BNY

iFlow
WEEK AHEAD

September 8, 2024

Safely Scared?

"Courage is being scared to death…and saddling up anyway." – John Wayne
"You can't stop being afraid just by pretending everything that scares you isn't there." – Michael Marshall

Summary:

Summer and horror movies used to be part of the drive-in theater meme of American baby-boomers this has all changed but for the entertainment of fear. That history of being scared, but being safely in a car or home or under-the-bed-covers screaming is as good a place as any to start thinking about last week and the week ahead for macro markets. The fear of a recession dominates the landscape for investors both in the US and abroad. The uncertainty of US policy both monetary and fiscal drive some of the concern. Fear that the FOMC is behind the growth curve, and still lagging a bit on inflation, leave stagflation risks. However, the last week's economic data show a less clear picture of such – with GDP estimates for 3Q around 2-2.5% and inflation still expected below 3%. The US exceptionalism that dominated the last 18-months isn't finished even as many would wish it so given flows into emerging markets and Europe. The week ahead will pivot on how the US CPI and US Presidential Debate play out in markets and whether the rest of the world can show better growth over the summer.

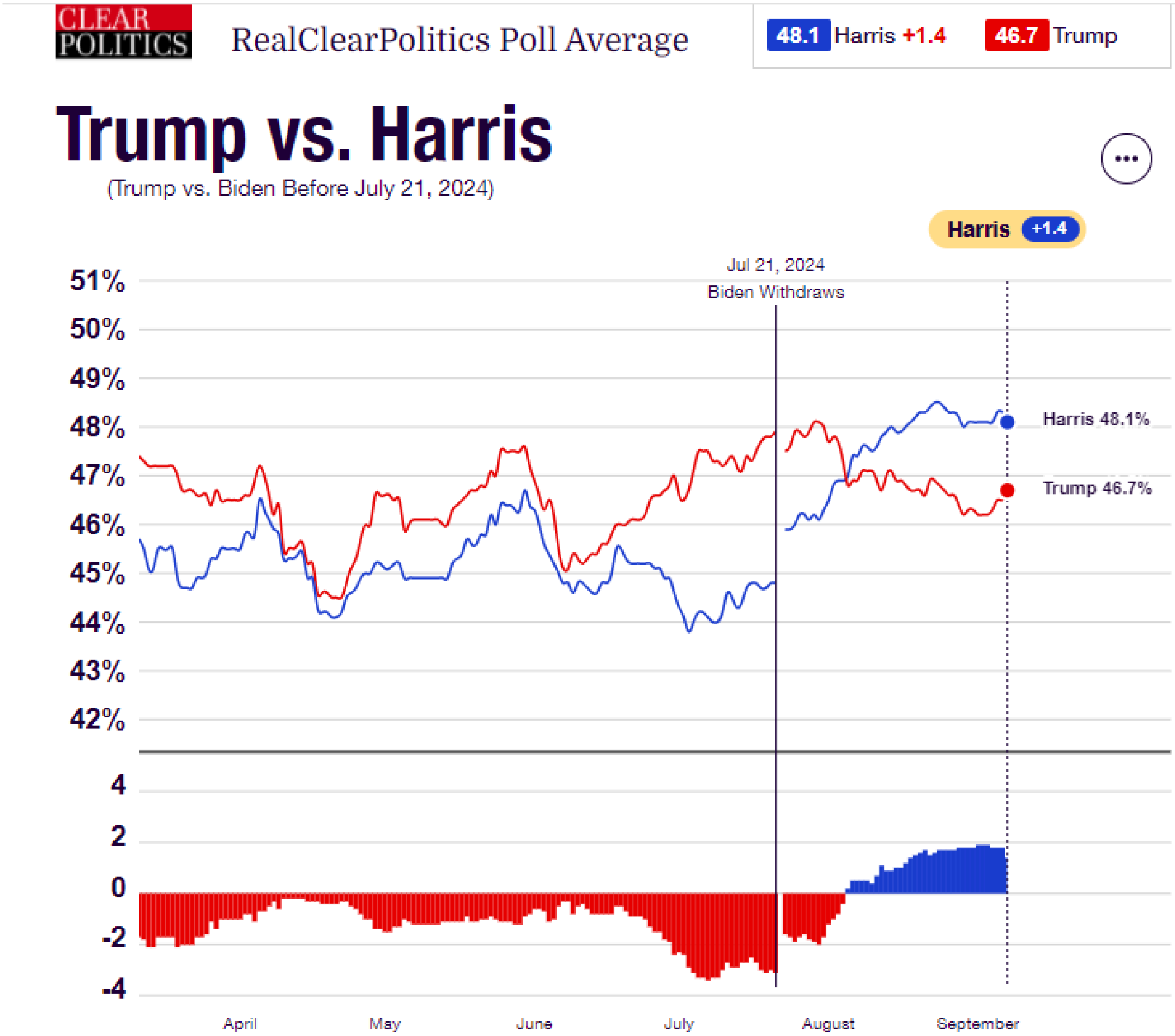
The most worrisome driver at the Friday close came from the selling of "safe havens." The weakness in US equities proved to be the worst week since March 2023 and that begs the return of cash for margin calls. Volatility follows. The Fed RRP saw a dip to $299.27 with about half the usual participants in it. The crypto favorite BTC fell 4-5% on the day back to $54k. While the central bankers' favorite

Gold fell off 0.8% (more than nickel or aluminum) to $2497 - this is also a market where USD is higher and where US bonds have given back some gains. Basically, front end holds the gains from the surprise of non-farm payroll revisions and that is it. The driver for fear ahead rests with politics and inflation and supply colliding in rate markets – which leave bonds hardly the right hedge against stocks.

