Market comment_15Jul2023

Inflation in the United States cooled significantly in June, exceeding expectations, and the yen and offshore RMB rebounded strongly

By Sandy Wang, 15 July 2023-6 pm SGT time

Key Takeaways:

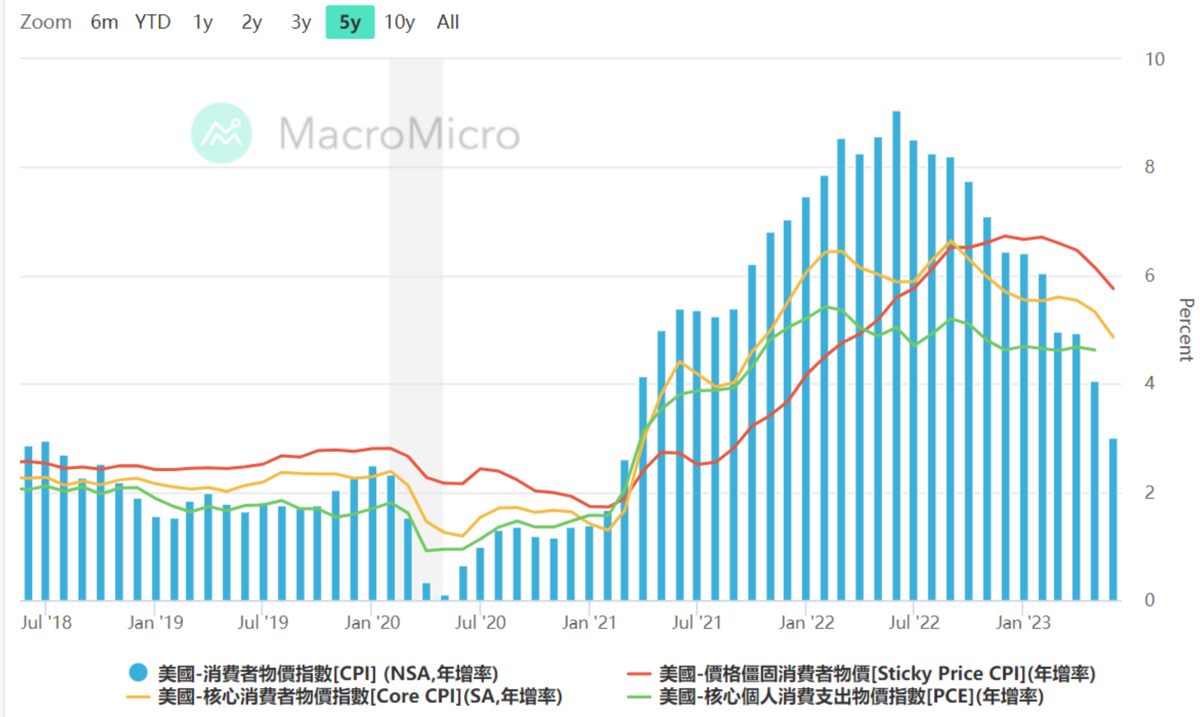
- *In June, the US CPI and PPI fell beyond expectations, causing a sharp drop in the US dollar;*
- *In June, the US CPI cooled significantly, returning to the era of '3%' in the headline figure, leading to a sharp decline in the US dollar;*
- *The US Consumer Confidence Index rose sharply in July, and the dollar rebounded slightly;*
- *The JPYUSD surged by 550 pips; caution arises ahead of the Bank of Japan's July interest rate meeting regarding YCC curve adjustments;*
- *The strong interest rate outlook and wage data from the Bank of England contributed to the continued rise in sterling. The rise of GBPJPY is limited;*
- *EURUSD has experienced significant gains, but the rise of EURJPY has been limited;*
- *Offshore RMB (CNH) sees its most substantial surge, surging 1200 pips against the US dollar;*
- *China's exports further declined due to the impact of decreasing demand in major global markets.*
- *With changing demand, China's consumer inflation rate eased to zero;*
- *Excess capacity weighs on China's Producer Prices.*

1. In June, the US CPI and PPI fell beyond expectations, causing a sharp drop in the US dollar.

1) In June, the US CPI cooled significantly, returning to the era of '3%' in the headline figure, leading to a sharp decline in the US dollar.

On Wednesday, 12 July, the US June Consumer Price Index (CPI) was reported at 3.0% YoY, which was below market expectations of 3.1% and lower than the previous figure of 4.0%. This data marks the twelfth consecutive month of decline and sets a new low in over two years. Meanwhile, the Core CPI YoY also fell from the previous 5.3% to 4.8%, breaking below the expected 5.0% and reaching its lowest level since November 2021. After the data was released, the market's immediate perception was that the decline in US inflation was not slowing down but rather accelerating downwards. This has resulted in a significant plummet in the US dollar, a substantial retreat in US treasury yields, and substantial increases in US stocks, non-US currencies, and gold prices. Analysing the reasons for this sharp decline in the data, it appears that the energy sector accounts for nearly 7% of the US Consumer Price Index (CPI) weights. In this dataset, the annual growth rate of the energy sector plummeted by

16.74%, making it the most significant contributor to the decline in US inflation. Solely the energy components contributed to a nearly 1% decrease in the US CPI YoY, bringing it down from 4% to 3%. If we exclude the energy components, the US CPI growth rate YoY may have remained at around 4%.



