



The craft of Central Banking at a crossroads

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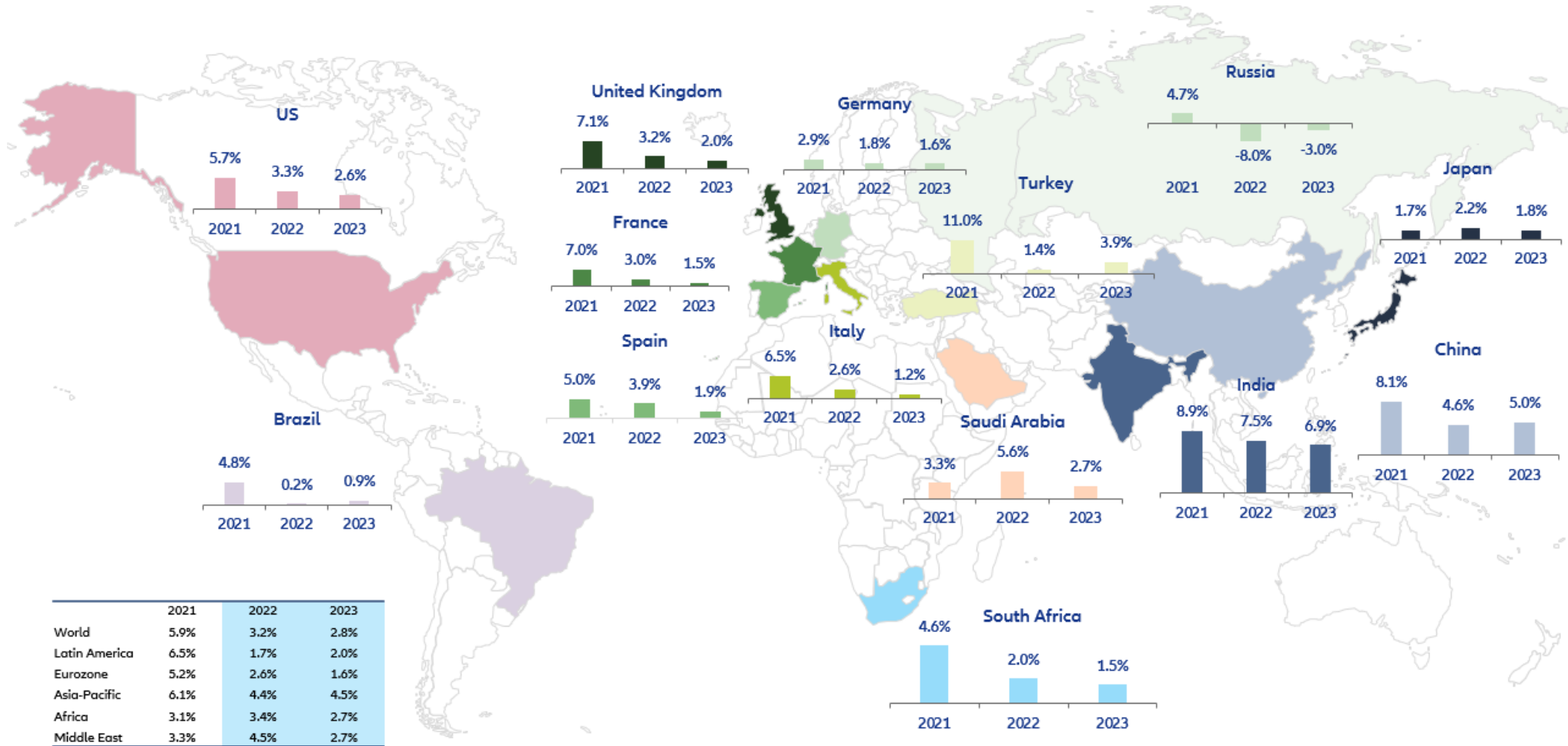
Current outlook

Russia-Ukraine scenarios

| | | Ceasefire (5%) | | Escalated Conflict (55%) | | Blackout (35%) | |
|-------------------------|------------|----------------------------------|----------------------|--|-------------------------------------|---|---|
| | | 2022 | 2023 | 2022 | 2023 | 2022 | 2023 |
| DM Growth | | Normalizing from far above trend | Still above trend | Growth hit (~-1%p. vs ceasefire) | About trend growth | Severe growth hit (~-2%p. vs ceasefire) | Recession |
| DM Inflation | | Inflation peaks and retreats | Converging to target | Price shock | Price pressure ebbing, above target | Even stronger price shock | Still notably above target, core below 2% |
| Monetary Policy | ECB | ends QE in July +75 bps | +75bps | QE ends in Q3, +50 bps | +50 bps | QE infinity, no rate hikes | |
| | Fed | +275bps | +100 bps | +200 bps | +75 bps | ZIRP maintained | |
| Russia Sovereign | | FX controls - no default | | Balance-of-payment crisis: default possible in 2022/23 | | Near-term default likely | |
| Energy Prices | | Normalization | | Elevated but below current levels | | Energy crisis | |

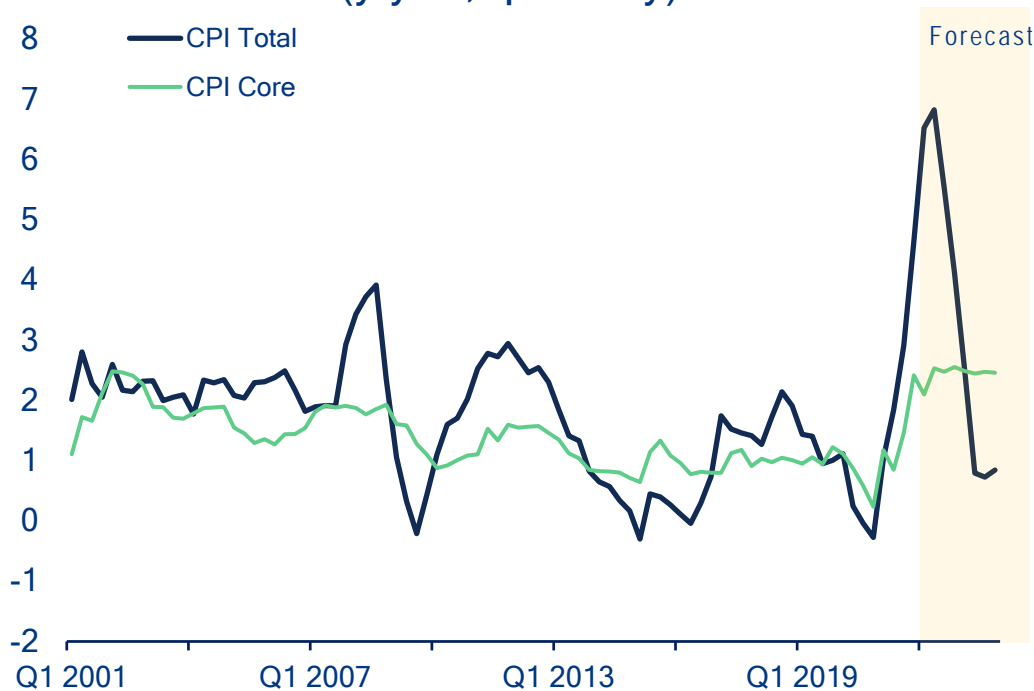
| | | | | | | |
|-----------------------------|-------|-------|-------|-------|-------|-------|
| 10Y Bunds (YE) | 0.35% | 0.55% | 0.55% | 0.75% | 0.15% | 0.35% |
| EUR IG (YE) | 105 | 110 | 130 | 135 | 180 | 165 |
| EUR Equities (YE TR) | +8% | +6% | +0% | +5% | -13% | +4% |
| EM HC (YE, vs USD) | 320 | 330 | 360 | 375 | 470 | 430 |

Growth outlook: Slowflation



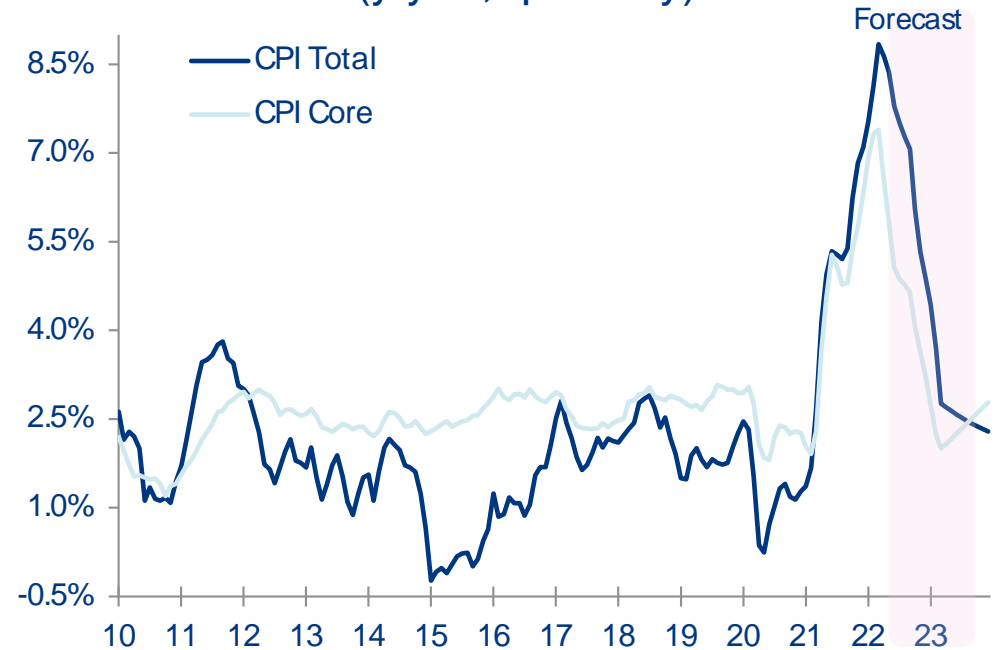
Inflation to average above 6% this year before normalizing by end-2023

Eurozone: Headline and Core (CPI) Inflation (y/y %, quarterly)



