What to focus on in Global Macro for the week of May 24th, 2021

Macro Themes on the Radar:

Fed and Inflation (again)

Fed minutes showed they have started talking about talking about tapering…

"A number of participants suggested that if the economy continued to make rapid progress toward the Committee's goals, it might be appropriate at some point in upcoming meetings to begin discussing a plan for adjusting the pace of asset purchases. …

Regarding asset valuations, several participants noted that risk appetite in capital markets was elevated, as equity valuations had risen further, IPO activity remained high, and risk spreads on corporate bonds were at the bottom of their historical distribution. …

Various participants commented on the prolonged period of low interest rates and highly accommodative financial market conditions and the possibility for these conditions to lead to reach-for-yield behavior that could raise financial stability risks."

Various Fed speakers last week…

Philadelphia Fed Harker on taper - "It is something that, in my mind, we should start to have a conversation about sooner rather than later."

Dallas Fed Kaplan on jobs issue taking a few months to sort out - "these structural issues, which we saw in the report for April…all those tensions are not going to go away even for the next jobs report," Kaplan said at a Dallas Fed conference. "We think you are going to see another odd or unusual report… Businesses are telling us they got plenty of demand, but they cannot find workers either skilled or unskilled."

Richmond Fed Barkin on inflation – "We are having turbulence now. Inflation to increase this year and likely to revert back to normal in 2022. Only when we get to substantial further progress, we will taper, want to live by our forward guidance."

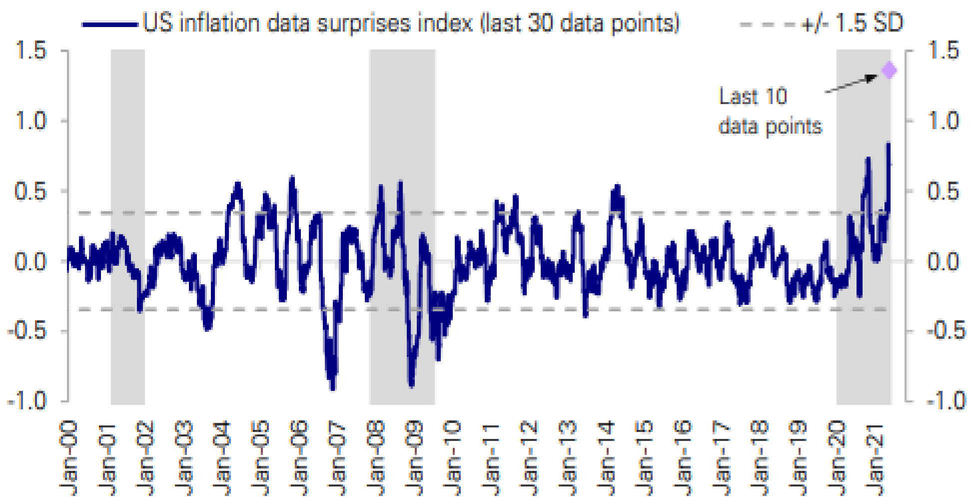
Atlanta Fed Bostic on economy and inflation - "I am monitoring the marketplace, trying to discern between transitory and permanent" … "If we see good progress and that the economy can stand on its own, in favor of getting to more normalized policy."

The Fed's average inflation targeting framework will be tested in the coming months. Expect more big inflation prints in the near-term and potentially explosive employment numbers when demand and supply in the labor market clear.

With so much uncertainty about how all the fundamentals will play out, the potential for forecasting error is large, to say the least. The Fed has never been that great at forecasting to start with which may be part of the reason for their move to outcome vs. forecast based policy. Generally, they have been too optimistic, and the market, for its part, has expected rate hikes sooner than they actually played out. Now, given the new framework, when the time finally comes, tighter policy is likely to come "slowly at first, then all of a sudden", as the saying goes.

COVID bottle-necks and supply chain issues are hitting hard…

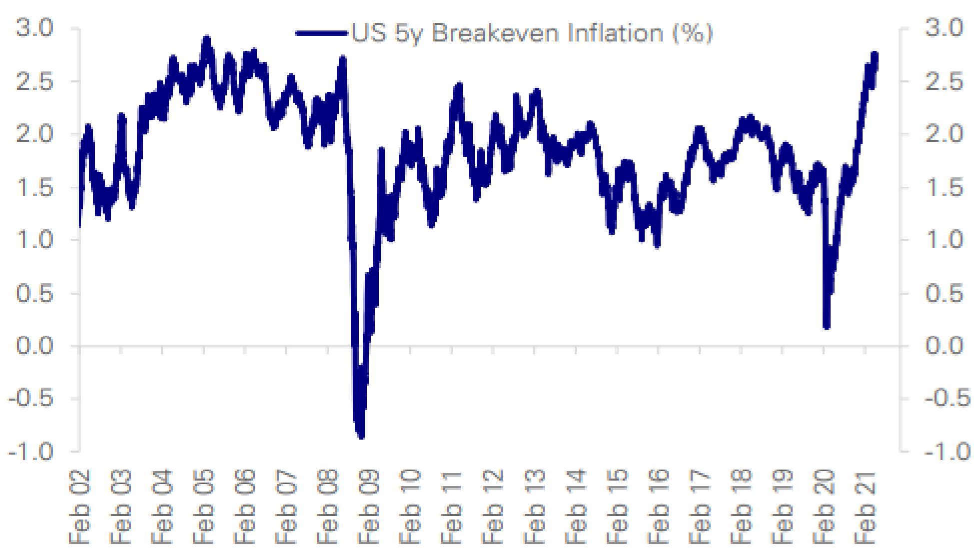
Figure 3: Inflation data surprises are running at the strongest on record



Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

And markets think there is more to come.

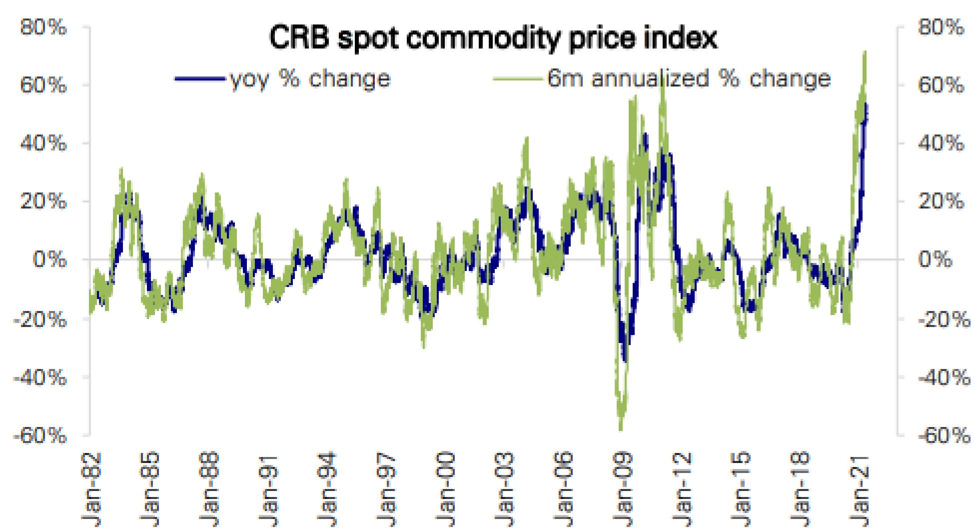
Figure 4: Breakeven inflation rates are near the top of their historical band



Source : Bloomberg Finance LP, Deutsche Bank Asset Allocation

Much of the commodity price boom has not yet been reflected in the numbers.

