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The single most important number of this week was out yesterday, and it was spectacular. October US consumer price inflation came out higher than expected. Headline number, which includes all contributors, was up 0.9% in the month, extending the year-on-year increase to 6.2%, a level not seen in three decades. The core numbers, which exclude food and energy, are respectively +0.6% and +4.6%. All measures were materially above the median forecast from economist, signaling a broad based increase in prices. Energy and food were unsurprisingly among the largest contributors, as well as auto, due to the supply chain issues, but also rents, which interestingly have nothing to do with global supply glut.
No surprise, financial markets reacted negatively – they don’t like surprises, and start to question the need for the Fed to respond quickly to such levels. Interest rates were, for once logically, sharply rising, with all maturities impacted. The 5-year Treasury yield added 13 basis points to 1.22%, the 10-year gained 11 basis points to 1.55% and the 30-year added 9 basis points to 1.90%. The trade-weighted dollar was stronger by+0.2%, against the yen and the euro in particular. In turn, US stocks retreated -1% on average with an underperformance from growth, i.e. long duration, sectors: the technology rich Nasdaq lost -1.7%. Stock markets were more resilient in Europe where all countries closed slightly in the green, with the UK outperforming due to its higher “short-cycle” exposure. In an usual move, the price of Brent crude oil was down -2.6%, closing at $82.5, as US crude inventories unexpectedly rose. Gold, our recent overweight, reacted as expected to lower real yields and just breached the $1850 level.

It didn’t take long however for a Fed official to comment and push back against the idea that the Fed could raise rates sooner rather than later. The San Francisco Fed Chief Mary Daly recognized that the number is “eye popping” but reiterated the priority is the job market recovery, and that it would be premature to start changing their calculations. Meanwhile President Biden made orders to explore ways to lower energy prices. Many commentators, especially the smartest of the permanently-bearish club, came out to warn about a world of high inflation and blind trust in the Fed. With regards to our own stance, we keep on believing that price pressures will normalize, before abating over time, and probably land higher than before the pandemic. Still, the factors behind the current spike are well known: an extraordinary wave of pent-up demand meeting constrained manufacturing, logistics and even job supply, and a base effect from services which had seen prices collapse in 2020. As the rise in inflation is linked to demand, we do not believe it will persist without underlying growth. Instead, the unfulfilled orders waiting for ships and chips are delayed, non-inflationary growth for the quarters to come. The idea of the Fed starting a cycle of sharp hikes as soon as tapering ends in mid-2022 is highly unlikely to us. Our current fair value for the US 10-year yield is 1.75% and we are still below, we see no reason to panic.

As we write this morning, there is no panic in Asian markets. Stocks are up in Japan, welcoming a weaker yen, but also in China where domestic markets are up +1%. Hong-Kong is slightly in the red, with tepid quarterly revenue growth from Tencent. Evergrande however seems to have paid their latest overdue interest on three US dollar bonds. Korea is the only clear loser this morning, with its high weight in growth sectors, most affected by rising interest rates. Oil prices are slightly higher, gold is flat, future contracts on western indices are flat and crypto assets are slightly up. US dollar interest rates are not moving at all, for a good reason: US bond markets are closed today for Veteran’s day, a funny timing after the strongest inflation release in 30 years
— this could also explain some exacerbation yesterday. November 11th is a national holiday in various European countries, market activity should be lower than usual.

Looking forward, we will definitely analyze the outcome of China’s Communist Party Plenum, which ends today. It could be important especially if President Xi secures power for life and provides more details about his vision and priorities. We will also look at GDP in the UK, current account balance in Turkey and get several speeches from ECB officials (not much to expect there, not sure we will listen to all of them). Earnings will include Siemens, Suzuki or ArcelorMittal. Stay safe.

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