BARINGS INVESTMENT INSTITUTE

30 September 2022

THE WEEK AHEAD

U.K.'s Mini-Budget Causes Major Market Moves

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Mon 10/3	ISM Manufacturing	Sep	52.4	▼	52.8
Mon 10/3	Wards Total Vehicle Sales	Sep	13.55 M	▲	13.18 M
Tue 10/4	JOLTS Job Openings	Aug			11239 K
Wed 10/5	ADP Employment Change	Sep	200 K	▲	132 K
Wed 10/5	Trade Balance	Aug	-$67.9 B	▲	-$70.7 B
Wed 10/5	ISM Services Index	Sep	56.5	▼	56.9
Thu 10/6	Challenger Job Cuts	Sep			30.3% Y/Y
Fri 10/7	Change in Nonfarm Payrolls	Sep	250 K	▼	315 K
Fri 10/7	Unemployment Rate	Sep	3.7%	-	3.7%
Fri 10/7	Consumer Credit	Aug	$25 B	▲	$23.811 B
Europe					
Mon 10/3	U.K. Nationwide Housing Prices	Sep			0.8% M/M
Tue 10/4	EA Producer Price Index	Aug			37.9% Y/Y
Thu 10/6	EA Retail Sales	Aug			-0.9% Y/Y
Fri 10/7	U.K. BBA Mortgage Rates	Sep			4.89%
Asia Pacific					
Sat 10/1	South Korea Exports	Sep	3.1% Y/Y	▼	6.6% Y/Y
Sat 10/1 – Fri 10/7	China Markets Closed for National Day Holiday		--		--
Sun 10/2	BOJ Tankan Large Manufacturing Index	Q3	11	▲	9
Sun 10/2	BOJ Tankan Large Non-Manufacturing Index	Q3	13	-	13
Tue 10/4	Hong Kong Markets Closed for Double Ninth Festival		--		--
Thu 10/6	China Foreign Reserves	Sep	--		$3054.8 B
Fri 10/7	Japan Labor Cash Earnings	Aug	1.5% Y/Y	▼	1.8% Y/Y

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

U.S.

- We will watch **job openings data** and the September **employment report** to gauge the strength of labor demand, which has so far proven resilient. Further strength would keep the FOMC aggressive.
- **ISM surveys** will show how demand for goods and services held up in September.

Europe

- We will look for evidence of a cooling housing market in **U.K. Nationwide Housing Prices** and **BBA Mortgage Rates**, which could make the Bank of England think twice about a large hike.
- Following the damage to the Nord Stream pipelines, we will be alert for any further disruptions to **European energy infrastructure**.

Asia Pacific

- The Bank of Japan's (BOJ) **Tankan survey** will reveal current business conditions for Q3 and the outlook for economic conditions ahead.
- **China foreign reserves** could show to what extent policymakers are intervening to cushion the renminbi's sharp depreciation.

What This Week Means For Markets

The announcement of a sweeping fiscal package in the U.K. resulted in a jump in U.K. gilt yields and caused the sterling to fall against the dollar. The severe market disruptions pushed the Bank of England (BOE) to intervene and buy long-dated gilts, delaying the beginning of QT to restore market stability. This led to a mild reprieve in U.S. markets with a temporary decline in U.S. Treasury yields and a slight rise in equities. However, upward revisions to Q2 consumption and a decline in initial claims Thursday led U.S. markets to resume focus on upcoming Fed rate hikes. Elevated inflation and tight labor markets in the U.S. and U.K. should keep both the FOMC and BOE on an aggressive path of rate hikes in the near-term. Please see our latest Macro Dashboard.

IN REVIEW

Bank of England to Bite Back

The British government's new fiscal plan precipitated a sell-off in sterling and government bonds as investors reacted to an anticipated glut of gilts. As sterling teeters on parity with the dollar, pressure mounts on the Bank of England to reinforce its recent rate hikes. The untargeted fiscal expansion by the new government challenges the Bank of England's contractionary agenda, with the bank's chief economist asserting its resolve to return inflation to its 2% target. The key question is the extent to which the bank will bite back with a big hike at its November meeting. While markets are pricing in a 150bp hike, a moderating factor in the bank's decision could be a potentially weak housing market with high mortgage rates. Financial stability, as well as inflation, will be a concern of the bank, and evidence of further stress on households and firms will likely be taken into consideration when it next meets November 3.

