BNY

iFlow

MACRO MORNING BRIEFING

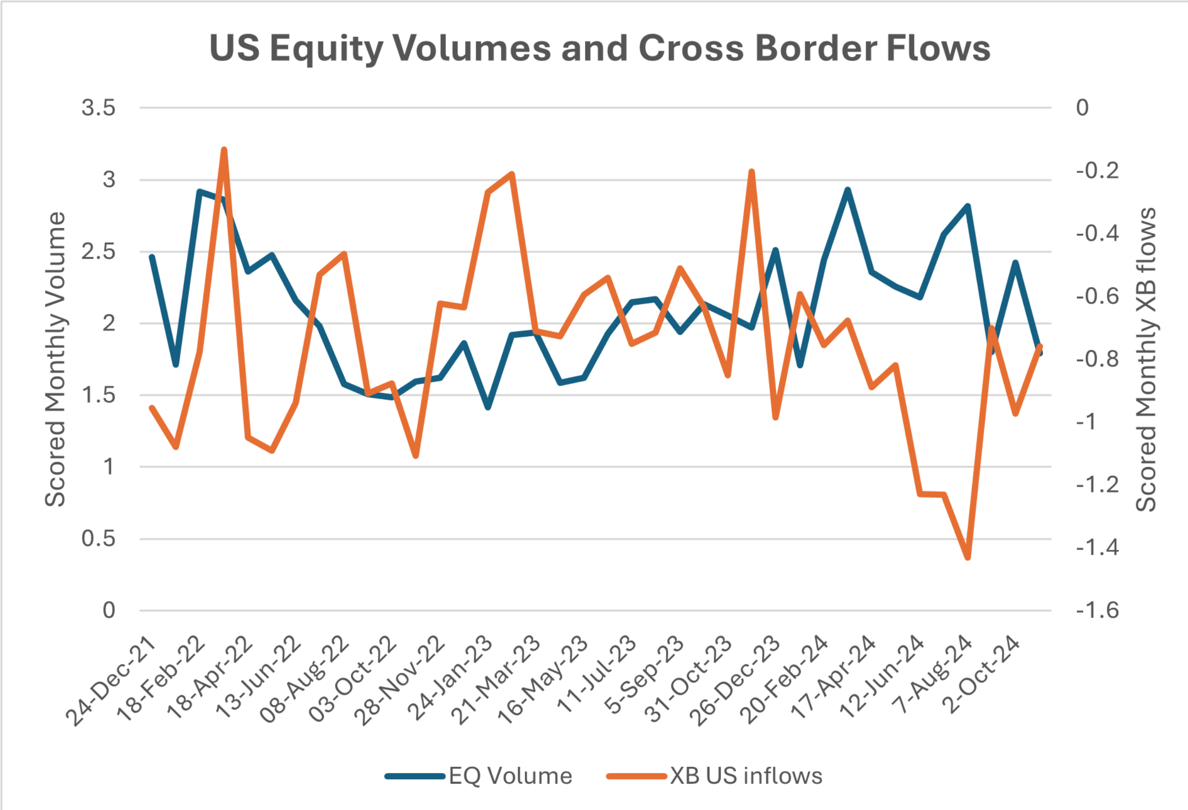
November 1, 2024

US Election Risk Premiums

- US election risk premiums are notable but uneven across markets – the S&P 500 implies 1.5% risk premium, US bond 10-year prices in 16bp, while MXN has 2.55% for the November 5 election.
- The holding of cash has risen over the last quarter but that is more about liquidity concerns related to quarter- and year-end risks along with size of US borrowing and Fed QT.
- The FX market is a better barometer of election fears, with a notable focus on Asia as well as Mexico. The volatility of Asia FX outstrips the G10 notably by 3% since July.
- The biggest movers in the last quarter related to FX markets are Bitcoin and gold. A number of analysts argue both moves are linked to the US election, but others highlight the role of geopolitical conflicts and crisis from Russia/Ukraine to Israel/Hamas.

