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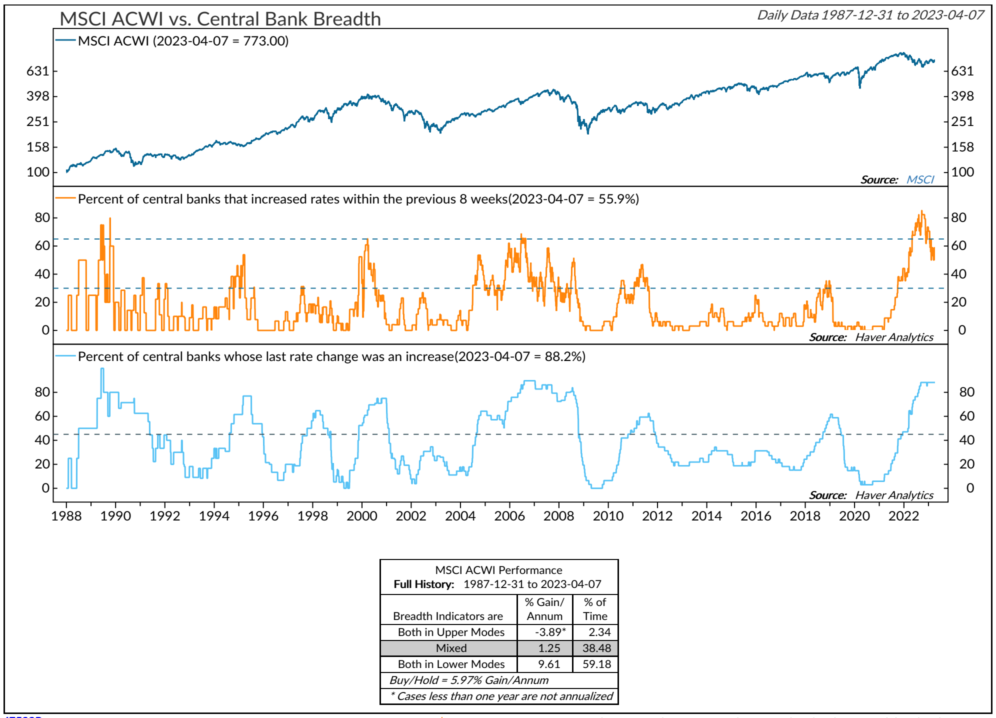
Global monetary policy – some signs of reprieve?

Key Takeaways

- Global monetary policy looks tighter than ever, but under the surface, we're starting to see some signs of reprieve.
- The equity market, however, usually performs best when most central banks have been in easing mode.
- Both historical precedent and the inflation environment suggest that we likely won't get to that point until at least the end of the year.

Some CBs have paused, but none have moved to easing



IE509R

Unprecedented tightening

The past year and a half saw some of the fastest and broadest tightening in global monetary policy in history. Our estimate of the global central bank rate has climbed almost 300 bp since the end of 2021, the largest gain in that period since our data began in 2000. Moreover, nearly 90% of the world's central banks are in tightening cycles, the most since 2007 and compared to fewer than half in late 2021.

More CBs pausing

But we may be seeing an end to this increasingly tighter policy soon. According to our calculations, just over half of the world's central banks have increased interest rates over the past two months, down from a peak of nearly 90% in late September. Notably, several emerging market central banks as well as the RBA and BoC have taken a pause. While the Fed and ECB may not be done tightening, it's highly likely that they will stop lifting rates this quarter. Moreover, central bank balance sheets in aggregate have also been expanding, but not due to traditional QE.

The equity market, however, usually performs best when the majority of central banks have been in easing mode. Both historical precedent and the inflation environment suggest that we likely won't get to that point until at least the end of the year.

Mixed CB breadth

As shown in the chart above, the weakest period for global equities has occurred when most central banks have been tightening (clip three) and have done so over the past two months (clip two). This essentially characterizes much of 2022.

