What to focus on in Global Macro for the week of October 25th, 2021

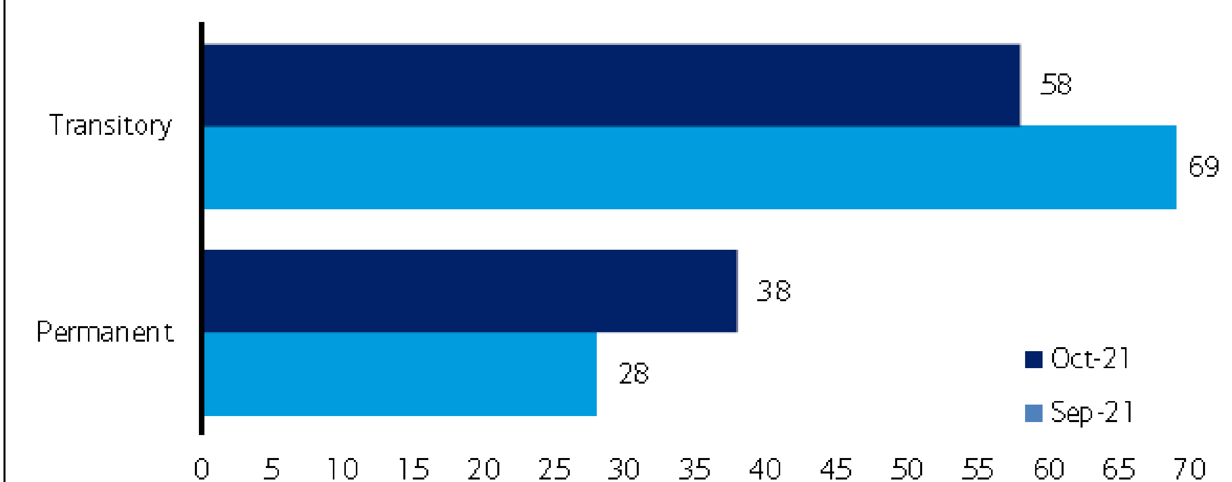
Macro Themes on the Radar:

The last two weeks saw a big jump in front-end rates as rate hike expectations were brought forward. This has been a global phenomenon as markets challenge central bank forward guidance. The Fed and the ECB both pushed back last week. The ECB's Lane said that it is "challenging to reconcile market rate pricing with ECB forward guidance", "markets may not have fully absorbed rate forward guidance". Fed's Waller (hawkish): "don't expect liftoff soon after taper finishes". However, the markets largely ignored them. Not all central bankers are seeing the current situation in the same way. The BoE Governor Bailey had helped push up front-end rates in the UK with last Sunday's comments that suggested that the first rate hike would be coming soon. Only a month ago the market was assigning a 5% probability to a UK hike by year end, now it stands at 77%.

Central bankers are in a tough spot. Monetary policy can't do much about supply induced price increases, but at the same time, they are getting worried that inflation expectations are rising more broadly.

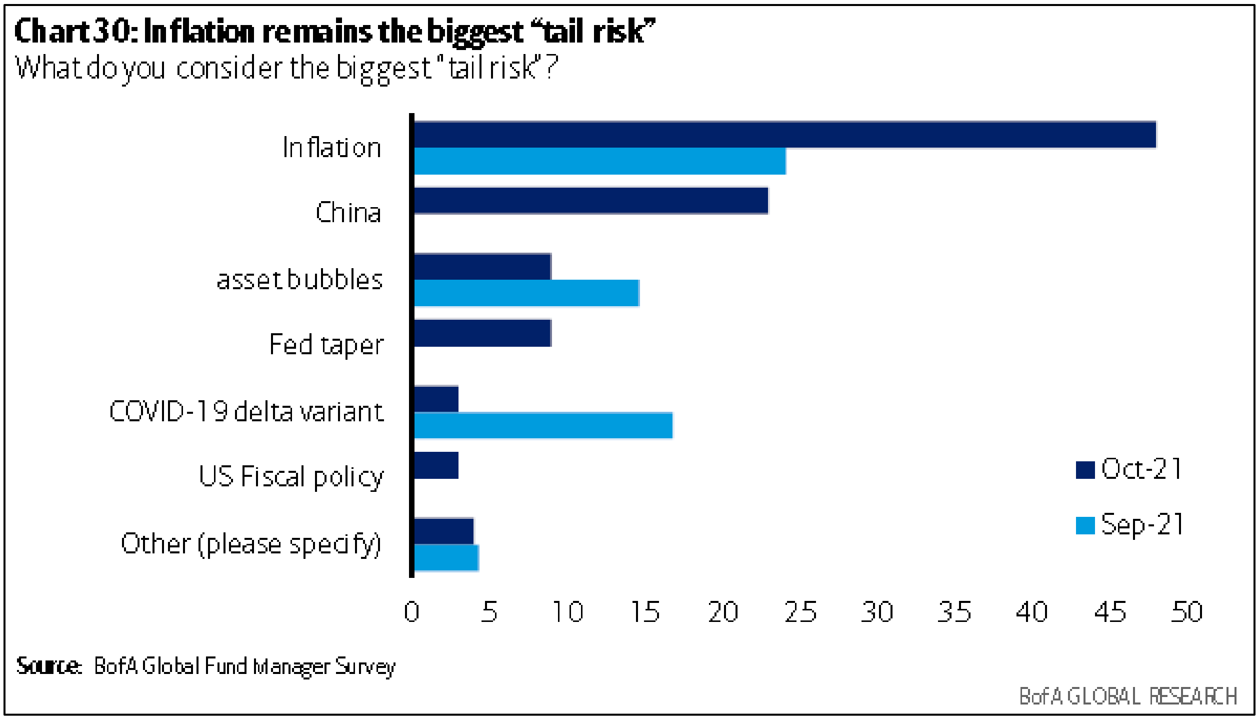
Investors' confidence in "transitory" is starting to slip.

