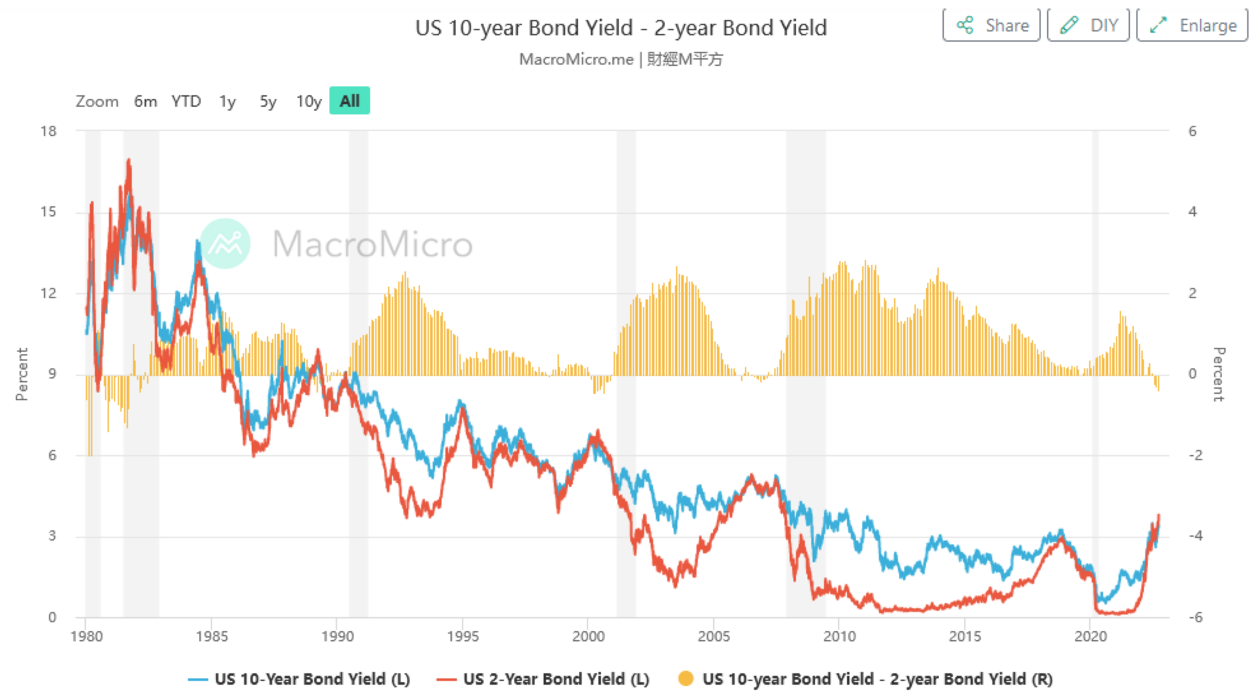
Market Comment_15 Sep 2022

CPI in August triggered a "Black Tuesday" in the global financial market and the discussion about the uncontrollable "inflation".

This Tuesday, 13 September, the US Bureau of Labor Statistics announced that the US CPI rose by 8.3 % year-on-year in August, unexpectedly higher than the expected 8.1 %, which was 8.5 % in July, and 9.1 % in June, and announced that the core CPI (excluding the volatile food and energy data) rose by 6.3% year-on-year in August, higher than the expected 6.1 % and the previous value of 5.9 %. The market had expected the CPI to be below 8.1% in August, or even to just over 7%. As a result, these two data were higher than expected, and the core CPI was still higher than the previous value, which made the market's speculation that US inflation may peak in August- September collapse. This led to the market's discussion of the Fed's more considerable interest rate hike to 100 basis points in September. The previously expected rate hike of 75 basis points is now almost a certainty, and expectations for a 100 basis point hike are also as high as around 50 %. Former US Secretary of the Treasury Lawrence Summers H. Summers also tweeted in support of a 100bps rate hike in September: " It has seemed self evident to me for some time now that a 75 basis points move in September is appropriate. And, if I had to choose between 100 basis points in September and 50 basis points, I would choose a 100 basis points to move to reinforce credibility."

