Market comment_15Mar2023

The Federal Reserve May Temporarily Pause Fighting Inflation to Maintain Financial Stability

Key points:

- *The failures of SVB, Silvergate, and Signature banks have increased market expectations for "Fed's temporary pause in raising interest rates" or even "rate cuts".*
- *The Fed may cut US interest rates before the end of this year to maintain "financial stability".*
- *The US 10-2 Year Treasury Yield Spread has sharply narrowed, and the critical turning point of the "Fed policy shift" may be approaching.*
- *Discussion on the performance of various financial assets during a "recession".*
- *February CPI inflation data in the US showed that inflation remains high, and there is an increased probability of a 25 basis point rate hike in March.*
- *Gold, Yen, and Swiss franc rose sharply amid risk aversion, while oil prices fell sharply, with WTI testing the 2022 low of US$70.*

1. The failures of SVB, Silvergate, and Signature banks have increased market expectations for the "Fed's temporary pause in raising interest rates".

Last Tuesday, Fed Chairman Jerome Powell expressed his "ultra-hawkish" stance in a US congressional hearing that the fight against inflation would be maintained to the end. Still, just two days later, last Thursday, Friday and Sunday, the failures of three major US banks exposed that the Fed's "steep rate hike" of 425 basis points over the past year had caused instability in the financial system and triggered panic in the markets, with gold, the Yen and the Swiss franc soaring. The VIX (Volatility S&P500 Index) spiked sharply on Monday, hitting a high of 30.80 (please note that above 30 represents irrational and extreme panic) and is now back at around 26.59. The three large US banks that failed were Silicon Valley Bank (SVB), Silvergate and Signature Bank, of which the collapse of Silicon Valley was the second major bank failure in US history since the collapse of Washington Mutual in 2008. The first bank failure also kicked off the global financial crisis. Following the beginning of the US banking crisis, market expectations of a "shift in Fed policy" have increased significantly, and market expectations of the Fed's terminal rate have been repriced considerably. According to the CME observation tool, the market's expectation for peak interest rates has shifted from 5.50-5.75%, following last week's hawkish testimony by Fed Chairman Powell to Congress, to 4.75-5.00%, with a significantly increased probability of a 25 basis point rate hike to 4.75-5.00% next Thursday (the likelihood of a 50 basis point rate hike is almost zero). It is expected that there will be a 25 basis point rate cut to 4.50-4.75% in June, another 25 basis point rate cut to 4.25-4.50% in July, and a further 25 basis point rate cut to 4.00-4.25% in September, and then maintain the range between 4-4.25% until the end of this year.

The problem with Silicon Valley's bankruptcy was a liquidity crisis caused by an " asset-liability mismatch". The Fed has accumulated 450 basis points of rate hikes over the past year, and the aggressive hikes have resulted in severe yield curve inversion for assets of different maturities in government bonds and other securities, magnifying the risks of this mismatch, and excessive concentration of investment in the technology industries that are sensitive to interest rates. At the same time, depositors concentrated their withdrawals during the financial industry's contraction cycle, leading to a "bank cash flow crisis" and, ultimately, the bank’s bankruptcy. If many American banks have similar problems, this could be the first domino to fall. According to FDIC statistics of the fourth quarter of 2022, due to the continuous rise in interest rates, the "unrealized losses" on investment securities held by the US banking industry amounted to US$620.4 billion, nearly ten times the peak of "unrealized losses" in the banking industry during the 2008 financial crisis. Therefore, FDIC Chairman Gruenberg said, 'Unrealized losses on securities have meaningfully reduced the reported equity capital of the banking industry.'

In the wake of the bank failures, President Joe Biden said, "I'm going to ask Congress and the banking regulators to strengthen the rules", and "the government regulator in charge, the FDIC, took control of Silicon Valley Bank’s assets. And over the weekend, it took control of Signature Bank’s assets, " and "thanks to the quick action of my administration over the past few days, Americans can have confidence that the banking system is safe." Gruenberg made a joint statement with Secretary of the Treasury Janet L. Yellen and Federal Reserve Board Chair Jerome Powell on Sunday that depositors' rights would be fully protected.

