

MAKING SENSE OF THIS WORLD

24 July 2023



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

<u>Elections in 2024: The Year That Can Change The World's</u>
<u>Fate (Part 1 – Developed Economies)</u>, by London Politica,
19 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).



@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

Justice and Development Party, Turkey	M5S	Five Star Mayamant Italy
	IVIJJ	Five Star Movement, Italy
annualized	m-o-m	Month-on-month
Argentinian Peso	mb	Million barrels
Average	mb/d	Million barrels per day
Billion	MENA	Middle East and North Africa
Bank of Canada	MHP	Nationalist Movement Party, Turkey
Bank of England	mn	Million
Bank of Japan	MPC	Monetary Policy Committee
Barrels per day	NAFTA	North-American Free Trade Agreement
Basis points	NATO	North Atlantic Treaty Organization
Balance sheet	OECD	Organization for Economic Cooperation and Development
Consensus	Opec	Organization of Petroleum Exporting Countries
Current account	p	Previous
Central bank	P2P	Peer-to-peer
Central Bank of Bahrain	PBoC	People's Bank of China
Central Bank of Kuwait	PCE	Personal Consumption Expenditures
Central Bank of Turkey	PE	Price to earnings ratio
Christian Democratic Union, Germany	PM	Prime minister
Chinese Yuan	PMI	Purchasing managers' index
Consumer Price Index	pps	Percentage points
Dow Jones Industrial Average Index		Previous week
	•	Oatar Central Bank
	QAR	Qatari Riyal
	QE	Quantitative easing
European Commission		Quarter-on-quarter
European Central Bank	RE .	Real estate
European Court of Justice	RBA	Reserve Bank of Australia
US Energy Information Agency	RRR	Reserve Requirement Ratio
· · · · · · · · · · · · · · · · · · ·	RUB	Russian Rouble
	SWF	Sovereign Wealth Fund
•	tn	Trillion
European Union	TRY	Turkish Lira
Euro	UAE	United Arab Emirates
Eurozone	UK	United Kingdom
US Federal Reserve	US	United States
US Federal Open Market Committee	USD	United States Dollar
US Federal Reserve Board	USD/b	USD per barrel
Foreian exchanae	UST	US Treasury bills/bonds
5 5		Value added tax
Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
	WTI	West Texas Intermediate
·	WTO	World Trade Organisation
·	W	Week
· · · · · · · · · · · · · · · · · · ·	W-0-W	Week-on-week
•		Year
, , ,	•	Year-on-year
	v-t-d	Year-to-date
·	,	South African Rand
		2-year; 10-year
	e Pali.	<u> </u>
	Average Billion Bank of Canada Bank of England Bank of Japan Barrels per day Basis points Balance sheet Consensus Current account Central Bank of Bahrain Central Bank of Turkey Christian Democratic Union, Germany Chinese Yuan Consumer Price Index Dow Jones Industrial Average Index Dow Jones Emerging Markets Index Dow Jones Emerging Markets Index Duropean Commission European Commission European Court of Justice US Energy Information Agency Emerging Markets European Parliament Earnings per share European Union Euro Eurozone US Federal Reserve US Federal Reserve US Federal Reserve Board Foreign exchange Fiscal Year Gulf Cooperation Council British pound Gross domestic product International Monetary Fund Indian Rupee Initial public offering Iranian Rial Japanese yen thousand Kingdom of Saudi Arabia	Average Billion MENA Bank of Canada MHP Bank of England MPC Barrels per day MAFTA Basis points MATO Balance sheet OECD Consensus Opec Current account PCentral bank of Bahrain Central Bank of Turkey PE Christian Democratic Union, Germany Dow Jones Industrial Average Index Dow Jones Industrial Average Index Dow Jones Emerging Markets Index US Dollar Index European Commission European Commission European Central Bank European Price Index PE European Commission European Commission European Commission European Commonument European Price Index US Energy Information Agency European Price Index European Commission European Commission Fereging Markets European Commonument European Price European Commission Fereging Markets US Energy Information Agency European Commonument European Price European Use European Union TRY Euro Use European Use Use European Use European Use Use European Use European Use European Use Use European Use European Use Use European Use Use European Use European Use Use European Use European Use Use European Use Europ

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.

