

Six Minute Strategy

The central bankers dilemma...

January 2022



An extraordinary recovery but at the cost of higher inflation

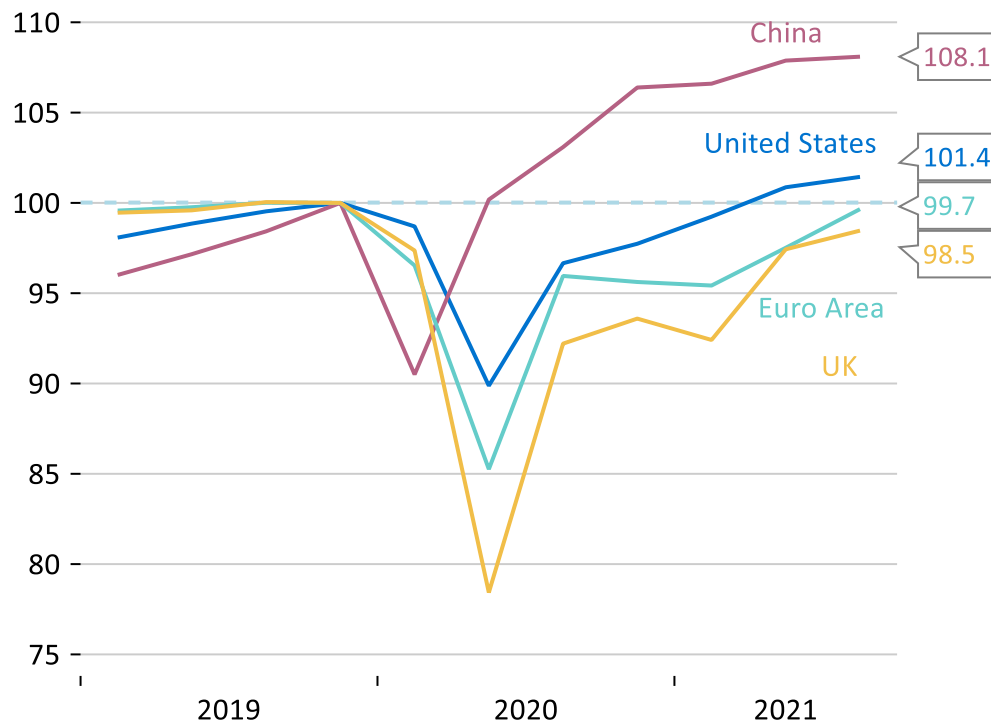
Inflation higher for longer: Base effects, supply bottlenecks and Omicron/labour costs



Most major economies at or above pre-COVID GDP levels

GDP in selected countries

Indices: 2019 Q4=100 (the start of COVID)

