BEA 東亞銀行

Economic Research

January 2022

Market Monitor – United States

Covid-19 Variants Threaten Outlook for 2022

Fed double speed of tapering off asset purchases and plans more rate hikes amid elevated inflation

US inflation surged to a 39-year high in November, with year-on-year growth of the headline consumer price index (CPI) rising further to 6.8%, up from the 6.2% in the previous month. The core CPI, which excludes volatile categories of food and energy, registered a 4.9% annual growth during the month, which is the largest rise since July 1991. Several product and service categories saw their largest price increases on record. For instance, new cars and trucks registered an 11.1% year-on-year growth in November, while fast-food restaurant food prices also recorded a 7.9% rise. At the same time, men's apparel and living room, kitchen, and dining room furniture also saw record price rises.

Meanwhile, the US labour market has seen continued improvement in its hiring momentum in November, albeit at a slower pace. Nonfarm payrolls saw 210,000 jobs added in November, building on an upward revision of 546,000 added jobs in the previous month. At the same time, the unemployment rate declined further to 4.2% during the month from the 4.6% in the previous month, closer to the 3.5% pre-pandemic level, while average hourly wages saw a 4.8% year-on-year growth in November.

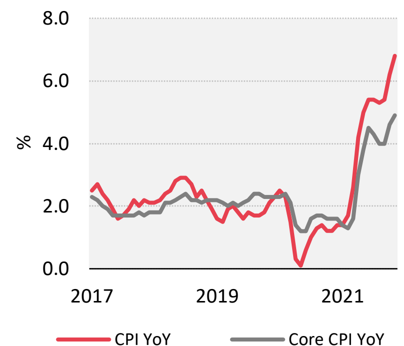
Against this backdrop, the Federal Reserve (Fed) announced that it would taper off its asset purchase programme faster and signalled more rate hikes at its December meeting. The reduction of asset purchases will double to USD 30 billion per month starting from January 2022, and the programme is expected to end in March 2022. The Fed's December projection signals that there will be three 25-basis point rate hikes in both 2022 and 2023, compared to only one to two rate hikes this year as implied in September's projection, as the Fed predicts inflation will stay elevated and the unemployment rate will decline faster in 2022. Market participants also expect to see first rate hike in Q2 2022, according to the latest Bloomberg survey released in December.

Fed doubles pace of tapering off asset purchases amid elevated inflation and continued improvements in the jobs market.

Covid-19 variant poses potential downside risk to the recovery trajectory in 2022.

Financial markets likely to be more volatile in 2022 amid persisting supply chain constraints and inflation, while lingering US-China tensions may alter investors' risk appetite.

US Inflation



Source: Bloomberg, data as of 20/12/2021

Covid-19 variant poses downside risk for 2022 economic outlook

Looking ahead, market participants generally expect supply chain constraints to extend into 2022 and inflation to remain elevated at least in the first half of 2022. This may result in a wage-price spiral. A survey by the Conference Board released in early December finds that base pay may increase by an average of 3.9% in 2022, the highest since 2008. Nearly half of the employers surveyed cited the need to offer higher wages to attract new workers amid the labour shortage, while nearly 40% cited high inflation as another factor.

Although the recently passed USD 1 trillion infrastructure spending bill is expected to support the economic recovery, the Omicron variant and any abrupt change in the central bank's policy stance will pose a downside risk to the economy in 2022. Current market expectation is that average US GDP growth for 2022 will be 4.0%, while the CPI is projected to grow by 4.4%. If the spread of the Omicron variant worsens significantly, governments will need to impose more stringent restrictions to curb the spread of the disease, which will dampen consumer and business sentiment.

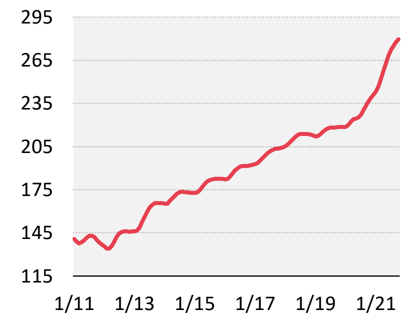
In addition, more lockdown measures will also lengthen supply chain bottlenecks, resulting in lingering high inflation and quicker interest rate normalisation by the Fed. This may be a further drag on economic growth as higher financing costs will reduce business investment.

The S&P Case-Shiller 20-City Composite Home Price Index had risen 16% between end-2020 and October 2021. According to Reuters, fed funds rate futures market has fully priced in a quarter-percentage-point hike by May 2022 after Fed's December meeting. If the Fed normalises interest rates faster than the market expects, asset prices that previously benefited from ultra-low interest rates may see corrections. The negative wealth effect will dent consumer sentiment and act as a further drag on economic growth. Moreover, the uncertainty associated with the passage of upcoming social and climate spending bill in the Senate may also pose additional risks to the US recovery.

