Macro and markets divorce

Despite higher than expected inflation in the US last night, 10Y US Treasury bonds rallied with bond yields falling to 1.43% as of writing - our analysts have been hard at work explaining all of this - I've provided links to "everything you need to know" about what is going on in very messy markets...

Source: shutterstock

What the...?

My colleagues in the US have been busy as usual with James Knightley writing about last night's surprisingly (maybe not so surprisingly) high inflation figure, taking US headline inflation to 5%YoY. But as you may have seen, US Treasury markets have not just shrugged this off, but have made an off-colour hand gesture at the numbers and turned their backs on them. Padhraic Garvey's note on the importance of liquidity is well worth a read.

We've also been busy in Europe, with Carsten Brzeski covering yesterday's ECB meeting - though he does quickly note that not a lot happened.

And our monthly note is also out - covering all of this and more, including our China and non-China Asia coverage. Do please give some of them a read if you can find the time.

OK - back to the news of last night...the macro news has been quite unremitting in terms of inflation. Last night's print is just one in a long string of evidence that inflation is not just rising, but is more than just transitory base effects. But the Fed, which meets next week, can still point to no deviation of inflation expectations to back up its continued mantra of transitory inflation. The market is buying that for now.

That view about expectations though requires you to believe that market measures of inflation expectations are immune to the sort of liquidity gluts that Padhraic has been writing about. They are not. No way. And other measures, such as survey evidence (look to today's longer-term inflation expectations from the University of Michigan) are already up sharply. So there is a very partisan approach to what data to consider, and what to ignore. I guess that's the Fed's prerogative but at some stage, surely the market will see through their words and start thinking for themselves...?

For the bond bulls, the absence of a payrolls figure close to 1 million each month remains an excuse for lengthening positions. But as JK would point out, the labour market's inability to print such a figure is due to inflationary bottlenecks in supply, and you have to utterly discount these, as well as assume that these will just dissipate in time to shrug them off. One thing seems sure, if the Fed does not at least hint about a forthcoming taper at Jackson Hole in August (we think they will, but a non-negligible chunk of people think they won't, because of the employment numbers) then bond yields are in for further declines.

What could change this? Well, obviously a stronger payrolls outcome would do that nicely. But these figures are impossible to forecast as well as highly volatile. So what about something we have a better chance of getting right? One possibility would be next month's inflation numbers. The consensus has basically accepted that current inflation is high but transitory and that this month's figures likely mark the peak. But what if we see another strong month-on-month print next month (it's definitely something to consider) could that undermine the transitory camp if inflation remained at 5% or even edged higher? Honestly, I don't know, but it is worth thinking about.

And what is the outlook for the USD while all this continues? For domestic US investors, I don't believe the outside world still looks particularly attractive right now and if all this liquidity were about to undermine the USD with a big outflow, I think it would have done so by now, instead of piling up in reverse repos earning 0%. Clearly, though, and as Padhraic has also written, there is some overseas interest in US Treasuries even at these lower yields which is helping to keep yields from rising, but which may also put a floor under any downside in yields. Simply put, last night's data did little to rock the USD, and a further range-trade short-term seems as likely as any other forecast. Which means a similarly dull outlook for most of the Asian currency pairs for the time being also probably beckons.

Prakash Sakpal has written the following on events closer to home in Asia:

"**Singapore** announced an easing of some of its Covid-19 restrictions on Thursday as the number of daily community infections dropped to low single digits and imported cases remain contained. Starting 14 June, the limit on people for social gathering will be increased from two to five, that for big events to be increased from 100 to 250, indoor mask-off activities will resume and malls will be able to accept more shoppers. However, restaurants will remain closed for dining-in for another week (starts on 21 June) and schools remain shut, while work from home continues to be the default. The relaxation may bring the economy back towards a path to recovery, though a moderate hit to growth in the current quarter looks inevitable. We recently cut our forecast of 2Q GDP growth to 12.2% from 14.2% but maintained the full-year 2021 growth view of 4.9%, which is within the government's 4-6% forecast range for this year.

Malaysia and **India** report industrial production figures for April today. As for the most other economic indicators lately, a sharp plunge a year ago explains forecasts of outsized year-on-year IP surges this April – ING forecasts 38% YoY for Malaysia and 67% for India. However, tighter Covid-19 restrictions, as these countries experienced new waves of pandemic, certainly depressed production. We believe the market will see through this data and instead focus on developments on the Covid-19 front. With daily caseloads running over 5,000 currently, Malaysia is far from easing its nationwide movement restrictions, implying a prolonged hit to the economy ahead. The same can be said about India where daily cases have slowed below 100,000 but that's still big enough to sustain the risk of new waves ahead".

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