



## Fed and ECB operate on different timelines

We expect that the FOMC meeting next week is unlikely to provoke the same market reaction as last month's meeting. No new projections (dot plots) will be published and it is too early for a stronger tapering announcement. However, President Powell might also argue that the Fed should be able to assess over the coming months whether it is on track to achieve the taper threshold. Consequently, we expect a strong signal at the September FOMC meeting and the official taper announcement in December. The actual reduction of asset purchases should start early next year and last until September. The lift-off in rates will likely take place in March 2023.

The ECB on the other hand has delivered a very dovish message by strengthening its forward guidance on interest rates. The lift-off in rates is now tied to three explicit conditions – anchoring inflation expectations firmly at the new symmetric 2% inflation target. Given the muted inflation outlook, this implies no rise in policy rates over the next 3 years. The ECB has signalled a clear commitment to maintain a highly accommodative monetary policy for an extended period. This also implies that asset purchases will be maintained at a rapid pace in 2022 and probably beyond.

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## US Macro

### July FOMC preview: an incremental step towards tapering

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**Mr. Powell will likely say that substantial further progress is still “a ways off”, but also argue that the Fed should be able to assess over the coming months whether it is on track to achieve the taper threshold. We expect the Fed to send a strong signal at the September FOMC meeting and make an official announcement in December.**

**Jay Powell will probably say that tapering is still “a ways off”**

The FOMC meeting next week is unlikely to provoke the same market reaction as last month’s meeting. There are no new projections and while both June CPI and employment reports surprised on the upside, there was probably not enough new information to shift the respective views of Fed officials. As a result, we expect Jay Powell to communicate that reaching the standard of substantial further progress is still “a ways off”.

**We expect the Fed to send a strong signal on tapering at the September meeting and make a formal announcement in December**

But we also expect Mr. Powell to communicate that they should be able to assess over the coming months whether the economy is on track to achieve the taper threshold. This should put the Fed in a position to send a strong signal on tapering at the September meeting, and to make a formal announcement in December (Exhibit 1). Over the past few weeks, FOMC members across the dovish spectrum, such as Presidents Bostic, Daly, Evans, Mester, and Rosengren, have all indicated a possible Q4 taper announcement.

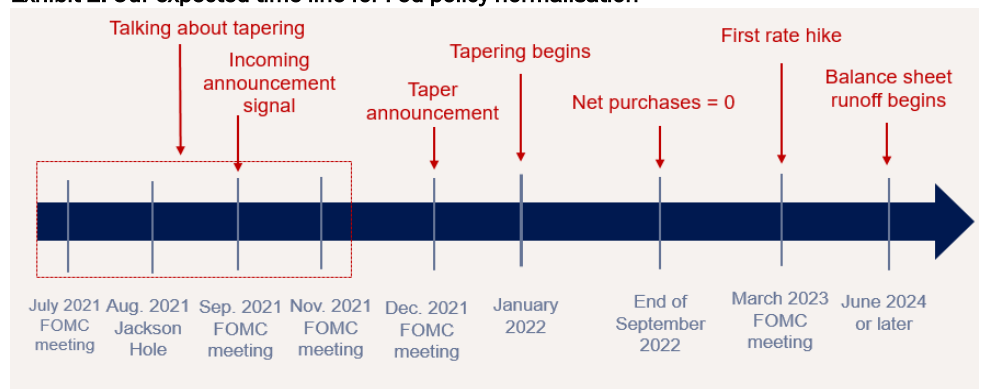
**Our Powell dashboard index suggests that ‘substantial further progress’ is within arm’s reach**

Indeed, the labour market has further strengthened since the last meeting. Our Powell dashboard index suggests that as of last month it had already ‘travelled’ 69% of the distance towards achieving ‘maximum employment’ from 53% in January (Exhibit 2). While the dominant view on the Committee is that higher inflation is largely transitory, the minutes from the June meeting indicate that “a substantial majority of participants judged that the risks to their inflation projections were tilted to the upside” as supply disruptions and labour shortages might linger for longer and might have larger or more persistent effects on prices and wages than previously assumed. Our indicator suggests that inflation expectations have normalised and that underlying inflationary pressures are getting closer to target (Exhibit 2).