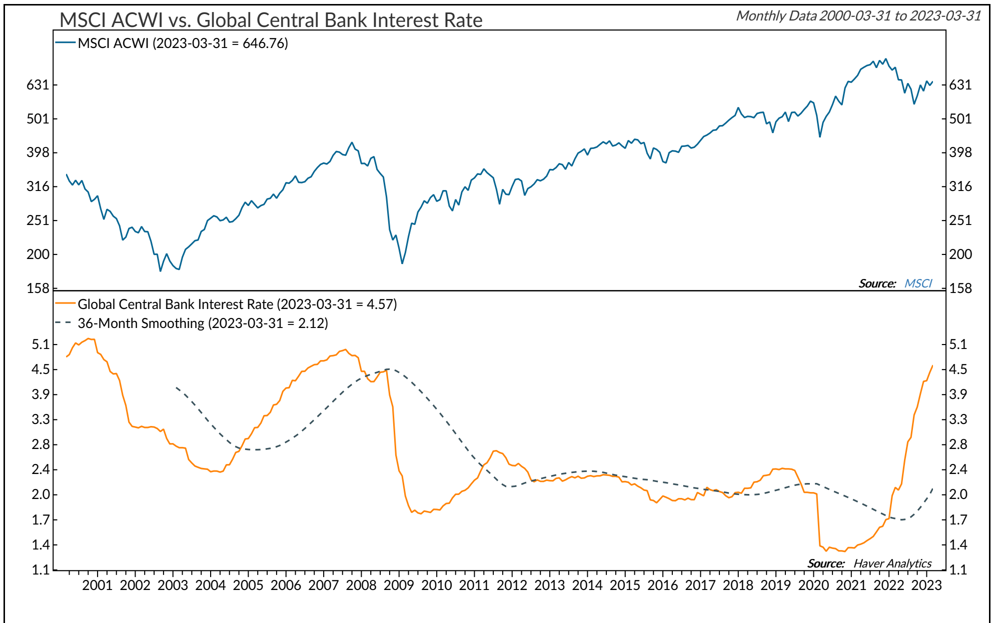
Right now, our indicator is mixed, which is generally associated with modest gains in global equities. While more central banks are taking a pause, none have on balance reverted to easing policy. In fact, we usually don't see more than half of the world's central banks in easing mode until 12 months after the data in the second clip of the chart has peaked. Based on that historical norm, that turning point would occur in October of this year.

Moreover, in the post-Volcker era the Fed has waited an average of nine months after ending a tightening cycle before easing. The BoE has been similar. The ECB has been shorter, partly due to less history and the 2011 cycle, which saw the ECB quickly reverse from tightening to easing in the wake of the sovereign debt crisis.

Global rate still well above average

Once central banks move back to easing, that will clearly bring down the overall global central bank rate. But for the time being, the marked gains we've seen in the global central bank rate over the past year present a headwind to global equities (chart at right).

Global central rate remains elevated



MSCI ACWI Performance
Full History: 2000-03-31 to 2023-03-31

Global Central Bank Interest Rate is	% Gain/ Annum	% of Time
Above 36-Month Moving Average	2.64	39.03
Below 36-Month Moving Average	9.09	60.97

