FINANCIAL MARKET CONDITIONS
October 2022

Local Government Finance Authority

Central banks around the world continued monetary tightening throughout October. However, there has been a notable change in messaging with regards to the pace and scale of rate hikes ahead. Whilst inflation continues to run hot in all major advanced economies except Japan, many are seeing signs of slowing economic activity, and potentially, of aggressive monetary tightening. The International Monetary Fund cut its forecast for global economic growth in 2023 from 2.9% to 2.7%. It said the risk of policy miscalculation has increased and noted fragile growth and signs of stress in many financial markets.

After consecutive months of weak equity markets globally (US -21%, the Eurozone -18% and Australia -15%), global equity markets witnessed a bounced back in October highlighted by the US S&P 500 rising by 8% in October, delivering its best one-month performance since 1976. With markets starting to predict that there will be a slowdown in the scale and frequency of rate hikes and when coupled with a positive reporting period, investors increased their risk appetite over the month.

Despite the markets anticipation of China changing its COVID-zero policy, the Chinese National Congress meeting provided no indication that this was going to change. Regardless, China continues to emphasise their expectations of a growing economy, while remaining resolute in their belief in the success of COVID-zero, as well as their geopolitical views. As expected, China's growth remains sluggish with manufacturing data indicating weakness, with continued disruption as lockdowns continue to impact global supply chains. However, Chinese President Xi continues to promote that the economy will strengthen, and that economic development will be achieved.

In the US, the Federal Reserve delivered a fourth successive 0.75% rate hike in October, as widely expected. Whilst the FOMC statement hinted at possibly smaller rate hikes ahead, Chair Powell expressed that it would be premature to consider pausing rate hikes. Borrowing costs are now at a new high since 2008. In terms of US economic data, there were hints of weakness with retail sales over September flat, house prices recording its largest monthly fall since 2009, consumer confidence falling and manufacturing data weakening for a fourth consecutive month. However, employment data continued to be resilient. Whilst the unemployment rate increased slightly to 3.7%, wages are still seeing growth and participation remained high. Inflation eased slightly to 8.2%, and whilst may have peaked, remains elevated.

In the UK, after just seven weeks in office, Liz Truss resigned, making her the shortest serving Prime Minister in Britain's history. This comes after weeks of financial market turmoil following the announcement of Truss' economic plan, focused on unfunded fiscal stimulus in the form of generous tax cuts at a time of historically elevated inflation. The UK's new Prime Minister, former UK Chancellor Rishi Sunak wasted no time in reversing the ill-fated budget, scrapping tax cuts, as well as flagging possible savings measures in the upcoming budget. The Bank of England delivering another 0.75% rate hike in November to tackle their high inflation, and economic data is already illustrating weakness in confidence and in employment. Expectations are for the UK economy to face a deep recession through to 2024 as their economy continues to slow.

Similarly in Europe, economic data is witnessing signs of weakness amidst an environment of persistent inflation. Manufacturing indexes across Europe are experiencing a downturn, showing signs of stagflation. At the same time Eurozone inflation rose in October to 10.7%, a fresh record high. As expected, the ECB raised rates by 0.75%, the third increase in a row in October, however signaled a slowdown of hikes after substantial process had already been made in the withdrawal of monetary policy support.

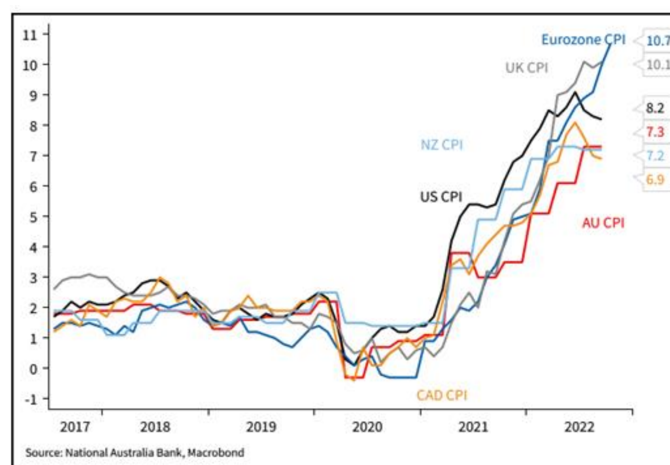
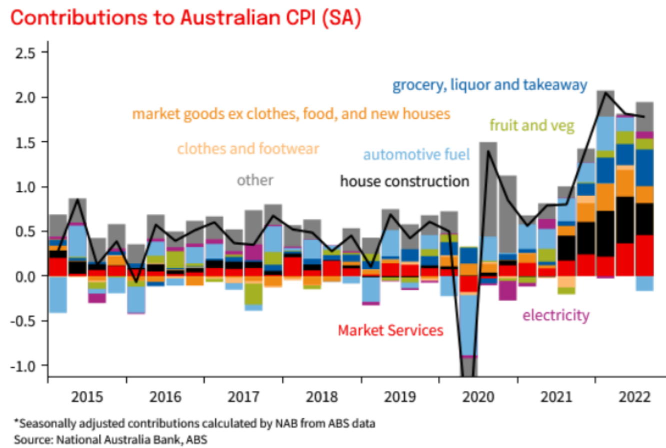
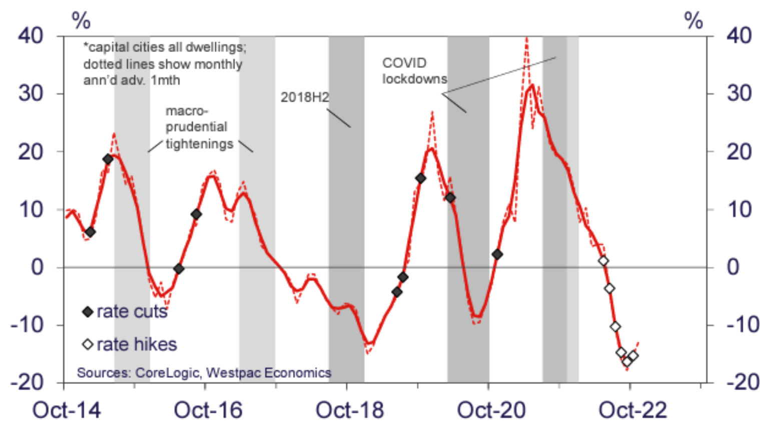


Chart 1: Headline inflation rose 1.8% q/q as market services, food, and utilities inflation offset some slowing in goods and housing construction



In Australia, the economy continues to show resilience, except for housing which has begun to see the impact of higher interest rates. Dwelling prices have fallen by 7% nationally, and housing finance approvals fell by 8% in September. Employment at 3.5% remains the lowest rate in nearly 50 years, and both retail sales and business credit continue to witness strength. Business credit is at its highest level since March 2008. Inflation surged higher than expected in the September quarter to 7.3%, the largest quarterly increase since 1990.

Australian dwelling prices: 3mth annualised



The RBA rose rates by 0.25% to 2.85% in November. This was the seventh consecutive hike in a row, and the highest it has been since May 2013. In the accompanying statement the RBA outlined that inflation remains 'too high' and that the 0.25% hike decision was done in the outlook of an uncertain environment, providing 'time to assess the effects of the increases to date and the evolving economic outlook'. The RBA expects that rates will increase further, and most major banks predict a peak in the cash rate of 3.60% by May 2023, significantly lower than the approximate 4% priced in by interest rate futures markets.