WEEKLY MARKET UPDATE

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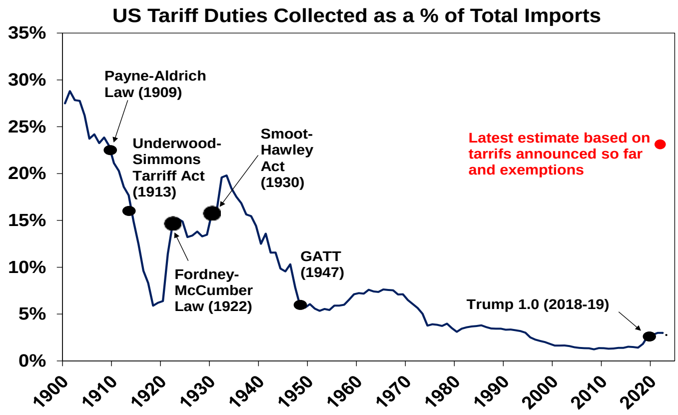
Investment markets and key developments

The rebound in shares continued over the last week helped by talk of trade deals, including with China, and Trump continuing to back track on tariffs along with good US earnings reports. The positive global lead along with a further fall in underlying inflation supporting the case for a rate cut this month saw the Australian share market rise around 3.3% led by IT, property, energy health and retail shares. Bond yields were little changed in the US and Australia but they fell in Europe. Oil, metal, gold and iron ore prices fell. The Australian dollar was little changed while the US dollar rose. Bitcoin also rose.

Trump's first 100 days have seen a roller coaster ride in share markets. Trump's term started with optimism evident in share markets hitting record levels on expectations that he would focus mostly on the positive aspects of his agenda – tax cuts and de-regulation – with tariffs taking a back seat. This turned out not to be the case as he announced far more aggressive tariffs than he indicated in the election campaign. This along with a messy and confusing delivery and uncertainty about what the end point saw shares plunge and bond yields start to surge as investors fretted about recession and a loss of confidence in US economic management and the status of the US as a safe haven. Trump and team then got worried at the prospect of financial panic, a bear market and recession and have been back tracking over the last few weeks – with delays to allow trade deals, an openness to cutting the tariffs on China and a scaling back or exemptions from some tariffs (notably in relation to computers and smart phones and then autos). This has helped markets settle with US, global and Australian shares now having recovered more than half of their losses from their highs early this year to their early April lows and bond yields settling down again. Trump's backdown is good news and indicates that financial markets (eg bond vigilantes) and fear of recession in the US still pose a constraint on Trump.

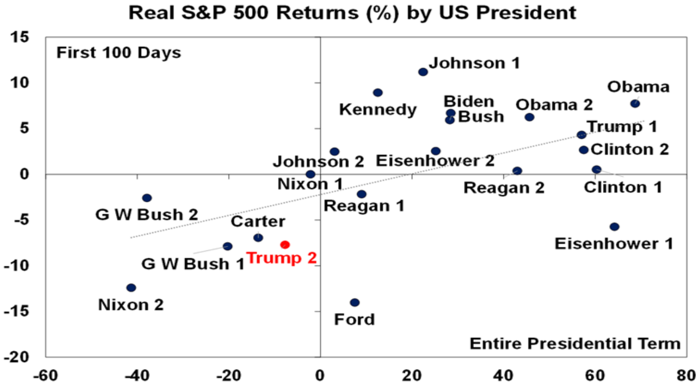
However, its still too early to say that we have seen the bottom in share markets or end of the wider market turmoil.

- Despite the tariff backdowns the effective average tariff rate on imports coming into the US will still be around 23% which is way up on 3% last year and back to levels of early last century.



