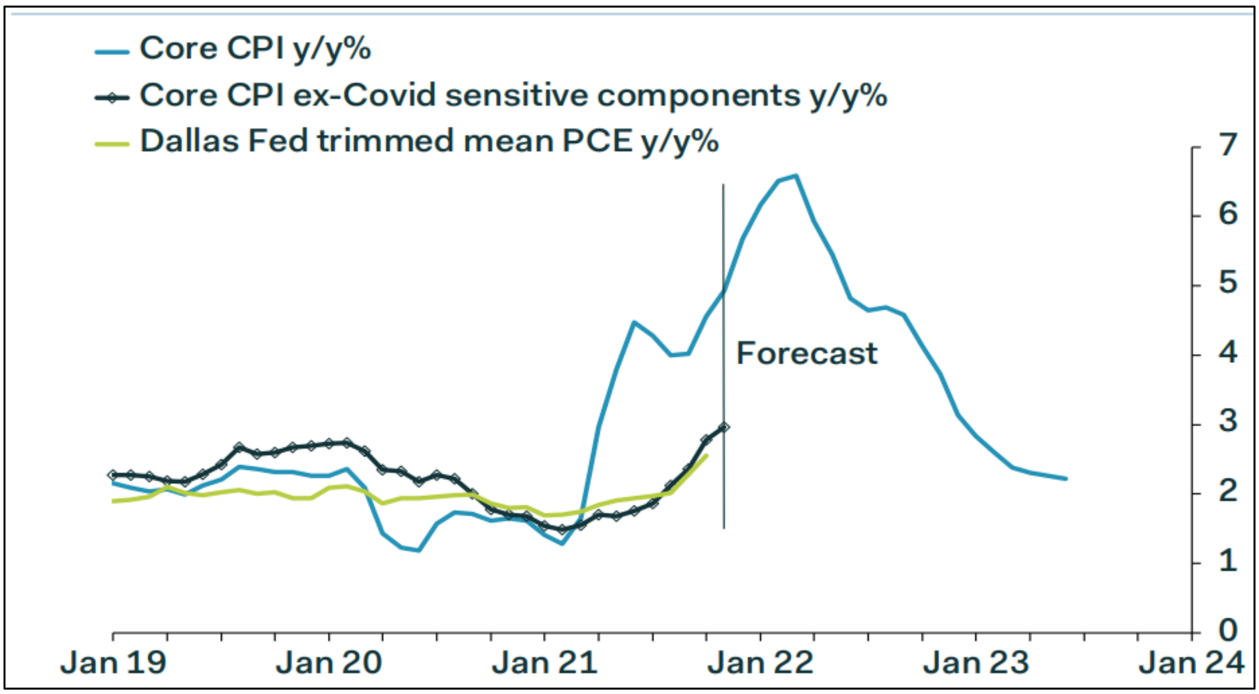
What to focus on in Global Macro for the week of December 27th, 2021

Macro Themes on the Radar:

As the end of the year quickly approaches, we are left with a growing list of unanswered questions about how the coming year will unfold. Inflation, COVID, CB policy, and China are top of mind.

We likely have a few more impressive Core CPI prints ahead. When the current wave peaks in the coming months is probably not as important as how much it actually recedes once the near-term peak is in. However, that will take many months to reveal itself and even optimistic projections see inflation rates well above the Fed's target for a protracted period.



Source: Pantheon Macro

That means the Fed will remain under pressure to continue removing stimulus.

Omicron is upon us, but so far at least, it seems to blast through the population relatively quickly. With vaccines, improved treatment options and a potentially less deadly variant, it could be behind us relatively quickly without doing nearly as much damage as previous waves.

If the current trend of widespread sickness with greatly reduced consequences holds, it is worth contemplating if this is the last wave that matters.

Judging by the UK experience (and they are a few weeks ahead of the US) an ugly outcome commensurate with the huge jump in the number of new cases from omicron has so far been averted.

