WEEKLY MARKET UPDATE

06 DECEMBER 2024

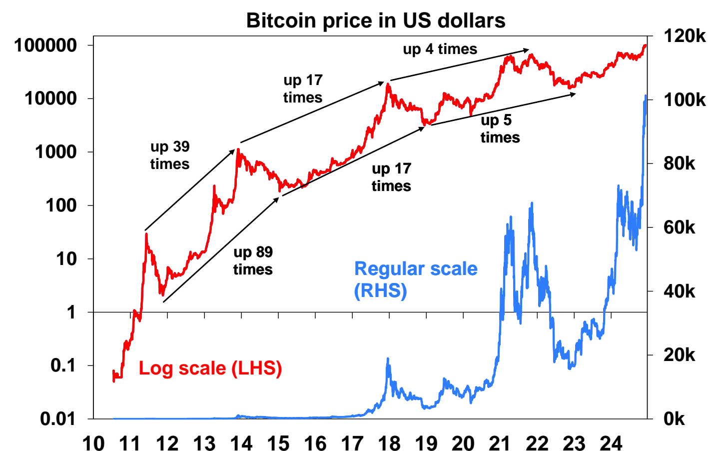
Investment markets and key developments

Despite another week of geopolitical noise with the "fall" of the French Government, a few hours of martial law in South Korea and more noise around Trump, global share markets rose helped by solid US economic data and ongoing expectations for rate cuts globally. For the week US shares rose 1% helped on Friday by benign jobs data supporting the case for a December Fed rate cut. Eurozone shares rose 2.9%, Japanese shares rose 2.3% and Chinese shares rose 1.4%. Despite the political noise, French shares actually rose 2.7% as the no-confidence vote in the French Government was not surprising and South Korean shares only fell 1.2%. Notwithstanding the positive global lead, the Australian share market fell 0.2% with weaker than expected economic growth only partly offset by increased prospects for an earlier rate cut with gains in retail and IT shares but falls in property and utility shares. Bond yields generally fell, including in France. Oil prices fell despite OPEC delaying a production increase until April in the face of rising US supply and weak Chinese demand for oil. Metal and iron ore prices rose but gold prices fell. The $A fell on prospects for earlier rate cuts and the $US rose slightly.

Shares remain torn between the negatives of rich valuations, higher bond yields, uncertainty as to how much central banks will cut rates and uncertainties around Trump's trade policies and geopolitical risks on the one hand versus the positives of global central banks being in an easing cycle, goldilocks economic conditions particularly in the US, optimism that Trump will reinvigorate the US economy and prospects for stronger profits ahead in Australia. And we are now in a seasonally strong period of the year for shares. Our overall assessment remains that the trend is still up, including for Australian shares, but expect a more volatile and constrained ride.

In the US President Trump's cabinet appointments are continuing to impact markets. On the tariff front indications that former Trump US Trade Representative Lighthizer will not get a Cabinet role have been interpreted as suggesting a universal tariff is less likely particularly with others in his team leaning towards using tariffs as a negotiating tool rather than an end state. That said even if they are just put up as a negotiating tactic it could still lead to a rough ride for a while. Meanwhile, China's ban on the export of some critical minerals to the US in retaliation to the Biden administration's latest ban on chip exports to China appears to be aimed at sending a message to Trump that it will respond to any tariffs more aggressively this time around. Interestingly, China's bans on exports to the US of gallium, germanium and antimony may provide some opportunities for Australia although its not a big producer of the first too and it will take time to increase production.