Source: US ITC, EvercoreISI, AMP

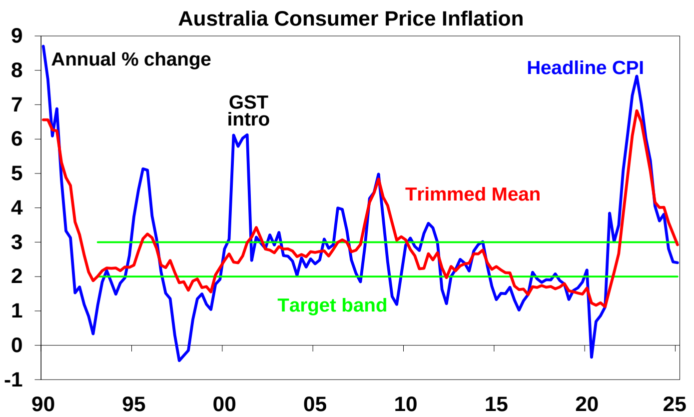
- It's unclear how much progress will be made in terms of tariff deals. Some look to be more like agreements to negotiate which means the situation could easily flare up again. Europe does not appear to be rushing to negotiate. And China is now reportedly assessing the possibility of talks but only after the US contacted it (in contrast to Trump's position that China had to contact the US first) and China still looks to be demanding that the US scrap the tariffs before negotiations begin.
- Trump has flagged more tariffs ahead for things like semi-conductors and pharmaceuticals
- The shock and uncertainty of the tariff announcements has already created significant damage. This is so far only evident in hits to confidence. Yes, US GDP fell in the March quarter, but this was due to imports front running the tariffs not weak demand (yet). But the impact of the tariffs will likely show up in hard economic data in the months ahead as supply chains are disturbed and spending, hiring and investment decisions are delayed due to the hit to confidence leading to a weaker profit outlook. There are some hints of weaker hard data in reports of falling shipping and travel to the US.
- The issue of Fed independence may flare up again as long as the Fed remains in wait and see mode and as Trump looks for someone to blame for weakening economic conditions.
- The rebound in share markets and easing in financial conditions since early April could re-embolden Trump to go hard again on tariffs.
- There is some evidence of a positive correlation between US share market returns in a president's first 100 days and the total return through the president's term. So Trump's poor start does not augur well. See the next chart.



Source: Bloomberg, AMP

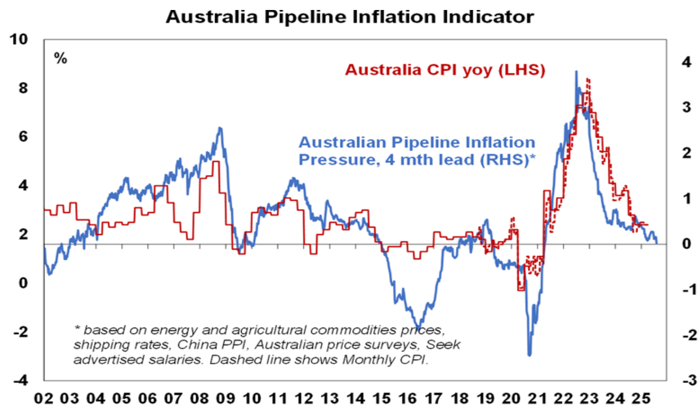
So, with more to go on the tariff front and related fall out it remains too early to say that we have seen the low in US, global and Australian shares. Ultimately though we continue to see Trump backing down on tariffs and settling at a lower average tariff rate than the 23% currently and pivoting to focus more on tax cuts and deregulation which along with more central bank rate cuts including from the Fed around mid-year should see shares stage a more sustainable recovery in the second half of the year.

In Australia, March quarter inflation data added to confidence that the RBA will cut rates again when it meets later this month. While the key trimmed mean (or underlying) inflation rate came in slightly stronger than expected at 0.7%qoq as opposed to our forecast for a 0.6%qoq rise the good news on inflation is continuing. In particular: both headline inflation at 2.4%yoy and underlying inflation at 2.9%yoy are now in the target range; underlying inflation averaged an annualised 2.4% over the last six months which is at the mid-point of the target range; goods price inflation is running around pre-covid levels, services inflation is continuing to fall and is now at its lowest in nearly three years; and market sector price inflation is around 2%.



