FINANCIAL MARKET CONDITIONS
July 2023

Local Government Finance Authority

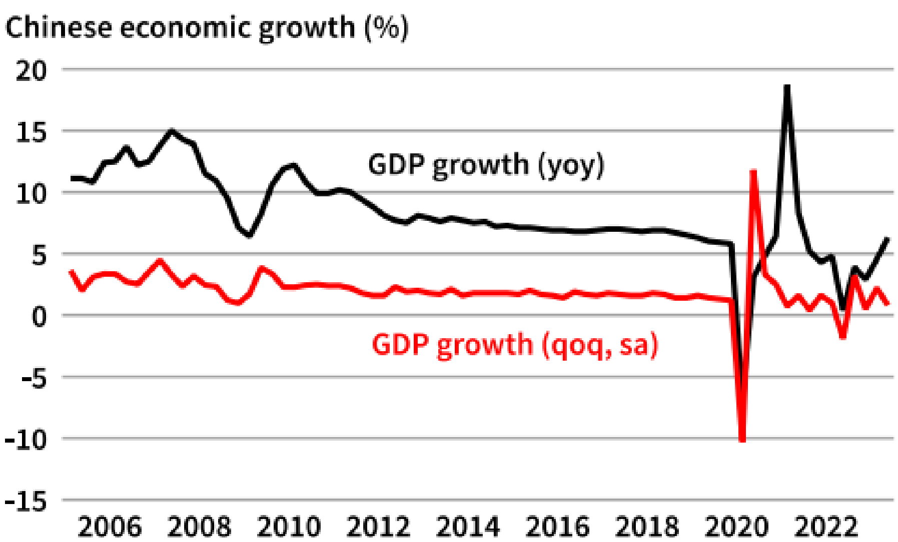
Market sentiment remained positive in July with weakening inflation and supporting strong economic growth data raised hopes for a soft landing, reinforcing confidence in global equity markets. Equities in the US were higher by around 4%, however emerging markets in Asia were the top performers over the month gaining up to 6%, which was also underpinned with hopes of stimulatory measures by the Chinese government to support growth in their economy.

In the US, data continues to be varied, with evidence of further falls in inflation from 5.3% to 4.8%, the lowest since October 2021. Further falls in gasoline prices and strength in equity markets has improved consumer confidence, extending gains over recent months. The Federal Reserve (FOMC) hiked rates by 0.25%, as universally expected. In the press conference, the FOMC Chair, Jerome Powell, made it clear that the Committee will be closely scrutinising the strength and capacity of the economy in the months ahead, with subsequent decisions 'data dependent'. With resilience underpinning some areas of the economy such as the employment market with unemployment at 3.5%, the market expects a 40% chance of a further hike before the end of the year, with monetary policy tightening appearing near the top of the cycle.

