The Weekly Snapshot

11 April

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

Global equity markets moved slightly lower this week as interest rates – and in particular, the pace of global monetary tightening – remained high on the list of concerns facing investors. Other worries were talk of further sanctions against Russia from the European Union, and political risks in France as the country headed to Presidential elections.

Following three back-to-back weekly gains, the S&P 500 Index in the US fell 1.2%. However, this did not detract from its strong recovery in March, with the index up 6.7% since its mid-March lows.

New Zealand equities were flat, with the NZX 50 Index unchanged over the week.

While share markets were relatively uneventful, there was plenty of action in bond markets. Bond yields continued their march higher, with the yield on the US 10-year benchmark bond trading above 2.70%, its highest level since March 2019. Yields continued to move higher (and their prices lower) following comments from members of the US Federal Reserve (US Fed).

New Zealand bond yields also moved higher, with the 10-year yield up as high as 3.44%, ahead of the Reserve Bank of New Zealand (RBNZ) interest rate decision this week – its highest level since late 2015.

Meanwhile, Australian bond yields jumped higher and edged closer to the 3.00% level, as the Reserve Bank of Australia suggested that it would be less 'patient' when it comes to potential rate rises.

What else is happening in markets?

Last week, a number of current and former members of the US Fed commented on the need for tighter monetary policy in order to tackle inflation. Further insight into the current thinking coming from the minutes from the last meeting of its rate-setting committee. This provided a bit more detail around the plan for reducing the size of the Fed's balance sheet, which is expected to start in May, and reach a maximum pace of $95b a month ($60b in US Treasuries and $35b in Mortgage Back Securities).

Another interesting insight around the pace of rate hikes came from the US Fed's consideration of a 50bp hike in March, which was only stepped down to the 25bp due to the geopolitical uncertainty that had emerged after Russia invaded Ukraine. Current market pricing expects just over 200bp of tightening to occur by the end of the year, with a high probability of some 50bp moves at the May and June meetings.

There was also a big beat on US jobless claims, which were down to 166k last week, matching their lows for the cycle. A trend lower in initial claims is consistent with a very tight labour market where firms are reluctant to let go of staff.

The Omicron outbreak in China continues to escalate, with Shanghai entering an indefinite lockdown. Purchasing Manager Indexes (PMIs) out of China last week reflected very weak sentiment on the services side. While the manufacturing side looked to have held up well, going forward it is expected to follow services lower – with the lockdown situation threatening to worsen already strained port and production bottlenecks. With no signs that the Chinese government is open to pivoting away from its lockdown strategy, this presents a near term risk for global supply chains and inflation.

What's on the calendar

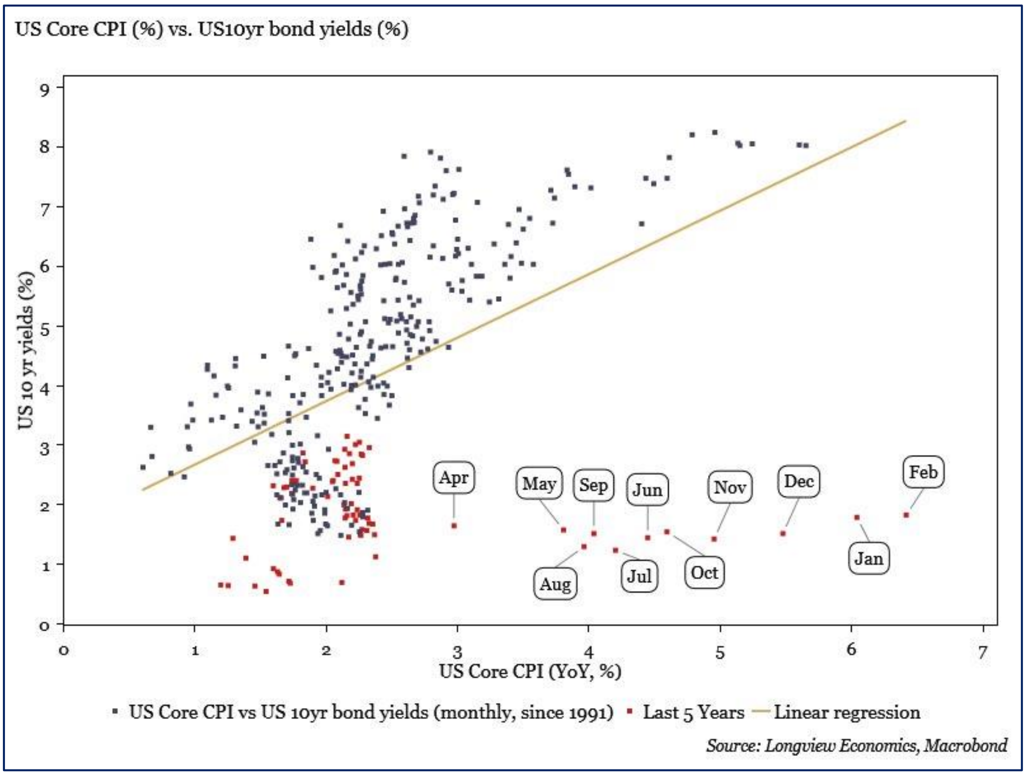
There's a lot happening in markets that's not necessarily data driven. Geopolitics will be a key area of focus, with markets hoping for a Russia/Ukraine ceasefire. Politics is also centre-stage in France, with voting underway in the opening round of its Presidential race; the initial vote will decide which two of the 12 candidates should take part in a run-off vote. Currently it looks like the incumbent, Emmanuel Macron, will be in a close fight with far-right challenger, Marine Le Pen.

It's another big week for global interest rates, with central bank rate decisions from the European Central Bank, the Bank of Canada, and the RBNZ. The RBNZ is expected to continue to raise rates, although the question remains whether it's a 25bp or a 50bp move.

Chart of the week

The chart below shows the unprecedented divergence between core inflation and 10-year US bond yields, and highlights a number of outliers over the past 12 months. Historically, higher inflation tends to signify higher bond yields.

Arguably, bond yields have never been this tolerant of high inflation. Bond markets therefore appear to be a putting an awful lot of trust in central bankers not allowing inflation to get going.



Here's what we're reading

Here's a quick primer explaining what a steep, flat or inverted yield curve means and whether it can forecast the next recession: https://www.reuters.com/business/finance/us-yield-curve-has-been-flattening-why-you-should-care-2022-02-03/

The worst run for bonds since 1980: Michael Batnick looks at their recent performance, but argues that it's not all bad: https://theirrelevantinvestor.com/2022/03/20/the-worst-run-for-bonds-since-1980/