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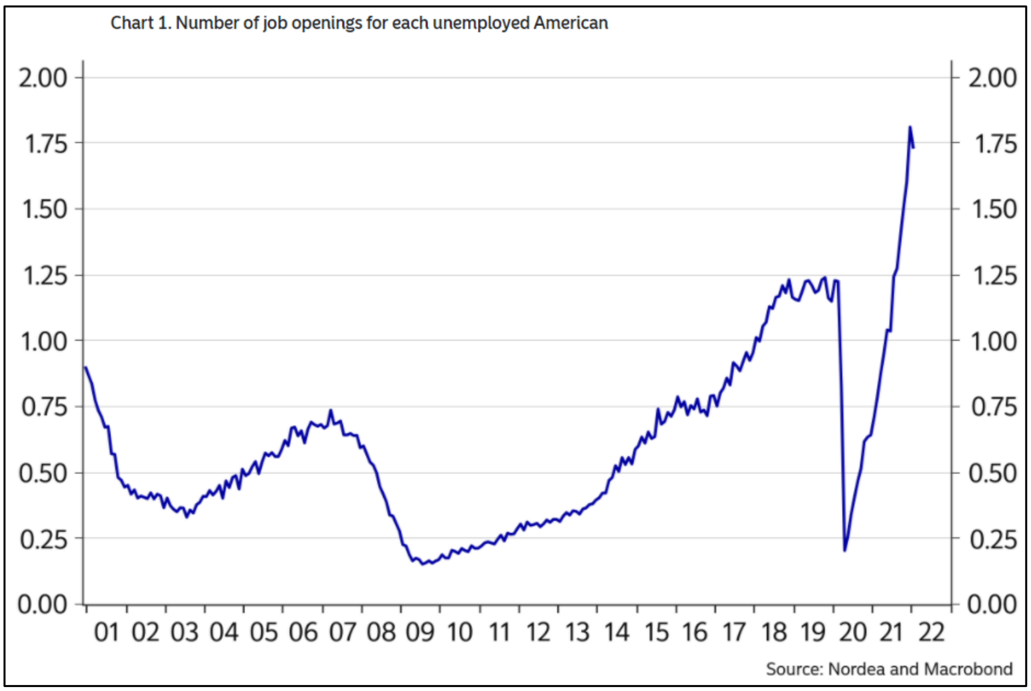
What to focus on in Global Macro for the week of March 21st, 2022

Fed

The Fed is now officially in panic mode. Every meeting this year is live and there is an increased chance that they do 50 bps at one or more meetings along the way (according to the dots and what Powell said). During the press conference, he said, "the time has come to raise rates and reduce the balance sheet." It was hard to count all the times he referred to the economy as "very strong" at one point suggesting that the strength in the labor market had in fact reached a level where it was "unhealthy" for the economy. He specifically referred to the ratio of job openings to unemployed which now stands at 1.7:1, saying a healthier number might be 1:1.



They are raising rates to slow growth and demand, that is the only way that rate hikes effectively slow inflation. In the dual mandate, the focus is now very much on the inflation component. It would be nice if labor remained relatively strong, but that is not the primary focus. He made that very clear saying, "We think we can return to price stability while maintaining a strong labor market, but we have to return to price stability."

They definitely see QT playing its part in the policy tightening process. Powell suggested they made a great deal of progress in drawing up QT plans at this meeting. We will see a faster reduction in the balance sheet than last time, and start earlier in the hiking cycle. I wouldn't be surprised if it is announced at the next meeting in May.

Last time around, repo rates started to get stressed and equities swooned after about a 10% reduction in the balance sheet. Back in 2018 that was about 400 bln, now, given the huge jump in the balance sheet during COVID, a 10% reduction would be closer to 900 bln.

There are a number of big differences between this cycle and other Fed hiking cycles over the last 30years. The magnitude of the inflation we are seeing is obviously one huge difference, as is its composition and cause. Another difference, and this one stems from the combination of having still been at “emergency” zero rates with exploding inflation, is how quickly the entire rate hike cycle has been priced.

As of Friday’s close, we now have Fed Funds at 2.50% at the end of next year already priced by the market. My point is not to debate whether that is the right number or not, but rather to point out that for markets, that rate rise has now already occurred and will start feeding into the economy in the next few months via floating rate loans, etc.

Fixed-rate mortgages have also already seen a meaningful lift.

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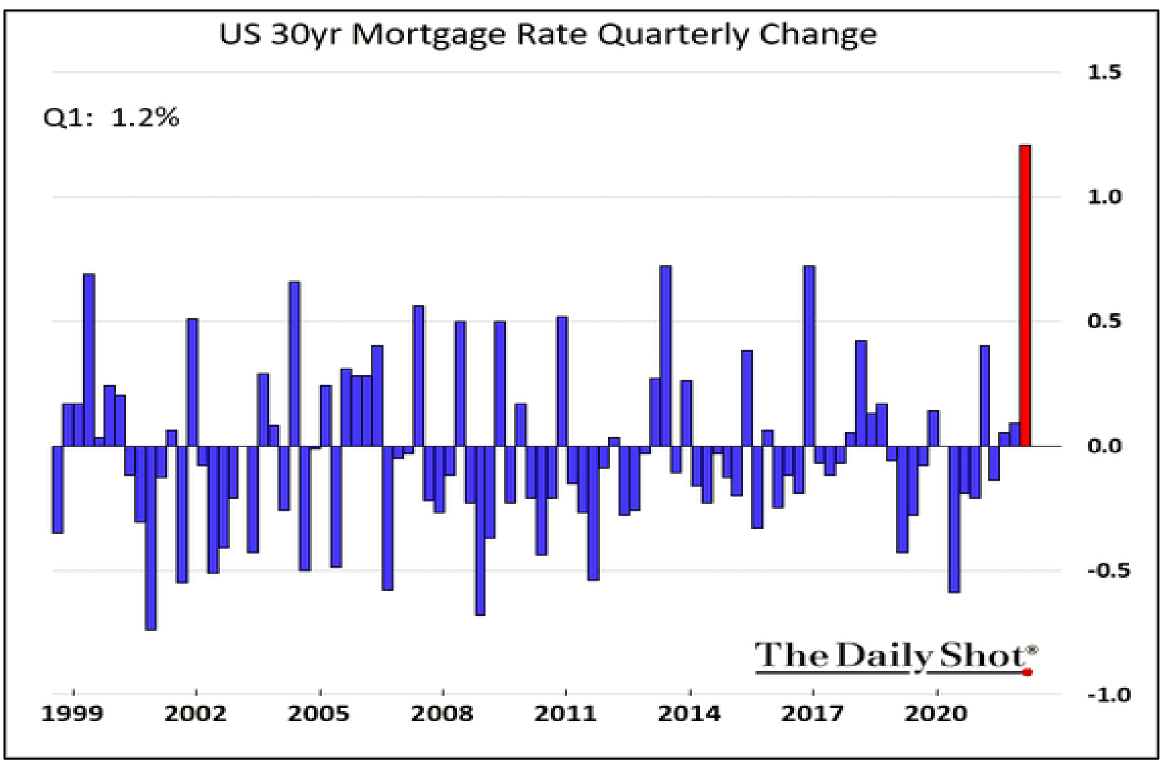
And it has happened quickly.



Powell talked about how financial conditions have been tightening and that it was "appropriate"! given their desire to slow demand.

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Chart 1. Financial conditions already suggest that Manufacturing PMIs will drop below 50 soon

Source: Andreas Steno and Macrobond

The jump in inflation has meant that real wage growth and real retail sales are negative.

