Market Comment_25Jan2023

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Market sentiment still favors "dollar depreciation". China’s reopening boosts oil prices, and it may look towards 100.

Key Points:
Market sentiment still favors "dollar depreciation", with the dollar consolidating at lower levels. USDJPY is consolidating in the 127.50-131.50 range, with the re-opening of China boosting oil prices to a possible 90-100 range, also providing strong support for the Australian dollar's gains.

1.Market tends to "dollar depreciation" but is blocked at 102.00 on the US Dollar index, with non-US currencies following the oscillation.

According to Lars Tvede's book "The Psychology of Finance", the "four fundamental laws of finance" are 1) the market is ahead, 2) the market is irrational, 3) chaos reigns and 4) charts are self-fulfilling. The basic idea is that the stock market is an early indicator of economic conditions. Many studies have shown that the stock market can be used as a leading indicator of economic activity and can be considered an essential indicator of a country's financial situation. And stock market reversals lead economic trend reversals by about 6-9 months. Although the market is often not rational and can be dominated by hope, panic and greed at any time, at least the stock market is more accurate than any single aggregate economic indicator. And as currency is the basis of all trading, it is the most sensitive of all indicators. The "law of chaos" of the market is self-reinforcing. As a simple example, a system in which event A triggers event B, which in turn leads to event C, which in turn leads to event A, is a simple positive feedback loop. Each positive feedback loop contributes to the self-reinforcing qualities of the economic phenomenon until other mechanisms emerge that can block this cycle. In summary, we can refer to these four fundamental financial laws as basic guidelines when studying and predicting the foreign exchange market.

Source: tradingview,the US dollar index

Based on the financial rule of "charts are self-fulfilling" above, the USD index has already retraced 11.35% (114.50 - 101.50) of its 27.22% (90.00 - 114.50) surge over the past year (since the end of May 2021) since the fourth quarter of 2022. The dollar’s decline since the peak of 114.50 is a bit too "abrupt". Just like it is up slowly by "escalator", down by "lift", which is somewhat inconsistent with the "aesthetics of the chart". From the irrational theoretical point of view of the market, in just over three months, the US dollar index has already lost almost half of the gains made in the past year and a half, which is too fast. The USDCHF, on the other hand, is even more dramatic. After three quarters of rallying from a low of 0.9090 at the beginning of January 2022, it hit a 2022 high of around 1.0150 on 18 October last year and fell back to this level last Wednesday (18 January). Based on the "Law of Chaos" theory of self-reinforcing mechanisms, this market may have formed a "positive cycle" of "easing inflationary pressures in the US" and "expectations of a dovish Fed policy" and gradually reinforced itself, which is the fundamental reason for the weakening of the US dollar.

Source: Tradingview, USDCHF

Swiss National Bank chairman Jordan said in a speech on Friday (20 January) that the monetary policy of central banks around the world is too expansionary while indicating that inflation is too high. The weakness in the economy should give a boost to the fight against inflation, while overall inflation is expected to fall rapidly. If inflation falls, there will be no hesitation to go back to negative rates again, and it will be difficult to push inflation down from 4% to 2%. His words seemed to restore the market's confidence in the Swiss franc quickly, and the USDCHF then turned to a significant drop from a short-term surge, with the CHF quickly recovering its previous losses and pulling further up. But overall, the current USDCHF volatility between 0.9100-0.9280 over the past week is similar to the US dollar Index's low volatility of 101.10-102.50.

Heading into 2023, the US dollar is expected to pull back higher in the first quarter of the year, but the pullback should be below the October 2022 high (114.50). Data released last Wednesday (18 January) showed that US core retail sales recorded a monthly rate of -1.1% in December, worse than the expected value of -0.8% and the most significant decline since December 2021. Retail data, a vital indicator of the US economy, fell sharply, suggesting increased weakness in the US economy and deepening market concerns that the US economy may be in recession. The data released simultaneously showed that the US Producer Price Index (PPI) data for December was 6.2%, much lower than the expected value of 6.8% and the previous value of 7.3%. This hints at increased expectations that US inflation may continue to cool in the future. This has also increased market expectations that the Fed may lower the terminal interest rate and also expects the Fed to start "stopping rate hikes" sooner. But the market's "rosy vision" of a "dovish" shift in the Fed's monetary policy does not seem to be shared by the Fed.

