MUSINGS

MACRO AT A GLANCE

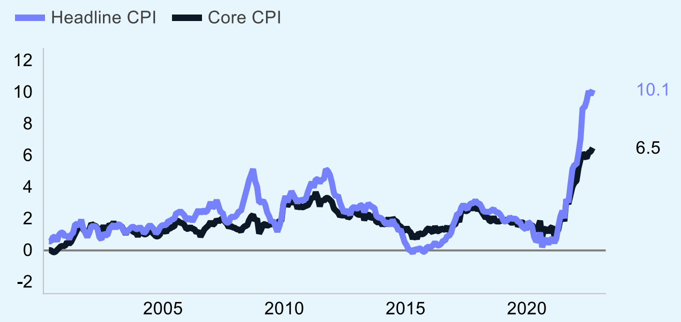
September data continue to paint a firm inflation picture. Annual headline inflation increased 10.1% in the UK (see Chart), primarily driven by higher food prices. Notably, rents rose by 4.2% relative to a year earlier—the sharpest increase since the BoE became independent in 1997 and well above the 1.9% average of the pre-pandemic decade[1].

Japanese inflation is less heated relative to its developed market (DM) peers but noteworthy in a domestic context. A measure of annual core inflation excluding food increased 3% last month, the highest level since August 1991, though the measure which also excludes energy remains below 2%.

Elsewhere, the Fed Beige Book, a report on economic conditions, revealed growing recession fears but easing inflation concerns. Initial jobless claims declined this week against expectations of an increase, pointing to a still-tight and resilient labour market in the US.

UK headline inflation hits a 40-year high

Annual UK inflation (%)



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

POLICY PICTURE

UK Prime Minister Liz Truss resigned; a new leader will be decided over the next week. Chancellor Jeremy Hunt has largely reversed tax cuts included in September's 'mini-budget' and compressed the timeline for the Energy Price Guarantee (EPG) from two years to six months. The scaled back fiscal measures have calmed volatility in UK assets, allowing the BoE to conclude its interventions in long-end UK gilts last Friday. The BoE also confirmed it will begin Quantitative Tightening (QT) on November 1, with gilt sales confined to bonds below 20-year maturities. With the EPG implying a better growth outlook relative to the BoE's August assessment, we continue to expect a 100bps rise in the Bank Rate next month, followed by 75bps in December.

UK policy and politics remains in flux

44	Number of days Liz Truss was in office as Prime Minister
83bps	The rise in the UK 10-year gilt yield during Prime Minister Truss' time in office
£92bn	Amount of tax cut reversals from a total of £170bn initially announced.[2]

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NAVIGATING FIXED INCOME

The persistence of inflationary pressures suggests we are not yet at peak policy hawkishness. As a result, government bond yields continue to climb higher (see Chart), though long-end UK gilts displayed some stability this week despite strong September inflation data, responding favourably to the BoE's decision to not sell long-dated bonds as part of its upcoming QT efforts. That said, some risk premium remains embedded in UK assets given continued uncertainty on the outlook for the EPG beyond April 2023 and on public sector pay and spending.

Amid high macro uncertainty, we think high quality short duration government and corporate bonds give investors an opportunity to capture higher yields—which imply better potential returns—without taking on undue interest rate or credit risk.

Bond yields continue to climb higher

10-year government bond yields (%)

Source: Goldman Sachs Asset Management, Macrobond. As of October 19, 2022.

KEY TAKEAWAYS FROM IMF CONFERENCE

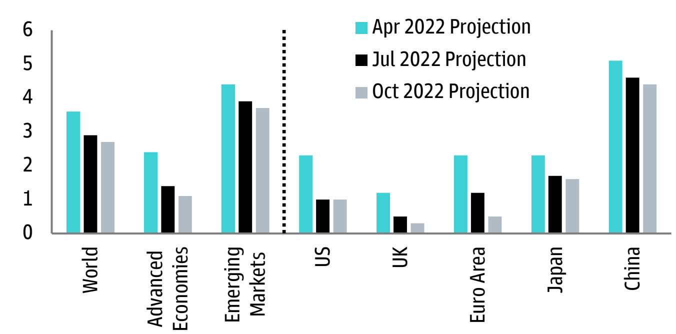
Our economists attended the recent IMF-World Bank Annual Meetings; we summarize their key takeaways below.

1. Downbeat growth expectations face downside risks. The IMF expects the global economy to grow 2.7% in 2023, a trend-like pace and above the 2% level that suggests global recession. However, this outlook is vulnerable to further downgrades considering continued policy tightening, ongoing Covid restrictions in China and energy challenges in Europe.