The market now expects that, to prevent the current panic from turning into a financial systemic risk crisis, Fed Chairman Jerome Powell may soon adopt a more cautious monetary policy, suspending aggressive rate hikes and increasing the likelihood of a "dovish stance". While high inflation will remain in place for a longer period, they remain a central concern for central banks and the majority of the population. Compared with the negative impact of the collapse of a large bank or the resulting "systemic collapse of the US banking system", the latter is more difficult to control and has a particular impact on "Dollar credit". The effect of the US February CPI data released on Tuesday (14 March) and the March FOMC interest rate meeting of the Federal Reserve on next Thursday (23 March) may be reduced.

After the crisis, the US government made efforts to restore market confidence in the banking system by guaranteeing the full repayment of SVB and Signature Bank depositors. In addition, the Federal Reserve has created a new lending facility that allows banks to qualify for loans if they are secured primarily by Treasuries and mortgage-backed securities. Despite these measures, many US bank stocks experienced a sharp decline on Monday. For example, First Republic Bank, Western Alliance Bancorporation, PacWest Bank, and Metropolitan Bank fell by 75% (from 122.00 to 31.00), 65% (from 75 to 26), 65% (from 27.50 to 9.75), and 56% (from 56.00 to 24.60), respectively, from 6 March till 13 March. Currently, Citigroup expects the Federal Reserve to raise interest rates by 50 basis points in March. Bank of America Merrill Lynch, BNP Paribas, Deutsche Bank, JPMorgan, and Morgan Stanley all expect a 25 basis point hike. Nomura Securities expects a 25 basis point cut, while Barclays and Goldman Sachs predict that the Federal Reserve will "stand pat."

Reflected in the financial markets, the failures of three large banks may shift the Federal Reserve's focus towards "financial stability" and temporarily suspend "fighting inflation," meaning that the Fed may "slow down or even cut interest rates," which is highly unfavorable for the US dollar. Amid turbulence in the US banking industry, the Federal Reserve announced a large-scale loan program on Friday to provide financing to banks that may be in trouble. With expectations of a significant shift in interest rate expectations, US Treasury yields sharply declined to varying degrees, and the decline in US Treasury yields quickly pulled down the US dollar, with the US Dollar index falling 2.37%, driving non-US currencies to rise to varying degrees. The three major US stock indices fell sharply, and gold rose to a new six-week high. Here are the ups and downs over the past week:

- *The DXY index fell 250 pips (from 105.50 to 103.00) and is now trading at 103.35.*
- *The Dow Jones Industrial Average fell 1950 pips (from 33450 to 31500) and is now at 31990.*
- *The S&P 500 index fell 250 pips (from 4050 to 3800) and is now at 3881.*
- *The Nasdaq index went down by 800 pips and then went up by 370 pips (from 12450 to 11650 and then to 12020) and is now quoting at 12157.*

- *Gold rose by US$105 per ounce (from 1810 to 1915) and is now trading at 1813.*
- *USDJPY went down by 540 pips and then went up by 160 pips (from 137.90 to 132.50 and then to 134.10) and is now at 134.10.*
- *USDCNH fell by 1600 pips (from 6.9950 to 6.8350) and is now trading at 6.8750.*
- *USDSGD fell by 150 pips (from 1.3570 to 1.3420) and is now trading at 1.3445.*
- *EURUSD increased by 200 pips (from 1.0550 to 1.0750) and is now at 1.0720.*
- *GBPUSD up 1400 pips (from 1.0800 to 1.2200) and is now trading at 1.2165.*
- *AUDUSD rose by 170 pips (from 0.6550 to 0.6720) and is now at 0.6665.*
- *NZDUSD up 150 pips (from 0.6100 to 0.6250) and is now trading at 0.6220.*
- *USDCHF dropped by 370 pips (from 0.9440 to 0.9070) and is now at 0.9110.*
- *USDCAD down 180 pips (from 1.3850 to 1.3670) and is now at 1.3665.*
- *Bitcoin rose by 5400 pips (from 19500 to 24900) and is now trading at 24900.*

2. The Federal Reserve may start cutting interest rates before the end of the year to maintain "financial stability".

1) US 10-year/2-year Treasury yield spreads have narrowed sharply, and a critical turning point in the "Fed's policy shift" may be approaching.

