5 August 2022

THE WEEK AHEAD

Markets Testing Central Bank Resolve

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Tue 8/9	NFIB Small Business Optimism	Jul	89.5	–	89.5
Tue 8/9	Nonfarm Productivity (Prelim. Est.)	2Q22	-4.5%	▲	-7.3%
Wed 8/10	Consumer Price Index	Jul	8.8% Y/Y	▼	9.1% Y/Y
Thu 8/11	Producer Price Index	Jul	10.3% Y/Y	▼	11.3% Y/Y
Fri 8/12	U. of Michigan Consumer Sentiment (Prelim. Est.)	Aug	51.8	▲	51.5
Europe					
Fri 8/12	EA Industrial Production	Jun	0.0% M/M	▼	0.8% M/M
Fri 8/12	U.K. GDP (Prelim. Est.)	2Q22	-0.1% Q/Q	▼	0.8% Q/Q
Fri 8/12	U.K. Industrial Production	Jun	-0.7% M/M	▼	0.9% M/M
Asia Pacific					
8/6-8/7	China Exports	Jul	14.2% Y/Y	▼	17.9% Y/Y
8/8-8/15	China Credit Growth	Jul	1500 B	▼	5170 B
Wed 8/10	China Producer Price Index	Jul	4.9% Y/Y	▼	6.1.% Y/Y
Wed 8/10	China Consumer Price Index	Jul	2.8% Y/Y	▲	2.5% Y/Y
Thu 8/11	Japan Markets Closed for Mountain Day		--		--

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

U.S.

- We will watch **July CPI,** which is likely to remain elevated given broad-based price pressures.
- The **University of Michigan Sentiment** index will be watched closely as well, to help gauge consumers' longer-term inflation expectations, which have so far remained fairly well-anchored.

Europe

- Military and economic responses to **Russia's war in Ukraine** remain at the top of the watch list as the risk of a significant disruption to energy deliveries in Europe increases.
- **Industrial production** in the EA and the U.K. will show whether the economy is resisting uncertainty, price pressures, and central bank tightening.
- **U.K. Q2 GDP** might deteriorate.

Asia Pacific

- **China credit growth** will likely soften as government bond issuance and mortgage activity slowed.
- **China CPI** is expected to rise despite energy price cuts, amid a sharp increase in food prices. Core CPI is likely to remain manageable on easing demand, however.

What This Week Means For Markets

The FOMC bid a final farewell to forward guidance as it instead opts for meeting-by-meeting decisions, leaving markets to decipher the implication of each economic data print for monetary policy. Markets interpreted the July press conference as dovish, and Fed officials responded by striking a hawkish tone during speeches this week. Markets were unconvinced, however, as market-implied rate hike expectations and a downward trend in breakevens this week reinforce beliefs the Fed won't be able to hike as much as the June Summary of Economic Projections suggests. Separately, the positive beat in Q2 earnings has aided a risk-on tone in equities. Elsewhere, the Bank of England hiked rates by 50bps and massively downgraded its forecast, now calling for a recession in the U.K. beginning in Q4. Notwithstanding the largest hike in decades, the pound fell on the news as markets are focusing on the BoE's gloomy outlook for the U.K. economy. OPEC agreed to a slim production increase, which isn't expected to materially move the needle on supply. Nevertheless, oil prices continued to edge lower, given expectations that a recession will weigh on demand. Overall, we remain with our central Stagflation Shock scenario, which calls for inflation to remain elevated and growth to slow materially over the next 12-18 months. Please see our latest Macro Dashboard.

IN REVIEW

Negative GDP Won't Stop the Fed

The FOMC's 75bp-rate hike at the July meeting showed the Fed is focused on bringing down inflation and believes the U.S. must experience a period of below-potential growth to meet its target, suggesting it still weighs inflation over growth. Fed Chairman Jerome Powell does not think the U.S. is in recession; given that inflation remains too high, we don't think the Q2 GDP contraction will alter the FOMC's path. Despite an initial dovish market reaction, Fed officials have stuck to a hawkish tone. Our central Stagflation Shock scenario calls for stubbornly high inflation over the next 12-18 months, meaning more rate hikes than are currently priced into markets (see the link on page 1). Heightened uncertainty on the economic outlook and lack of forward guidance remain, meaning markets will have to decipher what each data print means for monetary policy.

BoE Edged Rates up Half a Point

The Bank of England raised its interest rate by 50pbs to 1.75% in August, as expected—the biggest increase since 1995 following the June inflation print of 9.4% and the slowest expansion of the U.K. economy (1Q22) in three years. Inflation is expected to rise and peak in October as energy disruptions persist, exacerbating the fall in households' real incomes and putting pressure on the whole economy. The BoE is warning the U.K. is likely to enter recession in 4Q22. Unprecedented and accelerating inflation levels do not allow for much pause in rate hiking, however.

