GLOBAL LIQUIDITY CRUNCH NEARING AS GLOBAL YIELD CURVE FLATTENS/INVERTS

- The first half of 2018 was dominated by tighter global financial conditions amid the contraction in Global $-Liquidity, which resulted in the stronger US dollar weighing heavily on the performance of risks assets, particularly EM assets and, of course locally, on our currency (-15% YTD vs USD), bonds (+60bps YTD, R186) and equity market (-8% YTD, Top40).
- Global bond yields are on the rise again, led by the US Treasury yields, which as we have highlighted in numerous reports, is the world’s risk-free rate.
- The JPM Global Bond yield, after being in a tight channel, has now begun to accelerate higher. There is scope for the JPM Global Bond yield to rise another 20-30bps, close to 2.70%, which is the ‘Rubicon level’ for global financial markets, in our view.
- If the JPM Global Bond yield rises above 2.70%, the cost of global capital would rise further, unleashing another risk-off phase. Our view is that 2.70% will hold, for the time being.
- We believe the global bond yield will eventually break above 2.70%, amid the contraction in Global $-Liquidity.

GLOBAL BOND YIELDS ON THE MOVE AMID TIGHTER GLOBAL FINANCIAL CONDITIONS

- A stronger US dollar and the global cost of capital rising is the perfect cocktail, in our opinion, for a liquidity crunch.
- Major liquidity crunches often occur when yield curves around the world flatten or invert. Currently, the global yield curve is inverted; this is an ominous sign for the global economy and financial markets, especially over-valued stocks markets like the US.
- The US economy remains robust, but we believe a global liquidity crunch will weigh on the economy. Hence, we believe a US downturn is closer than most market participants are predicting.
SUPPORTS TO HOLD, FOR NOW…

As the JPM Global yield targets 2.70%, we believe local bonds will remain under pressure, targeting close to the 9.40% level. We, however, believe 9.35% will not be breached.

We expect the rand to consolidate around 14.70, potentially targeting 15.00 in the short term, but we do not expect weakness above 15.00 to be sustained.

In the next phase of Global $-Liquidity shortage, we expect local bonds to climb above 10%, targeting 10.50%, and the currency to breach 15.00, targeting 15.80.

The traditional velocity of money indicator can be calculated only on a quarterly basis (lagged). Hence, we have developed our own velocity of money indicator that can be calculated on a monthly basis.

Our Velocity of Money Indicator (VoM) is a proprietary indicator that we monitor closely. It is a modernised version of Irving Fisher’s work on the Quantity Theory of Money, MV=PQ.

We believe it is a useful indicator to understand the ‘animal spirits’ of the global economy and a leading indicator when compared to PMIs, stock prices and business cycle indicators, at times.

The cost of capital and Global $-Liquidity tend to lead the credit cycle (cobweb theory), which in turn filters through to prospects for the real economy.

Prospects for global growth and risk assets are likely to be dented over the next 6-12 months, as the rising cost of capital globally will likely weigh on the global economy’s ability to generate liquidity – this is already being indicated by our Global VoM indicator.