London market set for year of two halves after gloomy start to 2023, say experts

T
he London market kicks off 2023 with a gloomy backdrop as the UK is forecasted to plunge into recession and economies globally wrestle with sky-high inflation amid the energy and cost crisis.

After the extreme volatility of 2022, the FTSE 100 Index is expected to start the year on the back foot, as Britain is caught in the grip of a recession and rising interest rates, to calm painful price hikes.

But it is seen as being a year of two halves on the market, according to Susannah Streeter, senior investment and markets analyst at Hargreaves Lansdown.

There may begin to be some respite on the stock market in the second half of the year after the price spiral dips and central bank policymakers press pause on rate rises

She said: “The FTSE 100 is expected to dip back as the effects of the recession are felt, as even international revenue streams won’t fully protect UK listed companies from the impact of the contraction.

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"The war in Ukraine, which set off the inflation tsunami in 2022, is entrenched and, although scorching commodity prices have come down, the repercussions are still being felt through stubbornly high consumer prices.

"However, there may begin to be some respite on the stock market in the second half of the year after the price spiral dips and central bank policymakers press pause on rate rises."

She said the prospect of inflation cooling at the end of the year, as the cost of living crisis dampens household and business spending, may allow central banks in the UK and abroad to take their foot off the rates pedal.

"While output over the first half of the year will disappoint, there is a chance that growth in the latter part of 2023 could defy expectations as central banks reach peak interest rates and inflation cools off allowing them to press pause on rate rises," said Ms Streeter.

Another factor that will have influence stock markets worldwide is the reopening of China as it relaxes Covid restrictions, which would ease pressures on supply chains.

The good news with China's reopening is that it should boost global growth

But Ipek Ozkardeskaya, senior analyst at Swissquote Bank, said this could be a double edged sword.

"The good news with China's reopening is that it should boost global growth," she said.

"The bad news with China's reopening is that it will not only boost global growth, but also energy and commodity prices – hence inflation, the interest rate hikes from central banks and potentially the global Covid cases – which could then give birth to a new, and a dangerous Covid variant, which would, in return, bring the restrictive Covid measures back on the table, and hammer growth.”

On the bright side, China’s revival should provide a welcome boost to the FTSE 100, given that the top flight is largely made up of firms that make their earnings overseas, such as mining giants.

Its heavy weighting of natural resource stocks and firms that make their earnings in the US dollar has helped support the top tier through a volatile 2022, as commodity prices have risen and the greenback has strengthened, “and the FTSE 100’s outperformance could stretch into 2023”, Ms Ozkardeskaya said.

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“If the Chinese reopening brings along another bump in inflation due to higher energy and commodity prices, the FTSE 100 could continue offering a good shelter to those willing to hedge against an energy-led global inflation to temper the negative effects,” she added.

But it may be a different picture in the wider FTSE 350, with the FTSE 250 Index more representative of the health of smaller UK firms.

“The FTSE 100’s good performance won’t change the fact that smaller, and domestic focused companies will likely continue to suffer from high inflation, recession and perhaps another year of political turmoil as a cherry on top,” said Ms Ozkardeskaya.