SYFX Treasury Foundation

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- Weekly Market Update
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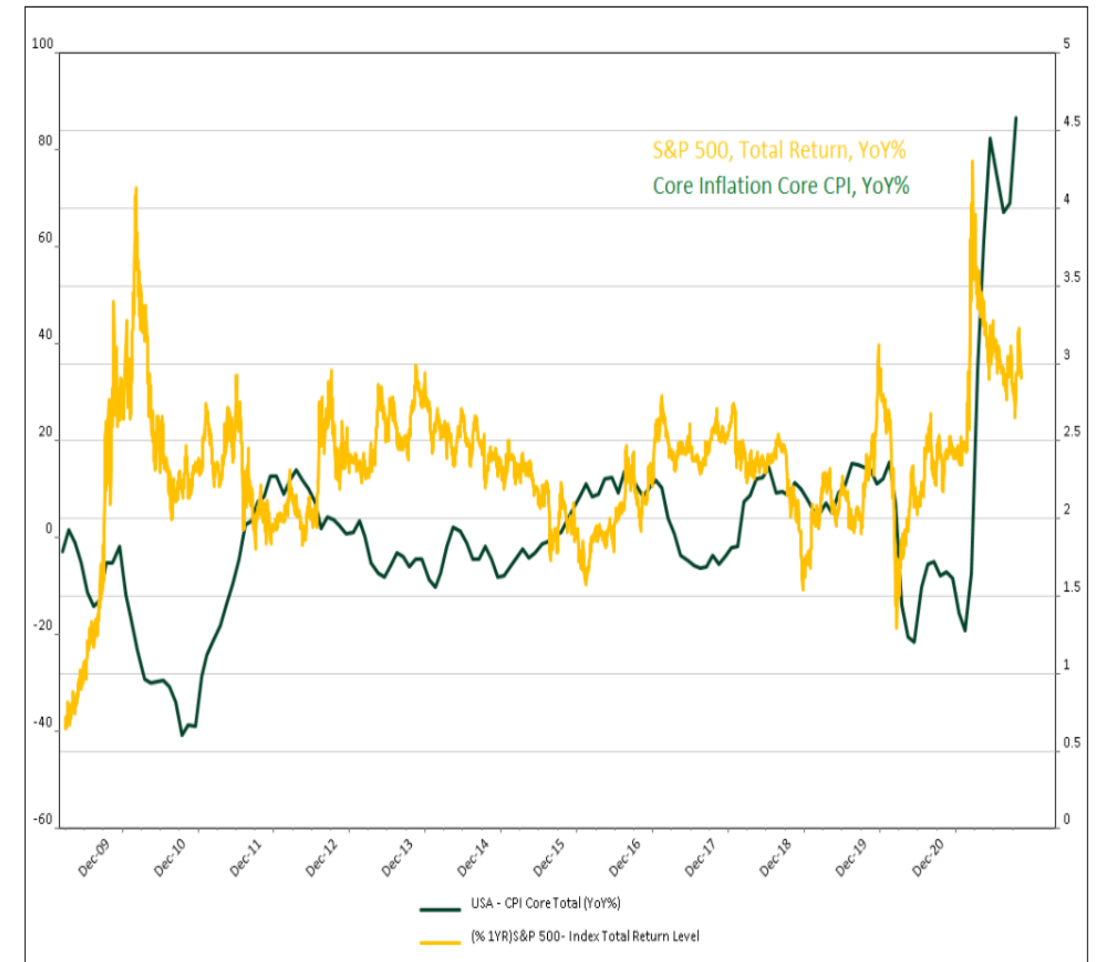
US Economy : Mixed Picture

- NY Fed's Center for Microeconomic Data reported that total household debt reached $15.2T rising 1.9% during Q3.
- Over the third quarter, $17B in credit card debt, $28B in auto debt, $14B in student debt, $230B in mortgage debt and $2B in other debt were added to household balance sheets, while home equity line of credit (HELOC) debt fell $5B. The good news is while debt has risen, it is not littered with growing delinquencies and defaults.
- The November preliminary University of Michigan Consumer Sentiment Index declined to 66.8 from October's 71.7 reading. The index hit a ten-year low as both the current conditions and the expectations portions of the index deteriorated. Consumers are also beginning to abandon the belief that prices are coming down anytime soon. Consumers now expect prices to rise 4.9% over the next year, which marks the highest in 13 years.
- As labour shortage remains a drag on business sentiment, the Labour Department's Job Openings and Labour Turnover Survey (JOLTS), a measure of unmet demand for labour, showed a retreat to 10.44 million jobs available to be filled in September, from August's upwardly-revised 10.63 million.

