What to focus on in Global Macro for the week of August 2nd, 2021

Macro Themes on the Radar:

Fed

The Fed delivered pretty much what was expected last week. While they are now talking about tapering, as per Powell, "the labor market has a ways to go", and the unemployment rate of 5.9% "understates the shortfall in employment, particularly as participation in the labor market has not moved up from the low rates that have prevailed for most of the past year."

My guess is still that they have started penciling in the timing of the taper for September, possibly November, depending on the data. If the next two employment reports are sufficiently impressive, it will be September. The average forcast for Friday's employment number is around +900k, although some see gains over 1 million. Last week's core PCE came in a bit softer than the market had feared. We will see if the next CPI print confirms. The COVID resurgence will be on their minds as well, and how that plays out over the next few weeks will be important.

Equities at all-time highs and interest rates at, or near, historic lows, is resulting in the most accommodative financial conditions… well ever. However, the Fed remains very reluctant to take away "the punch-bowl". With such ample liquidity, stocks have remained the only game in town and volatility has remained subdued.

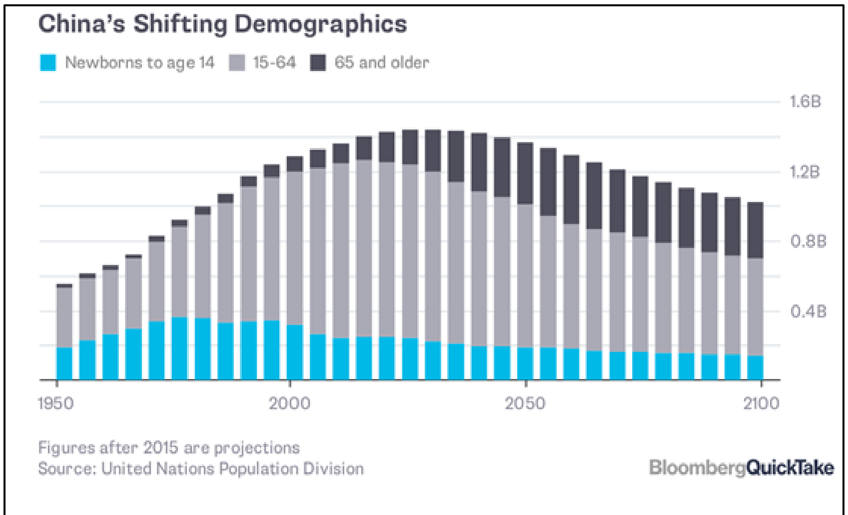
However, even with that very supportive backdrop from central banks, and continued (if slowing) fiscal spending, there are a number of developments to keep an eye on.

What to Focus on Now:

Markets have alternately been worried about rising inflation and bond yields, falling bond yields (does that means something sinister for global growth), the rate of vaccinations, and the current COVID resurgence. Residual effects of the lockdowns have generated extreme data prints, first to the downside, then to the upside. The resulting backlogs and bottlenecks have made it hard to see what awaits on the other side of the V-recovery. So far stocks have looked through all of it, thanks to the liquidity tailwind and the growth and earnings recoveries.

Last week the brewing challenges for Chinese markets found a tipping point. As the rolling crackdown progressed from technology companies to the property sector, healthcare, private education companies, and even hog farmers, markets started to worry. With technology now accounting for 38%, and real estate (including construction) for 28% of GDP, these affected sectors matter.