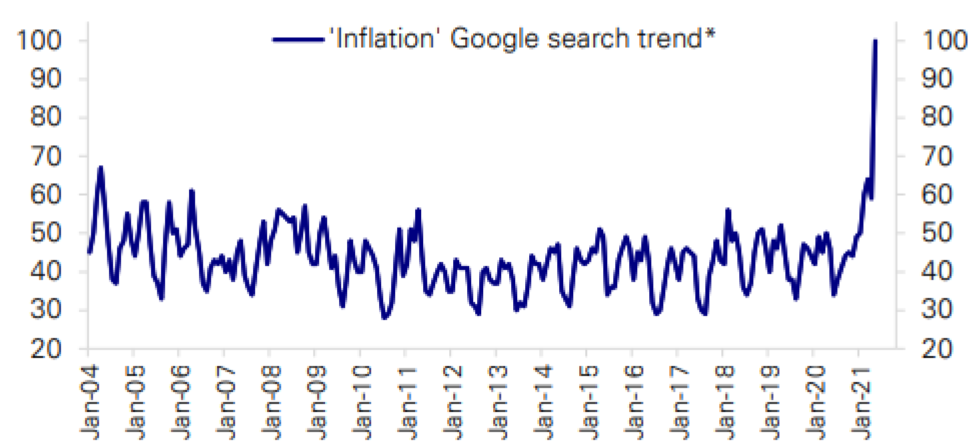
Figure 6: Appreciation in broad commodity prices is also the fastest on record



Source : CRB, Haver, Deutsche Bank Asset Allocation

The public is keenly aware of the jump in prices and wages we are seeing.

Figure 7: Web searches for inflation as a topic are running at record highs

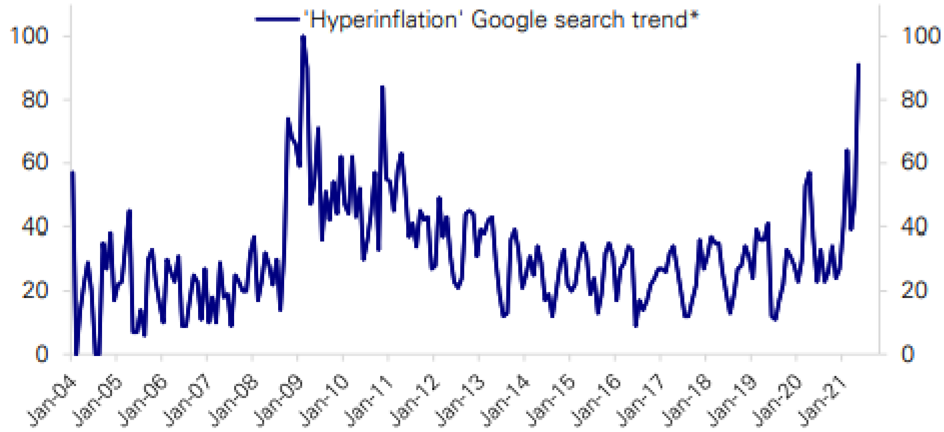


*Shows relative search interest over time since 2004 for "inflation" in the US. A value of 100 is the peak popularity for the term for a given region and time period.

Source : Google Trends, Deutsche Bank Asset Allocation

Some, with the help of social media, are very concerned.

Figure 8: Searches for "hyperinflation" have also spiked sharply

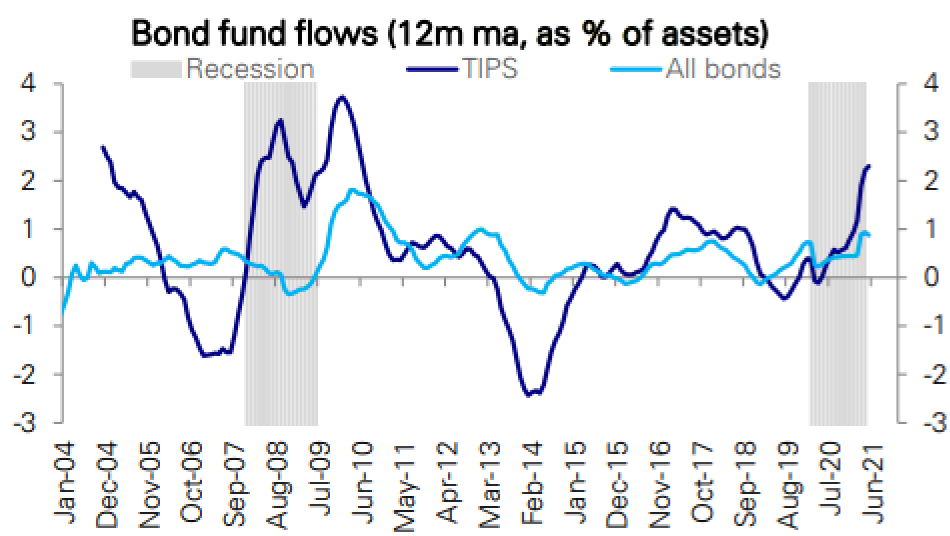


*Shows relative search interest over time since 2004 for "hyperinflation" in the US. A value of 100 is the peak popularity for the term for a given region and time period.

