SYFX Treasury Foundation

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- Weekly Market Update
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Global Economy : Stagflation

- With the global macro momentum turning lower and central banks slowly shifting gear, the mood in global financial markets turned more volatile .Macro data during September brought more evidence of a slowdown in the global macro momentum that is likely to extend into Q4.
- Supply-chain disruptions since the start of the year triggered a more visible manufacturing slowdown during the summer, and adverse spillover effects to Emerging Markets could become more visible.
- At the same time inflationary pressures remain elevated on account of energy prices amid a surge in European gas and electricity prices
- .In light of clear global slowdown signals and widespread bottlenecks/labour shortages, **'stagflation'** has become a hot topic
- ‘Stagflation' creates a tricky environment for central banks keen to avoid setbacks to the post-pandemic recovery via premature tightening of financial conditions. That said, there are also growing signs that global central banks are slowly shifting away from their accommodative monetary policy stances.
- The reopening boost to services has eased, while labor and materials shortages are weighing on manufacturing and construction. The rush for restocking amid historically high domestic production shortfalls and low inventories continues to accelerate the recovery in volumes and prices.
- The risk is that while restocking should become less of a driver for trade flows in 2022, companies are likely to operate in a “just-in-case” environment as the normalization in shipping capacity is unlikely to occur before 2023. Challenges with the delta variant over the winter could prolong freight challenges and hamper labour supply further. A result could be rising wage pressures to levels not seen for a long time and a further increase in inflation expectations.

US Economy : Data upbeat

- Personal consumption expenditures (PCE) price index, the Fed's preferred inflation gauge, rose 3.6% over the 12 months ending in August, matching consensus. However Inflation concerns seemed to be growing among consumers, as well.
- The gauges of consumer attitudes released during the week offered mixed messages, with the Conference Board's indicator falling to a seven-month low in September, while the University of Michigan's ticked higher.
- The lead Michigan researcher noted, however, that "consumers have become much more concerned about rising inflation and slower wage growth and their negative impact on their living standards."
- Much of the rest of the week's data were upbeat.
- Growth in durable goods orders for August exceeded expectations, and pending home sales jumped unexpectedly.
- Following a decline in July, personal spending bounced back more than expected (0.8% versus 0.6%) in August as consumers ramped up purchases for services, while The Wall Street Journal reported that some high-frequency data on spending at restaurants suggested that fears over the delta variant may be waning.
- The message from ISM is that supply chain issues have gone from a problem to a crisis. The top drivers behind jump in the ISM index to 61.1 were longer wait times for supplier deliveries and sharply higher prices paid. On the upside, hiring moved back into expansion.