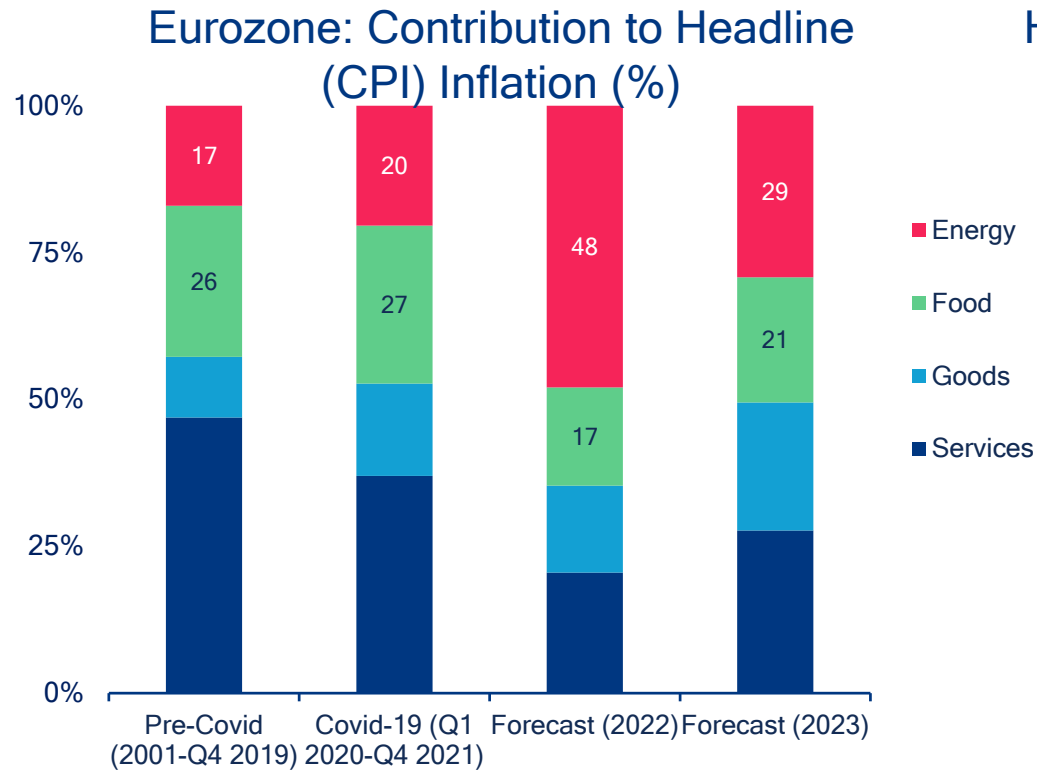
Sources: Refinitiv, Allianz Research

US: Headline and Core (CPI) Inflation (y/y %, quarterly)

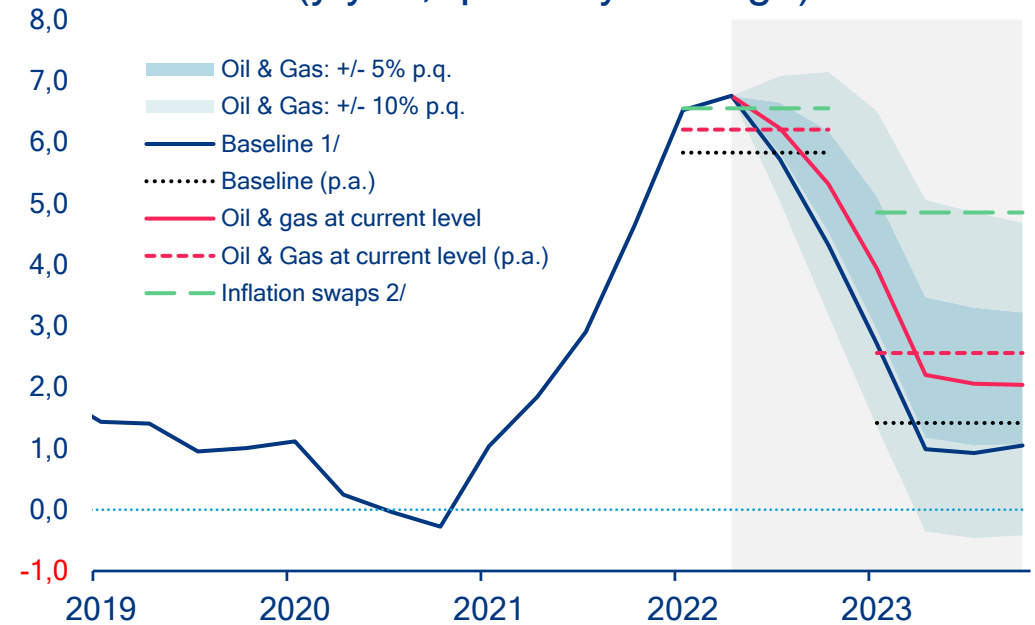


Sources: Refinitiv, Allianz Research

Energy still the main inflation driver



Headline Inflation Paths and Different Energy Price Scenarios (y/y %, quarterly average)

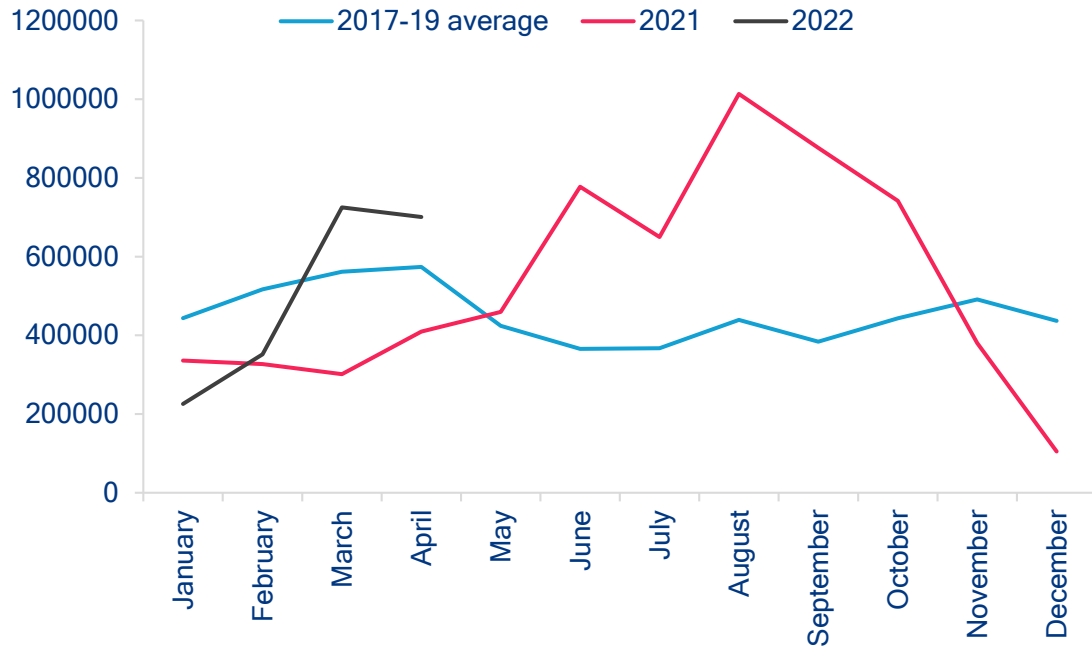


Sources: Refinitiv, Allianz Research.

Sources: Refinitiv, Allianz Research. Note: 1/ based on Allianz Research oil & gas forecasts (quarterly smoothed); 2/ Inflation swaps at one-year and two-year maturities.

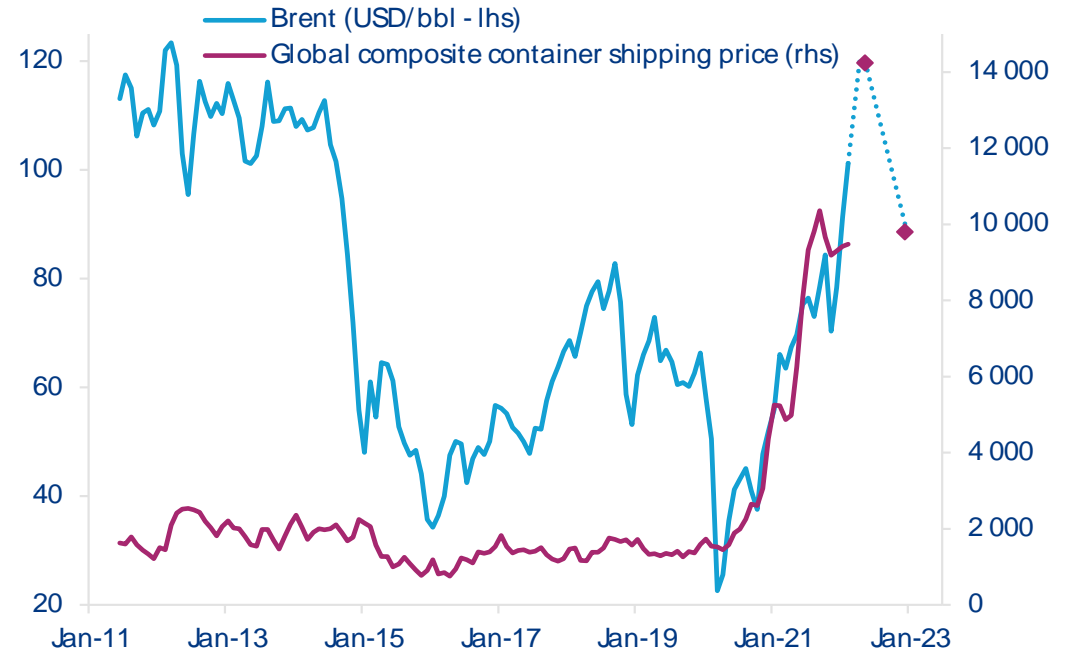
Supply chain bottlenecks – the extended version

Total volume of container vessels anchored outside Chinese ports (TEU) (y/y %, quarterly)



Sources: Refinitiv, Allianz Research

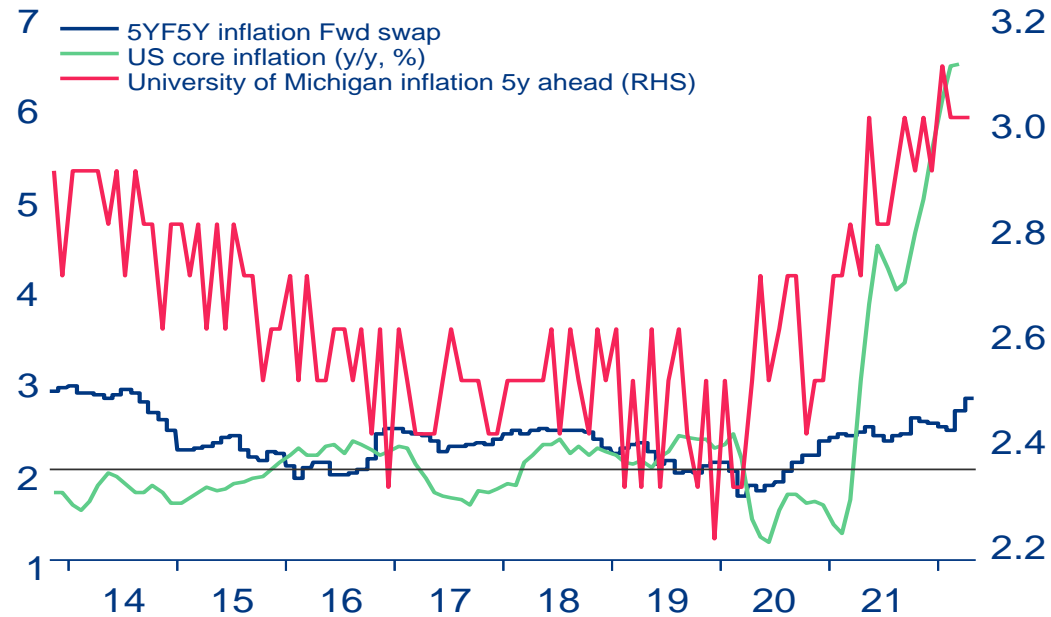
US: Headline and Core (CPI) Inflation (y/y %, quarterly)



