Week Ahead

28th June – 2nd July 2021

First Nonfarm Payrolls since Fed may cause significant volatility

Volatility in FX markets this week was largely driven by markets trying to price in the hawkish shift by the FOMC last week. Notable commentary from Fed members such as Bostic, Kaplan and Bullard provided markets with a bit more of an insight into the growing calls for earlier policy normalisation, while Chair Powell also stated that near-term inflation was more aggressive than the FOMC expected. On the whole, broad dollar moves drove price action in G10 currency pairs, with the exception of the pound on Thursday, which fell due to the Bank of England signalling a more dovish reaction function than previously suggested.

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> Next week, the focus remains largely on the US, with the release of the first Nonfarm Payrolls report since last week's Fed meeting.

Calendar

Monday – 28/06

The start of the week is light on the calendar with **Bloomberg's weekly Nanos confidence for Canada at 13:00 BST**, a sentiment measure based on household surveys, being the main data release of note. The confidence indicator hit highs not seen since 2018 earlier in June before moderating from 66 to 65.2 last week, the lowest reading in four weeks.

The European Central Bank's weekly asset purchase data under the Pandemic Emergency Purchase Programme (PEPP) is also released on Monday. Investors will carefully watch this data as we enter Q3, following the ECB's June meeting which discussed that purchases under PEPP will remain "significantly higher" compared to the start of this year. The high levels of purchases in Q2 leave room for the ECB to reduce bond-buying in Q3 moderately while still keeping higher levels of asset purchases compared to Q1. However, the true level of Q3 purchases is yet to be defined, placing the emphasis on the weekly data for a clearer signal of the quantitative target.

Tuesday – 29/06

Tuesday's data dock is filled with eurozone economic data, starting with **French consumer confidence from June at 07:45 BST.** The prior reading printed at 97, and with confidence in the eurozone growing as the pace of vaccinations has picked up throughout the entire quarter and many lockdown measures have been eased, consumer confidence is expected to rise through the 100 breakeven level.

At 08:00 BST, Spanish retail sales are on the agenda. Similar to last time, when the seasonally adjusted yearly figure printed at 41.0%, this month's year-on-year print will be distorted by base effects as last year's base was unusually low due to the lockdown. CPI inflation readings from Spain will be released at the same time, and markets will watch the month-on-month print to gauge how quickly prices are growing. Again, the year-on-year print will be distorted by base effects. The same holds for **German CPI inflation at 13:00 BST,** which printed at 0.5% MoM previously.

Wednesday – 30/06

Chinese manufacturing and non-manufacturing purchasing managers' index figures from June are set to be released at 02:00 BST on Wednesday. Last month's reading of the non-manufacturing index was supported by spending during the Golden Week holidays, which means this month may show a correction down from those levels. For the manufacturing index, a further moderation from last month's 51.0 reading is likely.

French CPI inflation comes in at 07:45 BST on Wednesday after May's reading showed an increase of 0.3% MoM and 1.4% YoY, before Italy and the eurozone come out with inflation prints at 10:00 BST.

The inflation data will be watched by investors even as the European Central Bank noted any overshoots are likely to be transitory.

A paper published by the ECB earlier this week, which put emphasis on the role of fiscal policy in increasing inflation more sustainably, suggests the ECB may be moving to a flexible inflation target in the review which is expected to conclude in September. **German unemployment figures will be released at 08:55 BST** after unemployment claims fell consequently throughout this year. The unemployment rate itself should still be distorted by the government labour support schemes, which means cues for the euro may be more limited. In the latter part of the trading session, **June's ADP employment change data from the US at 13:30 BST** will be watched ahead of Friday's pivotal Nonfarm payrolls. The ADP report itself usually is not a market mover, however, it may give investors insights on what to expect for Friday's figure.

At 14:30 BST, April's GDP figures from Canada are set to be published. Risks are skewed to the downside with the April figure given the renewed lockdown measures in Canada around April.

Thursday – 01/07

On Thursday, manufacturing purchasing managers' data from several eurozone countries will be released between 08:00 and 09:00 BST. For Germany and France it concerns final readings as the preliminary prints were published this week. The first readings from other nations can give markets an idea of what the numbers in Spain, Italy, the Netherlands and the eurozone as a whole may look like, and whether optimism about the bloc's recovery remains high.

At 07:30 BST, just an hour before the Riksbank policy decision, Sweden will come out with manufacturing PMI data for June as well. PMIs have remained elevated throughout the year for Sweden. Not only did the manufacturing sector prove resilient to the lockdown measures, as in many developed nations, but Sweden's general activity was little harmed by the restrictions since April as a whole according to mobility data from Apple and Google.

> "The Riksbank's asset purchase programme is set to expire in December and this is likely to remain unchanged at next week's meeting."