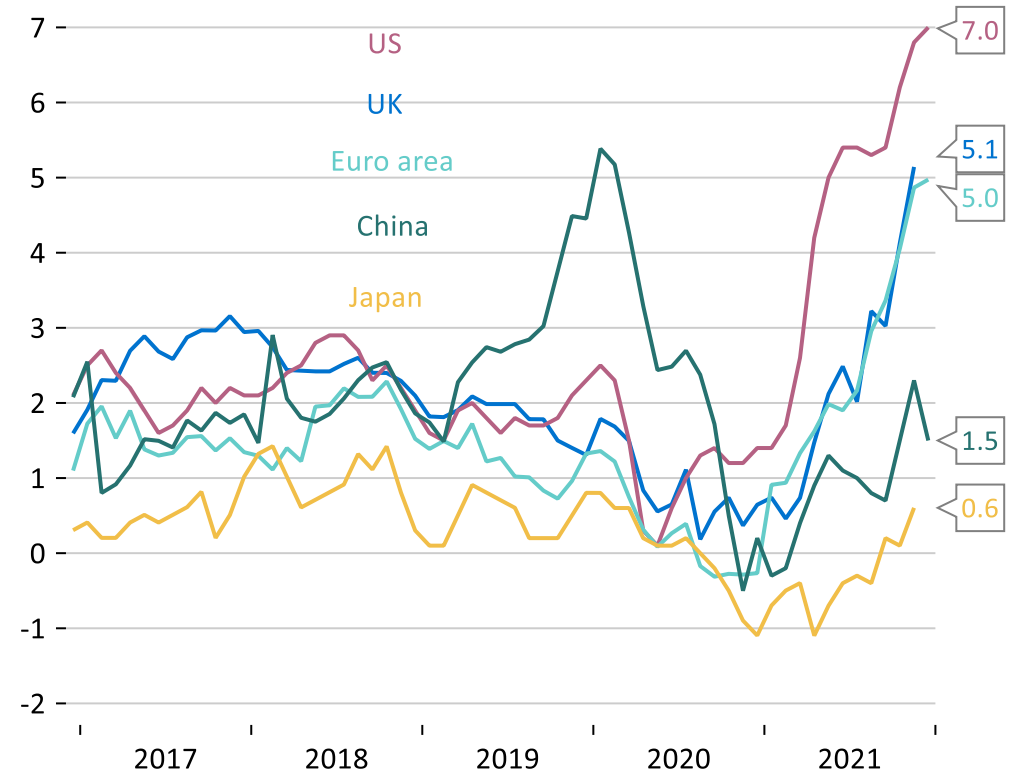


Source: Macrobond, 13.01.22



Consumer price inflation (yoy)

Global Inflation Rates



Source: Macrobond, 13.01.22

Source: Sarasin & Partners and Macrobond, December 2021

Factoring in Omicron



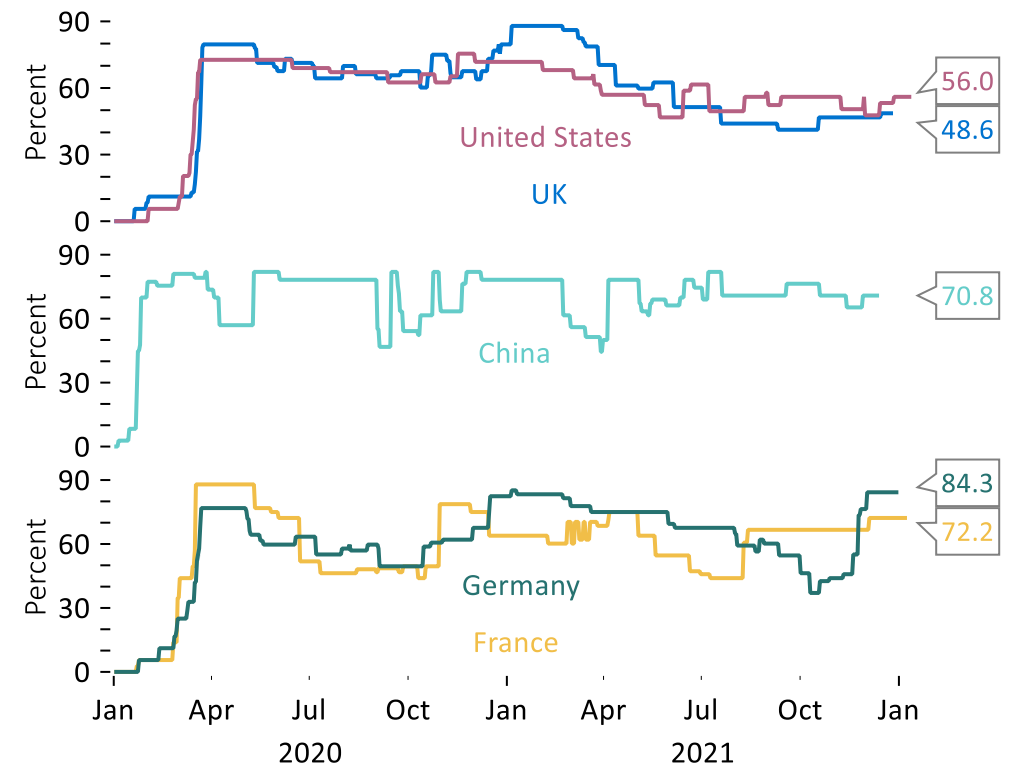
Classification of Omicron
(B.1.1.529): SARS-CoV-2
Variant of Concern
26 November 2021

- **Demand shock:** Pull back in services consumption data on widening restrictions.
- **Supply shock:** Planes and ships to face further disruption from border closures. Labour shortage will get exacerbated.
- **Outlook:** Conditions today are different to 2020 – Central banks have less flexibility:
 - Inflation has been running high for a year
 - Labour markets tight
 - Major central banks now opting to tighten
 - Zero infection policy increasingly disruptive in China



