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What to focus on in Global Macro for the week of May 17th, 2021

Macro Themes on the Radar:

Inflation and Fed

Tensions continue to build between the forecast-based markets and the outcome-based Fed. For many years the Fed has patiently explained to us that "monetary policy works with long and variable lags", which of course has been the reason for trying to predict what the most likely path is going forward. With meaningful "lags" you need to start your turn before it becomes obvious that the approaching wall is unavoidable. If anything, the range of possible outcomes is currently broader than usual, yet the Fed has reduced its ability to course-correct should it be necessary. If they are wrong now, catching up with an unexpected outcome, is going to be a problem.

It is becoming increasingly difficult to justify QE at its current pace, if at all. It is one thing to keep rates low for an extended period, but quiet another to continue buying $120bln in Treasuries and MBS. It is important to remember that they are not holding policy steady, but continuously easing financial conditions with more and more liquidity every day. More liquidity at this point will not help labor markets but could damage longer-term financial stability. Rather than suppressing volatility, as they have for many years, they are increasingly likely to become its source.

Last week's inflation numbers were indeed higher than expected. Even various Fed members were surprised, but quick to revert to the "transitory" inflation story. It is no longer a secret that inflation is jumping in the near-term, the question is what the magnitude and duration will be. Those are two variables that can rattle the cage going forward.

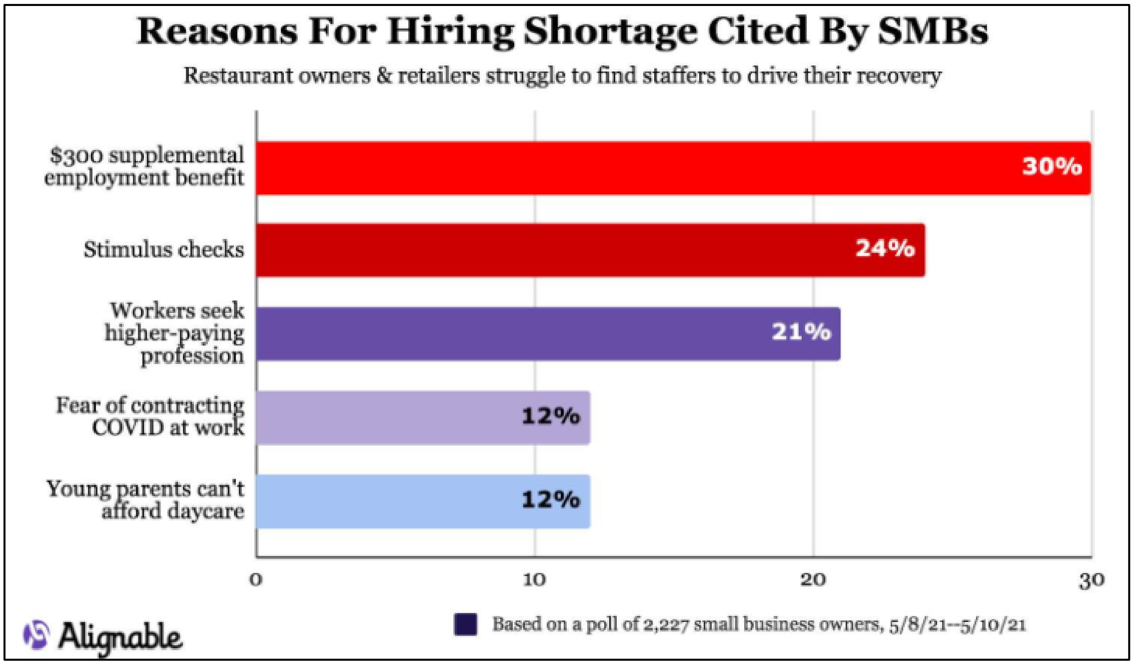
After the CPI print, new Fed Governor Waller indicated they will need to see May and June jobs data before they think about tapering. That means we could still see a September taper announcement that takes effect in November or by the end of the year. Maybe.

Core CPI (ex food and energy) rose 0.9%mom, largest rise since 1981, against consensus at 0.3%. Headline rose 0.8%mom versus consensus at 0.2%. Used car prices rose an incredible 10%mom, easily the largest on record (chips holding back new car production), lodging away from home up 7.6%mom and airfares up 10.2%mom. These 3 categories accounted for more than half the rise in CPI. With regard to the headline number of 4.2% YoY, 0.7 of that was base effects.

