

8 July 2022

THE WEEK AHEAD

## Energy Fuels European Inflation & Rate Fears

### WATCH LIST

Date		Period	Consensus		Previous
<b>U.S.</b>					
Tue 7/12	NFIB Small Business Optimism	Jun			93.1
Wed 7/13	Consumer Price Index	Jun	8.8% Y/Y	▲	8.6% Y/Y
Wed 7/13	Federal Reserve Beige Book	Jun	--		--
Thu 7/14	Producer Price Index	Jun	10.4% Y/Y	▼	10.8% Y/Y
Fri 7/15	Retail Sales	Jun	0.9% M/M	▲	-0.3% M/M
Fri 7/15	Industrial Production	Jun	0.0% M/M	▼	0.2% M/M
Fri 7/15	U. of Michigan Consumer Sentiment (Prelim. Est.)	Jul	49.0	▼	50.0
<b>Europe</b>					
Wed 7/13	EA Industrial Production	May	0.0% M/M	▼	0.4% M/M
Wed 7/13	U.K. Industrial Production	May	-0.5% M/M	▲	-0.6% M/M
Wed 7/13	U.K. Manufacturing Production	May			-1.0% M/M
Wed 7/13	U.K. Monthly GDP	May	-0.1% M/M	▲	-0.3% M/M
<b>Asia Pacific</b>					
7/8-7/15	China Credit Growth	Jun	4200 B	▲	2792.1 B
7/12-7/16	PBOC 1Y Medium Term Lending Facility Policy Rate	Jul	2.85%	-	2.85%
7/12-7/13	China Exports	Jun	13.0% Y/Y	▼	16.9% Y/Y
Fri 7/15	China GDP	2Q22	1.0% Y/Y	▼	4.8% Y/Y
Fri 7/15	China Industrial Production	Jun	4.2% Y/Y	▲	0.7% Y/Y
Fri 7/15	China Retail Sales	Jun	0.3% Y/Y	▲	-6.7% Y/Y
Fri 7/15	China Fixed Asset Investment (YTD)	Jun	6.0% Y/Y	▼	6.2% Y/Y
Fri 7/15	China Property Investment (YTD)	Jun	-4.1% Y/Y	▼	-4.0% Y/Y

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

#### U.S.

- **U.S. CPI** is expected to remain elevated, given higher prices for necessities, pent-up services demand, and elevated input prices.
- We will watch June **retail sales** to gauge resilience of consumption.
- **Q2 earnings season** begins next week, with attention on profit margins as input costs remain high and demand normalizes.

#### Europe

- We are following the **energy negotiations** as many countries are committing to phase out their dependency on Russian oil and gas while the Kremlin appears to be dialing down the supply of gas to Europe.
- **U.K. GDP** M/M change for May is expected to remain negative.

#### Asia Pacific

- **China activity data** for June should show a steady rebound as COVID restrictions eased in Beijing and Shanghai, but given the large economic cost these imposed, it's likely **Q2 GDP** came in negative.
- The **People's Bank of China** will announce key policy rates in the next two weeks, starting with the medium-term lending facility (MLF).

#### What This Week Means For Markets

Markets are still sifting through economic data that shows strong household and corporate balance sheets but rising risks of recession. Equities trended sideways ahead of the FOMC meeting minutes released Wednesday, which largely confirmed what was delivered at the press conference: the Fed will prioritize inflation over growth. However, much has changed since the June meeting, including downward revisions to consumption, inflation expectations, and lower commodity prices—leading to hopes this will allow the Fed to do less. Meanwhile, the U.S. yield curve remains inverted. Elsewhere, upward surprises in euro area inflation are leading to discussions of greater hikes by the ECB. Separately, China has announced stimulus measures, which are needed to support growth. Please see our latest [Macro Dashboard](#).

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## IN REVIEW

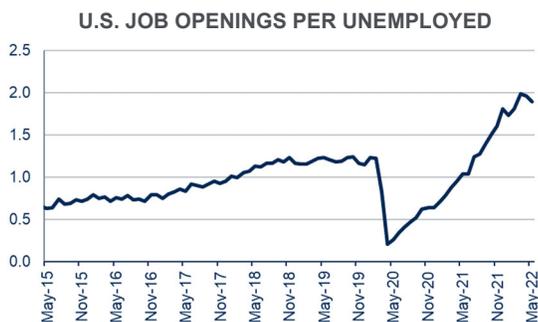
### More EA Inflation, More Growth Concerns

Euro area (EA) **inflation** jumped to a new record high of 8.6% Y/Y in June (cons. 8.4%). Energy, food, alcohol and tobacco, and non-energy industrial goods were the main inflation drivers, while services eased slightly this month. Annual inflation grew in most major European economies, with the exception of Germany, where inflation rate surprised to the downside thanks to government measures that controlled high fuel prices and reduced gasoline and diesel taxes. Natural gas prices are expected to stay high at least through the winter as the risk of further disruptions increases, which will boost prices for energy, food, and core goods. On top of that, the first summer with no COVID restrictions in three years is increasing expectations that services inflation will be sustained throughout tourist season; some market participants are already discussing the idea of the ECB July rate hike being bigger than 25bps.

