



HOW TO PREPARE FOR THE INFLATIONARY WINDS OF CHANGE

Inflation Outlook

Webinar
09.07.2020

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HISTORICAL
INFLATION DYNAMIC

2
CHANGES IN THE
INFLATION DYNAMICS

3
PORTFOLIO
IMPLEMENTATION



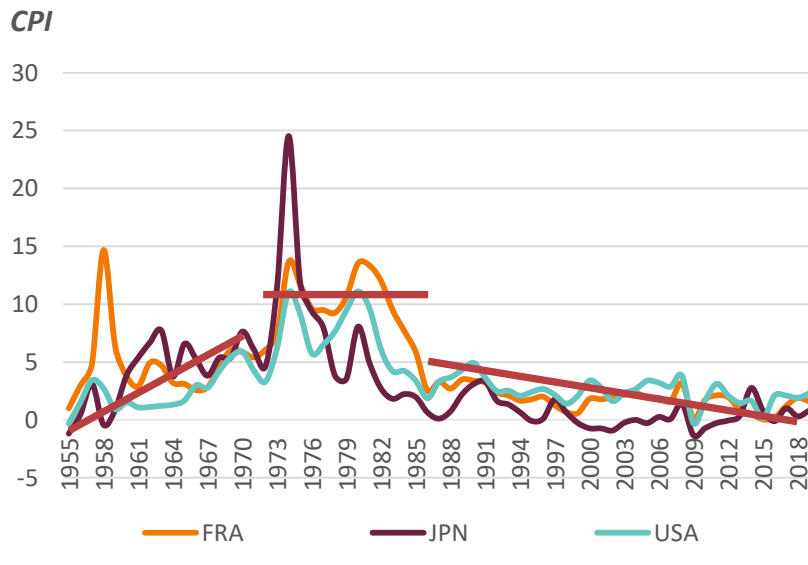
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HISTORICAL INFLATION DYNAMIC

