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What to focus on in Global Macro for the week of March 2nd, 2020

Macro Themes on the Radar:

A week ago, volatility looked cheap as the "bull market in everything" had only just started to slow. Little did I know we would get a full reversal so quickly. Of the four-horseman leading the prior FOMO charge, Equities, USD, Gold and Bonds, only Bonds remain standing.

Suddenly the idea that the coronavirus was contained has been shattered. An economic shock largely thought to be limited to China and its supply-chain knock-on effects, has become a global concern.

Markets reacted quickly as the narrative of "liquidity makes stocks go up regardless" was abandoned for a new narrative. The fear of missing was replaced with the fear of losing.

The markets suddenly had to face the possibility of an economic "sudden stop". In the case of a financially induced market shock, Central Bank liquidity can be effective in quickly relieving liquidity and credit tightness. However, what is currently being priced, a simultaneous demand and supply shock brought on by fear for people's physical safety, is out of the hands of Central Bankers. This sudden narrative switch has brought with it, unprecedented price action.

This shift from a liquidity/FOMO mindset to that of a potential virus driven shock to the real economy, leaves Central Bankers reluctant, and with a number of issues to grapple with:

- CB's don't really have any data. Recent data only matters in that it provides a jumping off point.
- They have no idea how bad the virus can/will get or how people will react.
- They don't know what measures the governments will take to try and contain/counteract the virus spread. As such they have no idea how severely any potential measures might impact the economy.
- The situation in China may be improving but the rest of the world is deteriorating. China was able to take relatively radical measures of shutting down cities and decreasing mobility. That is much harder to do in capitalist democracies where politicians face coming elections and criticism from the opposition. The ability to take short term economic pain for longer-term results is much reduced in the West.

- CB's know that liquidity alone won't help people get over their fears for physical safety.
- CB's have limited ammo in any case. They know it and as a result have all mentioned the need for fiscal policy to assume a larger role going forward.

This crisis will accelerate the inevitable shift from monetary to fiscal policy. Expect the worlds Finance Ministers to be the new superheroes, taking over from the Central Bankers, as markets refocus on who can really impact global markets and the economy.

A shift has been noticeable over the last few days…

- On Thursday the Bank of Korea surprised markets by leaving rates unchanged but announced that they were making more liquidity available to small businesses.
- Over the weekend, Italy announces "shock therapy" adding EUR 3.8B in fiscal stimulus via tax credits for small business reporting a 25% drop in revenues and tax cuts and cash for the healthcare system. At the same time Italy is requesting permission to increase the budget deficit from Brussels. This is in addition to EUR 900M in support that had already been announced last week for northern Italy.
- Hong Kong has announced an HKD 10,000 check for every citizen to spur spending.

The Fed is under increasing pressure from both the markets and Trump to cut rates. One cut of 25 basis points has been fully priced for the March meeting. A second cut has been fully priced by June. Four cuts are now priced by the end of the year. However, the Fed faces the same challenges that the other CB's do, although thankfully they have more ammo.

Powell issued a press release at 2:30pm on Friday, no doubt hoping to calm and reassure markets:

"The fundamentals of the U.S. economy remain strong. However, the coronavirus poses evolving risks to economic activity. The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy."

Markets did have a meaningful rally off the lows in the last 30 minutes on Friday, but some of that was almost certainly due to rebalancing given the large equity and bond moves on the month.

