



# A Rafter of Market Themes

9<sup>th</sup> September 2020

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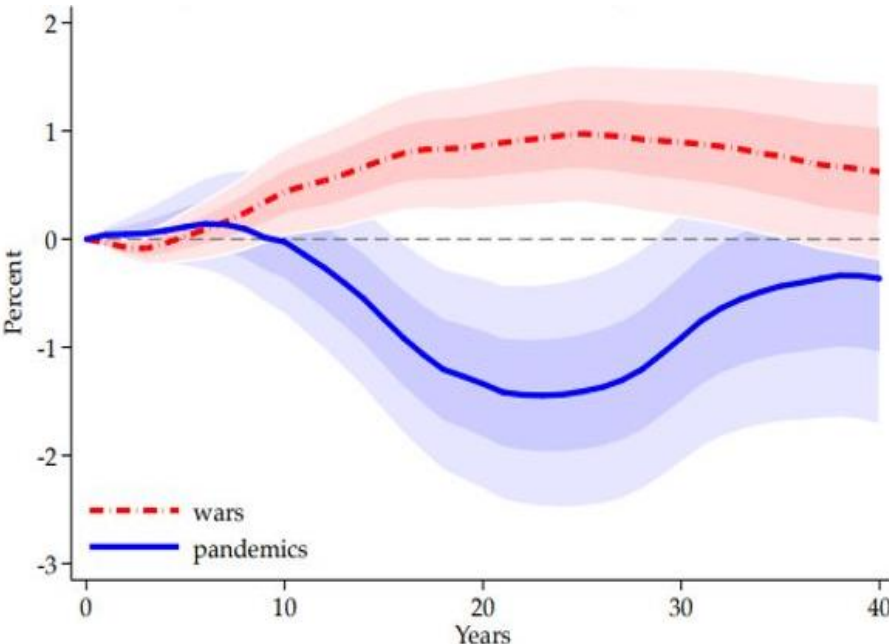
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# Cementing an era of depressed growth and real rates

## Pandemics depress real interest rates for prolonged periods

European real natural rate of interest following pandemics and wars



## A half-century explosion in debt underpins global economic fragility

Contributions to global debt, % of GDP

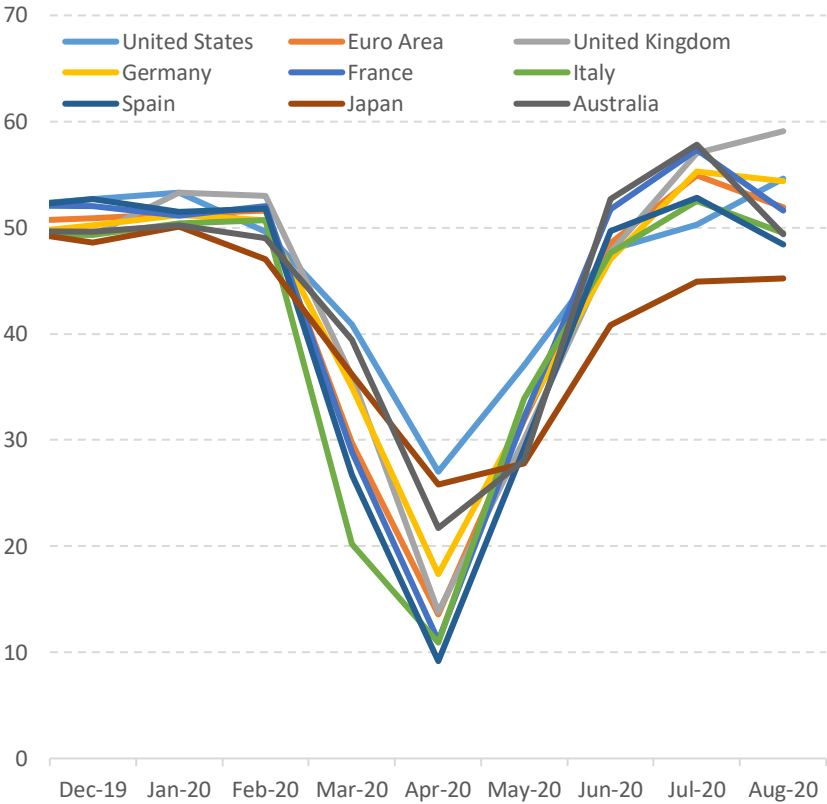


Source: Federal Reserve Bank of San Francisco, IMF calculations. Shaded bands are 1 and 2 standard error bands.

# As growth falters, financial repression prospers

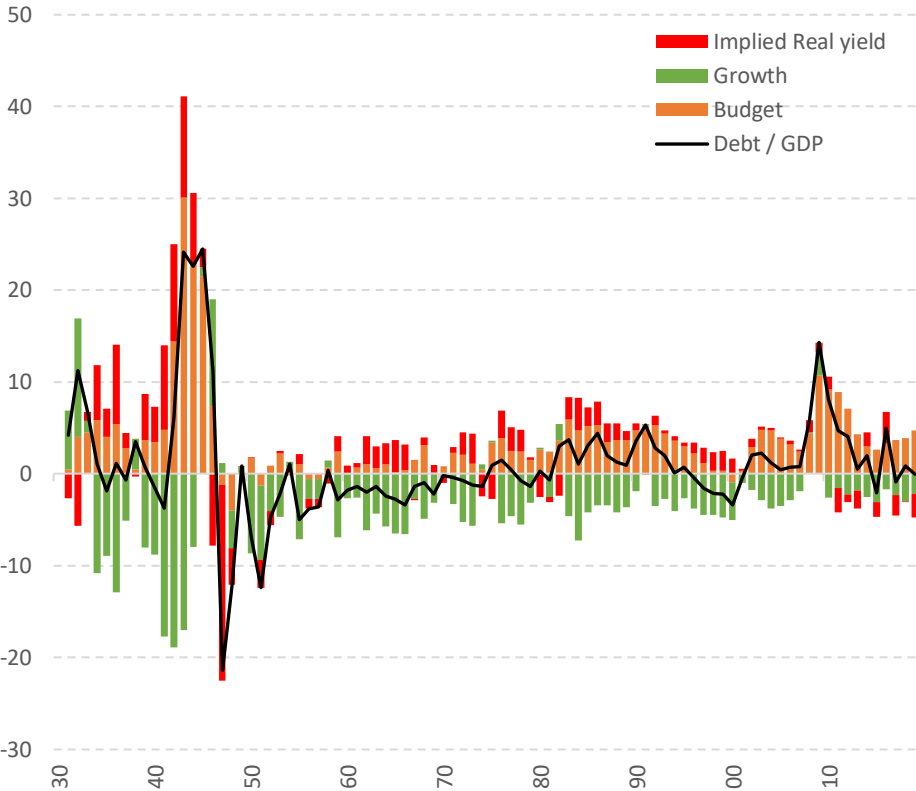
## The economic recovery is losing its steam

Markit Composite PMIs



## As growth falters, financial repression a tried and tested strategy

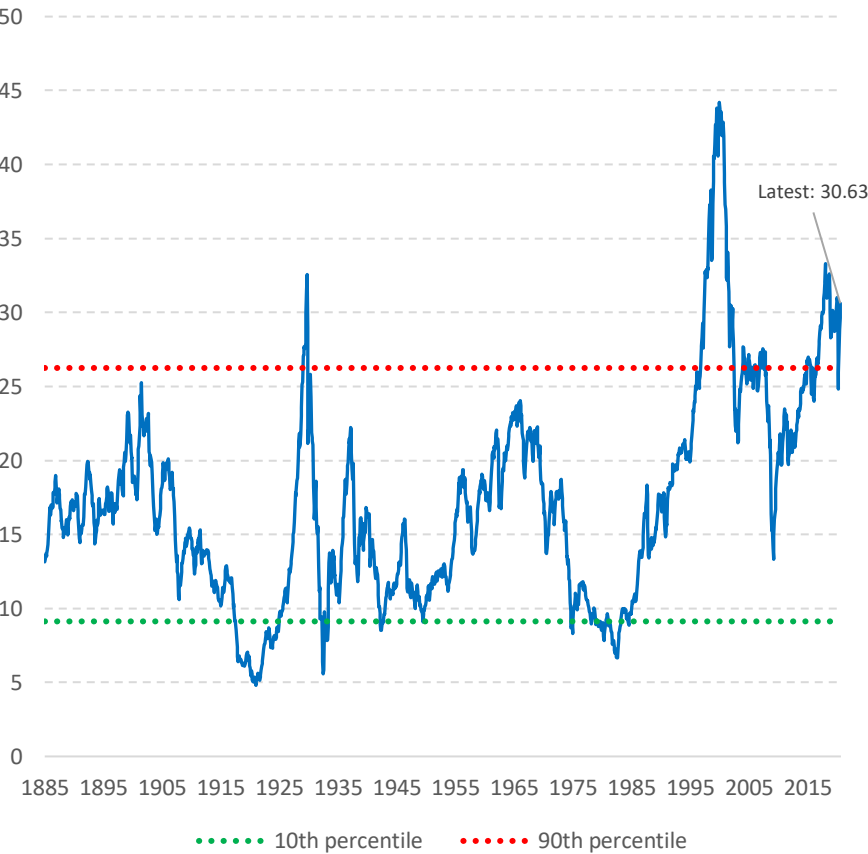
US contribution to debt stock as % of GDP



Source: Record, Markit, Federal Reserve Bank of San Francisco.

