VanEck ViewPoint™

The great paradigm shift

January 2023

If there was one word to define 2022 it would be 'policy'. With the inflation genie out of the bottle and the tectonic plates of the geopolitical sphere shifting, there has been a dial up of a new course of action by those empowered to do so. From central bank monetary policy, to decarbonisation and green investment policy, to unprecedented sanctions and the convergence of security and energy policy, arguably we are seeing a shift in the new world order.

Front and centre for investors was the magnitude and speed of policy rate rises, unprecedented for many as few participants experienced the 1970s stagflation era. The most aggressive tightening cycle since the early 1980s has materialised. If 2022 was the year of the Fed induced price to earnings (P/E) multiple contractions, then 2023 will be the year of the Fed induced earnings recession.

We are in the middle of the paradigm shift, back to where bonds and equities return to their long-term cyclical relationship, an inverse one. Economies around the world are moving spasmodically. Irrational exuberance and euphoria following a decade of cheap and easy liquidity is over, for now. Credit that was cheap and easy is now more expensive and less available.

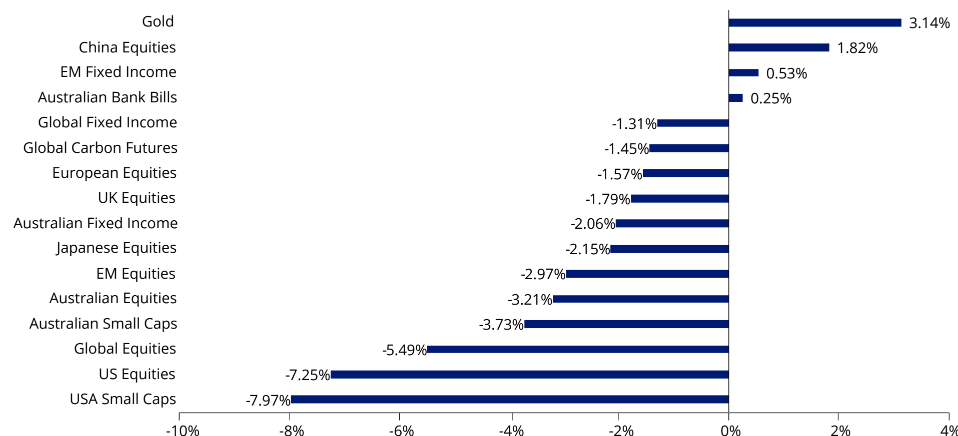
Cycles come and go but this stage of the economic cycle may be more protracted and deeper than previous ones. History shows us that there are always unintended consequences, and with the world in a parlous state a new paradigm awaits. Policy lags, and the outcome of 2022 may show up in full force in 2023.

The fairest assessment is that there is a great disconnect. Weak sentiment and optimistic earnings forecasts. US earnings have just commenced a downgrading cycle. The market is hooked on 'hopium'. In November the US curve, that is the 10- and 2-year yields, inverted further. An inverted curve is widely regarded indicator for a recession. Not that equity markets reflect this.

Investors don't seem to have received the memo, 'don't fight the Fed'. This year has seen the most deeply inverted US yield curve since the Paul Volker era of the early 1980s. Fed officials expect to keep rates higher through next year, with no reductions until 2024, though signs are emerging that growth is buckling. Again, the adage of 'don't fight the Fed' prevails.

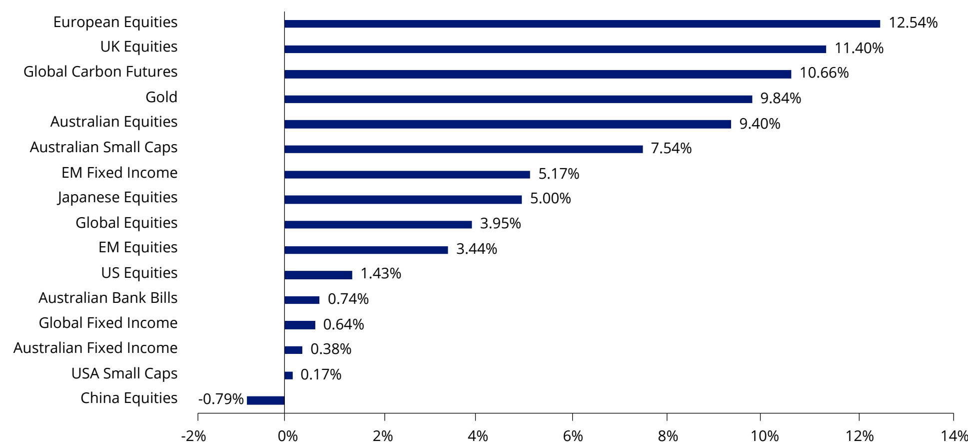
The last quarter was pronounced and atypical of a counter-trend rally. During October and November, with the US curve inversion and the market expecting a less-contractionary Powell, everything was up. Cyclicals ran hard. European, UK and Australian equities among the beneficiaries. This was another textbook bear market rally on the 'hopium' of a Fed pause or pivot. Come December and the Federal Open Market Committee (FOMC) meeting, the S&P 500 got the Fed's memo and with China reversing its zero-COVID policy, China A-shares have led the pack in December, but still trail over the quarter.

Chart 1a: Mainstream asset class returns for the month



Source: Bloomberg, 30 November 2022 to 30 December 2022, returns in Australian dollars. Global Carbon Futures is ICE Global Carbon Futures Index, US Equities is S&P 500 Index, International Equities is MSCI World ex Australia Index, European Equities is MSCI Europe Index, UK Equities is FTSE 100 Index, Australian Equities is S&P/ASX 200 Accumulation Index, Australian Small Caps is S&P/ASX Small Ordinaries Index, Gold is Gold Spot US$/oz, US Small Caps is Russell 2000 Index, China Equities is CSI 300 Index, Global Fixed Income is Bloomberg Global Aggregate Bond Hedged AUD Index, Australian Bank Bills is Bloomberg AusBond Bank Bill Index, Australian Fixed Income is Bloomberg AusBond Composite 0+ yrs Index, EM Fixed Income is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified, EM Equities is MSCI Emerging Markets Index, Japanese Equities is Nikkei 225 Index. Past performance is not a reliable indicator of future performance.

Chart 1b: Mainstream asset class returns for the quarter



Source: Bloomberg, 30 September 2022 to 30 December 2022, returns in Australian dollars. Utilities is MSCI World Utilities Index / S&P/ASX 200 Utilities Index, Industrials is MSCI World Industrials Index / S&P/ASX 200 Industrials Index, Materials is MSCI World Materials Index / S&P/ASX 200 Materials Index, Consumer Staples is MSCI World Consumer Staples Index / S&P/ASX 200 Consumer Staples Index, Consumer Discretionary is MSCI World Consumer Discretionary Index / S&P/ASX 200 Consumer Discretionary Index, Financials is MSCI World Financials Index / S&P/ASX 200 Financials Index, Energy is MSCI World Energy Index / S&P/ASX 200 Energy Index, Healthcare is MSCI World Heath care Index / S&P/ASX200 Heath care Index, Telecommunications is MSCI World Telecommunications Index / S&P/ASX 200 Telecommunications Index, Information Technology is MSCI World Information Technology Index / S&P/ASX 200 Information Technology Index, Real Estate is MSCI World REIT Index / S&P/ASX 200 AREIT Index. Past performance is not a reliable indicator of future performance.

We would caution, a pivot isn't a good thing for risk assets. A pivot is in response to an economic slowdown. If the slowdown is a hard landing, risk assets do not have a strong history pricing a recession. With the exception of the two 1970s bear markets, recession-driven bear markets rarely start more than 6 months before the recession starts.

