Weekly round up (Week 41)

It may have been a bad week for the bond markets, but the party's still going strong in the US stock market.

It was another tough week for investors. Bond markets offered few profit opportunities. Government bond curves continued to steepen, with two-year yields rising less than ten-year yields, while corporate credit markets posted negative total returns.

Commodity markets fared little better. Energy prices remained stable, while metal prices fell across the board. The US dollar stood out on the currency markets, appreciating against most other major currencies. Global equities bucked the trend, rising slightly, with technology-oriented indices the best performers.

From triumph to disaster (RP)

The week got off to a disappointing start after the press conference by Zheng Shanjie, Chairman of China's National Development and Reform Commission (NDRC)[1] Following the positive reaction to the announcement of monetary stimulus and support for property and financial markets last month[2], there were high hopes that Zheng would announce something similar on the fiscal front, targeting domestic consumption and demand.

However, at the briefing, the NDRC announced a modest expenditure of 200 billion yuan ($28 billion) to be brought forward from next year. This announcement triggered the worst daily fall in the Hang Seng stock market since the 2008 global financial crisis.

The NDRC press conference can only be described as a PR faux pas. Attention now turns to the Ministry of Finance, which is expected to announce further fiscal stimulus measures in the coming days. Analysts expect Beijing to announce a fiscal stimulus package worth around two trillion yuan to help the economy out of its deflationary doldrums[3].

A mixed picture for inflation

Last week's economic data calendar was relatively light, with US consumer prices the main topic of discussion. The September report offered mixed signals. The good news came from a continuing trend of rental disinflation, with primary and owner-equivalent rent (OER) inflation slowing to 0.3%, compared with previous increases of 0.4% and 0.5%, respectively[4]. However, this was offset by rising costs of transport services - particularly air fares, car insurance and repairs - pushing core consumer prices up by 0.3%, slightly above the 0.2% expected. This brought the 12-month core inflation rate to 3.3%, up from 3.2% in August.

September was the first month since March in which employment and consumer price figures exceeded expectations, raising the question of whether economists were too optimistic about the soft landing scenario.

Throughout the week, investors turned away from fears of a hard landing, preferring to focus on the possibility of no landing at all. However, the latest data suggest that a soft landing remains the most likely outcome.

The Federal Reserve released the minutes of the September meeting of the Federal Open Market Committee, revealing that some members favored a rate cut of 25 basis points (bps) instead of the 50 bps finally announced[5]. They suggested that future cuts follow a gradual trajectory to give policymakers time to assess the level of policy restraint.

Call me

On the political front, the call between President Biden and Israeli Prime Minister Netanyahu, said to be the first since August, attracted a great deal of attention. The White House described the conversation as “direct” and “productive”[6].

On the domestic front, it's been a banner week for the Republican campaign, with some polls showing Donald Trump with a 53% chance of winning next month's election[7]. This is the first time Trump has led the polls since Kamala Harris was named the Democratic nominee.

Meanwhile, the nonpartisan Committee for a Responsible Federal Budget has warned that a Harris presidency could increase the US national debt by $3.5 trillion over 10 years, despite her campaign's commitment to fiscal responsibility[8] By comparison, Trump's proposals could increase the debt by $7.5 trillion to $15.2 trillion, although he says strong economic growth would alleviate deficit concerns.

Let's face the music…

With the Fed focused on normalizing interest rates and both U.S. election candidates planning to avoid austerity, the path of least resistance for the Treasury curve should be one of continued steepening. Notably, the average 10-year yield differential between 2-year and 30-year Treasuries is currently 96 basis points, versus 43 basis points today (see this week's charts).

