BNY MELLON

Aerial View

Morning Briefing

Jan 25, 2021

Monday Morning Macro - Flatlining Growth, Heavy CAD and APac Overextended

- **Activity is flatlining in the US and globally**
- **Post BoC, CAD displays heavy positioning and risks to the oil price**
- **APac assets in high demand; could be overextended**

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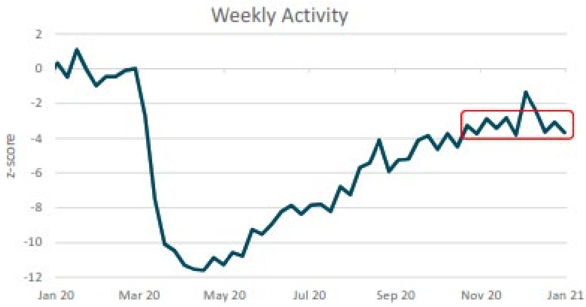
Current Indicators Showing Flat and Declining Activity

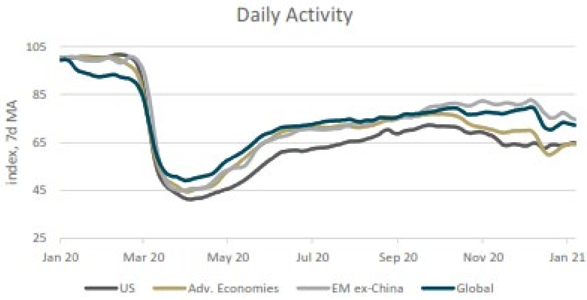
Our in-house weekly activity indicator– with the exception of a blip higher during the holiday week – has been flat since the end of November. This indicator is made up of a number of weekly readings on economic activity in the United States, as indicated in the note underneath the chart below.

We derive the first principal component of these data series – a factor they all have in common, which is a measure of economic activity that is reflected in the dynamics of this set of data.

A similar set of indicators by Bloomberg reports daily activity across a number of countries derived from mobility data, daily workplace data, electricity usage and the like. We can see in the chart below that across the world the pandemic is again suppressing activity in the new year, and really has been since November.

Flatlining





Source: BNY Mellon Markets Calculations, Bloomberg; data as of January 21, 2021
Weekly activity indicator is the standardized first principal component of rail freight traffic, initial jobless claims, weekly consumer confidence, steel and electricity production, same store sales and oil demand

PMIs released last week across the world indicated strong manufacturing expectations, while the service sector remains under pressure. This is something we have discussed many times whether in relation to the labor market, production, prices or other indicators of activity and demand.

Nevertheless the general thrust of the survey data – as well as comments from the raft of central banks that held policy meetings in the last two weeks in both EM and DM – betray a medium-term, forward looking optimism.

In this way, the vaccine rollout will be crucial in validating this rosy view of medium- to long-term prospects. With the exception of Israel, and to a lesser degree, the UK (which while having a still terrible COVID crisis on its hands at the moment, is doing moderately well on the vaccination front), vaccination distribution has been troubling.

We think that to some degree this will improve over time in developed markets, but worry that the reflationary exuberance in EM (see below) might be tempered by very poor vaccination distribution (see here), as well as elevated optimism for the region.

> ***The CAD's post-BoC rally should see the currency taking a pause***

CAD to Have Trouble Rallying Against DM

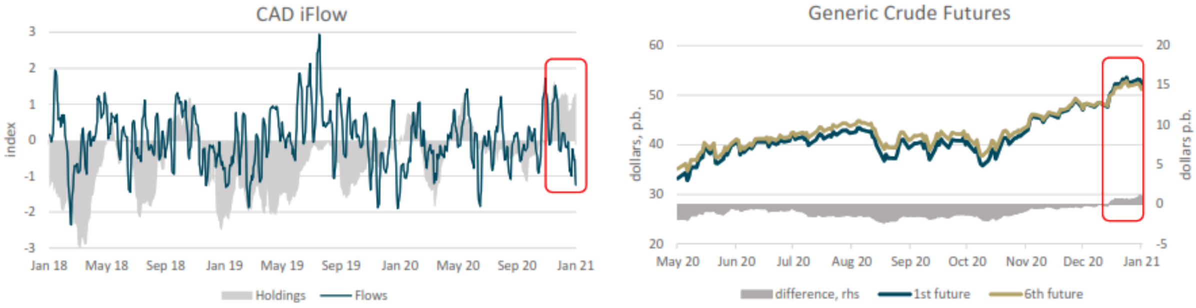
The Bank of Canada’s (BoC's) January meeting sent the currency rallying to its strongest level since April 2018. We had expected the CAD to weaken on the BoC’s discussion that a ”micro cut” in the overnight rate (i.e., reducing the current 0.25% level of rates by an additional 10 or 15 basis points) was discussed and is a tool in the bank's arsenal.

