WEEKLY MARKET UPDATE

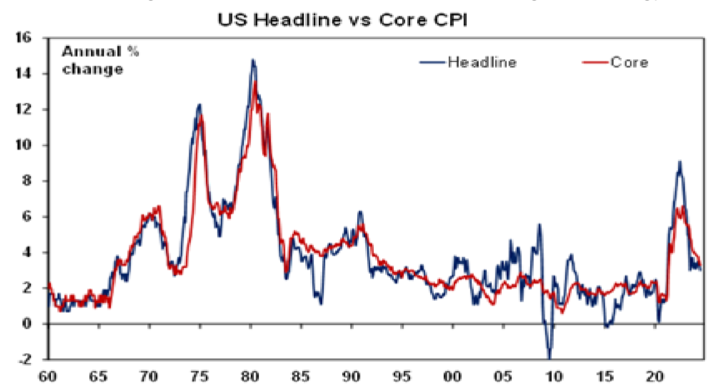
12 JULY 2024

Investment markets and key developments

Share markets mostly rose again over the last week with US, Japanese and Australian shares hitting record highs as expectations for Fed rates by September were reinforced by comments from Fed Chair Powell and soft US inflation data. US shares gave up some gains late in the week but this appeared to reflect a healthy rotation away from high flying tech stocks to underperforming areas like small caps. Japanese and Chinese shares also rose but Eurozone shares fell slightly with uncertainty about the impact of the French election. Helped by the positive US lead and hopes the resumption of falling inflation in the US will be replicated here saw Australian shares rise around 1.7% taking them above their March record high as strength in retail, telco, property and finance shares more than offset weakness in resources stocks. Bond yields mostly fell on lower US inflation. Oil, metal and iron ore prices fell but the $A rose as the $US fell.

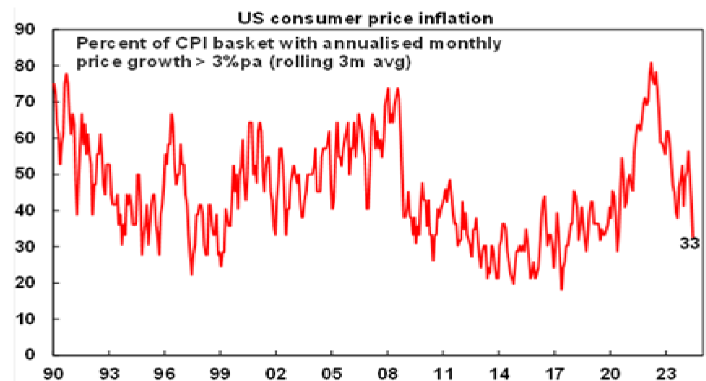
Shares are continuing to climb a wall of worry. Stretched valuations particularly for US shares, elevated investor sentiment, ongoing recession risks and high geopolitical uncertainty particularly around the US election warn of a correction and more volatility in share markets, possibly in the seasonally weak August/September period. But for now, the trend is up – July is usually a seasonally strong month, the US earnings reporting season is likely to again surprise on the upside and more central banks are getting on track to cut rates which should boost growth expectations for 2025-26 and drive lower bond yields, supporting share returns on a 12-month view. Australian shares are likely to remain relative underperformers reflecting risks around China & a more hawkish RBA and are also vulnerable to correction risks, but they are still likely to benefit from the rising trend globally and anticipation the RBA will eventually follow other central banks into rate cuts. Our calendar year end forecast for the ASX 200 of 7900 has already been surpassed and so we are raising it to 8100.

A September start to rate cuts in the US is firming on the back of Chair Powell's comments and another good inflation report for June. Powell's comments remained cautiously dovish, noting "some modest further" progress on inflation, the labour market has "cooled considerably" and "we have to take into account now the maximum employment side of the mandate" being a reference to the risk that the labour market and the economy ends up slowing too much. All of which is consistent with rate cuts ahead conditional on the Fed seeing "more good inflation" data. This was certainly seen in the June CPI, which saw both headline inflation at 3%yoy and core inflation at 3.3%yoy fall more than expected helped by softer readings for rents, airfares & used cars along with energy.



