Market Comment 22 Sep2022

Fed's September meeting "raised interest rates by 75 basis points" crashed the market. After the USD/CHN broke 7, it may continue to depreciate and look towards 7.2

1. The Fed raised interest rates by 75 basis points in September, which shocked the market and it may raise interest rates by 75 basis points in November again.

The highly anticipated Federal Reserve's September interest rate meeting finally announced the rate hike at 2.00 am this morning (Singapore time) and confirmed a rate hike of 75 basis points which is in line with market expectations. The Federal Reserve announced raising the federal funds rate from 2.25%-2.5% to 3%-3.25%. After the meeting, the market generally discussed:

1) The final interest rate of the Fed in this round of the interest rate hike cycle may exceed 4.6 %;

2) The possibility of the Fed raising interest rates by 75 basis points again at the interest rate meeting in November this year is higher than 80 %;

3) The Fed is not expected to cut interest rates until 2024.

The main points of the Fed's September monetary policy statement:

Employment growth is strong, unemployment is low, and high attention is paid to inflationary pressures and global economic difficulties caused by the "Russia-Ukraine war". To achieve "maximum employment" and "2% inflation" in the long run, the meeting raised interest rates to a range of 3%-3.25%, and it was expected that continued interest rate hikes would be appropriate. Continue to implement the "Plans for Reducing the Size of the Federal Reserve's Balance Sheet" issued in May this year. The core inflation forecast for 2022-2024 is raised across the board by 0.1-0.2 percentage points, the long-term unemployment rate is expected to remain unchanged at 4%, and the economic growth forecast for 2022 is significantly lowered to 0.2 %. Economic growth in 2023 is expected to be 1.2 %, and long-term economic growth is expected to remain at 1.8 %. According to the dot plot of Fed officials' interest rate forecasts, the median interest rate forecast at the end of 2022 is 4.4%, the median interest rate expectation at the end of 2023 is 4.6 %, the median interest rate projection at the end of 2024 is 3.9 %, and the median long-term interest rate is expected to be unchanged at 2.5%.

Federal Reserve Chairman Powell's speech highlights: "strongly committed to bringing inflation back down”, "highly attentive to the risks", "the pace of rate hikes will continue to depend on the incoming data, "at some point, as the stance of monetary policy tightens further, it will become appropriate to slow the pace of increases", "The historical record cautions strongly against prematurely loosening policy", "over coming months, we will be looking for compelling evidence that inflation is moving down", "no one knows whether this process will lead to a recession”, "there's certainly a possibility that growth can be stronger than that".

US 10Y/2Y Treasury yield curve inversion deepens.

Interest rate-sensitive US 2Y Treasury yields and 10Y Treasury yields rose sharply, and the US dollar index plunged by more than 100 pips, non-US currencies fell again across the board, US stocks plunged, and global stock markets followed the plunge in US stocks and opened up to varying degrees of decline. The yield on the US 2Y Treasury bond rose to 4.06%, the highest in nearly 15 years, and the yield on the US 10Y Treasury bond rose to 3.55 %. US 10Y/2Y Treasury yield curve inversion deepened by 51 basis points, and this may indicate that the market's worries about the risk of a US recession have intensified.

Stock market crashed

The three major US stock indexes took the brunt of the sharp collapse, and the stock market has never left the "bear market dominance" since the beginning of this year. Compared with a week ago, the Dow Jones index fell by 2,600 pips (from 32600 to 30000, or 7.98%), the standard S&P 500 fell by 400 pips (from 4150 to 3750, or 8.55%), and the Nasdaq fell by 680 pips (from 12180 to 11500, or 5.58 %). Meanwhile, in the Asian stock markets, the CHINA50 fell by 500 pips (from 13300 to 12800, or 3.80%). The TWIX fell by 5.22% (from 575 to 545). The JP 225 stock index fell by 5.59 % (from 28600 to 27000), and the AUS200 fell by 5.71% (from 7000 to 6600). European stock markets: The EU50 decreased by 7.61% (from 3680 to 3400), the GER30 fell by 7.75% (from 13550 to 12500), and the UK100 fell by 4.79% (from 7510 to 7150).

Forex market crashed

The US dollar rose, and the general downtrend in non-US currencies continued. The US dollar index rose sharply to 111.50, compared with a 5.77% gain (from 109.20 to 111.50) a week ago, which is also a new high in the past 20 years.

