

A Historic 2022 to a Pivotal 2023

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2022 ECONOMIC SUMMARY

While the year started with a firm belief that pandemic-era supply side constraints were easing and inflation would be transitory, the actual situation turned out to be completely different.

Inflation in much of the developed world started rising rapidly and touched levels last seen four decades ago. The two main drivers were the war in Ukraine that has inflated energy and food prices and tightness in the labor market that drove unemployment levels to 50-year lows and wages growth to historic highs. With inflation looking well entrenched, rather than transitory, central banks pivoted from their dovish stance at the beginning of the year to aggressively hike interest rates to prevent inflation from spiraling out of control.

Interest rate hikes: US Federal Reserve has so far increased interest rates seven times during the year, taking the fed fund rates to the 4.25%-4.50% range. The European Central Bank hiked rates to 2.5%, the highest since 2008 and the Bank of England stepped in nine times to increase rates to the current level of 3.5%, the highest in 14 years.

Inflation remains far above comfort level: Inflation in the US peaked at 9.1% in June 2022 and while it is on its way down, it remains above 7%. In Europe and the UK, inflation rates are still hovering above 10%. In Japan, core inflation is trading at 3.7%, the highest since 1981. Central banks in these countries are targeting to bring inflation down to the 2% level – which is a long way.

Hawkish central banks: At recent addresses, both Fed Chair J. Powell and ECB President C. Lagarde have sounded extremely hawkish pointing out that more interest rate hikes may be required, rates may have to be held at higher levels for longer and the economy may have to suffer below-normal growth – probably hinting that even a recession may not deter them.

2022 MARKET SUMMARY

Equities on a roller-coaster: For most of the year, equities kept fighting central banks – calling for an early pivot and slowing rate hikes – and hence witnessed sharp rallies that ended up being bear market rallies in the end. Major equity markets ended the year in deep red.

Bonds suffer historic losses: By some counts, bonds had their worst performance in a century. US bonds, including government and investment grade, are down between 12% to 16% while Asian and emerging markets bonds have plummeted from 16% to 20% in the year.

Highly diversified, investment grade bond funds ended the year with losses of about 8% whereas the same in the sukuk space lost only about 5.5% for the year.

Cost of borrowing shoots up: 3-month US dollar Libor rates moved up from a mere 0.21% p.a. to 4.73% p.a. during the year. Investors employing leverage to enhance returns on their investments faced a double-whammy of falling asset prices and rising cost of borrowing.

No place to hide: This is the first time in recent history that both bonds and equities are ending the year in red, at the same time.

The King Dollar: With risk off sentiments, demand for safe-haven dollar rose, taking the US dollar index, in July, to levels not seen in the last 20 years. At the same time, the euro fell below parity against the dollar for the first time in two decades while the pound sterling touched its lowest since 1985. By the end of the year, the US dollar ended higher than almost all major currencies.

The GCC is a standout: Gulf Cooperation Countries, UAE and Saudi Arabia in particular, continue to benefit from the post-pandemic reopening boom, higher oil prices, business-friendly government policies and hosting of major international events. The IPO boom in the UAE has revived the stock markets, delivering solid performances for the year.

2023 OUTLOOK

Synchronous economic slowdown: With the post-pandemic boom fading away fast, and higher inflation and interest rates eating away purchasing power of consumers, major economies are expected to slowdown further, and even experience mild and shallow recessions in 2023.

Peak hawkishness is behind us: Central banks have already front-loaded hikes in interest rates and have acknowledged that their full impact will be felt with a lag. Moreover, a high base effect will come into force. Central banks will not wait for inflation to read 2%; they are likely to pause or pivot as soon as they can see a glide path down to their desired level.

China reopening remains a wild card: The world's second largest economy affects both the demand side and supply side of the global growth prospects and hence its ability to successfully open (or not due to resurgence of Covid) will impact global growth prospects as well as global inflation outlook.

Equity markets in accumulation mode: Equity markets may witness some volatility till the time central banks indicate a change in stance. However, this volatility could offer a great opportunity for long-term investors to continue to dollar-cost-average and accumulate equities gradually over the year. Equities accumulated during periods of nervousness or in bear markets usually deliver extraordinary returns over the following years.

Income is back in fixed income: Bonds are once again giving attractive incomes after years of low yields. Short duration bonds may look more attractive but carry reinvestment risk. Investors can lock in high, durable cash flows for the long term in investment grade bonds and bond funds. A mild recessionary environment is even more positive for high quality bonds.

GCC sheltered from global slowdown: Oil markets will remain tight and any demand destruction due to global slowdown will be managed with additional supply cuts, if required. As a result, oil price may remain rangebound between \$80 and \$100, providing healthy financial conditions for the region. Robust initial public offering (IPO) activity in UAE and Saudi Arabia will provide further impetus to domestic stock markets.



MARKET DATA

Equities	Last price	2022 Chng
MSCI World	2602.69	-19.46%
Dow Jones Ind.	33147.25	-8.78%
S&P 500	3839.5	-19.44%
NASDAQ COMP	10466.48	-33.10%
EUROSTOXX 600	424.89	-12.90%
FTSE 100	7451.74	0.91%
Nikkei 225	26094.5	-9.37%
Shanghai Comp	3089 258	-15.13%
India Nifty50	18105.3	4.73%

Equities	Last price	2022 Chng
Dubai DFM	3336.07	4.40%
Abu Dhabi ADX	10211.09	20.30%
Saudi Tadawul	10,478.46	-7.10%

Currencies	Last price	2022 Chng
Dollar Index	103.522	7.60%
Euro	1.0705	-5.08%
GBP	1.2083	-10.19%
JPY	131.12	-13.61%
CHF	0 9245	-0.29%
AUD	0.6813	-5.25%
CNH	6.9115	-8.46%
INR	82.7015	-11.08%
SGD	1.3533	-1.09%

Commodities	Last	2022 Chng
WTI Crude	80.26	6.90%
Brent Crude	85.91	10.56%
Nat Gas	4.475	18.87%
Gold	1823.96	0.06%
Silver	23.9149	3.52%
Copper	381.05	-14.39%
Corn	678.5	14.37%

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