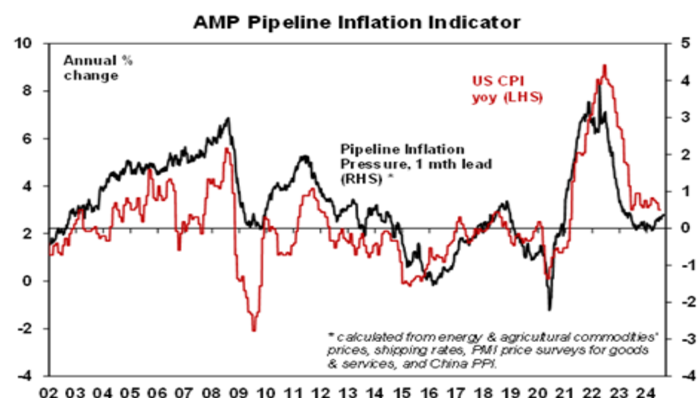
Source: Bloomberg, AMP

Measures of underlying inflation and the breadth of high price rises showed significant improvement. For example, the proportion of CPI basket components with monthly annualised inflation greater than 3% fell to 33%, its lowest since 2020.



Source: Bloomberg, AMP

Our US Pipeline Inflation Indicator has ticked up a bit reflecting rising shipping rates but its not seeing anything like the surge seen in 2021 when shipping rates last rebounded as its being offset by weakness in other inflation indicators. In particular, the ongoing weakness in labour market indicators point to lower wages growth and hence lower services inflation.

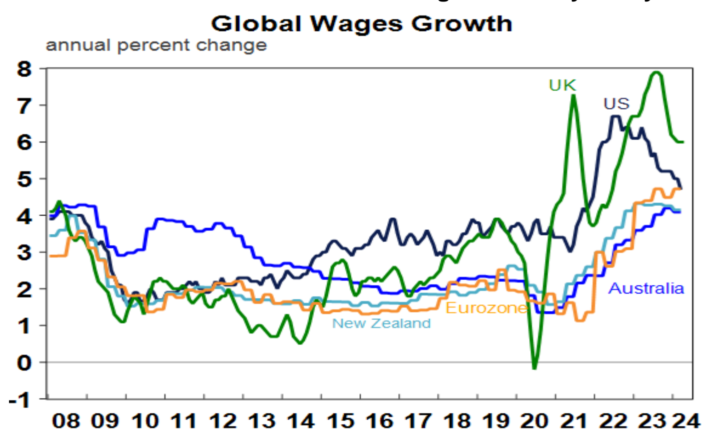


Source: Bloomberg, AMP

Fed on track to start cutting in September. The US CPI has now improved for three months in a row but its probably not enough for a July start to Fed rate cuts as the June core PCE may come in a bit higher than the CPI, the Fed will likely want to see "more good inflation" data and the economy is not weak enough to justify an earlier start, but is consistent with our view of a start to cuts in September and we continue to see two cuts this year, with a risk of a third cut.

