2 September 2022

THE WEEK AHEAD

Hawks Are Gaining Speed

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Mon 9/5	Markets Closed for Labor Day Holiday		--		--
Tue 9/6	ISM Services Index	Aug	55.2	▼	56.7
Wed 9/7	Trade Balance	Jul	-$70.1 B	▲	-$79.6 B
Wed 9/7	Federal Reserve Beige Book		--		--
Thu 9/8	Consumer Credit	Jul	$32.5 B	▼	$40.154 B
Fri 9/9	Household Change in Net Worth	2Q22			-$544 B
Europe					
Mon 9/5	EA Retail Sales	Jul			-1.2% M/M
Wed 9/7	EA GDP (Final Est.)	2Q22	0.6% Q/Q	-	0.6% Q/Q
Wed 9/7	Germany Industrial Production	Jul	-0.3% M/M	▼	0.4% M/M
Fri 9/9	ECB Main Refinancing Rate	Sep	1.00%	▲	0.50%
Asia Pacific					
Mon 9/5	Caixin China Services PMI	Aug	54.0	▼	55.5
Tue 9/6	Japan Labor Cash Earnings	Jul			2.2% Y/Y
9/6-9/7	China Exports	Aug			18.0% Y/Y
Thu 9/8	Japan GDP, Annualized (Final Est.)	2Q22	2.9% Q/Q	▲	2.2% Q/Q
Fri 9/9	China Producer Price Index	Aug			4.2% Y/Y
Fri 9/9	China Consumer Price Index	Aug			2.7% Y/Y
9/8-9/15	China Credit Growth	Aug			756.1 B

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

U.S.

- We will watch the **ISM Services Index** for August following a downward surprise in the S&P Global Services PMI but positive real services spending.
- With the strength of the U.S. consumer remaining center stage, **credit growth** will be followed closely to see if there is further room for borrowing to fuel spending and growth.

Europe

- European gas prices remain extremely volatile as EU institutions work on a price cap during **Nord Stream 1's** maintenance closure. We will continue to monitor this market, as it has huge implications for inflation.
- Higher-than-expected inflation increased odds of the **ECB hiking** rates by 75bps when it meets Thursday, September 8; it would be the biggest hike in two decades.
- We continue watching industrial production in **Germany,** which unexpectedly rose in June.

Asia Pacific

- **China credit growth** will be watched closely. Despite easing policy, weak sentiment has kept credit growth tepid which, if sustained, could lead to downward surprises in economic growth.
- **China inflation** will be released Friday, September 9, and has remained much lower than most other countries, given weaker internal demand.

What This Week Means For Markets

Fed Chair Jerome Powell's speech at Jackson Hole confirmed the FOMC's hawkish stance, which resulted in markets boosting rate hike expectations, yields rising, and the U.S. dollar strengthening, while equities fell given the risk-off sentiment. U.S. data this week added additional support for more Fed hikes, given better-than-expected job openings, initial claims, and manufacturing activity. Meanwhile, the upward surprise in euro area inflation boosted the probability of greater ECB rate hikes. Elsewhere, new lockdowns in China led commodities lower and added more support for the U.S. dollar, given a flight to safety. We remain with our central Stagflation Shock scenario in which monetary policy tightens aggressively and growth slows materially. Please see our latest Macro Dashboard.

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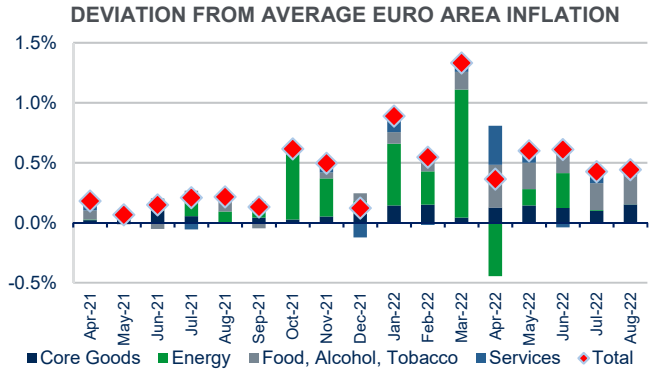
IN REVIEW

Another Inflation Surprise Forces the ECB's Hand

The upside surprise in euro area (EA) inflation for August (9.1% Y/Y vs. cons. 9%) makes a 75bp increase in rates the central scenario for this Thursday's ECB meeting. Not only was the upside surprise the latest in a series, it also showed further broadening of pricing pressures. Even if energy inflation slowed and detracted from overall inflation, all other major components (non-energy goods, services and food) accelerated. Inflation expectations have also risen lately, which is scaring policy makers in Frankfurt. The ECB is thus letting go of its cautious approach to policy tightening.



