For Individual Investors.

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Surprise UK tax cut and surging dollar rock global equity and bond markets before Bank of England intervenes

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Key points

- Treasury yields jump past four per cent for the first time since 2010
- Equities fall sharply as rate rises continue
- Inflation shows little sign of easing
- South Korea and Taiwan lead emerging markets lower
- Italian yields spike further on rate outlook

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EMERGING MARKET EQUITIES SEE BIGGEST DECLINES AS FEDERAL RESERVE REITERATES ITS COMMITMENT TO FIGHTING INFLATION

Global stocks declined further in September amid expectations of a sustained rise in borrowing costs of central banks continue their battle to contain inflation. A surprise proposed tax cut by the UK government, which sparked volatility in the pound sterling and UK gilts, also affected global markets, pushing up the US dollar and Treasury yields, and hitting stock and commodity prices. Global bond yields eventually fell back after the Bank of England announced emergency bond purchases to prevent a cycle of forced selling by UK pension funds.

The MSCI World Index of global equities fell by 8.3 per cent in local-currency terms, equating to a 5.4 per cent fall in sterling. Emerging markets led the decline on the back of a surge in the dollar – traditionally a poor environment for emerging-market assets, but all major markets suffered negative returns.

US stocks, as measured by the S&P 500, declined by 9.2 per cent. They have now fallen for three consecutive quarters, the worst performance since the height of the global financial crisis. Expectations of further sharp rate hikes hit stocks; the Federal Reserve raised interest rates by 0.75 percentage points in September, the third such increase this year. Moreover, the central bank's head, Jerome Powell, said the Fed would not relent in its fight against inflationary pressures. These show no signs of easing: a measure of inflation that excludes volatile food and energy costs rose to 4.9 per cent on an annual basis in September, from 4.7 per cent the prior month. Other inflation measures are running much higher. The consumer price index increased by 8.3 per cent year-on-year in August.

A spike in inflation in the euro area – to double digits for the first time since the creation of the common currency in 1999 – was among the factors that prompted a sharp sell-off in European equities, which fell by 6.4 per cent in September, as measured by the MSCI Europe (ex UK) Index. Inflation hit a record ten per cent during the month, up from 9.1 per cent in August. The European Central Bank has raised rates by a combined 125 basis points over its last two meetings and promised further increases.

Emerging markets, as measured by the MSCI EM index, lost 9.3 per cent, with South Korea and Taiwan leading the falls. Meanwhile, a surging dollar – and the prospect further UK rate hikes will fuel the greenback's advance – hurt the wider Asian region, much of whose imports are priced in dollars. A robust dollar also raises the cost of servicing US dollar-denominated debt. The technology and consumer discretionary sectors were among the worst performers on Asian markets.

Japanese stocks, as measured by the TOPIX Index, fell by 5.5 per cent, experiencing their worst month since the outbreak of the pandemic in March 2020. Automakers were among the worst performers on fears of a slump in global demand.

The UK unusually moved to the centre stage of global markets in September: the government's mini-budget contained unexpected, proposed tax cuts, particularly for the highest earners, along with support to cap energy prices. UK equities, as measured by the FTSE All-Share Index, fell by 5.9 per cent. Interest rates might now have to rise by more than anticipated to offset the looser fiscal stance and retain investor confidence in the government's ability to fund its spending.

The yield on ten-year US Treasuries rose to 3.81 per cent, from 3.20 per cent at the end of August, having broken above four per cent during the month for the first time since 2010. Corporate bond yields reacted accordingly; the lowest-rated US high-yield bonds have the losses. The yield on Germany's ten-year benchmark government bond ended the month at 2.1 per cent, up from 1.51 per cent at the end of August. Higher-than-expected inflation in Germany, which reached 10.9 per cent on an annual basis in September, up from 8.8 per cent in August, caused yields to jump. Meanwhile, the yield on Italy's ten-year debt rose to 4.51 per cent, from 3.89 per cent at the end of August. This reflected the country's exposure to interest-rate hikes in the eurozone, rather than the election of a new government, which had been widely anticipated.