BARINGS INVESTMENT INSTITUTE

16 October 2020

THE WEEK AHEAD

Outlook Upgraded, But Still Not in First Class...

IN REVIEW

- **NFIB small business optimism** beat expectations, rising 3.8 points to 104 in September. Encouragingly, capex, hiring, and inventory building plans edged higher as the holiday season approaches.
- **U.S. CPI** rose 0.2% M/M in September, led by a 6.7% rise in used car and truck prices. Overall and core CPI held steady at 1.4% Y/Y and 1.7% Y/Y, respectively.
- **Initial claims** rose 53,000 to 898,000 in W/E October 10, as the pace of the labor market recovery eases. Continuing claims fell 1.17 million to 10 million in W/E October 3 as regular benefits start to exhaust. PEUC claims (13-week extension) rose 818,054 to 2.78 million in W/E September 26.
- Regional manufacturing surveys showed continued strength. **The Philadelphia Fed survey** jumped 17.3 points to 32.3 in October, while the **Empire manufacturing index** edged lower 6.5 points to 10.5. Details were strong in both surveys, with gains in new orders and inventory drawdown.
- **EA industrial production** rose a modest 0.7% M/M in August, stabilizing about 7% below pre-crisis levels. The recovery is set to slow amid rising cases and restrictions.
- **German ZEW survey expectations** fell 21.3 points in October amid a surge in COVID-19 cases.
- **China inflation** eased in September. Weak core CPI suggests there's still a ways to go for the rebound in household demand.

WATCH LIST

Date		Consensus		Previous
U.S.				
Mon 10/19	NAHB Housing Market Index	83	-	83
Tue 10/20	Housing Starts	1450k	▲	1416k
Tue 10/20	Building Permits	1523k	▲	1470k
Wed 10/21	Beige Book	--		--
Thu 10/22	Initial Claims			898k
Thu 10/22	Existing Home Sales	6.18m	▲	6.00m
Fri 10/23	Markit Manufacturing PMI (Prelim)	53.4	▲	53.2
Fri 10/23	Markit Services PMI (Prelim)	54.6	-	54.6
Europe				
Wed 10/21	U.K. Consumer Price Index			-0.4% M/M
Fri 10/23	U.K. Retail Sales			0.6% M/M
Fri 10/23	EZ Markit Manufacturing PMI (Prelim)	53.1	▼	53.7
Fri 10/23	EZ Markit Services PMI (Prelim)	47.5	▼	48.0
Asia Pacific				
Mon 10/19	China 3Q GDP	5.5% Y/Y	▲	3.2% Y/Y
Mon 10/19	China Industrial Production (YTD)	1.0% Y/Y	▲	0.4% Y/Y
Mon 10/19	China Retail Sales (YTD)	-7.4% Y/Y	▲	-8.6% Y/Y
Mon 10/19	China Fixed Assets ex Rural (YTD)	0.9% Y/Y	▲	-0.3% Y/Y
Tues 10/20	PBOC Meeting	--		--
Fri 10/23	Japan Markit Mfg. PMI (Prelim)			47.7
Fri 10/23	Japan Markit Services PMI (Prelim)			46.9

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

U.S.

- **Flash PMIs** for October are expected to remain in expansionary territory as the U.S. economy continues to recover. Regional PMIs suggest continued strength in manufacturing, while elevated savings should provide a buffer to services spending.

Europe

- After disappointing economic activity data across Europe, consensus expects further softening in service sectors and some in manufacturing. As a result, October **Flash PMIs** across Europe may relapse into contractionary territory. If so, Q4 is likely to see very low growth in Europe.

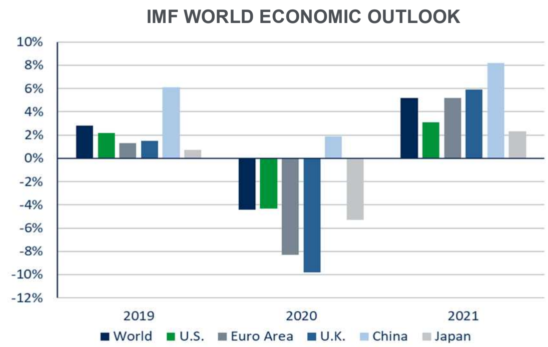
Asia Pacific

- **China 3Q GDP** is expected to confirm a robust recovery, which is set to be echoed in **activity data** for September. A close eye will be kept on retail sales to see if the data this week, which signaled a rebound in domestic demand, is confirmed.
- The **PBOC** is set to leave rates steady at their meeting next week, following better trade and credit data and a liquidity injection this past week. While the PBOC is looking to normalize policy, they appear committed to aid the recovery if needed.

