Market Comment_07Dec2022

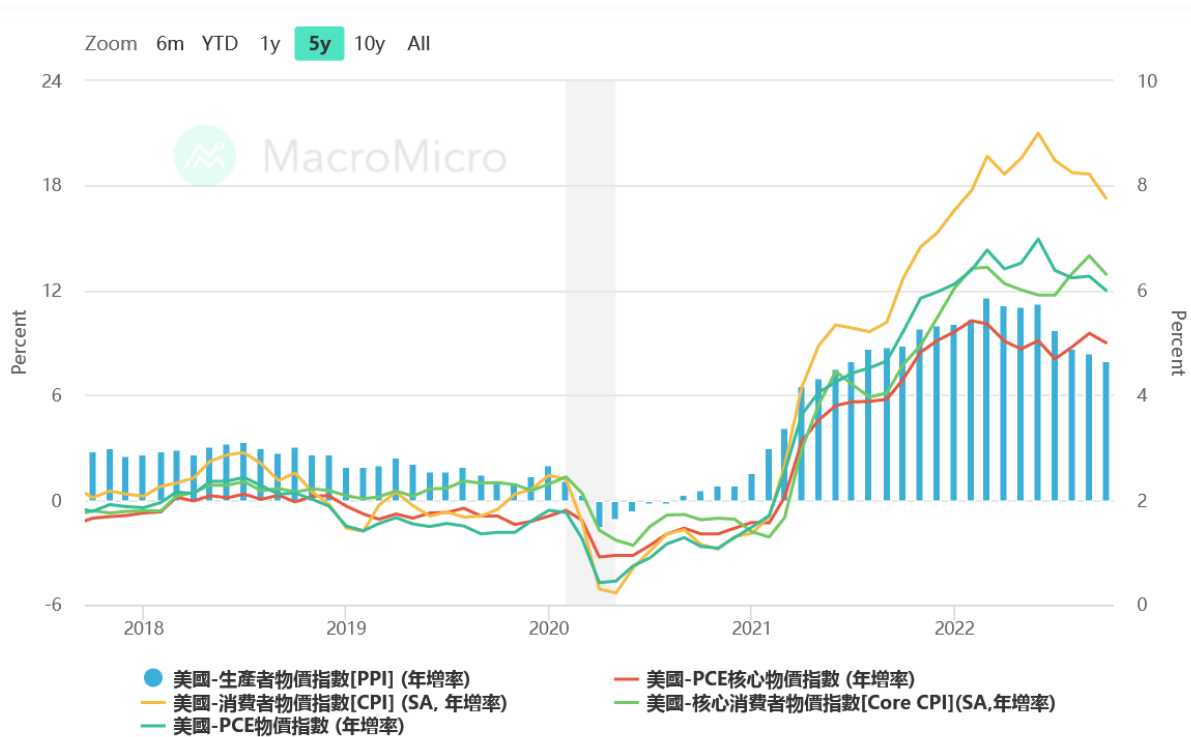
The yen and offshore RMB have risen strongly recently. Crude oil plunges and a further drop may point to 65.00.

1.US fundamentals are "solid" and support the Fed's continued rate hikes to "contain inflation"

A series of recent data releases in the US is evidence of "solid" US fundamentals. Last Wednesday (30 October), US GDP for the third quarter increased at an annual rate of 2.9%, better than the expected 2.6% and the previous 2.6%. The US non-farm payrolls released on Friday rose by 263,000 in November, significantly better than the 200,000 expected. The US unemployment rate remained unchanged at 3.7% in November, compared to its expected and previous value of 3.7%. Average hourly wages (annual rate) in the US recorded 5.1% in November, above the expectation of 4.6% and 4.7% in October. The upward revision in average hourly earnings and the positive employment situation signal that "steady growth in consumption" and a "healthy return on investment" are to be expected in the US. The core PCE (Personal Consumption Expenditures) price index (annual rate) posted 5.0% last Thursday (1 Dec), compared to the 5.0% expected and 5.2% previously; the core PCE price index (monthly rate) posted 0.2% in October, the smallest increase since July 2022, compared to 0.3% expected and 0.5% previously. The US PCE data for October further reinforced the view that US inflation may have peaked.

However, the US ISM Manufacturing PMI recorded 49.0 in November, down from 50.2 in the previous month and 49.8 expected, a worse-than-expected decline and increasing the risk of a deeper recession in the US economy than officially expected. The recently released US ISM non-manufacturing index for November recorded 56.5, better than the expected 53.3 and 54.4 in October, where the business activity sub-index increased the most since March 2021. The ISM's measure of services industry employment increased to 51.5 from 49.1 in October, which may indicate that the US economy is now more supported by the service sector (non-manufacturing).

