WEEKLY MARKET UPDATE

03 MAY 2024

DR SHANE OLIVER
Head of Investment Strategy and Chief Economist, AMP

Investment markets and key developments

Global shares mostly rose over the last week. While US shares had a volatile week they were buoyed by good earnings results and rose sharply on Friday in response to news of cooler jobs and wages growth in April which allayed fears of overheating. As a result, US shares rose 0.5% for the week. In holiday shortened weeks, Japanese shares gained 0.8% and Chinese shares rose 0.6%, but Eurozone shares fell 0.9%. The Australian share market rose 0.7% partly in catchup to the gain in US shares the previous week and as soft retail sales reduced fears of another RBA rate hike with gains led by property, IT and consumer discretionary stocks. Bond yields fell helped by the Fed being less hawkish than feared Fed and softer than expected US payrolls. Oil prices fell but copper and iron ore prices rose. The $A rose as the $US fell.

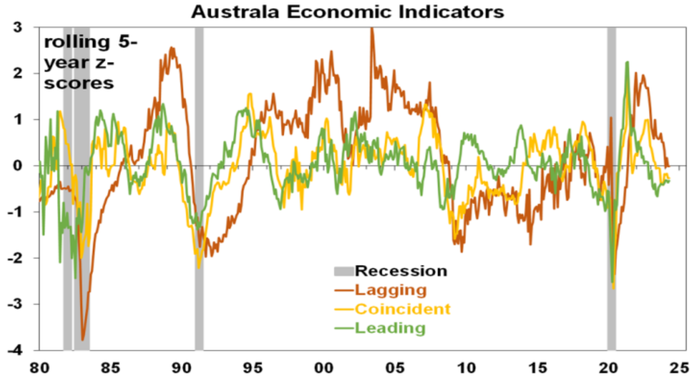
Shares to remain messy for a bit. While global shares have bounced and Australian shares have stabilised since their April lows following a 4 to 5% correction, it's still too early to say the correction is over as valuations remain stretched, sentiment is not at bearish extremes, uncertainty is high regarding the outlook for interest rate cuts and the risks regarding the Israel/Iran conflict remain high. We are still inclined to see the April fall in shares as a correction rather than something deeper though and continue to see further gains in shares this year as disinflation resumes, central banks ultimately cut interest rates and recession is avoided or proves mild. That said the gains in global and Australian shares over the remainder of the year are likely to be more constrained and more volatile than was the case in the first three months of the year.

Fed confirms that rates will stay high for longer, but it was less hawkish than feared. There was nothing really new in the Fed and Chair Powell indicating that recent data has shown a "lack of further progress" in getting inflation down and that it will take "longer than expected" for the Fed to get confidence that inflation is on track for its 2% target in order to cut rates. But Powell also indicated a rate hike was unlikely, policy is restrictive, and he is seeing strong data in the context of improving supply enabling labour market tightness to continue to ease. So overall it remains a case of rate cuts delayed rather than anything more threatening. Our base case remains for the first Fed cut to come in September.

Is the US heading into stagflation or just getting back on track? Expectations for imminent and big interest rate cuts earlier this year were dashed in the US as economic data and inflation surprised on the upside. This was initially seen as okay for share markets because stronger than expected growth and profits offset the downside from high for longer interest rates. It started to sour in the last month though as worries about overheating led to concern the Fed and maybe even the RBA will have to raise rates further. Data over the last few weeks though showing slowing US growth (weaker GDP, weaker business surveys, falls in consumer confidence, weaker payrolls and falling forward jobs indicators) at the same time that inflation indicators (CPI, core private final consumption deflator and employment cost index) have picked up have led to new a concern – that of stagflation which as the 1970s reminds us is bad for both shares and bonds. Our assessment though is that any stagflation is likely to be short lived and rather see the cooling in growth as a sign that inflation will soon start to slow again too. Inflation normally lags growth so there is often a brief part in the cycle where it looks like stagflation before inflation catches up to slower growth. In other words, the US economy is likely getting back on track for a cooling which will enable the Fed to ease latter this year.

