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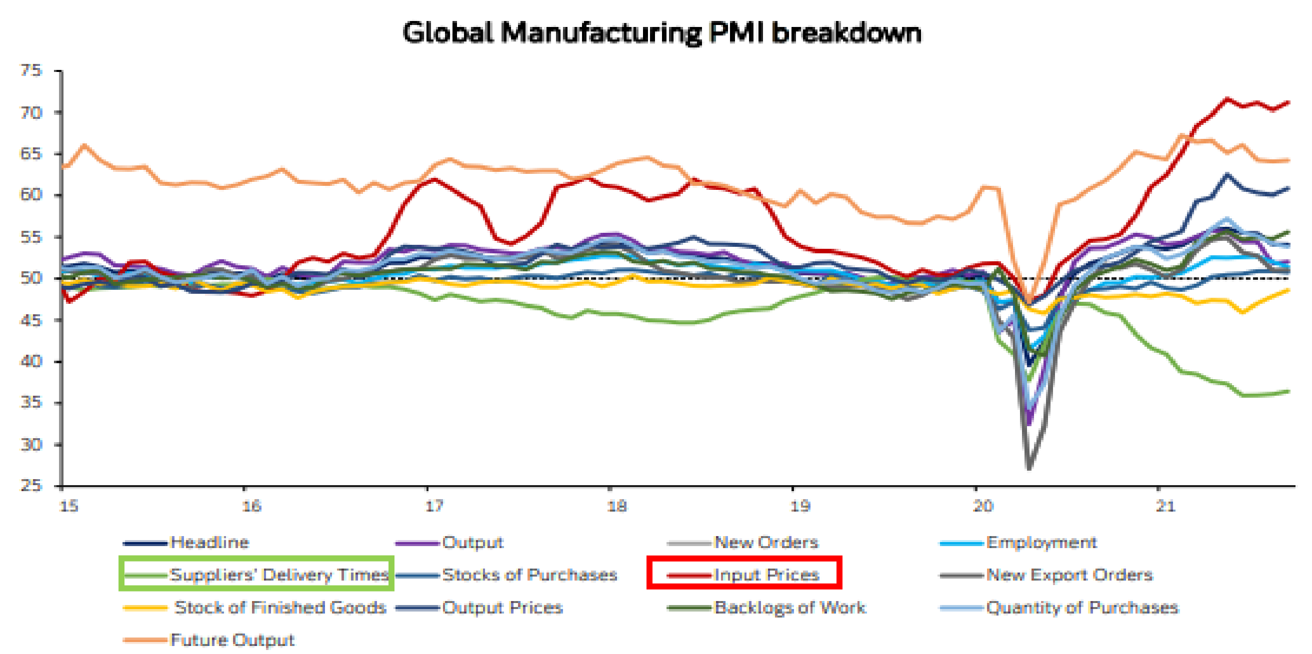
What to focus on in Global Macro for the week of October 4th, 2021

Macro Themes on the Radar:

The macro landscape is becoming increasingly messy. With inflation higher and not yet backing off, and the labor market still well below its pre-COVID levels, markets and central banks have lots to ponder. It has been a long time since the world has faced a scenario in which supply constraints are everywhere and are feeding inflation and holding back growth. There is lots of talk about stagflation as we face an upgrade to inflation and a downgrade to growth expectations, at the same time. That is a very different backdrop from the H1 reflationary environment that lifted most assets. Consumer spending has not been living up to high expectations as they reject higher prices and there remain questions about how earnings expectations will hold up if margins come under pressure.

While PMIs have come off the boil, as you might expect, there is lots of uncertainty about the degree to which the higher costs and supply constraints are holding back production.

Figure 1:Global Manufacturing PMI breakdown -Supplier deliveries show signs of stabilizing at v.poor levels as do price indices at very high levels.



Source :Deutsche Bank, IHS Markit, Datastream.

Faced with high global asset valuations and a potentially stagflationary mix for the time being, central banks are increasingly in a difficult situation that potentially carries a high cost if policy mistakes are made.

Various EM and commodity-linked countries have already seen interest rate hikes, and more are expected in the coming weeks. However, this is a very tricky scenario as central banks can most directly goose or throttle back demand but have very little control over these kinds of supply bottlenecks and constraints.

