12 November 2021

THE WEEK AHEAD

A Tough Week for Team Transitory

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Tue 11/16	Retail Sales	Oct	1.1% M/M	▲	0.7% M/M
Tue 11/16	Industrial Production	Oct	0.8% M/M	▲	-1.3% M/M
Tue 11/16	NAHB Housing Market Index	Nov	80	-	80
Wed 11/17	Building Permits	Oct	1630 K	▲	1589 K
Wed 11/17	Housing Starts	Oct	1573 K	▲	1555 K
Europe					
Tue 11/16	EZ GDP (Preliminary Estimate)	3Q21	2.2% Q/Q	-	2.2% Q/Q
Tue 11/16	U.K. Unemployment Rate	Sep	4.4%	▼	4.5%
Wed 11/17	U.K. Consumer Price Index	Oct	3.9% Y/Y	▲	3.1% Y/Y
Wed 11/17	U.K. Jobless Claims Change	Oct			-51.1 K
Asia Pacific					
Mon 11/15	Japan GDP (Preliminary Estimate)	3Q21	-0.2% Q/Q	▼	0.5% Q/Q
Mon 11/15	China Retail Sales	Oct	3.8% Y/Y	▼	4.4% Y/Y
Mon 11/15	China Industrial Production	Oct	3.0% Y/Y	▼	3.1% Y/Y
Mon 11/15	China Fixed Asset Investment YTD	Oct	6.2% Y/Y	▲	7.3% Y/Y
Mon 11/15	China Property Investment YTD	Oct	8.0% Y/Y	▼	8.8% Y/Y
Mon 11/15	China Surveyed Jobless Rate	Oct	4.9%	-	4.9%
Fri 11/19	Japan Consumer Price Index	Oct	0.2% Y/Y	-	0.2% Y/Y

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

U.S.

- We will watch **October retail sales** to gauge how declining COVID cases and an early start to holiday shopping are impacting consumer spending patterns.
- Watch **industrial production** numbers for October, given protracted supply constraints are keeping demand outpacing supply.

Europe

- **U.K. inflation and unemployment** numbers for October could tilt the balance at the Bank of England from dovish to hawkish and towards a hike (see next page for more details). Given this, statistics scheduled to be released Wednesday, November 17 will be closely followed.

Asia Pacific

- **China activity data** for October will likely show the impact of the latest COVID outbreak, particularly on retail sales and services. Meanwhile, easing production constraints could be a tailwind for industrial activity.
- **Japan Q3 GDP** is expected to contract, given fallout from depressed consumption and shortages impacting production.

What This Week Means For Markets

The upward surprise in the U.S. consumer price index stoked market fears surrounding higher and more persistent inflation. Following the print, equities declined, rate hike bets for 2022 increased and were pulled forward, which led short-end rates to rise as the curve continued to flatten. Meanwhile, inflation hedges such as gold and silver rose. The impact was also felt across the Atlantic, with euro area rates moving up—albeit less than in the U.S.—with the major adjustment in FX, as the euro reached its weakest value against the U.S. dollar in 15 months and the U.S. Dollar Index is making fresh year-to-date highs. Separately, the U.S. employment report highlighted continued labor supply constraints. Odds of our baseline outlook of a Brave New World—where inflation lingers into next year and then gradually declines—may be falling compared to our Perfect Storm scenario, in which inflation takes hold and drives the UST above 2% before demand destruction leads it to fall. However, we remain with our Brave New World outlook, as we believe normalization in supply and demand will ease price pressures in 2H22. Please see our Monthly Macro Dashboard.

