WEEKLY MARKET COMMENTARY
7 October 2022

TAX U-TURN EASES PRESSURE ON STERLING AS OPEC TRIES TO KEEP OIL PRICES HIGH

This week we saw the prime minister and chancellor stick to their guns for all of 10 days before giving in and scrapping their plan to scrap the 45p rate of income tax. This helped deliver a modest recovery in UK assets but was not enough to lift the FTSE or gilts back to the levels they traded at before the announcements. The U-turn highlights the weak position that Liz Truss and Kwasi Kwarteng are in - without solid support either inside or outside parliament - and makes the government more vulnerable to other rebellions. The difficult week led one analyst note to conclude that foreign investors will view the UK as uninvestable while there is such chaos in the government.

Meanwhile, the energy crisis is back in the news after OPEC decided to cut output and take advantage of the opportunity to bank profits while they can. The move has reversed some of the recent decline in the oil price. But it seems very short term as a higher oil price means higher inflation, which means more aggressive interest rates hikes, which increases the chance of a deep recession and means less demand for oil.

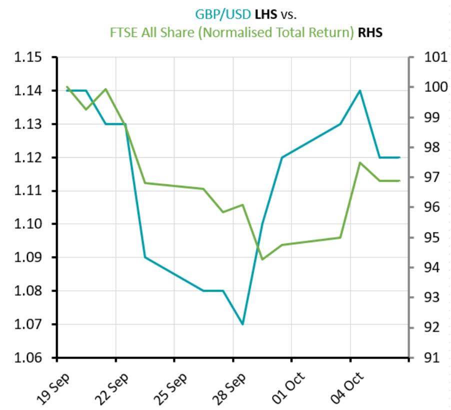
THE MARKETS THIS WEEK

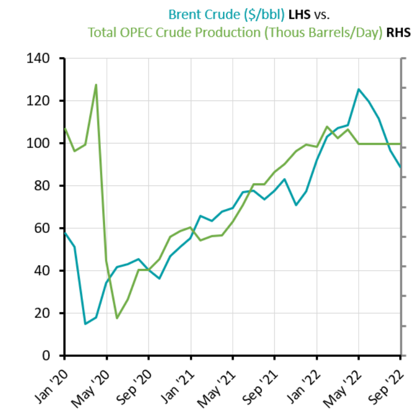
FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
+1.50%	+4.43%	+5.30%	+2.40%	+3.00%	+0.03%	+0.09%	+10.69%	+1.63%	-0.47%	+0.29%

UK: KWARTENG'S U-TURN HELPS CALM MARKETS

UK markets have partially recovered from their plunge following the mini-budget after chancellor Kwasi Kwarteng abandoned plans to get rid of the 45p additional rate of income tax. Sterling has recovered from its low of $1.035 and briefly rose above $1.13 (the rate it traded at immediately before the mini-budget). The FTSE All Share has also staged a recovery, although it remains below its pre-mini-budget level. Gilts have also seen something of a recovery as yields have fallen from their recent highs, but their recovery has not been a strong as markets assess the outlook for inflation and interest rates.

The outlook for UK government borrowing remains unclear. Kwarteng has grudgingly agreed to bring forward the publication of his detailed spending plan, while reversing course on the 45p tax cut reduces the estimated £45bn cost of the reforms by only £2bn. Ratings agency Fitch joined S&P by lowering the UK's credit outlook from stable to negative due to uncertainty about how the government will pay for tax cuts and the rising cost of borrowing.





OIL: OPEC+ CUTS PRODUCTION TO OFFSET ECONOMIC SLOWDOWN

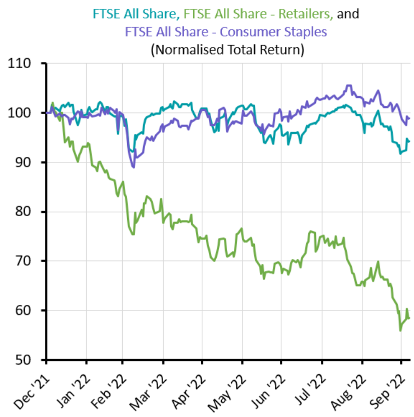
Oil cartel OPEC surprised markets by announcing a big cut in its production target. Oil producers are under pressure to increase output to offset soaring oil prices but OPEC announced a big reduction of 2 million barrels a day as it tries to keep prices high. The threat of a global recession has helped the price fall from $120 a barrel in mid-summer to around $85 but the price jumped after the production cut was announced pushing the price of Brent back to $95 a barrel. The decision was strongly criticised by the US which accused OPEC and Saudi Arabia of supporting Russia's aim of keeping prices high.

The cut is around 2% of global production but is as much symbolic as practical. OPEC members account for around 40% of total global production and many members are falling short of current production targets. Meanwhile many European countries are stepping up efforts to curb energy usage. In the UK, the National Grid warned of potential rolling blackouts if people do not take steps to use less energy this winter.

INFLATION: RETAILERS FEEL DIFFERENT EFFECTS OF RISING PRICES

Retailers are continuing to feel the impact of rapidly rising inflation. Tesco said its annual profits will be at the lower end of its predicted range. It said sales volumes are holding up but customers are spending less by choosing lower cost items. Inflation is also driving up its costs, including staff wages. High street bakery Greggs said inflation is affecting sales. Despite increasing its prices it reported an increase in sales as it picks up customers who are trying to make their money go further.

According to the British Retail Consortium retail inflation is at a record high of 5.7%. High street fashion retailer Next warned that a weaker pound will continue to drive up its costs as imports have become increasingly expensive. It said weaker demand means full priced sales have fallen slightly and it warned that without a recovery in sterling clothing prices are likely to be considerably higher next year. Businesses which are able to pass on rising costs to customers continue to fare much better than those with price-sensitive customers.



Data Sourced from FE Analytics and FactSet