UCAP Report No. 20 **Investing during Inflation, Part II** **23/4/ 2022**

The story for investors

In Part I of this report we outlined the consequences of inflation on the interest rate policy in the US and, hence, on investment decisions on equities and FI. Our conclusions were that the situation in the US did not represent a "global" condition and that the dynamics and trade off between rate hikes and inflation declines facing the Fed could well lead to fewer hikes. However, moving on to 2023 would still leave higher rates but lower and steadier inflation in the US. Not all developed and developing countries are being faced with the same policy dilemmas as the US, and an UScentric approach could result to misleading conclusions. In periods of inflation real assets, usually property, do well, as well as some banks, but all this is dependent on specific circumstances and expectations.

Not all inflations are the same nor are the remedies

In Fig.1 we show CPIs of Canada and Australia, both G20 of Sweden, a EU but not EUR participant, and Switzerland, not in the EU. In all cases inflation has accelerated sharply from the middle of 2020, but the percent increases from the near zero base varies widely and especially for Switzerland which started from deflation. Australia's headline rate, half of that of the EU, may have peaked. The situation for big and small Asians is equally varied. (Fig. 2) Indonesia, purely in terms of trend does not have a "crisis" of inflation, as indeed does India which saw the sharp uptick much earlier at the end of 2018, and whose inflation rate has been high and fluctuating since then. Other economies joined the 2020 upsurge such as Thailand (from deflation) and S.Korea. The CPI headline absolute numbers vary widely. The reaction of the central banks in these Asian economies has been equally very diverse and no way have approached the near panic levels of the Fed in terms of rate hikes. Of ten major Asian economies, China has loosened monetary policy, S.Korea and Taiwan hiked rates once so far, as did USD-pegged HK. Singapore, which does not have a rate but a forex policy, has strengthened USD/SGD. The rest, India, Indonesia, Malaysia, Thailand and Philippines have not yet hiked interest rates. Japan remained doggedly committed to low rates.

Fig 1: CPI Canada (red), Australia (gr), Sweden (blu), Switzerland (br)

Source: Bloomberg

Investment conclusions

Out of 11 major and minor Asian central banks 4 have hiked rates, 1 has cut and 1 has confirmed low rates going forward. The other 5 remain flat. So investment advice in Asia "during inflation" might be a misnomer Taking refuse to the expectation that what happens to the US will happen to Asia focuses on the Asian equity markets which are falling now an issue unrelated to Asian inflation and interest rates. Asian banks, with some exceptions, may not benefit yet from higher domestic rates, as most Asian central banks are not hiking yet. So our advice to Asian investors falls back to investing in USD terms in real assets and in USD-based banks as the inflation situation facing global markets is for now USD based and centered.

Choices for Asian investors in Asia in times of inflation (?)

There are two "mirror images" of advice on what to invest in periods of inflation. One reflects the expectation of rising interest rates both as central banks hike and as investors drive longer term yields higher by selling FI assets. The other is more functional and sectoral in terms of choosing firms, which can resist or even benefit from inflation, or of assets, which do well with actual and expected increases in their prices. We have dealt with these propositions in Part I of the report when we focused on USD and US investors. We focus here on the options open to Asian investors in local currency terms. Assuming that inflationary expectations will take hold in Asian economies, then real assets denominated in Asian currencies could be a choice except that the two major markets for real assets in terms of property are those of China and of Hong Kong and none of them is currently attractive. In the case of China because of the concerns over an overleveraged sector as well as the deteriorating macro outlook because of the continuing lockdown policies. HK follows closely for similar concerns. As indicated most Asian banks may not benefit yet from local rising rates. Asian investors may have limited options other than following the opportunities open to USD and US based investors.

Fig 2: CPI Sing (blu), Thailand (mauve)), S.Korea (gr), Indo (br), India (red)

Source: Bloomberg

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