Stargazer
Asset Management

What to focus on in Global Macro for the week of July 12th, 2021

Macro Themes on the Radar:

Getting the Macro right has been anything but easy in recent months, as the fear of an inflation feedback loop has given way to renewed fear of secular stagnation. Before I jump into that, let's have a quick look at what the ECB and PBoC announced last week.

ECB

We finally got the long-awaited results of their strategy review. As expected, they now have a symmetric 2% inflation target vs. the previous "below, but close to 2%" target. On balance, this new policy is a moderately dovish move. It will allow for temporary overshoots during which inflation is moderately above the target, especially if it has previously been running below target. Unlike the Fed, they won't seek to overshoot the target to make up for previous misses but will temporarily tolerate an overshoot if it occurs. It is a very weak nod to the Fed's FAIT, and probably means that over time, inflation can run 25 to 50bps hotter than previously.

It is interesting to note that as part of their review, they are adding a climate change action plan that will increasingly incorporate climate change considerations into their monetary policy framework. We will see what, if any effect that will have in practice, but it is worth watching out for, and is a potentially significant deviation from the Fed's framework.

China

In a surprise move, the PBoC cut the RRR by 50bps. This reduction in the reserve requirement ratio for most banks will free up about 1 trillion yuan ($154 bln) of long-term liquidity that banks are now free to lend. That is not a big sum but the move was definitely a sentiment changer for markets.

It is a big shift from the tighter liquidity outlook in Q1, and despite the PBoC saying it shouldn't be seen as a shift in their policy stance, the market has taken it as such. We definitely saw some of that on Friday as global markets rebounded. However, it also highlights that there have been growing growth concerns in China and that the PBoC may be finding it hard to walk the tightrope of encouraging economic growth and recovery while preventing financial market and credit bubbles.

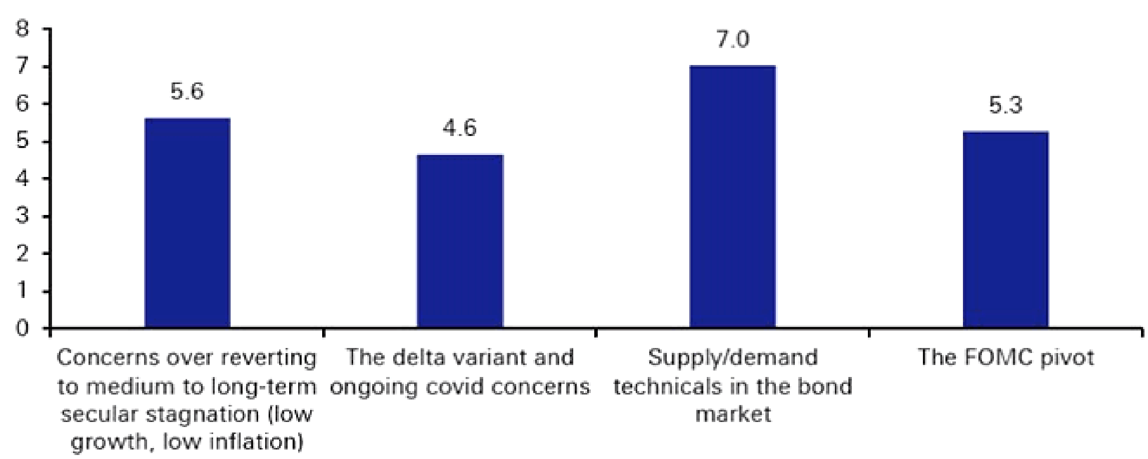
China has been a leader in terms of the global growth oscillations over the last few years. COVID only accentuated that trend. Certainly, China has been more worried about building imbalances due to massive monetary and fiscal stimulus than the rest of G20, but there is also concern that their current experience is a taste of what a post V recovery environment might look like.

China has been leading global yields…

Reflation Falters

The rally in the bond markets has everyone scratching their heads. This sums up the debate…

Figure 1: Using a scale of 0 to 10 where 0 is 'Had no impact' and 10 is 'Had extreme impact' ... In your opinion, what impact have the following had on the strong rally in US treasuries in recent weeks?



Source : : dbDIG Survey, Deutsche Bank Research

As per the above survey, investors see multiple factors at play here.

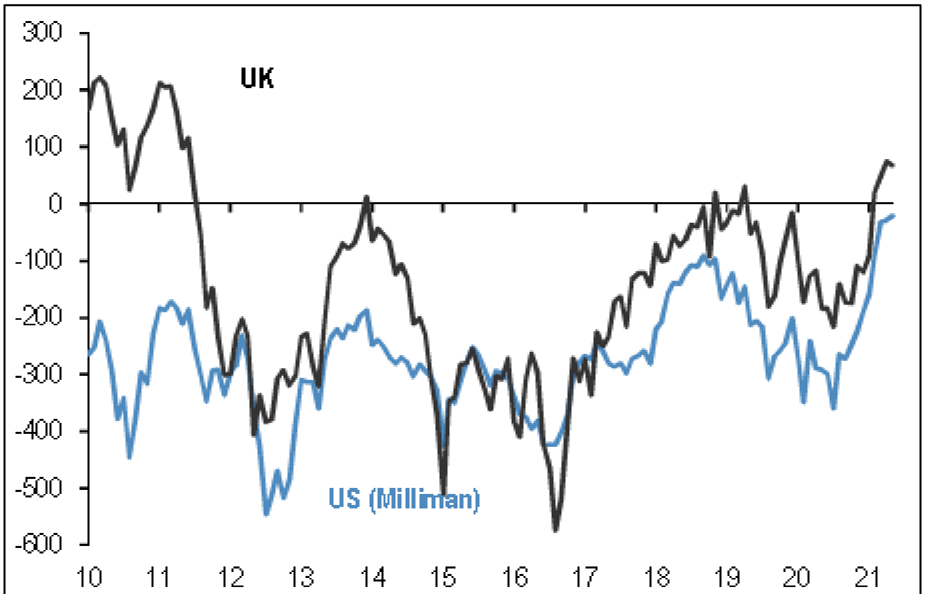
The resurgence of COVID and the delta variant clearly remain a concern. While the FOMC pivot at the June meeting, let some air out of the "irresponsible Fed policy" narrative, as they seemed to bring forward both taper talk and the possibility of the first hike into next year.

That leaves secular stagnation concerns and technical factors as the most popular drivers of the bond market rally.

The secular stagnation concerns reflect the fear that we will revert to pre-COVID conditions once the V-recovery has lost momentum and both fiscal and monetary stimulus are reduced in the coming quarters. The switch from catch-up demand, to recurring demand, will need to take place. Will consumers spend the big pile of savings they have accumulated? How quickly? Or, has economic scarring occurred? This rabbit hole leads to the debate about what the real neutral rate (r*) will be going forward. How much can the Fed really raise before the economy slows?