**Fed officials are leaning towards a simple process for reducing their monthly asset purchases**

In the press conference, Mr. Powell will probably be asked about the expected modalities of tapering. We don’t think there is a consensus yet on the Committee, though members, at this stage, seem to be leaning towards a simple framework i.e., to reduce purchases on both MBS and Treasuries at the same time and at a set pace.

**Exhibit 1: Our expected time line for Fed policy normalisation**



Source: Bank J. Safra Sarasin, 21.07.2021



## Exhibit:2 Getting close to the ‘substantial further progress’ threshold

	Goal	Jul-19								Jan-20								Jul-20								Jan-21							
		87	88	91	91	92	93	96	95	75	11	28	42	49	53	51	57	55	54	53	57	62	62	64	69								
<b>Labour market conditions</b>																																	
Non-farm payrolls (millions)	152	95	96	97	98	99	100	100	100	95	0	13	35	43	50	54	57	58	57	58	60	64	65	68	71								
Unemployment rate	4.0	100	100	100	100	100	100	100	100	96	0	14	34	43	59	65	73	75	75	79	80	81	81	83	82								
Long-term unemployment rate	0.7	100	97	95	97	98	99	100	100	98	100	97	92	88	85	58	22	9	8	6	2	0	1	15	8								
Unemployment rate, Black	5.5	99	100	100	99	98	94	95	96	88	0	0	13	21	35	42	53	57	61	67	61	63	63	68	67								
Unemployment rate, Hispanic	4.5	100	100	100	100	100	100	100	100	90	0	9	31	43	58	60	70	73	67	72	72	76	76	81	80								
Underemployment rate (U-6)	7.0	100	99	100	100	100	100	100	100	89	0	11	31	40	55	64	68	69	70	74	74	77	79	80	82								
Labor force participation Rate, 25-54 Yrs.	82.9	73	89	93	99	99	99	100	99	86	0	26	54	48	51	35	48	35	38	41	41	48	48	48	61								
Labor force parti. rate, Women, 25-54 Yrs.	76.8	58	85	88	100	94	100	100	100	82	0	21	55	52	45	27	39	30	39	39	42	52	48	45	58								
Labor force parti. rate, High school grad., 25 Yrs. & over	58.4	86	79	89	84	91	100	100	98	66	0	17	27	32	20	17	37	27	30	22	10	12	25	30	39								
Employment to population ratio, 25 to 54 Yrs	80.4	93	97	98	99	99	100	100	100	92	0	16	37	40	53	51	59	59	62	63	64	67	68	69	70								
Employment to population ratio, Women, 25 to 54 Yrs	74.4	89	96	98	100	97	100	100	100	90	0	14	39	43	54	50	61	62	64	64	65	69	70	72	73								
Employment to population ratio, 25-54 Yrs., Black	76.7	88	90	100	100	100	94	94	90	90	0	11	21	20	34	37	51	57	55	53	51	51	63	63	64								
Employment to population ratio, 25-54 Yrs., Hispanic	78.0	88	94	100	100	100	98	98	100	85	0	12	33	37	51	53	65	62	57	52	55	65	69	71	68								
Quits rate	2.4	100	97	85	81	86	87	93	81	39	0	5	39	85	64	91	94	88	99	89	95	100	100	100	100								
Opening rate	5.0	81	81	79	89	69	60	79	72	19	0	37	61	87	70	76	88	82	82	98	100	100	100	100	100								
Hires rate	4.0	97	91	94	82	85	87	92	92	38	0	100	100	100	100	100	100	100	100	79	82	100	100	100	100								
Wages 12m % change, Low skill occupation	4.0	40	40	50	50	60	60	70	70	30	20	10	0	10	10	0	0	10	10	0	20	50	50	40	60								
Wages 12m % change, First wage quartile	4.7	71	57	71	57	71	86	100	100	86	86	86	57	57	57	43	43	29	29	0	29	43	14	29	57								
<b>Inflation expectations</b>																																	
Uni of Michigan, consumer inflation exp. next 5 years	2.9	46	62	31	15	46	0	46	15	15	46	77	46	62	77	77	31	46	46	77	77	92	77	100	92								
FRB Cleveland, estimate inflation nxt 10 years	2.0	62	59	48	57	62	66	68	55	13	0	0	9	22	22	23	21	26	31	26	32	40	50	50	52								
