BEA 東亞銀行

Economic Research

September 2021

Market Monitor – United States

Covid-19 Variant Weighs on Economic Outlook

Consumer sentiment measures fall amid rapid spread of virus variant

The University of Michigan's consumer sentiment index dropped to 70.3 in its final reading in August, as the rapid spread of the delta variant in the US intensified worries about the path of economic recovery. The reading was the lowest since December 2011.

Despite the surge in confirmed cases, the US labour market continued to show improvements in July, with nonfarm payrolls adding 943,000 jobs and the unemployment rate dropping further to 5.4%. Meanwhile, headline inflation remained at 5.4% year-on-year in July and core inflation edged down slightly from 4.5% in the previous month to 4.3%. Headline inflation in July was mainly boosted by food prices, while a slight dip in core inflation was largely due to a smaller year-on-year price growth for used cars and apparel.

Meeting minutes of the Federal Reserve (Fed) from July revealed a growing consensus on the need to begin scaling back its US$120 billion monthly asset purchases this year, with some participants commenting that economic and financial conditions would likely warrant a reduction in the coming months. In addition, although Fed chairman Jerome Powell indicated that the central bank was likely to begin tapering before the end of this year at the Jackson Hole meeting, he still saw interest rate hikes off in the distance.

Looking ahead, although a reopening of the economy is expected to continue with ongoing vaccination progress, the number of confirmed cases has risen with the spread of the Delta variant. As of 30th August, about 60.9% of the US population had received at least one dose of Covid-19 vaccine, and 51.7% was fully vaccinated.

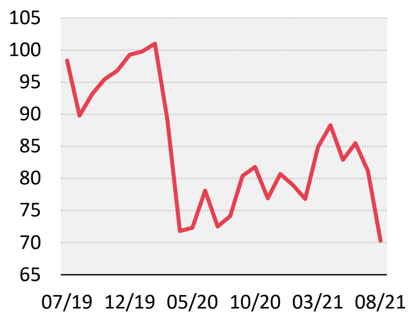
Nonetheless, the 7-day average of new cases also rose to over 160,000 as of the end of August, compared to about 78,200 at the end of July. A further rebound of the US economy in the rest of the year may be clouded by the emergence of virus variants that will challenge the efficacy of existing vaccines. The timing and pace of the Fed's tapering off of asset purchases will also be impacted by the development of the pandemic and the

Spread of virus variant weighs on consumer sentiment.

Fed signals tapering before the end of this year.

Corporate earnings support stock market sentiment, while risk aversion halts the rise in treasury yields.

University of Michigan Consumer Sentiment Index



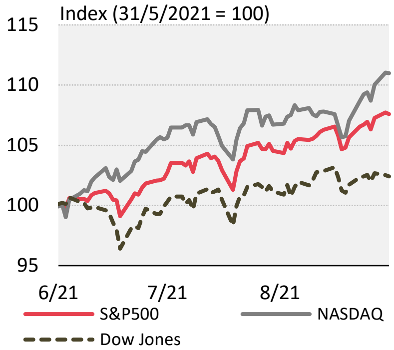
Source: Bloomberg, data as of 31/8/2021

speed of economic recovery, underpinned by multi-trillion dollar spending bills that are finally due to be passed by Congress.

Equity market sees volatility as Fed signals scaling back of asset purchases this year

The Fed minutes revealed that tapering off of asset purchases could start this year, which negatively impacted market sentiment. On 18th August, Nasdaq declined by 1.0% from the level at the end of July. S&P 500 Index and Dow Jones also saw narrowed to 0.1% over the same horizon. However, in the latter of the month, despite the recent resurgence in confirmed Covid-19 cases, US equity market sentiment was positive in August, as company earnings for Q2 2021 had beaten expectations. As of the end of August, about 86% of S&P 500 companies reported positive earnings surprise for the current quarter. As of 31st August, S&P 500 Index recorded 2.9% gain when compared with the level at the end of July. Meanwhile, Nasdaq and Dow Jones rose by 4.0% and 1.2%, respectively, over the same horizon.

US Equity Indices

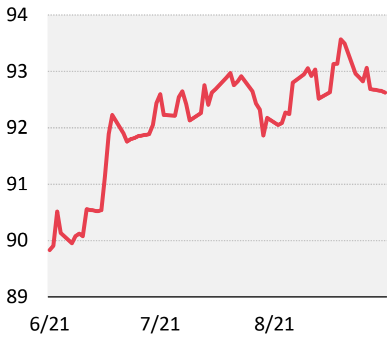


Source: Bloomberg, data as of 31/8/2021

Risk aversion pushes dollar higher and halts rise in treasury yields

In the meantime, risk aversion prevailed in foreign exchange markets, as economic data of China signalled a slower recovery and the Afghanistan conflict escalated, along with a resurgence of Covid cases in major economies. On 19th August, the US dollar index was about 1.5% higher than the level at the end of July. Later, as the Fed chairman said that the central bank would not be in a hurry to raise interest rate, dollar weakened. As of 31st August, dollar index stood at 92.626, about 0.5% higher than the level at the end of July.

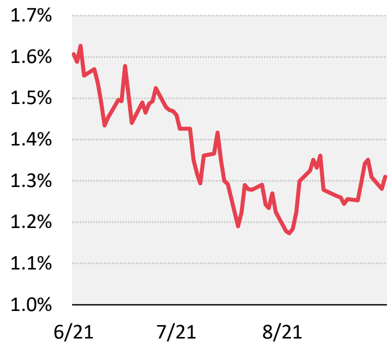
Dollar index



Source: Bloomberg, data as of 31/8/2021

Although the 10-year Treasury yield rose by 14 basis points to 1.361% on 12th August after the inflation reading, its rise was contained amid investor worries about the global economic outlook with the resurgence in Covid-19 cases and disappointing economic data from China. As of 31st August, the 10-year Treasury yield eased to 1.31%, only 9 basis points higher than the level at the end of July.

US 10-year Treasury Yield



Source: Bloomberg, data as of 31/8/2021

Going forward, if the Fed starts to reduce its pace of asset purchases and normalises the fed funds rate target earlier than expected, the dollar will continue to strengthen. Meanwhile, the movement of treasury yields will be impacted by the risk appetite of investors and the policy direction of the Fed.

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