SYFX Treasury Foundation

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- Weekly Market Update
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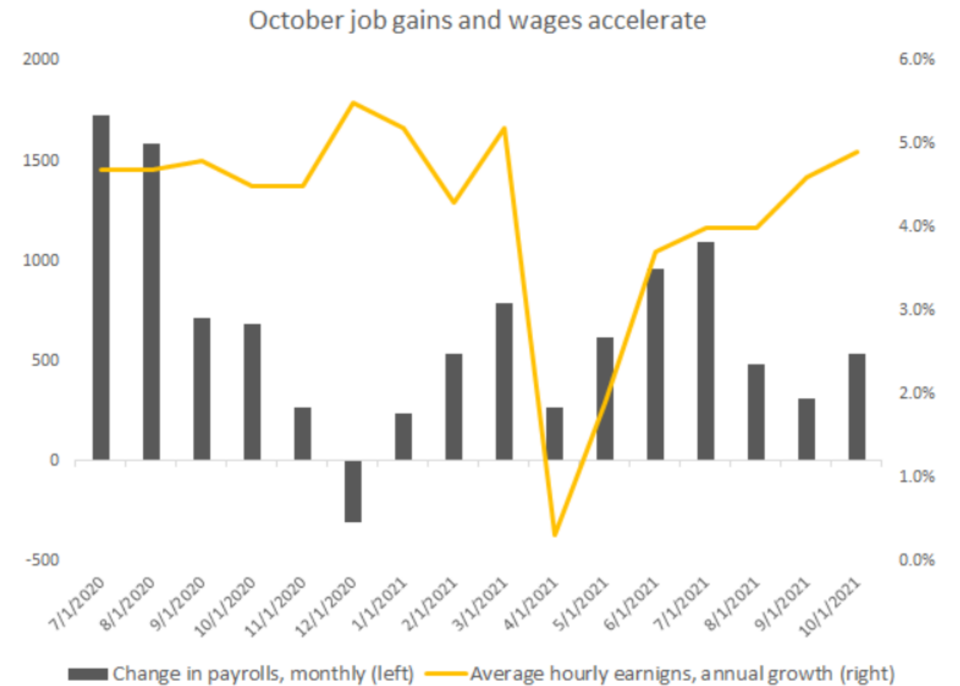
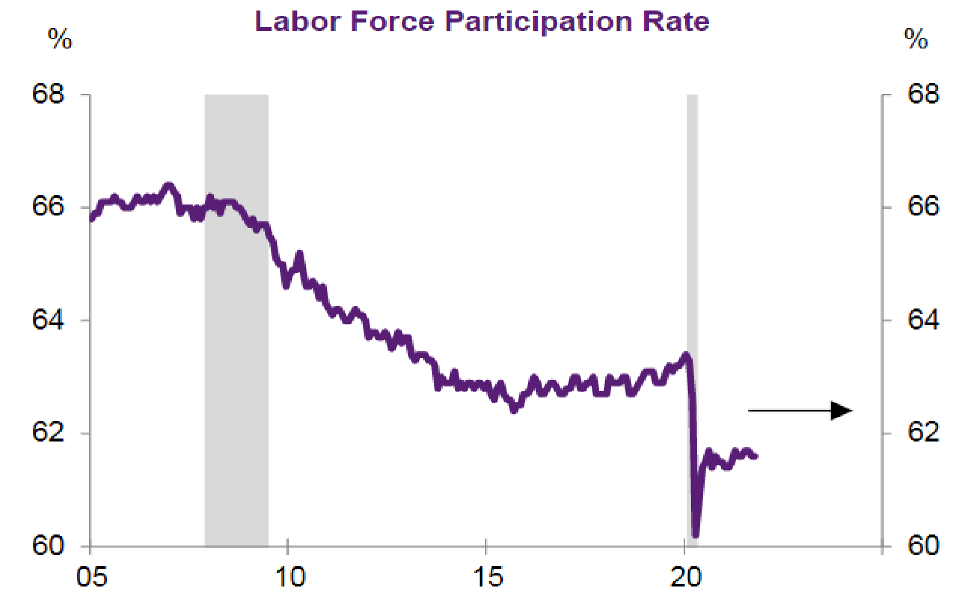
US : Higher inflation and Stronger growth

