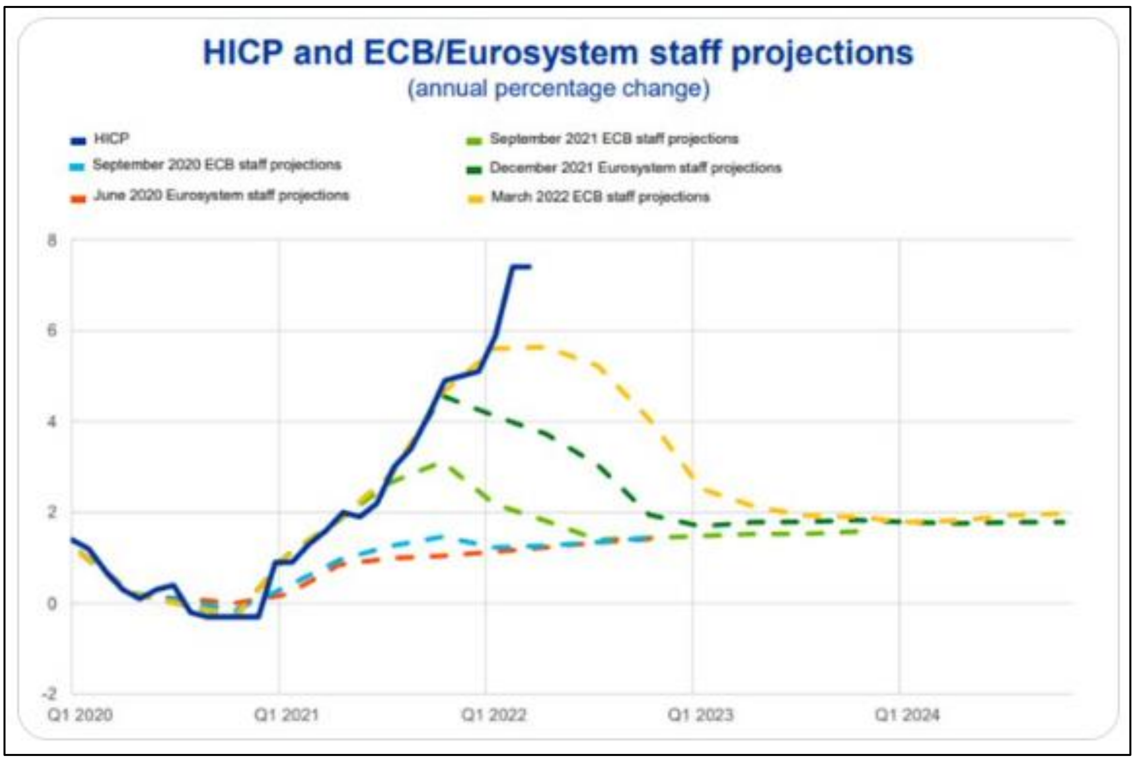
What to focus on in Global Macro for the week of July 25th, 2022

ECB

Last week's larger than expected 50bp hike was explained as front-loading the exit from negative rates which in turn would allow the ECB to abandon forward guidance and become totally data-dependent going forward.

Given how terrible they have been at forecasting, forward guidance had become a farce in any case.



Source: @MacroAlf

I would expect that this larger hike was also part of the horse-trading that the implementation of their new "anti-fragmentation" tool required. The Transmission Protection Instrument, "can be activated to counter unwarranted, disorderly market dynamics."

Lagarde went on to explain that:

- All euro-area members are eligible
- The Governing Council alone will decide whether the TPI is used, taking into account "multiple indicators" including compliance with European Union fiscal rules

- TPI "will avoid interference with the appropriate monetary-policy stance," suggesting bond purchases will be offset
- Some country-specific risks can still be addressed by an older instrument, Outright Monetary Transactions
- The Governing Council would "rather not use" TPI but won't hesitate to do so if required

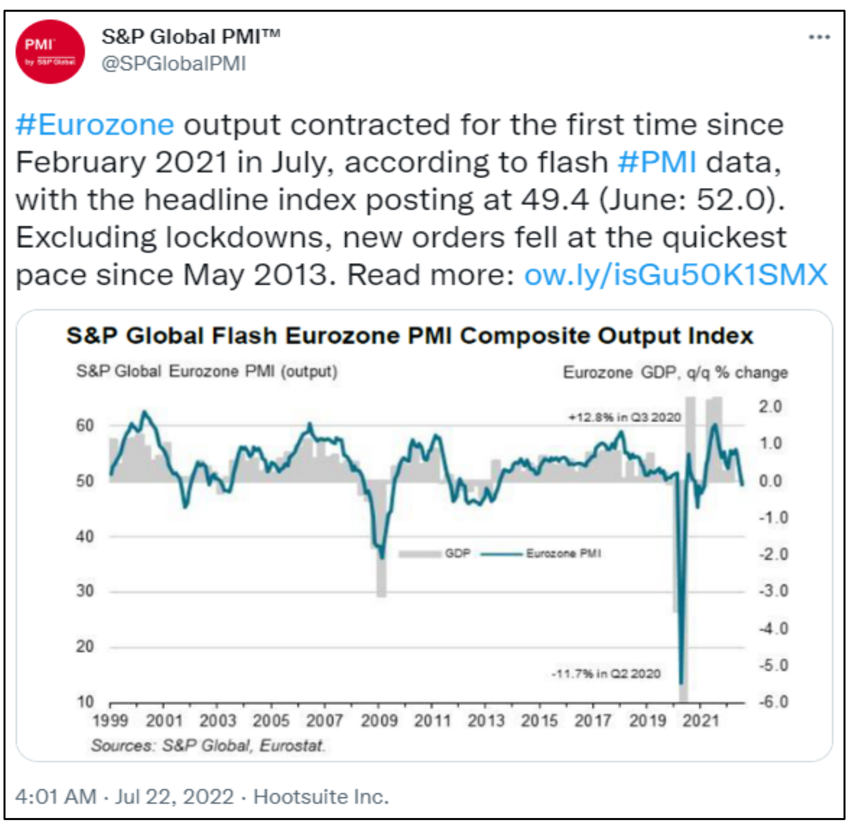
Expect the usual court challenges by German professors, shortly.

