INVESTMENT MARKET SNAPSHOT JULY 2022

By Mine Super Investments Team - 30 June 2022

Prices of global shares and bonds fell in June as rising inflation led to fears that interest rates would increase faster and further than previously forecast. Higher cash rate expectations are impacting Australian consumer confidence, adding to nervousness in the local housing market.

Share prices hit by inflation fears

Global shares resumed their downward trend over the first half of the month, having fallen over 20% since the January peak. Higher inflation suggested interest rates would rise more quickly and to higher levels than had been expected. Subsequent signs that the slowing global economy might require less monetary tightening to control inflation led to these losses easing later in the month. Shares closed June down 8.1% in the US and down 8.7% in Australia.

May consumer price inflation (CPI) increased by more than expected in most major economies, reaching 8.6% in the US, 8.1% in the Eurozone and 9.1% in the UK. Inflation is being driven by continued strong demand for goods as consumers spend less on services. This is compounded by higher energy and food prices - in part due to the war in Ukraine - and supply chain challenges in China due to ongoing COVID lockdowns.

US Federal Chair Jerome Powell stated that achieving a soft landing (i.e. avoiding a recession) would be "very challenging" and a recession is "certainly a possibility."

The deteriorating economic environment was reflected in falling May US retail sales and business conditions data. This led markets to reduce their expectations of year-end US interest rates to 3.4%. This is still way above the current level of 1.75%, following the 0.75% increase at the Fed's June meeting.

But bond yields may be moderating

Rising inflation and the expectation of more interest rate rises saw government bond yields rise (i.e. prices fell) steeply at the start of June. Yields fell back later in the month upon signs the global economy was slowing. 10-year government bond yields finished June up 0.16% at 3.02% in the US and up 0.26% to 3.63% in Australia.

Rising borrowing costs have led to the return of perceived sovereign credit risk as costs of borrowing widen for different Eurozone members. Italy now pays 2.00% and Greece 2.25% more than Germany to borrow 10-year funds.

In a rare glimpse of positive news, China's economy showed signs of improvement as COVID restrictions were lifted. This led to an increase in industrial production and a fall in unemployment, although retail sales and housing data remains weak.

But Australia still hopes to avoid recession

June quarter CPI is expected to have jumped from its 5.1% March level. May jobs data was strong, with unemployment remaining low at just 3.9%. The 5.2% increase in the minimum wage increases the risk of a wage price spiral if not offset by higher productivity.

Inflationary pressures led the Reserve Bank of Australia to increase the interest rate by 0.5% to 0.85% at its June meeting with that a further 0.5% rise likely in July.

Markets now expect interest rates to reach 3.2% by the end of 2022, before peaking around 4.0% next year. This is reflected in very weak consumer confidence data, although retail sales growth remained positive.

Australia's housing market continues to weaken, falling 0.6% nationally while Sydney house prices fell a further 1.6% in June. A 4.0% cash rate would increase the discount variable mortgage rate to around 7.5%, compared to just 3.5% in April. Lower borrowing capacity is expected to bring significant falls in home prices.

A slowing global economy is impacting commodity prices, with iron ore down US$15 to $122 per tonne. Coal prices are volatile but remain elevated on high demand for non-Russian energy supply sources, closing June down $40 at $384 per tonne.

The RBA does not expect a recession, which contrasts with other more pessimistic central banks.

Outlook

- Interest rates may rise over the next few quarters, bringing inflation back towards target ranges.
- Geo-political uncertainty is likely to keep share markets volatile.
- Bond yields have risen to more sustainable levels, offering the prospect of positive returns.
- Cash is expected to deliver modest medium-term returns given the inflation risk.
- Australia will gain some benefit from high energy and commodity prices, but house prices look increasingly vulnerable.

If you'd like more information about Mine Super's investment strategy, please get in touch on 13 64 63 or email help@mine.com.au

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