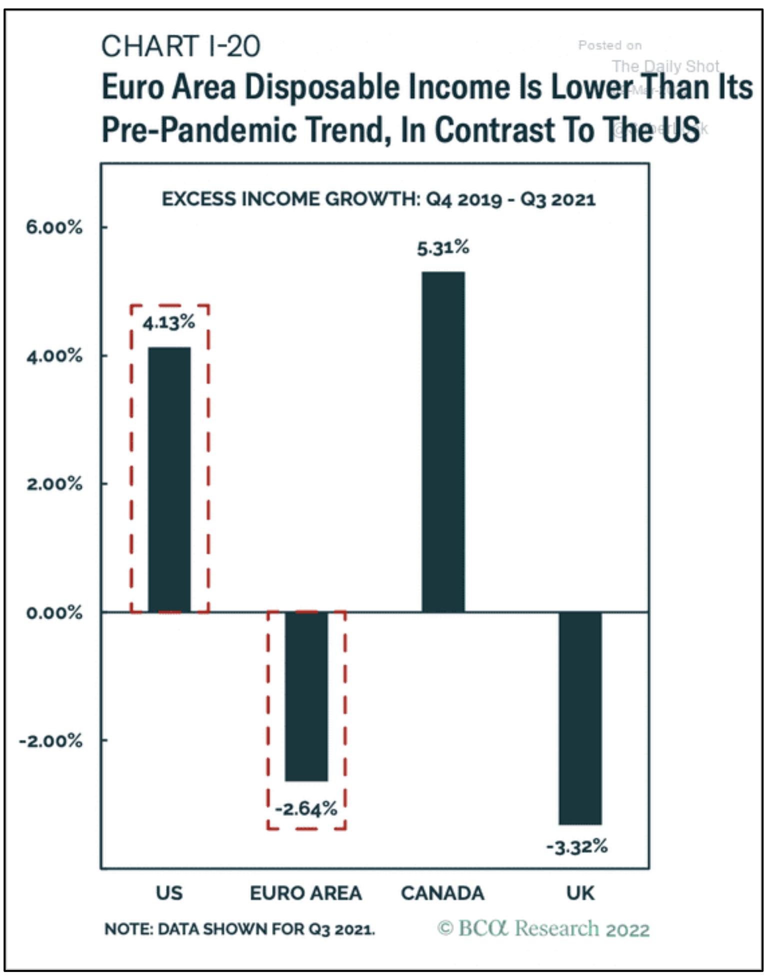
What to focus on in Global Macro for the week of March 14th, 2022

The ECB and the Fed

Caught between soaring supply side inflation and a weakening growth outlook, the ECB is the central banking equivalent of a deer in the headlights. Lagarde admitted that there was a lot of disagreement on the council regarding how to proceed, but that they all got behind Chief Economist Lane's proposal to at least bring forward the end of asset purchases, i.e. to stop easing.

In theory, the early end to QE means that they could hike as early as the Fall. However, they specifically changed the wording of their forward guidance to sever the link between the end of QE and rate hikes "soon after". Taking a page from what happened with US rate expectations, the market has now priced nearly two 25bp hikes from the ECB by year-end.

I'm skeptical that we'll get that, but the ECB does have a history of hiking rates into growth tops because of energy prices. Close to 60% of the inflation in Europe is now directly or indirectly due to the energy spike. With wage growth still lower than in the US and retail spending not yet back to pre-pandemic levels, they will go slower than the Fed.



Importantly, long-end yields spiked last week as the double whammy of an early end to QE and the anticipation of higher debt issuance for defense and energy programs made people question who the marginal buyer would be.

Regarding the potential new borrowing by the EU Commission, Bloomberg said the following:

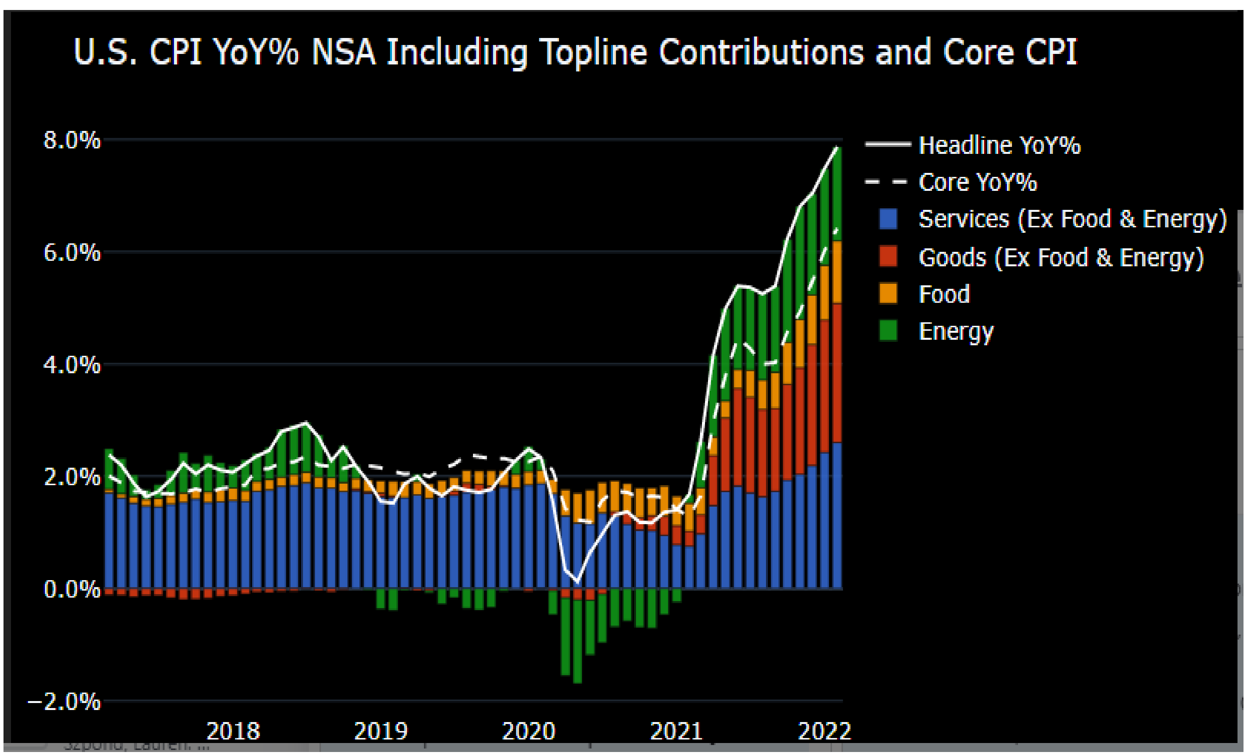
"The plan would involve the commission, the bloc's executive arm, issuing bonds and then channeling the proceeds to member states in the form of concessionary loans to finance spending in the areas, according to the officials who asked not to be identified because the plans are private."