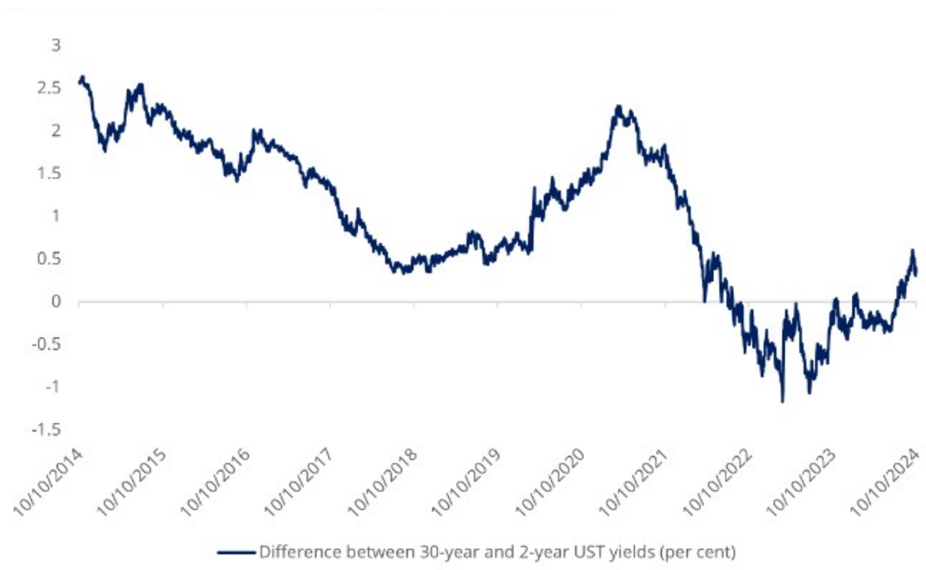
Logically, an increase in debt should lead to higher financing costs, ultimately resulting in further monetization[9] and asset price inflation. This may help explain record equity valuations, as shown in Figure 2.

However, investors may wish to recall former Citigroup CEO Chuck Prince's famous - or perhaps more accurately, infamous - comment on leverage in the financial system.

Speaking to the Financial Times in July 2007, just before the onset of the global financial crisis, Mr. Prince declared: “When the music stops, in terms of liquidity, things will be complicated. But as long as the music's playing, you've got to get up and dance. We're still dancing”[10].

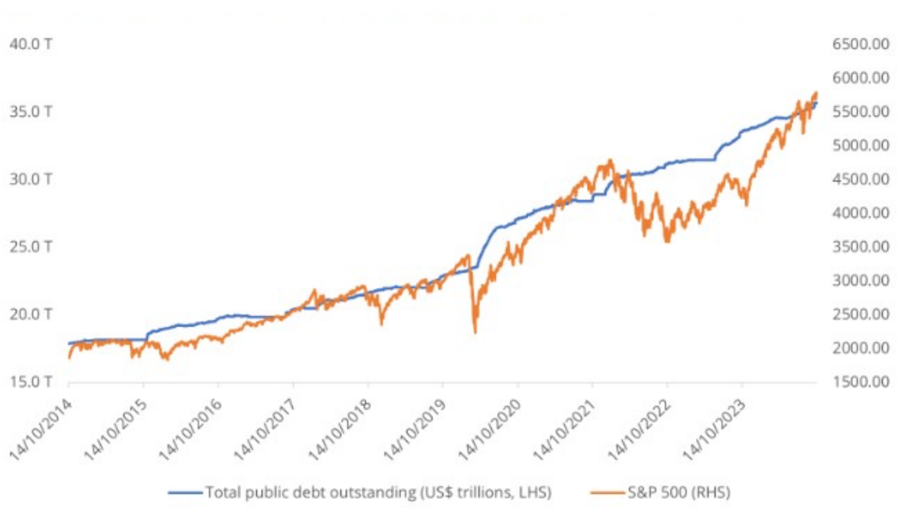
Charts of the week

Figure 1: The US yield curve may yet steepen



Source: Federal Reserve Bank of St. Louis, Market yield on US Treasury securities at 2-year and 30-year constant maturity, October 10, 2024.

Figure 2: U.S. equities continue to perform, despite record indebtedness



Sources: US Treasury, US public debt outstanding, Federal Reserve Bank of St. Louis, S&P 500 data, as of October 11, 2024.

[1] Bloomberg, 'China Markets warn Xi more stimulus needed to fuel rally,' October 8, 2024
[2] Muzinich Weekly Market Comment: China seeks a spark, September 30, 2024
[3] Bloomberg, 'China investors expect $283 billion of new stimulus this weekend,' October 10, 2024
[4] US Bureau of Labor Statistics, 'Consumer Price Index Summary,' October 10, 2024
[5] Federal Reserve, 'Minutes of the Federal Open Market Committee, September 17-18, 2024,' October 9, 2024
[6] The White House, 'Readout of President Joe Biden's Call with Prime Minister Netanyahu of Israel,' October 9, 2024
[7] PredictIt, 'Who will win the 2024 US presidential election?' October 11, 2024
[8] Committee for a Responsible Federal Budget, 'The Fiscal Impact of the Harris and Trump Campaign Plans,' October 4, 2024
[9] Monetization refers to a government converting its debt into currency. This happens when a central bank buys government bonds and finances spending through printing more money.
[10] Financial Times, 'Citigroup chief stays bullish on buy-outs,' July 9, 2024

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