What to focus on in Global Macro for the week of May 4th, 2020

Macro Themes on the Radar:

ECB

Last week's policy statement and press conference were interesting. The ECB expanded its support of the banking system via even lower (PE)LTRO rates (now paying banks to take the funds at -1% vs. the -.50% deposit rate). Lagarde also stated that asset purchases this year would hit EUR 1trn as the ECB continues to support the bond markets and "ensures the transmission of monetary policy is not impaired by fragmentation along national borders". Standard QE would deliver EUR 250bln while the Pandemic Emergency Purchase Programme (more QE but a special limited program) would deliver the other EUR 750bln. At the end of the year PEPP would either end/run out of funds or be extended, depending on the governing council's assessment at the time.

During the press conference there was discussion about PEPP vs. ESM/OMT and it seems that the ECB favors PEPP for now. The ESM and OMT (first used during 2012 Euro Crisis), require a country specific program and are not well suited for the current crisis. Additionally, Lagarde indicated that participation in ESM would not automatically trigger OMT, something that has been widely assumed.

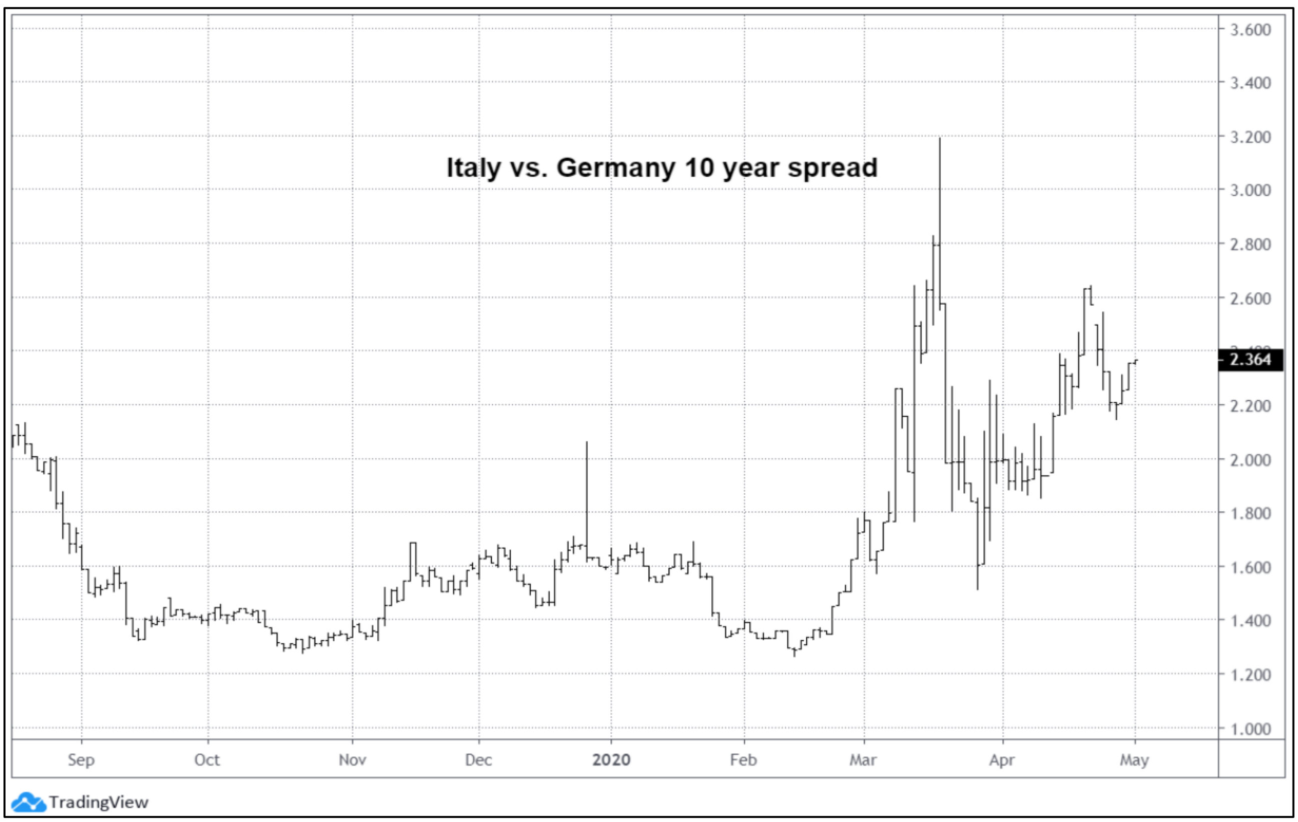
Here is a quick refresher on ESM and OMT:

"OMT (Outright Monetary Transactions) is considered by the European Central Bank once a Eurozone government asks for financial assistance. The Eurozone has established the European Stability Mechanism and the European Financial Stability Facility bailout funds in order to meet the challenges of the European debt crisis. From these funds and through OMT, the Eurozone's central bank can, henceforth, buy government-issued bonds that mature in 1 to 3 years, provided the bond-issuing countries agree to certain domestic economic measures – the latter being the so-called term of "conditionality". The aim of the program is then to prevent divergence in short-term bond yields, and to ensure that the ECB's monetary policy is transmitted equally to all the Eurozone's member economies. The central bank notes that the OMT is meant as a means to "safeguard an appropriate monetary policy transmission and the singleness of the monetary policy". Interventions through the program are stipulated to be potentially limitless."

This **Tuesday**, the German constitutional court will issue its decision on the legality of earlier ECB bond purchases. In the past, these court ruling have registered some disapproval and concern but no prohibition. This one is a little different, however. Recently the ECB has violated its "capital key" openly by buying disproportionately large amounts of Italian debt. Essentially, this is amounting to an attempted state rescue and is hard to defend as "ensuring monetary policy transmission." It has been estimated (GS), that 35-45% of PEPP purchases have consisted of Italian bonds since the start of the program.

Most expect that this ruling could result in a harsher warning to the ECB than has been seen in the past. The focus would be on proportionality of asset purchases and a cautioning that anything else would potentially be looked on as a breach of Treaty article 123 prohibiting monetary financing. The bombshell would be an outright prohibition of participation by the Bundesbank. That is however unlikely, as it is doubtful the constitutional court would want to put itself in a position that could challenge the entire Eurozone construct at this point.

The markets are cautious for now and all the buying of Italian paper has so far not been able to beat back down the yield spread to Germany.

