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R&R Weekly Column
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Covid's Fourth Wave Risks Derailing Europe's Economic Recovery

In a number of countries, but especially in Europe, an increase in the number of Covid cases has been registered in recent days. These are mostly related to the delta variant, but other variants are likely to be in circulation as well. In continental Europe, the most alarming countries have been Germany (with 60,000 new Covid cases per day), the Netherlands (20,000 cases), Austria (15,000), and Belgium (20,000).

Countries' reactions to these outbreaks have differed. In Germany, the government has introduced the 2G rule, whereby only those who have recovered from Covid or who have undertaken a full vaccination cycle may receive a Green Pass to access public places. In the Netherlands a partial form of lockdown has been introduced. In Austria, a 20-day full lockdown has been ordered by the government, and vaccination will become mandatory from February 1st.

In Italy, where the number of new cases is still relatively low (around 10,000 a day), the government is considering a tightening of the Green Pass rules. The Covid test may be accepted only to go to work; it would not be sufficient for social events. The validity of the tests would also be reduced from 2 days to 1 day for antigenic tests, and from 3 days to 2 for PCR tests. The government is also thinking of making vaccination obligatory, but it may not find the internal agreement necessary for a green light on that. Other European countries have reacted differently to the current situation. In the UK, for example, there has been a surge of new Covid cases since October. The number of new cases peaked in early October (at 51,000), and subsequently declined to around 40,000 now. Yet the government has resisted the pressure to introduce new restrictions after the "liberation day" was declared on July 19th. Instead the government accelerated the campaign for the booster shot of Covid vaccines, with the minimum time between second and third doses being reduced to 5 months.

The overarching principle in these government responses has been to preserve the recovery in economic activity, reduce the burden on fully vaccinated people, and incentivise (indeed almost oblige) those still reluctant to get vaccinated to get their shots. We agree with this approach. In principle, those who paid the price of getting vaccinated (in terms of the small risks associated with the process), to the benefit of the entire community, should be entitled to enjoy the benefits of more freedom of movement relative to the non-vaccinated, who risk their own and other people's lives with their choice.

From an economic perspective, the consequences could be significant. After the link between Covid cases and economic impact had been severely reduced by the introduction of vaccines, the ongoing recovery in economic activity may experience a slowdown or a more significant and prolonged soft patch if new restrictive measures are introduced in large or numerous countries. If the slowdown in economic activity growth proves to be deeper and longer-lasting than is currently assumed, policymakers may need to revisit their recently-expressed intentions. Governments may need to provide additional fiscal support, and central banks may need to rethink the phasing out of the extraordinary accommodation they have provided in the last couple of years. They may have to continue to purchase, for a longer period of time, private and public sector assets, and they may have to push back any intention of increasing their policy rates in the not-too-distant future.

If this proves to be the case, the implications for asset classes would also be large. Long-term sovereign bond yields would likely fall across the board. Equities may benefit from renewed liquidity injections, with EMs becoming interesting again. In the currency space, the USD may strengthen further versus European currencies, if the US government does not introduce new restrictive measures as much as the European countries will do.

Our Recent Publications

- *Flash Review: BOE Surprises The Market By Keeping Its Interest Rates Unchanged In November*, *by Brunello Rosa, 4 November 2021*

- **GEOPOLITICAL CORNER:** With Each Other: A Moribund South Africa Stagnates Under Endless ANC Rule, *by John C. Hulsman, 17 November 2021*

Looking Ahead

The Week Ahead: November PMIs Expected to Decline in Europe; US Inflation Expected To Increase

In most DMs, November PMI data are expected to decline, as *i)* French Composite PMI is likely to slow down to 53.4 (*p:* 54.7), with manufacturing and services declining to 52.8 (*p:* 53.6) and 55.5 (*p:* 56.6) respectively; *ii)* German Composite PMI is expected to decline slightly to 51.0 (*p:* 52), with manufacturing and services decreasing to 56.7 (*p:* 57.8) and 51.5 (*p*: 52.4) respectively; and *iii)* UK Composite PMI will likely decrease, along with manufacturing and services down to 57.4 (*p:* 57.8) and 58.5 (*p:* 59.1) each.

In the US, core PCE Index is expected to increase to 0.4% m-o-m (*p:* 0.2%) and 4.1% y-o-y (*p:* 3.6%); manufacturing and services PMIs are expected to edge up a bit from their October level (58.4 and 58.7 respectively).

