Weekly Market Update

15 August 2021

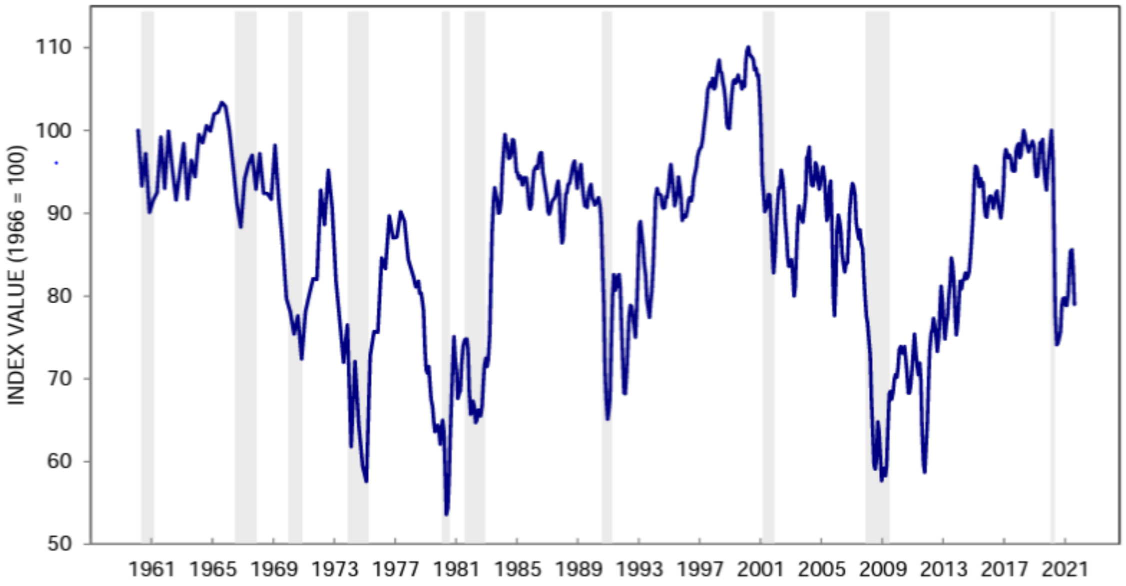
US Economy – Still Hot out there…

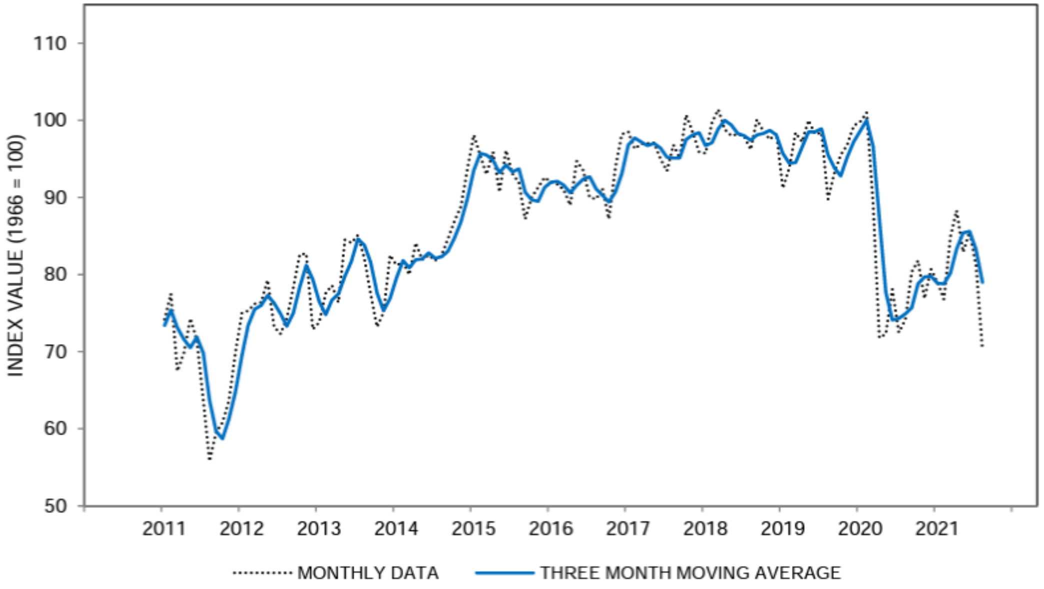
- The CPI data last week showed that the sharpest monthly consumer price hikes may be behind **but inflation is not about to quietly fade away.**
- U.S. producers also reported strong price increases in July. The Producer Price Index for final demand rose 1.0% and is now up 7.8% from a year ago. Although there were some signs of easing further back in the pipeline, input costs continue to rise at an eye-catching pace for both goods and services, such as transportation. For example, services for intermediate demand are up 9.2% over the past year, nearly triple the high-water mark of last cycle, while processed goods prices are up 23% from a year ago.
- Input costs pressures also extend to labor. The oddly tight labor market was on full display with job openings reaching a fresh record for June at 10.1 milllion. For every job opening, there was only 0.9 unemployed workers, a ratio similar to when the unemployment rate was at 4.0% in early 2018 versus 5.9% in June of this year. The rate at which workers are voluntarily leaving their job rose to 2.7%, well above prior cycle highs. **This is a sign that workers have growing opportunities and are using this time to improve their job situation.**
- The pace of job switching has led firms to offer more flexibility, training and time off, but also pay. With a record 49% of small businesses reporting at least one job as hard to fill, the **NFIB's latest small business survey shows that plans to raise compensation remain elevated in July**.
- But the ongoing struggles to find workers, secure product to sell and contend with rising costs seemed to take a toll on optimism in July. The survey's headline index fell more than anticipated, with the largest drops in expectations for sales, earnings trends and the economy more broadly.

But Michigan consumer is cool…

- August preliminary University of Michigan Consumer Sentiment Index plummeted to 70.2 versus the Bloomberg estimate calling for it to be unchanged at July's 81.2 reading.
- The index fell to the lowest level since December 2011 and below the April 2020 low of 71.8 as both the current conditions and the expectations components of the index fell sharply.
- The 1-year inflation forecast dipped to 4.6% from July's 4.7% rate, in line with forecasts, and the 5-10 year inflation forecast moved higher to 3.0% from the prior month's 2.8% level.
- The University of Michigan said, "The losses in early August were widespread across income, age, and education subgroups and observed across all regions. Moreover, the losses covered all aspects of the economy, from personal finances to prospects for the economy, including inflation and unemployment.
- There is little doubt that the pandemic's resurgence due to the Delta variant has been met with a mixture of reason and emotion.
- Consumers have correctly reasoned that the economy's performance will be diminished over the next several months, but the extraordinary surge in negative economic assessments also reflects an emotional response, mainly from dashed hopes that the pandemic would soon end.