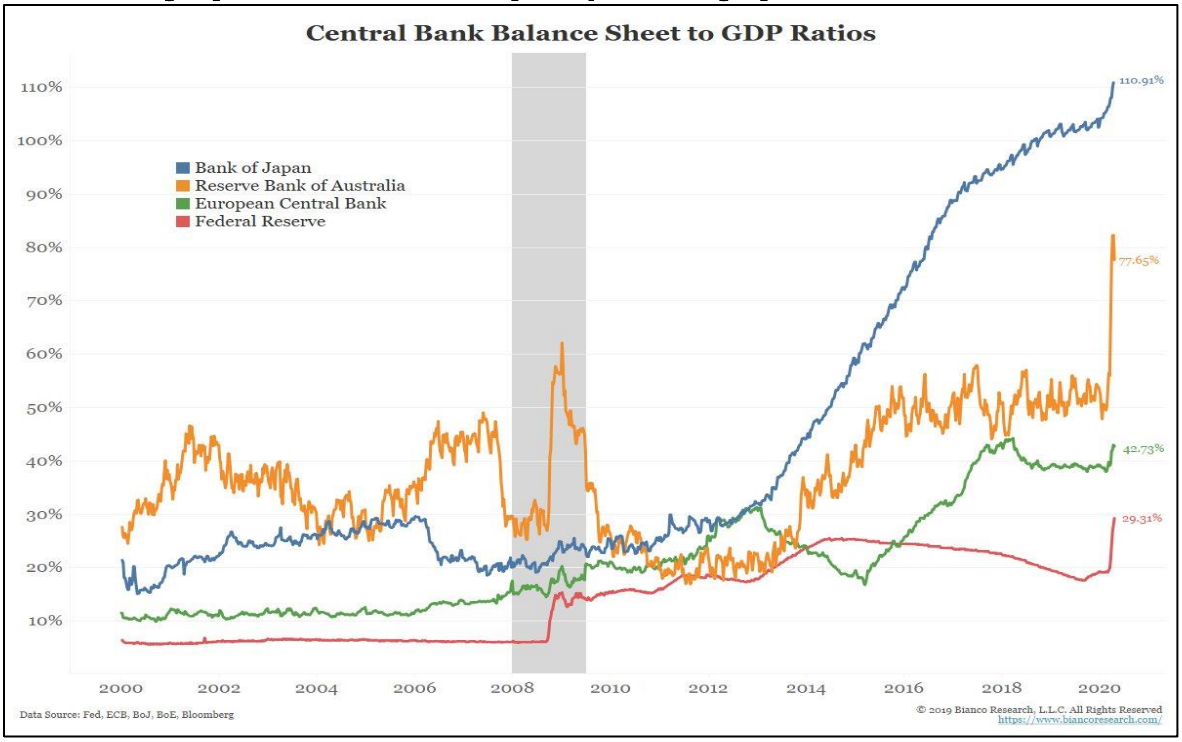


Central Banks and Fiscal

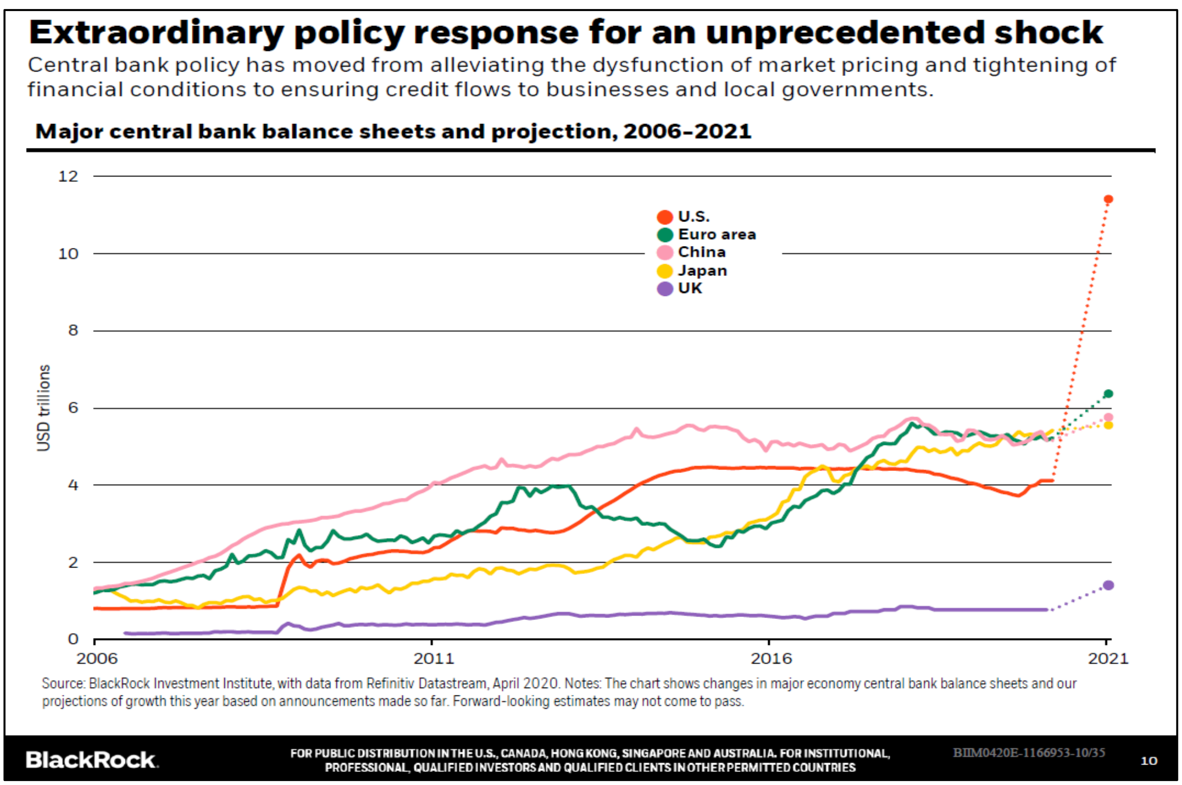
There continues to be a blizzard of new and enhanced programs from global central banks and governments. The acronyms are endless and difficult to relate to, and the ever-increasing scope is hard to get your head around.

Here are a few charts that provide some perspective with regard to the actual dollar amounts and the relative % of GDP we are talking about.

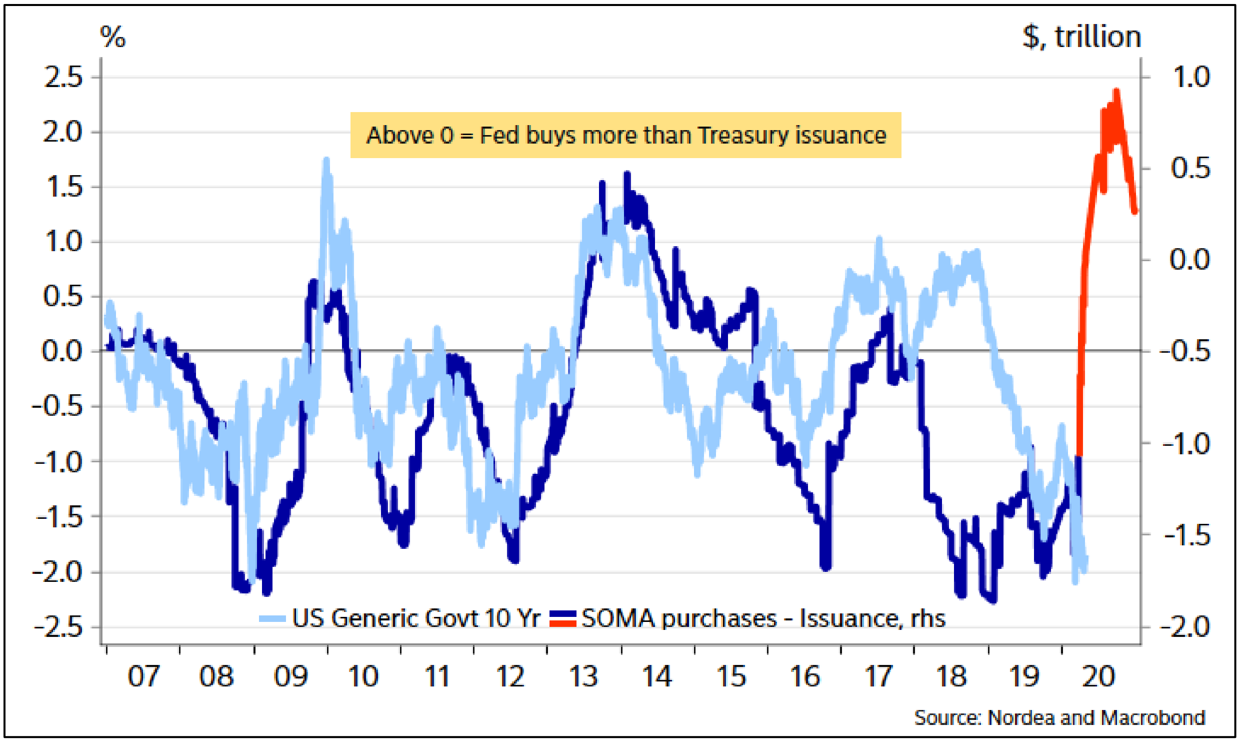
Are we all turning Japanese? Others now quickly cranking up balance sheets as a % of GDP.



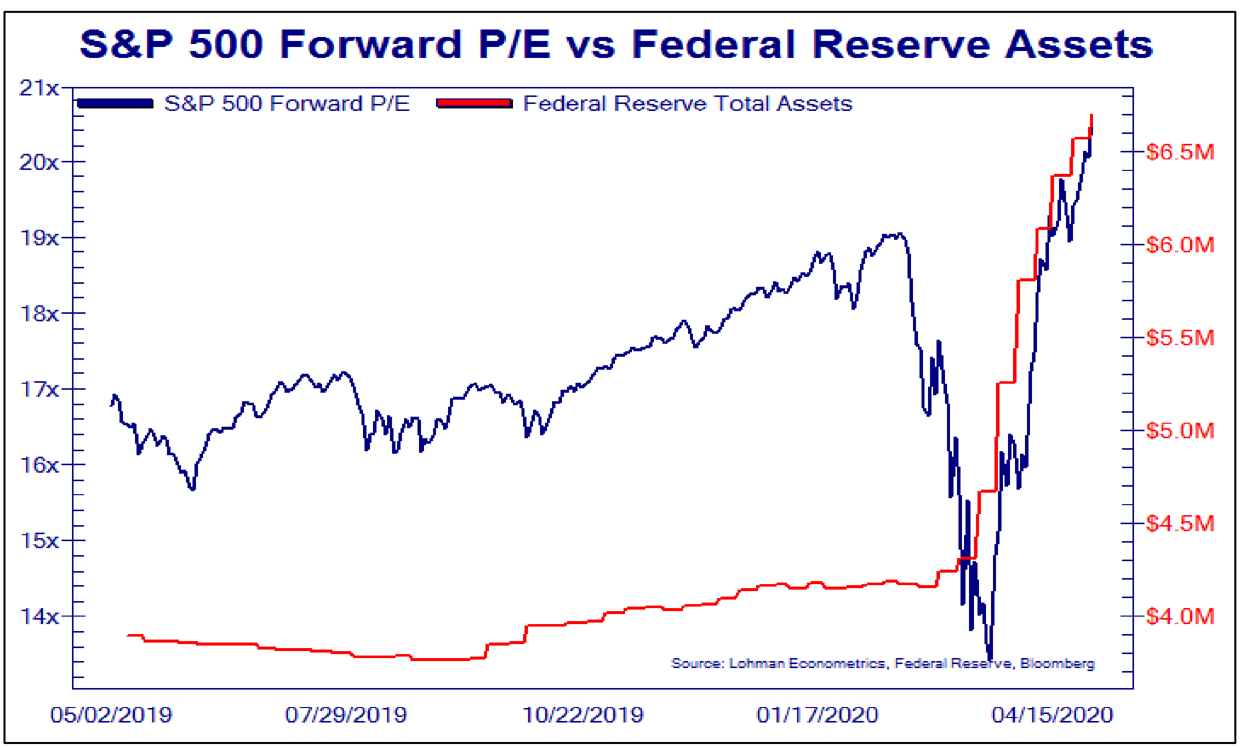
In dollars…



The Fed is again buying bonds quicker than the Treasury can issue them.



