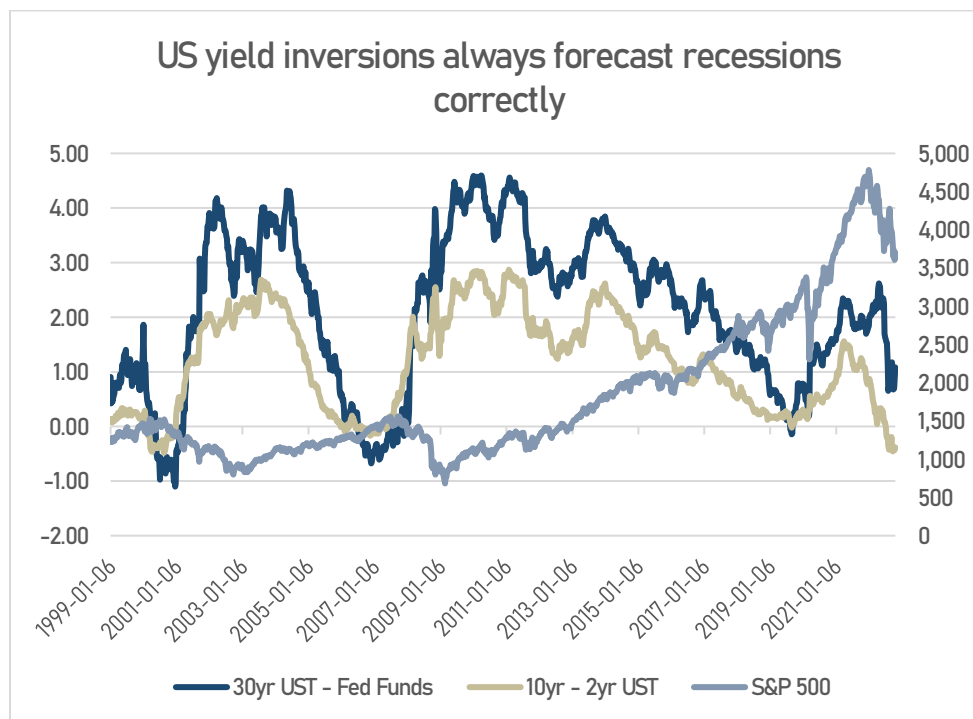


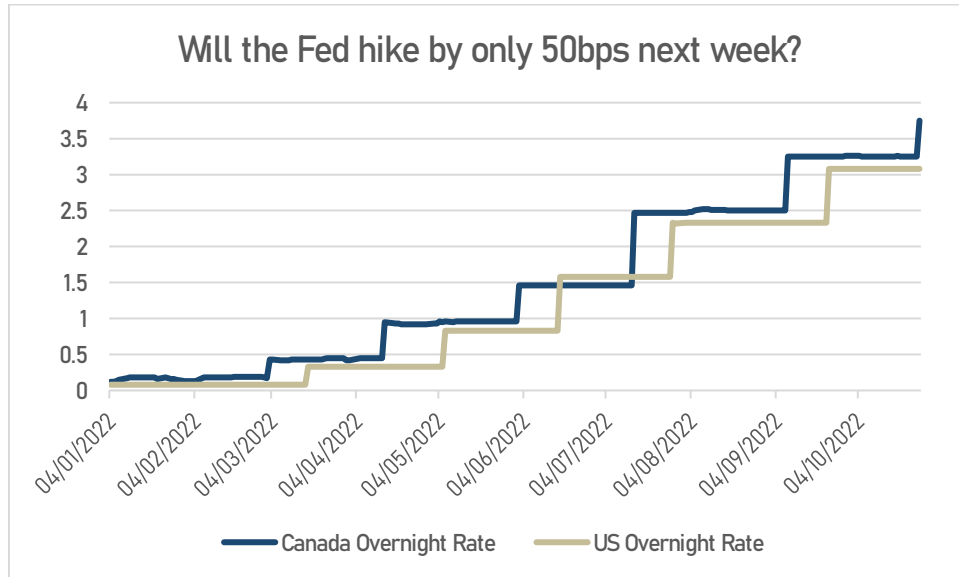
Are Central Banks trapped?

Risk sentiment has improved slightly, partly as a result of a decline in long-term interest rates in recent days. Like inflation, interest rate hikes take time to feed into the system. A slowdown in the economy therefore results in lower interest rate expectation and improvement in risk sentiment. However, this is likely short-term. We are 4 months into a 2s10s US yield curve inversion with as much as 50bps inversion. The last time we had such a deep inversion was in 2000 and began in February 2000 and lasted until end of December 2000. Furthermore, 30yr UST yields are still higher than Fed Funds rates, and if market pricing is correct with two 75bps to come until the end of this year, risk markets might still be supportive until end of 2022.



