8th July 2021

Market Update

Delaying Tactics

In August 2020 the US Federal Reserve changed its mandate in order to target an inflation rate which on average is 2%, rather than a precise 2% target. In effect this meant that the central bank could wait longer as inflation rises before raising interest rates and therefore allow the economy to grow further before the brakes are applied. This change in policy was in reaction to the difficulties experienced in generating consistent economic growth following the Global Financial Crisis and was also a reflection of the huge challenge facing the economy in the recovery from Covid disruption. In bond markets this had the impact of suppressing short to medium term interest rates, while increasing longer term yields. The expectation here being that by delaying rate rises now, larger rate rises will be required down the line.

Follow the Leader

This was a large shift in policy for the Fed and as with many factors in the world of finance, where the US goes, the rest of the Western world tends to follow. In this vein, the European Central Bank has just announced a similar shift in policy. The prior policy was to target inflation at close to, but below 2%, whereas the new policy is to target 2%, but with a tolerance for readings to temporarily exceed this level before action is required. This change in policy will have little impact immediately, but over time it could be seen as a significant change. Historically, the ECB has been quick to react to rising inflation, with heavy influence from Germany and their destructive experience of interwar hyperinflation. Now though there appears to a be a new era, where excessively low inflation, and the numbing effect it has on economic growth, is viewed as an equal threat to occurrences of overly high inflation. Long term, this could result in a more dynamic economy, but also perhaps one which is more prone to cyclicality.

A Welcome Tax

Last week it was announced an agreement has been reached by 130 countries, including all G20 members, on big changes to the global tax system. This aims to end the 'race to the bottom' on corporation tax rates while also allowing for the greater taxation of the largest companies' profits in jurisdictions where the sales take place, rather than where a company's offices are based. Many of the details are yet to be ironed out, and the deal could yet be scuppered by national parliaments, but this is a large step forward in a process that will allow greater tax revenues to be generated, which is especially desirable at a time when countries face huge debts resulting from the pandemic. Should this agreement make it to full implementation then clearly the companies targeted will be the losers, but with many countries having previously taken steps towards unilateral action in this area, a global accord has largely been welcomed by the leading companies as this will bring consistency and simplicity to the process. Market reactions were largely welcoming to the development as well, with the acceptance that the reductions in profits will be manageable and with a targeted launch date of 2023, there will be time to adjust.

Losing Steam?

A miserable mood has taken hold of investment markets in recent days with both longer term bond yields and equities falling, representing an increasingly pessimistic view for the global economy. Concern over the spread of the delta variant appears one cause, while questions of a slowdown in

China are being raised. Yet, both factors have been apparent for some time and therefore such a rapid shift in psyche appears more likely to be a shorter period of volatility, at this stage. Nonetheless, while markets often overreact, new trends can gain traction quickly and so this is a topic that should be monitored closely.

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