Finally, technical demand and supply factors have certainly also played a role. They really include all the flows that are not a vote on future economic outcomes but are more mechanical and price-driven.

- Pension funds switching to bonds as they become funded.

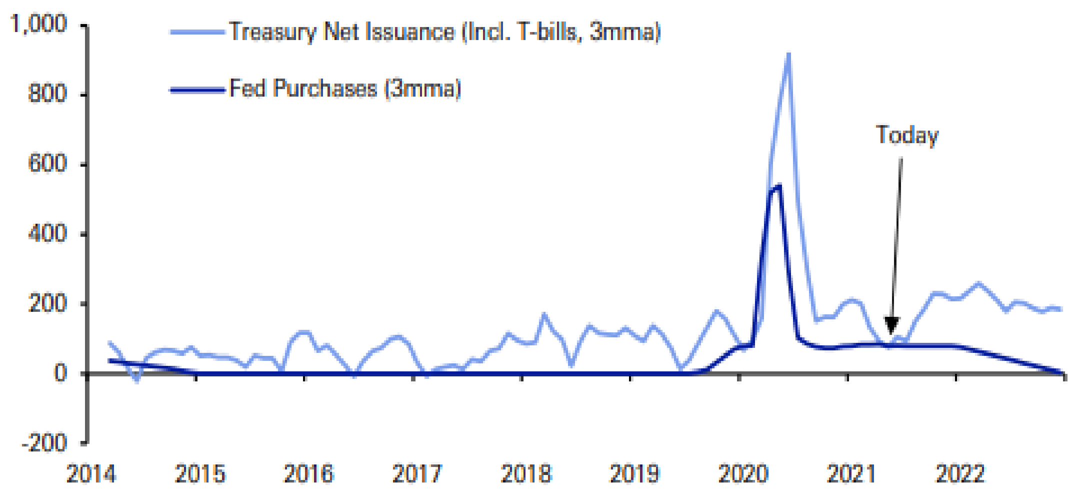


Source: Milliman, UK Pension Protection Fund, J.P. Morgan

- Fed buying… as DB points out:
  "We looked at the supply and demand for treasuries and found that on a rolling 3- month basis the entire net supply of treasuries had recently been taken down by the Fed on a net basis. This is extremely rare even in a QE world and also remarkable given it's coincided

with the biggest fiscal giveaway in history. And to compound those technicals, this has occurred in a period of exceptionally strong demand from banks and foreigners."

Figure 1: Treasury Net Issuance and Fed Purchases ($bn)



Source : FRB, SIFMA, Bloomberg Finance LP, Deutsche Bank

- Fall in the Treasury General Account that is adding to bank deposits while delaying issuance (less net issuance in above chart).

Figure 1: The TGA balance has declined significantly since February

Source : Federal Reserve, Bloomberg Finance LP, Deutsche Bank

- The big drop in the TGA and the large jump in consumer savings has created a glut of short-term liquidity in the system. That is being mopped up by the Fed via reverse repos. Is this another route by which the technicals are creating a feedback loop? I thought these two charts from Nordea were interesting.

Chart 1. When reverse repos increase in size, 10yr bond yields tend to drop

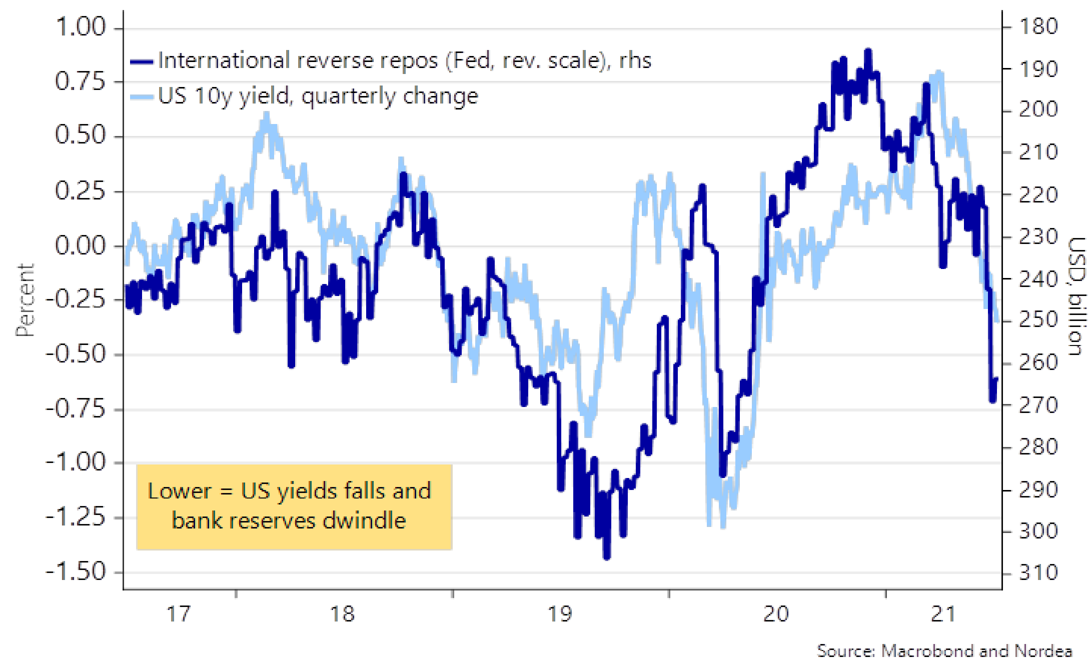
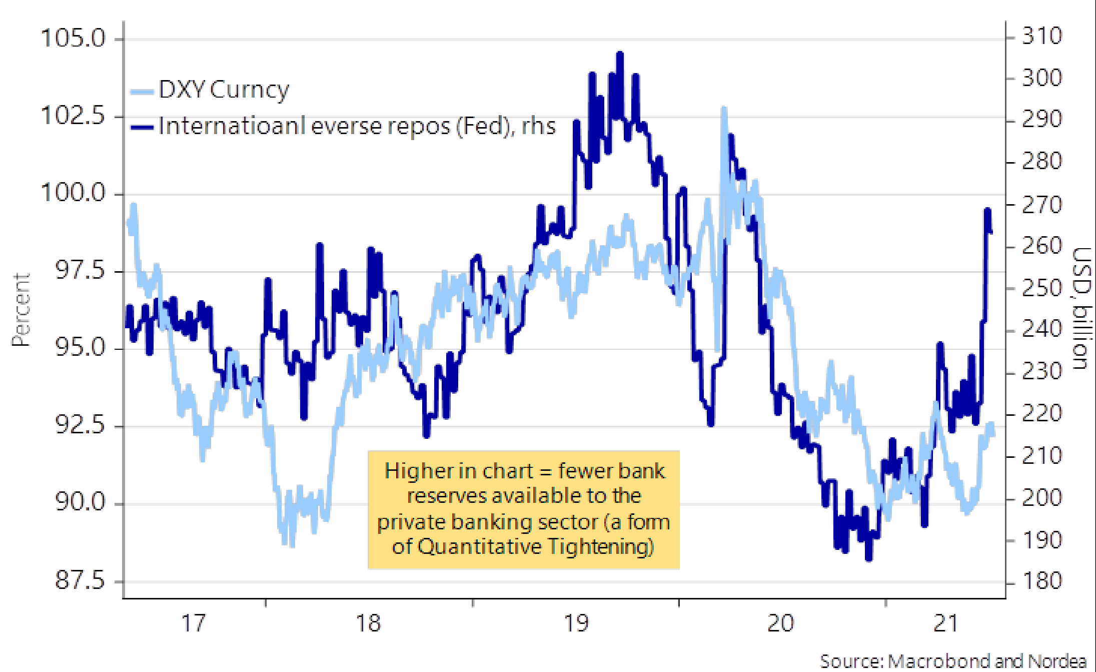


