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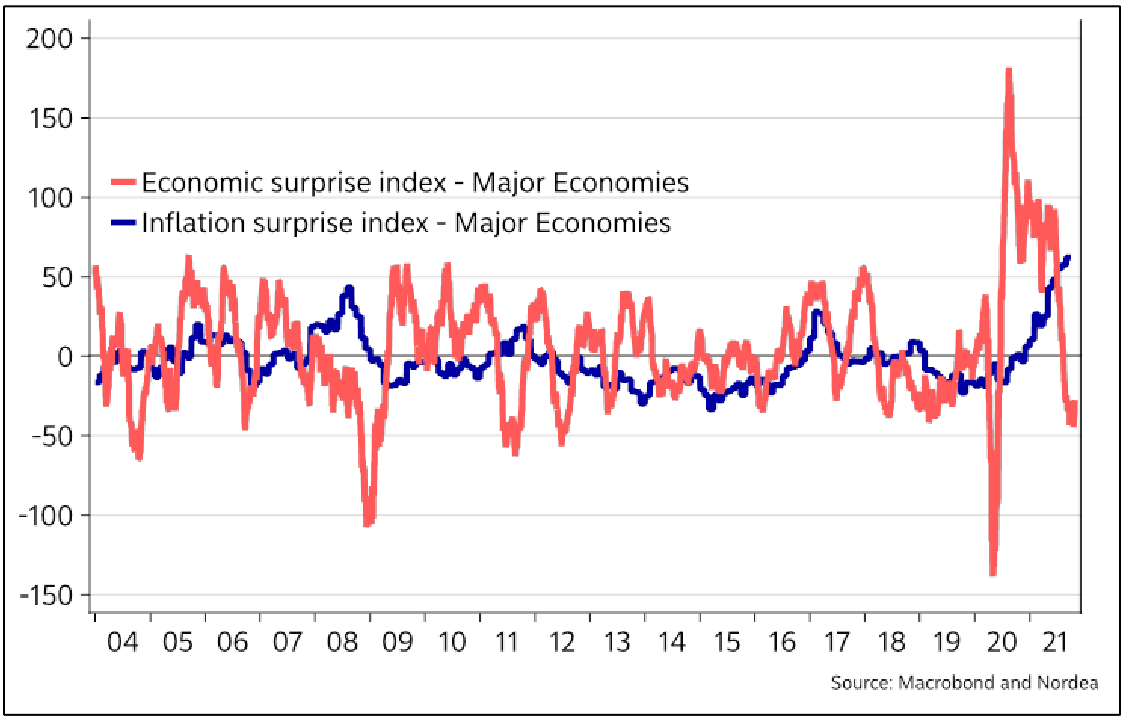
What to focus on in Global Macro for the week of November 1st, 2021

Macro Themes on the Radar:

Central Banks are feeling the squeeze as economic data shows some weakness, but inflation continues to push higher.



While demand for services has been generally good, although still uneven given rolling COVID outbreaks, GDP readings and manufacturing PMIs have been weakening. Overall, this looks to be largely due to supply constraints rather than a lack of demand.

CB's are caught, unable to fix the supply-chain issues and, afraid of killing off a recovery by tightening into what they still hope will be largely transitory price rises.

The problem is, that with no real end in sight to an inflation jump of much greater magnitude than they had expected, they are looking like deer in the headlights now. The market is taking the opportunity to call their bluff, as front-end rates globally spike, and yield curves flatten.