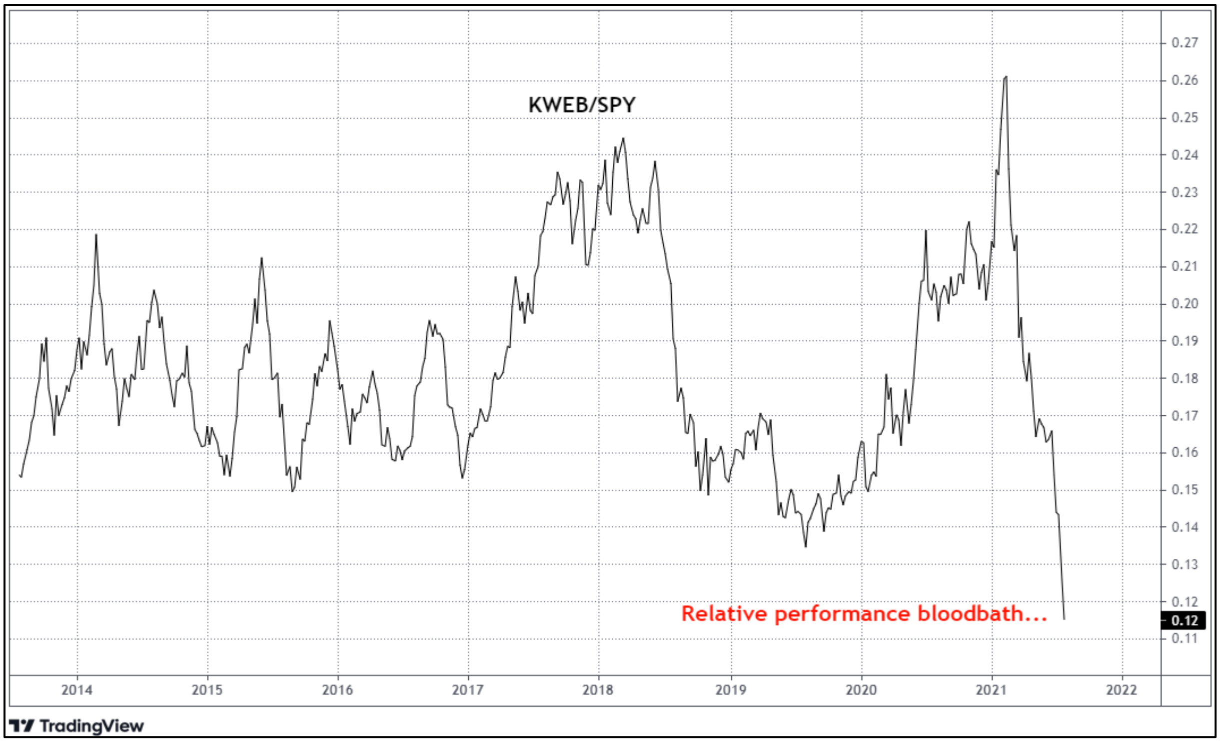
Chinese leadership seems focused on a few goals: 1) Risks to the financial system need to be controlled. They are trying to de-lever the economy to that end. On one hand the PBoC has cut the RRR (probably more to come) and last week added liquidity to the market. On the other hand, they are telling banks to raise mortgage rates in order to cool the property sector. In fact, recently the Ministry of Housing indicated that local governments will be held accountable for not managing rising property prices effectively. 2) Inequality should be reduced. 3) Beijing's authority must go unchallenged. 4) As demographics become a concern, official are trying to lower the cost of raising children, with at least one city now offering monthly payments if people have a second or third child.



United Nations Population Division

Last week, Chinese stocks posted their worst week since last February. Given the ugly break, I would be surprised, if after a pause, we don't see new lows in the coming weeks.

Chinese internet stocks (KWEB ETF) have been crushed vs. a resilient S&P 500.



Given the magnitude of the fall in Chinese equities, the US has held up very well, experiencing little contagion, so far.

