



R&R Weekly Column  
By Brunello Rosa



### The UK's Weeks Of Passion

On July 19, the UK celebrated what was emphatically labelled "Freedom Day:" the end of all restrictions related to the pandemic after the difficult months of the second lockdown, which had been particularly severe. More recently, though, the summer holidays, the gradual re-opening of the economy, the return of social interaction without social distancing, and the spreading of the Covid Delta variant have all contributed to a rapid increase in Covid cases.

According to government statistics, there are around 40,000 new daily cases of people having tested positive to Covid, and 330,000 new weekly cases. That is a 9.4% increase compared to the previous week. The number of people admitted to hospitals has also increased (it has surpassed 1000 cases daily), and the number of deaths is also increasing (it reached 72 per day and almost 1000 per week). This is also due to the spreading of a new sub-variant, called AY.4.2, VUI-21OCT-01 or "Delta Plus", which is thought to be up to 10% more transmissible than the original Delta. The new sub-variant is responsible for 6% of the new cases recently registered in the UK.

For this reason, the government is said to be preparing to implement the so-called Plan B, which would include the return of certain restrictions, such as wearing masks in some public spaces, the obligation to show a "green pass" to attend some events or public places, and the suggestion of working from home whenever possible.

If these new restrictions are adopted, this would likely result in less dynamic growth in economic activity, which was already downgraded by the IMF in its latest World Economic Outlook (as we discussed last week). All this is happening at a time when the UK is already going through a very challenging period, in which it is having to deal with the effects of the pandemic and Brexit at the same time.

The result of this dual challenge has been labour shortages in a number of sectors, including hospitality and logistics, with a dearth of workers who can legally operate as waiters, or as car or truck drivers, for example. This, compounded with the effects of higher gas prices, led to the gasoline shortages at pump stations of a few weeks ago, and the absence of key products (such as mineral water) in the shelves of supermarkets. Inflation, meanwhile, has reached 3.2% recently, and is expected to reach 4% or even 5% in coming months.

Facing all these emergencies at the same time, what will the policy response of the authorities be? As far as *fiscal policy* is concerned, this Wednesday the UK Chancellor of the Exchequer will deliver its annual budget, which is expected to bring a new spending review, new investments in education and culture, and digitisation of public administration, among other measures. However, the budget is not expected to massively deviate from the gradual fiscal consolidation path that was envisioned when an increase in corporate tax rates was announced months ago.

Monetary policy is also on the move, with the Bank of England expected to have "a live debate" on November 4<sup>th</sup>, when the new Monetary Policy Report will be issued, about whether or not the BoE should increase its policy rate by 15bps to 0.25%. At this stage, the MPC seems inclined to go in that direction. However, if the government implements new Covid restrictions and economic activity suffers as a result, a rate increase in 2021 may prove premature.

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Looking Ahead

The Week Ahead: Economic Activity Accelerates While Inflation Falls

**In the US**, GDP growth rate for Q3 is expected to rise to 2.5% q-o-q (*p*: 6.7%).

**In the EZ**, GDP growth rate for Q3 is expected to grow 2.0% q-o-q (*p*: 2.2%), and 3.5% y-o-y (*p*: 14.3%).

**In the US**, September's core-PCE index is expected to increase to 3.7% y-o-y (*p*: 3.6%), and PCE index to 4.4% y-o-y (*p*: 4.3%).

**In the EZ**, October's core inflation is expected unchanged at 1.9% y-o-y while headline inflation is seen falling to 3.7% y-o-y (*p*: 4.3%).

The Quarter Ahead: Global Economic Growth Aided By Service Sector Growth; Downside Risks Remain Elevated

**Service-sector strength aids global growth.** Business activity accelerated in some of the world's largest economies owing to a pickup in the services sector that has offset weakness in manufacturing caused by supply-chain bottlenecks and rising prices. That combination likely means the global economy will continue to recover in the final months of the year, but not at the pace reached in Q2, when re-openings led to a growth spurt.

**US infrastructure bill could help prevent the next supply chain crisis.** US President Biden and Democratic lawmakers are edging toward a deal on the scope of their cornerstone economic revival package, and hope to reach a compromise. Scrambling to broker an agreement, Biden met with 19 lawmakers in a busy day of legislative negotiations. He aimed to secure what may be the signature effort of his administration, a multitrillion-dollar, two-bill legislative package that: *i*) expands social safety net programs; and *ii*) infrastructure spending.