Bitcoin to infinity and beyond! Meanwhile, Trump's nomination of Paul Atkins, who favours lighter touch regulation and is seen as pro-crypto, to head the Securities Exchange Commission provided the trigger for Bitcoin to rise above $US100,000 after a mild correction. This was then reinforced by Trump's appointment of crypto supporter David Sacks as his "AI & Crypto Czar". Bitcoin's surge this year on the back of the advent of exchange traded funds that invest directly in it, the latest halving in the reward Bitcoin miners get and more recently perceptions that the Trump administration will be more favourably disposed towards it, which has been reinforced by his appointments of Atkins and Sacks, unfortunately have nothing to do with developments regarding its fundamental value (unlike the surge in Nvidia where demand for AI is real and huge). However, it is settling in as a form of "digital gold" - as a "non-confiscatable", independent of government asset like gold. And as it takes more of the money that would otherwise have gone to gold it potentially has more upside, particularly with momentum on its side as its move through $US100,000 will attract even more investors into it. However, while it likely has more upside investors need to allow that: Bitcoin's use case (beyond an asset to speculate on) remains unclear (unlike other cryptos like Ethereum); since it produces no income flow (unlike rents for property or earnings for shares) it's impossible to value; its highly volatile having had four 80% or so plunges in "crypto winters" since its inception, and the same is likely again after the current run comes to an end, maybe sometime next year; its increasingly correlated with shares with more than double the movements up and down; and the gains in each upswing appear to be slowing as the easy gains are diminishing over time – although a 2 or 3 fold increase from the 2021 high would still take it to around $US135,000 to $US200,000. See the next chart.

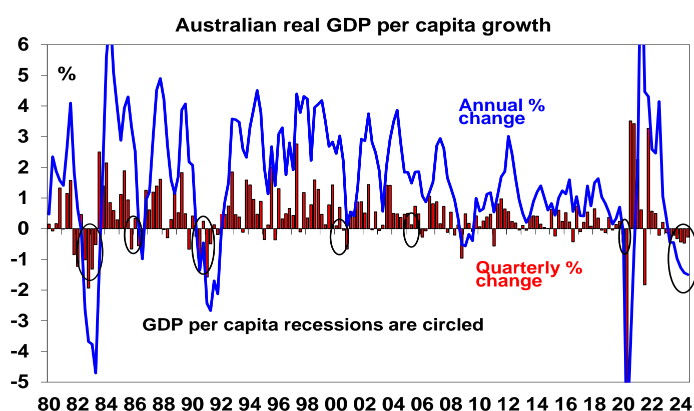


Source: Bloomberg, AMP

Dismal Australian economic growth. While the September quarter GDP data was not all bad as it did show a lift in household income and savings potentially supporting a future pick up in consumer spending, it was mostly pretty dismal: growth came in

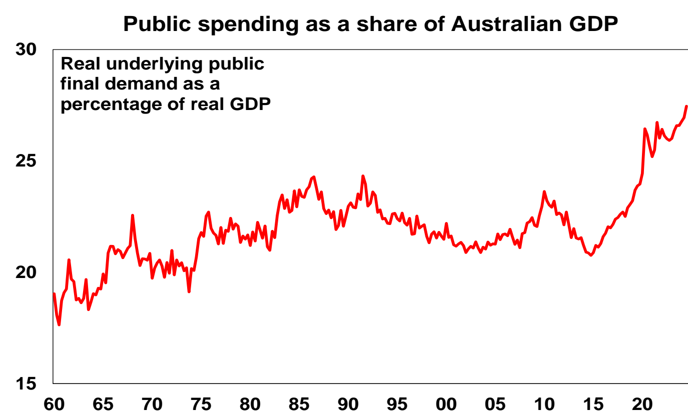
softer than expected at just 0.3%qoq; annual growth slowed to 0.8%yoy its slowest outside the pandemic since the early 1990s recession; consumers largely saved their tax cuts resulting in flat consumer spending after a 0.1%qoq fall in the June quarter; and the "per capita recession" continued with GDP per person down in 8 of the last 9 quarters. Were it not for strong growth in public demand and strong population growth Australia would be in recession as the former is partly offsetting the near recessionary conditions in private spending and the latter is keeping the economy growing despite the fall in GDP per person. However, there are three big problems with this:

- **Firstly, the fall in per capita GDP is an indicator of falling living standards per person in Australia**. Strong population growth has covered this up in terms of traditional GDP but it doesn't drive higher living standards per person in the short term and we can't rely on strong population growth to keep the economy going as its caused an undersupply of housing and both sides of politics are now looking to slow it down to more sustainable levels.