The equity markets in 2024 have been notable for breaking their seasonal patterns. October ends with the S&P 500 not having a +/-1% daily move on the month until Halloween, even as the average of the VIX has been 20% and is up 4% (0.8bp) on the month. In the last 50 years this relative trading calm has only happened twice, in 1995 and in 2017. The US equity scored flows into earnings have been surprisingly positive but cross-border volumes lag. The market has been long US exceptionalism for two years and the election risks a breaking point, particularly if the seasonality of November and December do not deliver should the certainty of a vote prove insufficient for policy direction and confidence.

Exhibit #1: iFlow Shows Summer Volume Lull Hangover



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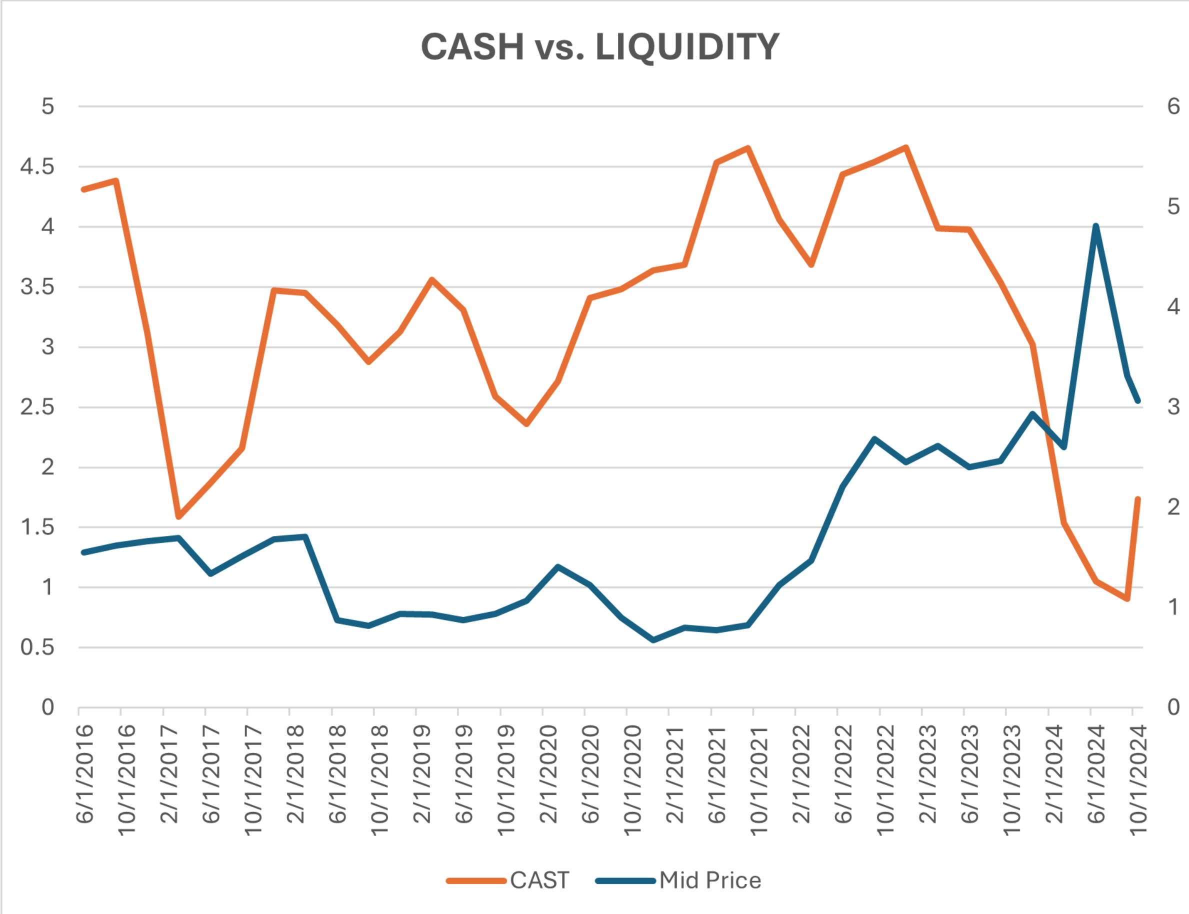
Source: iFlow, BNY