Without many alternatives, the US equity market has again embraced "don't fight the Fed".



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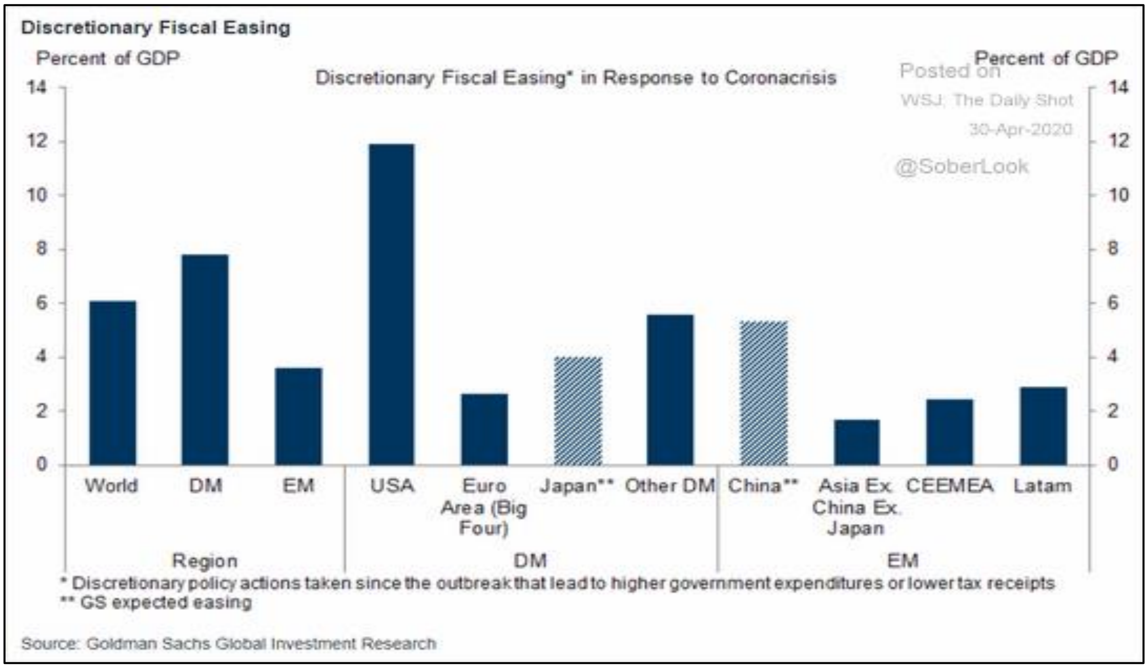
The fiscal response has been explosive as well. The US sticks out as very aggressive. This has continued to support US relative equity performance.



<u>What to Focus on Now:</u>

Credit

When COVID-19 has come and gone, one of the lasting impacts will be more debt for everyone.

The economic shock has brought downgrades to many companies on the edge of investment grade and has taken down the general credit worthiness of the country's corporations. To avoid a "credit event" the Fed has jumped in, buying not just investment grade, but in an unprecedented move, also high yield.

This support from the Fed has had a powerful impact. Not only have corporate bond ETF's come roaring back (Fed is buying them too) as investors follow the Fed, but issuance has exploded as well as the market for new debt re-opened.

LQD ETF is now almost back to where it started, thanks to Fed support.

HYG has also had a big bounce thanks to the Fed but is starting to falter again.

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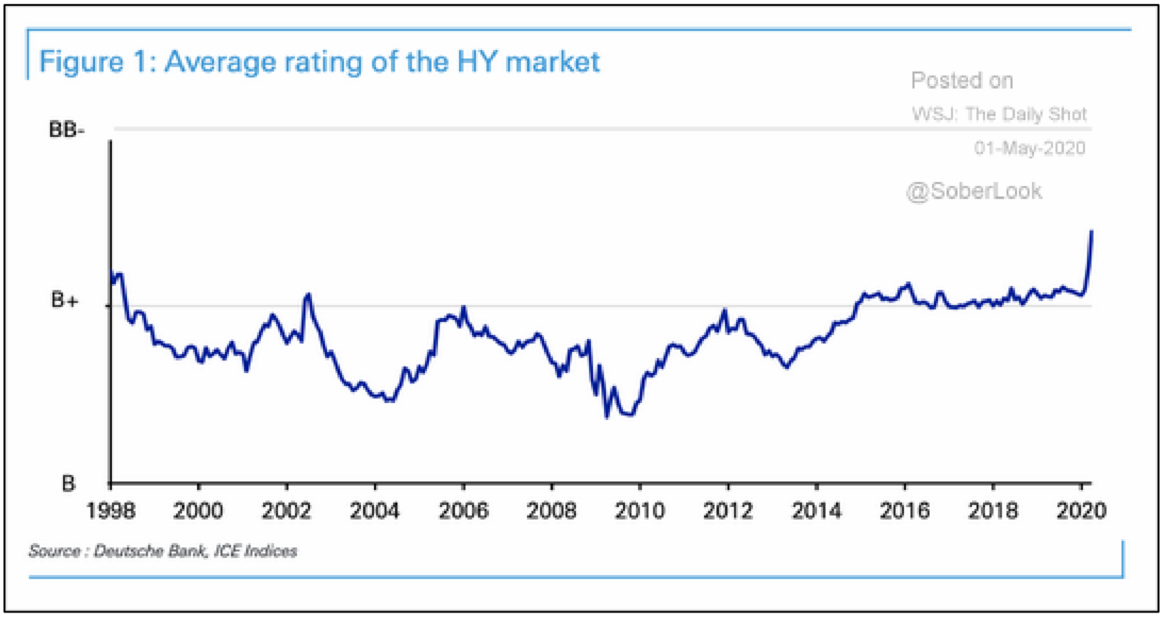
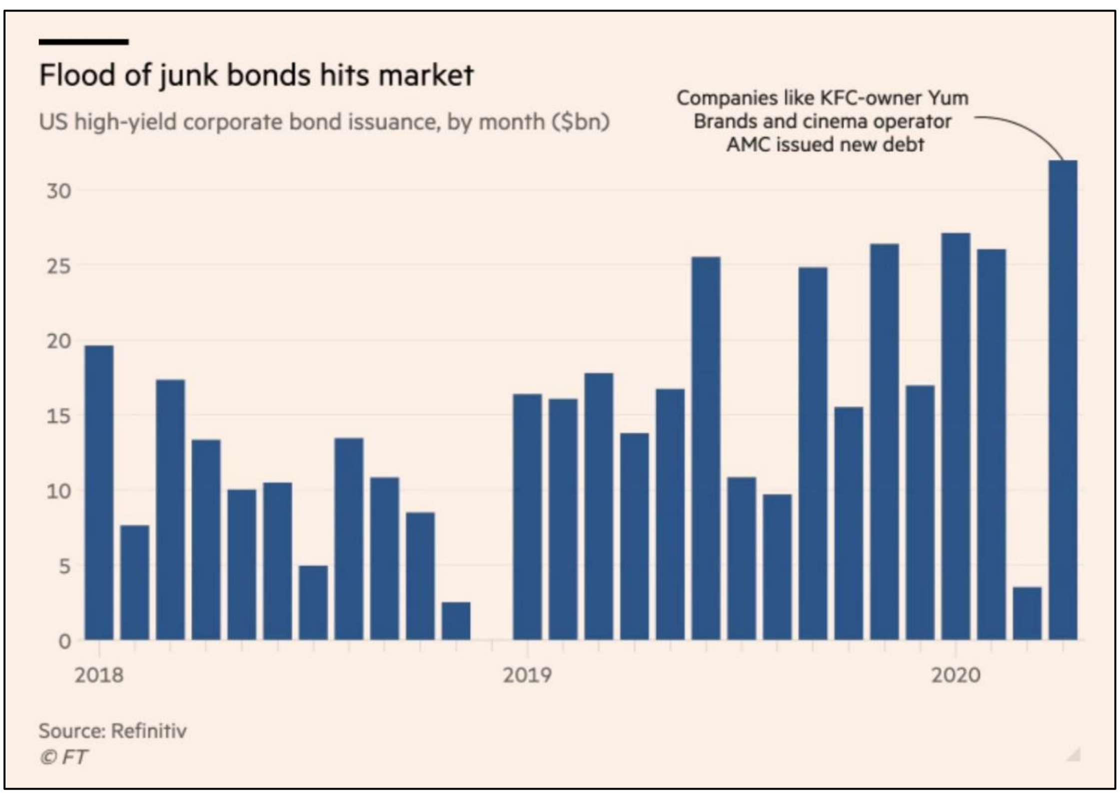
The ranks of high yield bonds are swelling as downgrades mount and the sector deteriorates.



