The Summer Of 2008

- Current market dynamic carries echoes of summer of 2008
- S&P 500 provided a useful early warning in late May/early June of 2008
- Downward pressure on AUD and KRW along with weaker oil prices and rising volatility followed a month or so after

As noted before echoes of what was happening in H2 2007 and H2 2008 have been emerging since September of last year. Of course there have been differences in the drivers (the Fed’s balance sheet reduction programme and the US/China trade war), specific events (no equivalent of the collapse of Bear Stearns) and even the strength of the Q1 recovery in equities. Nevertheless, the broad rhythm remains similar (see chart). Given this it’s worth revisiting how markets looked in the summer of 2008.

Newswatch

1. US: The FT reports that the US Department of Commerce has issued a notice of “proposed rulemaking” that would allow the government to impose penalties on countries that “act to undervalue their currency relative to the dollar, resulting in a subsidy to their
After the collapse of Bear Stearns in March something of sense of calm had returned thanks in part to policy easing by the Fed.

This sentiment shift saw the resumption of yield seeking behaviour with the AUD gaining against the JPY (the yield gap between 2-year Australian and Japanese government bonds stood close to 600 bps). 10-year US Treasury yields staged a modest recovery while oil prices headed higher again. Brent would rise by close to 50% over the next four months.

**Tellingly, the recovery in the S&P 500 had stalled in mid-May and by late June was already challenging the March lows**

By mid-July the markets were looking increasingly quiet. Realised volatility in AUD/JPY stood close to multi year lows while the yield gap was showing signs of beginning to narrow. At the same time the USD index had become range bound, with 21-day realised volatility declining to a

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**2. US/China: The People’s Daily says: “The US market is becoming a sample for risk” It notes that some US politicians are making a moves to start a "technology cold war," with the goal of curbing the development of other countries and establishing US hegemony in this sector.**

**3. US/China: President Donald Trump says that Huawei is “very dangerous, from a security standpoint”, but insists that it is “possible that Huawei could be included as part of a trade deal”.**

**4. US/China: US agriculture secretary Sonny Perdue says (regarding the first tranche of aid to US exports).**
low of around 6.6%.

However, there were signs that all was not well. Indicators of global growth such as shipping costs had begun to move sharply lower from mid-May onwards. Tellingly, the recovery in the S&P 500 had stalled in mid-May and by late June was already challenging the March lows.

High oil prices (Brent trade above USD 145 a barrel in July) also began to make themselves felt on the currencies of significant oil producing nations with the Bank of Korea reportedly intervening on a number of occasions to fend off weakness in the KRW while the MOF warned at the time against “herd behaviour” in the markets.

**Mid July proved the turning point for markets with 10-year US Treasury yields beginning to slide (along with oil) while the yield support for the AUD saw increasing erosion**

Mid July proved the turning point for markets with 10-year US Treasury yields beginning to slide (along with oil) while the yield support for the AUD saw increasing erosion. Early August saw the USD break upwards out of the narrow range it had been in against the KRW for several months. All these proved early warning signals of the turmoil that would emerge in September and October.

There are, of course, sharp differences between the summer of 2008 and today. Most notably equity markets have been far better supported over the past six months than they were in H1 2008. However, there are some similarities. The close to 50% rise in the price of Brent crude (followed by a sharp reversal), the downward pressure on the KRW, the low realised volatility in the USD index, the reversal in fortunes for the AUD (with a sharp declines in yield support) all echo the situation back then. History, of course, does not repeat itself. Nevertheless, this seems worthy of note in light of events over the past few days.

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A Volatile Summer Ahead for UK

Events are starting to unfold as might have been expected >

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