Market comment 06 Oct 2022

The US dollar "peaks in stages", AUD&NZD remain weak, and long GBPJPY is one of the best trading opportunities last week.

1. Discussions about the US dollar's "peaks in stages" decline recently

Several factors may have caused the US dollar " peak and fall" recently

1) The recent series of weaker data releases from the US may have caused increased market fears of a recession in the US, which is detrimental to the US dollar. US second-quarter GDP (terminal value) was released on 29 September at -0.6 %. The previously reported first-quarter GDP (terminal value) was -1.6%, confirming two consecutive quarters of negative growth and the US economy may have theoretically fallen into recession. The US Chicago PMI for September released on 30 September was 45.7, which was significantly lower than the 52.2 in August, and also fell below 50-the threshold separating contraction from expansion for the first time in the past two years (since July 2020). The US manufacturing PMI released on 03 October was 50.9 in September and 52.8 in August, hitting a new low in the past two years (since July 2020). The September ISM manufacturing employment index recorded 48.7, far lower than August's 54.2. In September, the US ISM manufacturing new orders index recorded 47.1, significantly lower than August's 51.3. The above data may suggest that the US manufacturing industry may fall into recession.

2) After the pound fell sharply last week, it rose by 11.10% in the past week, and the US dollar weakened in response to the sharp rise in the pound. The UK Truss government announced on 3 October to scrap "the 45% tax rate plan" announced a week ago, and GBP/USD is on a roller coaster ride. The United Kingdom announced £45 billion in tax cuts on 23 September, the largest tax reduction plan in the past 50 years. Still, it failed to announce the "significant interest rate hike" expected by the market at the same time (currently, the UK interest rate is 2.25 %) to "hedge" the plan, which makes it more difficult for the relevant departments of the UK to control inflation, and also makes investors' confidence in the UK's economic recovery plummet. GBP/USD once plummeted to a record low of 1.0350, after which the British government announced a plan to buy unlimited long-dated government bonds "as needed" to prevent a crisis in government pensions and to scrap "the 45% tax rate plan". GBP/USD has since rallied sharply, touching a high of

around 1.1500. That means in just one week, GBP/USD jumped 11.10%. This is one of the reasons that has dragged down the US index lower recently.

3) The Chinese government led the intervention in the foreign exchange market, and the offshore RMB surged by 2,500 pips. China's State Administration of Foreign Exchange, which hosted a national video conference, intervened in the sharp fall in the RMB recently. On 27 September 2022, a video conference was held on the self-discipline mechanism of the national foreign exchange market. The main points of the meeting: "The foreign exchange market is of great importance, maintaining stability is the priority, and two-way floating is the norm. Don't bet on the one-way appreciation or depreciation of the RMB exchange rate. You will lose if you gamble for a long time. The meeting requested that members of the self-regulatory mechanism should consciously maintain the primary stability of the foreign exchange market and resolutely curb large fluctuations in the exchange rate, while relevant departments should strengthen supervision and management and monitoring and analysis, enhance expectations management and curb speculation. From 28 September to 5 October, USD/CNH began to drop sharply by 2500 pips (from 7.2650 to 7.0150). The Chinese yuan offshore (CNH) surged 2,500 pips, or 3.44%, against the US dollar. The US dollar index also started a significant periodical correction after 28 September. As of 5 October, it fell sharply by 490 pips (from 114.70 to 109.80), or down 4.27 %.

4) The US dollar is seriously overbought, and "dollar shortage", and the US national debt is approaching the cap, exceeding US$31 trillion for the first time.

Since the beginning of the year, the US Dollar Index has risen by 21.38% (from 94.50 to 114.70). The strong dollar has also led to the "dollar shortage" in disguise. With all the dollars flowing back to the US, fewer dollars are flowing into the market. With fewer dollars flowing, fewer dollars can flow into the US Treasury market to buy US Treasuries, and the rise in US Treasury yields is a natural consequence.
Since April last year, China, Japan, the United Kingdom, France, Switzerland and other countries have successively sold huge amounts of US Treasury bonds to obtain more dollar liquidity. As the anchor of global assets, the "10Y US Treasury bond yield" has reached a maximum of about 4% recently (28 September), U.S. debt interest costs will also gradually rise. So, the size of the US federal government debt, as recently announced by the United States Department of the Treasury on 3 October, has exceeded US$31 trillion, which is already substantially more than the US GDP of US$23 trillion for the whole year of 2021. The US Congress passed

legislation in December 2021 to raise the debt ceiling to US$ 31.4 trillion. At present, the US "debt ceiling" may face the risk of being breached again, and the US government's "debt pressure” is huge. The "debt ceiling" is the maximum amount the US Congress can set for the government to borrow to meet "incurred payment obligations", and once this red line is reached, it means that the US Treasury's borrowing authority has essentially been exhausted. Therefore, the "strong dollar" may be more challenging to maintain in the future, and the peak of this round of the dollar's rise may not be far away. If the dollar’s strength continues, it will not only hit the real economy and global consumer market of countries around the world but also damage the interests of the United States.

The dollar is likely to continue with the previous rally.

