Economic Insights

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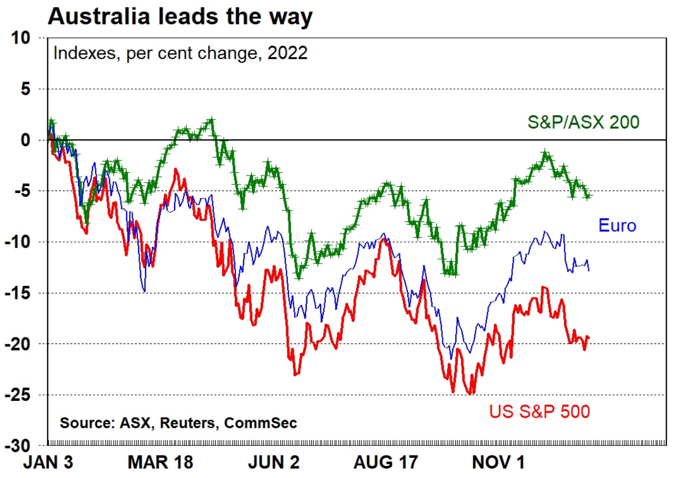
Tough 2022: And it's not going to get much easier

A tough year for investors

There's no doubt that Aussie sharemarket investors had a tough year in 2022. But the good news is that Australian share indexes held up better than most other advanced markets due to an out-performing economy.

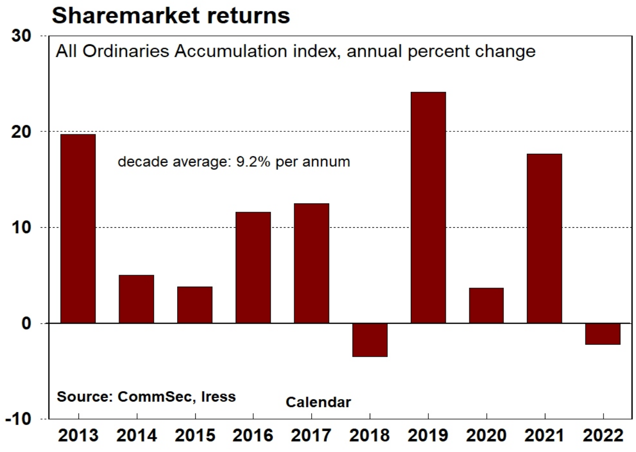
And while the coming year certainly won't be without its challenges, CommSec analysts tip modest gains for the benchmark S&P/ASX 200 index of 4-7 per cent to near 7,350-7,550 points.



But returning to 2022 – there was no shortage of challenges. Inflation spiked higher on Covid-induced supply-chain issues and firm demand in major economies. War in the Ukraine served to push up a raft of commodity prices, especially energy and agriculture. And in response to rising prices, central banks across the globe scrambled to lift interest rates from emergency lows to levels that are generally seen as more appropriate for the times.

But the aggressive interest rate hikes – the size and speed of the moves – also raised recession concerns. These concerns dominated investor attention across the globe over the latter half of the year.

So to wrap up 2022, in Australia the S&P/ASX 200 fell by 5.5 per cent over 2022, the biggest drop in four years. But Aussie investors can take some solace from the fact that it could have been worse. At a number of points over 2022 the ASX 200 was down by double-digits – for instance in June the ASX 200 was almost 14 per cent lower than the start of the year.



Taking into account dividends, total returns for the ASX 200 accumulation index fell by near 1 per cent over 2022.

But as noted, many major sharemarkets elsewhere in the world fared worse than Australia in 2022. In the US, key share indexes recorded their biggest declines since 2008. The technology-heavy Nasdaq fell by near 33 per cent with the broader S&P 500 index down 19 per cent and the Dow Jones index down 9 per cent.

European bourses fell by around 13 per cent in 2022. And the

Japanese sharemarket fell by 9 per cent. But there was a bright spot for global investors – an out-performer in the form of the UK sharemarket – posting a gain of 1 per cent on the back of higher prices for large mining and energy companies.

Energy and utilities shine

There weren't too many bright spots on the Australian sharemarket over the year. In fact just three sectors posted gains over calendar 2022.

In response to high oil, coal and gas prices, the Energy sector lifted by 40 per cent, followed by 24 per cent lift in Utilities and 5 per cent increase in the Materials sector.

