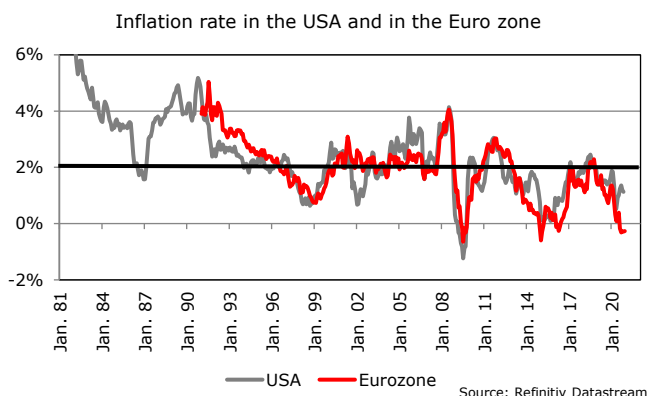




## ECONOMIC SITUATION AND STRATEGY January 15, 2021

### Inflation comeback?

Inflation has led a zombie-like existence for years. Although many economists, market participants, media commentators, politicians, companies, private individuals and central banks have fervently pursued this topic, inflation rate development has been mostly unspectacular. It has been so unremarkable that one might assume central banks had put inflation finally to rest with forward-looking monetary policy. In particular, prices have only risen very moderately since the 2008-2009 financial and economic crises, at a rate of about 1.5% on average in both the United States and the euro zone. The core inflation rate (excluding energy and food prices) has actually only climbed at an average of 1.3% in the same period.



However, there are different aspects of this "success" to consider from the standpoint of the central banks. Their objective (among others) is to ensure price level stability. Intuitively, one might think that is achieved at an inflation rate of zero. But that is not the case. For, it is definitely a positive from an economic standpoint if the value of money declines slightly as a rule. If economic

agents expect their money is going to be worth somewhat less in 12 months, there is (at least in theory) a greater incentive to spend it than if its value remained completely stable. For this reason, many central banks, including the US Federal Reserve (Fed) and the European Central Bank (ECB), have anchored their monetary policy reaction function to an inflation rate of 2%. However, both have mostly missed this target in the past years. The Fed drew consequences from that and decided last September to replace its exactly defined point target for inflation with a flexible, not further specified average target of 2%. It will tolerate a rise above that for a while, since the inflation rate level was previously too low. We consider it likely that the ECB will similarly modify its existing target (inflation near, but below 2%).

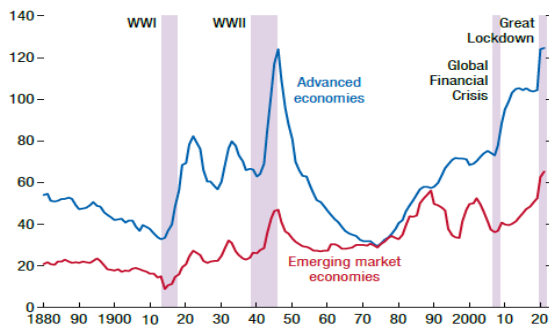
The Fed's new monetary policy strategy will have the effect that its key interest rate will stay at the current level even longer and only be raised later than would otherwise be the case, since the central bank will not have to raise interest rates in reaction to a short-term overshooting of the inflation target. Nevertheless, the yield on 10-year US Treasuries has advanced significantly in the past days. This is not due to increased speculation that monetary policy might be tightened sooner than most have expected, but rather to fears that inflation is making a comeback. This may be gathered from expectations about how inflation will develop in the next five years, which have increased to a rate somewhat above 2.3% for the United States. That is the highest in almost two years. Inflation expectations in the euro zone have also risen to almost 1.4%, their highest level in just over a year. One reason for this increase is

# Economic Situation and Strategy

the election of Joe Biden as US president and the Democratic Party's victories in two special US Senate elections in Georgia. That gives them 50 seats in the Senate, exactly the same number as the Republicans have. If there are tie votes, Vice President Kamala Harris will then have the deciding voice. Consequently, the new president's first acts in office are likely to include getting an extensive economic stimulus package passed, which will drive up US government debt further. More economic growth and higher debt, according to capital market logic, must lead to more inflation, especially if the Fed finances the new debt and for that reason leaves its policy interest rate untouched.

Will the inflation rate actually rise in the near future? The answer is clearly affirmative, but not because of accommodative monetary and fiscal policy or higher government debt. If this supposed interdependence actually existed, a strong and lasting rise of prices would have followed the 2008 collapse, since government debt has increased enormously since then. Instead, we have seen the exact opposite.

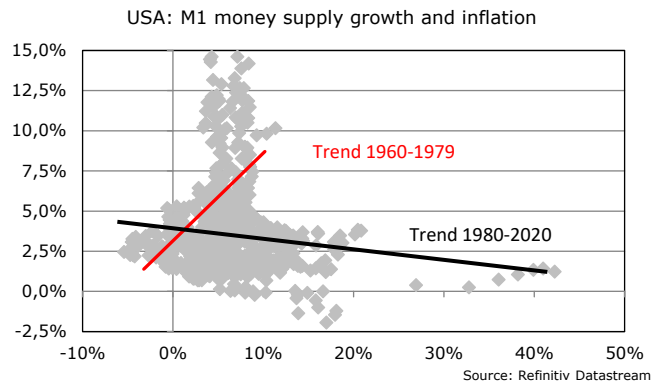
**Figure 1.2. Historical Patterns of General Government Debt (Percent of GDP)**



Sources: IMF, Historical Public Debt Database; IMF, World Economic Outlook database; Maddison Database Project; and IMF staff calculations.

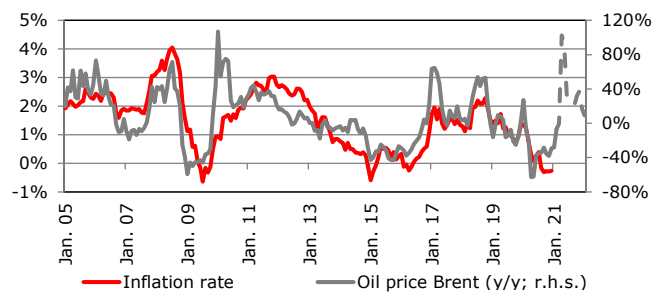
Source: IMF, Fiscal Monitor, October 2020

Contrary to what many expected and what monetarists postulated, strong money supply growth driven by the central banks did not lead to greater price acceleration. Instead, very high money supply growth has been accompanied by very low inflation rates in the past years.



Nevertheless, it is practically certain that inflation rates will rise in the coming months, at times even sharply. The obvious reason for this is the price of oil. After a steep decline last spring due to the pandemic, the price of crude oil has increased significantly in the last few months. If it should remain at the current level of about USD 56 per barrel (Brent), that would mean an approximate year-over-year doubling in April and May 2021. This effect alone will cause the inflation rate to rise by about two percentage points compared with the present level. In addition, Germany is raising its value-added tax at the beginning of the year, which will put the inflation rate above 2% at times from the spring onward. However, this price increase is solely due to a base effect and should not be mistaken for a lasting change of price acceleration. For, just as quickly as the specter of inflation appears, it will also disappear – and with it so will the bond market's worries about a significant yield surge. One should be careful with interest-bearing securities in the near term, though, and give preference to shorter duration.

