Government Actuary's Department

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Market Data Insights

Blog

Take a look at our latest blog on digital finance:
https://actuaries.blog.gov.uk/2020/05/01/digital-finance/

This Month in Brief

Over March there has been significant financial turmoil due to impacts from COVID-19. As a result of this, the Bank of England base rate fell twice over March – first to 0.25% and then to a record low of 0.1%. This has been done in order to lessen the economic impact of lockdown and stimulate economic activity.

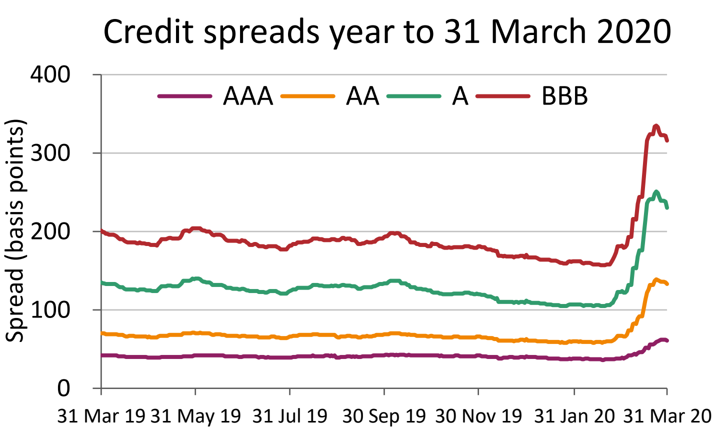
Across the UK many business and workplaces have been forced to close in response to this threat. This has led to many businesses changing working arrangements, furloughing staff or dismissing employees due to cost concerns. This has led to unemployment rates substantially increasing over the quarter, with fears that it will only continue to grow – with some predictions reaching 6 million people, approximately 21% of the workforce.

The negative impacts of lockdown have been felt across the globe with substantial reductions in investment performance in all markets amid significant commercial and consumer disruption. The USA's economy is contracting at its fastest rate since the 2008 financial crisis.

Credit spreads

An asset's 'credit spread' is the difference between its yield and that of a Government issued bond of similar maturity. It is an indicator of the perceived riskiness of the asset – how much investors want to be rewarded for investing in it instead of a lower risk Government bond.

The graph shows credit spreads of different rated corporate bonds over the past year. Credit spreads rose sharply in March as all financial markets reacted to the growing economic uncertainty. But, putting this in perspective, spreads remained considerably lower than post 2008 financial crisis, and even the consequent European sovereign debt crisis of 2011, as can be seen in the below graph showing spreads back to 2008.



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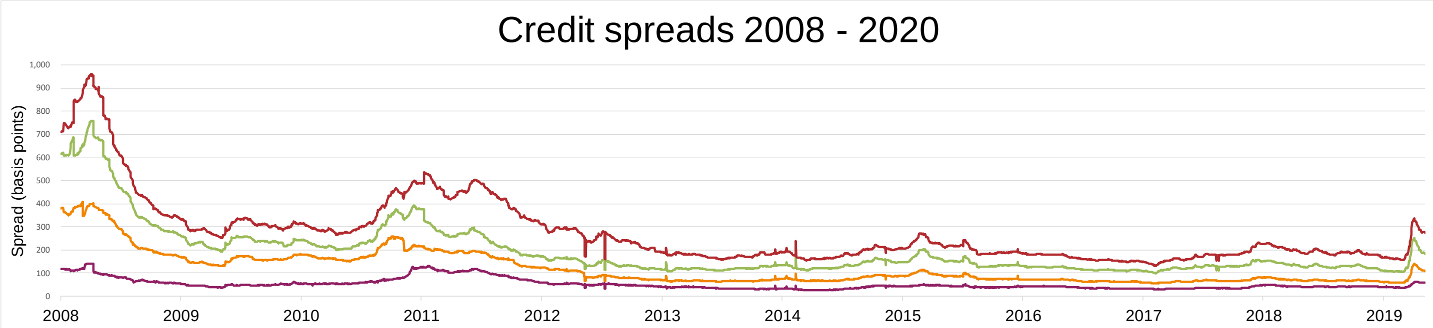
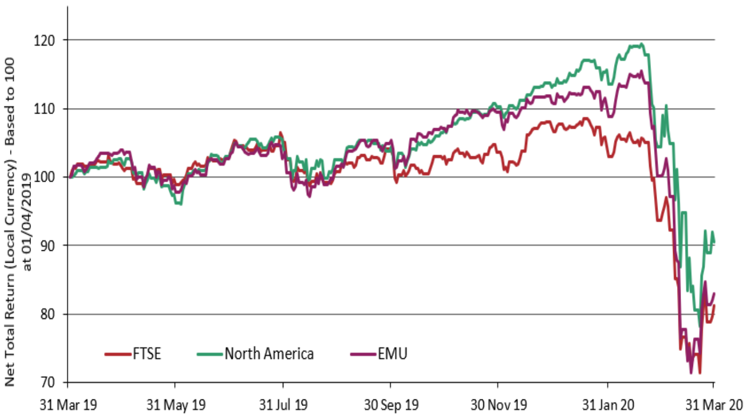