So, what are investors anticipating for 2023? The investment playbook is to avoid risk assets, buy bonds/treasuries and avoid highly volatile and speculative equities. A good start is to focus on balance sheets and cash flow. We could see the US dollar come off and gold regain its lustre. Navigating equities smarter through factor strategies such as 'quality' and 'value' becomes more meaningful. Asset allocation comes back to the fore, particularly after the brutal bond sell-off of 2022. Prudent investors focus on what is or what can probably go wrong, rather than to attempt to forecast what might go right. Risk management is everything. A new wave of opportunities will present themselves and smart money anticipates this. Emotive sellers make for good buying. Anticipating the irrational fear that economic weakness can instil has historically been the platform for long-term wealth creation.

"Successful investing is anticipating the anticipations of others"
John Maynard Keynes

Chart 2a: Global and Australian equity sectors monthly performance

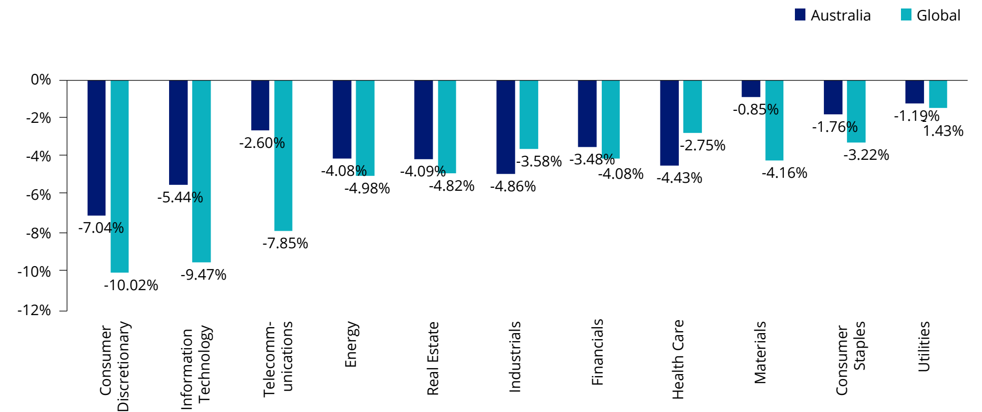


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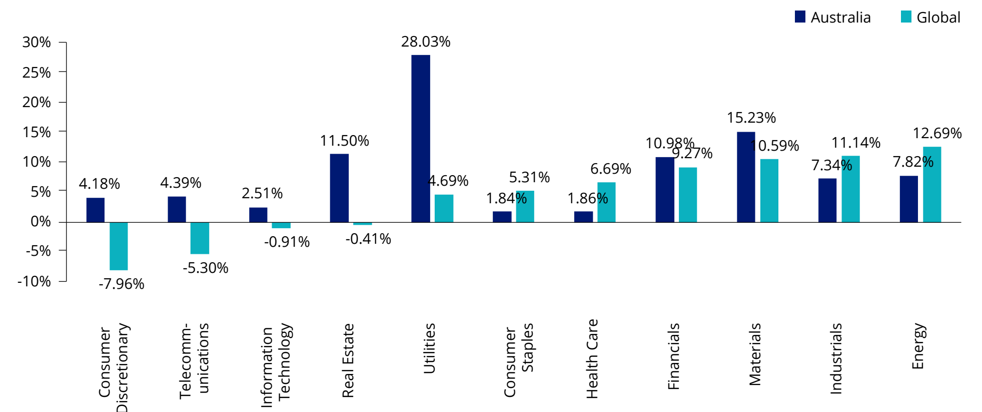
Chart 2b: Global and Australian equity sectors quarterly performance



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Reality and the Fed converge

Well, here we are again. It's beginning to feel like Groundhog Day. Each quarter the Fed tells the markets that rates are going to be higher for longer, each quarter the markets take any sign of softening in growth or inflation to start screaming "pivot", while buying risk and looking for rates to fall.

The result has been no tightening in overall financial conditions for the past six months, even though the Fed has hiked rates repeatedly. This is self-defeating behaviour by markets: if financial conditions don't tighten, the economy will not soften sufficiently, and the Fed will have to keep on tightening the screws.

Everyone should know the old adage "never fight the Fed" by now, so the easy explanation is to blame markets for single-mindedness. And, after more than a decade of "buy the dip", driven by super-low rates, there is probably some truth to this.

But perhaps the biggest problem is the Fed itself.

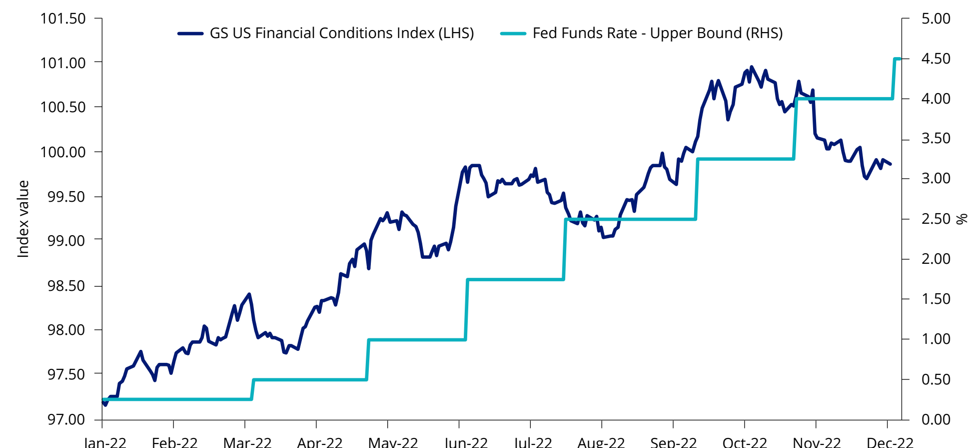
As we outlined last quarter, there is an inconsistency in the Fed's outlook: the extent of economic slowdown built into the Fed's forecasts didn't look to line up with the speed at which inflation is expected to retreat. To get the sort of sustainable reduction in the inflation path envisaged by the Fed most likely requires a recession, and the Fed was clearly unwilling to do so. It's been the Fed's little secret.

If the Fed won't forecast a recession, why would they expect markets to do so? In other words, if the Fed wants markets to accept that policy will have to tighten, and then stay tight until it hurts, then the Fed should publicly forecast that. Until then, markets will try to rally off every single friendly print or utterance.

At least for now the Fed seems to be slouching towards reality: this quarter's economic outlook embodies something that includes a mild, technical recession: Q4 2023 GDP growth compared to Q4 2022 has been scaled back to 0.5%, compared to 1.2% in their September forecasts and 1.7% in June. But this still strikes us as optimistic.

Chart 3: Despite rate rises financial conditions are not tightening

The Fed Funds Rate vs Goldman Sachs Financial Conditions Index



Source: Bloomberg, Goldman Sachs. GS US Financial Conditions Index - a lower value indicates financial conditions are easier.

Chart 4: Reflecting reality

Economic projections of the Federal Reserve Board members, December 2022

Variable	Median[1]				
	2022	2023	2024	2025	Longer run
Change in real GDP	0.5	0.5	1.6	1.8	1.8
September projection	0.2	1.2	1.7	1.8	1.8
Unemployment rate	3.7	4.6	4.6	4.5	4.0
September projection	3.8	4.4	4.4	4.3	4.0
PCE inflation	5.6	3.1	2.5	2.1	2.0
September projection	5.4	2.8	2.3	2.0	2.0
Core PCE inflation[2]	4.8	3.5	2.5	2.1	
September projection	4.5	3.1	2.3	2.1	
Federal funds rate	4.4	5.1	4.1	3.1	2.5
September projection	4.4	4.6	3.9	2.9	2.5

Source: Federal Reserve

1 – For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.

2 - Longer-run projections for core PCE inflation are not collected.

The unspoken secret

We don't think the Fed's new 'outlook' to be sufficient to get inflation back to its 2% target in a reasonable timeframe, i.e. before higher inflation expectations become embedded and in turn making the job of eradicating inflation many times harder.

