WEEKLY MARKET UPDATE

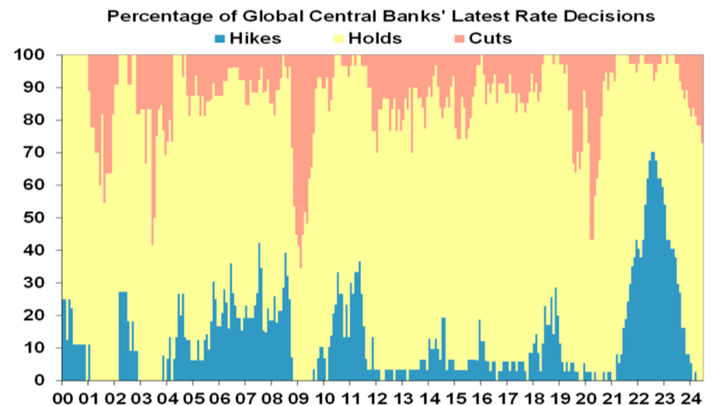
07 JUNE 2024

Investment markets and key developments

Major global share markets rose over the last week as the ECB and Canada cut interest rates and bond yields fell with strength in tech stocks pushing the US share market to a new record high. Despite slight falls on Friday in response to stronger than expected payroll data for May, US shares rose 1.3% for the week and Eurozone shares rose 0.9%. Japanese shares rose 0.5% for the week, but Chinese shares fell 0.2%. Helped along by the positive US lead and with weaker economic growth boosting confidence in prospects for RBA rate cuts, the Australian share market rose 2.1% over the last week leaving it just 0.5% below its record high reached in March with financial, consumer and property shares leading the rise. 10-year bond yields fell, although falls in the US and Europe were partially reversed after the strong US payrolls report. Oil, metal and iron ore prices fell. The $A also fell after the strong payrolls report pushed the $US back up.

While shares rebounded over the last week, the ride is likely to remain volatile and constrained. Valuations remain stretched, sentiment towards shares remains upbeat which is negative from a contrarian perspective, uncertainty remains regarding the outlook for interest rate cuts in the US and Australia and geopolitical risks around the Israel/Iran conflict and US election are high. The risks of a deeper correction beyond that seen in April are high and this could come in the seasonally weaker August/September period nearer to the US election. That said, we continue to see further gains in shares this year as disinflation continues, central banks ultimately cut interest rates and recession is avoided or proves mild.

More central banks start easing. Both the Bank of Canada and the ECB cut their policy rates by 0.25% in the last week on the back of easing inflation and foreshadowed further cuts if inflation continues to improve, although the ECB was a bit more cautious than the BoC. This follows central banks in Switzerland and Sweden that have already started to cut. Money markets are allowing for another two rate 0.25% cuts this year in Canada and another 1.7 in Europe. Around 25% of global central banks have now started to cut interest rates. See the next chart.



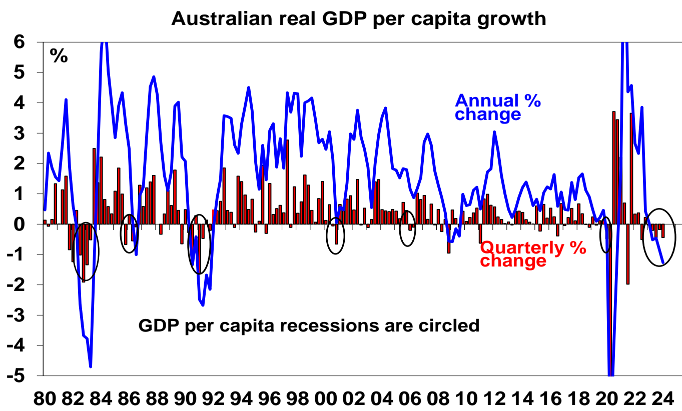
Source: Bloomberg, AMP

While stronger than expected growth in payrolls in the US for May added to uncertainty about the outlook for Fed interest rate cuts, the jobs data was actually quite messy with payrolls and earnings growth coming in stronger than expected but unemployment unexpectedly rising to 4% on the back of a sharp fall in the household survey measure of employment and temporary employment continuing to fall which is a sign of weakness. Meanwhile, job openings and quits are continuing to point to weaker jobs and wages growth ahead. While the strong rise in payrolls in May will keep the Fed cautious for now, we remain of the view that it will start to cut rates in September, providing we continue to see cooler inflation between now and then.

