BANQUE DE LUXEMBOURG INVESTMENTS

HIGHLIGHTS

Monthly Market Analysis **October 2021**

The first signs of a moderation in global economic growth are on the horizon. Although most activity indicators are holding up, they appear to be starting to drop back from the very high levels of previous months. In the United States, for example, the manufacturing activity index fell for the second consecutive month after 15 months in a row of almost uninterrupted growth. Nevertheless, the moderation in activity seems to be more the result of the ongoing disruptions in supply chains than any major weakening of demand. In services, the activity index was also down slightly due to the rise in coronavirus infections, although this should prove temporary. The trends appear similar in Europe, with activity remaining robust but possibly at a turning point. In China, the pace of growth has continued to moderate in recent months due to the simultaneous effect of strict restrictions to curb the epidemic, tighter regulatory measures in almost all economic sectors, a shortage of electricity, and the financial difficulties of China Evergrande, the country's second biggest property developer. In Japan, exports continue to be the most dynamic segment, as yet showing no signs of weakening.

After accelerating in previous months, inflation rates remain high. In the United States, headline inflation dipped from 5.4% in July to 5.3% in August. Excluding energy and food, inflation fell a little, from 4.3% to 4.0%. The Federal Reserve's preferred inflation indicator, the PCE (personal consumption expenditures) deflator excluding energy and food, remained at 3.6%, its highest level since December 1991. In the eurozone, inflationary pressures are still on the rise. From August to September, the headline inflation rate rose from 3.0% to 3.4%, the highest since October 2008. Excluding energy and food, it increased from 1.6% to 1.9%.

The FOMC (the Federal Reserve's monetary policy committee) left its monetary policy unchanged at its September meeting. Nevertheless, Fed Chair Jerome Powell signalled that it would start tapering asset purchases, from the next meeting in November through to mid-2022. On the subject of the future level of interest rates, Powell reiterated that the end of asset purchases did not mean a simultaneous rise in interest rates. Opinion in the FOMC seems to be divided on this subject since half its members are expecting a first interest rate hike in 2022. In Europe, in view of the economic improvement and the surge in prices, the ECB announced a slight readjustment of asset purchases under the pandemic emergency purchase programme to a level slightly below that of the previous two quarters. At the December meeting, the monetary authorities expect to give more details on the monetary policy outlook for 2022.

Government bond yields rose slightly in September, reflecting investors' doubts about the transitory nature of current inflationary pressures. The yield on the 10-year US Treasury note rose from 1.31% to 1.49% over the month. In the eurozone, the benchmark 10-year government bond yield rose from -0.38% to -0.20% in Germany, from -0.03% to 0.15% in France, from 0.71% to 0.86% in Italy, and from 0.34% to 0.46% in Spain.

Having risen almost every month since the beginning of the year, equity markets were more volatile in September. This was reflected in the MSCI All Country World Index Net Total Return expressed in euros declining by 2.4%. Uncertainty surrounding the financial difficulties of property developer China Evergrande and the rise in long-term interest rates weighed on share prices. The S&P 500 in the United States, the Stoxx 600 in Europe, and the MSCI Emerging Markets gave up 4.8% (in USD), 3.4% (in EUR), and 4.3% (in USD) respectively. The Topix in Japan was alone in rising by 3.5% (in JPY), partially making up for the accumulated lag of previous months. In terms of sectors, energy stocks stood out with a sharp increase in their share price on the back of rising oil and gas prices.

The prospect of the Federal Reserve's reduction in asset purchases had a positive impact on the dollar, with the euro/dollar exchange rate dropping from 1.18 to 1.16 during the month. Conversely, precious metals came under pressure. The gold price fell 3.1%, from $1,814 per ounce to $1,757. Silver depreciated even more sharply, with the price per ounce falling 7.2%, from $23.9 to $22.2.