Vontobel

Investors' Outlook

Inflation is like cholesterol, it's not all bad

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Inflation is like cholesterol, it's not all bad

Dear readers,

Inflation, especially the out-of-control type recently witnessed in countries like Zimbabwe, has been described as a scourge of humanity. A salary worth dramatically less day-to-day is indeed the recipe for economic decline and even revolution. Europe, haunted by wartime memories of hyperinflation, may be particularly sensitive to signs of rising prices. However, just like cholesterol, there is a bad kind and a good kind of inflation.

A modest amount of inflation is healthy. It reflects a solid growth of the economy, corporate earnings, or employee wages. We need this kind of inflation just like we need high-density lipoprotein, the "good" cholesterol that cleanses our blood.

Since the global financial crisis, central banks have been desperately trying to stoke inflation – without success. A moderate rise in prices of up to around 4 percent or 5 percent on the previous year's level in an economic upswing gives monetary authorities the option of cutting rates in a subsequent recession. However, the counter-current deflationary trends tied to digitalization, ageing populations, and globalization, have time and again proved stronger than central banks' efforts.

Until recently, double-digit inflation rates in industrial countries appeared to be a phenomenon of the past. Such levels were reached during war times between 1800 and the Second World War, and again during "oil price shocks" in the 1970s. This caused central banks to rethink their approach to monetary policy. Now that we see spikes in inflation here and there, is this finally the consequence of the large central banks' extraordinary steps?

—
Dan Scott
Chief Investment Officer,
Head of Impact & Thematics,
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Paying less for debt in the future
The upward pressure on headline inflation we have seen in the past few months is mainly still due to base effects, seasonal patterns, and some difficulties to increase the production capacity of otherwise well-greased economic engines. But even if this proved to be more than a blip on the inflation screen, it wouldn't be much of a worry if the rise remained under control. After all, inflation can be a scourge but, when remaining moderate, also a sign of vigorous economic activity. Moreover, a controlled inflation rate can help bring government debt down. It can be easier to settle a debt of, say, 1 billion US dollars in an inflationary environment because inflation lowers the price tag over time.

We should fear deflation, not inflation
We shouldn't forget that the opposite of inflation, deflation, can be far more devastating. There is no good version of this phenomenon. During periods of a broad downward move in prices, consumers have no incentive to spend. Companies respond by cutting costs and laying off workers, thus starting a toxic downward cycle. Deflationary trends have proven notoriously hard to break. Japan, the world's third-largest economy, has been using all means available to fight deflation and trying to prop up prices for years. This so-called Japanification of the global economy is what central banks and governments in the West have been trying to avoid. The liquidity flood they have unleashed on our global economic system must ultimately bring about at least a moderate degree of inflation. If it succeeds, we could witness a repeat of the last century's roaring twenties. If not, we may need to brace for a Japanese-style lost decade.

→ **Webcast**
To view our webcast on recent market developments, click:
vonto.be/macro-en-sept21

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Risk mitigation after a mixed summer – equities back to neutral

If you have spent the summer holiday in your home country – and there's a fair chance that you have given the still troubling pandemic situation – you have done a classic risk-mitigation exercise. The squandered opportunity of visiting an attractive foreign destination was offset by a gain in terms of increased safety and hassle-free travel. We have done something similar in our portfolio during this volatile summer that brought floods in some parts of Europe and forest fires in others.

After already reducing risk twice over the course of the past few months, we have trimmed our equity exposure to neutral. Central banks and governments are supporting the economy, but no additional packages will surprise us. Equities, most of them in record-breaking mode after stellar corporate earnings, may find it increasingly hard to continue their upward path especially during the next reporting season. Last but not least, economic activity is now decelerating after a previous strong rebound. China, for one, has disclosed unusually low growth rates.

