Market Comment_19 Jan202

19 Jan 2023, 5:50pm SGT

CPI data reinforces expectations of the Fed's slowing pace of rate hikes. BOJ remain YCC unchanged within -/+ 0.5%, USDJPY went on a "roller coaster" .

Key Points:

- *Dec CPI data reinforces expectations of the Fed's slowing pace of rate hikes, and the dollar accelerated its decline to a low of 101.50.*
- *Gold's upward momentum weakened with bearish signals in the short term.*
- *Discussions on the emerging market outlook*

1. CPI data reinforces expectations of the Fed's slowing pace of rate hikes, and the dollar accelerated its decline to a low of 101.50.

The December US Consumer Price Index (CPI) was released last Thursday (12 January) at 9:30 pm, primarily in line with expectations. After the data came out, the view that inflation is slowing down, and inflation is topping out may once again be confirmed by the market. Market expectations of a slow pace in interest rate hikes by the Federal Reserve have also increased, and the US dollar has continued to depreciate as a result. At the same time, the market generally expects the Federal Reserve to raise interest rates by 25 basis points in February. Over the past week, the US dollar has lost a further 1.60 % (103.00-101.35) and is now quoted at 101.80.

- *CPI (YoY) was recorded at 6.5% in December vs. 7.1% previously and 6.5% expected, having fallen for the last four consecutive months.*
- *Core CPI (YoY) was recorded at 5.7% in December vs. 6.0% previously, and 5.7% expected.*
- *The monthly core CPI rate for December was recorded at 0.3%, up from 0.2% previously and the 0.3% expected.*

US inflation data, which has continued to cool since October last year, has reinforced the market's view that the "Fed should probably 'soon' slow pace of rate rises" and that "the rate hiking cycle may be coming to an end". The inversion of the US 10Y/2Y Treasury yield curve spread continued to widen after the data was released, with traders betting less than 50 basis points on the Fed's

two meetings this year in February and March for a combined rate hike. Meanwhile, the US dollar index fell to a new low of around 101.35 before oscillating in a low range. The pressure of “the depreciation of the US dollar is hindered” is obvious around 101.50-102.50 range, the risky assets, non-US currencies mainly continue to fluctuate sideways.

In addition, recently released data from the University of Michigan showed that the US consumer confidence index for January was 64.6, significantly better than the expected value of 60.5 and the previous value of 59.7. This data also hit the highest level since April last year, suggesting market forecasts for the US economic outlook are still good. The data, however, did not boost the dollar, so it is clear that the "Fed policy expectations" are the main factor dominating the market.

Reflecting on the financial markets, here are the record gains and losses of the past week.

- *DXY Index was oscillating between 102.50-101.50, now quoted at 101.90*
- *EURUSD was oscillating between 1.0715 and 1.0870, now quoted at 1.0800*
- *GBPUSD up 300 pips (1.2100-1.2400) or 2.48%, now traded at 1.2310*
- *AUDUSD was oscillating between 0.6850-0.7050, currently quoted at 0.6885*
- *NZDUSD was oscillating between 0.6300 and 0.6500, currently traded at 0.6400*
- *USDJPY down 540 pips (132.90-127.50) or 4.06%, currently quoted at 128.10*
- *USDCHF down 250 pips (0.9350-0.9100) or 2.67%, now traded at 0.9160*
- *USDCAD was oscillating between 1.3450-1.3350, currently quoted at 1.3490*
- *USDCNH was oscillating between 6.7000 and 6.7800, now traded at 6.7780*
- *USDSGD was oscillating between 1.3330-1.3150, currently quoted at 1.3230*
- *Dow Jones was oscillating between 33500-34350, now quoted at 33170*
- *The S&P 500 was oscillating between 3910-4000 and is now traded at 3910*
- *The Nasdaq was oscillating between 11225-11650 and is now traded at 11370*
- *XAUUSD up $65 per ounce (1865.00-1930.00) or 3.49%, now traded at 1911.00*
- *Bitcoin surged 4230 pips (17320-21550) or 24.42%, currently quoted at 21285*