This Friday brings the latest update on employment. It is an important one, as it will be the last official update before the Fed's November 3rd policy meeting at which they are now widely expected to announce a tapering of asset purchases. Remember, Powell set the bar pretty low when he said that given the accumulated gains, only a "decent" number is needed for September.

An imminent government shutdown has been avoided, but the debt ceiling wrangling will continue this week. We will get a lot more headlines about the infrastructure bill and the "Build Back Better" plan as the Democrats try to hammer out the size and details of their reconciliation package.

China - We may not hear much out of China this week as they go on holiday, but there continues to be plenty brewing below the surface.

Policy and growth concerns remain. As mentioned previously, the Evergrande default isn't material if it is a one-off, but if it is a broader problem, look out. A number of other large developers are being closely watched. Sunac, which has denied asking for government assistance, has however admitted that it has seen a 30% fall in sales y/y. Another large developer, Fantasia, was downgraded by S&P to CCC, on repayment risk.

In the meanwhile, tensions with Taiwan remain high as China sent 38 fighters into Taiwan airspace on Friday, followed by another 39 on Saturday.

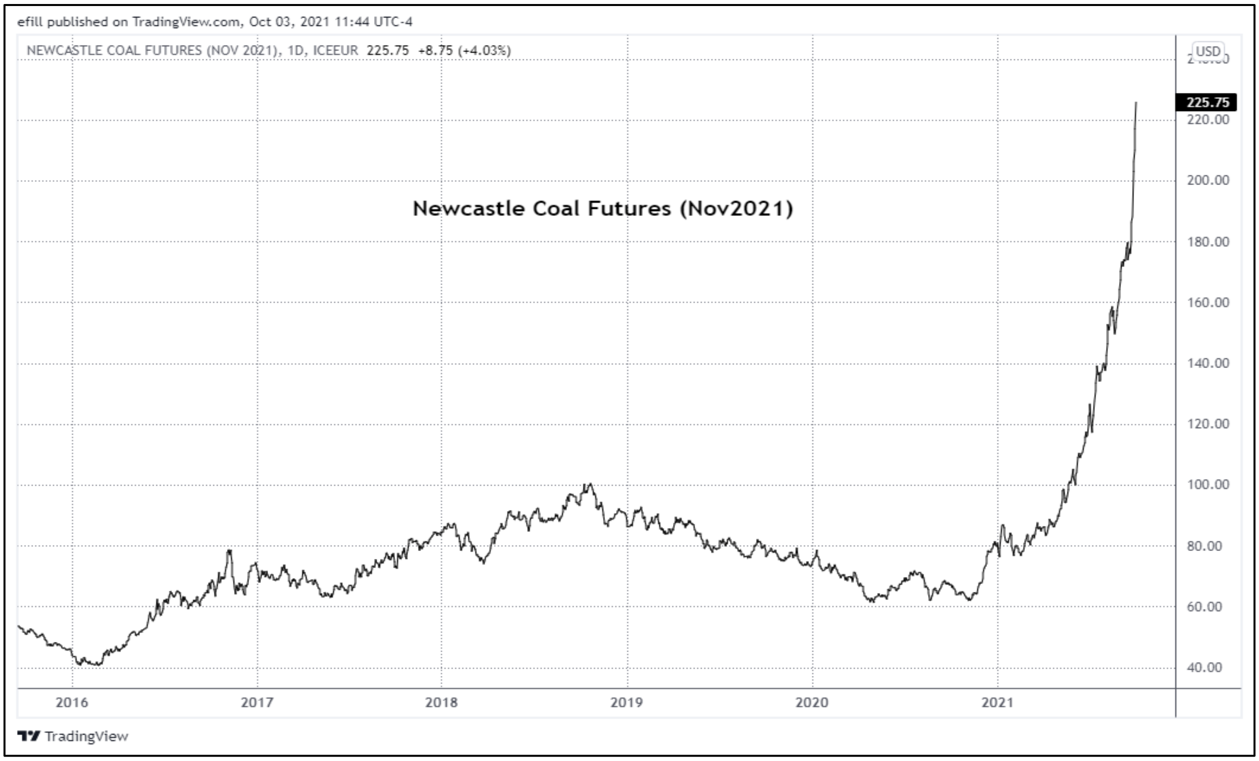
A number of sell-side analysts now see US growth beating Chinese growth over the next few quarters, something that has not happened since 1976.