Themes:

- **US soft-landing isn't dead.** The 3Q New York Fed GDP model comes in at 2.6%, while Atlanta is 2.1% . The Fed speakers didn't matter until Fed Waller who was clear in his approval of a cut but not so much for 50bps – leaving that debate to rage with Fed now on black out from press. His speech shifts the focus from inflation to jobless claims and retail sales in the US. So, the risk of CPI or some election noise moving markets ahead of the FOMC continues but few see the US risk to the upside. Any data that points to better growth could return markets to "good news is bad."
- **The US needs the rest of the world?** The hope for AI investment saving US productivity isn't dead but it's clearly being repriced. What does this for next week? Focus on growth in the rest of the world is going to matter as view that the US can't do it alone clearly dominates – the ECB rate decision will matter, as will the Japan GDP and Industrial Production data, China CPI, new CNY loans and trade, new EU GDP and CPI forecasts, UK GDP, trade and industrial production, US CPI/PPI and jobless claims, Mexico CPI, Sweden CPI, and India CPI. Leaving the key themes for the week ahead: 1) Growth anywhere helps will misses will be punished. 2) Equities can't find much comfort given bonds are already priced to a recession. 3) ECB and any other central bank commentary will be magnified given the FOMC blackout.
- **US Presidential Debate will set the election?** Markets want to know more about the race ahead and will closely watch the debate on September 10th to determine if the momentum for the Harris campaign continues. The election remains too close to call but the tails for control of Congress may be set by the perception of this event leading to some breakout moment, similar to the fallout from Biden/Trump on June 27.

Exhibit #1:US Polls remain too close to call



Source: RCP, BNY

What are we watching:

- **Economic Releases: Monday –** Japan GDP, China CPI, Mexico CPI; **Tuesday** – Australia business and consumer confidence, China trade, Norway CPI, Sweden GDP, UK Jobs, Brazil CPI; **Wednesday** – EU Commission forecasts, UK GDP, industrial production, US CPI; **Thursday** – Japan PPI, China M2 and new CNY loans, Sweden CPIF, South Africa CPI, US PPI; **Friday –** Japan industrial production, Eurozone industrial production, US Michigan consumer sentiment.
- **Central Banks: Monday –** ECB McCaul; **Tuesday –**RBNZ Silk, BOC Macklem; **Wednesday –** RBA Hunter, BOJ Nakagawa, ECB Buch; **Thursday** – BOE Breeden, ECB rate decision, Peru rate decision**; Friday** – BOJ Tamura, Euro Group meeting, ECB Rehn, Russia CBR decision 1% hike expected but close call.

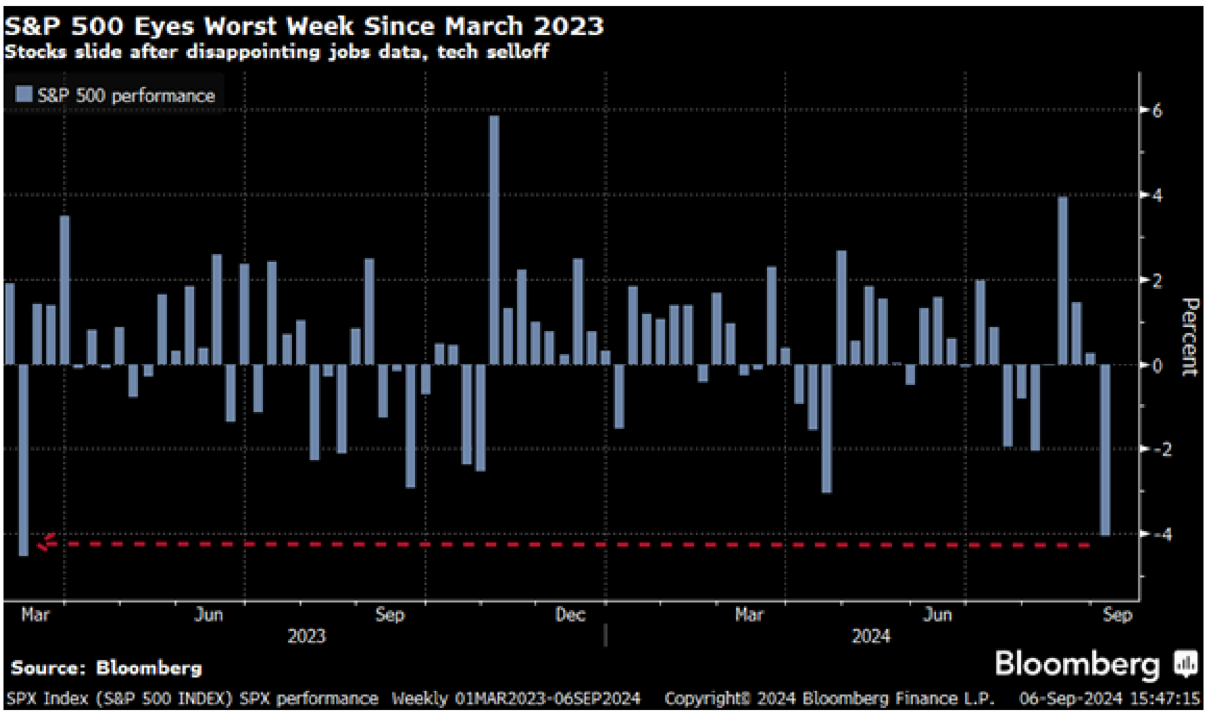
- **Issuance** The US sells $119bn in conventional issues with flat cash flow but negative $180bn in the next 4-weeks, the bond sales are expected to matter this week even with less IG than the historic flows $89bn of last week. The EU sells E16bn in conventional sales from the Dutch, Germany, Italy and Ireland. The cash flow is negative E25.5bn. The UK sells GBP0.9bn of 21Y Linkers and GBP3.8bn of 10Y Gilts with positive cash flow of GBP36.8bn. **Monday –** US Treasury to auction $76 billion 3-month bills, $70 billion 6-month bills; **Tuesday** – Dutch sell E2bn of 27Y DSL, Germany sells E1bn of 5Y Green Bobl and 26Y Bund, EU sells 5-7Y Syndicated issues for E5bn while Spain sells E7bn of 15Y SPGB, US Treasury to auction $60 billion 42-day bills, $58 billion 3-year notes; **Wednesday –** Germany sells E5bn of 10Y Bunds, US Treasury to auction TBA 17-week bills, $39 billion 10-year notes (reopening); **Thursday -** Italy sells E7.25bn of MT BTPs while Ireland sells E1bn, US Treasury to auction TBA 4-week bills, TBA 8-week bills, $22 billion 30-year bonds (reopening).

