GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

November 18, 2021

Central bank dissonance

Frédérique Carrier – London

The synchronised, extraordinarily accommodative response of global central banks since the early days of the pandemic is giving way to policymakers striking out on different paths to policy normalisation. We look at the key inflationary pressure points—housing and wages—and consider what the next moves of major central banks might be.

Housing and wages: The inflation connection

While stubbornly high inflation has largely been caused by supply chain disruptions, which should eventually wane in 2022, two other important factors, rising housing costs and wages, need to be monitored as those conditions could be stickier.

Eric Lascelles, chief economist at RBC Global Asset Management Inc., points out that housing costs represent a large proportion of the inflation basket for most countries though methodological approaches differ. Home prices across much of the developed world have increased to an extraordinary extent throughout the pandemic, which is fueling inflation. In the U.S., rental costs are now catching up. With housing costs representing a hefty 40 percent of the U.S. Consumer Price Index (CPI), inflation is likely to retain at least one key source of upward pressure over the coming year.

As for wages, given that seven of the last eight U.S. CPI prints have overshot consensus expectations, the risk, in our view, is that higher inflation seeps into wages, potentially setting up a wage-price spiral that would require central banks to abruptly rein in monetary stimulus, which could choke off the recovery and trigger financial market volatility.

Lascelles points out that significant wage pressures are already visible in the U.S. and UK. In the former, average hourly earnings grew 4.9 percent year over year in October, though this still represents negative real wage growth given that inflation is even higher. In the UK, wages on a total pay basis climbed 5.8 percent year over year in the July to September period. By contrast, average hourly earnings rose by an anaemic 2.0 percent year over year in Canada and remain subdued in the EU.

Upside pressure on wages arises from labour shortages that have put workers in a position to demand higher pay. COVID-19 lockdowns hindered immigration in developed countries, and some three million workers in the U.S. opted for early retirement, according to the Fed. UK labour shortages are being exacerbated by the banishment of EU workers after Brexit. The minimum wage was also increased in several countries.

The hawks

Markets expect the Bank of Canada (BoC) and the Bank of England (BoE) to be the most proactive in raising interest rates over the next 12 months, with as many as five BoC hikes by the end of 2022 priced into forward market expectations.

For perspectives on the week from our regional analysts, please see pages 3–4.

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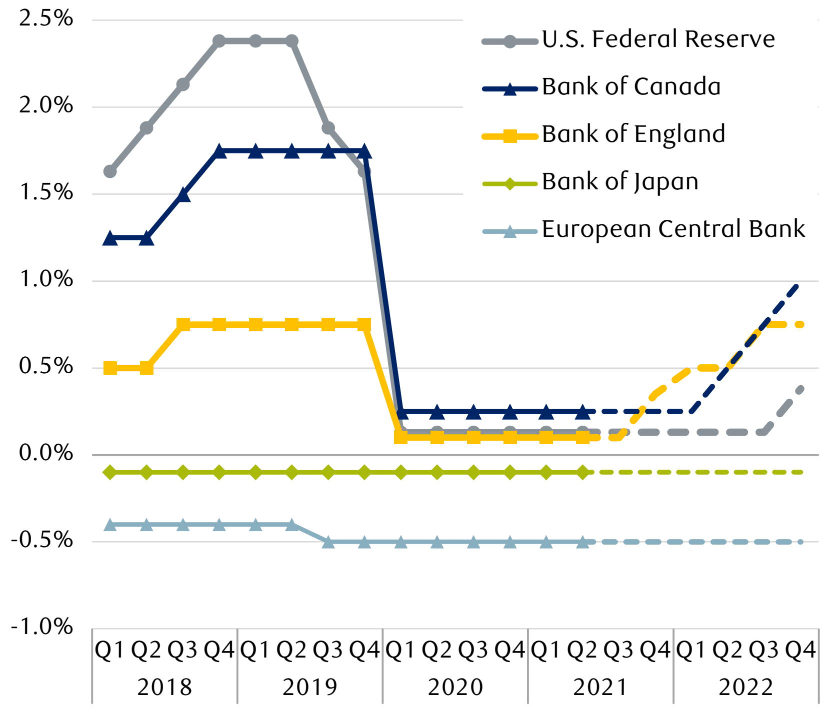
For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

The BoC has been aggressive in scaling back COVID-19 stimulus. Given robust economic growth, high COVID-19 vaccination rates, and strong employment gains, the central bank recently reduced asset purchases to the level of reinvestments only, which has effectively ended its quantitative easing programme. BoC Governor Tiff Macklem and his BoC colleagues suggested interest rates could rise as soon as April 2022. October inflation is running at a high 4.7 percent year over year, which we believe the central bank will likely see as vindicating its position.