Pressure Gauge

Indicator		Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21
Time	ISM Manufacturing Supplier Deliveries	57.3	65.0	76.0	68.0	56.9	55.8	58.2	59.0	60.5	61.7	67.7	68.2	72.0	76.6	75.0	78.8	75.1	72.5	69.5	73.4
	ISM Services Supplier Deliveries	52.4	62.1	78.3	67.0	57.5	55.2	60.5	54.9	56.2	57.0	62.8	57.8	60.8	61.0	66.1	70.4	68.5	72.0	69.6	
	Ships at Anchor-LA & Long Beach (Mo. Avg.)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	2.0	1.5	[illegible]	[illegible]	22.2	32.1	[illegible]	[illegible]	21.5	[illegible]	[illegible]	21.4	33.4	41.0
Volume	Taiwan Electronic Product Exports (YoY)	[illegible]	[illegible]	[illegible]	13.2%	[illegible]	15.3%	19.1%	[illegible]	[illegible]	[illegible]	22.2%	47.5%	14.4%	24.5%	[illegible]	[illegible]	[illegible]	[illegible]	21.9%	
	Cass Freight Index (YoY)	-7.5%	-9.2%	-22.7%	-23.6%	-17.8%	-13.1%	-7.6%	-1.8%	2.4%	2.7%	6.7%	8.6%	4.1%	10.0%	27.6%	35.3%	26.8%	15.6%	12.3%	
	Unfilled Orders (3-Mo. Ann.)	7.6%	3.7%	0.9%	-2.2%	-0.3%	2.8%	4.0%	5.1%	6.2%	7.4%	6.7%	8.4%	10.8%	14.7%	15.1%	15.3%	13.2%	13.5%	12.0%	
Price	World Container Index (WCI) (USD/40ft Box)	$1,633	$1,520	$1,500	$1,549	$1,788	$2,009	$2,144	$2,541	$2,592	$2,806	$3,955	$5,263	$5,227	$4,991	$4,919	$5,898	$7,052	$8,879	$9,556	$10,237
	WCI: Shanghai-Los Angeles (USD/40ft Box)	$1,525	$1,433	$1,615	$1,718	$2,343	$2,923	$3,283	$3,934	$4,072	$4,047	$4,118	$4,186	$4,292	$4,234	$4,267	$5,453	$6,793	$9,797	$10,721	$12,020
	PPI Transp. & Ware. of Goods (3-Mo. Ann.)	0.3%	-1.9%	-7.6%	-12.2%	-8.8%	1.0%	9.0%	8.0%	6.5%	7.8%	10.2%	10.7%	13.0%	16.3%	16.5%	20.7%	16.0%	12.6%	6.5%	
	Dry Van Rate Per Mile (YoY of 4-Wk. Mov. Avg.)	-3.3%	-2.3%	4.1%	-3.6%	-4.5%	3.4%	20.2%	33.0%	41.3%	48.7%	48.1%	39.0%	36.5%	49.5%	51.4%	70.0%	69.2%	43.7%	28.6%	21.8%
Inventory	Inventory-to-Sales Ratio (All Businesses)	1.42	1.50	1.73	1.55	1.41	1.36	1.35	1.35	1.35	1.35	1.35	1.30	1.33	1.26	1.25	1.26	1.25	1.25		
	ISM Manufacturing Inventories Index	46.5	46.9	49.7	50.4	50.5	47	44.4	47.1	51.6	50.8	51	50.8	49.7	50.8	46.5	50.8	51.1	48.9	54.2	55.6
	ISM Manufacturing Consumer Inventories	41.8	43.4	48.8	46.2	44.6	41.6	38.1	37.9	36.7	36.3	37.9	33.1	32.5	29.9	28.4	28.0	30.8	25.0	30.2	31.7
	Inventory Too Low (Net % of Firms)	-3.5%	-1.5%	-6.6%	-4.5%	1.2%	1.3%	2.7%	4.8%	4.4%	4.9%	6.5%	5.3%	4.5%	2.5%	7.0%	8.0%	11.0%	12.0%	11.0%	
Labor	Production & Manuf. Posts (vs. Feb. 2020)	0.2%	1.3%	-30.0%	-31.6%	-23.7%	-13.8%	-6.1%	4.2%	12.9%	20.6%	27.4%	26.3%	38.2%	46.8%	63.5%	74.8%	76.7%	84.0%	78.0%	87.3%
	Loading & Stocking Posts (vs. Feb. 2020)	1.4%	-0.4%	-32.5%	-32.7%	-17.6%	-0.8%	4.6%	12.3%	28.2%	38.8%	39.0%	26.3%	38.9%	46.4%	61.7%	72.7%	76.6%	90.2%	72.0%	82.4%

