UK Week in Markets

Week ending 24 June 2018

Market Moves

- Global equity markets declined over the week as trade tensions between the US and China deepened with the US threatening to impose fresh tariffs worth $200 billion on Chinese imports. The US also warned European Union (EU) automakers about a potential 20% tariff on imports into the US. The MSCI AC World Index fell 1.0% in local currency terms and 0.9% in sterling terms. The UK was the best performing region both in local currency and sterling terms, returning 0.7%, as the British Prime Minister Theresa May won a Brexit battle to pass the EU withdrawal bill. Japan was the worst performing market in local currency terms (-2.4%) as yen strength hit the export-oriented economy and tariff concerns affected automaker stocks. Emerging markets were the worst performing region in sterling terms (-2.1%) as weaker currencies and trade fears continued to keep investors away from the region.

- The Bank of England (BoE) kept its monetary policy unchanged as expected. BoE policymakers voted 6-3 to keep the rates unchanged, a slight shift from the 7-2 vote at the previous meeting. The 10 year UK gilt yield fell by 1bp to 1.30% while the 20 year UK gilt yield remained unchanged at 1.76%. The 10 year US treasury yield fell by 3bps to 2.90%. European government bond yields were mixed across the region. German bund yields fell by 7bps to 0.33% and the French government bond yields fell by 3bps to 0.70%. Italian government bond yields rose by 7bps to 2.67% after the Italian government appointed two Eurosceptics to lead key finance committees. Greek government bond yields fell by 34bps to 4.11% as the government negotiated a debt relief deal with its Eurozone creditors to postpone the repayment deadline on the approximately €100bn bailout loan and to provide a liquidity injection to support the Greek economy.

- Both the UK 20 year and the Over 5 year real yield rose by 1bp each to -1.60% and -1.55% respectively over the week. 20 year breakeven inflation fell by 1bp to 3.32%.

- The US high yield bond spread over US treasury yields rose by 6bps to 339bps over the week. The spread of USD denominated EM debt over US treasury yields fell by 1bp to 353bps. The sterling non-gilt spread over government yields (based on the Merrill Lynch index) rose by 2bps to 118bps.

- The S&P GSCI rose by 1.7% in USD terms over the week. The energy sector rose by 3.6% as the price of Brent crude oil rose by 2.9% to US$76/BBL. Crude oil prices rose despite oil producing countries deciding to increase the production cap by 600,000 barrels per day. Industrial metals fell by 2.2% following a decline in copper prices which fell by 4.6% to US$6,811/MT. Agricultural prices fell by 1.8% and gold prices fell by 1.3% to US$1,269/ounce.

- Sterling weakened against major currencies over the week. The US dollar appreciated by 0.1% against sterling, ending the week at $1.33/£. The euro appreciated by 0.3% against sterling, finishing the week at €1.14/£. The Japanese yen appreciated by 0.5% against the US dollar, ending the week at ¥109.90/$.

Economic Releases

- Following a strong couple of weeks, US economic data was more mixed over the last week with a number of releases falling below forecasts. Provisional Purchasing Managers' Index (PMI) data showed that growth in the US manufacturing sector slowed down over the month of June with the index falling to 54.6, missing expectations of a 0.3 point decline to 56.1. Although meeting analyst forecasts, the service index fell to 56.5 from 56.8. The Philadelphia Federal Reserve Business Outlook index declined sharply to 19.9 from 34.4 and missed consensus estimates of a more modest decline to 29.0. The Conference Board's Leading Economic index increased by 0.2% in May but was below both the previous and forecasted reading of 0.4%.

- In what was a quiet week for UK data releases. The focus was on the BofE. As expected, the Monetary Policy Committee left rates unchanged with the key bank rate remaining at 0.5%. However, the BoE Chief Economist unexpectedly voted for a rate hike, taking the total number of votes to 3 out of 9 policymakers. Public Sector Net Borrowing excluding Banking Groups improved in May with net borrowing falling by more than expected to £5 billion from a downwardly revised £6.9 billion in April. Based on Rightmove data, house price growth slowed in June to 0.4% from 0.8% in May but growth over the year increased to 1.7% from 1.1% in May. The Confederation of British Industry's monthly industrial orders balance swung back into positive territory to 13 from -3, indicating healthier order books for UK manufacturers.

- In the Eurozone, the Markit Services PMI improved to 55.0 in June from May's reading of 53.8. Analysts had expected the index to remain at 53.8. Conversely, the manufacturing sector decelerated as the manufacturing PMI met forecasts and dropped to 55.0 from last month’s reading of 55.5. The German Composite PMI also improved, but slightly underperformed market expectations. The increase to 54.2 in June from 53.4 in May was similarly driven by stronger performance in the services sector (increasing to 53.9 from 52.1) while the manufacturing sector was weaker than expected (55.9 for June against forecasts of 56.3). Euro Area Consumer Confidence fell to -0.5 in June from 0.2 in May but remains high when compared to previous years.

- In Japan, growth in the manufacturing sector picked up in June with the preliminary Nikkei PMI manufacturing index rising to 53.1 from May’s reading of 52.8. Headline consumer price inflation stood at 0.7% for the year to May, ending a two month slowdown in inflation. Japan's trade balance swung into a ¥578.3 billion deficit in May from April's ¥624.6 billion surplus. This worse than expected figure was due to faster growth of imports compared to exports. Exports grew by 8.1% for the year to May while imports grew by 14.0% which was far ahead of the expected 8.0% growth.

- Trade tensions continue to dominate news flow in China. In a bid to provide some additional cushioning to the slowing economy in the face of potentially damaging effects from trade tariffs, the People's Bank of China said it would reduce the reserve requirement ratio for large commercial banks by 0.5%.

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