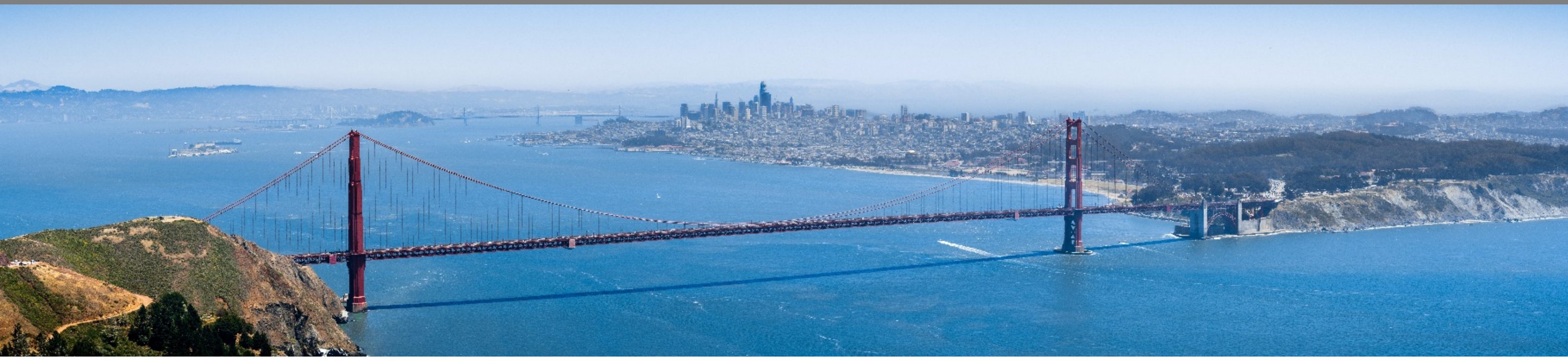
Economic Research

March 2022

Market Monitor – United States

Markets Sees Volatility amid Rising Geopolitical Tensions



Soaring inflation leads market participants to firmly expect rate hikes by the Fed at March meeting

US inflation surged to a 40-year high in January, with year-on-year growth of the headline consumer price index (CPI) rising further to 7.5%, up from 7% in the previous month. The core CPI, which excludes the volatile categories of food and energy, registered a 6% annual growth during the month, which is also the largest yearly rise since August 1982. The price increases were broad-based in January, led by soaring rents, electricity, food, and used vehicle prices.

Meanwhile, the US labour market has seen further improvement in its hiring momentum at the beginning of 2022. Nonfarm payrolls saw 467,000 jobs added in January 2021, higher than market expectations and building on an upward revision of 510,000 added jobs in the previous month. Although the unemployment rate edged up slightly to 4.0% during the month, this was mainly due more people joining the labour force, and the figure was still close to the pre-pandemic level of 3.5%. Average hourly wages also saw a 5.7% year-on-year growth in January, further up from a 4.9% growth in the previous month.

Against this backdrop, St. Louis Federal Reserve president James Bullard reiterated his stance that the US Federal Reserve (Fed) should take aggressive action to fight mounting inflationary pressure and called for a 100 basis-point hike by July. The January meeting minutes of the Fed show officials generally agreeing that removing policy accommodation at a faster pace will be appropriate if inflation persists. Officials also reckoned that a faster pace of rate increases than in the post-2015 period would likely be warranted if the economy evolves in line with their expectations.

Higher inflationary pressure, combined with the expectation of an aggressive rate hike trajectory by the Fed, has dented consumer sentiment. The University of Michigan Consumer Sentiment Index dropped to 62.8 in its final reading in February, down from 67.2 in the previous month and now at its lowest since October 2011. February's decline in consumer sentiment was mainly due to decline in inflation-adjusted personal finances, a broad awareness of rising interest rates, falling confidence in the government's economic policies, and the most negative long-term prospects for the economy in the

US inflation accelerates in January, with CPI rising 7.5% year on year.

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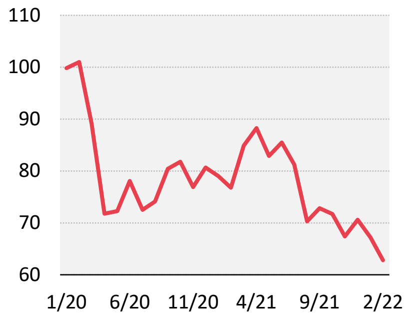
St. Louis Federal Reserve president James Bullard calls for aggressive implementation of interest rate hikes.