US/UK rely on vaccination - Euro area tighten - China zero policy

COVID-19 Global Stringency Index



Source: Macrobond, 13.01.22

As inflation risks rise central bankers dial back crisis-era policies

1. Inflation: broad based pressures

- Expect inflation to average 4.7% in US and 3.7% in UK, with upside risk everywhere except Japan.
- US inflation to trend at moderately above 2% target from 2023 onwards

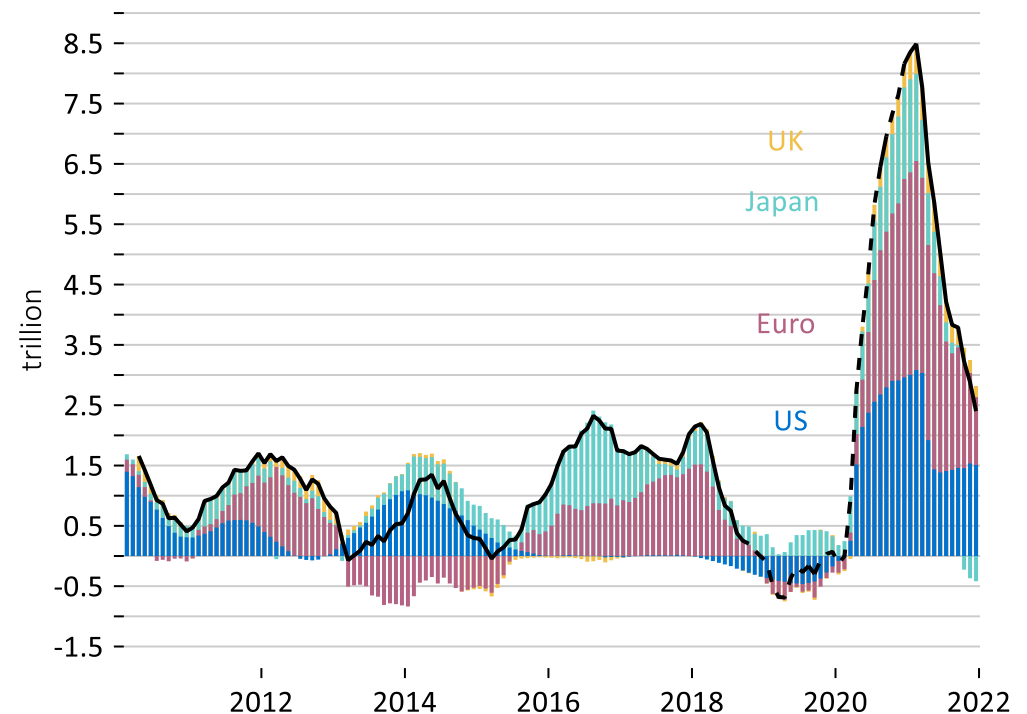
2. Monetary policy: tighter in the US, UK & EM/staying loose Europe/easier China

- Central bank asset purchases to fall significantly from \$3 trillion in 2021 to around \$1trillion in 2022
- Interest rate increases (3 in the US), (1 or 2 in the UK), Euro area and Japan unchanged, China to cut RRR



