



Global Financial Trends

IS A REBOUND IN SIGHT?

Shweta Singh/Nikol Hearn

- Global financing conditions have eased since the end of last year
- Money supply signals a stabilisation – or potentially even a modest pickup in global growth – in the coming quarters
- Could this be a false positive?

Summary

Global financing conditions

Money trends

Risks

Summary

key points

Global financing conditions

- Global financing conditions have eased since the end of last year
- Credit spreads have narrowed across the board
- Developed markets – especially the US and to a lesser extent the EA – have led the bounce
- A rapid pivot to the dovish side from global central banks – in particular, the Fed – has played a key role
- Markets are pricing in aggressive easing by next year

Money trends

- Money supply signals a stabilisation – or potentially even a modest pickup in global growth – in the coming quarters
- The annual change in world money supply growth bottomed out towards the end of last year
- DMs have driven the pickup, while EM money supply remains dismal
- Developed markets see a pickup in M3 growth in the euro area and especially the US
- Could the rebound in money supply growth in the EA and US be a false positive?

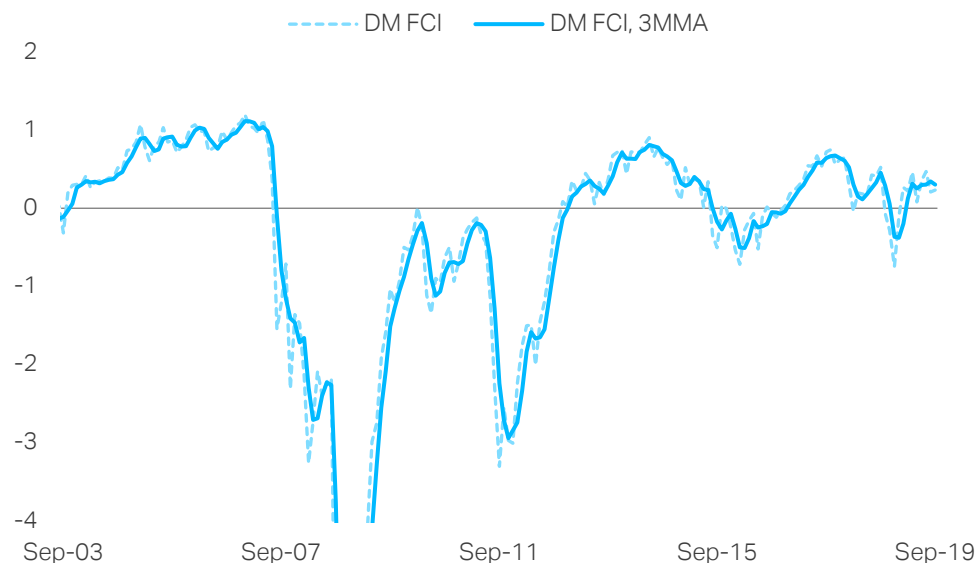
Risks

- It is too soon to say that growth will bottom out over the next couple of quarters
- Euro dollar funding costs could come under pressure again if the dollar stays high and the Fed disappoints
- Renewed trade tensions could throw a spanner in the works

Global financing conditions ease

Global financing conditions ease

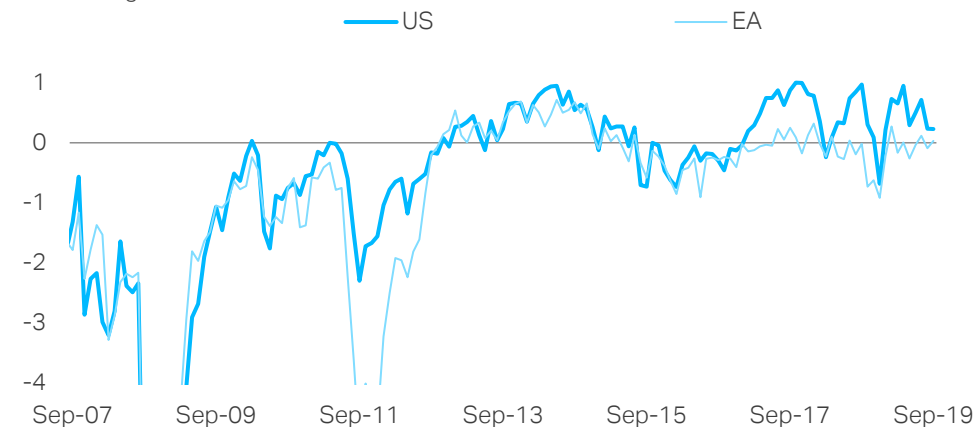
Bloomberg Financial Conditions Index, average of US, EA, UK



Liquidity conditions have improved since the end of last year when our measure of aggregate global financing conditions worsened the most since the EA debt crisis. Developed markets have driven the improvement, led by the US. The euro area has been a laggard, although financing conditions have eased since the recent December lows. Meanwhile, the ease of financing in Emerging Asia has deteriorated since April and is close to December levels. On an aggregate basis though, financing conditions look less punitive than they were three quarters ago.

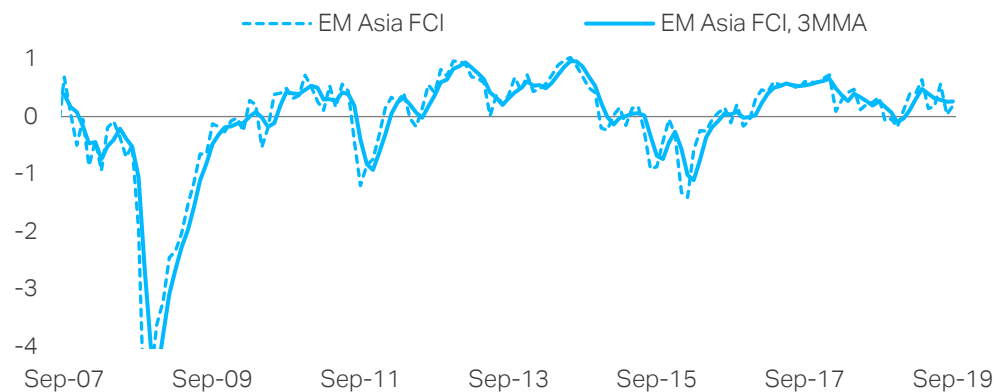
US financial conditions ease more than in the EA

