PeaQ News
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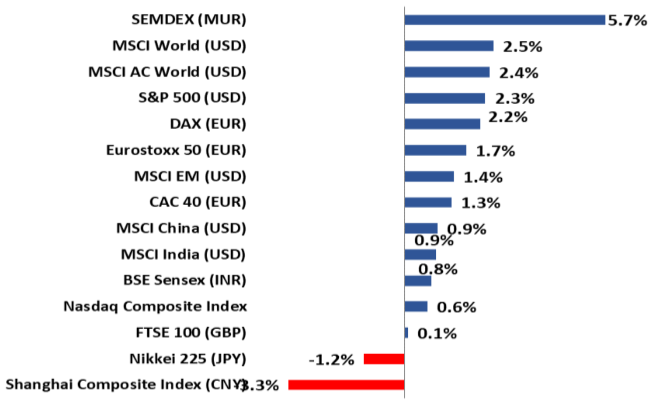
MARKET SUMMARY

Equities: Aug 24 performance (in Index currency)



- The first week of the month was highly volatile with an equity sell-off followed by a subsequent recovery, after which most of the indices regained their losses with some reaching all-time highs. The main catalyst for the decline was the unwinding of the yen carry trade, further to the BoJ raising interest rates on the last day of July.
- Weak US employment figures also led to investors fearing that the US economy would fall into a recession. Subsequently, markets recovered and there was a broadening of returns in sectors other than the technology sector. The US economy grew at an annual rate of 3.0% in 24Q2, up from an initial estimate of 2.8%.
- Inflation fell to 2.2% in August in the Eurozone from 2.5% in the prior month. At country level, rates also fell – in Germany, it fell to 1.9% in August from 2.3% in July, whilst in France, it registered the slowest reading since August 2021 at 1.9% in August. These figures increased the expectations of investors that the ECB has more room to cut interest rates.
- Central banks were on the easing path: following the ECB's first rate cut in June, the BoE cut interest rates to 5.00% from 5.25% - it was the first cut since the start of the pandemic in March 2020. The RBI kept interest rates steady in line with expectations at 6.5%.
- Brent and WTI prices continued to fall (-2.4% and -5.6% respectively over the month) due to low demand and increased supply. Gold prices rose (+2.8%) supported by geopolitical issues.
- In Mauritius, tourist arrivals by air rose by 7.7% y-on-y in August whilst gross tourism earnings rose by 6.6% for the period January - July 24.
- Headline inflation for the 12-months ended August 2024 was 4.0% (vs 9.6% for the previous period).

THE YEN CARRY TRADE

- The unwinding of the Yen carry trade rocked markets at the beginning of August.
- A carry trade involves borrowing in a currency at low interest rates to invest in other currencies or assets offering higher yields. Investors would invest in stocks, bonds or other money market instruments in that currency.
- The trade carries various risks including currency risk and interest rate risk with regards to both the borrowing rate and the coupon rate. There is also a risk of margin call if the investment value drops below the required margin.
- The Yen has been the funding currency of choice for carry trades in US Dollars and Mexican Pesos amongst others, given the Bank of Japan's (BoJ) stable monetary policy and the negative interest rates on Japanese Yen.
- With US interest rates up at 5.5% in July 2023, an attractive carry trade was on offer. Japan's key short-term interest rate was at -0.1% which could be used to invest in US money market funds at 5.5%. The interest rate differential between the currencies would put downward pressure on the Japanese yen, further improving returns when converting the USD back to JPY to close the trade.
- The tides began shifting in March 2024 when the Japanese central bank raised its benchmark interest rate to a range of 0.0-0.1% for the first time in 17 years, ending a longstanding policy of negative rates meant to boost the economy. The market's reaction was nevertheless muted as the move was expected.
- On 31 July 2024, BoJ's decision to raise rates to 0.25% caught markets off guard. Carry trades are sensitive to currency movements and rate expectations. Talks of further rates hikes by the BoJ and the possibility of Fed cutting interest in September drove the Yen 13% higher while also increasing the cost of the carry trade. Recession fears in the US weighed on equity prices and possibly triggered margin calls for big leveraged investors in the US markets. The unwinding of this trade thus ended up amplifying the rout.

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Source: FED, ECB, BOE, BOM, Bloomberg, SEMDEX, Statistics Mauritius, MSCI, WSJ, Reuters