Market Comment_23Nov2022

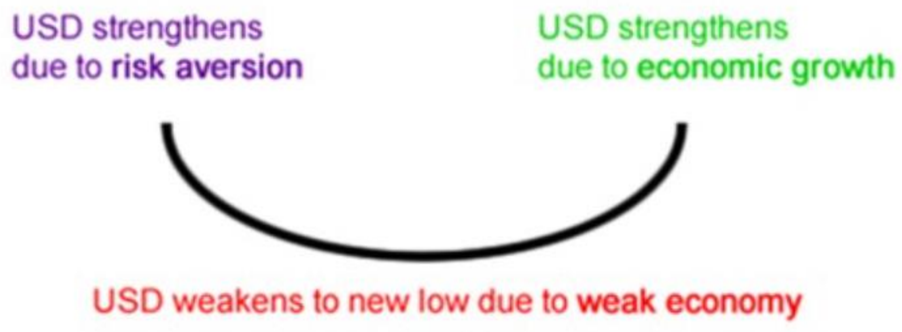
By Sandy Wang, 23 Nov 2022-12:20 pm SGT time

USD may be nearing the end of its current appreciation cycle; GBPJPY and EURJPY are back on the upside; G7 caps Russian oil at US$60.

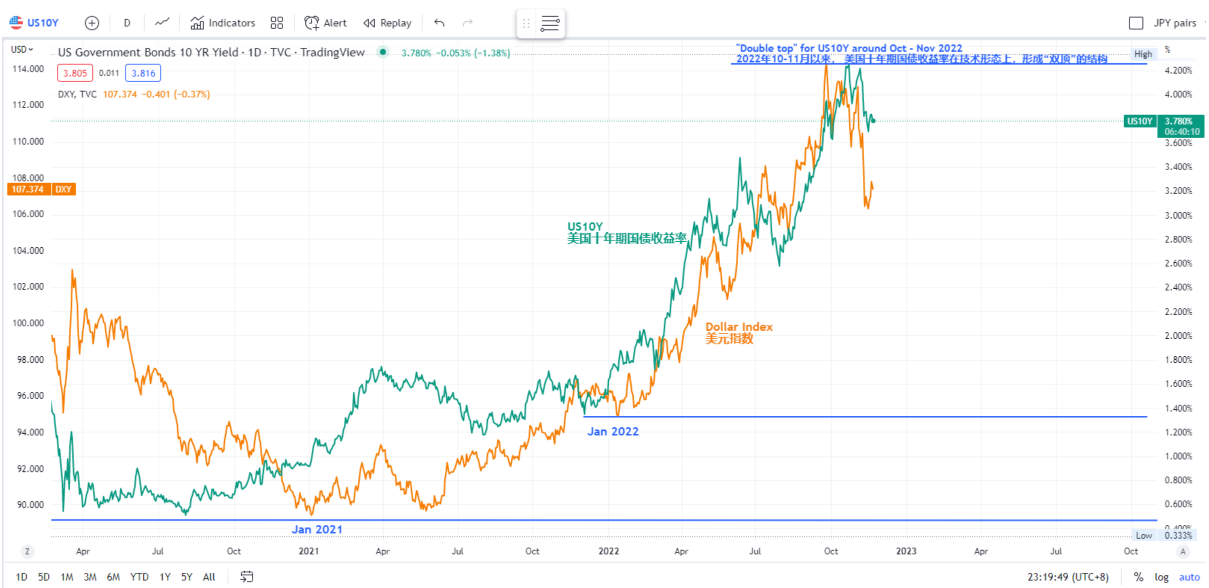
1. The momentum of US dollar appreciation has weakened, and the current cycle of US dollar appreciation may end.