FRB New York, consumer inflation exp., 3-year ahead	3.3	23	14	0	0	17	19	19	24	3	28	27	11	41	69	42	37	51	69	75	71	82	83	100	100								
Philly Fed, Livingston survey, CPI forecast next 10 years	2.5	52	52	51	50	47	44	36	27	19	11	4	0	4	9	17	26	36	46	55	64	73	82	91	100								
Philly Fed, SPF, CPI inflation over nxt 5 years	2.3	47	46	48	56	66	75	79	79	75	60	43	25	13	4	0	4	13	25	40	57	75	92	100	100								
Philly Fed, SPF, CPI inflation over nxt 10 years	2.3	63	63	63	63	63	63	64	64	63	57	49	39	23	9	0	7	19	33	43	53	63	75	87	100								
Philly Fed, SPF, PCE inflation over nxt 5 years	2.0	81	74	69	66	66	69	84	96	100	72	38	7	0	1	7	13	22	35	55	77	100	100	100	100								
Philly Fed, SPF, PCE inflation over nxt 10 years	2.0	100	100	100	100	100	100	100	100	100	73	41	13	3	0	3	9	20	35	61	89	100	100	100	100								
TIPS break-even inflation rate 5y forward	2.3	59	48	48	52	56	66	61	46	0	13	19	37	50	66	56	61	66	81	95	100	100	100	100	100								
TIPS break-even inflation rate 10y forward	2.3	62	48	46	47	52	63	55	38	0	14	20	33	48	65	53	58	63	78	88	90	100	100	100	100								
TIPS break-even inflation rate 5y 5y forward	2.3	68	48	44	37	45	58	43	23	0	16	21	26	43	63	49	53	58	74	76	63	90	95	97	88								
Inflation expectations composite measure (longer history)	2.0	42	42	35	34	32	37	28	18	5	5	1	0	3	14	11	6	9	32	58	85	100	100	100	100								
Inflation expectations composite measure (shorter history)	2.0	70	65	57	55	55	62	56	40	22	16	12	6	2	3	0	2	21	58	98	100	100	100	100	100								
<b>Inflationary pressures</b>																																	
Employment Cost Index, Wages and salaries, yoy	3.3	51	53	55	53	52	53	62	71	77	72	61	48	30	13	0	1	7	16	18	22	31											
Atlanta Fed wage growth tracker, 3mma, yoy	4.0	90	70	60	50	70	70	80	70	50	30	50	80	90	50	50	50	70	40	40	40	40	20	0	20								
Core CPI, yoy	2.3	91	100	100	100	100	91	100	100	82	18	0	0	36	45	45	36	45	36	18	9	36	100	100	100								
Core PCE, yoy	2.0	76	87	74	76	61	65	77	88	68	0	7	20	31	47	56	44	38	45	47	47	95	100	100									
Market-based core PCE, yoy	1.8	55	76	64	70	47	51	47	72	60	0	5	4	22	47	51	32	24	30	36	38	98	100	100	100								
Sticky CPI, yoy	2.5	100	100	100	100	100	100	100	100	100	70	56	57	91	83	64	39	34	24	2	0	19	88	100	100								
Core sticky CPI, yoy	2.5	98	100	100	100	100	100	100	100	100	71	57	56	85	77	57	34	28	19	0	1	18	77	100	100								
Sticky CPI excl. shelter, yoy	2.2	53	84	77	100	100	100	100	100	91	22	0	24	88	87	72	29	39	33	10	9	46	100	100	100								
Core sticky CPI excl. shelter, yoy	2.2	48	73	68	96	100	94	99	100	83	29	7	24	74	71	54	16	24	17	0	3	34	100	100	100								
FRB Cleveland Median CPI, yoy	2.5	100	100	100	100	100	100	100	100	100	100	100	100	100	100	76	78	44	39	12	13	0	19	21	41								
FRB Cleveland trimmed mean CPI, yoy	2.2	100	100	100	100	100	100	100	100	100	78	100	100	100	100	100	100	72	74	0	24	63	100	100	100								
FRB San Francisco cyclical core PCE inflation, yoy	2.7	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	0	71	100	100	100								
FRB Dallas trimmed mean PCE, yoy	2.1	84	90	80	86	71	71	100	100	76	53	63	53	57	63	63	43	29	29	0	2	20	37	49	49								
Composite measure of underlying inflation, yoy	2.2	100	100	100	100	100	100	100	100	100	49	42	42	87	94	80	45	37	33	2	0	47	100	100	100								
<b>Powell's dashboard index</b>																																	
		76	77	75	76	77	78	81	79	64	31	34	37	48	51	46	43	44	47	46	48	64	77	80	83								

