

A Risk Pull-Back, Not A Liquidity Reversal

But the Fed Ain't Playing Ball



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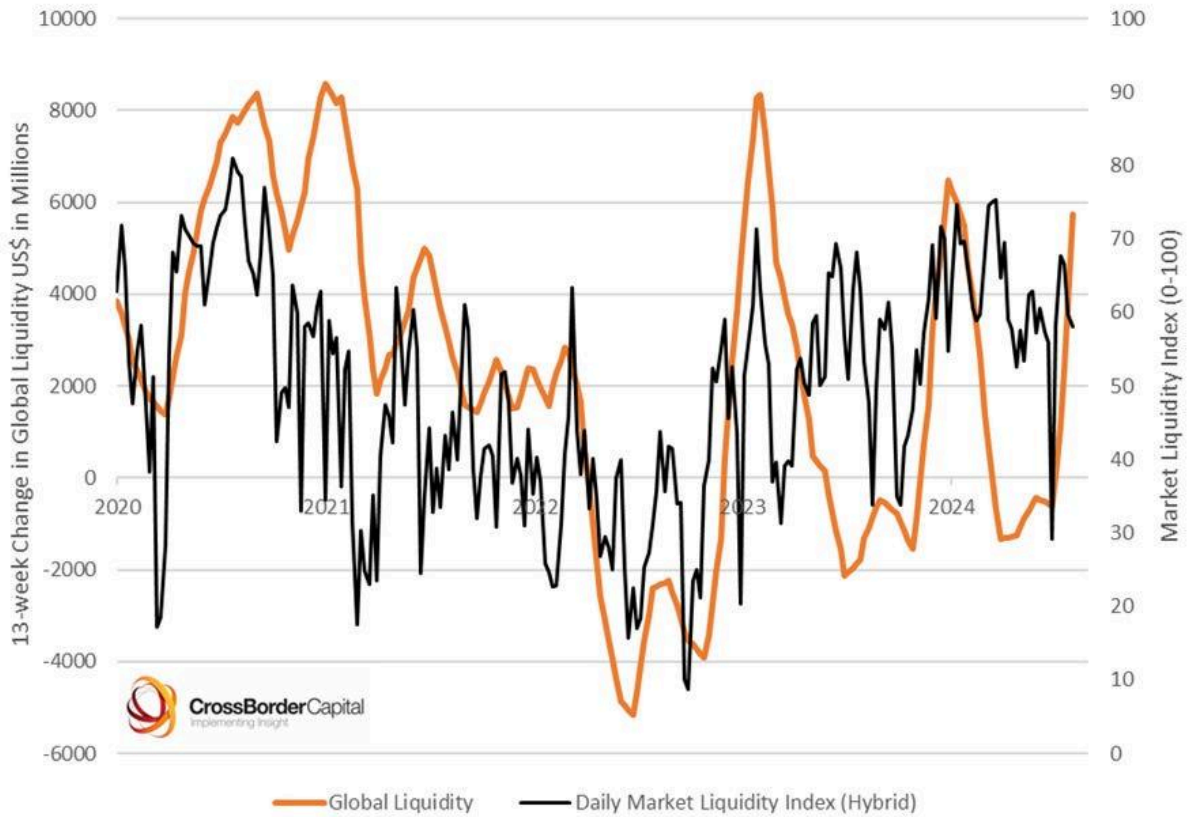
The latest pull-back in World stocks tells us that risk markets may have gotten ahead of themselves, or at least ahead of the pace that policy-makers are easing. **It does not signal a reversal in Global Liquidity conditions.** This conclusion is supported by the robust performances of gold and Bitcoin, and by the trending higher of several key Treasury yield spreads, notably the 10-5 year, which is a decent proxy for rising term premia.

