BARINGS INVESTMENT INSTITUTE

11 December 2020

THE WEEK AHEAD

Will Washington Deliver a Holiday Miracle?

IN REVIEW

- The **NFIB small business optimism index fell** from 104 to 101.4 in November as rising COVID cases and election outcome concerns outweighed vaccine progress.
- **Initial claims jumped** as COVID cases and restrictions rise. Claims rose 137,000 to 853,000 in W/E December 5. Continuing claims increased for the first time since August, up 230,000 to 5.76 million in W/E November 28. While claims are less reliable according to the Government Accountability Office, increases suggest further weakness in the December jobs report.
- **German ZEW survey expectations were much better** than expected, rising from 39 to 55 in December, aided by positive vaccine developments. However, current conditions took a step back and near-term risks are tilted to the downside, given the possibility of greater restrictions in Germany.
- **China exports surged** 21.1% Y/Y in November, as global trade continued to expand amid rising demand for goods and pandemic-related products. Strength in exports and a further rise in imports—suggesting rising domestic demand—confirms China's recovery remains strong.
- **China's M2 money supply and aggregate social financing expanded** in November, providing support for the recovery. However, the impact of targeted PBOC tightening was seen in declining corporate bond issuance and the share of long-term corporate loans.

WATCH LIST

Date		Consensus		Previous
U.S.				
Tue 12/15	Industrial Production	0.3% M/M	▼	1.1% M/M
Wed 12/16	Retail Sales	-0.2% M/M	▼	0.3% M/M
Wed 12/16	Markit Manufacturing PMI (Prelim)	56.0	▼	56.7
Wed 12/16	Markit Services PMI (Prelim)	56.5	▼	58.4
Wed 12/16	NAHB Housing Market Index	88	▼	90
Wed 12/16	FOMC Meeting	0.0%–0.25%	-	0.0%–0.25%
Thu 12/17	Initial Claims			853K
Thu 12/17	Building Permits	1555k	▲	1545K
Thu 12/17	Housing Starts	1525k	▼	1530K
Fri 12/18	Last Day Before Congress Recess	—		—
Europe				
Mon 12/14	EZ Industrial Production	1.8% M/M	▲	-0.4% M/M
Wed 12/16	EZ Markit Manufacturing PMI (Prelim)	53.0	▼	53.8
Wed 12/16	EZ Markit Services PMI (Prelim)	40.9	▼	41.7
Wed 12/16	U.K. Consumer Price Index	0.7% Y/Y	-	0.7% Y/Y
Thu 12/17	BOE Bank Rate	0.1%	-	0.1%
Fri 12/18	U.K. Retail Sales	-4.2% M/M	▼	1.2% M/M
Asia Pacific				
Tue 12/15	China Industrial Production (YTD)	2.2% Y/Y	▲	1.8% Y/Y
Tue 12/15	China Retail Sales (YTD)	-4.9% Y/Y	▲	-5.9% Y/Y
Tue 12/15	China Fixed Assets ex Rural (YTD)	2.6% Y/Y	▲	1.8% Y/Y
Wed 12/16	Jibun Bank Japan Mfg. PMI (Prelim)			49.0
Fri 12/18	Japan Consumer Price Index	-0.8% Y/Y	▼	-0.4% Y/Y
Fri 12/18	BOJ Policy Rate			-0.1%

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

U.S.

- At the December **FOMC meeting,** watch for a dovish tone and possible rhetoric on asset purchase program adjustments and long-term U.S. Treasuries purchases.
- **Congress faces a December 18 deadline** to fund the government and pass fiscal stimulus this year. Funding is expected, but stimulus talks remain uncertain.

Europe

- The **Bank of England** is expected to keep an accommodative tone amid the pandemic and Brexit talks, but a rate cut below zero is unlikely.
- Elevated COVID cases and restrictions will likely weigh on **Markit flash PMIs** in December, but some lifting of restrictions for holidays may provide added support.

Asia Pacific

- **China activity data** for November should improve, but watch internal demand recovery, which could nudge inflation higher after sinking into deflationary territory.
- The **Bank of Japan** is expected to remain dovish in-line with fiscal policymakers who just announced new fiscal support measures.