USDCHF rose by 1.57 % (from 0. 9550 to 0.9700)

USDJPY rose by 1.41 % (from 142.50 to 144.50)

USDCNH rose by 5.95 % (from 6.9650 to 7.0930)

USDCAD rose by 2.66 % (from 1.3150 to 1.3500)

USDSGD rose by 1.21 % (from 1.4030 to 1.4200)

EURUSD fell by 2.24 % (from 1.0050 to 0.9825)

GBPUSD fell by 4.35 % (from 1.1730 to 1.1220)

AUDUSD fell by 4.56 % (from 0.6910 to 0.6600)

NZDUSD fell by 5.69 % (from 0.6150 to 0.5800)

Commodity crashed

As the US dollar has continued to rise sharply recently, the EU's restriction on Russian oil in December this year came into effect. The G7 countries' cap on Russian oil by US$44 may take effect in the next few weeks (but Russia says it will not supply oil to countries that support price limits on Russian oil). The timing of the restart of the Nord Stream 1 pipeline remains uncertain, as well as the release of a further 10 million barrels from the US Strategic Petroleum Reserve (SPR), and oil prices continued their downward trend. Over the past week, WTI was down 7.78% (from 90.00 to 83.00), and Brent was down 7.88% (from 96.50 to 88.90). At the same time, the US Biden administration recently considered buying crude oil to replenish the US Strategic Petroleum Reserve (SPR) when oil prices fell to around US$80. The aim is to prevent a price plunge and protect US oil production growth. In the short term, it may look for psychological support for oil prices around US$80. The author believes that in the medium and long term, with the popularisation of "low-carbon energy", the future electric vehicle market may replace most of the current gasoline vehicle market, and the oil price will still tend to fall. At the same time, in the past week, Bitcoin also fell by 18.68 % (from 22750 to 18500), and gold also fell by 4.62 % (from 1730 to 1650).

2. After the USDCNH breaks through 7, it may look towards the 2019-2020 high of 7.2.

On 15 September, the USDCNH again broke through the crucial psychological support level of 7.0000. In 2019 and 2020, it also broke through 7 and tested the 7.2000 level. Around August-October 2019, it broke through 7, and the US dollar index was 95-99 range. A "break of 7" around February-June 2020 would put the USD index in the 100-105 range. This time, a "break of 7" would put the USD index in the 109-110 range. From the period of these three "breaks of 7", the range of the US dollar index has continued to move upward (from 95-99 to 100-105, and then to 109-110). It is clear to see that the CNH actually appreciates steadily, which is a side-effect of the backdrop of China's solid economic growth. It is expected that the USDCNH may reach the highest point of 7.2000 in the next three months and then return to below 7.000 with a high probability.

<u>The US economy is solid, it has the confidence to raise interest rates, and the appreciation of the US dollar is well-founded.</u>

In the past two years or so, despite the adverse effects of the "COVID-19 pandemic" and the "Russia-Ukraine war", in addition to China's good economic fundamentals, the fundamentals of the US economy are also very stable. On 01 September, the US ISM Manufacturing Purchasing Managers’ Index (PMI) was announced at 52.8. The US manufacturing PMI has remained above 50 (52.6-64.7) for over two years (since July 2020). The US ISM non-manufacturing PMI index released on 06 September was recorded at 56.9. Indeed, the US non-manufacturing PMI has remained solidly above 50 (55.3-69.1) for the past two years (since July 2020), which is evidence of an improving US economy. The latest University of Michigan Consumer Sentiment Index released on 16 September was recorded at 59.5, higher than the previous value of 58.2, indicating that although US inflation is high, it has not weakened the people's willingness to spend. The US unemployment rate was 3.7% in August and has remained below 4% since the beginning of the year, near the lowest level in more than 50 years. These economic data are generally positive, which is the confidence for the Fed to raise interest rates sharply.

Meanwhile, the US core CPI in August released last Tuesday (13 September) was 0.6% month-on-month, higher than the expected value and the previous value (last month) of 0.3%. The market expects that US inflation may slow sharply, and the expectation of "inflation peaking" has failed. Inflationary pressures in the US are still there, the Fed may continue to raise interest rates aggressively, and the US dollar's strengthening may continue to be a probable event.

<u>The downside risks to the RMB in the short term</u>:

