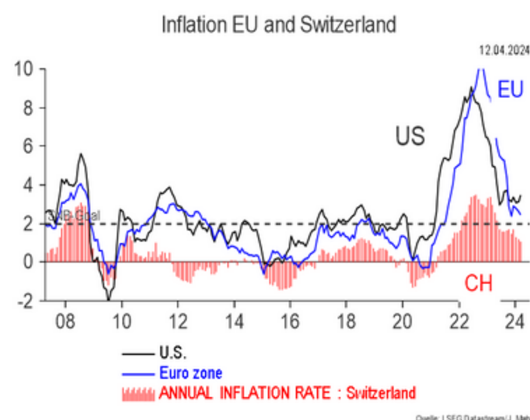
CORUM investment proposal Q2 2024

An inflationary shock gone with the wind?

The greatest burst of inflation since the seventies seems to have disappeared as fast as it arrived. Both in the USA and Europe, current inflation figures are once again within the central banks' target ranges. The concepts they affirmed in 2020 allow deviations from the 2% goal both up and down. Nevertheless, we should not simply go back to business as usual. Commentators are right to ask why so many economists and forecasters made such dire predictions, so much worse than what we are experiencing. This above all applies to the school of thought that labelled the monetary policy of the Western states as "too expansionary", expecting massive inflationary consequences to last for years ("camp permanent").



Representatives of this school of thought warned of a much harsher, longer-lasting restrictive regime. For justification, they always pointed to the 1970s, which demonstrated how high inflation could lead to a wage/price spiral requiring the drastic intervention of the central bank (the Volcker Shock).

The other school of thought ("camp transitory") emphasised the special character of the inflation, the consequence of a pandemic and military conflict. Its representatives pointed to the fact that it was primarily a supply shock, leading to increased prices and profits for all those offering scarce goods. These shocks would be necessary, they said, to even out imbalances in the market. For them, the task of fiscal policy in such situations is to avoid apportioning out the burden of the shock unequally. Monetary policy would have an important role to play in this if secondary effects developed because of a potential wage/price spiral. What followed were interest rate rises of a rapidity and magnitude without precedent in the history of central banks. This panicked reaction led to great losses on the stocks and bonds markets. Many banks also came under pressure, as they had too little time to readjust their maturity structures between assets and liabilities. The collapse of several US regional banks and – indirectly – the fall of CS slowed down the pace of interest rate rises and kept them to an acceptable level.

The fears of a wage/price spiral were also unfounded. Rather, the contrary was the case: in most states, wages were unable to keep pace with prices and the growth in productivity. This is another important lesson from experience: due to the monopolistic economic structure, economic shocks are rather more likely to lead to price and profit inflation. Labour, today, largely lacks negotiating power, as the level of labour organisation has constantly lost power across the globe in recent decades (BIS Papers No 133, Borio, Lombardi et al., March 2023, p.20). The risk of inflation escalating beyond wages is thus much lower today than it was in the 1970s. For monetary policy, this is good news: Volcker-style shock therapy has no place in this environment. The capital markets sent out this message loud and clear throughout the entire inflation cycle. Long-term bond rates never displayed "de-anchoring" of inflation expectations.

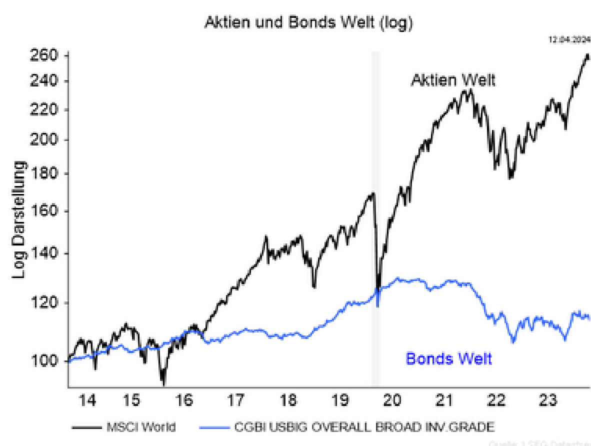
Other research papers determined that the reaction of labour prices (wages) to the decrease in unemployment over the last two decades was much more muted than in the preceding period (flatter Phillips curve). This positive experience with inflation that reached levels not seen for 40 years makes it seem wise to initiate the interest rate turnaround, not only in Switzerland but across Europe. And the earlier the better. Considering the unused production capacity in Europe, waiting for the USA to lower rates would not be recommended. It is an open question as to how far the rates can be lowered, as a fierce debate about the natural interest rate has broken out among experts. Will it return to the pre-Pandemic level, or has it increased?

