FINANCIAL MARKET CONDITIONS
August 2022

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Local Government Finance Authority

The determination of central banks to curb inflation despite rising recession risks continued to be the focus throughout the month of August. Data persisted to show a slowing yet resilient global economy. Employment remains buoyant in most developing nations; however, the energy crisis continues to intensify with little sign of a ceasefire in Ukraine.

Global equities over August resumed their declines with the clear signs that substantial interest rate rises are required to tame inflation. Recession fears also started forming over equity markets, creating doubt over company earnings. The S&P 500 which rallied 17% between mid-June to mid-August had erased half of those gains by the end of August. Locally in Australia, equities closed almost unchanged over the month, outperforming other developed markets.

China's focus on its zero-COVID policy continues to put the brakes on any rebound in its economy, with China's central bank cutting key lending rates in an attempt to revive demand. Whilst Chinese exports increased more than expected, a sign of improving supply chain pressures, further activity readings in China have been weak. There is a property market slump with overleveraged developers, with reduced demand from investors the pay for properties that are not being delivered on time.

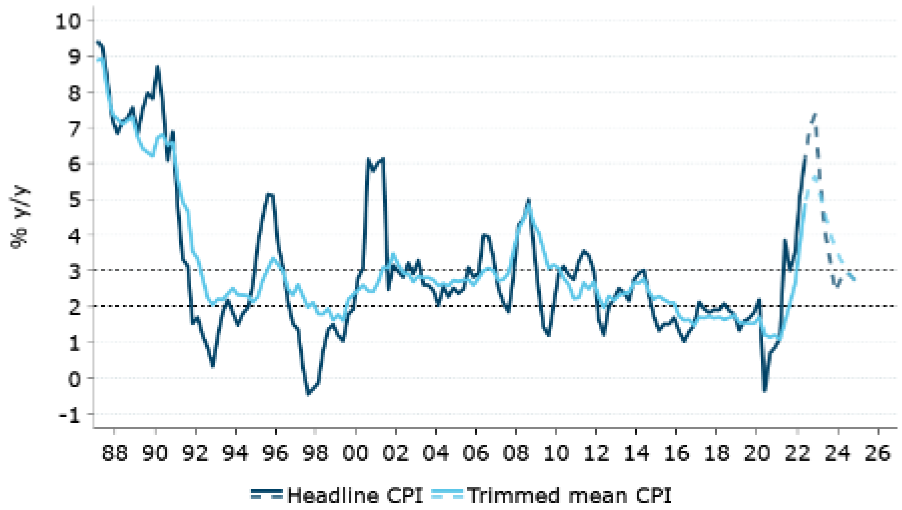
The US economic data continues to be mixed, suggesting that there are no signs of a cooling labour market, with a low unemployment rate and wages growing by 5.2%. Inflation data was lower than expected in August, decreasing from 9% to 8.5%, with much of the decline driven by lower energy prices. Manufacturing surveys have plunged to the lowest levels since the pandemic and housing starts also fell by 9.6% in July. US Federal Reserve Chair, Jerome Powell, spoke at the Jackson hole symposium, signaling the focus on inflation and potential impacts to growth. He stated that restoring price stability "will take some time" and "is likely to require a sustained period of below trend growth" and which "will also bring some pain to households and businesses". The Fed is expected to raise the reserve rate by 0.75% at its next meeting in late September from the current rate of 2.50%, with the market currently estimating a peak reserve rate at 3.60%.

The new Prime Minister, Liz Truss has started the job facing a looming recession, high inflation and energy prices, and unstable relations with the EU. With the focus on lowering the tax burden and the cost-of-living crisis, there is doubt on how this will be achieved with the current levels of UK debt, and potential pressure on unfunded fiscal expansion. The GBP touched a 2.5 year low, sliding 15% so far this year. UK inflation rose more than expected 10.1% over the year, with expectations of the Bank of England (BoE) will continue its path to raise rates to control inflation with the BoE Governor vowing that there would be "no ifs or buts" in the Bank's commitment to returning inflation to its 2% target. Another 0.50% rate hike is expected at the BoE's September meeting after rising by 0.50% in August to 1.75%, with markets expecting the UK's reserve rate to rise to a peak of 3.70%.