Chart 5: 38% of investors think inflation is permanent
Do you think inflation is transitory or permanent?

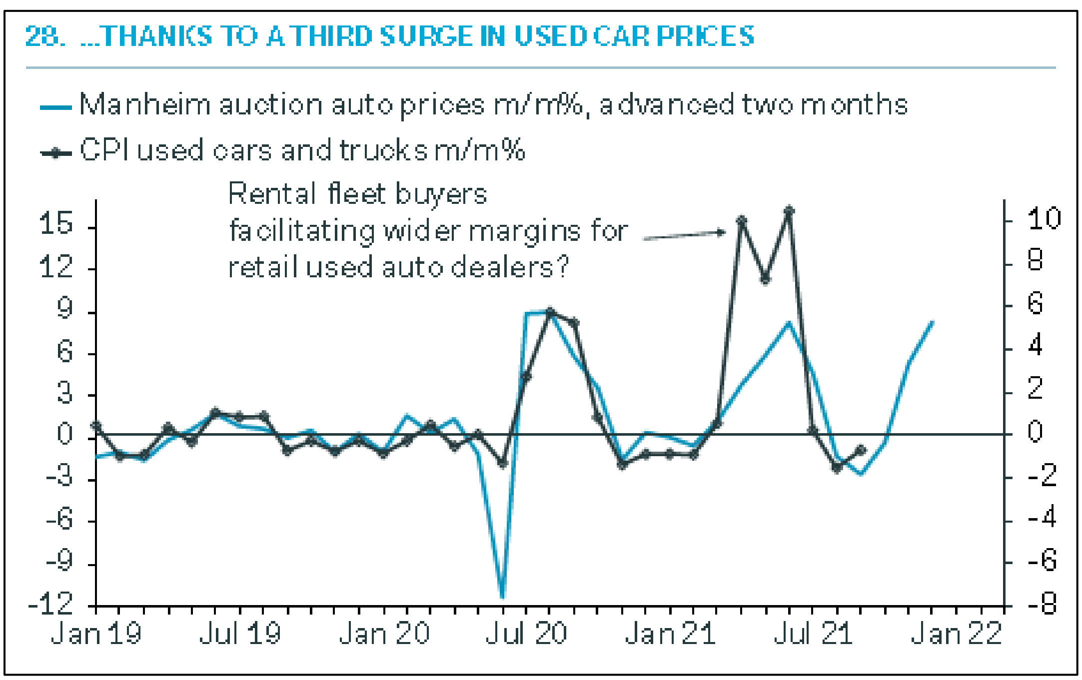


Source: BofA Global Fund Manager Survey
BofA GLOBAL RESEARCH

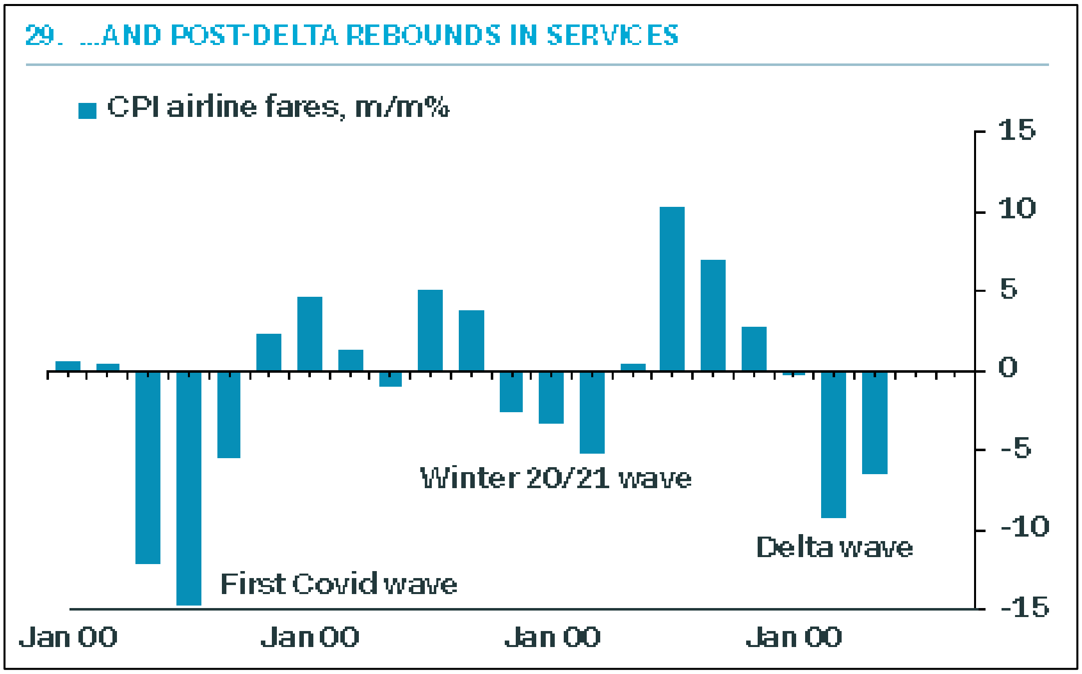
COVID has fallen as the biggest risk, while inflation continues to rise in the ranking.



If anything, the pressure on the Fed is likely to mount in the next few months as rotating drivers of the inflation surge take turns keeping it elevated. Used car prices have just done another leg higher and airline fares, suppressed by the most recent COVID wave, are due to bounce as case counts fall.



