Vontobel

Investors' Outlook

Central bank chiefs ready to slug it out over inflation

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Central bank chiefs ready to slug it out over inflation

—
Dan Scott
Head of Vontobel Multi Asset,
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Dear readers,

Every year, central bankers, policymakers, academics, and economists convene in an unlikely place in the US state of Wyoming to deliberate about important matters. Observers hang on the lips of the attendants of the Jackson Hole summit, trying to glean nuggets of wisdom and insights about the state of the global economy. In 2021, many pundits thought that inflation would be transitory. This year, the discussions revolved around how to maintain credibility in the fight against persistent inflation.

General Powell's latest stand disappoints some
Today, central bankers are in a double bind. Initially, they got rapped on the knuckles for belittling inflation, now they are criticized for a panicked U-turn. With the US Federal Reserve already having made fast and forceful hikes to the main lending rate, would now be the time for yet another step change? Those hoping that Fed governor Jerome Powell might announce a more cautious stance in Jackson Hole, i.e. a rethink of the US Fed's tightening policy, were disappointed. Powell didn't yield an inch, instead continuing to fly his newly adorned inflation-fighting colors (perhaps remembering General Custer's holding out in nearby Montana some 150 years ago). He stressed that it's both possible and necessary for central banks to keep prices low and stable, and reaffirmed his commitment to a tight monetary policy.

There is some room for debate here. Prior to the pandemic, the US Fed failed to reach its 2% inflation target with then-chairwoman Janet Yellen saying in 2017 that she and her colleagues didn't fully understand inflation. The unemployment rate had been falling for several years, yet inflation was not increasing.

→ Webcast
To view our webcast on recent market developments, click **here**

Fed tightening a policy mistake?
So, are key rates being hiked for the right reason? That's not clear. The International Monetary Fund's (IMF) senior economist Gita Gopinath recently observed that current economic models cannot account for the sharp rise in inflation. We are also aware of British-American economist David Blanchflower's work[1], which has already debunked the so-called Phillips curve – a model that predicts a higher rate of increase in wages with lower unemployment. Critics of the Fed's tightening action argue that the new policy only adds pain to an ongoing economic slowdown, and they have a point. What we do know with a high degree of certainty is that inflation will come down as the global economy cools.

When Powell gave his speech, financial markets promptly gave up much of the gains they had racked up during the summer months. But his "Last Stand" (remember General Custer) may not be so bad for investors after all. Once we leave the wobbly ground of negative interest rates, yield-hungry investors will warm to fixed income again, and those seeking risk mitigation can return to the classic 60/40 portfolio.

With the powerful Fed chief blazing the tightening trail, other heads of central banks will follow or have already done so. This year's Jackson Hole may come to symbolize the sensible end of a decade of easy money.

[1] *The Wage Curve,* David Blanchflower and Andrew Oswald, MIT Press, 1995

—
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—
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When stuck between a rock and a hard place

The news flow ebbed over the summer but the headlines that did come through weren't always positive. One small news item may have cheered us up, though: After 12 years under the European Union's watchful eyes, Greece (pictured: Santorini) was able to extricate itself from financial supervision. The country remains in relatively poor shape given a massive debt burden, but things are looking up at last.

Upon your return from summer vacation from a Greek island or another favorite destination, you may have found that market conditions haven't changed much. Inflation remains a worry, yet there is reason to believe that the world's big central banks are now at "peak hawkishness". Economic growth prospects still look shaky, yet most big companies have shown a surprising degree of resilience. The energy situation in Europe is a cause for concern, yet there are signs that Germany, for instance, is on course to fill its gas inventories despite fewer or no flows from Russia. The geopolitical situation remains tense given the war in Ukraine.

A situation where everything seems to hang in the balance presents a conundrum for asset managers. And when neither bull nor bear tips the scales, choosing one over the other would be inappropriate in light of the poor visibility. In our case, it means that we keep our neutral stance on most asset classes. Within equities, our positioning shows a bias towards non-cyclical markets such as the US and Switzerland. In bonds, we overweight government paper, are neutral on investment-grade corporate issues, and underweight high yield. Gold is the only sub-asset class we rate overweight. We like the metal for its inflation protection and hedging qualities. Details of our positioning can be found on the overview page 5 or the asset class-focused items on pages 12 to 15.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity			→			Our longstanding neutral view on cash remains in place. This is in line with our overall neutral market risk view.
2 Bonds			→			We remain neutral on the fixed income segment as well. On the one hand, there's the interplay of "peak inflation" and "peak hawkishness" – expectations that we may have seen the worst of monetary policy tightening. This suggests a degree of duration, i.e. a certain amount of bonds with longer maturities, in investors' portfolios. On the other hand, growth uncertainty and stricter lending standards for companies don't support an overly aggressive exposure to corporate bonds. Our preferences within the asset class remain unchanged. We stay overweight in government bonds and keep our neutral rating for investment grade (IG) paper, while high-yield securities remain on underweight. Our slight overweight in emerging-market debt in hard currency, where we see some attractive yields, remains in place.
3 Equities			→			The sentiment for equities has soured on the back of high inflation, tighter monetary policies, and faltering growth prospects, but we remain neutral. While some analysts have started revising downwards their earnings estimates, the past reporting season ended on a positive note in most markets. The robustness of the corporate world contrasts with commodity price pressure and lower consumer confidence. Our neutral positioning includes a non-cyclical bias. We therefore keep non-cyclical stocks on overweight, and these are mostly found in markets such as the US and Switzerland. By contrast, Europe and Japan remain on underweight, and emerging-market stocks on neutral.
4 Gold				→		We reiterate our slightly positive stance on gold given persistent inflationary pressure and the likelihood of a slowdown in economic growth. We like the yellow metal's ability to shield portfolios against these risks as well as the negative effect of Russia's invasion of Ukraine, for example. Our expectation of a weaker US dollar also supports our positive gold view in light of their inverse relationship most of the time.
5 Commodities			→			We retain our neutral view on commodities. Prices for metals and soft commodities have come down by 15% to 30% since June. Natural gas, by contrast, is upheld by Russia's reduced deliveries to the West. Considering the growing probability of recession as well as potential headwinds for the world economy, we continue to feel comfortable with a neutral view on commodities for the time being.
6 Alternative strategies			→			We retain our neutral on alternative investments overall. We are still modestly underweight in hedge funds, but that is offset by our neutral view on other types of alternative investments, such as real estate.