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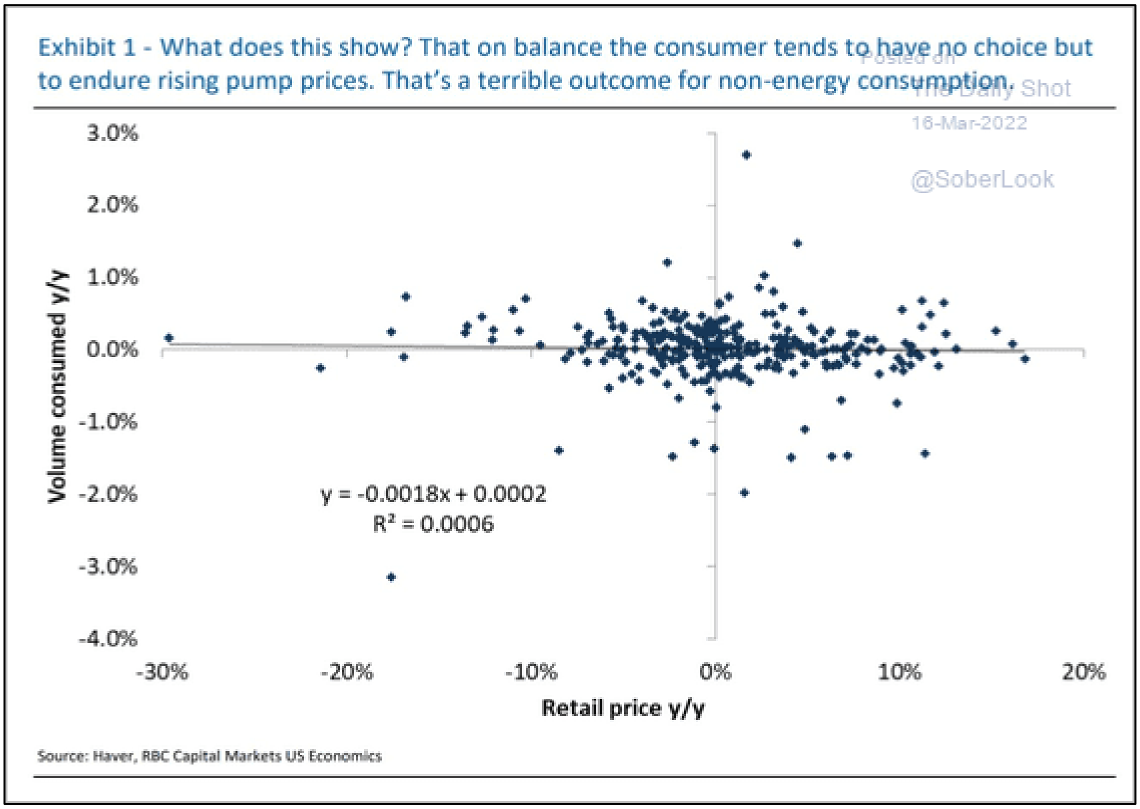
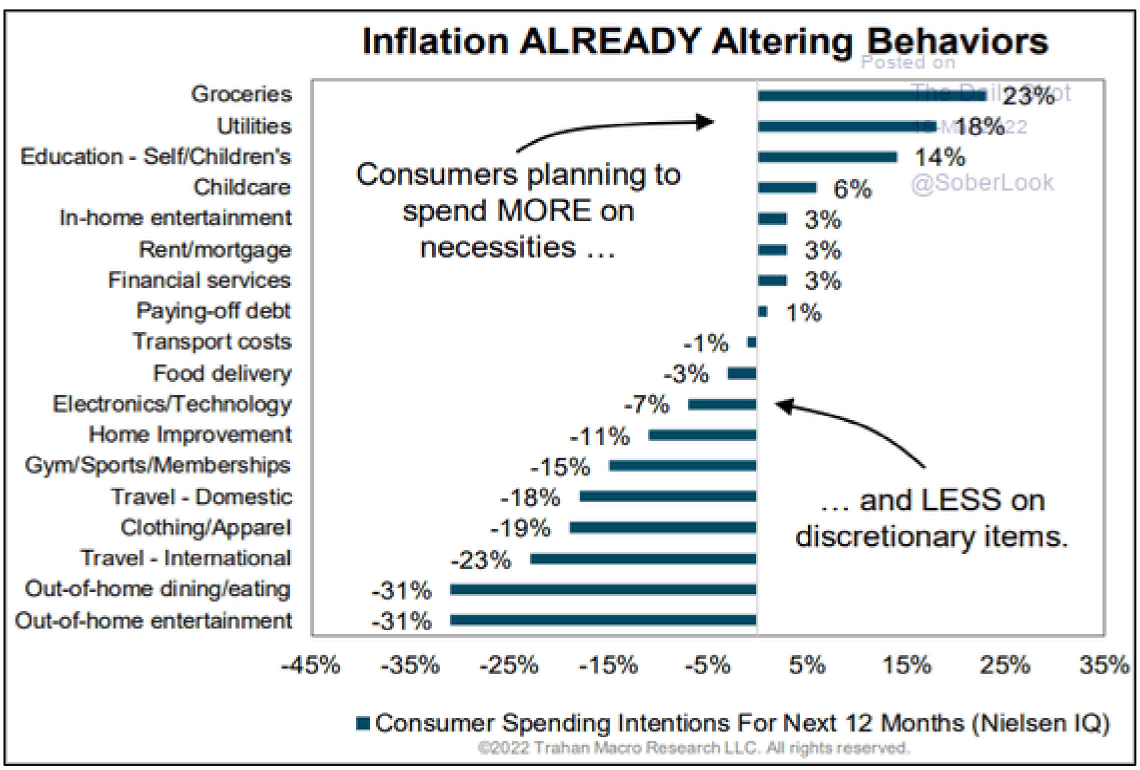
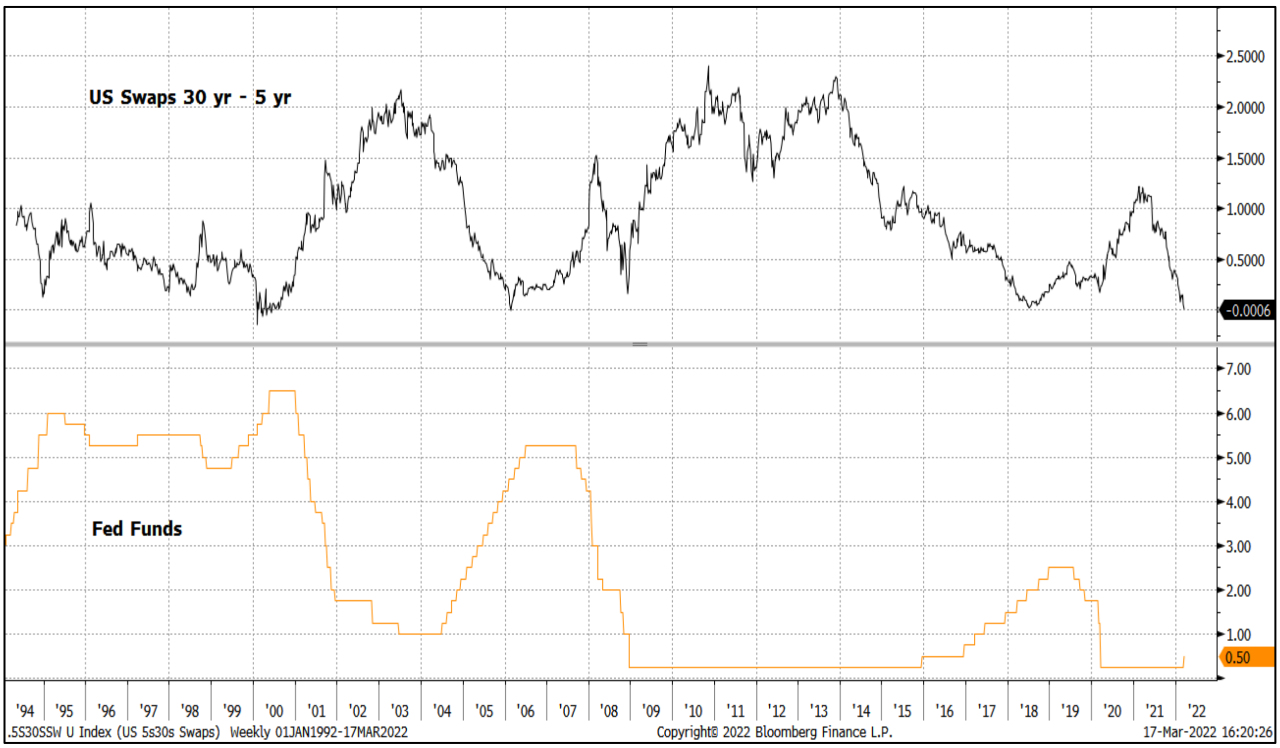
With gasoline demand relatively inelastic, discretionary spending preferences have already started to shift.





At some point soon (maybe already) even a very hawkish Fed will be fully priced. Hikes will then just become a validation process for higher interest rates that are already having an effect on the economy.