If they can follow through, this would be a further big step towards eventual federalization of the EU. Never let a good crisis go to waste, as the saying goes. Bear in mind that we don't know the timeline or the size of this potential plan, and that it would need to be approved by all members.

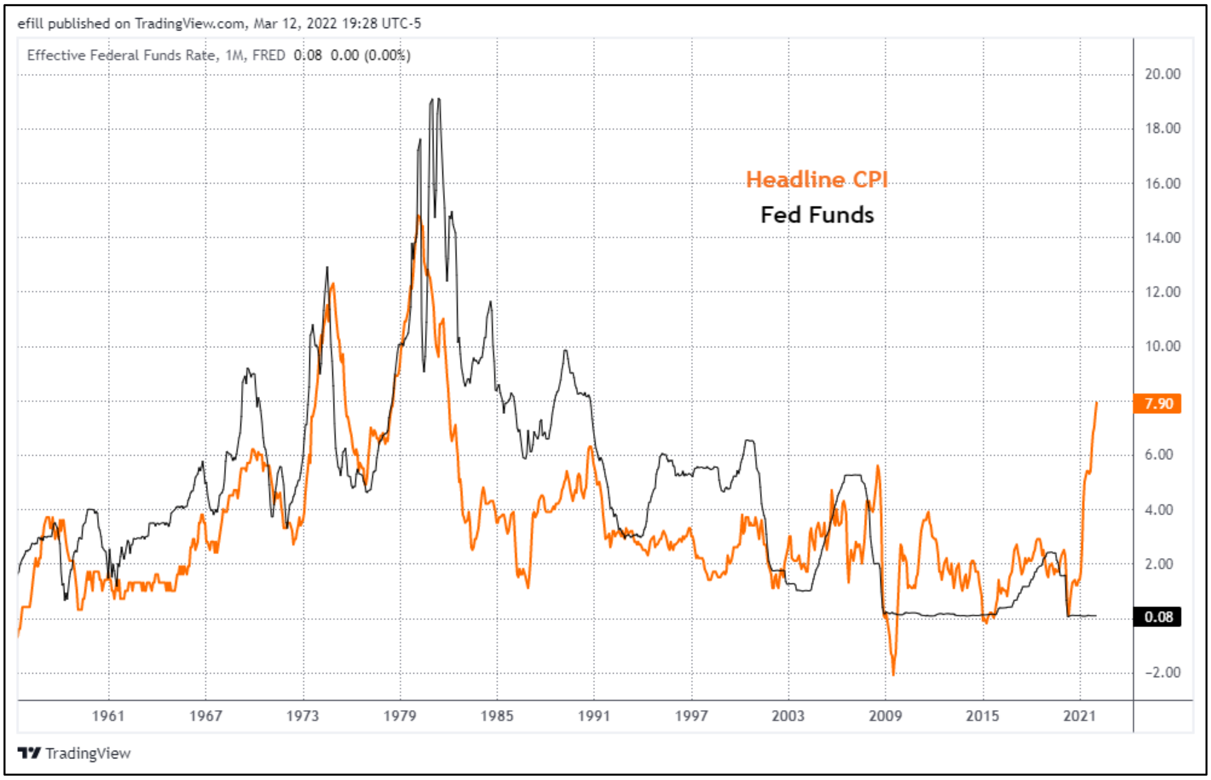
This week's Fed meeting will kick off the US tightening cycle with a 25bp hike. More interesting will be what the forward guidance looks like, and the press conference Q&A. A new dot plot will tell us what various member's projections look like. I doubt much will change for now, regarding the roughly six and a half tightenings currently priced in by markets.