In the UK, the BoE recently stressed that some modest tightening of monetary policy would likely be necessary to meet its two percent inflation target. Prices surged in October, with the CPI reaching 4.2 percent, the highest level since 2018. The BoE has been waiting to see the impact on the labour market of the termination of the jobs support programme in September before increasing rates, but with unemployment continuing to fall and robust wage growth, the probability of a rate increase in December has grown. The market expects another two hikes in 2022.

Hawks and doves: Diverging expectations for interest rates

RBC Economics policy rate forecasts



Source - RBC Economics, RBC Wealth Management, Bloomberg; data as of 11/18/21

In the U.S., higher and more persistent inflation may mean a shift in expectations. Could the current $15 billion per month pace of tapering be accelerated to say $20 billion per month? And how soon and by how much will interest rates be increased?

We continue to expect the Fed will keep the tapering pace at $15 billion as markets like consistency. With tapering likely to end in mid-2022, we expect the Fed to take stock of conditions at that time and look for unemployment below four percent before raising rates. We anticipate one increase in late 2022, though we acknowledge a second hike in 2022 is possible if inflation remains high.

The doves

At the other end of the spectrum, the Bank of Japan (BoJ) and the European Central Bank (ECB) are unlikely to increase interest rates before 2023.

Japan's economic recovery has been slower compared to peers in 2021 due to a series of long-lasting and stringent COVID-19 restrictions. Inflation has been soft at a mere 0.2 percent year over year, partially due to government policies such as encouraging major telecom carriers to cut mobile phone fees. Given the muted inflation, we expect the BoJ to maintain its policy rate at negative 0.1 percent until late 2023.

By contrast, the October CPI in the eurozone reached 4.1 percent, up from 3.4 percent the previous month. According to RBC Capital Markets, the price increases were broad-based. With the recovery proceeding at a healthy pace, we believe the ECB is likely to start to rein in monetary stimulus. It already indicated it aims to terminate its Pandemic Emergency Purchase Programme in March 2022, though it will likely transition to a separate, existing asset purchase programme, lasting well into 2023, to continue to support regional economic activity. Markets do not expect the ECB to increase interest rates until sometime in late 2023.

Stay alert

Higher and persistent inflation can change market expectations for tightening of monetary policy, creating volatility. So far, fixed income markets have borne the brunt of this as equity markets seem to have been largely immune (for more, see the Nov. 11 Global Insight Weekly), though this may change over 2022. With this in mind, keeping an eye on housing costs and wages can help investors assess future central bank moves.

UNITED STATES

Alan Robinson – Seattle

- **U.S. stock indexes traded in a narrow range near all-time highs during the week**, with the positive drivers of strong consumer spending and accommodative monetary policy just outweighing concerns over increasing COVID-19 case counts and higher inflation.

- **The U.S. Consumer Price Index jumped by 6.2% y/y in October**, according to the Bureau of Labor Statistics, marking the largest 12-month increase in this inflation barometer in 31 years. Price rises were driven by pandemic-related supply shortages and strong consumer demand. Core prices (excluding the volatile categories of food and energy) were also up a solid 4.6%.

