



MORNING BRIEFING

July 22, 2020

A Billion Here, a Trillion There

Check out the accompanying [chart collection](#).

(1) A global meltup. (2) Billions of dollars being spent on developing a vaccine at warp speed. (3) Trillions of dollars being spent and printed with abandon by fiscal and monetary policymakers. (4) EU agrees to issue “corona bonds.” (5) Japanese government writing a blank check for dealing with virus. (6) ECB, BOJ, and the Fed continue to pump massive amounts of liquidity to drown the impact of the virus. (7) Another CARES package on the way this week? (8) We are all MMTers now, including Bernanke, Yellen, and Powell. (9) MMT free-for-all: Why can’t we all stop paying taxes? (10) A trillion here, a trillion there add up to meltups in stocks, bonds, gold, commodities, and foreign currencies.

Strategy I: No Shortage of Liquidity. Asset prices around the world are melting up. It isn’t just stock prices that are soaring. It’s also the prices of inflation-protected bonds. Precious metals prices are moving higher too. Home values are appreciating as well. Some of these bullish trends may be driven by expectations that the *billions* of dollars being spent on a vaccine will pay off. Undoubtedly, the main reason for the widespread bull markets in assets is the fact that governments around the world are spending and printing *trillions* of dollars, euros, yen, and yuan to offset the economic shock from the Great Virus Crisis (GVC). Consider the following:

(1) *Vaccines.* Typically, it takes roughly a decade for a new vaccine to go through the various stages of development and testing. However, the urgency of the pandemic, which has killed more than 600,000 people worldwide, has resulted in a mobilization of global medical resources rarely seen before in human history. Billions of dollars, provided by both the public and the private sectors, are funding the global campaign to develop tests, vaccines, and cures for the virus.

For example, the Trump administration has launched “Operation Warp Speed” with the goal of delivering 300 million doses of a safe, effective vaccine for COVID-19 by January 2021, as part of a broader strategy to accelerate the development, manufacturing, and distribution of COVID-19 vaccines, therapeutics, and diagnostics. Congress has directed almost \$10 billion to this effort through supplemental funding, including the CARES Act.

More than 100 clinical trials of dozens of potential coronavirus treatments are already underway around the world. Yesterday, we [learned](#) that the early trial results for two vaccine candidates—one developed by the University of Oxford and AstraZeneca and the other by the Chinese company CanSino Biologics—showed that both were safe and could induce immune responses in participants. But the next phase will be critical to demonstrate that the potential vaccines can protect against infections.

For the Oxford-AstraZeneca and CanSino vaccine candidates, the next step in testing is known as “Phase Three” of human clinical trials. It’s in this stage that scientists will be able to see whether a potential vaccine truly works to prevent coronavirus infections. The newly released clinical trial results showed that the Oxford-AstraZeneca vaccine candidate triggered the production of both antibodies and T cells, which can recognize and attack virus cells.

(2) *EU ups the ante.* On April 9, Eurozone finance ministers agreed on a new coronavirus stimulus package worth €540 billion, but couldn’t agree on a crucial decision: whether to issue joint debt instruments, called “corona bonds,” that would combine debt securities from the 19 Eurozone countries. Germany and the Netherlands, traditionally more fiscally conservative than Italy and Spain, were holdouts.

Yesterday, a new [agreement](#) was reached authorizing the European Commission (EC), the executive arm of the European Union (EU), to create a €750 billion recovery fund, which will be distributed among the countries and sectors most impacted by the coronavirus pandemic, and will take the form of grants and loans.

The new deal means that the EU will become a major borrower in global financial markets for the first time. It plans to repay the money by 2058. Nevertheless, the EC intends to propose new taxes on financial transactions and fines on greenhouse gases released by companies. Tech companies can also expect a “digital levy.”

(3) *ECB is on the case.* Undoubtedly, some of the new bonds will be purchased by the European Central Bank (ECB), which is currently buying government bonds as part of its Pandemic Emergency Purchase Program (PEPP), which totals €1.35 trillion. The PEPP started on March 18 with a commitment to make €750 billion in open-ended asset purchases. It was expanded on June 4 by €600 billion.