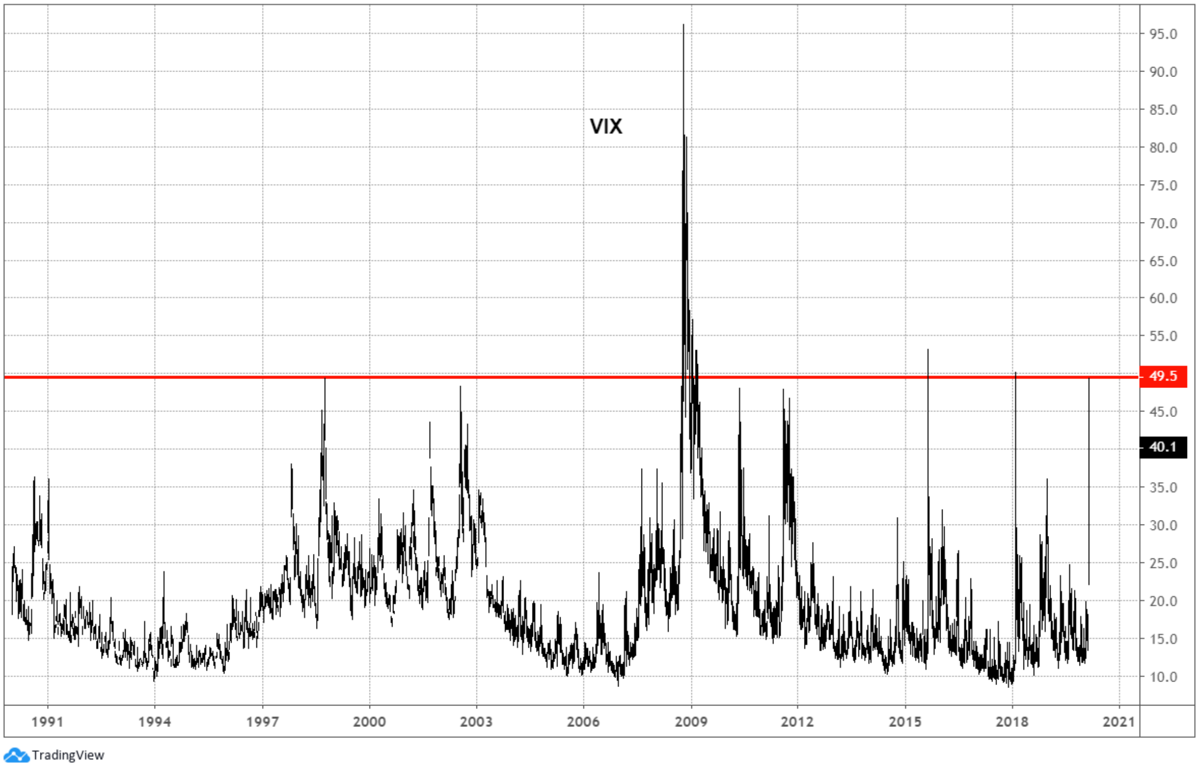
The Fed will likely cut rates in the coming weeks and months. In doing so they will have to weigh how effective they think cuts will be, and if now is a good time to spend the remaining ammo they have. The lurking fear of eventual Fed impotence has just been brought into the present. Expect policy ideas like yield curve control to be floated and rate cuts to be accompanied by forward guidance and mention of AIT. Inter-meeting 50bp cut is possible next week if we see another big leg down.

Bounce?

The US equity markets are certainly very oversold. In every case we have hit these RSI levels over the last 40 years we have seen a bounce, but only in 1987 was it the low (after a > 40% sell-off).

Not only are we oversold but the speed of the decline has been breathtaking. Is it simply the appearance of a potential pandemic Black Swan, right after a melt-up? Algos? Passive investing? Or, all of the above?

The plunge has taken the VIX to levels only surpassed on a few occasions over the last 30 years.



The technical are all well and good and would normally indicate that the probability of a meaningful bounce is high now. However, with Central Banks able to provide only limited support here, we really need some good news to make it durable. That could take some time to develop.

What to Focus on Now:

Starting points are important when there is an economic shock. Markets and economic actors are good at adjusting to changing conditions in demand and supply. A potential shock to both demand and supply is harder to deal with as it just means a sudden downshift in economic activity overall.

This is what we have seen in China. No surprise that when you shut down a country the PMI's plunge.