Source: ABS, AMP

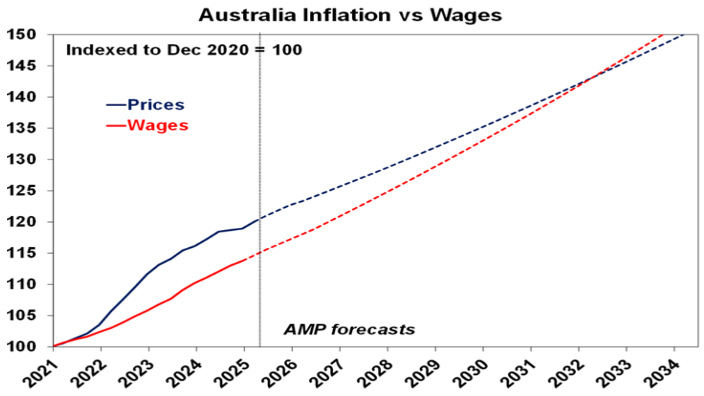
What's more, our Australian Inflation Indicator points to a further fall in inflation ahead.



Source: Bloomberg, AMP

With underlying inflation continuing to trend down in line with the RBA's forecasts, the March quarter inflation data is likely to have added to its confidence that inflation is heading sustainably back to target. So, with monetary policy still tight and Trump's trade war pointing to downside risks to the growth outlook we remain of the view the RBA will cut the cash rate again by another 0.25% on 20th May with a further 2 or 3 cuts into early next year.

Of course, none of this is to say that the "cost of living crisis" in Australia has gone away. Since 2020 average consumer prices are up 20% but average wages are up just 15%. Wages growth is now running above inflation but at the current rate real wages won't catch up to their December 2020 level until around 2032.



Source: ABS, AMP

While the "cost of living crisis" has been a key focus of the Australian election campaign the main disappointments have been that the focus has been on band-aid solutions with little on offer to boost productivity growth which is the key driver of living standards and there has been little in the way of budget discipline. Overall, though, the key policy differences between Labor and the Coalition are minor:

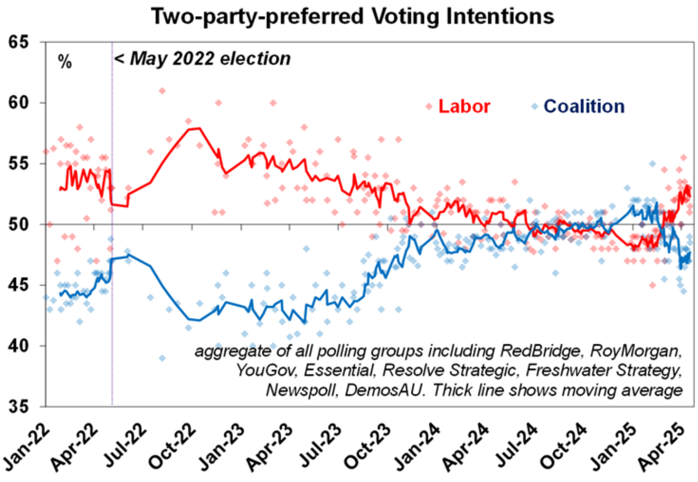
- Both are offering more support for first home buyers – which risks more upward pressure on home prices.
- Labor is offering ongoing modest tax cuts whereas the Coalition is offering a temporary $1200 tax refund for low and middle income earners and a temporary cut to fuel excise.
- The Coalition is planning to spend more on defence but only about 0.2% of GDP more by early next decade.
- The Coalition is planning a bigger cutback in permanent and student immigration (of around 100,000) over the year ahead.
- Labor is planning a continuing push towards renewables with eg battery subsidies whereas the Coalition is planning to extend the life of coal power stations, reserving gas for domestic use and building nuclear power stations longer term.
- Labor is claiming that its policies will leave the May Budget projections $1bn better off over the next four years whereas the Coalition is claiming that its policies will leave it worse off over the next two years but better off over four years by $14bn. The difference is not significant (at around 0.5% of GDP) and the numbers both look a bit rubbery. Labor is relying on more cuts to the use of consultants. The risk under the Coalition is that its near term deficit blow out extends for longer than its saying given the possible difficulty in ending its tax offset and petrol tax cut and in implementing a $17bn cut to the public service.
- Net public debt would likely be lower in the next few years under the Coalition as its planning to scrap several "off-budget" funds and Labor's student debt write off, but will be higher long term as it borrows to build nuclear power stations.