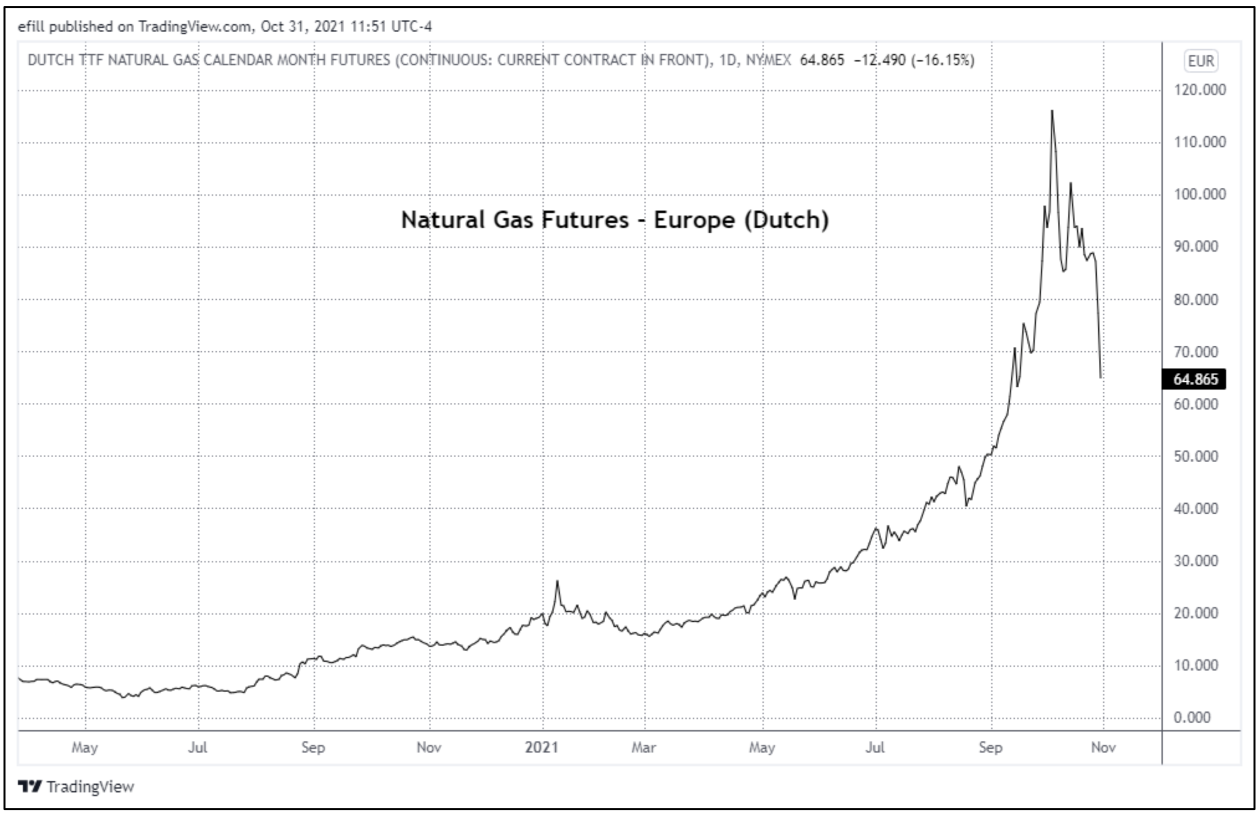
Now what?

Well, at last week's ECB meeting, the reaction was surprisingly muted. There was no attempt to address the current market pricing in the press release or monetary policy statement. During the press conference, Lagarde indicated that the pricing was not in line with EBC guidance and that conditions for a rate rise are not likely to be met in the time frame expected by markets. However, later on, she said that it was "not for me to say" if markets are ahead of themselves in pricing rate moves already for 2022. If she was trying to bring pricing more in line with the forward guidance, it didn't work. On Friday, Eurozone inflation came in at 4.1%, the highest since 2008.

Now, we have the Fed coming up on Wednesday. It would be a big surprise if they didn't announce the tapering of the QE asset purchases, starting next month. The big question will be what do they say about inflation and the move in front-end rates?

There are signs that some of the commodity moves are calming down, and even, that some of the bottlenecks in shipping are starting to open up.

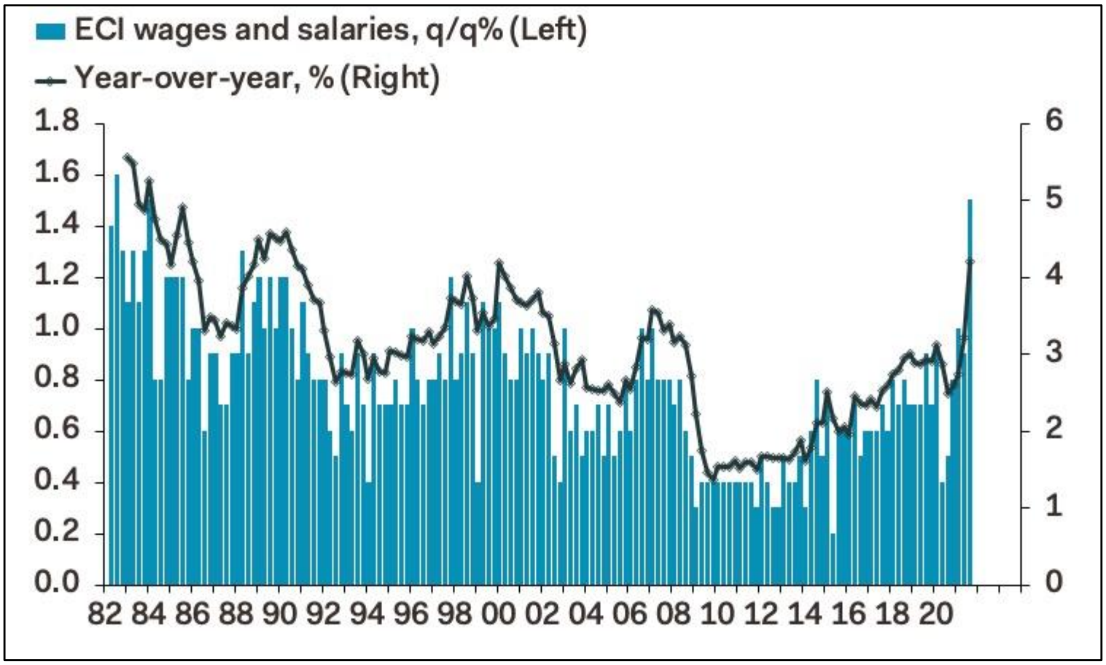
On the energy side, Chinese government intervention in the coal markets and the Russian announcement that they will be further supplying Europe with natural gas has brought both coal and NG prices lower.



