



R&R Weekly Column
By Brunello Rosa



Central Banks Set To Continue Their Tightening Cycles in July and August

Last week we discussed how [it will be difficult for central banks to achieve their inflation targets](#). A series of factors will likely keep core inflation, and eventually headline inflation, higher on average than in previous decades. Central banks will do as much as they can to bring inflation down to their targets, which tend to be around 2% in developed markets. But when inflation is between 3% and 4%, they will have to make a difficult judgment call.

Should they try to make an extra effort to bring inflation down to 2%, while causing a major loss of output, an increase in the unemployment rate, and potentially causing financial instability episodes? Or should they give up their targets in order to preserve economic and financial stability as well as social cohesion? Each central bank will choose for itself, but we believe that, on average, most central banks will choose the first option.

While mulling over what to do in the medium term, the world's major central banks are all meeting this week and next. They will start on Wednesday, when the US Federal Reserve will announce the outcome of its two-days FOMC meeting. [As we discuss in our preview](#), we expect the Fed to increase its Fed funds target range by 25bps, as is widely expected by the market and has been signalled by Powell in previews weeks. This is likely to be the penultimate rate increase of the year, with the final one to be delivered between September and November, depending on how aggressive the Fed wants to be.

On Thursday it will be the ECB's turn. [The Governing Council will likely agree, unanimously, on a 25bps increase](#), which has been amply publicised in advance by ECB President Christine Lagarde. The ECB started its tightening cycle one year ago, four months after the Fed, and from a lower base than the Fed (the ECB's deposit rate was -0.5%). We also expect the ECB to increase rates twice more this year, probably in July and September. If inflation surprises to the upside significantly, we cannot rule out a further increase by the year's end, possibly in December.

Finally, on Friday the BoJ will announce its own decision. In Japan inflation has been much better behaved than in other advanced economies; the country had after all been facing three decades of deflation. But recently [inflation has been higher in Japan than in the US, for the first time in eight years](#). In spite of this, we do not expect the BoJ to make any meaningful change to its policy stance, though it might start to tweak the language in its policy statement to suggest that, in coming months, the Bank may be ready to phase out its flagship yield curve control (YCC) policy.

The following week, on 4 August, it will be the BoE's turn to decide on its policy stance. After the surprise increase, by 50bps, that it carried out in June, following upon an unexpectedly sticky inflation reading, we expect the BoE to increase its Bank Rate by only 25bps, as inflation has in fact fallen to 7.9% from 8.7% the month before, more than the market had been expecting. The BoE remains the central bank in the most precarious position, considering how sticky inflation is in Britain when compared to other jurisdictions. This is also, in part, the result of the self-inflicted wound that was Brexit.

As we discussed last week, the other message that all central banks will try to give to market participants is that, once their terminal rate will be reached, they will keep rates high for longer than the market currently expects them to, so as to make sure that inflation has been tamed for good.

Our Recent Publications

📖 [Elections in 2024: The Year That Can Change The World's Fate \(Part 1 – Developed Economies\)](#), by London Politica, 19 July 2023



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

Looking Ahead

The Week Ahead: US QoQ GDP To Decelerate; US Core PCE To Ease; Composite PMIs To Decrease In DMs; CBs To Remain Hawkish

In the US, in Q2, GDP growth is expected to decelerate to 1.7% q-o-q (*p*: 2.0%). June's Core PCE is likely to cool off to 4.2% y-o-y (*p*: 4.6%). In July, according to flash estimates, S&P Global Manufacturing is expected to increase to 46.4 (*p*: 46.3), whereas Services PMI is likely to decrease to 54 (*p*: 54.4).

In the EZ, in July, Economic Sentiment is slightly deteriorate to 95 (*p*: 95.3) while Consumer Confidence is seen rising marginally to -15.1 (*p*: -16.1). In July, according to flash estimates, HCOB Manufacturing is expected to rise to 43.5 (*p*: 43.4), whereas Services PMI is likely to decrease to 51.5 (*p*: 52). Composite PMI is seen falling to 49.7 (*p*: 49.9).

