How long will the coming crisis last?
hpo economic commentary 4th quarter 2022

hpo forecasting

we predict your business

In Europe and the USA, a recession in 2023 can hardly be avoided.

The latest economic figures confirm the hypothesis already formulated by hpo forecasting in 2021: demand in the industry was fueled from mid-2020 to early 2022 by the huge stimulus packages of various governments. **Overheating of the economy** was the result. Now the pendulum is swinging back. According to our model calculations, the downturn is reaching us somewhat later than originally expected because we underestimated the enormous overconsumption. This was triggered by the unprecedented stimulus measures during the pandemic. But now, the anticipated **dip in growth** is imminent. Early-cycle segments of the engineering industry are already seeing a sharp decline in new orders.

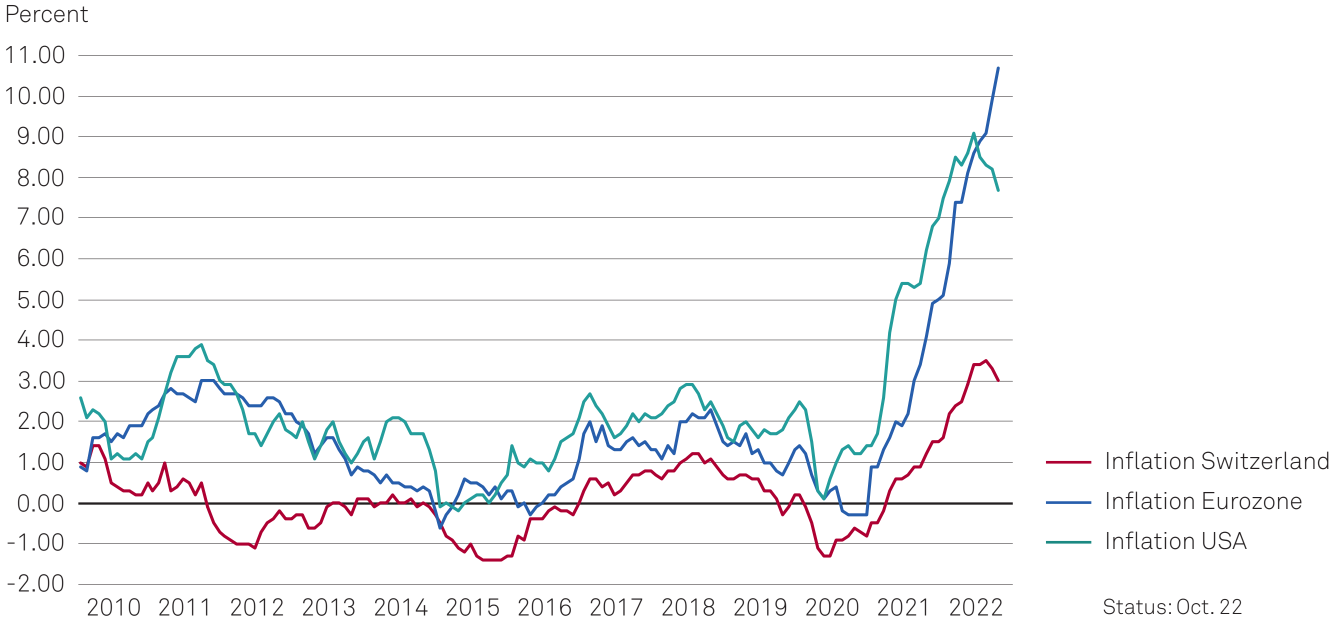

Fig. 1: Development of inflation rates in the USA, the Eurozone and Switzerland
Sources: raw data by BLS, Eurostat and FSO; illustration by hpo forecasting

As usual, this hpo economic commentary highlights the most important developments in the global economy, with a specific focus on the real economy and the consequences for the industry. We also asked ourselves: What lessons can we learn from past crises for the upcoming downturn?

Inflation has passed its peak in the USA

Inflation in the USA was 7.7 % in October, following 8.2 % in September. This was enough to boost joy in the financial markets. The broad U.S. equity market index S&P 500 closed on November 10 – the day the latest inflation figures were announced – with a gain of 5.5 %. The technology-heavy Nasdaq Composite Index even rose by a phenomenal 7.4 % over the course of the day. This corresponds to the fourteenth largest daily gain in the history of the Nasdaq since 1971. These price increases express the hope of market participants that the USA and the world's most important central bank will put the brakes on the vicious cycle of interest rate increases earlier than previously anticipated.