Index (100 = reached goal; 0 = furthest away from goal)

Red box: Furthest away from goal

Yellow box: Moving towards goal

Green box: Moving towards goal

Source: Macrobond, Bank J. Safra Sarasin, 22.07.2021



## European Macro

### New forward guidance from the ECB sends a dovish signal

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In line with its strategy review, the Governing Council changed its forward guidance on interest rates at this week's meeting. From now on, higher rates are more clearly tied to the inflation outlook of the ECB. With an inflation forecast of 1.4% for 2023 – the current end of its forecast horizon – it is very unlikely that policy rates will rise anytime soon. No changes were made or indicated to the purchase programmes of the ECB.

#### Three new conditions for higher policy rates

The main message from the policy statement is that the hurdle for a rise in policy rates is quite high. Namely, the ECB would like to see three conditions to be met: (i) "inflation reaching 2% well ahead of the end of its projection horizon", (ii) "remaining at these levels for the rest of the projection horizon", and (iii) "realized progress in underlying inflation is sufficiently advanced".

#### ECB inflation outlook is far away from the conditions needed for higher rates

So far, the ECB's inflation forecast is at 1.5% in 2022 and at 1.4% in 2023, which currently marks the end of its forecast horizon. 2024 forecasts will be released for the first time at the December meeting. President Lagarde also clarified the meaning of "well ahead of the end of its projection horizon" as specified in the first condition. It should be seen as the midpoint of the forecast horizon, but would in any case be a judgement of the Governing Council. Owner-occupied housing costs – which in the ECB's strategy review was identified as an important future element of the inflation basket – are yet to be incorporated in the inflation outlook. They might lift the inflation profile somewhat, but clearly not enough such that the 2% mark would be within reach until the end of 2023.

