Research & Strategy Insights

Data, finally

116 – 13 December 2021

Key points

- New data on Omicron confirms it is a significant challenge, forcing in particular a swift acceleration in the booster programme, but we are not back to square one on the pandemic.
- Momentous week for central banks.

Some precise data are finally starting to emerge on the Omicron variant. A study by the UK Health Security Agency on 581 symptomatic cases confirmed that the usual regimen of two vaccine shots provides little protection against the variant. However, it also suggests that a third dose would be effective, albeit less so than with the Delta variant. The latter is good news because it means that there is an alternative to merely waiting for a re-engineering of the vaccines: accelerating the booster programmes. They are already going relatively quickly in most western European countries – much more so than in the US – but the persistence of a not insignificant minority of adults who are not vaccinated at all, as well as the incompressible time needed to get the third jab to all those who are already vaccinated, probably means that some additional sanitary restrictions will be on their way, with some impact on economic activity. True, there are tentative signs that the infections brought about by the Omicron variant are less severe than in the historical versions, but governments are unlikely to take risks. However, while the variant is of course a setback on the recovery trajectory, the potential for a fairly quick rebound looks decent. We are not back to square one on the pandemic.

Amid this still incomplete information on the sanitary front, some central banks need to make some big decisions this week. The Federal Reserve (Fed) seems to partake to the generally higher tolerance to sanitary risk which has been prevailing in the US since the start of the pandemic and looks set to announce an acceleration of its taper which would now end at the beginning of Q2 2022, thus leaving lots of space for pre-emptive hikes if need be. The Bank of England (BoE) needs to compose with the additional sanitary restrictions from this week onward. While we accept that the UK is a good candidate for a persistent inflation drift, we fail to see the urgency in hiking given the level of uncertainty. Yet, for pure reasons of credibility, after last month's flip-flopping, the Monetary Policy Committee (MPC) may still decide to hike anyway. When it comes to the European Central Bank (ECB), we have refined the "two stage approach" we developed last week. We expect Christine Lagarde to announce a continuation of Asset Purchase Programme (APP) until the end of 2022, but the quantum of the up-scaling designed to cushion the market impact of terminating Pandemic Emergency Purchase Programme (PEPP) in March – we expect EUR 40bn per month for the new target – would be fixed only for Q2, with a rendez-vous clause in June and September coinciding with the new forecasts. More than the quantum itself, we expect the market to focus on the flexibility the ECB will still give itself to deal with potential market fragmentation. We think the PEPP reinvestments – for now due to continue until 2023 at least – will be a key instrument.

Micro or macro Omicron

16 days after Omicron was added to the list of variants of concern by the World Health Organization (WHO), the first studies based on large enough samples are starting to appear. The most complete at this stage is probably the one from the UK's Health Security Agency released last Friday (see here for the full text). Their dataset is relatively large with 581 symptomatic cases confirmed to be caused by Omicron, distributed across various vaccinal status. The first key finding confirms the conclusion from lab tests on much smaller samples in South Africa: **the habitual regimen of two vaccine doses provides little protection against Omicron.** In the case of Astra Zeneca no statistically significant level of protection emerged, and for Pfizer an effectiveness rate of only 34% was found for those having received their two shots more than 25 weeks before, and 48% for those having received the second jab between 10 and 14 weeks before (against a level of protection of respectively 63.5% and 77.7% against the Delta variant).

The more positive news is that **a third dose provides decent protection**: 71.4% after two weeks for Astra Zeneca completed by Pfizer (93.8% against Delta) and 75.5% for a full Pfizer course (92.6% against Delta). This is reassuring because it suggests that there is a transitory strategy – accelerating the booster programmes – before the re-engineered vaccines are available towards the end of Q1 2022 (based on the statements of the manufacturers). Still, a 25% to 30% "escape rate" post-booster remains high. Our habitual readers will remember the basic equation to work out the threshold for collective immunity: a drop in the vaccine effectiveness needs to be offset by a higher proportion of the population being inoculated.

