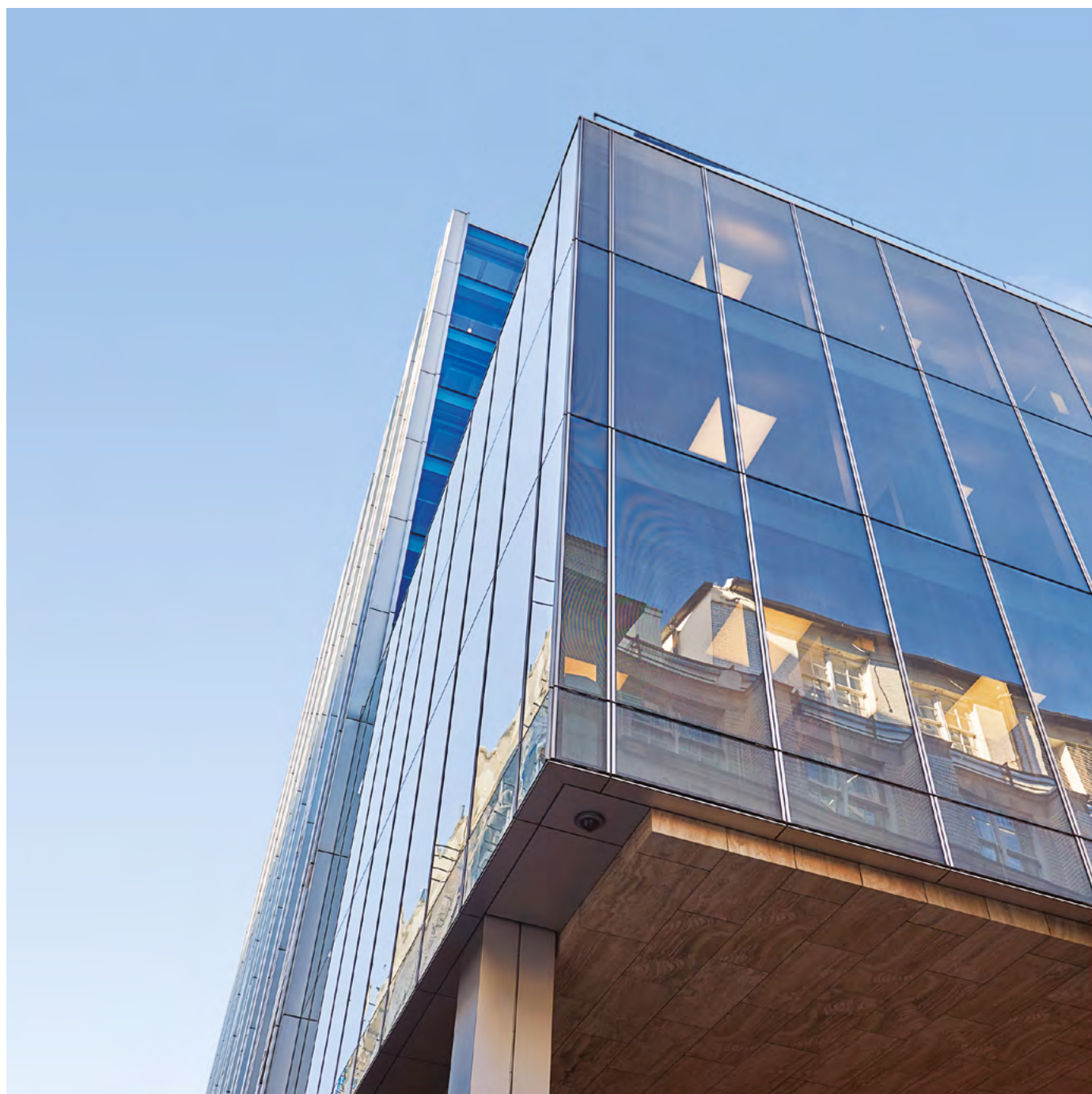


# Monthly Macro Insights



November 2021





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**The latest GDP reports confirmed the global economy downshifted in Q3 2021 amid substantial regional rotation. Looking ahead, this decoupling is expected to narrow, although gauging the magnitude of these shifts is challenging due to high uncertainty regarding supply and demand – hence inflation – dynamics while the pandemic resurges in some regions. Meanwhile, several central banks have pivoted toward a tighter monetary policy.**

