

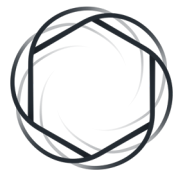


S.P. HINDUJA

BANQUE PRIVÉE

House View

FEBRUARY 2022



Thoughts of the CEO

«The central banks, above all the US Federal Reserve, are facing massive challenges.»

In recent weeks, I have read the following headlines: Italy's construction industry is thriving like it hasn't since the golden 1960s after the government fully underwrote the cost of green building renovations. Rolls-Royce sold 5,586 vehicles worldwide last year, 443 more than in 2019, its previous record year, while its factory runs at near-maximum capacity and order books are still full. Finally, gold imports to India have accelerated to the highest level in a decade, among a pickup of weddings and celebrations, as fears of the pandemic eased.

What this shows: Money paid out by governments in industrialized countries and financed by central banks is arriving in the real economy – all over the world. The economy is doing very well, even if the Omicron variant is currently causing headwinds in certain sectors.

Labor is therefore becoming scarce, and wages are rising. In the US, many have retired – bank accounts are well-filled, also thanks to the rise in asset prices, which reduces the incentives to work. Rising wages, however, increase the likelihood that the current high inflation rates will become entrenched.

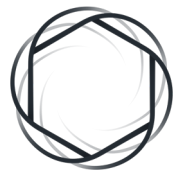
Central banks, above all the US Federal Reserve, are thus facing massive challenges. Will they dare to react strongly enough to push down the sharp rise in inflation? So far, the Federal Reserve relies more on strong communication than decisive actions, while the European Central Bank only recently seems to accept the realities. Perhaps they are still hoping for the emergence of an economic recession before inflation rates have taken on a life of their own. They should rather be looking to central banks that operate in more inflation-prone economies, like Brazil and Russia, which have rightly reacted strongly to the rising inflation rates. They know that inflation expectations need to be firmly anchored.

Investors should prepare for higher interest rates, also in the United States and in Europe. It is not surprising that this environment creates more headwinds and volatility in the stock markets. Nor is it surprising that the stocks that rose sharply during the pandemic are proving vulnerable in such an environment. However, we could not automatically read into this a scenario of an economic recession. Stay invested - but be alert.

Yours sincerely,

Karam Hinduja





Rising interest rates cause headwinds

Omicron is raging worldwide, China's economy is not getting off the ground. In the USA and Europe, however, inflation rightly remains the dominant topic. The US Federal Reserve has officially adopted the fight against inflation, while the European Central Bank seems to acknowledge reality only rather reluctantly. Meanwhile, financial markets are bracing themselves for rising interest rates.

Omicron is currently causing case numbers to reach unprecedented heights in many countries all over the world. But although Omicron is putting a strain on the healthcare system and causing staff shortages everywhere, optimism is mixing into the epidemiological situation. We hear more and more that Omicron might be the end of the pandemic. So far, the economic damage from the current wave has been limited.

The publication of the US central bank Federal Reserve's meeting minutes had startled the markets at the beginning of the year because the members of the Open Market Committee spoke very openly about inflation risks. The turnaround performed by the Fed is remarkable. Justifiably so – in January, US inflation hit 7.5 percent, its highest level since 1982, despite a slightly negative energy price effect. The most pleasant solution for the Fed would be if inflation were to normalize of its own accord soon. Indeed, our calculations show that the contribution of higher oil prices to

