

Stagflation Fears Send Markets an Early Fright

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Mon 10/18	Industrial Production	Sep	0.2% M/M	▼	0.4% M/M
Mon 10/18	NAHB Housing Market Index	Oct	75	▼	76
Tue 10/19	Building Permits	Sep	1670 K	▼	1728 K
Tue 10/19	Housing Starts	Sep	1610 K	▼	1615 K
Wed 10/20	Federal Reserve Beige Book		--		--
Thu 10/21	Existing Home Sales	Sep	6.00 M	▲	5.88 M
Fri 10/22	Markit Manufacturing PMI (Preliminary Estimate)	Oct	60.5	▼	60.7
Fri 10/22	Markit Services PMI (Preliminary Estimate)	Oct	55.1	▲	54.9
Europe					
Wed 10/20	U.K. Consumer Price Index	Sep			3.2% Y/Y
Wed 10/20	EZ Consumer Price Index (Final Estimate)	Sep			3.0% Y/Y
Fri 10/22	EZ Markit Manufacturing PMI (Preliminary Estimate)	Oct			58.6
Fri 10/22	EZ Markit Services PMI (Preliminary Estimate)	Oct			56.4
Fri 10/22	U.K. Markit Manufacturing PMI (Preliminary Estimate)	Oct			57.1
Fri 10/22	U.K. Markit Services PMI (Preliminary Estimate)	Oct			55.4
Asia Pacific					
Mon 10/18	China GDP	3Q21	5.0% Y/Y	▼	7.9% Y/Y
Mon 10/18	China Retail Sales YTD	Sep	16.3% Y/Y	▼	18.1% Y/Y
Mon 10/18	China Industrial Production YTD	Sep	12.2% Y/Y	▼	13.1% Y/Y
Mon 10/18	Fixed Assets ex Rural YTD	Sep	7.9% Y/Y	▼	8.9% Y/Y
Wed 10/20	China PBOC Meeting	Oct	--		--
Fri 10/22	Japan Consumer Price Index	Sep	0.2% Y/Y	▲	-0.4% Y/Y
Fri 10/22	Jibun Bank Japan Mfg. PMI (Preliminary Estimate)	Oct			51.5
Fri 10/22	Jibun Bank Japan Services PMI (Preliminary Estimate)	Oct			47.8

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

U.S.

- We will watch **Markit flash PMIs for October** to see if declining COVID cases are supporting the service sector and to gauge any disruptions from supply constraints.
- Earnings season continues next week.** Consensus expectations for Q3 S&P 500 earnings seem low compared with elevated company guidance.

Europe

- October flash PMIs should be lower than September** numbers in Germany, France, and the U.K., following ongoing supply chain disruptions and COVID regulations.
- The U.K. Consumer Price Index** is estimated to be high for September. We will watch the effect of the global supply squeeze, increasing gas and coal prices, and the BoE's response.

Asia Pacific

- China 3Q21 GDP** will likely moderate further, with risks tilted to the downside, given a quarterly rise in cases, bad weather, tightening regulations, and energy shortages.
- China activity data** should show the impact of energy constraints on production and a relaxation of mobility measures since August.

What This Week Means For Markets

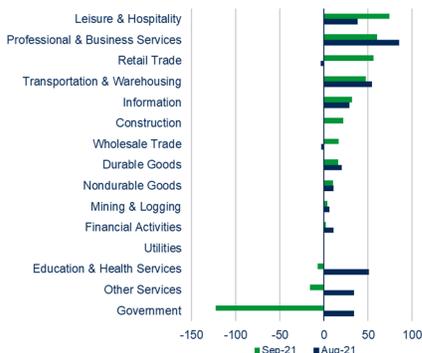
The upward surprise in headline U.S. CPI and rising oil prices led markets to pull forward rate hike expectations, leading to flattening in the U.S. yield curve. Moreover, higher breakevens and lower real yields suggest markets are increasingly concerned about stagflation in the U.S. However, we remain with our central scenario of strong growth and transitory price pressures as COVID cases and supply constraints both ease. Please see our [Monthly Macro Dashboard](#).