We have used the proceeds from the partial divestment of our equity position to raise our holding in hedge funds. However, this sub-segment remains underweight, albeit to a lesser degree than before, as does the wider asset class of alternative investments. We also reiterate our positive view on gold and an overall negative view on bonds. For details, see the overview page 5 or read the asset class-focused items on pages 10 to 13.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity				→		Cash remains marginally overweight. Our allocation here is rather opportunistic. Should buying opportunities emerge, we would be ready to add some high-conviction holdings.
2 Bonds		→				We retain an overall slight underweight in bonds. Investing in fixed income seems unattractive given our forecast of 1.6 percent for ten-year US Treasuries within three months and 1.9 percent within a year. Our view on all the fixed income sub-segments remains unchanged. It's neutral for both government and high-yield bonds and negative for investment-grade corporate bonds, whose yield spreads to government paper are too narrow to be attractive. We continue to favor emerging-market debt in hard currency, which hasn't suffered to the same extent as emerging-market stocks.
3 Equities			↘			Many stocks seem exceedingly expensive, but naturally, questions regarding a possible continuation of the market rally don't go away. Much will depend on the ability of companies to keep reporting better-than-expected earnings. Analysts could then increase their earnings forecasts again, although we may have seen the peak in such upgrades in the second quarter of this year. At the same time, equity markets have proven to be resilient to expectations of an economic slowdown and a less generous stance of central banks. All in all, this is probably a good time to put equities on neutral and adopt a more defensive view. We do so by scaling back our exposure to Swiss, US and Japanese stocks, abandoning our relative preferences in terms of regions. Owing to the current market environment, we believe it is a good idea to manage portfolios close to the benchmark and reduce an overall active positioning.
4 Gold				→		We reiterate our slightly positive view on gold. Whilst the precious metal doesn't seem to offer much upside at present – its price is currently mainly driven by the slowly moving US dollar – we like it for diversification and hedging purposes. Gold is also a handy buffer against heightened geopolitical risks and a possible spike in inflation.
5 Commodities			→			Our neutral position remains unchanged. While the asset class has benefited tremendously from post-pandemic recovery hopes, its prospects have worsened lately. A slowing economy depresses demand and keeps oil prices in check. At the same time, more supply is coming to the market. In addition, the weakness in the US dollar that supported commodities last year may now be over.
6 Alternative strategies			→			We keep hedge funds on underweight, albeit to a lesser extent than before because we reinvested the proceeds from our partial sale of our equity holdings in this segment. We maintain our neutral view on other types of alternative investments such as insurance-linked securities. This leaves us with an unchanged overall neutral rating on alternatives.

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

Keynes's legacy lives on while central banks are slowly withdrawing support

One of the world's great economists, John Maynard Keynes, popularized the idea that government action could stave off recessions. Keynes died in 1946, but judging by today's massive government spending, his legacy lives on. Meanwhile, central banks have started to prepare markets for a gentle dialling-down of their support.




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As you read these lines, global growth should peak while staying elevated. A possible worsening of the pandemic aside, we still expect growth rates for the US and the euro zone to remain above the pre-crisis averages (see chart 1). We predict global inflation rates to come down around year-end from the high levels seen in the past few quarters. Some bottlenecks are still hampering industrial production and driving prices higher. But if we consider the price of computer chips representative of the wider supply situation, things are slowly normalizing (see chart 2). Central banks are laying the groundwork for a less expansionary monetary policy and will probably start acting next year.

What are the risks to our current base case? New virus mutations could hamper global growth substantially. We don't see this happening, but China's zero-tolerance stance on new Covid infections should weigh on the economy in the months to come. A worsening sentiment in important markets could trigger stronger-than-expected second-round effects through a surge in corporate bankruptcies and layoffs. Moreover, there is the possibility of an overheated economy driving inflation higher and prompting central banks to abruptly reduce monetary policy support.

Europe: German political landscape greening?
The euro area's second-quarter growth of 2 percent versus the first quarter was better than expected. Even so, the engine still isn't running at pre-pandemic level of economic output, unlike that in the US and probably Switzerland. We expect a euro zone growth rate of similar strength in the third quarter before a cooling off from October through December (see chart 1). We assume no significant negative impact from the Covid situation, but there's an increased risk that a surge in new cases could depress consumption even without new lockdowns being imposed. The job market looks good but will have to prove its resilience once governmental support measures start expiring around year-end.

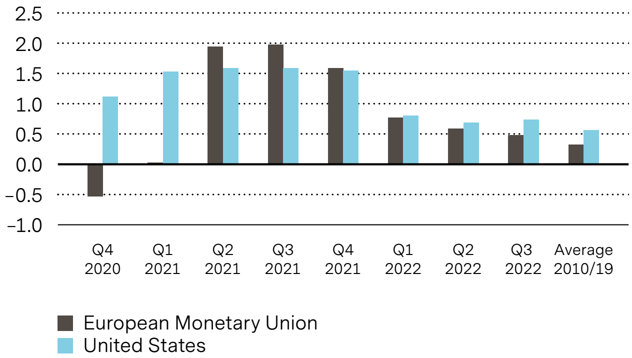
We forecast inflation to rise above the 3 percent mark towards the end of the year. Around that time, the European Central Bank could flag an end of the asset-purchasing program designed to keep markets liquid through the pandemic, known as PEPP. To soften withdrawal syndromes, it may set a new, smaller scheme, or top up an existing one. Similar to its US counterpart, the European monetary authority has adopted a "symmetric" inflation target of 2 percent, which heightens its flexibility to respond to rising consumer prices. Finally, German elections on September 26 may see the inclusion of the Green Party in a governing coalition, but such a scenario would hardly change much for European markets.

