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## 2022 August Market Wrap

**Thursday 1 September 2022**

August 2022 will be remembered for the Key comments from Jerome Powell's (US Federal Reserve Governor) speech at Jackson Hole central bank conference. This gave the markets a wake-up call, rates will be higher for longer, market valuations will reward positive cashflow, growth in earning and strong balance sheets. Blue sky, no profit, cash burn business will be valued with the true risk they carry. The days of free money and Government hand out has passed. The key moving forward is quality. Parts of Powell speech below wise words and a key insight into the next few years.

"The Federal Open Market Committee's (FOMC) overarching focus right now is to bring inflation back down to our 2 percent goal. Price stability is the responsibility of the Federal Reserve and serves as the bedrock of our economy. Without price stability, the economy does not work for anyone. In particular, without price stability, we will not achieve a sustained period of strong labour market conditions that benefit all. The burdens of high inflation fall heaviest on those who are least able to bear them.

Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance. Reducing inflation is likely to require a sustained period of below-trend growth. Moreover, there will very likely be some softening of labour market conditions. While higher interest rates, slower growth, and softer labour market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain.

At some point, as the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases. We are moving our policy stance purposefully to a level that will be sufficiently restrictive to return inflation to 2 percent.

Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy."

Our monetary policy deliberations and decisions build on what we have learned about inflation dynamics both from the high and volatile inflation of the 1970s and 1980s, and from the low and stable inflation of the past quarter-century. In particular, we are drawing on three important lessons.

The first lesson is that central banks can and should take responsibility for delivering low and stable inflation. Our responsibility to deliver price stability is unconditional. It is true that the current high inflation is a global phenomenon, and that many economies around the world face inflation as high or higher than seen here in the United States. It is also true, in my view, that the current high inflation in the United States is the product of strong demand and constrained

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supply, and that the Fed's tools work principally on aggregate demand. None of this diminishes the Federal Reserve's responsibility to carry out our assigned task of achieving price stability. There is clearly a job to do in moderating demand to better align with supply. We are committed to doing that job.

The second lesson is that the public's expectations about future inflation can play an important role in setting the path of inflation over time. Today, by many measures, longer-term inflation expectations appear to remain well anchored.

If the public expects that inflation will remain low and stable over time, then, absent major shocks, it likely will. Unfortunately, the same is true of expectations of high and volatile inflation. During the 1970s, as inflation climbed, the anticipation of high inflation became entrenched in the economic decision making of households and businesses. The more inflation rose, the more people came to expect it to remain high, and they built that belief into wage and pricing decisions.

One useful insight into how actual inflation may affect expectations about its future path is based in the concept of "rational inattention."3 When inflation is persistently high, households and businesses must pay close attention and incorporate inflation into their economic decisions. When inflation is low and stable, they are freer to focus their attention elsewhere.

Of course, inflation has just about everyone's attention right now, which highlights a particular risk today: The longer the current bout of high inflation continues, the greater the chance that expectations of higher inflation will become entrenched.

That brings me to the third lesson, which is that we must keep at it until the job is done. History shows that the employment costs of bringing down inflation are likely to increase with delay, as high inflation becomes more entrenched in wage and price setting. The successful Volcker disinflation in the early 1980s followed multiple failed attempts to lower inflation over the previous 15 years. A lengthy period of very restrictive monetary policy was ultimately needed to stem the high inflation and start the process of getting inflation down to the low and stable levels that were the norm until the spring of last year. Our aim is to avoid that outcome by acting with resolve now.

These lessons are guiding us as we use our tools to bring inflation down. We are taking forceful and rapid steps to moderate demand so that it comes into better alignment with supply, and to keep inflation expectations anchored. We will keep at it until we are confident the job is done.

If you have any questions do not hesitate to contact me.

**Summary of Major share indices**

| Index | 1 Month | 52 Weeks | YTD |
|---|---|---|---|
| **DJIA** | -3.97% | -10.77% | -13.29% |

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| | | | |
|---|---|---|---|
| **Nasdaq** | -6.73% | -22.82% | -24.47% |
| **S&P 500** | -4.82% | -12.58% | -13.34% |
| **Russel 2000** | -3.39% | -19.37% | -17.87% |
| **Europe 600 Index** | -5.29% | -12.26% | -14.90% |
| **UK FTSE 100 Index** | -2.17% | +1.88% | -1.36% |
| **Hong Kong Hang Seng** | +0.95% | -23.34% | -14.72% |
| **Japan Nikkei 225** | +1.26% | -1.26% | -2.43% |
| **China Shanghai Composite** | +1.22% | -10.23% | -12.02% |
| **India S&P BSE Sensex** | +2.41% | +3.45% | +2.20% |
| **ASX 200 (Australia)** | +1.18% | -7.18% | -3.63% |

**Australian Dollar**

| | Close | 52-week Range |
|---|---|---|
| **AUD** | 0.6842% | 0.6682-0.7662% |

**Government Bonds**

| | Close | 52-week Range |
|---|---|---|
| **US 3 Month Bill** | 2.931% | 0.020-2.937% |
| **US 10 Years Note** | 3.194% | 1.263 – 3.501% |
| **US 30 Years Bond** | 3.299% | 1.665 – 3.495% |
| **Australia 10 years** | 3.618% | 1.167-4.256% |

*Source: Wall Street Journal.*

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