2. Different tools for different issues. A backdrop of elevated inflation, cost-of-living pressures and UK-led market volatility prompted discussions around the interaction of economic objectives (primarily stable inflation) and financial stability. The general view is for policy rates to continue to be raised to tame inflation, while targeted fiscal measures address high energy (and in some cases food) prices. In addition, most observers believe financial stability concerns should be addressed through specific interventions, as recently evidenced by the BoE's buying of long-dated government bonds. Finally, for all the discussion on potential financial vulnerabilities, there was no consensus on where the vulnerabilities currently lie.

The IMF's growth expectations continue to step down

Annual real GDP forecasts for 2023 (%)



Source: Goldman Sachs Asset Management, IMF World Economic Outlook. As of October 2022.

3. Bearish sentiment unmatched by investment allocations. Sentiment on economic conditions and towards investment risk-taking was undoubtedly bearish. However, this did not appear to translate into appetite for government bonds, likely due to the broad-based view that we have not yet reached peak policy hawkishness.

WHEN WILL THE FED PIVOT?

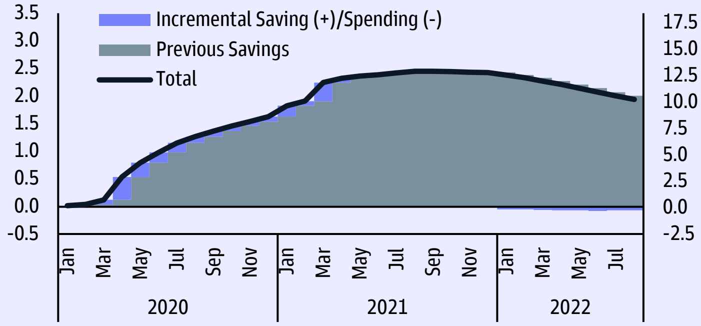
Last week, we outlined how the US economy had made further progress on its narrow path to a soft landing. This week, we review the impact of higher rates on the domestic economy and conclude the Fed is unlikely to pivot from its current policy stance just yet. Next week, we review foreign spillovers.

Households

Households benefit from favourable employment opportunities and balance sheets are strong in aggregate. Further, the interest rate burden—which stands at 3.2% of GDP—remains lower than the 4.5% pre-pandemic level, and well below the 8% and 10% seen pre-financial crisis and in the 1980s, respectively[1]. A larger share of fixed rate mortgages may also delay the passthrough of higher rates in the current cycle. As a result, household loan delinquency rates are contained. Looking ahead, households faces headwinds from weak real income growth and higher borrowing costs, and the excess savings stock is falling (see Chart). But for now, we do not see a Fed pivot on concerns around the US consumer.

US households have spent ~20% of excess savings

US household excess savings* ($ trillion, left) (% of 2022 income, right)



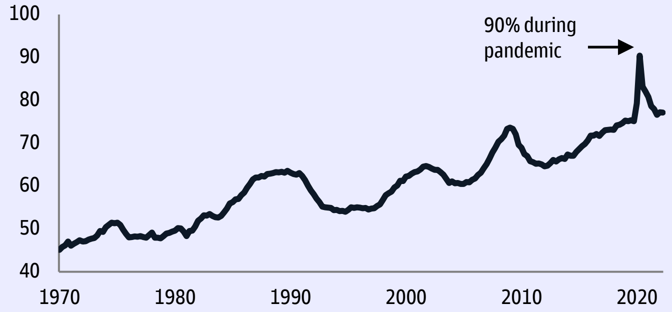
Source: Goldman Sachs Global Investment Research US Consumer Dashboard (October 17, 2022). *Defined as savings minus savings level implied by pre-pandemic saving rate.

Corporates

US corporate debt-to-GDP stands at 77%, marginally above pre-pandemic levels (see Chart). Importantly, if we assume Prime Rates apply to all outstanding corporate debt, the interest burden is one third of what it was at a peak in the 1980s[1]. In other words, interest costs are not yet particularly concerning in a historical context. Moreover, as noted in our latest Credit Check-In, we believe low near-term funding needs combined with strong balance sheets will allow many high-quality companies to navigate the higher rate environment.

The US corporate sector is not particularly levered

US corporate debt-to-GDP (%)



Source: Goldman Sachs Asset Management, Haver Analytics. As of June 2022.

Government

The increase in debt in the US economy since the financial crisis has been centred in the public rather than the private sector. That said, the government has benefited from an increase in tax revenues, while its interest burden (relative to GDP) is only marginally above pre-pandemic levels and is below the 16% levels observed in the 1990s.[1] Government debt has also benefited from a new buyer in recent years: the Fed. Although the higher stock of debt suggests the interest burden could rise quickly, we do not think these concerns will deter the Fed from its tightening path.