Bloomberg Financial Conditions Index (FCI)



EM financial conditions approaching December lows

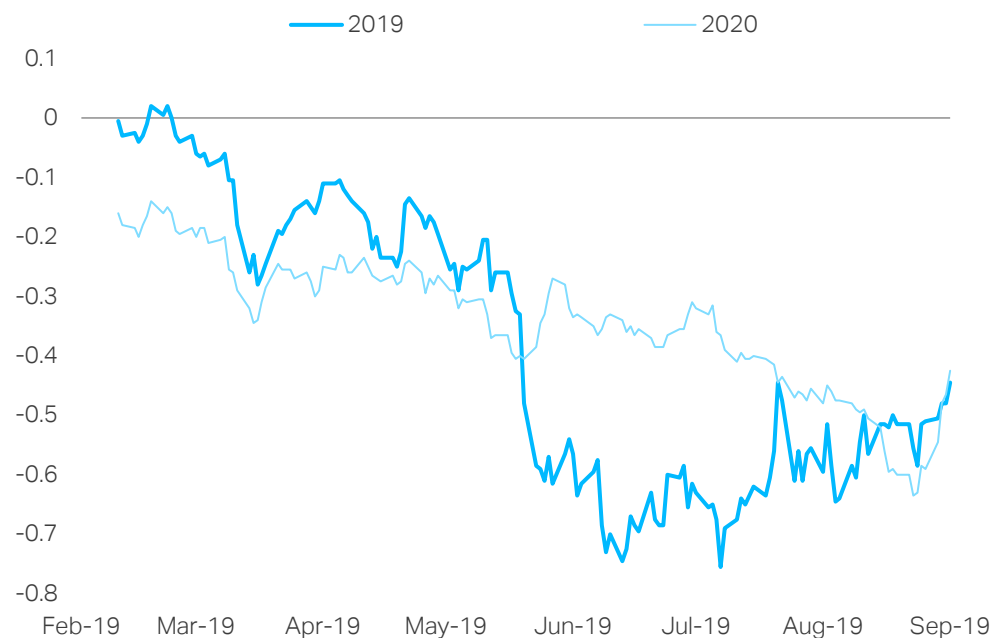
Citi Financial conditions index for EM Asia



Central banks ease

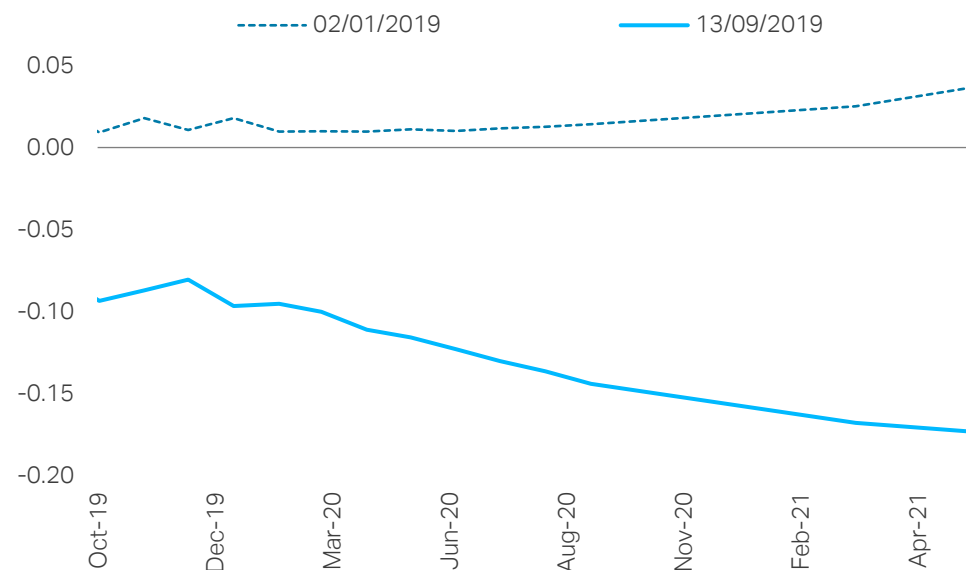
Markets pricing in 100bps more of Fed rate cuts

Changes in the Fed Funds Rate implied by the futures market, bps



Markets expect the ECB to cut the negative interest rate further

Changes in the ECB's deposit facility rate, implied by the EONIA curve, bps



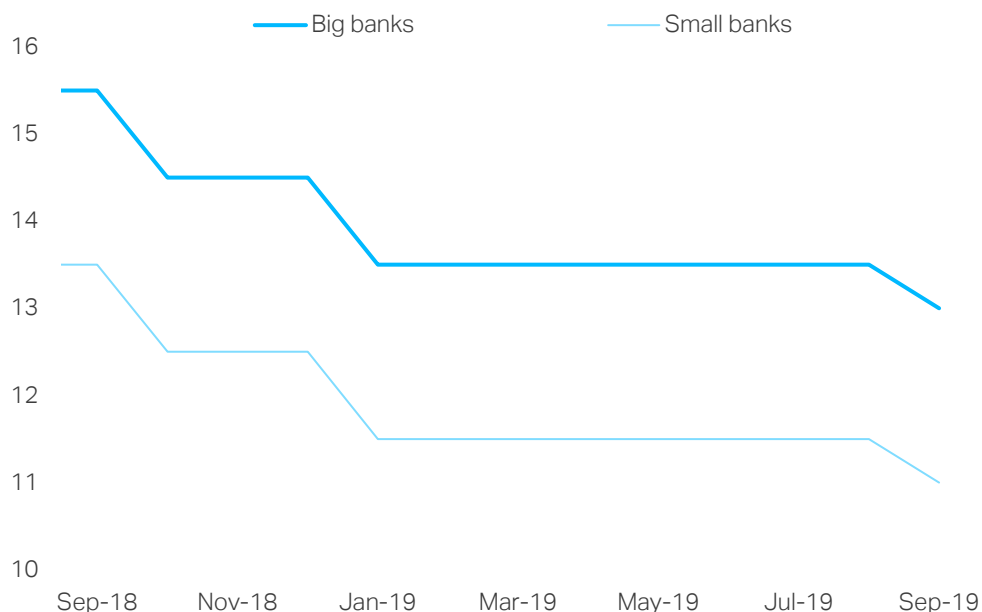
One of the main reasons why financing conditions have eased is the rapid dovish pivot by global central banks, [especially the Fed](#). The Fed signalled an end to QT. The central bank cut the policy rate by 25bps in July. The market is pricing in another 100bps of rate cuts.