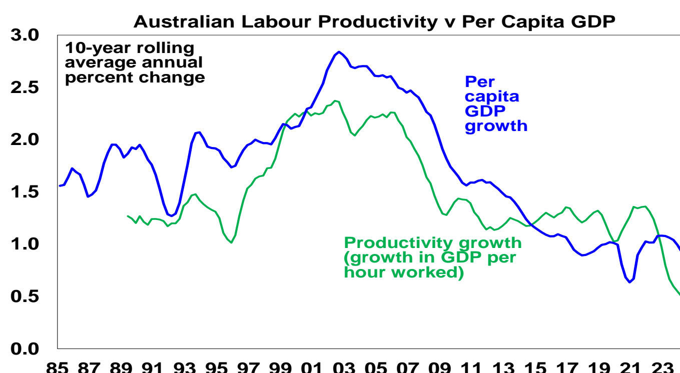
Source: ABS, AMP

- **Second, the surge in public spending to a now record 28% of GDP has made the RBA's job in controlling inflation harder** because it's kept demand in the economy higher than otherwise would have been the case which has meant that interest rates have had to stay higher for longer to slow demand, and hence inflation, which in turn has meant that private spending has had to be squeezed by more than would otherwise have been the case. Households have paid for this by having to cut back their discretionary spending. In other words, were it not for the surge in public spending inflation would now likely be lower and so too would the RBA's cash rate. So all the public spending has made things tougher for mortgage holders.



Source: ABS, AMP

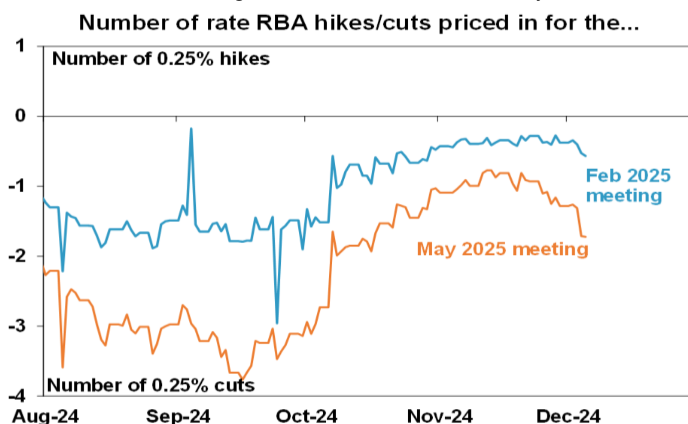
- **Finally, the surge in public spending is exacerbating Australia's productivity slump with productivity down another 0.8% over the last year** as private market sector productivity is invariably higher than public sector productivity and as public spending squeezes out private business investment it is likely exacerbating the weakness in private market sector productivity. And weak productivity growth makes it harder to get inflation down and will depress long term growth in per capita GDP and hence in living standards. See next chart.



Source: ABS, AMP

Australia's dismal GDP growth has implications for both governments and the RBA.

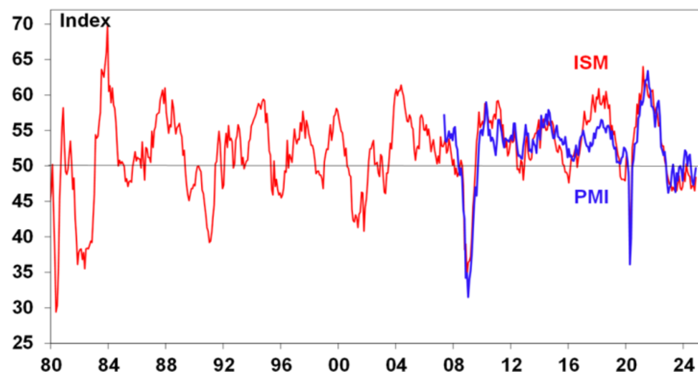
- While it may be politically unpopular, Federal and state governments need to slow their spending to stop squeezing out private spending and do more to fundamentally boost productivity (which requires tax reform, labour market deregulation, competition reforms, etc). And in the process work in tandem with the RBA rather than against it. Unfortunately, its hard to be optimistic with a Federal election ahead.
- For the RBA ongoing weakness in productivity is not good news and may reinforce their lack of urgency to cut rates, but weaker than expected GDP growth shows the economy is not picking up as quickly as they expect and so **the RBA is likely to downgrade their growth expectations again which should lessen concerns about excess demand in the economy**. Taken together with output price pressures in various business surveys this indicates the RBA should be considering a rate cut sooner rather than later. An RBA rate cut in the week ahead is unlikely and while we moved our base case for the first cut out to May on the grounds that the RBA appears to be in no hurry to cut rates a good December quarter trimmed mean inflation reading could push it over the line to cut in February given the softness we have seen in GDP and particularly so if upcoming jobs data is a bit softer. So, we see a high chance of a February cut (around 50%) and its quite likely that RBA commentary in the week ahead becomes a bit more dovish to allow for that possibility. Consistent with this, money market expectations have become less hawkish (again) and now see a 55% chance of a cut in February with one now fully priced in for April, whereas a week ago that wasn't the case till May.