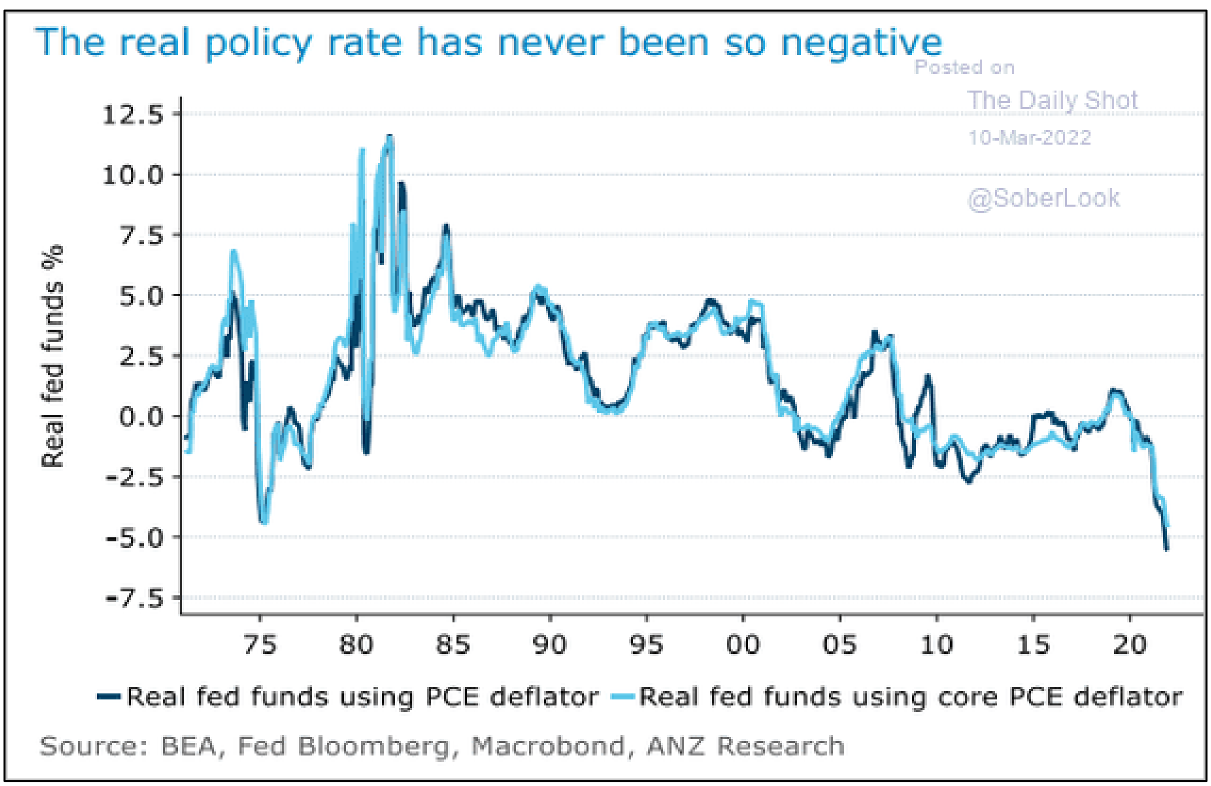
Look for comments regarding the degree of concern that Ukraine, as well as potentially stagflationary forces exerted by energy prices, are generating. The ECB raised its inflation forcast but downgraded the growth outlook. So far, the Fed has been more focused on inflation and less concerned about the still strong US growth backdrop.

Central banks remain in a tough spot. Living in a world where they primarily encourage or moderate demand via monetary policy, they are ill equipped to deal with supply shocks. At the same time, the need to "do something" about inflation, has become clear. This COVID driven cycle has been so extreme and without historic precedent that the temptation to wait and see arguably prevented a timely liftoff. Add to that the recently announced new framework, under which they would wait for outcomes rather than act on forecasts, and the trap was laid. It is better to act when you can, than when you must, and I have little confidence that the pressure they now feel to "go big" will lead to good decisions. For now, the days are gone when CBs could suppress market and GDP volatility.

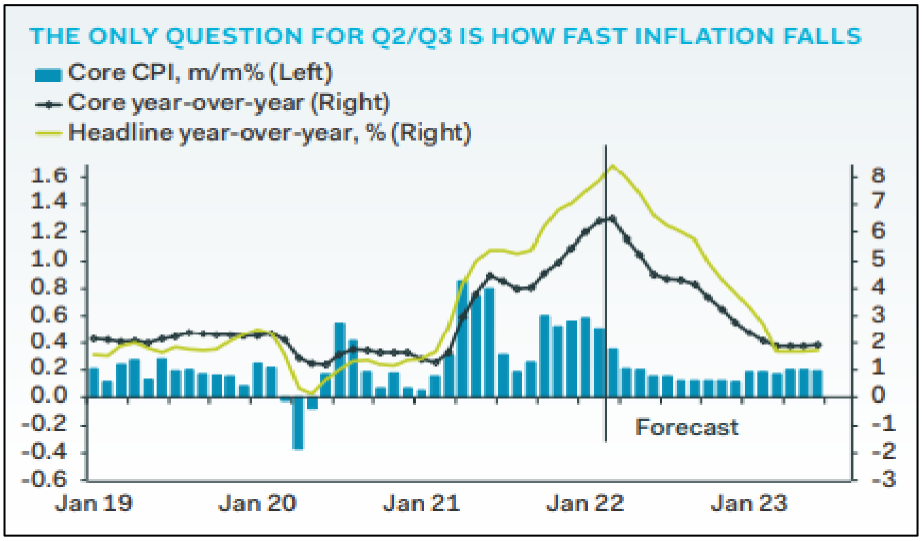


They are now being forced to respond, while given the supply shocks, they are effectively trying to drive the economic “car” from the passenger’s seat.





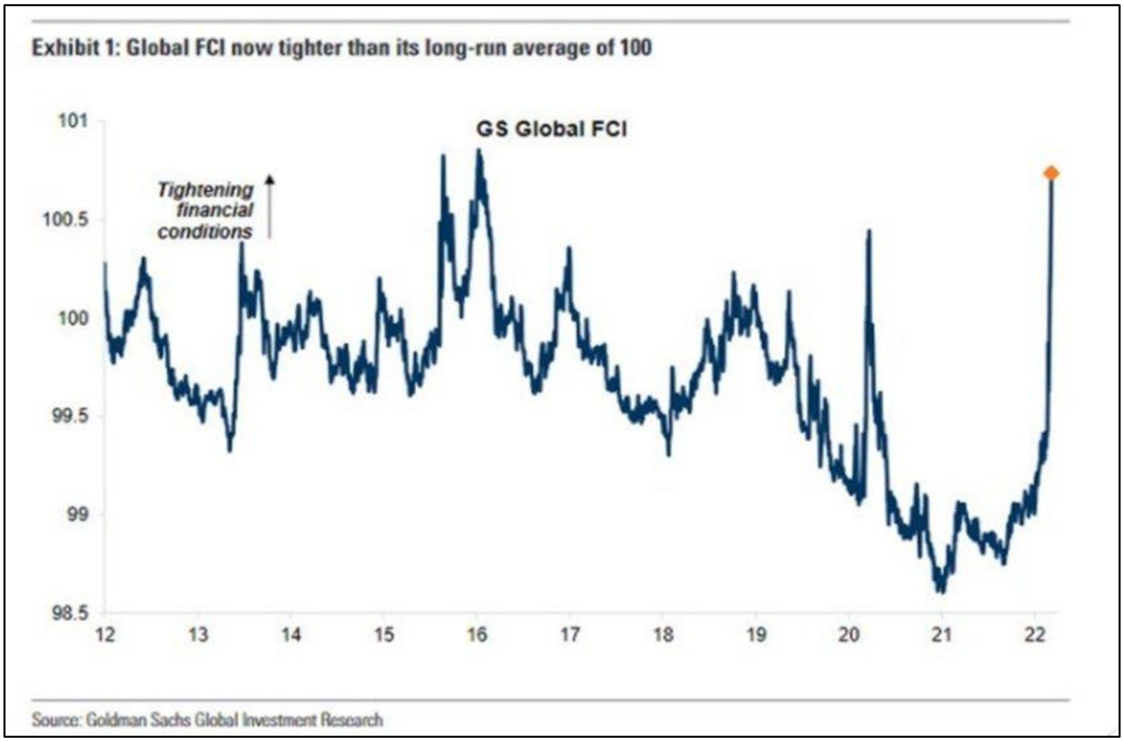
For the next few quarters, the big question will be when and how far does inflation fall? Even if inflation falls by half in the next nine months, it will still be way above the target rate.