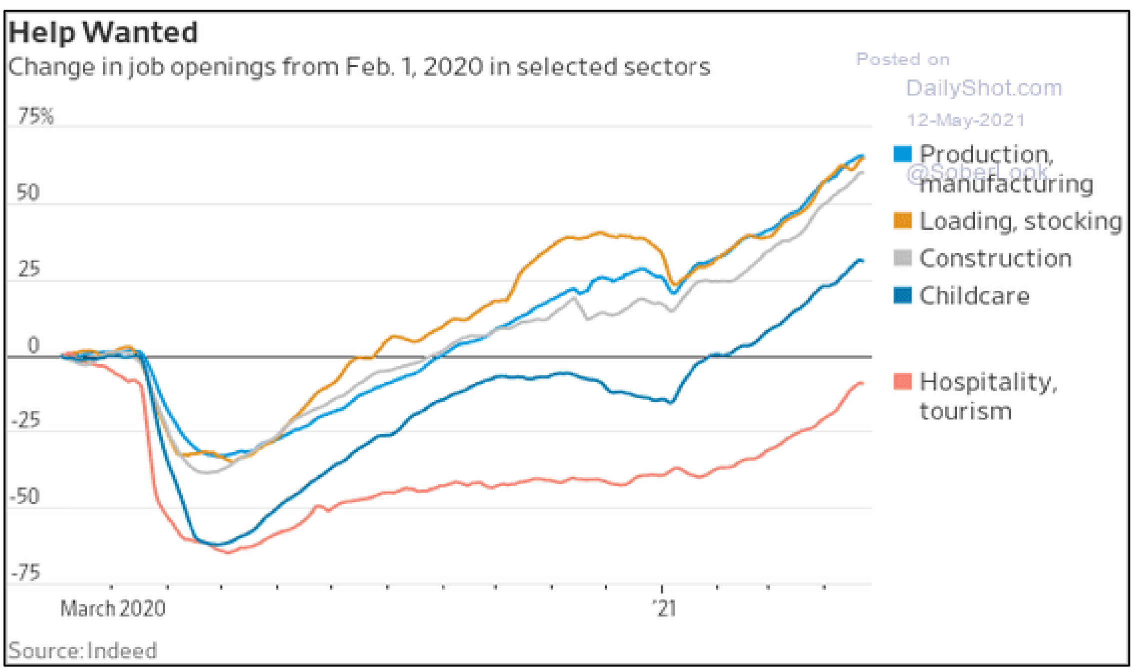
When you look at the breakdown there is clearly plenty of transitory stuff in there. However, big inflation prints, and the huge number of job openings, could be a springboard for wages, and feed into a more lasting shift in inflation expectations.

The Federal UI bonuses will run until early September; however, some states are talking about ending them early. Iowa and Mississippi have already announced they will halt them in June, so we should get an early indication of what effect reduced payments will have.

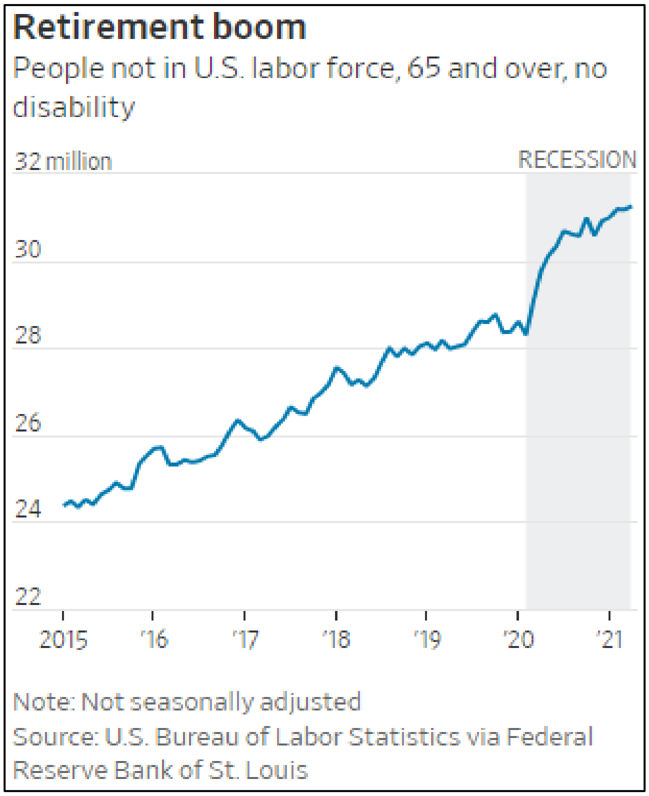
Small firms increasingly view the extra unemployment benefits as the reason for hiring shortages.