Recent spread widening vs. the periphery has made the ECB nervous, and the Italian PM Draghi's' departure has only served to increase the urgency. Essentially, this is a sovereign spread version of the Fed's "operation twist".

With Italian instability, continued concerns about natural gas flows into Europe, extreme heat and wildfires, and slowing economies, policymakers have their hands full.

Even Germany's Rhine isn't cooperating as water levels fall to a point that threatens to make it impossible to navigate. The last time that happened it shaved 1% off of German industrial production.

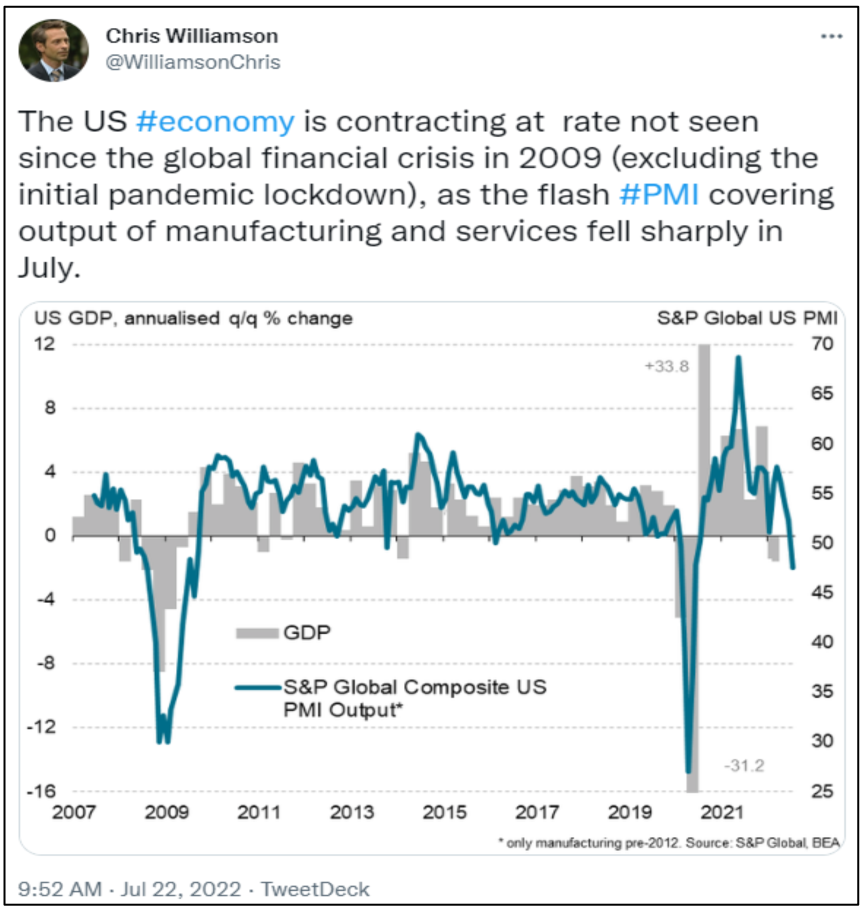
Friday's preliminary July PMI print only increased the pressure on policymakers as it fell to contractionary levels. The ECB is embarking on a tightening cycle at a point where it would normally be considering easing policy.



The Fed and the US

Next up, we have the Fed. With 75bps still the most likely for this meeting, markets are starting to wonder what comes after that and whether assumptions about the terminal rate need to be adjusted.

