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Economic Snapshot

August 2023

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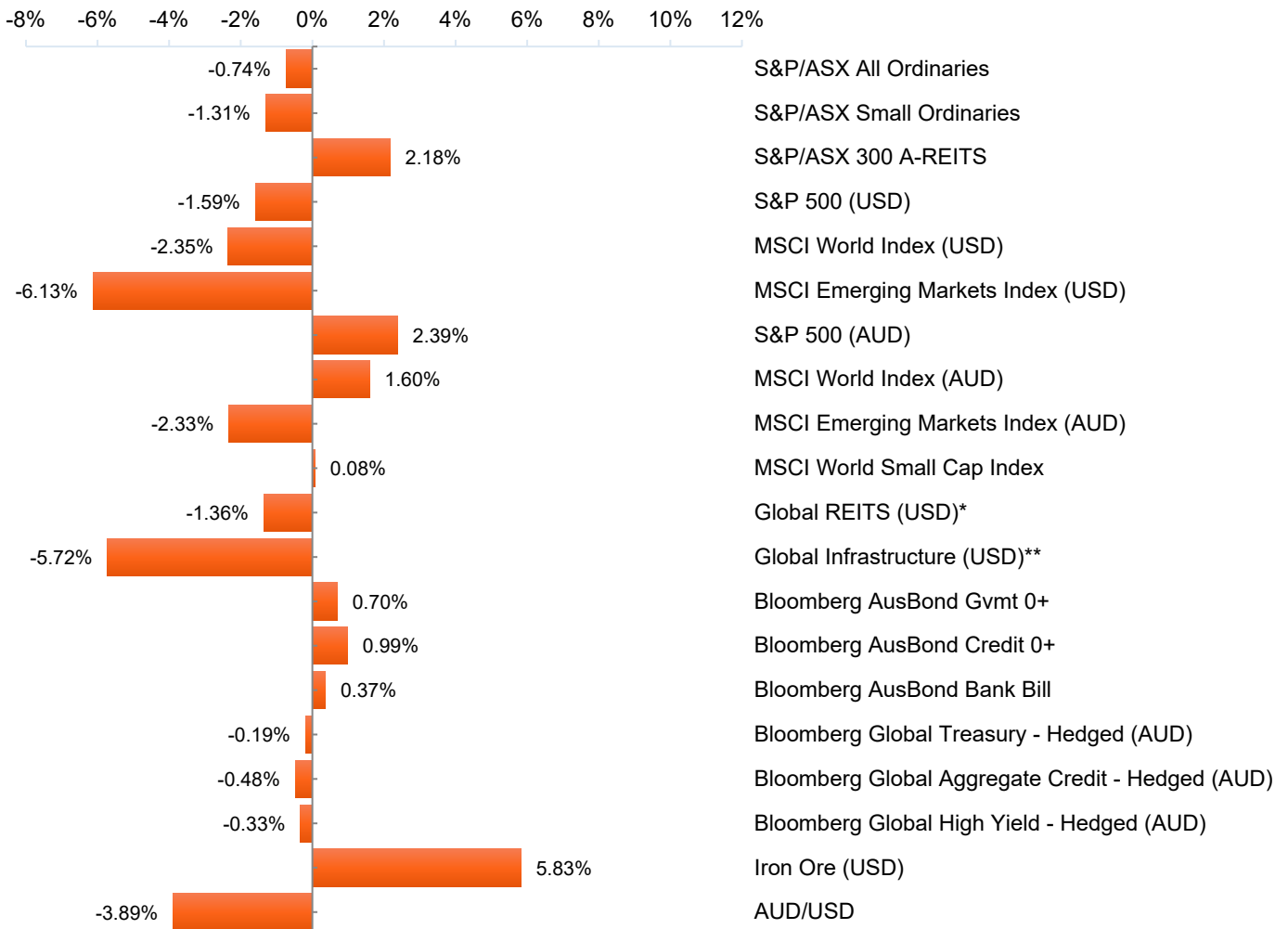
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August 2023

Monthly Highlights

- Global financial markets faced challenges in August, driven by inflation concerns and uncertainty surrounding the future direction of the US Federal Reserve monetary policy.
- The Federal Reserve Bank and European Central Bank discussed potential policy tightening at the Jackson Hole central bank conference but did not commit to imminent rate hikes.
- Chinese risk assets and emerging markets experienced substantial losses this month, exerting downward pressure on global equities.
- Sovereign bond yields initially surged during the month but later retraced, indicating limited scope for additional tightening given already restrictive monetary policies in place.
- Australian corporate results during earnings reporting season remained resilient despite mounting operational costs.
- Both the Australian and US labour markets displayed signs of softening in July, influencing movements in Treasury yields.

