



MORNING BRIEFING

September 14, 2021

Global Tapering Ahead?

Check out the accompanying [chart collection](#).

(1) Central bankers are the new Wild Bunch. (2) Since start of pandemic, major central bank assets up 51%. (3) Major central bank assets growing at slower pace. (4) Add that to the stock market's worries list. (5) Is ECB tapering or recalibrating? (6) ECB's LTRO facility is a big hit. (7) ECB is also struggling with whether inflation is transitory or persistent. (8) BOJ preparing to end Kuroda's excellent adventure. (9) PBOC likely to cut required reserves ratio. (10) Fed setting the stage for tapering before year-end.

Central Banks I: The Wild Credit Bunch. The Great Virus Crisis (GVC) started on March 11, when the World Health Organization declared that Covid-19 had turned into a pandemic. Credit markets froze around the world. A worldwide credit crunch spread faster than the pandemic. It was feared that the GVC would quickly eclipse the calamity that was the Great Financial Crisis (GFC). There was a mad dash for cash in late February and the first two weeks of March.

The major central banks had learned some emergency responses for dealing with a calamity during the GFC. They quickly responded to the GVC by flooding the global financial system with liquidity. The Fed did so with QE4ever on March 23. The European Central Bank (ECB) announced its Pandemic Emergency Purchase Programme (PEPP) on March 18. The Bank of Japan (BOJ) announced its measures to maintain order in the financial system in light of Covid-19 on March 26.

The result has been a flood of liquidity, as evidenced by the surging of the three central banks' total assets, which jumped \$8.3 trillion from \$16.2 trillion during the week of March 23, 2020 to a record-high \$24.5 trillion at the end of August ([Fig. 1](#)). Over this period, the assets of the three central banks increased as follows: Fed (\$3.1 trillion to \$8.3 trillion), ECB (\$4.1 trillion to \$9.6 trillion), and BOJ (\$1.1 trillion to \$6.6 trillion) ([Fig. 2](#)).

If you want to add to your worry list for the stock market, then look at the yearly growth rate in the total assets of the three central banks ([Fig. 3](#)). It has fallen abruptly from a peak of 58.2% during the February 19 week of this year to 16.8% at the end of August, which is still relatively high. Further declines are likely if the Fed joins the ECB in tapering asset

purchases; the ECB announced last week it's time to start tapering.

However, the growth rate in the combined balance sheets of the three central banks doesn't seem to work very well as a market-timing tool. On the other hand, the level of this combination has shown a tendency to correlate well with the level of the S&P 500 ([Fig. 4](#)). While the sum of the assets of the central banks may grow more slowly up ahead, it isn't likely to fall anytime soon.

The S&P 500 has experienced two "tapering tantrums," or declines in the price index resulting from investor panic over prospects of the Fed's tapering the pace of its asset purchases. One was during the spring of 2013, when the index fell 5.8%, and the other was during the fall of 2018, when it fell 19.8% ([Fig. 5](#)). The S&P 500 has exceeded its 200-day moving average by at least 10% since early this year ([Fig. 6](#)). So it may be overdue for a brief tantrum that could be triggered on September 22.

As Melissa and I noted yesterday, "Mark September 22 on your calendar. That's the day when the FOMC will release its latest 'Summary of Economic Projections' (SEP). We expect that at least 10 of the participants will project a rate increase next year, up from seven in June's dot plot. We also expect that the median inflation forecast will be raised for 2021. It was 3.4% in June's SEP, up from 2.4% in March." (See our [FOMC Economic Projections](#).)

In addition, we expect that the FOMC will vote to start tapering at that meeting if today's CPI for August blows a hole in Fed Chair Jerome Powell's thesis that the recent surge in inflation is transitory. As we also noted yesterday, August's PPI for personal consumption doesn't augur well for that month's CPI and PCED. If today's CPI news is relatively benign, then the FOMC might signal that they'll wait until their November 2-3 meeting to start tapering. By then, they will have September's employment report and September's inflation readings in hand.

