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MAKING SENSE OF *THIS* WORLD

10 August 2020

R&R Weekly Column
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Gold Emerges As A Clear Winner From Central Banks' "Covid-Related Forward Guidance"

After the disastrous collapse in economic activity recorded in Q2, with real GDP falling by double digit percentage points in many economies, including in the most advanced ones, the global economy is attempting a timid rebound in Q3. The re-opening of economies after months of widespread lockdown, when 1/3 to half of the world population was estimated to be subject to more or less draconian restrictions, is facilitating a comeback in economic activity. However, this rebound is uneven and uncertain at best. In its latest statement, the US Federal Reserve's FOMC warned about a slowdown in this timid rebound, as signalled by many leading and contingent indicators.

Governments remain alert and active in their plans to stimulate economic activity. Among others The US is preparing its third fiscal stimulus package, the EU has just adopted the new Recovery and Resilience Facility, and the UK has prorogued its furlough schemes (together with other forms of fiscal support).

Central banks remain fully accommodative after having launched what we called "Covid-related forward guidance". In fact, in August the Reserve Bank of Australia (RBA), in deciding to re-start QE after the lockdown in the state of Victoria, joined the Fed and the ECB in explicitly linking the duration of its monetary stimulus to developments of the virus. After the so-called "time-limited" and "state-contingent" forms of forward guidance, in which the central bank will continue to provide monetary stimulus until a certain date arrives or a pre-set economic condition materialises, some central banks seem to have decided to launch a new form of state-contingent forward guidance, in which the condition to be met to reduce the stimulus is fully exogenous. Specifically, central banks will continue to keep policy rates low (or lower) or make asset purchases until there is convincing evidence that the virus has been durably and credibly contained.

Considering that the number of cases is still accelerating in very large parts of the world, such as in the US, Brazil and India, this means that central banks will keep the tap of liquidity open for the foreseeable future. Most central banks, when showing their implicitly expected path of policy rates, do not show any sign of tightening over the forecast horizon.

Who is benefiting from this situation in financial markets? Clearly risk asset prices have been the ones that have benefited from the combination of monetary and fiscal stimulus (sometimes coordinated in "helicopter money" fashion). But there is plenty of evidence that both equity and credit markets valuations are stretched, as they are under-pricing the risk of the chain of defaults and bankruptcies which is likely to manifest itself in coming months. Perhaps also because of this reason, the clear winner so far seems to have been gold.

The yellow precious metal has in fact reached and recently overcome the 2000$ per troy ounce for the first time since the Global Financial Crisis. Gold was trading at just over $250 in the early 2000, before starting a glorious rally that brought it to $1750 (monthly prices) during the Euro crisis in 2011-12. After retracing and falling to just over $1000 in 2015, the rally re-started with some conviction in mid-2019 (when the Fed started to implement its "insurance cuts") with a serious acceleration in the last few months.

As discussed in our recent in-depth analysis, there are multiple reasons for this rally. Gold is perceived to be a good hedge against inflation, but also deflation (as it is a physical asset, but nobody's liability, unlike government bonds). It is a store of intrinsic value and is also perceived to be a store of US dollar value, during a time when political uncertainty and turmoil in the US, ahead of the Presidential election in November, is making many investors nervous about the greenback.

Our Recent Publications

- Flash Review: BOE Remains On Holds and Discards Negative Rates (for Now), *by Brunello Rosa and Farah Aladsani, 6 August 2020*
- Flash Review: RBA Remains On Hold But Re-Starts QE, Given The New Lockdown, *by Brunello Rosa and Fawaz Al Mughrabi, 4 August 2020*
- The Post-Covid Recovery Deal: Not A "Hamilton Moment" But Still A Turning Point In EU History, *by Grégoire Roos, 5 August 2020*
- Flash Previews: BOE and RBA To Remain Cautiously On Hold In August, *by Brunello Rosa, Farah Aladsani, F.S. Al Mughrabi, 31 July 2020*

Looking Ahead

The Week Ahead: US CPI Inflation To Rise While RBNZ Is Likely To Remain On Hold

In the US, July's CPI inflation is expected to rise to 0.8% y-o-y (*p:* 0.6%), while core-CPI is likely to remain unchanged (*p:* 1.2% y-o-y).

In the EZ, industrial production is expected to improve, while remaining in contraction at -11.7% y-o-y (*p:* -20.9%).

The RBNZ is expected to keep its official cash rate at the historical low of 0.25%.

