Market comment_08Feb 2023

11:50 am SGT 08 Feb 2023

US non-farm payrolls in January skyrocketed nearly three times more than expected. The focus of market attention is that after a short-term rise, the US dollar may accelerate its depreciation in the future.

Key Points:

The Fed's first FOMC meeting in 2023; US non-farm payrolls "far exceeded expectations" in January, and the dollar started to rally; Fed Chair Powell spoke on 7 February and stated that the "terminal rate" may be higher; gold may fall in the short term and look for support in the 1800-1850 range, and still looks to 2000 in the medium and long term; the RBA raised interest rates by 25 bps as expected, and the Australian dollar still shows a bullish outlook unchanged in the medium and long term; after a short-term rise, the US dollar may accelerate its depreciation in the future.

1. The first FOMC meeting of the Federal Reserve in 2023

At 3 am last Thursday (2 February), the Fed announced its monetary policy at the first FOMC meeting of the year, raising the target range for the federal funds rate from 4.25%-4.50% to 4.50%-4.75%, a 25 bps increase, in line with market expectations. The rate hike was approved unanimously by the FOMC voting members. This is the second consecutive slowdown in the pace of interest rate hikes by the Fed since last December's interest rate meeting. The first slowdown came in December last year when the Fed eased the rate hike from 75 bps to 50 bps. This is also the first time since March that the rate hike is only 25 bps. From June to November last year, the Fed aggressively raised rates by 75 bps at each of its previous four meetings.

The meeting statement reaffirmed that the FOMC is strongly committed to raising the inflation rate to 2%. Inflation has moderated to some extent but remains high. A series of factors, such as the lag effect of rate hikes, will be considered when determining future rate hikes. "The Russia-Ukraine war" has added to already high global uncertainty.

Fed Chair Powell emphasised that "Despite elevated inflation, longer-term inflation expectations appear to remain well anchored," "But that’s not grounds for complacency." "The longer the current bout of high inflation continues, the greater the chance that higher inflation expectations will become entrenched." The Fed is firmly committed to returning inflation to our 2 percent objective. The Federal Reserve is not considering changing its inflation target, but this may be a long-term project, and the FOMC discussed pausing after two rate hikes.

Source: Tradingview

US10Y, the anchor for global assets, reached its highest range of 4.25% to 4.35% during the period of October to November 2022. Currently, the classic "regular bullish divergence" is formed from the daily candlestick chart and RSI indicator of the US 10-year Treasury yield. After the US10Y price made a new low of 3.42%, it made a lower low (LL) of around 3.33%, while the RSI oscillator made a higher low (HL) above the previous low, which may signal that an opportunity for a wave of increase for the US10Y is on the horizon. The first target is the Fibonacci 38.2% retracement, approximately at 3.685%, the second target may be the Fibonacci 50% retracement, approximately at 3.800%. And the third target may be the Fibonacci 61.8% retracement, approximately at 3.905%. The current quote for US10Y is 3.642%.

After the FOMC meeting and Powell press conference, there was a dovish market interpretation, causing a further decline in market expectations for the "terminal rate" and an increased expectation of rate cuts before the end of the year. In the end, the Fed's interest rate resolution failed to change the weak pattern of the US Dollar Index, which hit a low of 100.50, falling back to around the level of April 2022. Risky assets generally rebounded. Non-US currencies generally rose, with EURUSD reaching a high of around 1.1025 and GBPUSD again approaching 1.2400 (a high level in mid-December 2022). AUDUSD hit a recent high of around 0.7150, NZDUSD hit a recent high of 0.6530, USDCHN fell to a recent low of around 6.7050, USDCHF hit a new recent low of around 0.9050, USDCAD hit a recent low of around 1.3250, USDSGD hit a new recent low of about 1.3050. Gold also broke a recent new high of about US$1950.00 per ounce. The Dow Jones, Nasdaq and S&P 500, the three major US stock indices, also rose to new highs since 2023 and also new high from October last year, at around 24,300, 12,880 and 4,035, respectively.