In Australia, while there has been much talk of a resumption of rate hikes after the hot March quarter inflation data our view remains that the RBA will leave rates on hold on Tuesday ahead of a delayed start to cuts later this year. See the "What to watch over the next week section?" below for a more detailed preview of the RBA meeting. A resumption of soft retail sales and broader household spending after seasonal distortions and a temporary Swift lift indicate the consumer remains under pressure and that high rates are working to slow demand which will continue to take pressure off inflation.

There is not much evidence of an upswing in the Australian economy justifying further rate hikes. The next chart shows a composite mix of economic indicators that lead (like building approvals, consumer and business confidence and the yield curve), are coincident with (like employment and retail sales) or lag (like unemployment and delinquency rates) the economy. While none are at recessionary levels and leading indicators have become a bit less negative there is no sign of any significant upswing in the economy let alone overheating that may require further rate hikes.



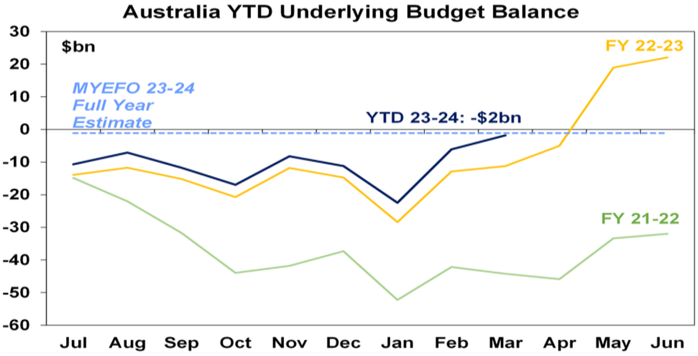
Source: Bloomberg, AMP

The 2024-25 Australian Budget (14 May) looks like its going to be mainly about getting "Future Made in Australia" protectionism underway. Key features are likely to be:

- A combination of subsidies, tax breaks, cheap loans and relaxed foreign investment rules to encourage investment in government chosen industries in a return to post war protectionism and picking winners as part of the "Future Made in Australia" policy.
- Minimal cost of living measures for low to middle income workers, including an extension off energy bill relief.
- A renewed talking up of the benefits to low and middle income households from the rejigged Stage 3 tax (worth $1929pa for someone on $90,000pa).
- Possibly further measures to slow structural spending growth, to better allow for a slowdown in windfall revenue gains.
- Net immigration of 450,000 this financial year up from a MYEFO forecast of 375,000, falling to 250,000 in 2024-25.
- A budget surplus of around $10-15bn this financial year thanks to higher than forecast commodity prices and personal tax collections, but a return to a deficit of around $12bn in 2024-25. March budget data shows a financial year to date deficit of just $2bn which is $4bn better than projected in MYEFO. As its tracking better than the 2022-23 budget profile another $22bn plus deficit is possible. See the next chart.
- The 2023-24 GDP growth forecast may be revised back down to 1.5% from 1.75% with the growth forecast for 2024-25 remaining at 2.25%. Inflation forecasts are likely to remain at 3.75% for this financial year and 2.75% for next.

The key is that with inflation proving sticky the Budget needs to take slightly more out of the economy than it puts back in so as to make the RBA's job easier. Any spending associated cost of living relief, Future Made in Australia subsidies or other measures should be more than offset by savings elsewhere.

