Market Comment_08Sep2022

Sandy Wang, 12.25 pm 08 Sep 2022 SGT time

Oil prices may continue to fall and could be at US$75.00. When will non-US currencies really bottom out?

Oil prices (Brent) have been "falling and falling" since the start of the fall from a high of 127.00 in mid-June this year. Quotes are currently around 89.55, approaching a low of around 75.00 in early 2022. The OANDA Brent candlestick below shows that at the end of February this year, when the war between Russia and Ukraine started, it was around 93.50. As of 08 September, 11.50 am SGT time, it was around 89.90, which has wiped out all the gains since the "Russia-Ukraine war". Since the outbreak of COVID-19 at the end of 2019, in mid-April 2020, Brent oil prices fell to an all-time low of around US$19 a barrel before rising to a high of around US$135.00 this year. Brent oil prices have been around US$60-US$80 a barrel since 2015, and now, even if oil returns to US$75 per barrel, it's back around the midpoint of the past seven years. Ed Morse, the Global Head of Commodities Research at Citigroup, said in a recent (June 2022) speech, "Demand for oil and refined products is falling as the economy starts bracing for a recession, and the fair value of Brent futures is in the US$70 range ".

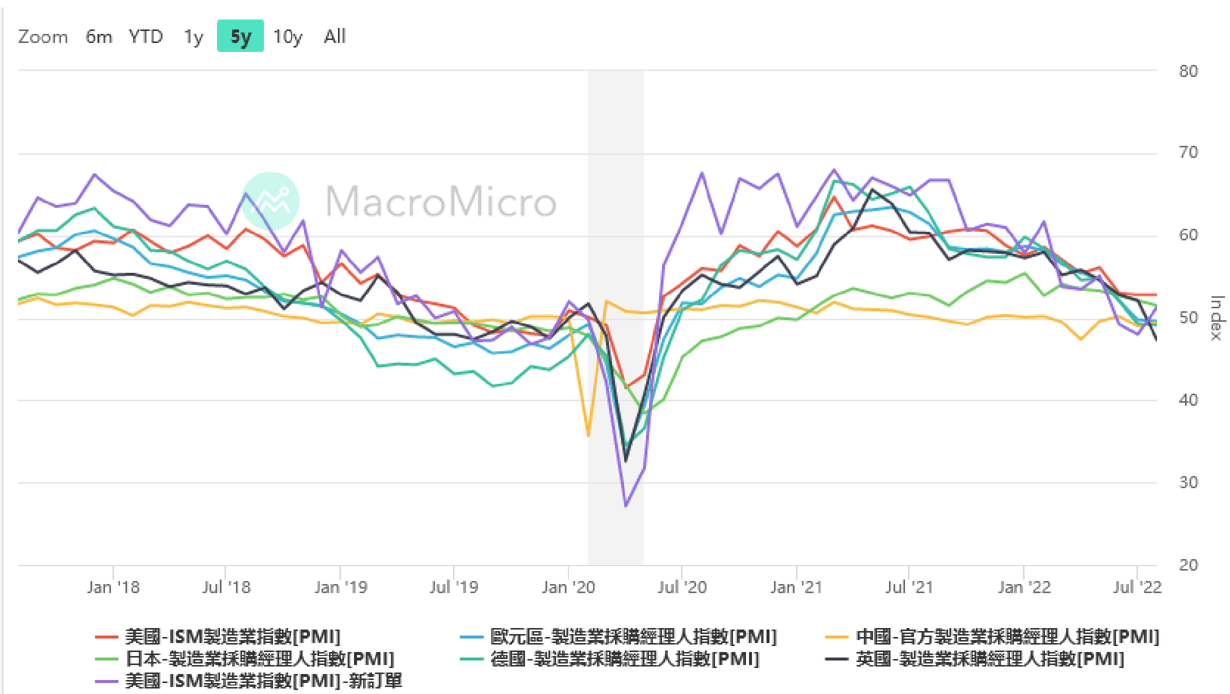
Source: Tradingview, the first target is Fibonacci 61.8% retracement at 88.30, and the second target is Fibonacci 50% retracement at around 75.00 if Oil continue keep weak.

