



## HOUSE VIEW

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# THE FEDERAL RESERVE AND RAVEL'S BOLÉRO

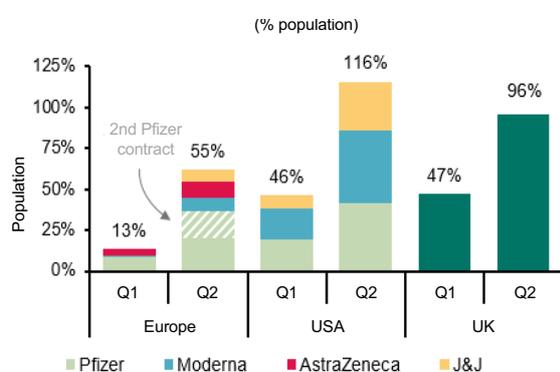
## THE FEDERAL RESERVE AND RAVEL'S BOLÉRO

There can be no doubt that Maurice Ravel, along with Debussy, ranks among the greatest contemporary French classical composers. We are all familiar with his Boléro, written in 1928. Inspired by a Spanish dance, the snare drum repeats its rhythm obsessively as the other instruments phase in gradually to build to a crescendo, ending the piece with a dramatic, full-orchestra coda.

The great economic reopening, made possible by the largest vaccination campaign in history – which will see countries like the UK and the US administer at least one dose to 100% of their populations by the summer – is building towards the most resounding global economic *crescendo* of the decade. Europe is lagging slightly behind. Our forecasts show we are on track to hit 55% July, once the J&J vaccine is in circulation.

### ESTIMATED DOSES ADMINISTERED AT END OF Q2

Source: Companies, The Brussels Times and Banca March



It is natural to expect, in a more normalised phase of the economic cycle, that as the output gap gradually closes and the economy approaches its growth potential, inflation will begin to rise; two-year inflation forecasts have begun to stir, and now stand at 2.6%. It is equally natural for plans to taper the 29 trillion dollars deployed in global stimulus measures, the largest stimulus since the Second World War, to trigger certain suspicions when they coincide with a new fiscal package in the US worth 8% of GDP. Doesn't it call to mind those final strains, as Bolero switches to a triumphant C major and

the trombones play the glissando towards the final climax? Like Ravel's Boléro, will the spectacular economic performance forecast for the months ahead be dramatically derailed in the form of inflation?

Although we are currently living in a structurally deflationary landscape due to demographics, technology and the inability of labour forces to set wages, the economic reopening in the months ahead will see precisely the opposite effect prevail, albeit temporarily.

The key factors at play from now on will be monetary expansion (in the US, M2 supply is up by 26% to its highest level since the 1940s), supply chain bottlenecks due inventory shortages, price tensions in certain sectors like tourism, which will be unable to meet demand, and first and foremost the base effect of energy and commodity prices; Brent crude was trading at under 17 dollars a barrel last April.

As we set out in the report, this spike in inflation above central bank targets will be a transient situation which will be confirmed towards the end of this year.

But central banks are coming under pressure now; the burden of proof lies with them, and it is up to them to choose the right time to taper the current stimulus measures, just as they did in 2013 as we emerged from the financial crisis of 2008.

Back then, after a five-year *crescendo*, real negative interest rates began to spike in what was dubbed the Taper Tantrum, after Bernanke – the world’s largest bond buyer – announced the tapering of the Fed’s asset purchases, which had tripled the size of its balance sheet over five years.

### REAL RATES BEGIN TO STIR (%)

Source: Bloomberg and Banca March



The current situation is not identical by any stretch of the imagination: since March, the Fed has bought 2.9 trillion dollars’ worth of bonds swelling its balance sheet to 36% of GDP, versus 20% in 2013. The current fiscal stimulus measures outstrip the efforts in the previous crisis by 3x. On the flipside, the Fed is no longer bound by the Evans Rule as it was then, which meant it had to intervene if unemployment dipped below 6.5% or inflation exceeded 2.5%. Powell has greater discretion, but he still has his work cut out for him, as he will need to ward off the impact of stimulus measures on prices.

In the Boléro of 2013, after Bernanke’s announcement, bond prices continued to plummet and the yield on 10-year Treasuries went from 2% to 3% in just four months. After a short-lived 6% dip, the S&P 500 continued to enjoy a lengthy crescendo which, along with the economic cycle, lasted another 7 years. This is further evidence still of the scant protection afforded at this stage in the cycle by bonds, and the need, therefore, to stay invested in equities and real assets, even as the debate on how the coda in this composition will play out fuels more abrupt market fluctuations. Powell: once again, the world is in your hands.

### S&P 500 PERFORMANCE AFTER THE TAPER TANTRUM

Source: Bloomberg and Banca March



**Joan Bonet Majó**  
 Chief Investment Strategist

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