**Eurozone: Inflation rate and oil price compared to previous year**



Source: Refinitiv Datastream

## Market Data Overview

| Stock markets                  | As of               | Change versus         |                        |                         |                       |                   |
|--------------------------------|---------------------|-----------------------|------------------------|-------------------------|-----------------------|-------------------|
|                                | 15.01.2021<br>11:42 | 07.01.2021<br>-1 week | 11.12.2020<br>-1 month | 13.10.2020<br>-3 months | 13.01.2020<br>-1 year | 31.12.2020<br>YTD |
| Dow Jones                      | 30992               | -0,2%                 | 3,1%                   | 8,1%                    | 7,2%                  | 1,3%              |
| S&P 500                        | 3796                | -0,2%                 | 3,6%                   | 8,1%                    | 15,4%                 | 1,1%              |
| Nasdaq                         | 13113               | 0,3%                  | 5,9%                   | 10,5%                   | 41,4%                 | 1,7%              |
| DAX                            | 13931               | -0,3%                 | 6,2%                   | 7,0%                    | 3,6%                  | 1,5%              |
| MDAX                           | 31260               | 0,1%                  | 5,6%                   | 12,1%                   | 10,0%                 | 1,5%              |
| TecDAX                         | 3283                | 1,0%                  | 5,8%                   | 2,7%                    | 6,1%                  | 2,2%              |
| EuroStoxx 50                   | 3623                | 0,0%                  | 3,9%                   | 10,5%                   | -4,2%                 | 2,0%              |
| Stoxx 50                       | 3195                | 0,7%                  | 3,8%                   | 7,8%                    | -6,7%                 | 2,8%              |
| SMI (Swiss Market Index)       | 10861               | 0,8%                  | 4,5%                   | 5,1%                    | 2,2%                  | 1,5%              |
| Nikkei 225                     | 28519               | 3,7%                  | 7,0%                   | 20,8%                   | 19,6%                 | 3,9%              |
| Brasilien BOVESPA              | 123481              | 0,9%                  | 7,3%                   | 25,4%                   | 5,2%                  | 3,8%              |
| Russland RTS                   | 1501                | 4,5%                  | 6,2%                   | 29,8%                   | -7,3%                 | 8,2%              |
| Indien BSE 30                  | 49035               | 2,0%                  | 6,4%                   | 20,7%                   | 17,1%                 | 2,7%              |
| China Shanghai Composite       | 3566                | -0,3%                 | 6,5%                   | 6,2%                    | 14,5%                 | 2,7%              |
| MSCI Welt (in €)               | 2738                | 1,3%                  | 4,3%                   | 7,9%                    | 5,1%                  | 2,9%              |
| MSCI Emerging Markets (in €)   | 1371                | 4,8%                  | 8,9%                   | 17,1%                   | 9,8%                  | 7,3%              |
| <b>Bond markets</b>            |                     |                       |                        |                         |                       |                   |
| Bund-Future                    | 177,84              | 59                    | -84                    | 278                     | 708                   | 20                |
| Bobl-Future                    | 135,23              | 11                    | -42                    | -20                     | 151                   | 5                 |
| Schatz-Future                  | 112,30              | 3                     | -14                    | -4                      | 40                    | 2                 |
| 3 Monats Euribor               | -0,55               | 1                     | 1                      | -4                      | -16                   | 3                 |
| 3M Euribor Future, Dec 2017    | -0,56               | 0                     | -2                     | -5                      | -19                   | 0                 |
| 3 Monats \$ Libor              | 0,24                | 2                     | 2                      | 0                       | -159                  | 0                 |
| Fed Funds Future, Dec 2017     | 0,08                | -1                    | -1                     | 0                       | -130                  | 0                 |
| 10 year US Treasuries          | 1,12                | 4                     | 22                     | 39                      | -73                   | 20                |
| 10 year Bunds                  | -0,54               | 1                     | 10                     | 2                       | -34                   | 4                 |
| 10 year JGB                    | 0,04                | 1                     | 2                      | 2                       | 5                     | 2                 |
| 10 year Swiss Government       | -0,48               | 1                     | 6                      | 3                       | 4                     | 2                 |
| US Treas 10Y Performance       | 704,45              | -0,1%                 | -1,8%                  | -3,1%                   | 10,1%                 | -1,6%             |
| Bund 10Y Performance           | 683,11              | 0,1%                  | -0,9%                  | -0,2%                   | 3,7%                  | -0,2%             |
| REX Performance Index          | 498,91              | -0,1%                 | -0,4%                  | -0,1%                   | 1,2%                  | -0,1%             |
| US mortgage rate               | 0,00                | 0                     | 0                      | 0                       | 0                     | 0                 |
| IBOXX AA, €                    | 0,04                | 0                     | 9                      | -6                      | -27                   | 2                 |
| IBOXX BBB, €                   | 0,53                | 1                     | 2                      | -29                     | -38                   | -2                |
| ML US High Yield               | 4,97                | 2                     | -18                    | -80                     | -100                  | -1                |
| Convertible Bonds, Exane 25    | 8406                | 0,1%                  | 2,8%                   | 5,8%                    | 9,1%                  | 0,9%              |
| <b>Commodities</b>             |                     |                       |                        |                         |                       |                   |
| MG Base Metal Index            | 363,95              | -1,1%                 | 1,1%                   | 15,0%                   | 21,3%                 | 2,6%              |
| Crude oil Brent                | 55,51               | 1,9%                  | 10,8%                  | 30,6%                   | -13,6%                | 7,0%              |
| Gold                           | 1854,89             | -3,2%                 | 0,5%                   | -1,9%                   | 19,5%                 | -2,3%             |
| Silver                         | 25,49               | -6,0%                 | 6,2%                   | 5,3%                    | 41,5%                 | -3,4%             |
| Aluminium                      | 2015,50             | -0,6%                 | 0,4%                   | 9,3%                    | 13,5%                 | 2,1%              |
| Copper                         | 7994,50             | -2,1%                 | 3,1%                   | 19,6%                   | 27,6%                 | 3,2%              |
| Iron ore                       | 169,80              | 0,3%                  | 11,7%                  | 38,7%                   | 80,6%                 | 9,0%              |
| Freight rates Baltic Dry Index | 1792                | 23,8%                 | 48,0%                  | 3,5%                    | 134,2%                | 31,2%             |
| <b>Currencies</b>              |                     |                       |                        |                         |                       |                   |
| EUR/ USD                       | 1,2140              | -1,1%                 | 0,1%                   | 3,0%                    | 9,1%                  | -1,1%             |
| EUR/ GBP                       | 0,8887              | -1,8%                 | -3,0%                  | -1,7%                   | 3,6%                  | -0,7%             |
| EUR/ JPY                       | 125,78              | -1,1%                 | -0,4%                  | 1,1%                    | 2,9%                  | -0,6%             |
| EUR/ CHF                       | 1,0767              | -0,6%                 | -0,2%                  | 0,3%                    | -0,4%                 | -0,3%             |
| USD/ CNY                       | 6,4712              | -0,1%                 | -1,2%                  | -4,1%                   | -6,1%                 | -0,9%             |
| USD/ JPY                       | 103,87              | 0,0%                  | -0,2%                  | -1,5%                   | -5,5%                 | 0,6%              |
| USD/ GBP                       | 0,73                | -0,8%                 | -3,3%                  | -4,9%                   | -5,0%                 | 0,1%              |

Source: Refinitiv Datastream

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