More recently, on Friday (13 January), CEO of the Federal Reserve Bank of Atlanta Raphael Bostic said that a slowdown in inflation is good news. Still, the preference is a terminal rate of 5.00%-5.25%, to be sustained through 2024. Federal Reserve Bank of Richmond President Thomas Barkin said he favors a slower pace of rate hikes, but still expects the terminal rate to be higher likely. Following the recent data, the US dollar index slipped slightly and set a new recent low of around 101.10.

The European Central Bank said it expects to raise interest rates to around 3.75% in the first half of this year, which has also stimulated the euro's recent sharp rally. But in contrast to the dollar's interest rate hike at least to 5% , coupled with the eurozone's current high inflation level of around 10%, the eurozone is also facing huge uncertainty that several countries may be about to enter a recession. The sharp appreciation of the euro may be challenging to sustain. This also supports the view that there is still room for the dollar to rally higher.

Reflecting on the financial markets, the US dollar index has repeatedly been sideways and oscillating between 101.10-102.50 over the past week, and maybe waiting for guidance from next week's non-farm payrolls data and the first Fed rate meeting of the year for clearer guidance. The 101.00-102.00 range is the key one to watch. Investors will need to keep an eye on the Fed's monetary policy statement, the Fed press conference and the Fed's interest rate resolution announcement next Thursday morning (2 Feb) around 3-3:30am and the US Non-Farm Payrolls Change for January next Friday (3 Feb) . The market is widely expected Fed to raise interest rates by another 25 basis points. From there, we get clues about the US economic fundamentals, the job market, and the Federal Reserve's policy attitude. These data are also one of the essential triggers for whether the US dollar index starts another wave of a rally in the near future. One also needs to be alert to the possibility that a loss of the US Dollar index in the 101-102 range could usher in more downside.

Reflecting on the financial markets, the following is a record of gains and losses over the past week.

- *DXY Index was oscillating in the range of 102.50-101.10 and now is quoted at 101.65.*
- *EURUSD was oscillating in the range of 1.0750-1.0920 and is now traded at 1.0850.*
- *GBPUSD was oscillating in the range of 1.2250-1.2450 and now is quoted at 1.2290.*

- *AUDUSD up 230 pips (0.6870-0.7100) or 3.35% and now is traded at 0.7100.*
- *NZDUSD was oscillating in the range of 0.6380-0.6520 and now is quoted at 0.6470.*
- *USDJPY was oscillating in the range of 127.50-131.50 and now is traded at 130.30.*
- *USDCHF was oscillating in the range of 0.9090-0.9260 and is now quoted at 0.9258.*
- *USDCAD was oscillating in the range of 1.3150-1.3500 and now is traded at 1.3360.*
- *USDCNH was oscillating in the range of 6.7450-6.7930 and is now quoted at 6.7850.*
- *USDSGD was oscillating in the range of 1.3150-1.3250 and now is traded at 1.3200.*
- *Dow Jones was oscillating in the range of 33950-32900, now is quoted at 33500.*
- *S&P 500 stock index was oscillating in the range of 3880-4030 and is now traded at 4005.*
- *Nasdaq was oscillating in the range of 11,250-11,900, now is quoted at 11,800.*
- *XAUUSD up $40 per ounce (1900-1940) and is now traded at 1936.00.*
- *Bitcoin surged 2550 pips (20600-23150) or 12.38% and is now quoted at 22995.*

2. China's reopening boosts oil prices, and it looks toward to 90-100 range.

The reopening of China has boosted a number of commodities, particularly oil, which is expected to rise in 2023 and will point to the 90-100 range. <u>Several factors are fundamentally supporting higher oil prices.</u>

1) Firstly, China's relaxation from the "zero-Covid policy" at the beginning of 2023 and its reopening to the world will certainly drive significant oil demand for aviation oil, automotive oil and industrial oil. China's oil demand is widely expected to increase by at least 1 million barrels per day, and the IEA expects China to account for half of the growth in oil demand in 2023.
2) Russia's planned production cuts in 2023, which would reduce supply by approximately 1 million barrels per day, would also boost oil prices.
3) OPEC production cuts of 2 million bpd will continue until at least June 2023. The OPEC ministerial meeting on 4 December 2022 announced the maintenance of the current oil production policy, i.e., the extension of the current oil production policy, the decision to "cut production by 2 million barrels per day" announced at the ministerial meeting on 5 October 2022, until the end of 2023. In addition, the OPEC Joint Ministerial Monitoring Committee (JMMC) meeting will take place on 1 February 2022, while the OPEC ministerial meeting will be held on 4 June next year. This means that the "2 million bpd production cut" will continue for the next six months.
4) The International Energy Agency (IEA) forecasts that global oil supply growth is expected to slow to 1 million barrels per day in 2023 due to falling Russian exports, while global oil demand is expected to grow by 1.9 million barrels per day in 2023, may to a record 101.7 million barrels per day. Oil prices are also supported by the fact that demand far outweighs supply.

