MARKET WRAP

AUGUST 2017

Market and economic overview

The Reserve Bank of Australia (RBA) Board met on 1 August and left the official cash rate on hold at 1.5%, as widely expected. There has been no change in the official cash rate since August 2016.

In contrast to the strength in business confidence, consumer confidence was weaker, falling 1.2% for August and below its long-term average.

The S&P/ASX 200 Index finished the month largely flat, for the third consecutive month. This return masked some considerable divergence in the performance of various industry sectors.

Hurricane Harvey led to widespread destruction in Texas that will require a significant recovery effort. This also saw a sharp increase in gasoline prices.

A downward trend in bond yields continued in August, as investors took shelter in safe-haven assets in the face of geopolitical unrest.

Australia

The RBA continues to balance three key risks in the economy for their monetary policy deliberations:

- the outlook for inflation,
- the strength or otherwise of the labour market, and
- household financial stability.

The RBA released its quarterly Statement on Monetary Policy (SMP). The key development in the SMP was a slight downgrade adjustment to the near-term GDP growth forecasts for Australia, and a slight upward adjustment to the headline inflation forecast. The GDP estimate for year-end 2017 has been revised down to 2%–3%, from 2.5%–3.5% in the May edition. The June 2018 figures now have the mid-point for growth at 3.0%, down from 3.25%. These lower forecasts were driven by a weaker Q1 GDP result and tighter financial conditions, primarily driven by a stronger Australian dollar.

The headline CPI forecast for June 2018 and December 2018 was revised to 1.75%–2.75%, up from 1.5%–2.5%. This was driven by an upward revision to utility prices, despite the stronger AUD.

The NAB business survey for July showed business confidence strengthening, up to +12, from +8. Business conditions rose again, now at +15, up from +14 in June, reaching the highest level since early 2008 and three times its average level. There is significant divergence between industries, with retail on the weaker side and professional services strong.

In contrast to the strength in business confidence, consumer confidence was weaker, falling 1.2% for August and below its long-term average.

The July labour market report saw job gains continue, with a monthly gain of 27,900. The unemployment rate fell to 5.6%, from a revised 5.7% in June 2017. In a reversal of recent trends, there was a strong gain in part-time employment of 48,200, with 20,300 full-time jobs lost.

But while the jobs market strengthened, wage growth remains at record lows. The Wage Price Index showed wages growing just 0.5% in the second quarter and 1.9% over the year, the same level as the last 12 months. Mining had the weakest wage growth by sector, with an increase of 1.1% per annum, while Health Care was the strongest with a 2.3% per annum rise.

Despite muted wage growth, house prices continue to rise. CoreLogic capital city dwelling prices were up 0.1% per month in August, with annual growth of 9.7% per annum. Prices rose in four out of six capital cities, with Canberra and Hobart both up 0.6%, Melbourne rising 0.5% and Brisbane up 0.2%. Sydney and Adelaide were mostly flat, while Darwin (+2.2%) and Perth (-0.8%) both fell.

US

The US Federal Reserve Open Market Committee (FOMC) met did not meet in August. The broad market expectation is for rates to remain on hold, with the focus on unwinding the Fed's $US4.5 tn balance sheet, which could be announced at the 19–20 September meeting.

The minutes to the July FOMC meeting confirmed that "most" Fed officials backed a balance sheet move at "an upcoming meeting" and this should only modestly tighten policy. The discussion also focused on the recent weakness in inflation with "many" Fed officials seeing weak inflation as being due to idiosyncratic factors.

Much of the focus was on the annual central bank symposium, held at Jackson Hole, Wyoming. The theme of this year's conference was "Fostering a dynamic global economy". Despite some market expectations prior to the symposium, there were minimum policy implications. Chair Yellen instead focused on financial regulation, saying:

> *"any adjustments to the regulatory framework should be modest and preserve the resilience at large dealers and banks associated with the reforms put in place in recent years."*

The second estimate of Q2 2017 GDP data was released, with real GDP rising at 3.0% on a seasonally adjusted annualised rate, up from the first estimate of 2.6%. Annual growth is now 2.2% per annum, up from 2.0% per annum in the first quarter.

The ISM Manufacturing Index rose sharply in August, up 2.5 points to 58.8, the strongest reading since March 2011.

