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iFlow

MACRO MORNING BRIEFING

November 28, 2024

Thanksgiving and USD

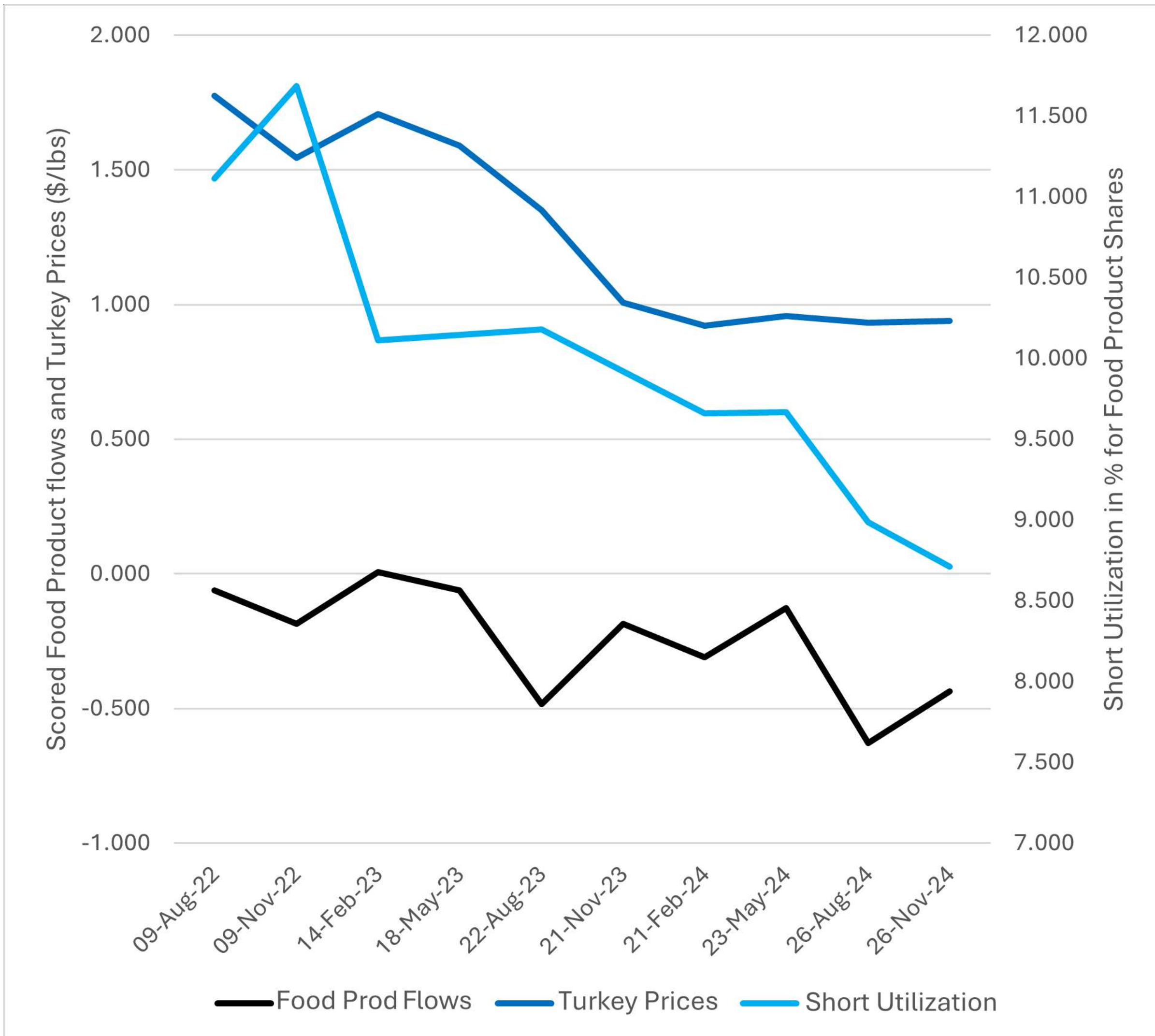
- The month-end rebalancing needs in November stand out, with USD approaching four standard deviations overweight on the month – the biggest upward move in 10 months, suggesting a need to sell to rebalance hedges. The biggest beneficiaries should be EUR – with massive selling and outflows in the top five of our 20-year history – GBP, and INR with MSCI rebalancing.
- The driver of USD buying in November was not carry, trend or value. Instead, geopolitical factors were the main driver, something that is not well modeled by FX short-term investors – but the German election, French coalition worries and an escalation of the war between Ukraine and Russia were all key.
- The rush to buy USD following the US election has resulted in concerns about US year-end and month-end liquidity as well. Non-US corporations with fiscal year-ends in November and December may struggle and squeeze funding costs.
- The role of trade and inflation is an interesting point of speculation into 2025, but one that has a practical impact on the dinner table, too, as US consumers look at Thanksgiving dinner and see that the cost of this meal is 19% higher than it was five years ago.