# Yet markets priced optimistically

**Thrice in a century has CAPE been here**  
Cyclically adjusted P/E on real S&P 500



**US high yield spreads divorced from reality**  
ICE BofAML option-adjusted spread, basis points

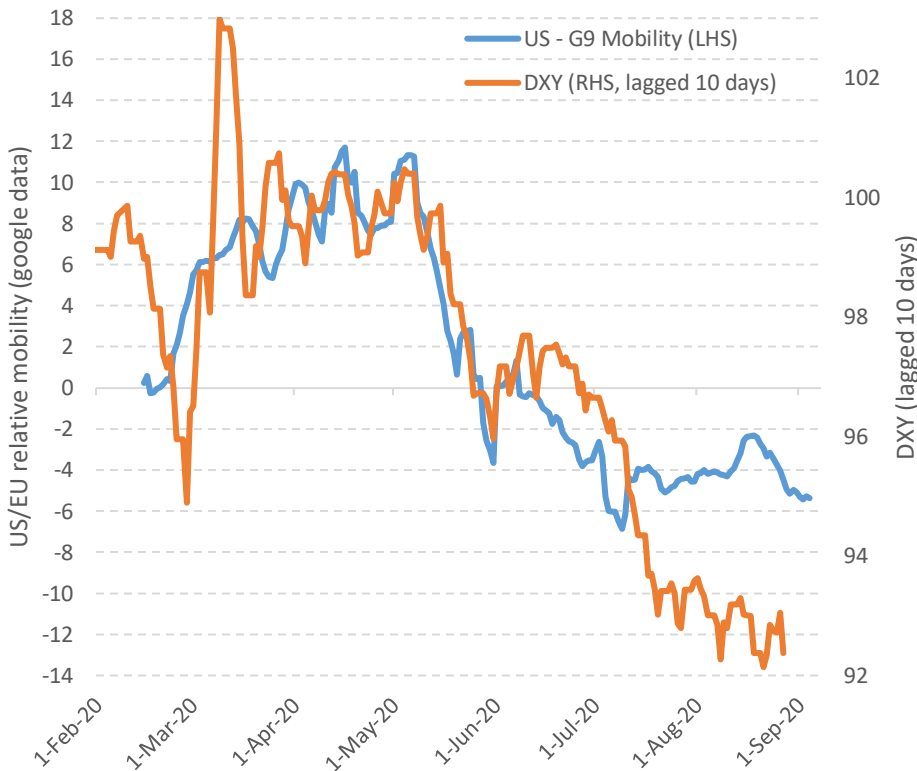


Source: Record, Shiller, Macrobond.

# The US dollar hasn't lost its hegemony yet

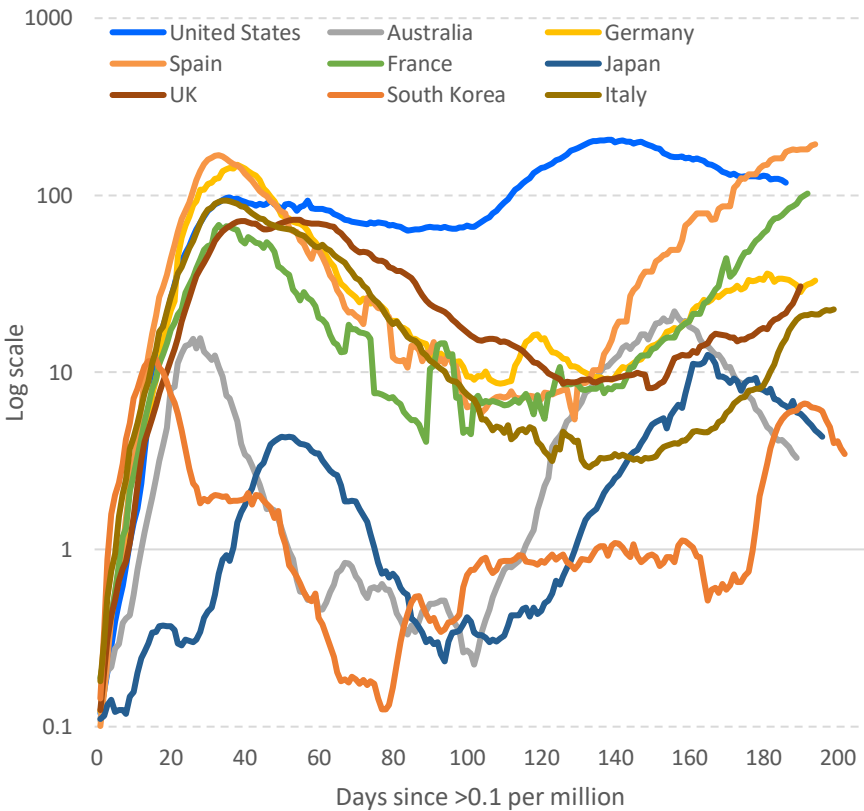
## USD a function of relative COVID dynamics and financial conditions

US dollar index and relative mobility



## US COVID-19 cases stabilising as European cases grow

7-day rolling average daily cases per million

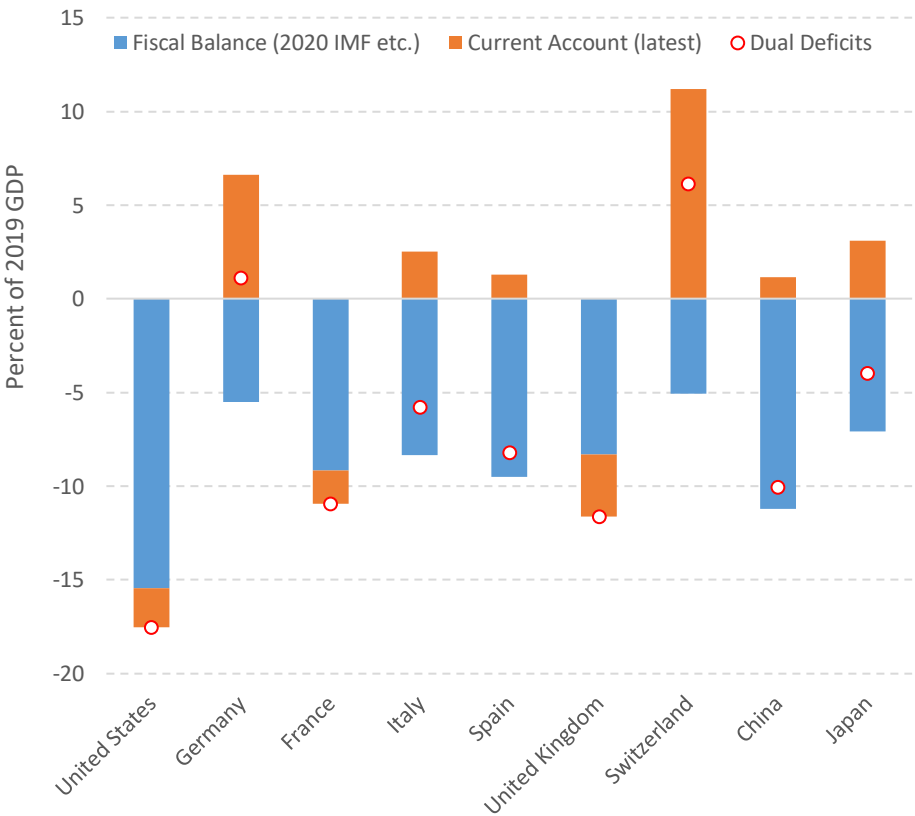


Source: Record, Google mobility reports, European Centre for Disease Prevention & Control.

# No challengers for reserve status

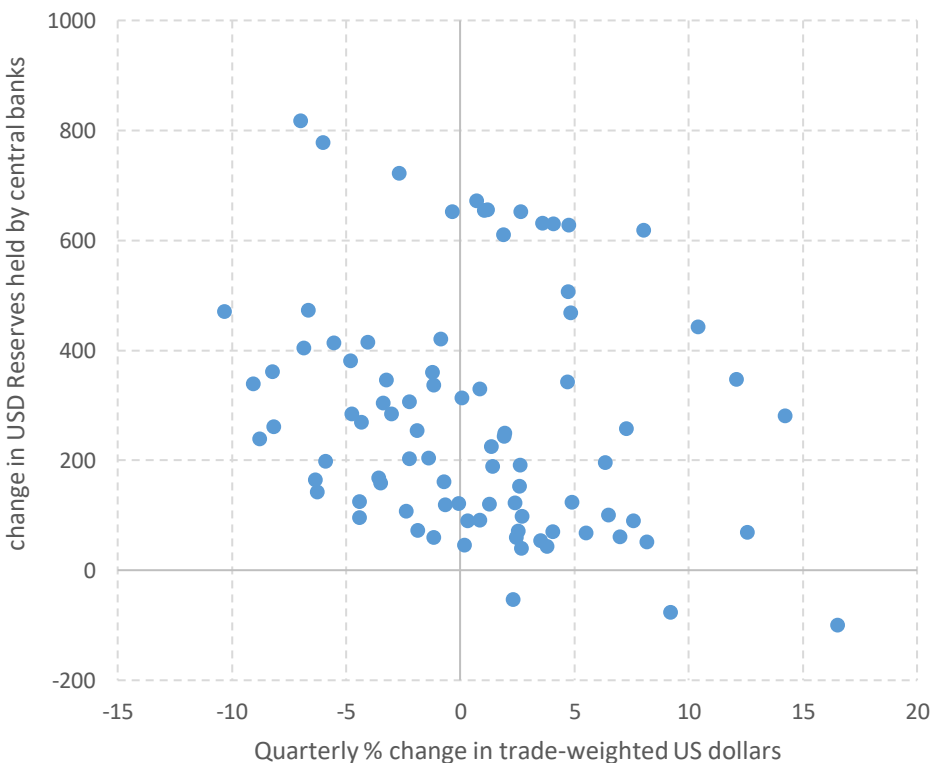
## US is a large economy with an open capital account