Changes month-on-month: same → higher ↗ lower ↘

What goes up, must come down—even inflation

—
Michaela Huber
Investment Strategist,
Vontobel

—
Stefan Eppenberger
Head of Multi-Asset Strategy,
Vontobel

Economists and central bankers had a tough time this year. Proclaiming that inflation has peaked—and getting it wrong time and again—has been an uncomfortable, even outright embarrassing exercise. Fortunately for them, July's US consumer price report showed that inflation had moderated to a lower-than-expected rate of 8.5% year-on-year. This immediately sparked hopes that the worst of central banks' aggressive tightening may be behind us.

Like malware sneaking into a government agency's IT, inflation has been infiltrating the world's economy for the past few quarters. But this worm may be about to wriggle out of the system again. Here's a ten-point list why we believe this will be the case.

Ten points to keep in mind
First, central bankers' actions. At the US Federal Reserve's Jackson Hole Symposium in late August, US Federal Reserve Chairman Jerome Powell warned of changing course too soon and reaffirmed his commitment to move interest rates higher. Representatives from other major central banks struck a similarly hawkish tone.

Second, slowing economic growth. Purchasing managers' indices (PMIs), which are important economic leading indicators, have come down in many parts of the world. Other indicators, such as the US ISM or Philadelphia Fed survey, also point to a more subdued growth outlook. As inflation is a so-called lagging indicator, i.e., a measure reacting with a time lag to a change in another correlated variable, we expect inflation to start reflecting the let-up in global economic activity in the months ahead (see chart 1).

Third, US dollar strength. The current appreciation of the US currency should help to bring inflation down, as a stronger Greenback typically translates into lower import costs for US consumers.

Fourth, realistic inflation estimates. We believe that inflation expectations remain well anchored. This is evident from market-derived inflation expectations (e.g. five-year forward interest rate swaps) or survey-based gauges, such as the widely watched consumer survey of the University of Michigan.

Fifth, easing energy prices. Crude oil has become cheaper, reflecting fears of a looming recession. We think that the so-called energy consumer price index (CPI), which contributes around one third to the overall headline inflation and is closely linked to gasoline prices, has hit a plateau.

Sixth, lower food prices. Food expenses, which account for more than 13% of the overall CPI basket, look set to come down. The United Nations Food and Agriculture Organization's food price index, while still elevated,

declined for the fifth month in a row in August due to an improved supply picture. This should translate into a lower food CPI.

Seventh, normalizing supply chains. After the Covid-19-induced disruptions, the Federal Reserve Bank of New York's Global Supply Chain Pressure Index is now down 57% from its peak (see chart 2). Other indicators, such as the Freightos Baltic Index, also point to declining container freight rates.

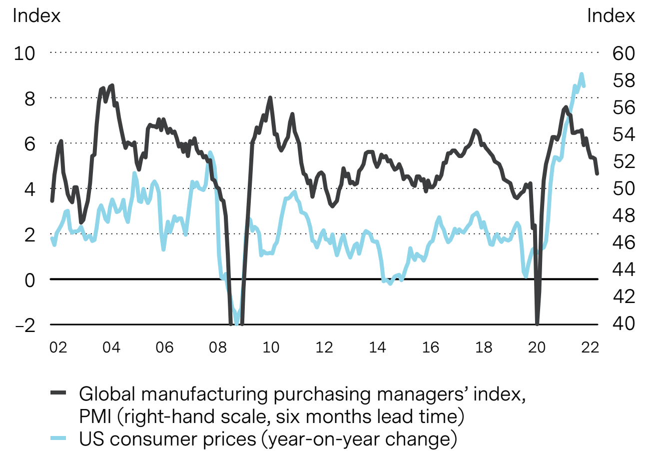
Eighth, prices for goods peaking. Due to pandemic-linked shortages, the prices for many goods have reached dizzying heights but will head south soon, according to our forecasts. Take the semiconductor chip shortage, which wreaked havoc on the production of new cars. As manufacturers were waiting for those crucial items to be delivered, many consumers switched to used vehicles instead. This, in turn, propelled the CPI for used cars and trucks higher. Manufacturers rushed to fill their inventories and often overstocked, prompting several chip makers to warn of excessive inventories for the remainder of the year and beyond (see chart 3).