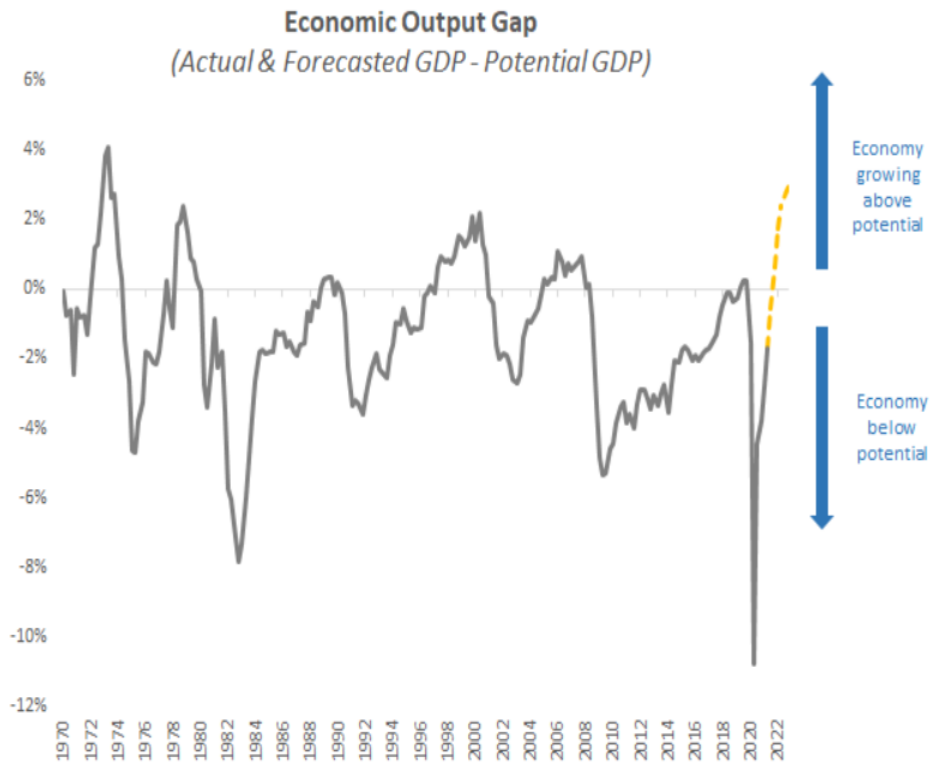
THE INDEX OF CONSUMER SENTIMENT





Inflation to stay elevated…

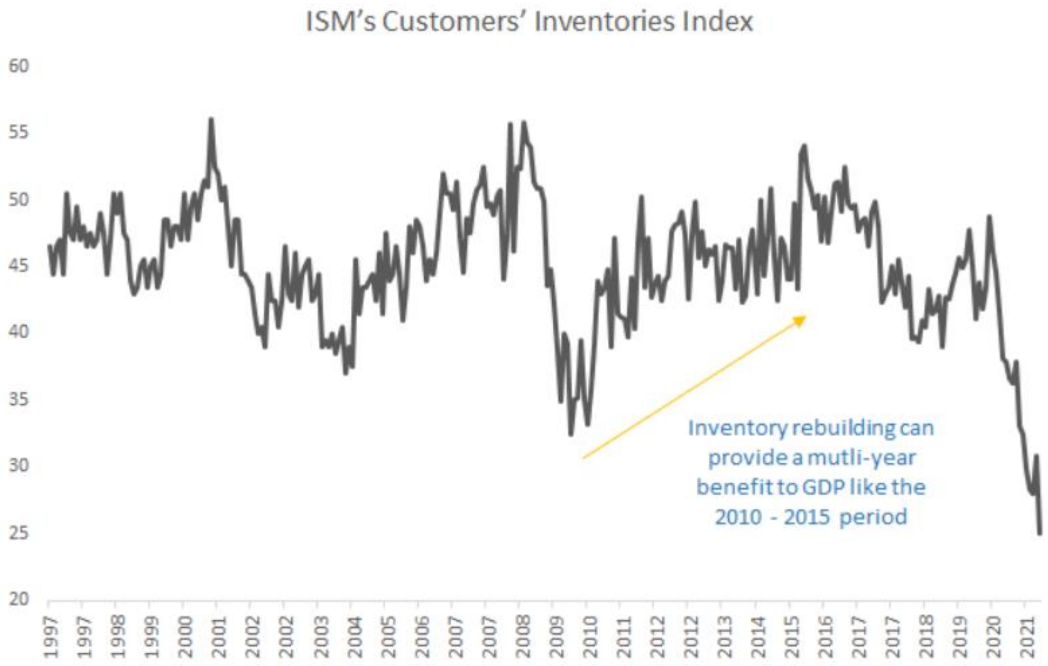
- CPI rose by 5.4% from a year ago, in line with estimates, and the core index, which strips out food and energy, rose by 4.3%, edging lower from June.
- Prices in categories that have experienced rapid increases over the last couple of months and are tied to the reopening of the economy, such as used cars, vehicle insurance and airfare, either moderated or slightly declined.
- On the other hand, food-away-from-home prices (restaurants) rose the most since February 1981, likely driven by labor shortages and wage increases.
- July data is somewhat aligned with Fed's view that the outsized gains will ease. Although sharp price pressures will moderate as supply catches up with demand and travel-related prices normalize , the moderation does not mean that inflation will persistently fall again below the Fed's 2% target as it did for most of the last decade.
- According to consensus estimates for GDP and the Congressional Budget Office projection for potential output, by the end of 2022 the economy is expected to operate significantly above its potential, with the economic-output gap the most positive in decades.
- Because of robust wage growth and limited permanent scarring from the recession, inflation is likely to settle at higher levels once the recent overshoot subsides.