Lower energy prices have been helping take the pressure off some industrial metals.

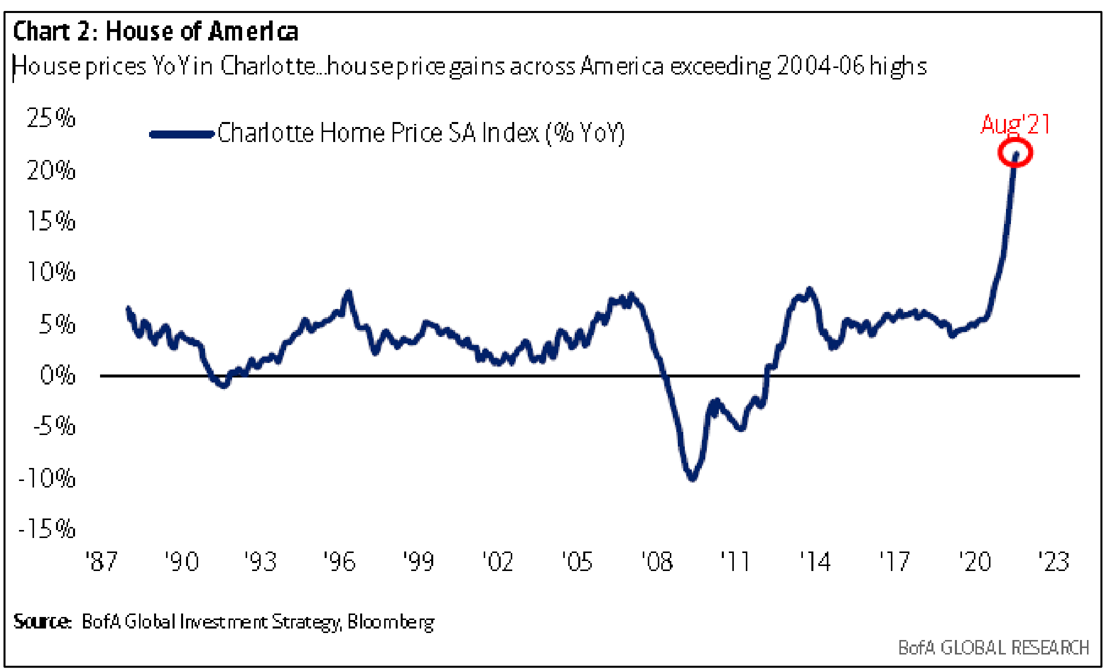
However, this inflation issue has been a story of rolling shocks and drivers, and now we need to worry about how rising wages and housing prices/rents will feed into the numbers.

The recent jump in the Employment Cost Index was the biggest in 31 years. The big question is whether labor supply rebounds in Q4! If it does, as is still expected, then the growth in labor costs should slow. If not, it will be big trouble for "transitory".

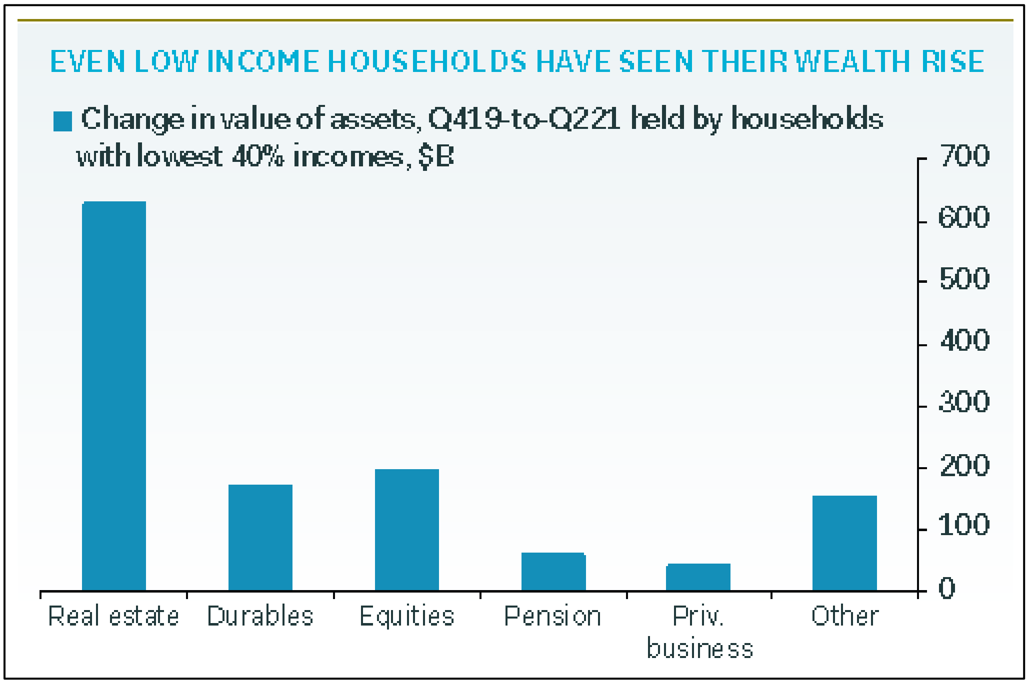


Source: Pantheon Economics

Rents and housing prices are other factors to watch. BoA reports that "US house prices up 19.7% YoY in Aug (note highest gain during '04-06 bubble was 17%); all-time highs in Dallas, Denver, Charlotte…"