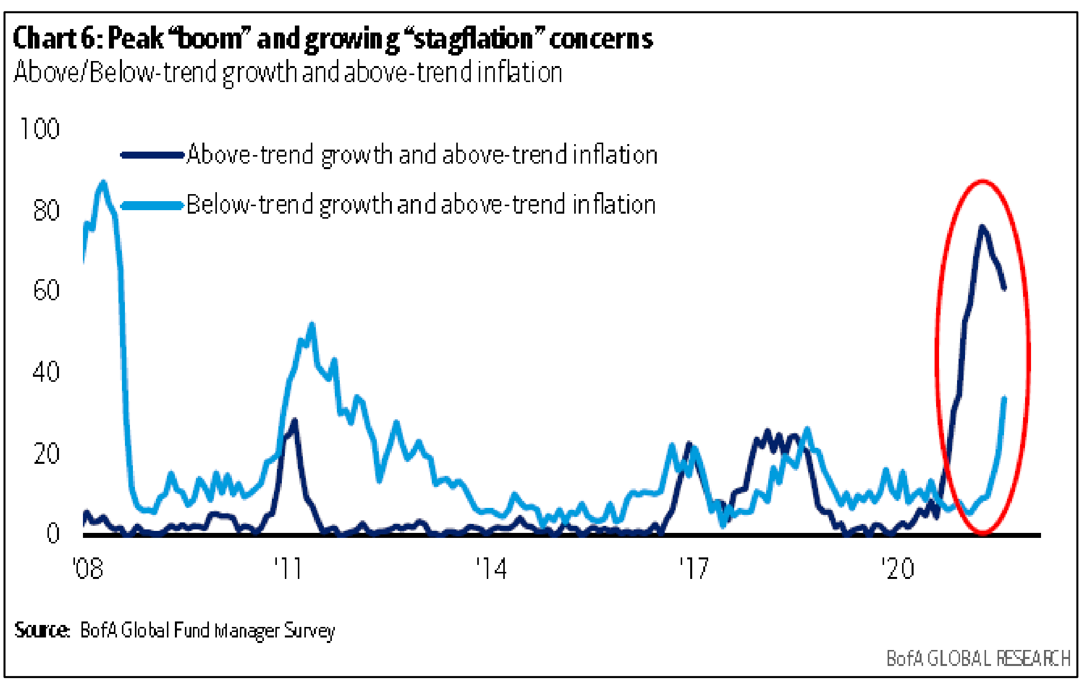
Source: Pantheon Macro



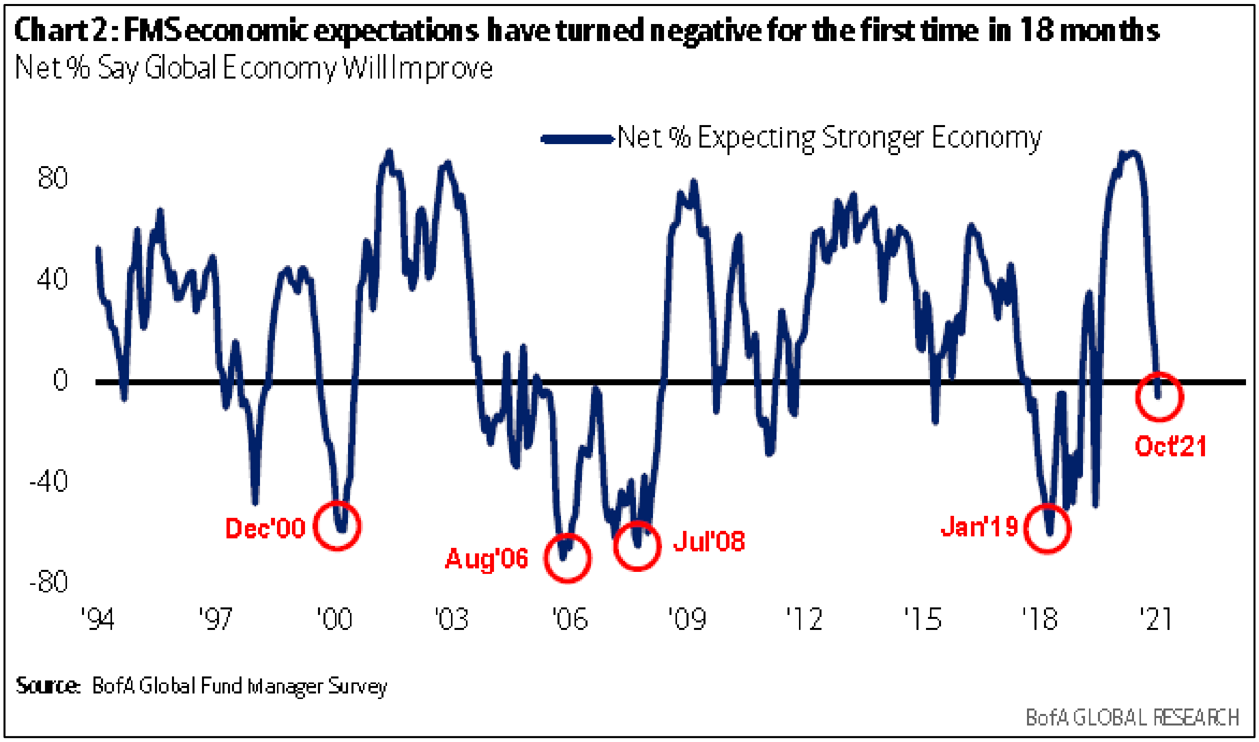
Source: Pantheon Macro

Rents continue to be a potential driver of further inflation strength, and the very strange situation in the labor market could easily put further upward pressure on wages.