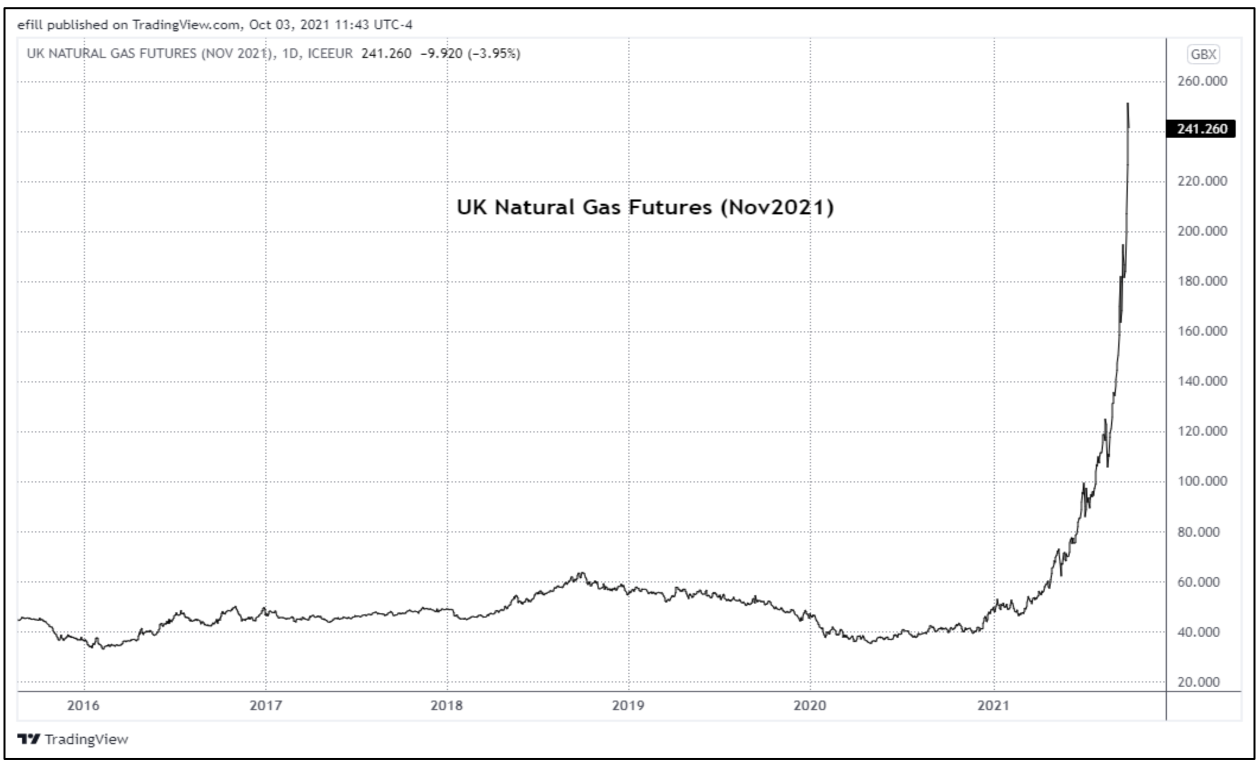
The combination of more aggressive US fiscal and monetary stimulus and a less restrictive COVID policy have certainly contributed. The extent to which this growth differential will pressure Chinese authorities to take action will be an important variable in the coming months.

In the meantime, the growing global energy crisis is raising the prospects for rolling blackouts across provinces in the coming weeks. That will not only delay production but likely create a powerful response as China's self-image will feel threatened. Already, during an emergency meeting last week, Vice Premier Han Zheng ordered the country's top state-owned energy companies to secure supplies for the winter at all costs.

However, China is not alone as it faces this energy crunch. Europe and the UK continue to see short supply and dramatic price jumps in coal and natural gas.

We will see if this starts to materially weigh on European equity markets.





What to Focus on Now:

Last week was all about the continued selloff in global bond markets, and at the end of the week, the partial reversal.

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The front end of the curve led on the way up and again on the way down.

