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Market Update

December 2014

Share markets rise

Global share markets made strong gains in the three months to 31 December. The early part of the period saw shares fall sharply amid renewed global growth concerns, Ebola fears and the fast-approaching end to the US Federal Reserve (Fed)'s quantitative easing program. However, sentiment soon turned positive following some solid US corporate earnings results, the Bank of Japan's decision to ramp up its economic stimulus program and news Japan's massive Government Pension Investment Fund would allocate half of its holdings to domestic and foreign equities. Share markets also benefited from European Central Bank president Mario Draghi's ongoing commitment to do "whatever is necessary" to head off deflation, a surprise interest rate cut in China and news the US economy expanded at its fastest pace in more than 10 years in the third quarter. Limiting the gains were concerns about the European and Chinese growth outlooks, news Japan's economy unexpectedly fell into recession in the September quarter and renewed political uncertainty in Greece.

Australian shares were also positive for the period; the local market benefiting from a strong rally across the major banks, the People's Bank of China's surprise decision to cut interest rates in November and further strong US economic data.

Interest rates still on hold

The Reserve Bank of Australia (RBA) left interest rates unchanged at a historically low 2.50% throughout the period; officials maintaining their view that, "on present indications, the most prudent course is likely to be a period of stability in interest rates." The bank also noted that a lower Australian dollar (AUD) was likely to be needed to help boost growth after key commodity prices extended their decline while growth overall was likely to remain a little below trend over the next couple of quarters.

Australian dollar extends decline

The AUD continued to weaken over the quarter; the local unit hurt by further US dollar (USD) strength, ongoing commodity price weakness and speculation the RBA could cut interest rates in 2015 in a bid to boost growth. The AUD fell 6.3% against the USD, 2.2% against the euro and 2.1% against the British pound. It rose 2.4% against the Japanese yen.

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Domestic growth disappoints in the third quarter

Domestic growth continued to disappoint in the third quarter with gross domestic product rising just 0.3% in the three months ended 30 September; less than half the 0.7% most economists had been expecting. Contributing to the softer outcome were sharp falls in government expenditure and mining investment. On an annual basis, the local economy grew 2.7%; less than the consensus forecast of 3.1%.

Looking ahead

Global economies kept investors guessing in 2014. We had anticipated the global economic recovery would broaden and strengthen through the course of the year, and this scenario largely played out. Whilst the US began the year with a dip in growth, it is now growing strongly and we expect this trend to continue in 2015. In a notable milestone, the US unemployment rate recently pushed below that of Australia's for the first time since the global financial crisis. This prompted us to bring forward the expected timing of the first Fed rate hike to the first half of 2015.

The US is further down the road in the recovery process than other major economies and this is where the main tensions over the 2015 outlook lie. Just how far will the Fed need to raise interest rates? And what will be the impact of those interest rate rises on central banks in Japan and Europe who are moving in the opposite direction? We expect it to turn out smoothly with the Fed moving gradually and with clear communication. However, markets could be spooked if inflation pressures emerge and force more aggressive Fed action, or if Europe and Japan fail to respond to additional central bank stimulus.

Here in Australia, there are still broad concerns about the economy's ability to adapt to a slowing resources boom. We believe domestic growth will slow in 2015, but not dramatically so.

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