Panic over expectations of a sharp hike in interest rates led to sharp volatility in global financial markets on Tuesday night ("Black Tuesday"). Interest rate-sensitive US 2Y Treasury yields and 10Y Treasury yields rose sharply, the US dollar index rose sharply, non-US currencies plummeted across the board, US stock markets plunged, and global stock markets also followed the plunge in US stocks and started to decline to different degrees. US 2Y Treasury yields jumped 29 basis points (from 3.50% to 3.79%), the highest in nearly 15 years, and US 10Y Treasury yields surged 15 basis points (from 3.30% to 3.45%), the US 10Y/2Y Treasury yield inversion further deepened to 34 basis points. This may indicate that the market's worries about the risk of a US recession have intensified. The three major US stock indices took the brunt of the sharp collapse, with the Dow Jones plunging by 1,590 pips (from 32,645 to 3,055, or 4.87%), the S&P 500 dropping by 230 pips (from 4,155 to 3925, or 5.54%) and the Nasdaq falling by 875 pips (from 12,875 to 12,000, or 6.80%).



Source: MacroMicro, the US 10Y/2Y Treasury yield inversion further deepened to 34 basis points. This may indicate that the market's worries about the risk of a US recession have intensified.

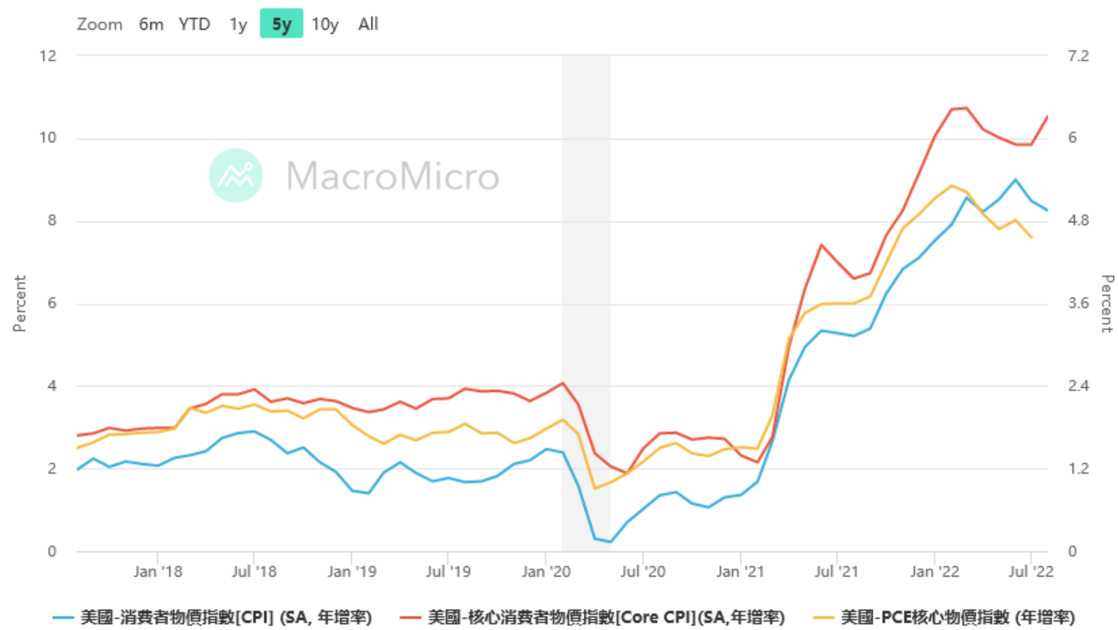
At the same time, the CHINA50 index, CHINAH and HK50 fell by 2.17 % (from 13580 to 13285), 3.74 % (from 6680 to 6430) and 3.59 % (from 19500 to 18800), respectively. TWIX also fell by 3.48% (from 575 to 555). JP 225 index fell by 3.16 % (from 28655 to 27750), and AUS200 also decreased by 3.14 % (from 7000 to 6780). Bitcoin fell by 11.09 % (from 22550 to 20050).

US dollar index rose by 200 pips, or 1.86 % (from 107.50 to 109.50) . USD/CHF rose by 1.58 % (from 0.9480 to 0.9630) , USD/JPY rose by 2.08 % (from 142 to 144.95) , USD/CNH rose by 0.85 % (from 6.9255 to 6.9845) , USD/CAD increased by 1.81 % (from 1.2960 to 1.3195), USD/SGD rose by 0.90 % (from 1.3940 to 1.4065) , EUR/USD fell by 2.31 % (from 1.0185 to 0.9950), GBP/USD fell by 2.17 % (from 1.1735 to 1.1480), AUD/USD fell by 2.89 % (from 0.6915 to 0.6710), NZD/USD decreased by 2.92 % (from 0.6155 to 0.5975).