Selected Market Returns, August 2023



Sources: *Refinitiv G-7 Diversified REIT Index, **FTSE Global Core Infrastructure 50/50 Index



Key Economic Developments in August

Financial markets

In August, global financial markets experienced a downturn following strong performances in June and July. Most major financial assets generated negative returns as investors became concerned about the risk of persistent inflation, which could trigger further tightening by the Federal Reserve.

Additionally, a lack of significant Chinese stimulus for their sluggish domestic economy contributed to investor pessimism. Chinese risk assets, particularly onshore and investable equities, suffered significant losses, dragging down the overall Emerging Market equity index (-6.1%), which performed worse than Euro Area and US indices. Poor equity performance was a widespread global trend.

In fixed income markets, global bond yields initially rose but later retraced, ultimately ending the month in negative territory. With monetary policies already being restrictive, there is limited room for further tightening, and it's likely that US and Euro Area government bonds have reached their peak for the current economic cycle.

Notably, the US dollar was one of the only major financial assets that posted positive returns. The relative resilience of the US economy, which is performing better than expected, supported the US dollar. Despite concerns about China's economic slowdown impacting industrial metals, crude oil and iron ore rallied due to expectations of tightening supplies.

Economics

Wrap up of the Jackson Hole Economic Symposium.

The three-day international conference of central bankers hosted by the Federal Reserve Bank of Kansas City at Jackson Hole was held in August. Central bankers from around the world confirmed that they are getting the inflation slowdown they have long been expecting.

The key takeaways from the Federal Reserve, European Central Bank and Bank of England are the possibility of further tightening and that rates will remain higher for longer. Collectively, central bankers' greatest worry is that economies reaccelerate into late 2023, forcing US authorities to consider 6% policy rates if inflation readings spike up or make a sustained increase.

Australian reporting season impacted by rising costs.

Overall, results were in line, but soft guidance and cost pressures (mostly labour and interest costs) drove FY24 earnings downgrades. As revealed in the results and conservative guidance offered by some companies, a key challenge for Australian firms is the rising cost of doing business.

This is due to multiple factors, including higher labour costs, low productivity, and higher energy prices. Many, if not most companies, have been able to raise prices in an inflationary environment, but passing on further incurred costs will get harder as the cycle slows, impacting the bottom line.

Australian inflation.

In July 2023, Australia's inflation rate went up by 4.9% in the past year. This is slightly lower than June's 5.4% and a big drop from December 2022's peak of 8.4%. The rise was mainly due to higher costs of housing and food, with increases of 7.3% and 5.6% respectively. However, lower prices for things like automotive fuel (-7.6%) and fruit and vegetables (-5.4%) partly offset the increase.

Australian labour market conditions deteriorate.

The job market in Australia worsened in July, with fewer jobs and a higher unemployment rate than expected. This shows a slow weakening of the job market and might mean the Reserve Bank of Australia (RBA) won't make changes to rates. Even though job demand is slowing, there are still many jobs advertised.

The RBA is looking at inflation and wages for rate decisions, but weak job data and China's economic worries could make the RBA cautious about raising rates.



US labour market cools.

The latest economic print showed that the US gained 187,000 non-farm payroll jobs, slightly below the 200,000 expected. The US job market seems to be cooling a bit, but it's still holding up well. After the report, Treasury yields fell, driven more by slower job growth than wage trends. This change counteracted the earlier steepening of the yield curve caused by increased Treasury issuance and the credit rating downgrade last month.

US inflation, steady as she goes.

In July, the US Consumer Price Index (CPI) stayed steady, with both monthly headline and core inflation remaining at 0.2%. Key points include a drop of 1.3% in used car and truck prices and a 0.1% decrease in new vehicle prices, leading to a total core goods price decline of 0.3%.

Core services inflation rose to 0.4%, with shelter staying at 0.4%. Inflation is expected to stay subdued in the coming months due to lower shelter inflation and ongoing used car price drops. The CPI report suggests the Fed will stick to its current approach for the rest of the year.

