Strategy

JefMacro Weekly–The Pivot & Fin'l Instability Redux; A Mirror on Private Equity

March 19, 2023

Key Takeaway

Zervos bottom line: rates & QT continue to be used to manage dual mandate; newly created 13(3) facilities will be used to address financial instability. GREED & fear's road map for '23 is a year of earnings downgrades hitting the market if a US recession occurs; '24 will be when markets have to deal with emerging credit problems in private space. Econ team expects 25bps hike; data shows too much pressure in core non-housing service inflation and not going away.

David Zervos—There is heightened risk of something more sinister lurking in the financial instability shadows, but my base case is that the Fed's 13(3) balance sheet tools will continue to quell those, just as we saw with the LDI flare-up in the UK. If the Fed was just willing to expand its balance sheet in less than a week by half the entire size of QE2, then it is sending a clear message. Rates and QT will continue to be used to manage the dual mandate, while newly created 13(3) facilities will be used to address financial instability.

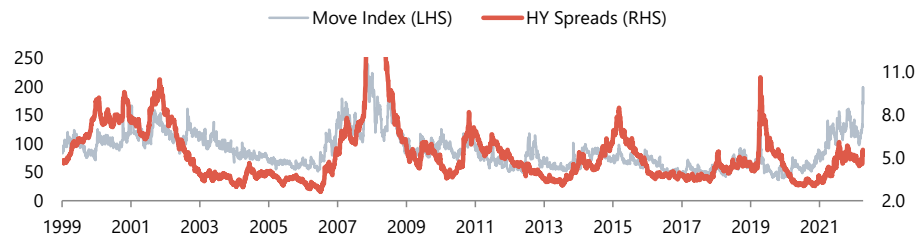
GREED & fear—'22 was the year when US equities suffered multiple contractions from monetary tightening. This year will be the year when earnings downgrades hit the stock market if the US recession forecast proves to be accurate. This is now the key issue in world financial markets. Then '24 will be the year when markets will have to deal with the emerging credit problems in the private space.

Thomas Simons & Aneta Markowska—We expect the liquidity crisis to pass soon, but the events of the past two weeks suggest a credit crisis will be upon us. This looks more like a Main Street credit crisis, where small businesses find access to credit restrained. The regional banks that fueled the small business boom will be limited in their ability and willingness to lend, irrespective of deposit stability or access to liquidity from Fed.

We expect FOMC to raise Fed Funds range by 25 bps. We do not think that the instability in financial markets justifies a pause when weighed against the risk that the Fed loses its credibility in fighting inflation, which it worked so hard to regain.

Mohit Kumar—We remain in the camp that the current crisis is not systemic, it is one of liquidity and profitability. Banks are in a much better shape and regulators are better equipped and willing to provide support if required. This implies an earlier pause and then potentially on hold for the rest of '23. We see the ECB taking rates to 3.50%, then pausing.

Bond volatility stands close to '08-09 levels



Source: Bloomberg; FactSet; Jefferies

The JefMacro Weekly is the accumulation of this week's best Macro research.

JefMacro Strategy *
Global Macro Team
jefmacro@jefferies.com

David Zervos * ~
Chief Market Strategist
dzervos@jefferies.com

Christopher Wood †
Global Head of Equity Strategy
+852 3743 8746
christopher.wood@jefferies.com

Aneta Markowska * ~
US Economist
amarkowska@jefferies.com

Mohit Kumar ‡ ~
European Economist
mkumar8@jefferies.com

Aniket Shah, PhD *
Global Head of ESG Strategy
(212) 323-3976
ashah14@jefferies.com

Sean Darby †
Global Equity Strategist
+852 3743 8073
sdarby@jefferies.com

Steven G. DeSanctis, CFA *
Equity Strategist
(212) 284-2056
sdesanctis@jefferies.com

Thomas Simons *
US Economist
(212) 323-7577
tsimons@jefferies.com

~ non-Research Department Economists.

^Prior trading day closing price unless otherwise noted.

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