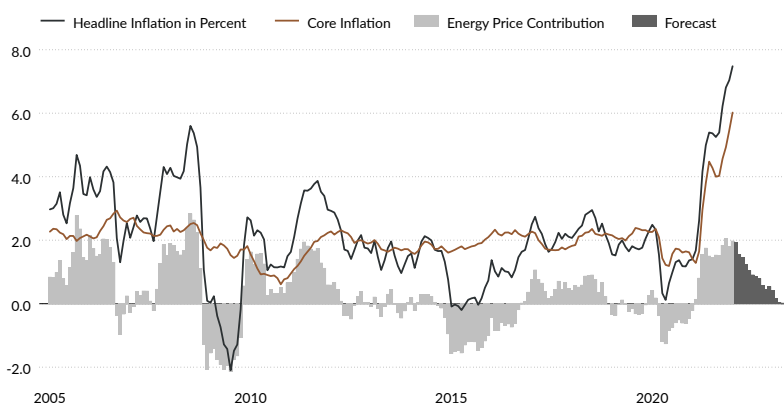
headline inflation already peaked in November and has remained more or less constant since then (see figure 1). But other factors driving inflation remain at work: Shortages of goods, especially cars (see figure 2), dried-up labor markets and thus rising wages, Corona measures restricting production and transport, and rising housing costs. This makes it unlikely that inflation will return below 4 percent this year.

Sector rotation on equity markets

The adjustment in the US monetary policy stance resulted in significantly higher interest rates worldwide. The increasing headwinds have already been evident in the stock markets since the beginning of the year. The publication of the minutes of the December monetary policy meeting made it clear that Fed members were discussing not only interest rate hikes but also balance sheet reduction. Equity markets reacted sensitively to this. The technology-heavy Nasdaq fell more than 4 percent in a week. Since the outbreak of the

Fig. 1: US inflation only partly driven by energy prices

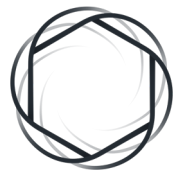
Contribution of energy prices to US consumer price inflation



SOURCE: REFINITIV, WPULS

US inflation rates have seen a significant spike over the past year, reaching the highest level since 1982. While the rising energy prices – in particular oil prices – have been a significant driver of the price increases, their contribution is now expected to diminish. However, unlike previous periods, this time inflationary pressures appear to be more broadly supported, thus driving the core inflation rate to 6 percent.





Corona crisis, this has only occurred three other times. The S&P 500 Index was also hit, albeit less severely. On the other hand, energy and financial-heavy stock markets benefited, with the British stock market leading the way.

Chinese equities also had a mixed start to the year. Although Omicron poses a challenge to the economy, this seems to be less of a driving factor its equity market. More central are still the regulatory measures and the problems in the real estate market. Policy support remains very cautious. China is thus serious about reducing its debt mountain, even at the expense of short-term growth.

Geopolitics and investment

Some clients want to know what to make of the increased geopolitical tensions between Russia and Ukraine, which have partly accentuated the losses on the financial markets. Statements by U.S. President Biden indicated that the U.S. sees an escalation between Russia and Ukraine as more likely. The Russian side has denied this. Tactically, we recommend not betting in any significant way on scenario outcomes. These binary calls fall outside standard economic and financial models.

What is clear is that Europe would be more vulnerable due to its dependence on Russian energy supplies, despite the EU and the US issuing a joint statement that they are in touch with potential suppliers worldwide for LNG deliveries. A potential conflict would, therefore, not affect the global economy in the same way, but would almost certainly re-

sult in volatile energy prices. While some investors may, therefore, wish to bet on energy price volatility, we cannot realistically infer conclusions from these developments for an internationally diversified portfolio. Our advice to clients, therefore, is: Be careful when playing tactics with this, but if you want to, we have instrument solutions for you.

Fig. 2: Prices of used cars in the US rise sharply

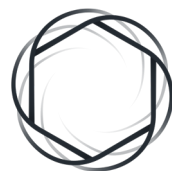
Indexed price of used cars in the US



SOURCE: REFINITIV, WPULS

US inflation rates reached 7.5 percent in the beginning of 2022. Among the drivers were used cars. The production of cars was especially hampered in 2021 by the shortage of semiconductors. At the same time, plenty of savings led American consumers to spend their money. As no repetition of the price increase can be expected in 2022, this part of the inflation pressure will decrease. However, higher wages and living costs will keep US inflation rates high.



