October 2022 | Market update

Contending with concerns over inflation and energy

Markets continued to waver in September amid recession worries and falling consumer confidence.

September started with a jolt for gas prices in Europe, which rose by over a third in the wholesale markets after Russia abruptly announced it would be suspending supplies through the Nord Stream 1 pipeline. This news came just a few hours after the group of G7 countries announced a plan to cap payments on oil exports from Russia.

The World Bank issued a warning during the month that a global recession may be getting closer as central banks continue to fight rising inflation by raising interest rates. With consumer confidence already depressed, the bank warned against an overly aggressive approach to hiking rates.

European and Asian markets had a sluggish start to September, carrying over some declines from the previous month, due in part to weaker than expected export data from China, where new Covid-19 lockdowns are affecting sentiment. The markets were also affected by the US Federal Reserve's (Fed) continuation of interest rate rises, as well as a September rate rise from the European Central Bank (ECB).

The job market in the US is continuing to show strength, spurring the Fed to increase interest rates by 75 percentage points, lifting the target range to between 3% and 3.25%. It hopes to cool the economy and slow the pace of price rises. Inflation in the US did not drop as expected in August, however, ticking up by 0.1%. US markets suffered losses not seen since June 2020 as a result.

A fiscal boost

Following the announcement of Liz Truss as Boris Johnson's successor, markets had a subdued response. Truss announced a relief package of £150 billion in an effort to help UK households deal with the rising energy costs coming this winter, and new Chancellor Kwasi Kwarteng announced an emergency fiscal statement that focuses on boosting the UK's economy.

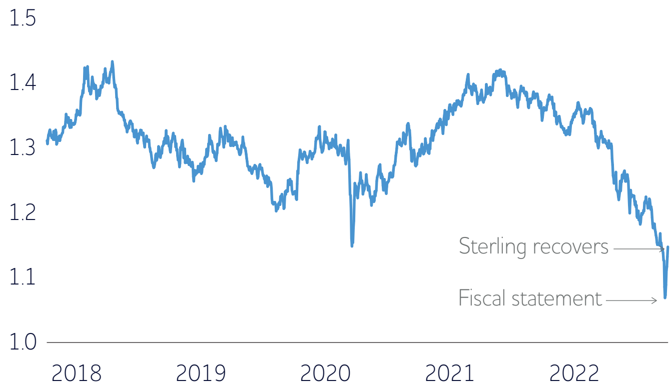
However, in response, the pound plunged to its weakest level against the dollar for decades due to the uncertainty surrounding the UK's economic outlook following the government's new fiscal plans. In an unusual step, The Bank of England stepped in to announce that it would start buying long-dated government bonds to calm markets and protect pension funds. The pound recovered within a week of the fiscal statement (figure 1), even before the Chancellor U-turned on one of the tax cuts announced.

Rising gas prices are a greater concern for the UK than some other parts of Europe that also rely on Russian supplies due largely to the nature of energy markets. As a result, the UK has been hit hard by the disruption, which has been inflationary. Yet the rate of inflation dipped slightly to 9.9% in August, with retail sales falling by more than expected too. Despite these falls, the Bank of England raised interest rates from 1.75% to 2.25%.

Annual inflation in the eurozone rose to 10% in September and economists believe prices could rise even more sharply over the coming months. High energy prices are a major reason for the rise in inflation, made worse by Russian policies. As widely expected, the ECB raised interest rates to 1.25%.

Figure 1: The value of sterling (in US dollars)

The pound plunged following the government's recent 'mini budget' and remains under pressure.



Source: Bloomberg.

www.omnisinvestments.com

Omnis INVESTMENTS