It is becoming clear that **"peak inflation" was reached in the USA in June.** Since then, inflation has declined for four consecutive months. The core rate, which excludes the volatile prices of food and energy, also fell from 6.7 % to 6.3 % after the previous peak in September. Despite this silver lining, an inflation rate of 7.7 % or core inflation of 6.3 % is still far too high. Opinions differ widely in expert circles regarding how quickly inflation rates will continue to fall. The risk of another disappointment for the financial markets is very real. It seems absurd that an inflation rate of still almost 8% should lead to such euphoria. The road to the **2 % inflation target** is still long and rocky – and significantly more arduous in Europe, where there is no sign of a trend reversal.

In the **Eurozone,** inflation reached double digits in October for the first time since the introduction of the Euro, reaching 10.7 % after 9.9 % in September. This development is pressuring the European Central Bank to continue raising key interest rates sharply. At the same time, it must be careful not to provoke another Euro crisis in view of the accumulated government debt. This is a very tricky task, and the risk of a monetary policy "accident" is increasing.

In **Switzerland,** inflation has been significantly lower at 3 % recently due to the appreciation of the Swiss franc, less dependence on fossil energy, and many government-set prices in agriculture.

Sentiment indicators show a dark picture

Irrespective of inflation, the leading economic indicators give no cause for optimism. Although unemployment rates in industrialized countries remain very low by historical standards, **consumer sentiment** is at an all-time low because of rapidly rising prices and major geopolitical risks. In all major economic regions, consumer sentiment is well into contractionary territory. Except for the USA, there are still no signs of a trend reversal in the major markets. And while the sentiment

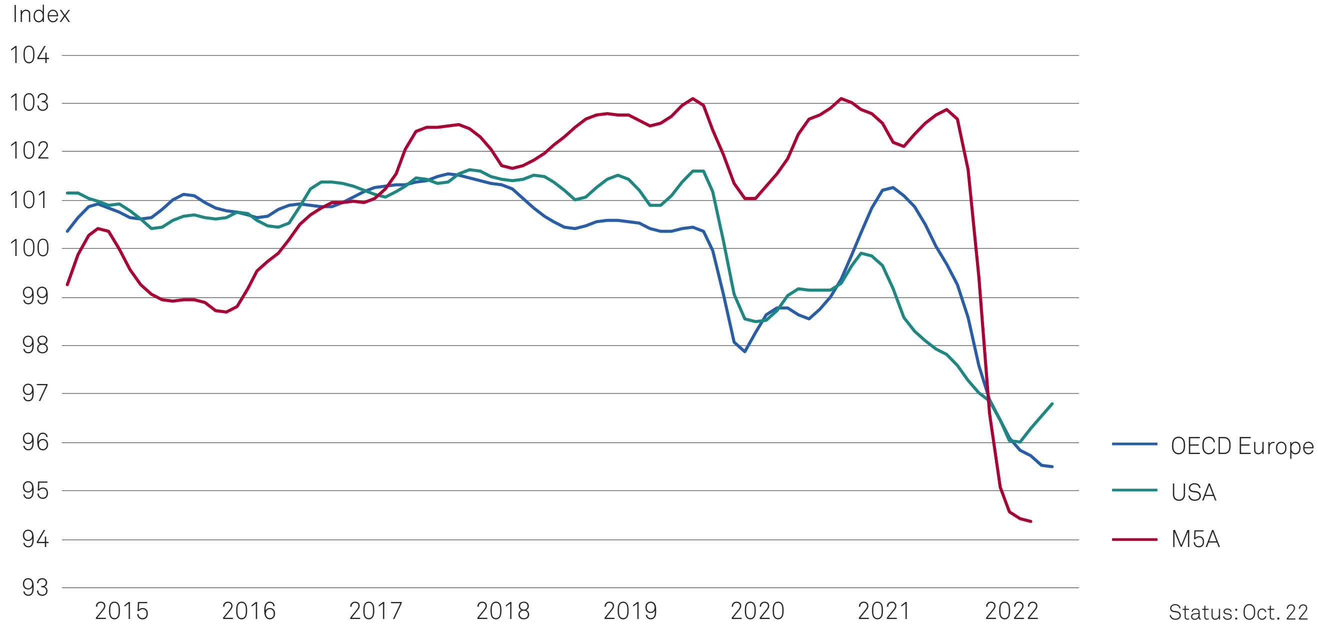

Fig. 2: Consumer Confidence Index (CCI) in Europe, the USA and the 5 largest economies in Asia; values below 100 = pessimistic consumer sentiment
Source: raw data by OECD; illustration by hpo forecasting

hpo forecasting
we predict your business

is not quite as bad as it was a few months ago, it is still anything but encouraging.