Australia YTD Underlying Budget Balance



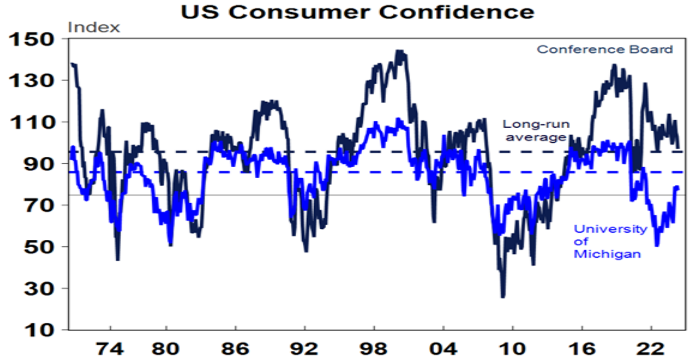
Source: Australian Treasury, AMP

This guy was an amazing guitarist and this a great anti-war song.

Major global economic events and implications

Soft US data suggests the US economy may be starting to cool again, ultimately taking pressure off the Fed. Employment costs came in stronger than expected in the March quarter at 1.2%qoq/4.2%yoy continuing the recent run of higher inflation readings. And home prices continue to rise along with continuing low jobless claims. However, most economic data was soft with April payrolls up a far less than expected 175,000, unemployment rising to 3.9%, the April ISM manufacturing and services conditions indexes falling back below 50, construction spending unexpectedly falling, mortgage applications continuing to fall and consumer confidence as measured by the Conference Board falling back to average levels and indicating a fall in consumers saying jobs are plentiful versus hard to get.

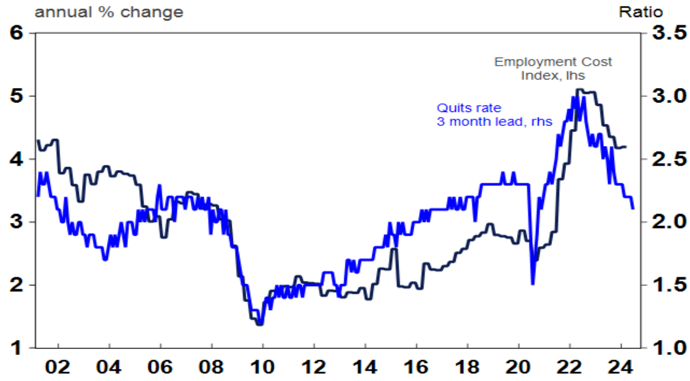
US Consumer Confidence



Source: Bloomberg, AMP

Meanwhile, although jobless claims remain low forward-looking jobs market indicators in the form of job openings, quits (ie workers quitting for other jobs), hiring and temporary employment continue to soften. In fact, the fall in the quits rate to now below pre pandemic levels points to a resumption of the downtrend in wages growth after its uptick in the March quarter. Consistent with this, average hourly earnings growth in April slowed to 3.9%yoy which is the lowest increase since June 2021.

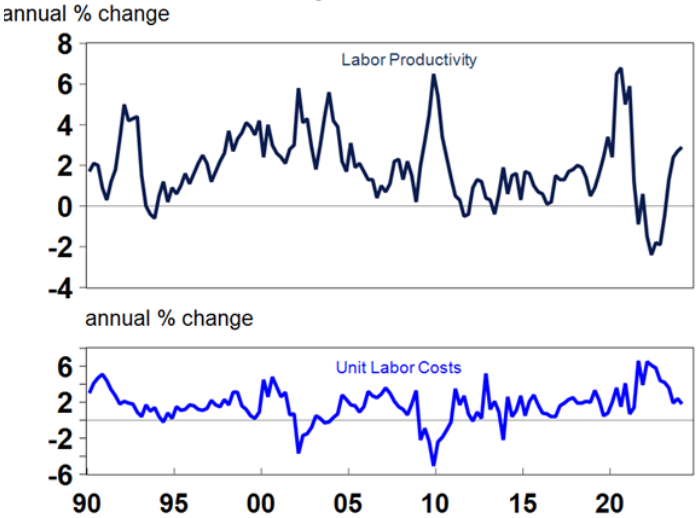
US Labour Market Conditions



Source: Macrobond, AMP

While March quarter productivity growth was slow and unit labour costs rose sharply, quarterly productivity data is very volatile and year on year data provides a better guide – on this basis productivity growth is up 2.9%yoy and unit labour costs up 1.8%yoy which is in line with the Fed's 2% inflation target.

