24th June 2021

Market Update

How Long is an Era?

The era of high inflation is upon us. If we were in a more sensationalist mood, this article could probably end here. Taking a more thorough approach, however, and the first question to ask is just how long will this era last? If the Bank of England and the Federal Reserve are to be believed, the answer is not long. UK inflation is now above target with May's CPI coming in at 2.1%. The US meanwhile has CPI running at an eye-catching 5%. Fear not, say the rate-setters, with 'transient' being the favoured word of the moment. Both Jerome Powell (Federal Reserve) and Andrew Bailey (Bank of England) believe that the current surge in price levels is largely caused by factors that will prove to be temporary in nature. They argue that oil prices are much higher than they were a year ago simply because last year's levels were extremely depressed; while bottlenecks in supply chains and labour markets will ease as economies stabilise after a temporary reopening boom. Put simply, they argue that inflation is nothing to worry about and recent spikes will subside over the next year or so.

When to Ease Off

Despite the belief that inflation will fade, there is growing acknowledgement that economies are doing well and that the time to reduce Quantitative Easing stimulus and to ultimately raise interest rates will eventually come. Getting this messaging right is proving rather difficult, however, with memories of what happened the last time the Fed eased off the accelerator pedal haunting both officials and markets.

Good News is Bad News

The 2013 Taper Tantrum was a period of turmoil in markets as investors reacted badly to plans by the Fed to move away from the ultra-loose monetary policy which followed the Global Financial Crisis. The good news of emerging economic strength, which allowed this planned shift in policy, was actually interpreted as bad news, as it meant that markets would no longer be pumped full of quite so much cheap money.

Taper Tantrum - Part II

Last Friday saw an abridged sequel to the Taper Tantrum, with global markets led downwards by the US as investors fretted over a marginal change in the Federal Reserve's guidance, where expectations of the first interest rate rise were brought forward from 2024 to 2023. This was interpreted as being the beginning of the end for the burgeoning economy and so particularly punished those stocks which are more cyclically sensitive.

Moving Slowly

These negative reactions were clearly not lost on the Fed, however, and more announcements were made over the following days which reiterated that while higher interest rates are likely to come sooner than had been previously expected, movements towards tightening will be very gradual. This then prompted a swift recovery in markets as we moved through the current week. As you were, then.

Perceptions Matter

Nonetheless, this event should not be dismissed out of hand. Central bankers are making it clear that they would rather be behind the curve, in that they will wait for sustained rises in inflation and GDP growth to actually occur, rather than pre-emptively acting in expectation of their occurrence. Overall, we believe this means a continuation of the current positive market environment, yet it is clear that if central bankers are perceived to have made a miss-step then sudden bursts of volatility are likely. As such, caution should be maintained.

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