The US Nymex crude price started the year around US$75 a barrel, spiked to record highs of US$128 a barrel in early March and ended 2022 around US$80 a barrel, up 7 per cent on the year.

A litany of factors supported oil prices in 2022: discipline by the OPEC+ oil producers group in restricting supply; supply disruptions; and the Ukraine-Russia war.

The main factor weighing on prices was the fear of recession – the assumption being that weaker demand would offset any attempts by OPEC+ in further restricting global supply.

Sector Performance

Percent change 2022 calendar year

Energy	40%
Utilities	24%
Materials	5%
S&P/ASX20	-2%
Financials ex Prop Trusts	-3%
Financials	-3%
S&P/ASX50	-3%
S&P/ASX100	-4%
S&P/ASX200	-5%
Industrials	-6%
All Ordinaries	-7%
Consumer Staples	-7%
Health Care	-8%
MidCap50	-9%
Telecom	-13%
Small Ordinaries	-21%
Consumer Discretionary	-23%
Property	-24%
Info Technology	-34%

Source: Iress, CommSec.

IT, Real estate sectors lead falls with small companies

The so-called 'growth' sectors led the declines over 2022. These are stocks and sectors that rely on buoyant economic conditions and low interest rates to lift revenues and profits and expand operations.

The small Information Technology sector fell by 34 per cent in 2022, followed by Property Trusts (down 24 per cent) and Consumer Discretionary, such as non-food retailers, (down 23 per cent).

The Financials sector eased almost 3 per cent in 2022. While higher interest rates crimp lending, there is potential for financial companies to expand net interest margins in a rising interest rate environment.

Amongst the company size indexes, the Small Ordinaries recorded the biggest fall in around a decade in 2022, down 21 per cent. Smaller companies are more reliant on lower interest rates to drive buoyant economic conditions such as higher revenues and profits. And that was the polar opposite of what central bankers served up in 2022.

By contrast, the ASX/S&P 20 index – effectively the 20 biggest companies – fell by 2 per cent in 2022.

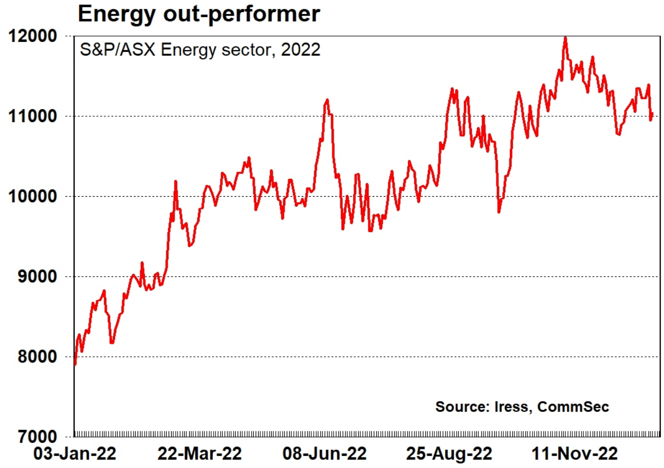
State of Play: The Aussie economy

The Aussie economy out-performed in 2022. The year ended with trade accounts solidly in surplus; the federal budget broadly balanced; and the jobless rate at 50-year lows. And while the inflation rate lifted over the year along with wages, other countries have seen far higher spikes in prices.

From a Covid-influenced low base, the economy grew by 5.9 per cent over the year to September, but it is likely to slow over 2023 in response to higher interest rates.

Starting in May, the Reserve Bank lifted the cash rate from 0.1 per cent to 3.1 per cent – the most aggressive monetary tightening ever imposed. The Consumer Price Index lifted 7.3 per cent over the year to September 2022.

