WEEKLY MARKET UPDATE

15 SEPTEMBER 2023

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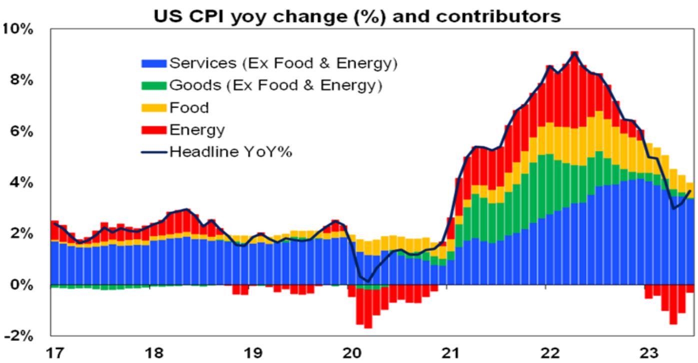
Investment markets and key developments

Global share markets were mixed over the last week. US shares initially rose as economic data provided confidence that the Fed won't have to raise rates again but fell on Friday on concerns about an auto workers strike amidst various options expiries which can magnify volatility leaving them down 0.2% for the week. Chinese shares also fell 0.8% for the week amidst growth concerns. However, Eurozone shares rose 1.3% helped by a "dovish rate hike" from the ECB and Japanese shares rose 2.8%. Helped by the earlier positive US lead and local jobs data consistent with the RBA leaving rates on hold next month the Australian share market rose 1.7% for the week. Bond yields rose as did oil, metal and iron ore prices. The $A rose despite a rise in the $US.

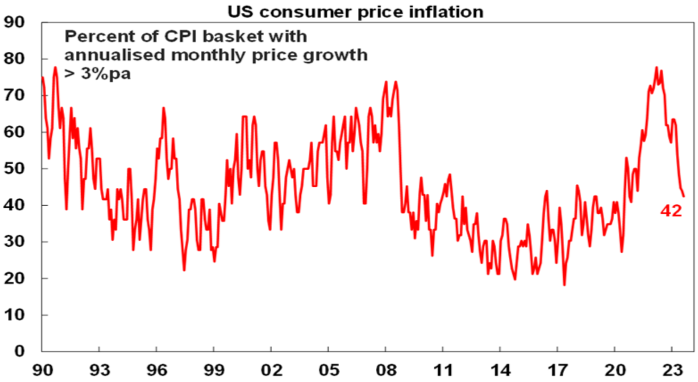
The risk of a correction in shares remains high with the main threats being: sticky services inflation; many central banks still leaning hawkish; the high risk of recession; the rebound in oil prices; China's economy still at risk; the very high risk of a US Government shutdown from 1 October; high bond yields pressuring share market valuations; continuing geopolitical tensions; and the weak seasonal period for shares into next month. However, our 12-month view on shares remains positive as inflation is likely to continue to trend down taking pressure off central banks and any recession is likely to be mild.

US inflation up in August, but trend remains down. Consistent with other countries inflation data for August, US inflation rose to 3.7%yoy from 3.2%yoy. However, this was mainly due to higher gasoline prices. Core inflation also came in slightly stronger than expected at 0.28%mom compared to an expectation for 0.2%mom, but the faster increase was mainly due to volatile airfares and annual core inflation fell further to 4.3%yoy from 4.7%yoy. Apart from transport services other core inflation categories – goods, shelter and other services - show ongoing downwards momentum.



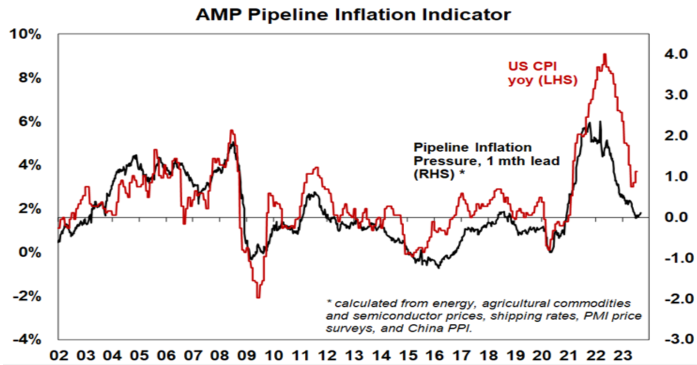
Source: Bloomberg, AMP

Measures of breadth continue to show a downswing in US inflationary pressures. Median inflation, the Atlanta Fed's sticky inflation measure and the percentage of CPI components with greater than 3% inflation are all continuing to slow.



