The Heights Oil Achieves

In Europe, inflation keeps rising

So, Christine and friends are revising

Their rate hiking plans

While importing bans

For oil are now organizing

From China, the market believes

The lockdowns are set for reprieves

Combine both these stories

With low inventories

And watch the heights oil achieves

Germany 8.7%

Spain 8.5%

Italy 7.3%

France 5.8%

Eurozone 8.1%

These are the latest Harmonized CPI readings for the four largest nations in the Eurozone along with the overall Eurozone reading. Only the French data was not actually higher than expected, but all are at record levels since the Eurozone was formally created in 1999. Oh yeah, the ECB’s inflation target is 2.0%. Perhaps what is more remarkable than the fact that inflation across Europe, as well as pretty much everywhere else in the world, is flying, is the fact that the ECB is STILL BUYING ASSETS!!! That’s right, despite all this rhetoric about how hawkish the ECB has become, with the latest idea from some members of a 50 basis point rate hike in July, the ECB is still expanding its balance sheet via QE as we speak and will purchase yet another €20 billion in government bonds in June. It becomes more and more difficult to believe central bankers when their actions are so radically different than their words.

But that is part of the plan. They are reliant on market participants and consumers to believe them when they say, this time we really mean it. At least the Fed has actually begun to raise interest rates and has stopped expanding the balance sheet, although they have not yet begun to shrink it. But the ECB has done nothing different than what they have been doing for the past two years.

It strikes me as highly unlikely that when they meet next week (June 9th) that they will raise their deposit rate by 50bps. There is too much pushback from the likes of Italy and France, and in the end, the hawks will be happy to get any movement at all. As of this morning, the OIS market is pricing in about 30bps in July, so a 20% probability of a 50bp hike. I think we would need to see next month’s CPI reading rise to near 9.0% for that to be the outcome.

In the meantime, the other key story in Europe is the agreement to ban oil imports from Russia over the next 6 months. At least oil that is received via ship. Pipeline deliveries, mostly to Hungary, will have a longer time before being embargoed. It should be no surprise that the price of oil (+1.3% today, +4.2% since Friday) has risen steadily on this news, as well as the news that the 2-month long lockdown in Shanghai is set to be relaxed somewhat starting tomorrow. Add it all up and you get increased demand and reduced supply, the perfect recipe for rising prices.

If we take a step back and consider what is currently happening in the world, it becomes increasingly difficult to get excited about risky assets. The combination of hawkish central bank rhetoric (e.g., Fed Governor Chris Waller explained that he believed there needed to be “several” 50bp hikes upcoming, widely interpreted as more than two, and that Fed funds needed to get above neutral by the end of the year), and rising energy prices, goosed by the Shanghai news, economic growth seems sure to come under significantly greater pressure in the near term. And if Chairman Powell is truly going to find, and live up to, his inner Paul Volcker, that implies he is going to try to achieve demand destruction via a recession. The point is, a strong growth story feels quite unlikely at this time.

So, let’s take a look at how markets are responding to this new information. In Asia, the Shanghai news was well received by the Hang Seng (+1.4%) and Shanghai (+1.2%) although the Nikkei (-0.3%) didn’t see the benefits. In Europe, there is clearly greater concern regarding the oil news and the latest hawkish ECB talk as the DAX (-0.6%) and CAC (-0.75%) both come under pressure along with the rest of the continental bourses. Only the UK (+0.3%) is bucking the trend, although on what basis it is not clear. US futures traders are definitely feeling blue with the NASDAQ (-1.2%) leading the way lower but the other major indices down by at least -0.5%.

Bond markets are also under pressure this morning with virtually every major market lower on the day with yields rising, sharply in some cases. Treasuries (+7.5bps) are leading the way as the Waller comments, as well as news of a meeting between Chairman Jay and President Biden, seem to have the bond bears back on top. Throughout Europe the damage has been less pronounced (Bunds +1.8bps. OATs +2.5bps, Gilts +1.7bps) although Italy (+7.0bps) is definitely stressing a bit.

Aside from oil’s rise, NatGas (unchanged in US, +7.25% in Europe, +16.9% in UK) is seeing some interesting price action. Gold (-0.5%) is feeling the heat of rising interest rates along with aluminum (-1.0%) while copper (0.0%) has managed to stabilize. The commodity market tension comes from structural supply shortages meeting weakening demand, and traders not sure which is a more powerful force.

Finally, the dollar is definitely stronger on the session with all its G10 brethren falling led by the euro (-0.75%) and then SEK (-0.7%) even down to the CAD (-0.15%) which is the best performer in the bloc. It seems that the higher US rate story is top of mind today, and that despite some talk of 50bps in Europe, there is a far greater belief in a number of consecutive 50bps hikes in the US. It should be no surprise that the CE3 (HUF -1.0%, CZK -0.7%, PLN -0.7%) are under pressure given the combination of oil and US rate hike news, nor that we saw weakness in THB (-0.4%) overnight or ZAR (-0.7%). Really the outlier here is TWD (+0.25%) which benefitted from easing Covid restrictions there as well.

As it’s the first week of a new month, there is much data to absorb culminating in the payroll report on Friday:

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| Today | Case Shiller Home Prices | 19.9% |
|  | Chicago PMI | 55.0 |
|  | Consumer Confidence | 103.9 |
| Wednesday | ISM Manufacturing | 54.5 |
|  | ISM Prices Paid | 80.5 |
|  | JOLTS Job Openings | 11.4M |
|  | Fed’s Beige Book |  |
| Thursday | ADP Employment | 300K |
|  | Initial Claims | 210K |
|  | Continuing Claims | 1333K |
|  | Factory Orders | +0.7% |
| Friday | Nonfarm Payrolls | 325K |
|  | Private Payrolls | 300K |
|  | Manufacturing Payrolls | 39K |
|  | Unemployment Rate | 3.5% |
|  | Average Hourly Earnings | 0.4% (5.2% Y/Y) |
|  | Average Weekly Hours | 34.6 |
|  | Participation Rate | 62.3% |
|  | ISM Services | 56.5 |

Source: Bloomberg

In addition to this, with payrolls the obvious focus, we hear from four more Fed speakers, including Vice Chair Brainerd on Friday, the last discussion prior to the quiet period.

There is an awful lot of new information upcoming, between the data and the ongoing questions of how both the ECB and the Fed will not only behave, but what they will signal going forward. For now, the Fed remains the primary hawk, and I believe the dollar will continue to benefit as long as that is the case. However, that is quickly subject to change in the event that the Fed does pause come September, as suggested last week by Atlanta Fed president Bostic. Clearly there are some difference of opinion at the Eccles building. But until the doves prove they are on top, I believe the dollar resumes its strength and risky assets, especially equities, have further to fall.

Good luck and stay safe

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