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MAKING SENSE OF *THIS* WORLD 17 October 2022

R&R Weekly Column
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Policy Uncertainty Dominates The IMF Meetings

The annual IMF meetings took place last week, and they were held in an in-person format for the first time in three years. At the centre of attention in these meetings there were of course the geopolitical developments that – as we discussed in our latest column – are having such a large impact on key macroeconomic variables, such as GDP and inflation, as well as on financial markets.

As usual, the IMF released its updated World Economic Outlook, titled “Countering The Cost-Of-Living Crisis”. It foresaw a revision of the key macroeconomic variables consistent with a stagflationary shock: an upward revision in the inflation profile and a downward revision in the growth outlook. Global growth is now forecast to be 3.2% in 2022 and 2.7% in 2023, compared to the 3.2% and 2.9% expected in July 2022.

Another element that was clearly present at the IMF meeting was the sense of policy uncertainty that is prevailing among policymakers. In March this year, in our article titled “Is There An Optimal Policy Mix To Get The Global Economy Out Of The Current Difficult Conjuncture?” we discussed how it is very hard to reach all policy goals that policymakers are setting for themselves (i.e., higher growth, lower inflation, low long-term interest rates and to severely punish Russia for its illegal invasion of Ukraine) with the instruments at their disposal, namely monetary and fiscal policy and sanctions. In particular, we noted how monetary policy and fiscal policy risked entering into a conflict with one another: fiscal easing would be inflationary whereas monetary tightening would depress economic activity.

Our conclusion was that policymakers would only have two solutions: either a) give up at least one of their goals, to focus instead on the others; or b) give up a bit of all goals, and achieve a sub-optimal result on all fronts. In all cases, in these circumstances policymakers cannot aim at finding an optimal policy mix, bur rather can only minimize the effects of the inevitable policy errors that they will make.

In the last few weeks, the UK provided a live case of the point we made: reckless fiscal policy (what we called a “gamble” in our column), uncoordinated with monetary policy or even with the forecasts of the Office for Budget Responsibility, led to a collapse in the value of GBP, and a spike in long-term rates that risked bankrupting the private pension system (undertaking LDIs – Liability Driven Investment). The Bank of England had to step in to bail-out the pension system by committing to re-open asset purchases for the sake of financial stability rather than price stability. Events unfolded further, with Liz Truss forced to sack the Chancellor Kwasi Kwarteng and replace him with the much safer Jeremy Hunt.

The UK case made clear what had already started to become visible on the horizon: central banks can increase short-term interest rates to fight inflation and also buy long-term government bonds to ensure the financial stability of the smooth transition of monetary policy (e.g. the ECB’s TPI). This seemed unconceivable until a few months ago, as it would have represented a policy inconsistency within monetary policy, given the mixed signals that this would send to market participants.

But in this word of policy uncertainty and absence of an optimal policy mix, we need to get used to policy inconsistencies, policy mistakes and even conflicts between the various areas of policymaking.

Our Recent Publications

- *Xi Jinping To Increase His Grip On the Chinese Communist Party, by London Politica, 12 October 2022*
- *The “Wind Of Change” Leaves Investors Puzzled, by Filippo Ramigni, 11 October 2022*
- *Balancing Economic Promotion and Cultural Challenges in the GCC , by Gulf State Analytics, 6 October 2022*
- *Ukraine-Russia Conflict: How Cyberwarfare Is Used Alongside Conventional Weapons, by London Politica, 5 October 2022*

Looking Ahead

The Week Ahead: EZ And UK Inflation To Rise; UK Retail Sales To Shrink; Consumer Confidence To Deteriorate In EZ And UK

In the US, in September, IP is expected to recover to 1.0% m-o-m (*p*: -0.2%).

In the EZ, in September, headline and core inflation are likely to increase to 10.0% y-o-y (*p:* 9.1%) and 4.8% y-o-y (*p:* 4.3%). Monthly inflation is expected to rise to 1.2% (*p:* 0.6%). October's consumer confidence is seen deteriorating further to -30.3 (*p:* -28.8).

In the UK, in September, headline and core inflation are likely to increase to 10.0% y-o-y (*p:* 9.9%) and 6.4% y-o-y (*p*: 6.3%). Monthly inflation is seen decreasing to 0.4% (*p:* 0.5%). Also in September, retail sales are expected to shrink by -5.0% y-o-y (*p:* -5.4%) and -0.5% m-o-m (*p:* -1.6%). October's confidence is seen deteriorating further to -52 (*p:* -49).

