



R&R Weekly Column
By Brunello Rosa



Central Banks Remain Hawkish, But the End of The Tightening Cycle Is in Sight

The US Federal Reserve held its FOMC meeting last week. [As we discussed in our review](#), the Fed increased its Fed funds target rate by 25bps, to 5.00%-5.25%. We – as well the consensus opinion – consider this to be the last increase before a pause that is likely to last at least until the autumn. The Fed is also continuing its policy of reducing its balance sheet, according to the criteria it established in May 2022.

As we discussed in our review, the Fed retained a hawkish bias with this decision. It made it clear that it could further increase its rates if the economy proves to be more resilient, the labour market tighter, and inflation stickier than is currently expected. A condition for this to happen is the absence of further negative surprises from the banking sector. This cannot be taken for granted at this stage, as regional banks remain vulnerable to a downturn in residential as well as commercial real estate, and all banks remain exposed to much higher interest rates. In spite of the Fed's hawkish bias, the market celebrated with a relief rally, especially in bonds. It has been perceived as the end of the hiking cycle – at least for a while.

Also last week, the ECB held its Governing Council (GC) meeting, [and decided a 25bps increase in its policy rates](#). It also decided to accelerate the shrinking of its balance sheet, given the end of the re-investment of maturing bonds from July 2023. Unlike the Fed, the ECB has signaled that further hikes will likely be necessary to tame inflation, which remains stubbornly high at three times the ECB's target level. But with a couple of more hikes in June and July, the ECB too will likely have finished its initial hiking phase.

The [Reserve Bank of Australia meanwhile carried out a surprise rate increase of 25bps, to 3.85%](#), because inflation, at 7%, is still too high compared to its target, even if it has passed its peak.

This week, it will be the [Bank of England's turn to increase its Bank Rate](#), again by 25bps, to 4.25%, to try to bring inflation down to single digit levels. Inflation remains above 10% in the UK, impacted not just by the re-opening of the economy and the energy shock, but also by the effects of Brexit on British supply chains.

In spite of the different jurisdictions, it is clear that central banks, especially in the developed world, have now reached, or are about to reach, a local peak in their increases of interest rates. The Fed has increased rates by 500bps in a little more than a year. The hiking cycle has been rapid, large and coordinated, to an extent unseen in recent decades.

The side effects of this massive tightening in policy rates conducted at global level has started to appear in terms of financial instability, with banks suffering a level of interest rates that may be beyond what the Fed has called a "[financial \(in\)stability rate](#)." Central banks will now have to try a difficult balancing act between slowing growth, persistently high inflation, and incipient financial instability. Not an easy job, surely.

Our Recent Publications

✿ [Review: "Non-Pausing" ECB Increases Rates, Signals Further Hikes and Will Stop APP Re-investment in July](#), by Brunello Rosa and Nato Balavadze, 4 May 2023

✿ [Review: The Fed Hikes Rates by 25bps And Signals The Beginning of A Pause, While Retaining a Hawkish Bias](#), by Brunello Rosa and Nato Balavadze, 3 May 2023

✿ [The Fed Between Expected Recession And Banking Crisis](#), by Filippo Ramigni, 2 May 2023

✿ [Preview: ECB To Increase Rates By 25bps in May and Remain Hawkish](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 2 May 2023

✿ [Preview: Fed To Increase Rates by 25bps in May and Signal a Hawkish Pause](#), by Nouriel Roubini, Brunello Rosa and Nato Balavadze, 1 May 2023

✿ [Looming Instability for Turkish Politics: An Explainer on the Upcoming Turkish Elections](#), by London Politica, 27 April 2023



Looking Ahead

The Week Ahead: UK QoQ And YoY GDP To Rise; US Headline Inflation To Stay Unchanged, While Core Is Expected To Increase

In the US, in April, the headline inflation rate is expected to stay unchanged at 5.0%, while core inflation is likely to edge up to 5.6% (p: 5.5%). In May, consumer sentiment is seen increasing to 63.5 (p: 63).

Among largest EZ economies, the inflation rate is expected to: i) ease off to 7.2% y-o-y in Germany (p: 7.4%); and ii) increase to 5.9% y-o-y in France (p: 5.7%).

In the UK, according to the preliminary estimates, in Q1, GDP growth is seen rising by 0.1% q-o-q (p: 0.1%) and 0.6% y-o-y (p: 0.2%). In March, IP is expected to shrink by 2.9% (p: -3.1%).