THE HIGHLIGHTS

IMF World Economic Outlook Gets Modest Upgrade

The International Monetary Fund revised their outlook on 2020 growth in advanced economies up 2.3 ppts to -5.8% due to better-than-anticipated U.S. and euro area 2Q20 GDP. Meanwhile, growth in Emerging Markets, excluding China, was revised lower to -5.7% for 2020. The IMF noted a "long, uneven and uncertain" recovery, with GDP levels not expected to return to pre-crisis levels for advanced economies until 2022 (2023 for emerging markets).



Source: International Monetary Fund. As of October 15, 2020.

They also noted that this crisis will likely leave scars on the global economy in the medium term, amid a slower recovery in the labor market and uncertainty and balance sheet problems restraining investment. This should gradually slow global growth to about 3.5% in the medium term, ultimately resulting in lower average living standards across the globe.

China Domestic Demand Shows Signs of Strengthening

China trade data pointed towards a strong rebound in internal demand and continued improvement in external demand. Imports jumped 13.2% Y/Y after sliding for two months, beating consensus expectations of a 0.4% Y/Y rise. Exports were up 9.9% Y/Y in September, in line with consensus expectations, as global growth continues to rebound. While part of the rise in imports may be attributable to stockpiling by the tech industry ahead of U.S. sanctions on Huawei and retail sales remaining somewhat subdued, rising internal demand is a boon for China's recovery, particularly as rising COVID cases elsewhere and greater trade tensions pose risks to the trade outlook. Separately, China's credit growth expanded strongly in September. The stock of aggregate financing rose 13.5% Y/Y—its fastest pace since 2018—suggesting financial conditions continue to aid the recovery and rebound in domestic demand. While the rebound in domestic demand is positive for the outlook, weak core CPI suggests household demand still has a long way to recover.

Policy

Brexit: British and EU negotiators announced they will continue Brexit trade talks beyond the October 15 deadline even if a wider deal proves impossible. The two teams will attempt throughout November to put together mini-deals in areas such as aviation and road transport to offset potential disruption.

U.S. Fiscal Stimulus: Odds of another bill passing before the election are dwindling. Undecided issues with both plans remain, including the level of enhanced unemployment benefits and additional state and local government funding, a strategic coronavirus plan, liability protections for businesses, health care aid, and apportion of tax credits. The Trump administration called on Congress to pass a stripped-down coronavirus relief bill using leftover funds from an expired $300 billion small-business loan program, as well as $500 billion proposed by the Senate as negotiations on a broader package ran into resistance. The unused funds and new smaller package would likely be used to reopen the Payroll Protection Program and a small businesses loan forgiveness program. President Trump offered a $1.8 trillion coronavirus relief package, closer to House Speaker Nancy Pelosi's $2.2 trillion proposal.

EU Recovery Fund Update: The EU parliament, which must approve legislation of the EU Recovery Fund, is asking for clear rules linking receipt of EU funds to respect for the Rule of Law, the constitutionality of which has drawn ire and threats of veto from Poland and Hungary. Even if an unlikely agreement is reached soon, the implementation of the Recovery Fund and the budget will be delayed to after the previously held January deadline. This should, however, not impact the disbursement of EU funds, as this will not happen until the approval of national recovery plans due in 2Q21.

Chinese Yuan: China's PBOC restrained a rally in the yuan by removing rules that made betting against the currency expensive. Financial institutions will no longer need to set aside cash when purchasing foreign exchange for clients through currency forwards; banks previously had to hold 20% of sales on some foreign exchange forward contracts, a move imposed two years ago when the currency slumped toward 7 yuan per dollar. The yuan has appreciated 5.39% against the U.S. dollar since March.

Tariffs: The EU has shortlisted a mix of U.S. products for tariffs, including aircraft, diggers, casino tables and fitness machines, as well as sensitive agricultural goods such as Florida blueberries (a move targeting Florida's position as a swing state in the coming election), following a World Trade Organization decision to hit $4 billion worth of U.S. products in its parallel complaint against aid for Boeing in Washington state. The U.S. offered to settle if Airbus repays the aid to European governments; interest rates on past loans to support Airbus would be reset to a level that assumed that nearly half of the projects would succeed and repricing could cost Airbus up to $10 billion. The U.S. last year imposed additional duties on $7.5 billion of EU products, ranging from French wines to Italian cheeses and German machine tools, after being handed the right to do so by the WTO. The EU also plans to impose up to 48% tariffs (up from 30.4%) on aluminum products from China. The Chinese banned all Australian coking coal this week, likely escalating tensions that have already jolted agricultural exports from China's biggest supplier of commodities. China is the leading consumer of Australia's metallurgical coal exports; over half of the coal needed for the country's steel-making giants comes from Australia.

