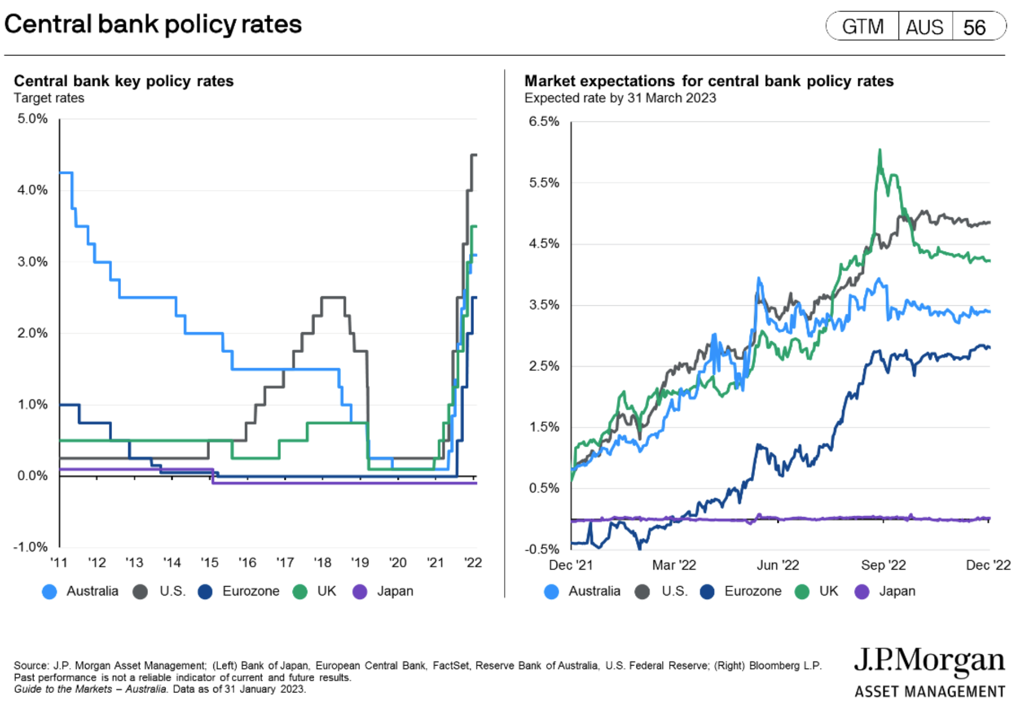
FINANCIAL MARKET CONDITIONS
January 2023

Local Government Finance Authority

The first month of 2023 ended positively as equity markets rose in both developing and emerging markets. In January, markets began the year with expectations of the potential end of rate hikes, cooling inflation and promising recovery into the new year with the assistance of the reopening of China. Falling energy prices in addition to the potential end of supply chain disruption improved the inflation outlook and set the tone for an optimistic start to the year for global financial markets.

Global equity markets closed weak in 2022 falling approximately 20% over the course of the year. Equity investors welcomed strong gains in January in both developing and emerging markets which witnessed gains of approximately 6% following views of stabilising economies, marking the best first month of the year ever. However, in early February it became clear that highly variable economic data releases were causing financial markets to second guess the inflation outlook and increased the probability of further interest rate hikes by central banks and illustrates that there remains significant uncertainty in the global economic backdrop for 2023.