Source: Bloomberg, AMP

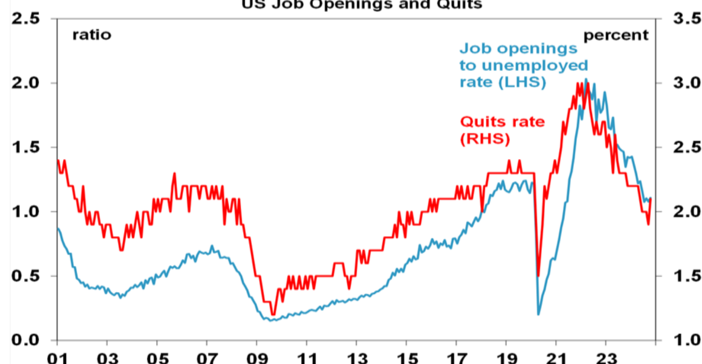
Major global economic events and implications

US economic data was consistent with still solid growth with the Atlanta Fed's GDPNow estimate of December quarter GDP growth rising to 3.3% annualised. The ISM services conditions index slowed but is still okay & manufacturing conditions improved. It's still weak although the US manufacturing PMI is a bit stronger.



Source: Macrobond, AMP

Meanwhile, jobs data for November provided no surprises and keeps the Fed on track to ease this month. Employment bounced back after the hurricane related weakness in October but was broadly in line with expectations and the trend remains down, unemployment rose slightly to 4.2% and wages growth was unchanged at 4%yoy. With productivity running at 2%yoy, wages growth of 4%yoy means growth in unit labour costs of 2%yoy and hence is consistent with the Fed's 2% inflation target. Meanwhile, job openings and quits both rose in October but both remain in a downtrend and the hiring rate fell. Commentary from the Fed suggests there is still a leaning towards a December rate cut, but its data dependent. Fed Chair Powell indicated the US is still making progress on inflation but with the economy strong it can afford to be a bit more cautious in easing. This could be consistent with a December cut then a slower easing pace next year. The benign jobs report keeps the Fed on track for a rate cut this month, providing inflation data in the week ahead is okay.



Source: Macrobond, AMP

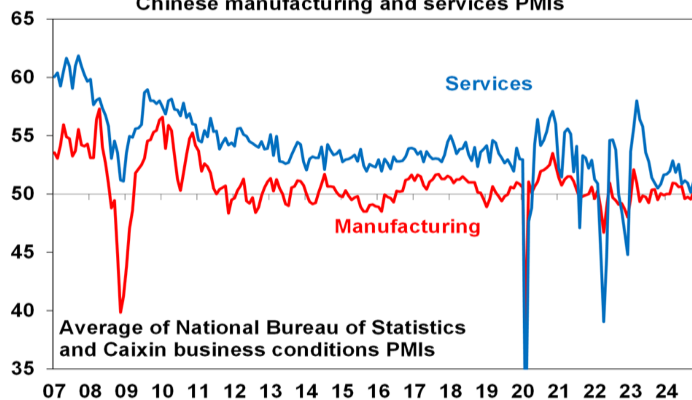
Eurozone unemployment was unchanged at 6.3% in October, but retail sales fell 0.5%mom.