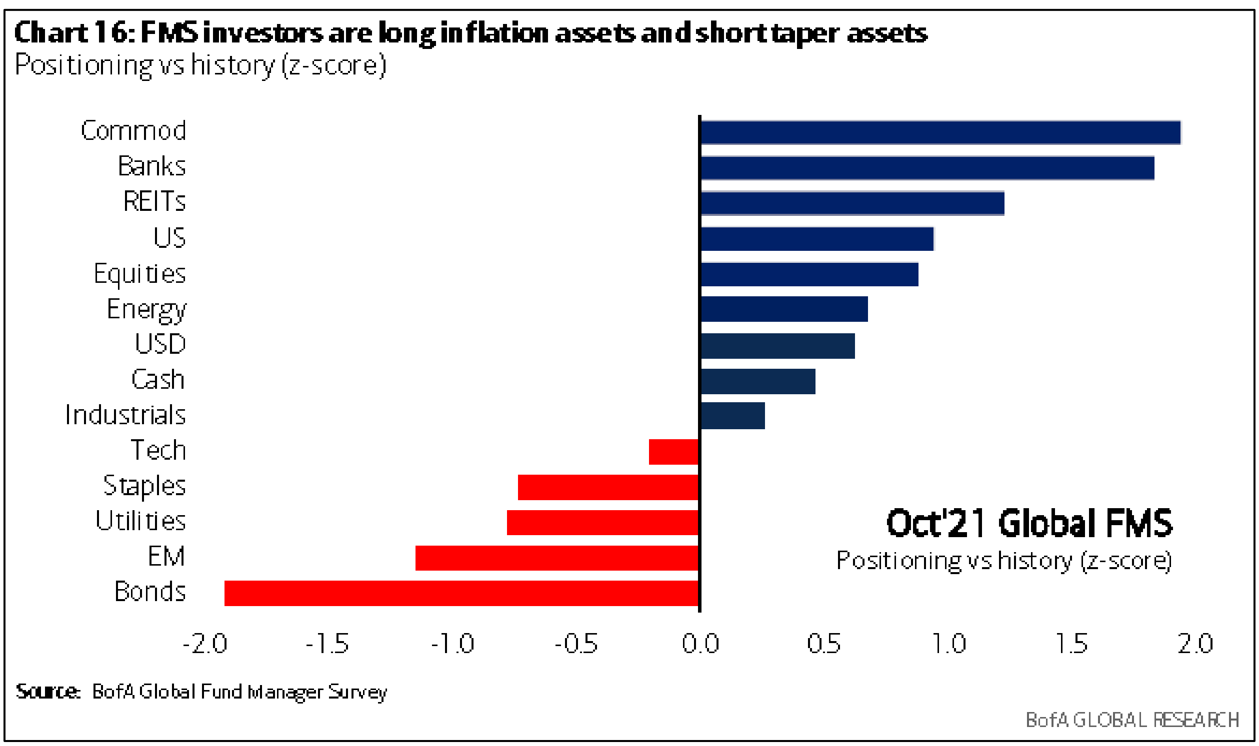
All the uncertainty about inflation and potential central bank policy error is starting to weigh on expectations.



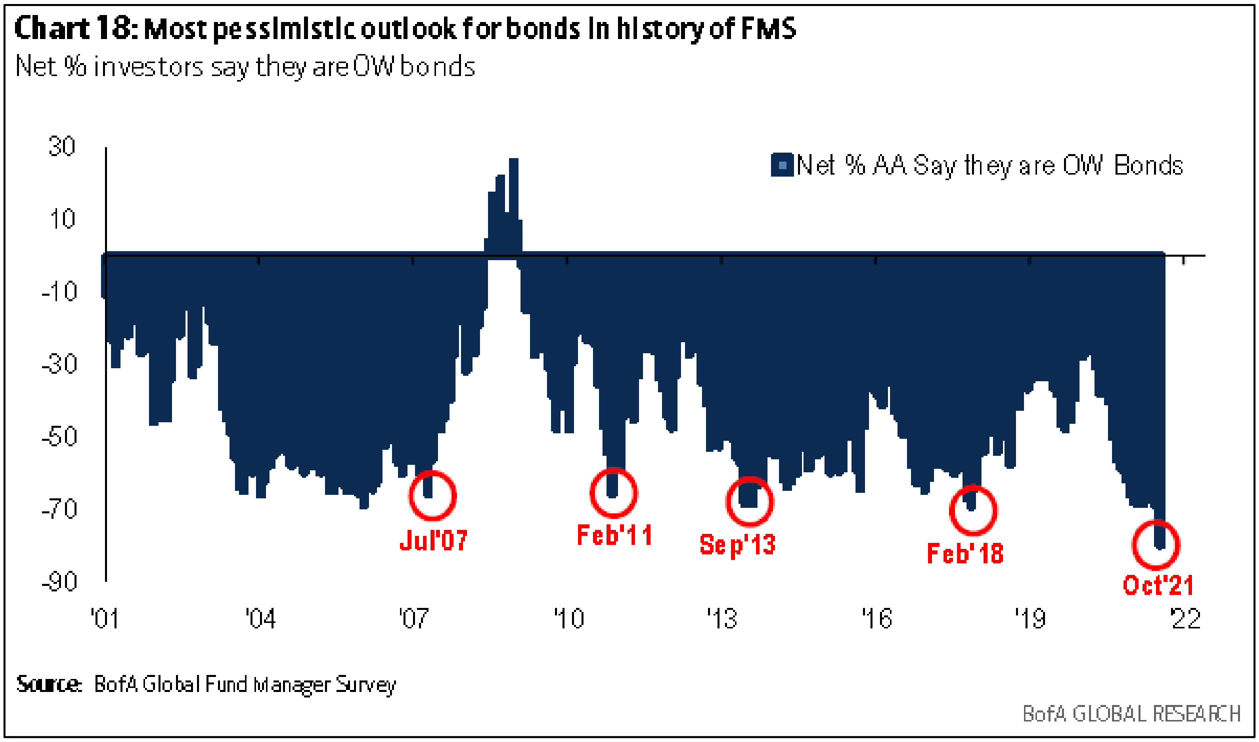
The latest Fund Managers Survey from BoA shows growing concern about the global economy.