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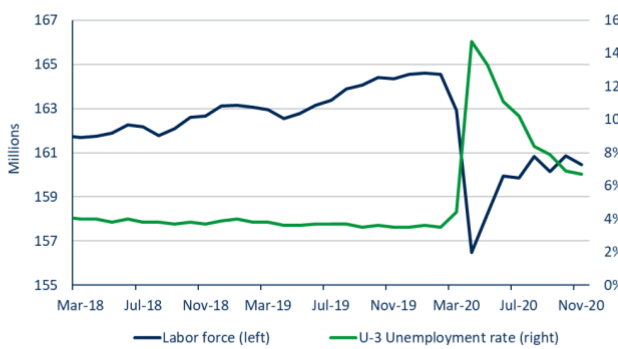
THE HIGHLIGHTS

U.S. Nonfarm Payrolls Boost Pressure for Fiscal Stimulus

The U.S. Employment Report greatly underwhelmed expectations in November amid rising COVID cases but provided greater motivation for Congress to pass additional fiscal stimulus by year-end. This slowing momentum is in line with our scenario for a "Not Quite Recovery" as pandemic scars take longer to heal. Nonfarm payrolls rose a modest 245,000 in November, compared with consensus expectations for a 460,000 increase and a slowdown from October's 610,000 gain. While government employment slid largely due to the elimination of temporary Census jobs, weakness was also seen in private sector services—which have greater exposure to lockdown measures.

U.S. UNEMPLOYMENT RATE VS. LABOR FORCE



Source: Bloomberg. As of December 10, 2020.

The Household Survey showed the unemployment rate edged lower from 6.9% to 6.7%. However, this was due in part to a decline in the labor force participation rate, which fell from 61.7% to 61.5%, suggesting much slack remains in the labor market. As cases and restrictions continue to rise across the U.S., further slowdown or even a temporary reversal in the labor market recovery is expected. We watch initial claims data—which has shown a strong correlation with rising COVID cases—over the coming weeks to gauge the magnitude of deterioration.

The underwhelming print led to greater urgency for additional stimulus, particularly as the PEUC (13-week extension) and PUA (self-employed and gig workers) unemployment insurance programs are set to expire December 26. While negotiations on Capitol Hill heated up as House Democrats reduced the dollar amount demanded, the same sticking points seen over the past several months—state and local aid, unemployment insurance benefits, and liability protections—remain. While negotiations continue, time is running out before December 18—the last day before Congress adjourns for its holiday recess.

ECB Remains Deeply Involved

The European Central Bank (ECB) showed at its December meeting that it remains firmly accommodative by increasing the Pandemic Emergency Purchase Programme (PEPP) by €500 billion and extending it by nine months (through the end of March 2020), "recalibrating" the targeted longer-term refinancing operations (TLTRO III)—effectively extending favorable bank loan terms by 12 months through June 2022—and leaving rates unchanged. The Central Bank actions, while largely expected, appear to be a continuation of its current accommodative policy, rather than a significant expansion, dashing hopes of one or two dovish surprises. Overall, the market reaction was relatively muted, but a slight increase in yields suggests markets were somewhat underwhelmed. Next week, we watch for other Central Banks across the globe to send dovish signals as well.

Global Inflation Pressures Remain Subdued in November

U.S. Inflation: U.S. inflation remained subdued in November. The Consumer Price Index (CPI) rose 0.2% M/M, up from no change in October. Compared to a year ago, the CPI rose 1.2%, while core CPI—excluding food and energy—increased 1.6%. Much of the rise compared with October can be attributable to higher prices for airfares, hotel stays and apparel. However, broader inflationary pressure remains at bay as rising COVID cases continue to restrain consumer demand for services, which account for a majority of the CPI basket. Tame inflation pressures are supportive of accommodative Central Bank policy, in line with our central expectations. At the FOMC meeting next week, policymakers should continue to send a dovish tone, signaling that they remain committed to aiding the economic recovery, if needed.

China Inflation: China's CPI fell into deflationary territory in November, down 0.5% Y/Y, weighed down by weaker food prices. Core CPI—excluding food and energy—was also weak, holding steady at +0.5% Y/Y. The Producer Price Index (PPI) remained firmly in deflationary territory for the 10th-consecutive month. Despite a dip into deflationary territory, the PBOC will likely continue on its path toward targeting policy tightening. We watch for China's economic activity data next week to gauge the return in domestic demand, as a stronger recovery would put upward pressure on prices.

Policy

Brexit: Despite U.K. Prime Minister Boris Johnson vowing to scrap all "lawbreaking" clauses from Brexit legislation in an effort to speed up negotiations, significant differences on fisheries, regulatory alignment and governance remain. Sterling has been subject to heightened volatility amid teetering negotiations.

Japanese Stimulus: Yoshihide Suga unveiled his first stimulus package as Japan's prime minister with an overall value of ¥73.6 trillion ($707 billion). The package will include around ¥40 trillion in fiscal measures, such as loans, investments and direct expenditures, and the spending will be partly financed by ¥19.2 trillion from a third extra budget.

EU Recovery Fund: Poland and Hungary reached a compromise with Germany to unblock the EU's budget and stimulus plan. The budget was approved and the Rule-of-Law mechanism they objected is expected to remain in place.

