# BARINGS INVESTMENT INSTITUTE

*22 October 2021*

THE WEEK AHEAD

# Shaking Off The Third-Quarter Slowdown

## WATCH LIST

| Date | | Period | Consensus | | Previous |
|---|---|---|---|---|---|
| **U.S.** | | | | | |
| Tue 10/26 | FHFA House Price Index | Aug | 1.5% M/M | ▲ | 1.4% M/M |
| Tue 10/26 | New Home Sales | Sep | 765 K | ▲ | 740 K |
| Tue 10/26 | Conference Board Consumer Confidence | Oct | 110.0 | ▲ | 109.3 |
| Thu 10/28 | GDP, annualized (Advance Estimate) | 3Q21 | 3.0% Q/Q | ▼ | 6.7% Q/Q |
| Fri 10/29 | Employment Cost Index | 3Q21 | 0.8% Q/Q | ▲ | 0.7% Q/Q |
| Fri 10/29 | Personal Income | Sep | 0.0% M/M | ▼ | 0.2% M/M |
| Fri 10/29 | Personal Spending | Sep | 0.5% M/M | ▼ | 0.8% M/M |
| Fri 10/29 | Core PCE Deflator | Sep | 3.7% Y/Y | ▲ | 3.6% Y/Y |
| **Europe** | | | | | |
| 10/27-10/28 | Consumer Confidence (France, Germany, Italy) | Oct | | | |
| Thu 10/28 | ECB Monetary Policy Meeting | Oct | 0.0% | - | 0.0% |
| Fri 10/29 | EZ GDP (Advance Estimate) | 3Q21 | 2.3% Q/Q | ▲ | 2.2% Q/Q |
| **Asia Pacific** | | | | | |
| Wed 10/27 | China Industrial Profits | Sep | | | 10.1% Y/Y |
| Thu 10/28 | Japan Retail Sales | Sep | 2.0% M/M | ▲ | -4.1% M/M |
| Thu 10/28 | BOJ Policy Rate | Sep | | | -0.1% |
| Fri 10/29 | Japan Jobless Rate | Sep | 2.8% | - | 2.8% |
| Fri 10/29 | Japan Industrial Production (Preliminary Estimate) | Sep | -2.0% M/M | ▲ | -3.6% M/M |

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

### U.S.

- **Third-quarter GDP** is expected to show a notable slowdown from the strong Q2 pace amid the Delta wave and supply constraints. However, tailwinds, such as a healthy consumer, suggest growth can improve in the year's final quarter.
- We will watch the **Q3 Employment Cost Index**—among our preferred measures of wage growth—particularly given longer-lasting labor supply constraints.

### Europe

- **We expect Q3 GDP** to increase to 3.2% Q/Q, up from 2.0% in Q2, as the recovery accelerated with the fast pace of vaccinations.
- **The ECB** is unlikely to announce any policy moves at its October 28 meeting.
- **The consumer confidence indicator** and **unemployment rate** should indicate whether demand will remain strong.

### Asia Pacific

- **China industrial profits** could continue to be weighed down by elevated PPI.
- The contraction in **Japan industrial production** is expected to moderate. With supply-chain constraints already materializing in real export data, risks could be to the downside for auto production, given the semiconductor shortage.

### What This Week Means For Markets

Positive earnings surprises are alleviating some fears of slower growth and helping drive the S&P 500 back to highs. However, elevated energy prices and stickier U.S. inflation are raising anxiety around more persistent price pressures. With inflation data in both the U.S. and U.K. remaining high, markets are more aggressively pricing in earlier and faster rate hikes for central banks across advanced economies. For the Fed in particular, almost two hikes by end-2022 are being priced in. Despite prolonged impacts from supply chain bottlenecks, our central scenario of a **Brave New World** calls for a downward trend in inflation next year and strong growth supported by a patiently accommodative FOMC and ECB. Please see our Monthly Macro Dashboard.

## IN REVIEW

### Earnings Season Eases Fears of Weak Demand

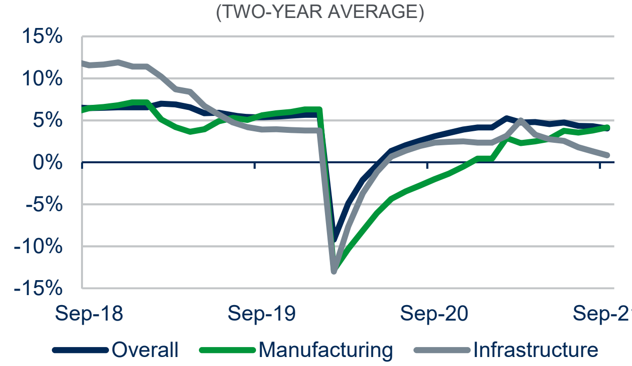
U.S. Q3 corporate earnings season is off to a good start, with both earnings and sales surprising to the upside. While markets have been increasingly concerned about stagflation over the past several weeks, the positive earnings surprises are alleviating some fears of weaker growth. Real yields have stabilized and the S&P 500 is nearing its previous peak. While the pace of earnings growth has eased from the unsustainably high pace seen in Q1 and Q2, the positive surprises come as a welcome sign. With about 16% of companies reporting, earnings have come in 11.6% above expectations, as sales and earnings are both on track to grow 15% Y/Y and 31% Y/Y, respectively. Across sectors, earnings growth has been the strongest for consumer discretionary, energy, and materials. While the release of pent-up demand supports strong top-line growth, inflation remains a concern looking ahead, as this could squeeze margins next year if it proves more persistent.