- The graph shows the difference between actual GDP and potential GDP, known as economic output gap.
- By the end of next year the U.S. economy is expected to be operating significantly above its potential.

Growth to stay in tact…

- There has never been a time when, in the second year of an expansion, valuations were as high and bond yields as low, a likely side effect to the outsized injection of liquidity in financial markets.
- As the bull market progresses and corporate earnings rise, but elevated valuations suggest more muted equity and fixed-income returns.
- No two cycles are ever the same, especially one that follows a very unusual recession. As the saying goes, history doesn't repeat itself, but it rhymes.
- US ISM Manufacturing Customer's Inventories Index is at a current level of 30.80, up from 28.00 last month and down from 44.60 one year ago.
- Customer inventories continued to shrink rapidly , as businesses continued to rely on the goods they already had in warehouses due to long lead times.
- Businesses across the US eventually would be restocking their shelves and that will be not only a big source of ongoing demand for manufactured goods, but also a tailwind for GDP growth.



50 years of Fiat Money

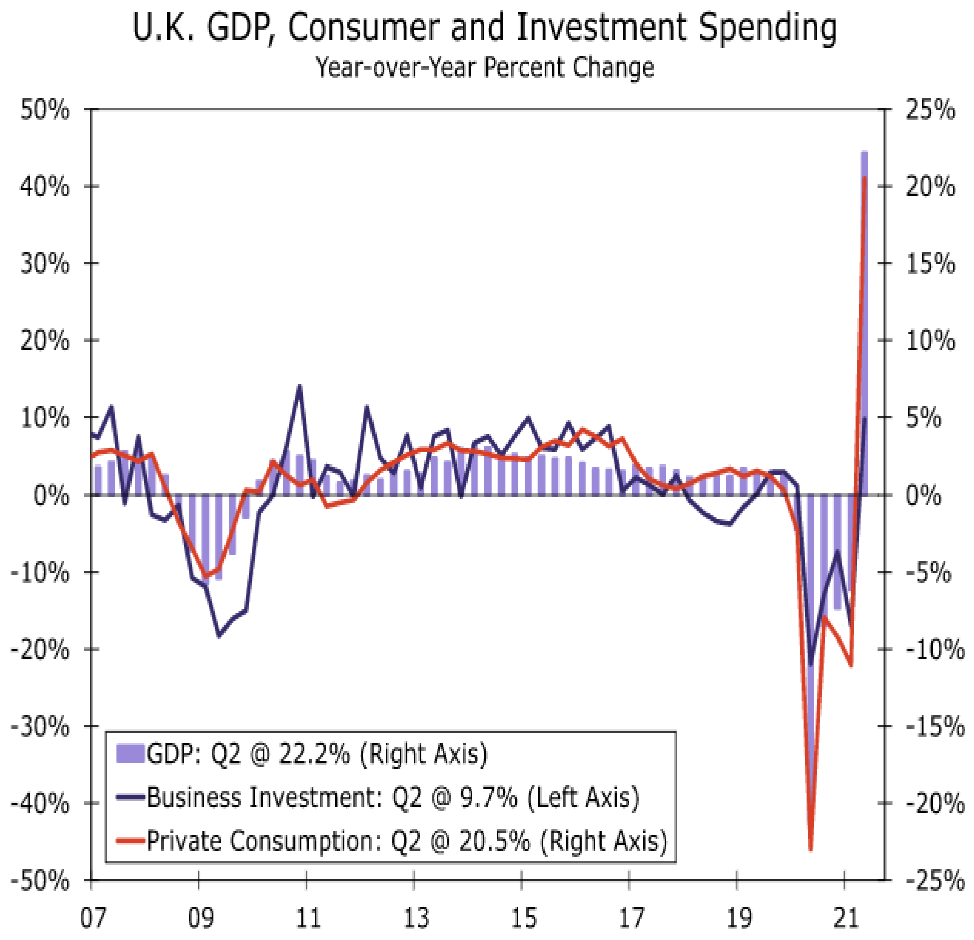
- On Sunday evening, August 15, 1971, Richard Nixon went on national television to announce that he was abolishing the right of foreign governments and foreign central banks to buy gold from the United States government at $35 per ounce. He said this would be temporary. It wasn't.
- He also announced that he was placing comprehensive price and wage controls on the American economy, which he said would be a temporary measure. After 90 days, a price control board would consider exemptions. Those price controls remained in force until Jan 12, 1973. The government extended the controls in healthcare products, food, and construction. Most of the system of controls came to an end in March 1974.
- The only thing that seemed pertinent at the time was that the US did not want to part with any more of its gold, and Nixon feared a recession that would undermine his chances for getting re-elected in 1972.