The United States recently hinted that it might set a price guide for Russian oil at US$44 a barrel. On Tuesday, 06 September, US Deputy Treasury Secretary Wally Adeyemo made remarks, "The United States is using Russia's own estimated cost of oil production of $44 per barrel as a guide as it seeks a Russian oil price cap compliance regime, but will be a level that still encourages Russia to produce, yet not allow it to gain benefits. The final price cap and how long it will be maintained will have to be decided after internal discussions within the Union." The G7 countries may all participate in the oil price cap in Russia, which aims to reduce Russia's access to more "war funds" from rising oil prices and can also curb further rises in international oil prices. Although this news has not yet been implemented, and Russia has almost no possibility of accepting the oil price limit of US$44 per barrel, from a psychological level, it has caused much downward pressure on international oil prices.

The Nord Stream 1 pipeline in the European region is still completely out of service. The price of natural gas has increased from US$4.5 per MMBtu at the beginning of the "Russia-Ukraine war" to a high of US$10.00 this year and has followed the fall in oil prices to US$7.85 MMBtu. But the price is still high relative to the US$3.50 per MMBtu in early 2022. If this channel is completely shut off, Fitch Ratings said that "the GDP level of the euro area will decline by 1.4%-2.0% in 2023, further increasing the possibility of a recession in the euro area, which in turn will hit the recovery of global oil demand, It even leads to further production cuts by OPEC.", which is also not good for oil prices.

In mid-August, the "Inflation Reduction Act" that President Biden had just signed into law was not good for oil prices in the medium and long term. The bill would dedicate US$430 billion to the climate, clean energy and health care industries. Although this plan cannot immediately "restrain" the rise in oil prices, in the long run, the bill may be the beginning of a "clean energy race" between the US "subsidised new energy" industry and the big electric car powers of China, Europe and Korea. In the medium to long term, it will also have a dampening effect on rising oil prices.

<u>The increased risk of a global recession is also not good for oil prices.</u> An analysis of the manufacturing PMIs for the following significant countries shows a general downward trend since July 2021, with the “decline in the PMI in July 2022” being significantly larger than the “increase in the previous June 2022” . The Manufacturing PMI is currently around 50 (the threshold separating contraction from expansion) in most countries, indicating that the risk of recession is increasing and putting pressure on oil prices.



Source: MacroMicro

The words in the picture above:

Red: United States ISM Purchasing Managers Index (PMI)

Light green: Japan Purchasing Managers Index (PMI)

Purple: United States ISM Purchasing Managers Index (PMI)-New Orders

Blue: Euro Area Manufacturing PMI

Dark green: Germany Manufacturing Purchasing Managers Index (PMI)

Yellow: China Manufacturing Purchasing Managers Index (PMI)

Black: UK Manufacturing Purchasing Managers Index (PMI)

At present, the manufacturing PMIs of most countries are near 50 (the threshold separating contraction from expansion), indicating that the risk of an economic recession is increasing.

In addition, the negotiation of the Iran nuclear deal is still "unresolved" and is also negative for oil prices. As one of the world's top ten oil-producing countries, Iran is still unable to reach a consensus with the United States on the issue of nuclear energy, causing further "geopolitical" tension and certain uncertainty in the "crude oil market".

Non-US currencies have depreciated against the US dollar for more than a year since it began in July 2021. When will "the bottom" be reached?

Under the dual pressure of the global inflationary pressure and the "energy crisis" in the European region, the US dollar gave full play to its safe-haven properties. It was the only one that "goes up continuously" for past one year plus. When will the "US dollar peak" and non-US currencies truly get out of the quagmire of "falling and falling"?

Recently, on the evening of the 7th of September, after the US dollar index hit a record high of around 110.50, it fell back and is currently consolidating around 109.50. The US dollar may peak in "phases" in the short term, USDCNH and USDJPY also tested significant all-time highs of 7.0000 and 145.00 last night, respectively. It remains to be closely observed whether this is the "top" or "staged top" of this round of the US dollar's rise. However, with the sharp fall in oil prices since mid-June this year, if it can stabilise in the range of 60-80 in the future, perhaps the global "inflation" with "oil prices" as the primary consideration may be largely controlled, which may confirm the previous market discussion and speculation that the US inflation "peaked" in July. Of course, the exact conclusion will depend on releasing the relevant "data" in the coming months.

Basically, the author believes that when the "energy crisis" in the European region caused by the "Russia-Ukraine war" can be genuinely lifted, then the euro may stop depreciating continuously. At the same time, under the leadership of the Federal Reserve, the monetary policy is tightened to "raise interest rates" to resolutely control the inflation level of the United States back to the normal range, which will also slowly lead to the inflation of various countries around the world to return to the normal level, or this could be the time when the EUR/USD really "bottoms out" and when other non-US currencies start to rebound and rise.

