The Political Consequences Of Reflation In 2024:
Reflationary Induced Inflation Shakes Status Quos Of Germany, US & Asia

Portfolio Attribution

14 November 2024 | HFI#861

Stirling Larkin, CIO

The global reflationary policies implemented since March 2020 in response to the COVID-19 pandemic have triggered a seismic shift in the political landscape across major economies in 2024. These measures, while initially successful in stabilising and reviving economies, ultimately led to persistent inflationary pressures that eroded public trust in incumbent governments worldwide.

Cite:- The Sino-J'AUKUS Great Pacific War: Triggered By '26/'27 Inflation Resurgence & MMT, 28 June 2024

Cite:- More Money Will Be Made In Financial Markets In The Next Two Years Than The Past Twenty Combined: Reflation, Cost Of Capital & Pricing Systematic Risks, 23 November 2020

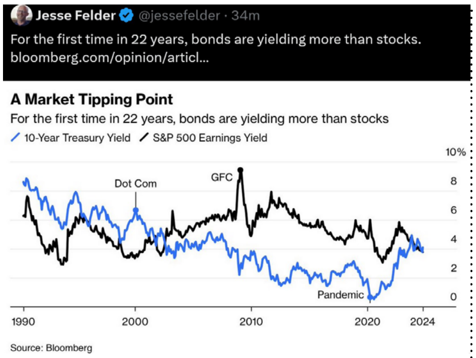
The recent victory of Donald Trump in the US presidential election last week underscores the complex interplay between economic recovery and political consequences. While reflation-induced inflation played a significant role in shaping the electoral outcome, it's important to acknowledge that other factors also contributed to Trump's victory over Harris and the Democrats. These may have included concerns over border security, energy policies and shifting social dynamics. Nevertheless, the economic impact of reflationary policies remained a central issue in the campaign. Since the start of October, markets have priced one of the largest month-on-month reflationary shifts across assets since 2000, with equities and other cyclical trades rallying alongside rising bond yields. Initially, this reflationary repricing was driven by more positive macro surprises in the US – after growth concerns in the Northern Hemispheric summer – and it has been boosted by the Republican results in the US elections last week.

Cite:- The Reflationary Effect Of Muted QT: Evidencing The Stimulation Of Residual Printed Money, 27 February 2024

Cite:- The Unprecedented Reflation Supercycle: Big, Bold, Strategic Moves, Surreptitious Inflation & The Incandescence of "Swarm Trading", 22 February 2021

Remembering that Reflation is simply any expansion in the level of output of an economy by government stimulus, using either fiscal or monetary policies, the double-edged nature of these reflationary measures is evident in their impact on the US and global economies, while they undeniably contributed to economic recovery, they also sowed the seeds of their own political undoing through elevated inflation rates. This economic turbulence has triggered a domino effect of political casualties across North America, Europe, Asia, and beyond. During previous reflationary regimes over the past twenty years, there was a benefit from replacing bonds with alternative risk mitigation strategies in multi-asset portfolios – particularly by adding liquid alternatives and the Greenback (as the reserve currency). There was less of a strong case for equity-specific risk mitigation, with most short-term overlays underperforming and tailwinds from FOMC rate cuts and ongoing Emerging Market, or EM, central bank buying plus European bonds as diverging macroeconomic backdrops and potential trade tariffs likely supporting further bellwether US Treasury-Bund spreads widening.

Cite:- German-American Interest Rate Differentials: The Bundesbank's, ESG & A Federalised Europe, 8 August 2020



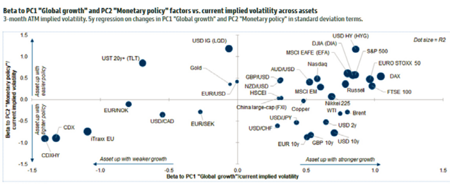
Source: Bloomberg

In the United Kingdom, the Conservative Party's once-commanding parliamentary majority has been reduced to the thinnest minority in the party's nearly two-century history. This dramatic shift can be largely attributed to public dissatisfaction with the government's handling of post-COVID economic challenges, particularly the cost-of-living crisis fueled by runaway inflation resulting from aggressive monetary and fiscal policies. Germany's governing coalition has collapsed under the weight of soaring unpopularity, as citizens grapple with rising prices and economic uncertainty. The European Central Bank's struggle to contain inflation while supporting economic recovery has contributed significantly to this political instability, reflecting the broader challenges faced by policymakers in managing the aftermath of reflationary measures. In France, Emmanuel Macron's party suffered a crushing defeat in parliamentary elections, reflecting widespread discontent with the government's economic policies and the erosion of purchasing power due to persistent inflation. The failure to effectively manage the inflationary pressures resulting from global reflationary measures has severely undermined public confidence in the incumbent government.

