# SYFX Treasury Foundation

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- Weekly Market Update
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V Thiagarajan

thyagoo@syfx.org

# US Economy : Turbulence but Resilient

- Last week ushered in a broad range of economic indicators that covered everything from supply chains to the housing market, but needless to say it was the labor market that was top of mind.
- Labor market data appeared to puzzle investors. On Wednesday, private payrolls firm ADP reported that its tally of private sector employment fell by 301,000 in January—the biggest drop since the start of the pandemic.
- Nonfarm payrolls rose 467K in January, which was not only nearly four times the consensus estimate but also well ahead of any forecast. The household survey showed a whopping 3.6M workers were out sick in January during the survey week, but that wasn't enough to weigh on the overall gain.
- What's more, over the past two months, payrolls were revised up 709K. With these jumps, payrolls now remain less than 3M (-1.9%) under their pre-pandemic levels and are within grasp of what could be seen by the Fed as "maximum employment".
- The unemployment rate ticked higher to 4.0%, but this seemed to reflect an increase in the labor force participation rate, which rose to its highest level (62.2%) since the start of the pandemic. It could be on account of the end of the increased federal Child Tax Credit and easing virus concerns.
- JOLTS and nonfarm productivity pointed to a strong and thriving labour force, while January's ISM surveys and construction spending data affirmed that we are not out of the woods yet when it comes to supply chain struggles and higher prices

# US Equities : Wild ride

- The markets have seen some wild swings amid diverging earnings results from some of the largest U.S. companies this season to add to the volatility seen to begin 2022.
- Meta Platforms' report of a decline in Facebook's average daily users and guidance for slower revenue growth resulted in a 26% decline in its stock price and wiped a record USD 232 billion off its market capitalization on Thursday.
- Conversely, Amazon.com's report of better-than-expected earnings, driven in part by its Web services business, helped the indexes jump back Friday morning.
- The earnings have broadly bucked the trends of the past six quarters—with a lower beat rate (percentage of companies beating expectations) and a lower percentage by which companies have been exceeding consensus estimates.
- Volatility is likely to remain as the global markets adjust to the prospect of tighter monetary policies, as well as geopolitical tensions between Russia and Ukraine, and a mixed Q4 earnings season, which will continue to roll on this week.
- M&A news is dominating the equity headlines, with Spirit Airlines and Frontier Group Holdings announcing an agreement to merge, while Peloton Interactive is reportedly exploring takeover options.

# What to Expect this Week

- Markets expect CPI report on Thursday to show 7.3% inflation year-over-year in January versus 7.0% in December.
- Core inflation, which excludes some more volatile prices, is expected to be 5.9% versus 5.5% the previous month. Hotter-than-expected inflation will likely raise bets of the number of Fed rate hikes this year and potentially keep the risk of a 50 bp March hike on the table.
- Conversely, a lower-than-expected print may satisfy investors that enough hikes (or possibly too many) are currently priced into financial markets. There is some hope that supply chain issues will show some improvement and lower goods prices will ease pressure on the topline index.
- Last week Germany toughened its stance against Russia's actions toward Ukraine, though some believe it is still not firm enough. The U.S. deployed troops to Europe (notably, less than some experts expected) in an attempt to spur more diplomatic talks.
- On Monday, Biden will meet with German Chancellor Olaf Scholz to discuss the two countries plans for dealing with the conflict.
- European earnings are trending at a 46% increase year-over-year while emerging market earnings are on pace to increase 36%.
- This week two major communication services companies will report earnings: SoftBank will report on Tuesday followed by Disney on Wednesday. U.S. large company earnings are 8% ahead of expectations, which is modestly above the historical average level (3–4%) but not yet enough to spark a rally in a market ripe with negative sentiment.

# Global PMI : Weaker impulse

- The large drop in the January manufacturing output PMI to an expansion low of 51.4 is a disappointment and suggests the sector is seeing a drag.
- January saw 22 out of the 27 nations for which data were available register an improvement in overall operating performance.
- However, of those countries seeing expansions, 13 also recorded a weaker rate of increase than in the prior survey month (including the US, the UK, France, Italy and India).
- Global PMI new orders fell to the long term average in January signalling growth around trend in manufacturing .
- The increase in new business was the weakest registered for one-and-a-half years, in part reflecting the drag of the first decrease in international trade volumes since August 2020.
- The index has broadly followed the trend signalled by the leading indicators in the past six months. Leading indicators now send mixed signals from here.
- Most of the indicators point to more downside in the short term, but others suggest a stabilisation/bottom before too long - Especially data tracking inventory dynamics point to further downside.