The larger problems for markets in October have revolved around the shift of focus from monetary to fiscal with the election not just about the US president but Congress as well. The cross-border flows into the US bond markets have stalled of late – but that may be more about rethinking Fed rate cuts than the election. Even so US sovereign bonds have been bought this past week (0.58 scored flow) and have been positive in flow on the month (0.19 scored flow). This even as 5-year US rates rose 65bp on the month. The most notable reaction by markets to higher US and EU rates in sovereign bonds comes from cash. For most of the last two years cash holdings have been declining. Exhibit #2 highlights our quarterly Cash and Equivalents flows vs. the Bloomberg Liquidity measure GVLQ.

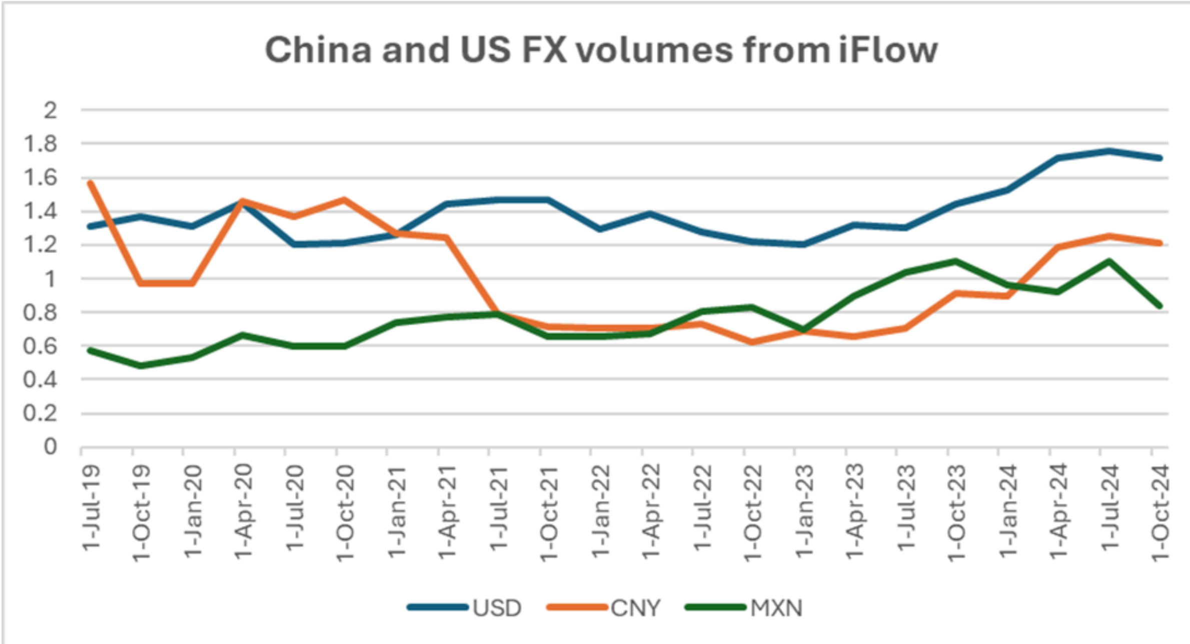
Exhibit #2: US Demand for Cash Linked to Liquidity Worries



Source: Bloomberg, BNY

The focus on CNY and MXN into the US election has been notable in price movements in spot FX, but the iFlow data indicate a slowing of interest in both, suggesting the knock-on effect of less investment in both nations and less FX hedging. The role of FDI in both China and Mexico in driving FX moves stands out. Mexico has seen a drought in new FDI timed around their own election in June and continuing with the judicial reform. China has seen a return from the pandemic lows, but the current stimulus hope has not been sufficient to return to pre-pandemic levels. The key point for risk into and after the US election is in the flow of capital both public and private into Mexico and China. The ability to hedge any election policy risks seems to miss the larger backdrop of global risks like climate change, pandemics, and technology. The AI boom in the US clearly has been part of the story for the USD and that is less correlated to either fiscal or monetary policy risks and more to global regulation risks and data center capacities. Exhibit #3 highlights the FX volumes by quarter in iFlow from the 2020 elections and pandemic to the present.

