

MAKING SENSE OF THIS WORLD

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R&R Weekly Column
By Brunello Rosa



Are We At A Turning Point In The Monetary Policy Tightening Cycle?

A number of major central banks held their policy meetings last week, to decide what course of action to take for the beginning of the year. 2023 was widely expected to be a year of recession for a number of countries. At the beginning of January, the head of the IMF Kristalina Georgieva said that [the IMF expected one third of the global economy to be in a recession during the year](#).

Subsequently, the IMF released the [January update](#) of its World Economic Outlook, initially released in October 2022, titled “Inflation Peaking Amid Low Growth”. In effect, the January update showed an upward revision to the growth forecasts made for a number of countries, and for the global economy as a whole. Meanwhile, inflation seems to have peaked in some key economies, such as [the US](#) (where inflation decreased from 9.1% in June 2022 to 6.5% recently), [the Eurozone](#) (from 10.6% in October 2022 to 8.5%), [the UK](#) (from 11.1% in October 2022, to 10.5%) and [Canada](#) (from 8.1% in June 2022, to 6.3%).

So, this year of stagflation, as we described in our 2023 outlook, appears to be a bit milder than initially anticipated, with slightly higher growth and slightly lower inflation. Still, one needs to remain vigilant about some ongoing risks, for example that of a new Russian offensive in Ukraine, which could bring the global economy to a standstill once again.

How have central banks reacted to this updated macroeconomic environment? The [Bank of Canada was the first to announce the outcome of its policy meeting](#) at the end of January. The Bank increased its policy rate by 25bps to 4.5%, while continuing its Quantitative Tightening program. But, most importantly, it announced that “[the] Governing Council expects to hold the policy rate at its current level while it assesses the impact of the cumulative interest rate increases”. In a nutshell, it announced a pause in its tightening cycle.

Last week, it was the turn of the Federal Reserve, the Bank of England and the European Central Bank to decide upon their own courses of action. The Fed announced another 25bps increase of its target range, to 4.5-4.75%, and two more rate increases in March and May. [As discussed in our in-depth review](#), during the press conference Chair Jay Powell sounded as hawkish as one can be given the circumstances, saying that the dis-inflation period has just begun and that there is still “a long way to go,” among other messages. The market totally disregarded the hawkish components of Powell’s press release, and celebrated the fact that the end of the tightening cycle is finally in sight. Funnily enough, the market had disregarded the same message for months; it had ignored the message that the peak of the cycle was in fact near, focusing instead only on the further rate increases and the rise in the terminal rate expected by the Fed.

A [similar fate occurred for the ECB](#), which increased its deposit rate by 50bps to 2.50% and announced another 50bps hike in March, while further specifying the criteria for its QT starting in March. Lagarde also said that there is still ground to cover and that further hikes are likely after March. But the market celebrated the statement in which the ECB says that, after March, it will “evaluate the subsequent path of its monetary policy”, as this future re-evaluation was already the end of the tightening cycle.

The [Bank of England chose an approach similar to the Bank of Canada's](#). It raised its repo rate by 50bps to 4.0%, but then indicated what seems to be a likely pause for the months ahead, without making further mentions of the QT program. Again, this generated euphoria in the market.

To conclude, it seems that the macroeconomic outlook is less malign than initially anticipated, and central banks are announcing a pause, or signalling an imminent end of, their tightening cycles. This clearly makes market participants very happy. Hopefully bad news will not intervene too soon to interrupt this moment of relief.

Our Recent Publications

- [Review: ECB Hikes Rates In February and Signals a 50bps Increase in March, But The Market Rallies As It Perceives the Peak In Sight](#), by Brunello Rosa and Nato Balavadze, 2 February 2023
- [Flash Review: BOE Increase Rates Again, But Signal A Potential End To Its Tightening Cycle](#), by Brunello Rosa and Nato Balavadze, 2 February 2023
- [Flash Review: Fed's Powell Talks Tough But The Market Rallies, As It Sees The End of The Tightening Cycle In Sight](#), by Brunello Rosa and Nato Balavadze, 1 February 2023

- [The Markets' Big Gamble Of 2023](#), by Filippo Ramigni, 31 January 2023
- [Preview: Fed To Further Reduce Its Pace of Tightening in February but Signal Further Rate Hikes](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 30 January 2023
- [Preview: ECB To Enter Into Persistent Tightening Territory in February](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 30 January 2023



Looking Ahead

The Week Ahead: UK GDP To Stall QoQ And Fall YoY; EZ Retail Sales To Recover Slightly; US Consumer Sentiment To Stay Unchanged

In the US, in February, Michigan Consumer Sentiment is expected to remain unchanged at 64.9.