The curve, already shockingly flat given where we are in the hiking cycle, has been driven there much earlier than "usual", by the market's quick and comprehensive pricing of the cycle.



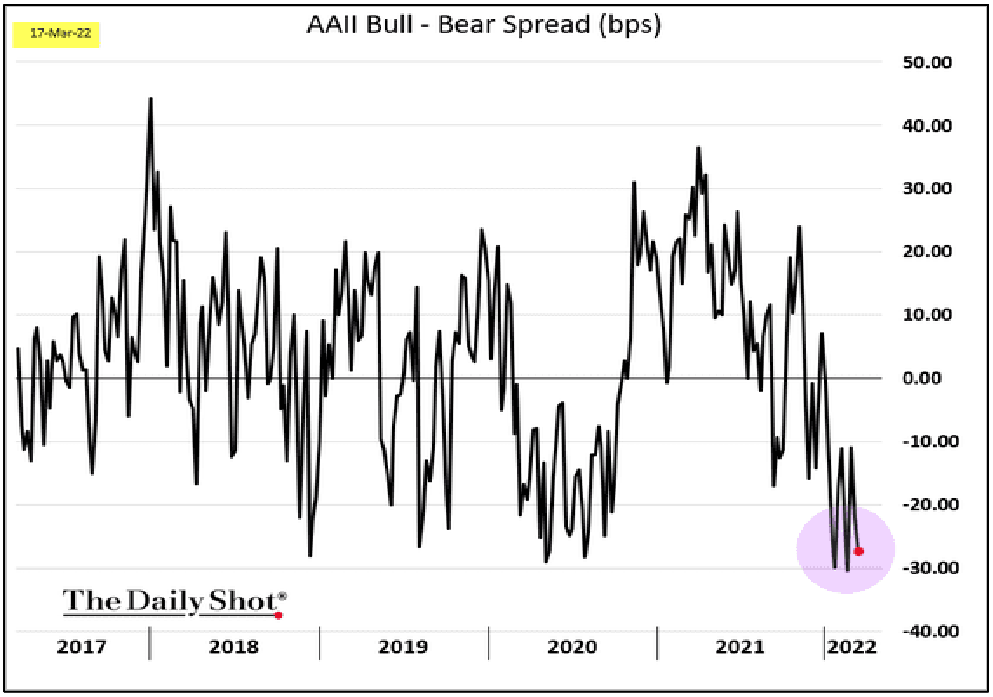
If further flattening now comes from the long-end yields falling it would be a sign that demand, and the economy, are starting to slow.

Equities

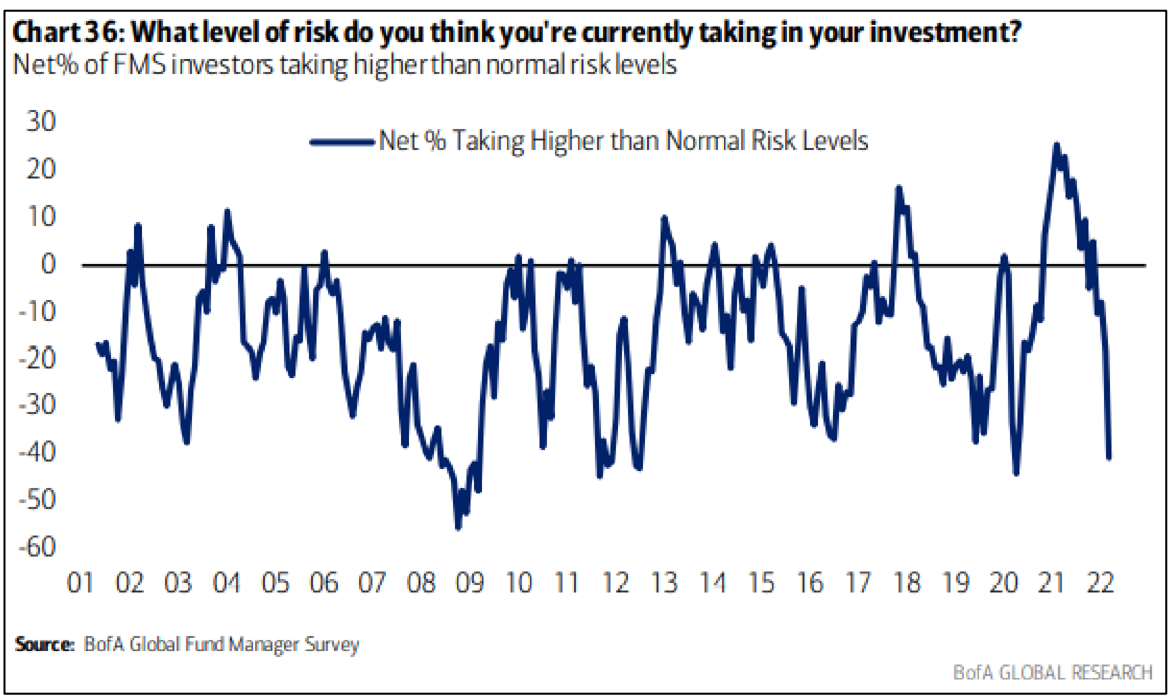
US data last week was good enough to withstand the heightened hawkishness from the Fed. Hopes that a peace deal of some sort would make the oil shock temporary, were reinforced by a $30 drop in oil off the highs. The idea that Fed hikes, at least for the first half of the cycle, are good for stocks, is well entrenched in the market and potentially also at play.

Sentiment and positioning had gotten rather bearish over the last few weeks, so maybe last week's rally was the inevitable squeeze.

