MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 25 October 2021

Key Themes

Central bank policy decisions

BoC - The BoC ended QE and shifted to 'reinvestment'. The policy rate and forward guidance were maintained. Growth forecasts for 2021 were further downgraded. Inflation forecasts were upgraded with the bank acknowledging that the main forces pushing up prices "now appear stronger and more persistent than we previously thought".

ECB - The ECB noted that bond purchases as a part of the emergency pandemic program would still come to an end in Mar 2022 and that purchases would slow over the next few months. Markets initially appeared to have interpreted a lack of push-back on the market timing of rate hikes as some sort of confirmation that Euro area rates would increase next year. The ECB also noted that the current phase of inflation "will last longer than originally expected", but the pace of growth is expected to ease through 2022.

BoJ - The BoJ maintained its accommodative monetary policy at this meeting. The dovish outlook was in contrast to other CB's as consumer price inflation remains low. Parts of the economy remain under pressure from supply chain issues (the auto sector especially). Services also remain under pressure due to covid restrictions (which are being eased).

Inflation

Aus inflation – headline slowed slightly more than expected but the trimmed mean rate increased more than expected into the 2-3% RBA target band. The quarterly data shows underlying inflationary pressures building. Still noisy though as Aus comes out pandemic and support programs are unwinding. But a clear trend of more recent pricing pressures – especially in housing construction and gasoline. Future pressure is likely to come from rents, clothing/footwear, and food prices (subdued in Q3 due to lockdowns, reduced demand).

US – PCE inflation came in lower than expected but still accelerated to +4.4%. Core PCE remained unchanged at +3.6%. The ECI registered a further acceleration in compensation costs during Q3. Consumer sentiment remained close to pandemic low levels;

> The positive impact of higher income expectations and the receding coronavirus has been offset by higher rates of inflation and falling confidence in government economic policies.

Europe – the flash Oct CPI increased more than expected. The acceleration in the prelim CPI for Oct was led by faster growth in energy prices. Excluding energy, consumer price growth still accelerated and is now just at 2% annual growth.

US Growth

US real GDP growth for Q3 decelerated more than expected. Real GDP increased at a pace of 0.5% QoQ – a sharp deceleration from the prior quarter. Most expenditure areas contributed to the deceleration this quarter – except for private inventories and government expenditures.

Most regional surveys show improved demand going into Q4. But this data doesn't show whether higher demand is from firms expanding ordering in response to the lengthening of lead-times and lower inventory levels. Most surveys showed that supply issues remain acute, and that price pressures remain widespread among firms.

US Personal income declined in Sep as the main federal pandemic unemployment insurance programs ended. Employee compensation increased at a faster pace of +0.7%. Expenditures continued to slow – led by slower goods consumption. Growth in services consumption was consistent at +0.6% for the month.

The pace of savings declined notably due to the fall in income. *The savings rate as a % of personal disposable income is now back down to the pre-pandemic levels of 7.5%.*

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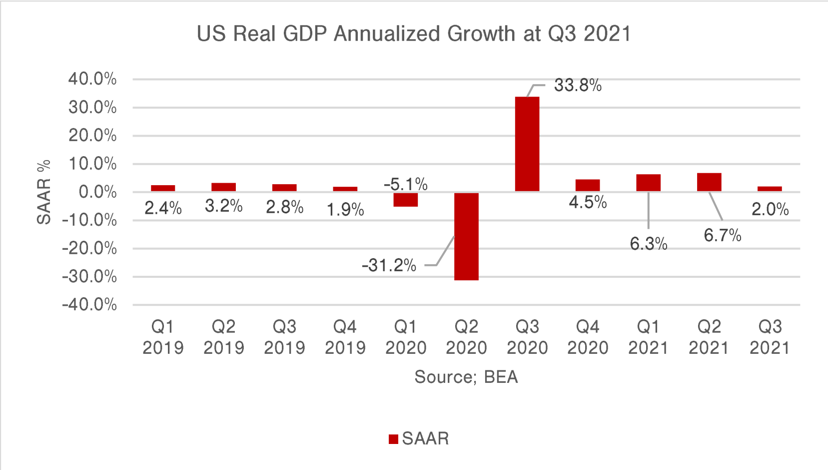
US Data

Advance Est GDP Q3

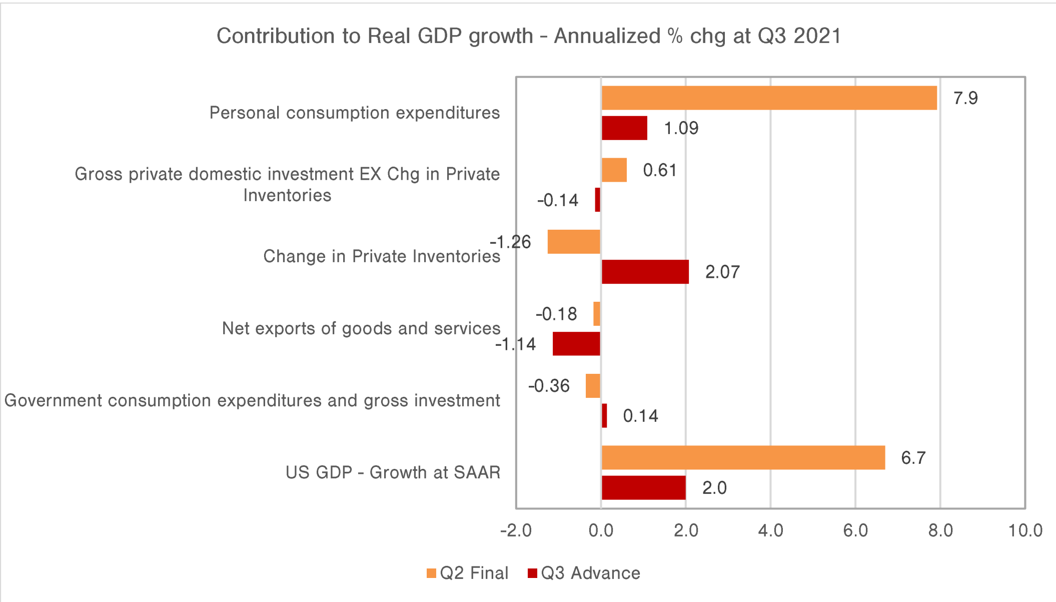
Summary: The advance estimate for Q3 GDP growth disappointed to the downside – growth came in at +2% annualized. Growth projections had been revised lower throughout Q3 and expectations were around +2.5% - +2.8% growth annualized for the quarter. Real GDP increased at a pace of 0.5% QoQ – a sharp deceleration from the prior quarter. Most expenditure areas contributed to the deceleration this quarter – except for private inventories and government expenditures.

Advance Est GDP – quarter annualised: Q3 2% (expecting +2.8%) versus Q2 6.7%



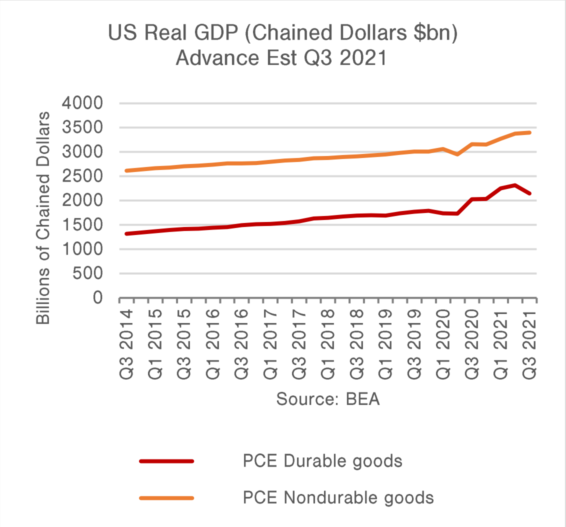
Expenditure View of GDP Deceleration

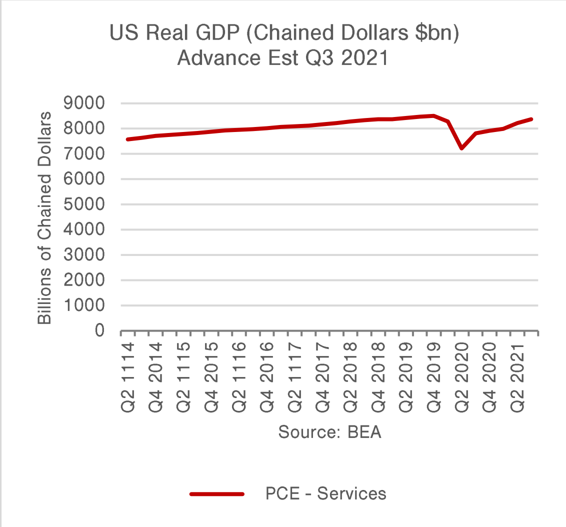
The deceleration in growth for the quarter was widespread;



The standout was the deceleration in PCE. This was led by a -7.3% decline in durable goods (real) expenditures in Q3 compared to a +2.8% increase in Q2. Growth in non-durable goods expenditures also slowed from +3.3% in Q2 to +0.6% in Q3. Growth in services consumption also slowed from 2.8% in Q2 to 1.9% in Q3.

Some context is important here. The fall in durable goods expenditure in Q3 was notable - the real level of expenditure remains above the pre-pandemic trend. Similarly for non-durable goods. Services expenditures are yet to rebound to pre-pandemic levels – the scale of service expenditures is still larger than that of goods (in real terms).

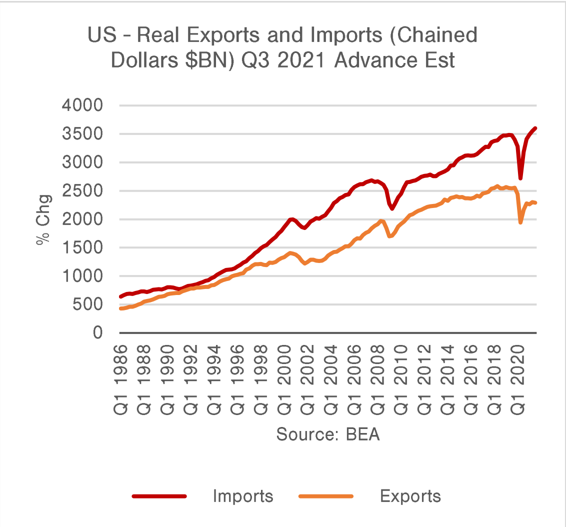




Private Fixed Investment shifted from growth of +0.8% in Q2 to a decline of -0.2% in Q3. This was led by non-residential structures and equipment, and residential fixed investment. Intellectual property products investment expenditures continued to increase.

The change in private inventories **added to GDP growth** this quarter. Inventories continued to decline in real terms but declined at a slower pace than in Q2.