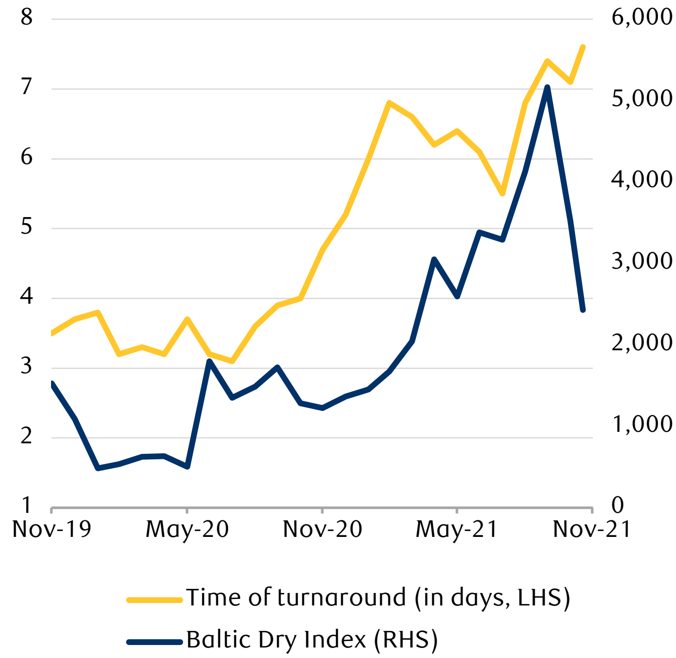
- These inflation figures didn't appear to dissuade U.S. consumers from opening their wallets, with the government reporting **October retail sales were up 16.3% y/y on a nominal basis**, indicating very strong volume growth after stripping out inflation.

- These data releases coincided with **earnings reports from retail bellwethers** including Home Depot (HD), Walmart (WMT) and Target (TGT). A common theme in these results was sales exceeding consensus estimates, offset by profit margin pressures caused by higher costs. According to FactSet, **285 S&P 500 companies referenced inflation during their Q3 2021 earnings calls**; this is more than double the five-year average. Investors' reactions to these reports generally depended on whether companies were able to pass these price increases on to their customers, with stocks of companies that demonstrated pricing power outperforming those that did not.

- One important cost pressure continued to ease during the week, with the Baltic Dry Index of shipping costs marking a five-month low. The **decline in shipping costs** has coincided with a number of industries, including global automobile manufacturers, reporting easing supply chain pressures and wider semiconductor availability. But this development may come too late to help stock the shelves for the holiday season, as **wait times for ships unloading at West Coast ports remain elevated** (see chart), partly due to the difficulty of finding truckers to take goods from the ports.

Shipping costs have peaked, but delays persist

Days at port for ships on West Coast versus shipping costs



Source - RBC Capital Markets, RBC Wealth Management; monthly data through 11/17/21

CANADA

Simon Jones – Toronto

- **The Consumer Price Index rose in line with consensus expectations in October**, increasing 4.7% y/y (0.7% m/m) according to Statistics Canada, up modestly from 4.4% y/y in September. Inflation was relatively broad-based with all major components increasing on a year-over-year basis. Higher energy prices (+25.5%) was a key contributor to October's price gains, as oil demand firmed amid coal and natural gas shortages globally. Ongoing supply disruptions also factored into October's increase as the semiconductor shortage continued to underpin motor vehicle prices (+6.1%), while labour shortages, supply chain challenges, and rising prices for livestock feed pushed the cost of meat higher (+9.9%). Although inflation continues to trend upward, its acceleration is consistent with the Bank of Canada's (BoC's) inflation forecast and, as a result, shouldn't cause the BoC to deviate from its current policy stance.

- **BoC Deputy Governor Lawrence Schembri reminded markets this week that the path to policy normalization remains uncertain**, noting that the pandemic has made it more difficult for central banks to assess economic capacity, inflationary pressures, and labour market dynamics. **His comments echoed the key message from BoC Governor Tiff Macklem's opinion piece** published earlier this week that stated the economy is "getting closer" to absorbing the slack necessary to begin raising interest rates, but "we are not there yet." The messaging comes amid the recent rise in short-term government bond yields that implies the market is expecting the BoC will raise interest rates at a faster pace than outlined in the BoC's current forward guidance. As it stands, the BoC doesn't anticipate achieving the conditions necessary to begin raising rates until "sometime in the middle quarters of 2022," but both Schembri and Macklem reiterated that any policy adjustments will remain outcome-dependent.

EUROPE

Rufaro Chiriseri, CFA & Thomas McGarrity, CFA – London

- **UK unemployment and inflation data released this week are key pieces of the puzzle for the Bank of England's (BoE) Monetary Policy Committee (MPC) to determine whether it should start tightening policy. Data showed 160,000 jobs were added in October** and openings soared to a record high. The figures suggest that very few of the 1.1 million workers who were on furlough became unemployed when the furlough program ended in September. The next unemployment data release is scheduled for Dec. 14, two days before the MPC's rate decision, and we expect the data to remain positive.

