The Federal Reserve's brake

Perhaps the awakening of Europe

By now we have to get used to at least two types of inflation (price increases). The one in the real economy and the one involving financial assets. Two worlds that in recent months have exasperated their distance. With the COVID-19 many economies have been quarantined, blocked, unable to produce profits. Unemployment, which has risen dramatically in many countries, has stopped the demand for goods and services and consequently inflation. The stock markets, on the other hand, have made prodigious recoveries since their lows in March. The NASDAQ, the index of the new economy, has even reached new highs. It is clear that it was the central banks that artificially inflated financial assets. They have succeeded well and quickly. For a long time there has been talk of “helicopter money” in the event of a new financial crisis, assuming the distribution of money in sprinklers to support demand. And this has - to a certain extent - been the case, especially in better organised countries such as Switzerland, Germany, but also the United States. It was not only the banks that were affected: the financial system, unlike the crisis of 2008, was not in urgent danger. The central banks' extraordinary financial measures were enriched by new approaches: the Federal Reserve, for example, buys high-yield (high-risk) bonds, even if only those that lost their reliability rating as a result of the crisis. But central banks, especially the American one, are used to seeing excesses spill over to stock exchanges. In the last decade they have tried several times, with persuasive verbal threats, to discourage the excessive recourse to the magic of the self-feeding stock exchanges. When they have then prepared punctual interventions (reducing the purchase of bonds, for example), they have often had to backtrack. The pandemic is much more treacherous than the crises of the last twenty years, because it involves not only the risk (which in finance can be measured), but the uncertainty, this yes, incalculable. So, the central banks have exaggerated in the means made available,

promising not to stop, even after the emergency. It was a boon for speculators, especially for the smallest (retail), who have hijacked, with online trading, part of the aid received, on the stock exchanges: just see what happened to the failed Hertz, whose stock was revived by unexpected purchases. The professionals, however, precisely because they are more attentive to the fundamentals, have pursued more palpable growth expectations, such as those promised by technology stocks and pharmaceuticals.

But the last two Federal Reserve interventions seem to give a signal to markets and speculators. The first, the loosening of the *Volcker Rule*, which limits speculative investments by banks that do not benefit customers, has been welcomed by the markets. But immediately afterwards, the issuing institution headed by Jerome Powell decided that the big banks must suspend buybacks (buy-back of own shares) and limit the payment of dividends. In the coronavirus business environment, banks risk finding themselves at the limits of the minimum capital required for their business. But they are not in immediate danger. The FED is saying that it will not accept excessive inflation of financial assets: could it generalize the limits to buybacks that have contributed so much to financial inflation over the last decade? The issuing institution is certainly ready to support the stock exchanges. It cannot do without them. But it wants financial flows to support demand and production in the real economy, at least in part. This time it is not alone in defending the functionality of the system, there’s also the government. FED margins are therefore wider. The warning must be taken seriously: the pace of stock market appreciation must slowdown in order to be achieved by the recovery in demand in the real economy and some signs of healthy inflation.

After the strong rally in March, the summer could at best be a phase of consolidation. But now there are many dangers, especially in the United States: recovery of the pandemic, presidential election, trade war with China. It is therefore to be assessed, while remaining invested, the tactical reduction of the equity sector that has grown too fast, parking liquidity in bonds and gold waiting for the signals of the real economy to mark a new start of the bull market. The FED wants it: don't fight the FED.

The signals of a restart of the European integration process could feed some imagination, even in summer, starting from a first strengthening of the euro against the dollar. But this is happening in a context of growing global risks. And we know that without the help of Wall Street, the cruising speed of the other markets is unlikely to increase much. Yes, to Europe and the euro, but with caution.