



R&R Weekly Column
By Brunello Rosa



Central Banks Worry About Inflation, While Governments Worry About Omicron

Two sets of events took place last week. The first was that governments started to move much more resolutely against the spread of the Omicron variant across the globe. New restrictions began being re-imposed by several countries. The Netherlands imposed a form of lockdown; Ireland re-introduced a curfew; a number of countries, including the UK and Italy, are thinking about introducing additional restrictions after Christmas. The “Rule of 6”, or similar limitations on the number of people that can meet at the same time may be re-introduced by several countries.

International travel has been actively discouraged, meanwhile. In Austria, people can enter the country only if they have received a third dose of vaccine. France banned non-essential travel from the UK. A number of countries, including Italy and the UK, have re-introduced pre-departure tests for incoming travellers.

These new restrictions are likely to have a significant economic impact, as did the restrictions introduced in previous winters in H1 2020 and in H1 2021. They are likely to reduce economic activity and possibly induce a further increase in inflation. Although the restrictions’ impact on prices is likely to be ambiguous at the beginning, and the reduction in economic activity they cause may imply a moderation in prices, they may also cause supply bottlenecks to persist for longer, and this may induce a further increase in prices.


Thus far, governments have not considered introducing financial compensation for companies and workers that may be forced to close or work less as a result of Omicron’s spread. To some extent, therefore, the task of providing policy accommodation remains with central banks. Central banks however now seem to worry mainly about inflation, and much less about the potential impact of Omicron on economic activity.

Indeed, the second set of events that took place last week was that the policy committees of a number of G10 central banks, and also EM central banks, met, and nearly all of them opted for a less accommodative policy stance. As [we discussed in our in-depth analysis](#), virtually all central banks became more hawkish and announced a variety of reductions to the policy accommodation they have so far provided during the pandemic. The Fed announced a faster pace of QE tapering and a speedier policy normalisation path. The ECB announced a severe reduction in net asset purchases starting in March 2022. The Bank of England and Norges Bank actually increased their policy rates, [as did the central banks of Chile and Russia](#). And the BoJ partially reduced the level of stimulus it has been providing until now.


These tightening measures are meant to counteract the rise in inflation that has been observed globally during the past few months. But they also risk doing harm to an economy that is already being hit by the new wave of the pandemic. So, unless governments introduce some form of compensation for companies and individuals, central banks may need to revisit their tightening plans in coming months.

Through all of this, markets are remaining volatile, being buffeted by the news of the pandemic and the uncoordinated policy response to it that is now taking place.

[Our Recent Publications](#)

 [Fed, ECB, BoJ, BoE, SNB and Norges Bank Flash Reviews: Major G10 Central Banks Turn Hawkish As Inflation Rises and Omicron Spreads](#), by Brunello Rosa, 17 December 2021

 [Preview: ECB To Launch Its Post-Pandemic Policy Package](#), by Brunello Rosa and Nouriel Roubini, 13 December 2021

 [Flash Preview: FOMC To Accelerate QE Tapering and Start Hiking Rates by Mid-2022](#), by Nouriel Roubini and Brunello Rosa, 13 December 2021

Looking Ahead

The Week Ahead: US PCE Inflation To Rise Further, While EZ Consumer Confidence is Expected To Fall

In the US, the y-o-y PCE deflator is expected to be 5.7% in November, rising from the previous 5.0%. Core PCE deflator is expected to be 4.5% y-o-y, rising from 4.1% previously.

In the EZ, consumer confidence indicator is expected to be -8.1 in December (p: -6.8).

The Quarter Ahead: UK COVID Cases Rise; Turkey Halts Trading; Russia-Ukraine Crisis evolves; Major Banks Turn Hawkish

The U.K.'s daily COVID cases hit the highest number since the Pandemic started, as the Omicron variant is expected to quickly become the dominant strain. Restaurants and bars are shutting themselves down, as the venues report the fewest dines since COVID restrictions eased. Importantly, the Chancellor of the Exchequer Rishi Sunak considers financial help for pubs and restaurants, following the chief medical officer announced to scale down their Christmas plans.