Net exports made a larger negative contribution to growth this quarter. The real value of exports declined by -0.6% in Q3 versus +1.9% in Q2. Imports increased at +1.5% for the quarter, slightly slower than +1.7% in Q2. There has been a stronger rebound in imports over exports;



Government expenditures made a positive contribution to growth this quarter also. This was led by faster growth in state & local expenditures.

https://www.bea.gov/news/2021/gross-domestic-product-3rd-quarter-2021-advance-estimate

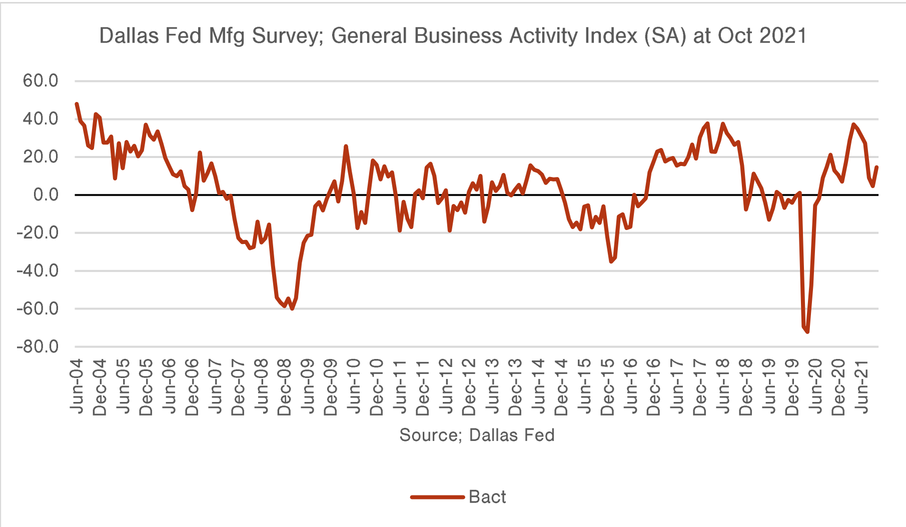
Dallas Fed Manufacturing Survey (Oct)

Summary: The headline activity index increased more than expected this month and after slowing for the prior three months. Demand growth expanded off a lower base. But output growth slowed as delivery lead times increased further. Firms relied on running down inventories of finished goods (which shifted back into contraction) to fulfill demand.

Firms passed on higher input costs at another record pace this month – with prices received reaching a new series high. Just over 50% of firms increased selling prices compared to the prior month.

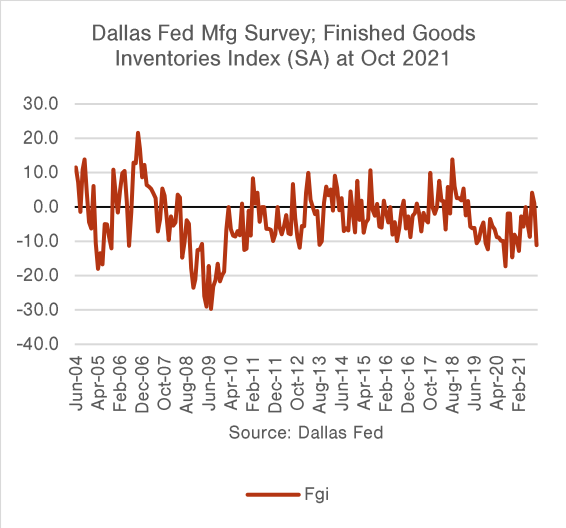
Employment increased at a faster pace while growth in the average workweek remained constant at an elevated pace.

Headline General Business Activity Index – Month: Oct 14.6 versus Sep 4.6



Activity improved this month due to faster growth in demand. New orders expanded at a slightly faster pace but the index at 14.9 in Oct remains below the Apr 21 peak of 38.

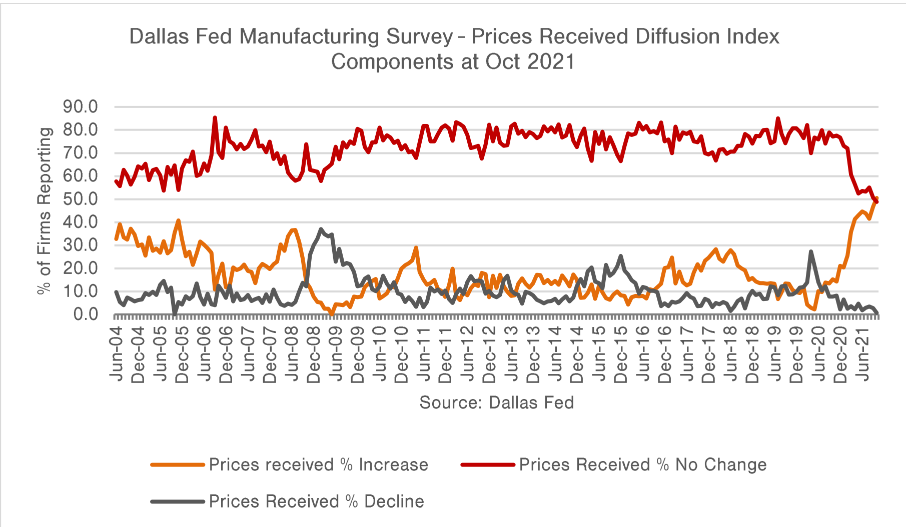
Despite the faster growth in orders for the month, production output slowed. Fewer firms reported an increase in output – while more firms reported no change in output. It appears that firms instead ran down finished goods inventories to fulfill demand. The finished goods inventory index shifted into contraction from 1.1 in Sep to -11 in Oct.



Delivery lead times increased at a faster pace this month. More firms recorded a lengthening of delivery times while fewer firms reported a decline. The index reached 25 in Oct (currently not that far away from the all-time high reached Mar 21 of 31.2).

The index for prices paid for raw materials eased slightly from 80.4 in Sep to 76 in Oct. There were still 76.7% of firms reporting higher prices in Oct compared to Sep. Only 0.4% of firms reported lower prices in Oct.

There was a further acceleration in prices received for goods this month with the index reaching a new series high. For the first time in the series, the proportion of firms reporting higher selling prices outnumbered (slightly) the proportion of firms reporting no change to selling prices:

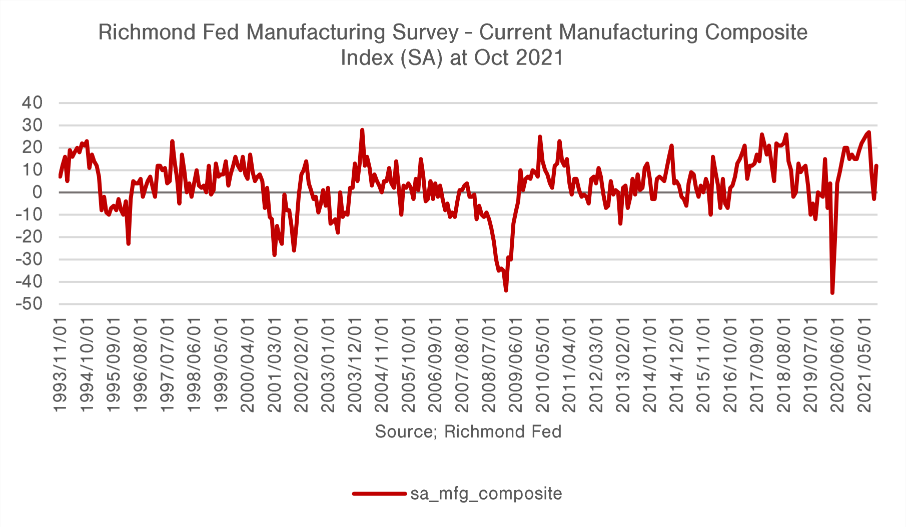


https://www.dallasfed.org/research/surveys/tmos/2021/2110.aspx#tab-report

Richmond Fed Manufacturing Survey (Oct)

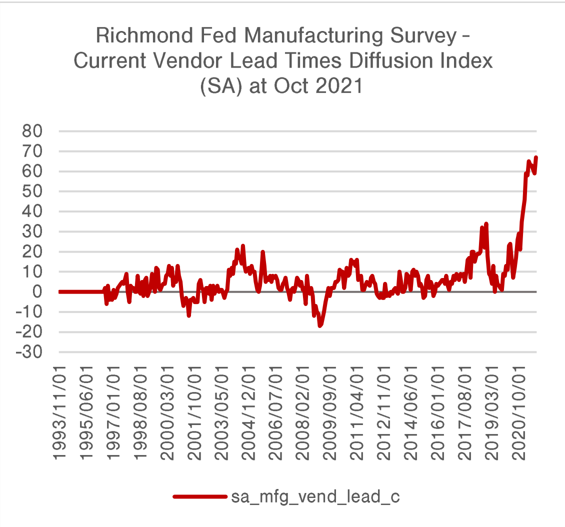
Summary: Demand growth rebounded this month from contraction to expansion. Firms' ability to meet that demand continued to be hindered by supply chain disruptions. Production growth was little changed while lead times for deliveries reached another series high this month. Depletion of inventories for finished goods and inputs remained at series lows. Price growth for inputs and selling prices remained at or close to series highs. Employment growth remains robust while there was more muted growth in the average workweek.

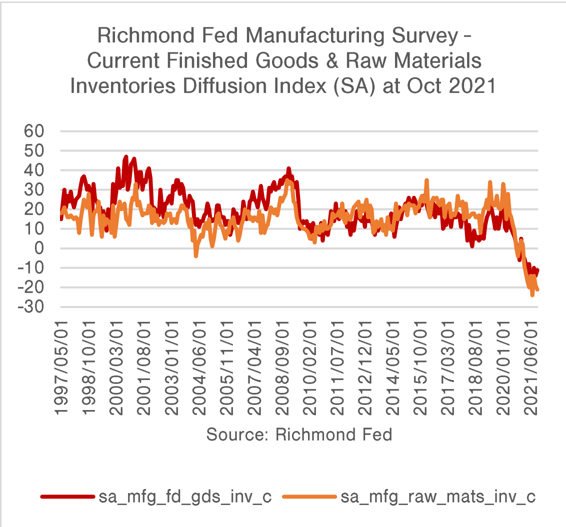
__Composite Manufacturing Activity Index – month__: Oct 12 versus Sep -3



The headline improvement in activity was led by stronger growth in new orders (from -19 in Sep to +10 in Oct) and employment (from 20 in Sep to 27 in Oct). Shipment growth shifted from a slight contraction of -1 in Sep to a slight expansion of +1 in Oct.

Supply chain disruptions continued to hamper output growth this month with the delivery lead time index reaching another series high. Backlogs increased at a faster pace and there was a continued contraction in finished goods and raw materials inventories (remaining near the series low).





The current % chg in prices received remains at a record high pace of 9% while prices paid is at +13% just down from the record 14% last month.

Employment continued to increase at a faster pace. Growth in the average workweek increased but remains more subdued.

https://www.richmondfed.org/-/media/RichmondFedOrg/research/regional_economy/surveys_of_business_conditions/manufacturing/2021/pdf/mfg_10_26_21.pdf

Kansas City Fed Manufacturing Index (Oct)

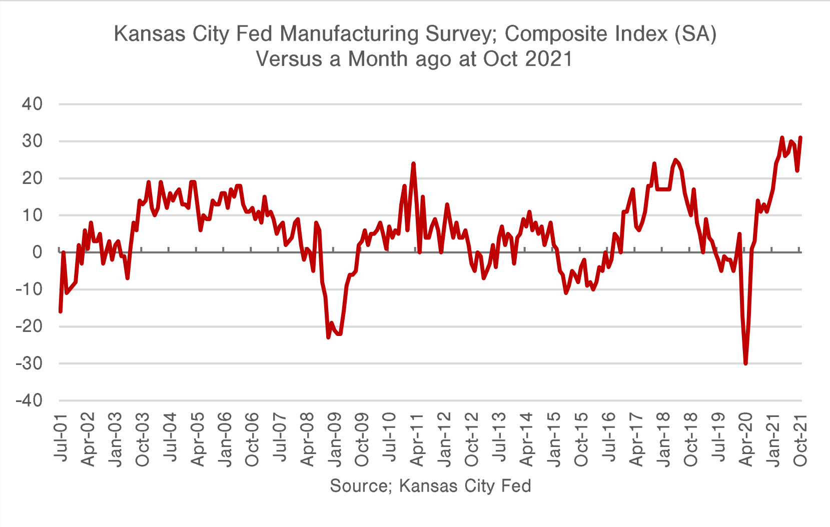
Summary: Firms expanded output and shipments this month. Demand also expanded at a faster pace – resulting in slower growth in order backlogs, just below the recent peak. Firms also experienced worsening supplier delivery lead times – reaching a new series high (longer lead times). Input costs increased to a new series high again. Selected comments note the worsening strain of supply chain disruptions and rising costs.

