The Weekly Snapshot

19 June 2023

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

It was a busy week in global financial markets, with central bank meetings in the US and Europe, key US inflation data and New Zealand first quarter GDP (Gross Domestic Product) all being closely watched.

The US Federal Reserve (the Fed) hit 'pause' on rate hikes after raising the fed funds rate at ten consecutive meetings. It followed inflation data earlier in the week which showed that the pace of price rises had slowed to its lowest rate in around two years. Meanwhile, the European Central Bank raised interest rates there by a further quarter of a percent, even though there are signs the region is faltering.

Despite this backdrop, global equity markets continued their recent march higher, with the S&P 500 Index in the US and the tech-heavy NASDAQ 100 Index up 2.6% and 3.2% respectively. European, Australian and Japanese markets also trended higher, taking their lead from their US counterparts.

New Zealand equities had a mixed week, as economic data confirmed the local economy fell into recession earlier this year. However, a strong Friday session saw the NZX 50 index up 1.0%.

Bond markets were mixed too. News that the Fed had paused on rate hike – at least for the time being – was well received by bond investors, as it suggests the peak in rates is edging closer. The yield on the US 10-year government bond rose 3 basis points to 3.77%. Confirmation of a recession in New Zealand was supportive of local bonds, with the yield on the equivalent 10-year bond down 1 basis point to 4.52%.

What's happening in markets?

Inflation in the US, as measured by the Consumer Price Index, cooled to its lowest rate in two years. Inflation has now fallen to a level less than half that of its peak a year ago. The annual headline rate fell to 4.0% in May, down from 4.9% in April. But while energy costs and some food prices have fallen, other measures – such as housing costs – have risen at a higher-than-hoped rate. It means that core inflation, which excludes volatile food and energy prices, remains sticky. The annual core rate fell, but not by much (5.3% in May, down from 5.5% previously).

The inflation news had little overall impact, although it prompted interest rate markets to price out the likelihood of a further rate hike from the Fed later in the week. And that's exactly how it played out, with the Fed announcing it would keep its target benchmark rate at 5%-5.25%.

"***Holding the target range steady at this meeting allows the Committee to assess additional information and its implications for monetary policy,***" it said in its post-meeting statement, while the Fed Chairman Jerome Powell said it was waiting for evidence that inflation was slowing "***decisively***".

The surprise came with the Fed's forward expectations of where interest rates are heading, its so-called 'dot plot' diagram. This showed that the majority of its members expect the key rate to be above 5.5% at the end of this year. It suggests there are at least two more rate hikes to come this year. However, markets have shrugged this off, and have rallied despite this news.

Elsewhere the European Central Bank (ECB) met market expectations and lifted its region-wide interest rate by a further 0.25%, to 3.5%, its eighth consecutive move, and taking it to a level not seen since 2001. In contrast to other central banks, it said that stubbornly high inflation all but guaranteed another move next month – and likely beyond that too.

"***Are we done? Have we finished the journey? No. We're not at our destination. Do we still have ground to cover? Yes, we still have ground to cover,***" said ECB President Christin Lagarde.

The ECB's move comes at a time when Germany – the industrial powerhouse of Europe – fell into a shallow recession late last year, and as inflation across the region remains at high levels.

Meanwhile, at home, economic data showed that New Zealand's economy slipped into recession in the first quarter of the year. GDP fell by 0.1% over this period, in line with market expectations, but weaker than the RBNZ's forecast less than a month ago. It follows a 0.7% contraction in the previous quarter. Back-to-back falls in growth means the economy is in a 'technical recession'.

"***The adverse weather events caused by the cyclones contributed to falls in horticulture and transport support services, as well as disrupted education services,***" said Statistics New Zealand.

The last time New Zealand's economy was in recession was in 2020, as economic activity slowed dramatically following the first COVID-19 lockdown. But that recession was short-lived as activity rebounded quickly as restrictions were eased.

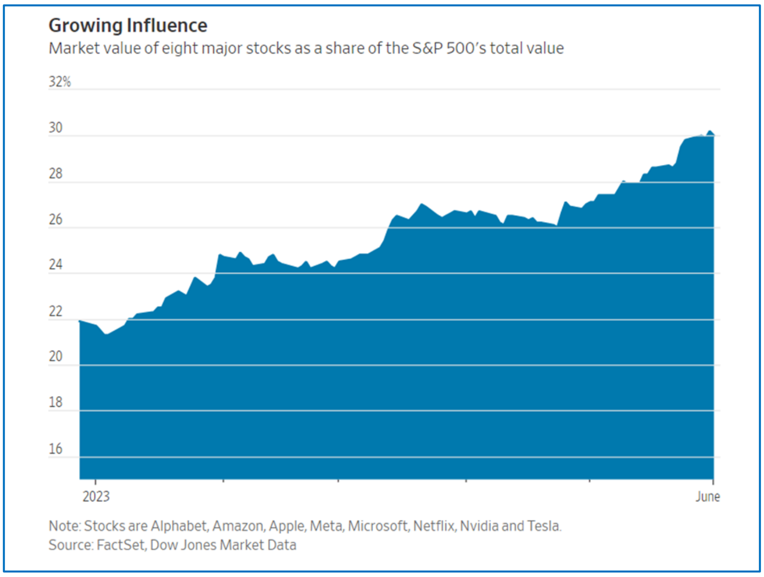
What's on the calendar

Following a busy one last week, it's a somewhat quieter one ahead. In the US, we have consumer sentiment data, which should give a steer on how well US households are holding up. Its last reading was 59.2, with forecasts being for a modest pick up to 60 this time around. Also in the US is the preliminary reading for Building Permits. April's number was surprisingly weak, and given a shortage of new housing in the US, May's number should give investors a steer on whether this is a continuing trend or not.

The other key events are in the UK, with inflation data out on Wednesday, a day ahead of the Bank of England's interest rate-setting meeting. Last time around, UK inflation fell to 8.7% (from 10.1%). While a significant fall, it was not as big a drop as expected. So this week's reading will no doubt set the tone for the Bank of England's announcement the following day, where it's widely expected to continue raising rates. While rate expectations were scaled back slightly following last weeks' Fed meeting and its decision to 'pause', UK interest rate markets expect five more quarter percent increases this year.

Chart of the week

The top eight companies now make up 30% of the S&P 500 Index's market capitalization, up from 22% at the start of the year. They are Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Tesla and Nvidia. Why has their share been growing? It's down to huge share price gains as investors speculate on how AI trends may boost these companies' future earnings – with members of this group claiming the top 3 spots in terms of their performance within the S&P 500 Index this year (Nvidia, Meta and Tesla). The weakest performer amongst these eight, Microsoft, has still delivered a 35% gain.



Here's what we're reading

Tech skills will continue to be in high demand But tech jobs will become less safe and, for many, less rewarding: https://www.drorpoleg.com/is-your-job-safe/

Busy vs. Productive. The gravest crisis facing the American people in the year ahead?: https://collabfund.com/blog/busy-vs-productive/