At 08:30 BST, the Riksbank announces its policy decision. In the absence of any fresh economic projections, which are due in July, markets will focus on the Riksbank's stance on inflation going forward, especially as their communication so far this year has been on the more dovish side.

Friday – 02/07

On Friday, all focus will be on the labour market report from the US, including the **Nonfarm Payrolls, unemployment rate, labour force participation and earnings at 13:30 BST.** A separate piece on this is included below. **At 15:00 BST, US factory orders and durable goods orders will also be released.** Since the Federal Reserve's latest hawkish shift, markets may pay more attention to these data prints going forward as they attempt to predict the timing and magnitude of the next policy step. If the data compounds the narrative outlined by the Nonfarm Payrolls data, the earlier trend in the dollar may be extended. **Canada's markit manufacturing PMI is then up at 14:30 BST** but may not show a further increase as the easing of the latest lockdown conditions bear little impact on that sector.

Volatility to rise around Friday's NFP as Fed's reaction function becomes more sensitive

One of the main takeaways from June's Federal Reserve meeting was the FOMC's interpretation of the Average Inflation Targeting (AIT) framework. Previously, Fed members projected that rates would remain on hold over the coming two-year period as inflation would prove transitory and the economic recovery remains uncertain.

However, in June, Fed members showed increasing conviction in their forecasts of the recovery, while the actual point forecasts experienced very little changes beyond 2021. The increased confidence in the economic forecasts, highlighted by narrowing central tendencies, and the near-term revision to inflation and growth forecasts resulted in the median interest rate projection rising from no-change in 2023 to predicting two 25bp rate hikes. Taken overall, and with core PCE inflation and the unemployment rate still expected to print at 2.1% and 3.5% in 2023 respectively, the adjustment in the Fed's dot plot suggests the central bank's reaction function can now be viewed as more sensitive to near-term economic developments.

> On the inflation front, increasing price growth in the short-term is likely to have limited spillover into policy expectations, but any signs of persistence are likely to embolden claims for faster and earlier QE tapering and potential rate lift-off in 2022.

However, given the lack of clarity over the Fed's averaging timeframe and how forward/backward looking it is, the FOMC can effectively keep moving the goalposts such that it fits their efforts under the dual mandate. In this regard, while we expect inflation data to fuel the debate among market participants and Fed members over the timing and speed of policy normalisation, we expect the labour market data will be more influential for actual policy moves.

June's Nonfarm Payrolls are unlikely to show a pick-up in employment growth, but that may not stop it from causing substantial market volatility.

The recovery in headline employment has been slow going over the past two months, with the change in Nonfarm Payrolls averaging 418.5k. Both times, the data has printed substantially below expectations. There are a number of factors that can be attributed to the slower net employment growth. Seasonal adjustments have diluted headline employment growth as the economic reopening coincided with seasonal employment gains, increased unemployment insurance payments and other government transfers has restricted the rebound in labour supply, schools breaking for summer has limited labour supply due to childcare concerns, and administration constrains has limited the amount of hiring's that can be processed within a month. While some of these constraints, such as administrative ones, are likely to remain, factors causing a labour supply shortage are expected to moderate somewhat come September. Until then, headline employment growth may continue to show

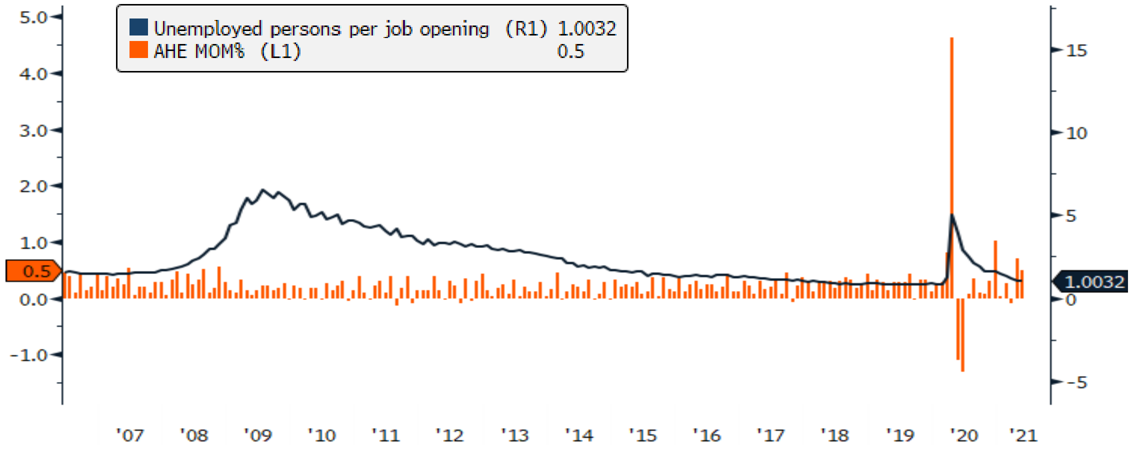
show a sluggish labour market recovery, while dislocation in the labour market results in rising wages. With the US Treasury curve bear steepening and the DXY index trading 1.5% higher after the FOMC decision, the risks heading into Friday's NFP release are tilted towards the headline employment figure undershooting expectations. The median expectations supplied to Bloomberg envisages a headline employment gain of 690k in June, which would be the largest employment gain since March. However, many of the headwinds to job creation are set to remain in place. The latest initial jobless claims data and June's flash PMIs also suggest that the risks of Friday's data under delivering expectations are substantial.

