

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

Market and economic overview

Economics overview

Australia

- The RBA left the official cash rate on hold at 2% at its meeting on 1 September 2015 and again on 6 October 2015 where it has remained since May this year.
- The RBA acknowledged in October "monetary policy needs to be accommodative" and "further information on economic and financial conditions to be received over the period ahead will inform the Board's ongoing assessment of the outlook and hence whether the current stance of policy will most effectively foster sustainable growth and inflation consistent with the target."
- Governor Stevens testified at the House of Representatives Standing Committee on Economics on 18 September noting that the "Australian economy continues to progress through a major adjustment, in the midst of testing international circumstances."
- The Governor noted there were some positive aspects to note on the Australian economy; "outside the mining sector and parts of the economy most directly exposed to it, there are signs that conditions have been very gradually improving." This could also be seen in job vacancies and "the rate of unemployment, though variable from month to month, seems to have stopped rising, and it is at a level a bit lower than we had thought, six months ago, it might reach."
- Building approval numbers continue to be a volatile monthly series, falling 6.9% per month and rising 5.1% per year for August. House approvals rose 4.4% while apartment approvals fell 16.9% in the month. Over the

past 12 months a record 225,406 new homes were approved.

- Credit growth numbers are showing some signs that regulatory initiatives are having an impact on investor lending. Overall private sector credit growth rose 0.6% per year and 6.3% per year. Investor housing lending growth slowed to 10.7% per year, down from the peak of 11.1% per year in June 2015. Owner-occupier lending rose to 5.6% per year from 5.3% per year in July. Business credit growth also improved, up 5.3% per year from 4.8% per year.
- Employment figures continued to surprise on the upside with 17,400 jobs added in August. The unemployment rate fell to 6.2% from 6.3%. Over the past 12 months 214,000 jobs have been added, the strongest in four years.
- Australian house prices rose 0.9% in September, following a 0.3% rise in August. This took annual house price growth to 11.0% per year, up from 10.3% per year in August. On a capital city basis Melbourne rose strongly, up 2.4% per month to be up 14.2% per year. Sydney (+0.1% per month), Brisbane (+0.8% per month) and Perth (+0.5% per month) all rose while Adelaide (-1.2%) fell.

United States

- The US Federal Open Market Committee (FOMC) met on 16-17 September 2015 and decided to leave the official Fed Funds target rate at 0%-0.25%.
- More importantly the statement accompanying the policy decision was seen as being on the 'dovish' side with an increased focus on the lack of inflation as well as the moderate pace of economic expansion.

- The Fed also mentioned the negative effects in the global economy and financial market volatility stating "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term."
- Chair Yellen did leave open the door for a rate hike this year and the Fed's dot plot continues to show one rate hike before the end of 2015. The Fed's median 'dot' for year-end 2015 is now at 0.4%, rather than 0.63% previously with 13 out of 17 members still expecting a rate hike this year.
- On the labour market, the Fed now expects an unemployment rate of 5% at year-end 2015, down from the previous forecast of 5.3%. The Fed then expects the unemployment rate to be 4.8% at year-end 2016, 2017 and 2018. The longer-run unemployment rate forecast has been lowered to 4.9% from 5.0%.
- The economic growth forecast for year-end 2015 has been revised up to 2.1% from 1.9% in the previous forecast in June.
- For 2016 the Fed now expects GDP growth of 2.3%, down a little from the June forecast of 2.5%. The 2017 growth forecast is now at 2.2%, from 2.3% previously, while the longer run forecast is unchanged at 2.0%.
- The inflation (Core PCE) forecast for 2015 has been revised marginally higher to 1.4% from 1.3%, but across the out-years the forecasts for inflation have all been lowered marginally.
- At this stage domestic economic activity indicators continue to point towards the need for higher interest rates in the US; Q2 2015 GDP was revised higher in the third estimate and is now at 3.9% on a seasonally-adjusted-annualised-rate, up from 2.7% in the second estimate.
- On the inflation side there remains limited signs of a trend up. The Fed's preferred measure, the Core Personal Consumption Expenditure Index rose 0.1% per month and 1.3% per year. Headline inflation is just 0.2% per year and ex food and energy at 1.8% per year where it has been for the last six months.
- On employment, the last two months has seen a step down in monthly employment

gains. In August 136,000 jobs were added and in September 142,000 were added. The unemployment rate held steady at 5.1% and earnings growth also held steady at 2.2% per year contrary to expectations of a rise.

- Late in the month a short-term spending bill was passed to fund government operations through to 11 December 2015. This came after House Speaker John Boehner's resignation. Attention will now turn to the need to raise the debt ceiling, currently expected in early November and then negotiations over government funding for 2016.