- The supplier delivers measure how longer that factories have to wait for supplies. Ordinarily a modest wait is consistent with a fast-growing economy.
- It is neither healthy nor sustainable when the supplier deliveries component is the primary driver of the increase in ISM. It is not uncommon for this component to spike in a supply shortage. What makes this cycle unique is the sustained duration of this component remaining elevated. It says more about the supply chain crisis. As if to put a big exclamation point on this issue, eight out of ten respondents reflecting almost every industry type cited supply chain and sourcing problems.
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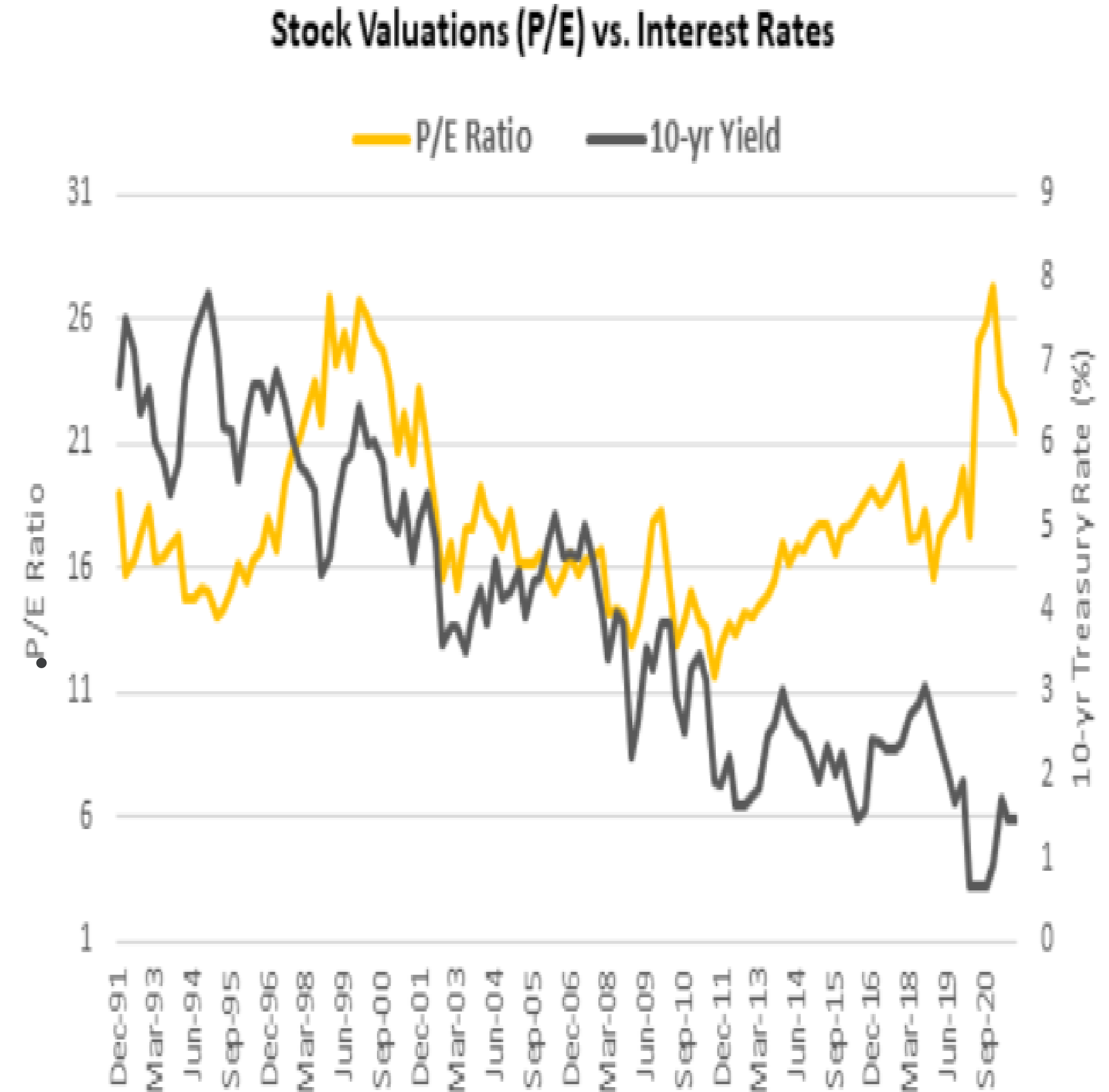
US Equities : Seasonal trends Reassert

- A Friday rally moderated the losses, but the large-cap benchmarks and Nasdaq Composite index recorded their biggest weekly drops since February and rounded out the worst monthly declines since the onset of the pandemic weighed down by persistent concerns over the debt ceiling, the ultimate impact of intensifying global supply-chain disruptions on inflation, along with increased expectations that the Fed is moving closer to tightening policy
- Following a choppy September, October is kicking off and has been historically volatile for stock market performance, but has typically set the stage for a strong seasonally Q4 period.
- Despite relatively little volatility at the index level, shifts at the sector level have been swift and frequent.
- The constant leadership reversals between growth-oriented sectors like Information Technology and Communication Services and value-oriented sectors like Energy and Financials have contributed to weakness.
- The fiscal policy environment appeared unsettling.
- The possibility that the federal government would experience another partial shutdown was averted late in the last week when the Senate and the House of Representatives passed a short-term spending bill.

