The Weekly Snapshot

19 September 2022

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

Global equity markets had one of their more volatile weeks in a while, as a sharp sell-off on Tuesday followed by further weakness into the close of the week saw share markets in the US trade to their lowest levels since July. For the week, the S&P 500 fell around 5%, while technology shares continued to underperform in the rising-interest-rate environment, which saw the NASDAQ 100 end nearly 6% lower.

Inflation and interest rates remained the main driver as bond yields rose over the week. In the US, the 10-year government bond yield rose 15 basis points, while yields in Europe followed suit as inflation concerns linger there too.

It was a better session locally, with the NZX 50 ending down just 1.5%, while domestic bond yields were dragged higher by offshore moves, which saw the 10-year bond yield close just above 4%.

What's happening in markets?

Last week was dominated by Tuesday's US inflation report that showed year-on-year inflation fell to 8.3% from 8.5%, but was well ahead of consensus, raising concerns that the path to lower inflation will be more challenging than policymakers had hoped. Furthermore, core inflation, which strips out volatile food and energy prices also beat consensus – rising 6.3% on an annual basis. Housing-related, or shelter inflation continues to be one of the main drivers.

This news sparked the sell-off, which saw the VIX Index – a measure of equity market volatility – spike to a two-month high, while bond yields rose sharply. In particular, the two-year treasury yield, which finished the week about 30 basis points higher, and is now about 40 basis points higher than the 10-year equivalent – further increasing the inversion of the yield curve that has in the past, been a precursor to a recession.

The downbeat week was exacerbated when global logistics company, FedEx, warned of a looming recession, saying it plans to close offices and freeze hiring in response to a steep decline in package shipping volumes. The news saw shares in the company fall more than 20% - the biggest one-day drop in the history of the company.

Meanwhile, there was some better news down under, with New Zealand GDP for the second quarter growing at 1.7%, ahead of expectations. However, with the central bank firmly focused on bringing inflation under control, it is unlikely to deter any slowing of monetary tightening.

What's on the calendar

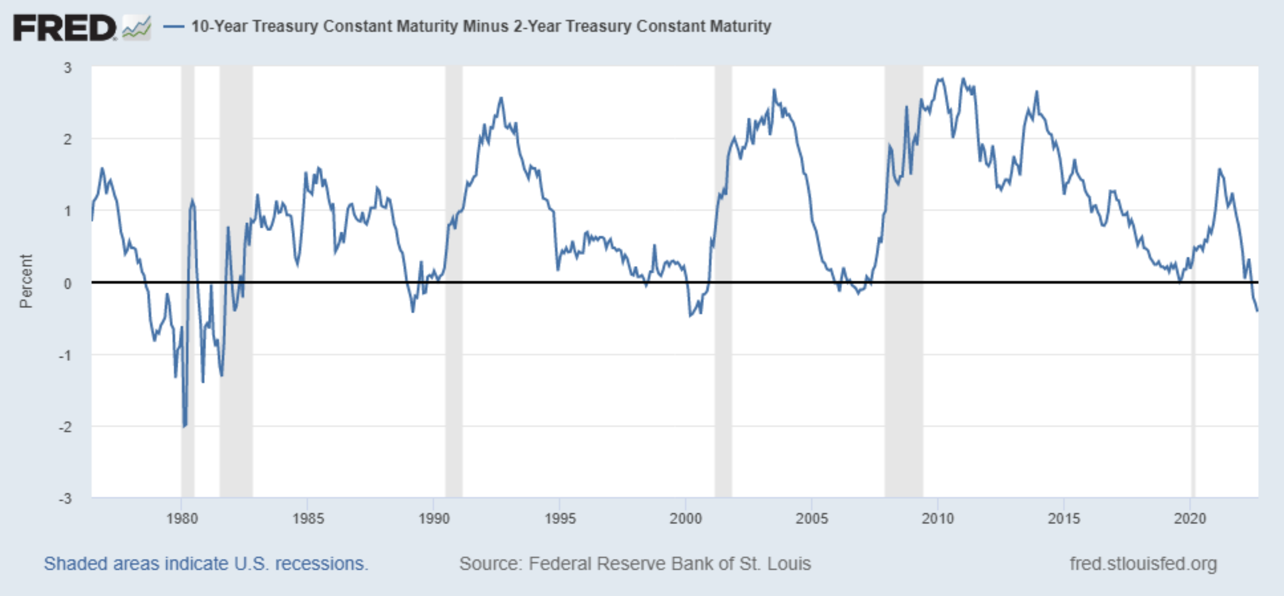
After last week's inflation report, and the ensuing surge in bond yields, all eyes will be on the Federal Reserve meeting this coming week. At the start of last week, interest rate markets were split between a 50 and 75 basis point hike, but after the inflation report, 75 basis points appears to be the minimum, and according to the CME FedWatch Tool, which tracks fed funds futures, there is about a 20% probability the Fed raises rates by 100 basis points.

It's also worth noting that the Fed will release its summary of economic projections. In June, the last time the Fed released its projections, the committee saw PCE Inflation at 5.2% at the end of 2022, while its projection of the fed funds rate was 3.4% - this will no doubt be revised higher, closer to the 4% level.

In other central bank activity this week, the Bank of England (BoE) meets this week where it is expected to raise its key interest rate by at least 50 basis points. It's the first meeting since the government announced its £150bn energy subsidy scheme that will cap energy bills. The central bank will have to ponder the flow-on effect of the scheme with better-off households more likely to spend the money, which could prove inflationary, further fuelling inflation, which is already running around 10%.

Chart of the week

As discussed above, the spread on the 10-year and two-year US government bond yields continued to fall further into negative territory, and historically this has proven to be a precursor to a recession. In 2018, the Chicago Fed put together a piece on why yield curve inversion can lead to a recession. You can read this here: [Why Does the Yield-Curve Slope Predict Recessions?]



Here's what we're reading

Ray Dalio: It Starts With Inflation - https://www.linkedin.com/pulse/starts-inflation-ray-dalio/

Howard Marks' latest: The Illusion of Knowledge - https://www.oaktreecapital.com/insights/memo/the-illusion-of-knowledge