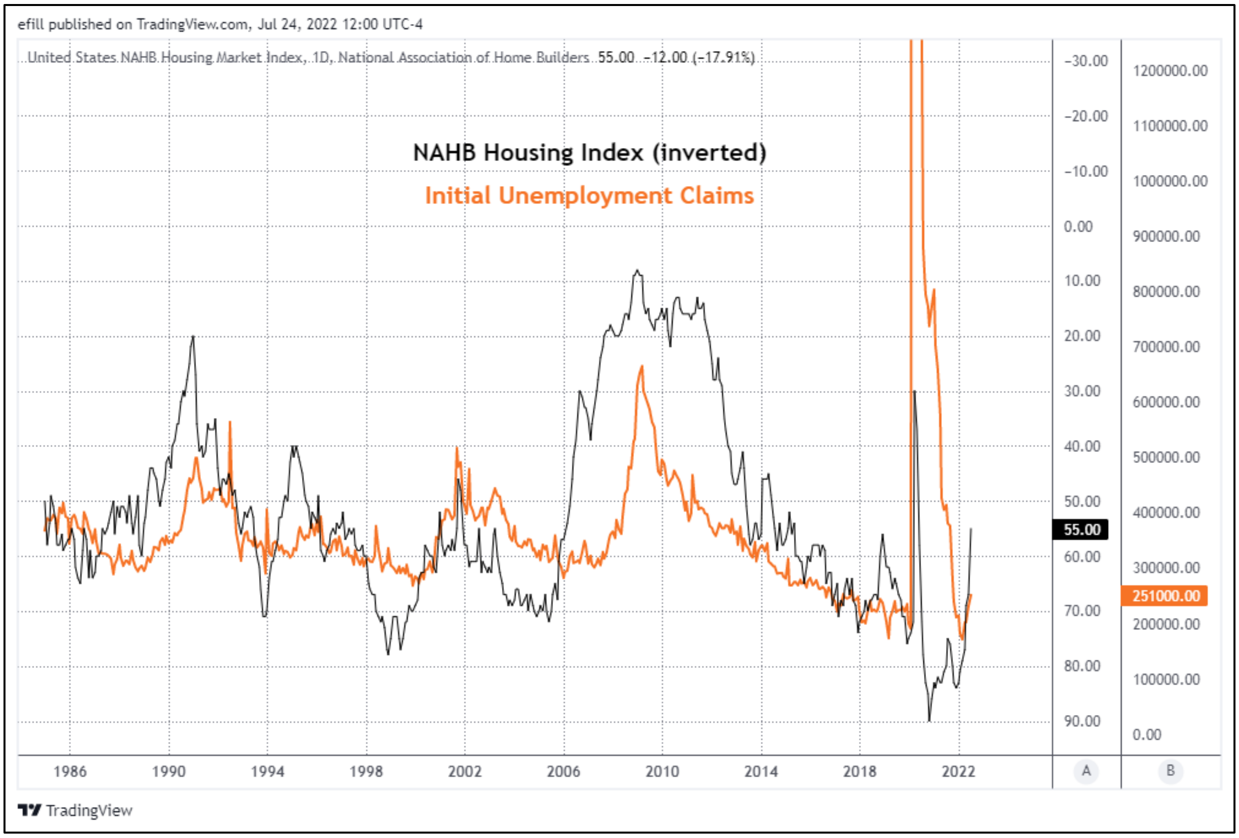
Consumer and business surveys have continued to validate the trend toward weakening economic data. Bit by bit, the Fed is on its way to achieving the softening of demand it has been looking for. Last week's preliminary Composite PMI also fell into contractionary territory as it printed 47.5.



The big questions for the US economy center on the recent but rapid weakening of the housing market, and the state of the labor market.

The housing market is a huge contributor to any wealth effect that people feel and represents a much larger percentage of assets for most people than equities.

In fact, housing tends to lead employment by 12-18 months.



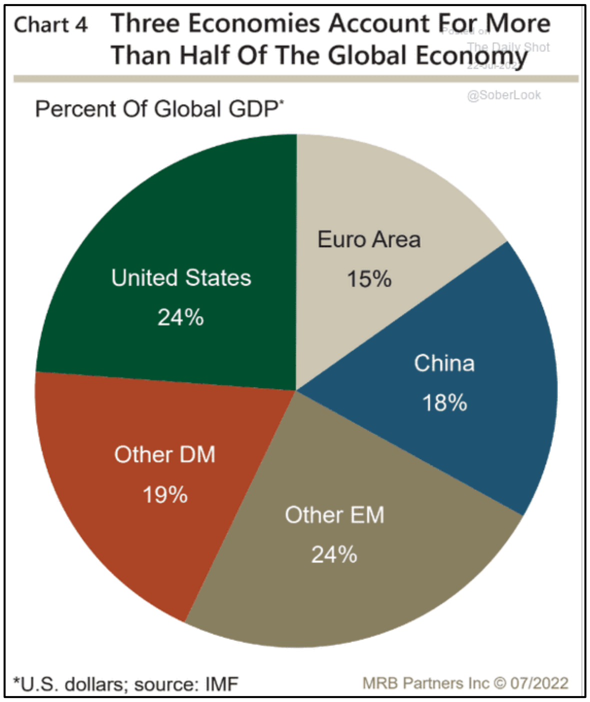
Currently, there is a big disconnect between a number of indicators of US economic activity and a labor market that remains solid by most measures. Just look at GDP vs. employment (seems output-per-hour is to blame here).

Yes, employment tends to be a lagging indicator and recently initial claims have been rising, but from a historical perspective, there isn't much to quibble with at this point.

In a post-COVID world, economic data has been more difficult to parse. One thing to note about the employment data is that there has been a growing disconnect between the two methods by which the BLS measures employment. One is the Establishment Survey, which is used to calculate the NFP, and the other is the Household Survey. While the NFP has continued to show gains this year, the data generated from the Household Survey has been registering declines since March. It seems that the spread between the two survey methods is now the largest it has been since 1948. A big difference between the two survey methods is that NFP measures the number of jobs, while the Household Survey measures the number of people employed. It will be interesting to see how this is resolved. Are a significant number of people holding multiple jobs now vs. before COVID? What about the participation rate? It should be no surprise that there are odd things going on in the economy given COVID and the government response. However, it certainly doesn't make the path forward any easier to predict.

China

That brings us to the next big global economic player.



Zero-COVID and internal government policy vs. real estate and technology companies are starting to have dramatic effects.

Gross domestic product expanded at a 0.4% annual rate in the April to June period, China's National Bureau of Statistics said Friday.

The slowing economy is making life more difficult for the government. Xi is under growing domestic pressure with the next big Communist Party meeting, at which he hopes to secure a third term, only months away.

Now there is an open revolt by homeowners across at least 301 projects in 91 cities, who are refusing to continue paying mortgages on unfinished properties.