General government balances and current account deficits, % of GDP



## Central banks accumulate *more* reserves when USD weak

Trade-weighted USD (% y/y) vs. USD COFER reserves (y/y)



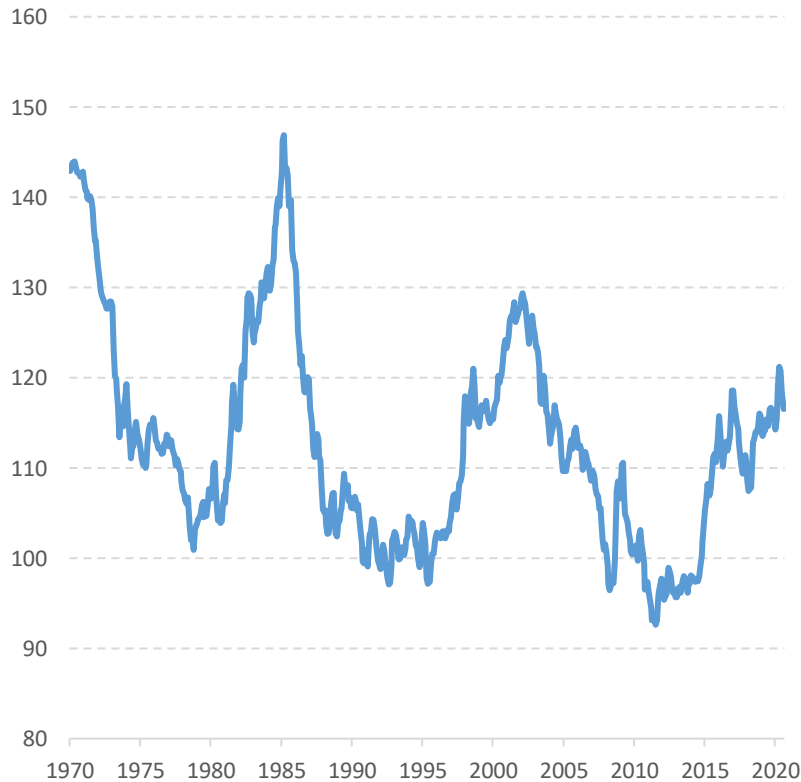
Source: Record, Macrobond.

# USD down cycle requires exceptionalism elsewhere



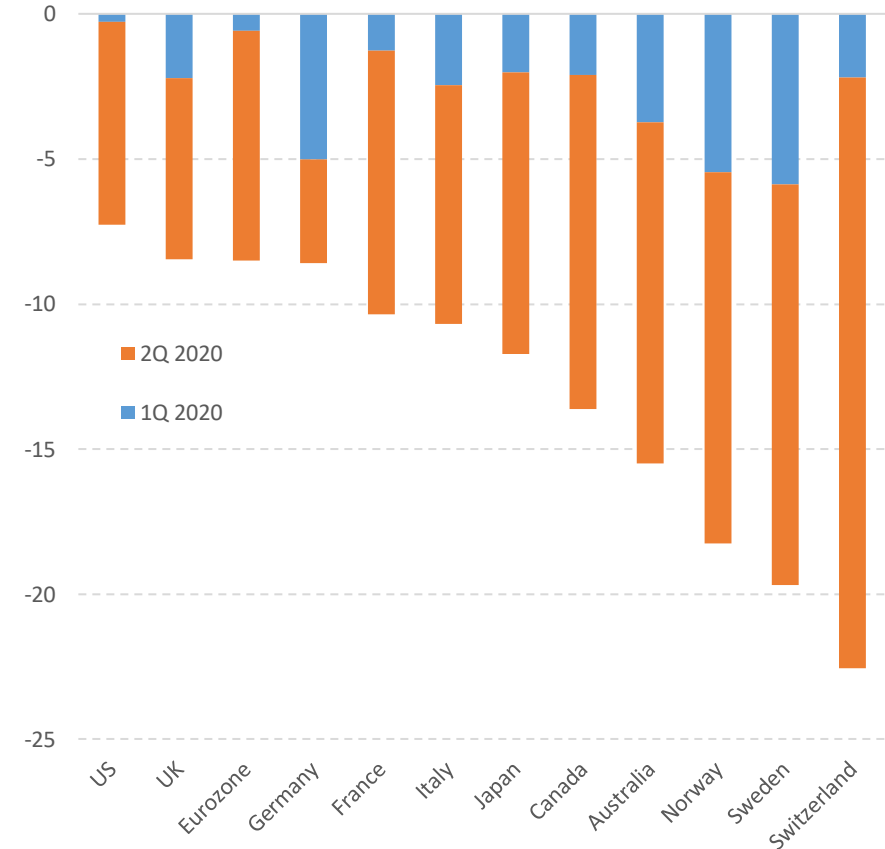
## Secular downtrend in dollar yet to be confirmed

US real effective exchange rate



## The US: best of a bad bunch?

1H 2020 GDP growth, % quarter-on-quarter

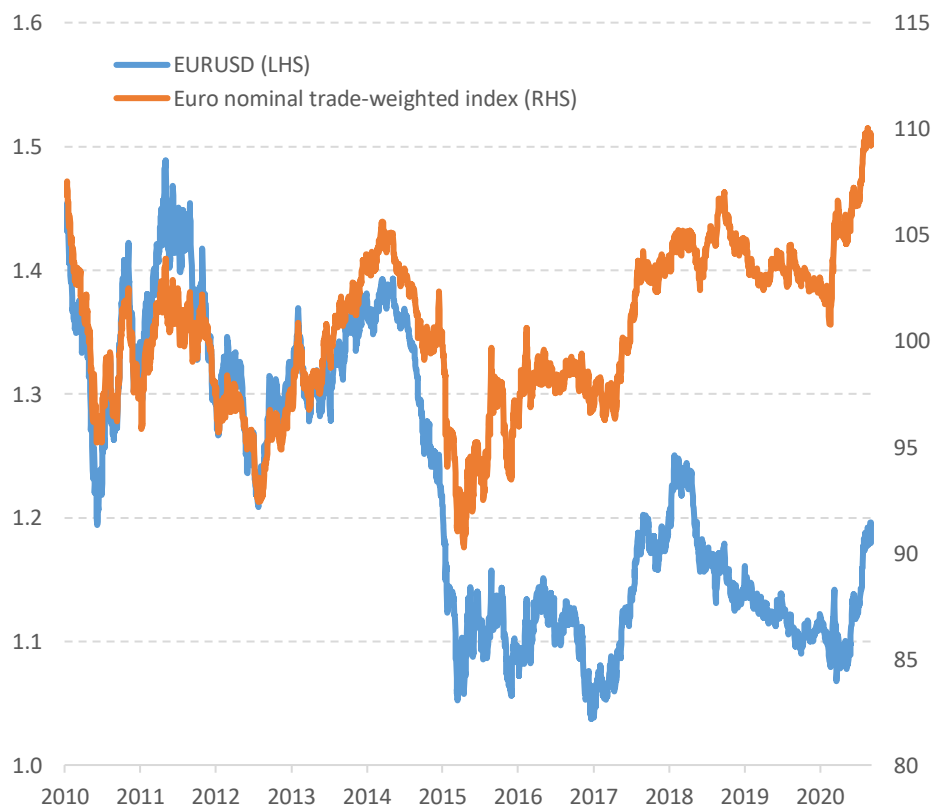


Source: J.P. Morgan, Record, Macrobond.