> "We are constantly searching for hard-to-find items, we are paying more for items along with freight. We are told material that was due this month may be December; delivery is still not guaranteed. Customers understand the situation because they are experiencing this everywhere."

Employment remained robust – with the increase in the number of employees index also reaching a new series high. The average workweek also expanded.

Headline Composite Index – month: Oct 31 versus Sep 22

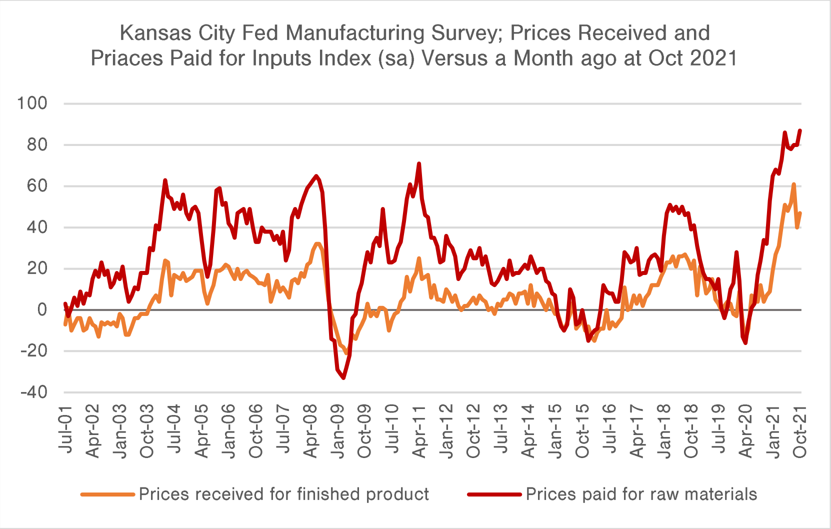
The headline composite index reached the new series high again in Oct (also reaching 31 in Apr 2021)



A slightly different dynamic to other regions. Production, shipments, and orders all increased at a faster pace this month. Growth in order backlogs slowed from a recent peak. Growth in inventory levels slowed from the recent near-term peak.

But this month, supplier lead times lengthened to a new series high. Firms noted the persistence of shortages and longer lead times for inputs.

The input price index expanded at a faster pace, reaching a new series high. Firms also increased output charges at a faster pace again:



The employment situation remained robust. The number of employees index increased at a faster pace – reaching a new series high in Oct. The average workweek also expanded at a faster pace.

https://www.kansascityfed.org/documents/8475/10_2021_KC_Survey_Manuf.pdf

Chicago PMI (Oct)

The headline PMI was slightly higher this month – led by rising order backlogs, and employment. Supplier deliveries lengthened even further with the index at 84.7;

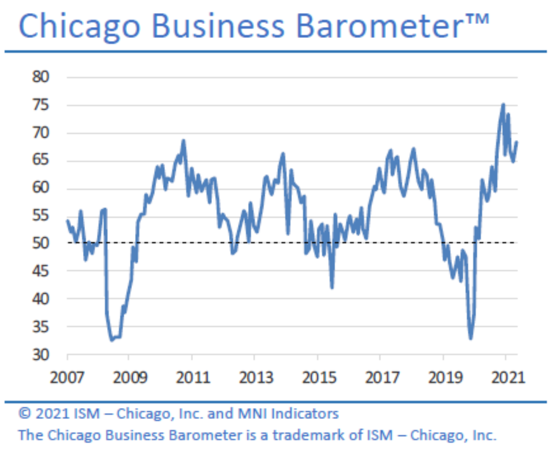
> "…firms again reported worsening port congestion and ongoing logistical issues with trucking, rail, and even air cargo."

Output declined in the month:

> "Some businesses said raw material shortages and a low supply of critical components like semiconductors at suppliers was impacting opportunities."

Prices continued to increase at a faster pace:

> Prices Paid rose by 3.6 points in October to a 42-year high, with many companies saying prices continued to be an issue.



https://s3.amazonaws.com/images.chaptermanager.com/chapters/b742ccc3-ff70-8eca-4cf5-ab93a6c8ab97/files/mni-chicago-press-release-2021-10.pdf

Advance Durable Goods Orders (Sep)

Summary: Durable goods orders remained weaker amid further falls in the value of transport equipment orders – both motor vehicles and non-defense aircraft orders declined in the month and this offset the increase in defense aircraft orders. The value of shipments was higher in the month as further declines in transport shipments were more than offset by increases across other industries (especially machinery and fabricated metals).

This report measures the *value* of orders and shipments.

Headline Durable Goods Orders – month change: Sep -0.4% (exp -1%) or -$1bn versus Aug +1.3%

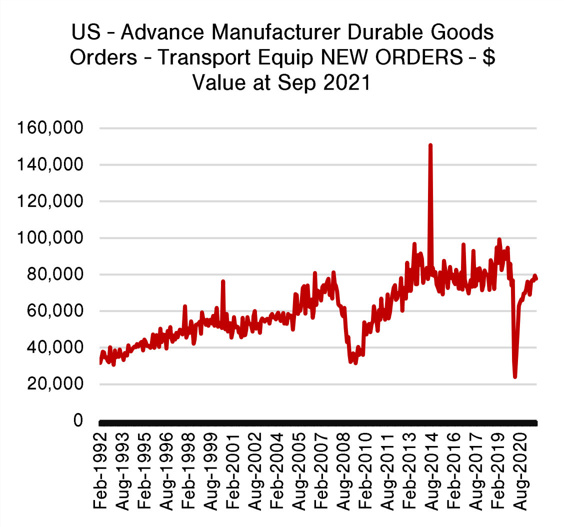
One of the larger drivers of the less-than-expected fall in orders was Defense aircraft orders. Excluding Defence aircraft orders, durable goods orders declined by 2% in Sep (versus +1.7% in Aug).

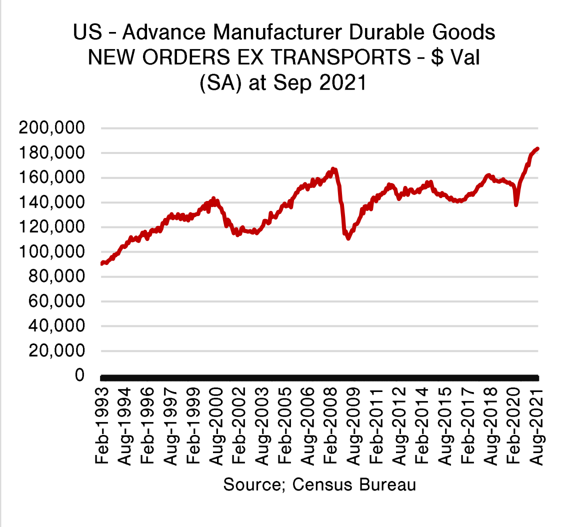
Transportation orders remained weaker in Sep. New orders for motor vehicles declined (albeit at a slower pace than in Aug) by -2.9% (or -$1.5bn).

Orders for non-defense aircraft also declined notably this month by -27% or -$4.2bn – almost giving up all the gains from the prior month.

Orders across the remaining durable goods industries increased over the prior month.

Overall weaker orders are a story of weaker motor vehicle and aircraft orders (transportation equipment) – especially in recent months. Growth in orders ex transports has more than rebounded on a dollar value basis:





<u>Headline Durable Goods Shipments – month change</u>: Sep +0.4% (+$1bn) versus Aug -0.5%

Weaker transport equipment shipments kept overall shipment growth lower this month. Transportation equipment shipments declined by another -1% in Sep (-$0.7bn) after declining by 3.1% in Aug. Shipments of motor vehicles were down by -2.3% in Sep.

Excluding transport equipment, durable goods shipments increased by 1% (+$1.8bn) in Sep.

Shipment growth was stronger across machinery and fabricated metal industries in Sep.

The overall weakness in shipments remains in transports. The value of manufacturer shipments ex-transports has more than rebounded since the depths of the pandemic (not price adjusted).

https://www.census.gov/manufacturing/m3/index.html

Mortgage Applications wk ending 22 Oct

Summary: The headline mortgage application composite index increased by +0.3% this week (after falling -6.3% in the prior week). Underlying this result was a fall of 2% in refinance applications and an increase of 4% in the purchase index.

The refi index is now 26% below the same week a year ago while the purchase index is 9% below the same week a year ago.

> "Mortgage rates increased again last week, as the 30-year fixed rate reached 3.30 percent and the 15-year fixed rate rose to 2.59 percent - the highest for both in eight months. The increase in rates triggered the fifth straight decrease in refinance activity to the slowest weekly pace since January 2020. Higher rates continue to reduce borrowers' incentive to refinance,"

> "Purchase applications picked up slightly, and the average loan size rose to its highest level in three weeks, as growth in the higher price segments continues to dominate purchase activity. Both new and existing-home sales last month were at their strongest sales pace since early 2021, but first-time home buyers are accounting for a declining share of activity."

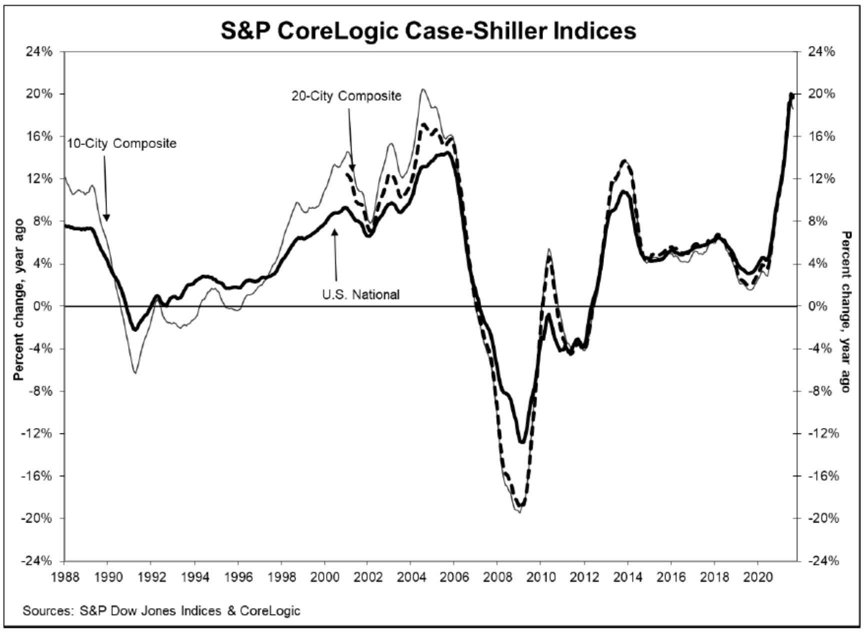
https://www.mba.org/2021-press-releases/october/mortgage-applications-increase-in-latest-mba-weekly-survey-x287209

Case/Shiller House Price Index (Aug)

Summary: The national home price index increased by +19.8% (slightly lower than the +20.1% expected growth) year over year for Aug. In July, the annual growth of home prices was +20%.