Sources: UNCTAD AIS database, IHS Markit, Allianz Research

Central bank credibility at stake as inflation expectations are on the move

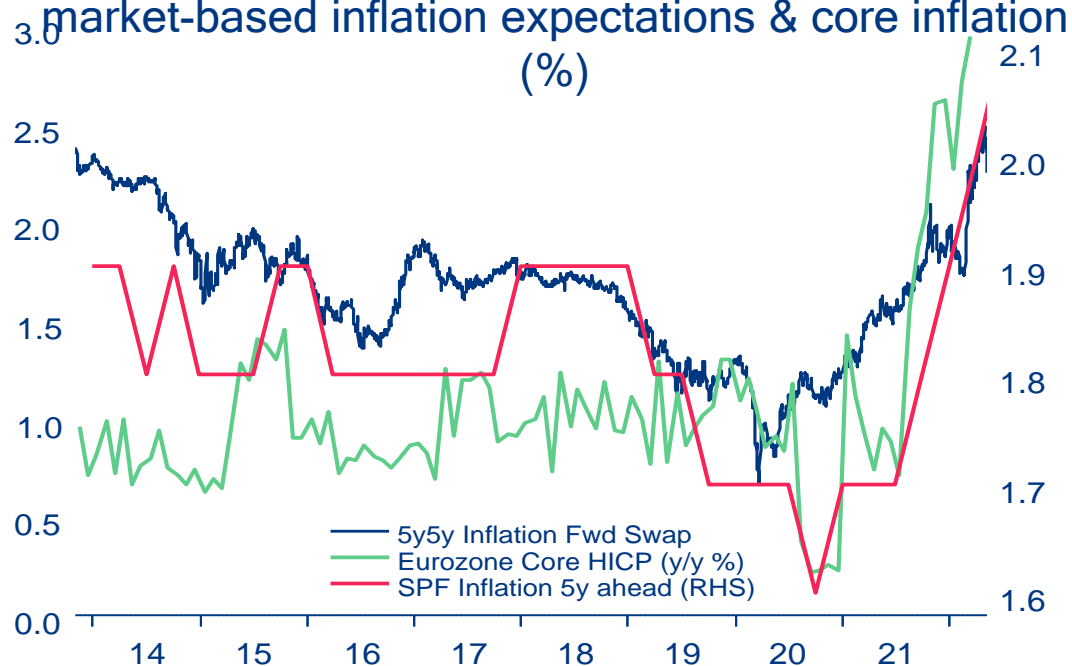
Uni. of Michigan inflation expectations vs market-based inflation expectations & core inflation (%):



Source: Refinitiv Datastream

Sources: Refinitiv, Allianz Research

ECB Survey Professional Forecasters (SPF) vs market-based inflation expectations & core inflation (%)

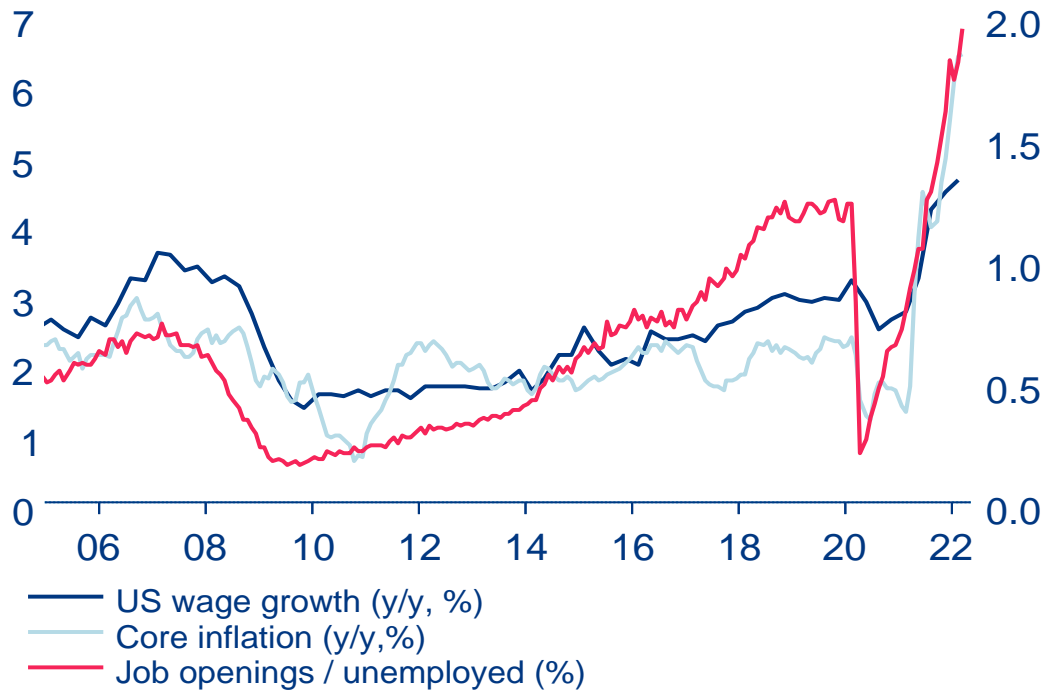


Source: Refinitiv Datastream; Allianz Research

Sources: Refinitiv, Allianz Research

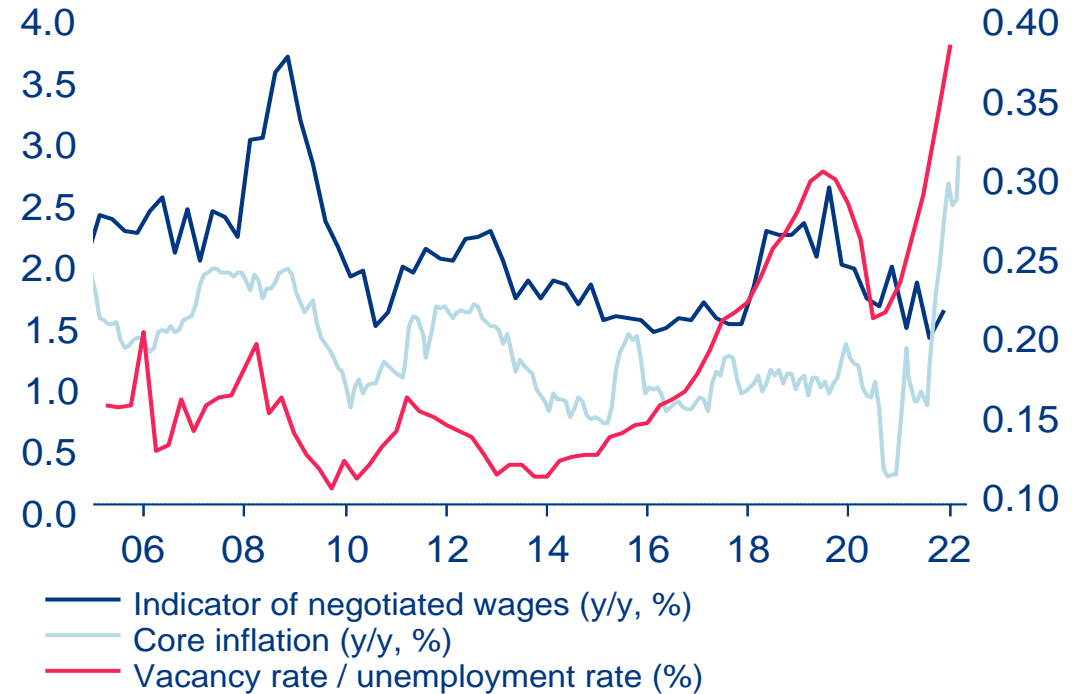
Supercharged labor market healing continues

US unemployment, job openings/unemployed vs. core inflation



Source: Refinitiv Datastream; Allianz Research (as of Q1 22)

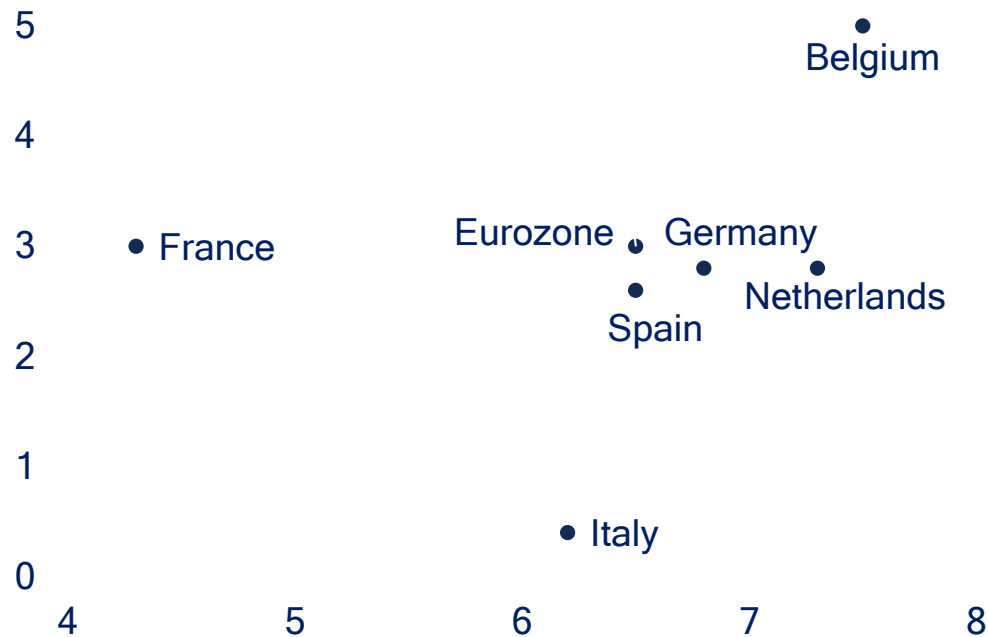
Eurozone unemployment, vacancies/unemployment rate vs. core inflation



Source: Refinitiv Datastream

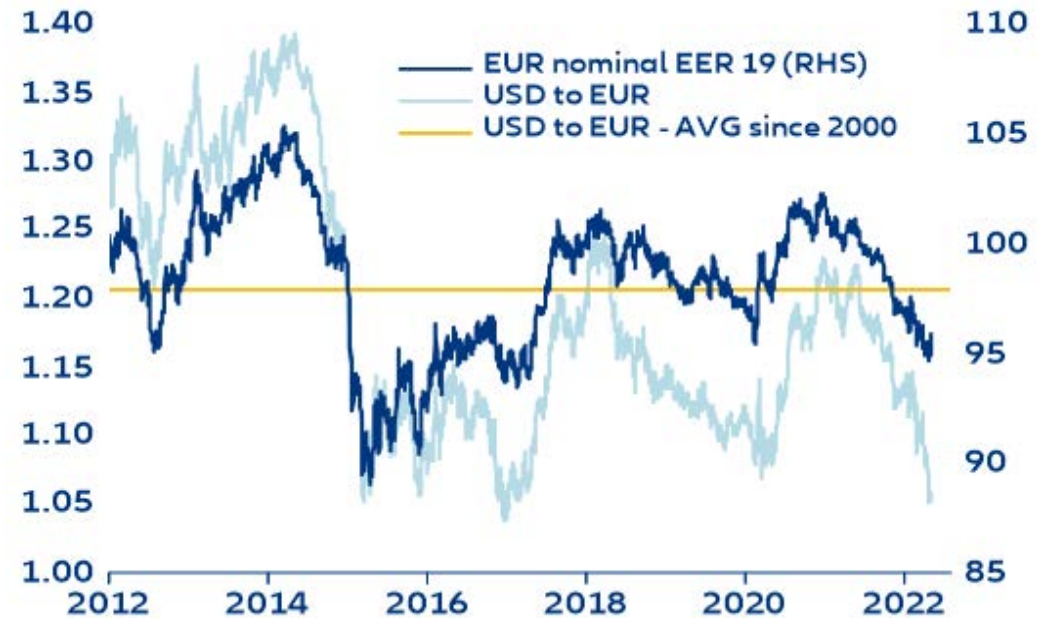
Rebalancing? Mixed price pressure bag

2022 forecasts for Inflation vs. wage growth



Sources: Refinitiv, Allianz Research.