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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	-175 bps	-150 bps
U.S. SOFR	0.09%	0 bps	0 bps	-2 bps	3 bps	-176 bps	-146 bps
3 Month USD Libor	0.23%	0 bps	-1 bps	-4 bps	-95 bps	-177 bps	-168 bps
3 Month Euribor	-0.51%	0 bps	-3 bps	-8 bps	-26 bps	-10 bps	-13 bps
3 Month U.S. T-Bill	0.12%	2 bps	1 bps	-3 bps	-9 bps	-156 bps	-143 bps
2-Year U.S. Treasury	0.13%	-2 bps	-1 bps	-2 bps	-9 bps	-146 bps	-144 bps
10-Year U.S. Treasury	0.72%	-7 bps	5 bps	11 bps	-2 bps	-101 bps	-120 bps
10-Year German Bund	-0.58%	-8 bps	-9 bps	-14 bps	-18 bps	-12 bps	-39 bps
10-Year U.K. Gilt	0.22%	-8 bps	3 bps	7 bps	-10 bps	-43 bps	-60 bps
10-Year JGB	0.03%	0 bps	1 bps	1 bps	2 bps	21 bps	5 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	0.52%	N/A	0.5%	-0.4%	-0.6%	8.2%	8.6%
Barclays Capital U.S. TIPS	0.72%	N/A	0.5%	0.3%	2.3%	10.4%	9.3%
Barclays Capital U.S. Aggregate	1.18%	57	0.4%	-0.2%	0.0%	7.4%	6.9%
Barclays Capital Global Aggregate	0.89%	47	0.7%	0.2%	2.3%	6.9%	6.3%
Barclays Capital U.S. ABS	0.55%	41	0.1%	0.1%	0.7%	4.6%	4.2%
Barclays Capital U.S. MBS	1.31%	61	-0.1%	-0.1%	-0.1%	4.2%	3.5%
Barclays Capital U.S. Corporate Investment Grade	1.95%	126	0.8%	0.0%	0.6%	9.1%	7.4%
BAML Euro Corporate Investment Grade	0.40%	110	0.4%	0.7%	2.2%	1.4%	1.4%
Barclays Capital U.S. Corporate High Yield	5.24%	465	0.6%	0.9%	4.8%	5.0%	2.2%
BAML European Currency High Yield Non-Financial	4.06%	463	0.4%	0.1%	2.9%	0.9%	-1.4%
CS U.S. Leveraged Loans	5.86%	562	0.3%	0.0%	3.7%	2.0%	-0.3%
CS Western European Leveraged Loans Non-USD	5.31%	525	0.4%	0.5%	3.4%	0.7%	0.0%
JPM CEMBI Broad Diversified	4.48%	389	0.6%	0.1%	2.9%	5.5%	3.5%
JPM EMBI Global Diversified	4.97%	410	1.0%	-0.7%	2.7%	2.9%	1.1%
JPM GBI-EM Global Diversified	4.45%	N/A	0.6%	-0.9%	0.2%	-1.7%	-5.2%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	3,488.67	1.65%	2.1%	3.2%	9.6%	19.9%	9.6%
Euro STOXX 600 (Local)	370.62	2.12%	1.4%	0.6%	0.9%	-4.9%	-10.9%
U.K. FTSE 100 (Local)	5,935.06	4.44%	-0.2%	-1.5%	-4.0%	-17.7%	-21.3%
Japan Nikkei 225 (Local)	23,626.73	2.22%	0.9%	0.3%	4.6%	8.4%	-0.1%
China Shanghai Composite (Local)	3,340.78	2.12%	3.8%	1.9%	-2.2%	11.1%	9.5%
MSCI AC World (Local)	586.67	2.01%	1.7%	3.7%	6.3%	12.8%	5.3%
MSCI Emerging Markets (Local)	1,135.56	2.21%	2.2%	3.7%	6.0%	16.1%	7.4%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	362.20	2.5%	5.8%	7.9%	30.0%	-10.6%	-17.0%
WTI Crude ($/bbl)	41.02	2.7%	10.2%	1.8%	103.6%	-23.4%	-32.9%
Copper ($/lb)	3.05	0.4%	-0.6%	4.5%	29.8%	16.2%	9.1%
Gold ($/oz)	1,910.05	1.4%	-2.5%	6.0%	9.7%	28.1%	26.1%
U.S. Dollar Index	93.38	-0.3%	0.4%	-3.0%	-5.6%	-5.2%	-3.1%
Euro (USD/EUR)	1.18	0.0%	-0.9%	3.2%	7.2%	6.7%	4.8%
British Pound (USD/GBP)	1.30	1.1%	1.2%	4.1%	3.5%	3.6%	-1.6%
Japanese Yen (Yen/USD)	105.11	-0.9%	-0.5%	-2.0%	-2.0%	-3.1%	-3.3%
Chinese Yuan (CNY/USD)	6.74	-1.1%	-1.3%	-4.0%	-4.6%	-4.7%	-3.3%

Source: FactSet and Bloomberg. As of October 14, 2020.