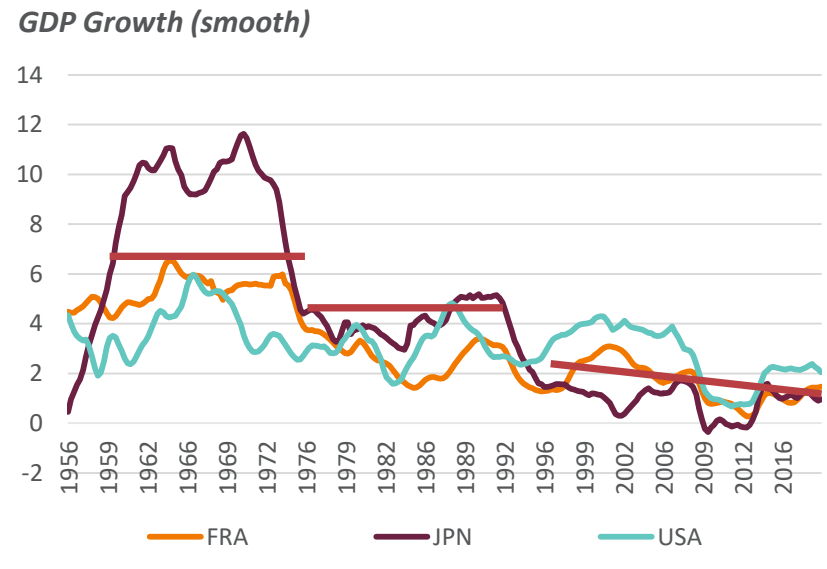


PAST 30 YEARS: LOWER GROWTH AND LOWER INFLATION

Lower growth and lower inflation have been driving down interest rates

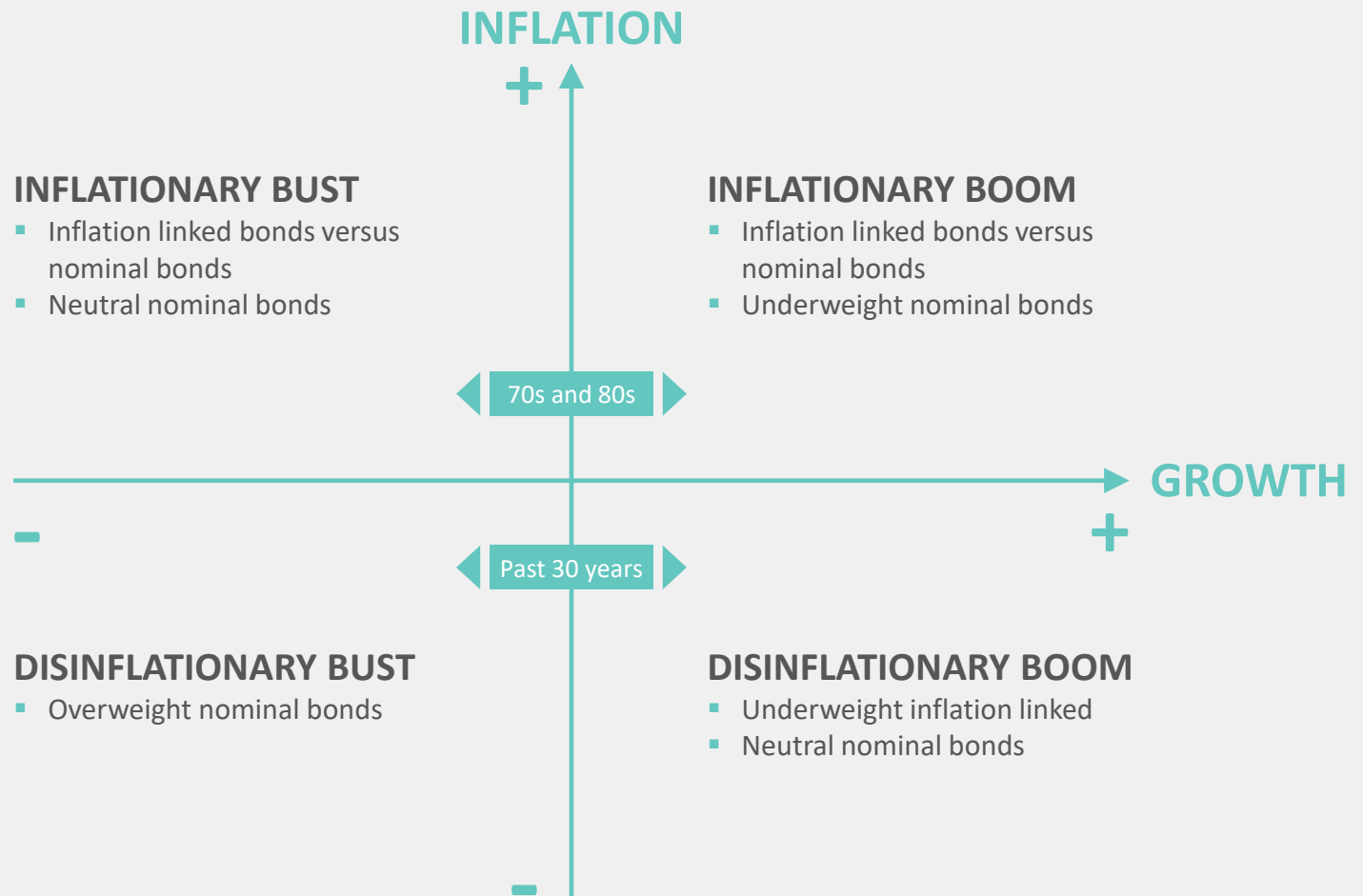


Source: Macrobhistory.net, June 2020



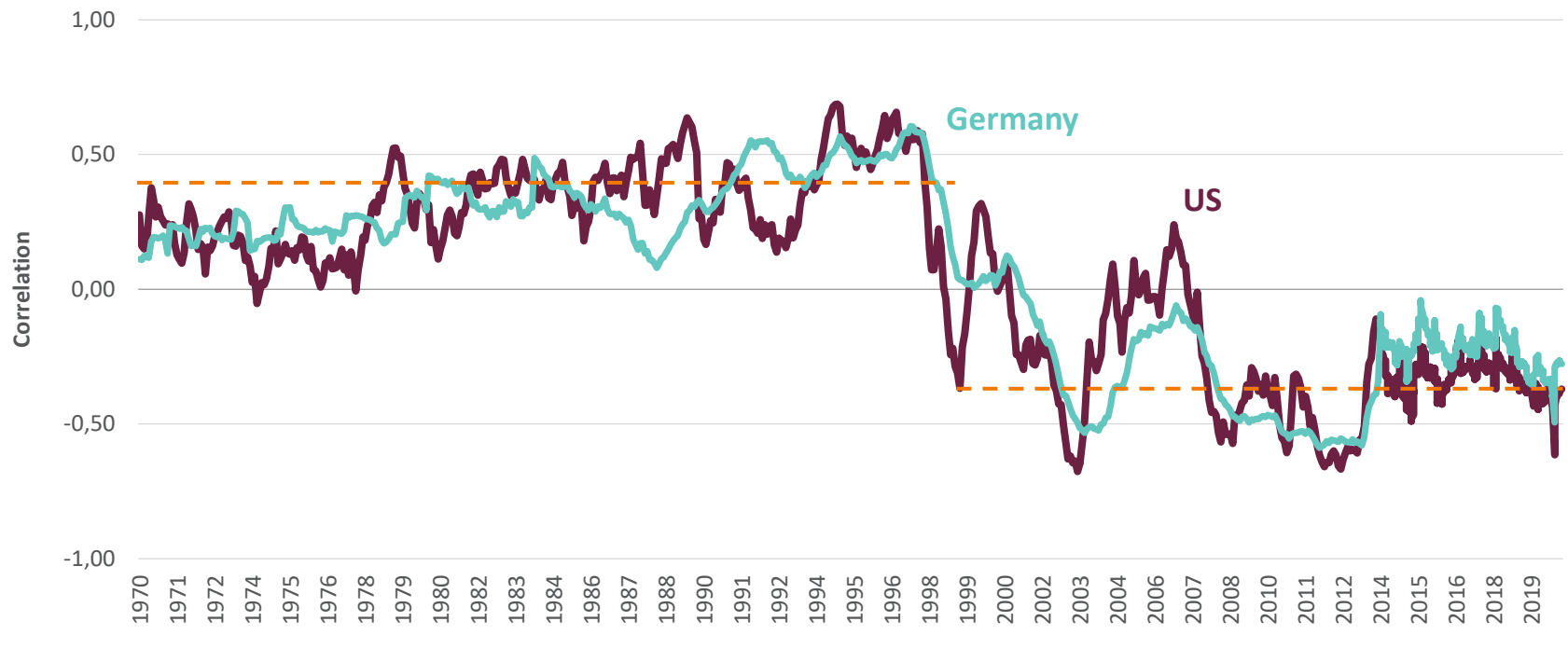
Source: IMF, June 2020





LINK BETWEEN INFLATION AND STOCK-BOND CORRELATIONS

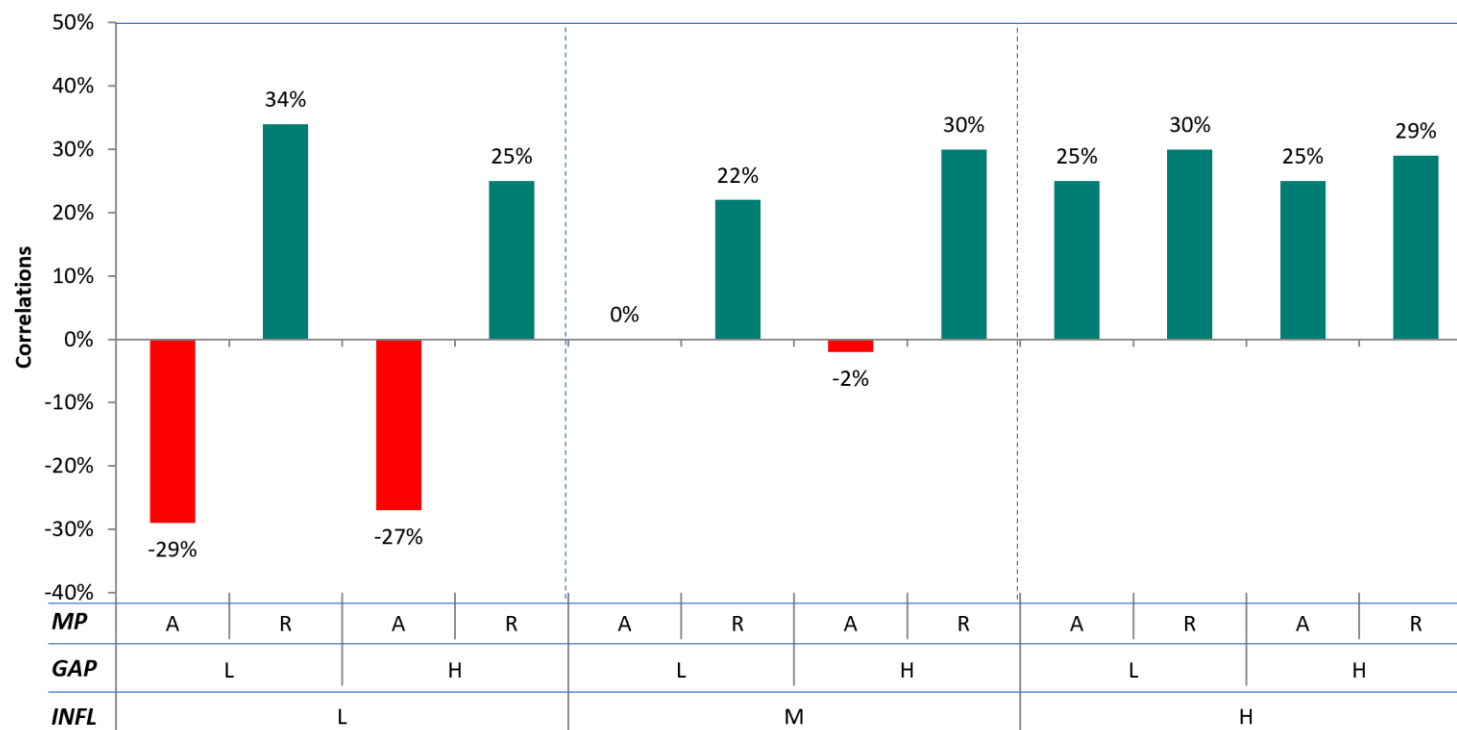
Local market stock-bond return correlation



Source: Baele, Lieven and Van Holle, Frederiek, Stock-Bond Correlations, Macroeconomic Regimes and Monetary Policy (October 1, 2017). Available at SSRN: <https://ssrn.com/abstract=3075816> or <http://dx.doi.org/10.2139/ssrn.3075816>



LOW INFLATION AND ACCOMMODATIVE CENTRAL BANKS: LOW STOCK BOND CORRELATIONS

