Weekly Market Summary

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Bears Take The Easter Award As Hard Landing Recession Fears Grow

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Equities down, Treasuries down, Crude up, Dollar up. That basically sums up a shortened week and a cloudy Friday.

In Europe, ECB President waffled on about the outlook for ending asset purchases, a precursor to a rate hike. The expectation was that the central bank would take a more aggressive policy stance with inflation running 7.5%, above most measures of price stability. The bank's policy rates remain unchanged at nil or less. Policymakers on the central bank's governing council, who met this week in Frankfurt, are grappling with how drastically to tighten monetary policy to tackle record inflation while assessing the risk of a sharp economic downturn caused by Russia's invasion of Ukraine. "The upside risks surrounding the inflation outlook have also intensified, especially in the near term," said Lagarde. She also said the "downside risks to the growth outlook have increased substantially as a result of the war in Ukraine". The "euro area is probably going to be more exposed and will suffer more consequences from the war in Ukraine" than the US or other regions, she said.

On QE, the ECB said that "incoming data since its last meeting reinforce its expectation that net asset purchases under its asset purchase programme should be concluded in the third quarter" and added that "looking ahead, the ECB's monetary policy will depend on the incoming data and the Governing Council's evolving assessment of the outlook." The ECB then fell back to a trite Mario Draghi cliche, saying that "in the current conditions of high uncertainty, the Governing Council will maintain optionality, gradualism and flexibility in the conduct of monetary policy. The Governing Council will take whatever action is needed to fulfil the ECB's mandate to pursue price stability and to contribute to safeguarding financial stability."

The ECB's first chief economist when it was created in 1998 said the central bank was suffering from a "misdiagnosis" of the factors behind the surge in prices, having "lived in a fantasy" that played down the danger of inflation spiralling out of control. "The ECB has contributed massively to this trap in which it is now caught because we are heading towards the risk of a stagflationary environment," said the 86-year-old, who is credited with shaping the central bank's use of money supply measures to decide interest rate policy. The bank is facing a conundrum of helping countries borrow at affordable rates while also keeping the lid on inflation.

The ECB's relatively dovish tilt failed to stem selling in the bloc's bond markets. The German 10-year Bund yield increased 0.13 percentage points this week to 0.84 per cent, having started the year at minus 0.18 per cent. Italian yields advanced with the 10-year up more than 25 basis points to 1.93%. US government bonds also took a hit this week, with the 10-year yield rising 0.12 percentage points to 2.83 per cent. The euro struck a nearly two-year low. The common currency fell below $1.08 for the first time since May 2020. The euro has shed almost 5 per cent against the dollar so far this year, adding to a 6.9 per cent fall in 2021.

The cocktail of a hawkish Williams, soaring US import prices, skyrocketing inflation, and rising oil prices sustained the bond selling and the stocks beating through the week.

Across the Atlantic, Fed Williams decided to change his tune by marking to market himself in terms of FOMC consensus. The New York Fed President said a large interest-rate increase is a good prospect at the U.S. central bank's early May meeting, as part of an effort to move short-term rates up aggressively to contend with high inflation. "From a monetary policy point of view, it does make sense for us to move expeditiously towards more normal levels of the federal-funds rate, and also did move forward on our balance-sheet reduction plans," he said. He added he still believes that a federal-funds target rate that neither stimulates or restricts growth is around between 2% and 2.5%, in comparison to the current setting of between 0.25% and 0.5%. Two other Fed officials also spoke on Thursday. Cleveland Fed leader Loretta Mester, who has a vote on the FOMC this year, said "labor markets in the U.S. are very tight and inflation is very elevated." Separately, Philadelphia Fed leader Patrick Harker repeated he also believes steady action is needed from the Fed to bring down levels of inflation, which he said are unacceptably high. "I expect a series of deliberate, methodical hikes as the year continues and the data evolve. I also anticipate that we will begin to reduce our holdings of Treasury securities, agency debt, and mortgage-backed securities soon," Mr. Harker said. The Fed funds futures strip has a 50 bp hikes nearly fully discounted for May and June. For the July meeting, the market has leans toward a 50 bp hike as well but is not quite there yet. It appears be consistent with about a 30% chance of 50 bp instead of 25 bp.

In US data, for those living in America and got a 5% raise this year, congratulations on their 3.5% pay cut. The latest seasonally adjusted inflation rate for March was 1.21% month over month, with a non-seasonally adjusted annual rate of 8.56%. Both of these numbers came in slightly above expectations. Expectations were elevated due to the war in Ukraine. The current increase is driven largely by a rise in energy prices which contributed .83% to the MoM move. This makes up 68% of the 1.21% move. YoY the price increases as more widespread. Energy is certainly a large component, but so are many other items. The Biden administration blamed surging prices on the war, with White House press secretary Jen Psaki saying the CPI reading would be "extraordinarily elevated due to Putin's price hike". Other data showed little change to broad trends. Retail sales were broadly in line, with a small miss on headline and control balanced by a small beat on ex-autos. Factor in some upward revisions to the prior data and you can probably call it a tiny beat in aggregate, but one that is unlikely to move any sort of market or policy needle. Meanwhile, both import and export prices rose faster than expected, even as prior data was revised higher. While these figures were impacted by commodity prices and other aspects of sanctions, it is nevertheless telling that import prices have trended along a 10% y/y gain for a year now and have just reached a fresh peak of 12.5%. There's little sign of moderating inflation pressure on that front. Finally, jobless claims were a touch higher than expected at 185k (versus 170k forecast), but remain extraordinarily low by historical standards, underscoring the strength of the labor market. S&P 500 stock index fell 2.1 per cent for the week, with the Nasdaq Composite off 2.6 per cent.

In the black gold market, crude benchmarks shrugged-off a larger-than-expected inventory build this week, instead taking cues from geopolitics, where major oil traders are set to lower purchases of Russian barrels in the months ahead, adding to the market tightness. News that the EU may impose a phased ban on Russian oil imports came out. Germany and other countries need time to find alternative suppliers. On Wednesday, the International Energy Agency warned that about 3 million barrels per day of Russian oil could be halted starting May 15 due to sanctions or buyers rejecting Russian cargoes. On Thursday, President Vladimir Putin said that Moscow would work to redirect energy exports to the east as Europe tries to reduce its dependence on them, adding that European countries will not be able to abandon Russian gas immediately. Meanwhile, OPEC has sat on the sidelines of the morning energy crises. OPEC secretary-General Mohamad Barkindo told the European Union on Monday that the oil market was beyond its control. That's a

sign that the cartel is unlikely to ramp up production in a bid to ease output constraints, even as it predicts that the war will crimp supplies. OPEC's de facto leader, Saudi Arabia, has been keen to preserve ties with Moscow.

Stocks and Treasuries took a beating. Unsurprisingly, inflation was yet again the culprit. The real question of the year is can the Fed stamp out inflation without causing a recession? Clearly, hard to say. As Powell said, "no one expects that bringing about a soft landing will be straightforward in the current context. Monetary policy is often said to be a blunt instrument, not capable of surgical precision."

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