



**R&R Weekly Column**  
**By Brunello Rosa**



## Central Banks Are Fighting Inflation Fears And Higher Bond Yields

Financial markets have been volatile during the past couple of weeks. Anti-Covid vaccination campaigns are attracting the attention of market participants, as the speed and effectiveness of the vaccination campaigns vary greatly around the world. In the US, President Biden managed to convince Johnson & Johnson (J&J), the producer of the last-approved anti-Covid vaccine, [to cooperate with Merck](#), its long-term arch-rival, to increase the production capacity of the new vaccine. This way, the US will have three domestically produced vaccines – by Pfizer-BioNTech, Moderna and J&J, respectively – available for its population. For this reason, Biden said that all adults in the US [may be given the chance of being vaccinated by May](#), which is two months earlier than had previously been expected. A similar success story is taking place in the UK, [where 21 million people](#) (more than 30% of the country's total population) have received at least the first dosage of a Covid vaccine.

Much less successful are the campaigns in the EU and Russia. In the EU, the limited availability of vaccines, a more vaccine-sceptical population, and logistical difficulties are making the beginning of the vaccination campaign extremely slow, with only around 5% of the EU population having received a first dosage. [The Commission may be blamed for the reduced availability of vaccines](#), as it wanted to negotiate on the price with the pharmaceutical companies, and its contracts were much less detailed, and hence enforceable, than those signed by the US and the UK. The limited supply has reached a point [that Italy has forbidden AstraZeneca to export vaccines to Australia](#), attracting [the criticism by UK PM Boris Johnson](#). Russia, meanwhile, is a peculiar case. Though having developed a vaccine much faster than its competitors (the notorious Sputnik vaccine), the [level of scepticism among the general population against something offered by the government](#) is such that only around 3% of the population has decided to be vaccinated. The fact that President Putin has not been willing to inoculate himself with the Sputnik vaccine certainly has not helped the cause.


Vaccination campaigns began while a lot of countries were still implementing severely restrictive measures, including full lockdowns in countries such as Germany and the UK. As such, economic activity remains subdued and [Q1 2021 will likely be a quarter of very low or even negative GDP growth](#). Governments continue to provide generous fiscal stimuli: in the US for example the [USD 1.9tn fiscal stimulus plan is likely to be implemented soon](#); and in the UK the Chancellor of the Exchequer has [just announced another "spend now, tax later" Budget](#). Central banks remain fully accommodative, in part so as to monetise the large deficits exhibited by national governments.


Given this background, those [countries such as the US](#), where vaccination campaigns are progressing more smoothly and the policy support is ample, economic activity has started to show early signs of vitality. Accompanying it there has been the return of some inflation fears, motivated by market participants' awareness of the huge amount of liquidity injected by central banks into the system at a time when large fiscal stimuli have been provided and the output gaps are starting to close. [In our recent in-depth analysis](#), we discussed how the return of high inflation is a risk scenario, rather than our baseline assumption of what will occur. Still, inflation fears have brought a sell-off in bonds, and therefore a rise in short- and long-term yields, as investors re-estimated the timing of central banks' policy normalisation phases. This in turn has led to volatility in equity markets, which are sensitive to rises in long-term yields.

Central banks around the globe (with the Fed and the ECB at the forefront) were keen to reassure market participants that they are ready to look through short-term rises in inflation, perhaps even rises above the target levels the banks have set, as long as such rises are temporary. [The US Fed has even changed its policy strategy](#) to allow temporary inflation overshoots, as long as they are limited in size. Other, smaller central banks, such as the Reserve [Bank of Australia, had to resort to additional market intervention](#) in order to bring yields back in line with the policy targets.

In any case, central banks will have a hard time in coming years as they attempt to combine their traditional role as guardians against inflation with their current strategy of monetising the large deficits produced by countries combating the pandemic.

### **Our Recent Publications**

 [Preview: ECB To Continue Focusing on Maintaining Favourable Market Conditions](#), by Brunello Rosa, Nouriel Roubini and Alessandro Magnoli Bocchi, 5 March 2021

 [China: Recovery Underway, As Global Liquidity Drives 'Risk On' Sentiment](#), by Alessandro Magnoli Bocchi, Fawaz Sulaiman Al Mughrabi and Karmen Meneses, 4 March 2021

 [RBA Ready To Increase QE to Combat Rising Yields](#), by Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 2 March 2021

 [Flash Preview: RBA To Stand Pat While Fighting Rises in Market Rates](#), by Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 25 February 2021

Looking Ahead

The Week Ahead: US CPI Is Expected To Rise, While The ECB Remains On Hold

**In the EZ**, January's IP is expected to ease to -0.3% y-o-y (*p*: -0.8%).

**In the US**, February's CPI inflation is expected to rise to 1.7% y-o-y (*p*: 1.4%), while core-CPI inflation is likely to stay unchanged at 1.4% y-o-y.

