



R&R Weekly Column
By Brunello Rosa



Interest Rate Normalisation Begins in the G10 Economies

The Reserve Bank of New Zealand (RBNZ) [increased its main policy rate](#) by 25bps last week, to 0.50%. This move was its first rate increase since 2014, and marked the end of the policy easing cycle that began in 2019, back when the US Federal Reserve implemented its three “[precautionary rate cuts](#)”, before the Covid-19 pandemic was even on the horizon. [As we said in August](#), the RBNZ was already ready to increase its policy rate this summer, but the sudden decision by the government to impose a national lockdown following a new Covid outbreak in Auckland convinced the central bank to [postpone the announcement until October](#).

What is interesting in the decision by the RBNZ is not just the recognition that the lockdown will lead to a localised contraction in economic activity, but also that the government has the tools to cushion its economic impact, and that the economy will be able to rebound quickly after these periods of contraction. As such, the Bank’s Monetary Policy Committee decided to carry on with the planned tightening of monetary policy, to counter the impact on inflation of rising capacity constraints.

The RBNZ is the second central bank among the G10 economies to increase its policy rate during this cycle. The first was Norway’s Norges Bank, which [increased its key sight deposit rate by 25bps](#) at the end of September, [to 0.25%](#). The Norwegian central bank had already [telegraphed its intentions to do so in June](#), when it explicitly said that if the economy performed in line with its policy committee’s expectations, the central bank would have to increase its main policy rate by 25bps. In this case, the Norwegian economy was benefiting from the rise in oil and energy prices as well, being a net exporter of oil.



These central bank decisions are coming after the ECB decided [to “recalibrate” its Pandemic Emergency Purchase Program \(PEPP\)](#) in September, and, most significantly, after the [US Federal Reserve pre-announced its intention to taper](#) its asset purchases by the end of the year.



Some analysts are now wondering whether the weak US employment report in September, showing [only 194,000 new jobs being created compared to the 500,000 that had been expected](#), may delay the decision to taper QE. During [his latest press conference](#), Chair Powell said that he needed to see a “decent” employment report to be satisfied with the condition that further progress had been made towards achieving the Fed’s employment target. It is difficult to know whether an increase of less than 200,000 jobs fits the bill, [even as the unemployment rate falling to 4.8%](#) (vs. the 5.1% that had been expected) is certainly an upward surprise.

If the RBNZ example can be of any guidance for what the Fed may decide to do, it may show that central banks are not likely to be disturbed by short-term volatility of economic variables, and will carry on with their stated intentions. At the same time, central banks want to err on the safe side so long as the pandemic continues and there is still a risk of new variants emerging.

In any case, [as we discussed in previous columns](#), the direction that G10 central banks are heading in seems to be well established. In the coming months, most central banks will start to withdraw the extraordinary stimulus provided since the beginning of the pandemic, while continuing to provide the necessary backstop to governments and their expansionary fiscal policies.

Our Recent Publications

-  [Flash Review: RBNZ Raises Interest Rates, Second G10 Central Bank In This Cycle](#), by Brunello Rosa, 6 October 2021
-  [Economic Recovery On Track, But Volatility Rises](#), by Alessandro Magnoli Bocchi, Fawaz Sulaiman Al Mughrabi and Karmen Meneses, 1 October 2021

-  [Iran and Saudi Arabia’s Perspectives on Post-US Afghanistan](#), by Giorgio Cafiero, 29 September 2021
-  [GEOPOLITICAL CORNER: The EU’s Suez Moment: The Stunning AUKUS Alliance Makes It Clear The Anglosphere Is Rising, As Europe Falls](#), by John C. Hulsman, 5 October 2021



Looking Ahead

The Week Ahead: Retail Sales and Economic Sentiment To Decline In US And EZ Respectively; Inflation To Stay Unchanged in US

In the US, in September, retail sales are expected to fall to 9.0% y-o-y (*p*: 15.1%).

In the US, September's headline and core inflation are expected to stay unchanged at 4.0% y-o-y, and 5.3% y-o-y, respectively.

In the EZ, in October's economic sentiment is projected to fall to 20.0 (*p*: 31.1).

The Quarter Ahead: Global Corporate Tax Agreed; Geopolitical Risks Remain High; CBs Start Tightening Policies

OECD announces major breakthrough on corporate tax rates, after years of disagreement. The group of developed nations agreed to a global minimum corporate tax rate of 15%, marking a huge shift for smaller economies, such as the Republic of Ireland, which have attracted international firms – to a large extent – via a lower tax rate. The deal, agreed by 136 countries and jurisdictions representing more than 90% of global GDP, will also reallocate more than USD 125bn of profits from around 100 of the world's largest and most profitable MNEs to countries worldwide – ensuring that these firms pay a fair share of tax wherever they operate and generate profits.