The [ECB followed suit](#) adopting an increasingly dovish tone. It announced another round of cheap loans to banks in March. The central bank launched a large stimulus package last week, including a re-start of asset purchases (QE-II) which will be open-ended. The ECB cut interest rates further into negative territory while announcing measures to shield bank profitability from interest rates staying lower for longer. Markets expect 20bps or more in rate cuts over the next two years.

More easing in EMs

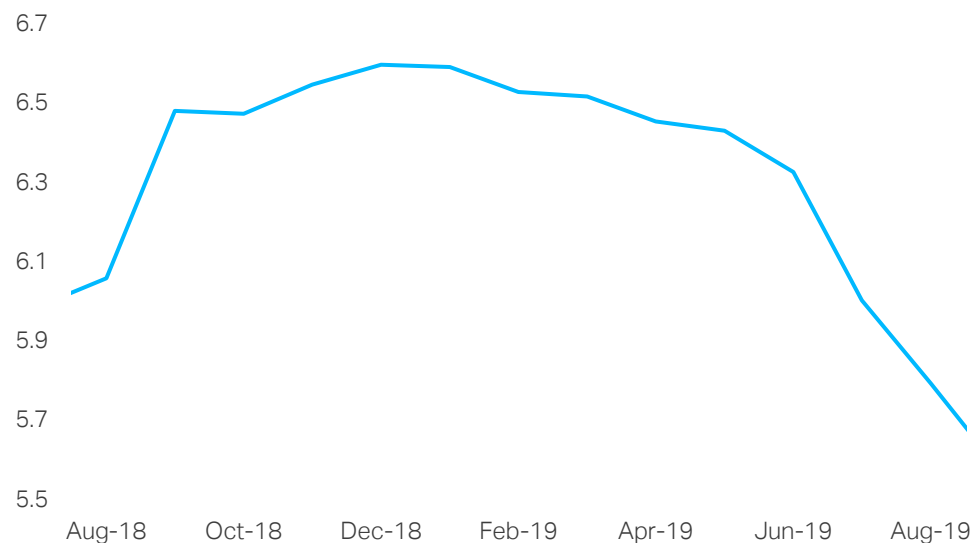
Several cuts in Chinese RRR

China, reserve requirement ratio



Other EMs also cut interest rates at a brisk rate

EM policy rate*, %



**GDP-weighted average of policy rates of India, Indonesia, S Korea, Taiwan, Malaysia, Philippines, Thailand, Brazil, Mexico, Chile, S Africa, Russia and Turkey*

Meanwhile, the PBoC has announced various easing measures, including 50bps of RRR cuts in September (see chart above). Our China team expects additional credit easing steps. This is [on top of fiscal easing](#): policymakers have announced 2.1% of GDP worth of fiscal stimulus this year, compared to 2018.

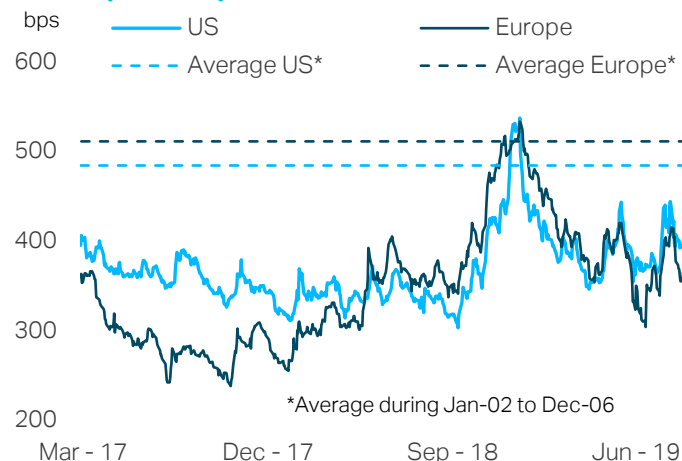
Central banks in other emerging markets have also been slashing interest rates. Our measure of EM policy rates (ex-China) has fallen by 100bps since December. To be sure, Turkey with a 750bps rate reduction exaggerates the decline in the EM policy index. If we exclude Turkey, interest rates in EMs have fallen by just over 50bps.