Let's go through the linkages, being careful to distinguish between changes and levels.

How do you get inflation to decline? You need to get wages to fall back to a growth rate consistent with your inflation target. Enter the Non-Accelerating Inflation Rate of Unemployment (NAIRU). NAIRU is the unemployment rate at which wages have no tendency to either pick up pace, or fall away.

Prior to COVID, in the US it was assumed the NAIRU was somewhere between 4% to 5%. Looking at the FOMC's long term forecasts you can see they assume the rate will fall to 4% in the long run. Is that number that low currently? Unlikely.

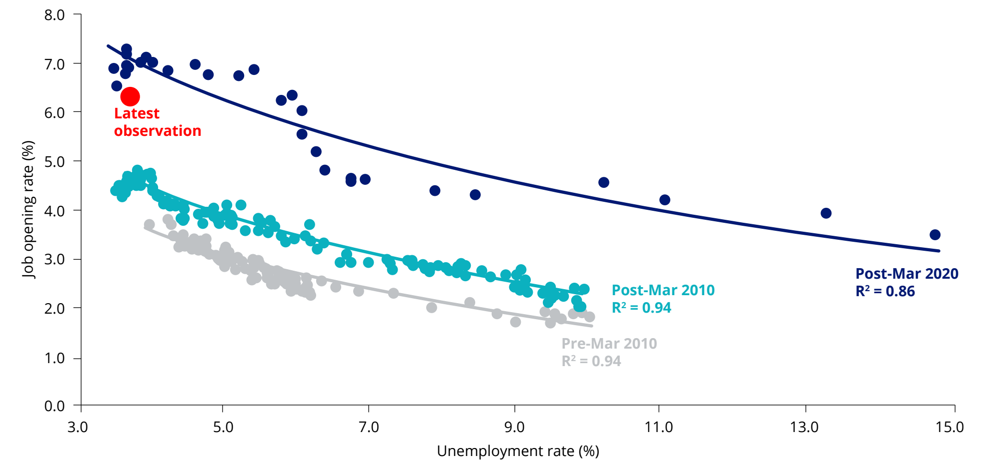
Employers bid up wages to fill job vacancies. Normally the relationship between vacancies and the unemployment rate is pretty stable. But with economic dislocation and older cohorts leaving the labour market, there is currently a higher rate of vacancies for a given level of unemployment. This suggests the unemployment rate required to stabilise wages growth is higher than before. Of course, this relationship may eventually normalise, but we don't expect this in the short term.

Note that we're still talking about a sort of neutral rate. So, to get wages growth rate down requires an unemployment rate higher than this. The larger the gap, the faster wages growth reverts to a rate consistent with inflation expectations.

It's our guess that, if the Fed intends breaking inflation over the next two years, they'll need an unemployment rate in the order of 6%. Okun's Law, which is really an approximation, is that you need Gross Domestic Product (GDP) 2% below potential to lift the unemployment rate by 1%. So, to get from 3.7% unemployment to 6% requires either a long or a deep recession. One year of growth a little over 1% below potential is not going to do it.

Chart 5: Mismatches remain in the labour market

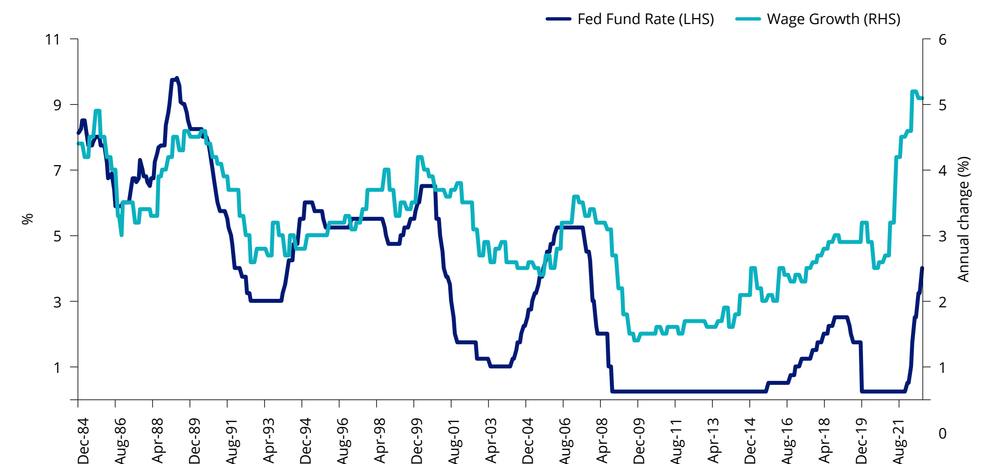
The Beveridge curve: US Job opening rates versus unemployment rate



Source: US Bureau of Labor Statistics, data to October 2022.

Chart 6: Employers bidding up wages

Fed Fund target and wage growth



Source: US Bureau of Labor Statistics, Federal Reserve, National Bureau of Economic Research.

The direction of the forecasts is right

So, the FOMC forecasts, while heading in the right direction for what's required, are not there yet.

That doesn't mean there won't be rays of sunshine. Rate hikes to date are already seeing a downshift in the economy, a classic inventory flush. In turn, this will lead to some inflation relief, as we've perhaps seen the past couple of months. Note that, despite this gearshift, H2 growth looks set to comfortably remain above potential growth which is not exactly what the doctor ordered.

It seems the Fed may be aware of the 'transitory' nature of this adjustment. Despite two months of helpful numbers, the FOMC shifted their inflation forecasts higher this month. Because most of the economy is the services sector, most of services sector inflation is driven by wages. Without an easing in the labour market, inflation will not be sustainably contained.

After years of aberrantly low interest rates and sloshing liquidity fuelled by quantitative easing (QE), the US/global economy is heavily geared. There is no telling exactly at what level of interest rates plus quantitative tightening will be required to rein things back in.

So, having got rates away from emergency levels back towards more normal levels, it's not a surprise that central banks are going to gearshift to slower, more data-responsive rate moves. It doesn't mean they are going to suddenly reverse. It is possible "pivot" is 2022's version of 2021's "transitory". Indeed, the market's fixation with "pivot" keeps prematurely easing financial conditions which, as noted, is self-defeating since it forces the Fed to do more.

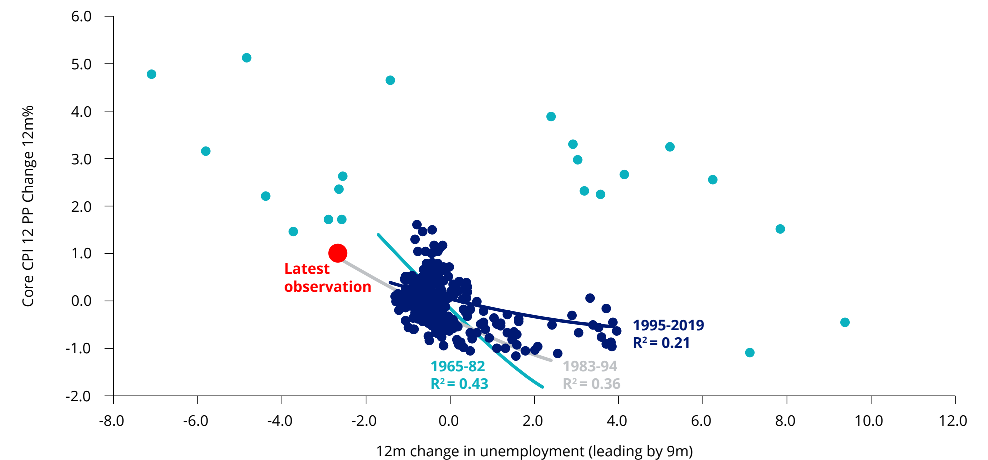
We would caution, given the concentration of risk into illiquid, yield-chasing investments, it is a reasonable bet that something will break at the high-risk end of financial markets well before the real economy keels over.