Source: Bloomberg, AMP

Our US Pipeline Inflation Indicator has ticked up a bit but continues to point down for US inflation. So while the August CPI was a bit disappointing, its unlikely to be enough to tip the Fed over into another rate hike at its meeting in the week ahead as the broad disinflationary trend remains intact. However, it is likely to retain a tightening bias & retain one more rate hike in its "dot plot".



Source: Bloomberg, AMP

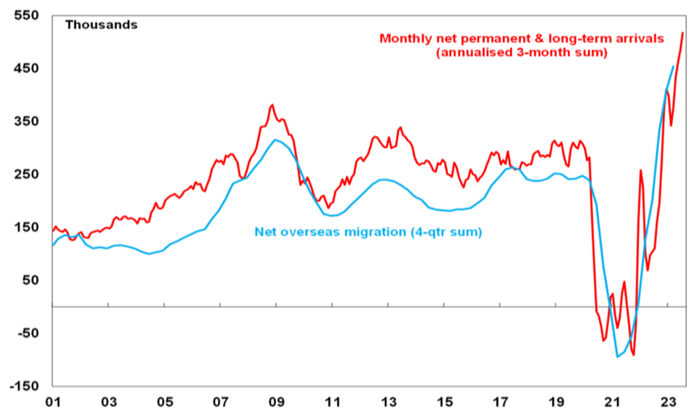
The ECB hiked their policy rates by 0.25% taking the main refinancing rate to 4.5% with higher inflation forecasts. It still has a mild hawkish bias, but its guidance implied this may be the peak. The hike was contrary to market expectations although it was a close call, but money markets see this as likely being the peak.

The Bank of Japan appears to be getting closer to removing negative interest rates. Comments by BoJ Governor Ueda that it may have enough information to make a decision on raising interest rates were more hawkish than previously indicated. Ueda's comments may have been aimed at trying to stop the fall in the Yen after its surprise move to relax its year cure control just had a temporary impact. Core inflation in Japan is now well above the 2% target but wages growth at present is still arguably below levels necessary to sustain inflation at that level. But if the economy continues to strengthen wages growth may be strong enough by year end. So, a rise in interest could come in the next six month.

Before then, possibly in October, the BoJ may remove its yield curve control. This will reduce a source of support for global bonds – but its significance is unclear as Japanese bond yields will likely remain well below those in the US and Australia for some time.

Australia's surging population growth. March quarter data showed that Australia's population rose by 563,000 or 2.2% over 12 months, with 454,000 of that coming from immigration. Permanent and long term arrival data up to July suggest that the surge in immigration is continuing to accelerate and we are on track for net immigration of 500,000 or more in the last financial year which would take population growth to 2.5%, its fastest since 1966. Some of this is catch up after the pandemic slump and it will help boost measured GDP growth and immigration makes for a more dynamic economy so there are benefits. But what really counts for living standards is per capita GDP (and its going backwards) and the surge in immigration is making the housing shortage even worse.

