Citi Global Wealth Investments November 04, 2021

EMEA Strategy Bulletin

Central banks continue to support growth despite inflation pressures

Jeffrey Sacks, Head – EMEA Investment Strategy | +44 207 508 7325 | Jeffrey.ian.sacks@citi.com
Maya Issa – Senior Vice President, Global Investment Strategy | maya.issa@citi.com
Judiyah Amirthanathar– Vice President, EMEA Investment Strategy |+44 207 508 7335 | judiyah.amirthanathar@citi.com

- **Bank of England (BoE):** Monetary Policy Committee (MPC) votes (7-2) to keep rates steady and (6-3) to continue with quantitative easing (QE).
- **European** Central Bank (ECB): Ms Lagarde pushes back strongly against market pricing of first-rate hike in late 2022 .
- **Norges Bank:** Planning for a further hike in December.
- **Market reactions:** Sovereign bonds rally strongly, equities remain well supported, currencies weaken slightly.

BoE voting not unanimous however concludes with no changes in policy

Today was not the time to move for the BoE's MPC, however the committee judged that "*it will be necessary over the coming months to increase the Bank Rate in order to return CPI inflation to the 2% target*", making a specific reference to a likely further improvement in the labour market after the end of furlough. The committee also pushed back against the market pricing of the Bank Rate rising up to 1.25% by the end of 2022, noting that "*based on the market-implied path for the Bank Rate, CPI inflation would likely be below the target at the end of the forecast period.*"

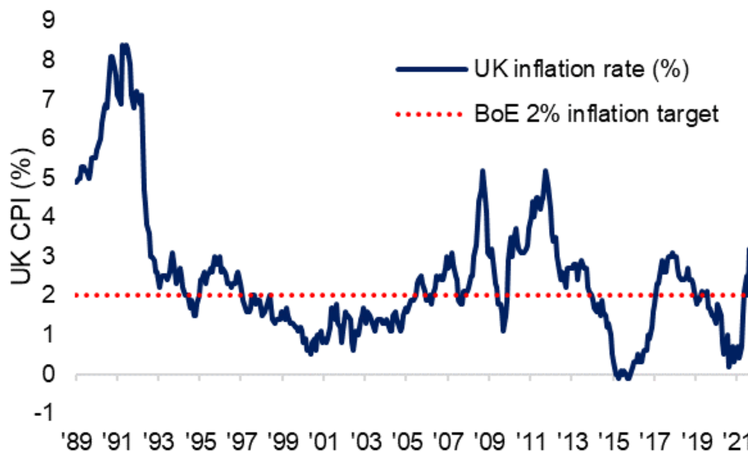
We identify three key takeaways from this meeting, the policy announcement, and the press conference:

1. **Not particularly worried about higher-for-longer inflation:** the MPC does not seem under strong pressure to act immediately, with still only two dissenters (Ramsden and Saunders) voting for a rate hike. Perhaps some signs of stabilization in the October Citi/YouGov survey of inflation expectations helped. BoE governor Andrew Bailey described the current inflation spike as transitory, while BoE deputy governor Andrew Bailey argued that the outlook for energy prices (likely to put downward pressure on household consumption) was a key input. See **figure 1.**
2. **Sequencing matters:** the decision not to hike interest rates and keep the asset purchases going at least until mid-December looks like a strong message to investors that the current sequencing (ending net asset purchases before hiking interest rates) remains an important anchor.

3. **Risk for a three-month delay to Feb-22** – The BoE could conceivably wait until February, when more details about the 'true' state of the labour market will be available. In addition another forecast round would allow to gauge the strength of possible headwinds to the recovery from the energy price spike as well as a possibly slower momentum in the global economy.

Overall, recent communication from the BoE has been challenging, perhaps making it dangerous to rely too much on the wording of today's statement. While we continue to think that the Bank Rate is likely to rise soon, most likely by 15 basis point (bp) to 0.25%, the bar to a 16 December hike (coinciding with the likely end of the QE programme move) now looks higher. We now think that there is a stronger likelihood of the first move in this hiking cycle to be in Feb-22.

Figure 1: UK Inflation rate (%) rising



Source: Bloomberg as of November 04, 2021. Past performance is no guarantee of future results. Real results may vary.