In many sectors job opening have recouped all the COVID losses +++



While most of those openings will be filled as the various labor supply constraints fall away, some workers appear to have accelerated retirement due to the pandemic.



As the data washes through, there is a lot of noise, and the Fed's dependance on that data is making for some very nervous markets. How long will the bottleneck in hiring last, and will unemployment quickly return to pre-pandemic levels once it clears? What does "transitory" mean in practice, and how long can core really be at 3% without it mattering?

The above is important relative to the current inflation spike. In the longer term however, the domestic and global political environment will likely matter as much or more. As strategist Lyn Alden recently wrote very succinctly:

Whenever the balance of power favors the wealthy, due to some combination of offshoring, automation, and the political environment, then monetary inflation is more likely to translate into asset price inflation. Whenever the balance of power shifts towards labor, due to labor onshoring, labor organization, and/or populist politics gaining a foothold, then monetary inflation is more likely to translate into consumer price inflation. This is largely correlated to wage increases or lack thereof, as well as being correlated to the size and scope of government transfer payments and tax policy.

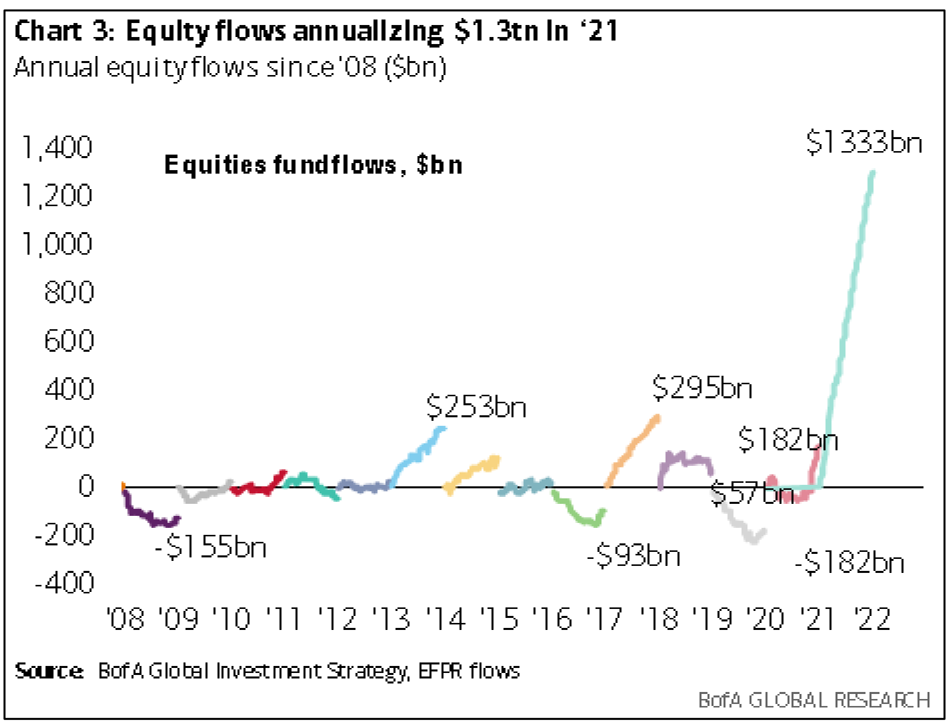
<u>What to Focus on Now:</u>

Equities

Although on the back foot all week, equities recovered on Thursday and Friday despite initially cracking what could have been key levels.

With bond markets not as impressed with the inflation numbers as one might have thought, stocks reverted to "buy the dip" in a low yield, good growth and high liquidity environment.

The YTD flows (here annualized) have really been amazing.