Australian net immigration on the rise again

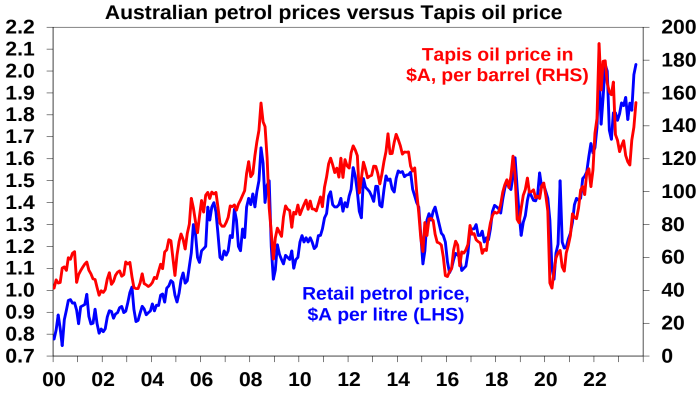


Source: ABS, AMP

The good news is that Australian governments led by Canberra appear at last to be serious about focussing on supply as the key to improving housing affordability, rather than first home buyer concessions which just add to demand. The target to build 1.2 million new homes over five years from July 2024 – or 240,000 pa – supported by: the now passed Housing Australia Future Fund the returns from which will be used to build 30,000 social and affordable homes over five years; the National Housing Accord with the states which aims to build 20,000 affordable homes over 5 years; along with various programs to incentivise states to build more homes are to be welcomed. Given that the Government's commitments regarding new homes are a tiny fraction of the 1.2 million target the private sector will be relied on to deliver the bulk of them. Over the five years to 2022 Australia built 1 million new homes mostly in the private sector but we need a stretch target to solve the housing affordability issue. However, this is not going to be easy. First, there is still a large backlog of approvals yet to be completed with delays due to labour and material shortages and regular failures amongst homebuilders. This will make it hard for the government building programs to ramp up initially although focussing on lower cost social and affordable housing will help and things may get easier as higher interest rates result in weak private sector home building in the next year. But if we have only managed to build 200,000 dwelling pa in the last five years where is the capacity going to suddenly come from to build 240,000 pa going forward. Second, the record surge in immigration is adding to the supply shortfall. On our estimates before the schemes start next year Australia will have a cumulative short fall of at least 165,000 dwellings. Underlying demand is running around 220,000 dwellings per annum but over the next year or so actual dwelling starts will be subdued at around 180,000 which means a new shortfall each year of about 40,000 dwellings adding to the already existing shortfall. Trying to make up for that short fall will be hard. So the focus should also be on capping the level of immigration to the ability of the property industry to supply homes for the new immigrants. Finally, similar supply side commitments have been announced in the past only to fail. Time will tell.

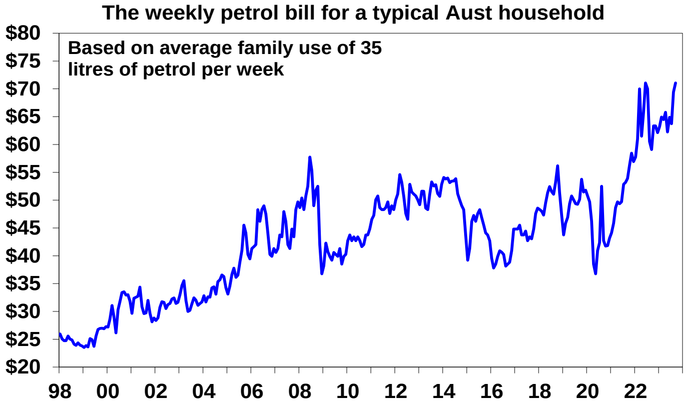
The surge in petrol prices – another boost to inflation or a disinflationary tax on spending? A surge in global oil prices to above $US90 a barrel (on Saudi and Russian production cuts) and wider refinery margins have pushed Australian petrol prices to near last year's record highs at over $2 litre. If petrol prices stay at current levels they will be up roughly 5.5% this quarter which will add around 0.2% to September quarter inflation. But in contrast to last year's petrol price surge the circumstances are a bit different this time. 18 months ago petrol prices were going up (with a 35%yoy rise to March quarter last year) along with prices for just about everything else backed by supply shortages and a reopening surge in demand. So the petrol price surge last year just reinforced high inflation. But now it's a bit different: the percentage rise in petrol prices so far has been less; goods supply shortages have largely corrected themselves; the reopening boost to demand has run its course; and higher interest rates are impacting on demand. So while higher petrol prices will add directly to inflation they will hurt already struggling households and act as a tax on spending as the typical household's fuel bill will have increased by around $9 a week since June, which will dampen inflation outside of fuel.

Australian petrol prices versus Tapis oil price



Source: Bloomberg, AMP

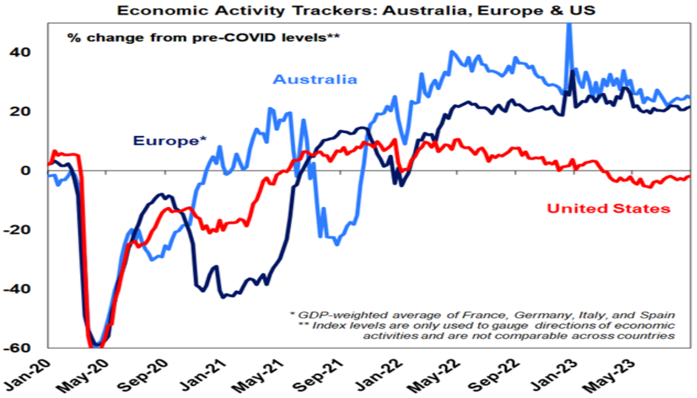
The weekly petrol bill for a typical Aust household



Source: Bloomberg, AMP

Economic activity trackers

Our Economic Activity Trackers are still not providing any decisive indication of recession (or a growth rebound).