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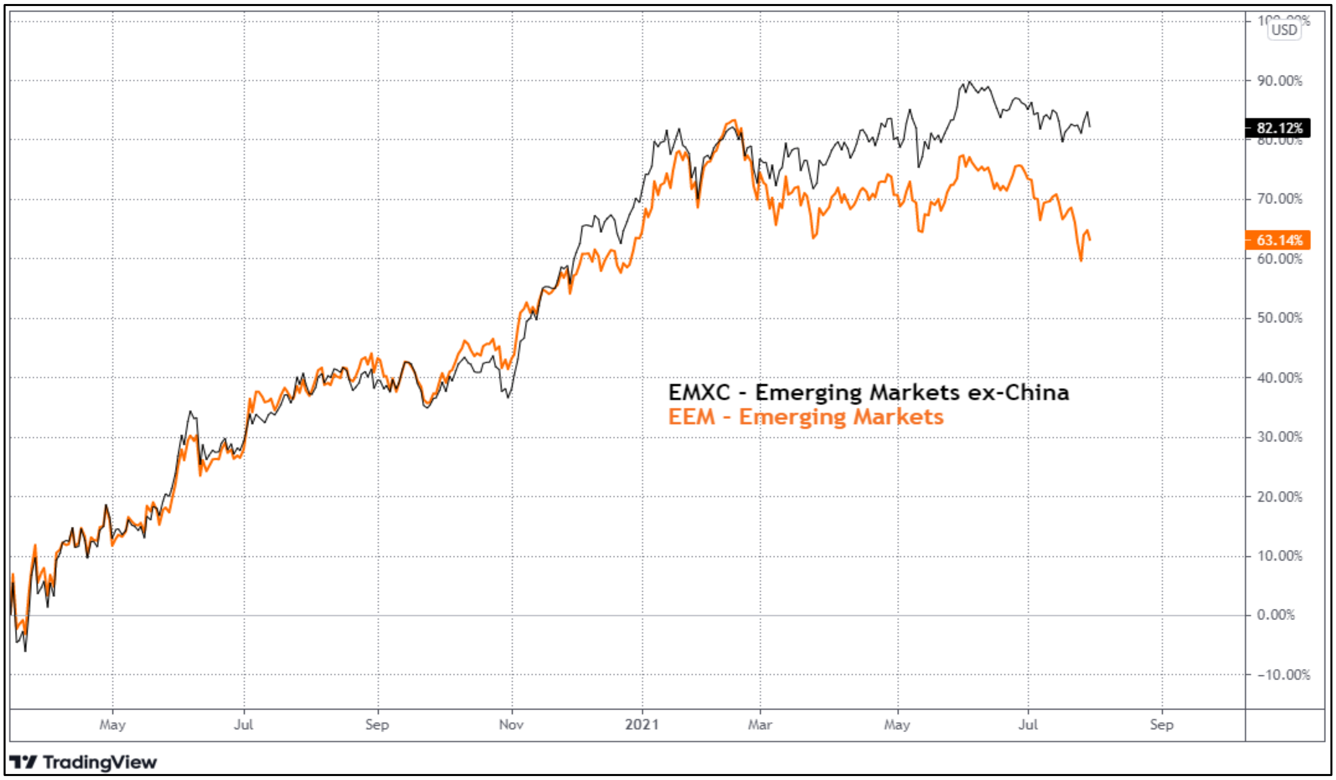
The VIX has remained calm, unlike what followed some other periods of Chinese equity weakness. So far, while investors are obviously having second thoughts about the investability of Chinese markets, the sell-off has been seen as an idiosyncratic issue, of China's own making.

Ex-China EM has held in well too, as the dollar hasn't run higher and commodities, like Copper and Iron Ore are not far from their highs.

