FINANCIAL MARKET CONDITIONS
January 2024

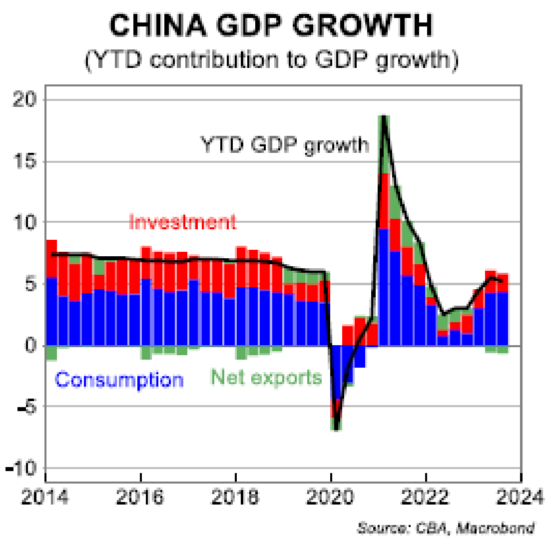
Local Government Finance Authority

Despite a tense geopolitical backdrop and escalating tensions between Iran and Pakistan, global equities had another great month in January, with United States (US) equities gaining 2%, up almost 21% over the past 12 months. Both the Australian share market and US markets reached a record high with the ASX200 index reaching 7680, levels not seen since 2021. Strong growth data, coupled with financial market's dovish outlook for rate cuts and consequently expectations of a 'soft landing' scenario, proved a positive environment for equities.

US economic growth data defied expectations in the final quarter of 2023, expanding by 3.1% over the past year, thanks to a resilient labour market that supported strong consumer spending. Labour market tightness persisted with employers hiring at a solid pace in December, with the US unemployment rate unchanged at 3.7%, remaining at lows not seen since the late 1960s. However, after two years of soaring home sales that started during the pandemic, the housing market skidded to a halt. Home sales last year dropped to the lowest level in nearly three decades after elevated mortgage rates and a lack of homes for sale frustrated buyers. In terms of inflationary pressures, this has also continued to weaken with annual core inflation falling from 4% to 3.9%, the lowest level since May 2021. At its January meeting, the Federal Reserve (FOMC) kept the Fed funds rate unchanged for a fourth consecutive meeting, in line with expectations. The timing of rate cuts remained in focus, as the Fed signalled a March rate cut was not the base scenario. Markets have pencilled-in easing from the second quarter onwards.

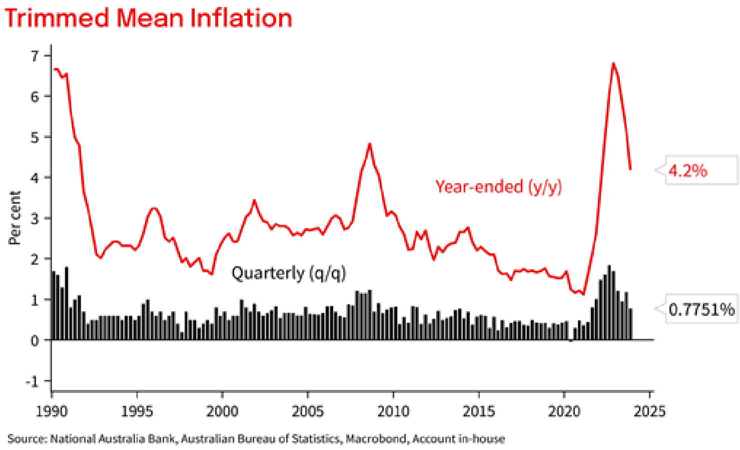
The Eurozone continued to witness soft economic data over the month, and Q4 GDP stagnated at 0.5%, narrowly avoiding a technical recession. Whilst some manufacturing data improved, new orders and output indicated further contractions. Eurozone inflation data edged lower in January to 2.8% from 2.9% the previous month, which is heading in the right direction. Despite concerns about a looming recession and a gradual easing in inflationary pressures, the European Central Bank kept rates unchanged, pledging to maintain them at sufficiently restrictive levels for as long as necessary to bring inflation back to its 2% target in a timely manner. In the United Kingdom, Bank of England (BoE) also left its policy rate unchanged as expected but removed its tightening bias in the statement. The board acknowledged that keeping rates unchanged from here would push inflation "significantly" below target of 2%, indicating rate cuts in the not-too-distant future.

