Weekly Round Up

Last week was largely positive for asset prices in a key week for data and central bank activity.

Government bond yields rose over the week, with the notable exception of UK yields, which fell aggressively after the release of monthly growth data showing that the UK economy contracted by -0.5% month-on-month in July, the fastest contraction since the start of the year. Although the data may have been affected by industrial action and bad weather, the negative surprise rekindled fears of recession in the UK.

Meanwhile, global corporate bond markets enjoyed a solid week, with high-yield credit outperforming. Commodities continued to climb, driven by supply concerns. Oil prices rose again, with WTI (West Texas Intermediate) topping $90 a barrel after OPEC indicated that the supply shortfall for the fourth quarter would be 3.3 million barrels a day.

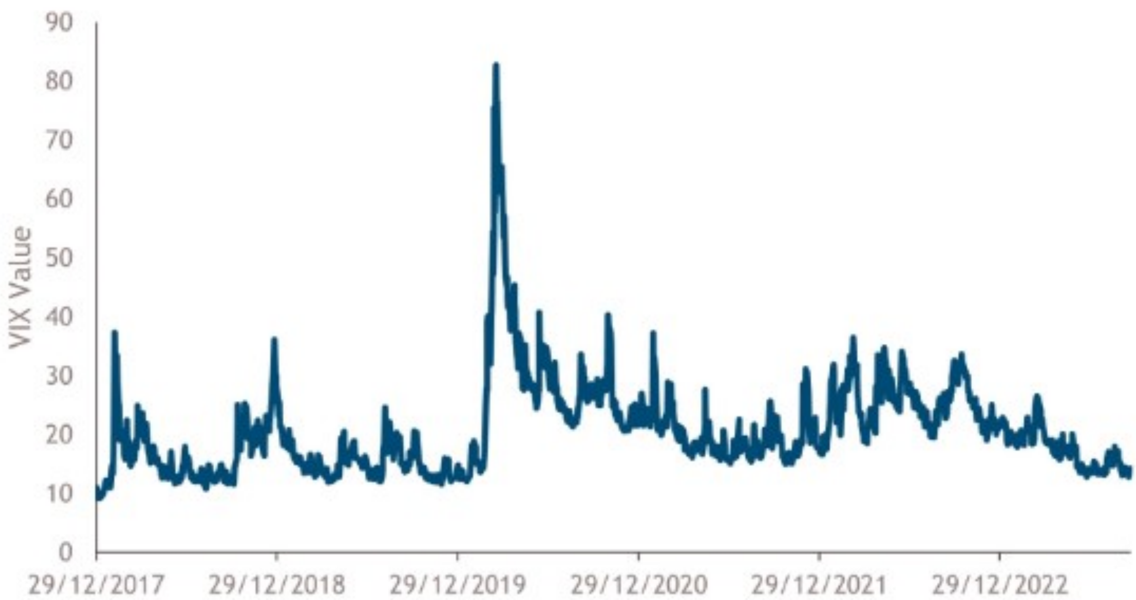
Having absorbed the new data, stock markets were buoyant around the world, as evidenced by our preferred measure of macroeconomic uncertainty, the VIX index, which reached its lowest level since the start of the year - a level of indicated certainty not seen since the run-up to the global pandemic . This begs the question: what is it about the weekly data that makes the equity market so confident about the near future?

China started the week by cutting the reserve requirement ratio by 25 basis points, representing an estimated 500 billion yuan injection of liquidity into the banking system. The effectiveness of the ongoing stimulus policy began to show in August's data on credit and activity. Credit growth surprised investors by rebounding in August, with overall financing reaching CNY 3.12 billion, exceeding the consensus of CNY 2.7 billion. Meanwhile, on the activity front, retail sales and industrial production rebounded strongly compared with July, well ahead of investor consensus. This seems to lead economists to conclude that growth in China bottomed out in the third quarter. We believe that the extent and sustainability of the rebound will depend on the stabilization of real estate sales, the expected pick-up in infrastructure investment and the continued recovery of consumption.

Probably the most important event of the week was the meeting of the European Central Bank (ECB). The central bank surprised (not all) investors by raising its key interest rates by 25 basis points, taking the deposit rate to 4.0%, whereas the Bloomberg consensus was for a status quo. The ECB staff's revised macroeconomic forecasts were gloomy, with inflation revised upwards for 2023 and 2024 by 0.1% and 0.3% respectively, and failing to reach the 2% target by 2025. In addition, the economy is now expected to grow by only 0.7% this year, and growth for 2024 has been revised downwards from -0.5% to 1.0%. However, investors reacted positively to comments by ECB President Lagarde, who said, "The focus will probably shift a little more towards duration, but it's not a question of saying - because we can't do that - that we've reached the top." These words were interpreted as a signal that the upward cycle is probably over; a green light for investors to buy European assets.

In the US, consumer prices rose by 0.6% month-on-month, with higher gasoline prices a major contributor, bringing year-on-year inflation to 3.7%. Core price inflation - contained over the past two months, with prices rising by just +0.16% month-on-month - accelerated in August to +0.278% month-on-month, driven by a 4.8% month-on-month rise in air fares. On the activity front, retail sales rose by 0.6% month-on-month, well above market expectations (0.1% per month), forcing economists to revise upwards their growth forecasts for the third quarter. Investors see the price pressures exerted by energy as short-lived - the FOMC (Federal Open Market Committee) is expected to take no interest in this temporary recovery.

Confidence in a soft landing - or perhaps no landing - continues to grow. The best evidence of this is the IPO of Arm Holdings Plc, which climbed 25% on its debut. Ray Dalio expressed a different view in an interview this week, suggesting that the biggest mistake most investors make is "believing that markets that have done well are good investments, rather than being more expensive”.



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