US: Eyes fixed on next Fed moves
A GDP increase of 6.6 percent for the second quarter (versus the previous quarter, annualized) reaffirmed our expectations of a maximum acceleration of US growth around that time. The purchasing managers' index for August, off its peak but still strong, also suggests as much. Prices remain elevated, especially in sectors such as travel and accommodation that had been hit by government anti-pandemic measures. Consumer price inflation stood at 5.4 percent in July. In that month, the US added close to 1 million new jobs (see chart 3), but many companies still struggle to recruit qualified workers. Meanwhile, the US Congress is expected to pass an infrastructure spending plan worth at least 1 trillion US dollars this autumn. The US Federal Reserve is getting closer to gently withdrawing monetary support later this autumn. Before any decision, Charmain Jerome Powell will not only weigh the Fed's progress towards its dual goal of full employment and price stability, but also the Covid-19 situation.

Japan: Olympic flame gives off little heat
The absence of foreign visitors dimmed hopes that the Tokyo Olympic games would prop up the world's third-largest economy. Instead, the country is again grappling with the economic fallout of rising infection numbers with authorities imposing new emergency measures. Given the still fragile economy and downward pressure on prices, the Bank of Japan has little choice but to maintain an extremely loose monetary policy.

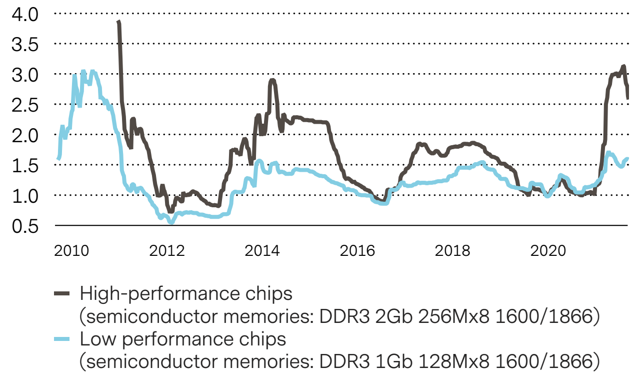
Emerging markets: Asia hit by virus and slowdown
Asia, the emerging region with the lowest share of fully vaccinated people, seems particularly vulnerable to new and more stringent lockdowns announced in August. These come on top of an ongoing economic slowdown, prompting us to downgrade our growth outlook for China to 8.2 from 9.0 percent for 2021. We believe the Chinese monetary authority could adopt new support measures such as a cut in reserve requirements for commercial banks, scrapping previous plans of policy normalization. This would be in contrast to the tightening bias of some other central banks in Latin America or Eastern Europe. Overall, we are still looking for a stellar 6.6 percent real GDP growth in emerging markets, but it's worth noting that Asia is already in an economic slowdown. Inflation is expected to slow over the next 12 months due to base effects.

Chart 1: European and US growth rates peaking, seen staying above pre-pandemic long-term average
GDP growth quarter-on-quarter in % non-annualized, Vontobel estimates after 2nd quarter



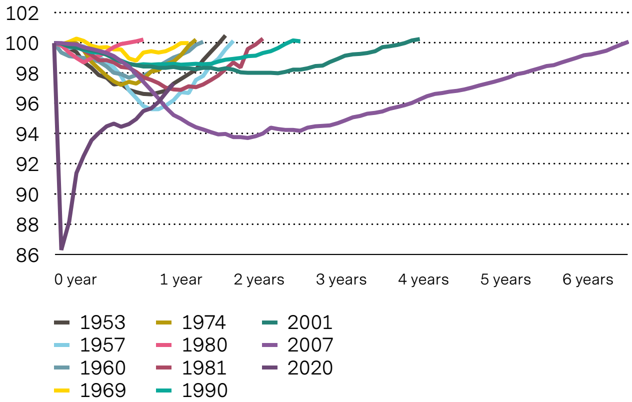
Source: Eurostat, Bureau of Economic Analysis, Vontobel

Chart 2: Prices for computer chips point to a slow easing of supply shortages
Semiconductor prices (USD per chip)



Source: DRAMexchange, Refinitiv Datastream, Vontobel

Chart 3: The US economy continues to add more jobs
Index of US employment (100=beginning of recession)



Source: Refinitiv Datastream, Bureau of Labor Statistics (BLS), Vontobel

Water: A source of life as well as a refreshing addition to any portfolio

—
Matthias Fawer
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—
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If oil greases the wheels of the global economy, water helps to make its turbines spin. The amount of water used in industrial processes may be less publicized than the "blue gold's" significance for planting crops, but it is no less significant.

