Market Comments 26 Oct 2022

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The Bank of Japan once again intervened in the depreciation of Yen. The US stock market and non-US currencies rebounded, and USDCNH broke above 7.3000.

1. Japan has intervened in the foreign exchange market again, and the USDJPY fluctuated by more than 600 pips.

With the sharp depreciation of the yen by 33.83% (from 113.50 to 151.90) so far this year, the government of Japan is under increasing pressure from "imported inflation" caused by "Yen depreciation". The Bank of Japan quietly entered the market on Friday night (21 October) again after the USDJPY broke 151.50 upwards and intervened in the foreign exchange market on the depreciation of the yen, which caused the USDJPY to fall by around 640 pips (from 151.90 to 145.50) in a short period of time. As of now, the government of Japan and the Bank of Japan have yet to announce the details of this foreign exchange intervention officially. In the short term, this "non-transparent" foreign exchange intervention resulted in the market's " power of shorting the yen" being significantly suppressed. We have to be alert that the government of Japan may continue to intervene in the foreign exchange market again quietly at any time.

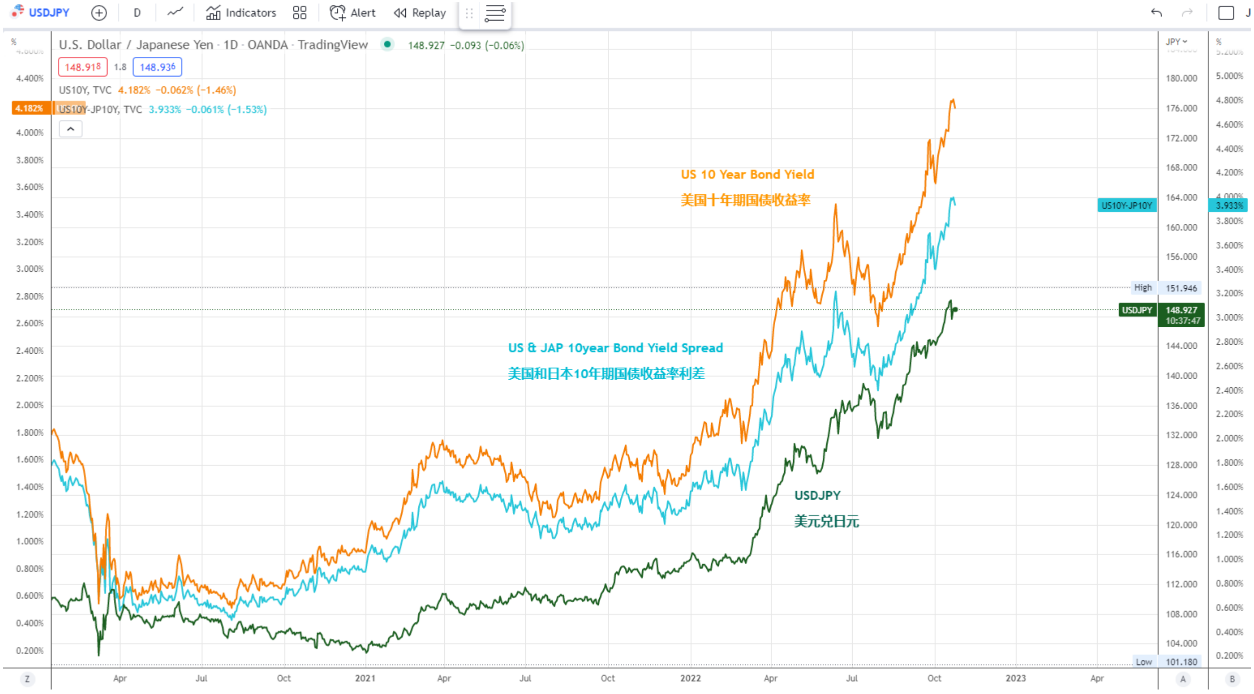
Source: tradingview. On 22 September, BOJ intervened in the depreciation of the yen. USDJPY oscillated between 140.50 and 146.00 and then started to rise again.

On 21 October, the Bank of Japan intervened again in the depreciation of the yen, and USDJPY oscillated widely between 146.00 and 151.90.

Japan's recently released CPI inflation data for September, which rose 3% year-on-year, was the first time in nearly three decades and also the sixth consecutive month that the Bank of Japan's inflation target of 2% or more was maintained. The JPY 10-year swap rate has risen above 0.6%, significantly exceeding the 0.25% ceiling defended by the BOJ's YCC and the highest level in nearly eight years.

