Colonial First State

Market View – April 2016

By Belinda Allen, Senior Analyst, Economic and Market Research

Summary

The Reserve Bank of Australia (RBA) cut the official cash rate from 2% to 1.75%, a new all-time low, at their May meeting. The Federal Open Market Committee (FOMC) of the US Federal Reserve Board met on 2 to 27 April 2016 and as widely expected held the Fed Funds target rate unchanged at 0.25% to 0.50. The European Central Bank (ECB) met on 21 April 2016 with no changes to monetary policy announced. The Bank of England (BoE) left policy unchanged when it announced its decision on 14 April 2016, as expected. The Bank of Japan's (BoJ) policy board convened on 28 April 2016 and disappointed markets by monetary policy unchanged.

Australia

The Reserve Bank of Australia (RBA) cut the official cash rate from 2% to 1.75%, a new all-time low, at their May meeting. The next RBA Board meeting is 7 June 2016.

The decision to cut rates was due to recent "information showing inflationary pressures are lower than expected". While Board noted that some temporary factors impacted the weak Q1 CPI print, they judged that this along with "ongoing very subdued growth in labour costs and very low cost pressures elsewhere in the world, point to a lower outlook for inflation than previously forecast".

The RBA slightly downgraded their outlook for the economy "growth is continuing in 2016, though probably at a more moderate pace" and their assessment of recent labour market indicators to "mixed of late".

The board "took careful note of developments in the housing market" but judged "that the effects of supervisory measures are strengthening lending standards and that price pressures have tended to abate" and that "the potential risks of lower interest rates in this area are less than they were a year ago".

The easing bias in the statement does appear to be somewhat reduced compared to previous months: "the Board judged that prospects for sustainable growth in the economy, with inflation returning to target over time, would be improved by easing monetary policy at this meeting." – However it is expected that the RBA will cut cuts a second time in August.

Q1 2016 headline CPI fell by -0.2% per quarter, significantly below expectations and the weakest since 2008. The annual rate decreased to 1.3% per year, from 1.7% per year, well below the RBA's 2% to 3% target range.

The weak inflation outcome was driven by the expected falls in automotive fuel (-10% per quarter), fruit prices (-11.1% per quarter) and general tradables weakness (-1.4% per quarter), despite the weaker AUD. While key seasonal items, including education (+3.1% per quarter) and health (+1.9% per quarter), increased less than expected, exacerbating the weakness.

The unemployment rate decreased to 5.7% in March, from 5.8% in February, the lowest since September 2013.

Employment growth was stronger than expected with 26,100 jobs added compared to the 17,000 expected. This was mostly driven by part-time jobs growth which is up by 150,000 over the past year. The participation rate held steady at 64.9%.

Business conditions and confidence, as measured by NAB remain supportive with Conditions up 3 to +12 while confidence was up by 3 to +6 in March before falling to +9 and +5 respectively in April.

Over the month speculation mounted that a Federal Election will shortly be called in Australia. The Federal Budget will be released on 3 May 2016 and most political observers have suggested that a 2 July 2016 Election will be announced shortly thereafter.

US

The Federal Open Market Committee (FOMC) of the US Federal Reserve Board meet on 2 to 27 April 2016 and as widely expected held the Fed

Funds target rate unchanged at 0.25% to 0.50% the rate set in December 2015.

On inflation the Fed stated that "inflation has continued to run below the Committee's 2% longer-run objective, partly reflecting earlier declines in energy prices and falling prices of non-energy imports."

March headline and core CPI rose by 0.1%, below the consensus of 0.2%. The headline was constrained by a 0.2% fall in food prices and a smaller increase in gasoline prices than expected. Core was held down by smaller than expected increases in medical costs and slightly subdued rents. The annual rate of headline CPI fell to 0.9% per year from 1% per year in February while Core inflation (ex food and energy) fell to 2.2% from 2.3%.

The Fed's preferred measure of inflation; Core Personal Consumption Expenditure Price Index rose 0.1% in March, lowering the annual rate at 1.6%, the three month annualised rate is however 2.1% suggesting a pickup in core inflation

Wage growth remains subdued with the Employment Cost Index showing an increases of 0.6% per quarter in Q1 2016 and an annual increase of only 1.9% per year down from 2.0% per year in Q4 2015.

Europe

The European Central Bank (ECB) met on 21 April 2016 with no changes to monetary policy announced. The ECB last made changes in March 2016 when they announced a broad easing package, including interest rate cuts, an increase of the asset purchase program and an expansion of the Targeted long-term refinancing operation (TLTRO) program. The next ECB meeting is 2 June 2016.

The statement reinforced the forward guidance, with policy interest rates expected to "remain at current or lower levels" well past the end of QE. While emphasizing the ECB's willingness to use all instruments at their disposal to achieve the inflation objective.

