

Inflation cooling, growth resilient

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 14 JULY 2023

The S&P/ASX 200 Accumulation Index returned 1.76% in June with the resource sector lifting by 4.55%. Global share markets increased by 3.12% as represented by the MSCI World ex-Australia Index with US technology and Japanese shares driving the performance over the month. Bond markets retreated on stronger economic data in the US. We continued to observe an easing in headline inflation both in the in the US and domestically. **However, as we have written in our past updates, core inflation around the world remains well above global central bank's target save China, and it is core inflation that is coming down slowly that has us expect that interest rates in the US and Australia will remain higher for longer.**

In the United States, there has been a clear divergence between confidence data and the economic data sets that shows what consumers, businesses and government are actually doing. Both Business and consumer confidence is poor, however data on employment shows resilience and headline inflation has moderated significantly. Average hourly wages were 4.4% higher over the year. This was the same rate of growth as in the previous two months and suggests that wage inflation is stabilising at a rate slightly above the most recent rate of inflation. If this continues, it will make it more difficult for the Federal Reserve to further suppress inflation, especially if productivity growth remains low. From the Federal reserve's perspective, there could be a need to weaken the labour market, thereby reducing wage pressure. Interestingly, the latest inflation data was positive. The annual headline and core CPI outcomes were

3.0% and 4.8%, materially below the 2022 peaks of 9.1% and 6.6%. Inflation for goods ex-energy and food was also lower recording a rise of 2.6% compared to 13.9% at the peak.

The Chinese recovery continues to underwhelm with GDP growth forecasts reduced following industrial output and retail sales both missing forecasts. It prompted the Bank of China to cut the interest rate on its one-year medium-term lending facility, the first easing in 10 months, paving the way for cuts in the benchmark loan prime rates. We expect more stimulus to follow. Industrial output grew by 3.5% in May from a year earlier, slowing from the 5.6% expansion in April. Retail sales - a key gauge of consumer confidence - rose 12.7%, missing forecasts of 13.6% growth and slowing from April's 18.4%. Consumer prices (inflation) was flat in June and pushed the reading to its lowest level since February 2021. It was driven mainly by falling pork and energy prices. More importantly core inflation, which excludes more volatile food and energy prices, actually fell 0.1% from a year ago in June suggesting China has a deflation problem. Even looking at wholesale prices, the producer price index recorded -5.4% and was the sharpest decline in more than 7 years. The



Emmanuel Calligeris

Chairman of the Investment Committee

reading was largely a result of “a sharp decline” in raw materials prices and waning demand from manufacturers. When growth slows in China, fixed asset investment often rescues the economy with government stimulus programmes boosting infrastructure spending. However, fixed asset investment growth is still slowing. The slowing in real estate investment is doing most of the damage and is worse than analysts forecast. Infrastructure investment is helping to offset the drag from property but seems to be losing the battle, not helped by weak local government finances.

The RBA opted to keep the official cash rate steady at its last meeting however despite the “on hold” decision we have yet to observe a shift in consumer and business sentiment. According to the Westpac-MI Consumer sentiment survey, sentiment remains at the deeply pessimistic levels that have prevailed for just over a year. The Index plunged 17% over the first half of 2022 and has barely moved since then, holding in the very weak 78-86 range. The main drags on sentiment have been the surging cost of living and sharply higher interest rates. The latest NAB business survey indicated a decline in business conditions in May, driven by a decrease across all three subcomponents, however, they remain just above their long-run average.

The decision to hold on the monetary policy front was likely the pleasing inflation report which showed a sharp fall in headline inflation to 5.6% in May from 6.8% in April. The fall was largely due to volatile items (fruit, vegetables and fuel) and holiday travel. Annual inflation in the CPI excluding volatile items and holiday travel fell from 6.5% to 6.4%, while the monthly increase in this measure lifted from 0.2% in April to 0.5% in May. Fuel provides a clear example of the risks involved with relying on monthly moves without adjusting for volatile items. Fuel prices fell 7.6% in May but are already up 6.4% over the June month to date.