As measured by the OECD's **Business Confidence Index (BCI),** the sentiment among companies continues to be better than among consumers. However, the trend here also shows a clear downward trend. In the USA and Europe, the BCI fell back to just below one hundred, i.e., into the restrictive range, in the third quarter for the first time since the beginning of 2021. This sharp decline is also exceptional because, in December 2021, this value in Europe was still at a record level of almost 103 points.

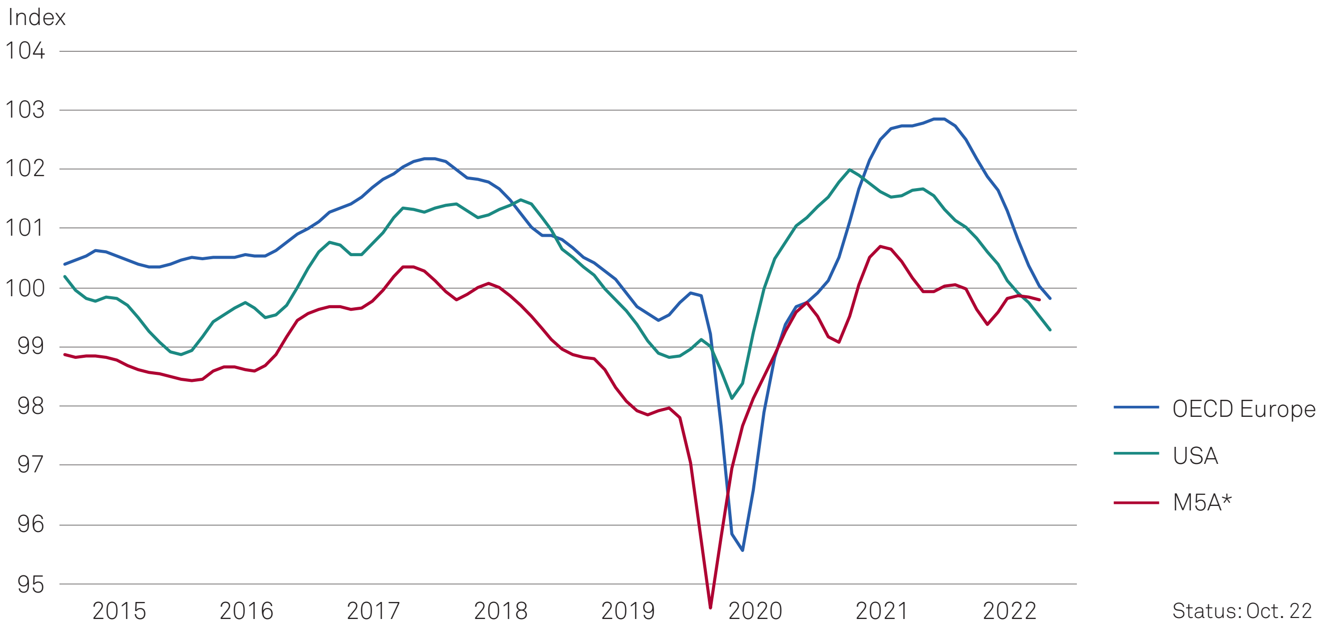

Fig. 3: Business Confidence Index (BCI)
Source: raw data by OECD; illustration by hpo forecasting

* five largest economies in Asia

The Federal Reserve Bank St. Louis estimates the probability of a recession in the USA at over 90%

Furthermore, 10-year government bonds in the USA continue to carry lower interest rates than government bonds with 2-year or 3-month maturities. This constellation is called an **inverse yield curve.** It means that investors rate the short-term economic risks higher than the longer-term dangers. In the past, this unusual interest rate constellation has proved to be a very accurate indicator of an impending recession in the USA. On this basis, the St. Louis office of the Federal Reserve calculates the probability of a recession in the USA in the next 12 months to be over 90 %.

