WEEKLY MARKET UPDATE

AMP

11 OCTOBER 2024

Investment markets and key developments

Global share markets rose over the last week helped by the absence so far of an Israeli retaliation against Iran & hopes that it will avoid disrupting oil supplies along with optimism for a continuation of "Goldilocks" - not too hot not too cold - economic conditions. For the week US shares rose 1.1% also helped by solid bank results kicking off the September quarter earnings reporting season, Eurozone shares rose 0.7% and Japanese shares gained 2.5%. Chinese shares fell 3.3% on the absence of follow through so far in terms of fiscal stimulus announcements. Reflecting the global lead Australian shares rose 0.8% with gains in IT, financial and consumer stocks offsetting falls in property and resources shares. Oil prices rose slightly on ongoing supply disruption fears and are up about 11% since Iran's missile attack but only back to levels seen in August. Metal prices fell with iron ore back down slightly on the back of a lack of a big fiscal announcement in China. The $A fell slightly and the $US rose.

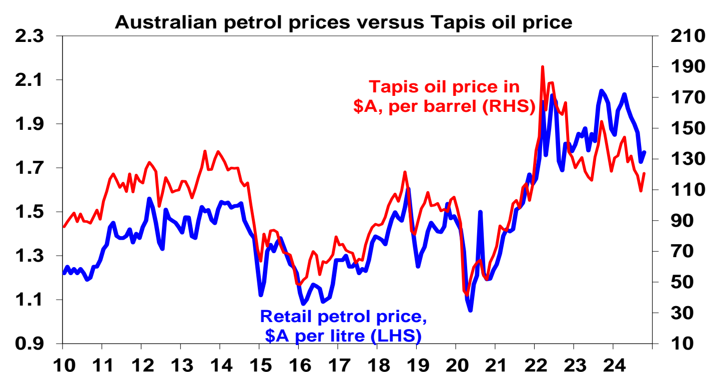
Shares continue to climb the proverbial wall of worry. The combination of stretched valuations, the still high risk of recession in the US and Australia, the expansion of the war in the Middle East to potentially impact oil supplies and the US election (with polling pointing towards rising prospects of a Trump victory) mean that the risk of another correction and ongoing bouts of volatility is high. On a 6-12 month view though shares are likely to head higher on the back of the success in getting global inflation down, central bank rate cuts (with the RBA getting closer to joining in) and China ramping up policy stimulus. October can often see high levels of share market volatility, but beyond that we are coming into a positive time of the year for shares from a seasonal perspective.

Middle East uncertainty remains very high. Fighting continues to intensify in Lebanon, but unless oil supplies are disrupted from an investment perspective it remains just another horrible war. And the key on this front is how Israel responds to Iran's missile attack and whether that results in further escalation between the two. There are basically four scenarios:

1. **Israel doesn't retaliate** – this is unlikely as it has said it will but if it doesn't oil prices are likely to fall back to where they were before Iran's attack. Of course, Israel may just take a while to respond until after it deals with Hezbollah.
2. **Israel attacks proportionately Iranian military targets and maybe secondary oil facilities like refineries** – oil prices would likely bounce around current levels but then settle back down.
3. **Israel attacks Iranian oil production and export facilities and/or nuclear facilities** – this could see oil prices spike $US10-15/barrel for several months as Iran's 1.75million barrels per day of oil exports are disrupted but would settle back down again as Saudi/UAE spare capacity makes up the gap.
4. **Iran retaliates to scenario 3 by attacking Saudi/UAE production and/or blocking the Strait of Hormuz through which 20% of global liquid fuel supply flows each day** - this could push oil prices back to the post Ukraine invasion highs around $US120/barrel or more which could add fifty cents a litre or more at the petrol bowser for Australian motorists. This in turn would add about $18 to the weekly household petrol bill which would act as a "tax" on spending depressing retail sales. It's a similar impact in other countries and a surge higher in oil prices could also threaten progress in getting inflation down although central banks including the RBA will focus on underlying inflation.