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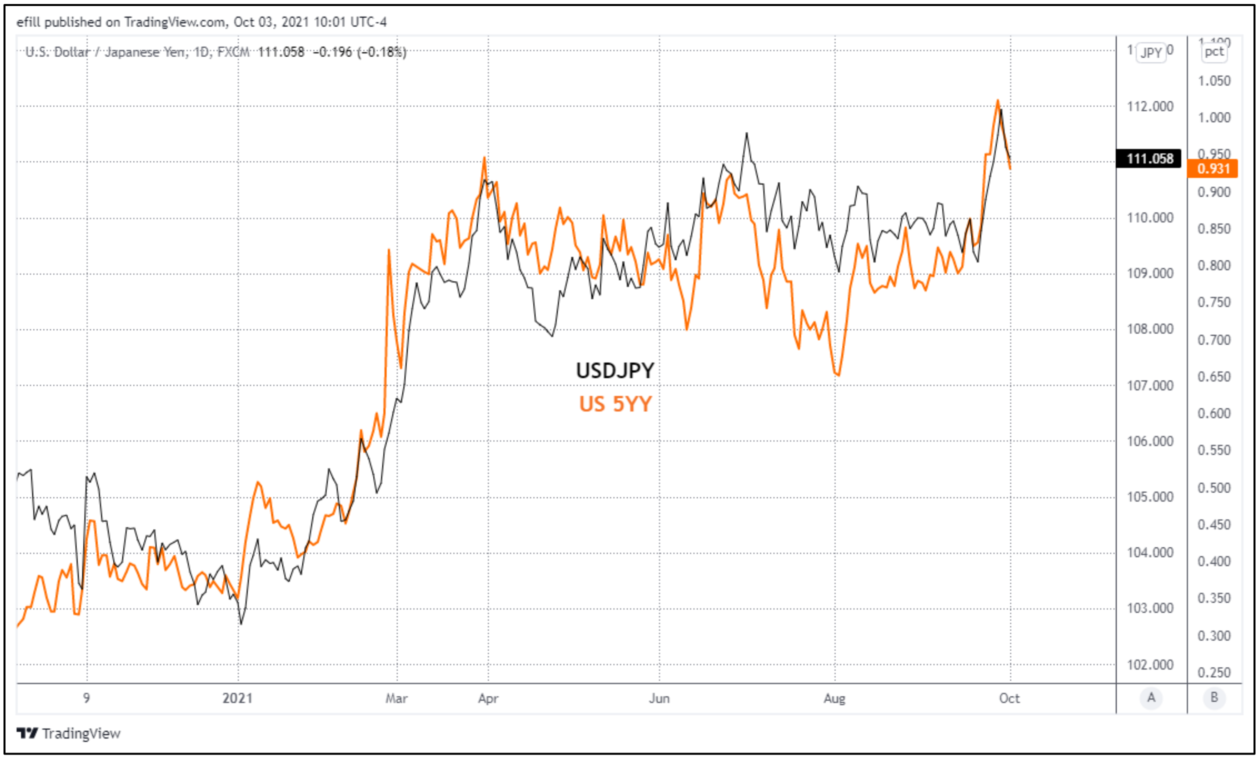
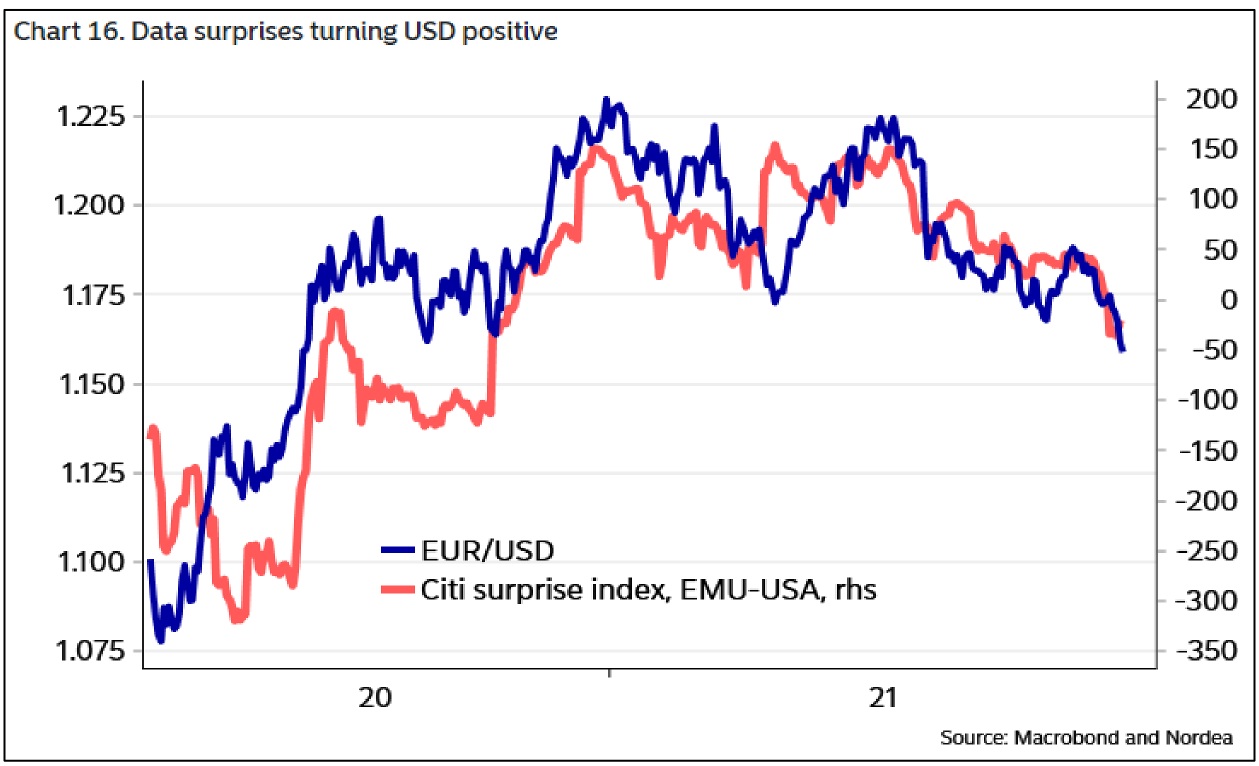
The curve continued to steepen last week.