- Economic data last week was generally robust, showing that economy gained strength as the late-summer delta variant eased.
- ISM manufacturing index slipped to 60.8 in October, down from 61.1 in September. The largest gains over the month came from the index's price paid and supplier deliveries components. The prices paid index jumped 4.5 points to 85.7 as limited supply continues to send input prices higher. Supplier deliveries index rose 2.2 points to 75.6 as materials are taking longer to arrive.
- U.S. trade deficit widened to a record $80.9 billion, as exports fell 3% and imports gained 0.6%. The weakness in exports was broad based, while imports were broadly positive. Real imports are now 6% above their pre-pandemic level, on surging domestic demand for consumer goods
- ISM services index rose to 66.7 in October, its highest level on record. Strong consumer demand bolstered the index's new orders component more than six points over the month; however, supply delays and labor shortages have made delivering on those orders increasingly difficult.
- Mortgage Bankers Association's (MBA) third quarter report on commercial and multifamily loan originations showed the index grew a whopping 119% over this time last year. Consumer credit, released in the final hour of trading, showed consumer borrowing expanded by $29.9 billion during September, more than the $16.0 billion forecast, while August's figure was adjusted downward to an increase of $13.8 billion from the originally reported $14.4 billion.
- NFIB reported that 44% of small business owners reported raising compensation in October, a 48-year record high. Rising labor costs combined with persistent supply chain constraints are sending prices higher as firms try to pass the cost hikes on to consumers. Taken together, inflation is set to continue to run hot in the near term.

Employment – Upside surprise

- U.S. economy added 531,000 jobs in October, the most since July and the first upside surprise in three months.
- Aside from the strength in the headline number, details were also positive, with large upward revisions to payrolls for the prior two months and broad-based hiring. As the delta-variant wave of infections eased, job gains in leisure and hospitality accelerated. Another bright spot was the strength in manufacturing employment, with gains doubling from September.
- Average hourly earnings came in line with expectations, rising 4.9% from a year ago, the most since February. This tells us the labor market is operating above its long-term capacit Unless matched by a step-up in productivity, current wage/cost dynamics point to persistent price pressure
- Despite the more-than-robust pace of wage growth, prime-working-age Americans have been slow to return to the job market.
- Labour force participation remained unchanged at 61.6% in October. It has shown no improvement for 14-months.
- Labour supply is flagging against the backdrop of surging wages.





Tapering is not tightening..

