CIO OFFICE MORNING MARKET WRAP – 18th October, 2021. ALSO AVAILABLE ON ALEXA.

Most Asian markets and US futures are sliding this morning on surging energy prices and mounting inflation concerns as Chinese Growth is slowing. China GDP slowed to 4.9% in Q3 against a consensus forecast of 5%, on Beijing's regulatory restrictions, the worsening Evergrande's debt crisis and electricity shortages which forced output curbs. Industrial output and fixed asset investments fell low of the mark as well, while retail sales expanded above forecasts in September. The National Bureau of Statistics said that the recovery "is still not solid", though China will ensure that annual targets are achieved.

Last week the IMF slightly downgraded global growth forecasts on persistent supply-side inflationary pressures and vaccine disparity between the developed and emerging countries. While the news in and of itself has the same degree of novelty as more rain on a rainy day, with the Fund notoriously trailing in the revision of forecasts, it is remarkable that the recommendation was for central banks to 'act appropriately' if price pressures threaten the recovery. So, if the persistency of price spikes was to dampen demand, for the IMF the tightening of monetary policy would be the right course of action. That the IMF blithely joined the Fed in letting us know their growing discomfort about the outlook for prices means that the path to a possible policy mistake has become shorter. To be sure, the Fed has boxed itself into a corner by letting liquidity flood the system even as the fastest recovery in history has unfolded. So, if they let inflation run out of hand they lose credibility, but if they tighten and then inflation subsides on its own as supply bottlenecks ease, then they will have stepped in for no reason and themselves killed the recovery. The bottom line is that both central banks and markets will be walking a very fine line, so much finer the longer the supply bottlenecks last. Yesterday prescient Wall Street investor Mohammed El Erian predicted “another year at least of high and persistent inflation”.

Actually, while it is now consensus to be concerned about stagflation, and it seems freakish to even contemplate deflation, it is the latter that would eventually come to pass if things go unexpectedly wrong in China. The Chinese growth model has ultimately been based on credit growth, which was on the weaker side in September. The credit impulse, the difference between credit growth and nominal GDP, fell further in August even as the authorities stepped in to support it. The negative interplay between the recent industry crackdown and market turmoil spurred by Evergrande’s woes reverberated negatively on bank loans and corporate bond demand. Should credit expansion continue to fall short of expectations, either because the fallout from Evergrande is too hard to control, or because the regulatory offensive killed the animal spirits, economic repercussions would not only be local. Consensus is for now convinced that the Chinese authorities will be able to pull off the credit trick once more, although the more it is pulled, the more the government will be pushing on a string. It is our base case as well that they will succeed again, and that otherwise any tail risk would be a story playing out well into 2022, with more attempts meantime being made to boost the credit impulse.

Bitcoin super-bulls should welcome the news that the SEC is going to allow the first Bitcoin futures ETF to begin trading next week. Shouldn’t they? They say that the devil is in the details, and this time it sits right in the folds of the futures curve, that causes losses when in contango. Indeed, the bitcoin futures curve, tracking futures prices as a function of expiries, is usually positively slanted, so that longer-dated expiry contracts are more expensive than shorter dated ones.

Bitcoin super bulls would be holding the ETF for the longer term, possibly eyeing a price target of 100,000, the current consensus target amongst super-bulls, losing also some money in the process as any expiring futures contract would be rolled into the next, more expensive, one. In short, a futures ETF is an inefficient way of owning bitcoin, as futures rollover losses would be eating into the potential gains of any long Bitcoin position. After all, why should a true-to-heart bitcoin super-bull be bothered with such trifle, if the ingrained belief is a final target of 100,000 versus the price of 62,000 as of the time of writing?

Stay safe.

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