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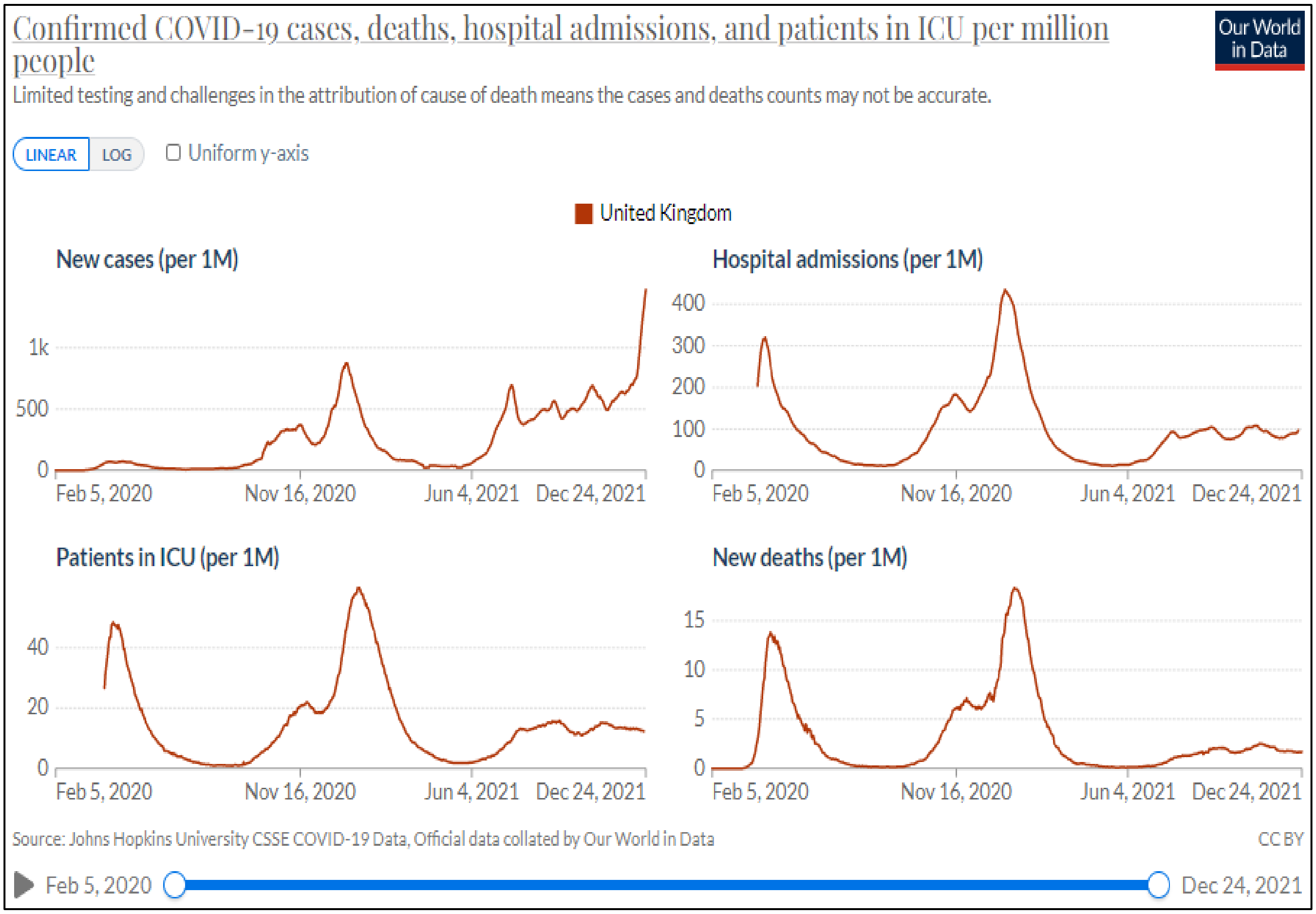

