Growth is slowing will inflation follow?

GPS Wealth Monthly Market Update

Inflation around the world is running at levels not seen since the 1970s. With recorded rates of 5.1% in Australia, 8.5% in the US and 7% in the UK, interest rates will likely keep rising to keep inflation in check. Central Banks have miscalculated the pace of recovery and are scrambling to move cash rates to a more neutral setting. This misstep was compounded by the invasion of the Ukraine by Russia leading to a sharp rise in the oil and gas market and the lockdowns in China disrupting supply chains once again. The global inflationary pressures saw the RBA and US Federal Reserve increase interest rates and more are expected as detailed last month. In response both bond and most stock markets around the world sold off in April. This was most pronounced in the US, where the S&P 500, Nasdaq and Russell 2000 fell by -8.7%, -13.2% and -9.9% respectively. In Japan the Nikkei was down a more modest -3.5% whilst the Australian stock market as represented by the S&P/ASX 200 returned -0.9%. The MSCI Europe index only fell by -0.5% despite the ongoing conflict.

In the U.S., GDP contracted 1.4% annualised in the first quarter versus expectations of a 1% increase. The negative GDP number is caused by a drop in exports (weak foreign demand due to Covid restrictions) and a surge in imports that meant net trade subtracted a full 3.2% from headline GDP growth. Inventories run downs amid ongoing supply chain disruptions subtracted a further 0.8% while government spending fell in consecutive quarters and subtracted 0.5%. Looking to the second quarter, the growth number should be better despite fiscal and monetary policy becoming less supportive. While inflation is hurting spending power, nominal incomes are rising strongly and there are decent employment gains that in combination can keep spending firm. On top of that there is the legacy of higher savings accrued through the pandemic and large wealth gains caused by rising asset values that can additionally be used to keep consumer spending growing. Residential construction in the US continues to perform well with rising housing starts and building permits, while robust durable goods orders point to a positive corporate investment backdrop. We are also expecting to see less of a drag from net trade, although it still will be a drag given strong domestic demand relative to elsewhere, while companies will continue to seek to rebuild inventory levels.

More frequent data indeed shows that consumer spending, specifically in retail and nonfinancial service firms, accelerated and whilst manufacturing activity was strong overall, ongoing issues such as supply chain backlogs, labour market tightness and elevated input costs continued to be an impediment. These factors are holding up inflation although there were some reports of early signs that the pace of wage growth had begun to slow. In April, core consumer price inflation rose a stronger-than-expected

Emmanuel Calligeris
Chairman of the Investment Committee

0.6% over the month, re-affirming our expectation that underlying inflationary pressures have not eased meaningfully. This brought the year-on-year reading from 6.5% in March to 6.2%. Strength was notable across many subcomponents, with a 0.56% increase in primary rents and a 0.46% increase in owners' equivalent rent. Airfares rose a substantial 18.6% over the month. Used car prices did decline modestly again in April by 0.4%, although new car prices rose 1.1%. Furniture prices rose 0.5%, the softest increase since July 2021. Headline consumer prices rose 0.3% in April as food prices rose 0.9% but energy prices declined 2.7%, partly due to seasonal adjustment factors. This brought the year-on-year reading to 8.3% from 8.5%. The Federal Reserve reiterated its determination to bring inflation under control, but eased concerns that this would be done with a couple of 0.75% increases.

In Australia, headline inflation was stronger than expected with price pressures clearly broadening as the share of items in the CPI basket recording above 3% inflation rising over 50% for the first time since 2009. National house price growth remained positive in March (Corelogic +0.3%) however house prices are widely expected to have peaked with higher rates and increasingly stretched affordability metrics weighing on housing demand. The latest NAB business survey reported further improvement in business conditions due to strengthened trading conditions and profitability. Business confidence rose, continuing the steady rise since the Omicron outbreak. However consumers are not so confident. The Westpac Melbourne Institute Index of Consumer Sentiment fell by 5.6% in May from 95.8 in April to 90.4. The Index is now at its lowest level since August 2020 when households were unnerved by the 'second wave' lockdown in Victoria. The Reserve Bank has begun its tightening cycle and Board is likely to follow up the move in May with a further move in June. The specific task of reducing demand-related inflation pressures and containing inflationary expectations is now at hand and the disturbing signal from the May sentiment report should not dissuade the Board from that objective.

