AMP

WEEKLY MARKET UPDATE

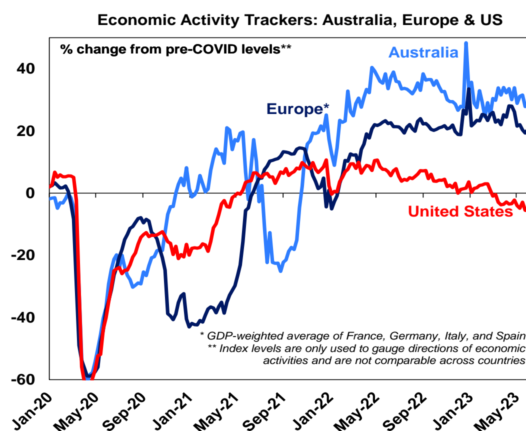
16 JUNE 2023

Investment markets and key developments

The positive momentum in sharemarkets continued this week. The US S&P500 was by 2.6%, with all sectors apart from energy higher over the week (and very large gains in tech). US shares are around 8% below the 2021 record highs. Shares are rising on the positive impact of artificial intelligence (to AI-specific firms, the broader tech sector and more broadly to other sectors which could experience a productivity boost), expectations that the Fed is close to the end of its tightening cycle (US bond yields are below their cyclical highs) and expectations that the US recession won't occur until later in 2024 (previous forecasts of a US recession were all based in 2023). Announcements of monetary stimulus in China via interest rate cuts this week helped to lift Chinese shares (up by 1.3% over the week) and commodities with cooper, iron ore, nickel and steel up over the week (which also helped to lift the Australian dollar to just under 0.69 US dollars). Australian shares rose by 2.1% over the week, with a lift in all sectors apart from healthcare. Eurozone shares were 2.5% higher while Japanese shares increased by 4.5% and remain at their highest level since 1989.

Economic activity trackers

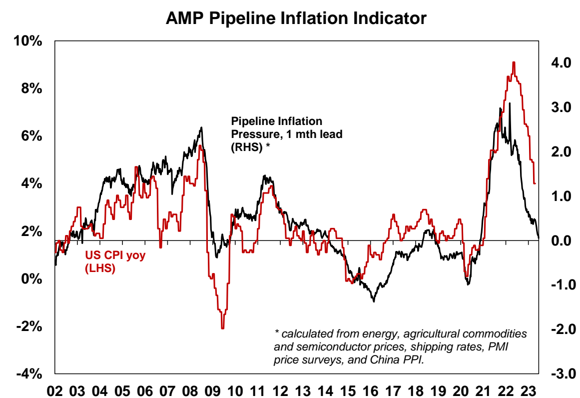
Our Economic Activity Trackers, based on high frequency data, slid slightly across Australia, Europe and Eurozone and are consistent with slowing economic activity (see the chart below).



Based on weekly data for eg job ads, restaurant bookings, confidence, mobility, credit & debit card transactions, retail foot traffic, hotel bookings. Source: AMP

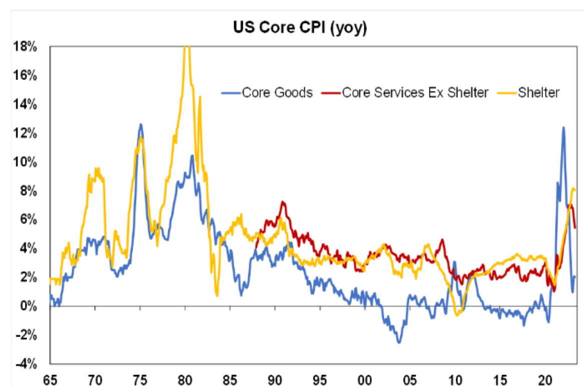
Major global economic events and implications

The US May consumer price data was in line with expectations and has tracked close to our own pipeline inflation tracker (see the chart below) which declined again over the past week.