Yet, issuance is rising as a buyer of last resort has been spotted. The Fed support allowed high yield issuance of $37bln by vulnerable companies in April. These are companies that otherwise would have found it challenging to issue new debt given the current economic conditions.

It will get very interesting if at some point the Fed is faced with defaults. Treasury has first loss.



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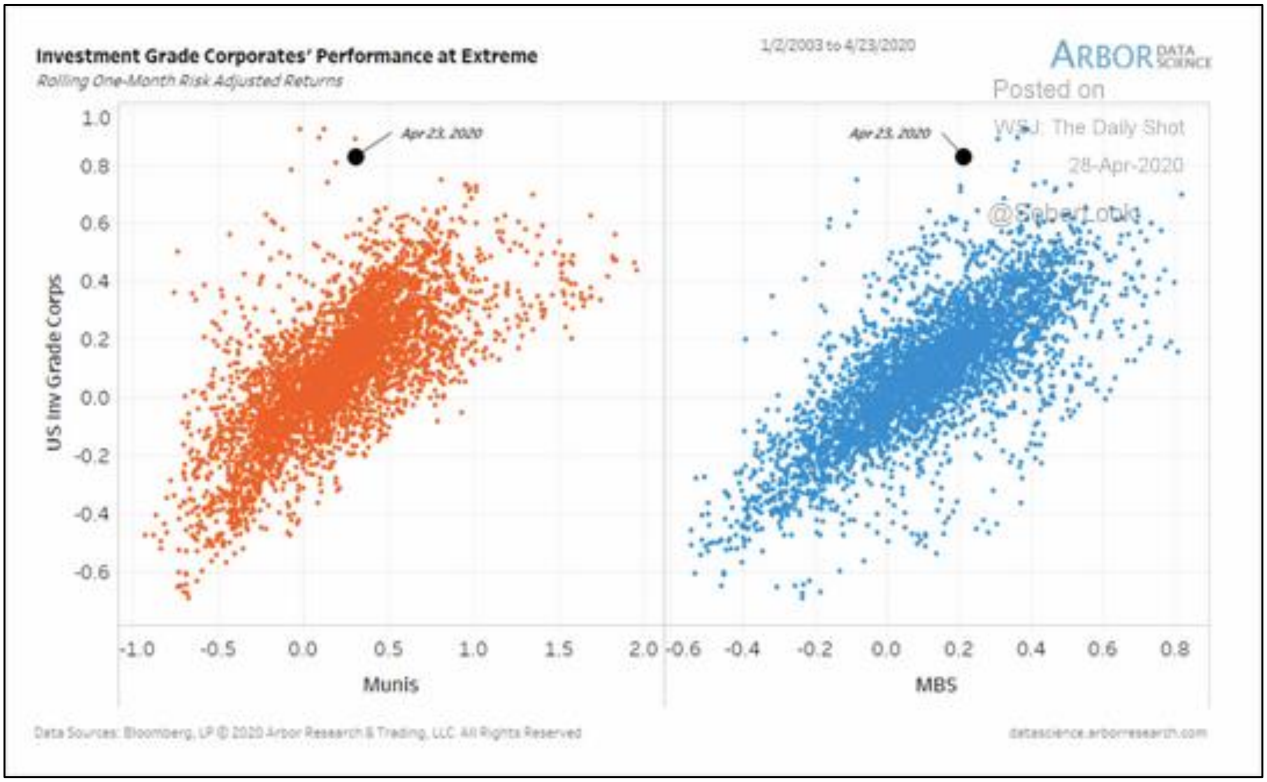
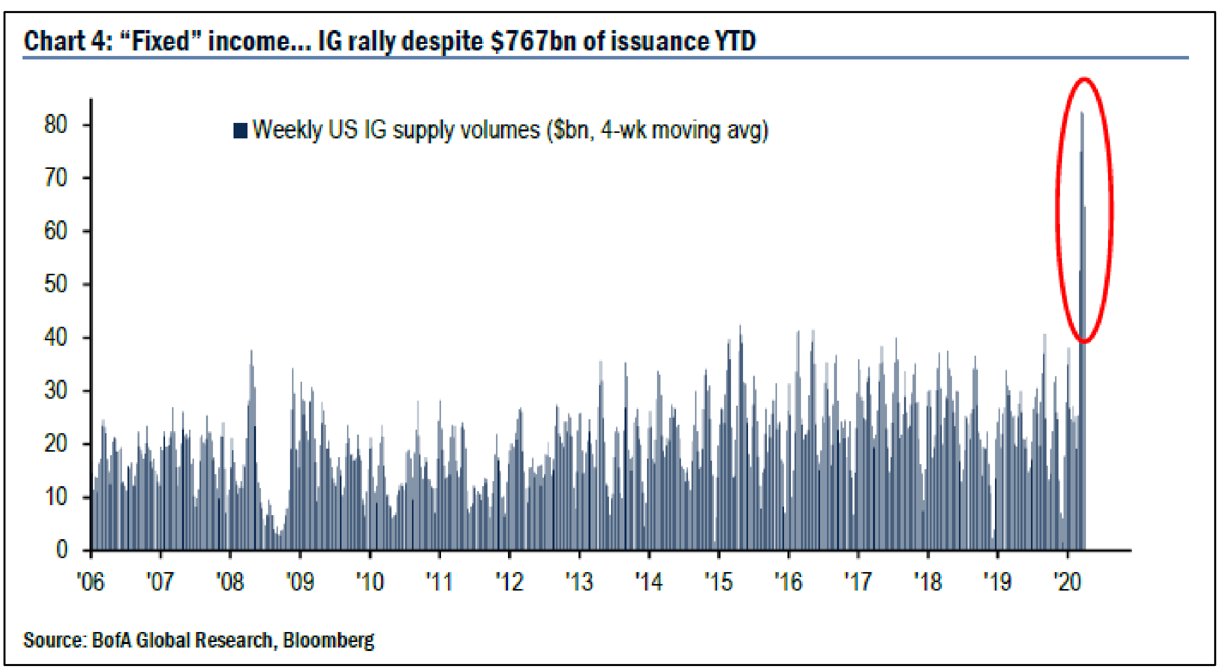
The benefits to investment grade from the Fed buying have been bigger still…

This chart shows how IG has performed vs. Munis and MBS.

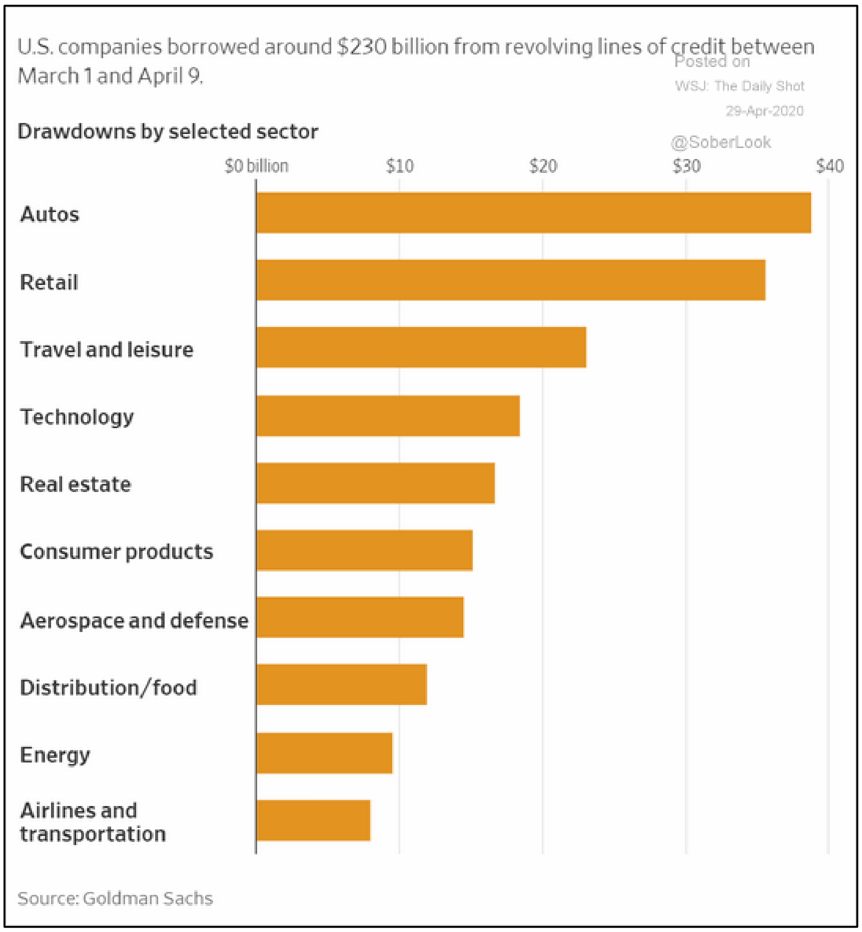


Boing's issuance of $25bln in debt pushed April new issuance in IG to 297 bln, the largest monthly number ever. That is vs. an already impressive 261bln in March.