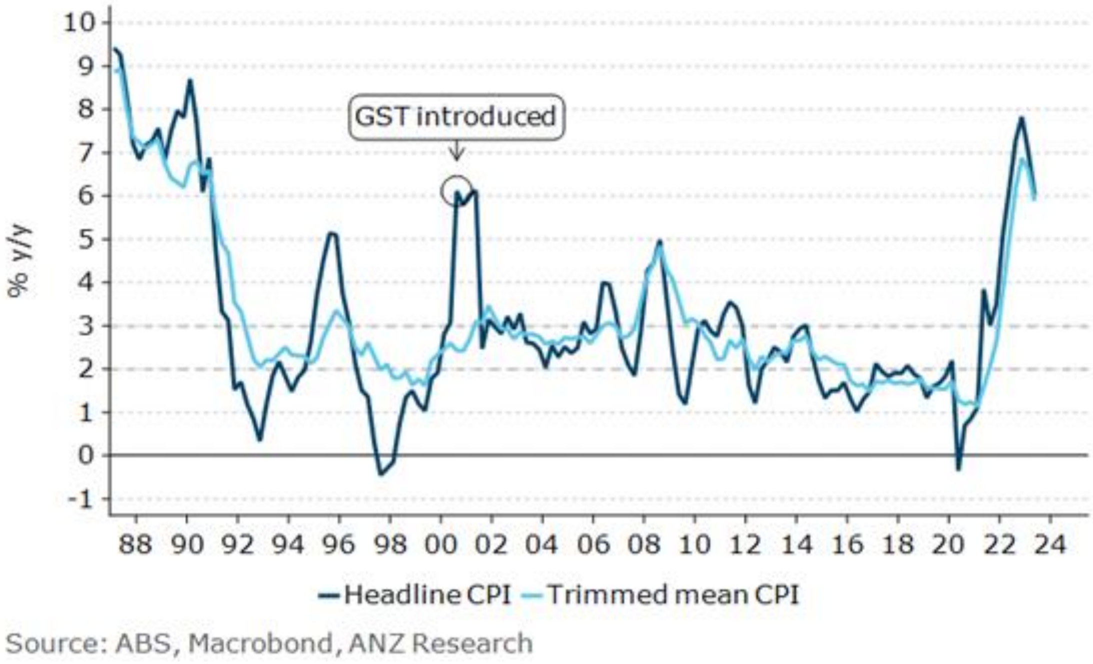
In Europe, the European Central Bank (ECB) raised rates by another 0.25% in July, the highest level since 2008, with key messaging committing to following a ‘data-dependent approach’ to future rate decisions. Data in the eurozone is already showing weakness such as manufacturing data falling to an eight-month low. Lending data is also weaker out of the region, currently at an all-time low since the start of the survey in 2003. Despite weakness in the economy, eurozone Q2 GDP was slightly stronger than expected at 0.3%, showing a recovery in demand from 0% the previous quarter, likely bolstered by a moderation in inflationary pressures.

The Bank of England (BOE) also raised rates in July by 0.25%, to a 15 year high of 5.25%, the statement also warned that borrowing costs were likely to remain high for some time. Inflation has continued to fall, with headline CPI falling to 7.9%, marking the lowest level since March 2022, and employment saw signs of weakness, with the unemployment rate rising to 4%, the highest level since 2021. Manufacturing data is at its lowest level this year and at the levels in May 2020, however retail sales bounced back by 0.7%, the third straight month of growth in retail trade, illustrating there may still be a need to raise rates further.

China saw further weak data prints over July including the manufacturing index revealing a larger than expected deceleration in activity, hitting its lowest reading in six months. Inflation data for June printed below expectations, with CPI declining to a 28th month low from 0.2% to 0%, raising concerns of deflation. GDP growth whilst meeting expectations in Q2 at 0.8%, there is a clear loss of economic momentum in the region and a risk that target growth of 5.5% is highly unlikely. With an ongoing property downturn, possible disinflation, record high unemployment rates and declining exports, the news of fiscal support measures by the National Development and Reform Commission were welcome, supporting optimism in emerging markets at the end of July.



Like the rest of the globe, inflation in Australia is seeing signs of a slowdown with inflation dropping to 6.0% year-on-year in Q2 2023, down from 7.0% in the previous period. The Reserve Bank of Australia (RBA) maintained its cash rate at 4.10% during its August meeting, commenting that recent data is consistent with inflation returning to the 2-3% target range over time. However, also commented that further tightening may be required to ensure that inflation returns to target in a 'reasonable timeframe'.



Economic data releases continue to illustrate resilience in some sectors of the economy and weakness in others. The unemployment rate remained at 3.5% in June, close to last October's 50-year lows. However, job ads fell 2.3% in June, continuing the trend decline, with the number of ads now 24% below the May 2022 peak. Retail sales witnessed a drop in June, with cost-of-living pressures weighting on consumer spending. However, housing data is still well supported by demand, with new housing lending by almost 5% in May (after a 20% decline year to date). Property prices in Australia rose for a fourth consecutive month in June, and rental prices continue to rise. Whilst consumer sentiment improved in July with the influence of the easing of inflation and RBA rate hike pauses, the current reading remains in the 'deeply pessimistic' territory.

In its Statement on Monetary Policy, the RBA downwardly revised forecasts for inflation and GDP growth, and forecasts assume a peak in the cash rate at 4.25%. Major banks believe the current cash rate is near the top of the cycle between the current 4.10% rate and 4.35%, with an expectation that the RBA will commence and easing cycle as early as Q1 2024.