Market View

January 2015

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

Market and economic overview

Australia

- The Reserve Bank of Australia (RBA) eased monetary policy on 3February 2015, cutting the official cash rate to a record low of 2.25%, from 2.5%. The move came after holding rates steady throughout 2014 and is the first move in interest rates since August 2013.
- The decision to ease monetary policy further seems to have been very finely balanced. The statement accompanying the rate cut is not very different from the views expressed last year when rates were held unchanged.
- However, the RBA has highlighted the view that "the economy is likely to be operating with a degree of spare capacity for some time yet." In addition, the RBA noted that the Australian dollar (AUD) remains "above most estimates of its fundamental value" and that "a lower exchange rate is likely to be needed to achieve balanced growth in the economy."
- The easing must be seen in the context of aggressive policy action elsewhere in the world over January, especially among other mid-sized commodity exporting nations.
- The RBA offered no forward guidance on monetary policy today. However, if history is any guide, RBA rate cuts never come alone and so a further 25bp move to 2.0% could be expected in coming months.
- Q4 2014 headline CPI rose by 0.2% per quarter, slightly below expectations, with the annual rate falling to 1.7% per year, from 2.3%. Headline inflation is now below the RBA's 2% to 3% target range.
- The largest falls in inflation were fuel prices (-6.8% per quarter) and audio visual and computing equipment (-5.2% per quarter). Offsetting the falls were price gains in domestic holiday and travel (+5.8% per quarter), tobacco (+4.8% per quarter) and new dwelling purchases (+1.1% per quarter).
- Underlying inflation was 0.5% per quarter, which was the average of the trimmed mean and weighted median measures. This took the annual pace of underlying inflation to 2.25%, down from 2.5%.
- The unemployment rate fell to 6.1% from 6.2% in December, with 37,400 jobs added. Over 2014, 214,000 jobs were created, compared to 99,000 in 2013.
- Business and consumer confidence remain laggards, the Westpac Consumer Confidence Index rose 2.4% in January after falling 5.7% in December. Overall with the index level at 93.2 it remains below its long-term average of 101.4 despite recent falls in petrol prices and speculation about official interest rate cuts.

United States

- The Federal Open Market Committee (FOMC) of the US Federal Reserve Board met on 27-28 January and maintained steady policy guidance and also highlighted the growing strengths of the US economy.
- The Fed described the pace of economic growth as "solid", rather than "moderate".
- On the labour market, the Fed has also upgraded its view, stating the labour market

is now “strong”, as opposed to its previous description of “solid”.

- The first estimate of Q4 2014 GDP was released indicating growth was 2.6% on a seasonally-adjusted-annualised-rate, below expectations and lower than the 5% recorded in Q3 2014. Personal spending rose 4.3%, the strongest since Q1 2006, while net exports subtracted 1% from GDP. Overall for 2014, the US economy grew by 2.4%, the fastest in four years.
- The fall in the oil price and the strong US dollar saw inflation fall 0.4% per month, taking the headline inflation rate to 0.8% per year in December, down from 1.3% per year in November. The Fed’s preferred measure of inflation; Core Personal Consumption Expenditure Price Index was flat in December, taking annual gains to 1.3%, below the Fed’s longer term goal of inflation at 2%.
- The US labour market continued to improve, 252,000 jobs were added in December and the unemployment rate fell again, and is now at 5.6%. Over 2014 2.952 million jobs were added, the highest annual increase since 1999.
- Wages growth however remains anaemicand hourly earnings fell 0.2% in December, lowering the annual rate to 1.7% in December from 1.9% in November.
- One upside continues to be consumer confidence with the University of Michigan Index rising 4.8% in January to 98.1, its highest level since January 2004.

Europe

- The European Central Bank (ECB) meeting announced an expanded asset purchase program as widely expected at its 22 January.
- This expanded asset purchase programme will encompass the existing purchase programmes for asset-backed securities and covered bonds.
- Under this expanded programme, the combined monthly purchases of public and private sector securities will amount to €60bn, in terms of new money it should include around €50bn of sovereign bond purchases each month.
- It is intended these purchases will be carried out until end-September 2016 and is effectively an ‘open-ended’ program, with success measured by “a sustained adjustment in the path of inflation which is consistent with our aim of achieving inflation rates below, but close to, 2%.
- Based on monthly purchases of €60bn between March 2015 and September 2016, the total size of the program is around €1.1tr. ECB purchases will include bonds issued by euro area central governments, agencies and European institutions.
- The ECB will be limited to 20% of losses, with the National Central Banks sharing the remainder. Securities will be purchased with a maturity of two years and 30 years.
- Three days post the ECB announcement, Greece elected a new government led by the far-left Syriza party, who won 149 seats out of a 300 seat Parliament, just falling short of an outright majority. Leader Alex Tsipras formed coalition with the Independent Greek party to form government with Tsipras sworn in as Prime Minister.
- The new Greek government is currently attempting to renegotiate its bailout program and seek debt relief in an attempt to improve both its budget and economic outlook.
- Volatility in financial markets, particularly European markets will increase during this negotiation process.

