



MORNING BRIEFING

November 10, 2021

Are We There Yet?

Check out the accompanying [pdf](#) and [chart collection](#).

(1) Hurdles to global recovery are receding in rearview mirror—yet that's where global central bankers' sights remain glued. (2) Is extreme accommodation still appropriate? (3) Central bankers of the past might have acted by now to resist inflation. (4) ECB, BOJ, and Fed all talk the talk about transitory nature of accelerating inflation and supply/labor shortages. (5) When will they walk the walk? (6) Covid-19 pandemic isn't over, but we are learning to live with it.

Central Banks: In No Rush To Raise Rates. The US Federal Reserve, the European Central Bank (ECB), and the Bank of Japan (BOJ) may be winding down their pandemic emergency asset purchases ([Fig. 1](#) and [Fig. 2](#)). However, none of the three central banks is in any rush to raise interest rates: The ECB's and BOJ's rates remain in negative territory, while the Fed's is near zero. Each has been claiming that extraordinarily easy monetary policy remains necessary to maintain the momentum of their economic recoveries. Are they being justifiably prudent, Melissa and I wonder, or stuck in autopilot?

The problem is that the list of problems justifying these central bankers' accommodative approaches is getting shorter and shorter. Most importantly, the pandemic is abating and becoming endemic in many regions, as discussed below. Global economic growth has recovered nicely from last year's lockdowns. Inflationary pressures are proving to be persistent rather than transitory. Even China's recent property debt crisis is generally [considered](#) by central bankers to be a problem that will be contained in that country.

Yet bankers are fiercely committed to the idea that now is not the right time to raise rates. Here's what's keeping global central banks from raising rates despite significant evidence of progress in the health crisis and global economic recovery:

(1) *Transitory inflation problem.* During his November 3 [press conference](#) after the FOMC's monetary policy meeting, Fed Chair Jerome Powell emphasized that the end of the bond buying would not mean a rush to raise interest rates: "I don't think that we're behind the curve. I actually believe that policy is well-positioned to address the range of plausible outcomes, and that's what we need to do," Powell said.

Likewise, ECB's President Christine Lagarde emphasized during her October 28 [press conference](#) the need to be "patient" and "persistent" with monetary policy.

Historically, the banks would have raised rates at the first sign of a pickup in inflation closer to their stated goals. Measures of inflation recently have exceeded the ECB's and the Fed's 2.0% targets. However, central bankers do not see the recent rise in inflation as a long-lasting problem.

"We foresee inflation rising further in the near term, but then declining in the course of next year," Lagarde simply stated during her presser. She added that the bank foresees inflation in the "medium term" (or roughly over three years) remaining below the 2.0% target. That means that the "conditions" for interest rate lift-off are "not satisfied."

Yesterday, we discussed Powell's fixation on the word "transitory" when discussing inflation. Both Powell and Lagarde feel that inflationary pressures will abate once supply-chain shortages associated with the pandemic are resolved. Recent inflationary pressures in energy markets, too, should be transitory, they believe. Specific to Europe, base-effects from adjustments to the German VAT (value-added tax) will fade from the inflation calculation by January 1.

Despite rising risks of a prolonged acceleration of inflation in the US and Europe, the BOJ's inflation target has not yet been met. So "there is absolutely no reason to adjust monetary easing," the BOJ stated in its November 8 [Summary of Opinions](#). Finally, the y/y rate of change in Japan's CPI is around 0.0%; it is no longer negative! That's mainly due to rising energy prices, the bank said, indicating that the CPI is likely to increase moderately in positive territory. "In Japan, where underlying inflation is still low, it is important to persistently continue with extremely accommodative monetary policy even when pent-up demand increases," the bank noted.

(2) *Shortage problem*. "We're seeing shortages" because "we have this supply-demand disconnection," Lagarde stated. ECB contacts reported that it will take a "good chunk" of 2022 for the shortages to be sorted out. The BOJ suggested that "downward pressure on production and exports stemming mainly from supply-side constraints is likely to strengthen in the short run."

Labor shortages should abate too, central banking officials seem to think, as the labor market has room for improvement. Powell said there is "still ground to cover" in the labor market recovery to reach "maximum employment." Lagarde observed during her presser

that “both the number of people in the labour force and the hours worked in the economy remain below their pre-pandemic levels.” Slack remains in the respect that “you have nearly two million people less employed in the economy today compared with pre-pandemic, where we have three million people who are still on furlough schemes,” she said.

(3) *Energy problem.* Consumer spending in the Eurozone has been robust during the recovery, especially on entertainment, dining, travel, and transportation. Contributing to high energy prices in Europe is low inventory, with “maintenance in Norway, with demand in China, with the supply by Russia,” Lagarde explained. She is concerned that “higher energy prices may reduce purchasing power in the months to come.” Similarly, the BOJ noted that energy prices were driving up the cost of food, which could have an impact on the strength of pent-up demand.