Ninth, weaker housing activity: We believe that rent inflation—which goes hand in hand with house price inflation—should be kept in check by weaker housebuilding activity. The National Association of Home Builders has already declared a "housing recession" because many would-be buyers can no longer afford the property or the mortgage. Other indicators, such as housing starts and building permits, have also taken a beating.

Tenth, upcoming labor market lull. Finally, we also think that the US labor market, while remaining historically strong, is slowly but surely showing signs of cooling. This became evident in the Labor Department's eagerly awaited jobs report for August, which showed that employers had added positions at a more moderate pace ("only" 315,000 jobs versus 526,000 in July).

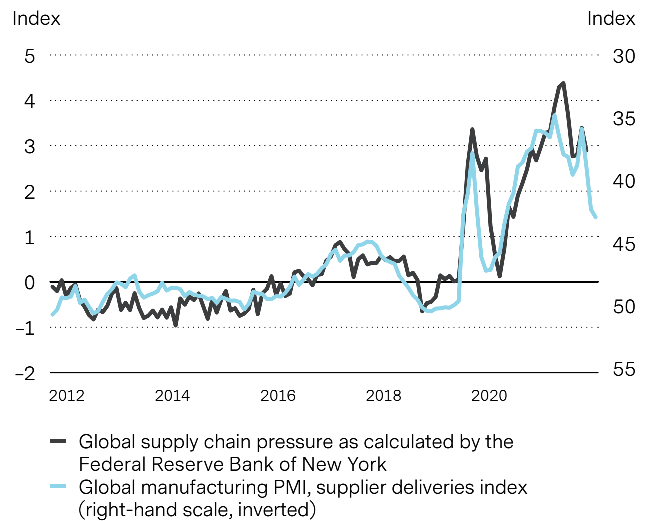
There is a margin for error
Where does this leave investors? When the surprisingly moderate US CPI figures were published, financial markets cheered. If such positive surprises keep coming, chances are that the market recovery will continue. We hope our ten-point summary helps investors assess the development. Could we be caught on the wrong foot, like we and many others were in the past? Absolutely, considering that unforeseen events such as energy supply shocks or fresh Covid-19 lockdowns in China could drive inflation higher again.

Chart 1: Inflation is still high but should start mirroring lower economic growth with a time lag



Source: Refinitiv Datastream, Vontobel

Chart 2: Global supply chains have started to normalize, easing price pressure



Source: Refinitiv Datastream, Vontobel

Chart 3: Chip inventories are building up, which points to deflation, not inflation

Source: Refinitiv Datastream, Vontobel

60 / 40 portfolios back in fashion despite an “annus horribilis”

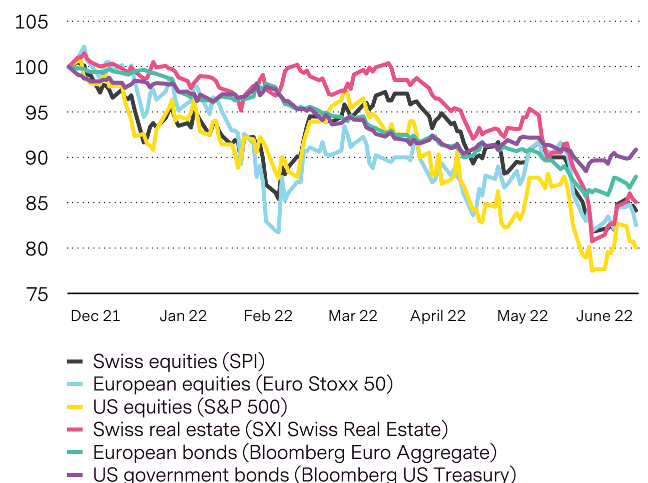
—
Anton Oberhofer
Head Global Balanced Solutions,
Senior Portfolio Manager,
Vontobel

Queen Elizabeth II used the term "annus horribilis" in 1992 when describing troubling events like the fire at Windsor Castle. Whether that was really the worst year in the monarch's reign is debatable. Sometimes calamities just keep coming, as many investors know.

Financial markets were thrown off balance in several *anni horribiles*, braving a succession of crises, such as the collapse of Lehman Brothers and the effect of the pandemic. Yet this year saw a singular culmination of disasters with Vladimir Putin's war in Ukraine compounding the effect of the inflation beast rearing its ugly head. This led to a simultaneous slump in equities and fixed income as well as narrower segments, such as real-estate securities during the first six months of 2022 (see chart 1). The exception was commodities because of the price-driving effect of energy security concerns that arose last year, recently exacerbated by Moscow's cuts in gas supplies to the West. But the upward trend in commodities contributed to the rise in consumer prices that was a core reason for the markets' woes. Bonds in particular, a traditional cushion against hard times in multi-asset portfolios, failed to live up to their reputation.

Chart 1: Simultaneous hit to asset classes as diverse as equities, bonds, and real estate leaves investors puzzled

Index (rebased to 100)



Source: Refinitiv Datastream, respective indices, Vontobel. Data as of June 30, 2022.