Chart 3. USD to gain from a surging usage of reverse repos?

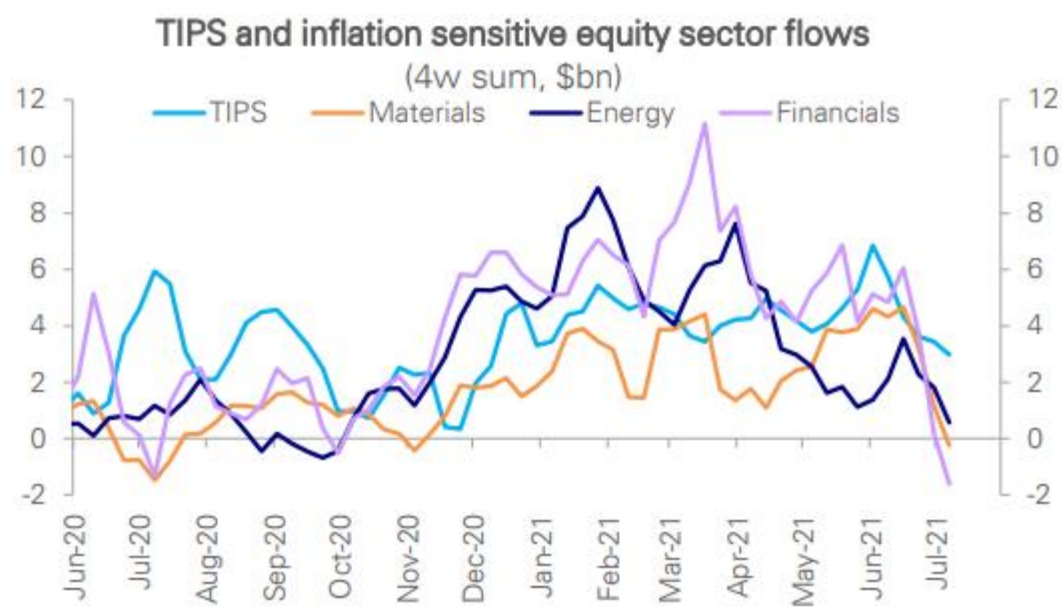


- Finally, a positioning short-squeeze in bond market

Whether the price action in the bond market is being fundamentally driven or by shorter-term technical supply/demand factors matters a lot, not just for the bond market, but for global markets overall. What is it going to be, technical factors causing a pause in the inevitable march higher in yields, or, a reassessment of post V-recovery growth prospects?

The rally in the bond market has set off a negative feedback loop for inflation trades.

Figure 24: Flows into TIPS funds and inflation sensitive equity sectors have slowed sharply



Source : EPFR, Haver, Deutsche Bank Asset Allocation

Over the last couple of months, we have seen a real cracking of the global growth focus across asset classes.

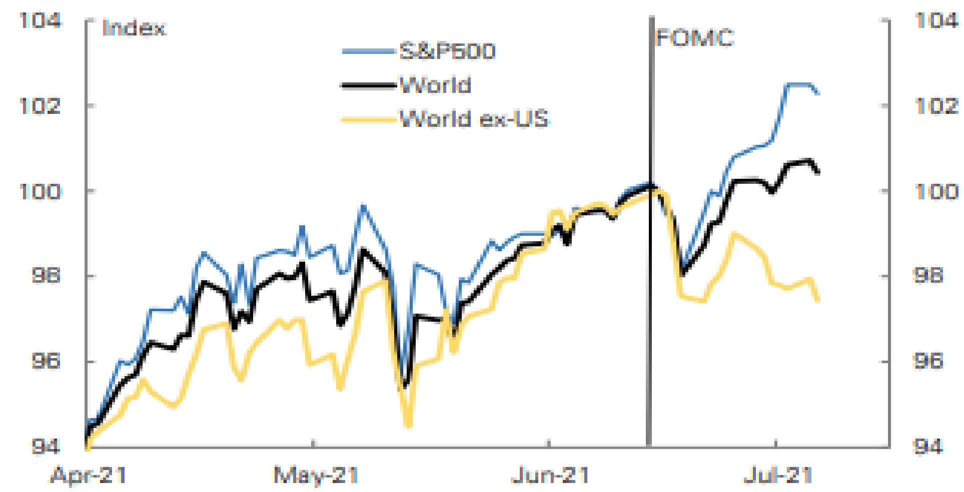
Large cap has again been leading small cap, globally growth stocks have led value, and most commodities (ex-Oil) have pulled back.

The dollar has rallied with this last leg up in bonds, and that is usually a reflection of poor global growth being priced. It also tends to mean that capital flows to the center, and out of the periphery, in terms of risk taking.

That is reflected in the US, but also globally, as a switch out of value back to growth assets.

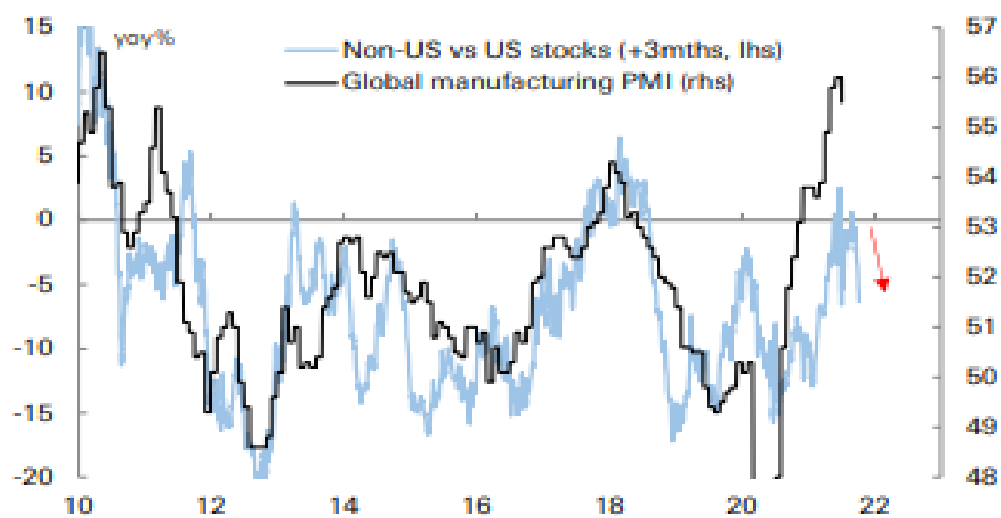
Back to growth… for now.