Other renowned institutions, such as the Conference Board in the USA, now also expect a **recession in the USA in 2023** in its latest forecast of November 9. Most economists assume that the dip in growth will be even more pronounced in Europe than overseas.

China is still spinning its wheels in the endless loop of restrictive pandemic measures, and the real estate sector has been in deep crisis for some time. Economic growth is currently far below the long-term trend growth.

Given the poor sentiment in the country and the destroyed confidence in the real estate sector, it is doubtful whether the recently communicated easing of the Covid-19 measures in the real estate sector will have a major impact soon.

Buoyant **exports** were an important pillar of growth for China during the pandemic against the backdrop of weak domestic consumption. If Western consumers now increasingly hold back, this will also leave its mark on the economy of China.

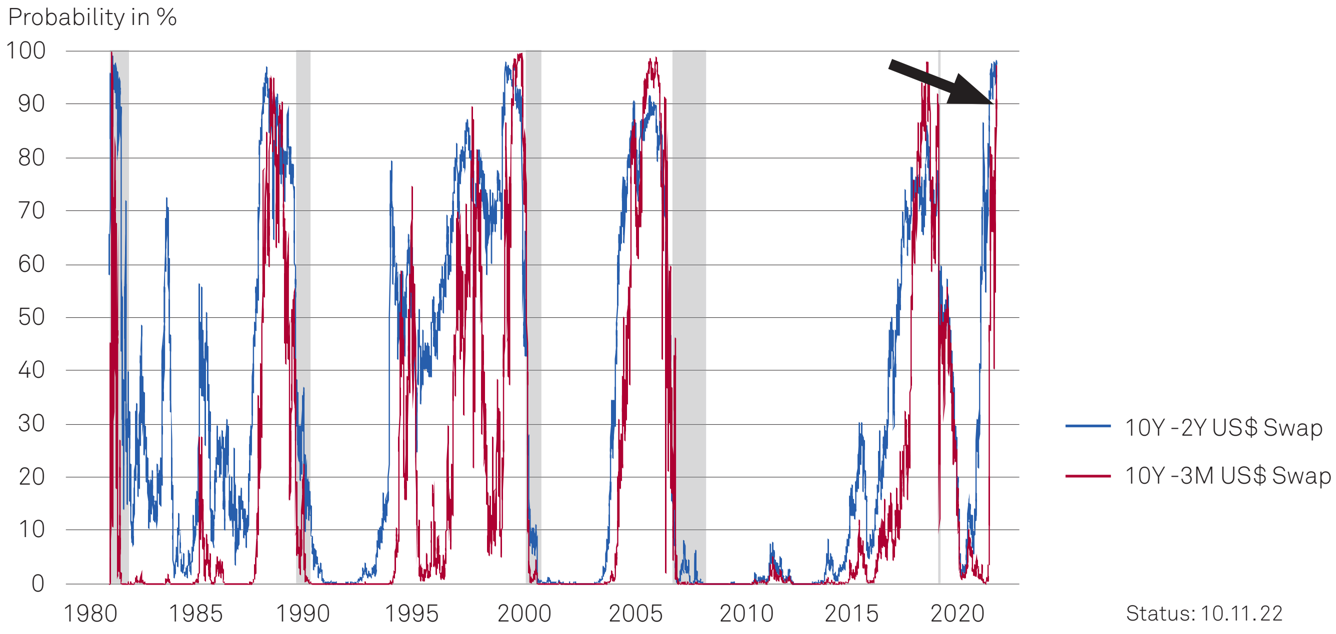

Fig. 4: Probability of a recession in the USA in the next 12 months
Source: Probit Model of the Federal Reserve Bank St. Louis

Order intake in the German machinery sector is declining

Despite lousy sentiment in all major markets, order intake in the **mechanical engineering** sector in Germany remains comparatively high. For the second time, the German statistics office Destatis reported a slightly lower order intake for the third quarter than the previous quarter.

However, the level of nominal order intake is still above the pre-crisis levels of 2018 and 2019. However, adjusted for inflation, the data fell for the fourth time in a row and are now just below the level of the fourth quarter of 2020 again.