The Federal Reserve is currently at a "contradictory" crossroads. To fight inflation, it needs to "continue to raise interest rates" and maintain high-interest rates for a long period. However, to maintain stability in the financial system, it also needs to lower interest rates. Looking back at the two times when the Fed began to lower interest rates in 2000 and 2008, it was before the real economy had entered into a recession. What caused the Fed to start a rate-cutting cycle? Looking back at history, in 2000, the Nasdaq tech stock market bubble burst, with the Nasdaq index plummeting 75% from March to October of that year. The Fed began cutting rates in January 2001. In the 2007-2008 subprime mortgage crisis, Fed tightening led to a decline in house prices, the bursting of the real estate bubble, and both households and financial institutions heavily deleveraging, which led to a deep economic recession. On April 2, 2007, the second-largest subprime mortgage company, New Century Financial Corporation, filed for bankruptcy protection. In August 2007, the fifth-largest investment bank, Bear Stearns Cos., announced the collapse of two funds investing in subprime mortgage securities. The Fed began its rate-cutting cycle in September 2007.

That is to say. It was only after the financial sector experienced severe problems that the Fed started to cut rates to maintain financial stability and prevent systemic risks in the future (even willing to launch "quantitative easing" to stabilise finance). After the financial sector experienced problems, the real economy also entered a recession.

Source: FRED

The words in the picture above:

Blue: Federal funds rate

Red: 10-2 Year Treasury Yield Spread

The grey area in the chart represents the recession of the US real economy, the blue line represents the federal funds rate. The red line represents the yield on the 10-year US Treasury bond minus the yield on the 2-year US Treasury bond (referred to as the "inverted yield curve" of the US 10-year/2-year Treasury bond yield). We can see that before the onset of the "real economy recession" in 2001 and 2008, the inverted yield curve of the US 10-year/2-year Treasury bond yield had already begun to reverse and rise. At the same time, the US federal funds rate began to reverse downward slowly.

The "yield curve inversion" of long-term and short-term US Treasury bond yields, which I have mentioned several times before, is not only a leading indicator of economic recession but also a precursor to problems in the US financial markets. The "yield curve inversion" indicates that the financial sector has already encountered problems and become distorted and tense. The problem has been accumulating until the financial system experiences significant problems. The most commonly analysed yield curve inversion is the difference between the 10Y and 2Y Treasury bond yields. For example, in the past few days, after the collapse of the three largest US banks, the market expects the Federal Reserve to start "cutting interest rates", and the "yield curve inversion" will slowly move towards flattening or moving in the direction of "deeper inversion". The yield spread of the "US 10Y/2Y Treasury bond yield inversion" is a critical threshold that we need to continue to observe closely as a trading strategy "profit and loss" threshold. Before the crisis of Silicon Valley Bank (SVB) occurred on 8 March, the yield curve inversion of the US 10Y/2Y Treasury bond yield reached a high of 110 basis points. Only two days later, on 10 March, this inversion rapidly shrank to 40 basis points and is currently around 68 basis points.

After Silicon Valley Bank (SVB) declared bankruptcy last Friday, the Federal Reserve decided to launch a massive lending program to provide financing for distressed banks. Traders bought a large amount of U.S. Treasury bonds, causing the yields on six-month, one-year, and two-year Treasury bonds to drop sharply. Against this backdrop, U.S. bond yields plummeted as market expectations of terminal rate changes led to a significant decline in bond yields. The two-year Treasury bond yield fell from a high of 5.08% last week (the highest level since July 2007) to a low of 3.85%, currently hovering around 4.35% (note: the peak reached in early November last year was 4.88%). The inversion of the yield curve between the two-year and ten-year Treasury bond yields narrowed by 41 basis points from its highest level last week (from -1.10% to -0.69%).