Buy/Hold = 2.77% Gain/Annum

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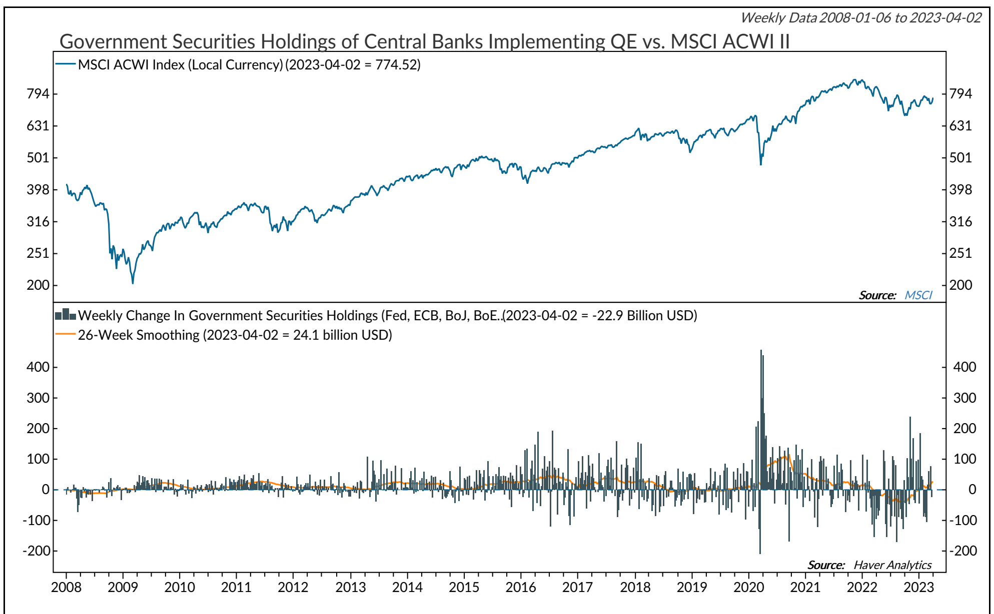
Central bank balance sheets expanding



MSCI ACWI Performance
Full History: 2003-06-22 to 2023-04-02

Smoothed Central Bank Gov't Security Holdings	% Gain/ Annum	% of Time
Growing	10.40	78.49
Contracting	-9.24	21.51

Buy/Hold = 5.85% Gain/Annum

MSCI ACWI Performance
Chart View: 2008-01-06 to 2023-04-02

Smoothed Central Bank Gov't Security Holdings	% Gain/ Annum	% of Time
Growing	11.60	84.15
Contracting	-27.74	15.85

Buy/Hold = 4.17% Gain/Annum

IE516K

Stealth QE?

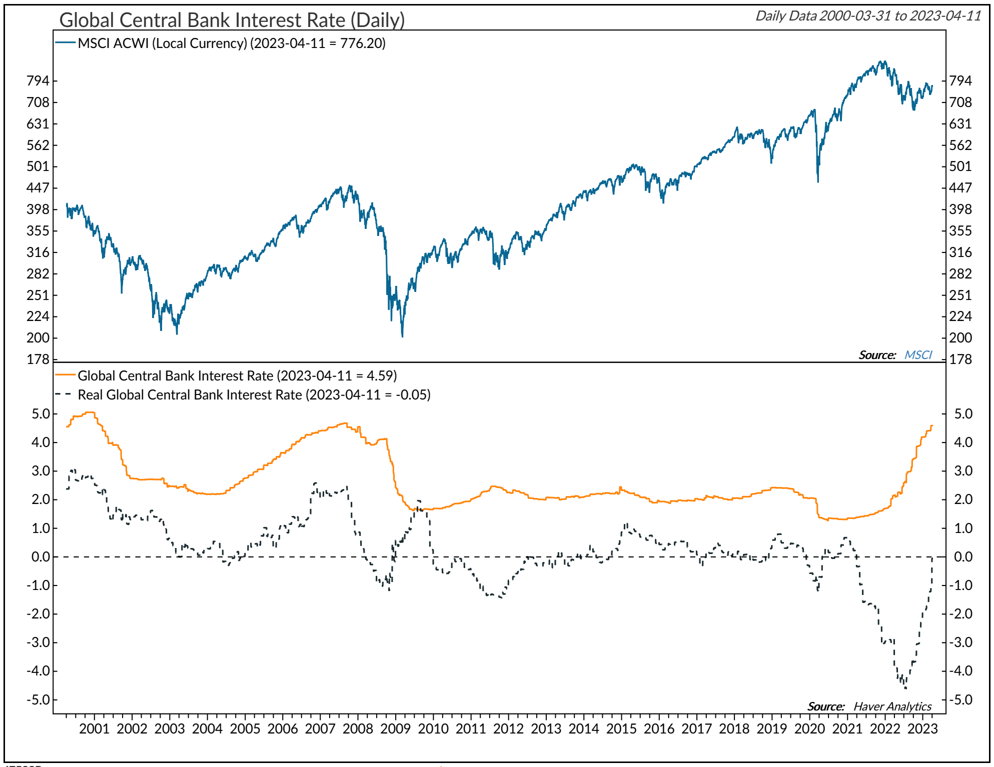
An interesting development is that the aggregate balance sheet of the major central banks has been expanding. Much of this is due to U.S. banks utilizing the Fed's discount window in the wake of the banking crisis in March. But the expansion began before then due to the BoJ and the Fed's TGA expansion.

