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Weekly market recap

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Summary for the week ending on Friday 26 November

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Economic and political backdrop

The US

Last Monday morning, President Joe Biden said he planned to re-nominate Jerome Powell as Federal Reserve chair. Powell was widely viewed as somewhat less dovish than Lael Brainard, a Fed governor who was the other leading candidate for the position. Biden nominated Brainard to be the vice chair of the Fed's Board of Governors.

Comments from other members of the Federal Open Market Committee (FOMC) about the potential to accelerate the tapering of the Fed's bond purchases contributed to the less dovish outlook for Fed monetary policy, helping to push Treasury yields higher. The minutes from the November FOMC meeting, released on Wednesday, also showed that some policymakers advocated for a quicker taper.

President Biden also formally announced that the US would release oil from the Strategic Petroleum Reserve to try to pressure lower gasoline prices, which are a key part of headline consumer price inflation figures. Oil prices actually rose on the news, which was widely anticipated, as the market seemed to think that the Organisation of the Petroleum Exporting Countries and Russia (known as OPEC+) will simply reduce its production to offset the move.

On Friday, stocks fell sharply after scientists in South Africa said they had found a new variant of the coronavirus that appeared to spread more quickly than the delta variant that caused a global wave of cases earlier in 2021. Although it is unclear if the new variant – named Omicron – is more effective at evading the immune defences triggered by current vaccines, the news prompted a sell-off in riskier asset classes and a rally in safe havens, such as Treasuries. The price of crude oil plummeted more than 10% on Friday on fears that the new variant will damage demand for oil.

Europe

The EU has agreed to halt air travel from South Africa and several surrounding countries over a new COVID variant Omicron. Earlier in the week, large-scale protests broke out in the Netherlands, Belgium, Austria and Italy after they imposed stricter controls due to the spike in infections. However, apart from the Netherlands and Austria, most countries stopped short of imposing lockdowns, and some made booster injections that enhance vaccine effectiveness available to all adults.

Social Democrat leader Olaf Scholz will succeed Angela Merkel as chancellor of Germany after clinching a deal with the Greens and the liberal Free Democrats (FDP) to form a coalition government. FDP Chairman Christian Lindner, a fiscal conservative, will be finance minister. The alliance said its main aims were to upgrade infrastructure to modernise the economy, accelerate measures to combat climate change and increase the minimum wage and social housing.

Sweden's first female prime minister, Social Democrat Magdalena Andersson, resigned after less than 12 hours in the post when parliament rejected her budget bill, which collapsed her centre-left government.

Eurozone business activity unexpectedly accelerated in November, according to purchasing managers' indexes (PMIs). Even so, the average reading of the main output index in the past two months came in lower than in the third quarter, indicating the economic recovery is slowing. Optimism about the immediate future for economic activity declined due to further coronavirus waves. Inflation warning signs also intensified, with firms' costs and average selling prices rising to record levels. Meanwhile, German business confidence fell for a fifth successive month, the Ifo Institute said.

Sweden's central bank, the Riksbank, maintained its accommodative stance but signalled for the first time that interest rates would rise modestly by the end of 2024.

The UK

The UK banned travel from South Africa and its neighbours to contain the new strain of coronavirus. The fear is that Omicron is already in the UK and may ruin the plans for Christmas.

Japan

Japanese equity markets began the shortened week in cautious fashion, as renewed coronavirus concerns in Europe, as well as rising cases in the US, sparked worries about the pace of the global economic recovery. Against this backdrop, areas like airlines and autos saw selling pressure. However, as markets closed ahead of the Thanksgiving Day holiday, early losses had been broadly pared back. The Japanese government's record USD 490 billion stimulus package announcement in the previous week was likely a supportive factor.

It was a different story upon returning from the public holiday, however, with Japanese equity markets opening on a decidedly weaker trend. The reappointment of Federal Reserve Chair Jerome Powell, on top of recent hawkish comments from other Fed officials, heightened expectations of earlier US interest rate hikes and further policy divergence from Japan. Growth-oriented companies and richly valued technology shares bore the brunt of hawkish bets on rising interest rates.

The weaker trend was short-lived, however, with tech stocks leading a quick recovery. Investors were buoyed by an upward revision to third-quarter US GDP, as well as a number of strong domestic readings.

On the local front, flash data showed the Japan Composite PMI rose to 52.5 in November – a 37-month high – from 50.7 in October, buoyed by loosening coronavirus restrictions and soaring vaccination rates. Similarly, the Japan Services PMI hit a 26-month high of 52.1 in November, up from 50.7 the previous month. And, rounding out the triumvirate of upbeat releases, Japan's Manufacturing PMI rose to 54.2 in November, up from 53.2 in October. This was the 10th straight month of expansion in factory activity and the strongest pace since January 2018.