5) The release of strategic oil reserves by several governments in 2022 may not be renewed in 2023. According to the US Energy Intelligence, the United States is reviewing and considering cancelling the plan to sell strategic oil reserves this year. The sale of 26 million barrels of war reserves previously authorized by the US Congress is now at risk of being cancelled as the US Biden administration moves to restock the Strategic Petroleum Reserve (previously set to replenish the SPR below $70).
6) The impact of the "Russia-Ukraine war" on the oil market remains and is also fundamentally changing the long-term outlook for the oil market, "energy security" will remain one of the critical concerns of governments, which is also the price of oil rose "rigid demand" basis for higher oil prices.

<u>At the same time, there are several factors that need to be kept in mind for the downside risks of oil prices.</u>

1) In early January 2023, the Managing Director of the International Monetary Fund (IMF) warned that the global economy would be tougher in 2023 than in 2022, with a third of economies expected to fall into recession this year, while growth will slow in most economies. Economic activity in the US, the EU and China could weaken simultaneously.
2) US inflation has rebounded, and the US government may not want to see oil prices rise sharply again, undermining the goal of "dampening inflation" and rereleasing strategic oil reserves. Recently (12 January), US President Joe Biden has also reiterated that he does not rule out the possibility of further releasing strategic oil reserves.
3) In mid-August last year, President Biden signed the "Inflation Reduction Act" into law, which may be detrimental to oil prices in the medium to long term. The bill will spend $430 billion on the climate, clean energy and healthcare sectors. Although this plan will not immediately have an effect on "curbing" rising oil prices, in the long run, the bill may be a way for the US to "subsidise the new energy industry" and start a "clean energy race" with China, Europe, South Korea and other major electric car countries. In the medium to long term, it may also have a negative impact on oil prices.
4) Since 2015, oil prices have been roughly between $60-80 per barrel and currently, even if oil returns to $75 per barrel, it will be back near the mid-point of the last seven years. Ed Morse, Managing Director and Global Head of Commodities Strategy at Citi, has stated (June 2022) that the fair value of Brent crude is in the $70 per barrel range as the economy is at risk of recession and oil and refined products are declining.

Source: Tradingview, technically, crude oil has generally maintained a "low volatility" and "modest increase" pattern since mid-December 2022, with WTI Oil oscillating between 70.50-82.00 and Brent Oil oscillating between 76.00-88.50. In 2023, WTI Oil is expected to look around $95.00-$100.00 per barrel and Brent Oil around $99.00-$105.00 per barrel.

3. China's reopening provides strong support for the Australian dollar rally.

China's economic reboot, and reopening to the world, boosted the Australian dollar significantly. Recently released data showed that China's GDP grew at a year-on-year rate of 2.9% in the fourth quarter, well above expectations of 1.6% but below the previous value of 3.9%. Overall, China's GDP performance was solid. China's industrial production came in at an annualized rate of 1.3% in December, beating expectations of 0.1% and the previous reading of 2.2%. Retail sales were released simultaneously at an annual rate of -1.8%, well above expectations of -9.0% and the previous -5.9%, although still negative. The reopening of China has boosted commodities, particularly iron ore, copper and gold, which are among several of Australia's largest export commodities. Copper, gold and iron ore have risen significantly since January this year by 16.20% (3.7350-4.3400), 6.30% (1825-1940) and 6.09% (115-122.00), respectively. A strong "China" factor has supported the rise in the Australian dollar.

On Wednesday (25 January), the Australian CPI was released at an annual rate of 7.8% for the fourth quarter, the highest level since 1990 and above expectations of 7.5% and the previous value of 7.3%. AUDUSD surged 60 pips to 0.7100. The Reserve Bank of Australia (RBA) is expected to continue to raise interest rates by 25 basis points at its meeting on 7 February. Even so, at the same time, according to the National Australia Bank, the RBA is close to a "pause in rate hikes".