EUR/USD vs. EUR nominal EER 19 (RHS)

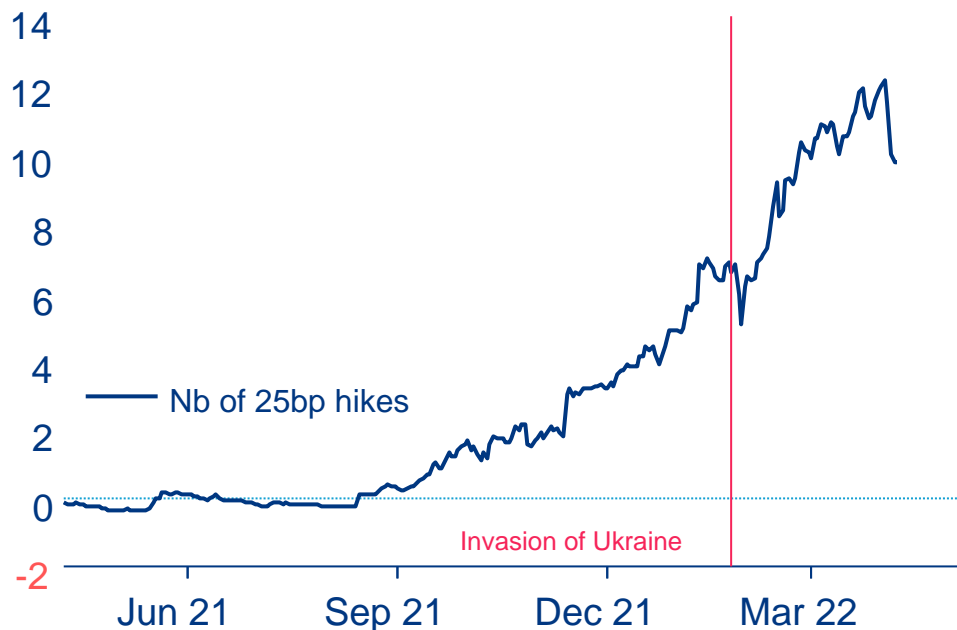


Source: Refinitiv Datastream; Allianz Research (as of 5/10/2022)

Central banks focus on inflation – for now

USA: Policy Rate Outlook

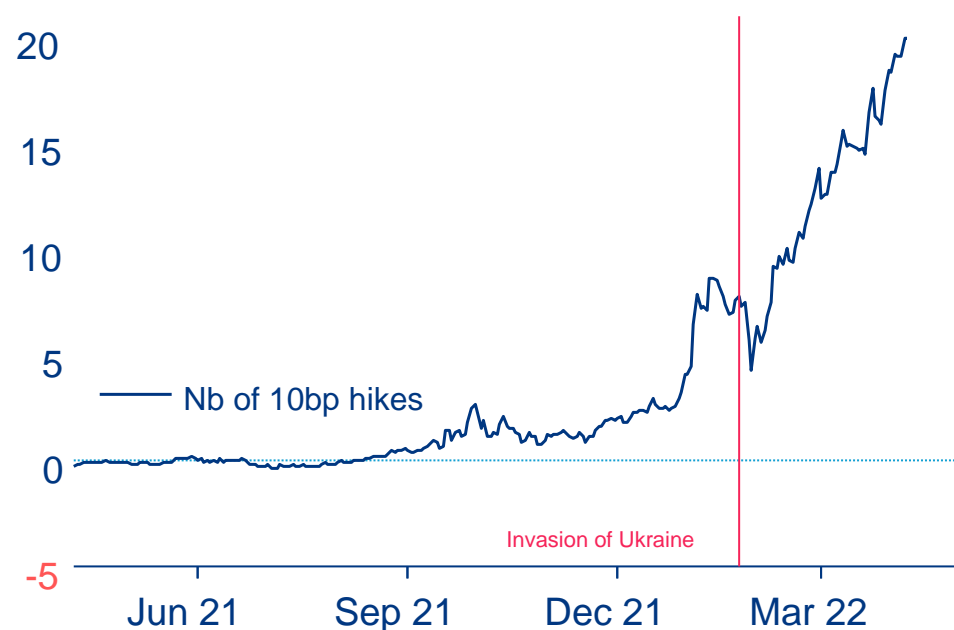
next 12M, based on EuroDollar Futures



Source: Refinitiv Datastream; Allianz Research

EUROZONE: Policy Rate Outlook

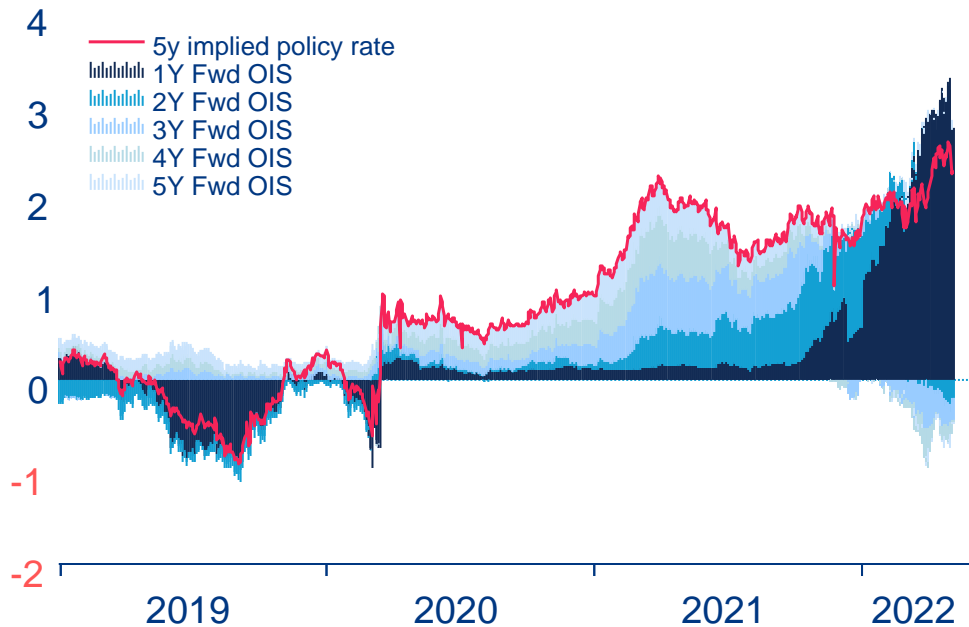
next 12M, based on OIS Forward Swaps



Source: Refinitiv Datastream; Allianz Research

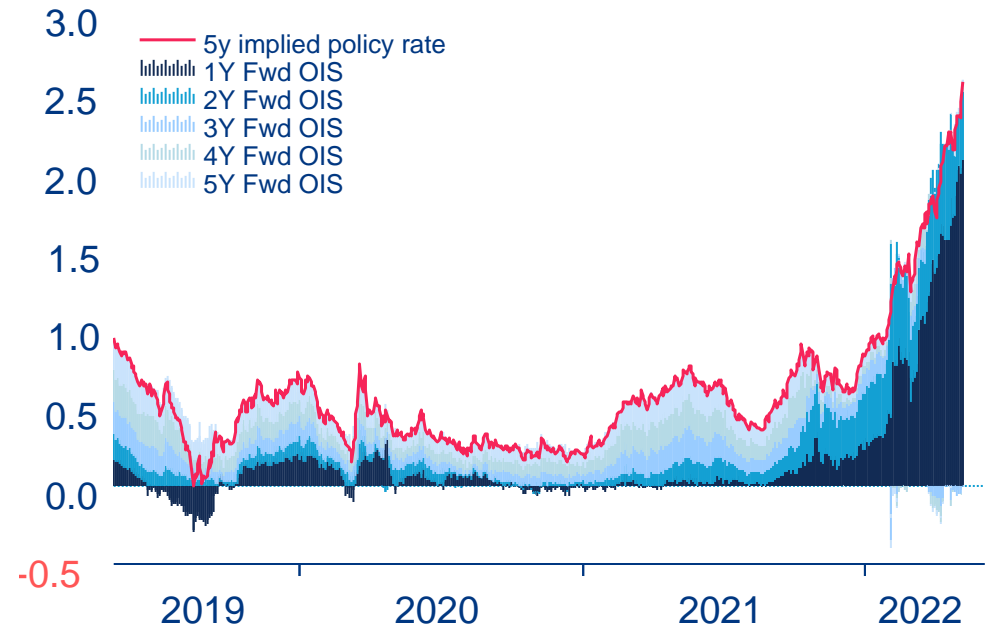
Steep rate hikes in 2022, u-turn in 2023?