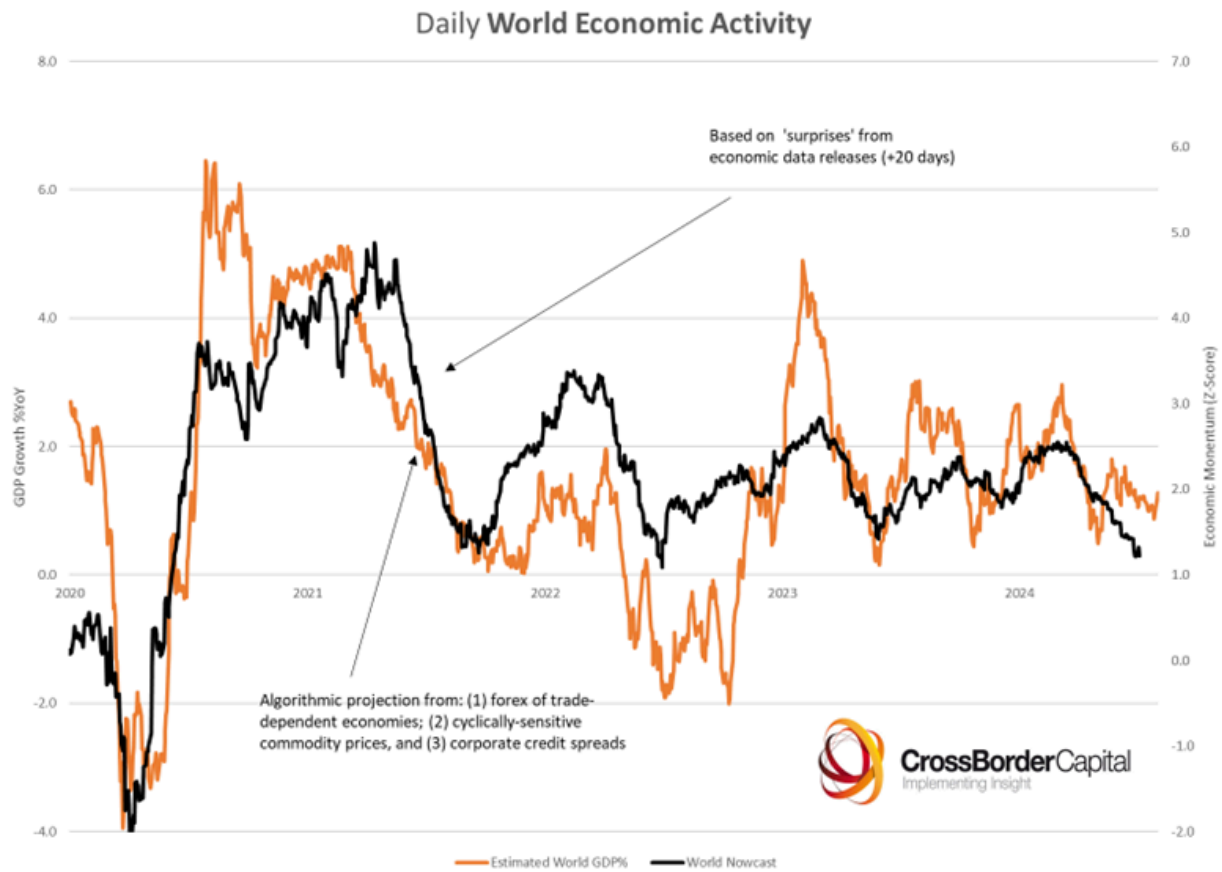
The on-going monetary policy easing is painfully slow, but it is coming.

Many Central Banks are starting to cut rates and add liquidity, and in the last 10-days of July China's People's Bank (PBoC) added a substantial RMB 1 trillion to her money markets. Yet, the general slowness is not helping to support fragile World business activity, certainly in the wake of China's earlier major monetary tightening following the 2024 Lunar New Year holiday. All this may be frustrating to watch, but nothing we see looks particularly unexpected.

Evidence two pieces of data: (1) **Global Liquidity conditions** versus an index of market liquidity factors, such as spreads, volumes, etc. And (2) latest daily **nowcast of World GDP** versus an AI-based model of daily GDP that uses credit spreads, commodity prices and trade-sensitive currencies. These indicators tell us that *funding liquidity* and *market liquidity* appear elevated, and that although World business has slowed it is not recessionary.

