

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.

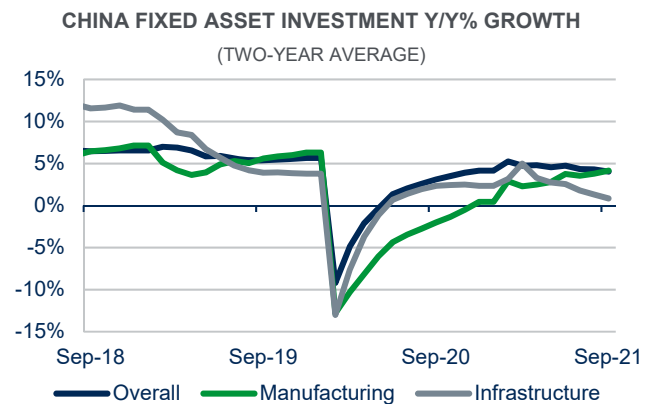
High U.K. Inflation Will Likely Push the BOE to Act

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 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.

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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	0.03%	-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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