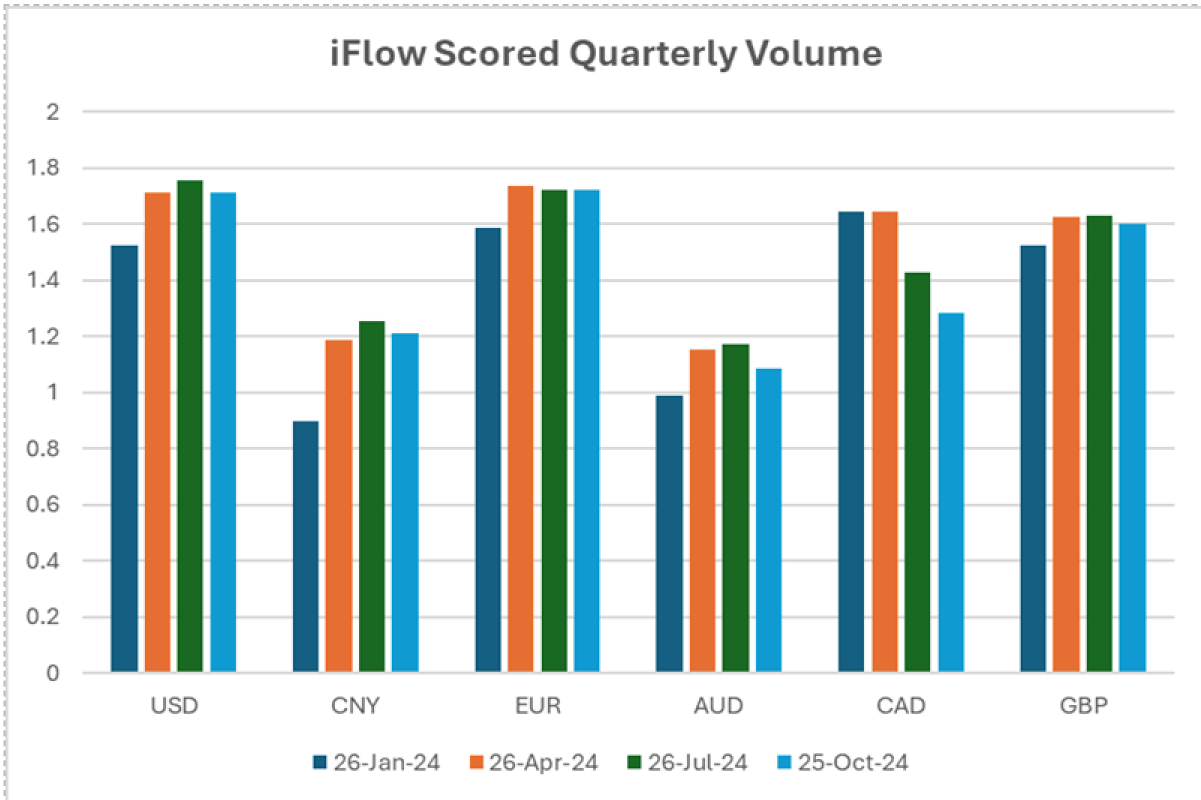
Exhibit #3: FX Volumes Shift on FDI and Other Cross-Border Flows



Source iFlow, BNY

Digging deeper into the FX markets as a barometer of risk into the US election, it is possible to see from looking at the quarterly volumes from our iFlow across major currencies that there has been a decline in flows from investors since July. This represents a thematic shift from monetary policy to fiscal policy concerns globally. While the New York Fed FX Survey in 2024 showed average volumes up in April 26.9% y/y, the iFlow after that peak suggests a steady decline, most notably in CAD, AUD and CNY.