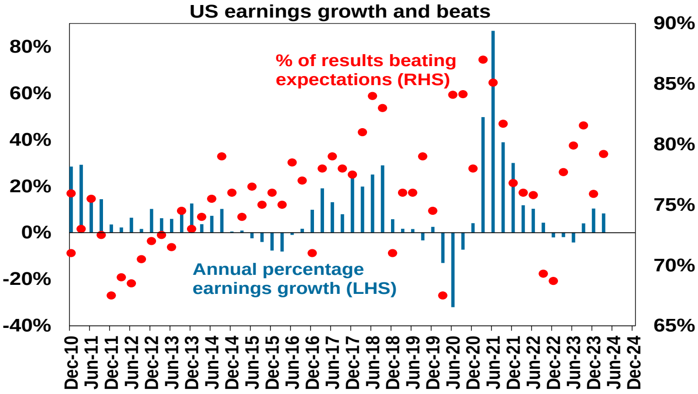
US Productivity vs Unit Labor Costs



Source: Macrobond, AMP

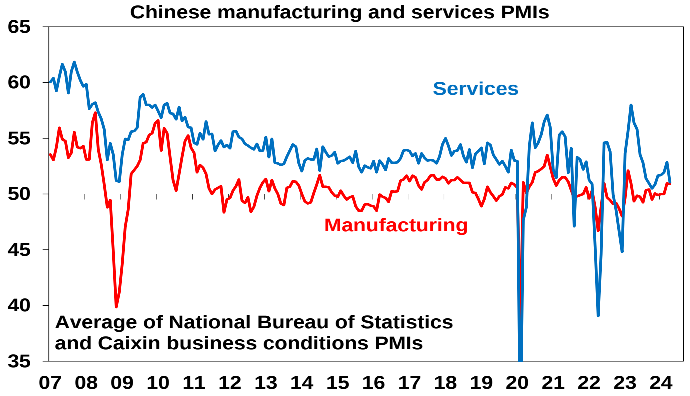
US March quarter earnings remain strong. 80% of S&P 500 companies have reported so far and the good news is that 79% have beaten expectations, against a norm of 76% and earnings growth expectations for the quarter have increased to 8.3%yoy, from 4.1% three weeks ago & looks likely to end around +10%yoy.

US earnings growth and beats



Source: Bloomberg, AMP

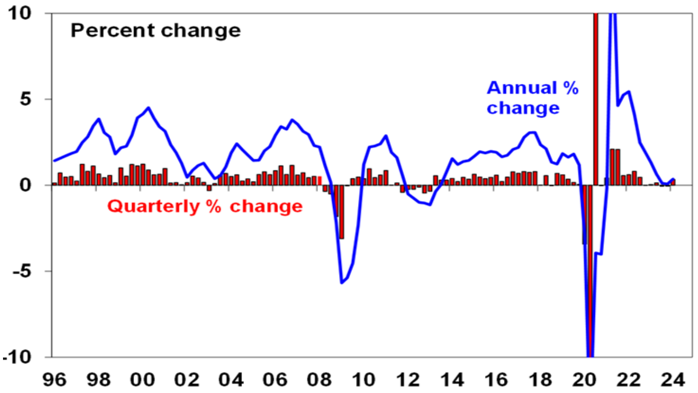
Chinese manufacturing and services PMIs



Source: Bloomberg, AMP

Eurozone GDP came in slightly stronger than expected in the March quarter at 0.3%qoq/0.4%yoy, up from 0.1%yoy, with a broadbased pick up after the energy squeeze of the last two years.