The French political situation went from bad to worse after the French Government fell, but it's not as bad as it looks. The Government fell after it lost a no confidence vote in parliament after PM Barnier failed to get support from the far-right National Rally for an austerity budget which was required under European Commission rules to bring the budget deficit back down from 6% of GDP. Economic and political chaos is in the interest of the RN as they can argue that only they can fix things and so hope for more votes at the next election. But with a new election not possible until July next year PM Macron is moving quickly to appoint a new PM, the current 2024 budget will simply be rolled over into 2025 and the new government will then work to amend it next year. So, there won't be a government shutdown or anything like that. The main risk is that renewed difficulties with the new government next year lead to a further rise in French borrowing costs and potential worries about Eurozone cohesion. But so far the spread between the French and German bond yields has fallen back into the range it's been since the mid-year election and there is no sign of contagion to other Eurozone members like Italy and Spain. And compared to the 2010-12 period growth is stronger, financial conditions are easier and there is more scope for the ECB to ease so it doesn't look like a re-run of last decade's Eurozone crisis. And after the recent turmoil the centre right and centre left parties may be more supportive of the new government suggesting it may be more durable. Of course, Germany has its own political dramas, but its budget deficit is less than 3% of GDP and next year's election is simply likely to see power shift back to the centre right CDU/CSU. The uncertainty will likely weigh on French growth though which is another reason to expect relatively aggressive ECB rate cuts – probably down to 1.5% next year.

Source: Bloomberg, AMP

South Korean politics were arguably even more dramatic with the President declaring martial law before it was overturned 6 hours later after a parliamentary vote, but it's unlikely to have much impact. President Yoon was under political pressure with falling popularity and miscalculated that declaring martial law would strengthen his hand. So far democratic institutions have held and its unlikely to have a major impact beyond political uncertainty weighing on the Korean economy. While Korean shares fell it was only modest and the Bank of Korea is likely to provide any support if needed although it looks unlikely.

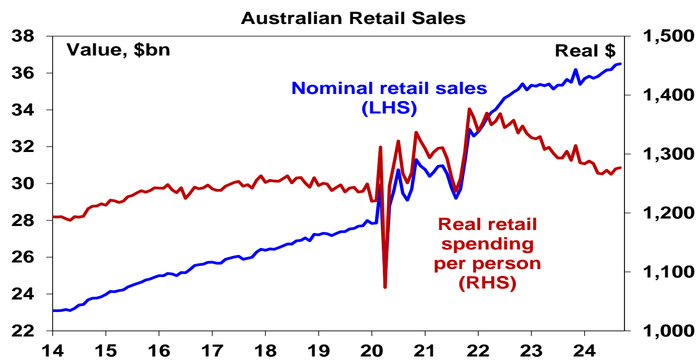
Chinese business conditions PMIs for November were mixed with manufacturing up but non-manufacturing down slightly. The overall picture is that recent stimulus announcements haven't led to a big rise in confidence and conditions but have helped stabilise GDP growth around or just below the 5% level.



Source: Bloomberg, AMP

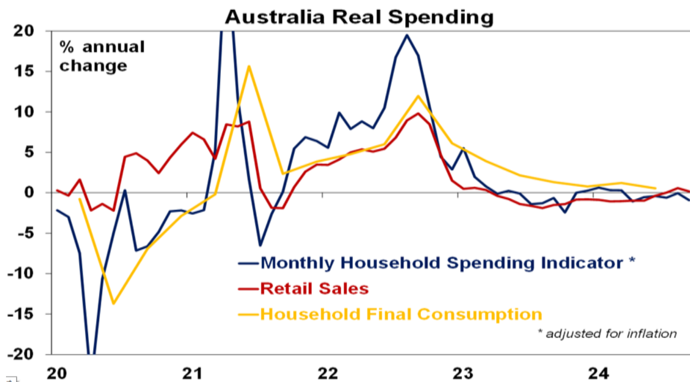
Australian economic events and implications

As noted earlier, GDP data for the September quarter was dismal but not all the data over the last week was bleak. Retail sales rose a stronger than expected 0.6% suggesting that maybe Australians are starting to spend more of their tax cuts. That said it may be yet another distortion due to households making the most of early Black Friday discounting.



