Market Monitor – United States

Inflation Prompts Monetary Tightening

US economy continues to recover in Q4 2021, while inflation accelerates further

Despite the onset of a new wave of Covid-19 due to the Omicron variant in December, the US economy saw solid rebound in Q4 2021. In a preliminary reading, US GDP recorded an annualised quarter-on-quarter growth of 6.9% in Q4 2021, higher than the market expectations and the 2.3% growth in previous quarter. The solid growth was mainly attributable to the rise in consumer spending and companies' restocking. Personal consumption grew by 3.3% during the quarter, up from the 2% growth in the previous quarter. At the same time, change in private inventories contributed 4.9 percentage points to the total GDP growth in Q4 2021. For 2021 as a whole, US registered GDP growth of 5.7%.

On the other hand, US inflationary pressure continued to climb. US inflation further surged to an almost 40-year high in December 2021, with year-on-year growth of the headline consumer price index (CPI) rising further to 7%, up from the 6.8% in the previous month. The core CPI, which excludes the more volatile categories of food and energy, registered a 5.5% annual growth during the month, which is the largest rise since March 1991**.** For 2021 as a whole, US CPI growth was 4.7%, up from the 1.2% in 2020. Continued supply chain bottlenecks stemming from the pandemic have been the main driver of inflation, with prices of energy, used vehicles, and various consumer durable goods rising substantial during the year. Ongoing high inflationary pressure have started to impact consumer spending, with retail sales seeing a month-on-month drop of 1.9% in December 2021 – as compared to the market estimate of a 0.1% drop.

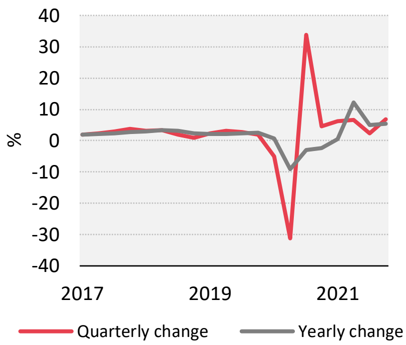
At the same time, the US labour market has seen marked improvement in its hiring momentum in 2021, albeit at a slower pace in the final month of the year. Nonfarm payrolls saw 199,000 jobs added in December 2021. The slower jobs growth in recent months mainly reflects employers' difficulties in hiring workers, coupled with the "Great

US economy sees strong rebound in 2021, with GDP growth of 5.7% during the year.

Market generally expects the Fed to start raising rates at its March policy meeting.

US equity market valuation sees challenges amid growing expectation of policy tightening by the Fed.

US GDP



Source: Bloomberg, data as of 31/1/2022

Economic Research

February 2022

Resignation" trend. In 2021 as a whole, jobs growth averaged 537,000 per month and a total increase of about 6.4 million jobs was recorded during the year. Meanwhile, the unemployment rate dropped further to 3.9% during the month, down from 4.2% in the previous month and closer to the pre-pandemic level of 3.5%.

Fed keeps fed funds rate on hold, but signals rate hike in March

The Federal Reserve (Fed) held the fed funds rate target unchanged at its January meeting. However, Fed's chairman, Jerome Powell, signalled that the Fed would start raising fed funds rate at March Meeting at the press conference. He also did not rule out the possibility of raising interest rates at consecutive policy meetings. Some investors even expect the Fed to raise benchmark interest rate five times in 2022 or raise interest rate by 50 basis points at March meeting, as inflationary pressure remains elevated. Meanwhile, the Fed stated that it will reduce its securities holdings over time in a predictable manner primarily by adjusting the amounts reinvested of principal payments received from the securities held. It is expected that the Fed will commence reducing the size of its balance sheet once it starts raising interest rates.

Going forward, if the supply chain bottlenecks continue longer than previously estimated, the Fed may need to speed up policy normalisation. December's Fed meeting minutes revealed that many participants believe the balance sheet runoff will need to be faster than during the previous period of normalisation. Excess liquidity will further decrease when the Fed starts to reduce the size of its balance sheet. Currently high asset valuations will face challenges, and the negative wealth effect may adversely affect consumer sentiment. Coupled with the ongoing impacts of new Covid-19 variants, US economic performance in 2022 will be subject to uncertainty.

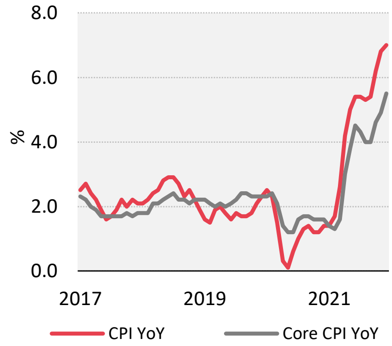
Equity market corrects with growing expectation of tightening by the Fed

The US equity market declined in January, as investors expect the Fed to begin raising interest rates as early as March and reducing the size of the balance sheet later this year. Tech stocks saw a larger correction, amid growing expectation of faster policy normalisation. As of 31st January, the Nasdaq dropped by 9% from the level at the end of December 2021, while the S&P 500 Index declined by 5.3% and the Dow Jones Industrial Average by 3.3% over the same horizon.

In the bond market, yields continue to climb, as market participants generally see interest rate lift-off by the Fed going ahead in March. The benchmark 10-year treasury yield stood at 1.778% as of 31st January, about 27 basis points higher than the level at the end of December 2021. In the foreign exchange market, the US dollar strengthened over the same horizon. The dollar index stood at 96.54 as of 31st January, about 0.9% higher than the level as of the end of December 2021.

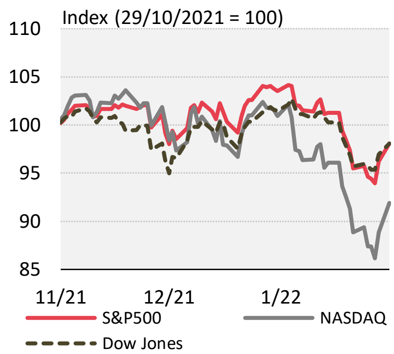
Looking ahead, the movement of equity market indices will be influenced by the trajectory of policy normalisation by the Fed. Meanwhile, the trend of benchmark US treasury yields and US dollar will also be impacted by investors' changing risk appetite.

US Inflation



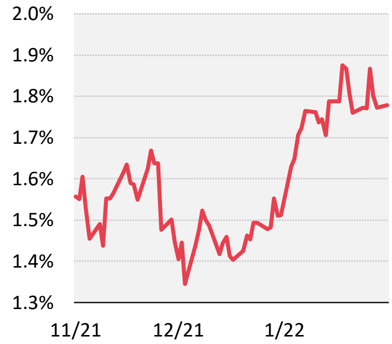
Source: Bloomberg, data as of 17/1/2022

US Equity Indices



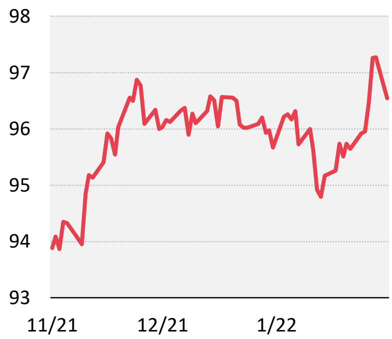
Source: Bloomberg, data as of 31/1/2022

US 10-year Treasury Yield



Source: Bloomberg, data as of 31/1/2022

Dollar Index



Source: Bloomberg, data as of 31/1/2022

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).