Chinese Consumer and Producer Prices looking challenged.

China's inflation data for July highlighted a significant trend of deflation in the economy, as consumer prices fell by 0.3% year-on-year and producer prices dropped by 4.4% year-on-year, marking the 10th consecutive month of decline. These numbers, match signals from other indicators like the GDP deflator, reduced trade, and a lower composite PMI, indicating weak growth. China's stuttering recovery is clearly at a pivotal point.

After the economy roared back to life early this year, momentum has waned. Across almost every metric, China is undershooting expectations; retail sales growth is modest, private fixed investment is going backwards, manufacturers are sitting on their hands and prices are dropping. Worse still, the property market's fall is showing no signs of slowing.

Outlook

While the market believes the rate hike cycle is ending, we note that the Federal Reserve is focusing on core inflation and the risks posed by a robust consumer-labour market. We also note that elevated rates challenge valuations, and that strong earnings might not propel the market to new highs if valuations adjust due to rising capital costs.

Inflation data also holds significance, particularly if services and wages rise in line with headline numbers due to a weakening US dollar and elevated prices for commodities. As it stands, late-cycle indicators are prompting a cautious approach to asset allocation.



Major market indicators

| | 31-Aug-23 | 31-Jul-23 | 30-Jun-23 | Qtr change | 1 year change |
|--|-----------|-----------|-----------|------------|---------------|
| Interest Rates (at close of period) | | | | | |
| Aus 90 day Bank Bills | 4.15% | 4.30% | 4.25% | +25.0 | +184.0 |
| Aus 10yr Bond | 4.13% | 4.03% | 3.92% | +63.0 | +76.0 |
| US 90 day T Bill | 5.32% | 5.28% | 5.17% | +6.0 | +245.0 |
| US 10 yr Bond | 4.10% | 3.95% | 3.81% | +46.3 | +96.4 |
| Currency (against the AUD) | | | | | |
| US Dollar | 0.648 | 0.674 | 0.666 | 0.08% | -5.53% |
| British Pound | 0.510 | 0.520 | 0.525 | -2.67% | -13.65% |
| Euro | 0.594 | 0.607 | 0.610 | -2.17% | -13.60% |
| Japanese Yen | 94.34 | 95.57 | 96.10 | 4.15% | -0.79% |
| Trade-Weighted Index | 60.60 | 61.30 | 61.70 | 1.34% | -4.27% |
| Equity Markets | | | | | |
| Australian All Ordinaries | -0.7% | 3.0% | 1.9% | 4.2% | 8.9% |
| MSCI Australia Value (AUD) | -0.8% | 3.8% | 3.2% | 6.3% | 13.4% |
| MSCI Australia Growth (AUD) | 0.5% | 1.5% | 0.8% | 2.8% | 7.1% |
| S&P 500 (USD) | -1.6% | 3.2% | 6.6% | 8.3% | 15.9% |
| MSCI US Value (USD) | -2.5% | 3.6% | 6.2% | 7.2% | 7.5% |
| MSCI US Growth (USD) | -1.0% | 3.3% | 7.1% | 9.6% | 23.3% |
| MSCI World (USD) | -2.3% | 3.4% | 6.1% | 7.1% | 16.2% |
| Nikkei (YEN) | -1.6% | 0.0% | 7.6% | 5.8% | 18.8% |
| CSI 300 (CNY) | -6.0% | 5.4% | 2.1% | 1.1% | -5.3% |
| FTSE 100 (GBP) | -2.5% | 2.3% | 1.4% | 1.2% | 6.2% |
| DAX (EUR) | -3.0% | 1.9% | 3.1% | 1.8% | 24.2% |
| Euro 100 (EUR) | -3.1% | 2.1% | 4.4% | 3.4% | 16.8% |
| MSCI Emerging Markets (USD) | -6.1% | 6.3% | 3.9% | 3.7% | 1.7% |
| Commodities | | | | | |
| Iron Ore (USD) | 5.8% | -2.2% | 13.4% | 17.4% | 20.4% |
| Crude Oil WTI U\$/BBL | 2.2% | 15.8% | 3.7% | 22.8% | -7.1% |
| Gold Bullion \$/t oz | -1.3% | 2.7% | -2.8% | -1.5% | 13.0% |

Source: Quilla, Refinitiv

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