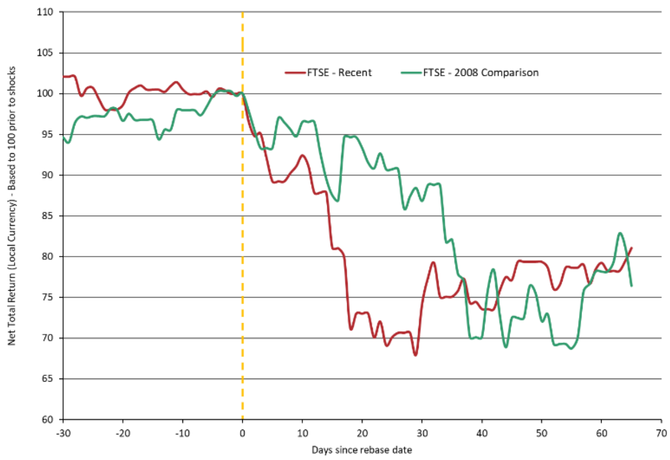
Equity Markets



This graph shows the market performance of different stock market indices. All dropped sharply last month before showing some recovery towards the end of March.

This has been the biggest investment shock since the 2008 banking crisis. The graph below shows how the shocks in 2008 and 2020 compare. It shows the FTSE 100 index rebased at the beginning of the most significant sharp drop for each (14 September 2008 and 23 February 2020 respectively) and allows comparison of the market movements before and after this shock.

As can be seen here, the relative fall in equity markets is comparable between 2008 and 2020 – falling by about 30% before slightly bouncing back. However, the drop this year has occurred faster, with the initial drop occurring over only a few days. It is also worth noting that the 2008 stock price drop was preceded by a year of economic troubles following from the beginning of the banking crisis, whereas the fall in stock prices over February and March was unexpected and incredibly abrupt.



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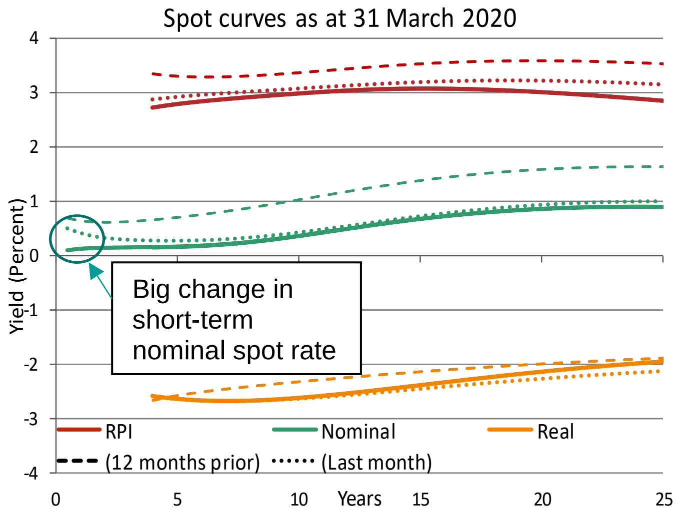
Spot curves

The nominal 'spot rate' at a given duration can be thought of as the market's expectation of the average 'risk free' interest rate over that duration. At very short durations it tends to be close to the Bank of England's base rate. At longer durations it will reflect any expected changes to the base rate over that period – however at all durations the rates can be affected by other factors such as supply and demand. By plotting the spot rate at different durations, you can build a picture of expectations of interest rates over different time periods. This is known as the spot curve.

Similarly, you can estimate spot rates (and curves) for inflation, and hence calculate the 'real' spot rate – i.e. the difference between the nominal spot rate and inflation spot rate. This graph shows these spot curves as at the end of March, compared to those 1 month, and 1 year ago.



The dramatic change in very short nominal spot yields in March is a reminder of just how quickly the landscape changed as the Covid-19 crisis unfolded, with most of the BoE's drop in base rate apparently unanticipated by the market at the end of February. Nominal yields at longer durations have not dropped so sharply, but the market had already been anticipating lower interest rates in the medium-term since the middle of last year. Medium-term inflation expectations relative to interest rates have remained broadly unchanged.

Oil Prices

Oil prices were volatile before coronavirus due to in-fighting between producers over output. However, monthly oil prices have consistently decreased from Jan 2020 – Mar 2020. Travel restrictions (car and airline) due to the pandemic have been keeping people inside, decreasing demand for oil. At the same time, despite Opec countries and allies agreeing a record deal earlier this month to reduce global production of oil by approximately 10%, the decrease in supply has not proven sufficient to maintain or increase oil prices.