The Australian economy is close to stalling with GDP up just 0.1%qoq in the March quarter. Revisions muddied the water a bit with the level of consumer spending being revised up 2% for last year reflecting a new higher measure of overseas travel spending but since this was all offset by higher imports (also resulting in a downwards revision to the current account balance) it had little impact on overall GDP so there is no significant impact on domestic spending or estimates of spare capacity in the economy so there should be no significant implications for inflation or the RBA. More fundamentally:

- consumer spending growth was stronger than expected in the March quarter but mainly driven by growing spending on essentials in line with population growth and a temporary boost from big sporting and music events;
- the household saving rate fell to just 0.9% from a previously reported 3.2% in the December quarter as consumers continue to run down their saving buffers built up through the pandemic;
- housing and construction investment fell;
- the upwards revision to consumer spending meant that the saving rate is now significantly lower since 2022 than previously reported which in turn means that the saving buffer built up through the pandemic has now fallen more sharply. Previous data suggested only 28% of the buffer had been run down whereas the latest data suggests that 46% has been run down, which leaves households more vulnerable going forward. For lower income households its likely close to all being run down;

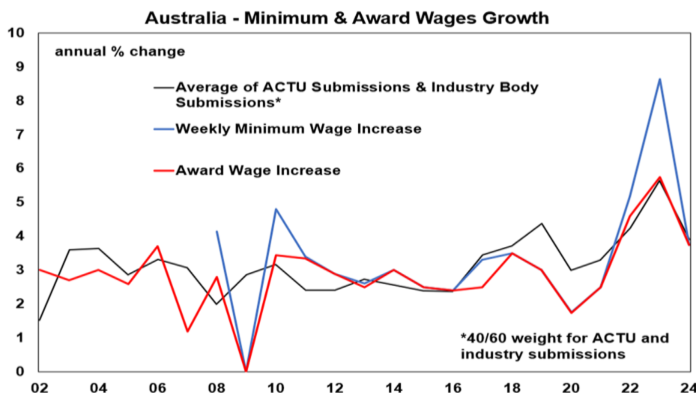
- trade detracted from growth as exports rose but were swamped by rising imports which are acting as an inflation relief valve;
- inventories rose but this may be partly involuntary and could act as a drag on future growth;
- annual GDP growth slowed to just 1.1%yoy, its weakest since the early 1990s recession (pandemic years aside) despite the fastest population growth rate since the early 1950s;
- per capita (or per person) GDP fell for the five consecutive quarter with the annual decline in per capita GDP of 1.3%yoy being the worst since the early 1990s recession (pandemic years aside). If population growth were a more normal 1.5%yoy rather than 2.4%yoy the economy would be up just 0.2%yoy; &
- growth in the wages bill, which reflects average wages & jobs growth, slowed to just 1%qoq, the smallest rise since September quarter 2021 which tells us that the labour market is cooling. This along with the productivity improvement over the last year saw a further slowing in unit labour cost growth.



Source: ABS, AMP

So the overall picture is one of very weak growth at risk of tipping over into a conventional recession and slowing growth in labour costs all of which is consistent with the RBA's rate hikes working to slow demand and growth in wages costs. As inflation lags the economy this points to a further decline in inflation ahead as business pricing power declines in the face of weak demand. While tax cuts will provide some boost in the September quarter, the slump in the household saving rate to well below pre-pandemic levels, the bigger than previously estimated fall in household saving buffers and mortgage interest and tax payments taking up a near record share of household income suggests a big chunk of the tax cuts will be saved.

The other big event in Australia in the past week was the Fair Work Commission's National Wage Case Decision which turned out to be pretty benign. The 3.75% rise in award and minimum wages (which impacts about 25% of the workforce) was well down from last year's 5.75% and 8.65% rises, it gives workers a small real wage rise but its in line with current wages growth and consistent with the assessment that wages growth has peaked.