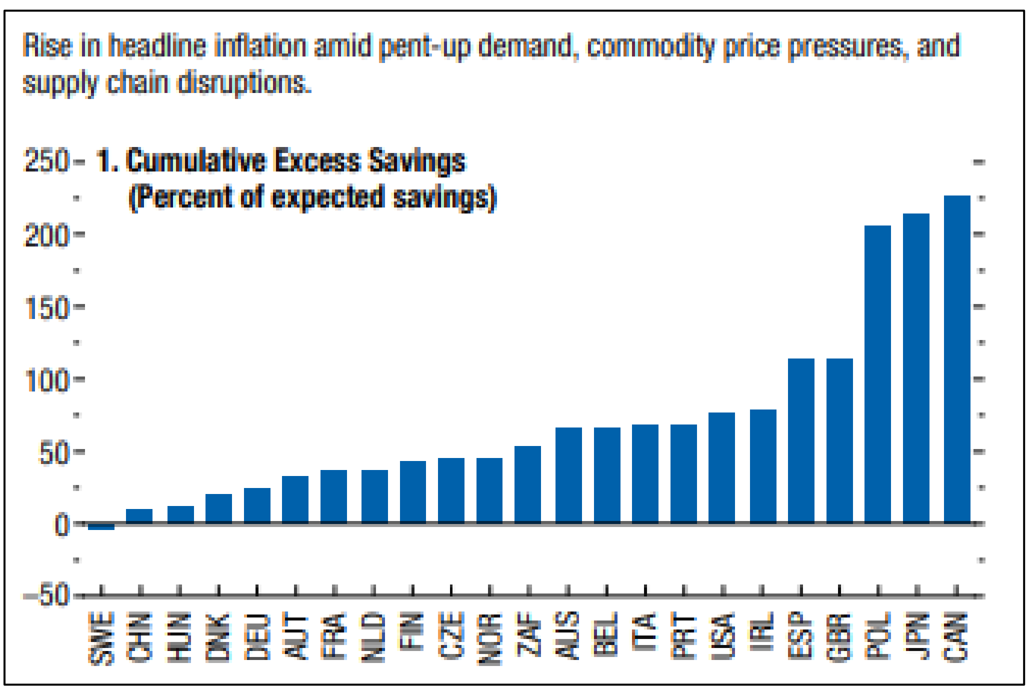


When it comes to wealth effects, equities matter a lot for the wealthiest 10% as they now own 89% of the stock market, but real estate matters for those with the lowest incomes.



Source: Pantheon Economics

Finally, will global consumers spend the savings hoard they have accumulated during the pandemic? That is a big unknown for monetary policy here.



Source: IMF

In the meantime, the reactions from global central banks are becoming increasingly divergent. Much of EM is already hiking rates.

Canada is ending QE and getting ready to hike. The market has been quick to react, now pricing the probability of five rate hikes through the July 2022 meeting at 84%. The UK has also been bringing forward hike expectations as mentioned last week. This is the stuff flattening yield curves, and the markets are now saying the US and the ECB will have to get with the plan next.

On the other side, the BoJ is now projecting lower growth and low inflation for years and is delaying any withdrawal of stimulus. (GBPJPY, anyone?)

China continues to face a lot of headwinds, and here you really have to think about how that is going to affect global growth.

China's zero-COVID policy is colliding with fresh outbreaks resulting in new lockdowns around the country. Falling PMIs are showing the country is under pressure from both supply and demand as energy shortages and rising costs meet falling consumer spending.

Property firms remain under mounting strain with Bloomberg reporting that 2/3 of the top 30 firms have crossed at least one of the governments "red lines".

"*The three lines are as follows, according to a state-media report on a government website:*

- *The property firms' liabilities shouldn't be more than 70% of assets*
- *Net debt shouldn't exceed equity*
- *And cash should be at least equal to short-term borrowings"*

Don't forget that land sales are now -30% and that local governments get 30-40% of their revenues from new land sales. More support from Beijing is going to be required.