PMIs Signal Certain Areas Slowing Quickly

Preliminary **U.S. S&P Global PMIs** came in better than expected in September. Despite showing a third-consecutive decline in output, the pace eased given a modest rebound in demand. The composite index rose from 44.6 in August to 49.3 September. Demand picked up over the month with new orders rising back into expansionary territory, with gains in both manufacturing and services sectors. While internal demand rose, external demand remains constrained given greater headwinds outside of the U.S., with new export orders remaining in contraction. Growth in input prices slowed over the month but remain elevated historically, and firms continue passing higher prices on to consumers. Employment rose across the board despite continued challenges finding qualified workers. Meanwhile, private sector firms were more optimistic on the outlook. With inflation still high and growth slowing in the second half of the year, the data is in line with our central Stagflation Shock scenario (see the link on page 1).

S&P GLOBAL PMIS

Region	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
U.S. Manufacturing	57.7	55.5	57.3	58.8	59.2	57	52.7	52.2	51.5	51.8
U.S. Services	57.6	51.2	56.5	58.0	55.6	53.4	52.7	47.3	43.7	49.2
EZ Manufacturing	58.0	58.7	58.2	56.5	55.5	54.6	52.1	49.8	49.6	48.5
EZ Services	53.1	51.1	55.5	55.6	57.7	56.1	53	51.2	49.8	48.9
UK Manufacturing	57.9	57.3	58.0	55.2	55.8	54.6	52.8	52.1	47.3	48.5
UK Services	53.6	54.1	60.5	62.6	58.9	53.4	54.3	52.6	50.9	49.2
Japan Manufacturing	54.3	55.4	52.7	54.1	53.5	53.3	52.7	52.1	51.5	51
Japan Services	52.1	47.6	44.2	49.4	50.7	52.6	54	50.3	49.5	51.9

Source: Bloomberg. As of September 29, 2022.

The **euro area composite PMI** continued to fall in September, in line with the consensus forecast. This brings the EA Q3 average to 49.0, placing it firmly in contractionary territory amid a challenging quarter of cost inflation and energy disruption. The difference in pain felt between member states is striking, with Germany's composite PMI falling 1.7 points to 45.9, while France has a 0.3 point increase to 51.2. The results are consistent with significant headwinds facing the EA, with heavier distribution to those most vulnerable to Russian energy supplies. Information on the EA Producer Price Index and retail sales should give valuable context to these struggles.

The **U.K. composite PMI** surprised to the downside, slipping 1.2 points to 48.4 in September, below consensus estimates of 49. Businesses quoted high costs and referred to a declining outlook for output and client spending. This sets a worrying scene for the propagation of rate hikes and a collapsed currency. How the October PMIs react to this month's turmoil will have big consequences for Prime Minister Liz Truss's gamble on growth, for without business investment, her stimulus will likely be inflationary.

Japan's manufacturing PMI declined for a sixth-straight month in September, coming in at 51.0, from 51.5 prior, as high prices weighed on demand for Japanese goods. Supply constraints appeared to have improved further, however, with the supplier delivery times index improving sharply in the month. The services PMI also returned to expansion territory, rising to 51.9, from 49.5 prior, amid a further loosening of pandemic restrictions. Looking ahead, concerns around weakening global growth and the difficulty firms may have fully passing on price increases is weighing on the business outlook.

Rising Rates Will Cool U.S. Housing Demand

Despite U.S. housing data coming in better-than-expected for August, weakness is expected to continue as the FOMC aggressively hikes rates. The average 30-year mortgage rate rose above 6.8% this week which, combined with elevated home prices, has caused affordability to plummet. The result has been a sharp turn lower in demand. With high interest rates continuing to price people out of the market, further cooling is expected. However, better underwriting standards, an undersupply of homes, and demographic trends that should support demand through the medium-term should also prevent the downturn from mirroring that in the Global Financial Crisis. In fact, at the current pace, it would take 3.2 months to sell all of the existing homes on the market. While this is up from 2.6 months last year, it remains well below the five-month neutral level, suggesting the supply of homes is still quite low.

