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Weekly Commentary

Issue **No. 18** | **MAY 2, 2022**

Macro View

By Hubert Marleau

Addendum To Last Week Commentary - The Mighty Dollar

Submitted April 30, 2022

The DXY Index, a measure of the value of the U.S. dollar relative to a basket of foreign currencies, touched 103.68 on Thursday, up 15% from a year ago. The U.S. dollar hasn't been this strong in 20 years as investors can't seem to shake off the appeal of an international reserve and global transactional currency the nominal yields of which are the highest in the developed world. And this is happening as the cost of food and energy prices has risen to record levels. This overall weight is having a toll on the dollar value of the world money supply (WMS). MacroStrategy Partnership has calculated that the WMS has fallen USD 2.536 trillion over the past three months for an annualized decrease of 6.5%, as economies and financial markets have adjusted to a fast-changing monetary environment. Indeed, it is probable that this situation could last. The U.S. economy registered an enormous trade deficit in the first quarter of 2022, which wiped out growth. Yet official reserves in foreign countries decreased, suggesting strongly that the U.S. is attracting huge amounts of private capital from the rest of the world. A Reuters poll of over 500 economists expects the global economy to grow more slowly than predicted 3 months ago, but no recession.

Consequently, volatility has picked up. The Bassman Move Index of bond yield volatility is at 140%, the VIX 33.4%, and JP Morgan Global FX Volatility Index at 11.3% - the highest since April 2020. This is a long way from foreseeing chaos, but high enough to foreshadow disinflationary conditions. High volatility tends to raise the effective cost of doing international business, which can potentially reduce the money supply further. The U.S. is not immune to all of this. The M2 measure of the U.S. money supply may have soared at an annual rate of 20% since February 2020, but has of late decelerated at a very fast pace. It's now up 9.9% y/y. In the past six and three months the annual run rate has decelerated further to 7.8% and 3.0% respectively, of which the largest chunk is still due to QE.

Macro View cont.

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Unsurprisingly, growth and inflation expectations have receded. Firstly, U.S. economic growth is expected to slow to a still respectable 3.3% this year from 5.7% in 2021, with only a 25% chance of a recession. Secondly, the bond market is now implying that the rate of inflation will remain elevated for the next 12 months at 5.2%, but slow to 3.5% in the following year, 2.6% and 2.5% thereafter. Stockpiles may not be bloated, but businesses have accumulated more than $450 billion worth of inventories in the last 6 months. That's disinflationary.

Thus, Fed Chairman Jerome Powell is likely to front-load rate hikes in May and June, but he may not need to be as bold as Fed Chairman Paul Volker was in the late 70s and early 80s.

Contrary to popular opinion, it was the rise in the exchange value of the dollar combined with the decelerating rate of money supply that broke the curse of inflation.

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