10% US government interest burden (% of GDP) – 40% of what it was in the 1980s[1]

25% Amount of government debt held by the Fed[1]

[1]Source: Goldman Sachs Asset Management, Goldman Sachs Global Markets Division. For clients with access to Goldman Sachs Marquee, see 4 Charts – Can US households / Corporates / Govt. handle the pace of Fed hikes? (October 10, 11 and 12 series).

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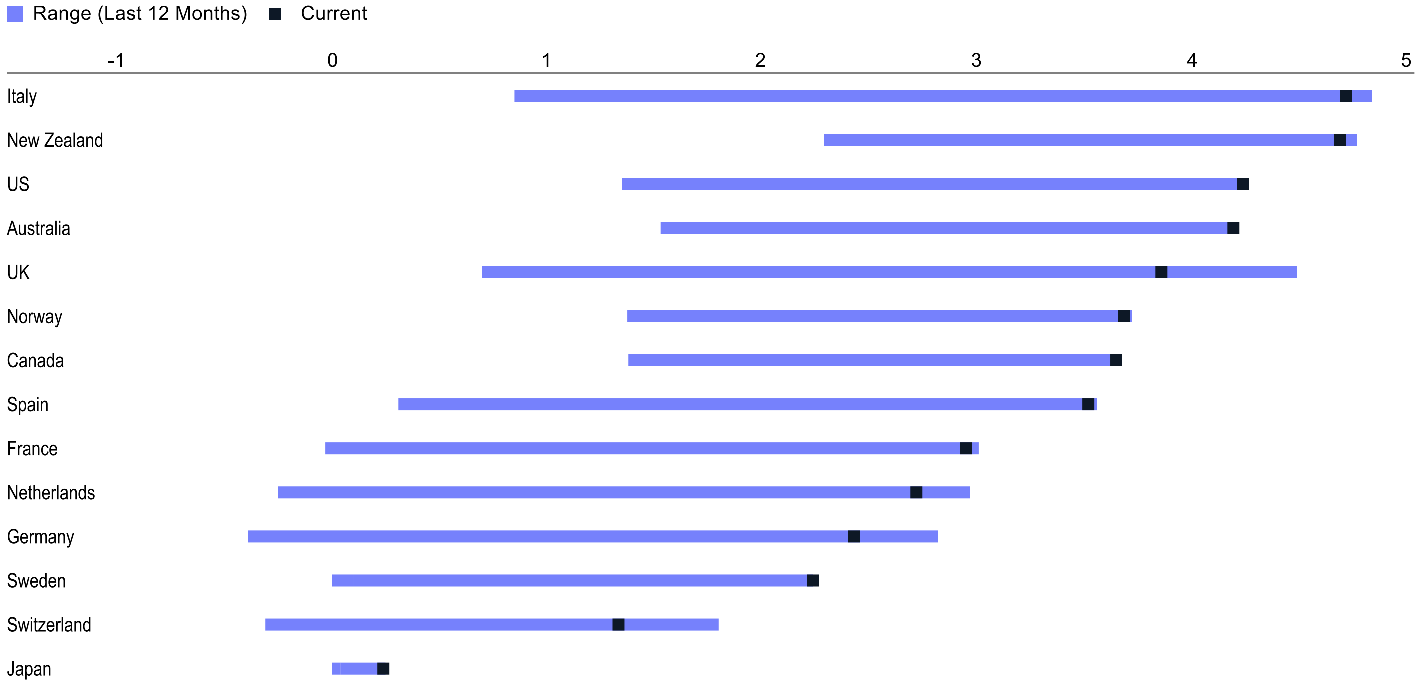
CENTRAL BANK SNAPSHOT