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IN REVIEW

U.S. Inflation Surprises to the Upside

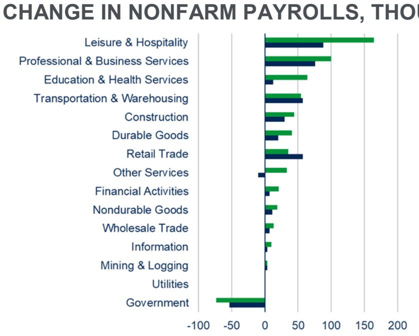
The U.S. consumer price index (CPI) surprised to the upside in October, rising 0.9% M/M (cons. 0.6%) and up 6.2% Y/Y (cons. 5.9%). Excluding volatile food and energy components, core CPI rose 0.6% M/M and 4.6% Y/Y. While energy, owners' equivalent rent, used vehicles, and food accounted for 70% of the M/M increase, price pressures broadened further. Protracted supply constraints are having a broad impact, and excess savings allows a portion to be passed on to consumers. October's CPI print will challenge the Fed to defend its view of transitory price pressures. Markets are increasingly worried about persistent inflation and are pricing in a Fed reaction to higher prices—with the market probability of two 2022 rate hikes rising after the report. If the FOMC maintains its view that inflation pressures will abate in 2H22, it will do what it can to refrain from hiking too soon and too fast, particularly as it noted at its November meeting that its tools would not impact supply constraints.

Our baseline scenario of a Brave New World calls for inflation to linger for longer—likely through 2H22, possibly getting worse before it gets better—and then to gradually subside as supply chains heal and demand normalizes. However, the possibility of stickier inflation boosting expectations and wage demands given current constraints on labor supply remain a risk to the outlook.

Job Gains Quicken But Supply Remains Constrained

The U.S. October employment report showed a faster pace of job creation. Nonfarm payrolls beat expectations, rising 531,000 (cons. 450,000) with strong upward revisions to the prior two months. Gains were broad-based across sectors, and declining COVID cases facilitated an acceleration in leisure and hospitality employment. Education employment remained a drag, given seasonal adjustments and less favorable sector conditions.

CHANGE IN NONFARM PAYROLLS, THOUSANDS



Source: Bloomberg. As of November 11, 2021.

The unemployment rate fell to 4.6% for the right reasons, but labor supply barely moved, suggesting constraints other than supplemental unemployment insurance benefits are keeping workers on the sidelines. This remains a key risk to the outlook: the longer workers are out, the longer wage pressures can persist. While we remain with the view that more workers will return as COVID cases decline and pent-up savings is spent, it is happening at a slower pace than previously expected.

China's Cautious Path on Stimulus

While impacted by the same disruptions as the rest of the world, inflationary dynamics in China remain very different. Headline CPI in October normalized to 1.5% Y/Y (from 0.7% prior), as food deflation eased and energy costs rose. Slow consumption and a sluggish service sector recovery, given the Zero-COVID approach, should continue weighing on prices. Meanwhile, producer prices continued to surge, rising to a 26-year high of 13.5% Y/Y in October, led by energy-intensive products. However, downstream consumer goods PPI remained subdued, implying weak pass-through of costs. The clampdown on coal and commodity prices should help limit further increases in PPI.

Total Social Financing and loan growth both stabilized in October, as government bond issuance and mortgage loans appeared strong. That said, policymakers will likely be cautious deploying broad-based stimulus, especially given elevated producer prices. Targeted easing such as the new decarbonization lending facility and tax deferrals for small- and medium-sized enterprises should help on the margin.

U.K. GDP Slowdown Adds Uncertainty on Rates

U.K. GDP grew 1.3% Q/Q, below consensus and Bank of England estimates of 1.5%. Growth showed some worrying signs—more than the downside surprise. Consumer spending was weak, causing consumer-facing services (recreation, restaurants, food and retail) to contract 0.6% Q/Q. Investment was again a disappointment, growing 0.8% Q/Q (cons. 2.4%). The concoction of supply and labor shortages, surging energy prices and phasing out of fiscal support point towards a further slowdown in the fourth quarter. An uncertain recovery, together with elevated inflation (current CPI is 3.1% and RPI 4.9%), put the BoE in a difficult spot. Markets are pricing a hike for the next BoE meeting in December, but they have already been blindsided by contradicting communication from the Bank last month. Should labor markets show a less-than-smooth transition of furlough workers back to employment, hike expectations could be disappointed again. Labor market statistics released next Wednesday will be followed very closely.

