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Charts of the Week: Summer storms

A HAVER ANALYTICS® podcast and publication

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Summer storms

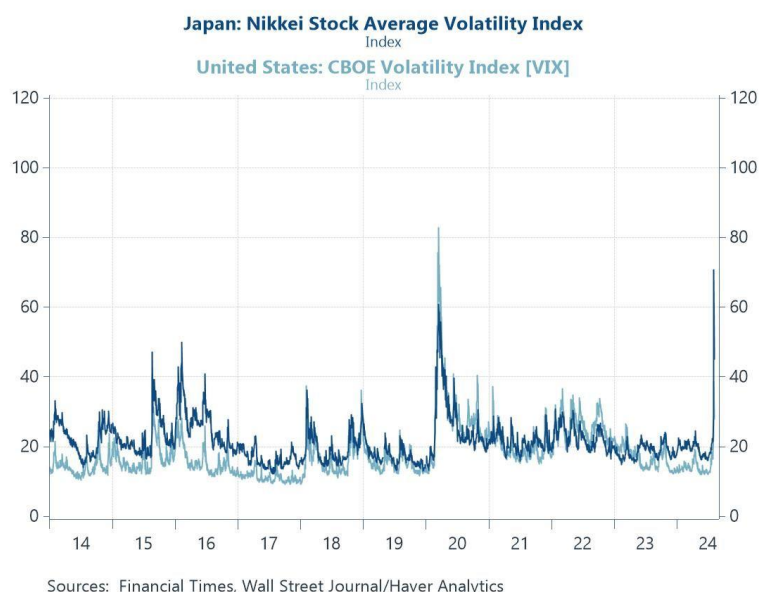
Financial market instability has been in the ascendancy over the past few days as investors shunned risk assets and flocked to safe havens such as government bonds (chart 1). A key catalyst was last Friday's weaker-than-expected US employment report (chart 2) but there have been other factors that have amplified investor concerns. These include last week's decision by the Bank of Japan to lift its policy rate and the impact of this on so-called carry trades (chart 3) coupled with heightened anxiety about the potential profitability of big US technology companies (chart 4). Geopolitical concerns regarding the Middle East together with thin summer trading conditions have additionally played a role. All that said, markets have returned to calmer waters over the past 48 hours, partly thanks to some dovish comments from central bankers, and most notably BoJ Deputy Governor Uchida. Concern about the impact of financial instability on the world economy could, in any case, have been over-baked. This week's US dataflow have certainly been more reassuring (chart 5). That inflation has been ebbing and there is now greater scope to relax monetary policy ought to also help allay recession fears (chart 6).

Financial market volatility in Japan and the US

The recent wave of global financial instability can be seen in a number of markets but the sharp spike higher in equity market volatility offers some neat context. Japan's volatility gauge, for example, bolted up

to multi-decade highs on August 5th while the US gauge (the VIX index) rose to its highest level since the onset of the pandemic in mid-March 2020.

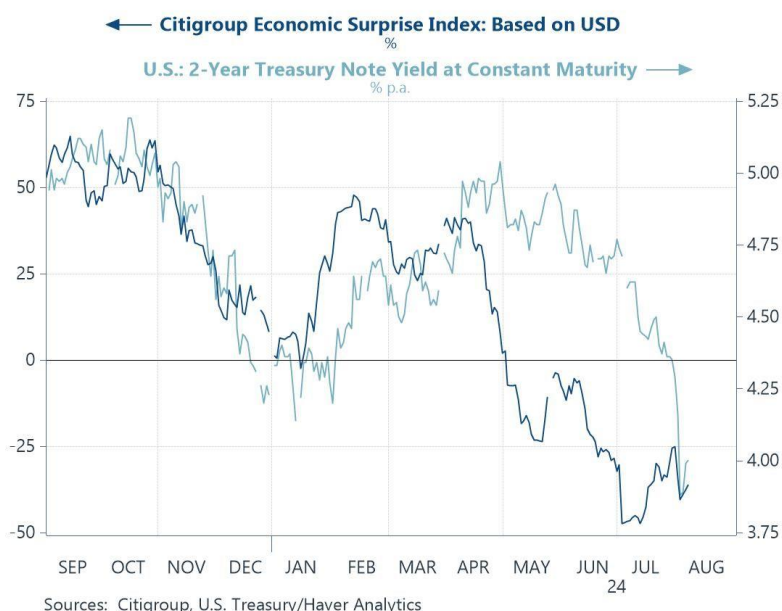
Chart 1: Global equity market volatility indexes