ECB President Ms Lagarde reinforces message from last week's meeting

Last week the ECB kept its deposit rate at -0.5%, the refinancing rate at 0.0%, and the minimum lending facility at +0.25%. Today the ECB President Christine Lagarde was quoted saying on Wednesday that *"I certainly do not see any interest rate taking place in the next year -- 2022 is off the chart in that respect",* in an interview with Portuguese television station TVI. Today, markets are pricing likely rate hikes of 8bp in 12 months, 26bp in 18 months and 36bp in 24 months. Yet, the ECB's Jul-21 interest rate guidance is crystal clear: until the 2023 HICP mid-point (currently 1.5%) and the new 2024 mid-point (perhaps to be close to 1.8% when first published in December) are at (or temporarily above) 2%, interest rates are likely to stay at their current levels. See **figure 2.**

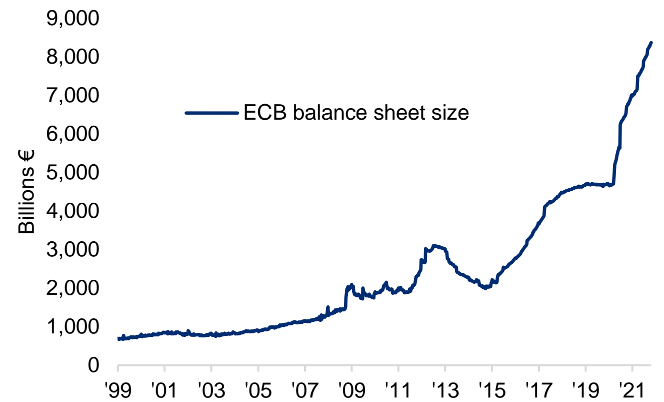
Investors are focusing on whether the ECB will make any changes to its open-ended asset purchases programme at the 16 December meeting, following the likely end of PEPP, its pandemic emergency purchase programme in Mar-22. We think that the signal about the length of Asset Purchase Programme (APP), more than the monthly amount of purchases, will be a key element of market pricing of the most likely timing of any interest rate hikes. Indeed, we expect the ECB to maintain the current sequencing requiring asset purchases to end before any possible hike in the policy rate: the ECB will likely want to test the level of financing conditions during a period of zero net asset purchases before embarking on a tightening of its policy stance.

In coming months, and probably throughout 1Q-22, data on economic activity and inflation is likely to get worse: the cut to households' purchasing power and the profit squeeze that firms could be facing (because of the rising cost of various intermediate goods including energy) are likely to weigh on spending and perhaps production. Any central bank including the ECB will likely interpret the current transitory spike in energy and headline HICP as a negative demand shock, even if its size is likely to be limited given the various government measures introduced to mitigate these effects. If anything therefore, despite the impression of a growing hawkish undertone, we expect the ECB to remain more dovish than many of its peers, keeping a very close eye on the risk of fragmentation in the transmission of its monetary policy stance and

the level (and direction) of euro area sovereign bond spreads when deciding how best to present its new guidance on asset purchases in December. See **figure 3.**

Figure 2: Euro Inflation (%) vs ECB Target

Figure 3: Monetary policy to stay accommodative



Source: Bloomberg as of October 28, 2021. Past performance is no guarantee of future results. Real results may vary.

Norges Bank on a tightening path

Norway was the first central bank to hike rates this year, in September by 25 basis points (bp). The Governor Oystein Olsen stated "A normalizing economy now suggests that it is appropriate to begin a gradual normalization of the policy rate". They continued to point to another hike before Christmas.

From the meeting today, there were no surprises – the policy rate was left unchanged at 0.25% and the Bank continued to reiterate its plan for a December hike. The better macro-outlook, higher oil price and rising headline inflation are key hawkish factors for the policymakers. In addition, the potential rise in wage pressure is expected to boost underlying inflation higher. The Bank is still on track to hike in December and a further three rate hikes next year. During the pandemic the Norges bank cut rates by 150bp, from March 2020 to May 2020, at a rapid pace and so we anticipate the same rapid increase to take effect this year and next.

Market reaction

Equities: The markets are supported by the ongoing loose monetary policies. With rates staying low, the discount rates for valuing equities stay low. At the same time the current earnings season is showing more beats than misses, with 2022 expected to see further earnings progress albeit at a slower pace. The dividend support has resumed with companies resuming payouts. The Euro Stoxx 600 index is already up 20% so far this year and should remain well-supported in the coming months. The FTSE 100 index is up almost 13% so far this year, and has a cheaper valuation so offers greater upside on our 12-18 month horizon. The Private Bank's Global Investment Committee (GIC) is now neutrally weighted in Europe ex-UK having been overweight all year until a fortnight ago, and overweight in UK equities.

Fixed income: At the time of writing the UK bond market has been rallying hard, with a 16bp drop in the 2Y yield to 0.55%, a 20bp drop in the 3Y yield to 0.56% and a 13bp drop in the 10Y yield to 0.95%, meaning some significant repricing of the medium-term path of interest rates. European banks have also been very strong, with falls in all 10-year sovereign bond yields (France down 6.7 bp to 0.11%, Germany down 6.1bp to -23%, and Italy down 12bp to 1.14%). We remain underweight sovereign bonds, mainly on valuation grounds.