The surging inflation story is hardly new, and investors are now positioned for it.



Positioning and sentiment for bonds are very negative already.



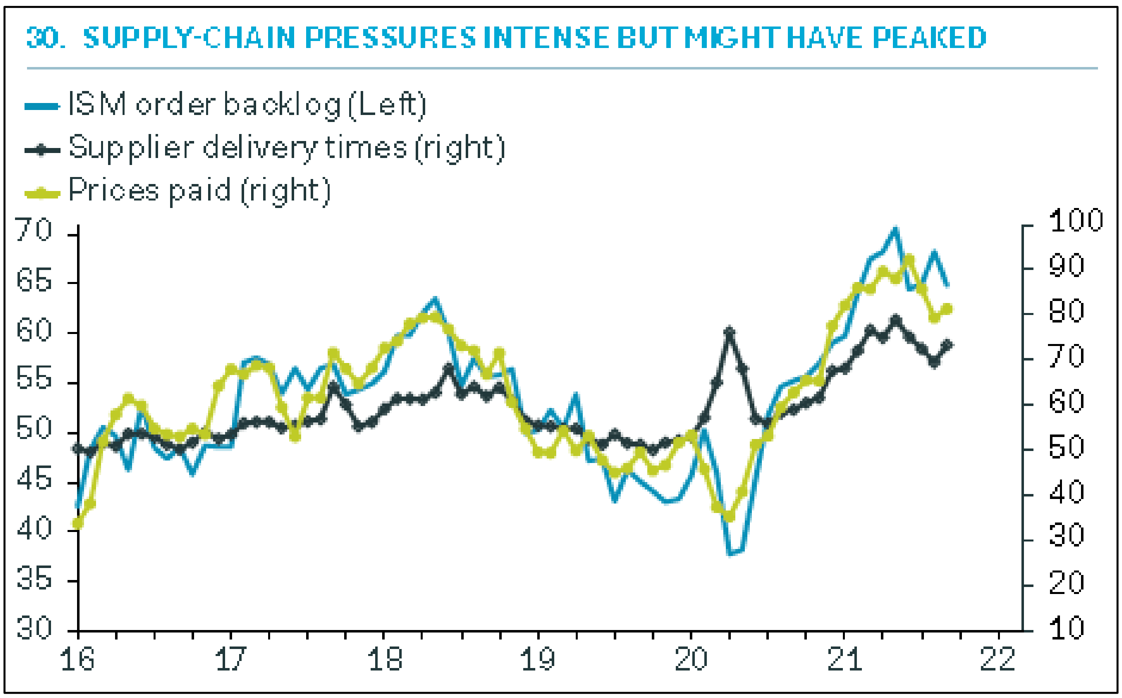
The recent jump in the front end hasn't helped bond bears much as the curve has flattened.

Stargazer Asset Management

Some of the growth concerns are coming from pockets of weakness in PMIs. However, it isn't clear if those again go back to supply disruptions or are demand driven. I think a lot of it is likely coming from the supply side. Automobile production is a prime example of manufacturing being held back by the inability to produce due to the lack of chips.

Ironically, if the supply-chain issues start to ease you could have a big jump in output and growth that would ease some inflation concerns but then put pressure on the Fed from the overheating growth side. We are not there yet as the supply-chain meltdown is still playing out, but something to keep in mind.

There are some initial signs that some of the supply-chain issues could be peaking.



Source: Pantheon Macro

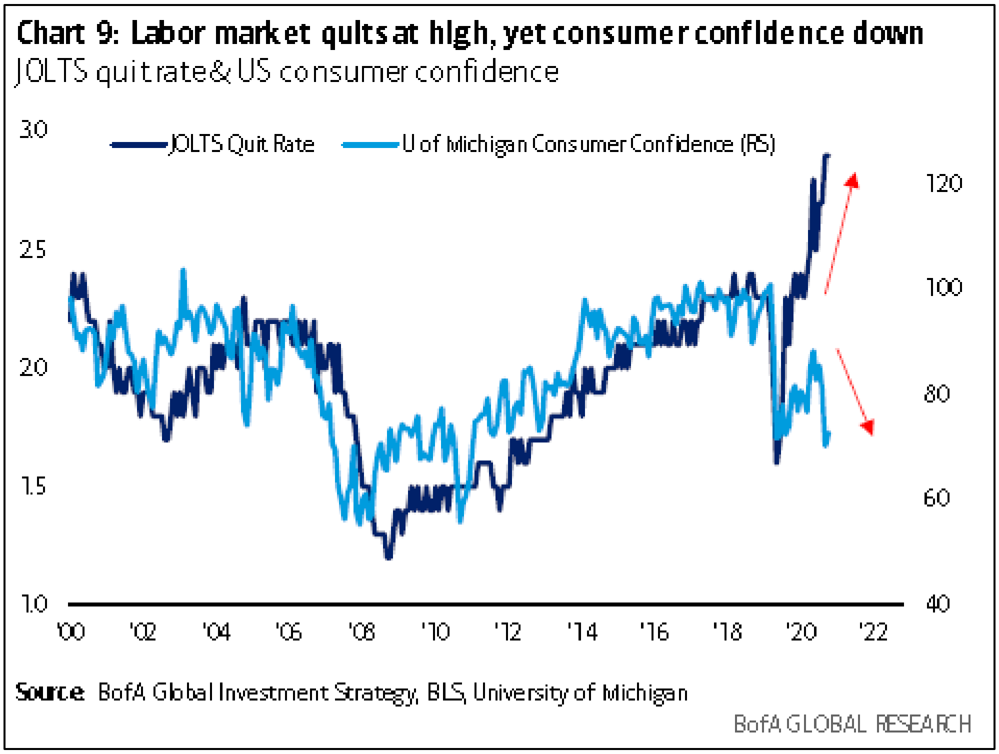
The other area to keep a close eye on is the bizarre situation in the labor market.