For this reason, it's advisable to (continue to) avoid speculative, cash-burning investments, especially those that are leveraged or considered 'junk'.

With government bonds back to ballpark valuations, we can argue exact pricing, but 3.5% to 4.5% seems a reasonable return on risk. With this TINA (There Is No Alternative) has been replaced by TARA (There Are Reasonable Alternatives).

Chart 7: Without an easing in the labour market inflation will not be sustainably contained

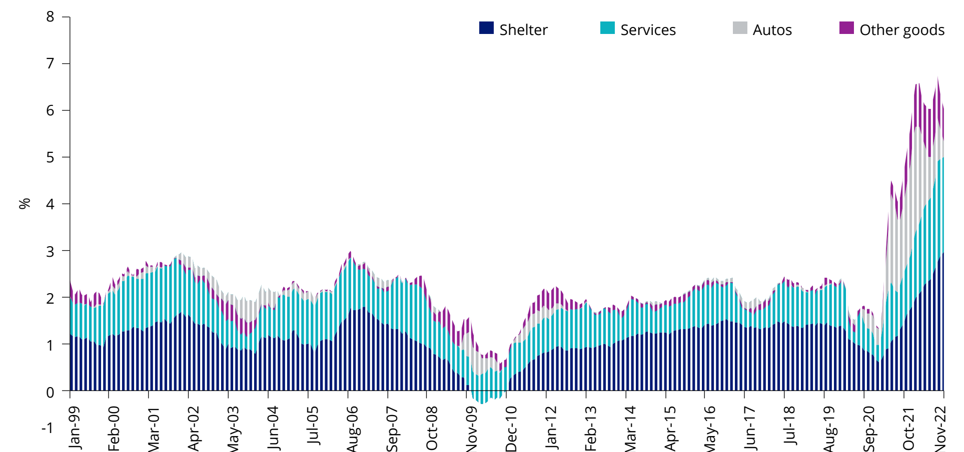
US unemployment change and change in core CPI



Source: US Bureau of Labor Statistics, data to November 2022.

Chart 8: Most of the US economy is services and its most of inflation

US Inflation composition



Source: US Bureau of Labor Statistics, National Bureau of Economic Research.

The return of bonds

With bond prices having fallen to a level to make them and their yield attractive again, investors are considering alternatives to their equity market allocation.

Looking at US equities, we think it's still too early to call a bottom there.

First, earnings expectations are still way overcooked. While earnings per share (EPS) expectations for 2022 and 2023 have declined modestly since mid-year (by 4% and 8% respectively), the market still expects earnings next year to be 5% higher than this. With a recession looming, this does not seem reasonable. A recession normally sees EPS fall 20 to 40%. For reference, 2008 saw EPS fall circa 90%.

It's also possible market valuations have not fallen far enough to justify earnings risk. Price to earnings (P/E) ratios usually bottom out anywhere from 9x to 14x, well below current levels. Given the US looks to be through sustainable full capacity, valuation looks even worse when measured by Cycle Adjusted Price Earnings (CAPE) ratio.

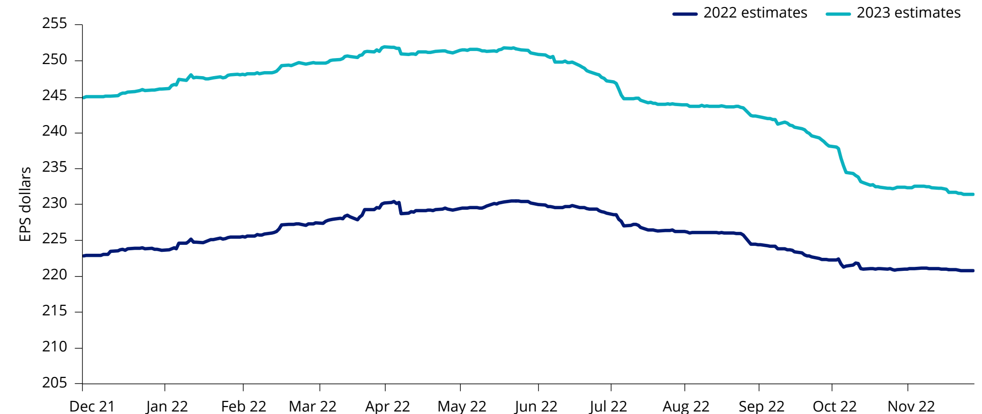
S&P 500 secular bull markets generally begin with CAPEs below 10x. The exception is after 2008, which began with a CAPE of about 13x, due to zero rates and QE. The current CAPE is around 27x.

The bull market will continue to reflect that recession has been accepted and markets have suitably de-rated, from lower levels than here. A focus on companies that earn through the cycle will be key.

The other thing that will be priced lower once the US recession is fully considered is the US dollar. We've talked all year about how the US dollar isn't universally loved. Considering geopolitics, you could argue it is unloved in a fair chunk of the globe. The strength of the US dollar in 2022 was that it was the cleanest dirty shirt, i.e. stronger growth and hence better investment returns than other majors.

Chart 9: Wall Street's 2023 EPS still 5% higher than 2022

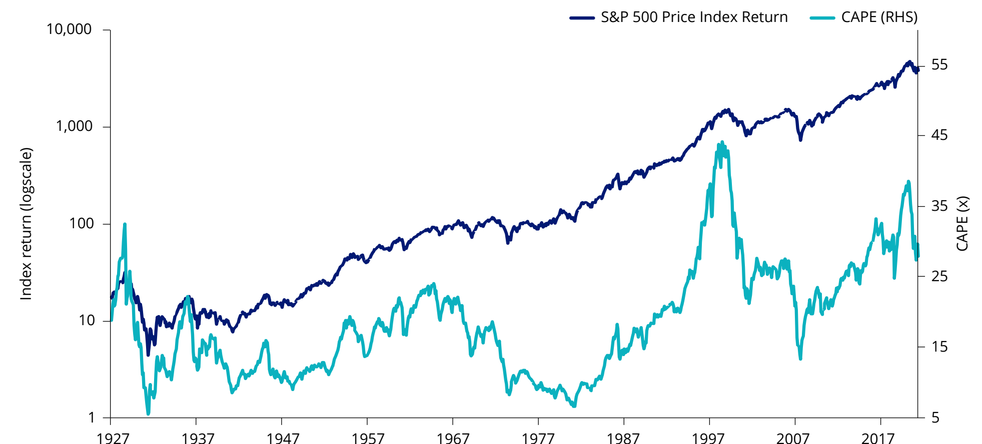
S&P 500 CY 2022 and CY 2023 Bottom-Up EPS: 1-Year



Source: FactSet.

Chart 10: Valuations have not yet fallen enough

S&P 500 versus valuations



Source: Bloomberg.

US dollar alternatives

There are signs that the market is getting on board with the thesis that US dollar strength in 2022 has been due to weakness elsewhere. Indeed, the broad trade weighted dollar looks already past its peak.

On the cyclical side, the US dollar has started trading in line with "the pivot", i.e. it weakens in line with hopes of Fed policy turn. On the secular side, the World Gold Council has confirmed a huge surge in central bank gold buying last quarter. While the central bank(s) involved haven't yet been identified, you wouldn't likely be wrong if you suspected China.

Like the broad US dollar, gold has been trading in line with the pivot, not trading as an inflation hedge: rallying on weak data. It's also trading well above of a favourite valuation indicator, US real rates, supporting the idea that US dollar is unloved.

Besides gold, there are US dollar alternatives. As we mentioned last quarter, an energy-starved winter is Europe's darkest hour, so by Spring the Euro may be looking more attractive, especially since the European Central Bank (ECB) looks likely to keep going after a Fed pause.

The other opportunity looks like the yen. As we pointed out last quarter, the yen has been battered by the Bank of Japan (BoJ) sticking to zero rates and yield curve control (unlimited QE) while the rest of the world moved away.