Source : Google Trends, Deutsche Bank Asset Allocation

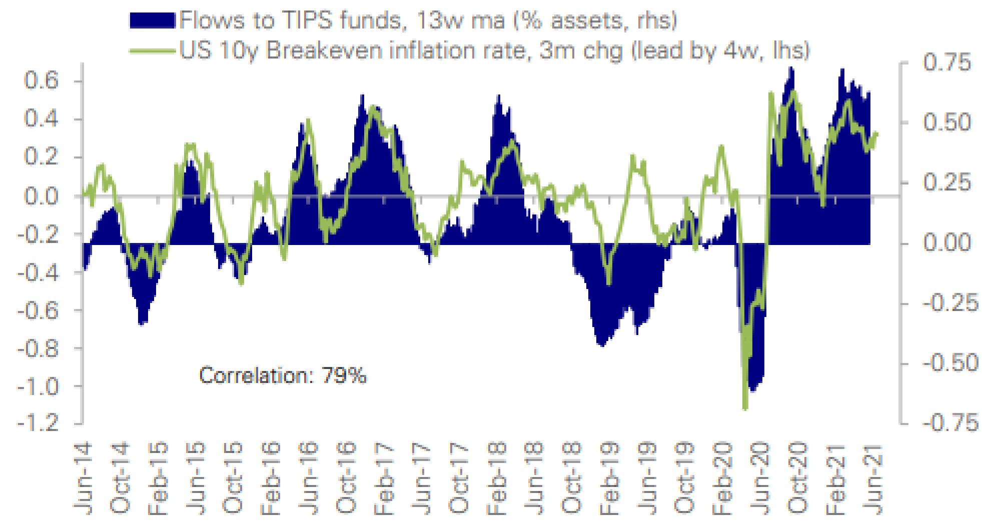
Money is flowing as a result.

Figure 11: The gap between flows into TIPS funds and overall bond funds is the largest since 2010



Source : EPFR, Haver, Deutsche Bank Asset Allocation

Figure 12: Flows into TIPS funds are following changes in breakeven inflation rates

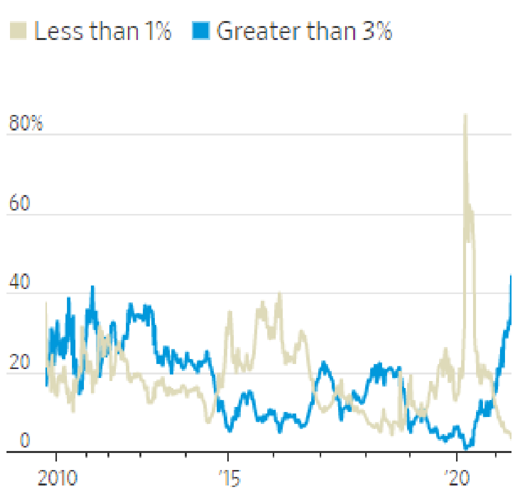


Source : EPFR, FRB, Haver, Deutsche Bank Asset Allocation

While a good portion of the recent jump is undoubtedly being driven by demand/supply imbalances, inflation expectations overall are rising given all the government spending, Fed policy, and structural changes. Those higher inflation expectations will complicate the debate about how transitory inflation will be. For now, markets are positioned for more to come…

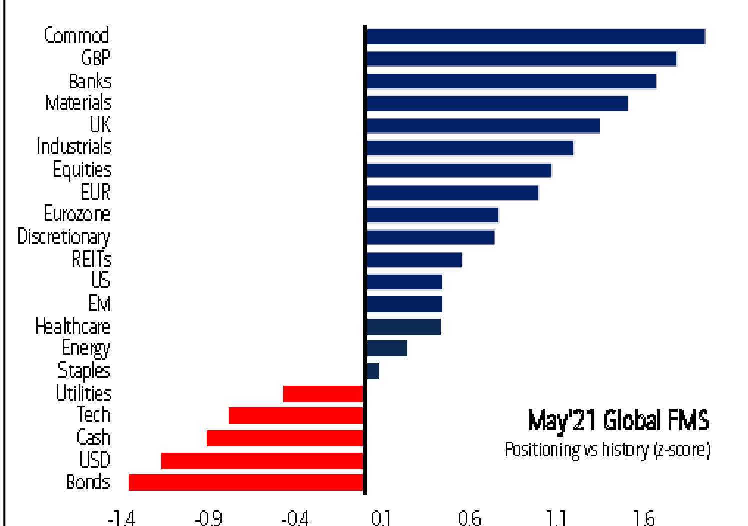
The Great Inflation Switcheroo

Option-implied probability of inflation over the next five years being:



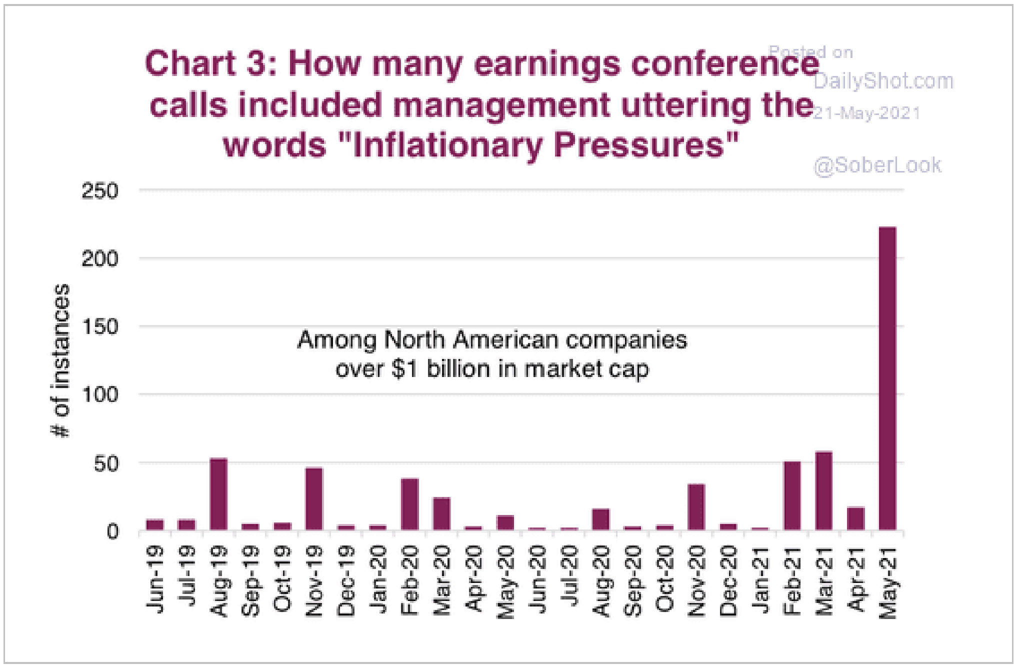
Note: Through May 5
Source: Federal Reserve Bank of Minneapolis

Exhibit 1: All-time high in "boom" expectations…
BofA FMS positioning vs history z-scores



Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

And it is on everyone's lips…



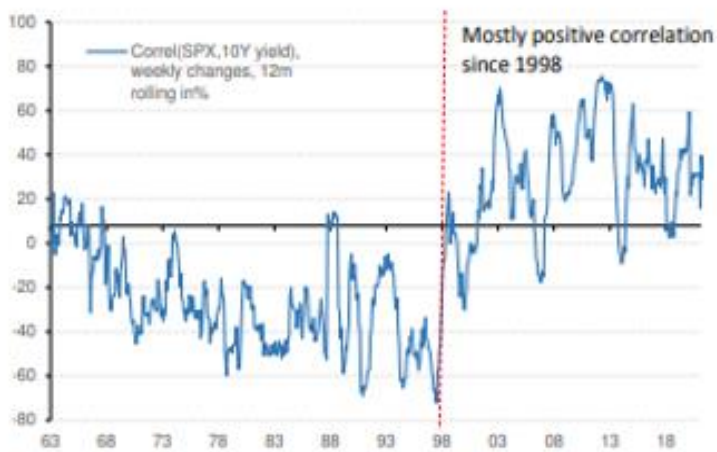
Source: Market Ethos, Richardson GMP

A lasting shift in inflation expectations would be big news, with lots of repercussions.