Central Bank bond purchases starting to slow

12 month change in Central Bank Assets
USD trillion



Source: Macrobond, 13.01.22

Policy normalisation in the US might look very different this time

Balance sheet run-off faster, sooner and shorter than in 2017/8

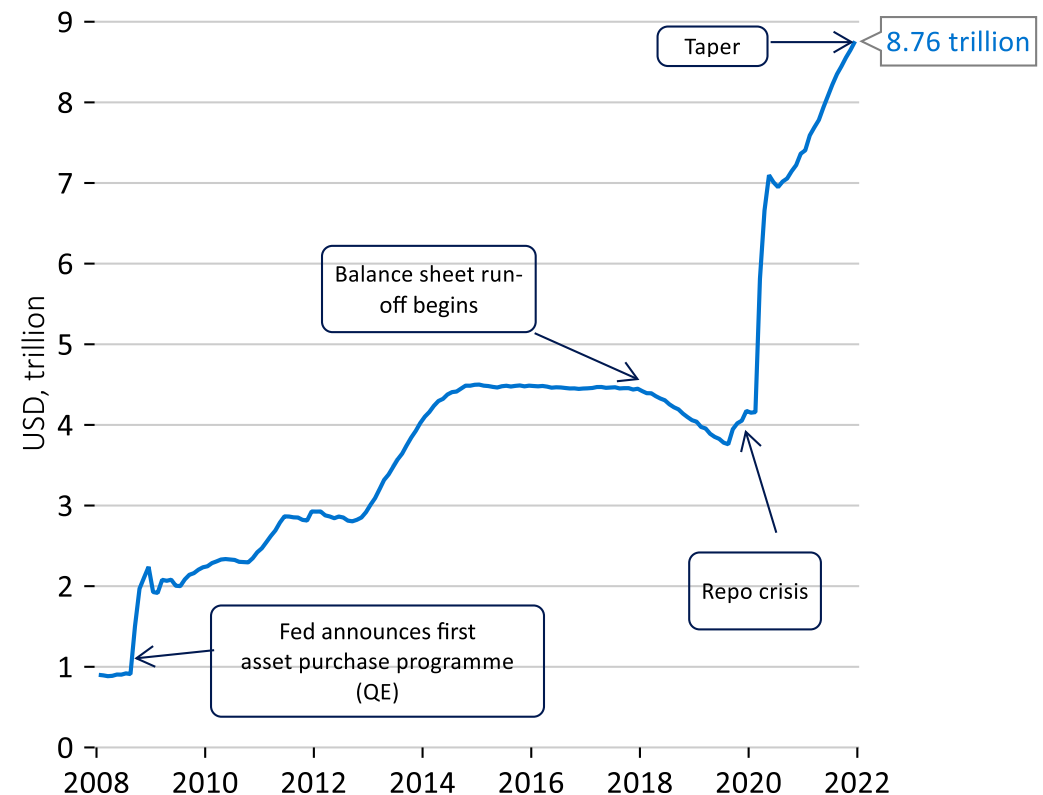
FOMC Minutes: a hawkish surprise

- Balance sheet runoff likely to be:
 - After the first increase in US interest rates (March 2022)
 - Closer to the first rate rise than in previous cycle (late 2017)
 - Faster, given the larger size of Fed Treasury holdings & shorter given the maturity
- Several FOMC members already see signs maximum employment



A history of Federal Reserve asset purchases & redemptions

Assets held by the Federal Reserve (\$tn)



