BARINGS INVESTMENT INSTITUTE

11 February 2022

THE WEEK AHEAD

Pressures Continue to Build for Fed Hikes

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Tue 2/15	Producer Price Index	Jan	8.9% Y/Y	▼	9.7% Y/Y
Wed 2/16	Retail Sales	Jan	1.7% M/M	▲	-1.9% M/M
Wed 2/16	Industrial Production	Jan	0.4% M/M	▲	-0.1% M/M
Wed 2/16	NAHB Housing Market Index	Feb	83	-	83
Wed 2/16	FOMC Meeting Minutes	Jan	--		--
Thu 2/17	Building Permits	Jan	1750 K	▼	1873 K
Thu 2/17	Housing Starts	Jan	1700 K	▼	1702 K
Fri 2/18	Existing Home Sales	Jan	6.10 M	▼	6.18 M
Europe					
Tue 2/15	EA GDP (Prelim. Est.)	4Q21	0.3% Q/Q	-	0.3% Q/Q
Tue 2/15	U.K. Unemployment Rate	Dec	4.1%	-	4.1%
Wed 2/16	U.K. Consumer Price Index	Jan	5.6% Y/Y	▲	5.4% Y/Y
Wed 2/16	EA Industrial Production	Dec	0.2% M/M	▼	2.3% M/M
Fri 2/18	U.K. Retail Sales Inc. Auto Fuel	Jan			-3.7% M/M
Asia Pacific					
Tue 2/15	Japan GDP, annualized (Prelim. Est.)	4Q21	6.0% Q/Q	▲	-3.6% Q/Q
Wed 2/16	China Producer Price Index	Jan	9.5% Y/Y	▼	10.3% Y/Y
Wed 2/16	China Consumer Price Index	Jan	1.0% Y/Y	▼	1.5% Y/Y
Fri 2/18	Japan Consumer Price Index	Jan	0.6% Y/Y	▼	0.8% Y/Y

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

U.S.

- We will watch **January retail sales data** to analyze Omicron's impact on consumer spending.
- **Housing data next week** is expected to **show a solid market** that remains strong amid elevated demand and limited inventories.

Europe

- **January U.K. inflation is expected to rise** further as price pressures come not only from energy but also the cost of food, household goods, and clothing.
- The **euro area Q4 GDP** estimate might show **the slowest growth in three quarters** following Omicron's spread across Europe.

Asia Pacific

- **China CPI is expected to moderate** as food prices fall. Meanwhile, **PPI is likely to remain elevated** on firm industrial commodity prices, but expect this to fade in coming months.
- **Japan 4Q21 GDP could show an upturn** amid an improvement in cases during the quarter, which likely helped boost private consumption.

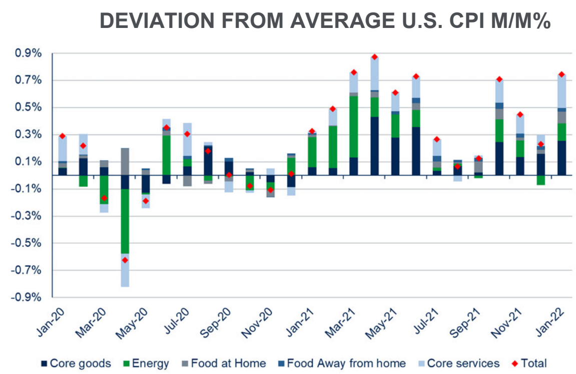
What This Week Means For Markets

U.S. yields rose following the upward surprise in U.S. CPI, with the 10-year U.S. Treasury yield reaching 2% for the first time since the onset of COVID. U.S. rate hike expectations increased following the release, with markets pricing in 50% odds of a 50bps hike in March, leading the curve to bear flatten. While we still believe U.S. inflation will trend lower by year-end, the employment report and CPI print are more in line with our Runaway Train scenario. Elsewhere, European inflation expectations are edging higher following upward surprises in the U.S. and euro area CPI data last week. Meanwhile, hawkish attitudes from markets are also being seen in Japan, where the 10-year JGB is approaching the Bank of Japan's (BOJ) upper bound yield target. As a result, the BOJ has made it clear it is willing to defend yield curve control, at least for the time being. Please see our Monthly Macro Dashboard.