The USD Index, at 101.50-102.50, may have formed a strong resistance. If it can rise above and stabilise at 103.00, there may be a chance of a sharp rally in the USD. If it falls below 101.50, it may fall deeper into the range. The focus for the next week is to see if it continues to oscillate in that area or breaks out to the upside. The author's view favours an upward breakout. After all, the dollar has already retraced 11.35 % (114.50 - 101.50) from the 27.22 % (90.00 - 114.50) surge of the last year or so (since the end of May 2021) since the fourth quarter

of 2022. The author still believes that the USD is expected to pull back higher in the first quarter of 2023, but the pullback should be below the October 2022 high (114.50).

2. BOJ kept YCC unchanged within +/-0.5%, USDJPY went on a "roller coaster" .

The market is highly focused on the BoJ interest rate resolution this Wednesday (18 January), following various discussions about the possibility of another widening of the YCC band target at this rate meeting. The JGB rate is currently held at a new ceiling of +/-0.5%. Still, as inflationary pressures in Japan continue to intensify (Japan CPI climbed to 3.8% year-on-year in November), the market expects high inflation to increase the pressure on the BOJ to exit the YCC policy. Market expectations of a possible tightening of monetary policy by the BOJ are rising, as the BOJ has previously started to adjust its ultra-loose monetary policy. Last year December, the BoJ revised its yield curve control by widening the target range for 10-year Japanese government bond yields to +0.50%/- 0.50%, compared to the previous range of +0.25%/- 0.25%. The 10-year Treasury yield currently sits near the top limit of the range. If the BOJ continues to adjust its policy towards "hawkishness" at its meeting this Wednesday (18 January), the yen could appreciate further sharply.

Japan's recently released Producer Price Index PPI (annual rate) for December last year was reported at 10.2%, above expectations of 9.5% and the previous value of 9.7%. The PPI (MoM) for December last year was released at 0.5%, above expectations of 0.3% and slightly below the previous reading of 0.8%. However, last November's PPI (monthly rate) rose to 0.8% from the previous 0.6%. These figures reflect the fact that inflation in Japan is still rising. From a macro perspective, the rebound in PPI is mainly driven by the rebound in global commodity prices, which are expected to increase further with the full reopening of China and the recovery in demand from the major importing country, China. The rising PPI has left Japanese companies facing the dilemma of higher production costs, which has left them with the choice of either passing on the costs to consumers, thus pushing up the CPI, or absorbing the rising costs themselves and squeezing margins, the latter of which will be a drag on corporate earnings. Investors will also need to pay close attention to the Japan CPI data for December, which will be released this Friday (20 January), and some analysts believe it will hit a new high in the last 40 years.

The Bank of Japan interest rate minutes announced today (18 January) at around 10:50 am to keep the "+0.50%/- 0.50%" YCC limit unchanged and maintain the quantitative easing (bond buying) policies. The Bank of Japan will maintain the interest rate forward guidance unchanged, adhere to the easing and continue large-scale bond purchases. The USDJPY and other non-US currencies against the yen surged 200-400 pips instantly, but in the following 6-12 hours, the "Strengthen of Yen" was staged again. USDJPY and all other non-dollar currencies against the Yen began to fall 200-400 pips, which perfectly performed the "roller coaster" markets scenario.

The key points of the Bank of Japan meeting are as follows:

- *The 10-year JGB yields will remain at around zero percent, compared to expectations of 0.00% and the previous 0.00%.*
- *The Bank will remain negative interest rate of minus 0.1 percent to the Policy-Rate.*
- *BoJ unanimously approved to "keep the yield band target unchanged", i.e. the yield curve control (YCC) +/-0.5% top limit unchanged.*
- *The Bank of Japan will offer to purchase 10-year JGBs every business day through fixed-rate purchase operation. The upper limit on ETF purchases remains unchanged at 12 trillion yen. And the Bank will not hesitate to take additional easing measures if necessary.*
- *Inflation expectations are rising; the Committee's median estimate for core CPI inflation in FY2023 is 1.6%, compared to 1.6% in October; core inflation excluding energy is expected to be 1.8% in FY2023, compared to 1.6% previously. The acceleration in price inflation will likely bring about sustained price increases, including wage growth. Prices will likely deviate downwards as wage inflation will not strengthen as much as expected. The Bank of Japan's GDP growth forecast for FY2023 is 1.7%, compared to 1.9% previously. The Japan economy remains highly uncertain, with rising inflation expectations and wage growth pushing inflation gradually towards the target level. The Japan economy is likely to recover as the impact of the Covid-19 pandemic and supply constraints ease.*