The concurrent downturn of previously uncorrelated asset classes has left many multi-asset investors scratching their heads. One of the answers has been hiding in plain sight: the global central banks' commitment to move key rates ever lower to stave off economic hardship. This policy, as unorthodox as controversial, has been in place since the global financial crisis in 2007, and was even expanded when measures to contain the spread of the Covid-19 virus froze economic activity around the globe.

Whilst the zero-interest cure got the patient out of intensive care, evident in the economy's surprisingly fast recovery from factory shut-downs and supply chain disruptions, its side effects were severe. The central banks' lifeline to the economy and financial markets was an important move, but the liquidity flood that came with it also helped to fan inflation, a long-forgotten problem initially belittled even by the world's most powerful monetary authority, the US Federal Reserve. Add to that skyrocketing energy prices, valuations of stocks and bonds blown out of proportion by a flood of central bank-generated liquidity, and policymakers' realization that they may have shrugged off the issue for too long. All things considered, this is a recipe for a broad downturn on Wall Street, London, Frankfurt, or Zurich.

60 / 40 shaken but not forsaken
Seeing the value of their multi-asset portfolios melt like ice in this year's European summer heat, some investors may start questioning the validity of the 60 % / 40 % portfolio altogether. Is the classic split of 60% equities and 40 % bonds (or variations thereof depending on risk appetite) a thing of the past? We don't think so.

First, let's take a look where central banks are headed. After a rude awakening from an inflation-free sleep, officials like the US Fed Chairman Jerome Powell have sprung into action. Their previous overly generous stance has changed to one some observers describe as exceedingly restrictive. With key rates bound to rise, valuations of stocks and bonds are likely to start coming down from unrealistic levels, eventually leading to heightened buying interest.

Second, investors' risk capacity will adjust. During the long period of so-called quantitative easing, a term from the central bank's guide to opaque language signifying massive asset purchases for the purpose of liquidity injections, bond market participants were forced to pick up riskier paper whose higher coupons outweighed concern about the issuer's solidity. Now the rising tide of higher interest rates is weighing on financial markets with parts of the sovereign segment regaining its attractiveness while offering the usual protection.

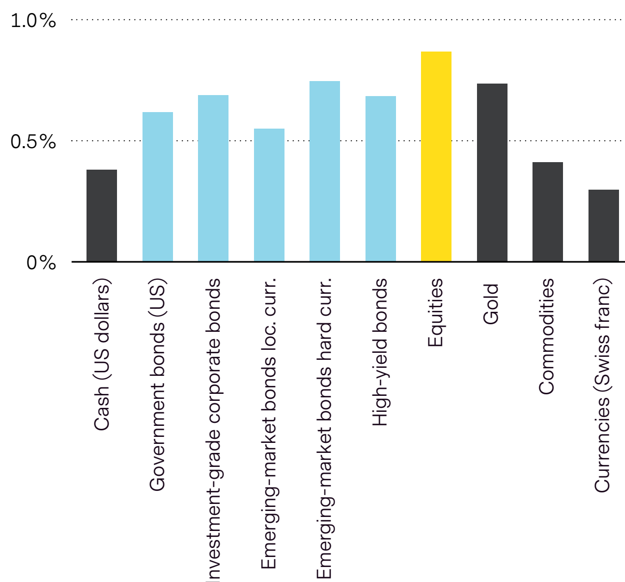
It's worth noting that inflation is bad enough but, if contained, still preferable to deflation. When prices rise moderately and gradually, companies can adapt and continue to invest. What's more, we believe that inflation will start coming down over the next few months, with the possible exception of energy inflation. Deflation, on the other hand—a potentially decade-long period of falling prices where everybody hoards cash—can be far harder to manage, as Japan's decade-long struggle with deflation has shown, for instance.

Shares and real estate can benefit in inflationary times
How should investors proceed? We believe they should acknowledge the new inflationary environment and adjust their financial planning. According to Vontobel research from January 2022, asset classes with underlying income streams, such as equities and real estate have a leg up in an environment of rising prices. Companies are mostly able to pass any increase in input costs onto their customers, and even more so if they boast a commanding market share. Shares of such companies, ideally picked by active managers for a portfolio, should consequently benefit. The same holds true for property companies, whose rental income is linked to inflation, protecting them in times of rocketing consumer and production prices.

Equities and property, so-called real assets with value drivers, such as products a company sells or floor space a developer rents out, contrast so-called nominal assets like fixed-income securities. Government or corporate bonds lack the income-generating mechanisms of stocks or real estate. With the exception of so-called inflation-indexed paper, coupons are fixed for the whole maturity of the security. Commodities can diversify a multi-asset portfolio but are marginal in the big scheme of things. Moreover, they are input factors in corporate manufacturing processes, which somewhat reduces their value as a stand-alone asset class. Like commodities, precious metals such as gold make sense as a stabilizing element in a multi-asset context (see chart 2).

Chart 2: A bond-and-equity portfolio remains the bedrock of investing, gold and commodities are good add-ons

Average monthly returns during times of inflation*



* Over a period of nearly 50 years since 1973
Source: Global Financial Data, Refinitiv Datastream, Vontobel. Data as per end of 2021 (no significant change since the start of 2022).

