The Weekly Snapshot

18 July

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

It was a busy week, with investors focused on key economic data releases, central bank meetings and the start of the second quarter earnings season.

Equity markets were down again following stronger than expected US inflation data, which suggested that the US Federal Reserve would keep up its aggressive approach to raising interest rates. Despite a rally on Friday, the S&P 500 Index fell 0.9% during the week, while the NASDAQ Index fell 1.6%.

New Zealand shares ended the week slightly lower, as domestic interest rates headed higher too, with the NZX 50 Index down 0.3%. The better performers during the week were Spark (following news of the partial sale of its telecommunications towers) and Meridian Energy and Contact Energy, as both saw a weighting upgrade in the S&P Global Clean Energy Index.

The hot inflation number and fears of an even more aggressive rate hike sent bond yields higher. Bond yields and bond prices move inversely to one another, and bonds generally underperform when rates are heading up. The yield on the US 2-year bond, which is more sensitive to changes in monetary policy, jumped 9 basis point (bp) to 3.14%. Meanwhile the yield on the 10-year bond fell 4bp to 2.92%. It meant the yield curve inversion between 2 and 10 year bonds moved to its biggest level since 2000. Yield curve inversions are generally seen as a sign that a recession lies ahead.

What's happening in markets?

The closely-watched inflation data showed that US consumer prices rose 9.1% in the year to June, well above the expected 8.8% (and higher than the 8.6% during the year to May). Excluding the volatile food and energy sectors, core CPI was up 5.9%, which while also being higher than expected, was lower than the prior month's 6.0%.

The increase comes at the same time as crude oil, commodity and housing prices all show signs of coming down, and it leaves a lot of investors wondering if inflation has in fact peaked. Brent crude oil dipped below $95 a barrel during the week on recession worries, but finished the week above $100.

The hot inflation number is likely to prompt the Fed to hike by another 75bp at its meeting next week, and even raised suggestions that it could go with an even bigger hike to try to get on top of inflation – thereby following in the footsteps of the Bank of Canada, who last week surprised with a 100 basis point move in its cash rate (more below). Fed officials tried to dial back expectations, with two governors coming out to advocate for 'just' another 75bp move. According to CME's FedWatch tool, the market has moved to price in a 70% probability of a 75bp move next week, and a 30% probability of a 100bp move. If it went ahead with a 100bp move, it would be the largest hike in the Fed's history.

The Reserve Bank of New Zealand (RBNZ) meanwhile delivered its sixth consecutive interest rate hike and signalled that it remained comfortable with its planned tightening path. It raised the Official Cash Rate (OCR) by a further 50bp, to 2.5%. Some thought it may tone down its aggressive rhetoric given sharp falls in business and consumer confidence and a pick-up in the pace of the housing market downturn. The bank has made its decision ahead of all-important second quarter inflation data, due later this week.

Meanwhile, the Bank of Canada raised interest rates by a full percentage point to curb inflation, and indicated that more rates would likely be needed. Its move surprised the market, its biggest increase since 1998.

"*With the economy clearly in excess demand, inflation high and broadening, and more businesses and consumers expecting high inflation to persist for longer, the Governing Council decided to front-load the path to higher interest rates,"* the bank said.

Finally, earnings season kicked off with some of the key US banks reporting last week, and they delivered mixed results. Sentiment around this reporting season is already quite negative, with investors expecting guidance to skew towards the negative side in the face on strong macro headwinds. While some disappointment may already be in the price, the next two weeks could still be volatile.