(Note that 2014, saw a very large USD rally)

For markets, 1998 marked an important turning point towards a fear of deflation regime that has meant that Treasury yields, and equities, have tended to move together (growth and reflation are good). If that correlation now flips back to the pre-1998 regime it will require a big adjustment given how most portfolios are constructed. Investors will need access to more investment options than just long stocks and bonds.

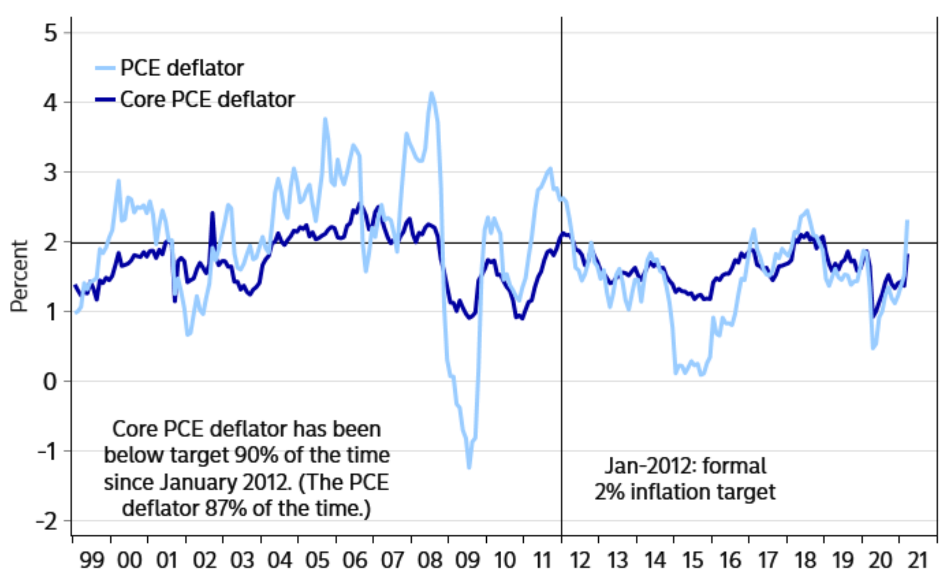
Figure 2: The yield/equity correlation switched post 1998



Source: Deutsche Bank, Bloomberg Finance LP

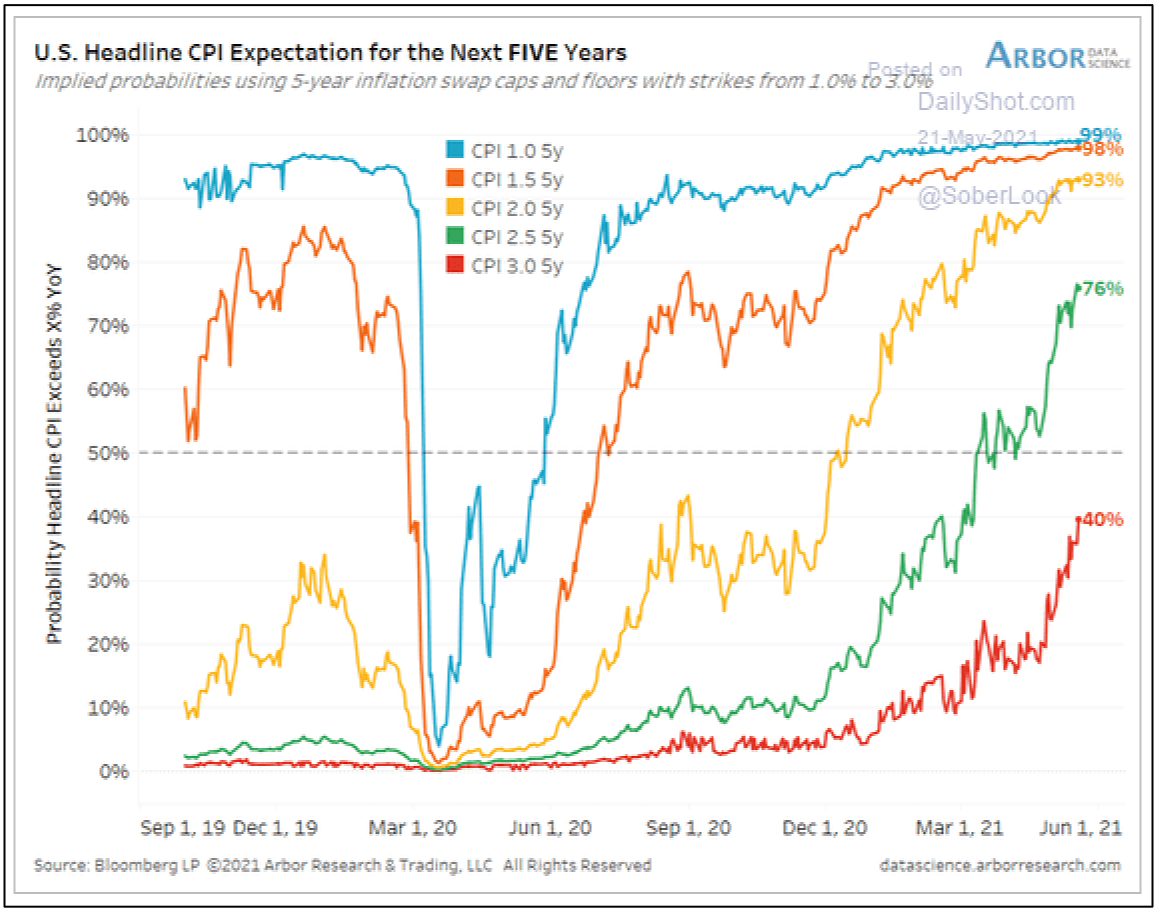
It is easy to see how the current regime has become the assumed status quo.

Chart 7. US inflation has been below target ~90% of the time since January 2012



Source: Macrobond and Nordea

However, increasingly the mood is shifting and the expectation of a sustained higher level of inflation is taking hold.