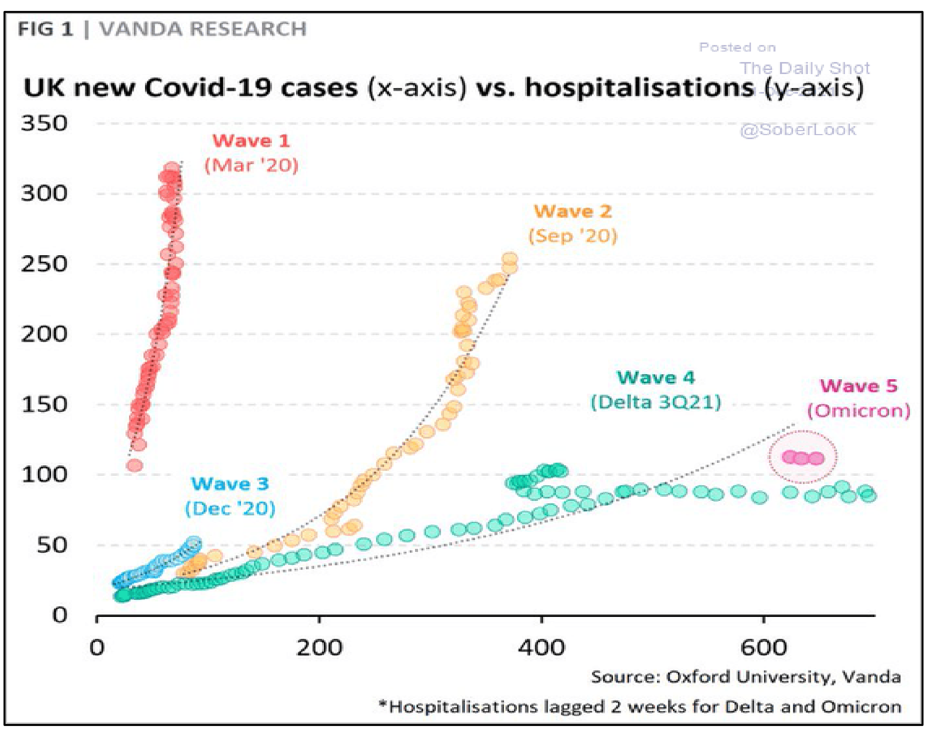

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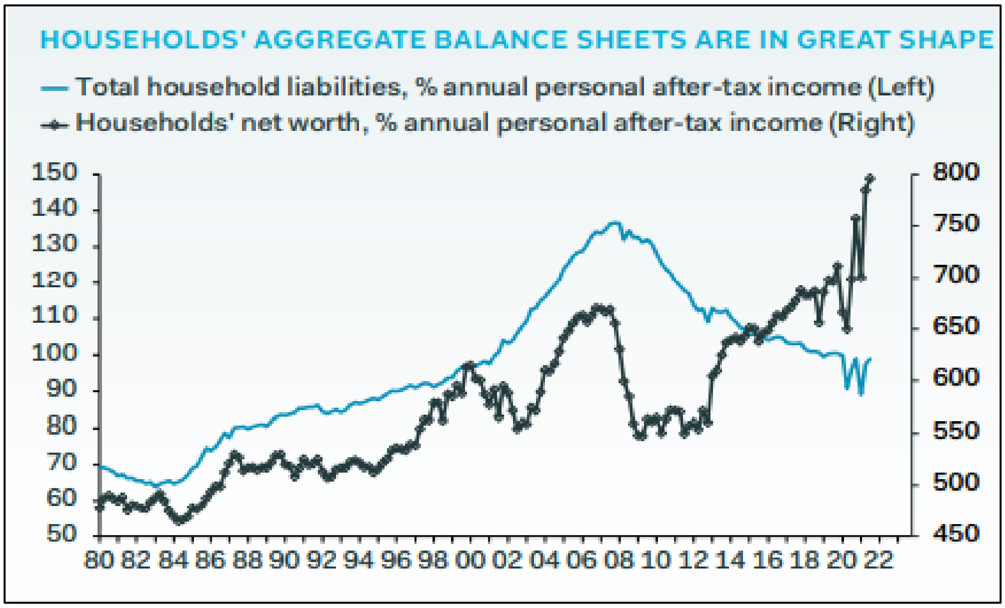
If, and it is still a big if, omicron is largely behind us by early February, or is increasingly seen as a bad cold in terms of outcome, do we then finally break the employment logjam? Do consumers start to seriously spend the $2.5 Trl in excess savings they have amassed during the pandemic?

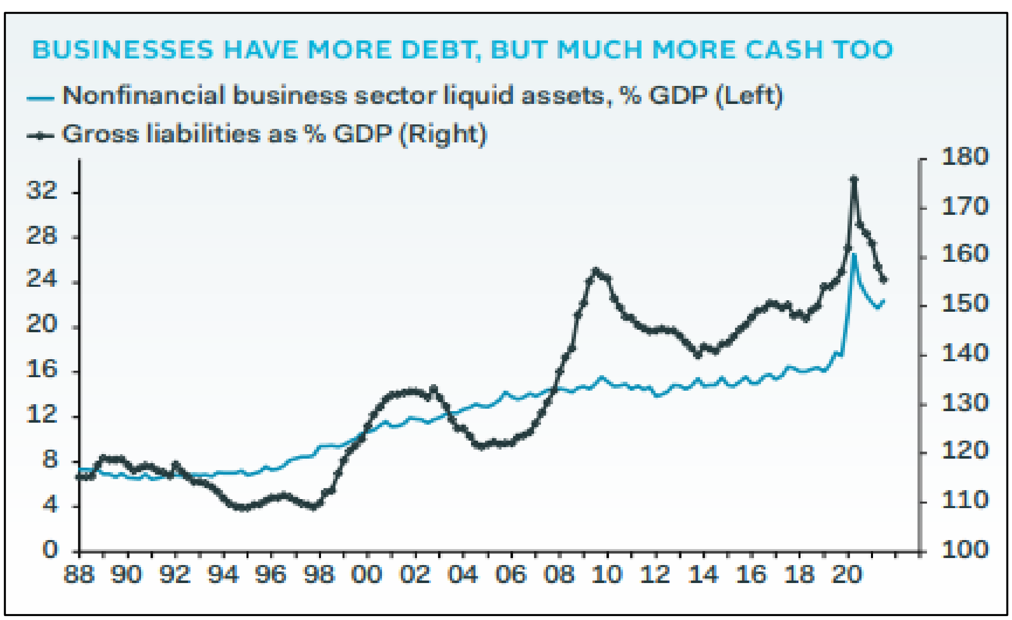
What does that mean for interest rates and equities? Do we get an economic boom and melt-up in equities, followed by a potentially difficult adjustment period as rates jump?