According to the Fed's interest rate decision in September, the terminal rate of the Fed's current rate hike cycle may exceed 4.60%, currently at 3.25%. The Fed is not expected to cut interest rates before 2024. According to the dot plot of Fed officials’ interest rate expectations, the median rate expectation at the end of 2022 is 4.4%, the median rate expectation at the end of 2023 is 4.6%, the median rate expectation at the end of 2024 is expected to be 3.9%, and the median long-term rate is expected to remain unchanged at 2.5%. In other words, the current round of US interest rate hikes will continue at least until the second half of next year. The US dollar rally may not be over yet. In the short term, the US dollar index is expected to be look at 115.00. Given that the top of this rally may not be far away, I expect the future to look towards the all-time high of around 120 in 2001-2002.

US stocks soar, commodities rebound.

The 10Y US Treasury yield has dropped by 45 basis points (from 4% to 3.55 %) and is currently at 3.75 %. The US 2Y Treasury yield has fallen by 35 basis points (4.35%-4.00%) and is currently at 4.15%. US 10Y/2Y Treasury yields remain inverted by 40 basis points, and the market concerns about the risk of a US recession persist. The US stock market has started a "periodical bottoming out" market, and the stock markets around the world have also followed the rise of US stocks and started rising to varying degrees.

The three major US stock indices rebounded sharply:

- The Dow Jones index rose by 1825 pips (from 28575 to 30400, or 6.39%);
- The S&P 500 stock index rose by 250 pips (from 3550 to 3800, or 7.04%);
- The Nasdaq index rose 820 pips (from 10830 to 11650, or 7.57 %).

At the same time, in the Asia-Pacific stock market, crude oil, gold and Bitcoin also rebounded sharply:

- CHINA50 jumped 800 pips (from 12650 to 13450), or 6.32%;
- CHINAH rose by 450 pip (from 5800 to 6250), or 7.76%;
- HK50 rose 1270 pips (from 16900 to 18170, or 7.52%;
- TWIX rose 40 pips (from 495 to 535), or 8.08%;
- JP225 index jumped 1780 pips (from 25600 to 27380) , or 6.95%;
- AUS200 rose 405 pips (from 6380 to 6785), or 6.35%;
- Bitcoin surged 2,300 pips (from 18150 to 20450), or 12.67%;
- WTI rose 1200 pips (from 76.50 to 88.50), or 15.69 %;
- Brent jumped 1120 pips (from 83.80 to 95.00), or 13.37 %;
- Gold rose US$110 per ounce (from 1615.00 to 1725.00), or 6.81 %.

2. Reserve Bank of Australia raised interest rates six times, Reserve Bank of New Zealand raised interest rates eight times, and the outlook for AUD and NZD is still not optimistic.

Since May 2022, the RBA has raised rates six times in a row since the benchmark rate of 0.1%, with four strong hikes of 50 basis points and the remaining two hikes of 25 basis points each. This Tuesday (4 October), based on the recent four consecutive strong interest rate hikes of 50 basis points, the interest rate was increased by 25 basis points to 2.6%, and the Australian dollar was consolidating at a low level. Since October 2021, the RBNZ has raised rates eight times in a row since the benchmark rate of 0.25%, the last five of which were strong 50 basis point hikes and the remaining three by 25 basis points each. This Wednesday (5 October), after the RBNZ announced a 50 basis point interest rate hike to 3.50% as expected, the New Zealand dollar only strengthened in the short term and is currently consolidating at a low level. Since last Wednesday night (28 September), the US dollar index has retraced sharply by 490 pips (from 114.70 to 109.80), or 4.27%, and non-US currencies have finally had a chance to catch their breath. The depreciation of the dollar in the past week is also a normal "periodical" correction after the "extreme appreciation" of the dollar in the past. To analyse, the Australian dollar and New Zealand dollar have relatively small fluctuations in this correction of non-US currencies. In contrast, the British pound has the most significant increase in this correction wave and rose by 11.11%.

- DXY: a sharp drop of 490 pips (from 114.70 to 109.80), or down 4.27%
- EURUSD: surged 450 pips (from 0.9550 to 1.0000), or 4.71%
- GBPUSD: surged 1150 pips (from 1.0350 to 1.1500), or 11.11%
- AUDUSD: narrow range between 0.6350 to 0.6550 (200pip range)
- NZDUSD: narrow range between 0.5550 to 0.5800 (250pips range)
- USDCAD: dropped 330 pips (from 1.3830 to 1.3500), or 2.39%
- USDJPY: narrow range between 143.50 and 145.50 (200 pips range)
- USDCNH: dropped a massive 2,500 pips (from 7.2650 to 7.0150), or 3.44%
- USDSGD: fell 290 pips (from 1.4490 to 1.4200), or 2%

Fundamental analysis for the weakness of AUD and NZD:

First, the Fed's interest rate hike expectations have boosted the dollar prospect, far exceeding the impact of the RBA and RBNZ rate hikes on the Australian and New Zealand dollar, and the US dollar dominates the rise and fall of the Australian and New Zealand dollars.