We have never seen anything like this before, and the causes of the current supply/demand mismatch are not fully understood. With schools back in session and supplemental unemployment payments having ended, do we now see the long-awaited surge in employment?

The next few patrol reports will be very interesting.

To further complicate the picture, the rate at which people are quitting jobs has skyrocketed.

That is usually the sign of a strong labor market. However, this time it is not going hand-in-hand with consumer confidence.



Inflation in the 1970's and now

DB did a piece last week that compares the inflation in the 1970s with the current situation.

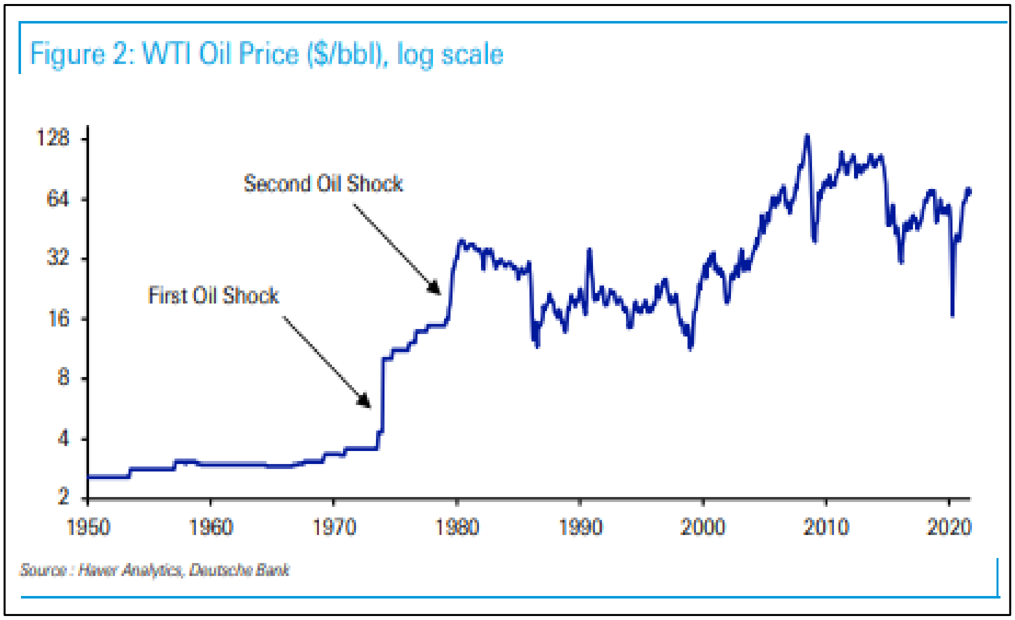
They had some interesting points:

- "The most important lesson is that even if inflation is down to transitory factors, the arrival of yet more "transitory" shocks can accumulate to keep inflation at high levels, with expectations becoming unanchored."
- This took the form of two oil shocks in the '70s.
- No reaction from central banks risks inflation expectations rising.
- Too strong a reaction to something they can't control (like supply-chain disruptions) risks real damage to the economy.
- Money supply growth has been much stronger now than in the '70s.
- Debt and globalization could make the current situation even more difficult.

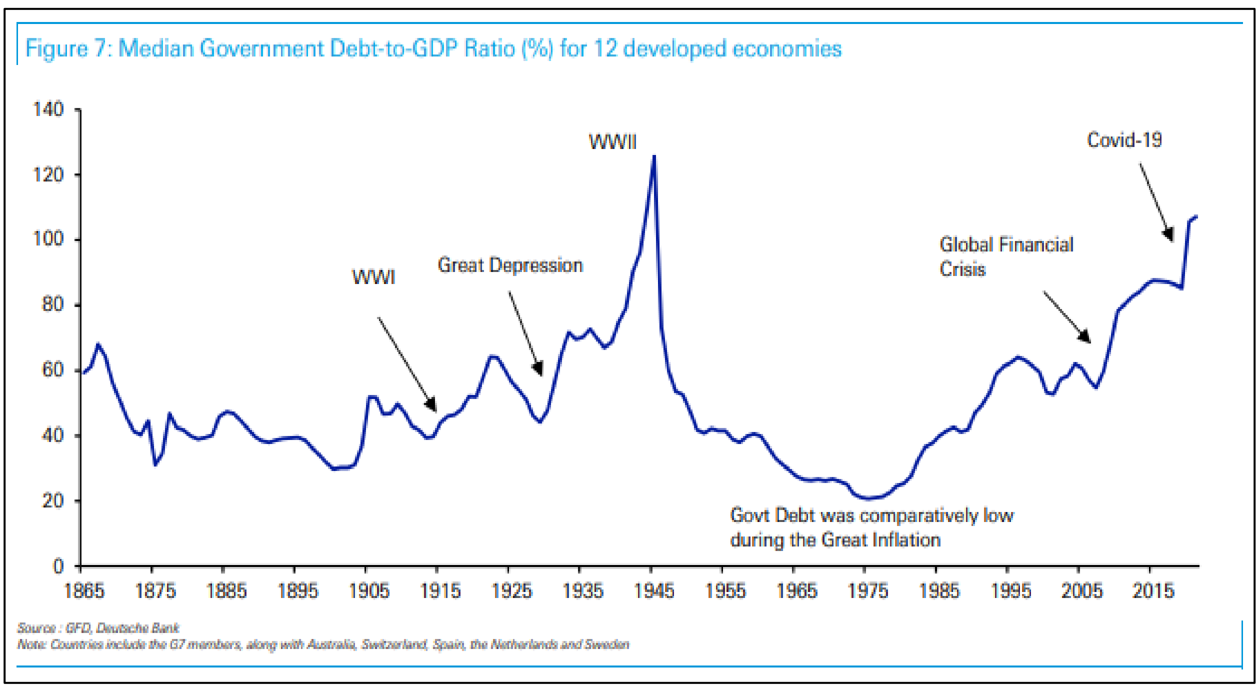
Central banks are facing conditions that almost guarantee that some of them will be making policy errors. In a highly leveraged would that is a dangerous situation.