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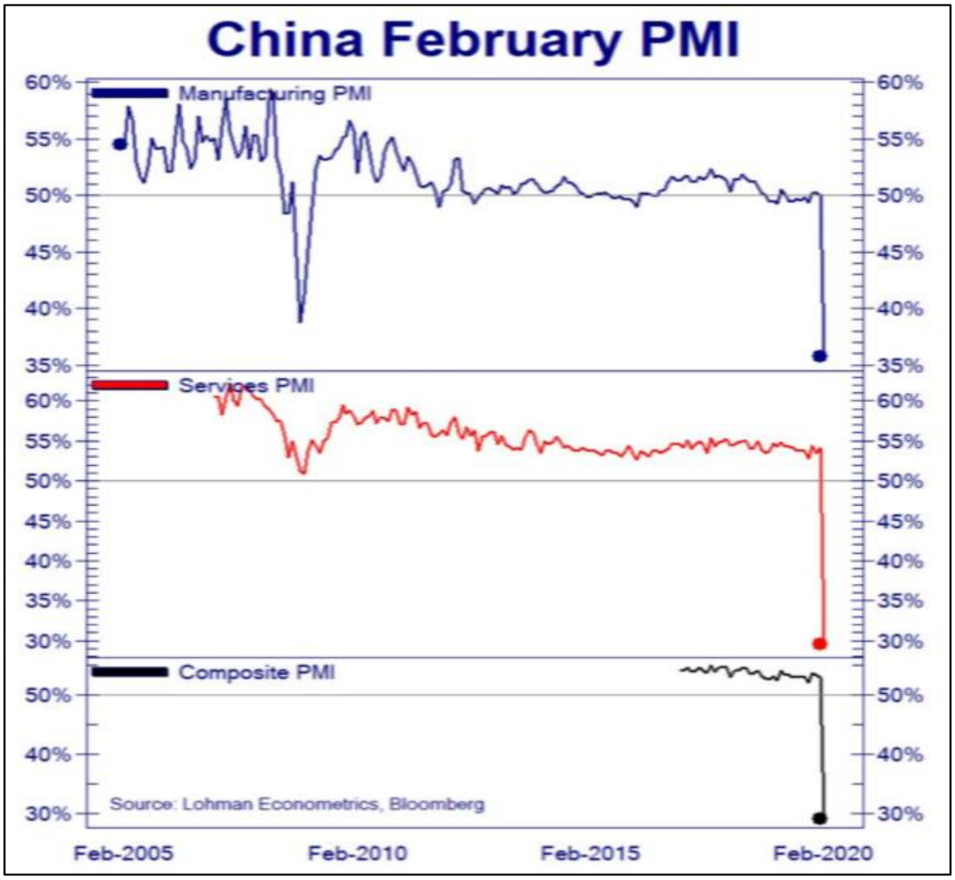