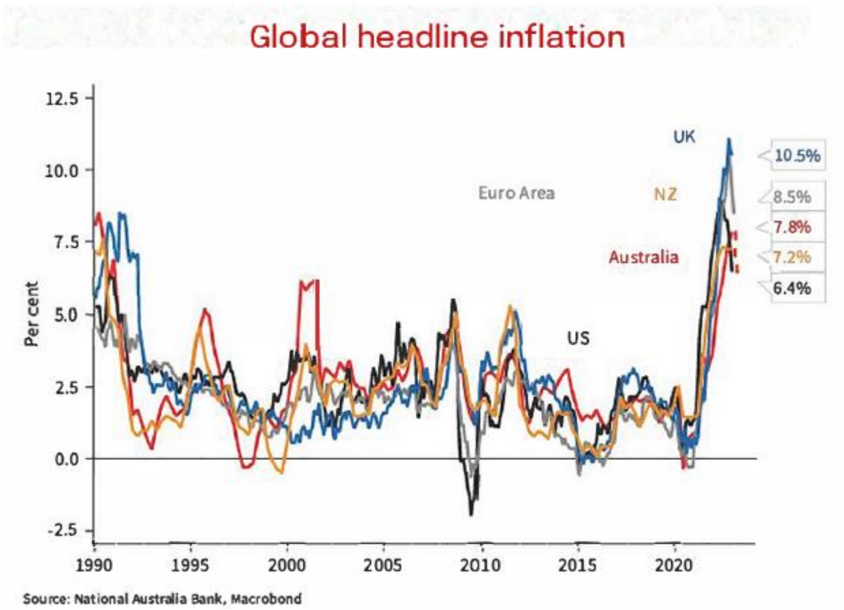


In China, the government released 10 new COVID guidelines, ending mass PCR testing, large scale lockdowns and quarantine requirements. Top government officials in January pledged to focus on boosting consumption at the Central Economic Working Conference in December 2022. The government has also reportedly set the 2023 gross domestic product (GDP) growth target at ‘about 5%’, significantly higher than the World Bank’s forecast. Obviously, there are risks to China’s economic recovery, including the consumer appetite and any forecasts are highly reliant on major western economies demand for Chinese goods.

The US Federal Reserve hiked rates by 0.25% at their February meeting, which was widely expected. In January, there were signs of an easing of inflation pressures with annual growth falling to 6.5%, the lowest data reading since October 2021. The data releases at the start of the month provided hope to markets that there could possibly be a soft landing. Wage growth data showed a slowdown in December, and weak retail sales data illustrated that interest rate hikes are taking effect. Even US Q4 GDP data of 2.9%, the growth had a softer tone to it, with barely any growth in the underlying demand of the economy. Consumer sentiment improved, rising to the highest level in nine months on the back of lower inflation expectations. However, as markets began to price in possible rate cuts by December, this quickly reversed with very strong US payrolls data for January. A drop in the unemployment rate to 3.4% and growth of 517k surprised markets. In addition, the manufacturing index for January bounced back, with the largest monthly advance since 2020.

In the UK, the BoE raised rates by a further 0.50% at their February meeting to 4.00%, with markets expecting they will be close to pausing over coming months. Whilst inflation is still high at 10.5%, there are expectations that with lower energy prices, this will lower inflation over coming months. The UK is still faced with weak economic data, at the same time as very strong employment and wage growth data, putting the BoE in a difficult position and the very real risk of a prolonged recession.

In Europe, data remains to be mixed across differing economies. Eurozone inflation fell by more than expected, to 8.5% from 9.2%, with sharp energy price falls driving the headline drop. Manufacturing data bounced back modestly over the month and consumer confidence rebounded and unemployment remained stable at 6.5%. The ECB raised rates by 0.50% in February, with the ECB pledging to ‘stay the course in raising rates significantly at a steady pace’, with most banks expecting a further 0.75% of hikes before pausing.



In Australia, consumer spending is showing signs of softening, as both higher interest rates and cost of living pressures affect many households. Retail trade fell by 3.9% in December, sharper than the 0.2% estimate. Housing data continues to weaken as expected, with new lending declining every month since February 2022, and is now almost 30% lower than levels a year ago.

The Reserve Bank increased the cash rate by a further 0.25% in February, the ninth consecutive increase. Whilst data released throughout January pointed towards a generally slowing of the economy, employment remains resilient at 3.5% and inflation continued to climb highlighted by the Q4 annual inflation rate which increased to 7.8%, its highest level since 1990. The key data release will be the wage price index in February to illustrate if there is further inflationary pressure on wages. The RBA continues to spread a hawkish message, expecting ‘further increases in interest rates will be needed in the months ahead’. Major banks expect that the RBA have a further 2 rate hikes to go, a peak of 3.85%, with potential rate cuts as early as Q1 2024.