Judging from the strong performance of the yen after the Bank of Japan's interest rate meeting, the general trend of "rising yen" in 2023 seems to be an "unbreakable" general trend. As mentioned in the author's previous article (The US dollar may have "peaked". Going long yen and gold could be one of the best trading opportunities in 2023.), "long yen" is one of the best trading opportunities in 2023, Casually shorting the yen is dangerous.

3. Gold's upward momentum has weakened, and bearish signals are strong in the short term.

With the Fed nearing the end of its tightening monetary policy in 2023 and even a potential "shift", the overall decline of the US dollar in 2023 may be irreversible. More importantly, with the gradual decrease in the attractiveness of dollar reserves and dollar assets, coupled with sanctions against Russia in Europe and the United States, the "oil settlement" triggered by the war between Russia and Ukraine, etc., may lead to a continuous sell-off and reduction of dollar holdings. According to data, the US dollar's share of global central bank foreign exchange reserves has fallen from 65.46% in the first quarter of 2016 to 59.15% in the third quarter of 2022. From the above analysis, it appears that gold's "monetary" and "investment" properties are expected to regain the attention of the market in 2023, as gold is dollar-denominated, and the likelihood of an overall rise this year has increased significantly.

Gold has bottomed in the 1600 -1650 range three times between late September and early November 2022, and it may confirm that XAUUSD has successfully bottomed. At present, gold has oscillated between 1765.00-1800.50 since last December. After stabilizing above $1765.00 per ounce for four consecutive weeks, it saw another big wave of gains last week, touching a high of around 1930 before starting a slight sustained retreat.

Source: Tradingview

From technical analysis, the 4-hour chart of gold and the RSI indicator form a classic "regular bearish divergence" pattern signaling that the RSI oscillator failed to exceed the previous high after XAUUSD refreshed at around 1930 and

the opportunity for a reversal in XAUUSD has arrived. The first target is the Fibonacci 23.6% retracement at roughly 1855.50, and the second target may look towards the Fibonacci 38.2% retracement at approximately 1810.50. The third target is Fibonacci 50% retracement, probably around 1773.00-1775.00.

4. Discussion on emerging market outlook

According to the latest data released by the International Institute of Finance (IIF) recently (12 January), the Fed's interest rate hike to fight inflation in 2021 has already led to capital flows out of emerging markets (EM), with inflows into EM falling sharply in 2022 compared to 2021. Emerging markets only attracted net inflows of US$33.7 billion in 2022, a drop of over 90% compared to US$379.6 billion in 2021. The sharp interest rate hikes by the Federal Reserve have led to a significant widening of US bond spreads and the dominance of US dollar-related assets, making more overseas capital willing to stay in the US in search of higher returns and a marked decline in willingness to allocate to emerging markets.

Ultimately the extent of this impact will depend on the pace of the Fed's rate hikes and whether the Fed's terminal rate ends up at 5.25% or higher and for how long it will remain unchanged, as well as the overall economic conditions in emerging market countries. Since the end of 2022, capital flows to emerging markets are quietly increasing as the pace of interest rate hikes by the Federal Reserve slows with the continued fall in the US dollar index. Coupled with the gradual relaxation of China’s Covid-19 restrictions, capital flows to emerging markets are quietly increasing. Since the fourth quarter of 2022, the rate of foreign capital inflows into Chinese equity markets and other emerging market countries and regions has accelerated significantly.

