# MARKET COMMENTARY

## Strategy

27 April 2020

# Inflation at last?
# The long-term effect of the Covid-19 pandemic

**Mark Richards, Strategist, Multi-Asset**

Mark Richards joined Jupiter in January 2019 as Multi-Asset Strategist.

Mark's experience covering economics and financial markets started in 2003, most of which has spent as an equity strategist. He works closely with Talib and the Multi-Asset team with a particular focus on the Jupiter Flexible Income fund (SICAV) and the Jupiter Flexible Macro fund (SICAV). Mark joined Jupiter from JPMorgan where he spent three years as a Multi-Asset Strategist, having previously held similar positions at PIMCO and Credit Suisse.

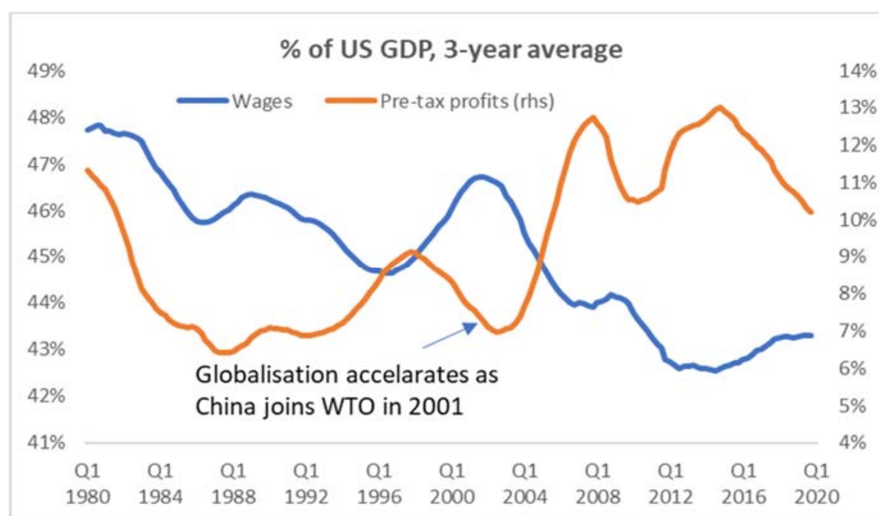
Mark has a BSc in Business Economics from the University of Surrey.

**About Jupiter**
The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups.

„The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 29 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 42.8 bn as of 31 December 2019.

**Since the global financial crisis, inflation has been stuck well below historical levels and central bank targets, averaging 1.3% in the Eurozone, and 1.6% in the US.[1] This is despite exceptionally easy financial conditions, as countries tried to combat deflation using things like negative rates, quantitative easing, deficit spending.**

A combination of structural factors has been keeping inflation low. Ageing populations save more and spend less, and rising social and health costs crowd out other infrastructure projects. Globalisation and deindustrialisation have reduced the collective bargaining power of a de-unionising workforce, and added a plentiful supply of cheaper labour to the global economy. Advances in technology have put downward pressure on costs. As illustrated in the following graph, this has increased corporate profits at the expense of wages. The share of wages in US GDP has fallen to its lowest level since 1929, putting downward pressure on inflation.




*Source: Refinitiv, 22. April 2020.*

**What is different this time?**

The impact of the coronavirus shock has been a massive demand shock across the global economy. The response from policymakers has been an enormous injection of monetary and fiscal stimulus. But this is a health crisis and a medical solution is required for economies to fully recover. Until that point, partial re-opening will lead to a spluttering economy with only timid consumption and investing behaviour. Once economies are fully reopen, the stimulus in place will start to act as a tailwind for global growth and it will be a difficult challenge for policymakers to reduce the amount of liquidity in economies. This has led many to suggest we may see inflation rebound.

Are we to believe that this time it's different? Structural deflationary factors remain. Population ageing continues to accelerate, sovereign indebtedness will be even greater after the crisis, and technology continues to evolve. Huge amounts of stimulus didn't cause inflation after the last crisis.

Nevertheless, we think a period of higher inflation is more likely than not. We don't think this is imminent: the demand shock caused by the pandemic may take years to unwind. However, as the global economy recovers in the medium term, the unusual nature of the virus-induced shutdown can unleash pent-up demand and likely impose additional costs in terms of labour and supply chain reconfiguration. This has the potential to accelerate the global economy through the usual phases of the business cycle quicker than usual, and take us into a more inflationary environment. Central banks are likely to tolerate or even aim for above-target inflation, partly to compensate for years of missing targets, partly to help inflate away sovereign debt.

[1] Eurozone HICP, US Core PCE, 31 March 2008-29 February 2020. Source: Bloomberg.

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At the same time, we expect some of the structural factors that limited inflation will weaken as a result of this crisis. Globalisation was already being undermined by trade tensions. The pandemic has shown some of the vulnerabilities inherent in globalised supply chains, and we expect politicians to bring key areas of production back onshore. The crisis has also laid bare the reliance of societies on relatively low paid key workers, not just in healthcare but across public services and areas of the private sector like retail, notably food, and delivery providers. Public support for better pay and conditions, added to pressure on governments to fix some of the infrastructure issues highlighted by this crisis, will provide political headroom for higher fiscal spending.

**What assets may do well in a moderately more inflationary environment?**

We can't underestimate the deflationary impact of the demand shock caused by the Covid-19 economic shutdown across the globe, and structural deflationary forces remain, but we do think it more likely than not that we will see moderate levels of inflation return to the global economy in the medium term. In the strategy, we like assets that can do well in a more inflationary environment such gold, inflation-linked bonds, and curve steepeners. In time, a more inflationary environment can be supportive for equity sectors such as energy and financials, but only when the economic uncertainty starts to diminish.

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