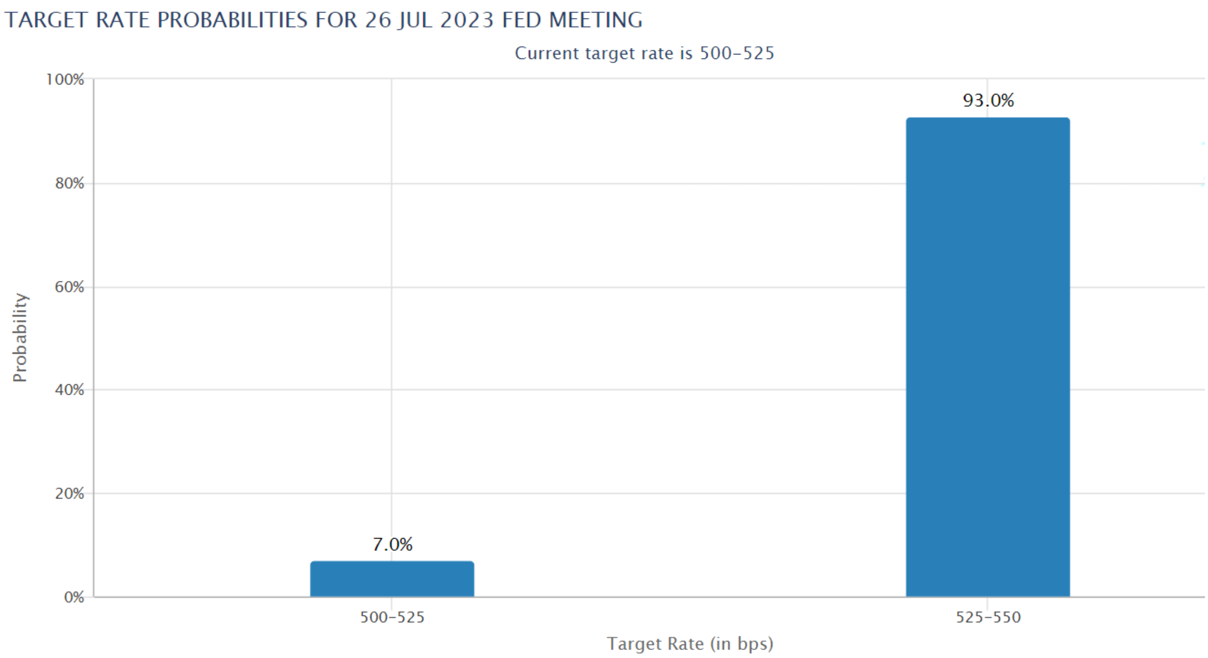
Source: MacroMicro

The words in the picture above:

Blue: US-Consumer Price Index [CPI] (NSA, YoY)
Yellow: US-Core Consumer Price Index [Core CPI] (SA, YoY)
Red: US-Sticky Price Consumer Price Index (YoY)
Green: US-Core Personal Consumption Expenditures Price Index [PCE] (YoY)

The Consumer Price Index (CPI) YoY in the United States has gradually declined since July last year, starting from a peak of around 9.05%, and the June data has now sharply decreased to 3.0%. The Sticky Price Consumer Price Index also shows a consistent downward trend. However, the data for the Core Personal Consumption Expenditures Price Index (PCE), which excludes food and energy, has not seen a significant decline. This may also mean that the inflation risk in the United States has not been completely lifted.

The aforementioned US CPI YoY data is the price increase over the past year compared to the same period last year. 12-month percentage change, the Consumer Price Index, which represents a breakdown of the YoY data, is typically considered a leading indicator of annual inflation in the country. According to the report, the monthly rate of change in the US Consumer Price Index for June registered 0.2%, slightly higher than the previous 0.1% but lower than the expected 0.3%. In the 1980s, during the era of Volcker leading the Federal Reserve in a period of Great Inflation, there were instances of inflation rebounds. Hence, investors need to be cautious about the possibility of a potential inflation rebound in the US, which could maintain levels above 3%. Further observation is required in the future. If inflation in the US increases by 0.2% each month, multiplied by 12 months, it will reach 2.4%, which still exceeds the 2% target. In other words, for the US CPI monthly rate of change to truly fall below 0.167% (0.2%/12=0.167%), the US monetary tightening policy would need to come to an end. The average monthly rate of change in the US CPI over the past three months is around 0.23%, indicating that the current consumer prices in the US remain above the 2% inflation target. This is one of the reasons why the Federal Reserve continues to raise interest rates in July.



Source: CME

Recently, both headline and core inflation in the United States for June were significantly below expectations, indicating that the Federal Reserve's tightening policy has achieved interim results and the likelihood of another rate hike after July has decreased. According to CME FedWatch Tool, the probability of a 25 basis points rate hike by the Federal Reserve in July to 5.25%-5.50% is 93.0%. However, the probability of a 25 basis points rate hike in September to 5.50%-5.75% has decreased to 11.2%, while the probability of keeping rates unchanged at 5.25%-5.50% has risen to 82.7%.

Currently, the Federal Reserve has two main policy objectives: price stability and maximum employment. Price stability refers to achieving a 2% inflation target. Regarding maximum employment, based on relevant data, the natural unemployment rate in the United States (the lowest unemployment rate level that will not stimulate inflation) is around 4.5%. In other words, as long as the unemployment rate remains below 4.5%, it can be considered full employment, and an annual increase in consumer prices of less than 2% indicates price stability. Currently, there is still a 1% decline in annual inflation, and the June unemployment rate in the US stands at 3.6%. For the past six months, the unemployment rate has been hovering around 3.5%. This suggests that the US labour market is not only at maximum employment but also experiencing some excessive tightness. We need to continue monitoring these two data because they are closely related to whether the Federal Reserve will continue to raise interest rates and how long they will maintain high rates.

After the release of the CPI data this time, although some officials, such as Minneapolis Fed President Neel Kashkari and Richmond Fed President Tom Barkin, continue to hold a hawkish stance, the June CPI data has raised doubts among some critical financial commentators about whether the Federal Reserve will still raise interest rates twice more.