According to the World Bank's Global Economic Prospects published in January 2023, growth in emerging markets and developing economies excluding China is expected to fall from 3.8% in 2022 to 2.7% in 2023, mainly due to a sharp decline in external demand, but also due to high inflation, currency depreciation, tighter financing conditions, disruptions to economic activity caused by Russia's invasion of Ukraine and other negative domestic factors. With global growth set to slow sharply, much of the slowdown will come from the major developed economies, which in turn will depress external demand from emerging markets and developing economies. The recovery in emerging markets and developing economies is expected to be weaker than in developed economies. Most emerging markets and developing economies have been more severely affected by the Covid-19 pandemic than developed economies. Their growth trajectory

is not expected to be sufficient to return investment or output to pre-pandemic levels by 2023. By the end of 2024, GDP levels in emerging markets and developing economies will be around 6% below the expected pre-pandemic levels. Although global inflation is expected to fall somewhat, it will still be above the pre-pandemic level.

The reopening of China will be the most important economic event of 2023. The likely increase in demand from China for the goods and services of its trading partners is certain to have a very positive impact on the economies of regional markets. The tourism and aviation industries in many countries, significant companies and central banks around the world will feel the impact. Economic activity will also rebound significantly as China's demand for products, services and goods increases. At the same time, there are some risks, as the effectiveness of the "herd immunity" of the Chinese population has yet to be confirmed. Several countries are concerned that the large number of Chinese tourists entering the country may lead to another surge in infection rates, which could also lead to increased competition for exports and manufacturing in some countries.

On 17 January, the People's Bank of China (PBOC) injected CNY 504 billion of liquidity via reverse repos, the most since January 2019. PBOC also decided to maintain the 1-year Medium Term Lending Facility (MLF) rate at 2.75% while injecting an additional 79 billion yuan to 779 billion yuan worth of loans through its one-year medium-term lending facility (MLF). The more accommodative monetary policy may help stimulate domestic economic growth.

With the gradual relaxation of China's "zero-Covid policy" and its recent full reopening, capital inflows to China are quietly increasing. From the end of October 2022 to January 2023, the pace of foreign capital flows into China, and other emerging market countries' stock markets have accelerated significantly.

The market is already pricing in the growth prospects of the world's second-largest economy, with the CHINA50, HK50 and CHINAH up 25.89% (11200-14100) and 49.69% (14650-21930), 51.37% (4915-7440) respectively. This Saturday (21 January) is Chinese New Year's Eve. What follows is the Chinese New Year atmosphere which generally continues until at least the end of January, and the joy of the New Year may further stimulate domestic consumption and investment in China.

Reflecting this in the financial markets, the following are the record gains and losses for the past week.

- *USDCNH oscillated in a range of 0.6980-6.7900, currently quoted at 6.7825.*
- *CHINA50 up 600 pips (13500 - 14100) or 4.44%*
- *CHINAH oscillated between 7230-7440.*
- *HK50 traded at a range between 21300-21930.*

Short-term risks:

Look out for the US Q42022 annual GDP rate next Thursday (26 January), the US December 2022 durable goods orders MoM, the US December Nondefense Capital Goods Excluding Aircraft data, and the US December monthly core Personal Consumption Expenditure Price Index data next Friday (27 January). This gives clues to the fundamentals of the US economy and the inflation-related situation. The USD has already retraced 11.35% (114.50-101.50) from the 27.22% (90.00-114.50) surge over the past year (since the end of May 2021) since the fourth quarter of 2022. Heading into 2023, the dollar is expected to pull back in the first quarter of the year, but the pullback should be below the October 2022 high (114.50). These figures are also one of the key triggers for the dollar index, whether to start another rally in the near term.

USD/JPY is a currency pairs with its unique "independence" and "influence", and its trend sometimes drives and affects the potential trend of other currencies pairs. So also, please pay attention to the Japan Consumer Price Index for December, released this Friday (20 January), which some analysts believe will be at a record high for the past 40 years. Moreover, look out for the Tokyo CPI for January and the Tokyo CPI excluding fresh food for January next Friday (27 January).

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