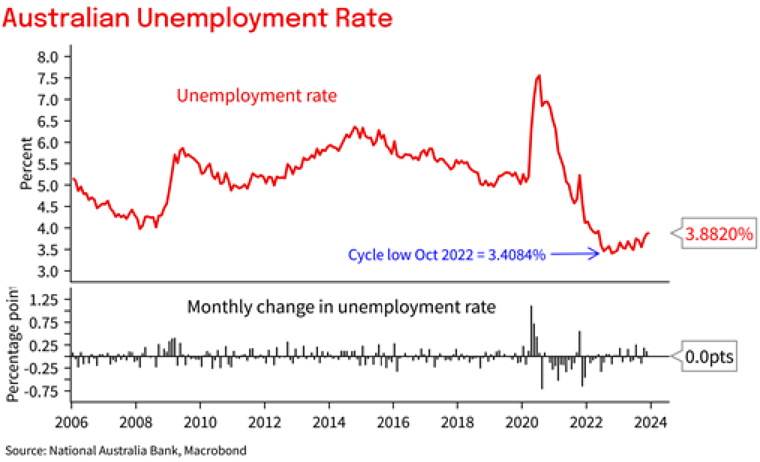
In China, the domestic economy continued to struggle, with disappointing retail sales and further deterioration in housing activity. Q4 GDP grew 5.2% year-on-year, in line with expectations, but is still historically weak. Although the PBOC announced a number of stimulus measures, it was not what markets were hoping for to re-ignite activity. China's consumer prices fell by 0.8% year-on-year, marking the fourth straight month of decline which was the longest streak of drop since October 2009. The weakness in China's domestic economy and the softness in consumption, in addition to weakness in the property sector may mean the 2024 annual growth target of 5% will be difficult to achieve.



Locally, Australia's economic landscape is bearing the impact of recent rate rises. Business confidence remains pessimistic, and higher interest rates have slowed the pace of credit growth from the peak in 2022. Retail sales came in much weaker than expected, with annual sales growth slowing to 0.8% over the year, an extremely weak pace given price and population growth. Employment data has weakened and job vacancies in November 2023 fell 0.7%, -14.4% over the year.

Despite this, the labour market is still tight with job vacancies still 70% above pre-pandemic, with the unemployment rate remaining low at 3.9%. Despite housing affordability significantly reduced, house prices continued to increase in December. The issue of the supply and demand mismatch remains which coupled with significant population growth has witnessed further increases in home prices, having risen for 12 consecutive months during a period of rising interest rates. However, the last three months show home prices are still rising, but the pace of gains are slower than mid-2023. Australian December quarter consumer price index (CPI) data was below market expectations on both the headline and underlying measures. Importantly for the outlook for monetary policy, it was materially below the RBA's forecasts. Australia's inflation moderated more than expected, with CPI rising 0.6% quarter-on-quarter, with the annual headline inflation now at 4.1%.





At its February board meeting, The Reserve Bank of Australia (RBA) kept rates unchanged, as widely expected. The RBA said cost pressure in the country continued to ease but inflation remained high as prices of services were not falling quickly enough, "while growth in demand has slowed, the level of demand is still robust and is assessed to be above the economy's capacity to supply goods and services, thereby creating inflationary pressures". The central bank warned that further monetary tightening could not be ruled out. Despite these dovish comments, major banks see that the cash rate has reached its peak, with expectations of the RBA commencing an easing cycle as early as September 2024.