2. US non-farm payrolls "far exceeded expectations" in January, and the dollar rallied.

Last Friday (3 February) at 9.30 pm, the US Department of Labour announced 517K new non-farm payrolls in January, far exceeding the expected 185K and the previous value of 223K. The unemployment rate was also reported at 3.4%, lower than the expected 3.6% and the previous value of 3.5%, setting a new low since 1969. Meanwhile, the January ISM non-manufacturing (i.e. service) PMI rose to 55.2%, far higher than the expected 50.4% and the previous value of 49.2%, the most significant monthly increase since August 2022. These data show that the US labour market can still bounce back strongly even against aggressive Fed rate hikes, highlighting its resilience. The non-farm payrolls that greatly exceeded expectations and services PMI data led to increased "hawkish expectations" for Fed policy. The US economy still has resilience in a high-interest rate environment and is expected to have a soft landing (i.e. avoiding a recession) in 2023. A hot labour market and the potential for wage growth may make it more difficult for inflation to return to the Fed's 2% inflation target.

According to the CME Fed Watch Tool, expectations for the terminal rate rose to around 5.1%. The probability of the Fed raising rates by 25 basis points to a range of 4.75%-5.00% in March is 94.5%. The likelihood that the Fed will raise rates by a cumulative 25 bps at the May meeting is expected to be 47.4%, and the possibility that it will raise rates by a cumulative 50 bps is 50.1%. Here are some financial experts who commented on the non-farm payrolls data, on expectations of a higher "peak terminal rate", and more optimism that the US economy will avoid recession.

Former Treasury Secretary Lawrence Summers said a "soft landing" for the US economy is more likely than a few months ago.

Federal Reserve Bank of Atlanta President Raphael Bostic made a "hawkish statement", saying that the strong January employment report makes it more likely that the Fed will need to continue raising interest rates, and the peak may exceed what policymakers previously expected. If the better-than-expected economic situation continues, "we must do a little more work. " Bostic reiterated that this will raise rates by more than currently expected, that his base case remains for rates to reach 5.1%, and that a rate hike of 50 bps is not ruled out.

Ira Jersey, the chief US interest rate strategist at Bloomberg Intelligence, stated that the stronger-than-expected employment report might eventually become one of the most critical pieces of evidence to convince the market that the Fed will not cut rates this year.

The Chief US Economist at Morgan Stanley, Ellen Zentner, stated that going forward, the labour market may become the critical indicator rather than CPI. US banks also stated that cooling down the labour market is the only way for the Fed to slow the core inflation to 2%.

Reflecting on the financial market, as the market shifts from a "dovish expectation" to a "hawkish expectation", the Federal Reserve's first interest rate decision of the year, which just raised 25 bps last Thursday, failed to shake the weak pattern of the US dollar index, but was rewritten by "strong employment data," showing the strong financial market effect of "US non-farm payrolls". The US dollar index finally broke through the narrow and low consolidation range of the previous three weeks and rose sharply by 2.90% (100.50-103.50), market risk appetite cooled sharply, non-US currencies generally plummeted (250 to 550 pips), gold plummeted by 4.60% (which also confirms the author's repeated view in the previous two articles that gold has a strong signal for a short term plunge due to the "regular bearish divergence" technical pattern).

Source: Tradingview , dollar index

US Dollar Index Technical Analysis: The US Dollar Index broke through the narrow ranges of the past three weeks, soaring 200 pips to reach around 103.50. The preliminary resistance for further upward movement is around 104.00-104.50, which is also the Fibonacci 23.6% retracement. Further resistance levels may be in the previous 105.50-106.50 range, which is also the Fibonacci 38.2% retracement, and an upward movement may then look towards the Fibonacci 50% retracement, approximately around 107.50-108.00. The author has repeatedly mentioned that the 114.50-115.00 range may be the range of the highest point of this round of US dollar appreciation.