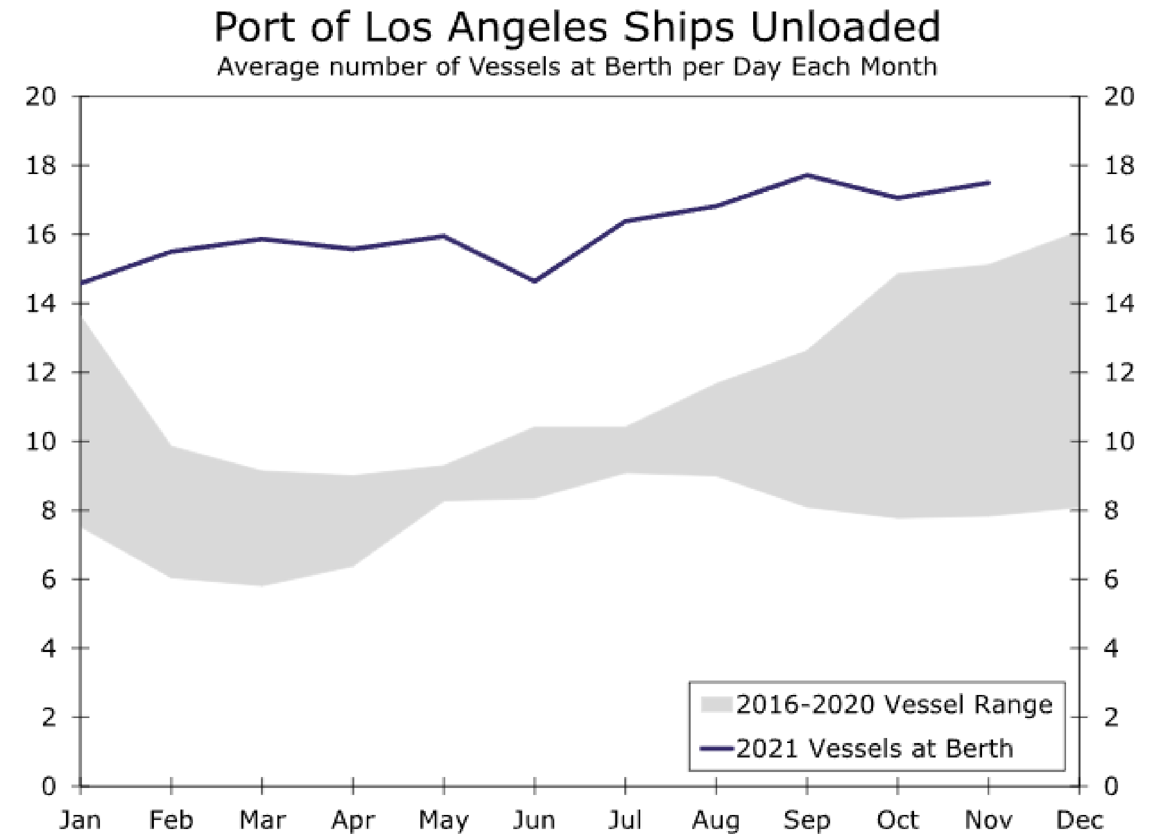
- After logging seven new highs over the last seven trading sessions and the most record highs in a year since 2013, the S&P 500 is on track to finish 2021 strong.
- Favorable seasonality might be another reason why the positive momentum could carry through to the end of the year. Historically, the two-month stretch between November and December has been rewarding for investors, with above-average equity-market gains and the highest chances of positive returns.
- November started off on solid footing, with equity markets logging their best weekly return in more than four months. Between a patient Fed, accelerating jobs gains, strong corporate earnings, and a promising COVID-19 pill that reduced hospitalizations and deaths in a clinical trial, there were plenty of reasons for the market to rally.
- Tapering is not tightening, as Fed will continue to inject stimulus over the next eight months, just at a slower pace. The last Fed tapering in 2013 had little impact on equity markets. While volatility increased as former Chair Bernanke hinted at a step-down in asset purchases, equities performed well during the 10 months of tapering.
- Economy is in a much better place compared with when these measures were initiated, and corporate earnings are growing at a fast pace. Also, according to the St. Louis Fed Financial Stress Index, financial conditions are near the loosest they have been over the past 30 years, which highlights that the stimulus has served its purpose and is no longer needed
- Last time in 2013 ,Bond yields rose sharply in anticipation of the tapering but actually declined while the Fed was reducing its stimulus. Rates will be shaped by economic growth and inflation rather than Fed tapering.

..Its just Tip toeing…

- In line with the consensus, Fed announced it would reduce the monthly QE buying pace by USD15bn per month starting from mid-November.
- This means that QE shall be concluded in June. Fed introduced some flexibility by saying the tapering pace could be adjusted if needed.
- Powell linked future rate hikes to labour market outcomes. The level of payrolls will not regain its pre-pandemic peak until the end of 2022.
- However, FOMC could pull forward its pace of tightening if payrolls recover more quickly than currently forecast and/or inflation remains stubbornly high.
- Fed sounded less certain about the inflation outlook now stating that "Inflation is elevated, largely reflecting factors that are <u>expected to be transitory"</u> where the underlined words are new.
- Fed put more words on its view that higher price pressure is caused by imbalances between demand and supply and that easing of supply constraints will lead to lower inflation down the road
- Markets have fully priced in a 25 bp rate hike by late summer or early autumn 2022.
- FOMC will probably wait until 2023 to tighten policy, at which point it might hike rates by 75 bps over the course of that year.

Supply chain disruptions –Persistent

- The global supply chain is severely out of whack. This isn’t new, but indications of wait times are lengthening and the knock-on effects across the entire supply chain continue to be extreme.
- There were a reported 70 ships waiting to unload their cargo outside the San Pedro Bay Ports of Los Angeles and Long Beach Thursday. While lower than the record 79 reported two weeks ago, this is still a previously unimaginable amount of backlog.
- Prior to the pandemic, it was rare for even one ship to be anchored off the coast awaiting space. Furthermore, holdups show no signs of slowing. Shipping data indicates that more ships are on the way to busiest ports in US .
- Once unloaded, containers are also waiting longer for transport to their final destination. What is known in the industry as container "dwell time" has surged, further constraining capacity at ports, since subsequent ships cannot unload until container space is freed up.
- The San Pedro Bay ports took action this week by imposing surcharges on ocean carriers for dwell times exceeding nine days for containers scheduled for truck pickups and six days for those set to be moved by rail. Pre-COVID, containers sat at terminals for under four days for truck pickups and under two days if set for rail delivery.