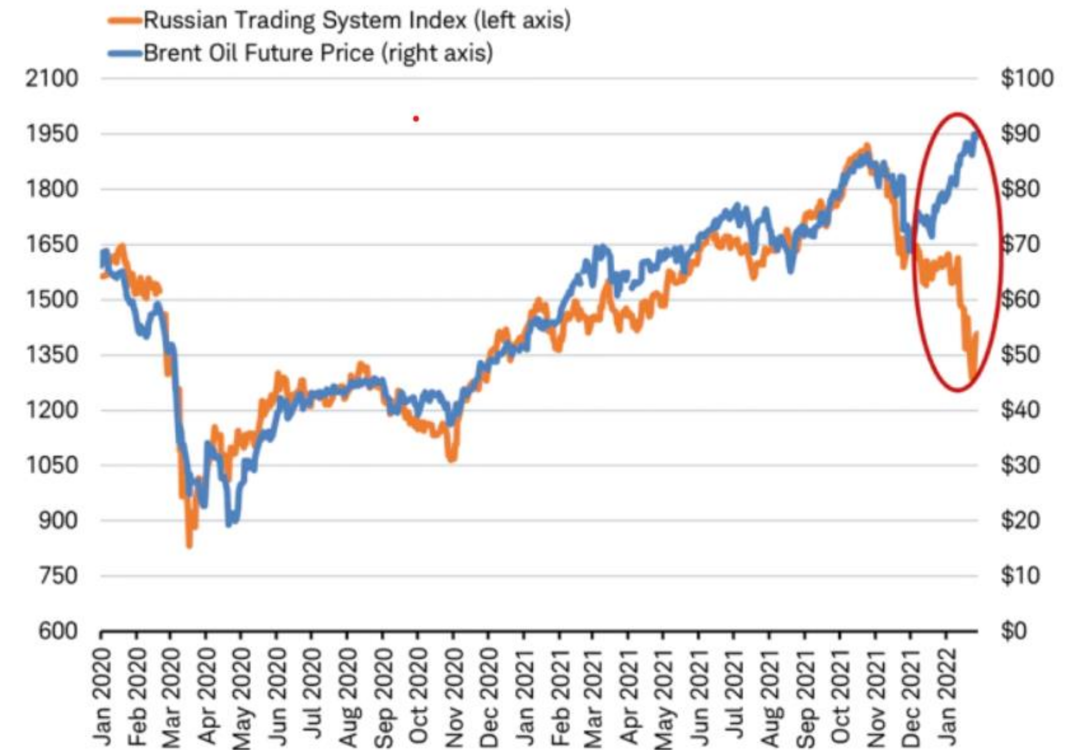
**Index summary**

sa, 50 = no change over previous month. *50 = no change over next 12 months.

| Index | Dec-21 | Jan-22 | Interpretation |
|---|---|---|---|
| PMI | 54.3 | 53.2 | Improvement, slower rate |
| Output | 53.3 | 51.4 | Growth, slower rate |
| New Orders | 53.4 | 52.2 | Growth, slower rate |
| New Export Orders | 51.2 | 49.7 | Decline, from growth |
| Future Output | 63.7 | 65.4 | Growth expected, stronger sentiment |
| Employment | 51.7 | 51.0 | Growth, slower rate |
| Input Prices | 69.7 | 68.4 | Inflation, slower rate |
| Output Prices | 59.8 | 61.0 | Inflation, faster rate |

# Russia- Ukraine Crisis

- Global equity Markets appear to be reluctant to react to the military developments in Ukraine.
- Russia's buildup of military forces around Ukraine is larger in scope than the exercises of March 2021 and echoes the Russian invasions in Georgia in 2008 and Ukraine in 2014.
- Russia has very small equity exposure in the global indices, making up only 3.2% of the MSCI Emerging Markets Index and just 0.4% of the global stock market measured by the MSCI AC World Index. Ukraine has no exposure in either index.
- Any sustained market impact could be influenced by economic sanctions imposed on Russia.
- Europe worries that the proposed U.S. sanctions might prompt Russia to retaliate by cutting off natural gas and oil flows to Europe, something Russia has done previously to exert its influence
- Russia has taken steps in recent years, such as building up foreign currency and gold reserves (source: Central Bank of the Russian Federation) and bolstering relationships with China, to minimize the impact of financial and trade sanctions on its economy after being subjected to them for almost a decade.