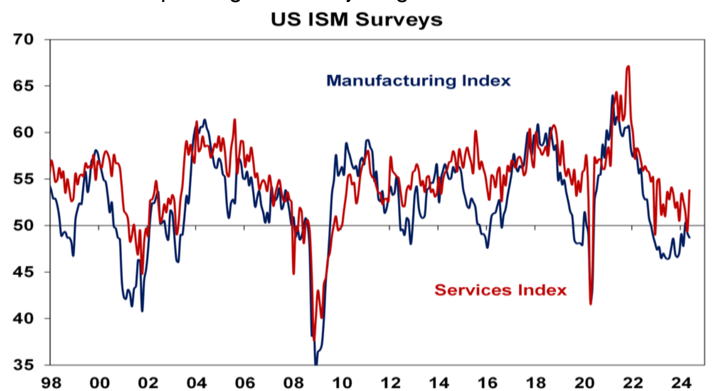
Source: Fair Work Commission, ABS, AMP

GDP data and the national wage decision should be welcomed by the RBA. RBA Governor Bullock's Senate testimony added nothing really new, basically reiterating that the RBA is not ruling anything "in or out" but still indicating more of a lean towards hiking again than cutting at this point. However, while the level of consumer spending was revised up this shouldn't affect the RBA's thinking as it was all spent on overseas travel (ie, imports) with no implications for inflation. Meanwhile, the further slowing in the economy indicating a further rebalancing in demand and supply, growth close to stalling at 1.1%yoy running below the RBA's implied 1.3%yoy forecast, lower than previously thought household saving buffers, easing growth in unit labour costs and the relatively benign Fair Work Commission wages decision all lean neutral to dovish on interest rates. **They certainly don't support another rate hike**. The RBA will still want to see lower inflation readings, how the economy responds to the tax cuts next month and more confidence that inflation will decline sustainably into the 2-3% target so the most likely outcome remains that the RBA will remain on hold for the next several months. But we continue to see the first rate cut coming by year end as continuing weaker than expected economic conditions provide the confidence it needs regarding the inflation outlook. Interestingly, after the GDP data the money market removed the probability of another rate hike and is now allowing for around a 46% chance of a cut by year end.

The RBA won't automatically follow Canada and the ECB into cutting rates as they are a bit further advanced in getting inflation back under control. But their move following other central banks is a further positive sign that global inflation pressures are coming under control, and this is a good sign for the RBA as Australian inflation lagged global inflation on the way up and is doing the same on the way down. So just as the RBA moved rates up with other global central banks, albeit with a lag versus some, its likely to ultimately do so in terms of cutting rates too, again with a lag.

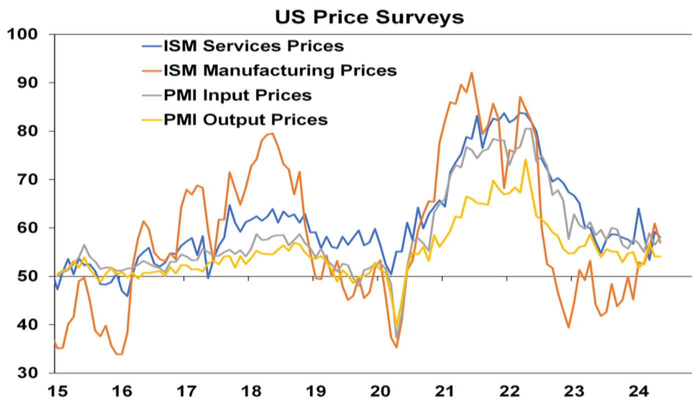
Major global economic events and implications

Mixed US economic data. The ISM business conditions indicators for May were mixed with manufacturing down but services up. While the services ISM was strong, its employment component remains weak pointing to slower jobs growth ahead.



