16 July 2021

THE WEEK AHEAD

Transitory is the Name of the Game

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Mon 7/19	NAHB Housing Market Index	Jul	82	▲	81
Tue 7/20	Building Permits	Jun	1690 K	▲	1681 K
Tue 7/20	Housing Starts	Jun	1590 K	▲	1572 K
Thu 7/22	Existing Home Sales	Jun	5.95 M	▲	5.80 M
Fri 7/23	Markit Manufacturing PMI (Preliminary Estimate)	Jul	62.1	-	62.1
Fri 7/23	Markit Services PMI (Preliminary Estimate)	Jul	64.8	▲	64.6
Europe					
Thu 7/22	ECB Monetary Policy Meeting	Jul	0.0%	-	0.0%
Thu 7/22	EZ Consumer Confidence (Advance Estimate)	Jul	-3.0	▲	-3.3
Fri 7/23	EZ Markit Manufacturing PMI (Preliminary Estimate)	Jul	62.1	▼	63.4
Fri 7/23	EZ Markit Services PMI (Preliminary Estimate)	Jul	60.0	▲	58.3
Fri 7/23	U.K. Markit Manufacturing PMI (Preliminary Estimate)	Jul	62.0	▼	63.9
Fri 7/23	U.K. Markit Services PMI (Preliminary Estimate)	Jul	62.5	▲	62.4
Fri 7/23	U.K. Retail Sales	Jun	0.4% M/M	▲	-1.4% M/M
Asia Pacific					
Tue 7/20	PBOC Monetary Policy Meeting	Jul	--		--
Tue 7/20	Japan Consumer Price Index	Jun	0.2% Y/Y	▲	-0.1% Y/Y
Tue 7/20	Japan Exports	Jun	46.3% Y/Y	▼	49.6% Y/Y
Wed 7/21	South Korea Exports (First 20 Days)	Jul			29.5% Y/Y

Arrows indicate consensus forecast compared to the previous period. Local dates of release.

U.S.

- **Markit flash PMIs for this month** will be released July 23. We will watch the second derivative to gauge if there's a shift from extremely fast, to slower (but still fast) growth.
- **Housing starts and permits are expected to remain robust.** Demand is strong despite recent volatility; with low inventories, this will support new home construction.

Europe

- **Expect the ECB to adjust forward guidance to its new policy strategy when it meets July 22.** It will likely prolong or increase asset purchases but may wait until fall, when there's more clarity around the Delta variant. A rise in euro area inflation expectations, now stuck around 1.5%, would be a sign of success.

Asia Pacific

- **Japan CPI should remain muted**, but rising PPI amid elevated commodity prices could lead policymakers to address margin pressures and the resulting impact on business investment and wage growth.
- **South Korea export growth could moderate** following months of impressive gains. Expect still-elevated levels amid robust DM demand.

What This Week Means For Markets

Muted reaction to a high U.S. CPI reading confirmed that markets believe the Fed is heading toward a policy mistake following the recent upward shift in median dots. The 2s10s and 2s30s curve flattened, consistent with rate hike expectations being pulled forward as shorter-term yields increased. Meanwhile, longer-term expectations have declined—reflecting more pessimistic growth, or our Gravity Prevails scenario. Separately, the Fed is perceived to be more hawkish than the ECB, particularly following the announcement of the ECB strategy review, which should fuel the dollar's strength. We are sticking with our "The Best of All Possible Worlds!" scenario as FOMC leadership remains steadfast in its accommodative stance, focusing on a full labor market recovery. Please see our Monthly Macro Dashboard.

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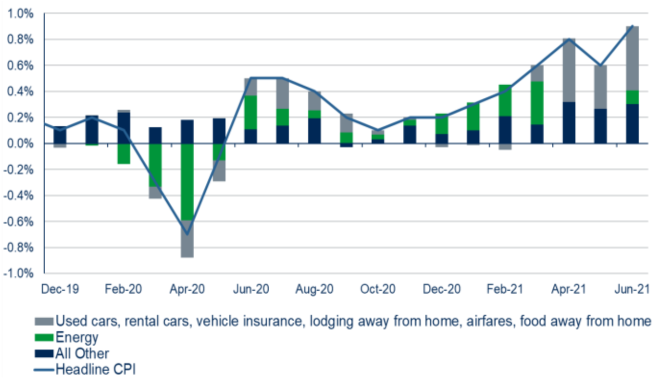
IN REVIEW

U.S. Inflation Exceeds Expectations, But Watch For Transitory Pressures

U.S. inflation data for June surprised to the upside. While many thought CPI would peak in May given fading base effects, headline CPI accelerated from 5% Y/Y to 5.4% Y/Y. Despite the overshoot, details show that a majority of the increase was driven by transitory factors. While there may be upside to near-term inflation, the data continues to support our baseline view of strong growth and temporary price pressures.

