

# Economic Update



## Market and Economic overview

### Australia

- CPI rose 0.4% in the September, but the annual pace of Australian inflation has slowed to 1.9%. This reduces the likelihood of policy tightening by the Reserve Bank of Australia.
- For now, official interest rates remain at 1.50%, where they have been for more than two years.
- Australian unemployment declined to 5.0% in September, the lowest level since 2012. There likely remains scope for further job growth; unemployment was as low as 4.1% before the GFC.
- Data indicated that the national savings rate has increased to 3.5%, from 1.9% previously. This suggests Australian households are reining in their discretionary expenditure.
- Building approvals weakened sharply in August and only partly recovered in September, suggesting developers may be reducing activity levels following stagnation in residential property prices.
- Growth in the value of new mortgages also decelerated to its slowest pace since early 2016; another sign of the cooling housing market.

### United States

- Initial estimates suggest US GDP grew at an annual pace of 3.5% in the September quarter. This was ahead of expectations and highlights ongoing strength in the world's largest economy.
- Conditions remain particularly buoyant in the services sector – a survey by the Institute of Supply Management rose to a near record level in September. This gauge of the services sector suggests conditions are the most favourable since 1997.
- Factory and durable goods orders also remain buoyant, which augurs well for manufacturers.
- These conditions are supporting ongoing employment growth; a further 134,000 jobs were created in September.
- The US has added more than two and a half million jobs in the past year and unemployment has fallen to a 49-year low of 3.7%.

### Europe

- Inflation in the Eurozone edged up to 2.1% in September, though is not yet sufficiently strong for the European Central Bank (ECB) to consider raising official interest rates.
- The ECB's quantitative easing program is due to be withdrawn by the end of 2018. Some observers are suggesting that the Bank should reconsider, citing ongoing economic sluggishness.
- Unemployment in the Eurozone has fallen to 8.1%, the lowest level since 2008. The labour market continues to show significant variation between countries and age cohorts. The jobless rate is above 15% in Spain, for example, and the youth unemployment rate is 16.6% in the euro area as a whole.
- The Bank of England left official UK interest rates unchanged at 0.75%. With inflation under control and the housing market showing signs of weakness, no further rate rises are anticipated in the near future.

## Asia

- There were some mixed signals in Japan. The quarterly Tankan survey of manufacturing activity deteriorated, but capital investment has risen more than 13% over the past year as companies have taken advantage of tax incentives.
- Unemployment in Japan is now just 2.3%, close to 25-year lows.
- In China, the GDP growth rate fell to 6.5% yoy in the September quarter; the slowest pace since 2009.
- More encouragingly China's trade surplus with the US widened to a record high, suggesting the implementation of tariffs has not yet significantly affected export demand.

## New Zealand

- Exports are seeing a seasonal slowdown, but the NZ\$4.33 billion figure for September was ahead of estimates. Dairy produce and meat remain the most important exports.
- Imports also increased markedly, however, resulting in the largest monthly trade deficit on record.
- Higher import values were primarily attributable to fuel prices, although machinery and vehicle volumes also increased.
- Higher fuel prices also helped push inflation up to 1.9% yoy in the September quarter. With the rate in the middle of the target 1%-3% range, the Reserve Bank of New Zealand has suggested it is in no hurry to amend policy settings. Official interest rates remain at 1.75% and are expected to remain there throughout 2019.

## **Australian dollar**

The local currency was hampered by the sell-off in global share markets, mixed domestic housing data and further weakness in the Chinese yuan.

The 'Aussie' dollar declined 2.1% against the US dollar and was similarly weak against a trade-weighted basket of currencies.

## **Commodities**

Commodity prices were mixed, largely reflecting uncertainty around a possible escalation in the trade war between the US and China and the associated impact on global economic growth.

Industrial metals mostly fell. Lead (-6.7%), aluminium (-3.3%) and copper (-1.7%) weakened, while zinc (+0.7%) edged higher.

Brent crude (-8.8%) fell sharply, after touching four-year highs at the beginning of the month. Hurricane Michael – the strongest storm to hit US mainland since 1992 – threatened to slash demand in the US south eastern fuel markets. Rising inventories and trade tensions also weighed on prices.

Gold (+1.8%) finally had a positive month after six consecutive months of falls, despite a strengthening US dollar. A slump in global equity markets stoked demand for gold as a store of value. Silver (+0.2%) and platinum (+2.5%) also posted gains.

Iron ore (+8.1%) had another strong month amid record high Chinese steel production and a rising Chinese steel rebar price. Expectations of more stringent checks and controls on China's coking coal production during the winter season supported coking coal prices (+10.1%). Thermal coal (0.0%) finished the month flat, masking some price volatility during the month.

## **Australian equities**

Market weakness in September extended into October, with the S&P/ASX 200 Accumulation Index declining -6.1%. Less than a fifth of index constituents rose and all sectors saw negative returns amid rising concern that solid economic data would result in central banks raising interest rates quicker than expected.