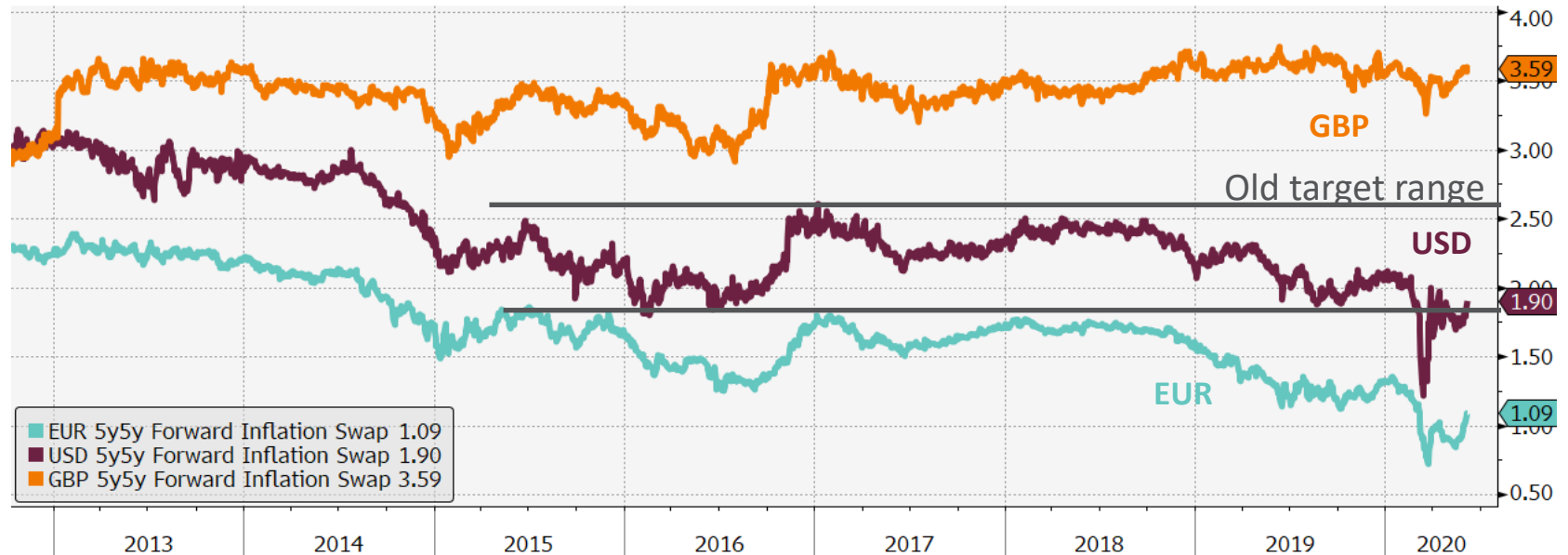


Source: Baele, Lieven and Van Holle, Frederiek, Stock-Bond Correlations, Macroeconomic Regimes and Monetary Policy (October 1, 2017).
Available at SSRN: <https://ssrn.com/abstract=3075816> or <http://dx.doi.org/10.2139/ssrn.3075816>,
MP = Monetary policy, A = Accommodative, R = Restrictive, GAP = Output gap, Infl = Inflation, L = Low, H = High



INFLATION EXPECTATIONS FORWARD MARKET

5Y5Y Forward inflation swaps



Source: Bloomberg, 08.06.2020



2

CHANGES IN THE INFLATION DYNAMICS



LET'S APPROACH INFLATION IN TWO DIFFERENT WAYS

1 MACRO-ECONOMICS: FACTORS DRIVING SUPPLY AND DEMAND

Covid 19 lead to a collapse in demand. Following the demand recovery, how will supply adjust?