So far, the markets are betting that rates can't rise all that much before the private sector starts to struggle. However, overall, the private sector in the US is currently not in terrible shape.



As Pantheon Macro points out, household balance sheets have improved…

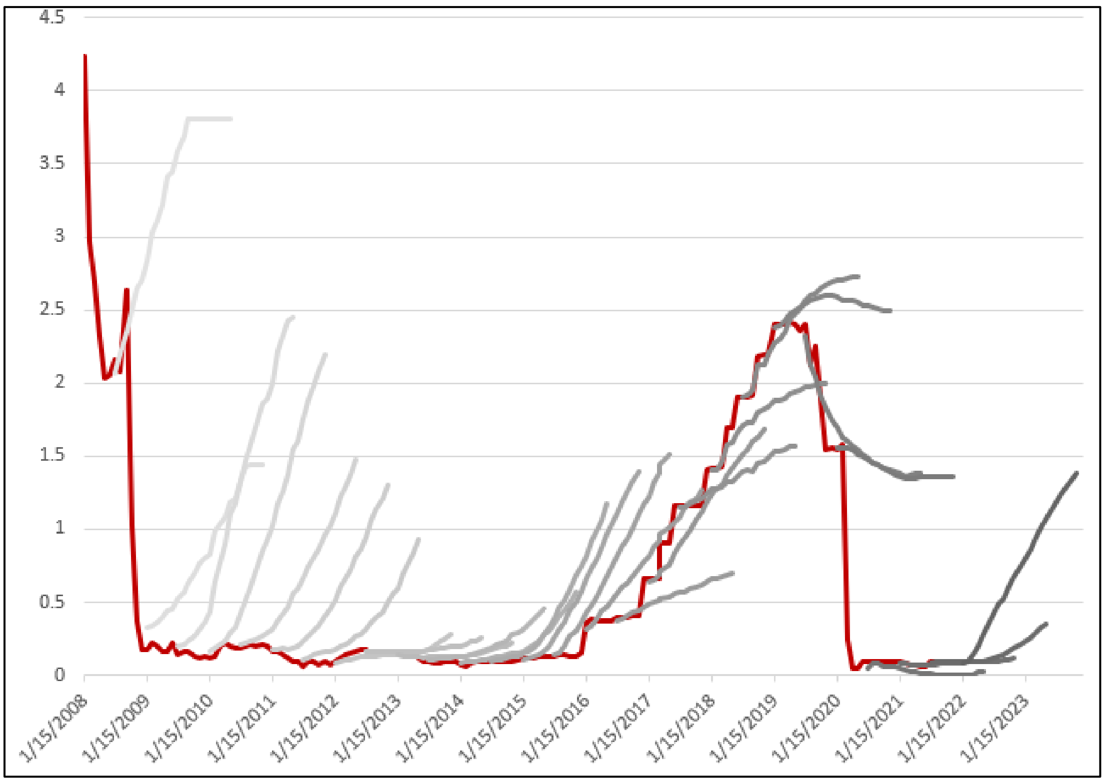
While corporations have taken on more debt, they also have accumulated more cash.



The starting point matters in terms of how high rates can get before the economy starts to feel the pinch. The market is currently undershooting the Fed's median dot for the end of 2023 by two hikes and sees the longer-term terminal rate about 100bps below the Fed's 2.5%. Rate views for both the market and the Fed have been evolving quickly. After all, it wasn't that many months ago that the market and the Fed thought there would be no hikes until the end of 2023, now there are already three hikes priced for 2022.

Historically, neither the Fed nor the market has been very good at forecasting future interest rates.

This chart shows the actual Fed Funds rate in red, and what the Fed Funds futures curve priced at different times.