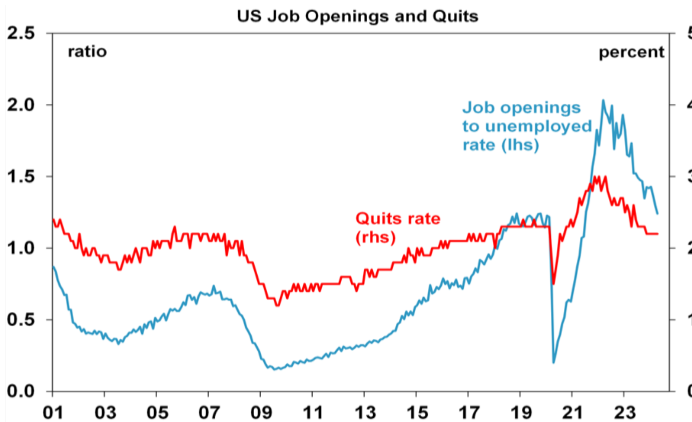
Source: Bloomberg, AMP

Meanwhile, the prices paid components in both ISM surveys fell slightly. As can be seen in the next chart, the price components in the ISM and PMIs look like a confusing mess – but at least they remain well down from their 2021/2022 highs which is good for inflation.



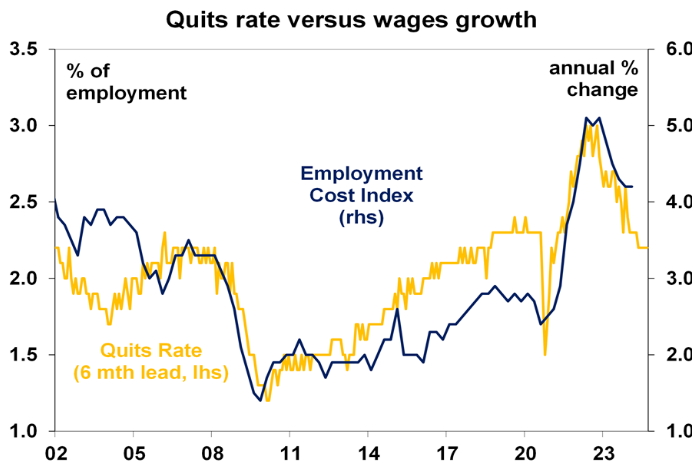
Source: Bloomberg, AMP

While payrolls surprised on the upside in May with a 272,000 gain, household survey employment was very weak with a 408,000 decline, temporary employment fell which is a sign of weakness and job openings and quits continued their downtrend in April consistent with a further easing in the US labour market. Jobless claims are also edging up but still remain low.



Source: Bloomberg, AMP

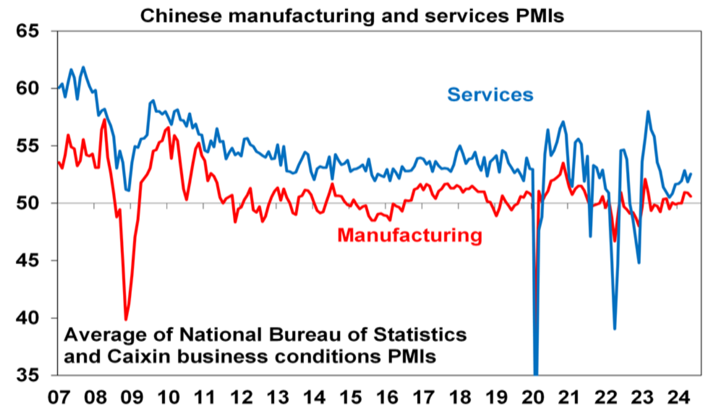
Both continue to point to slower wages growth ahead. Revisions to March quarter data showed a slight downwards revision to productivity growth although its up a strong 2.9%yoy and a downwards revision to growth in unit labour costs accentuating its slowdown since 2022.



Source: Bloomberg, AMP

Eurozone retail sales fell more than expected in April and were flat over the last year.