I would add that a key difference now is that during the '70s we saw a very large and continuous USD depreciation, something we have not seen now.

Back-to-back Oil shocks in the 1970s



However, US debt-to-GDP was much lower. Harder to stomach rate hikes now?



Interventions as pain-points are hit…

China - China has been softening some of its policies connected to its economic overhaul as the energy crisis, COVID and property market concerns weigh on the economy.

Next month's leadership meeting may determine if Xi remains in power indefinitely or not. The energy crisis comes at a difficult time and it spurred Beijing to intervene in the coal market on Friday. The result has been a 30% drop in coal futures from Tuesday's record highs.

Australia - In another sign that some central banks are pushing back on the recent move in front-end rates, the RBA intervened in 2-year yields that had jumped over its 10bps ceiling (reaching 17 bps).

Brazil - With mounting legal pressure at home and falling popularity, President Bolsonaro has been trying to get around a constitutional spending cap to increase welfare payments. The result was that four top Brazilian Treasury officials resigned, putting the financial markets in turmoil.

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

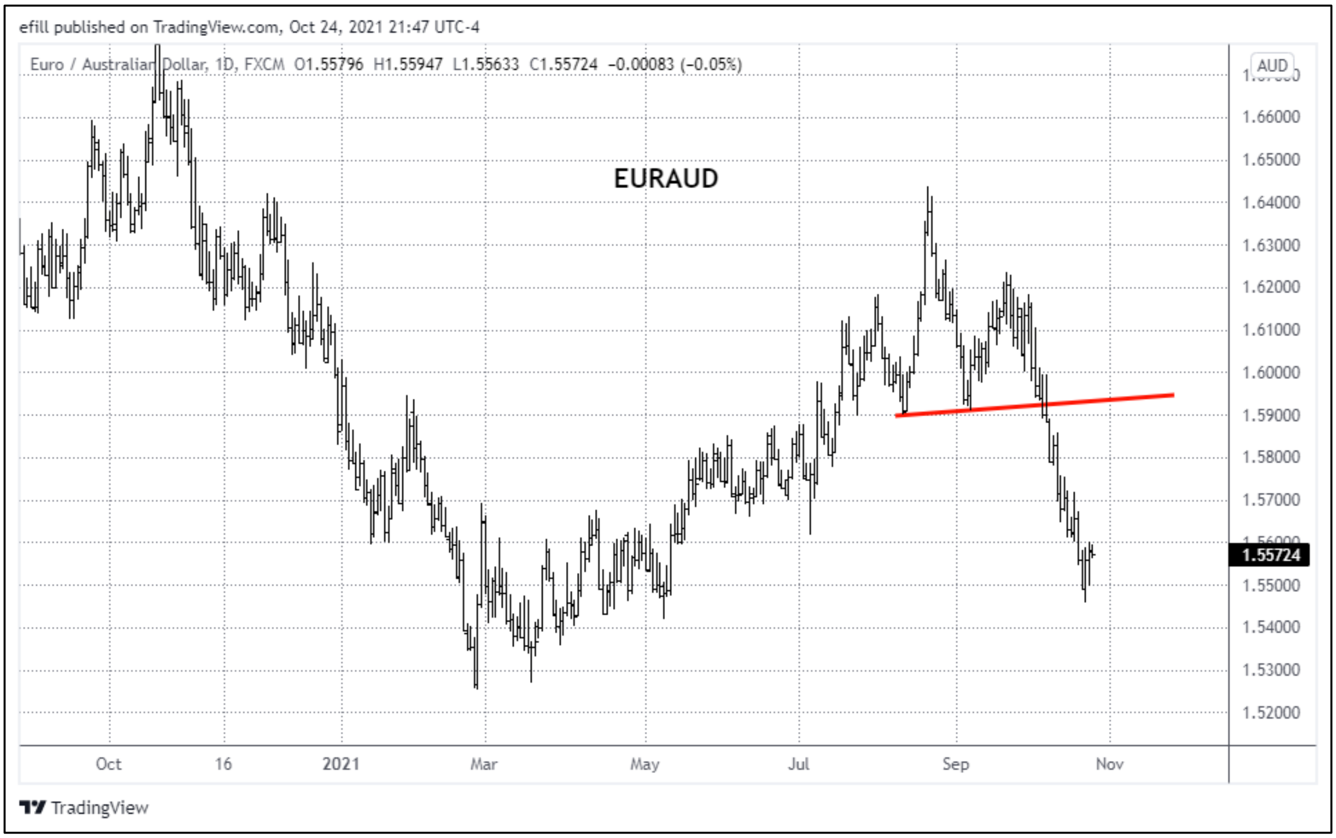
Equities have held up very well given the furious run higher in front end yields. Next week, I expect a lot more pushback from the various central banks as most will want to keep the "transitory" inflation argument intact. Interest rate markets are starting to express their doubts, however. Maybe it's just the ghosts of the bond market vigilantes getting into the Halloween spirit, but we will see. So far, the Q4 equity rally is on, and the S&P 500 is back at the highs.

With two hikes now priced for next year, the pressure on the Fed is mounting.

The yield curve is under pressure as font-end yields jump.

With the world becoming increasingly less synchronized FX is seeing a lot of dispersion as some currencies fall victim to political and economic failures (like BRL and TRY), while others are seeing windfalls (like NOK, CAD, and AUD) from the commodity runs. The EUR (and therefore the DXY) is stuck for the moment, while the real action is in the crosses.

