FINANCIAL MARKET CONDITIONS
December 2022

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Local Government
Finance Authority

The end of 2022 has been marked by historical shocks, with the continuing global pandemic, the war in Ukraine and soaring inflation. These shocks resulted in high levels of market volatility, causing sharp movements in equities and bond markets. The global pandemic-induced production constraints have fed inflation, not to mention soaring energy prices due to the war in Ukraine. Geopolitical tensions between nations have also been heightened. Economies have bounced back remarkably since the start of the global pandemic and growth has been resilient. Developed economies embarked on the steepest rate hike path since the 1980s, to lower inflation amidst tight labour markets and continued strength in their economies.

Whilst there has been a notable change in messaging in relation to the scale of rate hikes ahead, central banks in the worlds developed economies continued to reaffirm their goal of lowering price inflation, and that interest rates may remain high for some time. Financial data released over the month showed some evidence that the aggressive tightening strategies are taking effect. However, inflation remains resilient, highlighting the risk of stagflation being the combination of high inflation and economic recession.

Equity markets had the worst performing year since the 2008 global financial crisis (GFC). Global stocks have lost about a fifth of their value over the last year with stocks in the US finishing 2022 down by almost 20%. Despite the yearly losses, markets bounced back considerably in the last quarter of the year, with gains during October and November. However, equities saw losses of around 5% in December.

Global stock markets posted their biggest annual drop since the 2008 financial crisis in 2022

The MSCI, all-country world equity index, dollars

Guardian graphic. Source: Refinitiv. Note: The MSCI ACWI index, represents the performance of stocks across 23 developed and 24 emerging markets

Notable news in China is their decision to abandon their zero COVID strategy, with Chinese tourists no longer required to quarantine upon returning to their home country. It is a significant turning point for China. However, this decision comes at a time with hospitals in China overwhelmed with elderly and vulnerable patients testing positive, and continued low vaccination rates across the country, with only 50% of the population fully vaccinated. Economic data throughout the month continued its decline witnessed throughout 2022. Factory activity showed further contraction, signaling that it will likely fall short of the 5.5% GDP growth goal. The world bank estimates this will slow to 2.75% in 2022 before recovering to 4.3% in 2023.

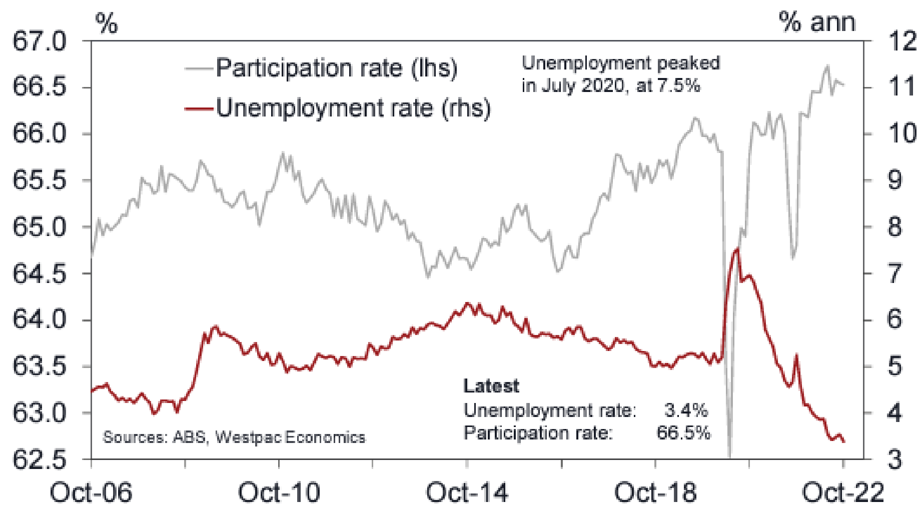
In the US, the Federal Reserve delivered a seventh successive rate hike in December, by a smaller 0.50%, as widely expected. The latest inflation data from the US shows the rate of inflation is slowing. Prices are still rising, just at a slower rate with CPI printing at 7.1%, the smallest increase since August 2021. This data endorses the Fed slowing the pace of rate hikes. Additional data indicates a broad slowing of activity throughout the month, with retail sales falling by 0.6% in November, manufacturing data fell for its sixth consecutive month and the housing market index falling to the lowest level since June 2012. However, employment continues to be resilient, with wages now rising persistently with low unemployment, giving the Fed a challenging task.