As expected, late-cycle sectors such as **machine tools** continue to experience strong demand. The 12-month moving average of new orders rose in this sector for the seventh quarter. According to Destatis data, however, early-cycle segments, such as the **textile machinery industry,** have already passed their peak in order intake at the beginning of 2022. When the textile machinery industry weakens, it usually has a strong signal effect on the entire mechanical engineering sector.

In the **USA, demand for machinery** remains very high by historical standards. The driver here is likely to be the boom in the oil and gas industry. But also in America, new orders, as measured by the 3-month average, fell for the second time in a row, and the 12-month average is only moving sideways and has probably peaked.

Anatomy of a crisis

The leading indicators are clear: We are facing a **dip in growth,** and many countries will slide into recession in 2023. We are currently observing a constellation of economic indicators which, according to hpo model calculations, has always led to an economic downturn in recent decades. In simple terms, this is when the consumption cycle has reached its peak and thus no longer supports the industrial cycle. The economic situation is unstable and susceptible to a sharp correction in such a constellation.

The severity of a crisis depends on various, quite **unpredictable factors:** What other bubbles of overvalued assets will burst? How will governments react to the economic crisis? Will (autocratic) governments be tempted to distract from domestic difficulties with foreign policy adventures? Will central banks give greater weight to fighting recession or inflation in a harsh environment? We cannot answer these questions.

Nevertheless, we can learn from history when it comes to roughly estimating the **duration of the presumably impending crisis.** Economic crises are part of history, and the parallels between past crises are remarkable despite their respective uniqueness. A first indication of how long the upcoming crisis will last can be given by analyzing past crises. To do this, hpo forecasting examined 256 data sets of new orders over the past 30 years for various industry sectors and regions. hpo then measured the time span from the high to the low point

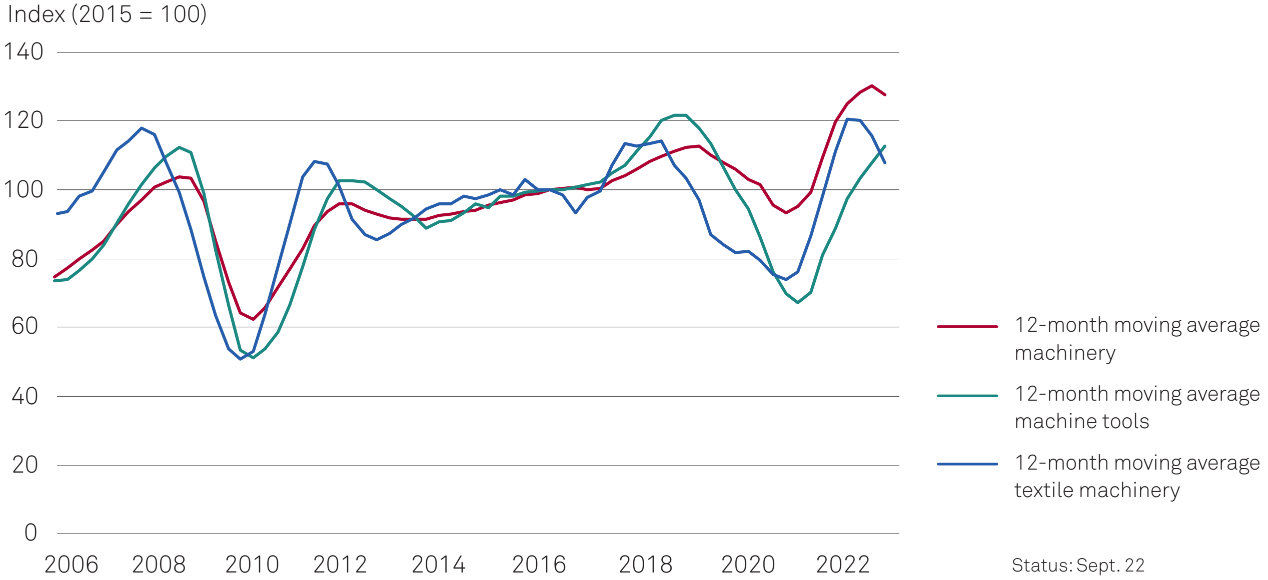

Fig. 5: Order intake as measured by the 12-month moving average of German manufacturers of machinery in general, machine tools, and textile machinery
Source: raw data by Destatis; illustration by hpo forecasting