What changed this week:

The wait for the US jobs report Friday dominated markets for much of the week but rather than resolve the debate about policy and market direction, the outcome extends uncertainty. With NFP missing at 142k and with 89k of revisions lower but wages up 0.4% and unemployment lower at 4.2%. The data before jobs was mixed in the US with ISM manufacturing soft, ISM services better while Fed Beige Book was dark warning of stagnant and declining economy. The Bank of Canada cut rates as expected to 4.25% now 1.75% spread from Fed Funds. The Trudeau government saw its coalition partner breakaway leaving the nation vulnerable to snap election risks. The China PMI report and German ones were lower and concerns about global growth remain in play with Oil off 8% on the week even as OPEC plans to stall its output increases and US draws in crude along with higher NatGas up 6% on week – all show clear demand in the US.

- **US equities had their worst week since March 2023**. The S&P500 fell 3.28% while the DJIA fell 2.39% and the NASDAQ fell 4.71%. Globally, the worst loses were in Japan with the Nikkei off 5.84% while the best performance was in Australia with ASX off a mere 0.97%. The EU EuroStoxx 50 fell 4.44% while the China CSI 300 fell 2.71%. Our iFlow Sector tracking paints a grim outlook with health care and utilities up – usually signs of recession. The correlation of sectors to the overall index still flat and that confirms the stock market isn't being led by just AI boom anymore. We see that clearly in our flows – with big US outflows this last week given the strong performance for the month – worst outflows were in industrials, financials and real estate. The **Mood Indicator** is neutral but negative and has dropped steadily for 21 days – now at -0.042 or 37% percentile – well off the highs of July and momentum is negative for week, month and quarter still – suggesting risk off trouble ahead as our clients are net selling equities and buying front end.

Exhibit #2: US shares worst week since March 2023



Source: Bloomberg, BNY

- **US bonds rallied sharply as recession fears rose on weaker ISM and JOLTS reports.** Massive issuance in IG $81bn in week but our flows show corporate selling on week, month and quarter**.** US sovereign bonds saw positive inflows for week, month and quarter – led by duration but international appetite for US bonds mixed. **Notable international interest in US bonds flipped from selling to buying in the last week but in 2Y but not long end – leaving us near flat holdings.** We saw MBS selling, Muni selling, and a reversal in cash – selling out after rising much of August. As for the rest of the world, the US rally helped push rates lower everywhere with UK Gilts off 17bps to 3.885%, German Bunds off 16.5bps to 2.17% and Japan JGBs off 6bps to 0.84%.

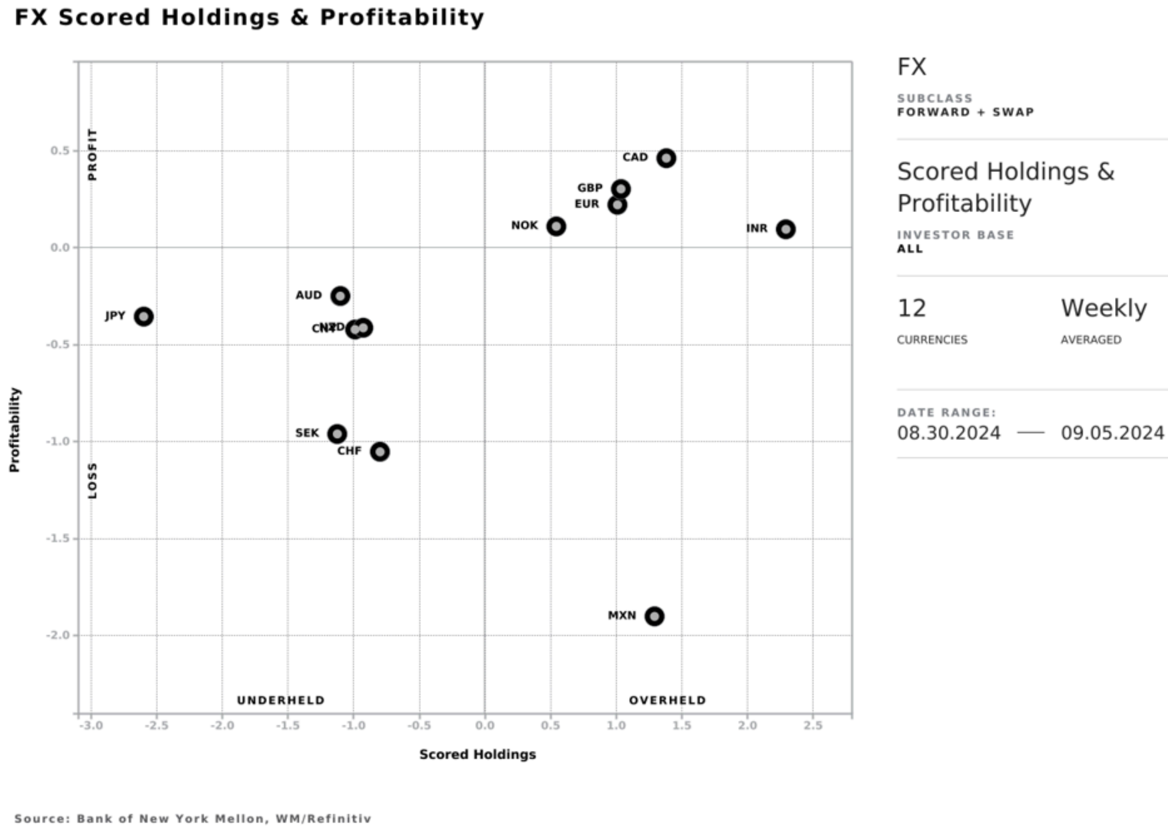
Exhibit #3: US bonds see curve steepening = recession risk