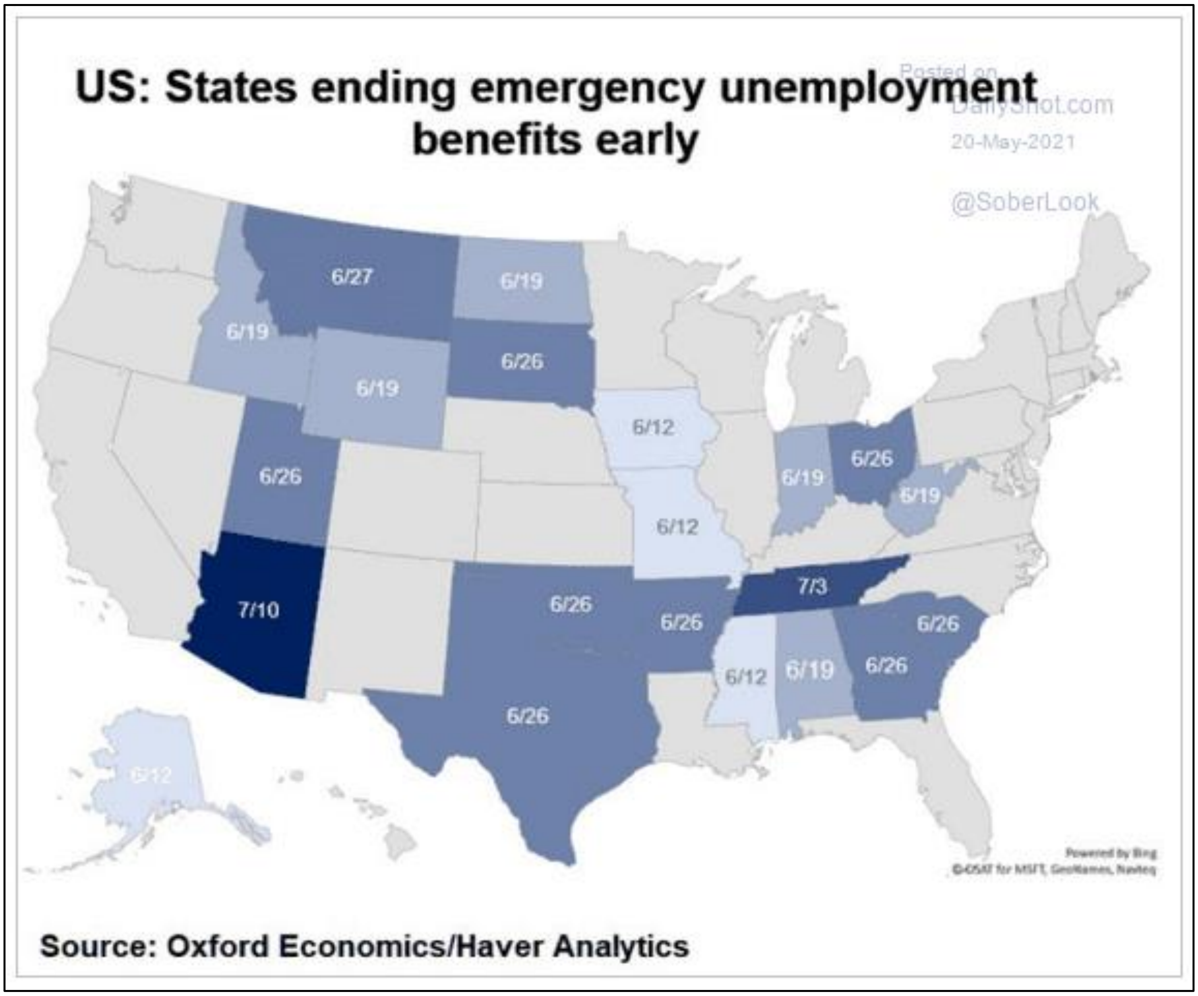


Employment

The demand/supply mismatch in employment should clear in the next couple of months. The magnitude with which that is resolved could rattle markets and have big implications for near-term policy.

While the Federal pandemic relief bonuses are not due to expire until September, an increasing number of states are lining up to end them early.

At last count, it was 22 states that are going to decrease unemployment insurance payments back to the normal levels between mid-June and mid-July. At the moment, that will affect 3.6 million people. Some states are even offering a back-to-work bonus to incentivize people to return to work. In addition to a bonus, Arizona is providing funds to cover three months' worth of child-care costs to people who return to work and earn less than $25 an hour at their new job.



PMI's and ISM

Overall composite PMI's are holding up well and even making new highs globally. However, we are seeing an increasing shift from manufacturing strength to services. Not surprising given the reopening in most developed market economies and where we are in the rebound.

What is worth noting is that at least some of the slowing in manufacturing is still being caused by transportation bottlenecks and material shortages.

This dynamic is causing some confusion and again makes forecasting very difficult. This is true globally, not just in the US.

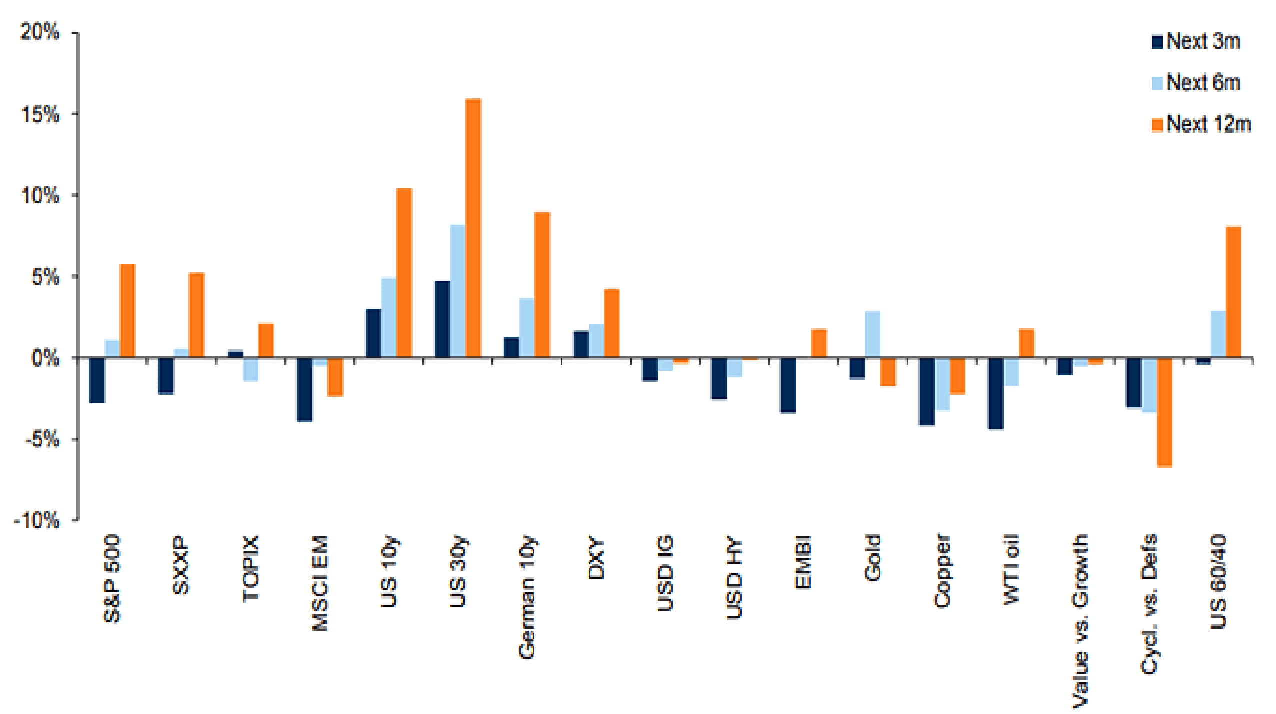
Here are the results for the Eurozone Flash PMI's for May that was released last week, with a comment from the Markit Chief Economist. Source: Bloomberg