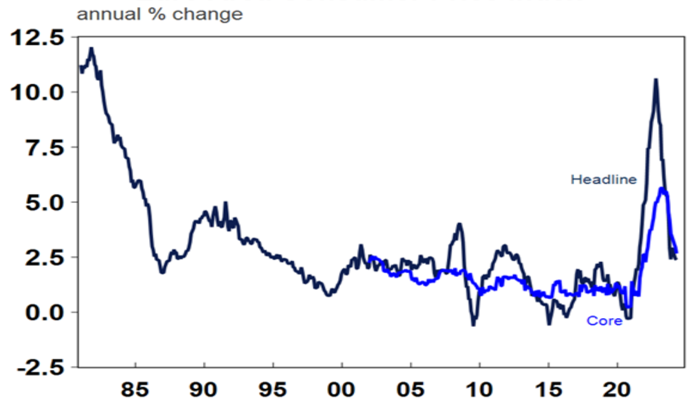
Eurozone real GDP growth



Source: Macrobond, AMP

The ECB remains on track to start cutting in June. Eurozone inflation was unchanged in April at 2.4%yoy, boosted by higher fuel prices but core inflation fell further to 2.7%yoy. While core inflation fell a bit less than expected a fall in services inflation to 3.7%yoy after several months at 4%yoy will likely keep the ECB on track to start cutting rates in June.

Euro Area Consumer Price Index



Source: Macrobond, AMP

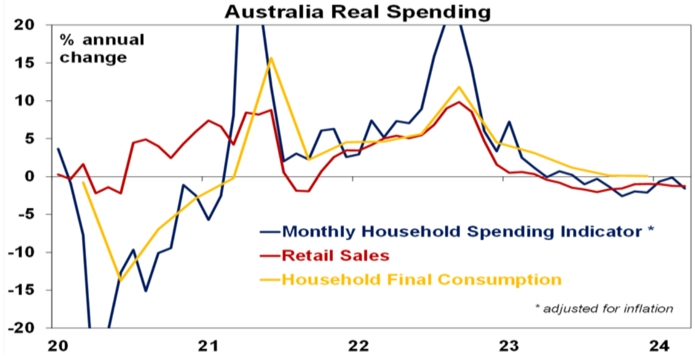
Japanese economic data was mixed. Unemployment was unchanged in March at 2.6%, the ratio of job vacancies to unemployed people rose slightly and industrial production rose sharply but is down by 6.7%yoy but consumer confidence and retail sales fell as did housing starts.

Chinese business conditions PMIs were mixed in April. Manufacturing conditions were little changed, whereas services fell. These numbers bounce around a bit but suggest that while the acceleration in growth may have petered out its not bad either. Meanwhile the April Politburo meeing signalled more policy support, particularly for property. This suggests more easing ahead but in recent times policy stimulus has been less than flagged.

Australian economic events and implications

Australian data releases over the last week were generally softer than expected. Retail sales fell more than expected in March after changed seasonal spending patterns along with a temporary Swift life boosted sales in January and February. The fall likely means March quarter retail sales fell in real terms. Similarly, the ABS' Household Spending Indicator slowed to 2.1%yoy in March after a brief pick up in January and February and points to flat to slightly negative real annual growth in consumer spending as measured. Both retail sales and the Household Spending Indicator point to real per person spending going backwards by 2.5%yoy or more as cost of living pressures and high rates continue to impact.