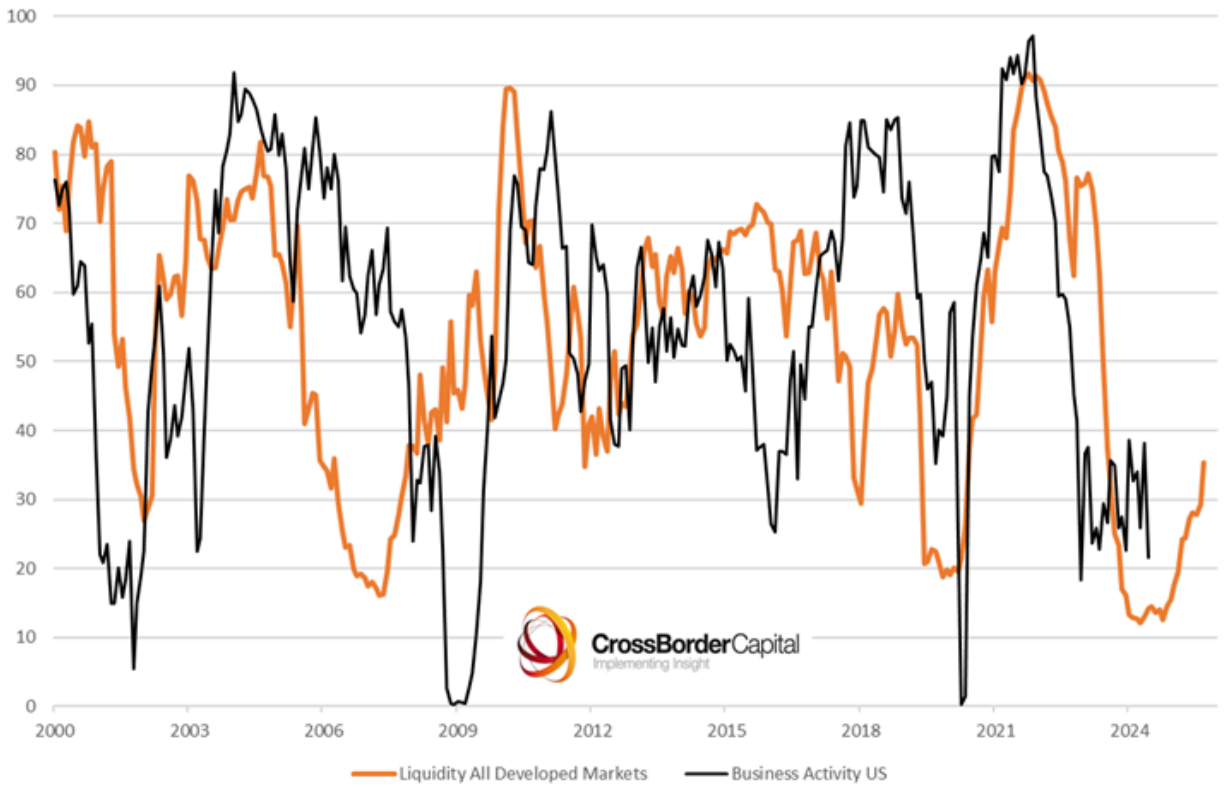
Global Liquidity and Market Liquidity Index