Therefore, the author insists that the rebound of the US dollar this time may be below the 114.50-115.00 range. If there is a further downward correction, the 103-103.50 range will become support. It may continue to be bullish if it can stand firmly in this support range. Otherwise, if it falls below 103 or quickly falls back to 102 and then looks towards the previous 101.50-100.50 range. Reflecting on the financial market, the following is a record of the rise and fall of the past week:

- *The DXY US Dollar Index rose 200 pips (100.50-103.50) or 2.90%, currently reporting 102.95.*
- *EURUSD plummeted 550 pips (1.1250-1.0700) or 4.89%, currently quoting at 1.0730.*

- *GBPUSD rose 430 pips (1.2400-1.1970) or 3.47%, currently reporting 1.2050.*
- *AUDUSD plummeted 300 pips (0.7150-0.6850) or 4.20%, currently reporting at 0.6960.*
- *NZDUSD rose 265 pips (0.6535-0.6270) or 4.06%, currently at 0.6315.*
- *USDJPY rose 480 pips (128.10-132.90) or 3.75%, currently reporting 131.25.*
- *USDCHF plummeted 240 pips (0.9050-0.9290) or 2.65%, currently reporting at 0.9220.*
- *USDCAD rose 220 pips (1.3250-1.3470) or 1.66%, currently reporting at 1.3395.*
- *USDCNH plummeted 1250 pips (6.7050-6.8300) or 1.88%, currently at 6.7835.*
- *USDSGD rose 240 pips (1.3050-1.3290) or 1.84%, currently reporting at 1.3245.*
- *The Dow Jones Index fluctuated between 33,485-34,330, attention to support around 33,500, currently reported at 34,138.*
- *The S&P 500 index rose 190 pips (4000-4190) or 4.75%, standing above 4000 and may continue to grow, currently reporting at 4160.*
- *The NASDAQ Index rose 1030 pips (11820-12850) or 8.71%, holds above 12000 or continues to be bullish., currently reporting at 12715.*
- *The XAUUSD increased slightly and then fell (1900-1955-1865), or fall 4.60%, currently reporting at 1876.90.*
- *Bitcoin fluctuated in the range of 22500-24200, currently reporting at 23222.*

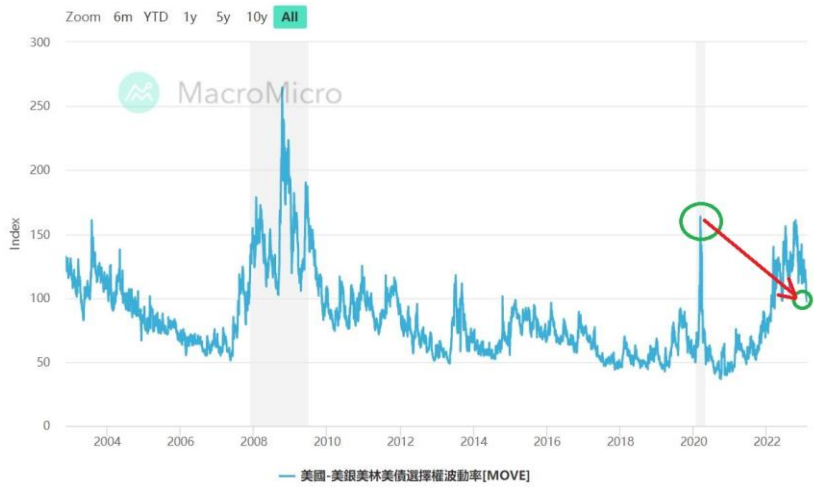
3. Fed Chair Powell's speech on 7 February suggests that the "terminal rate" could go higher.

