

# MUSINGS

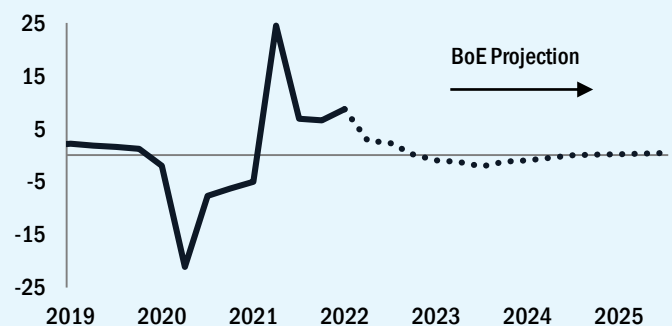
## MACRO AT A GLANCE

Recent US economic data tempers fears of a hard landing. The economy added 528,000 jobs in July, significantly above expectations, and the unemployment rate edged down from 3.6% to 3.5%, returning to its pre-pandemic low. Meanwhile, the ISM manufacturing index fell in July but remains in expansionary territory, while its services counterpart surprised to the upside. That said, there is evidence of an improvement in labor market balance; job openings declined in June and the jobs-workers gap moderated from 5.9 million in June to 4.8 million in July.

Across the Atlantic, the BoE set itself apart from other major central banks by projecting a recession, in large part due to deteriorating real household incomes, that may persist into 2024 (see Chart). The Bank also expects inflation to exceed 13% later this year due to domestic price pressures alongside high energy inflation.

### BoE projects a protracted recession in the UK

Annual GDP growth (%)



Source: Goldman Sachs Asset Management, ONS, BoE August Monetary Policy Report. As of August 4, 2022.

## POLICY PICTURE

The BoE joined peers in delivering a larger-than-usual rate hike, lifting the policy rate by 50bps to 1.75% against a backdrop of broadening price pressures. The policy outlook remains data dependent and uncertain, with the BoE maintaining its guidance to “act forcefully”. We think stagflation risks alongside the potential for further fiscal stimulus presents upside risks to our BoE policy rate outlook (see Central Bank Snapshot, page 3).

Big picture, post-pandemic policymaking is complicated by structural forces such as de-globalization, decarbonization and destabilization in geopolitics, all of which may elongate the presence of supply-driven inflation shocks as discussed in our summer edition of [Asset Management Perspectives](#).



Policy is not on a pre-set path, and what we do this time does not tell you what we’re going to do next time. All options are on the table at our September meeting and beyond”.

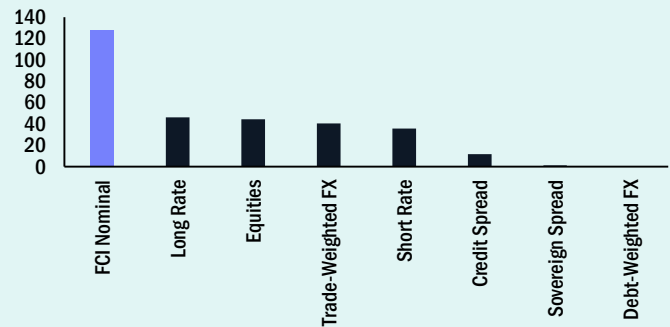
**Andrew Bailey, BoE Governor, August 2022**

## NAVIGATING FIXED INCOME

Markets have been living tightening financial conditions year-to-date, delivered through higher rates (amid tighter policy), weaker risk assets (on recession concerns) or at time both (see Chart). Since late June, market focus has shifted to downside growth risks and the potential for less monetary tightening. Indeed, the more balanced outlook for Fed policy offered some relief last week, thereby supporting our overweight exposure to corporate credit which is balanced with rates. Markets have retraced somewhat this week amid hawkish policymaker commentary, demonstrating high sensitivity to the policy outlook. Looking ahead, we think certain emerging market hiking cycles are set to draw to a close which may create opportunities in certain high-carry local rate markets.

### Living through tightening financial conditions

Global Financial Conditions Index (FCI) Contributions Change from 1 Jan 2022 to 4 Aug 2022 (basis points)



Source: Goldman Sachs Global Investment Research. As of August 4, 2022.

## ASK GS

From a cyclical perspective, the dollar remains supported by rising US policy rates and recession fears. As a result, until economic data moves in a direction that is convincing enough for the Fed to slow—or even pause—its hawkish policy path, we would expect the dollar to remain underpinned.

Sustained positive economic surprises in the rest of the world could also check the dollar's advance. However, this seems unlikely in the near term given energy-related downside growth risks facing Europe and several headwinds challenging emerging market economies including lingering impacts from the pandemic, dollar strength and food inflation.



Do you believe broad US dollar strength will continue?