Throughout history, the period when the “US dollar peaks” usually occur when "the US economy falls into recession" and "the stock market begins to strengthen" while "the Federal Reserve begins to ease monetary policy". At present, US stocks are starting to strengthen significantly from the recent performance of the Dow Jones. So two of these conditions may need to be met in the next 6 to 12 months. The current outlook for the US economy, which is likely to fall into recession in the next 12 months, may guide the dollar to a degree of weakness. The Fed's subsequent "continuation of interest rate hikes" will also be limited, with the Dollar Index struggling to break through the 115.00 line or, conversely, looking towards 120.

Once again, let's discuss “The Dollar Smile Theory”. According to Stephen Jen, a former Morgan Stanley Currency Strategist, the Dollar Smile Theory is that the dollar strengthens during both downturns and booms. One is that “risk aversion” is driving the appreciation of the dollar, and the other is that “the US economic boom” is driving the appreciation of the dollar. At present, the appreciation of the US dollar since this year has occurred against the backdrop of "high inflation" in the US and the "Russia-Ukraine war", which should be driven by "risk aversion". At present, there is no apparent tendency for the Federal Reserve to shift policy sharply towards "monetary easing", but it is now at the end of the rate hike cycle. If the US economy falls into recession over the next 12 months and growth is sluggish, the Fed may slowly shift to a "rate cut" cycle, and the dollar will begin a downward cycle, i.e. it will hit the bottom of the "Dollar Smile Theory curve". After a more extended period, when the US economy returns to growth and leads the global economy to rebound, the US dollar may move back into an upward range due to the US economic boom.



The "peak" of the current round of U.S. dollar index strength may have been locked around 115.00, which is where it hit around 114.50 on 28 September this year. Next, even after slowing down rate hikes, as Fed Chairman Powell said, interest rates will remain high for a long time. From the recent US inflation data and the overall reflection of the financial markets, the US dollar may have "peaked" in this round of rallies. Or it may also "peak" after repeated sideways consolidation over the next few months. According to current market expectations, the Fed will continue to raise rates to the 5%-5.25% range, then remain near this peak for a relatively long period before moving to a rate cut sometime in 2024. Even if the dollar resumes its rise again in the next 6-12 months, it may be limited. At the same time, the technical formation of a "double top" in the US 10-year Treasury yield may indicate that the current market "bets" on higher interest rates from the Fed in the future have cooled significantly. This may also signal that the dollar may have "peaked" in current stage.



Source: tradingview

Since the beginning of 2022, the US 10-year Treasury yield and the US Dollar Index have primarily moved in a consistent "positive “correlation pattern. During October-November, the US 10-year Treasury yield formed a "double top" regarding technical patterns**.** This may indicate that the current market "bets" on higher interest rates from the Fed in the future have cooled significantly. This may also signal that the dollar may have "peaked" the current stage.

US core retail sales recorded a monthly rate of 1.3% in October, substantially better than the 0.4% expected and the 0.1% in September. The manufacturing PMI published by the Institute for Supply Management (ISM) in the United States was recorded at 50.2 in October, a figure which has actually been in the 50.1-64.7 range for the past two years or so (since July 2020). The non-manufacturing PMI released by the Institute for Supply Management (ISM) in the US was recorded at 54.5 in October and had actually remained solidly in the upper 50s range (54.4-69.1) for the past two years or so (since July 2020). The US unemployment rate was 3.7% in October, compared to 3.5% in September. In fact, the figure has remained below 4% since the beginning of this year. Overall, these economic data show that the US job market and real economic growth are relatively solid, which is the "backbone" of the Federal Reserve's courage to raise interest rates significantly.

The Federal Reserve's definition of a neutral rate is around 2.5% and is currently at around 3.75%-4%. High-interest rates may have had a dampening effect on economic expansion activity, particularly in the housing market. In the future, the US dollar may enter a period of phased adjustment correction as expectations of a US recession strengthen and as the Fed slows rate hikes or becomes a "fait accompli" at the last interest rate meeting of the year (December). The U.S. dollar may enter a correction period of periodic adjustment. While recent data releases remain positive for the dollar, it has also failed to drive it out of the overall downtrend seen since early November. This may suggest that there may be more "depreciation pressure" afterwards, and if it can effectively break below 104.50, there may be more "downside" afterwards. The USD Index may not break below 115.00 again; conversely, it may look towards 120.