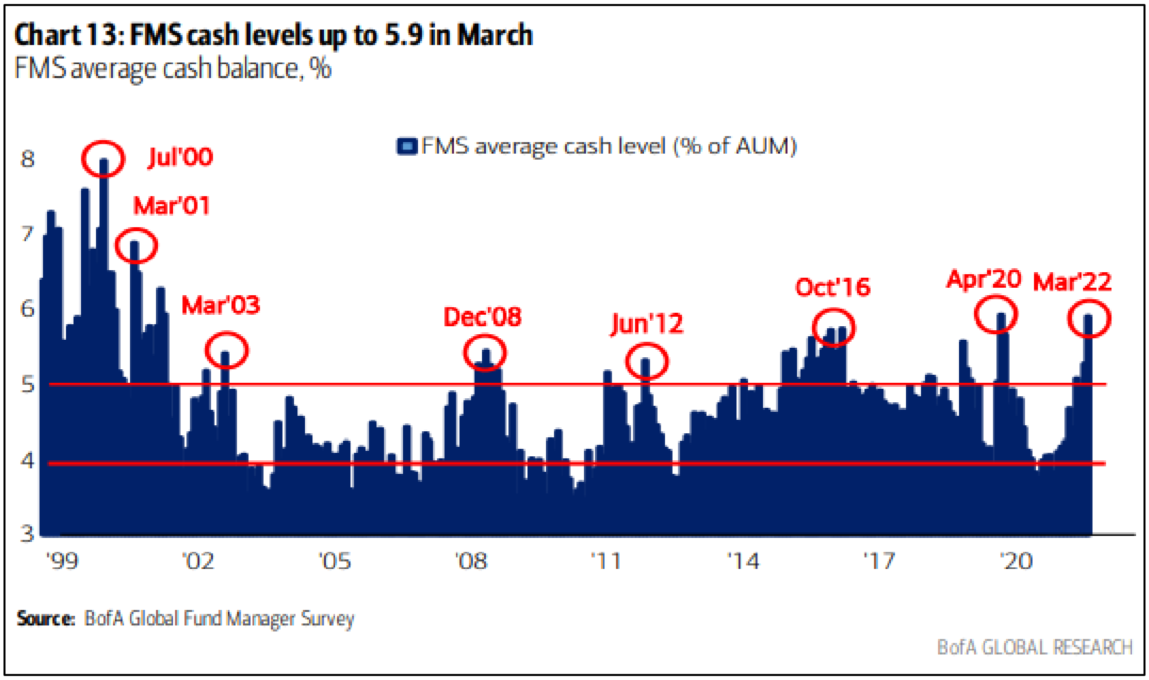
Bearish sentiment was high…



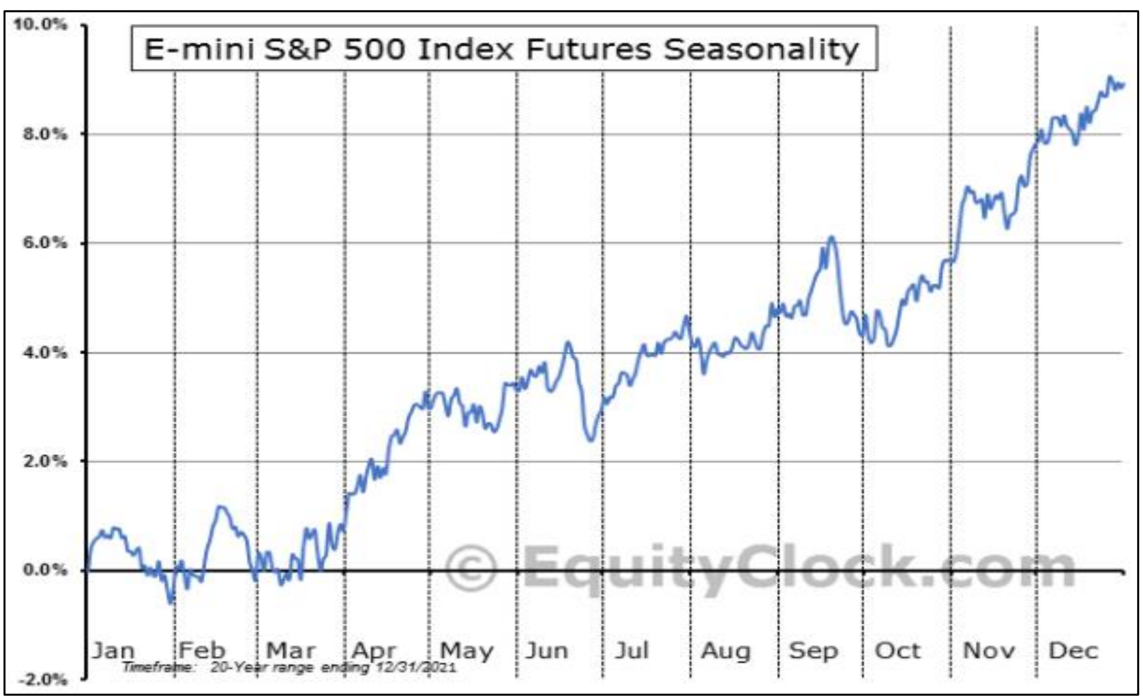
Asset managers have been reporting a reduced appetite for risk.



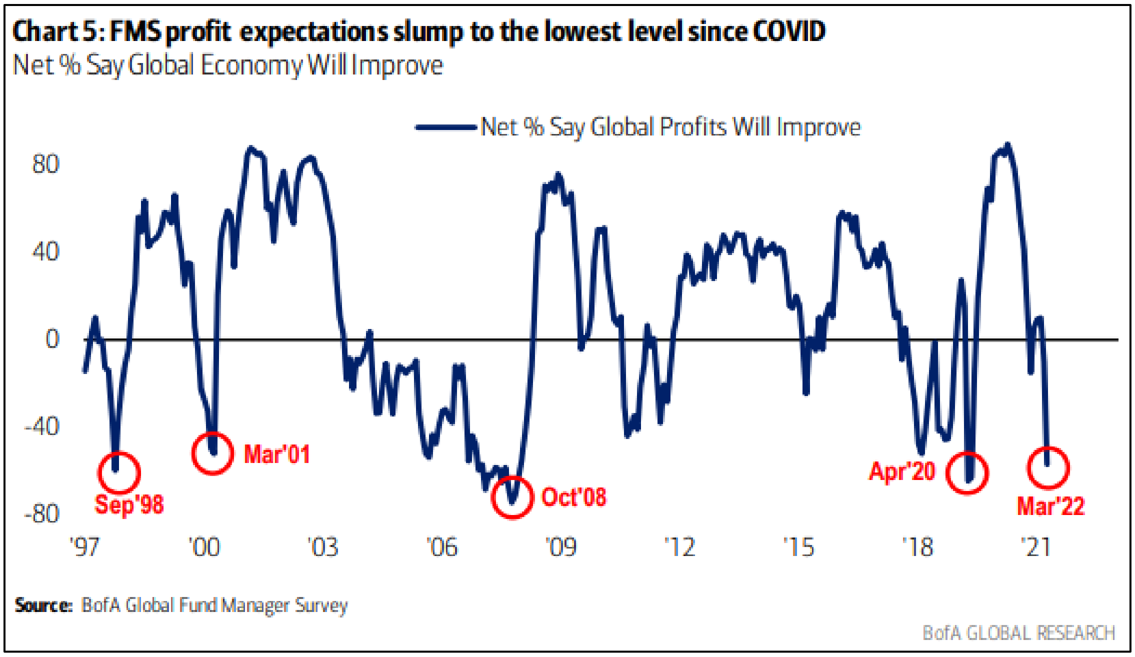
Cash levels of institutional asset managers had risen substantially.



While seasonality is likely less reliable than usual in an extraordinary environment like this, April is widely known to be an historically good month for stocks. I have had a few people point this out to me over the last week…



BoA points out the big fall we have already seen in profit expectations…

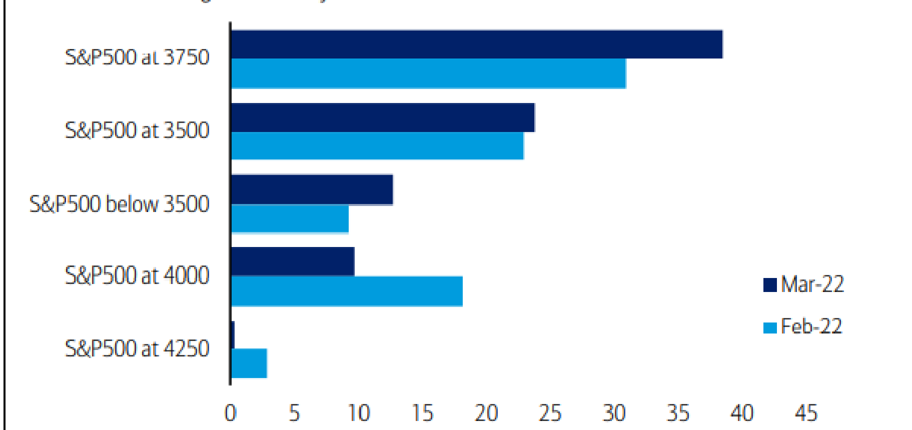


On the next chart, I have marked the above extremes on an S&P chart. Not surprisingly, it tends to tag the lows if the overall uptrend is intact, but not in a larger downtrend.

Last week's rally checked a few positive boxes on the technical. Tuesday's outside reversal day turned into an outside reversal week by Friday. We also put in the first higher high since this year's selloff started. What happens after the next dip will be key to whether this rally marks a more durable low or not.

One thing to remember here is that should the rally fade for whatever reason, the current Fed focus on inflation means that there is no "Fed put" in sight. The first indicator to watch of growing economic concerns will be long end yields falling.

Chart 27: Investors think the Fed "put" for the S&P500 is 3636
Which of the following is most likely to lead the S&P500 above 5000 in 2022?