Cost of Thanksgiving tests tradable vs. non-tradable prices

There is an important story behind the cost of Thanksgiving dinner dropping 5% y/y in 2024 and the role of demand. Turkey accounts for most of the cost of Thanksgiving dinner (44%). Turkey prices fell 6% this year even as supply is at its lowest level since 1985, with just 205 million turkeys raised. The avian flu hit both chicken and turkey farms in 2024, but the US Department of Agriculture (USDA) recorded a drop in demand for turkey that offset higher prices. What stands out about food production in the US is the interplay of demand destruction and the speed of the investment response.

Our iFlow data show how investors responded to the drop in public demand for turkey as prices rose during the pandemic. What varies, according to the USDA, is production. There is also a role for turkey imports, and this is the part that matters for 2025 given the uncertainty regarding tariffs – Canada and Chile are the largest exporters of turkeys to the US. During the height of the pandemic, Chile ramped up its exports of turkeys to the US, with exports peaking in October 2022. In contrast, reflecting shipments to the US and the interconnected nature of business between the two countries, Canadian exports of turkeys to the US have been inelastic to price and steady for years at around 2 million pounds per month. The value of turkeys produced during 2022 was $7.10 billion, up 21% from $5.89 billion the previous year. The spike in turkey prices did not last, though, and the value of turkeys produced in 2023 was $6.57 billion, down 8% y/y from the previous year. The outlook for 2024 and beyond revolves around price and the question of consumer demand – with the price stability of turkey leading to a return to food investments in the US and more production.