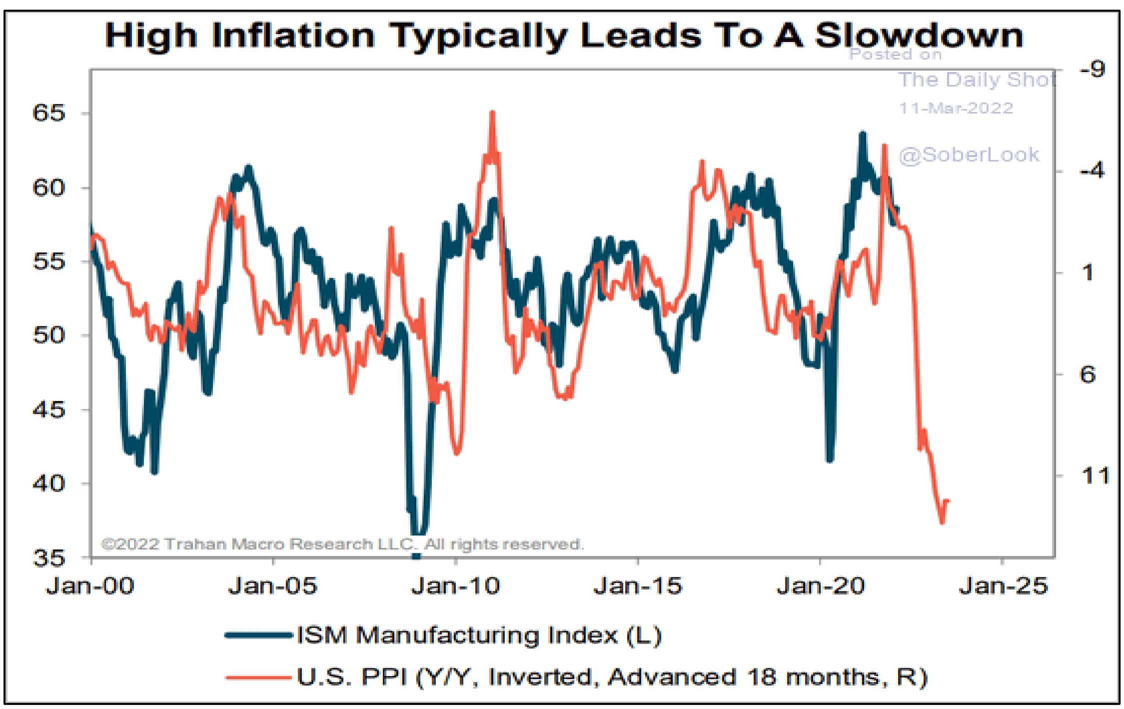
The inflation concerns are now top of mind for the CBs, but what about growth? Much depends on how long the Ukraine saga continues and what happens to energy prices. We have witnessed the unusual combination of rising energy prices, a strong USD and rising rates.

It is unusual for the dollar to rise as commodity prices rise. Previous episodes have not ended particularly well.

US financial conditions have started to tighten, but so far, the move has been relatively contained. According to Goldman, the same can't be said for global financial conditions…



At least partially due to resulting Fed tightening, higher inflation and higher energy prices usually lead to slowdowns.