Overall, the fundamentals of the US economy are "sound" and are the basis for the Fed's courage to continue to raise interest rates.



Source: MacroMicro

The words in the picture above:

Blue bars: US PPI YoY

Orange: US CPI (SA, YoY)

Dark green: US PCE YoY

Red: US PCE YoY

Light green: US Core CPI (SA, YoY)

Inflation in the United States is still at a "high level”. The Federal Reserve began tapering its bond purchases in November 2021, and, started "interest rate hikes" and "tapering" in March and June 2022. Since the Federal Reserve has implemented a tightening monetary policy until October this year, the growth rates of leading indicators of inflation, US Producer Price Index (PPI), US Personal Consumption Expenditures (PCE), US Core Personal Consumption Expenditures (PCE), US Consumer Price Index (CPI) and US Core Consumer Price Index (CPI) are still at historically high levels, although falling in tandem year-on-year. The Producer Price Index (PPI) is usually investigated in the following three areas of production: industry, commodities and companies in the processing stage. When producers spend more on consumer goods and labour, they are likely to

add that part of the increased cost to consumers, so the PPI is considered a leading indicator of the Consumer Price Index.

Federal Reserve Chairman Jerome Powell said last Wednesday, "It makes sense to moderate the pace of our rate increases", "We think slowing down at this point is a good way to balance the risks", and "The time for moderating the pace of rate increases may come as soon as the December meeting. However, he was not too pessimistic about the US economy's outlook, saying, "I do continue to believe that there's a path to a soft or softish landing, " "I think it's still achievable, "reining in inflation while avoiding recession or significant layoffs. " To summarize the recent negative fundamental factors for the US dollar: expectations that the US economy may fall into recession; increased expectations of a constrained terminal rate level; the market may have digested the Fed's expectations that "the terminal rate may exceed 5%" and the Fed's "slower pace of interest rate hikes" may now be seen by investors as somewhat of a positive for "risk assets". These factors, coupled with the wave of profit-taking by "dollar bulls" over the past one year, have led to the recent decline in the dollar index.

Reflecting on the financial markets, the US dollar once again performed a short-term rise followed by a plunge. The three major US equity indices moved slightly higher before moving sideways. Following the release of the non-farm payroll data, risk appetite climbed, and the US dollar index continued to fall from its intra-day high and returned below 105.00 and touched a low of around 103.80. Major non-US currencies rose collectively against the US dollar to varying degrees, and gold rallied sharply to reach the 1800-level twice. The following is a record of the gains and losses of the past one week.

- *DXY Index closed 2.81% lower (106.80-103.80), now at 104.80*
- *The Dow Jones is trading in a range of 33550-34600 and is now at 33900*
- *The S&P 500 stock index is range-bound between 3900-4100 and is now at 3995*
- *Nasdaq oscillates between 11450-12100, now at 11800*
- *XAUUSD oscillates in a range between 1738.50 -1808.00 and is now at 1775.50*
- *EURUSD up 300 pips, or 2.92% (1.0290-1.0590), now at 1.0510*
- *GBPUSD up 450 pips or 3.78% (1.1900-1.2350), now at 1.2195*
- *AUDUSD oscillates between 0.6650-0.6850 and is now at 0.6730*
- *NZDUSD up 300 pips or 4.88% (0.6150-0.6450), now at 0.6340*
- *USDJPY down 650 pips, or 4.64% (140.00-133.50), now at 137.00*

- *USDCHF down 220 pips, or 2.30% (0.9550-0.9330), now at 0.9400*
- *USDCAD oscillates between 1.3380-1.3650*
- *USDCNH down 3250 pips or 4.35% (7.2550-6.9300), now at 6.9725*
- *USDSGD down 350 pips, or 2.54% (1.3800-1.3450), now at 1.3575*

Source： tradingview

Since 2021, the negative correlation between the US Dollar Index and the SPX500 has become more and more evident. Since the beginning of October this year, the SPX500 index has risen by 14.57 % (3500-4010), and the USD index has fallen by 9.35 % (114.50-103.80) correspondingly. Based on past recessions, the SPX500 has fallen by an average of 32.5% and a median of 27.1%, lasting 13.1 months and 14.9 months, respectively. This means that if the US economy falls into recession in 2023, the SPX500 could fall from a high of around 4800 in early 2022 to a low of around 3250.