The Quarter Ahead: Glasgow Climate Pact Agreed; Europe Again Epicenter Of The Pandemic; Rate Hikes Unlikely In Eurozone

The COP26 ended on 12th November with Glasgow Climate Pact, which is the first climate agreement to explicitly target at reduction of coal usage. In addition to coal phase-out commitment, the pact also promises to increase climate financing for developing countries in order to keep the 1.5-degree Celsius target increase achievable.

Biden-Xi meeting was described as "healthy debate", but yielded no dramatic breakthroughs. The meeting aimed at stabilizing the U.S.-China relations, which deteriorated during the presidency of Donald Trump. Human rights, Taiwan, and trade issues were discussed, albeit no concrete agreement or initiative were taken.

Surging COVID cases engulfs Europe. According to WHO, the reason for rising COVID cases is the relaxation of public health measures. European countries, including Austria, Belgium, and Germany already introduced tighter restrictions.

Turkish Lira hits all-time low after Erdogan pressured CB to cut rates. The Turkish central bank decreased one-week repo rate to 15%, constituting the third straight cut in interest rates from 19% at the beginning of September. President Erdogan has fired multiple central bankers, including the former governor Naci Agbal who increased the borrowing costs. Erdogan's unorthodox monetary policy view threatens the economy that already experiences acute inflation of 20%.

Christine Lagarde calls for more patience when it comes tightening monetary policy. Following Lagarde's dovish comments, euro fell $1.13 against the dollar. In contrast to the US Federal Reserve, the ECB is not going to increase interest rates in 2022, despite rising eurozone inflation that is "unwelcome and painful".

Last Week's Review

Real Economy: US And EZ GDP Expands; Japan GDP Contracts; UK Inflation Surges

In the US, GDP in Q3 expanded at 2.0% q-o-q, below market expectations of 2.7%.

In the EZ, GDP in Q3 grew by 2.2% q-o-q (*p:* 2.1%), and 3.7% y-o-y (*p:* 14.2%). Among the countries, the stronger quarterly GDP growth in the third quarter was detected in Austria (3.3%), France (3%) and Portugal (2.9%).

In the UK, in October annual inflation rose to the highest level in a decade at 4.2% y-o-y (*p:* 3.1%).

In Japan, GDP in Q3 contracted by 0.8% q-o-q (*p:* 0.4%).

Financial Markets: Buffeted By Covid's Fourth Wave and US Fed Chair Pick

Market drivers: investor sentiment weakened, hampered by *i)* increasing COVID infections and anticipated lockdowns weighing on the global economic recovery; *ii)* inflationary pressures; and *iii)* bitcoin volatility. In addition, unpredictability is rising over the announcement of the next Federal Reserve Chair.

Global equities remained unchanged w-o-w (MSCI ACWI, +0.0%, to 756). In the US, the S&P 500 index increased slightly (+0.3% w-o-w to 4,698), led by tech shares predominantly. In the EZ, shares fell (Eurostoxx 50, -0.3% w-o-w, to 4,356), as Austria reimposes national lockdown and Germany warns it might follow suit. In EMs, equities increased only marginally (MSCI EMs, +0.1%, to 1,287) due to wide earnings miss from Alibaba and currency crisis in Turkey. China's benchmark Shanghai Composite rose (Shanghai Comp., +0.6%, to 3,560), rallied on significant rises in the property and logistics shares. Volatility rose (VIX S&P 500, +3.4 pts to 20.8, *52w avg.:* 20.9; *10y avg.:* 18.0).

Fixed Income: w-o-w, UST yields fell to a 6-week low (-2 bps, to 1.55%), as investors focused on the next Fed chair announcement. W-o-w, German 10-year bond yield tumbled (-8.4bps, to -0.34%) over the concerns of surging COVID cases. EMTX 7-10 RT index gained 17bps to 283.22 w-o-w.

FX: w-o-w, the US Dollar Index rose slightly (DXY, +1.0%, to 96.07; EUR/USD -1.5%, to 1.128). In EMs, currencies stayed virtually unchanged against the USD (MSCI EM Currency Index, -0.0% w-o-w, to 1,733).

Commodities: Oil prices fell (Brent, -4.7% w-o-w, to 78.5 USD/b), as rising COVID cases in Europe threaten global economic recovery as well as China and US agreed to release oil reserves. Gold declined (-1.1% w-o-w, to 1,847 USD/Oz), following hawkish comments from Fed.

Nato Balavadze *contributed to this Viewsletter.*

The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*
LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*