M&G Insights

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June 2022

Market overview: May 2022

Global equity markets were broadly flat in May as the war in Ukraine showed little sign of abating and concerns over slowing growth weighed on markets. Energy and food prices continued to rise, placing upward pressure on global inflation, with central banks adopting more hawkish undertones to their policy-tightening measures. In the US, the Federal Reserve raised the fed funds rate by 50bps, the highest margin in more than 20 years, while annual inflation slowed from April's 41-year high posted. In Europe, the Bank of England followed suit by raising its borrowing costs, albeit to a lesser extent, while the European Union announced a ban on Russian pipeline oil imports as part of new series of sanctions. Turning to China, investors welcomed the news that the government would lift its two-month lockdown of Shanghai, even as growth slowed. Meanwhile, in South Africa, risk-off sentiment compounded by weaker metal prices weighed on the local bourse, as did the continuation of rolling blackouts across the country.

Looking at global equity market returns (all in US$), the MSCI All Country World Index returned 0.1% for the month. Emerging markets outperformed developed markets, with the MSCI Emerging Markets Index delivering 0.4% and the MSCI World Index returning 0.1%. The Bloomberg Global Aggregate Bond Index (US$) returned 0.3%, while the EPRA/NAREIT Global REIT Index (US$) produced -4.8%.

The spot price of Brent crude oil closed the month 12.3% higher at around US$121 per barrel, spurred by the EU's partial Russian oil ban which is estimated to impact around half of Russia's oil production. Metals were mostly negative in May in light of slower economic growth prospects, with nickel returning -11.5%, copper -3.3%, gold -2.2%, aluminium -7.3% and palladium -10.3%. Platinum was among the only outliers, returning 2.9% for the month.

US

The Federal Reserve (Fed) raised the target for the fed funds rate by half a percentage point to 0.75%-1% in May, the largest increase since 2000. The central bank noted that ongoing increases to the target range would be appropriate, pointing to 50bp hikes over the next few meetings, but also added that a later pause could be appropriate, from which the market took heart. Meanwhile, the yield on the US 10-year government bond rose above 2.8% in May, largely on the back of the Fed's hawkish comments.

Turning to economic indicators, the US economy contracted by an annualised 1.5% q/q in Q1 2022, slightly worse than initial estimates of a 1.4% decline. In more positive news, annual inflation slowed to 8.3% y/y in April from a 41-year high of 8.5% in March. Energy and food prices were among the largest contributors to the rise in prices, with the cost of food increasing by 9.4%, the largest increase since April 1981. US unemployment remained unchanged at 3.6% in April, with the labour force participation rate falling to a three-month low of 62.2% in April. Meanwhile, retail sales increased 0.9% m/m in April, following an upwardly revised 1.4% surge in March, as consumers continued to spend despite stubbornly high levels of inflation.

Equities closed the month mixed, with the S&P 500 returning 0.2%, the Dow Jones Industrial Average 0.3%, and the technology-heavy Nasdaq Composite -1.9% (all in US$).

SOUTH AFRICA

The South African Reserve Bank raised its benchmark repo rate by 50bps to 4.75% in May as widely expected, signalling a gradual normalisation of the monetary policy through 2024. This was the fourth consecutive hike and the largest in over six years, amidst heightened inflation risks. The central bank said that the overall risks to the medium-term growth outlook were assessed to be balanced, while the risks to the inflation outlook were to the upside. It revised its headline CPI forecast for 2022 higher from 5.8% to 5.9%, for 2023 from 4.6% to 5% in 2023, and for 2024 from 4.6% to 4.7%. Meanwhile, GDP growth projections for 2022 were cut to 1.7% from an earlier estimate of 2%, mainly due to the impact of the flooding in KwaZulu-Natal and the resumption of rolling power blackouts. GDP growth forecasts were kept unchanged at 1.9% for 2023.

Annual inflation stood at a three-month high of 5.9% in April, unchanged from the previous month and in line with market forecasts. In other news, Standard & Poor's revised South Africa's sovereign credit rating outlook to positive from stable, noting improvements to the country's fiscal position. The ratings agency expects the government's budget deficit to gradually narrow to 5% of GDP by 2025.

The FTSE/JSE ALSI returned -0.4% in May. Most major sectors were in the red, with Resources returning -0.4% on the back of weaker metal prices and a firmer rand, Industrials -2.2% and Listed Property -0.3%. Financials, meanwhile, returned 3.5%. The FTSE/JSE Capped SWIX All Share Index, which we use as the equity benchmark for most of our client mandates, returned 0.5%. SA bonds (as measured by the FTSE/JSE All Bond Index) delivered 1.0%, SA inflation-linked bonds returned 2.0% and cash (as measured by the STeFI Composite) delivered 0.4%.

Finally, the rand appreciated against most major currencies, gaining 1.5% against a weaker US dollar and 1.0% against the pound sterling, but depreciating 0.1% against the euro.

UK and EUROPE

The UK economy expanded 8.7% y/y in Q1 2022, slightly below market forecasts of a 9% expansion, with a slowdown expected in the coming months due to the impact of the war in Ukraine and rising inflation. Annual inflation in the UK spiked to 9% in April, prompted by rising energy prices and marking the highest reading since 1982. Meanwhile, unemployment edged down to 3.7% in Q1 2022, the lowest reading since 1974. In other news, the Bank of England raised its key bank rate by 25bps to 1% during its May meeting. This marked the fourth consecutive rate hike, pushing borrowing costs to the highest level since early 2009. Policymakers noted that global inflationary pressures have intensified sharply following Russia's invasion of Ukraine, which has led to a material deterioration in the outlook for UK economic growth.

Turning to the Euro Area, annual inflation increased to 8.1% in May, well above market forecasts of 7.7% and marking the highest level on record. Energy prices continued to post the largest increase, which if excluded, would have seen inflation accelerate to just 4.6%, still more than double the European Central Bank's 2% target. In other news, EU leaders agreed to ban Russian oil brought in by sea, which accounts for two-thirds of the EU's oil imported from Russia, with a temporary exception for pipeline imports. Russia currently supplies roughly 27% of the EU's imported oil and 40% of its gas. In other news, unemployment in the Euro Area fell to a record low of 6.8% in March, slightly above market forecasts of 6.7%. Declines in the jobless rate were seen in Germany, Italy and France.

For the month, the UK's FTSE 100 returned 1.5%, Germany's DAX 3.6% and France's CAC 40 2.0% (in US$).

CHINA and JAPAN

Shanghai, China's largest commercial city, announced the end of its two-month lockdown following a steady decline in new Covid infections and increased pressure from the international community. China's stringent Zero-Covid policy resulted in major supply disruptions globally, while negatively impacting the county's economic growth prospects. To help stabilise the economy, the government announced several stimulus measures, including a package of 33 measures covering fiscal, financial, investment and industrial policies. In other news, annual inflation accelerated to 2.1% in April from 1.5% in March, above market forecasts of 1.8%; while unemployment rose to 6.1% in April, above the government's jobless target of 5.5%.

In Japan, preliminary data showed that the economy contracted by 0.2% q/q in Q1 2022, above market consensus of a 0.4% fall. This marked the second contraction in the last three quarters, amid heightened lockdown measures, rising inflation and a surge in commodity prices. Annual inflation rose by 2.5% in April, the most since October 2014. In more positive news, investors welcomed the government's announcement that it would be taking gradual steps toward a wider reopening of its borders. Among other easing measures, the country doubled the daily cap on the number of visitors to 20,000.

For the month, Japan's Nikkei 225 delivered 2.3%, the MSCI China 1.2%, and Hong Kong's Hang Seng 2.2% (in US$).