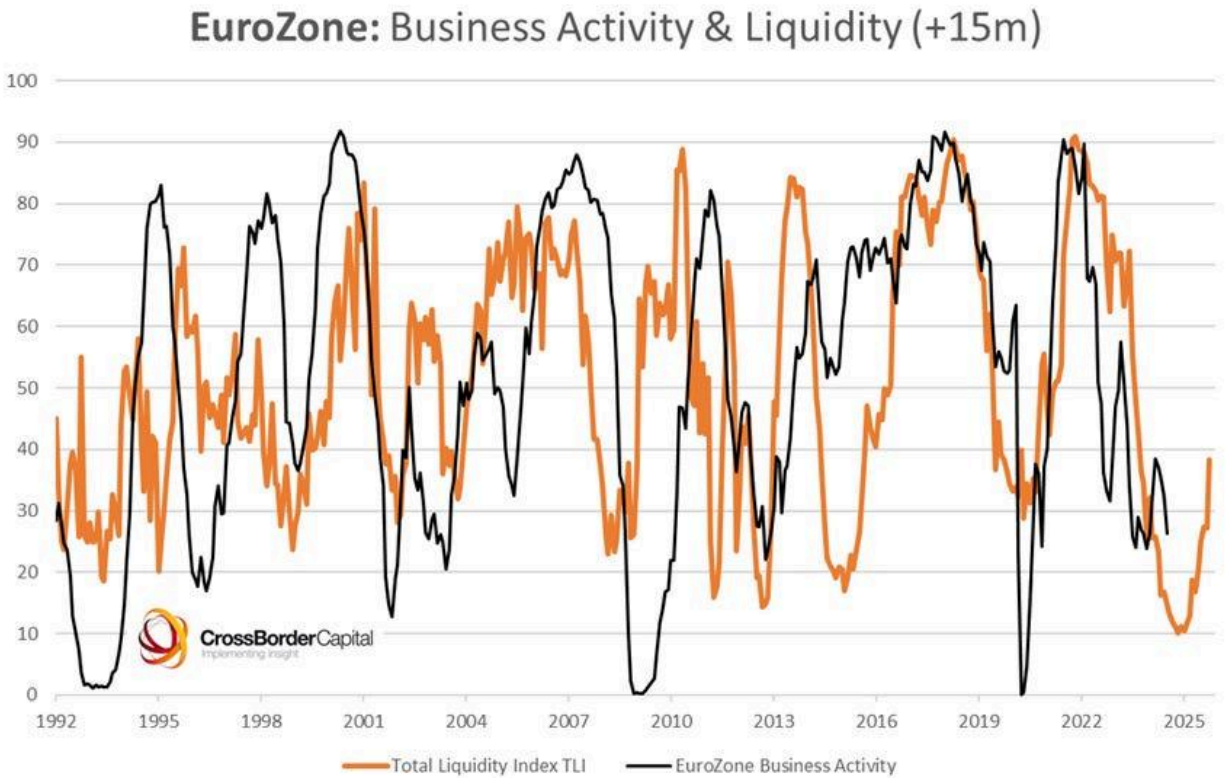




Also, consider the following two charts that link liquidity with future business activity. The first chart shows **US business activity** against Global Liquidity ex China: the second compares **Eurozone business activity** with Eurozone liquidity. Again, economies appear on track and look set to slowly recover.

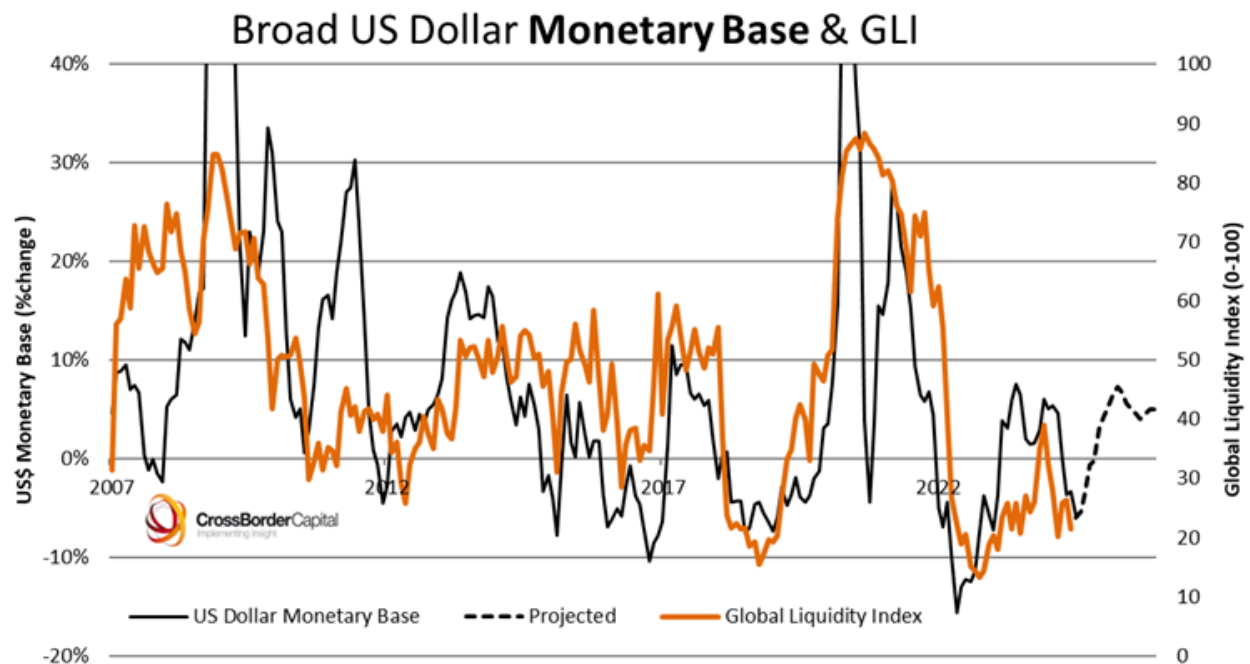
US Business Activity & Global Liquidity (ex China, +15m)





This is not to say that the future path for investors is either certain or will be smooth. We remain concerned by the slowness of policy-makers, and notably the stubborn US Fed, in easing liquidity conditions. And, as we have noted before, this is one of the weakest easing cycles since the mid-1960s.