The BoJ is starting to realise yield curve control (YCC) is not only unsustainable, in the week before Christmas it effectively allowed Japanese Government Bond yields to double, it's also pointless.

First, not only has core inflation in Japan picked up solidly (even after removing energy) but wages have joined in, making a sustainable end to deflation look likely. Second, businesses are now complaining about the cost of (imported) inputs, that is, a weak yen is now counter-productive. Third, discussion of an end to the policy is already starting to percolate in official circles, as demonstrated by the baby step the week before Christmas. Finally, the architect of YCC, BoJ Governor Kuroda, will retire next April.

With Japanese equities cheap against other global markets and the yen heavily undervalued it may be a good "pivot" play.

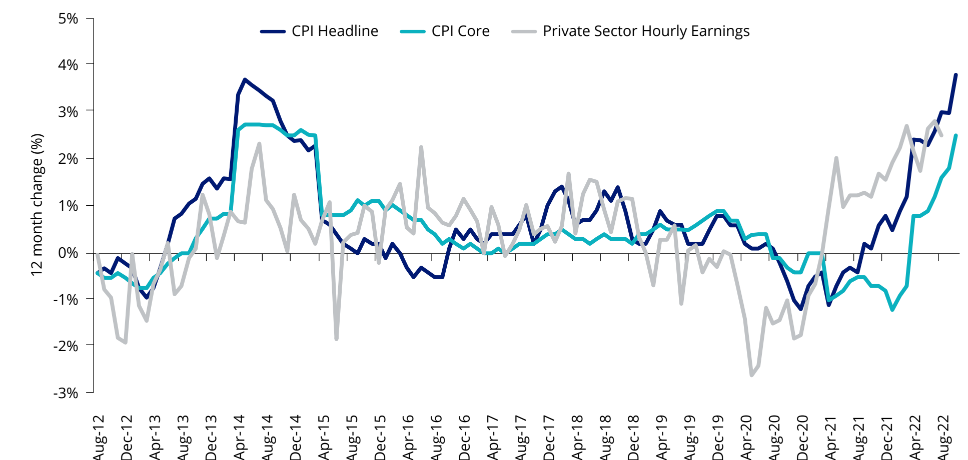
Chart 11: The story of 2022: US dollar strength

DXY Index

Source: Bloomberg.

Chart 12: A potential new paradigm in Japan

CPI, Core CPI and wages all heading away from deflation



Source: Bloomberg.

Europe's light at the end of the tunnel

The list of adversities that hit Europe in 2022 is long. Among them, Russia's invasion of Ukraine led to higher food and energy prices, supply chain disruptions, extra political/geopolitical noise and significant challenges on the policy side.

The faster geopolitical de-escalation can result in a milder recession/slowdown, especially in countries less dependent on Russian energy exports, such as Spain and Portugal. This makes it easier for the ECB to continue hiking and implement quantitative tightening (QT), as inflation is not expected to get back to target until 2025.

However, the end of the war does not necessarily mean the return of cheap energy, and this can (a) create longer-lasting growth headwinds (Germany), and (b) slow the pace of fiscal adjustment in a situation when the borrowing costs might continue rising. Italy and Greece could be particularly exposed in this scenario, given that bond spreads are already wider and net interest payments absorb a larger share of government's revenue.

Central Europe has been hardest hit with double-digit inflation still among the highest in emerging markets. The regional economy is now expected to expand by less than 1% in real terms next year, with the Czech Republic being the prime candidate for a recession.

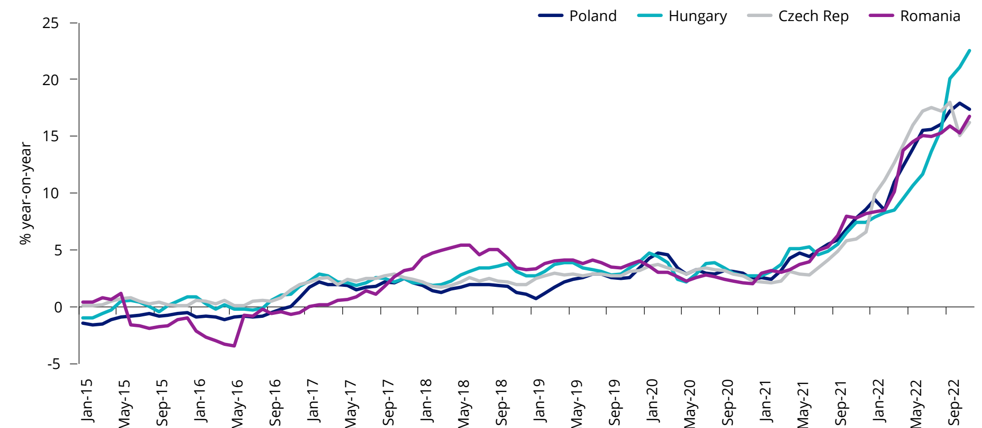
Remember, emerging markets started responding to inflation earlier than developed markets. The rising recession risks is the key reason why the Czech Republic decided to keep the policy rate on hold back in July, extending the pause into Q4. The Polish central bank jumped on the "on hold" bandwagon in October, arguing that it cannot control exogenous price pressures that are driving inflation higher. Hungary tried to do the same.

A slower pace of disinflation in Poland and the Czech Republic imply that the real policy rate might still be negative 12 months from now, stimulative and pro-growth just as central banks/governments want.

Central European local bonds posted double-digit total returns (US dollar unhedged) in Q4 retracing some of Q1 losses. The question is whether they can stay in the lead in the weaker growth environment. We think the following would be instrumental. Firstly, central banks should avoid the perception of falling behind the curve, no premature easing even with the disinflation progress. Secondly, fiscal discipline is a must. It is great that current accounts show signs of improvements, but large "twin" deficits are often frowned upon by the market. Finally, the geopolitical backdrop in the region should be broadly supportive, which means no further escalation of the Russia/Ukraine war.

Chart 13: Double digit inflation despite pivots

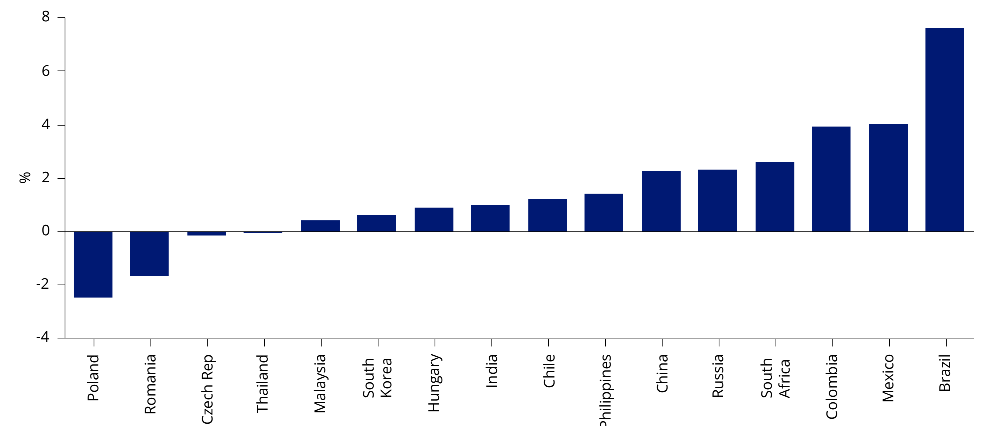
Central Europe Inflation



Source: Bloomberg.

Chart 14: Real policy rates in Central Europe might still be negative 12 months from now – stimulative and pro-growth

Real policy rates 12m from now if inflation and rates expectations materialise



Source: Bloomberg.