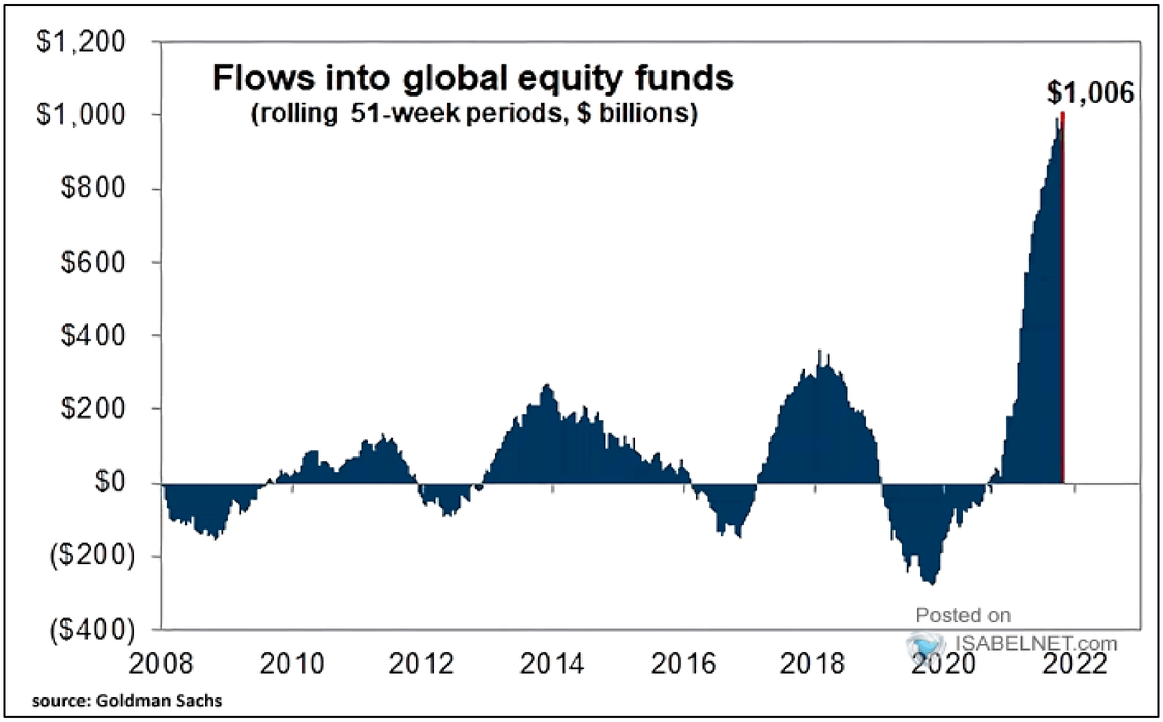
<u>What to Focus on Now:</u>

Equities

Huge flows continue to come into an expensive market.

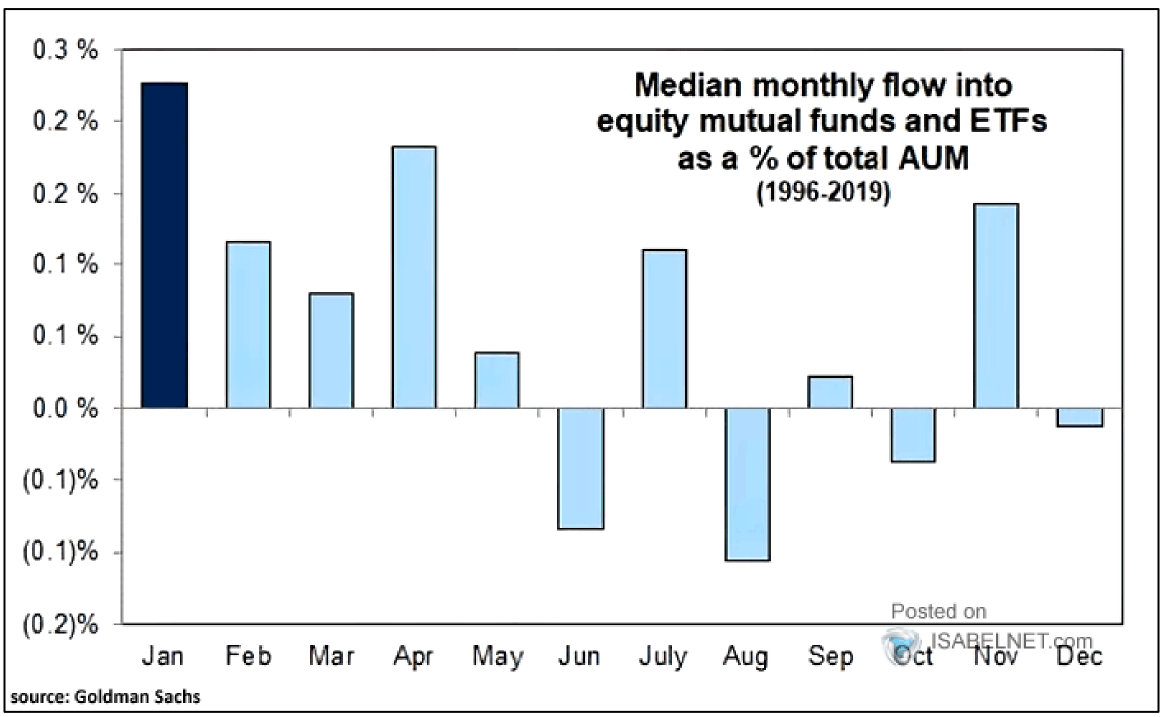
This chart was out last week from GS, following up on a statement two weeks ago that the last 12 months had seen more inflow into equities than the last 25 years cumulatively.

Mind-blowing stuff and a testament to what is driving prices.