The dollar had a good week, and while it gave back some gains as yields came back off, it has taken out some big levels. Further USD strength will unleash a new dynamic across markets.

Currencies like EUR, JPY and CHF have been very correlated to US yields.



As mentioned last week, economic data has started to surprise in favor of the USD.



Interest rate and USD moves have certainly contributed to a pick-up in equity volatility.

So far, the selloff hasn't hit my inflection points in the NDX or the SPX.

The move in energy and interest rates is helping some sectors outperform. On a relative basis, energy held the critical level and is likely heading for the top of the range again.

While yields are supporting the Russell on a relative basis.

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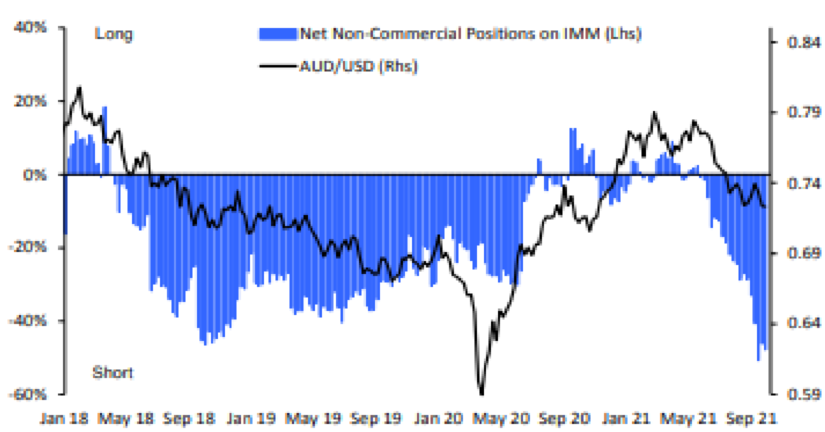
Europe still looks vulnerable to me here…. There continues to be plenty of divergence, as momentum runs out.

On a relative basis, the US is threatening to again start outperforming Europe.