House prices exhibited further recovery during June, with data released for May presenting rebounding housing finance and building approvals, which remain around 20% below their levels from the previous year. A sizeable pipeline of work is holding up housing construction but, abstracting for high-rise volatility, the weak trend in dwelling approvals suggests housing construction activity will decline over the coming year.

➤ Housing supply is therefore likely to remain constrained to end-2024 beyond, supporting the level of both prices and rents.

The unemployment rate showed a small decline to 3.6% in May – remaining near recent lows despite the 4% tightening cycle. Jobs growth printed 76,000 in May – well above market consensus of 15,000 and Westpac’s forecast of 40,000, meaning that the monthly pace of jobs growth has hardly slowed since the tightening cycle began.

Business surveys continue to point to intense labour shortages. Official job vacancies fell a modest 2% between February and May – a slightly slower pace than the 2.2% fall we saw between November and February with the vacancy-to-unemployed ratio still 0.83 compared to 0.27 before the pandemic. Lastly, retail sales growth remains above pre-pandemic levels. The economy benefitted from strong migration, and robust corporate balance sheets, which facilitated the retention of labour.

Despite the volatility in financial markets in June, little changed in terms of our outlook.

➤ We continue to anticipate a further slowdown in global economic activity and remain cautious that the breadth of the rise in the US share market is very narrow as it was in the late 1990’s.

The Federal Reserve continues to reduce the size of its balance sheet suggesting that financial conditions will remain tight for the remainder of 2023. In Australia the employment data validated the message from the RBA that more rate hikes are needed however we are at the tail end of the tightening cycle, The squeeze on lower income households and the further hit to confidence from the May and June rate increases suggests confidence is likely to remain depressed in the near term.

ASSET CLASS RETURNS ARE BASED ON

Australian Cash

RBA Bank accepted Bills 90 Days

Australian Listed Property

S&P/ASX 200 A-REIT TR

International Shares

MSCI World Ex Australia NR AUD

Australian Bonds

Bloomberg AusBond Composite 0+ Yr TR
AUD

International Property Hedged

FTSE EPRA/NAREIT Dv REITS TR Hdg
AUD

Emerging Market Shares

MSCI EM GR AUD

International Bonds Hedged

BarCap Global Aggregate TR Hdg AUD

Australian Shares

S&P/ASX 200 TR

RETURNS TO THE 30TH JUNE 2023

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.34	0.97	1.82	3.20	1.17	1.21	1.70
Australian Bonds	-1.95	-2.95	1.51	1.24	-3.51	0.51	2.43
International Bonds Hedged	-0.16	-0.30	2.07	-1.16	-3.64	0.18	2.54
Australian Listed Property	-0.05	3.40	3.94	8.10	8.12	3.48	7.66
International Property Hedged	3.05	1.24	2.15	-4.20	5.45	0.98	5.46
Australian Shares	1.76	1.01	4.51	14.78	11.12	7.16	8.56
International Shares	3.12	7.63	17.53	22.59	13.48	11.46	13.17
Emerging Market Shares	0.91	1.52	6.86	5.11	3.48	3.06	6.28

Prepared by DWA Managed Accounts Pty Ltd

ABN 89 104 065 250 | AFSL 264 125

The information contained in this report has been provided as general advice only. The contents have been prepared without taking account of your personal objectives, financial situation or needs. You should, before you make any decision regarding any information, strategies or products mentioned in this report, consult your own financial advisor to consider whether that is appropriate having regard to your own objectives, financial situation and needs. Investment markets past performance are not necessarily indicative of future performance. Whilst DWA Managed Accounts Pty Ltd is of the view the contents of this report are based on information which is believed to be reliable, its accuracy and completeness are not guaranteed and no warranty of accuracy or reliability is given or implied and no responsibility for any loss or damage arising in any way for any representation, act or omission is accepted by DWA Managed Accounts Pty Ltd and its affiliated entities or any officer, agent or employee of DWA Managed Accounts Pty Ltd and its affiliated entities.

