
	10:00	CPI core	May	yoy	--	5.3%
US	16:00	U Michigan Sentiment	Jun	Index	60.0	59.2

Source: Bloomberg, J. Safra Sarasin as of 08.06.2023

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Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W	Δ YTD	TR YTD in %
Swiss Eidgenosse 10 year (%)	1.00	13	-62	5.1
German Bund 10 year (%)	2.42	11	-15	1.9
UK Gilt 10 year (%)	4.23	5	56	-2.2
US Treasury 10 year (%)	3.73	4	-14	2.3
French OAT - Bund, spread (bp)	55	0	0	
Italian BTP - Bund, spread (bp)	176	0	-38	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	11,309	18.0	0.1	8.5
DAX - Germany	15,990	11.3	0.9	14.8
MSCI Italy	861	8.3	2.5	14.2
IBEX - Spain	9,338	10.4	1.9	15.6
DJ Euro Stoxx 50 - Eurozone	4,298	12.3	0.9	16.4
MSCI UK	2,175	10.5	1.6	3.5
S&P 500 - USA	4,294	19.7	1.8	12.7
Nasdaq 100 - USA	14,485	27.8	0.3	32.9
MSCI Emerging Markets	994	13.1	3.4	5.0

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.90	6.7	-1.1	-2.7
EUR-CHF	0.97	4.6	-0.4	-2.0
GBP-CHF	1.13	6.2	-0.1	1.0
EUR-USD	1.08	6.3	0.7	0.7
GBP-USD	1.26	7.4	0.9	4.0
USD-JPY	139.4	9.1	-0.3	6.3
EUR-GBP	0.86	5.3	-0.3	-3.1
EUR-SEK	11.63	7.2	0.6	4.2
EUR-NOK	11.68	10.1	-1.1	11.2

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	101	13.3	3.3	-10.3
Brent crude oil - USD / barrel	75	36.9	1.5	-11.5
Gold bullion - USD / Troy ounce	1,965	14.2	-0.6	7.7

Source: J. Safra Sarasin, Bloomberg as of 08.06.2023

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