The ECB's balance sheet has soared by €1.62 trillion since the week of March 13 through the July 17 week ([Fig. 1](#)). Securities held for monetary purposes rose €552 billion during that period.

(4) *Japan writes a blank check to fight the virus.* In Japan, Prime Minister Shinzo Abe's government has rolled out combined stimulus spending worth ¥234 trillion (\$2.2 trillion); that boosts its annual budget spending to ¥160 trillion, with new debt issuance totaling ¥90 trillion. To cushion the economic fallout from the virus, the new stimulus programs include handouts to 126 million residents of ¥100,000 (just under \$1,000) each.

Yesterday, Finance Minister Taro Aso said that the Japanese government's budget won't set a spending cap on requests aimed at fighting the COVID-19 pandemic for the fiscal year that begins in April 2021. The budget ceiling is usually set around mid-year by the Finance Ministry to keep tabs on spending requests from ministries for next year's budget, to be compiled in December.

The government would ask ministries to keep requests for other spending in line with the current fiscal year's initial budget totaling a record ¥102.7 trillion, Aso said at a Cabinet meeting. The government then would set aside an unspecified amount of budget requests to respond to "urgently needed expenses" to battle the fallout from the coronavirus.

(5) *BOJ is on the case.* The [Minutes](#) of the June 15-16 Monetary Policy Meeting of the Bank of Japan (BOJ) was released on Monday. After easing monetary policy in March and April, the BOJ kept policy settings unchanged and maintained its view that the economy will gradually recover from the damage caused by the pandemic. The BOJ's balance sheet has soared by ¥64 trillion (\$600 billion) since February, through June ([Fig. 2](#)).

(6) *Another CARES package in the US.* The CARES Act was passed on March 27. It provided \$2.2 trillion in various short-term support payments as state governors issued stay-in-place executive orders to slow the spread of the virus. It was widely expected that they would gradually lift these restrictions in a few weeks, reopening the economy. The first round of support payments is running out for many households and businesses, while the reopening of the economy has been slowed by rapidly rising cases.

On Monday, congressional lawmakers returned from their recess and started working on a second relief package. They are under pressure to come up with something this week. Though

the CARES Act allows the \$600-per-week federal boost to state unemployment insurance to be paid through July 31, most states' weekly benefits are based on a cycle that ends on a Saturday or Sunday, making this week the last one that recipients will get that extra money unless lawmakers intervene fast.

(7) *The Fed is on the case.* The US federal budget deficit totaled a record \$3.0 trillion during the 12 months through June ([Fig. 3](#)). After the CARES Act was passed, the Congressional Budget Office (CBO) estimated that it would total \$3.7 trillion this year. The CBO may have to add another \$1 trillion to \$2 trillion to its estimate if the economic recovery stalls and if Congress passes CARES Act II.

No problem: We are all MMTers now! We all believe in the magic of Modern Monetary Theory, which Melissa and I described as a big power grab by Big Government in the July 8 [Morning Briefing](#). In response to the GVC, the Fed embraced the theory and its practice on March 23 with its programs of QE4Ever and No Asset Left Behind (NALB). The Fed already has financed more than half of the currently projected FY2020 federal budget deficit by purchasing \$2.1 trillion in Treasury securities over the past year through the July 15 week ([Fig. 4](#)).

Among the biggest proponents of MMT are former Fed Chairs Ben Bernanke and Janet Yellen. Last month, they signed a [public letter](#) from more than 150 economists that called on Congress to pass another big spending bill to extend and broaden the CARES Act. In a joint July 17 [blog post](#), they commended the Fed's response to the pandemic: "Broadly speaking, though, the Fed's response has been forceful, forward-looking, and comprehensive." In other words, Fed Chair Jerome Powell did what they would have done. We guess that they've provided Powell lots of advice in recent months, which he acted upon.

What about the federal deficit? Bernanke and Yellen are all in on MMT: "Following our advice would further increase the already record-level federal budget deficit. With interest rates extremely low and likely to remain so for some time, we do not believe that concerns about the deficit and debt should prevent the Congress from responding robustly to this emergency. ... [A]t some point, we will have to think through how to ensure the long-run sustainability of federal finances. The top priorities now, however, should be protecting our citizens from the pandemic and pursuing a strong and equitable economic recovery."

