

## Inflation Starts Trending Down (Slowly)

### WATCH LIST

Date		Period	Consensus		Previous
<b>U.S.</b>					
Tue 8/17	Retail Sales	Jul	-0.2% M/M	▼	0.6% M/M
Tue 8/17	Industrial Production	Jul	0.5% M/M	▲	0.4% M/M
Tue 8/17	Business Inventories	Jun	0.8% M/M	▲	0.5% M/M
Tue 8/17	NAHB Housing Market Index	Aug	80	-	80
Wed 8/18	Building Permits	Jul	1605 K	▲	1598 K
Wed 8/18	Housing Starts	Jul	1610 K	▼	1643 K
Wed 8/18	FOMC Meeting Minutes		--		--
<b>Europe</b>					
Tue 8/17	EZ GDP (Preliminary Estimate)	2Q21	2.0% Q/Q	-	2.0% Q/Q
Tue 8/17	U.K. Unemployment Rate	Jun			4.8%
Wed 8/18	EZ Consumer Price Index (Final Estimate)	Jul	2.2% Y/Y	▲	1.9% Y/Y
Wed 8/18	U.K. Consumer Price Index	Jun			2.5% Y/Y
Fri 8/20	U.K. Retail Sales (ex Auto Fuel)	Jul			0.3% M/M
<b>Asia Pacific</b>					
Mon 8/16	China Retail Sales (YTD)	Jul	21.2% Y/Y	▼	23.0% Y/Y
Mon 8/16	China Industrial Production (YTD)	Jul	14.6% Y/Y	▼	15.9% Y/Y
Mon 8/16	China Fixed Assets ex Rural (YTD)	Jul	11.3% Y/Y	▼	12.6% Y/Y
Mon 8/16	China Property Investment (YTD)	Jul	12.9% Y/Y	▼	15.0% Y/Y
Mon 8/16	Japan GDP (Preliminary Estimate)	2Q21	0.1% Q/Q	▲	-1.0% Q/Q
Tue 8/17	Japan Exports	Jul	38.8% Y/Y	▼	48.6% Y/Y
Fri 8/20	PBOC Monetary Policy Meeting	Aug	--		--
Fri 8/20	Japan Consumer Price Index	Jul	-0.4% Y/Y	▼	0.2% Y/Y

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

#### U.S.

- **Retail sales should remain strong** amid support from U.S. shoppers. However, following the upward surprise in June, easing in government transfers could lead to some M/M volatility.
- **We will watch industrial production and business inventories** to gauge if and how supply is catching up with demand.

#### Europe

- **U.K. inflation print for July will be released** Wednesday, August 18. After the Bank of England's dovish (on negative rates) and hawkish (on earlier tapering) announcements last week, any major surprise to the consensus 2.5% headline number will likely reverberate through sterling markets.

#### Asia Pacific

- **China activity data for July is likely to continue moderating.** The latest outbreak will also likely drag on retail sales, particularly catering/restaurants.
- **Japan 2Q21 GDP** should be buoyed by a robust external sector. Meanwhile, household spending is likely to have been dragged down by restrictions during the April-May viral wave.

#### What This Week Means For Markets

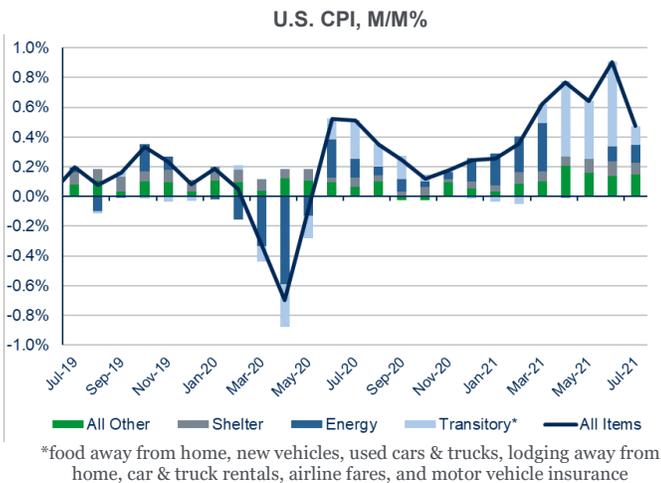
After weeks of markets pricing in our slower-growth Gravity Prevails scenario, the strong U.S. employment report kicked off a slight shift in the narrative, which was supported by positive progress in U.S. infrastructure negotiations. The U.S. 10-year yield moved higher W/W, helped by rising real yields amid a modest repricing of the growth outlook. Cyclical sectors in the S&P 500 (Financials, Materials, Energy, and Industrials) have also outperformed W/W, while IT lagged. Real yield differentials are helping provide a bid to the dollar, which has outperformed both the euro and the yen. Strong economic data and a muted reaction to CPI data that decelerated M/M provides more support for our central scenario of "The Best of all Possible Worlds!" Please see our [Monthly Macro Dashboard](#).

