Economic and market update

Bob Cunneen, Senior Economist
October 2022

Key events in October 2022

- High inflation, rising interest rates as well as the tragic Ukraine conflict continue to cast a shadow over global financial markets.
- Consumer annual inflation has surged to nearly 11% in Europe and remains above 8% in the US. Australia's annual inflation was 7.3% in the year to September 2022.
- Central banks continue to aggressively raise interest rates to reduce inflation. Both the European and the US central banks raised their policy interest rate by 0.75% in October and November respectively. The Reserve Bank of Australia (RBA) raised the interest rate by 0.25% in October as well as November.
- Global shares made a sharp recovery in October after the very weak performance for the September quarter. Hopes that central banks would moderate the pace of future interest rate increases proved to be the key positive driver for this share recovery.
- Australian shares also made a strong recovery with a 6% gain in October. The sharpest gains were in the Financial (12.2%) sector given solid credit demand and assurances from the RBA that business and household balance sheets were in "*strong shape*". The Real Estate Investment Trust (9.9%) and Consumer Discretionary (8.9%) sectors also made robust gains on the comforting commentary from the RBA. The Energy (9.5%) sector also made strong gains on continuing concerns about global supply. The Resources sector was more subdued with a mild 1.5% gain given worries about global economic activity prospects.

Asset class summary

Asset class returns in Australian dollars – periods to 31 October 2022

	CYTD %	1 month %	3 months %	1 year % pa	3 years % pa	5 years % pa	10 years % pa
Australian shares	-4.1	6.0	0.7	-2.0	4.8	7.2	8.7
Global shares (hedged)	-18.5	6.1	-6.3	-17.0	4.7	5.2	9.8
Global shares (unhedged)	-10.3	6.6	0.8	-6.0	7.5	9.1	13.3
Emerging markets (unhedged)	-19.8	-2.6	-6.3	-19.0	-2.0	0.5	5.8
Australian property securities	-21.3	9.9	-8.5	-13.9	-2.0	4.6	8.5
Global property securities (hedged)	-24.9	3.1	-14.3	-21.6	-6.3	0.1	5.1
Global listed infrastructure (hedged)	-7.1	3.2	-8.9	-3.3	0.9	4.0	8.7
Australian bonds	-9.2	0.9	-3.0	-7.2	-3.0	0.7	2.4
Global bonds (hedged)	-13.2	-0.4	-6.5	-12.9	-3.7	-0.3	2.3
Global high yield bonds (hedged)	-2.5	1.1	0.1	-2.1	1.7	2.3	0.0
Australian Inflation-linked bonds	-4.2	3.2	-1.3	-1.6	0.5	2.1	2.3
Cash	0.8	0.2	0.5	0.8	0.4	1.0	1.7
AUD/USD	-12.0	-0.5	-8.4	-14.9	-2.5	-3.6	-4.7

Past performance is not a reliable indicator of future performance.

Sources: Australian shares - S&P/ASX 200 Total Return Index; Global shares (hedged) - MSCI All Countries World (A$ hedged, Net); Global shares (unhedged) - MSCI All Countries World in A$ (Net); Emerging markets - MSCI Emerging Markets in A$ (Net); Australian property securities - S&P/ASX 300 A-REIT Accumulation Index; Global property securities - FTSE EPRA/NAREIT Developed (A$ hedged, Net); Global listed infrastructure - FTSE Global Core Infrastructure 50/50 (Hedged $A); Australian bonds - Bloomberg AusBond Composite 0+ Yr Index; Global bonds (A$ hedged) - Barclays Global Aggregate (A$ hedged, Gross); Global high yield bonds (A$ hedged) - Composite of BCGA US Corp HY BB/B (A$ hedged) & S&P LSTA BB/B Leveraged Loan Index; Australian inflation-linked bonds - Bloomberg AusBond Inflation Government 0+ Yr Index; Cash - Bloomberg AusBond Bank Bill Index; AUD/USD - WM/Reuters Daily (4 pm GMT).

Key events in global markets over the last three months to October

The troubling conflict in Ukraine, persistent inflation pressures and central banks aggressively raising interest rates remain the dominant issues for investors. Global shares (hedged) delivered a weak -6.3% return for the three months to October. The sharp fall in the Australian dollar absorbed the pain for global shares (unhedged) portfolios by allowing a mild 0.8% positive return.

Wall Street's benchmark S&P 500 Index delivered a very weak -6% return for the past three months. Inflation has been troubling to bond markets with government and corporate bond yields surging higher. Accordingly, investor sentiment has become very cautious in the face of these acute inflation and interest rate risks.

European shares have also disappointed in response to these inflation concerns as well as the Ukraine crisis. The EURO STOXX 50 Index delivered a weak -2.4% return for the past three months.

Asian share markets have also struggled. In local currency terms, China (-27.7%), Hong Kong (-24.3%) and Taiwan (-15.2%) have led the declines given concerns over global economic prospects.

Global bonds (hedged) remain weak with a -6.5% quarterly return. Government bond yields have climbed higher this year given inflation pressures and worries over aggressive interest rate rises by central banks.

Global high yield bonds (hedged) managed to stabilise with a sedate 0.1% return. Investors remain cautious given the climate of rising inflation and weaker share markets this year.

Key events in Australia over the last three months to October

Australian shares have also been shaken by global political and inflation concerns but managed a mild positive 0.7% return for the three months to October. The Energy sector continued its strong run with a 13.5% quarterly gain given the surge in coal and gas prices. The Financial sector delivered a favourable 4.2% quarterly gain as credit demand remained solid. However, there were disappointing returns from Utilities (-9%) and Real Estate Investment Trusts (-8.4%) given their sensitivity to rising interest rates.

Australia's economy appears solid in contrast to the global recession concerns. There have been encouraging results in business surveys and retail spending. Australia's unemployment rate fell to 3.5% in September. Yet the inflation acceleration is very concerning and has warranted the RBA raising interest rates from 0.1% in March to 2.85% in November. Australia's consumer inflation appears on track to meet the new inflation peak of 8% at the end of this year, as forecast by the RBA.

Global prospects

The troubling trio of rising inflation, higher interest rates and the war in Ukraine has provided a painful investing climate this year. Inflation is now at multi-decade highs around the world with consumers acutely pressured by the higher 'cost of living'. Central banks are rapidly raising interest rates to cool these inflation pressures.

Investors are worried about whether central banks can safely navigate the challenge of moderating inflation without severely damaging economic activity. As interest rates sharply rise and financial conditions for borrowers become tougher, investors become naturally concerned that a global recession could occur.

Investors confront a difficult task in assessing these considerable inflation and interest rate risks. Given the current investment climate is dynamic with multiple positive and negative scenarios possible, investors should maintain a disciplined and diversified strategy to manage these extraordinary risks.