As the US dollar rose, oil prices fell accordingly. WTI decreased by 4.80 % (from 89.50 to 85.20), and Brent fell by 4.67 % (from 96.35 to 91.85). The Biden administration in the United States recently considered buying crude oil to replenish the US Strategic Petroleum Reserve (SPR) when oil prices fall to around US$80. Its purpose is to prevent oil prices from plunging and protect US oil production growth. In the short term, this news may form psychological support for oil prices around US$80. The author believes that oil prices are still inclined to fall unchanged in the medium to long term.

The discussion about the uncontrollable "inflation."

Firstly, inflation has lasted too long. The COVID-19 that has been ravaging the world since the end of 2019 has led most countries to follow the Federal Reserve's unlimited "quantitative easing" policy and adopt a more accommodative monetary policy. The US has been experiencing a spike in inflation since April 2021 (as shown in the chart below), and it was a year later, in March 2022, that the Fed took inflation seriously and initiated its first 'rate hike', which was a little late. Previously, former US Secretary of the Treasury Summers had repeatedly warned against the Fed for not realising the persistence of inflation and acting too slowly when the Fed was still insisting on the "high inflation temporary" argument. He also warned of massive QE, which could cause inflation to spiral out of control.



Source: MacroMicro. In fact, the US has had a problem with soaring inflation since April 2021.

Second, the "Russia-Ukraine" war has led to a surge in global energy and commodities, making it more difficult to control "inflation quickly". Large countries such as Germany, Japan and South Korea, which have been in trade surplus for a long time before, have also turned into trade deficit countries this year under this pressure. Among them, Germany, which relies heavily on Russia's cheap oil, natural gas, and other energy imports, bears the brunt of it. The CPI has remained above 7% for over half a year, compared with 7.9 % in August. South Korea's CPI has been between 4%-6 % in the past six months and 6.3 % in August. Japan's inflation is well controlled, but it has also experienced trade deficits for 13 consecutive months. If the trade deficit continues, more Japanese companies will sell the yen and buy foreign currencies such as the US dollar, which may continue to push the yen to depreciate.

Third, "deglobalisation" is taking place, which may slow down the difficulty and speed of controlling "inflation". The US hegemony vs. China led to the trend of "localisation in manufacturing" and "democracy resource" and the ongoing restructuring of global supply chains and the division of labour in trade. In terms of manufacturing, for example, recently, on 09 August, the Biden administration signed the "Chip and Science Act", and on 06 September, it released a chip investment plan worth US$50 billion, providing huge subsidies for the localisation of chips. In effect, it is asking for the entire semiconductor industry chain to return to the US in the future. On 10 September, Bloomberg broke the news that US President Joe Biden was set to sign an executive order on "supporting US biomanufacturing" to reduce dependence on China for pharmaceuticals. In terms of natural resources, for example, Indonesia, one of the countries with the most abundant mineral resources in the world, has successively issued bans on the export of multiple mineral resources (nickel, bauxite, coal, tin, copper, etc.). After the "Russia-Ukraine" war ", this trend has become more serious, which has also caused a rise in commodity manufacturing costs in disguise, which in turn has led to an increase in the cost of manufacturing goods from the "most efficient and cheapest" model to the "safest and most reliable" model. These factors, also cause future commodity prices to be "easy to rise but hard to fall", making "inflation" more challenging to control.

Short-term risks: Please pay close attention to the minutes of the Fed's September interest rate meeting next Thursday (22 September). The market may have already priced in the Fed's September interest rate hike expectations. After all, the US dollar has risen sharply after the Jackson Hole conference by 2.22 % (from 108.00 to 110.40). The US dollar index surged by 200 pips, or 1.86% (from 107.50 to 109.50) after the US CPI for August was released on 13 September. The market has probably digested the expectation of at least two times for the "rate hikes" in September. After the release of the minutes of the meeting, if it is higher than the 75 basis points widely expected by the market and reaches 100 basis points, it may provide further support for the strength of the US dollar. Or there may also be a “Buy the rumour, sell the news" market, favoring to the pull back of non-US currencies.

By Sandy Wang,

11:50am 15 Sep 2022 SGT time