	Interest Rate Policy	Balance Sheet Policy	Outlook	Our outlook relative to market-implied pricing
Fed	Federal funds rate: 3.0-3.25% Last changed: September 2022 (+75bps) July 2022 (+75bps) June 2022 (+75bps) May 2022 (+50bps) March 2022 (+25bps)	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). Balance sheet size: 37% of GDP	We expect a 75bps rate hike in November followed by a 50bps rate hike in December and 2023. However, we flag substantial upside risks to the December hike. Expected terminal rate: 4.75%-5.0%	Neutral
ECB	Deposit facility rate: 0.75% Last changed: Sept 2022 (+75bps) July 2022 (+50bps), the first hike since 2011	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. Balance sheet size: 65% of GDP	We expect a 75bps rate hike at the October meeting followed by 50bps hikes at the December and February meetings. Expected terminal rate: 2.5%.	Slightly dovish
BoE	Bank Rate: 2.25% Last changed: September 2022 (+50bps) August 2022 (+50bps) June 2022 (+25bps) Prior changes: May 2022 (+25bps) March 2022 (+25bps) February 2022 (+25bps) December 2021 (+15bps)	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. The BoE announced it will temporarily purchase long-dated UK gilts until October 14 and postpone gilt sales until October 31. Balance sheet size: 30% of GDP	We expect a 100bps hike at the November meeting followed by a 75bps hike at the December meetings and two 50bps hikes in early 2023. Expected terminal rate: 5.0%.	Slightly dovish
BoJ	Policy deposit rate: -0.10% Last changed: January 2016, when the Bank introduced its negative interest rate policy (NIRP) 10-year JGB yield target: ~0%, with tolerance band of -/+25bp (yield curve control policy)	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. Balance sheet size: 135% of GDP	We expect unchanged policies through 2022 but see scope for a rate hike in 2023.	Hawkish

Source: Goldman Sachs Asset Management. As of October 7, 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.

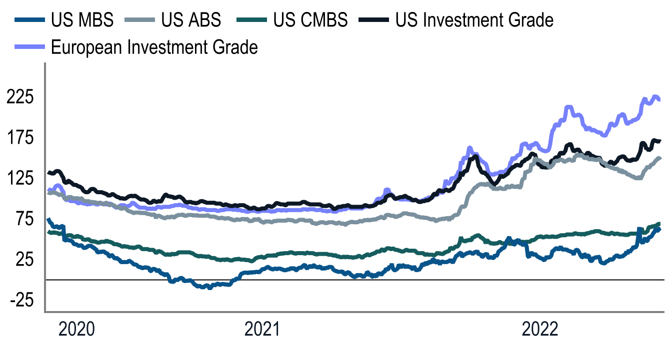
10-YEAR SOVEREIGN BOND YIELDS (%)



Source: Goldman Sachs Asset Management, Macrobond. As of October 21, 2022.

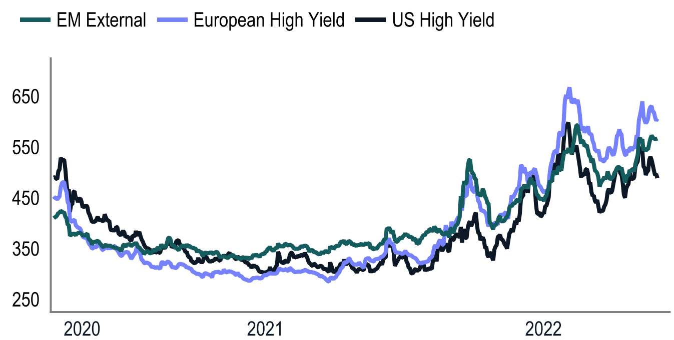
FIXED INCOME SECTOR SPREADS

Investment Grade and Securitized Spreads (bps)



Source:: Macrobond. ICE BoAML indices. As of October 20, 2022.

High Yield and Emerging Market Spreads (bps)



Source: Macrobond. ICE BoAML indices. As of As of October 20, 2022.

PAST MUSINGS

MUSINGS — October 14, 2022

MUSINGS — October 7, 2022

MUSINGS — September 30, 2022

MUSINGS — September 23, 2022

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Index Benchmarks

Indices are unmanaged. The figures for the index reflect the reinvestment of all income or dividends, as applicable, but do not reflect the deduction of any fees or expenses which would reduce returns. Investors cannot invest directly in indices.

The indices referenced herein have been selected because they are well known, easily recognized by investors, and reflect those indices that the Investment Manager believes, in part based on industry practice, provide a suitable benchmark against which to evaluate the investment or broader market described herein. The exclusion of "failed" or closed hedge funds may mean that each index overstates the performance of hedge funds generally.

Sector Spread Indexes

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

Past performance does not guarantee future results, which may vary. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur.

Abbreviations: US Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ), Swiss National Bank (SNB), Central Bank of Sweden (Riksbank), Reserve Bank of New Zealand (RBNZ), Central Bank of Norway (Norges Bank) Bank of Canada (BoC), Reserve Bank of Australia (RBA), Quantitative Easing (QE), Quantitative Tightening (QT), Pandemic Emergency Purchase Program (PEPP), Consumer price index (CPI), producer price index (PPI), developed markets (DM), emerging markets (EM).

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