Rising consumer prices weighed on consumer confidence and purchasing power, which is starting to show in EA **retail sales**. These grew 0.2% in May, rebounding from -1.4% in April, yet was still below the consensus of 0.4%. Retail sales also increased 0.2% Y/Y, the smallest gain since February 2021 (cons. -0.4%). Persistent inflation and war will likely weigh further on confidence and spending in the coming months.

### Demand for U.S. Labor Remains Resilient

The May Job Openings and Labor Turnover Survey (JOLTS) showed we have likely passed the peak imbalance between demand for and supply of workers. However, the labor market remains strong. The number of open jobs edged slightly lower to 11.254 million but is still near its record high. The quits rate held steady at 2.8% in May—down slightly from a high of 3% at the end of 2021, but well-above the average pre-COVID 2.3% rate.



Source: Haver. As of July 6, 2022.

An elevated quits rate is indicative of a tight labor market in which employees feel confident enough to voluntarily leave their jobs. However, the data is coming off its peak and initial claims data has edged higher; together this suggests that the pace of job gains should slow over the months ahead, and wage growth should trend toward a more sustainable pace.

### FOMC Still Wavering on 50 vs. 75 for July

Minutes from the FOMC's June meeting confirmed the Fed remains focused on bringing inflation down, even if it slows growth. The upward move in longer-term consumer inflation expectations in the preliminary University of Michigan Consumer Sentiment Survey raised concerns among committee members, who fear an unanchoring of expectations would make their job all the more challenging. The Committee left the door open for either a 50bps or 75bps hike at the meeting scheduled for July 26 and 27. However, data has evolved since the June meeting. For instance, since that meeting, the jump in inflation expectations was revised away, consumer spending was revised lower, and commodity prices have edged lower amid increased fears of recession. This means all eyes will be on the upcoming employment report, retail sales data, and CPI print ahead of the July meeting. We believe the Fed will continue on its hawkish path of rate hikes as it weighs inflation over growth, and our central scenario calls for headline inflation to remain elevated.

### Japanese Households Take a Hit From Inflation

Cash earnings rose steadily in May, albeit below market expectations, growing 1.0% Y/Y (versus 1.3% prior) amid a continued increase in base and overtime wages. Worryingly, however, inflation-adjusted earnings have contracted further, with real cash earnings declining 1.8% Y/Y (versus -1.7% prior), the most since the start of the pandemic. The decline represents a deterioration in household purchasing power as the cost of living rises faster than nominal wage growth, potentially weighing on the consumption recovery expected this year. This comes amid a mixed backdrop in employment data, with the jobless rate also ticking to 2.6% in May (versus 2.5% prior). Reflecting an increase in both the involuntarily and voluntarily unemployed, the latter suggests that the rise in the unemployment rate is not purely driven by economic deterioration. Overall, with global growth slowing and risks of recession rising in both the U.S. and euro area, domestic demand will likely play a key role in supporting the recovery in Japan.