#### Positive implications for money markets

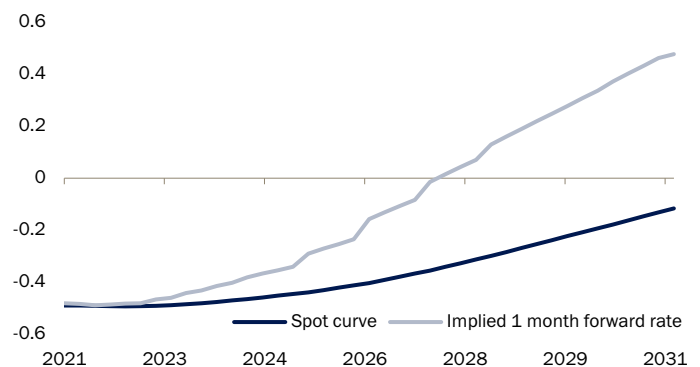
In our view, money markets should react positively to this week's statement. Right now, they are priced for an increase in the refinancing rate of 10bp over the coming three years and for 25bp over the coming five years. While five years is a long period for any forecast, we don't see any interest rate hikes within three years from now.

Exhibit 1: Our euro area inflation forecast



Source: Macrobond, Bank J. Safra Sarasin, 22.07.2021

Exhibit 2: Current money market rates



Source: Macrobond, Bank J. Safra Sarasin, 22.07.2021

**President Lagarde stressed that it would be too early to discuss whether the Asset Purchase Programme (APP) could be increased after the PEPP might run out next March**

No changes were made to the monthly purchases of the Pandemic Emergency Purchase Programme (PEPP) – consistent with the view that the ECB assessed incoming information on the inflation outlook and financing conditions in line with its assessment in June. The next meeting will take place on September 9.



## European Fixed Income

### Another dovish tilt by the ECB

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The ECB's new inflation target and strengthened forward guidance is a clear commitment to maintain a highly accommodative monetary policy for an extended period of time. The potential end to the Pandemic Purchase Programme (PEPP) next year should not constitute an obstacle to providing ample monetary accommodation. We expect euro area real rates to remain at record low levels along with higher inflation expectations and a steeper yield curve. Euro area peripheral markets should be well supported.

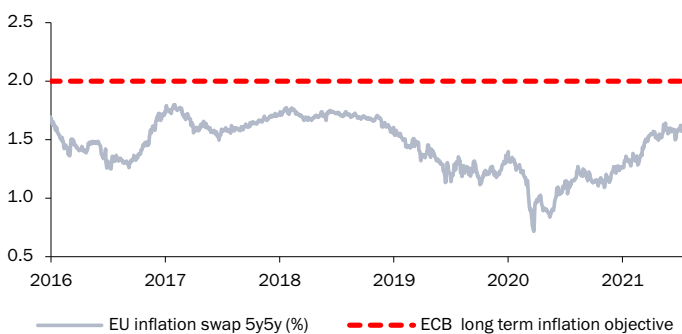
#### A symmetric inflation target and a new forward guidance for rates

On July 8 2021, the ECB announced the introduction of its symmetric inflation target of 2%, which does not explicitly aim to overshoot the inflation objective, but tolerates a period of above-target inflation rates. However, despite an increase in longer-term inflation expectations since the onset of the COVID pandemic, market-based measures are substantially below the ECB's target (Exhibit 1). Consequently, the ECB has strengthened its forward guidance for policy rates, with a clear commitment to *maintain a persistently accommodative monetary policy stance* until the objective is reached.

#### Expect a continuation of current policies for an extended period of time

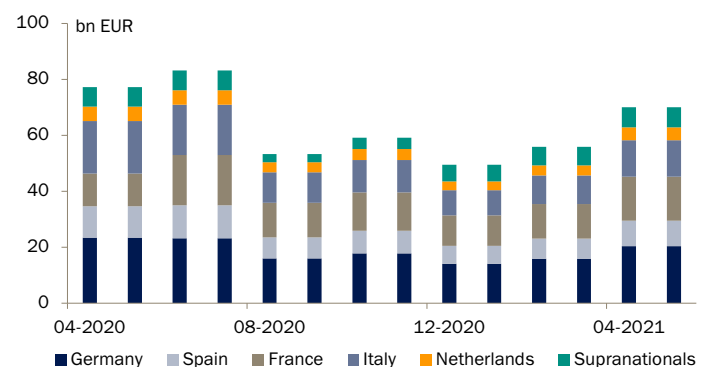
Forward guidance on policy rates and the substantial purchases of public sector bonds have pushed real yields to record low levels and so far caused inflation expectations to pick up along with steeper yield curves. It has also tightened peripheral and credit spreads, allowing for an efficient transmission of monetary policy to the whole of the euro area. As inflation expectations are still well below target, the achievement of the symmetric 2% objective will require current policies to run for an extended period of time.