# The euro's strength should concern the ECB

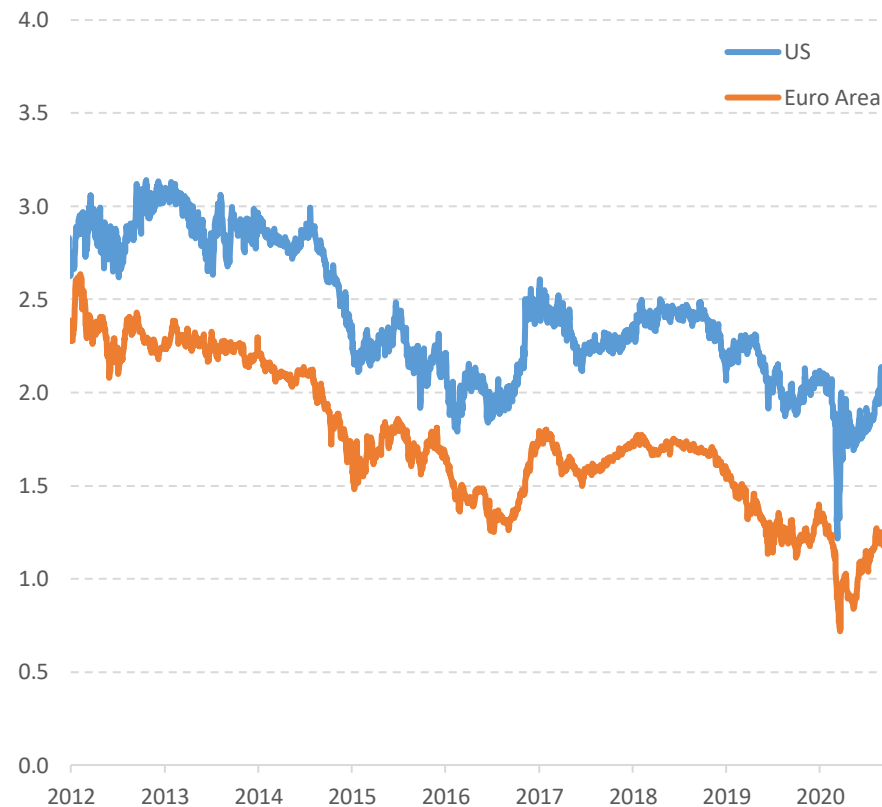
## Strong trade-weighted euro a worry for the ECB inflation mandate

EURUSD and trade-weighted euro



## The ECB should act to avoid a deflationary mindset

US and Euro Area 5y5y inflation swaps (inflation expectations)

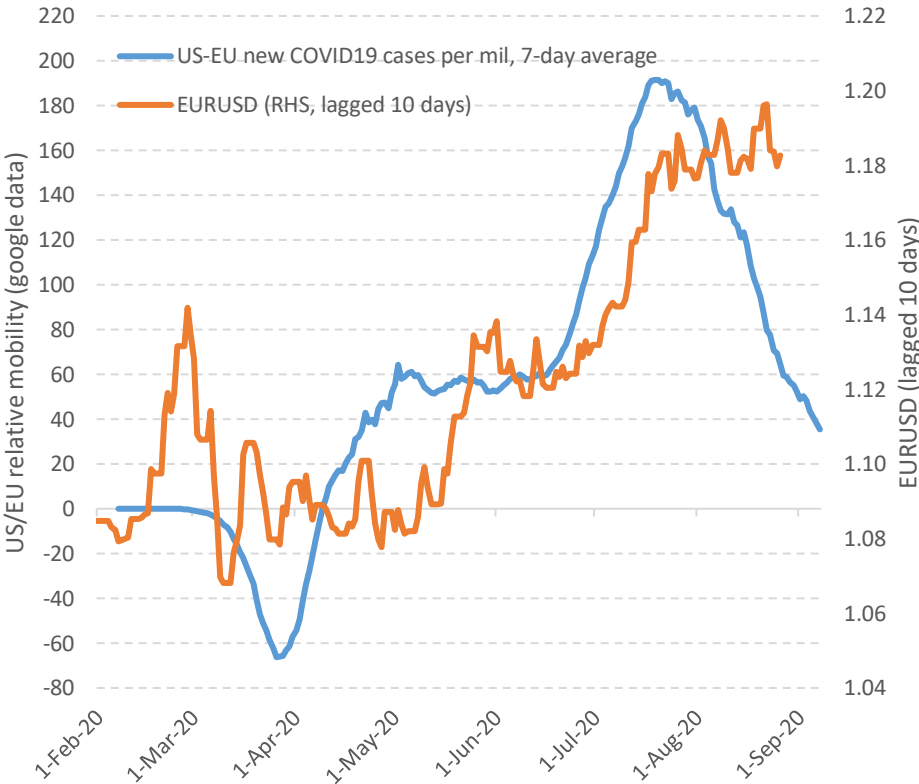


Source: Record, J.P. Morgan.



# Euro optimism excessive

**Relative COVID-19 case curves reversing in favour of US**  
Relative COVID-10 new cases and EURUSD



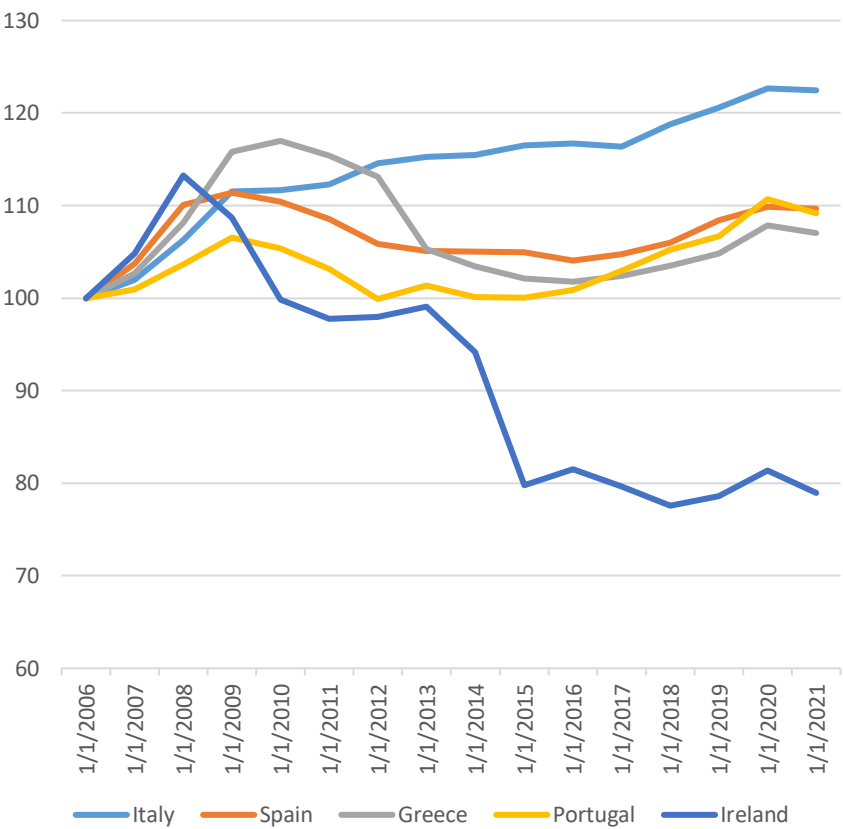
**Investors positioned for Eurozone dynamism**  
Net Non-Commercial futures positioning (% open interest)



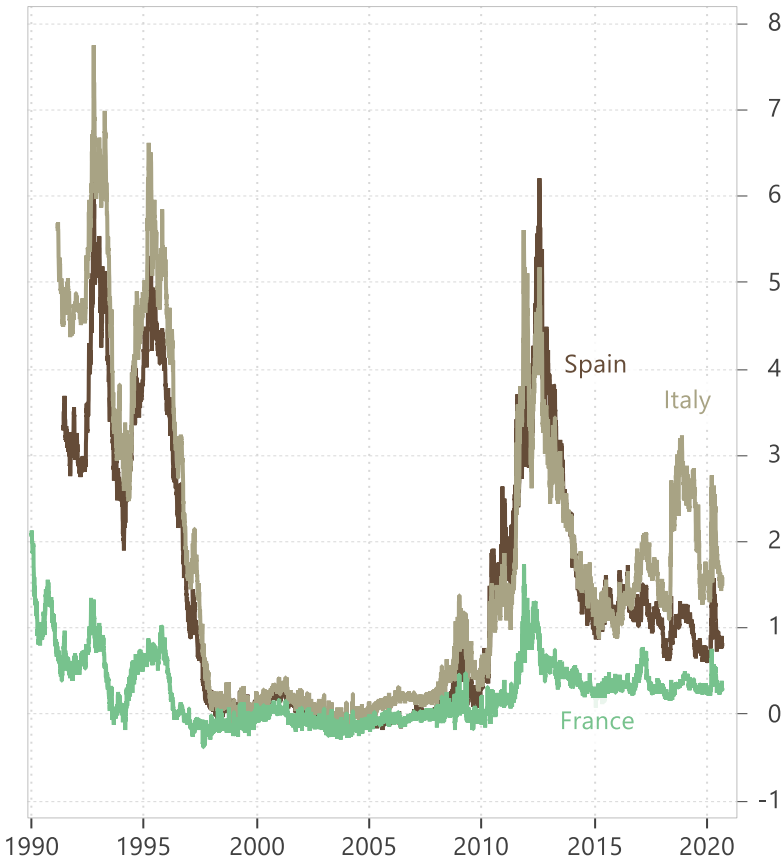
Source: Record, CFTC, Macrobond.