The IG vs. HY relationship is worth watching. Under the old paradigm of market analysis, you would really want to see HY start to outperform IG as a sign that the economy is again finding its footing. However, as the Fed busily demolishes the price signals, all these relationships are less dependable. For the moment, longer term analysis has been replaced with the instant gratification of "buy what the Fed is buying".

In addition to the debt raised in the markets, corporations have also been drawing heavily on bank credit lines.



USD

Market participants are now firmly entrenched as either USD bulls or bears.

The bearish argument is essentially that the US is now running extremely easy monetary policy combined with a very large fiscal deficit while providing ample USD liquidity provision in numerous forms. This should be enough to fill the demand for USD as the global reserve currency and to provide plentiful liquidity to those needing short-term USD funding. The hope here is that as the crisis moves to the rearview mirror, global growth will revive, and the USD crunch will subside and then reverse.

The dollar bulls would argue what has been done won't work because the dollars won't get into all the cracks of the global economy. Some countries and companies will be shut out and we will see a rolling wave of USD funding crisis in EM. This constant stress and uncertainty will further hinder global growth. US ability to further stimulate and support the economy while others are less able to do so effectively, will continue to attract capital to the US. The global equivalent of growth vs. value and TINA (there is no alternative) investing will persist. This is however a toxic path, less for us, but certainly for the world ex-US. The Fed knows it.

Swap Lines

Since October 31st, 2013 the US has had standing swap lines in place with:

- the Bank of Canada
- the Bank of England
- the Bank of Japan
- the European Central Bank
- and the Swiss National Bank

On March 19, 2020, the New York Fed entered into additional temporary U.S. dollar liquidity arrangements (swap lines) with:

- the Reserve Bank of Australia
- the Banco Central do Brasil
- the Danmarks Nationalbank (Denmark)
- the Bank of Korea
- the Banco de Mexico
- the Norges Bank (Norway)
- the Reserve Bank of New Zealand
- the Monetary Authority of Singapore
- and the Sveriges Riksbank (Sweden).

According to the Fed: "These new facilities will support the provision of U.S. dollar liquidity in amounts up to $60 billion each... These U.S. dollar liquidity arrangements will be in place for at least six months."

On top of that, the Fed announced its FIMA repo facility on March 31, 2020.

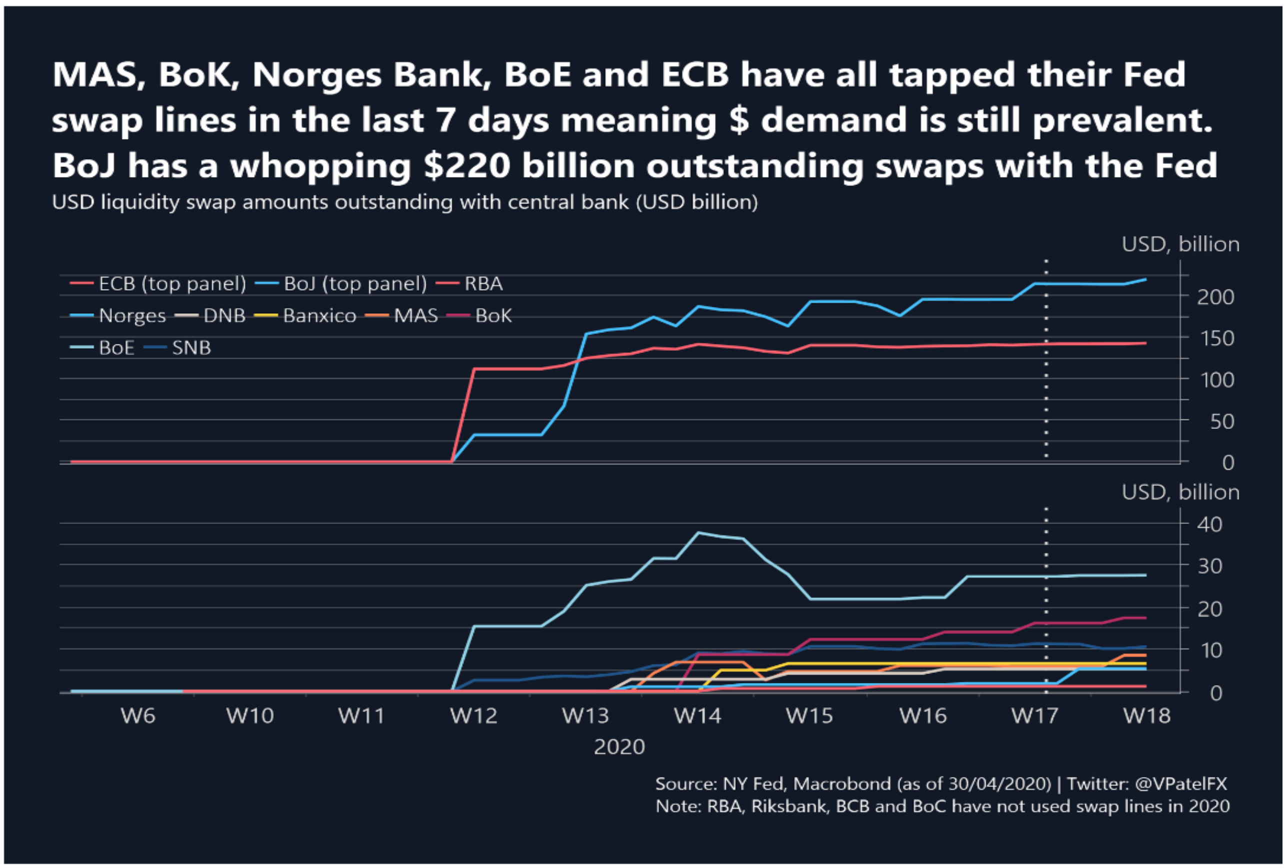
"The FIMA repo facility is designed to help maintain the flow of credit to U.S. households and businesses by reducing risks to U.S. financial markets caused by financial stresses abroad. The facility reduces the need for central banks to sell their Treasury securities outright and into illiquid markets, which will help to avoid disruptions to the Treasury market and upward pressure on yields."

Interesting that they seem more worried about higher US bond yields in this case.

This is a good link to all the NY Fed actions related to the COVID-19 crisis.

So far, these measures have been effective in reducing the funding stress vs. the developed market currencies like EUR, JPY, CHF etc. The basis swaps in forwards have confirmed this reduction in stress and those currencies have not been falling vs. the USD.

However, while the need has been reduced it persists.



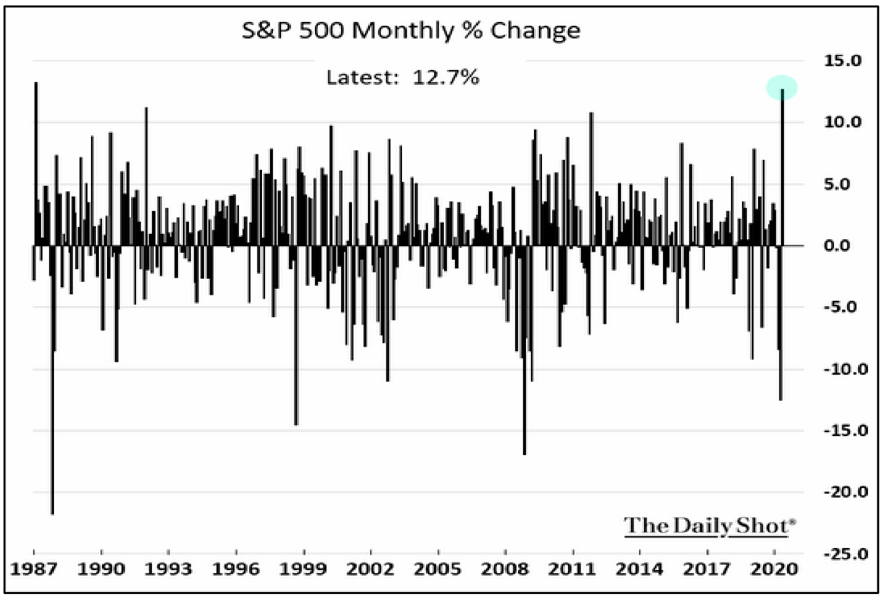
With 80% of EM trade denominated in USD, a falling currency can quickly become a problem if significant USD debt exists or is being generated. The USD has been flying vs. the currencies of Brazil, Turkey, Mexico and South Africa to name a few.

Over the last few days we have had increased volatility in FX markets as US / China relations have deteriorated with regard to who is to blame for the origin and spread of the virus. Reparations are a sudden hot topic and talk of canceling US debt held by China has markets on edge.