> "Growth would have been even stronger had it not been for record supply-chain delays and difficulties restarting businesses quickly enough to meet demand, especially in terms of rehiring," said IHS Markit Chief Business Economist Chris Williamson.

	MAY	SURVEY	APRIL
Services PMI	55.1	52.5	50.5
Manufacturing PMI	62.8	62.5	62.9
Composite PMI	56.9	55.1	53.8

As noted before, it is only a matter of time until these diffusion indices peak given their current levels. When they do, things tend to get more complicated for markets.

Exhibit 5: ISM peaks are usually followed by a less procyclical shift across assets
Average return following a peak in ISM manufacturing since 1980 (excess returns for credit)



Source: Datastream, Goldman Sachs Global Investment Research

ECB

While we wait for the approaching June ECB meeting, there is increased talk that the ECB may move to their own average inflation targeting regime. I think that might be hard to get through, given the pickup in inflation, but we will see. Given the low growth rates they have experienced over the last decade, they have a fair chance of that type of policy just turning into a stagflation quagmire in the coming years. Having said that, a move to AIT would almost certainly pop the inflation expectations initially and be a near-term positive for equities.

Liquidity

Increasingly, we are seeing central banks getting a little nervous about the level of easy money being supplied. Some are tapering QE, or at least starting to talk about it. Others are eyeing higher rates. Overall, one by one, the fluff is coming out of some of the hottest markets. IPOs and SPACs lost their mojo over the last few months, as have some of the momentum and innovation names. Is the market starting to sniff out the end of what was limitless liquidity?

That brings us to Crypto…

The news has conspired against crypto over the last two weeks.

- Tesla not taking BTC any longer on environmental concerns (yeah ok)
- The Treasury announcing that crypto transfers over $10k will need to be reported to the IRS
- China announcing they will crack down on the mining and trading of crypto

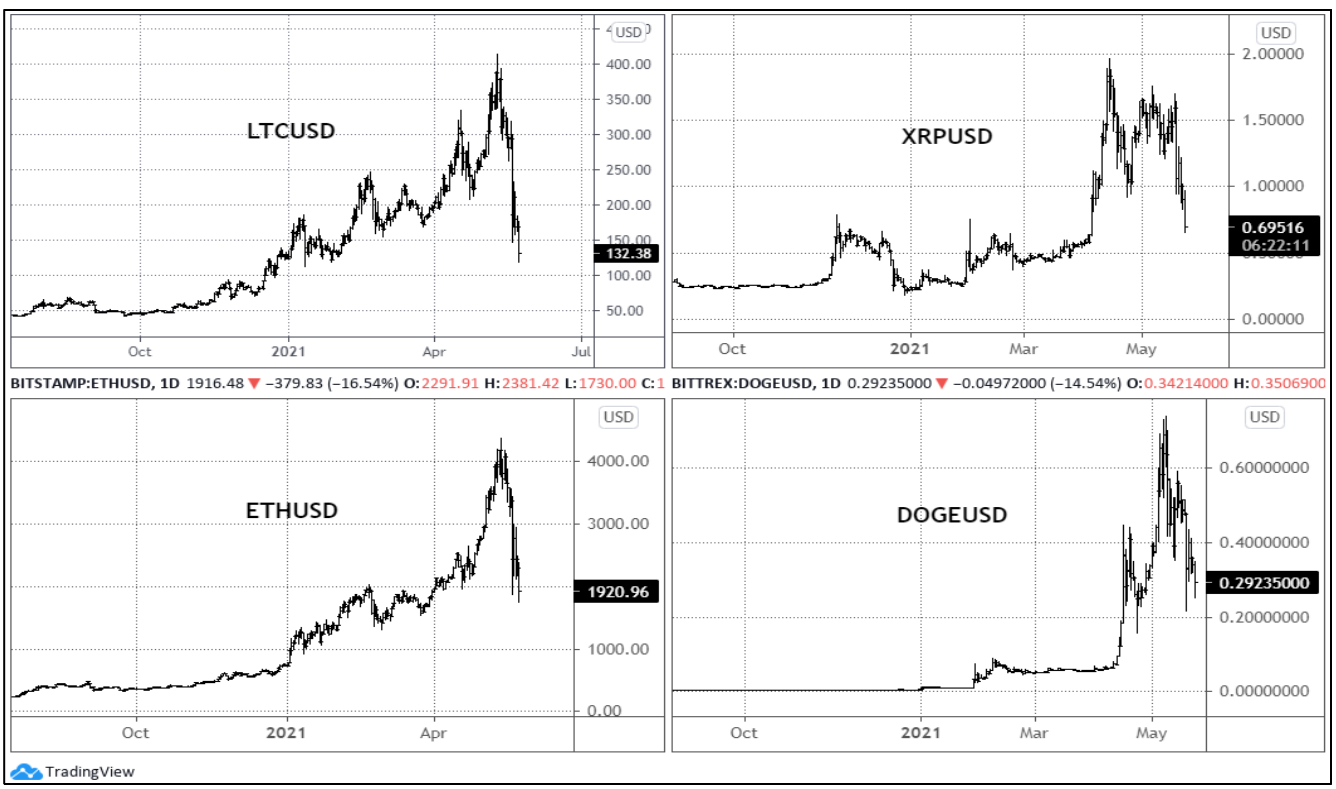
Last week I had suggested that BTC could make a trip to the green box… that was fast!

The question is whether BTC and its crypto "bros" are a bellwether of global liquidity expectations and risk sentiment?