2. Japanese Yen strength may continue. USDJPY may point to 130.

In 2022, the Yen was one of the worst-performing currencies, but since mid-October this year, the Yen has started to strengthen, and USDJPY has fallen 11.86% (151.80-133.80) and is currently quoted at 136.70. According to analysts at Bank of America, published by Bloomberg in June this year, the fair value of USDJPY was given at around 90.74. According to this estimate, there is still plenty of room for USDJPY to fall. At the same time, the Fed's "hawkish" interest

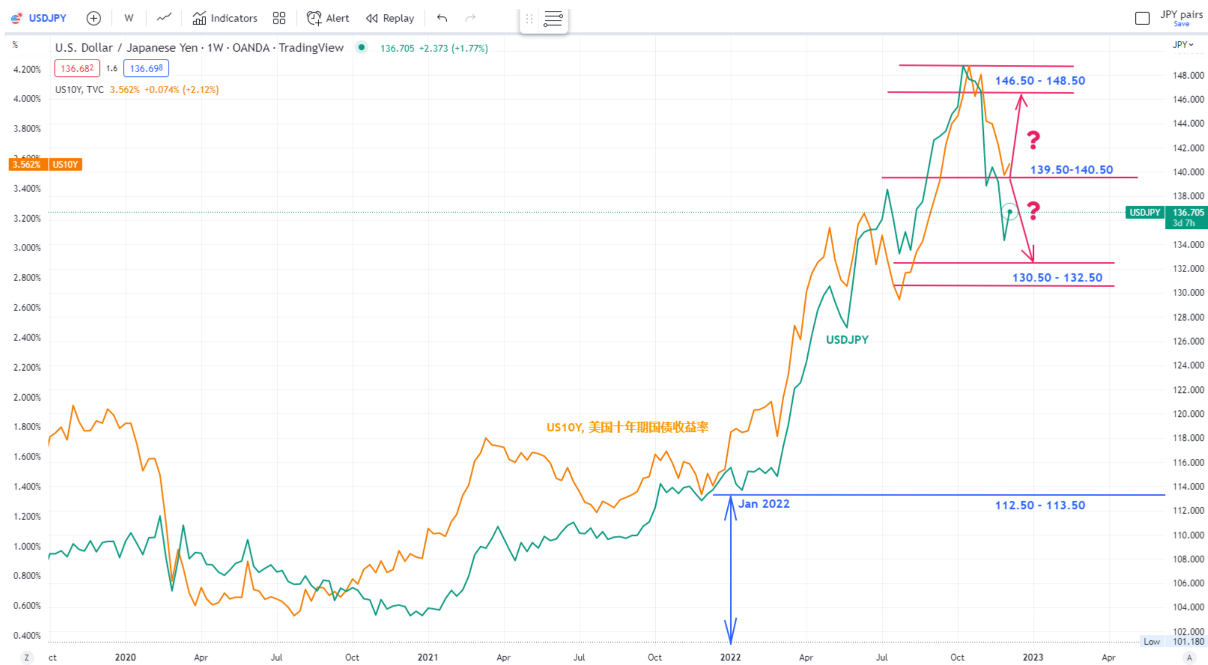
rate hike and the Bank of Japan's "dovish" easing policy may be reversed next year. The Bank of Japan's low-interest rate policy may last until the end of Governor Haruhiko Kuroda's term in April 2023. The market is betting on a growing shift in BoJ policy after that, and the BoJ has some voices now discussing the possibility of a policy shift.

The Bank of Japan's leading candidate for governor, former BOJ deputy governor Hiroshi Nakaso, said at a recent meeting last Thursday (17 November), “once the financial crisis is over, the central bank must cancel emergency support to avoid causing a moral hazard in the market. While the policies of Abenomics are appropriate, this monetary policy has also carried too much of a burden." His statement was interpreted to mean that he would not support a shift to a more accommodative monetary policy if he became governor of the Bank of Japan. That means there is a possibility of a significant policy shift at the BoJ next April when current BoJ Governor Haruhiko Kuroda leaves office.

Bank of Japan policymaker Asahi Noguchi recently said, "In order to raise wages, wages must rise about 3% for the inflation target to be met. The central bank could pre-emptively withdraw monetary stimulus if trend inflation". His statement may suggest that the BOJ may be preparing to exit the future low-interest rate environment.