At this stage scenario 2 looks most likely (with 50% probability) with the US likely pressuring Israel to be proportionate, followed by scenario 3 (30%) and scenario 4 (10%) being less likely as Iran would be shooting itself in the foot if it gets into a war with other Gulf states. As always, its really hard to forecast geopolitical events and their impact on investment markets and too easy to lean to the negative.

So far oil prices are up around 11% from their pre-Iran attack levels and back to levels seen in August which is just in the realm of normal volatility and not enough to a significantly impact global growth or inflation. For Australian petrol prices it maybe adds 5 cents a litre at most but that will be lost in the regular discounting cycles each city sees.



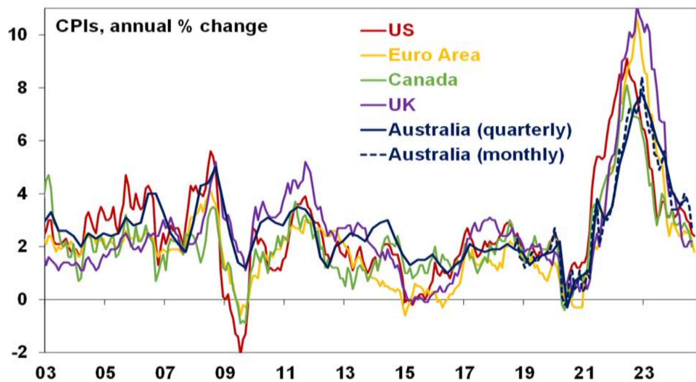
Source: Bloomberg, AMP

Global disinflation and rate cuts are continuing.

- **While US September inflation came in slightly higher than expected, disinflation is continuing, and the Fed likely remains on track for another 0.25% cut next month**. Still solid economic conditions with strong payroll data along with the minutes from the last Fed meeting indicating its not in a hurry argue against more 0.5% cuts but slowing leading jobs indicators (with rising continuing jobless claims in the last week) point to another 0.25% cut next month. This is also consistent

with comments from Fed speakers most of whom don't seem to have been fazed by the higher-than-expected September inflation data. In other words, we are likely to continue seeing "good cuts" (reflecting lower inflation) rather than a "bad cuts" (responding to plunging economic conditions). **Horrific hurricane damage in Florida is likely to distort some upcoming US economic data but is unlikely to signficantly alter the outlook** - with oil production/refining little impacted (unlike with Hurricane Katrina in 2005) and a short term hit to activity followed by a boost from rebuilding.

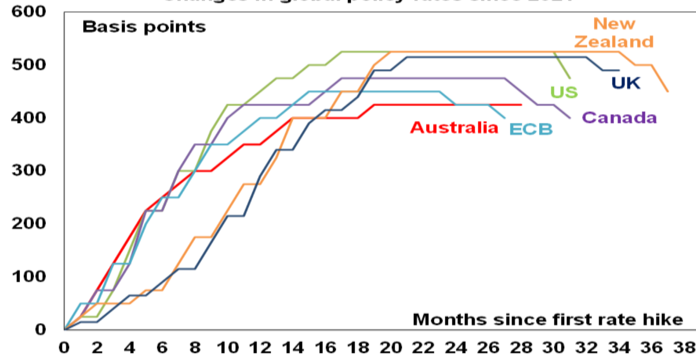
Global Inflation



Source: Bloomberg, AMP

- **The Reserve Bank of New Zealand cut its key policy rate by 0.5% taking it to 4.75% with another 0.5% cut likely in November** as it is becoming more concerned with rising excess capacity in New Zealand.