Particularly, members of the ECB are relatively firm in their opinion that it could end up higher. We consider this assessment unsound and speculative, taking as our motto: "if we must err, then let's err on the right side". That is, lowering rates too little would be at the cost of growth, rather than inflation. This is what is intended by the charter of the ECB, in contrast to that of the FED, where maximum employment is given the same value as price stability.

© CORUM Vermögensverwaltung AG, Mainaustrasse 21, 8008 Zürich, www.corumag.ch

Beyond this, we have access to a rich research literature showing that there is a range of structural factors explaining why real interest rates have systematically fallen over the last few decades. These include demography (ageing society, lower birth rates), the increasing concentration of income and assets, high surplus saving in many emerging countries, and others. These all have the effect of generating surplus savings. These would be even greater if the Western states had not systematically engaged in systematic borrowing.

This imbalance between saving and investment is another essential determining factor for the low inflation rates of recent decades. If consumers and investors no longer have demand for their own output, this puts pressure on prices. The idea that the shocks of the last four years could have had a fundamental effect on these structural factors is hardly likely, as even Jerome Powell stated at the central banks' meeting in Jackson Hole in 2021. If this assessment is valid, we will sooner, rather than later, be confronted with the same questions of low interest rates on capital and undesirably low inflation rates again. But we are not there yet. Nevertheless, experience to date with the current inflation cycle is extraordinarily positive. The stock markets have also reflected this. From the USA to Europe and Japan, they reached all-time highs in the 1st quarter of 2024.



There could be disappointment if those who have warned for a long time that loosening up monetary policy too early could lead to an increase in inflation turn out to be right: with yet stricter measures having to be introduced to counter it. We do not consider this scenario likely.

It is based too heavily on the old world of the 1970s. Nevertheless, it must be considered a residual risk. We also have to consider that new supply and demand shocks may arise, temporarily interrupting the deflationary process. These are not, however, cause for central bank activism.

Confirmation of a new level of restriction ought to represent the most efficient contribution to stabilising inflation expectations. It would not be surprising if the next developments turn out to be characterised by volatility. This estimation lets us abandon our overweighting of stocks in favour of a neutral position. The same applies to bonds. They still have potential to appreciate, but this can only be exploited if the central banks further reduce their high holdings of securities. Until then, they are a burden on the market.

This is as much as can be said regarding general trends.

You can receive the detailed documentation on the decision-making process from your advisor.

Best wishes, Prof. Josef Marbacher & CORUM Investment Committee

Diese Publikation dient ausschliesslich zu Ihrer Information und stellt kein Angebot, keine Offerte oder Aufforderung zur Offertenstellung und kein öffentliches Inserat zum Kauf- oder Verkauf von Anlage- oder anderen spezifischen Produkten dar. Der Inhalt dieser Publikation ist von unseren Mitarbeitern verfasst und beruht auf Informationsquellen, welche wir als zuverlässig erachten. Wir können aber keine Zusicherung oder Garantie für dessen Richtigkeit, Vollständigkeit und Aktualität abgeben. Die Umstände und Grundlagen, die Gegenstand der in dieser Publikation enthaltenen Informationen sind, können sich jederzeit ändern. ändern. Einmal publizierte Informationen dürfen daher nicht so verstanden werden, dass sich die Verhältnisse seit der Publikation nicht geändert haben oder dass die Informationen seit ihrer Publikation immer noch aktuell sind. Die Informationen in dieser Publikation stellen weder Entscheidungshilfen für wirtschaftliche, rechtliche, steuerliche oder andere Beratungsfragen dar, noch dürfen alleine aufgrund dieser Angaben Anlage- oder sonstige Entscheide getroffen werden. Eine Beratung durch eine qualifizierte Fachperson wird empfohlen. Anleger sollten sich bewusst sein, dass der Wert von Anlagen sowohl steigen als auch fallen kann. Eine positive Performance in der Vergangenheit ist daher keine Garantie für eine positive Performance in der Zukunft. Ausserdem unterliegen Anlagen in Fremdwährungen Devisenschwankungen. Wir schliessen eine Haftung für Verluste bzw. Schäden irgendwelcher Art - sei es für direkte, indirekte oder Folgeschäden -, die sich aus der Verwendung dieser Publikation ergeben sollten, aus. Diese Publikation ist nicht für Personen bestimmt, die einer Rechtsordnung unterstehen, die die Verteilung dieser Publikation verbieten oder von einer Bewilligung abhängig machen. Personen, in deren Besitz diese Publikation gelangt, müssen sich daher über etwaige Beschränkungen informieren und diese einhalten. Den mit der Erstellung dieses Berichtes betrauten Personen ist es, im Rahmen interner Richtlinien, freigestellt, den in diesem Bericht erwähnten Titel zu kaufen, zu halten und zu verkaufen.

© CORUM Vermögensverwaltung AG, Mainaustrasse 21, 8008 Zürich, www.corumag.ch