



Market Watch

Volatility ahead?

Summary

Chinese asset markets softened following weak economic data and renewed property sector concerns. The focus has increasingly shifted to the policy response, with the PBoC delivering another surprise rate cut.

Renewed pockets of distress across other Emerging Markets. Argentinian and Russian currency weakness arguably have some idiosyncratic drivers, but these follow a renewed surge in US government bond yields and the US dollar, elevated geopolitical risk and higher oil prices.

Policy response, seasonality and market technicals key signposts in coming weeks. A scenario where US bond yields break higher and/or Asian equities break lower risks triggering a bout of volatility.

Background

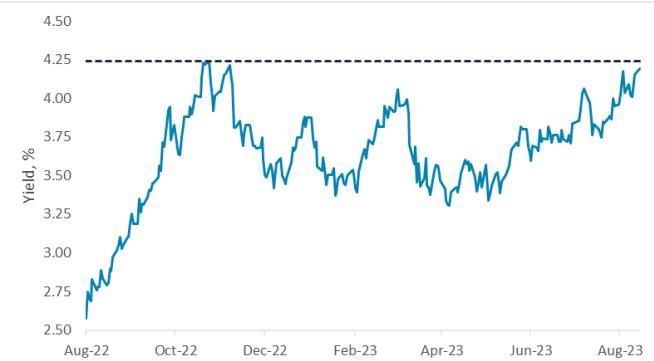
A run of weak economic growth data and renewed China property sector stress kept downward pressure on Chinese financial markets. Negative CPI inflation, weak trade data and slow credit growth kept downward pressure on Chinese equities, bond yields, the CNY and Asia HY USD bonds. China's largest real estate developer said it was being forced to delay a bond coupon payment, raising concerns over whether a new wave of sector defaults was now likely. China's PBoC cut policy rates against expectations of no change.

Argentina and Russia both faced significant currency weakness. Argentina's peso devalued following a surprise primaries victory by an 'anti-establishment' Presidential candidate. Russia's ruble also fell sharply following a rise in geopolitical risk.

These events all come against the backdrop of a renewed surge in US government bond yields, the US dollar and oil prices. The 10-year US bond yield is testing the 2022 (intraday) high of just over 4.3%. The USD Index (DX) also rebounded back into year-to-date range and oil prices rebounded to the top of their year-to-date range.

US bond yields are re-testing their 2022 high, lifting the US Dollar higher

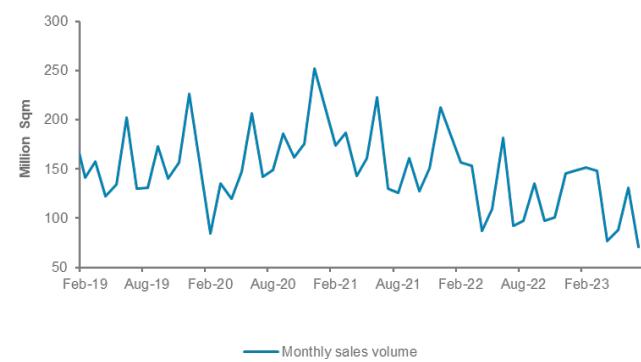
10-year US government bond yield (%)



Source: Bloomberg, Standard Chartered

China home sales remain weak, placing renewed pressure on the real estate sector

China monthly sales volume (mn sqmt.)



Source: Bloomberg, Standard Chartered

What does this mean for investors?

Chinese economic growth and China's policy reaction remains one driver of global risk appetite. Financial markets have thus far been unconvinced that China's policy responses have been sufficient to address ongoing growth concerns. This is particularly so in the property sector where new home sales remain soft, precluding stabilisation of the sector. The negative CPI print also raised concerns about risks of more prolonged deflation.

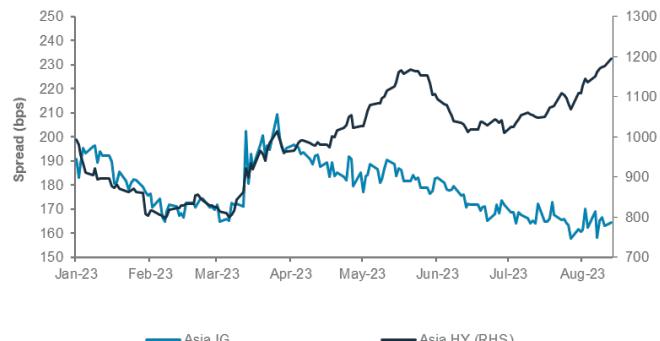
Policy reaction and market valuations remain key. The PBoC's surprise rate cut suggests policy action is becoming incrementally proactive. Our baseline assumption is that policymakers will continue to ease. Given oversold technicals and inexpensive valuations, further policy stimulus could trigger short-covering in Chinese equities. However, the risk of further near-term downside is not off the table.

US Dollar liquidity conditions remain the other key driver of global risk appetite. Here, the renewed surge in US government bond yields and accompanying rebound in the US Dollar pose a risk of tighter liquidity. This can be one factor linking what could otherwise be explained as relatively idiosyncratic currency weakness in Argentina and Russia, as well as renewed pressure on Asian risky assets. Our baseline view remains that US government bond yields are likely to be capped to previous (mid-2022) highs, given current yields price a Fed pause into 2024. However, any rise in inflation expectations on the back of higher oil prices and a sizeable rise in real (net-of-inflation) bond yields are key risks. Nevertheless, even a break higher in US bond yields is likely to be relatively modest as higher yields are likely to tighten financial conditions and hurt growth (via higher mortgage yields).

Policy, seasonality and technical levels likely to set the tone for the coming weeks. In addition to any further Chinese policy support, we would watch Fed meeting minutes due later this week. Fed policymakers appear to be comfortable with market pricing of a rate pause. This should help calm bond markets. Seasonally, September has been a weak month for equities, with negative average returns. Finally, a technical view of markets shows several asset classes are poised close to key technical levels. MSCI Asia ex-Japan appears to have broken below its 200-Day Moving Average (DMA), suggesting room for weakness at least in the short term. The 10-year US government bond yield is testing the prior mid-2022 high, the S&P500 fell below its 50-DMA and the US Dollar Index (DXY) is testing its 200-DMA.

Asia IG USD bonds have outperformed their HY counterparts since Q2 this year

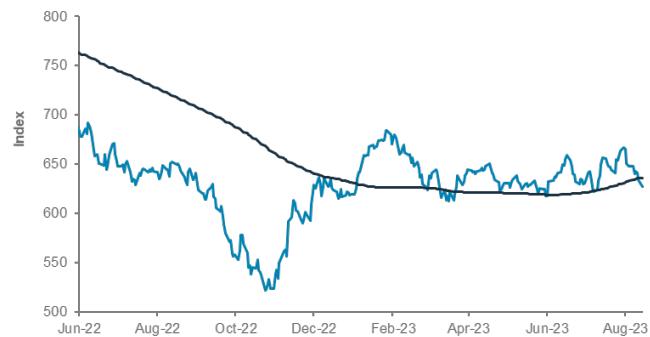
Asia USD bonds, IG spreads vs. HY spreads



Source: Bloomberg, Standard Chartered

Asia ex-Japan equities appears to have broken below its 200 Day Moving Average

MSCI Asia ex-Japan Index and 200DMA



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