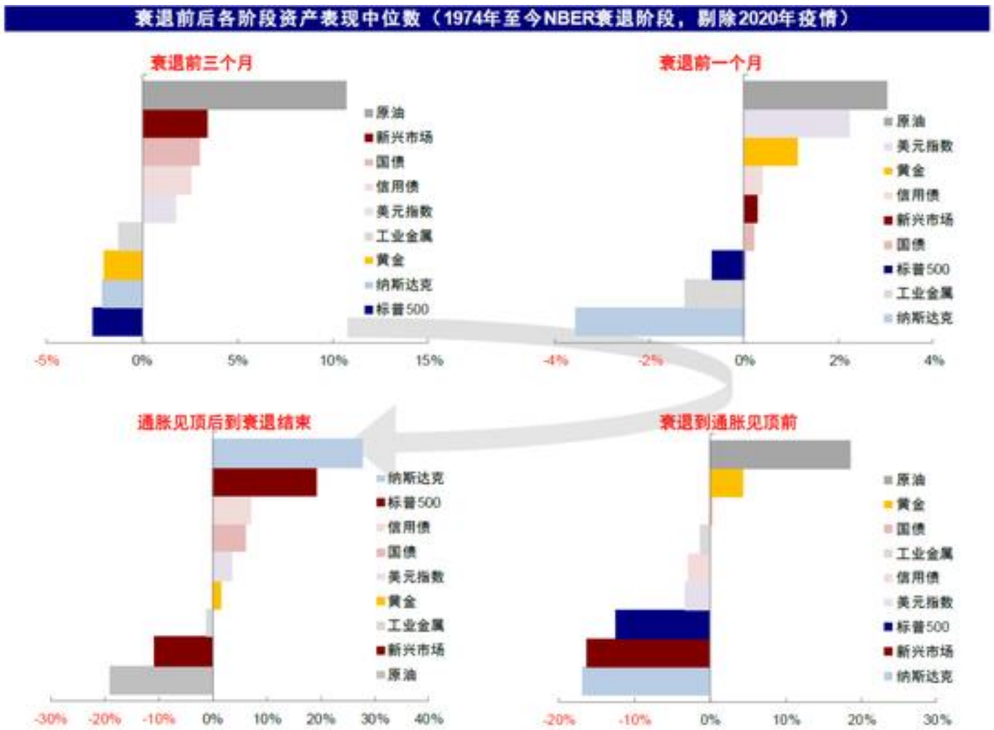
Source: TradingView

The US 10-2 Year Treasury Yield Spread has sharply narrowed, indicating a decrease in the inversion. The Federal Reserve began raising interest rates in March 2022, slowly start from July 2022 causing the financial sector to experience distortions and tensions, gradually leading to an "inverted yield curve." When significant systemic financial risks occur in the financial system, such as the recent collapse of the three largest banks in the United States, the Federal Reserve may be forced to consider "lowering interest rates." Once interest rates are lowered, short-term rates (such as the two-year Treasury yield or one-year Treasury yield) will immediately be lowered by the Fed, as short-term bond rates are highly sensitive to the Fed's interest rate decisions. As a result, the "spread between long-term and short-term rates" will invert. The effect of lowering interest rates is slowly eliminating the "yield curve inversion", which means the financial market returns to a normal state.

2) Discussion on the performance of various financial assets during a "recession".

As the Fed's interest rate hikes may be coming to an end, the discussion about whether the US economy will enter a recession and whether various assets will enter a recessionary phase is gradually heating up. "Economic recession" roughly has three types: ① substantive recession, which refers to the comprehensive economic downturn defined by the National Bureau of Economic Research (NBER), the probability of which is low; ② technical recession, which means two consecutive quarters of negative growth in real GDP in the US; ③ asset allocation recession, which refers to the "Merrill Lynch Clock" Reflation stage, which is closely related to asset allocation and economic downturn in asset trading. Trevor Greetham, the Director of Asset Allocation for Merrill Lynch, proposed the investment clock theory, abbreviated as the "Merrill Lynch Clock". Based on economic growth (measured by the "output gap") and inflation levels, the economic cycle is divided into four stages: Reflation (which can be understood as "recession"), Recovery, Overheat, and Stagflation. The economy will go through these stages in sequence and repeat continuously, as shown on the clock, starting from Reflation at the bottom left of the Merrill Lynch Clock and rotating clockwise.

Regarding the case of "substantive recession," we can refer to the following chart to see the performance of various financial assets in the US recession phase since 1974.



Source: National Bureau of Economic Research, NBER)

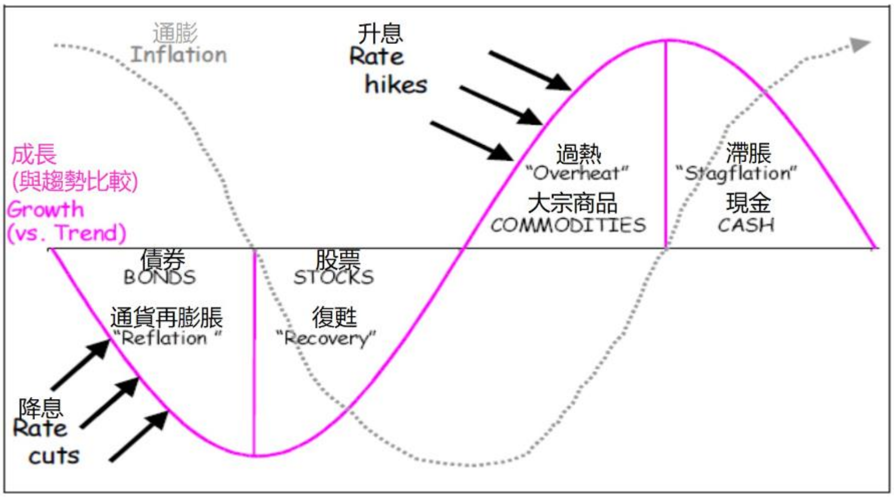
The words in the picture above:

The median performance of various financial assets before and after recessions in the US from 1974 to the present, excluding the 2020 Covid-19 pandemic)

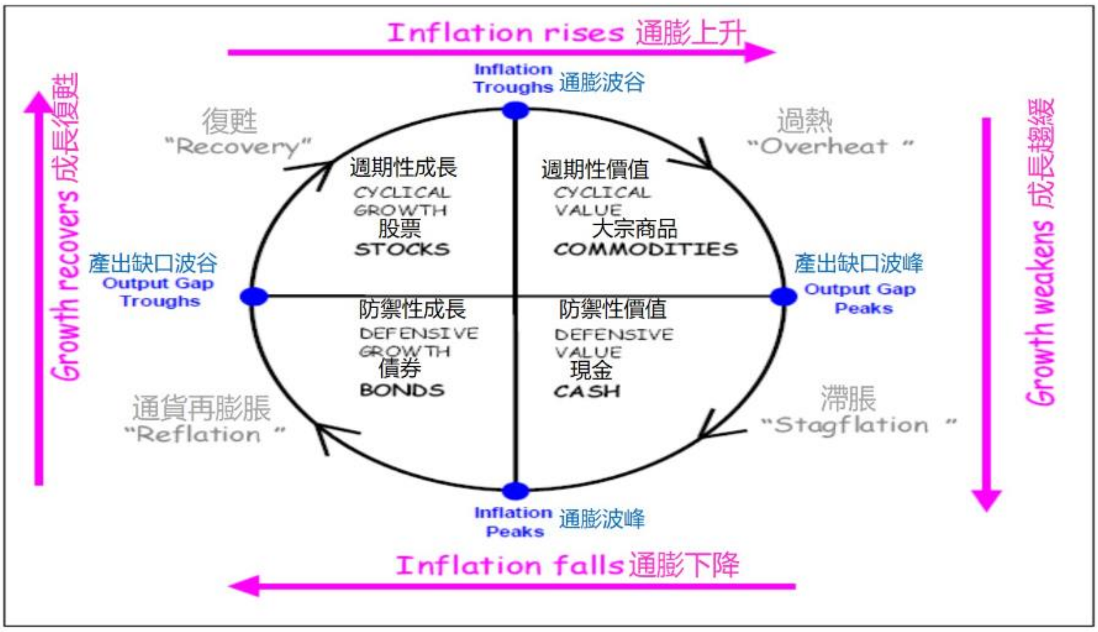
3 months before the recession	1 month before the recession
Crude Oil	Crude Oil
Emerging Markets	US Dollar Index
Treasuries	Gold
Credit bonds	Credit bonds
US Dollar Index	Emerging Markets
Industrial Metals	Treasuries
Gold	S&P 500
Nasdaq	Industrial Metals
S&P 500	Nasdaq

After inflation peaks to the end of recession Nasdaq S&P 500 Credit bonds Treasuries US Dollar Index Gold Industrial Metals Emerging Markets Crude Oil	Recession to the peak of inflation Crude Oil Gold Treasuries Industrial Metals Credit bonds US Dollar Index S&P 500 Emerging Markets Nasdaq

With regard to the recession in asset allocation, looking back at the past performance of various asset classes during different phases of the economic cycle, in general, bonds were best and commodities worst during the reflation phase (recession); equities were best and commodities worst during the recovery phase; commodities were best and bonds worst during the overheat phase; and in the stagflation phase, cash is best, and equities are worst.



Source: Merrill Lynch asset allocation team, the horizontal line represents the path of sustained growth.



Merrill Lynch Investment Clock, Boom-bust cycle (Source: Merrill Lynch asset allocation team) , for more information, please refer to: https://rich01.com/what-merrill-lynch-investment-clock/

3. US CPI inflation data for February shows that inflation remains high and the probability of a 25 basis point US rate hike in March is elevated.

