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Economic Snapshot

February 2022

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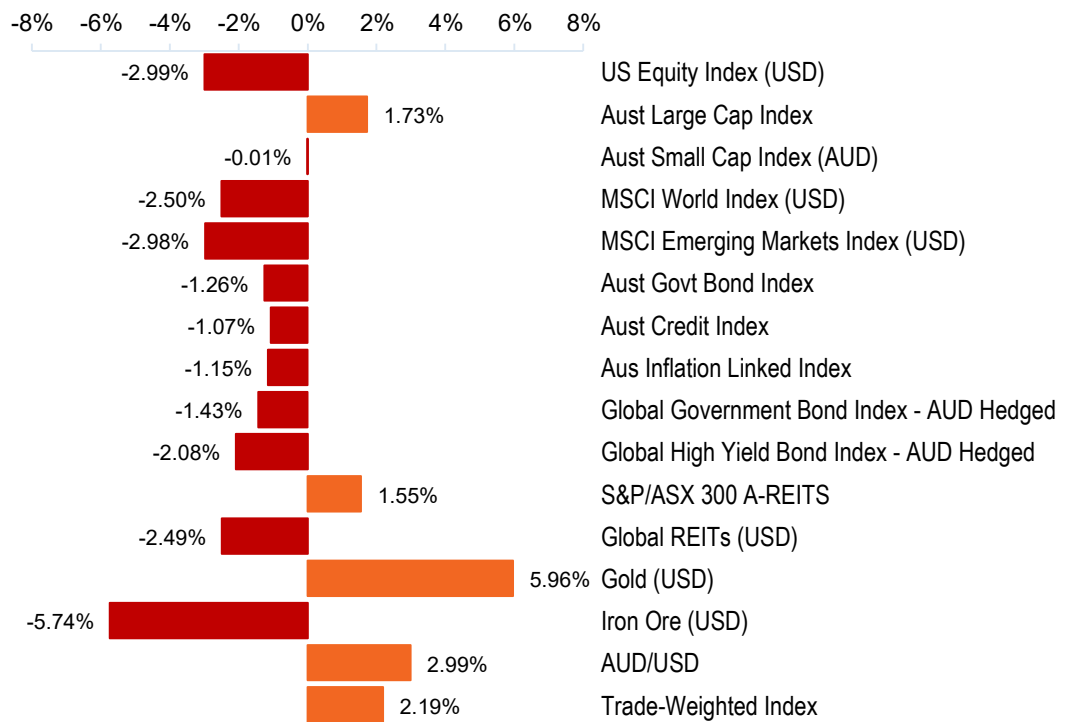
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In summary

- Russia's invasion of Ukraine adds another layer of uncertainty for global markets to digest. Gold and the oil price soar in response.
- US inflation rises to its highest level in 40 years leading to expectations that the Federal Reserve will need to urgently raise rates to bring inflation under control.
- Inflationary pressures are also steadily building in Australia, which could potentially force the Reserve Bank to capitulate and hike interest rates well ahead of expectations.
- Global equities sold off further in February, but Australian equities bucked the trend thanks to higher commodity prices and a solid profit reporting season.

Selected Market Returns, February 2022



Sources: Thomson Reuters, Bloomberg.



Key Economic Developments

Russia's deplorable invasion of the Ukraine in late February, sadly stole the headlines this month, fuelling a widespread pull back in global share markets. The fog of war contributed to an overriding sense of unease and uncertainty, exacerbating an already volatile macroeconomic backdrop still trying to come to grips with high inflation and the prospect that central banks will accelerate quantitative tightening.

Despite worldwide condemnation, heavy sanctions designed to cripple the Russian economy and a determined Ukrainian resistance, Russia continues to double down on its plans to take Ukraine by force with the prospect of a peaceful resolution looking increasingly distant with every passing day. Regrettably, as it stands, there is a high risk that the situation could get a lot worse before it gets better.

Markets have predictably responded to this latest shock in a volatile fashion out of fear of the unknown about how long the conflict will continue, the extent of the humanitarian crisis that is growing worse every day and, to a lesser extent, what if any adverse economic impacts may come to pass.

Falling global sentiment and confidence are obvious casualties of this war. However, the main threat to the global economy may come in the form of an energy crisis (and higher inflation) which would hit Europe especially hard given that Russia currently supplies approximately 30% of Europe's gas and oil.

If Russian energy exports continue to flow uninterrupted then further share market falls may be limited. However, if Russia cuts off supply of oil and gas to Europe and the conflict escalates, share markets could be in for a rough ride over the coming months.

So far, the US and Europe have sought to minimise this adverse scenario from developing by excluding the Russian energy sector from the raft of sanctions that have already been imposed. But even if there is no disruption to energy supply, energy prices are likely to be higher. The same goes for hard and soft commodity prices such as wheat where Russia and Ukraine are significant producers.

