Economic Research

June 2022

Market Monitor – United States

Financial Market Volatility Ahead of Expected Monetary Tightening

Inflation eases slightly in April but consumer sentiment continues to deteriorate

As the annual rise in energy prices eased slightly, the headline US consumer price index (CPI) registered a year-on-year growth of 8.3% in April, slightly down from 8.5% in March. The core CPI, which excludes the volatile categories of food and energy, registered a 6.2% annual growth during the month, also down from 6.5% in the previous month. Nonetheless, inflationary pressure may remain high as housing costs continue to rise. The annual increase in shelter costs, which make up about of a third of the US CPI, edged up to 5.1% in April from 5% in the previous month. With inflation staying elevated, consumer sentiment remains fragile. The preliminary reading of the University of Michigan Consumer Sentiment Index dropped to 58.4 in May from 65.2 in the previous month, hitting a new low since August 2011.

The US labour market continued to see a steady pace of jobs growth in April. Nonfarm payrolls saw 428,000 added jobs during the month, matching the slightly downwardly revised figure from the previous month. At the same time, the unemployment rate stayed at 3.6%, close to the pre-pandemic level of 3.5%. Labour earnings have continued to see solid growth amid a tight labour market, with average hourly wages registering year-on-year growth of 5.5% in April.

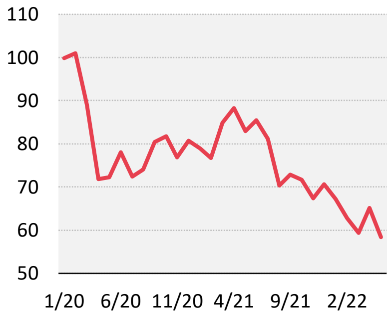
Looking ahead, US inflation will remain elevated for the rest of 2022 due to the likelihood of continuing supply chain bottlenecks amid the ongoing war in Ukraine and Covid lockdowns in China. Federal Reserve (Fed) chairman Jerome Powell warned that getting inflation under control could cause some economic pain, but it remains his top priority. As borrowing costs edge higher, business investment and household consumption will be negatively impacted. The US will face an increased risk of recession in the medium term.

Headline inflation declines slightly to 8.3% year on year in April, mainly due to a slower annual rise in energy prices.

University of Michigan Consumer Sentiment Index drops in May to lowest since August 2011 as rising living costs dent consumer confidence.

Labour market continues to see improvements, with nonfarm payrolls seeing 428,000 jobs added in April.

University of Michigan Consumer Sentiment Index

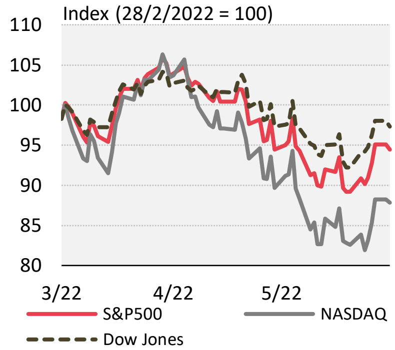


Source: Bloomberg, data as of 31/5/2022

Equity market saw increased volatility in May

US benchmark equity indices saw volatile performance in May. As investors expect financial conditions to tighten further while the Fed continues to raise interest rates and reduce its balance sheet, major equity indices trended downwards after 4th May. However, as Atlanta Fed chief Raphael Bostic said that a pause in September "might make sense" on 23rd May, some investors expected that the Fed might ease the pace of rate hike later this year. The US equity market recovered some losses at the end of May. From the end of April to the end of May, the S&P 500 Index and the Dow Jones Industrial Average registered mild gains of 0.01% and 0.04%, respectively. Meanwhile, the Nasdaq Composite Index was down 2.1% over the same horizon.

US Equity Indices



Source: Bloomberg, data as of 31/5/2022

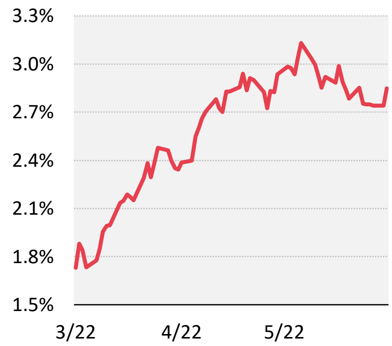
Treasury yields become volatile, while the dollar retreats after ECB president signals support for raising EU interest rates

The benchmark 10-year treasury yield saw volatile movements in May. The 10-year treasury yield extended its upward trend at the beginning of May. On 6th May, the 10-year Treasury yield closed at 3.131%, about 19 basis point higher than the level at the end of April. Nonetheless, as the stock market volatility continues and worries about growth outlook mount, some investors are seeking safe haven assets, and treasury yields have edged lower in May. As of 31st May, the 10-year treasury yield stood at 2.847%, about 9 basis points lower than the level at the end of April.

In the foreign exchange market, the dollar index was strong at the start of May. On 12th May, the dollar index closed at 104.851, about 1.8% higher than the level at the end of April. However, after European Central Bank (ECB) president Christine Lagarde recently signalled that she would support raising the ECB's main interest rate in July, the euro strengthened against the US dollar towards the end of May, erasing the dollar index's earlier gains. With some market participants adjusting their expectations for the pace of rate hike by the Fed, dollar weakened towards the end of May. As of 31st May, the dollar index stood at 101.752, about 1.2% lower than the level at the end of April.

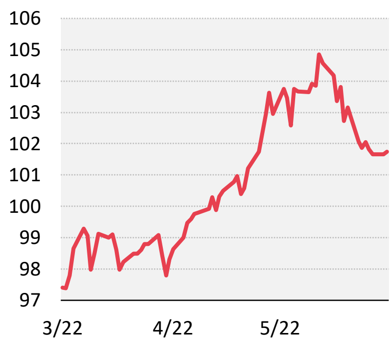
Looking ahead, the direction of treasury yields will be influenced by the pace of the Fed's policy tightening and investors' risk appetite. Meanwhile, falling valuations for risky assets that previously benefited from ultra-low interest rates may precipitate a more general downward adjustment amid tighter financial conditions.

US 10-year Treasury Yield



Source: Bloomberg, data as of 31/5/2022

Dollar Index



Source: Bloomberg, data as of 31/5/2022

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