Instead it appears that the BoC’s medium-term optimism on the second half of the year outlook sent the CAD hawks on a buying spree, especially when the BoC suggested that tapering could begin soon after demand recovers.

CAD holdings, according to our iFlow data, are at their highest level since 2014 (see the accompanying chart), and are the second highest in the G10 currently (after only the DKK) and flows have been negative since mid-December, a stretch of time that is among the longest we have seen in years.

Profitability, according to the iFlow Cloud (click here for the most recent iFlow Cloud graphic) is also quite positive. On iFlow metrics, CAD looks set to stop appreciating against the USD.

iFlow and Oil Suggest CAD Appreciation Should Take a Breather



Source: BNY Mellon Markets, iFlow, Bloomberg; data as of January 21, 2021

The BoC’s Governor, Tiff Macklem admitted that the current strength of the loonie is “not a made in Canada” phenomenon and it instead represented broader USD weakness. This coincides with our own view, as set out here. Even so, he acknowledged that further USDCAD weakness could weigh on Canadian export growth once global demand resumes.

Over longer horizons – several weeks and months – oil prices obviously play a major role in the CAD’s dynamics. However, even with the run of West Texas crude from approximately $40 per barrel to well over $50 since the middle of October last year, CAD lags its oil-related peer, the NOK. The latter is up 6.2% while the former is only up by 2.7% on a trade-weighted nominal basis (according to BIS data).

With a deteriorating short-term outlook (as described above) for the global economy, we are cautious on the short-term view for crude oil. The West Texas curve (six-month future versus one-month) is in backwardation now for the first time since the pandemic, underscoring pessimism that oil is destined to trade inexorably higher, even as vaccine-inspired optimism raises the medium-term view on global demand.

The American Energy Information Agency reported that crude stockpiles in the US rose for the first time since December. CAD might not get a lift from energy prices as previously expected.

> ***APac assets are seeing heavy inflows, currencies overheld***

Appetite for APac Assets Soars

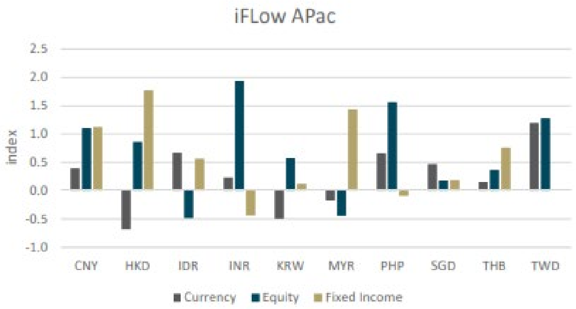
Last week we released a new set of indicators, iFlow PnL. In a follow-up piece, we pointed out that holdings across the APac region were exceptionally high – their highest level since mid-2018, as the chart below shows. They began getting full in the summer of 2020.

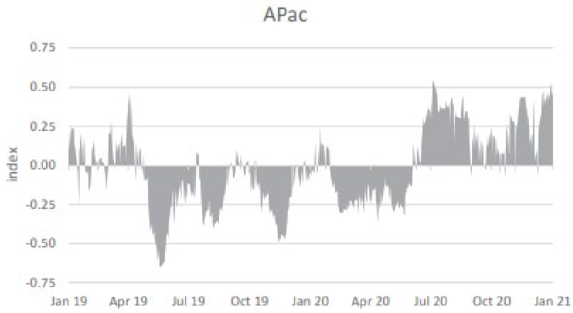
As our iFlow Cloud shows, holdings across a range of APac currencies are quite long, for INR, MYR, SGD, PHP and IDR. These positions are all profitable. Long and in-the-money positions are often at risk of reversal, and indeed some are beginning to unwind now.

What’s more striking, however, is the appetite we have started seeing for equities and bonds in the region. We plot the latest five-day cumulative flow indicator for the region, for both asset classes and see this demand across the board, with the exception of Indonesian and Malaysian equities, and Indian fixed income.

Flows into Chinese and Hong Kong assets are particularly strong across both asset classes. We don't see a concomitant appetite for the currencies in these countries, suggesting that there is a degree of hedging beginning to creep into the markets for these assets.

Asia Flows and Positioning Getting Long





Source: BNY Mellon Markets, iFlow; data through January 21, 2020

This appetite, combined with the extended currency positions argues for a degree of caution in the region, as we have concerns about a combination of a growing COVID problem, as well as a slow pace of vaccination rollout

Please direct questions or comments to:

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