



R&R Weekly Column
By Brunello Rosa



Major Central Banks Still On Full Throttle On Policy Tightening, Given Inflation's Continued Upward Surprises

At the beginning of H2 2022, the world's largest central banks have all delivered substantial monetary policy tightening. The first of these (in chronological order) was [the European Central Bank, which on 21 July delivered a 50bps rate increase](#), bringing the deposit rate back to zero, despite expectations of a 25bps initial increase in all three rates of the so-called "corridor".

There were two main motivations behind the ECB's decision. First was that inflation surprised on the upside compared to the forecasts released just a few weeks before in the June macroeconomic projections. Second was the simultaneous introduction of the Transmission Protection Mechanism (TPM), which is designed to reduce the fragmentation in the transmission of monetary policy. Without that instrument, the ECB should have been much more cautious in increasing rates, as the sovereign yields of the most fiscally-exposed countries (chiefly, Italy) were increasing much more than was warranted by expectations of a tighter monetary policy stance.

After the ECB, the Fed, at its July 20 FOMC meeting, [carried out its second 75bps rate increase in a row](#), the first having been [delivered in June](#). This was motivated by the need to bring rates into neutral territory (the upper end of the Fed funds corridor is now 2.50%, in line with the "longer end" forecast for the policy rates in the SEP dots), as inflation continued to surprise on the upside. Additionally, the Fed has also speeded up the pace of reduction of its balance sheet, to increase the overall amount of tightening in its policy stance.

Somewhat paradoxically, the market welcomed this second larger rate increase with a relief rally, as the Fed also changed its forward guidance. Chair Powell said that the Fed will not provide multi-meeting guidance anymore, as the FOMC will instead decide meeting by meeting, as it has become data dependent. However, [the latest very strong Non-Farm-Payroll figures for August](#), showing a 528K addition of jobs (much more than the 250K expected and even above the 398K addition recorded in July), may induce the Fed to deliver another 75bps increase in September.

Finally, on August 4th, the [Bank of England delivered a 50bps increase in its Bank Rate](#), bringing it to 1.75%, its largest rate increase for 27 years. Its Monetary Policy Committee, which had been split 6-3 in favour of a 25bps increase in June, moved to an 8-1 split for this larger move. This decision was motivated by the continued upward surprises of inflation, which is now expected to reach 13%, in spite of the incipient recession. In its latest Monetary Policy Report, the BoE now expects a contraction in economic activity to occur at the end of 2022, and to last for five quarters, one of the longest recessions in recent decades.

So, given the above background, with inflation continuing to surprise to the upside and labour markets still strong in the US, the EZ and the UK, it is likely that central banks will need to continue their job of reining in inflation with unrelenting determination in coming months. The only element that could make them think twice is the beginning of the recession that some of them are predicting (while others are still, delusionally, denying that it will take place). A recession that may be caused, also, by the very tightening of monetary policy that central banks are undertaking in order to control inflation.

Our Recent Publications

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📄 [Flash Review: Fed Hikes Fed Funds by 75bps, But Ongoing Rate Increases Will be Data Dependent](#), by Brunello Rosa and Nato Balavadze, 27 July 2022



Looking Ahead

The Week Ahead: In US Headline Inflation To Cool Off, With Core Inflation Rising; UK QoQ GDP To Contract

In the US, in July, inflation is likely to cool off to 8.7% y-o-y (*p*: 9.1%) and 0.2% m-o-m (*p*: 1.3%). On the other hand, core inflation is expected to increase to 6.1% y-o-y (*p*: 5.9%). July's PPI and core are seen decelerating to 10.4% y-o-y (*p*: 11.3%) and 7.7% (*p*: 8.2%). In August, according to a preliminary estimate, Michigan Consumer sentiment is likely to increase to 52.2 (*p*: 51.5).

In the EZ, June IP is expected to decrease to 0.7% y-o-y (*p*: 1.6%). In the largest EZ economies annual harmonized inflation rate is likely to: *i*) surge in Germany to 8.5% (*p*: 8.2%); *ii*) decrease slightly in Italy to 8.4% (*p*: 8.5%); and *iii*) increase in France to 6.8% (*p*: 6.5%).

In the UK, in Q2, preliminary estimates show that: *i*) GDP is expected to shrink by 0.2% q-o-q (*p*: 0.8%); and *ii*) the economy is seen decelerating to 2.8% y-o-y (*p*: 8.7%). June's IP is likely to increase by 1.6% y-o-y (*p*: 1.4%).