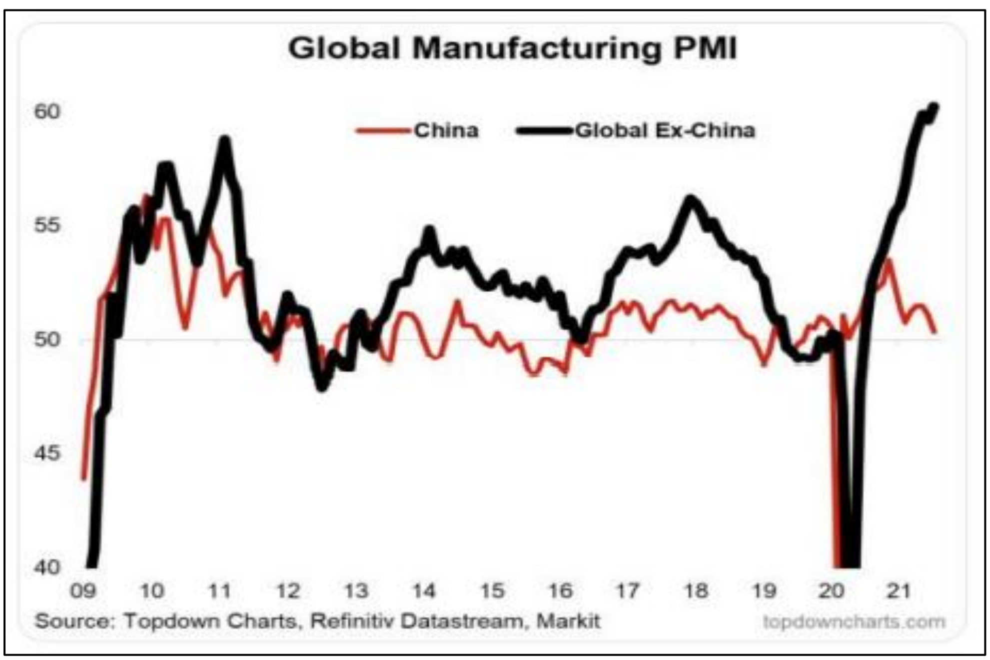


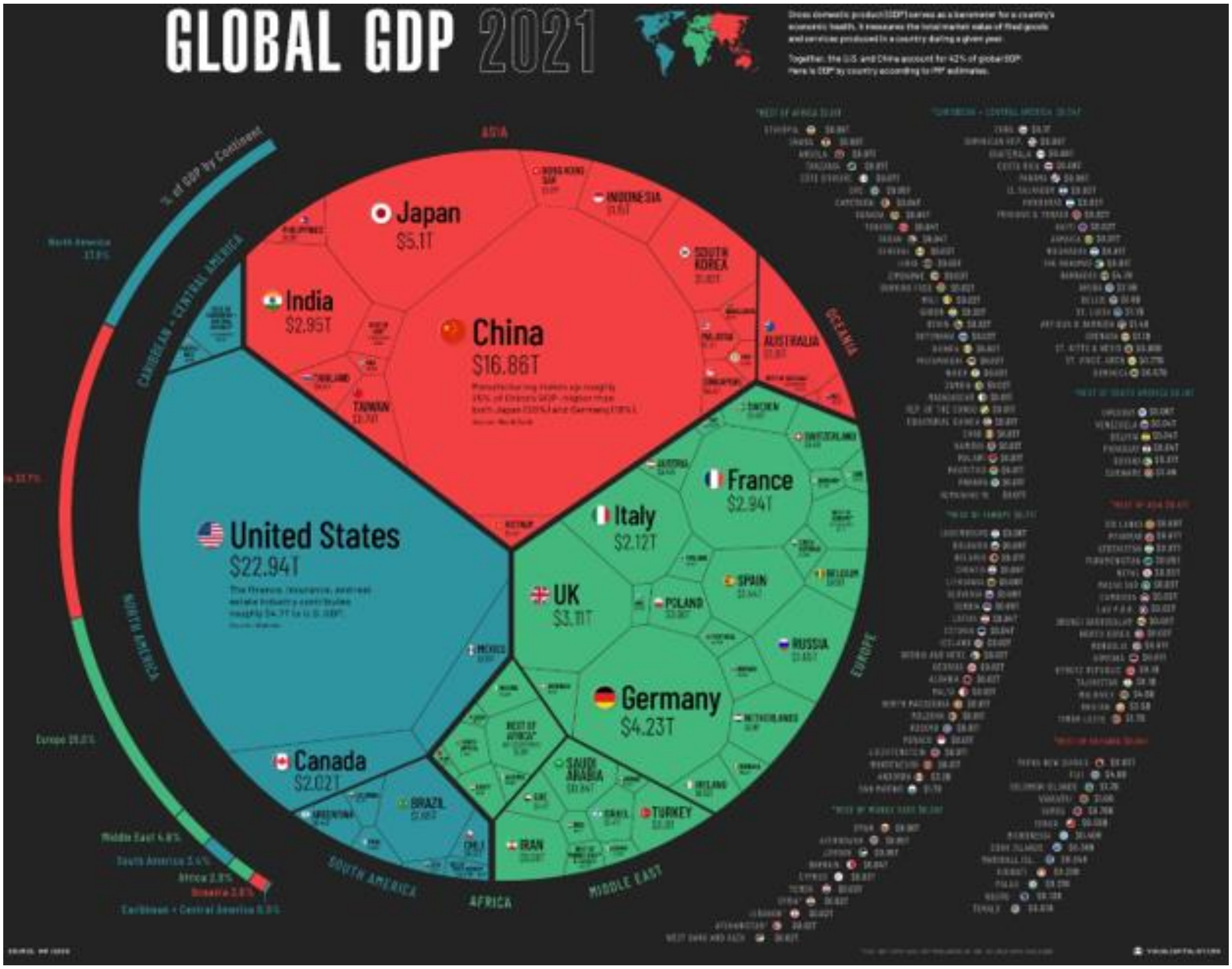
Of course, it is not only the Fed that is struggling with how to match monetary policy and very low absolute interest rates, with the large jump in inflation we have seen. A number of EM central banks have already been hiking, and even ultra-dovish central banks like the ECB and the BoJ are trying to find ways of at least slowing the rate of stimulus addition.