Cite:- Understanding Reflation & Central Bank Liquidity During A Taper Tantrum: 'Treasury Switches', FIMA Repo Facility & Other Market Microstructural Reforms Are Bullish For Eurozone, Japanese & US Blocs, 14 April 2022

South Korea witnessed a seismic shift in its political landscape, with the opposition party securing a landslide victory in parliamentary elections. This outcome was largely driven by public frustration with the government's inability to curb inflation and address economic disparities exacerbated by the post-COVID recovery and global reflationary policies.

Cite:- Seismic Shifts In 2019, 16 January 2019



Source: Bloomberg

Even Japan, known for its political stability with the Liberal Democratic Party, or LDP – governing almost uninterrupted since 1955 – saw the ruling party lose its House of Representatives majority. This unprecedented development is linked to growing public dissatisfaction with the government's economic policies, including its approach to inflation management and wage growth in the face of global inflationary pressures. These political upheavals across major economies underscore the profound impact of global reflationary policies and the subsequent inflationary pressures on public sentiment. The events of 2024, including Trump's victory in the US, demonstrate how the economic aftershocks of the COVID-19 pandemic and the challenges of managing inflation have reshaped political landscapes worldwide. While these policies initially helped to avert economic disaster and foster recovery, the price paid in terms of elevated inflation has ultimately led to a widespread rejection of incumbent governments, highlighting the delicate balance between economic stimulus and long-term stability.

Cite:- Evidencing The Continuation Of The Global Reflation Supercycle: Outlining Australians Proximity To The Money Multiplier And What Happens Next In The Pursuit Of Exceptional Investment Returns, 29 July 2021

There is also risk of a break from the current pro-risk reflation regime. Since 2000, there have been thirteen episodes with a similarly sharp month-over-month reflationary pricing; continued increases in bond yields might result in some reflation frustration for equities – more negative equity/bond yield correlations – equities should be able to digest higher bond yields as long as they are driven by better growth. That said, rising bond yields might eventually become a speed limit for equities if real yields start to increase (*vis-à-vis* real GDP growth expectations) or if increases in bond yields are too rapid. The anticipated resurgence of reflationary policies under President Trump's new term in 2025 portends significant implications for global economic dynamics. The potential reintroduction of unconventional monetary measures by the US Federal Reserve, such as Quantitative Easing, or QE, as early as Q2 2025, underscores the persistent macroeconomic challenges and the perceived necessity for continued stimulus. This monetary policy pivot, driven by the imperative to sustain economic growth and manage burgeoning sovereign debt, risks reigniting inflationary pressures in a manner reminiscent of the 1970s' double peak inflation experience.

Cite:- The Inexorable Effect Of Unconventional Monetary Experiments On Equity And Bond Prices: Contemporary State Capitalism & The 50-Year Jubilee Marking The End Of The Bretton Woods System (1970–1971), 5 July 2020

Cite:- Back To The 70's Inflation Pushes Sydney Out Of Reach, 12 September 2015

The specter of a renewed reflationary wave, led by the United States, could precipitate a global resurgence of inflationary pressures, creating a volatile macroeconomic environment with far-reaching geopolitical ramifications. The delicate equilibrium between stimulating growth and containing inflation presents a formidable challenge for central banks and policymakers worldwide. The indirect contribution of these economic policies to geopolitical instability cannot be understated: historical precedent suggests that economic stress often translates into political volatility, potentially leading to more aggressive foreign policies as governments seek to divert attention from domestic challenges. As policymakers navigate these treacherous economic waters, the lessons of the 1970s' stagflation era loom large. The double peak inflation experience of that decade serves as a stark reminder of the potential consequences of prolonged expansionary policies and the challenges of reining in entrenched inflationary expectations. Avoiding a similar scenario will require deft monetary management, international coordination and a delicate balance between short-term stimulus and long-term economic stability; **more a pipedream than a likely reality for the world we know is coming in 2025.**