The Quarter Ahead: Kwarteng Has Been Sacked; The BOE Ended Its Intervention; Minority Government Formed In Sweden

Britain's finance minister Kwasi Kwarteng has been sacked. Kwarteng's mini-budget included £45bn of tax cuts, funded by borrowing, which led to turmoil in financial markets and a drop in the value of the pound. Truss appointed Jeremy Hunt as Britain's new Chancellor of the Exchequer. Truss announced another U-turn and announced that corporation tax is going to be kept at its current rate. Jeremy Hunt will deliver the government's medium-term fiscal plan on October 31.

Last week the Bank of England intervened to provide extra support to UK markets, warning of 'a material risk to UK financial stability'. It is the third time the BoE intervened to ensure financial stability since the government's mini-budget prompted market turmoil. The Bank confirmed it ended its emergency UK government bond-buying plan on Friday as planned.

A minority government was formed in Sweden, ***relying on far-right support.*** As the likely next prime minister, Ulf Kristersson said, his Moderate party would be joined by the Christian Democrats and Liberals in a formal coalition. The biggest opposition party, the far-right Sweden Democrats, is not an official member of the government, but next PM will have to rely on a "responsible opposition" by the Sweden Democrats to govern effectively.

Russian President Putin claimed 'partial mobilization' would end in two weeks. As he said, 220,000 out of 300,000 reservists are called up so far. He further added that there is no need for large new strikes on Ukraine. Meanwhile Kyiv reported it has freed 600 settlements from Russian occupation this month, including 75 in Kherson.

Last Week's Review

Real Economy: US Headline Inflation Fell, While Core Rise; UK Unemployment Declined; US Retail Sales Decreased

In the US, in September, the headline inflation rate decreased to 8.2% y-o-y (*c:* 8.1%; *p:* 8.3%). Core inflation rose to 6.6% y-o-y (*c*: 6.5%; *p:* 6.3%). Monthly inflation increased to 0.4% (*c:* 0.2%; *p:* 0.1%). In October, according to a preliminary estimate, consumer sentiment increased slightly to 58.9 (*c:* 59; *p:* 58.6). In September, retail sales declined to 8.2% y-o-y (*p:* 9.4%) and 0.0% m-o-m (*c:* 0.2%; *p*: 0.4%).

In the EZ, August's IP recovered to 2.5% y-o-y (*c:* 1.2%; *p:* -2.5%) and 1.5% m-o-m (*c:* 0.6%; *p:* -2.3%).

In the UK, in August, unemployment edged down to 3.5% (*c:* 3.6%; *p:* 3.6%). August's IP shrank -1.8% m-o-m (*c:* -0.2%; *p:* -1.1%).

Financial Markets: Stocks Were Down And Yields Rose; Dollar Is Up, Whereas Oil and Gold Prices Are Down

Market Drivers: As investors digested inflation data and their implications for the Fed, the major indexes ended the week mostly lower. Bond yields surged as investors reacted to higher inflation expectations.

Global Equities: Decreased *w-o-w* (MSCI ACWI, -1.9%, to 552.00). The US S&P 500 index increased (-1.6% w-o-w, to 3,583.07). In the EZ, share prices were up slightly (Eurostoxx 50, +0.2% w-o-w, to 3,381.73). In EMs, equity prices fell (MSCI EMs, -3.8%, to 863.33). Volatility rose significantly to 31.9 (VIX S&P 500, 52w avg.: 25.0; 10y avg.: 18.2).

Fixed Income: *w-o-w*, the 10-year US treasury yields rose (+13.5 bps to 4.02%). The 2-year US Treasury yields rose as well (+18.4 bps to 4.50%). The German 10-year bund yield also rose (+13.9 bps to 2.34%).

FX: *w-o-w,* the US Dollar Index was up (DXY, +0.4%, to 113.17; EUR/USD -0.2%, to 0.97). In EMs, currencies fell (MSCI EM Currency Index, -0.8% w-o-w, to 1,584.17).

Commodities: *w-o-w,* oil prices fell (Brent, -6.6% to 91.46 USD/b). Gold prices decreased w-o-w (-3.5% to 1,650.20 USD/Oz).

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Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*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*