### Temporary soft patch?

While the Eurozone shone, the recent loss of momentum in global growth was largely concentrated in China and other North Asian economies. It was also apparent in the US, whereas GDP stepped down from a rate of 1.6% q/q in the first half of 2021 to just 0.5% in Q3<sup>(1)</sup>. Various indicators point to stubbornly persistent supply chain issues, Delta variant headwinds, higher inflation and a drop-off of fiscal stimulus contributing to the current US slowdown. The US savings rate plummeted to 7.5% in September and for the first time since the start of the pandemic it fell below its January 2020 level. This was, in part, explained by the drop in government transfers and brisk consumption earlier this year.

However, this regional divide is expected to narrow. On the one hand, a strong upswing in infections is now evident in Europe and mobility indicators are starting to slide. Furthermore, the energy crunch is particularly acute across the continent and will hit consumers' purchasing power as well as disrupt certain industries, e.g. the chemical sector. Overall, Eurozone GDP growth is expected to moderate sharply in Q4 from the very strong 2.2% q/q in the previous quarter<sup>(2)</sup>.

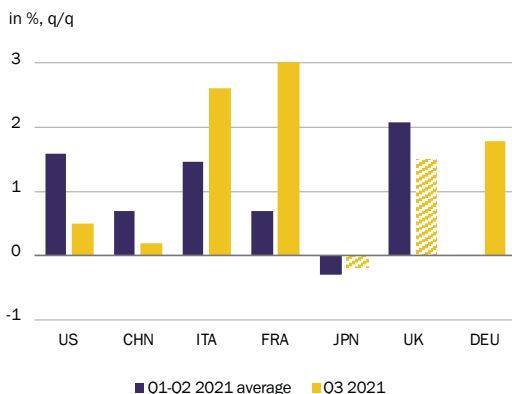
Against that backdrop, ex-Eurozone global business confidence improved in October according to Markit indices<sup>(3)</sup>, especially in the services sector. But the survey also showed record, or near-record, input cost inflation in most industries and indicated that the pass-through to clients led to the sharpest rise in the prices charged sub-index in the series' history (since October 2009).

(1) Source : Bureau of Economic Analysis, October 2021.

(2) Source : Eurostat, October 2021.

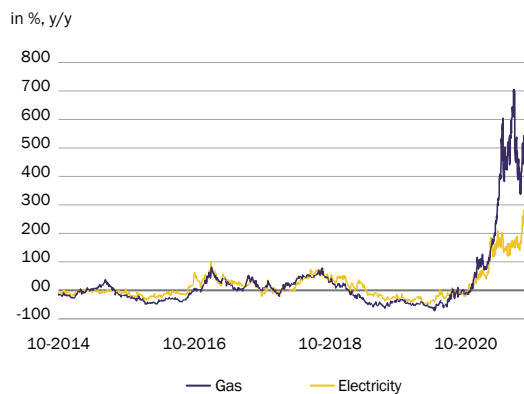
(3) Purchasing Managers' Index, an indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it indicates an expansion of activity, below 50, a contraction.

### World - GDP



Source: Macrobond, Rothschild & Co Asset Management Europe, November 2021.

### Europe - Energy prices



Source: Bloomberg, Rothschild & Co Asset Management Europe, November 2021.

In fact, during recent months, price pressures have increased rapidly, particularly in the US and in some emerging countries. Still, inflation is expected to fall in 2022, once pandemic-induced supply-demand mismatches resolve, especially since output gaps remain large, inflation expectations are still well anchored, and structural factors that have lowered the sensitivity of wages to shrinking labour market slack – such as increasing automation – continue to operate. What’s more, the impacts of policy-related developments, such as the expiration of last year’s temporary value-added tax cut in Germany, will fade. However, mismatches could persist longer than expected, leading to sustained price pressures and rising inflation expectations, which would definitely put central banks on the defensive.

