

From the Desk of CIO



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US Administering Financial Chemotherapy to Fight Inflation

Inflation is spreading to the entire of the United State (US) and this economic disease is affecting every facet of the American life as the initial belief of a temporary inflation turns out to be a raging one. To tame the inflation, the US has administered its usual financial chemotherapy i.e. to raise fed funds rate in order to force demand to slowdown but in the process causing a general weakness to the economy. The immediate reaction of a hike in fed funds rate is higher savings and lower borrowings. Interest rate sensitive sectors such as housing purchased through bank loans and automotive hire purchase are the most heavily impacted segments. Ordinary innocent people will also be affected by this severe dosage of financial medicine.

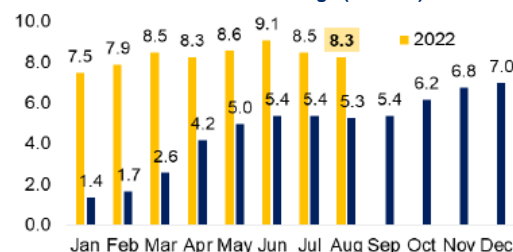
The easy access to information through internet enables everyone to have access to reasonable knowledge of a subject. Cancer, which is a common disease nowadays, is known to spread easily to other parts of our organs. Once that happens, doctors are unable to perform localised treatment such as radiotherapy. Hence, the common method is to use chemotherapy, which will attempt to kill off all the cancer cells but in the process it will also affect other healthy cells in the body such as hair, skin, blood, intestinal cells etc. As such, this treatment tends to cause some side effects and weakens the body.

The US has also employed similar remedy to fence off the raging inflation (see *Exhibit 1*). Since loans are used widely in the modern economy, a higher interest rate will have a far reaching impact on every facet of the economy. Innocent people and businesses are bound to be affected. Hence, an aggressive hike in interest rates will eventually bring the US economy to its knee.

The main culprit in causing the raging US inflation is shelter component with its high CPI weightage (see *Exhibit 2*), which accounts for a third of the CPI component. Shelter index reflects the rent-occupied units and the computed rent equivalent for owner-occupied homes. The latter accounts for a quarter of CPI weighting, slightly more than the combined for food and energy.

While other CPI components such as energy, have fallen and the same for food component after the decline in commodity prices, the shelter component is still growing (see *Exhibit 3*). Overall, rent tends to have a lagging effect as rentals do not change until the tenancy is expired where the tenure is usually for a year. Hence, this explains why the US inflation is slow in its decline.

Exhibit 1: US Inflation YoY % Change (2021-22)



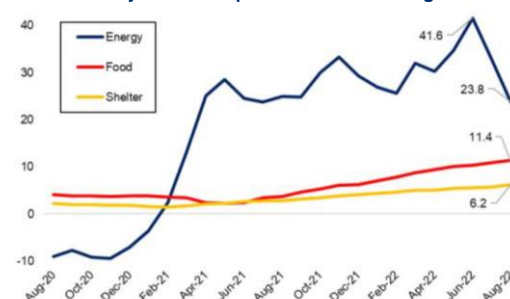
Source: US Bureau of Labor Statistics, PCM, Oct 22

Exhibit 2: Weightage of Major CPI Components in US

| Components | CPI Weightage (%) |
|-------------------------|-------------------|
| Shelter | 32.2 |
| Food | 13.5 |
| Energy | 8.8 |
| Medical care services | 6.8 |
| Transportation services | 5.9 |
| New vehicles | 4.0 |
| Used cars and trucks | 4.0 |
| Others | 24.8 |

Source: US Bureau of Labor Statistics, PCM, Oct 22

Exhibit 3: Major CPI Components YoY % Change



Source: US Bureau of Labor Statistics, PCM, Oct 22

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