US Bond	High	Low	Current	% from Low	1W Change
30Y	5.35	0.99	4.02	3.03	-0.18
20Y	5.44	0.87	4.09	3.22	-0.19
10Y	5.26	0.52	3.71	3.19	-0.19
5Y	5.18	0.19	3.49	3.3	-0.21
2Y	5.22	0.09	3.65	3.56	-0.27
3M	5.63	0	4.93	4.93	-0.04
FFR	5.43	0.04	5.32	5.28	0.00
The Yields and Fed Funds Rate data from January 2007					

Source: Bloomberg, BNY

- **FX saw the USD fall 0.5% on the week.** The biggest gainer was JPY up 2.7%, then Swiss up 0.8% while EUR rose 0.3% while CLP fell 3.5%, ILS fell 2.5% and MXN fell 1.3%. Notable that the GBP was flat and CAD after a rate cut fell 0.6%. **The FX Carry trade** holds neutral after being significantly positive in middle of August – the current index is 0.132 which is 70% percentile – still high and notable given the big move again in JPY. Shows interest in EM investment flows continues - however momentum is now negative on the week. The correlation of our index to risk parity remains high and significant suggesting more trouble ahead. **Biggest flows on the week** - FX inflows were led by THB, JPY, ZAR and TWD – making clear our clients are setting up for more APAC on growth, mixed with more from China policy (RRR cut expected by us). The USD was the biggest loser this week and that matched the market.

Exhibit #4: FX Positions mostly short USD in G10



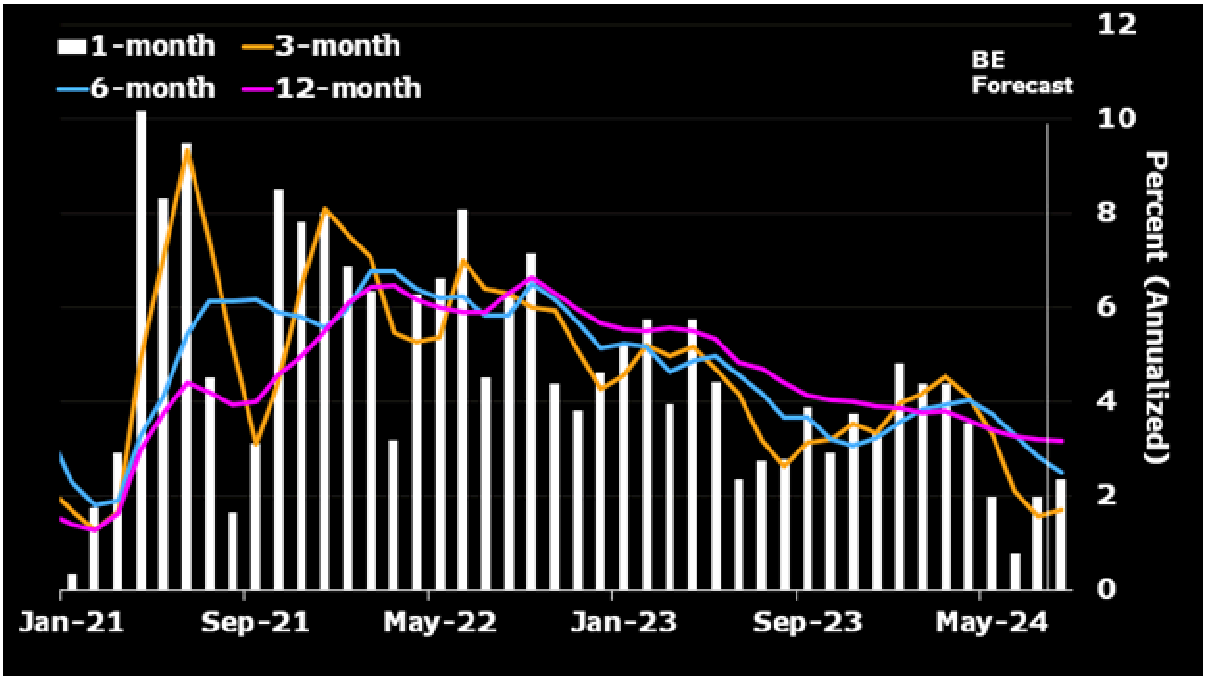
Source: iFlow, BNY

News Agenda and Weekly Themes – US CPI/PPI, US Presidential Debate, ECB, China trade and credit data, UK jobs and other data.

In the United States, all attention will be on inflation as both consumer and producer price indexes are set to be released. Investors will also be watching export and import prices, along with the Michigan consumer confidence survey. In the Euro Area, the key focus will be on the upcoming interest rate decision. China will have a busy week with foreign trade data, CPI, PPI, and new yuan loans. Inflation rates are also expected from Mexico, Brazil, Russia, and India. In the UK, the unemployment rate, July's GDP growth, and industrial production figures will be released. Additionally, industrial production data will be reported for Turkey, Italy, India, and the Euro Area. In Australia, the Westpac Consumer Confidence Index will be closely monitored.

1. US CPI and the assumption that prices don't matter to the FOMC anymore. The consensus for August CPI is up 0.2% m/m. The markets are still gaming out how much the Federal Reserve will need to cut rates at its Sept. 17-18 meeting, heightening the importance of every data report making this one the event of the week. Evidence that inflation remains relatively robust could argue against a 50-basis point rate cut - currently seen as a slightly less likely scenario than the Fed reducing rates by just 25 basis points. A sharp drop in consumer prices, on the other hand, could be interpreted as a sign economic growth has begun to slow more than expected, tipping the scales towards a jumbo cut. The path of rate policy rests on data still.