Australian M&A activity has increased sharply over the last 12 months, with several more potential deals announced in October, including a AU\$3.70/share bid for MYOB Group from KKR & Co.

Bond proxy sectors such as Real Estate and Utilities fared relatively well despite falling -3.8% and -4.0% respectively. Lower Australian bond yields provided a degree of support.

The IT (-11.2%) and Energy (-10.5%) sectors were the worst performers. Afterpay Touch was the largest underperformer in the IT sector as the announcement of a Senate inquiry into the credit lending industry contributed to the stock falling -30.4% over the month. Nearly all constituents of the Energy sector fell as lower oil prices weighed on near term earnings expectations.

Stocks in the Financials (-5.9%) and Materials (-5.2%) sectors also struggled. AMP (-22.6%) fell to a 15-year low after providing a market update that showed net outflows of AU\$1.5 billion in its wealth management business in the third quarter of 2018

## **Listed property**

A-REITs had a weak month in September, returning -1.8%. Diversified A-REITs (+0.2%) was the best performing sub-sector, while Industrial A-REITs (-3.2%) was the weakest. Outperformers included Growthpoint Properties (+4.0%) and Investa Office Fund (+3.6%). While Growthpoint did not release any material news, it benefitted from recent M&A activity among peers. The weakest performers were Scentre Group (-3.4%) and Vicinity Centres (-5.4%). Scentre Group was one of only two REITs whose June 2018 results were viewed as “credit negative” by credit ratings agency Moody’s.

## **Global equities**

A miserable month for global equity markets at least had a happy ending, as better corporate earnings on both sides of the Atlantic helped to lift what was looking like the worst monthly performance since the GFC to “merely” the worst month in six years. US investors became nervous over longer-term rates rising to seven year highs, perceived hawkish comments from the US Federal Reserve in regard to monetary policy and a deterioration in the US earnings season after a bright start earlier in the month. Market volatility then contributed to the equity market malaise with a rush to safety and a still-higher USD, which itself was attributed to US earnings deterioration. Outside the US, markets were buffeted by fears about the escalating trade war between Washington and Beijing, slowing economic growth in China and the impasse over Italy’s proposed budget for 2019. The MSCI World Index ended the month down -5.4% in AUD terms.

One of October’s weaker performers was the Nikkei, which fell -9.3% in JPY terms. Global influences were compounded by an anaemic local earnings season, further strength in the Yen given its safe haven status and Japanese industrial production in September falling more sharply than expected. In spite of the Italian budget crisis, ongoing worries over Brexit and political uncertainty stemming from a poor election result for the ruling Christian Democratic Union party in Germany, European markets were surprisingly resilient - the UK FTSE and the German Dax were amongst the stronger performers for the month - down only -4.9% and -6.5% respectively in local currencies.

Emerging markets also struggled over October with the MSCI Emerging Markets Index down -6.8% in Australian dollars.

## **Global and Australian Fixed Interest**

Bond yields traded in reasonably wide ranges. In the US, for example, yields rose sharply early in the month – reaching highs of 3.23% – before giving back most of these gains later. Benchmark 10-year Treasury yields rose 8 bps in the month as a whole, closing at 3.14% reflecting favourable economic data.

Yields drifted lower in other regions as investors reined in their risk appetite and favoured the relative security of government bond markets. Ten-year yields closed the month 14 bps and 9 bps lower in the UK and Germany, respectively.

Economic data in Europe has not rebounded to the extent anticipated and business and consumer sentiment both remain subdued. Investors also maintained a keen focus on Italy and the country's proposed budgetary plan. Italian ministers have until 19 November 2018 to amend the budget and make it acceptable to the European Union. The spread between Italian and German bond yields continued to widen, reflecting investors' unease.

Domestically, the CPI came in below the Reserve Bank of Australia's 2% to 3% target range; removing a potential driver of Australian yields. The benchmark 10-year CGS yield closed October 4 bps lower, at 2.63%.

## **Global credit**

Weakness in global equity markets affected sentiment towards corporate bonds and saw credit spreads widen globally. The yield on the investment grade Bloomberg Barclays Global Aggregate Corporate Index widened by 12 bps, closing the month at 1.24%.

High yield securities saw even more significant moves; the spread on the Bank of America Merrill Lynch Global High Yield Index (BB-B) widened by 48 bps, to 3.25%. The extent of these moves was similar to what was seen in March of this year during the most recent sell-off in equity markets.

The September quarter US corporate earnings reporting season broadly affirmed ongoing profitability strength. In a number of cases, however, spreads widened – and share prices fell – for issuers reporting strong earnings but noting some caution over future prospects. This added to a growing consensus that earnings may be close to a peak, as borrowing costs increase and with the impact of government stimulus now rolling off.