In the Tuesday (7 February) interview, Fed Chairman Jerome Powell again explained his commitment to fighting inflation by addressing last week's non-farm payroll data, inflation and the future path of interest rate hikes. Critical points from Powell's speech were as follows: Friday's payrolls data was stronger than expected, the labor market is vital because the economy is strong, while wage growth is slowing, fighting inflation will be a long process, and if the strong jobs data continues, the terminal rate could go higher. The process of falling inflation is only at the beginning, and we have not yet seen a fall in inflation in most services industries, nor housing services industries, but it is expected to fall, and patience is needed. The process of bringing inflation back has begun without damage to the job market. There is still a long way to go, and further interest rate hikes will be needed, with the most significant challenge being to complete the process of reducing inflation. A large part of the current inflation is related to the lockdown and reopening of the economy due to the pandemic. The FOMC's forecast depends on the economic data that follows. 2023 is expected to be a year of significantly lower inflation, with the Fed not seeking to change its 2% inflation target, which is the global norm. Global events will influence inflation, suggesting this is a source of uncertainty.

It is clear from Powell's speech that the Fed's determination to continue to raise interest rates to control inflation is certain to continue and that with more robust "economic data" in the future, the terminal rate is likely to be even higher. As a result, investors' expectations of a "rate cut in 2023" may be challenging to realize, and they may start to exit their previous bets on the Fed's policy of "easing expectations". The US Dollar Index has fallen since last year's fourth quarter, and a short-term pullback to the upside will be inevitable.

4. Short-term decline in gold may find support in the 1800-1850 range, but it still looks towards 2000 in the medium to long term.

Gold has been on a substantial cumulative rally of 20.37% (1620-1950) since the "triple bottom" pattern was confirmed and bottomed in October-November 2022. This pullback, therefore, is the subject of two recent articles by the author of this article, both of which warned that "gold may start to fall" because of the formation of a typical "regular bearish divergence" pattern between the 4-hour candlestick chart and the RSI indicator. After the first interest rate meeting of the year last Thursday (2 Feb), gold hit a high of around 1960.00 in the short term. Still, after the January US non-farm payrolls released last Friday (3 Feb) were unexpectedly significantly better than expected by nearly three times, as the market as a whole turned from "dovish expectations" to "hawkish expectations" about the Fed's future policy, gold began to plummet.



Source: MacroMicro

The MOVE indicator reflects the volatility in US bond futures. It is considered an observable indicator of the term premium of US bonds (the long-short spread) and a key indicator used to measure the liquidity of US Treasuries. The MOVE Index had now fallen significantly from the high levels seen around November 2022, when it was approaching March 2020 (the worst liquidity since the Covid-19 outbreak), meaning that the selling pressure in the Treasury market has eased in stages and the US government's concerns about the stability of the US financial markets may have eased. The Fed may be in a position to release more hawkish signals due to the downward shift in the MOVE indicator and the strong US non-farm payroll data in January. This is also detrimental to gold's rise in the short term.

Source: Tradingview

Gold Technical Analysis: *With the US Dollar Index on a staged rally, if the DXY points further to around 105.00, gold's short-term decline may continue and fall towards the US$1,800-US$1,850 per ounce range. Gold has also broken below the medium-term uptrend line formed by the rise since November 2022, and a loss of US$1,800 per ounce would alert the market to a further fall towards the US$1,750-US$1,700 per ounce range. However, it still shows a bullish outlook in the medium to long term for gold this year, with a possible breakout above US$2,000 per ounce. Gold is currently quoted at around US$1875.50 per ounce.*

5. RBA raised interest rates by 25 bps as expected, and the Australian dollar still shows a bullish outlook unchanged in the medium and long term.

On Tuesday morning (7 February), in the first Australian Federal Reserve interest rate resolution of the year, the Reserve Bank of Australia (RBA) raised rates by 25 bps in line with market expectations, raising the cash rate from 3.10% to 3.35%. This is the ninth consecutive rate increase since the RBA's first rate hike in May 2022, and it has now accumulated 325 bps of interest rate increases.