It follows that investors seeking to preserve the value of their portfolio should hold a significant share of stocks and real-estate funds. Whilst these are prone to price fluctuations because, in contrast to bonds, their future income streams cannot be adequately predicted, they are long-term value drivers. The percentage of such assets in a portfolio also primarily depends on the risk capacity of the investor. Generally, the longer the investing horizon, the greater the prospects of long-term value preservation and higher resilience to inflationary pressure.

Central bankers' rethink could prove a game changer

According to a pretty reasonable rule of thumb, investors should move funds they don't immediately need into real assets. These may be buffeted by short-term turbulence but usually excel over the longer term. By contrast, investors that depend on a fixed amount of money at the end of a given year—a basic requirement of pension funds and many private investors—should go for nominal assets like bonds. This directs our gaze towards the good old balanced portfolio that may have fallen out of fashion somewhat during the times of the extremely loose monetary policies.

While 2022 is "not a year on which we shall look back with undiluted pleasure", to use a wonderfully euphemistic line from the Queen's 1992 speech, 60/40 may yet get the respect it deserves as the US Federal Reserve has changed tack and is now cruising towards "normalized" waters (i.e. higher federal funds rates). If Elizabeth II were to put on an investors' hat today before attending the Royal Ascot, she might add: "Keep calm and carry on, and do remain confident that bedraggled portfolios will eventually come to life like the parched lawn adjacent to Windsor Castle."

Both bulls and bears have a point—we stay neutral

—
Frank Häusler
Chief Investment Strategist,
Vontobel

Warren Buffett's event for shareholders in Omaha may be an investor's annual highlight, but the Jackson Hole summit of central bankers is even more important. In the run-up to the meeting last August, rumor had it that the US Federal Reserve might signal a less restrictive policy. While this didn't happen, things are in flux. The bottom line from our point of view: stay neutral on bonds.

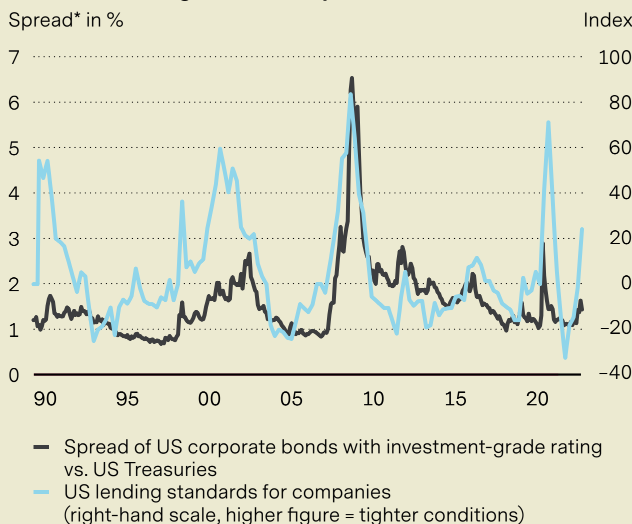
It took just a few quarters for inflation to mutate from a "temporary phenomenon" to a "long-forgotten threat haunting the global economy". Now, it appears that the upward trend has lost some of its previous momentum, at least in the US (see "Market highlights" section, page 6). By contrast, prices continue to rise in Germany, for instance, hovering at around 8% in August.

At the Jackson Hole meeting in late August, the US Federal Reserve reaffirmed its commitment to fight inflation, pouring cold water on hopes the Fed may take a breather on its hiking path. Other central banks, except for the Chinese and the Japanese monetary authorities, are taking the Fed's cue. The European Central Bank and the Swiss National Bank, to name a few, are tightening their reins as well.

Sooner or later, the Fed will pause for thought
However, Fed governor Jerome Powell will pause for thought at some stage. We assume that after delivering what markets expect, he and his colleagues will have to dial down their rhetoric. This means that possibly in 2023, the level of the federal funds rate could end up below what's implied in the so-called Dot Plot—the Fed's own interest rate projection based on the views of each member of its rate-setting body. Upcoming economic data releases will tell us more. In the past, the US central bank has usually adopted a more generous monetary policy when the labor market deteriorated and purchasing managers' indices (PMI) fell below a critical mark of 50—and such a scenario is on our books. It's also worth noting that inflation expectations are currently compatible with the long-term inflation target of central banks (see "Market highlights" section, page 6).

All things considered, both bond bulls and bond bears have a point. We for our part retain a neutral stance on the fixed income segment. On sub-segment level, we stay overweight in government bonds (it is prudent to hold a certain amount of sovereigns to hedge the portfolio), retain our neutral rating for investment-grade paper (for spread reasons, see chart 1 and 2), while high-yield securities remain on underweight. Further, we keep a slight overweight in emerging-market debt in hard currency, where we see some attractive yields.

Chart 1: Stricter lending standards for companies are usually a negative for corporate bonds



* Rising spread of corporate bonds means their prices fall, all else being equal
Source: Refinitiv Datastream, Vontobel

Chart 2: When economic growth slows and PMIs fall, corporate bonds often underperform government paper

Source: Refinitiv Datastream, Vontobel

Is there more behind the recent bear market rally?