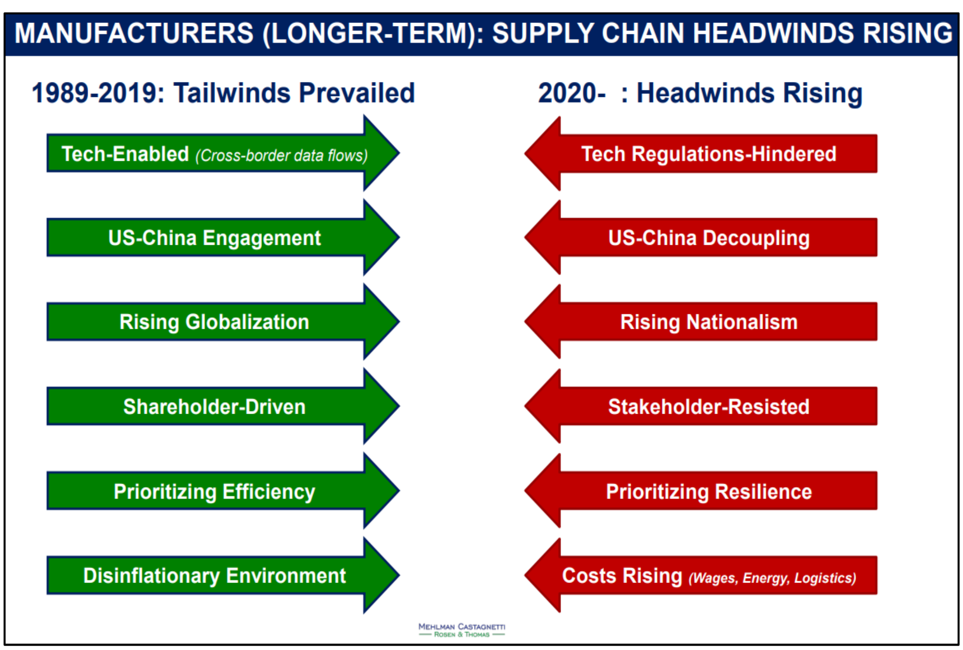
The ECB, in particular, may find itself between a rock and a hard place as it sees a jump in inflation but has to contend with a private and public sector that has become very used to low interest rates and the monetization of government debt.

This is an interesting chart that compares developed markets' monetary conditions with the performance of the S&P vs. Treasuries.

China continues to grow as a potential global growth driver. It remains to be seen how the internal policies develop and if external relationships continue to deteriorate or can at least be partially mended. Can the growing divergence in Chinese growth and markets vs. the rest of the world continue without consequences for the global economy, or will China now actively engage to support domestic growth with monetary policy and infrastructure spending?







One of the many lasting consequences of COVID is likely to be a changed relationship with China. Not only has XI taken China in a new direction, but Western countries are increasingly willing to trade some efficiency and cost savings for more resilience and national independence. The resulting challenge to globalization is itself inflationary.

What to Focus on Now:

The flows into the US have been extraordinary, but there is plenty of dispersion.

Add Europe, Japan, EM, and China and the 40% performance spread of NDX to HSI really pops.

I continue to wonder how long the growing divergence between the US and EM (with its heavy China weighting) can persist. Will they meet again, and in which direction?

In the meanwhile, long-end Treasuries continue to confound bulls and bears.

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US 10-years yields held support, again…

Partially, thanks to continued firm front-end yields with no let-up in Fed hike expectations.