China's property market is estimated to have a total value of $62T, making it the largest asset class on earth, according to Bloomberg.

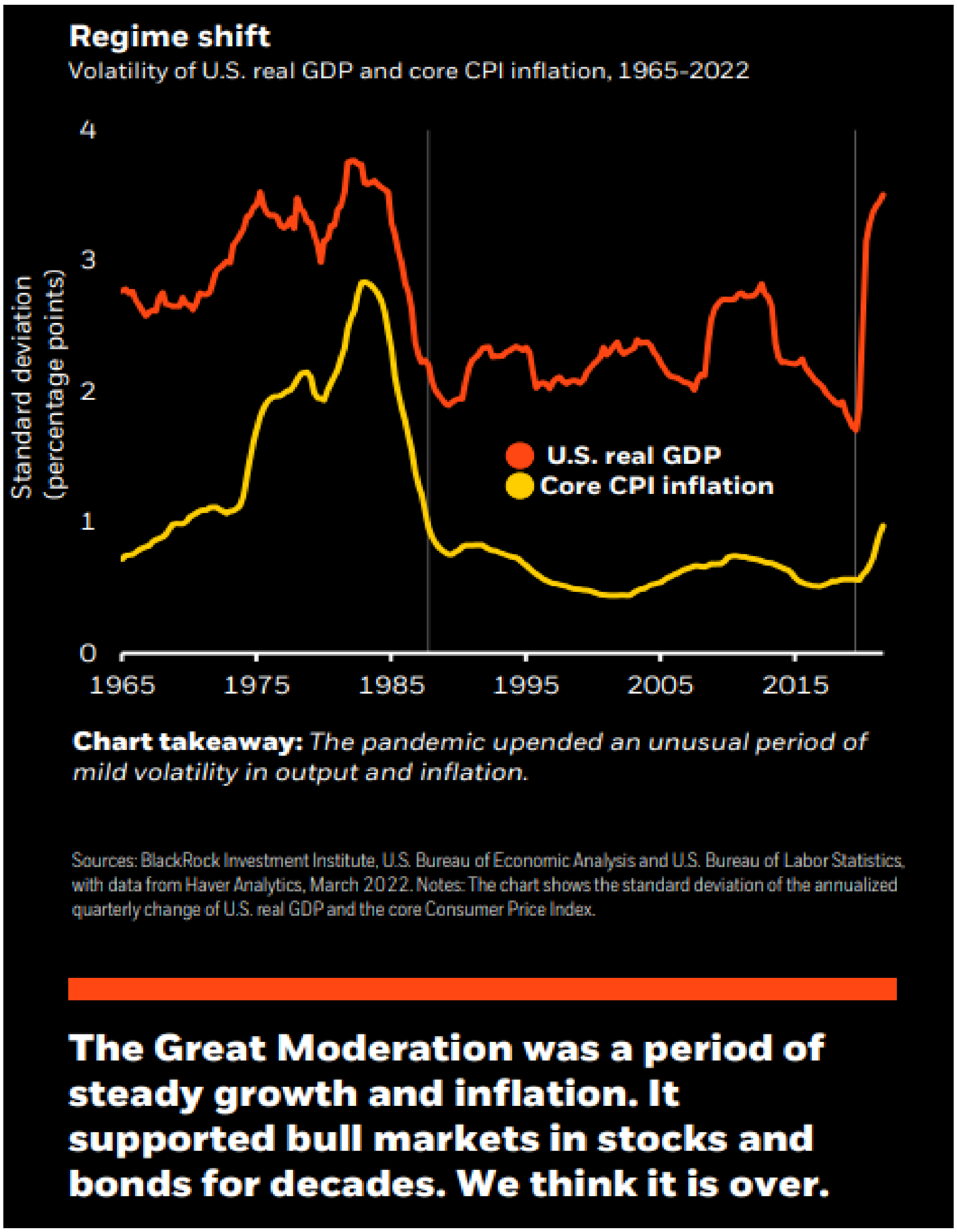
The Great Moderation: Over

I have been thinking about how the last twenty years are not likely to provide good analogs for anything that we are seeing now. Yet, given people's recency bias, that is exactly what people are drawn to.

BlackRock did an interesting white paper (here) that hits on this via their view that The Great Moderation is now over.

"The Great Moderation, a period of steady growth and inflation, is over, in our view. Instead, we are braving a new world of heightened macro volatility – and higher risk premia for both bonds and equities. This regime has echoes of the early 1980s, so we're calling our Midyear Outlook Back to a volatile future. We ultimately expect central banks to live with inflation, but only after stalling growth. The result? Persistent inflation amid sharp and short swings in economic activity.

Academics Jim Stock and Mark Watson coined the term Great Moderation in 2002 to describe the period of steadily lower volatility in inflation and activity. Was this combination due to good policy or good luck? For a long time, people thought it was sound policies. Stock and Watson argued it was mostly luck. We think they got it right. Steadily expanding production capacity and demand *shocks were key features of the Great Moderation. Exuberance and borrowing binges drove overheating, while souring sentiment and collapsing spending drove recessions. Central banks could mitigate both by raising or cutting rates. The policy response did not involve trade-offs; there was no conflict between stabilizing both. This helped spark a bull market in both bonds and equities. This is no more, in our view. The chart shows the regime of subdued inflation and output volatility is over."*