Figure 1: Global equities have rallied since the FOMC meeting, but only because of the S&P500



Source : Bloomberg Finance LP, Deutsche Bank

Figure 2: Non-US stocks lagging shows a lack of confidence in global growth

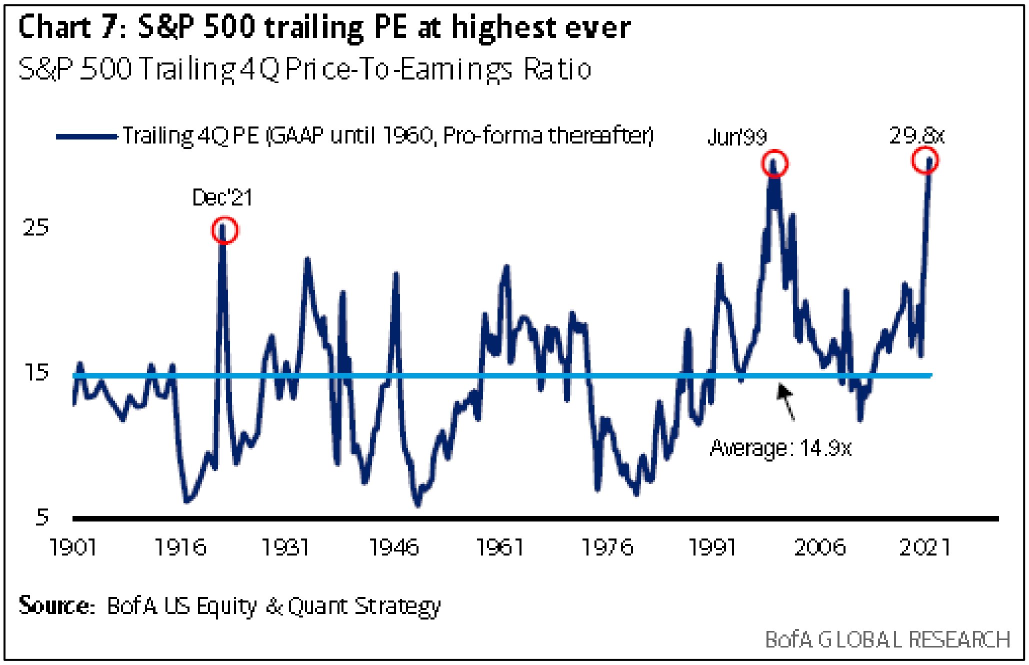


Source : Bloomberg Finance LP, Deutsche Bank

The confluence of all these factors leave us with a very unstable environment for investors to navigate. We are approaching a decision point as the markets strain to look past the V.

What to Focus on Now:

Equities - Sure, they are expensive, and increasingly narrow, as less than 50% of stocks are above their 50-day moving average. However, the US has continued to hold in very well.



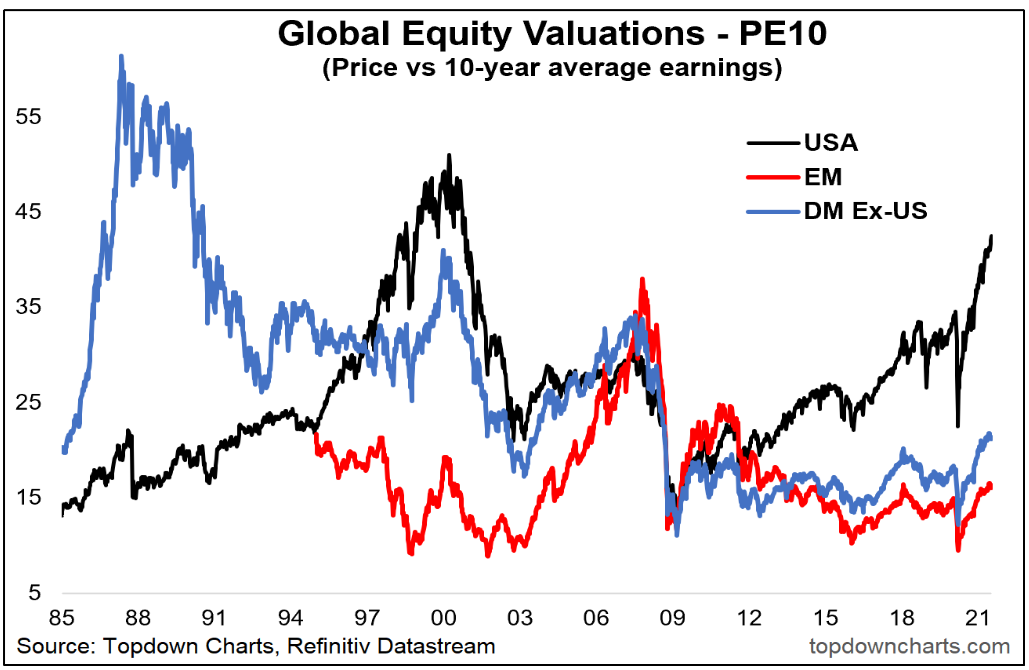
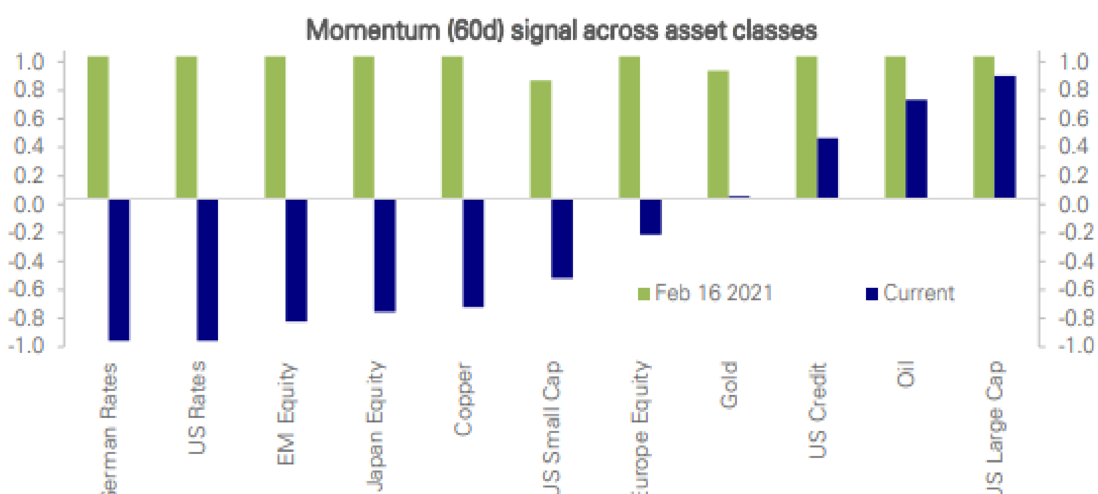


Figure 5: Breadth within the SPX has been weak

Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

Whether bond strength is temporary or fundamental, the synchronized V-recovery looks like it has been largely priced, and now life is likely to get more complicated for market participants.