- The main demand for US gold was not coming from the Soviet Union or Communist China but from America's capitalist rivals and allies, primarily in Europe.
- August 15, 2021 is the 50th anniversary of the end of Bretton Woods, Nixon ushered in the modern era, even if he did not intend to do so.
- This meant that the central bank could expand the money supply without legal restriction. All it had to do was buy the debt of the government. The borrowing increases, and no one expects to be paid. Everybody expects the debt of every national government to be rolled over without end. The result has been a vast expansion of the on-budget federal debt and money supply and the world of MMT.

Shipping cost underpins Inflation

- The Freightos Baltic Index spot rate to ship a forty foot container from Asia to the US West Coast in June was nearly $7,000, more than four times the price in May 2020.
- And with many importers paying thousands more in premium fees to secure scarce space, some businesses are paying more than $20,000 per container. These spikes are not only increasing logistics costs for importers, but also pushing prices up for consumers.
- it's important to note that, while shipping was barely a factor in inflation in the past, the unprecedentedly sharp rise in shipping rates in the last year is actually a significant factor to current inflation.
- n 2019, US businesses spent an estimated $48B on ocean logistics, accounting for 1.07% of total US spending on goods, and 0.33% of all spending on goods and services.
- Shipping costs as a share of consumer spending have doubled to 2.14% of total spending on goods and 0.66% of total spending on goods and services.
- In the near term, freight rates may yet reach new highs thanks to the combination of further increases in demand and the constraints of a congested system. And even when capacity constraints are eased, freight rates may remain at higher levels than before the pandemic.
- New orders for container vessels reached a record high of 229 ships with a total cargo capacity of 2.2 million TEU.
- When the new capacity is ready for use, in 2023, it will represent a 6% increase after years of low deliveries . But freight rates wont return to their pre-pandemic levels,