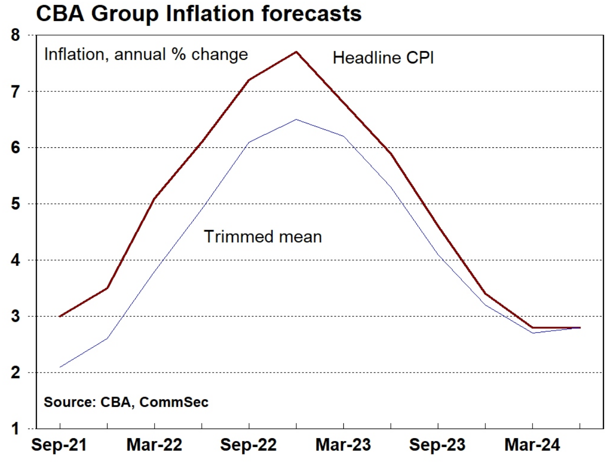
Energy out-performer



Inflation: Still public enemy No.1

The past three years have proven challenging for Aussie investors and no letup in the tough conditions is expected. Inflation still hogs centre stage as we enter 2023, together with uncertainty about where interest rates will settle. Job markets remain tight, high energy prices persist, the war in Ukraine still rages and the re-opening of the Chinese economy poses risks and opportunities.

The good news as we enter the New Year is that central banks are having success in reducing inflation rates. Broadly, if inflation retreats, the frequency of rate hikes will slow (or come to a stop), investors will become more confident and central bankers can aim for higher sustainable rates of economic growth.



Commonwealth Bank group economists expect that inflation peaked in Australia in the December quarter just past. But one further interest rate hike of 25 basis points is expected in February (lifting the cash rate to 3.35 per cent). However CBA group economists believe that rate cuts could start late in 2023 (December quarter) in response to slower consumer spending, recession concerns and modestly higher unemployment.

While Aussie shoppers have continued to spend freely in recent months, a slowdown lies ahead. Consumer spending will slow in response to higher interest rates, maturing of fixed home loans and weaker home prices. It is estimated that 23 per cent of the $500 billion of fixed rate loans will mature in the next year. And that should lead to a marked re-assessment in spending plans for those refinancing at higher interest rates.

So consumer-focussed stocks and sectors will face some challenges in the first half of 2023, but interest may lift later in the year as the prospect of rate cuts emerges.

The Financials sector may also pivot during 2023. Higher interest rates early in the year are likely to support interest rate margins but may dampen demand for loans. Once rate cuts emerge as a possibility, these factors may have opposing effects. So investors will need to be alert.

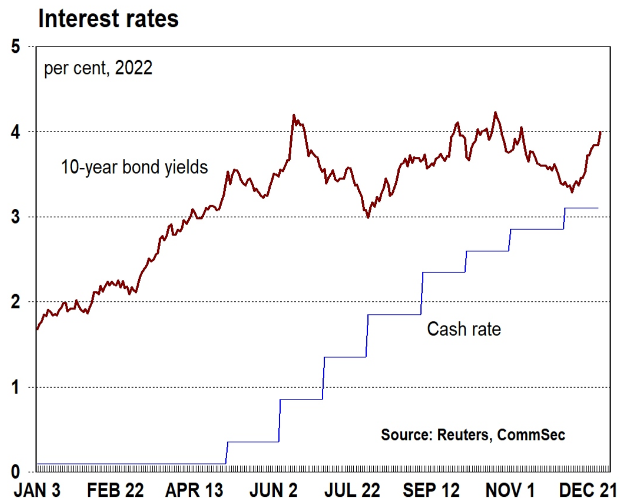
An easing in inflation and lower interest rates later in 2023 could also lead to a rally in government bonds and house prices. As a result real estate investment trusts (REITs) could see investor interest. House prices and interest rates generally move in opposing directions.

An economic slowdown – not shutdown

While mild recessions are expected in a raft of industrialised economies in 2023 (UK, US, European Union and Japan), the Aussie economy is tipped to slow, not stall. Of course, much depends on the deft touch applied by the Reserve Bank on interest rate settings.

Commonwealth Bank Group economists expect Australian economic growth to slow from 3.5 per cent in 2022 to 1.1 per cent in 2023 (remembering that so-called 'normal' growth is 2.25 per cent).

So while the economic environment in 2023 may not be the most conducive for 'growth-focussed' sectors, forward-looking investors may be more positive on prospects in 2024 – especially if rates are cut as expected late this year. Consumer Discretionary, Information Technology, Property and smaller companies should be watched.



China, Ukraine

One piece of encouragement in recent weeks is that Chinese authorities are easing Covid-driven restrictions, especially on travel. The re-opening of the Chinese economy and signs of détente between China and Australia has potential to boost economic activity and thus operating conditions for 'growth-reliant' companies and sectors.