Earlier this year TSMC, one of the world's largest manufacturers of electronic chips based in drought-hit Taiwan, had to resort to water imports to maintain production.[1]

A growing market yet to be fully discovered
Shipping water for purposes other than bottling sounds like a novel business. Whilst crude oil and its derivatives are part of a well-established industry that may be past its peak, water and its varieties – green, blue, grey,[2] or any other color – may still have surprises in store for us. For example, in a research note, UBS identified the treatment of so-called ballast water, used in the bulk of cargo ships for stabilization, as one of the fastest-growing segments of the water market.

Crude oil remains an abstract concept for most people except for oilmen, but "crude water" runs through our fingers and gullets – and machines – on a daily basis. This is also why investing in the resource invites controversy. Take away this resource somewhere to sell it elsewhere and you are sure to face the wrath of local people or environmental activists. There is a reason why Nestlé sold its North American water business last March.[3] Or consider the tensions building up at the Horn of Africa with Egypt and Sudan fearing that Ethiopia's giant hydroelectric dam on the Blue Nile will cut them off from vital supplies.[4]

The good news is that other areas such as wastewater treatment are less contentious. In a global water market already worth around 600 billion US dollars a year,[5] pockets of high value are already there or yet to be discovered, and specialized technology companies will help enterprising captains on their journey.

Like the problem of climate change, water scarcity has set global firefighters' alarm bells ringing. The United Nations has made H_2O one of its Sustainable Development Goals (SDGs), or top priorities.[6] In 2015, 29 percent of the global population lacked safely managed drinking water supplies, and 61 percent were without safely managed sanitation services. If these percentages are to come down clearly by 2030, as the SDGs suggest, major investments will be needed in the area of water resources including fighting pollution as well as building up infrastructure for transportation and water treatment. Equally important are privately funded initiatives to tend to the planet's water resources.

Swimming against the passive tide
Investors swimming against the passive tide have the advantage of being able to pick the water-related stocks that seem most likely to shower their portfolios with attractive returns. Given the multitude of companies with obvious or less obvious ties to the water processing or wastewater managing industries, they may welcome some guidance a dedicated asset manager can provide.

A much used and often overused resource

- According to the United Nations, 2.3 billion people live in water-stressed countries, 733 million of which live in highly and critically water-stressed regions.
- Children are among those worst affected by water scarcity because they are more vulnerable to diseases linked to dirty water.
- Only 3 percent of the world's water is fresh water, and two thirds of that is trapped in ice caps.
- Agriculture accounts for 72 percent of all water withdrawals, whilst municipalities use 16 percent and industry 12 percent of the resource, according to the UN's water department.
- Water resources are generally threatened by increased pollution. This even holds true for far-off Lake Baikal in Siberia, the largest reservoir of unfrozen fresh water on Earth, parts of which have suffered from proliferating algae.
- The production of one kilogram of beef requires approximately 15,000 liters of water.

1 "Taiwan's drought is exposing just how much water chipmakers like TSMC use (and reuse)", Fortune, June 12, 2021
2 In agriculture, green water is rain transpired by the plant, blue water is the amount added by irrigation, grey water is the resource polluted by agrichemicals. See "Green, blue and grey waters: Minimising the footprint using soil physics." Brent Clothier, Steve Green and Markus Deurer, the 19th World Congress of Soil Science, Soil Solutions for a Changing World, August 2010, published on the International Union of Soil Sciences web site www.iuss.org
3 See, for example, "The fight to stop Nestlé from taking America's water to sell in plastic bottles", The Guardian, October 29, 2019
4 "River Nile dam: Why Ethiopia can't stop it being filled." BBC News, July 8, 2021 https://www.bbc.com/news/world-africa-53432948
5 https://www.ubs.com/microsites/investing/en/stay-on-course/2016/growth-potential-global-ater-market.html
6 The Sustainable Development Goals Report 2018, Goal 6: Clean water and sanitation

Yields torn between Delta virus variant and US tapering variant

—
Sandrine Perret
Senior Economist,
Fixed Income Strategist,
Vontobel

During the past few months, yields on US government bonds have been buffeted by diverging signals. On the one hand, they fell due to concerns about the state of the economy, partly caused by troubling pandemic news. On the other, they rose amid persistent inflation rates and expectations that the US central bank would soon start reducing its massive liquidity injections.

