上海商業銀行
SHANGHAI COMMERCIAL BANK
Since 1950

Monthly Insight

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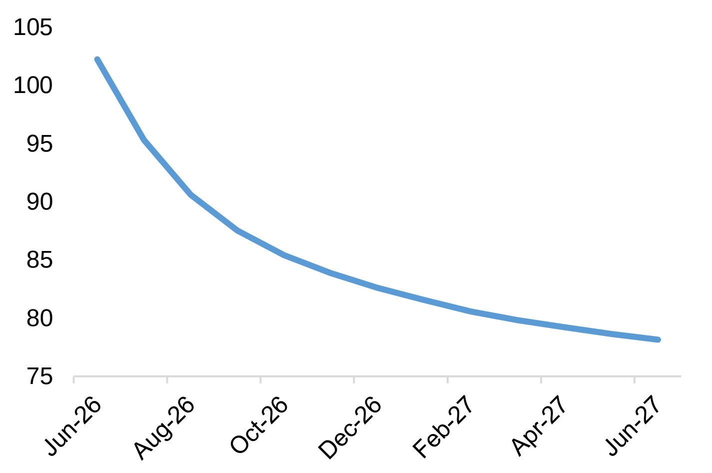
Armageddon Now?

- **The key to high prices is high prices. The energy impingement urges investors to reexamine the energy hedge ratios with an upside bias.**
- **Diversification is regime-dependent, not structural. The diversification away from petro-states could scarcely be more public.**
- **If the market continues to stabilize, more fund managers will wet their beaks. The Treasury auctions are thus expected to be taken down well, radiating a constructive bias on rates.**

The lesson over the past few weeks might be too much for many punters to accept. Much of the narrative in the spring was centered on the fragility of private credit. The outbreak of the third Gulf War flipped the script. The expectation of monetary easing to avert the "SaaS-pocalypse" became an odd bet. The market then saw a serious dose of long liquidation.

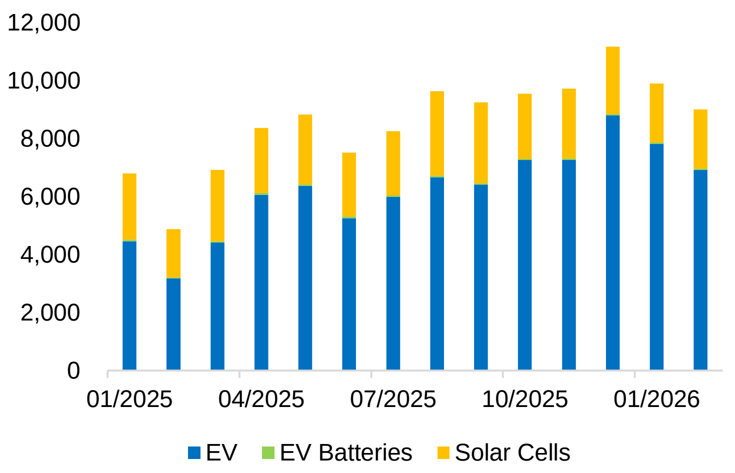
Is this a turning point? Whenever the conflict is eventually resolved, just don't assume that risky assets will move on from geopolitical snags effortlessly. A new, higher floor for energy prices is formed that will likely persist for months. Qatar, for instance, might need years for Qatar to repair the shuttered oil and gas complex in Ras Laffan. By then, all the easy buffers will be used up. The energy impingement will leave a long-term scar, urging investors to reexamine the energy hedge ratios with an upside bias in this telling. That explains a well-known maxim in energy - the key to high prices is high prices (Exhibit 1).

Exhibit 1: Brent Future (US$ per barrel)



Source: Bloomberg, Shanghai Commercial Bank

Exhibit 2: China's EV and Clean-Energy Exports (US$ mn)



Source: China Custom, Shanghai Commercial Bank

It begs the question whether it's time to re-engage with a dollar-appreciating bias. The world saves in dollars because it pays for petroleum in dollars. The higher the crude prices, the more they need to save. This logic is simplistic, just like the enemy of your enemy isn't necessarily your friend. Net oil exporters can underperform at the same time as the oil. The diversification away from petro-states could scarcely be more public. In February alone, China chalked up US$9 billion exports of electric vehicles and renewable energy devices (Exhibit 2). That will change the character of the petrodollar.

An added worry: The yield advantage of the greenback starts to fade. The greatest weapon is surprise, as evidenced by the Spanish Inquisition. The sell-first-and-ask-questions-later mentality is no longer taking hold. In fact, bond auction performance tends to be highly correlated with the amount of volatility that's in the market at a given moment. If the market continues to stabilize, more fund managers will wet their beaks. The Treasury auctions are thus expected to be taken down well, radiating a constructive bias on rates. The dollar crowd is better-to-sell.

One conclusion is clear as day: we are now firmly in an era of uncertainty. While Trump doesn't understand people who are devoted to a religious cause, zealots are emboldened to further their ambitions given the impunity with which Trump has acted. Geopolitical conflict is no longer a tail event that presents itself once in a blue moon. The dam can hold, but the aftershocks, we cannot fully grasp now, will be felt for a long time to come.

