The Weekly Snapshot

13 June

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

It was a tough week for financial markets, with inflation very much the focus for investors. In the US, May's Consumer Price Index (CPI) report showed that inflation was at its highest level since 1981 and that prices were rising faster than expected, putting pressure on global equity and bond markets. A weak consumer sentiment reading also weighed negatively on sentiment, as did Thursday's meeting of the European Central Bank (ECB), where it indicated that interest rates in the eurozone would likely head higher, starting in July.

The S&P 500 Index fell 5.1%, its worst week since January this year. It has now delivered 9 'down' weeks out of the last 10. Tech stocks were hit hardest, as investors worried about what the prospect of even higher interest rates – and a possible recession - could mean for the sector. The NASDAQ 100 Index fell 5.6%. It was a similar story in Europe, with Germanys' DAX Index down 4.8%.

The New Zealand and Australian share markets also fell, but they did not fall by as much as their international counterparts, with the NZX 50 Index down 2.4% and the ASX 200 Index down 4.2%. This however reflected the fact that the worst of the falls in international markets were on Friday (US time), when our local markets were closed, and so we should expect a weaker start to the current week.

However, the Australian share market was adversely affected early in the week by the surprise rate hike from the Reserve Bank of Australia (RBA). While the markets had expected interest rates to rise, they did not forecast the 50 basis point hike that the bank implemented.

Bond markets were also weak. The yield on the US 10-year government bond rose by 20 basis points to 3.16%. Of particular note was the yield on the equivalent 2-year government bond, which jumped 39 basis points to above 3%, and to a level not seen since 2008. The 2-year bond is seen as being more sensitive to US Federal Rates (US Fed) rate hikes.

What's happening in markets

US CPI surged 8.6% during the year to end May, compared to the 8.3% recorded in the previous month. The cost of petrol, food and other necessities all jumped, raising inflation in the US to a new four-decade high. On a month-to-month basis, prices rose 1% from April to May, a steep rise from the 0.3% increase from March to April. Significantly higher petrol prices are to blame for much of the increase.

High inflation has forced the Fed into what will likely be the fastest series of interest rates hikes in three decades. By raising borrowing costs aggressively, the Fed hopes to cool spending and growth enough to curb inflation without tipping the economy into recession. In fact, the Fed will meet later this week to decide what move to make next. While most expect the central bank to raise rates by 50 basis points, the very strong CPI reading has sparked speculation that policymakers could hike rates faster and higher.

Meanwhile, consumer sentiment in the US dropped to a record low. High inflation and rapidly increasing interest rates have raised concerns around a potential recession in the US. This is weighing on the consumer sector – bearing in mind that consumer spending drives a significantly large part of US GDP.

Meanwhile, in Europe, the ECB confirmed its intention to raise interest rates by 25 basis points at its July meeting, with a further hike to come in September – the size of which will be determined by the inflation outlook nearer the time. Last week, eurozone CPI rose 8.1%, much faster than expected and hitting a record high for the seventh month in a row.

What's on the calendar

It's a big week for the world's central banks. The focus will be the US Fed on Wednesday (Thursday, New Zealand time). There are also rate meetings in the UK and Switzerland on Thursday, and Japan on Friday (where the Bank of Japan is largely expected to announce no change to current policy settings).

Ahead of these are some key economic data releases in these countries. In the UK, there is GDP data on Monday, and employment data on Tuesday. In the US, retail sales data is due on Wednesday.

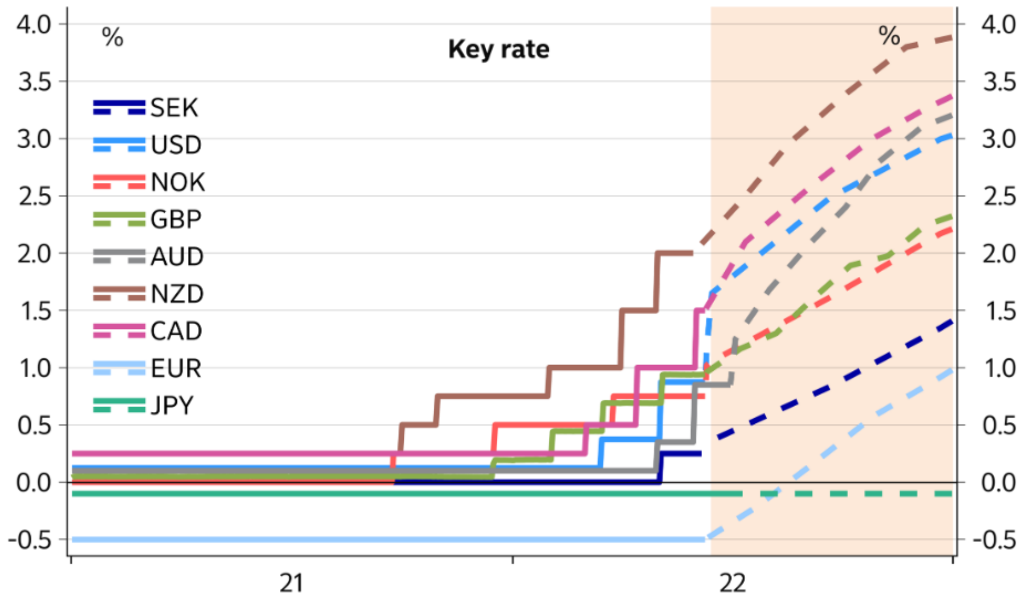
Closer to home we have New Zealand Q1 GDP on Thursday, while across the ditch we'll see Australian employment data for May, also on Thursday, where the market expects another strong reading.

Chart of the week

For most G10 central banks, 50 basis points in the new normal, for now.

It's not only the Fed and the ECB that see 50 basis points as the new normal for now among the G10 central banks. The RBA hiked its key rate last week by 50 basis points, and we expect to see a similar move next time around at its July meeting. The Bank of Canada has hiked by 50 basis points twice now, and New Zealand has similarly hiked twice by the same amount. The only central bank that is unlikely to raise rates in the foreseeable future is the Bank of Japan.

Chart 1: Most G10 central banks are in a rush to hike rates - OIS pricing ahead



Source: Nordea Markets and Macrobond

Here's what we're reading

How's the US consumer? That depends on who you ask and what they're looking at.
https://theirrelevantinvestor.com/2022/06/08/hows-the-consumer/

Rallies to the bottom – How the US stock market has bottomed historically and the false rallied that have occurred along the way.
https://ofdollarsanddata.com/rallies-to-the-bottom/