Treasury Monthly Market Commentary 09|22

Powell warns against premature loosening at Jackson Hole summit; Fed Chair Powell spoke for little more than nine minutes at the annual event and kept his message simple: Restoring price stability will likely require maintaining a restrictive policy stance for some time and the historical record cautions strongly against prematurely loosening policy. In recent months, markets anticipated sharp rate hikes but also expected rates to fall back from their peak quite quickly as the economy slowed. Powell pushed back on that notion in his recent address. He welcomed improvement in the July inflation figures but noted that one month's improvement falls far short of what the FOMC needs to see before it is confident that inflation is moving lower. Powell acknowledged that while higher interest rates, slower growth and softer labour market conditions will bring pain to some households and businesses, those are the unfortunate costs of reducing inflation.

Mixed US data keep investors guessing; The flash readings of August US purchasing managers' indices painted a grim economic picture as the composite index slumped further, to 45 from 47.7 in July. Sales of new homes continued to fall in July, dropping 12.6% from June amid higher mortgage rates and higher prices. One bright spot was a continued decline in initial jobless claims. The data, historically a leading indicator of recession, have eased modestly since reaching a peak seven weeks ago. In one more sign of a surprisingly resilient labour market, an annual benchmark revision to data from the US Department of Labour Department saw an additional 462,000 jobs added to payrolls in the year through March, nearly 39,000 more each month than previously reported. Q2 US GDP was revised to -0.6% from an initial -0.9% reading. Consumer spending grew at an annualised 1.5% in Q2, up from an initial 1% estimate. Aggregate US nonfinancial corporate profit margins expanded during the period to 15.5% from 14% in Q1. That's the most since 1950 and suggests that companies have thus far been able to pass rising input costs on to consumers.

China warns economic recovery "not solid"; China's State Council last week announced new stimulus measures aimed at shoring up economic confidence while acknowledging that the "foundation of economic recovery is not solid." Among the measures contained in the 19-point plan is additional credit support for state banks and allocations of special bonds for local governments, though the government continues to insist it will not flood the economy with excessive stimulus.

US inflation: The Fed's favourite inflation measure, the core personal consumption expenditures price index, eased to 4.6% in July from 4.8% in June. Core PCE peaked in February at 5.3%, well above the Fed's 2% target. A study by economists at the Federal Reserve Bank of New York showed that without supply chain bottlenecks, inflation would have been 6% at the end of 2021 instead of 9%.

European bond yields probing the highs; European bond yields maintain their upward trajectory following numerous indications that policymakers at the European Central Bank will discuss a 0.75% rate hike at their September meeting. Markets are now pricing in about around a 50% chance of such an outcome. Also, on Thursday, German Q2 GDP was revised to up 0.1% from the prior quarter from an initial flat reading while the Eurozone flash composite purchasing managers' index fell deeper into contraction at 49.2 in August, from 49.9 in July, while Japan's fell to 48.9 from 50.2. Meanwhile, Europe's energy crisis is growing more serious, with Bloomberg reporting that German energy prices have risen 10-fold over the past year. Last Friday, the United Kingdom's energy regulator raised the price cap on annual household energy and gas bills to more than £3,500 from just under £2,000. The Financial Times reported that industry forecasts suggest the cap could rise to more than £6,000 by spring.

Markets wise; Global equities are scaling the lows after hawkish comments from US Federal Reserve Chair Jerome Powell at the annual gathering of global central bankers in Jackson Hole, Wyoming. The yield on the US 10-year Treasury note has been steadily rising, now standing at around 3.20% from 2.95% last Friday while the price of a barrel of West Texas Intermediate crude oil increased to $92.25 from $88. The US Dollar dominion meanwhile continues for the time-being, with all-time lows within touching distance for the GBP, EUR and JPY.