United Kingdom

- The Bank of England (BoE) left policy unchanged at its 8 January meeting, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn.

- After two members of the Board having dissented in favour of higher rates since August 2014, the vote went back to being unanimous. The BoE is concerned for the outlook given recent falls in inflation, with the headline inflation at 0.5% per year in December, down from 1% in November. In particular the Bank is concerned this low inflation rate will find itself entrenched in wages and the economy.
- The advance estimate of Q4 2014 GDP was released showing the UK economy recorded growth of 0.5% per quarter and 2.7% per year, slightly below expectations. The consumer sector held up well with construction and mining the main cause of weakness.
- Data released in January showed the unemployment ended December at 5.8%, the lowest since August 2008.

Japan

- The Bank of Japan's (BoJ) policy board convened on 21 January 2015 and left its qualitative and quantitative easing (QQE) program at an annual increase of Y80trillion to its monetary base.

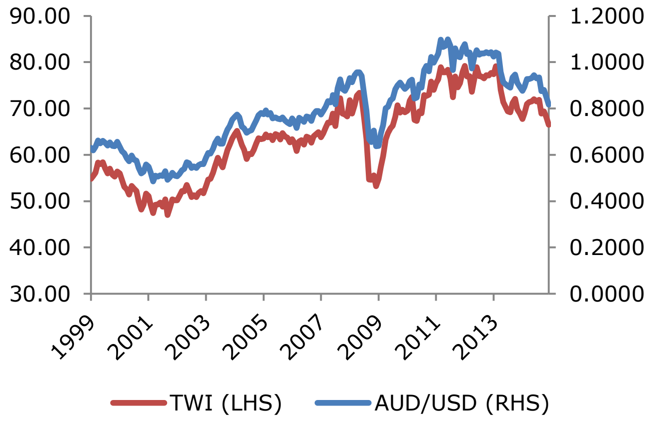
China

- Q4 2014 GDP was released with growth of 1.5% per quarter and 7.3% per year and continues to indicate a controlled slowdown of growth in China. The ongoing property downturn is being offset by an improvement in the services sector, particularly financial services.
- Inflation was recorded at 1.5% per year in December, up slightly from 1.4% per year in November. China will be a small beneficiary from the fall in the oil price.

Australian dollar

- The Australian dollar continued its weakness in January, falling to $US0.7766, from $US0.8172, a fall of 5.0%, its lowest level since May 2009. Expectations of a rate cut by the RBA accelerated in January, especially post the rate cut by the Bank of Canada, this was validated in early February. The Australian dollar has now fallen 11.3% over 12 months. Against the Australian trade Weighted Index (ATWI), the Australian dollar fell 3.9% over the month and 5.6% over the year and still remains above the RBA's 'comfort' level for the exchange rate.
- The Australian dollar rose against the Euro (+1.9%), fell against sterling (-1.7%) and yen (-6.8%) over the month of January.

AUSTRALIAN DOLLAR LOWER



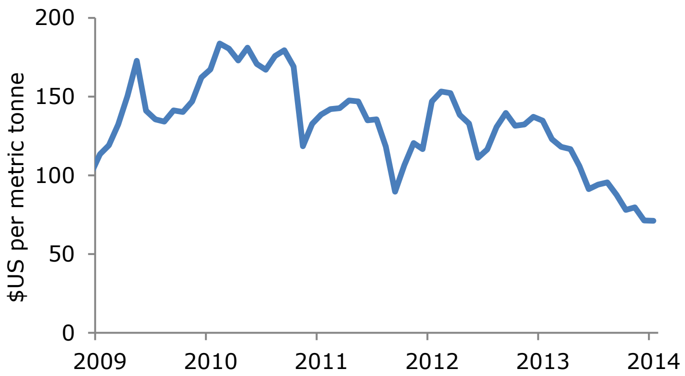
Source: Bloomberg as at 31 December 2014. Past performance is not an indication of future performance.

Commodities

- Commodity prices fell sharply again in December, with the oil price, again, leading the falls.
- The copper price was weak, down 12.8% in January on global growth concerns, particularly in China. Zinc (-2.4%) and tin (-1.9%) also fell. Lead (+0.1%), nickel (+0.1%) and aluminium (+0.6%) made small gains.
- The gold price continued to rise, up 8.3% to $US1284 an ounce.