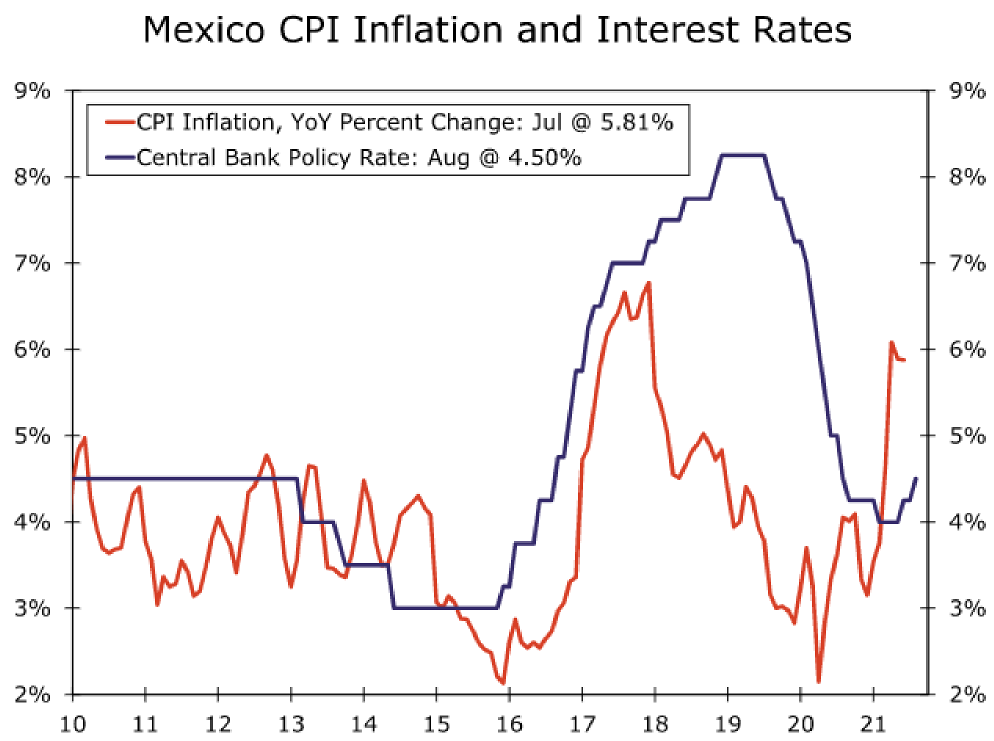
UK – Robust show

- U.K. economy put forth a sturdy performance in Q2, recovering from a COVID-related decline in activity during the first quarter of the year.
- Q2 GDP jumped 4.8% quarter-over-quarter, matching the consensus forecast, and by 22.2% year-over-year. In particular, private consumption and government spending were both strong, registering gains of 7.3% and 6.1% quarter-over-quarter, respectively.
- Q2 business investment was a slight disappointment, with a smaller gain of 2.4%.
- Not only was Q2 solid as a whole, but the quarter also ended on a firm note, as June GDP rose 1.0% month-over-month, which was more than expected.
- Service sector activity was especially strong, with a gain of 1.5%, partly offset by a 0.7% fall in industrial output.
- GDP rose in June, even as U.K. government delayed the final phase of its economic reopening from late June to late July.
- Looking ahead to the third quarter, U.K. economy may not repeat its Q2 increase, but a more-than-respectable 2.5% quarter-over-quarter gain.



Latin America- Inflation persists

- Striking feature of last week's releases was the persistence of inflation pressures in Emerging markets in general and Latin America in particular
- Brazil's July CPI quickened further to 8.99% year-over-year, the fastest pace of inflation since mid-2016. Housing and transportation costs were among the components contributing to the acceleration of inflation.
- With the CPI running more than double this year's CPI inflation target of 3.75%, Brazil's central bank would continue to rise in addition to the cumulative 325 bps of Selic rate increases so far this year at upcoming meetings.
- Mexico's July CPI inflation was also elevated, albeit easing slightly to 5.81% year-over-year, while the core CPI firmed slightly to 4.66%. Elevated inflation prompted Mexico's central bank to raise its overnight rate by 25 bps to 4.50% at this week's monetary policy meeting.
- The central bank said the balance of risks around the inflation outlook was to the upside, although in somewhat less hawkish comments also said that inflation shocks should be transitory and that future monetary policy decision would be data dependent.
- It was through a split vote, rather than a unanimous decision, that monetary policymakers decided to raise interest rates by a quarter point at this meeting.

