Vontobel

Weekly Flash

Central banks getting more hawkish

MARKET PERFORMANCES (as of November 26, 2021 – 14:50 CET)

	CURRENT	CHANGE 1 WEEK	CHANGE YTD		CURRENT	CHANGE 1 WEEK	CHANGE YTD
S&P 500 Index	4'701.46	0.27%	25.17%	Gold	1'806.49	-2.10%	-4.80%
S&P/Toronto Stock	21'613.18	0.27%	23.98%	Silver	23.50	-4.41%	-10.91%
EuroStoxx 50	4'145.25	-4.85%	16.68%	Oil WTI	73.83	-6.56%	52.16%
SMI Index	12'264.58	-2.24%	14.58%	EUR/USD	1.1292	0.12%	-7.53%
DAX Index	15'437.25	-4.47%	12.53%	EUR/CHF	1.0447	0.23%	3.41%
Nikkei Index	28'751.62	-2.86%	4.76%	USD/CHF	0.9252	0.13%	4.40%
Emerging Market Index	71'486.70	-0.81%	-0.29%	USD/JPY	113.85	0.06%	9.40%
Yield 10Y US Treasuries	1.531	-0.0160	0.6172	CAD/USD	0.7837	0.88%	0.19%
Yield 10Y German Bund	-0.319	0.0270	0.2558	USD/CNY	6.391	-0.07%	-2.11%

[Source: Bloomberg]

Summary

- The re-nomination of Jay Powell as Fed Chair confirms our expectation of a less expansive monetary policy path during 2022.
- Given rising inflation rates in the Euro area, ECB officials recently switched to a more hawkish tone.
- This week's release of strategic oil reserves will not significantly change the current oil market dynamics.

Powell re-nominated as Fed Chair

The nomination of Jay Powell for a second term points to continuity in Fed leadership and overall monetary policy. His nomination also helps to resist politicizing the central bank at a time its independence is challenged. High government debt levels in the U.S. may increase pressure from politics to keep rates at artificially low levels for an extended period of time. If bonds yields are kept considerably below nominal growth, the ratio of government debt to GDP improves over time. This is what happened after the Second World War, when federal debt to GDP reached almost 120%. During the following decade low yields and strong nominal growth helped to gradually improve the federal debt to GDP ratio, which fell below 60% in 1957. However, the practice to keep real interest rates at extremely low or even negative levels over many years de facto represents an expropriation of investors with a relatively low risk capacity. We believe that the Fed's plan to finish tapering and potentially start hiking by mid of 2022 is the right decision given the expectation that inflation will remain notably above 2% during 2022. With Powell re-nominated this lift-off in rates has a good chance of being implemented.

ECB more concerned about price trend

Given persistently high inflation pressures, communication of ECB officials recently changed to a more hawkish tone. Executive Board member Isabel Schnabel stressed that an increasing threat of inflation is taking hold and played down the risk that rising coronavirus infections may negatively impact the Euro area's economic recovery. Headline inflation in the Eurozone rose to 4.1%, while core inflation increased to 2.0% in October. This compares to 0.6% core inflation and 1.2% headline inflation in Switzerland. In our view, the rising inflation difference was the main driver of the recent Euro weakness against the Swiss Franc. A possible shift of the ECB to a more restrictive stance may be supportive for the Euro in the shorter term. While we do not expect rate hikes anytime soon, the ECB's Governing Council may very well slow down asset purchases to reduce monetary stimulus in the coming months.

Release of strategic Oil reserves

On November 23, the U.S., Korea, Japan, China, India, and U.K. started to release between 70 and 80 million barrels of their strategic oil reserves. We view the aggregate size of these releases as rather smallish and not sufficient to solve the current slow supply response of producers, which is mainly driven by low investments over the past years, the energy transition, and demand uncertainties related to the pandemic. However, with China consumption lower than in summer, the OPEC slowly moving towards normalization, Iran potentially coming back to the market during the first half of next year, and U.S. shale production slowly rising, we would expect the balance of the oil market to slowly improve.

Conclusion

Global central banks are increasingly switching to a less accommodative monetary regime, which is consistent with the current inflation trend and strong economic activity. As a result, financial conditions will tighten across the world, which reduces consumer demand as well as corporate investments and dampens economic growth. The likely impact on consumer prices and asset class valuations is disinflationary. Super expensive high growth stocks are already under pressure and may be most exposed to the risk of valuation compression during the next quarters.