Market bets on the government of Japan being forced to scrap its YCC policy has starting to grow again. According to data recently released by the Japan Securities Dealers Association, the net sale of the Japan Government Bond 10Y by foreign capital reached its highest level ever recorded back in June this year. The "widowmaker trade" may strike again. The "widowmaker trade" refers to the massive shorting of Japanese government bonds, especially the Japan Government Bond 10Y, which has cost international investors dearly over the past 20 years or so, with nothing to show for it. On 15 June last year, Wall Street's Japanese bond shorts went head-to-head with the BOJ, with the price of Japan Government Bond 10Y plunging 2.01 yen, the most significant one-day drop since 2013, and triggering the Osaka Exchange meltdown mechanism twice. The BOJ immediately invested 700 billion yen (about US$5.2 billion) on the same day to defend the 10-Year JGB Yield’s 0.25% ceiling, with little effect. After closing at 0.255% on 13 June and 0.256% on 14 Jane and 15 June, respectively, the Bank of Japan announced that "unlimited firepower was in place" and that it would continue to buy unlimited amounts of Japanese 10-year bond yields at a fixed rate of 0.25% on 16 and 17 June.

This Friday, the Bank of Japan's upcoming November interest rate resolution and Japan's third-quarter outlook report will be released. Although the market expects the Bank of Japan to maintain its "accommodative policy", it will be interesting to follow up on this report to see if the Bank of Japan has any new outlooks and ideas for the economy’s future. The Bank of Japan's "accommodative" monetary policy will likely continue. At the same time, there is a high probability that the Fed will raise rates again by 75 basis points at next Friday's rate resolution. The divergence between the underlying policies of the Federal Reserve and the Bank of Japan may continue to support a rise in USDJPY. With the Fed's rate hike cycle likely to continue into next year, and the Bank of Japan, expected to keep its easing policy unchanged until the end of BOJ Governor Haruhiko Kuroda's term in March next year, USDJPY could continue to move higher and test above near 152.00 (the July 1990 high) in the future. Meanwhile, the markets have been discussing whether the Bank of Japan will gradually exit its long-held yield control curve (YCC). Therefore, be wary that any announcement by the Bank of Japan of a future or relaxation in the yield curve could cause significant volatility in the foreign exchange market.



Source: tradingview, an analysis of the USDJPY and US 10Y Bond Yield, and the US-JP 10-year bond spread over the past year (October 2021 to October 2022) shows that the trend of USDJPY is getting closer and closer to that of US10 Year Bond Yield and US-JP 10year bond spread, which is a sign that USDJPY will have to rise as the Fed's rate hike policy continues and the US dollar continues to appreciate.

2. Under the pressure of the depreciation of the US dollar, the US dollar index fell after a consolidation within a narrow price range. US stocks and non-US currencies continue to rebound.

The liquidity of the US dollar still dominates the global financial market. The sharp rise and fall of the US dollar drive the rise and fall of all other financial assets. Regarding the "depreciation pressure of the US dollar", there is a detailed discussion in the previous article on 14 October (US dollar may continue to rise and the discussion on the “depreciation pressure” of the US dollar. USDJPY may look towards 150.). As we enter the fourth quarter and in the first three weeks of October, the US dollar index maintained a "phased peak" and "range consolidation" between 113.50 and 109.50. Overall, the "depreciation trend" of the US dollar is highlighted. It may fall further below 109.50 and look towards 107.50 before the November Fed meeting next Thursday (3 November).

The overall dollar’s "depreciation trend" is reflected in the financial foreign exchange market. The US 10Y Treasury yield broke through 4.00% in the past few weeks, reaching a maximum of 4.335% and started to fall, currently around 4.085%. More interest-rate-sensitive US 2Y Treasury yield topped 4.639% and fell to approximately 4.415%. At present, according to market rumours, some swap traders expect the Fed's policy interest rate to reach 5% in the first half of 2023, which is also the "peak" that the Fed's interest rate pricing has never reached before. Former United States Secretary of the Treasury Summers said, "Above 5% is kind of milestone."

Risk sentiment in the markets "heated up" as the three major US stock indices, the Dow Jones, the S&P 500 and the Nasdaq, rebounded higher after the last three consecutive quarters of decline in the past two consecutive weeks of "staged" bottoming out and bouncing higher. Non-US currencies also corresponded to the "fall of the dollar" and started to rise to varying degrees. The following is a record of the gains and losses of the last two weeks.