### US Institutional Client, Quarterly Review Meeting



Every recession has unique characteristics – the impending one will entail popping of the stay-at-home bubble with consumer spending on certain goods slowing due to both high inflation and satiated demand given purchases were pulled forward during the lockdown phase of the pandemic.<sup>1</sup>

### Overheard at Goldman Sachs Asset Management Investment Forum

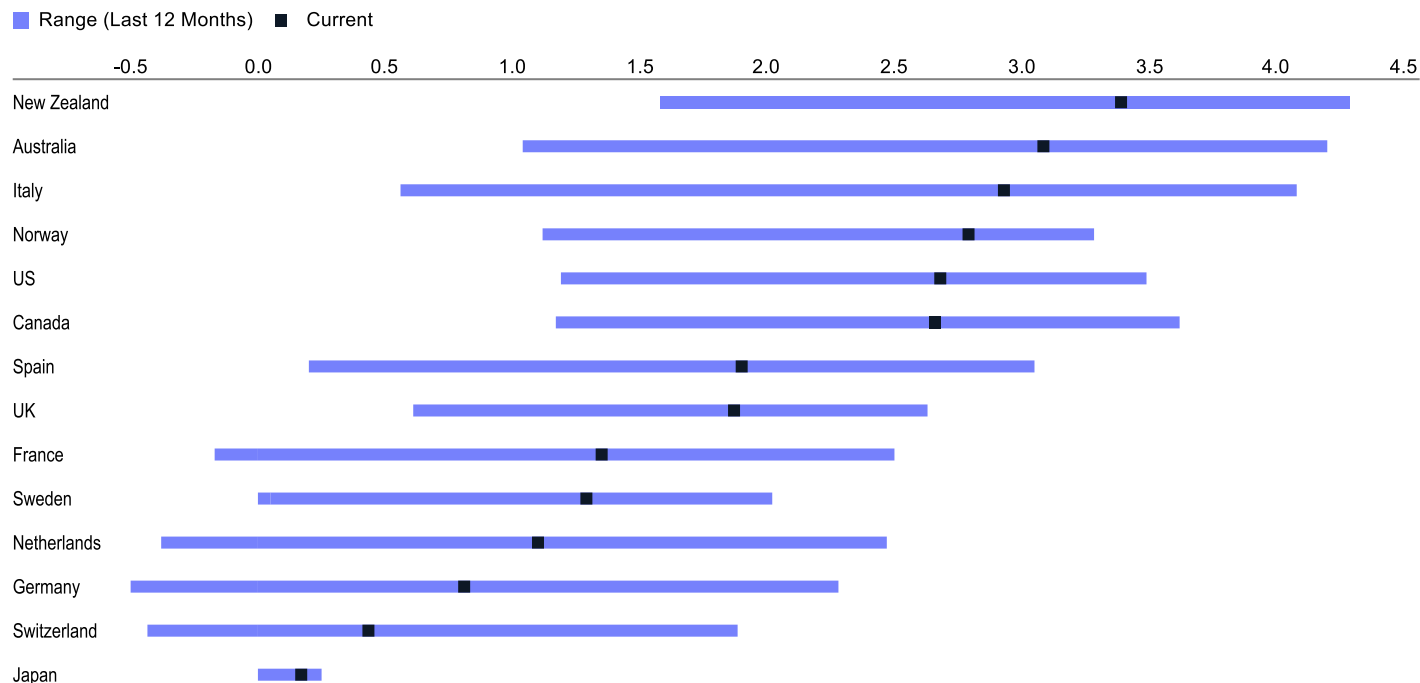
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## CENTRAL BANK SNAPSHOT