Source: BofA Global Fund Manager Survey

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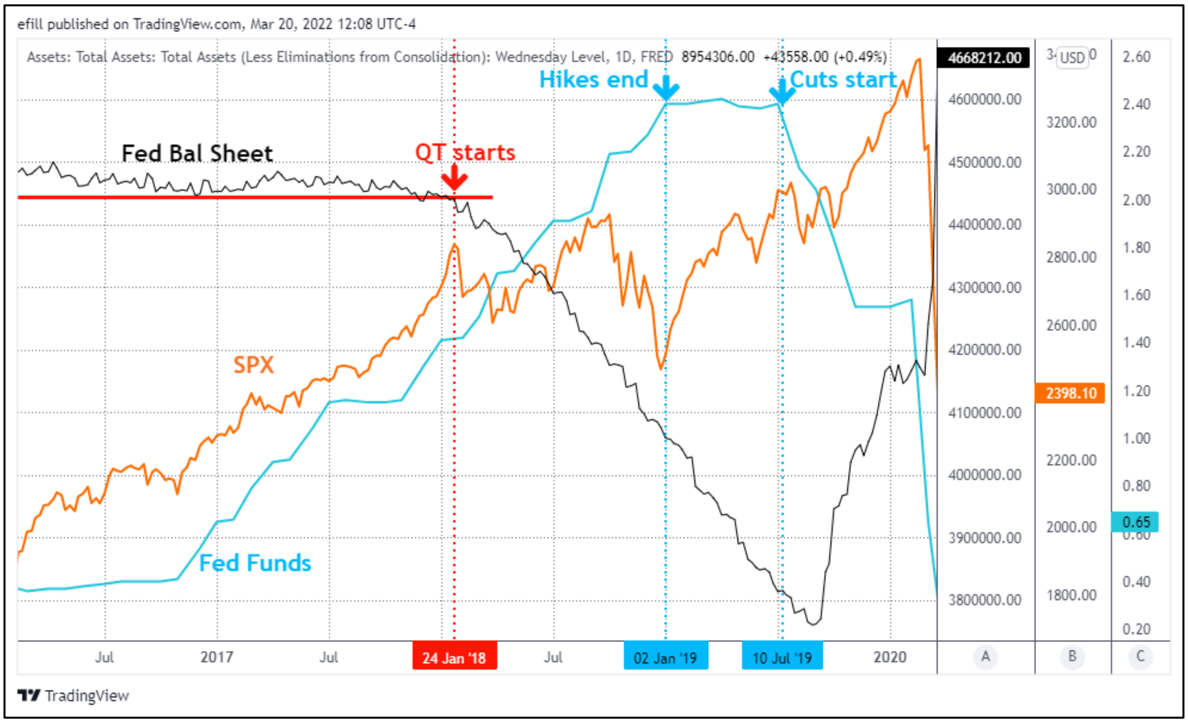
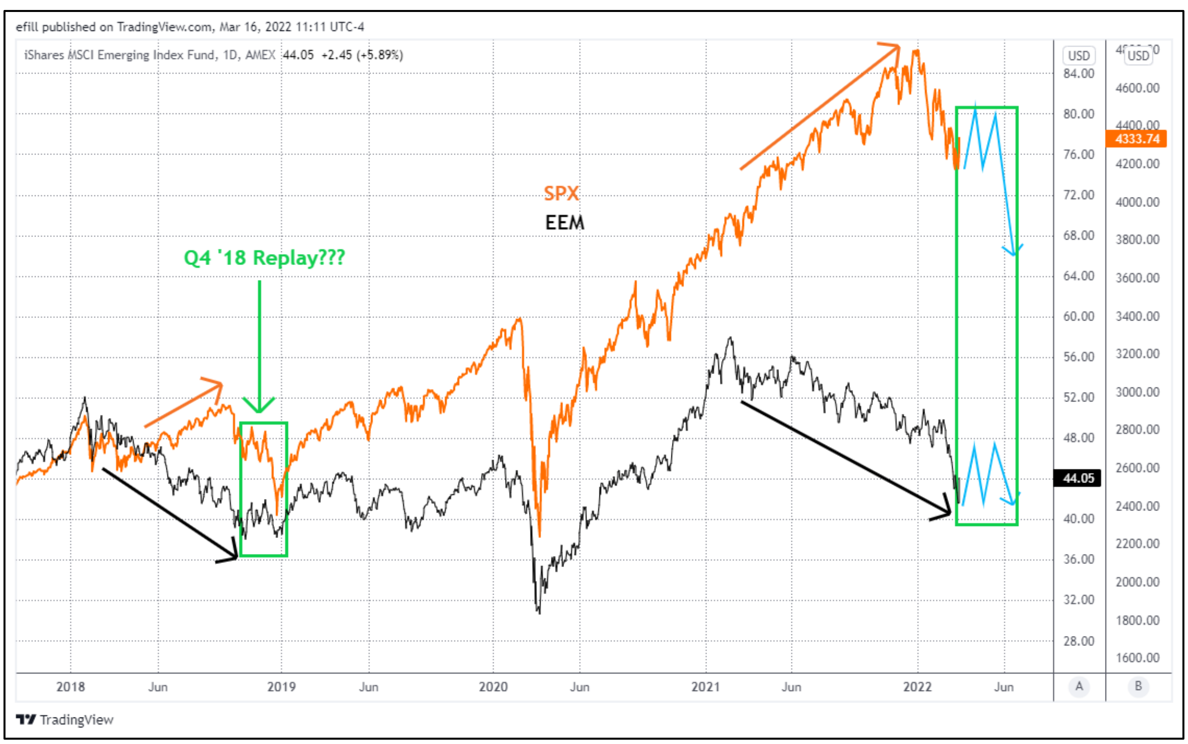
Here is a somewhat busy chart that takes a look at how the last hiking cycle, QT, and the S&P interacted in 2018. Notice how long it took last time for QT to get going. This time, the wait will be much shorter.



A bearish outlook could include an '18 replay in US equities.



