PORTFOLIO MONTHLY REPORT – March 2022

Situation

The last time inflation in Germany was 7.3% was in November 1981 and the central bank set rates at 11%. Today the ECB is the central bank and they have set interest rates at 0%. What this means is that rates in Germany are negative after taking account of inflation and this is also true in the UK and the USA. In the UK the central bank interest rate is 0.75% and inflation is 5.4% (Dec 2021) and the Bank of England expects it to be 7% by summer. In the USA the bank interest rate is 0.25% after a recent rise from 0% and the inflation rate is 7.9% (Feb 2022) a 40 year high. What we are seeing is central banks losing control of inflation.

The text book reaction to higher inflation is for the central bank to raise interest rates. That makes loans and mortgages more expensive, people have less disposable money and demand falls and therefore prices fall. That is the theory. However the central banks have got themselves into a situation where to now raise interest rates, beyond the rate of inflation to control inflation is going to lead to economic recession. Over the last several years and particularly in reaction to CV19 debt at government, corporate and personal level has become huge. If they put up rates then there is a real risk of large scale default and bankruptcies. The ECB has already said that rates will not rise (see Nov 2021 report at www.timunderwood.com) however the market view in the USA is that rates will now rise at every meeting the US central bank has this year and take rate up to around 2%. Unless inflation falls significantly that is still a negative real interest rate.

In the October 2021 report I pointed out that in 1980 inflation was 13% in the USA. In the UK it got up to 18%. There are of course no central bankers in charge now who were in office at that time or any politician but the history books are there to remind people that inflation can be a persistent problem. Inflation in Turkey has recently shot up to 54%. Two years ago in April 2020 it was only 11%. The currency has collapsed and power and food in short supply. This is a country on the edge of Europe. Last month we discussed the looming food crisis as a result of the Ukraine war. This could easily lead to famine and then millions of people from the region moving into Europe making the 1.5 million refugees from Syria crisis in 2015 look insignificant. Hopefully the war stops soon and food starts to move otherwise people will move.

One investment area that is going to be impacted is commodity prices. We have seen them move up already in the oil and the food sector then settle back a bit. But these are so important for society to function price pressure could easily return. Perhaps Saudi Arabia could turn up the oil taps if things got worse but you cannot turn up wheat. It needs a season to grow and if missed due to a disrupted harvest, people will go hungry and prices spike dramatically.

(see Bloomberg Commodity Index in June 2021 report at www.timunderwood.com)

Best wishes

Tim 2 April 2022