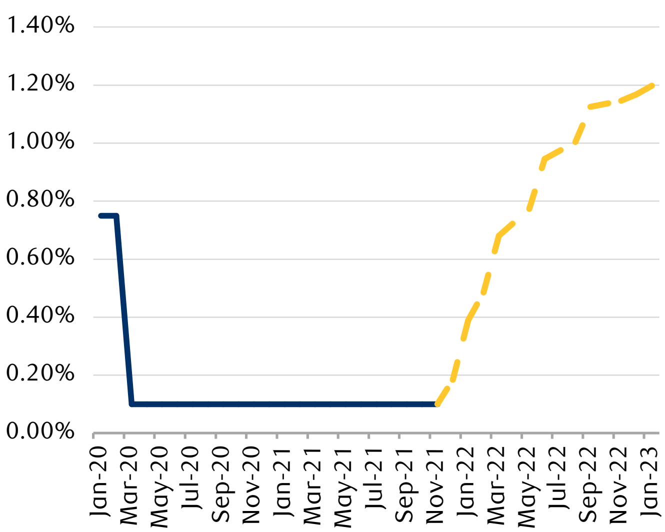
- Regarding inflation, **CPI rose to 4.2% y/y in October** from 3.1% y/y in September. This inflation print was above the 3.9% consensus estimate, but more in line with the November Monetary Policy Report (MPR) that forecast a figure slightly above 4%. The MPR inflation forecast peaks at 5% in Q2 2022 but falls back towards the BoE's 2% target over the medium term.

- The MPC stated that "if the data, particularly on the labour market, are broadly in line with the November MPR" then it would be necessary over the coming months to raise interest rates. Our base case is a hike in December followed by two further hikes, in Q1 and Q3 2022, to reach a 0.75% bank rate.

- **European equity markets continued to grind higher during the week**, despite rising COVID-19 infections in the region, including the continent's biggest economy—Germany. Notably, many of the new restrictions being introduced at this stage are focused on unvaccinated people, as governments push to increase vaccination rates.

The market expects the BoE base rate to increase to around 1.2% by the end of 2022

Historical and market-implied future bank rates



Source - RBC Wealth Management, Bloomberg; data through 11/18/21

- **Within the market's quarter-to-date rally, luxury stocks have significantly outperformed**. The subsector is now trading above the level it had reached in mid-August, before media reports that the Chinese government was considering changes to its "common prosperity" policies, including tackling excessive incomes, which initially hit the luxury goods names. Having digested the news, the market has seemingly opted to view the Chinese government's ambitions as having a positive impact on expanding the size of China's middle class, a key growth driver for the industry, and supporting a re-rating of price-to-earnings multiples. Strong Q3 results from across the industry, showing that the demand environment for luxury goods remains buoyant, has also been a factor driving luxury's recent outperformance, in our view.

ASIA PACIFIC

Jasmine Duan – Hong Kong

- **Chinese technology stocks recorded their worst day in three weeks on Nov. 18**, with the Hang Seng Tech Index down almost 3%. Baidu (BIDU/9988 HK) and Bilibili (BILI/9626 HK) had the largest declines in the index as both companies' Q3 2021 results reflected the effect of the country's regulatory crackdown and fueled investors' concern over the earnings of other tech companies. According to Bloomberg, among the 13 constituents of the Hang Seng Tech Index that have announced Q3 results, six reported lower-than-expected earnings.

- **U.S. President Joe Biden and Chinese President Xi Jinping had a virtual meeting earlier this week**, during which both sides proclaimed the need for mutual cooperation. Although there are no specific outcomes from the meeting, we think restarting dialogue is an important step and there is room for further improvement in the countries' relationship. It is also possible tariffs may unwind as lower tariffs could provide some relief on elevated U.S. consumer and producer inflation. We think a better U.S.-China relationship would help expand the valuation multiples of Chinese equities.

- **China is fine-tuning its property sector policies**. Regulators plan to let high-quality developers resume issuance of asset-backed securities (ABS) to repay outstanding debt. No developers have sold ABS since August after the government began restricting approvals in Q2. The country also plans to relax a rule that limits the size of new interbank bond issuance by developers to 85% of their outstanding interbank debt. However, the relaxation will also only apply to high-quality issuers.