Certainly, off the 2020 lows Bitcoin's correlation to equities has been relatively high.

Source: TS Lombard

Here is a sampling of the recent price action for a few of the others…



What to Focus on Now:

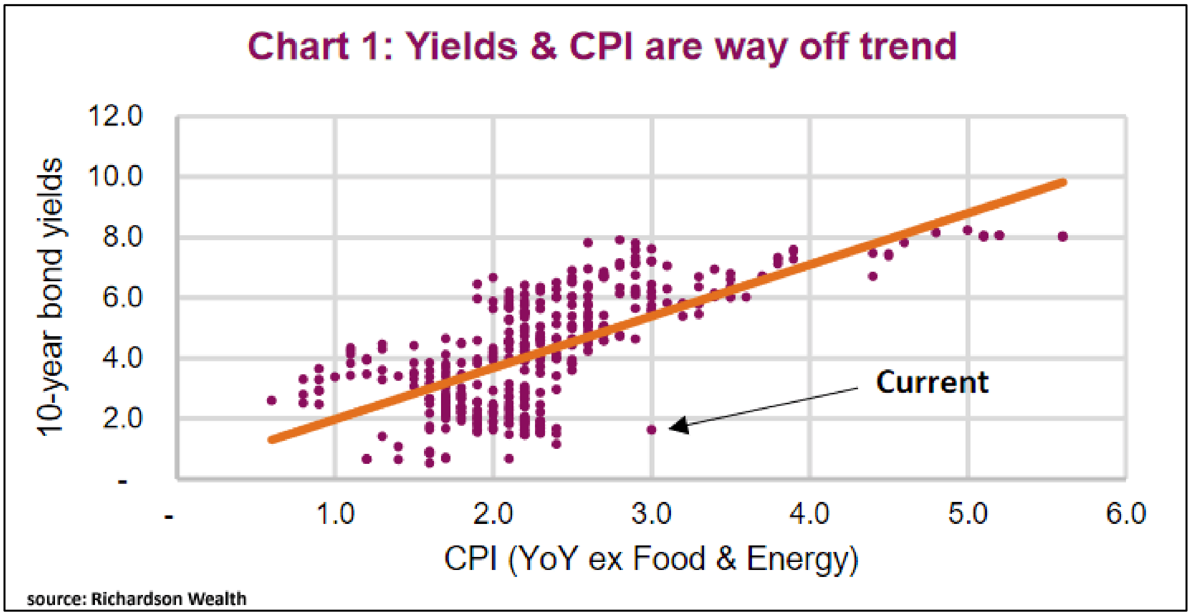
Equities – SPX still center of the channel, NDX looking a little more precarious… watch 13000.

The Russell is increasingly coiled for a move…

The DJIA continues to hold above support.

Bonds

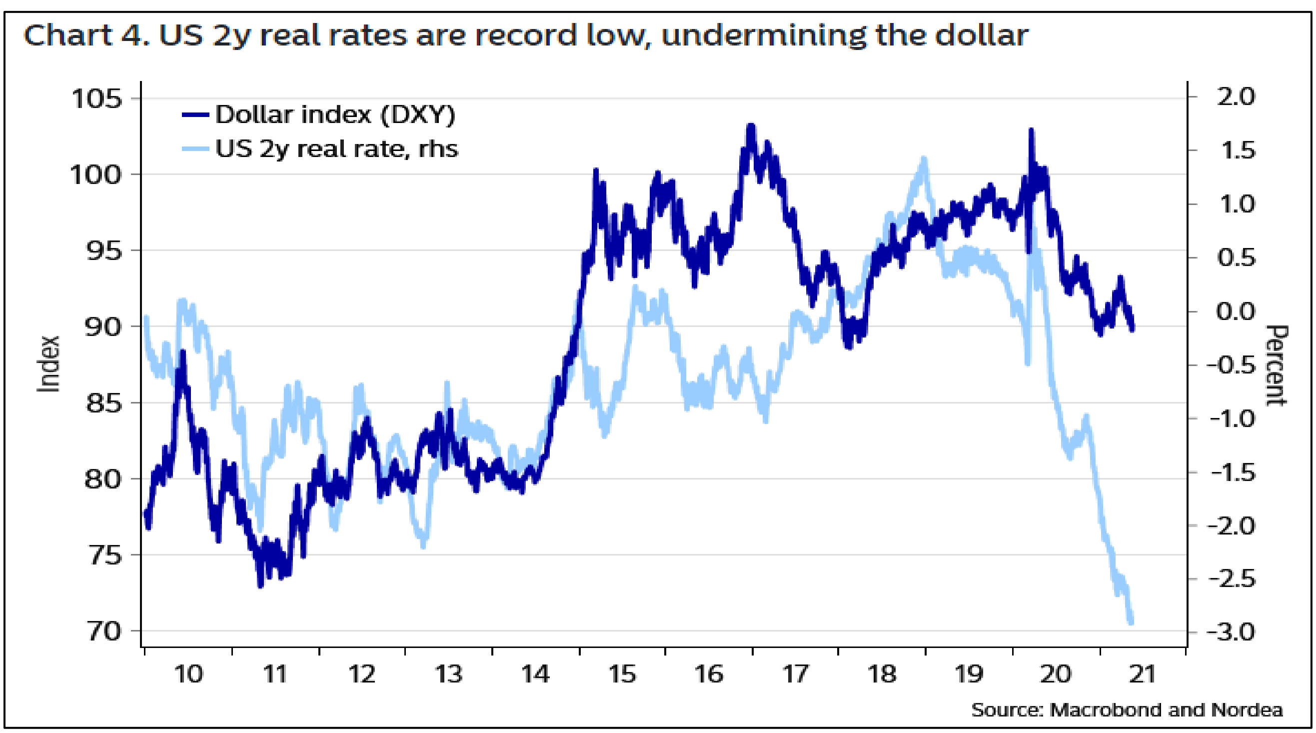
Either bond yields are way too low, or CPI is way too high (transitory), something will have to give. We already knew that, but interesting illustration.



With no follow-through after the recent inflation numbers, Treasury yields continued to struggle last week.

Chinese 10-year yields have been falling. This is worth watching.

FX - Increasingly it feels like it is now or never, for further USD weakness.



The dollar has arguably broken lower vs. the EUR heavy DXY but has been unable to push on.

We will need to crack 1.2250 in the EURUSD and 1.4250 in GBPUSD, for me to get excited about the next leg extending.

I am a bit concerned that the recent weakness in some of the big commodity leaders (copper, iron ore, steel, lumber, corn) and the fall in crypto will herald some short-term USD buying.

Friday afternoon saw a quick jump in USD and some of the commodity-related FX like AUD, NZD and BRL were hit.