Financial markets may see increased volatility in 2022

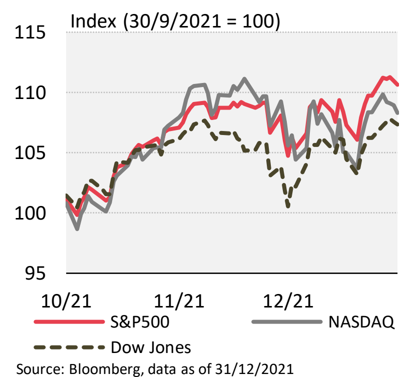
In 2021, benchmark US equity indices continued to see robust gains, which is chiefly attributable to the gradual reopening of the economy and the accommodative monetary policy stance of the Fed. As of 31st December, the S&P 500 Index had risen by 26.9% from the level at the end of 2020, while the Nasdaq recorded a gain of 21.4% over the same horizon and the Dow Jones increased 18.7%. When compared to the level at end-November, the Nasdaq rose by 0.7%, while the S&P 500 Index rose by 4.4% and the Dow Jones Index by 5.4%.

S&P/Case-Shiller 20-City Composite Home Price Index



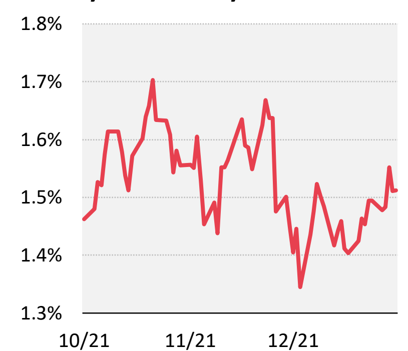
Source: Bloomberg, data as of 31/12/2021

US Equity Indices



Source: Bloomberg, data as of 31/12/2021

US 10-year Treasury Yield

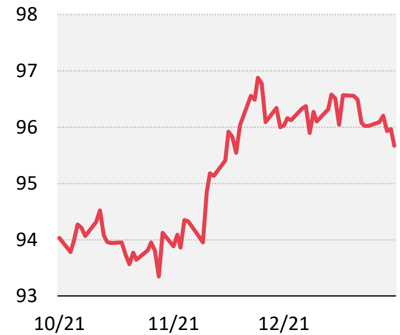


Source: Bloomberg, data as of 31/12/2021

As inflationary pressure intensified during 2021, the Fed began to taper off its asset purchasing programme. Market participants have started to factor in interest rate normalisation, resulting in higher bond yields and a stronger US dollar. As of 31st December, the 10-year treasury yield stood at 1.512%, about 60 basis points higher than the level at the end of 2020. Meanwhile, the dollar index rose by about 6.4% to 95.67 over the same horizon. When compared to the level at the end of November, the 10-year treasury yield up by about 7 basis points, while the US dollar was down by 0.3%.

Entering 2022, although the US economy is expected to continue to recover with fiscal support, US financial markets are set to see increased volatility. The uncertainties stemming from virus variants will increase the risk of lengthened supply chain disruption and hence intensify inflationary pressure, prompting investors to expect faster interest rate normalisation by the Fed. If high stock market valuations become unsustainable, this may spur risk aversion among investors, as might lingering US-China tensions. If demand for safe haven assets increases, the US dollar may strengthen further, while the upward trend of US treasury yields due to expected interest rate normalisation may be offset by investors buying into US treasury instruments as safe haven assets.

Dollar Index



Source: Bloomberg, data as of 31/12/2021

Disclaimer

This document is prepared by The Bank of East Asia, Limited ("BEA") for customer reference only. Other than disclosures relating to BEA, the content is based on information available to the public and reasonably believed to be reliable, but has not been independently verified. Any projections and opinions contained herein are as of the date hereof, are expressed solely as general market commentary, and do not constitute an offer of securities, nor a solicitation, suggestion, investment advice, or guaranteed return. The information, forecasts, and opinions contained herein are as of the date hereof and are subject to change without prior notification, and should not be regarded as any investment product or market recommendations. This document has not been reviewed by the Securities and Futures Commission of Hong Kong, Hong Kong Monetary Authority, or any regulatory authority in Hong Kong.

BEA will update the published research as needed and as required by the law. In addition to certain reports published on a periodic basis, other reports may be published at irregular intervals as appropriate without prior notice.

No representation or warranty, express or implied, is given by or on behalf of BEA, as to the accuracy or completeness of the information and stated returns contained in this document, and no liability is accepted for any loss arising, directly or indirectly, from any use of such information (whether due to infringements or contracts or other aspects). Investment involves risks. The price of investment products may go up or down. Past performance is not indicative of future performance. The investments mentioned in this document may not be suitable for all investors, and the specific investment objectives or experience, financial situation, or other needs of each recipient are not considered. Therefore, you should not make any investment decisions based solely on this document. You should make investment decisions based on your own investment objectives, investment experience, financial situation, and specific needs; if necessary, you should seek independent professional advice before making any investment.

The views and opinions in this document do not constitute the official views of BEA.

This document is the property of BEA and is protected by relevant intellectual property laws. Without the prior written consent of BEA, the information herein is not allowed to be copied, transferred, sold, distributed, published, broadcast, circulated, modified, or developed commercially, in either electronic or printed forms, nor through any media platforms that exist now or are developed later.

For more information, please visit our webpage at https://www.hkbea.com/html/en/bea-about-bea-economic-research.html. For any enquiries, please contact the Economic Research Department (email: lerd@hkbea.com, tel: (852) 3609-1504, post: GPO Box 31, Hong Kong).

© 2022 The Bank of East Asia, Limited