Economic News January 2024 - The year in Review

Global inflation is finally falling but the 'cost of living' is still a worry for consumers

It has taken some time after the astonishing inflation highs set in 2022, however global inflation pressures are finally cooling. Lower global oil and gas prices with improved production and transport supply chains have finally allowed consumer inflation to decline. For Europe and the United States, annual inflation is now averaging closer to 3% compared to the 9% to 11% inflation rate highs set last year. China is a notable exception with falling consumer prices at -0.5%. Australia has also seen inflation improvement with annual inflation at 4.3% in November 2023 compared to the peak of 8.4% in December 2022.

Yet there is still a "painful squeeze" for consumers who are struggling with cost of living pressures. Australian bread and cereal prices have risen by around 8%, electricity by 10%, gas closer to 13%, insurance by 9% and rents by 7% in the year to November 2023. These price increases combined to result in a high cost of living in Australia.

This painful squeeze has been very intense for loan borrowers. Central banks have rapidly raised cash interest rates to curb inflation. For the United States, official cash interest rates have risen by a further 1% to currently stand near 5.5%. The European Central Bank raised cash interest rates by 2% to 4.5%. The Reserve Bank of Australia (RBA) followed this script by raising the official cash interest rate from 3.1% last year to 4.35%.

There appears to be relief on the horizon for borrowers. Given recent lower inflation results, both the American and European central banks have paused raising interest rates since August 2023. Indeed, financial markets have become optimistic that interest rates are set to fall in 2024. The Reserve Bank of Australia (RBA) is more cautious, last raising interest rates in November 2023 as inflation concerns are still dominating.

The past year has also provided financial and political shocks. The global banking system had a major tremor in March 2023 with the collapse of three US regional banks and the takeover of Switzerland's second largest bank in Credit Suisse. This has seen both European and North American banks applying harsher credit conditions to businesses and consumers, casting a shadow over the global economy. The shock Hamas attack on Israel in October has seen considerable tragedy and turmoil in the Middle East. Russia's devastating invasion of Ukraine is a continuing shockwave that has proved influential for commodity prices and economic activity as well as global politics.

The global economy has provided both positive and negative surprises

The US economy has been the key positive by proving more resilient than expected throughout 2023. Many commentators were forecasting a US recession given higher interest rates and banking stresses. Yet American business and consumers have remained optimistic. Strong jobs growth has allowed the US unemployment rate to end the year at a very low 3.7%. Wages growth has held at a solid 5% annual pace given worker shortages. Even the US housing market has held up well with house prices making mild gains and construction activity stabilising. Essentially, the pressures emanating from high inflation and interest rates proved less troublesome than expected.

Europe disappointed with weak economic activity. Germany, which is renowned as Europe's 'industrial powerhouse' has stagnated with the loss of cheap energy supply from Russia and weaker export demand from China. The United Kingdom also struggled as consumers have trimmed their spending given rising energy and food costs as well as higher interest rates.

China's economic slowdown and the financial woes of their property developers captured headlines throughout the year. There was optimism that China's economy would post a strong recovery in 2023 after the ending of the national government's "Zero-COVID" strategy of lockdowns in late 2022. However, China's growth has been constrained by the national government's intense scrutiny of property and technology companies and the reluctance to provide significant budget and interest rate stimulus.

Australia’s economy is struggling

Australia’s economy also underperformed in the past year. The impact of higher goods and services prices, rising mortgage interest rates and rents generated a ‘painful squeeze’ for Australian consumers. Consumer sentiment is particularly negative with household budgets being stretched. As a result, consumers have been cautious in their retail spending as well as committing to new housing construction. Notably the Australian economy is in a ‘per capita’ recession where population growth at around 2.5% exceeds annual real economic growth at 2.1% for the September quarter. This demonstrates how important the economic benefits of immigration are to the Australian economy.

However there have been positive surprises. Australia’s labour market has recorded solid job gains and the unemployment rate remains low at 3.9%. Business investment and government infrastructure spending have made strong contributions to job gains as well as broader economic activity.

The RBA raised the cash interest rate five times in 2023. The most recent interest rate rise by 0.25% to 4.35% in November 2023 was motivated by the RBA’s view that inflation is “still too high and is proving more persistent than expected.” However, there were hopeful signs at the end of 2023 that inflation pressures were starting to fade and that interest rates may have peaked. The most recent November 2023 consumer annual inflation result came in at 4.3% which is the lowest in two years.

A favourable year for investment returns even with inflation, interest rates and political risks

Global shares experienced considerable turbulence in 2023 but still managed to produce strong financial returns. Inflation concerns, rising interest rates, as well as the tragic Russian – Ukraine and Hamas – Israel conflict have provided significant headwinds to global share prices. Encouragingly, global share returns have been very strong for the past year. Optimism over the promise of ‘Artificial Intelligence’ (AI), lower inflation outcomes and the encouraging resilience in the American economy have been the key drivers.

However, these exuberant expectations may not be fulfilled if inflation proves more persistent and central bankers are more stubborn in lowering interest rates. The continued Ukraine War and Middle East conflict are key threats to global economic stability and investor sentiment. Investors will also need to contend in 2024 with national elections in the United Kingdom, India, Indonesia, Mexico and the United States which could transform the global political landscape.

Investors should be cautious of the significant inflation, interest rate and political risks. Assessing these complex risks is particularly challenging. Given there are multiple positive and negative outcomes possible over the next year, investors should maintain a disciplined and diversified strategy.

We hope you have a very happy and healthy new year. If you have any questions or wish to discuss anything, please call us on 03 9544 1004.

All the best,

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