- **China Evergrande (3333 HK) agreed to sell its remaining 18% holding in HengTen Networks (136 HK) to Hong Kong-based Allied Resources Investment Holdings Ltd.** at HK$1.28 per share, a discount of approximately 24% to its closing price on Wednesday (Nov. 17). The transaction will raise HK$2.13 billion (US$273 million) for Evergrande and could slightly ease its short-term liquidity pressure.

MARKET
Scorecard

Data as of November 18, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,704.54	2.2%	25.3%	31.9%	50.7%
Dow Industrials (DJIA)	35,870.95	0.1%	17.2%	21.9%	27.9%
Nasdaq	15,993.71	3.2%	24.1%	35.5%	87.1%
Russell 2000	2,363.59	2.9%	19.7%	33.6%	48.4%
S&P/TSX Comp	21,637.54	2.9%	24.1%	28.1%	27.1%
FTSE All-Share	4,152.80	0.6%	13.0%	15.1%	2.9%
STOXX Europe 600	487.70	2.6%	22.2%	24.9%	20.1%
EURO STOXX 50	4,383.70	3.1%	23.4%	25.9%	18.3%
Hang Seng	25,319.72	-0.2%	-7.0%	-4.6%	-5.1%
Shanghai Comp	3,520.71	-0.8%	1.4%	5.2%	21.0%
Nikkei 225	29,598.66	2.4%	7.9%	15.0%	26.4%
India Sensex	59,636.01	0.6%	24.9%	35.0%	48.0%
Singapore Straits Times	3,237.02	1.2%	13.8%	16.1%	-0.7%
Brazil Ibovespa	102,426.00	-1.0%	-13.9%	-3.5%	-3.6%
Mexican Bolsa IPC	50,831.95	-0.9%	15.4%	20.3%	17.1%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.584%	3.2	67.1	71.4	-23.2
Canada 10-Yr	1.696%	-2.7	101.9	99.3	20.8
UK 10-Yr	0.925%	-10.9	72.8	58.8	17.5
Germany 10-Yr	-0.275%	-16.9	29.4	27.9	6.1
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.73%	-0.3%	-1.9%	-1.3%	5.8%
U.S. Investment-Grade Corp	2.31%	-0.6%	-1.6%	-0.2%	9.2%
U.S. High-Yield Corp	4.36%	0.0%	4.4%	7.1%	14.3%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,859.48	4.3%	-2.0%	-0.7%	26.4%
Silver (spot $/oz)	24.81	3.8%	-6.0%	1.9%	45.5%
Copper ($/metric ton)	9,421.40	-3.9%	21.6%	33.3%	62.0%
Oil (WTI spot/bbl)	79.01	-5.5%	62.8%	88.9%	38.5%
Oil (Brent spot/bbl)	81.10	-3.9%	56.6%	82.9%	29.9%
Natural Gas ($/mmBtu)	4.90	-9.6%	93.1%	80.8%	91.1%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	95.5350	1.5%	6.2%	3.5%	-2.3%
CAD/USD	0.7937	-1.7%	1.1%	3.9%	4.8%
USD/CAD	1.2600	1.7%	-1.0%	-3.7%	-4.6%
EUR/USD	1.1371	-1.6%	-6.9%	-4.1%	2.7%
GBP/USD	1.3500	-1.3%	-1.2%	1.7%	4.2%
AUD/USD	0.7277	-3.2%	-5.4%	-0.4%	6.8%
USD/JPY	114.2500	0.3%	10.7%	10.0%	5.1%
EUR/JPY	129.9200	-1.4%	3.0%	5.6%	8.0%
EUR/GBP	0.8423	-0.3%	-5.8%	-5.7%	-1.5%
EUR/CHF	1.0524	-0.6%	-2.7%	-2.6%	-4.0%
USD/SGD	1.3565	0.6%	2.6%	1.1%	-0.3%
USD/CNY	6.3861	-0.3%	-2.2%	-2.7%	-9.1%
USD/MXN	20.7711	1.0%	4.3%	2.2%	7.5%
USD/BRL	5.5660	-1.2%	7.1%	3.8%	32.2%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

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Source - Bloomberg; data as of 4:35 pm ET 11/18/21

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Hold [Sector Perform]	562	39.75	172	30.60
Sell [Underperform]	52	3.68	3	5.77

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