2 MONETARY DRIVERS: WILL QE CREATE INFLATION?

- Does QE lead to inflation?
 - Why hasn't it in the past?
 - Is it different now?
-



SUPPLY SIDE PRESSURE

1

CAPITAL STOCK AND INVESTMENT

- Lack of investment
- Burden of repayment of emergency loans
- Destruction of capital stock in certain sectors (airlines)
- Demand uncertainty
- Bankruptcies

2

PRODUCTIVITY

- Less efficient supply chains
- Social distancing

3

LABOUR

- Drop in participation rate
- Discourage workers
- Loss of skills
- Scarred new generation

4

DEGLOBALISATION

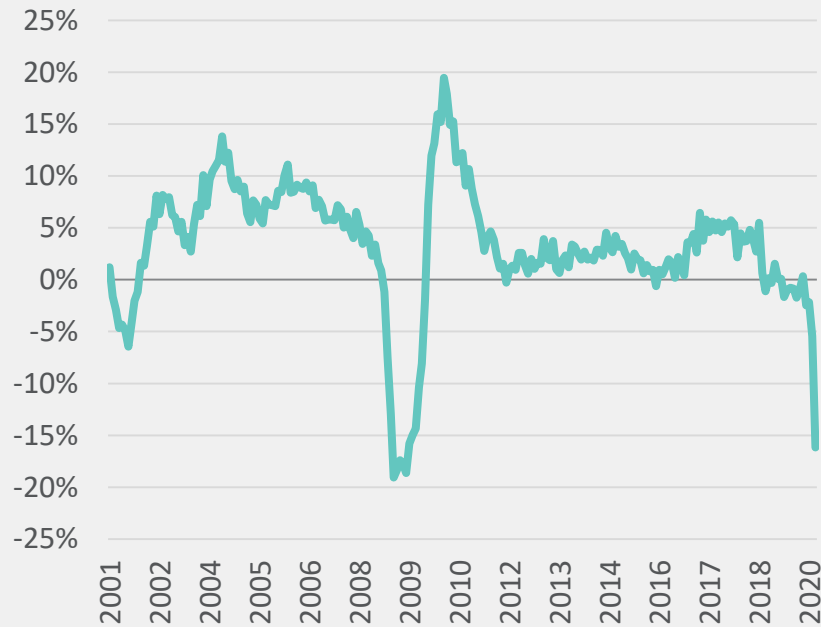
- Both from strategic perspective (Covid)
- Political pressure
- Risk management



- Rates -

SUPPLY SIDE PRESSURE GLOBALISATION PIVOT

World Trade Growth



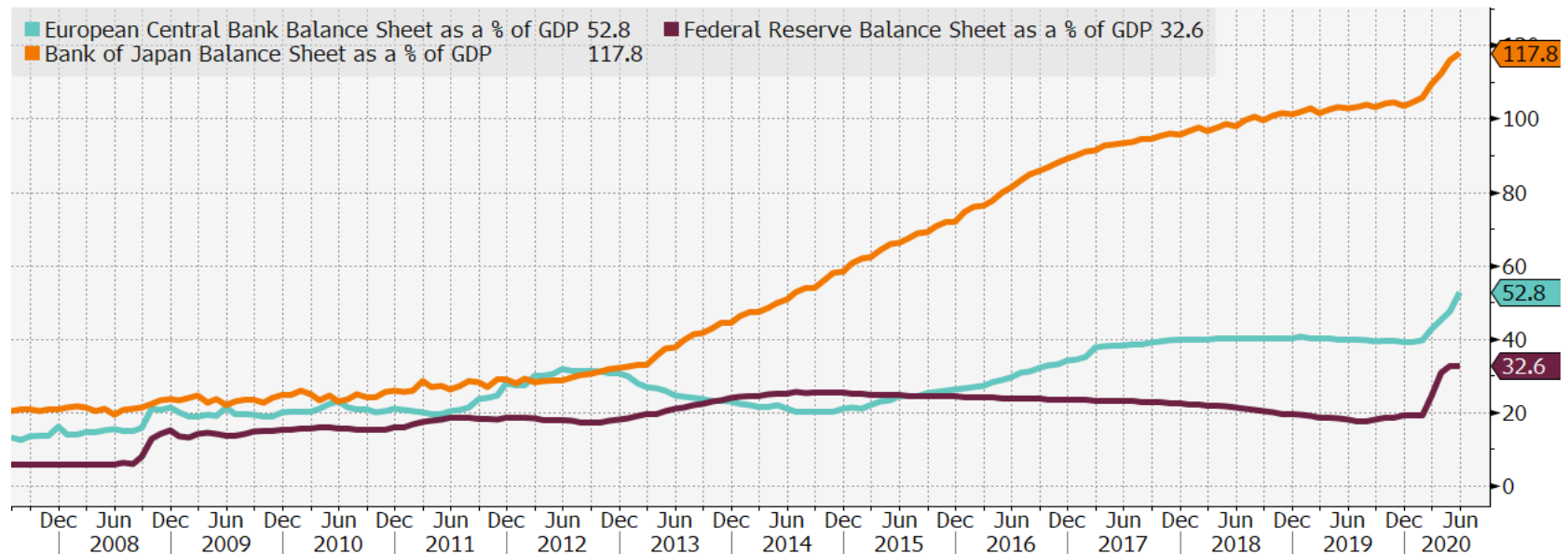
Source: Degroof Petercam Asset Management, Bloomberg, OECD, Dutch Bureau for Economic Policy Analysis, July 2020

- World trade growth has turned negative before Covid-19
- Result of protectionism / populism
- Favoring local value chains (and more automation?)



CENTRAL BANK BALANCE SHEET EXPANDING IS IT FEEDING INTO THE REAL ECONOMY?

