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amFX

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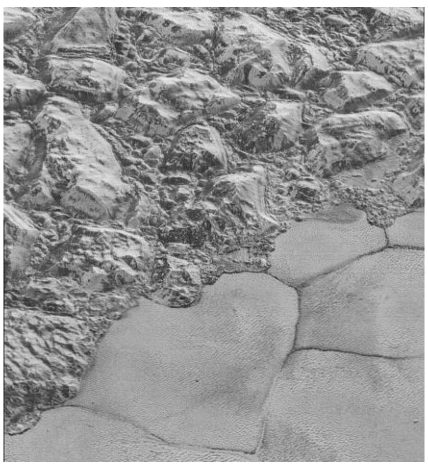

Pluto's icy dunes

Current Views

Short USDCAD @ 1.2355
Stop loss 1.2411
Take profit 1.2201

Short AUDNZD @ 1.0476
Stop loss 1.0622
Take profit 1.0200

Long 15NOV 1.3550 GBP put
Was a calendar spread
Price 21bps off 1.3730 spot
Short leg expired worthless today

Pegs are great (except when they don't work)

Minsky

The market has wrestled control of the Australian 3-year yield away from the RBA and the result is a huge hit to the future credibility of forward guidance from all central banks. Clearly, economic outcomes matter and so RBA YCC was outcome-contingent and so… Kind of meaningless? If the RBA doubles down on YCC tonight, then what I have written above is totally wrong but assuming they do not… The market has won this battle and central bank omnipotence takes another hit.

Instead of locking in low rates to bolster the Australian economic recovery, the RBA has herded speculators into what looked like guaranteed free money, held rates low about 3 months longer than peers, then stepped away and helped contribute to a global VAR shock. Like a miniature version of the SNB in 2015. Overpromise, and then fail to deliver. The RBA's website sums up the words vs. action disconnect:

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April 2024 Australian Government Bond Yield Target

Over recent decades, the Reserve Bank has targeted the overnight cash rate. The Bank has extended this by also targeting a risk-free interest rate further out along the yield curve to help lower funding costs across the economy. On 19 March 2020, the Board announced a target for the yield on the 3-year Australian Government bond of around 0.25 per cent. On 3 November 2020, the Board announced a reduction of this target to around 0.1 per cent. On 6 July 2021, the Board announced that the target would continue to apply to the then-current 3-year Australian Government bond – the April 2024 bond – rather than roll to a later-maturity bond.

The Bank stands ready to purchase government bonds in the secondary market to help achieve this target.

The target Australian Government bond yield graph below displays interactive information.

* Target bond is the April 2023 Treasury bond until 20 October 2020, and the April 2024 Treasury bond thereafter

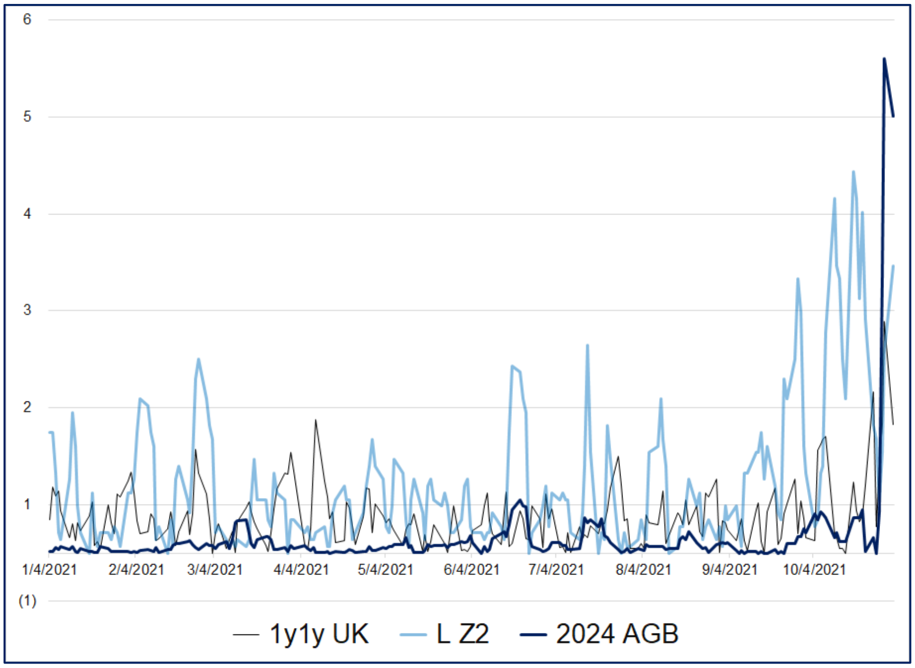
This line from the RBA: "The Bank stands ready to purchase government bonds in the secondary market to help achieve the target" sounds like a watered-down version of the SNB's unfulfilled commitment: "The SNB is prepared to buy foreign currency in unlimited quantities and stands ready to take further measures at any time."