Read that excerpt again and think about it. Contrarians should be alarmed. What could possibly go wrong with this who-cares-about-deficits approach? ? Well, let's see: i) inflation

might make a surprising comeback; ii) bond yields might rise; and iii) if the Fed imposes yield-curve control to put a cap on the bond yield, the dollar might take a dive, which could boost inflation.

(8) *The PBOC is on the case.* The People's Bank of China (PBOC) continues to flood the Chinese economy with more and more credit during the GVC, as it has ever since the Great Financial Crisis (GFC). Over the past 12 months through June, social financing totaled a record \$4.5 trillion, led by a record \$2.7 trillion in bank loans ([Fig. 5](#) and [Fig. 6](#)). Bank loans are up a whopping \$18.9 trillion to a record \$23.3 trillion from \$4.4 trillion at year-end 2008, when the government started to respond to the GFC with massive credit expansion ([Fig. 7](#)).

(9) *Bottom line is a bottomless pit.* As we noted at the start of this commentary, a billion here, a trillion here and there add up to serious money. With the help of MMT, government deficits are a bottomless pit. If they can be financed so easily with easy money without boosting inflation, why do we bother collecting taxes? I would be a big advocate of MMT if my taxes were cut to zero. Let's give it a try! Why not? Anything is possible in the Twilight Zone.

While MMT hasn't boosted inflation as measured by consumer prices, so far, it certainly is boosting asset inflation, potentially fueling the Mother of All Meltups (MAMU), which potentially could set the stage for the Mother of All Meltdowns (MAMD).

Strategy II: Liquidity Has Consequences. The total assets of the Fed, the ECB, and BOJ are up \$4.9 trillion since the March 13 week through the July 10 week ([Fig. 8](#)). They are up \$5.8 trillion y/y. The bullish impact on all sorts of assets has been dramatic:

(1) *Stocks.* By lowering the yield curve to zero at the short end and below 1.00% at the long end, the Fed has forced investors to rebalance out of bonds and into stocks. No wonder that the forward P/E of the S&P 500 soared from a recent low of 12.9 on March 23 to 22.0 at the end of last week ([Fig. 9](#)). This series is very highly correlated with the size of the Fed's balance sheet!

Leading the charge has been the forward P/E of the FAANGM (Facebook, Amazon, Apple, Netflix, Google's parent Alphabet, and Microsoft) stocks. It jumped from 26.1 during the week of March 20 to 41.0 during the July 17 week, as their market share rose from 22.4% to 24.9%. (See our [FAANGM](#) chart books, which is automatically updated.)

Other stock markets around the world have had similar P/E-led rebounds since March 23, though their valuation multiples remain below that of the US MSCI stock price index, mostly because of the high valuation and market-cap share of the FAANGMs, as we discussed in the “Stay Home or Go Global?” story in the July 20 [Morning Briefing](#).

(2) *Bonds & gold*. The 10-year TIPS yield dropped to -0.84% on Monday ([Fig. 10](#)). That's down from 0.25% a year ago and the lowest since December 11, 2012. This yield is inversely correlated with the price of gold, which rose 54% from a low of \$1,178.40 per ounce during August 2018 to \$1,815.65 on Monday.

(3) *Home prices*. Record-low mortgage rates and “deurbanization,” attributable to people seeking homes away from densely populated cities, have combined to boost the demand for single-family homes. The supply of such dwellings has tightened up as homeowners in the sought-after suburban and rural locations are staying put. Debbie and I like to track the yearly percentage changes in median and average existing single-family home prices ([Fig. 11](#)). The former is up 6.0%, while the latter is up 4.4% through May. We expect that both series soon will show higher home price appreciation rates.

(4) *Commodities & foreign currencies*. The Goldman Sachs Commodity Index (GSCI) is up 29% since March 23 through July 20 ([Fig. 12](#)). The index is heavily weighted with oil and petroleum products. The CRB raw industrials spot price index is up 2% since March 23 through July 20, led by a 37% increase in the price of copper.