USA - market implied hiking cycle
OIS forwards vs Fed funds rate



Source: Refinitiv Datastream; Allianz Research

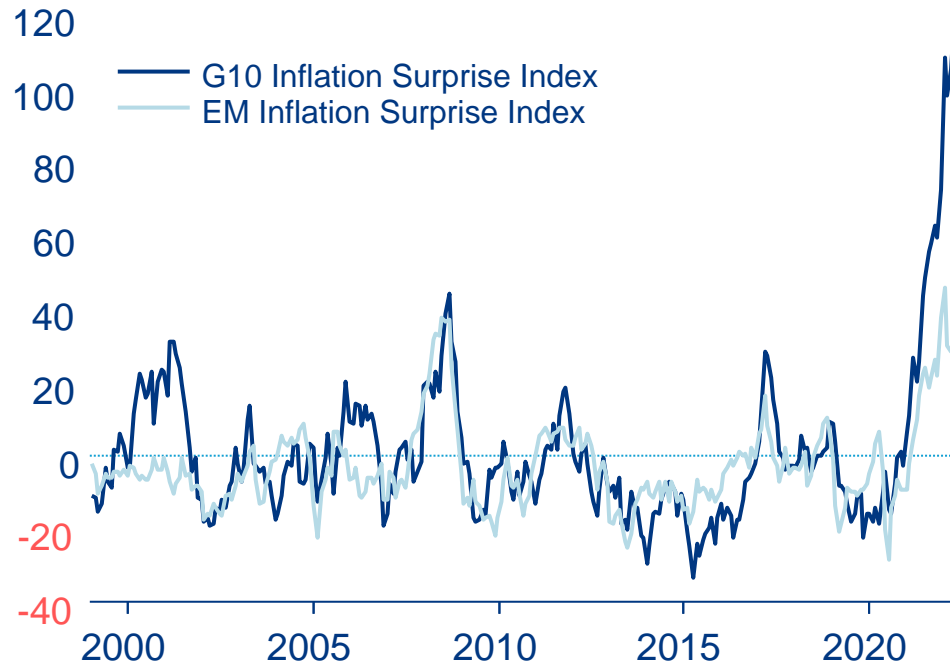
ROZONE - market implied hiking cycle
OIS forwards vs Deposit rate



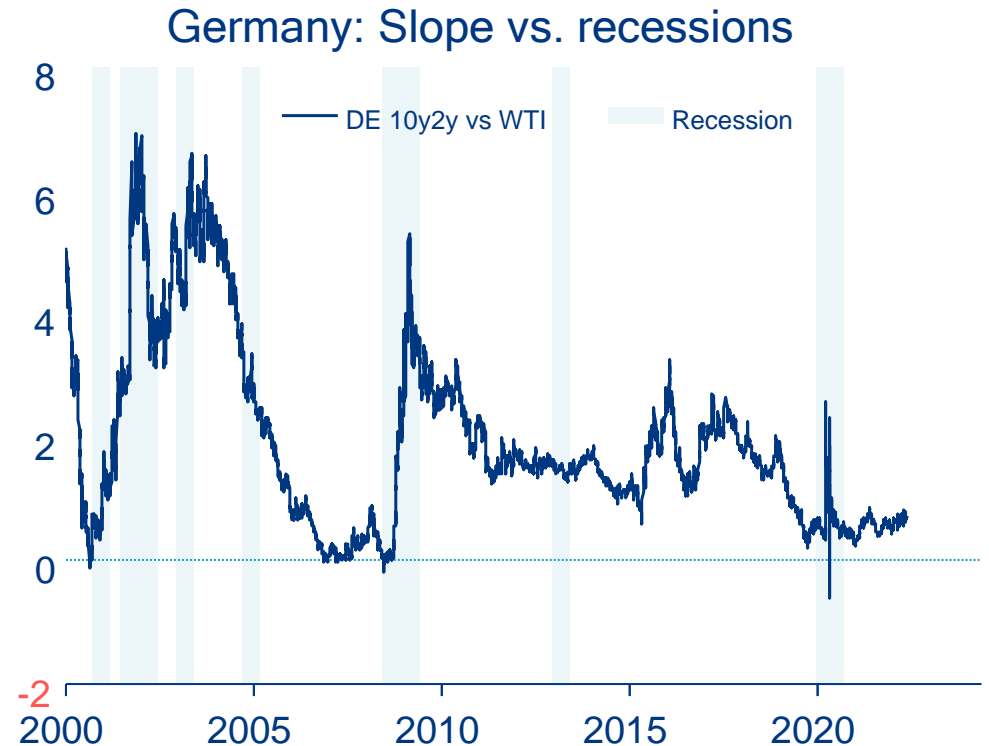
Source: Refinitiv Datastream; Allianz Research

Pricing in higher inflation & lower growth

Much more upside for inflation surprises?



Source: Refinitiv Datastream; Allianz Research

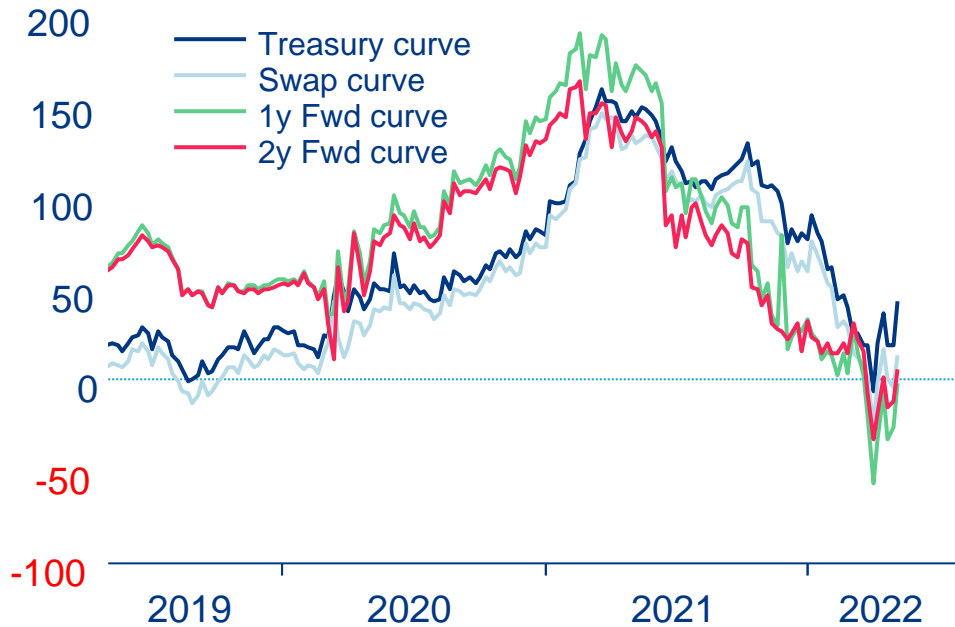


Source: Refinitiv Datastream; Allianz Research

Stagflation risk - curve flattening

Slopes of US curves

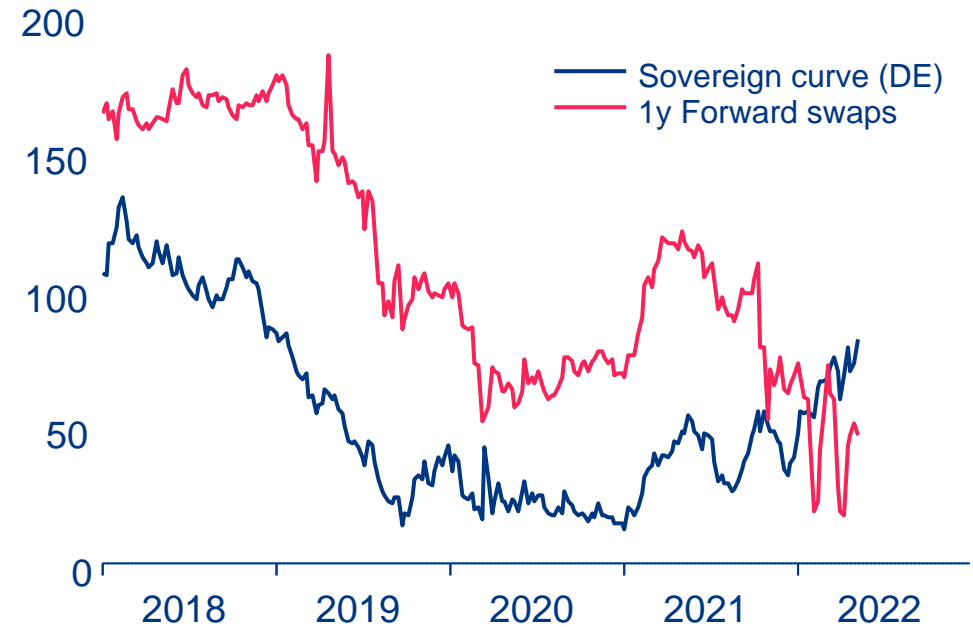
10y - 2y rate (in bps)



Source: Refinitiv Datastream; Allianz Research

zone Curve - steepening or flattening?

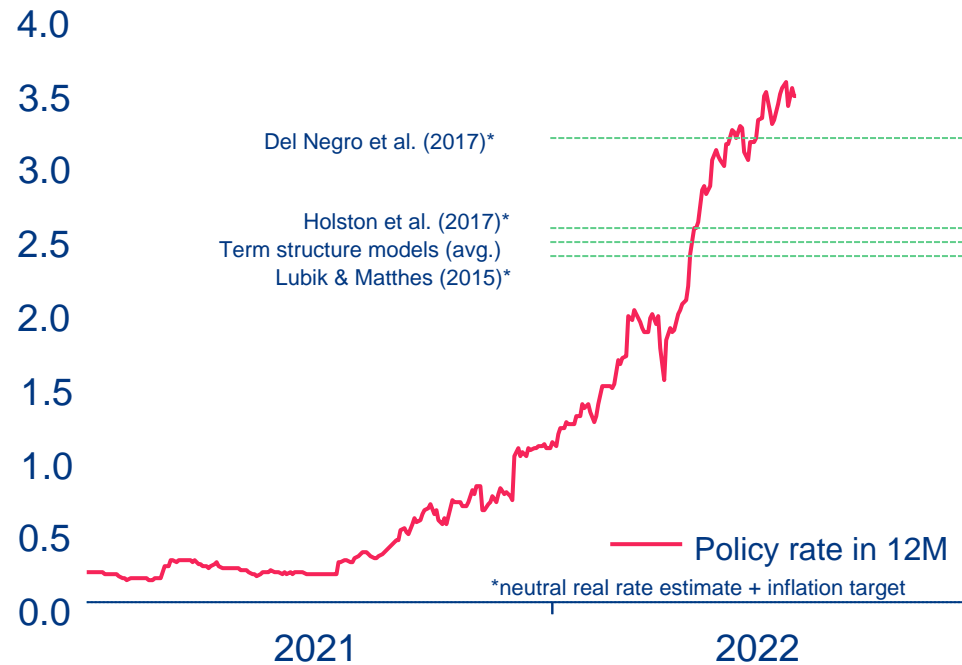
10y - 2y rates (in bps)