The Quarter Ahead: US-China Tensions To Keep Rising, While The Fed Will Likely Strengthen Its Forward Guidance

President Trump: *1)* imposed restrictions on 11 Hong Kong and Chinese officials, including Carrie Lam, Hong Kong's chief executive, and Luo Huining, mainland China's top official in the city - after revoking Hong Kong's special trade status, a designation that exempted the city from restrictions the US applied to mainland China; and *2)* ordered a sweeping ban *"on dealings with the Chinese owners of the popular apps TikTok and WeChat"*, declaring *"they are a threat to US national security, foreign policy and the economy"*. The ban will take effect in 45 days; while its impact on users remain unclear, the administration might face legal challenges over its authority to ban consumer apps. ***China and Hong Kong*** will likely reciprocate, escalating tensions.

In the US, President Trump signed four presidential orders to: *1)* extend jobless aid, by providing additional weekly benefits to the unemployed; and *2)* suspend the payroll tax - but Democrats argue his relief powers are limited.

Despite the UK's acceptance to pay a financial settlement to the EU, PM Johnson warned that - in the event of a 'no deal' - "*the GBP 39bn is no longer, strictly speaking, owed [to Brussels]".* Such refusal could lead the EU to take the case to the International Court of Justice.

The UK and Japan reached *"substantial agreement on most elements"* of a post-Brexit trade deal, largely mirroring the 2019 EU-Japan trade agreement.

Key Fed's facilities and programs, put in place during the COVID-19 crisis, cover: *i)* Treasuries; *ii)* mortgage securities; *iii)* commercial paper and corporate bonds; *iv)* municipal bonds; and *vi)* provide credit to businesses. The Fed declared it is *"extending its lending programs [set to expire on September 30] to businesses, governments, and individuals until the end of the year".*

Last Week's Review

Real Economy: The Global Recovery Remains Fragile; Rising Risks Of A COVID-19 Second Wave

In the US, July's Markit composite PMI rose to 50.3 (*c:* 50.0; *p:* 47.9), the first expansion of private sector activity since January - as: *i)* services PMI rose to 50.0 (*c:* 49.3; *p:* 47.9); while *ii)* manufacturing PMI fell to 50.9 (*c:* 52; *p:* 49.8). July's data indicated: *i)* a rise in nonfarm payrolls (*a:* 1.76m; *c:* 1.60m; *p:* 4.79m); *ii)* better-than-expected average hourly earnings (*a:* 4.8% y-o-y; *c:* 4.2%; *p:* 4.9%); and *iii)* a fall in the unemployment rate (*a:* 10.2%; *c:* 10.5%; *p:* 11.1%). In the week ending August 1, the number of claims for unemployment benefits rose by 1.2m (*c:* 1.4m; *p:* 1.4m) – the lowest since the pandemic started. Finally, jobless benefits applications recorded the largest weekly drop in almost two months.

In the EZ, July's composite PMI stood at 54.9 (*c:* 54.8; *p:* 48.5) – the steepest monthly expansion in business activity since June 2018, as: *i)* manufacturing PMI rose to 51.8 (*c:* 51.1; *p:* 51.1); while *ii)* services PMI fell to 54.7 (*c:* 55.1; *p:* 55.1). Finally, June's retail sales expanded by 1.3% y-o-y (*c:* -0.5%; *p:* -3.1%), up from the contraction recorded in May.

As expected, both BoE and RBA kept their key policy rates on hold at historical lows (BoE: 0.1%; RBA: 0.25%); policymakers reiterated they *"will do whatever is necessary to support an economic recovery"*.

Financial Markets: Positive Economic Data Encourage Investors; Equities Up, Bonds Flat

Market drivers: as investors monitor both the: *1)* US Fed forward guidance; and *2)* upcoming US Congress USD 1tn stimulus package, DM stocks rose on: *i)* signs of the economic recovery gaining traction; and *ii)* policy-stimuli hopes.

Equities: w-o-w, global stocks rose (MSCI ACWI, 2.1%, to 563), led by the US (S&P 500, +2.5% to 3,351; Eurostoxx 50, +2.5% to 3,253).

Fixed income: w-o-w, global debt indices were unchanged (BAML Global, 0.0% to 299.0). Across key DMs, yields rose mildly (10y UST, +3bps to 0.56%; 10y German bund, +3bps to -0.51%).

FX: w-o-w, the USD spot index remained flat (DXY, +0.1% to 93.435) as well as the EUR (EUR/USD, +0.1% to 1.179), while EM currencies fell slightly (MSCI EMs FX, -0.2% to 1,609). The USD/TRY tumbled to 7.307, a record low.

Commodities: Oil prices strengthened (Brent, +2.5% to 44.4 USD/b). Gold soared (Gold, +3.0% to 2,035 USD/Oz.), driven by inflation fears triggered by: *i)* CB easing; and *ii)* government stimulus programs.

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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*
LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*

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