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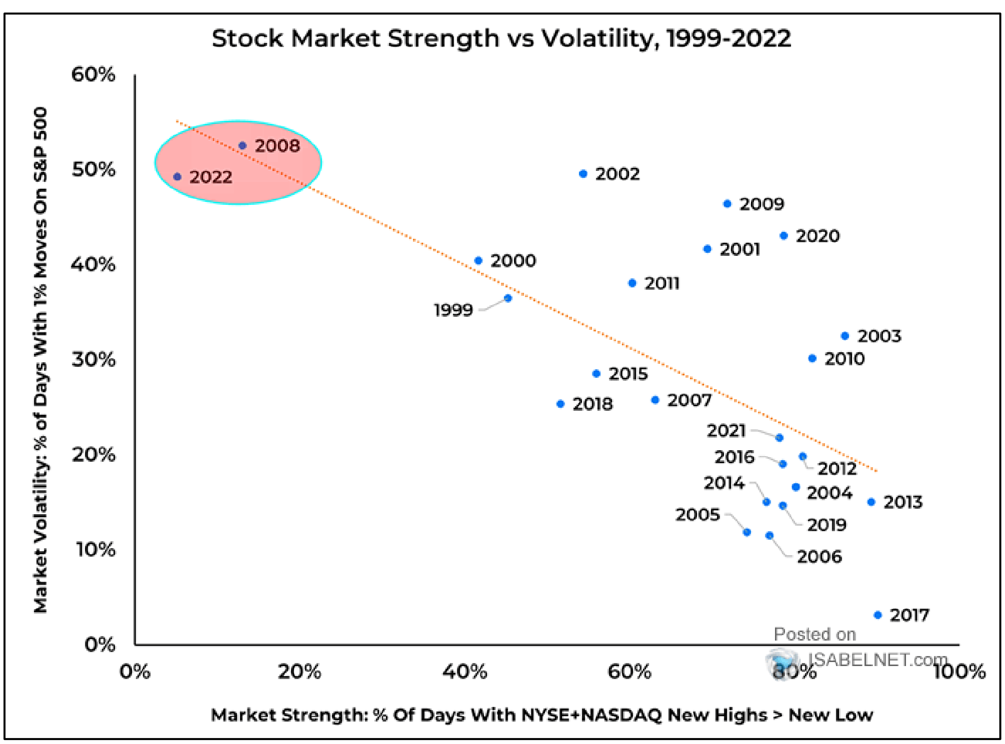
COVID and its aftermath have certainly injected new volatility into economic indicators like the Philly Fed's 6-month forecast…

That volatility is being reflected in markets, and to a degree rarely seen over the last 20-years.



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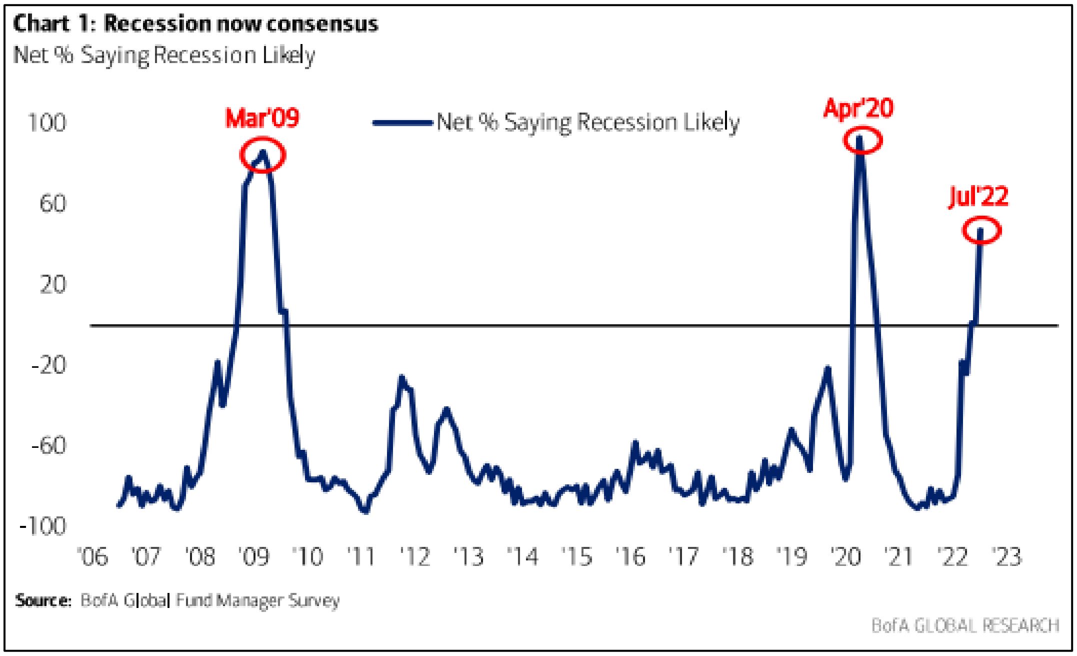
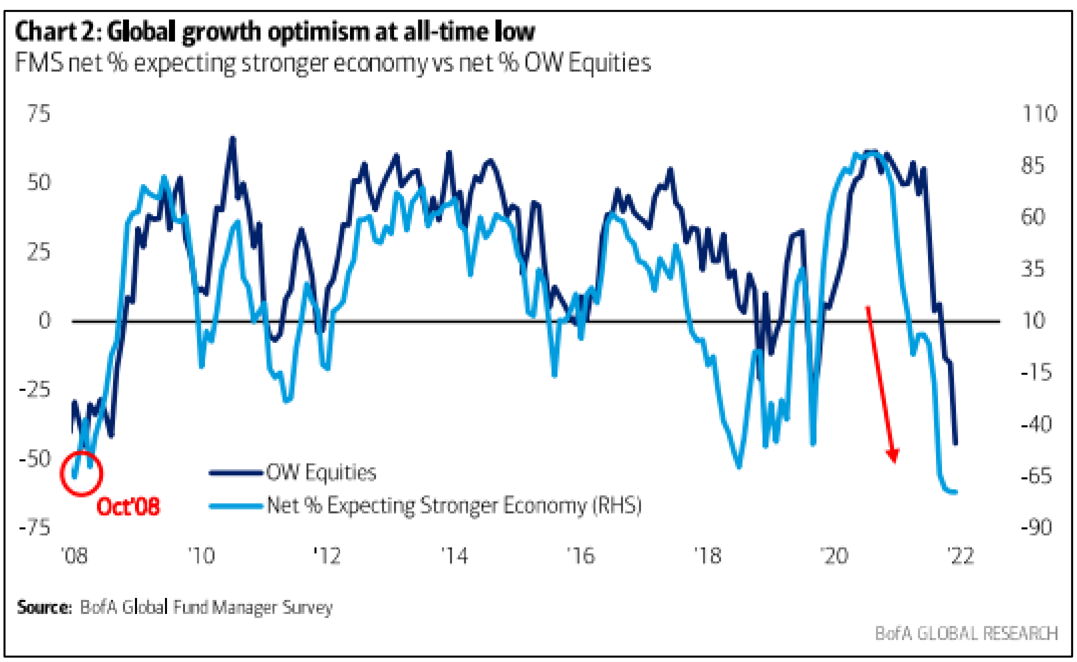
Equities

