Monthly economic commentary – October 2018

Global employment continues to improve in October, however markets have reacted to trade risks, rising bond yields, Brexit uncertainty and concern over Italy's fiscal position.

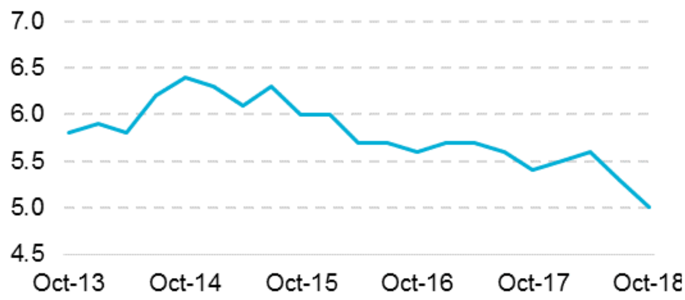
Developments in the global economy

Australia's unemployment falls to lowest rate in 6 years

The September quarter saw consumer prices increase 0.4%, just below the market median forecast of 0.5%. With base effects, the CPI rate eased back to 1.9% from 2.1% the previous quarter. Inflation continues to bump along just at or below the RBA's target band, whilst the RBA cash rate remains at 1.5%.

Australia's unemployment rate fell to 5% in September, the lowest rate in six years. September saw a rise of 5,600 jobs, below expectations of 15,000, however full-time jobs grew by 20,300. The proportion of full-time workers appears to be increasing with 80% of all jobs created in 2018 being full-time.

Chart 1: Australian Unemployment (%) – last 5 years



Source: Bloomberg

In September, the trade surplus widened to $3.0bn, well above expectations, driven primarily by the value of non-rural goods exports. August figures were upgraded to a surplus of $2.3bn, previously reported as $1.6bn.

The Westpac Melbourne Institute Index of Consumer Sentiment rose to 101.5 in October from 100.5 in September. The boost in sentiment from the tax cuts announced in May has faded, while the leadership change, mortgage rate increases, declining house prices and rising petrol prices have been weighing on confidence. Furthermore, dwelling approvals fell by 9.4% in August, following a 4.6% decline in July, in response to the tighter credit market and weak house price growth.

US strong on labour market and consumer confidence

GDP grew by 3.5% annualised in the September quarter, down from the prior quarter's rate of 4.2%. Despite concerns regarding increased tariffs, geopolitical risk and rising borrowing costs, the labour market and consumer confidence remains strong.

The US labour market is close to full employment, with the unemployment rate at 3.7%, down from 3.9% in September. This represents a 48-year low. Meanwhile, wage growth remains stable at 2.8%. In October, non-farm payrolls showed a 250,000 job increase, whilst September saw a 134,000 increase.

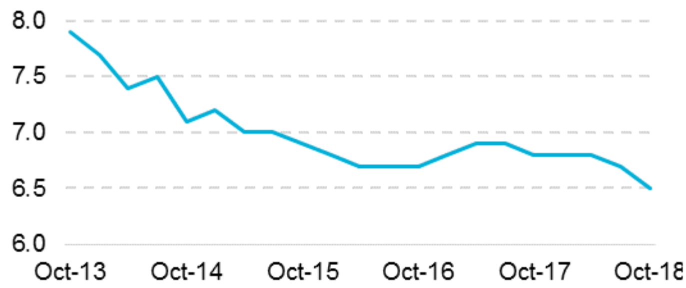
US consumer prices rose less than expected in September, reinforcing the Fed's gradual path on rates. Both the headline and core CPI rose 0.1%, below consensus expectations for a 0.2% rise. These figures were driven by low price growth in housing and education, as well as an irregular, steep fall in used car prices. The annual core CPI rate was unchanged at 2.2%.

China cuts reserve ratio again

Chinese macroeconomic concerns remained in October with annualised growth at 6.5% for the September quarter, slightly below expectations of 6.6%. A combination of factors, including increased tariffs and the Chinese government's goal to slow credit growth, caused the IMF to downgrade their projection of GDP growth in 2019 from 6.4% to 6.2%.

The central bank for the People's Republic of China cut the required reserve ratio for the second time in three months amid slowing economic growth and ongoing trade concerns. The central bank lowered the amount of reserves some lenders are required to hold by 1%, increasing the amount of credit banks can extend to its customers, creating liquidity and multiplier effects through the economy. The change in the requirement became effective on 15 October, releasing a total of 1.2 trillion yuan.

Chart 2: China's GDP Annualised (%) – last 5 years



Source: Bloomberg

Japan increases consumption tax

Economic data was mixed on the back of the recent natural disasters in Japan, although monetary policy remains stable. The Japanese government confirmed a consumption tax increase for October 2019, for which they are also designing alternative stimulus measures to mitigate resource dislocation.

Euro weakened on back on US dollar appreciation

GDP growth in Europe was below expected for the most recent quarter at 0.2%, compared to 0.4% growth in quarter 2. The ECB kept monetary policy on hold, stating that economic data was not as strong as expected, but still on course for long term growth with net asset purchases to conclude in December. However, the Euro weakened on the back of US dollar appreciation and rising European political instability in the UK and Italy.