As shown on the chart at left, an expanding balance sheet has been associated with strong equity market gains. We do, however, take this analysis with a grain of salt due to its limited history and the current cause of the balance sheet expansion, which is different from traditional QE.

Global real rate still negative

Despite the large jump in the nominal global central bank rate, on a real basis, the rate is slightly negative due to still-high inflation in most parts of the world. Although the real rate is close to neutral and far less negative than what it was in mid-2022, it still suggests that policies remain accommodative.

Real rate remains accommodative



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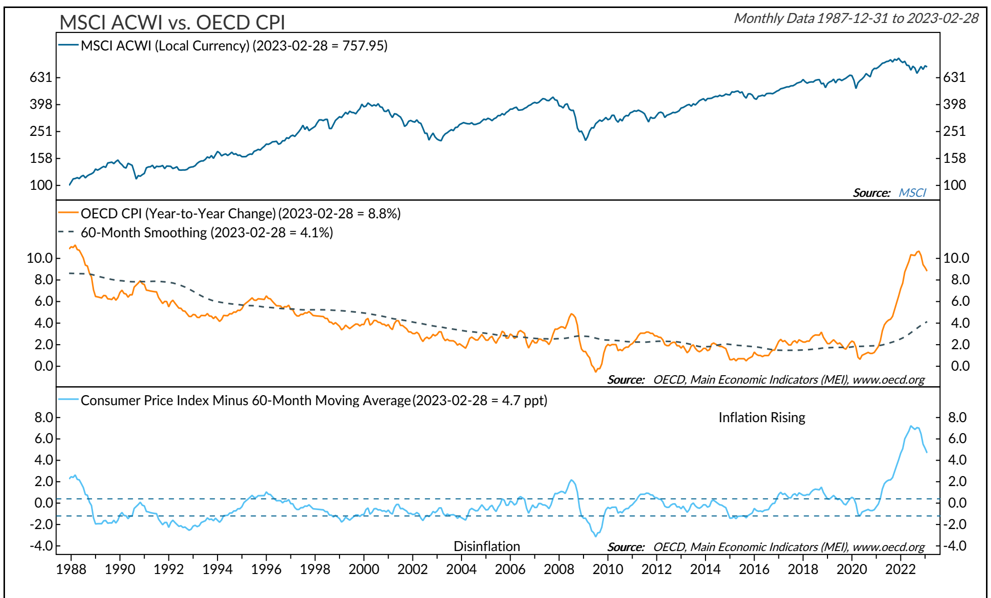
Inflation has fallen, but remains elevated



MSCI ACWI Performance
Full History: 1987-12-31 to 2023-02-28

CPI Less 5-Year Average Is	% Gain/ Annum	% of Time
Above 0.4	-3.75	24.18
-1.2 - 0.4	8.49	55.21
Below -1.2	11.17	20.61

Buy/Hold = 5.93% Gain/Annum

IE704A

Inflation still too high

A policy pivot to easing will come when there are clear signs that inflation has gotten closer to central bank targets. Although peak inflation is likely behind us due to goods disinflation, services inflation has been stickier to the downside amid elevated wages and continued pricing power in the face of strong demand, as discussed in our April 6 publication.

Tighter credit conditions, evident in the U.S. and Europe even before the March banking crisis, will likely weigh on inflation as the year progresses. But for now, inflation remains too high for central banks to reverse course in the near-term.