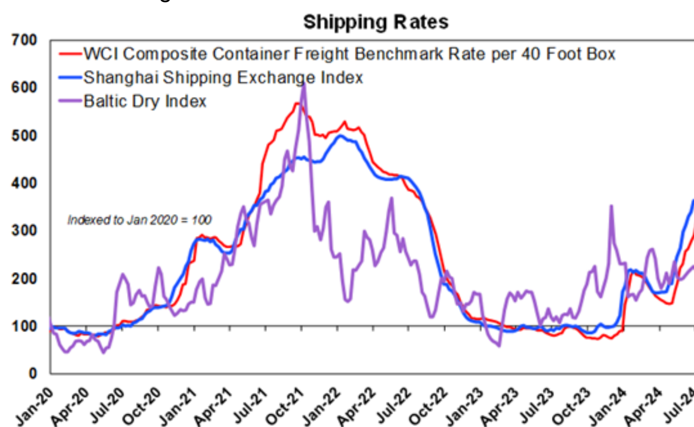
Even the hawkish Reserve Bank of New Zealand is having a dovish turn…with implications for Australia. At its May meeting the RBNZ was flagging another possible rate hike, but at its July meeting it left its cash rate at 5.5% as expected. And it was dovish in noting a range of data that "all point to declining activity", indicating that "the extent of [monetary policy] restraint will be tempered over time consistent with the expected decline in inflation pressures" and it made no mention of a rate hike. The NZ money market is now pricing a cut for October and nearly three cuts this year. Of course, the RBNZ's cash rate is well above the RBA's 3.35% and NZ has weaker GDP growth at -0.2%yoy in the March quarter compared to +1.1%yoy in Australia and slightly higher unemployment (at 4.3% versus 4% here). But its wages growth has been higher (see the next chart) and inflation up to the March quarter was also slightly higher than here so it's dovish pivot after alluding to the possibility of more rate hikes in May could be a sign of things to come from the RBA.

The fall in US inflation and the RBNZ's pivot are positive signs for the RBA. Of course, Australian inflation and the RBA don't always just follow other countries, but Australia was part of the global upswing in inflation (and hence rates) and there is no reason to expect it to be radically different on the way down. Particularly with wages growth here not reaching the level of other countries. And the US experience with 3 hot monthly inflation readings followed by a return to softer readings suggest we may see the same here after three hot inflation readings from March to May. Of course, the June quarter CPI will be key to what the RBA does at its August meeting, but **our view remains that the RBA will leave rates on hold ahead of rate cuts starting in February next year**.



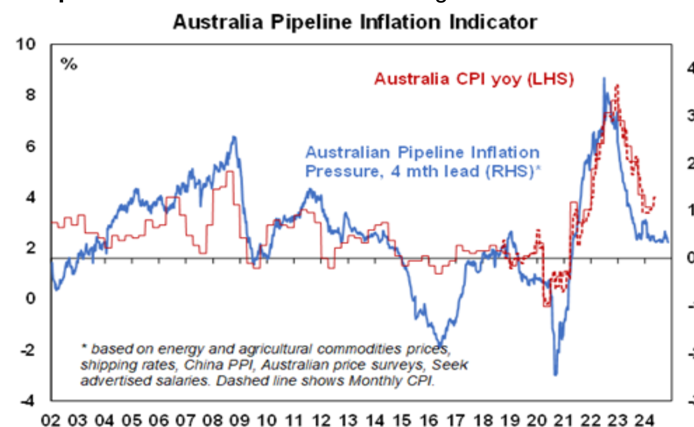
Source: Macrobond, AMP

What about the inflationary impact of the surge in global shipping costs? Global shipping costs have surged this year primarily on the back of ships being forced to go around Africa rather than through the Suez Canal (adding two weeks to a normally four-week Rotterdam-Singapore voyage). A 2022 IMF study found that a doubling in shipping freight rates can add about 0.7% to inflation. Most of our goods imports come from Asia but there is still an impact given the pressure on shipping capacity due to the extra time ships are taking to travel from Europe. Goods imports are about 17% of our economy and so the rise in global shipping costs will potentially boost goods prices and hence inflation at a time when we have been relying on slowing goods price inflation to bring down overall inflation.



