FINANCIAL MARKET CONDITIONS
August 2023

Local Government Finance Authority

Market sentiment deteriorated over the course of August amid worries over concerns relating Chinese economic growth and possible deflation. The real estate sector and other economic data from China continued to be worse than expected, and emerging markets underperformed. Despite inflation continuing to abate, Global equities fell by around 3% over the month.

US data continues to be varied, however, continued to indicate underlying strength. Annual core inflation eased in July from 4.8% to 4.7%, its lowest read since October 2021. Whilst retail sales exceeded expectations increasing by 0.7% against a 0.4% consensus, GDP and employment data slowed, providing some hope for a 'soft landing'. Q2 GDP growth was revised down to 2.1% and employment data showed that hiring rates have slowed, and the jobless rate rose from 3.5% in July to 3.8%, its highest level since February 2022. Whilst the Federal Reserve (FOMC) messaging continued to signal that further tightening may be necessary, markets have interpreted recent data as indicating that the current tightening cycle may have ended.

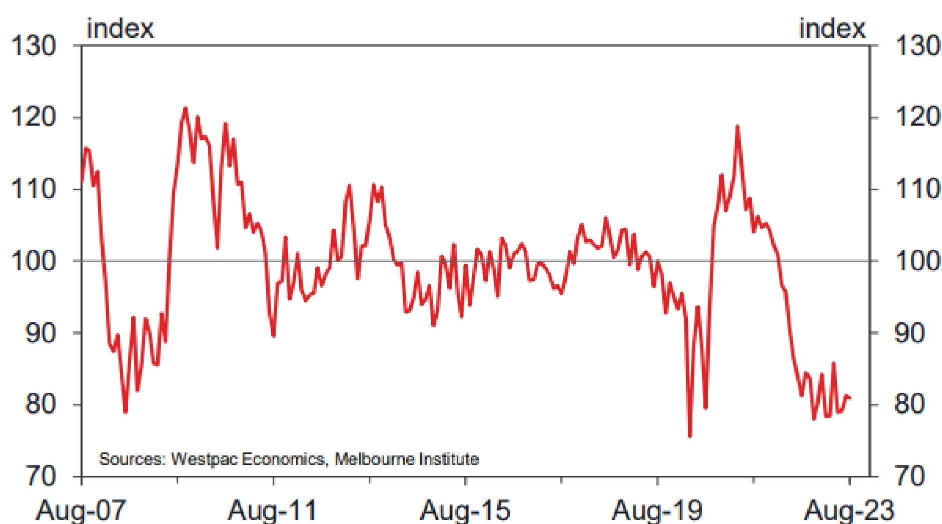
In Europe, Eurozone data has been very soft, however the labour market remains tight. Credit conditions are tightening which may lead to further softening in growth. Manufacturing data across Europe printed in deep contractionary territory, however inflation continues to be varied across the region. Inflation slowed in Germany and rose to a 3-month high in Spain with the entire Eurozone CPI was slightly higher than expected remaining flat at 5.3%, which is trending in the right direction. The European Central Bank (ECB) will watch the supply and demand for credit, and whilst at its July meeting the forward guidance was more neutral, inflation remains well above ECB's target and markets continue to price in at least one more rate increase before year end.

In the UK, the Bank of England (BoE) hiked rates by 0.25% in August with the BoE highlighting the intention to hold rates at restrictive levels for some time. Despite the tight monetary environment, the UK economy surprised to the upside in Q2 with GDP rising by 0.2%. UK inflation continued to ease to 6.8% from 7.9%, however the labour market continues to be tight. Growth in pay over the April-June period was the highest rate since comparable records began in 2001. In this context, markets continue to expect further rate increases from the BoE this year.

Data in China continued to disappoint over August. Activity data was much weaker than expected and inflation turned negative in July, falling the first time since 2020 by 0.3%. Investment data highlighted low business confidence particularly in real estate, witnessing an 8.5% fall between January and July. China's trade data showed both imports and exports were well below market expectations. To address the lack of confidence as well as deflationary risks, the People's Bank of China (PBoC) lowered its interest rates twice in August, in addition to several initiatives to support financial markets, such as halving the stamp duty on stock trading. The Chinese Yuan is now at its weakest level in 16 years. The Australian Dollar (AUD) continues to be influenced by weak China news, and is currently trading below 0.64 USD, which is its weakest levels since November 2022.

Locally, consumer confidence remained low, however business conditions stayed resilient in July with retail firms continuing to report strong current conditions despite weakness in leading indicators over recent months. House prices rose by 0.8% in August, a lack of supply and strong demand driven by population growth continue to push prices higher. Retail sales increased over July, however the annualised rate remains weak at 2.1%. The monthly inflation reading continued to slow to 4.9% from 5.4%, which provides some support for an expected August CPI print due at the end of September close to 5%. A weakness in the tight labour market was a welcome relief for the RBA, with the unemployment rate increasing from 3.5% to 3.7%. The RBA appear more confident that the Australian economy is on track for a soft landing, and the Q2 GDP numbers support this with GDP growing by 0.4% for the quarter.

Consumer Sentiment Index



Retail sales have barely grown throughout 2023 and are well down from the peak in November 2022

Source: ABS, Macrobond, ANZ Research

The Reserve Bank of Australia (RBA) held the cash rate steady again at 4.1% in September, as expected. The 12 rate hikes over the last 15 months appear to be having the intended effect, with households tightening purse strings and inflation starting to ease. As in previous decisions, the RBA have maintained a tightening bias, continually making it clear the Board is prepared to raise rates as much as needs be to bring inflation back to target levels. 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.