Great Economic-Reset Outlook Update - August

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Atlas Shrugging in China, Rising Rates and Economic-Reset Tilt

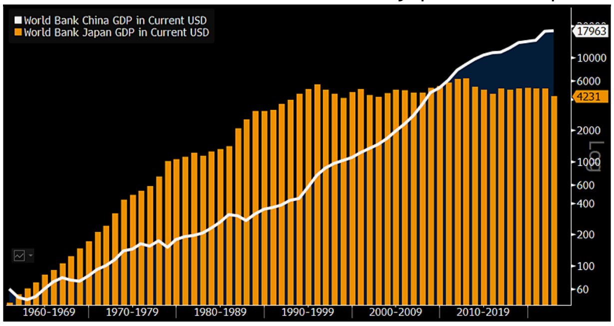
(Bloomberg Intelligence) -- China appears like some combination of "Atlas Shrugged," peak Japan and the Soviet Union over 30 years ago, with deflation implications. That is, Ayn Rand's novel focused on the calamities of autocratic leadership. Now, with Europe leaning into recession, negative US leading indicators and rates still rising, a global economic contraction may lie ahead. (08/24/23)

1. A Momentous Spark for China Reversion?

Some normal retracement of China's parabolic economic growth may have significant deflationary implications. A potential too-high trajectory and lack of bumps in the road can be takeaways from our graphic of GDP growth in China vs. Japan, which stalled about three decades ago. A worthy catalyst can spark normalization, and President Xi Jinping's "unlimited friendship" with Vladimir Putin prior to the latter's invasion of Ukraine may set historical standards on how to exasperate your best export customers: Europe and the US.

That the best way to properly measure and compare global GDP is in dollars appears profound. For the first time in about two decades, the US is importing more from Mexico than China. The inverted yield curve and Europe still hiking rates despite recession leanings may portend a big economic reset. (08/24/23)

Overdue to Narrow a Bit? China-Japan GDP Gap



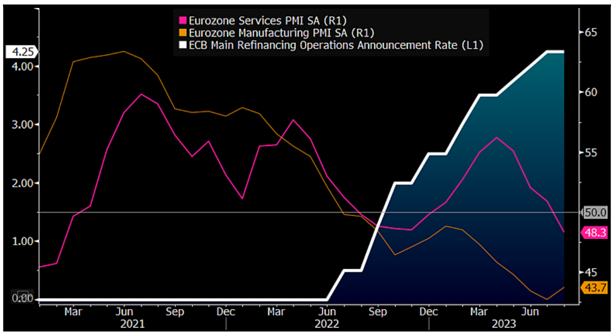
Source: Bloomberg Intelligence

2. Europe Bodies in Motion Toward Severe Recession

Rates are still rising on the back of the fastest coordinated hikes in history, and both euro-area manufacturing and services PMIs are contracting below 50. These trajectories toward the end of August are clearly recessionary and the key question is what stops it? Our bias is little. Typically it takes a long lag to central-bank easing or a lower plateau in risk assets. A global economic slump after the greatest-ever liquidity pump that dumped is not an unusual outcome, if history is a guide.

This remains our base case as central bank-focused inflation metrics remain sticky, keeping rates elevated, while higher-inflation beta producer prices in both China and the US are deflating. The bottom line may be that the primary force that created the inflation -- massive liquidity -- is still contracting in August. (08/24/23)

Rates Still Rising, Euro-Area PMIs Contracting



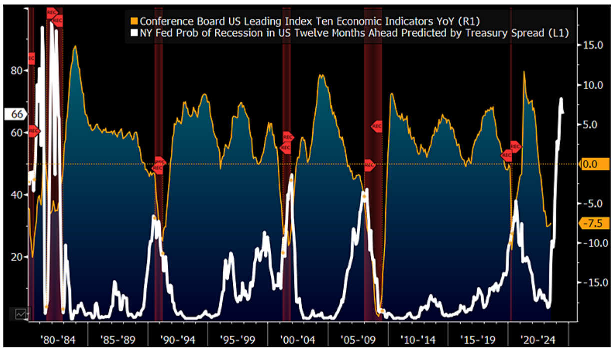
Source: Bloomberg Intelligence

3. Stuff That May Matter More Than Ever

In the category of stuff that doesn't matter until reaching extremes: the inverted US yield curve and leading indicators. Our bias is to heed the warnings, particularly in the context of the unprecedented aberrations that got us here. The graph shows the leading index of 10 economic indicators at minus 7.5% and the New York Fed's probability of recession from the Treasury spread at the most since 1982. What might be most significant is the elongated period of near-zero interest rates that buoyed the roughly 600% advance in the S&P 500 from the March 2009 low to the 2022 peak.

This period of exceptional risk-asset appreciation may face some normal reversion, particularly because the primary fuel has turned around. The fed funds upper-bound target of 5.5% is the highest since 2001 and may portend headwinds for risk assets. (08/24/23)

Heed the Warnings or Different This Time?



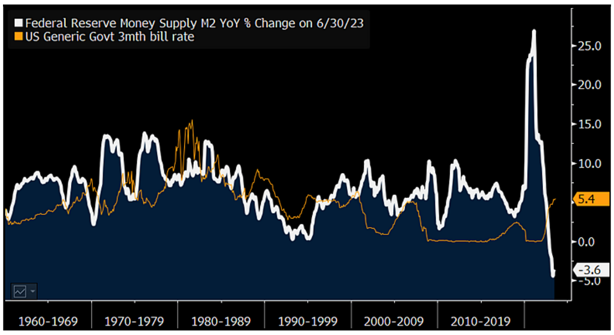
Source: Bloomberg Intelligence

4. What Stops Typical Risk-Asset Reversion?

In the category that it doesn't matter until it moves a lot may be negative US money supply following the biggest rise in history to the 2021 zenith. If the rules of liquidity and risk asset prices still apply, this single chart might be all that matters -- money is still dumping following the pump. Bullish underpinnings for stocks, commodities, cryptos and most risk assets may be limited, with liquidity running at minus 3.6% year over year to Aug. 21. What's notable is that there's an alternative -- US Treasury three month bills at about 5.4%.