The CPI report data released by the U.S. Bureau of Labor Statistics on Tuesday (14 March) showed that the US February inflation data was roughly in line with market expectations but still remained high. Although the annual rate of the consumer price index fell from 6.4% to 6.0% compared to the previous value, which was consistent with the market estimate of 6.0%, the unexpected increase in the core consumer price index (month-on-month) rebounded from 0.4% to 0.5%, exceeding the expected 0.4%. This implies that the sticky inflation problem in the US in February still exists, and the probability of a 25 basis point rate hike in March has increased. After the data was released, it caused small and short-term fluctuations in the market, with the overall result being a slight decrease in the US dollar and a slight rebound in non-US currencies.

- *The US February unadjusted annual rate of the core consumer price index (CPI) recorded 5.5%, down from the previous value of 5.60% and in line with the expected 5.50%.*
- *The US February core consumer price index (CPI) recorded a monthly rate of 0.5%, higher than the previous value of 0.4% and the expected 0.4%.*

- *The US February seasonally adjusted CPI recorded a monthly rate of 0.4%, down from the previous value of 0.50% and in line with the expected 0.40%.*
- *The US February unadjusted CPI annual rate recorded 6.0%, lower than the previous value of 6.40% and in line with the expected 6.00%.*

After the collapse of Silicon Valley Bank recently, the Federal Reserve's interest rate policy target, in addition to "combating inflation," now includes "maintaining financial system security." In the short term, if US financial liquidity can be effectively alleviated with the support of a series of policies enacted by the US government, "combating inflation" will still be the main focus of the US central bank. Unless a more severe liquidity crisis occurs, forcing the Fed to "lower interest rates ahead of schedule," which may trigger a resurgence of inflation, the Fed will have to initiate "rate hikes" again. This unstable rate path of cutting and raising interest rates may differ from what the Fed and the market hope to see. Therefore, the probability of the Fed using interest rate hikes to curb inflation in March is higher.

4. Gold rallies on risk aversion

The recent outbreak of the Silicon Valley bankruptcy crisis has led to a significant shift in market expectations for the Fed's interest rate hike, a sharp fall in US Treasury yields, driving the dollar weaker, while coupled with the rise in risk aversion, gold surged 5.72% (from 1810 to 1913.50), currently at around 1905.00. If the upcoming "bankruptcy crisis" is well-assisted by the government and the market returns its attention to "high inflation," the Fed may continue to raise interest rates to combat inflation and keep high interest for a long period of time, this is not favourable for gold, if risk aversion remain high, gold may rise again.

Source: TradingView

Will this wave of the retaliatory rebound in gold be sustainable? The Fed's 25 basis point rate hike in March to combat inflation, and the high possibility of maintaining high-interest rates in the future, may still be high. Gold has already risen more than US$100 in just four trading days, but after the risk aversion subsides, the bear market for gold may come back at any time.

5. The Yen has strengthened sharply recently. The "The US 10 Years/Japan 10 Years Government Bond spread" may continue dominate the USDJPY.

The traditional safe-haven assets, gold, the Japanese yen and the Swiss franc, have been in a rally since last Thursday's news of the bankruptcy of three other major banks, including Silicon Valley Bank. The USDJPY fell 540 pips (from 137.90 to 132.50) between 9 March and 13 March and is now at 134.10.

In a recent statement, Japan's Finance Minister Hirokazu Matsuno said that the Silicon Valley Bank crisis would not have a significant impact on Japanese financial firms and that Japanese financial institutions had sufficient liquidity. Japan's financial sector may only be overly affected by the Silicon Valley bank bankruptcy once overall market liquidity is impacted. As the Bank of Japan remains dovish, the Federal Reserve may continue to raise interest rates, and US Treasury yields may rise again. When the US bank bankruptcy fiasco passes, the "The United States 10 Years/Japan 10 Years Government Bond spread" may put the yen under pressure again.