US-China trade talks take first steps in re-engagement. The Biden administration kicked off its trade-policy engagement with China via a virtual meeting between US Trade Representative Katherine Tai, and Chinese Vice Premier Liu He. In the meeting, Ms. Tai raised a range of concerns including what the US says have been China's "state-led, nonmarket policies and practices" and its failure to live up to the commitments it made under the 2020 Phase-1 trade pact signed with the Trump administration. The resumption of trade policy discussions come as the two nations prepare for a long-awaited virtual summit meeting between Biden and Xi.

UK China-Taiwan tensions: Xi Jinping says 'reunification' must be fulfilled. China's rising military might and demonstrated willingness to ignore agreements it once made over Hong Kong's one-country-two-systems formula are changing the US strategic outlook for Taiwan. Recently, China has dispatched nearly 150 warplanes into Taiwan's defense zone – part of what the State Department describes as a series of "destabilizing" actions in the Taiwan Strait that risk resulting in "miscalculations." Taiwan's defense minister has also warned that China will have the capacity within four years to mount a "full scale" invasion.

CBs to begin tightening. In the US, despite a disappointing September jobs report, Fed officials have signaled the gains are likely to satisfy the thresholds they have laid out to start reducing their bond buying at their policy meeting next month.

Last Week's Review

Real Economy: Economic Recovery Gains Ground, While CBs Start To Ease Pandemic-Era Stimulus

In the US, September's labor market data showed: *i*) nonfarm payrolls increased below expectations by 194k (*c*: 500k; *p*: 366k); *ii*) average hourly earnings rose in-line with market forecasts (*a*: 4.6% y-o-y; *c*: 4.6%; *p*: 4.0%); and *iii*) the unemployment rate dropped more-than-expected to 4.8% (*c*: 5.1%; *p*: 5.2%) – well above the pre-crisis level of 3.5% – due to ongoing labor shortages, but is seen declining further in the coming months as: *a*) companies fill widespread vacancies; and *b*) more workers are expected to go back into the labor force.

In the EZ, retail sales in August remained mute at 0%, easing from a 3.1% increase in July, and missing forecasts of 0.4% growth.

In Australia, the RBA kept its cash rate unchanged at 0.1% during its October meeting, but continued plans to trim the purchase of government bonds to AUD 4bn a week until at least mid-February 2022.

In New Zealand, the RBNZ raised its OCR by 25bps to 0.5% during its October meeting, marking the first rate hike since June 2014, with policymakers saying the decision was appropriate to: *i*) maintain low inflation; and *ii*) support maximum employment.

Financial Markets: Global Stocks Gain; Bond Yields Spike; USD Strength Weighs On Gold Prices

Market drivers: investor sentiment strengthened, as: *i*) the US reached a deal to raise the debt ceiling into December; and *ii*) worries over a spike in inflation prompted by soaring energy prices eased.

Global equities rose w-o-w (MSCI ACWI, +0.7%, to 717). In US, the S&P 500 gained the most since August (+0.8% w-o-w to 4,391), as energy stocks led the gains, while the small real estate sector lagged with modest losses. In EZ, shares ended higher (Eurostoxx 50, +0.9% w-o-w, to 4,073), as natural gas prices surge to record highs. In EMs, equities advanced (MSCI EMs, +0.8%, to 1,257), as Chinese stocks rose (Shanghai Comp., +0.7%, to 3,592). *Volatility* fell below averages (VIX S&P 500, -2.4 pts to 18.8, 52w avg.: 20.9; 10y avg.: 17.2).

Fixed Income: w-o-w global bonds plunged (BAML Global, -0.6% to 293.0), while UST yields spiked (+15 bps, to 1.61%), reaching the highest in 4 months, as investors digest the latest US labor report.

FX: w-o-w, the US Dollar Index was mute (DXY, 0%, to 94.067; EUR/USD -0.2%, to 1.157). In EMs, currencies fell against the USD (MSCI EM Currency Index, -0.3% w-o-w, to 1,719).

Commodities: Oil prices rose (Brent, +3.9% w-o-w, to 82.4. USD/b), as major oil exporters decided not to increase production more than their modest previously agreed-upon amount. Gold lost its safe-haven appeal (-0.7% w-o-w, to 1,757 USD/Oz), driven by a stronger USD, and dropping more than 4% since its August highs.



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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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