Gold in the fold

In 2022, investors were tasked with deciding whether to hold gold to protect their portfolios from high inflation and geopolitical tensions or to reduce their holdings as global interest rates rise. In an environment of rising rates and an outlook for lower inflation as a result of the monetary tightening programs by Fed and other central banks, investors have chosen the safety of the US dollar, propelling it to 20-year highs, which has been a headwind for gold this year. As noted above that has changed, the US dollar index (DXY) was down 5% during November.

In 2022 there has been a remarkable divergence recently between gold in US dollars and the price on gold in yen and pounds. Historically, these prices tend to move in tandem. These are G7 countries with major reserve currencies. These currency dislocations reflect the extraordinary risks faced by the world today.

The US has problems with inflation, debt, divisive politics and a weakening military but in 2022 other countries had problems that outweighed those in the US, allowing gold to trend higher as a local safe haven in those countries. You can see in the most recent quarter, the dislocation started to correct as the market wondered for much longer can the US be insulated from the crises that increasingly afflict the rest of the world.

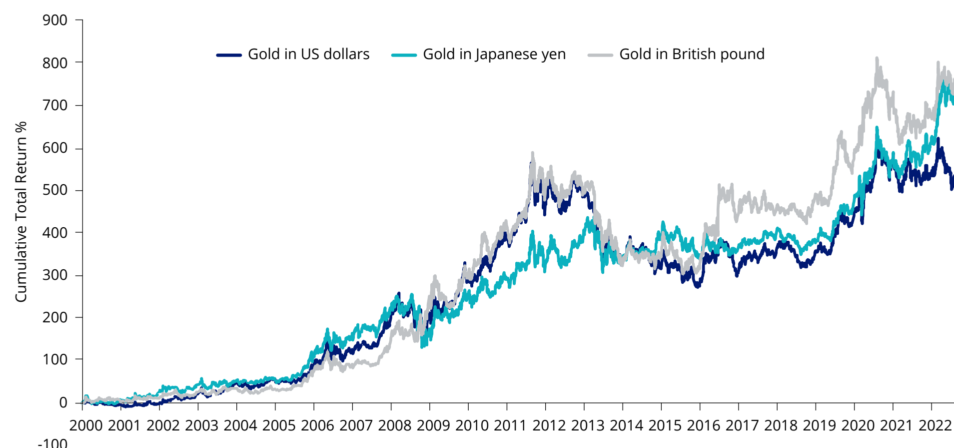
Gold broke out of its recent downward trend trading well above US$1,700 per ounce and it now looks like it may be back on the longer-term bull trend that has been in place since 2016. This is a significant development for gold.

We expect gold to continue to trade around the US$1,700 to US$1,800 per ounce range in the near term. If inflation remains at or near current levels, we would expect this to support gold. A pause of the Fed's tightening program would likely be a strong catalyst for gold. However, gold may rally even ahead of a Fed pause or pivot. The recent gold price action following the CPI report for October is a perfect example of this. Gold broke out as the market anticipated that Fed rate increases might soon start to slow down. Gold also rallied well ahead of a Fed pause during the last tightening cycle.

In the longer term there are several factors supportive of gold. Slowdowns, including recessions, in the past, have been a tailwind for the price of gold.

Chart 15: Mind the gap

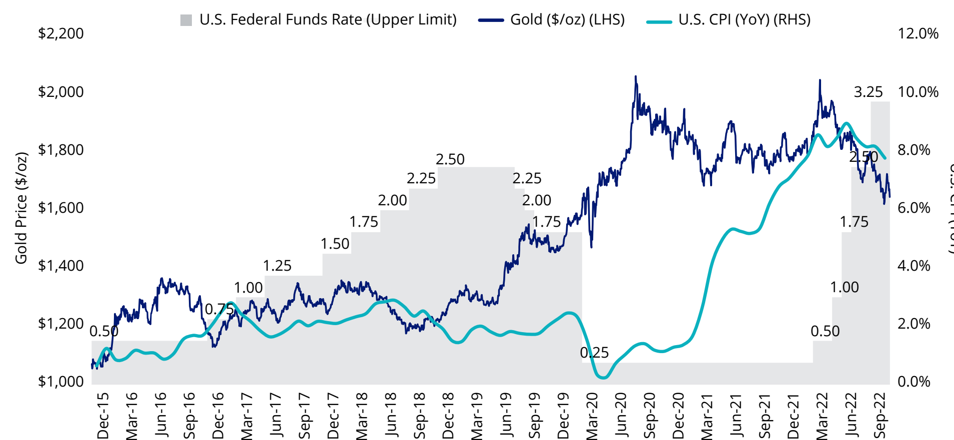
Gold price returns in dollar, yen and pound terms



Source: Bloomberg. Data as of December 20, 2022. Past performance is no guarantee of future results.

Chart 16: Similar to past rate hiking cycles, gold could get a boost from a pause

The gold price during the past cycle



Source: FactSet, St. Louis Federal Reserve Bank. Data as of December 1, 2022. Past performance is no guarantee of future results.

China's tectonic policy shift

In China the official growth target might no longer be a binding goal, but ignoring the slipping growth forecasts, with the 2022 growth potentially going below 3%, is not an option either. Chinese authorities tried various measures to prop up growth in the past months, including infrastructure programs, nudging banks to boost lending to developers and SMEs, and even outright rate cuts, but with limited success. What makes the latest policy shift different from the earlier easing measures and support packages is that it addresses the two most important growth headwinds – the zero-COVID policy and real estate crisis.

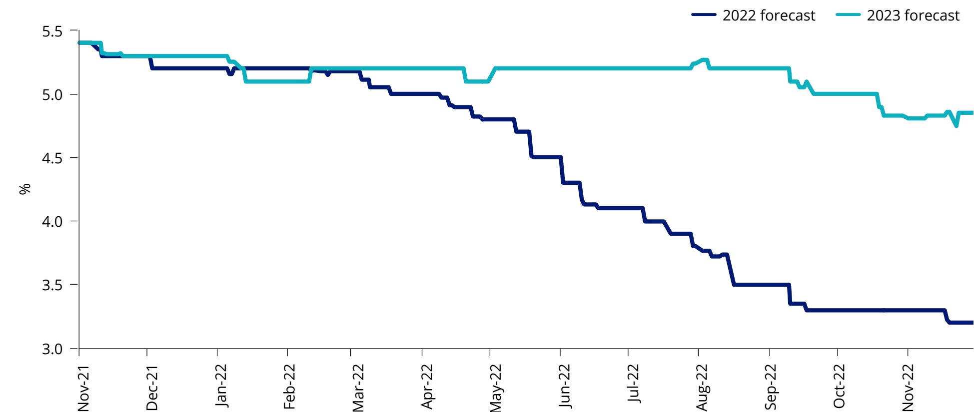
The timing of China's zero-COVID policy reversal was interesting – after the 20th Congress of the Communist Party and in the middle of a major spike in the number of new cases – but the U-turn seems real, with high-frequency indicators showing improvements in mobility, domestic flights frequency, box office, etc. The first big test of the new approach's viability will take place in January, during Chinese New Year, when more people will travel across China and the number of infections would be expected to increase.

In terms of China real estate, '16-point plan' and 'three arrows' are some of the monikers for China's policy push to end the multi-month uncertainty in the sector. The authorities are not only opening all avenues to provide ample and "stable" financing – bank loans/credit lines, corporate bonds, and equity funding – but also absolving lenders from personal responsibility if something goes wrong, easing escrow account regulations, promising equal treatment of state-owned and private developers, and lining up additional mortgage support for homebuyers. As usual, implementation is key, but China's High Yield/developers' bonds staged a rally after the announcements.

China's domestic consumption took a big hit in 2022. It looks like the policy focus is still on the supply side, but the reopening and the prospect of a housing sector stabilisation point to a much better outlook for consumption (including pent-up demand), which should become a key growth driver in 2023.