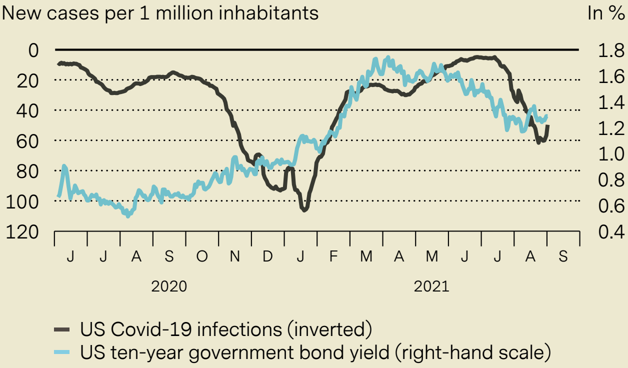
The summer months once again proved more eventful than expected for bond investors. Against our and market expectations, yields on US Treasuries mostly started drifting down in June amid signs of peaking growth in the US followed by underwhelming GDP data for the second quarter. In addition, the fast-spreading Delta variant of the Covid-19 virus and worries about an economic slowdown in China saw investors turn to safe heavens such as US government bonds. Ten-year Treasury yields reached a low of 1.13 percent in early August. They have since recovered somewhat, but remain below 1.30 (see chart 1). We consider Treasuries expensive at the current level given that the US Federal Reserve is probably mulling a reduction of monetary support.

Risks of more persistent inflation developments are currently balanced by negative virus news, so we deem it appropriate to keep our neutral stance on government bonds. Real yields are at a new record low. Unlikely to move down much more in the short term, in our opinion, they look set to drift higher in the medium term as the "tapering" debate heats up and inflation expectations drop from an elevated level.

EM debt favored, corporate bonds less so
Whilst emerging-market (EM) equities corrected sharply over the summer, EM bonds were more resilient, returning flat to slightly positive returns. We continue to favor emerging-market debt denominated in US dollars, where the yield premium is still attractive for global investors (see chart 2). Emerging economies' fundamentals are also better than at the time of the Fed's so-called taper tantrum in 2013 – the first hint at a withdrawal of liquidity that alarmed the markets – and we think this bond segment will be able to manage a gradual reduction of monetary policy support in the US better than eight years ago.

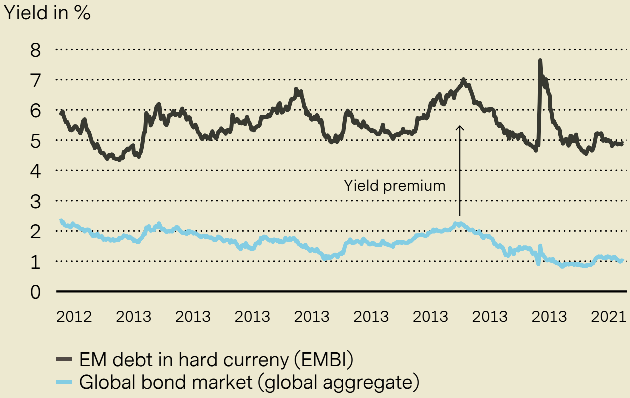
We keep our underweight position in high-rated corporate bonds. Generally, companies should remain well-funded because banks are facilitating lending to the corporate sector as evidenced by a net record-high level of banks easing their lending standards in the third quarter. This should ensure that corporates remain well funded and default rates remain under control. That said, the low expected returns and the high valuations of many good-quality corporate bonds suggest an overall cautious positioning in the investment-grade bond segment.

Chart 1: Yields have stabilized after dropping on returning virus fears and market jitters



Source: Refinitiv Datastream, World Health Organization, Vontobel

Chart 2: Attractive yield premia in emerging-market debt



Source: Refinitiv Datastream, JP Morgan indices, Bloomberg Barclays, Vontobel

Time to take a sober look at the frantic merry-go-round

—
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel

Many stock markets are rallying like there's no tomorrow, shrugging off a slowing economy. But sooner or later, the central banks will throw a spanner in the works. The days of the frantic equity merry-go-round seem over, and we are happy to enjoy a quieter ride.

Even in pandemic times, the stock amusement park drew masses of people, boasting attractions such as a successful corporate earnings season and, in particular, positive earnings surprises. Global companies on average managed to beat analysts' earnings expectations by 17 percent during the past reporting season, versus a typical single-digit percentage (see chart 1).

The large central banks have kept the park's gates wide open so far, refusing to increase interest rates despite rising inflation concerns. Their inaction has frozen nominal interest rates below 2 percent in industrial countries. Real interest rates – nominal rates minus inflation – remain low as well, supporting equity valuations and driving return-seeking investors into riskier asset classes such as equities.

However, there is cause for caution. Earnings expectations for this year and next are already quite optimistic and corporate profit margins have reached the highest levels in several decades. Also, central banks will in all probability start scaling back their stimulus measures in the coming months. This will probably not only weigh on economic activity, but also push down the high equity valuations.

A lesson from China?

Does the end of the stock market rally in China hold a lesson for us? Its economy recovered more quickly from the Covid-19 crisis than those in the western world, prompting Chinese authorities to lower stimulus efforts this spring. Whilst this may have clouded the prospects for equities somewhat, the breaking point came in the form of unexpected Chinese regulatory action targeted at parts of the homegrown technology sector.