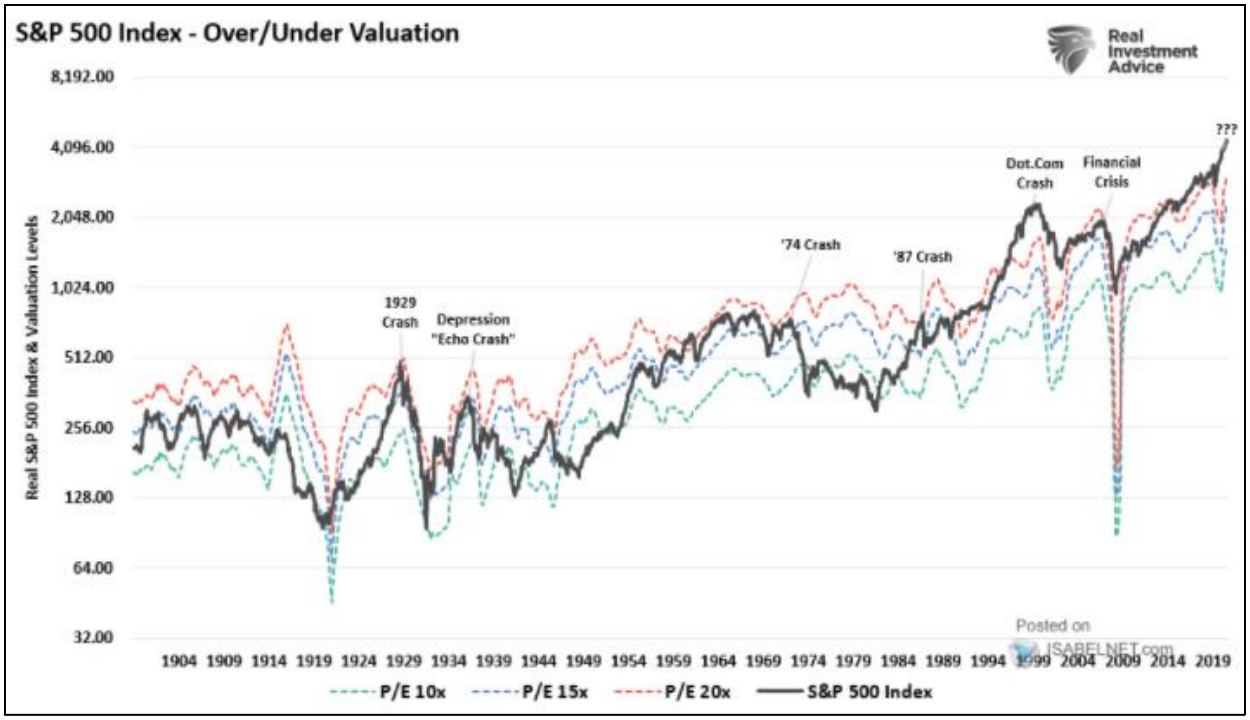
Does seasonality matter these days?

Just in case they do, November has historically been one of the strongest months in terms of inflows into equities.

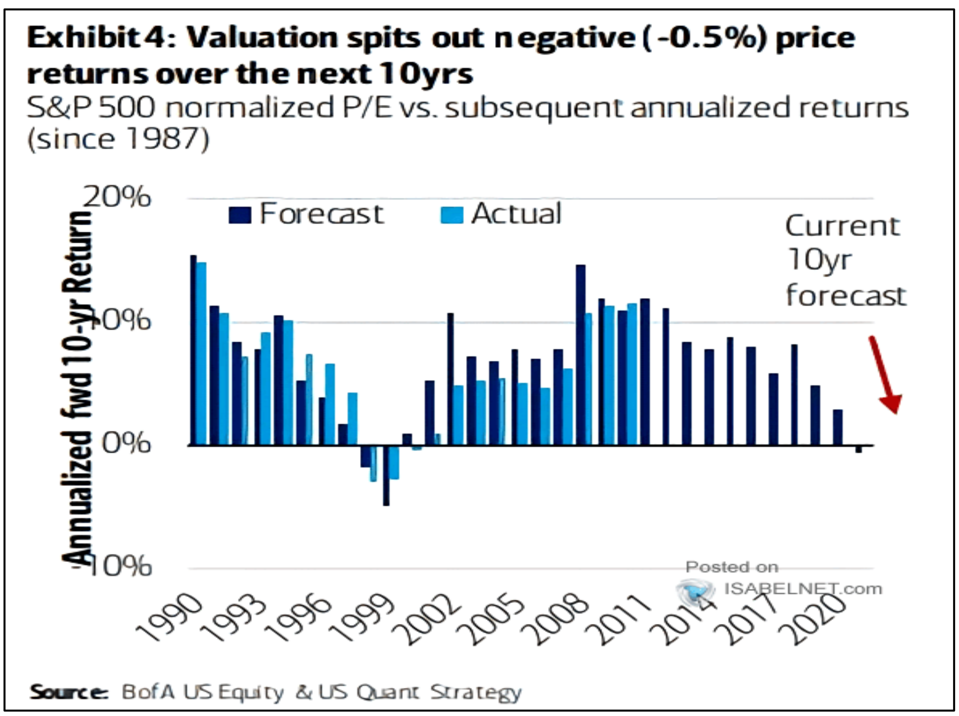


In aggregate, equities are not cheap, but that only matters when/if flows change.