- The average wait time for ships trying to enter the port of Los Angeles exceeded 14 days last week.
- It takes an equivalent amount of time to cross the Pacific Ocean, so awaiting port space has doubled the total delivery time for some ships.
- This not only delays the current delivery but has implications for the next one as well.

Global PMI :Supply chain issues

- For the first time since May 2021, the global manufacturing PMI showed an improvement – driven by EMs – albeit a marginal one, rising to 54.3 (from 54.1 in September).
- A significant summation of challenges occurring in October was depicted as:
- *"The impact of supply chain issues filtered through to price inflation during October. Input costs increased at the fastest pace in over 13 years, while average output charges rose to the greatest extent on record."*
- Meanwhile, the global subindex for delivery times dropped by 1.7 point to a record low of 34.8 (indicating longer delivery times), with delivery times particularly long in DMs (aggregate DM index 24.3). Key sub-indices like output, future output, new orders and exports all came down compared to last month, particularly for DMs.
- This highlights the longer than expected persistence of supply side bottlenecks . These are currently forming the key headwind for global manufacturing, while also posing upward inflation risks.
- The global PMI subindices for input and output prices rose to record highs in October, driven by a renewed surge in commodity prices.

- Expansion of global wide manufacturing production was the weakest in the past 16-month period.
- Growth has been stymied by ongoing substantial disruptions in raw material flows, rising cost inflation and a near stalling of international trade flows.
- Of the 31 nations which comprised October's data, all but two, Mexico and Myanmar, registered readings above the 50 no-change mark .

BoE- Unreliable Boy friend

- Bank of England sent shock waves last week by pushing back on market expectations and not raising rates.
- Leading up to this week, Governor Bailey suggested a hike was all but guaranteed as he expressed concern over the pace of U.K. inflation and suggested the central bank “may have to act soon”.
- Such strong comments led market participants to significantly bring forward expectations for when the BoE would begin normalizing monetary policy.
- A 15 bp rate hike was priced for this week, while close to 100 bps of additional tightening was priced over the course of the next 12 months.
- However, MPC voted 7-2 to keep monetary policy settings unchanged. Interest rates were left at 0.10%, while the current asset purchase program was left unchanged, with the central bank maintaining its purchase target at £875B.
- Markets were caught off guard by the decision to not lift interest rates. Confusion also came from the fact Governor Bailey himself did not vote to raise interest rates, leading media outlets and market participants wondering if the "unreliable boyfriend" was back. The phrase "unreliable boyfriend" refers to former BoE Governor Mark Carney, who had a penchant for confusing financial markets about the direction of monetary policy
- Even though market expectations for a rate hike have been moved back and scaled down, financial markets are priced for too much tightening at the Bank of England, and expect the pound to continue to weaken going forward

USD set to stay strong

- The surprise decision of the Bank of England last week to not lift rates and to stay on a dovish course is a reminder that central banks still dictate monetary policy, even if financial markets believe otherwise.
- Having been late in identifying persistent drivers of inflation, central banks in developed countries are—as a group—now figuring out how best to play catch-up – without impacting the markets .
- If the ECB's dovish communication proved insufficient to ease tightening expectations, decision by the BoE not to hike rates definitely helped to cast some doubt about hawkish bets on other central banks – including on the ECB itself.
- There's a good chance this week's decisions by Fed and BoE may in the future be used as a compare-and-contrast case study in how, and how not, to communicate monetary policy decisions.
- Both essentially had the same difficult decision to make: whether or not to try to curb inflation (which is looking ever less transitory by the day) without stymying an incipient economic recovery (that is looking ever more lacklustre by the day). They also had to strike this balance without spooking the markets and certainly without giving the impression that they were swayed by political considerations.
- On that basis, the Fed passed the test and the Bank failed.
- With a Fed that has just fired the starting gun on its normalisation process, momentum on the monetary policy divergence story seems to be swinging back towards the US side, which is putting a quite solid floor under the dollar.