Central Banks II: ECB Is Recalibrating. The latest meeting of the ECB's Governing Council was held last week on Thursday. The group voted to maintain the interest rate on the ECB's main refinancing operations at 0.00%, on the marginal lending facility at 0.25%, and on the deposit facility at -0.50%. "Based on a joint assessment of financing conditions and the inflation outlook, the Governing Council judges that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the [PEPP] than in the previous two quarters," the ECB said in a [statement](#).

The PEPP was implemented in March 2020 to counter the negative impact of the pandemic

on the Eurozone economy and financial system. It is due to end in March 2022 at a value of around €1.85 trillion. Here's more on the ECB and developments in the Eurozone:

(1) *ECB's version of QE4ever.* In a press conference on Thursday after the meeting, ECB President Christine Lagarde said the verdict was a “unanimous decision in all respects.” She said that the ECB wasn't tapering, but rather “recalibrating.” Meanwhile, the asset purchase program (APP)—which is being used in combination with PEPP to support the 19 member countries' economy—will continue at a monthly pace of €20 billion: “The Governing Council continues to expect monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates,” the statement said.

In addition to buying bonds, the ECB has also pumped up lending to Eurozone credit institutions with long-term refinancing operations (LTROs). LTROs provide low-interest-rate funding to Eurozone banks, with sovereign debt as collateral on the loans. The loans are offered monthly by the ECB and are typically repaid in three months, six months, or one year. They've soared by €1.4 trillion since the end of March 2020 to €2.2 trillion at the start of September ([Fig. 7](#) and [Fig. 8](#)).

(2) *ECB's inflation debate.* The Eurozone's CPI increased by 3.0% y/y during August, according to preliminary estimates published last Tuesday, after rising by 2.2% in July ([Fig. 9](#)). If the August figure is confirmed in a few weeks' time, it would represent the highest inflation reading for 10 years. This comes after Germany reported on Monday of last week its highest consumer prices since 2008, with a headline inflation rate of 3.4% in August. France also reported its highest inflation rate in nearly three years on Tuesday ([Fig. 10](#)).

On the ECB's Governing Council, as on the Fed's FOMC, there are doves who believe that the rebound in inflation is transitory and hawks who worry that it might be more persistent. Yannis Stournaras is a member of the Council and the Governor of the Bank of Greece. He is a dove. In a Bloomberg [interview](#) on September 1, he said, “According to most estimates, the recent jump in inflation is due to temporary factors related to various supply-side bottlenecks caused by the pandemic.” Klaas Knot and Robert Holzmann are two hawks on the Council who want the ECB to slow the pace of bond buying in Q4, reflecting the region's improving economy.

(3) *Consumer-led recovery in the Eurozone.* The Eurozone's real GDP grew more than initially estimated for Q2—by 2.2% q/q and 14.3% y/y ([Fig. 11](#)). That's in line with the 12.2% y/y rebound in US real GDP during Q2. The August 30 *FT* [reported](#): “This summer's

resurgence of coronavirus cases across the eurozone has had little impact on the bloc's economic recovery, according to unofficial data which suggest that European consumers are driving the rebound." Apparently, the Delta variant hasn't been as painful as feared in Europe, economically at least. Europeans, like Americans and other people around the world, are going about their lives and business despite the pandemic. August's PMIs remained elevated, with the C-PMI at 59.0, the M-PMI at 61.4, and the NM-PMI at 59.0 ([Fig. 12](#)).

Central Banks III: BOJ Starts Retreating. The BOJ may be on course to unwind its ultra-easy monetary policies over the next couple of years. That's according to a September 13 Reuters [article](#) titled "After the 'bazooka', Bank of Japan dismantles the work of its radical chief." Here is the gist of the story:

"After years of shock-and-awe stimulus, the Bank of Japan is quietly rolling back radical policies introduced by its bold chief Haruhiko Kuroda and pioneering controversial new measures that blur the lines between central banking and politics. The unwinding of Japan's complex policy is driven by Deputy Governor Masayoshi Amamiya, insiders say, a career central banker considered the top contender to replace Governor Kuroda whose term ends in 2023."

