UK Week in Markets

Week ending 12 August 2018

Market Moves

- Global equity markets edged lower over the week as trade tensions between the US and China continued to escalate, with both countries imposing 25% tariffs on US$16bn worth of goods. Elsewhere, the Turkish Lira depreciated by 18.5% over the week as comments from the Turkish President and fears over the high level of foreign denominated debt in the Turkish banking system was compounded by the US doubling steel and aluminum tariffs on Turkish imports on Friday. Market concerns spread into Europe as investors worried about European banks' exposure to Turkey. The MSCI AC World Index fell 0.3% in local currency terms over the week. Broad sterling weakness pushed up returns to 1.2% in sterling terms. Developed Pacific ex Japan was the best performing region in local currency terms (1.4%). The AC Pacific ex Japan was the best performing region in sterling terms (2.7%). Japan was the worst performing market in local currency terms (-1.3%) despite better than expected GDP data. Developed Europe ex UK was the worst performing region in sterling terms (-0.5%).

- UK gilt yields fell across all maturities over the week, as declining investor sentiment led investors into bonds. The 10 year UK gilt yield fell by 9bps to 1.25% and the 20 year UK gilt yield fell by 6bps to 1.69%. The 10 year US treasury yield fell by 9bps to 2.86%. In Europe, German bund yields fell by 8bps to 0.33% and French government bond yields fell by 7bps to 0.67%. Italian government bond yields remained unchanged at 2.95%. Greek government bond yields rose by 13bps to 4.19% as the European Central Bank confirmed it will stop accepting Greek government bonds as collateral from August 21 once the current bail-out program ends.

- Both the UK 20-year and Over 5-year real yield fell by 5bps each to -1.68% and -1.63% respectively over the week. 20-year breakeven inflation fell by 1bp to 3.31%.

- The US high yield bond spread over US treasury yields rose by 7bps to 350bps and the spread of USD denominated EM debt over US treasury yields rose by 30bps to 363bps over the week. The sterling non-gilt spread over government yields (based on the Merrill Lynch index) remained unchanged at 119bps.

- The S&P GSCI fell by 0.8% in USD terms over the week. The energy sector fell by 0.5% as the price of Brent crude oil declined 0.5% to US$73/BBL with US crude oil inventories staying at higher levels than expected. Industrial metals rose by 1.1% despite copper prices falling by 0.8% to US$6,120/MT. Agricultural prices fell by 2.7% and gold prices fell by 0.2% to US$1,214/ounce.

- Sterling depreciated against major currencies over the week. The US dollar appreciated by 1.9% against sterling, ending the week at $1.28/£. The euro appreciated by 0.5% against sterling, finishing the week at €1.12/£. However, the euro fell by 1.4% against the US dollar due to spillover from the issues in Turkey. The Japanese yen appreciated by 0.4% against the US dollar, ending the week at ¥110.72/$.

Economic Releases

- Inflationary pressures continued to build in the US. Headline consumer price inflation remained at 2.9% as expected but core inflation, which excludes fresh food and energy, rose at its fastest pace since September 2008. The core Consumer Price Index increased by 2.4% over the year to July 2018, above expectations of a 2.3% increase. Wages, however, have failed to keep up with the pace of inflation with the annual change in real average hourly earnings turning negative over July. Growth in real wages slipped by 0.2% from June's flat reading. Meanwhile, US consumer debt rose less than expected at only $10.2bn over June; less than the forecasted $15.0bn and previous reading of $24.3bn.

- In the UK, GDP growth met expectations and accelerated slightly but remained subdued in the second quarter of 2018, growing by 0.4% over the quarter and 1.3% over the past year. Household consumption continued to rise and business investment rebounded after declining in the first quarter. However, net trade detracted from growth as exports slumped by 3.6%. Industrial production data came in above expectations with production increasing by 0.4% in June and May's reading was revised up to -0.2%. Over the year, industrial production increased by 1.1%, 0.4% ahead of market expectations. Elsewhere, the Halifax House Price index rose 1.4% in July, above market expectations of a 0.2% increase, taking year-on-year growth in the three months to July to 3.3%, the largest increase since November last year.

- In the Eurozone, the Sentix investor confidence index came in above market expectations, increasing by 2.6 points to 14.7 in August, but remains below levels seen in 2017 and its recent high of 31.9 in February. However, news from Germany was less positive with industrial production declining by 0.9% in June, below market expectations of a 0.5% decline and the 2.4% increase in May. The decline in production occurred across consumer (-1.6%), capital (-0.6%) and intermediate (-0.8%) goods. German factory orders also came in well below market expectations, falling 4% in June against expectations of a 0.4% fall, due to falling foreign demand (-4.7%) and domestic orders (-2.8%) – the sharpest decline in factory orders since January 2017.

- Japan avoided a technical recession in Q2 2018 with preliminary numbers showing that the economy rebounded by an annualised 1.9%, beating the forecasted growth of 1.4%. Japan's current account surplus narrowed to ¥1175.6bn in the year to June, below forecasts of ¥1222.2bn. Labour markets continued to improve as labour cash earnings accelerated by 3.6% for the year to June from the previous 2.1% increase. Real wages rose at its fastest pace in more than 21 years as it increased by 2.8% over the same period from a previous 1.3% increase, and above a forecasted increase of 0.9%. The rise in real wages was driven by an increase in summer bonuses.

- In China, the consumer price index increased by 2.1% over the year to July; 0.2% higher than the previous month and beating consensus estimates of a 2.0% increase. Against a backdrop of tense trade talks, exports and imports grew by 12.2% and 27.3% respectively over the year to July. The sharp rise in Chinese import growth compared to that of exports, led to a narrowing of China's trade surplus to US$28.05bn, well below analyst forecasts of US$38.92bn.

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