- *Tom Barkin, the Richmond Fed President, stated that inflation remains too high, and the labour market remains strong, leaving uncertainty about whether inflation will stabilise. His remarks seem to imply that the Federal Reserve may be cautious about abandoning aggressive rate hikes, which means that being excessively bearish on the US dollar and bullish on non-US assets could face risks.*

- *Nick Timiraos, a Wall Street Journal reporter often seen as a "Fed mouthpiece" and a "New Federal Reserve News Agency," recently commented on the June CPI data, stating the inflation level in June reached the lowest point in over two years, confirming that the Federal Reserve is making progress in containing high inflation. Fed officials may still raise rates to the highest point in 22 years at the July meeting, but this inflation report increases the possibility that the Fed will pause rate hikes after this month's increase.*

- *Member of the Board of Governors of the Federal Reserve Christopher Waller stated on Thursday, 13 July, that with two more strong CPI data releases, it may imply a "pause" in rate hikes; the September meeting will be a consequential one for monetary policy; a soft landing for the economy is still possible; as the Fed works to reduce inflation, the economy may still face headwinds; the robust balance sheet allows the economy to withstand substantial rate increases.*

- *Chicago Fed President Charles Evans expressed on Friday, 14 July, that recent CPI data suggests that inflation is expected to ease, although it remains above the policymakers' 2% target. At least for this week, the inflation data we received shows that inflation is declining at a fairly fast pace, and the Fed can restrain inflation without causing a recession.*

The substantial downward revision of the US June inflation data, which for the first time fell into the 3% range, has significantly increased market expectations for the Federal Reserve to end its current cycle of rate hikes. Market participants should recall that as early as around October last year, when the Fed was still in the intermediate phase of its rate hike cycle, the US dollar had already peaked and retreated when the CPI YoY data first showed a turning point, dropping from 9.06% to 8.52%. So, at a time when US interest rates are about to reach their peak, it is not difficult to understand that the US dollar is facing a more ominous downward outlook. Ahead of the Federal Reserve's July rate decision at the end of this month (26 July), there is a possibility of a corrective bounce. However, it may be limited, and the Dollar Index still faces greater downside risk.

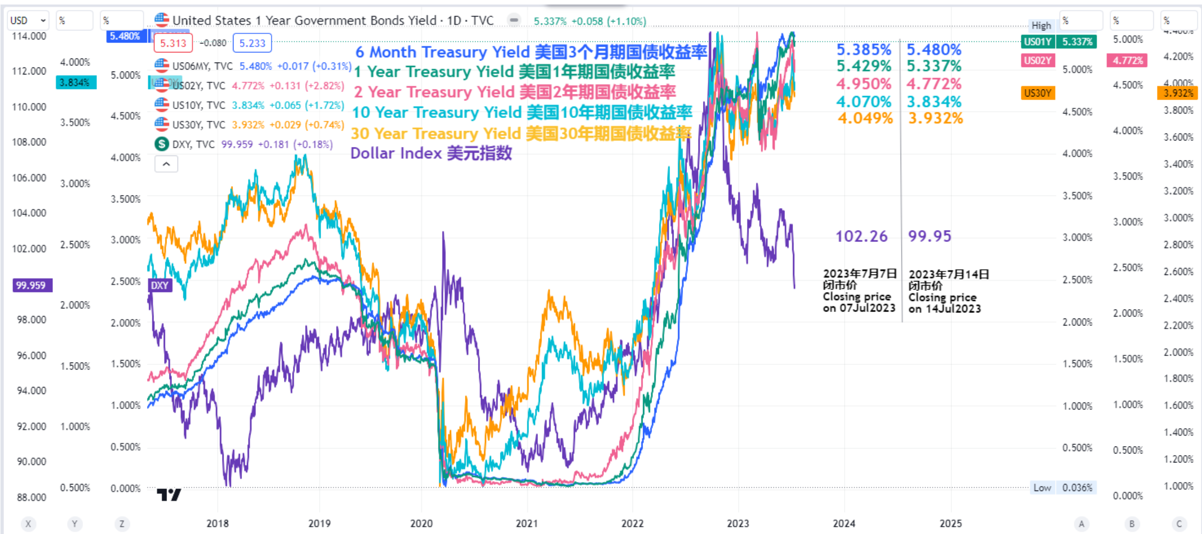
Around 17 May of last year, Goldman Sachs indicated that the US dollar was overvalued by 18%. The United States faces a high risk of falling into an economic recession, and the dollar's performance during contraction periods will be more complex. Looking back at the Dollar Index, it peaked and declined from around 114.50 last year to about 100.00 as of the closing on 14 July 2023, representing a decline of 12.66%. This suggests that the US dollar still has at least a 5.34% downward potential, which would correspond to a Dollar Index of approximately 94.66. Alternatively, it implies that after effectively breaking below 100.00, the Dollar Index could target 95.00, which is around the low point the Dollar Index reached in 2022. Considering a longer-term perspective, historically, the Dollar Index has performed around 85.00, indicating a medium to long-term range of 85-90 for the Dollar Index.

Source: TradingView

This week, the Dollar Index has perfectly completed the "ABCD" pattern formed since early March, reaching the D point near 100.00. The phase highs set in early March at 105.50 and in early June at 104.50 levels may not be revisited. In the third quarter of this year, if the index successfully breaks below 100.00, the next target could be around 95.00. Conversely, if it consolidates about 100.00, there is a high probability of another decline below 100.00.

2) The US PPI plummeted significantly in June.

On Thursday, 13 July, the US June Producer Price Index (PPI) recorded 0.1% YoY, significantly lower than the previous figure of 0.9% and the expected 0.40%. The US June Core Producer Price Index (PPI), excluding food and energy, recorded 2.4% YoY, lower than the previous figure of 2.80% and the expected 2.60%. PPI assesses the price changes faced by producers of goods at various stages of production in the US initial markets and is an important indicator of inflationary pressures on goods. The significant decline in PPI YoY may further indicate that the Federal Reserve's tight monetary policy has achieved desirable progress in controlling inflation. It also reinforces the market's confidence in the Federal Reserve's potential pause in rate hikes after July and raises expectations for the possibility of a rate cut cycle starting in 2024. Following the news release, US Treasury yields experienced a widespread decline, with the 10-year Treasury yield falling nearly 30 basis points this week, to around 3.76%, fully reversing last week's gains. In contrast, the 2-year Treasury yield fell below the critical level of 5%.



Source: TradingView

As of the market close on 14 July 2023, the US Treasury yields for the 6-month, 1-year, 2-year, 10-year, and 30-year bonds recorded 5.480%, 5.337%, 4.772%, 3.834%, and 3.932%, respectively. As of the market close on 7 July 2023, these figures were 5.385%, 5.429%, 4.925%, 4.070%, and 4.049%. Two weeks ago, these figures were 5.461%, 5.425%, 4.900%, 3.843%, and 3.863%. Except for a slight increase in the shortest-term 6-month US Treasury yield, the yields for other treasuries have all decreased, with the 10-year US Treasury yield experiencing the most significant decline.