**Exhibit 1: Long-term inflation expectations still below the ECB's target**



Source: Bloomberg, Bank J. Safra Sarasin, 21.07.2021

**Exhibit 2: PEPP was the main driver for asset purchases since 2020**



Source: Bloomberg, Bank J. Safra Sarasin, 21.07.2021

#### Should PEPP purchases end in March 2022, the regular APP will have to take over

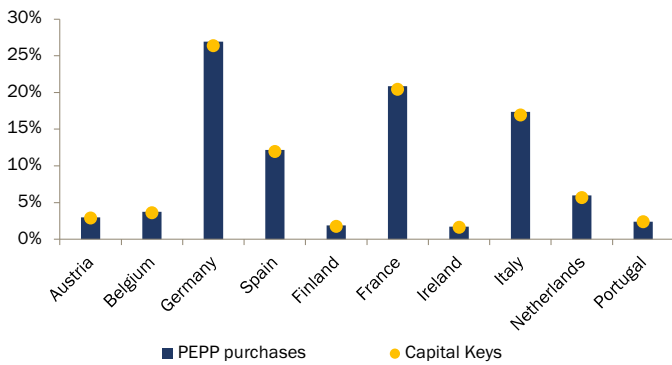
The *Pandemic Emergency Purchase Programme* (PEPP) has borne the brunt of asset purchases since its introduction in March 2020. It will run at least until March 2022 depending on the progress in the fight against the COVID-pandemic. The average monthly PEPP purchase volumes since April 2020 have averaged roughly 75bn EUR over all euro area countries while the regular Asset Purchase Programme (APP) is currently limited to only 20bn per month (Exhibit 2). The ECB's strengthened forward guidance implies that asset purchases will be maintained at a rapid pace even after PEPP has been phased out. As we have already noted (see our Cross Asset Weekly "*Reducing PEPP purchases without collateral damage*", 21<sup>st</sup> May 2021), we expect the envelope of the APP to be increased substantially to make up at least in part for the absence of PEPP purchases.



## A termination of PEPP will not be an obstacle to providing continued monetary accommodation

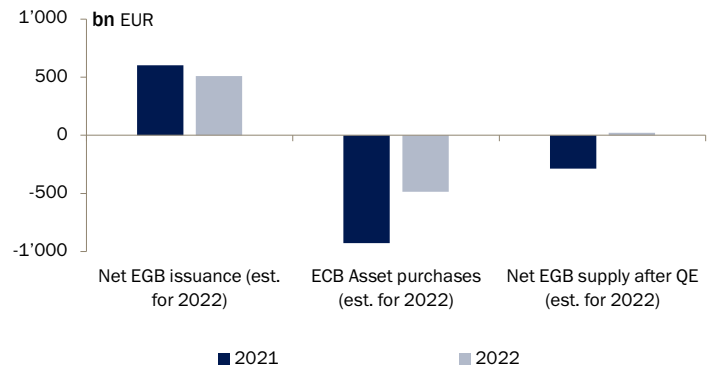
Given the size and the almost unlimited flexibility of the PEPP program, it is obvious that even with an upsized APP envelope, it will be a challenge to fully compensate for the absence of PEPP purchases. In 2020 and 2021, the ECB purchased substantially more than total net European government bond (EGB) issuance, effectively removing outstanding government bonds from the market. The APP provides less flexibility for the ECB as it comes with more restrictions such as issuer limits. Yet, maintaining capital keys has not been an area of contention for PEPP, in fact, purchases were closely aligned to the capital keys (Exhibit 3). A back-of-the-envelope calculation suggests that a 40bn to 50bn monthly purchase volume of an upsized APP – coupled with expected smaller EGB issuance in 2022 – would still allow the ECB to take up new all net EGB issuance next year, thus providing significant monetary support while complying with restrictions (Exhibit 4). Moreover, the ECB has acted in a decisive and flexible manner within its mandate when it has seen the need to do more. Therefore, an end to PEPP will not be an obstacle to providing continued monetary accommodation.

