UK Week in Markets

Week ending 09 December 2018

Market Moves

- Global equity markets generally fell over the week. The MSCI AC World Index fell by 3.5% in local currency terms and 3.4% in sterling terms with the information technology and financial sectors declining the most.

- Despite an apparent tentative reprieve in trade hostilities between the US and China following the G20 summit, there are lingering concerns over its durability which was exacerbated after the US extradition order for Huawei's chief financial officer. Trade worries alongside the continued flattening of the US yield curve, may be unnerving investors at the moment.

- Developed Pacific ex-Japan was the only region to generate positive returns in local currency terms (0.3%) and it also fell the least in sterling terms (-0.3%). The US was the worst performer in both local currency terms and sterling terms at -4.5%.

- Bond yields fell across major developed markets as investors moved to safe-haven assets. The 10-year UK gilt yield fell by 9bps to 1.27% and the 20-year UK gilt yield fell by 17bps to 1.74% over the week. In Europe, German Bund yields fell by 5bps to 0.26%. French government bonds bucked the wider downward trend as yields rose by 1bp to 0.69%. Italian government bond yields fell by 8bps to 3.13% after the Italian prime minister signaled a willingness to amend the country's budget plan to avoid sanctions from the European Commission. Greek government bonds fell by 4bps to 4.21%.

- The US yield curve flattened the most since 2007. The spread between the US 2-year and 5-year treasury yields turned negative for the first time since 2007 while the spread between the 2-year and 10-year yields reached its lowest level since the same year. 10-year US treasury yields fell by 16bps to 2.85%.

- Both the UK 20-year real yield and the Over 5-year real yield fell by 23bps each to -1.82% and -1.64% respectively. 20-year breakeven inflation rose by 2bps to 3.48%.

- In general, credit spreads widened over the week. The US high yield bond spread over US treasury yields rose by 21bps to 450bps. The spread of USD denominated EM debt over US treasury yields rose by 4bps to 400bps over the week. The sterling non-gilt spread over UK gilt yields (based on the Merrill Lynch index) rose by 5bps to 150bps.

- The S&P GSCI rose by 2.4% in USD terms over the week. The energy sector rose by 3.3% as the price of Brent crude oil rose by 5.0% to US$62/BBL in a week in which the OPEC nations and Russia planned to cut their respective crude oil production by 1.2 million barrels per day. Industrial metal prices fell by 0.5% as copper prices fell by 1.0% to US$6,173/MT. Agricultural prices rose by 1.9% and gold prices rose by 2.1% to US$1,243/Oz.

- Sterling had mixed performance against major currencies over the week. It remained unchanged against the US dollar, ending the week at $1.28/£, but slipped by 0.6% against the euro to €1.12/£. The Japanese yen appreciated by 0.8% against the US dollar, ending the week at ¥112.70/$.

Economic Releases

- Economic releases in the US were fairly mixed over last week. A measure of national factory activity, the Institute of Supply Management's (ISM) manufacturing index for November bucked expectations of a modest 0.2 point decline and climbed to 59.3. Both the New Orders and Employment sub-indices rose over the month but there was a marked deceleration in the prices being paid by US manufacturers. The ISM Prices Paid sub-index dropped to 60.7 from 71.6, although the reading still suggests prices are increasing. November's non-farm payroll release failed to meet analyst forecasts of 198k with only 155k new jobs being added over the month; a fall from October's 237k reading. The unemployment rate held firm at 3.7%, as did the year-on-year increase in average hourly earnings at 3.1%; both meeting consensus estimates.
- In the UK, the Markit Manufacturing Purchasing Managers' Index (PMI) rose to 53.1 in November from 51.1 in October and above market expectations of 51.7. The pick-up in the manufacturing sector was driven by stronger domestic orders which helped to offset a second consecutive month of falling export orders. Economic activity in the UK services sector, as measured by the services Purchasing Managers' Index (PMI), slipped to 50.4 from 52.2, the lowest level since the Brexit vote and below expectations of 52.5. However, the Construction PMI rose to 53.4 from 53.2, defying forecasts of it slowing to 52.5. Elsewhere, there was further evidence of a slowdown in UK house price growth as year-on-year growth in the Halifax House Price index fell to 0.3% in the three months to November 2018, the lowest annual increase in six years.
- In the Euro Area, the final reading for third quarter GDP growth was unexpectedly revised lower to 1.6%. Releases concerning the fourth quarter were slightly more upbeat, however, with upward revisions to both manufacturing and services PMI readings for November at 51.8 and 53.4, respectively. Retail sales rebounded by 0.3% in October following September's downwardly revised 0.5% fall which took the year-on-year growth to 1.7% from the revised 0.3%. In Germany, industrial production contracted by 0.5% in October against forecasts of a 0.3% increase while factory orders unexpectedly rose by 0.3%, outperforming expectations of a 0.4% decrease. Similar to the wider Euro Area, the final manufacturing PMI reading for November was upwardly revised to 51.8 from 51.6.
- Japanese economic growth declined in Q3 2018, impacted by a series of natural disasters. Final readings showed that the economy contracted at an annualised 2.5%, worse than the initial estimate of a 1.2% contraction. The Nikkei Services PMI inched 0.1 point lower to 52.3, although it remains in expansionary territory. Meanwhile, year-on-year labour cash earnings accelerated to 1.5% in October from a downwardly revised 0.8% in the previous month. The current account surplus narrowed from ¥1,821.6bn to ¥1,309.9bn in October but was above forecasts of ¥1,262.7bn.
- Amid a backdrop of heightened trade concerns, Chinese trade data was sluggish. Exports growth slowed to 5.4% in the year to November as front-loading ahead of tariffs faded. This was below the 15.5% growth recorded previously and forecasted growth of 9.4%. Over the same period, imports rose by 3.0% (the slowest reading since October 2016), significantly below the 20.8% growth recorded previously and well short of the estimated 14.0% increase. Overall, China's trade surplus widened to US$44.74bn, well ahead of analyst estimates of a US$34.40bn surplus. Elsewhere, consumer price inflation slowed to 2.2% over the year to November and came in below analyst forecasts of 2.4%.

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