Source: Refinitiv Datastream; Allianz Research

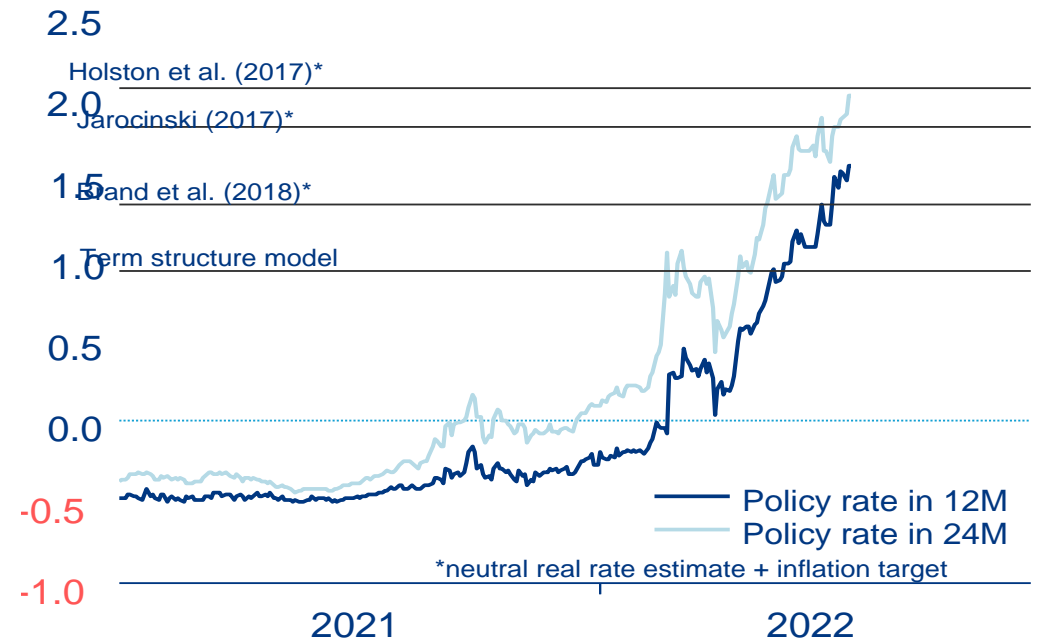
Market pricing in contraction territory

US policy rate pricing & estimates of the neutral rate



Source: Refinitiv Datastream; Allianz Research

EZ policy rate pricing & estimates of the neutral rate

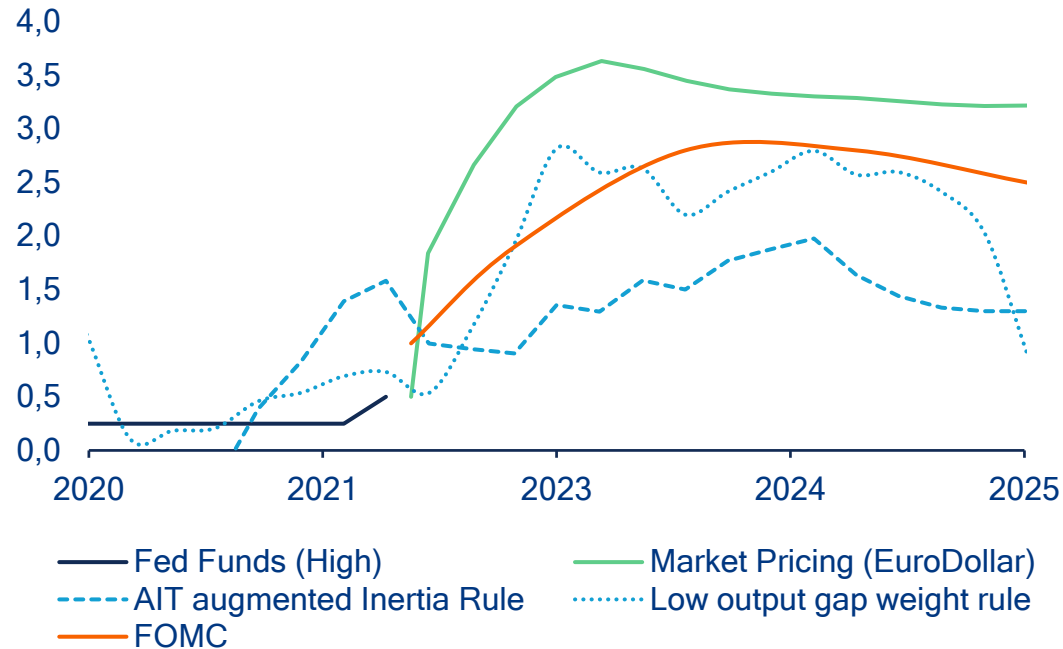


Source: Refinitiv Datastream; Allianz Research (as of 5/6/2022)

New era for policy makers

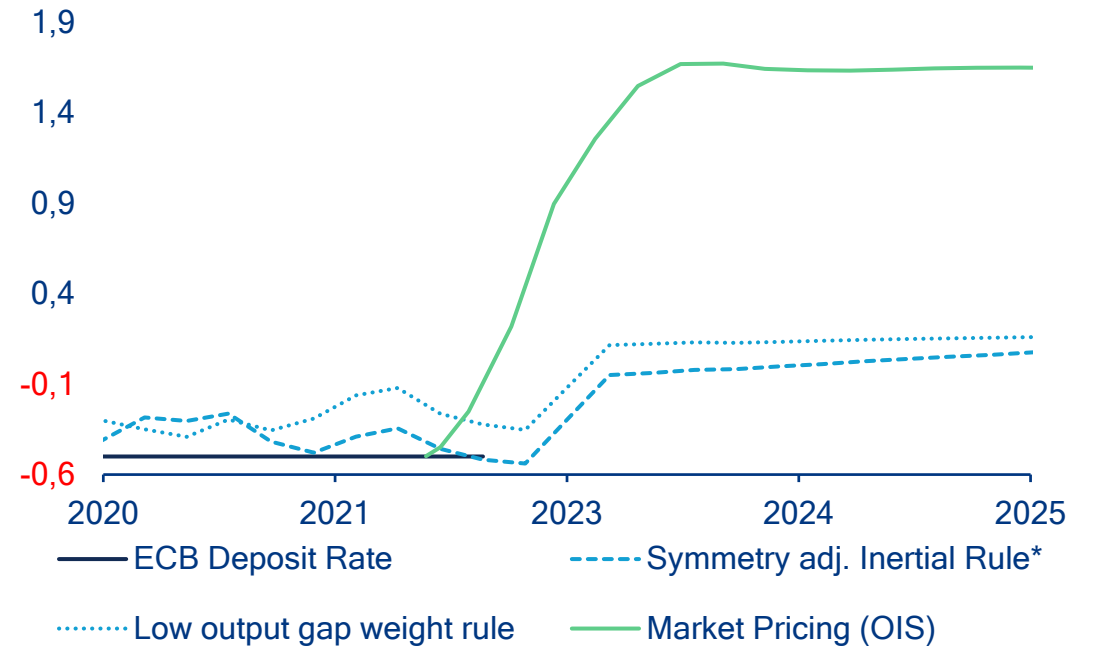
Policy rules outdated?