# Italian and peripheral spreads mispriced

**Italy has been unable to adjust competitiveness**  
Unit labour costs index, 2006 = 100



**Peripheral spreads**  
10-year government yields minus Germany 10-year yield

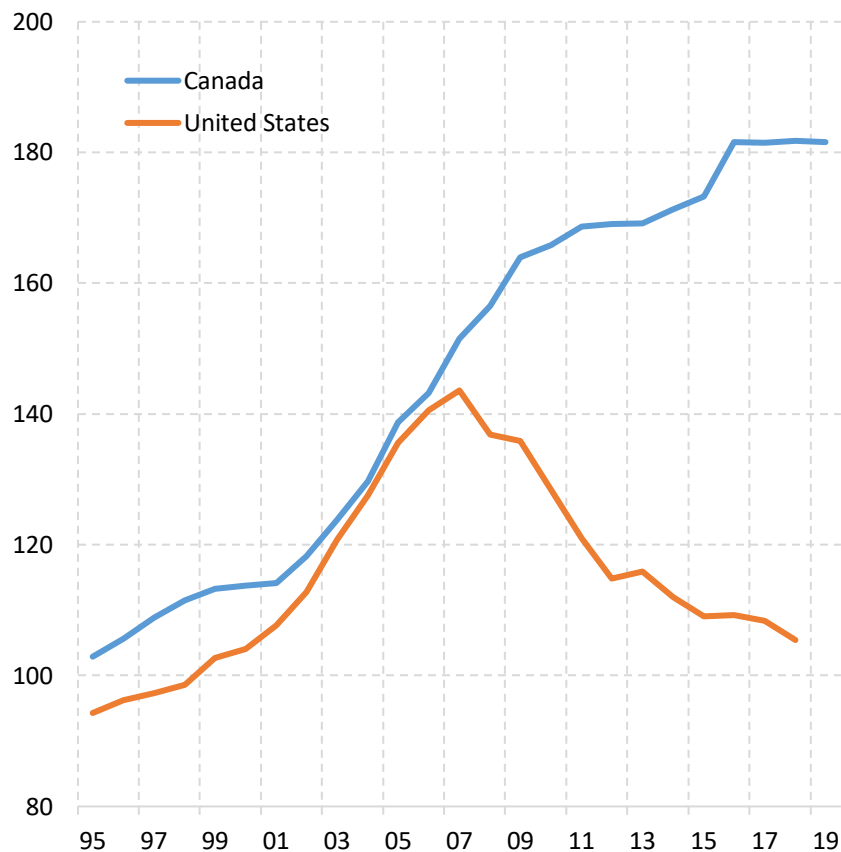


Source: Record, Macrobond.

# Canadian maple leaves late to bloom early to fall

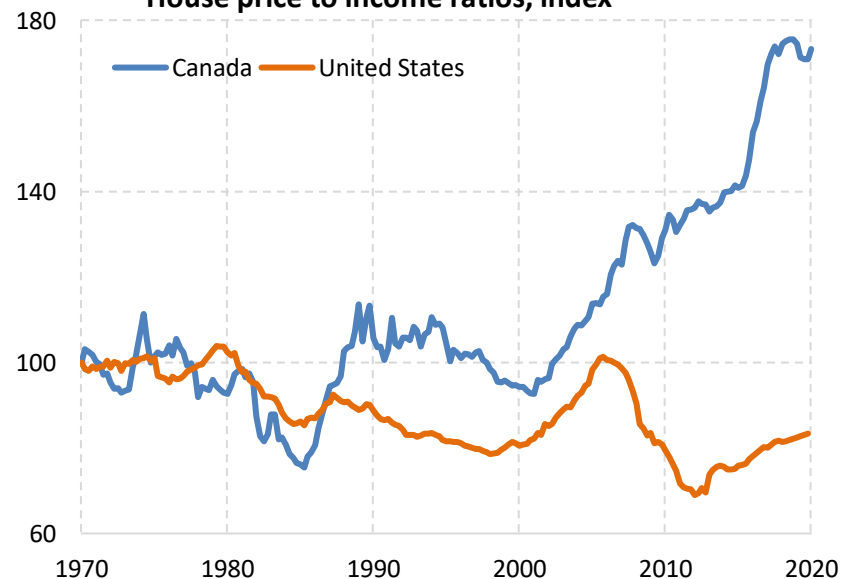
RECORD

Household debt % of disposable income



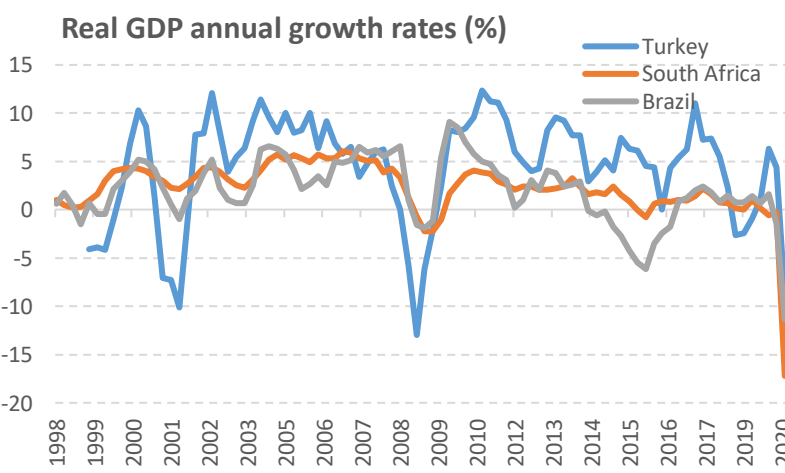
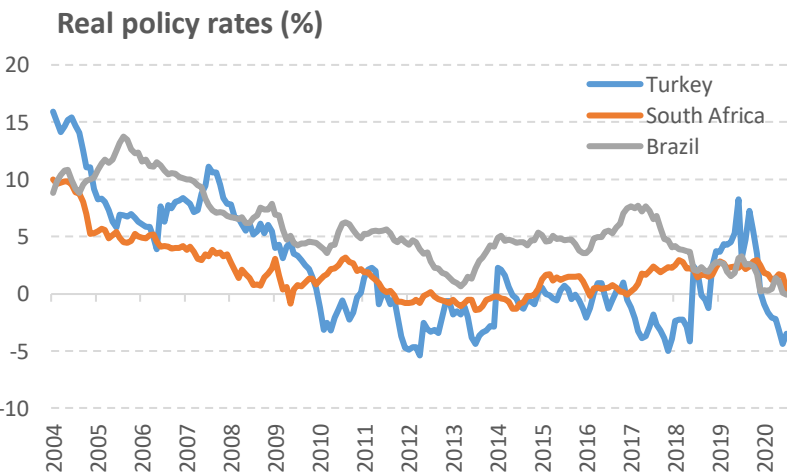
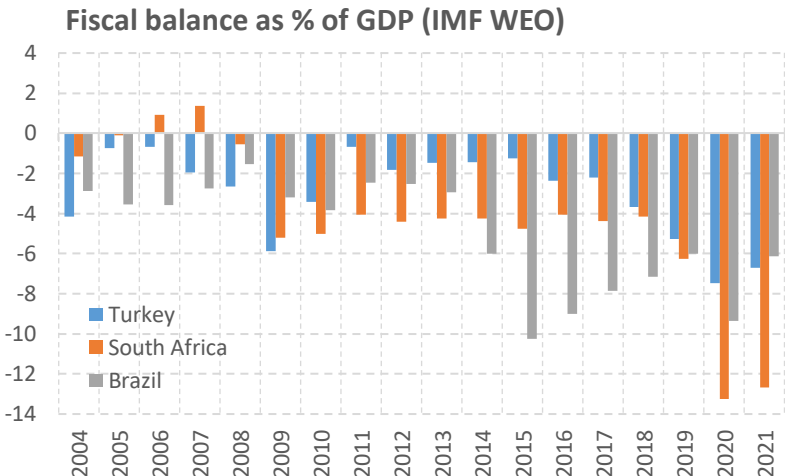
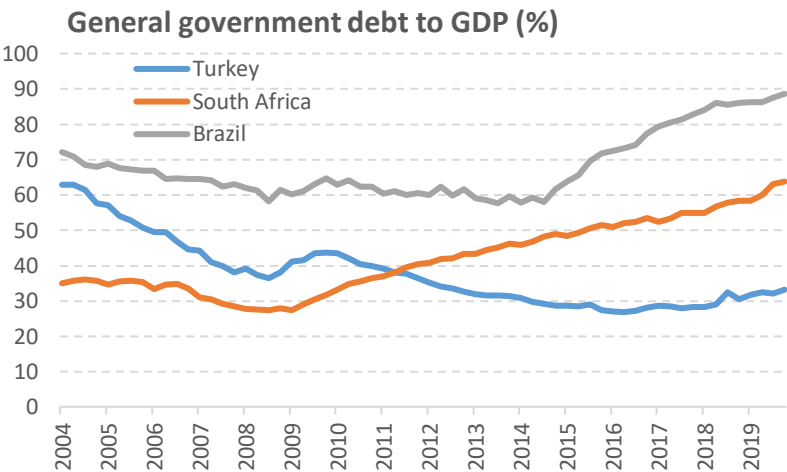
- Canadian household debt is particularly high
- Residential debt to equity has grown from c. 1x pre-GFC to c. 1.5x
- CMHC downside economic scenario sees house prices drop by 18%
  - Corresponds to c. 45% loss of homeowner equity
  - Knock-on effect of approx. 2.2% drag on consumption, 1.3% drag on GDP growth

House price to income ratios, index



Source: Record, StatCan, Macrobond. "Changes in wealth across the income distribution, 1999 to 2012", Uppal, LaRoche Côté (2015).