The highest risk-free rates since 2000, about a decade before the birth of Bitcoin, may exemplify reversion risks in what some have called the fastest horse in the race. Now that there's an alternative, leading indicator Bitcoin could face further reversion. (08/22/23)

Negative Liquidity and High Rate Alternative



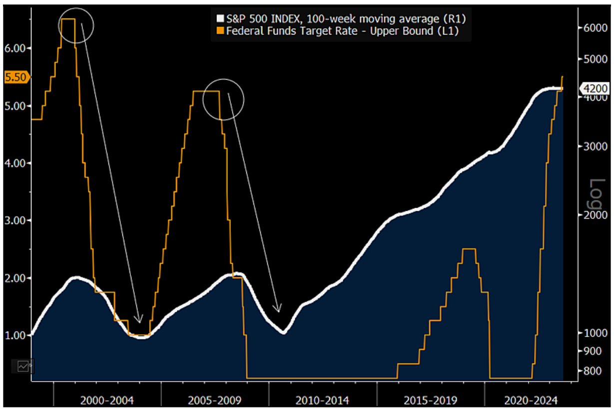
Source: Bloomberg Intelligence

5. What's Changed? The Fed Tailwind Has Reversed

Declining Bitcoin in 2H may be assessing the stock market's propensity since the peak of the internet boom in 2000 -- to carve out bottoms long after the Fed has started easing. There are always good narratives for intense rallies and extremely low interest rates, and cryptos and AI may draw parallels to the stock-market high about 23 years ago. Our graphic shows what's typically required to start looking for risk-asset bottoms -- central-bank easing. The Fed started cutting rates in January 2001 and the S&P 500 trough came in October 2002. Stocks bottomed in March 2009 after rate cuts that started in September 2007.

Risk assets may face an extended reversion period reciprocal to the elongated rally shown in the graphic from the bottom in 2009, when Bitcoin was born. Reversion room and Fed tightening are primary headwinds. (08/21/23)

Stocks May Be Rolling Over - Fed is Still Hiking



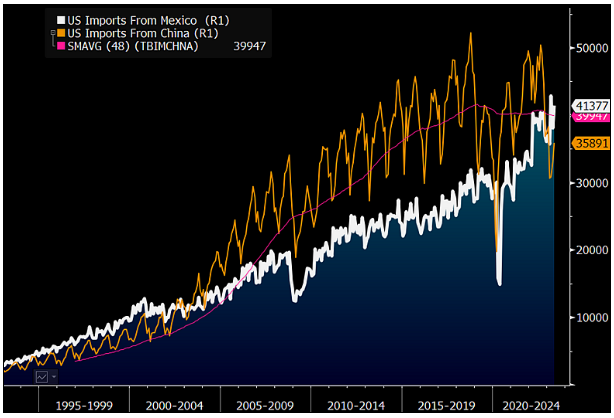
Source: Bloomberg Intelligence

6. US Imports From China Slip Below Mexico

For the first time in about two decades, the US imported more from Mexico than from China, and the economic implications will have a notable effect on commodity prices. Our base scenario is gaining support: China may be on a path akin to some combination of peak Japan and the Soviet Union about 30 years ago. President Xi Jinping's increasingly autocratic style and "unlimited friendship" with Vladimir Putin prior to his invasion of Ukraine may set historical standards on how to exasperate your best export customers: Europe and the US.

Juxtaposed to China, the only major country cutting rates, is the most aggressive global rate-hike period in history, that continues in 3Q. President Richard Nixon's visit in 1972 helped bring China into the global mainstream, but the ride appears on the road toward some reversion. (08/08/23)

US Imports From Mexico Soaring, Falling From China



Source: Bloomberg Intelligence

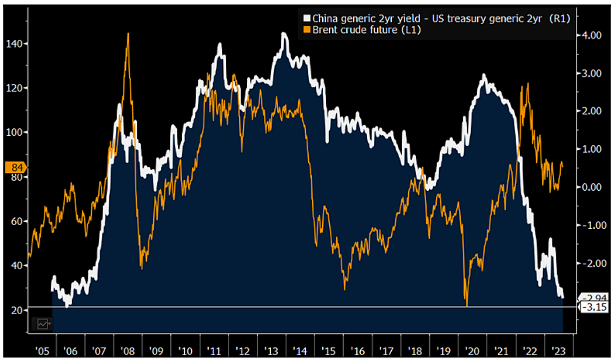
7. Crude May Have Good Reason to Fall -- China

Contributing Analysts **Henik Fung** (Energy)

The rally in Brent crude oil coincided with rising rates in China vs. US Treasuries to the 2013 high, and so may a decline. The US two-year note yield at almost 300 bps above China's is a headwind for crude and the yuan. Approaching 315 bps -- the widest in our database since 2006 -- it's the rule of bodies in motion that may be disconcerting for the global economy and price of most commodities, notably crude. What stops the widening yield-spread trajectory? The world's largest economy and importer hiking rates at a nearly unprecedented pace, juxtaposed with the No 2. and biggest exporter cutting rates, possibly heralding an economic debacle with commodities in the middle.

Our graphic shows Brent crude on the cusp of resuming the bear market since the 2008 peak, and for good reason -- weakening growth in China. (08/23/23)

Epicenter of an Economic Train Wreck? Crude Oil



Source: Bloomberg Intelligence

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