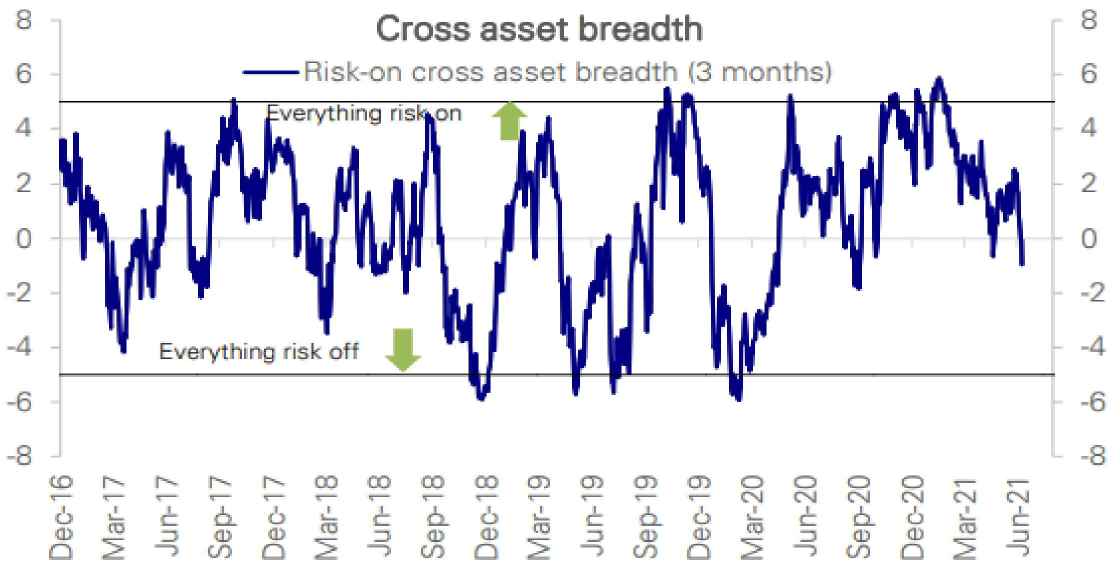
Figure 7: Momentum signals are mixed, in contrast to uniform risk-on sentiment across assets earlier in the year



Note: Sign reversed for Gold, US rates, US credit, German rates and German credit

Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

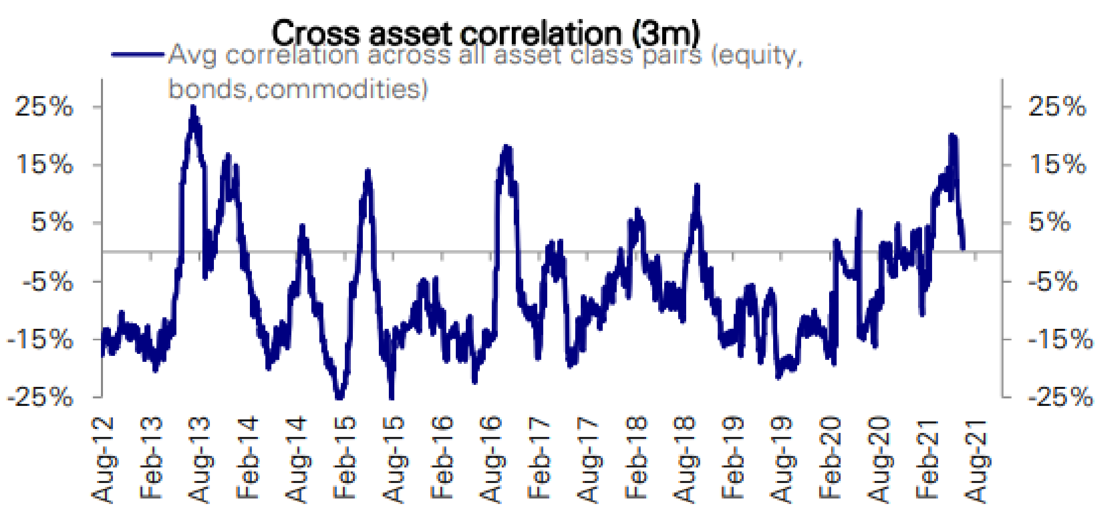
Figure 6: Our cross asset breadth measure has fallen into slightly negative territory



Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

Again, a rising USD would make a difference here.

Figure 8: Cross asset correlations broadly are back to zero …

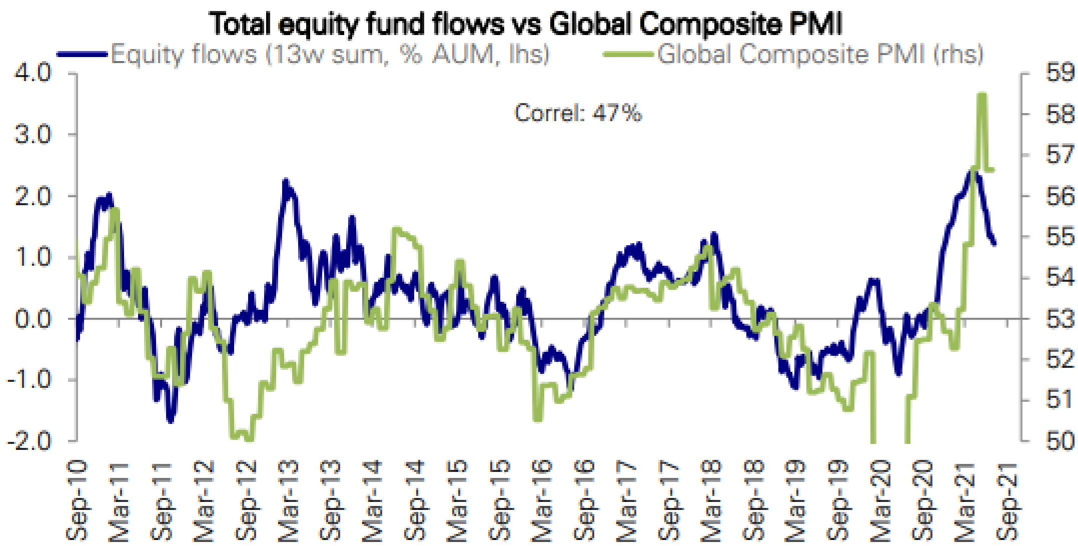


Average of 3m rolling correlation of daily returns between asset pairs: S&P 500 TR index, Barclays US Treasury TR index and CoreCommodity CRB Index

Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

With a large part of the V-recovery already expected, we have supply constraints and bottlenecks putting downward pressure on PMI's. This could mean another jump in PMI's when those blockages finally clear, and further clouds what the world will look like when we normalize.

