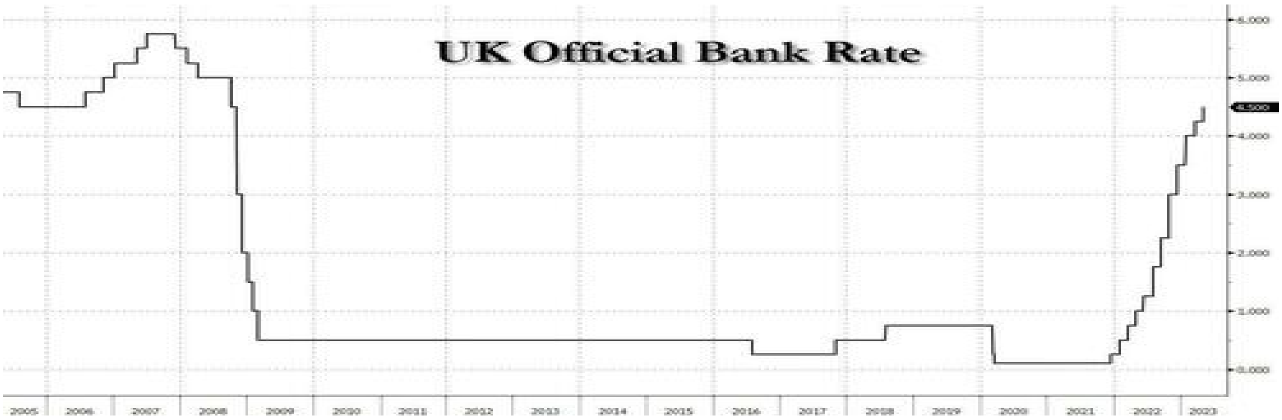
Monthly Report – April 2023



On Thursday 11 May 2023 the Bank of England raised interest rates for a 12th consecutive time by a quarter of a percentage point to 4.5%, the highest level since 2008, and warned that "if there were to be evidence of more persistent [inflationary] pressure, then further tightening in monetary policy would be required". This follows on from the US raising rates last week to over 5% and the ECB to 3.5%. Look at the chart. It is a severe series of rate hikes and the same for the US and the ECB. They are worried about inflation but will they break something in the economy with this action?

As we have seen the interest yield curve does not believe these rates will hold for long. See the report Nov 2022 and the charts of the interest rate inversion. It is the same today. In the USA for example the rate is 5% but bonds for 10 years yield only 3.5%. Why would pension funds and other investors bid for 10 year bonds at a lower rate than the overnight rate? The same is true for the UK, ten year rates are only 3.7%. The same in Euroland. The ECB has over night rates at 3.5% but the German year 10 bond yields only 2.2%. These ten year bond are not set by central bankers but by investors, pension funds etc who bid higher and higher prices for the ten year bonds which lowers their yield. (yields move inverse to the price of bonds). Why not the overnight at a higher rate?

Some economists believe this market action is because investors do not believe these current over night rates will last for long. That central banks will lower rates soon. Why would they do that after the most rapid rises in their fight to combat inflation? Because they think the central banks have done too much, that inflation has passed and they are going to have to reverse policy very soon.

If the central banks do reverse policy and start to lower rates soon we are in a new world. What happens to inflation expectations and asset prices? With a potential change in policy diversification, income and gold are the way ahead.

Best wishes

Tim 12 May 2023

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