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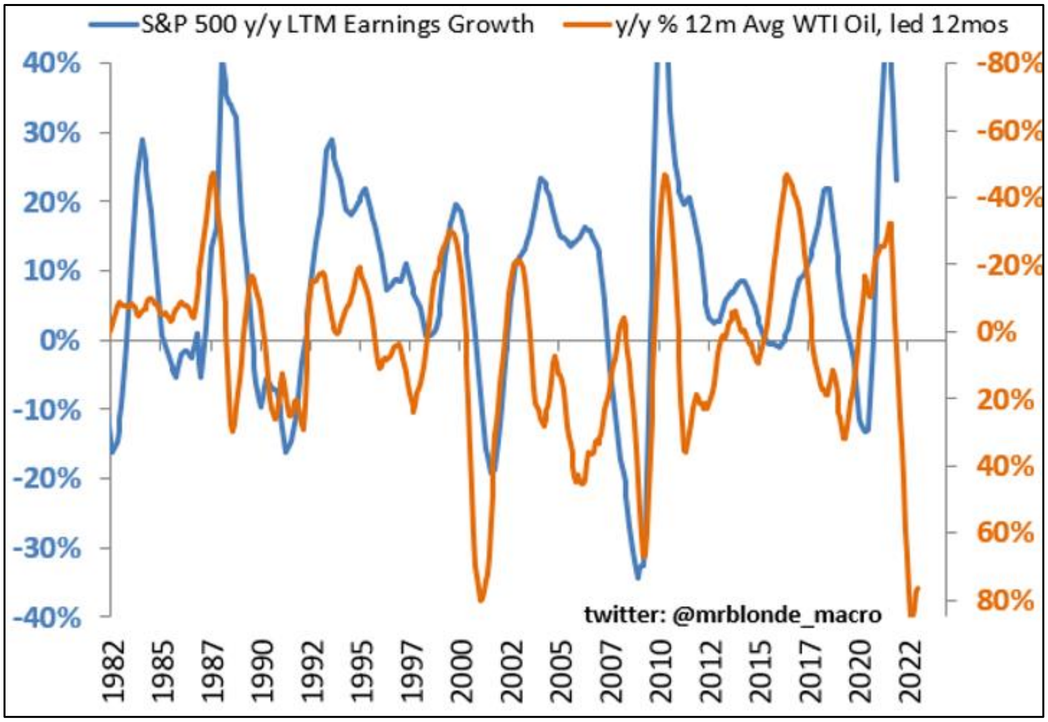
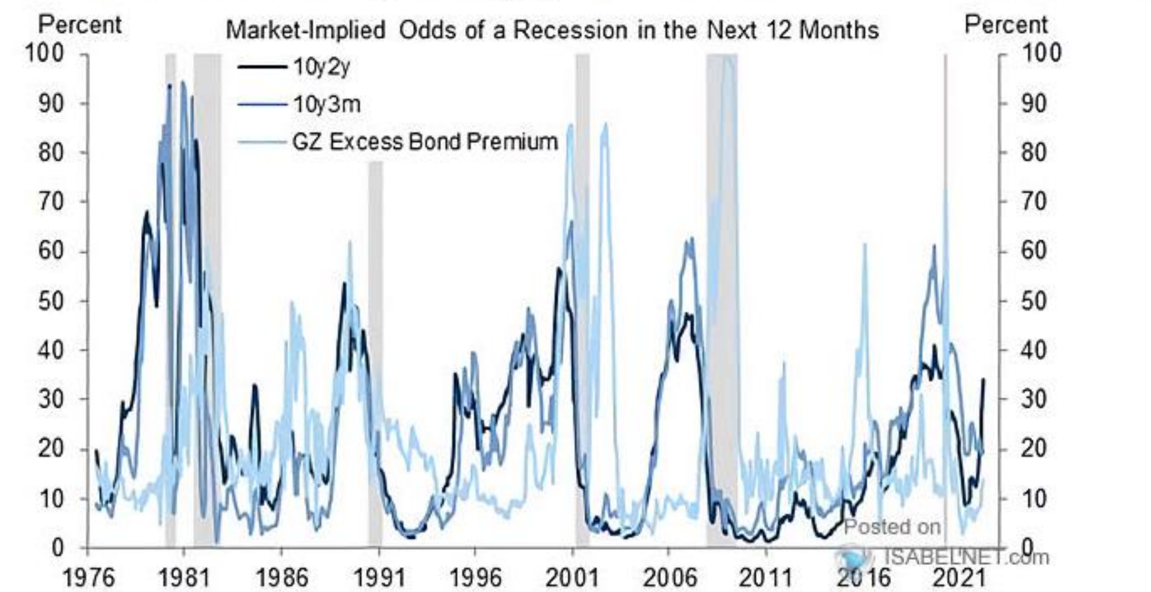
And margin pressure? YoY earnings growth vs. % change in WTI, inverted.



As well as a tax on consumers…

How long inflation and high energy prices last will matter, as will the Fed's reaction function. Relatively flat curves, front loaded hiking expectations, and a still relatively low terminal rate, speak to forward growth concerns. <u>How the tension between relatively aggressive Fed hikes and growth concerns plays out this year, will be key to making money in the markets.</u>

Exhibit 5: The Yield Curve Implies Roughly 20-35% Odds of a Recession over the Next Year

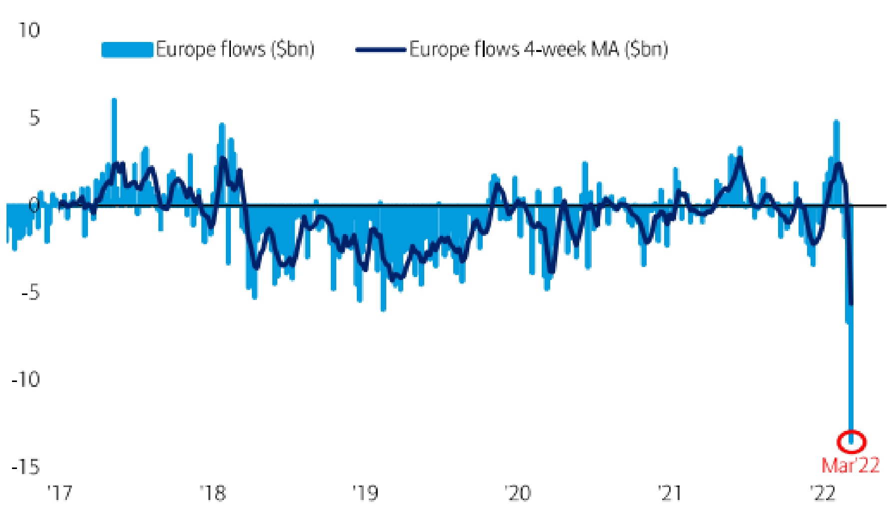


Source: Bloomberg, Goldman Sachs Global Investment Research

Equities

Over the last few weeks overweight longs in Europe have been punished.