Figure 23: Broad-based slowing of flows into equity funds has coincided with moderating growth metrics

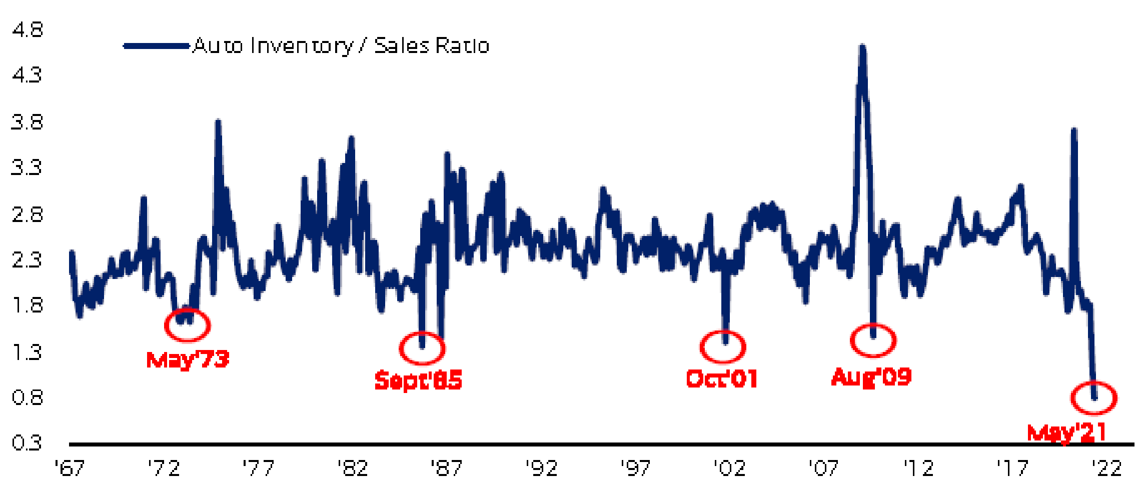


Source : EPFR, Markit, Haver, Deutsche Bank Asset Allocation

Look at autos. It is hard to maximize sales when you don't have any inventory.