The war in Ukraine has also affected interest rate market expectations more generally. In recent months, most central banks have intimated that a stronger than expected economic recovery and headline inflation had effectively brought forward their timetables for rate hikes. The war in Ukraine, however, muddies the waters as policy makers are now faced with a situation of seemingly constant, unpredictable change.

Interestingly, the financial markets now expect the US Federal Reserve to reduce the number of rate hikes to five for this year (down from seven just a few weeks ago). With US inflation sitting at 7.5% (the highest reading in 40 years) and a very tight labour market, the Federal Reserve made it clear at last month's policy meeting that they expect it will be appropriate to raise the target range for the federal funds rate in March.

Closer to home, the Australian economy is in relatively good shape based on recent economic data. At the end of 2021, the Australian economy was officially 3.4% bigger than it was before the start of the COVID-19 pandemic in December 2019. Of note in the national accounts released during the month was the huge amount of money consumers spent on shopping and dining out. The unemployment rate is at a 14 year low of 4.2% and is expected to fall below 4% later this year. Underemployment is also around its lowest level since 2008. Headline inflation in Australia has picked up recently to 3.5% but is likely to rise further in response to the unfolding war in Ukraine and devastating floods across NSW and Queensland. If inflation becomes broader and persistent, it could force the Reserve Bank to lift rates much sooner than they had originally envisaged.

Unlike global equity markets, the Australian share market rose 2.1% in February, outperforming the MSCI World Index by 4.6%. Gold stocks were the best performers, supported by safe-haven demand during this volatile period of rising geopolitical risk. Energy was the second-best performer propped up by the significant rise in the oil price (up 8.6% in February). Technology stocks were the worst performers for the second month in a row as high inflation and the expectation of tighter monetary policy weighed heavily on the sector.



Major Market Indicators

| | 28-Feb-22 | 31-Jan-22 | 31-Dec-21 | Qtr change | 1 year change |
|--|-----------|-----------|-----------|------------|---------------|
| Interest Rates (at close of period) | | | | | |
| Aus 90 day Bank Bills | 0.07% | 0.07% | 0.06% | +3.0 | +6.0 |
| Aus 10yr Bond | 2.11% | 1.88% | 1.61% | +30.0 | +79.0 |
| US 90 day T Bill | 0.37% | 0.24% | 0.06% | +32.0 | +33.0 |
| US 10 yr Bond | 1.84% | 1.78% | 1.50% | +39.8 | +38.3 |
| Currency (against the AUD) | | | | | |
| US Dollar | 0.726 | 0.705 | 0.727 | 2.34% | -6.27% |
| British Pound | 0.538 | 0.523 | 0.538 | 0.35% | -4.05% |
| Euro | 0.644 | 0.628 | 0.641 | 1.91% | 0.05% |
| Japanese Yen | 83.55 | 81.38 | 83.63 | 3.53% | 1.88% |
| Trade-Weighted Index | 60.60 | 59.30 | 61.10 | 0.66% | -6.05% |
| Equity Markets | | | | | |
| Australian All Ordinaries | 1.7% | -6.6% | 2.7% | -2.4% | 10.0% |
| MSCI Australia Value (AUD) | 3.9% | -3.4% | 4.1% | 4.5% | 13.1% |
| MSCI Australia Growth (AUD) | 0.9% | -10.0% | 0.6% | -8.7% | 9.4% |
| S&P 500 (USD) | -3.0% | -5.2% | 4.5% | -3.9% | 16.4% |
| MSCI US Value (USD) | -1.8% | -2.4% | 6.9% | 2.3% | 17.8% |
| MSCI US Growth (USD) | -4.1% | -8.9% | 1.2% | -11.6% | 10.3% |
| MSCI World (USD) | -2.5% | -5.3% | 4.3% | -3.7% | 11.2% |
| Nikkei (YEN) | -1.7% | -6.2% | 3.6% | -4.5% | -6.9% |
| CSI 300 (CNY) | 0.4% | -7.6% | 2.2% | -5.2% | -12.6% |
| FTSE 100 (GBP) | 0.3% | 1.1% | 4.8% | 6.3% | 19.2% |
| DAX (EUR) | -6.5% | -2.6% | 5.2% | -4.2% | 4.9% |
| Euro 100 (EUR) | -3.7% | -3.1% | 4.8% | -2.2% | 15.5% |
| MSCI Emerging Markets (USD) | -3.0% | -1.9% | 1.9% | -3.0% | -10.4% |
| Commodities | | | | | |
| Iron Ore (USD) | -5.7% | 20.8% | 16.1% | 32.2% | -20.5% |
| Crude Oil WTI US\$/BBL | 8.6% | 17.2% | 13.6% | 44.6% | 50.7% |
| Gold Bullion \$/t oz | 6.0% | -1.4% | 2.4% | 6.9% | 10.2% |

Source: Quilla, Thomson Reuters Datastream

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