The US economy and the Fed

Last week's disappointing US employment report and the recession alarm bells that this report has triggered was one of the catalysts for this instability. That said, prior to that report there had been a steady drumbeat of weaker than expected US data over the previous two to three months. As chart 2 below equally suggests the Fed may have been a little slow to respond to this unexpected weakness. Financial markets are certainly now anticipating a steeper decline in policy rates by the Fed over the next couple of years.

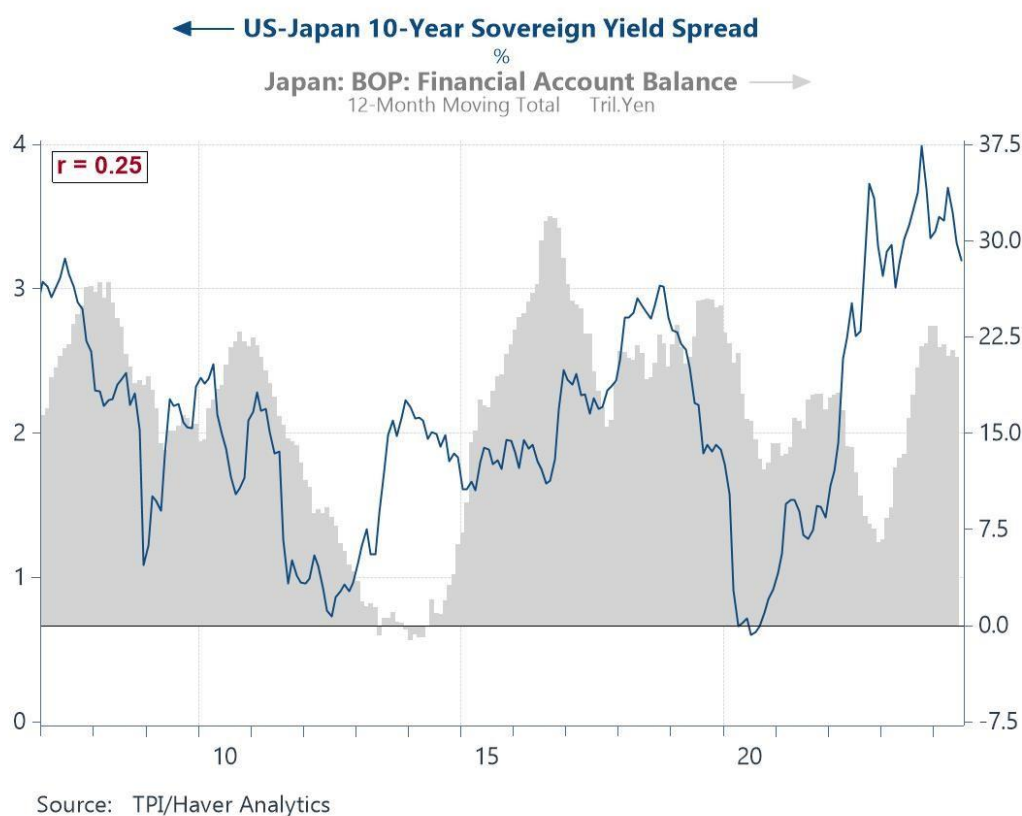
Chart 2: US growth surprises versus changes in 2-year Treasury yields



The BoJ and the carry trade

While the US dataflow and Fed policy have been influential the role of the Bank of Japan in this saga should not be understated. Last week's decision by the BoJ to lift its policy rate, which was unexpected by many market participants, has narrowed interest rate differentials with other major economies and the US in particular (chart 3). And that in turn has had ramifications for the so-called carry trades where investors borrow in yen and invest in higher yielding assets in overseas markets. The profitability of this trade has certainly now declined and that's had reverberations for global financial flows as Japanese investors have repatriated their funds. Against that backdrop more recent remarks from BoJ Deputy Governor Uchida about potentially delaying any further normalization in Japan's monetary policy has perhaps understandably been welcomed by investors.