Central bank balance sheet as % GDP



Source: Bloomberg, 02.07.2020



IRVING FISHER'S EQUATION

VELOCITY OF MONEY

TRANSACTIONS (REAL GDP)

$$M \times V = P \times T$$

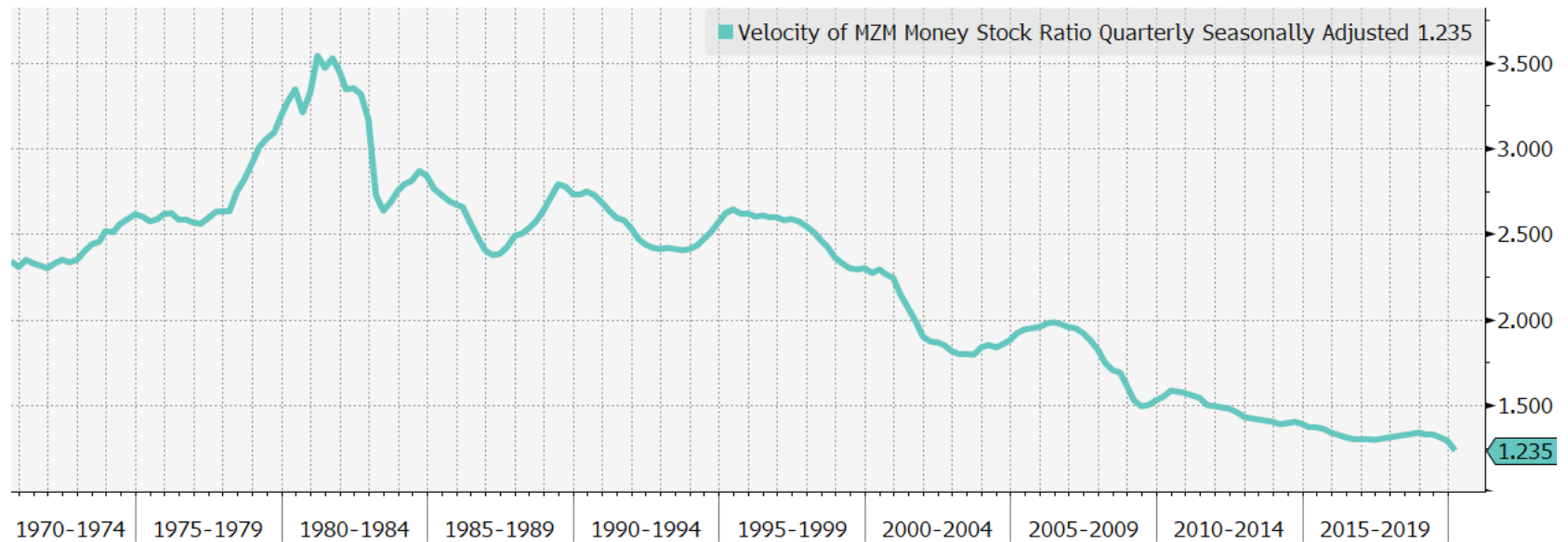
QUANTITY OF MONEY

PRICES



DESPITE QE, VELOCITY KEPT DROPPING

Velocity of Money (USD)

