The surprising burst of inflation suggests parallels with the 1970s/rapid about-face from the central banks

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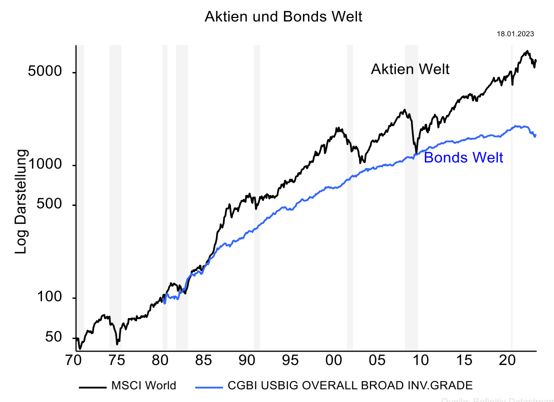
2022 goes down as the worst year for bonds in decades. In Swiss francs, a global portfolio has lost over 16% in value. Stocks have also dropped by a comparable percentage.

Investors have been surprised by the unexpected onset of global inflation. In the USA, rates are just under 10%; in Europe higher.

This has spooked central banks. They feel forced to take massive countermeasures. The trigger for this action is the Chair of the American Federal Reserve Jerome Powell who, in the annual meeting of central banks, got his colleagues to commit to abandoning their long-standing expansive policies and making battling inflation their first priority. This volte-face is astonishing. For over a decade, central banks have worried about the possibility of entering into a deflationary spiral. For longer than this period, they were barely able to get inflation above 2%. The low inflation figures were based on long-term real trends in the global economy, including globalisation, which increased competition in the labour market, an ageing population, increased participation of women in the workforce and strong development of network structures capable of generating substantial monopoly rents. They also include systematic shifts from wage to profit income, ultimately reflected in an increased concentration of income and wealth. In countless studies, these effects were uncritically assessed and empirically estimated. The common denominator of these efforts manifested itself at a macroeconomic level in a surplus of savings over investments. Falling interest rates were the consequence. The lack of demand for investment kept the demand for labour in balance. It was finally the state that jumped into the breach with budget deficits and higher debt. Otherwise, inflation and interest rates are estimated to have fallen by more than a percentage point lower.

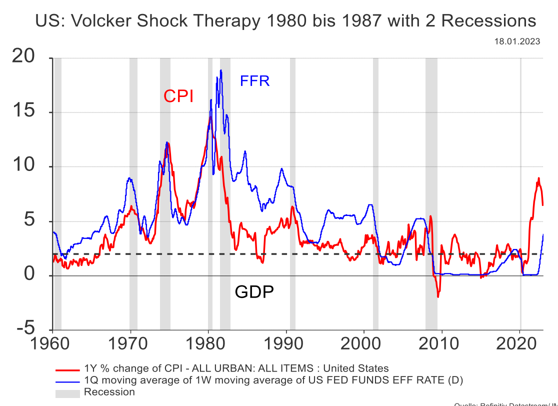


Coronavirus, the supply chain disruption and energy crisis changed little about these long-term deflationary trends.

They were one-time shocks primarily of a transitory character. They should leave the picture over the next two years. This can already be seen in the field of energy prices.

However, we must consider that wages will now follow suit, putting companies under further strain. Many energy contracts can only be adjusted to market prices after a delay. These second-round effects need time. They cause the disinflation process to last markedly longer than the inflationary one.

Here, the central banks are also called upon to act. They have to make sure that, over the medium term, the 2% goal is stuck to. And they have the means to do so. With short-term rates, they can achieve this goal. If that is not enough, they have an unprecedented potential number of bonds to place on the market. In this way, long-term rates can be brought to a level leaving no room for any further inflationary tendencies. However, the price – an economic slump – would be high. Volcker at the Federal Reserve did it at the start of the 1980s. Two long, severe recessions were the result.



Today, this route seems barely necessary. The conditions are different from those of the seventies. Workers have transitioned away from industry into the service sector where the labour market is more heterogeneous and the level of organisation lower. This makes the risk of a wage-price spiral less pressing.

If assumptions of the transitory nature of the three shocks prove true and purchasing power losses are partially compensated for by one-off payments, the risk of over-restrictive monetary policy is not to be considered excessive.

However, we must consider that economic perspectives have clouded over as consumers' loss of purchasing power is set to hamper growth to a significant extent. If the central banks overreact, a recession may be almost impossible to avoid. In Europe, this is already thought likely.

Overall, however, the outlook is good for investment policy. We can count on a continuous, if volatile, reduction in inflation. At the end of 2024, a value below 3% may be reached. As a result, the relatively low inflation premium on long-term rates is also sinking further. Central banks, on the other hand, will maintain the highest levels, which we anticipate will be reached by the end of the second quarter, for some time to come, leaving no doubt that they are giving top priority to combating inflation. Stocks will also benefit from the lower rates. Higher wages to be paid and worse economic forecasts will, however, have a dampening effect.

Overall, though, the mood in investment circles suggests more opportunities than risks. We have therefore set bond investments from slightly underweighted to slightly overweighted. Stocks are also to be increased. We consider a neutral position reasonable.

This is the basic shape of our investment policy.

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