



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



### Five Themes To Watch At The Beginning Of 2022

With 2022 upon us, it is worth discussing the key themes to watch during the early part of the year. New themes emerge will doubtless occur as the year progresses and events unfold, but for now, here are some of the issues we are keeping a close eye on:

**The Pandemic – The Beginning of The End?** With the arrival of the Omicron variant, 2022 is unfortunately beginning in the same way that 2021 did with the Delta variant. By February/March 2022 we will have marked two full years of pandemic, and at least four waves of it. It is confirmed that Omicron is much more transmissible than all other strains, as proven by the spike in infections observed around the globe. But its hospitalisation and mortality rates are not worse than its predecessors, thanks in part to the diffusion of vaccines, especially for those who received their third, “booster” dose. This means that it is possible that Omicron represents the lucky mutation we are all looking for: a very transmissible but not very serious virus, which renders Covid akin to a severe flu, rather than a deadly disease. The first few months of the year will clarify whether this is the case or not.


**Inflation – The Monster Is Raising Its Ugly Head Again.** There will be plenty of inflation data coming out this week, especially from Europe, where CPI reached nearly 5% recently. Coupled with the (nearly) 7% figure reached in the US, this means that large parts of the developed world have now been experiencing rates of inflation unseen during the past few decades. This short-term inflation, due to supply bottlenecks, base effects, and the reopening of economies, may be coming to an end (Omicron permitting) and in the meantime central banks have also been very alert to it. We remain more concerned about medium-term inflation, influenced by the balkanisation of global supply chains, a more equitable distribution of income between labour and capital (including an increase in minimum wages) and the cost of ecological and related technological transitions. All these factors may result in a one-off price-level adjustment (in a positive scenario) or in persistently higher inflation rates (in a less favourable scenario).


**Central Banks – Barking and Biting?** Central banks have certainly turned more hawkish in December as a result of recent inflation outturns, in what we believe is an under-appreciation of the economic impact of the new restrictions imposed by governments as a result of Omicron’s emergence. Some of them have already started to “bite”, with interest rate increases (such as the BOE, Norges Bank, RBNZ and many EM central banks), or by accelerating the process of tapering asset purchases (such as the US Fed). Others, such as the ECB, have only “barked” so far, and it will take time for their words to be followed by action. But we are certainly entering a phase in which central banks will give priority to fighting inflation rather than supporting economic activity.

**The Italian Presidential Election.** Italy will elect its new president at the end of January. As discussed several times, this could fundamentally change the equilibria that exist within Europe, if a EU-sceptical president is elected to succeed Mattarella. Draghi remains the key candidate, but if he goes to Quirinale palace, a new government must be formed, and that could result in renewed political instability.

**The Risk of A Russian Invasion of Ukraine Persists.** Russia has massed troops at the border with Ukraine, threatening an invasion if Ukraine makes further moves to approach Western alliances such as the EU and NATO. The US has reacted by saying that an invasion will result in a very serious response. What Russia wants is Ukraine becoming like Finland, i.e. neutral. But mistakes may be made by both sides, threatening to cause an unwanted escalation.

#### Our Recent Publications

 Fed, ECB, BoJ, BoE, SNB and Norges Bank Flash Reviews: Major G10 Central Banks Turn Hawkish As Inflation Rises and Omicron Spreads, by Brunello Rosa, 17 December 2021

 Flash Preview: FOMC To Accelerate QE Tapering and Start Hiking Rates by Mid 2022, by Nouriel Roubini and Brunello Rosa, 13 December 2021

Looking Ahead

**The Week Ahead: Business Activity To Slow Down In US and EZ; Annual Inflation Expected To Decrease in EZ**

**In the US**, non-farm payrolls are expected to rise to 400K (p: 210K) in December, while the unemployment rate is expected to remain at 4.1% (p: 4.2%). In December, manufacturing PMI and services PMI are expected to slow down to 57.8 (p: 58.3) and 57.5 (p: 58.0) respectively. As a result, the IHS Markit US Composite PMI is seen decreasing to 56.9 (p: 57.2).

**In EZ**, i) December's inflation is expected to decrease to 4.7% y-o-y (p: 4.9%); ii) November monthly retail sales are likely to decrease to -0.5% (p: 0.2%), while annual retail sales are seen increasing to 5.6% (p: 1.4%); iii) consumer confidence in December is expected to further decline to -8.3 (p: -6.8); and iv) December's manufacturing and services PMI are expected to decelerate to 58.0 (p: 58.4) and 53.3 (p: 55.9). December's IHS Markit Eurozone Composite PMI is expected to decline to 53.4 (p: 55.4).