Last Friday was particularly messy in FX as large month end rebalancing trades in DM collided with risk-off sentiment as global equities got hit and EM and commodity related currencies were sold.

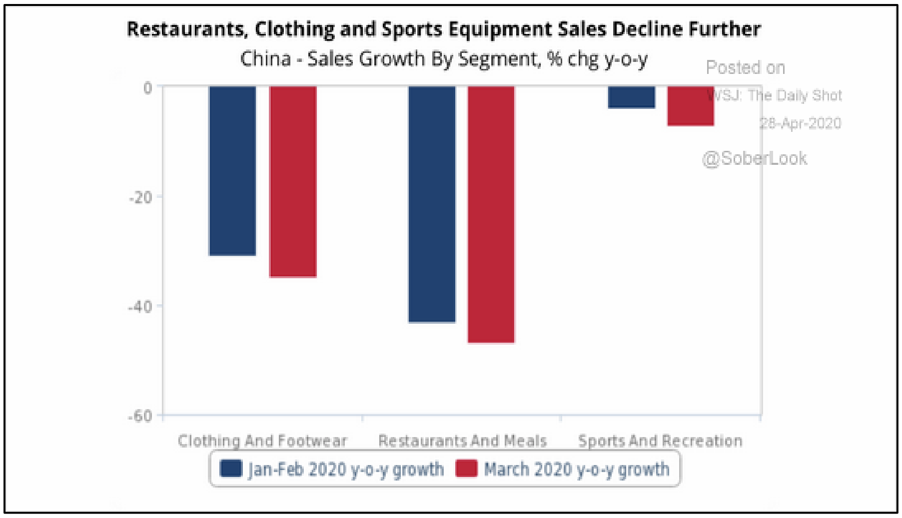
Market now…

Stocks ran up into classic retracement levels in most markets. The US and the big tech names in particular, outperformed everything and everyone. Spike down followed by a spike up.

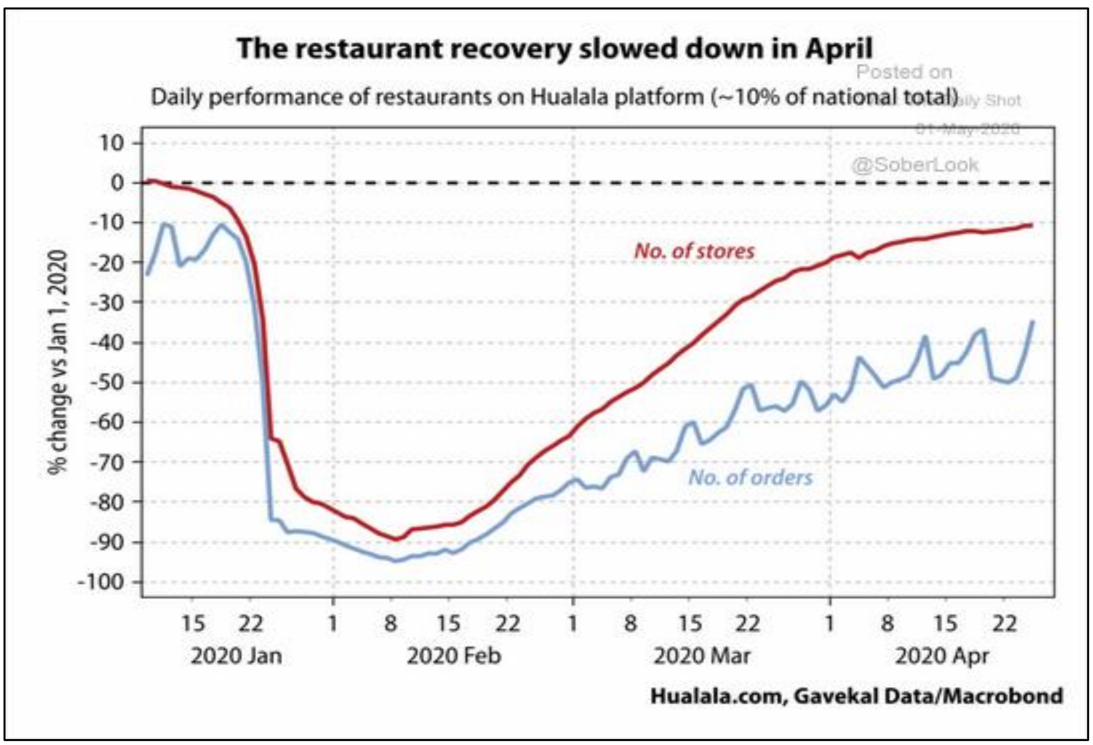


They now look to be rolling over again. The reality of what the end to lockdowns may actually mean is starting to sink in. Lingering consumer demand weakness is a worry and will be hard to overcome with more policy measures. Of course, that is why the hunt for a vaccine and for effective therapeutics has been all over the news for the last week. Until we get either of those it is likely that for the time being, we get the 90% economy the Economist had as its lead story last week. I know, the magazine front page is rarely how it works out in the end. So maybe its worth owning some longer-term tails, i.e. the way better or way worse outcomes?

If China remains one of the few templates for post lockdown, it looks like the slower demand recovery, at least in some areas is likely for a while.

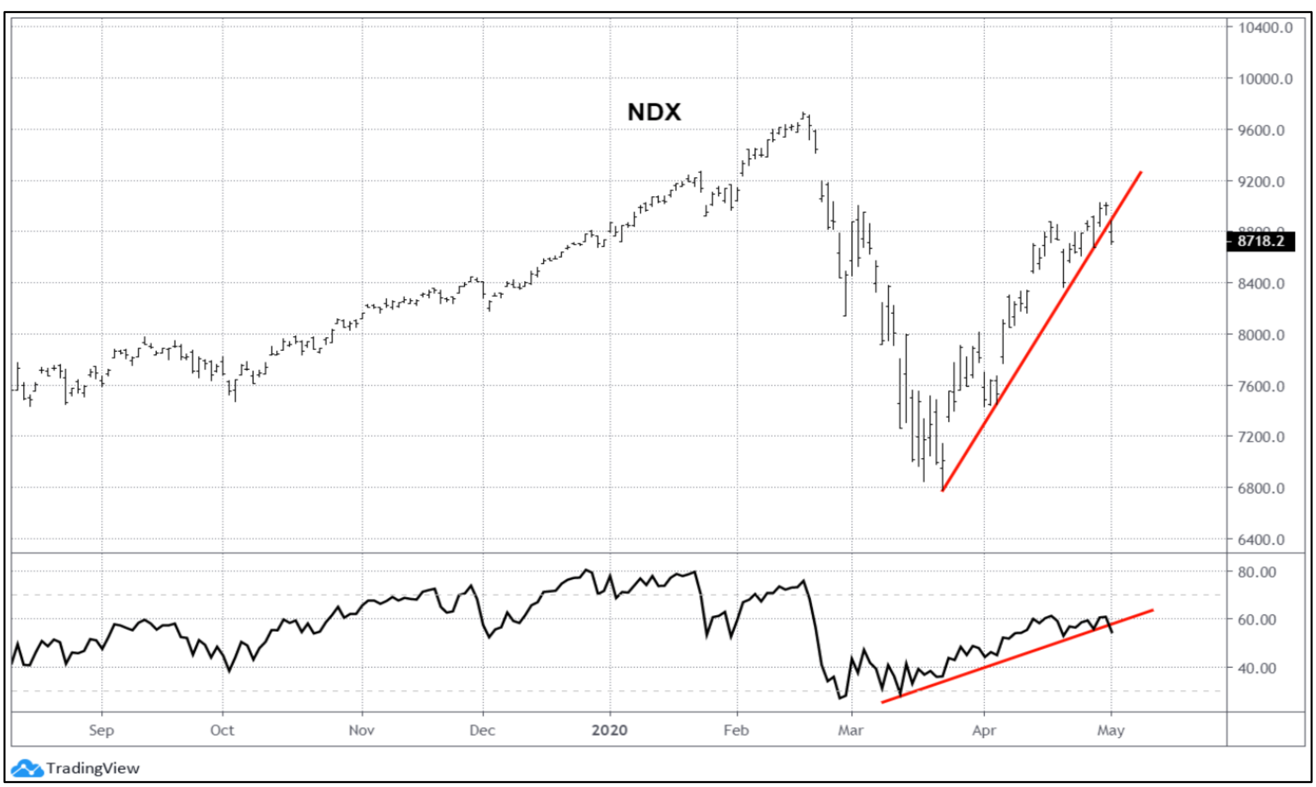


Recovery may plateau below previous levels.