The GSCI is highly inversely correlated with the trade-weighted dollar, which is down 5.7% since March 23. The enormous fiscal and monetary policy stimulus provided by governments around the world could revive global economic growth if progress is made in combating the virus. Better global economic growth would be reflected in further gains in commodity prices and weakness in the dollar, i.e., strength in foreign currencies.

In this scenario, the dollar could really get whacked if the Fed stops US bond yields from rising by implementing yield-curve control.

CALENDARS

US: Wed: Existing Home Sales 4.8mu, MBA Mortgage Applications, EIA Crude Oil Inventories. **Thurs:** Leading Indicators 2.1%, Initial & Continuous Jobless Claims

1.300k/17.067k, Kansas City Fed Manufacturing Index, EIA Natural Gas Storage. (DailyFX estimates)

Global: **Wed:** Canada Headline & Core CPI 0.3%/0.9% y/y, Guindos, Buch. **Thurs:** Eurozone Consumer Confidence Flash Estimate -12, Germany Gfk Consumer Confidence -5, France Business Confidence 85, UK Gfk Consumer Confidence -26, Guindos, Haskel. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q2 Earnings Season Monitor ([link](#)): With over 10% of S&P 500 companies finished reporting revenues and earnings for Q2-2020, revenues are beating the consensus forecast by a whopping 3.3%, and earnings have crushed estimates by 11.2%. The large surprises are primarily due to a lack of financial guidance from the companies that analysts follow. At the same point during the Q1 season, revenues were 1.1% above forecast, but earnings missed by 3.6%. For the 51 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth are below the similar Q1 measures, but the percentage of companies reporting a positive revenue and earnings surprise actually improved. The small sample of Q2 reporters so far has a y/y revenue decline of 2.6%, and earnings are down 44.3% in what's sure to be the worst quarter since Q1-2009 during the financial crisis. For the time being, a similar percentage of companies is reporting a positive revenue and earnings surprise (77%). More companies are reporting positive y/y revenue growth in Q2 (49%) than are reporting positive y/y earnings growth (37%). That's the lowest rate for earnings growth since Q2-2009. These figures will change markedly as more Q2-2020 results are reported in the coming weeks, but the y/y revenue and earnings growth results are expected to remain dismal. Now more than ever, what companies say about the state of their business and their plans to ride out the COVID-19 crisis will be investors' main focus. However, many companies still are not providing guidance about their future financial periods.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): The rapid pace of COVID-19 estimate cuts has abated, and forecasts are showing increasing signs of recovery now. Consensus S&P 500 forecasts previously had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues ticked up 0.1% w/w and is now 6.1% below its record high in mid-February. Forward earnings ticked down 0.2% w/w and is now 18.4% below its record high in early March. Forward revenues growth remained steady for a second week at 2.9% after jumping 1.2ppts the week before that. Forward earnings growth of