The most recent Global Fund Managers Survey had a near-record level of bearishness.

These charts have been making the rounds, but I thought it was worth running through them quickly. Remember these are institutional investors.



Bearish on growth…



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Bearish on profits…

Chart 3: Global profit optimism at all-time low
Net % Say Global Profits Will Improve

Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

And want to take less risk as a result.

Chart 13: Where's Lehman?
Net % Taking Higher than Normal Risk Levels

Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

So much negativity makes markets very prone to bear market rallies, even if the bearish views play out in the end. Are long bonds a better trade now than short stocks?

Few expect higher long-term rates at this point (that doesn't mean they are now long duration, however).

Chart 7: Investors no longer expect higher bond yields
Net % expecting higher long-term rates

Source: BofA Global Fund Manager Survey

They do like cash...

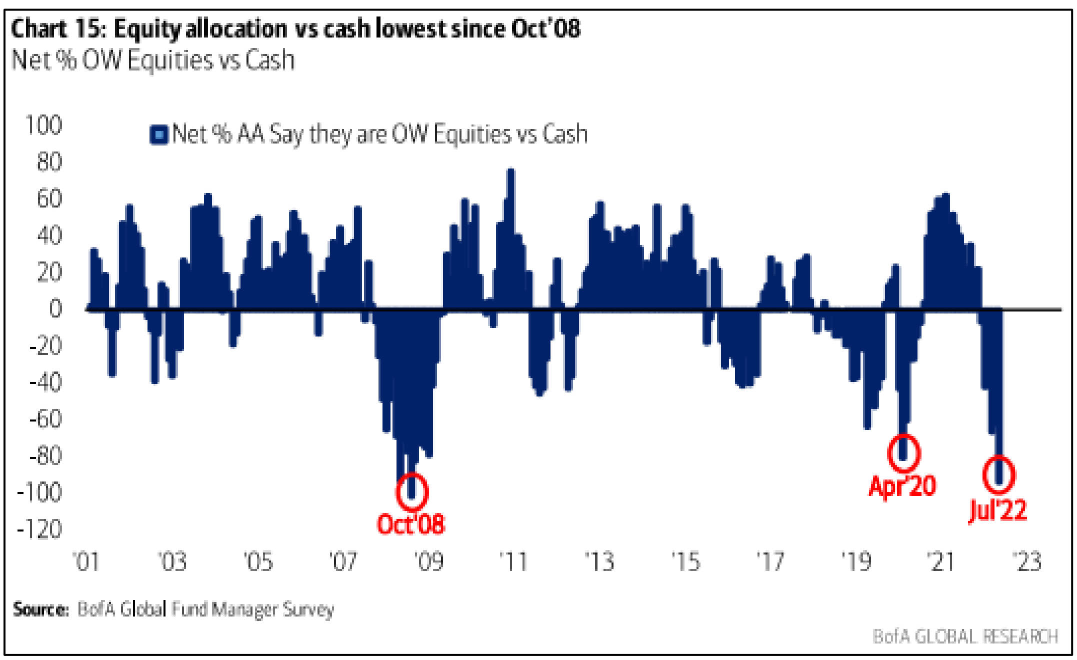
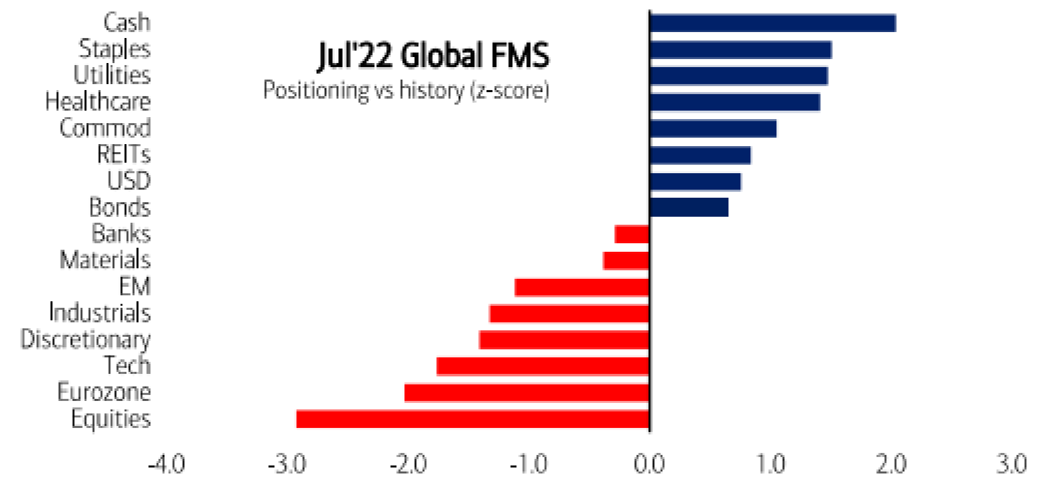