In the UK, the bounce in consumer confidence seen post the change in Prime Minister was short lived with both consumer and business confidence falling to the lowest reading since the height of the pandemic. Concerns of high inflation, lower disposable income and signs of a prolonged recession is having an impact. The BoE delivered another 0.50% rate hike in December, pushing costs to borrow to the highest level since 2008. The biggest challenge in the UK remains the tight labour market, wage growth and inflation.

Consumer sentiment improved slightly in December in Europe, however, remain close to all-time low levels reached in September. European economic data has continued to illustrate further weakness, with construction activity in Germany falling, and factory orders down by 9.8% over the year. Industrial production in Europe slowed by 2.0% in October, which was a greater decline than expected, and Eurozone manufacturing index shrank for the sixth straight month. Despite this, the ECB raised interest rates by 0.50% in December. This is a level not seen in fourteen years. The ECB maintained that rates are expected to rise further due to a substantial upward revision to the inflation outlook, despite the risks that the Eurozone is already in recession.

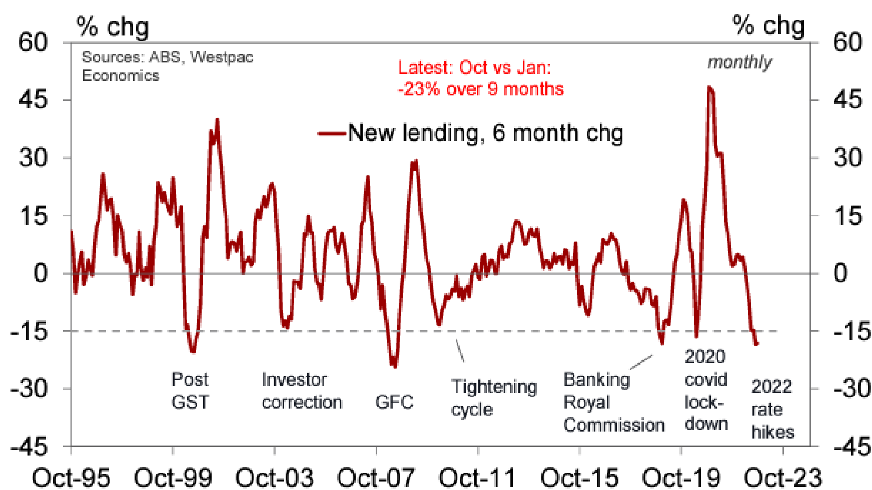
In Australia, the Reserve Bank increased the cash rate by a further 0.25% in December, in line with market expectations, making the 3.00% of tightening between May-December the fastest policy tightening in the inflation-targeting era of the RBA. Data-wise, employment, wages and consumer spending remain resilient. The Wage Price Index increased to be 3.1% higher over the year and the unemployment rate for November remains at 3.4% remaining at its lowest level in 48 years.

Unemployment at 3.4%, a 48 year low



The housing market and credit growth have slowed, with dwelling prices down -7.5% from their peak in April. New lending fell by 3%, making it the ninth consecutive monthly decline. Business confidence fell into negative territory, in line with recent consumer confidence data.

Housing finance: retreats as RBA hikes rates



Major banks expect that the RBA have a further 1-3 rate hikes to go, for a peak of 3.35-3.85%. The RBA remain committed to keep bring inflation to 2%-3% target, but recognise the lag effect of rate increases, which may mean there is the ability to pause and monitor economic data.