The market is now pricing in the growth prospects of the world's second-largest economy, China, with Chinese stocks and the offshore RMB recording a "New Year's surge" since January 2023, with the A50, HK50 and the CHINAH up 10.94%, 13.80% and 13.94% respectively. In addition, the USDCNH rose 3.32% and also drove the AUDUSD up 5.97%. Reflecting on the financial markets, the following are the record gains and losses since the beginning of January this year.

- *USDCNH down 2300 pips (6.928-6.6980) or CNH up 3.32%, is currently quoted at 6.7750.*
- *AUDUSD up 400 pips (0.6700-0.7100) or 5.97%, currently is quoted at 0.7090*
- *AU200 up 500 pips (6950 - 7450) or 7.19%, is presently quoted at 7425*
- *CHINA50 up 1400 pips (12,800-14,200) or 10.94%*
- *CHINAH up 920 pips (6600-7520), or 13.94%*
- *HK50 up 2,690 pips (19,500-22,190), or 13.80%*

4. USDJPY consolidated in the 127.50-131.50 range.

Looking back to 2022, the world's major developed country central banks have started to raise interest rates and tighten monetary policy. Only the Bank of Japan is "independent and special" and insists on easing. In particular, the divergence between the fundamental policies of the Bank of Japan and the Federal Reserve has supported the USDJPY all the way up from the beginning of 2022 until late October, rising 33.48% (113.50-151.50) before opening a decline. It has fallen 13.86 % (151.50-130.50) so far and is currently quoted at around 130.25. The pressure of the sharp depreciation of the yen in the past has eased somewhat, the reopening of China should support the start of a recovery in the Japan economy in the first half of this year. The next BoJ meeting in March will be the last meeting of Governor Haruhiko Kuroda's term of office. Bank of Japan governor candidate Takatoshi Ito recently said that if the BoJ abandons yield curve control, it will need to conduct a comprehensive review of its policy framework. The BoJ may abandon its negative interest rate policy this year, depending on inflation and wage. The Bank of Japan may not adjust its yield curve controls until at least April this year. The Bank of Japan's next move may be to widen the range of its 10-year yield target, possibly raising the cap of the yield range to 0.75% or 1.0% in mid-year.
Japan’s Consumer Price Index (CPI) rose by 4.0% year-on-year in December last year, up from 3.8% in November. This was mainly due to higher energy costs. Both energy and food prices rose as import costs increased due to the lagged effect of a weaker yen and high international prices. The BoJ expects core inflation (CPI excluding fresh food) to cool gradually after mid-April 2023, partly

due to the expected decline in energy costs. Japan's economy is currently relatively weak, and the Japan economy will need a boost from the global recovery later this year, including the prospect of China reopening to return to a stable growth trajectory. Hence, a shift to a "hawkish" rate hike by the BoJ is unlikely. Watch for data related to Japan's December retail sales and Japan's December industrial production next Tuesday (31 January) to get clues about Japan's economic recovery.

Technically, USDJPY has been consolidating in the 127.50-131.50 range from last week so far. The US dollar dominates the overall foreign exchange market and is now awaiting guidance after the Fed's first interest rate meeting of the year and non-farm payroll data next week.

Short-Term Risks:

Please pay attention to the US Q4 GDP annual rate, the US December 2022 Durable Goods Orders monthly rate, the US December Non-defence Durable Goods Orders Ex Air data and the US December Core Personal Consumption Expenditure price index data on Thursday evening (26 January). Also, pay attention to the US ADP Employment Change for January and the ISM Manufacturing PMI for January on Thursday (1 February) and the US Non-Farm Payrolls Change for January and the ISM Non-Manufacturing PMI for January on Friday (3 February).

Among them, investors need to focus on the Fed's monetary policy statement, the Fed press conference and the Fed's interest rate resolution announcement next Thursday morning (2 Feb) from 3 am to 3:30 am. The market is widely expected to see another 25 basis point rate hike by the Fed. Also, please stay tuned for the change in US non-farm payrolls for January next Friday (3 Feb). In this way, we can get clues about the US economic fundamentals and the job market, as well as whether the Fed's policy stance is "shifting from hawkish to dovish". These data are also critical key triggers for whether the dollar index can break out of its narrow range of 101.00-102.50 in the near term and start another wave of rally or fall more sharply.

By Sandy Wang
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