EURAUD for example had a nice run lower after breaking support. It has now gotten very close to my target.



The JPY has seen a big selloff over the last few weeks as higher interest rates are priced in the US and higher energy costs hurt Japan.

USDJPY hit big resistance at 114.50 and now looks to be doing a bit of a retracement, but I don't think that move is over yet.

Some of the Yen crosses continue to look very interesting in the medium-term.

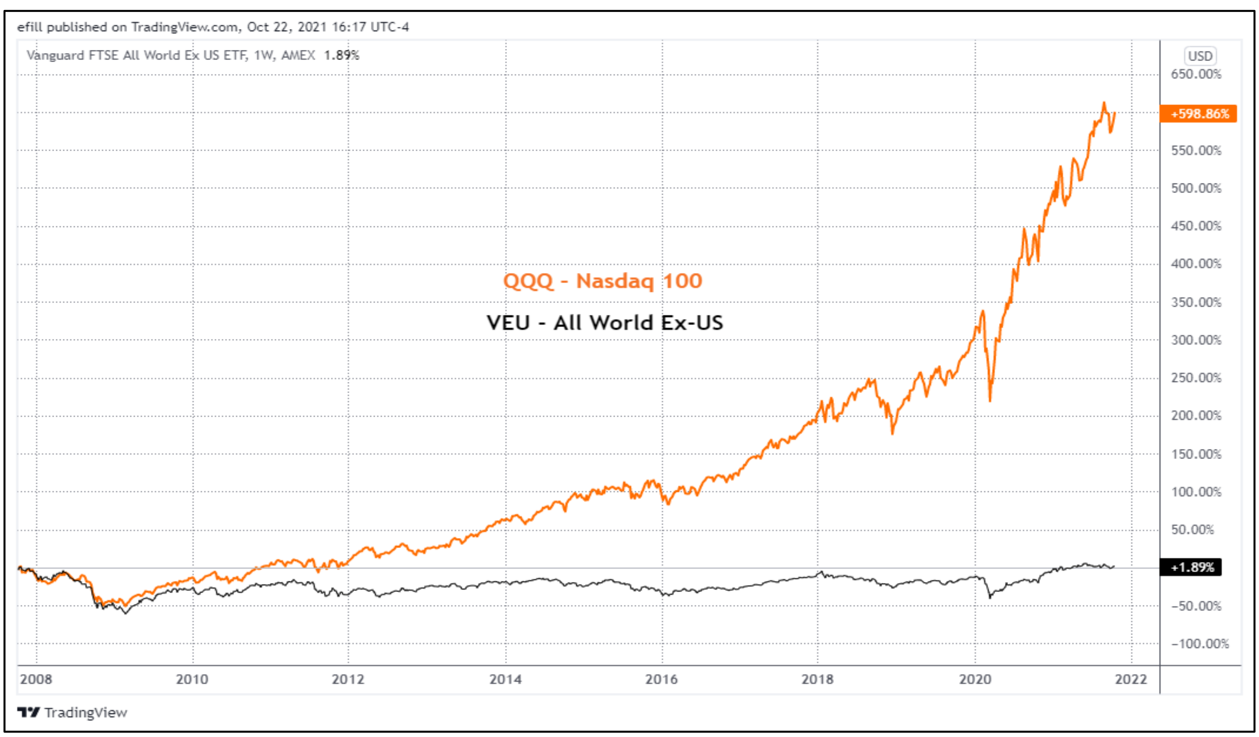
They have also seen quick and powerful moves over the last few weeks, but after a rest, look set to continue higher.

In particular, the GBPJPY chart looks interesting, with a huge longer-term target if the recent break can be sustained.

Precious metals have been trying the topside again. I continue to watch XAUEUR, which is trying the topside again but has not yet broken convincingly.

Silver has had a nice pop off the lows so far and is now sitting below the last recent high. A move above $25 is worth watching for.

Closing Chart – Since July 2007, VEU ETF (the world ex-US) is + 1.89% in price while the NASDAQ is up just shy of 600%. When people talk about stocks for the long term, it does matter which ones.



Next week brings a lot more earnings reports with 165 of the S&P500 reporting. The lineup includes Microsoft, Alphabet, Facebook, Apple and Amazon. We also have monetary policy decisions from a number of important central banks.

Important Macro Data Releases and Events for the Week

Monday 10/25/2021
- IFO - Business Climate, Current Assessment, and Expectations (Oct)

Tuesday 10/26/2021
- ECB Bank Lending Survey
- Housing Price Index MoM (Aug)
- S&P/Case-Shiller Home Price Indices YoY (Aug)
- New Home Sales MoM (Aug)
- Consumer Confidence (Oct)

Wednesday 10/27/2021
- Gfk Consumer Confidence Survey (Nov)
- Durable Goods Orders, ex-Defense, ex-Transportation, Capital Goods (Sep)
- BoC Interest Rate Decision, Policy Statement, and Press Conference

Thursday 10/28/2021
- BoJ Interest Rate Decision, Policy Statement, and Press Conference
- Consumer Confidence and Business Climate (Oct)
- ECB Interest Rate Decision, Policy Statement, and Press Conference
- Harmonized Index of Consumer Prices YoY (Oct)
- Initial Jobless Claims Forecast: -, Prior: 290k
- Initial Jobless Claims 4-week average Forecast: -, Prior: 319.75k

- Continuing Jobless Claims, Prior: 2.481M
- PCE and Core PCE (Q3)
- GDP Annualized (Q3) Forecast: 2.5%, Prior: 6.7%

Friday
10/29/2021

- GDP (Q3) across Europe
- PCE and Core PCE (Sep)
- Personal Income and Personal Spending (Sep)
- Chicago Purchasing Managers' Index (Oct)
- Michigan Consumer Sentiment Index (Oct)