On Thursday of this week, initial jobless claims data fell less than expected, with the 7k decline in the week of June 19th being far smaller than the 38k expected. Additionally, this week's release of flash PMI indices for June indicate strong, although moderating, hiring intentions from businesses.

However, June's headline employment data won't be enough to change the Fed's overall view

Despite our expectations of headline employment undershooting expectations on Friday, we don't think it will have far-reaching market implications. Instead, short-term volatility is the likeliest result. This is because the singular data point is unlikely to change the Fed's medium-term view on the labour market recovery and, in turn, will have little impact on moderating the market's expectations of US rate hikes across multiple instruments. The Federal Reserve has made it clear that they expect the labour market recovery to speed up in the second half of the year as constraints on labour supply ease, likely once unemployment insurance top-ups elapse on a broader scale in September and schools reopen after Summer. On top of this, strong tailwinds such as elevated job openings and improving demand conditions remain in play.

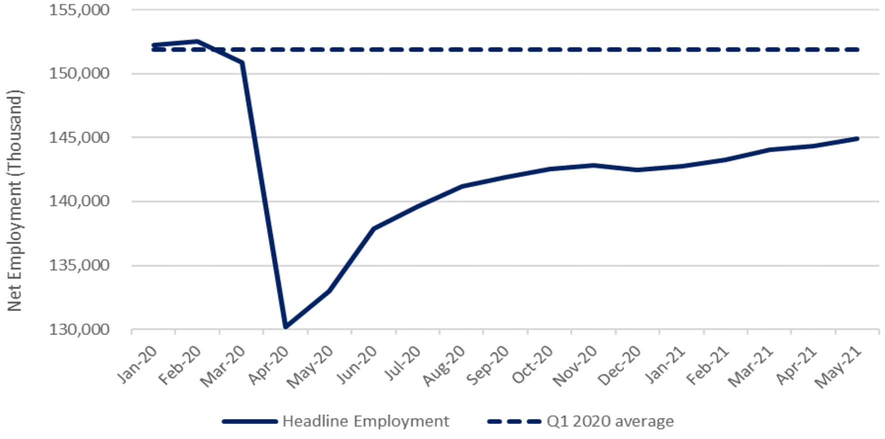
Unemployed to job opening ratio steadily declines, suggesting further job gains will be supported.

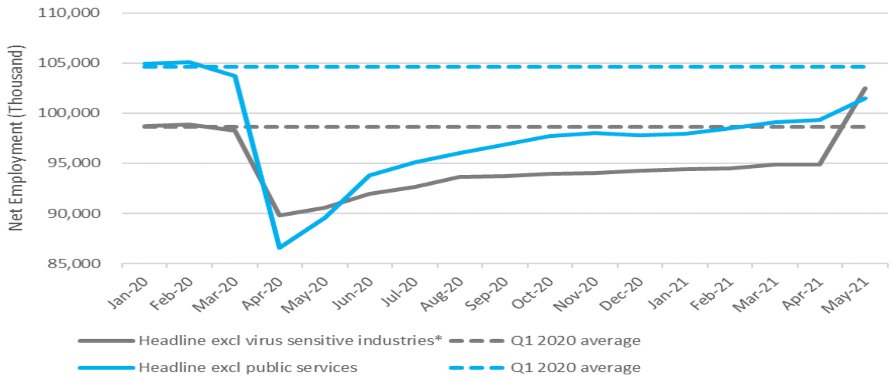


The headline data doesn't show the full story either. Geographically, labour shortages are more concentrated in states where Federal transfers remain elevated, suggesting further job gains are to be squeezed out once they elapse in Q4. On an industry level, the labour market also looks stronger than the headline data suggests. Employment in industries less susceptible to virus restrictions has already recovered to pre-pandemic levels. As the health backdrop improves and wage growth filters into these sectors over the coming months, employment in virus sensitive industries is also likely to increase, similar to in Canada. Meanwhile, employment in public services is set to pick-up in the latter part of the year once fiscal stimulus is released and education services reopen.

Headline employment doesn't tell the full picture of the US labour market.

**Virus sensitive industries include; Trade, Transportation, and Utilities; Information; Leisure and Hospitality; and Other Services.*





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