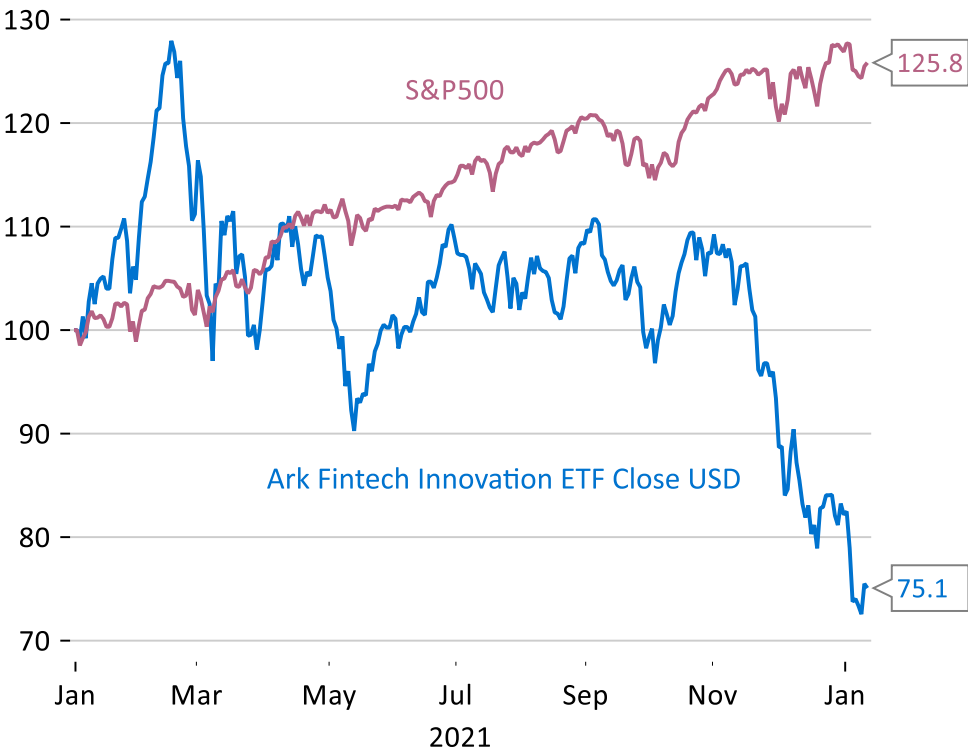
Source: Macrobond, 13.01.22

Markets: Anticipation of Fed tightening hurts higher risk assets



Smaller technology & innovation stocks suffer

Ark Fintech Innovation ETF Vs. S&P500

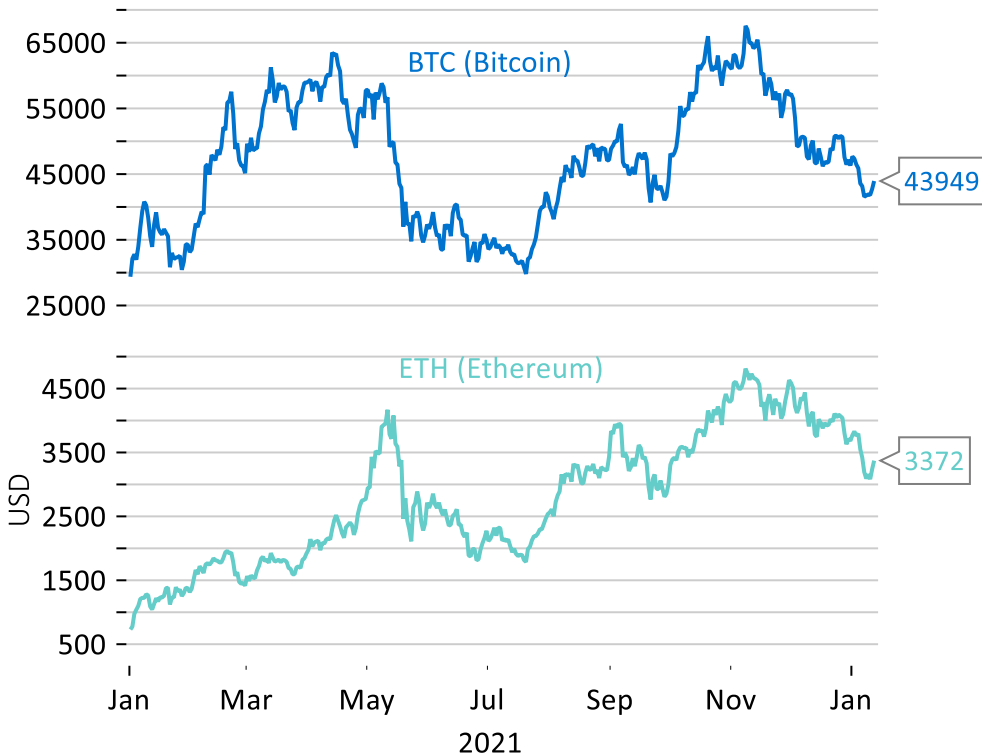


Source: Macrobond, 13.01.22



Heightened volatility across Crypto assets

Crypto Assets



Source: Macrobond, 13.01.22

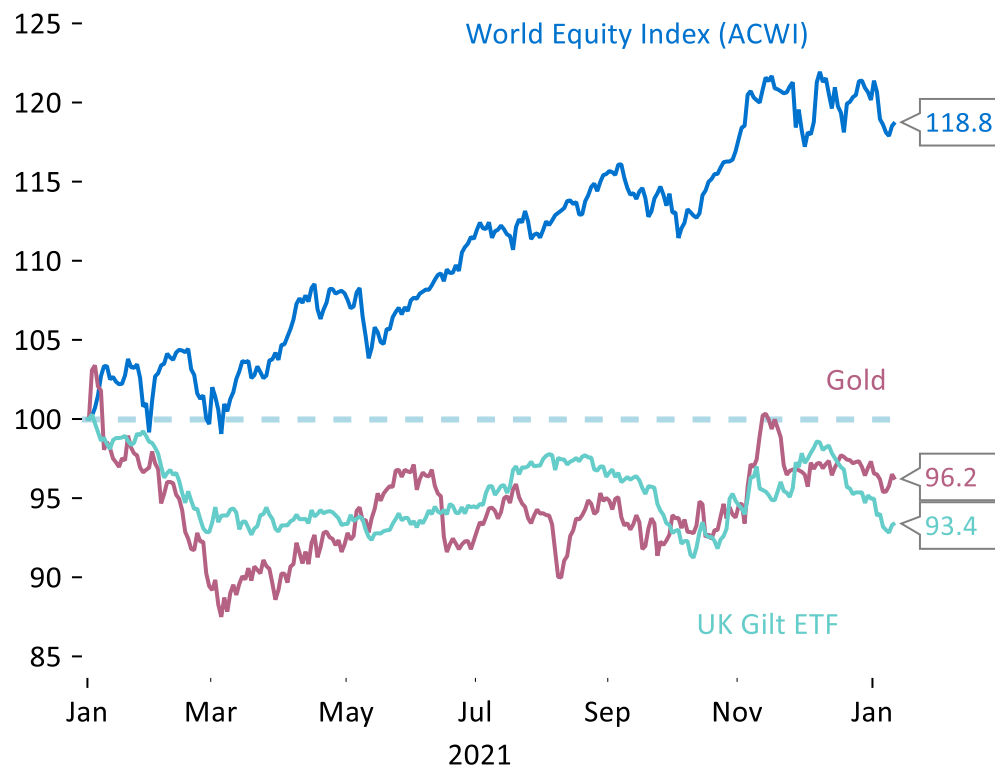
Asset class performance 2021 to-date

