Global Liquidity

Money moves markets …Global Liquidity has been devised to track the gross ebb and flow of credit and international capital through World financial markets

[Markets] are now cross-border businesses…not understood by the man in the street … or Washington… If one wants to know what will happen next in the American economy and its financial markets, one has to study and understand what is happening in other parts of the World.

David Mulford, Senior US Treasury Official, writing about January 1984
Understanding **Macro-Valuation** Shifts

- Analysis of the **Stockmarket** NOT the market in individual stocks

  - Markets are driven by **supply of liquidity** and **demand for different financial assets**

- Study **behaviour of market players**, such as Central Banks and major investors
Daily US ‘Market Liquidity’ 2020-21

Index (0-100)

2020 2021 2022

Daily MLI 200 day MA
US Federal Reserve Net Liquidity Injections and S&P500 Index

Key FOMC: 'Transitory' dropped from inflation narrative; Fed Chair Powell re-appointed, and jumps in employment and CPI, Dec 15th, 2021.
Global Liquidity & World Wealth (inc. Gold, Crypto & Housing)

Correlation +0.57

Correlation +0.84

Source: CrossBorder Capital
Liquidity Always Features in Crises

The Evening Standard - May 24, 1932

- It's a global problem. 'Leak' in 1930s appears in Middle Europe and then threatens to capsize World Economy.

- In an echo of today’s crises, 85 years ago policy makers similarly ignored Global ‘financial stability’ question

Ufa, é um vazamento desagradável mas, felizmente, não no nosso lado do barco!
Global Liquidity

Global Liquidity is defined from the assets-side of credit provider’s balance sheets. It comprises: (1) Central Bank interventions, (2) bank and shadow bank credit, corporate cash flow, collateral-based wholesale and repo market activity and (3) net foreign flows.

Think of it as essentially starting where conventional definitions of ‘money’, e.g. retail bank deposits, stop.
Global Liquidity

It is independent of and nearly twice the size of World GDP

Global Liquidity is a measure of balance sheet, i.e. the CAPACITY of capital

NOT the COST of capital

It matters when debt has to be rolled over
Global Liquidity: Now Falling in Absolute Terms

Global Liquidity, 1980-2022

US$ Trillions

- China
- US
- Eurozone
- Japan
- Switzerland
- UK
- Other Developed
- Other Emerging

Global Liquidity, 2000

Global Liquidity, 2022
Components of US Liquidity

- **Wholesale Markets**: 16,395
- **Real Estate Loans**: 5,135
- **Federal Reserve in Wholesale Markets**: 6,728
- **Currency**: 2,172
- **I&C Loans**: 2,756
- **Other Real Economy Loans**: 1,953
- **Consumer Credit Loans**: 1,800
- **Financial Commercial Paper**: 924
- **Non-Financial Commercial Paper**: 1%
Cross-border Liquidity Flows, 1977-2022 (% World Domestic Liquidity)
## Global Liquidity’s 7x Rise Vs China’s 87x Jump

<table>
<thead>
<tr>
<th>Year</th>
<th>US$trillion</th>
<th>USA</th>
<th>China</th>
<th>Global Liquidity</th>
<th>World Central Banks</th>
<th>US Fed</th>
<th>PBoC</th>
<th>Cross-Border Flows $</th>
</tr>
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<tbody>
<tr>
<td>1990</td>
<td>5.5</td>
<td>0.6</td>
<td>23.8</td>
<td>1.7</td>
<td>0.3</td>
<td>0.1</td>
<td>-0.1</td>
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<tr>
<td>2000</td>
<td>11.9</td>
<td>2.4</td>
<td>38.0</td>
<td>2.6</td>
<td>0.6</td>
<td>0.4</td>
<td>-0.2</td>
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<tr>
<td>2008</td>
<td>22.3</td>
<td>8.3</td>
<td>84.9</td>
<td>7.6</td>
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<td>1.8</td>
<td>-0.4</td>
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<tr>
<td>2019</td>
<td>29.8</td>
<td>37.6</td>
<td>131.7</td>
<td>19.8</td>
<td>3.4</td>
<td>4.5</td>
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<tr>
<td>2022</td>
<td>41.0</td>
<td>52.1</td>
<td>165.6</td>
<td>28.3</td>
<td>5.9</td>
<td>4.9</td>
<td>0.5</td>
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</tr>
<tr>
<td>Times</td>
<td>7.7x</td>
<td>87x</td>
<td>7x</td>
<td>16.5x</td>
<td>20x</td>
<td>50x</td>
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</tr>
</tbody>
</table>
Looking Ahead: Two Key Investment Questions

• Will cost inflation revert back to low underlying trend? .... Yes

• Will Central Banks continue to create monetary inflation? ... Yes

... Conclusion = underlying trends remain intact: we are simply debating scale and timing of the cycle, and how long inflation lasts
Is This What The Bond Markets Are Telling Us?