Here is where we are on an historical envelope of 10-20x PEs.



Although longer-term, it probably does matter what you are paying.



Low interest rates, and a dislike for bonds, have been very supportive so far.

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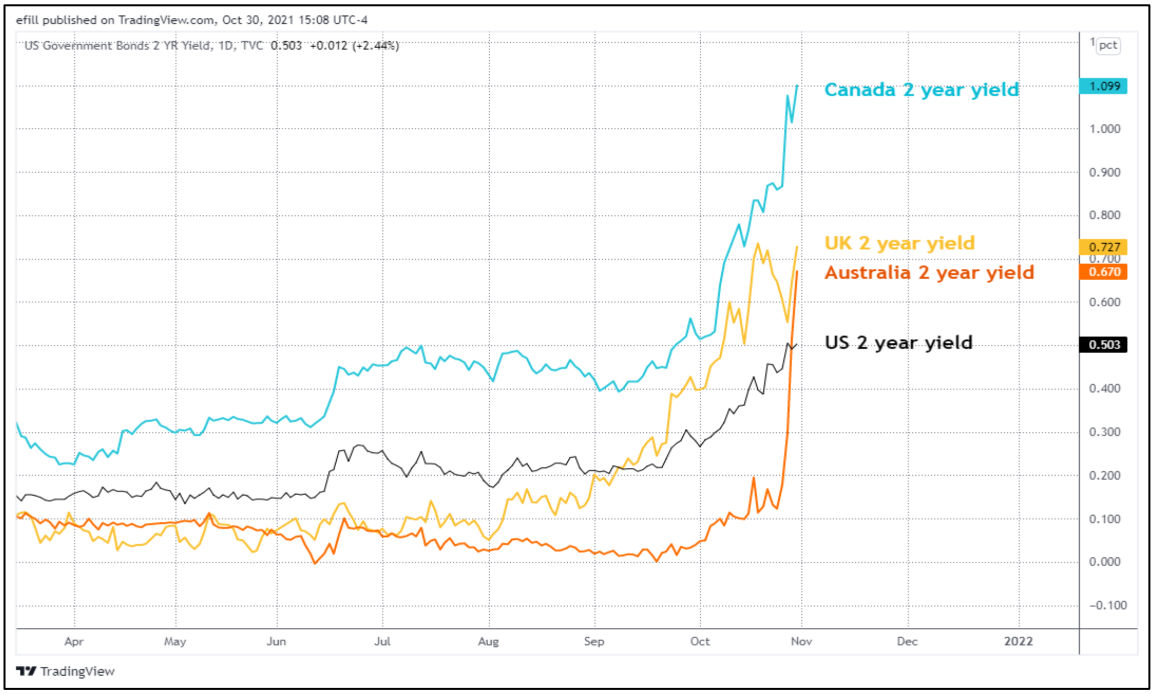
Interest Rates

The recent moves in front-end rates have been dramatic. It has been global. Some of the moves have been CB induced as they get more hawkish, other moves have occurred despite forward guidance to the contrary.



The flattening of yield curves globally continues.

And is moving down the curve now…. Very disappointing for long-end shorts.

It will be interesting to see what happens if some of the supply-chain and labor shortages do ease and growth picks up.

FX

Although we have seen big moves in front-end rates, the fact that they have been fairly synchronized across G7 has kept down currency volatility. I don't think that is going to last.

Here is an interesting chart that is threatening to break higher potentially reflecting changing rate differentials.

Overall, I still like being short JPY, vs. a number of currencies. That has definitely been a rate differential trade already, but now Japan is actually starting to weaken outright. Asian trade, supply shortages and energy import dependence, are not helping them. The dangers to the trade remain a sudden retrace of the front-end rate moves in G7, and equity weakness.

Thursday and Friday saw some pretty extreme moves in the EUR, and as a result DXY, relative to the recent low volatility. How much of that was month end is hard to say, but with the ECB now behind us, and the Fed and Payrolls coming up, it could be an interesting week in FX.

GBPJPY still looks very interesting to me from a longer-term perspective. Big targets… if it can reach escape velocity.

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EUR – so far, no break higher, no break lower.

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Commodities

With Silver finally taking a break from its multi-month downtrend, keep an eye on $25 now as a sign that the mood vs. precious metals might be turning.

Ags are coiling for a move...