### Divergent monetary policies

At its latest meeting, the ECB stuck to its view that inflation will moderate next year and settle below its 2% target over the rest of the forecast horizon. Hence, President Christine Lagarde stressed that conditions for lift-off, as laid out in the forward guidance published last summer, are unlikely to be met by the end of 2022, or anytime soon after that either. The Bank of Japan also retained its easy monetary policy settings and projected inflation would undershoot its 2% target for at least two more years, reinforcing expectations it will not dial back crisis-mode policies for the foreseeable future. Indeed, while rising

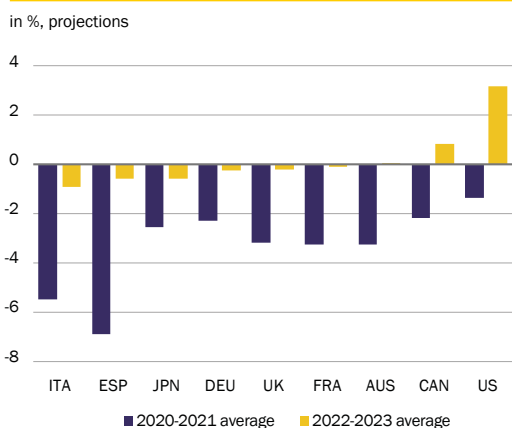
commodity costs have pushed Japan’s wholesale inflation to a 13-year high in September, the pass-through to households has been remarkably slow due to sluggish domestic demand.

However, other central banks have clearly turned more hawkish<sup>(4)</sup>. Norway became the first advanced economy to start its normalisation in September and although the Norges Bank kept the policy rate unchanged at 0.25% in November, the statement reiterated that “the policy rate will most likely be raised in December”. Brazil’s Central Bank Monetary Policy Committee decided to increase its key interest rate 150bps to 7.75%, in what turned out to be the sharpest rise since December 2002, bringing the year-to-date increase to 575bps. The Czech National Bank stunned investors again by lifting its main interest rate by 125bps, delivering its biggest hike since 1997 while signalling borrowing costs had more room to rise. The National Bank of Poland raised its reference rate by 75bps to 1.25%, surprising markets by the scale of the tightening, despite the fact it noted in its press release that most of the inflation’s upward drive is due to external factors beyond the control of domestic monetary policy.

Indeed, monetary policy is ill-equipped to solve supply side shocks. What’s more, participation rates and employment around the world are troublingly lower than pre-pandemic levels, reflecting a mix of childcare constraints, worker fears of getting infected in contact-intensive occupations, labour demand changes as automation picks up in some sectors, and frictions in job searches and matching.

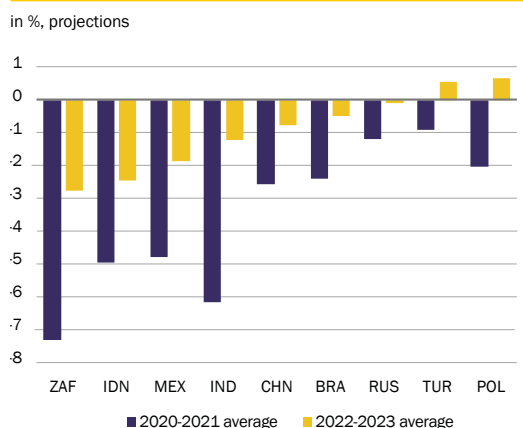
(4) Positioning in favour of a less accommodating monetary policy to fight inflation.

### Advanced economies - Output gap



Source: IMF, Rothschild & Co Asset Management Europe, November 2021.

### Emerging Markets - Output gap



Source: IMF, Rothschild & Co Asset Management Europe, November 2021.

These factors explain why the Bank of England (BoE) has backed away from an immediate rise in interest rates at its November meeting, even as it forecasted inflation would reach 5% next spring, up from 4% previously and the highest level in a decade. That said, the decisions were not unanimous as two of the nine members voted for an immediate rate rise to 0.25% and three wanted the BoE to end, immediately, its quantitative easing programme<sup>(5)</sup>.