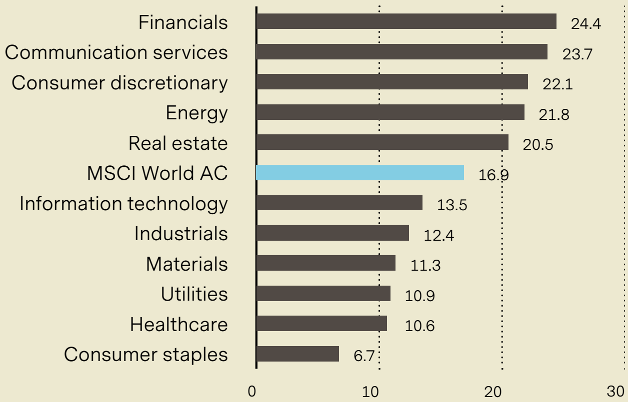
Western stock exchanges are also vulnerable. We're in the second year of a bull market, a period that is typically accident-prone. A larger, albeit temporary, correction wouldn't surprise us (see chart 2). In addition, a peak-growth environment such as the current one usually produces lower and more volatile equity returns than during a period of an economic recovery.

Adopting a more defensive equity view

After hitting rock bottom in March 2020, global equity markets have doubled in value in record-breaking time. In our view, it is now time to reduce some risk in portfolios. We have recently given up our overweight stance on equities that had been in place for over a year, adopting a neutral view. Also, we recommend seeking higher exposure to defensive stocks, which would be less affected by a temporary setback.

Chart 1: Companies' 2Q earnings reports have often exceeded analyst expectations

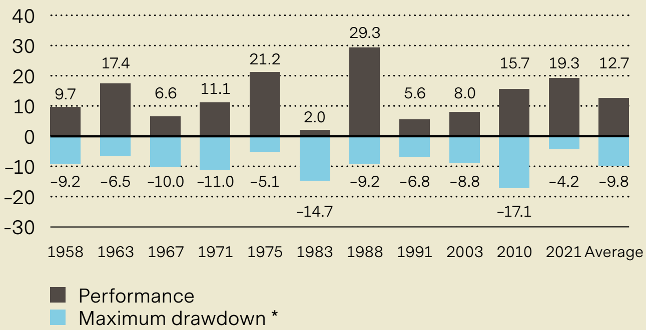
Percentage indicates by how much earnings beat analyst forecasts (by sector)



Source: Eikon, Vontobel

Chart 2: The second year of a bull market usually brings higher drawdowns

Performance and drawdowns in 2nd year of equity rallies (S&P 500 index)



* The biggest observed loss measured in a security's peak-to-trough difference, before a following new peak

Source: Strategas, Refinitiv Datastream, Vontobel

Oil bulls are back in the corral

—
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel

The black gold has shown its true golden color during the recent economic recovery. But demand growth now seems to be slowing down. Moreover, the Organization of the Petroleum Exporting Countries (OPEC) is increasing its oil exports. This is not a good environment for oil bulls.

Crude oil has staged a surprising recovery after briefly costing “less than nothing” last year. However, the market is now running out of steam amid concerns that continued pandemic woes will dampen oil demand.

Whether or not the Delta variant of the Covid-19 virus will trouble us much longer is anybody’s guess. What seems clear is that we’re past the period of peak economic growth, and therefore, rising oil demand. Petroleum consumption in China, for instance, dropped in June versus the year-ago level. Other emerging economies will also be consuming less soon, as oil prices in local-currency terms, already close to all-time highs (see chart 1), look set to drive cash-strapped buyers out of the market.

The supply situation also bodes ill for oil. OPEC, together with Russia, plans to increase production by a daily rate of 400,000 barrels each month until April 2022. This comes against the backdrop of the cartel’s pumps running well below capacity since late 2016 due to a previous decision to support oil prices. The recent policy change will result in more supply flowing into a market already weakened by sluggish demand. In the past, this has always resulted in oil prices not rising further or even falling most of the time.

Shale oil miners face shareholder pressure

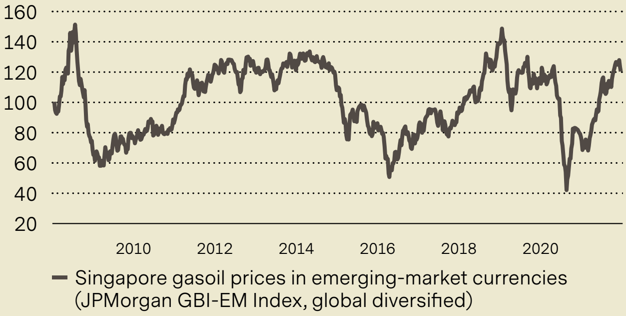
That said, the US shale oil industry’s disappointing production volumes offer a glimmer of hope for oil investors. Although this year's oil price recovery should in theory incentivize fresh drilling in the US, the number of new wells is significantly below the surge seen after the oil crisis in 2016. This is partly due to sustainability concerns. Listed US companies in particular are under pressure from investors to divest businesses whose activity takes a toll on the environment. This means that oil supply from the Permian Basin in Texas and other shale oil fields could grow at a slower rate in the coming months and years than before the Covid-19 crisis. However, any shale oil shortfall won’t be enough to give prices a significant boost because OPEC can always step in to fill the gap.