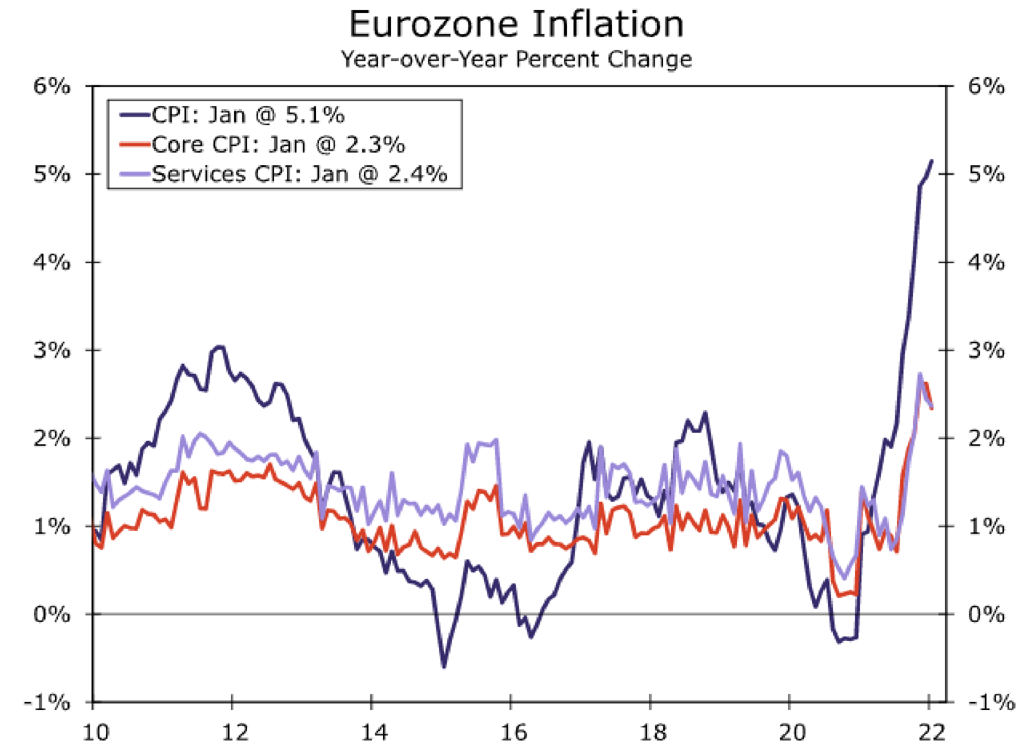

- Russia's stock market usually trades in sync with oil prices.
- But recently, as oil hits new highs, Russian stocks however have fallen into a bear market, likely tied to the rising risk of a Russian incursion into Ukraine.

# Comparison with 2015 Cycle

- In December 2021 meeting, Fed removed the word “transitory” from the statement. It makes sense when looking at survey-based inflation expectations. Short-term inflation expectations from the University of Michigan consumer survey is now 4.9%, significantly above the 2.6% in December 2015. The current level is also higher than the 2004-07 average -a benchmark- as it was a period where the Fed was not struggling with too low inflation and the zero lower bound, of 3.2%.
- The risk is that higher inflation expectations become a self-filing prophecy, especially because the economy is in a different situation with a closed output gap and a tight labour market .Longer-term inflation expectations (5-10 years ahead) are also higher now than in 2015 (3.1% vs. 2.6% in December 2015) and above the 2004-07 average of 2.8%.
- Overall, the labour market is also significantly tighter than it was back in December 2015. It is noteworthy that labour demand is significantly stronger compared to December 2015. Job openings make up 6.7% of the labour force (versus 3.7% in 2015), which is record-high.
- The combination of a lower labour force and high labour demand means that the unemployment rate is now 4 % (Fed’s estimate of NAIRU at 4%), significantly below the 5% in December 2015. Additionally, the tight labour has also led to notable higher wage growth today compared to more modest wage growth in December 2015. Further, continuing claims have fallen from very high levels and are now lower than in 2015 despite a bigger population.
- The labour force participation rate is about 1.0-1.5 %-point lower compared to 2015 while the employment to population ratio is still marginally lower than in December 2015. Based on Powell’s answer at the press conference, the Fed has bought into the story that not all Americans, who left the labour market when they got fired in the early stage of the pandemic, will return or at least not very quickly, especially because of retirements. If the lower labour force is more long-lasting in nature, which seems to be the case, the indicators actually support the case for more tightening