3) The US Consumer Confidence Index rose sharply in July, and the dollar rebounded slightly.

On Friday, 14 July, the University of Michigan consumer sentiment for the US for July (preliminary) surged from the previous value of 64.4 to 72.6, far exceeding the expected value of 65.5. The US University of Michigan consumer expectations for July (preliminary) also jumped from the previous value of 61.5 to 69.4, well above the expected value of 61.8. The US 5-year inflation expectation for July is 3.1%, higher than the previous value and the expected value of 3.00%. The US 1-year inflation expectation for July is 3.4%, higher than the previous value of 3.30% and the expected value of 3.10%. This is the first increase in this inflation indicator in 5 months. University of Michigan surveys of consumers data have proven to have a certain degree of forward-looking predictive ability, as it has previously anticipated the unexpected decline in US inflation multiple times. Therefore, the significant increase in US consumer sentiment may imply the possibility of a rebound in US inflation, boosting the Dollar Index to a short-term rebound of around 100.00. Nevertheless, it is also essential to be vigilant that any upward correction of the US dollar may be limited and temporary.

Since July, the Dollar Index has fallen for two consecutive weeks. Especially after the release of US CPI data in June this week, the decline has been like a waterfall, falling directly below the crucial psychological level of 100, reaching a minimum of about 99.50, which is also the largest weekly decline since last November. As of this Friday (14 July), when the market was closed, the Dollar Index recorded 99.95, a new low since 22 April last year. The following are the record highs and lows for the past week:

- *US Dollar Index (DXY) dropped 300 pips (from 102.50 to 99.50), closing at 99.95 on 14 July.*
- *EURUSD rose 300 pips (from 1.0950 to 1.1250), closing at 1.1225 on 14 July.*
- *GBPUSD rose 400 pips (from 1.2750 to 1.3150), closing at 1.3090 on 14 July.*
- *AUDUSD rose 270 pips (from 0.6620 to 0.6890), closing at 0.6837 on 14 July.*
- *NZDUSD experienced a 250-pip upward movement (from 0.6160 to 0.6410), closing at 0.6368 on 14 July.*
- *USDJPY dropped 550 pips (from 143.00 to 137.50), closing at 138.79 on 14 July.*
- *USDCHF dropped 350 pips (from 0.8910 to 0.8560), closing at 0.8617 on 14 July.*
- *USDCAD dropped 210 pips (from 1.3300 to 1.3090), closing at 1.3213 on 14 July.*
- *USDCNH fluctuated and down 1260 pips (from 7.2480 to 7.1220), closing at 7.1500 on 14 July.*
- *USDSGD fluctuated and down 330 pips (from 1.3500 to 1.3170), closing at 1.3209 on 14 July.*
- *Gold rose $50 per ounce (from $1913.50 to $1963.50), closing at $1955.28 on 14 July.*
- *Bitcoin fluctuated within the range of 29930 to 31830, closing at 30181 on 14 July.*

This week, the US Dollar experienced a significant decline, leading to a surge in global stock markets. Major European and Asia-Pacific stock markets also followed the upward trend of the US market, resulting in gains of varying degrees over the past week. Among the biggest gains, the Dow rose 1000 pips, the Nikkei climbed 1050 pips, and China's Hang Seng Index rose 1150 pips. The following is the record for the past week:

- *Dow Jones Industrial Average surged 1000 pips (33600-34600) to close at 34490 on 14 July.*
- *S&P 500 Index rose 150 pips (4380-4530) to close at 4505 on 14 July.*
- *Nasdaq Index gained 780 points (14950-15730) to close at 15570 on 14 July.*
- *JP225 increased 1050 pips (31800-32850) to close at 32332 on 14 July.*
- *AUS200 rose 340 pips (7000-7340) to close at 7310 on 14 July.*
- *GER30 surged 730 pips (15450-16180) to close at 16068 on 14 July.*

- *EU50 climbed 200 pips (4200-4400) to close at 4382 on 14 July.*
- *UK100 increased 250 pips (7220-7470) to close at 7412 on 14 July.*
- *NL25 rose 30 pips (750-780) to close at 774.73 on 14 July.*
- *FRA40 gained 350 pips (7050-7400) to close at 7352 on 14 July.*
- *CH20 climbed 300 pips (10800 -11100) to close at 11109 on 14 July.*
- *ES35 rose 320 pips (9200-9520) to close at 9422 on 14 July.*
- *SING30 increased 17 pips (280-297) to close at 295.42 on 14 July.*
- *TWIX gained 35 pips (630-665) to close at 662.8 on 14 July.*
- *CHINA50 rose 330 pips (12500-12830) to close at 12726 on 14 July.*
- *CHINAH surged 420 pips (6200-6620) to close at 6506 on 14 July.*
- *HK50 climbed 1150 pips (18400-19550) to close at 19273 on 14 July.*

Currently, the main driving force behind the rise in the US stock market is the AI stock frenzy. That is, the technology stocks represented by the NASDAQ index of the United States were driving the gains in the US stock market. If the NASDAQ index turns downward, there is a high possibility that all three major stock indices in the United States will undergo a new round of downward correction, which may drive global stock markets to fluctuate downward. On the contrary, if investors continue to firmly buy technology stocks, then US stocks may still continue to rise against the trend.

2. The JPYUSD surged by 550 pips; caution arises ahead of the Bank of Japan's July interest rate meeting regarding YCC curve adjustments.

1) The JPYUSD's upward momentum seems unstoppable, causing the USDJPY to plummet by 550 pips.