—
Stefan Eppenberger
Head of Multi-Asset Strategy,
Vontobel

The past few months saw stock markets recover, yet it's important to remember that, like the proverbial swallow, one rally doesn't make a summer. True, we have registered first welcome signs of a let-up in inflation, but we would need to see an improved economic outlook to consider the upward trend more than a fluke.

The financial markets used the summer break to catch their breath. They did so quite spectacularly in some cases with US stocks now up almost 14% versus their June low. Not all investors cheered the news, though, given that many had positioned themselves for further trouble. After all, global equities are still more than 10% below their early January levels, the summer blip notwithstanding.

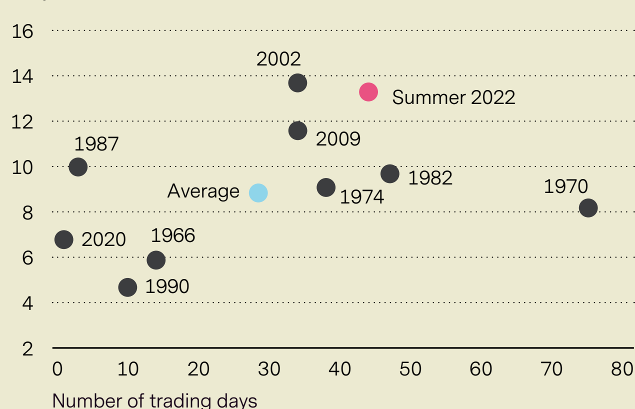
Many previous recoveries were shorter and weaker
Prospects for the world's stock markets remain unclear. A look at previous recoveries during periods of weakness shows that since 1960, temporary market rallies have lasted an average of 28 days, typically petering out after an advance of 9%. This summer's rally was significantly stronger and longer (see chart 1). This means that from a historical point of view, it's either not a bear market rally, or it's already faltering.

We see three drivers behind the recent recovery. For one, market participants, riled by falling prices and panicked reductions of stock price targets, were overly pessimistic. This often prompts a short-term change of heart. Another reason was the good news from the US consumer price front (see "Market highlights" section on page 6). It gave rise to hopes that inflation, one of the main reasons for the stock market correction earlier this year, is coming down slowly but surely, and that central banks might stop tightening monetary policies to guarantee price stability.

Market watchers still expect key rates to move up, but their estimates suggest a stabilization on a high level. Even so, the central bank's recent inflation-fighting stance has hammered equity valuation measures such as the price/earnings ratio (see chart 2). Therefore, hopes are pinned on a reversal of the upward trend in inflation as well as a more forgiving central bank policy. This combination also boosted stock markets in the 1970s when inflation last got out of hand. Trouble is, we don't expect these two factors to send a favorable signal before the end of the year.

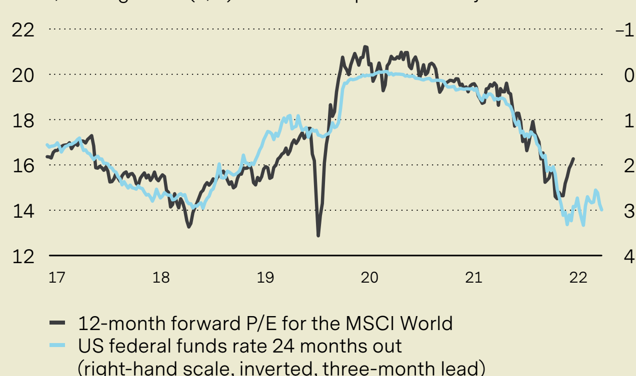
It's the economic outlook that counts
Moreover, global economic prospects would need to improve significantly, and that again depends on whether and when central banks or governments will be ready to give up their restrictive policies. All in all, we expect the difficult environment for equities to continue and remain neutrally positioned.

Chart 1: When bulls put up a fight in a market haunted by bears
Rise in the S&P 500 index during stock market downturns since 1960
In %



Source: Refinitiv Datastream, Vontobel

Chart 2: Stock markets' summer 2022 recovery driven by hopes of less restrictive central banks
Price/earnings ratio (P/E) Expected US key interest rate in %



Source: Refinitiv Datastream, Vontobel

We tip our hat but remain wary of falling demand

—
Stefan Eppenberger
Head of Multi-Asset Strategy,
Vontobel

After lifting off like a rocket earlier this year, prices for commodities have come back into the Earth's orbit since June. And that downward pull looks set to persist amid peaking inflation and weaker consumption, especially in China.

Commodities remain the most successful asset class in 2022 despite the recent move lower. The stars remain aligned for energy and most other components of the Bloomberg commodity index: there is geopolitical uncertainty (i.e. the war in Ukraine), commodity supply constraints (Russia cutting gas deliveries to Europe), low inventory levels, and the possibility of higher demand as outside temperatures in the northern hemisphere start falling.

Nevertheless, many commodity prices have retreated significantly since June. There are three main reasons for this. First, inflation rates appear to be coming down, especially in the US (see "Market highlights" section on page 6). If this occurs, as we expect, demand for commodities should decline in the coming months. After all, the less inflation hurts investors' portfolios, the less investors are inclined to use "Energy & Co." as a hedging strategy (see chart 1).