Changes in global policy rates since 2021

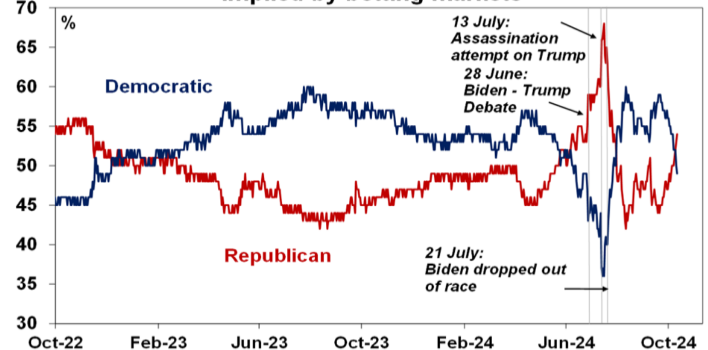


Source: Bloomberg, AMP

- **The Bank of Korea kicked off an easing cycle** lowering its policy rate by 0.25% to 3.25%.
- **Falling inflation and rates globally are positive for Australia as we lagged on the way up and are just likely doing the same on the way down**. The minutes from the last RBA meeting retained the RBA's cautious relatively hawkish stance. Yes, it omitted the line that "it was unlikely that the cash rate…would be reduced in the near term" but Governor Bullock repeated the same line at the post meeting press conference. However, we remain of the view that the fall in inflation and interest globally is good news for Australia because just as Australia lagged on the way up in inflation and rates its doing the same on the way down and so is no cause for alarm. Its also worth noting that Australian monthly trimmed mean inflation at 3.4%yoy is only just above US core inflation at 3.3%yoy and running about three months behind. And the latest NAB business survey and Melbourne Institute Gauge point to an ongoing fall in underlying inflation in Australia. So our base case remains for the RBA to start cutting in February with a risk that it could come in December after September quarter and October monthly inflation data.

Trump pushing ahead in US election polling. Harris is still ahead in national polling but only by 1.8 points whereas Biden was ahead by more than 9 points at this point in 2020, Trump is now leading in 5 of the 7 battleground states and betting markets now favour Trump over Harris. And the hurricanes and war in the Middle East appear to be giving him a boost as he claims he would handle the storms better and the wars wouldn't have happened if he were president. So far the US share market does not seem to fussed – although shares that might benefit under Trump are starting to outperform shares that might benefit under Harris – but we could start to see more volatility if this continues given Trump's policies to ramp up tariffs and kick off another trade war.

Probability of winning the Presidency, implied by betting markets



Source: Bloomberg, AMP

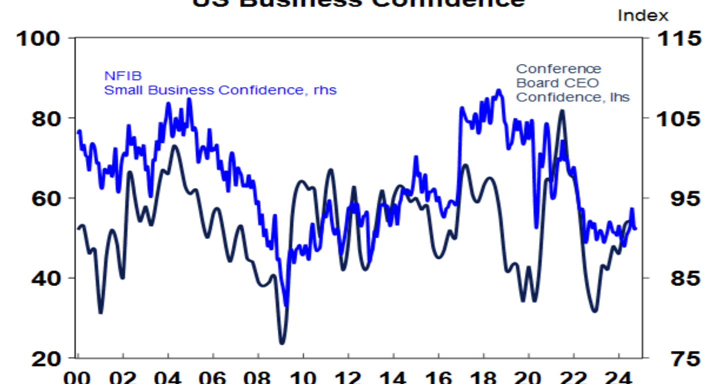
Still waiting for Chinese fiscal stimulus details. While a National Development and Reform Commission press conference disappointed investors by only bringing forward about RMB100bn of spending into this year against some expecting a RMB2trillion ($A420bn) or so boost, this was not really that surprising as the NDRC is more focussed on reform and structural policies rather than on fiscal policies and new funding. A Ministry of Finance press conference scheduled for Saturday 12 October will be watched closely although its unclear how much it can do in the absence of National People's Congress approval. In the meantime the Chinese share market pulled back after rallying 33% on the back of the move to stimulus two weeks ago – but it had run way ahead of itself so its 9% or so pullback is healthy.

Cold Play and The Pet Shop Boys. Over the years The Pet Shop Boys have done a great job of integrating rock/pop songs into their electronic disco sound. Their cross of Cold Play's [Viva La Vida with their Se a vida e] is worth checking out.

