



## **Weekly round up (Week 40)**

On this weekly take on key developments in the financial markets and economies examines, we feel that the start of the fourth quarter has fallen short for risk assets, despite favorable economic data.

Welcome to the fourth quarter, traditionally the strongest period for equities and high-yield corporate credit. The Bloomberg World Equity Index has closed in positive territory in eight of the last ten quarters. High yield markets have been more mixed, with positive returns in only five of the last ten, although four of these have been in the last five years.

This quarter, however, has got off to a somewhat shambolic start. Equities are generally weak, except in China, where the Hang Seng Index is up 33% year-to-date, thanks to a series of unexpectedly large stimulus measures, as we reported in our last weekly commentary. Industrial commodities have also benefited from a recent rebound, buoyed by optimism of increased demand from China, with iron ore leading the pack last week, up 6%.

Oil prices, on the other hand, remain volatile due to geopolitical tensions. Prices plummeted after the Saudi oil minister warned that crude could fall to \$50 a barrel if OPEC+ members failed to adhere to production agreements. However, prices rebounded after US President Joe Biden said Iranian oil facilities could be targeted by Israel. Analysts estimate that if Iranian oil production is cut by up to a million barrels a day, prices could rise by \$20 a barrel. Oil ended the week up 9%.

### **The Bank of Japan learns the lesson of public relations**

After coming under heavy criticism for its unexpected interest rate hike at the end of July, which triggered a brief but significant bout of market volatility, the Bank of Japan (BoJ) seems to have learned that markets don't like surprises. The minutes of the BoJ's September monetary policy meeting stressed the importance of improving communication: "When making further key interest rate hikes, the bank will need to communicate its policy stance and other factors more carefully to the markets". This was followed by a series of firm statements from government officials, including Japan's new Prime Minister, Shigeru Ishiba, whose dovish statement was that the environment was not ready for another rate hike.



Meanwhile, Bank of England Governor Andrew Bailey said in an interview with The Guardian that the central bank's Monetary Policy Committee could take a "more aggressive" approach to rate cuts if inflation data continues to improve. Meanwhile, Christine Lagarde, President of the European Central Bank (ECB), speaking before the European Parliament, indicated that policymakers were becoming more confident in their ability to control inflation, suggesting that a 25 basis point cut would probably be announced at the ECB's October meeting. In the US, Federal Reserve Chairman Jerome Powell indicated that the Fed would continue to lower rates to support economic growth, but that there was no immediate need for further aggressive cuts.

### **Dollar strengthens again**

The cumulative effect of these announcements was a strong week for the US dollar, which gained 4% against the Japanese yen, 2% against sterling and 1.5% against the euro.

On emerging markets, the Mexican peso fared best, gaining over 2% against the dollar. In her inaugural speech on October 1, the country's new president, Claudia Sheinbaum, announced her intention to maintain fiscal discipline, ensure the autonomy of the central bank and promote business relocation. In addition, Mexico's Supreme Court agreed to review the judicial reforms adopted by Congress in September.

If there was a consistent theme last week, it would be found in the economic data. Activity data supported growth, while price data indicated disinflation, at least in developed markets. Purchasing Managers' Indices (PMIs) met or exceeded expectations. China's composite PMI, for example, rose from 50.1 to 50.4, thanks to a slower-than-expected contraction in manufacturing. The Eurozone's composite PMI came in at 49.8, well above the 48.6 expected, with robust services and strong activity in Spain contributing to the positive surprise.

The US services PMI expanded at the fastest pace since February 2023, with new orders rising more than expected, pushing the index to 54.9, above the consensus of 51.7. However, the biggest surprise came from the monthly employment report, which was solid across the board. The unemployment rate fell to 4.1% and the number of non-farm jobs rose by 254,000 in September, well above the consensus forecast of 150,000.

On the price front, Swiss inflation slowed to its slowest pace in over three years, with consumer prices rising by just 0.8% year-on-year. Meanwhile, inflation in the eurozone fell to 1.8% in September, in line with forecasts and below the ECB's 2% target. In the wake of these events, government bond



markets fell, with two-year yields rising more sharply than ten-year yields. While inflation fears have eased, there are concerns that the normalization of monetary policy may be slower than expected. The US overnight interest-rate swap market has now aligned itself with the Fed's median projection of two 25-basis-point rate cuts this year. This environment benefited high yield credit, which outperformed investment grade last week, with emerging market high yield once again the best-performing sub-asset class.

## Questions, questions

With the first week of the fourth quarter behind us, investors are focusing on several key economic issues: Is the easing of financial conditions starting to take effect? Our preferred financial conditions index has eased to levels not seen for over two years.

Has inflation bottomed out? Winter utility subsidies have been abolished, base effects have dissipated and deflation in Chinese goods exports appears to be over. On October 4, European Union member states voted to impose 45% tariffs on Chinese automobiles. Finally, some emerging countries, which are a good leading indicator, are once again experiencing inflationary pressures.

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