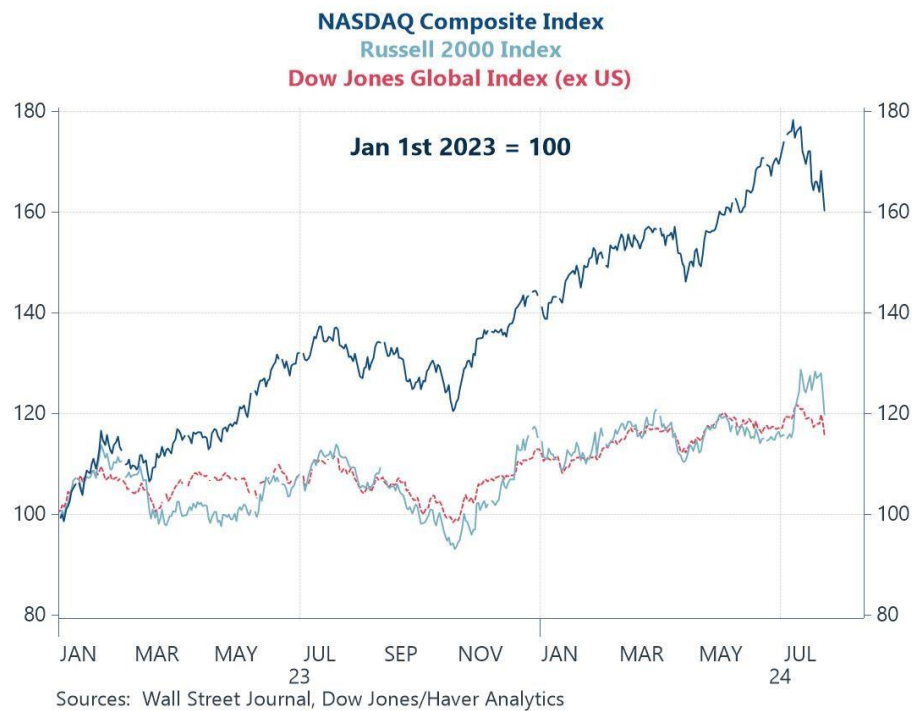
Chart 3: Japan's financial account balance versus US-Japan 10-year bond yield spread



US technology companies and equity markets

Also worthy of some mention is technology. There has, as chart 4 below indicates, been much optimism in financial markets about the profitability and broader productivity-related benefits that might stem from investing in and harnessing Artificial Intelligence. And that optimism had been reflected in somewhat lofty valuations for many large technology companies. These narratives, however, are now being more actively challenged in financial markets. And if these challenges now morph into more deep-seated concerns, this could generate negative spillovers for the world economy.

