The Weekly Snapshot

17 October 2022

ANZ Investments brings you a brief snapshot of the week in markets

It was a choppy week in equity markets. While they enjoyed some big 'up' days, most major international equity markets ultimately finished the week lower. Stronger-than-expected US inflation data and events in the UK kept investors on edge.

Against this backdrop the S&P 500 Index in the US finished the week down 1.5%, while the tech-heavy NASDAQ 100 Index was down 3.1%. Other markets followed, with the UK's FTSE 100 Index down 2.0%.

Bond markets similarly saw a lot of action. The UK saw the Bank of England once again take action to shore up its bond market, as it reinforced its commitment to buying bonds – by doubling the daily limit of bonds it was prepared to buy from £5bn to £10bn, as the central bank approaches the end of its 'period of emergency support'. The uncertainty flowed through to international bond markets. In the UK, the yield on the 10-year government bond rose to a high of 4.63% (having started the week at 4.24%), while in the US, the equivalent yield rose – and stayed - above the 4% level.

Locally, the NZX 50 Index was down 2.0%, as it followed international equity markets lower. There were some good performers however, with Air New Zealand up following news of Qantas' large profit upgrade across the ditch – demonstrating the unique and highly profitable environment that airlines find themselves in. Tourism Holdings was another big mover, after it upgraded its profits guidance. Meanwhile, local bonds continued their sell-off in line with their international counterparts.

What's happening in markets?

The big focus last week was on US inflation data, which came in slightly hotter than expected. While headline inflation declined slightly to 8.2% year-on-year, core inflation (which strips out the volatile food and energy components) reached a 40-year high, of 6.6%.

One of the more significant components is shelter (rents), which makes up about one third of the total consumer prices basket, and continues to rise at an elevated pace. Higher frequency data points do suggest we should see some relief in this area in the coming months, but we are also seeing wage inflation as a key driver of broader inflation pressures.

The inflation data was seen as solidifying market expectations for a 75 basis point hike from the US Federal Reserve at its next meeting, in early November. The market's initial reaction to the inflation data was a strong 'risk-off' move, with the S&P 500 Index briefly trading below 3500, its lowest level since March 2020. However, a strong reversal followed, resulting in an intraday rally of close to 5%. This may be due to technical factors, with positioning amongst risk assets very light and the options market showing that plenty of protection against a negative reaction had been taken out ahead of the report.

Meanwhile it was another tough week for new UK prime minister, Liz Truss. While the Bank of England was reinforcing its position to buy bonds to support the local bond market, she was busy backtracking on her government's plans to scrap an increase in corporate tax – the second such backtrack since her government's mini-budget (the other being her party's plan to abolish the 45% top rate of income tax).

Furthermore, on Friday, she sacked her finance minister, Kwasi Kwarteng, making him the second shortest-serving finance minister on record. It puts her own position in jeopardy, as she risks facing a leadership challenge from within her party, or a vote of no confidence in her government.

What's on the calendar

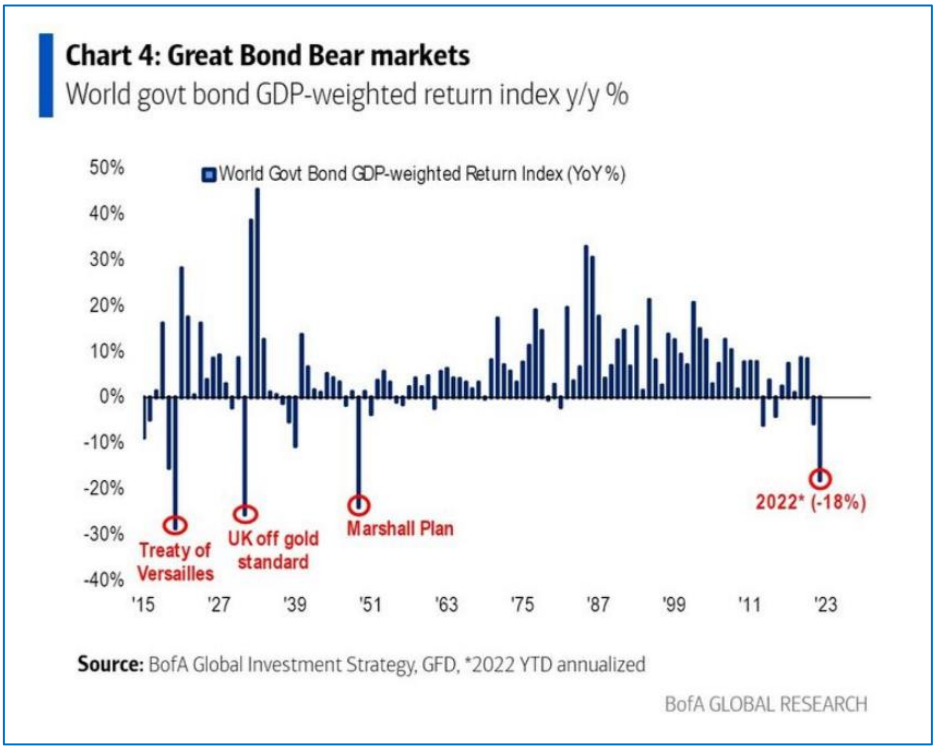
This week, markets will be keeping a particularly close eye on inflation data in the UK and Europe.

In the UK, the last reading showed a slight decline in the headline rate to 9.9% for the year to end August, however core inflation continued to rise, to 6.3% Over the weekend the governor of the Bank of England warned that interest rates may need to rise by more than previously expected, and said that inflation pressures mean a "stronger response" could be needed from the Bank than thought in August.

Meanwhile, in Europe, the last Eurozone CPI data showed a 9.1% increase over the year to end August, with core inflation of 5.5%. Another high reading will set expectations for the upcoming meeting of the European Central Bank meeting, on 27 October.

Chart of the week

It's fair to say it has been a challenging environment for equities, although it's arguably been even more so for bonds. According to Bank of America, it's been the 4th worst year since 1700.



**Source: The Economist*

Here's what we're reading

Where are the workers? When it comes to US inflation, and at least as far as the Federal Reserve is concerned, demand must be reduced the hard way – involuntarily. Enough people need to lose enough income that they will have no choice but to reduce their spending.
https://www.mauldineconomics.com/frontlinethoughts/where-are-the-workers