IN REVIEW
Sticky U.S. Inflation Stokes Stagflation Fears

The headline U.S. consumer price index rose slightly above consensus expectations in September (5.4% Y/Y vs. consensus 5.3%), while core inflation held at 4% Y/Y, in line with expectations. Slower Q3 growth, combined with stickier inflation, is stocking fears of stagflation. Headline inflation rose 0.4% in September, largely driven by owners' equivalent rent (OER), food at home, and energy prices. Excluding volatile food and energy, core CPI rose 0.2% M/M. The rise in OER was expected, given that it enters CPI calculations with a delay. Meanwhile, prices for airfare, apparel, and used vehicles fell amid elevated COVID cases. With demand continuing to outpace supply, price pressures are set to stay elevated this year. Longer-lasting supply chain bottlenecks continue to boost inflation; however, lessening congestion at California ports may point to a possible peak. We remain with our central scenario, that price pressures should prove transitory as supply chain bottlenecks fade, leading to lower inflation in 2022.

Jobs Report Underwhelms But Bright Spots Emerge

The U.S. employment report for September underwhelmed expectations, but some positive signs below the surface suggest the Fed remains on track to announce tapering at its November meeting. Nonfarm payrolls rose 194,000 in September, versus consensus expectations for a 500,000 gain. Education—which largely falls under government employment—was the biggest weight. Private payrolls rose a stronger 317,000. Meanwhile, August data was revised up by a solid 131,000.

CHANGE IN NONFARM PAYROLLS, THS


Source: *Haver, As of October 14, 2021.*

The labor force participation rate edged slightly lower as many workers remain on the sidelines, for now. Elevated COVID cases during the payroll reference week were likely a weight. Declining cases should provide more support for a pickup in employment growth, particularly within the service sector.

The Establishment Survey and the Household Survey diverged again, with relatively stronger employment gains in the latter (up 526,000). The unemployment rate fell from 5.2% to 4.8%, for good reasons, despite a pull-back in the labor force. This was the final Employment Report ahead of the FOMC's November meeting. The Fed doesn't need a knockout September jobs report to announce tapering, and this report wasn't that. The FOMC remains on track to announce tapering in November, with a record number of open jobs, an upward revision to August payrolls, a relatively stronger Household Survey, declining COVID cases, and stickier inflationary pressures.

Weakening Credit Offsets Strong Exports in China

The PBOC's liquidity release was evident in M2 money growth, which edged higher in September. However, credit data, including total social financing, surprised modestly to the downside. Continued contraction of shadow banking activity and the dampened property market outlook, given the tight regulatory backdrop, were likely headwinds—despite PBOC guidance on accelerating loan extensions. The upside surprise on exports continued as the external demand environment remained strong, suggesting energy shortages and production curbs have minimal impact on shipments. Imports eased, implying still-challenged domestic consumption. Increasing downside risks to growth mean authorities will maintain an easing bias, providing targeted easing to weak sectors with added potential for a reserve requirement ratio cut by year-end.

Supply Chains Hamper EA Industrial Production

As supply chain disruptions continue to hit global production, industrial production in the euro area declined 1.6% M/M in August, matching market expectations. Germany, with the tightest links to global supply chain and trade, had the biggest drop (-4%), while the decline was 0.2% in Italy and 0.3% in Spain. France industrial production grew 1%. On a yearly basis, EA industrial production rose 5.1%, slightly more than market consensus at 4.7%, but slower than revised 8% growth in July.

IMF Forecasts a Differentiated Recovery

The IMF downgraded 2021 global growth from 6% in July to 5.9% in its October World Economic Outlook report amid supply chain bottlenecks in AEs and health concerns in EMs. It cut its U.S. 2021 growth forecast by 1 percentage point to 6%, while upgrading euro area growth. It also noted a large divergence for low-income countries where vaccination rates lag, leading to lower growth for longer. The IMF continues to view inflation as transitory but noted it is "highly uncertain" and risks are firmly to the upside.