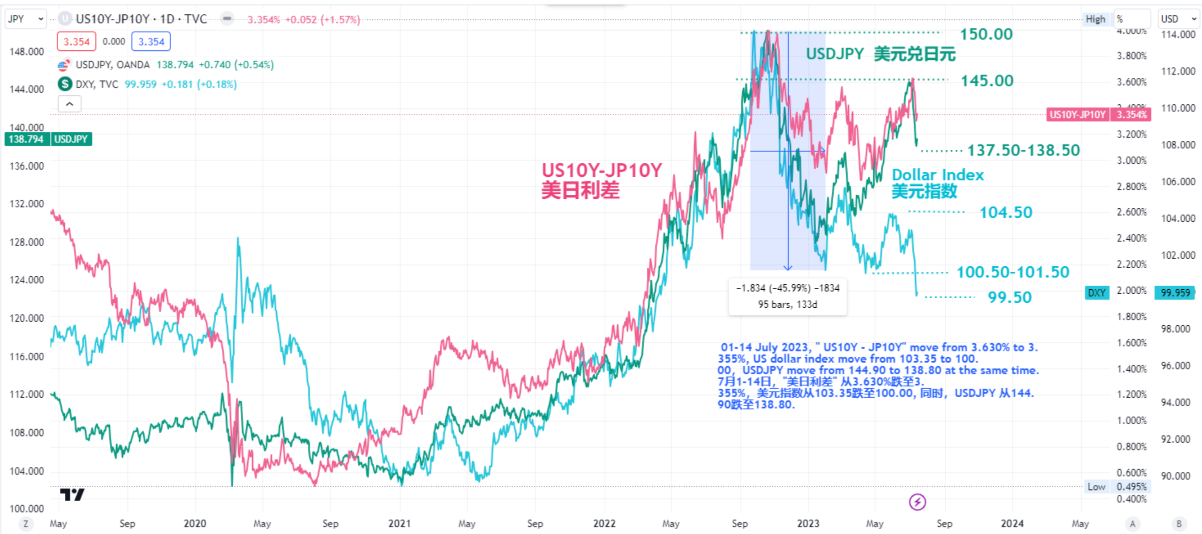
In the latter half of this year, the author of this article warned twice (on 3 July and 10 July) that the "reversal of yen carry trades" could be one of the biggest black swan events of the second half of the year and if the market has already fully priced in expectations of the Fed's rate hikes, a firm decline of the US dollar in the face of diminishing inflationary pressures would logically result in a strong Japanese yen. Unexpectedly, this week, as the US CPI data fell below the 3% threshold for the first time, indicating a significant cooling of inflation in the US, and with the substantial decline in the US dollar, the Japanese yen achieved its remarkable strengthening by 550 pips against the US dollar. The yen's substantial gains signal a true strengthening trend and suggest that the Federal Reserve's tightening monetary policy is nearing its end. Consequently, we witnessed the US dollar's "wild decline" this week, and the USDJPY may never return to the levels around 145.00 that were achieved at the end of June and early July.

Source: TradingView

The strengthening of the JPYUSD is synchronous with the weakening of the US 10Y Treasury yield. If the JPYUSD continues to rise next week, it could target around 133.50. Conversely, it may retest about 141.50. Westpac Bank predicts that the USDJPY will fall to 136 by the end of 2023 and 128 by the end of 2024.

For years, the Bank of Japan has been striving to escape from deflation, but with limited success. In the context of high inflation erupting among developed countries globally, since October 2022, Japan's core consumer price index (CPI) has exceeded 2% for the first time and has remained at 2.7-3.1% for nine consecutive months, averaging around 2.83%. The Bank of Japan still considers the current inflation rate exceeding 2% as a result of global inflation and does not intend to change its ultra-loose monetary policy. In recent news (14 July), Hideo Hayakawa, former Bank of Japan Executive Director, expects the Bank of Japan to adjust the yield curve control (YCC) policy at the July meeting and thinks widening the band around zero for the 10-year Japanese Government Bond to 1% (from currently 0.5%) is the policy 'tweak' being considered." But MUFG Bank predicts that the Bank of Japan will not change its monetary policy before October this year.

If the Bank of Japan adjusts its yield curve control policy, the potential upside for US Treasury yields is much smaller compared to Japan. Additionally, it is essential to note that the 10-year Japanese Government Bond yield reached its highest level in nearly 5 months, around 0.48%, on this Friday. The Bank of Japan is set to announce its next interest rate decision at the July rate meeting (28 July), two days after the Federal Reserve. If, at that time, the Bank of Japan indeed announces any news of further loosening of the YCC curve, the JPYUSD may experience another significant surge.



Source: TradingView

Over the past two weeks, the US10Y-JP10Y declined from 3.63% to 3.30%. The Dollar Index dropped from 103.35 to 100.00, and concurrently, USDJPY fell from 144.90 to 138.80. The trends of these three indicators have synchronously declined. The significant decline in the US Dollar suggests that the Federal Reserve's tight monetary policy is nearing its end. With market expectations of the Bank of Japan's easing remaining unchanged and with extremely limited upside for the US10Y-JP10Y, as the US dollar continues to weaken, the USDJPY is likely to experience further declines.