The first estimate of Q1 2016 GDP beat expectations, accelerating to 0.6% per quarter from 0.3% per quarter in Q4 2015, with the annual rate steady at 1.6% per year. Spain (+0.8% per quarter) and France (+0.5% per quarter) beat expectations, Germany and Italy will report later this month.

UK

The Bank of England (BoE) left policy unchanged when it announced its decision on 14 April 2016, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. The next BoE meeting is 12 May 2016.

The minutes showed little change in rhetoric or outlook from March but did however discuss the potential impact of the upcoming EU referendum in June. They note signs that 'Brexit' uncertainty may be impacting H116 growth and expressed the view that a vote to "leave" would create uncertainty around the economic outlook which could possibly weigh on demand and asset prices.

The first estimate of Q1 2016 GDP growth was in-line with expectations, up 0.4% per quarter and steady at 2.1% per year. Construction (-0.9% per quarter) and industrial production (-0.4% per quarter) were both weaker while services (+0.6% per quarter) continued to drive growth.

CPI data showed inflation increased by 0.4% in March, with strength in transport services enough to offset weakness in food, alcohol and tobacco. The annual rate of inflation increased to 0.5% per year while core inflation rose to 1.5% per year.

Japan

The Bank of Japan's (BoJ) policy board convened on 28 April 2016 and disappointed markets by monetary policy unchanged. They did however announce a funds-supplying operation to banks in the area affected by the Kumamoto earthquakes.

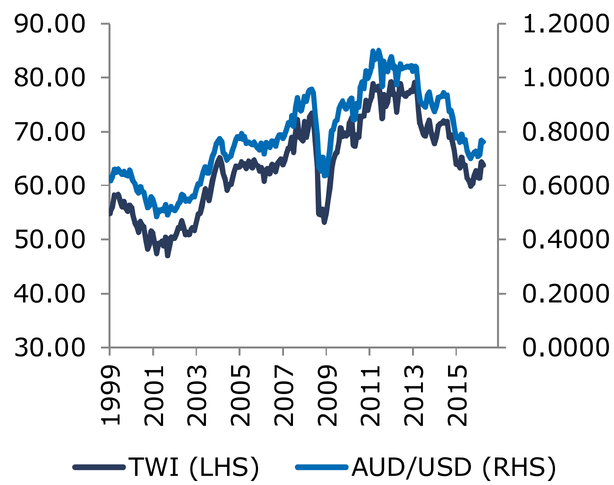
When asked why there was no easing despite the downgrade to the inflation outlook, Governor Kuroda replied that the BoJ pre-emptively eased in January with the introduction of negative interest rate policy and board members believe it will take time to see the impact of that easing.

Australian dollar

The Australian dollar depreciated against the major currencies in April. The AUD finished down 0.9% against the USD to $US0.7603. This fall was largely driven by increased expectations of an RBA rate cut after the weak Q1 CPI print.

The Australian dollar fell against the euro (-1.5%), the sterling (-2.4%), the yen (-6.2%) and NZ dollar (-1.7%) over the month of April.

AUSTRALIAN DOLLAR WEAKENS AFTER WEAK INFLATION



Source: Bloomberg as at 30 April 2016

Commodities

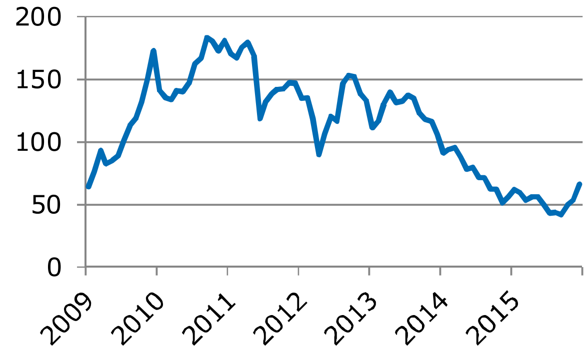
Commodity prices were stronger in April driven by continued USD weakness, increased confidence in Chinese growth and early signs of global supply rebalancing.

The price of West Texas Intermediate Crude finished the month at $US45.9/bbl, up 19.8%, while the price of Brent was up 16.2% to $US47.4/bbl. Supply side disruptions in Nigeria, Kuwait and Venezuela as well as falling non-OPEC supply and strong demand for refine products supported oil over the month despite the failure of production freeze talks in Doha.

Gas prices remained volatile with the US Henry Hub spot price down 1.6% to $US1.90/MMBtu while the UK natural gas price was up 18.3% over April.