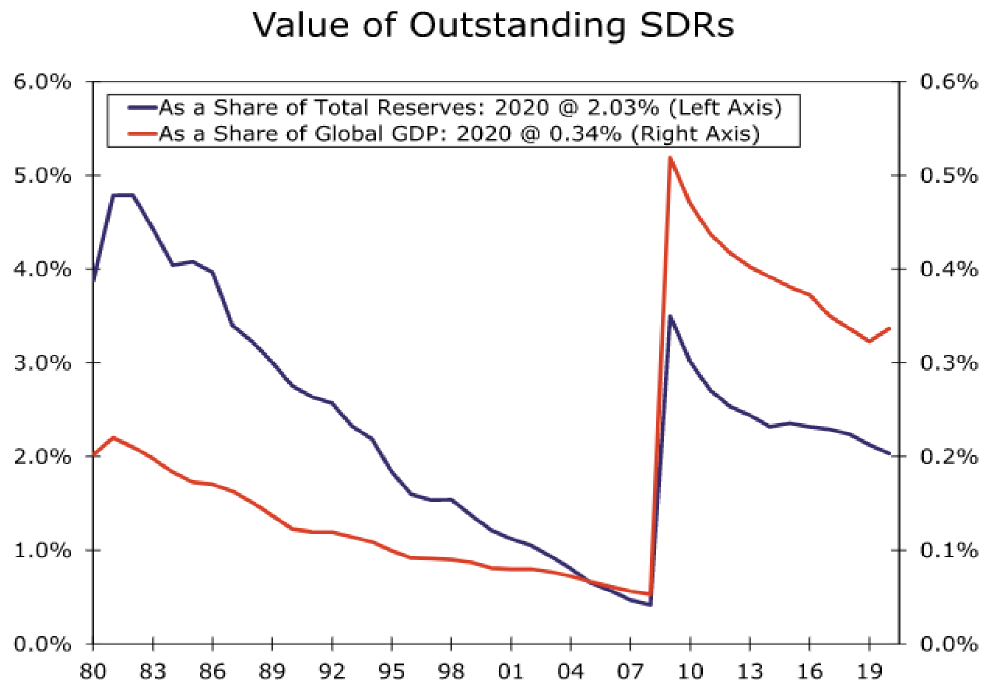


Europe: Past the peak speed

- Eurozone's trade surplus narrowed to €12.4bn in June from May's €13.8bn reading, but it remains broadly in line with levels seen over the past ten years. The slight fall back in exports can be put down to global supply-chain disruption, which we know has affected the performance of European industry over Q2, particularly Germany. Furthermore, while export volumes are hovering close to their February 2020 level, imports have well exceeded theirs as resilient consumption for goods among the bloc's consumers supports import demand.
- At a time when concerns around inflation are tilted to the upside across the world, France's drop back in inflation to 1.2% y/y in July from 1.5% was surprising .But this was mainly due to the postponed summer sales (similar in Italy) exerting negative pressure on manufactured goods inflation, which declined by 1.1% after rising by 0.7% in June.
- The widely followed ZEW indicator of economic sentiment in Germany fell for the third month running in August, tumbling by 22.9 points to 40.4 points. That shows the weakest economic expectations since last November.
- The chances are increasing that the peak speed of European economic recovery is already behind us, and more time may be needed for a full economic recovery and the normalisation of monetary policy