The relatively modest difference in economic policies and their impact on the budget between Labor and the Coalition suggests

minimal impact on investment markets if there is a change of government. That said, the common perception that the Coalition is more business friendly could see a marginal boost to the share market, bond prices (slightly lower yields) and the $A should it win but I doubt there would be much in it.

The main risk for investment markets would come if neither side win enough seats to govern forcing a reliance on independents and/or minor parties leading to a period of uncertainty until a government is formed. It took 17 days for Labor to do this in 2010. This would probably only be a significant issue for investment markets though if Labor was forced to govern with Green support which would likely force it down a less business friendly path.

The latest two party preferred polling though suggests a swing back to Labor with its lead running around where it was in the 2022 election. While Trump appeared to benefit the Coalition into January this has now more than fully reversed making it feel a bit like Canada (where the left of centre Liberals looked like suffering a landslide loss a few months ago only to be returned to power in the past week's election thanks partly to Trump). Of course, what happens in the marginal seats is key and this suggests that the risk of Labor losing its three seat majority resulting in minority government is high but maybe not to the point where Labor will have to rely on Green support to form a minority government.

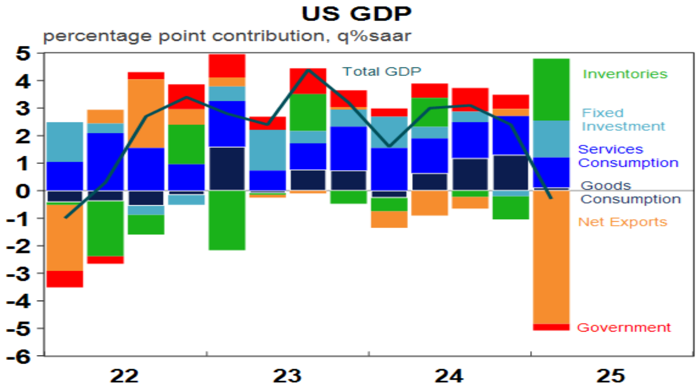


Source: Polls as indicated, AMP

The risk of Australia losing its AAA credit rating is low, but this election campaign has been fiscally irresponsible. S&P has warned that a downgrade was a risk if election promises resulted in larger structural budget deficits and debt than expected. Our assessment is that the risk is low as deficit and debt projections are unlikely to be significantly different as a result of the election from what they were at the time of the March Budget. However, this election has been marked by a spendathon of election promises with little commitment to balancing the budget in a reasonable timeframe. While the budget projections may not be that different to what was in the March Budget that Budget had already seen an extra $35bn in net spending promises compared to the December budget update with much of that adopted by the Coalition. And, S&P is right to be concerned about the increasing use of "off budget" funds (covering the NBN, Snowy Hydro, the Housing Australia Fund, etc) which don't add to the underlying cash deficit but do add to debt. These funds are weakening budget discipline and are contrary to the Charter of Budget Honesty which needs to be reviewed.