### High U.K. Inflation Will Likely Push the BOE to Act

The U.K. annual inflation rate fell to 3.1% Y/Y in September (vs. consensus estimate of 3.2%) from a nine-year high in August 2021. This is still far above the BOE's 2% target, and the Bank expects price pressures to increase further in 4Q2021 and remain elevated throughout 2022. The BOE maintained its benchmark interest rate at 0.1%, but hawkish comments by Governor Andrew Bailey cemented expectations of increased interest rates at the November or December meetings. Some central banks, including the Reserve Bank of New Zealand, have already raised interest rates in response to inflationary pressures. The Reserve Bank of Australia kept the interest rate unchanged but still plans to trim the purchase of government bonds. However, this is unlikely to set off a domino effect of rate hikes, especially if the Fed remains accommodative, given the view of transitory price pressures and emphasis on a full labor market recovery. The ECB is unlikely to increase interest rates between now and the end of 2022, as eurozone inflation is expected to fall close to 2% (ECB's target) by the end of next year.

### China's Economic Momentum is Slowing

Economic activity weakened in Q3, with GDP growing only 4.9% Y/Y. The below-consensus print was impacted by several headwinds, including: adverse weather, COVID outbreaks and ensuing control measures, carbon-reduction initiatives, energy shortages, and tightening regulations on the property sector. September activity data pointed to a continuation of the broad-based deceleration, particularly on the production side. Fixed asset investment slowed as both real estate and infrastructure investment remain depressed, though manufacturing investment continued to accelerate. Industrial production also fell to 3.1% Y/Y (from 5.3% prior).




*Source: Haver. As of October 21, 2021.*

Offsetting the weakness, however, was a bounce in both service production (+5.2% Y/Y) and retail sales (+4.4% Y/Y), consistent with control of the recent Delta wave. Going forward, both should continue to rebound (absent additional virus flare-ups) while targeted easing from the PBOC and a pick-up in fiscal spending should benefit Q4 growth. Spreading property dysfunction and a policy mistake remain prominent downside risks and could complicate our expectations for above-trend global growth in the baseline scenario of our latest Macro Dashboard (see link on page 1).

### U.S. Retail Sales Suggest Stronger Q4 Growth

U.S. retail sales surprised to the upside in the final month of the third quarter, up 0.7% M/M, compared with the consensus estimate for a 0.2% M/M decline. The upward surprise largely came from an unexpected rise in vehicle and parts. Elsewhere, the details showed higher gasoline prices supported a strong 1.8% M/M gain in gas station sales. Meanwhile, restaurant sales rose a modest 0.3% M/M, suggesting elevated COVID cases weighed on the pace of services spending in September. While consumer spending is set to slow notably from the strong Q2 pace, the positive beat suggests it has room for a pick-up in in Q4 as COVID cases decline, given strong household balance sheets, an improving labor market, and the stronger end to the third quarter. This is in line with our baseline outlook of a Brave New World.