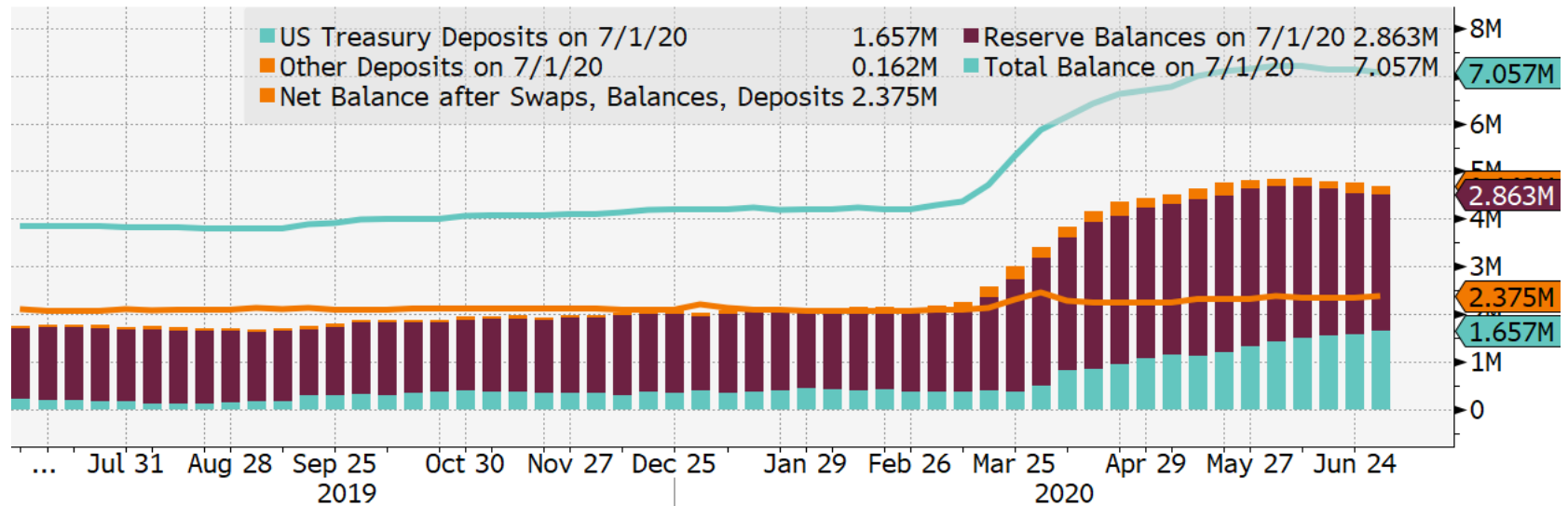


Source: Bloomberg, St. Louis Fed, 03.07.2020



QE PURCHASES HAVE MAINLY RESULTED IN ADDITIONAL DEPOSITS AND RESERVES AT THE FED

FED Balance sheets expansion

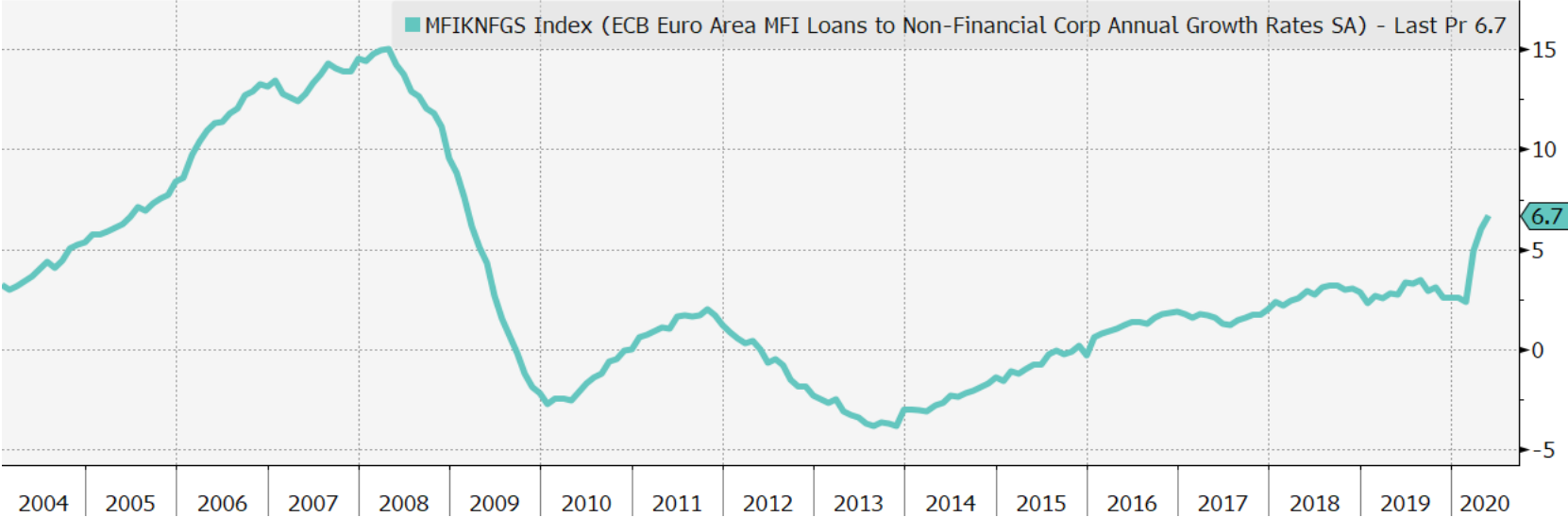


Source: Bloomberg, Federal Reserve, 04.07.2020



LOANS PICKING UP BECAUSE OF **LOAN GUARANTEES** AND COMPANIES DRAWING **CREDIT LINES**

Euro Area Loan to Non-Financial Corporations
Annualised growth

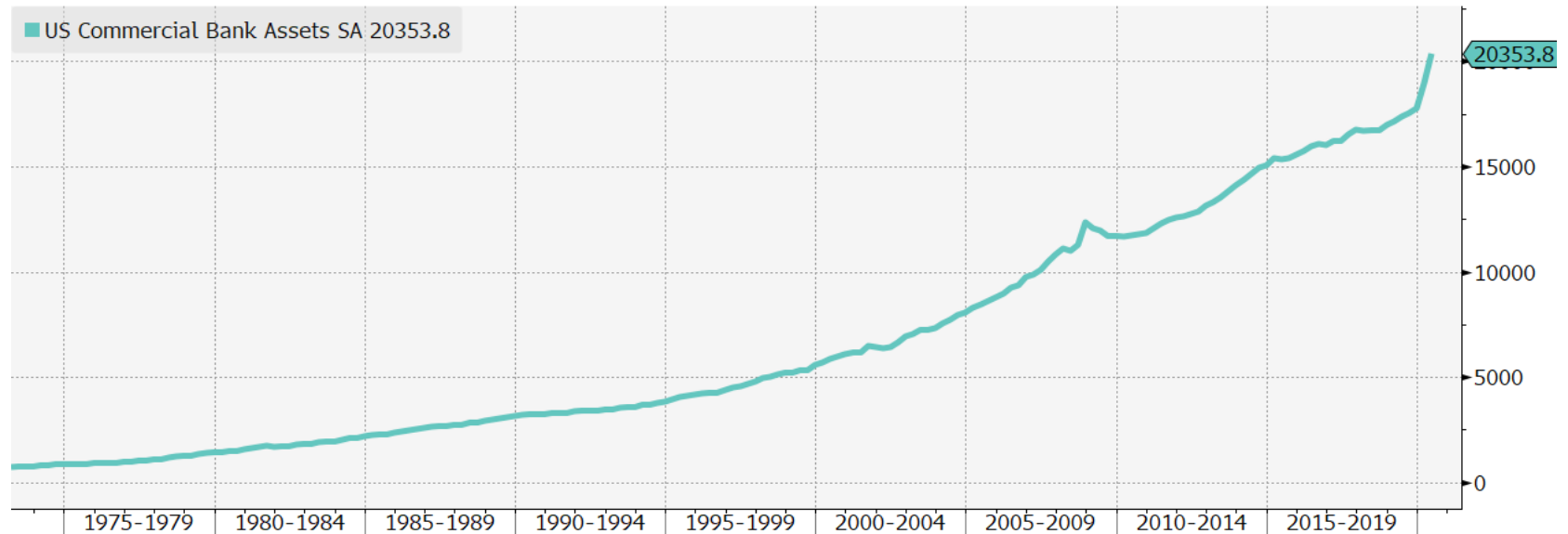


Source: Bloomberg, ECD, 01.07.2020



CENTRAL BANKS FAILED, COMMERCIAL BANKS ARE SUCCEEDING: IN PART THANKS TO GOVERNMENT INTERVENTION

US Commercial bank balance sheet



Source: Bloomberg, Federal Reserve, 06.07.2020

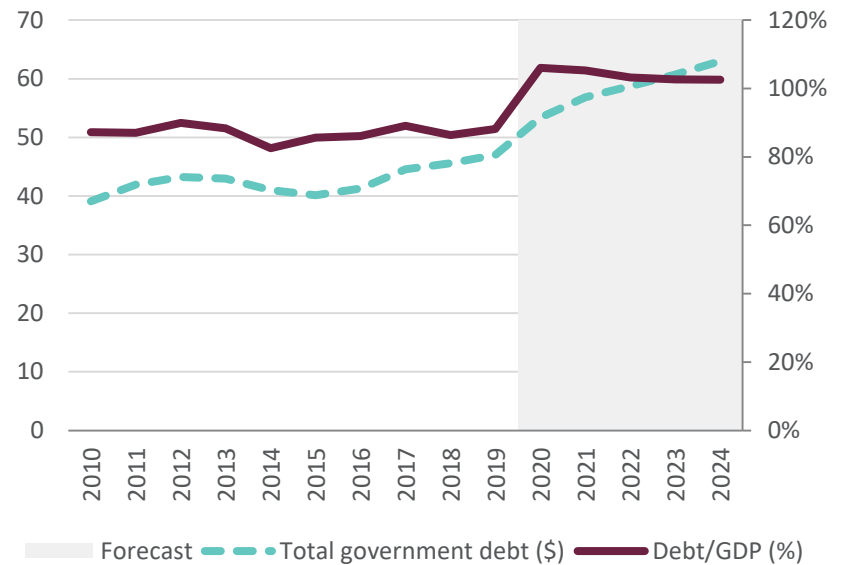


WILL GOVERNMENTS START SPENDING?