US Equities : Inflationary impetus

- Stretched sentiment (in either direction) itself isn't a strong enough reason to suggest equities are due for an imminent reversal. Also, it has been partly offset by the recent improvement in the market's breadth (that is, the number of stocks whose prices are rising versus the number whose prices are falling).
- Q3 earnings season : Of the 460 S&P 500 companies that have reported thus far, roughly 68% have topped revenue forecasts and nearly 81% have bested profit projections. Compared to last year, sales growth has been approximately 19% higher and earnings are up about 42%.
- The week was also notable for IPO of electric vehicle maker Rivian—the largest for a U.S. company since Facebook's in 2012.
- The headlining story on the equity front was the announcement from Dow member Johnson & Johnson that it will split its consumer health business into a separate publicly-traded company.



One of the best hedges to inflationary pressures in a non reactive monetary response is to invest in equities, which tend to outpace the rate of inflation over time

What to expect this week

- This week's key release will be the US retail sales which has continued to surprise on the upside in recent months.
- Elevated US goods consumption remains an important driver behind the global supply chain pressures and Tuesday's figures will reveal whether goods spending has started to weaken in October on the back of high inflation.
- A range of Fed speakers will also be keenly watched by the market for monetary policy hints.
- In the Euro area, final HICP figures will reveal more details about the trend in underlying inflation pressures, after core inflation surged to the highest level since 2002 in October.
- Given the Bank of England's renewed focus on labour market outcomes to determine the hiking cycle, the UK jobs report on Tuesday (as well as the CPI figures on Wednesday) will also be of interest.
- In Japan, new PM Kishida will reveal a new stimulus package to kick-start the recovery.
- Biden and Xi Jinping are scheduled to hold a virtual summit this week. In China, retail sales and industrial production figures for October to be on the soft side, given disruptions from power shortages and another Covid-19 wave.