IN REVIEW

U.S. CPI Fanned the Flames of Inflation Fears

U.S. CPI surprised to the upside in January. While inflation is expected to drift lower by year-end, this print is more in line with our Runaway Train scenario (see link on page 1) given broadening price pressures and an acceleration in the core measure. Headline and core CPI both rose 0.6% M/M (up 7.5% Y/Y and 6% Y/Y, respectively).



Source: Haver and Barings calculations. As of February 10, 2022.

The upward surprise in core services despite Omicron was notable—particularly rents and medical care. Meanwhile, core goods prices continued to increase. This, with the employment report's upward surprise last Friday, increases pressure on the Fed to act; following the release, markets increased rate hike expectations, now pricing in 50% odds of a 50bps hike in March.

U.S. Labor Market Recovering More Than Expected

The January employment report surprised to the upside and confirmed a strong U.S. labor market recovery despite the spike in Omicron cases, with nonfarm payrolls rising 467,000 (vs. cons. 125,000). There was a robust 709,000 upward revision to the final two months of 2021, which shows a stronger recovery than previous data suggested. Job gains were broad-based across sectors. Meanwhile, the unemployment rate rose to a still-impressive 4% for the right reasons, as more people were looking for work. This suggests the economy is strong enough to handle policy tightening this year and makes the beginning of the hiking cycle in March an easier decision for the Fed.

The jump in the labor force was a notable surprise, and the release included revisions to population estimates and seasonal adjustment factors, making a direct comparison to previous months difficult. Including these changes, the labor force participation rate came in at 62.2% in January (61.9% in December, 63.4% pre-COVID). Given data adjustments, the increase was not due to a large inflow of job seekers in January. Instead, this indicates the labor force decline was not as severe as expected and there is still room for further increases. This will be a welcome data point for the Fed—if labor supply continues to improve, it could help ease wage pressures and inflation. Continued uncertainty on the outlook for the return of labor supply will be watched closely. With liftoff set for March, the Fed will remain data dependent thereafter.

Policy Supports Credit Flow in the Chinese Economy

January total social financing growth had a meaningful acceleration to 11.9% Y/Y from 11.7%, with loan growth also coming in above expectations. While some seasonality is expected this time of year, importantly, the latest policy push helped drive aggregate credit growth. Driving the upside were the reserve requirement ratio and policy rate cuts since late last year, the PBOC's recent window-guidance for banks to extend credit, and strong corporate and government bond issuance—particularly with the latter amid the front-loading of fiscal spending intentions. While supportive of policymakers' intentions to stabilize growth this year, it comes amid ongoing headwinds in the property sector and China's zero-COVID strategy. More policy easing is likely, with another policy rate cut probable in the near-term as well as more targeted measures for steadying the property sector, including calling for relaxing mortgage credit access and loosening in developer credit access.

EA Retail Sales Surprised on the Downside

Euro area retail sales fell 3% M/M with Omicron restrictions in December (cons. -0.5%), the biggest decline in eight months. Non-food product retail sales declined 5.2%, while sales of auto fuels went up by 0.1%. Retail sales saw a 2% Y/Y increase, significantly lower than 5.1% consensus and the 8.2% increase in November—all pointing to a slowdown in European economies around the end of 2021. Growth is expected to increase in Q2 as Omicron restrictions lift.

Better Earnings, But More Margin Pressure Ahead

With over two-thirds of the S&P 500 reporting 4Q21 financials, earnings growth is on track to grow 27% Y/Y in 4Q21, beating consensus expectations by over 7%; while above the historical average beat of 2.5%, it is the lowest since the pandemic began. Consumer discretionary and financials were the biggest surprises, while industrials and materials lagged. Despite solid earnings, corporate commentary suggests labor shortages and supply chain issues may worsen in 1Q22, potentially weighing on margins. Higher sales and prices may also not be sufficient to offset significant inflation and supply chain inefficiencies.