This is the second time a major central bank set a specific numerical target for a market price, then abandoned the target without warning, triggering a crash-like unwind. The Fed learned a cheap lesson with the failed 6.5% employment threshold error in 2014 and now uses slippery, non-specific targets like the following description that came with their junk bond buying program ("We will continue to use these powers forcefully, proactively, and aggressively until we are confident that we are solidly on the road to recovery"). Their failure to define transitory is a similarly strategic use of slippery syntax to sidestep any head-on collisions with the market.

The lessons from this failed RBA experiment are essentially the same lessons from the SNB failure.

- Taking the side of the central bank is massively convex and has bad asymmetry unless you structure as a limited loss trade. It is a low-vol drip drip carry trade, or a high-vol P&L explosion. Everyone is on the same side of the boat because it seems logical to "go with" the central bank. In reality, central banks are not omnipotent or, more importantly, not all central banks have the daring to take on the market in unlimited quantities after promising to do so. You could argue the BOJ has had the daring (and the CNB too, I guess), so it's not free money to fade the CB. But speculators should be aware that trading the CB numerical target is rarely worth it. There is no exit door if the CB backs off, so these trades have horrendous risk reward. Remember this will be true next time, too, no matter how juicy the trade looks. If you want to bet on a CB successfully pegging something, find a limited loss way to do it.
- To be fair, there was almost as much pain in UK rates as there was in AU rates and UK rates were not pegged. Still, the next chart gives you an idea of the extra pain a "pegged" rate can lead to. Note the extremely low vol-of-vol in Australian government bonds (AGBs) as the policy crushed both vol and vol-of-vol. Then, the Minsky or Krakatoan release leaves any attempt to correctly size the position in shambles. When the central bank is in control, no position is big enough as you collect the nickels. When they lose control, no position is small enough as the market cracks and goes dysfunctional.

Standard deviation of 5-day move in Aussie bonds, UK 1y1y and short sterling



Everyone knows financial market movements are not normally distributed. We use these z-scores to normalize moves, not to say they are 1 in a billion or whatever.

SPECTRA MARKETS

- Central banks should not set numerical targets. These targets draw bullseyes on policymakers' backs and set the market up for non-linear crash-like events. For every BOJ or CNB (or HKMA) that threaded the needle successfully, there is a EURCHF and RBA 3-year target and THB 1997 that rattled the system. It's just not worth it. You lose too much policy flexibility, and you risk your credibility for a target that you may not be willing to defend when macroeconomic changes inevitably arrive. Pegs are great, except when they don't work.

  The RBA could have said something like: "The Board announces it plans to hold the 3-year government bond yield at a level low enough to encourage a strong rebound in economic growth and inflation. We will intervene in the government bond market as necessary to achieve our targets."

Why have the rates moves barely impacted FX?

There are a variety of theories as to why epic front-end moves have not had much FX impact. Here is how I see it:

- According to rate differentials, the dollar should be lower as global rates move more than US rates and the USD's yield advantage was part of the US Exceptionalism story. BUT! US equities are ripping to new all-time highs vs. the rest of the world, and this just about perfectly offsets the drop in the US yield advantage. So the short-term level of the USD looks reasonable here.
- Terms of trade driving FX more than rates these days, even before this recent rates move.
- It's a VAR shock. Years of playing roll-down and other risk premium strategies all blew up in a few weeks. Meanwhile, FX positioning is not big enough to trigger contagion.
- Terminal rates haven't changed much, and this should buffer the FX impact. If we get to the terminal rate faster, but that rate is about the same as it was before… and r* is still low and falling… Maybe less reason to adjust FX? It's an explanation, but not one I love.

Free Calendar!