**Still In the EZ**, the ECB is expected to maintain the: *i*) interest rate at 0.00%; and *ii*) deposit rate at -0.50%.

The Quarter Ahead: COVID-19 Vaccines Reach 111 Countries; Inflationary Worries Rise; CBs To Maintain Easing Stance

**Investors are divided** about whether the rise in longer-term UST yields is due to: 1) an upswing in growth expectations – driven by optimism over the rollout of COVID-19 vaccines; or 2) a worrisome increase in inflationary pressures.

**Despite rising long-term interest rates**, the US Fed Chair Powell continues to emphasize his willingness to “see inflation temporarily rise above 2%”, as well as his “satisfaction with the current stance of monetary policy” – disappointing investors, and unsettling equity and bond markets.

**In the US**, the government began distributing the Johnson & Johnson single-dose vaccine – approved by regulators – and President Biden announced “new deals with drug makers”, to ensure that every American adult have access to vaccines by the end of May – two months earlier than anticipated.

**The US Senate approved the USD 1.9tn package** - as Vice President Harris broke the 50-50 tie, in Democrats' favor. Most elements of the bill - including the USD 400 per week in unemployment benefits - remained intact and in-line with the legislation passed in the House of Representatives. Critics of the bill continued to point to the danger of reigniting inflation by overheating the economy.

**The EU and the US reached a deal to suspend punitive tariffs** both on aircraft and non-aircraft products, for an initial period of four months – a sign that the 16-year-old transatlantic trade battle over state aid to Airbus and Boeing could be coming to an end.

Last Week's Review

Real Economy: Global Growth Recovery Driven By Vaccine Rollout And Eased Restrictions

**In the US**, February's labor-market data showed signs of strength, as: *i*) 'non-farm payrolls' rose above-consensus to 379k (*c*: 182k; *p*: 166k); *ii*) 'average hourly earnings' remained unchanged at 5.3% y-o-y; *iii*) the unemployment rate declined to 6.2% (*c*: 6.3%; *p*: 6.3%); and *iv*) in the week ended on February 27, the number of 'filings for unemployment benefits' rose below-consensus to 745k (*c*: 750k; *p*: 736k) – as the US economy still struggles to sustain the labor market recovery amid the COVID-19 induced restrictions and a lack of fiscal support.

**In the EZ**, in January: *i*) retail sales slumped to -6.4% y-o-y (*c*: -1.2%; *p*: 0.9%), the steepest decline in nine months, as a number of member states re-imposed or extended lockdown measures; and *ii*) the unemployment rate stayed unchanged at 8.3%, the lowest level since June 2020.

**In Australia**, during its March meeting the RBA left its 'cash rate' unchanged at a record low of 0.1%, as widely expected.

Financial Markets: Rising Yields Continue To Hamper Investor Sentiment; USD And Oil Prices Up

**Market drivers**: Uncertainties hit most markets, prompting investors to pull money from stocks and bonds. In particular, the rise in rates weighed on growth stocks, by increasing the discount on future earnings, while value stocks managed gains.

Yet, **global equities closed higher w-o-w** (MSCI ACWI, +0.1%, to 657). In the **US**, the S&P 500 Index rose (+0.8%, to 3,842), as: *i*) energy shares outperformed, as oil prices hit their highest levels in over a year; *ii*) technology shares were broadly weak; while *iii*) consumer discretionary stocks continued to be dragged lower by Tesla. In the **EZ**, shares rose (Eurostoxx 50, +0.9%, to 3,670), buoyed by the prospect that: 1) easing restrictions implemented to curb the coronavirus's spread; and 2) supportive monetary and fiscal policies could set the stage for an economic recovery.

**Fixed Income**: w-o-w global bonds remained flat (BAML Global, 0.0% to 292.3); tax-exempt bond funds experienced outflows during the week, marking the first period of outflows in nearly four months. In the **US**, 10-year UST yields rose (+10 bps, to 1.55%).

**FX**: w-o-w, the USD rose against other currencies (DXY, +1.2%, to 91.977; EUR/USD -1.3%, to 1.192).

**Commodities**: OPEC's decision to maintain current production levels instead of the widely expected increase sent oil prices higher (Brent, +4.9% to 69.4 USD/b). Gold continued to fall (-1.9% to 1,701 USD/Oz), due to rising US bond yields, and a stronger-than-expected USD.



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The picture in the front page comes from [this website](#)

## Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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