Inflation rose 0.1% per month in July with the annual rate rising to 1.7% per annum, up from 1.6% per annum but down from a peak of 2.7% per annum in February 2017. Core inflation rose 0.1% per month and 1.7% per annum. Idiosyncratic factors were once again at play, with the price of lodging away from home falling by a record 4.2% per month and new vehicle prices down 0.5% per month, the most since 2009. The Fed's preferred measure of inflation, the Core Personal Consumption Expenditure Index, rose 0.1% per month and 1.4% per annum for July, down from 1.5% per annum in June.

The US labour market continues to perform well. There were 156,000 jobs added in August, compared to 189,000 in July. The unemployment rate rose to 4.4% and the participation rate was steady at 62.9%. There was strong growth in manufacturing and construction jobs. Average Hourly Earnings rose to 2.5% per annum.

Hurricane Harvey led to widespread destruction in Texas that will require a significant recovery effort, north of $US120bn. This also saw a sharp increase in gasoline prices.

September is a key month for US politics with the increase in the debt ceiling, a spending bill to authorise government spending and tax reform all on the agenda.

Europe

The European Central Bank (ECB) did not meet in August, with the next meeting due on 7 September. Comments from ECB members over the month, including ECB President Mario Draghi, focused on the need for significant accommodation, with inflation still not converging to the 2% target.

European Commission President Jean-Claude Juncker commented on the Brexit negotiations, noting the disappointment with the UK Government's Brexit positioning papers. The focus initially has been on financial settlement, citizen rights and the Irish border.

The second estimate of Q2 2017 GDP data was released for the Eurozone, with growth of 0.6% per quarter and 2.2% per annum, up from 1.9% per annum in Q1 2017 and above trend for the region. Annual growth was 2.1% for Germany, 3.1% for Spain, 1.8% for France and 1.5% for Italy.

The Eurozone unemployment rate was steady at 9.1% in July.

Headline inflation rose to 1.5% per annum for August, from 1.3% per annum in July, while core inflation was steady at 1.2% per annum.

UK

The Bank of England (BoE) made no changes when it released its minutes on 3 August 2017. The BoE voted 6-2 to maintain the benchmark interest rate at 0.25%. There was a unanimous decision to keep its gilt and corporate bond purchase programs unchanged. It cut its forecasts for economic growth and wages, with the downgrades linked to Brexit.

GDP growth of 1.7% for 2017 and 1.6% in 2018 is forecast, which is down from 1.9% and 1.7% previously.

Real wages will also fall 0.5% in 2017, crimping consumer spending.

Headline inflation data for July fell 0.1% per month, with annual growth stead at 2.6%. Core CPI was also steady at 2.4% per annum.

Q2 GDP was 0.3% per quarter (1.7% per annum), with weak consumer spending still an issue.

New Zealand

The Reserve Bank of New Zealand (RBNZ) met on 10 August and left the official cash rate on hold at 1.75%, as widely expected. In its accompanying statement the RBNZ again refered to recent strength in the NZD on a trade-weighted basis noting that "a lower New Zealand dollar is needed to increase tradables inflation and help deliver more balanced growth."

On growth, the RBNZ commented that it is expected to improve going forward, due to:

- accommodative monetary policy,
- strong population growth,
- an elevated terms of trade, and
- the fiscal stimulus outlined in Budget 2017.

With this outlook, it is expected policy will remain accommodative for a "considerable period" with numerous uncertainties remaining; policy may need to adjust accordingly.

Q2 2017 labour market data was released, with the unemployment rate at 4.8%, compared to 4.9% prior. Wages remain weak, growing at 0.5% per quarter.

Canada

The Bank of Canada (BoC) did not meet in August, with the next meeting scheduled for 6 September. The last meeting (on 12 July) saw the BoC lift its target for the overnight rate to 0.75%.

Domestic economic data released in August continued to show strength. The unemployment rate fell to 6.3% for July, down from 6.5% with a 10,900 increase in employment.

Q2 2017 GDP data was released and was much stronger than anticipated, rising 4.5% on a seasonally adjusted annualised rate. This is the strongest since 2011, driven by strength in household consumption, rising income and improvements in trade thanks to a synchronised improvement in global trade.

Japan

The Bank of Japan (BoJ) did not meet in August, with the next meeting due on 21 September.

Comments made by Bank of Japan Governor Haruhiko Kuroda focused on the need for extremely accommodative monetary policy for some time, given the lack of inflation pressure.

Strong Q2 2017 GDP data showed a 1.0% rise for the quarter, driven by a 2.4% per quarter increase in business spending and a 0.9% per quarter increase in household spending.