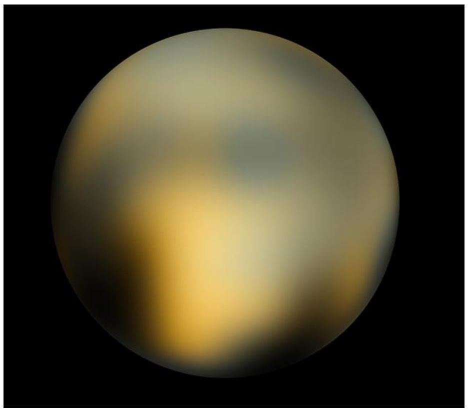
Big week this week. Have a clear and focused day.

		1-Nov	2-Nov	3-Nov	4-Nov	5-Nov
LDN	**NYC**	**Monday**	**Tuesday**	**Wednesday**	**Thursday**	**Friday**
9:00	5:00				Norges	
12:00	8:00				**BoE**	
12:15	8:15			ADP (400k)		Ramsden, Pill speak
12:30	8:30				*OPEC meeting (no specific time for outcome)*	**NFP (450k)** **Canada jobs (35k)**
13:00	9:00					Tenreyro speaks
14:00	10:00	ISM (60.5)		ISM services (62.0)		
17:50	13:50				Cunliffe speaks	
18:00	14:00			**FOMC**		
18:30	14:30			Powell Presser		
20:00	16:00		RBNZ FSR			
20:30	16:30	RBNZ Orr on unsustainable housing levels				
21:45	17:45		NZ jobs data (3.9% UR)			
20:30	20:30				RBA SoMP	
3:30	23:30	**RBA**				

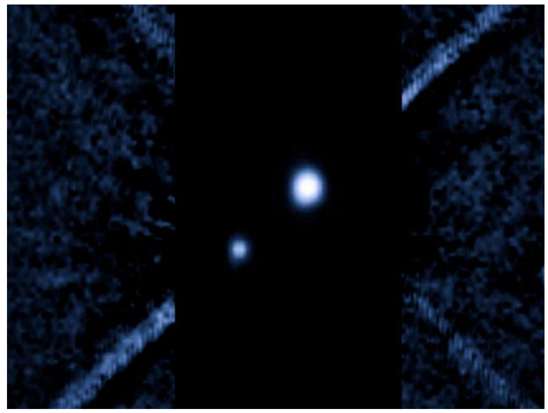
good luck ⇅ be nimble

The evolution in the quality of humanity's photos of Pluto is astonishing.

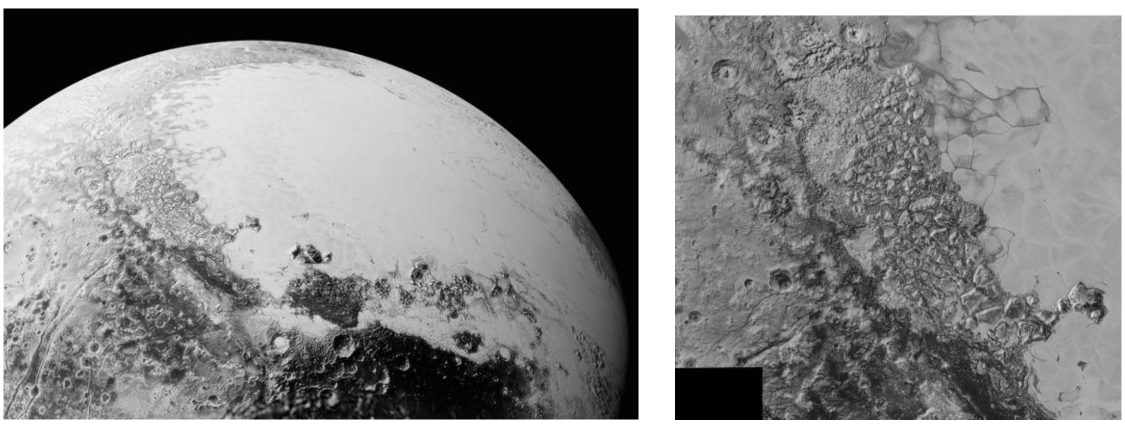
2003



2011



2015



https://petapixel.com/2015/07/16/this-is-how-our-photos-of-pluto-have-improved-over-the-years/

https://www.nasa.gov/feature/new-pluto-images-from-nasa-s-new-horizons-it-s-complicated

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