



R&R Weekly Column
By Brunello Rosa



Fiscal and Monetary Policy Coordination Continues, In Spite of Recent Bumps

There were three major central bank decisions among the G10 economies last week. *In the US*, the Federal Reserve decided to reduce the pace of its asset purchases by USD 15bn a month (USD 10bn of Treasuries and USD 5bn of MBS), beginning as of this November. [As we discussed in our review](#), the Fed will retain some flexibility regarding the pace of further reductions, as the FOMC is aware that the winter season could see a spike in Covid cases and potentially new restrictive measures, and thus any decision may need to be reversed at short notice. Even in China, [the zero-Covid policy is proving ineffective](#) in spite of the country's strict enforcement.

The Fed made this decision to reduce asset purchases independently of any fiscal policy consideration, but nevertheless it is a fact that during this same week the [US Congress passed the long-awaited USD 1.2tn infrastructure investment plan](#), which will provide fiscal support to the ongoing US economic recovery. President Joe Biden promised to pass an additional USD 1.75tn package to invest in the country's social safety net in the coming weeks, but considering the wrangling that has been necessary to pass this bill in Congress, such additional spending seems "aspirational." Democrats and Republicans have also fought recently over the increase of the debt ceiling – [a battle that is likely to re-start in December](#). Also, Biden may need to act carefully while his approval rating is tanking (though it is not clear whether his approval has fallen because he is perceived as being too progressive by the moderate base of his party, or too moderate by the progressive side of his party).


In this informal coordination between monetary and fiscal policy, an important step will be the appointment of Jay Powell's successor as Fed Chair during the coming term, which will start at the end of February 2022. It is worth remembering that the current Secretary to the Treasury, Janet Yellen, is a former Chair of the FOMC. Again, the two sides of the Democratic party will likely have different views as to this re-appointment. Lael Brainard, however, who has served on the Fed's Board of Governors since 2014, is touted to be on the shortlist of potential candidates to succeed Powell.


In the UK, meanwhile, the Bank of England left its policy rate unchanged, [surprising the markets](#), which in the past few weeks had been alerted by the Bank itself about a possibly imminent rate increase. As we discussed [in our preview](#), from a *normative* perspective we thought that the Bank could afford and should wait *at least* until February before raising rates. So, to some extent we were glad the Bank made that decision. On the other hand, we remain highly sceptical of the Bank's communication, which clearly wrongfooted the market. In this case, the BoE also had the benefit of looking at the details of [the budget plans of the UK government](#) for 2022 and beyond. They probably saw that the budget plans were not as generous as one could have anticipated, implying that the country had to rely on additional monetary support from the central bank instead.


In Australia, the [RBA left its policy rates unchanged but brought forward the time in which raising rates could happen](#) (from 2024), and *de-facto* ditched the yield curve control on the 3y government bond yield. This relatively hawkish move also came after the Australian treasury released a very expansionary budget in May and [allowed the deficit to increase substantially over the course of the year](#), which permitted the central bank to start withdrawing some of their policy accommodation.


As we discussed at the beginning of this crisis, the coordination between monetary and fiscal policy has been the real innovation of the crisis. It is good news that this coordination continues as public authorities now withdraw the extraordinary stimulus provided during the crisis.

Our Recent Publications

 [Flash Review: BOE Surprises The Market By Keeping Its Interest Rates Unchanged In November](#), by Brunello Rosa, 4 November 2021

 [Flash Review: Fed To Begin QE Tapering in November, While Keeping Some Optionality On The Pace](#), by Brunello Rosa, 3 November 2021

 [Flash Preview: Fed To Announce QE Tapering Beginning In Mid-November](#), by Nouriel Roubini and Brunello Rosa, 1 November 2021

 **GEOPOLITICAL CORNER:** [The Death of the Grown-Ups: The Decline of the Center-Right in the Advanced Economies](#), by John C. Hulsman, 2 November 2021



Looking Ahead

The Week Ahead: Inflation Pressures Expected To Remain Elevated; UK Q3 GDP To Fall

In the US, the annual and monthly inflation rate is expected to reach 5.8% (p: 5.4%) and 0.6% (p: 0.4%) respectively. October's core inflation is seen rising slightly to 4.3% y-o-y (p: 4.0%).

In the UK, GDP growth is expected to slow down in Q3 from Q2 (c: 1.5%; p: 5.5%).

In China, inflation is expected to rise 1.4% q-o-q (p: 0.7%) and 0.6% m-o-m (p: 0.0%).

The Quarter Ahead: Stablecoins Subject To New Rules; COP26 Continues; COVID Pill Approved By UK

Biden Administration calls for a new regulatory framework around stablecoins - digital currencies pegged to traditional currencies.