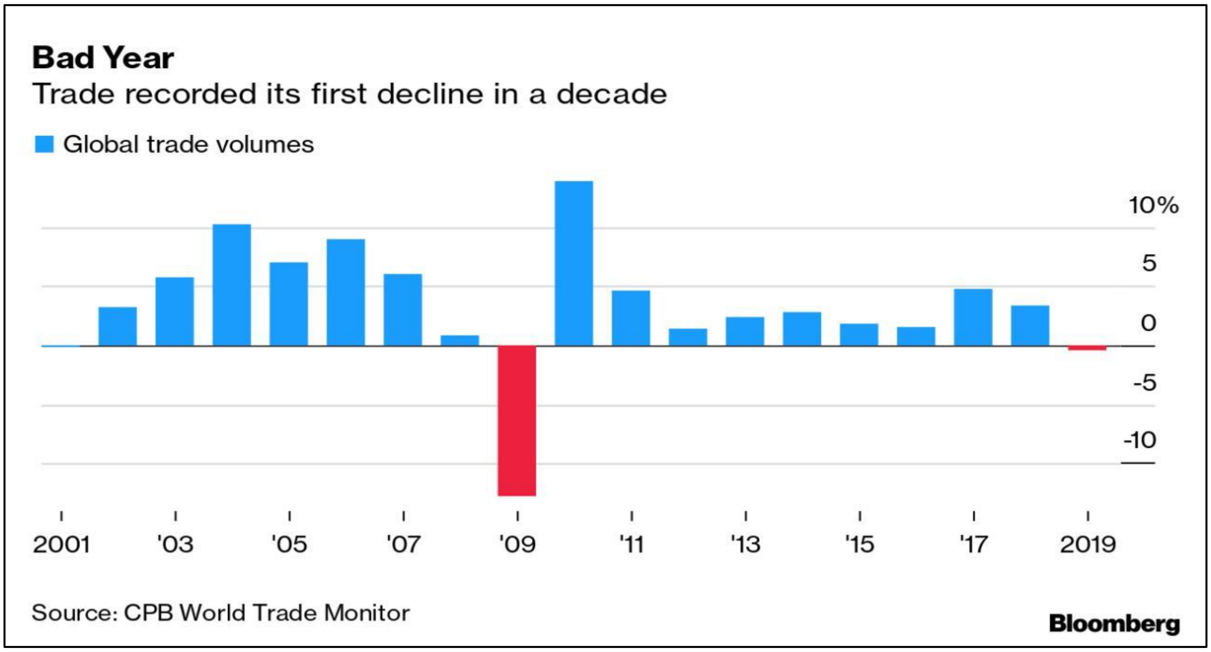
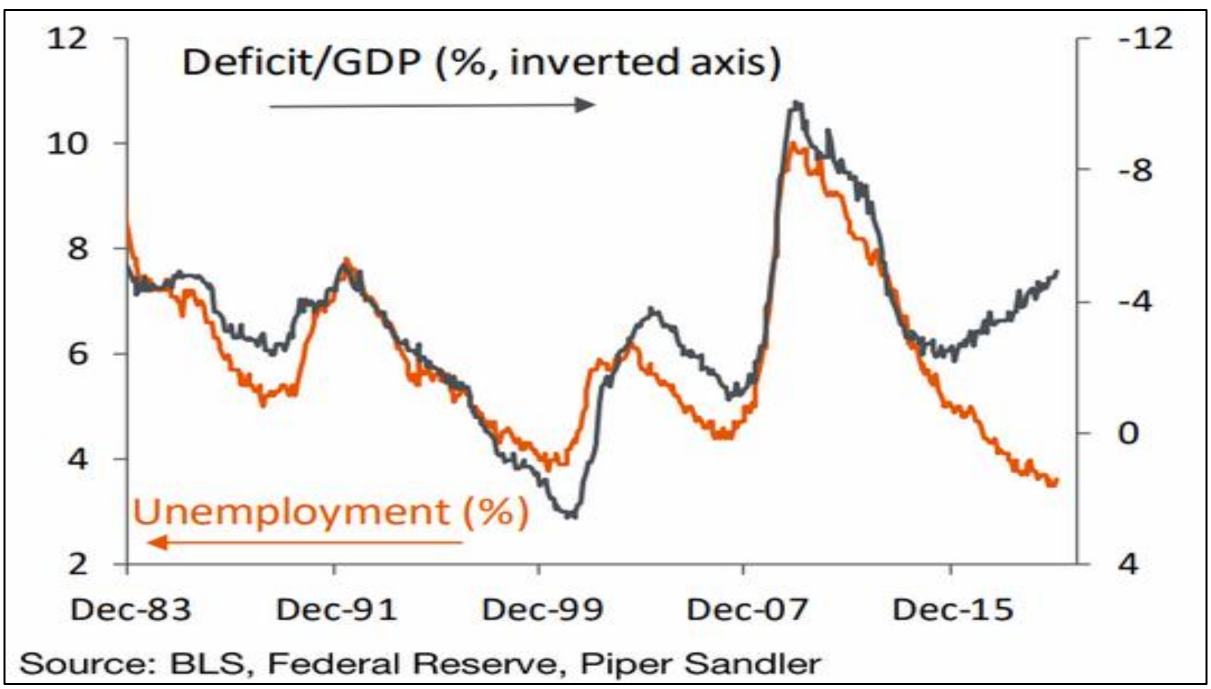