Chart 2: Largest outflow ever from European equities
Europe equities flows (weekly & 4-week moving average)

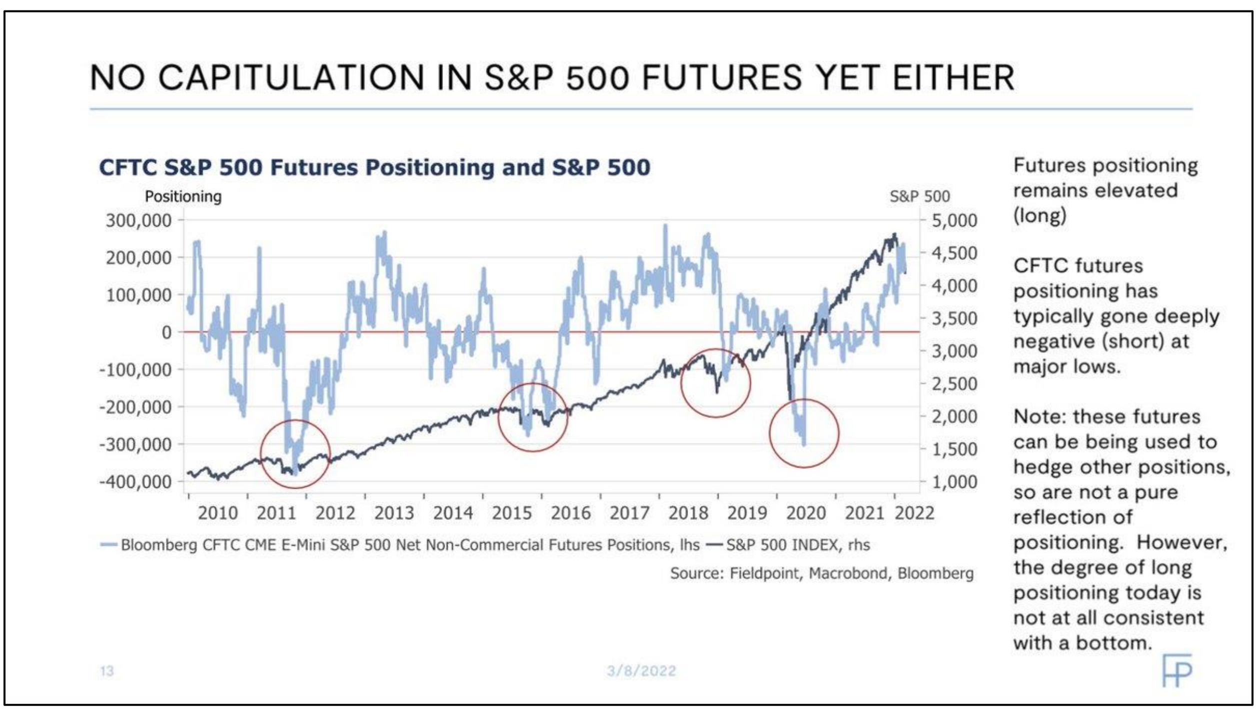


Source: BofA Global Investment Strategy, EPFR

BofA GLOBAL RESEARCH

Once we broke the range, prices quickly flushed. The top to bottom move in Euro Stoxx slightly exceeded -23%. Being at ground-zero for continued potential headline bombs, makes the near-term price action difficult to gauge at this point.

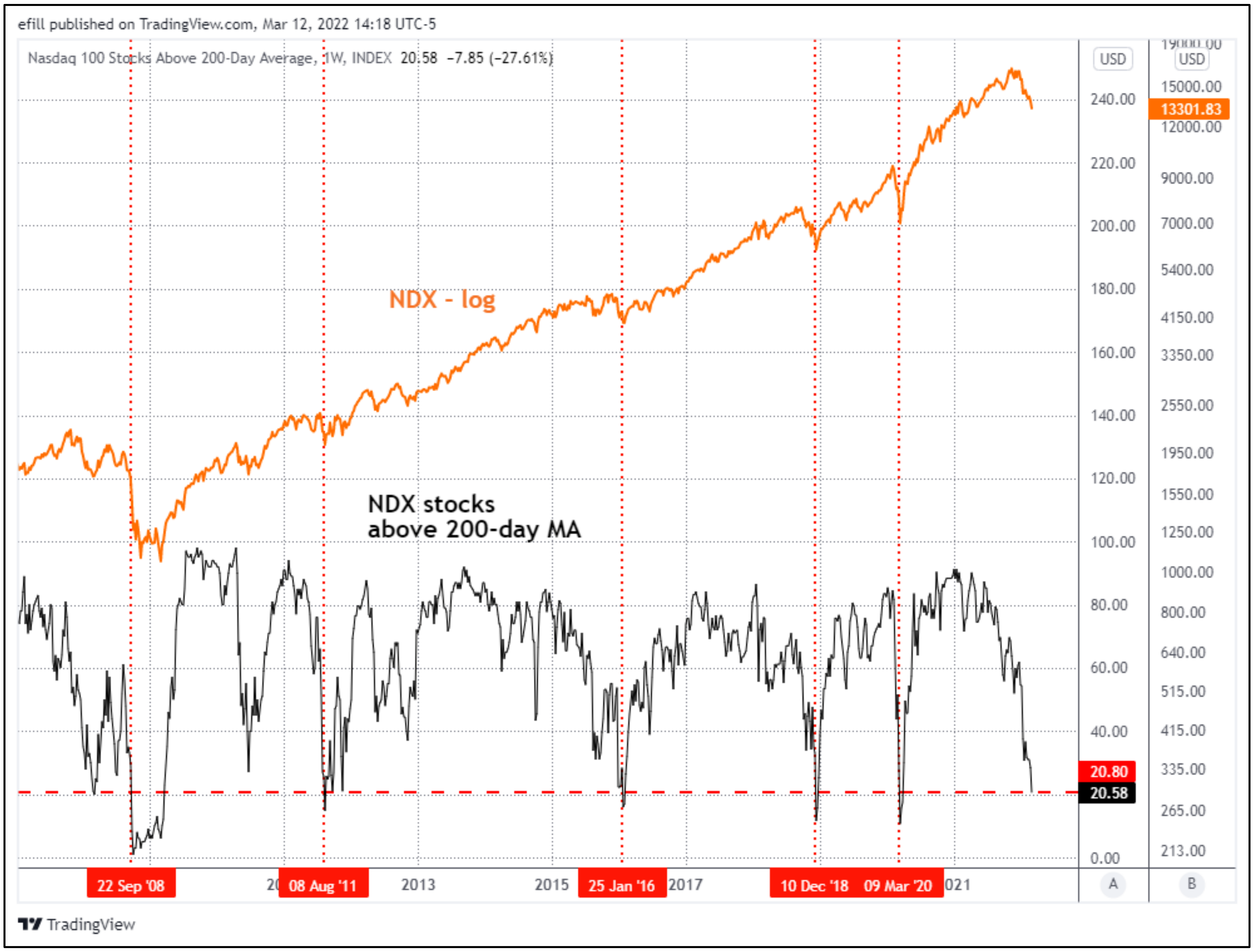
Aggregate US positioning has fallen, and cash levels have gone up. But is more needed?



