June 2022 | Market update

A difficult patch for the global economy

Financial markets were unsettled in May as the effects of the war in Ukraine along with concerns over inflation and growth dominated investor sentiment.

The International Monetary Fund (IMF) cautioned global finance leaders to expect multiple inflationary shocks in 2022 as markets continued to be unsettled in May amid fears of an economic downturn and potential recessions. There was a continuation of energy and food supply issues caused in part by the war in Ukraine and supply chain disruption in China, which is still mired in zero-Covid policies.

Recession fears also affected financial markets, with rising inflation and supply chain problems driving up the cost of living and putting pressure on company profits. There are concerns that economic growth could slow as central bankers look to raise interest rates to stem the surge in inflation.

Inflation and recession worry markets

In the US, the S&P 500 fell sharply early in the month, and at one point was down by as much as 4%, which marked its largest fall since June 2020. The NASDAQ also fell and the sense of nervousness on Wall Street affected markets in Europe and Asia too. Household names in the tech sector suffered losses during May, with drops not seen since 2008 for some of the largest companies.

Along with inflationary worries and disappointing earnings reports from retailers in the US, investors were also concerned about signs of a Chinese slowdown and Russian gas flows to Europe. However, the S&P and other leading stock market indices recovered some of their losses towards the end of the month.

Fed increases interest rate

The US Federal Reserve (Fed) raised its benchmark interest rate by 0.5% for the first time since 2000 and revealed plans to shrink its $9 trillion balance sheet in an effort to tackle high inflation. Policymakers also hinted that they may implement further multiple 0.5% rate rises this year.

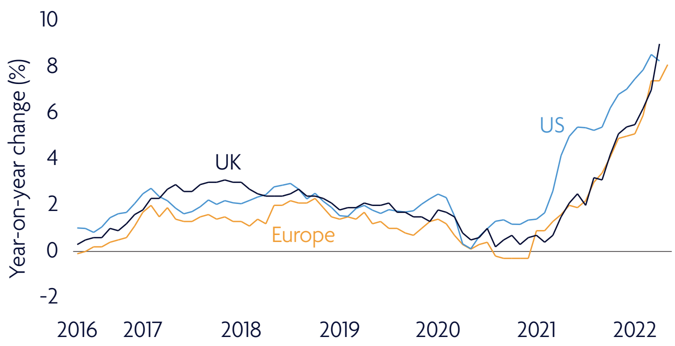
The energy price rise pushed up the UK's inflation rate to a 40-year high of 9%, fuelling concerns about a cost-of-living crisis. The Bank of England – which again raised interest rates in May by 0.25% to 1% – said it expects inflation to hit 10% before the end of the year.

The Bank also warned that the economy could slide into a recession as higher energy prices continue to squeeze household finances. There was some brighter news, however, as the UK's unemployment rate fell to its lowest level in nearly half a century in the first three months of 2022.

Inflation in Germany is at a record high too, pushed up by food and energy prices and the effects of the war in Ukraine. The European Central Bank (ECB) suggested it would raise interest rates in July, and that it expects to abandon negative interest rates by the end of September. Any rise in rates would be the first from the ECB in more than a decade.

In an effort to inject stimulus into its property market, China cut its benchmark mortgage lending rate in May. The country's property sector has seen a decline in the last year, amplified by its lockdown measures to curb coronavirus outbreaks.

Figure 1: Inflation has been rising over the last year, but there are early signs that it may be peaking



Source: Bloomberg. Note: European inflation as measured by the Eurozone harmonised index of consumer prices (HICP), UK and US inflation measured by CPI.

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