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UK Week in Markets

Week ending 18 February 2018

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Market Moves

- Global equity markets gained over the week with investors largely shrugging off concerns of higher inflation and interest rate expectations as risk appetite appeared to return. The Cboe's VIX volatility index also fell below its long-term average of 20. Encouraging corporate earnings also supported equities whilst economic data were mixed. The MSCI AC World Index rose 3.7% in local currency terms and 2.7% in sterling terms. The US was the best performing region in local currency terms with a return of 4.4%, led by positive corporate earnings and strongly performing Information Technology stocks. Developed Europe ex UK was the best performing region in sterling terms (3.3%), supported by strong economic growth data. Japan returned the least both in local currency (0.3%) and sterling terms (1.1%) as renewed yen strength hurt exporters' stocks.

- Movements in UK gilt yields were small across maturities in a week in which the UK posted stronger than expected inflation data whilst retail sales data disappointed. The 10 year UK gilt yield fell by 1bp to 1.59% whilst the 20 year UK gilt yield was unchanged at 1.96%. The 10 year US treasury yield rose by 6bps to 2.90% as higher than expected US inflation data raised expectations for aggressive monetary tightening by the US Federal Reserve. Meanwhile, German bund yields fell by 4bps to 0.65% and French government bond yields fell by 3bps to 0.85% over the week. Greek government bond yields continued to rise as the index yield rose by 30bps to 4.81%.

- The UK 20 year real yield was unchanged at -1.51% whilst the Over 5 year real yield fell by 6bps to -1.52%. 20 year breakeven inflation rose by 2bps to 3.42%.

- The US high yield bond spread over US treasury yields offset most of the previous week's spread widening and fell by 32bps to 350bps. The spread of USD denominated EM debt over US treasury yields finished the week 11bps lower at 284bps. The sterling non-gilt spread over government yields (based on the Merrill Lynch index) rose by 2bps to 102bps.

- The S&P GSCI rose by 3.3% in USD terms over the week. The energy sector rose by 3.5% with the price of Brent crude oil increasing by 0.5% to US$64/BBL. Industrial metals increased by 5.6% as copper prices rose by 7.1% to US$7,191/MT. For a second successive week, agricultural prices moved higher (up 1.5%) and gold prices rose by 3.3% to US$1,356/ounce.

- Sterling appreciated against major currencies with the exception of the yen over the week. The US dollar depreciated by 1.7% against sterling, ending the week at $1.40/£. The euro weakened by 0.1% against sterling, finishing the week at €1.13/£. The Japanese yen appreciated by 2.5% against the US dollar, with the US dollar exchange rate against the yen ending the week at a 15-month low of ¥106.05/$.

Economic Releases

- Following the previous week's positive jobs report, US inflation data accentuated the greater likelihood for rate hikes in the future. Over the month of January, prices rose by 0.5% as measured by the Consumer Price Index (CPI); above forecasts of a 0.3% increase and the revised 0.2% inflation reading in December. Annual consumer price inflation was unchanged at 2.1%, thereby exceeding estimates of inflation slowing to 1.9%. Furthermore, the data indicated a broad-based increase in prices with core CPI also unchanged at 1.8%. Retail sales unexpectedly declined by 0.3% over the month of January, below estimates of 0.2% growth. Moreover, the previous month's reading was revised lower from 0.4% to no growth. Similarly, industrial production missed expectations of 0.2% growth and instead fell by 0.1%, dragged lower by falling mining output. Despite these negative releases, consumer sentiment remains very buoyant with the University of Michigan's index rising to 99.9 from 95.7. Analysts had forecasted a slight fall to 95.5.

- In the UK, headline CPI inflation was unchanged at 3.0% over the year to January, in line with the increase in December. While inflationary pressures from sterling's depreciation are petering out, domestic pressures drove prices higher. Core inflation, which excludes energy, food, alcohol and tobacco, accelerated to 2.7% on an annual basis in January from 2.5% in December. Retail sales, excluding auto and fuel, increased by 0.1% in January, below analyst forecasts of a 0.6% increase but up from the previous month’s 1.5% decrease. On an annual basis, sales grew by 1.5%, undershooting expectations of a 2.4% rise, as high inflation continues to squeeze consumer spending.

- Economic expansion continued in the Eurozone with GDP growing by 0.6% in Q4 2017, in line with the previous quarter's GDP reading. Industrial production grew by 0.4% in December, above expectations of a 0.1% increase, but down from 1.3% growth in the previous month. In Germany, final inflation figures for January were left unchanged from the flash readings, increasing 1.6% annually despite a month-on-month fall of 0.7%. Preliminary data showed German GDP growing by 0.6% in Q4 2017, in line with analyst expectations but slightly down from 0.8% growth in the previous quarter. Meanwhile, the Eurozone trade surplus widened to €23.8bn in December from €22.0bn, exceeding expectations of a €22.3bn surplus.

- Japanese economic growth slowed to an annualised rate of 0.5% in Q4 2017; the lowest rate in two years. Although it marked the eighth consecutive quarter of growth, it was short of estimates of 1.0% and well below the previous quarter's revised reading of 2.2%. Over the quarter, private consumption rebounded from last quarter's decline and increased by 0.5% while business spending rose by 0.7% which undershot analyst estimates of 1.1% growth. Core machine orders for the month of December fell by 11.9% against analyst estimates of a fall of 2.0%.

- New loans issued by Chinese banks surged to a new record of 2.9 trillion yuan in January, up markedly from the previous reading of 584.4 billion yuan and above estimates of 2.1 trillion yuan. The previous record for net new loans was 2.5 trillion yuan in January 2016. Money supply growth (M1 and M2) in China was recorded at 15.0% and 8.6% respectively for the year to January, higher than the estimates of 13.5% and 8.2%.

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