BOJ Governor KURODA Haruhiko also recently made "dovish remarks" on the prospect of Japan shifting to an accommodative monetary policy stance, saying, "The BOJ is seeking to sustainably and stably achieve its 2% inflation target accompanied by wage growth. Our view is that this will likely take more time," "expects to see wage increases outstrip inflation before any public discussion of policy shifts". Kuroda's comments reinforced market expectations that he will not adjust policy until the end of his term next April.

From a fundamental point of view, the "divergence" between the monetary policies of the Fed and the Bank of Japan is weakening, as the Bank of Japan is basically unlikely to have a more dovish policy. There is even the possibility of the Bank of Japan turning "hawkish" next year. And the Federal Reserve's monetary policy is slowing down. There is a higher probability that the USDJPY will fall, which means that the yen will strengthen.



Source: tradingview

The USDJPY is likely to remain in a range of 132.50-146.50 for the next few months, with a return to the 130.50-132.50 range more likely. USDJPY would need to break out of the 146.50-148.50 range to return to the highs of around 150-151 set in October, which I expect to be less likely.

Over the past week, USDJPY, CADJPY, AUDJPY and NZDJPY each lost around 250-650 pips, with USDJPY losing the most, meaning that the USDJPY gained the most, up about 650 pips. Meanwhile, the CADJPY rose sharply by around 400 pips as the Canadian dollar weakened sharply due to the recent fall in oil prices. The following are the record gains and losses for the past one week.

- *USDJPY down 650 pips (140.00-133.50), or 4.64%, currently quoted at 136.95*
- *GBPJPY oscillates within 300 pips between 164.00-167.00, presently quoted at 166.20*
- *EURJP oscillates within 400 pips between 145.00-141.00, presently quoted at 143.30*
- *NZDJPY oscillates in a 100 pip range between 86.00-87.00*
- *AUDJPY down 280 pips (93.80-91.00), or 2.99%, presently quoted at 91.80*
- *CADJPY down 400 pips (103.5-99.50), or 3.87%, currently quoted at 100.50*
- *CHFJPY down 380 pips (146.80-143.00), or 2.59%, currently quoted at 145.30*

- *SGDJPY down 300 pips (102.00-99.00), or 2.94%, currently quoted at 110.90*

3. Offshore RMB hovers near its most robust levels, and USDCNH is back below 7.0000.

The impact of the Covid pandemic and the excessive lockdown imposed by some local governments have led to recent protests in several cities and factories. The most widely known of these is the one that happened at the Foxconn factory in Zhengzhou, the world's largest factory producing mobile phones for Apple. Since 23 November, hundreds of workers have clashed with guards over fears of contracting Covid-19 in the enclosed environment and discontent over wages. These factors have caused the already sluggish Chinese economy to fall into contraction, with China's manufacturing PMI falling to 48.0 in November from 49.2 in October and China's non-manufacturing PMI falling to 46.7 in November from 48.7 in October. China's manufacturing purchasing managers' index(PMI) fell to 48.0 in November, below market expectations. The manufacturing PMI has been below 50 for the past two months, with the previous four-month reopening period seeing figures above 50.

New orders fell from 48.1 to 46.4, while new export orders fell from 47.6 to 46.7, indicating that the Chinese economy is struggling as demand from domestic and overseas markets is weakening. As the global economy enters a downturn in the future, the manufacturing sector may no longer be able to rely significantly on overseas export demand. These factors have affected domestic consumer demand amid a surge in new cases of Covid-19, a struggling real estate sector and low household consumer confidence.

Following the protests over the zero-Covid policy in several Chinese cities last week, the Chinese government recently convened a symposium on the prevention and control of the pandemic for two consecutive days, saying that the Omicron's pathogenicity has decreased and that prevention and control measures would be optimized. Chinese official media say that the pathogenic power of Omicron has significantly reduced. Many places in China have adjusted their prevention and control measures one after another and will resume normal production and living order in an orderly manner. China's strict "Dynamic zero-COVID" strategy is finally expected to come to an "end" after the past "three years of fighting the pandemic". The recent introduction of the "20 New Guidelines for Easing Covid Zero" and the "10-point notice" paved the way for a

coordinated loosening of the "zero-COVID" policy. They could also end the most stringent control measures, which have lasted almost three years, as early as next January. It may take several months to see meaningful progress in China's "economic recovery" as the Chinese government is gradually stepping away from its "zero-COVID" policy and with the recent introduction of new real estate policies and loose monetary policies by banks.