MEASURES IN THE PIPELINE, IMPLEMENTATION OFTEN DIFFICULT

	Immediate fiscal impulse	Deferral	Other liquidity /guarantee	Last update
Belgium	1.4%	4.8%	21.9%	03/06/2020
Denmark	5.5%	7.2%	4.1%	01/07/2020
France	4.4%	8.7%	14.2%	18/06/2020
Germany	13.3%	7.3%	27.2%	03/06/2020
Greece	3.1%	1.2%	2.1%	05/06/2020
Hungary	0.4%	8.3%	0.0%	25/03/2020
Italy	3.4%	13.2%	32.1%	22/06/2020
Netherlands	3.7%	7.9%	3.4%	27/05/2020
Portugal	2.5%	11.1%	5.5%	04/05/2020
Spain	3.7%	0.8%	9.2%	23/06/2020
UK	4.8%	1.9%	14.9%	30/04/2020
United States	9.1%	2.6%	2.6%	27/04/2020

OECD Government Debt and Expenditure (\$trn - Fitch projections)



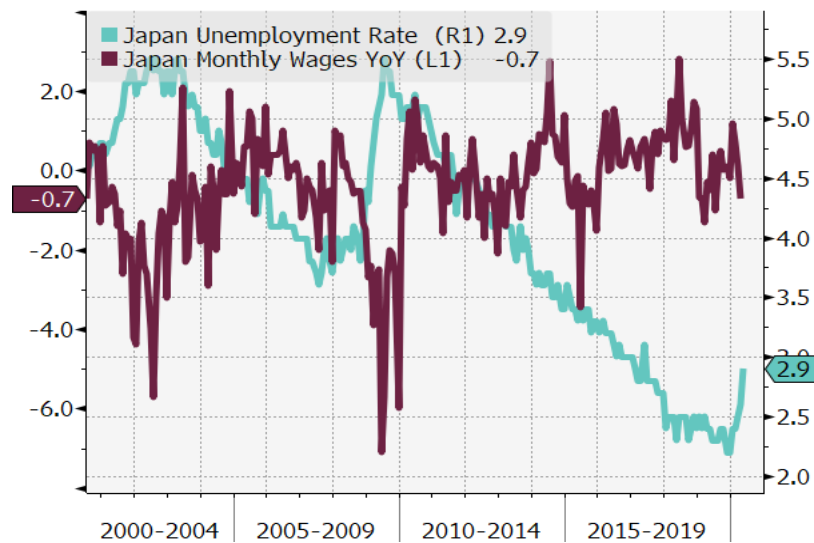
Source: Bruegel, June 2020
<https://www.bruegel.org/publications/datasets/covid-national-dataset/>





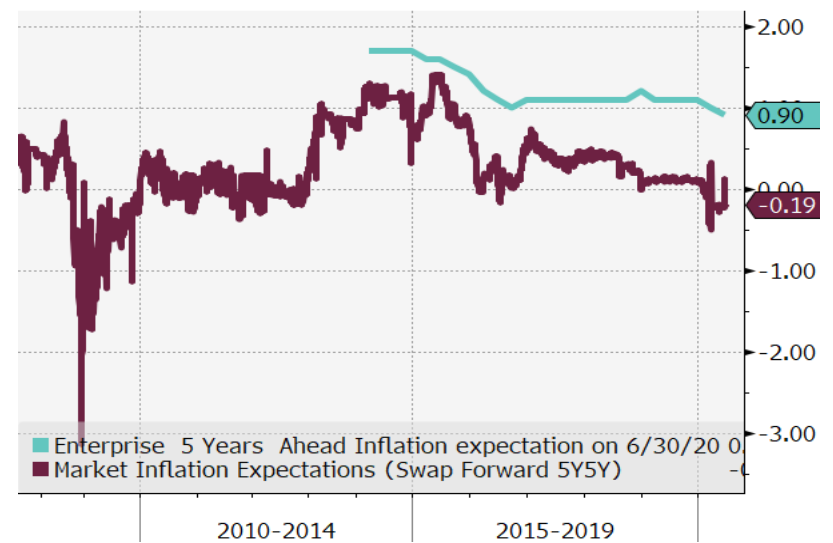
WHAT HAPPENED IN JAPAN?