SDR – Additional liquidity

- SDR was created by the IMF in the aftermath of the Second World War as a way to supplement international liquidity. It is a so-called "basket currency" that is composed of five important national currencies. At present, one SDR is composed of roughly 0.6 U.S. dollars, 0.4 euros, 12 Japanese yen, 0.09 British pounds and 1 Chinese yuan.
- IMF recently announced a significant new allocation of SDR that is valued at $650 billion.
- The new allocation will boost the total value of outstanding SDRs from nearly $300 billion to about $950 billion. The allocation will go into effect on August 23, and it is the largest increase in SDRs in the 77-year history of IMF.
- That said, the last allocation of $250 billion that went into effect in August 2009, in the immediate aftermath of the global financial crisis, caused the stock of outstanding SDRs to skyrocket nearly ninefold.
- The new SDRs will be allocated to all 190 member countries of the IMF, according to the amount of capital that each country has contributed to the IMF.
- For example, US will receive roughly $100 billion of new SDRs, which will be a significant increase to its present holdings that are valued at nearly $53 billion.
- SDRs will simply bolster countries' international reserve positions, which enhance their ability to combat future financial shocks.



- SDRs accounted for nearly 5% of all outstanding reserves in the 1980s, but that percentage has shrunk to only 2% over the past 40 years.
- The value of all outstanding SDRs at present is equivalent to only 0.3% or so of global GDP.
- Once the allocation takes effect, the value of SDRs will represent about 6% of total reserves and be equivalent to approximately 1% of global GDP.

India : Data Highlights

- Credit growth continued to remain subdued as compared with the period prior to the pandemic and this could be ascribed to the risk aversion on the part of lenders and borrowers. The rate of growth in non-food credit fell to 6.2% y/y for the fortnight ended July 30 from 6.51% in the previous fortnight. While loan growth has recovered from its sub-6% levels after the lifting of restrictions during the second Covid wave, it remains muted in an environment of weak economic growth.

- As on July 30, outstanding non-food credit stood at Rs 108.33 lakh crore .Deposit growth slowed to 9.8% y/y from 10.65% in the previous fortnight. The value of bank deposits was Rs 155.49 lakh crore as on July 30.

- Merchandise exports surged 50% in July from a year before and 35% from the pre-pandemic level (July 2019), as thee global demand strengthened and that the global commodity prices remained elevated. Imports, too, shot up by 63% from a year before and 15% from the same month in 2019, mirroring a rise in domestic demand. With this, exports have exceeded the pre-pandemic level (same months in 2019) for five months in a row, suggesting a resurgence in external demand

- Headline CPI for July eased to 5.6% (vs 6.3% in June) falling a tad below the consensus of 5.8%. On a sequential basis, CPI inflation rose by 70bps. Inflation softened primarily due to lower food and services inflation. Core inflation remains sticky at 6% (vs 6.2% in June). Urban inflation has eased to 5.8% (vs 6.4% in June) and Rural inflation softened to 5.5% in July (vs 6.2% in June).

- Gasoline sales at 985,852 tonnes between Aug 1-15 were 4.93% lower compared with those between July 1-15

Nifty : Not even a mild pause

- Nifty gained 2nd week in a row and posted weekly close above 16500 -at record highs
- At the start of the last week, there was some form of fragmentation and market began doubting the continuation of the upside momentum.
- It was the first time in several months that the broader market indices underperformed the benchmark in a rapid selloff that ensued after BSE announced some additional surveillance measures.
- Sentiment was however buoyed by the later clarification on newly enacted 'add-on price framework' by the BSE
- Typically, such a momentum-driven surge is a signal to exercise caution as valuations have moved ahead of their fundamentals. At this point, any news flow could have triggered the selloff and, hence, the friction in midcaps and small caps mid-week. However, this was just a pause.
- While DIIs are focusing on the broader market, FPIs have begun pumping money in large caps, showing renewed interest after a four-month hiatus.
- The domestic liquidity continues to add impetus for the upside . Market has absolutely no macro concerns at this moment to even cause a mild pause in the euphoric run .