Major global economic events and implications

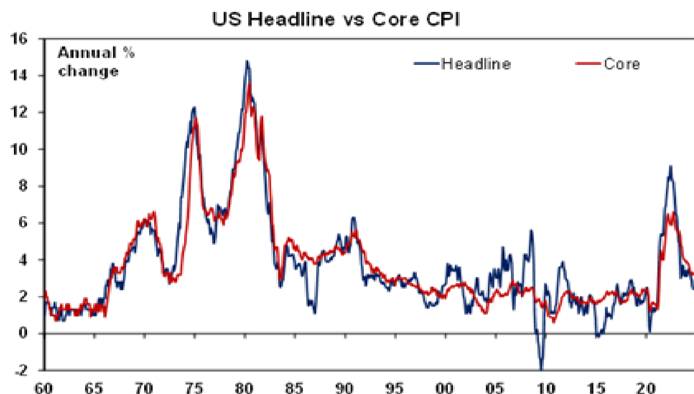
US small business optimism remained low in September. Initial and continuing jobless claims spiked in the last week. Hurricane Helene along with port and Boeing strikes likely drove the spike in initial claims with Hurricane Milton suggesting a further spike to come. So it would be dangerous to read too much into the spike in initial claims, but the spike in continuing claims is more significant and consistent with other indicators of a softening US jobs market.

US Business Confidence



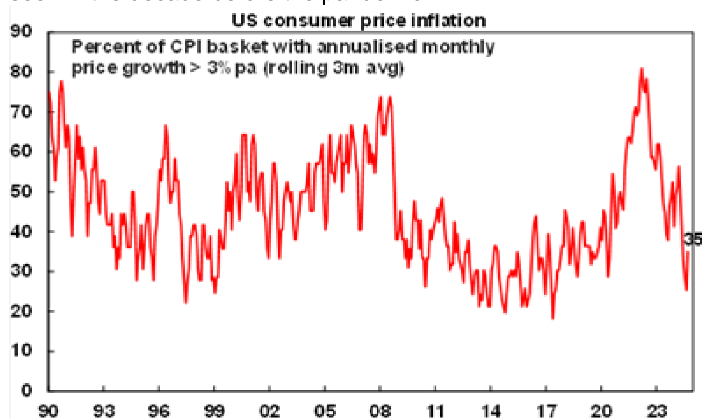
Source: Macrobond, AMP

US CPI inflation came in slightly stronger than expected in September, but disinflation remains on track. Headline inflation was 0.2%mom and fell to 2.4%yoy with core inflation unchanged at 0.3%mom seeing a slight rise to 3.3%yoy. This was 0.1% higher than expected, but much of the upside surprise was driven by volatile items (used car prices, car insurance and airfares) and rent inflation resumed its downswing. September producer price inflation was benign at no change in the month and 1.8%yoy and along with the CPI points to September core PCE inflation of around 0.23%mom and 2.6%yoy, down from 2.7%yoy.



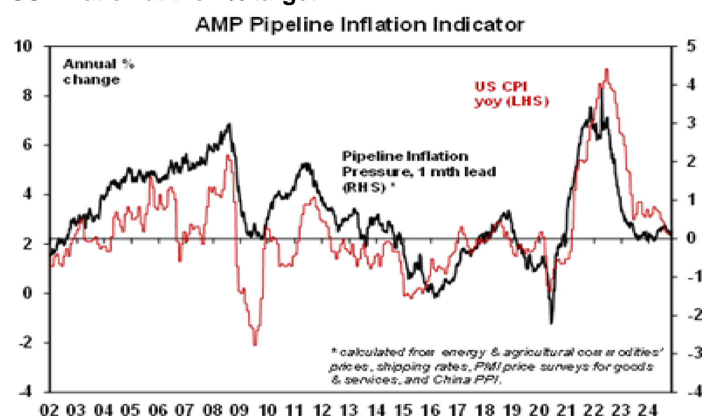
Source: Bloomberg, AMP

The breadth of high US inflation remains benign with the proportion of CPI basket components seeing monthly annualised inflation over 3% running at 35% in September which is in the range seen in the decade before the pandemic.



Source: Bloomberg, AMP

Our Pipeline Inflation Indicator is around levels consistent with US inflation at the 2% target.