Inflation is Structurally Low Because of Demographics, Not High! Ageing Populations Are More Likely Deflationary Than Inflationary. Labour Force Growth Matters, Not OAPs. Japan Surely Tells This Story?
The Debt-Liquidity Spiral

• Empowering China (& NE Asia) economically has weakened the West financially
• The reversal in polarity in World financial flows has forced Western financial markets to become **re-financing mechanisms** (dependent on B/S and liquidity) NOT new **financing systems** (where interest rates matter)
• High debts demand more liquidity and create low interest rates. Low interest rates incentivise more debt… Are we locked forever into a spiral of **low interest rates and rising debts**?
Ratio of Re-Financing to New Financings: World Economy, 1980-2022
The remarkable rise in both World Debt and Global Liquidity continues apace.
Global Liquidity Index (GLI™), 1965-2022

Source
CrossBorder Capital, US Federal Reserve, People’s Bank of China, ECB, Bank of Japan, IMF
Global Liquidity Index (GLI™) Long-Term Cycles

Source
CrossBorder Capital, US Federal Reserve, People’s Bank of China, ECB, Bank of Japan, IMF
Higher Oil Prices Smash Global Liquidity … Lower Oil?

Source
CrossBorder Capital, US Federal Reserve, FRED
The Global **Liquidity** Cycle

Yield Curve Turning Points (+8 months after ‘liquidity’)
Risk Appetite Turning Points (-3 months before economy)

*Implication yield curve leads markets by 6-9 months and economy by 9-12 months. Liquidity leads markets by 9-12 months.*
What Drives Bonds & The Yield Curve?

The slope of the yield curve moves pro-cyclically with liquidity. The transmission occurs via term premia and the net demand for ‘safe’ assets.

Pairwise Granger Causality Tests
Date: 05/31/18  Time: 09:50
Sample: 1986M01 2018M12
Lags: 6

Null Hypothesis: Obs F-Statistic Prob.
US Liquidity does not Granger Cause Yield Curve 10-2 388 2.50553 0.0217
Yield Curve 10-2 does not Granger Cause US Liquidity 0.79594 0.5735
US Treasury 10-2 Year Yield Curve and US Liquidity (Advanced By 9 Months)

Source
CrossBorder Capital, US Federal Reserve
US Treasury 10-5 Yield Curve Spread (+12m) and US Credit Cycle

- Credit spreads move in opposition to yield curve/term premia

Source: CrossBorder Capital, US Federal Reserve
Major Economies’ Business Activity & Global Liquidity (+9 Months)
Global Liquidity & Monetary Inflation Hedges (Gold & Crypto)

Source: CrossBorder Capital
Chinese People’s Bank and World Commodity Prices

Source
CrossBorder Capital, People’s Bank of China
Ratio of World Investors’ Equity Holdings to Global Liquidity

- World stock markets converge towards target level of Global Liquidity 0.51x
‘Average’ S&P500 Index Performance and US Liquidity Index

Note: Overall Bear Market drop -31% in 25 months; Overall Bull Market rally 42% in 25 months
US Dollar Real Trade-Weighted Index

*US dollar sits well-above its historic Real Exchange Rate trend*

Excess demand for ‘safe’ assets

Source
CrossBorder Capital, US Federal Reserve
Capital Flows into US$ and % Dev US$TWI from 3yr Trend

Source
CrossBorder Capital, US Federal Reserve, IMF

Capital flows into US over past decade have been a ‘perfect storm’

Source
The US Dollar-based World Financial System

- **US$-centric Bretton Woods I** still exists, there is no BWII nor BWIII

- **BWI is a funding/investment** system, not an accounting system for World trade

- **BWI was originally a club for** the ‘Liberal International Order’. Friend and Foes again demarcated No PRC or USSR
Asian ‘Euro’ (Currency Basket)

Source
CrossBorder Capital, US Federal Reserve, People’s Bank of China, Bank of Japan, IMF
Final Thoughts: The *Financialisation* of China

“...we should promote the Renminbi to be the primary currency of Asia, just as the US dollar first became the currency of North America and then the currency of the World ... Every globalisation was initiated by a rising empire ... As a rising super power, the ‘One Belt, One Road’ strategy is the beginning of China’s own globalisation ... it is a counter-measure to the US strategy of shifting focus to the East.”

(Excerpts from a speech by Major-General Qiao Liang, Chinese PLA, April 2015)
Soaring global debt, the US vs China power competition, and financial liquidity are all connected.

This week’s OTM guest @crossbordercap explains why.