ECONOMIC SITUATION AND STRATEGY

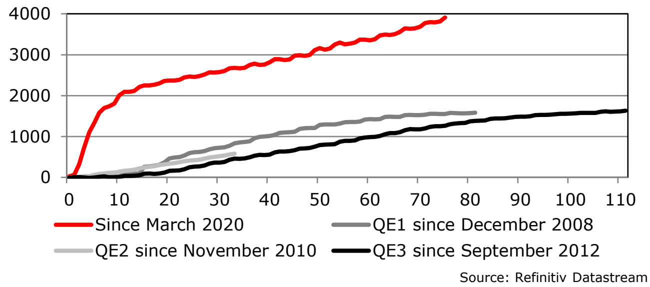
31. August 2021

Tapering, Shmapering

Central Banks have been throwing everything but the kitchen sink at the economy since the pandemic broke loose. From interest rate cuts to bond purchasing programs, they did all they could to keep countries, companies, and private households financed and at the best of terms at that. This expansive monetary policy achieved what it set out to do, particularly as government fiscal policies ran in sync. Meanwhile, many economies have overcome the economic woes from the various lockdowns. As fiscal policies especially in industrialized countries are going to remain generous for the next few years, this raises the question whether monetary policy shouldn't slow down a touch to avoid economic overheating. Some market observers are interpreting rising inflation rates as indication that central banks should have put on the monetary brakes quite a while ago.

However, monetary policy may accelerate like a speed boat but it sure brakes like a supertanker. This particularly applies to the monetary policy of central banks after they expanded their tool kits beyond traditional interest rate policy to include 'quantitative easing.' And they agree that they first have to finish their bond purchasing programs before they can resolve explicit interest rate increases. Central banks will certainly not pull all liquidity out of the markets over night but rather gradually adjust them from a policy of plenty to one of reason. That means the central banks are going to phase out their bond purchases over a predetermined period in a process called tapering.

Fed balance sheet: Cumulative volume of purchases in billions of US dollars (week after the start of the program)

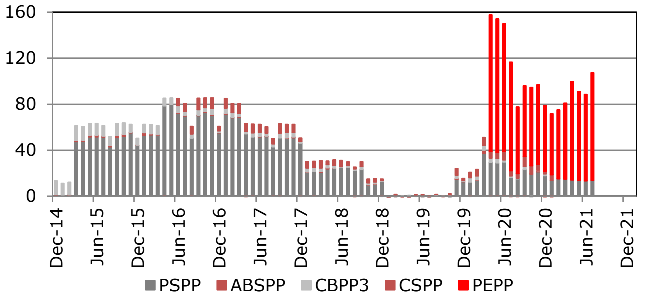


The Fed's open market committee is already openly discussing when to start rolling back the bond purchases currently at USD 120 billion per month and at what pace this should happen. The cumulated bond purchases since March 2020 currently total almost four trillion dollars and the Fed's balance sheet is now topping eight trillion dollars. The community argues we may get some more detailed information from the monetary policy symposium of the Kansas City Fed, an annual meeting of international central bankers typically held in the little Rocky Mountain town of Jackson Hole. This year, however, the meeting will be held online due to the resurging pandemic. Especially tomorrow's speech by Fed Chair Jerome Powell is highly anticipated given the symposium's reputation for breaking monetary policy news. We do not consider it very likely that Mr. Powell will divulge concrete details on the tapering process tomorrow. It has only been four weeks since the last FOMC meeting and not much economic news has transpired since. Recent price data suggests that inflation may have peaked while the labor market continues to recover but employment remains well below pre-pandemic levels.

We therefore think that the Fed will announce first details on its tapering plans at the next FOMC meeting on 22 September. The tapering will probably commence in October or November with a reduction on the order of 10-20 billion dollars per month. That means it would take six to twelve months until bond purchases come to a complete halt. Considering the dynamic economic recovery in the US, tapering bond purchases over a twelve-month period seems overly long while most FOMC members could probably agree on six to at most eight months. That would make a bond purchase reduction around 15-20 billion dollars per month a plausible scenario. If the tapering starts in October, it will be closer to 15 billion dollars per month and a December start would mean 20 billion dollars per month assuming an end of the bond purchase program in May 2022 for both scenarios.

The European Central Bank reiterated four weeks ago that it will run its PEPP (last year's emergency bond purchasing program) as planned at least until the end of March 2022. Until then, the volume of bonds bought under this program would come to a cumulative total of EUR 1,850 billion. At the end of last week, the total had already reached EUR 1,737 billion leaving the ECB for the remaining term a budget of EUR 17 billion per week on average for further bond purchases until the target value is reached. However, March 2022 is not a cut-off date for ECB bond purchases. Euroland, too, will rather taper them off. On the one hand, the ECB has indicated that it will continue PEPP until the pandemic crisis is over meaning that PEPP may persist beyond March 2022. Moreover, PEPP is not the only one of its kind. The ECB also has another, albeit smaller, bond purchasing program called APP that has been around since October 2014. While APP had been put on ice between January and October 2019, it has been revived in November 2019 to the tune of EUR 20 billion net per month mostly invested in sovereigns (EUR 15 billion) and corporate bonds (EUR 5 billion). According to the ECB, APP will not end until an interest rate hike is imminent. It is entirely unknown when that would be (see our more extensive analysis of Euroland inflation from last week). As such, Euroland will take substantially more time to bring its bond purchases down to zero than the US.