The BOJ took a very tiny first step toward normalizing monetary policy when its Policy Board met on March 19 and voted to allow long-term interest rates to move up and down by 0.25% around its 0% target, instead of by the implicit band of plus or minus 0.2%. The committee also decided to remove explicit guidance about the BOJ's purchases of exchange-traded funds (ETFs). Instead, such purchases would be more "flexible and nimble." On the other hand, the BOJ adopted a new scheme similar to that of the ECB's LTRO program, under which it pays interest of up to 0.2% to financial institutions that tap its loan programs.

Based on interviews with various insiders, the Reuters article reported that these measures pave the way for an eventual retreat from Kuroda's policies. "While that intention was hidden from markets, it would mark a symbolic end to Kuroda's bold experiment based on the text-book theory that forceful monetary action and communication can influence public price expectations and drive inflation higher." The textbook theory hasn't worked in Japan.

Data through the week of August 27 show that the BOJ's assets and holdings of long-term government bonds (both in yen) are still rising to record highs, but the pace of increase has slowed sharply since the week of December 18 ([Fig. 13](#)).

Central Banks IV: PBOC Expected To Ease. While the Fed, ECB, and BOJ all are talking about talking about tapering, the People's Bank of China (PBOC) is expected to ease credit conditions in response to the slowing of China's economy as a result of high raw material costs, new Covid-19 outbreaks, and floods.

The PBOC delivered a surprise cut in bank reserve requirements during July ([Fig. 14](#)). Another one is likely before the end of this year. In mid-August, the PBOC also injected billions of yuan through medium-term lending facility (MLF) loans into the financial system. The PBOC isn't expected to reduce interest rates because inflationary pressures are rising in the property market and in producer prices.

Over the past 12 months through August, Chinese bank loans are up \$3.1 trillion to a record-high \$29.0 trillion ([Fig. 15](#) and [Fig. 16](#)).

Central Banks V: In the Fed We Trust. The *WSJ* assigns one of its top reporters to watch the Fed. A few years ago, Jon Hilsenrath was the guy. Now it's Nick Timiraos. Fed officials often have set the stage for their next policy move by "planting" the story with the *WSJ*. On Friday, September 10, Nick wrote an [article](#) titled "Fed Officials Prepare for November Reduction in Bond Buying."

Fed officials clearly are doing everything they can to avoid a tapering tantrum. We think that they will succeed. The *WSJ* article reported that the FOMC is likely to discuss tapering at its September 21-22 meeting and vote to do so at the November 2-3 meeting. "Under the plans taking shape, officials could reduce those purchases at a pace that allows them to conclude asset buying by the middle of next year." That certainly sounds like an off-the-record comment by somebody high up at the Fed.

Melissa and I have opined in recent weeks that the FOMC should get started with tapering so that they can end doing so before interest rates might have to be raised in the event that inflation is less transitory and more persistent than Fed officials expected. The *Journal* article observed: "Fed officials have indicated they don't want to be in a position where they are still increasing their \$8.4 trillion asset portfolio when an interest-rate increase might be needed to keep inflation in check."

Calendars

US: Tues: Headline & Core CPI 5.3%/4.2% y/y, NFIB Small Business Optimism, EIA Monthly Report. **Wed:** Headline & Core Industrial Production 0.4%/0.4%, Capacity Utilization Rate 76.4%, Empire State Manufacturing Index 18.0, Import & Export Prices 0.3%/0.4%, MBA Mortgage Applications, Crude Oil Inventories. (Bloomberg estimates)