Credit risks have eased

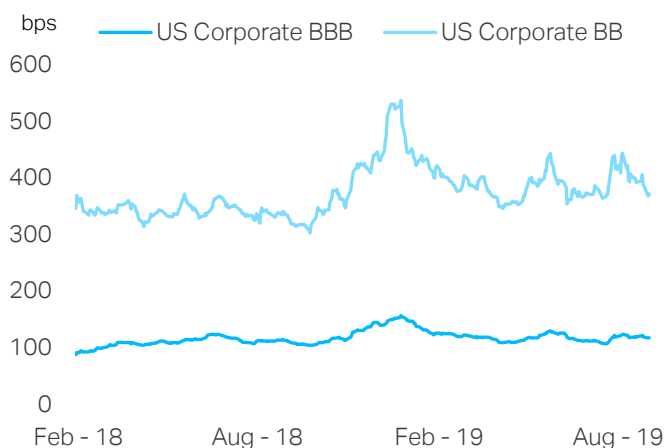
IG Corporate spreads consolidate



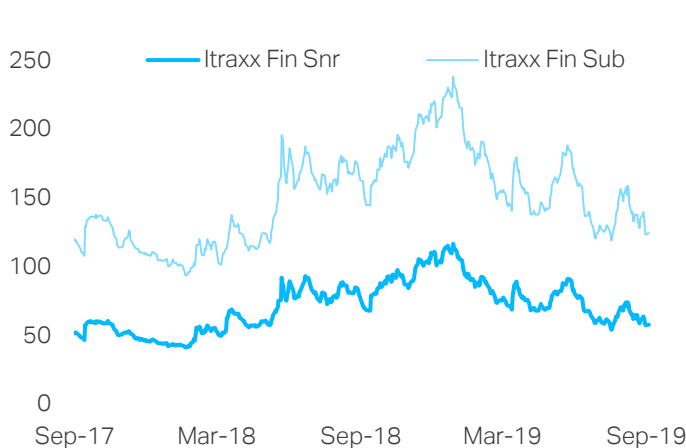
HY Corporate spreads consolidate



Corporate default fears ease



European banks' CDS spreads narrow



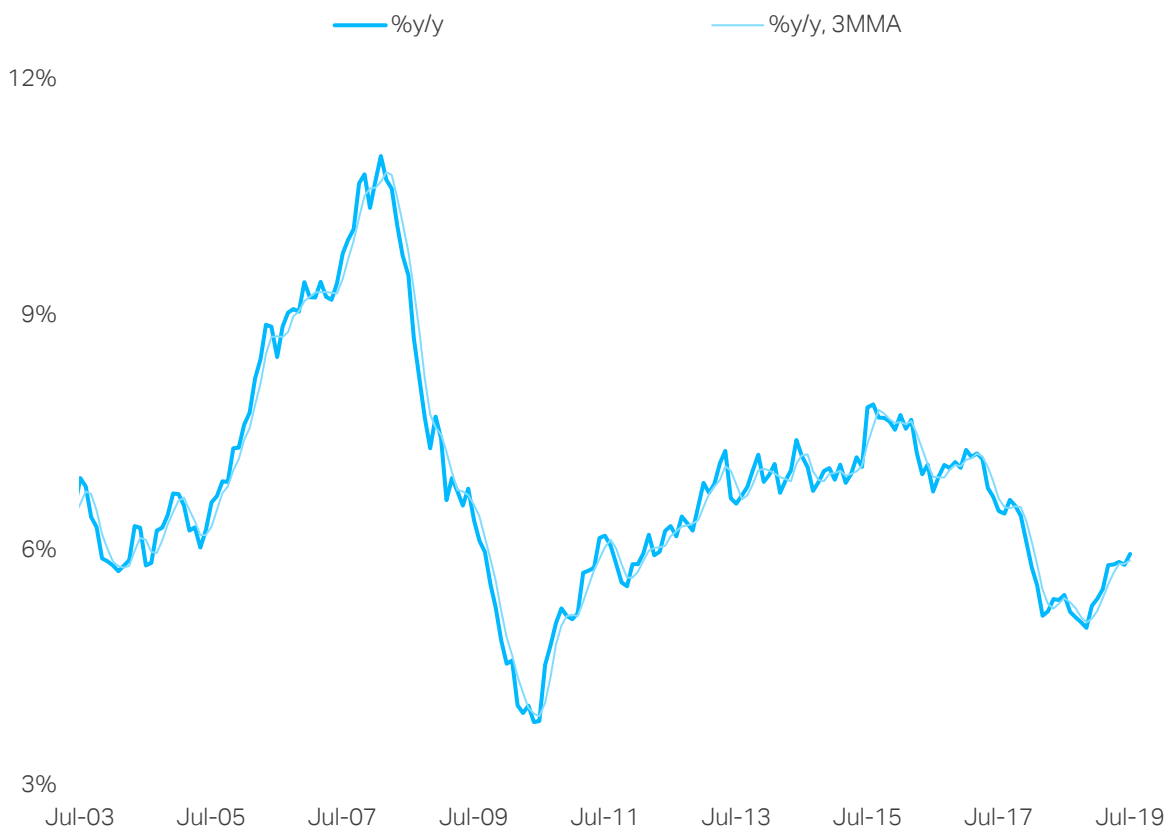
Credit spreads started the year at elevated levels, but have narrowed at a brisk rate since then. Much of the widening into the end of 2018 was led by heightened volatility in equity markets amid fears of an escalating trade war and tighter monetary policy. Concerns for corporates, particularly those with covenant-lite loans and a fall in the global oil price also fuelled the jump in spreads, especially in HY spreads.

Much of these trends have seen a consolidation into 2019 and as a result, the spreads have narrowed. Credit spreads are lower than their elevated levels at the end of 2018, although they remain above the 2017 base. Meanwhile, the VIX has moved lower than its December 2018 range, but remains elevated in relation to the barely-there equity vol experienced in 2017.

European financials, however, have seen less spread contraction as deeper negative rates fuel profit concerns. Given this year's rapid move lower by government bond yields and the renewed loosening of financial conditions since December 2018, yield spreads ought to be supported at their current levels. Without positive growth or earnings surprises, the yield range should remain at current levels into Q4 2019.

Broad money supply on the up

World Broad money growth



Money supply measures also signal a stabilisation – or potentially even a modest pickup in global growth – in the coming quarters. We construct our own measure of global broad money supply growth. The annual change in world money supply growth bottomed out towards the end of last year, suggesting we may be nearing a turning point for global demand. Assuming a 4-quarter lag, it may be in mid-2020.

Why use money supply measures? For all the criticisms, money – when measured correctly and when judged properly – plays a crucial role in forecasting turning points in nominal growth. There are various other caveats as well, including what time horizon we are interested in. But at the very least, developments in monetary aggregates provide a cross-check for other economic indicators that are subject to uncertainty.