	Interest Rate Policy	Balance Sheet Policy	Outlook	Our outlook relative to market-implied pricing
<b>Fed</b>	<p><b>Federal funds rate: 2.25-2.5%</b></p> <p>Last changed: July 2022 (+75bps) June 2022 (+75bps)</p> <p>Prior changes: May 2022 (+50bps) March 2022 (+25bps)</p>	<p>Started reducing the monthly pace of its net asset purchases in November 2021 and ended net additional purchases of Treasuries and agency MBS in early March. Balance sheet runoff begins in June; an eventual monthly cap will be set at \$95bn—split \$60bn-\$35bn between US Treasury and mortgage-backed securities (MBS)—and the caps will initially be set at half of those levels for the first three months of runoff (\$30bn UST-\$17.5bn MBS).</p> <p><b>Balance sheet size: 37% of GDP</b></p>	<p>We expect a 50bps rate hike in September followed by a reversion to 25bps rate hikes.</p>	Slightly hawkish
<b>ECB</b>	<p><b>Deposit facility rate: 0.0%</b></p> <p>Last changed: July 2022 (+50bps), the first hike since 2011</p>	<p>The ECB will end net APP purchases from July 1, 2022. Reinvestments under the PEPP will continue until at least the end of 2024. On July 21, the ECB announced a new anti-fragmentation tool, the Transmission Protection Instrument (TPI), used to ensure monetary policy is transmitted smoothly across all euro area countries. <b>Balance sheet size: 65% of GDP</b></p>	<p>We expect a 50bps hike in September and two further 25bps rate hikes at the October and December meetings.</p>	Slightly dovish
<b>BoE</b>	<p><b>Bank Rate: 1.75%</b></p> <p>Last changed: August 2022 (+50bps) June 2022 (+25bps)</p> <p>Prior changes: May 2022 (+25bps) March 2022 (+25bps) February 2022 (+25bps) December 2021 (+15bps)</p>	<p>BoE members voted in February 2022 to begin reducing the stock of UK government bond purchases by ceasing to reinvest maturing assets, as well as to begin to reduce the stock of sterling non-financial investment grade corporate bond purchases by ceasing to reinvest maturing assets and by a program of corporate bond sales.</p> <p>The BoE announced it will start UK gilt sales in September at a pace of £10 billion per quarter.</p> <p><b>Balance sheet size: 30% of GDP</b></p>	<p>We think the BoE will deliver another 50bps hike at the September meeting, followed by a 25bps hike in November and then pause at 2.5%, though we acknowledge risks are skewed toward more tightening.</p>	Slightly dovish
<b>BoJ</b>	<p><b>Policy deposit rate: -0.10%</b></p> <p>Last changed: January 2016, when the Bank introduced its negative interest rate policy (NIRP)</p> <p>10-year JGB yield target: ~0%, with tolerance band of +/-25bp (yield curve control policy)</p>	<p>The Bank voted in January 2021 to purchase ETFs and Japanese REITs as necessary with upper limits of ~¥12tn and ~¥180bn, respectively, on annual paces of increase in their outstanding amounts, as well as to purchase commercial paper and corporate bonds with an upper limit on the outstanding amount of ~¥20tn in total until the end of March.</p> <p><b>Balance sheet size: 135% of GDP</b></p>	<p>We expect unchanged policies through 2022 but see scope for a rate hike in 2023.</p>	Slightly dovish

Source: Goldman Sachs Asset Management. As of August 4, 2022. The economic and market forecasts presented herein are for informational purposes as of the date of this presentation. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation.

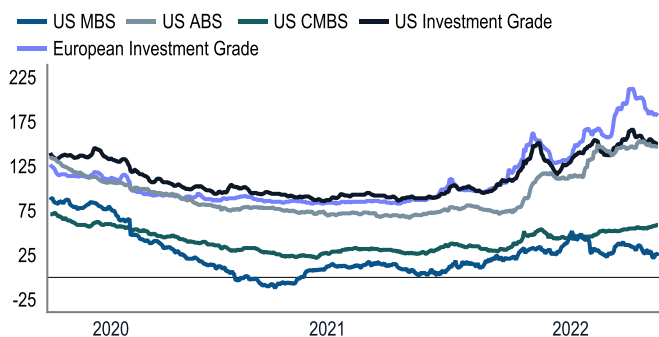
## 10-YEAR SOVEREIGN BOND YIELDS (%)



Source: Macrobond, Goldman Sachs Asset Management. As of August 5, 2022.

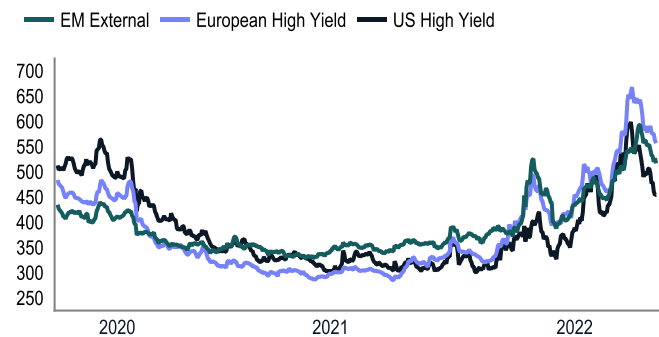
## FIXED INCOME SECTOR SPREADS

### Investment Grade and Securitized Spreads (bps)



Source: Macrobond. ICE BoAML indices. As of August 4, 2022.

### High Yield and Emerging Market Spreads (bps)



Source: Macrobond. ICE BoAML, J.P. Morgan indices. As of August 4, 2022.

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**US Investment Grade Corporates:** ICE BofAML US Corporate Index

**US High Yield Corporates:** ICE BofAML US Corporate High Yield Index

**European Investment Grade Corporates:** ICE BofAML Euro Corporate Index

**European High Yield Corporates:** ICE BofAML Euro High Yield Index

**ABS:** ICE BofAML US Fixed Rate Asset-Backed Securities Index

**MBS:** ICE BofAML US Agency Mortgage-Backed Securities Index

**CMBS:** ICE BofAML US Fixed Rate Commercial Mortgage-Backed Securities Index

**EM External Debt:** J.P. Morgan, EMBI Global Diversified Face Constrained Index

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