ECB: Monthly Asset Purchases



Source: Refinitiv Datastream

The imminent tapering down of bond purchases in the US should have no major impact on investors. In contrast to the markets' 2013 'taper tantrum' when Ben Bernanke (the Fed Chair at the time) completely surprised the world of finance with the announcement that the Fed was going to taper off its bond purchases, lively discussions about the when and how of the inevitable tapering are already under way. As such, there will (probably) be no moment of surprise causing a revaluation of risks and raising risk premiums. Yields on US government bonds may rise slightly but stock markets should continue to trend up for the remainder of the year in light of the good economic prospects and an emerging peak in new Covid infections. Particularly growth stocks still have potential. The biggest winner from the tapering gap between the US and Euroland will be the US dollar, which may well gain a bit on the euro over the next few months. We think an exchange rate of EUR 1.15 EUR/USD is easily attainable by the end of the year.

Market data

Stock marktes	As of 31.08.2021 13:54	Change versus 24.08.2021 -1 week	30.07.2021 -1 month	28.05.2021 -3 months	28.08.2020 -1 year	31.12.2020 YTD
Dow Jones	35400	0,1%	1,3%	2,5%	23,5%	15,7%
S&P 500	4529	0,9%	3,0%	7,7%	29,1%	20,6%
Nasdaq	15266	1,6%	4,0%	11,0%	30,5%	18,4%
DAX	15857	-0,3%	2,0%	2,2%	21,7%	15,6%
MDAX	36135	0,0%	2,8%	8,5%	31,3%	17,3%
TecDAX	3937	0,2%	6,9%	14,9%	26,6%	22,5%
EuroStoxx 50	4189	0,3%	2,4%	2,9%	26,3%	17,9%
Stoxx 50	3612	-0,4%	1,6%	4,3%	21,3%	16,2%
SMI (Swiss Market Index)	12411	-0,2%	2,4%	8,6%	22,1%	16,0%
Nikkei 225	28090	1,3%	3,0%	-3,6%	22,8%	2,4%
Brasilien BOVESPA	119740	-0,4%	-1,7%	-4,6%	17,2%	0,6%
Russland RTS	1682	1,3%	3,5%	4,9%	32,9%	21,2%
Indien BSE 30	57552	2,8%	9,4%	11,9%	45,8%	20,5%
China CSI 300	4806	-1,7%	-0,1%	-9,7%	-0,8%	-7,8%
MSCI Welt (in €)	3147	0,0%	3,0%	8,3%	28,9%	21,3%
MSCI Emerging Markets (in €)	1285	0,4%	1,1%	-3,1%	15,4%	3,2%
Bond markets						
Bund-Future	176,28	-55	-29	634	60	-136
Bobl-Future	135,03	-28	-33	29	33	-15
Schatz-Future	112,29	-3	-6	25	26	2
3 Monats Euribor	-0,55	2	2	2	-7	3
3M Euribor Future, Dec 2017	-0,54	0	0	-1	-6	0
3 Monats $ Libor	0,12	0	0	-1	-12	-12
Fed Funds Future, Dec 2017	0,08	-1	0	0	5	0
10 year US Treasuries	1,29	2	5	-30	58	38
10 year Bunds	-0,40	12	10	-21	5	18
10 year JGB	0,03	1	2	-5	-3	0
10 year Swiss Government	-0,34	4	4	-19	8	16
US Treas 10Y Performance	706,45	0,1%	-0,1%	3,5%	-2,7%	-1,3%
Bund 10Y Performance	679,90	-0,4%	-0,3%	2,8%	0,8%	-0,7%
REX Performance Index	497,05	-0,3%	-0,3%	1,0%	-0,4%	-0,4%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,15	4	6	-15	-7	13
IBOXX BBB, €	0,52	4	6	-20	-47	-3
ML US High Yield	4,54	-9	-3	-17	-130	-44
Convertible Bonds, Exane 25	8345	0,0%	0,5%	0,1%	6,6%	0,2%
Commodities						
MG Base Metal Index	434,36	0,6%	-2,7%	-1,6%	36,6%	22,5%
Crude oil Brent	72,87	2,5%	-4,7%	4,5%	61,5%	40,4%
Gold	1812,25	0,4%	-0,6%	-4,4%	-7,8%	-4,5%
Silver	23,96	0,3%	-6,3%	-14,0%	-13,0%	-9,2%
Aluminium	2675,25	1,8%	3,0%	8,8%	51,6%	35,6%
Copper	9423,75	0,5%	-2,9%	-8,0%	40,7%	21,6%
Iron ore	159,58	-0,3%	-24,7%	-22,4%	30,3%	2,4%
Freight rates Baltic Dry Index	4235	0,8%	28,6%	63,1%	184,6%	210,0%
Currencies						
EUR/ USD	1,1837	0,8%	-0,5%	-2,5%	-0,7%	-3,5%
EUR/ GBP	0,8584	0,2%	0,6%	-0,1%	-3,8%	-4,1%
EUR/ JPY	130,03	1,0%	-0,3%	-2,7%	3,7%	2,8%
EUR/ CHF	1,0807	0,9%	0,3%	-1,4%	0,5%	0,0%
USD/ CNY	6,4603	-0,2%	-0,1%	1,4%	-5,9%	-1,1%
USD/ JPY	109,93	0,3%	0,2%	0,1%	4,3%	6,5%
USD/ GBP	0,73	-0,4%	0,8%	2,8%	-3,3%	-0,9%

Source: Refinitiv Datastream

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