Which is the best measure of money supply? Is a narrow metric, like the monetary base (M0), the best? Or, should we focus on broad money metrics, like M3 and M4? For national income determination, the more inclusive the metric, the better. But the issue with the broader measures of money supply is that the empirical relationships between money and growth have tended to be unreliable over short time periods.

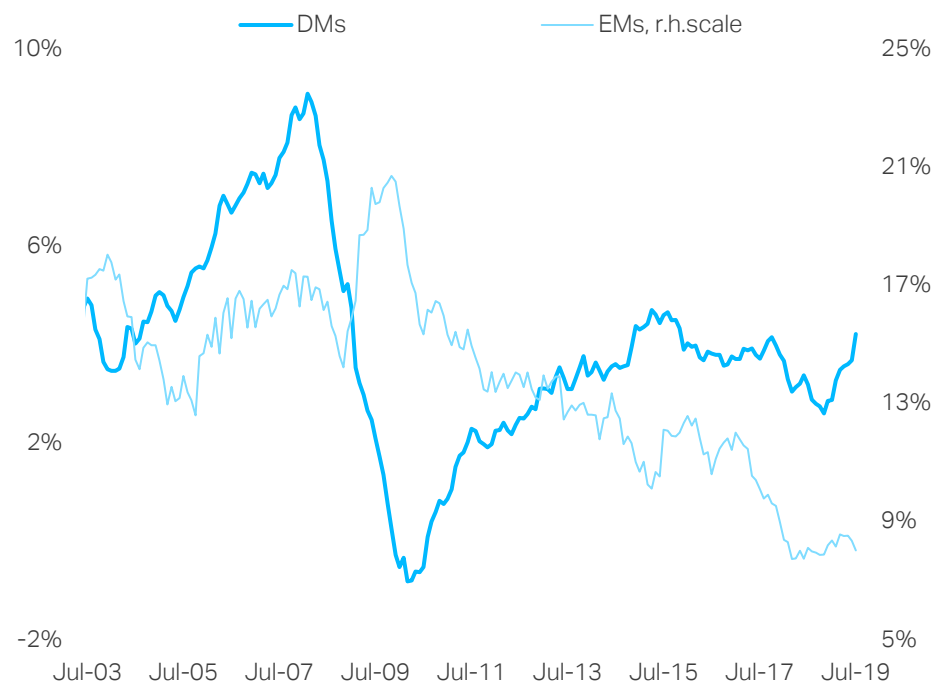
As a result, we supplement broad money supply trends with growth in narrow money supply to get a better handle on the growth path and a potential build-up of excesses and imbalances.



Looking for a turning point

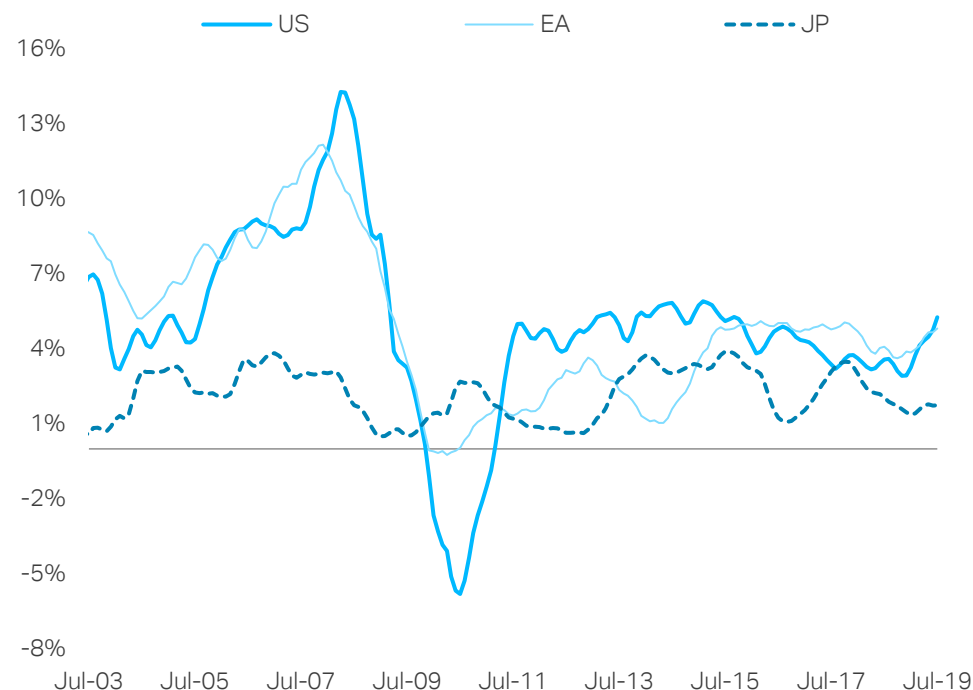
DMs accelerate, EMs still languishing

Broad money growth, %y/y



Strength in US and EA money supply

Broad money growth, %y/y, 3MMA



Global broad money supply (M3) growth bottomed out at the end of last year, signalling that global growth may be approaching a floor in the next few quarters.