Chart 15: Equity allocation vs cash lowest since Oct'08
Net % OW Equities vs Cash

Source: BofA Global Fund Manager Survey

And are short equities vs. historical positioning

Chart 21: ...and are long cash, short equities...
Positioning vs history (z-score)

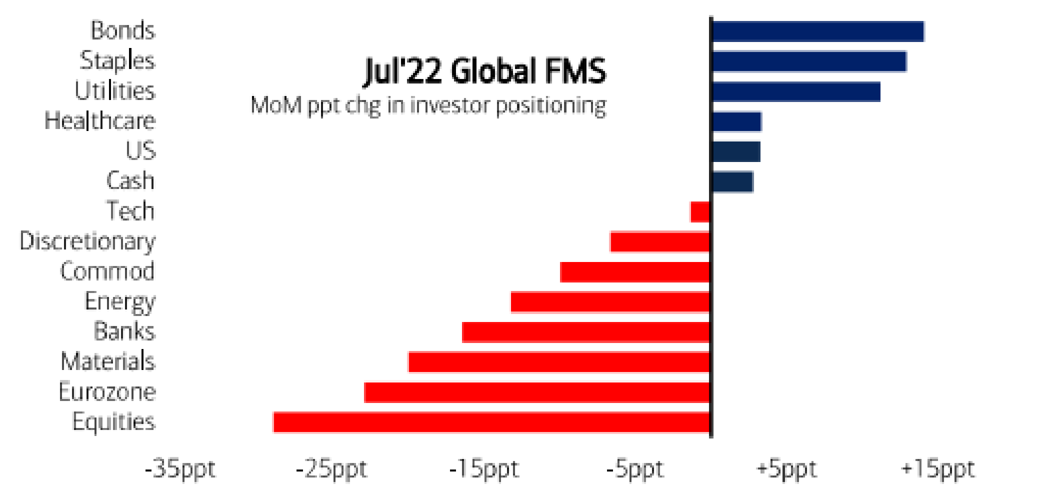


Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

While they can't get themselves to buy stocks other than defensives, they have started buying bonds

Chart 22: ...July rotation into bonds and defensives and out of stocks...
MoM ppt change in investor positioning



Source: BofA Global Fund Manager Survey

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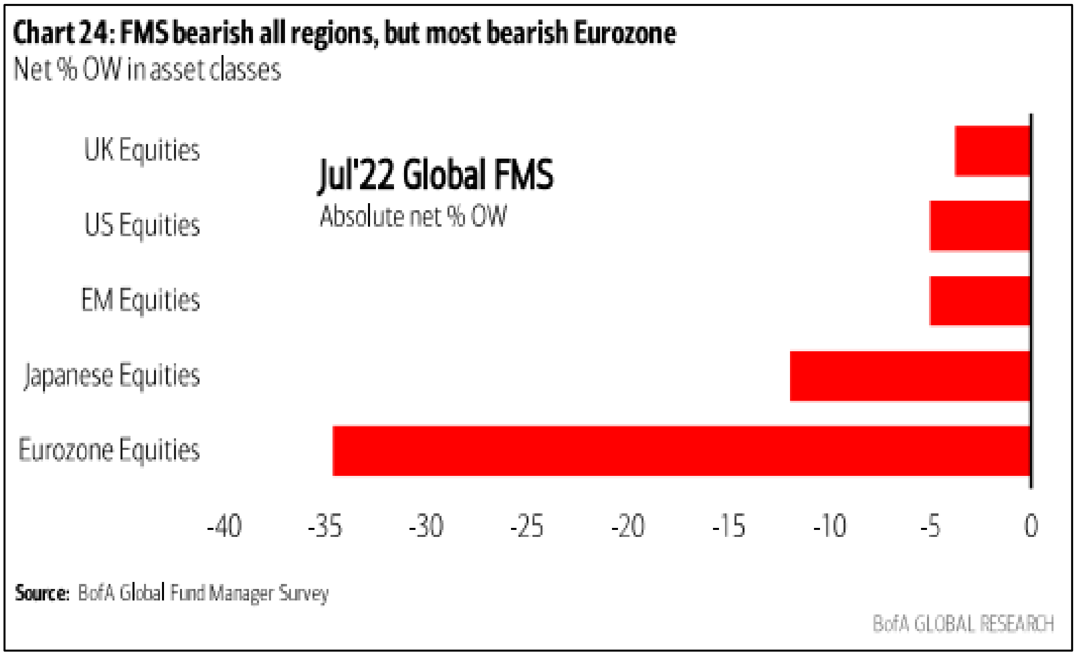
For obvious reasons, European equities have remained the least appealing to institutional investors. Some serious upside if they ever catch a break in Europe. If.