Chart 9: Desperately low level of inventories relative to sales

Auto Inventory / Sales Ratio

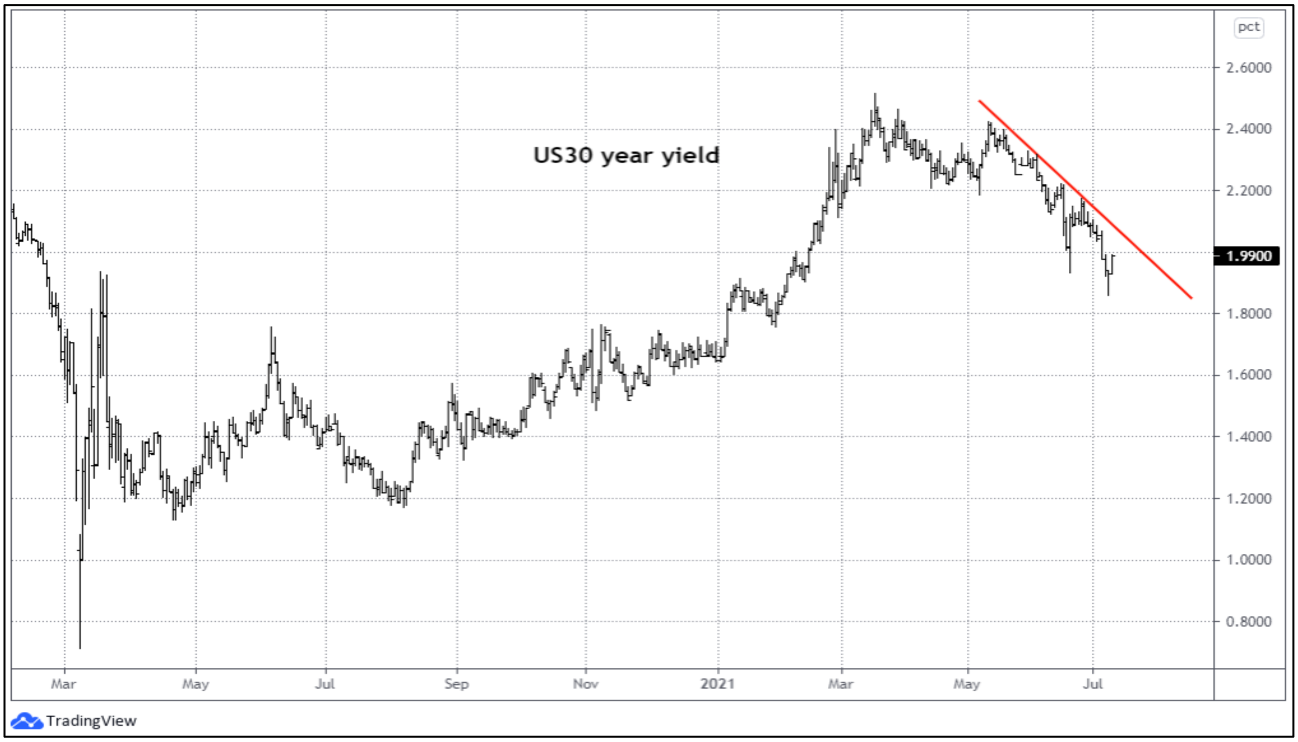


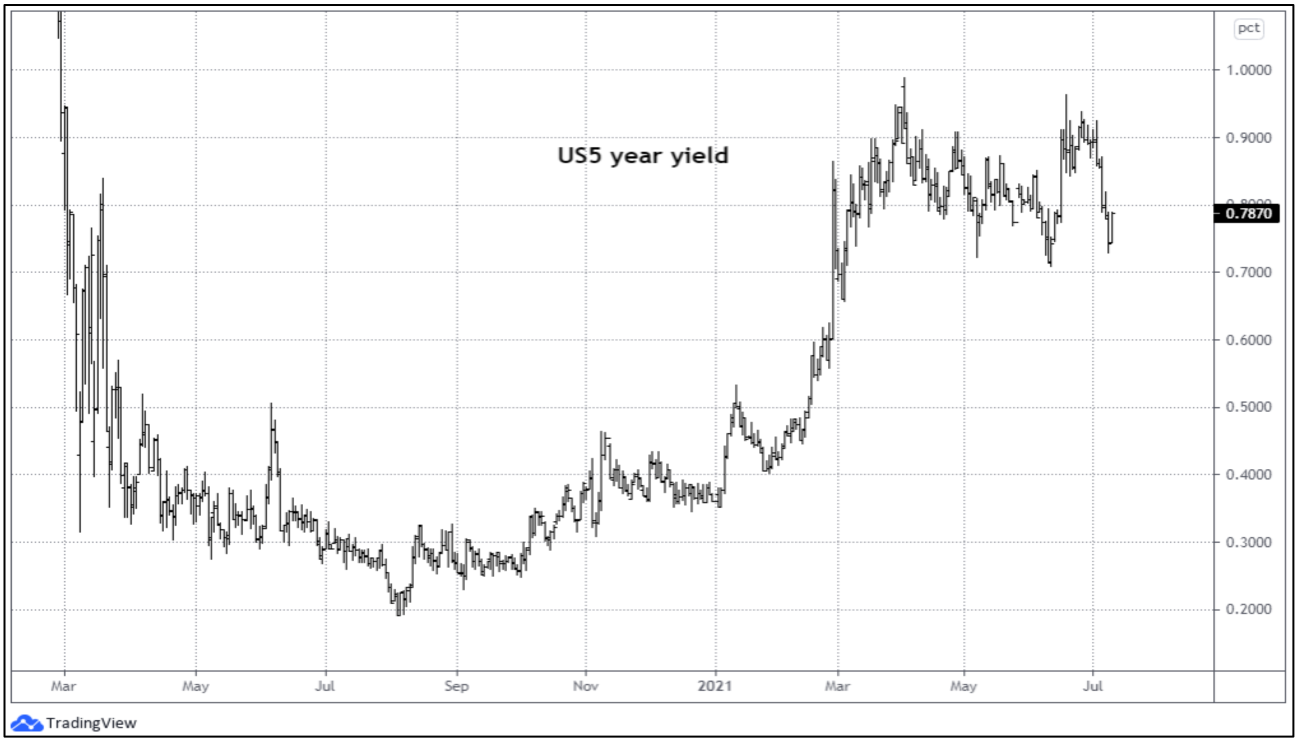
Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

FI and FX

We hit some big levels in yields and FX last week. I would argue they held, at least partially thanks to the RRR cut by the PBoC.