The monthly growth in the house price index was (SA basis) was +1.4% - somewhat slower on an annualized basis.

> "We have previously suggested that the strength in the U.S. housing market is being driven in part by a reaction to the COVID pandemic, as potential buyers move from urban apartments to suburban homes. More data will be required to understand whether this demand surge represents an acceleration of purchases that would have occurred anyway over the next several years, or reflects a secular change in locational preferences. August's data are consistent with either explanation. August data also suggest that the growth in housing prices, while still very strong, may be beginning to decelerate".



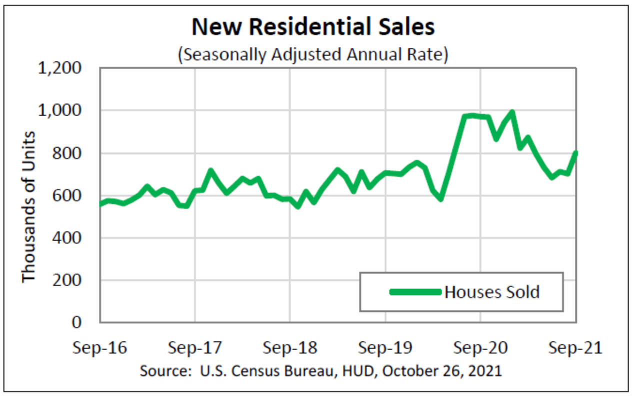
https://www.spglobal.com/spdji/en/documents/indexnews/announcements/20211026-1444567/1444567_cshomeprice-release-1026.pdf

New Home Sales (Sep)

Summary: New home sales increased more than expected in Sep, increasing by 0.800m (SAAR basis) – expecting +0.755m. This was a notable increase compared to Aug which was revised lower to 0.700m.

New home sales increased by +14% in Sep v Aug, but the 90% confidence interval is +/- 17.9% pts. This means sales could have increased or decreased.

On an annual basis, new home sales declined by -17.6%. The 90% confidence interval was +/- 12.1% pts – which suggests that sales did remain below a year ago.



https://www.census.gov/construction/nrs/pdf/newressales.pdf

Initial Jobless Claims (wk ending 22 Oct), Continuing Claims (wk ending 15 Oct)

Summary: Initial jobless claims continued to fall this week to +281k from 291k in the prior week (SA). State programs continuing claims for the prior week ending 15 Oct were also lower at 2.2m (-237k persons).

The view of continuing claims over all programs (NSA) for the latest week ending 9 Oct shows a further substantial fall in claims as the federal pandemic support programs come to an end.

CONTINUED WEEKS CLAIMED FILED FOR UI BENEFITS IN ALL PROGRAMS (UNADJUSTED)

WEEK ENDING	October 9	October 2	Change	Prior Year[1]
Regular State	2,161,080	2,255,919	-94,839	8,025,806
Federal Employees	7,712	7,682	+30	11,752
Newly Discharged Veterans	5,203	5,453	-250	13,066
Pandemic Unemployment Assistance[3]	270,013	517,949	-247,936	10,781,090
Pandemic Emergency UC[4]	244,379	331,567	-87,188	4,052,669
Extended Benefits[5]	117,559	134,379	-16,820	406,127
State Additional Benefits[6]	2,445	2,909	-464	2,395
STC / Workshare[7]	22,270	23,189	-919	187,008
TOTAL[8]	2,830,661	3,279,047	-448,386	23,479,913

https://www.dol.gov/ui/data.pdf

Employment Cost Index Q3

Summary: Compensation costs increased by more than expected by +1.3% for Q3 2021 (exp +0.9%). On an annual basis, wages and salaries increased by +4.2% - just below the current annual PCE rate of inflation at 4.4%.

Chart 1. Three-month percent change, seasonally adjusted, civilian workers, total compensation

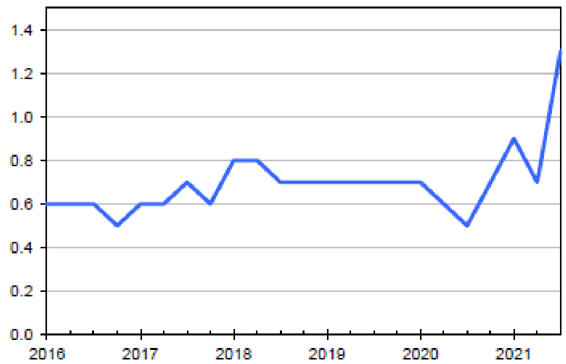
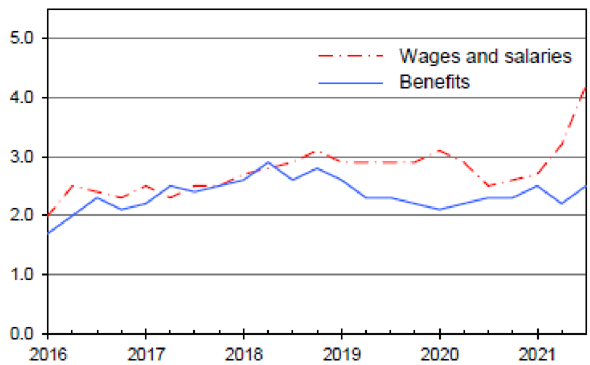


Chart 2. Twelve-month percent change, not seasonally adjusted, civilian workers



https://www.bls.gov/news.release/pdf/eci.pdf

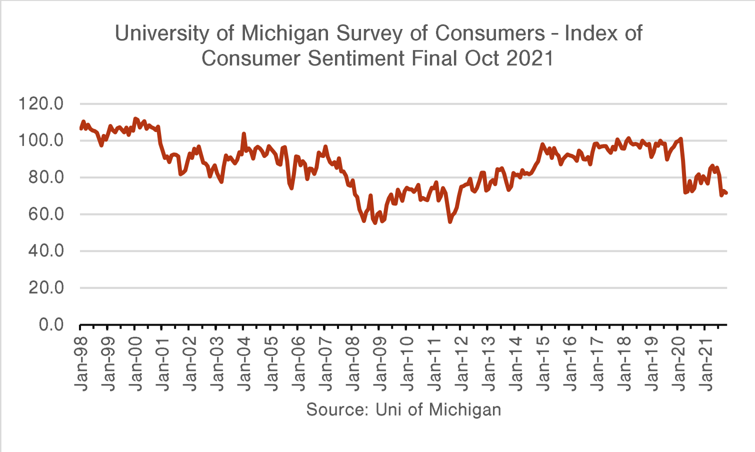
University of Michigan Consumer Sentiment Final (Oct)

Headline Consumer Sentiment final – month index: Sep 71.7 (prelim 71.4) versus Aug 72.8

There was barely any improvement in consumer sentiment at the end of Oct from the mid-month reading. The reading also remains marginally above the Aug 21 pandemic low;

The positive impact of higher income expectations and the receding coronavirus has been offset by higher rates of inflation and falling confidence in government economic policies.

Declining living standards due to inflation were spontaneously mentioned by one-of-every five households, concentrated among older and poorer households.



The sentiment of current conditions and expected conditions were also little changed from the weaker mid-month readings.

http://www.sca.isr.umich.edu/

Personal Income, Expenditure, and Price Index (Sep)

Summary: Personal income declined in the latest month as the main federal pandemic unemployment insurance programs ended. Employee compensation increased at a faster pace of +0.7%. Expenditures continued to slow – led by slower goods consumption. Growth in services consumption was consistent at +0.6% for the month.

The pace of savings declined notably due to the fall in income. The savings rate as a % of personal disposable income is now back down to the pre-pandemic levels of 7.5%.

Personal Income – month change ($bn): Sep -1% (-$18bn) (exp -0.1%) versus Aug +0.2%

The larger than expected to decline in personal income this month was the result of a larger fall in government transfer payments. The broader Federal emergency pandemic unemployment benefits ended at the start of Sep. Overall government transfer receipts are still elevated compared to pre-pandemic levels:

Importantly, the pace of growth in employee compensation increased at a faster pace this month (+0.7% in Sep versus +0.3% in Aug)

The growth in employee compensation was not large enough to offset the decline in government transfer payments and overall disposable income declined by $19bn compared to the prior month.

	Month on Month chg	
$bn	Sep-21	Aug-21
TOTAL PERSONAL INCOME $bn	-18.02	3.44
Sources of Income		
Employee Compesation	7.32	3.51
Income from Capital	0.23	-0.53
Transfer Receipts	-24.66	0.83
Less Taxes	1.73	1.24
Total Personal Dispsoable Income	-19.75	2.21
Less Total Outlays	7.67	12.81
Equals Personal Saving	-27.42	-10.60

Personal Consumption Expenditure – month change ($bn): Sep +0.6% (+$7.6bn) versus Aug +1%

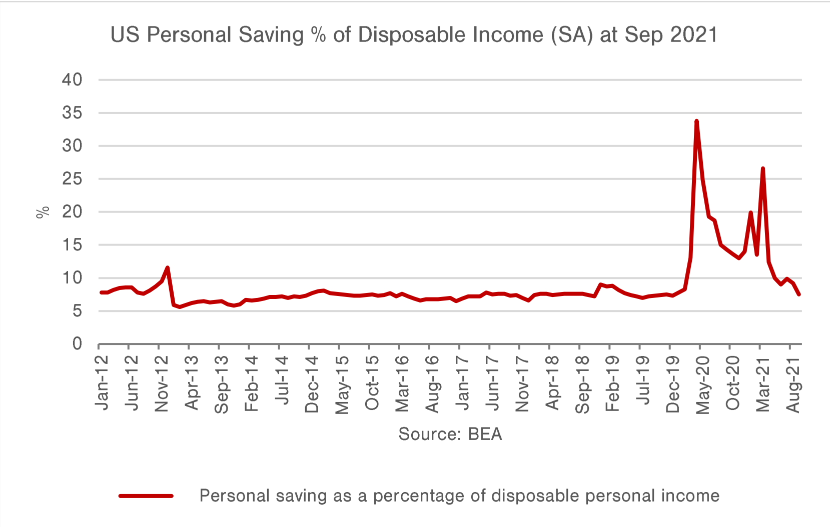
Growth in consumption expenditures slowed this month. This was the result of a decline in durable goods expenditures (-0.2% in Sep versus +0.4% in Aug) and a slow-down in the growth of non-durable goods.

Growth in services expenditures for the month remained at a similar pace of +0.6%.