Europe

- The European Central Bank (ECB) met on 3 September 2015 and made no changes to policy. The main refinancing rate remains at 0.05% and a target of €60bn of securities are to be purchased each month.
- The ECB did however highlight what would be required for another round of easing measures and is concerned about negative flow on effects from Emerging Market growth concerns.
- The ECB continues to highlight its willingness and ability to act with further stimulus if needed.
- GDP growth was revised down for the next few years, with the ECB expecting growth of 1.4% in 2015, 1.7% in 2016 and 1.8% in 2018, this compares to 1.5%, 1.9% and 2.0% from its June projections.
- In terms of inflation there were also downgrades with 0.1% in 2015, 1.1% in 2016 and 1.7% in 2017, this compares to previous forecasts of 0.3%, 1.5% and 1.8% respectively.
- Elections held in Greece on 20 September saw Alexis Tsipras remain Prime Minister with his party, Syriza winning 145 seats in the national parliament. While failing to win an overall majority, Syriza will form a coalition with the Independent Greek party.
- The election win does highlight the support for the bailout package agreed to with the EU creditors and the harsh austerity measures that came with it.

- Inflation remains low, with the CPI estimate for September at -0.1% per year, with core inflation at 0.9% per year .

United Kingdom

- The Bank of England (BoE) left policy unchanged when it announced its decision on 10 September 2015 meeting, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. There was one dissent on the nine member board, the second meeting in a row. Market expectations have been pared back after the Fed left rates on hold and now point towards the first hike in Q2 2016.
- The decision to remain on hold largely reflects the view that with inflation below target, there remains some underutilised resources in the economy and monetary policy should be set to ensure growth is sufficient to absorb the remaining slack and return inflation to target within two years.
- Currently inflation remains low, headline CPI was just 0.2% per month in August and flat over 12 months. Core inflation was 1.0%. There has been some improvement in wages growth with average weekly earnings at 2.9% per year for July with the unemployment rate at 5.5%.

New Zealand

- The Reserve Bank of New Zealand (RBNZ) met on 10 September 2015 and lowered its official cash rate (OCR) by 25 basis points to 2.75%. This is the third consecutive meeting where the official cash rate was lowered.
- The RBNZ noted "a reduction of the OCR is warranted by the softening in the economy and the need to keep future average CPI inflation near the 2% target midpoint. At this stage, some further easing in the OCR seems likely. This will depend on the emerging flow of economic data."
- Q2 2015 GDP data showed the NZ economy grew at 0.4% per quarter and 2.4% per year. This has slowed from 3.5% per year recorded in Q4 2014. Economic momentum is slowing as construction and manufacturing activity plateaus and the outlook continues to look

softer with falling dairy production and weak confidence.

Canada

- The Bank of Canada (BoC) met on 9 September and made no change to policy. The overnight lending rate was last lowered by 25 basis points in July 2015 to 0.5%.
- In its decision the BoC noted that the "stimulative effects of previous monetary policy actions are working their way through the Canadian economy" and the adjustments to the economy from lower oil and commodity prices are complex and expected to take considerable time.
- Currently the BoC judges that "the risks to the outlook for inflation remain within the zone for which the current stance of monetary policy is appropriate."

Japan

- The Bank of Japan's (BoJ) policy board convened on 15 September 2015 and left its qualitative and quantitative easing (QQE) program at an annual increase of ¥80trillion to its monetary base. There was one dissent at the meeting with Kiuchi proposing instead to taper annual Japanese Government Bond purchases to ¥45trillion and keeping asset buying, zero rates for as long as needed under flexible price target.
- The final estimate of Q2 2015 GDP was released, with growth negative in the quarter at -0.3% per quarter. While this was slightly better than consensus expectations it was still a disappointing result.
- The quarterly Bank of Japan Tankan Index showed reasonable numbers with the large manufactures business conditions index falling 3pts to 12 in Q3 2015. The large non-manufactures index rose 2pts to 25, while the outlook for both fell to 12 from 19. On the positive side was a lift in planned capital expenditure plans to 10.9% per year up from 9.3%.

