

February 2021

Is an inflation revival underway?

2021 has already been marked by several significant events

In the US we have a new president with a more inclusive and less protectionist agenda.

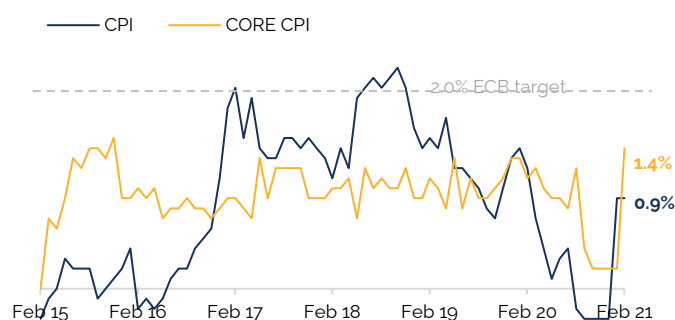
A massive global roll-out of COVID-19 vaccines is underway, with early evidence showing vaccination programs will likely be successful in containing the pandemic.

At the same time, the monetary and fiscal boost created by the expansionary policies of central banks and governments in 2020, combined with changed consumer behaviour due to the pandemic, have resulted in a rise in inflationary expectations and higher inflation prints.

Data shows a change to recent low and stable Eurozone inflation

In January, Eurozone inflation jumped to **0.9% year-on-year** (compared to -0.3% YoY in December). The January print of core inflation saw an acceleration to 1.4% on an annual basis.

Having tumbled due to the pandemic, Eurozone inflation jumped in January



Data: Tabula/Bloomberg, 12 February 2021

Germany's VAT holiday comes to an end

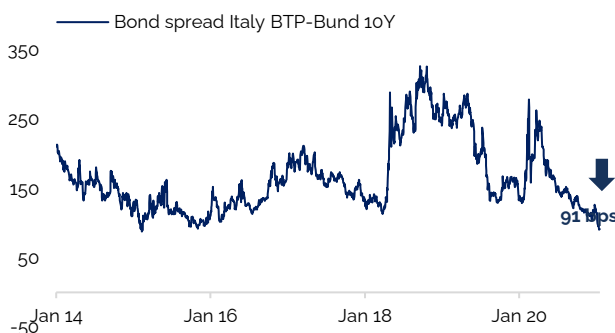
After years of stable low inflation, Germany registered a **+1.6% annual increase** in January CPI, compared to a 0.7% price decline YoY the prior month. Much of this can be attributed to the end of Germany's Covid-19 stimulus program VAT cut. In addition, the rise in prices was influenced by delays in winter sales, higher energy prices and annual revisions to the CPI basket.

Italy's new government is poised to take action

The recent change of the Italian government has resulted in the former president of the ECB taking over as prime minister. The "Draghi effect" has caused the 10-years BTP/Bund yield spread to tighten to 91 basis points, a level never seen before 2015.

There are now signs that the new government will be able to deploy EU funds in a more efficient manner. The country has only deployed 38% of the €44bn in EU funds available since 2014.

Italian BTP yields fall to record low as investors back Draghi



Data: Tabula/Bloomberg, 15 February 2021

Covid-19 has changed consumer behaviour and prices

Euro area HICP basket weights and inflation

	Basket weight			Annual inflation rate		
	Dec-20	Jan-21	change	Dec-20	Jan-21	change
Services	44.87%	41.97%	↓	0.70%	1.40%	↑
Non-energy industrial goods	26.21%	26.77%	↑	-0.50%	1.40%	↑
Food, alcohol & tobacco	19.07%	21.76%	↑	1.30%	1.50%	↑
Energy	9.85%	9.49%	↓	-6.90%	-4.10%	↓

Data: Tabula/Eurostat, 12 February 2021

The annual Euro CPI basket component revision reflected the changes in spending caused by the pandemic. Weights shifted in favour of **food and non-energy industrial goods** while the basket weight fell for services and energy, sectors which have been depressed by national lockdowns.

In the event of an exit from lockdown, it is possible that there will be an upward push on prices once there is a restart in the hospitality and transport sectors of the economy.

An American spending spree

In America President Biden has pressured congressional legislators to pass a stimulus package of US\$1.9 trillion, prompting yields on 30-years US bonds to reach their highest level in over a year, returning to pre-COVID crisis levels at more than 2%.

US inflation expectations, measured by 10-year **break-evens**, **rose to 2.21%** in early February - the highest level since 2014.

The US manufacturing and services PMI index also rose sharply in January, touching 59.1 - the highest since 2018.

US 10-year break-evens



Data: Tabula/Bloomberg, 12 February 2021

China is bouncing back

The world's second largest economy expanded 2.3% in 2020, the only major economy to show a positive number last year.

Thanks to an early exit from national lockdowns, industrial production was a particularly big driver of growth, jumping 7.3% in December from a year earlier. Looking ahead to 2021, it is likely that the Chinese recovery will continue, with double-digit growth estimates are forecasted for the first quarter.

These changes will likely instigate a reversal of the recent trends of low interest rates and stable inflation. Deflationary headwinds over the last three decades have been primarily due to an enormous surge in the world's available labour supply, owing to very favourable demographic trends and the entry of China and Eastern Europe into the world's trading system.

Whatever happens next, it appears that the trend of stable and low inflation is over.

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