Two additional parameters need to be quantified: the speed at which the variant spreads and the severity of the symptoms it triggers. The combination of the two, added to the vaccine effectiveness would allow to assess the level of pressure on the healthcare system and hence the need to restrict day-to-day activity. On the first point, the news has been concerning from the start. The "reproduction rate" in South Africa has been very high, with a more vertical acceleration in the number of cases than during the previous waves (see Exhibit 1), confirmed by the speed of the "in-community" progression in the UK (number of cases doubling every 2.5 days). However, even if we have only indirect observations at this stage – the UK's Health Security Agency (HSA) did not provide information on the severity of the 581 symptomatic cases in its sample – **the data from South Africa continues to be reassuring on severity,** with a level of casualties which remains in line or even below what had been seen in the previous waves (see Exhibit 2).

True, we need to remain prudent given the lag between infections, hospitalizations and then deaths, but excluding the first wave – at a time when the lack of tests made comparisons difficult – at the same stage on the infection front, lethality has been higher in the past. In wave 2, the number of cases doubled in 21 days from trough, and deaths did so only 9 days later. In wave 3, the first doubling in cases took 16 days, with deaths following only 4 days later. No such things have happened over the last 2 weeks in South Africa.

Exhibit 1 – Omicron spreads much faster…

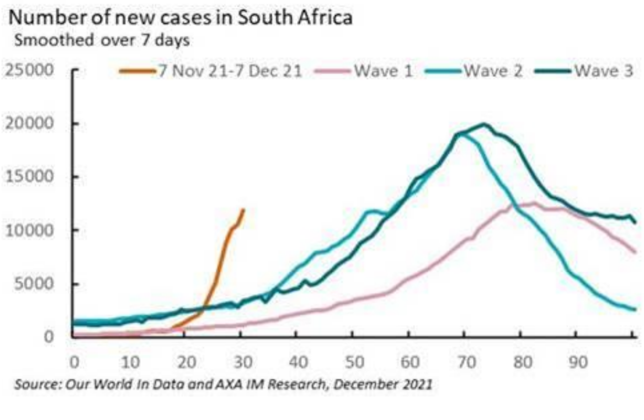
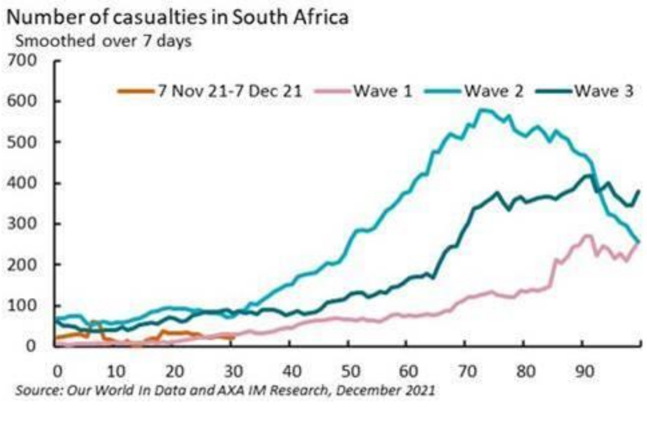


Exhibit 2 – …without visible impact on casualties so far



Another point to note is that **in the sample analysed by the UK Health Security Agency, younger people were over-represented.** Those below the age of 40 accounted for 68.6% of the 581 Omicron symptomatic cases, against only 46% for the Delta ones. It may be that older people might be removed from the first "points of contagion" when a new variant emerges (e.g. because they socialize less), but this would fit observations in South Africa of a higher prevalence among the youth of the Omicron variant. This would mean that those more susceptible to develop symptoms would in general be in a better general physical shape to fight the infection, thus potentially lessening the pressure on hospitals.