Turkey suspended trades on all listed stocks, as the country's currency crisis spreads through the markets. Borsa Istanbul announced a circuit breaker, as its main 100 Index fell by 7%. Following the resumption of trading, the benchmark was more than 8% lower, constituting the biggest drop since March, when Erdogan fired the central bank Governor Naci Agbal.

Russia-Ukraine crisis deepens, as Russia continues to amass new troops at the border. The EU and US President Joe Biden warned Russian President Putin about possible sanctions being imposed on Russia in case of a military invasion of Ukraine, while the UK's defense secretary said that Britain is unlikely to send troops. Amid worries over the position of Russian forces at the Ukrainian border, Russia demands NATO to roll back its positions from East Europe, including Ukraine.

Major Central Banks turn Hawkish. Among the largest economies, i) the Bank of England raised its policy rate by 15bps to 0.25%, defying market expectations; ii) the majority of Fed members expect three interest hikes in 2022, while the Federal Reserve doubled its pace of QE tapering; and iii) ECB decided to taper pandemic bond buying from March 2022.

Last Week's Review

Real Economy: EZ Business Activity Slows Down; US Inflation Accelerates; Fed Accelerates QE Tapering; Norges Bank Raises Rates

In the US, November CPI rose at the fastest pace in 40 years with i) headline CPI came at 0.8% m-o-m and 6.8% y-o-y; ii) core CPI rose to 0.5% m-o-m and 4.9% y-o-y.

In the US, FOMC decided to reduce the pace of its net asset purchases by \$20bn and \$10bn for Treasury securities and agency mortgage-backed securities respectively starting from January.

In the EZ, the IHS Markit Composite PMI fell to 53.4 (p: 55.4%) in December; as i) manufacturing PMI decreased to 58.0 (p: 58.4%); and ii) services PMI drops to 53.3 (p: 55.9%), as service sector suffers from COVID restrictions.

In Norway, Norges Bank increased its policy rate by 25bps to 0.5%, as anticipated in September.

Financial Markets Buffeted by Omicron News, Rising Inflation and Central Banks' Action

Market drivers: investor sentiment weakened, driven by: i) uncertainty, as Pfizer announced that the pandemic could extend through the next year; ii) decreasing yields, in the face of the spreading Omicron variant that is highly transmissible; iii) tightening restrictions across Europe; and iv) speeding up bond-buying tapering.

Global equities fell w-o-w (MSCI ACWI, -1.6%, to 735), with Dow Jones Industrial Average, the Nasdaq Composite, the pan-European Stoxx 600 all falling. The US S&P 500 Index also fell (-2.0% w-o-w, to 4,621), as investors digested the Fed's latest monetary policy announcement. In addition, big tech related shares declined, weighing on the index. In the EZ, shares fell (Eurostoxx 50, -0.9% w-o-w, to 4,161), as pessimism was fueled by i) countries expected to implement restrictive measures to contain the Omicron variant; and ii) inflation hitting record highs in the Eurozone. In EMs, equities declined too (MSCI EMs, -1.8%, to 1,216), as central banks acted and are expected to act further in order to stabilize prices. Chinese stocks decreased accordingly (Shanghai Comp., -0.9%, to 3,632) due to the US sanctions put on Chinese tech firms. Volatility rose above average compared to the last week (VIX S&P 500, +125 pts to 21.1, 52w avg.: 21.0; 10y avg.: 17.8)

Fixed Income: UST yields fell (-7.5 bps, to 1.41%), as fears over Omicron variant weighed on investor sentiment. German 10-year bond yield decreased (-3.2 bps, to -0.38%) due to the possibility of new COVID restrictions in the UK.

FX: w-o-w, the US Dollar Index increased only slightly (DXY, +0.6%, to 96.67; EUR/USD -0.6%, to 1.124) – recoupling its lost ground after the Fed and other major banks turned hawkish. In EMs, currencies fell slightly against the USD (MSCI EM Currency Index, -0.01% w-o-w, to 1,726).

Commodities: w-o-w, oil prices declined, as concerns over Omicron variant grew (Brent, -2.9% to 73.0 USD/b). Gold prices rose compared to last week (+0.8% to 1,798 USD/Oz), as the US dollar weakened post-Fed.



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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