Source: tradingview

If the Dollar Index can effectively fall below 104.50, it may see more "downside" after that, the current round of dollar rally, the Dollar Index may "peak" at around 114.50 below 115. If not, on the contrary, it may look towards 120.

From a technical view, over the past week, the US dollar index has oscillated from the 104.90-107.50 range, the three major US stock indices have also basically maintained sideways consolidation, and non-US currencies are now also maintaining range oscillation, or sideways consolidation, or a small rise.

- *DXY Index oscillates between 104.90-107.50, currently quoted at 106.68.*
- *The Dow Jones trades sideways between 33150-34000 and rising slightly to 34090.*
- *The S&P 500 is trading sideways between 3900-4030.*
- *The Nasdaq is trading sideways between 11500-12030.*
- *XAUUSD is down US$52.50 per ounce (1786.00-1733.50), or 2.94%.*
- *EURUSD oscillates in the 1.0480-1.0220 range.*
- *GBPUSD oscillates in the 1.1750-1.2000 range.*
- *AUDUSD oscillates in the 0.6800-0.6600 range.*
- *NZDUSD moves sideways between 0.6050-0.6200.*
- *USDJPY oscillates between 137.70-142.30.*
- *USDCHF oscillates between 0.9350 - 0.9600.*
- *USDCAD oscillates between 1.3230-1.3490.*

- *USDCNH oscillates at 7.0230-7.1850.*
- *USDSGD oscillates between 1.3650-1.3830.*

At a time when the US stock market may have "bottom out" in the current stage, Asia-Pacific and European stock markets have started to rally slightly higher, or rangebound, to varying degrees over the past one week.

- *CHINA50 oscillates in a range of 12000-12550*
- *CHINAH oscillates in a range of 5850-6300*
- *HK50 oscillates in a range of 17320-18450*
- *TWIX oscillates in the 555-575 range*
- *SING30 oscillates in a range of 280-300*
- *JP225 up 670 pips (27700-28370), or 2.42%*
- *AUS200 up 200 pips (7000-7200), or 2.86%*
- *GER30 oscillates in the 14110-14470 range*
- *EU50 up 100 pips (3850-3950), or 2.60%*
- *UK100 up 170 pips (7280-7450), or 2.34%*
- *NL25 up 20 pips (700-720), or 2.86%*
- *FRA40 up 170 pips (6525-6695), or 2.61%*
- *CH20 oscillates in the 10830-11230 range*
- *ES35 up 370 pips (7980-8350), or 4.64%*

2. USDJPY may have peaked around 150-151 for current stage; GBPJPY and EURJPY are back on the upside.

USDJPY, which has been on an uptrend since the beginning of 2022, may have recently "peaked" in the 150.00-151.90 range. Technically, as the USDJPY has followed the US 10-year Treasury yield closely this year, the US 10-year Treasury yield formed a "double top" in terms of technical patterns during October-November. This may indicate that the current market "bets" on higher interest rates from the Fed in the future have cooled significantly. This may also signal that the USDJPY may have "peaked" in the current stage.

Japan's CPI (less fresh food) rose by 3.7% year-on-year in October, higher than 3.0% in September and expectations of 3.6%. Japan's CPI, excluding food and energy, rose by 2.5% year-on-year in October, higher than 1.8% in September and expectations of 2.4%. Overall CPI inflation in Japan exceeded expectations, increasing 0.7% (year-on-year) to 3.7% in October. This was due to the impact on the economy of a new round of food price increases and higher import costs.

With Japan's food self-sufficiency rate at 38%, the country is now debating the "food security issue" as it relies on imports for most of its food.