The EU Summit in Brussels focused on strengthening the bilateral ties between the EU and Asia, although Brexit was a major focus. There are some positive indicators for the UK consumers, with wage growth at 3.1% (annualised) and inflation falling. However, the UK budget was published early and the Office for Budget Responsibility revised GDP growth for 2018 down from 1.5% to 1.3%.

Deficit for Italy's 2019 budget

Italy's 2019 budget, with a deficit of 2.4%, was rejected by the European Commission and a new budget is to be revised. Moody's has kept the country's debt rating at investment grade, although the 10 year government bond spread between Italy and Germany rose to a high of 330 basis points (3.3%) in October, showing the market's concern over their fiscal situation.

The Eurozone Purchasing Managers' Index (PMI) fell from 54.1 in September to 52.7 in October, a 25-month low. This fall was driven primarily by the 'new export orders' component of the PMI and the decrease in German PMI, resulting from new regulations affecting the car manufacturing industry.

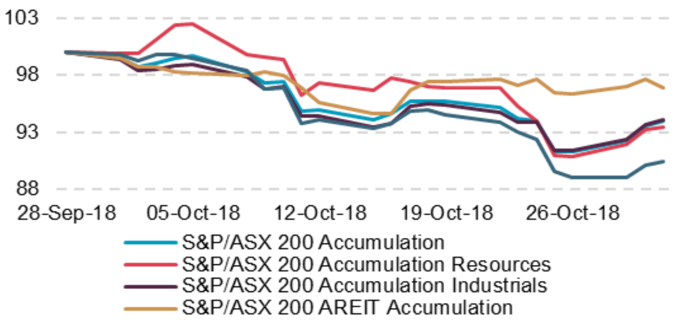
Developments in financial markets

Australian shares: AMP sells insurance business

The Australian share market followed the lead of a sell-off in global equity markets over October with the S&P/ASX200 Accumulation Index losing 6.1% over the month. Major Australian indices were all down, with the S&P/ASX 200 Accumulation Industrials Index (-5.9%), the S&P/ASX 200 AREIT Accumulation Index (-3.1%) and the S&P/ASX Resources Accumulation Index (-6.6%) all losing ground. The S&P/ASX Small Ords Accumulation Index was the hardest hit, falling 9.6% over the month.

During the month, AMP announced that it was selling its Insurance business for $3.3bn to global wealth protection group Resolution Life. The announcement saw the company's share price come under significant pressure, with shares in AMP losing 22.6% over October.

Chart 3: Australian Indices – October (rebased to 100)



Source: Bloomberg

International shares decline

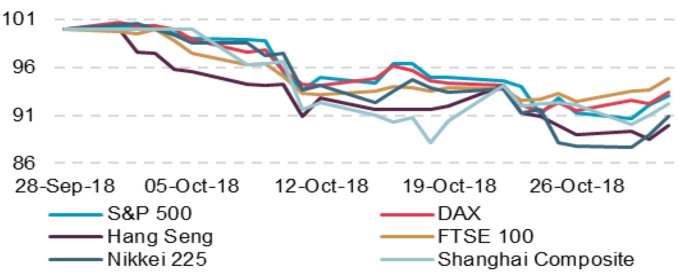
Volatility swept markets in October, resulting in all major global indices experiencing significant declines. Over October the MSCI World ex-Australia (Unhedged) Index fell by 5.4% with this fall being led by a sell-off in US equities. The S&P500 (-6.8%), Dow Jones (-5.0%) and Nasdaq (-9.2%) were all lower on a total return basis, with rising US Treasury yields and geopolitical concerns among contributing factors to investor sentiment.

European markets drop 5.5%

European markets were also significantly lower with the STOXX Europe 600 Index losing 5.5% on a total return basis. This was led by the French CAC 40 Index (-7.3%), while the German DAX (-6.5%) and UK FTSE 100 (-5.1%) also came under pressure.

In Asia, equity markets were substantially sold-off, with Japan's Nikkei 225 Index (-9.0%), the Shanghai Composite (-7.8%), Hang Seng (-10.1%) and Korea's KOSPI (-13.4%) all losing ground on a total return basis.

Chart 4: Major Market Indices – October (rebased to 100)



Source: Bloomberg

Fixed Interest

Sovereign bond yields saw mixed trajectories through October, with the US 10-year bond yield continuing to experience upward pressure, rising 8 basis points (bps) to 3.14%, while the UK's 10-year bond yield fell 13 bps to end the month at 1.44%. Further concerns regarding Italy's debt saw the spread between the Italian 10-year bond yield (+28 bps to 3.43%) and the German 10-year bond yield (-8 bps to 0.39%) widen. The Bloomberg Barclays Global-Aggregate Total Return A$ Hedged Index fell by 0.23% over the month.