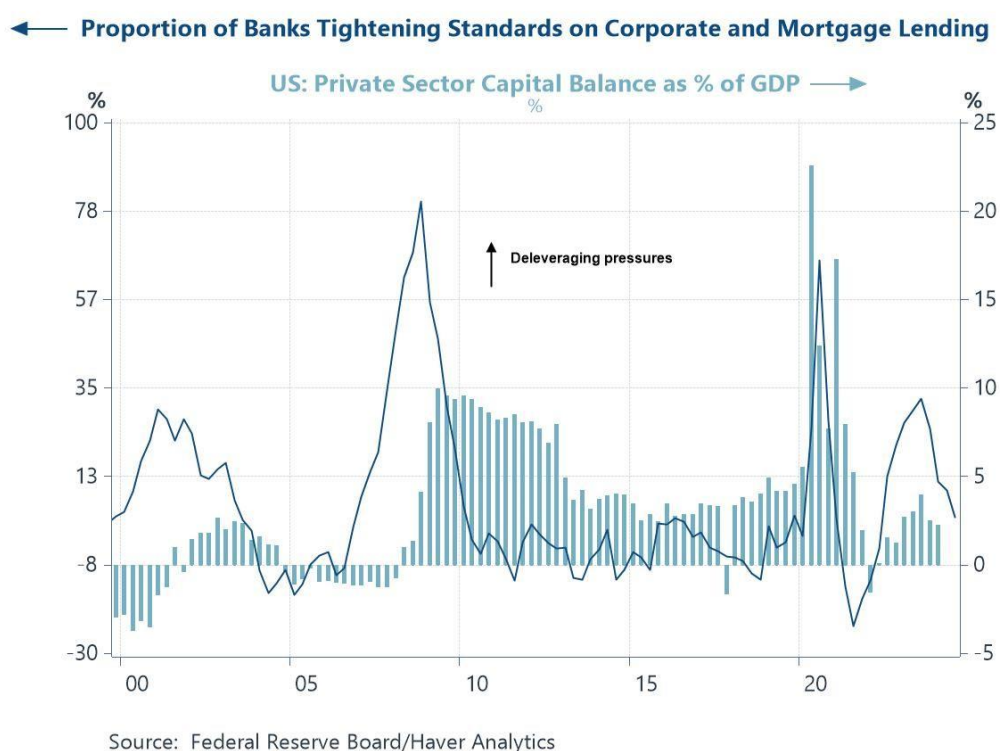
Chart 4: Equity markets: The NASDAQ, the Russell 2000 and the Dow Jones Global Index (ex US)



US banking conditions and financial balances

That said the feedback loops between financial conditions and the real economy may not be that big. Private sector financial imbalances in the US economy, for example, are not that acute. It's been notable this week too that the latest survey of US Senior Loan Officers from the Fed did not suggest any material pressure on households or companies to further deleverage balance sheets (see chart 5).

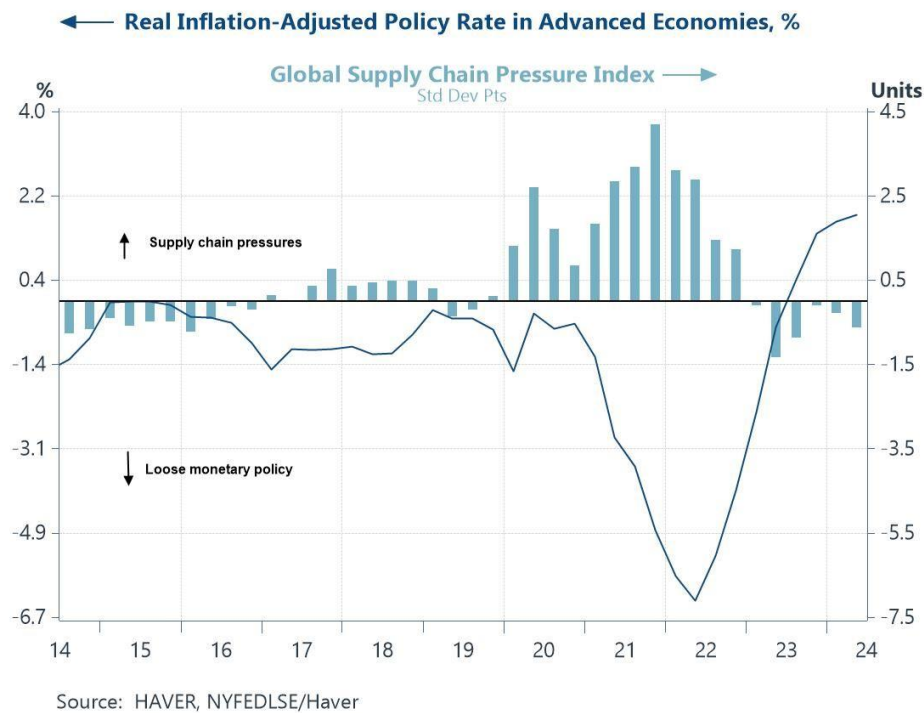
Chart 5: The proportion of US banks tightening lending standards versus private sector saving



Supply chain pressures and monetary policy

Finally, it may also be worth bearing in mind that other recession forces are not as acute at present as they were two to three years ago. Monetary policy has already been pulled into the restrictive zone and is now moving to more accommodative territory in many major economies. With inflationary pressures subsiding there is also scope for further easing in the period ahead. The supply side pressures that were doing so much to generate inflation, in the meantime, have also normalized (see chart 6).