Source: Bloomberg, AMP

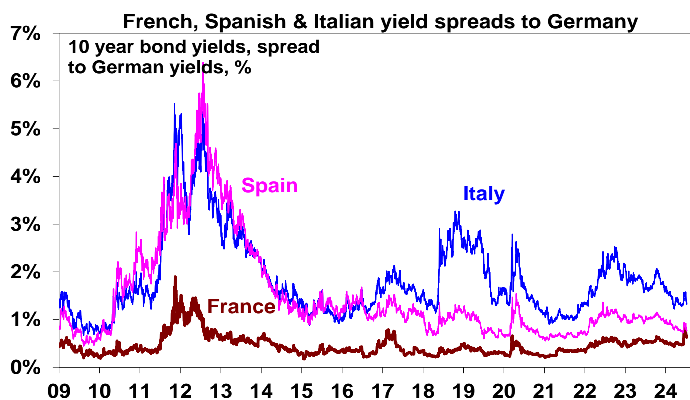
However, the impact of higher shipping costs may be less than feared as this is very different to what happened in 2021-22. First, we are dealing here with a sharp rise in the shipping portion of transport costs not a surge in the cost of everything that goes into a product as occurred in 2021-22 when surging shipping costs were combining with a shortage of materials, goods and workers all due to pandemic disruptions and consumer demand was strong on the back of reopening so inflation surged. Now the surge in shipping costs is occurring at a time when global factory production has returned to normal, labour markets are cooling and demand is weakening with falls in discretionary spending and weak growth in demand for essentials. So the inflationary impulse should be far less and the weakening in demand will make it harder for companies to just pass the increased cost of transport onto their customers. This is reflected in our US Pipeline Inflation Indicator (shown above) and our Australian Pipeline Inflation Indicator (shown below) not surging like they did in 2021-22, because while the shipping costs component is up other components are flat to down. In Australia the rise in shipping costs is partly being offset by a downtrend in business survey indicators regarding purchase costs and final selling prices (see the Australian section below) and very low Chinese inflation (in contrast to three years ago) and signs of topping wages growth. **All up the rebound in shipping costs is certainly a threat, but the boost to inflation is unlikely to have a huge impact on central banks', including the RBA's, interest rate policies**. But it's a risk worth watching.



Source: Bloomberg, AMP

The rise of the far right – whoops far left - in France! Thanks to a high turnout (well, high by French standards) and centrist and left candidates putting a "cordon sanitaire" around the far-right National Rally by dropping out of three-way races, the worst case outcome for markets of an extremist NR government was avoided. In fact, the left alliance came first with 180 seats, Macron's centrist alliance was second with 160 and NR came third with 143 which is well

down on the final polls which had them "winning". All are well short of a majority, leaving a "hung parliament". The most likely scenario is some sort of centre left government with Macron's alliance possibly with some combination of the Republicans and Socialists and Greens but to get to that may take time and may occur only after a Left minority government first. To some degree Macron's gamble has paid off as the NR has been defeated and his centrist alliance holds the balance of power. Whatever the outcome it will be hard to enact significant economic reforms and get the budget back under control and the NR is still on a rising trajectory (getting 35% of the vote, up from 22% in 2022 and 11% in 2017). But for now the worst case scenario has been averted and so French bond yield spreads to German yields have reversed half of their blowout since the election was called. Meanwhile French shares after their recent 6% fall are relatively cheap trading on a forward PE which is less than 70% of that in the US and half of the French share market by market capitalisation gets most of its earnings internationally leaving the French economy not so important to it anyway.



Source: Bloomberg, AMP

Having just discovered Love Affair I have found they are a treasure trove of happy songs. So here is [A Day Without Love].