Source: Haver, Barings calculations. As of September 1, 2022.

The ECB perceives financing conditions as too accommodative in this context, and it will likely frontload rate increases this year. Three increases of 75, 50, and 25 basis points are likely at the next three meetings, respectively.

The EA economy is already starting to show signs of weakening, with retail sales and PMIs slowing considerably. Once the current tailwinds of the post-COVID reopening and tourist season dissipate, it may become clearer just how strong the structural headwinds (the historical energy shock, the need to redirect supply chains away from Russian imports, green transition investment needs) are—and all these shocks are hitting an economy that was not experiencing strong growth even before these impediments.

Hence, the ECB hikes could easily exacerbate the slowdown in growth. Unfortunately, the central bank has little choice but to increase rates when inflation does not show any sign of respite. A full cut of Russian gas imports would make the ECB's job even more difficult, forcing it to deal with an even worse trade-off of a deeper recession and higher inflation.

Jackson Hole Confirms Hawkish Tilt

The big event last week was FOMC Chairman Jerome Powell's speech at Jackson Hole, in which he maintained his hawkish tone. Powell noted that the main goal of the FOMC is bringing inflation back down to the 2% target. To do this, he expects a sustained period of below-trend growth, weakening in the labor market, and "some pain to households and businesses." He also made it clear that the FOMC will maintain a sufficiently restrictive policy stance for some time, which was meant to push back against market pricing of Fed rate cuts as soon as mid-2023. While Powell noted that longer-term inflation expectations remain well-anchored, he said this was not grounds for complacency, given how high inflation has been for so long. He also acknowledged economic data has been mixed recently but made it clear that his view shows "strong underlying momentum." We believe this means that risks are toward more rather than less rate hikes this cycle, in line with our central Stagflation Shock scenario in which the Fed is forced to hike more than is currently priced into markets (see link on page 1). While the speech didn't contain any new information, markets interpreted it hawkishly, with the dollar, U.S. Treasury yields, and market implied Fed rate hikes rising, and equities declining.

Labor Demand Remains Resilient

Despite tightening monetary policy, demand for labor remains strong. The JOLTS job openings data surprised to the upside, rising to 11.239 million in July with upward revisions to June, counter to consensus expectations for a decline. There are now two open positions per unemployed person, matching the previous peak. While the quits rate edged slightly lower to 2.7%, it is still elevated historically, indicative of a very tight labor market. Furthermore, initial claims fell for the third-consecutive week and remain at low levels. This data adds further support to our central Stagflation Shock scenario in which the Fed will have to hike more aggressively to cool demand, the labor market, and inflation pressures.

China's Economy Loses Momentum in August

China's August PMIs showed further easing amid the property slump, COVID outbreaks, and power supply issues. The official manufacturing PMI edged up to 49.4 from 49.0, remaining in contraction for second-consecutive month. Meanwhile, growth in the non-manufacturing sector slowed in August as the PMI eased from 53.8 to 52.6. Despite recent policy support, risks remain firmly to the downside amid the many headwinds facing the economy. Moreover, weakening external demand would exert downward pressure on the manufacturing sector.

KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	2.50%	0 bps	0 bps	150 bps	225 bps	225 bps	225 bps
U.S. SOFR	2.29%	2 bps	2 bps	150 bps	224 bps	224 bps	224 bps
3 Month USD Libor	3.10%	9 bps	31 bps	149 bps	260 bps	298 bps	289 bps
3 Month Euribor	0.65%	16 bps	42 bps	99 bps	119 bps	120 bps	123 bps
3 Month U.S. T-Bill	2.86%	15 bps	53 bps	181 bps	255 bps	282 bps	281 bps
2-Year U.S. Treasury	3.44%	7 bps	53 bps	90 bps	201 bps	323 bps	271 bps
10-Year U.S. Treasury	3.13%	2 bps	49 bps	29 bps	130 bps	183 bps	162 bps
10-Year German Bund	1.54%	17 bps	70 bps	40 bps	138 bps	194 bps	173 bps
10-Year U.K. Gilt	2.82%	13 bps	93 bps	72 bps	142 bps	222 bps	185 bps
10-Year JGB	0.22%	1 bps	4 bps	-2 bps	4 bps	20 bps	15 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	3.42%	N/A	-0.1%	-2.5%	-1.8%	-10.8%	-10.0%
Barclays Capital U.S. TIPS	3.59%	N/A	-1.2%	-2.7%	-1.6%	-6.0%	-7.5%
Barclays Capital U.S. Aggregate	3.96%	50	-0.4%	-2.8%	-2.0%	-11.5%	-10.8%
Barclays Capital Global Aggregate	3.10%	54	-0.7%	-3.9%	-5.1%	-17.6%	-15.6%
Barclays Capital U.S. ABS	4.12%	62	0.0%	-0.7%	-0.6%	-4.6%	-3.9%
Barclays Capital U.S. MBS	3.96%	40	-0.5%	-3.4%	-1.9%	-9.7%	-9.1%
Barclays Capital U.S. Corporate Investment Grade	4.83%	140	-0.6%	-2.9%	-2.6%	-14.9%	-14.2%
BAML Euro Corporate Investment Grade	3.28%	198	-1.3%	-4.2%	-3.1%	-13.2%	-12.0%
Barclays Capital U.S. Corporate High Yield	8.42%	484	-1.6%	-2.3%	-3.5%	-10.6%	-11.2%
BAML European Currency High Yield Non-Financial	7.23%	568	-0.9%	-1.3%	-3.5%	-12.2%	-11.8%
CS U.S. Leveraged Loans	9.24%	564	0.0%	1.5%	1.1%	0.2%	-1.2%
JPM CEMBI Broad Diversified	6.99%	375	-0.2%	0.2%	-1.8%	-14.0%	-12.9%
JPM EMBI Global Diversified	8.37%	502	-1.2%	-0.9%	-4.2%	-20.8%	-18.8%
JPM GBI-EM Global Diversified	6.89%	N/A	-0.2%	-0.1%	-4.0%	-19.4%	-14.4%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	3,955.00	1.56%	-4.4%	-4.1%	-3.9%	-11.2%	-16.1%
Euro STOXX 600 (Local)	415.12	2.45%	-3.9%	-5.3%	-6.4%	-11.8%	-14.9%
U.K. FTSE 100 (Local)	7,284.15	3.66%	-2.5%	-1.9%	-4.3%	2.3%	-1.4%
Japan Nikkei 225 (Local)	28,091.53	2.00%	-0.8%	1.0%	3.0%	0.0%	-2.4%
China Shanghai Composite (Local)	3,202.14	2.55%	-0.4%	-1.6%	0.5%	-9.6%	-12.0%
MSCI AC World (Local)	613.11	2.28%	-3.2%	-2.9%	-3.1%	-11.4%	-14.2%
MSCI Emerging Markets (Local)	994.11	3.24%	1.1%	1.2%	-2.4%	-15.4%	-12.3%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	665.93	-3.7%	-3.9%	-15.3%	-1.1%	26.3%	18.7%
WTI Crude ($/bbl)	89.55	-6.3%	-11.6%	-21.7%	-6.8%	30.9%	18.9%
Copper ($/lb)	3.52	-3.9%	-1.8%	-18.1%	-20.8%	-19.3%	-21.0%
Gold ($/oz)	1,715.90	-1.7%	-2.1%	-6.7%	-10.2%	-5.5%	-5.0%
VIX Index	25.87	13.4%	21.3%	0.7%	-14.7%	57.0%	50.2%
U.S. Dollar Index	108.70	0.0%	2.6%	6.8%	12.4%	17.4%	13.3%
Euro (USD/EUR)	1.01	0.6%	-1.4%	-6.1%	-10.5%	-14.8%	-11.6%
British Pound (USD/GBP)	1.16	-1.6%	-4.4%	-7.7%	-13.3%	-15.5%	-14.1%
Japanese Yen (Yen/USD)	138.63	1.4%	3.7%	7.8%	20.4%	26.2%	20.4%
Chinese Yuan (CNY/USD)	6.89	0.4%	2.3%	3.6%	9.2%	6.7%	8.2%

Source: FactSet and Bloomberg. As of September 1 2022.

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