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A Quarter in the Markets

Q2 2022

We are pleased to introduce our latest edition of ‘A Quarter in the Markets’, which provides an insight into financial markets from the Multi-Asset Solutions team at Santander Asset Management UK.

What were the key factors influencing markets in the second quarter of 2022?

Persistent inflation and rising interest rates created a volatile environment for stock markets during the second quarter. Consumer prices continued to rise[1] as strong demand continued to bump up against supply chain disruption, while the war in Ukraine caused energy and grain prices to spike.[2]

Major central banks, such as the Bank of England[3] (BoE) and the US Federal Reserve[4] (Fed), continued to hike interest rates over the quarter in an attempt to rein in consumer prices. These have been soaring due to high demand and limited supply. Furthermore, the COVID-19 pandemic continued to have an impact on global economies. This was most notable in China where strict lockdowns[5] in Shanghai had an observable impact on manufacturing activity in the country.

[1] New York Times, 10 June 2022
[2] The Guardian, 8 April 2022
[3] Sky News, 17 June 2022
[4] The Guardian, 15 June 2022
[5] Yahoo Finance, 29 April 2022

What happened in markets during the quarter?

It was a difficult period for investors as most major stock markets around the world fell[6] as a result of pessimism about inflation and interest rates. With inflation at its highest level for 40 years in both the US and UK[7], both the Fed and BoE had little choice than to continue raising interest rates[8/9]. With an uncertain outlook for high inflation and interest rates rising at a pace not seen in decades, investors began to worry that this may trigger a recession in the coming months, prompting a sharp sell-off.[10]

In global stock markets, the US and Europe were among the worst performers among major markets.[11] This was followed by the UK, emerging markets, Japan and Asia Pacific excluding Japan.[12] Bucking the trend was China, which bounced back from a long losing streak with solid positive performance for the quarter.[13] Investors viewed it more favourably after lockdowns were lifted and its technology crackdown appeared to have passed.[14]

Making matters more challenging for investors was the fact the bond markets were also negative for the quarter.[15] Rising interest rates cause bond yields to rise and their prices to drop (bond prices move in the opposite direction to yields). Historically, bonds have been seen as a safe haven for investors when shares are falling, but they did not provide any protection this time around.

How did different economies react?

Countries around the world continued to face a cost-of-living crisis as consumer prices kept rising.[16] This was combined with uncertainty over the ongoing war in Ukraine, concerns about rising interest rates, slower growth and the prospect of an economic downturn.

In the UK, economic growth was subdued[17], inflation soared to 9.1%[18] and consumer confidence hit a record low[19]. While energy prices remained higher, the overall rise in inflation was largely credited to higher prices for food and non-alcoholic drinks.[20] The BoE raised interest rates with a 0.25% hike on two occasions during the quarter, to 1.25% from 0.75%.

[6] The Guardian, 14 June 2022
[7] Bloomberg, 19 June 2022
[8] Bank of England, 5 May 2022
[9] Bank of England, 16 June 2022
[10] CNBC, 10 June 2022
[11] Bloomberg, 3 July 2022
[12] Refinitiv Datastream, 6 July 2022
[13] Reuters, 30 June 2022
[14] Financial Times, 30 June 2022
[15] Refinitiv Datastream, 8 July 2022
[16] The Guardian, 20 June 2022
[17] The Guardian, 29 June 2022
[18] Reuters, 29 June 2022
[19] Bloomberg, 23 June 2022
[20] Reuters, 29 June 2022

Contrary to its previous statements it would hold off on interest rate hikes until the final three months of the year[21], the European Central Bank (ECB) changed course in June and signalled that it would soon raise rates.[22] This was mainly due to inflation, much like the rest of the world, which reached a record-high of 8.6% in June[23] in the Eurozone. Economic sentiment in Europe fell in June, with rising prices causing consumer confidence to its lowest level since the onset of the pandemic in 2020.[24]

With inflation running at more than 8% during the quarter[25], the Fed made aggressive moves to slow the rate of price increases. It raised interest rates by 0.50% in May and 0.75% in June.[26/27] This brought the central bank's benchmark interest rate to 1.75%.[28] These steep hikes also rattled markets, causing shares and bonds to fall sharply.[29] Fears of a recession grew over the quarter after updated figures showed the economy shrank by 1.6% in the first quarter[30] and consumer spending in May was weaker than expected[31].

In Asia Pacific, much of the attention was focused on China during the quarter. The prolonged COVID-19 lockdown in Shanghai not only made headlines around the world but was largely credited with slowing down manufacturing activity in the country.[32] Suggestions that China was ready to ease its zero-tolerance approach to COVID-19, which includes strict lockdowns, were firmly quashed in late June. President Xi Jinping stated that he would rather temporarily sacrifice economic growth than harm people's health.[33] After the Shanghai lockdown was lifted, official government data showed there was noticeable growth in China's manufacturing and services sectors in June.[34]

[21] Reuters,10 March 2022
[22] BBC News, 9 June 2022
[23] Eurostat Statistics, 1 July 2022
[24] European Commision, 29 June 2022
[25] U.S Bureau of Labor Statistics, 10 June 2022
[26] CNBC, 15 June 2022
[27] Investopedia, 15 June 2022
[28] CNBC,15 June 2022
[29] Financial Times, 23 June 2022
[30] CNN, 29 June 2022
[31] Reuters,30 June 2022
[32] Yahoo Finance, 29 April 2022
[33] The Guardian, 27 June 2022
[34] XinhuaNet, 30 June 2022

What is the outlook for markets?

The first six months of 2022 were nothing short of difficult for investors. Higher inflation, rising interest rates, the ongoing pandemic and the war in Ukraine have all contributed to negative sentiment and falling stock markets. With inflation likely to remain high for longer than expected, central banks are poised to continue raising interest rates until the rate of price increases begins to slow. This is likely to cause further volatility in the months ahead.

While markets have already fallen a long way this year, there is likely room for them to fall further if inflation persists and we see more supply chain disruptions and flaring geopolitical tensions. We believe the environment will remain negative for shares and bonds, and as a result it is not a time to take additional risk.

Find out more

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