# A stop on the road

The economic activity cycle is facing its umpteenth test in the months ahead, taking into account: the emergence of the new variant in the pandemic (Omicron), the mobility restrictions announced in countries of central Europe, the accumulation of negative surprises related to inflation and the continuing deterioration of industry due to supply chain disruptions. The sensation is that the forecasts for at least Q1 of next year will need to be revised down, as we are facing a new mini-cycle in which the limitations on the movement of goods and people will increase. Right now there is still a lot we do not know, from the reproduction rate of the Omicron variant (initial estimates place it slightly above the delta variant) to the extent to which the vaccines will prove effective (opinion is split in the health industry). In any case, it is still too early to estimate what the net effect on economic activity will be, and it should be noted that economic agents' and authorities' capacity to respond has been improving with each new episode of COVID-19 mutation, as part of a continuous adaptation and learning process.

What is new on this occasion is that the Omicron variant has emerged at a time when we are seeing a string of negative surprises in prices. In November, inflation in the euro area rose once again to 4.9% (2.6% for core inflation), reaching the highest level in decades in countries such as Germany (6%) and Spain (5.6%), while industrial prices continue to climb to levels not seen since the oil shocks of the 1970s (+32% in Spain and +19% in Germany in October). Thus, even in the most favourable scenarios, a turning point in inflation is not anticipated until well into next year. As the Federal Reserve chairman (Jerome Powell) has just acknowledged, the transitory hypothesis is beginning to lose credibility, given that there is no immediate end to the problem in sight. This is especially the case in the US, where the price increases in the most volatile components are filtering down to the rest, and job turnover ratios (The big quit) are already at 3% of the workforce (7% in sectors such as hospitality), causing labour shortages in many segments of the labour market. We expect inflation in the US to peak at around the 7% mark in late Q1 2022, but more importantly, core inflation at that point will be approaching 6%, and this could force the Fed to intensify the tapering process with a view to raising interest rates before the summer if necessary.

In this context, the question is: how might the new variant of the virus affect price behaviour? Judging from the experience of what happened in 2020, the drop in demand should reduce pressure on production markets and lead to a fall in prices, starting with commodities. However, this time may be different, as with global logistics already strained, any further disruption (closure of ports in China, etc.) could introduce new restrictions on the functioning of value chains, complicating stock management and entrenching tensions in the price formation process. This would complicate the incipient process of monetary normalisation, as central banks would find themselves stuck between a rock and a hard place, trying to keep financial conditions very lax while facing a longer-than-expected period of inflation deviating sharply from the targets. The most fragile part of the scenario will remain emerging countries, especially those dependent on tourism and with high short-term funding needs.

Therefore, the recovery will have to face a new hurdle in the short term. While this should not change its trajectory, it could once again cloud the economic landscape over the coming weeks, at least until we have all the necessary information to refine the health and economic policy responses. The expectations of businesses and consumers will determine the impact in the short term. In the medium term, the factors that have been consolidating the revival in recent quarters continue to apply: the effectiveness and adaptability of the vaccines, high levels of savings, and highly expansionary monetary and fiscal conditions. We are facing a new stop on the road, after which the business cycle should continue on the path of recovery.

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