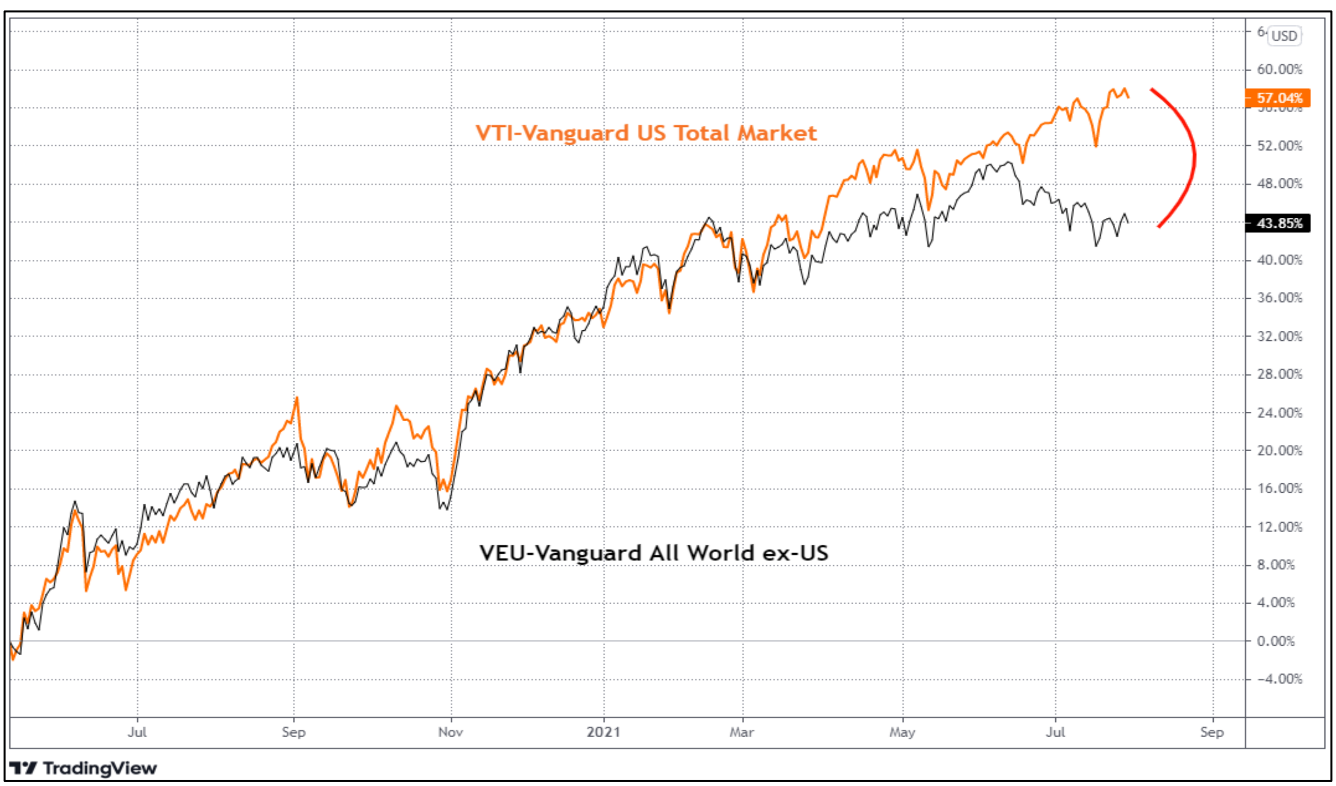
Both the dollar and industrial commodities are well worth watching here for signs that the situation unfolding in China is having knock-on effects on Chinese demand, potentially resulting in spillover consequences for global growth.

There have been growing divergences across a number of markets over the last few months, but over the last few weeks these divergences have begun to widen further. As we know, divergences can persist, sometimes for longer than one would expect, but they do tend to make markets more volatile and prone to sudden re-correlation.