**EU mulls terminating Brexit trade deal if UK rift deepens.** The EU could weigh terminating the post-Brexit trade deal if the UK government pulls out of its commitments over Northern Ireland. UK PM Boris Johnson has threatened to unilaterally suspend parts of the Northern Ireland Protocol, which governs trade between the province and the rest of the UK, using the powers granted in Article 16 of the pact. European officials have been discussing the need to prepare a powerful response.

**US Fed Chairman Powell is readying markets for an announcement of a slowdown in its asset purchases** – suggesting that the US economic recovery looks fit enough to sustain reduced Fed stimulus as soon as next month. Powell said the Fed is “on track” to begin slowing the pace of its UST and agency MBS purchases, which it is currently doing at a clip of about USD 120bn a month.

Last Week's Review

Real Economy: Downside Risks Could Slow The Economic Re-Opening, As Inflation Remains High

**In the US**, the IHS Markit composite PMI rose to 57.3 in October (*c*: 54.7; *p*: 55.0), showing the fastest pace of expansion in private sector business activity for three months, as: *i*) service sector growth accelerated to the strongest since July (*a*: 58.2; *c*: 55.1; *p*: 54.9); and *ii*) manufacturing output increased the least in 15 months (*a*: 59.2; *c*: 60.3; *p*: 60.7).

**In the EZ**, the IHS Markit composite PMI fell to 54.3 in October (*c*: 55.2; *p*: 56.2), pointing to the slowest pace of expansion in the EZ private sector business activity, as: *i*) manufacturing posted the weakest increase in production seen over the past 16 months (*a*: 58.5; *c*: 57.0; *p*: 58.6); while *ii*) service growth eased to a six-month low (*a*: 54.7; *c*: 55.5; *p*: 56.4).

**In Japan**, the au Jibun Bank composite PMI was up to 50.7 in October (*c*: 50.7; *p*: 47.9), pointing to the first expansion in private sector activity in six months. The rebound came with: *i*) services activity registering an increase in activity for the first time since January 2020 (*a*: 50.7; *c*: 48.0; *p*: 47.8); while *ii*) manufacturing was at a 3-month high (*a*: 53.0; *c*: 51.4; *p*: 51.5).

**In China**, the PBoC kept its one-year LPR unchanged at 3.85%.

**In Russia**, the CB raised its policy rate by 75 bps to 7.5%, the highest since June 2019.

**In Turkey**, the CBT slashed its one-week repo auction rate by 200bps to 16%, defying market expectations of a 50bps cut.

Financial Markets: Global Stocks Gain; Bond Yields Rise; USD Weakens, As Commodity Prices Rise

**Market drivers:** *i*) positive Q3 earnings; as *ii*) investors pay close attention to how higher energy and raw materials prices were affecting both Q3 profits and future guidance.

**Global equities** rose w-o-w (MSCI ACWI, +1.3%, to 742). In the *US*, the S&P 500 gained (+1.6% w-o-w to 4,545), lifted by real estate, utilities, and health care stocks. In the *EZ*, shares ended higher (Eurostoxx 50, +0.1% w-o-w, to 4,189), as optimism about corporate earnings season overcame worries about the potential risks if CBs tighten monetary policy as economic growth loses momentum. In *EMs*, equities advanced (MSCI EMs, +0.7%, to 1,293), as Chinese stocks rose (Shanghai Comp., +0.3%, to 3,583). *Volatility* fell below averages (VIX S&P 500, -2.5 pts to 14.4, 52w avg.: 20.5; 10y avg.: 17.2).

**Fixed Income:** w-o-w global bonds fell (BAML Global, -0.4% to 292.7.9), while UST yields rose (+6 bps, to 1.64%), after the Fed warned that supply constraints and elevated inflation are likely to last longer than previously expected, and well into next year.

**FX:** w-o-w, the US Dollar Index fell (DXY, -0.3%, to 93.642; EUR/USD +0.4%, to 1.165). In *EMs*, currencies rose against the USD (MSCI EM Currency Index, +0.2% w-o-w, to 1,732).

**Commodities:** Oil prices rose (Brent, +0.8% w-o-w, to 85.5 USD/b), as an ongoing energy crunch in Europe and Asia. Gold gained (+1.4% w-o-w, to 1,792 USD/Oz), as the USD weakened after Fed Chair Powell said that the Fed is ready to begin tapering.



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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