MAKING SENSE OF *THIS* WORLD — *19 July 2021*

R&R Weekly Column
By Brunello Rosa

OPEC+ Boosts Oil Production As Climate Change Risks Increase

Last week, the countries belonging to the oil-producing cartel OPEC+ (the "+" refers to Russia and Kazakhstan, which are not in OPEC proper) decided to increase oil production by 400,000 barrels a day, in response to the surge in oil prices that has occurred in the past 15 months. In April 2020, oil prices turned negative for the first time in history, as storage costs soared in the middle of the first wave of the pandemic, when half of the world population was in lockdown. Since then, the price of Brent surged to $75pb, along the pick-up in economic activity in large parts of the global economy. OPEC+ also decided to increase the baseline production of oil in many countries, signalling that the cartel believes the recovery will continue and that higher production will be a persistent phenomenon, rather than a transitory one.

The increase in oil prices has led to a marked increase in headline inflation prints around the globe, sparking fears of incipient hyper-inflation, fears which are likely to be overblown. Most central banks have reacted calmly to the sudden rise in inflation prints, reassuring markets that policy rates will remain low for longer, and that short periods of moderately above-target inflation will be tolerated. This explains the fall in long-term yields observed in the US and elsewhere, which has puzzled investors.

While central banks have reassured markets that they will be tolerant against above-target inflation, they have also changed their policy frameworks to start addressing the impact of climate change on financially sensitive matters. The Bank of Japan has recently launched a "green-lending" scheme, set to last at least 10 years, in which banks receive central bank financing at zero per cent if those funds are lent to projects aimed at reducing the impact of climate change. The ECB has included the fight against climate change among the goals of its recently released strategy review. These moves follow the Bank of England's seminal work on central banks and climate change, championed by former governor Mark Carney.

The inclusion of climate change among the goals of central banks, though it may seem esoteric, is justified by the risks potentially deriving from extreme climate events. Tragic examples have occurred in recent days, with the floods experienced in Germany and Belgium, which have claimed hundreds of victims and caused immense economic damage. The south of Italy has also recently been hit by storms resulting in flooding, though fortunately without causing any deaths thus far. These violent floods in the middle of the summer are extremely unusual, and scientists are saying they can only be explained by climate change (as the wildfires that ravaged Canada recently).

Our Recent Publications

- Flash Preview: ECB Starts Implementing Its New Policy Strategy, *by Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 16 July 2021*
- Flash Review: BoJ Unveils Details Of Its New "Green" Lending Scheme, *by Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 16 July 2021*
- Flash Review – Bank Of Canada Reduces Further The Pace Of Its Asset Purchases, *by Brunello Rosa and Karmen Meneses, 14 July 2021*
- **GEOPOLITICAL CORNER:** After the Party: How China Is Planning To Become The World's Dominant Power, *by John C. Hulsman, 13 July 2021*

Looking Ahead

The Week Ahead: DM Manufacturing PMIs To Soften Whilst Japan's Inflation Rate Is Expected To Stay Subdued

In DMs, manufacturing PMIs are expected to soften, as*: i)* US indicators point to a gentle slowdown (*c:* 61.9; *p:* 62.1); and *ii)* EZ activity slows *(c:* 62.5; *p:* 63.4). DM services PMIs are likely to improve (US: *c:* 64.8; *p:*64.6; EZ: *c:* 59.6; *p:*58.3).

In Japan, June's inflation rate is expected to stay subdued at 0.0% y-o-y (*p:* -0.1%), and core inflation is seen to stay unchanged at 0.1% y-o-y).

The Quarter Ahead: US-China Relations Continue To Deteriorate; UK To Ease Covid-Restrictions; CBs On Hold, As Rising Inflation Is Deemed Transitory

The Biden administration warned US businesses about the increasing risks of operating in Hong Kong as China's tightening grip on the city causes business conditions to deteriorate. The Biden administration issued an advisory cautioning businesses and individuals that they are subject to a restrictive national-security law that Beijing imposed on Hong Kong a year ago.