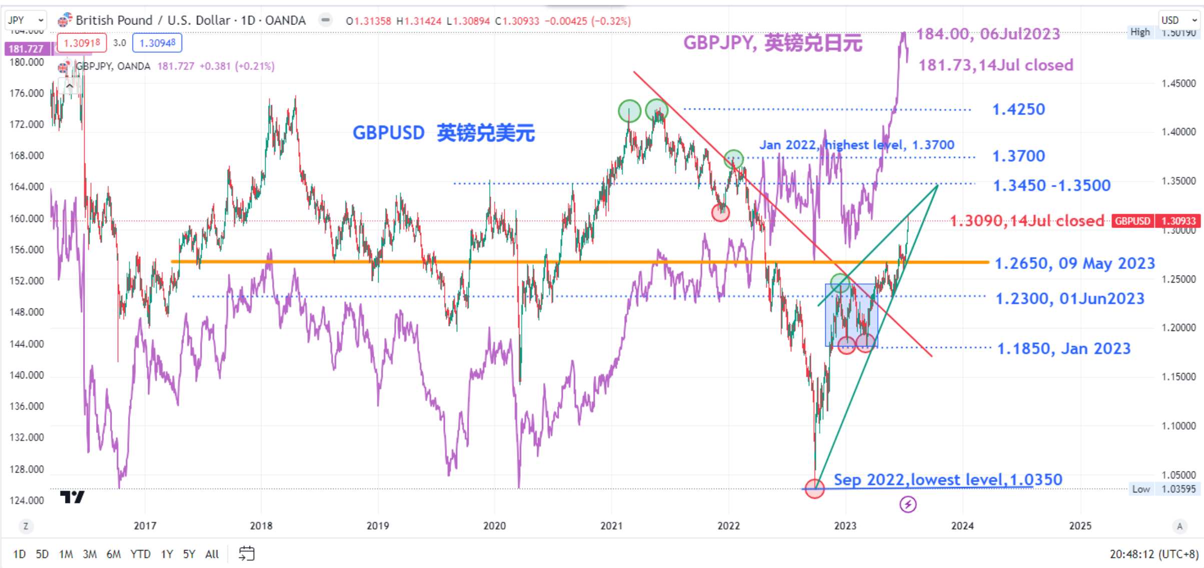
In early July, several Japanese government officials from the Bank of Japan issued warnings about the rapid depreciation of the yen, which somewhat limited the yen's downward momentum. Coupled with this week's sharp drop in the US Dollar, all non-US currencies recorded substantial gains this week, with the JPYUSD continuing to surge by 550 pips or 3.85% and is expected to sustain its upward momentum. Other non-US currencies exhibited fluctuations in the range of 200-300 pips against the US Dollar. Among them, only the JPYCAD rose by approximately 300 pips, closely following the rise in USDJPY. Below is the performance over the past week:

- *USDJPY declined by 550 pips (from 143.00 to 137.50) and closed at 138.80 on 14 July.*
- *GBPJPY fluctuated within a 350-pip range (from 183.20 to 179.50 to 181.70) and closed at 181.70 on 14 July.*
- *EURJPY fluctuated within a 300-pip range (from 156.50 to 153.50 to 155.80) and closed at 155.80 on 14 July.*
- *AUDJPY fluctuated within a 200-pip range (from 95.50 to 93.50 to 95.50) and closed at 94.90 on 14 July.*
- *NZDJPY fluctuated within a 200-pip range (from 88.50 to 86.50 to 88.50) and closed at 88.39 on 14 July.*
- *CADJPY declined by 300 pips (from 107.50 to 104.50) and closed at 104.99 on 14 July.*
- *CHFJPY fluctuated within a 300-pip range (from 160.50 to 158.50 to 161.50) and closed at 160.95 on 14 July.*

- *SGDJPY fluctuated within a 200-pip range (from 106.00 to 103.80 to 105.30) and closed at 105.02 on 14 July.*

2) The strong interest rate outlook and wage data from the Bank of England contributed to the continued rise in sterling. The rise of GBPJPY is limited.

On Tuesday (11 July), the UK's Growth in employees' average total pay (including bonuses) was 6.9%, surpassing the expected 6.8% and the previous figure of 6.7%. Compared to the United States and other European countries, the UK faces higher inflationary pressures. The UK's Consumer Price Index (CPI) for May recorded 8.7% YoY, making it the highest inflation level among major advanced economies. The Bank of England responded to this inflation surge by implementing an aggressive 50-basis-point interest rate hike to 5.0% during its recent June policy meeting. The Bank of England's strong hawkish stance is the most robust among major developed countries, and the inflationary pressures may prompt the Bank of England to continue raising interest rates in the remaining four interest rate meetings of the year. According to news on Thursday (13 July), there is an 85% probability that the Bank of England's terminal rate will reach a peak of 6.25%. Based on the market's implied interest rate expectations, the highest possible interest rate level for the UK is projected to be around 6.50%. With the significant drop in US inflation data, it is expected that the Federal Reserve will soon end its monetary tightening cycle. In the short term, the divergence in monetary policies between the Federal Reserve and the Bank of England will likely favour the British pound. Despite the recent significant decline in USDJPY, the drop in GBPJPY is limited.



Source: TradingView

This week, GBPUSD surged by 400 pips and broke above the critical psychological level of 1.3000. The closing price on Friday, 14 July, was 1.3090. Further gains may lead it towards the range of 1.3450-1.3500; otherwise, it may retest the range of 1.3000-1.2650. As for GBPJPY, it experienced minor fluctuations this week, closing near 181.73 on 14 July. A further rise could lead to a retest of around 184.00. Conversely, it may look towards around 180.50.

3) EURUSD has experienced significant gains, but the rise of EURJPY has been limited.

From the perspective of manufacturing PMI and GDP, the Eurozone is still experiencing technical recession and economic weakness. As of now, the Eurozone's core inflation rate has not shown a significant decline or confirmed a turning point despite the European Central Bank's tightening policies. The Eurozone's Consumer Price Index (CPI) for May recorded an annual rate of 6.1%, more than three times the ECB's target of 2%. Additionally, the Eurozone's Core Consumer Price Index (CPI) for the same period reached 5.3%. Hence, the ECB's hawkish stance on raising interest rates to fight inflation is understandable, and further rate hikes between July and September may become inevitable. Simultaneously, recent data showing a significant cooling of US inflation suggests that inflation in the United States is weakening substantially. Consequently, market expectations of further rate hikes by the Federal Reserve are gradually diminishing, and the possibility of a pause in rate hikes after the July meeting narrows the interest rate differential between the US and the Eurozone. This development is one of the reasons behind the rapid appreciation of the euro in recent times.

European Central Bank (ECB) June Meeting Minutes Highlights: The weakness in manufacturing may potentially spill over to the services sector. The European Central Bank (ECB) may need to continue raising interest rates after July to bring inflation back to its target level. It is crucial to convey the message that achieving the target inflation level will require further actions in monetary policy. Some members of the ECB express doubts about emphasising core inflation as a valid indicator for headline inflation in the future. The majority of the members believe that core inflation has not yet shown signs of a turning point. To achieve the inflation forecast targeting, the governing council would need to implement at least two consecutive interest rate hikes in June and July.

