UK Week in Markets

Week ending 3 March 2019

Key News and Events

- Theresa May scheduled a series of Brexit votes from 12-14 March: the second meaningful vote, a vote on No Deal and a vote on whether to request an extension to Article 50. Meanwhile, the government continued to try to seek concessions from the EU on the Northern Irish backstop but once again made little progress with Geoffrey Cox, the Attorney General, now seeking an "enhanced arbitration mechanism" having dropped demands for a time limit or unilateral exit mechanism. However, senior Brexiteers seemed to have softened their stance and are no longer calling for the backstop to be replaced. Markets reacted positively to the week's Brexit developments boosting gilt yields and sterling.
- Progress continues to be made in US-China trade talks with the US and China agreeing to a trade enforcement process. Talks are now entering final stages, with the US President Donald Trump calling for a removal of all tariffs on US agricultural products.
- The US-North Korea Hanoi summit ended without an agreement as US President Donald Trump refused North Korea's demand for the UN Security Council's economic sanctions on North Korea to be lifted in their entirety. However, Trump remained optimistic and hinted that talks will continue.
- MSCI is set to increase Chinese A shares' weight in its Emerging Markets index with the inclusion factor increasing to 20% from the current 5% by November 2019.

Market Moves

- Global equity markets rose over the week as US-China trade tensions de-escalated after the US dropped its plan to impose additional tariffs of $200bn on 1 March citing substantial progress on a range of issues. The MSCI AC World Index rose by 0.4% in local currency terms and fell by -1.0% in sterling terms. The Financials sector was the best performer at +1.1% in local currency terms. The Real Estate sector was the worst performer at -0.9% in local currency terms.
- European equities were the best performing market in local currency terms (+1.0%) and sterling terms (+0.1%), benefitting from the de-escalation of trade tensions and improved Chinese trade data. UK equities were the worst performing market in local currency terms (-0.9%). Japanese equities were the worst performing market in sterling terms (-2.1%) largely as a result of yen weakness.
- The 10-year gilt yield rose by 16bps to 1.31% and the 20-year gilt yield rose by 14bps to 1.75%. 10-year US treasury yields rose by 10bps to 2.75%. German bund yields rose by 10bps to 0.19% and French government bond yields rose by 6bps to 0.58%. Italian government bond yields fell by 11bps to 2.75% in a week in which the credit rating agency Fitch left its BBB rating for Italian bonds unchanged. A further cut would have shifted the bonds into sub-investment grade status.
- The Over 5-year real yield rose by 10bps to -1.59% and the UK 20-year real yield rose by 17bps to -1.65%. 20-year breakeven inflation rose by 2bps to 3.38%.
- UK investment grade bonds fell over the week, returning -0.5% as underlying gilt yields increased following a perception of a softening of opposition to Theresa May's deal from senior Brexiteers. The US high yield bond spread over US treasury yields fell by 19bps to 386bps over the week. The spread of USD denominated EM debt over US treasury yields fell by 14bps to 341bps over the week. The sterling non-gilt spread over UK gilt yields (based on the Merrill Lynch index) fell by 6bps to 133bps over the week.
- The S&P GSCI index fell by 1.8% in USD terms over the week. The S&P GSCI Energy index fell by 2.2% as the price of Brent Crude oil fell by 3.1% to US$65/BBL. Industrial metal prices rose by 0.7% as copper prices rose by 1.3% to US$6,572/MT. Agricultural prices fell by 3.2% and gold prices fell by 1.3% to US$1,312/Oz.
- Sterling appreciated by 1.6% on a trade-weighted basis over the week as markets began to price in a lower chance of a No Deal Brexit following Theresa May's announcement of a series of Brexit votes from 12-14 March. Sterling strengthened by 1.4% against the US dollar and rose 1.0% against the euro, ending the week at $1.32/£ and €1.16/£. The US dollar increased by 1.0% against the Japanese yen, ending the week at ¥111.9.