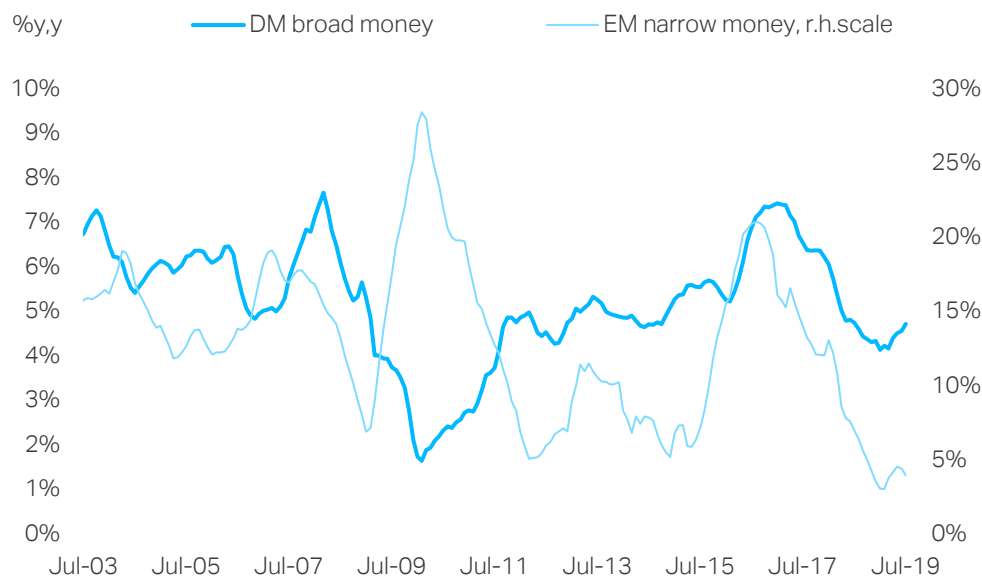
DMs have driven the pickup, while EM money supply remains dismal, likely reflecting the poor transmission of stimulus in China and elsewhere in emerging markets.

Within developed markets, a pickup in M3 growth in the euro area and especially the US have led the bounce while monetary trends in Japan remain lacklustre (see chart above).

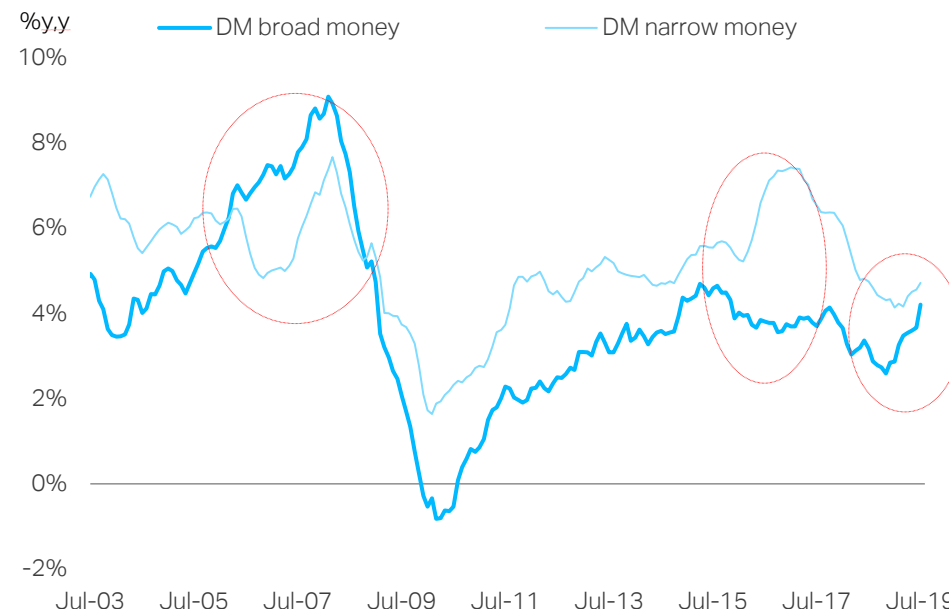


A false positive?

Narrow money supply growth picks up in US and EA



A false positive?



EM narrow money supply (M1) growth has also shown some momentum recently, albeit the pickup is modest compared to the gains in DM broad money supply. M1 trends in emerging markets remain poor, in line with the poor showing in their M3 growth.

Could the rebound in money supply growth in the EA and US be a false positive? It is too soon to say that growth will bottom out over the next couple of quarters. But we are more certain than a few months ago that global demand could be about to move up a gear in the coming quarters.

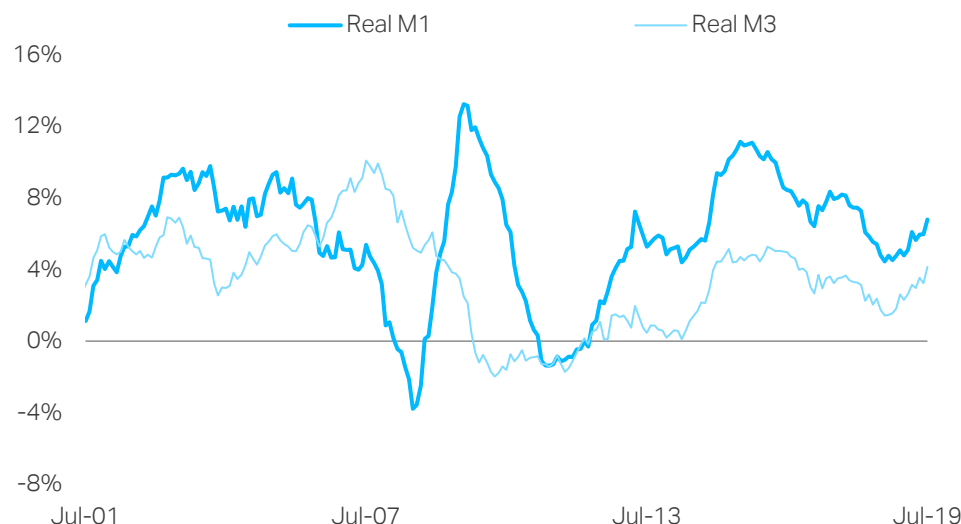
The pickup in developed market M1 and M3 is more synchronised and measured so far in comparison to the trends in the run up to the GFC when M3 growth was surging while the pace of M1 expansion was decelerating sharply. Similarly, during 2015-16, M3 growth was decelerating as M1 was growing rapidly.

While there is room for optimism, there are various caveats as we highlight in the case of the euro area on the next few slides. We will analyse the US money trends in greater detail in an upcoming GFT.