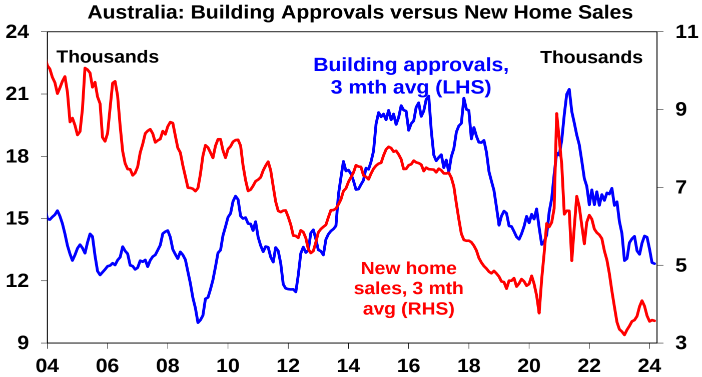
Australia Real Spending



Source: ABS, AMP

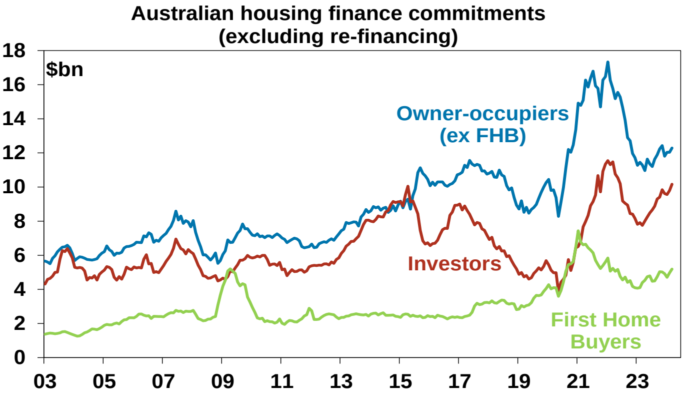
Building approvals rose less than expected in March with the housing shortage worsening. So far this year approvals are running around an annual pace of just 154,000 dwellings, which is well below underlying demand for housing of around 250,000 dwellings a year on the back of record immigration levels and well below the objective of Australian governments to build 240,000 dwellings a year. So the housing shortage is continuing to worsen.

Australia: Building Approvals versus New Home Sales



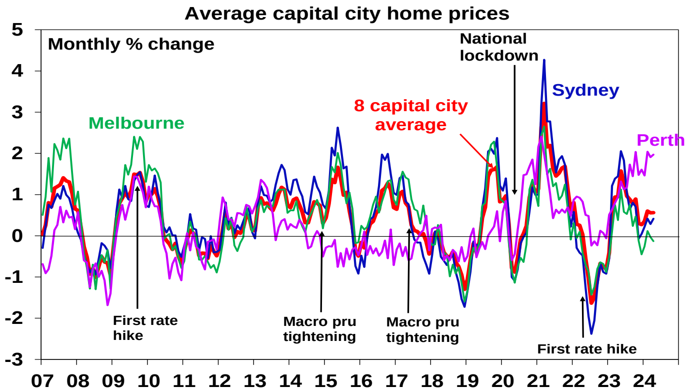
Source: ABS, AMP

Private credit growth also rose less than expected in March with housing credit growth remaining relatively subdued, but housing finance had a stronger than expected. Housing finance is still below the levels associated with the last peak in home prices and is around levels consistent with modest home price growth.



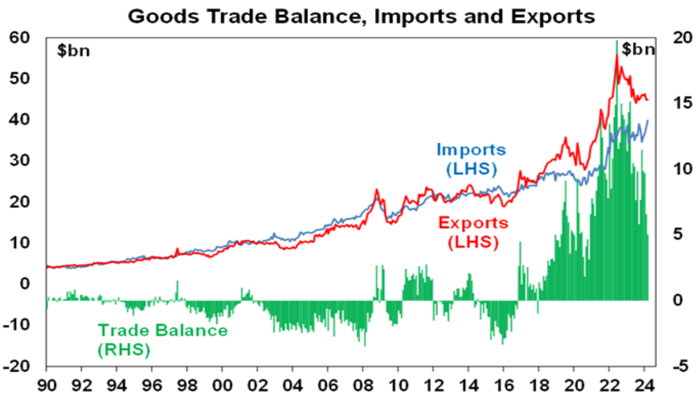
Source: ABS, AMP

Home prices rose 0.6% in April as the housing shortage continues to dominate the drag from high mortgage rates. There remains a huge divergence between cities with Perth booming but Melbourne subdued. The housing shortage continues to point up for home prices, but the delay in rate cuts and talk of rate hikes risks renewed falls in property prices as its likely to cause buyers to hold back and distressed listings to rise.