US Policy Rules



Sources: Refinitiv, Allianz Research

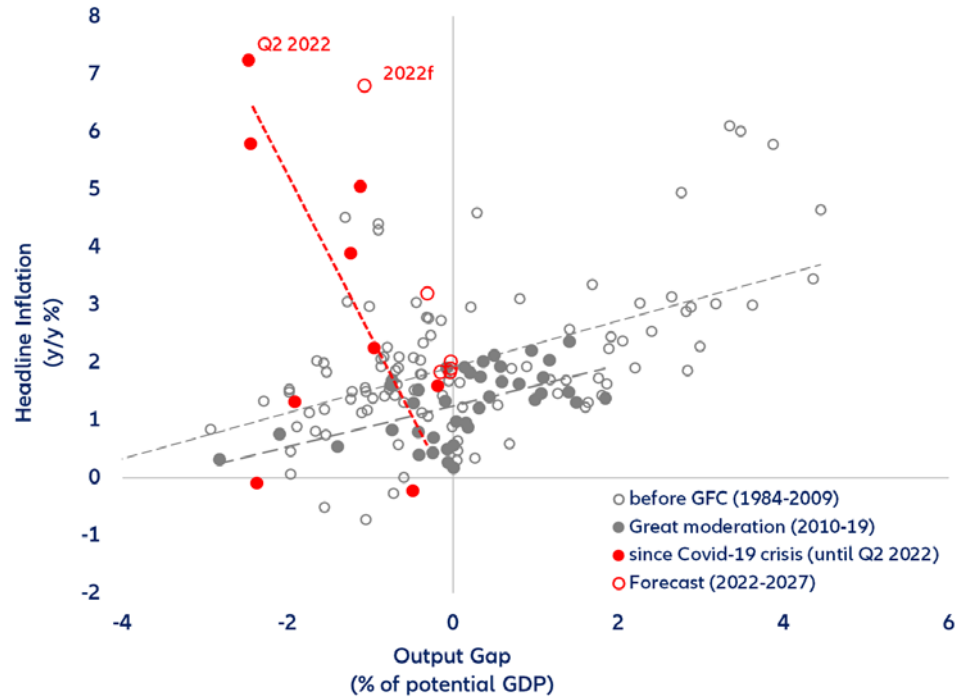
Eurozone Policy Rules



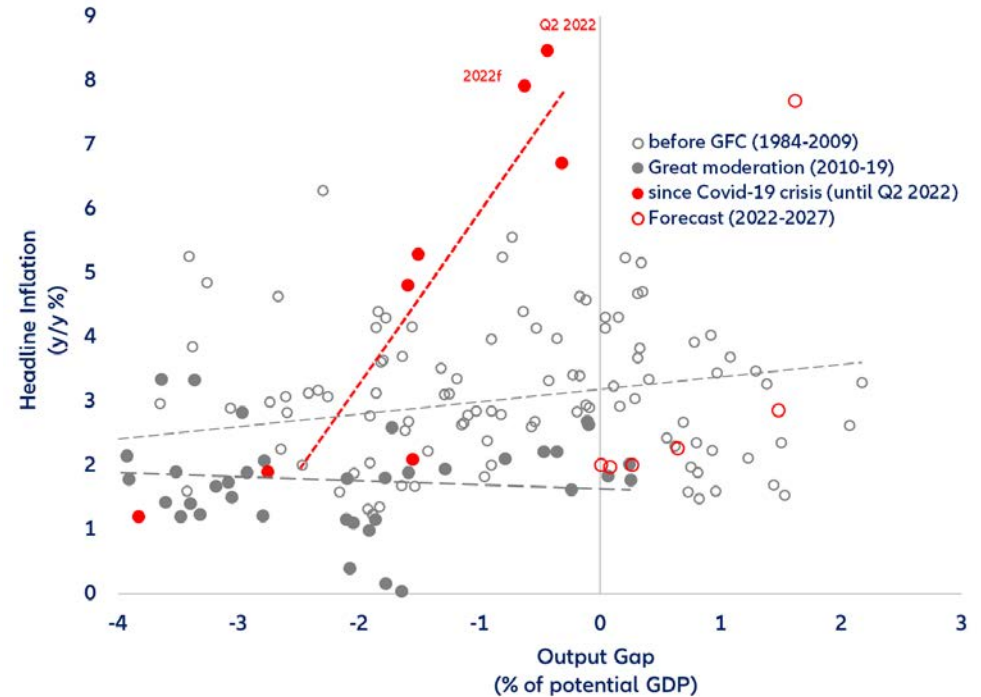
Sources: Refinitiv, Allianz Research

Transition to negative supply shock world

Germany: Monetary Policy Trade-off



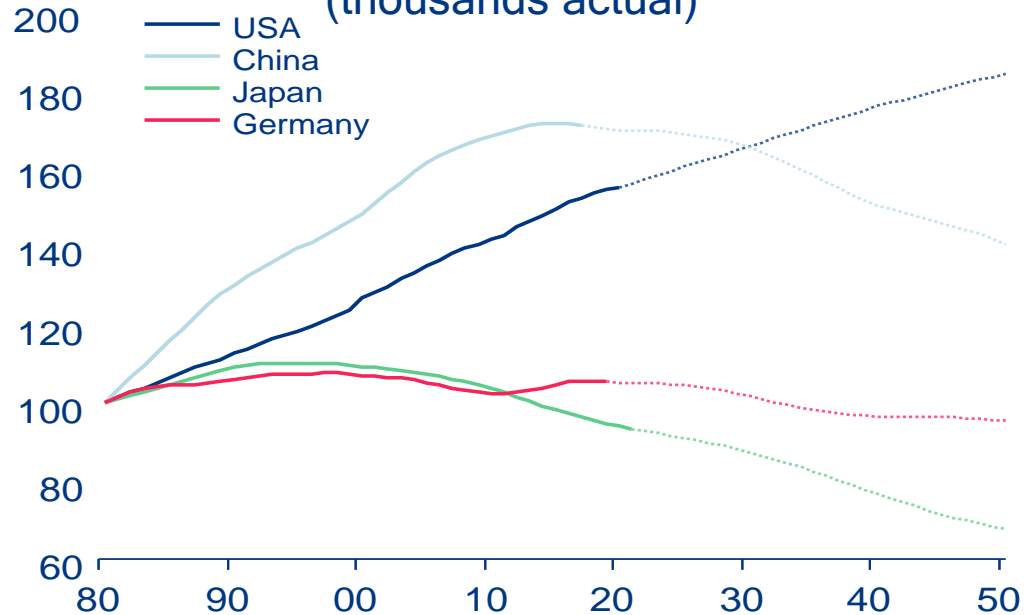
United States: Monetary Policy Trade-off



Sources: IMF, Oxford Economics, Refinitiv, Allianz Research

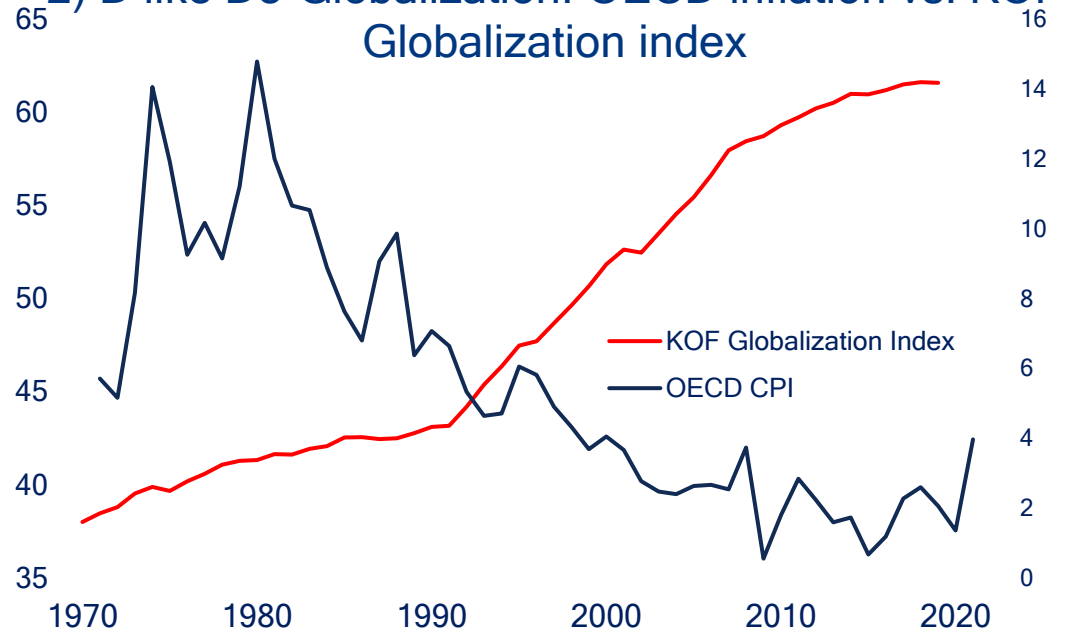
The 3 Ds are ringing in a new inflation era

1) D like Demography: Working-age population (thousands actual)



Source: Refinitiv Datastream; Allianz Research

2) D like De-Globalization: OECD inflation vs. KOF Globalization index



Sources: Refinitiv, Allianz Research

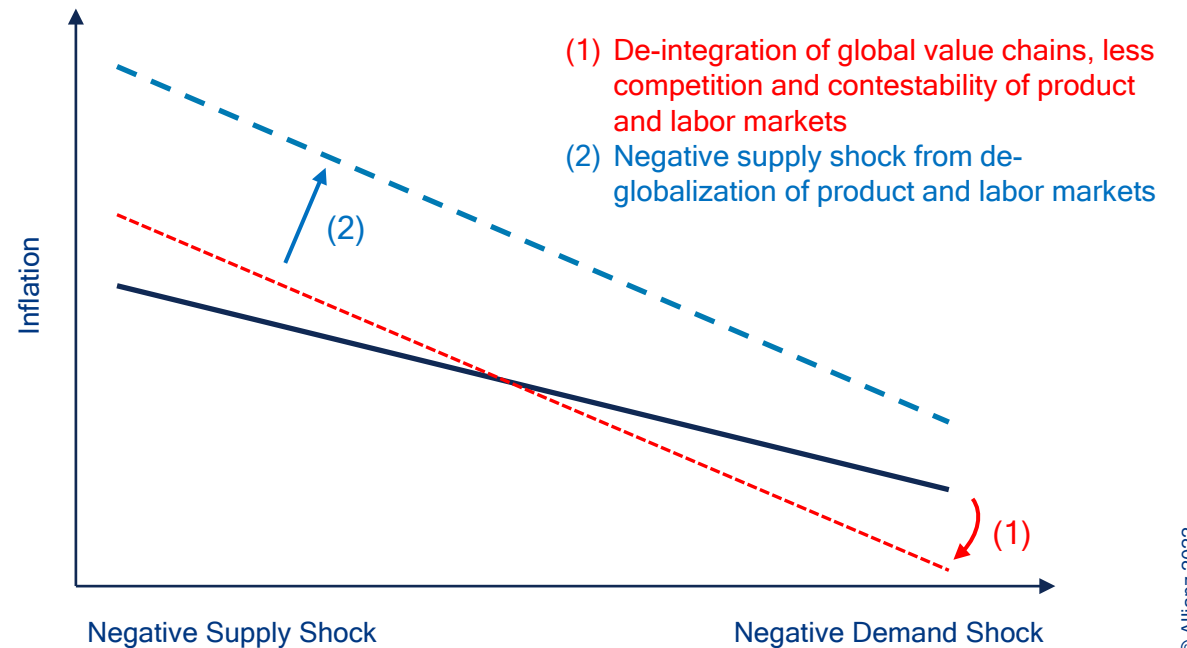
Inflation will normalize but remain higher

3) D-like Decarbonisation: CO2 emission rights



Source: Refinitiv Datastream; Allianz Research (as of 5/6/2022)

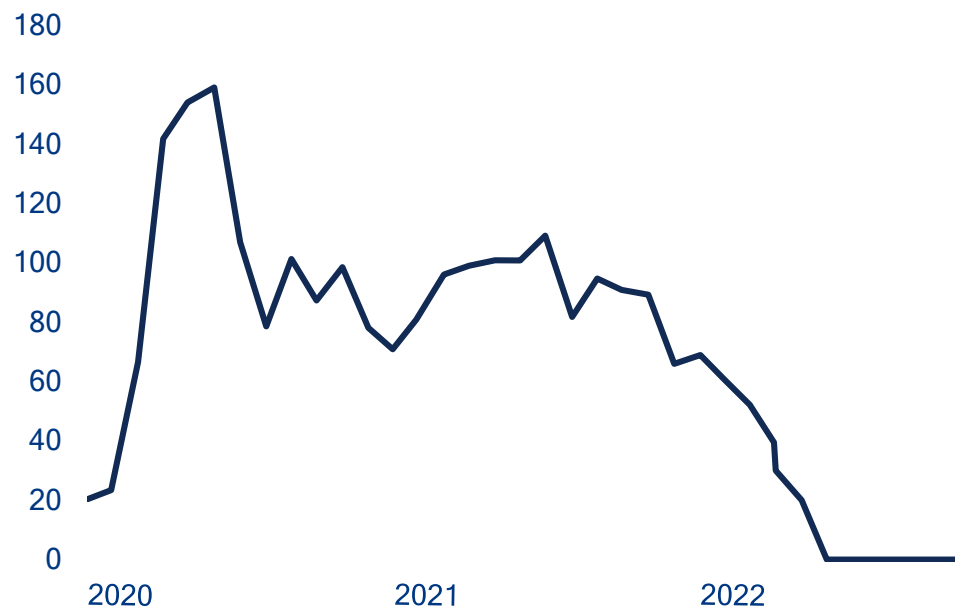
Re-steepening of the Phillips Curve



Sources: Refinitiv, Allianz Research

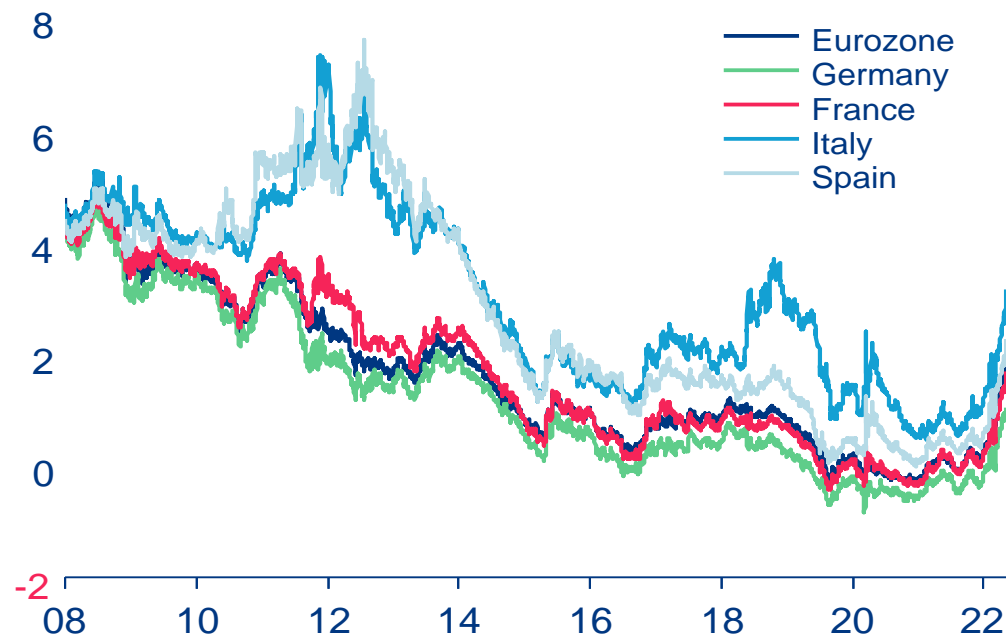
How can the ECB “close spreads” while normalizing policy?