Still not the Peak?

Euro area CPI beat June's record of 8.6%, reaching 8.9% Y/Y in July (cons. 8.6%). Prices for food and tobacco as well as non-energy industrial goods and services continue to accelerate. Core inflation advanced to 4% (cons. 3.7%) from 3.7% the previous month. Underlying inflation pressures remain strong, and this likely won't be the highest number this year. In July, growth and inflation came in above expectations, which supports the view that the ECB will continue hiking, with 50bps expected in September, and another 50bps by year-end, after which markets expect the central bank to pause.

Positive Q2 Earnings Beat, Despite Recession Fears

With 82% of the S&P 500 reporting, earnings is on track to grow 7.4% Y/Y in Q2, versus expectations of 4.1%. Utilities and consumer discretionary industries saw the biggest surprise, while tech and real estate shocked the most to the downside. Downbeat corporate commentary suggests increased recession risks, particularly amid recent layoff announcements and weak demand as consumer spending is squeezed by high inflation. Nevertheless, analysts expect earnings growth to accelerate with record margins in 2023.

Global PMIs Show Easing Demand

U.S. PMIs signaled further slowing in July amid rising interest rates and the cost-of-living shock. The services PMI fell into contraction as output declined at the quickest pace since May 2020, though new orders reached back into expansion territory. The manufacturing PMI noted a softer pace of expansion given weaker demand. On the other hand, the separate ISM services and manufacturing indices both beat expectations for July, pointing to relatively better economic conditions. Despite confusing signals from economic data, which makes the market's interpretation of Fed actions more difficult, we remain with our central scenario, which calls for slowing growth over the next 12-18 months.

The July **eurozone** composite PMI contracted for the first time since February 2021 (49.9, above cons. of 49.4), while the manufacturing PMI fell to 49.8 (cons. 49.6). New orders decreased for a third-straight month as more firms expect to cut output than increase production in the coming year. Services PMI revised higher to 51.2 (from preliminary 50.6), as fading COVID restrictions, a solid tourist season, and easing demand enabled firms to reduce strain on capacities while expanding production. Business confidence fell to a 21-month low.

GLOBAL PMIS

Region	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22
U.S. Manufacturing	60.7	58.4	58.3	57.7	55.5	57.3	58.8	59.2	57	52.7	52.2
U.S. Services	54.9	58.7	58.0	57.6	51.2	56.5	58	55.6	53.4	52.7	47.3
EZ Manufacturing	58.6	58.3	58.4	58.0	58.7	58.2	56.5	55.5	54.6	52.1	49.8
EZ Services	56.4	54.6	55.9	53.1	51.1	55.5	55.6	57.7	56.1	53	51.2
UK Manufacturing	57.1	57.8	58.1	57.9	57.3	58	55.2	55.8	54.6	52.8	52.1
UK Services	55.4	59.1	58.5	53.6	54.1	60.5	62.6	58.9	53.4	54.3	52.6
Japan Manufacturing	51.5	53.2	54.5	54.3	55.4	52.7	54.1	53.5	53.3	52.7	52.1
Japan Services	47.8	50.7	53.0	52.1	47.6	44.2	49.4	50.7	52.6	54	50.3
China Manufacturing	49.6	49.2	50.1	50.3	50.1	50.2	49.5	47.4	49.6	50.2	49
China Services	52.4	51.6	51.1	52.0	50.3	50.5	46.7	40	47.1	54.3	52.8

Source: Bloomberg. As of August 4, 2022.

Japan manufacturing PMI eased to 52.1 (from 52.7 prior), as diminishing supply-chain constraints were offset by a weakening external demand environment. Services also stagnated to 50.3 (from 54.0) as the boost from economic reopenings waned, particularly amid a recent rise in cases.

The official manufacturing PMI in **China** dropped more than expected, to 49.0 (from 50.2 prior), amid weak demand and production cuts in high energy-consuming industries. Survey results also showed a growing number of manufacturing firms face insufficient demand conditions, a major headwind to the outlook of industrial activity. The services PMI expanded again, driven by policy measures to stabilize growth and consumption.

KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	2.50%	75 bps	75 bps	200 bps	225 bps	225 bps	225 bps
U.S. SOFR	2.29%	76 bps	77 bps	199 bps	224 bps	224 bps	224 bps
3 Month USD Libor	2.83%	3 bps	54 bps	147 bps	252 bps	271 bps	262 bps
3 Month Euribor	0.25%	1 bps	43 bps	68 bps	80 bps	80 bps	83 bps
3 Month U.S. T-Bill	2.45%	4 bps	80 bps	155 bps	225 bps	239 bps	240 bps
2-Year U.S. Treasury	3.11%	11 bps	27 bps	35 bps	191 bps	293 bps	238 bps
10-Year U.S. Treasury	2.75%	2 bps	-14 bps	-21 bps	93 bps	158 bps	124 bps
10-Year German Bund	0.90%	-3 bps	-27 bps	-4 bps	76 bps	138 bps	108 bps
10-Year U.K. Gilt	1.95%	0 bps	-7 bps	0 bps	57 bps	143 bps	98 bps
10-Year JGB	0.18%	-2 bps	-4 bps	-4 bps	0 bps	18 bps	12 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	2.99%	N/A	0.5%	1.0%	1.2%	-9.1%	-7.7%
Barclays Capital U.S. TIPS	3.16%	N/A	1.0%	2.8%	0.6%	-4.3%	-5.5%
Barclays Capital U.S. Aggregate	3.51%	50	0.5%	1.6%	1.7%	-9.5%	-8.3%
Barclays Capital Global Aggregate	2.66%	54	0.9%	1.3%	-0.9%	-15.2%	-12.4%
Barclays Capital U.S. ABS	3.86%	79	-0.1%	-0.1%	0.1%	-4.4%	-3.6%
Barclays Capital U.S. MBS	3.47%	33	0.3%	1.8%	2.5%	-7.4%	-6.5%
Barclays Capital U.S. Corporate Investment Grade	4.38%	141	1.0%	2.8%	1.8%	-12.8%	-11.5%
BAML Euro Corporate Investment Grade	2.39%	183	0.6%	3.6%	-0.1%	-10.0%	-8.3%
Barclays Capital U.S. Corporate High Yield	7.63%	444	1.9%	6.2%	-0.1%	-7.5%	-8.7%
BAML European Currency High Yield Non-Financial	6.54%	579	1.2%	5.8%	-2.5%	-10.5%	-10.3%
CS U.S. Leveraged Loans	9.11%	594	0.4%	2.3%	-2.2%	-0.6%	-2.4%
JPM CEMBI Broad Diversified	6.84%	410	1.2%	1.0%	-2.1%	-13.5%	-12.9%
JPM EMBI Global Diversified	8.17%	527	2.3%	2.1%	-2.9%	-19.4%	-17.8%
JPM GBI-EM Global Diversified	6.80%	N/A	1.6%	0.2%	-2.6%	-19.0%	-14.6%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	4,155.17	1.46%	3.3%	8.7%	-0.1%	-4.7%	-12.1%
Euro STOXX 600 (Local)	438.29	2.31%	2.4%	7.7%	-1.8%	-5.8%	-10.1%
U.K. FTSE 100 (Local)	7,445.68	3.52%	1.3%	3.9%	-1.5%	4.8%	0.8%
Japan Nikkei 225 (Local)	27,741.90	2.01%	0.1%	7.0%	3.4%	0.4%	-3.6%
China Shanghai Composite (Local)	3,163.67	2.55%	-3.4%	-6.6%	3.8%	-8.2%	-13.1%
MSCI AC World (Local)	639.00	2.18%	2.5%	7.0%	-2.7%	-6.7%	-11.3%
MSCI Emerging Markets (Local)	985.81	3.13%	-0.5%	0.3%	-4.0%	-16.0%	-13.7%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	656.84	-4.0%	-8.7%	-12.2%	3.4%	23.9%	17.0%
WTI Crude ($/bbl)	90.66	-9.4%	-17.8%	-11.6%	0.5%	28.3%	20.4%
Copper ($/lb)	3.47	1.2%	-4.1%	-18.8%	-22.3%	-20.8%	-22.1%
Gold ($/oz)	1,761.25	2.8%	-2.0%	-5.8%	-1.8%	-2.8%	-2.5%
VIX Index	21.95	-5.6%	-17.8%	-13.7%	-9.9%	21.7%	27.5%
U.S. Dollar Index	106.51	0.1%	1.3%	2.9%	11.7%	15.7%	11.0%
Euro (USD/EUR)	1.01	0.1%	-2.5%	-3.9%	-11.3%	-14.6%	-10.9%
British Pound (USD/GBP)	1.21	0.7%	0.9%	-3.2%	-11.0%	-12.8%	-10.6%
Japanese Yen (Yen/USD)	134.39	-2.1%	-0.5%	3.4%	17.0%	23.4%	16.7%
Chinese Yuan (CNY/USD)	6.76	0.0%	0.8%	2.6%	6.1%	4.5%	6.0%

Source: FactSet and Bloomberg. As of August 4, 2022.

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