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NDR HOUSE VIEWS (Updated April 6, 2023)

For global asset allocation, NDR recommends an overweight allocation to stocks and underweight allocations to bonds and cash. Our recommendations are in-line with our Global Balanced Account Model.

Equity Allocation

U.S. | Our U.S. asset allocation recommendation is 60% stocks (5% overweight), 35% bonds (marketweight), and 5% cash (5% underweight). On an absolute, basis we are marketweight the S&P 500. Macro and earnings concerns are offset by extreme pessimism and technical improvements. We favor large-caps over small-caps and are neutral on Growth versus Value.

INTERNATIONAL | We are overweight United States and Europe ex. U.K., marketweight Japan, and underweight on all other regions.

Macro

ECONOMY | The global economy is in a sustained slowdown due to waning monetary and fiscal support, stubbornly high inflation, and rising geopolitical risk. While the slowdown remains moderate, the risk of severe recession increases in 2023. Global inflation pressures are easing but will remain historically elevated in the foreseeable future.

FIXED INCOME | We raised our bond exposure to 110% of benchmark duration. We are neutral on the yield curve. We are overweight Treasurys and MBS and underweight high yield, ABS and TIPS. We are marketweight everything else.

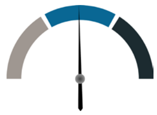
GOLD | We are currently bullish.

DOLLAR | We are bearish due to worsening momentum and model readings.

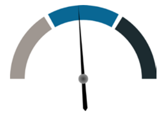
Economic Summary

April 10, 2023

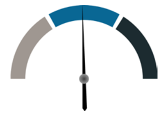
Near term activity: ● Accelerating ● Neutral ● Decelerating



Global Economy
(2.4%)



U.S. Economy
(-0.5% – 0.5%)



U.S. Inflation
(3.0% – 3.5%)

Economic gauges reflect changes in near-term economic activity. Numbers in parenthesis refer to NDR 2023 forecasts.

Global Asset Allocation

● Overweight ● Marketweight ● Underweight

- Overweight: Stocks (65%)
- Marketweight:
- Underweight: Bonds (30%) | Cash (5%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Equities — Regional Relative Allocation

- Overweight: United States (64%) | Europe ex. U.K. (16%)
- Marketweight: Japan (6%)
- Underweight: Emerging Markets (8%) | U.K. (2%) | Pacific ex Japan (2%) | Canada (2%)

Benchmark – U.S. (61.3%), Europe ex. U.K. (12%), Emerging Markets (11.1%), Japan (5.4%), U.K. (3.8%), Pacific ex. Japan (3.1%), Canada (3.1%)

Global Bond Allocation

- Overweight: U.S. (60%)
- Marketweight: Europe (25%) | U.K. (5%)
- Underweight: Japan (10%)

Benchmark: U.S. (55%), Europe (26%), Japan (14%), U.K. (5%)

U.S. Allocation

- Overweight: Stocks (60%) | Large-Cap
- Marketweight: Bonds (35%) | Mid-Cap | Growth | Value
- Underweight: Cash (5%) | Small-Cap

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Sectors

- Overweight: Technology (30%)
- Underweight: Real Estate (1%)

Benchmark: Technology (26.7%), Health Care (14.5%), Financials (10.8%), Communication Services (8.5%), Consumer Discretionary (11.3%), Consumer Staples (7.4%), Industrials (8.1%), Energy (4.6%), Utilities (2.9%), Real Estate (2.7%), Materials (2.6%)

U.S. Bonds — 110% of Benchmark Duration

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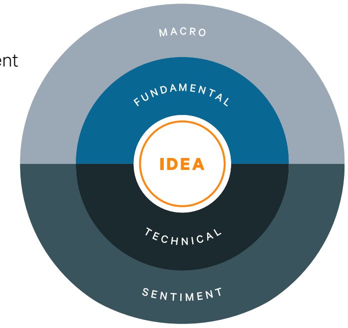

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