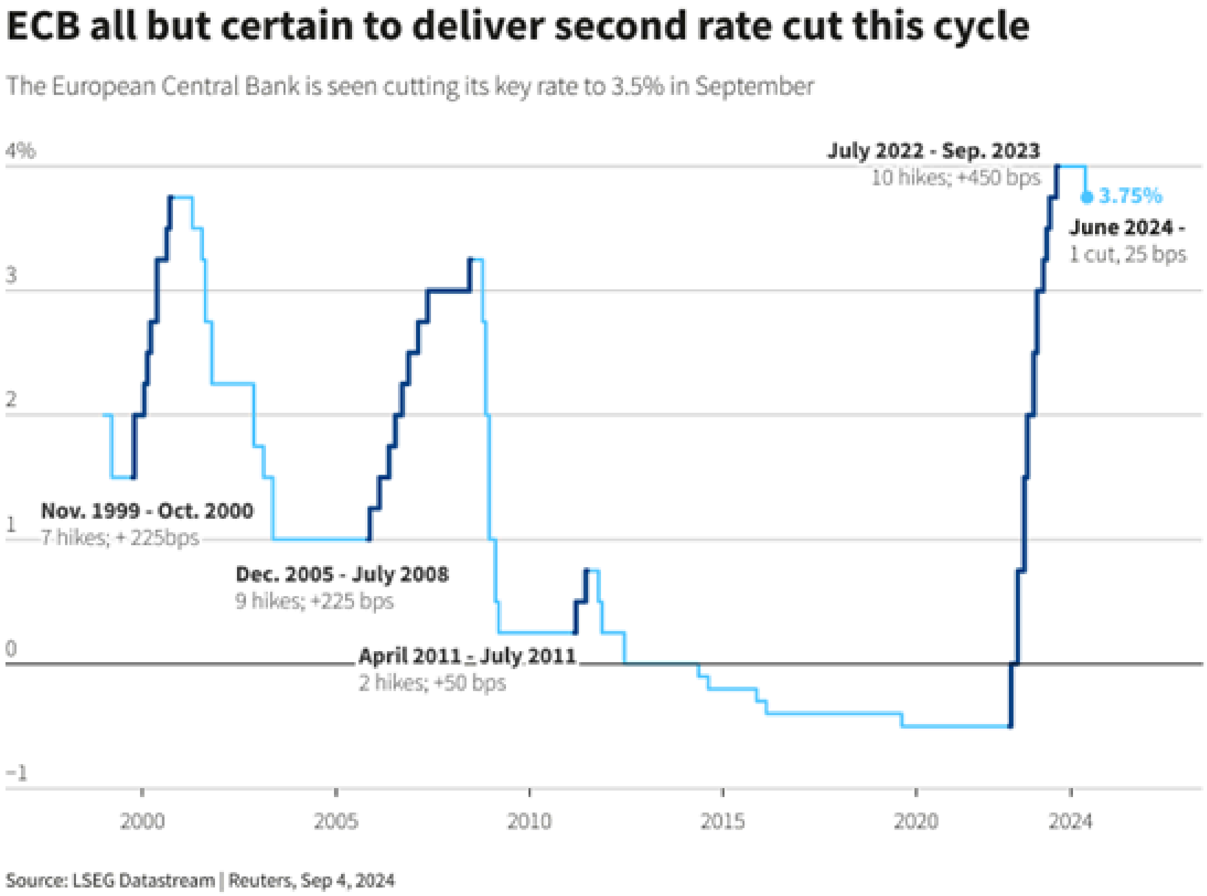
Exhibit #5: CPI risks to upside?



Source: Bloomberg BE, BNY

2. ECB rate cut and their forward guidance. The European Central Bank is all but certain to deliver its second rate cut this cycle, so what matters more is any clues on what's next. The ability for President Lagarde to be convincing that the meeting after next won't again deliver 25bps easing matters. Traders now fully price another cut after September and close to a 50% chance of an additional move this year. Tracking the FOMC curve matters to the EUR direction which matters to inflation and growth. Back in July, markets priced in just 50% chance of a post-September cut.

Exhibit #6: ECB guidance drives more than cuts?



Source: Reuters, BNY

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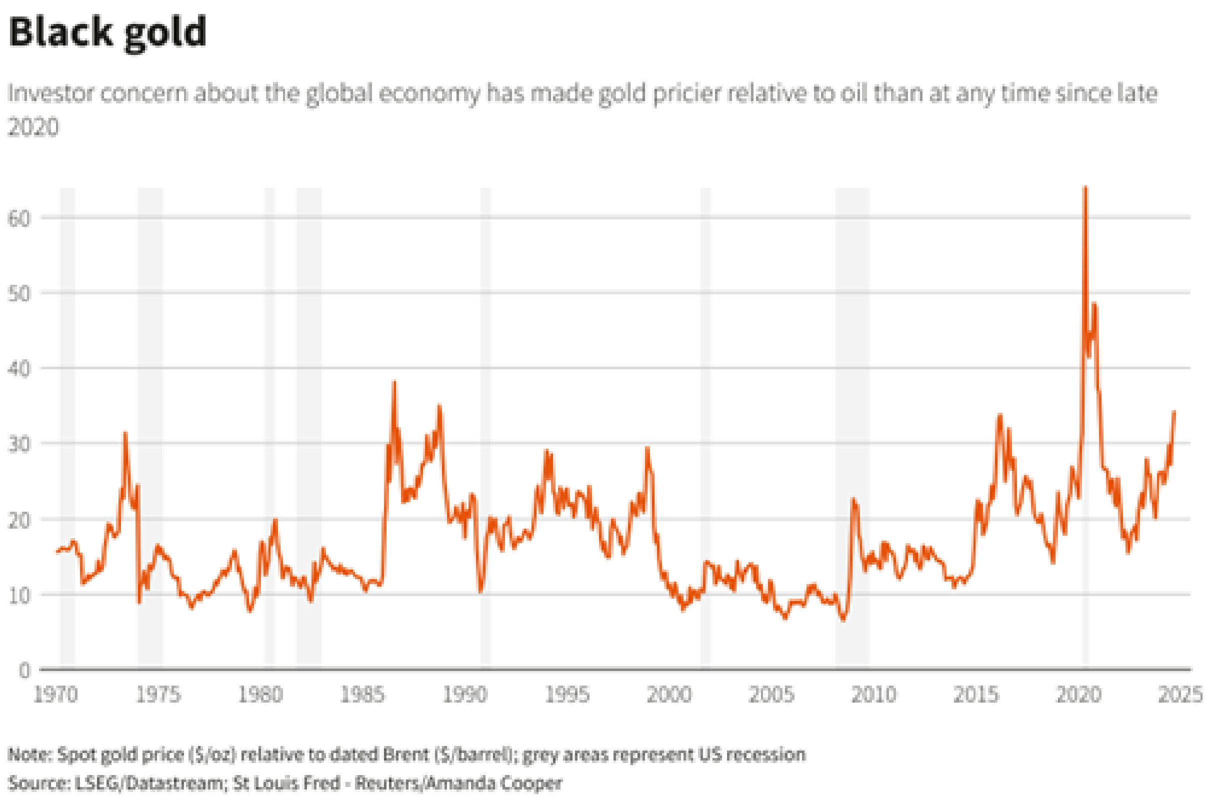
3. Oil weakness and gold strength and the balance of stocks to bonds. Investors are struggling to decide if the bond or stock market has the correct pricing for the future of the global economy. Bonds point to oncoming recession, while stocks - this most recent selloff notwithstanding - have vaulted to yet more record highs, reflecting a sense of confidence in a benign landing. The problem is, only one can be right. As Reuters notes in its analysis, consider the gold/oil ratio. This metric, which reflects how many barrels of crude it takes to buy one ounce of gold, is at its highest since 2020. The ratio drops when confidence in the economy increases, as it assumes energy demand will improve, and rises when concern about growth and recession - and therefore the prospect of gold-friendly rate cuts - sets in. Gold is trading close to record highs around $2,500 an ounce, while oil is struggling to stay above $70 a barrel. Once again, only one can be right. The role of China in this decision is important to consider given it has significantly raised its holdings of Gold and remains a critical part of the oil market with its demand. How this plays out next week with China data and the OPEC monthly will be important to global markets.