The continued nasty price action in crypto over the weekend could make for a rocky start of the week for some asset classes if the volatility spreads.

One old-school risk on/off pair is AUD/JPY. It hasn't disappointed over the last few years as a way to play via FX. Sometimes it leads and sometimes it lags, but it rarely fails to capture the mood. Not only has it not participated much in recent months, but it is threatening to break lower. One well worth watching for further deterioration and as a potential canary.

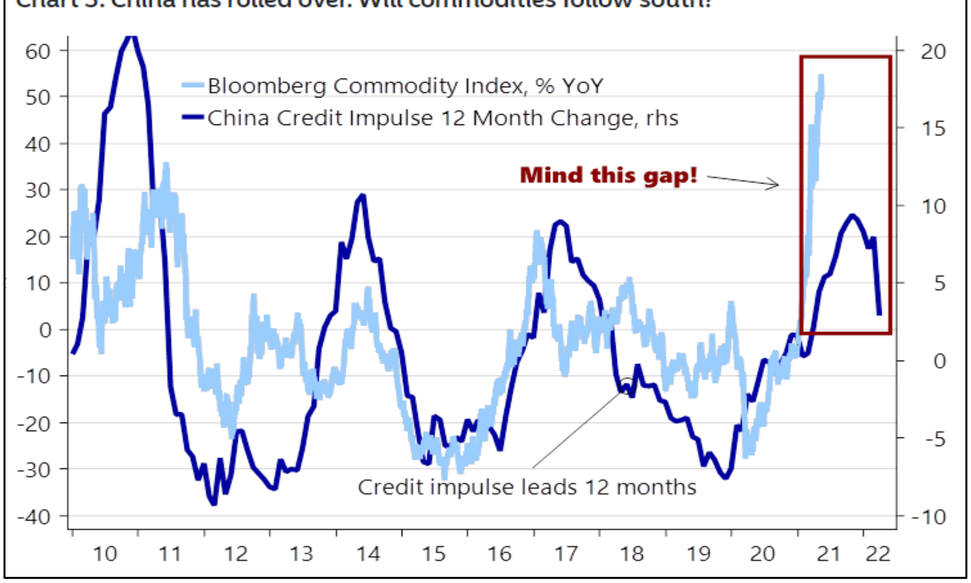
Commodities – They have certainly had an amazing run. However, many are over bought.

Only rarely can they get this over bought and push on materially without a rest/ pullback.

Maybe this time is different given all the COVID shocks… but to buy them here requires a long view or a tight stop.

Last week China [announced](#) they could try to curb "unreasonable" prices and investigate hoarding in industrial commodities. They mentioned potentially releasing some reserves as well. This chart keeps popping into my mind given their concerns about financial stability.

Chart 3. China has rolled over. Will commodities follow south?



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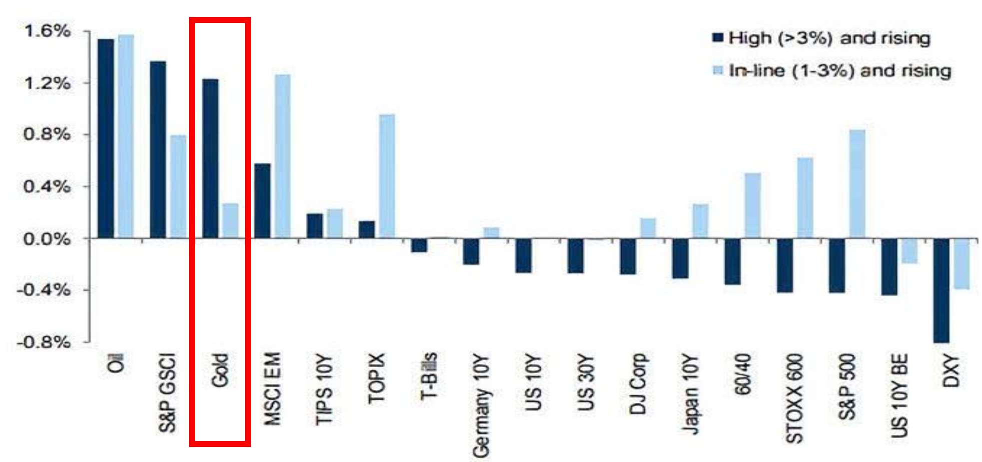
Increasing commodity exposure vs. industrial commodities has been very popular in recent months given the inflation fears and the price action. Gold has been less popular given the safe-haven nature (who needs that) and the fear that rising yields will eventually take up real yields.

With positioning much lighter than it was, the price action is holding. I continue to like having upside exposure on this one. A further move lower in USD would help a great deal.

Exhibit 6: Gold tends to do well when realised inflation is elevated and rising

Average monthly, real total returns (since 1950) based on US CPI regimes



Source: Datastream, Haver Analytics, Goldman Sachs Global Investment Research

Stargazer
Asset Management

Important Macro Data Releases and Events for the Week

Monday
5/24/2021

- BoJ's Kuroda Speech
- Chicago Fed National Activity Index
- Fed's Brainard speech

Tuesday
5/25/2021

- German GDP
- IFO - Business Climate (May) Forecast: 98.1, Prior: 96.8
- IFO - Current Assessment (May) Forecast: 95.5, Prior: 94.1
- IFO - Expectations (May) Forecast: 101, Prior: 99.5
- Housing Prices Index MoM (Mar)
- New Home Sales MoM (Apr)
- **Consumer Confidence (May)**

Wednesday
5/26/2021

- Leading Economic Index (Mar)
- Fed's Quarles Speech

Thursday
5/27/2021

- Gfk Consumer Confidence Survey (Jun) Forecast: -5.3, Prior: -8.8
- Durable Goods Orders - various versions
- GDP Q1 Preliminary Forecast: 6.5%, Prior: 6.4%
- GDP Price Index
- Core PCE Prices QoQ Q1 Forecast: -, Prior: 2.3%
- Initial Jobless Claims Forecast: 430, Prior: 444k

Initial Jobless Claims 4-week average Forecast: -, Prior: 504.75k

Continuing Jobless Claims -, Prior: 3.751M

Pending Home Sales

Treasury Sec Yellen Speech

Friday
5/28/2021

Consumer Confidence

Business Climate

Core Personal Consumption Expenditure - Price Index MoM (Apr)

Core Personal Consumption Expenditure - Price Index YoY (Apr)

Personal Income MoM (Apr) Forecast: -14%, Prior: 21.2%

Personal Spending MoM (Apr) Forecast: 0.6%, Prior: 4.2%

Chicago Purchasing Managers Index (May) Forecast: 70, Prior: 72.1

Michigan Consumer Sentiment Index (May) Forecast: 82.9, Prior: 82.8

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