Chart 6: Real policy rates in advanced economies versus global supply chain pressures



About the author



Haver Analytics is pleased to bring [Andrew Cates's](#) commentaries on the state of the global economy to its clients.

Andy Cates has more than 25 years of experience forecasting the global economic outlook and in assessing the implications for policy settings and financial markets. He has held various senior positions in London in a number of Investment Banks including as

Head of Developed Markets Economics at Nomura and as Chief Eurozone Economist at RBS. These followed a spell of 21 years as Senior International Economist at UBS, 5 of which were spent in Singapore. Prior to his time in financial services Andy was a UK economist at HM Treasury in London holding positions in the domestic forecasting and macroeconomic modelling units.

He has a BA in Economics from the University of York and an MSc in Economics and Econometrics from the University of Southampton.

Data featured in this commentary:

Chart 1: Global equity market volatility indexes

Series 1: [S158NKX@INTDAILY](#)

S158NKX@INTDAILY [Japan: Nikkei Stock Average Volatility Index (Index)]

Series 2: [S111VIX@INTDAILY](#)

S111VIX@INTDAILY [United States: CBOE Volatility Index [VIX] (Index)]

Chart 2: US growth surprises versus changes in 2-year Treasury yields

Series 1: [V111CSI@INTDAILY](#)

V111CSI@INTDAILY [Citigroup Economic Surprise Index: Based on USD (%)]

Series 2: [R111G2@INTDAILY](#)

R111G2@INTDAILY [U.S.: 2-Year Treasury Note Yield at Constant Maturity (% p.a.)]

Chart 3: Japan's financial account balance versus US-Japan 10-year bond yield spread

Series 1: [\(R111MA@INTDAILY - R158MA@INTDAILY\)](#)

R111MA@INTDAILY [United States: 10 Year Treasury Bond Mid Yield (% p.a.)][AGG=AVG, Default]

R158MA@INTDAILY [Japan: 10 Year Treasury Bond Mid Yield (% p.a.)][AGG=AVG, Default]

Series 2: [movt\(BNF@JAPAN,12\)](#)

BNF@JAPAN [Japan: BOP: Financial Account Balance (100 Mil.Yen)]

Chart 4: Equity markets: The NASDAQ, the Russell 2000 and the Dow Jones Global Index (ex US)

Series 1: [index\(SPNA@DAILY,20230101=100\)](#)

SPNA@DAILY [Stock Price Index: NASDAQ Composite (Feb-5-71=100)]

Series 2: [index\(SPRUS2@DAILY,20230101=100\)](#)

SPRUS2@DAILY [Russell 2000 Share Price Index (Dec-31-86=135)]

Series 3: [index\(S001DJX@INTDAILY,20230101=100\)](#)

S001DJX@INTDAILY [Dow Jones Global Index: World excl U.S. (Dec-31-91=100)]

Chart 5: The proportion of US banks tightening lending standards versus private sector saving

Series 1: [\(\(FTCNMH@SURVEYS + FTCIL@SURVEYS\) / 2\)](#)

FTCNMH@SURVEYS [FRB Sr Loan Survey: Res Mortgages: Net Share, Banks Tightening (Haver Est, %)]

FTCIL@SURVEYS [FRB Sr Officers Survey: Banks Tightening C&I Loans to Large Firms (%)]

2

Series 2: [S111ZCPP@G10](#)

S111ZCPP@G10 [US: Private Sector Capital Balance as % of GDP(%)]

Chart 6: Real policy rates in advanced economies versus global supply chain pressures

Series 1: [\(N110RTAR@G10 - yyr%\(S110PC@G10\)\)](#)

N110RTAR@G10 [Advanced Economies Policy Rate (EOP, %)]

S110PC@G10 [Advanced Economies: Composite CPI (SA, 2015=100)][AGG=AVG, Default]

Series 2: [W1NGSCPI@TRANSPRT](#)

W1NGSCPI@TRANSPRT [Global Supply Chain Pressure Index (Std Dev Pts)]

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