Exhibit #1: Food Prices Matter to Demand and Trade

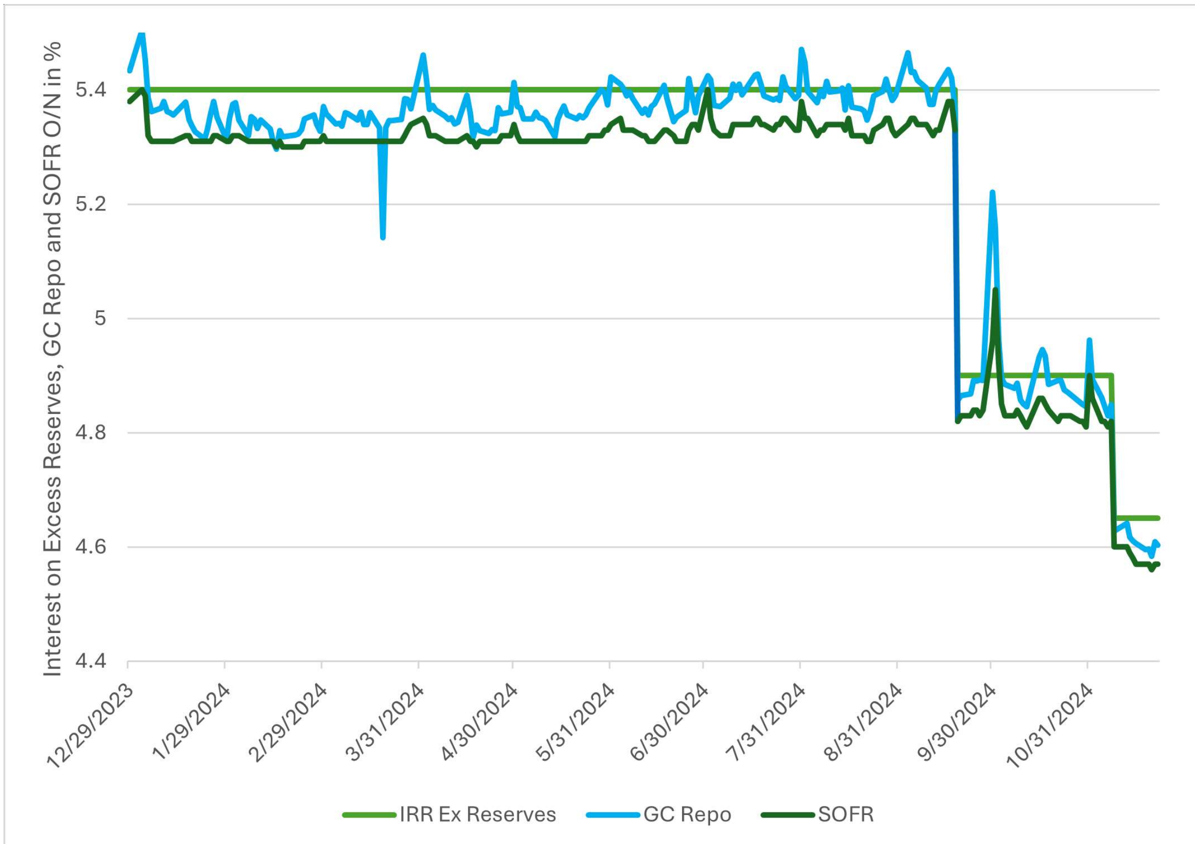


Source: iFlow, BNY

Liquidity need for year-end, not November?

Corporate year-end for US and Canadian companies varies, with the majority coming on December 31, but November is the next most common, followed by September. The rate squeeze in September was noticeable, and speculation about December has increased over the last two weeks. Markets are trading a premium of around 65-70bps for December 31, and a more modest 5-10bps for November. The quarterly squeezes for money overnight were important in 2024, but the October squeeze was greater than expected and suggests this will be a factor for November and a clear focus for December. From an iFlow perspective, we have seen a rise in cash and cash-like holdings over the last two weeks. The scored flows in November are 0.257, up sharply from the quarter average of 0.03.