In the UK, in July, according to flash estimates, S&P Global Manufacturing and Services are expected to edge down to 46.1 (*p*: 46.5), and 53 (*p*: 53.7). Composite PMI is seen falling to 52.4 (*p*: 52.8).

CBs are expected to remain hawkish. In the US, the Fed is expected to increase its target Fed funds range by 25 bps to 5.25% - 5.50%. In the EZ, ECB is expected to raise its main policy rates by 25 bps, with the deposit rate reaching 3.75%.

The Quarter Ahead: Spanish Elections Could Bring The Far Right Back To Power; Oil Rallies On Tightening Supply

Elections in Spain. The 2023 Spanish general election were held on Sunday, 23 July 2023, to elect the 15th *Cortes Generales*. The election may lead to the far right taking power, a situation unprecedented since Francisco Franco's dictatorship. The result showed a narrow conservative win by the PP (Partido Popular) with about 33% of votes and 136 seats (with the Socialists of PSOE gathering almost 32% of votes and 122 seats) — which would not be sufficient to form a majority government. The leader of PP, Alberto Feijóo said he would govern with Vox if he needed their votes. Vox has faced criticism from mainstream politicians due to its opposition to abortion rights, denial of climate change, anti-immigration and anti-LGBT policies.

Oil prices have increased for the fourth consecutive week due to a reduction in supply. Prices rose over the war between Russia and Ukraine could have a further impact on supplies. According to Joseph McMonigle, the secretary general of the IEF, the rise in oil prices is driven by the growing demand from China and India, which are the two largest oil consumers after the U.S.

Last Week's Review

Real Economy: EZ And UK Headline Inflation Fell; Core Inflation Rose In EZ, While Decreased In the UK

In the US, in June, retail sales rose by 1.5% y-o-y (*c*: 1.6%; *p*: 2.0%) and IP shrank by 0.4% y-o-y (*c*: 1.1%; *p*: 0.0%)

In the EZ, in June, headline inflation eased off to 5.5% y-o-y (*p*: 6.1%) as expected, whereas core inflation rose to 5.5% y-o-y (*c*: 5.4%; *p*: 5.3%).

In the UK, in June, headline inflation eased off to 7.9% y-o-y (*c*: 8.2%; *p*: 8.7%). Core inflation fell too to 6.9% y-o-y (*c*: 7.1%; *p*: 7.1%). June's retail sales increased to -1.0% y-o-y (*c*: -1.5%; *p*: -2.3%). In July, Gfk Consumer Confidence contracted by 30 (*c*: -26; *p*: -24).

Financial Markets: Stock Prices Increased In US; Yields Edged Down; Dollar Index And Oil Prices Rose

Market Drivers: In the US, increased hopes of the economy avoiding a hard landing were reflected in the upward movement of several key U.S. equity indexes, driven by the tight labor market and a trend of moderating inflation. The 2y UST yield rose, while 10Y UST yield edged down, causing the yield curve to invert further and indicating that investors were anticipating a high probability of another rate hike by the Fed. In the EZ, bond yields declined as inflation in the U.S. and the UK showed signs of cooling.

Global Equities: rose slightly w-o-w (MSCI ACWI, +0.0%, to 696.48). The US S&P 500 index edged up (+0.7% w-o-w, to 4,536.34). In the EZ, share prices were down (Eurostoxx 50, -0.2% w-o-w, to 4,391.45). In EMs, equity prices moved down (MSCI EMs, -2.6%, to 1001.62). Volatility rose to 15.70 (VIX S&P 500, 52w avg.: 24.6; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US Treasury yields fell (-23bps to 3.84%). The 2-year US Treasury yields increased (+8 bps to 4.85%). The German 10-year bund yield edged down (-4 bps to 2.44%).

FX: w-o-w, the US Dollar Index increased (DXY, +1.2%, to 101.08; EUR/USD -0.9%, to 1.1). In EMs, currencies decreased (MSCI EM Currency Index, -0.3% w-o-w, to 1,699.59).

Commodities: w-o-w, oil prices increased (Brent, +1.3% to 80.89 USD/b). Gold prices were stable w-o-w (-0.0% to 1,963.90 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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