UK

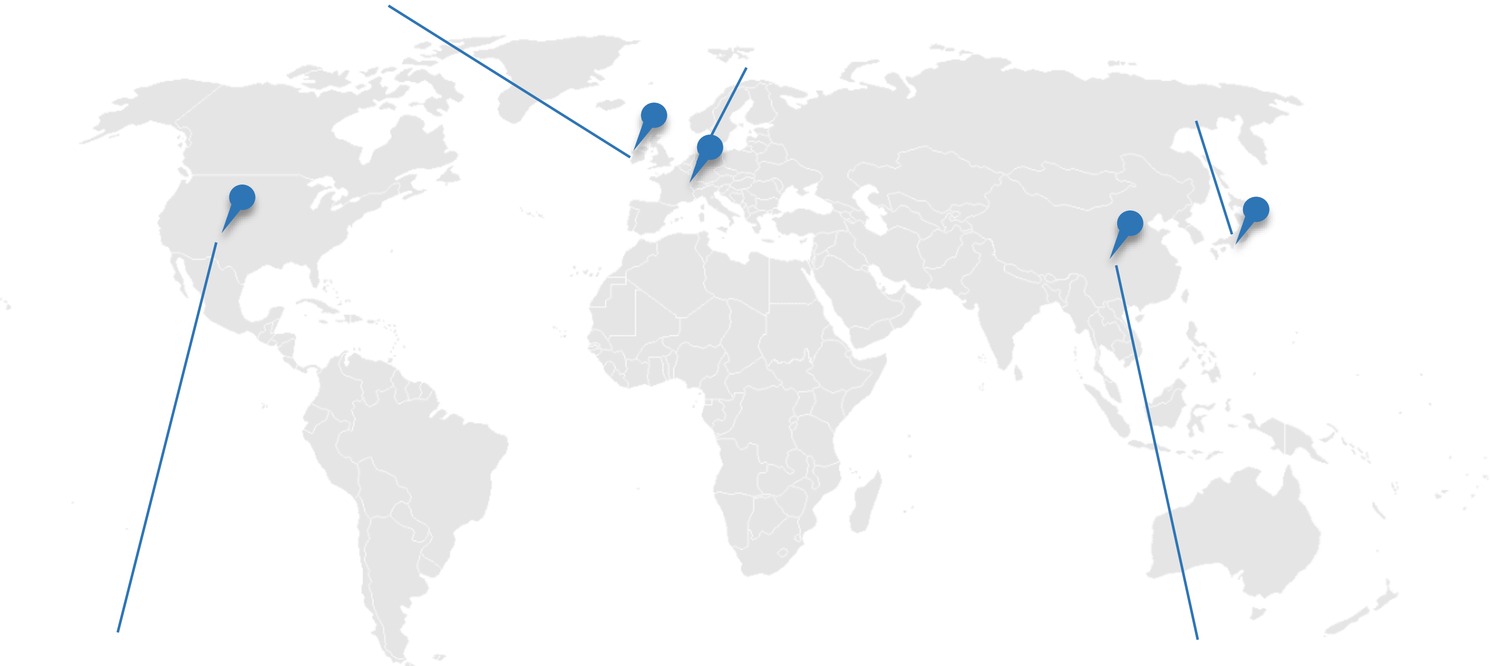
The energy crisis could shave 0.2-0.4 percentage point off the growth. A lot of bearishness is already priced in gilt yields.

EU

Inflation print jumps on the back of higher fuel prices. We see inflation climbing to above 3% in April and staying there for a few months.

Japan

Challenged by surging fuel prices, fiscal leeway is constrained by the elevated government debt. Concerns over unpredictable policy missteps may well linger in the JGB market.



US

US-Iran negotiations have collapsed, prompting President Trump to order a blockade of the Strait of Hormuz. With the cost of living emerging as a central issue in the upcoming midterm elections, Trump may have limited time to find a graceful exit.

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Chinese Mainland

Latest figure marks the end of a deflationary period of 3.5 years. The worst impact of tariff war is likely behind us.

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Foreign Exchange Outlook

USD

Overweight
Neutral
Underweight

We will be glued to the Middle East headlines. Trump's whimsy reveals the dollar as an unreliable ballast. With a retreat in front-end yields, the central story is one of real money de-dollarisation.

EUR

Overweight
Neutral
Underweight

The ceasefire has brought some relief to EUR. But the set-up feels uneasy. A sustained decline in gasoline price is a necessary condition for further removal of rate hike pricing, which may or may not realise. We suspect Europe's inferior growth profile will move back to the centre stage.

GBP

Overweight
Neutral
Underweight

Another month dictated by Iranian headlines. The cable has kept calm and carried on, but risks remain skewed to the downside given the U.K. structural reliance on portfolio inflows and gas-exposed households.

RMB

Overweight
Neutral
Underweight

Military de-escalation could usher in a period of firmer yuan. Official tolerance is now a lower hurdle to clear. Stronger fixings reveal that the Chinese authorities may be content with some RMB strength. Incessant bid from Trade-related FX remittances is expected to lend further support.

JPY

Overweight
Neutral
Underweight

Consumer confidence has taken a heavier hit than elsewhere. Yen bulls should be concerned about the yen's inability to hedge risky assets. The officials are throwing the full weight of jawboning to keep the yen from further weakening. The yen is still a waiting game.

AUD

Overweight
Neutral
Underweight

Local events are likely to take a front seat eventually. It is possible that the RBA starts to put more weight on the risk of stagflation. Still, the AI-linked commodity boom is a secular tailwind for the Aussie. The instinct might be to let winners run.

NZD

Overweight
Neutral
Underweight

The RBNZ was willing to send a signal on inflation vigilance and to act if needed. Worries about the country's imports reliance from the Gulf via Singapore and Korea will linger.

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