GOVERNMENTS AND POLICY MAKERS WRESTLE WITH SURGING ENERGY PRICES

This week was especially turbulent as the ongoing energy squeeze and the baseless speculation about what that might mean for central bank policy rattled financial markets. The energy sector's problems show that while it's easy to shut production down, it's much harder to start it up again. In hindsight, it would have been prudent for governments to help maintain production through the pandemic through expanded storage, but this takes years to develop. The market is functioning as intended to fix the issue as sky high prices are meant to lure marginal producers back. Indeed, we've already seen Russia's Gazprom opt to take the money over whatever political leverage they were suspected of using.

Elsewhere policy makers are struggling to react. Energy prices are pushing inflation up sharply and boosting the case for interest rate hikes. However, high energy prices are already dampening economic growth and could possibly justify more support to recovering economies. History tells us the most likely outcome is they'll wait and see. With three possible paths and little guidance, the markets will be jumpy for a while yet.

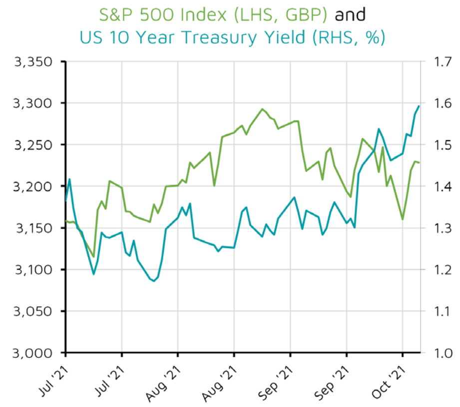
THE MARKETS THIS WEEK

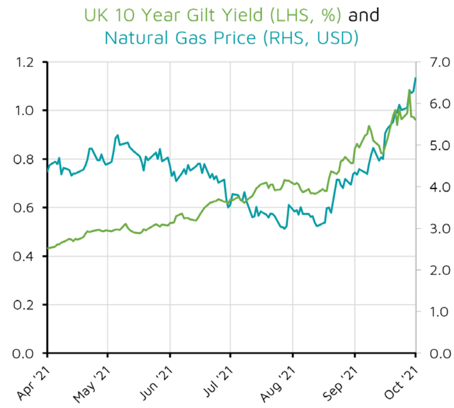
FTSE 100	S&P 500	Nikkei 225	Euro Stoxx 50	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Wheat	GBP USD
+0.72%	+2.14%	-2.51%	+1.09%	+1.07%	+0.13%	+0.13%	+4.35%	-0.16%	-1.42%	+0.51%

US: SENATE AGREES SHORT-TERM DEAL TO RAISE DEBT CEILING

US equity markets rallied strongly at the end of the week as the Senate approved a deal to temporarily raise the debt ceiling and avoid a government shutdown. Brinksmanship and partisan politics caused global equity markets to fall and pushed up US government bond yields over the last seven days, due to fears the US Treasury could run out of money as early as this month. The new deal would see a small increase in the debt ceiling to allow the government to continue to function until December. Republicans have said they will not agree any larger increase in an attempt to force Democrats push through a longer lasting solution without cross-party support.

Short-dated US government bond yields fell as fears of default receded. The positive reaction was not confined to bonds and equity markets also responded positively as the temporary deal should give the Democrats more time to try and pass Joe Biden's plans for huge infrastructure spending and social welfare reforms.





UK: RUSSIA STEPS IN TO BRING DOWN SOARING GAS PRICES

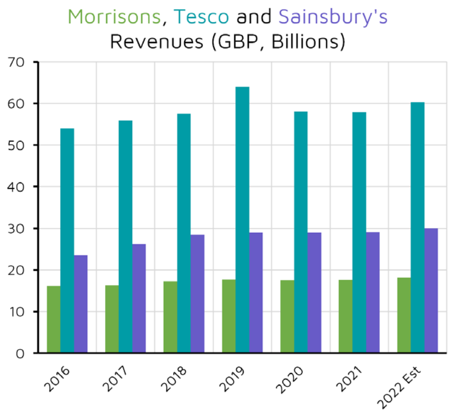
The gas markets experienced further volatility this week as prices pushed up to their highest level since 2014. This added to concerns about inflation and knocked the value of government bonds as investors became fearful of the Bank of England reacting to the surge in oil and gas prices by increasing interest rates. UK 10-year government bond yields surged to 1.09%, the highest since May 2019, and the US 10-year Treasury yield rose to 1.53%.

Markets made a sharp turn after Vladimir Putin said Russia was prepared to intervene and tackle rising global energy prices by expanding supplies to Europe. The price of wholesale gas fell 10% and gilt yields fell slightly after the announcement, although gilt yields remain considerably above their previous high this year. Last month the Bank of England said inflation may rise above 4% this year but the recent surge in energy costs has led to some predictions that inflation could go as high as 6%.

EQUITIES: MORRISON'S TAKEOVER AGREED FOR £10BN

The private equity bidding war for Morrison's ended at the weekend with US firm Clayton, Dubilier and Rice agreeing a price of £10bn for the UK's fourth largest supermarket. The deal values the company at a 61% premium to the pre-bid share price and, although Morrison's shares fell slightly following the announcement, the news helped boost the price of rivals Tesco and Sainsbury's on Monday.

Despite competition from discounters like Aldi and Lidl, the market share for the big four has barely changed in the last two years. Supermarkets were also relatively unaffected by the coronavirus as disruption was offset by a surge in demand from people eating every meal at home. This growth in demand is proving to be sticky. This week Tesco reported that sales and profits are ahead of estimates and announced a £500m share buyback. Sainsbury's also reported increased year on year sales at its last update. Tesco ended the week up around 10% and all the supermarkets are well above their pre-pandemic levels.



Data Sourced from FE Analytics, and Bloomberg Finance LP