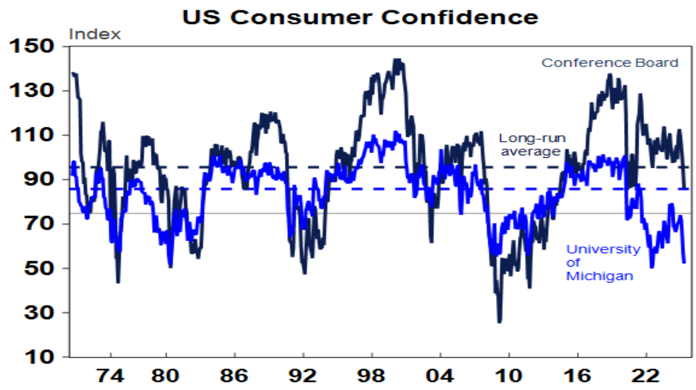
Major global economic events and implications

US economic data was weak, but not as weak as suggested by the 0.3% annualised fall in March quarter GDP. This has been reported as a sign that the US is already entering recession, but the fall was solely due to a 51% annualised surge in imports ahead of the tariffs which meant that net exports knocked 4.8% percentage points off GDP growth. Adjusting for this and a positive contribution to growth from inventory, domestic final sales growth was actually a reasonable 2.3% annualised with strong growth in investment and okay but slowing growth in consumer spending. In other words, while the US is at risk of going into recession what we saw in the March quarter isn't it!



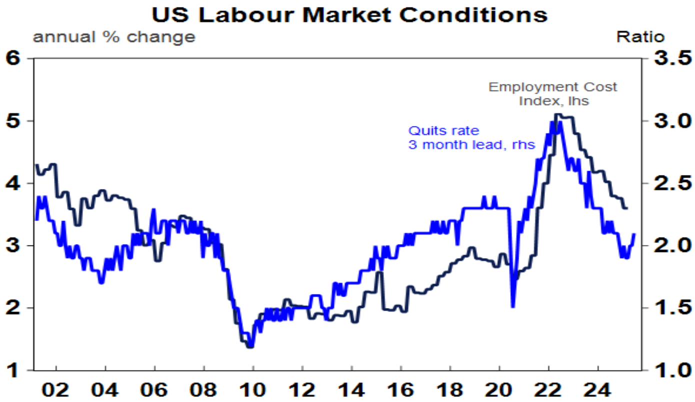
Source: Macrobond, AMP

That said other US economic data was soft. Yes, pending home sales rose in March and home prices are still rising, but the former is flat on a year ago and home price gains are slowing. Meanwhile, consumer confidence fell sharply in April with consumers less positive on the jobs market. And the ISM manufacturing conditions index fell in April with prices paid continuing to rise.



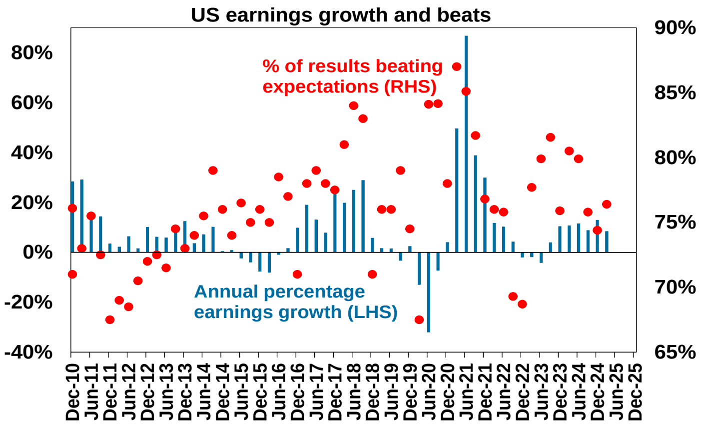
Source: Macrobond, AMP

And jobs data was messy with still low unemployment claims and a rise in hiring and people quitting their jobs but a fall in job openings and a private employment survey pointing to weaker jobs growth. Meanwhile, growth in employment costs slowed further to 3.6%yoy with the downtrend in quits pointing to a further slowing. And core private final consumption inflation slowed to 2.6%yoy in March, but of course this was before the impact of tariffs shows up.



Source: Macrobond, AMP

Meanwhile, US earnings growth appears to be holding up well. 70% of S&P 500 companies have reported March quarter results with 76% beating expectations which is around average and consensus earnings expectations have risen to 8.5%yoy and look likely to come in around 9.5%yoy, up from 4.1%yoy two weeks ago. That said numerous companies including Apple have highlighted the threat from the tariffs.

