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fxPoetry

August 12, 2022

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Goldilocks Lives

Apparently that was the bell
The PPI data that fell
Now everyone's thinking
The Fed will be blinking
Though Fedspeak, those thoughts, try to quell

So, stock markets worldwide are rising
And pundits are strongly advising
That Goldilocks lives
And buying risk gives
The best chance, more gains, of realizing

And they say that nobody rings a bell at the top (bottom)! Clearly, that is not true based on the remarkable euphoria that has gripped risk assets of late. Surprisingly, it seems that yesterday's PPI data, generally the red-headed stepchild of inflation data, was the catalyst as it fell sharply, to 9.8% Y/Y, after last month's energy price declines. This was well below the 10.4% expected and was a pleasant addition to the CPI data released on Wednesday. The result of these two related data points is the narrative has quickly shifted to, the goldilocks economy is returning and so the Fed will be able to ease off the brakes. This will result in a soft landing and stock prices should explode higher amid much improved profitability. Or something like that.

Hey, maybe that is exactly what will happen. After all, nobody really knows. But it strikes me that is a tad too optimistic of a view based on the first reasonable decline in a data series that has been trending at 40-year highs. Consider that, barring a deep global recession, the price of energy is unlikely to fall much further. And since the bulk of this price decline was energy, if a deep global recession manifests itself, that doesn't sound like a recipe for owning risk assets. In fact, just the opposite. And without that recession, energy prices seem likely to resume their uptrend as there remains a structural shortage of the stuff everywhere in the world (except Russia perhaps). In fact, just yesterday the IEA raised its forecast for oil use by 2 million bpd given the amount of fuel switching that is taking place in the electricity sector. With NatGas prices so crazily high in Europe, Asia and the UK, utilities are retrofitting their boilers to burn oil which is much

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cheaper per unit of output at $100/bbl, than NatGas at $50/MMBtu. In fact, at those levels, oil is about one-third the price of NatGas. The point is the market response to yesterday's data seems a bit overdone.

And what of the Fed (and its brethren central banks)? Are they along for this ride? Once again, Fed speakers have tried to disabuse the market bulls of the idea that they are going to pivot soon and not merely stop tightening but begin cutting as well. SF Fed President Mary Daly was back in the spotlight last evening, explaining that her base case is 50bps in September, but that depending on the data between now and then, that could easily be turned back to 75bps. Today we hear from Richmond's Thomas Barkin, who based on previous comments as well as the general trend of what we have been hearing, seems likely to say the same thing.

The problem for the Fed is that nobody is listening to their words. Ever since Alan Greenspan was Fed Chair and stepped in to support the banking sector (and the economy) in the wake of the Black Monday crash in 1987, investors have learned that the Fed, regardless of their rhetoric, will never allow a market dislocation without a response. Maybe this time truly is different. Maybe QT, as it (theoretically) ramps up the pace of asset disposals will be the "dog that didn't bark" and will be the clue to a change in Fed behavior. But the Fed will need to prove themselves many times over, by maintaining a strong stance and continuing to tighten policy if they are to regain any sense of the credibility they crave. Is Chairman Powell up to the task? If a recession is upon us leading into the presidential election in 2024, will he be able to continue to address any inflationary concerns? All this has yet to be answered, but the market's view is clear. There remains an overriding belief that the Fed will blink, and probably soon, and that by 2023, QE is more likely than QT. Hence the stock market rally on the first miss in inflation data in a year.

Ok, as we finish out the week, the bulk of the story remains positive on the day. Equity markets in Asia were mostly higher (Nikkei +2.6%, Hang Seng +0.5%, Shanghai -0.2%) while Europe is all green, but has given back some earlier gains. Right now, bourses are higher by about 0.2%, down from 0.6% gains seen just an hour ago (6:00am NY). We have seen the same type of price action in US futures, where current levels of ~+0.35% compare to gains of +0.6% earlier in the session.

Bond markets in Europe are all selling off a bit, with yields rising. Gilts (+5.1bps) lead the way despite (because of?) slightly better than expected GDP data (-0.1% Q/Q vs. expected -0.2%), while Bunds (+2.1bps) and OATs (+2.0bps) have seen less selling pressure. Treasuries (-1.5bps) meanwhile are rebounding from yesterday afternoon's sharp sell-off as 10-year yields rose 10bps on the day. That served to reduce the curve inversion substantially and it now sits at -33bps.

Oil prices, (-1.5%) which rallied yesterday on the IEA story mentioned above, are settling back down a bit, but remain well above their key support levels of $88/bbl. NatGas (-2.5%) is retracing some of yesterday's surprising gains but is still closer to $9/MMBtu than $8 and with the timeline now set for the reopening of the Freeport LNG plant, US inventories are certain to decline. Gold (-0.2%) continues to trade around $1800/oz and seems unlikely to move very far without another major catalyst, but both copper (-1.6%) and aluminum (-1.4%) seem to be pointing to less positive times ahead.

As to the dollar, it is firmer this morning pretty much across the board. SEK (-1.0%) is today's laggard as slightly softer than expected CPI data (8.5% vs exp 8.7%) has tongues wagging that the Riksbank will be less aggressive. But JPY (-0.6%) followed the Treasury yield move yesterday and the pound (-0.55%) seems to be the piece of the UK puzzle that is responding to negative growth. But the entire G10 bloc is falling this morning. As to the emergers, IDR (+0.7%) is the outlier as indications of better trade performance are supporting the rupiah, but generally the rest of the bloc is weaker led by PHP (-0.6%) and CZK (-0.5%) with the former suffering from concerns over reduced foreign remittances, a key source of foreign exchange for the nation, while the koruna fell on the back of much weaker than expected current account data, a near record deficit.

On the docket this morning is the Import Price Index (exp 9.4%) an unadjusted data point, and then Michigan Sentiment at 10:00 (52.5). The latter continues to hover near its lowest historic levels since the survey began in 1978. One other noteworthy piece of data overnight was Chinese Aggregate Financing and New Loans, both of which fell sharply and were much below expectations and potentially a harbinger of slower growth ahead in China, and by extension, most everywhere else.

Well, if the new paradigm is right, and inflation has peaked and the Fed is going to be slowing down their tightening, then the dollar will soon lose its support. However, I am not convinced that is the case yet, and given the ongoing disaster that is Europe, I continue to look for the dollar to eventually strengthen and go back below parity. But it could be a while, perhaps if Powell is truly hawkish at Jackson Hole, before that happens. Until then, I see no directional trend in view.

Good luck, good weekend and stay safe
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