22 July 2022

THE WEEK AHEAD

Farewell, Forward Guidance

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Tue 7/26	FHFA House Price Index	May			1.6% M/M
Tue 7/26	Conference Board Consumer Confidence	Jul	96.0	▼	98.7
Tue 7/26	New Home Sales	Jun	675 K	▼	696 K
Wed 7/27	Pending Home Sales	Jun			0.7% M/M
Wed 7/27	FOMC Meeting	Jul	2.25%-2.50%	▲	1.50%-1.75%
Thu 7/28	GDP, annualized (Advance Estimate)	2Q22	0.6% Q/Q	▲	-1.6% Q/Q
Fri 7/29	Employment Cost Index	2Q22	1.1% Q/Q	▼	1.4% Q/Q
Fri 7/29	Personal Income	Jun	0.5% M/M	-	0.5% M/M
Fri 7/29	Personal Spending	Jun	0.8% M/M	▲	0.2% M/M
Fri 7/29	Core PCE Deflator	Jun	4.8% Y/Y	▲	4.7% Y/Y
Europe					
Thu 7/28	EA Consumer Confidence (Final Est.)	Jul			-27.0
Fri 7/29	EA Consumer Price Index (Prelim. Est.)	Jul	8.8% Y/Y	▲	8.6% Y/Y
Fri 7/29	EA GDP (Advance Estimate)	2Q22	0.2% Q/Q	▼	0.6% Q/Q
Asia Pacific					
Wed 7/27	China Industrial Profits	Jun			-6.5% Y/Y
Fri 7/29	Japan Jobless Rate	Jun	2.5%	▼	2.6%
Fri 7/29	Japan Retail Sales	Jun	0.3% M/M	▼	0.6% M/M
Fri 7/29	Japan Industrial Production (Prelim. Est.)	Jun	4.2% M/M	▲	-7.5% M/M

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

U.S.

- The July **FOMC meeting** is expected to deliver another rate increase of 75bps.
- We will watch **Q2 GDP,** particularly as there are prominent risks of a second-quarter contraction. However, this likely won't stop the Fed, as the Q1 decline was largely related to weaker trade and inflation remains too high.

Europe

- We are monitoring the **Ukraine-Russia conflict** and Russia's gas flows to Europe. The risk of a severe cut-off in energy deliveries persists.
- **Euro area (EA) Flash July CPI** is expected to reach a new record high.
- **EA Q2 GDP** will signal how increasing uncertainty and rising prices are impacting the region.

Asia Pacific

- **June activity data for Japan** is expected to show a modest rebound in consumption as the economy reopened further, as well as a resurgence of tourism.
- **China's industrial profits** will likely continue to face constraints from the zero-COVID policy and elevated producer price inflation.

What This Week Means For Markets

The ECB went big, ending the era of negative rates by raising interest rates 50bps. The central bank is focused on ensuring an even transmission of monetary policy and unveiled its new anti-fragmentation tool. The ECB joined the Fed in bidding farewell to forward guidance, and the immediate reaction saw the euro appreciate against the dollar and markets boosting ECB rate hike expectations. This leaves the BOJ as the last dovish central bank in the G-7, keeping its yield curve control caps unchanged, leading to further weakening of the yen, which doesn't seem to be a problem for the BOJ, yet. Earnings season is in full swing, and with nearly 20% of the S&P 500 reporting, companies are surprising modestly to the upside, with earnings on track to grow 5.9% Y/Y in Q2. Finally, gas flows through Nord Stream 1 resumed following maintenance, but EA energy risks remain prominent. These developments underlie our below-consensus views on growth for the region and a general risk of stagflation in major economies. Please see our latest Macro Dashboard.

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IN REVIEW

The End of the Negative Rates Era

The ECB raised the policy rates for the first time since 2011. It frontloaded the policy tightening with a 50bp hike, twice the amount expected.

What was more in line with expectations is the announcement of the anti-fragmentation toolbox. The first line of defense is a pure reinvestment tool, with a fixed envelope of bond purchases equivalent to the amount of bonds the ECB bought under PEPP that mature by 2024. The second line of defense is a new Transmission Protection Instrument, through which ECB purchases will "not be limited ex ante." We expect these purchases will be sterilized so they don't interfere with the policy tightening. Conditionality relies on an assessment of debt sustainability and various economic monitoring but the judgement will be left to the sole discretion of the ECB.