Wild card : Inflation

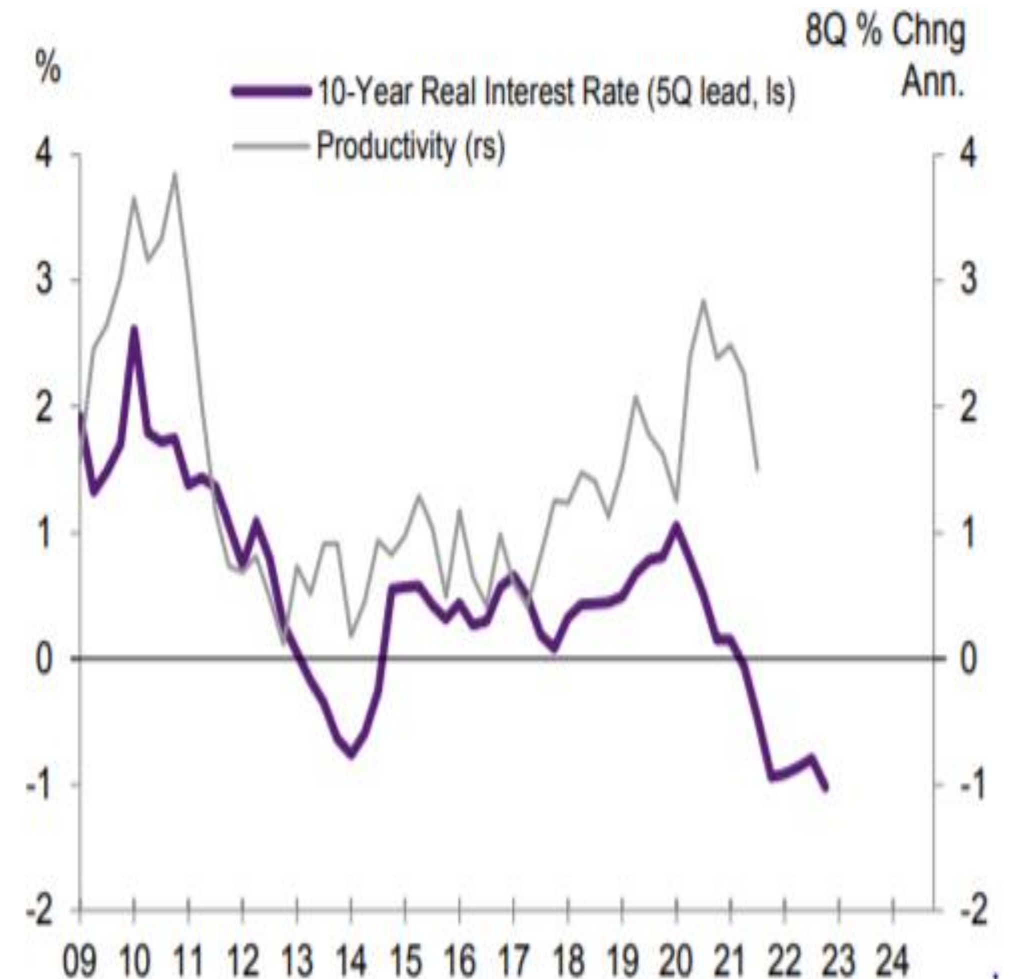
- Inflation remains the central focus of policymakers and markets . Price pressures have continued to broaden out as the economy has matured since its reopening. So far, the main financial impact of the higher inflation over the past months has been in the bond market
- Last week, there have been firm signals that inflation in U.S. remains hot, with both the producer price index and consumer price index coming in above expectations, now at multidecade highs.
- The headline CPI reading came in at 6.2% year-over-year, the highest level since 1990, while the PPI reading was 8.6%, the highest on record since 2010. Inflation has remained elevated – with core CPI above 2.0% -- for nearly eight months now, since April of 2021.
- 10 years prior to the pandemic, average CPI was 1.6% and average core CPI was 1.8%, well below latest CPI of 6.2% and core reading of 4.6%.
- The combination of strong demand and soft supply, caused by supply-chain bottlenecks, slow global reopening and labor shortages, and commodity-price inflation, have created imbalances, pushing up prices. Wage growth is increasing, most likely reflecting shortage of labour (not least within "leisure and hospitality" where wage growth is above 11% y/y).
- For the Fed, elevated inflation is worrisome because it could mean they are "behind the curve" in battling inflation and therefore need to raise rates.
- Markets are now pricing in two rate hikes next year, and, after this week's inflation readings, some are even expecting three.
- But Bond markets have not yet shown any distress and price action across the US treasury curve has been relatively tame despite the hardening inflation

Lower yields on New Fed Chair ?

- In a move to appease the progressive wing of Democrats ,Biden is very likely to nominate Lael Brainard to succeed Jerome Powell as Fed chair .Not only is Brainard a "diversity hire", she is also an uber-dove when it comes to monetary policy and a closet proponent of Modern Monetary Theory**. She would be inclined to keep rates "lower for longer."**
- However, monetary policy decisions by Fed are not made solely at the discretion of the Chair. Rather decision are made collectively by the 18 members of FOMC. The Fed Chair is just one voice, albeit an important one, on that committee.
- Moreover, we think there is very little daylight between Powell and Brainard in terms of monetary policy views. In her seven years as a Fed Governor, Brainard has never dissented on a monetary policy decision by the FOMC. It is in the realm of regulatory policy where there is some difference between Brainard and PowelL
- Biden and his Democrats know they need all the easy money they can get in order to fund their multi-trillion-dollar spending programs and Powell, as an old-line Republican-nominated Fed chair, is unlikely to give it to them. Therefore, the plans to remake the Fed have been put into place. There have been leaks and subsequent reporting of the insider trading by Fed governors Kaplan and Rosengren with many of the same issues plaguing vice chairman Clarida and even Powell himself. These revelations have led to an unprecedented stream of resignations and early retirements, the most recent being Monday's announcement from Randal Quarles
- **THIS** is what the bond market has sniffed out and **THIS** is why yields are plunging and gold is soaring. The "Fed Put" will soon be back as debt monetization is taken to a whole new level With Brainard leading a "remade" Fed, you're about to see a multi-year surge in nearly everything

