Economic and Market Review

Monthly Report as at 30 November 2014

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Economic and Policy Trends: The global economy continues to expand at a moderate and uneven pace. Output gaps remain in many regions and unemployment rates continue to remain stubbornly high. Inflation outcomes are on the low side, reflecting a combination of falling oil prices and subdued demand conditions.

Against such backdrop, central banks can afford to maintain or expand their accommodative policy stances. Last month it was the BOJ which eased conditions, this month it was the turn of the Chinese central bank which announced a 40 basis point cut to the 12 month lending from 6.00% to 5.60%. While the ECB left policy unchanged at its monthly meeting, EBC President Draghi reiterated that the ECB was open to further unconventional measures, including the purchase of sovereign bonds. In the US, the Fed still expect their economy to grow at an above trend rate over 2015 and 2016 but noted that weaker demand conditions outside the US posed a downside risk to their view.

The latest set of forecasts from the OECD has world growth lifting from 3.3% in 2014 to 3.7% in 2015 and 3.9% in 2016. Recovery is supported by current accommodative monetary settings, a lessening in fiscal drag and modest improvements in labour markets. Such a set of projections are not too dissimilar from the latest set of IMF forecasts. To the extent that the G-20 can deliver on their commitment to lift output by an additional 2% by 2018, there is potential upside to the outlook. There is increasing policy focus on the role of public infrastructure investment given current low borrowing rates and its potential to lift declining trend growth rates.

In Australia, data readings were mixed and consistent with the narrative of a re-balancing economy. On the stronger side, business conditions surged in November according the NAB survey. In the labour market, total employment rose by 24,100 over October while the unemployment rate remained steady at 6.2%. Retail sales jumped by 1.2% in September and lifted a solid 1% in real terms over the quarter. Private sector credit growth continued to improve, lifting by 0.6% over October.

On the weaker side, building approvals fell 11% over September. Wages growth of 0.6% over the September quarter was subdued by historical standards and points to sluggish household income growth. While private capital expenditure only eked out a 0.2% gain over the September quarter, the result was better than expected and the forward looking component of the survey indicated ongoing improvement in the outlook for non-mining investment.

Against this backdrop, the RBA left the cash rate unchanged at 2.5% and again noted 'that the most prudent course is likely to be a period of stability in interest rates'. We look for that period of stability to last until early 2016 when we expect the RBA to commence a modest tightening cycle. Nevertheless, like the RBA, we are well aware of the risk that chronic pessimism becomes entrenched and that the risks to our view are tilted to the downside.

Equity Market Trends: Offshore equity markets had a solid month and benefitted from supportive central bank actions and solid US earnings and economic data. In the US, the S&P500 ended the month 2.5% higher. In Europe and Japan, gains were even stronger with the Euro STOXX 50 up 4.4% and the Nikkei up 6.4%. The MSCI World ex-Australia Accumulation Index in Australian dollars gained a healthy 5.3% over November, with a weakening Australian currency boosting sector returns. In Australia however, a late month fall in commodity prices helped drive the S&P/ASX 300 Accumulation Index 3.2% lower over the month.

Bond Market Trends: Yields fell over the month with most of the fall coming late in the month and appearing to reflect a global search for yield against the backdrop of expectations for further ECB quantitative easing. Three and ten year government bond yields ended the month 17 and 26 basis points lower at 2.39% and 3.03% respectively. As a result of these moves, the sector experienced solid capital gains with the Bloomberg AusBond Composite Index rising 1.27%. The cash sector, as measured by the Bloomberg AusBond Bank Bill Index, rose by 0.22%.

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