Market expectations for China's economic recovery have improved significantly, with Chinese stocks, Hong Kong stocks and the RMB rising across the board over the past week. CHINA50 Index up 9.89%, the CHINAH Index up 18.13% and the HK50 up 16.07%. The CHNUSD rose above the critical psychological level of 7.0000, with the USDCNH hitting a low of 6.9300. Below is a record of the ups and downs of the past week.

- *USDCNH is now quoted at 6.9725 after a sharp drop of 3250 pips (7.2550-6.9300) or a 4.48% rise in CNH.*
- *CHINA50 is up by 1300 pips (11850-13150) or 9.89% after falling to a low of 11850*
- *CHINAH up 1030 pips (5680-6710), or 18.13%, after falling to a low of 5680*
- *HK50 up 2700 pips (16800-19500), or 16.07%, after falling to a low of 16800*

Source: tradingview

From technical analysis, the USDCNH's daily K-line chart and RSI oscillator have come out of a classic "regular bearish divergence" pattern. The USDCNH is forecasting a reversal opportunity or coming if the RSI oscillator fails to exceed the previous high after the price has made the next high. In other words, the CNHUSD may start a wave of upward movement.

At the same time, the USDCNH may have formed a "Head and Shoulders Top" technical pattern between September and November. If the USDCNH fails to break above the recent high of 7.2750, the "right shoulder" of the "Head and Shoulders Top" pattern may continue to brew, and it has already broken below 7.0000, currently quoted at 6.9750. If another retest of 7.0000 fails, a sharp downward retracement could be initiated. The first target is Fibonacci 50% retracement at around 6.8500, and the second target is Fibonacci 61.8% retracement at approximately 6.7150.

4. RBA's December interest rate resolution raises rates by 25 basis points.

The RBA raised interest rates by 25 basis points to 3.1% on Tuesday (6 December), in line with market expectations, with a relatively muted reaction from the Australian dollar. According to recent data, Australia's inflation (annual rate) rose to 7.3% in the third quarter of this year, compared to the RBA's inflation target range of 2%-3%. The RBA expects inflation to peak at around 8% by the fourth quarter of this year and expects inflation to be slightly above 3% in 2024. Australian GDP is expected to grow by 1.5% in 2023 and 2024. Australian GDP was at an annualized rate of 5.9% in the third quarter, below expectations of 6.2% but above the previous 3.6%. Australian Minister for Finance said the Australian economy would remain under the full impact of interest rate hikes. The economy is expected to soften, and growth will slow due to higher interest rates. The Reserve Bank of Australia (RBA) began to weaken their hawkish stance in October, November and December, raising rates by just 25 basis points each to a current official cash rate of 3.1%. However, the RBA raised rates by 50 basis points in June, July, August and September this year. The RBA's monetary policy tightening has reached 300 basis points since May.

The dollar is still the key driver of the Australian dollar. Please focus on the Federal Reserve's December interest rate meeting next week and the first quarter of next year's monetary policy. Although the market expects the Fed to exceed 5% for the terminal rate, the market may have already digested this expectation. Investors may now see the Fed's "slower pace of interest rate hikes" as somewhat of a positive, favoring some risk assets. So recently, we have

seen a general rise in non-US currencies, including the British Pound, Euro, Australian Dollar, New Zealand Dollar, and Offshore RMB.

Meanwhile, due to Australia's close trade relationship with China, the relevant Chinese government departments are seeking to accelerate the lifting of the massive lockdowns, and the "zero-Covid policy" may be in the process of being eased. The Chinese manufacturing PMI data released in recent months have been below 50-the threshold separating contraction from expansion, indicating that the Chinese manufacturing sector may be in contraction, which is detrimental to the overall commodity trend. However, with the recent sharp strengthening of the offshore RMB and the lifting of the "zero-Covid policy", the gradual strengthening of the AUDUSD since mid-October is expected to be further supported by the "Chinese economic recovery", and the "Fed's slowing pace of rate hike policy" in the coming months.

5. Crude oil plunges and hits new lows since 2022, WIT crude may point to 65.00.

On Monday (5 December), the G7's price cap of US$60 on Russian crude oil was officially implemented, and oil prices plunged, with WTI Oil down 11.45% (83.00-73.50) and Brent oil down 11.11% (90.00-80.00) over the past week. Other factors in the fall in oil prices are ample OPEC supply, the risk of a global recession, continued policy tightening by major central banks around the world and low economic growth in China.