China

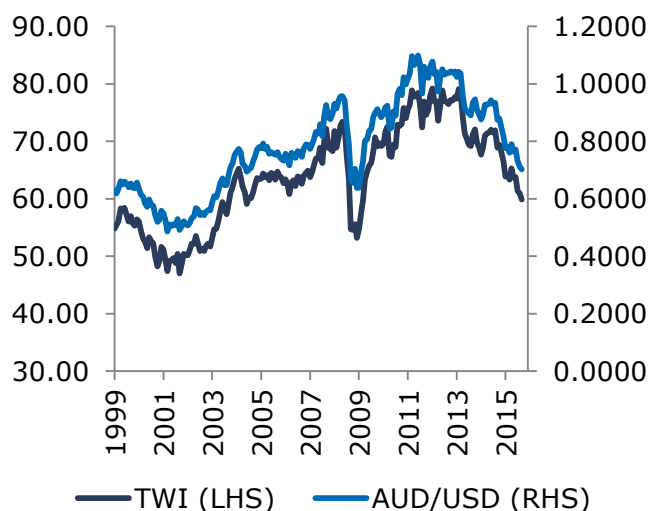
- After a number of easing measures were announced in August, September was a relatively calmer month for the world's largest economy.

- President Xi conducted his first state visit to the US and noted there was no foundation to expect a continuous depreciation of the RMB. Importantly the Obama administration also said that it supported the inclusion of the RMB in the International Monetary Fund's Special Drawing Rights basket.
- The Caixin Manufacturing PMI was 47.2 at its final September estimate, its lowest reading since March 2009. This is the seventh consecutive month of contraction.

Australian dollar

- The Australian dollar finished down 1.4% against the USD in September to \$US0.7017. The Australian dollar traded as low as \$US0.6911 and as high as \$US0.7219 during the month, largely reflective of changes in views of the first rate hike for the US Federal Reserve.
- The Australian dollar also moved lower against both the euro (-1.0%), the New Zealand dollar (-2.3%) and the Japanese yen (-2.5%). In contrast the Australian dollar rose 0.1% against the sterling.

AUSTRALIAN DOLLAR DOWN AGAIN



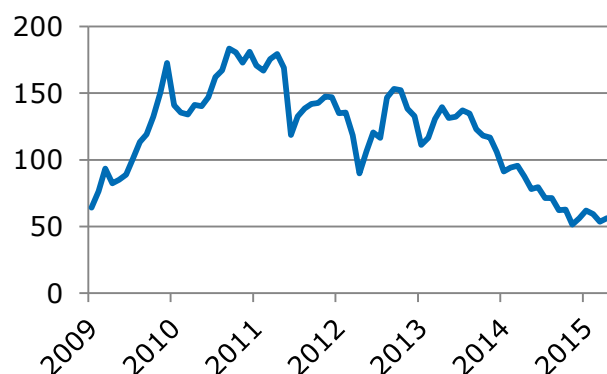
Source: Bloomberg as at 30 September 2015

Commodities

- Commodity prices traded with volatility again in September, weighed down by the US dollar and growth concerns in China. Overall commodity prices were weaker but this hides significant divergence of price performance between various commodities.

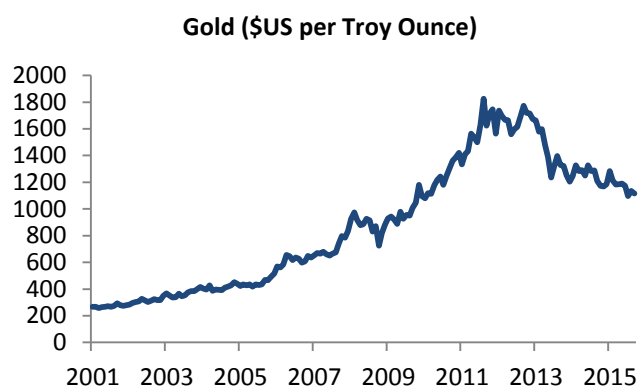
- The oil price traded in a wide range, with the price of West Texas Intermediate Crude finishing the month down 8.4% after rising sharply in late August. The iron ore price, as measured by the benchmark price of iron ore delivered to Qingdao China – 62% Ferrous Content rose 0.2% to \$US56.32 a metric tonne and was largely stable over the month.
- Metal prices were mixed with zinc (-6.7%) and lead (-3.5%) falling while tin (+9.3%) and nickel (+3.4%) rose.

IRON ORE STABLE



Source: Bloomberg as at 30 September 2015

GOLD DOWN SLIGHTLY



Source: Bloomberg as at 30 September 2015

Australian equities

- Weakness in the Australian equity market persisted in September, with the S&P/ASX 200 Accumulation Index declining by a further 3.0%. The market remained volatile throughout the month, with regular and significant swings in investor sentiment.
- Energy and Materials stocks remained under pressure, reflecting ongoing weakness in commodity prices.