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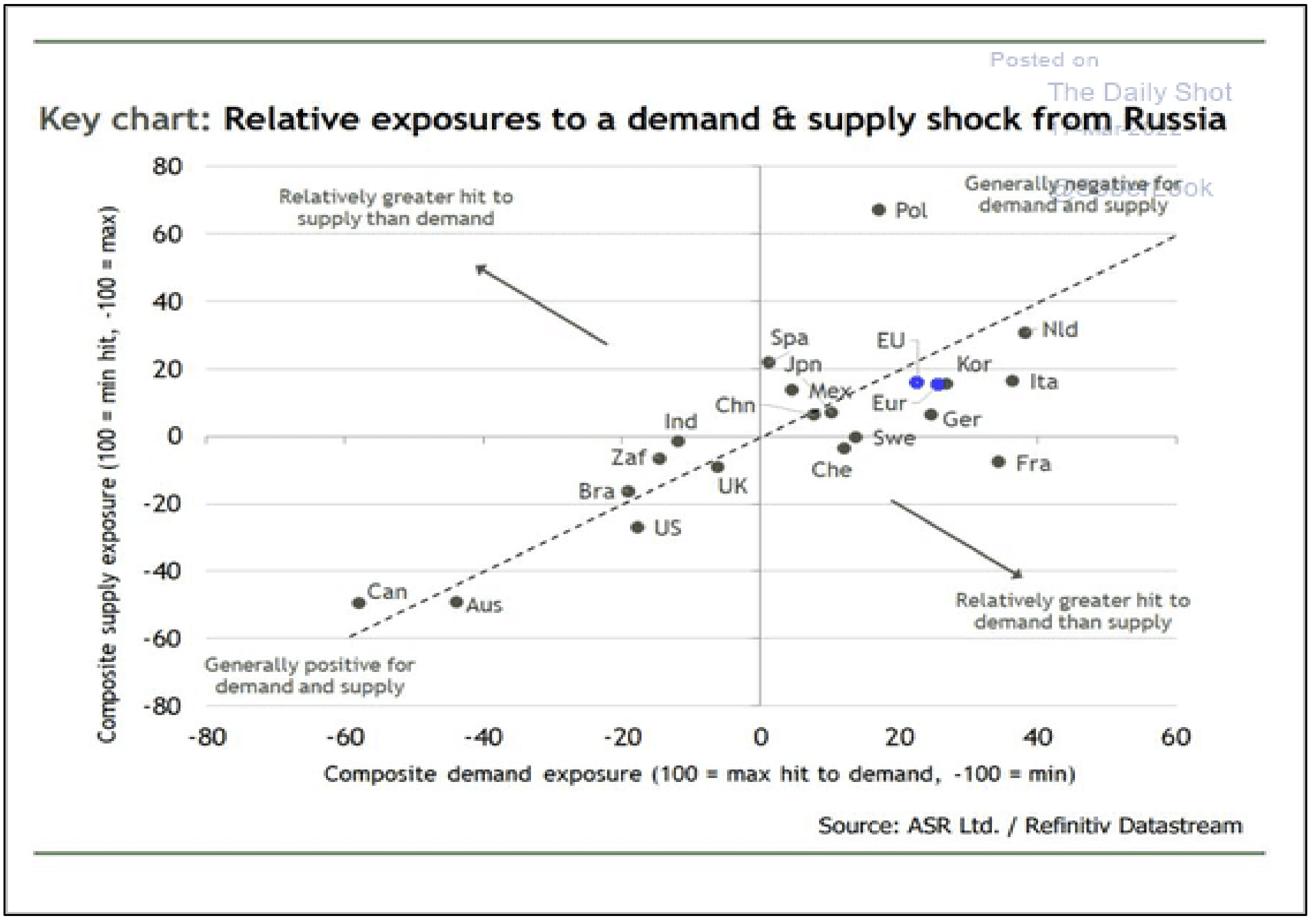
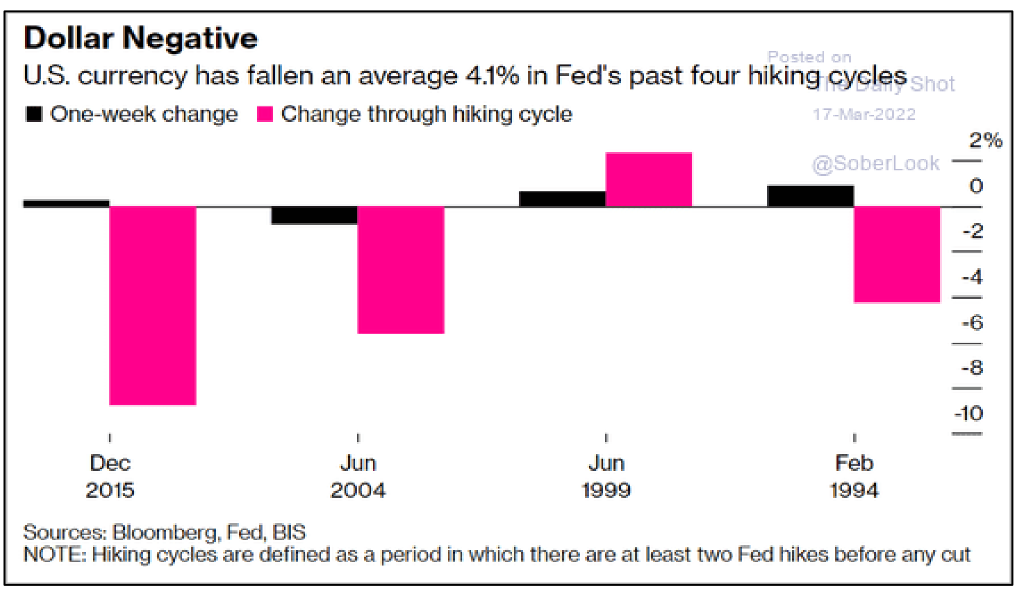
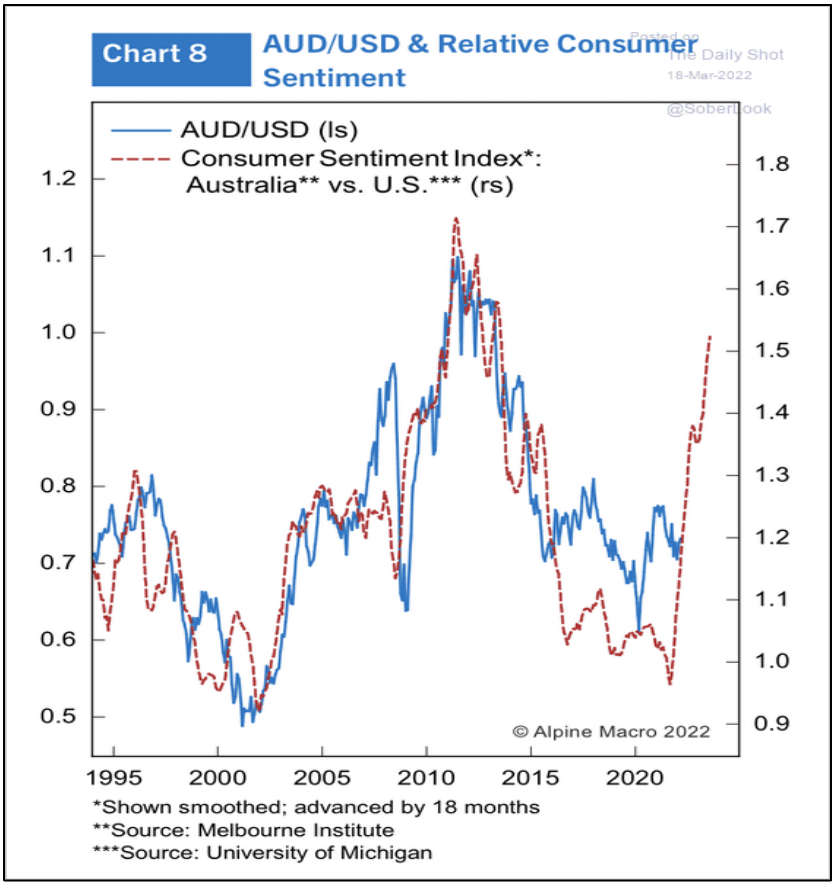
FX – These markets are awash in moving parts and if/then scenarios. FX is no different.

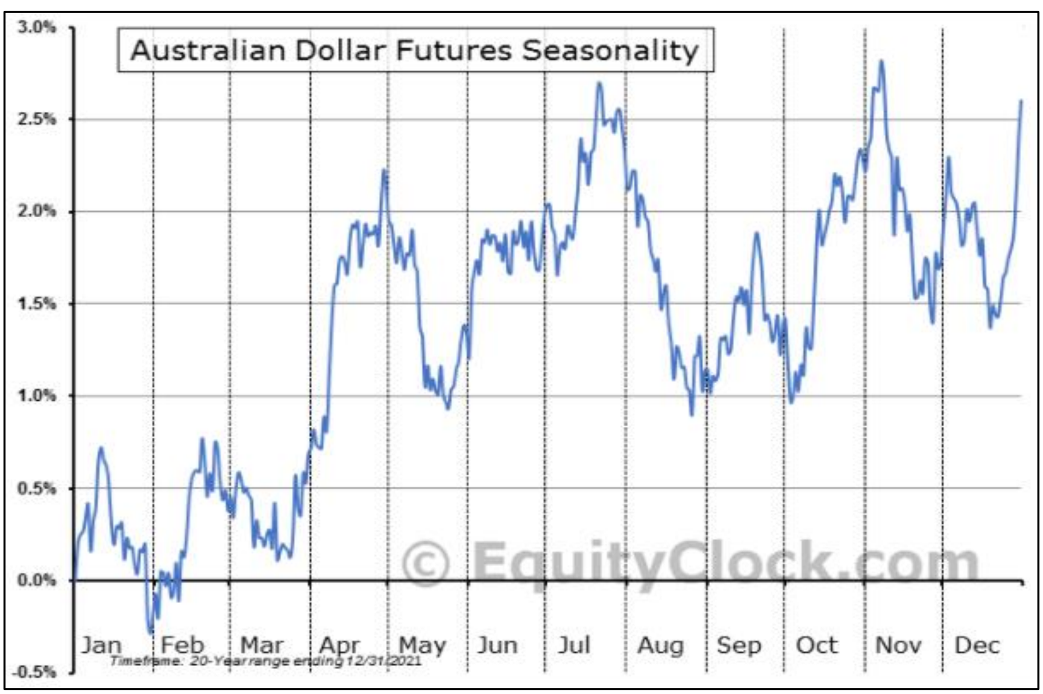


Historically, the first two thirds of the average hiking cycle have been bad for the dollar. Only when the economy rolls over and yields fall does the dollar rally.



AUD has been bid for a number of reasons. We will see if it can reach escape velocity above .7500 in the coming weeks. Seasonality is good in April.