Eurozone : Rising Inflation & Weakening Growth

- The growth outlook for Q4 is clouded, with business surveys still pointing to a marked slowdown in momentum, as the tailwind from pent-up services demand fades.
- Additionally, European consumers have to grapple with increasing real disposable income losses amid surging energy prices as winter approaches
- The supply chain troubles continue to rattle the manufacturing sector, with car manufacturers especially producing much less than they want to. On top of that, high energy prices are sapping consumption, even though the strong labour market remains supportive.
- Industrial production took another hit in September, dropping by 1.1% month-on-month, from -3.5% MoM in August. German industry is suffering from ongoing supply chain frictions and has become a drag on the economy for two consecutive quarter
- With the Chinese economy slowing rapidly and supply chain problems persisting at least until H1 22, a near-term manufacturing rebound is less likely. However on the positive side , Order book positions were close to historic highs in October, while hiring intentions remain very strong and consumers' perceptions of the labour market are increasingly buoyant. All of this means that even if growth turns out to be a bit weaker in the coming months – some catch-up seems likely in the course of 2022
- Although the pandemic is not something being discussed now in the markets , there is a cause for concern, New cases have skyrocketed to record-high levels in Germany –cases are also rising in Netherlands, Ireland, Beligum, Austria and in many parts of Eastern Europe. Looking at the Nordics, new cases are also climbing. New cases are also still high in the UK.
- The bar for new lockdowns is higher this year due to the vaccine rollout but countries with low vaccine uptake may be forced to implement tougher measures like Latvia and Russia. In Germany, some are even arguing for new lockdowns.

Impact of Gas crisis on Europe

- One of the most tangible risks for the European economy right now is the surge in energy costs.
- Natural gas prices have risen sharply over the last couple of months, breaking out of their historical price range.
- High gas prices reflect a variety of underlying causes, some of which will exert a lasting upward push.
- The markets expect prices to stay around the €70 level throughout the winter
- The "gas bill" could rise from a historical €100 billion per year to around €200 billion (around 1% of euro area GDP). Thus, all else equal, and abstracting from second round effects, the income loss will amount to 1% of GDP.
- Higher gas prices will directly hit household income but will also affect industrial output.
- Unlike the oil price, the price for natural gas has been range bound in the past. This makes it difficult to draw any firm conclusions regarding the growth effect of the current surge in the prices.
- It is, for example, conceivable that there are nonlinearities in the response of the economy to the current level of gas prices.
- News reports regarding closures of companies for which natural gas is an important intermediate input (such as fertilizer producers) point to the existence of such non-linearities in certain segments of the economy.

EZ Gas crisis : Key emerging risk

- For a few weeks a full-out political, economic and possibly security crisis has been building up between Algeria and Morocco, mainly caused by the still continuing Western Sahara-Mauritania conflict.
- Algeria has been using the Gaz-Maghreb-Europe pipeline (GME) for the past 25 years to deliver natural gas to Spain and Portugal via Morocco.
- Morocco, in turn, has been receiving about 10% of its gas supply as compensation. However, the contract ended without renewal in late October this year. Algiers decided to close down the conduit.
- Due to the closure, the overall impact on Spain could be significant. Natural gas is not only used for heating or industry use, but also for combined cycle power plants, which are generating around 30-33% of total electricity consumed.
- Even though Spain has been known as a major renewable energy proponent, mainly wind and solar, the country still relies on natural gas for almost 50% of its energy needs
- Spain has been left scrambling for whatever gas supply it can get hold of. Increasing LNG imports is the first option that comes to mind, but buying spot cargoes on the market isn’t going to be easy.

Nifty : Weaker Bias

- Since it was a truncated week , the markets remained rangebound within predefined 300 points., although inherent weakness is perceptible
- It is in keeping with the broader seasonal trend that market does not sell off in the festive backdrop and corrective moves lower happen after the festivities .
- However, the index continues to trade under pressure and is likely to do so as long as it remains below 18000, which is the immediate resistance level. A break below 17630 may trigger a retest of the crucial support level placed at 17450.
- Auto numbers did disappoint on a YoY basis with PV being the hardest hit given the ongoing chip crisis followed by two-wheelers witnessing a double-digit decline.
- Weekly range between 17450 17950 to prevail.

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