Exhibit #4: FX Volumes Shifted into Election

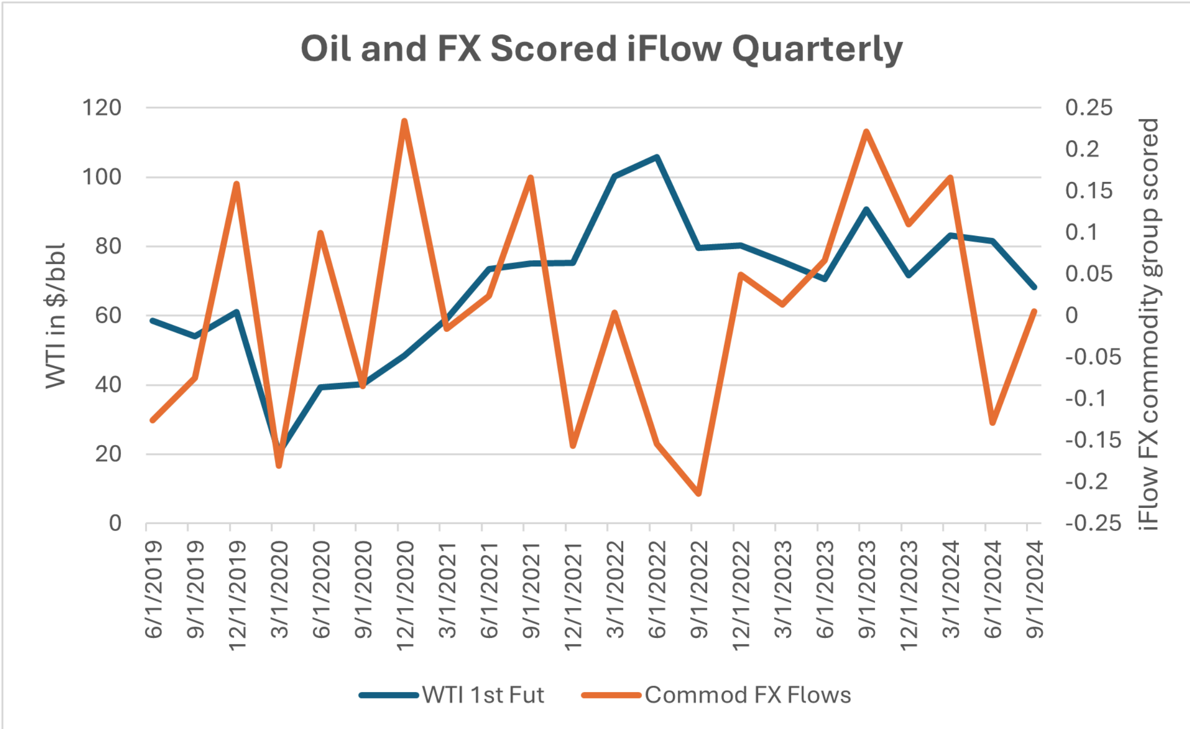


Source: iFlow, BNY

FX markets also tell us something about commodities and the link of global growth demand reflected in oil prices against the fears of currency debasement reflected in gold prices. This week has highlighted the risk of commodities and geopolitical events with the focus on oil and gold to the USD. The election again plays a dominant role. The fear of the escalation of conflicts in Russia and the Middle East rests on the outcome. Trump trade dynamics are less in play in FX markets outside of CNH and MXN than in oil. The correlation of the gold price to commodities is positive but clearly not as dominant as oil and other energy products. The oil and FX relationship during Covid was clearly confused by demand disruption.

Bottom Line: The US election remains too close to call and that uncertainty hangs over markets but not in a uniform way. The risk setup for markets reveals that US dollar short positions are significant but mostly explained by hedging of both US bonds and US shares (we see positive inflows and negative holdings of 1.2). The duration positions that were put on around Fed rate cut expectations are also a risk given fiscal policy uncertainty. However, the biggest risks for markets are not in stocks or bonds but FX – that shows up clearly in volatility markets first, but our worry is less in China and Mexico and more in commodity FX. The link of risks to oil and gold and other metals stands out as the biggest uncertainty for 2025 growth following the outcome of the November 5 vole.

Exhibit #5: Commodities and FX Linked Key into Election



Source: iFlow, Bloomberg, BNY

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Please direct questions or comments to: iFlow@BNY.com

Bob Savage
HEAD OF MARKETS STRATEGY AND INSIGHTS

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