U.S. CONSUMER PRICE INDEX, M/M%



Source: Bloomberg. As of July 15, 2021.

Details show used car sales up 10.5% M/M, lodging-away-from-home rose 7% M/M, and airfares rose 2.7% M/M. We expect some easing in the coming months as consumer preferences shift and supply and demand normalize.

Federal Reserve Chairman Jerome Powell remained firm in his July 14 testimony to Congress that price pressures are transitory and he is focused on a full labor market recovery. This implies that while the median dot may have shifted higher in the last Summary of Economic Projections, FOMC leadership remains committed to its accommodative stance and new policy framework.

Looking ahead, the July print will be important to watch. While it is expected to ease over the month, a further M/M rise in inflation will raise additional concerns. Keep an eye on the underlying details driving inflation in the months ahead.

New ECB Strategy: Close to But Not Exactly Average Inflation Targeting

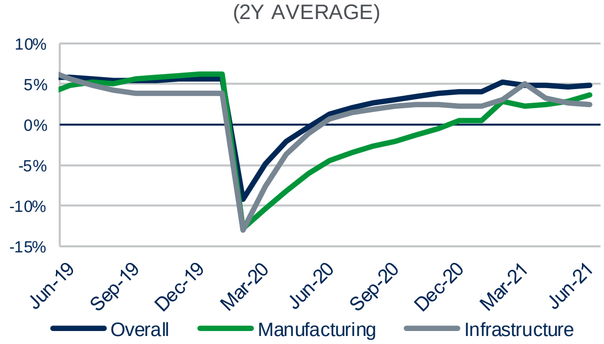
The ECB gave itself space to push inflation up in its Strategy Review. The new inflation target is symmetric, around 2%, and there are more similarities than differences with the Fed's 2% average target. Both are vague and aim at lifting inflation closer to 2% in the medium term. The ECB will not target inflation above 2%, but it will tolerate it. The euro depreciated slightly on this news, an indication markets understood the dovish signal.

China Growth Continues a Slow Rebalance

Fears of a drastic slowdown in Chinese growth may be overblown, despite last week's surprise announcement to lower required reserve requirements. China Q2 GDP rose 7.9% Y/Y, slightly below consensus of 8%, but showed acceleration on a sequential basis, with GDP growing 1.3% Q/Q in Q2 from 0.4% in Q1. While generally still lagging the recovery, the service sector's contribution to growth exceeded the industrial sector's contribution in Q2, showing a gradual rebalancing of growth drivers.

Meanwhile, non-property investment and consumption also improved gradually. Fixed Asset Investment picked up 6% Y/Y in June (5.5% prior), supported by manufacturing and infrastructure capex. Retail sales in June were also strong, growing 12.1% Y/Y—down slightly from 12.4% in May on fading base effects but still above expectations. Activity was led by strong online sales despite a slight moderation in restaurant transactions amid the latest surge in infections.

CHINA FIXED ASSET INVESTMENT Y/Y GROWTH
(2Y AVERAGE)



Source: Bloomberg. As of July 15, 2021.

Looking ahead, further investment gains should be fueled by still-robust industrial profits amid resilient exports, together with the expected acceleration in government spending in H2. Consumption should benefit from reaccelerating income growth, declining unemployment, and a steady drawdown of still-elevated household savings. Both should drive growth, particularly through year-end. Uncertainty remains, however, as internal demand is still highly sensitive to contagion risks, as seen in the latest outbreak in Guangdong.

KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	0.25%	0 bps	0 bps	0 bps	0 bps	0 bps	0 bps
U.S. SOFR	0.05%	0 bps	4 bps	4 bps	-3 bps	-6 bps	-2 bps
3 Month USD Libor	0.13%	0 bps	1 bps	-6 bps	-10 bps	-14 bps	-11 bps
3 Month Euribor	-0.55%	0 bps	0 bps	-1 bps	0 bps	-11 bps	0 bps
3 Month U.S. T-Bill	0.06%	1 bps	3 bps	4 bps	-3 bps	-9 bps	-2 bps
2-Year U.S. Treasury	0.22%	0 bps	7 bps	7 bps	6 bps	7 bps	10 bps
10-Year U.S. Treasury	1.35%	3 bps	-15 bps	-28 bps	22 bps	74 bps	43 bps
10-Year German Bund	-0.31%	0 bps	-6 bps	-3 bps	24 bps	13 bps	26 bps
10-Year U.K. Gilt	0.64%	6 bps	-10 bps	-15 bps	34 bps	49 bps	44 bps
10-Year JGB	0.02%	-1 bps	-2 bps	-7 bps	-1 bps	0 bps	0 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	0.89%	N/A	-0.2%	0.9%	1.8%	-3.1%	-1.9%
Barclays Capital U.S. TIPS	1.05%	N/A	0.4%	1.5%	3.9%	6.8%	2.8%
Barclays Capital U.S. Aggregate	1.44%	34	-0.2%	0.8%	1.7%	-0.5%	-1.1%
Barclays Capital Global Aggregate	1.06%	33	0.2%	-0.3%	0.8%	2.3%	-2.7%
Barclays Capital U.S. ABS	0.45%	23	0.0%	0.0%	0.3%	1.3%	0.3%
Barclays Capital U.S. MBS	1.71%	31	0.0%	0.3%	0.1%	-0.2%	-0.5%
Barclays Capital U.S. Corporate Investment Grade	2.00%	84	-0.3%	1.4%	3.1%	2.2%	-0.7%
BAML Euro Corporate Investment Grade	0.25%	83	0.1%	0.4%	0.7%	3.7%	0.1%
Barclays Capital U.S. Corporate High Yield	3.74%	275	-0.1%	0.9%	2.5%	14.3%	4.0%
BAML European Currency High Yield Non-Financial	2.64%	309	0.0%	0.1%	1.1%	11.0%	3.1%
CS U.S. Leveraged Loans	4.75%	441	0.0%	0.3%	1.2%	11.0%	3.6%
CS Western European Leveraged Loans Non-USD	4.22%	411	0.1%	0.0%	0.9%	9.4%	3.0%
JPM CEMBI Broad Diversified	4.24%	305	0.0%	0.4%	2.1%	8.2%	1.5%
JPM EMBI Global Diversified	4.91%	349	-0.1%	-0.4%	2.6%	6.7%	-0.5%
JPM GBI-EM Global Diversified	4.97%	N/A	0.3%	-2.9%	0.8%	4.6%	-4.2%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	4,374.30	1.29%	0.4%	2.9%	6.4%	38.9%	17.4%
Euro STOXX 600 (Local)	460.56	2.75%	0.2%	0.5%	5.5%	25.4%	15.4%
U.K. FTSE 100 (Local)	7,091.19	3.01%	-0.8%	-0.8%	2.2%	14.7%	9.8%
Japan Nikkei 225 (Local)	28,608.49	1.52%	0.9%	-1.9%	-3.4%	26.7%	4.2%
China Shanghai Composite (Local)	3,528.50	2.06%	-0.7%	-1.7%	3.3%	3.3%	1.6%
MSCI AC World (Local)	726.09	1.70%	0.2%	1.8%	5.1%	34.3%	14.8%
MSCI Emerging Markets (Local)	1,338.13	2.00%	-0.1%	-1.3%	0.6%	25.7%	6.1%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	531.43	1.4%	0.4%	9.0%	21.6%	58.3%	29.8%
WTI Crude ($/bbl)	73.13	1.3%	3.1%	15.8%	36.8%	81.5%	51.3%
Copper ($/lb)	4.28	-1.2%	-5.6%	3.3%	16.6%	46.7%	21.7%
Gold ($/oz)	1,823.20	1.0%	-2.3%	5.1%	-1.0%	1.2%	-3.4%
U.S. Dollar Index	92.41	-0.3%	2.1%	0.8%	2.4%	-4.0%	2.7%
Euro (USD/EUR)	1.18	0.2%	-2.5%	-1.2%	-2.6%	3.7%	-3.4%
British Pound (USD/GBP)	1.39	0.6%	-1.8%	0.6%	1.4%	10.7%	1.4%
Japanese Yen (Yen/USD)	110.09	-0.5%	0.1%	1.0%	6.0%	2.6%	6.6%
Chinese Yuan (CNY/USD)	6.47	0.1%	1.3%	-0.9%	0.1%	-7.8%	-1.0%

Source: FactSet and Bloomberg. As of July 14, 2021.

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