SMBC Capital Markets, Inc.

fxPoetry

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Pent-Up Demand

The one thing consistently heard
Is growth in H2 will be spurred
By pent-up demand
Throughout all the land
As people buy things they've deferred

But what if the virus has wrought
Some changes in what people sought
Perhaps now it's saving
That people are craving
Not spending, as routinely thought

There appears to be one universal view regarding economic activity going forward; there is an enormous amount of pent-up demand for things that people have been craving since the onset of the widespread government lockdowns as a result of the spread of Covid-19. This includes eating out, going to the gym, going to the movies and traveling on vacation. And it seems pretty clear that there is some truth to this idea. But given the trauma that governments around the world inflicted on their populations via the inconsistent messaging and lockdown mania, isn't it possible that many people have reevaluated what they deem as most important? I know that this author has certainly reconsidered what is really necessary to live a happy and fulfilling life, and I imagine I am not the only one.

But the point is, virtually every economist's assumption in their econometric models is that there will be a substantial pick-up in activity, especially in those service sectors that have been decimated by the ongoing restrictions, in the second half of the year. There is no doubt that savings rates are higher now than they were before the pandemic, with the latest BEA data showing a 13.7% rate at the end of 2020 vs. a 7.3% rate at the end of 2019. But the 2019 data was below the long-term (75 year) average savings rate of 9.0%, and two-thirds the rate seen from the end of WWII to1989. The point is recent profligacy by the American people is something of a historical anomaly. While Americans never saved like some other cultures, where savings rates would hover in the 20% range, historically, people really did try to save some money.

The other thing to remember is the past twelve months have been remarkably traumatic to the entire nation, if not the entire world, with a generation of children having their educations disrupted and changed significantly. As was evident in the wake of the Great Depression, an entire generation altered their behavior, as the Roaring 20's morphed into the Depression. The one thing that hasn't changed is human nature, with peoples' response to trauma informing their future activities. This is all a long-winded way of saying that, perhaps, there isn't nearly as much pent-up demand for things as is currently assumed. Perhaps, the increase in savings rate is a way for people, in general, to feel a bit more secure about their situation. While FOMO will never completely disappear, it certainly could wane.

With this in mind, it is possible to turn a more critical eye at forecasts for GDP growth around the world going forward. For instance, the UK reported that Q4 GDP rose 1.0%, well above forecasts of a 0.5% increase, and insuring that despite likely negative growth in Q1, there will be no double-dip recession. But BOE Chief Economist, Andy Haldane was positively effusive in his forecasts, saying, "A year from now, annual growth could be in the double digits." Wow is all I can say. That is an optimistic point of view, but it is not an isolated one. Here in the US, forecasts now indicate that GDP will grow 4.9% in 2021, well above trend and enough to offset 2020's 3.5% decline. And maybe they are right. Certainly, equity markets are all-in on the idea. However, I would be cautious in blindly accepting these numbers as gospel given no econometric model takes into account the changes wrought in perceptions by Covid-19. I fear growth could be much less impressive as 2021 evolves which means markets will need to adjust their thinking. Stay nimble!

On to today's session, which has seen another lackluster performance across markets. With most of Asia closed for the New Year holiday, only the Nikkei (-0.15%) was trading and it displayed a general lack of interest. European bourses are mixed with the DAX (-0.5%) a key underperformer while the CAC and FTSE 100 are both flat on the day. Given the better than expected data from the UK, it would seem that performance is a bit disappointing, but there are ongoing Brexit travails which seem to be putting a damper on things. US futures, meanwhile, had spent the bulk of the overnight session in the green, but are now all lower by about 0.2%. It appears we may be seeing some risk being unloaded into the holiday weekend.

Bond markets are ever so slightly firmer this morning, with the biggest mover Italian BTP's (-1.5bps) after the FiveStar party voted to support Super Mario for PM. Otherwise, Treasury yields are essentially unchanged as are bunds and Gilts.

Oil (WTI -1.0%) is under pressure again today, for the second consecutive session, but the uptrend remains firmly in place. This has all the hallmarks of a modest correction. Gold, however, is under pressure as well, and has been lagging most other commodities. Base metals are mixed as are agriculturals, which, again, tells you that there is no strong theme in the markets.

As to the dollar, it is broadly higher this morning, albeit not dramatically so. In the G10, the commodity currencies are under the most pressure (NZD (-0.5%, AUD -0.3%, CAD -0.3%) but we are also seeing weakness in the two havens with both JPY and CHF softer by 0.3%. In the emerging markets, RUB (-1.0%) is the weakest of the bunch after the central bank explained they won't be cutting rates further amid concerns over new sanctions to be imposed by the EU as well as the ongoing spread of Covid. But aside from the ruble, while most currencies in the bloc are softer, the movement has been relatively small, on the order of -0.1% to -0.3%, indicating this is really a dollar story.

On the data front, the only thing we see today is the preliminary Michigan Sentiment Survey (exp 80.9), which would need to be wildly different to change any views. As well, we continue to lack Fed speakers, and the data has clearly not shown "substantial further progress" on the Fed's efforts to support the economy, so policy changes are not in the air.

The dollar's consolidation after a nearly year-long decline continues, although, as I mentioned yesterday, there seems little impetus for the dollar to extend its corrective rally. Rather, it feels like we are going to see a little more market chop with no direction into the holiday weekend,

Good luck, good weekend and stay safe
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The views expressed are his own and may differ from Research.