Back to starting points for the rest of the world… With last year's trade issues and global growth slowdown, much of the world came into this outbreak in a relatively precarious position.



The US has been a top performer as employment and growth have held up well. However, at least some of that outperformance has been due to continued goosing of the economy via tax cuts and government spending. Should the economy slow now the deficit will explode which could have a meaningful impact on the dollar and the yield curve.

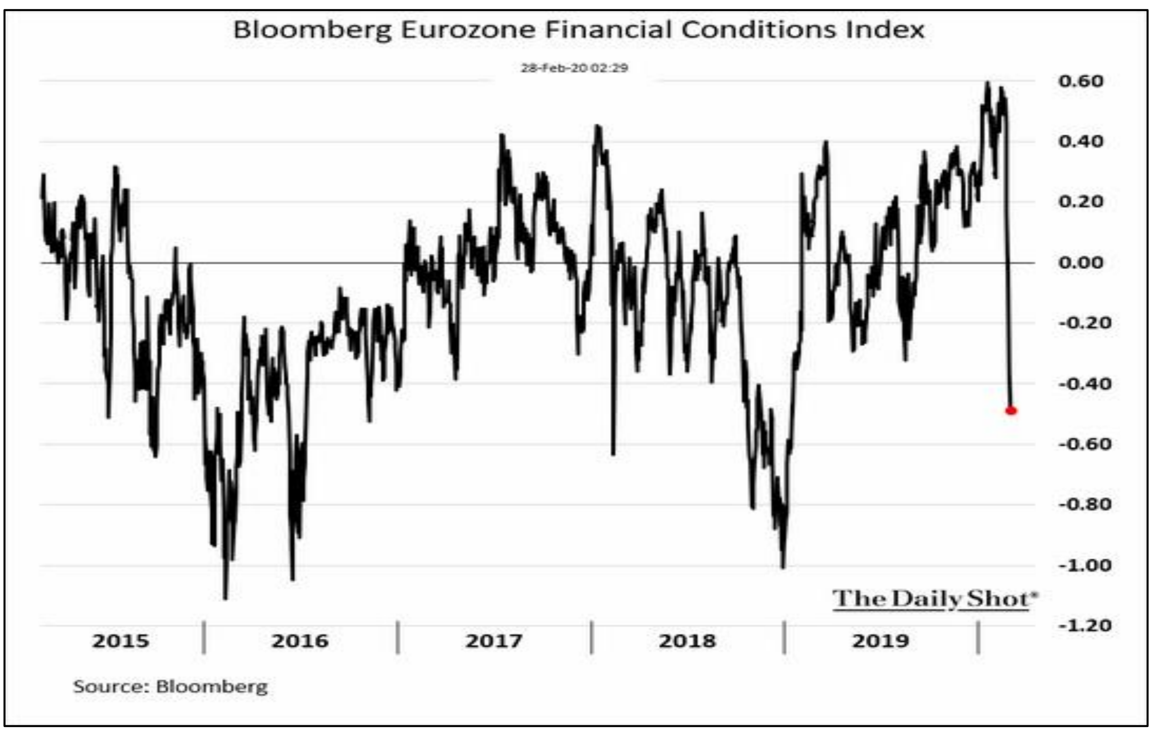


The US however is still relatively well placed to deal with an economic crisis. Not only are we starting with a relatively strong economy, but the Central Bank still has the ability to cut rates and restart QE. While I think the Fed would try to resist negative interest rates, they have mentioned yield curve control as an option. They initially have discussed this in terms of shorter-term Treasuries but should yields start to rise in the longer end due to large deficit spending this would be a way to monetize the debt. Let's hope we never come to that.