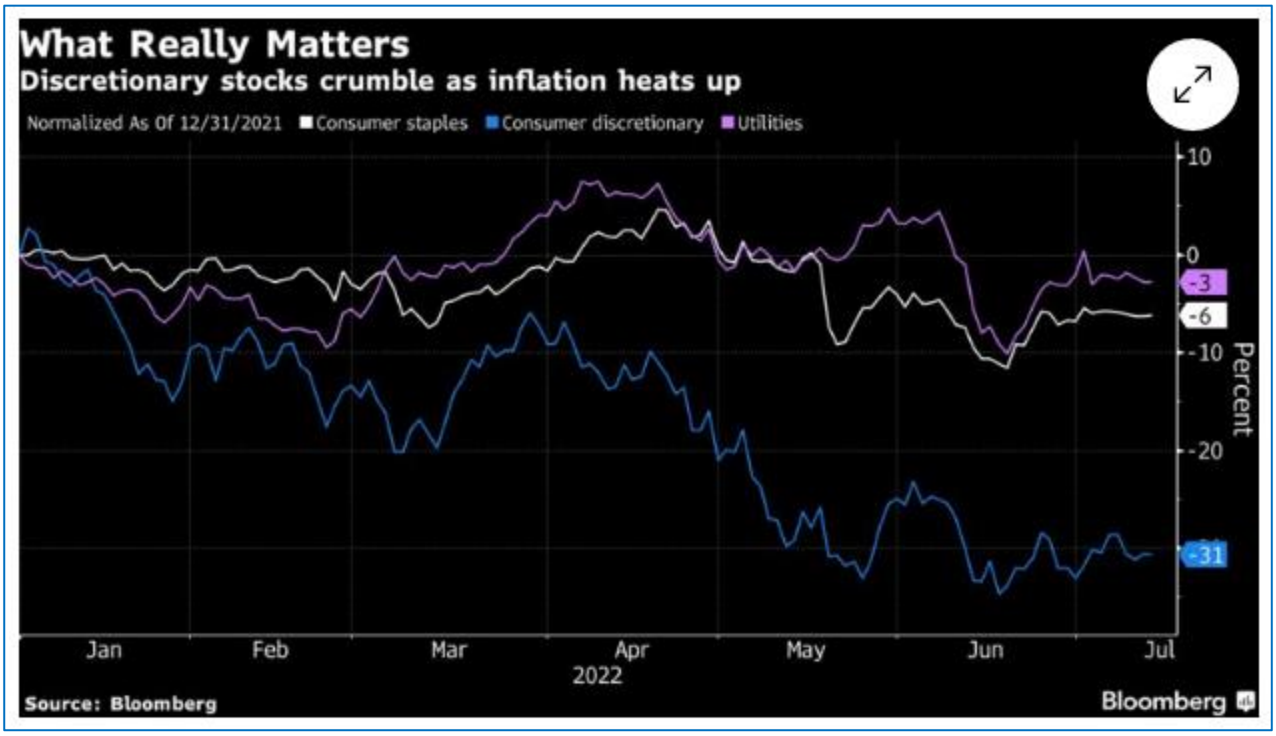
What's on the calendar

The European Central Bank meets this week on Thursday and is expected to follow the lead of other global central banks, but with a somewhat more muted 25bp hike likely. Inflation in the region is at record highs, and the challenge for the bank is how much can it raise rates without causing even more instability within the region.

At home, New Zealand's second quarter inflation will be released on Monday, and many are expecting annual inflation to break through the 7% level – which would be its highest level in more than 30 years. Adding additional pressure to high fuel, food, building and household costs, is the near 10% fall in the value of the kiwi dollar over the last three months, meaning imported inflation is likely to be even higher.

Chart of the week

It's no surprise that the risk of a US recession has increased, and has made its way into the equity market. Leaving the energy sector aside, utilities and consumer staples are the two best-performing segments of the S&P 500 Index this year (both are in the red, but less so than everything else). Companies in these sectors provide the essentials for everyday life. At the other end, are consumer discretionary stocks, which are down more than 30% year-to-date. The make-up of that sector is mostly retailers and automakers – the kinds of purchases one might put off as the costs of living rise.



Here's what we're reading

Why no one knows if we're about to have a recession:
https://fullstackeconomics.com/why-no-one-knows-if-were-about-to-have-a-recession/

Dollar cost averaging through some of the most difficult periods in market history:
https://ofdollarsanddata.com/in-defense-of-dollar-cost-averaging/