Ultimately, however, news on Friday of a worrying new coronavirus variant in South Africa, as well as rumours that the Fed may be preparing to double the pace of its tapering of bond purchases to USD 30 billion early in the new year, finally proved too much, breaking investors resolve and sending equity markets sharply lower at week's end.

China

Relations with the US remained tense over the status of Taiwan and trade issues. The US Commerce Department issued a trade blacklist naming a dozen Chinese companies that it said supported the military modernisation of the People's Liberation Army. In response, a Chinese official said the US should not expect China's military to compromise regarding Taiwan.

In a separate development, the US Federal Communications Commission (FCC) asked a federal appeals court to reject China Telecom's bid to continue providing services in the US, arguing that China Telecom's ownership allows Beijing to access and possibly disrupt or misroute US communications. The FCC's action followed its designation of China's Huawei Technologies and ZTE Corp as US national security threats last year. Reports that China's tech watchdog has asked the management of China's ride-hailing app Didi Global to delist the company from the New York Stock Exchange due to data security concerns also underscored the depth of mistrust between both countries.

On the economic front, Premier Li Keqiang said that China should step up efforts to stabilise employment, financing and other key areas and that the government was studying policies on tax and fee cuts, along with some reforms, to support businesses. Last week, China kept its loan prime rate unchanged for the 19th straight month. However, monetary policy easing has been taking place through other channels, including looser mortgage lending, deposit rate reforms and reductions to domestic banks' reserve required ratio.

The property sector remained under duress. Kaisa Group, the latest high-profile developer trying to avert default, announced a bond exchange programme for its creditors. Kaisa has unpaid coupons totalling over USD 59 million that were due on 11 and 12 November, with 30-day grace periods for both. If the offer to bondholders fails, "we may not be able to repay the Existing Notes upon maturity on 7 December 2021, and we may consider alternative debt restructuring exercise," the developer said in a stock exchange filing. Kaisa made headlines in 2015 when it became the first Chinese builder to default on its dollar bonds. The company has the most offshore debt in China's property sector coming due over the next year after embattled China Evergrande Group.

Australia

The economic data released last week sent mixed messages. Retail sales jumped 4.9% month over month in October; well above expectations. The preliminary PMI composite rose as well. CAPEX fell 2.2% quarter on quarter for the third quarter, but leading indicators are pointing to a rebound. Inflationary pressures are also building, with companies reporting rising input costs but flat output price inflation.

Equity markets

Last week, MSCI All Country World Index (MSCI ACWI) returned -2.8% (15.5% YTD).

In the US, the S&P 500 declined 2.2% (23.9% YTD) for the holiday-shortened week after Friday's news about the emergence of a new, potentially more contagious, coronavirus variant in South Africa triggered a sharp sell-off in riskier assets such as equities. Before the Thanksgiving holiday, information technology stocks suffered as rising Treasury yields made expected corporate profits far in the future less valuable in today's terms. Yields decreased on Friday amid the flight to assets viewed as safe havens. Value stocks held up better than growth companies despite Friday's selling pressure on stocks related to leisure and travel, while small capitalisation stocks lagged larger ones. Russell 1000 Growth returned -3.3% (24.6% YTD), Russell 1000 Value -1.2% (20.1% YTD) and Russell 2000 -4.1% (14.7% YTD).

In Europe, the Euro Stoxx 50 fell sharply 6.1% (18.0% YTD) on fears that the economic recovery might be derailed by the imposition of tight coronavirus restrictions and the spread of a new variant of the virus. Germany's DAX tumbled 5.6% (11.2% YTD), France's CAC 40 dropped 5.2% (24.1% YTD) and Italy's FTSE MIB was down 4.9% (19.9% YTD). Switzerland's SMI returned -2.8% (17.2% YTD). The euro was little changed against the US dollar, ending the week at 1.13 USD per EUR.

In the UK, the FTSE 100 lost 2.4% (12.8% YTD), a less profound loss compared to some other markets as the British pound depreciated against the US dollar, ending the week at 1.33 USD per GBP, down from 1.35. A weaker pound tends to support the FTSE 100 index because many of its companies are multinationals with overseas revenues. The more domestically focused FTSE 250, however, dropped 4.0% (12.0% YTD).

Japanese equities battled on gamely for much of the shortened week, only to succumb late in the week as worries about the pace of economic recovery ultimately undermined sentiment. The Nikkei 225 shed 3.3% (6.4% YTD), the broader TOPIX lost 2.9% (12.2% YTD) and the TOPIX Small Index fell 2.7% (10.2% YTD).

The Japanese yen skidded to a three-year low on Friday but finished the week modestly stronger at 113.4 versus the US dollar compared with JPY 114.0 at the end of the prior week. Earlier in the week, the yen hit 115.53, a level not seen since January 2017, as expectations for higher US interest rates increased. Policy outlooks between the Federal Reserve and the Bank of Japan diverged further after the latest Fed minutes showed increasing acceptance among US policymakers of faster tapering and earlier rate hikes to tame inflation.