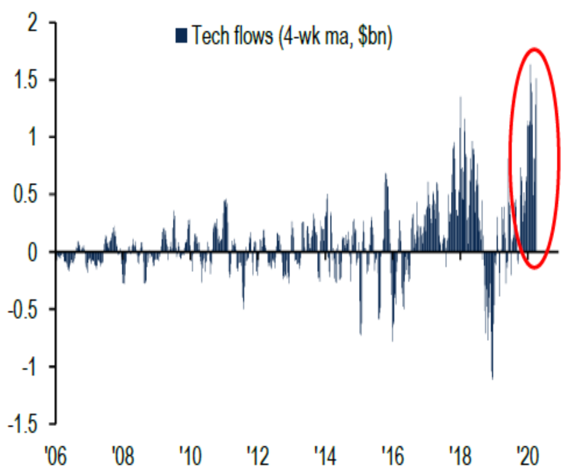
Looks like this run up is stalling and it could be time that we define the range for the coming months. 2300-3000?

The NASDAQ rally has of course been the most impressive with its FAANGM and Healthcare exposure.



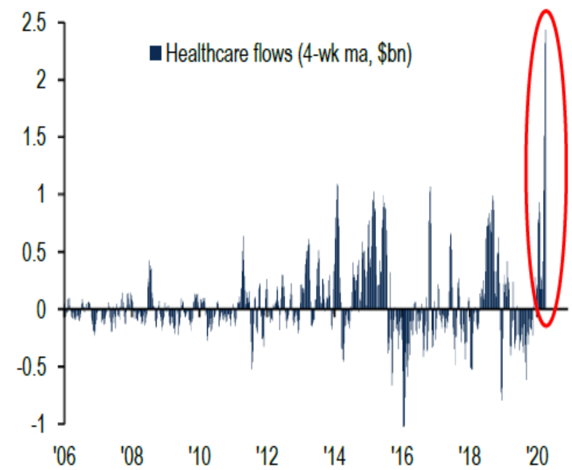
So far, they are sticking with it…

Chart 12: Investors continue to crowd into tech…



Source: BofA Global Investment Strategy, EPFR Global

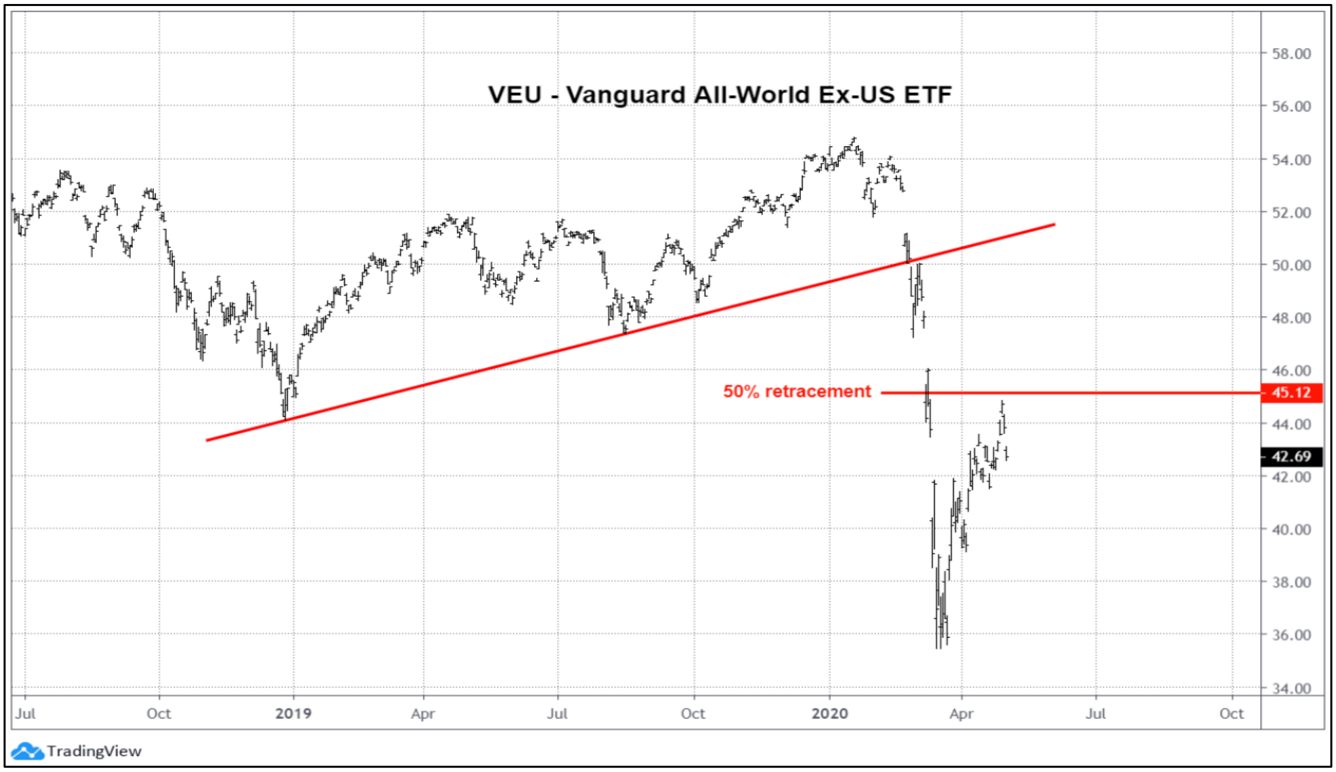
Chart 13: … and healthcare funds



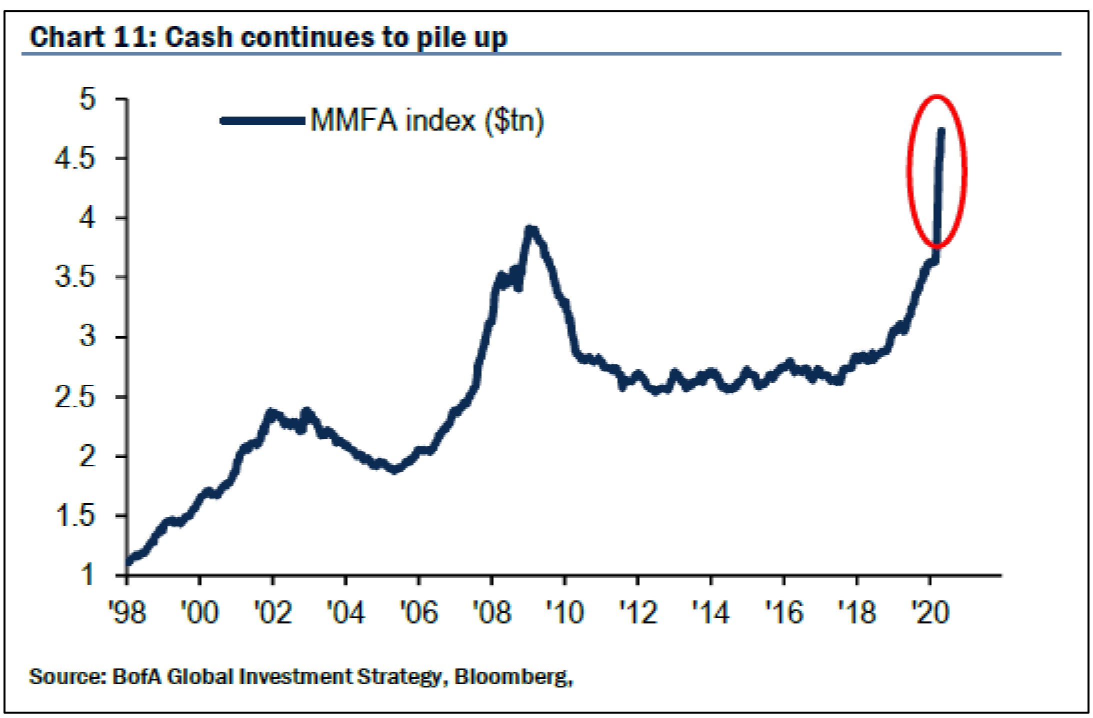
Source: BofA Global Investment Strategy, EPFR Global

The rally in Europe has been unimpressive by comparison. The bounce has been textbook, with a failure on Thursday (closed Friday).