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	-150 bps	-150 bps
U.S. SOFR	0.08%	0 bps	-2 bps	-1 bps	0 bps	-148 bps	-147 bps
3 Month USD Libor	0.22%	-1 bps	2 bps	-3 bps	-9 bps	-167 bps	-169 bps
3 Month Euribor	-0.55%	-2 bps	-3 bps	-5 bps	-18 bps	-15 bps	-16 bps
3 Month U.S. T-Bill	0.07%	-1 bps	-3 bps	-5 bps	-11 bps	-147 bps	-148 bps
2-Year U.S. Treasury	0.15%	-1 bps	-3 bps	1 bps	-5 bps	-147 bps	-142 bps
10-Year U.S. Treasury	0.94%	-1 bps	-1 bps	24 bps	11 bps	-89 bps	-98 bps
10-Year German Bund	-0.60%	-8 bps	-9 bps	-14 bps	-27 bps	-29 bps	-41 bps
10-Year U.K. Gilt	0.27%	-9 bps	-10 bps	4 bps	-5 bps	-49 bps	-55 bps
10-Year JGB	0.02%	-1 bps	0 bps	-1 bps	0 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	0.61%	N/A	0.1%	0.4%	-1.0%	7.3%	7.6%
Barclays Capital U.S. TIPS	0.78%	N/A	0.5%	1.8%	0.9%	10.1%	10.0%
Barclays Capital U.S. Aggregate	1.21%	47	0.0%	0.5%	0.1%	7.0%	6.9%
Barclays Capital Global Aggregate	0.87%	39	0.4%	1.6%	2.3%	8.7%	8.2%
Barclays Capital U.S. ABS	0.48%	33	0.1%	0.3%	0.3%	4.5%	4.4%
Barclays Capital U.S. MBS	1.36%	47	0.0%	0.1%	-0.2%	3.9%	3.6%
Barclays Capital U.S. Corporate Investment Grade	1.87%	104	-0.2%	1.2%	1.7%	9.0%	8.7%
BAML Euro Corporate Investment Grade	0.19%	92	0.5%	0.9%	2.2%	2.7%	2.8%
Barclays Capital U.S. Corporate High Yield	4.40%	378	0.6%	1.7%	4.7%	7.8%	6.1%
BAML European Currency High Yield Non-Financial	2.97%	363	0.5%	3.5%	4.5%	3.6%	2.8%
CS U.S. Leveraged Loans	5.25%	500	0.5%	1.3%	2.8%	3.1%	2.2%
CS Western European Leveraged Loans Non-USD	4.68%	462	0.2%	2.0%	3.3%	3.0%	2.6%
JPM CEMBI Broad Diversified	4.12%	334	0.6%	2.4%	2.9%	7.2%	6.3%
JPM EMBI Global Diversified	4.69%	363	0.5%	2.3%	2.1%	5.6%	4.0%
JPM GBI-EM Global Diversified	4.32%	N/A	1.4%	4.0%	6.1%	4.5%	1.5%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	3,672.82	1.57%	0.1%	3.6%	8.5%	19.3%	15.7%
Euro STOXX 600 (Local)	394.90	1.85%	0.8%	3.7%	6.8%	-2.8%	-5.0%
U.K. FTSE 100 (Local)	6,564.29	3.62%	1.6%	6.1%	9.2%	-9.3%	-13.0%
Japan Nikkei 225 (Local)	26,817.94	2.22%	0.1%	8.0%	16.4%	14.5%	13.4%
China Shanghai Composite (Local)	3,371.96	2.10%	-2.2%	-0.1%	3.6%	15.7%	10.6%
MSCI AC World (Local)	630.89	1.87%	0.6%	6.0%	9.8%	15.7%	12.4%
MSCI Emerging Markets (Local)	1,255.85	2.01%	1.5%	5.2%	12.8%	22.0%	16.2%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	387.12	0.2%	7.2%	13.5%	19.3%	-8.2%	-11.3%
WTI Crude ($/bbl)	45.52	0.6%	13.7%	19.6%	16.8%	-22.8%	-25.5%
Copper ($/lb)	3.51	0.9%	11.3%	15.4%	34.9%	27.7%	25.6%
Gold ($/oz)	1,841.75	1.1%	-1.4%	-5.4%	7.5%	26.0%	21.6%
U.S. Dollar Index	91.09	0.0%	-1.8%	-2.3%	-5.4%	-6.7%	-5.5%
Euro (USD/EUR)	1.21	0.0%	2.2%	2.3%	6.4%	9.1%	7.6%
British Pound (USD/GBP)	1.34	0.5%	1.9%	3.0%	5.3%	1.8%	1.1%
Japanese Yen (Yen/USD)	104.21	-0.4%	-1.1%	-1.9%	-3.3%	-4.1%	-4.1%
Chinese Yuan (CNY/USD)	6.54	-0.5%	-0.5%	-4.5%	-7.8%	-7.1%	-6.1%

Source: FactSet and Bloomberg. As of December 9, 2020.

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*As of September 30, 2020
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