Personal Saving – month change: Sep -20% (-$27bn) versus Aug -7%

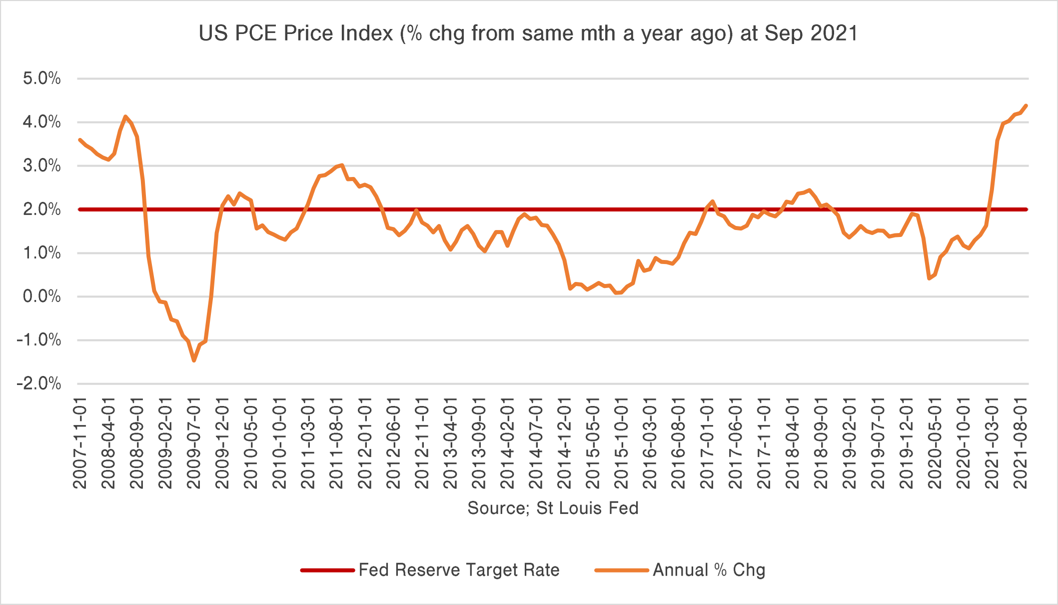
Personal saving is a calculation of the difference between income and outlays. Given the fall in income and, despite the slower growth in outlays, personal saving slowed notably this month.

The level of saving as a % of personal disposable income is now back in line with pre-pandemic levels of 7.5%.



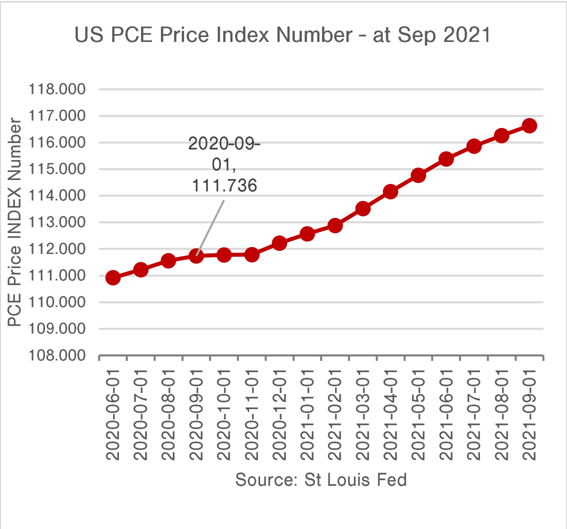
PCE Price Index – annual change: Sep +4.4% (exp +4.7%) versus Aug +4.2%

Personal consumption expenditure prices continued to increase at a faster pace this month – albeit less than expected.

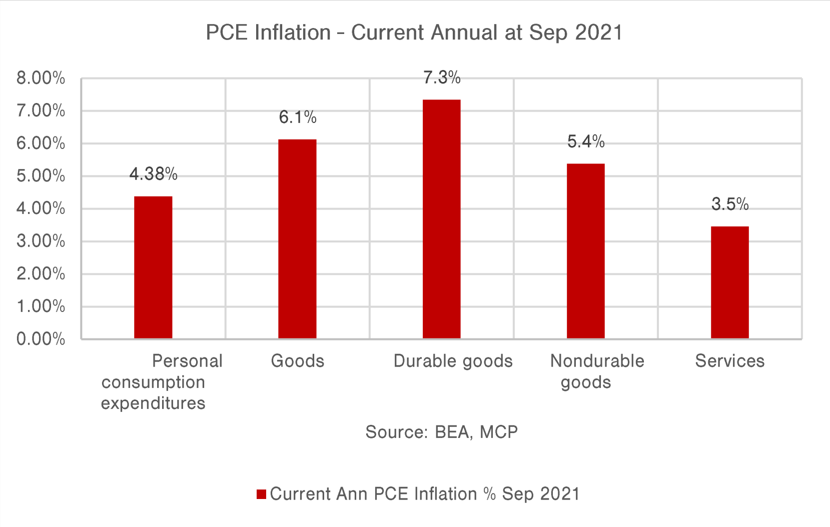


The monthly headline PCE price index increased at a similar pace of +0.3% in Sep (+0.3% in Aug). The quarterly PCE growth also slowed from 1.3% in Aug to 1.1% in Sep – and has been slowing for the last three months. But the quarterly rate is elevated compared to prior years.

The PCE index over the last year shows that the base comparison will start to flatten in the next two months which may result in a higher pace of growth (assuming prices in the latest months continue to increase).



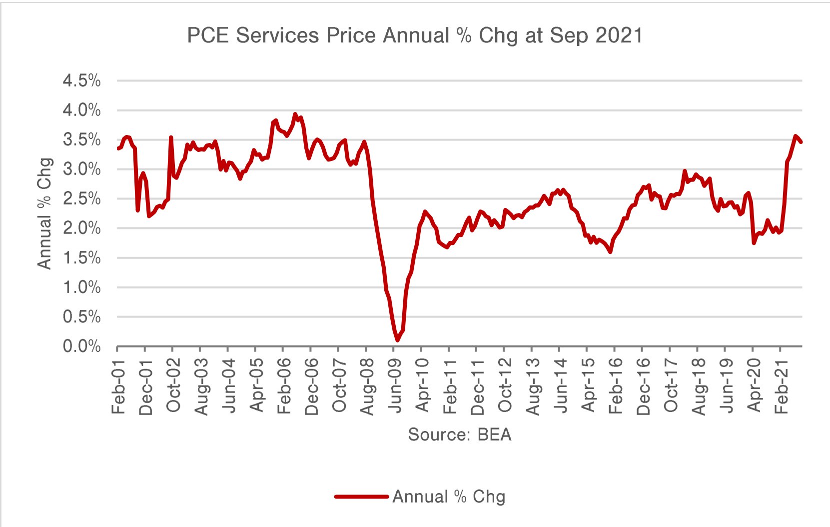
Growth in prices continues to be led by goods;



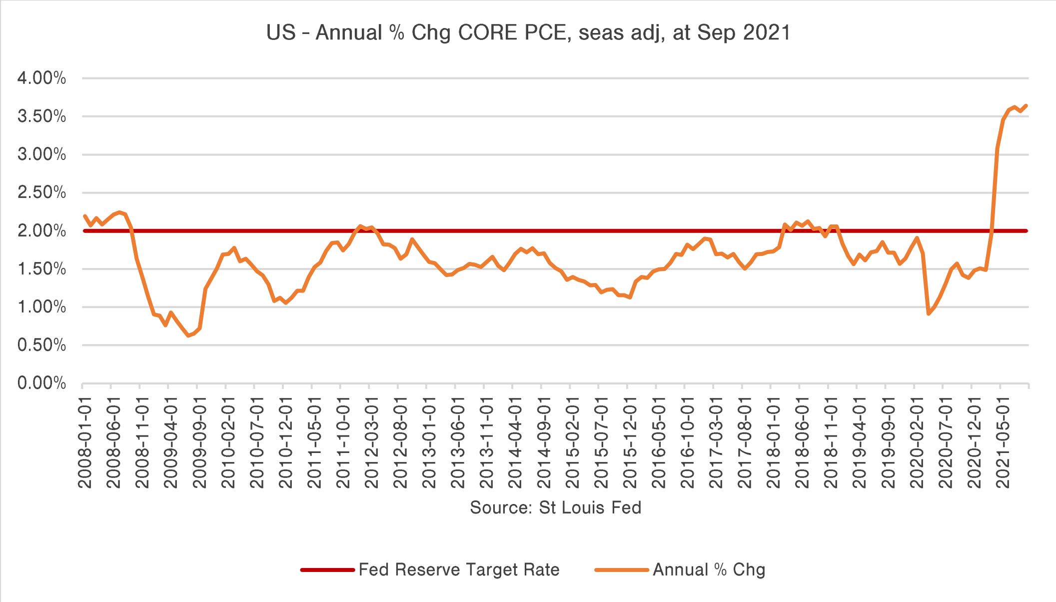
Food price (at home) prices continued to accelerate. This month, food prices increased by +1.2% compared to the +0.4% in Aug. The annual growth jumped from +2.9% in Aug to 4.3% in Sep.

Energy prices (gasoline and other energy goods) prices increased by +1.4% this month – slower than then +2.5% in Aug. The annual pace of growth remained at +41%. The index is now at the highest point since 2014.

Growth in services prices remains lower (as does consumption) than in goods, but is elevated compared to the year between the GFC and the pandemic:



Core PCE (ex food & energy) – annual change: Sep +3.6% versus Aug +3.6%



The monthly change of core prices slowed slightly from +0.3% in Aug to +0.2% in Sep. The trend of the index shows that the base comparison months will also start to flatten over the next few months, possibly resulting in an acceleration in the growth rate.

https://www.bea.gov/news/2021/personal-income-and-outlays-september-2021

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Europe

ECB Policy Decision 28 Oct 2021

Summary: The ECB noted that bond purchases as a part of the emergency pandemic program would come to an end in Mar 2022 and that purchases would now slow over the next few months. Markets initially appeared to have interpreted a lack of push-back on market timing of the first hike in rates as some sort of confirmation that Euro area rates would increase next year.

From the press conference – emphasis added;

> Two very quick question for you. **Are markets getting ahead of themselves in expecting a rate rise as early as the end of next year**, and how important is it for you to maintain some of the flexibility of PEPP after PEPP ends in March next year?

President Lagarde was asked a similar question at the start of the press conference. The President pushed back similarly saying that their analysis doesn't support that the conditions of their forward guidance have been (or would be) met by the time, or soon after, what the market is currently expecting as a rates lift-off timing.

The second time President Lagarde was asked that question she pushed back even less;

> Lagarde: **Are markets ahead of themselves? Not for me to say.** What I have to do, and what I have to assess is the validity of our analysis, and then testing our analysis once we've determined that it was correct, against the conditions for our forward guidance. What I can tell you, is that our analysis does not support that the conditions of our forward guidance are satisfied, neither at the time expected by markets of lift-off or any time thereafter soon.

A Bloomberg article also outlines this – but suggests that it was a conscious decision to "stop short of saying that investors bets on a hike are wrong". The concern during deliberations was that an outright pushback could "backfire".

ECB Rates

Rates to remain at the current level until:

> "…the Governing Council expects the key ECB interest rates to remain at their present or lower levels until **it sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon**, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target".

Asset Purchases

Net asset purchases under the APP will continue at a pace of €20bn/month.

The Pandemic emergency program will continue into Mar 2022 with a lower pace of net asset purchases. This was positioned as NOT tapering – *"this is calibrating appropriately on the basis of the commitment that we made back in December last year to look at a combination of* *the financing conditions to determine that they are favourable, and look at what the inflation outlook is".*

<u>Inflation Outlook – no mention of 'transitory'</u>

Following from the BoC, the ECB noted that the current phase of inflation "will last longer than originally expected". But the pace of growth is expected to ease through 2022.