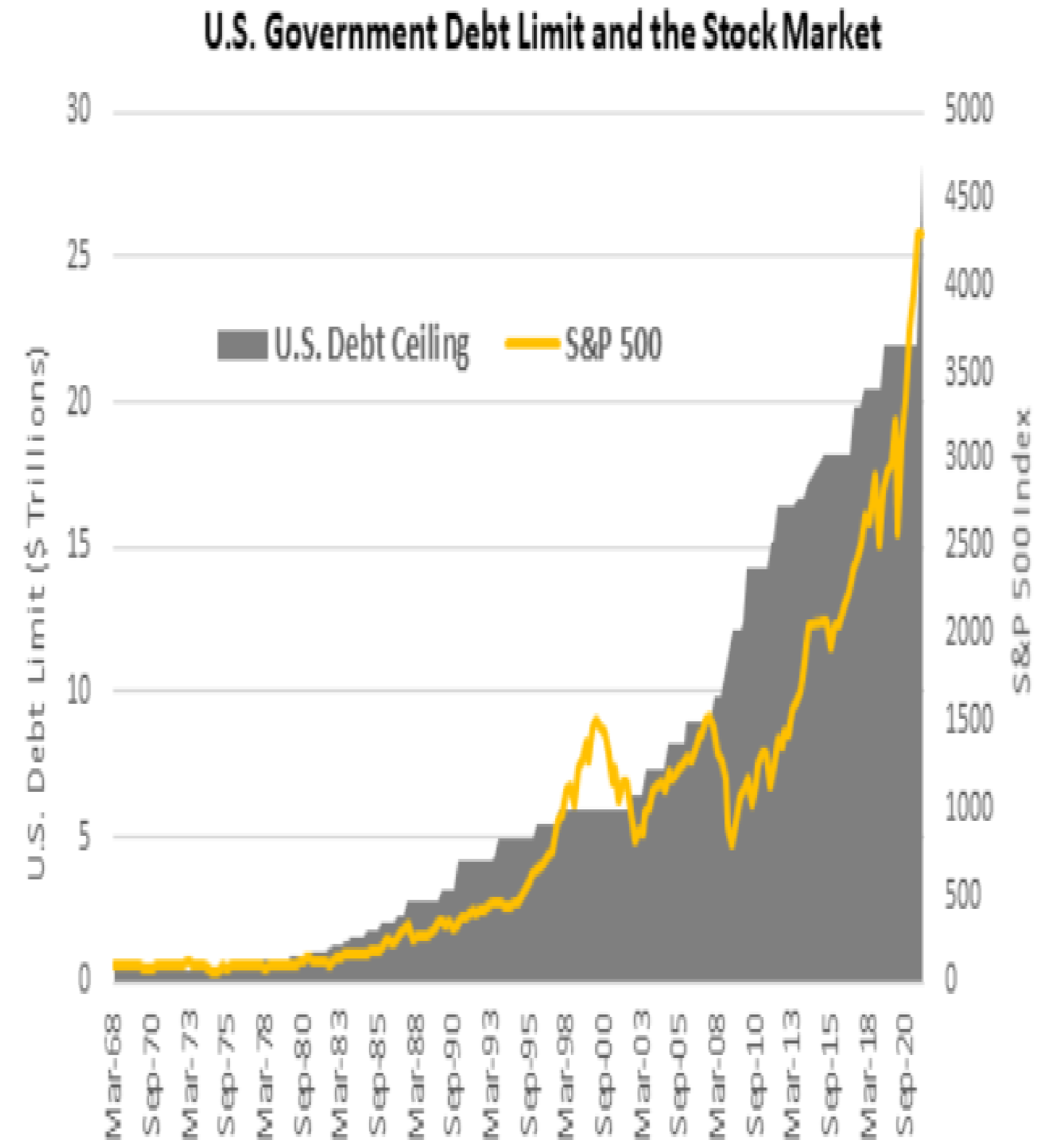
US Equities : Its all about Earnings

- There is not much of room for valuations to rise meaningfully from here, which means upcoming equity-market returns will more closely approximate earnings growth and dividend yields.
- With the outlook for earnings growth remaining relatively stable next year, there is a higher probability of positive but more moderate equity-market returns in this bull market.
- Rates will eventually rise to a level that would be more challenging to above-average equity-market valuations.
- Low rates reduce the rate at which future profits are discounted, often supporting higher valuation levels (the price-to-earnings ratio).
- The P/E ratio, while off its highs, remains above the long-term average.
- As rates rise over time, the valuation ratio is likely to trend lower.
- This doesn’t mean the market has to fall, but it raises the importance of earnings growth as a driver of stock-market returns.