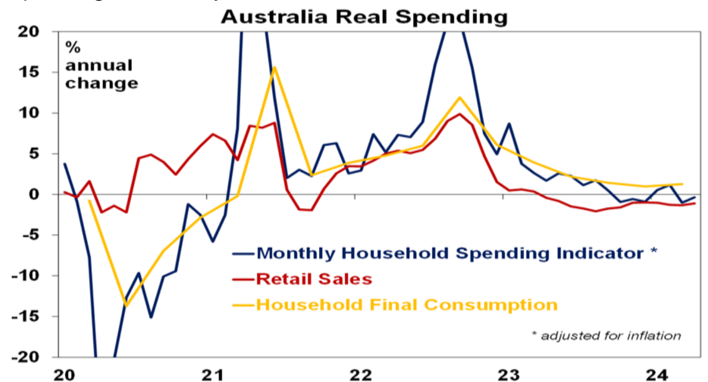
China's Caixin business conditions PMIs for May provided a somewhat stronger picture than the official PMIs. This may reflect the greater exposure to smaller companies in the Caixin survey, but whatever it is it looks more consistent with GDP growth around 4.5-5% this year. This wasn't confirmed by import growth though which slowed to just 1.8%yoy in May, but export growth rose more than expected to 7.6%yoy.



Source: Bloomberg, AMP

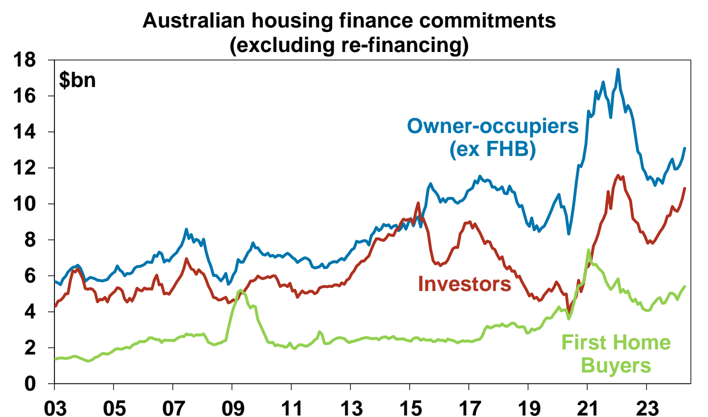
Australian economic events and implications

Aside from the GDP data, Australian economic data releases over the last week were mixed. The ABS' Household Spending Indicator suggests consumer spending remained weak into April. It rose 3.4%yoy in nominal terms but after inflation that's a fall of 0.2%yoy in real terms. Spending on essentials rose 5.8% but this was helped along by a 15.7%yoy rise in spending on health. Spending on discretionary items rose just 0.6%yoy which means a sharp fall in real terms as households continue to try and limit spending where they can.



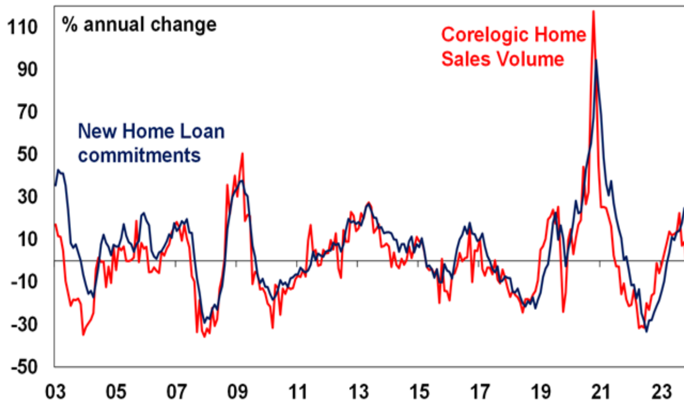
Shows real growth in all three consumer spending indicators. Source: ABS, AMP

Housing finance rose more than expected in April consistent with the rebound in home prices, with particularly strong growth in investor finance which is now 37% of total finance.



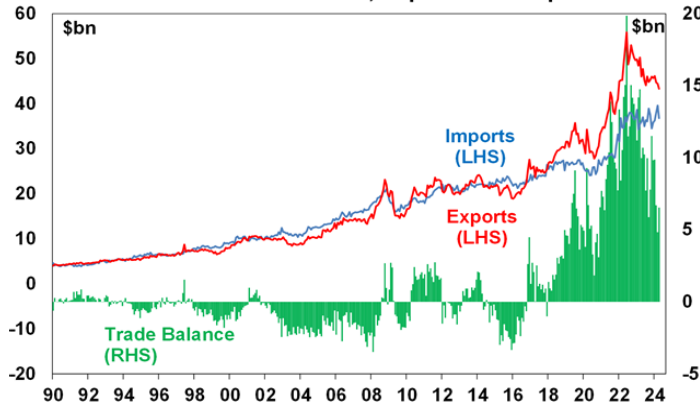
Source: ABS, AMP

Slowing sales volumes based on CoreLogic data points to a possible slowing in housing finance ahead though.