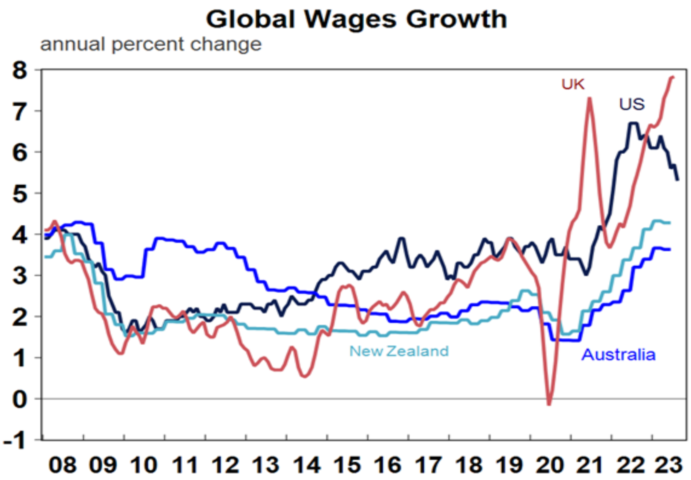


Levels are not really comparable across countries. Based on weekly data for eg job ads, restaurant bookings, confidence, credit & debit card transactions and hotel bookings. Source: AMP

Major global economic events and implications

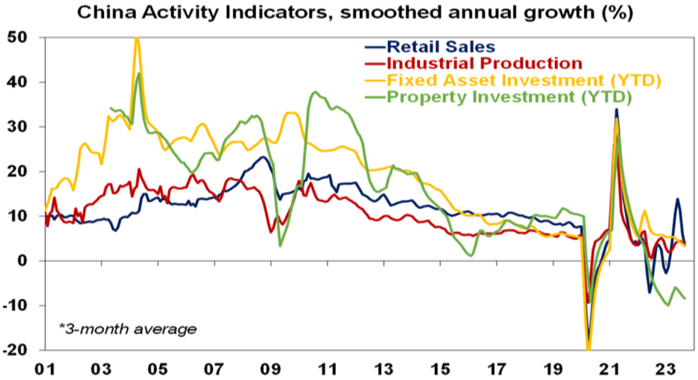
US economic data was mixed. Consumer sentiment fell. Retail sales growth slowed in August and July sales were revised down. Growth in industrial production slowed, particularly in manufacturing. Small business optimism remained low with weak capital spending plans but manufacturing conditions in the New York region improved continuing a zig zag pattern seen over the last year. Both these surveys saw some rise in price components although they remain well down from their highs. Like the CPI, US producer price inflation rose to 1.6%yoy in August but core producer price inflation fell to 2.2%yoy. The University of Michigan consumer survey reported falls in both 1 year and 5-10 year inflation expectations with the latter now at a benign 2.7%.

UK jobs data was weak in July with another rise in unemployment and fall in job vacancies but wages growth remained strong at 7.8%yoy and this will worry the Bank of England. UK wages growth is way above that in other countries, including Australia.



Source: Macrobond, AMP

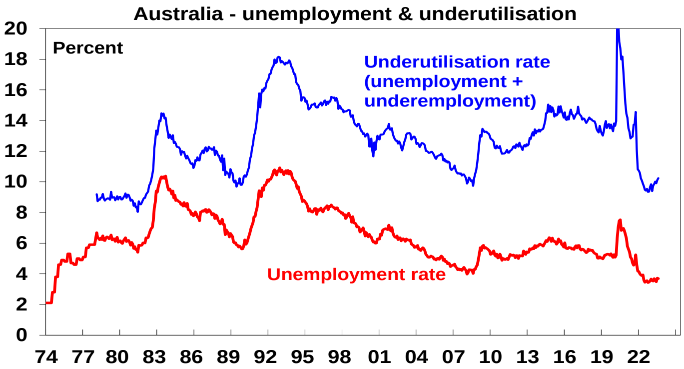
Chinese economic data for August was stronger than expected suggesting that growth may be stabilising. Growth in industrial production, retail sales and credit picked up more than expected, falls in exports and imports slowed and deflation abated. All of which could reflect policy stimulus measures although on a three-month smoothed basis the data is still soft (see next chart) and property indicators are very weak. China followed up with another monetary easing move by cutting banks required reserve ratio by 0.25% to help boost bank lending. It's questionable whether the policy stimulus seen so far with its focus on easier monetary conditions is enough though given weak demand and the risk that households may be in a liquidity trap after a rapid rise in debt.