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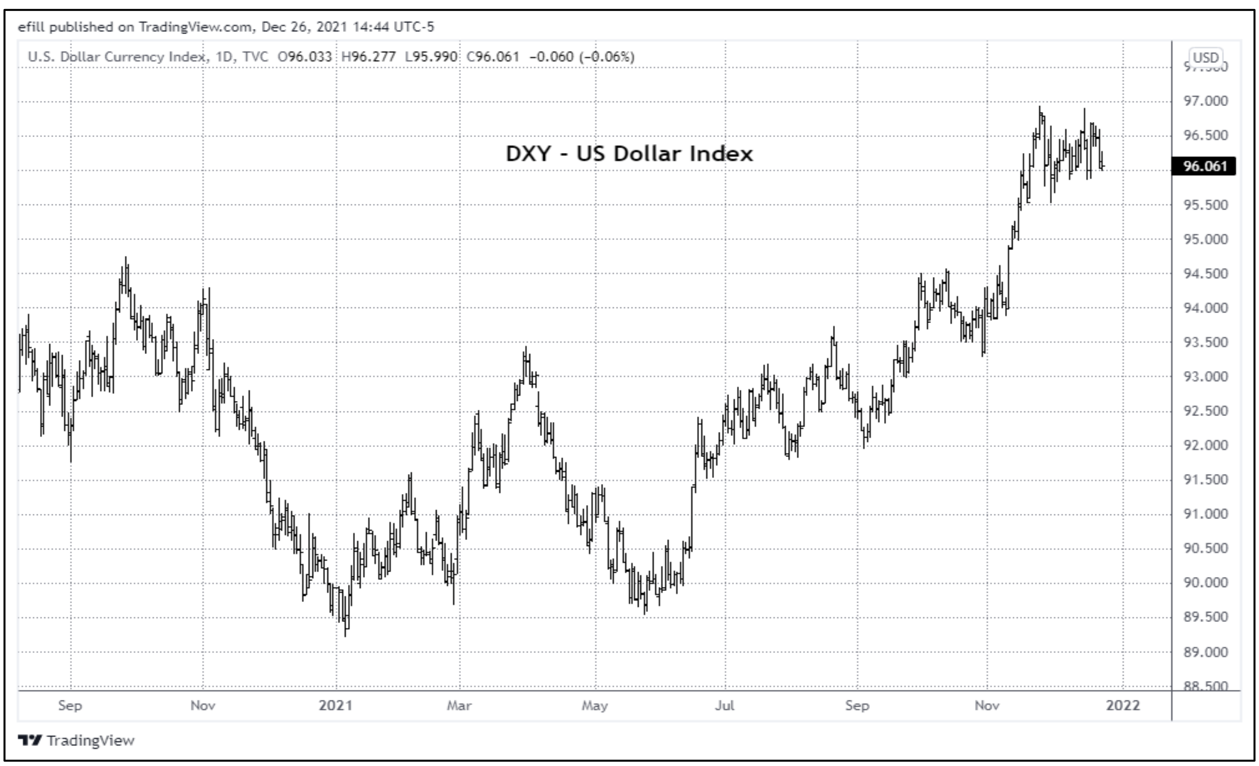
So far, we have seen no acceleration or reversal over the last few weeks in the curve flattening.

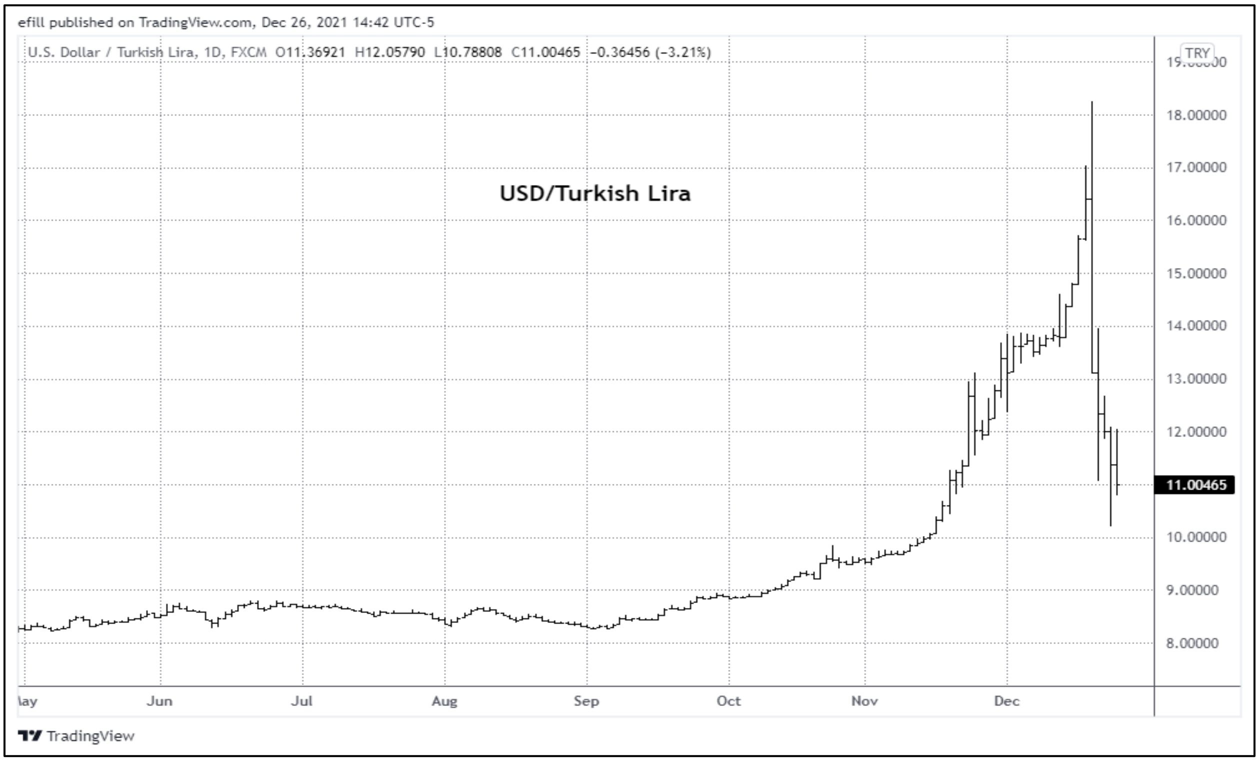
While there has been a lot of dispersion between FX pairs, the EUR-heavy DXY has stalled too.