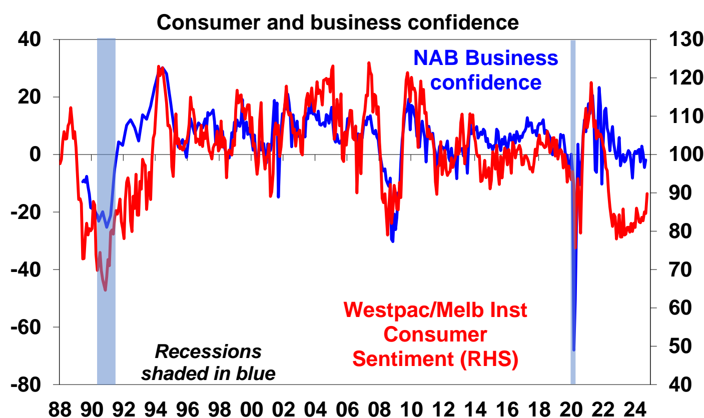
Source: Bloomberg, AMP

Eurozone retail sales rose just 0.2%mom in August and are up 0.8%yoy.

Japanese wages growth remained solid (for Japan) at 3%yoy, keeping the Bank of Japan on track for further monetary tightening although with mixed economic data and core inflation below target it will remain gradual.

Australian economic events and implications

Australian economic data over the last week was a touch stronger. **Consumer confidence rose 6% in August taking it to its highest level since May 2022, when the RBA started to raise rates**. Optimism that rate cuts are getting closer after the August CPI release looks to have been the main driver with tax cuts probably helping too. That said it remains weak.

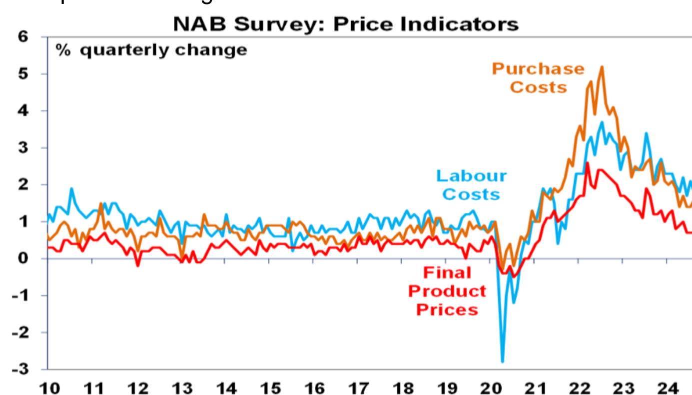


Source: Westpac/Melbourne Institute, AMP

The September NAB business survey showed slight lifts in confidence and conditions. Orders remain weak but employment improved although it continues to point to weaker jobs growth.

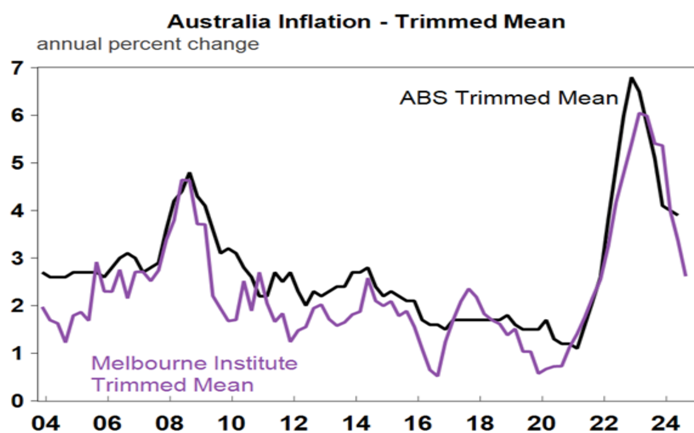
Source: ABS, NAB, AMP

The good news is that the NAB survey showed a further easing in cost and price pressures. Labour costs remain elevated but final product price increases are back to the top end of their pre-Covid range.