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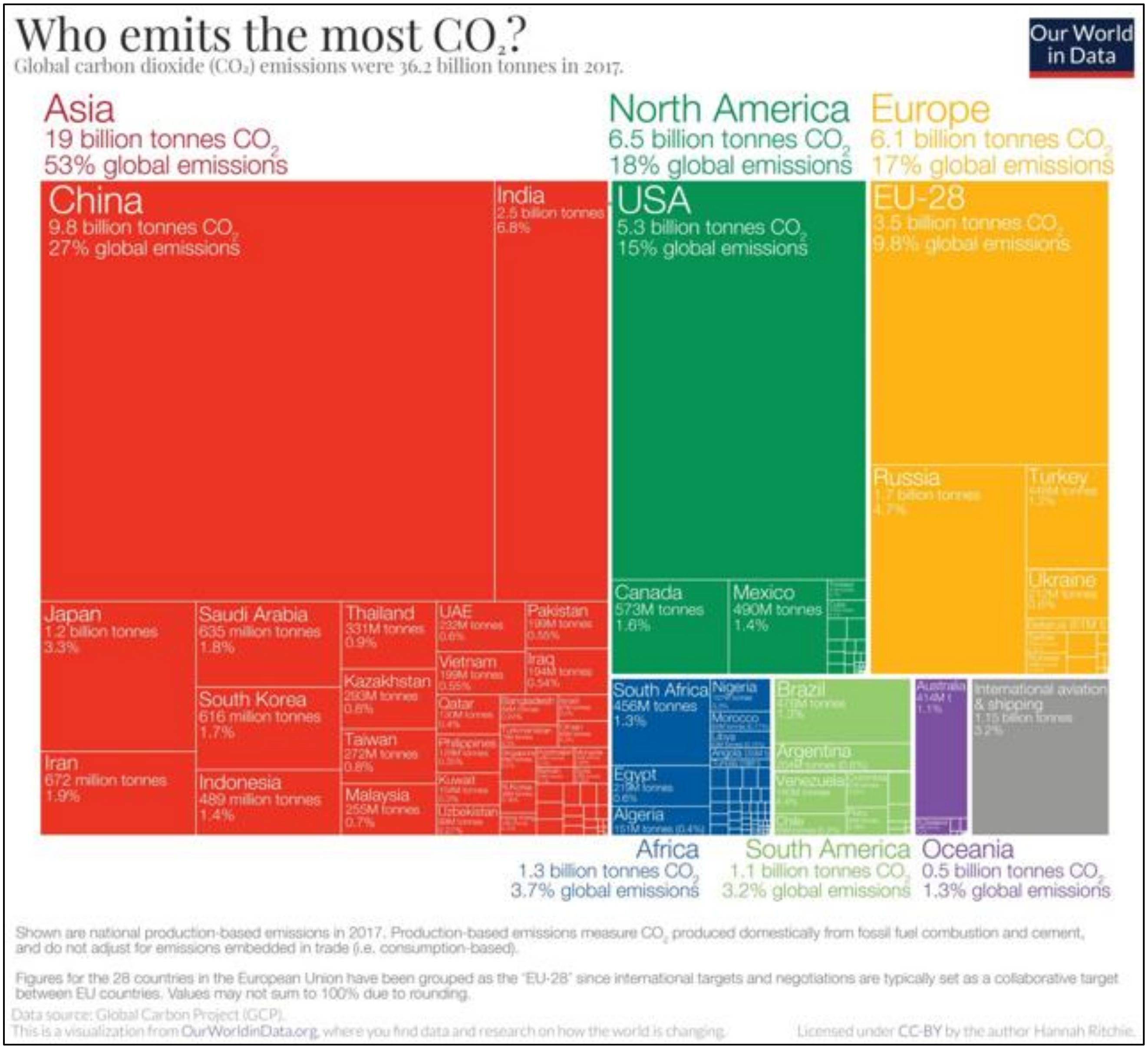
A few unrelated closing items of interest:

Given the upcoming UN COP26 Climate Summit in Glasgow…



And in Crypto-

[ECB announces members of Digital Euro Market Advisory Group] – Taking first concrete steps towards European CBDC. This is coming.

Finally, given a carefully cherry-picked time period (like the last two years) TSLA has now even outperformed BTC. Welcome to the YOLO markets…

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Important Macro Data Releases and Events for the Week

Monday
11/1/2021

- US, UK, and CAD Markit Manufacturing PMIs (Oct)
- US ISM Manufacturing (Oct) Forecast: 60.4, Prior: 61.1
- RBA Interest Rate Decision and Policy Statement

Tuesday
11/2/2021

- European Markit Manufacturing PMIs (Oct)

Wednesday
11/3/2021

- ECB's Lagarde speech
- ADP Employment Change (Oct)
- Markit Service and Composite PMI (Oct)
- **Fed Interest Rate Decision, Policy Statement, and Press Conference**

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Thursday
11/4/2021

- Markit Services and Composite PMIs across Europe
- OPEC Meeting
- **BoC Interest Rate Decision and Policy Statement**
- ECB Schnabel and Lagarde speeches
- Initial Jobless Claims Forecast: -, Prior: 277k
- Initial Jobless Claims 4-week average Forecast: -, Prior: 299.25k
- Continuing Jobless Claims, Prior: 2.07M

Friday
11/5/2021

- ECB De Guinos and Panetta speeches
- Retail Sales YoY (Sep)
- US Employment data Forecast: Nonfarm Payrolls 425k, Unemployment Rate 4.7%
- Canada Employment Data (Oct)

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