



R&R Weekly Column
By Brunello Rosa



Why It Will Be Difficult For Central Banks to Return Inflation To Their Targets

There is a lively debate over how long central banks will continue to increase their policy rates. Clearly lots of ground has been covered by the world's major central banks in order to rein in inflation, but there is the widespread expectation that more needs to be done to ensure that inflation will remain low, and as close as possible to their pre-pandemic and pre-war target levels. Let's look at the three major central banks, knowing well that other G10 central banks have followed and will continue to follow a similar pattern.

The [US Federal Reserve](#) has started its tightening cycle sooner than any other developed economy's central bank (though after some key emerging market central banks, which moved in anticipation of the Fed's decision in order to avoid a repetition of the "taper tantrum" of 2013-14). The Fed started to [increase rates in March 2022](#), and has brought their Fed funds target range from 0-0.25% to 5.00-5.25%. This tightening cycle has had some effect, as both headline and core inflation have dropped, according to various gauges. For example CPI is now at 3.0% and core-CPI is at 4.8%. But as the labour market remains resilient and wage growth quite dynamic, the Fed has signalled that it intends to increase rates at least another couple of times before year end, with July being the first of such occasions.

The ECB started increasing rates later than the Fed and from a lower starting point, as the deposit rate was -0.5% at the beginning of the campaign. [Now the deposit rate is at 3.5% and the ECB has already announced that it intends to hike rates again in July](#). With headline inflation at 5.5% and core inflation at 5.4 % the ECB will likely continue increasing rates into the autumn, and possibly winter. September remains a possible time for a rate increase.

The Bank of England continues to be in the most complicated situation, as inflation remains stubbornly high, a result not just of the Ukrainian war-induced energy shock, but also of the self-inflicted Brexit, which now a large part of the population is regretting. Headline inflation is at 8.7% and core inflation 7.1%. In June, when headline inflation remained at 8.7% instead of falling to 8.4% as expected, [the Bank of England decided to increase rates by 50bps instead of the 25bps anticipated by market participants](#). Now it's clear that the BoE will increase rates again in H2 2023, starting from August, and a cumulative increase of Bank Rate to 6% is almost certain by year-end.

So, all major central banks will increase rates further in coming months, and - after having reached their "terminal rates" - they will keep rates at a high level for a period of time longer than the market currently expects, just to make sure that they have finished the job of killing this sort of inflation, which has proven to be much stickier than was initially anticipated.

But the real question is: will central banks manage to bring inflation down to their original targets, on a sustained basis? Central banks can certainly temporarily bring inflation down, possibly to even below their targets, especially when base effects work in their favour. But in the medium term, inflation is likely to remain higher than initially thought, and certainly higher than pre-pandemic and pre-war levels, [for the various reasons we have discussed on previous occasions](#) (such as the tech and ecological transition, de-globalisation, the balkanisation of global supply chains, and the re-distribution of income from capital to labour). And so the question is whether central banks will make an extra effort to bring inflation down from 3-4% to their target of 2%.

We do not think it is the case that they will, as the price in terms of loss of output and increase in unemployment is too high for any central bank to bear, however independent they may be. Even if they are politically independent, central banks do not want to be responsible for adding further fuel to the electoral competitiveness of populist parties, which thrive from this combination of high inflation and sluggish growth.

This does not mean that central banks will ask for an upward revision of their inflation targets. Nor will governments rush to do so, as they do not want to be accused of having failed on their promise of reining in inflation. They will likely de-facto accept an above target inflation, patiently waiting for the system to adjust to the new price level and hoping that this will remain a one-off adjustment process, rather than a continued feature of the next few years.

Our Recent Publications

📖 [The Wagner Coup: What Happened And What To Expect Soon?](#), by London Politica, 13 July 2023

📖 [The Impact of Prigozhin's Armed Rebellion On the Stability of Putin's Regime](#), by Marco Lucchin, 11 July 2023

📖 [Central Banks Between Delusions And Certainties](#), by Filippo Ramigni, 27 June 2023

📖 [Key Takeaways from Antony Blinken's Visit to China](#), by London Politica, 23 June 2023



Looking Ahead

The Week Ahead: EZ And UK Headline Inflation Expected To Fall; Core Inflation To Rise In EZ, While Remaining The Same In the UK

In the US, in June, retail sales are expected to advance by 0.5% m-o-m (*p*: 0.3%) and IP is likely to stall (*p*: -0.2%)

In the EZ, in June, headline inflation is likely to ease off to 5.5% y-o-y (*p*: 6.1%), whereas core inflation is expected to increase to 5.4% y-o-y (*p*: 5.3%).

In the UK, in June, headline inflation is seen easing off to 8.2% y-o-y (*p*: 8.7%), whereas core inflation is expected to stay the same at 7.1% y-o-y. June's retail sales are expected to shrink by 1.5% y-o-y (*p*: -2.1%) and advance by 0.2% m-o-m (*p*: 0.3%). In July, Gfk Consumer Confidence is seen contracting by to -26 (*p*: -24).

The Quarter Ahead: China Reacts Angrily To a NATO Statement; NATO Summit In Vilnius And Ukraine; Spanish Elections

China promises a 'resolute response' to any NATO expansion in Asia. Beijing expressed strong dissatisfaction with a NATO statement that presents China as a significant obstacle to the security and interests of the military alliance, resulting in an angry response. The presence of four Asia-Pacific leaders at the NATO summit suggests that Ukraine is not the only major security issue. **NATO summit was held in Vilnius.** NATO summit declaration reports that 'Ukraine's future is in NATO'; however, the alliance declined to set a timeline for Ukrainian accession. In fact, Biden said war with Russia must end before NATO can consider membership for Ukraine. Zelenskyy reiterated that the best guarantees are for Ukraine to be in NATO.