Interestingly, the Euro Stoxx index has not been underperforming the SPX and is right where it was on the day of the invasion of Ukraine, on a relative basis. The weak EUR helps.

FI - With investors bearish growth and profits but long cash rather than bonds it does make you wonder if there is room for more capital to flow into longer-duration fixed income at this point. The yield curve is betting that the economy won't be able to tolerate higher yields for long.

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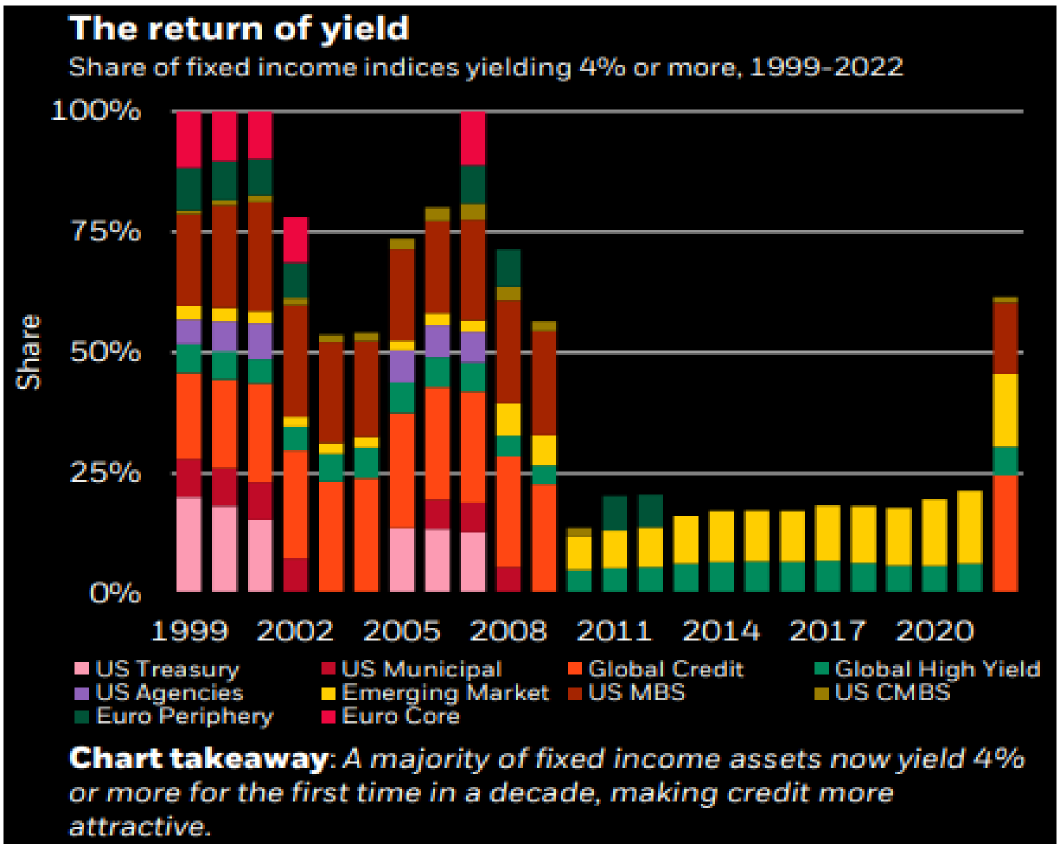
With yields having risen fixed income, in general, is now more interesting as an asset class than it has been in years. Having said that the decree of exposure to credit spreads needs to be carefully timed in this environment.



FX

The dollar has felt downward pressure from falling US interest rates in recent weeks. However, there have been few alternatives given the growth and geopolitical concerns. Falling US interest rate expectations due to a better-than-expected inflation outcome would put downward pressure on the USD, but improved inflation numbers due to rapid growth deceleration would likely have a much more disparate outcome.

Dollar trades aside, there are some potentially interesting crosses to watch. GBPAUD in particular has been in a tight range after breaking long-term support. The downside continues to look vulnerable to me.

Commodities – Energy is the exception (and a big weight in the index) but many commodities have now reversed all of the Ukraine invasion moves.

Hats off to The Economist for at least putting in an interim top in the grains with their late May article on the “Coming Food Catastrophe”.

Important Macro Data Releases and Events for the Week

Monday 7/25/2022

- IFO - Business Climate, Current Assessment, and Expectations (Jul)
- Chicago Fed National Activity Index (Jul)
- BoJ Monetary Policy Meeting Minutes

Tuesday 7/26/2022

- US Housing Data (May, Jun)
- Consumer Confidence (Jul)
- Richmond Fed Manufacturing Index (Jul)

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Wednesday 7/27/2022	Gfk Consumer Confidence Survey (Aug)
	Durable Goods Orders (Jun)
	Pending Home Sales (Jun)
	Fed Interest Rate Decision, Monetary Policy Statement, and Press Conference
Thursday 7/28/2022	Consumer Confidence and Business Climate (Jul)
	HICP YoY (Jul)
	Initial Jobless Claims
	Initial Jobless Claims 4-week average
	Continuing Jobless Claims
	GDP (Q2) PREL
	PCE Headline and Core QoQ Q2
	Industrial Production and Retail Sales (Jun)
Friday 7/29/2022	GDP, HICP, and CPI across Europe
	PCE Headline and Core MoM and YoY (Jun)
	Personal Income and Spending (Jun)
	Chicago Purchasing Managers Index (Jul)
	Michigan Consumer Sentiment Index (Jul)

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