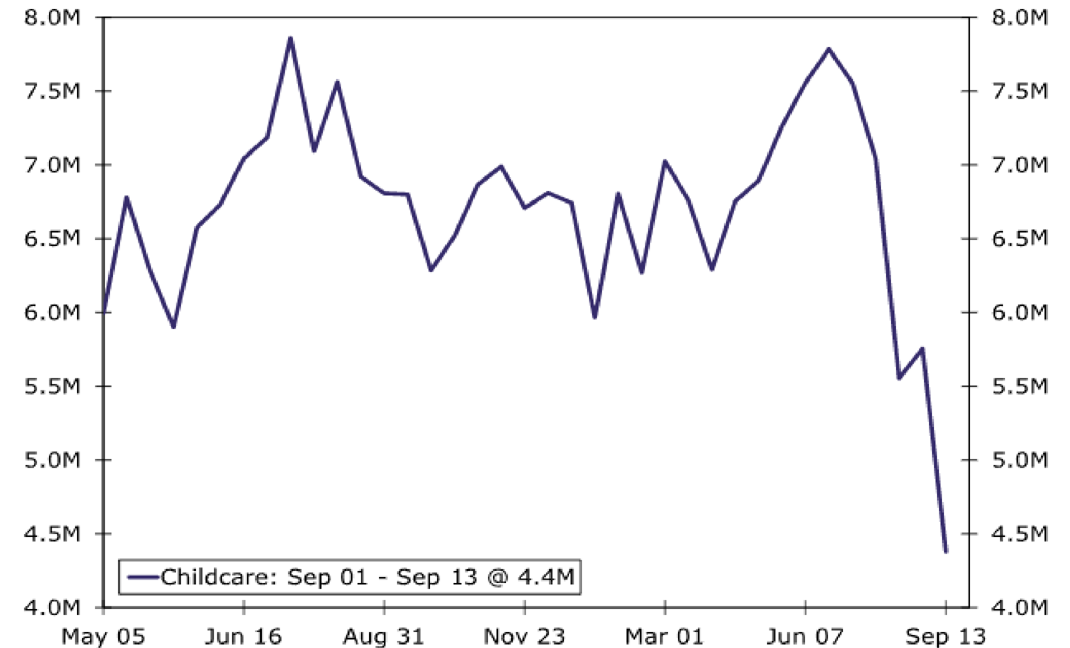
Debt Ceiling : Its all about Politics

- The debt ceiling is a legislative policy that limits the amount of national debt that can be accumulated by the US Treasury. In other words, it is a limit on how much the federal government may borrow to meet its financial commitments.
- Before 1917, the debt ceiling did not exist, but after World War I Congress implemented the debt ceiling following the Second Liberty Bond Act of 1917. This allowed the Treasury to accumulate debt and issue bonds as long as it was below the debt ceiling.
- In subsequent years, the debt ceiling was raised from $125 billion in 1942 to $300 billion in 1945, which was later reduced very slightly to $275 billion in 1946.
- The policy has seen many shifts in the past decade shifting 74 times from 1962 to 2011 and even more since then to today in 2021.
- Both sides of the aisle know the debt limit must be raised, but neither side wants to bear the burden of being seen as championing more federal debt – which already exceeds $28 trillion.
- Yellen warned again that the limit needed to be suspended or raised by October 18 in order for the Treasury to meet its obligations.
- Republicans continue to insist that Democrats raise the ceiling on their own as the debt incurred for social programs comes directly from the basis of their 2022 midterm election strategy.
- The debt ceiling will be increased, but likely at the last minute, as the cost of not doing so would be far grave. This doesn’t mean, however, that the political drama and brinkmanship between now and then won't rattle the market's cage.



Payroll - Certain of strong bounce

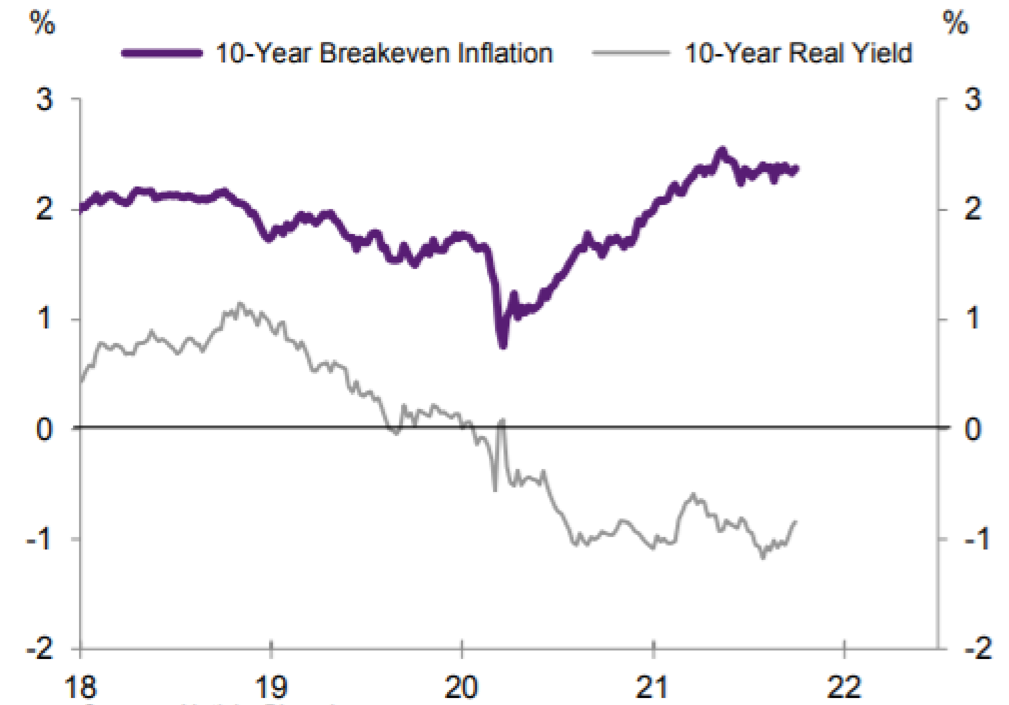
- The broad expectation is that September payroll growth might rebound to 650K after August's underwhelming gain.
- But the impact from schools reopening and the end of emergency unemployment programs will play out over many months, not just September.
- Job openings, hiring plans, and consumers' views of whether jobs are "plentiful" all rose to record highs over the past month. The timing of the survey week falls as late as it possibly could on the calendar, leaving employers and job-seekers more time to gain confidence in the improving health situation.
- Leisure & hospitality hiring also looks set for a boost. Dining reservations stabilized in September, and the likelihood of fewer layoffs than a usual September since the industry struggled to fill jobs all summer, suggest hiring in the industry, at least on a seasonally adjusted basis, should rebound strongly .
- Based on FOMC members' comments since the September meeting, there appears to be a very low bar for a tapering announcement in November.
- This week's jobs report will clear it, but the environment remains highly unusual, and it would not be the first time a payroll report has surprised this year.



