THE GLOBAL CIO OFFICE

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Gōng xǐ fā cái

2022 is the year of the Black-Water Tiger. Water Tiger of 2022 implies caution, growth, development, challenge, creation, and planning.

Central Bankers - Tigers Still with no Teeth

- **The Fed appears to be on the path of "nimble" policymaking, hoping to get a grip on inflation soon**
- **While inflation was of global central banks' making, they now realise that they bit off more than they can chew**
- **The probability of at least five rate hikes by the Fed this year is something that cannot be ruled out**
- **The euro is weak against the dollar, with little material support ahead for the currency to hold ground**
- **While we have been more sanguine about a global equity sell-off so far, going forward we don't see equities taking a significant beating**

The Federal Reserve continues to adjust to the reality of the inflation risk. Chairman Jerome Powell has taken us from a world of 'transitory' inflation to now 'nimble' policymaking. Despite all the resources at the central bank's disposal, it still gives the impression of living from week to week in its forecasts and policymaking, perhaps just hoping that inflation will eventually slow down.

Remember, the Fed and other central bankers created a mandate to explicitly create inflation. Now that they have 'created' inflation, they find they may have created a monster they can't easily control. Adding to the quandary is COVID, which continues to be a challenge. Still, central bankers have only themselves to blame for abject policymaking that has caused significant imbalances in the global economy, with massive inflation in asset prices marginalising a considerably percentage of the population.

Last week, the markets saw the Fed meeting as hawkish, but what did investors expect? US inflation is above 7%. The Fed is clearly spooked, and the market now prices five rate increases this year, whereas just a few months ago the Fed was reluctant to increase interest rates in 2022. The change of tone in the messaging from Chairman Powell suggested that the Fed has left the door open to raising rates more sharply and frequently, with the possibility of a 50bps increase at the March meeting.

With the change of tone from the Fed, in essence, pulling forward rate rises, Gold was on the rack with the spot price falling 3.1% on the week to $1779. Ironically, the US announced its money supply data last week; US M2 money supply has increased 43% in the past two years. Typically, such a debasing of the dollar would lead to a higher gold price. However, investors have been forgiving of the unusual central bank policy as the world remains in a state of flux. We believe that in time investors will worry about the legacy of the imprudent policies of central bankers,

particularly if inflation persists as a problem. Timing, therefore, will be everything. For the moment, we are riding the weakness in the gold price and remain committed to the asset for the long term.

The Bank of England may have market pressure for tighter monetary policy this week in the wake of much stronger than expected inflation. There is an increasing probability that the BoE will increase interest rates by 25bps and signal to the market that it will taper quantitative easing very soon.

The market anticipates that the **Reserve Bank of Australia** will soon end quantitative easing and signal that it is unlikely to wait until 2024 to raise rates; indeed, a rate increase is quite possible this year.

The ECB is under less pressure to change tack on policy. Wage growth remains benign compared to high consumer price inflation; hence there are enough restraints on growth to stop the ECB from materially changing its signals to the market, at least for the moment. Thus, a rate rise still seems to be at least a year away.

The euro hit the weakest level since 2020 against the dollar last week, trading below 1.113. Although the euro is quite oversold, there is little material support ahead for the currency until the negative impact of Omicron on growth abates and the Ukraine situation hopefully blows over. The next level to watch is the psychologically important 1.10 level. The dollar is likely to maintain its strength against other low-yielding currencies such as the Yen.

This week, we see several industrial confidence data points that should help us gauge how much of a hit global growth has taken from the disruption caused by Omicron. After quarterly annualised growth of 6.0% in the fourth quarter of 2021, the global economy seems on track for around 3.0% growth for Q1 2022. It is no disaster, but it is a significant loss of momentum certainly.

We have been more sanguine about the equity market sell-off than some only because the sell-off to date, in our mind, was a logical correction of a fundamental overvaluation in certain parts of the market. However, the premise for our belief that there won't be a more significant sell-off is built on the assumption that the risk of a global recession remains small. A likely source of a global recession would be tightening credit conditions – not just a rise in interest rates but also a reduction of credit availability. The equity market as a source of credit has started to wobble. The Financial Times quotes Dealogic data as showing that technology companies that listed in 2021 are down on average 34% from their offering price. The drop in prices is discouraging other companies from listing in public markets.

For the moment, the bond market is relatively calm. Credit spreads remain relatively well behaved despite the rise in market expectations for rate rises. Crucial to credit spreads remaining fairly tight is the prospect of ongoing reasonable global growth. Consensus forecasts remain centred on 4% to 4.25% global growth in 2022. The hope will be that as the world deals with Omicron, global activity will reaccelerate. The next few months will be crucial to keeping the sanguine view of the world intact.

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