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In this week's recap: Friday rally stems week of losses.

Weekly Economic Update

Presented by Ed Papier, July 18, 2022

THE WEEK ON WALL STREET

A record-high inflation report, the prospects of a more aggressive Fed, and growing recession fears sent stocks lower– though a Friday rally pared losses.

The Dow Jones Industrial Average slipped 0.16%, while the Standard & Poor's 500 lost 0.93%. The Nasdaq Composite index dropped 1.57% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, lost 3.49%.[1,2,3]

STOCKS SLIDE

As the week opened, recession fears intensified with reports of renewed Covid-related lockdowns in China. Also, the U.S. dollar continued to climb, reflecting global economic weakness.

June's consumer price index report showed price increases accelerating. Year-over-year prices jumped 9.1%, the fastest pace in over 40 years. Speculation grew that the Federal Reserve might contemplate a 100 basis point increase in short-term rates later this month rather than the 75 basis point hike it earlier signaled. The market rebounded on Friday following a Federal Open Market Committee member saying he favored a 75 basis point hike. Also helping the Friday rally was a strong retail sales report and additional second-quarter company reports.[4]

DOLLAR STRENGTH

The increasing strength of the U.S. dollar moved to center stage last week as the dollar index (a measure of the U.S. dollar to six other major currencies) reached a fresh high, while the euro fell to parity with the dollar and to its lowest level since 2002.[5]

A rising U.S dollar hurts overseas profits when converted into dollars and it also makes U.S. products and services more expensive. It's a challenge for large, multinational companies that derive a portion of their earnings from overseas markets. Investors may gain greater insight into the extent of that impact as companies provide forward guidance with their upcoming reports.

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Housing Starts.

Wednesday: Existing Home Sales.

Thursday: Jobless Claims. Index of Leading Economic Indicators.

Friday: Purchasing Managers' Index (PMI) Composite Flash.

QUOTE OF THE WEEK

"The more a society drifts from truth

the more it will hate those who speak it."

GEORGE ORWELL

Market Index	Close	Week	Y-T-D
DJIA	31,288.26	-0.16%	-13.90%
NASDAQ	11,452.42	-1.57%	-26.80%
MSCI-EAFE	1,784.89	-3.49%	-23.59%
S&P 500	3,863.16	-0.93%	-18.95%

	Treasury	Close	Week	Y-T-D
	10-Year Note	2.93%	-0.16%	+1.41%

Sources: The Wall Street Journal, July 15, 2022; Treasury.gov, July 15, 2022

Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, July 8, to Friday, July 15, close. Weekly performance for the MSCI-EAFE is measured from Friday, July 8, open to Thursday, July 14, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

China appears to be chipping away at dollar dominance. While there is no indication that the dollar is in imminent danger of toppling from its perch as the global reserve currency, more central banks are warming up to the yuan.

According to UBS Asset Management's annual reserve manager survey, about 85% of central banks said they are invested in or are considering investing in the Chinese yuan. That's up from 81% a year earlier. USB surveyed 30 top central banks.

On average, central bank foreign exchange managers plan to hold about 5.8% of reserves in yuan within the next 10 years. That would represent a sharp increase from the 2.9% level of global reserve yuan holdings reported by the International Monetary Fund in late June.

Meanwhile, the average share of US dollar holdings dropped to 63% as of June 2022, according to the survey. That was down from 69% in the previous year. According to *Business Insider*, the response to the invasion of Ukraine "has increased talk about a 'multipolar' world, in which the US is no longer the overwhelmingly dominant force.

There is some speculation that the weaponization of the dollar to punish Russia for the invasion of Ukraine has motivated some countries to diversify away from the dollar. Less exposure to the greenback means less exposure to diplomatic and economic pressure from Washington DC.

Declining confidence in the dollar started long before recent events in Ukraine. The Federal Reserve printed trillions of dollars out of thin air in response to COVID-19. This devalued the dollar as evidenced by the surge in prices over the last year. This was the predictable result of creating money out of thin air and handing it out to spend. More money chasing the same amount (or with governments shutting down economies, fewer) goods and services will always lead to a general rise in prices.

The only reason the US can get away with this policy to the extent that it does is its role as the world reserve currency. There is a built-in global demand for dollars that helps absorb the money printing. But what happens if that demand drops? What happens if China and other countries decide they don't want to hold a currency that is losing value every day?

After Russia invaded Ukraine, the US cut some Russian banks, including the central bank, off from the SWIFT payment system. SWIFT stands for the Society for Worldwide Interbank Financial Telecommunication. The system enables financial institutions to send and receive information about financial transactions in a secure, standardized environment. Since the dollar serves as the world reserve currency, SWIFT facilitates the international dollar system.

SWIFT and dollar dominance gives the US a great deal of leverage over other countries. And the US went a step further. In an unprecedented move, the Federal Reserve froze Russia's dollar reserves. In effect, Russia's dollar assets are valueless to the country. It can't use them at all. Even if you think Russia deserves these draconian economic sanctions, it's important to remember that they could come at a cost.

Recent dollar strength compared to other world currencies suggests that the dollar remains in a strong position. But things could shift quickly. How much more borrowing and printing will the world tolerate before they become wary of holding dollars? And will the US propensity to use the dollar as a foreign policy weapon undermine trust in the greenback? The world is watching.[6]

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Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:

1. The Wall Street Journal, July 15, 2022
2. The Wall Street Journal, July 15, 2022
3. The Wall Street Journal, July 15, 2022
4. The Wall Street Journal, July 13, 2022
5. CNBC, July 11, 2022
6. zerohedge.com/geopolitical/chinese-yuan-beginning-chip-away-dollar-dominance