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	-5 bps	-2 bps
3 Month USD Libor	0.15%	1 bps	3 bps	3 bps	-1 bps	-6 bps	-8 bps
3 Month Euribor	-0.57%	0 bps	-2 bps	-2 bps	-4 bps	-6 bps	-2 bps
3 Month U.S. T-Bill	0.05%	0 bps	0 bps	1 bps	4 bps	-5 bps	-3 bps
2-Year U.S. Treasury	0.49%	2 bps	19 bps	27 bps	35 bps	31 bps	38 bps
10-Year U.S. Treasury	1.56%	-2 bps	-5 bps	21 bps	-4 bps	59 bps	64 bps
10-Year German Bund	-0.27%	-10 bps	-11 bps	20 bps	-5 bps	22 bps	31 bps
10-Year U.K. Gilt	0.88%	-19 bps	-26 bps	30 bps	9 bps	49 bps	69 bps
10-Year JGB	0.06%	-2 bps	-2 bps	4 bps	-2 bps	3 bps	4 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	1.17%	N/A	0.3%	0.5%	-0.6%	-1.7%	-2.5%
Barclays Capital U.S. TIPS	1.36%	N/A	1.6%	2.3%	2.5%	8.9%	6.2%
Barclays Capital U.S. Aggregate	1.69%	34	0.2%	0.5%	-0.3%	-0.4%	-1.5%
Barclays Capital Global Aggregate	1.25%	34	0.2%	0.4%	-1.5%	-1.5%	-4.1%
Barclays Capital U.S. ABS	0.93%	37	-0.1%	-0.4%	-0.5%	0.2%	-0.2%
Barclays Capital U.S. MBS	1.92%	27	-0.1%	0.0%	-0.4%	-0.6%	-1.0%
Barclays Capital U.S. Corporate Investment Grade	2.24%	87	0.4%	1.2%	0.2%	1.6%	-0.9%
BAML Euro Corporate Investment Grade	0.34%	90	0.4%	0.3%	-0.9%	0.6%	-0.2%
Barclays Capital U.S. Corporate High Yield	4.16%	280	0.5%	0.7%	1.2%	7.8%	4.9%
BAML European Currency High Yield Non-Financial	2.93%	331	0.5%	0.4%	-0.1%	6.0%	3.5%
CS U.S. Leveraged Loans	5.02%	433	0.2%	0.3%	1.5%	7.1%	5.1%
JPM CEMBI Broad Diversified	4.52%	304	0.0%	0.0%	-0.5%	4.0%	1.0%
JPM EMBI Global Diversified	5.09%	349	0.8%	1.2%	-0.2%	2.2%	-0.8%
JPM GBI-EM Global Diversified	5.60%	N/A	1.1%	-0.2%	-2.3%	-2.9%	-7.1%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	4,646.71	1.23%	-0.2%	5.9%	5.1%	33.0%	25.2%
Euro STOXX 600 (Local)	483.76	3.06%	0.5%	5.8%	2.4%	25.8%	21.2%
U.K. FTSE 100 (Local)	7,340.15	3.35%	1.3%	3.4%	2.5%	16.6%	13.6%
Japan Nikkei 225 (Local)	29,106.78	1.63%	-1.4%	3.8%	4.4%	16.9%	6.1%
China Shanghai Composite (Local)	3,492.46	2.08%	-0.2%	-2.8%	-1.1%	3.9%	0.6%
MSCI AC World (Local)	751.46	1.76%	0.0%	4.9%	3.4%	28.2%	20.2%
MSCI Emerging Markets (Local)	1,274.39	2.41%	0.7%	1.0%	-0.7%	11.0%	2.7%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	579.21	-0.3%	0.4%	11.1%	11.2%	57.0%	41.5%
WTI Crude ($/bbl)	81.34	0.6%	2.3%	19.0%	25.3%	97.5%	68.2%
Copper ($/lb)	4.33	0.0%	1.1%	-0.5%	-8.6%	37.4%	23.2%
Gold ($/oz)	1,859.40	5.4%	4.9%	7.9%	1.0%	-1.0%	-1.5%
U.S. Dollar Index	94.85	1.1%	0.8%	1.9%	5.1%	2.3%	5.5%
Euro (USD/EUR)	1.15	-0.6%	-0.5%	-1.7%	-5.3%	-2.6%	-5.9%
British Pound (USD/GBP)	1.35	-1.4%	-1.2%	-2.7%	-4.7%	1.7%	-1.4%
Japanese Yen (Yen/USD)	113.91	-0.1%	1.7%	3.0%	4.8%	8.3%	10.3%
Chinese Yuan (CNY/USD)	6.39	-0.1%	-0.9%	-1.4%	-0.4%	-3.2%	-2.3%

Source: FactSet and Bloomberg. As of November 10, 2021.

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