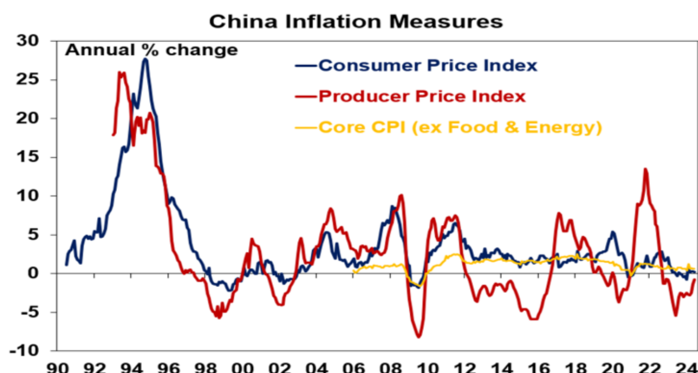
Major global economic events and implications

US economic data over the last week was mixed. Small business optimism rose slightly but remains weak with less than 5% seeing now as a good time to expand. CEO confidence is up from its lows but remains subdued. Meanwhile, jobless claims fell back but this was possibly impacted by the Independence Day holiday.

Source: Bloomberg, AMP

Japanese wages growth picked up in May, likely reflecting the 3.6% rise for 2024-25 in Shunto negotiations with the basic wage accelerating from 1.8%yoy in April to 2.5yoy. This supports prospects for further modest BoJ rate hikes this year.

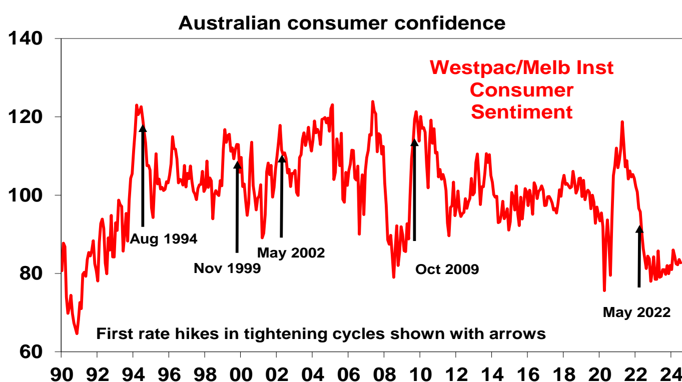
Chinese CPI inflation slowed to 0.2%yoy in June from 0.3%yoy in May with producer price inflation rising to -0.8%yoy from -1.4%yoy. Loflation is continuing in China. Chinese trade data for May showed solid growth in exports but a renewed fall in imports.



Source: Bloomberg, AMP

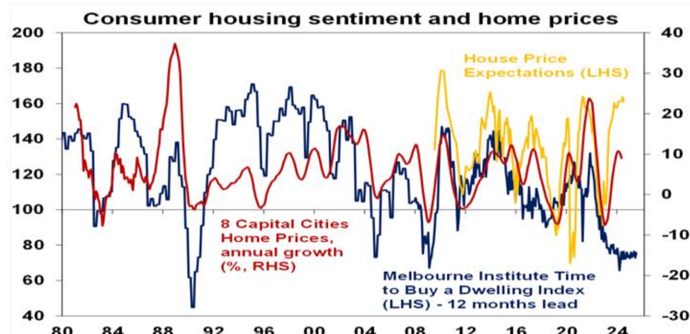
Australian economic events and implications

Australian economic data was on the soft side. Consumer confidence fell slightly in July. Falling inflation may have helped drive a slight uptrend in confidence from its lows, but it remains around recessionary levels with talk of higher interest rates and fears of higher unemployment offsetting the boost from the tax cuts.



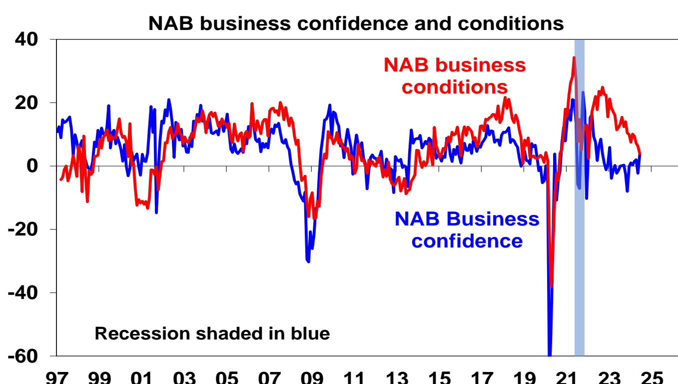
Source: Westpac/Melbourne Institute, AMP

While consumers' home price expectations are high, most don't see now being a good time to buy a dwelling.



