Colonial First State

# Market View

August 2014

**Read the latest market update from the Economic and Market Research team at Colonial First State Global Asset Management.**

## Market and economic overview

### Australia

- The Reserve Bank of Australia (RBA) held the cash rate steady at 2.5% at its 5 August 2014 meeting. There was no change to the Board's neutral policy 'guidance' and signal that there is likely to be "a period of stability in interest rates".
- The RBA released its Statement on Monetary Policy and updated its GDP and inflation forecasts. The RBA lowered its GDP growth forecast by 0.25%/pts to 2.75% for December 2014, and lowered its June 2015 forecast to between 2 and 3% (was 2.5 to 3.5%). These downgrades largely reflect a stronger Australian dollar, weaker than expected non-mining capital expenditure and a softer labour market.

**Belinda Allen**
Senior Analyst

**Stephen Halmarick**
Head of Economic and Market Research

**James White**
Senior Analyst

- The RBA slightly revised down its near term CPI forecast to 2% from 2.75% for December 2014, with removal of the price on carbon.
- There remains a high degree of uncertainty over forecasting the outlook for growth and inflation, largely due to the current transition from mining to non-mining sources of growth and movements in the Australia dollar.
- Governor Glenn Stevens provided his semi-annual testimony to the House of Representatives Standing Committee on Economics during the month. While keeping the same theme as the SOMP, Glenn Stevens did state "the thing that is most needed now is something monetary policy can't directly cause: more of the sort of 'animal spirits' needed to support an expansion of the stock of existing assets (outside the mining sector), not just a re-pricing of existing assets."
- He also stated "the Board has been mindful of allowing time for measures already taken to have their effects and of the very considerable limitations for monetary policy in fine-tuning economic outcomes over short periods. It has also seen some value, in present circumstances, in maintaining a sense of steadiness and stability".
- As a result most market participants concluded the RBA would leave rates on hold for a considerable period of time, most likely until mid-2015.

- The unemployment rate rose for the month of July (data released in August), from 6.0% to 6.4%, a larger rise than expected. Overall 300 jobs were lost in July.
- Q2 2014 Capital Expenditure data showed a rose of 1.1% 4.2% per quarter, to be down 4% over 12 months. There are some tentative signs of stabilisation in the non-mining side of plans.
- The seventh estimate for 2013/14 was revised down 3% to $A158bn driven by plans in the mining sector, while the third estimate for 2014/15 was revised up by 5% to $A145bn.

**United States**

- There was no meeting of the Federal Open Market Committee (FOMC) in August. However the minutes to the July meeting were released and Chair Janet Yellen spoke at the annual Jackson Hole symposium on the topic of 'Labour Markets'.
- The release of the July minutes of the FOMC indicated a slightly more 'hawkish' Federal Reserve Board then the short statement post the July meeting suggested, especially in relation to the labour market. The minutes noted "participants generally agreed that both the recent improvement in labor market conditions and the cumulative progress over the past year had been greater than anticipated and that labor market conditions had moved noticeable closer to those viewed normal in the longer run."
- The employment market continues to heal with 209,000 jobs added in July, this was lower than the 298,000 added in June, however the six-month average is now 244,000. The unemployment rate rose to 6.2%, from 6.1% with a gain in the participation rate. However wages growth remains stagnated at 2.0%.
- However Chair Yellen did caution in her Jackson Hole speech of paying too much attention to wages data, as it could be hindered by "pent-up wage deflation" with "downward nominal wage rigidity" likely holding wages higher than expected during the earlier part of the economic recovery and now creating a slower than expected recovery in wages.
- The second estimate of Q2 2014 GDP growth was revised up from 4.0% on a seasonally adjusted annualised rate to 4.2%.

**Europe**

- The European Central Bank (ECB) left all three of its key interest rates on hold at its 7 August 2014 meeting as expected.
- There are growing expectations of future policy action at the ECB, potentially as early as the September meeting. This follows ECB President, Mario Draghi's comments at the Jackson Hole symposium "we stand ready to adjust our policy stance further". This follows a fall in inflation expectations, weaker activity indicators and low inflation figures.
- Inflation for July was recorded at -0.7% per month and 0.4% per year. While Q2 2014 GDP was recorded as flat, taking the annual figure to 0.7% per year.

**United Kingdom**

- The Bank of England (BoE) left policy unchanged at its 7 August 2014 meeting, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. However for the first time since July 2011 two members of the nine-member committee voted for a rise in the Bank Rate, arguing economic circumstances were sufficient to justify an immediate rise in the Bank Rate and even after this rise, policy would remain extremely supportive.