Chart 17: China's growth no longer a binding goal

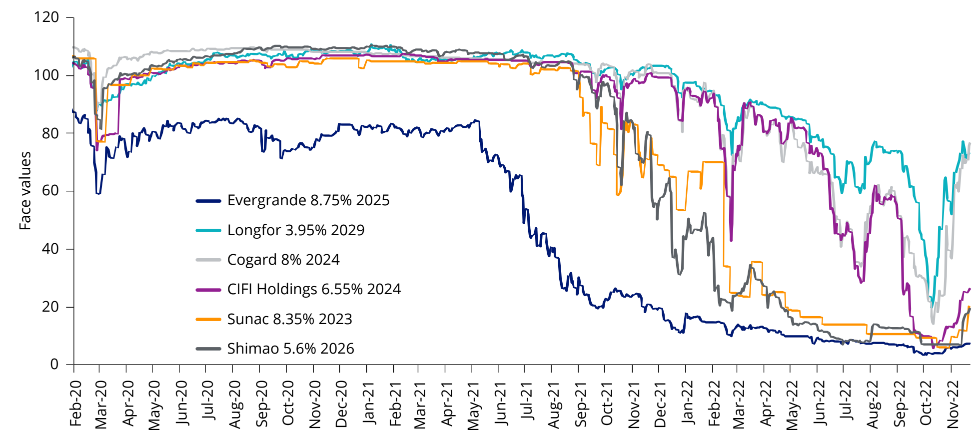
China Real GDP Growth Consensus Forecast



Source: Bloomberg.

Chart 18: Responding to policy shifts

China property bonds - prices



Source: Bloomberg.

Emerging markets, a perfect storm

Emerging economies should benefit from favourable tailwinds in 2023. First, there's a strong commodities backdrop, due to both supply constraints and now accentuated by China's reopening. This is creating potentially persistent inflation in some developed economies, but emerging market economies includes commodities exporters.

Another tailwind is emerging markets (EM) interest rates are generally already high, which both better insulates EM economies from inflation, and generates the potential for rate cutting cycles. These two tailwinds combine to a perfect storm of continued EM global growth dominance.

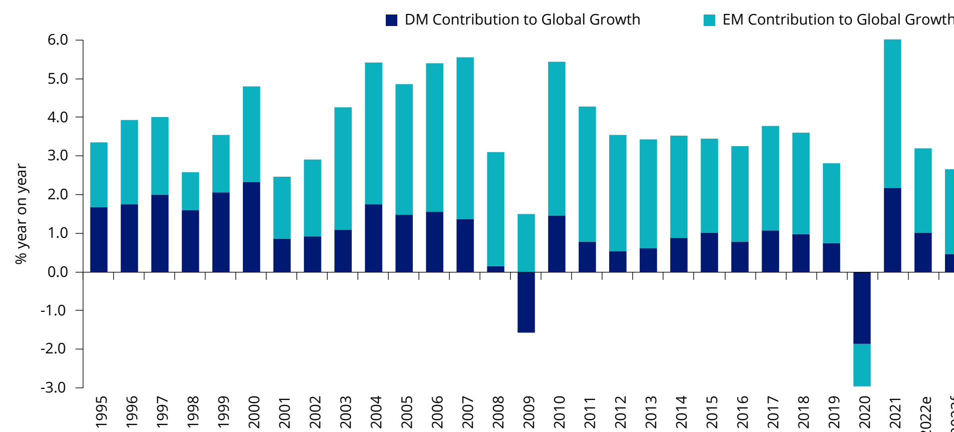
EM exports commodities, and hiked real policy rates to deal with any inflationary impact, whereas DM largely imports commodities and didn't hike real policy rates as significantly. This bodes well for EM into 2023. EMs we think, will dominate global growth, as they have done since the dotcom bust earlier this century.

Opportunities for investors exist. China's re-opening is nascent and unpriced in our opinion because the market is focusing on commodities-intensive sectors.

The bigger context, and the biggest geopolitical development facing the markets is Eurasia, which is remarkably un-discussed and priced. Russia, China, Iran, and all the countries in between are "locked up". Commodities exports from that region are no longer reliable for western buyers. Pipes are being re-directed to China and eastward generally. Kazakhstan alone produces around 40% of global uranium. The region's position as a major resource producer will be leveraged as Russia re-directs all oil and gas pipelines toward Asia (by 2025). In fact, China and Russia have stated plans to deepen financial infrastructure with ideas such as digital gold, commodity-backed-currencies and a currency bloc. All of these would attract dollars to EM currencies, especially in Asia and in commodity exporters. In any case, our point is that this is a story of greater trade integration, attraction to EM currencies, and growth.

Chart 19: Emerging markets growth dominance should continue

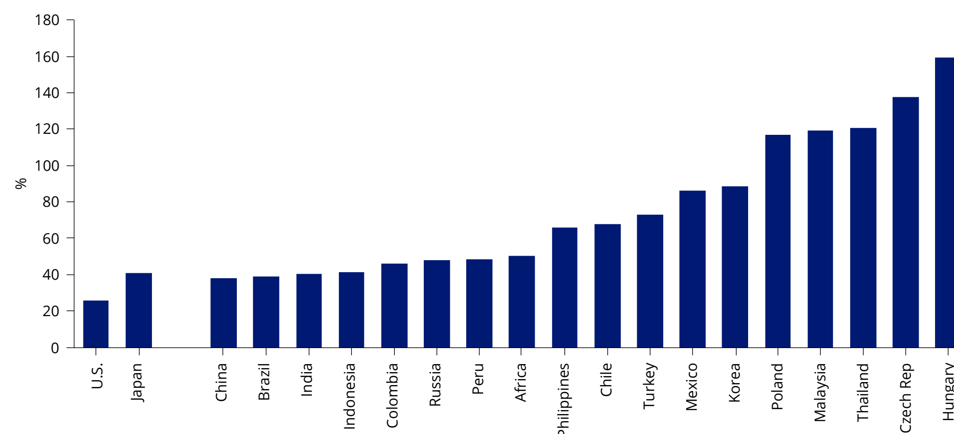
Contribution to global growth – emerging markets versus developed markets



Source: Bloomberg, data as of November 2022.

Chart 20: Emerging markets have far-greater exposure to trade

Openess of the economy (sum of exports and imports of goods and services/GDP)



Source: IMF.

The lucky country again?

Where the US dollar had a strong 2022, there is a runner-up with better prospects: the Australian dollar, the little Aussie battler.

While Australia faces some significant risks, China's policy shift away from COVID zero and the RBA getting a significant amount of tightening in before wages had a chance to take off both mean it's possible Australia could avoid a recession. It is worth noting that Australian wage measures are not great, and while most show continued moderation, the broadest measure of labour cost, compensation of employees, rose 3.2% in Q3. Of course, this included one-off super contributions and national wage case, plus rising employment levels. Wages and salaries, which includes only rising wages and employee numbers, rose 2.7%.

If China can pick up pace and Australia can skirt a property/credit implosion, the Australian dollar could do well, particularly against a sliding US dollar. An easing of China trade sanctions would be icing on the cake.

Of course, there are a couple of big "ifs" in there. While the housing market and consumer sentiment have looked a little more stable of late, there's a sense in which this is still the "phony war", that is, the impact of rising rates has yet to fully hit households.