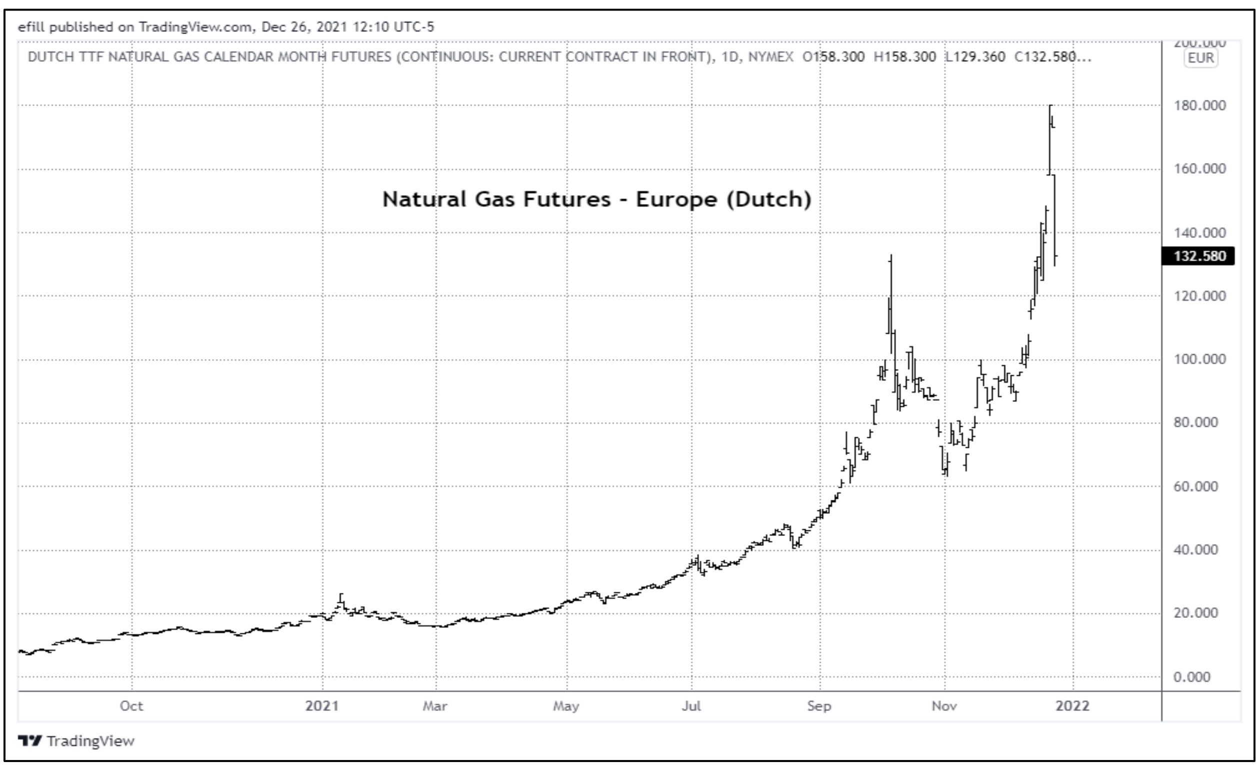


With Oil and Copper bouncing, Commodity indices have come off recent lows.

Gold and Silver are off recent lows but have not yet impressed.

That is not to say there hasn't been some very impressive volatility in things like Turkish Lira and European Natural Gas… I wouldn't be surprised if some bodies float to the surface after those moves.





And finally, some powerful seasonals you may be caught up in over the next week.

With the holidays and the new year looming, we are very light on the data front, although there could be plenty of price action in thin markets.

Important Macro Data Releases and Events for the Week

Monday 12/27/2021	None
Tuesday 12/28/2021	Housing Prices (Oct)
Wednesday 12/29/2021	Pending Home Sales (Nov)

Thursday 12/30/2021		Initial Jobless Claims
		Initial Jobless Claims 4-week average
		Continuing Jobless Claims
		NBS Manufacturing PMI (Dec)
		Non-Manufacturing PMI (Dec)
Friday 12/31/2021		None