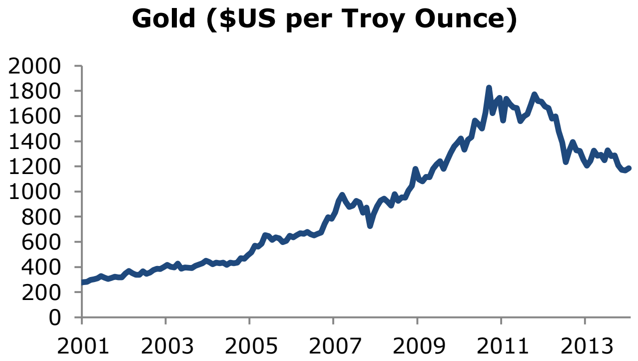
- The iron ore price[1] fell 12.7% in January after stabilising in December. It finished the month at $US62.2 a metric tonne.
- The wheat price fell 14.8% in US dollar terms due to gains in supply since May 2014

IRON ORE LOWER AGAIN



Source: Bloomberg as at 31 December 2014. Past performance is not an indication of future performance.

GOLD BUCKS THE TREND AND RISES



Source: Bloomberg as at 31 December 2014. Past performance is not an indication of future performance.

Australian shares

- Australian shares performed well in the first month of the new calendar year, with the S&P/ASX 200 Accumulation Index adding 3.3%.
- A subdued inflation print for the December quarter prompted investors to question whether the Reserve Bank of Australia will ease monetary policy (which it did).
- The Australian dollar's continued weakness against the US dollar has the effect of increasing the Australian dollar value of earnings generated offshore.
- The market was prevented from making further progress by weakness in the Energy and Materials sectors. Oil and iron ore prices remained under downward pressure, which continued to dampen sentiment towards these areas of the market.
- Attention now turns to the 'reporting season', which will continue throughout February. Most ASX-listed companies will announce earnings for the six or 12 months ending 31 December 2014 during this period.

Listed property

- The Australian listed property sector made a strong start to the year, with the S&P/ASX200 Property Accumulation Index returning 7.7% in January 2015.
- A-REITs outperformed the broader Australian equity market (ASX200 Accumulation Index +3.3%) supported by lower Australian bond yields, with the 10-year CGS yield declining by 35bps to 2.38% - an all-time record low.
- Dexus Property Group (+10.6%) was a strong performer after it finally settled on the Lakes Business Park, having acquired the business precinct located near Sydney's largest port, Port Botany, in December 2014 for A$153.5m.
- Retail giant Westfield Corporation (+9.3%) continued to benefit from the decline in the Australian dollar (-5.1% vs. US dollar, USD), given that there were no material company announcements in January.
- Global listed property markets marginally underperformed their Australian counterparts in January with the UBS Global Property Investors' Index (local currency) increasing by 7.3% over the month. The Index was propelled higher by Europe (+13.4%) on the back of the European Central Bank's (ECB) announcement of an open ended sovereign

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[1] iron ore delivered to Qingdao China - 62% Ferrous Content - USD/dry metric ton

program due to begin in March. The worst performing region was Japan (-0.8%).

Global shares

- Global developed equity markets were mixed in January with weakness in the US and strength through Europe and Asia. European markets were supported from the aggressive and forceful expanded asset purchase program announced by the European Central Bank. The ECB will be adding additional liquidity into the market with the expectation some of this could leak into the equity market.

- The Greek election result added some volatility to European equity markets late in the month with Syriza winning the election and looking to renegotiate its official program with EU creditors.

- Overall the MSCI World Developed Markets Index fell 1.9% in USD terms and rose 3.2% in AUD terms given the fall in the AUD over the month.

- After strong gains throughout 2014, the S&P 500 Index fell 3.1% in the month, the Dow Jones was down 3.7% and the NASDAQ fell 2.1%. The MSCI Energy sector was the main detractor, down 5.4% on further falls in the oil price.

- As at the end of January 24% of S&P500 companies had reported Q4 2014 earnings with 73% companies beating earnings estimates.

- Equity markets in Europe were strong, boosted by ECB policy action and despite weakness in macroeconomic data. Equity markets in Germany (+9.1%), France (+7.8%), Italy (+7.8%) and Spain (+1.2%%) all rose. The Euro Stoxx top 50 was up 6.5%. The UK FTSE 100 rose 2.8%.

- The Japanese Nikkei 225 rose 1.3% over the month, with the yen continuing to depreciate over January. Hong Kong (+3.8%) and Singapore (+0.8%) also rose.

Global emerging markets

- Emerging market (EM) equities rose in January after sharp falls in December and outperformed developed markets. The MSCI EM Index returned +0.6% in USD terms and +5.8% in AUD terms. The MSCI Emerging Markets Latin America Index (-6.3% in USD terms) was the main detractor from performance while MSCI Asia ex-Japan (+2.5%) outperformed.

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