Oil seen settling around 70 USD a barrel

Furthermore, last year’s dollar weakness should be over and a strengthening tendency in the US currency has often coincided with a peak of oil prices. We continue to assume that oil prices will settle around the 70 dollar mark.

Chart 1: Oil is very expensive from an emerging-market perspective

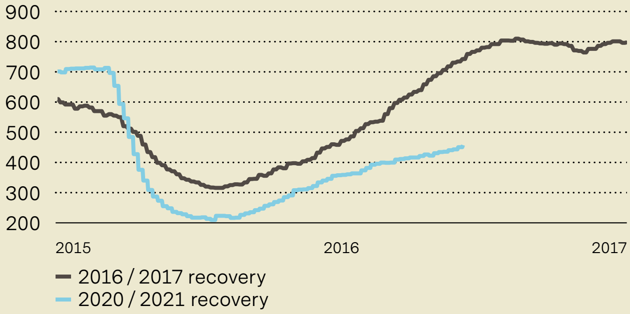
Price per barrel



Source: Refinitiv Datastream, Vontobel

Chart 2: US shale oil companies slow to drill new wells, unlike during a previous economic recovery

Number of US horizontal rigs



Source: Energy Information Administration, Refinitiv Datastream, Vontobel

Cyclical currencies hit a ceiling, US dollar fails to pick up slack

—
Sven Schubert, PhD
Head of Strategy Currencies,
Vontobel

"Peak growth" is behind us and cyclical currencies are slowly losing their luster. The US dollar may pause on its way up amid the inaction of the American and European central banks as well as a high twin deficit in the US.

Slowing growth rates and fading economic momentum are the attributes of a past-peak economy, a situation in which investors often turn away from so-called cyclical currencies. A very mild form of buyers' remorse has recently pulled currencies such as the euro, pound sterling, the Australian dollar, and emerging-market currencies from their cyclical peaks. The weakening of the latter sub-category will have unsettled some bond investors holding debt in local currencies, but prospects of capital gains in fixed income that an economic cooling typically brings may calm their nerves.

Less bond buying in Europe?

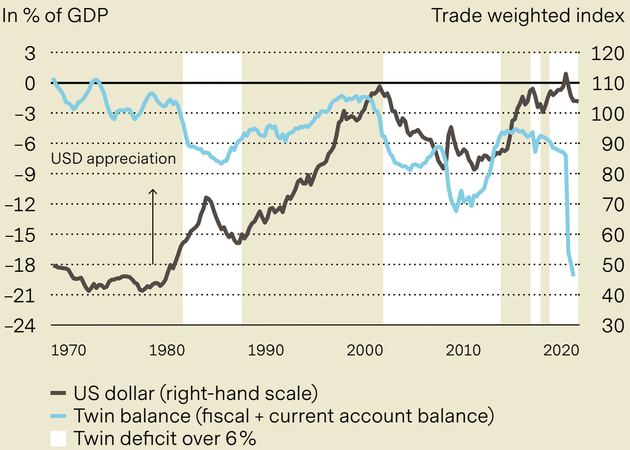
The US economy's continued strength has prompted the US Federal Reserve to contemplate a carefully calibrated breaking exercise. The first step, which we expect around year-end, will probably be a reduction of its massive asset purchases. However, a similar US Fed move failed to translate into support for the US dollar in 2014. It later did start a spectacular rally of 30 percent versus the euro between summer 2014 and early 2015, but it took a clear signal that the US Fed was about to raise interest rates to send the world's leading currency on an upward path. Currently, market participants are looking for two to three US rate hikes in 2023.

It will be also interesting to see whether and when the European Central Bank will replicate any US cut in asset purchases. We believe such a step in Europe could occur next spring. This should limit the EUR/USD downside to 1.15 over a 12-month horizon versus 1.17 at present. Moreover, the dollar may be held back by the high current and fiscal deficit in the US (see chart 1).