Exhibit #7: Oil vs. Gold set by China growth and OPEC?



Source: Reuters, BNY

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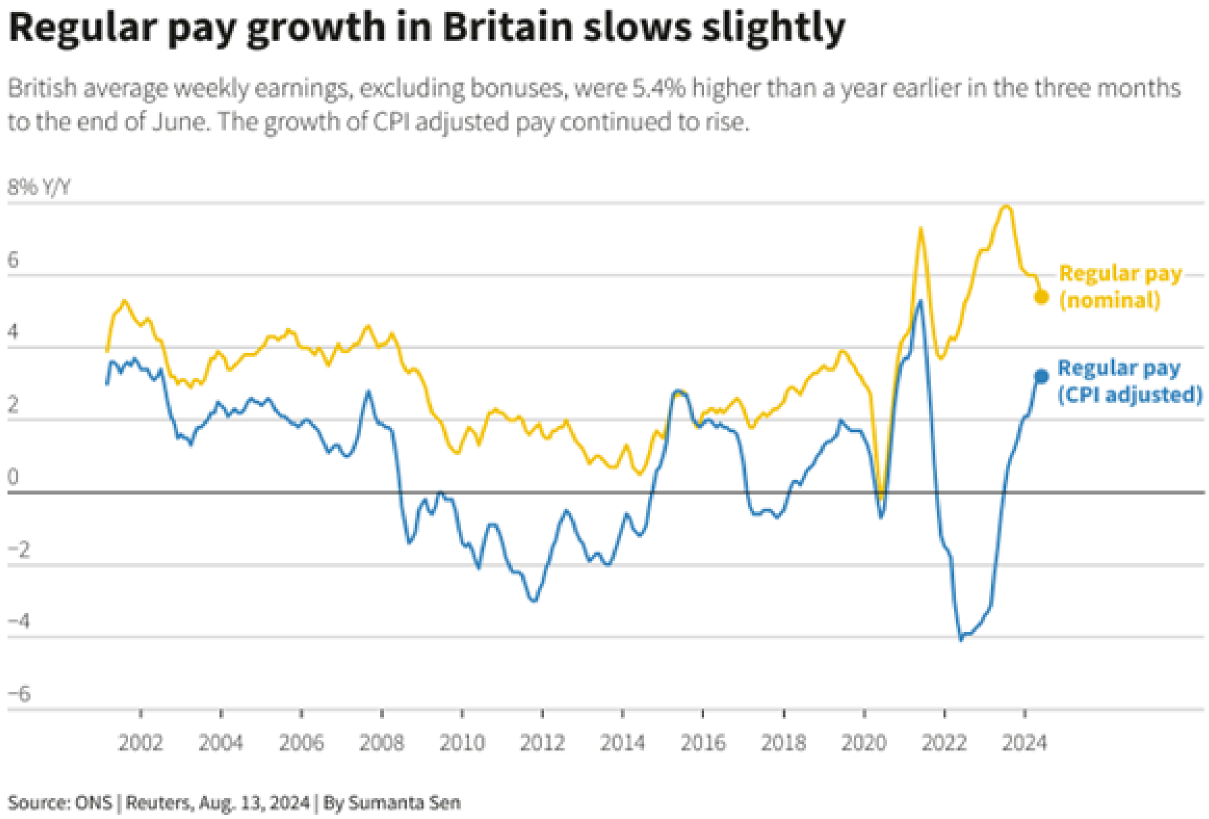
4. UK Jobs and the risks for GBP. The Bank of England was quicker than its peers to raise interest rates in 2021 and is expected to cut them more slowly, unless important data such as the Sept. 10 monthly wages report proves labor markets are easing up on their inflation. The BOE rate cut in August was a close call and the narrow vote margin make clear that pay growth matters. UK wages rose at their slowest in nearly two years in the quarter to June 30, but unemployment dropped unexpectedly and the working population rose by significantly more than forecast. A soft jobs report could benefit borrowers, but weaken the pound, which has boomed on bets the BoE will keep rates relatively high. Long GBP positions are mostly held by debt-funded speculators, who are motivated to sell at signs of trouble rather than risk margin calls.

Exhibit #8: UK wages matter to BOE?