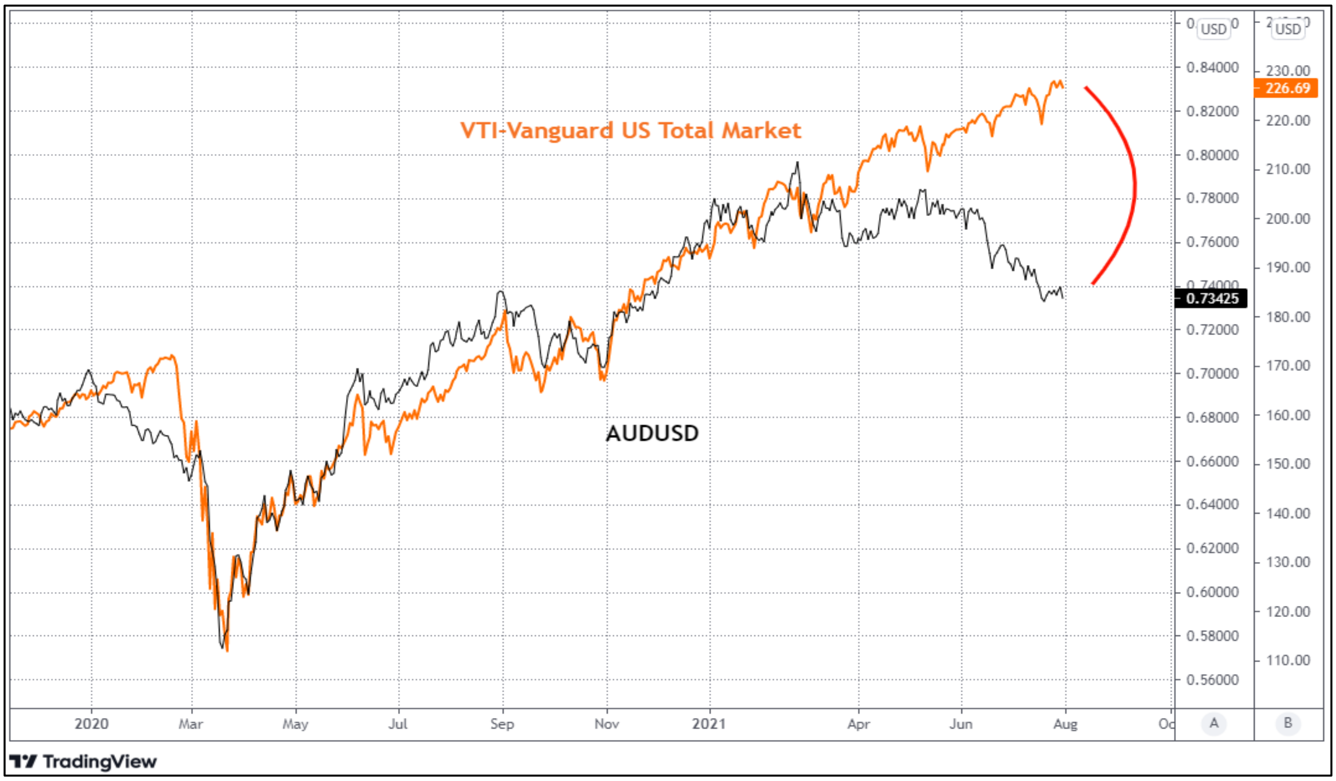
COVID makes it all much harder to parse, as there is always the possibility that the divergences are really just expressions of the varying infection/vaccination rates, and their growth consequences.



The broader markets are seeing growing divergences too, as the US remains the global leader.



The Australian Dollar's relative weakness could easily be attributed to low vaccination rates and the resulting continued lockdowns. That is well illustrated by the weak local PMI's. However, the AUD peaked back in mid-February, and the current China situation isn't helping. In a pre-COVID world, this price action would have been a signal to up your vigilance level regarding risk-on overall.