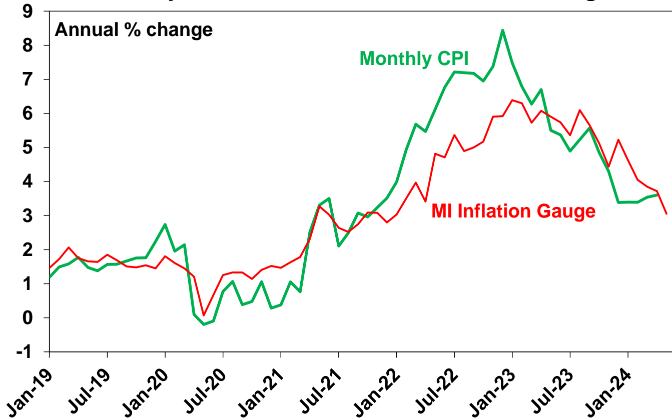
Source: ABS, AMP

Trade data for April showed a rebound in Australia's goods trade surplus on the back of weaker imports, but it remains in a downtrend from its post pandemic highs.



Source: ABS, AMP

The Melbourne Institute's Inflation Gauge for May continues to point to lower ABS CPI inflation. The Gauge tries to replicate the CPI measuring most of the same components. It lagged the CPI on the way up and possibly also on the way down but its continued slowing points a resumption of the fall in monthly CPI inflation.



Source: ABS, AMP

What to watch over the next week?

In the US, the Fed (Wednesday) is expected to leave interest rates on hold at 5.25-5.5% and retain a cautious easing bias on the grounds that inflation will fall as the labour market cools, but with the dot plot of Fed officials' forecasts showing two rate cuts this year down from three in March. Inflation data for April was a bit cooler after the hot outcomes seen in the first three months of the year, but the Fed will want to see at least three months in a row of lower inflation and further evidence of cooling growth and jobs before starting to cut rates. We expect Powell to indicate this.

On the data front its another inflation week in the US, with the May CPI (Wednesday) likely to show a slowing to 0.1%mom helped by a fall in gasoline prices or 3.4%yoy with core inflation of 0.2%mom or 3.5%yoy down from 3.6%yoy in April. Producer price inflation for May (Thursday) is also likely to slow. Small business optimism for May will be released Tuesday.

In Japan, the BoJ (Friday) is expected to leave rates on hold but with the risk of another small hike.

Chinese inflation data for May (Wednesday) is likely to show a slight increase with CPI inflation rising to 0.4%yoy from 0.3%yoy and producer price deflation easing to -1.5%yoy from -2.5%yoy.

In Australia, jobs data for May (Thursday) is expected to show a 20,000 gain in employment with unemployment falling back slightly to 4% from 4.1% as the higher than normal number of people in April indicating that they were waiting to start in a job they had already found is unwound. The NAB business survey for May (Tuesday) will be watched to see whether the downtrend in business conditions and cost and price indicators continues. December quarter population growth (Thursday) will likely show some easing in population growth from 2.5% (or 660,000) over the year to the September quarter but to a still very strong 2.3%yoy.

Outlook for investment markets

Easing inflation pressures, central banks moving to cut rates and prospects for stronger growth in 2025 should make for reasonable investment returns this year. However, with a high risk of recession, delays to rate cuts and significant geopolitical risks, the remainder of the year is likely to be rougher and more constrained than the first three months were.

We expect the ASX 200 to return 9% this year and end the year around 7900. 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 be negative again due to the lagged impact of high bond yields & working from home.

Australian home prices are likely to see more constrained gains this year 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, but in the near term the risks for the $A are on the downside.

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