Monthly Newsletter
Savings and Investments

Inflation data cooled down market optimism, but only for a moment

2021 June

Market overview

As the inflation topic became more and more popular, investor optimism somewhat eased in May, leading to increased market volatility and negative stock returns in the first half of the month. However, after the initial shock equity indices recovered the losses and continued to rise.

As expected, market participants received news of a sharp jump in US year-on-year inflation numbers. Although high inflation was expected given last year's low price base, announced inflation data in the US exceeded many analysts' expectations. In April alone, the price level in the US rose by 0.8 percent (expected 0.2 percent), and the annual inflation rate jumped 4.2 percent (expected at 3.6 percent) and was the highest since 2008. In addition to the already mentioned low price base effect, inflation was also strongly influenced by rising commodity prices, still recovering supply chains and, as a result, rising transportation costs. However, inflation is expected to get slightly lower in the coming months, leading to a calmer period in financial markets. If inflation growth slows in the summer, investors will again turn their attention to the global economic recovery story and improving global pandemic situation. The easing of constraints by governments in many countries is increasing consumer mobility and spending, and this will undoubtedly have a huge positive impact on both companies' financial performance and public finances. With the lifting of restriction measures, the hardest-hit sectors of the economies are also gradually returning to normal, leading to a sharper decline in unemployment rates. For example, In the US and Europe, unemployment has dropped to 5.8 and 8.0% respectively. Due to the rapidly recovering consumption and growing demand, PMI manufacturing index (representing moods and expectations in the manufacturing sector) rose for the fourth month in a row and is currently at the highest level since 2010. True, the rapidly recovering demand predicts a highly working (and profitable) phase for many U.S. and European business sectors, but developing countries are still struggling with the pandemic and are lagging far behind. This can also be seen from the changes in financial market indices - since the beginning of the year, both emerging market equities and bonds have lagged far behind developed country indices. On the other hand, the situation in developing countries is also improving due to the acceleration of vaccination.

Pressure on the US Federal Reserve (FED) has also eased in recent weeks as long-term interest rates in the US have stabilized and even drifted lower. There was no other major news related to the major central banks in May, so their monetary policy will also remain a favorable factor for financial markets. Although the markets are slowly starting to speculate when the Fed will start talking about tapering the bond-buying program. It is estimated that the Fed chairman J. Powel may mention this as early as in the third quarter. Still, monetary policy should not change significantly until there are clear signals of a recovering labor market.

Stock market indexes' performance (until 31st May 2021)

Region	Index	Currency	May 2021	2021 YTD	3 months	1Y	3Y	5Y
World	MSCI World	EUR	-0,1%	11,5%	8,90%	32,06%	42,97%	77,10%
World	MSCI Emerging Markets	EUR	0,7%	7,3%	2,54%	36,31%	25,86%	74,38%
US	S&P 500	USD	0,5%	11,9%	10,31%	44,35%	55,40%	100,49%
Europe	MSCI EURO	EUR	2,0%	13,8%	11,13%	39,00%	16,21%	33,73%
Eastern Europe	MSCI EM Eastern Europe	USD	9,3%	13,9%	14,63%	36,89%	16,85%	51,01%
Asia	MSCI EM Asia	USD	1,1%	5,5%	0,29%	49,05%	29,35%	88,23%
Latin America	MSCI EM Latin America	USD	7,8%	4,4%	15,61%	53,24%	-0,03%	25,59%

Expectations

Economic recovery. The reopening up of the world economy to unprecedented stimulus by governments and central banks will lead to a continued rapid economic recovery. As one of the world leaders in vaccination process, the U.S. economy this year and the next will grow at the fastest pace since the 1980s. Economic development in the rest of the world will lag slightly and is likely to gain momentum at the end of the year.

Our GDP forecasts. With governments lifting more and more constraints it is expected that global economy will gather a strong pace in the second half of the year. The US economic growth forecast for this year is 6.5%. Next year, the world's largest economy is expected to grow by about 4%. The euro area region's economy is expected to grow by around 3.8% this year and a little more (about 4.2%) next year. Baltic economies, which have shown impressive resilience last year, are expected to continue to outpace the euro area, with the Baltic economies expected to grow by around 4.1% this year and 4.4% next year.

This year's risks. Perhaps the most important risk in the near future remains accelerating inflation. Although the recent rise in inflation is explained by last year's low-price base and the incomplete recovery of the global supply chain, there is still a possibility that significant increases in household savings and opening economies could lead to longer term higher inflation. This could change the highly market- and economy-friendly central banks' policies. The COVID-19 virus pandemic situation is steadily improving which means lower risk for global economic health and financial markets.