Bank of Japan Governor Haruhiko Kuroda chaired the last policy meeting of his term on Friday, 10 March. His main points were: that the monetary easing policy has been successful, and the benefits of the policy outweigh the side effects. It is appropriate to continue implementing the easing policy at present, and the interest rate is expected to remain at the current or lower level. If necessary, it will be increased without hesitation; ten years ago, Japan faced deflation, but it is no longer in deflation now. The uncertainty of the Japanese economy is very high, but it is recovering. The wage standards are starting to change, and the 2% target is getting closer. The spring wage talks are expected to yield better results, which is crucial to support the economy. Wages are expected to rise further, and they are an essential component in seeking a virtuous cycle. It is expected that the labour market will become tighter in the future, and it is possible to achieve the inflation target while wage growth occurs. The predicted inflation rise in the next fiscal year will slow down. He believes that Masayoshi Amamiya will effectively lead the Bank of Japan. The Bank of Japan will maintain the annual purchase limit of ETF at 12 trillion yen and the commercial bill limit at 2 trillion yen. Short-term and long-term interest rates are expected to remain at the current or lower levels. Although Japan exports and industrial production are affected by overseas economic entities, they will remain more or less stable under the support of the relief of supply-side restrictions. Inflation expectations have risen, and the CPI annual rate, excluding fresh food, is currently around 4%. The Bank of Japan will continue to operate the QQE with YCC framework until the CPI annual rate, excluding fresh food, exceeds 2% and stabilises above it.

- *Bank of Japan's interest rate decision as of 10 March: -0.10%, expected -0.10%, and the previous value was -0.10%.*
- *Japan's 10-year government bond yield target as of 10 March: 0%, expected 0.00%, and the previous value was 0.00%.*

Bank of Japan Governor Haruhiko Kuroda spoke on Wednesday, 15 March, at the minutes of the central bank meeting: attended the International Bank of Settlements meeting from 12 to 13 March and participated in discussions about the impact of Silicon Valley Bank's collapse on the global market. We need to monitor the impact of Silicon Valley Bank's failure carefully. It is not appropriate to share decisions before the policy meeting. Although it may take some time, measures taken under the existing market tools are expected to improve market functionality. It is appropriate to continue to maintain the easing policy and YCC. Negative interest rate policy has brought the yield curve down and supported the economy; the effects of negative interest rates have been more beneficial than detrimental; the BOJ is certain to exit easing when Japan continues to stabilise its 2% inflation target; our efforts on price expectations have been halfway successful.

With the global economy in the doldrums, the Japan economy has yet to show any signs of picking up momentum. The final GDP forecast for the fourth quarter of last year was revised downwards for private consumption growth. Real wages fell by 4.1% year-on-year in January, down from a revised -0.6% in December. In addition, China has recently set a conservative "around 5%" GDP growth target, and Japan may only receive limited support from a renewed rebound in the Chinese economy.

6. AUD, NZD and CNH rose slightly.

The Reserve Bank of Australia raised interest rates by 25 basis points to 3.60% last Tuesday, sparking market discussions about the bank's "dovish stance". RBA Governor Lowe indicated that the bank may raise rates by another 25 basis points at its April meeting. Since last year, the Australian Bureau of Statistics (ABS) has been publishing monthly CPI data between quarterly data. This monthly figure accounts for 62-73% of the weighted quarterly basket. The RBA's inflation target will continue to be linked to quarterly CPI. However, at this rate meeting, the RBA cited this monthly CPI data, which grew 7.4% year-on-year in January, lower than the expected 8.1%. The RBA stated that the monthly CPI indicator shows that inflation in Australia has peaked" .

According to S&P Global, New Zealand's credit rating may come under pressure, as its current account deficit is "much larger than expected". The deficit needs to be reduced, and attention will be paid to the New Zealand government budget in May.

<u>China's consumer inflation data fell, raising questions about China's consumer demand in the market.</u> According to data from the National Bureau of Statistics of China, due to a decrease in demand after the Chinese New Year holiday and sufficient food supply due to warm weather, China's consumer inflation in February slowed down by 1.1% year-on-year to 1.0%. This provides a conflicting signal about the strength of the rebound in the strong service PMI in February. The Caixin services PMI rose 2.1 points to 55.0, indicating that China is in a solid early stage of recovery and businesses remain highly confident. The cooling of China's CPI is comprehensive, but about half of the overall slowdown is attributed to the slowdown in food prices. The contribution of food prices to the 1.0% CPI in February fell from 1.1% in January to 0.5%. Due to sufficient supply, vegetable prices fell by 0.5% year-on-year in February after rising by 0.8% in January. Pork prices rose only 0.6% year-on-year in February, lower than 1.8% in January, while fruit prices rose 0.7% in February, lower than 1.1% in January.