# ECB : Last Dove Standing ?

- Last week's ECB meeting will also be remembered to show the largest difference to date between the ECB's released decision and the press conference. The ECB's decision carried almost no changes, where the 'at present or lower' and sequencing was confirmed.
- ECB left its forward guidance on policy interest rates and asset purchases unchanged in its policy statement. However, clearly the ECB is not in the mindset that it was in a few weeks ago. The press conference gave the impression of a central bank that is gearing up to unwind net asset purchases and start raising its policy rate before the end of this year
- Lagarde noted that 'the situation has changed' with regards to the outlook, noting upside risks to the December inflation projections, especially in terms of the near term.
- She signalled that the guidance was contingent and that the Governing Council would be flexible and data dependent.
- Unlike in December, Lagarde did not take the opportunity to steer markets away from a 2022 rate hike, saying that she would reserve her judgement until the institution's March updated macroeconomic projections.
- Although she confirmed the sequencing of the exit (net asset purchases need to end before policy rates go up), she did suggest that the path of net asset purchases under the APP could be changed if necessary.

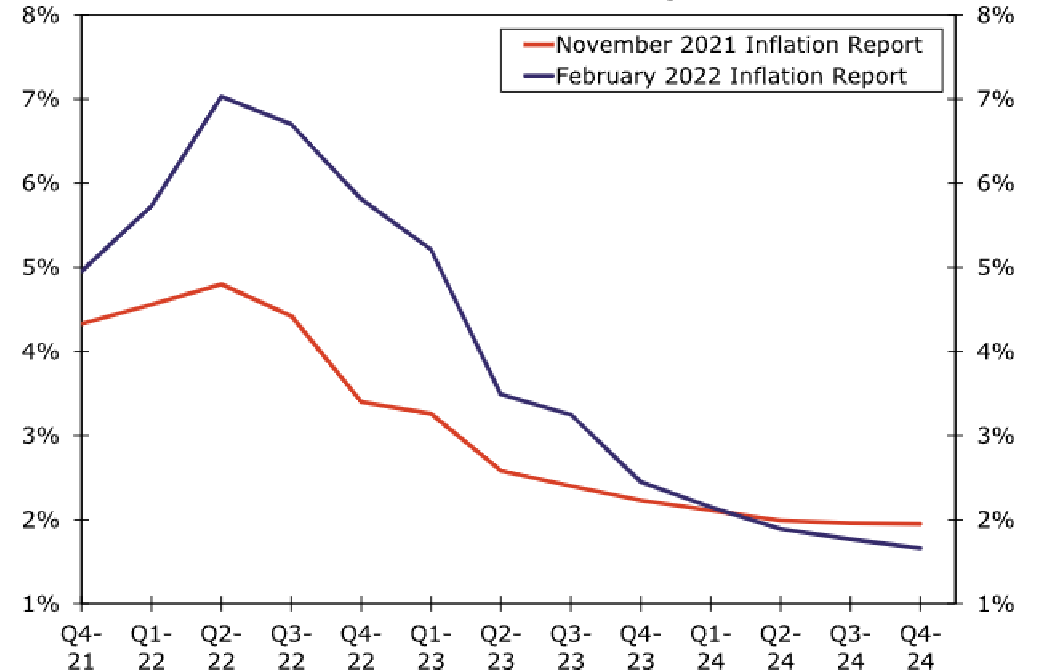


# EM : Inevitable squeeze ?

- EM is faced with a substantially more challenging financing environment this year. With rising inflation and tightening labour market,Fed is 'behind the curve' and will need to tighten monetary policy faster than in 2015.
- Historically, tighter US financing conditions have led to broad-based EM FX weakness but Fed hikes alone have not triggered a sustained tightening in financial conditions. In fact, tighter conditions often result from market stress, and hence, we think particularly wider credit spreads will be a key determinant for EM FX, with LatAm FX historically the most exposed.
- While external vulnerability indicators are mixed across EM compared to 2015, notably in BRICS economies, overall debt situation remains worse and borrowing needs remain elevated due to pandemic-related spending.
- Outside BRICS, rise in foreign debt and lack of sufficient buffers add to vulnerabilities.
- Given the risk of even more aggressive Fed tightening than what is priced in by the market, and associated market stress, the risks are skewed to more pronounced broad-based EM weakness on the back of sharper global downturn and induced fall in commodity prices.
- A broader EM debt crisis would also carry potential negative implications for Europe and US through direct financial exposure and the trade channel. Particularly Spanish banks have a large exposure to EM relative to other European banks, while non-OECD exports have increased across Europe over the last two decades.

# BOE : Hawks assert

- As expected, Bank of England raised the Bank Rate by 25bp to 0.50% and announced the beginning of "passive QT" (ceasing reinvestments of maturing bonds) last week.
- A major surprise was that four out of nine policymakers voted for a 50bp rate hike sending a hawkish signal to markets that the BoE is very concerned about high inflation.