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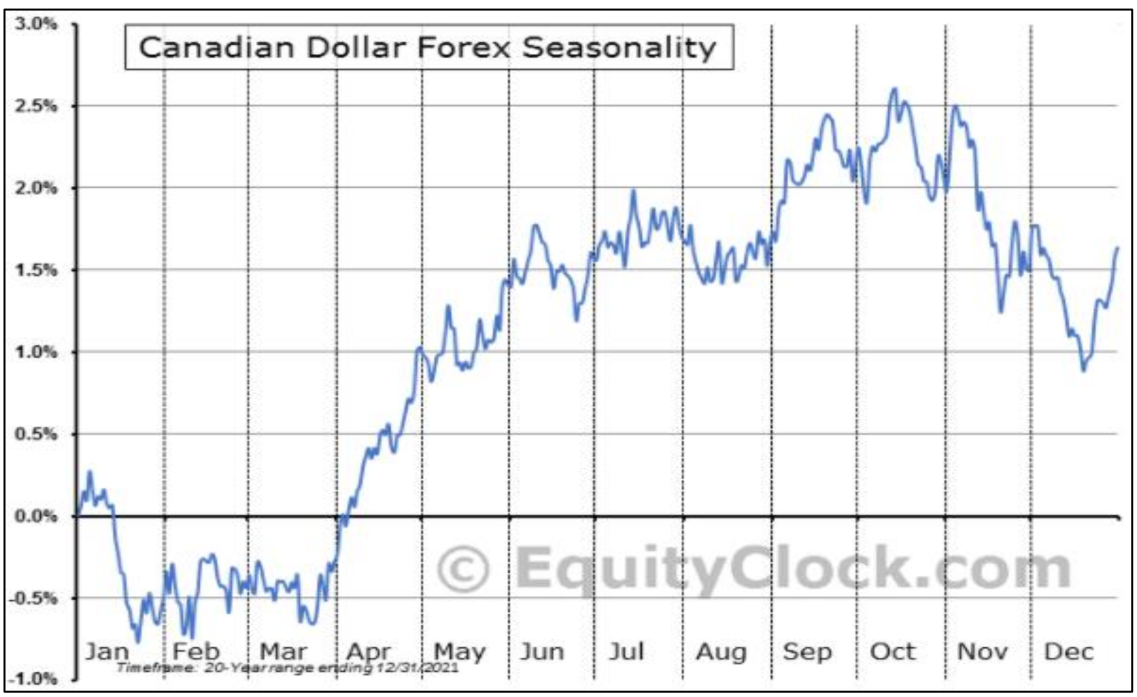
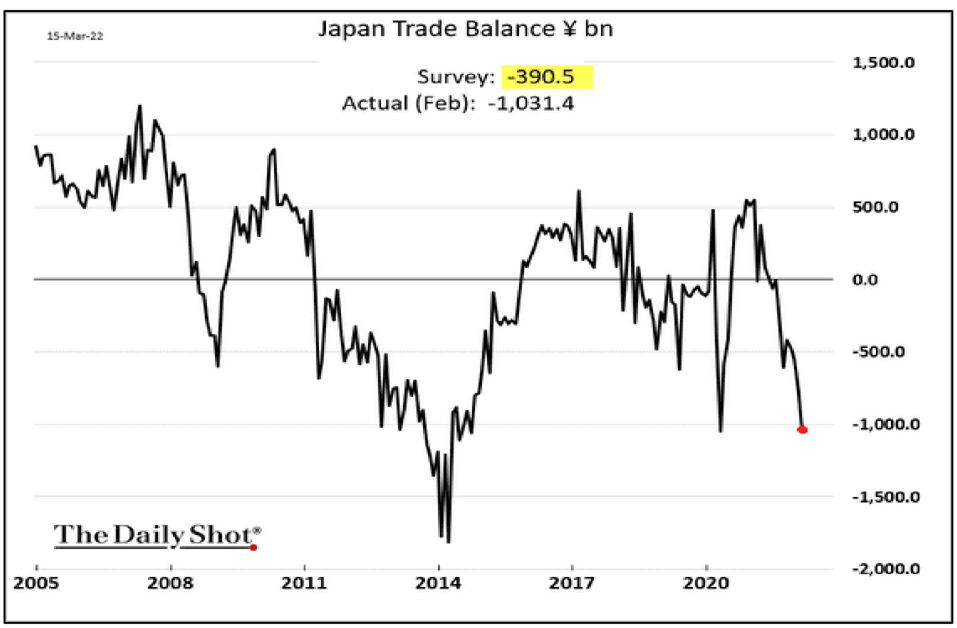
CAD is a beneficiary of the energy mayhem and has arguably only been held back by the risk-off environment. If that is now calming down it could do well also.



While MXN has not benefited from the energy and commodities booms in the same way as AUD and CAD, its relationship with the US economy is helping. If we are starting to see a weaker USD environment it could see capital flows. An interesting break higher in the ETF.

JPY has been hurt by the energy rally and commodities in general. USDJPY has tended to correlate to US yields as well. The result has been that JPY has remained weaker than many expected during the risk-off period we have seen.



Last week I mentioned AUDJPY but many of the Yen crosses are now at an interesting longer-term juncture.

A simple index of five crosses highlights the importance of where they are as a group.

USDKRW had a big outside reversal week. It is probably time to put South Korea on your radar.

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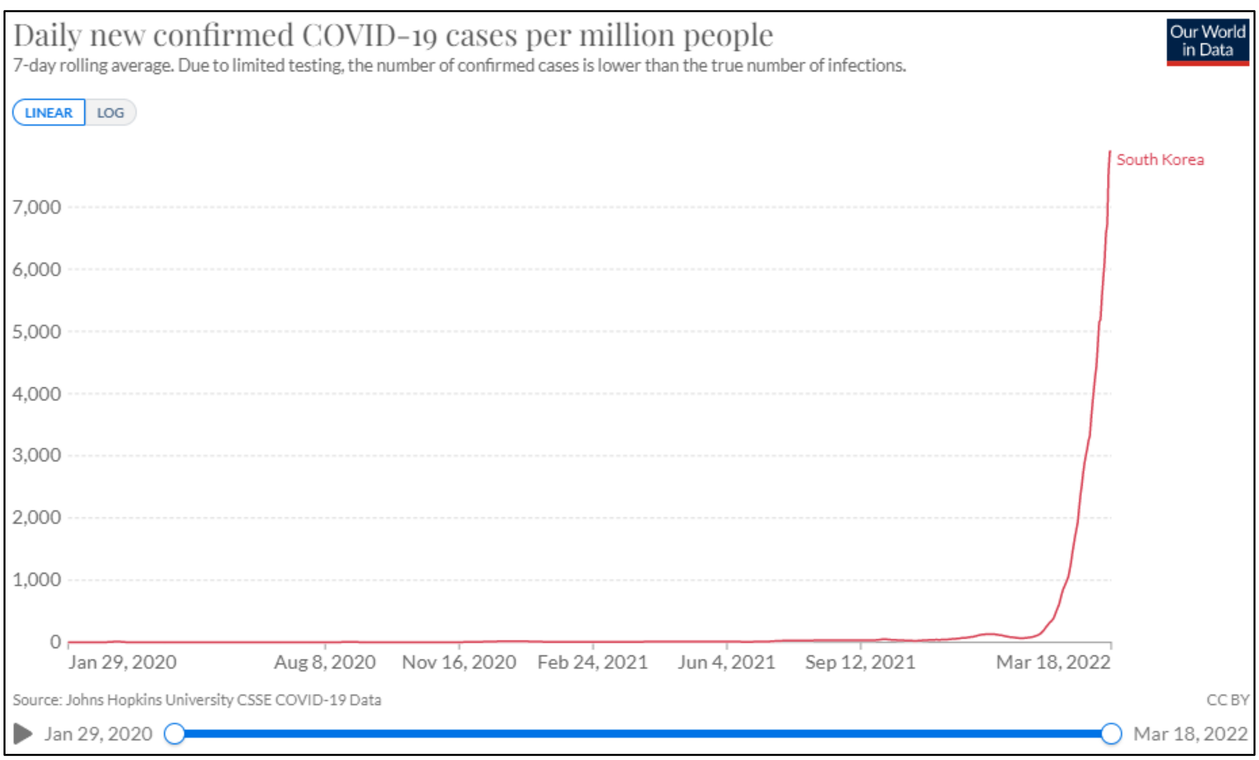
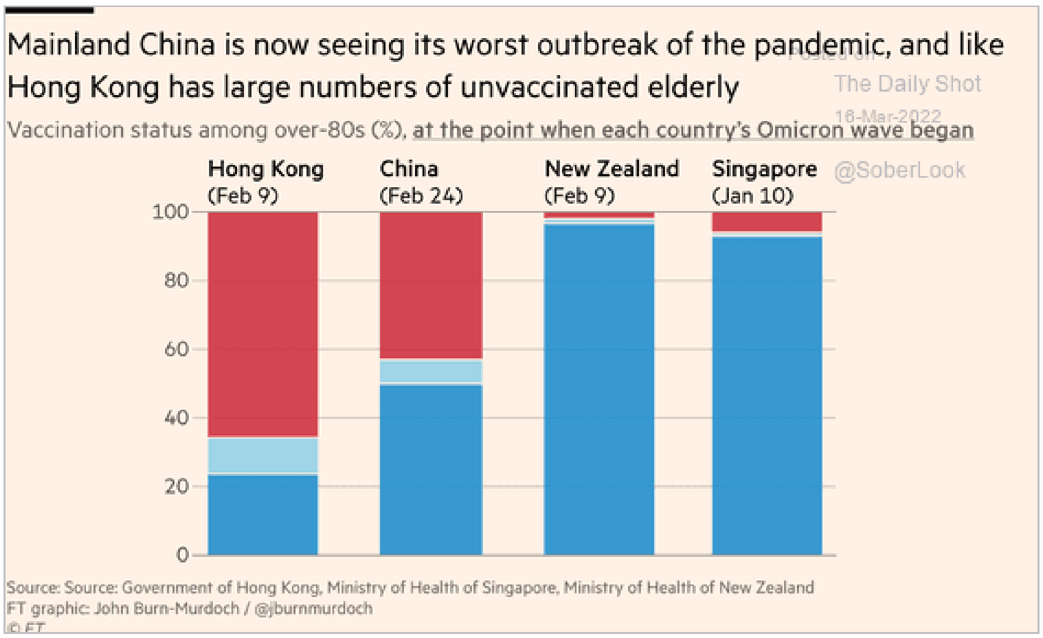
We have seen a deep retracement of the 2000 rally in South Korean assets. However, for now…