EA money supply accelerates, but don't get carried away (yet)

EA money supply growth picks up

% annual change, real, deflated by headline CPI inflation

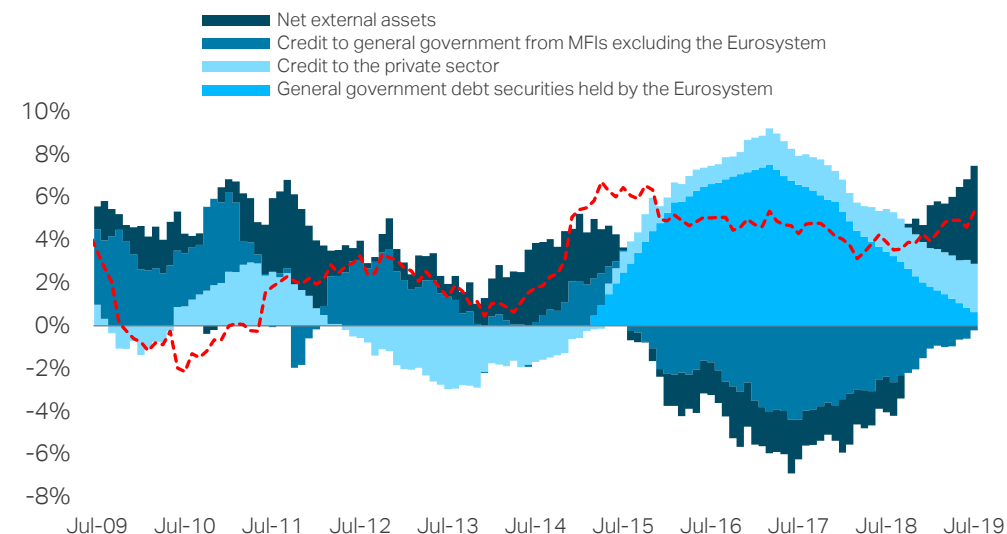


When we investigate the rebound in EA money growth it is not necessarily signalling a healthy rebound story just yet. [Empirical evidence](#) and various academic studies suggest that, in general, real M1 growth leads real GDP growth with a lag of around three to four quarters in the EA. Euro area money supply has been on an uptrend since mid-2018 (chart above). But the EA economy has remained in the doldrums.

Growth may indeed stabilise towards the end of the year as ECB stimulus kicks in, fiscal policy gets (mildly) expansionary, and global demand finds a bottom. But we continue to be wary of drawing upbeat conclusions about the pace of EA expansion from headline money growth as the underlying details convey cautionary signals.

What is driving the acceleration in EA money supply?

%-point contribution to annual M3 money supply growth

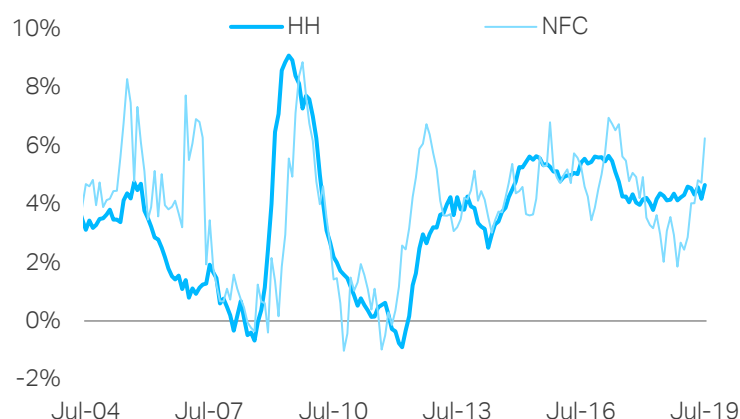


Viewed from the counterpart side (the asset side of the balance sheets of MFIs), the acceleration in broad money growth is being largely driven by an increase in net external assets as capital flows into the EA (chart above). We have set out in previous reports why EA debt was attractive for foreign investors. At the same time, for EA residents the yield pick-up available on non-EA debt has remained elusive. While this is positive for EA assets, it does not necessarily bode well for economic growth.

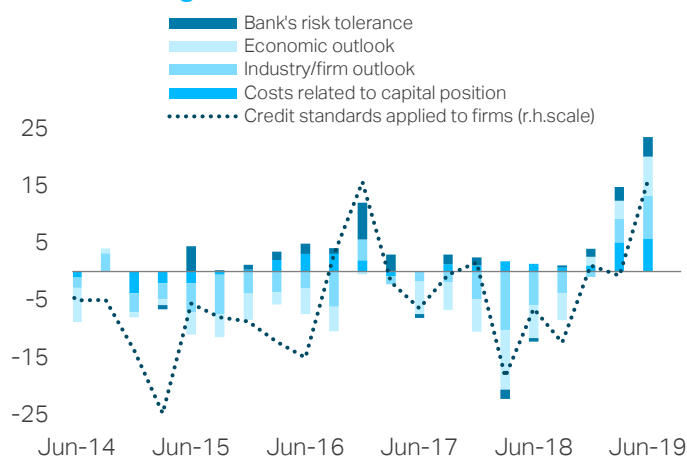
Precautionary demand has been on the rise