5.1% was down 0.1ppt w/w, after surging 4.4ppts the week before that. Forward revenues growth is 3.4ppts below its seven-year high of 6.3% in February 2018, but is up from 0.2% in April, which is the lowest reading since June 2009. Forward earnings growth remains 11.8ppts below its six-year high of 16.9% in February 2018, but is up 10.7ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 5.1% y/y in 2020 compared to the 4.3% reported in 2019. That's up 0.1pt w/w and down 10.3ppts since the start of the year. Analysts expect an earnings decline of 23.0% y/y in 2020 compared to a 1.4% rise in 2019. Their 2020 growth rate was down 0.1ppt w/w and is down 32.0ppts since the beginning of the year. The forward profit margin remained steady at 10.4%, which is down from a 10-week high of 10.5% in early July. That's up just 0.1ppt from 10.3% during April and May, which was the lowest level since August 2013. It's still down 2.0ppt from a record high of 12.4% in September 2018. Analysts expect the profit margin to fall 2.2ppt y/y in 2020 to 9.3%—from 11.5% in 2019—and to improve 1.8ppt y/y to 11.1% in 2021. The S&P 500's weekly forward P/E rose 0.4pt to 22.3. It's down 0.1pt from 22.4 on 6/11, which had been the highest level since early 2002, and up from a 77-month low of 14.0 in mid-March. The S&P 500 price-to-sales ratio rose 0.05pt w/w to 2.32 and is down just 0.01pt from its record high of 2.33 on 6/11. That's up from the 49-month low of 1.65 in mid-March and compares to the previous record high of 2.29 in mid-February.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Last week saw consensus forward revenues rise w/w for seven of the 11 S&P 500 sectors and forward earnings rise for 5/11 sectors. Due to the sharp decrease in forward earnings this year, forward P/E ratios for nearly all sectors now are back above their recent record or cyclical highs prior to the bear market. However, forward P/S ratios remain below their highs for most sectors. Utilities is the only sector expected to maintain its profit margin in 2020, down from eight sectors expected to improve on a y/y basis in early March. During 2019, just two sectors improved y/y: Financials and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since 2018, it has moved lower for nearly all the sectors. In the latest week, the forward profit margin rose for Health Care, but fell for three sectors: Consumer Discretionary, Financials, and Industrials. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.8%, down from 23.0%), Real Estate (14.1, down from 17.0), Communication Services (13.3, down from 15.4), Utilities (14.0, down from a record high of 14.1% in early July), Financials (13.7, down from 19.2), S&P 500 (10.5, down from 12.4), Health Care (10.2, down from 11.2), Materials (9.0, down from 11.6), Industrials (7.6, down

from its record high of 10.5% in mid-December), Consumer Staples (7.2, down from 7.7), Consumer Discretionary (4.9, down from 8.3), and Energy (1.3, down from 8.0).

S&P 500 Sectors Forward Revenues and Earnings Recovery from COVID-19 Trough

[\(link\)](#): The S&P 500's forward revenues and earnings as well as its implied forward profit margin appear to have bottomed on May 28 after 14 weeks of COVID-19 declines. Since then, S&P 500 forward revenues has risen 2.0%, and forward earnings has gained 3.7%. The profit margin remained steady w/w at 10.4%, which is down from a 10-week high of 10.5% in early July. That compares to a cyclical low of 10.3% during May and June. On a sector basis, all but two sectors have been rising from the lows in their forward revenues, earnings, and profit margins. Communication Services marked a new post-COVID-19 low in its forward profit margin in the latest week. Also, Utilities posted new lows in their forward revenues and earnings. Here's how the sectors rank by their forward revenues change since May 28, along with their forward earnings change: Financials (revenues up 3.4%, forward earnings up 4.9%), Energy (3.0, 138.0), Consumer Discretionary (2.7, 7.6), Communication Services (2.6, 1.9), Materials (2.6, 5.0), Industrials (2.2, 5.5), S&P 500 (2.0, 3.7), Information Technology (2.0, 2.2), Health Care (1.2, 2.9), Consumer Staples (1.0, 1.2), Real Estate (0.0, -1.1), and Utilities (-1.5, -0.7).

S&P 500 Sectors Net Earnings Revisions [\(link\)](#): The S&P 500's NERI improved in July for a second straight month, suggesting that the worst of COVID-19-related downward revisions has passed. NERI improved m/m in July to -12.1% from -30.7% and is up from an 11-year low of -37.4% in May. However, NERI was negative for a 13th month and for the 19th time in 21 months. That compares to a tax-cut-induced record high of 22.1% in March 2018. NERI improved m/m for all 11 sectors for a second month; that compares to all 11 worsening on a m/m basis from March to May. However, NERI remained negative in July for all 11 sectors for a fourth straight month. Materials has the worst track record, with 22 months of negative NERI, followed by Industrials (21), Consumer Discretionary (20), and Utilities (18). Here are the sectors' July NERIs compared with their June readings: Energy (-6.5% in July, up from -34.8% in June), Consumer Staples (-6.7, -16.7), Health Care (-8.5, -23.3), Information Technology (-8.5, -24.9), Communication Services (-10.2, -27.0), Financials (-10.5, -34.1), Utilities (-12.4, -17.1), Consumer Discretionary (-16.6, -36.3), Industrials (-18.1, -41.9), Real Estate (-18.1, -30.9), and Materials (-19.4, -40.4).

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