Source: FRED St. Louis

The Bank of Canada has raised their interest rates faster than any other central bank to stay ahead of the Fed. However, with the 50bps instead of 75bps hike today, will the Fed follow the BOC with only 50bps hike next week and what could be the result of that?



Source: Bank of Canada, FRED St. Louis

House prices vs. commodities vs. interest rates

Already in the summer I have come to believe that we might have reached peak inflation in the US with the UK being driven solely by the delay of energy price increases due to the Ofgem tariff. I was quite wrong about this, as inflation continued to accelerate with 2nd and 3rd round effects taking place. However, a large part of the inflation in the US we are currently seeing is mostly in food and rent of property. Looking at Rightmove for places to rent in London where we also had strong increases in rental prices, which appear to be levelling off, as there are some reductions visible in the market, which is not appearing in the data yet. Housing in the US contributes between 15-18% of GDP¹, and therefore any slowdown there will affect growth negatively. When the Fed stopped hiking rates in 2006 and then began cutting rates in 2007, the US\$ weakened substantially and drove oil prices to record highs. Could this happen again?

¹ <https://www.nahb.org/news-and-economics/housing-economics/housings-economic-impact/housings-contribution-to-gross-domestic-product>

US Inflation in August & September 2022

+0.1% August 2022 CPI Print

Biggest drivers:

-0.1% used cars (4.02% weight)
+0.8% new vehicles (4.02% weight)
-0.5% car and truck rental (0.15% weight)

+0.1% lodging away (0.98% weight)
-4.6% airline fares (0.67% weight)
+0.7% rent of shelter (31.9% weight)
+0.5% transportation services (5.9% wgt)
+0.2% apparel (2.39% weight)
-5% energy (8.78% weight)

+0.8% Food (13.53% weight)

+0.8% Medical care services (6.81% wgt)

+0.4% September 2022 CPI Print

Biggest drivers:

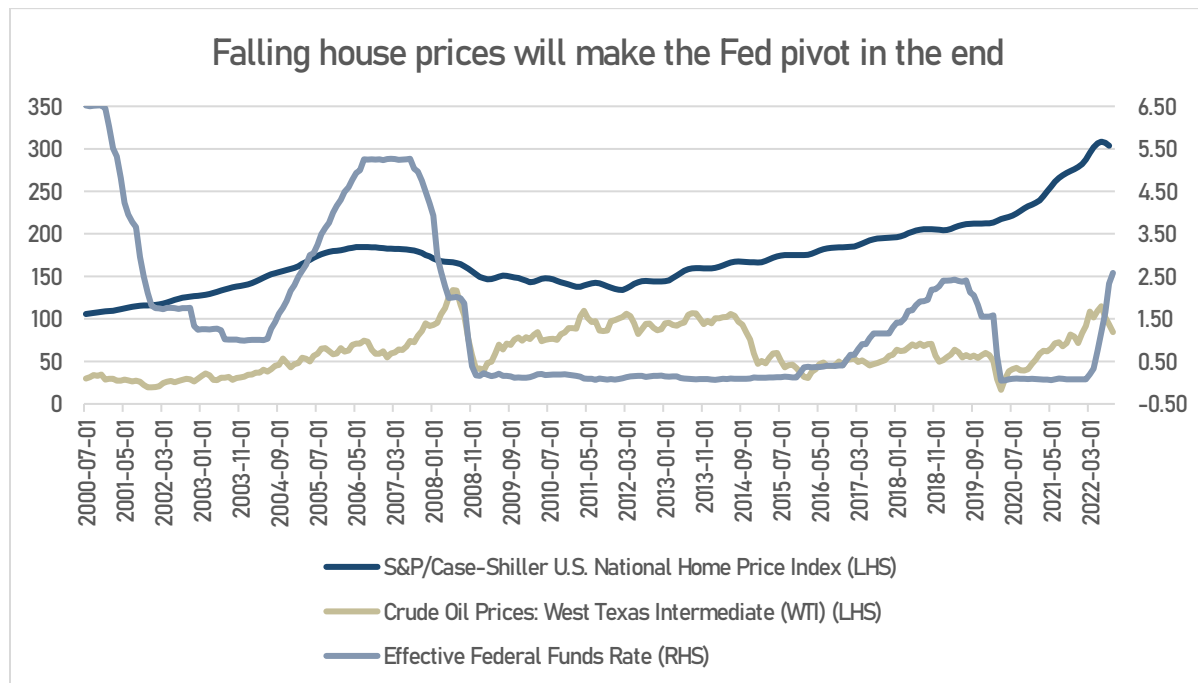
-1.1% used cars (4.0% weight)
+0.7% new vehicles (4.05% weight)
+2.5% car and truck rental (0.15% weight)