Europe on the other hand is coming into this situation on its back foot economically. Italy was already entering a recession and Germany was slowing quickly, at least partially due to China. The ECB is staring into an empty monetary policy toolbox. They are already engaged in QE and are at -.50 on deposit rates. There has been growing internal debate regarding the effectiveness of negative interest rates and I think the appetite for going more deeply negative is limited. Eventually they could follow the BoJ and buy equities, but that would take some doing.

Fiscal spending is the obvious choice. How that looks and when it arrives will be important.

Globally this equity sell-off has tightened financial conditions via stocks and credit spreads. Europe is no exception.



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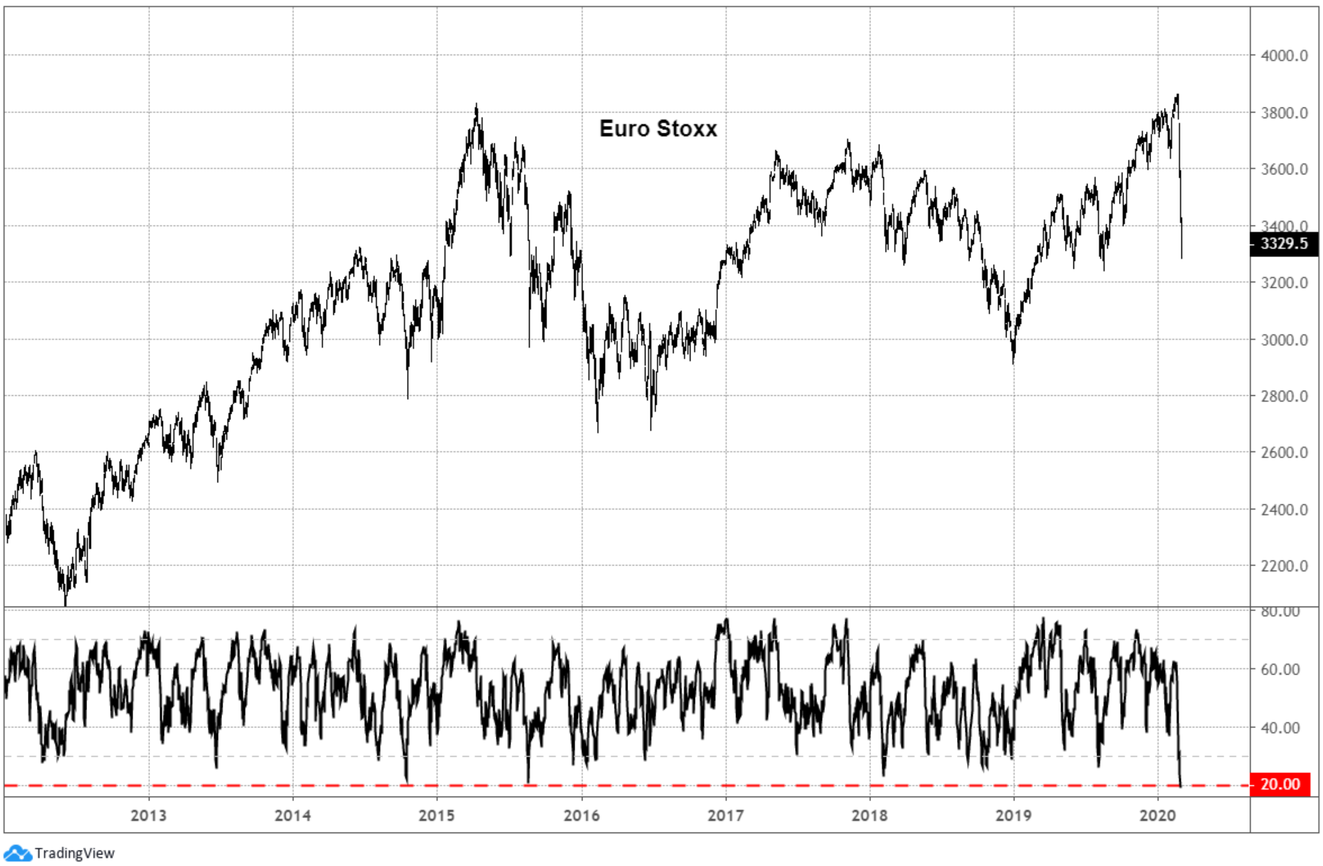
Technically, European equities are also very oversold.