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KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	0.25%	0 bps	0 bps	0 bps	0 bps	0 bps	0 bps
U.S. SOFR	0.05%	0 bps	0 bps	0 bps	4 bps	-4 bps	-2 bps
3 Month USD Libor	0.12%	0 bps	1 bps	0 bps	-6 bps	-11 bps	-11 bps
3 Month Euribor	-0.55%	0 bps	0 bps	0 bps	-1 bps	-4 bps	0 bps
3 Month U.S. T-Bill	0.05%	1 bps	0 bps	0 bps	4 bps	-5 bps	-3 bps
2-Year U.S. Treasury	0.37%	7 bps	15 bps	11 bps	21 bps	22 bps	25 bps
10-Year U.S. Treasury	1.55%	3 bps	23 bps	13 bps	-8 bps	82 bps	63 bps
10-Year German Bund	-0.14%	6 bps	20 bps	17 bps	15 bps	42 bps	44 bps
10-Year U.K. Gilt	1.05%	-2 bps	40 bps	43 bps	27 bps	82 bps	86 bps
10-Year JGB	0.08%	0 bps	4 bps	6 bps	-2 bps	6 bps	6 bps
Fixed Income	Yield	OAS	1W Return	1M Return	3M Return	12M Return	YTD Return
Barclays Capital U.S. Government-Treasury	1.07%	N/A	-0.1%	-1.2%	-0.3%	-3.1%	-2.5%
Barclays Capital U.S. TIPS	1.24%	N/A	0.5%	-0.2%	1.8%	6.0%	4.5%
Barclays Capital U.S. Aggregate	1.61%	33	-0.1%	-1.1%	-0.2%	-1.0%	-1.7%
Barclays Capital Global Aggregate	1.23%	33	-0.2%	-2.0%	-1.5%	-1.6%	-4.3%
Barclays Capital U.S. ABS	0.71%	29	-0.2%	-0.3%	-0.1%	0.4%	0.1%
Barclays Capital U.S. MBS	1.87%	27	-0.1%	-0.6%	-0.1%	-0.5%	-0.8%
Barclays Capital U.S. Corporate Investment Grade	2.18%	86	0.0%	-1.4%	-0.2%	1.0%	-1.4%
BAML Euro Corporate Investment Grade	0.41%	88	-0.4%	-0.9%	-0.9%	0.4%	-0.8%
Barclays Capital U.S. Corporate High Yield	4.29%	301	-0.2%	-0.9%	0.0%	9.0%	4.0%
BAML European Currency High Yield Non-Financial	3.07%	338	-0.3%	-1.2%	-0.4%	7.0%	2.6%
CS U.S. Leveraged Loans	4.87%	437	0.1%	0.5%	1.1%	8.1%	4.8%
CS Western European Leveraged Loans Non-USD	4.26%	408*	-0.1%	0.1%	1.0%	7.1%	4.0%
JPM CEMBI Broad Diversified	4.52%	307	-0.3%	-1.5%	-0.6%	4.4%	0.9%
JPM EMBI Global Diversified	5.22%	364	0.1%	-2.8%	-1.4%	1.9%	-1.9%
JPM GBI-EM Global Diversified	5.45%	N/A	0.2%	-3.2%	-2.5%	1.3%	-6.6%
Equities	Price	Div Yield	1W Return	1M Return	3M Return	12M Return	YTD Return
S&P 500	4,363.80	1.30%	0.0%	-2.2%	0.2%	26.1%	17.5%
Euro STOXX 600 (Local)	460.39	2.74%	2.0%	-1.6%	-0.1%	24.1%	15.4%
U.K. FTSE 100 (Local)	7,141.82	3.45%	2.1%	1.0%	0.2%	19.6%	10.5%
Japan Nikkei 225 (Local)	28,140.28	1.57%	2.2%	-7.6%	-2.0%	19.2%	2.5%
China Shanghai Composite (Local)	3,561.76	2.05%	-0.2%	-4.1%	-0.1%	6.0%	2.6%
MSCI AC World (Local)	716.73	1.81%	1.0%	-2.0%	-0.2%	24.3%	14.5%
MSCI Emerging Markets (Local)	1,260.23	2.38%	2.8%	-2.1%	-3.9%	13.4%	2.0%
Commodities/Currencies	Price	1W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
S&P GS Commodity Index	579.20	1.8%	8.6%	7.9%	22.3%	61.6%	41.5%
WTI Crude (\$/bbl)	80.44	3.9%	14.0%	6.9%	33.6%	100.9%	66.4%
Copper (\$/lb)	4.52	8.7%	3.6%	4.8%	11.8%	48.6%	28.6%
Gold (\$/oz)	1,785.70	1.5%	-0.5%	-1.6%	2.2%	-5.6%	-5.4%
U.S. Dollar Index	94.08	-0.2%	1.5%	1.4%	2.4%	0.6%	4.6%
Euro (USD/EUR)	1.16	0.3%	-2.0%	-2.1%	-2.9%	-1.4%	-5.4%
British Pound (USD/GBP)	1.36	0.5%	-1.6%	-1.5%	-0.7%	5.0%	-0.3%
Japanese Yen (Yen/USD)	113.37	1.9%	3.1%	2.8%	3.8%	7.4%	9.8%
Chinese Yuan (CNY/USD)	6.45	-0.3%	-0.1%	-0.3%	-1.6%	-4.4%	-1.4%

Source: FactSet and Bloomberg. As of October 13, 2021.

Note: *As of October 7, 2021.

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