Sentiment has become very bearish as well, and some breadth indicators are nearing extremes.

Here the NASDAQ 100 and the percentage of stocks above the 200-day moving average.

This kind of thing tends to work well in a broader uptrend. Less well, in a bear market.



FX

The dollar has remained strong in recent weeks as the risk-off environment and its safe-haven status has attracted capital. In addition, rate spreads have remained supportive.

Not surprisingly the EUR has been hit, and now sits at/near critical support.

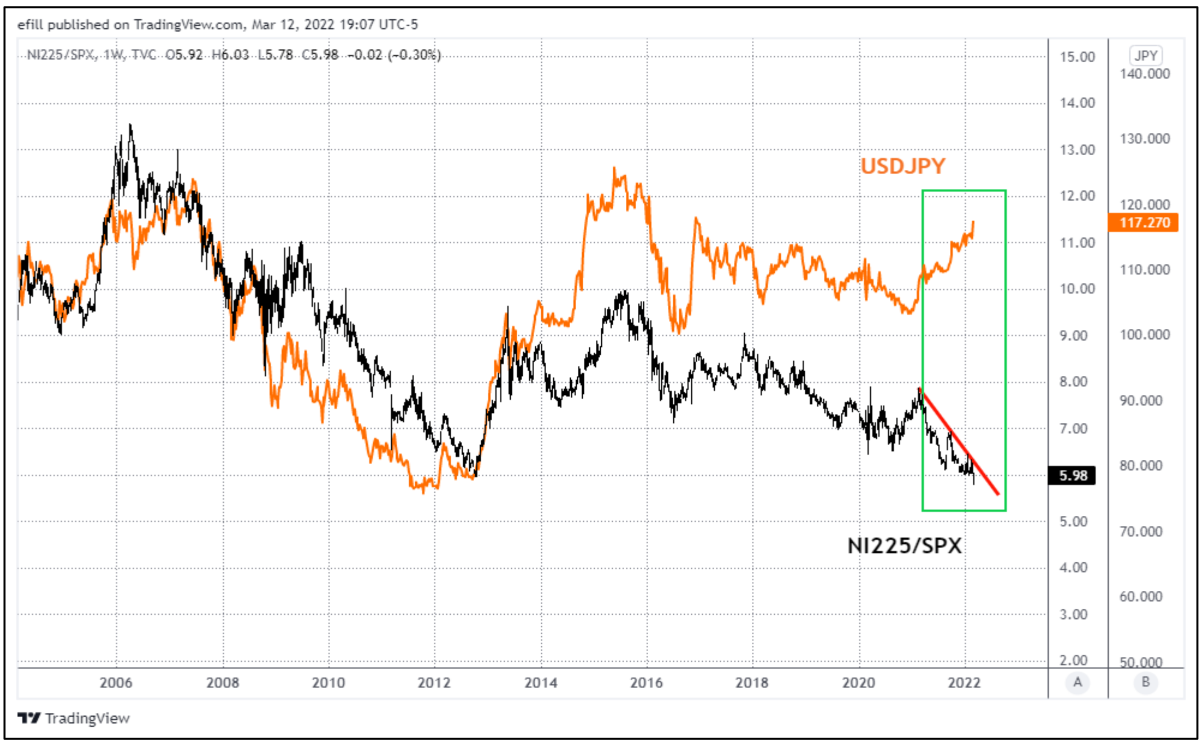
Interestingly, GBP and JPY also closed out the week at critical levels. A more forceful USD rally from here could have big implications for markets.

EURUSD has support between here and 1.0650, downside opens up below there.

Last week's break in GBPUSD targets 1.2500 if maintained.

USDJPY is toying with some long-term levels as well. USDJPY has held up very well in recent weeks despite the risk-off environment. Rate differentials and dependance on energy imports are likely among the factors.

Will the historic relationship between USDJPY and Nikkei outperformance re-emerge?



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Asset Management

AUDUSD tried to reaccelerate last week but has been held back by risk-off, general broad dollar strength and weak Chinese markets. AUDJPY looks interesting longer-term. Back to the top line?

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China – New COVID outbreaks and lockdowns are mixing poorly with continued talk of "common prosperity" and real estate woes. USDCNH even popped despite what had been persistent Yuan strength. Here a long-term chart, and zoomed in to a daily… Watch 6.40

The combination of pressure on Chinese big-cap tech and the real estate sector has hit some indices very hard. Last week added more COVID outbreaks and new lockdowns.

