The Weekly Snapshot

9 May

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

It was another tough week for investors, with some big swings in financial markets. The focus was on central bank policy, with the US Federal Reserve, the Reserve Bank of Australia and the Bank of England the key authorities meeting to discuss interest rates in their respective economies.

In the US, the S&P 500 Index finished the week down 0.2%, although this masked some bigger moves, with the benchmark index having been up over 4% at one point during the week. Technology companies underperformed, with the NASDAQ 100 Index down 1.6% over the week as a whole.

Australian and New Zealand shares were weaker performers, down 3.0% and 2.7% respectively.

Despite some brief respite from the pressure being piled on bond markets from the fear of multiple future rate hikes, bond yields ultimately continued their march higher. The yield on the US government 10-year bond surpassed the 3% level, finishing the week up 19 basis points at 3.12%. The yield on the equivalent New Zealand government bond rose 10 basis points to 3.74%.

What's happening in markets

Thursday morning saw the US Federal Reserve hike rates by 50bps, as widely expected. Jerome Powell, Chair of the Federal Reserve, talked down the possibility of a 75bp hike, which the market had partially priced in for its June meeting. Instead the plan would be for a series of 50bp hikes over the next few meetings along with the start of its balance sheet reduction (also known as "quantitative tapering"). This prompted a brief rally in equity markets and a fall in bond yields. However, this rally was unwound later in the week as investors again focused on inflation and the reality of higher interest rates.

The plan for quantitative tapering was set with an initial pace of balance sheet reduction running at US$47.5b for three months, which would then double to US$95bn in September. The Federal Reserve remains focused on guiding the economy towards a "soft landing" with the main concerns still being heavily tilted towards the inflation outlook.

The Federal Reserve wasn't the only central bank meeting last week. In Australia, the Reserve Bank of Australia (RBA) kicked off its monetary tightening cycle as it raised its policy rate by 25 basis points – more than most had forecast. It's the first rate hike in 11 years, and comes ahead of the country's federal elections. Like most other central banks, RBA officials are starting to show some concerns about rising inflation.

"*The economy has proven to be resilient and inflation has picked up more quickly, and to a higher level, than was expected. There is also evidence that wages growth is picking up*" said RBA governor, Philip Lowe. *"Given this, and the very low level of interest rates, it is appropriate to start the process of normalising monetary conditions."*

The Bank of England meanwhile raised its base rate of interest to 1.0%, its fourth consecutive increase, as it continued to move against surging inflation – while also issuing a warning about a recession ahead. The Bank has forecast that the UK economy will shrink later this year in the face of double-digit inflation and an unprecedented squeeze on household incomes (see chart of the week).

What's on the calendar

It's a quieter week ahead. In the US, inflation will be in the spotlight, with consumer price inflation due out on Wednesday. Another jump higher in inflation would test support for riskier assets following the Federal Reserve's forward guidance last week.

In Europe, all eyes will be on economic sentiment data for Germany and the Eurozone, while a speech by ECB president, Lagarde, will also draw interest on Wednesday, with markets looking for guidance on future monetary policy. Meanwhile, in the UK, the focus will be on GDP data for the first quarter, especially given the country's central bank expects growth to decline later this year.

In Australia, authorities will be keeping a close eye on business and consumer confidence data.

Broader than that, markets will be looking for updates from Beijing on COVID lockdown measures (with the capital so far having managed to avoid a city-wide lockdown), and any news updates on the war between Russia and Ukraine.

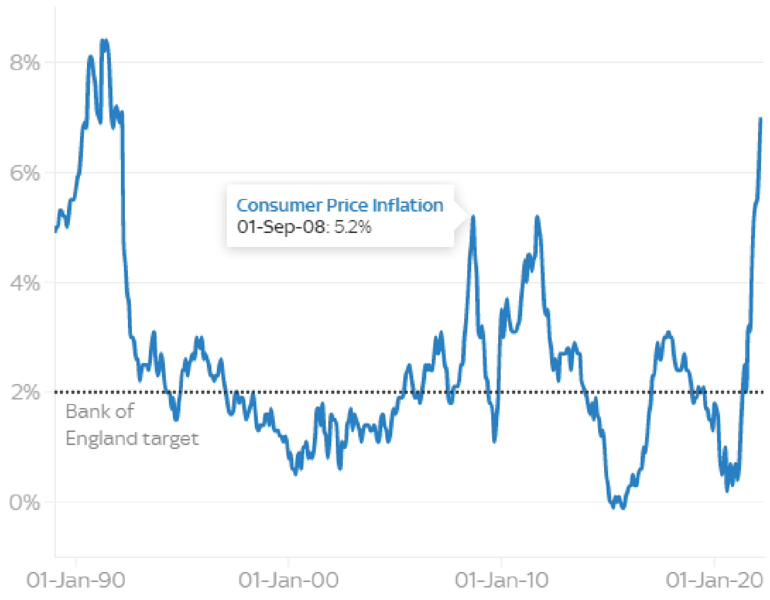
Chart of the week

The Bank of England slashed its forecast for Gross Domestic Product (GDP) growth next year from 1.25% to -0.25%. It also expects unemployment to begin to climb.

But perhaps most striking of all its forecasts is that inflation, as measured by the consumer price index, would rise to 10.25% towards the end of this year - nearly double its previous forecast of 5.75%.

That level of inflation would be the highest the UK has faced in four decades.

Consumer price inflation rose by 7% in the 12 months to March - the fastest for 30 years



SOURCE: Office for National Statistics

Here's what we're reading

Why does the stock market go up over the long-term?
https://awealthofcommonsense.com/2022/05/why-does-the-stock-market-go-up-over-the-long-term/

You've been thinking about inflation all wrong:
https://ofdollarsanddata.com/youve-been-thinking-about-inflation-all-wrong/