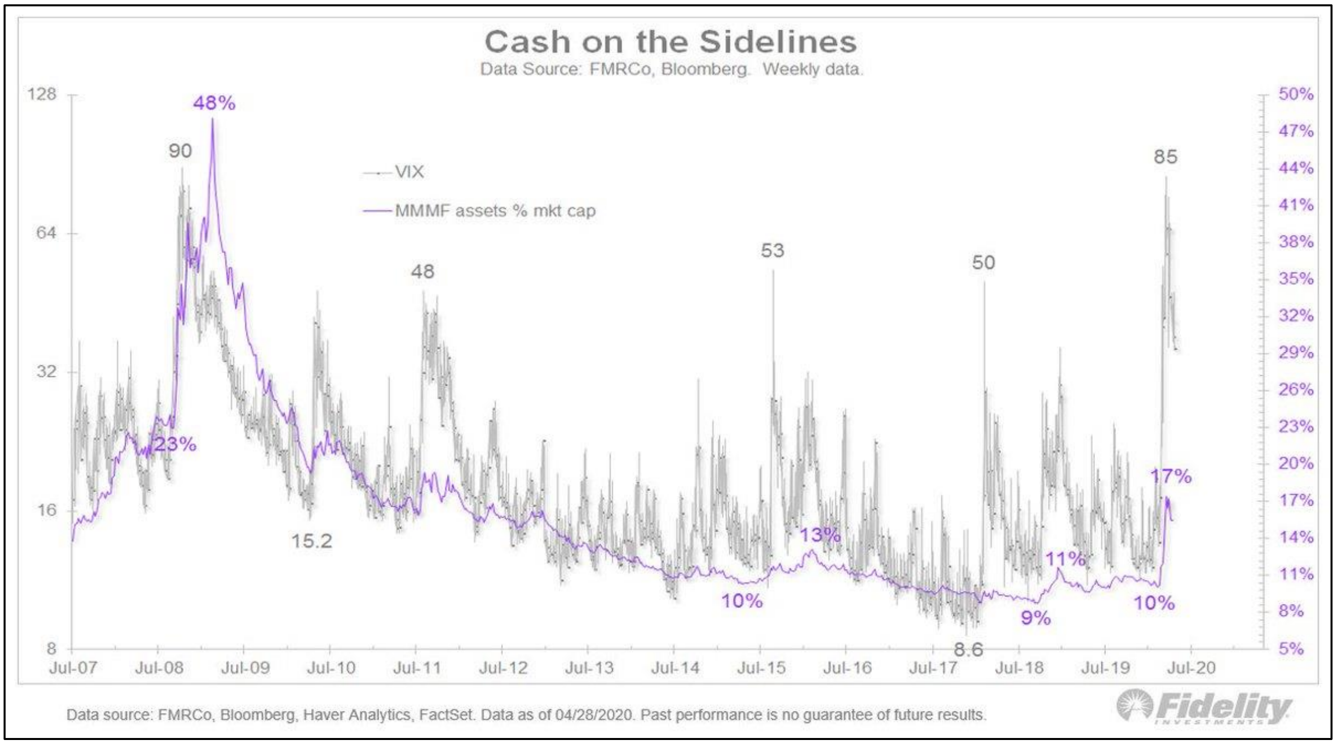
The world ex-US in general look similarly.



There is a lot of talk about all the cash on the sidelines at the moment as money has poured into money market funds. We have seen these cash levels pop to 4.7trl from 3.6trl only a month ago.



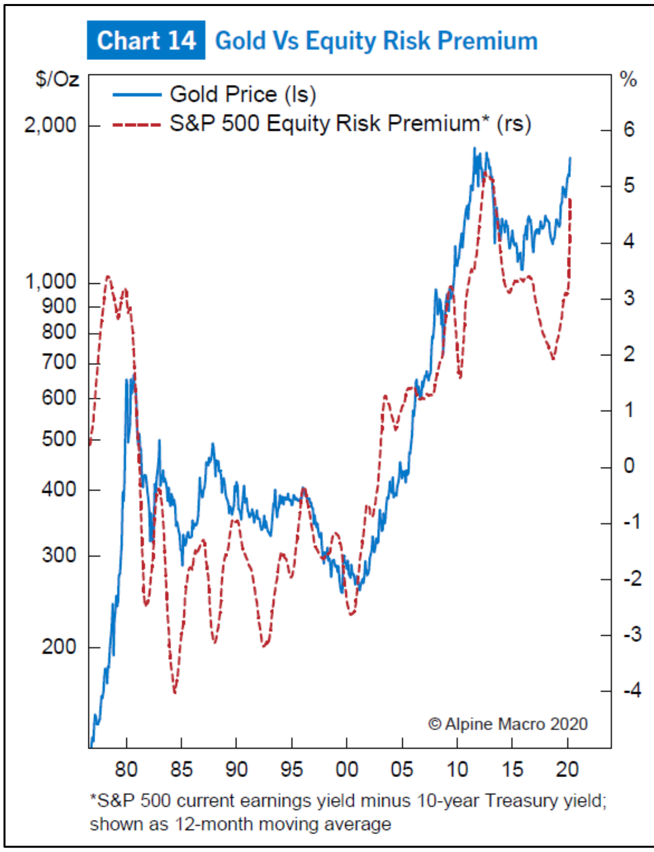
Jurrien Timmer, Director of Global Macro at Fidelity, points out that if you look at this as a percentage of total equity market capitalization, it isn't quite as impressive and not even close to what we saw during the GFC. Now 17% vs. 23% in mid-2008 and 48% at the extreme in early 2009.

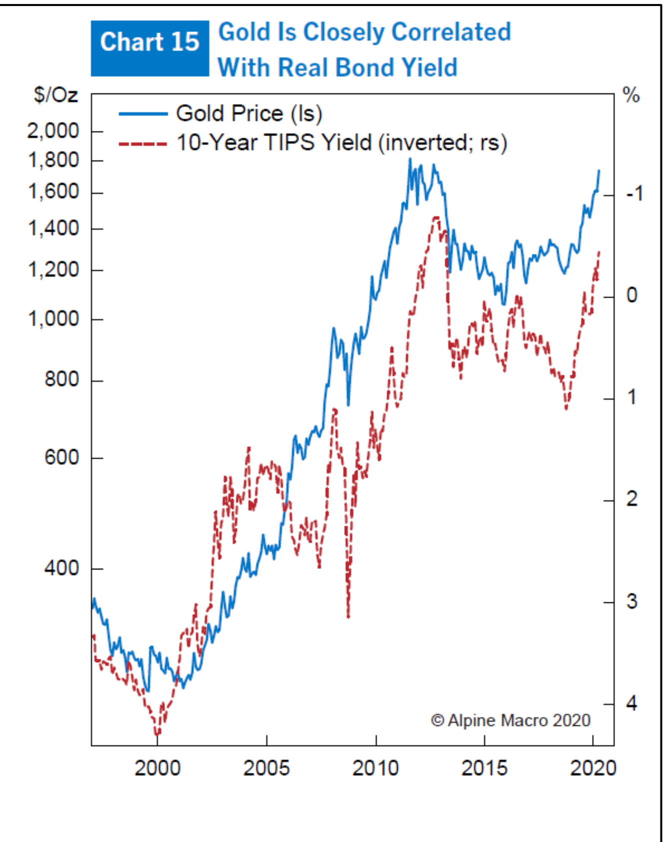


Gold

Everyone likes it and I think for good reasons, but for the last few weeks it has stalled. As markets debate the inflation (global money printing) vs. deflation (credit event) narratives it seems stuck between stories. Its correlation to the USD and equities is also in flux as some days it seems to trade one way, only to have a different driver the next. There has been a lot of buying over the last few months and some of the price action is almost certainly being driven by extended positioning with varying levels of commitment. For a time, Gold was in demand as a substitute for negatively yielding currencies (better than negative carry). Now it is being seen as a substitute for any currency that a central bank can just print. While both have real yields as a driver there is a different narrative behind how those real yields are kept down.

Two good charts from Alpine Macro I wanted to share.





With lockdowns ending and extremes in at least some of the economic numbers probably already printed, the data is becoming more relevant again.

Important Macro Data Releases and Events for the Week

Monday
5/4/2020

Markit Manufacturing PMI (Apr) Forecast: - , Prior: 34.4

Factory Orders MoM (Apr) Forecast: -9.5%, Prior: 0%

Tuesday
5/5/2020

RBA Interest Rate Decision and Statement Current: .25%

European Commission: Economic Growth Forecast

German Constitutional Court Decision on bond purchases

Trade Balance (Mar) Forecast: $-38B, Prior: $-39.9B

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Markit Services PMI (Apr) Forecast: -, Prior: 27

Markit PMI Composite (Apr) Forecast: -, Prior: 27.4

ISM Non-Manufacturing PMI (May) Forecast: 32, Prior: 52.5

ISM Non-Manufacturing Employment (May) Forecast: -, Prior: 47

Wednesday
5/6/2020

Caixin Service PMI (Apr) Forecast: -, Prior: 43

Factory Orders s.a. MoM (Mar) Forecast: -9%, Prior: -1.4%

Markit PMI Composite (Apr) Forecast: -, Prior: 17.1

Markit PMI Composite (Apr) Forecast: -, Prior: 11.7

Retail Sales YoY (Mar) Forecast: -, Prior: 17.1

ADP Employment Change (Apr) Forecast: -13050K, Prior:27K

BoJ Monetary Policy Meeting Minutes

Thursday
5/7/2020

Exports YoY (Apr) Forecast: -, Prior: -6.6%

Imports YoY (Apr) Forecast: -, Prior: -0.9%

Trade Balance (Apr) Forecast: -, Prior: $19.9B

BoE Monetary Policy Report and Interest Rate Decision Current 0.1%

Financial Stability Report

Initial Jobless Claims Forecast: - , Prior: 3.839m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 5.033m

Continuing Claims Forecast: - , Prior: 17.992m

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Friday 5/8/2020	RBA Monetary Policy Statement
	Nonfarm Payrolls (Apr) Forecast: -2m, Prior: -710k
	Unemployment Rate (Apr) Forecast: 14%, Prior: 4.4%