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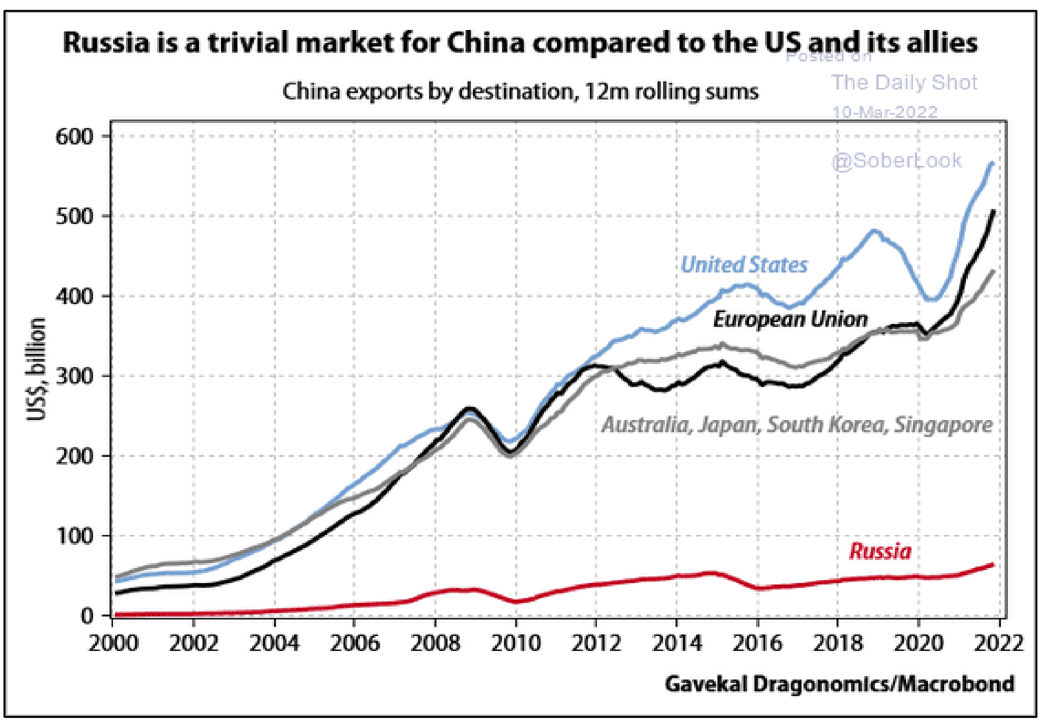
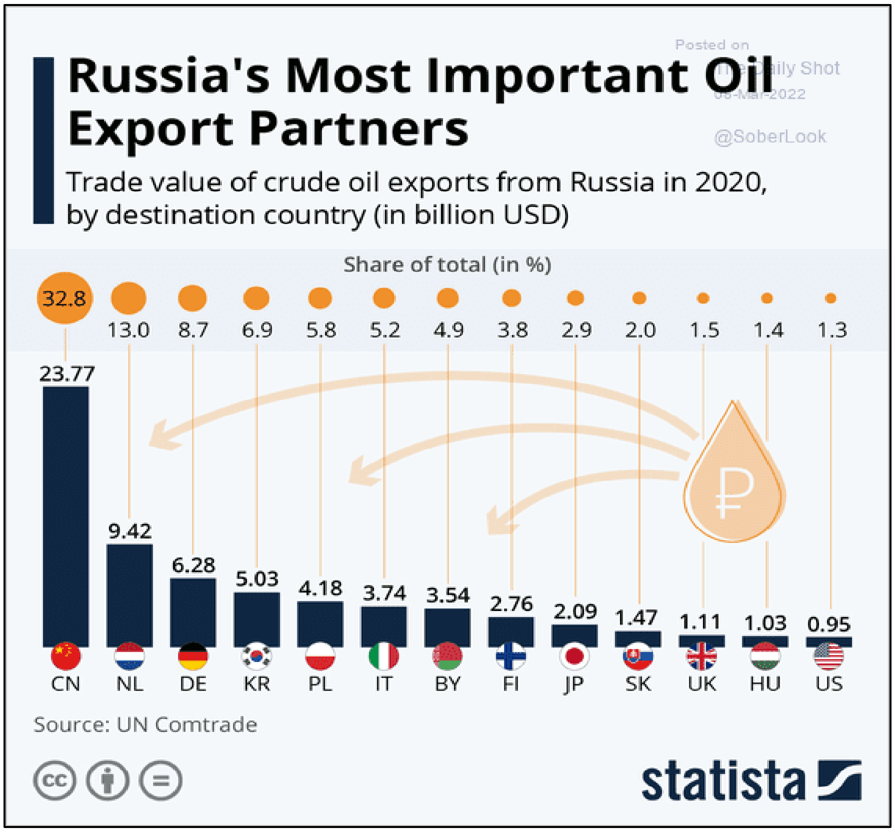
Alibaba continues to illustrate the plight of big-cap tech.

Russian / Chinese trade…

The Russian market doesn't matter much for Chinese exports, but the reverse isn't true.





With Putin's blitz on Kyiv stalled and mounting casualties, if Russia cannot achieve results at the negotiating table soon, it seems likely Putin will have to turn East for support. Given the state of the Russian economy however, any arrangement will be heavily in favor of Beijing. It seems possible that if Putin is dead set on taking all of Ukraine to secure Russia's geopolitical position, he will lose Russia's economic sovereignty in the bargain.

On one hand we have negotiators saying a deal between Ukraine and Russia could be achievable in the coming days, on the other hand this headline just came over the wire:

*** RUSSIA ASKS CHINA FOR MILITARY ASSISTANCE IN ITS INVASION OF UKRAINE – FT

The Fed decision, and maybe more importantly, their projections, are at the top of the ticket next week. Of course, massive headline risk remains around Ukraine and energy as well.

Additionally, it appears that the State Dept / Congress / WH are all developing proposals for new legislation to fight the global energy crisis. Watch for headlines regarding what this multi-faceted proposal might look like. It could be "shock and awe" style.

Important Macro Data Releases and Events for the Week

Monday 3/14/2022	RBA Meeting Minutes
	Industrial Production and Retail Sales YoY (Feb)
Tuesday 3/15/2022	ZEW Survey - Economic Sentiment and Current Situation (Mar)
	PPI (Feb)
Wednesday 3/16/2022	EcoFin Meeting
	10-year Bund Auction
	Retail Sales (Feb)
	BOC CPI (Feb)
	Fed Interest Rate Decision, Monetary Policy Statement and Press Conference
Thursday 3/17/2022	**BoE Interest Rate Decision, Monetary Policy Statement and Press Conference**
	Building Permits (Feb)
	Initial Jobless Claims
	Initial Jobless Claims 4-week average
	Continuing Jobless Claims
	BoJ Interest Rate Decision and Policy Statement
Friday 3/18/2022	Retail Sales (Jan)

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