Source: Westpac/Melbourne Institute, CoreLogic, AMP

While the June NAB business survey showed a lift in business confidence, conditions continue to trend down with weakness in orders, capex plans and employment.

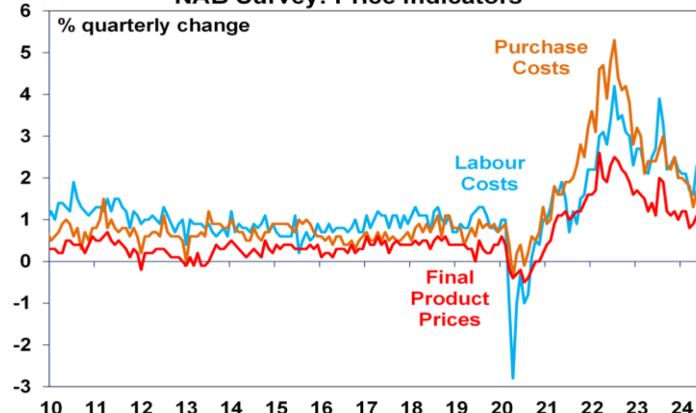


Source: NAB, AMP

The weakness in the NAB survey employment component points to a significant slowdown in jobs growth ahead.

Source: NAB, AMP

The NAB survey also showed a resumption of the downtrend in costs and final product prices, pointing to a resumption of falling CPI inflation. As noted earlier this downtrend has been occurring despite a rise in global shipping costs this year largely on the back of Houthi disruption to shipping through the Red Sea and into the Suez canal.



Source: NAB, AMP

Finally, housing finance commitments fell back in May. The trend is still up but a loss of momentum in property sales points to a potential slowing.

Source: ABS, CoreLogic, AMP

What to watch over the next week?

In the US, expect a 0.2% fall in June retail sales and soft underlying growth and another soft reading in home builder conditions (both Tuesday) and a modest rise in housing starts and industrial production (Wednesday). Manufacturing conditions indexes for the New York and Philadelphia regions for July are likely to have remained soft. The June quarter earnings reporting season will start to ramp up with consensus expectations for a 7.4%yoy rise in earnings, which is likely to end up being around 10%yoy again. Excluding tech, the consensus expectations are for 2%yoy growth.

The ECB (Thursday) is expected to leave rates on hold after cutting in June but flag a September cut if inflation remains on track with its forecasts.

Japanese inflation for June (Friday) is expected to show a slight lift to 2.9%yoy and 1.8%yoy for core inflation.

Chinese June quarter GDP (Monday) is expected show a slowing to 1%qoq or 5%yoy (from 1.6%qoq and 5.3%yoy in the March quarter. June activity data is likely to be subdued with growth in industrial production slowing to 5%yoy and retail sales growth slowing to 3.4%yoy.

Australian jobs data (Thursday) is likely to show a slowing in employment growth to 25,000 with unemployment rising to 4.1%, continuing the gradual rising trend.

Outlook for investment markets

Easing inflation pressures, central banks moving to cut rates and prospects for stronger growth in 2025-26 should make for reasonable investment returns over 2024-25. However, with a high risk of recession, possible delays to rate cuts and significant geopolitical risks, the next 12 months are likely to be more constrained and rougher compared to 2023-24.

We have raised our year end forecast for the ASX 200 to 8100. A recession is probably the main threat.

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.

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. The delay in rate cuts and talk of rate hikes risks renewed falls in property prices as its likely to cause buyers to hold back and distressed listings to rise.

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.

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