Source: Reuters, BNY

Calendar September 9-13:

Central Bank Meetings:

- **Eurozone ECB (Thursday, September 12) –** The ECB is widely expected to cut its deposit rate by 25bp to 3.50bp but the main refinancing and marginal lending facility rate will be reduced by 60bp, thereby reducing the spread between the spread between the benchmarks. This was already announced in March, with the ECB announcing at the time that “This narrower spread will incentivize bidding in the weekly operations, so that short-term money market rates are likely to evolve in the vicinity of the DFR, and it will limit the potential scope for volatility in short-term money market rates”. The main policy focus remains on the outlook for October, where markets have stepped back from pricing in a full cut. Despite severe weakness in activity data in the Eurozone, the ECB remains concerned about wage and services inflation appears more willing to adopt a ‘higher for longer’ approach.
- **Peru BCRP (Thursday, September 12) –** The BRRP’s surprise cut in in August underscored concerns over the state of the economy and like many LatAm central banks, policymakers could be willing to gamble that the Fed will be much more dovish up ahead and provide more policy space for the region to ease financial conditions. Inflation is holding well at 2% since the last decision and the current sequential figures are acceptable while economic activity is slowing sharply but without excessive impact on the labor market yet. The balance of risks continues to support easing as real rates can come down further.

Key data/releases

Date	Time	EDT	Country	Event	Period	Cons.	Prior
09/09/24	00:50	19:50*	JN	GDP SA QoQ	2Q F	0.80%	0.80%
09/09/24	00:50	19:50*	JN	GDP Annualized SA QoQ	2Q F	3.20%	3.10%
09/09/24	00:50	19:50*	JN	GDP Deflator YoY	2Q F	3.00%	3.00%
09/09/24	00:50	19:50*	JN	BoP Current Account Balance	Jul	¥2496.0b	¥1533.5b
09/09/24	02:30	21:30*	CH	PPI YoY	Aug	-1.50%	-0.80%
09/09/24	02:30	21:30*	CH	CPI YoY	Aug	0.80%	0.50%
09/10/24	07:00	02:00	NO	CPI MoM	Aug	--	0.50%
09/10/24	07:00	02:00	NO	CPI YoY	Aug	--	2.80%
09/10/24	07:00	02:00	GE	CPI YoY	Aug F	1.90%	1.90%
09/10/24	07:00	02:00	GE	CPI MoM	Aug F	-0.10%	-0.10%
09/10/24	07:00	02:00	UK	ILO Unemployment Rate 3Mths	Jul	--	4.20%
09/10/24	07:00	02:00	UK	Jobless Claims Change	Aug	--	135.0k
09/10/24	07:30	02:30	HU	CPI YoY	Aug	3.60%	4.10%
09/10/24	08:00	03:00	CZ	CPI MoM	Aug	0.00%	0.70%
09/10/24	08:00	03:00	CZ	CPI YoY	Aug	2.00%	2.20%
09/10/24	12:00	07:00	SA	Manufacturing Prod NSA YoY	Jul	--	-5.20%
09/10/24	13:00	08:00	BZ	IBGE Inflation IPCA YoY	Aug	4.26%	4.50%
09/10/24	13:00	08:00	BZ	IBGE Inflation IPCA MoM	Aug	0.00%	0.38%
09/11/24	07:00	02:00	UK	Industrial Production MoM	Jul	--	0.80%
09/11/24	07:00	02:00	UK	Manufacturing Production MoM	Jul	--	1.10%
09/11/24	12:00	07:00	US	MBA Mortgage Applications	Sep-06	--	1.60%
09/11/24	13:30	08:30	US	CPI MoM	Aug	0.20%	0.20%
09/11/24	13:30	08:30	US	CPI YoY	Aug	2.60%	2.90%
09/11/24	23:45	18:45	NZ	Food Prices MoM	Aug	--	0.40%
09/12/24	00:50	19:50*	JN	PPI YoY	Aug	2.80%	3.00%
09/12/24	07:00	02:00	SW	CPI MoM	Aug	--	0.10%
09/12/24	07:00	02:00	SW	CPI YoY	Aug	--	2.60%
09/12/24	07:00	02:00	SW	CPI Level	Aug	--	416.22
09/12/24	08:00	03:00	TU	Current Account Balance	Jul	--	0.41b
09/12/24	13:00	08:00	BZ	Retail Sales YoY	Jul	--	4.00%
09/12/24	***13:15***	***08:15***	***EC***	***ECB Deposit Facility Rate***	***Sep-12***	***3.50%***	***3.75%***
09/12/24	***13:15***	***08:15***	***EC***	***ECB Main Refinancing Rate***	***Sep-12***	***3.65%***	***4.25%***
09/12/24	13:30	08:30	US	PPI Final Demand MoM	Aug	0.20%	0.10%
09/12/24	13:30	08:30	US	Initial Jobless Claims	Sep-07	--	227k
09/12/24	23:30	18:30	NZ	BusinessNZ Manufacturing PMI	Aug	--	44
09/13/24	***00:00***	***19:00****	***PE***	***Reference Rate***	***Sep-12***	***5.25%***	***5.50%***
09/13/24	05:30	00:30	JN	Industrial Production MoM	Jul F	--	2.80%
09/13/24	09:00	04:00	PD	CPI YoY	Aug F	--	4.30%
09/13/24	11:30	06:30	RU	Key Rate	Sep-13	--	18.00%
09/13/24	15:00	10:00	US	U. of Mich. Sentiment	Sep P	--	67.9