- To the relief (and some angst, but mostly relief) of parents, Children across the country have returned to campus to start the school year.
- The return to full-time, in-person instruction reduces one constraint of getting workers back to the jobsite.
- The Census Bureau's latest Household Pulse survey showed the number of individuals not working due to child care plummeting to the lowest level since the pandemic by a wide margin

Are Bond markets too sanguine ?

- Despite the fears of history repeating, investors remained placid when the Fed hinted at tapering in July 2021. The Treasury yields remained placid declining from its recent peak in early April.
- One explanation for this difference in market responses is that the announcement in 2021 was in line with market expectations and the announcement in 2013 came earlier than expected.
- The bond market is still not worried about inflation despite the persistence of supply-chain disruptions, rising wages, and elevated energy costs.
- The key question is **Whether Taper talk amidst inflation will not drive Yields higher ?**
- More than half of the Fed's treasury purchases have been in the 5- to 10-year sector during which time the average maturity of treasury debt has been rising. Fed has purchased 57% of ALL marketable treasury issuance since the onset of the pandemic.
- Since February 2020, the Fed's holdings of mortgage-backed securities increased by $1.1 trillion. This effectively represents all new mortgage origination wrapped by the GSEs over the last 18 months. Housing is resultantly booming.
- Hence in case   Fed tapers, more duration will need to be absorbed by the private sector.
- All else being equal, Yields will trend higher.



- The rise in interest rates has been entirely due to rising real yields.
- They are less negative than they were one month ago. During this time, breakeven inflation has been steady.
- Since early September, the real rate has increased from -109 basis points to -84 bps, while breakeven inflation essentially has been flat, at 240 bps then compared to 237 bps now

German Election Results - Recalibration

- With the era of Angela Merkel drawing to an end, German politics has entered unchartered territory with a possible change in government.
- Preliminary results put the Social Democrats (SPD) as largest party in the Bundestag with 25.7% of the votes, giving its candidate Olaf Scholz the best chances to succeed Angela Merkel as chancellor.
- For the Conservatives (CDU/CSU), election night confirmed a bitter defeat with its worst ever election result of 24.1%, that could see the party returning to opposition for the first time in 16 years.
- In line with past experiences, the Green party underperformed on election night compared to polling, but with a vote share of 14.8%, still achieved its best ever result in federal elections, positioning the party as a kingmaker in upcoming coalition negotiations.
- Another election 'winner' (and possible kingmaker) in the coalition talks is the liberal FDP party, which increased its vote share to 11.5%.
- The Eurosceptic AfD party on the other hand could not capitalize on the weakness of the 'established' parties and gained less votes (10.3%) than in 2017.
- As a political untouchable its chances of affecting actual policy-making remain slim.