and back to the next cyclical high point for all these data sets. The average duration from the high to the low point of the crisis in all these data sets and over the last three decades is remarkably stable, ranging from 1.7 years to 2.8 years. On the other hand, the upturns are much more variable, ranging from 1.8 years in the recent recovery with the unprecedented stimulus measures to 8.8 years after the financial crisis. If this pattern repeats itself, the bottom of the crisis will not be reached until well into the future. Industry- and company-specific peculiarities also play a key role. We consider these in our company-specific forecasts for our contract customers to determine the low point as accurately as possible.

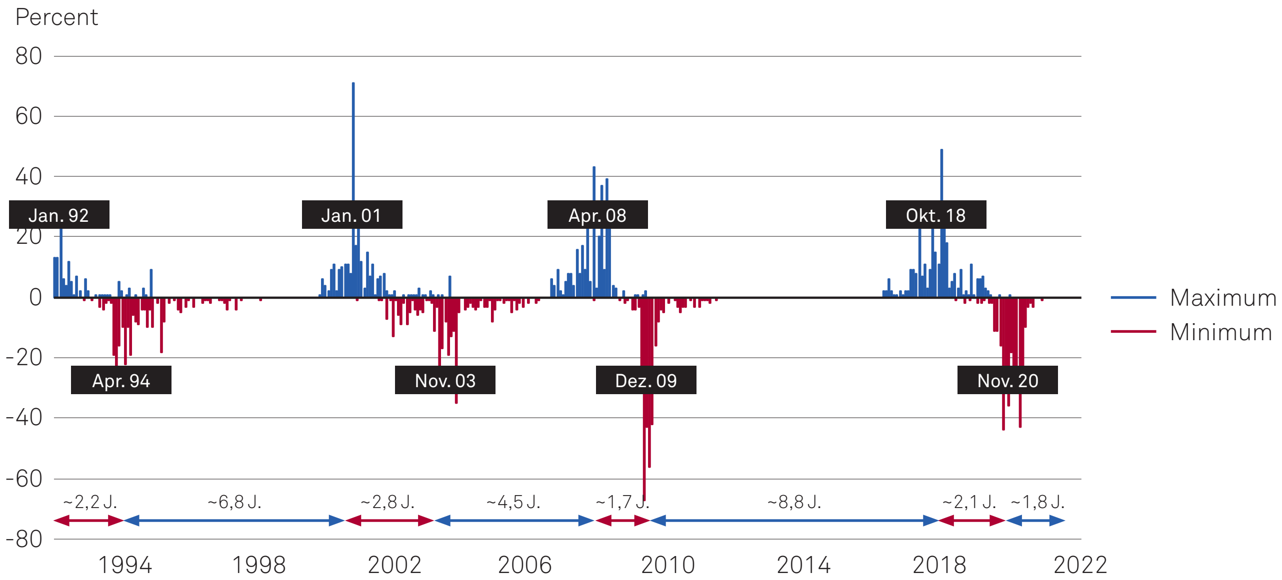

Fig. 6: Average duration of downturns and upturns of 256 data sets of different industry sectors and regions from the high to the low point and again to the next high point

Source: various raw data; calculation and presentation by hpo forecasting

Interested?
Put us to the test!

hpo
forecasting
we predict your business

Contact us for a free **preliminary analysis** of your incoming order data.

Who is hpo forecasting?

Our specialists at hpo have an in-depth understanding of the macroeconomic context and sound knowledge of the industries in which their clients operate. Prediction is their passion.

They enjoy working in a team and are committed to the concerns of their clients.

hpo forecasting – we predict your business

If you would like to know more about hpo forecasting and would like to receive a free preliminary analysis, schedule a free, no-obligation appointment using this **QR-Code:**

Your contact at hpo forecasting

Josua Burkart
M. A. HSG
Managing Director
josua.burkart@hpo.ch
+41 44 787 60 15

Benjamin Boksberger
M. A. HSG
Senior Forecasting Manager
benjamin.boksberger@hpo.ch
+41 41 461 00 22

Walter Esposito
Dipl. Arch ETH
Senior Manager Business Development
walter.esposito@hpo.ch
+41 79 289 61 94