Three key factors impacting inflation: higher energy prices, "recovering demand related to the reopening of the economy is outpacing supply", and base effects from the end of cuts in German VAT.

> We expect the influence of all three factors to ease in the course of 2022 or to fall out of the year-on-year inflation calculation.

https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.mp210909~2c94b35639.en.html

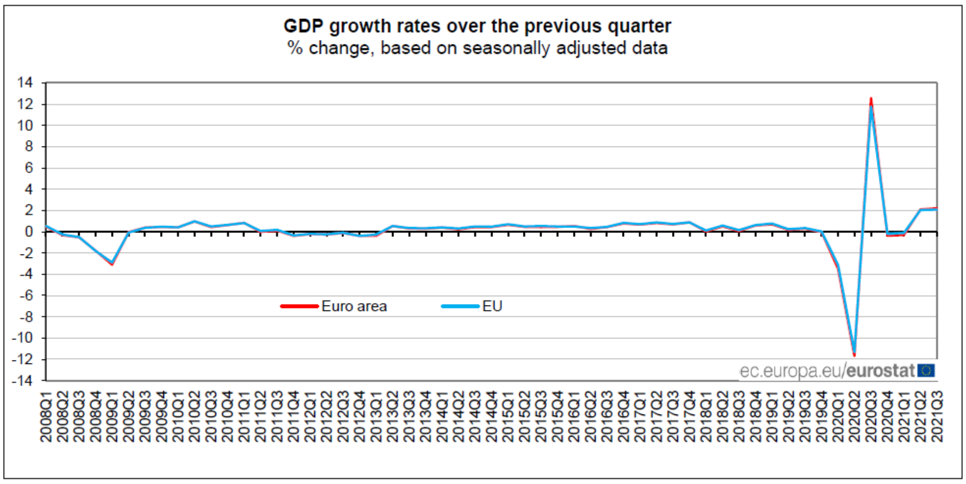
press conference transcript
https://www.ecb.europa.eu/press/pressconf/2021/html/ecb.is211028~939f22970b.en.html

Eurozone GDP – Flash Q3

<u>Euro Area Real GDP – annual chg</u>; Q3 Flash est +3.7% versus Q2 +14.2%

Quarterly real GDP growth accelerated slightly:

<u>Euro Area Real GDP – Quarter chg</u>: Q3 flash +2.2% versus Q2 +2.1%



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Eurozone Prelim CPI (Oct)

Summary: The acceleration in the prelim CPI for Oct was led by faster growth in energy prices. Excluding energy, consumer price growth still accelerated and is now just at 2% annual growth.

Euro Area Headline All-Items CPI – annual chg: Oct +4.1% (exp +3.4%) versus Sep +3.4%

Headline consumer prices increased at a faster than expected pace in Oct – still led by faster growth in energy prices.

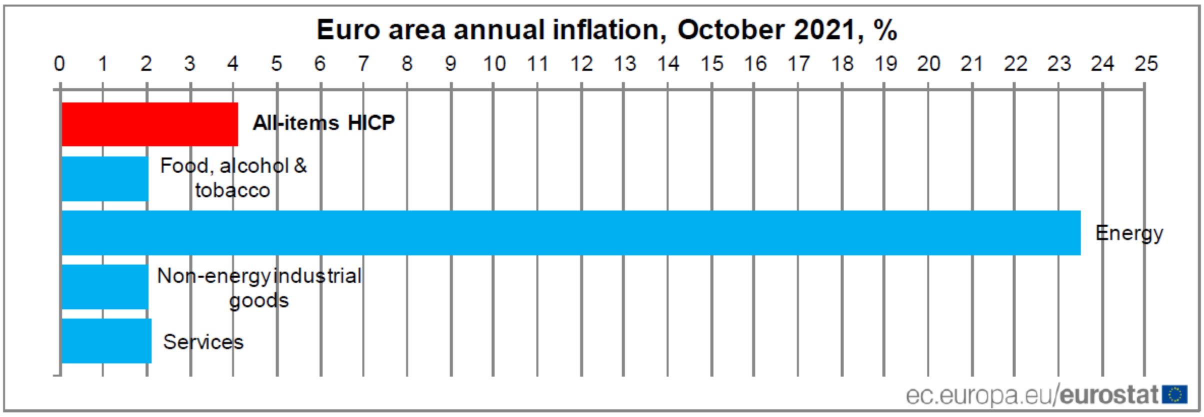
Energy prices increased by +23.5% versus a year ago and were up +5.5% on the prior month.

Food, alcohol, and tobacco prices increased at a constant +2% pace versus a year ago. Unprocessed food prices increased at a slower annual pace of +1.4%.

Services Prices continued to accelerate on an annual basis from +1.7% in Sep to +2.1% in Oct. Monthly growth of services prices were unchanged.

Euro Area All-Items CPI EX Energy – annual chg: Oct +2% versus Sep +1.9%

The monthly change ex-energy was +0.3%.



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Japan

BoJ Policy Decision

<u>**Summary:**</u> The BoJ maintained its accommodative monetary policy at this meeting. The dovish outlook was in contrast to other CB's as consumer price inflation remains low. Parts of the economy remain under pressure from supply chain issues (the auto sector especially). Services also remain under pressure due to covid restrictions (which are being eased).

> The outlook for Japan's economy is that, for the time being, downward pressure stemming from COVID-19 is likely to remain on services consumption, and exports and production are expected to decelerate temporarily due to supply-side constraints.

> "The risk of accelerating inflation is extremely limited in Japan unlike other nations facing such concerns," Kuroda said,

Real GDP forecasts for 2021 were revised lower from +3.8% (Jul) to +3.4% (Oct)

CPI Less Fresh Food inflation was also revised lower from +0.6% (Jul) to 0% (Oct meeting).

https://www.boj.or.jp/en/announcements/release_2021/k211028a.pdf

https://www.boj.or.jp/en/mopo/outlook/gor2110b.pdf

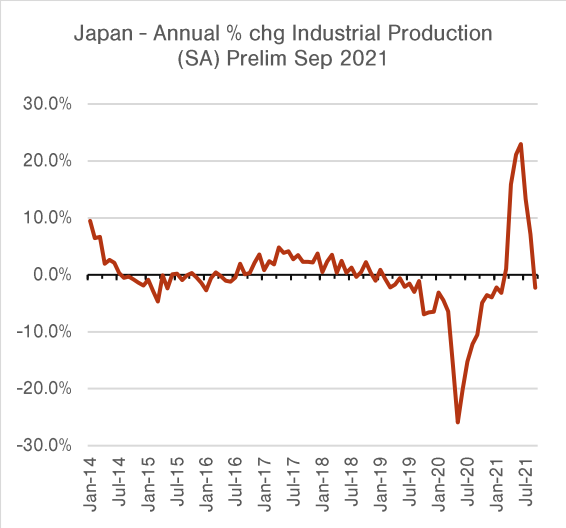
Industrial Production Prelim (Sep)

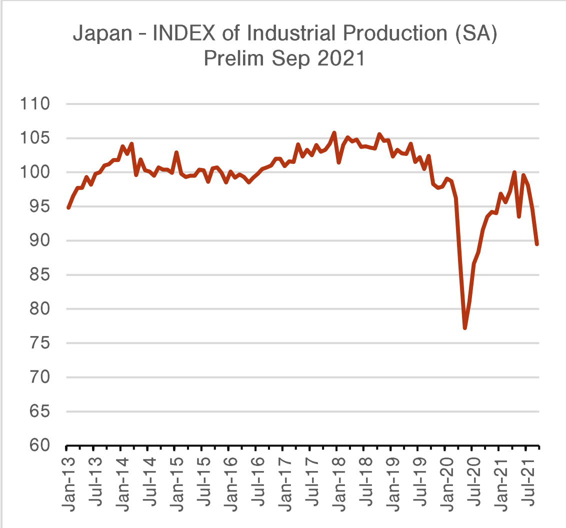
<u>**Summary:**</u> This was a much weaker month for production with most industries recording a decline in production over the prior month. Shipments also contracted, while finished goods inventories increased. A notable area of weakness is in Transport Equipment – in line with global supply issues.

The PMI's had indicated a weaker Sep. The more recent prelim Oct manufacturing PMI indicates an improvement.

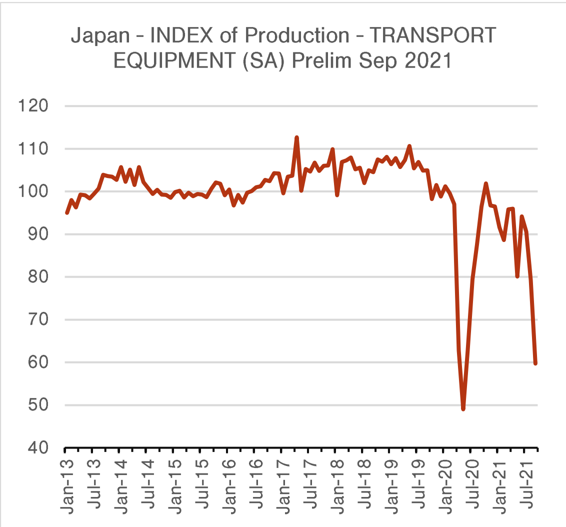
<u>**Headline Production – month change:**</u> Sep -5.4% versus Aug -3.6%

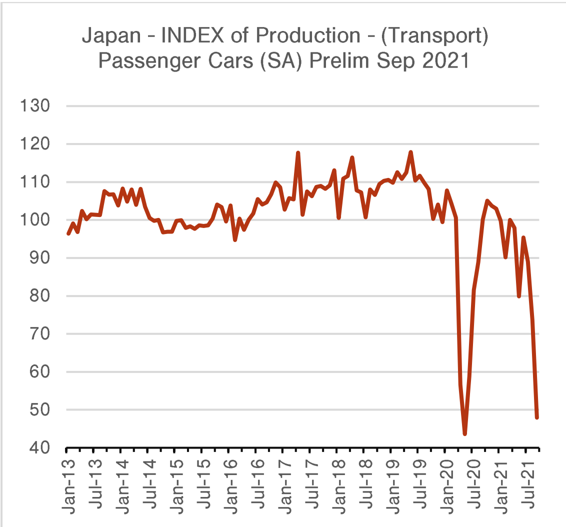
The decline in production accelerated in Sep – so much so that the annual pace of production fell below the same month a year ago (-2.3% below a year ago) and is 10% below the Jan 2020 pre-pandemic level.