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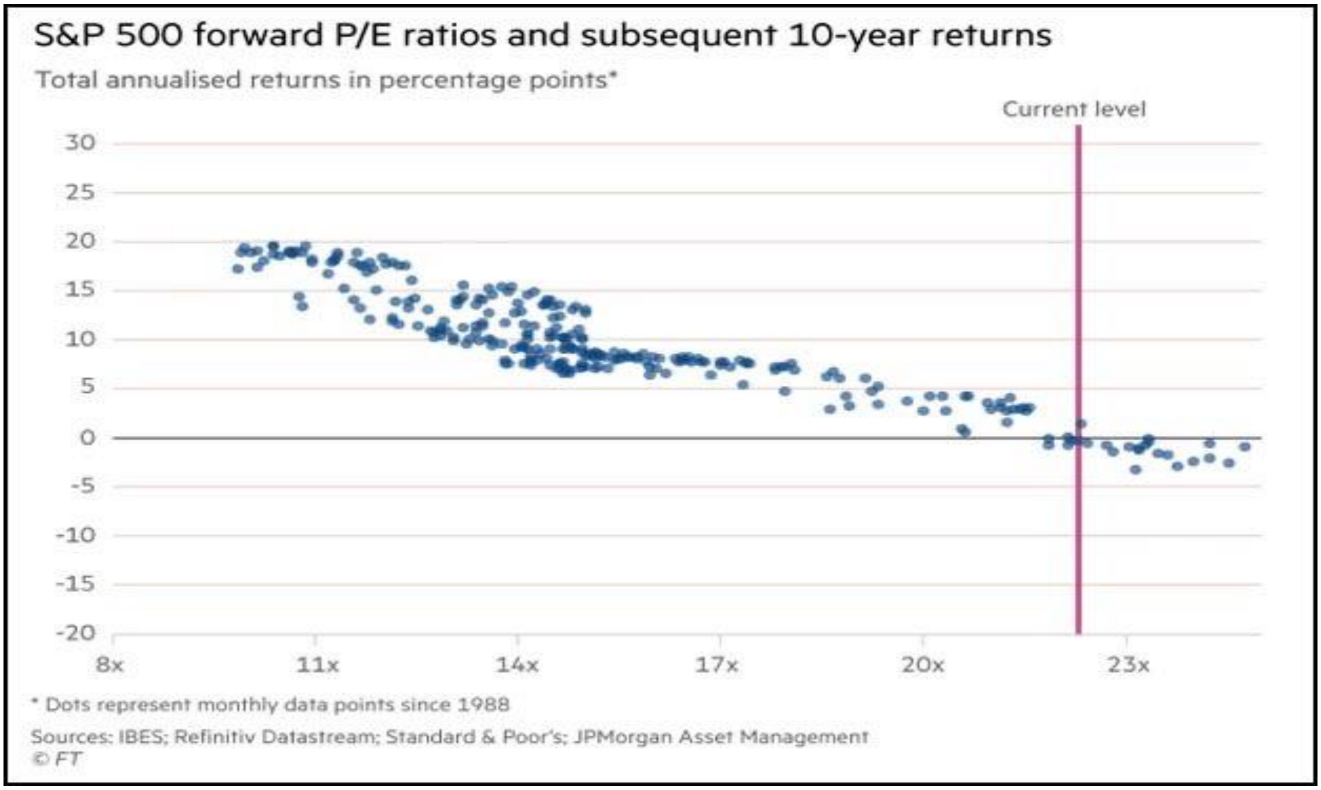
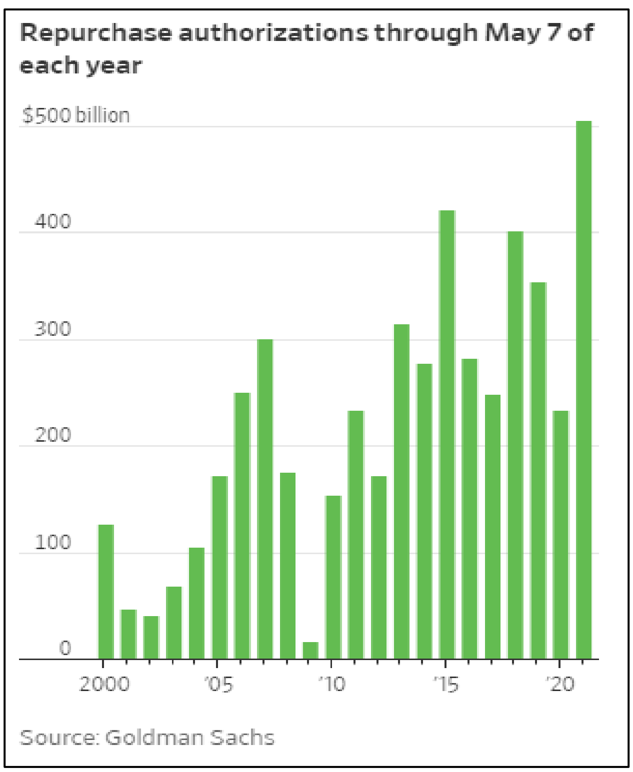
The P/E's are now at levels that usually don't bode so well for forward returns. However, there are still plenty of prints to the right of the red line, so we can still get more expensive.