Yet, **in the absence of definitive answers on the severity of the outbreak, precautions are being taken and some measures of restrictions are being imposed,** if anything because the Delta variant – still dominant in Europe – was already proving difficult to manage. We are currently witnessing a tentative deceleration in the total number of cases in some key countries, for instance Germany (see Exhibits 3 and 4) but we might be in a sort of "eye of the storm" where for now the restrictions are enough to curb the Delta variant but would prove insufficient to stop the spread of an Omicron wave.

Exhibit 3 – Delta-wave easing in some countries

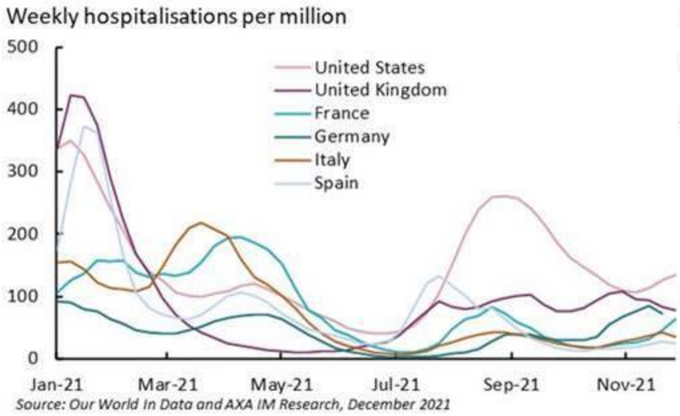
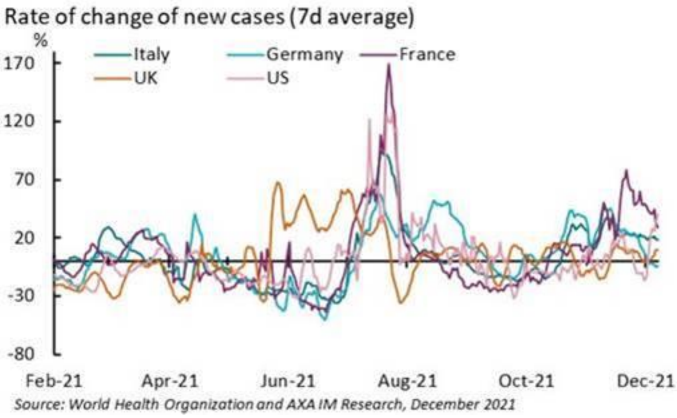


Exhibit 4 – Especially when looking at the second derivative



The variable on which we are going to focus in the weeks ahead is the change of the vaccination rate of the population. Based on the average number of boosters inoculated in the week to 9 December, it would take between 2 and 2.5 months from now to reach 75% of the population in France, Germany, and the United Kingdom. Among developed nations, the US is a country of concern. Booster take-up is slow over there. At the current pace, it would take 7.5 months to reach 75% of the population, which is an entirely hypothetical target of course since only 60% of the US population has already taken the two jabs.

We need to see beyond the booster programme which by definition they will only improve the level of protection of those who were already convinced of the necessity of getting jabbed. Logically, the adoption across Europe of differentiated access to activity according to individuals vaccination status, combined with the renewed concern brought about by the Omicron variant and the localized signs of saturation of healthcare capacity, should incentivize more "vaccine-hesitants" to shift their position. There are tentative signs this is happening in Germany (see Exhibit 5).

Exhibit 5 – A positive inflexion in Germany

Since 25 November, first jabs have been growing at 80k per day in Germany, almost double the pace seen since mid-September. Yet, given the intervals between jabs, it will take months before this "new converts" to vaccination get a decent level of protection against the Omicron variant**. In the meantime, some level of restriction is likely to be needed to protect the c.20% of the adult population which is not even covered by two jabs and which is thus very far "booster territory".** We note however that despite the Oxford University "stringency index" for Germany now higher than any point this year, available real-time indicators such as the Google mobility index do not point to a dramatic decline in activity. Its level is below baseline, but comfortably above what was seen in the winter of 2020-2021. This would suggest that the differentiated approach, depending on the vaccinal status, is indeed consistent with a visible but manageable impact on GDP.