Exhibit 3: PEPP purchases closely aligned to required capital keys



Source: ECB, EA Treasuries, Bank J. Safra Sarasin, 21.07.2021

Exhibit 4: APP can be easily upsized to take up all 2022 EGB issuance

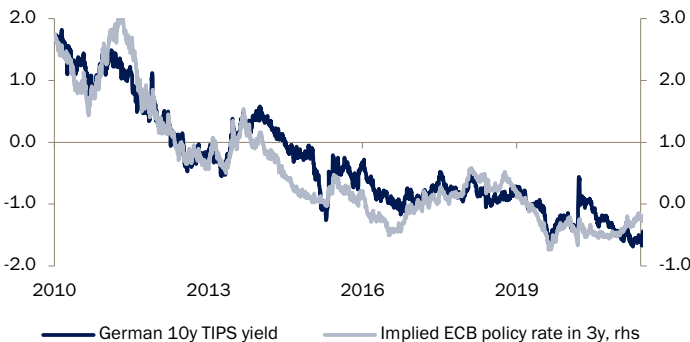


Source: ECB, Bank J. Safra Sarasin, 21.07.2021

## Higher inflation expectations and somewhat steeper yield curves in the euro area

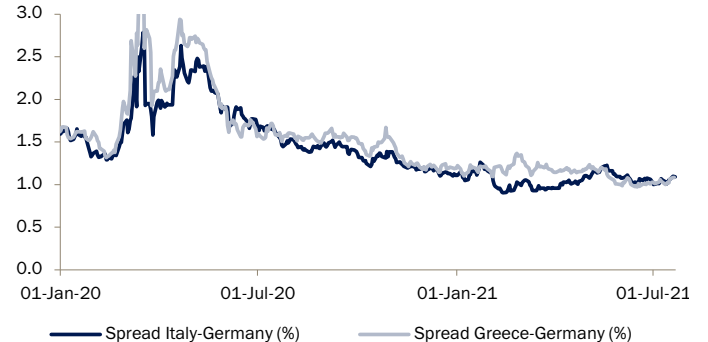
The ECB has given a clear commitment to maintain a highly accommodative monetary policy for the foreseeable future and has underlined the need for *forceful and persistent monetary action to avoid negative deviations from the long-term inflation target*. We expect real rates to remain at record low levels for the next 6 to 12 months and we see potential for higher inflation expectations along with a steeper yield curve. Peripheral markets should continue to be well supported (Exhibits 5, 6).