Pandemic: Is It Abating? Covid-19 may never go away, but it seems to be transitioning from pandemic to endemic status in many regions around the world. Progress in vaccinations against Covid-19, especially in the US, has been significant, and Covid-related infections, hospitalizations, and deaths have waned. However, evidence of breakthrough cases, such as that mounting now in Europe, could become a bigger problem for more vaccinated countries.

Even in parts of the world where vaccinations remain out of reach, the data points are improving. Natural immunity has driven a decline in the prevalence of the virus in these areas. But it remains uncertain for how long natural immunity will work to fend off the virus. In any event, these unvaccinated regions may have been spared the worst of the virus thanks to their youthful demographic profiles.

Perhaps more dangerous to the health and economic well-being of societies than the virus is the response of governments to keep it contained as it continues to pop up. China’s approach, for example, to aim for zero cases of the virus could be especially damaging.

Let’s further explore the status of the virus by region:

(1) *US vaxxed and maskless.* The Covid-19 pandemic could be over in the US by the time President Joe Biden’s workplace vaccine mandates take effect in early January, Pfizer board member Dr. Scott Gottlieb [told](#) CNBC’s “Squawk Box” on November 5. Some 84 million private-sector workers must get either their second Moderna or Pfizer shot or one dose from Johnson & Johnson by January 4 or face regular testing for the virus. “By Jan. 4, this pandemic may well be over, at least as it relates to the United States after we get

through this delta wave of infection. And we'll be in a more endemic phase of this virus," Gottlieb said.

Nearly 75% of the US population has received two jabs of the Covid-19 vaccine, while nearly 85% has received at least one dose ([Fig. 3](#)). As vaccines have proliferated in the US, infection rates and hospitalizations related to the virus have waned significantly, particularly following the wave of Delta variant infections during Q3 ([Fig. 4](#)). Deaths recently have risen, but that's to be expected since they lag cases and hospitalizations; and deaths too seem to have peaked following Delta.

The great news is that, despite the Delta variant, the latest peak in infection rates was well below the previous peak. The other good news is that hospitalizations and deaths should continue to subside relative to cases because the treatments to fight the virus have become quite robust, and more are coming. Data from Pfizer on Friday indicated that its Covid antiviral pill, when paired with an HIV medication, slashed the potential for hospitalization or death by 89% in adults at risk for severe complications.

(2) *Europe breaking through.* Europe's breakthrough cases have been all over the news. Those are positive occurrences of the virus in vaccinated people. The World Health Organization [said](#) last week that Covid cases in Europe have risen steadily over the past five weeks. But keep in mind that vaccines are not 100% effective. As millions more people get the vaccine, we are going to see an increase in the number of breakthrough infections.

New cases in France, Italy, Germany, and Spain had been on the decline following the Delta outbreak, but now appear to be ticking up again ([Fig. 5](#)). Infection rates have been harder to squash in the UK ([Fig. 6](#)). Similar patterns are seen in Europe's hospitalization rates, but hospitalizations are low.

(3) *Japan celebrates success.* "The bars are packed, the trains are crowded, and the mood is celebratory, despite a general bafflement over what, exactly, is behind the sharp drop," the Associated Press [observed](#). Japan seems to have effectively squashed the virus for now, with zero new cases appearing since late October ([Fig. 7](#)). Some possible explanations include a rapid vaccination campaign and the widespread practice before the pandemic of wearing masks. "Rapid and intensive vaccinations in Japan among those younger than 64 might have created a temporary condition similar to herd-immunity," said Dr. Kazuhiro Tateda, a Toho University professor of virology.

(4) *China going for zero.* Most people would agree that the Disney theme parks are fun

places to visit. But it probably wouldn't be much fun to be locked in one with healthcare workers in hazmat suits instead of cast members in costume. Recently, a Halloween Covid scare [forced](#) Shanghai Disney into lockdown as China took further steps to eradicate the virus. China's success story against the virus is tied most closely to its authoritarian approach to contain it. In our April 8 [Morning Briefing](#), we explored China's harsh intolerance of even one instance of the virus. Indeed, the approach as worked. Since March 2020, China's cases of the virus have been at or around zero, the Chinese government reports ([Fig. 8](#)).

(5) *Africa spared*. "The pandemic appears to have spared Africa so far. Scientists are struggling to explain why," was the title of a recent Science.org [article](#). It noted that antibody studies suggest that large numbers of infections have occurred but that the death toll remains low. The article omitted one reason we can think of: demographics.

"Age has been observed as a significant risk factor for severe COVID-19 illness. Most deaths occur in those aged 65 or older. The median age in North and South America, Europe and Asia ranges from 32 to 42.5 years. The age demographic structure of sub-Saharan Africa is much younger—the median age is 18," according to a [piece](#) in *The Conversation*.

