Economic and Market Review

Monthly Report as at 31 October 2014

The uneven nature of the global recovery remains evident, with expected growth in emerging economies outstripping that for advanced economies.

Economic and Policy Trends: Policy makers looked through the financial market volatility that eventually unwound over the month. Fears of a negative feedback loop developing between financial market volatility and the real economy were allayed by stronger US earnings and economic data. The US economy grew by 0.9% over the September quarter and labour market improvement was sufficient to the give the Fed the confidence to announce the ending of its quantitative easing programme. Provided the US recovery continues to unfold as expected, conventional monetary tightening is likely to begin around the middle of 2015. Any tightening cycle is likely to be modest and drawn out as the Fed wants to make sure that the US recovery is well entrenched and broad based.

In Japan, the Bank of Japan (BOJ) upped the pace at which it wants to expand the monetary base from an annual rate of around 70 trillion yen to 80 trillion yen. It also announced a higher rate of purchases of government debt, exchange traded funds and real estate investment trusts. These steps were taken to support the economy after a period of softness following an increase in the VAT in April and ensure that inflationary expectations remain positive.

The uneven nature of the global recovery was evident in the latest set of comprehensive forecasts from the IMF. For 2014, they expected the world economy to grow by 3.3% with growth of 4.4% in emerging and advanced developing economies outstripping the 1.8% expected for advanced economies. Assuming geo-political tensions ease and fiscal drag continues to moderate, the IMF have world growth lifting 3.8% in 2015. Growth rates in both advanced and emerging and developing economies are expected to lift to 2.3% and 5.0% respectively.

In Australia, the over tone of data readings were on the subdued side. Retail sales rose a paltry 0.1% in August and while consumer sentiment lifted in October, the overall level remains modest by historical standards. Following heavy revisions, the labour market looks flat when averaging August and September observations with the unemployment rate ticking up to 6.1%. Forward indicators point to a stable to slightly improving labour market. Business conditions eased in September but still consistent with around trend growth. On the prices front, the consumer price index for the September quarter came in at 0.5% as did the average of the statistical measures.

Against the backdrop of patchy demand conditions and a near term moderation in inflation, the RBA is under little pressure to change current policy settings. We continue to hold the view that the RBA will not commence a modest tightening cycle until the end of 2015.

Equity Market Trends: Offshore equity markets fell heavily over the first part of the month on European growth concerns and the implications of a widening in the Ebola virus outbreak. Sentiment improved over the second half of the month as the tone of data improved and US companies reported solid earnings. Against this backdrop, the S&P500 ended the month 2.3% higher. A loss of economic momentum in Europe was behind the 3.5% fall in the Euro STOXX 50. In Japan, BOJ policy easing helped lift the Nikkei by 1.5%. The MSCI World ex-Australia Accumulation Index in Australian dollars crept ahead by 0.05% over October, with a mild lift in the Australian currency a slight headwind for sector returns. In Australia, the S&P/ASX 300 Accumulation Index had a solid rebound ending the month 4.3% higher.

Bond Market Trends: Yields fell sharply over the first half of the month, propelled by flight to quality flows from falling equity markets. Three and ten year government bond yields fell as low as 2.49% and 3.19% before a rebound in equity markets and improving offshore data led to a modest rise in yields. Yields still ended the month lower though, with the three year government bond 14 basis points lower at 2.57% and the ten year, 19 basis points lower at 3.29%. As a result of these moves, the sector experienced some capital gain with the Bloomberg AusBond Composite Index rising 0.96%. The cash sector, as measured by the Bloomberg AusBond Bank Bill Index, rose by 0.23%.

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