# The challenged three – Turkey, South Africa, Brazil

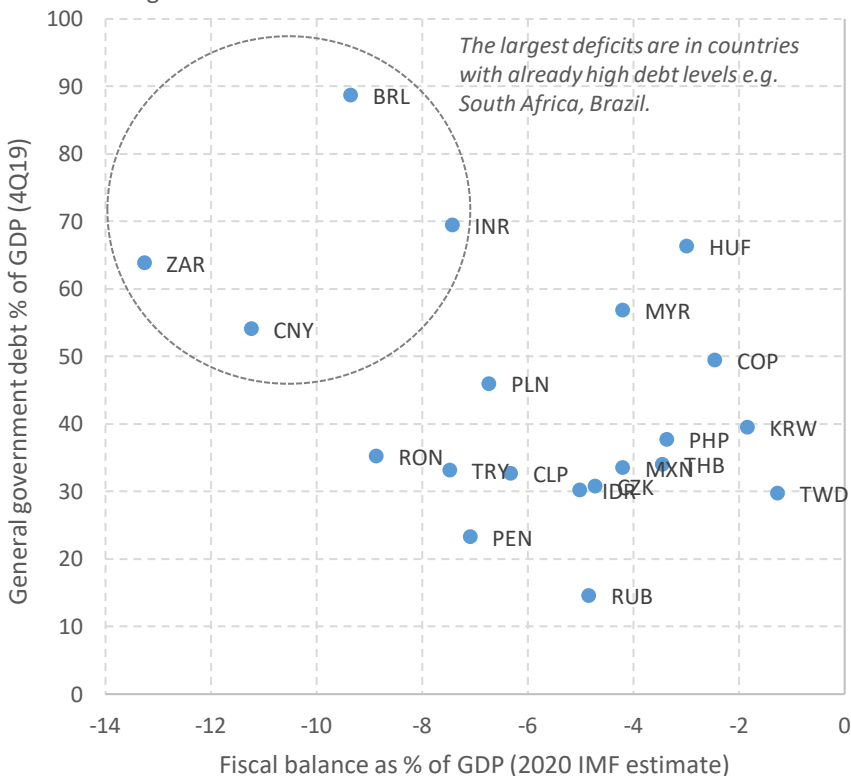


Source: Federal Reserve Bank of San Francisco

# Pandemic exposes vulnerabilities within EM

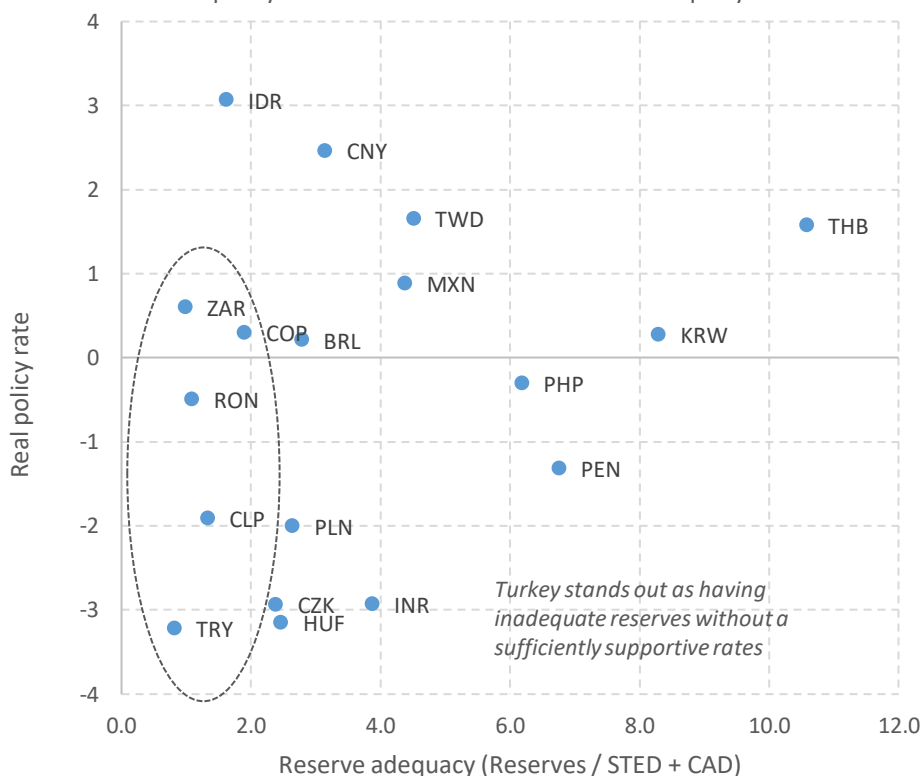
## Debt / Deficit dynamics worrying in some EMs

EM government debt vs. fiscal balance



## Some facing choice between economy and external stability

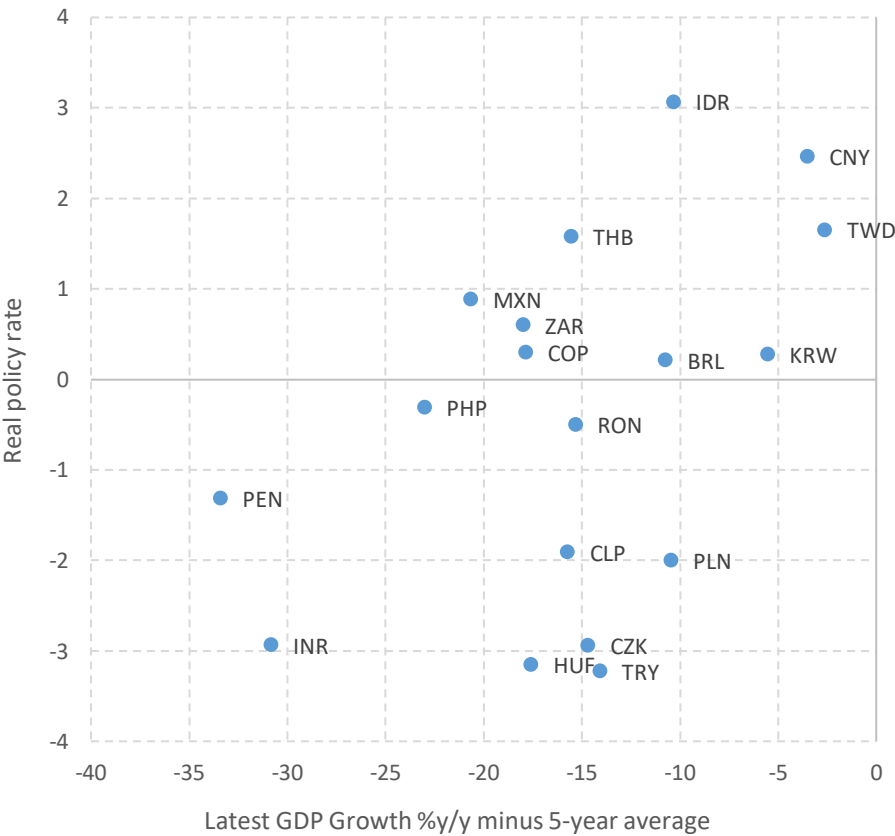
EM real policy rate versus international reserve adequacy



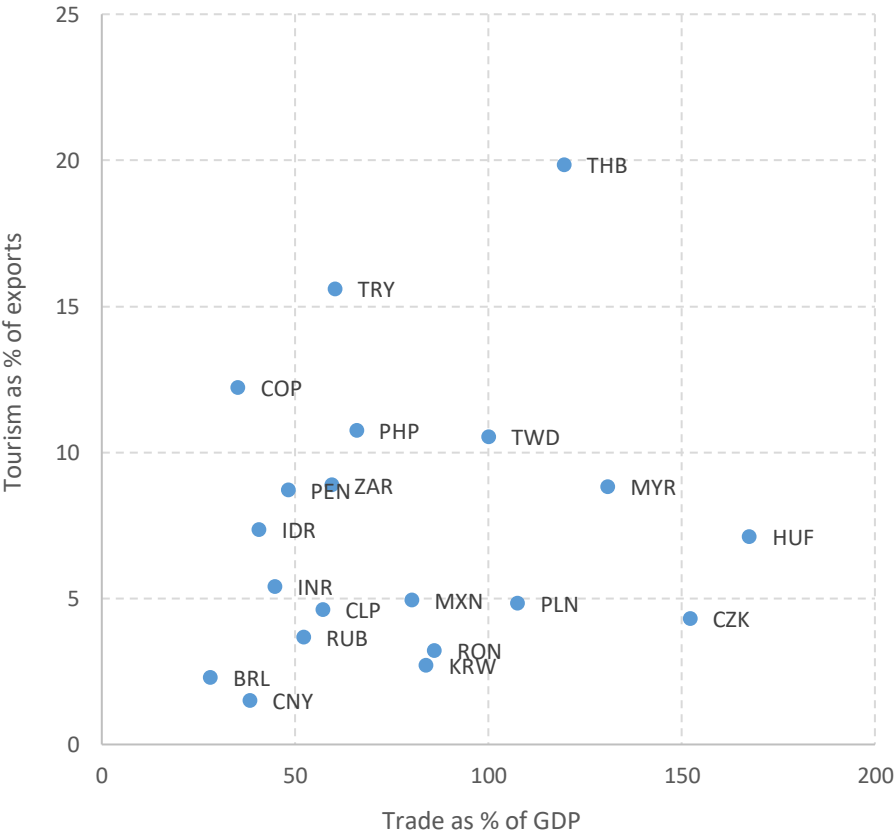
Source: Record, Macrobond.