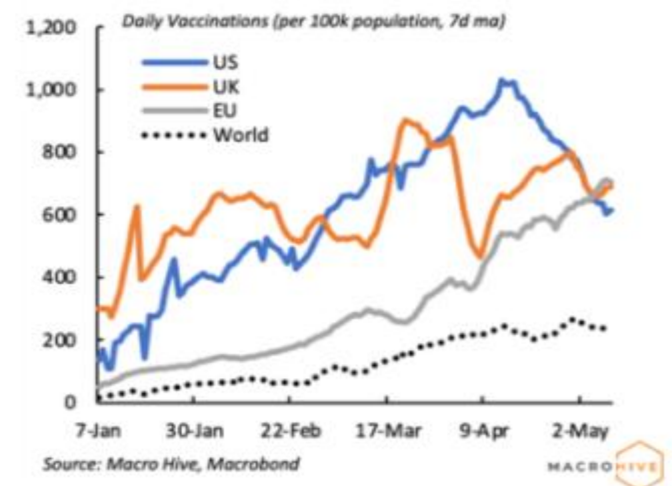


In the meantime, corporations are returning to buybacks in a big way.

With the economy going gangbusters and a lot of new debt issued over the last year, at low rates, it will be interesting to see how many use those borrowings to buy back stock.

European equities also held up very well last week. The COVID news is improving and more widespread re-opening on the continent looks imminent. Vaccination rates continue to climb now crossing with US rate that have already peaked. Europe looks to be roughly 8 weeks behind.

Chart 1: EU Vaccinating At A Quicker Pace Than UK and US



Source: Macro Hive, Macrobond

On the ECB front there is growing debate about tapering vs. embracing some kind of "average inflation targeting", of their own. We will see in June how that is resolved. That meeting will be followed up in September by the German election, which are increasingly being seen as a possible game-changer if the Green's are able to hold, or build, their current lead.

Thanks to the tailwind of a rally in the EUR, ETF's like EWP and EWI continue to hold above important breakout levels.

Bonds

When all was said and done, US 10-year yields gave back nearly all the CPI and PPI gains by the end of the week. Eurodollar were also relatively unimpressed, with the lift-off for rates still not seen until December 2022. Extended positioning and sentiment combined with negative carry, is making it hard to generate the next leg higher in yields. Markets are waiting for further clarity on employment and/or inflation with the most recent numbers pointing in opposite direction.