The lockdown in Shanghai has lasted more than a month and will continue throughout May. Beijing is now starting mass Covid-19 testing and is therefore in partial lockdown. Beijing could experience similar issues if large numbers of Covid cases are found. The government, including the People's Bank of China, (PBoC) has said it will execute policy actions to support economic growth. The main thing we have seen so far is that the PBoC has cut the Reserve Requirement Ratio on foreign currency deposits to release dollars for financial institutions to buy yuan in financial markets. This has prevented a further depreciation of the USD/CNY and USD/CNH beyond 6.60. The PBoC has also said that it will speed up regulation on the platform economy (i.e. companies including Alibaba and Tencent) that have provided fintech services to society. This also helped lift the Chinese equity market, but only for a short while. The government also pledged to push forward the construction of infrastructure projects. If this is put into action, it means an increase in bond issuance by local governments to fund those projects as well as to kick off construction. Airport infrastructure is already under construction, and some highways, too. Despite these policies and pledges, growth will likely slow from 4.8% to 3.6% by the end of 2022.

Eurozone GDP grew by 0.2% quarter-on-quarter. However, demand is clearly weakening. On the back of the war in Ukraine and dwindling purchasing power, consumer confidence crashed in March and remained around the same low level in April. The component regarding major consumption purchases fell back in April to the lowest level since the lockdowns in 2020. Business confidence held up better, but also seems to have peaked. With the Omicron lockdowns in China intensifying in April, supply-side issues are likely to hamper eurozone industrial production in the coming months.

The continued tightening by global central banks and the possibility of recession is likely to continue to remain the focus for markets in the weeks and months ahead. The Russian / Ukraine situation continues to add another layer of volatility for financial markets as fuel prices have reached consumption sapping levels and will likely keep inflation elevated. Despite peaking, inflation is likely to plateau as opposed fall quickly.

Both domestically and globally, bonds are less expensive given the recent selloff however it does feel a little early to be increasing portfolio exposure even if inflation returns to 2.25%-2.5% the risk is on the upper side. Growth is slowing however inflation will likely slow with a longer lag than we have witnessed since the global financial crisis.

Returns

30th April 2022

ASSET CLASS RETURNS ARE BASED ON

Australian Cash
RBA Bank accepted Bills 90 Days

Australian Bonds
Bloomberg AusBond Composite 0+ Yr TR AUD

International Bonds Hedged
BarCap Global Aggregate TR Hdg AUD

Australian Listed Property
S&P/ASX 200 A-REIT TR

International Property Hedged
FTSE EPRA/NAREIT Dv REITS TR Hdg AUD

Australian Shares
S&P/ASX 200 TR

International Shares
MSCI World Ex Australia NR AUD

Emerging Market Shares
MSCI EM GR AUD

RETURNS TO THE 30TH APRIL 2022

	1 Month	3 Months	1 Year	3 Years	5 Years
Australian Cash	0.03	0.05	0.08	0.35	0.95
Australian Bonds	-1.49	-6.33	-7.47	-0.91	1.40
International Bonds Hedged	-2.88	-6.18	-7.00	-0.14	1.24
Australian Listed Property	0.57	3.27	15.06	6.27	7.37
International Property Hedged	-3.92	-1.11	7.78	5.00	6.03
Australian Shares	-0.85	8.24	10.16	9.42	8.81
International Shares	-3.17	-9.33	4.73	10.07	11.37
Emerging Market Shares	-0.21	-11.22	-11.23	1.92	5.39

GPS WEALTH

GPS Wealth Ltd | AFSL 254 544

Level 7, 115 Pitt Street, Sydney NSW 2000

+61 2 8074 8599

info@gpswealth.com.au

www.gpswealth.com.au

Prepared by DWA Managed Accounts Pty Ltd

ABN 89 104 065 250 | AFSL 264 125

The information contained in this report has been provided as general advice only. The contents have been prepared without taking account of your personal objectives, financial situation or needs. You should, before you make any decision regarding any information, strategies or products mentioned in this report, consult your own financial advisor to consider whether that is appropriate having regard to your own objectives, financial situation and needs. Investment markets past performance are not necessarily indicative of future performance. Whilst DWA Managed Accounts Pty Ltd is of the view the contents of this report are based on information which is believed to be reliable, its accuracy and completeness are not guaranteed and no warranty of accuracy or reliability is given or implied and no responsibility for any loss or damage arising in any way for any representation, act or omission is accepted by DWA Managed Accounts Pty Ltd and its affiliated entities or any officer, agent or employee of DWA Managed Accounts Pty Ltd and its affiliated entities.