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Newsletter

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2022 Review and 2023 Outlook

Global Economy

In 2022, the global economy experienced many challenges. In October, the International Monetary Fund (IMF) released its World Economic Outlook report titled, "Countering the Cost-Of-Living Crisis," in which global growth is forecast to slow from 6% in 2021 to 3.2% in 2022 and 2.7% in 2023. This would be the weakest growth profile since 2001 except for the global financial crisis and the acute phase of the Covid-19 pandemic.

The report placed particular emphasis on the following three issues:

1. High inflation and central bank tightening
2. Russia's invasion of Ukraine
3. The continued effects of Covid especially in China

Inflation

The return of inflation was one of the biggest topics of 2022. The IMF anticipates that global inflation will peak in late 2022, increasing from 4.7% in 2021 to 8.8%, and even though it will remain elevated for longer than previously expected, it is forecasted to decline to 6.5% in 2023 and to 4.1% by 2024.

To combat the sharp increase in inflation, the Federal Reserve raised its benchmark interest rates seven times in 2022 and by December, it reached 4.375%, the highest level in 15 years; see Figure 1. This is a clear indication that the fight against inflation is not over. There was also the indication that officials expect to keep rates higher through next year, with no reductions expected until 2024.

Figure 1: Federal Reserve target rate

Source: The Federal Reserve Bank (https://www.cnbc.com/2022/12/14/fed-rate-decision-december-2022.html)

Russia's invasion of Ukraine

At the same time, Russia's ongoing war in Ukraine and the subsequent Western sanctions brought the recovery from the pandemic to a screeching halt. It caused food and energy prices worldwide to increase as Russia is a key global energy and fertilizer supplier and both countries are major exporters of grain for millions of people worldwide.

The Organization for Economic Cooperation and Development (OECD) in its *Economic Outlook* published in November 2022, stated that Russia's war of aggression against Ukraine has provoked a massive energy price shock not seen since the 1970s. Russia's reduced supply of natural gas, which is needed to heat homes, generate electricity and power factories, led to energy shortages. This resulted in an increase in energy prices which is taking a heavy toll on the world economy and could force businesses to ration, pushing many European countries into a recession next year.

The report also states that growth for 2023 could be weaker than projected if energy prices rise further, or if energy supply disruptions affect gas and electricity markets in Europe and Asia.

Covid and China

Although the pandemic's impact has moderated in most countries, its lingering waves continue to disrupt economic activity, especially in China. Despite being one of the fastest-growing economies in the world over the past several decades, China has suffered economically. This is a result of President Xi Jinping's "zero-Covid" strategy, which has forced massive lockdowns of cities and regions, with serious disruption to economic activity as well as the collapse of the real estate sector that represents roughly 20% of the economy.

The International Finance Forum (IFF), in its 2022 *Global Finance and Development Report*, stated that it expects significant loosening in China's policy in 2023, which will lead to the economic growth of as much as 2.0% as China attempts to revive itself. In December 2022, the Chinese government took the first step when new guidelines were issued, which eased some of the strict zero-Covid policies that were maintained over the past three years.

Fiscal Policy

The IMF's October 2022 *Global Financial Stability Report* stated that budget constraints are tightening as global financial conditions become more challenging. The sharp rise in food and energy prices also puts pressure on government budgets.

Despite inflation being a broad phenomenon, which has been affecting most economies across the world in 2022, it has the most severe impact on lower-income groups in developing economies. In these countries, up to half of a household's consumption expenditure is on food which means that inflation can significantly impact health and living standards.

In 2023, governments will therefore be facing the difficult challenge of supporting their citizens during a time when prices are rising dramatically, particularly for necessities like food and fuel, which have been deeply affected by the war in Ukraine. The IMF pointed to the difficult balancing act governments must manage. They stated that governments should avoid adding to aggregate demand that risks dialling up inflation but instead, in many advanced and emerging economies, implementing fiscal restraint can lower inflation while reducing debt.

Local Economy

The Central Bank of Trinidad and Tobago in November's 2022 *Monetary Policy Report* stated that domestic inflation will continue to be impacted by the external environment, such as the fallout from adverse weather, and from a few measures announced in the National Budget for the fiscal year 2023.

Data from the Central Statistical Office (CSO) showed that headline inflation accelerated over the period, moving from 4.1% (year-on-year) in March 2022 to 6.3% in August before settling at 6.2% in September 2022. Core inflation, which omits the volatile food component, increased over the period moving from 3.2% in March 2022 to 4.8% in September 2022. Meanwhile, food inflation maintained its upward trajectory over the period, moving from 7.9% in March 2022 to 11.6% in September 2022.

Despite the current uncertainty on the global front and inflationary pressures that were spilling over to Trinidad and Tobago, the Monetary Policy Committee decided to maintain the repo rate at 3.50% as there were encouraging signs of a revival of credit in support of domestic business expansion.

The Central Bank is predicting improved domestic economic activity in the short to medium term. This is in line with the IMF which projected 4% growth for 2022 and anticipates 3.5% growth for 2023. This is a massive improvement from the negative growth recorded in each of the previous six years (2016-2021).

INVESTMENT CHECKLIST

Even though the macroeconomic outlook for 2023 may appear disconcerting, it is important to remember that markets rarely follow economics in a straight line. Consumers' responses to the cost-of-living challenges and their impact on corporate profits will be a key determinant of investment returns in 2023.

Given the uncertainty surrounding 2023, investors should be trying to determine the best course of action to ensure that their investments can weather any storm as well as benefit from the positives that may arise. What can you do?

The following steps can be used as a guide:

1. Stress-test your portfolio

Ensure that your portfolio can withstand market shocks and other ups and downs, especially when it comes to rising rates. Consider which sectors, regions, and securities are most rate-sensitive and make the necessary adjustments to allocations to manage risks.

2. Double-check diversification

It is essential that your portfolio's asset allocation is aligned to your financial goals; rebalance where required as equity and fixed-income weightings may be out of whack. The right mix of assets between sectors and geographies is also important.

3. Be tactical and flexible

Pay close attention to the economy, legislative and regulatory policy, corporate earnings and valuations, as experts think at this point, we are nearing the end of the cycle, and trends for these key variables can zig and zag before the final path is clear. While flexibility is always important to successful investing, it's critical now.

Mail: Mrs. Linda Wilson-Mano
Assistant Vice President
Advisory Services Department
3rd Floor, UTC Financial Centre
82 Independence Square
Port of Spain

Tel: 624-8648 Ext. 3013

Email: yourwealthmanager@ttutc.com

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