# Real policy rates

**Real policy rates correspond to economic damage**  
EM real policy rates and economic growth vs 5-year average



**Damage likely lasting in open, tourist-dependent countries**  
Trade openness and tourism as % of exports

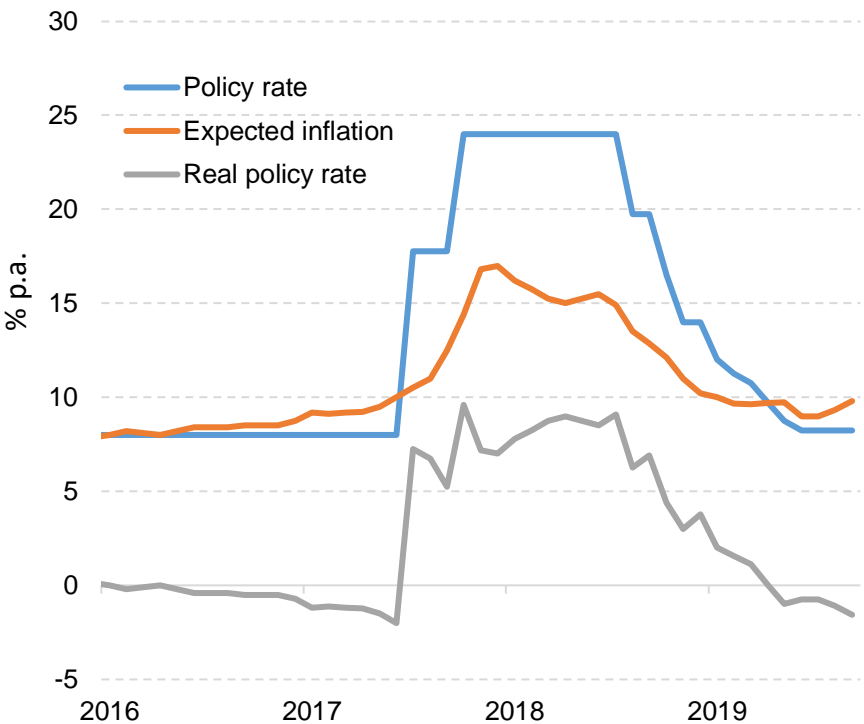


Source: Record, Macrobond.

# Stuffed Turkey?

## Negative real rates and excess credit

**A dollop of negative real rates....negative for the first time since 2017**



**Go easy on the credit...TRY loans and money supply have exploded**



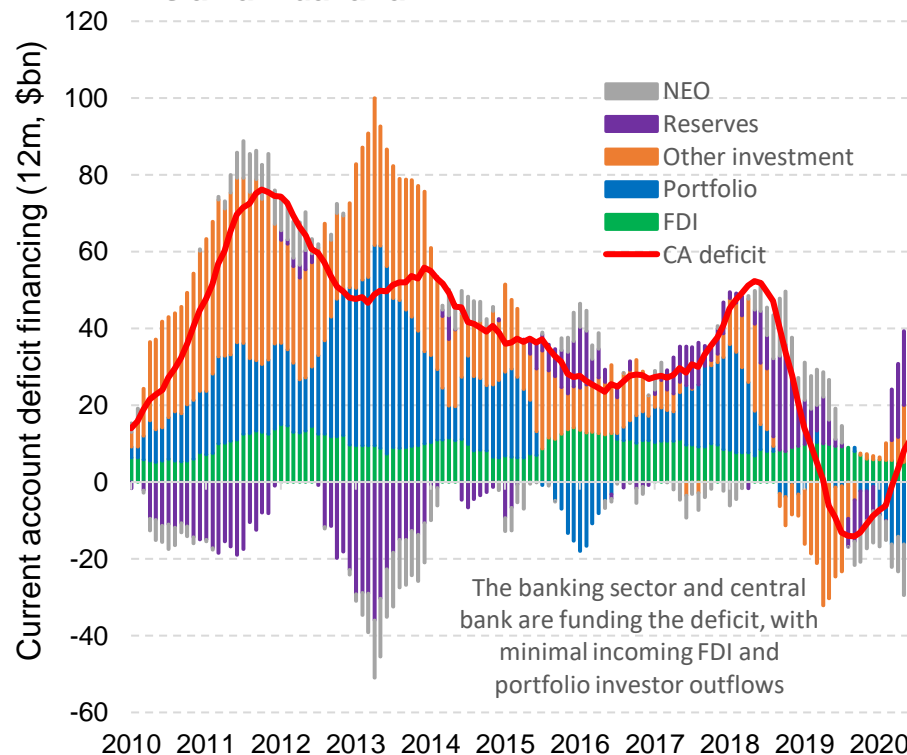
Source: CBT.

# Stuffed Turkey?

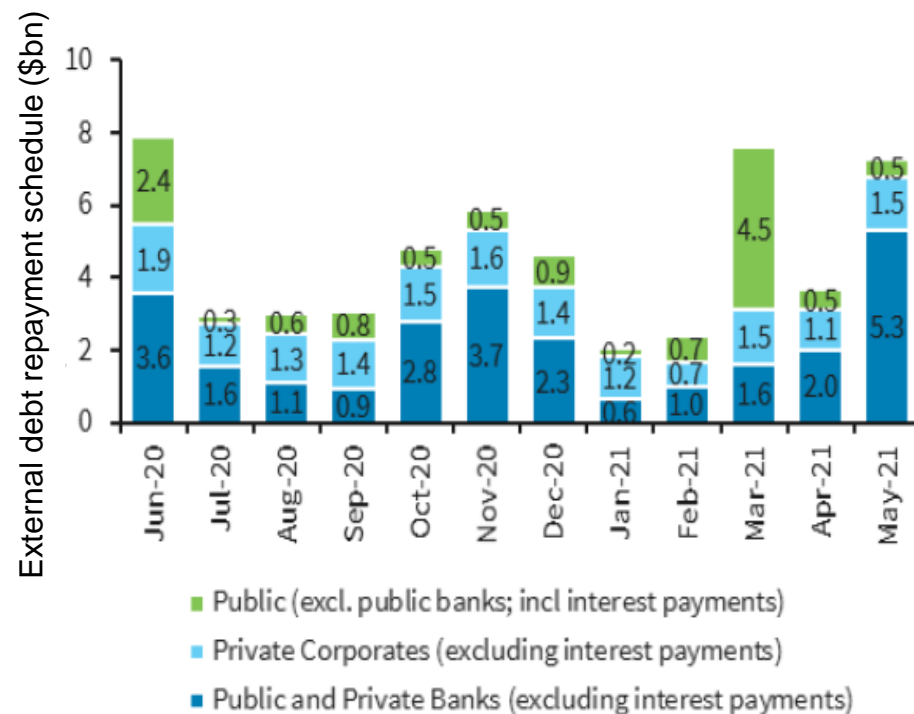
## Debts and deficits

RECORD

**A sweet tooth for deficits...funding the deficit is an annual affair**



**And a history of external indulgence...that needs to be rolled over**



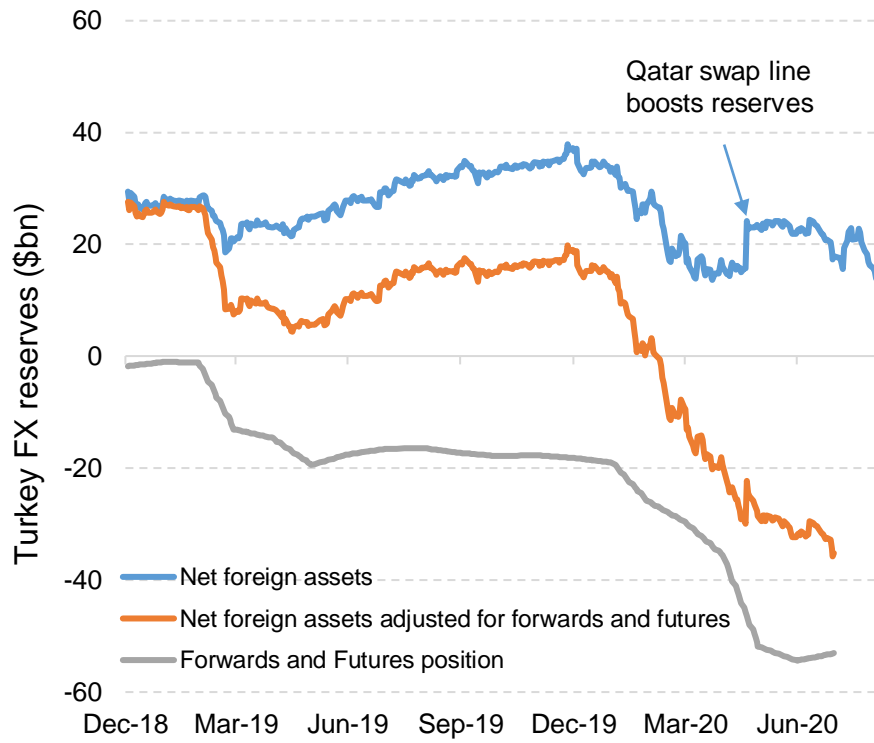
Source: CBT, Barclays. Note: NEO stands for net errors and emissions, FDI stands for foreign direct investment, CA stands for current account.