Exhibit #2: Liquidity Squeeze Focus for Year-end

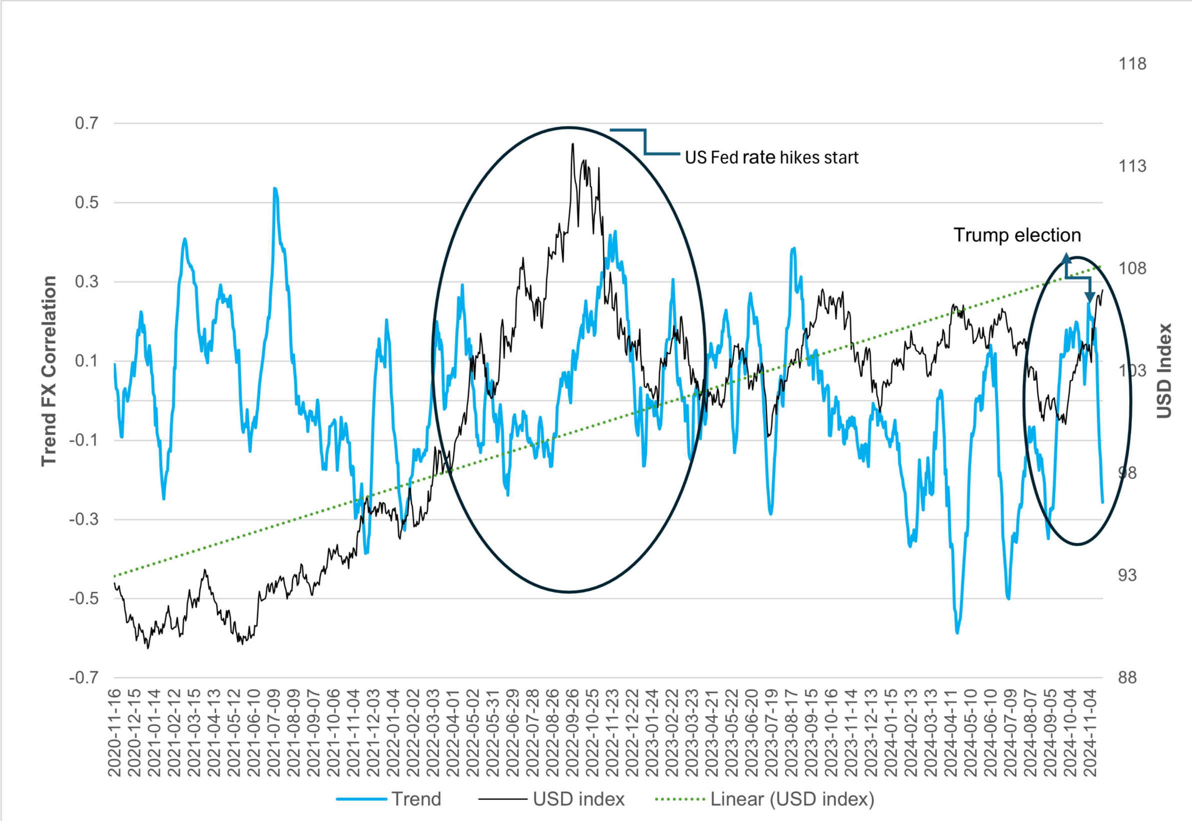


Source: Bloomberg, BNY

The factors that explain the USD rally in November – the 4% gain following the US election on the back of the Trump win and a Republican sweep – are not evident in trend or carry factors. This makes the unwind from monthly rebalancing pressures more complicated and adds to volatility as investors may not reweight benchmarks in the same way. The USD gains have been linked to tariffs and growth expectations in the US policy mix for 2025. Also in play is the role of EU politics, with elections looming in Ireland and Germany. The best explanation of US performance is the weakness of EUR. The USD trend and its volatility have left the trend factors significantly negative across foreign exchange markets.

