

Risk off driving markets

There's not just a single factor driving markets, but many, though they are mostly pointing the same way - a reduction of risk appetite...



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Risk on or risk off? It's risk off

The daily task of unravelling what mood the market is in is not always an easy one, but right at the moment, it seems pretty clear. Friday's equity action doesn't send a screaming message of fear, with the S&P500 slightly down on the day and the Nasdaq actually making gains. But the picture elsewhere is more obvious. A further sharp rally in EURUSD of about a big figure, taking it to about 1.1274 could just be a response to Europe's more aggressive lockdown plans against the backdrop of surging European Covid cases. But that wouldn't explain away the slight gains in the JPY - a traditional safe-haven currency in times of stress. So this seems more than a simple "Europe" effect. Indeed, in the Asia-Pacific, the AUD was weaker than the rest of its peers on Friday, along with high-beta currencies like the KRW, so this feels more of a classic "risk-off" move than anything country or region-specific.

These equity and FX moves are echoed by the bond market, where more curve flattening was the order for the day on Friday. The socializing of the message of a more rapid taper and by implication, more imminent and faster liftoff from the Fed is keeping yields at the front end of the Treasury yield curve elevated, but depressing them at the back end. That's consistent with fear that a more active Fed will snuff out the recovery earlier than a more laid back Fed. And this is

where the choice of the next Fed chair could also be pivotal, with Brainard judged to be a little more dovish than Powell - yet we still have not had any confirmation of who will get the next 4-year term - something we were led to believe was imminent at the end of last week. Falling oil prices also tie in with the slower global growth outlook that is gripping markets and we don't get much on the economic calendar this week to either confirm or dispel such thoughts. US personal income and spending figures for October at the end of the week are probably the main pick of the economic releases this week.

Adding noise to the mix is news that China's authorities are signalling to banks their disquiet over recent CNY gains, which raises the prospect of some weaker fixes over the coming week. This will send a message to markets that price action should not be one-way and maybe provide a few metaphorical bloody noses to make the point more clearly. With the CNY a force for regional currency moves, this could also exacerbate recent regional FX weakness.

And then there is the rising concern about Russian military build-up on the Ukraine border. Any military escalation here would also likely support the USD near-term and see longer-dated Treasury yields fall further. And it probably doesn't help that against this tense backdrop, Turkey's financial markets seem to be having one of their sporadic meltdowns. There may be no direct linkages between Turkey and EM Asia, but broader EM angst does have a habit of spreading, and Turkey often seems to be at the epicenter of these moves when they kick-off. Could be an interesting week...

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