The Quarter Ahead: Pelosi Visits Taiwan And China Reacts; Putin And Erdogan Extend Economic Ties; US Senate Pushes Inflation Bill

U.S. House of Representatives Speaker Nancy Pelosi visited Taiwan. Meanwhile China's foreign minister called Pelosi's trip '*manic, irresponsible and irrational*', imposing sanctions on her and her family. Following the visit, China resumed its largest-ever military exercises in the waters around Taiwan. US Secretary of State Antony Blinken condemned China's military drills, which also included firing missiles into Japan's economic zones. China suspended some imports of Taiwanese fish and fruits and blocked exports of sand.

Putin and Erdogan met in Sochi. They agreed to boost economic cooperation despite war sanctions. Following a four-hour meeting, the two presidents said they were looking to strengthen cooperation in the transport, agriculture, finance, and construction industries in a joint statement. Turkey will also pay part of its payments for gas in Russian roubles, extending use of Russia's Mir payment system.

The US Senate is looking to advance a bill, that addresses climate change, cost of energy, and senior citizens' drugs. The bill – also named the Inflation Reduction Act – aims to tame inflation by reducing the deficit, lowering prescription gas prices and investing into domestic energy production. The legislation would impose new taxes to pay for it, including a new 1% excise tax on stock buybacks.

Last Week's Review

Real Economy: Unemployment Decreased In US And Remained Still In EZ; PMIs Decreased In DMs, Falling Below 50 In US And EZ

In the US, in July, the unemployment rate decreased to 3.5% (*p*: 3.6%; *c*: 3.6%) and NFPs rose by 528K (*p*: 398K; *c*: 250K)

In the EZ, in June, unemployment rate stayed unchanged at 6.6% as expected. Also in June retail sales contracted -1.2% m-o-m (*p*: 0.4%; *c*: 0.0%) and -3.7% y-o-y (*p*: 0.4%; *c*: -1.7%). June's PPI decelerated to 35.8% y-o-y (*p*: 36.2%; *c*: 35.7%).

In the UK, the BoE increased its Bank Rate by 50bps 1.75%.

In DMs, business activity slowed down: *i*) In the US, manufacturing and services PMI declined to 52.2 (*p*: 52.7; *c*: 52.3) and 47.3 (*p*: 52.7; *c*: 47.0) respectively. Composite PMI fell to 47.7 (*p*: 52.3; *c*: 47.5); *ii*) In the EZ, manufacturing and services PMI declined to 49.8 (*p*: 52.1; *c*: 49.6) and 51.2 (*p*: 53.0; *c*: 50.6) respectively. Composite PMI decreased as well to 49.9 (*p*: 52.0; *c*: 49.4); and *iii*) In the UK, manufacturing and services PMI declined to 52.1 (*p*: 52.8; *c*: 52.2) and 52.6 (*p*: 54.3; *c*: 53.3) respectively. Composite PMI fell to 52.1 (*p*: 52.7; *c*: 52.8).

Financial Markets: Stocks Rose Slightly; Yields Were Sharply Higher; Dollar Is Up, While Oil Is Down; Gold Also Rose

Market Drivers: As investors reacted positively to stronger than expected jobs report, *i*) yields surged and *ii*) dollar rose. For robust payroll report and hawkish messages from the Fed, the probability for more aggressive monetary policy tightening is raised. As a result of which, the major U.S. indexed demonstrated mixed results.

Global Equities: Increased w-o-w (MSCI ACWI, +0.3%, to 639.5). The US S&P 500 index increased (+0.4% w-o-w, to 4,145.2). In the EZ, share prices were up (Eurostoxx 50, +0.5% w-o-w, to 3,725.4). In EMs, equity prices increased (MSCI EMs, +0.9%, to 1002.9). Volatility fell to 22.6 (VIX S&P 500, 52w avg.: 23.4; 10y avg.: 18.1).

Fixed Income: w-o-w, 10-year US treasury yields rose (+16.9 bps to 2.83%). The 2-year US Treasury yields increased too (+33.9 bps to 3.23%). The German 10-year bund yield rose (+12 bps to 0.94%).

FX: w-o-w, the US Dollar Index was up (DXY, +0.6%, to 106.6; EUR/USD -0.4%, to 1.02). In EMs, currencies were virtually unchanged (MSCI EM Currency Index, +0.0% w-o-w, to 1,661.57).

Commodities: w-o-w, oil prices fell significantly (Brent, -14.0% to 94.7 USD/b). Gold prices increased w-o-w (+0.6% to 1,792.4 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



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