

Economic and market update

Bob Cunneen, Senior Economist
May 2022

Key events in May 2022

- The Russia-Ukraine war continues with tragic consequences for the Ukrainian population.
- Energy and food prices are surging higher given concerns that commodity supplies from Russia and Ukraine will be limited until the conflict ends.
- This surge in commodity prices as well as production delays and high transport costs in supply chains remain the key drivers of global inflation pressures.
- Consumer annual inflation has surged above 8% in both Europe and the US.
- Central banks have begun raising interest rates to contain inflation. The US central bank raised interest rates by 0.5% in May while Australia's central bank raised the interest rate by 0.25%.
- Global shares stabilised in May with only a mild 0.2% fall in hedged terms. This comes after the sharp falls for global share prices recorded in prior months. Rising inflation, the prospect of central banks raising interest rates further as well as the Russia-Ukraine conflict remain the key risks.
- Australian shares disappointed with a 2.6% fall in May. There were notable sharp falls in the Real Estate Investment Trusts (-8.7%) and Information Technology (-8.7%) sectors in response to higher bond yields. Consumer Staples (-6.6%) and Consumer Discretionary (-5.2%) shares were also weak given concerns that rising inflation is squeezing household budgets.
- The election of the new Labor Federal Government on 21 May seems to have minimal immediate impact on Australian financial markets.

Asset class summary

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

	CYTD	1 month	3 months	1 year % pa	3 years % pa	5 years % pa	10 years % pa
Australian shares	-1.3%	-2.6%	3.2%	4.8%	7.8%	8.8%	10.4%
Global shares (hedged)	-11.9%	-0.2%	-5.0%	-4.4%	10.5%	8.5%	11.8%
Global shares (unhedged)	-11.7%	-0.8%	-4.8%	0.6%	10.4%	9.8%	13.6%
Emerging markets (unhedged)	-10.6%	-0.5%	-6.2%	-13.5%	3.8%	4.6%	7.4%
Australian property securities	-14.1%	-8.6%	-6.6%	4.6%	3.1%	6.3%	11.2%
Global property securities (hedged)	-11.7%	-4.6%	-4.1%	-1.2%	1.7%	3.7%	8.0%
Global listed infrastructure (hedged)	2.6%	1.8%	6.4%	10.7%	6.6%	6.8%	10.8%
Australian bonds	-8.1%	-0.9%	-6.0%	-8.5%	-1.8%	1.0%	2.7%
Global bonds (hedged)	-7.9%	-0.2%	-5.1%	-7.4%	-0.7%	1.1%	3.3%
Global high yield bonds (hedged)	-2.4%	-2.6%	-2.3%	-0.5%	1.9%	2.7%	0.0%
Australian Inflation-linked bonds	-5.0%	-0.5%	-4.4%	-4.2%	0.7%	1.8%	2.3%
Cash	0.0%	0.0%	0.0%	0.0%	0.4%	1.0%	1.8%
AUD/USD	-1.3%	0.9%	-1.1%	-7.3%	1.2%	-0.7%	-3.0%

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 May

Global shares (unhedged) delivered a disappointing return of -4.8% for the three months to May 2022. Investors were initially concerned about persistent inflation pressures, rising bond yields and the signal from the US central bank that higher interest rates were coming in 2022. Russia's invasion of Ukraine on 24 February then generated alarm in financial markets. The tragic loss of Ukrainian lives and the traumatic flight to safety westwards has cast a troubling shadow across Europe.

Wall Street made a sharp retreat from record highs set in early January. The S&P 500 Index posted a very weak -5.3% return for the past three months. Inflation concerns dominated with US consumer price annual inflation reaching 8.3% in April. US government bond yields rose sharply given these inflation risks, thereby denting investor's previous optimism. The US Federal Reserve (Fed) raised the US interest rates by 0.25% in March and then by a further 0.5% increase in May in response to high inflation.

European shares also fell sharply in response to inflation concerns as well as the Ukraine crisis. The MSCI Europe Index delivered a weak -5.2% return for the past three months.

Asian share markets also delivered very weak returns. The MSCI China Index slumped by 9.6% (in local currency terms) given concerns over China's economic slowdown and the continued financial weakness of property development companies such as Evergrande.

Global bonds (hedged) delivered a disappointing -5.1% return for the quarter. Government bond yields have climbed as persistent inflation pressures is seeing central banks signal higher cash interest rates are likely.

Global high yield bonds (hedged) also posted a weak -2.3% return. Investors have become cautious given rising inflation and weaker share markets.

Key events in Australia over the last three months to May

Australian shares have been remarkably resilient to these global political and inflation concerns. For the three months to May, Australian shares delivered a strong 3.2% return.

The Utilities (17.4%) and Energy (11.7%) sectors led the market with exceptionally strong gains given higher power and energy prices in response to the Ukrainian conflict. The Resources (5.9%) sector also made very strong gains with higher commodity prices. However, there were disappointing returns from the Information Technology (-7.3%) and Consumer Discretionary (-4.3%) sectors which struggled with rising bond yields and a more cautious assessment by investors.

Australia's economy appears to be progressively improving judging by solid results in business surveys, employment, and retail spending. Australia's unemployment rate fell to 3.9% in April, the lowest since 1974. However, the inflation acceleration is very concerning and has warranted the Reserve Bank of Australia (RBA) raising the interest rate by 0.25% to 0.35% in May.

Looking forward

Global economic activity was showing more promising signs entering 2022 given low interest rates and the virus threat moderating. However the troubling trio of rising inflation, higher interest rates and the war in Ukraine is now providing a more challenging investing climate. Investors face a difficult task in assessing these considerable inflation, interest rate and political risks this year.

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