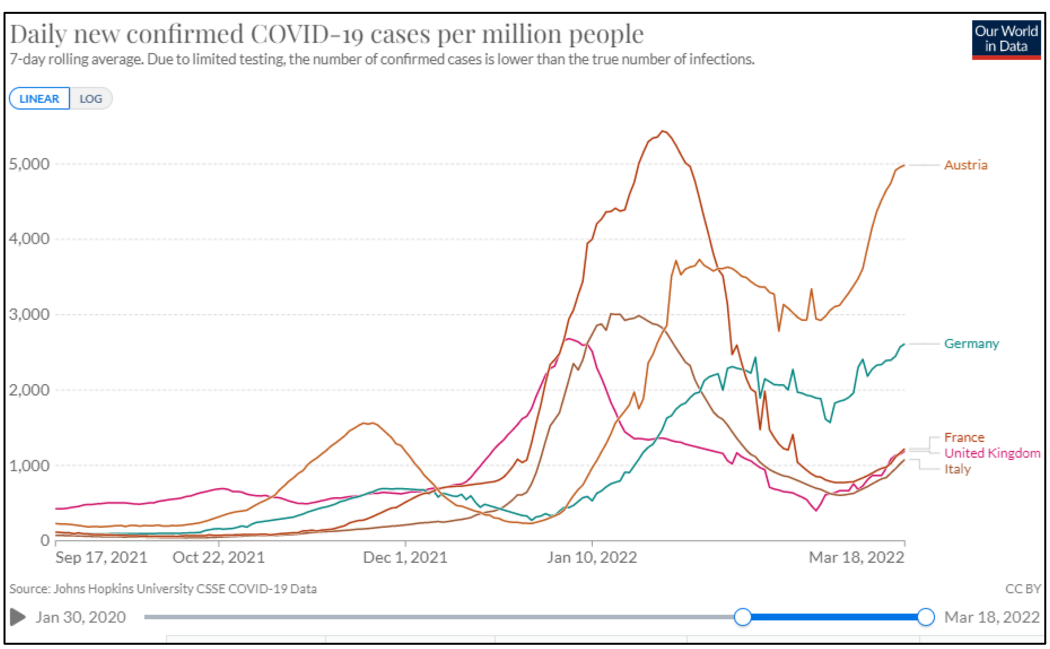
exploding COVID cases, energy import costs, and China growth concerns may hold it back.



Last week's price action saw Chinese policy makers roll out their version of the Plunge Protection Team as they published a list of measures to stabilize markets. They also back-pedaled a bit on the persecution of the tech sector that had been underway. Bigger picture, however, the drive to Common Prosperity has not ended and the growing divide between East and West has not yet been contained. Positioning may now be washed out, which of course, itself can power a rally for a bit, however, a lot could depend on how the growing COVID outbreak is handled.



Speaking of COVID, it has continued its recent rise in Europe. Hopefully, we won't see the usual 2-3 week lag before cases again start to rise in the US.



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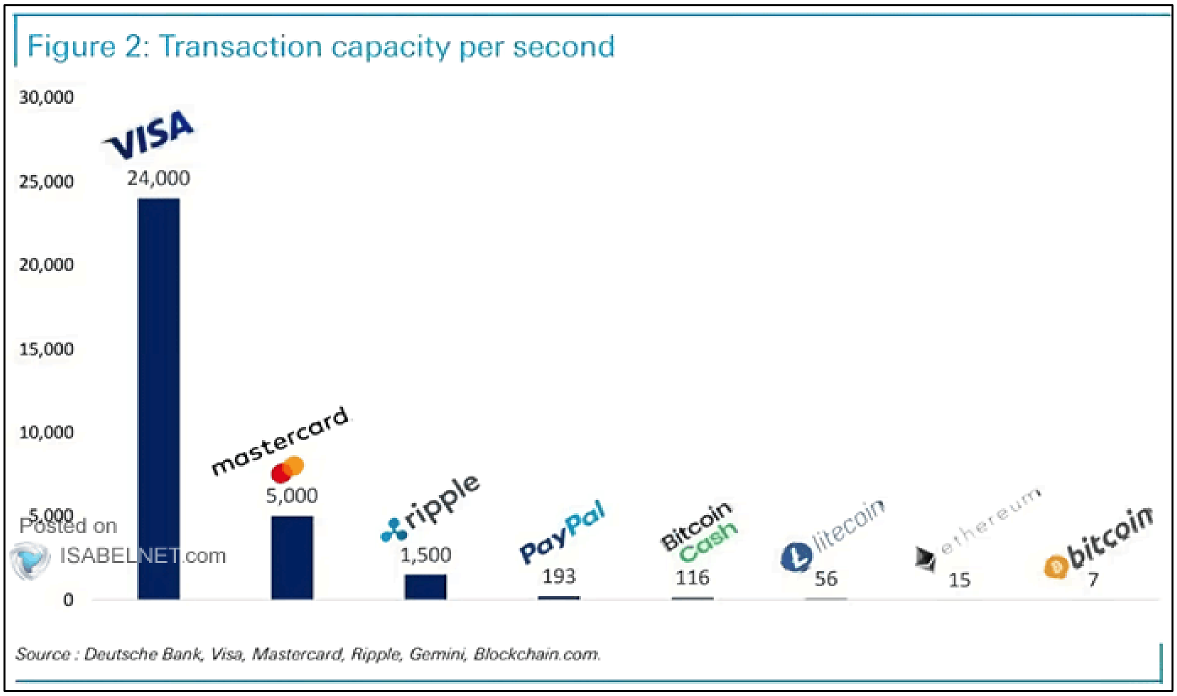
Food for thought

Transactions per second continue to be a big headwind for crypto use case. The latest Fed/MIT joint study into a US CBDC found that it could have a capacity of 1.7 mln transactions per second.



Important Macro Data Releases and Events for the Week

Monday 3/21/2022	PBoC Interest Rate Decision (Sunday night ET)
	PPI (Feb)
	Chicago Fed National Activity Index (Feb)
	RBA Governor Lowe speech
Tuesday 3/22/2022	Nothing of note
Wednesday 3/23/2022	CPI and PPI (Feb)

		Fed's Chair Powell speech
		New Home Sales (Feb)
		Consumer Confidence (Mar)
		BoJ Monetary Policy Meeting Minutes
Thursday 3/24/2022		Markit Manufacturing, Services and Composite PMIs across Europe (Mar flash)
		SNB Interest Rates Decision and Monetary Policy Assessment
		Initial Jobless Claims
		Initial Jobless Claims 4-week average
		Continuing Jobless Claims
		Durable Goods Orders, Nondefense Cap Goods Orders Ex-Aircraft (Feb)
		Fed's Waller speech
		Markit Manufacturing, Services and Composite PMIs (Mar flash)
		EU Leadership Summit
Friday 3/25/2022		IFO - Business Climate, Current Assessment, and Expectations (Mar)
		Michigan Consumer Sentiment Index (Mar)
		Pending Home Sales (Feb)

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