GLOBAL & LOCAL
THE INVESTMENT EXPERTS

Global Macroeconomic Factors That Shaped 2022

The year 2022 is a watershed moment in history, marked by economic, geopolitical, and environmental disruptions. Matters quickly escalated from fighting off what was hoped to be the pandemic’s final phase to a full-fledged war.

As the sun sets on 2022, here’s a look back at global macros that have had cascading effects in most asset classes, singling out equities. Throughout the year, the following global macroeconomic factors agitated the markets:

Russia-Ukraine war and its impact on the global economy

The biggest military conflict in Europe since World War II began on February 24, with Russia’s invasion of Ukraine. While Russian President Vladimir Putin has had restricted rational success in clarifying his goals for the invasion, it is widely assumed that it is simply the ambition of annexing Ukraine and expanding Russian territory.

Whatever the cause, the conflict had a frightening set of repercussions for the global economy. In response to Russia’s aggression, the West imposed economic sanctions on Russia to weaken its economy. Such restrictions include reducing Russia’s imports of oil and natural gas. This resulted in an oil supply shortage, which exacerbated inflation.

As a result of Russia’s aggression, agricultural exports from Ukraine to other parts of the world were hampered, resulting in commodity price increases. Ukraine is one of the world’s top producers and exporters of agricultural commodities such as oil seeds and grains. Furthermore, several companies and countries with ties to Russia or Ukraine suffered.

Resultantly, investors switched into flight to safety mode thereby strengthening the US dollar. As of October, the dollar was 12% stronger against the euro,9% against the British pound, 16% versus the yen and 8% against the rand. The anchoring reason surrounding investors’ flight to safety is that US assets are considered safe in turbulent economic environments and therefore can be used for hedging purposes.

Spiralling global inflation

The global economic shock induced by the pandemic in 2020 prompted central banks worldwide to pump more money into economies to support demand recovery. It’s no surprise that, as demand increased, prices rose, and inflation exceeded desirable levels. In addition to causing domestic problems, inflation had a significant impact on global supply chains. To rein in inflation, most global central banks embarked on a monetary tightening campaign characterized by strategic interest rate hikes, which have been the main actor in 2022 to curtail the rampant effects of historic inflation levels. The US inflation rate is 8.2% year-on-year, while the Eurozone’s rate is 10.1% year-on-year, the UK’s rate is 8.8%, and South Africa’s rate is 7.78% year-on-year.

Central banks’ monetary tightening crusade

As a result of inflation nearing 40-year highs in the US, the Federal Reserve raised interest rates by 25 basis points in March, 50 basis points in May, and 75 basis points in June. Fortunately, the inflation trajectory in the US is beginning to show signs of retreating from a high of 9.1% recorded in June to 8.2% in the last reading. Despite the positive trend, one stubborn factor defying the US Federal Reserve’s hawkish tone is the labour market. Unemployment in the US remains stable at 3.7%, while the number of jobs added per month and wage increases remain far above desired levels.

Wage inflation is a major contributor to overall inflation, and once the labour market is effectively slowed, the rate of disinflation can accelerate.

The South African Reserve Bank was not left out in this monetary policy tightening crusade; the central bank hiked rates seven consecutive times since policy normalisation started in November 2021 as a way to anchor inflation expectations more firmly around the mid-point of the target band. Currently, South Africa's repo rate is sitting at 7%.

With persistent rate hikes, caution has to be taken to avoid sliding the economy into a recession, which would spark more problems for the socioeconomic fabric.

Equities are severely hurt by spiking inflation levels

Notwithstanding the lethal combo of interest rate hikes, decades-high runaway inflation, and a strong labour market notably in the US, the stock markets globally, endured unprecedented levels of pain throughout the year with record-high selloffs wiping out gains made in previous years. Chief among them is the technology sector which has been hardest hit and is very sensitive to interest rate hikes. Year-to-date the tech-heavy Nasdaq 100 index plunged 32% reflecting how deep the index is in the bear territory. With high interest rates, equity valuations are much lower than their 10-year averages and also the cost of borrowing in households and corporates for investment in capex purposes is discouraged thus stalling economic growth.