The market prices in little change after the meeting minutes were released, mainly because the probability of rate hikes in July and September is higher than the probability of no rate change. The likelihood of a rate hike in September stands at 65%. The most probable scenario is that once the deposit rate reaches 4% in September, the European Central Bank (ECB) will "skip" October and is likely to implement another rate hike in December. The ECB anticipates that inflation will not return to its target level until 2026, making the prospect of further multiple rate hikes more certain.

Source: TradingView

As early as 5 June, the author of this article published a piece of writing warning that the daily candlestick chart and RSI indicator of EURUSD form a hidden bullish divergence, implying a potential uptrend for EURUSD. If it fails to break below the range of 1.0500-1.0600 or initiates a rebound, the price could aim towards the high points of May around 1.0950-1.1050. At that time, the quote was around 1.0650, and as of 14 July, the EURUSD closing price was 1.1227. Economists from Commerzbank and ANZ recently forecasted a year-end exchange rate of 1.14 for EURUSD. Despite the significant 300-pip increase in EURUSD this week (from 1.0950 to 1.1250), when combined with the substantial 550-pip decline in USDJPY, the EURJPY exchange rate has been relatively stable within a range of 300 pips (156.50-153.50-155.80) with limited declines and gains.

3. Offshore RMB (CNH) sees its strongest surge, surging 1200 pips against the US dollar.

This week, amidst the impact of the significant drop in the US dollar, all non-dollar currencies experienced varying degrees of gains, and the offshore RMB (CNH) was no exception. Last year, during the fourth quarter, from mid-September to early December, USDCNH spent nearly three months above the critical psychological level of 7.0000. Since breaking above the 7.0000 level again in mid-May this year, it has maintained a fluctuating and rising pattern. After reaching around 7.2850 in late June, it started to decline and closed on Friday (14 July) at 7.1500. It is anticipated that at some point in the second half of this year, the USDCNH may once again fall below the crucial psychological level of 7.0000. Simultaneously, Chinese stocks showed evident signs of rebounding in response to the strong recovery of the US stock market. Here are the price movements of the past week:

- *USDCNH declined by 1260 pips (from 7.2480 to 7.1220), with a closing price of 7.1500 on 14 July.*
- *CHINA50 rose by 330 pips (from 12500 to 12830) with a closing price of 12726 on 14 July.*
- *CHINAH increased by 420 pips (from 6200 to 6620) with a closing price of 6506 on 14 July.*

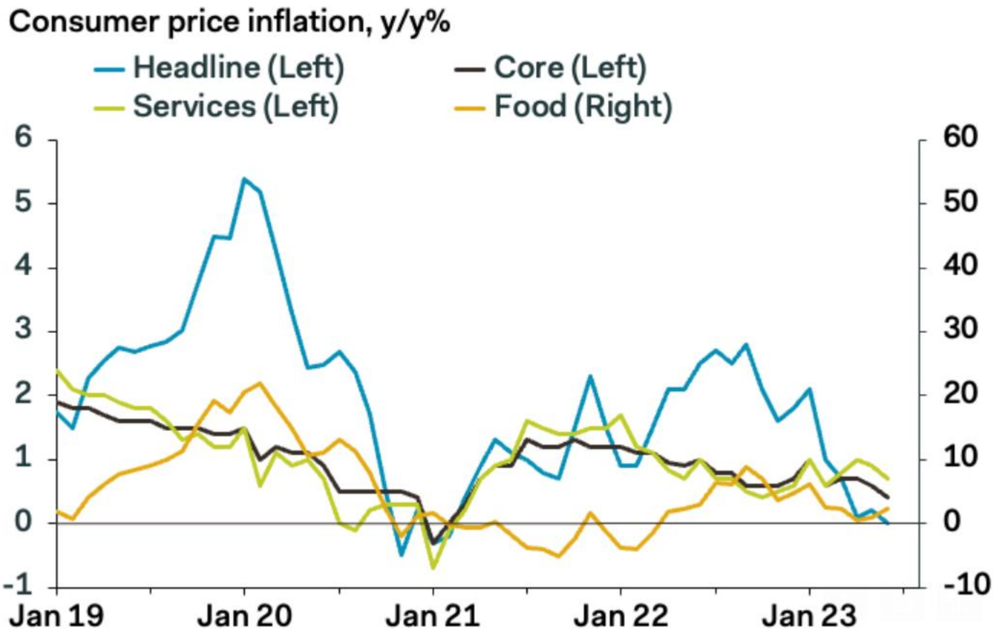
- *HK50 surged by 1150 pips (from 18400 to 19550) with a closing price of 19273 on 14 July.*

1) China's exports further declined due to the impact of decreasing demand in major global markets.

In June, China's overall exports dropped significantly, primarily affected by weak global demand. On Thursday (13 July), it was reported that China's June total exports decreased by 12.4% YoY, marking another substantial decline following a 7.5% drop in May. China's exports to the United States plunged by 23.7% in June, following an 18.2% decrease in May. Exports to the Eurozone also declined by 12.9% in June, following a 7.0% drop in May. China's exports to ASEAN countries declined by 16.9% in June, similar to the previous month. In contrast, China's exports to Russia surged by 90.9% in June, with some growth in exports to South Africa and Singapore. The positive news is that despite the faster-than-expected decline in China's overall exports, automobile exports bucked the trend and increased.

2) With changing demand, China's consumer inflation rate eased to zero.