Swiss franc climbing slowly but steadily so far

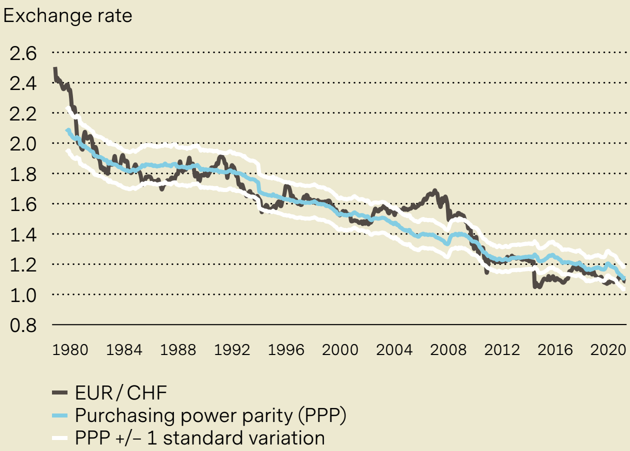
In truly Swiss style, the franc has recently moved higher without making a fuss, particularly against the euro. There was no market-moving news out of the Swiss National Bank (SNB), nor unusual changes in its sight deposits, a proxy for SNB interventions. A reason for the central bank's silence could be that the fair value of the Swiss franc has risen over the past few years. Our EUR/CHF fair value estimate currently stands at around 1.10, indicating only a very modest CHF overvaluation against the euro (see chart 2). The SNB may become more tolerant of a franc appreciation over time, but the real test will come at below EUR/CHF 1.07, a level usually prompting SNB action. We still believe that EUR/CHF levels around 1.10/12 are a good selling opportunity. For USD/CHF, we see a consolidation around 0.92.

Chart 1: High US twin deficits have troubled the US dollar in the past



Source: Refinitiv Datastream, Vontobel

Chart 2: Swiss franc no longer significantly overvalued in terms of purchasing power parity



Source: Refinitiv Datastream, Vontobel

Economy and financial markets 2019 – 2022

The following list shows the actual values, exchange rates and prices from 2019 to 2020 and our forecasts for 2021 and 2022 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

GDP (IN %)	2019	2020	CURRENT	FORECAST 2021	FORECAST 2022
Euro zone	1.4	–6.6	13.7	4.9	4.2
US	2.3	–3.4	12.2	6.2	4.2
Japan	0.0	–4.7	–1.5	2.5	2.4
United Kingdom	1.4	–9.9	22.2	6.1	5.2
Switzerland	1.1	–2.7	–0.5	3.5	2.8
China	5.8	2.3	7.9	8.2	5.7
INFLATION (IN %)					
Euro zone	1.2	0.3	2.2	2.1	1.6
US	1.8	1.2	5.3	3.9	2.7
Japan	0.5	0.0	–0.4	0.1	0.3
United Kingdom	1.8	0.9	2.5	2.1	2.0
Switzerland	0.4	–0.7	0.7	0.5	0.7
China	2.9	2.5	1.0	1.3	2.2

KEY INTEREST RATES (IN %)	2019	2020	CURRENT	FORECAST 3 MONTHS	FORECAST 12 MONTHS
EUR	–0.50	–0.50	–0.50	–0.50	–0.50
USD	1.75	0.25	0.25	0.25	0.25
JPY	–0.10	–0.10	–0.10	–0.10	–0.10
GBP	0.75	0.10	0.10	0.10	0.20
CHF	–0.69	–0.76	–0.75	–0.75	–0.75
CNY	4.35	4.35	4.35	4.35	4.35
10-YEAR GOVERNMENT-BOND YIELD (IN %)					
EUR (Germany)	–0.2	–0.6	–0.5	–0.3	0.0
USD	1.9	0.9	1.3	1.6	1.9
JPY	0.0	0.0	0.0	0.1	0.1
GBP	0.8	0.2	0.7	0.8	1.1
CHF	–0.5	–0.5	–0.4	–0.2	0.0
EXCHANGE RATES					
CHF per EUR	1.09	1.08	1.08	1.09	1.07
CHF per USD	0.97	0.88	0.92	0.92	0.92
CHF per 100 JPY	0.89	0.86	0.83	0.85	0.88
CHF per GBP	1.28	1.21	1.28	1.28	1.24
CHF per AUD	0.68	0.68	0.68	0.70	0.66
USD per EUR	1.12	1.22	1.17	1.19	1.16
JPY per USD	109	103	110	108	105
USD per AUD	0.70	0.77	0.74	0.76	0.74
CNY per USD	6.95	6.51	6.86	6.35	6.40
COMMODITIES					
Crude oil (Brent, USD/barrel)	66	52	72	70	70
Gold (USD/troy ounce)	1521	1898	1749	1900	1900
Copper (USD/metric ton)	6149	7749	9483	9000	10000

Source: Thomson Reuters Datastream, Vontobel; closing prices for all data: 18.08.2021, forecasts as of 11.08.2021

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