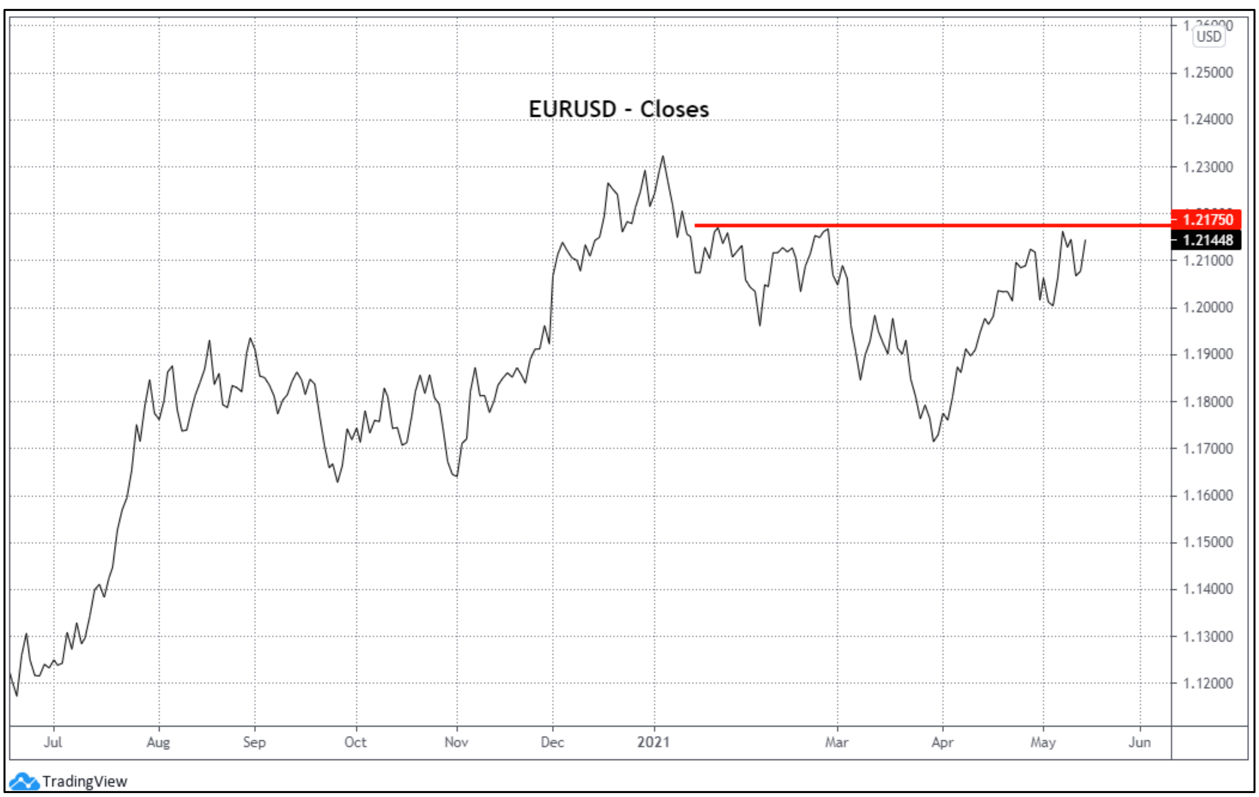
FX

While there have been some idiosyncratic moves, overall, the USD is more or less where it was six months ago vs. many of the majors.

Over the last two weeks we have tested the bottom of the range, but it has been messy.

The Dollar Index chart of closes only suppresses some of the noise and still makes me lean towards a continued push lower in the coming days and weeks. Back above 91.00 in DXY however, would be problematic for that view.

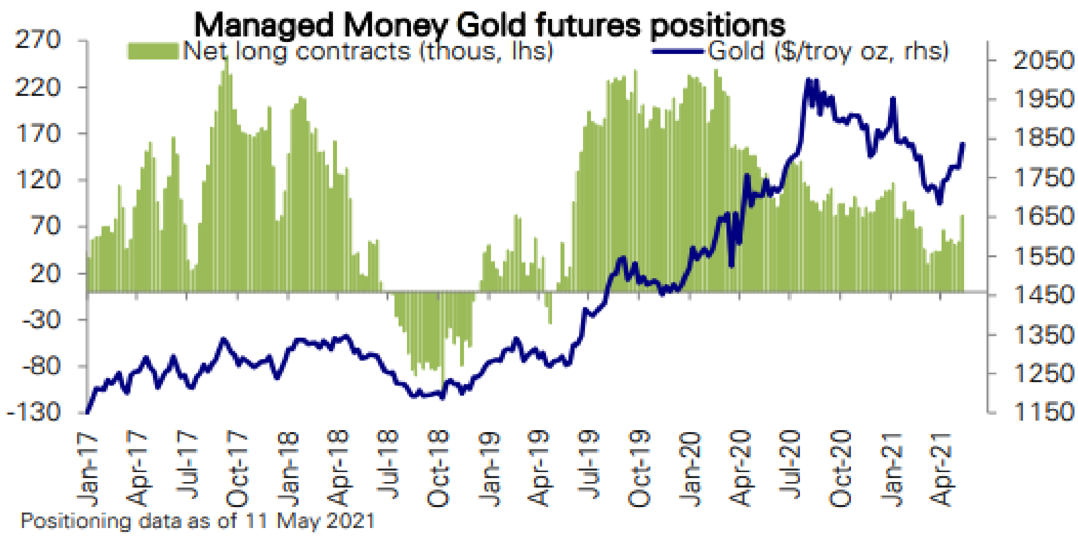
For EURUSD we need to capture and retain the 1.2175 level.