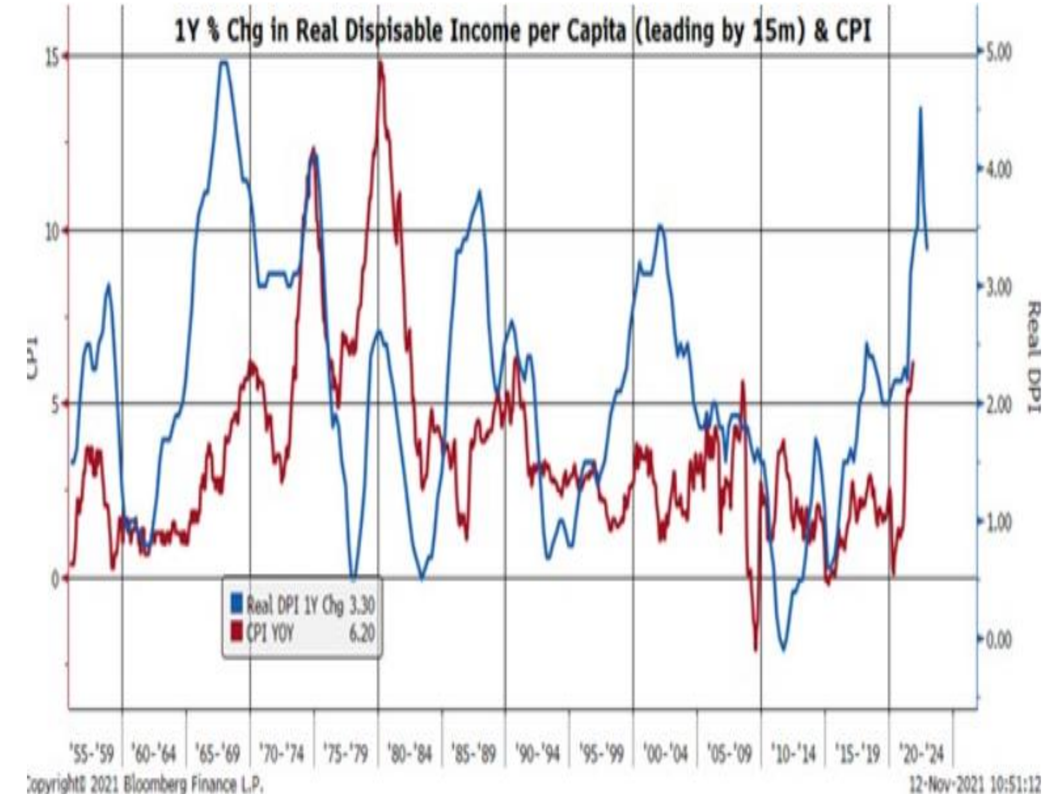
Lower yields on Lower Growth ?

- The nominal yield can be broken down into two parts: an inflation expectations subcomponent and a real interest rates subcomponent. At present, most of the rise in the former is being offset by a decline in the latter.
- In other words, a falling real rate is dampening the impact of rising inflation expectations. In turn, nominal interest rates are not rising as quickly as the breakeven subcomponent alone might suggest.
- Does this make sense? Only if US growth is structurally weak over the next decade.
- This is evident in the **comparison between the real interest rate and the productivity growth – the building block of real GDP.**
- The bond market is factoring that real GDP growth will slow sharply next year, and that underlying trend activity is likely to expand by less than 2% afterwards.
- Essentially, it is the same thing the bond market was discounting in Q3 2020.
- This stagnation thesis proved incorrect as the economy experienced a V-shaped recovery and a record fall in the unemployment rate.
- It is difficult to believe the economy's longer-term prospects are as dim as what the markets expect, notwithstanding the current inflation situation



Real disposable income and CPI

- Fed may be underestimating the potential for inflation to persist at above-target levels. High prices from supply chain issues are taking longer than expected to resolve, while demand could remain firm as wages rise amid a tight labor market and still-expansive fiscal policy. Moreover, some of the longer-term factors that have contributed to keeping inflation low—such as the expansion of the global workforce and trade —may be abating.
- Compare the 1-year percent change in real disposable income to CPI, CPI lags changes in disposable Income by about 15 months, or 5 quarters.
- The good news (for inflation) is that disposable income stopped accelerating in March of 2021. The bad news is that this implies inflation will remain stubbornly hot through the first half of next year
- The supply shock that is underway adds complexity and supports the “inflation for longer” story. Nevertheless, the 15 month lag between changes in disposable income and inflation may prove accurate.
- A comparison with an inflation spiral due in part to supply shortages (the 1965-1982 period) there is a fairly consistent lag of 15 months. The only problem was that each cyclical peak in inflation also coincided with a recession.