Meanwhile, the Fed announced it will reduce its USD120bn monthly asset purchases by USD15bn this month and again in December, and plans to end the program mid-2022. Fed Chair Jerome Powell highlighted that risks are skewed towards higher inflation and confirmed he's prepared to adjust the pace of purchases, if warranted by changes in the inflation outlook. A prolonged period of high inflation would thus accelerate the pace of tapering<sup>(6)</sup>. However, Powell also explicitly separated the decision to begin tapering from raising rates. It looks like any hike in the fed funds rate is unlikely until the Fed judges that the labour market has made enough improvement and reached its – vague – definition of full employment. Overall, the Fed has decided to remain patient and stick to the transitory nature of inflation.

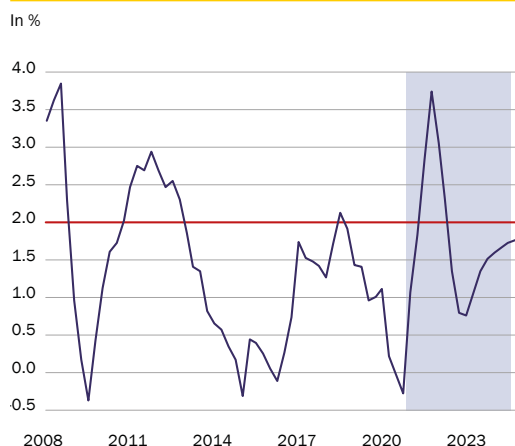
In fact, in assessing the appropriate monetary policy strategy, the Fed and the BoE seem to consider the costs, as well as the benefits, of acting pre-emptively against possible upside risks to medium-term inflation from second-round effects on wages and prices. They recognise that the ability to loosen monetary policy in response to a potential negative shock in the future is constrained by the effective lower bound, whereas interest rates could be increased easily should any second-round effects materialise. Therefore, on a risk management basis, they decided to remain patient.

In sum, the risk profile for the economic outlook has deteriorated as inflation projections could be revised up, while risks to growth are skewed to the downside, precisely because of higher inflation, and also due to the resurgence of Covid infections. As such, monetary policy trade-offs have become much more complex and debates regarding a policy mistake have intensified. ■

Completed writing on 8 November 2021

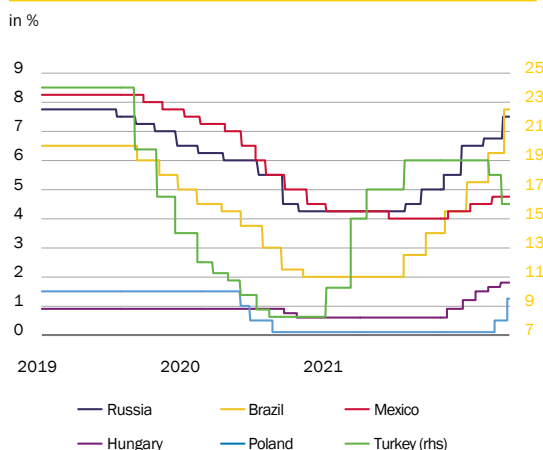
(5) "unconventional" monetary policy measure involving large purchases of sovereign and corporate bonds by a central bank to avoid deflation.  
 (6) Gradual reduction of quantitative easing by central banks.

### Eurozone - Inflation



Source: Macrobond, Rothschild & Co Asset Management Europe, November 2021.

### Emerging Markets - Policy rate



Source Macrobond, Rothschild & Co Asset Management Europe, November 2021.

## Performance of the indices and interest rate levels

	Price as of 29/10/2021	1 month % change	2021 % change
<b>Equity markets</b>			
CAC 40	6 830	4.8%	23.0%
Euro Stoxx 50	4 251	5.0%	19.6%
S&P 500	4 605	6.9%	22.6%
Nikkei 225	28 893	-1.9%	5.3%

<b>Currencies</b>			
EUR/USD	1.16	-0.2%	-5.4%
EUR/JPY	131.77	2.2%	4.4%

	Price as of 29/10/2021	1 month bp <sup>(1)</sup>	2021 bp <sup>(1)</sup>
<b>Interest rates</b>			
3 months	Eurozone	-0.83%	-7
	United States	0.05%	-1
10 years	Eurozone	-0.11%	46
	United States	1.55%	64

(1) Basis point.

Source: Bloomberg, data as of 29/10/2021. Performances in local currency.

Past performance is not a reliable indicator of future performance and is not constant over time.

Index's performance is calculated on the basis of net dividend reinvested.

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