Second, the global economic slowdown and high commodity prices dampen demand for raw materials. More restrictive monetary and fiscal policy measures have recently caused leading economic indicators to trend south. Consumer sentiment has already slumped due to high inflation. For example, demand for gasoline in the USA remains below pre-pandemic levels. This also holds true for the airline industry's kerosene consumption.

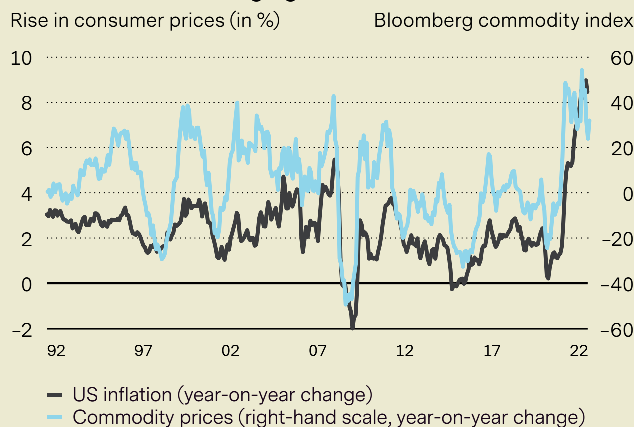
Chinese construction woes weigh

The third reason is the most substantial one, namely China's gravitational pull on the prices. A slowdown of the economy, particularly in the housebuilding sector, has significantly reduced the biggest metals consumer's appetite for commodities. Chinese construction activity has nearly collapsed last year, partly because of regulatory measures to prevent households taking on too much debt. The development of total Chinese imports suggests more trouble for commodity prices (see chart 2).

Support from supply side questioned

At the same time, the prospect of a continued rise in energy's scarcity value has proven premature. In Europe, gas prices aren't likely to rise much further after more than trebling this summer. Also, Russian oil production has held up surprisingly well amid interest from various buyers. This means the supply side doesn't seem as clearly supportive as only a few months ago.

Chart 1: Once inflation passes its peak, demand for commodities as a hedging instrument diminishes



Source: Refinitiv Datastream, Vontobel

Chart 2: Energy and metals lose their luster amid sagging Chinese uptake

Source: Refinitiv Datastream, Vontobel

Dollar and Swiss franc are a pair to be reckoned with

—
Sven Schubert, PhD
Senior Investment Strategist,
Head of Strategy Currencies,
Vontobel

The US dollar is among the beneficiaries of this year's economic and geopolitical worries. Another winner is the Swiss franc, whose recent fall below parity versus the euro would have alarmed Switzerland's companies not long ago. We continue to believe that the currency's upward trend is fundamentally justified.

The fears about stagflation—a period of rising inflation and low economic growth—that emerged early in 2022 put the spotlight on the US dollar as one of the world's preferred safe havens. The Greenback's strength looks set to continue for a while. In its wake, although for slightly different reasons, the Canadian dollar gained ground relative to other currencies, helped by rising energy prices. By contrast, European currencies were mostly lower on concerns over a possible energy crisis, and the Japanese yen felt the drag from the Bank of Japan's continued commitment to a generous monetary policy (see chart 1).

Euro/franc parity no longer a line in the sand

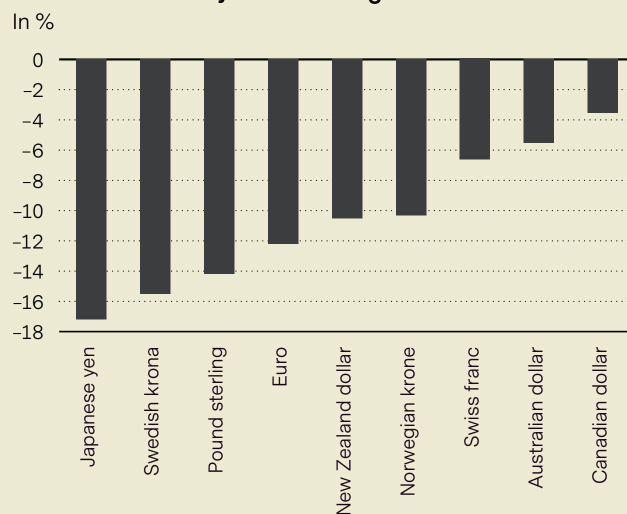
Like the dollar, the Swiss franc has been on an upward trajectory for months. And like the Greenback, the Swiss currency looks set to continue to perform, especially versus the euro. It has established itself firmly below parity to the European legal tender, and it did so without causing upheaval on foreign exchange markets.

In 2015, when the Swiss franc last overcame that line in the sand, we had argued it was overvalued. This is no longer the case. Today, we see good reasons why the currency is closer to fair value (of CHF 0.88 per euro) and could even extend its bull run. Our valuation model based on purchasing power parity reflects some franc-supportive facts. For example, inflation rates in the euro area are much higher than in Switzerland. German producer prices were up 37% in July year-on-year, compared with a plus of 4% for the Swiss rate (see chart 2). Moreover, the German economy has been hit hard by supply chain problems. This means that Germany's competitiveness has diminished in relative terms versus that of its southern neighbor.