The People's Bank of China lowered the foreign exchange deposit reserve interest rate by two percentage points to ease the pressure of RMB depreciation.

After the Jackson Hole conference, the market recognized the Fed's firm decision to fight inflation, and the US dollar's appreciation accelerated. In just over a week (26 August-05 September), the US dollar index rose by 2.32% (108.00-110.00), and the USCDCNH rose by 1500 pips, or 2.19% (6. 8450-6.9950), just one step away from the important psychological price of 7.0000. Meanwhile, CHINA50, HK50 and CHINAH fell by 5.57 % (13820-13050), 8.72 % (20650-18850) and 10.10 % (7 130 - 6410), respectively.

This Monday (05 September), when the US dollar index broke above 110.00, the pressure of the rapid depreciation of the offshore RMB in the short term was apparent. At around 5 pm, the People's Bank of China announced that it would cut the foreign exchange deposit reserve ratio of financial institutions by two percentage points and cut the foreign exchange reserve ratio by 6% from the current 8%. This is the second time the People's Bank of China has lowered the foreign exchange reserve ratio this year. The last time it was cut by one percentage point was 25 April. This move has a specific effect on increasing the liquidity of the US dollar in the market and enhancing the stability of the RMB exchange rate within 6.90-7.00 in the short term. As the USD/JPY rose above the test of 145.00 on the evening of 07 September, the RMB also briefly tested 7.000. As of 12.25 pm (SGT time) on 08 September 2022, the USDCNH was quoted at 6.9675.

RBA's September rate resolution raises rates by another 50 basis points, but AUD/USD is still mainly down.

The RBA's fourth interest rate hike of 50 basis points to 2.35% this year was in line with market expectations, but the AUD/USD continued to fall. The Reserve Bank of Australia said it would raise interest rates further in the next few months, and the CPI is expected to fall back to around 3% in 2024. The impact of Australia's interest rate hike on the Australian dollar is far less than the prospect of the Fed's interest rate hike on the US dollar. At the same time, Australia's largest trading partner, China, recently announced that the annual rate of imports and exports in August and the trade balance in August were significantly lower than the expected and previous value. It is also negative for the Australian dollar. The AUD/USD also fell by 300 pips, or 4.3% (0.7000 – 0.6700), in the week after the Jackson Hole conference, and the AUS 200 also fell by 400 pips, or 5. 63% (7100-6700). Similar to the Australian dollar, the NZD/USD also briefly fell below 6.0000 on 07 September and also fell by 230 pips, or 3.70 % (0.6230-0.6000).

<u>USDJPY has touched 145, and the further rally may see 150.</u>

Last Thursday (01 September), the author of this article expressed the opinion that USD/JPY may be looking at 145.00 but did not expect to test the 145.00 line on the evening of 07 September, just a week later. Since the Jackson Hole conference, the USD/JPY has fallen by 900 pips, or 6.62 % (136.00-145.00), and has fallen by 600 pips since last Thursday, or 4.32 % (139. 00-145.00). Japan's Chief Cabinet Secretary, Hirokazu Matsuno, said on 07 September, " I'm concerned about rapid, one-sided moves in the currency market recently. Would like to take necessary steps if such movements continue." However, his verbal intervention had little effect. As the divergence in the fundamental policies of the Federal Reserve and the Bank of Japan continues to widen, the continued rise of USD/JPY may be inevitable. If next, the dollar index strengthens again to test 115.00, USD/JPY may test 150.00.

Short-term risk:

It is necessary to pay attention to the US CPI data for August to be released on 13 September. The data will confirm whether the recent sharp drop in oil prices will also lead to a continuous decline in US inflation and whether the US CPI data in July is “the peak top” of this round of inflation. At the same time, we also need to pay attention to the Fed’s interest rate meeting on 22 September. At present, the market expects a high probability of raising interest rates by 75 basis points. Just a week after the Jackson Hole conference, the US dollar index has risen sharply by 2.22 % (108.00-110.40), and the market may have already priced in a 75 basis point rate hike in advance. Therefore, after the meeting minutes are actually released, there may be a "Buy the rumour, sell the news" market, which is conducive to the technical correction of all non-US currencies.

Written by: Sandy Wang

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