Economic and Market Review

Monthly Report as at 30 June 2015

Despite the spectre of European crises past being raised by Greece's default, the uneven global recovery currently underway should continue.

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Economic and Policy Trends: The spectre of European crises past moved centre stage in late June when the Greek Prime Minister called an unexpected referendum on July 5th asking the Greek people to accept or reject the terms of European creditors for ongoing financial support. With creditors not extending terms in the lead up to the referendum, capital controls were imposed and Greece missed its June 30 €1.7bn payment to the International Monetary Fund (IMF).

It appears as though European creditors wish for Greece to stay in the Euro and a strong "yes" vote would be interpreted that way. In contrast, the Greek Prime Minister is advocating that the stronger the no vote is, the greater his hand will be in re-negotiating more favourable terms. A strong yes vote would make his position untenable and likely trigger another round of elections or the formation of another government. All of this will take time and the risk is that a bout of "Euro break-up hysteria", however unfounded given advances in policy frameworks, leads to a loss of confidence that derails the current European cyclical recovery.

Most likely, the uneven global recovery that is underway will continue, fanned by ultra-accommodative monetary settings, lessening fiscal drag and the net boost from lower oil prices. Chinese authorities maintain their pro-cyclical mindset and eased monetary conditions again in late June when the Chinese central bank cut the one year RMB benchmark loan interest rate and deposit rate by 25 basis points to 4.85% and 2.00% respectively. They also announced targeted cuts to the reserve requirement ratio for selected institutions.

In the US, the Fed's Yellen re-iterated that lift-off remained data dependent and contingent on the Fed's two conditions of further labour market improvement and confidence in achieving its medium term inflation objective, being met. She also noted that any tightening cycle would be gradual and that even after employment and inflation reached mandated levels, the lingering effects of the financial crisis may result in a period where the US cash rate remains below the Fed's 3.75% estimate of the longer run fed funds rate. The lift off window remains between September and December with most Federal Open Market Committee (FOMC) participants looking for at least one tightening by year end.

Australian data releases out over the month continued to highlight the unevenness of conditions across the economy and over time. While the headline GDP number had the economy growing by a flattering 0.9% over the March quarter, most of that growth came from a build-up in stocks and a strong contribution from net exports. Consumption and dwelling investment also made modest positive contributions to the quarter's growth rate, while business investment was a significant drag.

Data readings for the June quarter remain mixed. April building approvals fell a stronger than expected 4.4% and retail sales data for April came in flat, also undershooting expectations. May data readings were brighter, picking up the May rate cut and more favourable Budget. The NAB survey had both business conditions and confidence rebounding. In the labour market, total employment leapt ahead by a much stronger than expected 42,000 and the unemployment rate fell from 6.2% to 6%. Despite this improvement in May, consumer sentiment fell sharply in June with the forward looking components, like time to buy a major household item, particularly weak.

Against this uneven backdrop, the RBA moved to a more explicit easing bias with the Governor noting during a speech that "we remain open to the possibility of further policy easing, if that is on balance, beneficial for sustainable growth". Like other central bankers, the RBA warn that monetary policy is being overburdened and that other macro policy tools need to play a role in supporting aggregate demand. Our base case has the cash rate holding at 2% until H1 2017 with the risks tilted slightly to a further easing later in the year if non mining investment remains lacklustre.

Equity Market Trends: Offshore equity markets gave up earlier gains following the dramatic deterioration in relations between Greece and its creditors. The European equity market was hardest hit with the Euro STOXX 50 falling 4.1% over June. Falls were less severe in the United States and Japan where the S&P 500 and Nikkei fell 2.1% and 1.6% respectively.

The MSCI World ex-Australia Accumulation Index in Australian dollars fell 2.7% over June. In Australia, the S&P/ASX 300 Accumulation Index had a poor month falling 5.3% over June. Over the 2014/15 financial year, the S&P/ASX 300 Accumulation Index rose 5.6%.

Bond Market Trends: Despite developments in Greece and the RBA moving to an explicit easing bias, domestic yields lifted over the month. The move up reflects the combination of a low starting point in yields following a strong rally in late May, bursts of stronger than expected domestic data and the pressure from increasing confidence in the underlying global growth outlook and subsequent scope for offshore central banks to eventually normalise their cash rates. Three and ten year government bonds ended the month 14 basis and 28 basis points higher at 2.02% and 3.01%. These moves meant that the Bloomberg AusBond Composite Index experienced capital loss and ended the month 0.93% lower. Over the 2014/15 financial year, the Bloomberg AusBond Composite Index rose 5.6%. The cash sector, as measured by the Bloomberg AusBond Bank Bill Index, rose by 0.18% over June and by 2.6% over the year.

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