

Mood changes - not just Delta

Financial markets have turned a little sour today. That isn't just a response to the Delta variant's progress, but a mixture of that, some softer US data, and perhaps a sombre reflection on what is going on in Afghanistan



Wall of red in equity screens

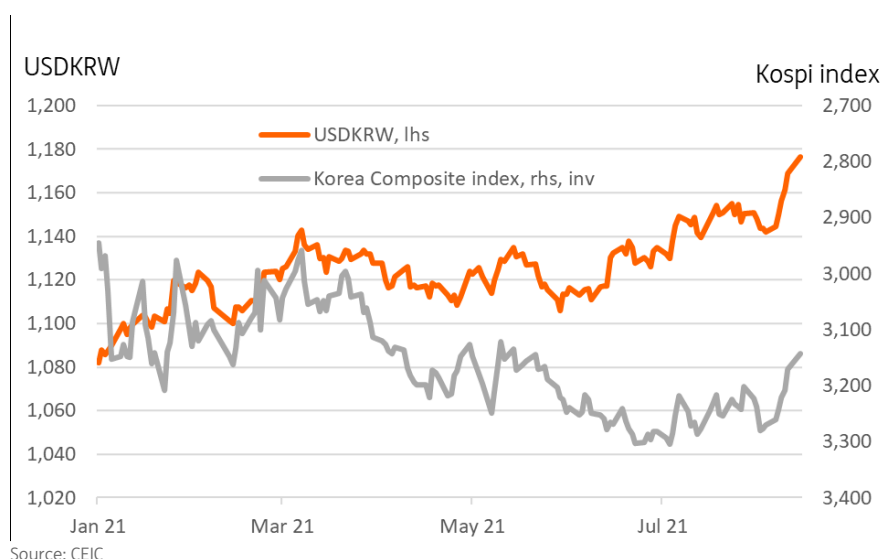
It has been a "neither here nor there" environment for stocks in recent days, a bit up, a bit down, but no real direction though still at a very high level. That all changed yesterday. The mood swing is being put down to the weak July retail sales figures out of the US ([for detail on which you need go no further than this note from our very own James Knightley](#), and which he doesn't think were as bad as they at first appear), but there may also be some further reflection of the spread of the delta variant. For some balance on the US data story, their July industrial production numbers were actually better than had been anticipated ([again, see link for details](#)).

The spread of the Delta variant has brought the US back to the top of the global daily case tally again, with death rates higher than most people probably thought likely at this stage of the year and with vaccination rates peaked out. And it isn't just the US. Here in the Asia Pacific region, New Zealand's "Alamo-style" defence against Covid-19 looks likely to go the same way eventually (in case you can't remember the movie, Mexico's Santa Anna won). NZ went into a 3-day lockdown on the back of one Delta confirmed case yesterday, though another four have since been discovered.

This puts the RBNZ into a bit of a bind. They were widely expected to hike rates today by 25bp. There is still a strong argument for them to do so, though there is a growing risk that this turns out to be a mistake if Delta gets a stronger toe-hold in New Zealand. This will be an interesting decision to watch. The NZD will no doubt whip around in response depending on the outcome.

The broad-based risk sentiment downturn has been supportive for the USD, and we continue to see most Asian currencies losing ground to the greenback, though the JPY should probably outperform in this environment. The high-beta KRW in contrast continues to get battered despite prospects for a rate hike from the BoK before the year-end. That thought doesn't appear to be helping amid concern that rising chip prices may be peaking out and a recent slide in Korean stocks.

USDKRW and Korean stock market



Bonds staying out of it for now

The turnaround in equities doesn't seem to have spread to the bond markets yet, which you might have expected to see rallying in response. Real yields (based on core CPI) on US 10Y Treasuries are about -107bp, about as low as they have got and that may provide a little resistance to further declines. The last few days has seen small, but interesting increases in the front end of the yield curve, and small but opposite moves further out. This has resulted in very slight yield curve flattening. Though it is worth watching to see if this becomes a more evident trend as it ties into the narrative that higher inflation will result in weaker growth, either by undermining household purchasing power or through a more aggressive Fed response.

On the theme of the Fed, Jerome Powell managed to avoid saying anything in his comments yesterday that could help the market decide which direction to take, basically noting that it wasn't clear what the impact of the Delta outbreak would have (its not positive though is it?). In any case, the possible event risk from his speaking engagement seems to have passed without much notice. He will be expected to be a bit clearer at Jackson Hole.

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