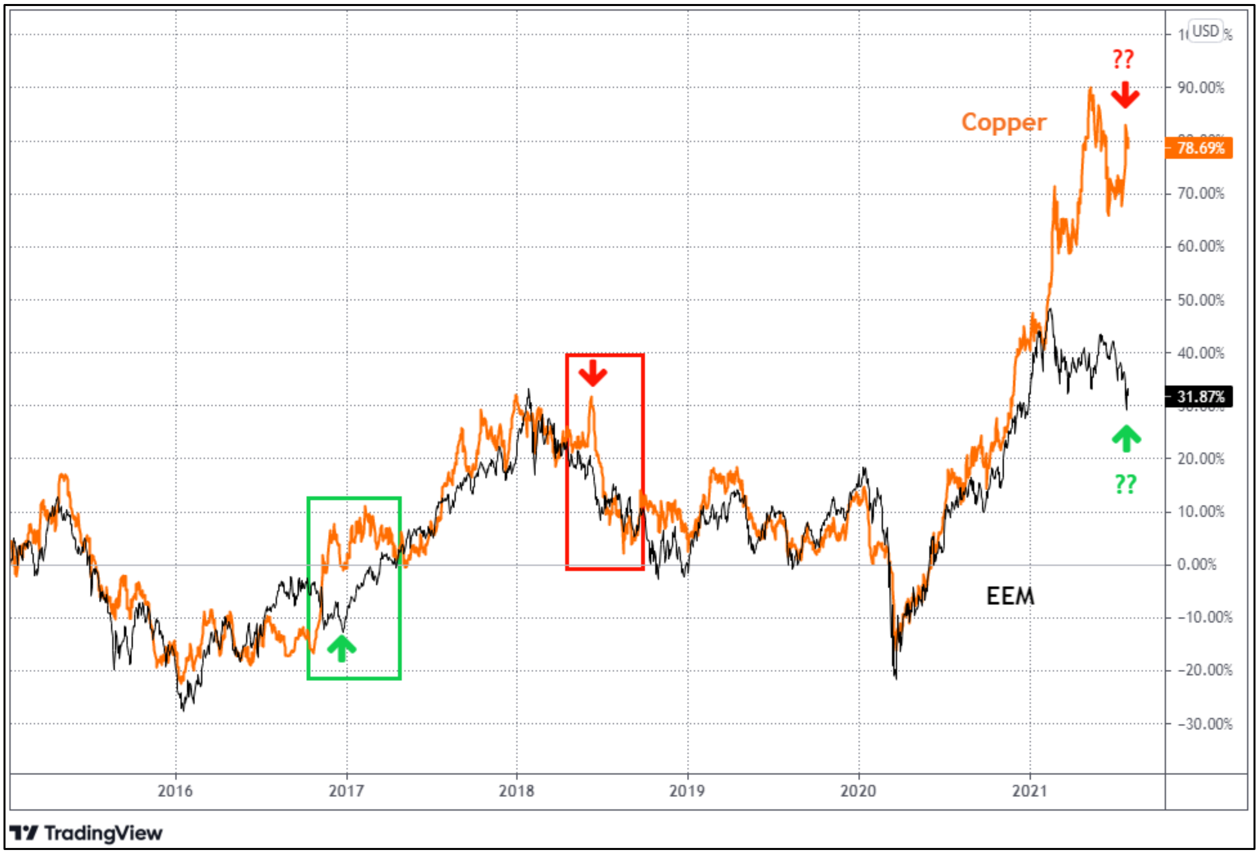
As the divergences add up, the NDX, and big cap tech, have continued to hold up very well. Even with Friday's ugly price action in a number of tech names, the NDX still managed to outperform the Russell by the close.

QQQ/IWM has gotten to my retracement window, as mentioned previously. A rollover from here, assuming its not led by the NDX getting thrashed, but rather by the Russell starting to perform, would be a good sign for value and global recovery trades. Of course, the opposite is true if this pair starts breaking higher again.

Given the previously mentioned divergences in other markets the volatility in this pair is likely to pick up again shortly, after the pause we have seen for the last two weeks.

So far, the NASDAQ has held up well after its break higher.

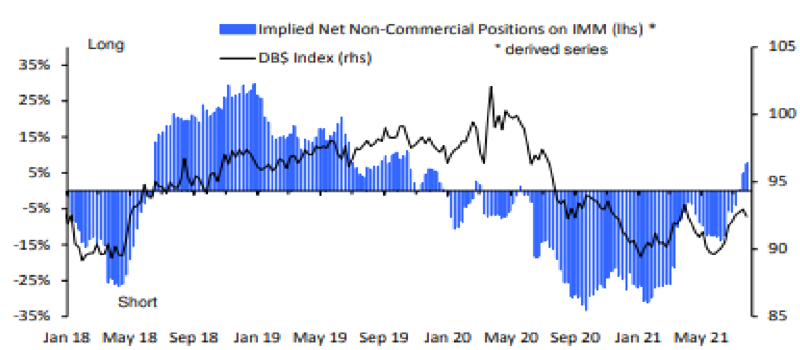
One last chart on the divergence front. I can explain it all via the COVID route, but can it persist?