Commodities

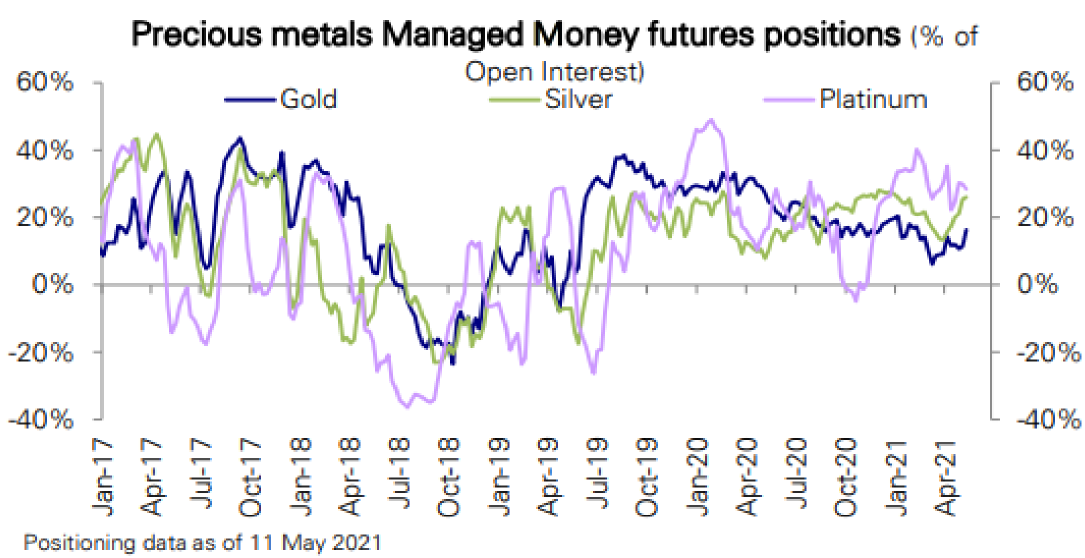
The inability of bond yields to rise materially in recent weeks, as inflation expectations continue higher, has combined with a weaker USD, to support Gold. Positioning is ticking up from much reduced levels.

Figure 121: Gold futures positioning



Source : Deutsche Bank Asset Allocation, CFTC, Bloomberg Finance LP , Haver

Figure 123: Precious metals futures positioning



Source : Deutsche Bank Asset Allocation, CFTC, Bloomberg Finance LP

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Gold is now at downtrend resistance vs. the dollar.