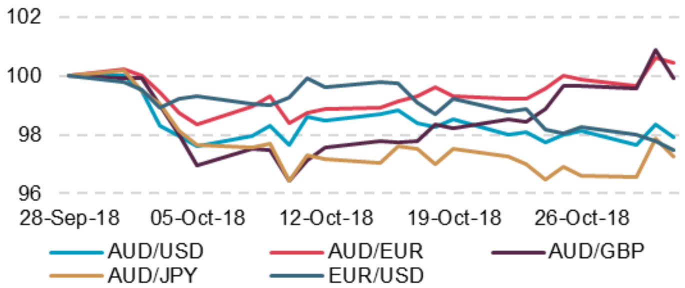
In Australia, the 2-year bond yield fell by 6 bps to 1.97%, while the 10-year bond yield fell by 4 bps to 2.63%. The Australian bond market as measured by the Bloomberg AusBond Composite 0+ Yr Index rose by 0.48% in September, due to falling bond yields leading to positive fixed interest returns.

Currencies: US dollar continues to appreciate

The US dollar continued to appreciate against other major currencies in October, with the Euro falling 2.5% against the US Dollar to 1.1312, while the British Pound also depreciated 2.0% against the US Dollar to end the month at 1.2766. The Australian dollar fell a further 2.1% against the US Dollar, having now depreciated 9.4% since the beginning of 2018, finishing October at 0.7073.

The Australian dollar held steady against the British Pound, falling 0.1% to 0.5541, while it appreciated slightly against the Euro, rising 0.5% to finish October at 0.6253.

Chart 5: Major Currencies – October (rebased to 100)



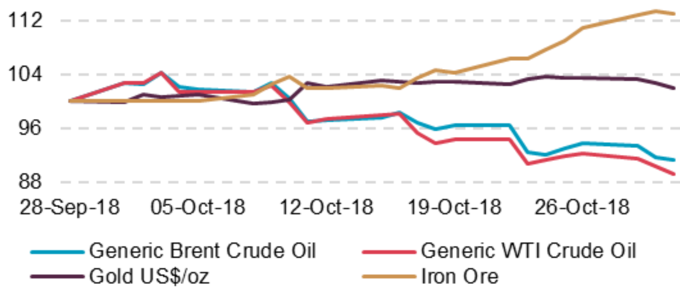
Source: Bloomberg

Commodities: oil prices fall sharply

After rising strongly over late August and in September, the price of oil pulled back sharply in October, with Brent Crude Oil falling 8.8% to $75.47/barrel, while West Texas Intermediate Crude Oil fell 10.8% to end the month at $65.31/barrel. Falling oil prices contributed to Bloomberg's Commodity Index losing 2.4% over the month.

After rising by 6.5% in September, the price of Iron Ore continued to experience significant upward strength, rising by a further 13.0% in October. Over the month the price of gold lifted by 2.0% to US $1214.76/oz.

Chart 6: Major Commodities – October (rebased to 100)



Source: Bloomberg

October Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	-6.05%	-5.92%	2.94%	8.25%	6.02%
S&P/ASX 200 Industrials Accumulation	-5.92%	-5.92%	0.18%	6.41%	6.62%
S&P/ASX 200 Resources Accumulation	-6.55%	-5.89%	16.00%	17.51%	3.22%
S&P/ASX 200 Accumulation AREIT	-3.11%	-2.25%	7.27%	7.08%	11.12%
S&P/ASX Small Ords Accumulation	-9.60%	-7.67%	2.59%	10.54%	6.00%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	-5.40%	-0.94%	9.60%	8.15%	13.40%
EPRA/NAREIT Developed Index Hedged A$	-3.18%	-3.78%	2.10%	4.02%	7.23%
STOXX Europe 600 Total Return	-5.51%	-7.21%	-5.40%	2.15%	5.75%
S&P 500 Total Return	-6.84%	-3.25%	7.35%	11.52%	11.34%
Nikkei 225 Total Return	-9.04%	-2.04%	1.57%	6.76%	10.89%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.17%	0.49%	1.89%	1.93%	2.18%
Bloomberg AusBond Composite 0+ Yr	0.48%	0.87%	3.09%	2.92%	4.39%
Barclays Global Aggregate TR Hedged A$	-0.23%	-0.32%	0.19%	2.91%	4.36%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	83.1903	-2.36%	-2.58%	-3.48%	-1.64%	-7.85%
Generic Brent Crude Oil	75.47	-8.76%	1.64%	22.98%	15.05%	-7.06%
Generic WTI Crude Oil	65.31	-10.84%	-5.02%	20.10%	11.92%	-7.49%
Gold US$/oz	1214.76	2.01%	-0.77%	-4.46%	2.08%	-1.69%
Iron Ore	74.61	13.01%	22.57%	27.84%	13.82%	-11.00%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7073	-2.09%	-4.73%	-7.61%	-0.30%	-5.64%
EUR/USD	1.1312	-2.52%	-3.24%	-2.87%	0.92%	-3.59%
USD/JPY	112.94	-0.67%	0.97%	-0.62%	-2.17%	2.80%
GBP/USD	1.2766	-2.03%	-2.73%	-3.89%	-6.12%	-4.46%

Source: Bloomberg

For more information on market activity and investments, please contact your BT relationship manager or call 132 135.