In Australia, the S&P ASX 200 returned -1.6% (15.8% YTD). The stock market was trading positively until Friday, when the news around a new virus strain discovered in South Africa sent a broad risk off signal across the board. Stocks were down for the week, as was the Aussie dollar. Government bond yields compressed and expectations of future hikes from the Reserve Bank of Australia (RBA) also decreased.

Emerging markets and other markets

MSCI Emerging Markets Index returned -3.6% last week (-3.4% YTD).

In China, the CSI 300 Index of large-cap stocks eased 0.6% (-5.1% YTD) while the Shanghai Composite Index edged up 0.1% (4.8% YTD) amid US-China tensions and rising economic pressures that raised expectations for supportive government measures. Yields on China's 10-year government bonds fell to 2.881% from the prior week's 2.946% as investors sought safe-haven assets. The yuan gained marginally to 6.3917 per US dollar from last week's 6.4009 per dollar.

In Turkey, the BIST-100 Index returned 2.2% (24.9% YTD). While equities added to recent gains, the lira plunged in value on Tuesday and bonds weakened following comments from President Recep Tayyip Erdogan. The president, who holds the unconventional belief that high interest rates cause elevated inflation – which was recently measured at about 20% year over year – defended the central bank's recent interest rate reductions as part of an "economic war." The lira rebounded partially on Wednesday, possibly in response to a central bank statement in which policymakers indicated that they have "no commitment to any exchange rate level" and that the central bank would only intervene in response to "excessive volatility" in the currency market.

T. Rowe Price sovereign analyst Peter Botoucharov believes the recent price action in the Turkish financial markets – among equities, fixed income securities and the lira – is concerning and that the risk of the government imposing administrative measures, including reduced access to foreign exchange (FX) swaps and a limited form of domestic capital controls, is rising. That said, he also believes it would be difficult for Turkey to impose capital controls on non-residents at this time, considering that Turkey is dependent on external capital flows and that its sovereign debt payments are currently manageable. However, Botoucharov would not be surprised to see some form of domestic capital controls, such as a partial "freezing" of FX assets or limiting withdrawals from FX accounts.

In Chile, the S&P IPSA Index rallied 5.1% (9.6% YTD). Chilean assets performed well in a relief rally on Monday – although they gave back some gains later in the week – following the results of the elections held on Sunday, 21 November.

In the first round of the presidential election, far-right candidate José Antonio Kast did slightly better than far-left candidate Gabriel Boric. These two candidates were generally expected to fare best in the first round, though neither received more than 30% of the ballots cast. As a result, there will be a second-round runoff between them on 19 December.

At present, T. Rowe Price emerging markets sovereign analyst Aaron Gifford believes that Boric has a slight advantage, due in part to his platform, which is more in line with what Chilean voters want – including a new constitution, more social rights and a public pension system. However, according to postelection polls, a substantial portion of the electorate is undecided about which candidate to support in the second round, so the election could go either way.

As for the legislative elections, general expectations were that both chambers of Congress following the elections would lean more to the left. However, right-leaning political parties did better than expected – they won 70 out of 155 seats in the Chamber of Deputies and 25 out of 50 seats in the Senate. Gifford believes these results will help counterbalance extreme proposals from the left or the right, including the constitutional assembly.

Fixed income markets

Last week, Bloomberg Global Aggregate Index (hedged to USD) returned 0.1% (-1.2% YTD), Bloomberg Global High Yield Index hedged to USD -1.4% (0.9% YTD) and Bloomberg Emerging Markets Hard Currency Index -1.0 (-2.6% YTD).

Positive economic data – including the lowest level of weekly jobless claims since 1969 – helped drive the increase in US Treasury yields. The increases were particularly meaningful in short- and intermediate-term maturities. This trend ended abruptly on Friday as investors fled to lower-risk assets amid fears that rising coronavirus cases could lead to renewed lockdowns and economic downturns. The benchmark 10-year Treasury yield ended the week at 1.48%, down seven basis points from 1.55% (56 basis points higher YTD).

Core eurozone bond yields ended roughly flat after the coronavirus news dragged them off the week's highs. Over the week, German 10-year bund yield was unchanged, ending the week at -0.34% (23 basis points higher YTD). However, peripheral eurozone bond yields stayed higher on inflation and the prospect of central banks tightening their policies.

The UK 10-year gilt yield ended the week six basis points lower, down from 0.88% to 0.82% (63 basis points higher YTD).

Despite the benchmark 10-year Japanese government bond yields rising to 0.085% during the week – the highest level since 1 November – yields ultimately closed little changed by the close, at 0.07%. Appetite for bonds returned sharply amid renewed coronavirus concerns, first in Europe and then South Africa.

The US high yield corporate bond market was weak amid lighter-than-average trading volumes.

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