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KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	3.25%	75 bps	75 bps	150 bps	275 bps	300 bps	300 bps
U.S. SOFR	2.98%	73 bps	70 bps	146 bps	270 bps	293 bps	293 bps
3 Month USD Libor	3.67%	7 bps	60 bps	142 bps	268 bps	354 bps	347 bps
3 Month Euribor	1.19%	8 bps	65 bps	140 bps	167 bps	174 bps	177 bps
3 Month U.S. T-Bill	3.26%	4 bps	49 bps	155 bps	273 bps	322 bps	321 bps
2-Year U.S. Treasury	4.10%	11 bps	69 bps	96 bps	176 bps	380 bps	337 bps
10-Year U.S. Treasury	3.71%	19 bps	67 bps	50 bps	123 bps	217 bps	220 bps
10-Year German Bund	2.15%	26 bps	73 bps	51 bps	158 bps	235 bps	234 bps
10-Year U.K. Gilt	4.09%	76 bps	145 bps	160 bps	245 bps	318 bps	312 bps
10-Year JGB	0.25%	0 bps	3 bps	2 bps	0 bps	19 bps	18 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	4.02%	N/A	-1.1%	-3.4%	-2.8%	-12.3%	-12.5%
Barclays Capital U.S. TIPS	4.16%	N/A	-1.9%	-6.0%	-3.5%	-9.7%	-11.9%
Barclays Capital U.S. Aggregate	4.62%	58	-1.6%	-4.3%	-3.0%	-13.8%	-13.9%
Barclays Capital Global Aggregate	3.66%	60	-2.7%	-6.3%	-6.6%	-20.9%	-20.2%
Barclays Capital U.S. ABS	4.73%	54	-0.2%	-1.0%	-0.8%	-5.4%	-4.9%
Barclays Capital U.S. MBS	4.64%	57	-1.4%	-4.7%	-3.0%	-12.8%	-12.6%
Barclays Capital U.S. Corporate Investment Grade	5.57%	158	-2.7%	-5.7%	-3.7%	-17.9%	-18.1%
BAML Euro Corporate Investment Grade	4.11%	214	-1.7%	-4.6%	-2.9%	-15.6%	-15.0%
Barclays Capital U.S. Corporate High Yield	9.57%	548	-2.8%	-5.3%	-1.5%	-13.9%	-14.5%
BAML European Currency High Yield Non-Financial	8.55%	621	-2.8%	-5.2%	-1.2%	-15.8%	-15.4%
CS U.S. Leveraged Loans	10.75%	655	-1.4%	-2.0%	1.0%	-2.3%	-3.0%
JPM CEMBI Broad Diversified	7.87%	406	-2.1%	-4.1%	-2.4%	-16.4%	-15.9%
JPM EMBI Global Diversified	9.52%	564	-4.4%	-7.5%	-4.4%	-24.0%	-23.7%
JPM GBI-EM Global Diversified	7.31%	N/A	-3.5%	-5.9%	-5.4%	-21.2%	-19.0%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	3,719.04	1.67%	-1.9%	-8.2%	-2.3%	-13.2%	-21.0%
Euro STOXX 600 (Local)	389.41	2.32%	-4.3%	-8.6%	-6.4%	-13.9%	-20.2%
U.K. FTSE 100 (Local)	7,005.39	3.84%	-3.2%	-5.7%	-4.3%	-0.3%	-5.1%
Japan Nikkei 225 (Local)	26,173.98	2.15%	-4.2%	-8.6%	-3.2%	-13.3%	-9.1%
China Shanghai Composite (Local)	3,045.07	2.71%	-2.3%	-5.9%	-10.7%	-15.5%	-16.3%
MSCI AC World (Local)	565.81	2.43%	-2.6%	-8.1%	-3.5%	-14.3%	-19.5%
MSCI Emerging Markets (Local)	875.85	3.45%	-4.6%	-9.9%	-8.8%	-21.3%	-20.2%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	618.63	-1.8%	-10.2%	-17.0%	-17.1%	10.9%	10.2%
WTI Crude ($/bbl)	82.15	-1.5%	-12.3%	-27.7%	-23.6%	8.9%	9.1%
Copper ($/lb)	3.38	-3.7%	-8.9%	-10.6%	-28.3%	-20.3%	-24.1%
Gold ($/oz)	1,652.15	-1.2%	-5.7%	-9.2%	-14.7%	-4.7%	-8.5%
VIX Index	30.18	7.8%	18.1%	7.2%	46.8%	29.8%	75.3%
U.S. Dollar Index	112.60	1.8%	3.5%	7.7%	13.6%	20.1%	17.3%
Euro (USD/EUR)	0.96	-2.5%	-3.9%	-8.4%	-12.2%	-17.5%	-15.3%
British Pound (USD/GBP)	1.07	-5.2%	-8.9%	-11.9%	-17.9%	-20.6%	-20.7%
Japanese Yen (Yen/USD)	144.59	0.3%	5.3%	6.1%	17.0%	29.7%	25.6%
Chinese Yuan (CNY/USD)	7.25	2.8%	5.6%	8.4%	13.8%	12.2%	13.7%

Source: FactSet and Bloomberg. As of September 29, 2022.

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