FINANCIAL MARKET CONDITIONS
May 2023

Local Government
Finance Authority

Whilst concerns around the global banking system dissipated throughout the month of May, renewed concerns surrounding the United States (US) debt ceiling caused some volatility throughout the month. On the 11th hour, a deal was made to raise the US debt ceiling, and as a result US equity markets closed slightly higher at the end of the month. Renewed concerns regarding the soft economic recovery in China led weakness in equity markets in Asia to fall by 4-6% over the month. Economic data globally has been varied, and central banks continue to be committed to the cause to fight inflation, with many central banks continuing to deliver rate hikes, at times against expectations. The fine balance is to achieve a soft landing versus potential recessions. Data across the globe continues to be mixed, with a clear divergence between the service and manufacturing sectors, with services maintaining resilience despite higher interest rates.

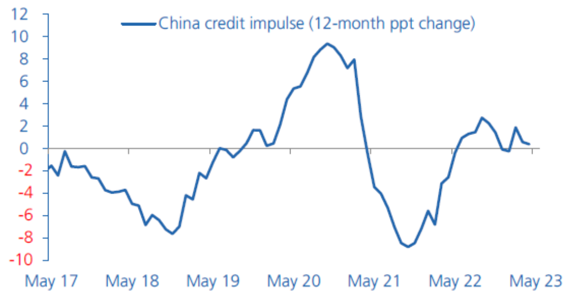
In the US, annual inflation fell to 4.9% in April, its lowest level in two years. While the trend is going in the right direction, core inflation is still too high for the US Federal Reserve (Fed) to be convinced that inflation is under control. At its 3 May 2023 meeting the Fed hiked the funds rate to 5.25% and is the highest level since August 2007. Many analysts are predicting that the end of the tightening cycle appears near; however, they played down the likelihood of looming cuts. US manufacturing data showed a contractionary reading; however, services data continues to be strong, pointing to the strongest expansion in the services sector since April 2022. US payroll data is still resilient, however the unemployment rate increased to 3.7% in May indicating the employment situation may be weakening.

Similarly in the Eurozone, inflation ticked down to 6.1% in May 2023, from 7.0% in the previous month and is at its lowest level since February 2022, though it remained significantly higher than the European Central Bank's target of 2.0%. Against this inflation backdrop, the ECB delivered an expected 0.25% hike, with messaging indicating that the transmission of past rate hikes into tighter monetary and financing conditions justifies the change to a slower pace of hikes.

In the United Kingdom (UK), labour market data showed some easing with an increase in unemployment, but a wages growth backdrop that is among the highest among advanced economies and just too high for comfort for the Bank of England (BoE). The BoE raised rates by 0.25% in May 2023, marking the twelfth consecutive rate increase, in line with market expectations. The BOE sees inflation falling to 5.1% in Q4 2023, compared to 3.9% in the February forecast and to meet the 2% target by late 2024.

After an initial strong bounce back in Chinese data following the post covid reopening, Chinese economic data is starting to show weakness. Industrial production contracted for the first time since November 2022, retail sales growth slowed and fixed asset investment contracted. China’s export growth slowed in April while imports slumped. The larger than expected decline in imports -7.9% are a concern to China’s demand recovery story. The forward-looking new export orders component of the manufacturing PMI suggests the slowdown in export growth will continue. China’s soft economic recovery has kept a lid on consumer inflation. At just 0.3% per year, China’s CPI inflation is now at risk of following in Japan’s footsteps by falling into deflation.

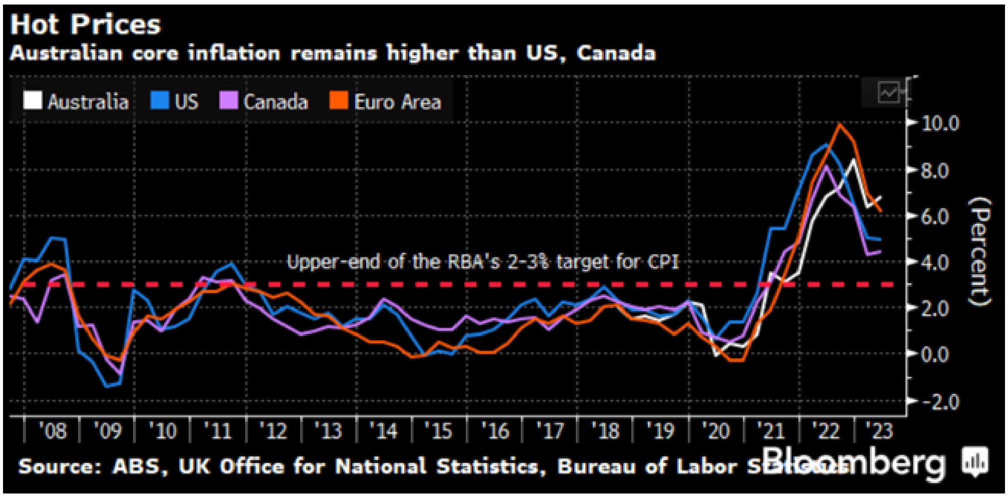
China’s reopening boom is starting to show some cracks



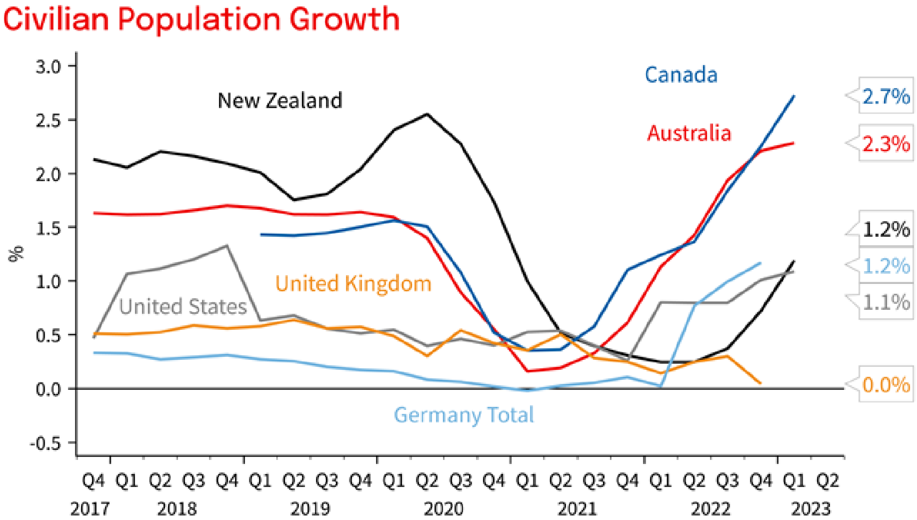
Source: Bloomberg

In Australia, the Reserve Bank of Australia (RBA) once again surprised markets by hiking rates in June by 0.25% after its surprise May hike. This was the 12th rate hike since May 2022, and the cash rate is now above 4% for the first time in more than 11 years.

Economic data in Australia throughout the month was mixed. Consumer confidence and business conditions continue to be weak, dwelling approvals have continued to fall to levels not seen since April 2012 and dwelling approvals for housing continued to fall. However persistent high inflation above its target range, potentially inflationary impacts due to increases to award pay rates, a tight labour market despite an increase in population due to high migration, and a turnaround in property prices are still concerns for the RBA. The RBA remains focused on the task to bring inflation back to its 2-3% target range, which might mean further increases ahead, at the potential risk of a hard landing. As a result, many banks are predicting potential rate cuts in 2024.



Increase in employment is being driven by the recovery in population growth being absorbed by a tight labour market



Source: National Australia Bank, Macrobond