- In the Monetary Policy Report, the BoE notices that both short- and long-term inflation expectations are increasing and above past averages.
- While the BoE said it cannot do much about supply shocks to prices, policymakers are worried that inflation will become more persistent through e.g. higher wage growth. (BoE's wage growth projection is to the low side).
- BoE Governor Bailey, however, pushed slightly against market pricing by saying that it would be a mistake to assume rates are on an inevitable long march up.
- The BoE reaffirmed that it will consider "active QT" (selling government bonds) when the Bank Rate reaches 1.00%.




- BoE sees inflation slowing to 2.15% in two years and to 1.6% in three years
- The revisions to the GDP growth outlook were in the other direction, with the forecast for 2022 GDP growth lowered to 3.75%.
- BoE acknowledged that energy and other price increases would squeeze real household incomes and economic growth.
- Lower Growth and Higher inflation simply sates that the Currency should be lower

# MPC : Dovish Hike ?

- The Government will borrow Rs. 14.95 trln rupees through the sale of dated securities on a gross basis in 2022-23 (Apr-Mar), much higher than the revised borrowing of Rs. 10.47 trln rupees scheduled for the current year. The projection is a record high, more than double the pre-pandemic record of Rs. 7.1 trln rupees in 2019-20.
- On a net basis, the government will sell bonds worth Rs.11.19 trln rupees, taking into account repayment of 3.76 trln rupees,
- 10-year GSec yields have increased more than 50bps, the sharpest two-month jump in yields since mid-2018
- The 10-year benchmark gilt yield is set to be higher towards 7.00 handle as market sentiment is likely to remain sour following the Budget's double whammy of a humongous borrowing in 2022-23 (Apr-Mar) and complete silence on listing of Indian bonds in debt indices.
- MPC will have to find answers to the question of fiscal dominance of monetary policy - At its upcoming policy review this week, RBI is expected to appease market participants by assuring its support through open market purchases of government bonds. Any assurances by RBI unless backed by concrete measures, may not be enough to assuage the market's concerns about excessive bond supply.
- The disruptive effect of a reverse repo hike is going to be relatively low while it will signal that RBI is still on its path of policy normalisation.
- The weighted average reverse repo rate is already close to 3.9% and markets have been anticipating a reverse repo hike for some time now. **A reverse repo rate hike to please all constituencies is more likely now than ever before.**

# Equities : Turbulence Ahead

- Indian equites snapped two-week losses as investors cheered after the Union Budget 2022-23 stepped up capital expenditure allocation by 35% for fiscal 2023. benchmark indices rose around 2.5%
- However, sporadic profit booking and mixed global cues following major central banks’ key announcements and ongoing Ukraine-Russia crisis kept gains in check.
- However, the index is facing resistance around its 20 EMA and now seems to be forming a lower top.
- Sacrosanct support of 17240 on a closing basis and a break there sets up test of 16850

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