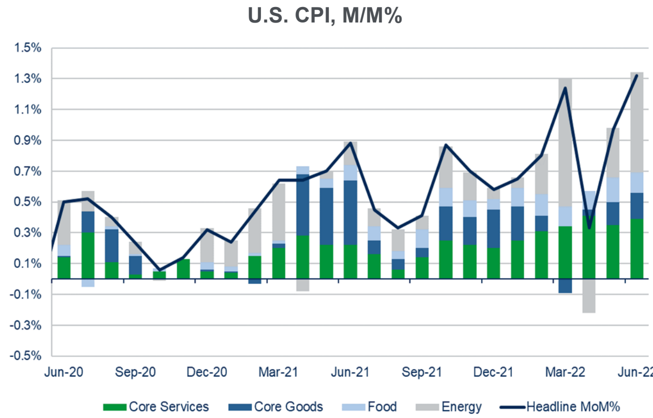
The next policy move is likely to be another hike as the threat of a severed energy supply from Russia is keeping pressure on inflation—and the size of this next hike is now wide open.

Strong U.S. Economic Data Means More Hikes

Both U.S. retail sales and CPI came in above expectations in June, supporting our view of a more aggressive path of rate hikes by the FOMC in the near-term.

Retail sales rose 1% M/M in June, as pent-up demand, savings buffers, and rising credit supported spending. Spending growth was fairly broad-based, with gains in nine of the 13 major categories. However, given elevated inflation, retail sales—mostly of goods—edged lower in real terms. The services component (restaurants and bars) notched an impressive increase, suggesting there could be upside to services spending as consumer preferences have shifted. Eyes will be on the broader personal spending data this Friday. We expect the pace of consumer spending to slow in 2023, given rising prices for necessities and the delayed impact of monetary policy.

U.S. CPI rose 9.1% Y/Y in June—the fastest pace since 1981—and accelerated from 1% M/M in May to 1.3% M/M. Inflation is broad-based and continues to be driven by both supply and demand factors. The largest contributors to price pressures over the month were gasoline, shelter, food, and autos. The Fed will look for slower monthly inflation before it starts to feel comfortable. This shift did not begin in June, and we believe greater risks lie with more, rather than less, rate hikes in the near-term.



Source: Bloomberg. As of July 21, 2022.

U.K. Inflation Hits a Record High

June U.K. CPI jumped to 9.4% Y/Y (cons. 9.3%), the largest rise since 1982. The main pressure came from energy and food prices, in particular necessity goods (milk, eggs, and vegetables). Housing and utilities prices also increased further. Core inflation declined slightly, from 5.9% to 5.8% Y/Y. The Bank of England is expected to hike 25bps at its next meeting, as inflation is likely to stay elevated for the coming months.

China Bounces Back in June, But Headwinds Mount

Following Q2 GDP coming in well below expectations—contracting 2.6% in the quarter—the latest June activity data confirmed a normalization and recovery in economic activity after large-scale lifting of lockdowns. Retail sales and exports beat expectations, growing 3.1% and 17.9% Y/Y in June, respectively. Industrial production also picked up, rising 3.9% Y/Y amid a notable recovery in auto and machinery equipment, suggesting supply chain disruptions have steadily faded. Robust manufacturing activity was supportive of capex, expanding 6.1% Y/Y. Infrastructure investment should also benefit from the increased fiscal spending and policy push to accelerate credit growth.

The good news stops there, however, as several headwinds are gaining momentum, with rising COVID cases, slowing global growth, and a mortgage payment strike that threatens to further destabilize the property sector. Policymakers are likely to take incremental measures to stabilize the recovery, but more may be needed as risks remain firmly to the downside.

KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	1.75%	0 bps	0 bps	125 bps	150 bps	150 bps	150 bps
U.S. SOFR	1.53%	0 bps	8 bps	126 bps	149 bps	148 bps	148 bps
3 Month USD Libor	2.76%	25 bps	66 bps	162 bps	250 bps	262 bps	255 bps
3 Month Euribor	0.13%	18 bps	29 bps	60 bps	68 bps	67 bps	70 bps
3 Month U.S. T-Bill	2.42%	8 bps	88 bps	160 bps	225 bps	237 bps	237 bps
2-Year U.S. Treasury	3.25%	11 bps	7 bps	67 bps	220 bps	305 bps	252 bps
10-Year U.S. Treasury	3.04%	13 bps	-20 bps	20 bps	121 bps	183 bps	153 bps
10-Year German Bund	1.24%	7 bps	-49 bps	38 bps	128 bps	166 bps	143 bps
10-Year U.K. Gilt	2.13%	5 bps	-41 bps	21 bps	90 bps	159 bps	116 bps
10-Year JGB	0.24%	1 bps	0 bps	-1 bps	11 bps	24 bps	18 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	3.24%	N/A	-0.7%	1.1%	-1.5%	-10.4%	-9.4%
Barclays Capital U.S. TIPS	3.47%	N/A	0.1%	0.2%	-3.6%	-5.6%	-8.1%
Barclays Capital U.S. Aggregate	3.79%	51	-0.4%	1.5%	-1.4%	-11.1%	-10.2%
Barclays Capital Global Aggregate	2.92%	55	-0.2%	0.6%	-5.3%	-16.3%	-14.3%
Barclays Capital U.S. ABS	4.03%	76	-0.2%	0.4%	-0.7%	-4.8%	-4.1%
Barclays Capital U.S. MBS	3.76%	39	-0.3%	2.2%	-0.4%	-9.2%	-8.4%
Barclays Capital U.S. Corporate Investment Grade	4.69%	144	-0.2%	1.5%	-2.4%	-14.4%	-13.6%
BAML Euro Corporate Investment Grade	2.79%	190	0.0%	2.9%	-3.9%	-11.7%	-10.4%
Barclays Capital U.S. Corporate High Yield	8.22%	480	1.7%	2.1%	-4.8%	-9.8%	-11.3%
BAML European Currency High Yield Non-Financial	7.11%	603	1.7%	0.5%	-6.9%	-12.1%	-12.4%
CS U.S. Leveraged Loans	9.55%	622	1.2%	0.0%	-3.7%	-1.6%	-3.3%
JPM CEMBI Broad Diversified	7.39%	429	-0.3%	-2.1%	-5.6%	-15.7%	-15.1%
JPM EMBI Global Diversified	8.77%	557	1.0%	-2.2%	-9.0%	-22.4%	-21.0%
JPM GBI-EM Global Diversified	7.20%	N/A	0.2%	-2.6%	-8.7%	-20.3%	-16.8%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	3,959.90	1.54%	4.2%	7.9%	-10.8%	-7.0%	-16.2%
Euro STOXX 600 (Local)	422.51	2.31%	2.3%	3.8%	-8.2%	-5.4%	-13.4%
U.K. FTSE 100 (Local)	7,264.31	3.60%	1.5%	2.0%	-4.8%	5.6%	-1.6%
Japan Nikkei 225 (Local)	27,680.26	2.01%	4.5%	7.4%	1.7%	1.1%	-3.9%
China Shanghai Composite (Local)	3,304.72	2.42%	0.6%	-0.3%	4.9%	-6.6%	-9.2%
MSCI AC World (Local)	616.02	2.24%	3.5%	6.1%	-9.0%	-8.1%	-14.4%
MSCI Emerging Markets (Local)	986.56	3.03%	1.9%	0.4%	-5.1%	-17.1%	-13.5%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	681.89	3.4%	-9.5%	-9.2%	11.5%	33.0%	21.5%
WTI Crude ($/bbl)	102.26	3.9%	-6.7%	-0.3%	18.5%	51.9%	35.7%
Copper ($/lb)	3.33	0.1%	-17.1%	-28.4%	-27.2%	-22.1%	-25.3%
Gold ($/oz)	1,709.30	-0.9%	-7.2%	-12.3%	-7.4%	-6.2%	-5.3%
VIX Index	23.88	-9.5%	-23.3%	5.3%	-17.2%	21.0%	38.7%
U.S. Dollar Index	107.08	-0.8%	2.3%	6.7%	11.8%	15.2%	11.6%
Euro (USD/EUR)	1.02	1.0%	-3.1%	-6.0%	-10.0%	-13.2%	-10.2%
British Pound (USD/GBP)	1.20	0.4%	-2.1%	-8.1%	-12.1%	-11.9%	-11.4%
Japanese Yen (Yen/USD)	138.09	0.7%	2.3%	8.1%	21.1%	25.6%	19.9%
Chinese Yuan (CNY/USD)	6.75	0.5%	1.0%	5.3%	6.5%	4.2%	6.0%

Source: FactSet and Bloomberg. As of July 21, 2022.

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