A report issued by the President's Working Group on Financial Markets found that stablecoins, reaching a market value of \$130 bn, could "support faster, more efficient, and more inclusive payments options", but need to be regulated and issued by insured banks.

US House passes \$1.2tn infrastructure bill, including a generational investment in: i) roads; ii) bridges; and iii) railroads that had languished for several months as Democrats feuded over the terms of its approval. The bill reauthorizes existing federal infrastructure programs for five years and pours an additional USD 550bn into water projects, broadband internet, the power grid and more.

US Fed chairman Powell met with president Biden at the White House, just three months to go until Powell's term at the helm of the Fed expires. Biden separately met Lael Brainard, Powell's possible successor, although the president had yet to make a final decision.

COP26 Climate Summit enters into an active phase. Signatories of the COP2 deal, except the U.S., agree to phase out coal-fired power, whilst more than half of the firms listed on FTSE 100 announce to eliminate emissions by 2050. According to Treasury chief Yellen, the U.S. would back the issuance of green bonds to finance sustainable infrastructure in developing countries.

The European gas crisis is unfolding. Following Moldova's gas crisis, a surge in gas prices and a forecasted colder winter has put Europe in a vulnerable position if the sources of its gas supplies are not diversified.

Merck's and Pfizer's Covid pills are labeled as "a potentially game-changing" in the ongoing pandemic fight. Merck signed 9 deals to sell 3 million courses of its antiviral drug. Following the UK's approval that already approved Merck's pill, US and EU regulators are due to consider whether the pill should be authorized. Pfizer plans to share the data with FDA as soon as possible to seek authorization.

China sets new restrictive measures amid COVID outbreaks, aiming to hold the situation under control as the country prepares for an important meeting of Communist Party elites this week, as well as the Beijing Winter Olympics next February.

Last Week's Review

Real Economy: Unemployment Falls; Services PMI Increase

In the US, the Fed decided to begin reducing the monthly pace of its net asset purchases by USD 10bn for Treasury securities and USD 5bn for agency mortgage-backed securities starting later in the month. **Manufacturing PMI fell below forecast** (c: 59.2; p: 60.7), whilst services rebounded (c: 58.2; p: 54.9) and **October's labor data showed**: i) the unemployment rate decreasing more than expected (c: 4.6; p: 4.7); ii) non-farm payrolls increasing to 531K (p: 450K); and iii) wages rising 0.4% m-o-m, and 4.9% y-o-y basis.

In the EZ, the seasonally adjusted unemployment rate decreased to 7.4% (p: 7.5%).

In the UK, manufacturing PMI remained unchanged at 57.8, while services PMI increased (c: 59.1; p: 58.0).

In Australia, the RBA kept its interest rate unchanged during its November monetary policy meeting and ended the yield target of 0.1% on April 2024 government bond.

Financial Markets: Equities Rise Globally; Fixed Income Falls; Sentiment In Gold Improves

Market drivers: investors remained upbeat on: i) strong earnings reports; ii) Merck's and Pfizer's antiviral drugs treating COVID-19; iii) Biden's social infrastructure plan; and iv) Wall Street record high closing.

Global equities rose w-o-w (MSCI ACWI, +1.6%, to 757). In the US, the S&P 500 index hit a new record high (+2.0% w-o-w to 4,698), led by tech and consumer discretionary and more importantly by new Pfizer pill. In the EZ, shares gained (Eurostoxx 50, +2.6% w-o-w, to 4,363), supported by a jump in travel stocks after a positive update on anti-COVID-19 drugs and upbeat earnings. In EMs, equities fell (MSCI EMs, -0.1%, to 1,264), as Chinese stocks fell over property debt crisis concerns (Shanghai Comp., -1.6%, to 3,492). Volatility rose (VIX S&P 500, +0.2 pts to 16.5, 52w avg.: 19.9; 10y avg.: 17.1).

Fixed Income: w-o-w, UST yields fell to a 6-week low (-11 bps, to 1.45%), despite strong employment data, while German 10-year bond yield tumbled (-38bps, to -0.29%). EMTX 7-10 RT index gained 4.4 points to 282.62w-o-w.

FX: w-o-w, the US Dollar Index rose slightly (DXY, +0.2%, to 94.320; EUR/USD 0.0%, to 1.157). In EMs, currencies stayed virtually unchanged against the USD (MSCI EM Currency Index, -0.0% w-o-w, to 1,732).

Commodities: Oil prices fell (Brent, -1.9% w-o-w, to 82.7 USD/b), as OPEC+ agreed to increase output by a pre-agreed 400k b/d from December defying US pressure. Gold rose (+1.9% w-o-w, to 1,817 USD/Oz), as investors seek to reset monetary policy expectations.



@RosaRoubini



Rosa & Roubini



Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED

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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