EIA expects US crude oil production to hit a record high next year. On Tuesday (6 December), the US Energy Information Administration (EIA) released its Short-Term Energy Outlook report, which showed that the EIA expects US crude oil production to reach 12.34 million barrels per day in 2023, an increase of up to 1.5 million barrels per day from 2022, surpassing the record high production of 12.315 million barrels per day set in 2019. In addition, according to Baker Hughes, the number of US oil rigs has increased by about 30% so far this year, all of which indicate that US shale oil is in a rapid recovery phase. In addition, the EIA lowered its global oil demand forecast for next year. The EIA expects global oil demand to be 99.82 million barrels per day (bpd) in 2022, unchanged from its previous forecast. It expects global oil demand to be 100.82 million BPD in 2023, down from its earlier forecast of 100.98 million bpd.

Russia may set a "price floor" in response to the G7 oil price cap. On Tuesday (6 December), Russian Deputy Prime Minister Novak said that Russia might reduce

oil production but not by much. Russia's mechanism to ban sales of oil that are subject to a price cap imposed by Western countries should begin working before the end of the year.” This means that Russia is cutting production to a limited extent and will not be supplying oil to oil price cap countries. More importantly, Russia is currently considering setting a price floor for its oil exports to international markets in response to the Group of Seven (G7) price cap.

Market expectations for further OPEC "production cuts" have failed. Last Sunday (4 December), the OPEC ministerial meeting announced that the current oil production policy would be maintained, i.e. the current oil production policy, i.e. the decision to cut production by 2 million barrels per day announced at the ministerial meeting on 5 October, would be extended until the end of 2023. In addition, the OPEC Joint Ministerial Monitoring Committee (JMMC) meeting will be held on 1 February next year, while the OPEC ministerial meeting will be held on 4 June next year. This means that the "2 million bpd cut" will likely continue for the next six months. OPEC maintained the 2 million bpd cut announced in early October (1 million bpd actual cut), while Russia's seaborne supply to the EU was around 500,000 to 1 million bpd. This means that even if Russia were to cut production by more than 1 million bpd, a total of 2 million bpd of production cuts from OPEC plus Russia might not reverse the decline in the oil market. OPEC's decision means that the market's expectations for further OPEC production cuts have completely "failed". This is also the reason why oil prices have fallen sharply recently.

Technically, crude oil has generally maintained a downtrend since the beginning of December, with WTI Oil down 11.45% (83.00-73.50) and Brent Oil down 11.11 % (90.00 - 80.00) which both fell below their lowest price levels since January 2022 and may continue to be at range-bound in the short term. WTI Oil may remain limited to around US$93.50/bbl in the short term, while Brent Oil may remain limited to around US$99.50/bbl in the short term. If it fails to break above this level, WTI Oil and Brent Oil may point to a lower range of 65.00-60.00 and 65.00-75.00, respectively.

Short-term risks:

Risk appetite has been heating up in recent weeks, with positive factors coming from : 1) US inflation finally fell more than expected in October. Fed Chairman Powell has clearly hinted at a slower pace of interest rate hikes, with the market generally expecting the Fed to slow the pace of rate hikes in December and hopefully cut rates by the end of next year. The most considerable headwinds that have held back global risk assets over the past year may be waning. 2)

China's recent series of adjustments to its real estate, banking and economic policies and epidemic prevention and control policies may bring an end to the three-year "zero-Covid policy", which will benefit the future growth prospects of the world's second-largest economy. 3) As we approach the end of the year, risk appetite may be accompanied by a "Santa Claus Rally".

As the US dollar dominates the forex market, critical US data to focus on are next Tuesday (13 December), US November inflation data CPI monthly (and annual rate), next Thursday (15 December) Federal Reserve interest rate resolution for December and US November retail sales (monthly rate) data. These data will serve as a guide to the Fed's policy shift next year. Once again, they are expected to sharply influence the overall foreign exchange market, leading to gains and losses in non-US currencies.

The author believes the probability of a slight rebound in the US dollar is relatively high. On the one hand, this is because the US dollar has recently retraced 10.13% (115.50-103.80). On the other hand, US inflation remains high, with the US CPI recording an annual rate of 7.7% in October, but this is still a long way from the Fed's inflation target of 2.0%. The Fed's "tightening monetary policy" will continue to "curb inflation". The Fed is not currently in the position to initiate a significant "monetary policy" shift. It will continue to maintain its policy of "slowing the pace of interest rate increases but maintaining high-interest rates for a longer period". If the trend of "dollar depreciation" continues to ferment next week, the likelihood of "extreme depreciation" is high. Next Tuesday's US inflation data could be an essential guide.

By Sandy Wang,

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