No negative rates

US Fed's Powell says "no" once more to negative rates, but is this all that is unsettling the markets?

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Markets looking nervy

The S&P500 fell further overnight setting us up for a risk-off tone in Asia today. Yesterday, I wrote that the equity market is hard to knock down, and stays resilient right up to the point where it is standing on the abyss and realizes there is no safety net any longer. I'm still not sure we are at that point yet. The last 48 hours have given us nothing new to digest. But then again, this crisis feels like more of a marathon than a sprint, and just maybe there are some runners out there who aren't built for the relentless slog that battered earnings and a painfully slow recovery will offer, irrespective of the amount of fiscal stimulus and virtually free money sloshing around the system.

Moreover, I'm no technical analyst, but even I can see how well the latest sell-off, recovery and renewed downturn are mapping onto Fibonacci levels, and unless I'm very much mistaken, we are sitting just above the bottom of a double top. Equity futures suggest that we will hold these levels, which could set up markets for more buying on dips. But the mood, which is so important for the equity sphere, seems to be changing perceptibly. This morning's newswire headlines are full of comments from top investors sounding pessimistic on the outlook for stocks, as well they might. The facts of the matter support a much lower market than is in fact the case. But the market mood has been by far the more important factor than (for example) the more than 30 million jobs lost in recent months, and that mood is what we should continue to monitor because moods are not substantial - they are built of fairy dust and can evaporate for no apparent reason.

No to negative rates

One factor that might not be helping market sentiment is the continued rejection of negative rates by the Fed. James Knightley in New York has written in more detail here on the Fed's latest economic assessment.

In a virtual conference with the Pieterson Institute yesterday, Fed chair, Jerome Powell, once more indicated that the Fed was not considering negative interest rates as an option. Personally, I'm with Powell on this. But I was a little surprised to see a number of research papers from some well known US banks and fund management companies suggesting that negative rates for the $4tr US Money Market industry might not be the disaster it sounds to me. Much of this is based on the experience of similar funds in Europe. And I'm not sure the comparison holds, given the much more important role played by Money market mutual funds (MMFs) in market liquidity provision in the US. I will write at greater length on this shortly, but for balance, here is a positive note on negative rates from Kenneth Rogoff as part of our "Think Outside" series, which I totally disagree with. So who are you going to believe? Rogoff or me? Don't answer that.

I'd add that it is not even clear if it is legal for the Fed to pay a negative rate on its reserves, as this paper from the St Louis Fed notes.

The St Louis Fed paper also quotes former Fed Chair, Ben Bernanke, who argues that the mere possibility of negative rates could have the effect of keeping the expected path of short-term rates more negative than otherwise. This could be right out of the playbook from the Reserve Bank of New Zealand's Governor, Adrian Orr, who yesterday expanded New Zealand's QE programme and also kept the door open to other policy moves, including negative rates. We don't think he will implement such a policy, but it probably doesn't hurt to have the market thinking that he might, especially if it helps keep yields over the entire yield curve low and the NZD soft.

Today in Asia Pacific

Australian labour market data is out later this morning, and it will look quite horrible. Anything between a few hundred thousand to a million job losses in April is the market view, so its really just a question of degree. But as the Reserve Bank of Australia has already pulled back from its QE programme slightly, and with copious fiscal stimulus in the pipeline, its hard to see this having a big market impact, aside from any temporary knocks to the AUD and government bond yields that may follow a weaker than expected number.

In the Philippines, Nicky Mapa notes: "The cabinet revised official economic projections for 2020 and 2021 in the wake of the Covid-19 outbreak with GDP expected to drop to -2.0 to -3.4% in 2020 before rebounding sharply to 7.1-8.1% in 2021. Government officials also expect the budget deficit to widen sharply to -8.1% of GDP on the projected drop off in revenue collection and increases in spending to offset the economic downturn. Bond yields have remained subdued due to BSP’s aggressive rate cuts and benign inflation (April inflation at 2.2%) but we expect the Treasury to begin issuing longer-dated bonds once the 2-month lockdown is lifted to help finance the planned fiscal rescue bill".

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