Ahead of Spanish elections. The Spanish elections will be held on July 23 to elect the 15th Cortes Generales of the Kingdom of Spain. According to the polls, Spain's opposition conservative People's Party (PP) is ahead of the ruling Socialists (PSOE) of Prime Minister Pedro Sanchez. However, according to the PP falls short of obtaining a decisive majority.

Last Week's Review

Real Economy: US Inflation Eased Off; Inflation Fell In France And Italy, While Continued to Rise In Germany

In the US, in June, both headline and core inflation rates eased off to 3.0% y-o-y (*c*: 3.1%; *p*: 4.0%) and 4.8% y-o-y (*c*: 5.0%; *p*: 5.3%) respectively. The Michigan Consumer Sentiment edged up to 72.66 (*c*: 65.5; *p*: 64.4).

In the EZ, in May, IP contracted by 2.2% y-o-y (*c*: 0.2%; *p*: -1.2%). In July, ZEW Economic Sentiment Index shrank to -12.2 (*p*: -10).

Among the largest EZ economies, the headline inflation rate: *i*) increased to 6.4% y-o-y (*p*: 6.1%) in Germany as expected; *ii*) fell to 4.5% y-o-y (*c*: 4.5%; *p*: 5.1%) in France; and *iii*) decreased to 6.4% y-o-y (*c*: 6.8%; *p*: 7.6%) in Italy.

In the UK, in May, the unemployment rate edged down to 4.0 (*c*: 3.8%; *p*: 3.8%). May's IP shrank by 2.3% y-o-y (*c*: -2.3%; *p*: -1.6%).

Financial Markets: Stock Prices Increased; Yields Edged Down; Dollar Index Fell, While Oil And Gold Prices Rose

Market Drivers: In the US, stocks surged during the week due to positive investor response to data indicating a continued cooldown in inflation. The dollar index fell to a 16-month low and 10Y UST yields fell back below 4.0% on soft US inflation. European government bond yields fell also as investors perceive that the end of the policy tightening cycle is nearing.

Global Equities: Increased w-o-w (MSCI ACWI, +3.4%, to 696.22). The US S&P 500 index edged up (+2.4% w-o-w, to 4,505.42). In the EZ, share prices were up (Eurostoxx 50, +3.9% w-o-w, to 4,400.11). In EMs, equity prices moved up (MSCI EMs, +4.9%, to 1028.49). Volatility fell to 13.77 (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 (-23 bps to 3.83%). The 2-year US Treasury yields decreased (-18 bps to 4.77%). The German 10-year bund yield edged down (-16 bps to 2.48%).

FX: w-o-w, the US Dollar Index decreased (DXY, -2.3%, to 99.96; EUR/USD -2.4%, to 1.1). In EMs, currencies increased (MSCI EM Currency Index, +1.6% w-o-w, to 1,704.94).

Commodities: w-o-w, oil prices increased (Brent, +1.4% to 79.63 USD/b). Gold prices rose w-o-w (+1.4% to 1,959.30 USD/Oz).



@RosaRoubini



Rosa & Roubini



Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED

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



Rosa & Roubini Associates Ltd is a private limited company registered in England and Wales (Registration number: 10975116) with registered office at 118 Pall Mall, St. James's, London SW1Y 5ED, United Kingdom. VAT registration number GB 278 7297 39. **Analyst Certification:** We, Brunello Rosa and Nouriel Roubini, hereby certify that all the views expressed in this report reflect our personal opinion, which has not been influenced by considerations of Rosa&Roubini Associates's business, nor by personal or client relationships. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the views expressed in this report. **Disclaimer:** All material presented in this report is provided by Rosa & Roubini Associates-Limited for informational purposes only and is not to be used or considered as an offer or a solicitation to sell or to buy, or subscribe for securities, investment products or other financial instruments. Rosa & Roubini Associates Limited does not conduct "investment research" as defined in the FCA Conduct of Business Sourcebook (COBS) section 12 nor does it provide "advice about securities" as defined in the Regulation of Investment Advisors by the U.S. SEC. Rosa & Roubini Associates Limited is not regulated by the FCA, SEC or by any other regulatory body. Nothing in this report shall be deemed to constitute financial or other professional advice in any way, and under no circumstances shall we be liable for any direct or indirect losses, costs or expenses nor for any loss of profit that results from the content of this report or any material in it or website links or references embedded within it. The price and value of financial instruments, securities and investment products referred to in this research and the income from them may fluctuate. Past performance and forecasts should not be treated as a reliable guide of future performance or results; future returns are not guaranteed; and a loss of original capital may occur. This research is based on current public information that Rosa & Roubini Associates considers reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. Rosa & Roubini Associates, its contributors, partners and employees make no representation about the completeness or accuracy of the data, calculations, information or opinions contained in this report. Rosa & Roubini Associates has an internal policy designed to minimize the risk of receiving or misusing confidential or potentially material non-public information. We seek to update our research as appropriate, but the large majority of reports are published at irregular intervals as appropriate in the author's judgment. The information, opinions, estimates and forecasts contained herein are as of the date hereof and may be changed without prior notification. This research is for our clients only and is disseminated and available to all clients simultaneously through electronic publication. Rosa & Roubini Associates is not responsible for the redistribution of our research by third party aggregators. This report is not directed to you if Rosa & Roubini Associates is barred from doing so in your jurisdiction. This report and its content cannot be copied, redistributed or reproduced in part or whole without Rosa & Roubini Associates' written permission.