- DXY fell 220 pips (from 113.70 to 111.50), or 1.94%
- The Dow surged 3,200 pips (from 28600 to 31800), or 11.19%
- The S&P 500 stock index rose 350 pips (from 3500 to 3850), or 10.00%
- The Nasdaq rose 1240 pips (from 10430 to 11670), or 11.89%
- EURUSD increased 320 pips (from 0.9630 to 0.9950), or 3.32%
- GBPUSD jumped 580 pips (from 1.0920 to 1.1500), or 5.31%
- AUDUSD rose 230 pips (from 0.6170 to 0.6400), or 3.73%
- NZDUSD rose 250 pips (from 0.5500 to 0.5750), or 4.55%
- USDJPY rose 640 pips (from 145.50 to 151.90) or 4.47%, range-bound between 147.50-149.10 after BoJ intervention
- USDCHF fluctuates in the range of 1.1015-0.9910 and tends to be downward by 2.37%
- USDCAD fell 380 pips (from 1.3980 to 1.3600), or 2.72%
- USDCNH rose 2300 pips (from 7.1450 to 7.3750), or 8.26%
- USDSGD fell 270 pips (from 1.4400 to 1.4140), or 1.81%

3. Rishi Sunak elected as the new British Prime Minister, GBPUSD rose 5.31%, and GBPJPY rose 6.25%

In the face of the British pension crisis, the new policies of British Prime Minister Truss and British Finance Minister Kwarteng failed to solve the problem, and also caused the British pound (to a 37-year low of around 1.0350) and British government bonds (UK 10-year term) to plummet. The price of government bonds fell to a record low of around 91.50, while the UK 10-year government bond yield hit a record high of 4.5% twice recently), and was finally forced to resign. On 24 October 2022, Rishi Sunak, a second-generation Indian-born British immigrant, was elected as the new Prime Minister of the United Kingdom. The pound was also slightly boosted, breaking above 1.1500, or up 5.31%. Meanwhile, the last two times the Bank of Japan intervened in the "depreciation of the yen", the GBPJPY fell only briefly before quickly resuming its rise, accumulating a gain of around 2,100 pips (from 149.00 to 170.00), or up 14.09%.

Over the past two decades, the LDI investing strategy, which has been highly respected in the UK market for over two decades, has become a significant source of "vulnerability" for the pension fiasco. In the previous global "low-interest rate" environment, this was a perfect strategy, equivalent to buying an interest rate financial insurance policy, using "interest rate swaps" to exchange "floating cash flows" for "fixed cash flows" by pledging a certain amount of margin and "repurchasing UK government bonds with leverage". When interest rates are falling in a low-interest rate environment, it is profitable to use 'floating cash flow' to cover 'insurance costs. With the rolling overnight cost of short-term funding getting lower and lower, the larger the asset size, the more money can be made by using "repo UK government bonds to leverage". However, as the Fed's "rate hike cycle" begins and the BoE's benchmark rate has to follow the rise in the US dollar rate, that is, when the BoE rate starts to move up in the medium to long term, this strategy is losing money on both sides. "Insurance premiums are getting higher", and when the money previously pledged in interest rate swap contracts becomes insufficient, margin calls are made, and when UK pensions do not have so much money to pay, they are forced to sell UK treasury bonds. "If hundreds of pension insurers do this, UK government bonds will fall, and UK government bond yields will rise, and the pressure for margin calls on "swap rates" will increase, and both sides will be caught in a vicious circle so that eventually the UK government bond market will be forced to "freeze" trading, because everyone is "selling government bonds", but cannot find buyers to "buy government bonds". So, next, investors will have to pay close attention to how Rishi Sunak saves the UK pension market, which is crucial to the UK's medium to long-term economic recovery.

Non-US currencies still tend to rise against the yen. Against the backdrop of "strong USDJPY" or continuation of the "general rebound in non-US currencies against the USD", the BOJ's intervention on the yen's depreciation only limited the USDJPY from making new highs in the short term. The other non-US currencies, against the Japanese yen, also saw short-term fluctuations before quickly resuming their previous gains. One of them, GBPJPY, rose the most, jumped around 1,000 pips in the last two weeks or so (from 10 October to 21 October). The following records the gains and losses over the past two weeks.

- USDJPY rose 640 pips (145.50-151.90) or 4.47%
- GBPJPY rose 1000 pips (160.00-170.00), or 6.25%
- EURJPY jumped 700 pips (141.00-148.00), or 4.97%
- AUDJPY increased 470 pips (90.80-95.50), or 5.18%
- NZDJPY rose 600 pips (80.50-86.50), or 7.45%
- CADJPY rose 530 pips (105.00-110.30), or 5.05%
- CHFJPY rose 500 pips (145.50-150.50), or 3.44%
- SGDJPY rose 520 pips (101.00 -106.20), or 5.15%

At the same time, Japan, Singapore and Australia in the Asia-Pacific region, as well as the United Kingdom, Germany and other countries in the European area followed the US stock market and started rebounding to varying degrees.