University of Michigan Consumer Sentiment Index



Source: Bloomberg, data as of 28/2/2022

past decade, according to the chief economist of the survey.

Going forward, as global supply chains face challenges from the ongoing pandemic and the new war between Russia and Ukraine, inflationary pressure may remain high in the upcoming months. This will fuel market expectation that the Fed will raise its target for the fed funds rate faster and start reducing its balance sheet earlier. This may negatively impact valuations of assets like tech stocks and property, which benefited from the ultra-low interest rate environment. As a result, the US economic outlook may face challenges in the medium term from the negative wealth effect resulting from asset price corrections.

Equity market correction continues as geopolitical tensions heightened

With market participants betting on policy normalisation by the Fed taking place soon amid higher inflation readings and mounting geopolitical tensions in Ukraine, US benchmark stock indices continued to decline in February, despite better-than-expected results among the roughly 76% of companies in the S&P 500 Index which had already reported earnings for Q4 2021. As of 28th February, the S&P 500 Index had dropped by 3.1% from the level at the end of January, while the Nasdaq was down by 3.4% and the Dow Jones Industrial Average by 3.5% over the same horizon.

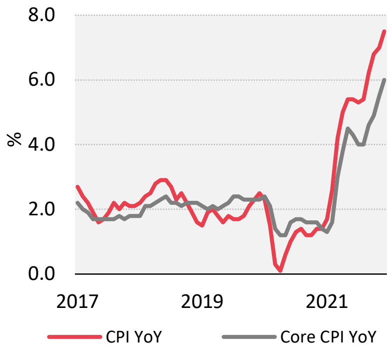
US dollar stabilises amid risk aversion while treasury yields head downwards

The US dollar once weakened slightly in February, mainly because of signs of de-escalation along the Russia-Ukraine border as some Russian troops initially appeared to be returning home after military exercises in the vicinity. Nonetheless, as Russia launched a military invasion of Ukraine towards the end of February, market risk aversion intensified and the dollar rebounded. As of 28th February, the dollar index stood at 96.707, about 0.2% higher than the level at the end of January.

In the bond market, US treasury yields continued to climb as more market participants now expect the Fed to raise interest rate faster. The 10-year treasury yield rose to 2.045% in mid-February, about 27 basis points higher than the level at the end of January. However, as market participants became more risk averse after Russia invading Ukraine towards the end of February, the previous rise in treasury yields was largely erased. As of 28th February, the 10-year treasury yield stood at 1.827%, only about 5 basis-point higher than the level at the end of January.

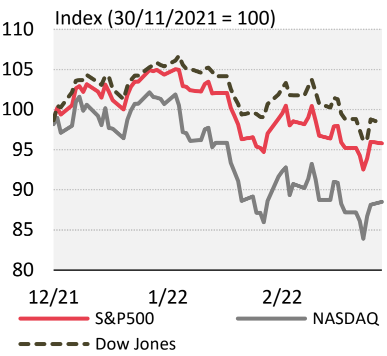
Looking forward, if geopolitical tensions rise again, the US dollar may strengthen again as demand for haven currencies rises. Meanwhile, the upward trend of treasury yields will continue, as inflationary pressure remains high. Elevated equity market valuations will continue to face challenges as investor sentiment will be adversely impacted by upcoming policy normalisation from the Fed as well as by geopolitical tensions surrounding Ukraine and between the US and China.

US Inflation



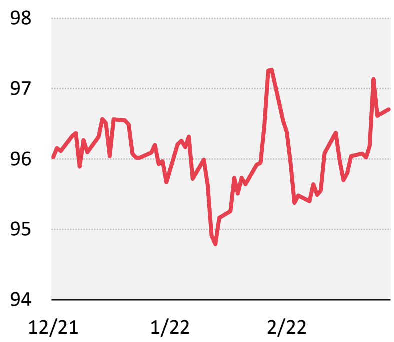
Source: Bloomberg, data as of 15/2/2022

US Equity Indices



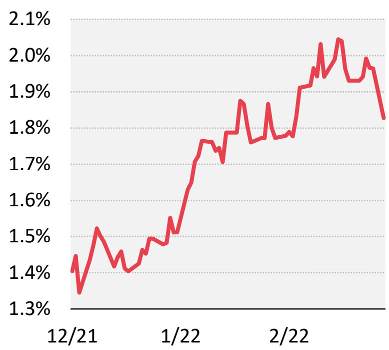
Source: Bloomberg, data as of 28/2/2022

Dollar Index



Source: Bloomberg, data as of 28/2/2022

US 10-year Treasury Yield



Source: Bloomberg, data as of 28/2/2022

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