Still in the UK, the BoE is expected to increase its Bank Rate by 25 bps to 4.50%.

The Quarter Ahead: Russia Accused Ukraine And Then US Of Drone Attack On The Kremlin; Massive split in Russian military forces

Kremlin drone attack. According to Moscow officials, Ukraine has reportedly carried out a number of drone attacks on Russian soil in the past few days. The Kremlin first accused Ukraine of attempting to assassinate Russian President Putin by launching a drone attack on his residence on Tuesday. However, the Russian air defence system managed to intercept and bring down two drones, and President Putin was reportedly not present at the time. Now Russia shifted focus from Kyiv to Washington, without providing evidence.

Massive split in Russian military forces. The leader of the Wagner private military company in Russia has notified Putin that his troops will be pulled out from the eastern city of Bakhmut due to insufficient military assistance from Moscow. Wagner accused Russia's defense ministry of causing a shortage of shells for their fighters, resulting in significant casualties. The group's statement claims that the Kremlin is envious of their achievements on the front lines, especially following the retreat of defense ministry units from Kharkiv and Kherson during Ukraine's counteroffensive in September 2022.

Last Week's Review

Real Economy: EZ Headline Inflation Rose, While Core Fell; US Unemployment Decreased And NFPs Increased; CBs Tightened Policy

In the US, in April, S&P Global Manufacturing and Services PMIs edged up to 50.2 (c: 50.4; p: 49.2) and 53.6 (c: 53.7; p: 52.6). Composite PMI rose to 53.5 (c: 52.3; p: 53.5). Unemployment rate fell to 3.4% (c: 3.6%; p: 3.5%) and NFPs rose by 253K (c: 180K; p: 165K).

In the EZ, in April, headline inflation increased to 7.0% (p: 6.9%) as expected, while core fell to 5.6% y-o-y (c: 5.7%; p: 5.7%). In March, unemployment rate edged down to 6.5% (c: 6.6%; p: 6.6%). In April, HCOB Manufacturing PMI fell to 45.8 (c: 45.5; p: 47.3), whereas services PMI increased to 56.2 (c: 56.6; p: 55). Composite PMI increased too to 54.1 (c: 53.7; p: 53.7).

In the UK, in April, S&P Global Manufacturing PMI edged down to 47.8 (c: 46.6; p: 47.9). Services and Composite PMIs edged up to 55.9 (c: 54.9; p: 52.9) and 54.9 (c: 53.9; p: 52.2) respectively.

CBs tightened policy stances. In US, the Fed increased its target Fed funds range by 25 bps to 5.0% - 5.25%. In the EZ, the ECB raised its main policy rate by 25 bps, i.e. it raises its i) interest rate on the 'main refinancing operations' to 3.75%; ii) interest rate on the 'marginal lending facility' to 4.0%; and iii) 'deposit facility' to 3.25%.

Financial Markets: Stock Prices and Bond Yields Decreased. The Dollar Index and Oil Prices Fell, While Gold Prices Rose

Market Drivers: Stock prices posted declines, as the Fed suggested it may be too soon to cut rates. Concerns around the US debt ceiling and US regional banks also weighed on sentiment, and specifically on the UST yields.

Global Equities: Decreased w-o-w (MSCI ACWI, -0.4%, to 652.45). The US S&P 500 index edged down (-0.8% w-o-w, to 4,136.25). In the EZ, share prices were down (Eurostoxx 50, -0.4% w-o-w, to 4,341.05). In EMs, equity prices moved up (MSCI EMs, +0.5%, to 981.66). Volatility rose to 19.4 (VIX S&P 500, 52w avg.: 24.6; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US treasury yields were down (-0.0 bps to 3.44%). The 2-year US Treasury yields also decreased (-10 bps to 3.92%). The German 10-year bund yield edged down (-5 bps to 2.27%).

FX: w-o-w, the US Dollar Index declined (DXY, -0.4%, to 101.2; EUR/USD -0.0%, to 1.1). In EMs, currencies increased (MSCI EM Currency Index, +0.4% w-o-w, to 1,694.65).

Commodities: w-o-w, oil prices decreased (Brent, -5.2% to 75.37 USD/b). Gold prices rose w-o-w (+1.3% to 2,024.60 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