- SING 30 rose 750 pips (262.50-270.00), or 2.86%
- JP225 surged 1700 pips (25850-27550), or 6.58%
- AUS200 increased 310 pips (6500-6810) , or 4.77 %
- GER30 jumped 1050 pips (12000-13050), or 8.75%
- EU50 rose 330 pips (3250-3580), or 10.15%
- UK100 rose 330 pips (6700-7030), or 4.93%
- NL25 increased by 5450 pips (610.50-665.00), or 8.93%
- FRA40 surged 550 pips (5700-6250), or 9.65 %
- CH20 rose 750 pips (10000-10750), or 7.5 %
- ES35 rose 620 pips (7180-7800), or 8.64%

Crude oil and gold are trading sideways at lower prices after falling sharply over the past two weeks, Since September, Bitcoin recently topped 20,000 for the first time after 'consolidating' at low levels.

- WTI, down 1180 pips (93.80-82.00), or 12.58%, is trading sideways between 83 to 87 per barrel.
- Brent, down 1040 pips (99.70-89.30), or 10.43%, is now trading sideways between 90 to 94 per barrel.
- XAUUSD fell US$110 per ounce (1730-1620) and is currently consolidate between 1620 to 1700.
- Bitcoin rose 2750 pips (18100-20850), or 15.19%

4. Interpretation of the report of the 20th National Congress of the Chinese Communist Party; USDCNH broke above 7.3000.

In the past week, the much-anticipated 20th National Congress of the Chinese Communist Party officially kicked off the previously anticipated third term of Xi Jinping's re-election, further cementing the top leadership team in China with Xi Jinping at the center of the leadership. According to the conference report, the policy on the prevention and control of COVID-19, which is of significant concern to the general public, remains unchanged with the "zero-COVID policy". In terms of science and technology, it clearly points out the importance of "innovation", "scientific and technological progress", and "professional labor" for high-quality economic development. On ESG (abbreviation for Environment, Social and Governance) sustainable development, the emphasis is on "actively and steadily promoting carbon dioxide peaking and carbon neutrality" and accelerating the development of "green transformation" and "energy revolution", i.e. promoting "clean energy and efficient use of coal". It emphasizes "integrity", "comprehensive development", and "safeguarding national security", which was widely interpreted as a need to promote domestic political, social, environmental and cultural development, as well as to ensure "supply chain security", "food security" and "energy security" in the context of the "Russia-Ukraine war", "COVID-19" and "global supply chain may be restructured". On the Taiwan issue, insist on not committing to "renounce the use of force" and reserve the option of taking all necessary measures. The "zero-COVID policy" may lead to a "partial closure", which may slow down China's economic growth. At the same time, the meeting's ambiguity about the leader's "successor" deepened market concerns about China's future political uncertainty. The USDCHN fell below 7.3 against a week of "narrow fluctuations" in the USD index and touched a low of around 7.3750 after the "20th National Congress of the Chinese Communist Party". The Chinese stock market also hit a new low and fluctuated in a narrow range at the low level. However, the author remains bullish on the RMB and the Chinese stock market in the medium to long term. Over the past week, the Chinese and Taiwanese stock markets, instead of following the rally in the US, have been on a separate "down" and "low sideways" market:

- USDCNH rose 2300 pips (7.1850-7.3750), or CNHUSD fell 2.64%
- CHINA50 fell 1180 pips (12900-11720) , or 9.15%
- CHINAH fell 830 pips (5780-4950), or 14.36%
- HK50 fell 2200 pips (17000-14800), or 12.94%
- TWIX consolidated in a narrow range between 508-475, or 6.50 %

Short-term risk:

Next Friday (3 November) at 2am, the US Federal Reserve's interest rate decision in November will be one of the focuses of the market. This data will have a significant impact on the trend of the US dollar. All assets, non-US currencies, equities and commodities are subject to the overall movement of the US dollar. Please be aware that Japan may continue to intervene in the foreign exchange market again "without warning". There has also been ongoing discussion and rumors in the market about whether the Bank of Japan will take a step-by-step exit from the long-held yield control curve (YCC) in the future. So be wary that any announcement by the Bank of Japan of a future or relaxation in the yield curve could cause significant volatility in the foreign exchange market.

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