The DAX hit my inflection point two weeks ago and has provided good opportunities to trade the delta around a long volatility position, since then.

If I was going to go with a dollar short here (contrary to my overall USD view) I would have a look at buying AUDUSD. One of the few meaningful FX positioning extremes in the market at the moment is short AUD.

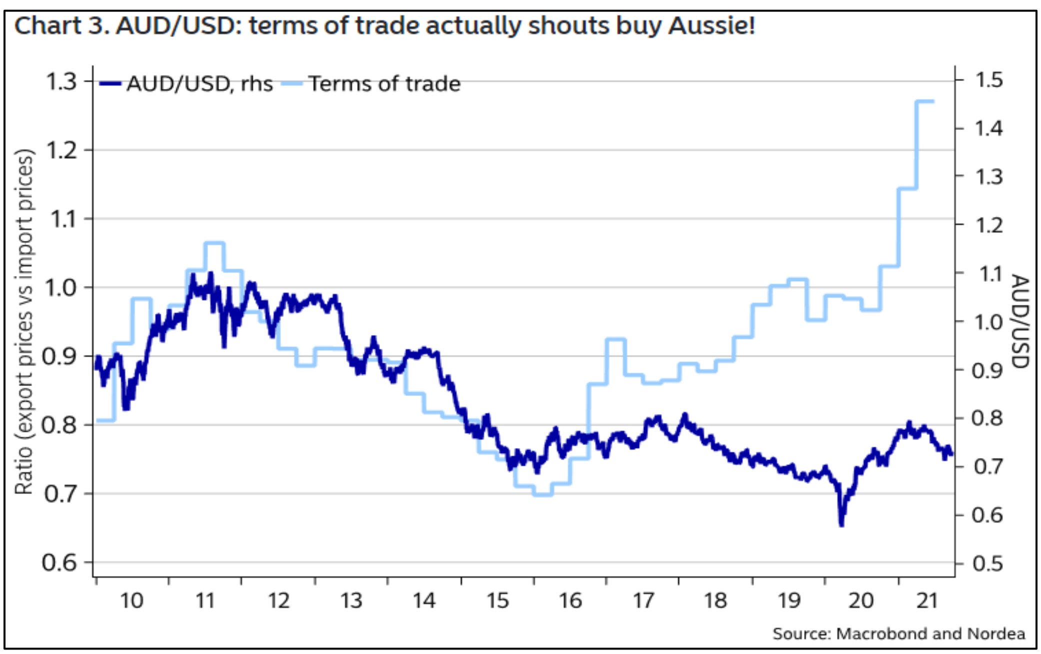
Figure 16: Speculative AUD positions



Source : CFTC, Deutsche Bank

The reasons are well known, China relations and growth, COVID lockdowns, etc., yet with the recent USD strength, AUDUSD has not been able to make new lows. If anything, a .7300 break would make it look interesting to the topside.

From a terms of trade perspective, AUD looks well supported.



At least in the near term, long AUD looks potentially interesting, even if only on a relative basis vs. EUR. At a minimum, AUD looks like a poor short here.

Another potential contrarian outcome to keep an eye on is the Oil vs. USD relationship.

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It isn't something for today or tomorrow, however, if USD strength continues or accelerates, oil will become very sensitive to any signs that the energy crunch is starting to break. Just one to keep in your back pocket for now and watch how it develops.

Important Macro Data Releases and Events for the Week

Monday 10/4/2021	OPEC Meeting Factory Orders MoM (Aug) RBA Interest Rate Decision and Policy Statement
Tuesday 10/5/2021	Markit PMIs across Europe (final) (Sep) Markit PMI and ISM Services
Wednesday 10/6/2021	**ADP Employment Change (Sep) Forecast: 475k, Prior: 374k**
Thursday 10/7/2021	Initial Jobless Claims Forecast: -, Prior: 362k Initial Jobless Claims 4-week average Forecast: -, Prior: 340k Continuing Jobless Claims, Prior: 2.802M Caixin Services PMI (Sep) Forecast: 50.7, Prior: 46.7
Friday 10/8/2021	**Nonfarm Payrolls (Sep) Forecast: 500k, Prior: 235k** **Employment data and Unemployment rate (Sep)** Employment data (Sep) CPI YoY (Sep)

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