Source: Bloomberg, AMP

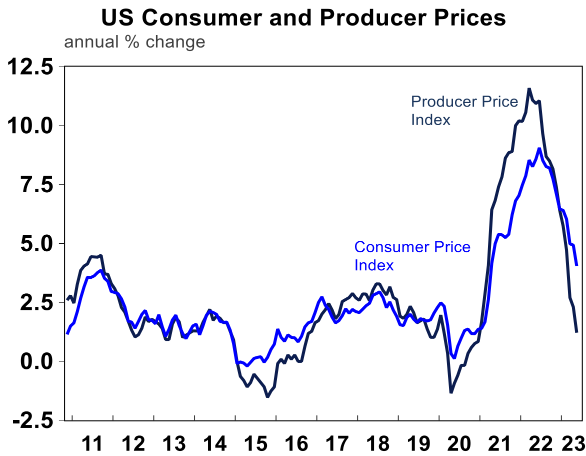
Headline consumer prices rose by 0.1% over the month (4% over the year) and core prices were 0.4% higher (or 5.3% over the year). Energy prices are declining and detracting from inflation, food prices are rising modestly (but below last year's levels), core goods prices rose by 0.6% but a big rise in used car prices (+4.4% over the month) looks unlikely to be repeated based on forward-looking indicators of used vehicle prices, core services prices rose by 0.4% but a lot of the rise was driven by a 0.6% lift in shelter prices accounted for a large amount of the rise and new rents are now declining (but the rent component in the CPI data lags this data). The Fed's "supercore" measure of CPI (core services inflation less shelter) which is a good measure of "sticky" inflation is up by 3.2% on a 3-month annualised basis (well down from its high of ~9% in June 2022) which shows that inflation is clearly slowing and that there is further downward momentum in prices.



Source: Bloomberg, AMP

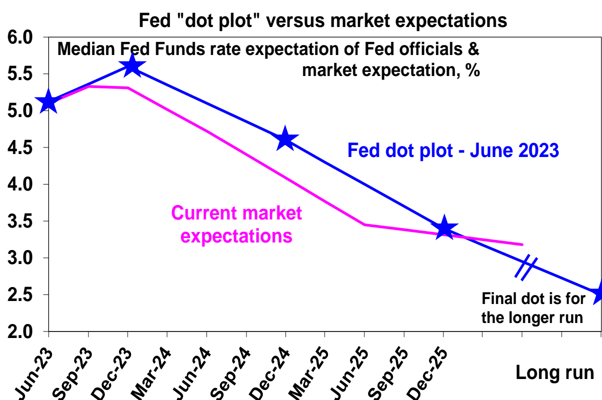
Other US price data showed a decline in imported prices (by -0.6%) or 5.9% lower over the year and **producer prices** fell by 0.3% in May (lower than expected), with annual growth in producer prices up by 1.1%, well down from its high of 11.7% in

early 2022. This disinflation in producer prices will leak into consumer prices in coming months.



Source: Macrobond, AMP

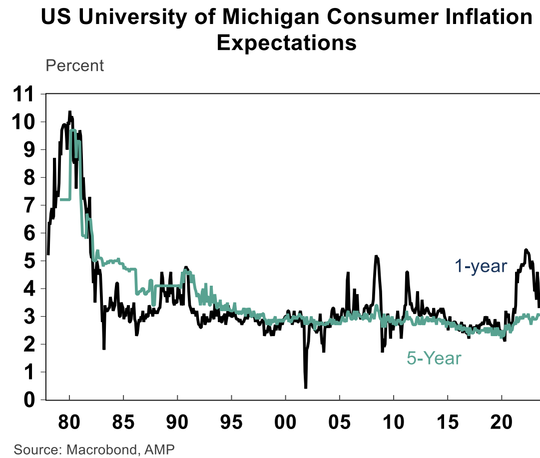
The US Federal Reserve held interest rates steady at 5-5.25%, the first pause since the Fed started hiking in March 2022. In holding interest rates steady, the Fed said it would be able to "assess additional information and its implications for monetary policy" and is "prepared to adjust the stance of monetary policy as appropriate if risks emerge". The Fed also updated its own committee members projections for the economy and interest rates. Policymakers upgraded near-term GDP forecasts (in line with most economists pushing out predictions of the US recession), downgraded the unemployment rate for 2023 and updated near-term PCE inflation. Policymakers forecasts of the fed funds rate is interpreted via a "dot plot" of projections and **shows that the "median" member expects the fed funds rate to reach 5.6% by December 2023, which implies another two interest rate hikes** (which is why some commentators are calling the decision to hold rates steady as a "hawkish pause"). **However, there is a wide range of expectations, with two policymakers expect no change from current levels and one expects interest rate to be over 6%.** This shows that the Fed itself is very divided on how much further tightening is required and is more data dependent than ever. Financial markets are not as hawkish as policymakers and only see some chance of one more rate hike from current levels (see the chart below).