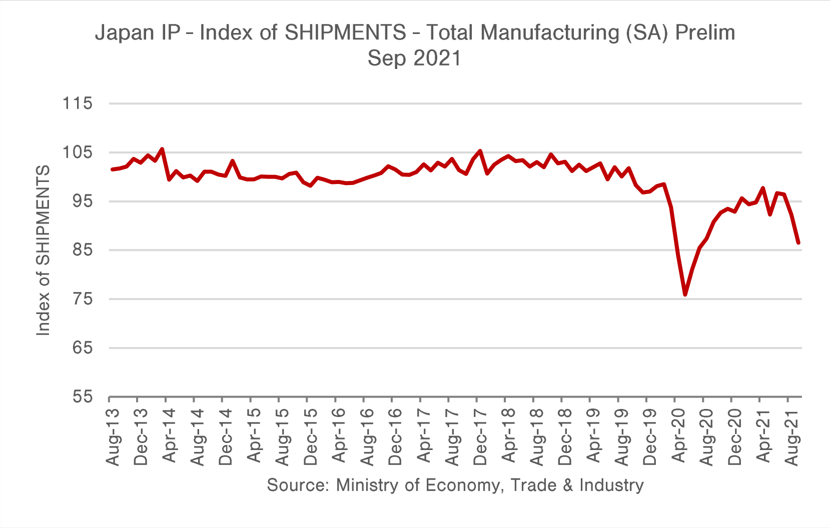
While most industries recorded further declines in output this month, the largest decline in output was recorded in transport equipment of -24.7% versus the prior month. The production of passenger cars declined by 35% in the month and is only 10% above the pandemic low of May 2020:





One of the few industries that recorded growth in output for the month was electrical machinery +0.7% after a -10.7% fall in the prior month.

Shipments – month change: Sep -6.2% versus Aug -4.4%

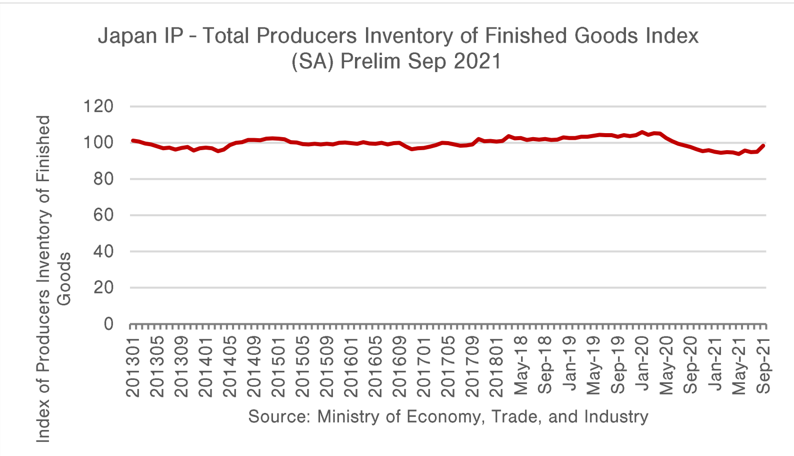


The decline in shipments also accelerated this month and declines were recorded across most industries. The largest decline in shipments was recorded in transport equipment of -27% after an 11% fall in the prior month. Shipments of passenger cars fell 40% in Sep – to a level lower than that of the depths of the pandemic in May 2020.

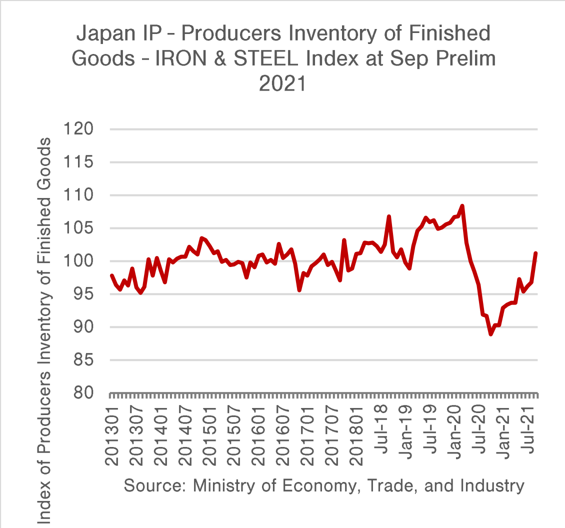
The better performers were iron and steel shipments, declining by -0.9% in the month and fabricated metals declining by 2% in the month.

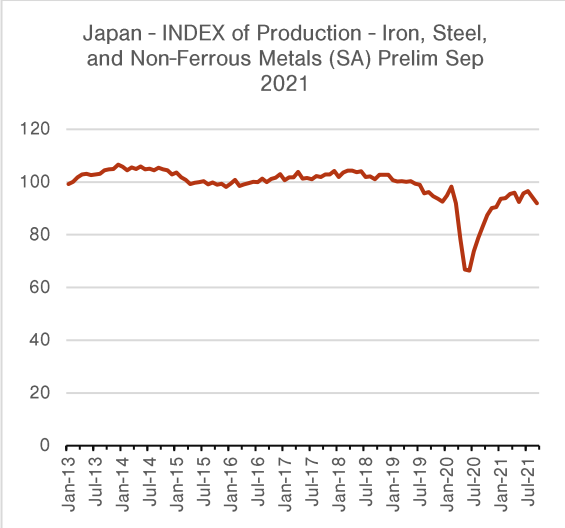
Inventory of Finished Goods – month change: Sep +3.7% versus Aug -0.1%

There was a more notable lift in inventory this month. It's difficult to determine exactly what this lift in inventory means in an environment where supply chain issues and input shortages are impacting/limiting output.



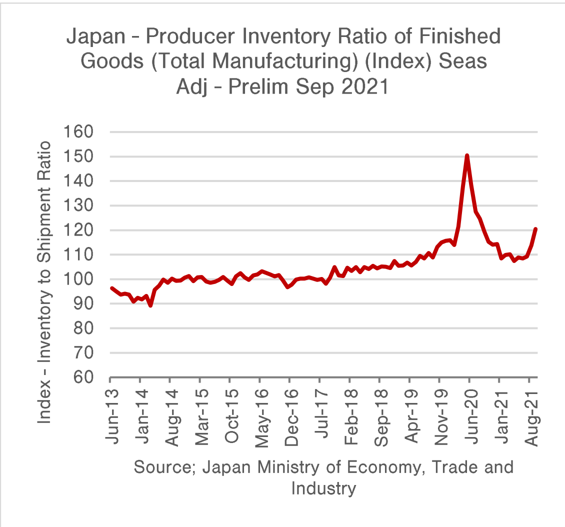
The index weights are quite different compared to shipments and production. The highest weight item in the finished goods inventory index is iron, steel, and non-ferrous metals. Iron and steel inventory increased by 4.5% in Sep. Inventory for iron and steel continues to increase – yet shipments and production have continued to drift lower over the last few months.

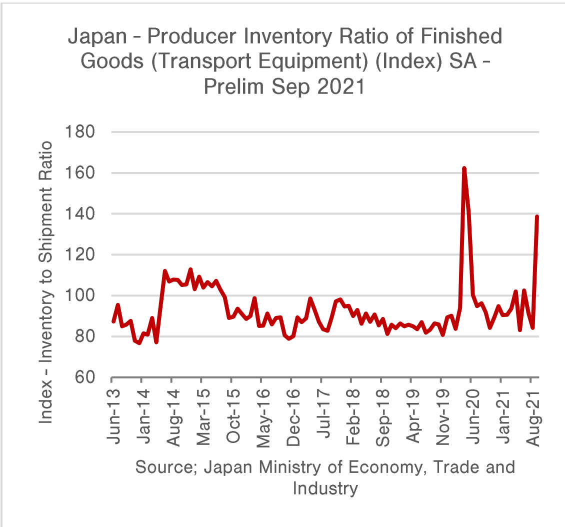




Inventory of finished goods increased across most other industries – including transport equipment which increased by 8.4% for the month – after declining by 16.8% in the month prior.

As a ratio to shipments, the producer inventory of transport equipment is approaching the peaks of the pandemic, but this measure is less pronounced at the total manufacturing level:





https://www.meti.go.jp/english/statistics/tyo/iip/index.html

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Canada

BoC Policy Decision

Summary: The BoC ended QE and shifted to 'reinvestment'. The policy rate was maintained, and forward guidance was also maintained (a wording shift though). Growth forecasts for 2021 were further downgraded. Inflation forecasts were upgraded with the bank acknowledging that the main forces pushing up prices "now appear stronger and more persistent than we previously thought".

End of QE

The BoC announced it was ending QE. The Bank announced it would shift instead to the 'reinvestment' phase – and continue purchasing securities only to maintain the level of bank holdings.

> How long the reinvestment phase lasts is a future monetary policy decision. It will depend on the strength of the recovery and the evolution of inflation. But as I indicated in September, it is reasonable to expect that we will be there for a period of time, at least until we raise our policy interest rate.

The Bank would continue to purchase between $4-5bn (C) in securities each month to maintain the current level of holdings.

Target rate and forward guidance maintained

The target for the overnight rate was kept at 0.25% and forward guidance was maintained. There was a slight shift in timing from Sep:

> We remain committed to holding the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. In the Bank's July projection, this happens **in the second half of 2022**.

To:

> We remain committed to holding the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. In the Bank's projection, this happens **sometime in the middle quarters of 2022.**

Presumably, the ending of QE provides more optionality on ST rate changes:

> While we ended QE, we kept our policy interest rate at its lowest level, and reaffirmed our commitment to keep it there until slack in the economy is absorbed so that the 2 percent inflation target is sustainably achieved. Based on our current projection, this happens sometime in the middle quarters of 2022.

Growth for 2021 downgraded from the Jul meeting as bottlenecks "restrain" growth

In Jul, the BoC had downgraded the growth forecast from Apr to "around 6 percent in 2021". At the time, the BoC revised up its 2022 forecast to 4.5% and 3.25% growth in 2023.

At this meeting, 2021 growth was revised lower to “around 5 percent this year”. The forecast for 2022 was revised slightly lower (4.25%) while 2023 was revised higher to 3.75%.

Inflation ‘takes a little longer to come back down”

> The main forces pushing up prices—higher energy prices and supply bottlenecks—now appear stronger and more persistent than we previously thought.

The BoC noted that it was likely that there is “less excess supply in the economy than we thought would be”.

> We now expect the output gap to close sometime in the middle quarters of 2022, which is earlier than we projected in July. Let me underline there is more uncertainty than normal around the economy’s productive capacity due to the unusual circumstances of the pandemic.

Inflation is expected to increase to 5% by the end of 2021 before slowing back to 2% by the end of 2022. This means inflation is “higher for longer”. The bank also noted that medium-to-longer-term inflation expectations were well anchored in the 2% target, suggesting that “higher prices are not becoming embedded in expectations of ongoing inflation”.

https://www.bankofcanada.ca/2021/10/opening-statement-271021/

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Australia

CPI Q3

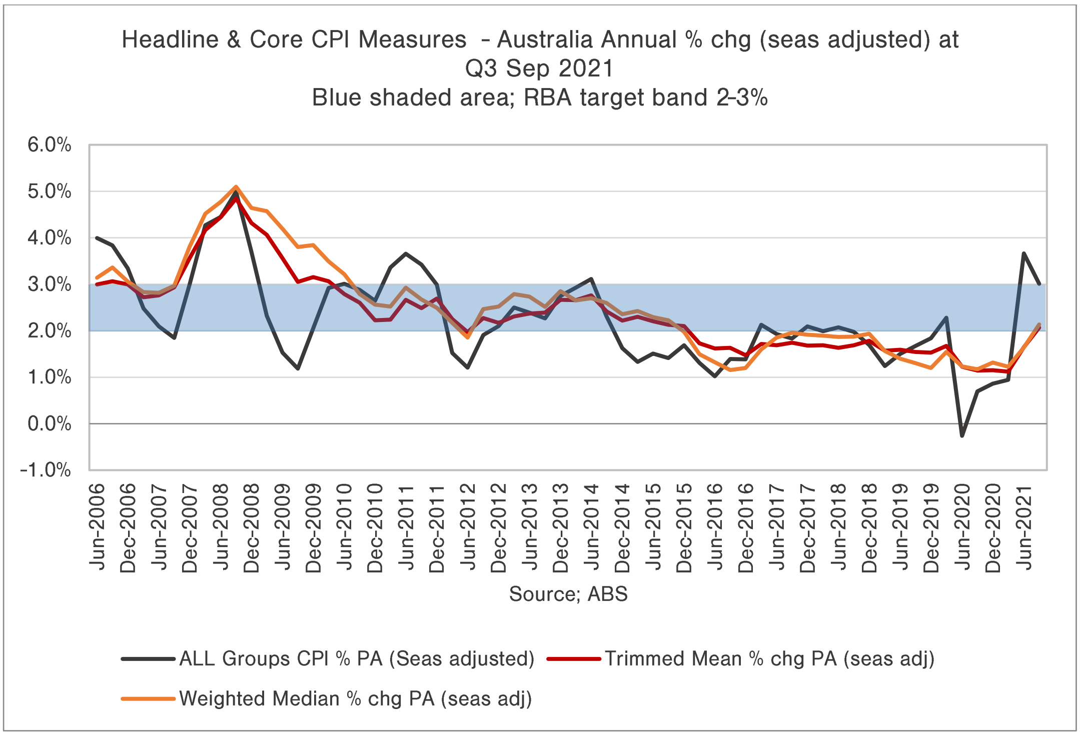
Summary: The data remains noisy – programs from last year continue to unwind and there are effects of the current lockdowns. Headline CPI growth decelerated – but price growth remained elevated. It's been a long time since Aus inflation has been in and around the target band.

