July 24th, 2020

MARKETS
NOTE: The Daily will take a short summer recess next week, and the week after that. We will return Tuesday, August 11th.
Three Things…

- Mexico's GDP shrank 2.6% in May, but unfortunately this looks great when compared to April's 17.3% black-hole collapse. These back to back contractions are leading some to revise deeper their predictions for negative growth in 2020. The best-case scenario now has GDP down 8.8% for the full year, with some calling it at 10% or worse. In an otherwise uniformly negative report, there was one positive standout. So-called primary activity—farming, fishing, and mining—grew 1.6% in May. Manufacturing (secondary) and services (tertiary) contracted 1.8% and 3.2% respectively.
- In times of stress or uncertainty, the gunslingers and golden boys (and girls) that make up the myth that is the global trading community, tuck tail and run for their mommies. In this case, mommy is one of several traditional safe havens. We need look no further than the Japanese Yen and gold today to realize that this is a risk-off market. Both are up more than ¾% to 106.00 and $1,900 respectively as we start the US trading session, each rising as we pull back from more volatile consumer tech, trade-dependent and riskier investments.
- In the run-up to next week's FOMC meeting, the Fed will be forced to claw back much of its rosier assumptions which underlay both last month's Policy decisions and statements, as well as the several stimulus and rescue packages they are deploying. After the June 10th meeting, Chair Powell said, "assuming that the disease remains or becomes pretty much under control, I think what you see is…an expansion that builds on momentum over time." And who can fault him or the Fed for saying that at the time. The number of new cases had dropped to a 7-day average below 20,000 at that time. We're now somewhere north of 70,000 and rising with a bullet, or so it seems. Next week's meeting may provide

some new accommodation. Like some other health and economic measures, that monetary policy assistance may be chasing the problem, not out in front. Also, like those other measures, the fact that the Fed is adapting to current conditions is encouraging. We hope that all these newer measures prove to be effective.

FOREIGN EXCHANGE

The dollar is trading lower again this morning with the DXY dollar index down 0.057 to 94.636, the lowest level since end September 2018. Markets have a bit of a risk off tone although it's difficult to pinpoint any catalyst for the change over the past 24 hours. US-China tensions are ongoing, there are signs that the outbreak is starting to dampen the US recovery and some tech stock news along with some antitrust headlines have all contributed. Senate leader McConnell suggested that Republicans will begin releasing a series of proposed bills on Monday that would constitute the Republican plan for a $1 Tln or so fiscal package that would be split between individual stimulus checks, enhanced unemployment benefits, an employer hiring incentive and aid to state and local gov'ts. Odds are that the negotiations will stretch past July when enhanced benefits are set to expire. Lawmakers are targeting August 7th for passage although that easily spill over into the weekend and pass August 10th. The eventual bill will likely make the enhanced benefits retroactive. Republicans are opposed to extending the full $600 a week benefits while Democrats oppose a temporary fix. Interest rates in the US continue to grind lower with the 5 yr. Treasury hitting a record low of 0.2548, which is pulling USD/JPY to the lower end of its recent trading range; although the country is currently on holiday. The Swiss Franc is also trading stronger against the dollar benefiting from safe haven status. EM market currencies in Asia are underperforming with the offshore Chinese yuan trading lower at 7.0260.

- The euro is consolidating its recent move higher and trades at 1.1612. Euro area PMIs came in stronger than expected and indicate a strong domestic recovery. There were higher output orders and lower inventories. Supply chain disruptions also eased further, with shorter delivery times distorting the manufacturing index lower in France and the UK. However, price-based indicators suggest there are still sizeable output gaps and travel oriented service sectors continue to lag, which led to a smaller gain for the periphery than in Germany or France. Employment categories were more mixed, suggesting that the short-term worker protections are waning a bit and underscoring that the recovery in demand is not sufficient to maintain or expand the current workforce. There are some signs of a second wave of infections in Europe. With increased travel, the virus appears to be spreading more quickly again in those countries where it had suffered a particular slump. There is an upward trend in cases in Spain and most other countries are reporting rising cases; although nothing on the scale of what happened in the spring. Consumer confidence released yesterday showed confidence slowly returning but fell short of expectations. National data will be published next week, and concerns are that consumer confidence has stagnated in all EU countries. For the euro the fact that the EU reached an agreement on the reconstruction fund removes a major risk factor.

Also, the risk that the ECB will have to do another “whatever it takes,” had been reduced. In the US, there are still some divergent views between Republicans and Democrats about the next fiscal package. The Fed is expected at its meeting next week to again underline that it will remain expansionary for a long time to come and if necessary, will become even more expansionary. The ECB other than increasing bond buying can’t really be more expansionary as it feels it’s already hit the end of rate cuts. Combined it should support the euro and a target of 1.2000 by the end of the year doesn’t seem unreasonable.

- The offshore Chinese yuan is trading at 7.0260. Escalations have risen between China and the US after the closure of the Chinese consulate in Houston and the closure of the US consulate in Chengdu by Monday 10 am Beijing time. US Secretary of State; Mike Pompeo made a speech on China’s threat, calling President Xi a true believer in a bankrupt totalitarian ideology. President Trump said that the trade accord with China saying, “the trade deal means much less to me now than when I made it.” This comes fresh after news that the DoJ arrested 4 Chinese nationals for visa fraud claiming they lied about their status as members of the People’s Liberation Army. As the election approaches President Trump is taking a harder stance against China. However, he still wants China to purchase agricultural products to placate voters in swing states. The continuing tit for tat suggests that for the time being the yuan will face depreciation pressures. As a recap, China at the end of 2019 exported $472 bln to the US while importing $164 bln, the US exports $470 bln to the EU while the US imports $600 bln, China exports $392 bln to the EU while importing $302 bln.

GLOBAL MARKETS

- Despite today’s extended slide lower in US and global equities, US Treasury yields are mixed, with shorter maturities ever so slightly lower, longer maturities imperceptibly higher. The moves are just enough to tip the yield curves slightly steeper, but not enough to really get excited about.
- One thing that fear and uncertainty to accomplish is the aforementioned safe haven flight. In addition to gold, Yen and Franc, Bonds, and specifically US Notes Bonds are the safe haven asset of choice.
- We saw no greater evidence of that in yesterday’s auction of $14 Bln of 10-year US TIPS (Treasury Inflation Protected Securities). The US issued Inflation Protected Securities (seriously, INFLATION PROTECTION!) at a record low -0.93%, the lowest yield ever at auction. TIPS yields are priced on the yield of the relevant security (in this case 10-year notes) minus EXPECTED annual inflation. In some respects, 5- and 10-year TIPS are considered the real bellwethers of future interest rates. Yields on 10- and 30-year TIPS suggest inflation running around 1.5% to 1.6% for the foreseeable future. Most of the rescue measures enacted to date seem to have little if any impact on perceived or actual inflation, so this is likely to hold for some time.

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