-1.0% lodging away (0.97% weight)
+0.8% airline fares (0.62% weight)
+0.8% rent of shelter (32.1% weight)
+1.9% transportation services (5.9% wgt)
-0.3% apparel (2.43% weight)
-2.1% energy (8.24% weight)

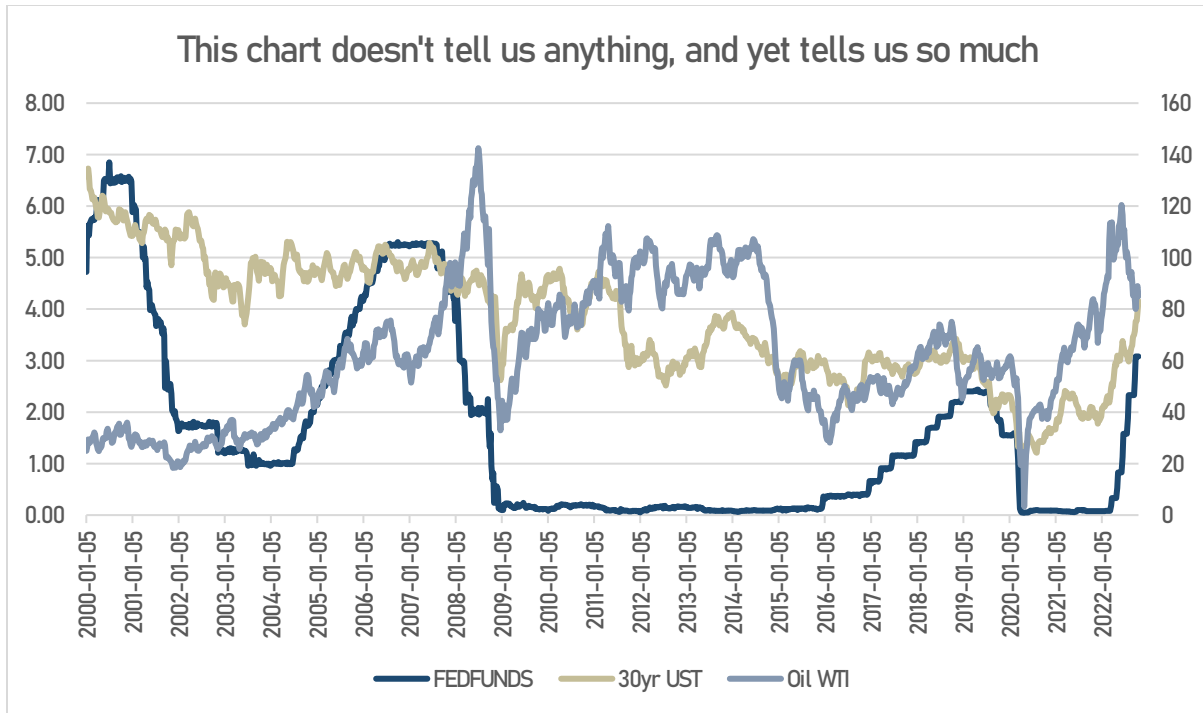
+0.8% Food (13.63% weight)

+1.0% Medical care services (6.89% wgt)