Second, Australia and New Zealand's largest export market is China. China's recent series of economic data from July to September was less than expected. China's economic growth may slow down, which may be detrimental to AUD and NZD. China's domestic demand is weak, the housing prices have been falling for 12 consecutive month-on-month, and the housing price 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. Since July-August in China, about 14 provinces and cities in China have experienced extreme climates of high temperatures and drought in history, and many areas have faced the dilemma of water shortages and power restrictions. China's manufacturing PMI recorded 50.1 in September, compared to 49.4 in August, which is the fifth time since March this year that it fell below 50-the threshold separating contraction from expansion. Only June and September recorded 50.1-50.2, meaning it has remained in the 47.4.0-49.6 range for five months this year. 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. 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.

Third, with inflation high across the globe, particularly in the United States, one of Australia's largest trading partners, Australia is no exception. RBA's October interest rate policy statement stated that the central bank's core forecast is that inflation will peak at 7.75% in the fourth quarter of 2022, and the core CPI will reach 6% by the end year. The CPI is expected to be slightly higher than 4% in 2023 before falling back to the target range of 2-3% by the end of 2024. The current Australian benchmark interest rate is 2.6 %. It is necessary to pay close attention to Australia's CPI data for September to be released on 26 October, which may be the guideline for the rate hike rate of the RBA's interest rate meeting in November this year.

Source: MacroMicro, Analyzing the AUDUSD, the RBA benchmark rate and the Australian Consumer Price Index CPI annual rate over the past 20 years or so, each

time the AUDUSD has strengthened, it has been a period when the RBA benchmark rate was more significant than the Australian Consumer Price Index CPI annual rate. Currently, the Australian Consumer Price Index (CPI) annual rate is much higher than the RBA benchmark rate, and the AUDUSD is generally in a downward trend.
The words in the picture above:
Blue: AUDUSD
Red: RBA benchmark rate
Yellow: Australian Consumer Price Index CPI annual rate

Analyzing the chart above, "AUDUSD vs RBA Benchmark Rate vs CPI Annual Rate", over the last 20 years or so, every time the AUDUSD has strengthened again, it has been during a period when the RBA Benchmark Rate was more significant than the CPI Annual Rate. Currently, the annual rate of the Australian consumer price index (CPI) is much higher than the benchmark interest rate of the Australian central bank, so it is easy to understand that the AUD/USD is still in a downward trend. The situation in New Zealand is similar with Australia, and will not explain in details here.

In the medium and long term, if the Fed's "hawkish policy peaks " or "dollar strength" peaks, and the United States leads the world's economies out of the quagmire of "high inflation". In the meantime, if China can abandon its "zero COVID policy" as soon as possible, avoid falling into a regional war conflict in the "Taiwan Strait", and start the economic recovery in the post-epidemic era in an orderly and effective manner, the Australian and New Zealand dollars are expected to be strong again.

3. Long GBPJPY is one of the best trading opportunities last week.

Last Thursday, after the Bank of Japan's intervention in the yen, the dollar fell sharply by 500 pips (from 145.50 to 140.50, or 3.44%) against the yen. During the period, the yen strengthened sharply, but non-US currencies were still weak against the dollar. In the short term, the yen has become the strongest currency. Therefore, the yen has generally strengthened against non-US currencies. Among them, the pound has depreciated by 1550 pips against the yen, which is the most volatile. Combined with the British government's most significant tax cut in half a century announced last Friday, the pound fell sharply to a record low of 1.0350 against the dollar. GBPJPY = GBPUSD + USDJPY. If when GBPUSD and USDJPY fall, GBPJPY falls, it will be the effect of a double fall. Therefore, GBPJPY fell by over 1,500 pips in only three trading days (22 September, 23 September and 26 September).

<u>"How deep it goes down, how high it could go up". One week later, GBPJPY realized the reality of rising by more than 1,500 pips.</u>

The UK Truss government announced on 3 October to scrap "the 45% tax rate plan" a week ago, and at the same time, announced the launch of a plan to buy unlimited long-dated government bonds "as needed" to prevent a crisis in government pensions. From a low of 1.0350, the GBPUSD rebounded sharply to a high of around 1.1500. That means in just one week, GBPUSD jumped 11.11%. At the same time, since the Bank of Japan intervened in the yen's decline last week has little effect, the USDJPY has only fluctuated in a narrow range between 143.50 and 145.50 and is still inclined to rise in general. GBPJPY, led by a sharp rise in GBPUSD, has sharply increased by 1600 pips (from 149.50 to 165.50) in the past week, recovering all of last week's losses.

Source: tradingview. The UK Truss government announced on 3 October to scrap "the 45% tax rate plan" a week ago, and GBPUSD rose sharply, and Japan's intervention in the foreign exchange market had little effect. *In the past week, GBPJPY has sharply increased. It rose 1,600 pips, recovering all of last week's losses.*

Short-term risk: This Friday (7 October) at 8:30 pm, the "non-farm payrolls change" data and next Thursday (13 October), the US September core CPI annual rate and

September core CPI monthly rate data release. These data will be an essential guide for the market to reconfirm whether there is a "turning point" in inflation in the US.

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