UK Week in Markets

Week ending 31 March 2019

Key News and Events

- The Brexit crisis deepened last week as MPs voted against all eight alternative Brexit options in indicative votes on Wednesday. However, MPs will have another chance to vote on these today with Ken Clarke's customs union the favourite to pass – it was defeated by just 8 votes (264 vs. 272). MPs also voted down the Withdrawal Agreement for the third time, this time by a smaller majority of 58, despite many Conservative Brexiteers, including Boris Johnson and Dominic Raab, switching to backing the deal given the increased likelihood of MPs forcing a softer Brexit and a promise by Theresa May to step down ahead of the next stage of Brexit negotiations.
- On the US-China trade war front, the U.S. held constructive meetings in Beijing last week to partly ensure there were no discrepancies in the English- and Chinese-language versions of the agreement ahead of a visit by Chinese officials this week. However, the U.S. is demanding better terms including: improved treatment of U.S. intellectual property, opening up market access for American companies and agreeing on an enforcement mechanism for the trade deal. The U.S has threatened to re-impose tariffs on China if they do not comply to an agreed deal.
- In Japan, the parliament approved a record 101 trillion-yen draft budget for the next fiscal year starting April 1. This year's budget features increased spending on welfare, public works and defense. Also, it vowed to increase the sales tax to 10% in October this year. To mitigate the effects of an increased sales tax, the government plans to spend an additional 2 trillion yen.

Market Moves

- Global equity markets rose over the week. Continued fears of a growth slowdown were countered by progress in US-China trade talks. The MSCI AC World Index rose by 0.9% in local currency terms and rose by 2.1% in sterling terms. The Industrials sector was the best performer at (+1.8%) in local currency terms. The Communication Services sector was the worst performer at (-0.6%) in local currency terms.
- US equities were the best performing region in local currency terms (+1.2%) and sterling terms (+2.7%) led by the Industrials and Consumer Discretionary sectors. Japanese equities were the worst performing region in local currency terms (-0.6%) and sterling terms (+0.1%) with all sectors generating negative returns (except Real Estate which remained flat).
- The 10-year gilt yield fell by 2bps to 1.00% and the 20-year gilt yield rose by 4bps to 1.47%. 10-year US treasury yields fell by -4bps to 2.42%. During the week, the US 10-year treasury yields fell to 2.35%, hovering around the mid-point of the Fed funds target rate band. German Bund yields fell by -4bps to -0.07% and French government bond yields fell by 2bps to 0.32%. Italian government bond yields rose by 4bps to 2.49%.
- The Over 5-year real yield rose by 19bps to -1.80% and the UK 20-year real yield rose by 16bps to -1.94% following the sharp falls seen in the previous week. However, 5y and 20y real yields remain down over the year-to-date by 22bps and 17bps respectively. 20-year breakeven inflation fell by 11bps to 3.43%.
- Local currency EM debt outperformed over the week, returning 0.7%. The US high yield bond spread over US treasury yields fell by 4bps to 399bps over the week. The spread of USD denominated EM debt over US treasury yields fell by 1bps to 356bps over the week. The sterling non-gilt spread over UK gilt yields (based on the Merrill Lynch index) fell by 2bps to 131bps over the week.
- The S&P GSCI index was unchanged in USD terms over the week. The S&P GSCI Energy index rose by 1.1% as the price of Brent Crude oil rose by 2.0% to US$68/BBL. Industrial metal prices rose by 1.7% as copper prices rose by 1.7% to US$6,485/MT. Agricultural prices fell by 2.4% and gold prices fell by 1.2% to US$1,295/Oz.
- Sterling depreciated by -0.7% on a trade weighted basis over the week. Sterling weakened by 1.4% against the US dollar and fell 1.0% against the euro, ending the week at $1.3/£ and €1.16/£. The US dollar increased by 0.8% against the Japanese yen, ending the week at ¥110.69.

Economic Releases

- US economic growth slowed more than initially thought in the final part of 2018 as the GDP growth for the fourth quarter was revised lower to an annualized rate of 2.2% from 2.6%, missing expectations of 2.3% growth. The economic slowdown has translated to lower US consumer sentiment, as indicated by the Conference Board's Consumer Confidence index which fell to 124.1 from 131.4 in March, significantly below analyst expectations of a slight increase to 132.5. The US Federal Reserve's (Fed) preferred measure of consumer price inflation, the core Personal Consumption Expenditure price index, stood at 1.8% for the year to January 2019, down from the upwardly revised 2.0% growth recorded in December 2019 and below the forecasted rate of 1.9%. Elsewhere, the US trade deficit narrowed to $51.1bn in January from $59.9bn, against an estimated deficit of $57.0bn.

- UK economic growth was confirmed at 0.2% quarter on quarter in Q4 2018. Business investment fell by 0.9% in Q4, better than the initial estimate of 1.4% fall but contracting for the fourth consecutive quarter. The Q4 2018 current account balance shifted to its largest deficit since Q3 2016 at £23.7bn from the upwardly revised £23.0bn deficit recorded previously. The deficit accounts for 4.4% of Gross domestic product. Growth in the Nationwide House Price Index rose by 0.2% in March against market expectations of it being unchanged. Elsewhere, the GfK consumer confidence index remained at -13 in March against expectation of it falling to -14.

- In Europe, year-on-year M3 money supply growth rose to 4.3% in February versus market expectations of 3.9% and 3.8% in January. In Germany, the inflation rate slowed and remained below the European Central Bank's target level as the EU harmonized consumer price inflation slowed to 1.4% from 1.7% over the year to March against 1.6% expected by the analysts. On a positive note, the German unemployment rate fell to 4.9% in March from 5.0%, its lowest level since German reunification in 1990. Retail sales in Germany rose by 0.9% in February, slowing from downwardly revised 2.8% growth recorded previously but significantly ahead of expectations of a 1.0% decline. Elsewhere, the German IFO business climate index came in at 99.6 in March, ahead of 98.7 in February and exceeding analyst expectation of 98.5.

- In Japan, the Bank of Japan's Q1 2019 Tankan survey revealed negative sentiment in both manufacturing and non-manufacturing sectors. The Tankan large manufacturer's index fell to 12 from 19 and the non-manufacturing index fell to 21 from 24. Both the readings came in below expectations of 13 and 22, respectively. The final reading of the Nikkei manufacturing Purchasing Managers Index (PMI) was revised higher to 49.2 in March from a preliminary reading of 48.9 but nonetheless remains in contractionary territory. Based on preliminary data, Japanese industrial production met consensus estimates and rebounded by 1.4% in February, following a contraction of 3.4% in the previous month. Retail sales also rebounded by 0.2% in February from an upwardly revised 1.8% contraction in January but missed expectations of 1.0% increase. Japan's labour market strengthened as the jobless rate for February fell to a nine-month low of 2.3%, against forecasts of it remaining at 2.5%. The job-to-applicant ratio, however, remained unchanged at 1.63.
- The Chinese manufacturing sector, based on PMI data, returned to expansionary territory following three consecutive months of contraction. The official Chinese manufacturing PMI for March rose to 50.5 from 49.2 against expectations of a smaller increase to 49.6. The Caixin manufacturing PMI, which focuses on small and mid-sized Chinese business, also outperformed expectations and rose to 50.8 from 49.9 over the same period. The official non-manufacturing index inched higher to 54.8 from 54.3 over the month.

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