China

The official Manufacturing PMI data for August showed a slight improvement, rising to 51.7, up from 51.4 in July. The Non-manufacturing PMI fell to 53.4 in August, down from 54.5 in July. Other monthly indicators were mixed, with Industrial Production weaker in July at 6.4% per annum, down from 7.6% per annum in June.

Inflation remains low, at 1.4% per annum to July, down from 1.5% per annum in June. Much of the weakness has been driven by food prices, which fell 0.1%.

The focus on China continues to be the upcoming 19th National People's Congress and the important 5-year leadership change on the seven-member Politburo committee. There are reports that the date has been set for 18 October, slightly earlier than expectations.

Australian dollar

There were some interesting moves in currency markets over August. A move into safe haven currencies was driven by an escalation of geopolitical risks with North Korea, after further missile testings and exchanges of rhetoric with President Trump.

The Australian dollar was mixed in August, rising 1.5% against the Sterling and 3.9% against the NZ dollar. Falls were recorded against the US dollar (-0.7%), Euro (-1.2%) and Japanese Yen (-1.0%).

Outside of the Australian dollar, both the Euro and Yen were generally stronger over the month, with the US Dollar Spot Index falling 0.2% in August. This masks some bigger moves against some currencies. The Euro strengthened 0.6% against the US dollar in August, and 2.8% against the Pound, with the later driven by Brexit negotiations and an improving European economy.

Commodities

There were overall gains in the commodity space over August, with the largest gains in the metal complex. Oil was weaker.

The main influences on the metal space was continued signs of synchronised global growth, some supply disruption and signs from China that overcapacity will be reduced. Nickel (+15.5%), zinc (+12.6%), aluminium (+10.4%), copper (+6.6%) and lead (+2.6%) all rose.

West Texas Intermediate (WTI) crude oil finished the month at $US47.23/bbl, down 5.9%. This was primarily driven by the effects of Hurricane Harvey on the Texas coast, which reduced demand for oil. (Up to one-third of refining capacity was offline due to the devastating impacts.) By early September, refining capacity had started to come back online, but not before gasoline prices rose 25.5% in August.

Iron ore prices rose again this month, with the spot iron ore contract (Qingdao 62% Fe fines) up 7.1% to $US78.9/t, a lift of 48% from the low in mid-June. Stronger than expected economic growth figures in China and other industrial indicators helped propel the iron ore price higher.

Reflecting rising geopolitical risks, precious metal prices were stronger, with gold up 4.1% to $US1321.4 an ounce — its highest level in 11 months.

Australian equities

Despite big swings in the share prices of individual companies during the August 'reporting season', the S&P/ASX 200 Index, for the third consecutive month, finished the month largely flat, returning +0.7%. This return masked some considerable divergence in the performance of various industry sectors.

Energy (+5.7%), Materials (+4.4%), Industrials (+4.6%) and Consumer Staples (+5.3%) were the market's best performers, as companies in these sectors reported production upgrades, stronger cash flow and debt reduction driving earnings. Materials companies, including BHP Billiton and Rio Tinto, performed well on exceptionally strong cash flows.

Telcos (-7.4%) was the worst performing sector, dragged lower by sector giant Telstra, which posted a double-digit loss following its dividend cut announcement. In Financials (-2.2%), weaker-than-expected results from general insurers, including IAG, QBE and Suncorp, dragged insurers lower, while banks were led lower by CBA, which came under investigation by AUSTRAC and APRA.

Consumer Discretionary stocks (-1.5%) were mostly lower, with weaker guidance and a lack of conviction around the outlook a common theme. Health Care (0.3%) was flat, with a small gain by CSL offset by losses from smaller stocks, including Sonic Healthcare and Healthscope.

Listed property

The S&P/ASX 200 A-REIT index rose 1.3% in August and outperformed the broader S&P/ASX 200 by 0.6%.

The A-REIT index was up as much as 3.3% over the month, buoyed by some promising earnings results announced in early August. It was also buoyed by the market's interpretation of the minutes of the most recent monetary policy meeting of the Reserve Bank Board, which indicated that any interest rate hikes are still some way off. However, some disappointing results from larger cap stocks, including Scentre Group and Goodman Group, saw the index give back some of its returns later in the month.