The Fed has lately proved key. The chart below shows the likely path of our Global Liquidity Index (GLI) based solely on an extrapolation of the *broad US dollar monetary base* through year-end 2025. The latter includes both the liquidity-creating parts of the US Fed balance sheet and the US dollar holdings of foreign Central Banks. The future Fed balance sheet is estimated from the announced QT run-off and the latest QRA (*Quarterly Refunding Announcement*). The latter allows us to calculate the likely TGA and RRP components of the Fed's balance sheet. Conclusion: future liquidity growth looks positive, but slow.... It will need to pick up.



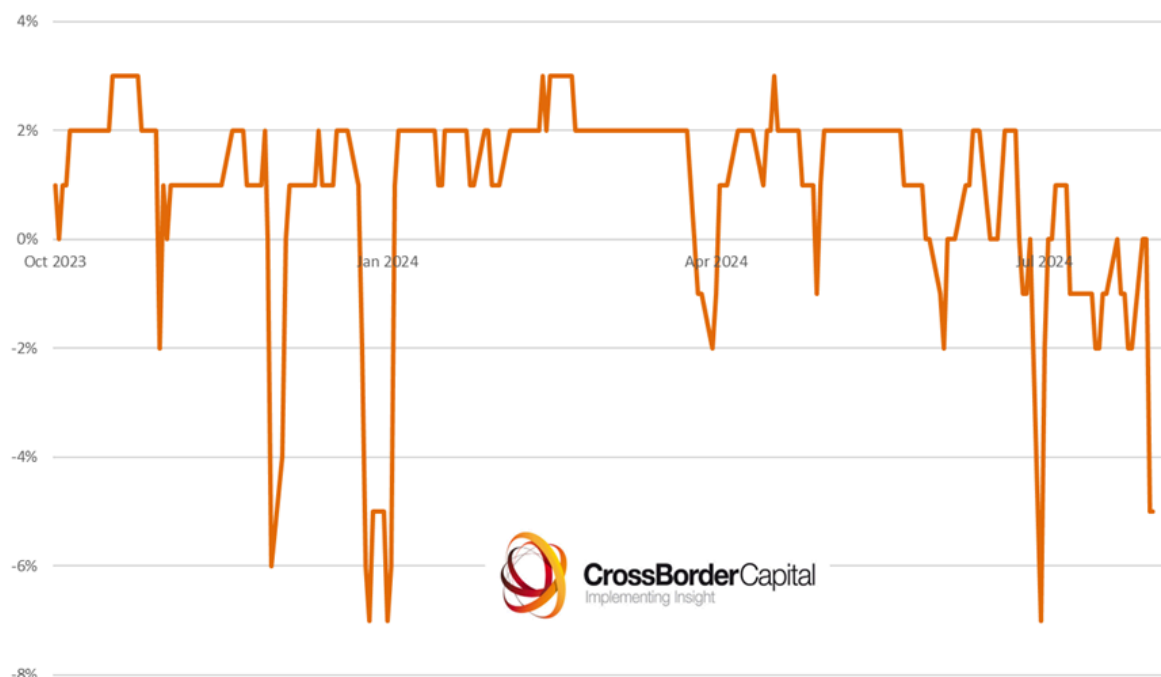
What could drive an acceleration in Global Liquidity? Our eyes are now mainly focused on the US Fed. Their deliberate slowness may turn out to be a policy error because US banks' reserves are starting to fall below the threshold that could trigger renewed regional banking problems. Consider the following chart derived from the Fed's latest H4.1 Press Release. The lower bound for reserves is drawn at minus 1 standard deviations to capture the negative skew away from regional banks. The threshold is estimated by extrapolating previous Fed estimates of 'adequate reserves'. The projections are again based on the Fed's stated QT profile and the latest QRA. Watch out...

US Banks' Reserves and Lower-bound (-1sd)



We must monitor the repo markets for any signs of tension. The following chart evidences 'collateral shortages' from the Fed funds-SOFR spread. Downward displacements on the chart (SOFR above FF) are becoming more frequent and likely signal growing liquidity shortfalls and a scarcity of decent collateral.

Collateral Surplus (FF-SOFR)



Help should be on its way, but we are reminded that 'hope' is not an investment strategy. The daily chart below shows that the US fixed income markets are signalling around four 25bp US policy rate cuts in the next 12 months. This is consistent with the current low tempo of US GDP growth. A measured Central Bank easing to help a slow economy is bullish for risk assets: a rapid policy easing to support a recessionary economy is rarely bullish. **The data still point to the former case and not the latter. Hence, we remain 'Risk-On'.** But as Mark Twain could have said, August is always dangerous month to speculate in stocks. The others are....

Daily US GDP Momentum and # Policy Rate Cuts

