



## MACROECONOMIC *view*

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### *Consumer stress test*



#### Key highlights:

- The global economy continues to slow but has avoided a recession so far.
- Consumers have withstood the inflation shock thanks to a high level of employment and ample savings.
- Now, unemployment is likely to rise again and excess savings are depleting quickly.
- The full effect of restrictive monetary policies is yet to come.



It is often said that expansionary phases never die of natural causes, but are always gunned down by the central bank. Indeed, there comes a point in any recovery where signs of overheating multiply. This forces to tighten monetary policy which, after some time, leads to an economic downturn.

The expansion phase that followed the 2020 global recession had all the makings of this pattern. First, a strong stimulus to overcome the effects of lockdowns. Then, a surge in inflation unseen in four decades. And finally, a rapid rise in policy interest rates. **The risk of a global recession has been debated for at least a year, but has yet to materialise.** Growth rates have certainly slowed everywhere but to date, this hasn't led to job losses, falling profits or a contraction in demand, all of which are typically observed in recessionary phases.

**The simultaneous resilience of employment, profit margins and demand is due to the atypical disruptions caused by the pandemic.** For example, labour market shortages emerged. As a result, even when the recovery lost some of its momentum from spring 2022 onwards, companies continued to recruit. At the same time, businesses had to respond to positive demand shocks. At the start of

the pandemic, demand for manufactured goods was high, putting a strain on the industrial capacities and logistics alike. In the reopening phase, everyone wanted to catch up on hospitality, leisure and tourism. The repetition of these shocks made demand less elastic to rising prices. Companies' pricing power increased. Lastly, the substantial savings accumulated by households at a time of restricted mobility acted as a shock absorber later on. Households did not have to cut back on spending despite the drop in their real wages.

**In the coming quarters, consumer resilience will be sorely tested.** Firstly, while excess savings are still abundant, they are rapidly normalising. In the United States, they have already halved since their peak. At the current pace, they would be depleted by late 2023 or early 2024. Consumption trends will then have to realign with lower real income.

**Secondly, companies will now have less scope to extend their margins.** Supply shortages in transport, logistics and even energy have been overcome. As a result, upstream price pressures have disappeared. In a phase of normalising profitability, it would be surprising if companies did not moderate spending, both on capital and recruitment. With economic growth remaining



below potential, an increase in unemployment rates is therefore likely. In any case, it is difficult to go any lower than current levels (graph).

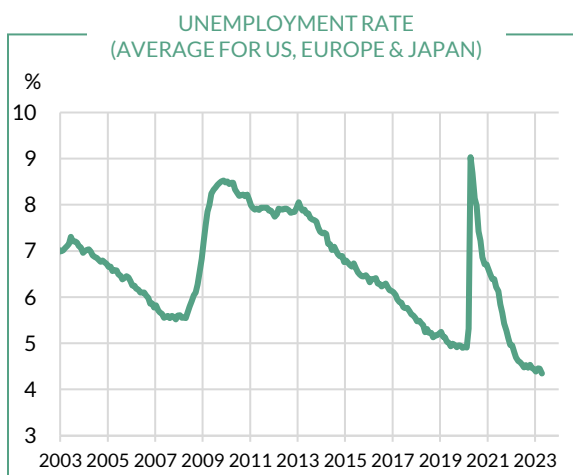
**Thirdly, credit conditions have continued to tighten over the past year.** In response, the demand for credit by the private sector has plummeted, especially after the recent episode of banking stress in the United States. In the eurozone, bank credit flows have nearly dried up since the start of the year. The correction is particularly acute for mortgages.

**Fourthly, economic policies are also becoming increasingly restrictive.** On the fiscal front, rising interest rates have rekindled questions about debt dynamics. Last autumn's mini-budget crisis in the UK showed that market complacency had its limits. To avoid a similar fate, European governments are adopting a more restrictive medium-term fiscal stance. According to the European Commission, the budgetary effort will be close to one point of GDP in 2024. In the United States, the deal negotiated to raise the debt ceiling points to a modest fiscal restraint over the next two years.

On the monetary front, given the long lag in transmission to the real economy, the restrictive effect continues to grow and will not reach its maximum until 2024. One might wonder if central bankers who were so slow to react to the inflationary surge that began in 2021 risk not making the opposite mistake in 2023. They were too accommodative then, are they not too restrictive now? Of course, there's no denying that

inflation remains very high, despite a slight downturn. However, upstream price pressures have eased in a spectacular way. That same trend will be passed on downstream to the end consumer. **To continue tightening monetary policy, as the ECB intends to do, is to react to yesterday's shocks, not to tomorrow's economic conditions.**

Overall, as a result of disinflation, household purchasing power will certainly be under less pressure in the coming quarters, but the components of their disposable income (employment, wages, net transfers) will all evolve less favourably. In short, consumers in Europe and in the United States will face a test of resilience over the coming months.



Source : Thomson Reuters, ODDO BHF

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