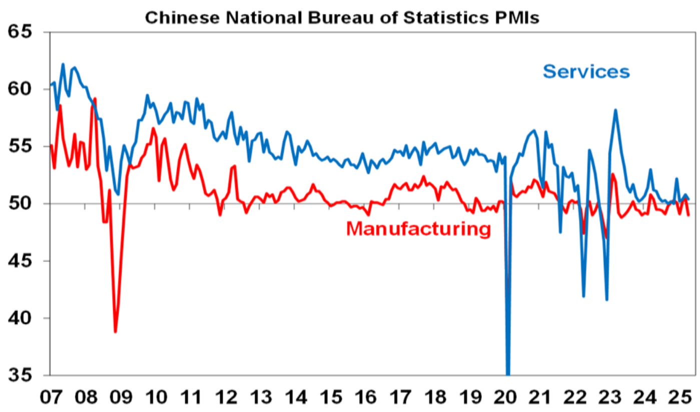


Source: Bloomberg, AMP

Eurozone GDP growth came in stronger than expected in the March quarter at 0.4%qoq or 1.2%yoy but this was boosted by a 20% annualised rise in exports to the US, front running the tariffs (and mirroring the surge in US imports). Eurozone economic confidence weakened in April, but the fall is modest compared to that seen in the US. The ECB remains on track to cut rates again in June with another two cuts likely after that this year.

The Bank of Japan left rates at 0.5% and revised down its growth and inflation forecasts with risks seen as on the downside and doesn't appear to be in a rush to raise rates. Industrial production, retail sales and unemployment were weaker than expected.

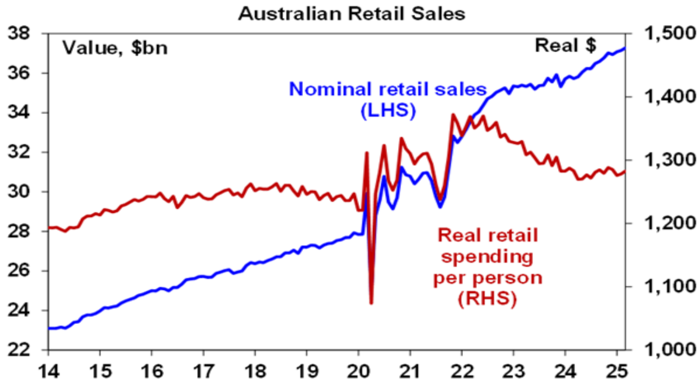
Chinese business conditions PMI's weakened in April as the tariffs hit, particularly for manufacturing. This highlights the need for more policy stimulus with the April Politburo meeting pledging this.



Source: Bloomberg, AMP

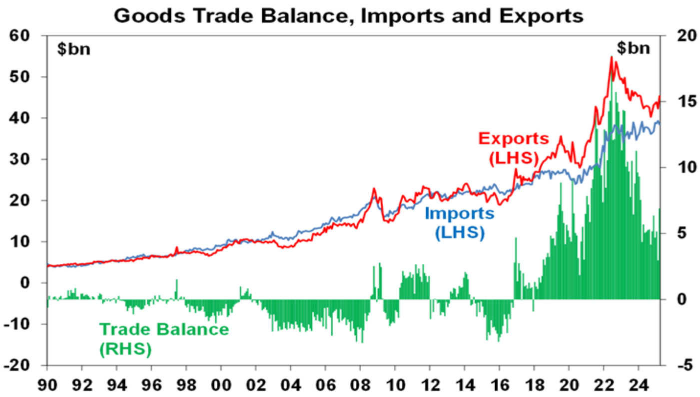
Australian economic events and implications

Australian data remains consistent with just a modest pick up in economic growth. March retail sales rose a softer than expected 0.3%mom mainly due to food spending ahead of Cyclone Alfred in Queensland, and retail volumes were flat in the March quarter and fell 0.4%%qoq per person. While price discounting boosted sales in the December quarter, households are clearly still struggling. After a roughly 6% fall in real retail sales per person over the two years to June last year, they are now basically trending sideways. A gradual uptrend is likely to resume on the back of rising real wages, low unemployment and improved confidence but its likely to require more rate cuts, particularly in face of the economic uncertainty flowing from Trump's trade war.