Economic Releases

- Although slowing from the 3.4% growth recorded in the previous quarter, the initial reading for fourth quarter US GDP growth showed that the US economy expanded by 2.6%; above expectations of a 2.2% increase. Personal spending, which accounts for more than two-third of US economic activity, fell by 0.5% in December; the biggest decline since September 2009. However, consumer confidence rebounded strongly over February with the Conference Board's Consumer Confidence index rising to 131.4, above expectation of 124.9 and higher than the previous reading of 121.7. A measure of national factory activity, the Institute of Supply Management's (ISM) manufacturing index for February, fell to 54.2 from 54.6, weakest level in more than two years. As expected, the core Personal consumption expenditure (PCE) index, which strips out volatile items such as energy prices and is one of the Fed's preferred measures of inflation, held steady at 1.9% for the year to December.

- In the UK, the Markit Manufacturing Purchasing Managers' Index (PMI) fell to a four-month low of 52.0 in February from a downwardly revised 52.6 in January. Companies stepped up their purchases of input inventories over February ahead of the UK's scheduled EU exit date. However, new orders slowed to a near standstill and, according to the survey, British manufacturing companies cut jobs in February at the steepest rate since February 2013. Growth in the Nationwide House Price Index fell by 0.1% in February against market expectations of it being unchanged. Elsewhere, the GfK consumer confidence index improved slightly to -13 in February from -14 against expectation of it falling to -15.

- In Europe, headline consumer price inflation accelerated by 0.1% to 1.5% in the year to February, in line with consensus estimates. However, core inflation eased by 0.1% to 1.0%, against expectations of it remaining unchanged. The German inflation rate held steady with the EU-harmonized Consumer Price Index increasing by 1.7% year-on-year in February. The Euro Area Economic Confidence index declined for the 8th consecutive month by falling to 106.1 from 106.3. Elsewhere, German retail sales rebounded by 2.6% in the year to January 2019, well ahead of the upwardly revised 1.6% contraction recorded in December 2018 and 1.2% growth expected by analysts.

- In Japan, the final reading of the Nikkei manufacturing PMI was revised higher to 48.9 in February, up from a preliminary reading of 48.5 but still remains in contractionary territory. Based on preliminary data, Japanese industrial production fell at its fastest pace in a year, contracting by 3.7% in January. Not only was the fall steeper than the expected 2.5% decline but also significantly more than December's 0.1% decrease. The fall in production was attributed to a decline in activity in the motor vehicle and electronics sectors. The poor economic releases over the week was compounded by retail sales falling by 2.3% in January from the 0.9% increase recorded in December and below forecasts of a 0.8% dip. Japan's labour market weakened as the jobless rate for January inched slightly higher to 2.5%, against forecasts of it remaining at 2.4%. However, the job-to-applicant ratio remained unchanged at 1.63.
- In China, manufacturing sector contracted for the third consecutive month. The official Chinese manufacturing PMI for February inched lower to 49.2 from 49.5. Although moving 1.6-points higher to 49.9, the Caixin manufacturing PMI, which focuses on small and mid-sized Chinese business, remained (albeit marginally) in contractionary territory. The official non-manufacturing index underperformed expectations and slipped to 54.3 from 54.7 over the month.

Contact Information

Joshua Roberts
Aon - London
+44 (0) 20 7086 7087
joshua.roberts.2@aon.com

Indranil Mukherjee
Aon - Bangalore
+91 80 3091 8454
indranil.mukherjee@aon.com

About Aon

Aon plc (NYSE:AON) is a leading global provider of risk management, insurance and reinsurance brokerage, and human resources solutions and outsourcing services. Through its more than 66,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative and effective risk and people solutions and through industry-leading global resources and technical expertise. Aon has been named repeatedly as the world's best broker, best insurance intermediary, best reinsurance intermediary, best captives manager, and best employee benefits consulting firm by multiple industry sources. Visit aon.com for more information on Aon and aon.com/manchesterunited to learn about Aon's global partnership with Manchester United.

Aon Hewitt Limited
Registered in England & Wales No. 4396810
Registered office: 122 Leadenhall Street, London, EC3V 4PT
Authorised and regulated by the Financial Conduct Authority.