First, "the US will continue to raise interest rates, and the US dollar will continue to strengthen" may continue to dominate the market. Non-US currencies are generally weak against the US dollar, and the offshore RMB has to continue to depreciate. Second, China's domestic demand is weak. China's housing prices have been falling month-on-month for 12 consecutive months, and the inflation rate has dropped to -2.1 % year on year. Real estate has always been the main consumption item of Chinese household wealth and a pillar industry of China's economy. The continuous decline of this data fully proves that people's consumption is weak. The third is the impact of a highly high-temperature climate. Since July-August in China, about 14 provinces and cities in China have experienced extreme climates of high temperature and drought in history, and many areas have faced the dilemma of water shortages and power restrictions. Fourth, China's manufacturing PMI data in August was recorded at 49.4, which is the fifth time since March this year that it fell below 50-the threshold separating contraction from expansion. Only in June, it was recorded at 50.2, which means that it has remained in the 47.4.0-49.6 range for five months this year. At the same time, the unemployment data for youth (16-24 years old) released by the National Bureau of Statistics of China in July was 19.9 %, which is at a historically high level, which may prove that the manufacturing industry is shrinking. After all, it used to be that China's young workforce was quickly absorbed and employed by the manufacturing industry in the market. Fifth, China’s "Zero COVID Policy" to control the pandemic may continue, affecting employment and economic recovery. The 20th National Congress of the Chinese Communist Party will be held on 16 October. It is now widely expected in the market that adjusting the prevention and control policy regarding the pandemic may be one of the critical themes of this meeting.

The upside risks of the RMB in the medium and long term:

First, China has consistently ranked as a significant country with "the world's largest foreign trade surplus" all year round. With all countries in the world at risk of recession, significantly as demand in the European Union slows, China's trade surplus in August was still US$79.39 billion, compared with US$101.26 billion in July, according to data from the General Administration of Customs of China. It is still the first in the world, thanks to the fact that China has the most complete industrial system in the world and a "complete and independent" industrial chain. Second, China's domestic political situation is highly stable. The Chinese government has a high degree of influence on the stability of the "onshore RMB". It can also affect the stability of the "offshore RMB" from the side China's central bank has the ability to use a wide range of financial instruments to lead sound growth in the domestic economy. Third, the global pandemic that has lasted for more than two years, under the guidance of the "Zero COVID Policy" of the Chinese government, in general, the number of new confirmed cases and deaths in China is relatively well controlled, which is also conducive to economic recovery after the pandemic. Fourth, in the context of "high inflation" and "energy crisis" raging around the world, many countries may fall into the risk of recession, and China is hardly troubled by these two problems. With most countries following the Fed's "interest rate hike" policy and raising interest rates one after another, China started "interest rate cuts" in August to create the most easing environment possible for the recovery of the domestic economy.

Offshore RMB may reverse its current weakness, opening the possibility of a rising market.

In the past ten years (2012-2022), the USDCNH has generally fluctuated between 6.000 and 7.2000. The candlestick chart and the RSI technical indicator for USDCNH are trending towards a classic "regular bearish divergence" pattern. "Regular bearish divergence" refers to the candlestick chart showing that the price made a higher high while the oscillator made a lower high. After the price makes a second high, if the oscillator fails to surpass a previous high, it may be a sign that the market may start to anticipate a decline, that is, an opportunity for a reversal.

Source: Tradingview

Technical analysis shows that the USDCNH candlestick chart and RSI oscillator are currently in a classic "regular bearish divergence" pattern, signalling a reversal opportunity if the RSI oscillator fails to exceed the previous after the USDCNH price refreshes to the next high. In other words, if there is a call back at that time, the first target may look at the Fibonacci 61.8% retracement, about 6.9750, and the second target may look at the Fibonacci 50% retracement) position, probably around 6.9050.

Short-term risk:

The war caused by the conflict between Russia and Ukraine may recently escalate sharply into a "nuclear war". Russian President Vladimir Putin announced yesterday (21 September) that he had signed a decree on partial mobilisation, and Russia will call up about 300,000 people. Putin said: "If the territorial integrity of our country is threatened, to defend and protect our country and our people. We will use all the means that we have. I'm not bluffing. " His remarks were understood to be that Russia will not rule out using " nuclear weapons" to counter the ensuing military conflict.

The rules of Russia's nuclear weapons doctrine are: "If Russia is attacked by nuclear weapons or other weapons of mass destruction, or if Russia faces an existential threat from conventional weapons, Russia will allow the use of nuclear weapons." According to the relevant data, Russia and the United States have 6,255 and 5,550 nuclear bombs, respectively, and the two countries together account for about 90% of the global total. Once a "nuclear war" breaks out, it may trigger a third world war. White House National Security Council spokesman Kirby said: " it's just irresponsible for him to be talking about the potential use of nuclear weapons or any weapons of mass destruction," "We're monitoring this as closely as we can," but "we have no indications that we need to change our strategic deterrent posture."

Putin also announced that he would support a "referendum on accession to Russia" in areas controlled by the Russian military. This immediately prompted a collective statement of opposition from the US and the EU countries concerned. On this Tuesday, 20 September, according to the Interfax news agency, four Ukrainian regions controlled by Russian-backed separatists requested a referendum to join Russia this weekend (23-27 September). This referendum may lead to more significant geopolitical risks and the risk of war escalation.

Sandy Wang,
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