In the past, these levels have always meant that a meaningful bounce was close in time, even if some further price deterioration occurred. Sometimes these extremes marked the end of the move and a durable low, other times we got a bounce to sell. Given the economic background coming into this it might be too early for a durable low.



Hopefully we will see ex-China infection rates flatten out over the coming weeks and turn down. In the meantime watch for a patchwork of global easing and fiscal / macroprudential announcements.

VP Pence announed today that they have shipped out an additional 15,000 test kits. At least in the near-term that probably means more test kits = more cases found. However, more widespread testing will increase confidence in the data measuring the scope of the outbreak and eventually reassure people.

Watch:

Credit Spreads (could trigger Fed cut)

Consumer Confedence

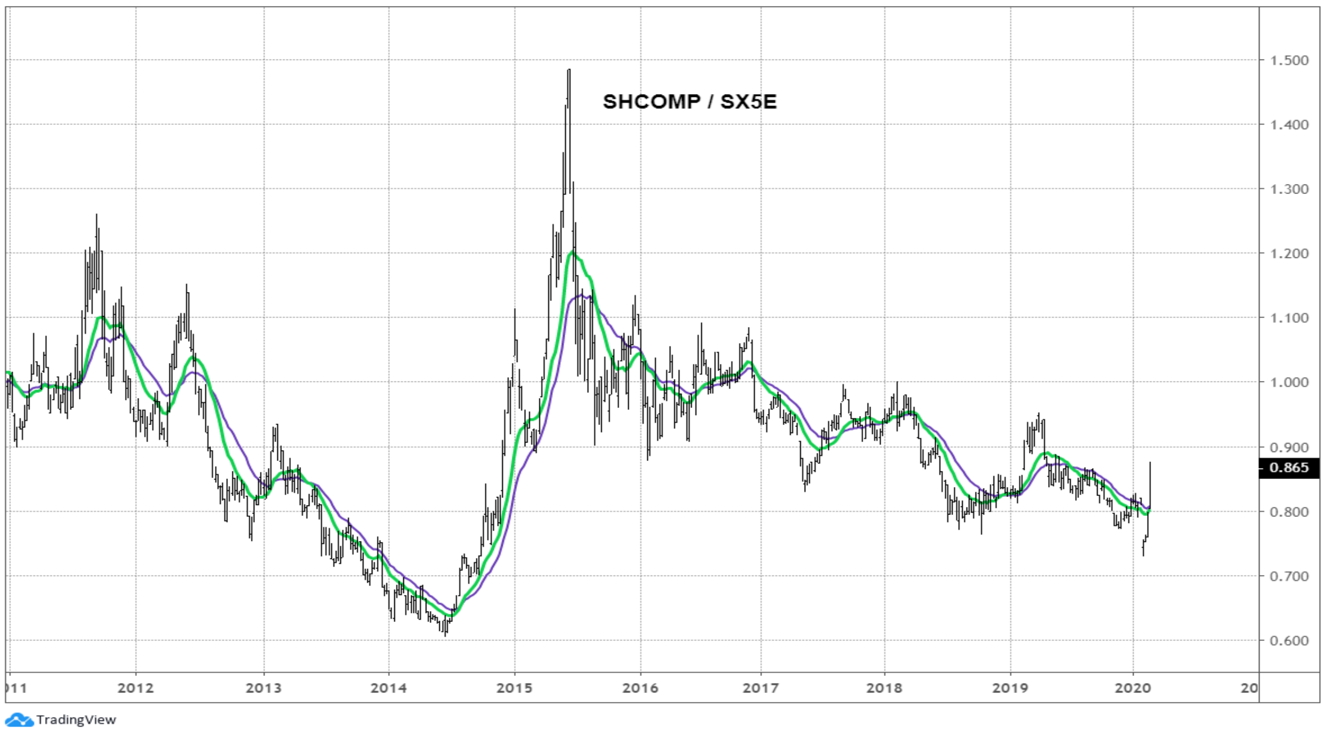
Employment Data

-20% off the highs in stocks (could trigger Fed cut)

Two final charts to keep an eye on. It could just be the US equity dump and China buying stocks, but still.