Germany : Weak Growth

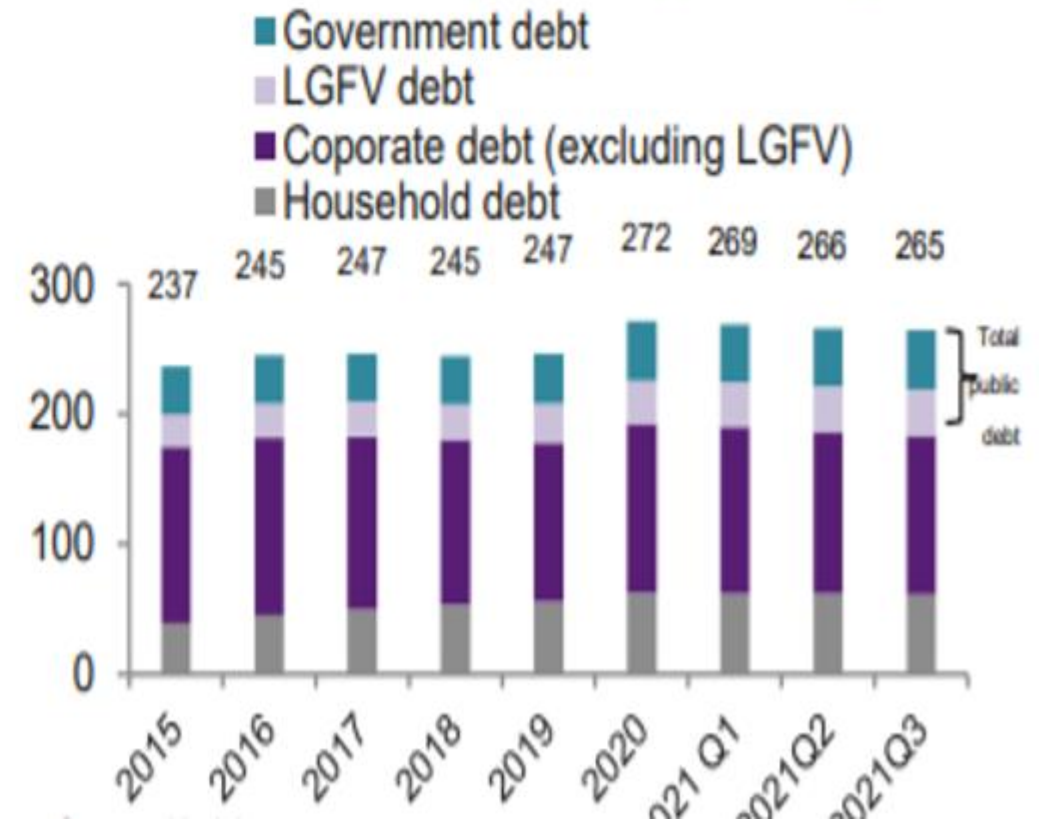
- Gap between German orders and production at unprecedented levels - A number of key data for Germany's industrial sector was published late last week. They showed that the gap between growth in orders, on the one hand, and production in the manufacturing sector, on the other, widened even further in September.
- The volume of new orders received by the manufacturing industry increased by 1.3% mom in September, whereas manufacturing output fell by 1.5% mom. As a result of different trends in orders and productions since around the middle of 2020, the gap between the level of manufacturing orders and the level of manufacturing production has risen to unprecedented highs
- Production in Germany is hindered by a serious lack of materials and intermediate goods and that this problem is worse than in the eurozone on aggregate. When looking at the factors that are limiting production, 86% of all respondents in Germany mentioned a shortage of material and/or equipment, which is well above the eurozone total of 53%. This is sharp contrast to the decline in manufacturing output during the aftermath of the Global Financial Crisis, when the majority of manufacturers reported a lack of demand as the factor that was limiting production.
- .As the manufacturing sector makes up about a quarter of Germany's GDP, the contraction in manufacturing output has reduced GDP growth in Germany by around 1.5 percentage points since the start of this year.
- This is an important factor behind the growth differential between Germany and the eurozone as a whole, with Germany's GDP expanding by 1.8% in total during 2021Q1-Q3, versus 4% for the Eurozone.