Exhibit 5: Strengthened forward guidance should keep real yields low



Source: Bloomberg, Bank J. Safra Sarasin, 21.07.2021

Exhibit 6: The euro area periphery should be well supported



Source: Bloomberg, Bank J. Safra Sarasin, 21.07.2021



## Economic Calendar

### Week of 26/07 – 30/07/2021

Country	Time	Item	Date	Unit	Consensus	
					Forecast	Prev.
<b>Monday, 26.07.2021</b>						
JN	02:30	Jibun Bank Japan PMI Manf.	Jul P	Index	--	52.4
GE	10:00	IFO Expectations	Jul	Index	--	104.0
US	16:30	Dallas Fed Manf. Activity	Jul	Index	32.1	31.1
<b>Tuesday, 27.07.2021</b>						
US	16:00	Conf. Board Present Situation	Jul	Index	--	157.7
	16:00	Conf. Board Expectations	Jul	Index	--	107.0
	16:00	Richmond Fed Manf. Index	Jul	Index	22.0	21.0
<b>Wednesday, 28.07.2021</b>						
GE	08:00	GfK Consumer Confidence	Jul	Index	--	-0.3
FR	08:45	Consumer Confidence	Jul	Index	--	102.0
US	13:00	MBA Mortgage Applications	Jul 23	mom	--	-4.0%
	20:00	FOMC Rate Decision (upper band)	Jul 28	%	0.25%	0.25%
	20:00	Interest Rate on Excess Reserves	Jul 28	%	--	0.15%
<b>Thursday, 29.07.2021</b>						
GE	14:00	CPI EU Harmonised MoM	Jul P	mom	--	0.4%
	14:00	CPI EU Harmonised YoY	Jul P	yoy	--	2.1%
US	14:30	Core PCE QoQ	2QA	qoq	6.0%	2.5%
<b>, 30.07.2021</b>						
EU	11:00	CPI Core YoY	Jul P	yoy	--	0.9%

Source: Bloomberg, J. Safra Sarasin as of 22.07.2021



## Market Performance

### Global Markets in Local Currencies

<b>Government Bonds</b>	<b>Current value</b>	<b>Δ 1W</b>	<b>Δ YTD</b>	<b>TR YTD in %</b>
Swiss Eidgenosse 10 year (%)	-0.36	-6	19	-0.7
German Bund 10 year (%)	-0.41	-6	16	-0.7
UK Gilt 10 year (%)	0.57	-6	35	-2.6
US Treasury 10 year (%)	1.28	-1	36	-1.8
French OAT - Bund, spread (bp)	34	0	11	
Italian BTP - Bund, spread (bp)	105	-1	-6	

<b>Stock Markets</b>	<b>Level</b>	<b>P/E ratio</b>	<b>1W TR in %</b>	<b>TR YTD in %</b>
SMI - Switzerland	11'977	19.0	0.0	15.0
DAX - Germany	15'515	14.9	-0.7	13.1
MSCI Italy	788	13.6	-0.3	10.5
IBEX - Spain	8'622	17.7	1.1	8.6
DJ Euro Stoxx 50 - Eurozone	4'059	17.9	0.1	16.6
MSCI UK	1'959	13.1	-0.8	10.5
S&P 500 - USA	4'367	22.6	0.2	17.2
Nasdaq 100 - USA	14'940	30.1	1.0	16.4
MSCI Emerging Markets	1'326	14.0	-1.6	4.0

<b>Forex - Crossrates</b>	<b>Level</b>	<b>3M implied volatility</b>	<b>1W in %</b>	<b>YTD in %</b>
USD-CHF	0.92	5.9	0.1	4.4
EUR-CHF	1.08	3.9	-0.2	-0.1
GBP-CHF	1.27	6.7	0.0	5.4
EUR-USD	1.18	5.4	-0.3	-4.3
GBP-USD	1.38	6.9	-0.1	1.0
USD-JPY	110.3	5.6	0.2	6.9
EUR-GBP	0.86	5.5	-0.2	-5.2
EUR-SEK	10.22	4.8	-0.2	1.4
EUR-NOK	10.42	8.5	-0.4	-0.8

<b>Commodities</b>	<b>Level</b>	<b>3M realised volatility</b>	<b>1W in %</b>	<b>YTD in %</b>
Bloomberg Commodity Index	96	18.5	1.3	23.2
Brent crude oil - USD / barrel	73	34.1	-1.4	43.8
Gold bullion - USD / Troy ounce	1'808	12.6	-1.2	-4.6

Source: J. Safra Sarasin, Bloomberg as of 22.07.2021





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— SUSTAINABLE ASSET MANAGEMENT —



# Cross-Asset Weekly

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