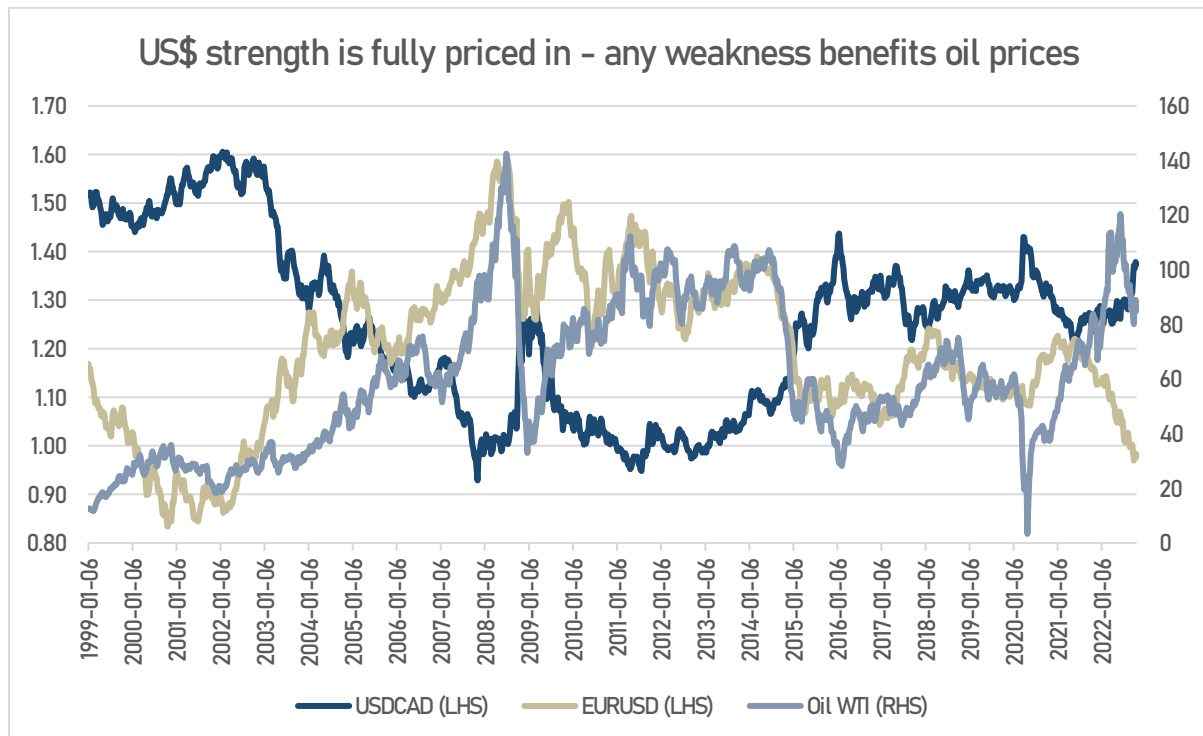
Source: US Bureau of Labor Statistics



Source: FRED St. Louis



Source: FRED St. Louis



Source: FRED St. Louis

The Russian oil price cap

Russia is exporting around 8mio barrels of oil and products per day, of which about 60% have gone to Europe in 2021² with around 3.2mio barrels a day going to the EU alone. While Moscow has shifted around 1.5mio barrels a day to China, India and Turkey³, the cap would either take 1.5mio barrels off market or Russia will have to find more crude oil tankers for the longer journey. But the question will be whether these three countries have appetite to bid more Russian crude... This comes on top of 1mio bopd being taken off the market amid the end of the SPR release and OPEC+ cutting output by around 0.4mio to 1.1mio bopd⁴. The 0.4mio bopd is roughly equal to the 0.5mio bopd in expected world oil demand decline⁵.

The Fed's pivot

Canada's central bank today delivered a 50bps rate hike against 75bps expectations, noting slowing economic activity abroad, particularly in the United States, which is weighing on exports⁶. 2x75bps were priced in for the Fed's November and December meeting + additional hikes of 50bps in 2023 before cuts are being priced in. This peak in interest rate hikes was priced on 20th October and has since begun subsiding. The dramatic slowdown in housing could deliver a Fed pivot, which in turn would weaken the US\$ (also because Europe seems to be getting through the winter, having enough gas in storage), and lead to a rally in US\$ priced commodities such as oil and gold. The Fed needs to make a choice: Save the housing market or protect from energy related inflation. So far it appears like the Fed is focused on the latter (& the 2nd round effects it brings), but at some point there will be a shift, which could turn out to be positive for commodities – at least in the short-term. A 50bps hike could be the turning point, while a 75bps could be seen as weakening the US economy too much. Either way, this could make the US\$ sell-off...



² <https://www.iea.org/reports/russian-supplies-to-global-energy-markets/oil-market-and-russian-supply-2>

³ <https://www.bloomberg.com/news/articles/2022-10-24/eu-sanctions-already-crimping-russian-crude-sales-to-prime-markets>

⁴ <https://www.reuters.com/business/energy/opec-heads-deep-supply-cuts-clash-with-us-2022-10-04/>

⁵ <https://momr.opec.org/pdf-download/>

⁶ <https://www.bankofcanada.ca/2022/10/fad-press-release-2022-10-26/>

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