**The Quarter Ahead: COVID Cases Rise Globally; Tighter Post-Brexit Import Controls; Deutsche Bank Fined**

**WHO Chief warns of a 'tsunami' from Omicron and Delta variant cases since the start of the pandemic.** COVID cases reached record-high numbers in US, Italy and France, as Omicron is described as a highly transmissible COVID variant. France breaks European daily records with cases above 200K and makes masks mandatory outdoors in Paris, while Italy introduced a stricter green pass.

**In the UK, COVID cases soar to new daily records.** Lack of lateral flow tests is described as a huge problem amid growing Omicron wave, constituting more than 90% of all community COVID cases in England. Hospital admissions reach the highest number since March 2021.

**Businesses find it difficult to cope with UK's post-Brexit import controls, coming into force finally on 1 January 2022.** A further set of controls are expected to be due in July 2022. Due to new import controls, UK importers should fill complicated customers declarations. The business sector has announced that the new border controls will seriously hamper the trade flow from small businesses, as they still adjust to trading outside the EU single market. In 2020, the imports from the EU accounted for half of all UK imports, which is worth £300 bn.

**Deutsche Bank has been fined \$9.8ml by the German financial regulator** for weak controls on rate data. The bank is still trying to recover from Libor Scandal, which cost Deutsche Bank a record-high \$2.5bn in penalties.

**Putin warns Biden of the 'Complete Rupture' of the U.S.-Russia relationship if new sanctions are imposed.** Amid rising Ukraine tensions, in a second call, Biden told Putin that the serious consequences should be anticipated in case of any invasion of Ukraine.

Last Week's Review

**Real Economy: US Q3 GDP Accelerates; Rise In Consumer Confidence in the US; Consumer Prices Increase in Japan**

**In US**, Q3 GDP was revised higher to 2.3% y-o-y (c: 2.1%; p: 6.7%). In December, consumer confidence rose to 70.6 (c: 70.4; p: 67.4).

**In Japan**, the unemployment rate rose to 2.8% in November (c: 2.7%; p: 2.7%). November's consumer prices increased to 0.6% y-o-y (p: 0.1%), as the largest upward contribution came from fuel, light and water charges of 9.2%.

**Financial Markets: Year-End Equity Rally Bodes Well For The Beginning Of 2022**

**Market drivers:** US's stocks climbed, and GDP growth was readjusted to a higher estimate. The positive sentiment was strengthened by i) further evidence that the new Omicron variant is milder; and ii) FDA granted emergency authorization to Pfizer's and Merck's COVID pills. Likewise In Europe, despite tighter travel restrictions, the investor sentiment was boosted by: i) the comment from Christine Lagarde suggesting that inflation is expected to fade out in 2022; ii) Boris Johnson ruled out COVID restrictions before Christmas; and iii) Moderna's COVID vaccine booster is shown to be effective against the Omicron variant.

**Global equities** rose w-o-w (MSCI ACWI, +0.8%, to 755). Despite travel stocks drop driven by flight cancellations, the US S&P 500 Index also increased (+1.1% w-o-w, to 4,779), as U.S. holiday season retail sales rose, strengthened by the e-commerce boom. In the EZ, shares were up in holiday-thinned trade (Eurostoxx 50, +1.2% w-o-w, to 4,306), as market players expect Omicron's impact on the economy is milder following hawkish moves from central banks. In EMS, equities rose slightly too (MSCI EMs, +0.2%, to 1,222), albeit still lagging compared to the beginning of the year partly due to Beijing's regulatory pressures. Chinese stocks increased accordingly (Shanghai Comp., +0.6%, to 3,640) driven by tech stocks and e-commerce. Volatility fell above averages to 19.9 (VIX S&P 500, 52w avg.: 21.0; 10y avg.: 17.9).

**Fixed Income:** UST yields rose compared to last week (+0.9 bps, to 1.50%), suggesting investors see limited Omicron impact on the economy. German 10-year bonds increased (+7 bps, to -0.18%) to its highest since November 4, lifted as the Omicron fears ease and investors focus on ending pandemic bond buying.

**FX:** w-o-w, the US Dollar Index is virtually unchanged (DXY, +0.6%, to 96.02; EUR/USD +0.1%, to 1.132) – as concerns relating to Iran, China and Ukraine rise. In EMS, currencies increased slightly against the USD (MSCI EM Currency Index, +0.2% w-o-w, to 1,733).

**Commodities:** w-o-w, oil prices increased ahead of OPEC+ (Brent, 1.9% to 78.3 USD/b). w-o-w, Gold prices rose (+0.9% to 1,825 USD/Oz).



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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