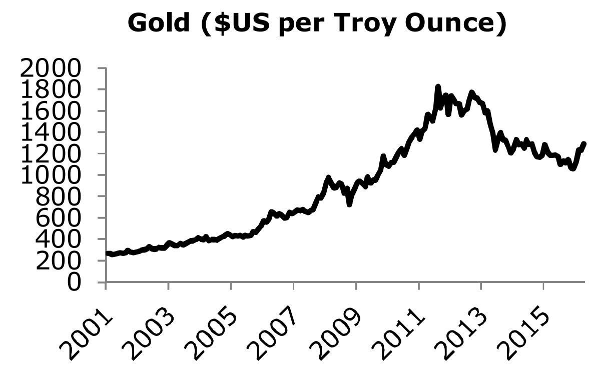
Iron ore prices continued their strength in April, up 23.2% to $66.2/metric tonne, as measured by the benchmark price of iron ore delivered to Qingdao China – 62% Ferrous Content.

IRON ORE CONTINUES RECOVERY



Source: Bloomberg as at 30 April 2016

GOLD REMAINS SUPPORTED



Source: Bloomberg as at 30 April 2016

Australian equities

Australian shares continued to appreciate in April, with the S&P/ASX 200 Accumulation Index adding 3.4%. The market has now regained all of its lost ground from earlier in 2016 and is trading slightly above its end-2015 level.

April was a month dominated by resources names. Most stocks in the Materials and Energy sectors announced production reports for the three months ending 31 March 2016, which focused attention on these areas of the market. The results announcements themselves held few genuine surprises for investors, but resources stocks nonetheless performed very well on the whole.

Materials stocks, for example, added more than 14% thanks to favourable commodity price movements. This supported margins and profitability for producers and provided a major boost to miners’ share prices.

Listed property

ASX-listed property securities continued to perform well in April, with the S&P/ASX 200

Property Accumulation Index adding 2.8%. A very subdued inflation print for the March quarter increased speculation that Australian interest rates will be lowered further this year, providing support for income-producing assets such as A-REITs. Against this background, property stocks have added nearly 10% in 2016 to date.

Dexus Property Group (+6.1%) was among the best performers in the sector following its failed takeover proposal for Investa Office Fund (-0.5%). Just 61% of Investa shareholders approved the proposed deal; well short of the 75% required to approve the deal. Cromwell Property Group (-1.9%) acquired a 9.8% stake in Investa days before the vote, although has not yet made its future intentions known.

Mirvac Group (-3.4%) was among the underperformers. Attention focused on the increasing settlement risk on newly built apartments as Australian banks reined in lending to foreign residential property investors. This had an impact on investor sentiment towards developers such as Mirvac.

In early May, Iron Mountain was added to the S&P/ASX 200 Property Accumulation Index following its successful takeover of document management business Recall Holdings (+11.1%). Following this transaction Iron Mountain CDIs are now listed on the ASX and the stock has been classified as a REIT, consistent with its classification in its home market of the US.

Global developed market equities

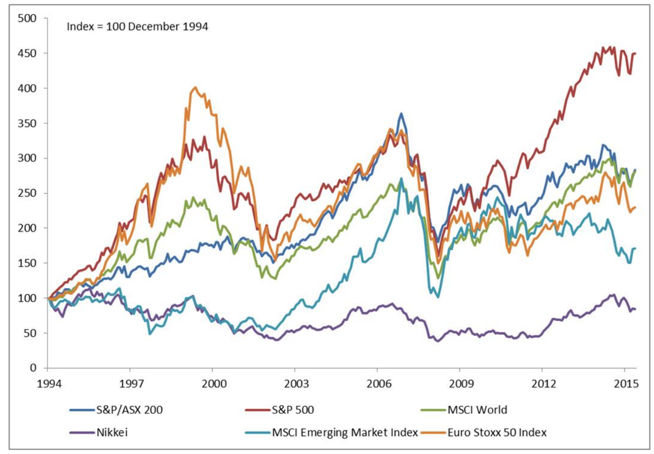
Global financial markets mostly maintained their positive sentiment during April with most major equity markets recording gains over the month.

The continued rebound in commodity prices led resource related equities higher over the month with Materials and Energy outperforming most sectors.

The main driver of markets at month end was the start of US reporting season. Disappointing results from Apple and Alphabet (Google's parent), the two most valuable publically traded companies in the world, drove markets lower despite better than expected results from other tech names (Facebook and Amazon) and financials (JP Morgan and Citi Group).

The MSCI World Index rose by 1.4% in US dollar terms in the month of April and 2.3% in Australian dollar terms.

EQUITY MARKETS MAINTAIN POSITIVE SENTIMENT



Source: Bloomberg as at 30 April 2016. Past performance is not an indication of future performance.

Global emerging markets

Emerging market equities were mixed in April, with the MSCI Emerging Market Index up 0.4% in US dollars and 1.3% in AUD terms.
The weaker USD and continued recovery in commodity prices drove some markets with the Latin American region recording the largest gains. MSCI EM Latin America rose 5.7%, once again driven by Brazil (+7.7%), the MSCI EM Europe, Middle East and Africa was also up 3.4% in US dollar terms.

MSCI Asia Ex Japan was down 1.0%, with weakness in the Shanghai Composite Index (-2.2%) and most other Asian markets over April.