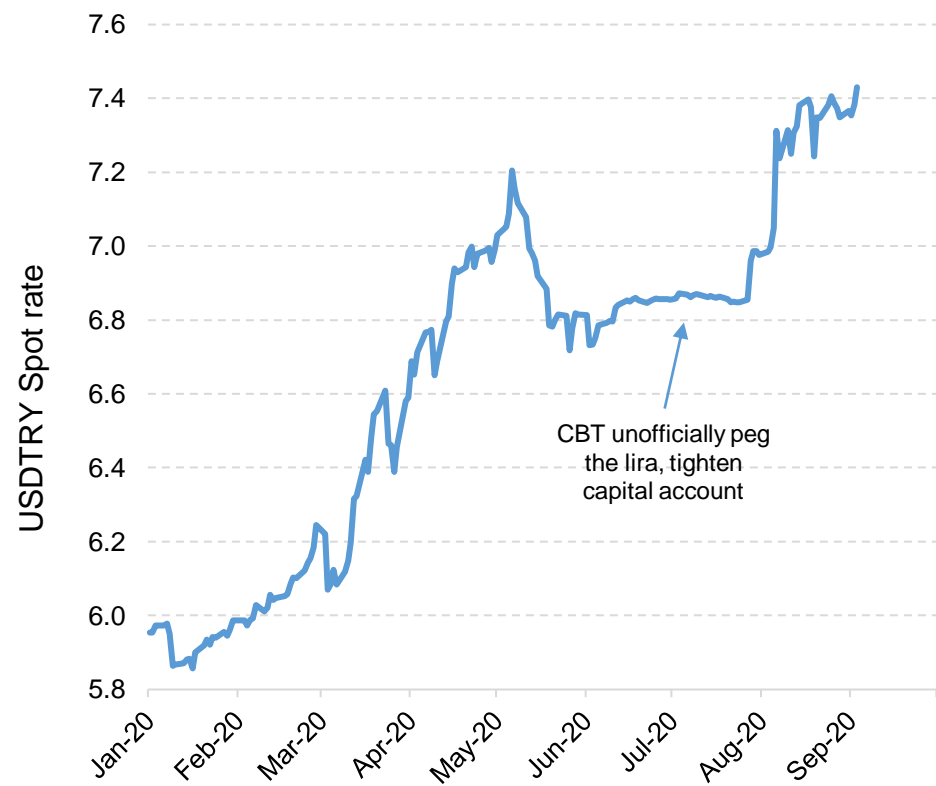
# Stuffed Turkey?

## What reserves?

**Nothing organic about these reserves...as net reserves are now negative**



**Market forces coming home to roost ...the heat at 7.0 is demagnetizing**



Source: Macrobond, IMF. CBT swap book based on monthly data, interpolated through the month.

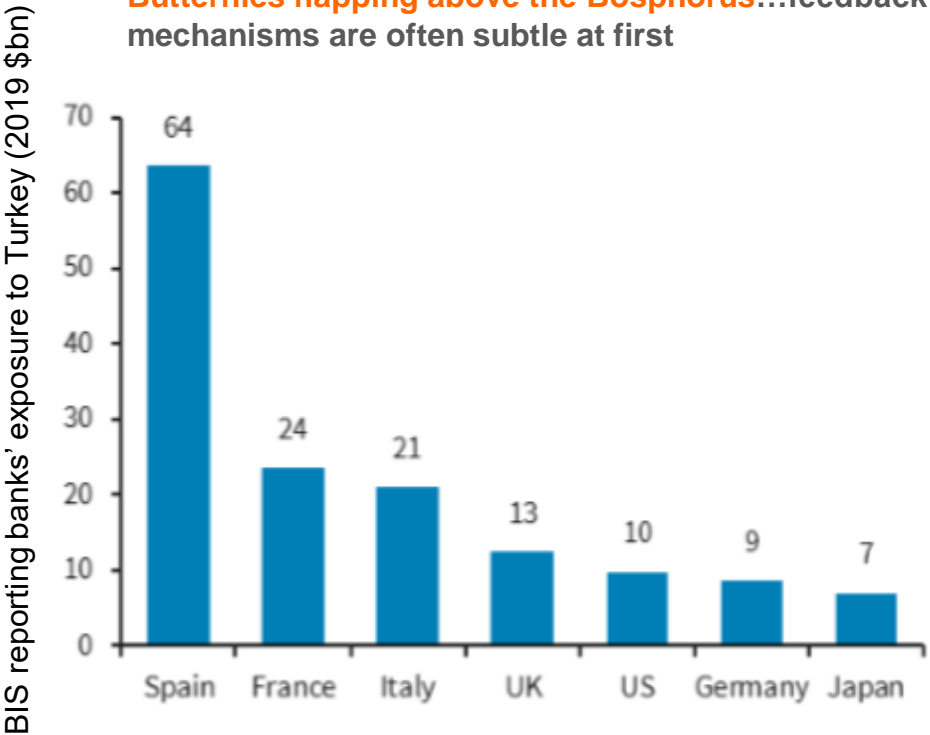
# Stuffed Turkey?

## The banking sector

**More cooks in the kitchen...** Turkish banks utilised to stabilise currency



**Butterflies flapping above the Bosphorus...** feedback mechanisms are often subtle at first



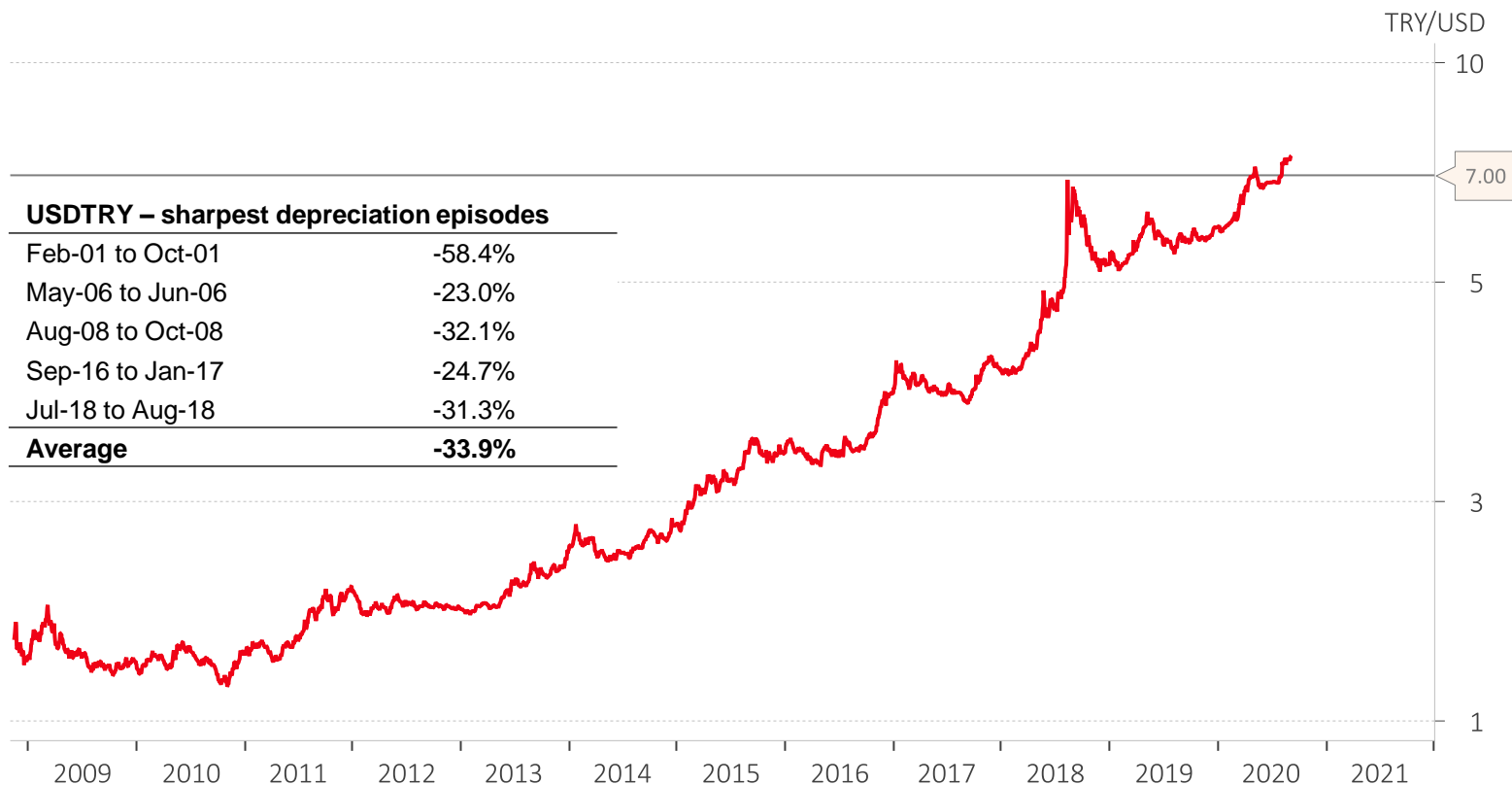
Source: Banking Regulation and Supervision Agency of Turkey, BIS, Barclays. Banking sector FX position includes both on balance sheet and off balance sheet positions.

# Stuffed Turkey?

## A history of depreciation episodes



USDTRY, log scale



Source: Macrobond.



## Additional information

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