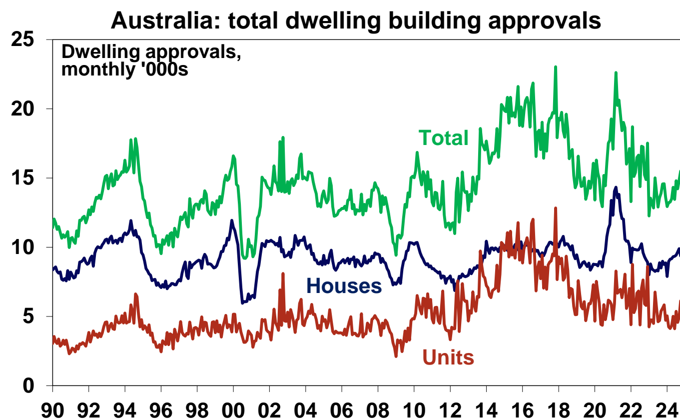
Source: ABS, AMP

The ABS's Monthly Household Spending Indicator also had a solid bounce in October driven by a rise in spending on concerts and sport events. As with retail sales it may be a positive sign but its too early to tell and can be volatile month to month.



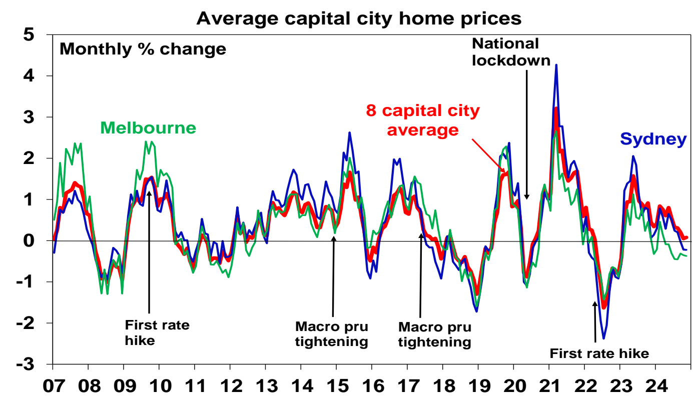
Source: ABS, AMP

Home building approvals rose another 4.2% in October. The trend appears to be up which is positive for home building. That said home building approvals running around 178,000 are still well below the Governments' objective to build 240,000 homes a year.



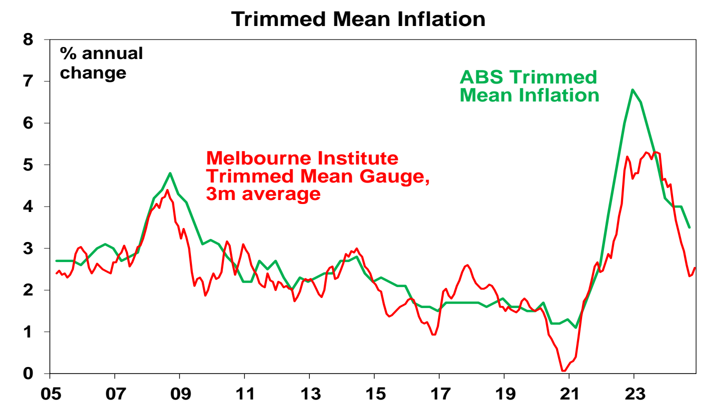
Source: ABS, AMP

Home price growth slowed again in November according to CoreLogic, and looks like softening further until rates start to fall. Signs of softness remain evident in: subdued auction clearance rates; rising listings; lower quartile and unit prices leading growth; and properties taking longer to sell. For the RBA the downturn in the property cycle is turning a positive wealth effect boosting consumer spending into a negative wealth effect and adds to the case for rate cuts sooner rather than later.



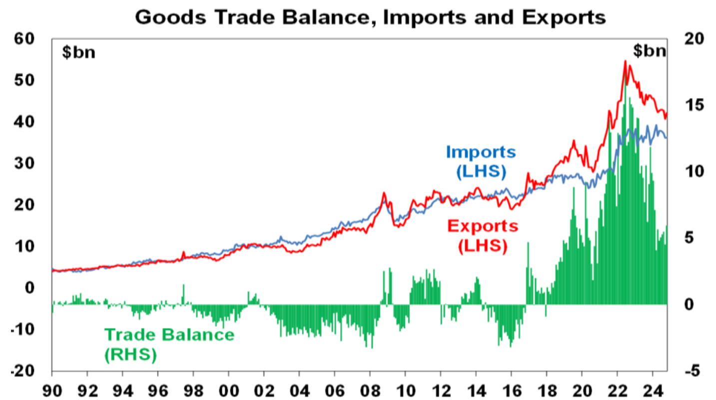
Source: CoreLogic, AMP

The Melbourne Institute's Inflation Gauge for November saw a slight uptick in underlying or trimmed mean inflation but still points down for ABS's trimmed mean inflation rate.