Source: Federal Reserve, AMP

US retail sales data for May was up by 0.3% (consensus was looking for a decline) and excluding volatile items like automobile purchases and gas, spending rose by 0.4%. **Labour market indicators like initial and continuing jobless claims** rose again over the past week, continuing the trend from recent weeks but are not at concerning levels (yet!).

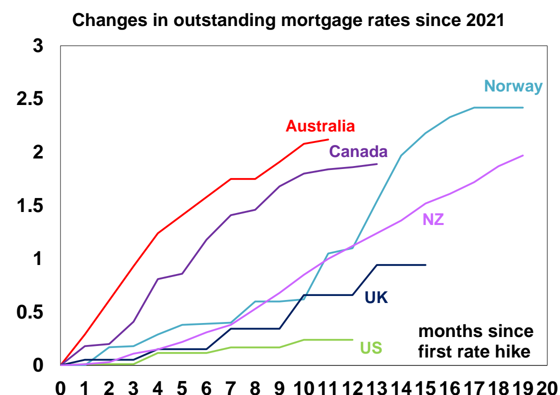
The **US University of Michigan** survey showed an improvement in consumer confidence (although its still at low levels), a big drop in 1-year inflation expectations to 3.3% (from 4.1% last month) and unchanged long-term inflation expectations which remain at 3%.



Source: Macrobond, AMP

The European Central Bank hiked interest rates by another 0.25%, as expected, taking the deposit rate to 3.50% and the refinancing rate to 4% and have hiked interest rates by 400 basis points or 4% overall in this cycle. The ECB revised 2023 core inflation projections up to 5.1%, from 4.6% previously and 2024 core inflation to 3% from 2.5%. GDP forecasts was revised some ever so slightly in 2023/24 with 2023 GDP forecast at 0.9% and 2024 at 1.5%. The ECB indicated that it is expecting to hike interest rates by another two times (at 0.25% increments) at least.

The March quarter New Zealand (NZ) GDP data fell by 0.1% after declining by 0.7% in the December quarter which means a technical recession (defined as two quarters of negative GDP growth). Some may argue that this is not a "real recession" because the unemployment rate has barely increased (as at March it was at 3.4%, up from a low of 3.2%) and that the components of GDP growth were not as bad as the headline suggests. Either way, growth is going backwards and the Reserve Bank of New Zealand's (RBNZ) aggressiveness in lifting rates means further weakness in growth. It is also a warning sign to other central banks and especially to Australia, whose economy many similarities to NZ. The RBNZ has hiked by 5.25% while the RBA has hiked by 4%. However, the outstanding Australian mortgage rate has gone up by more than NZ (2.1% versus 2%) which shows the faster pass through of rate hikes because of a higher degree of variable loans in Australia. We think the risk of an Australian recession is very high, at 50% in the next 12 months.



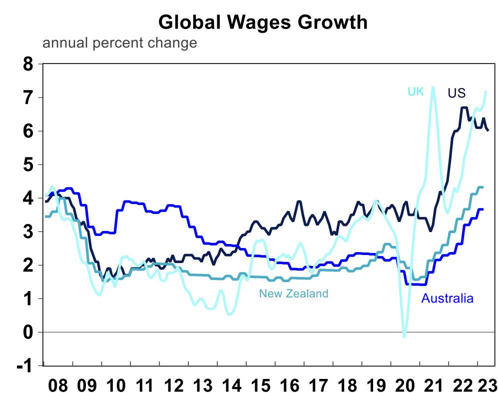
Source: Macrobond, AMP

China cut short-term policy rates, lowering the 7-day reverse repurchase rate by 10 basis points to 1.9% which was then followed through by a cut to the medium-term lending facility, by 0.1% to 2.65% (the first reduction since August) and will lead to the banks lower lending rates in an effort to support the economy

and lift credit growth. **Chinese monthly activity** data came in below forecasts, with retail sales up by 9.3% year to date which implies a slight rise in May (probably due to the labour day holiday week), fixed asset investment was 4% higher year to date (however month on month this looks like a decline) and industrial production lifted by 3.6% year to date. **Home prices** were up by a minor 0.1% in May, the **youth jobless rate** hit a record high of 20.4% and **property investment** is down by 7.2% over the year to May.