In the EZ, in December, retail sales are expected to recover slightly by -2.7% y-o-y (*p*: -2.8%) and deteriorate further by -2.5% m-o-m (*p*: 0.8%).

In the UK, in Q4, according to preliminary estimates, GDP is expected to stall q-o-q (*p*: -0.3%) and decelerate to 0.4% y-o-y (*p*: 1.9%). In December, IP is likely to shrink by 5.3% y-o-y (*p*: -5.1%).

The Quarter Ahead: Antony Blinken Cancels China Trip Following Discovery Of Spy Balloon; Adani Market Rout Deepens

Antony Blinken canceled Trip to China. US Secretary State Antony Blinken has postponed his visit to China after the Pentagon said it discovered a Chinese balloon that has been flying over sensitive nuclear missile sites in the western state of Montana. US officials said this was an “unacceptable” violation of the country’s sovereignty.

Shares in most Adani Group companies slumped, as the research firm was accused of stock manipulation and financial fraud. India’s parliament was adjourned, as opposition leaders called for an investigation.

Last Week's Review

Real Economy: EZ QoQ GDP Advanced Slightly; Headline Inflation Fell In EZ; Composite PMIs In US And EZ And Fell In the UK

In the US, in January, the unemployment rate edged down to 3.4% (*c*: 3.6%; *p*: 3.5%). NFPs surged by 517K (*c*: 185K; *p*: 223K). In January, S&P Global Manufacturing PMI increased to 46.9 (*p*: 46.2). Services and Composite PMIs rose to 46.8 (*c*: 46.6; *p*: 44.7) and 46.8 (*c*: 46.6; *p*: 45.0)

In the EZ, in Q4, GDP growth advanced slightly by 0.1% q-o-q (*c*: -0.1%; *p*: 0.3%). The economy decelerated by 1.9% y-o-y (*c*: 1.8%; *p*: 2.3%). In January headline inflation eased off to 8.5% y-o-y (*c*: 9.0%; *p*: 9.2%), whereas core inflation stood unchanged at 5.2% y-o-y (*c*: 5.1%) respectively. In December, the unemployment rate was unchanged at 6.6%. Still, in January, S&P Global Manufacturing and Services PMIs increased to 48.8 (*c*: 48.8; *p*: 47.8) and 50.8 (*c*: 50.7; *p*: 49.8) respectively. Composite PMI edged up to 50.3 (*c*: 50.2; *p*: 49.3). In January, economic sentiment rose to 99.9 (*c*: 97; *p*: 97.1) and consumer confidence recovered slightly to -20.9 (*p*: -22.1).

In the UK, in January, S&P Global Manufacturing PMI rose 47.0 (*c*: 46.7; *p*: 45.3), whereas Services and Composite PMIs edged down to 48.7 (*c*: 48.0; *p*: 49.9) and 45.8 (*c*: 47.8; *p*: 49.0).

Major CBs increased their policy rates. In the US, the Fed rose its target Fed funds range by 25 bps to 4.5% - 4.75. In the EZ, the ECB increased all its policy rates by 50bps. In the UK, the BOE increased its Bank Rate by 50bps to 4.0%.

Financial Markets: Stocks Rose; Bond Yields Increased In US And Fell In EZ; Dollar Edged Up, Whereas Oil And Gold Prices Decreased

Market Drivers: Stocks were boosted by upside surprises in economic data and encouraging signals from the CBs that may be nearing the end of their tightening phase. On the other hand, labour market news, including impressive US NFP report, led to reconsideration of rate expectations and UST yields moved up.

Global Equities: Increased w-o-w (MSCI ACWI, +1.0%, to 656.26). The US S&P 500 index edged up (+1.6% w-o-w, to 4,070.56). In the EZ, share prices were up (Eurostoxx 50, +1.9% w-o-w, to 4,257.98). In EMs, equity prices moved down (MSCI EMs, -1.2%, to 1,038.71). Volatility fell to 19.4 (VIX S&P 500, 52w avg.: 26.1; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US treasury yields were up (+1 bps to 3.52%). The 2-year US Treasury yields rose (+9 bps to 4.29%). The German 10-year bund yield decreased (-3 bps to 2.21%).

FX: w-o-w, the US Dollar Index increased (DXY, +1.1%, to 102.8; EUR/USD -0.7%, to 1.08). In EMs, currencies rose (MSCI EM Currency Index, +0.4% w-o-w, to 1,707.86).

Commodities: w-o-w, oil prices decreased (Brent, -7.6% to 79.82 USD/b). Gold prices fell w-o-w (-3.0% to 1,877.70 USD/Oz).



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The picture in the front page comes from [this website](#)



Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	M5S	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 Ryal
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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