SMBC Capital Markets, Inc.

fxPoetry

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Money's Still Free

There once was a time, long ago
When traders all just had to know
If payrolls were strong
So they could go long
If not, they would sell with the flow

But these days, with ZIRP and QE
Attention's not on NFP
Instead it's the pace
Of central bank grace
And making sure money's still free

One of the biggest changes in the market environment since the onset of the global pandemic has been the change in what markets find important. This is not the first time market focus has changed, nor will it be the last, but a change has definitely occurred. Consider, for a moment, why the market focuses so intently on certain data points. Essentially, traders and investors are looking for the information that best describes the policy focus of the time, and therefore, changes in that information are sufficient to change opinions, at least in the short term, about markets. And remember, that policy focus can come from one of two places, either the Fed or the Administration.

A step back in time shows that in the early 1980's, when Paul Volcker was Fed Chair, the number that mattered the most was the M2 money supply which was reported on Thursday afternoons. In fact, the market impact grew so large that they had to change the release time from 3:50 pm to 4:10 pm, after the stock market closed, to reduce market volatility. Trading desks would have betting pools on the number and there were a group of economists, Fed watchers, whose entire job was to observe Fed monetary activity in the markets and make estimates of this number. At the time, the Fed would not explicitly publish their target Fed Funds rate, they would add and remove liquidity from the money markets in order to achieve it. And, in fact, you never heard comments from FOMC members which is why Fed Chairs are now compelled to testify to Congress twice a year.

But as time passed and the economy recovered from the recession of 1980-81, the Reagan Administration became highly focused on the US Trade Balance, (especially the deficit with Japan) which became THE number right up through the early 90's. Once again, betting pools were common on trading desks and futures markets would move sharply in the wake of the 8:30am release.

At some point there, while Alan Greenspan was still Fed Chair, but there was a new administration, the market turned its attention away from trade and started to focus on domestic indicators, with payrolls claiming the mantle of the best indicator of economic activity. This suited the Fed, given its mandate included employment, and it suited the Clinton Administration, given they were keen to show how well the economy was doing in order to distract the populace from various scandals.

With the change in Fed Chair from Greenspan to Ben Bernanke, the Fed suddenly became a very different source of market information. No longer did economists need to read tea leaves, but instead the Fed told us explicitly what they were doing and where rates were set. Thus, during the GFC, Bernanke was on the tape constantly trying to guide markets to his preferred place. And that place was full employment, so payrolls still mattered a great deal. Of course, the market still cared about other things, like the level of interest rates, but still, NFP was seen as the single best indicator available. Remember, during Bernanke's leadership, the Fed initiated the QE that began the expansion of its balance sheet and changed the way the Fed worked, seemingly forever. No longer would the Fed adjust the reserve balances in the system, instead, they would simply post an interest rate and if supply or demand didn't suffice to achieve that rate, they would step into the markets and smooth things out.

Payrolls were still the focus through Chair Yellen's term, especially since her background is as a labor economist, so the employment half of the mandate was far more important to her than the inflation half, and so, if anything, NFP took on greater importance.

Jay Powell's turn at the Fed started amid a period where the economy was getting significant fiscal support and interest rates were trying to be normalized. In fact, the Unemployment Rate had fallen to its lowest level in more than 50 years and seemed quite stable there, so Powell seemed to have an easy job, just don't screw things up. Alas, his efforts to continue normalizing interest rates (aka tightening policy) resulted in a sharp equity market correction in December 2018. The President was none too pleased with that outcome, as the Trump administration was highly focused on the stock market as a barometer of its performance. Thus, once again, the Fed stepped in to stabilize markets, and turned from tightening policy to easing in the Powell Pivot. And perhaps that is the real message here, the most important data point to both the Fed and every administration is not payrolls or unemployment or inflation. It is the S&P500.

But Covid's shock to the market was unlike anything seen in a century, at least, and arguably, given the interconnectivity of the global economy compared to the last pandemic in 1918-20, ever. So, the first NFP data points were shocking, but the market quickly grew accustomed to numbers that would have been unthinkable just months prior. Instead, the numbers that mattered were the infection count, and the mortality rate. And arguably, those are still the numbers that matter, along with the vaccination rate and the stimulus size. All of these have been the market's primary focus since March last year, and until the idea of the government lockdown fades, are likely to continue to be the keys for market behavior.

Which brings us back to this morning, when the payroll report is to be published. Does it really have that much impact any longer? Or has its usefulness as an indicator faded? Well, it seems apparent that market participants are far more intent on hearing from Fed speakers and trying to discern when monetary accommodation is going to be reduced (never) than on the jobs number. In fact, given virtually every major central bank has explained that rates will remain at current levels for the next 3 to 4 years, at least, the only thing the data can tell us is if that will last longer than currently expected.

Ok, ahead of payrolls we have seen a general embrasure of risk, with equity markets strong, following yesterday's US rally. The Nikkei (+1.5%) and Hang Seng (+0.6%) both performed well although shanghai (-0.2%) slipped slightly. In Europe, the CAC (+1.1%) leads the way followed by the DAX (+0.3%) after weak Factory order numbers (-1.9%) and the FTSE 100 (+0.1%). US futures are currently trading higher by about 0.5% to round things out.

Bond markets are behaving as you would expect in a risk on session, with 10-year Treasuries printing at a new high yield for the move, 1.16%, up 2.1bps. In Europe, the bond selling is greater with Bunds (+2.5bps) and Gilts (+5.3bps) getting tossed in favor of stocks. Commodities are still in vogue, with oil (+1.0%) and gold (+0.4%) firm alongside all the base metals and agriculturals.

Finally, the dollar, is acting a bit more like expected, softening a bit while risk is being acquired. The dollar's recent rally alongside the equity rally seemed unusual compared to recent history, but today, things look more normal. S,o NOK (+0.4%) and CAD (+0.3%) lead the G10 charge while JPY (-0.15%) is today's laggard. Clearly these stories are commodities and risk preference. In the EMG space, APAC currencies were under a bit of pressure overnight, led by KRW (-0.4%) and MYR (-0.25%), but this morning we are seeing strength in TRY (+1.0%), RUB (+0.8%) and MXN (+0.4%) to lead the way. The CE4 are also performing relatively well alongside modest strength in the euro (+0.2%).

Now the data:

Nonfarm Payrolls	105K
Private Payrolls	163K
Manufacturing Payrolls	30K
Unemployment Rate	6.7%
Average Hourly Earnings	0.3% (5.0% Y/Y)
Average Weekly Hours	34.7
Participation Rate	61.5%
Trade Balance	-$65.7B

Source: Bloomberg

Which brings us back to the question, does it really matter? And the answer is, not to the stock market, and therefore not really to the Fed. However, a strong number here could well hit the bond market pretty hard as well as support the dollar more fully. We shall see. FWIW, I don't believe the dollar's correction is over, and another 1%-2% is entirely viable in the short-run.

Good luck, good weekend and stay safe
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