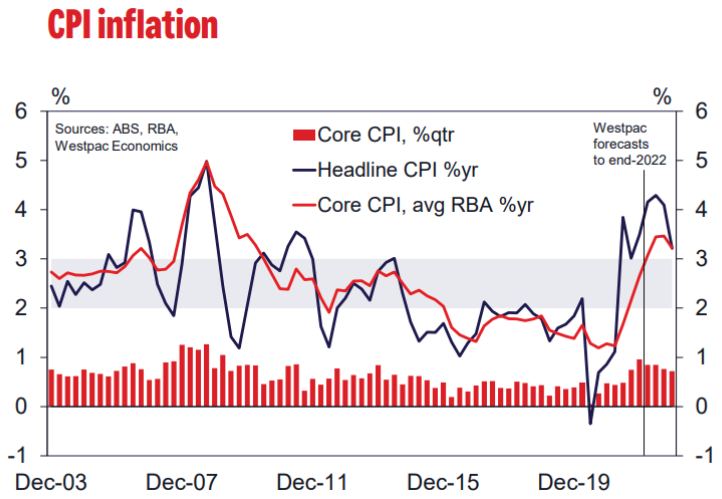
Local Government Finance Authority

Financial Market Conditions – January 2022

As countries focussed on increasing vaccination rates and boosting already vaccinated individuals, the beginning of 2022 has witnessed record COVID-19 case numbers being reported. Scientists have found that the Omicron variant spreads more quickly than the previously dominant Delta variant with studies suggesting its four times more transmissible. There is clear evidence that most that are dying or are being hospitalised from Omicron are unvaccinated, showing that vaccines do make a difference in reducing hospitalisations and deaths. Increasingly, countries around the world are learning to live with the virus with less isolation requirements for the vaccinated. Economic data globally has continued to show strength, despite increased COVID-19 cases, higher numbers of the population facing isolation requirements, and pressure on hospital systems.

The other reality that is evident globally is higher inflation, and the prospect of the end of emergency rate settings, fiscal stimulus, and quantitative easing from central banks. Every country is treating the prospect of inflation and stronger economic data differently, and markets are increasingly pricing in chances of rate hikes, well before and more than most central banks care to admit. For the US, five rate hikes are priced for 2022, and markets expecting a 0.25% increase in March. The ECB has 0.4% of rises priced in by the end of the year. In the UK there are 1% of rises priced for 2022. Meanwhile in Australia four hikes totalling an increase of 0.9% almost fully priced for 2022 with the first 0.25% rise factored in by July 2022.



Equity markets retreated over January month-end. However, February has seen quite the recovery with strong earnings results continuing to support the equity market despite the potential rising cash environment. In the S&P 500, 80% have bet or met earnings estimates, and were up as high as 6% in the first two days of trading in February.

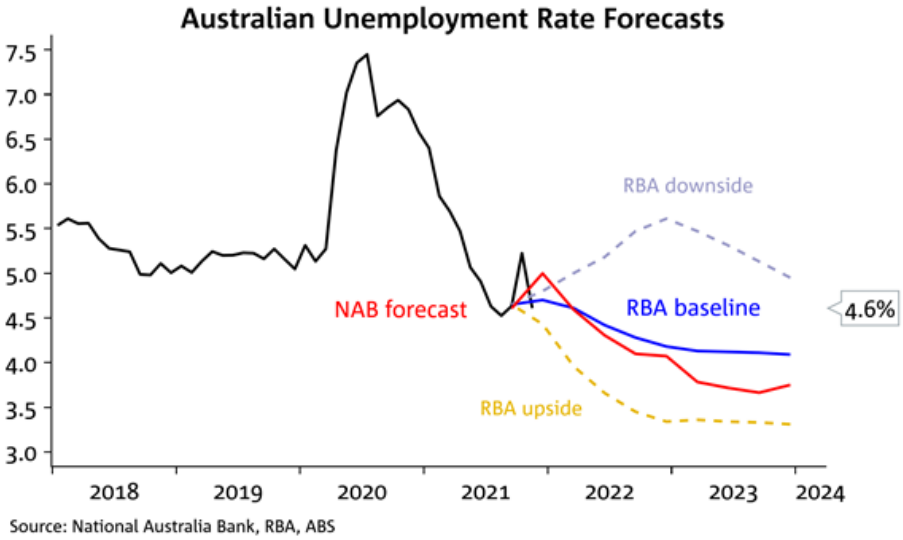
In the US, data releases have helped reaffirm the notion that the US economy is travelling with some momentum. Despite retail sales falling by 1.9% in December, there is still strong evidence of a tight labour market and elevated inflationary pressures. The US economy expanded by a robust annualised 6.9% in Q4 2021. This is the strongest GDP growth in five quarters. The producer price index (PPI) lifted 0.2% in December to be up by a near record 9.7% on the year. During the month, the Federal Reserve signalled a rate hike is likely at the March meeting, saying " the Committee expects it will soon be appropriate to raise the target range for the federal funds rate".

The UK continued to illustrate a strong economic recovery, helping to justify the decision to raise rates in December and February, the first back-to-back rate rise since 2004. Production data for November surprised to the upside, and GDP in Q4 rose 0.9% vs an expected 0.4%. Unemployment has continued to decline reaching 4.1%. UK inflation continued to climb to 5.4%, levels not seen since 1992, with energy prices playing a large part, up by 25% over the course of the year. In Europe, there is a strong contrast between countries in GDP data. France, whose preliminary GDP scored a 0.7% rise, and Germany's which contracted by the same magnitude, meaning France's economy grew by 5.4% in 2021 and Germany's by just 1.4%. Spain, the Eurozone's fourth largest economy, grew by an impressive 2%.

The ECB in its February meeting changed its tune, refusing to rule out a rate increase this year, with the market now pricing in a 70% chance of a rate hike in June.

In China, the PBOC cut its 7-day repo rate and one-year medium-term loan rate to banks by 10bps, signalling that PBOC continues to be cautious but in contrast to the rest of the world, the direction of policy is clearly set on easing. Q4 GDP growth beat expectations, growing by 1.6%, to be 8.1% in 2021, well above the governments growth target rate. However, consumption has slowed, which is a major concern for China.

Locally Australia continued to publish above consensus data, compelling the RBA to significantly amend its forecasts for inflation, unemployment, and wage growth. Despite multiple lockdowns through the year, retail sales were 5.8% higher over 2021. Staff shortages has been a significant focus, with COVID isolation requirements compounding the issue. Job vacancies rose by 18% over November, and the unemployment rate dropped to 4.2%, the lowest since mid-2008. Inflation data was the key data release in January, with headline CPI 3.5% (YoY); with the trimmed mean at 2.6% (YoY). Core inflation is now above the mid-point of the RBA's inflation target, not something the RBA was expecting in its forecast profile this early nor of this magnitude. The AFR released a “poll” of bank economists on the day of that announcement which showed: Westpac (August); CBA (November); ANZ (early 2023); NAB (mid 2023); and HSBC (late 2023) as the forecast dates for the first move by the various banks.



Pressure has been put on the RBA to consider the Australian economy and RBA’s updated forecasts seeing trimmed mean inflation at 2.75% over 2022 and 2023, unemployment at 3.75% by end 2022-23, and Wage Price Index to be 2.75% this year and 3% over 2023. This is in line with RBA’s milestones to justify an increase in interest rates. However, the RBA Governor was quick to state that it is “too early to conclude that inflation is sustainably in the target range”, and whilst conceding that a rate rise “later” in 2022 was one plausible scenario, Governor Lowe made the point that they would remain “patient” as it is too early to conclude if the updated forecasts will be achieved.