More broadly, a stronger Chinese economy would improve the prospects for a soft landing of the Australian economy.

The international environment however could throw up some more challenges for the out-performing Energy and Materials sectors. As noted, CBA global strategists currently tip recessions in the US, UK, Europe and Japan in 2023. The softening global conditions could drive the Aussie dollar down to US59 cents in the early part of the year.

But again, developments in China will need to be watched carefully. As will the progress that is achieved in driving inflation rates to levels viewed as more sustainable around 2 per cent.

War in the Ukraine is a major unknown. The Russian President says that he wants peace. If that was to be secured it could have a raft of potentially offsetting effects, especially on energy prices.

An end to the war could boost economic activity and thus energy demand. But the freeing up of energy supplies could serve to constrain oil prices. A difficult one to predict but one to keep on the radar screen.

Winners and Losers 2022
(Current members of ASX200 index)

Biggest % rises	
Whitehaven Coal (WHC)	261%
New Hope Corporation (NHC)	185%
Coronado Global Resources (CRN)	94%
Core Lithium (CXO)	74%
Woodside Energy (WDS)	62%
Origin Energy (ORG)	47%
Sayona Mining (SYA)	46%
Worley (WOR)	41%
Monadelphous Group (MND)	38%
Mineral Resources (MIN)	38%
Biggest % falls	
Novonix (NVX)	-84%
Megaport (MP1)	-66%
Imugene (IMU)	-64%
Magellan Financial Group (MFG)	-58%
Reliance Worldwide (RWC)	-53%
James Hardie Industries (JHX)	-52%
The Star Entertainment Group (SGR)	-52%
Domain (DHG)	-52%
Centuria Capital (CNI)	-51%
ARB Corporation (ARB)	-51%

Source: Iress, CommSec. TLC & SQ2 only listed in 2022

Where to for Aussie shares?

In 2023, CommSec analysts tip modest gains for the benchmark S&P/ASX200 index of 4-7 per cent to near 7,350-7,550 points. There is upside potential to the forecasts should Chinese authorities be successful in re-opening their economy. And an end to the war in Ukraine should boost investor sentiment across the globe.

But deeper recessions in major economies from persistently-high inflation and interest rates could lead to downward revisions on Aussie sharemarket forecasts.

One factor holding in favour of Aussie shares is attractive valuations. The ratio of share prices to historic earnings stands at 10.58 according to Iress – the lowest PE ratio since 2009. Dividends also remain attractive with the dividend yield sitting near 4.23 per cent.

Craig James, Chief Economist @CommSec

Key Indicators

	31 Dec 21	30 Dec 22	% change
Aussie Shares			
ASX 200	7444.6	7038.7	-5.5
All Ordinaries	7779.2	7221.7	-7.2
Returns on Aussie shares	87626.1	85033.5	-3.0
Global Shares			
US Dow Jones	36338.3	33147.3	-8.8
US S&P 500	4766.2	3839.5	-19.4
World index (MSCI)	3231.7	2612.0	-19.2
Currencies			
$US per $A, cents	72.56	67.75	-6.6
Interest Rates			
Cash rate, %	0.10	3.10	
90 day bank bills, %	0.07	3.26	
3-year bond yields, %	0.92	3.51	
10-year bond yields, %	1.68	4.04	

	31 Dec 21	30 Dec 22	% change
Commodities			
Iron ore, $US per tonne	119.00	111.28	-6.5
Thermal coal, $A per tonne	151.75	404.15	166.3
Oil, $US per barrel	75.21	80.26	6.7
Gold, $US per ounce	1828.60	1812.60	-0.9
Wool, Eastern market indicator	1358.00	1327.00	-2.3
Natural gas; US$/mmBtu	33.80	28.00	-17.2
Wheat, $US cents per bushel	770.75	791.00	2.6
CommSec commodity index	186.85	201.89	8.0
Aussie Share Indicators			
Price earnings Aussie shares*	15.62	10.58	
Dividend yield Aussie shares*	3.42	4.23	
Market size $bn, Aussie shares	2798.5	2549.7	
Global Perspectives			
US dollar index	95.66	103.48	
US 10-year bond yield, %	1.52	3.88	

Source: Refinitiv, Iress, CommSec, Bloomberg, CME Group. *November 2022