



CIO OFFICE MORNING MARKET WRAP – Tuesday March 15, 2022. ALSO AVAILABLE ON ALEXA

Financial markets were mixed on Monday, with the key move being the sharp increase in bond yields. The 10-year Treasury yield added an impressive +14 basis points to close at 2.13%, in a bear-flattening pattern which saw the 5-year adding +14 basis points to 2.09% and the 30-year +12 basis points to 2.47%. The final countdown to the Fed's first interest rate hike in more than two years has started, and market participants are pushing their inflation expectations higher. Meanwhile, the price of Brent crude oil moved sharply down to close around \$106, a -5.8% drop. Stocks showed some dispersion: Europe and Japan gained respectively +0.6% and +1.2%, while the US retreated -1%, with an underperformance of tech, and emerging markets slipped -1.3%.

There are two topics we will highlight today: the Fed, and China. The monthly FOMC policy meeting will start today and conclude tomorrow. With the Ukraine conflict boosting headline inflation, market-implied expectations have sharply moved up to now price in seven quarter-point hikes this year alone, starting tomorrow with +25 basis points. The situation is not simple for the Fed: on one hand, inflation is at a 30-year high with reasons to persist and even grind higher when including oil and food. On the other, the war is destabilizing global growth through higher energy prices as well as supply chain and sentiment disruptions. Inflation is certainly the most pressing topic, which means that a +50 basis points increase should not be totally excluded. Markets also expect some guidance on the Fed's intentions with regards to both interest rates and balance sheet. The "dot plot" will be of high interest to see if their projected level of interest rates remains at 2.5%. Chairman Powell's speech is certainly one of the most important of his tenure, with an extreme bond volatility adding pressure in the background.

Moving to China and starting with geopolitics, the US warned Chinese officials that any support for Russian invasion would have consequences, which sounds a bit odd as China has repeatedly called for "all parties" in Ukraine to exercise restraint, and strongly denies the US claims. Both countries held a 6-hour high level meeting in Rome, which was called "substantial" by the US and "constructive" by Beijing, which in diplomatic language probably means that there was no outcome, but a willingness to keep the lines of communication open. While China is struggling with a resurgence in covid cases, which triggered the lockdown of Shenzhen, economic data released earlier this morning were good. Year-to-date industrial output was sharply up +7.5%, almost twice the median forecast of 4%, and investment in fixed assets rose by +12.2%, also way better than expected. Against this backdrop, China's central bank refrained from cutting interest rates further but injected more liquidity in the financial system, 100 billion yuan, and set a weaker-than-expected reference rate for its currency.

As we write this morning, markets from the red Dragon are indeed in the red, with Hong-Kong down -2.7% and onshore markets losing -2%. Many international investors are unnerved by the US warning against any support for Russia, which could trigger sanctions, and by the pressure on US listed companies. Stocks are only modestly down in Korea and up +0.5% in Japan this morning, which confirms the impression that the world is gradually being split into two blocks. To that extent it will be interesting to see whether Russia will pay \$117 million of interest on two dollar denominated bond due tomorrow. If the payment comes in rubles or doesn't come, this would be a default. Interest rates are steady and so are future contracts on Western stock markets. By contrast, oil prices continue to fall with the Brent currently trading around \$102.

In other news, closer to us, Foxconn is said to be in talks with both Saudi Arabia and the UAE to build a \$9 billion factory to produce electronics in our region – which would be an important milestone in its economic transformation.

Volatility should remain extreme due to the collection of risks, from geopolitics to inflation and policy uncertainty. However, it's good to keep in mind that economic data from China is robust, and that oil prices are better for the world around \$100 than around \$120. We remain invested for the medium term and keep on expecting some positive developments in Ukraine in the coming weeks. There is no crucial economic data today, waiting for tomorrow's US retail sales and Fed decision of course.

Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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