- There were some notable company events in these sectors too. Woodside Petroleum launched an all-stock, \$11.6 billion takeover approach for Oil Search. This bid was rejected by the Oil Search Board, which suggested it undervalued the company. Later in the month, Origin Energy announced a \$2.5 billion equity raising. The low oil price has put pressure on the company's financial position and may have jeopardised its credit rating.
- The next significant period of earnings announcements in Australia is in late October / early November, when three of the four major banks will announce their results for the period ending 30 September 2015.

Listed property

- ASX-listed property stocks outperformed the broader sharemarket, with the S&P/ASX 200 Property Accumulation Index declining in value by just 0.3%.
- Stocks exposed to discretionary consumer expenditure continued to perform relatively well. Scentre Group (+2.4%) and Westfield Corporation (+2.3%) were among the best performing stocks in the index, for example. Official data has confirmed that retail sales growth in Australia remains reasonably robust, likely supported by ongoing low borrowing costs.
- In other news, Australian Industrial REIT attracted competing takeover approaches from 360 Capital Investment Management and a consortium of offshore listed investors. Both offers remained live at month end.
- Despite broader weakness in global equity markets, offshore property stocks managed a small gain. The FTSE EPRA/NAREIT Global Developed Index added 1.2% in USD terms. The Index was supported by favourable performance among US REITs (+3.0%), which offset weakness in Asian markets including Hong Kong (-1.5%) and Singapore (-3.8%).

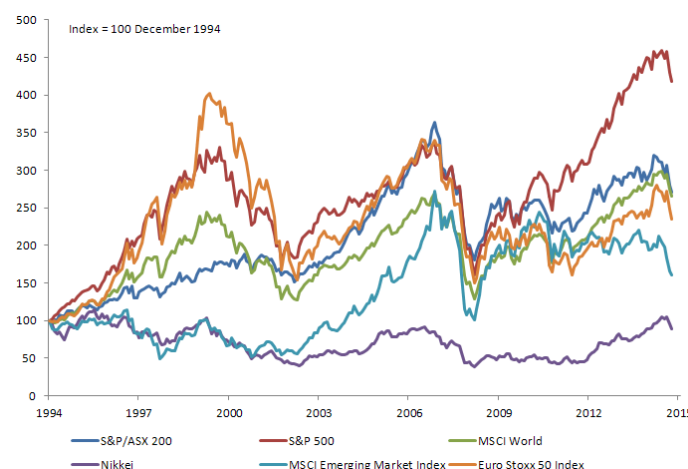
Global developed market equities

- Global developed equity markets traded with extreme volatility again in September, following on from weakness in August with the same issues impacting markets last

month unresolved in September. There remained concerns over weakness in commodity prices and the pace of economic growth in China and Emerging Markets. Coupled with this a downbeat statement by the US Federal Reserve when leaving the Fed Funds rate on hold led to questions about the overall pace of growth in the global economy and it was another weak month for global equities. There were also two stock specific issues over the month that contributed to the volatility. VW fell 42.3% in September as a result of an emissions scandal and Glencore fell 35.7% as its financial health was called in to question.

- All major global equity markets fell in September. Overall the MSCI World Index fell 3.9% in USD terms and 2.4% in AUD terms. The S&P500 (-2.6%), the Dow Jones (-1.5%) and the NASDAQ (-3.3%) all fell.
- MSCI Materials (-9.0%) and MSCI Energy (-7.6%) fell, as did all sectors but MSCI Consumer Staples which finished flat.
- Equity markets in Europe were also weaker. The German DAX (-5.8%), France (-4.2%), Spain (-6.8%) and Italy (-2.9%) all fell. The UK FTSE 100 was down 3.0% for the month.
- In contrast the Athens Stock Exchange rose 4.9% on the Greek election result.
- In Asia, the Japanese Nikkei 225 was weak, down 8.0% while Hong Kong fell 3.8% in the month.

EQUITY MARKETS MIXED



Source: Bloomberg as at 30 September 2015

Global emerging markets

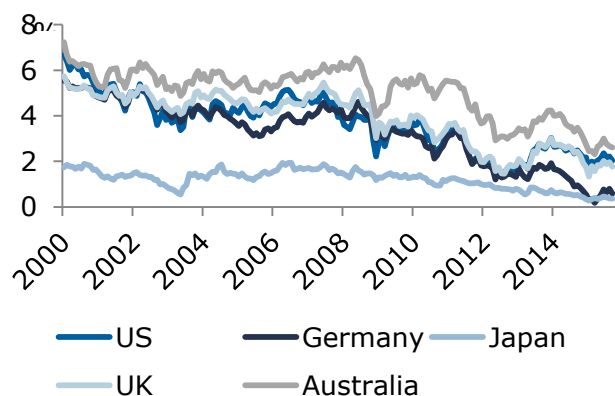
- September was another challenging month for emerging market equities with ongoing concern over the pace of economic growth and how these economies will deal with an eventual rate rise by the US Federal Reserve and further US dollar appreciation.
- The Reserve Bank of India surprised the market and cut its repurchase rate by 50 basis points to 6.75%. Its last interest rate cut was in April and with central bank citing stronger global headwinds, lower 2016 inflation expectations and a weak monetary policy transmission mechanism. Emerging market (EM) equities fell 3.3% (MSCI Emerging Market Index), taking year to date losses to 15.3%. Latin America was again the weakest performer with Argentinean BURCAP Index falling 11.5% in the month.
- The Shanghai Composite Index lost a further 4.8% in the month as growth concerns lingered.