In the US, Fed Chairman Powell said the economy is *"far"* from where it needs to be for the CB to change policy. *"Conditions in the labor market continued to improve, but there is still a long way to go,"* he said, adding that inflation has *"increased notably"* due mostly to temporary factors.

In the EZ, the ECB is working on creating a digital version of the Euro (EUR). The digital euro would allow consumers to pay electronically, without the need for banknotes and coins. However, it would *"complement"* the existing monetary system rather than replacing physical cash and erasing the business of commercial lenders.

In China, the economy grew at 7.9% y-o-y in Q2 2021 (*c:* 8.1%; *p:* 18.3%), driven by a slowdown in: *i)* factory activity; *ii)* higher raw material costs; and *iii)* new COVID-19 outbreaks in some regions all weighed on the recovery momentum. During H1, the economy grew by 12.7%, due to a low base effect from last year's coronavirus-triggered slump. For 2021, China has set an economic growth target of "above 6%" after expanding the least in over four decades of 2.3% in 2020.

Starting July 19, the UK will remove of all pandemic restrictions, and many politicians from the ruling Conservative Party have dubbed July 19 as *"Freedom Day".* The economy is expected to temporarily benefit, as all businesses can operate normally amid concerns over the delta variant.

Last Week's Review

Real Economy: Economic Activity At Risk Of Slowdown As Downside Risks Linger; CBs To Hold

In the US, June's IP dropped by 9.8% y-o-y (*c:* 12.2%; *p:* 16.1%) due to base-effect and a slowing economic recovery. Retail sales rose more-than-expected by 0.6% m-o-m (*c:* -0.4%; *p:* -1.7%), and expanded by 18.0% y-o-y (*c:* 14.0%; *p:* 27.6%).

Still in the US, in June: *i)* headline inflation accelerated to 5.4% y-o-y (*c:* 4.9%; *p:* 5%), hitting a fresh high since August of 2008; and *ii)* core-inflation increased 4.5% y-o-y (*c:* 4.0%; *p:* 3.8%). Inflation has been on the rise this year amid low base effects from 2020 and a pick-up in economic recovery, easing business restrictions and surging demand - amid widespread vaccination and fiscal support.

In the EZ, May's IP rose to 20.5% y-o-y (*c:* 22.2%; *p:* 39.4%).

Still in the EZ, headline inflation declined to 1.9% y-o-y (*p:* 2.0%), and core inflation to 0.9% y-o-y (*p:* 1.0%).

In Japan, Canada, New Zealand, and Turkey CBs kept their policy rates on hold at -0.1%, 0.25%,0.25%, and 19.0%, respectively.

Financial Markets: Global Stocks Fall; Bonds Up; The USD Strengthens; Oil Falls As Gold Prices Rise

Market drivers: investors continue to worry about rising inflationary pressures and surging coronavirus cases, while other investors digest: *i)* upbeat retail trade data; *ii)* better-than-expected earnings reports from financial giants; and *iii)* dovish comments from the US Fed.

Global equities fell w-o-w (MSCI ACWI, -0.6%, to 719). The S&P 500 Index fell (+1.0% w-o-w, to 4,327), as a decline in cyclical stocks out weighted gains in growth stocks. The selloff was due to: *i)* concerns about higher inflation; and *ii)* a slump in consumer sentiment. In the *EZ*, shares fell on concerns that the increase in CVODI-19 cases could derail an economic recovery, and market participants also worried that CBs might tighten monetary policy sooner than expected to quell inflation (Eurostoxx 50, -0.8% to 4,036).

Fixed Income: w-o-w global bonds rose (BAML Global, +0.3% to 296.7) and UST yields fell (-6 bps, to 1.30%).

FX: w-o-w, the USD rose against the EUR (DXY, +0.6%, to 92.687; EUR/USD -0.6%, to 1.181).

Commodities: Oil prices fell (Brent, -2.6% to 73.6 USD/b), amid fuel demand concerns and oversupply fears. Gold prices rose (+0.2% to 1,811 USD/Oz) following worries over global growth and the spread of the COVID-19 delta variant.

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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*	*M5S*	*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*