Source: Bloomberg, AMP

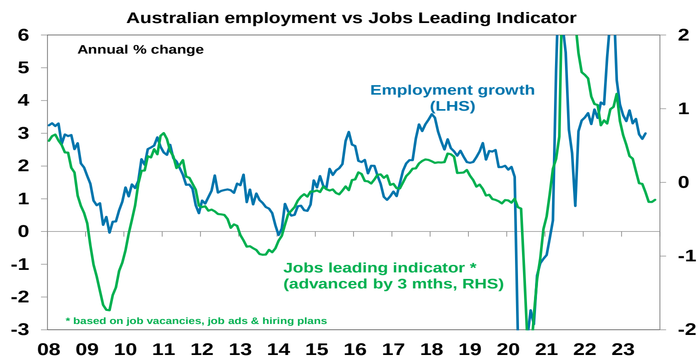
Australian economic events and implications

A messy jobs report for August. Employment was up a strong 64,900 after a weak school holiday affected July, but the quality of jobs growth was poor (with full time employment up just 2,800 after an 18,700 fall in July), hours worked fell and a rise in the participation rate to a record high saw unemployment unchanged at 3.7%, still up from a low of 3.4% last October. The jobs market is still tight but the rising trend in unemployment and underemployment indicates that its gradually cooling.



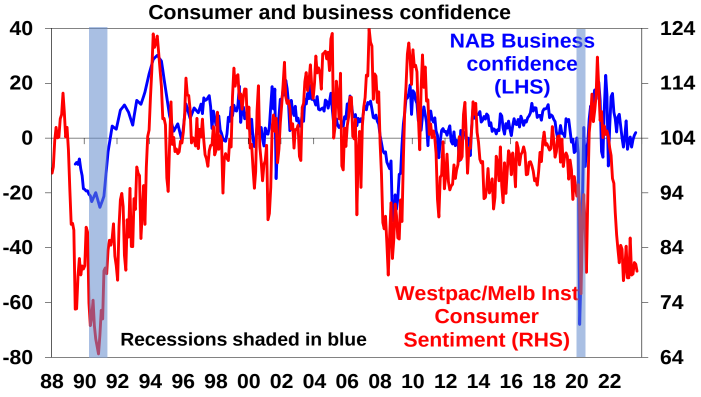
Source: ABS, AMP

Leading indicators of jobs growth point to a further slowing ahead. Our Jobs Leading Indicator based on job vacancies and hiring plans points to a sharp slowing in jobs growth to around 1%yoy (or 12,000 net new jobs a month). Rising applicants per job ad and deteriorating consumer unemployment expectations are also consistent with a cooling jobs market. **With the surge in immigration driving strong population and hence workforce growth, around 37,000 net new jobs a month are currently required to stop unemployment from rising**. Anything below this (absent a fall in participation) will see higher unemployment. We expect unemployment to rise to above 4.5% by the second half of next year. **The ongoing evidence of a softening jobs market is consistent with our forecasts that the RBA will leave rates on hold at its next meeting, although retail sales and inflation data in the next few weeks could also impact that decision**.



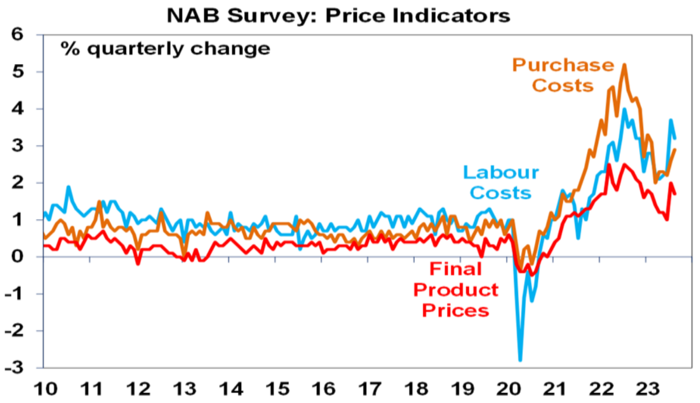
Source: ABS, AMP

Australian consumers still depressed, but business conditions still okay. According to the September Westpac/MI consumer survey, consumer confidence fell slightly remaining at recessionary levels despite the RBA's decision to leave rates on hold for the third month in a row indicating that the lagged impact of rate hikes and cost of living pressures continue to impact. By contrast business confidence according to the July NAB survey remains at average levels and business conditions remain okay.