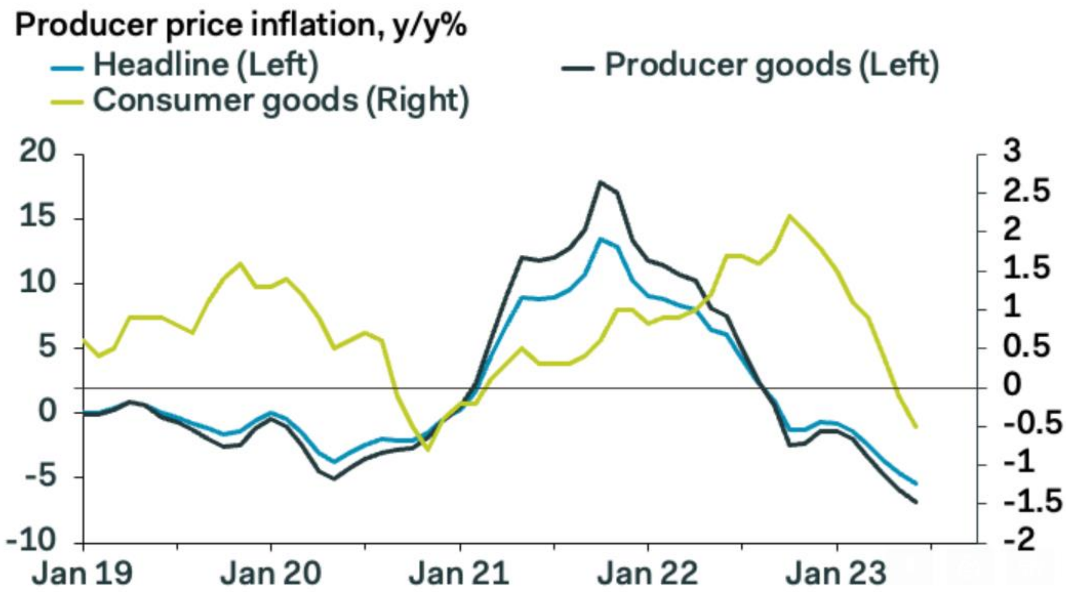
In June, China's headline Consumer Price Index (CPI) YoY growth rate slowed to 0.0% from 0.2% in May, reaching the lowest level since February 2021. The core inflation for June also declined by 0.2% YoY, reaching 0.4%, the lowest level since January 2021. China's June producer prices dropped by 0.5% YoY, following a 0.1% decrease in May, reflecting the impact of excess capacity. China's Consumer price index (CPI) performance was flat, indicating that the domestic economy was depressed and overcapacity, but consumer spending, mainly commodity spending, recovered. China's Services CPI slightly decreased by 0.2% to 0.7% in June, while Core commodity prices fell by 0.5% again in June, following a 0.3% decline in May. This indicates that domestic consumer spending in China, especially in terms of commodities, is generally weak.



Source: Pantheon Macro

3) Excess capacity weighs on China's Producer Prices.

China's Producer Price Index (PPI) in June recorded its most significant decline in seven and a half years. On Monday (10 July), it was reported that China's June Producer Price Index, following a 4.6% decrease in May, dropped by 5.4% year-on-year, marking the steepest decline since December 2015. Meanwhile, China's June Consumer Price Index (CPI) has also slowed and reached its lowest level since 2021. These economic data indicate that the Chinese government may need to introduce more stimulus measures to boost weak demand. The key factors driving the price decline are weak international commodity and energy prices and domestic excess capacity. Excess capacity might be a result of the robust manufacturing investment triggered by government stimulus measures during the COVID-19 pandemic in the past few years. Still, the demand at home and abroad was sluggish.



Source: Pantheon Macro

On Thursday (13 July), Chinese Premier Li Keqiang held a symposium with eight economists to seek their views on China's economy. Later, there was news released stating that a series of "targeted, comprehensive, and coordinated policy measures" will be implemented, focusing on stabilising growth, ensuring employment stability, and preventing risks. "Targeted" measures may imply refraining from adopting large-scale stimulus actions; instead, the responsibility will be placed on supporting short-term growth and promoting long-term objectives in manufacturing and strategic sectors. Policymakers may aim to strike a balance between risk control, limiting the increase in local government and real estate debt, and supporting economic growth, employment, and expectations.

4. Short-term risks

Since the beginning of the third quarter this year, the most notable change in the market is that an increasing number of investors are betting that after the 25-basis-point rate hike in the July meeting, the Federal Reserve will pause its rate hikes, signalling the nearing end of the current policy tightening cycle. Regarding this week's significant drop in the US dollar, the market has fully priced in a 25-basis-point rate hike in the July Federal Reserve meeting (on 27 July), which may be the final rate hike before a pause in rate hikes. Some investors are now contemplating whether it is the right time to bet on a dovish Fed expectation. The author believes that after the July Federal Reserve meeting, there will be no rate meeting in August, and there are still three rate meetings scheduled for September, November, and December this year. The US core inflation remains at 4.8%, and although core commodity prices have started to decline, core service prices continue to rise. Services inflation is stickier than commodity inflation, and the service sector accounts for over 80% of the US GDP. The potential for a rebound in US inflation remains a focal point to watch in the future. Additionally, inflation levels in countries closely linked to the US economy, such as the United Kingdom, Canada, Australia, and Eurozone countries, remain at high levels, especially with the Bank of England's terminal rate indicating 6.5%-7.0%. The Eurozone, Canada, and Australia's central banks are also likely to push for higher terminal rates. These external factors may lead to the possibility of the Federal Reserve continuing to raise interest rates after the July meeting. Please beware that the recent sell-off in the dollar may have gone too far.

In the Euro-American region, particular attention needs to be paid to the US Retail Sales data for June, which will be released next Tuesday (18 July), as well as the Federal Reserve's July interest rate decision, which will be announced next next Thursday (27 July). Additionally, the focus should be on the Canada Core Consumer Price Index for June, set to be published next Tuesday (18 July), and the Consumer Price Index data for the Eurozone and UK, which will be released next Wednesday (19 July).

In the Asia-Pacific region, key data to watch include China's Retail Sales for June and its Q2 GDP figures, which will be released next Monday (17 July), as well as the interest rate decision by the People's Bank of China on Thursday next week (20 July). Furthermore, Japan's Consumer Price Index data, scheduled for release on Thursday next week (20 July), and the Reserve Bank of Australia's meeting minutes, to be published on Tuesday (18 July), are crucial data points to monitor. Lastly, the New Zealand Consumer Price Index for Q2 of this year will be released on Wednesday (19 July).

As we enter the third quarter of the year, it is essential to continue closely monitoring inflation-related data from various countries worldwide. However, overall, it seems challenging for the US dollar to reverse the downward trend that has been in place since September last year. The interim highs of the Dollar Index, which were reached around 104.50-105.50 during the months of March to June this year, may also be unlikely to be revisited. The depreciation rate of the US dollar remains the focus of market attention.

By Sandy Wang,

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