Key Speeches/Events

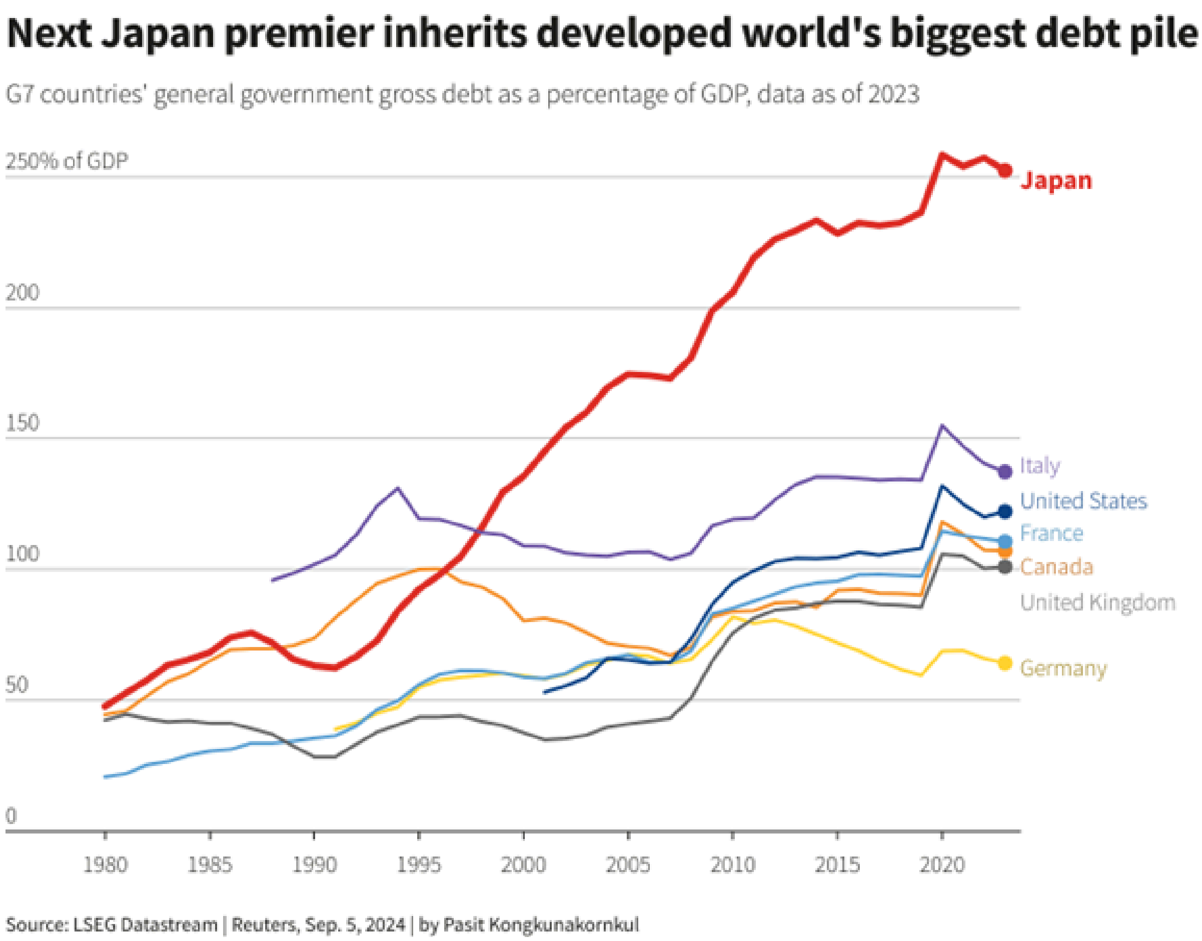
Date	BST	EDT	Country	Event
09/10/24	22:05	17:05	NZ	RBNZ Assistant Governor Karen Silk Speaks
09/11/24	01:20	20:20*	AU	RBA's Hunter-Speech
09/11/24	02:30	21:30*	JN	BOJ Board Nakagawa Speech in Akita
09/12/24	02:00	21:00*	JN	BOJ Board Tamura Speech in Okayama
09/12/24	***13:45***	***08:45***	***EC***	***ECB President Christine Lagarde Holds Press Conference***
09/13/24	09:30	04:30	EC	ECB's Rehn Speaks in Helsinki

Conclusions: Fiscal Dominance in G7?

The worries about debt are wrapped into the next week with US politics mixing with the usual Treasury auctions and the worries about growth against inflation in the September 17-18 Fed rate decision, with CPI/PPI potential impediments to faster easing. The ability for the US to ignore its fiscal deficits has passed and the focus on all markets will be in play as the BOJ and ECB also have to grabble with new politics and old debts. The role of growth and just the right amount of inflation balances against the ongoing political debates from Japan to Europe to the US. The LDP choice for the next PM to the US election to the focus on Canada Trudeau to Germany's coalition – all matter to how bonds and FX markets trade in the weeks ahead.

Bottom Line: The surprise risks for CPI everywhere are still to the upside as tradeable vs. non-tradable inflation coalesce around service wages. The ability for governments to risk stagflation or to lead with financial repression to cut back debt make for difficult politics and higher degrees of uncertainty. This puts the US CPI and the political debate into perspective and makes the USD part of the risk barometer for trading all markets next week. The ongoing worries about how AI investment pay off and how US exceptionalism can sustain are the backdrop to finding some value in the noise of September markets with the role of the rest of the world growing essential to keeping values intact. The three unknowns that worry me most into the week ahead are 1) Weather – with 3 tropical storms in the Atlantic and ongoing Typhoons in the Pacific. 2) Geopolitics with the escalation risk of Israel and Ukraine conflicts higher. 3) Data surprises with any print of inflation or growth that suggests current pricing for a softish, or harder landing is wrong leading to faster markets and higher volatility in rates, FX and stocks.

Exhibit #8: Is government debt sustainable?



Source: Reuters, BNY

Please direct questions or comments to: iFlow@BNY.com

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CONTACT BOB

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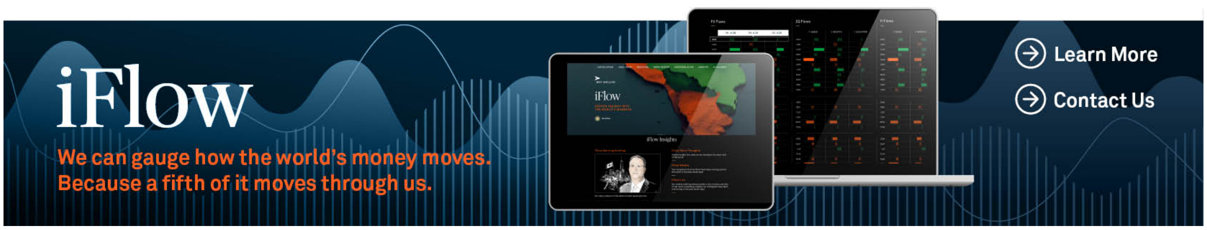

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