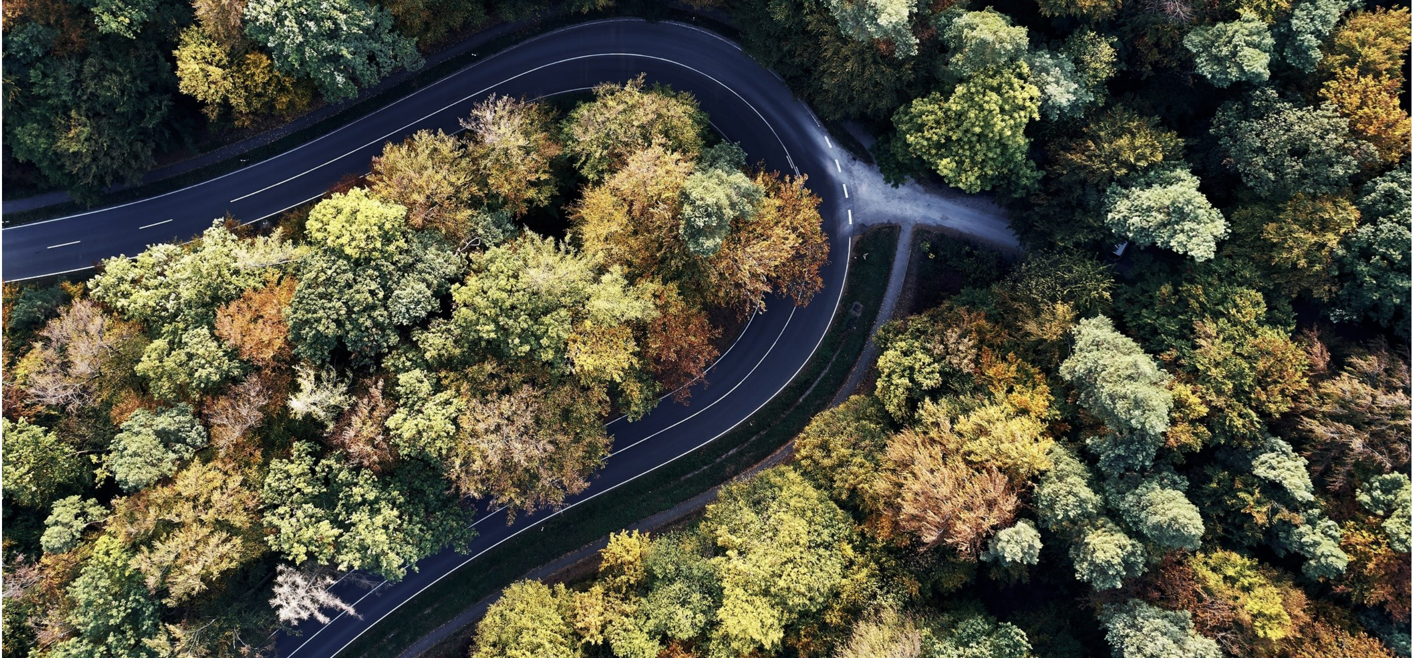
Turnaround in interest rates?



Major developments in financial markets usually emanate from the United States. Its large, broad, and deep capital market sets the trends and fashions for other important countries. Currently, topics such as inflation and the interest rate turnaround are dominating discussions in the financial media. The tenor is that although the most recently reported American inflation figures were shockingly high, overall they are to be regarded as temporary. This, after all, is the official view of the U.S. central bank, the Fed.

The Fed has every reason to talk down the rates of monetary depreciation because it has verbally committed itself to maintain its zero interest rate policy until the end of 2023. In addition, until that date, it plans to continue buying up bonds on the market on a large scale. Market observers expect the Fed's balance sheet to total around $9 trillion by December 2023. Already today, the central bank is the U.S.'s largest creditor by far.

But with prices rising faster than expected, the central bank could come under pressure to raise interest rates and end its bond-buying program earlier than planned. In 2017 and 2018, initial attempts by the Fed to exit the economic stimulus programs had failed when former U.S. President Trump put his central bank under harsh verbal bashing.

Meanwhile, numerous economists believe that private demand for government bonds is far too low at current interest rate levels to meet America's enormous financing needs. They see the only way out as offering significantly higher interest rates to attract investors - not least foreigners - to U.S. government bonds. If this were to happen, it would mark a historic turnaround in U.S. interest rates after four decades. Of particular interest will be the observation of wage developments. There are signs of a tight labor market despite relatively low labor market participation and rising minimum wages, most recently at McDonald's, Amazon, and Walmart. A wage-price spiral could get underway, making demonetization a perennial issue.

Since the United States of America tends to lead other markets, Europe would also be drawn into the maelstrom of such an interest rate turnaround. Indeed, inflation is currently rising sharply in the "old world" as well. This has recently become particularly visible in energy prices, although it should be noted that a newly introduced CO2 tax and the renewed increase in VAT are contributing considerably to this development. However, the observable price increases are by no

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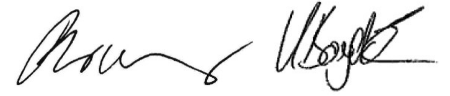
means limited to the energy sector. Rather, price increases can be diagnosed across a broad spectrum.

In the short term, this is bad news for interest rate investors, because rising interest rates mean falling bond prices. Whether an exit from the European Central Bank's 'zero interest rate policy' can be achieved in the long term remains to be seen. Recently, the ECB's headquarters in Frankfurt has only been talking in terms of appeasement. Compared with bonds, equities make a much better impression, which is why this dynamic asset class remains without alternative for the time being. In any case, tangible assets have the advantages on their side.

Sincerely yours,

Fund managers and co-investors



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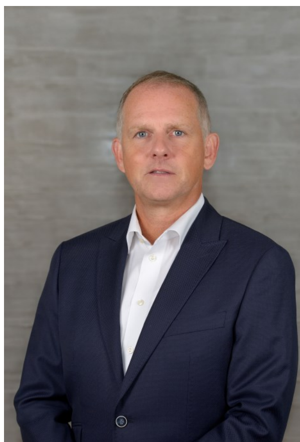

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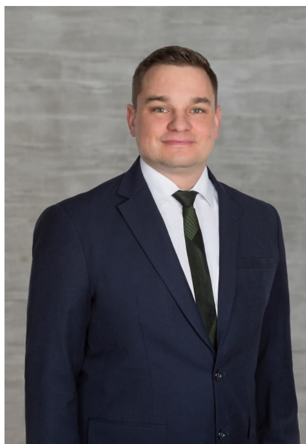

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