Source: Bloomberg, AMP

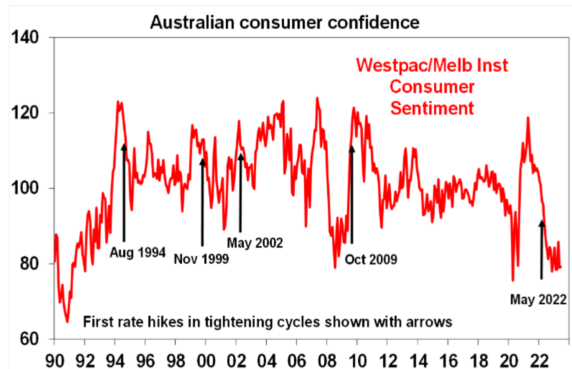
In the UK, average wages growth over the past 3 months to April increased by 7.2% per annum (from 6.9%), trending up in recent months and have much higher than other comparable countries (see the chart below). This is a problem because the economy is weakening but the labour force has been hit with a fall in participation and a Brexit shock that has reduced productivity and the elasticity of the labour market. This will keep the Bank of England nervous about the outlook for inflation and suggests more rate hikes are likely.



The Bank of Japan did not make any adjustments to its yield target or interest rates, which will be positive for Japanese shares.

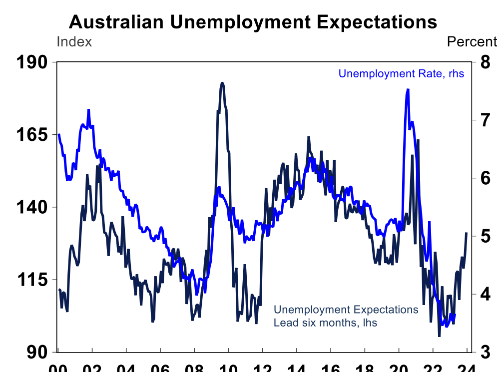
Australian economic events and implications

The June Westpac/Melbourne Institute consumer sentiment index was up marginally by 0.2 points to 79.2 but still remains around recessionary-like levels (see the chart below), has deteriorated since the first rate hike in May last year and the proportion of respondents who were surveyed *after* the RBA meeting had lower confidence (at 72.6) than the headline which means that rate hikes are continuing to weigh on consumers.

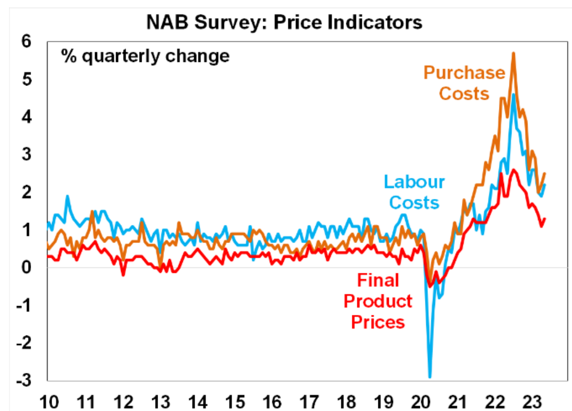


Source: Westpac/Melbourne Institute, AMP

Consumer unemployment expectations are also rising, which has historically been a leading indicator of a rise in the unemployment rate (see the chart below).



The **May NAB business survey** showed a deterioration in business confidence which is now negative, a decline in business conditions (although its still above its long-run average), a collapse in forward orders, a deterioration in the employment outlook and some tick up in price indices (although they are down from their highs - see the chart below).

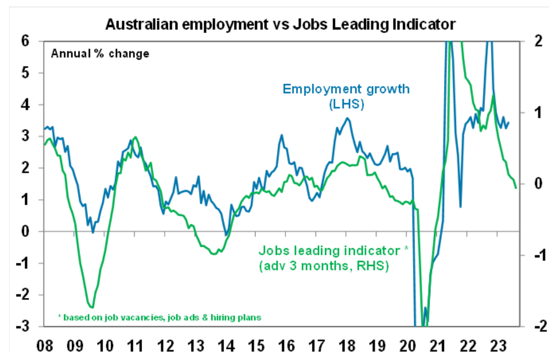


Source: NAB, AMP

Australian financial regulators reinforced APRA's 3% serviceability buffer for new borrowers despite news in recent weeks that some banks were becoming lenient around this rule to help households who are in "mortgage prison" and can't refinance with their lender. This is another negative for borrowing capacity, which is down by around 28% since the RBA started hiking interest rates.