Narrow money by holding sector

EA narrow money, nominal, % 6 month change

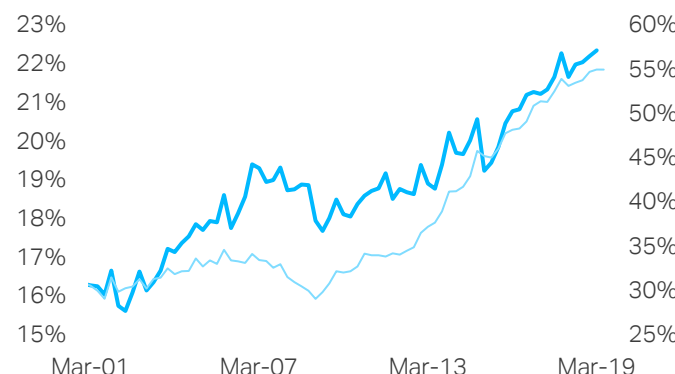


EA banks tighten credit standards



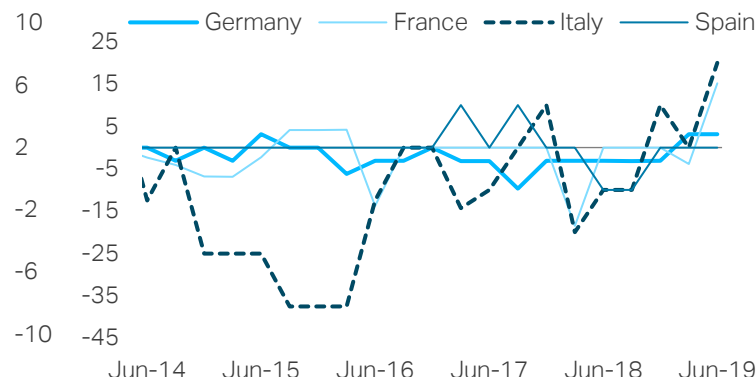
EA firms build their liquidity buffers

— Broad liquidity ratio (using Flow of Funds)
— Narrow liquidity ratio (using MFI balance sheet), r.h.scale



Italian banks tighten most

Credit standards for firms for the last three months, (net % of banks reporting tightening credit standards)



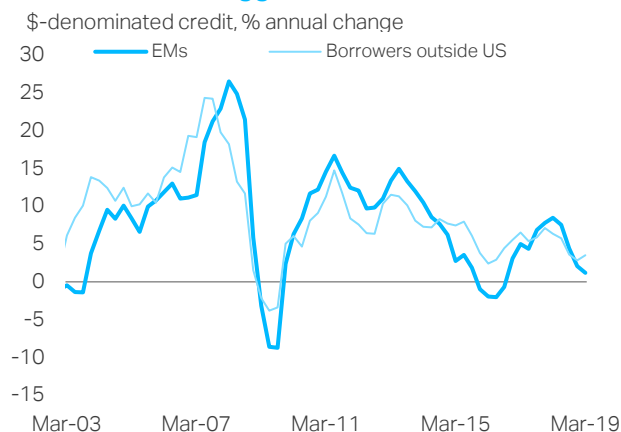
While analysing EA narrow money growth from the component side (the liability-side of the balance sheets of MFIs), we observe a large uptick in deposits of non-financial corporates (chart on the top-left corner). Crucially though, firms are not raising their cash holdings in anticipation of a ramp-up in capex. Instead, they are turning increasingly cautious about access to credit. This is also evident from the ECB's bank lending survey, which shows a tightening in loan standards for the first time since 2014 (charts at the bottom). As a result, companies are continuing to build their liquidity buffers (top-right chart), which is boosting narrow money supply.

Additionally, the share of M1 in M3 continues to rise over and above the difference in the holding cost of liquid and illiquid money. This implies a preference for liquidity that is driven by reasons other than opportunity cost, which could perhaps be the precautionary demand for money.

The good news is that consumers still provide some (limited) room for optimism. And QE-II could perhaps stimulate money growth by encouraging a switch to riskier assets, reducing uncertainty and encouraging new lending. In that case, the argument for a rebound in EA growth becomes stronger.

Risks to a rebound

International dollar credit growth continues to struggle



\$ basis and \$Libor-OIS spread



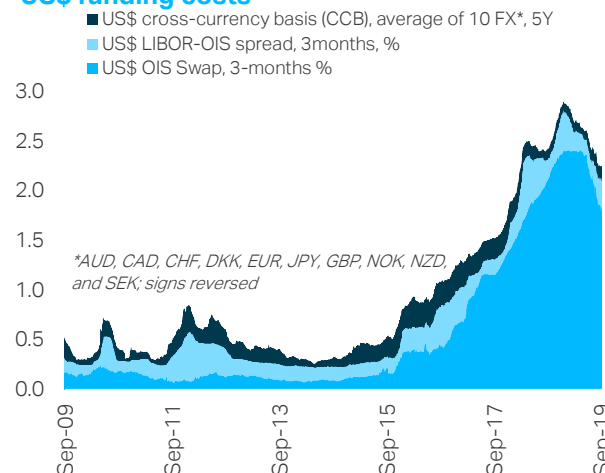
*AUD, CAD, CHF, DKK, EUR, JPY, GBP, NOK, NZD, and SEK. A \$-cross-currency basis is defined here as the difference between the implied \$ interest rate from the swap market when swapping foreign FX into \$ and \$ interest rate in the cash market.

Tighter offshore \$ liquidity?

Fed liabilities, reverse repo of foreign official and international accounts, weekly, \$ bn



US\$ funding costs



Clearly there are many risks to a potential rebound in global growth as being signalled by an improvement in money supply trends. The pickup in M1 is only modest and tentative so far. M3 has shown a stronger uptick, but the gains are limited to the developed markets, especially the US and to a lesser extent, the euro area. Without a meaningful rebound in EMs, it is difficult to forecast a healthy and sustained uptrend in global demand.

Euro dollar funding costs could come under pressure again if the dollar stays high and the Fed disappoints. A strong dollar has been weighing on global financing conditions, especially in EMs and has hurt the cross-border flow of \$-denominated credit (top-left chart). Some analysts point to the recent increase in reverse repo liabilities of foreign central banks at the Fed as a sign that offshore dollar liquidity is tightening again (top-right chart). Meanwhile, the \$LIBOR-OIS spread has started to widen, perhaps in anticipation of an increase in issuances as the Treasury replenishes its cash at the Fed. The 5-year \$-cross currency basis swap has also widened recently (bottom-left chart). But we don't expect a re-run of 2018 when Eurodollar costs came under severe pressure. On an aggregate basis, \$-funding costs have eased since the start of the year, led by a fall in the \$-OIS swap rate.

Renewed trade tensions could throw a spanner in the works by pushing the yuan and other EM FX lower against the dollar, hurting global demand. Should global central banks – especially the Fed – disappoint aggressive stimulus expectations priced in by markets – it would hurt global financing conditions. But barring these – not very minor risks – money trends are signalling that global growth may bottom out by mid next year. Famous last words?

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