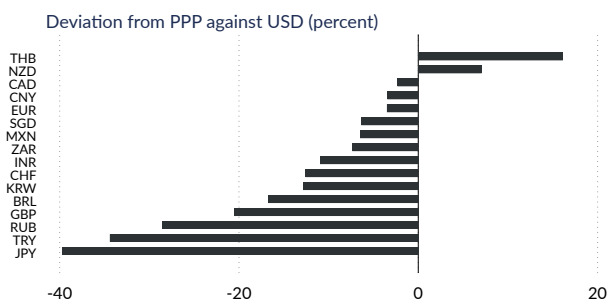
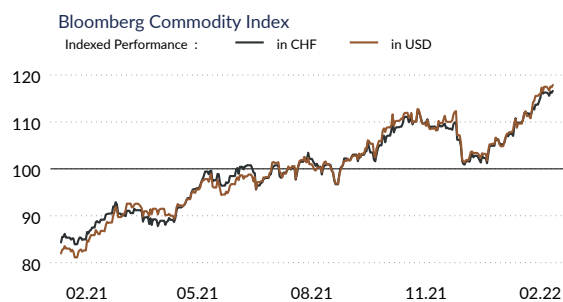
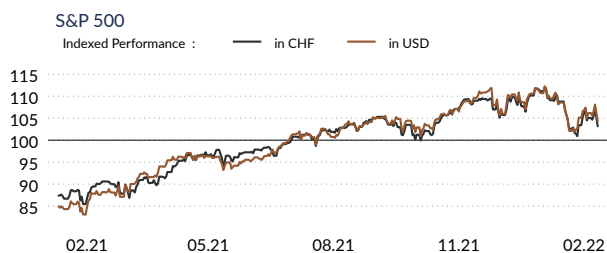
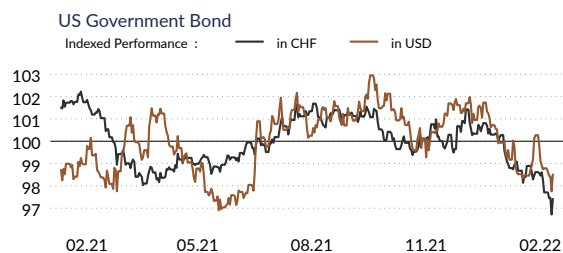


Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M2
	Trend	2021F	2022F	2021F	2022F	Q4 2021	2021
USA	1.6	5.8	3.4	4.7	5.5	0.25	15.3
Eurozone	1.0	5.4	3.3	2.6	4.5	-0.50	8.3
UK	1.6	7.6	4.5	4.0	4.7	0.5	10.6
Switzerland	1.4	3.7	2.7	0.6	1.4	-0.75	4.7
Japan	1.0	1.7	2.1	0.0	0.7	-0.10	6.9
China	4.5	8.7	5.2	1.3	2.3	4.35	9.0
Brazil	1.1	5.1	1.3	8.1	7.5	10.75	7.6
India	5.0	9.5	8.5	5.2	6.5	4.00	16.3
Russia	1.0	5.9	2.6	5.8	5.0	8.50	13.0
World	2.9	5.5	4.0	4.4	4.9	-	-

SOURCE: REFINITIV, WPULS

Financial Markets



SOURCE: REFINITIV, WPULS





Figure of the Month

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At the end of January 2022, financial markets were expecting a total of five interest rate hikes of 0.25 percentage points by the US Federal Reserve over the course of the year. This would be a much faster exit from ultra-expansionary monetary policy than after the financial crisis. Indeed, the situation is completely different: Inflation rates are well above the target, a completely dried-up labor market, plenty of savings to spend. We even think that the Federal Reserve would have to raise interest rates even faster if it really wants to lower inflation.

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We are private bank with an entrepreneurial spirit, embracing collective action and building creative solutions that advance the world, economically and socially.

The future of banking is emerging at the intersection of profit and purpose.

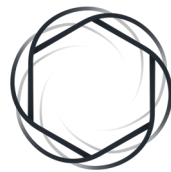
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