Shanghai Comp. vs. SPX

Shanghai Comp. vs Euro Stoxx



With the recent price action and coronavirus developments, most of this week's data is meaningless other than as a starting point. Watch speeches from Central Bankers and of course weekly Initial Claims followed by NFP on Friday.

Important Macro Data Releases and Events for the Week

Monday
3/2/2020

- Caixin Manufacturing PMI (Feb) Forecast: 45.7 (no way), Prior: 51.1
- Markit Manufacturing PMI (Feb) Forecast: 47.8, Prior: 47.8
- Markit Manufacturing PMI (Feb) Forecast: - , Prior: 50.8
- ISM Manufacturing PMI (Feb) Forecast: 50.5, Prior: 50.9

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Tuesday 3/3/2020	RBA Interest Rate Decision
	SUPER TUESDAY Primaries
	CPI and PPI
	Unemployment Rate Forecast: 7.4, Prior: 7.4
Wednesday 3/4/2020	Caixin Services PMI (Feb) Forecast: 52.6, Prior: 51.8
	Retail Sales MoM (Feb) Forecast: 0.9%, Prior: -3.3%
	Markit PMI Composite (Feb) Forecast: 51.1, Prior: 51.1
	Markit PMI Composite (Feb) Forecast: 51.6, Prior: 51.6
	Retail Sales YoY (Feb) Forecast: 0.9%, Prior: 1.3%
	ADP Employment Change (Feb) Forecast: 191k, Prior: 291k
	Markit Service PMI (Feb) Forecast: - , Prior: 49.4
	Markit PMI Composite (Feb) Forecast: - , Prior: 49.6
	ISM Non-Manufacturing New Orders Index (Feb) Forecast: 56.3, Prior: 56.2
	ISM Non-Manufacturing PMI (Feb) Forecast: 55.5, Prior: 55.5
	ISM Non-Manufacturing Employment Index (Feb) Forecast: 54.1, Prior: 53.1
	ISM Non-Manufacturing Prices Paid (Feb) Forecast: 54.5, Prior: 55.5
	BOC Interest Rate Decision and Statement Current: 1.75%
	Fed's Beige Book **REPORT**

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Thursday 3/5/2020	OPEC Meeting
	Nonfarm Productivity Q4 Forecast: 1.4%, Prior: 1.4%
	Factory Orders MoM (Jan) Forecast: -0.3%, Prior: 1.8%
	Initial Jobless Claims Forecast: 216k, Prior: 219k
	Initial Jobless Claims 4-week ave. Forecast: - , Prior: 209.75k
	Continuing Claims Forecast: 1.722m, Prior: 1.724m
	BoE's Governor Carney **SPEECH**
	BOC's Governor Poloz **SPEECH**
	Overall Household Spending YoY (Jan) Forecast: -4%, Prior: -4.8%
Friday 3/6/2020	Leading Economic Index (Jan) PREL Forecast: 91.9, Prior: 91.6
	Industrial Production s.a. MoM (Jan) Forecast: - , Prior: -3.5%
	Factory Orders s.a. MoM (Jan) Forecast: 1.5%, Prior: -2.1%
	OPEC Meeting
	Nonfarm Payrolls (Feb) Forecast: 178k, Prior: 225k
	Unemployment Rate (Feb) Forecast: 3.6%, Prior: 3.6%
	Net Change in Employment (Feb) Forecast: - , Prior: 34.5k
	Unemployment Rate (Feb) Forecast: 5.6%, Prior: 5.5%

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