Equities still supported by strong earnings and generous monetary conditions but risks are rising



Equities rally, bonds & gold decline

Global Asset Class Returns 2020 (GBP) to date

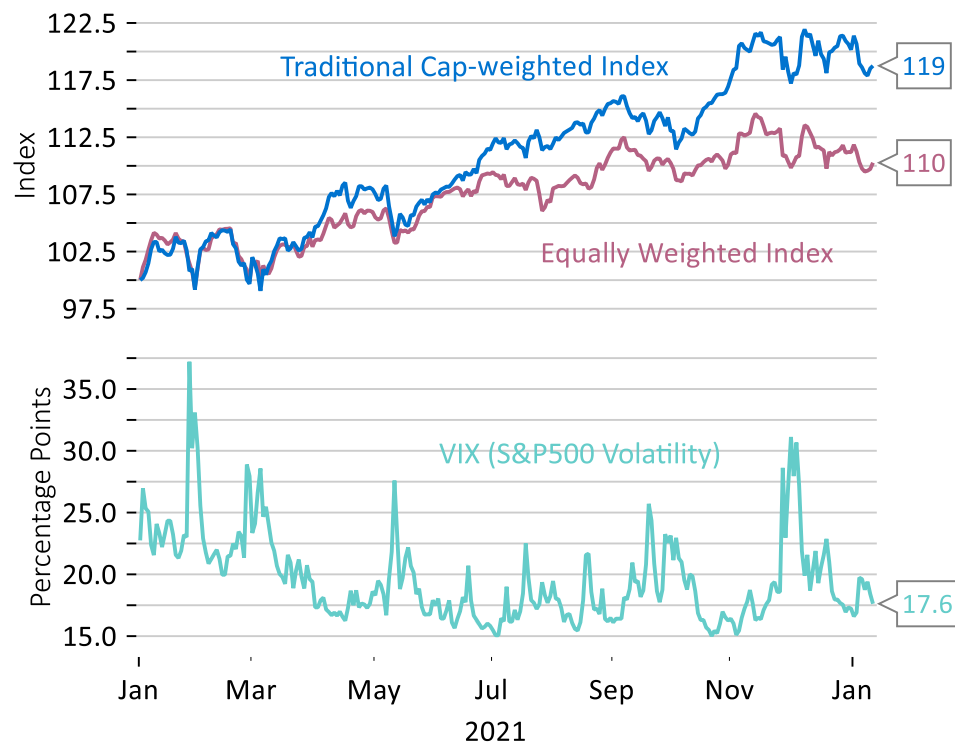


Source: Macrobond, 13.01.22



Extreme divergence of equally weighted index – VIX steady

MSCI World equities & VIX Index



Source: Macrobond, 13.01.22

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