But has already broken higher vs. the EUR…

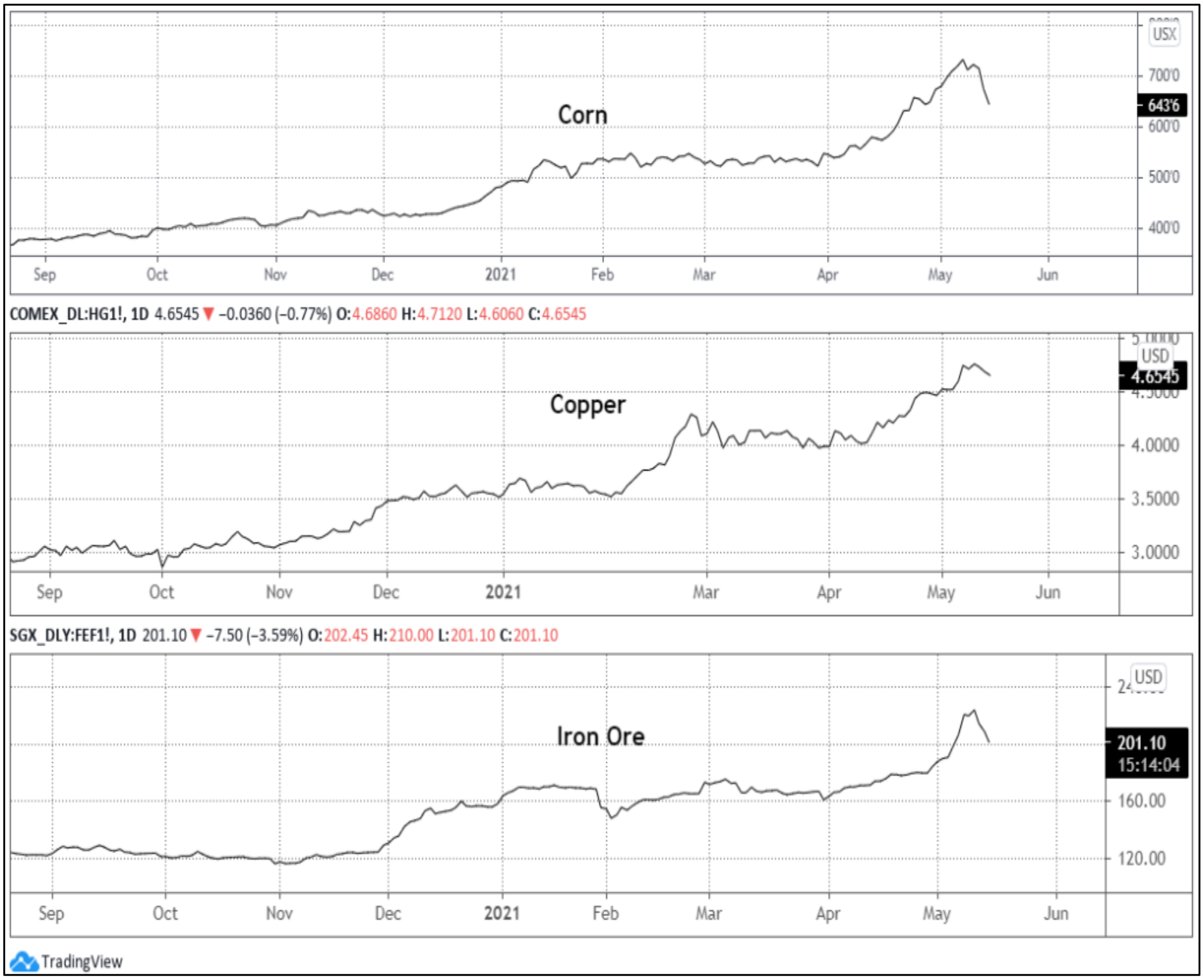
JPY…


XAUJPY
JPY
201527.2
TradingView

and CNY


XAUCNY
CNY
11864.15
TradingView

Three of the other commodity headline-makers of the last few months, took a breather at the end of last week. Just something to watch, given how overbought they are. With more people watching the roll-over in the China Credit Impulse, and relatively stretched positioning in some of these commodities, we might be due for a pullback.



Also, if this was a currency, or a stock chart, I would say there is a good chance that we take a look at that green box on the right. Given that it is crypto, who knows. Multiple outcomes are only a Tweet away! I only mention it because of the chilling effect a drop like that could have on risk taking overall.

Calendar

Next week we have flash PMIs for May, US housing starts, building permits and existing home sales. In the coming months we should see Service PMIs jump and Manufacturing PMIs start to run out of steam. Ironically some of the Manufacturing headwinds will be from bottle necks and supply shortages. UK data for retail sales and inflation will be worth watching as they could be pushed towards reducing monetary accommodation before the Fed or the ECB.

Important Macro Data Releases and Events for the Week

Monday 5/17/2021	Fed's Clarida and Bostic Speak
	GDP QoQ Q1 Forecast: -1.2%, Prior: 2.8%
	RBA Minutes

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Tuesday 5/18/2021	EcoFin Meeting
	GDP s.a. QoQ Q1 Forecast: -0.6%, Prior: -0.6%
	GDP s.a. YoY Q1 Forecast: -1.8%, Prior: -1.8%
	Building Permits MoM (Apr) Forecast: 1.774, Prior: 1.759
	Housing Starts MoM (Apr) Forecast: -1.8%, Prior: -1.8%
	ECB's President Lagarde SPEECH
Wednesday 5/19/2021	Industrial Production YoY (Mar) Forecast: 4%, Prior: 4%
	Various UK inflation measures
	CPI Index and Core
	CPI Core and various
	ECB's Lane SPEECH
	FOMC Minutes
	PBOC interest rate decision
	Unemployment Rate
Thursday 5/20/2021	PPI MoM (Apr) Forecast: 1%, Prior: 0.9%
	ECB's Lane SPEECH
	ECB's President Lagarde SPEECH
	Philadelphia Fed Manufacturing Survey (May) Forecast:44, Prior: 50.2
	Initial Jobless Claims Forecast: 450k, Prior: 473k

		Initial Jobless Claims 4-week average Forecast: -, Prior: 534k
		Continuing Jobless Claims -, Prior: 3.655M
		Eurogroup Meeting
		Retail Sales s.a. Forecast: 0.5%, Prior: 1.3%
Friday 5/21/2021		Retail Sales
		Markit PMI's for Europe (Flash)
		Retail Sales MoM (Mar) Forecast: 2.3%, Prior: 4.8%
		Markit Manufacturing PMI (May) Forecast: 60.4, Prior: 60.5
		Markit Service PMI (May) Forecast: 64.6 Prior: 64.7
		Markit PMI Composite (May) Forecast: -, Prior: 63.5
		Consumer Confidence (May) Forecast: -6.8, Prior: -8.1

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