Euro: The Euro has weakened slightly to US$1.1544. While the currency is supported by the firming growth and inflation outlooks, along with the "calibration" of the PEPP with less bond buying in the short term, against that Ms. Lagarde has given little encouragement that the deposit rate will rise anytime soon. Sterling weakened slightly to $1.3504 however has a reasonable valuation and technical support at $1.34.

This email contains promotional materials. If you do not wish to receive any further promotional emails from Citi Private Bank, please email donotspam@citi.com with "UNSUBSCRIBE" in the subject line. Email is not a secure environment; therefore, do not use email to communicate any information that is confidential such as your account number or social security number.

Announced in January 2021, Citi Global Wealth ("CGW") is comprised of the wealth management businesses of Citi Private Bank and Citi's Global Consumer Bank. Through these businesses, CGW delivers Citi's wealth solutions, products and services globally. The unified management and delivery of CGW's wealth strategy represents a further commitment by Citi to become a leading global wealth business. Citi Global Wealth Investments ("CGWI") is comprised of the Investments and Capital Markets capabilities of Citi Private Bank, Citi Personal Wealth Management and International Personal Bank U.S.

Citi Private Bank and Citi Personal Wealth Management are businesses of Citigroup Inc. ("Citigroup"), which provide clients access to a broad array of products and services available through bank and non-bank affiliates of Citigroup. Not all products and services are provided by all affiliates or are available at all locations. In the U.S., investment products and services are provided by Citigroup Global Markets Inc. ("CGMI"), member FINRA and SIPC, and Citi Private Advisory, LLC ("Citi Advisory"), member FINRA and SIPC. CGMI accounts are carried by Pershing LLC, member FINRA, NYSE, SIPC. Citi Advisory acts as distributor of certain alternative investment products to clients of Citi Private Bank. Insurance is offered by Citi Personal Wealth Management through Citigroup Life Agency LLC ("CLA"). In California, CLA does business as Citigroup Life Insurance Agency, LLC (license number 0G56746). CGMI, Citi Advisory, CLA and Citibank, N.A. are affiliated companies under the common control of Citigroup.

Outside the U.S., investment products and services are provided by other Citigroup affiliates. Investment Management services (including portfolio management) are available through CGMI, Citi Advisory, Citibank, N.A. and other affiliated advisory businesses. These Citigroup affiliates, including Citi Advisory, will be compensated for the respective investment management, advisory, administrative, distribution and placement services they may provide.

International Personal Bank U.S. ("IPB U.S."), is a business of Citigroup Inc. ("Citigroup") which provides its clients access to a broad array of products and services available through Citigroup, its bank and non-bank affiliates worldwide (collectively, "Citi"). Through IPB U.S. prospects and clients have access to the Citigold® Private Client International, Citigold® International, International Personal, Citi Global Executive Preferred, and Citi Global Executive Account Packages. Investment products and services are made available through either Citi Personal Investments International ("CPII"), a business of Citigroup Inc., which offers securities through Citigroup Global Markets Inc. ("CGMI"), member FINRA and SIPC, an investment advisor and broker–dealer registered with the Securities and Exchange Commission; or Citi International Financial Services, LLC ("CIFS"), member FINRA and SIPC, and a broker–dealer registered with the Securities and Exchange Commission that offers investment products and services to non–U.S. citizens, residents, or non–U.S. entities. CGMI and CIFS investment accounts are carried by Pershing LLC, member FINRA, NYSE, and SIPC. Insurance is offered by CPII through Citigroup Life Agency LLC ("CLA"). In California, CLA does business as Citigroup Life Insurance Agency, LLC (license number 0G56746). Citibank N.A., CGMI, CIFS, and CLA are affiliated companies under common control of Citigroup Inc.

Read additional Important Information

Past performance is not indicative of future results. Real results may vary.

Citi and its employees are not in the business of providing, and do not provide, tax or legal advice to any taxpayer outside Citi. Any statement in this Communication regarding tax matters is not intended or written to be used, and cannot be used or relied upon, by any taxpayer for the purpose of avoiding tax penalties. Any such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

MBS are also sensitive to interest rate changes which can negatively impact the market value of the security. During times of heightened volatility, MBS can experience greater levels of illiquidity and larger price movements.

Important information, including information relating to risk considerations can be found in the link above.

Views, opinions and estimates expressed herein may differ from the opinions expressed by other Citi businesses or affiliates, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice, and are subject to change without notice based on market and other conditions. Citi is under no duty to update this presentation and accepts no liability for any loss (whether direct, indirect or consequential) that may arise from any use of the information contained in or derived from this presentation.

© 2021 Citigroup Inc., All Rights Reserved. Citi, Citi and Arc Design and other marks used herein are service marks of Citigroup Inc. or its affiliates, used and registered throughout the world.

INVESTMENT PRODUCTS: NOT FDIC INSURED · NOT CDIC INSURED · NOT GOVERNMENT INSURED · NO BANK GUARANTEE · MAY LOSE VALUE

www.citiprivatebank.com