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## IN REVIEW

### U.S. CPI Data Supports the Transitory Narrative

While headline U.S. CPI held at its 5.4% Y/Y peak in July, a deceleration in the core index, as well in M/M growth, adds more support to our and the FOMC’s baseline outlook that price pressures are transitory. CPI decelerated from 0.9% M/M in June to 0.5% M/M in July, while the core index eased from 4.5% Y/Y to 4.3%Y/Y—in line with consensus expectations. Meanwhile, as supply and demand begin to normalize in the goods sector, price pressures are shifting from goods to the re-opening services sector.



Source: Bloomberg. As of August 12, 2021.

The transitory nature was seen this month in components such as used car prices, which eased sharply from 10.5% M/M in June to just 0.2% M/M in July. Similarly, car and truck rentals fell 4.6% M/M in July after rising 5.2% M/M in June. However, as normalization begins in the goods sector, strong demand in the services sector kept prices accelerating in areas such as dining out and personal care services.

While inflation will likely remain elevated in the near-term as supply struggles to meet demand, it should drift lower through the end of this year and next.

### U.S. Employment is Heating Up

The July employment report was extremely positive but won’t likely change the path of U.S. monetary policy. Nonfarm payrolls beat consensus expectations, rising 943,000 in July, and the previous two months were revised higher by 119,000. Job gains

were driven by reopening sectors, with leisure and hospitality adding 380,000 jobs in July.

The Household Survey showed the unemployment rate fell from 5.9% to 5.4% for the right reasons, as the labor force edged slightly higher. However, with about 5 million additional people not in the labor force than before pandemic, the FOMC will likely need to see further improvement before it declares “substantial further progress” has been made. Therefore, we expect the path of policy to remain unchanged, with taper beginning either at the end of 2021 or early 2022.

### China’s “Barbell” Approach to Policy

CPI eased to 1% Y/Y in July (from 1.1% prior), above expectations, as food deflation narrowed and non-food inflation picked up, fueled by increased travel demand. Meanwhile, PPI inflation continued to rebound, led by a rise in commodity prices. The continued PPI-CPI divergence will likely put pressure on industrial profits and disproportionately impact smaller firms. Finally, credit and monetary data in July was modestly disappointing. Slowing loan growth across corporates and households was likely weighed down by weather disruptions and Nanjing’s latest Delta outbreak, which now impacts provinces totaling 38% of GDP.

With this, policymakers, via the recent Q2 PBOC Monetary Policy Report and the Q2 Politburo meeting, have reaffirmed their “barbell” approach to policy—de-risking in certain industries (property and technology) while offering targeted support to others (SMEs and firms engaged in decarbonization). Focusing on conducting monetary policy with a cross-cycle perspective to avoid formation of bubbles, and still elevated PPI, the bar for more easing via Reserve Requirement Ratio or rate cuts may be high, unless the viral surge slows growth conditions.

### Activity Acceleration Continues in Europe

The reopening and a strong tourism season continue to show in activity data. PMIs for July posted another increase to or close to all-time highs in Italian and Spanish services sectors (58 and 61.9, respectively). Modest downward revisions in France and Germany caused the eurozone services PMI to be revised down, to 59.8 from 60.4. The eurozone composite index was also revised slightly down to 60.2 (from 60.6), still representing a series all-time high. Solid retail sales across the continent and the arrival of tourists in Spain added consistency to the strong rebound unfolding.