	CDU/CSU	SPD	Greens	Liberals	The Left	AfD
2021	24.1%	25.7%	14.8%	11.5%	4.9%	10.3%
Number of seats	196	206	118	92	39	83
2017	33.0%	20.5%	8.9%	10.7%	9.2%	12.6%

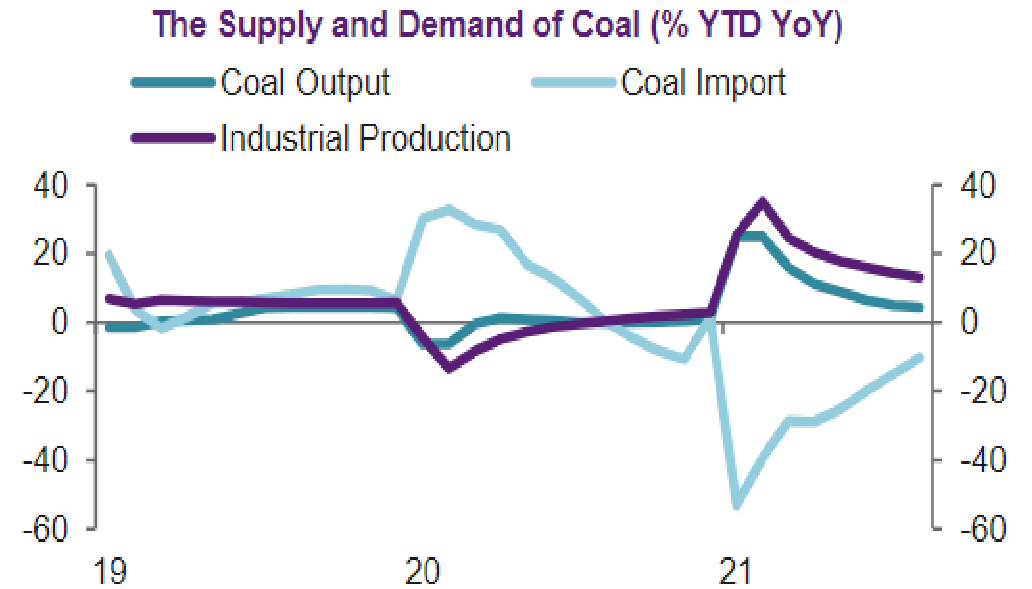
- A left-wing 'Red-red-green' coalition of the SPD, Greens and the Left, that held the biggest potential for a fiscal regime shift, failed to gain a majority, contributing to the muted market reaction.
- Difficult and lengthy coalition negotiations now lie ahead and we would be surprised to see a new German government in place before the end of the year (after the 2017 election it took 172 days).
- Whatever the outcome of the coalition talks, they are unlikely to result in dramatic policy changes.
- Fighting climate change and engineering the green transition will be the main priority of the next government