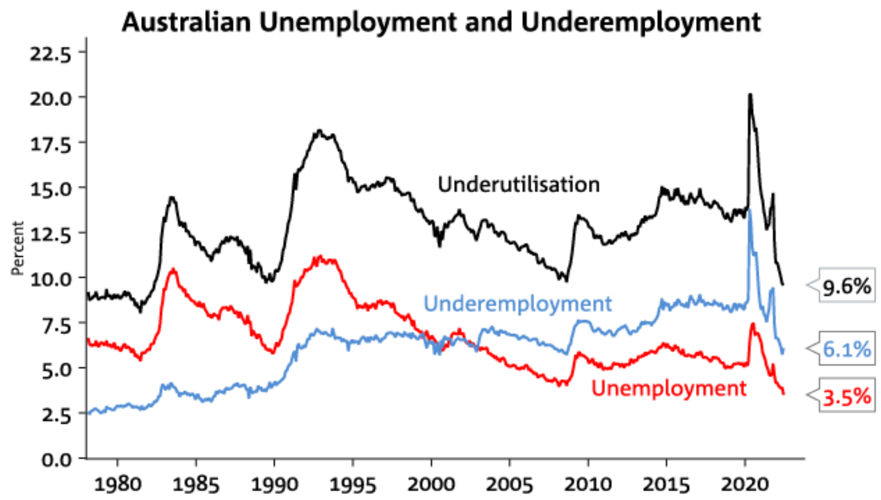
In Europe, inflation also printed higher than expected, with the headline annual rate at 9.1%. Continued pressure on energy prices are expected to push inflation to double digit levels in coming months. The European Central Bank (ECB) delivered its biggest interest rate increase in more than two decades in September, raising rates by 0.75% to 1.25%, whilst also signaling a clear intent to continue tightening to combat inflation.

Locally, The Reserve Bank of Australia (RBA) raised the official cash rate for the fourth consecutive 0.50% increase on the 6th of September to 2.35%. The cash rate is at its highest level since December 2014. At a recent forum, RBA Governor, Phillip Lowe, hinted that while further increases to the cash rate are likely the pace of rate hikes may slow from here. Data-wise, consumer confidence continues to fall, down 23% since November 2021. However, business confidence has surprisingly bounced back, potentially due to consumers feeling extreme pessimism about the economy, however economic activity holding up, likely supporting business confidence. Labour markets continued to be tight, with the unemployment rate in July falling to 3.4%, at 48-year lows. Retail sales have been resilient despite the housing market starting to feel the pinch. Housing finance approvals fell sharply, and Australian property prices fell for the fourth consecutive month, with August publishing the biggest monthly fall in almost 40 years. Despite this, Australian GDP had a solid June quarter posting a 0.9% increase. The data pre-dated the RBA rate hikes, illustrating that the Australian economy had plenty of momentum when the RBA embarked on its tightening cycle. Banks continue to anticipate further rate increases to reach a peak of 3.00-3.50%, and potentially rate cuts in late 2023/early 2024.

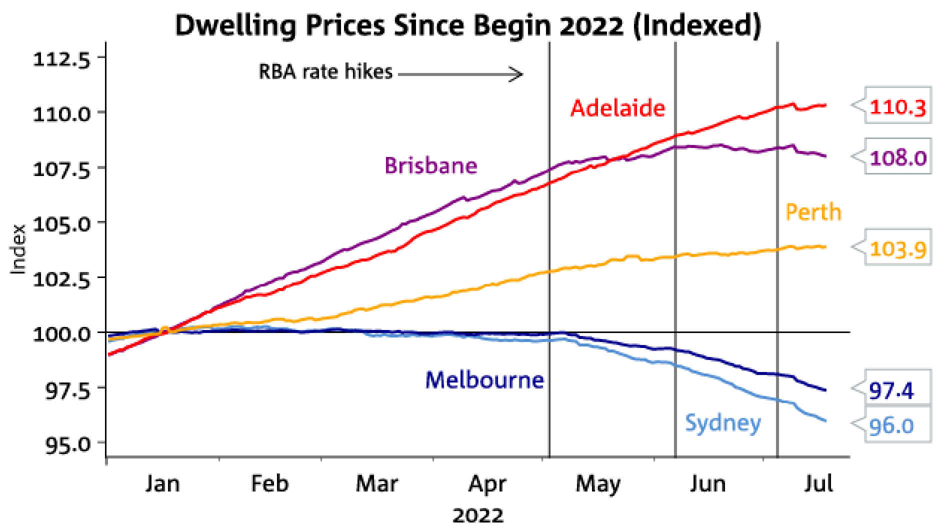
Figure 1. Inflation to peak later this year



Source: ABS, Macrobond, ANZ Research



Source: National Australia Bank, ABS



Source: National Australia Bank, Macrobond