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## 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	0 bps	4 bps	-1 bps	-5 bps	-2 bps
3 Month USD Libor	0.12%	0 bps	-1 bps	-4 bps	-8 bps	-13 bps	-12 bps
3 Month Euribor	-0.55%	-1 bps	-1 bps	-2 bps	-1 bps	-7 bps	0 bps
3 Month U.S. T-Bill	0.05%	0 bps	0 bps	4 bps	1 bps	-5 bps	-3 bps
2-Year U.S. Treasury	0.21%	4 bps	0 bps	6 bps	10 bps	5 bps	9 bps
10-Year U.S. Treasury	1.34%	17 bps	-1 bps	-28 bps	18 bps	68 bps	42 bps
10-Year German Bund	-0.46%	2 bps	-17 bps	-29 bps	1 bps	2 bps	12 bps
10-Year U.K. Gilt	0.59%	6 bps	-7 bps	-24 bps	13 bps	39 bps	39 bps
10-Year JGB	0.03%	3 bps	0 bps	-4 bps	-4 bps	1 bps	1 bps
Fixed Income	Yield	OAS	1W Return	1M Return	3M Return	12M Return	YTD Return
Barclays Capital U.S. Government-Treasury	0.90%	N/A	-1.0%	0.1%	1.8%	-2.9%	-1.9%
Barclays Capital U.S. TIPS	1.03%	N/A	-0.5%	1.6%	3.0%	6.4%	3.8%
Barclays Capital U.S. Aggregate	1.46%	35	-0.9%	0.0%	1.6%	-1.0%	-1.1%
Barclays Capital Global Aggregate	1.03%	34	-0.9%	0.2%	0.2%	0.6%	-2.6%
Barclays Capital U.S. ABS	0.51%	25	-0.1%	0.1%	0.2%	1.1%	0.3%
Barclays Capital U.S. MBS	1.71%	30	-0.3%	0.2%	0.4%	-0.2%	-0.4%
Barclays Capital U.S. Corporate Investment Grade	2.05%	89	-1.4%	-0.2%	2.8%	0.6%	-1.0%
BAML Euro Corporate Investment Grade	0.16%	85	-0.2%	0.8%	1.7%	2.9%	0.7%
Barclays Capital U.S. Corporate High Yield	4.12%	309	-0.2%	-0.4%	1.5%	9.4%	3.6%
BAML European Currency High Yield Non-Financial	2.57%	310	0.0%	0.6%	1.6%	9.1%	3.6%
CS U.S. Leveraged Loans	4.88%	454	0.1%	0.0%	0.9%	9.0%	3.6%
CS Western European Leveraged Loans Non-USD	4.20%	409	0.1%	0.5%	1.0%	8.9%	3.4%
JPM CEMBI Broad Diversified	4.30%	310	-0.1%	0.1%	1.6%	5.6%	1.6%
JPM EMBI Global Diversified	4.93%	351	-0.7%	-0.1%	1.8%	2.3%	-0.5%
JPM GBI-EM Global Diversified	5.01%	N/A	-1.1%	-0.6%	-1.4%	2.8%	-4.9%
Equities	Price	Div Yield	1W Return	1M Return	3M Return	12M Return	YTD Return
S&P 500	4,447.70	1.27%	1.1%	1.9%	7.5%	35.5%	19.4%
Euro STOXX 600 (Local)	474.32	2.74%	1.3%	3.6%	8.6%	27.9%	18.9%
U.K. FTSE 100 (Local)	7,220.14	2.97%	1.4%	1.4%	3.9%	17.3%	11.8%
Japan Nikkei 225 (Local)	28,070.51	1.56%	1.8%	0.5%	-1.9%	23.4%	2.3%
China Shanghai Composite (Local)	3,532.62	2.03%	1.6%	0.2%	2.6%	5.8%	1.7%
MSCI AC World (Local)	734.01	1.69%	0.9%	1.7%	8.2%	32.0%	16.3%
MSCI Emerging Markets (Local)	1,297.58	2.14%	-0.1%	-1.2%	0.5%	19.0%	3.4%
Commodities/Currencies	Price	1W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
S&P GS Commodity Index	525.08	0.6%	-1.3%	0.1%	14.5%	51.3%	28.2%
WTI Crude (\$/bbl)	69.25	1.6%	-7.1%	6.0%	18.9%	66.7%	43.2%
Copper (\$/lb)	4.36	0.8%	0.3%	-8.7%	15.2%	51.9%	24.2%
Gold (\$/oz)	1,743.60	-4.7%	-3.5%	-4.7%	-5.2%	-10.1%	-7.6%
U.S. Dollar Index	92.92	0.7%	0.9%	3.1%	2.8%	-0.8%	3.3%
Euro (USD/EUR)	1.17	-0.9%	-1.1%	-3.5%	-3.2%	-0.2%	-4.1%
British Pound (USD/GBP)	1.39	-0.3%	0.2%	-2.0%	0.3%	6.0%	1.4%
Japanese Yen (Yen/USD)	110.47	0.8%	0.3%	1.8%	5.5%	3.8%	7.0%
Chinese Yuan (CNY/USD)	6.49	0.4%	0.0%	0.9%	0.8%	-6.7%	-0.8%

Source: FactSet and Bloomberg. As of August 11, 2021.

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