Australian employment growth was strong in May, with jobs up by 75.9K, a rise in the participation rate to a record high of 66.9% and a decline in the unemployment rate back to 3.6%. While the labour market is still clearly in a tight position, with the unemployment rate around its lowest level in 48 years, the forward-looking indicators of employment growth (job advertisements and hiring intentions) have slowed,

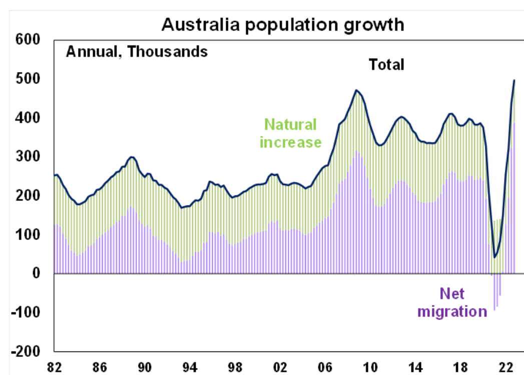
underemployment rose to 6.4% from 6.2% last month and is back to its highest level since March 2022 and hours worked fell which could be a sign that employers are trying to hold onto staff, but reduce hours worked as economic activity is slowing.



Source: ABS, Bloomberg, AMP

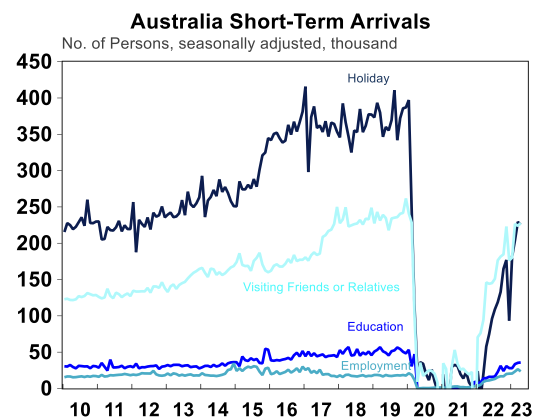
The strength in jobs growth will keep the RBA concerned that the tight labour market will keep wages growth elevated and jeopardise its 2-3% inflation target which means another 0.25% rate hike is likely in July and the risk of another one in August or September.

Australian population data December quarter showed a sharp turnaround in population growth, up by 1.9% over the year thanks to a surge in net migration (up by 387K over the year) while "natural increase" (births less deaths) was only up by 109.8K which is well below its more normal levels of ~150K/annum.



Source: ABS, AMP

Australian overseas arrivals and departures data for April showed that the rebound in short-term holidaymakers is rising, but has much further to rise to get back to pre-Covid levels (see the chart below).



Source: Macrobond, AMP

What to watch over the next week?

US economic data next week includes many housing indicators (NAHB housing index, housing starts and home sales) which have started to turn up recently, some regional services PMI's, leading indicators (which are still indicating a recession) and the June PMI's.

The Bank of England meet next week and another 0.25% interest rate hike is likely, taking the official bank rate to 4.75% after this week's elevated wage figures. The UK consumer price data is released next week and is expected to show that annual inflation remains high at 8.5% year on year (to May).

Japan's May consumer price index (expected to be up by 3.2% over the year to May) is released and the June PMI's.

In Europe, watch the June PMI's and Germany's retail sales figures for May.

The Australian RBA June meeting minutes are released and are expected to be hawkish given the RBA's recent hilt, Assistant Governor Christopher Kent speaks on a panel in Sydney and Deputy Governor Michele Bullock gives a speech to the AI Group (no topic has been announced) and like the rest of the world, the June PMI's are released which give an update on business activity.

Outlook for investment markets

The next 12 months are likely to see easing inflation pressures and central banks moving to get off the brakes. This along with improved valuations should make for reasonable share market returns. But the next few months are likely to be rough given high recession and earnings risks, uncertainty around US banks, the potential of unexpected rate rises and poor seasonality out to around September/October. This is likely to impact both global and Australian shares.

Bonds are likely to provide returns above running yields, as growth and inflation slow and central banks become less hawkish.

Unlisted commercial property and infrastructure are expected to see slower returns, reflecting the lagged impact of last year's rise in bond yields on valuations. Commercial property returns are likely to be negative as "work from home" hits space demand as leases expire.

With an increasing supply shortfall, we have revised up our national average home price forecast for this year from a fall of -7% to around flat to up slightly ahead of 5% growth next year. However, the risk is high of a further leg down putting us back on track for a 15-20% top to bottom fall on the back of the impact of high and still rising interest rates and higher unemployment.

Cash and bank deposits are expected to provide returns of around 3.5%, reflecting the back up in interest rates.

The $A is at risk of more downside in the short term, but a rising trend is likely over the next 12 months, reflecting a downtrend in the overvalued $US and the Fed moving to cut rates.

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