



R&R Weekly Column
By Brunello Rosa



Monetary And Fiscal Authorities Are Searching For The Optimal Policy Mix

The US Federal Reserve [increased its Fed funds target range](#) by 25bps last week, to 0.25%-0.50%. The Fed also indicated that it could implement six additional rate increases this year, and three next year, and that it could start reducing the size of its balance sheet as early as May 2022. Additionally, [the updated Summary of Economic Projections](#) showed a median Fed funds rate at 1.9%, with a core PCE at 4.1% at the end of 2022, implying a negative real rate (of 1.2%) that indicates a still-accommodative monetary stance, which could be removed in coming months.

Also last week, the Bank of England increased its Bank Rate by 25bps to 0.75%, for the third consecutive time since December, taking the rate back to the level it was at pre-pandemic. While the tone of the accompanying [statement was less hawkish than it had been previously](#), thanks in part to the dovish dissent of Deputy Governor Jon Cunliffe, the BoE might still increase rates in the upcoming May meeting, at the same time as it releases its next Monetary Policy Report (MPR). Otherwise one would not understand the reason to rush with a rate increase in a non-MPR month.

A week before these moves by the Fed and the BoE, [the ECB ended its extraordinary pandemic-related PEPP program](#) and accelerated the pace of tapering of its net asset purchases (which could finish entirely in June), while also upwardly revising its inflation projections by a significant amount.

These moves signal a fact we [correctly predicted, namely that central banks will remain relatively hawkish in spite of the war in Ukraine](#), being more concerned about the inflationary impact of the conflict than its potential negative impact on economic activity. The Bank of Japan, among the “Big 4” central banks, remains however an outlier here, [having left its policy stance unchanged in March](#). But this can be explained by the still-low rate of inflation in Japan, following three decades of deflation/lowflation.

In our column we also argued that governments will need to do their part in supporting economic activity while central banks focus on combating rampant inflation and preventing the de-anchoring of inflation expectations. A simple solution would be for governments to partly offset the rise in energy prices (gas and oil) by reducing the taxes on final energy products, such as petrol at the gas station. Some governments have started to do so. In Italy, Mario Draghi has announced a temporary reduction of [the fuel duty by EUR 0.25 per litre](#). In the UK, [Chancellor Rishil Sunak is widely expected](#) to adopt a similar measure to reduce the impact on households and businesses in the Spring Budget Statement on Wednesday.

Hence, it seems that a division of labour is emerging between central banks (focusing on inflation) and governments (supporting economic activity). However, it is not so simple as this. Additional fiscal stimulus in this phase may prove inflationary, defeating the purpose of the central banks’ tightening, or at least making it more complicated. The example of the fiscal stimulus provided by the US during the pandemic, which is certainly one of the reasons behind the rapid surge of inflation in the country, is illuminating in that respect.

Furthermore, the fiscal stimulus provided during the pandemic was directly or indirectly monetised by central banks, which is not going to be the case in this instance. This may result in higher market rates, i.e. in tighter financial conditions as a result of government intervention, at a time when central banks are already raising policy rates.

All this suggests that although economic policy authorities are moving to do what they perceive to be their job, finding the correct policy mix, let alone the optimal policy mix, may prove elusive.

Our Recent Publications

📌 [Flash Review: A Less “Hawkish” BOE Continues Its Policy Normalisation Process](#), by Brunello Rosa and Nato Balavadze, 17 March 2022

📌 [Flash Review: Fed Raises Rates and Announces Imminent Beginning of QT](#), by Brunello Rosa, 16 March 2022

📌 [Flash Preview: Bank Of England To Increase Rates For the Third Time Running in March](#), by Brunello Rosa and Nouriel Roubini, 14 March 2022

📌 [Flash Preview: US Fed To Begin Its Policy Rate Normalization Plan](#), by N. Roubini, B. Rosa and N. Balavadze, 14 March 2022



Looking Ahead

The Week Ahead: PMI To Fall In US And EZ; Inflation To Rise In The UK

In the US, in March, the manufacturing PMI is seen to decrease to 55.8 (*p*: 57.3), as well as the services PMI (*c*: 56; *p*: 56.5).

In the EZ, in March, the manufacturing PMI and service PMI are expected to slow down to 56.0 (*p*: 58.2) and 54.1 (*p*: 55.5) respectively.