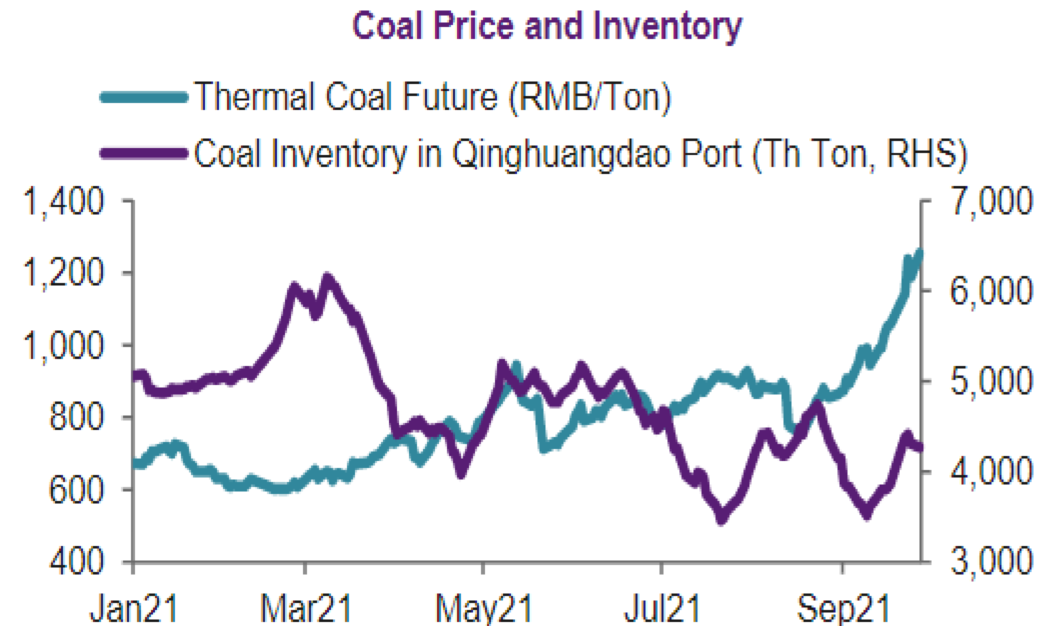
Gas runs out in Europe …

- Europe's energy crunch is continuing, as gas storage volumes have shrunk to 10-year lows.
- Front-month gas futures are now more than six times more expensive than at this point last year, as the region struggles to import enough gas to refill its depleted storage ahead of the winter peak heating season.
- A possible harsh winter could lead to severe energy shortages and shutdowns of large parts of the economy.
- Threats of an energy crisis are being discussed widely, but no real solutions except lower taxes are available.
- Due to higher energy costs, a possible record price level of $100 MMBtu or $250 per barrel of crude oil equivalent is very bad news for Netherlands, Germany, France, and UK.
- Even with the partial restart of the Groningen field, which could relieve some of the pain in Western Europe, there is a larger problem that must be addressed.
- It is now proved that Europe's gas supply diversification strategy has been a failure, not only due to EU tactics and regulations but also because of the ongoing one-sided emphasis on a rapid energy transition, hydrocarbon divestment, and full-scale investments in renewables, without realizing that the backbone of the European economic system is still hydrocarbon fueled.
- UK is suffering the most from the drop in wind power output, caused by mild weather. UK produced less than 1 GW of wind power on several days. This compares with a generation capacity of 24 GW,

Coal runs out in China..

- China is facing an unprecedented power crunch.
- There are three main reasons for this:
    - (i) local governments' rush to comply with their emissions targets,
    - (ii) the supply-demand gap in coal and
    - (iii) price caps on electricity, which leaves demand unaffected by the increasing input costs in the supply of electricity.
- China has dramatically reduced its coal consumption since 2017, cutting back the proportion used to generate electricity from more than 80% to 51.8% in 2019. However China is the world's largest importer of coal ahead of India
- Since the beginning of the year electricity production has increased by about 10%. It's just that the Chinese energy sector has run out of steam after running down stocks of coal apparently in the hope that either Beijing would lift all environmental restrictions that increase the cost of producing electricity with coal or that world prices would fall.
- While Beijing has eased some emissions targets, world prices have carried on soaring.





Bond market : Normalisation begins this week ?

- While the repo rate has not moved from its all-time low of 4.00% since May 2020, it is the massive amount of liquidity that has eased financial conditions. According to a report by ICICI Securities , the surplus liquidity has lowered the "true" policy rate down to as much as 0.2%. No doubt the equity markets have stayed strong.
- Terming this as the 'shadow policy rate’, they stated that the 380-basis-point difference between the shadow policy rate and the current repo rate was on account of the RBI's liquidity policies.
- As the real extent of accommodation is so large, the probability of an "accident" is high if normalisation is pursued without proper planning.
- Share of retail lending in total bank credit rose to 26.6% in June, up from 24.5% a year ago and 18.9% five years ago. This is a sharp increase considering overall bank credit growth was up just 5.8% on year and 5.1% higher from March
- The government will borrow Rs 5.03 lakh crore in the second half of the current fiscal.
- With RBI setting the cutoff at 3.99%–closer to the repo rate of 4%–markets took that as a signal that RBI may have hinted towards higher short-term rates
- G Sec yields continued trending upward as the probability is very high of RBI hiking its reverse repo rate earlier-than-expected, at its policy meeting this week,
- At a time when debt markets are already on the lookout for any signs of overt or covert monetary tightening, Cutoff yields at the auction today for the 91-, 182-, and 364-day Treasury-bills were set 11, 15, and 25 bps higher than those set at the previous auction on Sep 22. This was despite liquidity in the banking system continuing to be in huge surplus at around 7.4 trln rupees.
- The main reason for the rise in rates is that the RBI has substantially scaled up its variable rate reverse repo operations, over and above what it had announced in its monetary policy review on Aug 6. Initially, the central bank had said that it would double the liquidity absorption through 14-day variable rate reverse repo auctions to 4 trln rupees through fortnightly increases of 500 bln rupees.

Nifty : Negative bias

- With last week's price action, Nifty has snapped its recent winning streak . However , the scale of negative impact on Indian equity markets is nominal considering the weakness in the global equity markets
- Higher oil prices have sofar been ignored by the markets as equity markets expect macro impact to be limited as RBI would refrain from responding with any kneejerk reaction .
- However , the Markets will attempt to read between the lines of the RBI's monetary policy and examine as to whether RBI too refrains from using transitory language in keeping with FED .
- Indian markets are currently richly valued and therefore not immune from the negative headwinds including the global energy crisis which is engulfing both Europe and China
- In the context of abundant domestic liquidity , the markets remain euphoric
- Trading range to shift lower 17350 17650 and a break below 17350 to see 16666