## 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 | 0.03% | -2 bps | -2 bps | -2 bps | 2 bps | -5 bps | -4 bps |
| 3 Month USD Libor | 0.13% | 0 bps | 0 bps | -1 bps | -6 bps | -9 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% | 0 bps | 2 bps | 0 bps | 3 bps | -5 bps | -3 bps |
| 2-Year U.S. Treasury | 0.38% | 1 bps | 16 bps | 18 bps | 23 bps | 23 bps | 26 bps |
| 10-Year U.S. Treasury | 1.64% | 9 bps | 33 bps | 43 bps | 7 bps | 84 bps | 72 bps |
| 10-Year German Bund | -0.13% | 1 bps | 19 bps | 29 bps | 12 bps | 48 bps | 45 bps |
| 10-Year U.K. Gilt | 1.15% | 10 bps | 44 bps | 61 bps | 40 bps | 96 bps | 95 bps |
| 10-Year JGB | 0.09% | 1 bps | 4 bps | 8 bps | 1 bps | 7 bps | 7 bps |
| **Fixed Income** | **Yield** | **OAS** | **1W Return** | **1M Return** | **3M Return** | **12M Return** | **YTD Return** |
| Barclays Capital U.S. Government-Treasury | 1.14% | N/A | -0.6% | -1.9% | -2.0% | -3.2% | -3.1% |
| Barclays Capital U.S. TIPS | 1.34% | N/A | -0.2% | -0.2% | 1.1% | 6.1% | 4.2% |
| Barclays Capital U.S. Aggregate | 1.67% | 32 | -0.4% | -1.6% | -1.5% | -1.2% | -2.1% |
| Barclays Capital Global Aggregate | 1.27% | 33 | 0.0% | -1.7% | -1.9% | -1.7% | -4.3% |
| Barclays Capital U.S. ABS | 0.79% | 32 | -0.1% | -0.4% | -0.4% | 0.3% | 0.0% |
| Barclays Capital U.S. MBS | 1.91% | 22 | -0.2% | -0.7% | -0.7% | -0.6% | -1.0% |
| Barclays Capital U.S. Corporate Investment Grade | 2.25% | 85 | -0.6% | -2.1% | -1.8% | 0.9% | -1.9% |
| BAML Euro Corporate Investment Grade | 0.42% | 87 | 0.0% | -0.8% | -1.2% | 0.2% | -0.8% |
| Barclays Capital U.S. Corporate High Yield | 4.16% | 285 | 0.4% | -0.3% | 0.8% | 9.4% | 4.4% |
| BAML European Currency High Yield Non-Financial | 2.98% | 326 | 0.3% | -1.1% | -0.1% | 7.4% | 2.9% |
| CS U.S. Leveraged Loans | 4.92% | 438 | 0.0% | 0.4% | 1.3% | 8.0% | 4.9% |
| JPM CEMBI Broad Diversified | 4.51% | 299 | 0.2% | -1.1% | -0.5% | 4.8% | 1.1% |
| JPM EMBI Global Diversified | 5.22% | 357 | 0.2% | -2.5% | -1.5% | 2.7% | -1.8% |
| JPM GBI-EM Global Diversified | 5.53% | N/A | 0.4% | -1.6% | -1.6% | 1.2% | -6.2% |
| **Equities** | **Price** | **Div Yield** | **1W Return** | **1M Return** | **3M Return** | **12M Return** | **YTD Return** |
| S&P 500 | 4,536.19 | 1.26% | 4.0% | 4.2% | 5.3% | 33.7% | 22.1% |
| Euro STOXX 600 (Local) | 470.07 | 2.74% | 2.1% | 3.5% | 5.3% | 28.6% | 17.8% |
| U.K. FTSE 100 (Local) | 7,223.10 | 3.41% | 1.1% | 4.6% | 5.0% | 22.6% | 11.8% |
| Japan Nikkei 225 (Local) | 29,255.55 | 1.51% | 4.0% | -4.1% | 6.8% | 24.1% | 6.6% |
| China Shanghai Composite (Local) | 3,587.00 | 2.05% | 0.7% | -0.7% | 1.4% | 7.8% | 3.3% |
| MSCI AC World (Local) | 742.08 | 1.76% | 3.3% | 1.9% | 3.8% | 30.4% | 18.3% |
| MSCI Emerging Markets (Local) | 1,301.13 | 2.32% | 2.6% | 2.3% | 0.1% | 16.7% | 4.6% |
| **Commodities/Currencies** | **Price** | **1W Change** | **1M Change** | **3M Change** | **6M Change** | **12M Change** | **YTD Change** |
| S&P GS Commodity Index | 595.78 | 2.9% | 12.5% | 16.2% | 21.8% | 63.3% | 45.5% |
| WTI Crude ($/bbl) | 83.87 | 4.0% | 19.1% | 24.6% | 34.0% | 102.7% | 73.5% |
| Copper ($/lb) | 4.76 | 5.2% | 15.5% | 11.3% | 12.6% | 51.3% | 35.3% |
| Gold ($/oz) | 1,778.00 | -0.4% | 1.2% | -2.5% | 0.0% | -6.3% | -5.8% |
| U.S. Dollar Index | 93.56 | -0.6% | 0.3% | 0.6% | 2.5% | 0.5% | 4.0% |
| Euro (USD/EUR) | 1.16 | 0.6% | -0.7% | -1.0% | -3.3% | -1.5% | -4.8% |
| British Pound (USD/GBP) | 1.38 | 1.3% | 1.1% | 1.5% | -1.0% | 6.6% | 1.1% |
| Japanese Yen (Yen/USD) | 114.32 | 0.8% | 4.4% | 4.0% | 5.7% | 8.3% | 10.7% |
| Chinese Yuan (CNY/USD) | 6.39 | -0.8% | -0.9% | -1.3% | -1.6% | -4.3% | -2.2% |

Source: FactSet and Bloomberg. As of October 21, 2021.

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