

MARKET SIGHT LINES



Global Central Bank Policies: A Kettle of Hawks

By Michael O’Keeffe, *Chief Investment Officer*

Jobs have recovered, inflation is elevated, and our Federal Reserve (Fed) has pivoted to a hawkish policy stance. We see similar shifts by other central banks around the world, albeit at different paces and magnitudes.

In this week’s Sight|Lines, we review how global central bank policies have shifted since last year, shifts that have resulted in a group – or “kettle” – of hawks.

Evolution of Fed Policy

As we’ve discussed actively, we’ve seen Fed policy evolve from a dovish, highly accommodative one to a more hawkish stance over the last year. Consider Figure 1. When we look back at December 31, 2020, inflation was under control, with CPI up 1.4% over the year prior. Unemployment sat at 6.7%, with the Fed signaling that we were not at full employment and that the current policy was appropriate. Futures contracts forecasted no Fed hikes in 2022.

But things changed through the year. Inflation rose, and the employment picture improved. When we look at the same information today, we see that inflation rose by 7.5% over the last year, and unemployment sits at 4%. The Fed says it believes employment has improved, and we’re close to full employment. The Fed has also dropped the concept of “transitory” inflation. It is now seeking to calm inflation by tapering security purchases, hiking rates, and starting to reduce the size of its balance sheet, with the belief that the strong economy and employment can handle the shift.

Figure 1

	Policy Rate		Inflation (CPI%)		Unemployment (%)		# of Implied 2022 Hikes	
	12/31/20	Today	12/31/20	Today	12/31/20	Today	12/31/20	Today
United States (Fed)	0 - 0.25%	0 - 0.25%	1.4%	7.5%	6.7%	4.0%	0	7
European Union (ECB)	0.0%	0.0%	-0.3%	5.1%	8.2%	7.0%	0	5
United Kingdom (BOE)	0.0%	0.50%	0.6%	5.4%	5.2%	4.1%	0	6
Japan (BOJ)	-0.10%	-0.10%	-1.2%	0.8%	3.0%	2.7%	0	0
China (PBOC)	12.50%	11.50%	0.2%	1.5%	4.2%	3.9%	N/A	N/A

Source: *Stifel Investment Strategy via Bloomberg, as of February 11, 2022*

Global Central Banks

We've seen other central banks around the world shift toward a more hawkish policy. This can be interpreted as policymakers increasingly holding a view that inflation poses a bigger threat to the economic recovery than COVID-19. Here is a summary of each.

The *European Central Bank (ECB)* has not yet changed its policy rate, but as inflation has risen to 5.1%, ECB President Christine Lagarde has signaled a policy shift may be forthcoming as soon as the March 10 meeting. Through last year, the ECB signaled its intent to keep rates steady and continue buying eurozone debt on a large scale. The *Bank of England (BOE)* has hiked rates 0.5% over the last year and has signaled its intention to start reducing the size of its bond holdings in a smooth manner. Our [2022 Outlook](#) spoke about balancing acts, and with inflation at 5.4% in the UK, BOE Governor Andrew Bailey described a balancing act the BOE faces as it turns more hawkish: "We face a trade-off between strong inflation and weakening growth." The *Bank of Japan (BOJ)* is standing pat on its accommodative monetary policy, with inflation well under control and its inflation forecasts higher, but only slightly. In a press conference after the January policy meeting, Governor Haruhiko Kuroda said, "We will keep our monetary policy loose until after consumer inflation stably exceeds 2%."

The *People's Bank of China (PBOC)* is facing a balancing act of its own; it worries about too much debt in its system, which is fueled, of course, by loose monetary policy. But even with that worry, the PBOC is signaling an intention to possibly shift toward a more accommodative policy to support more economic growth, which has fallen recently. The PBOC began this process by lowering bank reserve requirements last year. So the PBOC is an outlier, compared to other central banks.

In emerging market countries, many central banks started raising rates last year. For example, Brazil hiked rates 725 basis points (bps) last year and just last week delivered its third consecutive 150-point hike. Russia hiked 425 bps in 2021, and the Czech Republic lifted its policy rate to the highest in the European Union.

Investment Implications

The prospect of higher policy rates has investors worried, and market volatility is elevated so far this year. But the economy is still growing, and history tells us that markets often post a positive return during rate hike cycles. We remain modestly positive on the equity market for the remainder of the year.

Conclusion

Elevated inflation has central banks worried. In the wake of the pandemic, each central bank seeks to balance economic recovery, employment, the health of its economy, and inflation as it sets policy. We've seen a shift, much driven by inflation, to a more hawkish policy stance all around. We have a group – or "kettle" – of hawks.

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