Global: Tues: UK Employment Change & Unemployment Rate 75k/4.6%, UK Average Earnings Including & Excluding Bonus 8.2%/6.8% y/y, Spain CPI 0.4%/m/m/3.3%/y/y, Japan Industrial Production, Japan Core Machinery Orders 3.1%/m/m/15.7%/y/y, China Industrial Production 5.8% y/y, China Retail Sales 7.0% y/y, China Fixed Asset Investment 9.1% y/y. **Wed:** Eurozone Industrial Production 0.6%/m/m/6.3%/y/y, France CPI 2.4% y/y, Italy CPI 2.1% y/y, UK Headline & Core CPI 2.9%/2.9% y/y, UK PPI Input & Output 10.3%/5.4% y/y, Canada CPI 3.9% y/y, Australia Employment Change -90k, Australia Unemployment & Participation Rates 4.9%/65.7%, RBA Bulletin, Schnabel, Lane, Balz. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): All three of these had forward earnings at a record high last week. LargeCap's was at a record high for a third week after being out briefly in early August following Amazon's negative earnings guidance. MidCap's was at a record high for a 31st straight week, and SmallCap's was at a record after dropping a week earlier for the first time in 26 weeks. In what has shaped up to be an extraordinary V-shaped recovery, LargeCap's forward earnings has risen during 67 of the past 69 weeks, with the two down weeks due to Tesla's addition to the index last December and Amazon's earnings shortfall in August. MidCap's is up in 65 of the past 67 weeks, and SmallCap's posted 64 gains in the past 68 weeks. Forward earnings for these indexes had been on an uptrend from November 2019 until February 2020, before tumbling to a bottom by June 2020 due to the Covid-19 economic shutdown. LargeCap's forward earnings has risen 52.1% from its lowest level since August 2017; MidCap's is now up 98.0% from its lowest level since May 2015; and SmallCap's has soared 155.6% from its lowest point since August 2013. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the yearly rate of change in LargeCap's forward earnings was 37.6%, down from a record-high 42.2% at the end of July. That's up from -

19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings fell w/w to 66.4% y/y from 67.8%. That's down from a record high of 78.8% at the end of May and up from a record low of -32.7% in May 2020.

SmallCap's rate dropped to 98.8% from 101.8%; it's down from a record high of 124.2% in late June and up from a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' y/y earnings growth forecasts for 2021 to improve instead of decline as is typical. Here are the latest consensus earnings growth rates for 2021 and 2022: LargeCap (44.0%, 9.6%), MidCap (74.5, 6.6), and SmallCap (112.4, 13.6).

S&P 500/400/600 Valuation ([link](#)): Valuations were little changed last week for all three of these indexes, and they remain close to their multi-month lows. LargeCap's forward P/E dropped 0.4pt w/w to 20.8, just 0.1pt above its eight-month low of 20.7 at the end of July. LargeCap's forward P/E compares to a 19-year high of 22.7 in early January and is up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's fell 0.4pts to a 17-month low of 16.4. That compares to a seven-month high of 20.5 in early March and is 6.5pts below its record high of 22.9 in June 2020. SmallCap's tumbled 0.6pts w/w to a 17-month low of 15.4. It's now down 11.3pts from its record high of 26.7 in early June 2020. During March 2020, MidCap's 10.7 and SmallCap's 11.1 were their lowest readings since March 2009. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017. SmallCap's P/E was below LargeCap's for a 49th week. That's the longest stretch at a discount since 2002-03; SmallCap's current 26% reading is its biggest since 2001. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 13th straight week; SmallCap's current 6% discount is near its biggest since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): Since the Q2-2020 earnings season—which came in substantially better than greatly reduced forecasts—analysts as a whole have been raising their consensus forecasts for all future quarters instead of lowering them as is the norm. Those gains have endured even through the earnings warnings season, when forecasts typically decline. In the latest week, the S&P 500's Q3-2021 blended earnings-per-share estimate remained steady at \$49.21. That \$49.21 estimate for Q2-2021 represents a gain of 27.2% y/y on a frozen actual basis and a 29.8% y/y gain on a

pro forma basis. That would mark a third straight quarter of double-digit percentage growth and compares to a pro forma gain of 95.6% in Q2-2021. All 11 sectors are again expected to post positive y/y earnings growth during Q3-2021. Here are the S&P 500 sectors' latest expected earnings growth rates for Q3-2021 versus their final Q2-2021 growth rates: Energy (1,435.5% in Q3-2021 versus 244.4% in Q2-2021), Materials (93.1, 139.2), Industrials (86.8, 698.1), S&P 500 (29.8, 95.6), Information Technology (28.4, 49.5), Communication Services (23.9, 73.1), Financials (18.5, 156.7), Real Estate (17.8, 38.8), Health Care (14.1, 26.4), Consumer Discretionary (9.9, 370.1), Consumer Staples (2.4, 20.4), and Utilities (0.5, 12.7).

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