**New Zealand**

- The Reserve Bank of New Zealand (RBNZ) did not meet in August, its next meeting is on 11 September 2014. It is expected the RBNZ will now pause its interest rate hiking cycle and allow the economy to adjust to the higher interest rates.
- The unemployment rate fell to 5.6% for Q2 2014 from 5.9% in Q1 2014, although a lower participation rate did assist the fall.

- The Pre-Election Economic and Fiscal Update was released ahead of the 20 September 2014 election. Treasury marginally reduced its operating balance forecasts in each fiscal year due to a slightly softer economic outlook.

**Japan**

- The Bank of Japan's (BoJ) policy board convened on 8 August 2014 and decided by unanimous vote to leave current monetary policy settings unchanged, as expected. The BoJ will continue to carry out money market operations so that the monetary base increases by around ¥60-70trn a year.
- Q2 2014 preliminary GDP data was released and indicated the economy contracted 1.7% per quarter, compared to a gain of 1.5% in Q1 2014. This was the sharpest contraction in three years and was driven by falls in consumption and investment after the 1 April rise in the consumption tax. The Yen continues to depreciate falling a further 1.3% against the USD in the month.

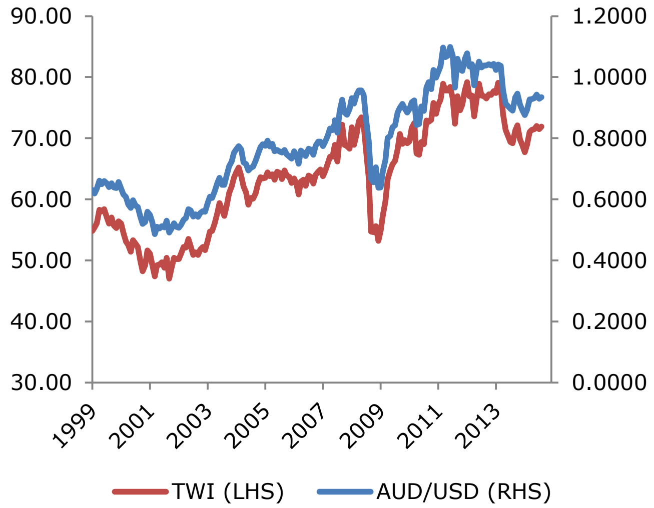
**China**

- There were signs of fading economic momentum in China over August. The official Manufacturing PMI fell to 51.1 in August from 51.7 and the HSBC Manufacturing PMI fell to 50.2 from 50.3. Both the new orders and production components fell suggesting weakening domestic demand.
- Total Social Financing data was weaker than expected, as was new Yuan loans. The interpretation of this data is challenging with potential regulatory changes impacting the supply and demand of credit.
- Property prices continued to weaken with prices in 64 out of 70 cities falling in July, compared to 55/70 in June.

## Australian dollar

- The Australian dollar (AUD) rose by 0.5% per month to finish August at $US0.9341. The Australian dollar continues to trade in a tight range against the USD dollar with markets keenly waiting for a change in policy direction by the Federal Reserve. Over the past five months the Australian dollar has troughed at $US.9226 and reached as high as $US0.9496 indicating low volatility in currency markets.

**AUSTRALIAN DOLLAR RANGE BOUND**

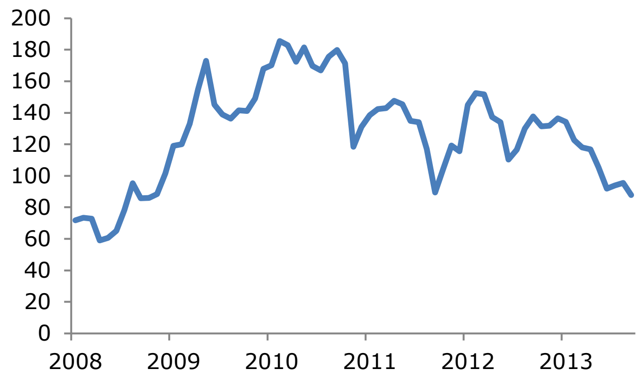



Source: Bloomberg as at 31 August 2014. Past performance is not an indication of future performance.