China : Mixed Picture as well

- A string of Chinese data released during the last week continued to paint a mixed picture.
- On the back of booming (US) goods demand, exports beat expectations in October.
- China's exports to US and the European Union now amount to nearly 30% of manufacturing GDP, after an unprecedented surge in shipments this year. US imports from China are 30% higher than before the pandemic, and Europe's imports are 50% higher.
- The cost of goods leaving China's factories surged by another record rate last month, and there are increasing signs that consumers are starting to feel the pain. The Producer Price Index jumped 13.5% in October from a year ago, accelerating from September's 10.7%.
- Last month's increase was already the fastest since the government began releasing such data in the mid-1990s,
- CPI inflation at 1.5% also remained comfortably below the PBOC's 3% inflation target.
- The credit impulse has turned higher, but strains in Chinese property markets linger, with stress spreading to investment grade bonds and the Chinese off-shore USD high-yield index reaching a new record high.
- Media reported that the government is mulling steps to ease bond issuance rules for developers and preparing capital injections from banks and institutional investor

China : Debt Burden eases

- China’s debt-to-GDP ratio continued to decrease from 266% in Q2 to 265% in Q3 2021.
- Household debt to GDP decreased slightly by nearly 0.5 percentage on the back of moderating mortgage loan growth .
- The corporate sector also reduced their debt to GDP, especially after excluding the debt generated by local government financing vehicles (LGFVs). Corporate debt came down quite substantially, from 125.0% to 122.3% of GDP over the past quarter. Both banks’ loans and corporate bond issuance declined. Moreover, the shadow banking component of the corporate debt declined as much as -3.6%, reflecting the government determination to rein in the shadow banking.
- At the other end of the spectrum, the government has been accumulating more debt, both at the central and local level, with their ratio as a percentage of GDP moderately rising from 19.6% and 25.2% in Q2 to 19.8% and 25.9% in Q3 respectively
- However, one of the most important aspects of fiscal spending, namely, China’s infrastructure investment, remained subdued despite the rise in government debt, suggesting that most of the government’s debt finance has not been channeled to fulfill the infrastructure gap



- Albeit moderate, the reduction in the debt to GDP ratio in Q3 was especially difficult given the economic slowdown.
- One of the contributing factors to the fall in debt ratio is the policy efforts towards deleveraging, but it may also result from the lack of demand for investment

India : Firmer Inflation

- India’s CPI inflation rose to 4.48% YoY in October from 4.35% YoY in September due to hardening of food and fuel prices while core inflation rose to 6.17% YoY, highest in 4-mths to October. The recent reduction in excise on petrol and diesel is estimated to provide a 25-30 bps comfort to Headline CPI, accounting for both the direct and indirect effects.
- However ,In its latest Purchasing Managers' Index survey of the manufacturing sector, IHS Markit found that input cost inflation rose to a 92-month high in October. India's WPI inflation is expected to have risen to 10.9% in October from a six-month low of 10.66% in September,
- Liquidity in the banking system is estimated to be in a surplus of over 8.25 trln rupees.
- Loan growth remained muted due to lack of demand for big-ticket loans from corporates and as banks remained cautious in anticipation of rising asset quality stress due to the COVID-19 pandemic.
- The short-term swaps are totally reflecting the shift in interest rate view that has taken place since US' CPI.
- The latest CPI readings from Other Emerging Markets showed inflation pressures remain elevated.
    - Brazil's October CPI quickened more than expected to 10.67% year-over-year, while Mexico's October CPI also quickened slightly beyond expectations to 6.24% year-over-year.
    - Mexico's central bank also announced its latest monetary policy decision this past week, raising its Overnight Rate by 25 bps to 5.00%.

Nifty : Bears Hold the Key

- The secular rally has been a sequential sectoral run-up and consolidation play and hence the broader undertone continues to be directionless
- Jan-March’21 leg of the rally was majorly supported by Nifty Metal (22% returns v/s Nifty’s 4.80%) which turned out to be a laggard in July to September’21 (7.7% returns v/s Nifty ’s 12.4%).
- Similarly Nifty Pharma, which led April-June’21 rally (15.6% returns v/s Nifty ’s 5.75%), eased in July to Sept’21 (0.2% returns v/s Nifty 12.4%).
- Renewed concerns over inflation amid a sharp surge in commodity prices and persistent supply-side constraints continue to keep equities muted.
- Range 17630-18030 continues to stay in tact but there is a distinct possibility of a strong downmove so long Nifty does not reclaim 18275 on the upside,

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