Source: Melbourne Institute, AMP

The trade surplus rebounded to $6bn in October driven by higher gas and gold exports.



Source: ABS, AMP

What to watch over the next week?

In the US, the focus will be back on inflation with November CPI data (Wednesday) likely to show a lift in headline inflation to 2.7%yoy from 2.6% and core inflation remaining slightly elevated for now at 0.3%mom and 3.2%yoy. Producer price inflation will also be released Thursday and the NFIB small business optimism survey will be released Tuesday.

The Bank of Canada (Wednesday) is expected to cut by 0.5% taking its policy rate to 3.25%, particularly after unemployment rose to a three year high of 6.8% in November.

The ECB is expected to cut rates by another 0.25% on Thursday reflecting weak growth and the fall in inflation, taking its main refinancing rate to 3.15% and its deposit rate to 3%. The

Swiss central bank on Thursday is also expected to cut by another 0.25% taking its key policy rate to 0.75%. There is some chance of a 0.5% cut in both.

In Australia, the RBA is expected to leave rates on hold at 4.35% for the 13th month in a row on the grounds that underlying inflation remains too high at 3.5%yoy, but weaker than expected September quarter growth is likely to see it pivot to a more dovish tone signalling the potential for rate cuts early next year. Speeches by RBA Deputy Governor Hauser on Wednesday and Chief Economist Hunter on Friday will also be watched for indications on this front. The NAB business survey (Tuesday) is likely to show mixed business conditions and a continuing normalisation in cost and price pressures. Jobs data (Thursday) is likely to see a 30,000 gain in employment with unemployment edging up to 4.2%. At some point in the next two weeks the Government's Mid-Year Economic and Fiscal Outlook will be released and is likely to confirm a steep slide back into a budget deficit for this financial year and the years ahead as the "rivers of gold" flowing to Canberra from strong commodity prices and the strong jobs market slow and structural spending pressures impact. This year's budget deficit forecast may be smaller than the $28bn forecast back in the May Budget though as budget data up to October show the budget tracking around $6bn better than expected. The Treasurer is also likely to unveil more government spending in terms of childcare and "decisions taken but not yet announced" but to be unveiled ahead of the coming election, although he has said it won't be "big spending". The Government's inflation forecasts are likely to be little changed but near-term growth forecasts are likely to be revised down to around 1.5% for this financial year from 2%.

Outlook for investment markets

Global and Australian shares are expected to return a far more constrained 7% in the year ahead. Stretched valuations after two strong years, the ongoing risk of recession, the likelihood of a global trade war and ongoing geopolitical issues will likely make for a volatile ride in 2025 with a 15% correction somewhere along the way highly likely. But central banks still cutting rates with the RBA joining in and prospects for stronger growth later in the year supporting profits should still see okay investment returns.

Expect the ASX 200 to end 2025 at around 8,800 points.

Bonds are likely to provide returns around running yield or a bit more, as inflation slows to target, and central banks cut rates.

Unlisted commercial property returns are likely to start to improve in 2025 as office prices have already had sharp falls in response to the lagged impact of high bond yields and working from home.

Australian home prices are likely to see further weakness over the next six months as high interest rates constrain demand and unemployment rises. Lower interest rates should help from mid-year though and we see average home prices rising by around 3% in 2025.

Cash and bank deposits are expected to provide returns of over 4%, but they are likely to slow in the second half of 2025 as the cash rate falls.

The $A is likely to be buffeted between the positive of a narrowing in the interest rate differential between the Fed and the RBA and the negative of US tariffs and a potential global trade war. This could leave it stuck between $US0.60 and $US0.70.

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