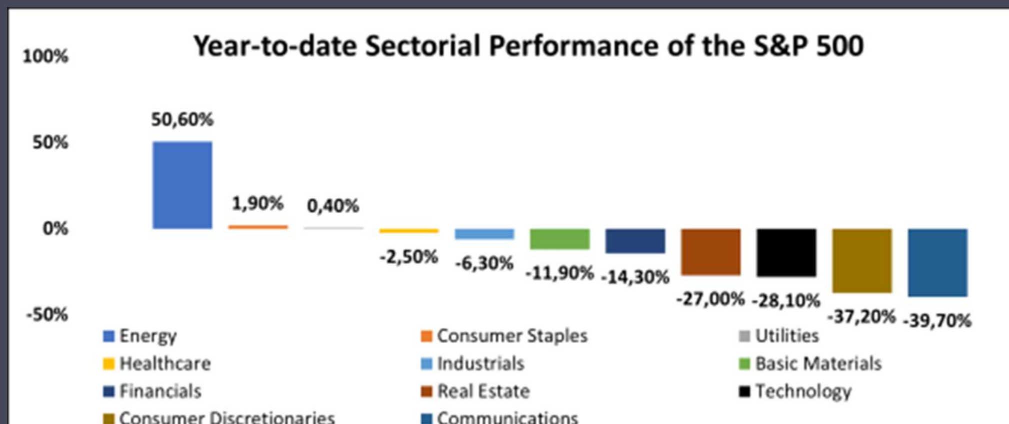
China factor in the global economy

For three years in a row, China, the world's second-largest economy, has been exhausted by Covid-19. The increase in Covid-19 cases in March, combined with harsh lockdowns in several parts of that country, has hampered economic recovery. This also had a significant negative bearing on the global supply chain by jamming the ports of trade partner countries, resulting in unprecedented delays.

Furthermore, China's military display in Taiwan to keep Taiwan from joining forces with the US left a bad taste in the mouth of the US, which is already at odds with China over chip supremacy. This has led the US to intensify its crackdown on Chinese firms in an effort to prevent China from using advanced US chips to develop advanced military technology.

Sectorial performance

As alluded to above, macroeconomic uncertainty, geopolitical instability, and a hawkish Fed have pushed the S&P 500 down 17% year to date. The best-performing sector has been energy, which has increased by roughly 50%, partially offsetting the massive losses in other sectors. In fact, with the exception of some minor gains in utilities, almost every other sector has been in the red this year. With that said, let's go over the sectors in order of performance, from best to worst.



Source:Nasdaq.com

Well, 2022 has presented a difficult investment environment to navigate, leaving every financial practitioner with little room to traverse the investment terrain. Questions linger in the minds of all investors, given that the sticky macros that brought us to this point remain in place, despite some encouraging gains in cooling down inflation in some parts of the world. Such questions include: "Has the year 2022 prepared us for a probable bearish 2023?" What investment lessons have we learned from 2022? Is the US Federal Reserve going to pivot in 2023 given the policy shift by the Bank of Japan early this week? Will 2023 treat us better? This remains to be seen.

Optimistically, the Fed will meet its objectives for a "soft landing," resulting in equities regaining at least some of the ground lost in 2022. Still, be wary of dead cat bounces, including a possible Santa Claus rally near the end of the year. With that in mind, we leave you with this quote from Carlos Slim Helu, "With a good perspective on history, we can have a better understanding of the past and present, and thus a clear vision of the future."

Happy investing and we wish you and your loved ones a very Happy Holiday season and a peaceful and prosperous New Year.

Contact Us

Global & Local
The Investment Experts

18th Floor Metalbox, 25 Owl Street,
Auckland Park, Johannesburg, 2092

T | +27 11 486 2500

info@globallocal.co.za
www.globallocal.co.za