In the UK, February's inflation flash estimates are expected to show: *i*) inflation rate rising to 5.9% y-o-y (*p*: 5.5%) and to 0.6% m-o-m (*p*: -0.1%); and *ii*) core inflation rising to 4.8% y-o-y (*p*: 4.4%).

The Quarter Ahead: Russia And Ukraine Conduct Peace Talks; Shocks To Global Supply Chain Due To Chinese Covid-19 Restrictions

The EU and the US are deciding how to fund the Ukrainian resistance, impressed by President Zelensky's plea. The Russian invasion has united EU countries, paving the way to a unified and resilient response to pay for humanitarian relief and overcoming the economic disruption linked to the conflict. While the US President approved the delivery of new US weapons to Kyiv to support the country.

Russia and Ukraine are engaged in a peace plan for a ceasefire. Negotiators are discussing a 15-points draft that demands Kyiv to renounce to NATO's membership as well as to not hosting foreign military bases or weaponry, as Russia will try to break any link between Ukraine and the West, which could compromising Russia's security.

Middle Eastern states are dealing with the West and Russia on backup plans for the energy-crunch. Pakistan is planning to finalize a Russian-built gas pipeline, while straining links with its ally, the US. Similarly, the UK Prime Minister will visit Saudi Arabia to coordinate Saudi investments in British renewable energy and to convince the UAE government to increase its oil production to tackle market volatility.

White House Officials warn that the US could be unprepared for a fifth Covid-19 wave. As infection levels are rising in Europe, experts are expecting a similar scenario in the US, while the federal budget to pay for vaccines, tests and treatments is being reduced. It is still uncertain how the Biden administration will rebuild financial capacity and find new funding for healthcare, amid rising military spending.

China lockdowns are creating a shock to global supply chains, which is likely to reduce growth and profitability across the technology industry. Foxconn, Apple's supplier, has warned that revenues could contract by three-percent, while other tech companies are distressed by restrictions on transport as the supply chain between Hong Kong and mainland in 'semi-meltdown'.

Last Week's Review

Real Economy: Higher Inflation Rates In The EZ, Unemployment Falls In The UK

In the EZ, February's annual and monthly CPI inflation rose to a flesh record of 5.9% y-o-y (*p*: 5.1%) and 0.9% m-o-m (*p*: 0.3%) respectively, while core CPI inflation increased to 2.7% y-o-y (*p*: 2.3%).

In the UK, January's unemployment rate declined to 3.9% (*p*: 4.1%) as the labour market continued to recover.

In the US, UK, Japan, at their monetary meetings, Fed and BoE rose their policy rates to 0.5% (*p*: 0.25%) and 0.75% (*p*: 0.5%) respectively; the BoJ kept its interest rate unchanged (*p*: -0.1%).

Financial Markets: Global Equities, 10Y US And German Bond Yields Surge, Oil Prices Keep Rising

Market drivers: the war in Ukraine continued to drive markets as: *i*) the US banned Russian oil imports; *ii*) inflation kept surging in most countries.

Global equities increased w-o-w (MSCI ACWI, +5.72%, to 701). In the *US*, the S&P 500 ended higher (+6.16% w-o-w to 4,463). In the *EZ*, shares increased (Eurostoxx 50, +5.85% w-o-w, to 3,902). In *EMs*, equities raised (MSCI EMs, +3.744%, to 1,123), while the Chinese stocks dropped (Shanghai Comp., -1.77%, to 3,252). **Volatility** lost (VIX S&P 500, -7.83 pts to 23.87, 52w range.: 14.1-37.51).

Fixed Income: US 10-year bond yield and Germany's 10-year bond yield rose slightly (+1bps, to 2.15% and +1bp, to 0.36% respectively. The EMTX 7-10 RT increased by +0.86pts, to 269.

FX: w-o-w, the US Dollar Index fell (DXY, -0.66%, to 98.215; EUR/USD gained by +1.06%, to 1.1055). In *EMs*, currencies weakened against the USD (MSCI EM Currency Index, +1.03% w-o-w, to 1,724).

Commodities: Oil prices rose (Brent, +0.96% w-o-w, to 107.96 USD/b) as a reaction to the conflict between Russia and Ukraine and the US ban on Russian oil imports. Gold Futures slightly fell (-1.61% w-o-w, to 1,922 USD/Oz), while the price of gold surged to \$2,072 per ounce on Tuesday, surpassing its previous record closing high set in August 2020.



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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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