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## KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	1.75%	0 bps	75 bps	125 bps	150 bps	150 bps	150 bps
U.S. SOFR	1.54%	3 bps	76 bps	124 bps	149 bps	149 bps	149 bps
3 Month USD Libor	2.39%	11 bps	73 bps	140 bps	216 bps	226 bps	218 bps
3 Month Euribor	-0.15%	4 bps	16 bps	31 bps	42 bps	39 bps	42 bps
3 Month U.S. T-Bill	1.85%	13 bps	66 bps	118 bps	176 bps	181 bps	180 bps
2-Year U.S. Treasury	2.94%	-13 bps	23 bps	44 bps	206 bps	273 bps	222 bps
10-Year U.S. Treasury	2.91%	-19 bps	-12 bps	30 bps	118 bps	154 bps	140 bps
10-Year German Bund	1.15%	-38 bps	-15 bps	49 bps	127 bps	141 bps	134 bps
10-Year U.K. Gilt	2.11%	-29 bps	-11 bps	38 bps	96 bps	146 bps	114 bps
10-Year JGB	0.25%	2 bps	1 bps	2 bps	13 bps	21 bps	18 bps
Fixed Income	Yield	OAS	1W Return	1M Return	3M Return	12M Return	YTD Return
Barclays Capital U.S. Government-Treasury	3.06%	N/A	0.7%	0.4%	-2.2%	-9.2%	-8.9%
Barclays Capital U.S. TIPS	3.28%	N/A	0.3%	-2.6%	-4.1%	-5.4%	-8.5%
Barclays Capital U.S. Aggregate	3.68%	56	0.8%	-0.2%	-3.0%	-10.4%	-10.0%
Barclays Capital Global Aggregate	2.83%	57	0.3%	-2.3%	-6.8%	-15.7%	-14.1%
Barclays Capital U.S. ABS	3.77%	75	0.3%	0.0%	-0.4%	-4.3%	-3.7%
Barclays Capital U.S. MBS	3.71%	45	1.0%	-0.1%	-2.2%	-8.8%	-8.3%
Barclays Capital U.S. Corporate Investment Grade	4.66%	157	0.6%	-1.4%	-5.5%	-14.4%	-14.1%
BAML Euro Corporate Investment Grade	2.83%	211	1.7%	-1.5%	-5.6%	-11.8%	-11.0%
Barclays Capital U.S. Corporate High Yield	8.82%	566	0.1%	-5.7%	-8.6%	-12.7%	-13.8%
BAML European Currency High Yield Non-Financial	7.81%	692	-0.8%	-7.1%	-11.0%	-14.9%	-15.1%
CS U.S. Leveraged Loans	9.82%	674	-0.9%	-2.9%	-5.2%	-3.1%	-4.8%
JPM CEMBI Broad Diversified	7.14%	418	-0.4%	-3.3%	-5.7%	-14.6%	-14.2%
JPM EMBI Global Diversified	8.51%	542	0.3%	-5.5%	-9.9%	-20.8%	-20.0%
JPM GBI-EM Global Diversified	7.03%	N/A	-2.3%	-6.6%	-9.7%	-20.3%	-16.3%
Equities	Price	Div Yield	1W Return	1M Return	3M Return	12M Return	YTD Return
S&P 500	3,845.08	1.57%	0.7%	-6.6%	-13.8%	-10.2%	-18.7%
Euro STOXX 600 (Local)	407.34	2.54%	-1.5%	-8.3%	-10.7%	-10.7%	-16.5%
U.K. FTSE 100 (Local)	7,107.77	3.67%	-2.8%	-6.6%	-6.3%	0.1%	-3.7%
Japan Nikkei 225 (Local)	26,107.65	2.13%	-2.6%	-6.5%	-4.5%	-8.9%	-9.3%
China Shanghai Composite (Local)	3,355.35	2.27%	-0.2%	3.7%	2.2%	-5.0%	-7.8%
MSCI AC World (Local)	598.51	2.29%	-0.3%	-6.2%	-12.1%	-11.7%	-16.9%
MSCI Emerging Markets (Local)	981.01	2.97%	-2.2%	-4.3%	-9.2%	-19.5%	-14.5%
Commodities/Currencies	Price	1W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
S&P GS Commodity Index	664.15	-9.9%	-18.7%	-6.9%	14.9%	25.6%	18.3%
WTI Crude (\$/bbl)	98.53	-10.2%	-16.8%	2.2%	24.0%	33.8%	30.8%
Copper (\$/lb)	3.42	-9.6%	-23.0%	-27.8%	-21.4%	-19.7%	-23.3%
Gold (\$/oz)	1,754.30	-3.5%	-5.0%	-9.1%	-2.0%	-3.1%	-2.9%
U.S. Dollar Index	107.10	1.9%	4.5%	7.5%	11.2%	15.7%	11.6%
Euro (USD/EUR)	1.02	-2.7%	-4.9%	-6.6%	-9.8%	-13.8%	-10.4%
British Pound (USD/GBP)	1.19	-1.7%	-5.2%	-9.0%	-12.0%	-13.8%	-12.1%
Japanese Yen (Yen/USD)	135.67	-0.9%	3.3%	9.6%	17.2%	22.7%	17.8%
Chinese Yuan (CNY/USD)	6.70	0.1%	0.9%	5.3%	5.1%	3.7%	5.2%

Source: FactSet and Bloomberg. As of July 7, 2022.

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