The Bank of Japan remains "unmoved" by the already "high" CPI and sticks to its current monetary policy settings because it believes that inflation in Japan is cost-driven, driven by the "weak yen" and "rising energy and raw material prices". Japan's GDP "unexpectedly declined" in the third quarter. Japan's exports grew by 25.3% in October, down from 28.9% in September. Japanese exports to China also grew at a 7.7% year-on-year rate in October, down from 17.1% in September. Growth in Japanese exports to most major markets, including the US and the EU, fell by several percentage points. Meanwhile, Japan's trade deficit remained much higher than expected in October. These figures may reinforce BoJ's view that the “inflation is unsustainable”. The BoJ is not expected to change its monetary policy stance, although higher import costs are expected to continue to push up the overall CPI in the future.

Technically, non-US currencies still tend to rise slightly against the yen. In last week, "USDJPY" rose slightly, and "non-US currencies generally rebounded against the dollar". The Bank of Japan's intervention stopped the yen slide and the recent rise in expectations of a "peaking of inflation" in the US. These factors are limiting the USDJPY, or the short term is difficult to hit new highs. GBPJPY, EURJPY and NZDJPY led the way, with GBPJPY the most significant gainer against the yen, up around 500 pips over the past one week. The following are the record gains and losses for the past one week.

- *USDJPY up 480 pips (137.50-142.30), or 3.49%*
- *GBPJPY up 500 pips (163.00-168.00), or 3.07%*
- *EURJPY up 300 pips (142.50-145.50), or 2.11%*
- *NZDJPY up 320 pips (83.80-87.00), or 3.82%*
- *AUDJPY moves sideways between 92.50-94.50*
- *CADJPY moves sideways between 104.20-105.80*
- *CHFJPY moves sideways between 145.50-149.00*
- *SGDJPY moves sideways between 101.00-103.00*

3. "500,000 b/d production increase" rumor causes the WIT oil price to fall below US$80, G7 caps Russian oil at US$60

1) Crude oil plunged on Monday (21 Nov) and approached a new low for the year on rumors that OPEC is considering increasing production by 500,000 b/day

next month. This Monday (21 November), the Wall Street Journal, reported that Saudi Arabia is discussing with OPEC members to announce that there is plan for a production increase of up to 500,000 b/d at the OPEC ministerial meeting on 4 December. The news came as a shock to the market as the announcement of a 2 million b/d production cut at the OPEC ministerial meeting on 5 October just a short while ago, and the implementation of the "decision to cut production by 2 million b/d" with November just started. Once OPEC announces an increase in production next month, it will depress crude oil prices, and the plunge in oil prices after this news has reflected this impact, making the already weak oil prices "worse" recently. WTI Oil plunged to a low of US$75.80 a barrel, pointing to a low of around US$76.50 a barrel around 26-27 September this year, which is where crude oil prices were earlier this year. Brent Oil plunged to a low of 83.80, pointing to a low of around US$83.50 per barrel on 26-27 September this year, the price at the beginning of the year was around US$77.50 per barrel.

2) On the same day, 21 November, Saudi Arabia quickly came out to "clarify and explain" the news and said that the production cut agreement, i.e. "cut oil production by 2 million barrels per day" would last until the end of 2023. OPEC will not discuss any decisions before the meeting, and that Saudi Arabia is ready to further cut production if necessary. WTI crude oil then recovered quickly to US$80.00/barrel. WTI Oil is currently at $81.75 per barrel, and Brent Oil is around $89.35 per barrel. Crude oil is one of the vital pricing bases for the US dollar, and US inflation data was just confirmed by the market last month that "inflation may start to move downward", which is a clear sign that US inflation has finally eased and cooled in October after climbing continuously for the past nearly two years. The earliest clue to the possibility of such an "inflection point" in inflation data may have come from the sharp fall in crude oil prices since mid-June this year. As "energy" are second only to food in the US consumer price index, the news that the Saudi production cut agreement continues until the end of 2023 may lay the "hidden danger" for a return of US inflation.