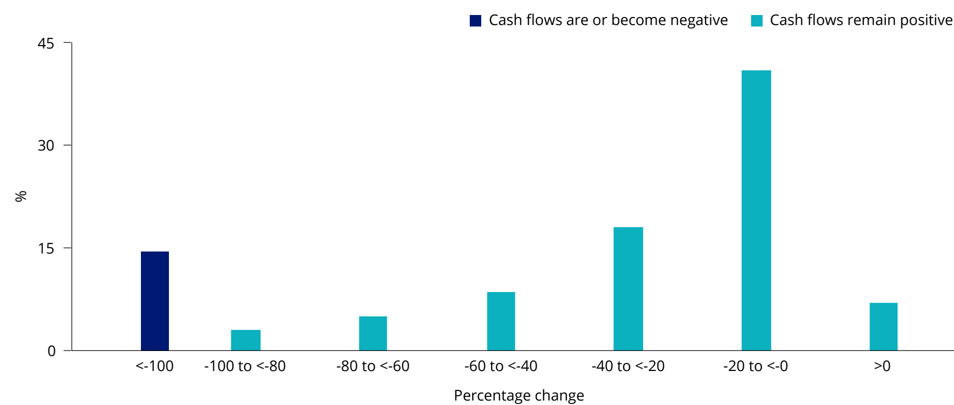
When it does, it will be exacerbated by fixed rate mortgages rolling off to be replaced by much higher floating rates. The RBA estimates that surging mortgage repayments will see around 40% of households' spare cashflows drop by 40% or more. Up to 15% of households will see spare cashflows turn negative.

At the same time, falling real wages, the dark side of moderate wages growth in the face of soaring inflation, looks to be exhausting COVID savings. In Q3, the household savings ratio dropped back to 6.9%, in the ballpark of pre-COVID levels.

So, the RBA looks likely to be on pause, perhaps throughout Q1. Whether it resumes tightening or not depends on whether households are over-cooked or not. We hope there's more to do. The alternative is a recession. It will be a tight landing, but that's the cost of holding rates down too long, then having to play catch-up.

Chart 21: Surging mortgage repayments are problematic

Distribution of changes in spare cash flows[1]: Inflation and interest rate scenario, variable-rate owner occupiers

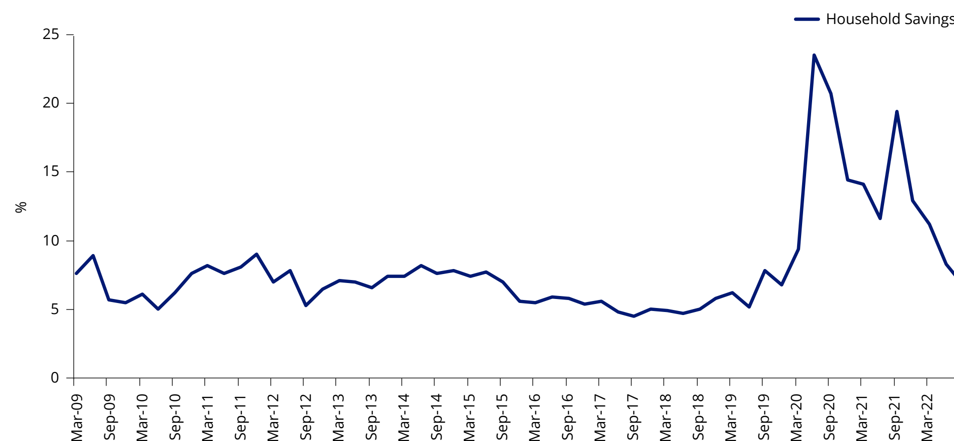


Source: RBA

1 – Cash flow estimated as income net of mortgage payments and essential lining expenses; assumes interest rates rise by 350 basis points relative to April 2022 levels; wages and inflation evolve in line with August 2022 SMP forecasts.

Chart 22: The dark side of moderate wages growth and high inflation

Australian household savings has retreated to pre-COVID levels



Source: ABS.

VanEck's range of Exchange Traded Funds on ASX

Equity opportunities

VanEck ETF	ASX code	Index	Management fees (% p.a.)*
Australian Broad Based			
Australian Equal Weight ETF	MVW	MVIS Australia Equal Weight Index	0.35%
Australian Small and Mid Companies			
Small Companies Masters ETF	MVS	MVIS Small-Cap Dividend Payers Index	0.49%
S&P/ASX MidCap ETF	MVE	S&P/ASX MidCap 50 Index	0.45%
Australian Sector			
Australian Property ETF	MVA	MVIS Australia A-REITs Index	0.35%
Australian Banks ETF	MVB	MVIS Australia Banks Index	0.28%
Australian Resources ETF	MVR	MVIS Australia Resources Index	0.35%
Sustainable Funds			
MSCI Australian Sustainable Equity ETF	GRNV	MSCI Australia IMI Select SRI Screened Index	0.35%
MSCI International Sustainable Equity ETF	ESGI	MSCI World ex Australia ex Fossil Fuel Select SRI and Low Carbon Capped Index	0.55%
International			
MSCI International Quality ETF	QUAL	MSCI World ex Australia Quality Index	0.40%
MSCI International Quality (Hedged) ETF	QHAL	MSCI World ex Australia Quality 100% Hedged to AUD Index	0.43%
MSCI International Small Companies Quality ETF	QSML	MSCI World ex Australia Small Cap Quality 150 Index	0.59%
Morningstar International Wide Moat ETF	GOAT	Morningstar® Developed Markets ex Australia Wide Moat Focus Index™	0.55%
Morningstar Wide Moat ETF	MOAT	Morningstar® Wide Moat Focus NR AUD Index™	0.49%
MSCI International Value ETF	VLUE	MSCI World ex Australia Enhanced Value Top 250 Select Index	0.40%
MSCI Multifactor Emerging Markets Equity ETF	EMKT	MSCI Emerging Markets Multi-Factor Select Index	0.69%
FTSE China A50 ETF	CETF	FTSE China A50 Index	0.60%
China New Economy ETF	CNEW	MarketGrader China New Economy Index	0.95%
Global Sector			
Gold Miners ETF	GDX	NYSE Arca Gold Miners Index® (AUD)	0.53%
Global Healthcare Leaders ETF	HLTH	MarketGrader Developed Markets (ex-Australia) Health Care AUD Index	0.45%
FTSE Global Infrastructure (Hedged) ETF	IFRA	FTSE Developed Core Infrastructure 50/50 Index Hedged into AUD	0.52%
FTSE International Property (Hedged) ETF	REIT	FTSE EPRA Nareit Developed ex Australia Rental Index AUD Hedged	0.43%
Thematic			
Video Gaming and Esports ETF	ESPO	MVIS® Global Video Gaming and eSports Index (AUD)	0.55%
Global Clean Energy ETF	CLNE	S&P Global Clean Energy Select Index	0.65%

*Other fees and costs apply. Please see the respective PDS.

VanEck's range of Exchange Traded Funds on ASX

Income opportunities

VanEck ETF	ASX code	Index	Management fees (% p.a.)*
Australian Equity Income			
Morningstar Australian Moat Income ETF	DVDY	Morningstar® Australia Dividend Yield Focus Equal Weighted Index™	0.35%
Fixed Income			
Australian Corporate Bond Plus ETF	PLUS	iBoxx AUD Corporates Yield Plus Mid Price Index	0.32%
Australian Floating Rate ETF	FLOT	Bloomberg AusBond Credit FRN 0+Yr Index	0.22%
Australian Subordinated Debt ETF	SUBD	iBoxx AUD Investment Grade Subordinated Debt Mid Price Index	0.29%
Global Income		**Performance Benchmark**	
Emerging Income Opportunities Active ETF (Managed Fund)	EBND	50% JPM EMBI Global Diversified Hedged AUD and 50% JPM GBI-EM Global Diversified	0.95%
Capital Securities		**Index/Benchmark**	
Global Capital Securities Active ETF (Managed Fund)	GCAP	RBA Cash Rate + 3% per annum	0.59%

Alternative opportunities

VanEck ETF	ASX code	Index	Management fees (% p.a.)*
Alternatives			
Global Listed Private Equity ETF	GPEQ	LPX50 Index	0.65%
Global Carbon Credits ETF (Synthetic)	XCO2	ICE Global Carbon Futures Index	0.45%
Gold Bullion ETF	NUGG	Tracks the price of gold	0.39%

*Other fees and costs apply. Please see the respective PDS.

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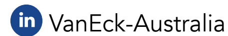

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