All in all, available information would suggest that, as we suggested last week, we are not "back to square one" in the pandemic. Beyond the capacity to re-engineer the vaccines, it appears the existing ones provide some level of protection conditional on the rapid success of the booster programme. From an economic point of view the variant is likely to be a setback, since the additional restrictive measures needed while vaccinations are accelerated will have some impact on activity in the weeks ahead, which could still be painful from a sanitary point of view, but the capacity to rebound within months seems decent.

ECB readying for a busy 2022

The week ahead is going to be momentous for key central banks. The Fed needs to decide whether to accelerate its tapering, the ECB needs to tell us about the fate of its Pandemic Emergency Programme and how its Asset Purchase Programme will be recalibrated, while the Bank of England needs to finally make up its mind on the necessity to hike rates this side of Christmas. In all three cases, it's a discussion on the pace of a normalization which itself is the obvious direction of travel. That we are past "peak monetary accommodation" is crystal clear to everyone at this stage. Yet, although financial markets have so far digested the imminent change of overall direction pretty well, the speed at which the stimulus will be dialled down can be conducive to quite some pain. Central banks need to tread carefully.

Let's start with the Bank of England. At first glance, it should be a "no brainer". A key difference between the UK on the one hand, and the US and Euro area on the other is that in the former, inflation had not been particularly weak pre-pandemic. Actually, the growth rate in consumer prices has stood above the BoE's target on average between the rebound from the Great Financial Crisis in 2010 and the end of 2019. It is thus fair to say that the UK is already "fertile ground" for an inflation drift, hence calling on the central bank to take a more pre-emptive approach than its two counterparts.

This however has to be measured against the underlying strength of the UK economy and its capacity to take the consequences of tightening earlier than the Fed and the ECB – in particular on the exchange rate – in a context of already shaky competitiveness post-Brexit. Last month's final decision to postpone the hike was probably chiefly motivated by the need to see how the British labour market was faring after the removal of the "furlough" scheme. Data is reassuring on this front, but now of course there this "nagging Omicron thing" to consider. The UK government has just recommended 100% work from home from this week onward. We will need to see how much of the recommendation is actually complied with, but it's likely that activity will take some visible hit in the weeks ahead in the form of lower footfall in big cities. Growth in October has already been mediocre, with a 0.1% gain in monthly GDP. At this stage, we think a hike this week is marginally likelier than not primarily because the BoE may want to "re-set" its communication strategy by getting the lift-off done after the damaging flip-flopping of the last month, but with a very limited level of confidence.

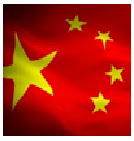
We think the picture is clearer on the Fed front. We expect the Fed to announce a quicker taper which would come to end by early Q2 2022, creating technical space to hike before the summer if need be, even if we don't think Powell will elaborate on the latter point. In principle, as we discussed last week, the Omicron variant should be cause for pause, while the ongoing Covid wave is far from over – hospitalizations have started to rise again in the US (see Figure 3). But it seems the Fed partakes in the overall "higher tolerance to the sanitary risk" displayed in the US since the beginning of the pandemic. The inflation print for November – with yet another significant price push of key items such as rents - has probably solidified the central bank's resolve to get ready for a pre-emptive tightening, even if we continue to think that a majority of the Federal Open Market Committee (FOMC) still expect inflation to decelerate significantly in 2022.