There are two big unknowns in the European foreign exchange market. First, the European Central Bank (ECB) could continue to follow the US Federal Reserve's aggressive policy tightening. And second, a further cut in Russian gas supplies could throw Germany's economy into disarray, which may force the Frankfurt monetary authority to go into reverse. And of course, whether the US Federal Reserve will retain its hiking bias is another open question.

Chart 1: Yen and European currencies lose ground, their weakness may last a bit longer

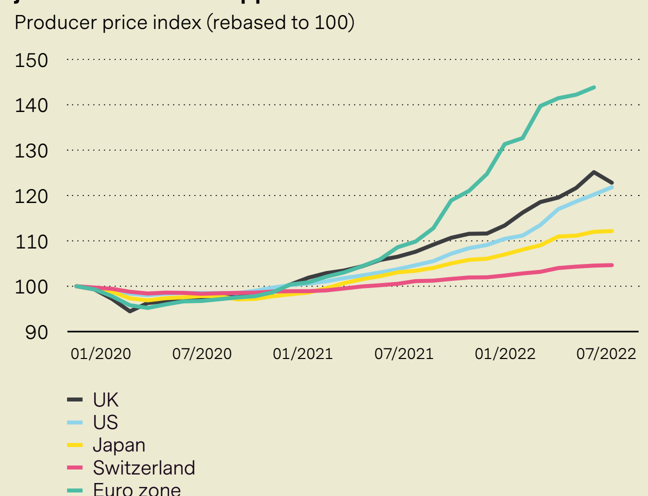
In %



Source: Refinitiv Datastream, Vontobel

Chart 2: Moderate rise in Swiss producer prices justifies the franc's appreciation

Producer price index (rebased to 100)



Source: Refinitiv Datastream, Vontobel

Economy and financial markets 2020 – 2023

The following list shows the actual values, exchange rates and prices from 2020 to 2021 and consensus forecasts for 2022 and 2023 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

GDP (IN %)	2020	2021	CURRENT[1]	2022 CONSENSUS	2023 CONSENSUS
Global (G20)	–2.6	5.2	0.8	2.4	2.5
Eurozone	–6.3	5.3	0.6	2.8	0.8
USA	–3.4	5.7	1.7	1.7	1.1
Japan	–4.7	1.8	1.1	1.5	1.6
UK	–9.3	7.2	–0.1	3.5	0.1
Switzerland	–2.5	3.8	4.5	2.4	1.4
Australia	–2.1	4.9	0.8	4	2.3
China	2.2	8.1	–2.6	3.5	5.2

INFLATION	2020	2021	CURRENT[2]	2022 CONSENSUS	2023 CONSENSUS
Global (G20)	1.7	3.3	7.3	7.0	4.2
Eurozone	0.3	2.6	8.9	7.9	4.1
USA	1.2	4.7	8.5	8.0	3.7
Japan	0.0	–0.3	2.6	2.0	1.3
UK	0.9	2.6	10.1	9.3	6.4
Switzerland	–0.7	0.6	3.4	2.8	1.5
Australia	0.9	2.9	6.1	6.1	4.0
China	2.5	0.9	2.7	2.3	2.3

KEY INTEREST RATES (IN %)	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR	–0.50	–0.50	0.00	1.06	1.30
USD	1.75	0.25	2.50	3.60	3.45
JPY	–0.10	–0.10	–0.10	–0.10	–0.10
GBP	0.75	0.25	1.75	2.50	2.45
CHF	–0.69	–0.76	–0.25	0.48	0.68
AUD	0.75	0.10	1.85	2.85	3.00
CNY	4.35	4.35	4.35	4.30	4.30

GOVERNMENT BOND YIELDS, 10 YEARS (IN %)	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR (Germany)	–0.6	–0.2	1.53	1.26	1.29
USD	0.9	1.5	3.11	3.06	2.96
JPY	0.0	0.1	0.25	0.22	0.22
GBP	0.2	1.0	2.60	2.21	1.96
CHF	–0.5	–0.1	0.96	0.97	1.29
AUD	1.0	1.7	3.67	3.58	3.29

FOREIGN EXCHANGE RATES	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS END OF 2023
CHF per EUR	1.08	1.04	0.96	0.98	1.04
CHF per USD	0.88	0.91	0.97	0.96	0.95
CHF per 100 JPY	0.86	0.79	0.70	0.73	0.76
CHF per GBP	1.21	1.23	1.13	1.15	1.18
USD per EUR	1.22	1.14	0.99	1.02	1.1
JPY per USD	103	115	139	132	124
USD per AUD	0.77	0.73	0.69	0.70	0.75
GBP per EUR	0.90	0.84	0.85	0.85	0.87
CNY per USD	6.51	6.37	6.92	6.76	6.68

COMMODITIES	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
Brent crude oil, USD per barrel	52	78	101	104	91.5
Gold, USD per troy ounce	1,898	1,822	1,722	1,800	1,850
Copper, USD per metric ton	7,749	9,740	8,161	8,800	9,042

[1] Latest available quarter
[2] Latest available month, G20 data only quarterly
Source: Vontobel, respective statistical offices and central banks; as of 29.08.2022

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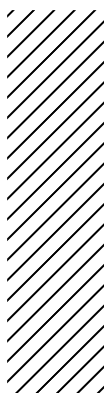

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