Exhibit #3: USD and Trend Factor Divergence

USD trend factor shifts



Source: iFlow, BNY

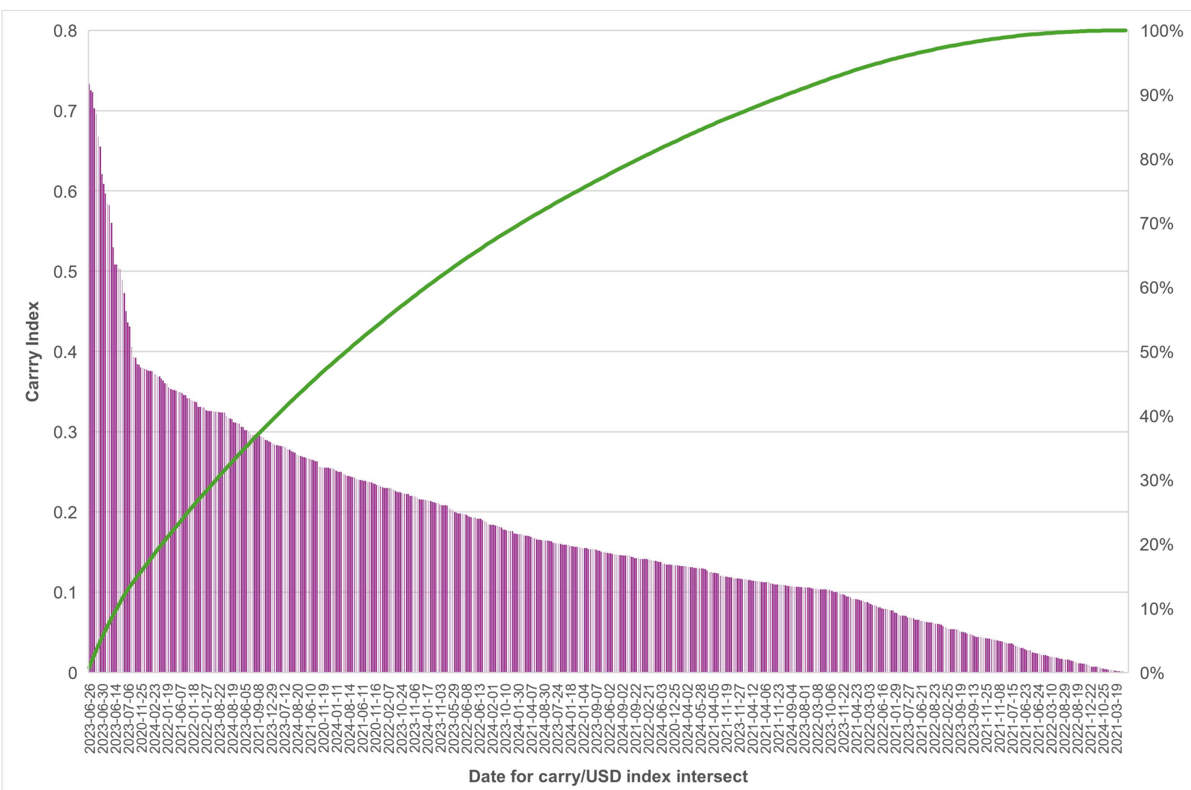
The carry trade dominated the USD in 2023, not 2024. On the reverse side, Covid and the Fed action also dominated the USD in 2020. Carry as an explanation for dollar strength is not the normal state over the last four years. Using a Pareto line – taking all the correlation results across the last four years and ranking them – makes clear that the 80-20 rule holds. Most of the time, the USD is not a carry trade. The times that stand out when this worked were at the start of the pandemic when the Fed cut rates sharply, and at the end of the pandemic when the Fed started its rapid rate hike regime. Right now, rates are not the main driver of FX markets and clearly not the USD.

US dollar value models start with inflation and the ability of the US economy to grow at potential. Holding prices stable around 2% and growing at 1.8% GDP is essential to holding USD value. Real effective exchange rates are the academic baseline for any USD valuation, and they point to a USD overvaluation of 10-20%. As an example, the value of a 1990 USD in 2024 is $2.42 – with 2.63% inflation between 1990 and today leading to a 141.52% increase, putting today's USD at a notable discount. If you go back to 1950, the annual CPI average was 3.52%. The value relationship of the USD to other fiat currencies begins with inflation spreads and views on how policy both fiscal and monetary will perform over the longer term.

The attraction of Bitcoin or gold is in their limiting of supply – which competes with all governments as they control the creation of money and seiniorage. Factors like carry and trend are shorter term, while value metrics are linked to potential growth improvements in nations, with productivity, demographics and resilience all key focus areas.

Bottom Line: Thanksgiving dinner in the US is a time when most Americans enjoy a meal with family and friends, reflect on the year and give thanks for their well-being. There are three areas that stand out in 2024. One is the success of FOMC policy in lowering inflation – which shows up in the cost of Thanksgiving dinner. Another is the success of the normalization of the balance sheet as liquidity concerns in rate markets have been modest, though many worry the buffers for 2025 are going to be more difficult. Finally, the USD success has been notable and serves as an example of the nation's relative outperformance in growth, price stability and productivity. How all this works into 2025 will be the focus for many investors and the only certainty is in the changes in markets ahead.

Exhibit #4: Pareto Line on USD and Carry Index



Source: iFlow, BNY

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

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