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	0.04%	-1 bps	-1 bps	-1 bps	-1 bps	-1 bps	-1 bps
3 Month USD Libor	0.38%	7 bps	14 bps	23 bps	25 bps	17 bps	17 bps
3 Month Euribor	-0.52%	2 bps	5 bps	4 bps	2 bps	2 bps	5 bps
3 Month U.S. T-Bill	0.27%	8 bps	17 bps	23 bps	22 bps	23 bps	22 bps
2-Year U.S. Treasury	1.34%	19 bps	47 bps	94 bps	114 bps	123 bps	62 bps
10-Year U.S. Treasury	1.93%	16 bps	16 bps	50 bps	62 bps	77 bps	42 bps
10-Year German Bund	0.22%	19 bps	28 bps	51 bps	69 bps	67 bps	40 bps
10-Year U.K. Gilt	1.44%	17 bps	29 bps	60 bps	86 bps	97 bps	47 bps
10-Year JGB	0.21%	3 bps	9 bps	15 bps	20 bps	15 bps	14 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	1.78%	N/A	-1.1%	-1.4%	-3.5%	-3.8%	-3.0%
Barclays Capital U.S. TIPS	1.91%	N/A	-1.2%	-1.5%	-4.2%	1.8%	-3.7%
Barclays Capital U.S. Aggregate	2.30%	37	-1.2%	-1.7%	-3.9%	-3.8%	-3.2%
Barclays Capital Global Aggregate	1.72%	39	-0.9%	-1.4%	-3.9%	-6.0%	-2.6%
Barclays Capital U.S. ABS	1.66%	29	-0.4%	-0.6%	-1.3%	-1.4%	-0.9%
Barclays Capital U.S. MBS	2.46%	23	-1.0%	-1.4%	-3.0%	-3.6%	-2.5%
Barclays Capital U.S. Corporate Investment Grade	2.95%	105	-1.5%	-2.7%	-5.6%	-4.1%	-4.5%
BAML Euro Corporate Investment Grade	1.07%	117	-1.6%	-2.6%	-3.7%	-3.9%	-3.0%
Barclays Capital U.S. Corporate High Yield	5.37%	334	-0.8%	-2.0%	-2.7%	1.0%	-2.9%
BAML European Currency High Yield Non-Financial	3.99%	387	-1.5%	-2.9%	-3.0%	-0.8%	-2.7%
CS U.S. Leveraged Loans	5.84%	429	0.0%	0.2%	0.7%	4.2%	0.5%
JPM CEMBI Broad Diversified	5.07%	314	-0.6%	-1.5%	-2.2%	-1.6%	-2.1%
JPM EMBI Global Diversified	5.82%	378	-1.0%	-1.8%	-4.3%	-4.3%	-3.3%
JPM GBI-EM Global Diversified	5.91%	N/A	0.8%	2.2%	-0.3%	-6.7%	1.5%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	4,587.18	1.27%	0.0%	-1.8%	-1.7%	18.9%	-3.6%
Euro STOXX 600 (Local)	473.33	2.66%	-0.8%	-2.7%	-1.9%	15.3%	-3.0%
U.K. FTSE 100 (Local)	7,643.42	3.10%	0.8%	2.1%	5.1%	17.0%	3.5%
Japan Nikkei 225 (Local)	27,579.87	1.74%	0.2%	-3.2%	-5.8%	-6.5%	-4.2%
China Shanghai Composite (Local)	3,479.95	2.06%	3.5%	-2.8%	-0.8%	-3.4%	-4.4%
MSCI AC World (Local)	733.20	1.82%	0.5%	-1.4%	-1.8%	12.3%	-2.7%
MSCI Emerging Markets (Local)	1,239.79	2.48%	1.9%	0.7%	-2.0%	-8.4%	0.4%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	636.98	1.0%	10.2%	8.6%	24.3%	38.6%	13.5%
WTI Crude ($/bbl)	89.66	1.7%	13.5%	6.6%	34.7%	53.7%	19.0%
Copper ($/lb)	4.60	2.4%	4.5%	5.0%	7.3%	23.2%	3.3%
Gold ($/oz)	1,827.80	1.3%	2.0%	0.0%	5.1%	-0.6%	1.2%
U.S. Dollar Index	95.49	-0.5%	-0.2%	1.6%	2.7%	5.6%	-0.5%
Euro (USD/EUR)	1.14	1.2%	0.7%	-1.3%	-2.7%	-5.5%	0.5%
British Pound (USD/GBP)	1.35	-0.1%	-0.2%	0.0%	-2.2%	-1.8%	0.0%
Japanese Yen (Yen/USD)	115.47	0.9%	-0.1%	2.2%	4.7%	10.4%	0.3%
Chinese Yuan (CNY/USD)	6.36	-0.1%	-0.2%	-0.5%	-1.8%	-1.4%	-0.2%

Source: FactSet and Bloomberg. As of February 9, 2022.

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