## Commodities

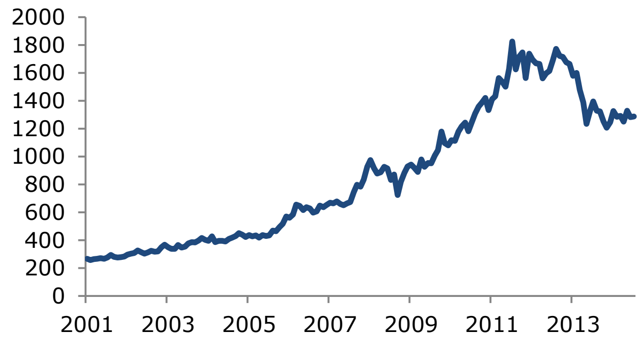
- Commodity prices were mixed in August, although the clear standout was a 8.1% fall in the price of iron ore. This took the iron ore price to $US87.9 per dry metric tonne for 62% fines on rising supply and questions over the demand profile from China.
- The oil price fell 2.7% despite rising geopolitical tensions and is reflective of rising US oil production, with US inventories at the highest levels since 1990.
- Aluminium prices rose 5.5% and have gained 16% year to date with several years of low supply growth now leading to price recovery.
- In the soft commodity space, wheat rose 3.8% after falling for three consecutive months on anticipated supply gains on favourable weather over the northern hemisphere summer. Other soft commodity prices were weaker and included corn (-0.6%) and pork (-17%). Supply of pork is recovering following the porcine virus that impacted US stocks earlier in the year.

**IRON ORE PRICE FALLS ON CONCERNS OVER CHINA**




Source: Bloomberg as at 31 August 2014

- The gold price rose 0.4% over the month to $US1287 an ounce and has remained relatively range bound since April.




**GOLD STEADY**

Source: Bloomberg as at 31 August 2014. Past performance is not an indication of future performance.

## Australian shares

- News flow in the Australian sharemarket was dominated by the release of companies' earnings for the six or 12 months ending 30 June 2014. Few companies announced results that significantly surprised investors; most were broadly in line with expectations.
- As has been apparent for some time, revenue growth across the market as a whole has been subdued. Most of the growth in earnings over the past year has come from cost reductions and productivity improvements. While this is encouraging to see, clearly it cannot last forever. Revenues will need to increase for companies to generate more meaningful earnings growth in FY15 and beyond.
- Investors continue to reward companies that are committed to returning cash to shareholders, in some cases through higher dividend payout ratios. With global bond yields continuing to trend lower, dividends from equities are proving an attractive source of income for investors. The Australian sharemarket as a whole currently offers a yield of ~4.5%, which remains appealing relative to alternative investments.
- In terms of performance over the month, the S&P/ASX 200 Accumulation Index edged 0.6% higher, extending gains made in July. The health care sector was the best performing area of the market – partly due to the strong share price performance of blood plasma company CSL – while energy stocks also tended to fare well. Materials stocks performed less well, partly due to the declining iron ore price.

## Listed property

- The Australian listed property sector rose by 1.7% in August, bringing its year-to-date gains to 20.4%. A-REITs announced full year earnings results. The numbers were largely in line with forecasts, with no significant surprises.

## Global shares

- Global developed equity markets were predominantly stronger in August, although some equity markets in Japan did fall.
- Gains came despite ongoing geopolitical issues focussing on Ukraine/Russia and Northern Iraq. Instead equity markets focused on hope for more policy accommodation from the European Central Bank and further evidence of the resilience of US economic growth.
- The Chicago Board Options Exchange Volatility Index (VIX) moved back to near

record lows over the month despite rising geopolitical risks.

- The MSCI World Developed Markets Index rose by 2.0% in USD terms and 1.5% in AUD terms over the month.
- In the US the S&P 500 Index crossed through the 2000 mark for the first time and closed August at an all-time high of 2003.37.
- Overall the S&P 500 returned 3.8% for August, while the Dow Jones Index rose 3.2% and the NASDAQ was up 4.8%. Mergers and acquisition activity continued to help market performance in the US as did a strong Q2 14 earnings season.
- Equity markets in Europe were stronger in all countries except Italy. The FTSE MIB Index fell 0.6% in August with weaker economic data out over the month. Elsewhere in Europe, Germany's DAX (+0.7%) and Spain (+0.2%) recorded modest gains. The CAC Index in France recorded a strong 3.2%, helped by the weaker euro.
- The Japanese Nikkei 225 (-1.3%) and Topix (-0.9%) both fell in August.

## Global emerging markets

- Emerging market (EM) equities performed broadly in line with developed market counterparts in August. The MSCI EM Index returned 2.1% in USD terms and 1.6% in AUD terms. This return did hide considerable divergence between regions and countries.

**Need more information?**

Please speak with your financial adviser or visit our website at colonialfirststate.com.au. Alternatively, you can call us on 13 13 36.