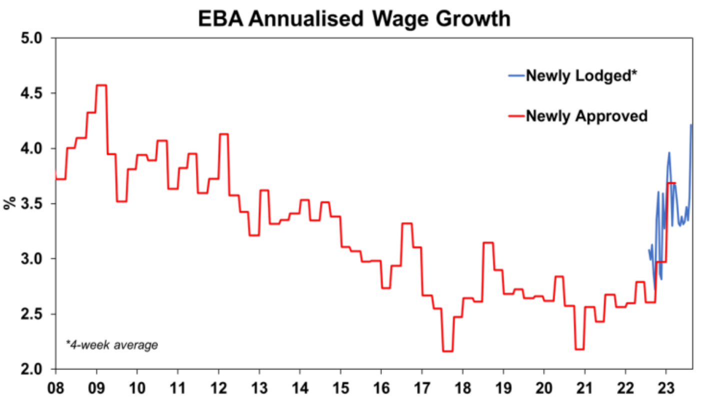
Source: Westpac/MI, NAB, AMP

Inflation pressures still elevated in the NAB survey. The NAB survey showed that labour cost and price pressures eased slightly in August but remain elevated, suggesting that upside risks to inflation and hence interest rates remain high.



Source: NAB, AMP

The upside risks in terms of labour costs are also highlighted by a further strengthening in proposed wage rises under newly lodged Enterprise Bargaining Agreements. This is part of the reason why the RBA will likely retain a tightening bias for a while yet.



Source: Fair Work Commission, AMP

What to watch over the next week?

In the US, the Fed is expected to leave interest rates on hold reflecting cooling inflation pressures and the significant tightening already undertaken leaving room for a pause, but retain a mild tightening bias. On the data front expect falls in home builder conditions (Monday) and housing starts (Tuesday), a pull back in the Phily Fed regional manufacturing index and continuing weak leading economic indicators (both Thursday). Business conditions PMI's for September (Friday) will be watched for a further fall.

Canadian inflation for August (Tuesday) is likely to rise slightly from 3.3%yoy reflecting higher energy prices.

Eurozone PMIs (Friday) are likely to show further weakness.

The Bank of England (Thursday) is likely to raise its policy rate to 5.5% from 5.25% reflecting still high inflation and strong wages growth. UK inflation for August (Wednesday) is likely to have increased slightly from 6.8%yoy reflecting higher energy costs.

The Bank of Japan (Friday) is likely to leave monetary policy on hold but possibly signal that its moving towards winding back monetary stimulus consistent with recent comments by Governor Ueda. Inflation data for August (also Friday) is expected to show a fall to 3%yoy (from 3.2%) but core (ex food and energy) inflation is likely to rise further to 2.8%yoy.

In Australia, the minutes from the last RBA meeting (Tuesday) are likely to provide more details on why it left rates on hold again this month, but also provide a reminder that it may still raise rates again. PMIs for September (Friday) are likely to remain soft.

Outlook for investment markets

The next 12 months are likely to see a further easing in inflation pressures and central banks moving to get off the brakes. This should make for reasonable share market returns, provided any recession is mild. But for the next few months shares are still at risk of a further correction given high recession and earnings risks, the risk of still more hikes from central banks, rising bond yields and poor seasonality out to October.

Bonds are likely to provide returns above running yields, as growth and inflation slow and central banks become dovish but given the recent rebound in yields this may be delayed a few months.

Unlisted commercial property and infrastructure are expected to see soft returns, reflecting the lagged impact of the rise in bond yields on valuations. Commercial property returns are likely to be negative as "work from home" hits space demand as leases expire.

With an increasing supply shortfall, our base case remains that home prices have bottomed with more gains likely next year as the RBA starts to cut rates. However, uncertainty around this is high given the lagged impact of interest rate hikes and the likelihood of higher unemployment.

Cash and bank deposits are expected to provide returns of around 4-5%, reflecting the back up in interest rates.

The $A is at risk of more downside in the short term on the back of a less hawkish RBA and weak growth in China, but a rising trend is likely over the next 12 months, reflecting a downtrend in the overvalued $US and the Fed moving to cut rates.