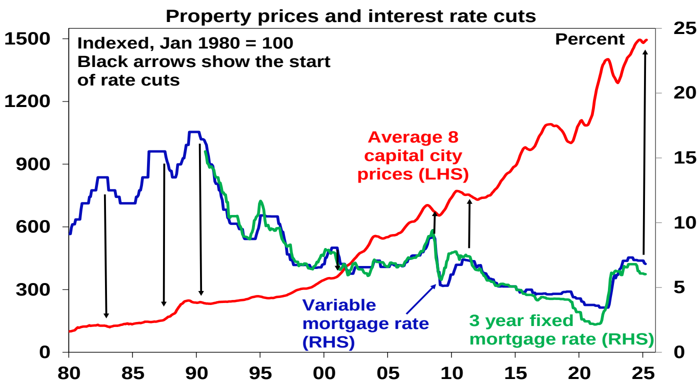
Source: ABS, AMP

Australia's trade surplus rebounded in March helped by a 7.6%mom rise in exports as iron ore exports rebounded and exports to the US, particularly gold, continued to surge ahead of the implementation of tariffs. The front running of US tariffs (which was reflected in the fall in US March quarter GDP) won't be sustained and along with the trade surplus seen with the US in the March quarter will be reversed going forward. Net export volumes look like making a flat contribution to March quarter GDP growth.



Source: ABS, AMP

Home prices rose for the third month in April with an average rise of 0.3% and all capital cities seeing gains.



Source: Cotality, RBA, AMP

What to watch over the week ahead?

Apart from US tariff developments and reactions to the Australian election result…

In the US, the Fed (Wednesday) is likely to leave rates on hold again at 4.25-5%, as it remains in wait and see mode in relation to the impact of the tariffs in hitting economic growth and boosting inflation. The services conditions ISM (Monday) is likely to show a further fall to around 50 from 50.8.

On Thursday the Bank of England is expected to cut its key policy rate by 0.25% taking it to 4.25%, but the Swedish central bank is expected to remain on hold at 2.25%.

Chinese exports for April (Friday) are expected to slump after they were boosted by tariff front running in March. Import growth is likely to remain weak.

In Australia, expect March data to show a 3% gain in building approvals and flat household spending (both Tuesday).

Outlook for investment markets

Shares are at high risk of further falls given the ongoing tariff war, increased recession risk particularly in the US and the risk of a US/Israeli strike on Iran's nuclear capability if diplomacy doesn't work. Even if the low has been seen volatility is likely to remain high. But with Trump likely to ultimately back down further on the tariffs (after declaring victory of course!) and pivot towards more market friendly policies like tax cuts and deregulation, and central banks, including the RBA, likely to cut rates further shares are likely to recover on a more sustainable basis into year end. But it's likely to be a rough ride.

Bonds are likely to provide returns around running yield or a bit more, as growth weakens, and central banks cut rates.

Unlisted commercial property returns are likely to improve in 2025 as office prices have already had sharp falls in response to the lagged impact of high bond yields and working from home.

Australian home prices have likely started an upswing on the back of lower interest rates. But it's likely to be modest with US tariff worries constraining buyers and posing a near term threat of a reversal in prices and affordability remaining poor. We see home prices rising around 3% this year.

Cash and bank deposits are expected to provide returns of around 4%, but they are likely to slow as the cash rate falls.

The $A is likely to be buffeted between the negative impact of US tariffs and the global trade war and the potential positive of a further fall in the overvalued US dollar as its safe haven status comes under question. This could leave it weak around or just below $US0.60 in the near term. Undervaluation should support it on a medium-term view with fair value around $US0.73.