According to recently released data (25 January), the Australian CPI reached an annual rate of 7.8% in the fourth quarter of 2022, the highest level since 1990, which also exceeded expectations of 7.5%, and the previous value of 7.3%. Meanwhile, CPI rose by 1.9% from the last quarter, above expectations of 1.6%. The TD Securities Inflation Index (annual rate) for Australia, announced on Monday (6 February), was 6.4%, higher than the previous value of 5.9%. The TD Inflation (monthly rate) for January in Australia was 0.9%, also higher than the last value of 0.2%. These continuously rising CPI data indicate that the Australian central bank may have underestimated the stubbornness of Australian inflation, which also means that the bank may have misjudged the situation. Due to the expected cooling of inflation, the central bank became the first among developed countries to start easing interest rates as early as October last year. Now that inflation in the US has peaked, while inflation in Australia is setting new highs, this may force the Australian central bank to reconsider the possibility of more significant interest rate increases.

The Reserve Bank of Australia issued a hawkish policy statement and forwarded guidance at this interest rate meeting: Further interest rate increases may be necessary for the next few months, the pace of which will depend on the data and the global economy. As previously expected, revising the cash rate target from 3.6% to 4.1% is appropriate and in line with market consensus. Inflation is expected to decline this year and may be very slow. Under the central scenario, the 2023 CPI inflation rate forecast is expected to decrease to 4.75% and around 3% by mid-2025. In terms of the inflation outlook, the RBA expects inflation to decline this year due to various global factors and a slowdown in domestic demand in Australia. Inflation expectations remain stable in the medium term, and it is essential that this is maintained. Australian domestic demand is strong, and the labour market remains tight. The unemployment rate is expected to rise slightly to 3.75% by the end of this year and to around 4.5% by mid-2025. Wage growth is expected to increase as wages and inflation rise, and labour costs and price setting will be closely monitored.

Meanwhile, the Governor of the Reserve Bank of Australia (Philip Lowe) also said further increases in interest rates are expected to be needed in the coming months to ensure that inflation returns to the target range and that this period of high inflation is only temporary. On the economic front, the RBA said that Australia's economic growth was strong in 2022. The economic outlook has mostly stayed the same from what was expected three months ago, with GDP growth expected to slow to around 1.5% in 2023 and 2024. The RBA meeting had a limited impact on the movement of the AUDUSD. The dollar still continues to dominate the Australian dollar movement. In the short term, AUDUSD may continue to follow the rally of the US dollar and decline. In the medium to long term, the weakening of the US dollar, the reopening of China and the "improved Australia-China relations", and other changes in the external environment are favoring the recovery of the Australian economy and the continued strength of the Australian dollar.

Short-term risks:

As Fed Chair Powell has recently repeatedly stressed that the FOMC's forecast on future terminal rate depends on the economic data that follows, the US CPI data for January, due out next week, will be of great interest. At the same time, last Friday's significantly better-than-expected non-farm payrolls data has redefined the market's "overall risk sentiment" preference from the previous dovish expectation that “the Fed will be more earlier to end the current tightening cycle” to the hawkish expectation that Fed's "rate hikes continue " and "unlikely to cut rates this year", and with more robust "economic data" in the future, the terminal rate may be expected to be higher. The dollar index has fallen deeply since the fourth quarter of last year, and short-term pullback to the upside will be inevitable. The critical market guidance is the potential for more significant depreciation in the medium to the long term, following a short-term pullback in the appreciation of the US dollar.

Please pay attention to the US Core CPI data for January to be released next Tuesday (14 February), as well as the minutes of the Federal Reserve Open Market Committee meeting to be released next Thursday (16 February), and news on the "Who are candidates to become next BOJ governor? "

By Sandy Wang

08 Feb 2023 at 11:50 am SGT