Calendars

US: Wed: Headline & Core CPI 0.6%/m/m/5.8%/y/y & 0.4%/m/m/4.3%/y/y, Initial & Continuous Jobless Claims 265k/2.10m, Wholesale Trade Sales 0.4%, MBA Mortgage Applications, Federal Budget Balance -\$179.0b, Crude Oil Inventories, Natural Gas Storage. **Thurs:** OPEC Monthly Report. (Bloomberg estimates)

Global: Wed: Germany CPI 0.5%/m/m/4.5%/y/y, Italy Industrial Production -0.1%, Japan Industrial Production, Japan Core Machinery Orders 1.7%, China Industrial Production 3.1% y/y, China Fixed Asset Investment 6.3% y/y, Australia Employment Change & Unemployment Rate 50k/4.8%, Elderson, Weidmann, Tenreiro. **Thurs:** UK GDP 1.5%q/q/6.8%/y/y, UK Headline & Manufacturing Industrial Production 0.2%/m/m/3.1%/y/y & 0.2%/m/m/3.1%/y/y, UK Trade Balance - £14.3b, ECB Economic Bulletin, ECB Forecast, Lane, Schnabel. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q3 Earnings Season Monitor ([link](#)): With nearly 91% of S&P 500 companies finished reporting revenues and earnings for Q3-2021, revenues have beaten the consensus forecast by a well-above-trend 2.9%, and earnings have exceeded estimates by 11.1%. At the same point during the Q2 season, revenues were a higher 5.4% above forecast and earnings beat by a greater 17.1%. For the 454 companies that have reported Q3 earnings through mid-day Tuesday, the aggregate y/y revenue and earnings growth rates and the percentage of companies reporting a positive revenue and earnings surprise have slowed considerably from their Q2 measures. The Q3 reporters collectively have a y/y revenue gain of 17.4% and an earnings gain of 45.5%. That compares to y/y growth of 25.9% for revenues and 119.5% for earnings at the same point during Q2. Nearly 81% of the Q3 reporters so far has reported a positive earnings surprise, and 77% has beaten revenues forecasts. Fewer companies have reported positive y/y earnings growth in Q3 (82%) than positive y/y revenue growth (90). These figures will continue to change as more Q3-2021 results, primarily from the retailers, are reported in the coming weeks. With the US economy largely re-opened compared to a year earlier, the y/y growth rates have slowed considerably in Q3 compared to Q2. The revenue and earnings surprises are moderating as well due to missed deliveries and higher costs.

US Economic Indicators

NFIB Small Business Optimism Index ([link](#)): “One of the biggest problems for small businesses is the lack of workers for unfilled positions and inventory shortages, which will continue to be a problem during the holiday season,” warns William Dunkelberg, chief economist of the NFIB. October’s Small Business Optimism Index (SBOI) sank to a seven-month low, falling for the third time in four months, by 0.9 point in October and 4.3 points over the period, to 98.2. Only one of the 10 components of the SBOI rose last month—capital outlay plans (to 31% from 28%)—while seven declined and hiring plans (26) and expected credit conditions (-4) were unchanged. The biggest drag on October’s SBOI was owners expecting business conditions to improve (-37 from -33)—dropping 4ppts in October and 17ppts the past three months, to its lowest reading since November 2012. Also pushing the SBOI lower were earnings trends (-17 from -14), sales expectations (0 from 2), current job openings (49 from 51), now is good time to expand (10 from 11), and plans to increase inventories (8 from 9). Quality of labor (24) and inflation (16) are among the top three biggest problems facing small business owners, with the former easing from the record high

of 28% reported in August and September, while the latter remains on a steep upward trajectory, up 6ppts in October and 14ppts since February to its highest percentage since September 2008. A net 53% of owners reported raising average selling prices, while 51% plans to hike prices—up from 15% and 20%, respectively, a year ago. Meanwhile, the Uncertainty Index fell to 7 points to 67 (the lowest since January 2016), down from 98 a year ago.

Producer Price Index ([link](#)): The producer price index for final demand continued to climb in October to new record highs—with the yearly rates for both headline (8.6% y/y) and core (6.8) final demand holding at their record highs. Meanwhile, the year-over-year rate for final demand goods (14.2) reached yet another record high in October, while the one for final demand services (5.9) eased from its record high of 6.4% posted in both August and September. During October, final demand prices rose 0.6% after slowing from 0.7% to 0.5% in September, with final demand goods rising 1.2%—its eighth monthly gain of 1.0% or more this year—while final demand services rose 0.2% for the second month, down from 0.7% and 0.8% during August and July, respectively. Three-quarters of the increase in final demand goods can be traced to a 4.8% jump in energy prices, with gasoline accounting for one-third of the gain in final demand goods and trade services accounting for nearly two-thirds of it. Looking at pipeline prices, pressures remain very high. The yearly rate for intermediate goods prices continued to accelerate, up 25.4% y/y in October, its highest since the mid-1970s, while the rate for crude prices picked up to 56.5% y/y after easing from April's record high 59.4% to 46.2% by September.

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