Monthly flow of net purchases under APP and PEPP (EUR bn)



Sources: Refinitiv, Allianz Research

Eurozone 10y bond yields (%)



Source: Refinitiv Datastream; Allianz Research

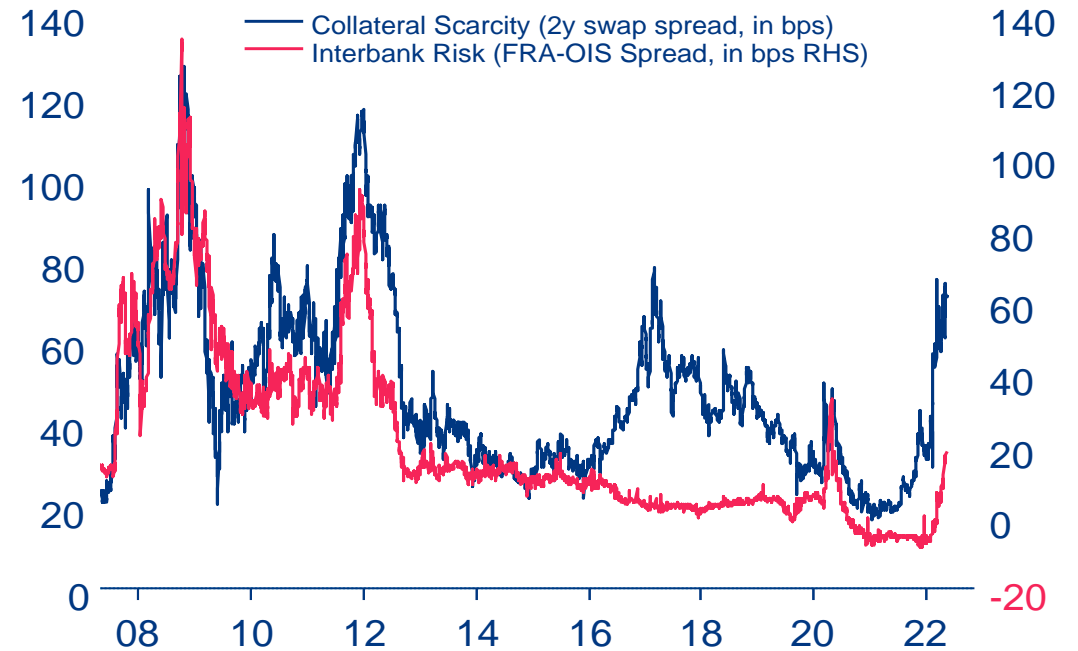
Normalization to reveal financial stability concerns

Italy: Yield on 7yr sovereign bonds vs. implicit interest rate on government debt (%)



Source: Refinitiv Datastream; Allianz Research

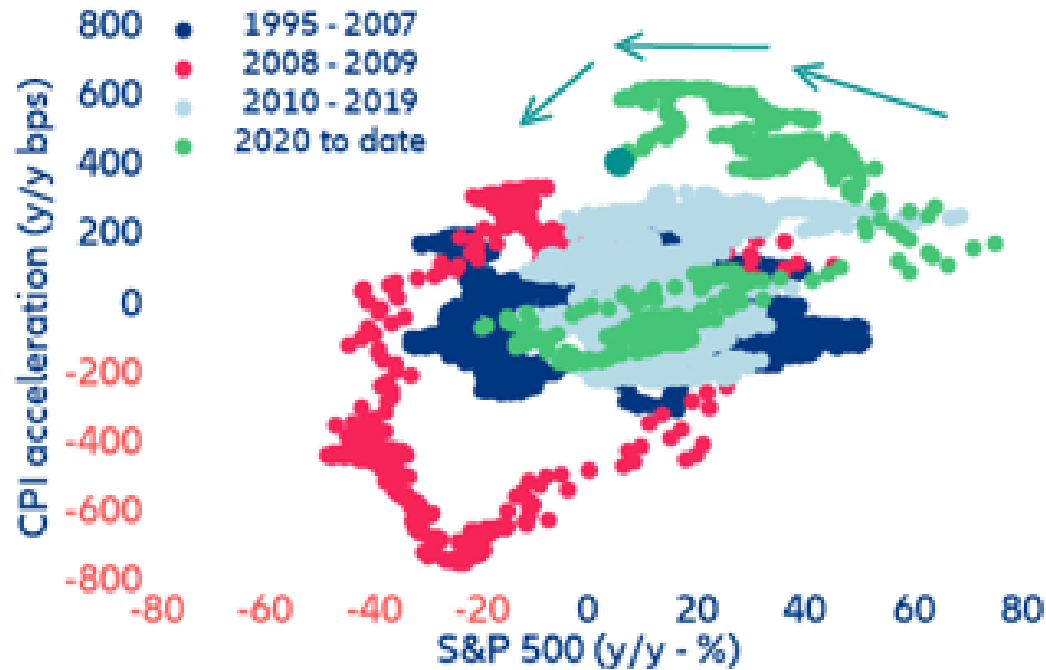
Line - Elevated stress in financial sector



Source: Refinitiv Datastream; Allianz Research (as of 5/6/2022)

Uncontrolled inflation weighs on Equities

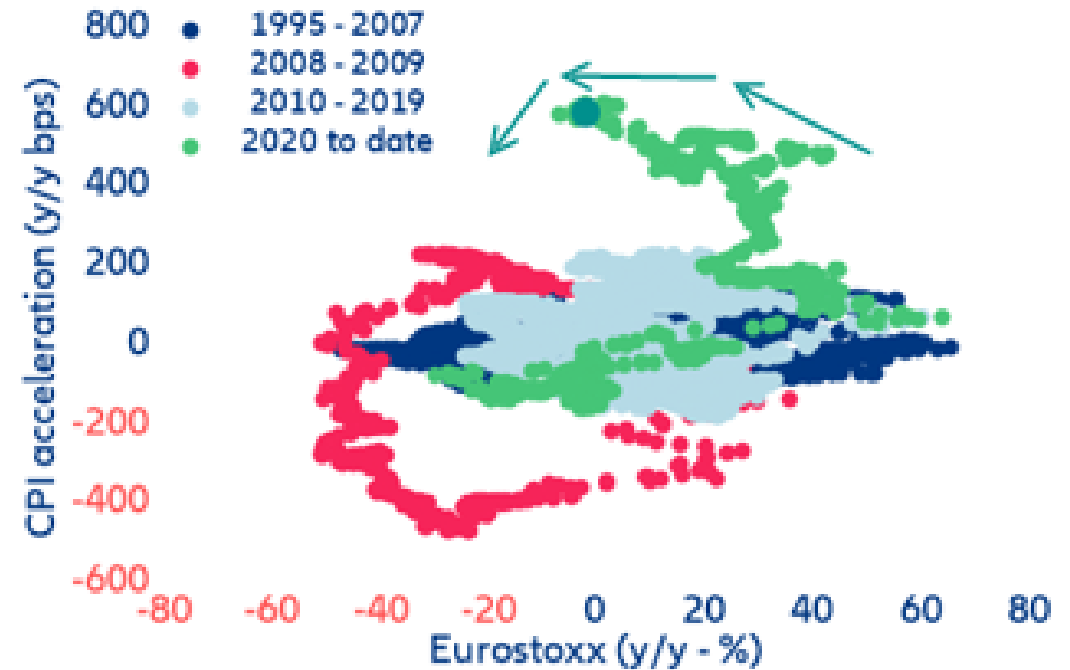
US inflation acceleration vs equities hurricane



Source: Refinitiv Datastream; Allianz Research

A similar message can be drawn from inflation acceleration. Accelerating inflation and even mild de-anchoring vis a vis inflation expectations tends to be positive for equity performance with most data lying on the right-hand side of the scatter-plot.

EZ inflation acceleration vs equities hurricane

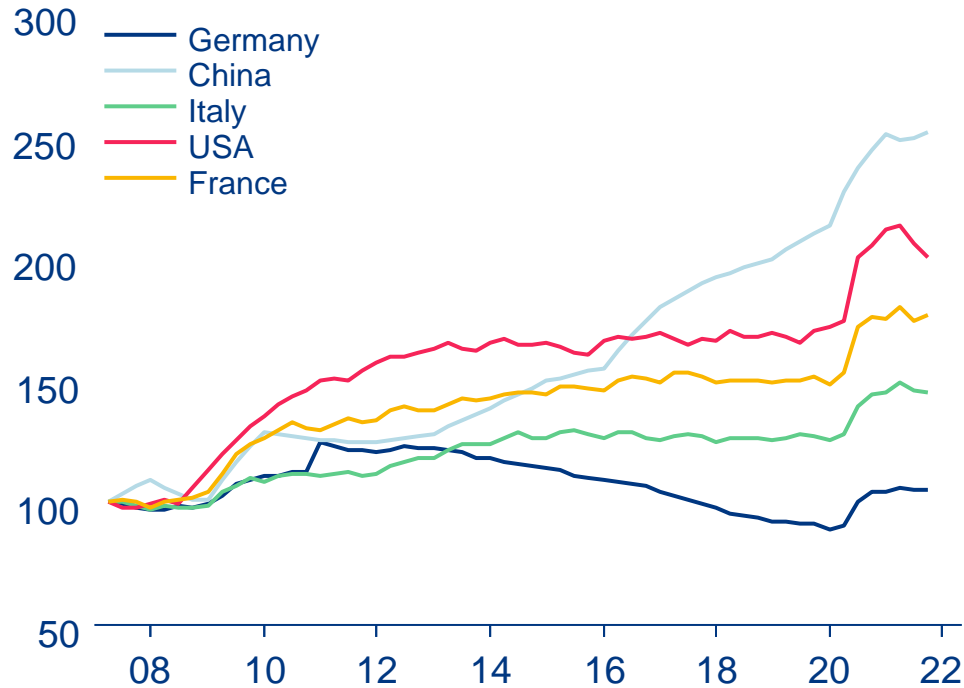


Source: Refinitiv Datastream; Allianz Research

Like levels when inflation is accelerating too much or inflation expectations de-anchor with values lying within the outer ring of the clock, an anti-clockwise rotation is triggered with equities starting to underperform while inflation starts to retract.

Reality-check for fiscal policy

Sovereign debt (Index: 100=Q1 2007)



Source: Refinitiv Datastream; Allianz Research (as of Q3 21)

How can mounting demands on fiscal policy be met going forward?



Eurozone: New era, new tools?

EU central fiscal capacity to finance fiscal priorities i.e. green transition & defense

Pro-growth reforms at national level

Wonderweapon
TLTROs

Update EU fiscal framework (LT perspective, focus on flow, exclude investment)

Rein in national fiscal policy

ECB Permanent pandemic purchase program

Thank you !