FX

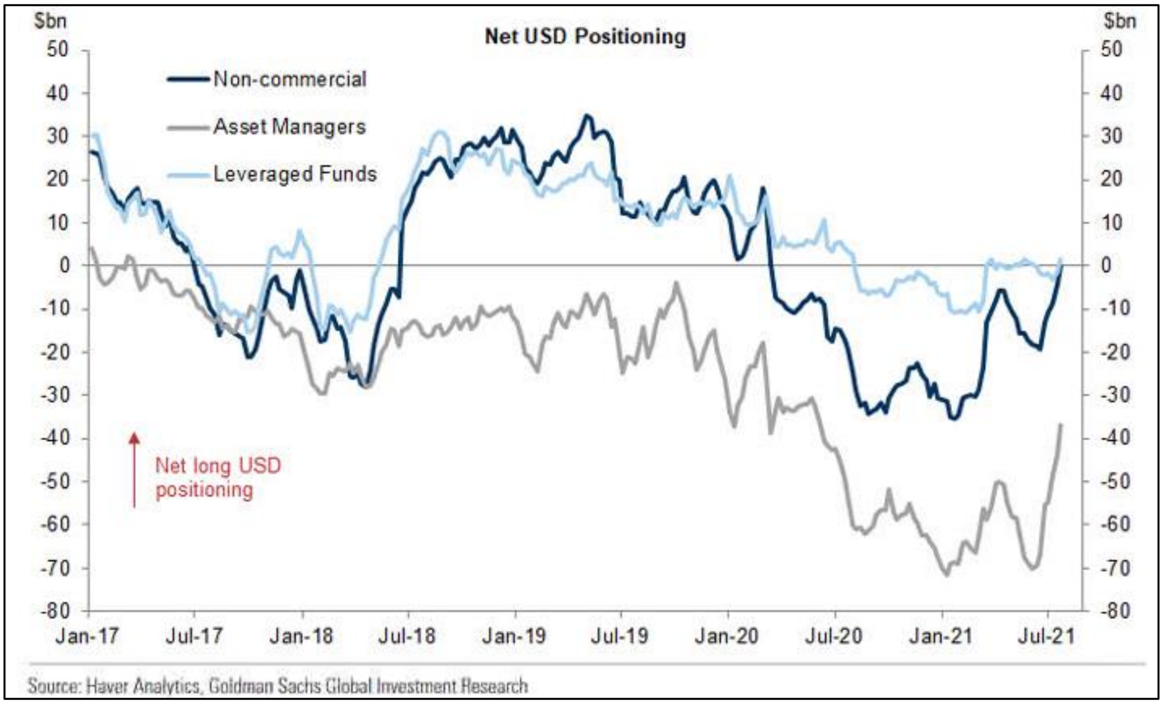
The dollar has been in a big and painful range for months and months now. Speculators have gone from very short at the start of the year, to slightly long.

Figure 3: Non-commercial USD length



Source : CFTC, Bloomberg Finance LP, Deutsche Bank

As have Hedge Funds. Asset Managers remain short but getting close to the average seen over the last few years.



The Dollar Index says it all. Oscillating in a range. A break of 93.50 above would be noteworthy.

In the meanwhile, there is a lot of dispersion between EM/Commodity and DM currencies.