Part of the deceleration in headline CPI growth is due to a sharper move higher in the base 2020 period. But if the current quarterly pace of growth remains higher, we could start to see a further acceleration in the headline the next few quarters. This is possible as the economy reopens.

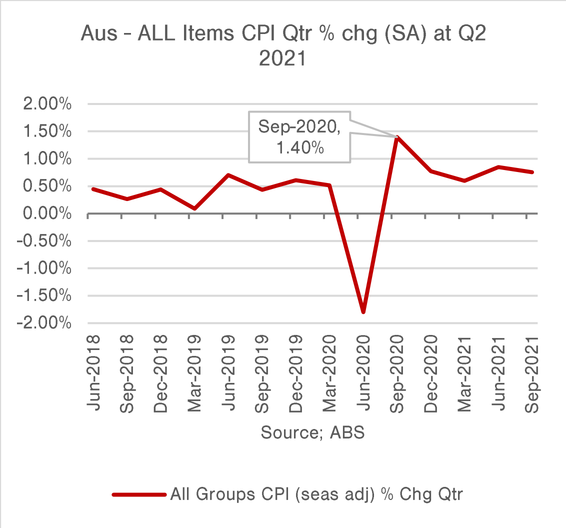
The quarterly pace of core CPI has been accelerating – based on faster growth in the more recent quarters.

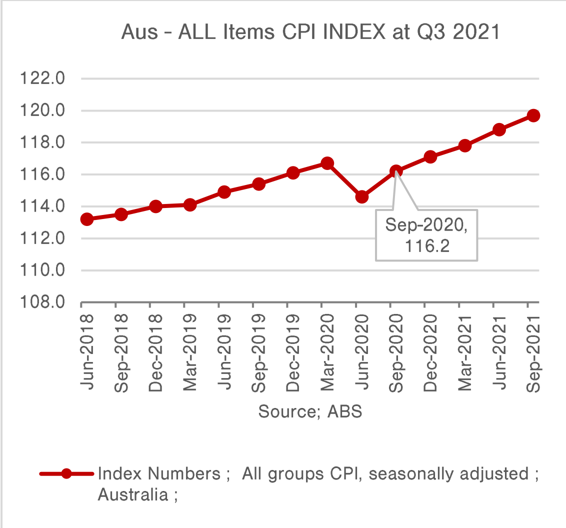
The RBA has been fairly clear on the 'type' of inflation that it needs (wants) to see – high wages growth stemming from a tight labour market. The RBA doesn't see this condition being achieved before 2024.

Headline All Groups CPI (SA) – annual chg: Q3 +3% (expecting +3.1%) versus Q2 +3.8%



Annual CPI growth slowed due in part to a higher base in Q3 2020. But the more recent quarterly pace of CPI growth has remained higher than in the quarters prior to the pandemic.





The largest contributors to inflation in the quarter were:

Housing – Contributed over half of the growth in the CPI for the quarter. In prior quarters, government grants for construction and first home buyers helped keep price growth lower. The payment of these grants is slowing. Councils have also started to increase rates again after implementing freezes in the prior year. Rental conditions in Melb and Sydney had remained subdued – this will likely shift as restrictions ease.

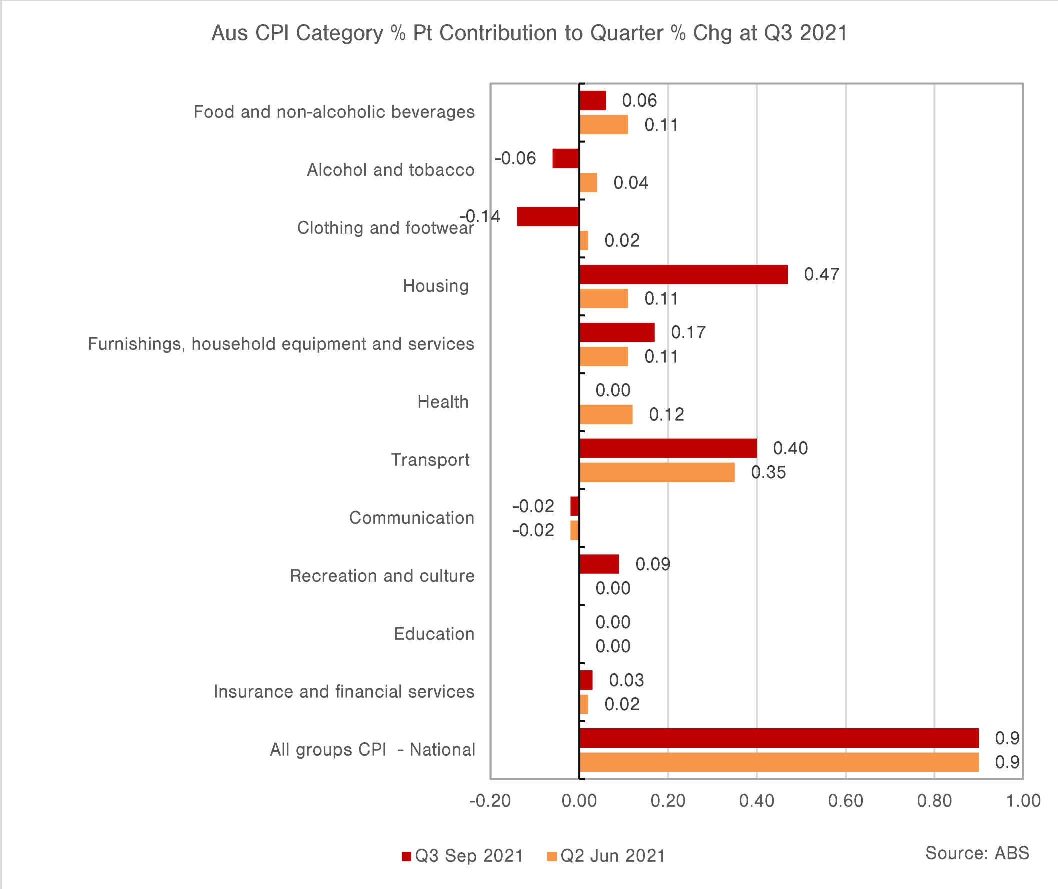
New dwelling purchase by owner-occupiers rose 3.3%. This is the largest rise since the September 2000 quarter driven by substantial increases in base prices in all capital cities. Continuing strong demand for housing construction enabled builders to pass through increases in costs for both materials and labour.

Transport – Higher transport prices also contributed almost half of the increase in CPI this quarter. Higher fuel prices (+24% on a year ago) and higher car prices (+6.2% on a year ago) both contributed to the increase.

Automotive fuel rose 7.1% due to an increase in global oil prices. The **Automotive fuel series reached record levels,** surpassing the previous high set in the March 2014 quarter.

Furnishings/Household Equip – still made a notable contribution based on higher furniture prices (shortages leading to higher prices) and a shift back to paid childcare after emergency measures were introduced last year.

Over the past twelve months the group rose 6.0%. The main contributor was Childcare due to the unwinding of free childcare introduced last year. Excluding the impact of Childcare, the group would have risen 1.3% over the past twelve months.



There was a notable contraction from headline CPI growth from clothing and footwear – this is related to the recent shutdowns;

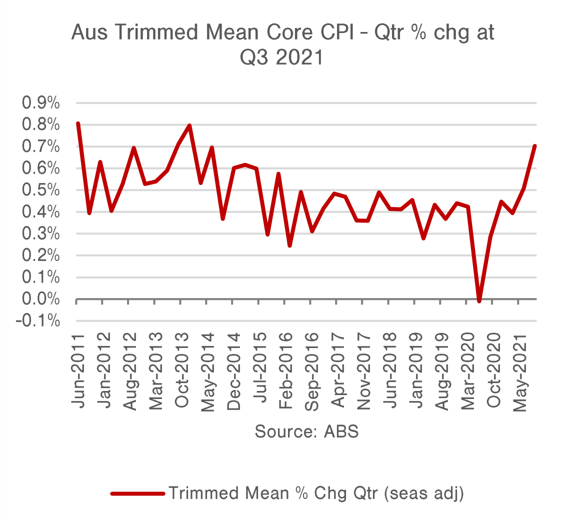
Garments fell 5.5% as retailers looked to move excess winter stock resulting from low demand during lockdowns in some capital cities.

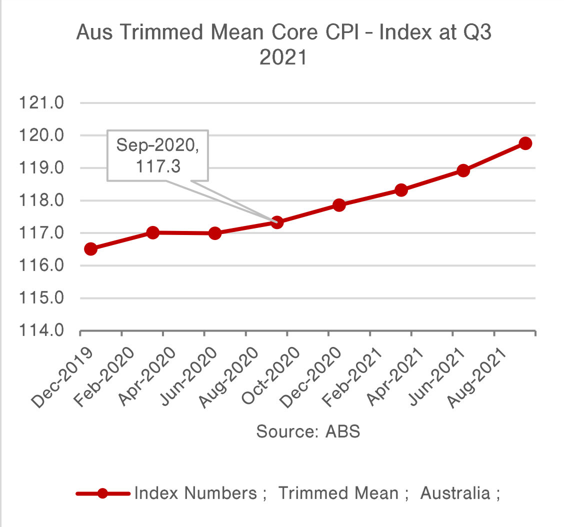
The measure of core CPI that the RBA prefers also recorded an acceleration in growth;

<u>Trimmed Mean Core CPI – annual chg:</u> Q3 +2.1% (expecting +1.8%) versus Q2 +1.6%

This is the first time since Dec 2015 that the core measures of CPI growth have just edged back up into the 2-3% target band.

The significance is that even after trimming the tails, growth in the prices of the remaining 'less volatile' items has been accelerating. This is even more evident on a quarterly basis – which indicates that it's not overall base effects driving the headline growth.





https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-2021#data-download

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