Global and Australian developed market fixed interest

- Global bond markets' attention was focused on the meeting of the Federal Open Market Committee (FOMC) of the US Federal Reserve (Fed) and on subsequent communication by many of its members. The Fed ultimately left rates on hold and issued a more downbeat statement than expected. Bond markets had only priced in a moderate chance of this occurring at the meeting.
- The US 10 year Treasury yield fell by almost 10 bps immediately following the meeting and ended the month at 2.04%, about 18 bps lower than at the beginning. UK and Germany 10-year bond yields fell by about 20 bps over the month to 1.76% and 0.59% respectively.
- In addition to the uncertainty around when the Fed would commence policy normalisation, continued volatility in the Chinese stock market and the weaker growth outlook for the Chinese and other emerging economies resulted in a bid tone in sovereign bond markets.

- In Japan, the 10-year JGB yield fell 3bps to 0.35%, and traded in a relatively narrow range of 9bps.
- In Australia the 10-year government bond yield traded in a 28 basis point range during September. Despite the volatility the yield was only down 6 bps to 2.61% at the end of the month.

BOND YIELDS FALL IN JULY



Source: Bloomberg as at 30 September 2015

Global credit

- Over the month, global credit spreads drifted wider as investor sentiment continued to be impacted by macro events, particularly China's growth concerns. The Barclays Global Aggregate Corporate Index average spread widened 13 basis points in the month, closing at 1.67%. In Europe, the average spread on the Barclays European Aggregate Corporate Index closed at 1.48%, widening by 23 bps in September, and the Barclays US Aggregate Corporate Index average spread finished the month at 1.61%, widening by 6 bps. US High Yield credit spreads again widened significantly in September as the high yield market continues to be impacted by the increased market volatility and uncertainty. The Bank of America Merrill Lynch Global High Yield index (BB-B) spread closed 83 bps wider at 5.57%.
- Asian credit markets also weakened in September, with the JPMorgan Asia Credit Index (JACI Composite) average spread widening by 20 bps to 3.14%.
- Metals/Mining and Energy sectors again contributed materially to the broad market spread widening driven generally by macro themes. Automotive spreads also widened

materially sparked by the Volkswagen emissions testing scandal.

- In line with their global counterparts, Australian credit spreads drifted wider as investor sentiment was impacted by global

events, particularly China's growth concerns and the start of policy normalisation by the Fed. The average spread of the Bloomberg AusBond Credit Index relative to swap increased from 95 bps to 108 bps.

Index return

	Index Level in Base Currency	1 month	12 month
S&P/ ASX200 Index	5,022	-3.6%	-5.1%
S&P / ASX 200 Accumulation Index	45,405	-3.0%	-0.7%
MSCI WORLD (AUD)		-2.8%	18.3%
MSCI World Net Index AUD Hedged		-3.4%	1.2%
Dow Jones Index	16,285	-1.5%	-4.4%
UK FTSE 100	6,062	-3.0%	-8.5%
German DAX Index	9,660	-5.8%	2.0%
France CAC Index	4,455	-4.2%	0.9%
Japan - Nikkei	17,388	-8.0%	7.5%
Hong Kong – Hang Seng	20,846	-3.8%	-9.1%
MSCI EM (EMERGING MARKETS) (AUD)		-2.1%	0.6%
US 10 year bond yield	2.04%	-18bps	-45bps
Australia 10 year bond yield	2.61%	-6bps	-88bps
UBS All Maturities Composite Bond Index	8,582	0.3%	6.9%
90 Day Bank Bill Index	2.18%	3bps	-56bps
Bloomberg AusBond Bank Bill Index	8,319	0.2%	2.5%
S&P / ASX 200 - A-REIT Accumulation Index	37,231	-0.3%	20.3%
AUD/USD (end of month)	0.7018	-1.3%	-19.8%
Oil price	\$US45.09/barrel	-8.4%	-50.5%
Gold price	\$US1115.07/ounce	-1.7%	-7.7%

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