Source: CoreLogic, AMP

The trade surplus fell again in March with lower commodity prices and stronger imports impacting. Trade looks likely to be a big detractor from March quarter GDP growth, possibly by as much as 1 percentage point.



Source: ABS, AMP

What to watch over the next week?

The next week is relatively quiet for key data releases globally, but in the US the focus will remain on the March quarter earnings reporting season. The Fed's latest bank lending officer's survey on Monday will provide a guide to lending standards after last year's tightening.

The Bank of England (Thursday) is expected to leave its key policy rate on hold at 5.25% with the possibility of a further dovish tweak in forward guidance. Money markets are pricing in the first cut for around August.

Chinese trade data (Thursday) will likely show stronger exports and imports but inflation data (Saturday) will likely show roughly flat consumer prices and continued deflation in goods prices.

In Australia, the RBA (Tuesday) is expected to leave the cash rate on hold at 4.35% and is likely to signal a return to a mild tightening bias after moving to a neutral bias ("not ruling anything in or out") at its March meeting. The return to a tightening bias could be similar to the wording the RBA used in February that a further rise in rates "cannot be ruled out." March quarter inflation came in stronger than the RBA expected, particularly for the trimmed mean, and this along with recent stronger jobs data will concern it. As a result, the RBA is likely to consider another rate hike, particularly on the back of a likely slight upwards revision to its forecast for underlying inflation for this year to around 3.3%yoy from 3.1%. However, with retail sales and household spending data indicating the consumer remains under pressure and that rate hikes are continuing to work to cool demand and given the danger of overreacting to the inflation data its likely to sit tight and rely on the jawboning of warning that it may have to raise rates again. With inflation continuing to fall and given the consecutive quarterly pattern of upside followed by downside surprises on inflation that we have been seeing, our view remains that moving to hike rates again would be an unnecessary overreaction to the poor March quarter inflation data. We continue to see the RBA starting an easing cycle this year but have pushed out the first rate cut to year end.

On the data front in Australia, March quarter retail sales in real terms (Tuesday) are likely to have fallen 0.3%. The Melbourne Institute's Inflation Gauge for April and ANZ job ads will be released Monday.

Outlook for investment markets

Easing inflation pressures, central banks moving to cut rates and prospects for stronger growth in 2025 should make for good investment returns this year. However, with a high risk of recession, delays to rate cuts and significant geopolitical risks, the remainder of the year is likely to be a far rougher and more constrained than the first three months were.

We expect the ASX 200 to return 9% this year and rise to around 7900. A recession is probably the main threat.

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

Unlisted commercial property returns are likely to be negative again due to the lagged impact of high bond yields & working from home.

Australian home prices are likely to see more constrained gains in the year ahead as the supply shortfall remains, but still high interest rates constrain demand and unemployment rises. The delay in rate cuts and talk of rate hikes risks renewed falls in property prices as its likely to cause buyers to hold back and distressed listings to rise.

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

A rising trend in the $A is likely taking it to $US0.70 over the next 12 months, due to a fall in the overvalued $US, but in the near term the risks for the $A are on the downside as the Fed delays rate cuts and given the still high risk of an escalating conflict in the Middle East.

Important note: While every care has been taken in the preparation of this document, neither National Mutual Funds Management Ltd (ABN 32 006 787 720, AFSL 234652) (NMFM), AMP Limited ABN 49 079 354 519 nor any other member of the AMP Group (AMP) makes any representations or warranties as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided. This document is not intended for distribution or use in any jurisdiction where it would be contrary to applicable laws, regulations or directives and does not constitute a recommendation, offer, solicitation or invitation to invest.