Retail A-REITs struggled over August (-2.9%) as most retail landlords reported that they face a challenging leasing environment and slowing speciality sales growth. Meanwhile, the Industrial subsector continued its run of stronger returns, posting +4.1% in August. Office A-REITs delivered 2.0% on the back of pleasingly resilient occupancy levels.

Outside Australia, listed property markets were weaker. The FTSE EPRA/NAREIT Developed Index (TR) fell -0.5% over the month in USD terms. New Zealand was the worst performing market in USD terms for a second month (-4.9%), with the UK, Japan and the US all down in USD terms as well (-3.0%, -2.9% and -1.0% respectively). Hong Kong was the strongest performer with a rare positive result in USD terms (+3.4%).

Global shares

Global developed equity markets were muted in August, weighed down by the Northern Hemisphere summer break and rising geopolitical tensions with North Korea – but also the domestic legislative agenda, particularly as the debt ceiling deadline nears in the US.

The VIX Index, a market estimate of future volatility using implied volatility, showed greater variance in August, driven largely by strains following North Korea's missile testing. The average was 11.9 in August and spiked as high as 16.0, compared to an average of 10.3 in July.

The MSCI World Index fell 0.1% in US dollar terms in the month, but up 0.6% in Australian dollar terms on the weaker AUD.

In the US, the S&P500 (+0.1%), the Dow Jones (+0.3%) and the NASDAQ (+1.3%) produced positive returns, with the NASDAQ outperforming on strong gains in Apple (+10.7%). MSCI Information Technology (+2.8%) outperformed, while MSCI Energy (-3.9%) fell on weaker oil.

Equity markets in Europe were mixed. France (-0.2%), Germany (-0.5%) and Spain (-1.9%) fell, driven by Euro strength. Italy rose 0.9%. In the UK the FTSE100 rose 0.8% despite concerns around Brexit negotiations. Asian markets were mixed, with the Japanese Nikkei 225 down 1.4%, Singapore down 1.6%, but Hong Kong up +2.4% on property and bank stocks.

Global emerging markets

Emerging market equities had another positive month, assisted by the cyclical improvement in the global economy, commodity price gains and the weaker US dollar. The MSCI Emerging Market Index was up 2.0% in USD terms and 2.7% in AUD terms. In the calendar year to date, the index is up 28.6% in USD terms.

MSCI EM Latin America (+4.4%) rose strongly due to gains in iron ore and base metal prices. MSCI EM Asia ex Japan gained 1% over the month, while the MSCI EM Europe, Middle East and Africa was up 4.3%, led higher by Russia.

Fixed interest

Since the spike in bond yields at the end of June, driven by perceptions of global central bank coordinated action, the downward trend in bond yields continued in August. This was helped along by investors taking shelter in safe-haven bonds, as geopolitical unrest ramped up following North Korea's missile launches.

Also impacting markets in August were heightened concerns around potential for a lack of any positive fiscal reform in the US, and as the debt ceiling deadline approaches.

Looking at 10-year government bond yields across the globe, yields have generally traded toward the bottom of the range for 2017. UK gilts were down 20 bps in the month to 1.03%, with while US treasuries and German bunds were down 18 bps to 2.12% and 0.36% respectively. Japanese government bonds were down a lesser 7 bps to 0.01%. Australia was the only market to see a rise in yields (up 4 bps), reflecting a decoupling with offshore yields and the positive business investment data toward month end. Ten-year yields finished August at 2.71%.

Global credit

Global investment grade credit spreads widened slightly in the month, as investors sought to reduce risk in response to tensions in North Korea and concerns over the future of US fiscal policy reforms.

The Bloomberg Barclays Global Aggregate Corporate Index average spread moved 7 bps wider to 1.09%. US credit moved 6 bps wider, with the Bloomberg Barclays US Aggregate Corporate Index average spread closing at 1.04%. In Europe, the spread on the Bloomberg Barclays European Aggregate Corporate Index was 7 bps wider to 0.99%.

US high yield credit spreads moved notably higher, with the Bank of America Merrill Lynch Global High Yield index (BB-B) out 20 bps to 3.01% by month end. The high yield market continues to be impacted by downgrades, particularly in the energy and mining sectors.

Australian credit performed well in the month, with the spread on the Australian iTraxx grinding tighter despite an initial reaction to the first round of North Korea's missile tests. The average spread relative to swap on the Bloomberg Australian Corporate Index was half a basis point narrower to 80 bps.

HEADING FORWARD
FINANCIAL PLANNING