We are not expecting the same level of clarity from the ECB next Thursday. Let's start with what probably is consensual within the Governing Council.: not hiking the policy rate in 2022. The debate between hawks and doves has become very public, but still focuses squarely of quantitative easing (QE). If hiking rates is not on the table, then it's probably acceptable to a majority of the Council to continue quantitative easing until the end of 2022 – finishing earlier than that would make it difficult for the market not to start pricing hikes next year, as they did for a short time in late October-early November. What is also probably consensual is that the continuation of QE will need to be done via the old APP scheme while PEPP would be seen as "overkill". Everything else is being fiercely discussed in our view. The doves would probably argue in favour of recalibrating APP significantly up to cushion the impact of PEPP termination on sovereign spreads for the entirety of 2022. Hawks probably want to "wean the market off" QE faster and want to retain the possibility of stopping QE altogether if inflation were to prove persistent beyond the middle of the year. A compromise needs to emerge. We thus elaborate on the 2-stage approach scenario we sketched out last week. **We think the central bank will announce an intention to purchase EUR40bn per month through APP from March to December 2022 at least, but with a "rendezvous clause" to recalibrate the quantum at each new forecast batch, so in practice in June and September.** This suggests the ECB will be subject to regular speculations throughout next year, which would be conducive to quite a bit of volatility.

The quantum and timeline of APP won't be the only point of focus on Thursday. PEPP is much more flexible than APP. This materialized for instance in the fact that Greek sovereign bonds are eligible to the former but not to the latter, since they still lack the "investment grade status" from the rating agencies which the ECB looks at. There was some expectation that Moody's and S&P would have upgraded the sovereign in October and November 2021, but they "passed", despite the undeniable improvement in the country's economic performance and macro-management. It may well be that the agencies would prefer to wait until the next general elections – which must be organized by 6 August 2023 - before making that move. Mitsotakis' centre-right New Democracy remains dominant in the polls but has lost some ground in the last months. There is certainly a case to provision for some insurance policy for Greece in 2022. A solution would be to use the reinvestments from PEPP to be heavily skewed, if need be, towards this constituency.

A similar approach could be adopted to deal with potential fragmentation risks elsewhere in the periphery. Italian government bonds have benefited a lot from the PEPP's deviation from the capital key. A stricter return to the key would be expected with QE reduced to APP, leaving the Italian market vulnerable**. Diverting PEPP reinvestment towards this market would also be a way to provide some protection.** A key focus for us on Thursday will be the extent to which the ECB will elaborate on these various streams. We think the market may react negatively if the ECB is not explicit enough on the possibility to PEPP's reinvestments tactically. Note finally that while we expect the ECB to keep the Targeted Longer-Term Refinancing Operations (TLTROs) on its arsenal on a permanent basis – in all likelihood without the special "50 basis points subsidy" - we may not hear about the calibration of any post-June 2022 instalments this week already.

Of course, we will also pay quite a lot of attention on the ECB's new forecasts. We have already discussed in Macrocast the fact that some of the key assumptions may be obsolete by publication day – e.g. on oil prices – but it's the endpoint in 2024 which we think we'll find most interesting. Most observers – and ourselves – expect the inflation forecast to be slightly below 2.0% in 2024. This could raise some questions. Indeed, if the ECB acknowledges that it doesn't expect inflation to be back to target by the end of its forecasting horizon, one may wonder why then they don't do more on their stimulus.