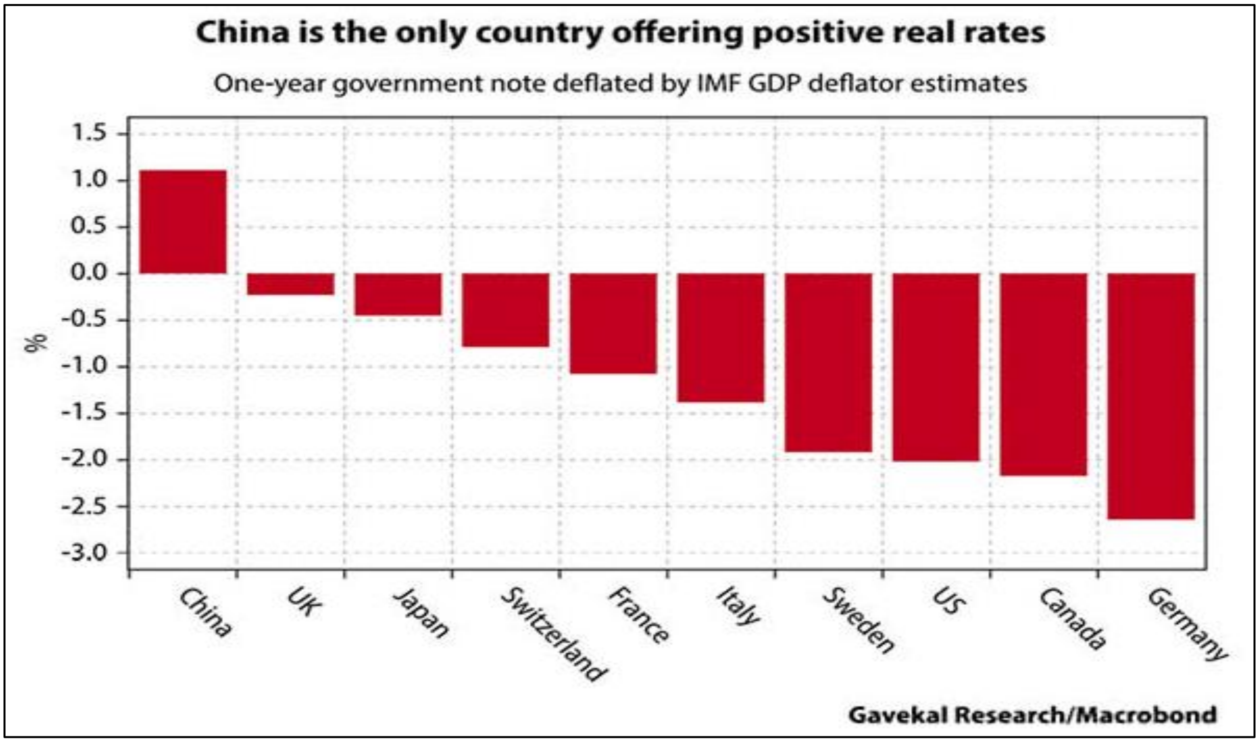


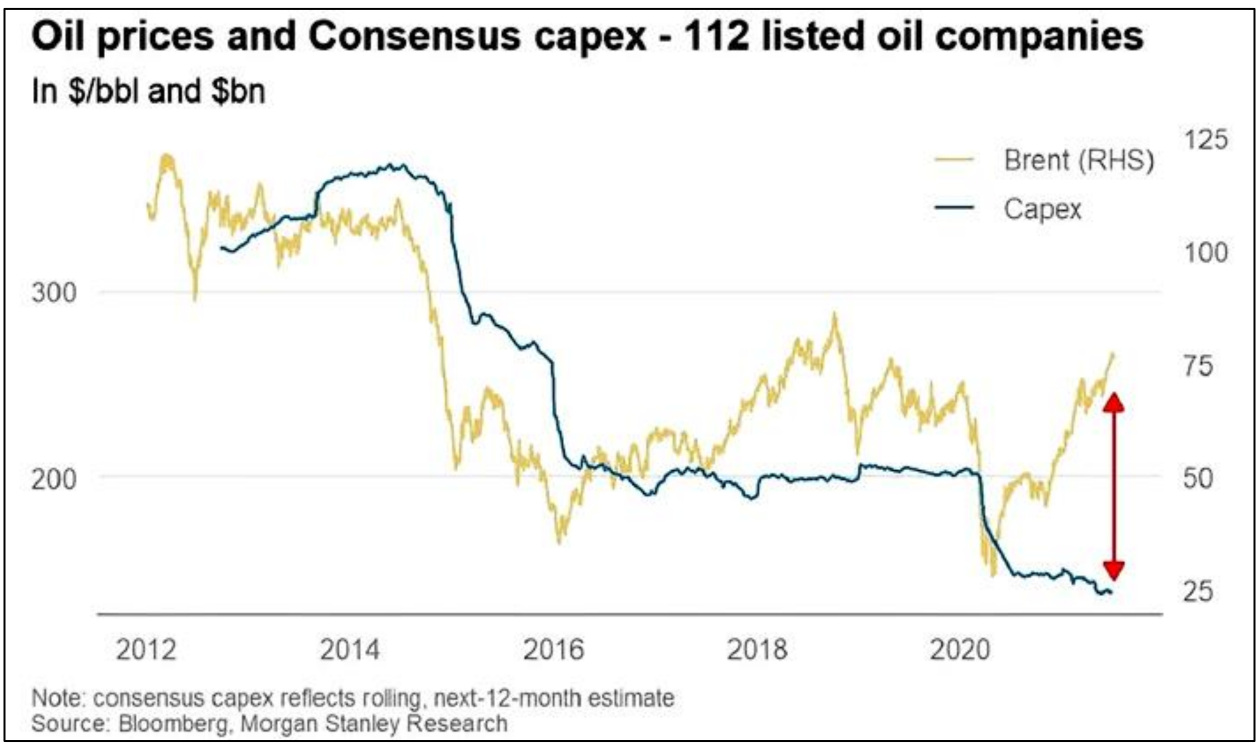


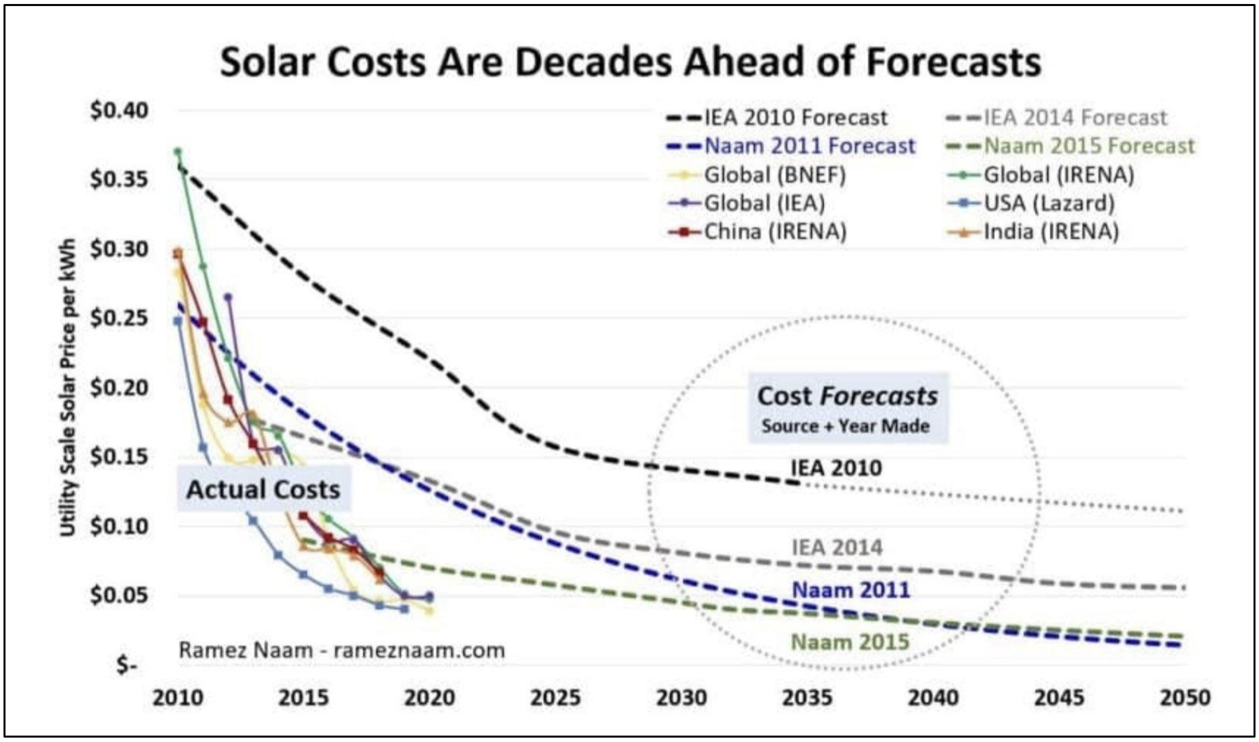
Top of the range, or setting up for a break higher?

The market's reaction to CPI and Powell's testimony will be key next week.

Finally, I thought these are a few unrelated but interesting charts to close with…







This week we have US CPI for June and Q2 GDP for China. There will be a lot of focus on the recently deflated inflation trade. Also, Fed Chair Powell is due to give his congressional testimony.

Important Macro Data Releases and Events for the Week

Monday
7/12/2021

- ECB De Guindos speech
- Fed's Williams Speech
- Trade Balance

Tuesday
7/13/21

- Harmonized Index of Consumer Prices YoY (Jun) Forecast: 2.1%, Prior: 2.1%
- EcoFin Meeting
- CPI in various forms Headline YoY forecast: 4.9%, Ex-food & Energy: 4%

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Wednesday 7/14/21		BoC Interest Rate Decision and Policy Statement
		Fed Chair Powell Testifies
		Fed's Beige Book
		GDP (Q2)
Thursday 7/15/21		Philadelphia Fed Manufacturing Index (Jul) Forecast: 28.3, Prior: 30.7
		Initial Jobless Claims Forecast: 360k, Prior: 373k
		Initial Jobless Claims 4-week ave. Forecast: -, Prior: 394.5k
		Continuing Claims Forecast: -, Prior: 3.339M
		Fed Chair Powell Testifies
Friday 7/16/21		BoJ Interest Rate Decision and Monetary Policy Statement
		Retail Sales MoM (Jun) Forecast: -0.6%, Prior: -1.3%
		Retail Sales Control Group MoM (Jun) Forecast: 0.2%, Prior: -0.7%
		Fed's Williams speech
		Michigan Consumer Sentiment Index (Jul) Forecast: 87, Prior: 85.5

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