Low unemployment – No wage pressure



Source: Bloomberg, 06.07.2020

Inflation expectations: Stuck at low levels

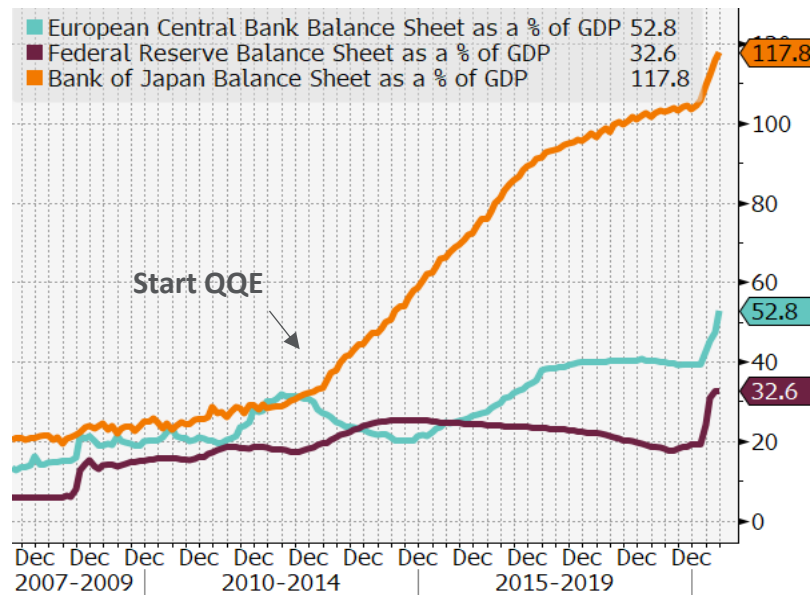


Source: Bloomberg, 06.07.2020



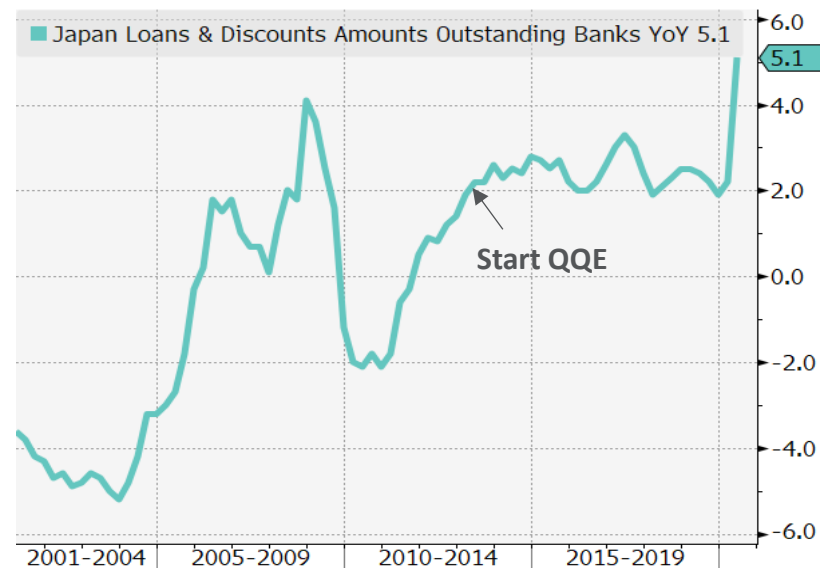
QQE DID NOT HELP CREDIT GROWTH FLAT

Central bank balance sheet as % GDP



Source: Bloomberg, 06.07.2020

Japan: Bank lending to private sector



Source: Bloomberg, 06.07.2020



ARE WE NEAR THE BOTTOM OF INFLATION?

SOME DRIVERS ARE STARTING TO TURN

Previously	Future
Inflation targeting	Inflation overshooting
Monetary dominance	Fiscal dominance (or both)
Capital > Labour	Living wage, inclusive growth
Wealth concentration and inequality	Fiscal redistribution
Globalisation	Regionalisation
Corporate profit	Green Deal / Digital (revenue) tax
Low credit growth	State sponsored credit growth



3

PORTFOLIO IMPLEMENTATION



CONCLUSION



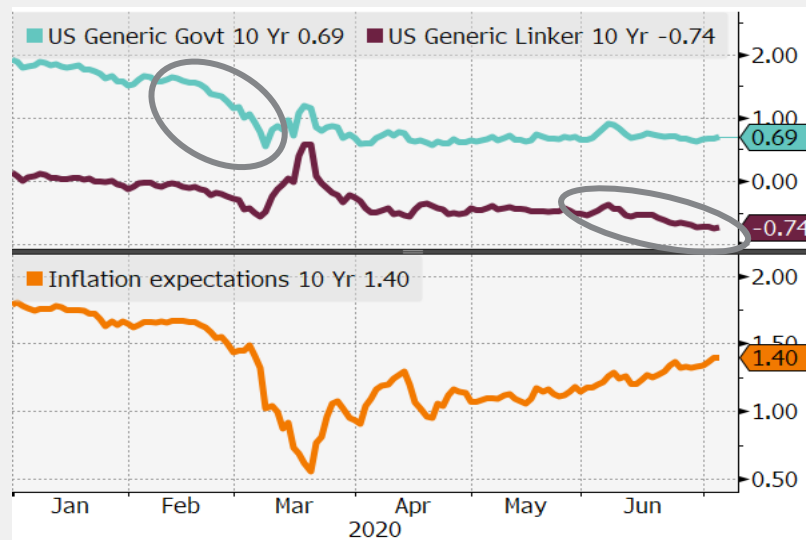
BASED ON AN ANALYSIS OF SUPPLY SIDE ECONOMICS AND MONETARY ANALYSIS:

- We expect **inflationary pressures to increase** once the demand shock of Covid 19 has subdued.
- Given the current very accommodative monetary policies from central banks we see the **upside pressure on nominal rates as limited**.
- We see inflation expectations increase mainly through **lower real yields**.
- In this environment, **inflation linked bonds** should do relatively well



RECENT RECOVERY IN BREAKEVENS DUE TO **LOWER REAL YIELDS** IN FEB-MARCH DUE TO **LOWER NOMINAL YIELDS**

US 10 year Nominal versus Real Yield

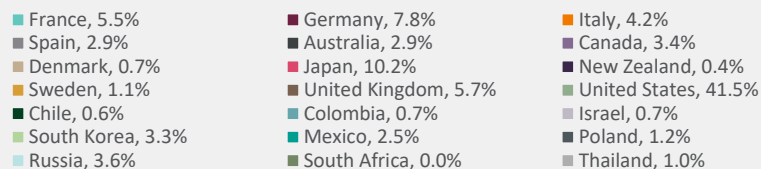
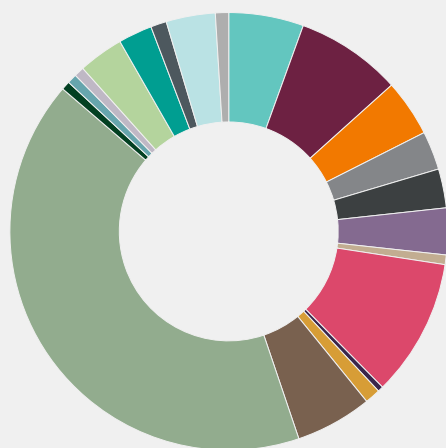


Source: Bloomberg, 06.07.2020

- Overall, trend has been for lower rates, first through lower nominal rates, leading to lower inflation expectations
- The recovery of inflation expectations in June was lead by a further decline in real rates
- Going forward, we expect an increase in inflation expectations to be more driven by real rates for a long a nominal rates are covered by QE, forward guidance and (implicit) Yield Curve Control



BETTER PROTECTING A GOVERNMENT BOND PORTFOLIO AGAINST **INFLATION SURPRISES?**



Based on Bloomberg Barclays Universal Inflation GDP Weighted Investment Grade Index, December 2019, Source: Bloomberg PORT+

- The size of the Inflation linked bond market is about 3.4 trn euro
- Compared to 26 trn euro for nominal government bonds
- Globally very diversified

Accessible through:








- **Inflation linked bond strategies**
- **Global unconstrained strategies**



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