Country/Region	What we focused on last week	What we will focus on in next weeks
	• CPI inflation (Nov) rose to 6.8% - a near 40-year high – core recorded 4.9%, highest since Jun 91 • Biden-Putin summit on Ukraine • JOLTS survey (Oct) rose back to 11.0m, while jobless claims set a new record low since 1969 at 184k, although seasonals appear important • Weaker Q3 productivity -5.2% meant unit labour costs rose to 9.6% • COVID cases remain elevated, hospitalisations rising	• FOMC meeting. Expect Fed to quicken taper to finish early Q2. Powell press conf to downplay link to rates, makes sooner lift-off more likely • Debt ceiling pressing as Yellen-identified 15 Dec date arrives, reconciliation solution • Retail sales (Nov) exp'd softer rise than strong 1.7% in Oct, Black Friday sales dipped on year • Philly Fed and Empire surveys (Dec) • PPI inflation (Nov) exp'd higher at 9.2%, core stable at 6.8%
	• Ge IP (Oct) surprised on the upside (2.8%mom), helped by recovery in auto sector • Ge ZEW Economic sentiment (Dec) eased to 29.9 from 31.7, pulled down by current conditions (-7.4 from 12.5) • V.Pecresse will represent Les Republicains for Fr Presidential elections (curr 16-20% in polls)	• The ECB should announce the end of PEPP and increasing net APP purchases. Details on how they maintain flexibility through programs, whether they adjust forward guidance on rates and HICP projections will be key to monitor • Flash PMIs (Dec) in Ge, Fr, Eurozone • Fr Bus climate and Ge Ifo (Dec)
	• Fresh social restrictions introduced – Plan B - to quell spread of Omicron in the UK • GDP (Oct) +0.1%mom (cons 0.4%) despite buoyant retail sales. Q4 outlook inc impact of restrictions now below 1% • Mfg and IP came in weak at 0% & -0.6%mom	• MPC decision (Thurs), omicron provides option to delay. A tight call, but we expect +0.15% to 0.25% with focus on labour market pressures • Labour market data watch for first post furlough unemployment data (Oct) • CPI inflation (Nov) set to rise further cons 4.7%
	• Reuters Tankan Mfg and Non-Mfg surveys (Dec) progressed to 22 (from 13) and 6 (from 1), bus survey (Q4) also improved • Q3 GDP growth has been revised lower to -0.9% (-0.1pp)	• Tankan surveys are expected to progress especially in non mfg sector. It will also worth to monitor whether small enterprises catch up • The BoJ should confirm the end of the extraordinary loan program, on hold otherwise
	• November TSF growth picked up modestly • PBoC announced a 50bp RRR cut, which is to take effect on 15 December • Chinese export continued solid growth	• November activity data to be released (retail sales, fixed asset investment and industrial production as well as housing data)
	• CB: Brazil hiked +150bps to 9.25%, Poland +50bps to 1.75% & Peru +50bps to 2.50%. India stood on hold at 4.0% • Inflation (Nov) rose in Colombia (5.3%), Chile (6.7%), Hungary (7.4%), Mexico (7.4%), Russia (8.4%) & Taiwan (2.8%) • Q3 GDP declined by 1.5% q/q in South Africa • Export momentum moderating in Asia	• CB: Colombia is expected to hike +50bps to 3.0%, Chile +125bps to 4.0%, Hungary +120bps to 3.30%, Mexico +25bps to 5.25% & Russia +100 bps to 8.50%. Indonesia & Philippines to stay on hold at 3.5% & 2.0%, respectively. Turkey could cut 200bps to 13.0% • Russia Q3 GDP yoy should accelerate slightly • CB: Brazil expected to hike +150bps to 9.25%, Poland +50bps to 1.75% and Peru +50bps to 2.50%. India could stay on hold (4.0%)

Upcoming events		
	US :	Tue: NFIB survey (Nov), PPI inflation (Nov); Wed: Retail sales (Nov), Empire state survey (Dec), NAHB indx (Dec), Business inventories (Oct), FOMC announcement, TIC data (Oct); Thu: jobless claims (11 Dec), Philly Fed indx (Dec), Housing starts (Nov), Ind prod (Nov), PMI (Dec,p);
	Euro Area:	Tue: EU19 Ind prod (Oct); Wed: Fr, It, Sp HICP (Nov); Thu: EU19 PMI (Dec,p), ECB announcement, Ge & Fr PMI (Dec,p), Fr Insee mfg (Dec); Fri: EU19 CPI (Nov), Ge PPI (Nov), Ge IfO indx (Dec)
	UK:	Mon: BoE's Financial Stability Report; Tue: labour market report (Oct); Wed: CPI and PPI Inflation (Nov); Thu: PMI (Dec,p), MPC announcement; Fri: GfK consumer conf (Dec), Retail Sales (Nov)
	Japan:	Sun: Private 'core' machinery orders (Oct), Tankan large mfg indx (Q4); Tue: Ind prod (Oct); Thu: Mfg PMI (Dec,p); Fri: BoJ announcement
	China:	Wed: Ind prod (Nov), Retail sales (Nov), Fixed asset investment (Nov)

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