3) G7 proposed a price cap of US$60 a barrel on Russian oil, working to reduce Russian energy revenues as Russia threatens to cut production. On Tuesday (22 November), according to the Wall Street Journal, the G7 and the EU are discussing setting a price cap on Russian crude oil at around US$60. At the same time, the EU will ban imports of Russian crude oil from 5 December and Russian oil products from 5 February next year. The G7, EU and Australia will ban the provision of marine insurance, trade finance and shipping services for Russian oil if it is sold above this ceiling. And in fact, the EU and the G7 account for 90%

of the global shipping insurance industry's market share. In other words, this is a disguised attempt to force Russia oil to shift to other markets or reduce production. Russia doesn't plan to supply crude or oil products to nations that implement a price cap, according to Deputy Prime Minister Alexander Novak, and he also threatened that Russia would reduce production. The International Energy Agency (IEA) has said that Russia may struggle to find new markets for its oil after the European ban takes effect, saying in its monthly report last week that by the end of March next year, Russian production could be almost two million barrels per day lower than pre-Russia-Ukraine War levels.

4) US defends oil price at $70/bbl. On Tuesday (22 November), US Energy Security Special Envoy Hochstein said: "to be opportunistic with SPR and buy back oil near US$70. " In the case of the IEA and OPEC successive downgrades in oil demand, the US Strategic Petroleum Reserve replenishment stocks, probably to avoid a sharp drop in oil prices, but also to a certain extent to protect the interests of oil-producing countries. Looking ahead, if OPEC and Russia together cut production by more than 3 million barrels per day, then the downward trend in oil prices may reverse. The "global oil suppliers" may become the key to the future pricing of oil prices, and investors need to be wary of the possibility of further volatility in the short term.

Technically, crude oil has generally maintained a downtrend since the beginning of November, with WTI Oil oscillating sharply between 93.80 and 75.80 and Brent Oil oscillating sharply between 99.50 and 83.80.

4. RBNZ hawkishly raised rates by 75 basis points to 4.25% at the November rate meeting.

The RBNZ's central bank rate meeting this Wednesday (23 November) hawkishly raised rates by 75 basis points to 4.25%, and the market now expects the RBNZ's expected terminal rate to rise to perhaps 4.75%. Since October, inflation in New Zealand has risen sharply to 7.2%, exceeding expectations of 6.6%. Although still marginally below the previous 7.3%, the deviation from expectations has fueled the RBNZ's determination to continue the fight against inflation. As the risk of a global recession remains and stock market volatility is likely to remain high, the New Zealand dollar, which is more sensitive to risky assets, may remain under pressure. In the medium term, if the Fed's monetary policy turns and China's economy accelerates its rebound, the US dollar index may peak and fall, which will really ease the downward pressure on the New Zealand dollar exchange rate.

Short-term risks:

This round of dollar appreciation, which began as early as around 2011, has been going on for ten years following the global financial crisis that started in 2008. The US dollar index has risen significantly by 55.78% (73.50 - 114.50), since 2022, it has dramatically increased by 21.16% (94.50 - 114.50). After June this year, driven by the sharp fall in oil prices and the Federal Reserve's "aggressive tight monetary policy", which has seen four consecutive sharp rate hikes of 75 basis points, US inflation may show signs of a "significant slowdown" from October onwards. Meanwhile, since October this year, the Reserve Bank of Australia and the Bank of Canada have begun to slow the pace of interest rate hikes. The Federal Reserve is expected to slow the interest rate hike pace in December. The upward momentum of the dollar index has weakened significantly since October, and the cycle of solid dollar appreciation may be nearing its end. The market will likely be more of a "range-bound" market until the dollar does "peak".

The US dollar continues to dominate the forex markets. Keep an eye on the US Q3 GDP data next Wednesday, the release of the US October non-farm payroll data next Friday, and a speech by Fed Chairman Jerome Powell next Thursday. It is expected to significantly impact the overall foreign exchange market, which will lead to the rise and fall of other non-US currencies.

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