The next few months…

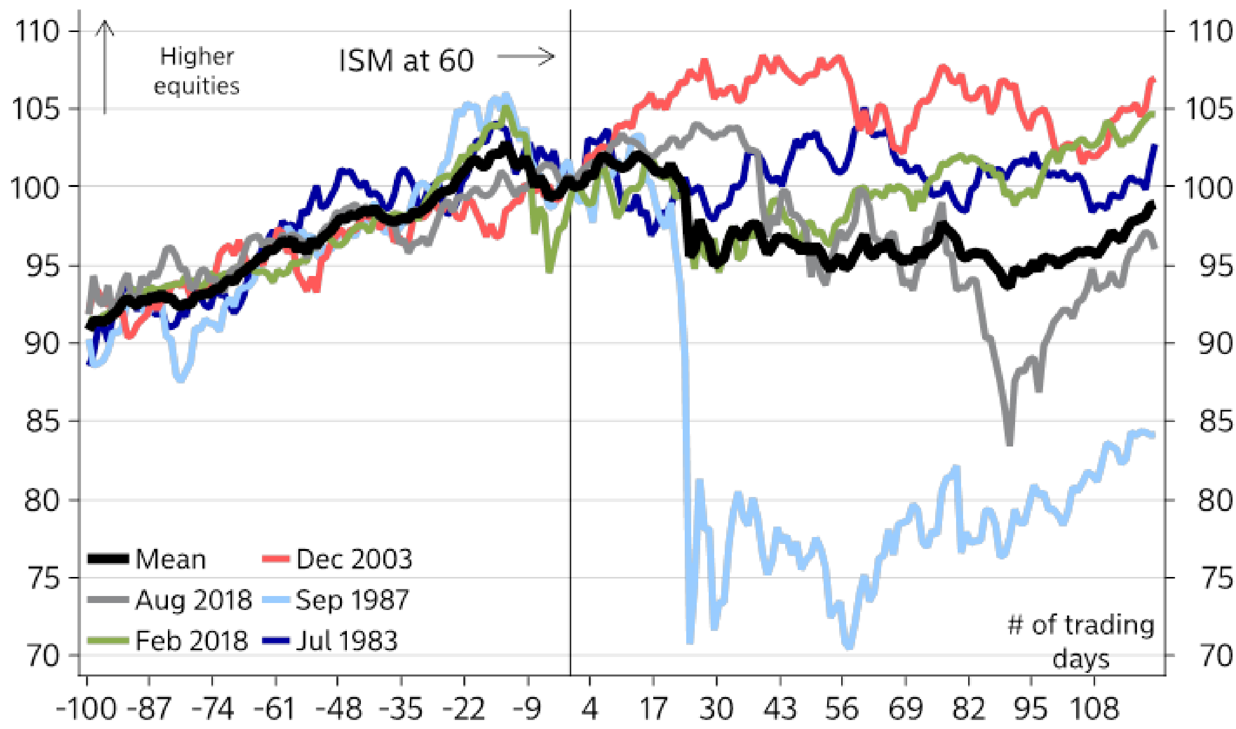
I continue to think things are about to get a lot more complicated for markets as we head for Q4. We face: COVID and its complicated aftermath, China events, upcoming inflation and employment numbers, potential Fed taper… to mention a few factors coming to a head.

The global manufacturing recovery has been dramatic and is arguably still being held back by bottlenecks and supply/transportation issues.

However, a big part of the manufacturing recovery is now likely behind us, even under the positive scenario where the heavy lifting is now passed to the services components of the economy.

ISM Manufacturing is likely to top in the next few months… historically that has meant that the everything rally becomes more selective, and that there is a greater probability of dispersion in outcomes.

Chart 5. A bumpier ride for risk assets ahead if usual ISM patterns hold true



Source: Nordea Markets and Macrobond

Stargazer
Asset Management

Next week, we have the US jobs report front and center, as well as July global PMI's and some central bank policy meeting, including the Bank of England.

Important Macro Data Releases and Events for the Week

Monday
8/2/2021

Caixin Manufacturing PMI (Jul) Forecast: 51, Prior: 51.3

Retail Sales YoY (Jun) Forecast: -, Prior: -2.4%

Markit Manufacturing PMI across Europe

ISM Manufacturing PMI (Jul) Forecast: 60.8, Prior: 60.6

Tuesday
8/3/2021

RBA Interest Rate Decision and statement

Factory Orders MoM (Jun) Forecast: 1.1%, Prior: 1.7%

Caixin Services PMI (Jul) Forecast: -, Prior: 50.3

Wednesday
8/4/2021

Markit Service and Composite PMI's across Europe

ADP Employment Change (Jul) Forecast: 721k, Prior: 692k

Markit Service and Composite PMI (Jul)

ISM Services PMI (Jul) Forecast: 60.4, Prior: 60.1

Thursday
8/5/2021

BoE Interest Rate Decision and Policy Statement

Initial Jobless Claims Forecast: -, Prior: 400k

Initial Jobless Claims 4-week average Forecast: -, Prior: 394.5k

Continuing Jobless Claims, Forecast: -, Prior: 3.269M

Friday
8/6/2021

Nonfarm Payrolls (Jul) Forecast: 900k, Prior: 850k

Unemployment Rate (Jul) Forecast: 5.7%, Prior: 5.9%

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