On 15 March, the People’s Bank of China (PBOC) said it was keeping the rate on 481 billion yuan (US$70.03 billion) worth of one-year medium-term lending facility (MLF) loans to some financial institutions at 2.75%, unchanged from the previous operation and also injected 104 billion yuan through seven-day reverse repos while keeping the borrowing cost unchanged at 2.00%, unchanged from the previous one.

Since the news of the bankruptcy crisis of three major banks, such as Silicon Valley Bank, came out last Thursday, the US dollar has fallen, driving a slight rise in CNH. Against the backdrop of the general decline in the US stock market, the Chinese stock market also followed a downward trend. The following is the performance record for the past week.

- *USDCNH dropped by 1600 pips (6.9950-6.8350), now trading at 6.8750*
- *AUDUSD rose by 170 pips (0.6550-0.6720), now at 0.6695*
- *NZDUSD rose by 150 pips (0.6100-0.6250), currently trading at 0.6230*

- *CHINA50 dropped by 650 pips (13500-12850), now at 13000*
- *CHINAH fell by 600 pips (7000-6400), currently trading at 6545*
- *HK50 dropped by 1600 pips (20700-19100), now at 19480*
- *Oil prices plummeted, with WTI testing the 2022 low of US$70.*

7. Oil prices fell sharply, with WTI testing the 2022 low of US$70.
The failures of the three largest banks in the United States recently may have shaken market confidence in a soft landing for the US economy, and a recession in the US may be unavoidable. This may be the main reason for the recent sharp drop in oil prices. With an economic downturn on the horizon, which is bad for oil prices, oil prices are expected to continue to fall, and they may drop further below US$70, testing the US$65.00 level. However, the overall downward space for oil prices is expected to be limited, and investors should pay attention to support levels near US$65.0.

- *WTI oil fell by 1000 pips (from US$80.80 to US$70.80) and is currently trading at US$72.30.*
- *Brent oil fell by 700 pips (from US$84.00 to US$77.00) and is currently trading at US$78.55.*

Recently, Saudi Arabia has made a strong statement indicating its determination to maintain high oil prices. According to Saudi national media reports on Tuesday (14 March), the Saudi Energy Minister stated, "Kingdom will not sell oil to any country that imposes a price cap." In addition, Saudi Arabia reiterated its commitment to continue the agreement to cut production by 2 million barrels per day until the end of this year, which was agreed upon in October of last year. OPEC cuts production by 2 million barrels a day, and Russia has been cutting production by 500,000 barrels per day since March. Given that OPEC accounts for 40% of global production supply, once the reduction exceeds 3 million barrels, it is expected to trigger a rapid rebound in oil prices. As Saudi Arabia and Iran resume diplomatic relations, the future of Middle East geopolitics will also play a role in oil price movements. Therefore, it is not ruled out that oil prices may rebound after hitting bottom.

Short-term risks:
Last weekend's bankruptcy events at the three large banks may lead the Federal Reserve's short-term focus to shift towards "financial stability" and temporarily postpone "fighting inflation". The market expects the Fed may "slow down or even cut interest rates" to prevent the current panic from evolving into a systemic risk crisis. Federal Reserve Chairman Powell may soon adopt a more cautious monetary policy, suspend aggressive rate hikes, and

increase the possibility of a "dovish stance". However, the author expects that Fed Chairman Powell's determination to continue to suppress inflation will not change and expects the Fed to maintain high-interest rates unchanged for a long time. The short-term focus of market attention now turns to the upcoming U.S. interest rate resolution announced in March next Thursday (23 March), as well as the Federal Reserve press conference, where the market is expected to raise interest rates by 25 basis points.

In the Asia-Pacific region, attention will be paid to the People's Bank of China's interest rate decision on Wednesday (20 March), Japan February consumer price index and February’s consumer price index excluding fresh food data on Friday (23 March). The Reserve Bank of Australia's meeting minutes will be released on Tuesday (21 March), and the March S&P Global service PMI data will be released on Friday (24 March).

The dollar is expected to continue to appreciate and depreciate in parallel next week, with the Fed's rate hikes to fight inflation unchanged or continue to support the dollar's appreciation, but "economic development and financial stability" will require a depreciation of the dollar. It is also important to be wary that when the market fully digests and fully prices in the Fed's tightening policy this year, the dollar's downward trend could return at any time.

By Sandy Wang,

15 Mar 2023 at 1 pm SGT