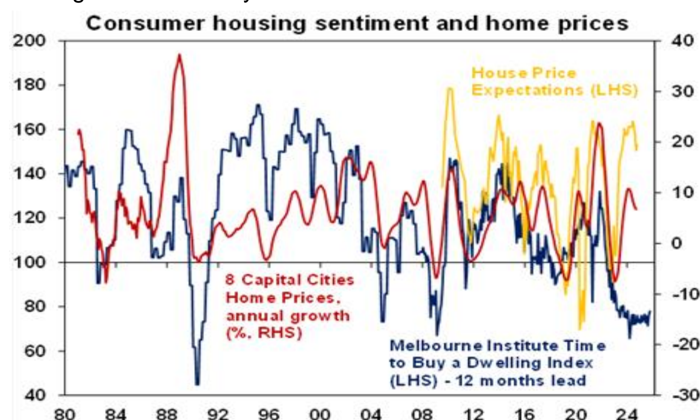
Source: NAB, AMP

Similarly, the Melbourne Institute's Inflation Gauge slowed again in September pointing to a further fall in underlying inflation.



Source: ABS, AMP

The October Westpac/MI consumer survey showed continuing high expectations for home price growth and a slight lift in perceptions of whether now is a good "time to buy a dwelling", although it remains very weak.



Source: CoreLogic, Westpac/MI, AMP

Finally, ANZ job ads rose 1.6% in July but are down 19.8% on a year ago pointing to slowing jobs growth & rising unemployment.

What to watch over the next week?

In the US, the main focus will be on retail sales for September (Thursday) which are expected to show a modest 0.2%mom gain. Other data is expected to be a bit mixed with industrial production expected to fall slightly and home builders' conditions for October expected to rise slightly (both also due Thursday), housing starts for September expected to show a slight fall (Friday) and manufacturing conditions in the New York and Philadelphia regions expected to remain subdued. The September quarter earnings reporting season will also start to ramp up with consensus expectations for a 4%yoy rise, ranging from -21%yoy for energy to +15%yoy for technology. After upside surprises its likely to come in around 8%yoy.

Canadian inflation for September (Tuesday) is likely to show a further fall to 1.9%yoy (from 2%) with core measures remaining unchanged at 2.3%yoy and 2.4%yoy.

The ECB (Thursday) is expected to cut its key deposit rate by another 0.25% taking it to 3.25%, with some chance it could be a 0.5% cut. ECB guidance is likely to remain dovish.

UK inflation for September (Wednesday) is expected to fall to 1.9%yoy, with core inflation falling to 3.4%yoy.

Japanese inflation for September (Friday) is likely to fall to 2.5%yoy (from 3%) with core inflation unchanged at 1.7%yoy.

Chinese GDP growth for the September quarter is expected to show a slight tick up to 1%qoq but with annual growth slowing to 4.6%yoy (from 4.7%). September monthly data is expected to show a slight tick up in industrial production to 4.6%yoy and retail sales to 2.5%yoy but with fixed asset investment slowing further to 3.3% and property prices continuing to fall. Inflation data (Sunday) is expected to show CPI inflation remaining very low at 0.6%yoy with continued producer price deflation. Trade data (Monday) is expected to show a slowing export growth and weak growth in imports.

In Australia, jobs growth for September is expected to slow to 20,000 with unemployment rising to 4.3%.

Outlook for investment markets

Easing inflation pressures, central banks cutting rates, China ramping up policy stimulus and prospects for stronger growth in 2025-26 should make for reasonable investment returns over the next 6-12 months. However, with a high risk of recession, poor valuations and significant geopolitical risks particularly around the Middle East and US election, the next 12 months are likely to be more constrained and rougher compared to 2023-24.

Bonds are likely to provide returns around running yield or a bit more, as inflation slows, and central banks cut rates.

Unlisted commercial property returns are likely to remain negative due to the lagged impact of high bond yields and working from home reducing office space demand.

Australian home prices are likely to see more constrained gains over the next 12 months as the supply shortfall remains, but still high interest rates constrain demand and unemployment rises. Lower interest rates should help the market next year though and we see average property prices rising by around 5% in 2025.

Cash and bank deposits are expected to provide returns of over 4%, reflecting the back up in interest rates.

A rising trend in the $A is likely taking it to $US0.70 over the next 12 months, due to a fall in the overvalued $US and a narrowing in the interest rate differential between the Fed and the RBA. A recession is the main downside risk.

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