Protagonists of *Butch Cassidy and the Sundance Kid*. 1969.
Katherine Ross (Etta Place), Paul Newman (Butch Cassidy) and Robert Redford (Sundance Kid).

HOUSE VIEW

PLOTTING A NEW COURSE FOLLOWING JACKSON HOLE

BancaMarch

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The world's leading central bankers are set to meet in Jackson Hole on 24 August. This annual economic symposium has been held for more than 40 years in Wyoming, right on the edge of the Rocky Mountains and near where, just over a century ago, Butch Cassidy and the Sundance Kid would rob Union Pacific trains with their Hole-in-the-Wall gang, thus providing the inspiration for the now legendary western *Butch Cassidy and the Sundance Kid*. The Sundance Kid was so fast on the draw that the price placed on his head was far higher than the bounty for his fellow gang members.

Will it be in August when Jerome Powell, in true Sundance Kid style, dons his monetary policy holster and announces the end of the interest rate hikes?

The Fed needs to buy time. Although inflation is clearly retreating —this Wednesday the headline rate could fall to 3.1%— the trend in prices is proving to be more stubborn if we exclude the effect of energy and food, with core inflation lingering at 5% due to the increase in the price of services (+6.6%) and imputed rental (+8%). Moreover, the labour market remains resilient. In the first half of the year, 1.7 million nonfarm jobs were created, and an unemployment rate at an all-time low is perhaps not the best environment to contain wages, which are growing at 4.4% and are already up in real terms. The economy seems to be holding up and consumption, far from withering, is climbing at a rate of 2.1%.

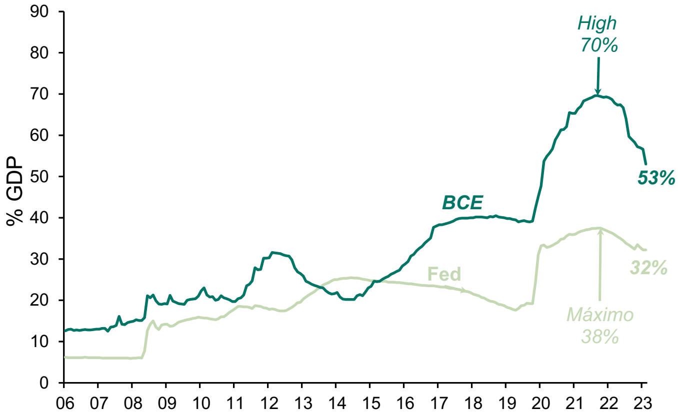
In any case, buying time is all fine and dandy, but not at the cost of derailing the economy. We therefore believe that, while the Fed is sticking to its guns and its extremely hawkish rhetoric, it will settle for hiking rates to 5.5% at the end of July and then, in Jackson Hole, announce that most of the work has been done and that rates will not go up much further.

What matters most right now is to recalibrate the tightening effects of monetary policy. Let us not lose sight of the fact that over the past 16 months, we have witnessed the most aggressive and rapid rate hike process since the 1980s and, with real interest rates positive at above 1%, the economic slowdown will not be long in coming.

Although the effects of interest rate hikes often take time to materialise, we are already beginning to see the impact on credit. For the economy, they are like raindrops falling on its head: a little bit is fine, but if it goes on too long the results can be dire. I'm sure you all recall that famous scene in *Butch Cassidy and the Sundance Kid* where Paul Newman, playing Butch, takes Etta for a ride on his bicycle to the tune of *Raindrops Keep Fallin' on my Head.*

1. FED AND ECB BALANCE SHEETS

Sources: Bloomberg and Banca March



Aside from the matter of interest rates, central banks are continuing to reduce their balance sheets. Since the post-pandemic peak, the Fed balance sheet has shed 7.5% (6% in GDP terms). It will take at least a year to bring it back to the peak level at which it began to pare back its balance sheet in 2017.

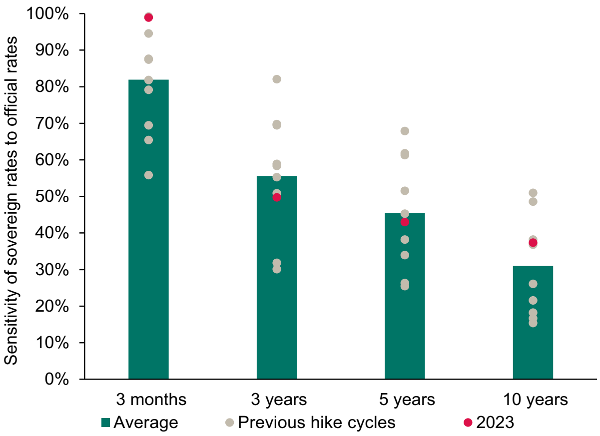
In Europe, the ECB will strike up a faster pace because the balance sheet growth seen during the COVID-19 pandemic was much more significant. The rate hike process started later and inflation remains at 5.5%, which will force the ECB to set its deposit rate at 4% at least.

How will the end of the rate hikes in the US affect the outlook for financial assets?

In fixed income, we now see a good opportunity to extend duration following the recent scare generated by the Fed's tough talk. As Figure 2 shows, the sensitivity of further increases in policy rates on long-term fixed income is low, especially as we near the end of this lengthy hiking process. We believe that we should take advantage of the movement seen over the last few days to buy longer durations and thus reduce the reinvestment risk for future maturities.

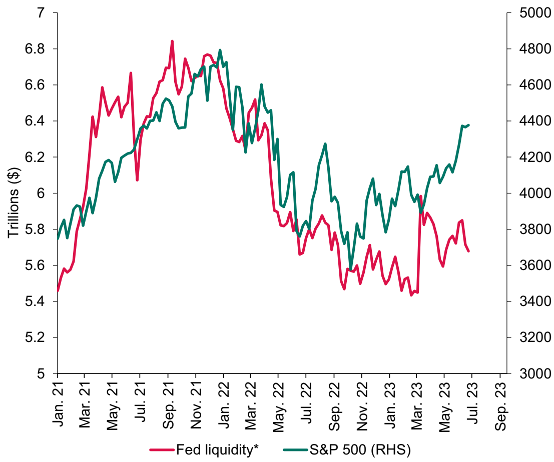
2. SENSITIVITY OF BONDS TO OFFICIAL RATE HIKES

Sources: Bloomberg and Banca March



3. FEDERAL RESERVE LIQUIDITY* VS. S&P 500

Sources: Bloomberg and Banca March



(*) Fed balance sheet – Treasury General Account (TGA) at the Fed – Reverse repo account (RRP).

We remain wary when it comes to equities. The cumulative gains made since October of last year have been significant and, as we can see in Diagram 3, liquidity levels are beginning to decline. With Q2 corporate earnings season now upon us, we prefer to wait for better opportunities to increase our exposure.

Watch out for the Fed's message on 24 August: plotting a new course following Jackson Hole.

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IMPORTANT REMARK: